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Economic and fiscal update—what does it mean for markets?

Throughout the first half of the year, as the pandemic took hold, governments around the world delivered stimulus packages aimed at softening the impact of mobility restrictions and forced business closures. While the picture remains highly uncertain, thoughts are now turning to the health of economies in the second half of the year, how these stimulus measures will evolve, and what impact they will have on government balance sheets.

Today, the Australian Government provided a fiscal and economic update addressing some of these issues for Australia. As part of this update, the Government had previously made some changes to the JobKeeper program and Jobseeker Coronavirus Supplement, extending both but tapering the amounts of the payments over time. This is a welcome development and helps allay concerns held by some about a fiscal cliff that may otherwise have developed as we move from Q3 to Q4 this year.

From an investment standpoint, today's update, as well as Tuesday's announcement on the labour market stimulus, are not surprising and are unlikely to have a material near-term market impact. Longer term, the ongoing fiscal support is a positive for markets and aligns with sentiment from the Reserve Bank of Australia, which is calling for additional government spending to help support the economic recovery in the period ahead.

What are the changes to JobKeeper and Jobseeker?

The major part of the labour market stimulus funded from this budget update is the extension of the JobKeeper program, which is a temporary subsidy for businesses significantly affected by COVID-19 that aims to keep employees in jobs. The JobKeeper program, which was originally scheduled to expire at the end of September, will now run until the end of March, although there are some changes to the levels of the payments and who will be eligible. From October, the current $1,500 flat payment will be reduced and will move to a two-tier system. The new system sees workers employed for 20 hours or more per week in the pre-COVID world receive a payment of $1,200 per fortnight, while those who were working for less than 20 hours per week will receive $750 per fortnight. From 1 January 2021, these amounts will reduce to $1,000 and $650 respectively.

The thresholds for companies eligible for the program are unchanged, with small businesses (turnover less than $1 billion) required to demonstrate a 30% decline in turnover as a result of COVID-19, and larger businesses (turnover more than $1 billion) required to show a 50% decline in turnover. Not-for-profit organisations need to show a 15% reduction in turnover to be eligible, and these criteria will now be monitored quarterly to ensure ongoing eligibility. The extension of the JobKeeper program is expected to cost $16 billion, raising the cost from an initial $70 billion to an updated $86 billion. Running a two-tier system makes sense as it will reduce instances of recipients being paid more under JobKeeper than they were in wages prior to the pandemic. This has been the primary criticism of the original structure of the program.

In addition to the JobKeeper update, the Government also announced changes to the Jobseeker program this week. The prior $550 per fortnight Coronavirus Supplement will be reduced to $250 per fortnight in Q4 and will be extended to the end of Q1 2021. This change is expected to cost $3.8 billion.

What does this mean for the economy and markets?

Today's update included details around the expected budget position, as well as forecasts for the labour market and broader economy. The underlying budget deficit is expected to be $184.5 billion, or 9.7% of GDP for the 2020-21 financial year. Tax receipts for the 2019-20 financial year are down $31.7 billion, while receipts for the current financial year are expected to be $63.9 billion lower, both compared to estimates from the prior budget update last December. The increased spending of $187.5 billion, largely in relation

to labour market stimulus and welfare payments, but also on other initiatives, such as those aimed at bolstering the health system, will see the net debt position blow out to $677.1 billion, or 35.7% of GDP (up from 24.6% at June 2020). This number sees Australia rank comparatively well against similar countries, some of which have debt positions greater than 100% of GDP. Finance Minister Mathias Cormann estimates that net debt would take "somewhat longer" than a decade to pay back, but with the yield on 10-year Australian government bonds currently below 1%, the additional debt required to finance the proposed spending will not be costly to service. Furthermore, S&P had also noted that Australia can support higher debt levels, suggesting that its AAA rating is not under threat.

Labour market expected to be weak, wage growth and inflation subdued

Despite the ongoing and additional support, the outlook for the labour market is weak, with the Government expecting an unemployment rate of 8.75% for this financial year, materially higher than the current 7.4%. It is broadly in line with forecasts from both CBA and UBS, which see a move higher in the months ahead as stimulus is reduced and more people return to the work force. With the labour market forecast to be weak, wage growth and inflation are also expected to be subdued. Today's update shows both wages and inflation are expected to increase by just 1.25% in the current financial year. In terms of the overall economic picture, the Government forecasts a 0.25% contraction for the 2019-20 financial year and a 2.50% contraction for the current financial year. The outlook is highly uncertain however, as evidenced by the fact that longer-dated forecasts have been omitted from this latest update.

Near-term market implications not expected to be material

The near-term implications of today's announcement, as well as the prior changes and additions to other stimulus measures, are not expected to be material. For equity markets, the ongoing stimulus is likely to be supportive, as additional measures should help offset the effects of COVID-related weakness and boost confidence. Increasing public debt and issuing new bonds to finance that debt could be viewed as a negative for bonds, but yields are unlikely to come under upward pressure while inflation remains subdued and cash rates are held close to zero, which is expected to be the case for the foreseeable future. The Australian dollar has shown little response to today's budget update and is expected to be more heavily influenced by risk sentiment around the global pandemic and US-China trade relations in the immediate future.

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