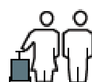
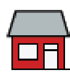
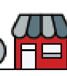
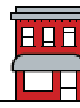
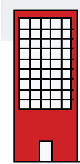
2021 FEDERAL BUDGET

more than money nab

Comment

The Treasurer wasn't kidding when he said budget repair has been put on hold till unemployment was below 5%, with a raft of new spending measures offsetting the cyclical improvements in the budget due to a better than expected economic outcome (See chart on Policy and Parameters in the Key metrics section). Overall, the momentum of the recovery has more than offset the pullback in stimulus but this budget aims to provide further support.

In terms of spending the largest item was the aged care package – at around $17.7bn over the forward estimates. But there were other big spends in the areas of Infrastructure ($15bn) and NDIS ($13.2bn). The Low - and Middle-Income tax offset was extended a year ($7.8bn) and the Investment Asset Write Off also was extended. Other areas of focus included childcare, home ownership support and a number of tweaks to superannuation to ensure greater flexibility (as well as support for women).

Something of a surprise was relatively little to boost private sector investment which will be critical to maintain the recovery's momentum. Also there was not a lot of emphasis on public housing and no attempt to bring forward the third phase of tax cuts (which will be much cheaper than first thought given the better labour market outcomes forecast) or company tax changes. It is worth noting that the Budget does not include election spending which will either occur via an early Budget (the election must be called by May 2022) or via Government announcements.

The size of the total fiscal package can be seen from our analysis of the Structural Budget impulse using OECD methodology. That suggests that structurally the Budget is taking back only around 2% of GDP in policy stimulus – compared to a net 8% stimulus in 2019/20 and 2020/21. Clearly a structural surplus is a long way off (See our Section on the Fiscal Stimulus).

In looking at the near-term trends, the fiscal situation is once again driven by the expense side rather than revenue. Indeed, compared to MYEFO there is little change. See Fiscal Stimulus section.

Overall, we have no problem with the focus on maintaining the support for economic growth but we see the scope for more structural / productivity enhancing measures to have been included. Cutting red tape, tax changes and greater support for alternative energy environment would have been preferred. That said, as noted above, we are only getting a partial view of the likely budget outlook and much can and will probably change in the lead up to the election.

Fiscal Outcome

The underlying cash balance for 2020/21 is estimated at $161bn (or around 8% of GDP), around $40bn better than at MYEFO. While for 2021/22 a deficit of $107bn is forecast (we had expected around $75bn), after that progress is slow and by 2023/24 the deficit is still expected to be around $79.5bn. A return to surplus looks many years away.

Economic Outlook

Both we and the Treasury see the economy continuing to recover over the next couple of years. In aggregate our outlook for real GDP sees a similar end point over the forward estimates but there are some underlying differences. We see a bigger boost to business investment in the near term and a more pronounced cycle in dwelling investment, while Treasury sees stronger consumption and a bigger contribution from net exports. On the labour market we are more optimistic with unemployment around 0.5ppt lower than the budget outlook by the end of the forecast horizon. That said, both sets of forecasts embody a weak outlook for wage growth, which will see soft inflationary pressure and the need for ongoing support from policy makers. Our forecasts are based on much the same assumptions for a reopening in borders next year and the possibility of further small outbreaks of the virus but no large scale shutdowns.

Financial Markets

S&P maintained its negative outlook for Australia's AAA credit rating, noting that "risks remain tilted toward the downside". S&P has said before that a narrowing in the deficit towards 3% of GDP is more consistent with a AAA rating (not projected till 2024-25 in the budget).

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The Key Metrics

	Estimates						Projections		
	2020-21(e)		2021-22(e)		2022-23(e)		2023-24(p)		2024-25(p)
	MYEFO	Budget	MYEFO	Budget	MYEFO	Budget	MYEFO	Budget	Budget
Underlying cash balance, $bn	-197.7	-161.0	-108.5	-106.6	-84.4	-99.3	-66.0	-79.5	-57.0
% of GDP	-9.9	-7.8	-5.3	-5.0	-4.0	-4.6	-3.0	-3.5	-2.4
Net operating balance	-185.2	-154.5	-98.2	-92.7	-81.0	-90.2	-57.1	-70.2	-55.7
% of GDP	-9.2	-7.5	-4.8	-4.3	-3.8	-4.1	-2.6	-3.1	-2.3
Net capital investment	8.8	8.6	9.9	10.3	11.1	10.9	10.8	10.1	9.2
% of GDP	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Fiscal balance, $bn	-193.9	-163.2	-108.0	-103.0	-92.0	-101.2	-67.9	-80.3	-64.9
% of GDP	-9.7	-7.9	-5.3	-4.8	-4.4	-4.6	-3.1	-3.5	-2.7
Net debt, $bn	691.9	617.5	798.5	729.0	884.3	835.0	951.7	920.4	980.6
% of GDP	34.5	30.0	39.3	34.2	41.9	38.4	43.0	40.4	40.9

Source: Commonwealth Treasury

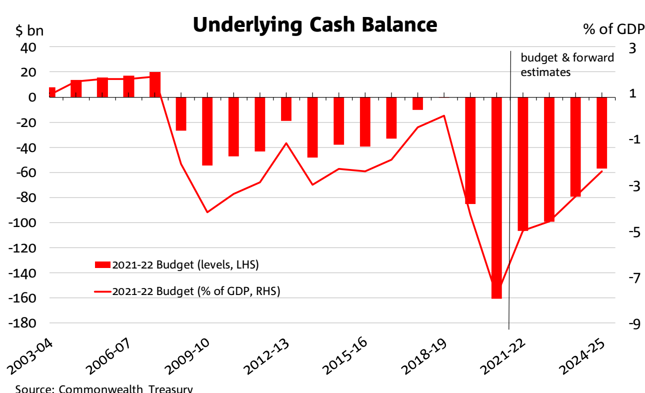
The Government's fiscal strategy is framed around two phases. Phase one – the current phase – is focussed on supporting the economic recovery. Once this is achieved, the focus is intended to shift to putting the budget on a more sustainable basis including stabilising the level of net debt.

Consistent with still being in Phase one, the Government has taken the improved revenue outlook revealed in this budget and largely used it to fund extra spending and tax reductions.

While this year's federal budget projects an improvement in the budget position over time, it projects that the underlying cash balance will remain in deficit right through to 2024-25. The improvement reflects a gradual unwinding of the post-COVID boost to spending and (from 2022-23) a recovery in revenue (as a % of GDP).

While there is a large fall in the underlying cash deficit expected in 2021-22 (reflecting the end to temporary government programmes such as JobKeeper), expenditure remains well above its pre-COVID level and the improvement in the cash balance between 2021-22 and 2022-23 is marginal. The projected improvement in the budget position then picks up pace in the final two years at a time when the Government expects the unemployment rate to be entrenched well below 5%.

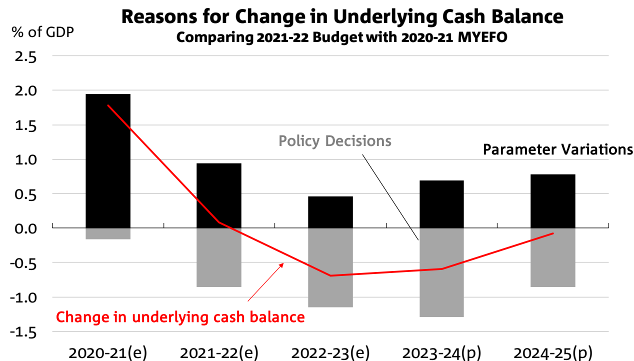
As a per cent of GDP, the underlying cash deficit is expected to drop from 7.8% in 2020-21 to 5.0% in 2021-22, and to then reach 2.4% by 2024-25. If achieved this would represent a substantial amount of fiscal repair, but it would be incomplete given that the cash position was in balance in 2018-19.



Source: Commonwealth Treasury

Relative to the December's Mid-Year Economic and Fiscal Outlook, the underlying cash deficit is substantially smaller in 2020-21, similar in 2021-22 but then is larger over the remainder of the projection period.

The 2020-21 improvement against MYFEFO reflects the net positive impact of 'parameter' adjustments (which include differences in take up rates for various programmes, and changes in revenue projections as the economic outlook changes). The net parameter improvement mainly comes from the receipts side reflecting the faster than expected economic recovery and high commodity prices.



Source: Commonwealth Treasury, NAB calculations

Budget Reconciliation

Underlying cash balance estimates

	2020-21(e)	2021-22(e)	2022-23(e)	2023-24(p)	2024-25(p)
Budget 21-22	-160,952	-106,619	-99,266	-79,514	-56,966
% of GDP	-7.8	-5.0	-4.6	-3.5	-2.4
Policy Decisions					
Receipts	38	14	-7,357	-14,392	-5,890
Payments	3,372	18,224	17,401	14,939	14,351
Total	-3,334	-18,210	-24,758	-29,331	-20,241
% of GDP	-0.2	-0.9	-1.1	-1.3	-0.9
Parameter Variations					
Receipts*	26,660	23,541	14,300	20,972	24,615
Payments	-13,468	3,490	4,422	5,181	6,182
Total	40,129	20,051	9,878	15,791	18,433
% of GDP	1.9	0.9	0.5	0.7	0.8
MYEFO 20-21	-197,747	-108,461	-84,386	-65,974	-55,158
Budget 2020-21	-213,654	-112,003	-87,883	-66,926	-57,456

Source: Budget Papers, NAB calculations.

The (net) improvement to the budget from parameter changes is largely (but not completely) offset by discretionary policy changes included in this budget in 2021-22. From 2022-23 onwards the policy changes (which are acting to increase spending and reduce revenue) are larger than the parameter gains, resulting in a larger underlying cash deficit than at MYEFO.

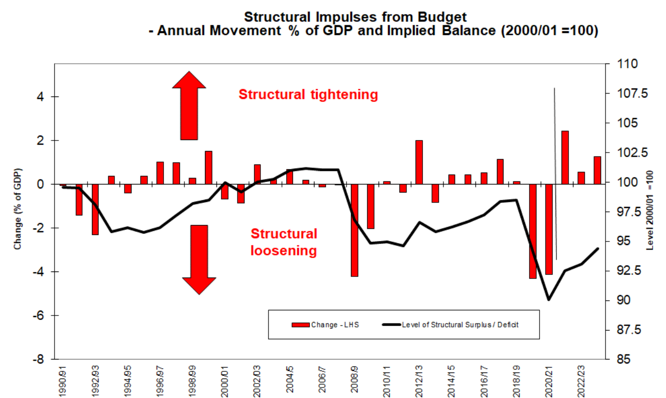
Fiscal Stimulus

Traditionally we use this section to comment on the medium- term Budget outlook and the sustainability of the return to surplus. That however is not really relevant in current circumstance where the focus is very much on maintaining the short- term growth momentum.

Instead we have turned to trying to give a better handle on the size of the stimulus involved. To do that we again turn to using an OECD methodology which attempts to show the structural changes of Budget measures by excluding cyclical factors. That is, what the Budget is doing to the economy and excluding what the economy is doing to the Budget.

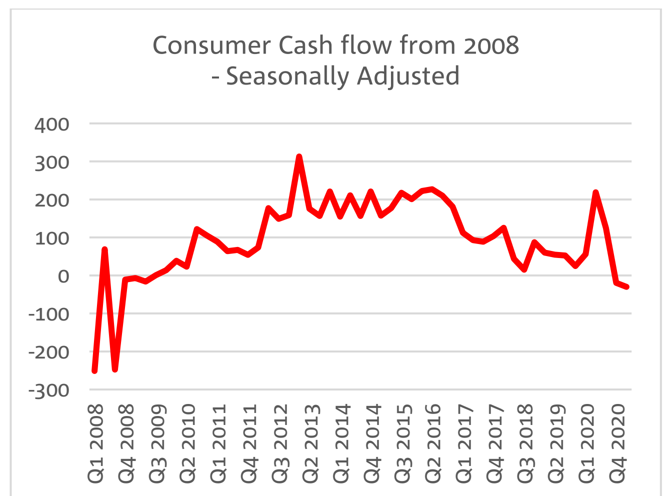
The chart below indicates the Budget in 2019/20 and 2020/21 added around 8% to GDP from policy stimulus. This year only around 2% has been given back – with policy significantly eating into the cyclical benefit.

To date growth momentum has been more than sufficient to see some policy tightening fully offset – especially in the labour market where employment has recovered all jobs lost during the pandemic. It also appears that GDP has returned to pre pandemic levels (on our forecasts for Q1 2021 at least).

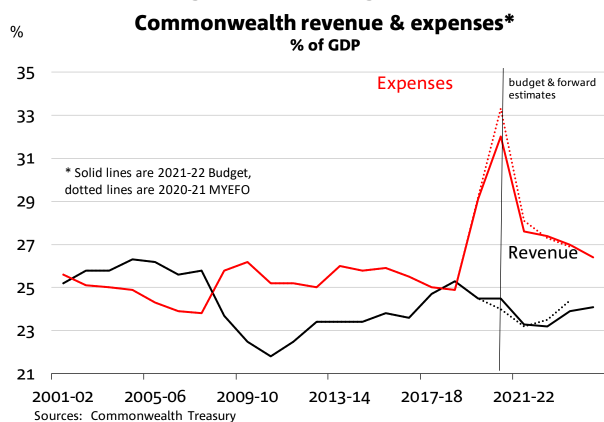


That said even before election spending is fully captured a structural surplus is still many years away (currently a structural deficit of around 5.5% is still there at the end of 2023/24*).*

Another way to look at the issue of the extent to which the Government's near term support has underpinned the recovery is to look at household cash flows over a 10 year period – again going back to the GFC. The chart clearly highlights the role of Government support during 2020/21. What is interesting however is that the withdrawal of support had significantly impacted consumer cash flows by early 2021. That clearly puts the emphasis on productivity enhancing reform going forward and the importance of business investment stepping up as consumer demand fades – or at the very least goes back to more normal rates of growth.

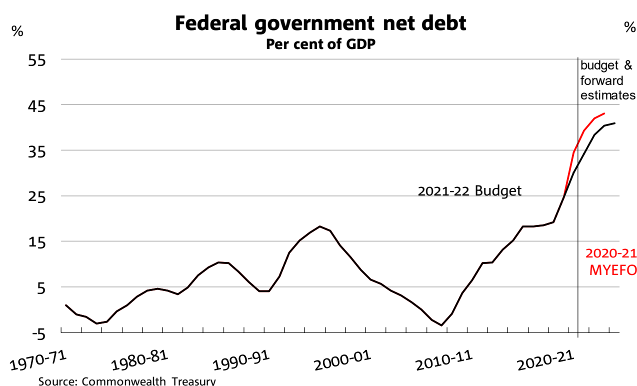


Finally, we look at the Governments "jaws" – that is their revenues v their expenses. As can be seen it is clear that much of deficit and the repair process comes from the expenses line. Indeed very little has changed in the profile from the MYEFO despite all the economic recovery now underway.

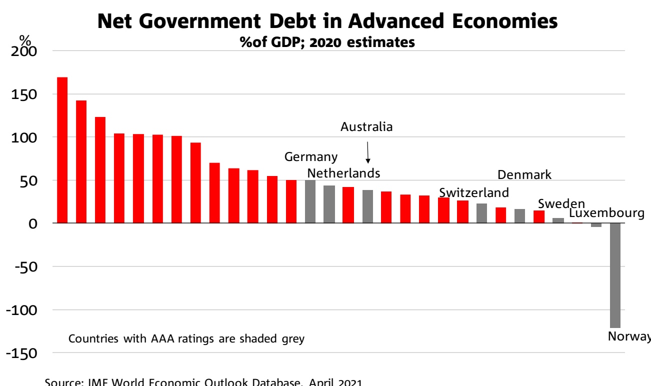


Government Debt

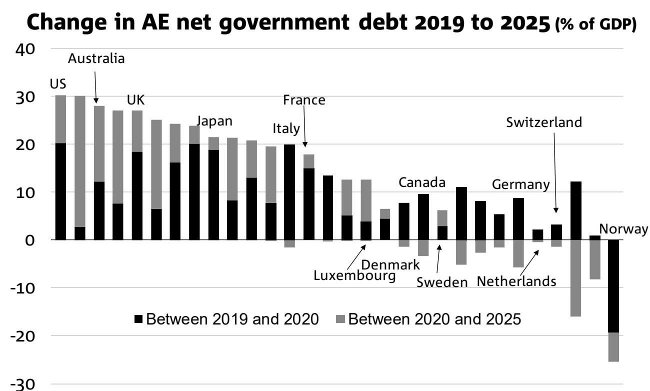
Net debt is expected to peak at 40.9% of GDP in 2024-25 according to medium term estimates published in the budget papers. This is a lower peak than expected as recently as MYEFO, largely due to the projected better budget outcome for 2020-21 which more than offsets the larger deficits expected over 2022-23 to 2024-25. Nevertheless, net debt is still well above anything seen since the 1970s.



Pre-COVID-19, Australian government net debt (combined federal and state) to GDP was low by international standards and around the middle of the pack of AAA rated countries. While the fiscal support measures of many other advanced economies (AEs) was not as large as Australia (the US a notable exception), IMF estimates (released last month) suggest that this broad picture had not significantly changed by the end of 2020.



However, between 2019 (pre-COVID) and 2025, the increase in Australia's net debt as a % of GDP is projected by the IMF to be higher than most other AEs (including all other triple-A rated countries). While the IMF estimates will be reviewed in light of this budget (and as policies change overseas) its projections are consistent with the notion that the government is making full use of the breathing space provided by having a strong fiscal position pre-virus to support the economy and to only slowly return the budget to the point where debt stabilizes.



Implications for the Bond Market

The 2021-22 Budget debt statement implies net debt issuance by the Commonwealth during FY22 of $134bn. With net issuance during FY21 projected to be $147bn, the net issuance load over the coming year is not going to be much reduced from FY21.

With a $16.4bn nominal bond maturity in December 2021 and a linker maturity of $6.8bn face value (or $8.3bn indexed face value), the gross Commonwealth debt issuance program will be about $159bn. Assuming the linker maturity is mostly refinanced from within that market, the nominal bond program alone is likely to gross around $150bn, subject to variation in T-note balances.

A full update from the AOFM is expected on 12 May. We anticipate a confirmation that nominal bond issuance for FY21 will be only about $212bn, $18bn less than announced after MYEFO. However, the pace of issuance for FY22 might not slow as much as previously expected and, depending on the number and size of new lines to be established a weekly tender guidance of $2-3bn might still be given. But assuming, for example, there are three syndications of up to $15bn apiece then tender pace will remain around the low end of that band.

The RBA's second tranche of quantitative easing began a month ago and will run until early September, which at current program settings ($4bn of ACGBs per week) will see the RBA buy a further $62bn of ACGBs over that time. Timing of any new issue syndications aside, this means the RBA will continue to draw down substantially more than the

AOFM is issuing most weeks. In the longer run the RBA does remain at risk of its purchase program causing market dysfunction, but to the extent the FY22 Budget leads to a slightly higher issuance program, the issue will become more acute a little further down the track than if issuance was to be sharply reduced.

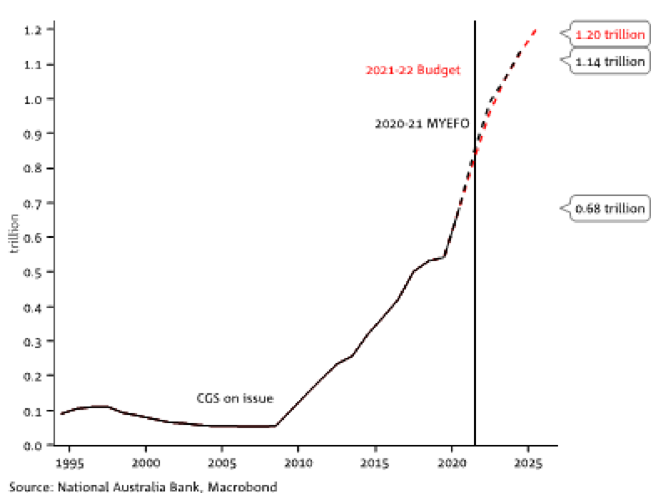
Bond Supply Projections

2021-22 Budget	2020-21	2021-22	2022-23	2023-24	2024-25
Year end face value	829	963	1058	1134	1199
Implied net issuance		134	95	76	65
Term debt maturities*		16	85	33	67
Gross issuance ($bn)		**150**	**180**	**109**	**132**

* $6.8bn ix22 maturity excluded

2021-22 Budget	2020-21	2021-22	2022-23	2023-24	2024-25
Year end face value	829	963	1058	1134	1199
Implied net issuance		134	95	76	65
Term debt maturities*		25	85	33	67
Gross issuance ($bn)		**159**	**180**	**109**	**132**

* Linker maturities grossed up at current index factor



Source: National Australia Bank, Macrobond

New Budget Measures – In Brief

As is usually the case, most new measures had been announced prior to budget night. Unlike last year's budget which saw the bring forward of tax cuts, most of the new measures included this year relate to spending – though both the temporary LMITO and full-expensing of investment we extended for an additional year.

Tax Measures

Temporary full expensing and loss carry back allowances were extended for an additional year (previously slated to end in June 2022, now June 2023) – totaling an additional $20.7bn of tax relief to encourage business investment.

For households, the government extended the LMITO for an additional year, providing tax cuts of $1080 for individuals or $2160 for dual income couples. This program provides around $7.7bn of support to around 10m income earners.

New spending measures:

The budget contained a raft of new spending measures, to boost economic activity and provide substantial support for vulnerable parts of the population.

Headlining the spending measures were:

- An extra $15.2bn of infrastructure investment for road, rail and community infrastructure projects over 10 years.
- An additional $17.7bn over 5 years on aged care spending.
- A $13.2bn boost to NDIS funding.
- A $2.3bn package for mental health services.
- $1.7bn boost to childcare subsidies through the removal of caps.
- $1.2bn targeted and direct support to industries which see ongoing impacts from international border closures including aviation and tourism.

Other Measures

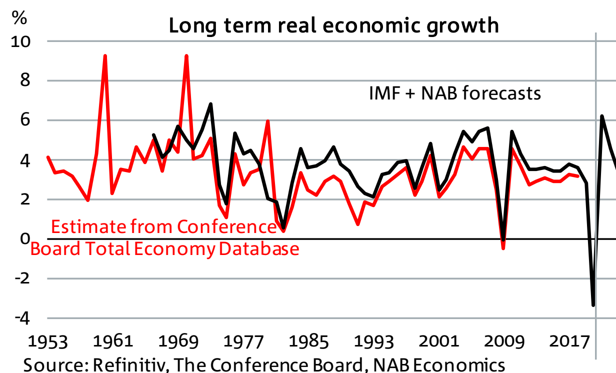
The budget included a range of other measures to support home ownership as well as a more flexible superannuation system.

On homeownership, the government lifted the amount of available withdrawals from additional concessional contributions to super from $30k to $50k. It also expanded the First Homeowners Deposit scheme, which provides loan guarantees to build or purchase a new home with a 5% deposit, by another 10k places. Additionally, this year the government introduced a Family Home Guarantee which will allow single parents with dependents to purchase any home with as low as a 2% deposit.

On superannuation it expanded the super guarantee to include employees earning less than $450 per month and removed the "work test" for salary sacrificed and non-concessional contributions by retirees and reduced the downsizer age to 60 years (allowance to make a one off deposit into super after selling a residence of 10 years).

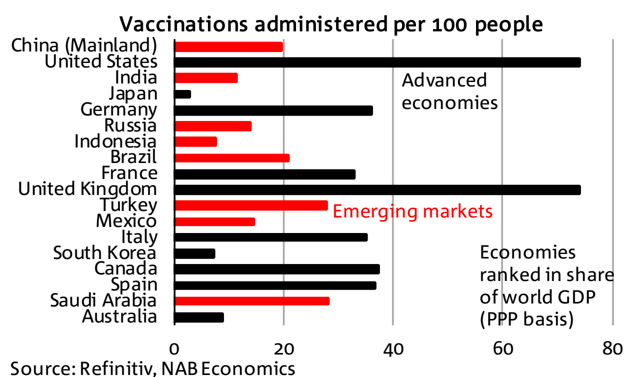
Global Economic Outlook

The global economy contracted by 3.3% in 2020, the largest economic downturn since at least the early 1950s, if not the Great Depression. This contraction was driven by restrictions on economic activity intended to control the spread of COVID-19, negatively impacting demand for goods and services as well as disrupting global supply chains. Although the global economy started to recover in the second half of 2020, the path to recovery has been far from smooth, with a wide range of countries forced to reintroduce measures to deal with additional waves of the virus.



Source: Refinitiv, The Conference Board, NAB Economics

Fresh lockdowns in selected regions, combined with an unequal distribution of COVID-19 vaccines and differing fiscal policy responses will result in an uneven recovery in 2021. Advanced economies are expected to outperform this year (in part reflecting the comparatively larger downturn recorded in these countries last year). This is led by the United States, which is boosted by a high vaccination rate and large-scale fiscal stimulus in December 2020 and March 2021 (with the potential for further government spending to come). In contrast, a wide range of emerging market economies are facing a challenging environment – particularly those that have struggled to bring COVID-19 infections under control (such as India and Brazil). This means that the global recovery will continue into 2022 – with economic growth remaining above its long-term trend rate.

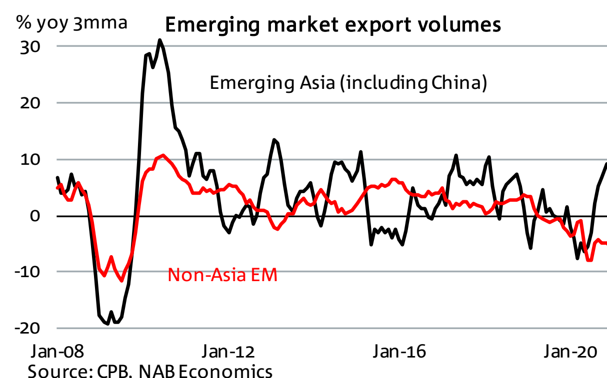


Source: Refinitiv, NAB Economics

Monetary and fiscal authorities were quick to reduce policy rates and implemented a range of support measures to ensure the functioning of financial markets. Despite a recent upturn in inflation, major central banks are likely to remain dovish. In particular, the US Federal Reserve intends to keep rates close to zero until inflation is moderately above 2% "for some time" and the labour market recovers. It has also committed to continue its asset purchase program until substantial progress is made towards these goals. This should reduce pressure on other central banks to raise rates – particularly in emerging markets.

It is worth noting that fiscal spending in response to the pandemic has increased government debts considerably when compared with pre-pandemic levels. This could constrain the capacity of governments to respond to future economic downturns, as well as increase the risk of sovereign defaults (particularly in countries that already had a high debt burden prior to 2020). Budget repair over the longer term may require more austere policy settings in the future.

At a high level, global trade trends have continued to improve – in line with the recovery in the global economy – however there is also considerable disparity in trends between individual countries and regions. Strong global demand for electronics – in part related to the increased trend of working from home, as well as high end computing power required for cryptocurrency mining – has supported growth in export volumes from north Asian manufacturing countries. In contrast, export volumes from other emerging market regions have remained comparatively weak.



Source: CPB, NAB Economics

The table below compares NAB's global economic forecasts with that of the Commonwealth Treasury. Overall, we expect the global economy to grow by 6.3% in 2021 and 4.6% in 2022 before growth eases back to its long-term average of 3.5% in 2023. At a high level, Treasury is marginally less optimistic in its outlook for this year and next – with weaker growth forecasts for the United States, China and other East Asian economies partially offset by a stronger outlook for India – however global growth is broadly similar for 2023, with some compositional differences.

Comparison of Treasury Budget Forecasts and NAB Forecasts

	2021		2022		2023	
	Treasury	NAB	Treasury	NAB	Treasury	NAB
US	6.3	6.7	3.5	4.1	1.8	2.1
Euro-zone	4.5	4.2	4.0	4.7	2.0	2.1
Japan	3.5	3.9	1.8	2.3	0.8	1.0
China	8.5	9.5	5.3	5.8	5.5	5.6
India	11.0	10.0	5.8	5.7	7.0	5.6
Other East Asia	4.8	5.4	4.0	4.9	4.0	4.6
World	6.0	6.3	4.3	4.6	3.5	3.5
Major trading partners	6.5	7.2	4.3	4.9	4.0	4.2

The COVID-19 pandemic remains a significant risk to the economic outlook, as highlighted by the recent countermeasures introduced in parts of Europe, Asia and South America. It is worth noting that recent measures have had a less significant impact on economic activity than those implemented at the start of the pandemic, with businesses and consumers proving more adaptable to changes, while the lack of widespread manufacturing closures has limited global supply disruptions. Delays to COVID-19 vaccinations present a risk of further virus

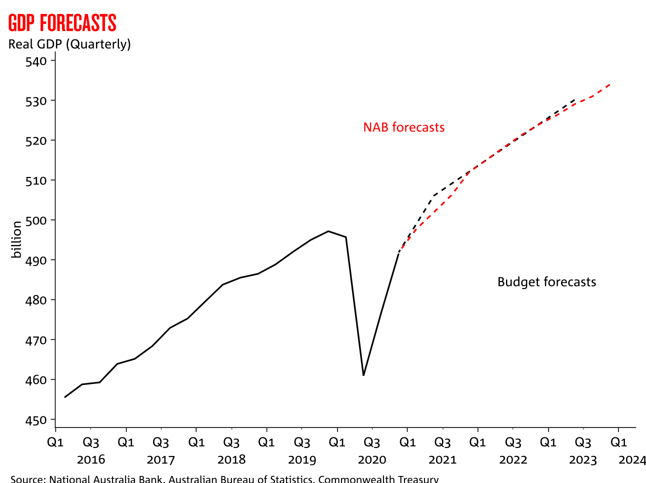
mutation into variants that may spread faster, increase the likelihood of death or long-term illness or prove more resilient to current vaccines.

Beyond the pandemic, risks around the global trade environment persist, including China's trade relationship with the United States, Australia and potentially other major economies. The fragility of global supply chains, which was exposed by the early stages of the pandemic, could also result in realignment of global trade. A broad range of geopolitical tensions could threaten global economic activity – including in the Middle East, the Korean peninsula and the South China Sea.

Australian Outlook

Our forecasts are broadly unchanged since April. The budget has come in largely as expected – with the tapering in fiscal stimulus largely as we had forecast. Further, the budget forecasts for Real GDP in aggregate are very similar to ours, albeit with some offsetting timing differences across the components. It is important to remember that while there has been some tapering of fiscal stimulus, that both fiscal and monetary policy remain exceptionally stimulatory (and are working in the same direction), and will see further growth even as the pre-COVID level of GDP is reached in Q1 2021. As an assumption we agree with the budget outlook for a reopening of borders in 2022 – where we will likely see a bigger normalisation in consumption patterns.

GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics, Commonwealth Treasury

We expect the economy to grow at an above trend rate next year. Thus, after growth of 1.0% in 2020/21 (Budget: 1¼%) we have 4.2% for 2021/22 (Budget: 4¼%). We then see growth returning closer to trend 2022/23 of around 2.5% (similar to the budget). Therefore, our overall profile for the level of Real GDP is very similar over the forecast period.

The ongoing lift in activity will see further gains in the labour market beyond the pre-COVID level of employment which has already been recovered. The unemployment rate has declined much more quickly than anticipated falling by 1.6ppts over the past 6 months to 5.6%, while underemployment has fallen to the lowest level (7.9%) since mid-2014. We expect the unemployment rate to decline further from here, falling to 5% by end 2021 and 4.3% by end 2023. The budget outlook is slightly less optimistic on employment growth and therefore unemployment, which remains around 0.5ppts higher by the end of the 2022-23 financial year. For now, it appears that the expiration of the JobKeeper program has done little to reduce the momentum in the labour market, with the number of JobSeeker recipients actually declining in April.

Alongside the tightening in the labour market, we expect wage growth to lift from current lows (1.4%) to around 2.8% by end-2023. On a financial year basis, the budget forecasts for wage growth are broadly similar to ours. The longer-term treasury forecasts beyond 2022/23 see wage growth remaining at around 2.5%. While this would be stronger than the trajectory prior to the pandemic, it is still a relatively soft outlook and implies that wages driven inflationary pressure will remain weak, warranting ongoing easy monetary policy.

While in aggregate, employment and (probably) GDP have returned to their pre-COVID levels, there are ongoing impacts for certain sectors.

Those sectors most exposed to international travel (tourism and education exports) will see ongoing impacts with borders remaining closed into 2022.

Commercial property continues to see impacts, with the NAB Commercial Property Survey seeing only a modest improvement to date, despite the gains in activity and employment over the past year. CBD retail, hotels and offices will all see ongoing impacts with the shift to working from home. At the same time, other sectors have benefited; industrial commercial property related to distribution of goods for example.

CBD's will also likely see ongoing impacts with less activity centered on city centers and a shift to spending in suburban and regional areas with employees working from home more often.

Business Sector

The business sector has experienced large swings in conditions over the past year. Early in the pandemic business conditions rapidly declined to levels last seen in the 1990s recession, and confidence fell to a level around 3 times weaker than the trough in the last technical recession. Capacity utilisation fell sharply in all industries, while surveyed and official measures of business investment also declined sharply.

The second half of 2020 and early 2021 has seen a very strong rebound in the business sector with pandemic-related restrictions easing and consumer demand strengthening. Some sectors continue to be directly impacted by the closure of international borders, but others have benefitted from substitution towards domestic goods and domestic tourism.

The NAB April 2021 Monthly Business Survey saw most aggregate variables strengthen to record highs. Both confidence and conditions have risen sharply, with strength across trading, profitability and employment. There is also a building pipeline of work as Forward orders also set a new high by some margin. Alongside the highest read for capacity utilisation since prior to the GFC this points to a lift in business investment. Indeed, reported capex has strengthened to high levels suggesting that the pickup in investment intentions in both the NAB Quarterly Business Survey and the ABS capex survey may be beginning to materialise.

Indeed, we forecast business investment to pick up from here, but end 2020/21 down 3.1% before recording strong increases of 11.5% in 2021/22 and 8.8% in 2022/23. The budget forecasts for the business sector see a more delayed recovery in business investment with only a 1.5% rise in 2021/22 before a more substantial pick-up in growth to 10% in 2022/23.

The major boost for business investment in the budget was an extension of full expensing for another year (previously slated to end in June-2022), allowing businesses to write-off the full cost of the asset at purchase. This measure will likely provide the most significant boost to the machinery & equipment component of business investment. Indeed, on the expansion of this measure in last year's budget, machinery & equipment spending saw a significant turnaround in the December quarter accounts. In addition to this measure the government has reduced tax rates for SMEs to 2025 from 1 July 2021.

Consumption

The bulk of the cycle in GDP over the past year or so has come from fluctuations in household consumption. The most significant impact of the pandemic outside of the widespread lockdowns in April 2020 has come through a reduction in services spending. Household consumption has driven much of the rebound in economic activity in the second half of 2020, rising by 12% (though in Q4 2020 it was still around 2.7% lower than a year ago).

The pandemic has seen a significant shift in the patterns of consumption, with goods spending up around 10% over the year, while services spending remains slightly lower. This has been partially driven by the impact of closed borders and the substitution towards domestic consumption. Household income actually increased in 2020, despite the significant hit to the labour market and the economy. Wage support by the government and restrictions on consumption saw the savings rate rise very sharply though it has begun to normalise in late 2020.

Eventually, we expect that consumption patterns will normalise (as will the savings rate) though this will depend on the full reopening of borders. There appears to have been some normalisation within household consumption with retail volumes declining by 0.5% in Q1 – driven by a softening in spending on food and household goods.

The ongoing impact of low rates, tax cuts, rising household wealth will continue to support household spending, as will the ongoing improvement in the labour market and strengthening in wage growth. We see consumption rising by 1.4% in 2020/21 before lifting further (6.4%) in 2021/22. The out year sees a normalisation in consumption growth to around 2.7%. This compares with budget forecasts for a slower recovery in consumption in the near term (1¼% and 5½%) but stronger growth in the out year.

Housing

The housing market has rebounded strongly across the country – with auction clearance rates at high levels, prices rising strongly, volumes recovering and housing construction picking up (after declining in recent years).

The Corelogic 8-Capital City Dwelling price index declined by 2.8% between April and September 2020. Since then dwelling prices have risen by 9.5%. House prices growth (11.7%) has outpaced that of units (5.2%) with large capital city rental markets hit by the weakness in migration and students.

Record low interest rates have been a key driver of the pickup in prices while the hit to the labour market was much less severe than expected and household income saw significant support via government handouts. As the impact of lower interest rates wanes, we expect house price growth to moderate from here (though still be healthy). This sees prices in aggregate rise by around 14% this year and 6% next.

On the activity side, in Q4 2020 new dwelling investment as measured by the national accounts rose for the first time since mid-2018. The government's HomeBuilder program saw a very strong take-up, with anecdotal reports suggesting it has led to a build-up of a 2-year pipeline of work in the sector and various state and territory programs have also been introduced. We see dwelling investment rising by 10% in 2021 and declining by 4% in 2022 with the impact of homebuilder bringing forward investment. Interestingly, the budget forecasts see a less pronounced cycle in dwelling investment, with a lower but more sustained peak. Like us, the budget forecasts see a hole in investment in the out year as the pipeline of work declines following the bring forward of work in the near-term.

The main budget measures for housing include an increase to the limit for concessional contribution releases of $50k for first home buyers under the First Home Super Saver Scheme as well as extending the New Home Guarantee for 5% deposits to build or purchase newly build homes. The Government also

introduced a program of 10k guarantees for single parents to purchase homes with a deposit as low as 2%.

Monetary Policy

In addition to the exceptionally supportive stance of fiscal policy over the last year, monetary policy has been a key support to activity, with household and business interest rates at very low levels and credit continuing to flow. However, we expect the RBA to make two key changes to its monetary policy settings at the July board meeting. We expect that the RBA will not roll the 3-year yield target to the Nov-2024 bond – effectively trimming its forward guidance for the period of unchanged rates. The rapidly unfolding recovery – particularly in the labour market – means the RBA can no longer credibly commit to unchanged rates to end 2024. We forecast the labour market to have reached full employment by end 2023 and wage growth to have begun picking up – but to remain below 3%.

In addition to the wind-back of the YCC program, we also expect the RBA to taper the QE program following the second $100bn tranche (to end in September). With some progress having been made on reducing unemployment, the RBA will likely need to alter the program to slow the rate of purchases to ensure no dysfunction is generated in bond markets. By around September the RBA will own around 30% of the government's debt and would likely continue to outpace issuance if a further 100bn program was put in place.

The term funding facility will close as announced but continue to provide support via low funding costs for banks until drawings mature in 2024.

While the RBA is expected to tweak its unconventional policy measures, we expect the cash rate to remain on hold until at least 2024. While the outlook may challenge the RBA's guidance in the near term, wage growth will likely only begin to rise substantially once the labour market reaches full capacity (on our forecasts around early 2024) and then see a lag before higher wage costs begin to be passed through to consumer inflation. That said, the starting point for the unemployment rate is much lower than expected and there is significant uncertainty around the true level of full employment. Therefore, we believe the risks around the first cash rate increase in 2024 have centralised over recent months.

Budget economic forecasts table

	2020-21 (f)		2021-22 (f)		2022-23 (f)		2023-24 (f)	2024-25 (f)
Annual % Change	Budget	NAB	Budget	NAB	Budget	NAB		
Private Consumption	1 1/4	1.4	5 1/2	6.4	4	2.7		
Private Investment – Dwelling	2 1/2	3.2	0	7.1	-1 1/2	-3.9		
Underlying Business Investment	-5	-3.1	1 1/2	11.4	10	8.8		
Underlying Public Final Demand	5 3/4	6.1	5	4.3	1 3/4	2.8		
Domestic Demand	n.a	**2.6**	n.a	**6.6**	n.a	**3.2**		
Stocks – Contribution to GDP	1/4	0.5	0	0.0	0	0.0		
GNE	2 1/2	**3.1**	4 3/4	**6.5**	3 3/4	**3.2**		
Exports	-8	-11.4	4	-1.6	3	1.0		
Imports	-4	-2.7	6 1/2	10.0	9 1/2	5.0		
Real GDP	1 1/4	**1.0**	4 1/4	**4.2**	2 1/2	**2.4**	2 1/4	2 1/2
- Non-Farm GDP	n.a	0.6	n.a	4.0	n.a	2.4		
- Farm GDP	n.a	24.5	n.a	16.1	n.a	2.0		
Nominal GDP	3 3/4	**2.5**	3 1/2	**6.6**	2	**3.9**	4 3/4	5
Federal Budget Balance (fiscal balance, $bn)	**-161.0**	**–**	**-106.6**	**–**	**-99.3**	**–**	**-79.5**	**-57.0**
Current Account Deficit: % of GDP (-%)	3 3/4	1.9	1 1/4	0.6	-2 1/4	-0.2		
Terms of Trade	10	5.2	-8	4.7	-10 1/2	-0.5		
End Period								
Wage Price Index	1 1/4	1.4	1 1/2	1.7	2 1/4	2.4	2 1/2	2 1/2
Employment	6 1/2	7.9	1	3.3	1	2.3	1 1/4	1 1/4
Unemployment rate	5 1/2	5.6	5	4.7	4 3/4	4.3	4 1/2	4 1/2
Underlying CPI	n.a	1.4	n.a	1.5	n.a	1.8		
Official Cash Rate (%) (c)	n.a.	0.1	n.a.	0.1	n.a.	0.1		
10 Year Govt. Bond Yield	n.a.	1.9	n.a.	2.5	n.a.	--		
US cents/$A	0.77	0.80	0.77	0.82	0.77	0.77		
Trade Weighted Index (d)	64.0	63.6	64.0	63.6	64.0	61.8		

(a) Percentage change on previous year, unless otherwise indicated (b) Calendar year forecast (c) Budget assumes profile similar to market pricing
(d) End of period (f) Forecast

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