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FEDERAL BUDGET 2021 / MORE STIMULUS TO ENTRENCH RECOVERY

Treasurer Frydenberg delivered Australia's federal budget for 2021-22 on 11 May 2021. A dramatic turnaround in the jobs market and record prices for key commodities underpinned a sharp improvement in the budget outlook relative to just a few months ago. But new policy spending worth $96 billion consumes almost the entire $104 billion windfall, with a focus on helping those most vulnerable and ensuring the economy's recovery. Somewhat surprisingly, there is no further improvement in the fiscal position by mid-2025, where the forecast deficit is unchanged from last October at $57 billion (2.4% of output, falling from 7.8% in 2021).

Spending the entire budget windfall to ensure the recovery remains on track

The pandemic-led recession of 2020 was initially expected to deliver a record post-World War II deficit of 11.0% of output for 2020-21. However, the Government now expects a much lower deficit of 7.8% in 2020-21 and a modestly improved profile over the next few years. The budget improvement significantly reflects the success of the Government's 2020 stimulus measures to support the economy and limit job losses, as well as the temporary nature of many of the stimulus measures. The strength of China's economy and global vaccine discoveries have also been key drivers. The budget bottom line (before new policy spending) has benefitted most from the lower-than-expected unemployment rate and sharply higher iron ore prices.

Rather than allowing some of the improvement in the outlook to foster a faster return to surplus, the Government has, for the second year in a row, delivered a very stimulatory budget. For 2021-22, $18 billion has been added to the economy (another 0.9% of output) and a further $25 billion added for 2022-23 (1.3%). Reflecting this, the deficit for the coming year is forecast to be $107 billion (5.0% of output), well above market forecasts, but improving from the expected $161 billion (7.8%) for the current 2020-21 year. The deficit improves gradually to $57 billion (2.4%) in 2024-25. Net debt rises to $981 billion or 41% of output in 2024-25—a level still well below that of most other developed countries. After economic growth of 1.25% in 2020-21, the Government expects a rebound to 4.25% in 2021-22, slowing to 2.5% in 2022-23. The unemployment rate falls from a peak of 6.9% mid-2020 (originally 9.25%) to 5.0% by mid-2022. The budget assumes international borders remain closed until mid-2022, extending the sharp slowdown in population growth at 0.2% in 2021-22 (after 0.1%), well below the 1.5% pace over the past several decades.

Key policies focus on 1) **supporting vulnerable sectors**, with new spending for aged care ($17.7 billion over four years), mental health ($2.3 billion), aviation and tourism ($1.8 billion), small businesses ($20.7 billion), low income earners ($7.8 billion) and those with disabilities ($13.2 billion); 2) **women's safety and economic security**, with spending on security and health ($1.8 billion), further childcare rebates ($1.7 billion); 3) **securing future growth**, reflected in new funding for apprenticeships and training ($2.7 billion), the digital economy ($1.2 billion), universal pre-school ($1.6 billion), and extended housing construction stimulus; and 4) **infrastructure**, with an additional $8.0 billion spent on road projects, including regional areas and Northern Australia. There is also additional spending on vaccinations, defence, national security, the agriculture sector and climate action.

Extent of spending may surprise, which is positive for aged care, childcare, consumer and infrastructure sectors

The significant spending in the 2021-22 budget combines with the recently extended Reserve Bank of Australia (RBA) bond-buying stimulus to continue the co-ordinated policy effort focused on ensuring a strong recovery over the next couple of years. While the budget stimulus had been well telegraphed, contributing to the recent domestic equity market highs, its extent likely exceeds expectations. We continue to see upside for 2021-22 corporate earnings, and the budget supports our overweight to domestic equities. However, there is room for concern, given the risks related to not improving the fiscal position any further, and that many of last year's 'temporary' stimulus measures have been replaced by more 'permanent' (albeit worthy) expenses. This could weigh on equities and raise bond yields, particularly if the RBA (and other global central banks) begin easing back on their quantitative policy (bond buying) over the coming year. The Australian dollar was little changed post the budget. The credit rating was also unchanged at AAA but remains on negative watch due to the recent fiscal deterioration.

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Superannuation reforms

Extending access to downsizer contributions

From 1 July 2022 the minimum age for the downsizer contribution will be lowered from 65 to 60. This will allow people nearing retirement to make a one-off post-tax contribution of up to $300,000 per person (or $600,000 per couple) when they sell their family home.

Downsizer contributions can be made after the sale of a person's principal place of residence, held for a minimum of 10 years. Importantly, downsizer contributions do not count towards the concessional and non-concessional contributions caps.

Abolition of the work test

From 1 July 2022 individuals aged 67 to 74 will no longer be required to meet the work test allowing them to:

- Make/receive non-concessional superannuation contributions or salary sacrificed contributions
- Access the non-concessional bring forward arrangement (subject to meeting the relevant eligibility criteria)

Concessional personal deductible contributions for individuals aged 67 to 74 will still be subject to meeting the work test. The test requires 40 hours of work over 30 consecutive days.

Improving the Pension Loans Scheme

The Government is increasing the flexibility and attractiveness of the Pension Loans Scheme (PLS) for senior Australians. From 1 July 2022, the Government will introduce a No Negative Equity Guarantee for PLS loans and allow people access to a capped advance payment in the form of a lump sum.

Legacy product conversions

The Government will simplify our retirement system by providing consumers with a temporary option to transition from legacy retirement products to more flexible and contemporary retirement products, promoting efficiency and reducing costs in the superannuation system.

A two-year period will be provided for conversion of market-linked, life expectancy and lifetime pension and annuity products. Importantly, it will not be compulsory for individuals to take part.

Relaxing SMSF residency requirements

From 1 July 2022, the residency requirements for self-managed superannuation funds (SMSFs) will be relaxed by extending the central control and management test safe harbour from two to five years and removing the active member test.

This will allow members to continue to contribute to their SMSF whilst temporarily overseas and will provide the flexibility to keep and continue to contribute to their preferred fund while undertaking overseas work.

Removal of the $450 per month threshold for superannuation guarantee eligibility

From 1 July 2022 the current $450 per month minimum income threshold, under which employees do not have to be paid the superannuation guarantee by their employer, will be removed.

Employer Superannuation Guarantee payments

The previously legislated increase to the superannuation guarantee rate to 10% from 1 July 2021, and the legislated phasing of future increases to reach the 12% rate by 1 July 2025, is not changing.

Early release for victims of family and domestic violence

The Government will not proceed with a measure to extend early release of superannuation to victims of family and domestic violence.

First home super saver scheme

The maximum amount of money able to be released through the First Home Super Saver Scheme introduced in 2017 will be increased from $30,000 to $50,000 of savers' voluntary contributions.

Personal tax measures

Personal tax offsets

The Government will retain the low- and middle-income tax offset (LMITO) for the 2021-22 income year. The LMITO provides a reduction in tax of up to $1,080.

Consistent with current arrangements, the LMITO will be received on assessment after individuals lodge their tax returns for the 2021-22 income year.

Removal of the $250 exclusion for prescribed courses of education

The first $250 of a prescribed course of education expense is currently not deductible. Removing the $250 exclusion for prescribed courses of education will reduce compliance costs for individuals claiming self-education expense deductions.

Employee Share Schemes

The Government is supporting Australian companies to attract and retain talent by removing the cessation of employment taxing point for tax-deferred Employee Share Schemes (ESS) that are available for all companies from 1 July following Royal Assent.

By removing the cessation of employment taxing point, the measure will result in tax being deferred. Further regulatory improvements to the ESS regime will also reduce red tape.

Increasing the Medicare levy low-income thresholds

The Medicare levy low-income thresholds for singles, families, and seniors and pensioners will increase from 1 July 2020 to take account of recent movements in the CPI. The threshold for singles will be increased from $22,801 to $23,226. The family threshold will be increased from $38,474 to $39,167.

Modernising the individual tax residency rules

The Government will replace the individual tax residency rules with a primary test, which will be a simple 'bright line' test—a person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident.

Individuals who do not meet the primary test will be subject to secondary tests that depend on a combination of physical presence and measurable, objective criteria. These changes will apply from 1 July following Royal Assent.

Business support

Depreciable assets

The Government has extended the 'temporary' full expensing of depreciable assets for businesses with turnover below $5 billion, with no limit on the value of assets that are eligible, up to 30 June 2023. The cost of improvements to existing eligible depreciable assets made during this period can also be deducted in full. This will reduce the after-tax cost of new investments and provide cash flow benefits.

Extension of temporary loss carry-back

Companies with turnover of up to $5 billion can apply tax losses incurred during the 2019-20, 2020-21, 2021-22 and now the 2022-23 income years to offset tax paid in 2018-19 or later years.

Increased rights for small business to pause the collection of disputed debts

The Government will make it simpler, faster and cheaper for small businesses to pause or modify Australian Taxation Office (ATO) debt recovery actions in relation to cases under review by the Administrative Appeal Tribunal (AAT) by broadening the AAT's powers to pause actions until the underlying dispute is resolved.

Self-assessment of intangible assets

This will allow taxpayers to self-assess the effective life of depreciating intangible assets such as patents, registered designs, copyrights and in-house software from 1 July 2023.

Supporting the growth of the digital games development industry in Australia

A Digital Games Tax Offset (DGTO) will be introduced to promote the growth of the digital games development industry in Australia. From 1 July 2022 the DGTO will provide eligible game developers with a 30% refundable tax offset for qualifying Australian games expenditure. The DGTO will be available in the year when the qualifying expenditure has ceased on a game.

The maximum DGTO a developer will be able to claim in each year is $20 million. Eligibility criteria will require that the game must not have gambling elements and that a minimum of $500,000 qualifying expenditure has been spent on the game.

Tax concession for Australian medical and biotechnology innovations

The Government will introduce a patent box tax regime to further encourage innovation in Australia by taxing corporate income derived from patents at a concessional effective corporate tax rate of 17%, with the concession applying from income years starting on or after 1 July 2022.

The patent box will apply to income derived from Australian medical and biotechnology patents. The Government will also consult on whether a patent box would be an effective way of supporting the clean energy sector.

Other items

- Establishing an early engagement process within the Australian Taxation Office (ATO) to provide investors with certainty around the tax implications of large investments.
- The childcare subsidy will be raised by 30 percentage points for second and subsequent children aged five years and under in care, up to a maximum rate of 95% for these children. The annual cap of $10,560 per child per year will be dropped.
- The Government has extended the six month construction commencement period to 18 months for all existing 'HomeBuilder' applicants, which will smooth out the HomeBuilder construction activity in 2021 and into 2022.
- A further 10,000 places under the New Home Guarantee initiative in 2021-22 for first home buyers seeking to build a new home or purchase a newly built home with a deposit of as little as 5%.
- There will be an additional 10,000 Family Home Guarantees to eligible single parents allowing them to build homes or purchase select existing properties with deposits as low as 2%.
- The Government is delivering additional funding of $17.7 billion for a comprehensive aged care reform package in response to the Royal Commission into Aged Care Quality and Safety.

What does it mean for investors?

Equity market implications: Super guarantee increase will result in a natural flow of funds

Last night's budget, although perhaps not as important as last year's co-ordinated stimulus effort for markets, is nonetheless significant for how it shapes market performance in a post-COVID environment. Although the economy is clearly progressing better than expected, there remains significant focus on sustaining the recovery and giving businesses and the consumer every chance to grow, ensuring that last year's very successful recovery is not wasted. Since the final leg of the recovery (which is one based on borders reopening) is yet to begin, the Government has chosen to fill that void until the large export industries, such as education and travel, resume.

At a broad, equity level, the Government will allow the superannuation guarantee to increase to 12%, which increases the natural flow of funds into the domestic equity market. At a sector level, there were several key initiatives:

- **Income tax breaks for low- and middle-income earners:** The low- and middle-income tax offset (LMITO) is to be rolled over to the benefit of 10 million people who earn up to $90,000 a year, sparing them a tax increase. The LMITO is an end-of-financial year rebate of up to $1,080 for singles and $2,160 for dual-income couples. It was meant to end this year but will be extended at a cost of $7.8 billion to bolster consumer confidence and avoid alienating female workers who are the main beneficiaries. The Government has ruled out bringing forward stage three of its income tax cut package. Stocks exposed to this expenditure are predominantly those that benefited from previous tax cuts and JobKeeper support payments.
- **Childcare:** The budget includes a $1.7 billion investment in childcare that will remove the annual subsidy cap of $10,560. It will also increase aid for families with two or more children, who will receive a maximum subsidy of 95% of childcare fees paid for their second and subsequent children. If these policies lead to higher day care centre occupancy, which they are designed to do (by getting women back in the workforce), it should bode well for listed players in the childcare sector.
- **Infrastructure:** The Government will earmark more than $15.2 billion for road and rail projects (over the next 10 years) to support 30,000 jobs. The Building Better Regions Fund is expected to be topped up by $250 million for infrastructure projects and community grants in the bush. An extra $190 million over five years has been announced for developing northern Australia, including improving digital connectivity for businesses. A Western Australia infrastructure package worth $1.3 billion for road and rail projects has also been announced.
- **Aged care:** The Government has ruled out the Royal Commission's recommendation of a levy to pay for the aged care reforms, but has announced an $17.7 billion package to be delivered over four years, aimed at training aged-care workers and increasing funding for people with disabilities, as well as mental health. Including in this number is $3.2 billion to cover a $10 per person, per day increase in payments to aged care providers and $3.9 billion to increase the number of "care minutes" each aged care resident receives. This is positive for aged care stocks.
- **Digital Economy:** The Government has pre-announced a $1.2 billion investment strategy that will support digital skills and allow firms to quickly depreciate software. Measures also include a digital games tax offset for eligible businesses that

spend a minimum of $500,000 on qualifying Australian games expenditure. This is positive for companies exposed to video gaming. The government announced additional funding for AI, cybersecurity and digitisation.

- **Energy and climate:** The Government will invest $275.5 million to speed development of four hydrogen hubs in regional Australia and implement a clean hydrogen certification scheme. Another $263.7 million will support the development of carbon capture, use and storage hubs. This is potentially negative for coal, oil and refinery exposures, as an alternative energy source is receiving government support, although it remains longer dated.
- **Agriculture:** The Government has pledged $371 million in funding to strengthen the country's biosecurity measures to protect against diseases and pests. There is little near-term impact on the listed players—but, at the margin, it might lower supply risk.
- **Health:** Telehealth services for general practitioners, allied health providers and specialists will be extended to December, according to Health Minister Greg Hunt. The Government also announced a $354 million women's health package, including funding for cervical and breast cancer and reproductive health.
- **Education:** Private education colleges reliant on international students will see a $53 million package to support local students and expand online and offshore course offerings amid border closure.
- **Tourism:** Pre-announced in March, the Government will pay half the price of airfares for 800,000 domestic travellers who holiday in destinations normally frequented by overseas tourists as part of a $1.2 billion package to keep the international tourism sector afloat when JobKeeper ceased at the end of March.
- **Brewing**: The Government has announced an increase in the beer excise tax rebate from $100,000 to $350,000. From July this year, eligible brewers and distillers will be able to claim a refund on any excise they pay up to an annual cap of $350,000. Brewers can currently claim a rebate of 60% of the excise they pay, up to an annual cap of $100,000.
- **Junior Minerals Exploration Incentive (JMEI):** The Government has announced that it will contribute a further $100 million to extend the JMEI for four more years. The JMEI is a tax credit arrangement, which allows junior mineral exploration companies to pass future tax deductions (losses) to Australian resident investors for Greenfields mineral exploration in Australia. It was otherwise due to end in 2020–21. This is positive for small mining and mining services companies.
- **Housing:** The Family Home Guarantee will give eligible single-parent families access to a home loan with just a 2% interest rate but with just 10,000 single parents eligible, this will be immaterial. The First Home Super Scheme has been extended, with the maximum amount of voluntary super able to be withdrawn increased to 50,000, from 30,000. A further 10,000 government backed home loan guarantees will be made available to first home buyers with deposits of 5%. This is not expected to be a huge driver for the housing or lending markets, especially under the assumption that borders will remain closed until mid-2022, leaving a large immigration hole for the housing market.

Fixed income and currency: record debt issuance, but significantly absorbed by RBA purchases

The Government forecasts gross debt on issue to rise from $684 billion (35% of output) in 2019-20 to $963 billion (45%) in 2021-22 before reaching $1.199 trillion (50%) in 2024-25. Net debt rises from 25% to 41% of total output. Despite the increase, demand for Australia's government debt is likely to be supported by ongoing RBA purchases, relatively higher yields across the curve, and a significantly stronger relative debt position than other developed economies. While bond yields will likely remain low and contained due to global quantitative policy (central bank bond buying), the additional debt issuance and potentially stronger growth outlook may add upward pressure to yields (also supporting the currency). The further stimulus to economic growth, as well as policies directed at improving corporate profitability (such as the tax loss 'carry back' policy and capex accelerated write-downs) are also likely, at the margin, to be supportive for domestic credit markets.