BULLETIN

4 May 2023

Federal Budget, preview
New policy and cost escalation to trim improvement

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

Last Friday, we released a Bulletin discussing the shifting Budget Outlook.

[Australian Federal Budget May 2023: a preview | Westpac IQ]

In that article we considered the likely budget position on a "no policy change basis" – factoring in the windfall from stronger national income growth, associated with higher commodity prices, as well as ongoing labour market strength.

On our figuring, the budget position relative to the October Budget profile has improved by $110bn over the four years to 2025/26 on a combination of higher revenue ($70bn) and lower payments ($40bn).

Here, we extend our budget preview considerations.

The revised budget profile in the May Budget will incorporate not only the boost from a larger economy but the headwinds from cost escalation of existing programs and the impact of net new policy initiatives.

There is limited visibility on the scale and dimension of new policy and cost escalation – but nevertheless, there is a need to attempt to make some allowance for these forces. To assist with this, we discuss the key themes of the 2023 Budget.

Budget 2023: balancing "relief" and "restraint"
The 2023 Budget is set against the backdrop of high inflation and sharply higher interest rates, which is placing considerable pressure on household incomes.

The Budget will attempt to deliver some relief for the most vulnerable households, balancing that against the need for restraint in terms of the impact of fiscal policy on the economy.

Budget themes / measures
Providing relief to households will be a key theme of this Budget, with a package of new policy measures targeted at the most vulnerable. There will be energy bill relief (a joint deal with state governments) and there may be some rental relief - both measures would act to lower inflation. Increased JobSeeker payments to people aged 55 and above (who are largely women) has been discussed.

Health will receive additional spending (cheaper medicine, a possible lift in the rebate for a GP visit).

Housing will be in focus, potentially expanding eligibility for the government's Home Guarantee Scheme.

Going Green is a key priority – with a likely tax incentive for small business to invest in energy efficient equipment.

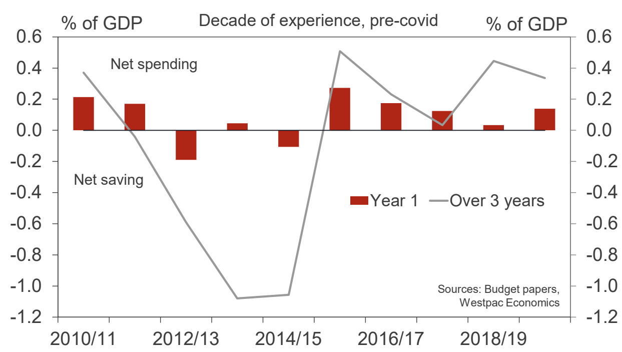
Defence is in need of an overhaul, following the government's Defence Strategic Review.

Raising additional tax dollars to help fund increased spending will be a focus. This could include: increased tax on gas (via

Budget position, $bn

	2022/23	2023/24	2024/25	2025/26	4yrs
Balance, October	-36.9	-44.0	-51.3	-49.6	-181.8
% of GDP	-1.5	-1.8	-2.0	-1.8	
Windfall	30.0	36.5	22.9	20.3	109.7
Balance, no policy change	*-6.9*	*-7.6*	*-28.4*	*-29.2*	
New policy		-6.4	-3.2	-3.4	-13.0
Cost escalation		-6	-8	-9	-23.0
Net improvement	30.0	24.1	11.7	7.9	73.7
May Balance	-6.9	-20.0	-39.6	-41.6	-108.1
% of GDP	-0.3	-0.8	-1.5	-1.5	

Net policy decisions in May Budgets: impact



the PRRT); increased tax on tobacco; further tax reform for multinationals and reform of superannuation tax arrangements - as well as the usual greater tax compliance measures.

Program cost escalation
Rising costs of existing programs remain a key dynamic impacting the budget position – this will again be the case in the 2023 Budget.

The Treasurer has identified the BIG 5 as the key source of upward cost pressure, namely: aged care, health, the NDIS, defence and debt servicing costs.

Aged care is in focus, with reports that costs have jumped by at least $30bn over four years to 2026/27 (rather than the period to 2025/26 – which is the focus here), with a partial offset from a $7.5bn drawdown of the contingency reserve.

On the NDIS, the Minister has highlighted the need for reform, to provide better outcomes while at the same time reducing cost escalation, as well as to potentially engage with the states to renegotiate joint funding arrangements.

The full extent of the net cost blowout of existing programs that will be recognised in this official budget update is unclear.

Here, we have attempted to allow for cost escalation in our figuring – including a $23bn impact over the three years to 2025/26.

Sizing the scale of net new policy: historical experience
So what might be a reasonable scale of net new policy initiatives?

On this, history provides some guide. If we look at the decade prior to the pandemic, the net impact of new policy measures in the May annual Budget in year 1 (the first full fiscal year after the budget) was around 0.25% of GDP, or less, and over 3 years, around 0.5% of GDP, or less (see chart above).

Using this as a benchmark, the net impact of new policy would be $6.4bn in 2022/23 (0.25% of GDP) and $13bn over the three years to 2025/26 (0.5% of GDP).

This historical benchmark is one way to assess the scale of new policy initiatives unveiled in the 2023 Budget and whether or not they are large or small compared with previous Budgets.

With the current very tight labour markets and high inflation, this Budget is occurring at a time when the risks to inflation of over stimulus are unusually severe. Accordingly, the scale of net new policy takes on more significance in this Budget - with the need for fiscal policy restraint – to ensure that fiscal policy is not seen to be adding to an already daunting inflation challenge.

Despite the strong starting position and the urgent need for household support, the Treasurer is likely to deliver a package of measures which are – in aggregate – at least as constrained as we have seen in earlier Budgets.

Conclusion
The 2023 Budget will unveil an improved budget position due to stronger national income growth and ongoing strength in the labour market.

As indicated in our earlier article, we expect a budget windfall of $110bn over the four years to 2025/26.

Some of that windfall will be used to fund a package of new policy initiatives – which will attempt to balance relief for the most vulnerable and restraint, such that fiscal policy does not add to inflationary pressures.

Historical experience, in the decade prior to the pandemic, shows that the net impact of new policy measures is around 0.25% of GDP or less in year 1 – which would mean for 2022/23 around $6.4bn.

After an allowance for net new policy and program cost escalation, on our figuring the improvement in the budget position over the four years to 2025/26 is pared back from the $110bn windfall to around $74bn (with new policy costing $13bn and rising costs adding $23bn).

See Table 1 above for detail on the budget profile.

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