Australian Federal Budget 9 May 2023.
Budget edges into surplus, returns to deficit. 2022/23: +$4.2bn; 2023/24: -$13.9bn.

The 2023 Budget is set against the backdrop of high inflation and sharply higher interest rates, with the RBA responding to the greatest inflation challenge in a generation. Currently, the unemployment rate at 3.5% is the lowest level in almost 50 years and commodity prices are around historic highs. Household incomes are under intense pressure from higher prices, rising debt servicing costs and additional taxation payments. The Federal budget has received an economic windfall from stronger incomes, some of which the Government is using to provide cost of living relief for the most vulnerable households. The outlook is challenging, with output growth set to slow as higher interest rates bite.

Budget deficit path revised lower
The budget deficit profile has been revised lower reflecting the windfall from stronger incomes (higher inflation and higher commodity prices) and from ongoing labour market strength, and after incorporating the cost of new spending initiatives. The cumulative deficit for the four years 2022/23 to 2025/26 is reduced to $81bn, down from $182bn in the October Budget, an improvement of $100bn.

For 2022/23, the budget position has improved by $41bn to be a wafer thin surplus of $4.2bn, representing 0.2% of GDP. The last time the budget was broadly in balance was immediately before the pandemic, in 2018/19. The surplus is a one–off, with the budget returning to deficit in 2023/24, a forecast $13.9bn (which respresnts a $30bn improvement on the October forecast). The deficit widens to $35.1bn in 2024/25 and to $36.6bn the year following, representing –1.3% of GDP in both years.

Budget windfall
The "stronger economy" delivers a budget windfall of $121.5bn across the four years to 2025/26, centred on a $112bn increase in revenue. Payments are somewhat lower, $10bn below the October forecast. Note, that there is a $13.9bn undershoot of payments in the 2022/23 year. Thereafter, payments are higher, with escalating costs of existing programs included in "parameter variations".

New policy
The government has increased spending, with a focus on cost of living relief. Net new policy costs $12bn in 2022/23, representing 0.5% of GDP, and over the three years to 2025/26 costs $20bn, representing 0.76% of GDP. By historical standards, this is a relatively expansionary budget. The experience over the decade prior to the pandemic was that the year 1 impact of new policy was around 0.25% of GDP (or less) and the impact over 3 years was 0.5% of GDP (or less).

Cost of living relief includes rental assistance and energy price relief – two measures which have an initial impact of lowering out of pocket expenses of households and thus lowering measured Consumer Price Inflation. New policy measures also span health and aged care. There are a number of tax increases to help pay for additional spending. See pages 2 and 3 for additional detail on initiatives and budget themes.

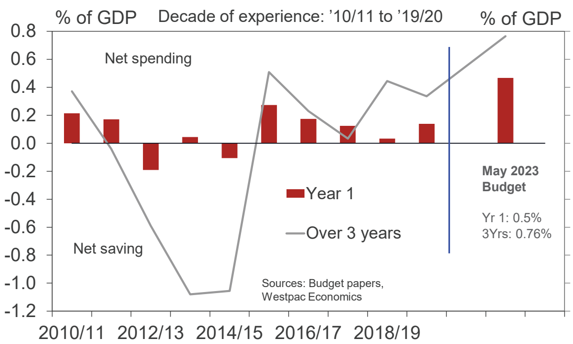
Payments remain above long–run average, after 2022/23 dip
Payments as a share of the economy, having been very elevated during the pandemic, dip to 24.8% of GDP in 2022/23 (benefitting from the stronger labour market) and then snap back to above 26% of GDP thereafter, which is well above the pre pandemic long run average of 24.9%. Revenue as a share of the economy remains elevated in 2022/23 at 25.0% of GDP, then is forecast to hold above 25% of GDP thereafter.

Debt profile lowered
Federal debt profiles have been lowered materially reflecting the improved budget position and lower long term bond rates (see chart on page 6). Net debt is now forecast to lift from an estimated 21.6% of GDP at June 2023 to a still modest 24.0% of GDP in 2025/26 (downgraded from 28.5% of GDP in the October Budget). Gross debt rises from an estimated 34.9% of GDP at June 2023 to a peak of 36.5% of GDP for 2025/26 (downgraded from 43.1% of GDP for 2025/26 and a peak of 46.9% in 2030/31).

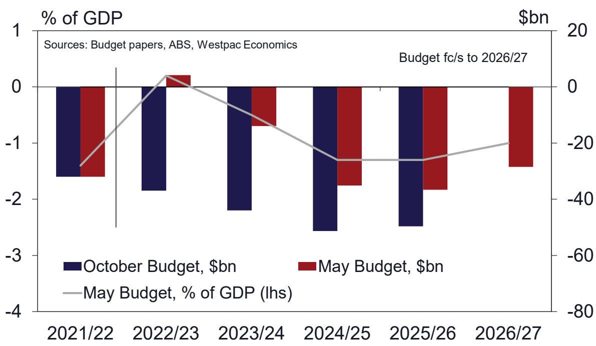
Risks
The are a number of risks to the fiscal projections – both upside and downside. The risks to the view on national income are potentially tilted to the high side given that commodity price assumptions are still cautious, notwithstanding the adoption of a somewhat longer glide path down from current levels to "target prices" (as discussed on page 4).

Downside risks relate to the potential for a more significant labour market downturn and to the output growth outlook, with the possibility of a "hard landing" domestically and globally triggered by aggressive tightening of monetary policy, with the risk that inflation proves more persistent. The other key downside risk to the fiscal outlook relates to the ongoing upward pressure on expenditures, particularly in the caring economy (health, aged care, the NDIS).

Net policy decisions in May Budgets: impact



Federal budget: underlying cash balance



Budget 2023: key numbers

9 May 2023

	2021/22(a)	2022/23	2023/24	2024/25	2025/26	2026/27
Underlying cash balance*, $bn	–32.0	4.2	–13.9	–35.1	–36.6	–28.5
% of GDP	-1.4	0.2	–0.5	–1.3	–1.3	–1.0
Receipts, % GDP	25.3	25.0	25.9	25.4	25.2	25.2
Expenses, % GDP	26.7	24.8	26.5	26.8	26.6	26.1
Headline cash balance, $bn	–33.3	–7.5	–19.7	–49.2	–51.8	–41.3
% of GDP	-1.4	–0.3	–0.8	–1.9	–1.9	–1.4
Net debt, $bn	515.6	548.6	574.9	620.6	665.2	702.9
% of GDP	22.5	21.6	22.3	23.5	24.0	24.1
Gross debt, $bn	895.3	887.0	923.0	958.0	1015.0	1067.0
% of GDP	38.8	34.9	35.8	36.3	36.5	36.5

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

Major policy initiatives in May Budget 2023

AUDbn	'23/24	5 yrs*	Comment
Spending measures			
Strengthening Medicare	1.4	5.6	Increase bulk billing incentives.
Increase to Working Age Payments	1.0	4.7	Increase payments including JobSeeker and extend eligibility.
Cost of Living - Commonwealth Rent Relief	0.5	2.7	An increase in the rental subsidy for low income households.
Parenting Payment (Single) - improved support for single parents	0.4	1.9	$176.9 extra per fortnight affecting 57,000 carers.
Cost of Living - Energy Bill Relief	N/A	1.5	Direct reduction on energy bills; $3bn package shared with the states.
Improving Aged Care Support	0.2	0.8	Improve aged care delivery and interim 15% wage increase.
Medicare Levy (tax relief)	0.1	0.5	Increase to levy across low-income thresholds.
Not yet announced	0.9	7.8	
Total *(including measures not listed above)*	**13.8**	**42.6**	
Saving measures **– expenses (i.e. spending cuts)**			
Improving the Investment in Aged Care	0.0	2.2	Temporary reduction in aged care provision ratio.
Reinvesting in Health and Aged Care	0.4	1.7	Redirection to Improving Aged Care Support.
Saving measures **– revenue raising**			
GST Compliance Program	0.8	3.8	Extending the ATO's program for another four years.
Tobacco Excise	0.3	3.0	Increasing by 5% per year over three years, starting 1 September 2023.
Petroleum Resource Rent Tax (PRRT) Review	0.5	2.4	Bringing forward revenue collection from LNG projects.
Heavy Vehicle Road User Charge	0.1	1.1	Lifting by 6% per year over three years, from 27.2¢/litre to 32.4¢/litre.
Superannuation Reform	0.0	0.9	Tax on superannuation balances above $3mn lifted from 15% to 30%.

* Includes 2022-23 through to 2026-27.

* 5 years to 2026/27

Budget 2023: Key themes & key measures

9 May 2023

Cost of living relief (CoLR)
The package focusing on supporting the direct cost of living includes a number of elements, with a focus on energy price relief as well as a $2.7bn increase in Commonwealth Rent Assistance.

CoLR: energy subsidies
The government initiative provides $3bn for energy bill relief with state & federal governments providing $1.5bn each (up to $500 for households and $650 for small businesses); $1.3bn for Household Energy Upgrades Fund with low interest loans for energy saving home upgrades by low income households and renters.

CoLR: health
'Strengthen Medicare' sees $5.6bn over 5 years spent on improving access to primary care and investing in health protection and prevention services. This includes $3.5bn to triple bulk billing incentives to support patients with low incomes and children aged under 16 and $0.445bn on increasing support for GPs by having nurses and allied health professionals working with them.

Welfare
Provide $4.7bn over 5 years to increase working age payments including Jobseeker payments, increasing base rate (working age and student) by $40 per fortnight and extending eligibility for those 55 years and over (60 and over previously) receiving payments for 9 or more continuous months.

The budget also improved support for single parents by investing $1.9bn over 5 years increasing payments by an additional $176.9 per fortnight affecting 57,000 single parents (comprising of 91% women)

Aged Care
In response to the Royal Commission Report, the Budget commits $0.827bn over 5 years to improve delivery of aged care services with $0.487bn to extend Disability Support for the Older Australia Program as well as $0.515bn over 5 years in providing an interim 15% rise in award wages for many aged care workers. An additional $0.59bn over 2 years to be spent on COVID–19 aged care response with $0.536bn to reimburse aged care providers who experienced additional costs from COVID–19 outbreaks.

Temporary reduction in residential aged care provision ratio from 78 to 60.1 per 1000 people over 70 saves $2.2bn over 3 years and redirects funds to Improving Age Care Support. $1.7bn over 4 years from other Health and Aged Care Programs are reinvested into new and expanding current services. It is unclear whether all or some of these savings are redirected into spending measures.

Tax: GST compliance program
The Government will provide $588.8mn to the ATO in order to support ongoing schemes aimed at promoting GST compliance. Beginning from 1 July 2023, this is expected to produce a net increase in GST receipts of $3.8bn over the five years to 2026–27

Tax: on heavy vehicles
The Heavy Vehicle Road User Charge rate will be increased by 6% per year over three years, from 27.2¢/litre to 32.4¢/litre. This will decrease expenditure on the fuel tax credit by $1.1bn and contribute to road maintenance and repair projects.

Tax: on gas
In response to the Treasury's Review, the Petroleum Resource Rent Tax (PRRT) will be amended to reduce the deductible expenditure on the assessable proportion of PRRT project incomes. Aimed only at LNG projects, this will effectively bring forward tax receipts from those projects that are yet to pay PRRT, which under the prior arrangement was not going to occur until the 2030s.

This is expected to raise $2.4bn in revenue and will support the Government's plans to implement other recommendations from the Treasury, including updates on tax avoidance rules and adjustments to rules for emerging LNG projects.

Tax: on tobacco
Beginning 1 September 2023, the Government will raise tobacco excise and excise–equivalent customs duties by 5% per year, over three years, increasing tax revenue by a collective $3bn through to 2026–27. With the aim of improving health outcomes, this will complement increased spending on lung cancer screening, $264mn, and anti–smoking/vaping programs, $205mn, over the next four years.

Tax: superannuation reform
The headline tax rate on total superannuation balances that are in excess of $3 million will be doubled, from 15% to 30%. This is expected to raise $1.1bn in tax revenue over the five years to 2026–27. Additionally, revenue raised from an increase in payment frequency of the Superannuation Guarantee (SG) will facilitate the planned company tax deductions of SG payments in 2027–28.

Economic outlook

9 May 2023

The 2023–24 Budget points to a challenging path ahead for the economy with high inflation and an associated sharp rise in interest rates impacting both locally and abroad, and the balance of risks firmly tilted to the downside. That said, Australia's near-term growth prospects are largely unchanged from the October Budget. The economy is forecast to expand 1.5% in 2023–24, growth lifting to 2.25% in 2024–25 – unchanged from October. Treasury sees medium term prospects as slightly firmer, stronger population growth and higher labour force participation lifting growth to 2.75% in 2025–26 compared to 2.5% forecast in October, and sustaining at this pace in 2026–27.

National income and commodity prices
While the near-term profile for the real economy remains the same, forecasts for national income – nominal GDP – have shifted materially. Stronger-than-expected price and wage inflation and elevated commodity prices are now expected to provide more support near term, with slowdowns and commodity price declines coming through later in the piece. Nominal GDP is forecast to rise a further 1.25% in 2023–24 but post a more subdued 2.5% gain in 2024–25. This compares to a 1% decline and 4.25% rebound for these years forcast in October. Much of this comes back to changes in the technical assumptions used to project commodity prices, spot iron ore, met coal, thermal coal, LNG and oil all now assumed to return more gradually (over four quarters instead of two) to slightly higher long term levels than assumed in October (up 10–15%).

Consumer-led slowdown
Households remain at the centre of the slowdown domestically. Here it should be noted that spending has come off more quickly than expected in October, but with the main impact in 2022–23 offset in GDP growth terms by an improvement in service exports. The consumption growth outlook for 2023–24 has been nudged up slightly, to 1.5%yr from 1.25%yr in October, stronger population growth and firmer wage gains providing more support. The forecasts also continue to assume some additional support from lower household savings rates. Improving real incomes are expected to drive a lift in spending growth to 2.5%yr in 2024–25.

Dwelling investment is expected to see a more prolonged period of moderate decline. A 2.5% fall in 2022–23 is expected to be followed by a 3.5% contraction in 2023–24 (compared to –1% forecast in October) and a further 1.5% decline in 2024–25. The milder than usual profile reflects the slow completion of a large backlog of dwellings under construction. A strong recovery is expected to gain traction over 2025.

Business investment is forecast to maintain reasonable momentum despite an undershoot in 2022–23. Growth is forecast to come in at 3% for 2022–23, downgraded from 6% in October, but slow only slightly to 2.5% in 2023–24 and 2% in 2024–25. A large pipeline of work underway provides some support, strong balance sheets and tight capacity also seen as positives. Notably all the gains are expected to come from non-mining sectors with mining investment expected to hold flat despite high commodity prices.

Government spending is expected to hold steady at a subdued pace, having slowed materially from the panedmic period. Growth in public demand is forecast to slow from 1.75%yr in 2022–23 and 1.5%yr in 2023–24, down from a brisk 6.8% in 2021–22.

Net exports performed slightly better than expected in 2022–23, tracking towards a flat contribution rather than a slight drag, and are still expected to add 0.5pts to GDP growth in 2023–24. Border reopening is seeing a rapid lift in service exports, international education now expected to return to pre-pandemic levels in 2024, a year earlier than forecast in October. This is balanced by strong gains in service imports.

Labour market, wages and prices
The labour market is expected to soften but more gradually and from a slightly tighter starting point than forecast in October. Employment growth is expected to slow from 2.5%yr in 2022–23 to 1%yr in 2023–24, holding at this pace in 2024–25. As noted, the migration-driven turnaround in population growth is shaping as much stronger, net migrant inflows now expected to come in at 400k in 2022–23 and hold at 315k in 2023–24, slowing back to 260k in 2024–25, well up on the flat-line forecasts of 265k a year in October. That sees population growth of 2% slowing to 1.7% and 1.5% over the three years. The employment population mix and a slightly lower participation rate sees the unemployment rate track gradually higher, from 3.5% to 4.25% in mid-2024 and 4.5% in mid-2025, holding steady from there.

Wages growth is expected to show a slightly firmer rise to 4%yr in 2023–24, but moderate back to 3.25%yr in 2024–25. Real wage growth turns slightly positive from early 2024.

Inflation is expected to run slightly higher at 6% in 2022–23 but show a slightly more pronounced slowing to 3.25% by mid-2024. The downgrade reflects the government's cost-of-living measures, the Energy Price Relief Plan taking 0.75ppts off headline inflation, and increases in Commonwealth Rental Assistance and PBS subsidies also impacting. These measures are not expected to add to broader inflationary pressures.

Risks
The Budget's growth forecasts are firmer than Westpac's 0.9% forecast for 2023–24 and 1.7% for 2024–25, the main differences around domestic demand, consumer spending in particular. This is balanced by changes to the profile for commodity prices which see markedly lower nominal GDP growth on the government's forecast. The main risks to the view centre on a more persistent period of high inflation drawing additional monetary tightening and or delaying monetary easing in 2024, both in Australia and abroad.

Key forecasts		'22/23	'23/24	'24/25	'25/26	'26/27
Real GDP	October	3.25	1.50	2.25	2.50	–
(% chg)	May	3.25	1.50	2.25	2.75	2.75
Nominal GDP	October	8.00	-1.00	4.25	5.00	–
(% chg)	May	10.25	1.25	2.50	5.25	5.25
Unemployment	October	3.75	4.50	4.50	4.25	–
(% chg)	May	3.50	4.25	4.50	4.50	4.25
CPI Headline	October	5.75	3.50	2.50	2.50	–
(% chg)	May	6.00	3.25	2.75	2.50	2.50

Sources: Budget papers

Forecasts '23/24	Government	Westpac
World GDP (2023)	2.75	3.0
Australia: real GDP	**1.50**	**0.9**
Consumption	1.50	0.7
Housing	-3.50	-4.7
Business Investment	2.50	-2.5
Gross National Expenditure	1.00	-0.4
Net exports, ppt contr'n	0.50	1.3
Unemployment, Jun qtr	4.25	4.8
Nominal GDP	1.25	2.7
Terms of trade	-13.25	-6.8

Sources: Budget papers, ABS, Westpac Economics.

Economic forecasts: Australia

9 May 2023

	Actual	Government (yr avg)			Westpac (yr avg)		
	2021/22(a)	2022/23	2023/24	2024/25	2022/23	2023/24	2024/25
Private consumption	3.7	5.75	1.5	2.5	5.5	0.7	1.8
Dwelling investment	2.9	–2.5	–3.5	–1.5	–2.8	–4.7	–1.4
Business investment*	6.1	3.0	2.5	2.0	3.2	–2.5	0.8
Private final demand*	4.3	4.0	1.0	2.25	3.9	–0.4	1.5
Public final demand*	6.8	1.75	1.5	2.0	1.6	0.9	1.7
Domestic final demand	5.0	n.f.	n.f.	n.f.	3.2	–0.1	1.6
Inventories, contribution ppts	0.1	0.0	0.0	0.0	–0.1	–0.3	0.2
GNE	5.1	3.25	1.0	2.25	3.1	–0.4	1.7
Net exports, contribution ppts	–1.3	0.0	0.5	0.0	0.2	1.3	0.1
Exports	–0.3	8.0	6.0	3.5	8.4	7.4	4.2
Imports	6.9	9.0	4.0	3.5	8.6	1.5	4.7
Real GDP	**3.7**	**3.25**	**1.5**	**2.25**	**3.2**	**0.9**	**1.7**
Nominal GDP	**11.0**	**10.25**	**1.25**	**2.5**	**9.9**	**2.7**	**3.2**
GDP deflator	7.1	7.0	–0.25	0.25	6.5	1.8	1.5
Terms of trade	11.8	1.5	–13.25	-8.75	–0.5	–6.8	–4.8
Employment (Jun qtr)	3.6	2.5	1.0	1.0	2.7	–0.6	1.4
Unemployment rate (Jun qtr)	3.8	3.5	4.25	4.5	3.5	4.8	5.2
Participation rate (Jun qtr)	66.6	66.5	66.25	66.25	66.7	65.7	65.7
CPI (Jun qtr)	6.1	6.0	3.25	2.75	6.3	2.8	2.9
Wage price index (Jun qtr)	2.6	3.75	4.0	3.25	3.8	3.8	3.0
Current account, % of GDP	1.9	0.75	–2.5	–3.5	1.3	0.8	–0.2

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

	Actual	Government			Westpac		
	2022(a)	2023	2024	2025	2023	2024	2025
World growth	3.3	2.75	3.0	3.5	3.0	3.1	3.1

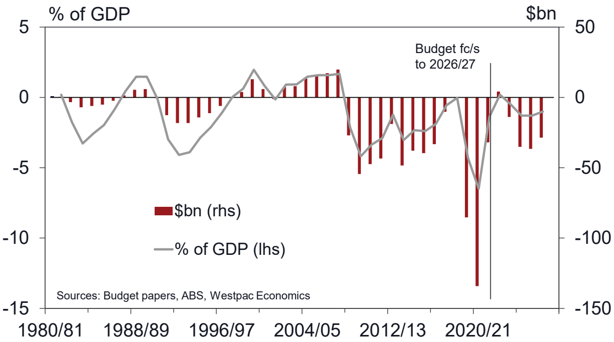
Macroeconomic variables – recent history

	2022							2023			
Monthly data	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Employment '000 chg	92	–17	54	14	43	60	–13	–11	64	53	–
Unemployment rate %	3.6	3.5	3.5	3.6	3.4	3.5	3.5	3.7	3.5	3.5	–
Westpac–MI Consumer Sentiment	86.4	83.8	81.2	84.4	83.7	78.0	80.3	84.3	78.5	78.5	85.8
Retail trade %mth	0.7	0.8	0.8	0.7	0.4	1.6	–3.9	1.9	0.2	0.4	–
Dwelling approvals %mth	0.1	-16.0	28.0	–9.3	–5.5	–4.6	14.3	–27.1	4.0	–	–
Credit, private sector %yr	8.6	8.6	8.6	8.9	8.9	8.3	7.8	7.5	7.2	6.8	–
Trade balance AUDbn	17.1	8.4	8.7	12.5	12.2	13.4	12.6	10.8	14.2	15.3	–

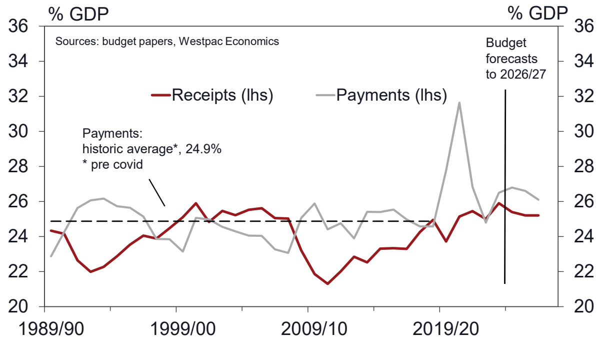
Budget trends

9 May 2023

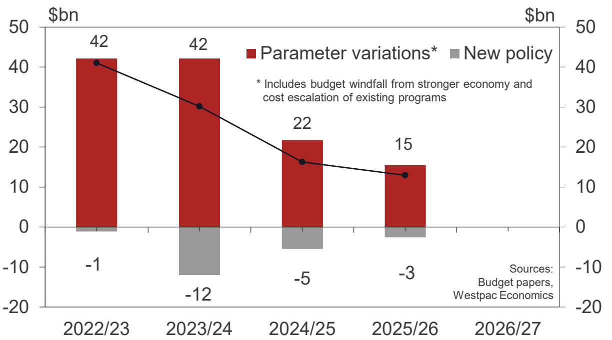
Federal budget: underlying cash balance



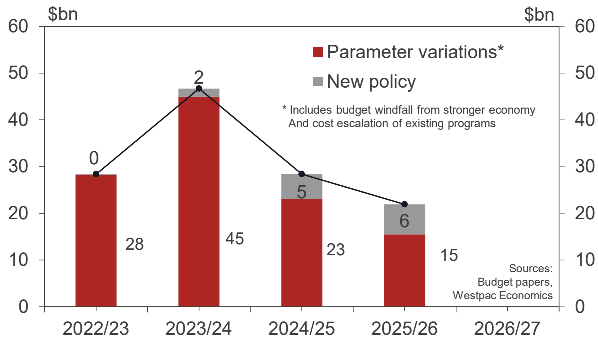
Federal Budget: receipts and payments



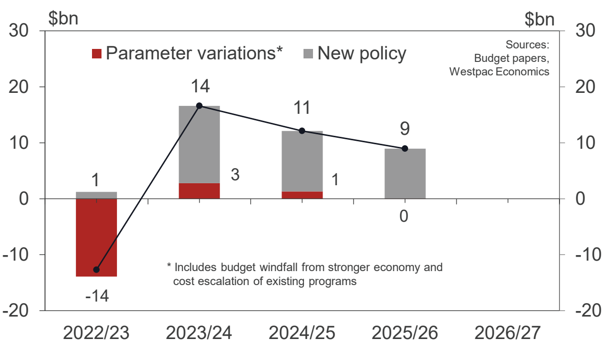
Federal budget: changes from October Budget



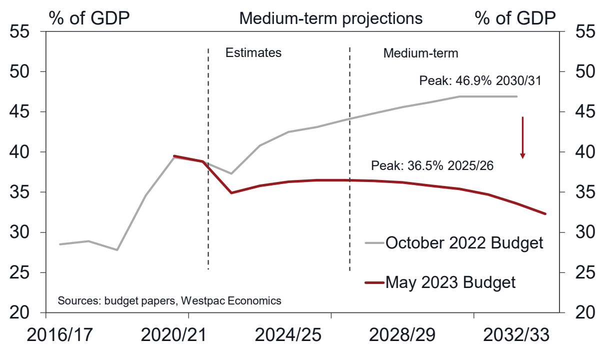
Revenue: changes from October Budget



Expenses: changes from October Budget



Public gross debt projections



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