Economic commentary

Federal Budget 2023-24

Temporary Gain, Long-term Strain

Key takeaways

- The economy is expected to slow sharply, leading to an increase in the unemployment rate over the next two years. Dwelling investment is expected to fall over three consecutive years, putting further pressure on an already tight housing market. Inflation is expected to return to the Reserve Bank's band by 2024-25 where its forecast to be 2.75%.
- The Budget is expected to end 2022-23 in surplus – the first surplus in 15 years. The improvement was driven by a stronger economy and higher commodity prices. Net spending is partly offsetting the automatic stabilisers. Net spending increased by $20.6b. In addition, the aged care package will cost $13.4b.
- The Budget surplus is temporary. The Budget returns to a deficit of $13.9b in 2023-24, although by the end of the medium term the Budget is expected to be broadly in balance (2033-34). It relies on delicate assumptions to achieve this balance in the medium term.
- Cost of living package ($14.6b) is significant and the centrepiece of this Budget. It will benefit a large share of households and small businesses.
- Housing package disappoints. Rent-to-build incentives and providing National Housing Finance and Investment Corporation (NHFIC) with more capital are a step in the right direction. However, housing headwinds remain with Treasury forecasting dwelling investment to fall amid strong population growth.
- Measures announced for businesses include the $20k instant asset write off scheme and the small business energy incentive scheme. There is also enhanced support for SMEs and start-ups and alignment of superannuation cycles with payroll cycles.

Impact on inflation

- The Reserve Bank (RBA) is in the midst of fighting off its biggest inflation challenge since the 1990s.
- Ensuring the Budget provides support to the most vulnerable while not making the RBA's job harder was a key challenge. Spending is also necessary to advance the Government's economic agenda.
- The centrepiece of the Budget included a $14.6b cost-of-living package, which together with other spending commitments pushed the cost of new Government decisions in the Budget to $20.6b.
- This spending is front loaded, including $12.0b in the 2023-24 financial year (around 0.5% of GDP). This stimulus flows to households with the highest propensity to consume, increasing the risk that the measures may be inflationary.
- In contrast, the cost of policy decisions in the previous October 2022 Budget totalled $9.8b over the forward estimates.
- When the economy is pushing up against capacity constraints, any additional spending will place upward pressure on inflation, regardless of what form the spending takes (i.e. rebates, cash handouts, tax measures).
- Therefore, it is likely that the Budget will add to inflationary pressures. However, the pass through is not expected to be direct, as some spending, such as energy price relief, will directly lower prices in the short term.

- Rising housing costs, including rents, are expected to prolong the inflation fight. The Budget is forecasting a fall in dwelling investment over the forward estimates and provides little relief to address acute shortages in housing supply.
- The additional spending announced may also cushion the economy as we move through a slowdown in economic activity.
- The upside risks to inflation raises the risk that the RBA may need to raise the cash rate further to lower inflation.

Economic outlook – inflation returns to band in 2024-25

Federal Budget 2023-24 - Comparison of the Oct 2022 and May 2023 Budget Economic Forecasts

KEY AGGREGATES AND PARAMETERS					
	Estimate	Forecasts			
	2022-23	2023-24	2024-25	2025-26	2026-27
Economic Aggregates:					
Real GDP					
May 2023	3.25	1.50	2.25	2.75	2.75
Oct 2022	3.25	1.50	2.25	2.50	n/a
Change	0.00	0.00	0.00	0.25	n/a
Employment					
May 2023	2.50	1.00	1.00	1.75	1.75
Oct 2022	1.75	0.75	1.00	1.25	n/a
Change	0.75	0.25	0.00	0.50	n/a
Unemployment rate					
May 2023	3.50	4.25	4.50	4.50	4.25
Oct 2022	3.75	4.50	4.50	4.50	n/a
Change	-0.25	-0.25	0.00	0.00	n/a
Consumer price index					
May 2023	6.00	3.25	2.75	2.50	2.50
Oct 2022	5.75	3.50	2.50	2.50	n/a
Change	0.25	-0.25	0.25	0.00	n/a
Wage price index					
May 2023	3.75	4.00	3.25	3.25	3.50
Oct 2022	3.75	3.75	3.25	3.50	n/a
Change	0.00	0.25	0.00	-0.25	n/a
Nominal GDP					
May 2023	10.25	1.25	2.50	5.25	5.25
Oct 2022	8.00	-1.00	4.25	5.00	n/a
Change	2.25	2.25	-1.75	0.25	n/a
Net overseas migration ('000)					
May 2023	400	315	260	260	260
Oct 2022	235	235	235	235	n/a
Change	165	80	25	25	n/a

Source: Federal Budget 2023-24

* GDP data are percentage change on the previous year. The consumer price index, employment and w age price index are through the year grow th to the June quarter. The unemployment rate is for the June quarter.

- Economic growth forecasts are unchanged over the next 2 years. GDP is expected to grow at a weak pace of 1.50% in 2023-24 before recovering from 2024-25. Economic activity does not return to trend until 2025-26.
- A softening in household consumption is the key driver of the weaker growth in 2023-24, as the impact of higher interest rates and cost-of-living weigh on spending.
- Also notable is that the economic trajectory includes a decline in dwelling investment for three straight years (see housing section for more) amid a sharp uplift in population growth.
- The unemployment rate of 3.5% in the year ended 2022-23 is forecast to lift to 4.25% in 2023-24 and rise again to 4.50% in 2024-25 where it stays in 2025-26. These forecasts for the unemployment rate suggest the labour market will ease over time but remain tight compared with history.
- Inflation has been revised higher in 2022-23 but revised modestly lower for 2023-24 to 3.25% (3.50% previously). Federal Treasury anticipates inflation to return to within the target band in 2024-25. The timing of the return to target is consistent with RBA forecasts.

Economic outlook – productivity remains a challenge

- Wages growth is expected to rise to 4.0% in 2023-24. In this financial year, the CPI is also expected to step down sharply from 6% to 3.25%.
- Real wages (i.e. wages adjusted for inflation) is expected to return to annual growth in 2023-24.
- Lifting productivity remains a challenge for the Australian economy. The Budget delivered little meaningful reform directed at lifting productivity growth. Without it, challenges will persist in sustainably lifting real wage growth and preventing a decline in living standards over the long run.
- Nominal GDP is expected to be firmer in 2023-24 with 2022-23 also expected to be better than anticipated in October 2022. An upgrade in the assumptions for commodity prices have helped lift the growth forecasts for nominal GDP.
- Net overseas migration (NOM) forecasts are a notable stand out – they have been revised up again in this Budget and are expected to remain elevated through the forward years.

Economic outlook - more optimism than the central bank

Federal Budget 2023-24 - a Comparison of the October 2022 Budget and Latest RBA Forecasts

KEY AGGREGATES AND PARAMETERS					
	Estimate	Forecasts			
	2022-23	2023-24	2024-25	2025-26	2026-27
Economic Aggregates:					
Real GDP					
Budget	3.25	1.50	2.25	2.75	2.75
RBA	3.25	1.25	1.75	n/a	n/a
Difference	0.00	0.25	0.50	n/a	n/a
Employment					
Budget	2.50	1.00	1.00	1.75	1.75
RBA	2.50	1.10	1.10	n/a	n/a
Difference	0.00	-0.10	-0.10	n/a	n/a
Unemployment rate					
Budget	3.50	4.25	4.50	4.50	4.25
RBA	3.50	4.25	4.50	n/a	n/a
Difference	0.00	0.00	0.00	n/a	n/a
Consumer price index					
Budget	6.00	3.25	2.75	2.50	2.50
RBA	6.25	3.50	3.00	n/a	n/a
Difference	-0.25	-0.25	-0.25	n/a	n/a
Wage price index					
Budget	3.75	4.00	3.25	3.25	3.50
RBA	3.80	3.90	3.70	n/a	n/a
Difference	-0.05	0.10	-0.45	n/a	n/a

Source: Federal Budget 2023-24

* GDP data are percentage change on the previous year. The consumer price index, employment and w age price index are through the year grow th to the June quarter. The unemployment rate is for the June quarter.

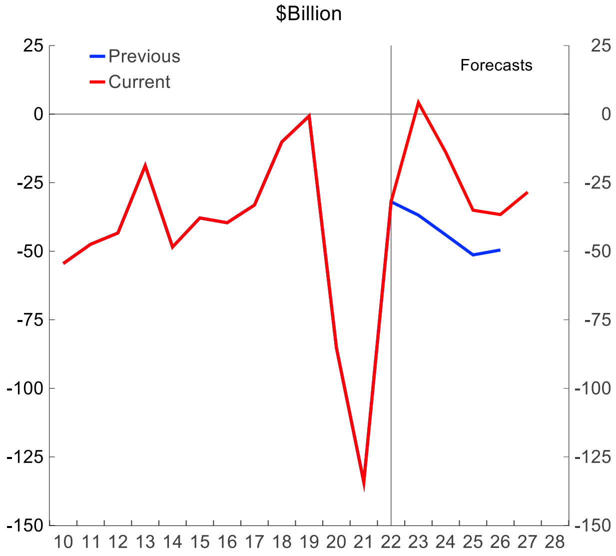
** RBA forecasts are the latest, from the quarterly Statement on Monetary Policy published 5 May 2023.

- The Government anticipates inflation to be lower than what the RBA is expecting. It has an inflation forecast of 3.25% in 2023-24 and 2.75% in 2024-25 (when it enters the target band). The RBA's forecasts are 0.25 percentage points higher in each of these two years.
- The Government expects inflation in 2023-24 to be both lower than the RBA's forecasts and lower than what it flagged in Oct 2022. Yet spending by the Government in 2023-24 is $12.0b – a significant amount.
- Jim Chalmers of course had a difficult Budget to frame – trying to help the hip pockets of Australians most vulnerable to the higher cost of living whilst not stoking inflationary pressures further. It was always going to be incredibly tough to frame. Increased spending by the government fosters an improvement in household consumption and economic activity. It means inflationary pressures could be greater.

Budget expected to end 2022-23 in surplus

- The Budget bottom line for 2022-23 is expected to be a surplus of $4.2b (or 0.2% of GDP) – the first surplus in 15 years.
- This surplus is temporary.
- Temporary revenue gains and growing spending pressures see the Budget fall back to deficit in 2023-24 (of $13.9b or 0.2% of GDP).
- The Budget deficit grows to $28.5b (1.0% of GDP) by 2026-27.

Australian Federal Budget
Underlying Cash Balance

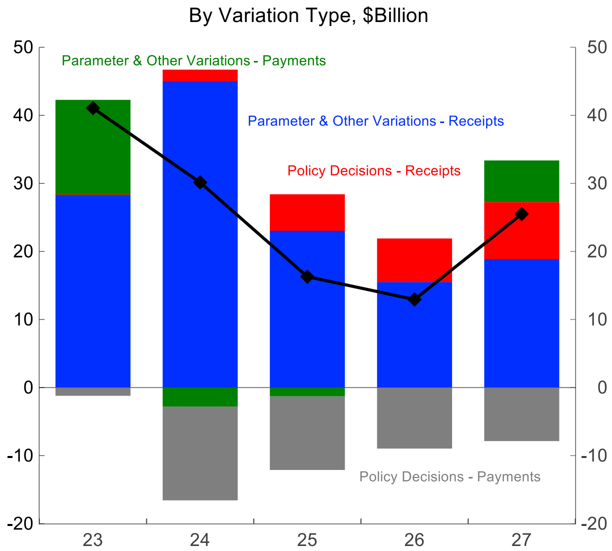


Sources: Australian Department of the Treasury, Macrobond

Policy offsetting the fiscal stabilisers?

- $125.9b improvement in the Budget bottom line over the 5 years to 2026-27.
- $146.5b due to economy (stronger labour market and commodity prices).
- $68.9b due to the stronger personal income taxes (largely reflecting the stronger labour market) and $52.7b due to company taxes.
- Net government spending of $20.6b – front loaded with offsets in the outer years.
- $42.6b of new spending and $22.1b in more revenue which include $19.1b in increased taxes.
- Additional $13.4b in the aged care funding.
- $13.8b net spending in 2023-24 alone.

Australian Federal Budget
Revision to UCB since October Budget



Sources: Federal Budget 2023-24 , Macrobond

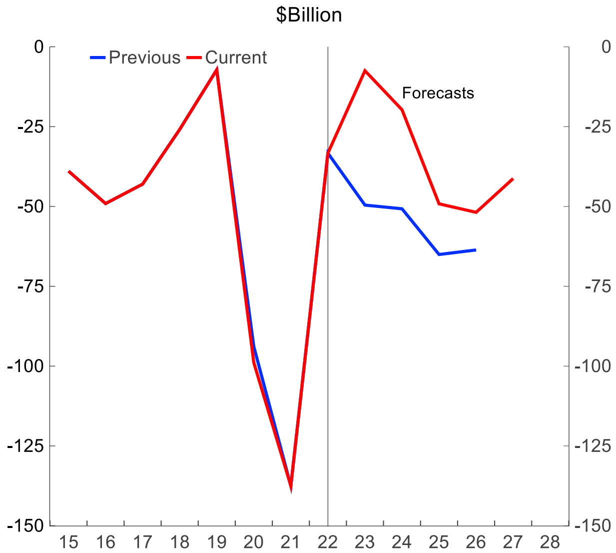
What are the largest decisions?

Spending increase $42.6b over five years to 2026–27	Revenue increase $22.1b over five years to 2026–27
$5.7b to strengthen Medicare	$9.1b due to ATO compliance
$4.9b to increase JobSeeker	$3.3b due to Tobacco excise
$2.7b for higher Rent Assistance	$2.4b due to PRRT change
$13.4b Aged Care Package (included in variation)	$950m due to superannuation changes
Spending positive variations $15.9b over five years to 2026–27	**Revenue positive variations $130.6b over five years to 2026–27**
$10.4b due to lower take up of Medical Benefits	$69b due to the stronger labour market
$9.9b due to lower bond yields reducing the interest bill	$52b due to company taxes

The headline budget balance has also improved

- Headline Budget measure of the bottom line has improved in line with the improvement in the underlying Budget measure.
- Includes borrowing to deliver policy outcomes - such as the Reconstruction Fund.
- Borrowing for policy is expected to be $59.6b over the five years to 2026-27.
- This is higher than the $48.5b of borrowing to deliver policy outcomes over the five years to 2025-26 at the 2022 October Budget.

Australian Federal Budget
Headline Cash Balance

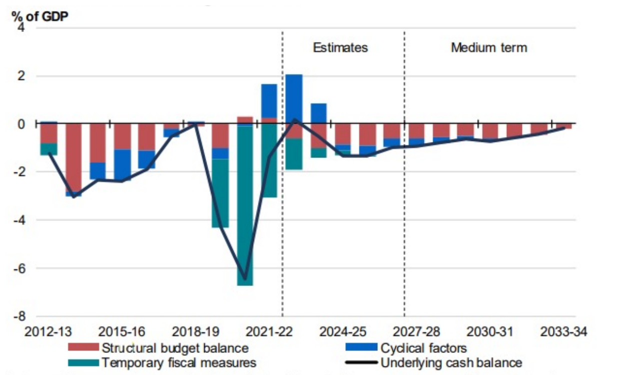


Sources: Australian Department of the Treasury, Macrobond

Structural balance back to balance?

- Over the medium term (to 2033-34) there is a significant improvement in the Budget balance.
- Abstracting from temporary factors, in 2033-34 the Budget is expected to be broadly balanced as a share of GDP.
- This is a large improvement from the ongoing and persistent structural deficit of 2% of GDP projected in the 2022 October Budget.
- The improvement is due to lower interest expenses given lower bond yields (annual average growth of 8.8% v 14.4% in October) and lower NDIS costs due to the National Cabinet Agreement to cap growth (annual average growth of 10.4% v 13.8% in October).
- Higher long-term assumptions for commodities and stronger population growth has also contributed to this turnaround.

Australian Federal Budget
Structural budget balance



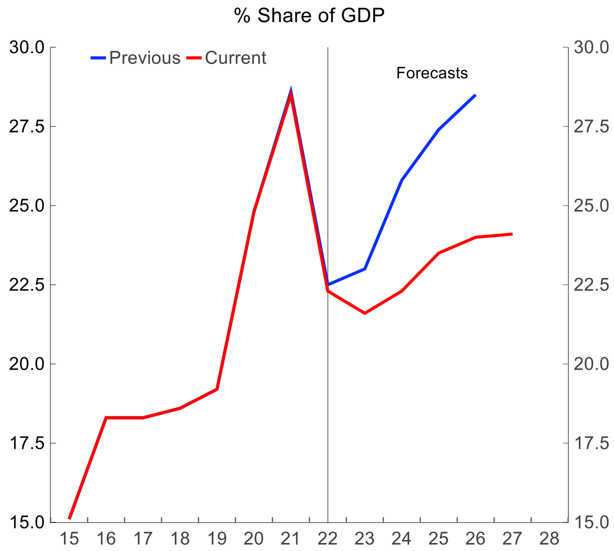
Note: The approach separating the budgetary impact of temporary measures from structural measures follows the methodology detailed in Treasury Working Paper 2013-01. Cyclical factors measure the estimated impact on the underlying cash balance from automatic stabilisers and cyclical movements in asset and commodity prices. Temporary fiscal measures comprise direct economic and health support measures initiated between the onset of the COVID-19 pandemic and the 2022–23 October Budget. Underspends in these direct economic and health support measures are not captured in the derivation of the structural budget balance, which may result in an improved structural budget balance estimate.

Source: Treasury.

Net debt expected to peak earlier and lower

- Net debt measures the market value of the government's liabilities (or bonds on issue) net of the market value of assets (like buildings).
- Net debt is expected to peak earlier and at a lower share of GDP.
- The peak is expected to be 24.1% of GDP in 2026-27 and projected to fall to 19.9% of GDP in 2033-34.
- In the October 2022 Budget, net debt was expected to be 31.9% by the end of the medium term (2032-33).

Australian Federal Budget
Net Debt

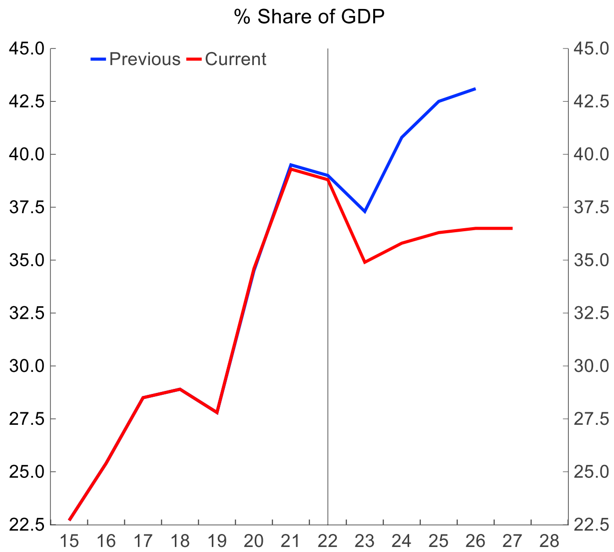


Sources: Australian Department of the Treasury, Macrobond

Gross debt also forecast to peak lower and earlier

- Gross debt is the face value of bonds and securities issued by the government to fund outlays.
- Gross debt is expected to peak earlier and at a lower share of GDP.
- The peak is expected to be 36.5% of GDP in 2025-26.
- This is 10.4 percentage points lower and five years earlier than estimated at the October 2022 Budget.

Australian Federal Budget
Gross Debt



Sources: Australian Department of the Treasury, Macrobond

Cost of living package – spending more to lower inflation?

- A $14.6b cost-of-living package formed the centrepiece of the 2023-24 Budget. This is on top of the $13.4b aged care package, which includes higher wages for the sector.
- The package includes a wide range of new measures. The package will provide support for vulnerable households and small businesses across a range of categories.
- A key question of the package is whether it will add to inflation and place further upward pressure on interest rates.
- The Government claims that the measure will not be inflationary. Indeed, the Government notes that the Energy Price Relief Plan is expected to reduce the Consumer Price Index (CPI) by ¾ of a percentage point in 2023-24.
- So does this stack up? In short, not quite.
- The reduction in expected inflation partly reflects the way CPI is measured. Government subsidies are not considered to be payments made by consumers and, therefore, reduce measured out of pocket cost. However, the Government footing the bill doesn't magically make inflation go away.
- There will be a subsequent increase in the CPI once some of the payments roll off in future years. Additionally, reducing some spending pressures for households frees up additional funds to be spent on other goods and services. This may lead to increased inflationary pressures in other areas. The Government notes that it's cost-of-living measures "are not expected to add to broader inflationary pressures in the economy".

Cost of living package – key measures

Item	Description	*(Cost)/benefit
Energy Bill Relief Fund	Government to subsidise electricity bills for pensioners, Seniors Health Card holders, Family Tax Benefit A & B recipiences, & small business customers of electricity retailers. Paying electricity retailers up to $500 p.a. for households and $650 for small businesses to reduce out-of-pocket expenses for two years from July 2023.	($1.5b matched by another $1.5b from states) 5m households 1m small businesses
Strengthening Medicare	Improve quality and accessibility of multidisciplinary primary care, modernise digital health infrastructure, improve financial sustainability of general practices, grow and upskill health workforce, and ease the pressure on hospitals. Main aspect: $3.5b to triple bulk billing incentive for concession card holder & patients under 16.	($5.7b)
JobSeeker/Austudy/ Youth Allowance	+$40 per fortnight. Exact payments vary depending on circumstances. E.g. base rate for single people with no children lifted to $733.10, from $693.10. Eligibility for higher rate for older people unemployed for 9 months or longer lowered to 55, from 60.	($4.9b) 1.1 million individuals
Parenting payments	+$176.90 per fortnight. Eligibility will be adjusted so parents receive payment until oldest child turns 14 years of age, up from 8 years of age currently.	($1.9b) 57k single parents, 91% women
Rent assistance	15% increase for 1.1 million households.	($2.7b) & ($0.7b) ongoing
Lower costs of prescription drugs	Adding a range of new medicines on the Pharmaceutical Benefits Scheme (PBS).	($2.2b)

Green transition gets a boost

- Accelerating the decarbonisation of the economy and meeting the 2050 net-zero emissions target is a key policy agenda for the Government. $4.6b in new climate-related spending has been announced in the Budget.

Electrification

- $1.3b to establish the Household Energy Upgrades Fund to promote electrification and energy efficient upgrades for households. Includes $1.0b to create 110k low-interest loans for energy-saving home upgrades.
- Businesses with turnover of less than $50m will be able to claim an additional 20% income tax deduction on investments that support electrification and the efficient use of energy. Eligible expenditure will be capped at $100k per business for assets used or installed between 1 July 2023 and 30 June 2024. The policy change will cost $314m over four years.
- Introducing an emissions standard via the National Electric Vehicle Strategy to boost transition to lower emissions vehicles.

Hydrogen

- $2.0b of revenue support through the new Hydrogen Headstart program to accelerate investment in hydrogen projects.

Other

- Establishing the Capacity Investment Scheme; a revenue underwriting mechanism for eligible clean energy investment projects. The scheme includes an agreed 'revenue floor' with revenue subsidised by the government up to the agreed floor. Profit above an agreed 'ceiling' will be shared by the Government. The scheme will increase certainty for investors accelerating new investment and is expected to unlock $10b in new clean energy generation and storage.
- The Government is legislating a national Net Zero Authority to assist workers, industries and communities transition to renewable energy. Funding of $83.2m will be contributed to establishing the Authority.
- $18.1m to implement priority reforms from the Chubb review into the safeguard mechanism and Carbon Credit market.

Housing pressures mounting, little relief ahead

- Housing remains a critical issue as rents ramp up, dwelling prices remain very elevated and are on the rise again following recent falls, and the population expands at the fastest pace in history.
- Dwelling approvals surged during the pandemic, driven by strong demand, low interest rates, and government stimulus measures such as HomeBuilder and state-based first home buyer grants. However, despite a surge in approvals, work has been hampered by a range of factors and completions have been low.
  - Materials shortages, elevated labour costs, and poor weather have contributed to rising prices and delayed competitions. Addit ionally, many builders who locked in fixed price contracts have not been able to absorb higher costs, contributing to increased insolvencies.
- These pressures are evident in the Budget forecasts. Dwelling investment is forecast to go backwards for three full financial years (2022-23 to 2024-25). Dwelling investment is not expected to recover until 2025 onwards.
- This is despite record population growth. Net overseas migration is projected to surge to 400k in 2022-23, 315k in 2023-24, and 260k in 2024-25 to 2026-27. In the medium term, NOM is expected to return to 235k per year.
- The Budget included a range of housing measures. Some measures were announced in the October 2022 Budget but have yet to be implemented. Both demand- and supply-side measures have been announced.
- Overall, the measures are modest and unlikely to ease pressures in the housing market, particularly given the contrasting upward pressures on demand and expected weak supply response in the near term.

Supply-side

- Incentivise the construction of build-to-rent projects through lowering the withholding tax rate for managed investment trusts (MITs) to 15% (from 30%) and increasing the rate of depreciation to 4% (from 2.5%).
- $2b increase in liability cap for National Housing Finance and Investment Corporation (NHFIC) to support more lending to community housing providers for social and affordable housing projects.
- The Government also noted the below measures which were previously announced but are yet to be implemented.
  - Housing Accord: An agreement between all levels of government, the construction sector, and institutional investors (inc. super funds) to increase housing supply. Aim to build 1m new, well-located homes over five years from 2024.
- $10b Housing Future Fund, with earnings being used to fund the construction of social and affordable housing.

Demand-side:

- 15% increase in rent assistance for recipients ($2.7b over five years and $0.7b ongoing).
- Expanded Home Guarantee Scheme.
  - Enable joint purchases by friends, siblings, and other family members, rather than singles or couples.
  - Include non-first home buyers who have not owned a property in Australia for at least 10 years.
  - Include single legal guardians and expanded to include Australian permanent residents.

Business measures

1. Small business support - $20k Instant Asset Write Off (IAWO) Scheme

- Government will make the IAWO threshold $20k. Small business with aggregated turnover of less than $10m will be able to immediately deduct the full cost of eligible assets costing less than $20k that are first used or installed between 1 July 2023 and 30 June 2024. $20,000 threshold will apply on a per asset basis, so multiple assets can be written off.
- Assets valued at $20k or more can continue to be placed into the small business simplified depreciation pool.

2. Small business energy incentive scheme

- Government will support SMEs to save on energy bills through incentivising the electrification of assets and improvement of energy efficiency. Applies to SMEs with aggregate turnover of less than $50m and will allow an additional deduction of 20% of the cost of eligible depreciation of assets that support electrification. Up to $100k of total expenditure will be eligible with a maximum bonus deduction being $20k.
- Eligible assets will need to be first used or ready for use between 1 July 2023 and 30 June 2024. Exclusions include electric vehicles, renewable electricity generation assets, capital works and use fossil fuels.

3. Small business support – managing tax instalments and improving cash flow

- Government will amend the tax law to set the GDP adjustment factor for PAYG and GST instalments to 6%, a reduction from 12% under the statutory formula. Reduced factor will provide cash flow support to small businesses and other PAYG instalment taxpayers.

4. Tax integrity – expanding the general anti-avoidance rule

- Government will improve the integrity of tax system by expanding the scope of the general anti-avoidance rule for income tax (Part IVA) so applies to:
- Schemes that reduce tax paid in Australia by accessing lower withholding tax rate on income paid to foreign residents
- Schemes that achieve an Australian income tax benefit, even where the main purpose is to reduce foreign income tax
- Apply to income years commencing on or after 1 July 2024, regardless of when the scheme was entered into.

5. Enhanced support for SMEs and start-ups

- Government will provide $431.9m over 4 years to improve support for SMES and start-ups, including:
- $392.4m over the next 4 years to establish the Industry Growth Program to support Australian SMEs and start ups to commercialise their ideas. Support towards businesses operating in priority areas of National Reconstruction Fund.
- $39.6m over the next 4 years to continue Single Business Service.

6. Aligning the frequency of superannuation payments with payroll cycles

- From 1 July 2026, employers will be required to pay employees’ SG entitlements on same day as salary/wages paid (vs quarterly basis now).

Other notable measures

Measure	Description	*(Cost)/benefit
Strengthening Medicare	Funding to fix primary healthcare services, take pressure off the hospital system and begin Medicare reform process	($5.7b)
Minimum wage increase for aged care workers	15% base pay increase for aged care workers taking effect from 30 June 2023	($11.3b)
NDIS reform	Additional spending to increase NDIS staff and implement reforms needed to drive costs down to 8% p.a. growth target	($720m)
Tax on super earnings for balances over $3m	Earnings on superannuation balances above $3m will be taxed at a marginal rate of 30%, up from 15%	$2.0b
Petroleum Resources Rent Tax (PRRT) Change	16 technical changes to the calculation of PPRT including a cap on annual deductions at 90% of the project income each year. Anti-avoidance tax rules will also be bolstered	$2.4b
Raising the Temporary Skilled Migration Income Threshold (TSMIT)	The Government will increase the Temporary Skilled Migration Income Threshold from the current rate of $53,900 to $70,000 from 1 July 2023.	($100.0m)

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