Commonwealth Bank of Australia

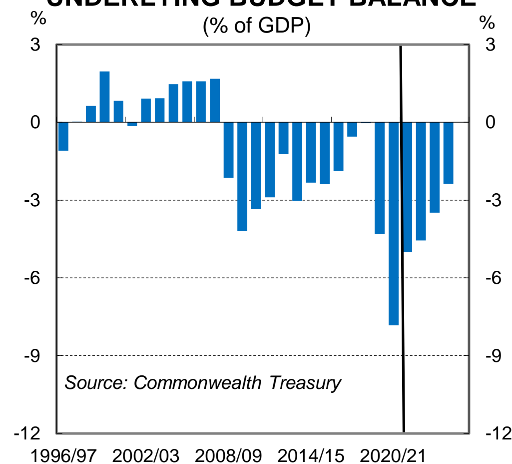
11 May 2021

2021/22 Australian Budget – Fiscal policy supports strong recovery

- With the Australian economy now growing strongly after the COVID-19 recession and with commodity prices high, the Australian Federal Budget position for 2020/21 has improved significantly.
- The 2020/21 deficit is now estimated at $A161bn (7.8% of GDP), down from the MYEFO estimate of $A198bn (9.9% of GDP). The 2021/22 deficit is estimated at $A106.6bn (5.0% of GDP), little changed from the MYEFO estimate of $A108.5bn (5.3% of GDP). The deficit is expected to decline further in the out years to $A57.0bn (2.4% of GDP) in 2024/25.
- Despite this improvement and the strength of the economy, the Government has embarked on a number of significant spending initiatives, both designed to ensure the economic recovery continues and is widespread and to address a number of long-standing areas of much-needed policy support.
- These have focused on: the COVID-19 response, support for low-to-middle income earners, business investment and cash flow, infrastructure, skills & training, community services, aged care, mental health, the NDIS, women's safety and wellbeing, economic and environmental resilience and new energy technologies. It's quite a long list!
- The economic forecasts in the Budget are credible. They are similar to ours for output with GDP growth forecast at 4¼% in 2021/22, before settling to around 2¼%-2½% out to 2024/25. The CPI is forecast at 1¾% in 2021/22, before moving into the 2%-3% target zone from 2022/23 onwards. The unemployment rate is forecast at 5% in 2021/22 and down to 4½% by 2024/25. The Government's forecasts around inflation and wages look conservative.

Overview:

Last years (delayed) Budget focused on extraordinary fiscal stimulus to support the economy through the Covid-19 induced recession. Combined with ultra-easy monetary policy and highly effective control of the coronavirus, this fiscal policy support has meant that the Australian economy is now well down the road of recovery and, indeed, is growing strongly.



The strength of the economy, along with high commodity prices and ultra-easy monetary policy, means that the Australian Budget position has improved relative to the October 2020 Budget. But a significant amount of the extra revenue has been spent to spread the benefits of the economic recovery. The 2020/21 deficit is now estimated at $A161.0bn (7.8% of GDP), well down from the MYEFO estimate of $A198bn (9.9% of GDP).

For 2021/22 the deficit is expected to decline to $A106.6bn (5.0% of GDP), only marginally lower than the MYEFO estimate of $A108.5bn (5.3% of GDP). For 2021/22 the stronger economy delivered an extra $A26.8bn to the bottom-line, but $A21.5bn of this was spent. By 2023/24 the deficit is expected to be down to $A57.0bn (2.4% of GDP). See page 6 for further details.

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These lower deficit estimates mean that net government debt is now expected to rise from $A617.5bn (30% of GDP) as at June 2021 to peak at $A980.6bn (40.9% of GDP) as at June 2025. These estimates are down from the previous expected peak in net debt of 43.0% of GDP ($A950bn) as at June 2024.

Most significantly, the very low interest rate environment and the RBA's monetary policy framework means that net interest payments will remain around 0.7% of GDP for each year out to 2024/25 (but grow from $A14.1bn in 2020/21 to $A17.1bn in 2024/25). The bottom-line is that the Government's debt repayments should remain very manageable and that the economic benefits of this debt will far out-way the interest costs.

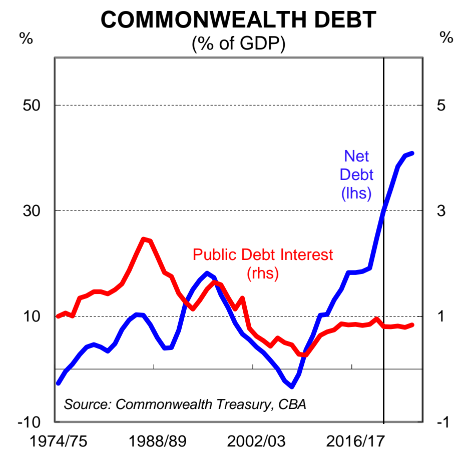
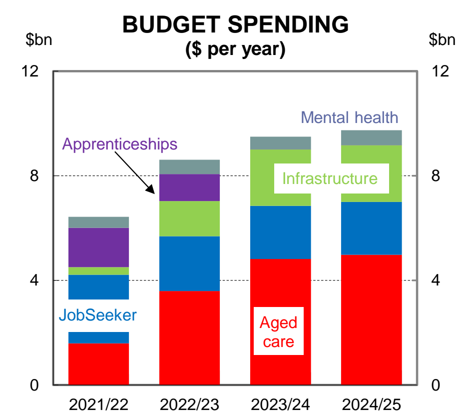


Table 1: 2021/22 Budget figuring

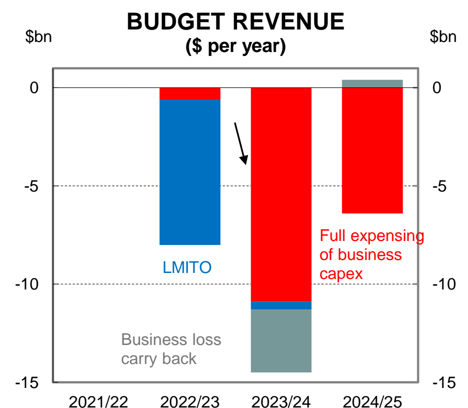
$Abn	2020/21	2021/22	2022/23	2023/24	2024/25
Budget balance as at Oct 2020 Budget	-213.7	-112.0	-87.9	-66.9	N/A
% of GDP	-11.0	-5.6	-4.2	-3.0	
Changed economic parameters	+60.9	+26.8	+15.5	+18.6	N/A
New policy announcements	-8.2	-21.5	-26.9	-31.1	N/A
Budget balance as at May 2021 Budget	-161.0	-106.6	-99.3	-79.5	-57.0
% of GDP	-7.8	-5.0	-4.6	-3.5	-2.4
Net Debt	617.5	729.0	835.0	920.4	980.6
% of GDP	30.0	34.2	38.4	40.4	40.9

Source: Commonwealth Treasury



The 2021/22 Budget contains significant new spending initiatives. This is in-line with the Government's well signalled intention to continue supporting the economy in an effort to drive the unemployment rate below 5% and towards the NAIRU (non-accelerating inflation rate of unemployment) – now estimated by the Commonwealth Treasury at 4.5%-5%.

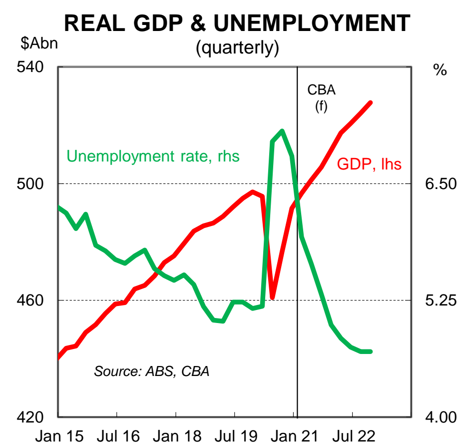
As a result, the Government has announced new policy initiatives in the Budget that add up to $A8.2bn in 2020/21 and $A21.5bn in 2021/22. Over the four years to 2023/24 new policy initiatives add up to a substantial $A87.7bn.



Importantly, the Government's new spending initiatives are focused on a transition from broad-based support for the economy to a more targeted approach, but with this targeted approach supporting a wide range of sectors in the economy and focussing on some policy areas where much-needed policy support is required.

See page 5 for the key policy announcements in the Budget:

We see this package of fiscal policy as providing the Australian economy with strong ongoing support. Our economic forecasts are based on a continuation of the strong economic recovery. For 2020/21 we expect GDP growth of 0.9%, with a solid year of 4.5% growth expected in 2021/22. The Budget forecasts the economy to have grown by 1¼% in 2020/21 and then grow by 4¼% in the coming financial year.



In the Budget, the CPI is forecast at 1¾% for 2021/22, with the unemployment rate forecast down at 5% as at June 2022. Our own forecasts have headline inflation at 2.0% for 2021/22 and the unemployment rate down at 4.7% as at 30 June 2022. See page 3 for further details.

Our forecasts for commodity prices are higher than those in the Budget in 2021/22. As such, we expect stronger nominal GDP next year.

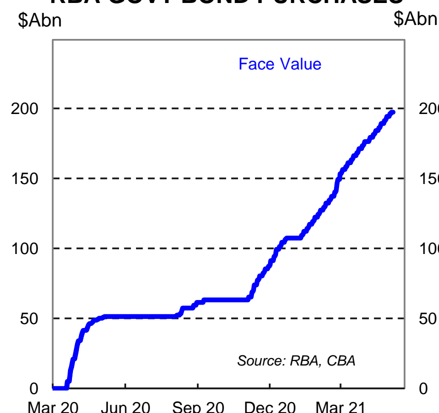
The lower deficit in 2021/22 compared with 2020/21 means that the borrowing program for the Australian Office of Financial Management (AOFM) will be smaller next financial year.

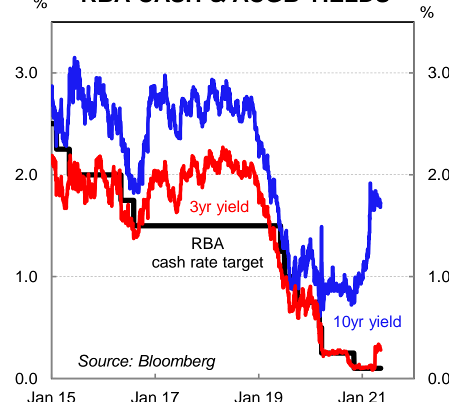
While more details will be provided tomorrow by the AOFM, we estimate that the borrowing need for the AOFM in 2020/21 will be around $A210bn. For 2021/22 the AOFM is now expected to need to borrow around $A150bn of nominal bonds, with a small allocation to T-notes and Indexed linked also. See page 8 for further details.

The 2021/22 Budget may have some medium-term implications for the RBA and monetary policy. Our monetary policy review remains for the RBA to announce at the July Board meeting that the yield curve control (YCC) program will continue to target the April 2024 bond yield at 0.1% as it rolls down the yield curve, ie. no shift to the November 2024 bond when it becomes the benchmark 3yr in coming months.

In addition, we expect (also at the July meeting) for the RBA to announce that the third round of their bond purchase program (QE3) will be at the lower pace of $A50bn over a 6 month period, ie. a taper from the $A100bn seen in each of QE1 and QE2. The term funding facility (TFF) for Australian banks is expected to end as planned on 30 June 2021.

The cash rate is expected to remain on hold at 0.1% over the coming years, with the RBA persisting with the '2024 at the earliest' forward guidance. However, the extent of the fiscal policy stimulus announced in the 2021/22 Budget does raise the risk of a stronger economy and lower unemployment rate in the years ahead, holding out the risk that the RBA will need to raise the cash rate before 2024.





Economic & Commodity Forecasts

The economic forecasts in the Budget are an insight into the Government's expectations for the path of the economy over coming years. The Government has made big upward revisions to their economic forecasts, as expected given the much better performing domestic economy.

As is custom, economic forecasts are provided for the Budget year and the subsequent financial year and then economic projections for the following two years. The projections assume the output gap is close by end-2022/23. Given the high degree of uncertainty in the economic outlook at present we assess the Government's economic forecasts over 2021/22 and 2022/23 rather than their economic projections in the outer years.

Assumptions are critical to economic forecasts. The Government assumes that a population-wide vaccination program is likely to be in place by the end of 2021. We think that is a credible assumption, but the risk is that the rollout takes a little longer than the Government has forecast. The assumptions around the movement of people imply that the international borders are largely closed until mid-2022. More specifically, a gradual return of temporary and permanent migrants is assumed to occur from mid-2022. Small phased programs for international students will commence in late 2021 and gradually increase from 2022. And inbound and outbound international travel is expected to remain low through to mid-2022.

International travel restrictions have a big impact on net overseas migration (NOM) which in turns has an impact on population growth. This is important because the assumptions around population growth also have a large bearing on projected outcomes – both economic and fiscal. Net overseas migration (NOM) is forecast to fall by 97k in 2020/21 and 77k in 2021/22. This means that population growth

Table 2: Budget Economic Forecasts

	2021/22 (f)	2022/23 (f)
Real GDP (% ch)	4.25	2.5
Of which:		
H/hold consumption (% ch)	5.5	4.0
Dwelling Investment (% ch)	0	-1.5
Business Investment (% ch)	1.5	10.0
Public demand (% ch)	5	1.75
GNE (% ch)	4.75	3.75
Net exports (ppt contrib)	-0.25	-1.25
CPI (% ch yr to June)	1.75	2.25
WPI (% ch yr to June)	1.5	2.25
Terms of trade (%ch)	-8	-10.5
Nominal GDP (% ch)	3.5	2.0
Employ. (% ch yr to June)	1.0	1.0
Unemployment (%, June)	5.0	4.75
Current A/c def (% GDP)	1.25	-2.25

Source: 2021 Commonwealth budget

is forecast to be 0.1% in 2020/21, 0.2% in 2021/22 and 0.8% in 2022/23. This is well below the ~1.5% annual growth rate in the population pre-COVID.

Lower population growth is a headwind on the economy from a GDP and revenue perspective, albeit the impact on GDP per capita is far smaller. Lower NOM, however, raises the prospect that wages growth accelerates as the labour market tightens as skill shortages will have more chance of manifesting themselves if firms are not able to recruit from a global pool of labour (see below).

To the forecasts themselves, real GDP is expected to rise by 1.25% in 2020/21 and to rise by a strong 4.25% in 2021/22. This represents a significant *upgrade* on what the Government had projected in MYEFO (the Government forecast GDP to *contract* by 1.5% in 2020/21 and to rise by 4.75% in 2021/22). The upgrade to GDP isn't surprising given the strength of the domestic economic data since the MYEFO was published, particularly around spending, employment and hours worked. The Government's forecasts for real GDP look fine to us. They are broadly in line with our forecasts and a bit stronger than the forecasts the RBA published in the May *Statement on Monetary Policy* (SMP).

Employment is forecast to rise by 1.0% over the year to Q2 22. And the unemployment rate is forecast to be 4.75% by mid-2022. This is very much in line with our forecasts (CBA (f) unemployment rate to be 4.7% at mid-2022).

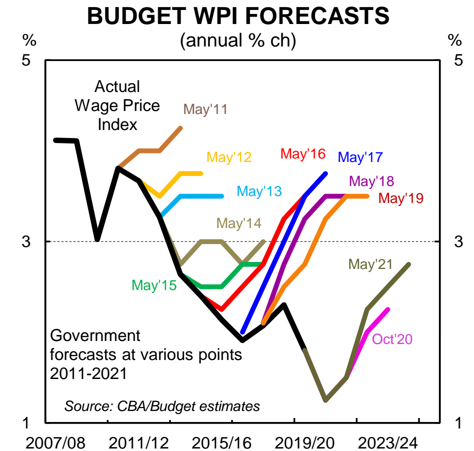
Wages growth, as measured by the wage price index, is forecast to be 1.25% at mid-2022 and 2.25% at mid-2023. This is broadly in line with Government's forecasts for inflation. The upshot is that no real wages growth is expected.

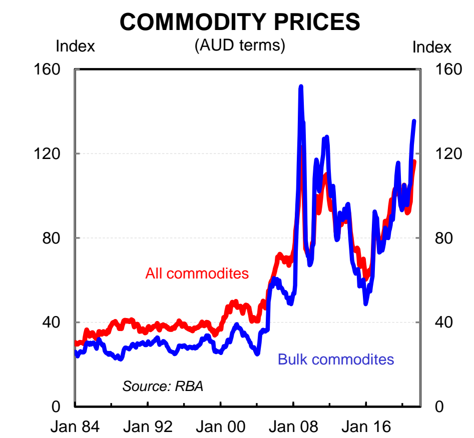
The risks to the Government's wages forecasts are to the upside given the international borders are closed and growth in labour market supply is low. The sharp drop in NOM means that employees in many industries have had a lift in their bargaining power that is independent of the level of slack in the local labour market. Essentially talent is scarce because firms can't hire from abroad like has previously been the case. We expect wages growth to accelerate to 2.5% by mid-2022.

Commodity prices are a key input into nominal GDP forecasts. We think that the Government's forecasts for Australia's key mining and energy commodities in the coming years are too conservative. We made similar remarks on the commodity forecasts in the October 2020 Budget. Specifically, we believe the Budget's iron ore and coking coal price forecasts are far too conservative in 2021/22 and 2022/23.

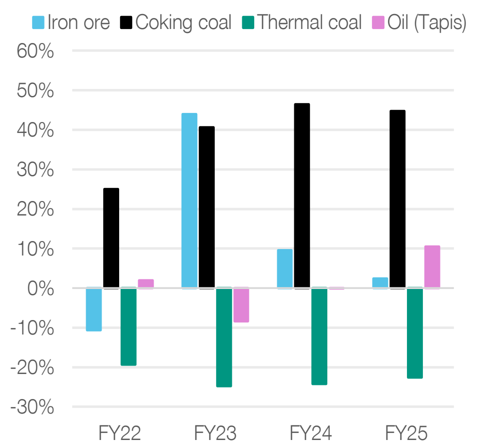
The Budget's iron ore price forecast is similar to our outlook in later years, but is notably lower than our outlook in 2022/2023. The difference reflects our view that prices will only gradually fall to $US55/t-$US60/t (FOB Australia) by late 2023/24. The Budget assumes that iron ore prices will fall to $US55/t (FOB Australia) by the end of Q1 2022. Spot prices are currently trading at record highs as markets face strong demand from China's infrastructure-heavy stimulus support. Supply issues in Brazil have also supported prices. It's worth noting that Brazil's supply woes pre-date COVID-19 and primarily reflect the fatal dam collapse in January 2019 that saw Vale curtail supply on safety concerns. We broadly expect iron ore prices to decline as Vale brings back that curtailed production gradually and China's steel demand eases (as stimulus fades later this year).

The Budget's coking coal price view is markedly lower than our view from 2021/22 to 2024/25. The Budget expects coking coal prices to remain at $US112/t (FOB Australia), suggesting that the plunge in coking coal prices from China's unofficial ban on Australian coal has little chance of reversing. We think at some point the ban will be reversed despite the recent worsening of Australia-China tensions. India's coking coal demand should eventually lift too, but that could take longer than expected given the recent surge in COVID-19 cases in India.





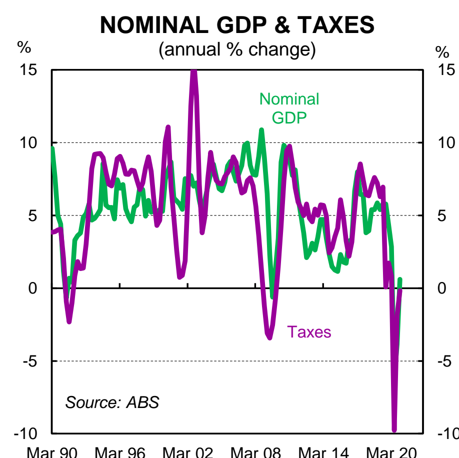
CBA vs Budget commodity price assumptions



Source: Budget, CBA estimates

The Budget's outlook for thermal coal is higher than our forecast in the outlook period. The Budget assumes that recent thermal coal prices of $US93/t (FOB Australia) will continue. We see downside risks to the Budget's thermal coal price outlook, particularly with decarbonisation likely to weigh on thermal coal demand from Japan, South Korea and China.

Overall the Budget's more pessimistic forecasts on commodity prices mean that we have a stronger profile for nominal GDP in 2021/22 than the Government. The Government has forecast nominal GDP growth of 3.5% in 2021/22 compared with our forecast of 4.6%. It also means that we do not expect the terms of trade to decline by as much as the Budget forecasts. And by extension we expect large trade surpluses to continue.



Major Policy Announcements

Aged care: The Budget has included an extra $A17.7bn for aged care over five years. Extra funding will go towards training an additional 33,800 staff, support for the elderly to stay in their own homes and more resources for residential facilities.

Medicare and the National Disability Insurance Scheme (NDIS): The Government has committed an extra $A13.2bn over four years to the NDIS. More health services will be included on the Medicare Benefits Schedule. And more medications will be included on the Pharmaceutical Benefits Scheme.

Mental health: The Budget allows for $A2.3bn for the provision of mental health treatment prevention and treatment services over the forward estimates.

Child care: An extra $A1.7bn has been allocated to child care. Child care costs will fall for families with two or more children in child care. The annual cap on the subsidy will be removed. These changes will come into effect from 1 July 2022.

Extension of the low and middle income tax offset (LMITO): The LMITO, due to expire 30 June 2021, has been extended for another year. This offset gives workers earning less than $A126,000 per year up to $A1,080 of tax relief. This extension is expected to cost $A7.8bn.

Housing affordability: The Family Home Guarantee program has been announced to help single parents buy a home. This program allows single parents with a household income of less than $A125,000 to buy a home with a deposit of just 2% with the government guaranteeing the remainder of the deposit. There will be 10,000 places available from 1 July 2021.

The existing New Home Guarantee program has been extended, with another 10,000 places added. This program allows first home buyers to build or buy a new home with a deposit of just 5% with the government guaranteeing the remainder of the deposit.

The First Home Super Saver Scheme (FHSSS) has been tweaked. At the moment under the FHSSS, anyone wishing to save a deposit for their first home can make voluntary contributions to their superannuation fund, capped at $A15,000 a year, to take advantage of the special tax treatment of super. That maximum they can save under the scheme is $A30,000. However, that cap has been raised to $A50,000 in the budget.

The three policies above add to demand for housing. The HomeBuilder grant scheme, which came into play in 2020, has supported a large lift in housing supply.

The Government already allows older Australians to make a post-tax contribution to super when they sell their family home. From 1 July 2022 the minimum age will be lowered from 65 to 60. This policy is designed to encourage downsizing and free up larger homes for families.

Women: There is a $A1.1bn package of initiatives to support the victims of domestic violence. And funding for legal support for women. The government has set aside $A16.6m for programs that cover women's health

Infrastructure: Funding for transport infrastructure is a feature of the Budget with an extra $A15.2bn of spending over 10 years. Infrastructure spending of $A110bn is planned over the next ten years.

Business: The tax rate for small and medium companies has been ratcheted down for a number of years. From 1 July 2021 the tax rate will drop to 25% (from 30% in 2014/15).

The temporary full expensing of capex and temporary loss carry-back provisions will be extended to include the 2022/23 financial year. These two measures are expected to provide an additional $A20.7bn in take relief over the forward estimates.

Small craft brewers and distillers will receive up to $A250,000 in tax breaks.

There are provisions to reduce taxes on R&D. And a tax offset for digital game development.

Tourism: There is $A1.2bn in spending to support the tourism and aviation sectors. Measures include over 800,000 half price air fares. There is $A300m for support of the creative and cultural sector.

Education: There is $A6.4bn earmarked in the Budget for skills training and subsidies for apprenticeships. There is $A2bn set aside for spending over 2022 to 2025 for pre-school funding.

Superannuation: The Budget scraps the $A450 per month superannuation threshold so super contributions will now paid on amounts less than this.

Key Budget and Debt numbers

The Budget estimates an underlying cash deficit for 2021/22 of $A106.6bn (5.0% of GDP), an improvement on the $A161.0bn, 7.8% of GDP, deficit for 2020/21.

The underlying cash balance then remains in deficit over the forecast horizon, but moderates to 'just' $A57bn, 2.4% of GDP, for 2024/25. The medium term projections have the budget balance still in deficit in 2031/32 at 1.3% of GDP.

Fiscal policy has been very expansionary and instead of switching to the second stage of budget repair as was planned in 2020/21 given the unemployment rate is now below 6%, the Federal Government has changed course. The first stage of the budget strategy is now focussed on driving down the unemployment rate back to where it was pre pandemic, or lower. The Government wants to ensure the recovery is sustained and secured and is using the full force of fiscal policy as demand management to ensure this.

Only after we have reached full employment will the Government pivot to budget repair. The medium term objective is stabilising and then reducing debt as a share of GDP.

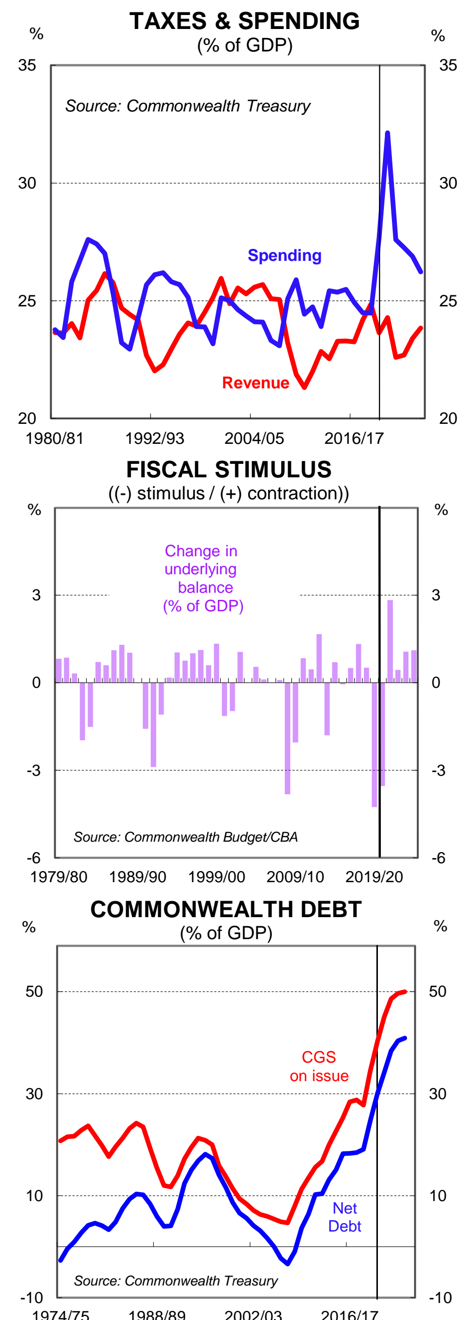
For 2021/22 the fiscal impulse (ie. the change in the budget deficit between years) is negative, ie contractionary due to the smaller deficit than 2020/21. There is another small negative fiscal impulse in 2022/23, but much smaller than was the case in the 2020/21 Budget and even in MYEFO given the increase in expenditure in this Budget and the out years.

The deficits do reduce, albeit very slowly. The starting point in 2021/22 is now much higher than expected given the gains from the automatic stabilisers have been spent. This puts the credit rating under the spotlight.

For 2021/22 some of the key budget numbers are:

Spending is expected to fall in 2021/22 to 27.6 of GDP, compared to 32.1% in 2020/21. Spending is then expected to fall only slightly as a share of GDP to 26.2% in 2024/25, but still much higher than the 24.5% of GDP in 2017/18 and 2018/19.

Revenue is expected to fall to 22.6% of GDP in 2021/22, from 24.3% in 2020/21, largely due to the extension of the low and middle income tax offset and the extension of business tax incentives. Revenue is then expected to lift to 22.7% of GDP in 2022/23 before lifting to 23.9% in 2023/24. This is still above the 24.9% in 2018/19 when the Government began to reduce income taxes.



Given the wide ranging policy announcements in this Budget, there has been very little change to the deficit since MYEFO. The MYEFO placed the 2021/22 deficit at $A108.461bn. Since then parameter changes account for a $A20.051bn improvement to the underlying deficit and policy decisions account for $A18.224bn, effectively cancelling each other out.

Over the forward estimates the pendulum swings each year. In 2022/23 policy decisions of $A24.758bn far outweigh parameter improvements of $A9.878bn. The same situation occurs in 2023/24, but is less by 2024/25. The policy decisions are all supportive of the economy.

Over the forward estimates to 2023/24 parameter changes improves the bottom line by $A121.8bn, while policy decisions add $A87.7bn to the deficit.

The net operating balance is expected to be in deficit over the forecast horizon. It is estimated to be $A154.5bn in 2021/22 and reduce to a deficit of $A55.7bn in 2024/25.

A headline cash deficit of $A117.0bn is expected in 2021/22. The headline cash balance remains in deficit over the forecast horizon, falling to $A65.1bn in 2024/25.

Net debt is expected to rise over the forecasting horizon due to the large deficits in place. Net debt is expected to be $A729bn, or 34.2% of GDP in 2021/22. This compares to $A491.217bn or 24.7% of GDP in 2019/20, and 19.2% of GDP in 2018/19. Australia has no net debt back in 2008/09, before the GFC.

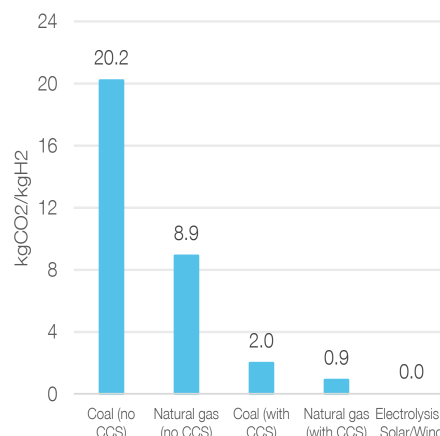
Net debt is expected to now peak at 40.9% as at June 2025, lower than the estimate in the 2020/21 Budget of 43.8% of GDP. However the dollar value will now be higher at $A980.561bn with all the improvement coming from higher nominal GDP.

Net interest payments are expected to remain low as a % of GDP, at 0.7% of GDP due to the low cost of debt currently in place. It has averaged 0.7% since 2013/14. Net debt is expected to fall to 37.0% by the end of the medium term.

Caring for the environment

- $A565.8m for international technology partnerships/initiatives and co-funding research and demonstration projects.
- $A275.5m to accelerate the development of four additional clean hydrogen and implement a clean hydrogen certification scheme
- $A263.7m to support the development of carbon capture, use and storage (CCS/CCUS) projects.
- $A316.7 million to help industry and businesses reduce their emissions through voluntary action and adopting low emissions technology.

CO2 intensity of hydrogen production



Source: BNEF

The Government's plan to invest in four additional clean hydrogen hubs in regional Australia shows the Government recognises that it has a major role to play to commercialise the clean hydrogen sector.

Clean hydrogen refers to producing carbon-free or low-carbon hydrogen. 'Green' hydrogen is the only carbon-free pathway to produce hydrogen. Green hydrogen is produced when renewable electricity (i.e. wind and/or solar) powers electrolysers to split water into hydrogen and oxygen.

The spending on carbon capture (CCS/CCUS) suggests that 'blue' hydrogen (i.e. hydrogen derived from fossil fuels with carbon capture) is still a potential pathway for Australia too. The major drawbacks of blue hydrogen is that up to 90% of the carbon emissions can technically be captured. And that doesn't include methane emissions associated with natural gas production further upstream.

Even outside of 'blue' hydrogen, we think carbon capture is worth pursuing despite the setbacks such projects have faced around the world to date. Successfully capturing carbon emissions from fossil fuels may not be the perfect solution, but it would extend the viability of fossil fuel industries in a decarbonising world.

A hydrogen hub effectively refers to co-locating industries that will produce, consume and export hydrogen. Co-location is crucial to establishing scale in order to bring down clean hydrogen costs. Co-location also reduces transport and

potentially even storage costs, which can be significant in the hydrogen supply chain.

A number of locations in Australia are vying to be a hydrogen hub. Bell Bay (Tasmania), Pilbara (WA), Gladstone (QLD), La Trobe Valley (VIC), Eyre Peninsula (SA), Hunter Valley (NSW) and Darwin (NT) are the main contenders.

We think the Hunter Valley in NSW is the most promising hydrogen hub proposal. The region faces the most immediate stranded asset risks given the Port of Newcastle is one of the world's largest thermal coal export hubs. Thermal coal trade faces significant downside risks as the world looks to decarbonise. The International Energy Agency (IEA) estimates that thermal coal trade could half over the next decade if the global economy adheres to the Paris Agreement (limit any increase in global temperatures to well below 2°C).   Australia's thermal coal exports also face heightened risks given that the three largest buyers of Australia's thermal coal (Japan, China and South Korea) announced carbon-neutrality goals last year. Japan and South Korea are aiming to reach net-zero emissions by 2050, while China is looking to get there by 2060.

The Hunter Valley is also set to see significant transmission become available as four major coal power plants retire over the next 15 years. Transmission will be vital for electricity-intensive green hydrogen production. Infrastructure costs required for a successful hydrogen hub can also be reduced in the Hunter Valley. Hydrogen storage costs could be cut significantly if abandoned coal mines can be used, Hydrogen pipeline costs can also be reduced if the proposed LNG import terminal in Newcastle can share some of costs. Our note here outlines in more detail our view on hydrogen and how the Port of Newcastle can become a hydrogen hub.

It's worth noting that a clean hydrogen hub is likely to be in a pilot and demonstration phase over the next decade as clean hydrogen production and consumption are explored. The commitment by the Morrison government for international technology partnerships and co-funding research and demonstration projects is necessary for a hydrogen hub to grow successfully in Australia. That will also be true for other nascent decarbonisation technologies that are vying for commerciality. These include longer-duration batteries and electric heat pumps, but also technologies that can enhance the reliability and security of a renewable-heavy grid.

Source: Platts, ICE, China Coal Resource, Bloomberg, Budget, CBA estimates

Implications for Bond Markets & the AUD

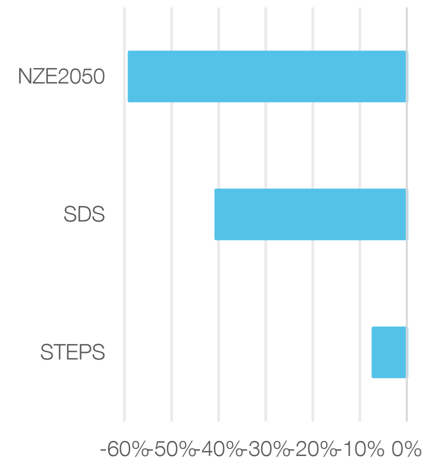
The AOFM borrowing task for the current financial year (2020/21) has fallen a little, to around $A210bn, which largely means the AOFM will continue at the current rate of $A2bn of nominal per week and $A1bn of T-notes per week until 30 June.

In 2021/22, the annual task appears to be around $A150bn of nominal bonds, with a small allocation to T-notes and to linkers also. Allowing for a couple of syndications, that $A150bn total suggests the AOFM borrowing rate for nominals will remain at $A2bn per week, or thereabouts, after 30 June 2021, too. The RBA bond purchase program (QE2) will remain at around $A4bn per week of ACGBs until at least the end of August. We expect the RBA buying to taper after that, though if our expectation of a third tranche of bond buying (QE3) at the reduced volume of $A50bn is correct, the net weekly supply of ACGBs may well remain around nil well into 2023.

Because of the timing of the July 2022 maturity, the borrowing task for 2022/23 is even larger than 2021/22 at more like $A175bn, despite the smaller budget deficit. That suggests the AOFM will be syndicating to replace the July 2022 in July of 2022.

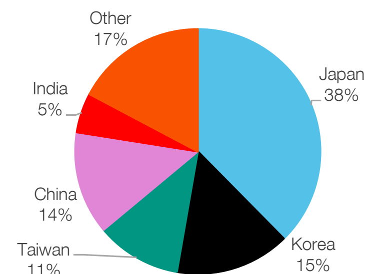
As is usually the case, and in line with our expectation, the AUD/USD was not influenced by the Budget announcement. Most of the government's policies were leaked to the media in recent days. Therefore, there was little to surprise the

Primary coal demand by scenario – 2019-2030 (NZE2050 – Net Zero Emissions by 2050, SDS – Sustainable Development Scenario, STEPS – State Policies Scenario)

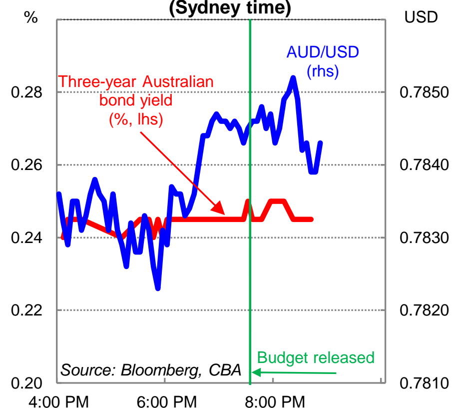


Source: International Energy Agency (2020), World Energy Outlook 2020, IEA, Paris

Australia's thermal coal exports – by volume

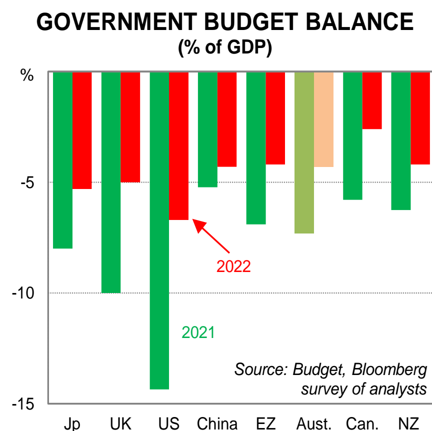


Source: ABS, CBA estimates



currency market. The main drivers of AUD/USD in recent months is the USD trend against the main currencies (such as EUR and JPY) and the surge in commodity prices.

The government's ongoing large budget deficits, and accumulation of debt, does not change our outlook for the AUD/USD. Australia's projected budget deficits are in the middle of the international pack. Even if the government's credit rating is cut, we expect AUD/USD to decrease only modestly (less than 2%) and temporarily. The government's credit rating is not a medium term driver of currencies. Commodity prices are the main medium term driver of AUD/USD. Commodity prices are very high and underpin our prediction AUD/USD will appreciate further over 2021.



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