The 2021-22 mid-year economic and fiscal outlook

A review of the major implications for business

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Introduction

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With a federal election less than six months away, the government has held back from announcing new measures in the 2021-22 mid-year economic and fiscal outlook ("MYEFO") statement.

Somewhat in keeping with the festive season, the largest item in the table of new MYEFO decisions is an intriguing "mystery box" of a net $15 billion in spending measures over the forward estimates attributable to "decisions taken but not yet announced".

The expectation is that we will have to wait until 2022, closer to the election, for the contents of this package to be revealed. The 2022-23 federal budget is scheduled for 29 March 2022 and a federal election must occur before the end of May 2022.

Scope for this proposed spending has been supported by some improvement in the federal finances since the 2021-22 Budget, despite the restrictions that affected the activities of many of the population during the last six months.

Treasury has forecast that the underlying cash balance for 2021-22 will be a deficit of $99.2 billion, an improvement of $7.4 billion since this year's Budget. A major contributor to this is a forecast additional $45 billion in income tax receipts from individuals, companies and superannuation funds.

The underlying cash balance is expected to remain in deficit each year through to the end of Treasury's projection timeframe of 2031-32, although by that time it is projected to be less than 2 percent of GDP.

In keeping with MYEFO's generally positive tone, unemployment is expected to reduce to 4.25 percent in 2022-23 and stay there for the remainder of the forward estimates period. As always, it will be necessary to look behind this number and understand the extent of under-employment and withdrawal from the workforce.

Finally, we wish all readers a safe and happy holiday period.

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Economic overview and analysis

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The revised forecasts presented in MYEFO suggest the economic recovery will gather momentum through 2022 with household consumption and business investment driving the upswing in growth.

The Australian economy in effect hit the pause button during the second half of 2021 because of the Delta-related lockdowns that shut parts of the New South Wales, Victorian and ACT economies.

Non-mining investment expenditure is expected to skyrocket during 2022, in part from the Federal Government's instant asset tax write-off inducing businesses to bring forward investment spending, and in part from catch-up expenditure which was unable to be spent during the most recent lockdown.

Net imports are forecast to contribute about the same to the national economy as proposed in the May 2021 Budget, albeit with lower export growth and delayed imports. KPMG considers this element of the macroeconomic forecasts to be the most open to variation. Imports are likely to be higher given expected levels of business investment, while exports are also likely to soften given expected Omicron-related disruptions to world trade and forecast commodity price falls.

Coincidentally, in a speech today to the CPA Australia Riverina Forum the RBA Governor noted that monetary stimulus through Quantitative Easing (QE) will be pared back during 2022, with bond purchases most likely tapering down from February to a phasing out by May.

However, this was dependent on two factors – firstly, the economy not experiencing another major setback, and secondly (and conversely), if there are better than expected employment and inflation results, then the QE program may cease quicker than current plans.

Today's Labour Force data shows an incredibly strong bounce back in employment during November, with the unemployment rate back down to 4.6 percent. While there is underlying strength in the labour market, MYEFO forecasts also show declining real wages for 2021-22, and a barely positive outlook for 2022-23.

This recovery in the labour market is ahead of both the RBA November's Statement of Monetary Policy forecasts and today's MYEFO, suggesting QE will stop sooner rather than later, and the forecast deficit in underlying cash balances for 2021-22 may be even lower than Treasury's revised predictions.

Again, it is important to recognise the difficulty of preparing accurate forecasts in this environment (still) of a global pandemic. The hope is that COVID-19 transforms itself into an endemic, and becomes something like the seasonal flu, but until global vaccination rates lift the risk of another major concerning variation occurring remains high. If this were to occur "all fiscal and monetary bets will be off", and we will have to revisit the game of COVID snakes-and-ladders at next year's budget all over again.

Key Insights

- Economic growth projections have softened for 2021-22 due to recent COVID lockdowns in NSW, Victoria and ACT.
- Planned economic activity is still expected to happen, albeit through 2022. Non-mining business investment is anticipated to be turbocharged over the coming year, reflecting both tax incentives and slippage of forecast spending.
- Stimulus support is likely to be pulled back sooner rather than later, as the labour market tightens and pockets of inflation emerge across the economy.

Business restructuring

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Despite recent COVID lockdowns, the Australian economy is recovering strongly.

Australian businesses are expected to see a strong year of recovery and growth in 2022, underpinned by:

- the ongoing impact of federal and state stimulus packages which have maintained employment, supported businesses and enabled households to boost their savings balances; and
- high levels of vaccinations supporting the gradual reopening of the economy.

Business insolvencies are approximately 50 percent below long-term (pre-COVID) normalised levels. Where there has been financial stress, many organisations have lent into difficult conversations with their financial stakeholders (e.g. financiers and landlords) and reached consensual outcomes including waivers, deferrals and rescheduling of financial obligations.

We expect a gradual return to pre-COVID insolvency levels over the next 12-24 months as business practices normalise and the effect of COVID stimulus begins to wane.

Small and Medium Enterprises (SMEs)

SMEs are a cornerstone of the economy and a large contributor to employment. Often SMEs can find it challenging to access finance to respond to the changing operating environment.

The Federal Government will extend the SME Loan Recovery Scheme until 30 June 2022. Businesses with a turnover of less than $250 million will be able to apply for loans of up to $5 million over a term of up to ten years, with the Australian Government guaranteeing 50 percent of the loan.

Outlook for 2022 and beyond

Businesses should be alert to but not alarmed by potential challenges on the horizon over the next 12-24 months.

On balance, economic conditions remain strong and those sectors which have suffered the most such as hospitality and tourism are likely to start to see some tailwinds as borders re-open. Notwithstanding, there are some structural headwinds which are likely to affect many organisations including:

- increases to borrowing costs as interest rates normalise, particularly if the speed of the economic recovery accelerates; and
- ongoing labour and supply chain issues impacting input costs, margins and working capital cycles.

Key Insights

- Businesses that have experienced a long-term change in their market or operating environment should be taking proactive steps to adapt their business models.
- Corporates and individuals should be modelling the impact of potential increases to borrowing costs and/or input costs, and have appropriate plans in place to respond to these challenges.
- Where signs of distress persist, speak with a restructuring professional.

Individuals

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Personal income tax receipts are forecast to beat Budget expectations for 2021-22. This may impact decisions for the upcoming Budget in March 2022.

Personal income tax

Figures released in MYEFO show that personal income tax receipts have increased by approximately $20 billion (or close to 9 percent) compared to estimates contained within the May 2021 Federal Budget. This was chiefly driven by a faster than expected recovery in the labour market, increasing average wages and causing stronger than expected payments related to 2020-21 tax returns.

MYEFO remained silent on the acceleration of personal income tax cuts, and the potential extension of the Low and Middle Income Tax Offset (of up to $1,080) past the 2021-22 income year, but it is possible that we may see more on this in the 2022-23 Federal Budget.

In measures to further protect tax revenues, the Australian Taxation Office's compliance program on personal income tax and the shadow economy has received additional funding of $111 million, extending the program to June 2023 and driving anticipated additional tax receipts of $1.2 billion over the forward estimates.

Migration and labour shortages

MYEFO predicts that unemployment in Australia will fall to 4.25 percent by the June quarter of 2023 for only the second time since the 1970s, indicative of the acute workforce shortages being experienced across many industries.

Continued measures to address these shortages include investment in a more skilled and capable workforce and a number of immigration initiatives including a new Australian Agriculture Visa, relaxing of work-hours limits on student visa holders in certain circumstances and concessions for working holiday maker visa holders allowing them to remain in Australia and fill workforce shortages in critical industries.

The reopening of international borders is expected to return Australia to a positive net overseas migration position by 2022-23 which should further alleviate skills shortages.

Key Insights

- Higher than expected tax receipts were driven by a swift recovery in the labour market. MYEFO includes a net $15 billion of unannounced payments which may include the extension or introduction of personal tax reliefs.
- A number of measures to boost inbound migration to Australia to alleviate skills shortages in critical industries is welcome news.

Corporate income tax

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Whilst not introducing new measures relevant for corporate taxpayers, MYEFO provides an update on previously announced Budget measures.

Extension of company loss carry-back and temporary full expensing

The Government has now introduced Bills to Parliament that would extend the ability for eligible companies to carry back tax losses and benefit from full expensing of eligible asset purchases by 12 months.

The company loss carry-back measures are proposed to be extended to 30 June 2023 and would enable corporate tax entities with an aggregated turnover of less than $5 billion to carry-back tax losses generated in the 2022-2023 income year to offset previously taxed profits in the 2018-19 or later income years.

Similarly, temporary full expensing is proposed to be extended for a further 12 months to 30 June 2023. If the legislation passes, the cost of eligible depreciable assets acquired from 7:30pm (AEDT) on 6 October 2020 and first used or installed ready for use by 30 June 2023 would be able to be deducted in full by eligible businesses.

Extension of tax exemption for certain COVID-19 business grants

The Government has implemented the previously announced extension to the temporary treatment of certain state COVID-19 business grants as non-assessable non-exempt (NANE) income. The extension means that taxpayers that receive funding from eligible state COVID-19 grant programs will not be taxed on receipts up to 30 June 2022 (the previous limit was 30 June 2021). The ability to treat grants received as NANE has also been extended to certain Commonwealth COVID-19 support programs.

Despite the tax concessions that apply in the current financial year, MYEFO forecasts an increase in company income tax receipts for 2021-22 of $18 billion (or nearly 22 percent) compared to the forecast in the 2021-22 Federal Budget. This is an indication of the change in expectations of business profitability during that time.

Key Insights

- Extensions of temporary full expensing and loss carry back measures to 30 June 2023 are currently before Parliament.
- Extension of the NANE treatment of funds received from eligible state and Commonwealth COVID-19 grants to 30 June 2022.

Enterprise

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The Government's MYEFO outlined several measures relevant to mid market taxpayers including COVID-19 related assistance and ATO compliance programs.

Funding for ATO compliance program

$111 million has been committed to fund the ATO's personal income tax and shadow economy compliance programs. These programs will fund ongoing ATO review activity through to 30 June 2023.

Tax free treatment for COVID-19 business grants

Certain State and Territory COVID-19 business support grants will continue to be tax free for income tax purposes from 30 June 2021 up to 30 June 2022.

The tax-free treatment applies to an exclusive list of COVID-19 grant programs directed at supporting businesses that are the subject of a public health directive in specific geographical areas.

The tax-free treatment has also been expanded to include Commonwealth COVID-19 business support programs up to 30 June 2022.

Extension of SME Recovery Loan Scheme

The Government's SME Recovery Loan Scheme was due to expire on 31 December 2021. However, the Scheme has been extended to 30 June 2022.

The Scheme is available to eligible COVID-impacted businesses with a turnover of less than $250 million. Under the Scheme, loans are potentially available for up to $5 million.

Export

To build on the May 2021 Budget measure titled 'Simplified Trade System', the Government will provide further funding of $154.5 million over the next four years to modernise Australia's trade system and streamline border clearance services.

Employee Share Schemes

In welcome news for employee share scheme participants, the removal of cessation of employment as a taxing point will apply to all deferred taxing points occurring from the 1 July following Royal Assent. This is a departure from the previous announcement whereby this measure was to only apply to grants made after Royal Assent.

Addressing labour market shortages in Regional Australia

In what is a tight labour market, small to medium enterprises in regional Australia and agricultural industries are likely to benefit from the recent doubling of the Pacific Worker Programs, and the new AgVisa program to attract labour capacity for this important sector.

Key Insights

- The Government continues to prioritise COVID-19 business support.
- At the same time, the mid-market can expect ongoing ATO review and compliance programs.

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