BULLETIN

4 August 2023

Australian Federal Budget, in focus. Fiscal position estimated to improve by $62bn relative to May Budget forecasts over the 3 years 2022/23 to 2024/25.

At the time of the May 2023 Budget the Federal Government forecast an underlying cash surplus in 2022/23 of $4.2bn, to be followed by deficits in 2023/24 and 2024/25 of $13.9bn and $35.1bn respectively.

These forecasts were based on the government's economic forecasts, which include employment; wages; inflation; output and commodity prices; as well as their forecasts for government expenditure.

Westpac's forecasts for the budget positions over that period indicate a surplus of $22bn in 2022/23; a surplus of $11bn in 2023/24; and a deficit of $16bn in 2024/25. That would mean a combined improvement in the cumulative Budget positions over the three years of $62bn.

Westpac differs with the government's economic forecasts with respect to inflation; output growth; the labour market including the unemployment rate, wages growth; and commodity prices. The main differentiating factor relates to our more constructive view on the key commodities.

The table opposite contrasts Westpac's key economic forecasts with those in the May Federal Budget.

The May Budget anticipated that the key commodity prices would weaken from the elevated levels at the time, declining over the four quarters to the end of the March quarter 2024, to the assumed "target levels" – of most importance is the iron ore spot price declining to US$60/t (fob).

We see these "target prices" to be on the conservative side, with risks clearly to the upside.

Since the May Budget, commodity prices have indeed pulled back, weakening materially over the June and September quarters. However, Westpac anticipates that the downward trend in commodity prices will slow and that prices will settle above the low "target prices" assumed in the Budget, see table opposite.

Our view on commodity prices points to a less dramatic decline in the terms of trade in 2023/24 and 2024/25 and, in turn, stronger nominal GDP growth. As a result, the size of the economy will be larger than expected by official forecasts.

On Westpac's forecasts, the Australian economy in 2023/24 will be some $40bn larger than projected in the May Budget, rising in 2024/25 to be greater by $70bn. The larger economy will generate additional revenue, improving the budget position.

The underlying cash surplus for the 2022/23 year will exceed the May Budget forecast of $4.2bn, as indicated by the Department of Finance figures up to May. The rolling annual budget surplus to May is $20.4bn and the surplus for the 2022/23 year to May is $19bn.

The table opposite sets out the fiscal position and Westpac's expectations relative to the May Budget.

Budget numbers

		2021/22	2022/23	2023/24	2024/25
Budget balance, $bn	Budget	–32.0	4.2	–13.9	–35.1
	Westpac		22.0	11.0	–16.0
	difference		*17.8*	*25*	*19*
Revenue, % chg	Budget	12.4	8.8	5.1	0.5
	Westpac		10.3	7.1	1.0
Expenses, % chg	Budget	–5.8	2.4	8.0	3.6
	Westpac		1.0	9.1	5.0

Source: May 2023 budget papers, Westpac Economics.

Economic forecasts

		2021/22	2022/23	2023/24	2024/25
Real GDP	Budget	3.7	3.25	1.50	2.25
	Westpac		3.10	1.00	1.60
Nominal GDP	Budget	11.0	10.25	1.25	2.50
	Westpac		9.70	3.30	3.60
Terms of trade	Budget		1.50	–13.25	–8.75
	Westpac		–0.80	–7.70	–3.00
Unemployment, Jun qtr	Budget	3.8	3.50	4.25	4.50
	Westpac		3.60	4.50	4.80
CPI, Jun qtr	Budget	6.1	6.00	3.25	2.75
	Westpac		6.00	3.40	2.90
Wages, Jun qtr	Budget	2.6	3.75	4.00	3.25
	Westpac		3.80	3.80	3.10

Sources: May 2023 budget papers, ABS, Westpac Economics.

Commodity prices

		Mar-23	Mid-2024	Mid-2025
Iron ore*	Budget	117	60	–
	Westpac		91	86
Coking coal	Budget	342	140	–
	Westpac		235	242
Thermal coal	Budget	260	70	–
	Westpac		132	125

Sources: May 2023 budget papers, Westpac Economics
* iron ore budget price of $60/t free on board is equivalent to around $65/t.

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The surplus for the 2022/23 year will potentially be in the order of $22bn. This $18bn surprise, is split between an expenditure undershoot and revenue upside, centred on higher company tax collections.

The government will reveal the actual 2022/23 budget surplus and the underlying detail in the Final Budget Outcome document – which last year was released on September 28.

For 2023/24 we are predicting a surplus of around $11bn compared to the government's current forecast of a deficit of $13.9bn – a $25bn improvement.

This 2023/24 view factors in the improved starting position for revenue, as well as the undershoot on expenditures (discounted somewhat to reflect upward cost pressure on existing programs). Overlaid on this, is the boost to revenue in 2023/24 from the larger economy than was assessed at Budget time, associated with commodity prices holding above the lows assumed in the budget. These higher commodity prices improve the tax take especially given the likelihood that mining companies' tax losses have been depleted.

For 2024/25, we anticipate that the underlying cash balance will move back into deficit, potentially a deficit in the order of $16bn (or more). That would still represent a $19bn improvement on the May Budget, a forecast deficit of $35.1bn.

The plus is that there is some further upside to revenue in 2024/25 given the likely larger economy. However, we anticipate that this will be outweighed by rising expenditure pressures – reflecting potential further program cost escalation and our modestly weaker labour market outlook reflecting a more downbeat view on output growth.

We are not suggesting that these numbers will be adopted by the government in their December Mid-Year Economic and Fiscal Outlook, or in the May 2024 Budget.

Rather, our view on the 2023/24 and 2024/25 budget balance is where we expect the final budget outcomes will likely **print before any additional policy initiatives**.

In the months ahead, we will need to reassess and review our 2023/24 and 2024/25 budget figuring to incorporate any revisions to our economic forecasts (including the commodity price profile) and to incorporate the impact on government expenditures of program cost overruns and new policy initiatives.

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