Australian Federal Budget October 2022.
Deficit to widen after near-term improvement.
2022/23: $36.9bn deficit, -1.5% of GDP.

Ahead of the October 2022/23 Federal Budget it was announced that the deficit narrowed to $32bn in 2021/22, 1.4% of GDP, a dramatic improvement from the COVID-related deficit of $134.2bn for 2020/21, and $47.9bn lower than anticipated back in April. The sharp improvement in the starting position for the budget is a significant positive. However, the October Budget is framed against a looming sharp economic slowdown as the RBA, along with other central banks, aggressively raises interest rates to tame inflation.

Budget deficit, near-term improvement
The 2022/23 budget deficit is now expected to be $36.9bn, representing 1.5% of GDP, only a relatively small $4.9bn deterioration on the 2021/22 outcome and $41.1bn lower than the $77.9bn forecast in the April Pre-election Economic and Fiscal Outlook (PEFO).

The 2022/23 improvement on PEFO is driven by a stronger economy, with revenue up by $57.3bn, which more than outweighs a $15.1bn increase in expenditures. The impact of new policy is minimal, with a net increase in spending of $1.1bn. Nominal GDP growth is now expected to be a brisk 8% this financial year, upgraded dramatically from only 0.5% in PEFO, on higher commodity prices and higher inflation.

Deficit widens again, as cost pressures rise
The budget deficit is expected to widen modestly across the forward years: to $44.0bn in 2023/24 (1.8% of GDP); $51.3bn in 2024/25 (2.0% of GDP); and $49.6bn in 2025/26 (1.8% of GDP).

Relative to PEFO, the deficit for 2023/24 is lower by some $12.5bn, but for 2024/25 and 2025/26 the deficit is larger, by some $4.3bn and $6.6bn respectively.

The deficit profile thus differs from that in PEFO, which envisaged a progressive narrowing from an expected 3.5% of GDP for 2021/22 to 1.6% of GDP by 2025/26. Now, the deficit starts lower, at around 1.5% of GDP, and then lifts modestly to be around the 2% mark over the final two years.

The revised profile benefits near-term by upside on revenue due to stronger income growth, but over time, expenditure pressure is more pronounced than previously anticipated. Payments as a share of GDP lifts and becomes entrenched at around 27.1% of GDP, well above the historic average and above that factored into the PEFO projections.

Budget reconciliation, October vs PEFO
Over the four years 2022/23 to 2025/26, the accumulated budget deficit is now expected to be $181.8bn, which is $42.7bn lower than in PEFO.

Parameter variations drive a $52.5bn improvement, led by a $144.6bn increase in revenue which more than outweighs a $92.2bn increase in payments. Higher commodity prices are boosting incomes and tax revenue, so too a stronger labour market. However, higher inflation and higher interest rates are boosting payments, so too the specific costs of some key programs, such as the NDIS.

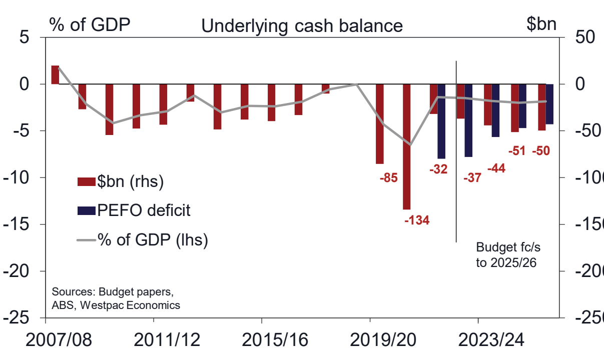
New policy had minimal net impact, adding $9.8bn to the deficit over the four years, representing 0.1% of GDP. Hence, the government is not adding to the task of the RBA to tame inflation.

Debt profile
Gross debt is projected to rise to $1,159bn as at June 2026, representing 43.1% of GDP. That is little different from PEFO, down by $10bn, and as a share of the economy is lower by 1.6% of GDP. Over the medium-term projections, the October Budget envisages that gross debt will climb and then stabilise at about 46.9% of GDP by around 2030/31. By contrast, in PEFO, it was envisaged that debt would moderate, easing back to around 40.3% of GDP by 2032/33.

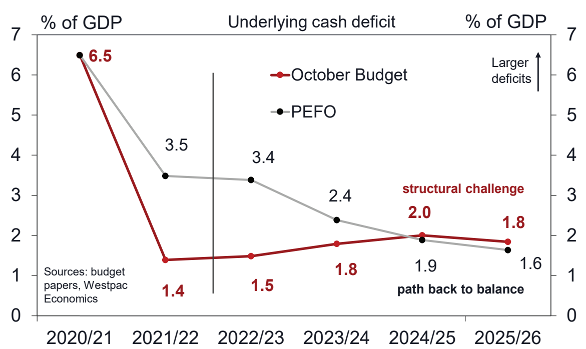
Risks
The economic outlook, and in turn the fiscal outlook, is more uncertain that normal. Global recession risks have increased as central banks aggressively tighten policy in efforts to tame a significant inflation challenge. Domestically, a recession is not expected, but a sharp slowdown looms, with output growth to decelerate from 3.25% in 2022/23 to 1.5% in 2023/24. The unemployment rate which is currently below 4%, the lowest level in almost 50 years, is forecast to lift to 4.5%.

The Budget economic forecasts are cautious in regards to commodity prices, which drives an expected 1% contraction in nominal GDP in 2023/24. The likelihood is that commodity prices will stay higher for longer, which would contribute to a smaller budget deficit.

Federal budget: comparison with PEFO



Budget deficit profile: October vs PEFO



Budget 2022: key numbers

25 October 2022

	2020/21(a)	2021/22(a)	2022/23	2023/24	2024/25	2025/26
Underlying cash balance*, $bn	–134.2	–32.0	-36.9	-44.0	-51.3	-49.6
% of GDP	–6.5	–1.4	-1.5	-1.8	-2.0	-1.8
Receipts, % GDP	25.1	25.4	24.5	25.3	25.1	25.2
Expenses, % GDP	31.6	26.8	25.9	27.0	27.1	27.1
Headline cash balance, $bn	–137.5	–33.3	-49.6	-50.7	-65.0	-63.6
% of GDP	–6.6	–1.5	-2.0	-2.1	-2.5	-2.4
Net debt, $bn	592.2	515.7	572.2	634.1	702.8	766.8
% of GDP	28.6	22.5	23.0	25.8	27.4	28.5
Gross debt, $bn	817.0	895.3	927.0	1,004.0	1,091.0	1,159.0
% of GDP	39.5	39.0	37.3	40.8	42.5	43.1

* Underlying cash balance = Revenue less Expenses. Sources: ABS, Budget papers, Westpac Economics

Major policy initiatives in October Budget 2022

AUDbn	'22/23	4 yrs	Comment
Spending measures – Expenses			
Child Care Plan	0.0	4.7	Increased child care subsidy to support families.
Infrastructure Investment	0.0	4.2	Priority rail and road projects across Australia.
Aged Care Plan	0.0	2.5	Registered nurse 24/7 on premises and increased care minutes.
COVID-19 Packages	2.2	2.2	Funding across aged care, hospitals, Medicare and treatments.
Additional Official Development Assistance	0.0	1.4	Support to Pacific region to enhance security and Australia's influence.
Fee-Free TAFE Placements	0.4	0.9	Provide 480,000 fee-free vocational education places.
Plan for Cheaper Medicines	0.1	0.7	Decrease PBS co-payment from $42.50 to $30.00 from 1 January 2023.
Pharmaceutical Benefits Scheme	0.2	1.4	New and amended listings.
Safer and More Affordable Housing	0.0	2.1	Delivery of additional 20,000 of social and affordable homes.
Disaster Ready Fund	0.0	0.6	Funding for disaster resilience projects nominated by state governments.
Administration of COVID-19 and Emergency Payments	0.6	0.6	Delivery of COVID-19 and Disaster Recovery payments in 2022-23.
Boosting Parental Leave	0.0	0.5	Additional 2 weeks, to 26 weeks leave.
Not yet announced	0.7	3.1	
Total *(including other)*	**2.5**	**22.9**	
Saving measures – Expenses			
Infrastructure Investment	2.9	8.9	Cancellation and reallocation of previous infrastructure projects.
Savings from External Labour	0.6	3.6	Government to reduce spending on external labour, advertising, travel.
Government Spending Audit	1.2	3.4	Reprioritisation of existing funding measures.
Saving measures – Revenue			
Safer and More Affordable Housing	0.2	1.4	Investment returns from the Housing Australia Future Fund.
Extension of ATO Compliance Programs	0.0	3.7	Increase taxation revenue through targeting non-compliance.
Multinational Tax Integrity Packages	0.0	1.0	Greater regulation on multinational tax and increased transparency.

Budget 2022: Key themes & key measures

25 October 2022

Cost of living relief
The October Budget aims to provide a cost of living relief. Elements of this strategy include: cheaper child care; paid parental leave; more affordable housing; and reductions in medical costs – each of which we discuss below.

Climate change
The Budget includes a 'Powering Australia Plan' to drive investment in cleaner, cheaper energy, including $20bn of low-cost finance under Rewiring the Nation to upgrade our electricity infrastructure. The government is acting on climate change – including through a $1.8bn investment in strong action to protect, restore and manage our precious natural environment.

Education boost for universities and TAFE
Delivering 480,000 fee-free TAFE places and a $50 million TAFE Technology Fund to modernise TAFEs. Providing 20,000 additional university places for disadvantaged Australians. $474.5 million over 2 years to support student well-being and improve classrooms.

Improving access to childcare and paid parental leave
Plan for Cheaper Childcare increases the maximum subsidy for first child in care and maintain and extend high rates for families with multiple under-5s in care, $4.69bn over 4 years, assisting 1.26m families. Boosting Parental Leave to give improved flexibility for claims and to start expanding the scheme by two extra weeks a year to reach 26 weeks by July 2026, $0.52bn over 4 years but the bulk of that backloaded to the final year.

Addressing deficiencies in the aged care system
Fixing the Aged Care Crisis program to reform the aged care system including funding for 24 hour onsite registered nurses and increased care minutes, $2.52bn over 4 years. Implementing Age Care Reform program also provides $0.54bn over 4 years to improve the sector's systems and respond to Royal Commission recommendations.

COVID-19 and Natural Disaster Management
COVID packages for age care and hospitals/emergency services to help cover claims for costs incurred during pandemic, $1.65bn in 2022-23. Pandemic Support Payment Extensions provide extended leave payment provisions for mandatory isolation requirements through to mid-Oct ($0.86bn in 2022-23). Additional funding to ensure administration of COVID and Disaster Recovery Payments, $0.59bn in 2022-23, and a Disaster Ready Fund to co-contribute to state and local government initiatives that improve disaster resilience, $0.63bn over 4 years.

Audit of previous government measures
The Government Spending Audit begins the process of budget repair by cutting $3.6bn in outsourcing expenses on external contractors, consultancies, advertising, travel and legal expenses. As well, save some $3.4bn through reprioritisation of existing funding measures.

Foreign Aid injection
Additional $1.43bn over 4 years to rebuild Australia's international development program, re-establish Australia as a partner of choice in the region and enhance regional security and cooperation focussed on the Pacific and Southeast Asia.

Increased subsidies for medicines and funding for community services
$787.1 million over 4 years to reduce the general patient co-payment for treatments on the Pharmaceutical Benefits Scheme from $42.50 to $30 per script. New and amended listings for Pharmaceutical Benefits Scheme, $1.38bn over 4 years. Support for Community Sector Organisations to cover additional staff wage and inflation pressures, $0.56bn over 4 years.

Housing Accord to coordinate boost to supply
The Budget aims to provide more affordable housing, including through a new national Housing Accord which brings together governments, investors and industry to boost supply and deliver up to 20,000 new affordable homes.

Telecommunication
$2.4 billion in NBN Co to extend fibre access to 1.5 million more premises and $1.2 billion for the Better Connectivity for Regional and Rural Australia Plan.

Manufacturing initiative
Establishing the $15bn National Reconstruction Fund to support a future made in Australia.

Cuts in spending to the regions
The October Budget finds savings by reprioritising policies – with the newly elected government cancelling some policies of the previous government. Notably, savings are made by cuts in spending to the regions – via the Responsible Investment to Grow Our Regions program. This saves $0.9bn in 2022/23 and $1.7bn over the four years.

Reprofiling existing infrastructure spending - budget savings
The incoming government has reprofiled spending on existing infrastructure projects – that is delaying spending. This saves $8.9bn over the next three years: $2.9bn in 2022/23; $4.7bn in 2023/24; and $1.4bn in 2024/25. However, this adds $4.2bn to spending in 2025/26, for a net saving of $5.1bn.

This infrastructure re-profiling contributes to the profile of payments for new policy measures. In net terms, new payment measures add a modest $2.5bn to the deficit in 2022/23 and $1.7bn in $2023/24, but that jumps to $6.0bn in 2024/25 and $12.7bn in 2025/26.

Tax crack down
The October Budget expects the ATO to collect additional tax revenue through cracking down on the shadow economy, $2.1bn over three years from 2023/24, and tax avoidance, $2.6bn over four years (rising from $0.3bn in 2022/23 to $1.3bn in 2025/26. Against this $4.7bn in additional revenue is a partial offset of $1.4bn in higher expenses (with some additional resources to be provided to the ATO). Measures around multinational tax (thin capitalisation and around deductions) are expected to raise $1.0bn over the four years.

Economic outlook

25 October 2022

The October Federal Budget sets out a challenging path ahead as a sharp slowdown in global growth, high inflation, rising interest rates, and falling real wages impact, with some additional drag from recent floods. Growth prospects have again been downgraded, the Australian economy now forecast to expand 3.25% in 2022-23 and just 1.5% in 2023-24 with a more sluggish recovery seeing growth lift to 2.25% in 2024-25 then 2.5% in 2025-26. The slowdown is significantly more pronounced with growth bottoming out 1ppt below the profile set out in the Pre-election Fiscal Outlook (PEFO) and ½ppt below the more recent July Ministerial Statement.

National income and commodity prices

Despite the weaker profile for the real economy, the near term outlook for national income – nominal GDP – has again been upgraded materially, supported by stronger than expected price and wage inflation and elevated commodity prices. Nominal GDP growth is forecast to come in at 8%yr in 2022-23. That compares to the 0.5% gain set out in the PEFO.

The flush of income slows abruptly in 2023-24 as growth slows, inflation moderates and the terms of trade enters a sharp 20% pull-back. The latter largely reflects technical assumptions around commodity prices, spot iron ore, met coal, thermal coal, LNG and oil all assumed to see steep declines as they 'normalise' by the March quarter 2023. The combination sees nominal GDP contract 1%yr in 2023-24.

Consumers drive sharp slowdown

The domestic slowdown centres on households as a sharper than expected rise in the RBA cash rate – assumed to reach a peak of 3.35% in the first half of 2023 – weighs on indebted households and cost of living pressures weigh on low-income households. Consumption growth is forecast to drop back sharply from 6½%yr in 2022-23 to 1¼%yr in 2023-24. Notably, this slowdown is despite some cushioning effect from savings – the household savings rate forecast to decline to just 3¼% by the June quarter 2024.

The outlook for dwelling investment has also been lowered with supply disruptions, capacity constraints and weather conditions expected to continuing hampering activity. That said, the forecast decline for new dwelling investment (–2% in 2022-23 and –1% in 2023-24) are minor compared to those seen in previous interest rate tightening cycles, the record backlog of dwellings under construction clearly giving significant support.

A backlog of investment projects is also expected to support business investment, which is forecast to maintain reasonable growth, rising 6%yr in 2022-23 and 3½%yr in 2023-24, some of which reflects supply disruptions and delays. Non-mining investment is expected wane as these issues ease but mining investment is forecast to strengthen throughout. That said, the investment response to elevated commodity prices is expected to be modest compared to the mining boom in the mid-2000s.

Government spending in the form of public demand is expected to slow materially as pandemic-related spending unwinds near term and the focus turns to fiscal repair. Public demand is forecast to rise just 1%yr in 2022-23 and 1½%yr in 2023-24, down from a brisk 6½% in 2021/22.

A turnaround in net exports provides some support to activity in 2023-24, a lift in mining and tourism exports combining with slower demand for consumer goods imports to turn a ¾ppt detraction from growth in 2022-23 into a +½ppt addition.

Labour market, wages and prices

The labour market is expected to soften going forward but from a very tight starting point. Employment growth is forecast to slow to 1¾%yr in 2022-23 and ¾%yr in 2023-24. That in turn sees the unemployment track steadily higher to 4½% by June 2023 (notably higher than the 3¾% forecast in the PEFO). A quicker return to migration-driven population growth is a contributing factor here, with net migration inflows forecast to run at 235k a year in both years – comparable to the pace seen pre-COVID, which was previously not expected until 2025.

Inflation is expected to be markedly higher near term and persist for longer. Headline CPI inflation is forecast to peak at 7¾%yr in the December quarter of 2022 but still be running at 3½%yr by June 2024, above the RBA's target band. This partly reflects an expected steep rise in electricity prices – retail prices forecast to record an average increase of 20% in late 2022 and a further 30% rise in 2023-24, adding 1ppt to headline CPI.

Wages growth is expected to quicken, lifting to 3¾%yr over the next two years, a stronger pace than the 3¼% envisaged in the PEFO. Despite this, and a small real gain in 2023-24, the overall picture is still one of a sharp decline in real wages near term following a prolonged period of stagnation.

Risks

The Budget's near term forecasts look reasonable, albeit a little firmer than Westpac's 1.1% forecast for 2023-24. That is balanced against the conservative assumptions on commodity prices and wages growth which make the nominal GDP growth profile overly weak – we expect a slight 1½% gain in 2023-24 rather than a 1% contraction. The main risks to the view centre on a potential 'hard-lending' for the global economy – a modelled recession scenario across our major trading partners is estimated to lower Australia's growth to just ¾%yr in 2023-24. A more precautionary consumer response is seen as the biggest risk locally.

Key forecasts		'21/22a	'22/23	'23/24	'24/25	'25/26
Real GDP	PEFO	4.25	3.50	2.50	2.50	2.50
(% chg)	Budget	3.9	3.25	1.50	2.25	2.50
Nominal GDP	PEFO	10.75	0.50	3.00	5.25	5.00
(% chg)	Budget	11.0	8.00	–1.00	4.25	5.00
Unemployment	PEFO	4.00	3.75	3.75	3.75	4.00
(% chg)	Budget	3.8	3.75	4.50	4.50	4.25
CPI Headline	PEFO	4.25	3.00	2.75	2.75	2.50
(% chg)	Budget	6.1	5.75	3.50	2.50	2.50

Sources: Budget papers

Forecasts '23/24	Government	Westpac
World GDP (2023)	2.75	3.3
Australia: real GDP	**1.50**	**1.1**
Consumption	1.25	1.4
Housing	–1.00	-5.2
Business Investment	3.5	-1.2
Gross National Expenditure	1.0	0.4
Net exports, ppt contr'n	0.5	0.7
Unemployment, Jun qtr	4.5	4.8
Nominal GDP	–1.00	1.5
Terms of trade	–20.0	-10.5

Sources: Budget papers, ABS, Westpac Economics.

Economic forecasts: Australia

25 October 2022

(year average)	Actual		Government		Westpac	
	2020/21(a)	2021/22(a)	2022/23	2023/24	2022/23	2023/24
Private consumption	1.0	4.1	6½	1½	6.2	1.4
Dwelling investment	3.6	2.8	–2	–1	2.1	–5.2
Business investment*	–0.8	5.2	6	3½	5.5	–1.2
Private final demand*	1.4	4.5	5¼	1¼	5.4	0.2
Public final demand*	5.9	6.8	1	1½	3.0	1.7
Domestic final demand	2.6	5.1	n.a.	n.a.	4.7	0.6
Inventories, contribution ppts	0.8	0.1	0	–¼	–0.2	–0.2
GNE	3.4	5.2	4	1	4.5	0.4
Net exports, contribution ppts	–1.5	–1.5	–¾	½	–0.8	0.7
Exports	–8.4	0.0	7	5	8.7	7.9
Imports	–2.7	7.7	11	3	13.0	4.8
Real GDP	**1.6**	**3.9**	**3¼**	**1½**	**3.8**	**1.1**
Nominal GDP	**4.5**	**11.1**	**8**	**–1**	**8.4**	**1.5**
GDP deflator	2.7	6.9	4¾	–2¼	4.4	0.5
Terms of trade	10.4	12.1	–2½	–20	–5.9	–10.5
Employment (Jun qtr)	6.6	3.3	1¾	¾	1.5	–0.4
Unemployment rate (Jun qtr)	5.2	3.8	3¾	4½	3.8	4.8
Participation rate (Jun qtr)	66.1	66.6	66¾	66½	66.8	66.2
CPI (Jun qtr)	3.8	6.1	5¾	3½	5.4	3.5
Wage price index (Jun qtr)	1.7	2.6	3¾	3¾	4.4	4.0
Current account, % of GDP	3.1	2.2	½	–3¾	–0.1	–1.6

* business investment and government spending excluding the effect of private sector purchases of public sector assets.

	Actual	Government			Westpac		
	2021(a)	2022	2023	2024	2022	2023	2024
World growth	6.1	3	2¾	3	3.0	3.3	3.3

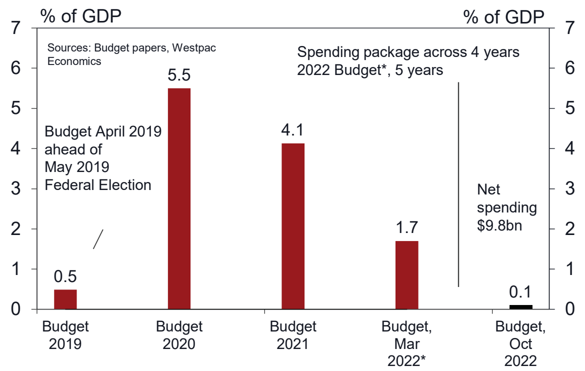
Macroeconomic variables – recent history

	2021	2022									
Monthly data	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**
Employment '000	70	19	106	36	10	39	68	–37	36	1	–
Unemployment rate %	4.2	4.2	4.0	3.9	3.9	3.9	3.5	3.4	3.5	3.5	–
Westpac–MI Consumer Sentiment	104.3	102.2	100.8	96.6	95.8	90.4	86.4	83.8	81.2	84.4	83.7
Retail trade %mth	–4.1	1.6	1.8	1.6	0.9	0.7	0.2	1.3	0.6	–	–
Dwelling approvals %mth	9.0	–24.2	38.6	–15.2	–1.2	9.0	0.3	–18.2	28.1	–	–
Private sector credit %ann	7.2	7.6	8.0	8.0	8.6	9.1	9.1	9.1	9.3	–	–
Trade balance AUDbn	7.6	12.0	7.0	8.9	11.9	14.3	17.5	9.0	8.3	–	–

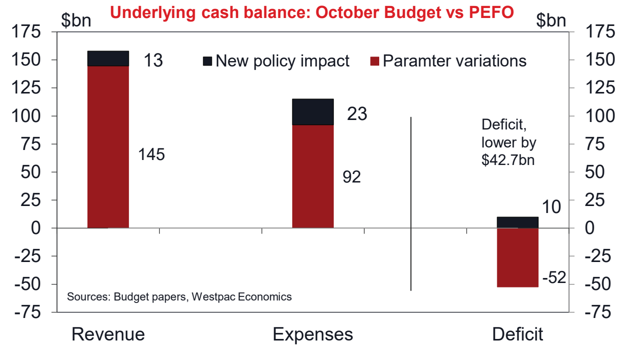
Budget trends

25 October 2022

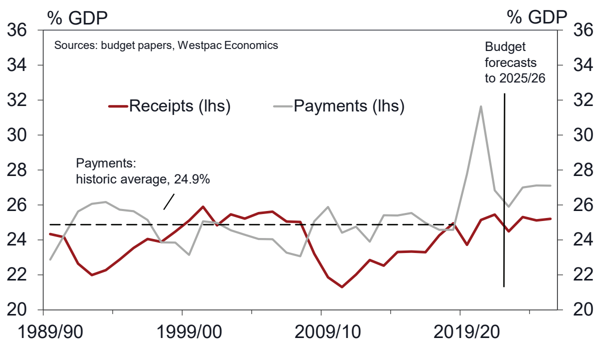
Budget: new policy / spending package – stimulus



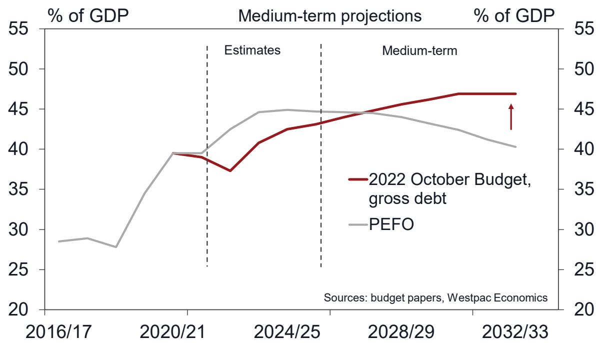
Budget, 2022/23 to 2025/26: a reconciliation



Federal Budget: receipts and payments



Public gross debt projections



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