

Vivek Prabhu: Stage 3 tax changes could delay rate cuts

By Perpetual Asset Management

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The Albanese government's Stage 3 tax cut changes are touted as cost-of-living relief. But they could delay the RBA's hand on cutting rates, argues Perpetual's Vivek Prabhu.

- Stage three changes redirect cuts to lower income workers
- Potential for 'slightly more inflationary outcome'
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Anthony Albanese's modification of the Stage 3 tax cuts will likely delay any Reserve Bank rate cut until late in 2024 as stimulus is redirected towards lower-income households more likely to spend the windfall, says Perpetual's head of fixed income Vivek Prabhu.

The Prime Minister announced changes to the legislated Stage 3 tax cuts last month, reshaping the stimulus away from high income earners and triggering accusations that he broke an election promise.

The new package – forecast by Treasury to lift the total income tax take by \$28 billion over 10 years – is “slightly more inflationary” in the near term than the previous package, says Prabhu.

“At the margin, the tweaked tax cuts are re-distributed from higher income households – with a higher propensity to save – to lower income households with a higher propensity to spend,” says Prabhu.

“All other things being equal, this may be slightly more inflationary as it stokes the demand side of the equation a little more than would otherwise have been the case.”

Prabhu says the implication of higher inflationary pressures could mean delays to start of a widely expected monetary policy easing from the RBA this year.

“At the end of the day, this is unlikely to materially change the near-term outlook for inflation and bond yields – though it may at the margin mean any potential rate cuts may take a little longer to come through.”

The new stage three package reduces the 19 per cent marginal tax rate to 16 per cent for people earning up to \$45,000 and reinstates a 37 per cent tax rate for those earning between \$135,000 and \$190,000.

The net effect of the changes is to reduce the tax cut for someone earning \$200,000 from \$9075 to \$4529, while lifting the tax cut for a person earning \$100,000 from \$1379 to \$2179.

People earning \$40,000, who were not due to get a tax cut in this round, will now pay \$654 less tax.

Prime Minister is pitching the Stage 3 changes as cost-of-living relief for households doing it tough after an inflation spike sent prices sharply higher.

But any delay to rate cuts this year could undercut the effect of the tax reduction and leave households under pressure.

Despite being slightly stimulatory in the short term, the reintroduction of the 37 per cent rate will drive an additional \$28 billion in tax revenue over the next 10 years as wage rises lift individuals past the \$135,000 threshold.

"The stage three tax cuts were already legislated and largely factored in by the RBA and economists in terms of their stimulatory impact," says Prabhu.

"But the tweaks mean the distribution of the tax savings shifts even though the aggregate dollar value is largely unchanged."

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