Data Snapshot

Thursday, 17 December 2020

Mid-Year Economic and Fiscal Outlook
Is the Treasurer Wearing Dark Glasses?

- **The Budget bottom-line for 2020-21 has improved by $15.9 billion since the Federal Budget was handed down on October 6. A faster economic recovery and stronger-than-expected iron ore prices are behind the improvement.**
- **The Federal government warns that there is a "long way to go" until the Australian economy fully recovers and the unemployment rate is brought down comfortably below 6%.**
- **Since October 6, there have been encouraging developments around COVID-19 vaccine research. But the government warns these vaccines are still subject to uncertainty with respect to timing, distribution and efficacy in controlling the spread of the virus globally.**
- **An elevated unemployment rate and trade tensions were flagged as the key domestic risks.**
- **Several of the key forecasts underpinning the Budget bottom line projections are too pessimistic. In particular, the forecasts for iron ore, unemployment and economic growth.**
- **This suggests to us there is a good chance the Budget's bottom-line will be better-than-expected next year. It is akin to a "hollow log" or the Treasurer looking through dark-coloured glasses.**
- **However, we also think there is a high probability the Federal government will have to extend the JobKeeper scheme, which will impact the Budget's bottom-line.**

Key MYEFO Aggregates and Parameters					
	Actual	Forecasts			
	2019-20	2020-21	2021-22	2022-23	2023-24
Budget Aggregates					
Underlying cash balance ($bn)	-85.3	-197.7	-108.5	-84.4	-66.0
% of GDP	-4.3	-9.9	-5.3	-4.0	-3.0
Net debt ($bn)	491.2	691.9	798.5	884.3	951.7
% of GDP	24.7	34.5	39.3	41.9	43.0
Major Economic Parameters					
Real GDP	-0.20	0.75	3.50	2.50	2.75
Employment (June quarter)	-4.30	4.00	1.75	1.25	1.75
Unemployment rate (June quarter)	7.00	7.25	6.25	5.75	5.25
Consumer price index (June quarter)	-0.30	2.25	1.50	1.75	2.00
Wage price index (June quarter)	1.80	1.25	1.25	2.00	2.25
Nominal GDP	1.70	1.00	1.25	3.75	4.75

Source: Federal Treasury

Earlier today, Federal Treasurer Frydenberg handed down the Mid-Year Economic and Fiscal Outlook (MYEFO), 2½ months after delivering the 2020-21 Federal Budget (on October 6).

Underlying Cash Balance

The Budget bottom-line has improved by $15.9 billion since October 6. The underlying cash balance is now expected to be $197.7 billion (or 9.9% of GDP) for 2020-21. An improvement over the forward estimates is also expected. The underlying budget deficit is expected to fall to $66.0 billion (or 3.0% of GDP) in 2023-24.

The improvement was driven by a stronger-than-anticipated economic recovery and higher-than-expected iron ore prices. These developments have helped swell company receipts and tax revenues. Moreover, the stronger recovery has meant unemployment levels have been below expectations. Therefore, the Federal government has not spent as much as anticipated through their JobSeeker and JobKeeper schemes.

Gross and Net Debt

Gross and net debt estimates are broadly consistent with the estimates published on October 6. Gross debt is expected to be 42.5% of GDP in June 2021, increasing to 51.5% of GDP in June 2024. Net debt is expected to be 34.5% of GDP in June 2021 and peak at 43.0% of GDP in June 2024.

Risks

The Federal government warns that there is a "long way to go" until the Australian economy fully recovers and the unemployment rate is brought down comfortably below 6%. The MYEFO underscores that significant risks remain to the economic outlook. These risks are the ongoing threat from the presence of the virus, which generates uncertainty for consumers and businesses.

Since the 2020-21 Federal Budget, there have been encouraging developments around COVID-19 vaccine research. The government acknowledges the development of vaccines are progressing well. But it warns these vaccines are still subject to uncertainty with respect to timing, distribution and efficacy in controlling the spread of the virus globally. An elevated unemployment rate and trade tensions were flagged as the key domestic economic risks.

Key Economic Forecasts

Several of the key forecasts underpinning the Budget bottom-line projections are too pessimistic. In particular, the forecasts for iron ore, unemployment and economic growth. This suggests to us that next year there is a good chance the Budget's bottom-line will be better than expected. It is akin to a "hollow log" or the Treasurer looking through dark-coloured glasses. However, we also think there is a high probability the Federal government will have to extend the JobKeeper scheme, which will impact the Budget's bottom-line. The JobKeeper scheme is currently scheduled to end on 31 March 2021.

The Federal government cut their projected peak for the unemployment rate, from 8.0% to 7.5%. The peak is expected to occur in the first quarter of next year, before the unemployment gradually reduces to 6.25% in Q2 of 2022 and to 5.25% in mid 2024. However, we predict the peak has passed and the unemployment rate will sit at 5.6% in mid-2022. The Federal government is assuming it will take around four years for the unemployment rate to return to pre COVID-19 levels whereas we think it will take half that time.

In terms of real GDP, the Federal government has upgraded its near-term growth forecasts. It now expects growth of 0.75% for 2020-21 compared with expectations of a contraction in GDP of 1.5% just 2½ months ago.

For 2021-22, growth of 3.50% is expected, down from the previous estimate of 4.75% growth.

Our own growth forecasts are slightly firmer; we are expecting growth of 0.3% this financial year, followed by 4.1% in the following financial year.

The iron ore forecasts outlined by the Federal government stand out as particularly gloomy. The government expects the price of iron ore to drop substantially from the current price of around US$155 per tonne free-on-board (fob) to US$55 per tonne (fob) by the end of the September quarter next year. In comparison, we expect the price to decline more gently and stay elevated at US$118 per tonne fob.

Key Initiatives

Key initiatives announced today include the extension of the JobSeeker coronavirus supplement scheme for a further three months to 31 March 2021 (at a cost of $3.2 billion), extra spending devoted to the vaccine rollout ($1.6 billion) and additional spending on aged care ($0.5 billion).

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