WILSONS

Federal Budget 2021

Our analysis of the Federal Budget.

12 May 2021

Red is the new black

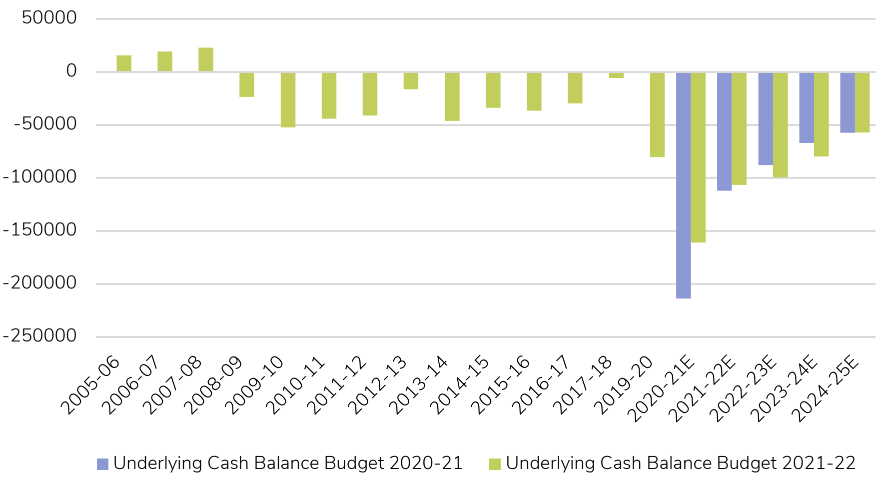
The latest Federal Budget commits to a continuing focus on supporting the economic recovery by starkly prioritising job creation and enhanced social programs over medium-term budget repair.

This pro-growth and social spending focus delivers minimal improvement to the last year's assumed deficit profile. Despite significant notional gains in the budget position from a better-than-forecast economy ($104bn over 4 years), the budget spends an additional $96bn (over 4 years) focussed on a combination of short-term household tax cuts for low and middle incomes, and extended business incentives alongside much higher structural spending on aged care, the NDIS and childcare.

The government has clearly framed the budget with an eye to the next election (likely timing between August this year and May next year) with ample near-term stimulus, no tax hikes and plenty of medium-term spending initiatives aimed at neutralising perceived political pressure points.

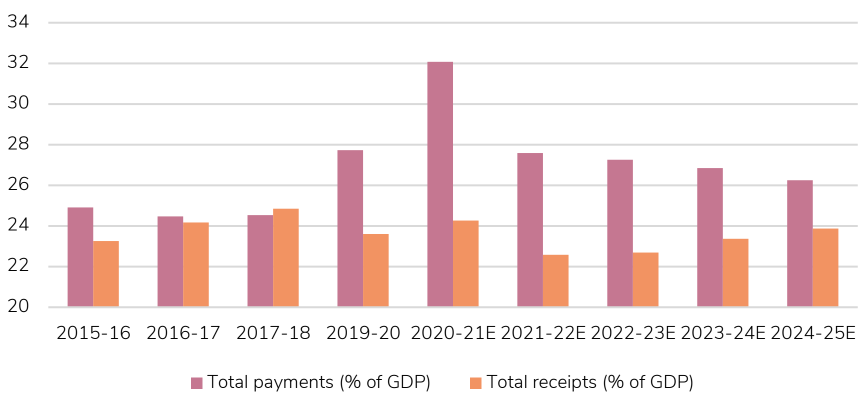
Overall, **the degree of stimulus should be broadly equity market friendly** (particularly for the consumer), but the complete absence of any attempt at fiscal repair may put some upward pressure on interest rates (contingent on global influences) and bring forward assumptions on RBA tapering and cash rate hike timing (RBA still guiding to 2024 for the first hike).

Exhibit 1: A much better outcome than forecast in FY21 but the economic windfall is spent in the forecast years.



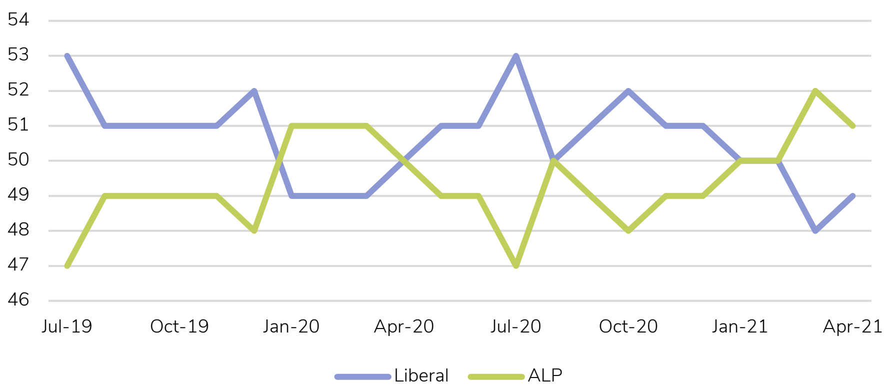
Source: Federal Budget Paper, Wilsons.

Exhibit 2: Higher structural spending locks in a structural deficit



Source: Federal Budget Paper, Wilsons.

Exhibit 3: A voter-friendly budget with tight polls and an election due by May next year



Source: Newspoll, Wilsons

Key macro elements include:

1. **A much better budget result for FY21** ($161bn versus $214bn) stems from a much stronger actual economic and commodity price backdrop than forecast.

2. **The expected deficit for FY22 improves only $5bn to $161bn versus last year's budget projection**. Forecasts deficits after FY22 will then actually increase versus last year's projections, due largely to the impact of higher structural spending on a variety of programmes.

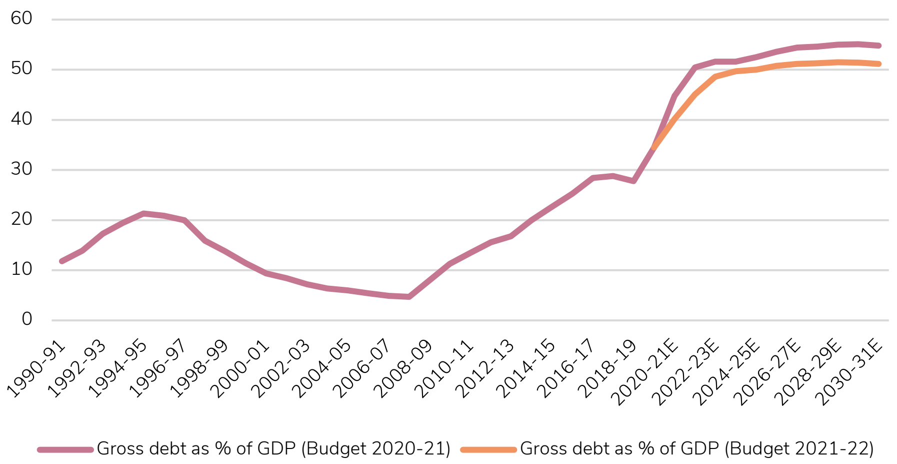
3. **There is no return to surplus projected in the 10-year forecast horizon**. The gross debt peak is higher in 2024/2025 than previously forecast at a record $1,199bn or 50.0% of GDP. However, this is still low in a global context.

While the deficit and debt have grown dramatically, the **near-term interest bill has actually fallen** due to a big fall in borrowing costs. The weighted cost of debt is assumed to be just under 0.90 basis points for FY22. Rates are assumed to lift over the medium-term but estimates could prove too conservative versus reality.

GDP growth is forecast to be 4.2% in FY22 (with consumption at a very strong 5.5%). GDP is then forecast to ease back to a "trend" 2.5%, which appears conservative.

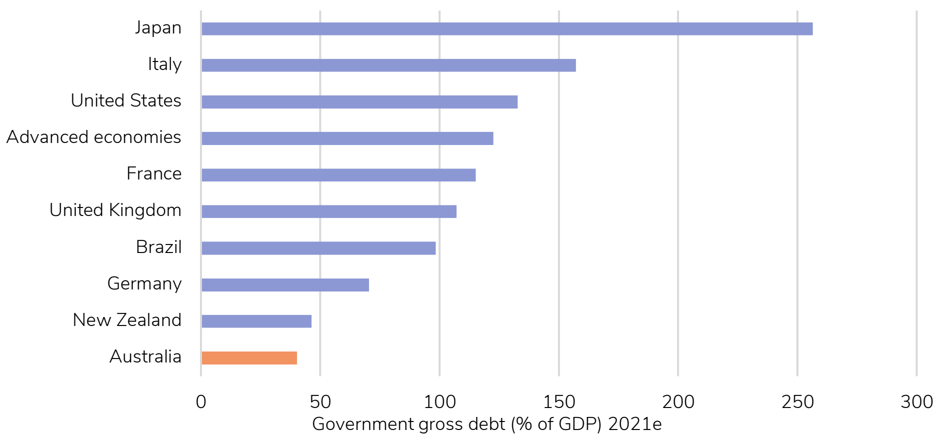
Unemployment is forecast to drop to 4.75% (currently 5.6%) in FY23, with wages still subdued at 2.25% and inflation back in the RBA's target band at 2.25%, but still very benign.

Exhibit 4: Debt to GDP accelerates then assumed to stabilise as growth revives



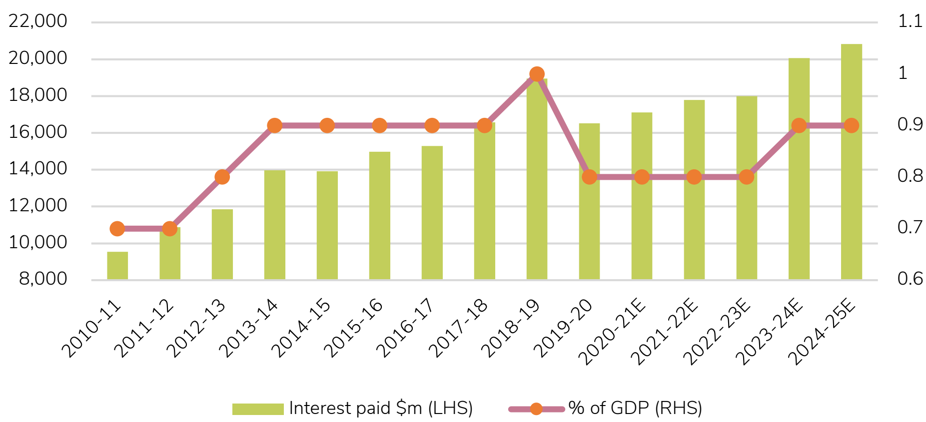
Source: Federal Budget Paper, Wilsons.

Exhibit 5: Despite the acceleration in deficit spending our debt to GDP is still very low in a global context.



Source: Federal Budget Paper, Wilsons.

Exhibit 6: Interest bill cheaper than in FY19 with sub 1% weighted cost of borrowing (for now)

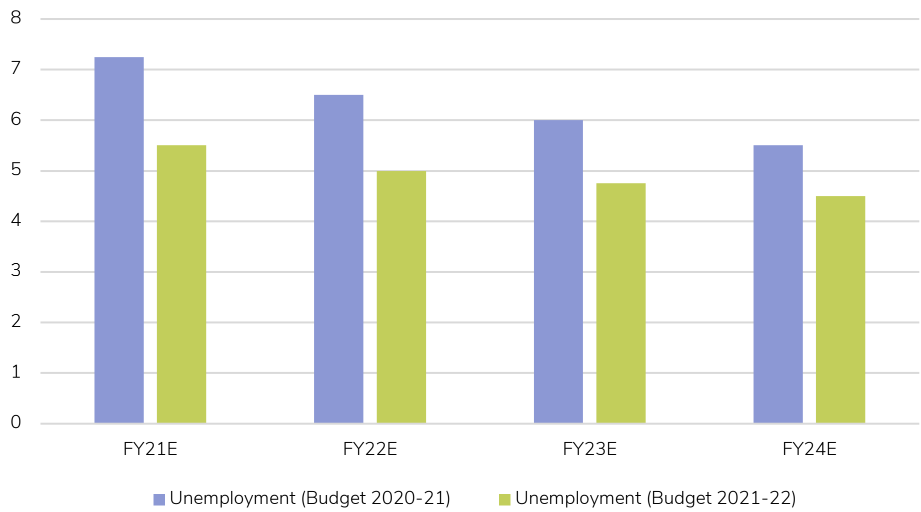


Source: Federal Budget Paper, Wilsons.

The **iron ore price is assumed to revert quickly** to the long-term trend assumption of $55 per tonne by March 2022, which appears very conservative. Each $10 variation would give a $1.3bn boost to the budget per annum.

The budget assumes a further **delay to the re-opening of the international border until mid-2022** which is likely to be a slower re-opening than the consensus has assumed. This places extended pressure on international travel/tourism-based areas of the economy. Net overseas migration is expected to contract near-term before growing 96k in FY23, 201k in FY24 before returning to just under pre-pandemic levels of 235k in FY25.

Exhibit 7: Unemployment projections are lower.



Source: Federal Budget Paper, Wilsons.

Key spending initiatives and sector impacts

While the government has locked in sizeable deficits for both the short and medium term based primarily on higher levels of spending, the breadth of spending (something for just about everyone) and the emphasis on social welfare programmes does not throw up too many clear sector winners from a share-market perspective. Broadly we see the consumer sector as the winner given the extension of near-term tax rebates for low and middle incomes alongside the generally positive fiscal thrust of the budget. Good for growth and good for jobs. The extension of business tax incentives should spur a further revival in business investment, much of which could flow into retail spending from small and mid-sized firms (see table below for more detail).

The major sectoral loser appears to be those firms linked to the international travel and inbound tourism sectors by virtue of the extension in the assumed international border closure (to mid 22) and only limited additional assistance in the budget.

Spending initiatives and sector impacts continued

Sector	Spend	Time Period	Details and Implications
Business tax breaks	$20.7bn	1yr extension to FY23	Instant asset write-off extended 1yr to FY23. The Government will also extend the Budget 2020-21 measure allowing for the temporary loss-carry back for a further 12 months, to include the FY23 year. Positive for AP eagers (APE), ARB Corporation (ARB), Autosports Group (ASG), MotorCycle Holdings (MTO), PWR Holdings (PWR) as well as positive impacts for hard-line goods retailers Harvey Norman (HVN), JB Hi-FI (JBH), WesFarmers (WES).
Aged care	$18bn	5yrs	Increased funding bed supply, labour incentives, care and regulation. Industry had called for $10bn pa. Moderate positive for Estia Health (EHE), Japara Healthcare (JHC), Regis Healthcare (REG).
NDIS + Mental Health	$15.5bn	4yrs	Increased funding for existing programs. Most of this spending bypasses the listed players.
Infrastructure	$15.2bn new spending	10yrs	Primarily roads focused. Moderate positive for Adbri (ABC), Boral (BLD), Cimic Group (CIM), Downer EDI (DOW), Seven Group (SVW).
Consumer (Tax Cuts)	$7.8bn	1yr extension to FY22	Low/Middle Income Tax offset. $1k for couples, $2k for dual income. Positive for general consumption/discretionary retail.
Construction/ Building	$2.7bn	1yr	Wage support for apprentices/trainees for all business until March 2022. Basic industries, builders, construction. Service providers like ReadyTech (RDY).
Childcare	$1.7bn	5yrs	Reducing cost for child care for 250k families. Moderate positive for G8 Education (GEM), Think Childcare (TNK).
Insurance	$1.4bn	4yrs	Preventative measures for minimising natural disasters. Some marginal benefit for IAG, QBE Insurance Group QBE (QBE) , Suncorp Group (SUN).
Technology	$1.2bn	+5yrs	Incremental spending on digital conversion initiatives - AI, security, digitisation. Small benefit to Information Technology sector.
Agriculture	$0.9bn	5yrs	Support for key issue (i.e. bio-security) to grow sector to $100bn by 2030. CGC well placed to benefit.
New Energy	$0.8bn	4yrs	Hydrogen hubs, carbon capture, new emissions technologies. Potential marginal benefit (long dated) FMG,. Origin Energy (ORG), Santos (STO), Worley (WOR), Woodside Petroleum (WPL.).
Tourism	$0.6bn incremental	1yr	Industry will be disappointed - nothing significantly incremental for the private sector. Previously announced half price flights for nearly 800k airline tickets to max of $1.2bn but window is short. 3 months from 1 April to 30 July this year. Negative versus expectations for Travel/Tourism AQZ, CTP, FLT, QAN, SYD.
Brewing/ Distillers	$0.3bn	1yr	Excise tax relief to $350k vs $100k. LRK and, TSI should both benefit.
Healthcare	N/A	N/A	No major policy settings unchanged across PHI, Hospitals, Dental, Radiology, Pathology. This industry will probably welcome a period of stability.
Oil Refineries	N/A	N/A	Direct industry assistance until 2030 to keep local refineries open. $$$ not quantified -. Clear albeit unquantified positive for Viva Energy Group (VEA), Ampol (ALD).
International Travel	N/A	N/A	~6-month border re-opening delay, now estimated at mid-2022.. A clear negative for Central Petroleum (CTP), Flight Centre Travel Group (FLT), Qantas Airways (QAN), Sydney Airport (SYD), WEB .and no new additional industry assistance.

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Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures

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All figures and data presented in this research are accurate at the date of the report, unless otherwise stated.

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