BULLETIN

28 April 2023

Federal Budget
Improvement, on higher commodity prices and inflation

On Tuesday May 9, the Federal Treasurer will release the annual Federal Budget, unveiling refreshed economic and fiscal forecasts.

The latest fiscal numbers will be informed by shifts in the economic outlook, as well as any changes to program costs of existing policies and the costing of any new initiatives.

Here, we focus on the likely revised fiscal outlook on a "no policy change basis".

This approach incorporates any change to the starting position for the budget balance in 2022/23 and the impact of the likely new set of economic forecasts.

Not included are possible changes to program costs and potential new policy initiatives. These factors, on which there is limited visibility, will become (somewhat) clearer as we count down to Budget night. If we believe that a reasonably clear picture on these initiatives is available, we will publish an update to attempt to forecast the announced budget positions on the night which will incorporate the costings of new policy.

On a no policy change basis, the Federal budget position has improved materially – largely because of the combination of higher commodity prices; higher economy wide inflation; and ongoing strength in the labour market, relative to the October Budget profile.

The October Budget assumed that commodity prices would fall to "target prices" by the end of the March quarter 2023. That crunch in commodity prices over the first half of calendar 2023 has not transpired.

The October Budget anticipated the iron ore price would decline from around US$90/t fob at the time to US$55/t fob by the end of March 2023, whereas of late the price has been more than double that at around US$120/t fob – benefiting from the reopening and fiscal and monetary stimulus in the Chinese economy.

The May 2023 Budget, will likely allow a longer glide path for prices to deflate from current levels back to "target prices" – with the US$55/t iron ore price target being reached by December 2024.

Nominal GDP growth is on track to be around 9.25% for 2022/23, rather than the 8% anticipated by the government in the October Budget – mostly due to upside on global commodity prices, and inflation more generally.

On this revised approach to commodity prices, income growth will be upgraded for 2023/24, but lowered for 2024/25.

On our figuring, the budget position for the four year period 2022/23 to 2025/26 has improved by around $110bn on the October Budget forecasts.

Revenue collections are about $70bn higher than anticipated, while payments are $40bn lower.

Budget position, $bn

	2022/23	2023/24	2024/25	2025/26	4yrs
October	-36.9	-44.0	-51.3	-49.6	-181.8
% of GDP	-1.5	-1.8	-2.0	-1.8	
May*	-6.9	-7.6	-28.4	-29.2	-72.1
% of GDP	-0.3	-0.3	-1.1	-1.1	
Improvement	30.0	36.5	22.9	20.3	109.7
Revenue, upside	20.0	26.5	12.9	10.3	69.7
Payments, downside	10.0	10.0	10.0	10.0	40.0

* Budget position, on a "no policy change" basis

The revised budget deficit profile is as follows:

- 2022/23, the deficit is likely to come in around $7bn, some $30bn lower than the October forecast of $36.9bn;
- 2023/24, the deficit moves sideways, at $7.6bn, representing a $36.5bn improvement on an expected deficit of $44bn;
- the deficit then widens to be around $28.4bn and $29.3bn in the following two years, representing around a $23bn and $20bn improvement on the corresponding October forecasts.

The budget deficit profile unveiled by the Treasurer on Budget night will differ from this as it incorporates policy initiatives along with revised estimates of the costs of existing programs. We anticipate a less favourable position as the government attempts to balance "restraint" and "relief".

The government is likely to loosen fiscal policy, to some extent, in that not all of the economic windfall will be banked. That said, we would expect the majority of the windfall to be saved.

There will potentially be a net increase in spending, with some measures to focus on providing relief to households facing an income squeeze from high inflation and higher interest rates.

Also, existing programs in the caring economy, as well as defence, are experiencing ongoing cost escalation – a dynamic that has been evident for some time.

In addition, there are likely to be a number of revenue initiatives including taxes on multinationals; resource companies; and the usual targeting of tax avoidance.

Federal budget to be "broadly" in balance in 2022/23
The Federal budget will likely be broadly in balance for the 2022/23 fiscal year, just as the budget was broadly in balance prior to the pandemic, with a deficit of only $0.7bn for 2018/19.

On available information, the deficit will narrow to around $7bn this financial year, representing 0.3% of GDP.

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Department of Finance figures to the month of February, reveal that for the 2022/23 financial year to date the deficit is $12.9bn, some $20.5bn lower than expected, with receipts up by $13bn and payments lower by $7.5bn.

For the full financial year, we anticipate that the improvement will widen from $20.5bn to $30bn.

Revenue will surprise to the upside by $20bn, representing 24.9% of GDP, on the updated nominal GDP estimate.

In the October Budget, the forecasts anticipated that the revenue share would dip from 25.3% in 2021/22 to 24.5% in 2022/23, then rebound to 25.3% in 2023/24. In the event, the October view overstated the likely dip in the revenue share and understated the likely size of the economy.

Expenditures come in $10bn lower than forecast in October. That improved starting position on payments flows through to the following years – providing around a $40bn improvement in the budget position across the four years.

Commodity price forecasts, a change of approach
The October Budget anticipated that commodity prices would fall from current elevated levels to "targets" by the end of the March quarter 2023.

This approach is overly cautious, anticipating an almost immediate (and unlikely) crunching of global commodity prices.

The Commonwealth Treasury has reportedly recommended to the government adopting a more plausible, but still cautious, approach.

While the precise approach to be adopted in the May Budget is unclear, here we assume that prices return to target by the December quarter 2024 – allowing a near two year glide path.

On our calculations, that would still imply around a 12% decline in the terms of trade in the year to the December quarter 2023, followed by a further 12% decline in the year to December 2024.

In the May Budget, the adoption of alternative timings for achieving the target prices is possible, so too a modest upgrading of those target prices – eg the iron ore price assumption could be lifted from US$55/t fob.

Economic growth profile
As noted above, the size of the Australian economy is larger than anticipated in the October Budget, due to the combination of higher commodity prices and higher economy wide inflation. The May Budget will see an upgrade to nominal GDP growth forecasts.

That upgrade to nominal GDP and national income is despite the potential for a trimming of the output growth profile.

We anticipate that real GDP growth will be trimmed by 0.25% each year across the forecast horizon, with the exception of 2025/26.

This would be a cautious approach in light of global and domestic risks as the intense headwinds of high inflation and higher interest rates impact. It would be despite a lift to the population numbers associated with the larger than expected jump in immigration numbers on the national border reopening.

The output growth profile for the four years 2022/23 to 2025/26 would be: 3.00%; 1.25%; 2.00% and 2.50%. Such forecasts would not be greatly different from Westpac's profile of: 3.2%; 0.9%; 1.7%, and 2.50%.

Growth forecasts

	2022/23	2023/24	2024/25	2025/26
Real GDP				
October	3.25	1.50	2.25	2.50
May	3.00	1.25	2.00	2.50
Nominal GDP				
October	8.00	-1.00	4.25	5.00
May	9.25	1.50	2.00	4.50
Terms of Trade				
October	-2.50	-20.00	~	~
May	-2.00	-10.75	-10.00	-1.00
Size of economy				
$bn change	+42	+105	+51	+41

The nominal GDP profile for the four years, including commodity prices returning to "target levels" by December 2024, would be as follows: 9.25%; 1.50%; 2.00% and 4.50%.

On this revised profile, the economy is some $105bn larger in 2023/24 than anticipated in the October Budget, a figure which narrows to $41bn by 2025/26.

Revenue profile
The updated revenue profile reflects: the revised economic outlook (the size of the economy); and we have assumed that revenue as a share of GDP broadly follows the profile in the October Federal Budget.

On our figures, revenue upside lifts from $20bn for 2022/23 to $26.5bn in 2023/24, reflecting the upgrade to nominal GDP. Thereafter, the upside narrows, reflecting the revised nominal GDP growth profile.

As noted above, across the four years, the revenue windfall is in the order of $70bn. That lift in revenue, along with the $10bn downside on expenditures in 2022/23 (which we have flowed through to the outyears), generates a $110bn improvement in the budget position for the four year period to 2025/26 - relative to the October forecasts. This is on a "no policy change" basis, with no allowance made in these figures for cost escalation of existing programs.

Conclusion
On Budget night the Treasurer will announce a package of important initiatives for the Australian people. We expect a range of policies including tax changes; reforms to existing programs; and relief for households.

We estimate that before the Treasurer costs these policies advantageous developments around commodity prices; inflation; and the labour market will improve the budget starting position by around $110bn over the four years to 2025/26.

A responsible budget targeted at addressing the structural deficit while at the same time recognising the need to assist vulnerable households should retain at least half of this improved starting position.

Andrew Hanlan, Senior Economist
Bill Evans, Chief Economist

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

DISCLAIMER

© Copyright 2023 Westpac Banking Corporation

Things you should know.

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary only and is not intended to constitute or be relied upon as personal financial advice. To the extent that this material contains any general advice, it has been prepared without taking into account your objectives, financial situation or needs, and because of this, you should, before acting on it, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs, and, the disclosure documents (including any product disclosure statement) of any financial product you may consider. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a client of Westpac.

For XYLO Foreign Exchange clients: This information is provided to you solely for your own use and is not to be distributed to any third parties. XYLO Foreign Exchange is a division of Westpac Banking Corporation ABN 33 007 457 141 and Australian credit licence 233714. Information is current as at date shown on the publication. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs. XYLO Foreign Exchange's combined Financial Services Guide and Product Disclosure Statement can be obtained by calling XYLO Foreign Exchange on 1300 995 639, or by emailing customercare@XYLO.com.au.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Disclaimer continued overleaf

DISCLAIMER

Disclaimer continued

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

I. Chinese Wall/Cell arrangements;

II. physical separation of various Business/Support Units;

III. Strict and well defined wall/cell crossing procedures;

IV. a "need to know" policy;

V. documented and well defined procedures for dealing with conflicts of interest;

VI. reasonable steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.