Tuesday, 14 May 2024

2024–25 AUSTRALIAN FEDERAL BUDGET

Comprehensive coverage and key impacts.

Key points

- The government is walking a fine line on spending to keep the economy on a narrow path. The cost-of-living squeeze is real, but the government does not want to stoke inflation further. Many measures have been designed to lower reported inflation, including expanded energy bill relief, greater rent assistance and cheaper medicines. The government's forecast of headline inflation reaching 2.75% by the end of 2024–25 is a little below our own but it is entirely plausible. These changes should not materially shift the timing of RBA decisions on rate cuts.
- But new spending – including on housing, infrastructure and the care sector – adds additional stimulus. Most of the net new spending (close to $20bn) is front-loaded into 2024–25 and 2025–26.
- After recording a second consecutive surplus in 2023–24, the budget swings into a bigger deficit than we expected in 2024–25. Some of this stems from the new spending and slower nominal growth. As in past years, though, conservative assumptions about commodity prices and bond yields also contribute. One cannot rule out another positive surprise in the 2024–25 final outcome in 12 months' time. And at 1% of GDP, the projected deficit for 2024–25 is notably smaller than those in many peer economies.

The big numbers

BUDGET REMAINS IN SURPLUS IN 2023–24, BEFORE SWINGING INTO DEFICIT FROM 2024–25.

2023–24: (+0.3% GDP)

+$9.3bn

2024–25: (–1.0% GDP)

-$28.3bn

NET IMPACTS OF POLICY CHANGES:

$24.4bn

NEW INVESTMENTS IN FINANCIAL ASSETS FOR POLICY:

$11.6bn

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Budget 2024–25

Westpac Economics

Budget holds in surplus but to return to deficit

The budget forecasts a surplus in 2023-24 of $9.3 billion. This has been revised higher from a $1.1 billion deficit at the MYEFO in December and means two budget surpluses in a row are expected to be delivered, which would be an outcome not recorded in more than 20 years. The windfalls from elevated commodity prices are temporary and expected to fade, which sends the bottom line back into deficit in 2024-25. Beyond 2024-25, growth in expenses is forecast to outpace revenue gains, keeping the bottom line in the red.

Shifting fiscal landscape

High nominal national income growth on the back of elevated commodity prices, strong employment growth, solid wages gains, high inflation, record population growth and a tight labour market have driven the remarkable turnaround in the budget position – from an expected deficit of $56.5 billion in May 2022 when the Government was elected, to a surplus of $9.3 billion – a turnaround of $65.9 billion.

However, the revenue upgrades were never likely to last forever and these conditions are now shifting. The prices of some of Australia's commodity exports are easing, while others remain elevated. Growth in nominal labour income is likely to slow as the labour market softens. The number of hours worked has been going sideways for the past nine months. Net migration (NOM) and population growth are slowing. As inflation continues to moderate, multiple tax bases closely linked to price increases, such as GST collections, will expand more slowly.

Windfalls smallest since post-COVID reopening

Parameter variations, that is, the change in the bottom line due to the economy, are expected to provide a windfall of $12.6bn over the 5 years to 2027-28. This is made up of $23.8 billion of upgrades to receipts, partly offset by $11.2 billion of upgrades to spending.

Digging deeper into revenue, $26.0 billion reflects upgrades to personal income taxes, as the stronger labour market and record population growth add to increased income tax receipts. Higher-than-expected commodity prices mean that company tax collections are expected to be $26.2 billion higher over the forward estimates. However, these upgrades are partly offset by downward revisions over the five years to 2027-28 to superannuation fund taxes ($12.6 billion), tobacco excise ($12.5 billion) and GST receipts ($5.5 billion).

While these windfalls remain significant, they are well down on the $131bn windfall recorded last year.

New policy significant and form also shifting

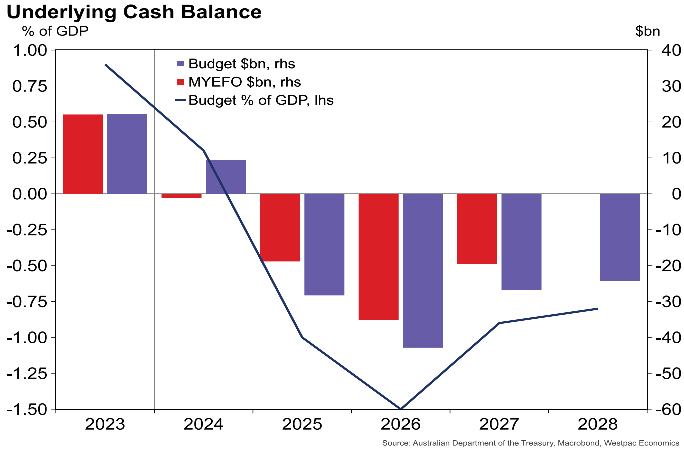
New policy decisions total $24.4 billion over the five years to 2027-28. This is made up of $32.5 billion of new spending over this period, partly offset by $8.0 billion of additional receipts. The spending is front loaded, with $9.5 billion in 2024-25 and $10.3 billion 2025-26.

Debt profile

Net debt remains higher than estimated at MYEFO over the entire projection period due to the deterioration in the bottom line and lower yields. Net debt is estimated to be 20% of GDP in 2024-25, increasing to 21.9% in 2027-28.

On the other hand, gross debt (i.e. the face value of government debt) is expected to be lower than the MYEFO profile over the entire projection period. This reflects the near term surplus and lower yields on government debt, which impact interest payments for new debt issuance in the future.

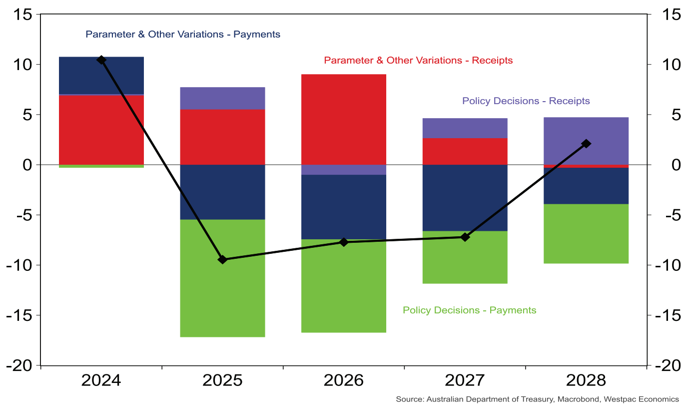
Underlying Cash Balance



Source: Australian Department of the Treasury, Macrobond, Westpac Economics

Revision to Underlying Cash Balance Since MYEFO

By Variation Type, $Billion



Source: Australian Department of Treasury, Macrobond, Westpac Economics

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Balance sheet transactions

Some of the policy changes designed to maximize the benefits from the transitions to net zero emissions will hit the bottom line, including setting up the Net Zero Economy Agency and establishing a hydrogen hub in North Queensland.

Others, to be delivered under the Future Made in Australia Act, will be in the form of loans and equity injections to third parties who spend the capital to deliver on the Government's policy objective. These policy changes do not impact the bottom line. Instead, they will show up in the headline cash balance, which includes investment in financial assets for policy purposes. This metric has increased by $11.6 billion over four years from 2023–24 to 2026–27 – and reached a record high over the forwards.

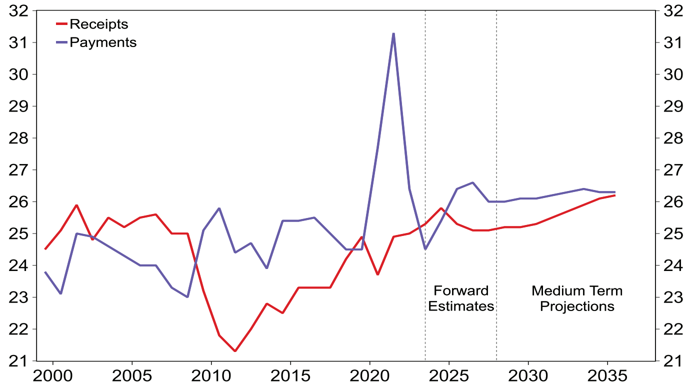
Long-term outlook

Beyond the forward estimates, the Government is projecting that the structural budget deficit (i.e. the budget position excluding the impact of temporary factors) hovers around 1.0% of GDP for most of the medium term, before improving to be balanced (i.e. around 0.0% of GDP) by the end of the medium term in 2034-35. This is an improvement from the structural budget balance estimates in MYEFO. The Budget papers attribute this to revisions in the underlying cash balance, which is expected to improve over the medium term compared with MYEFO.

Risks

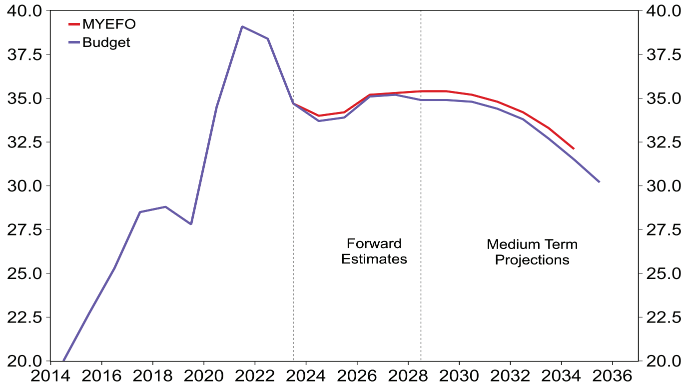
While we think that the temporary windfalls from commodity prices will fade, in our view this will take longer to play out, providing the budget with upside (or around $7bn in revenue in 2024-25). This is balanced to some extent by downside risks to economic growth in the near term.

Receipts and Payments
% Share of GDP



Source: Australian Department of the Treasury, Macrobond, Westpac Economics

Gross Debt
% Share of GDP



Source: Australian Department of the Treasury, Macrobond, Westpac Economics

Table 1: Key Fiscal Aggregates

	2022–23(a)	2023–24	2024–25	2025–26	2026–27	2027–28
Underlying cash balance*, $bn	22.1	9.3	–28.3	–42.8	–26.7	–24.3
% of GDP	0.9	0.3	–1.0	–1.5	–0.9	–0.8
Receipts, % GDP	25.3	25.8	25.3	25.1	25.1	25.2
Expenses, % GDP	24.5	25.4	26.4	26.6	26.0	26.0
Headline cash balance, $bn	14.1	6.5	–47.2	–63.8	–46.8	–42.0
% of GDP	0.6	0.2	–1.7	–2.2	–1.5	–1.3
Net debt, $bn	491.0	499.9	552.5	615.5	660.0	697.5
% of GDP	19.2	18.6	20.0	21.5	21.8	21.9
Gross debt, $bn	889.8	904.0	934.0	1007.0	1064.0	1112.0
% of GDP	34.7	33.7	33.9	35.1	35.2	34.9

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

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Table 2: Major policy initiatives in Budget 2024-25

AUDbn	2024-25	5 Years*	Description
Spending Measures – Expenses			
Defence: National Defence Strategy and Integrated Investment Program	0.4	5.7	Will deliver an additional $50bn funding over the next decade to meet Australia's strategic defence needs. The focus on supporting and expanding priority capabilities and providing certainty on growing Australia's defence industry.
Cost-of-Living: Energy Bill Relief	2.6	3.5	Extension of the Energy Bill Relief Fund to provide a $300 rebate to more than ten million households and a $325 rebate to around one million small businesses. Together with the Rental Assistance, it is expected to reduce headline inflation by 0.5ppts in 2024-25.
Infrastructure Investment	0.3	2.9	Direct support in delivering priority road and rail infrastructure in Australia's $120bn infrastructure investment pipeline. This includes $4.1bn over seven years for 65 new priority projects and $10.1bn over eleven years for existing projects.
Services Australia Funding	1.2	2.8	Additional resourcing to support the delivery of essential services. This will include $1.8bn to stabilise backlogs of claims and $0.6bn to sustaining and identifying possible enhancements to the myGov platform.
Improving Aged Care Support	1.5	2.2	Building on recommendations from the Royal Commission. Highlights include $1.2bn to be put toward sustaining and enhancing digital systems and $0.5bn to release an additional 24,100 additional home care packages in 2024-25.
Cost-of-Living: Commonwealth Rent Assistance	0.4	1.9	Increase all Commonwealth Rent Assistance maximum rates by 10% from 20 September 2024 (building on the 15% increase in 2023). Expected to benefit nearly one million households and, together with the Energy Bill Relief, it is expected to reduce headline inflation by 0.5ppts in 2024-25.
Renewable Energy Investment (Future Made in Australia)	0.2	1.9	Providing $19.7bn over the next decade to accelerate investment in priority industries associated with renewable energy, including $7.1bn toward critical minerals processing and $8.0bn to support production of renewable hydrogen.
Housing Support	0.1	1.2	Build more homes and train more construction workers to support social and affordable housing. Subject to state/territory agreement, $1.0bn toward new housing infrastructure via a "priority works" stream.
Health Care: Strengthening Medicare	0.4	1.2	Supporting earlier discharge from hospital for older Australians, improving access to essential services, modernising Australia's digital health infrastructure. $0.6bn to address long stay/old patient challenges.
Education: Tertiary Systems Reform	0.2	0.8	Establishing a $320/wk payment for students undertaking placements in nursing, teaching, or social work. Additionally, the Government will cap the HELP (student loan) indexation rate and backdate student loan supports to 1 June 2023.
Not yet announced	1.1	5.7	Expenditure that is yet to be announced.
Total *(including other)*	**11.7**	**32.5**	
Spending Measures – Revenues			
Cost-of-Living: Stage 3 Tax Cuts	-1.3	1.3	The rejigged Stage Three tax cuts will see the 19% tax rate reduced to 16%, the 32.5% tax rate reduced to 30%, the income threshold for 37% tax rate increased from $120,000 to $135,000 and the income threshold for the 45% tax rate increased from $180,000 to $190,000.
Small Business Write-Off	0.0	0.3	Extending the $20,000 instant asset writer-off until June 2025 for small business that purchase eligible assets costing less than $20,000.
Total *(including other)*	**2.2**	**8.0**	
Saving Measures – Expenses			
NDIS "Back on Track"	1.9	14.1	The NDIS Actuary projected that without further action, NDIS payments would increase by $14.4 billion over four years from 2024–25. The reforms being undertaken are expected to moderate this additional growth.
Savings from External Labour	0.1	1.0	Savings of $1.0 billion over four years from 2024–25 by further reducing spending on consultants, contractors and labour hire.

* Includes 2023-24 through to 2027-28.

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An Even Softer Landing

Inflation and Wages

A central source of discussion in tonight's forecasts is the trajectory of inflation. The Federal Government has cut its near-term inflation forecasts.

In 2023-24, the Government has lowered its inflation forecasts to 3.5%, from 3.75% in the MYEFO. The new policy announcements around subsidies for housing and energy relief to households and small businesses are expected to take ½% off headline inflation in 2024-25.

However, the net impact on inflation is difficult to ascertain. The direct effect is to soften inflation via the associated subsidies and lower indexation of some other prices the following year. It may also help contain inflation expectations. But there's an indirect effect; the relief provided to households may spill over into extra spending that could see inflation take longer to moderate.

For 2023-24, the RBA forecasts CPI growth of 3.8%, which will not include the impact of subsidies announced on budget night. Our forecast, taking into account the subsidies, which were largely as anticipated, is higher than the Government's at 3.7%.

In 2024-25, the Federal Government expects the rate of growth in the CPI to fall to 2.75%, within the RBA's inflation target band, which if materialised would allow for rate cuts from the RBA. The government's forecast contrasts with the RBA's higher forecast of 3.2% in 2024-25. Our forecast adjusting for subsidies is between these estimates at 2.9%.

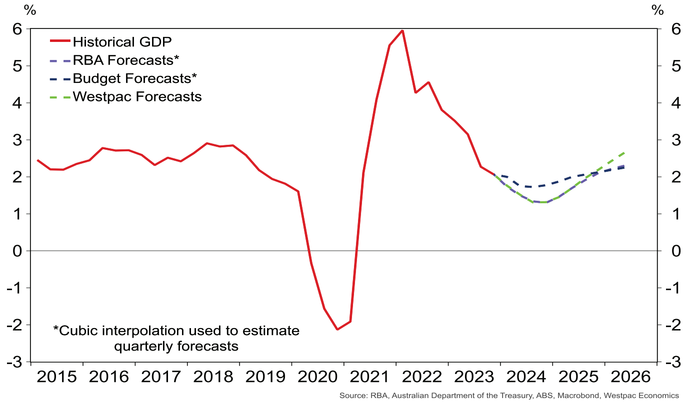
Forecasts for the wage price index remain unchanged and appear reasonable at 4.0% for 2023-24 and 3.25% for 2024-25 and 3.25% for 2025-26.

Optimistic consumer rebound

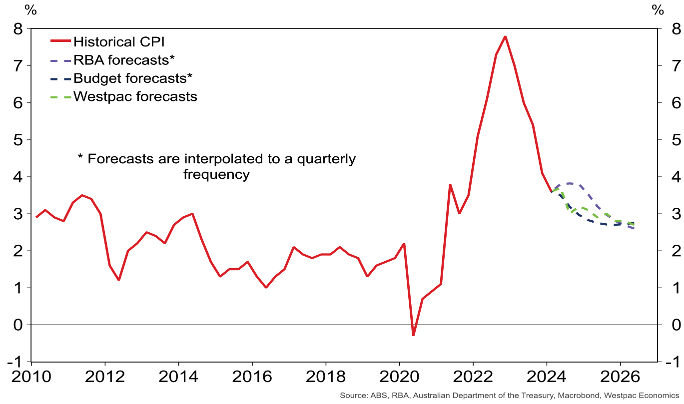
Real disposable income is forecast to grow by 3.5% in 2024–25, driven by growth in labour incomes, the cost-of-living tax cuts, lower interest rates and a smaller drag on real incomes from inflation compared to recent years. If realised, this would be the fastest rate in over a decade (excluding the COVID period), although this is mostly clawing back the heavy decline in 2022 and 2023. The forecasts look a little optimistic given the soft profile for employment growth.

Turning to GDP and the Federal Government is forecasting softer growth in 2024-25. Real GDP is expected to grow by 1.8%, similar to the MYEFO forecast, but real GDP growth in 2024-25 has been cut from 2.3% previously to 2.0%. It recovers modestly to 2.3% in 2025-26.

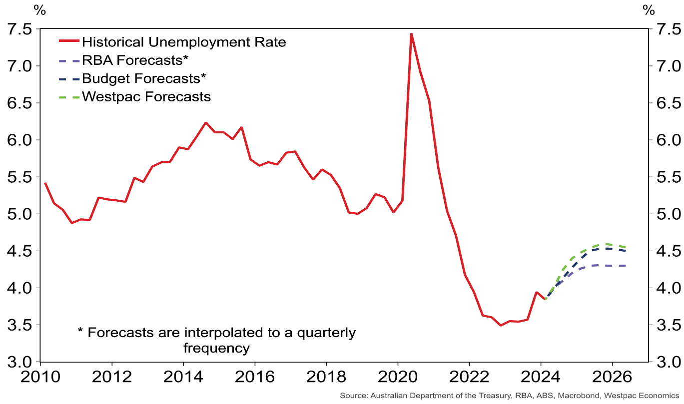
Real GDP Growth
Quarterly, Year-Average



Consumer Price Index
Year Ended % Change



Unemployment Rate
Quarter Ended



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Within the GDP mix, there's an expectation of a sharp turnaround in household consumption from 0.3% growth in 2023-24 to 2.0% in 2024-25. We expect the consumer recovery to follow a slower, more gradual path, growth only lifting to 1.3% in 2024-25. The Government notes this as a key uncertainty for the domestic outlook.

Investment and public demand

Business investment and public final demand have also been upgraded, business investment noticeably so. If realised, the Government's business investment forecasts imply the longest sustained upswing in business investment since the mining boom. We actually see some upside to this profile, with an upturn in business investment expected to become a more prominent driver of growth in 2025-26.

Dwelling investment forecasts were marked down in the near-term reflecting ongoing challenges in boosting housing supply. However, the Government is backing the impact of its housing policies, forecasting dwelling investment to surge 6.5% in 2025-26 compared to a flat reading in 2024-25.

Nominal GDP growth has been revised up by 0.5 percentage points in 2023-24 and again in 2024-25, leaving nominal growth at 4.75% and 2.75%, respectively. And the declines in the terms of trade over 2023-24 to 2025-26 are smaller than previously anticipated.

Labour market and population

The Budget forecasts mark to market the near-term strength of the labour market reducing the June 2024 unemployment rate forecast to 4.0%. However, the expected terminal unemployment rate was left unchanged at 4.5% in both 2024-25 and 2025-26, despite a slight downgrade to economic growth.

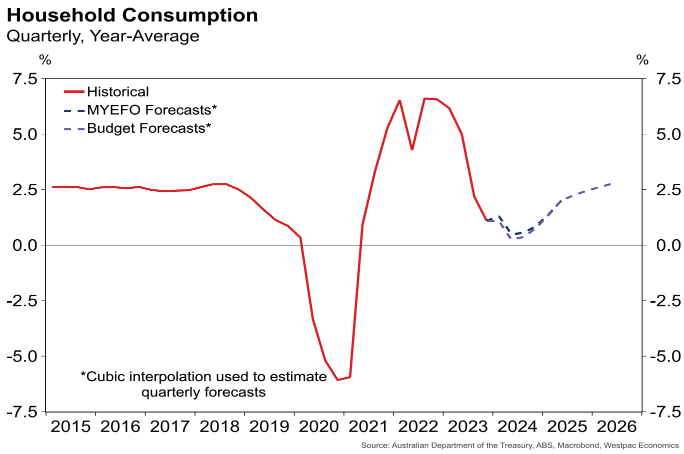
The resilience of the labour market is perhaps justified by the ambitious projected slowdown in NOM, which will reduce the labour supply pulse. Budget forecasts have NOM drying up to 395k in 2023-24. The latest population statistics have NOM running at 548k over the year to the September quarter of 2023. In 2024-25 and 2025-26 NOM is expected to slow to 260k and 255k, respectively.

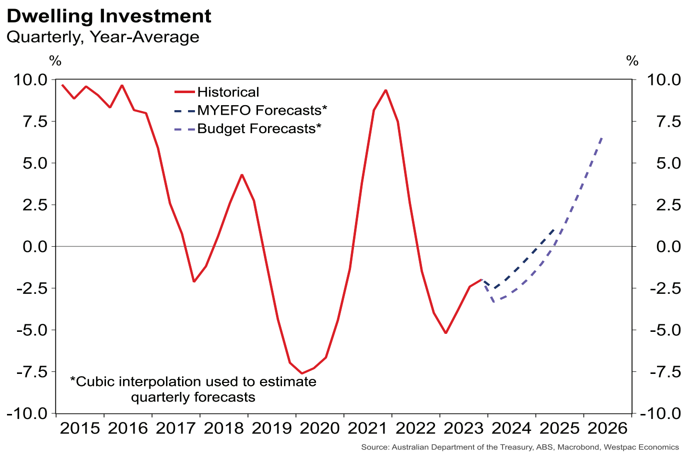
Risks

Pulling this all together, the budget's economic forecasts are not all that different to Westpac's. We are slightly more pessimistic on growth near term and around the pace of the consumer and housing recoveries, but more positive on growth in 2025-26 with these and an upturn in business investment expected to provide more momentum.

The budget's domestic forecasts are also more positive than Westpac's around consumer spending and dwelling investment, but this is balanced by a flatter profile for business investment and public demand. For 2025-26, we are stronger on business investment.

Price effects largely wash out for the nominal GDP growth profile with a slightly milder terms of trade decline narrowing the gap slightly between Westpac's forecasts and the budget's, both in at around 2.75%. The dominant risk continues to be the trajectory for inflation, the demand support from fiscal measures potentially slowing the pace of disinflation and delaying the point at which monetary easing comes into frame.





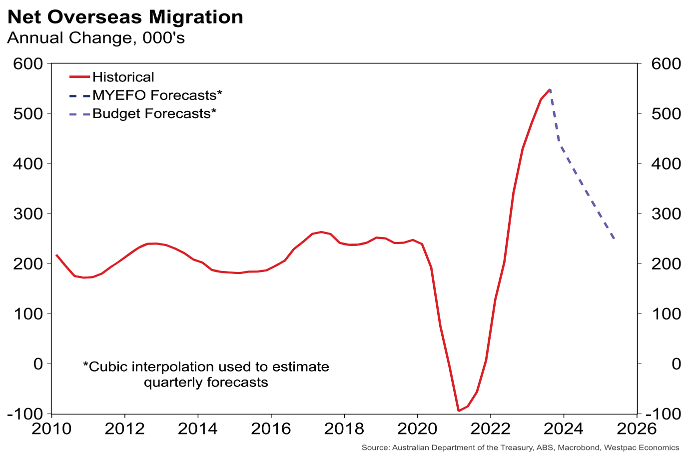


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Table 3: Budget Economic Forecasts

	2022–23	2023–24			2024–25			2025–26*
	Actual	Budget	MYEFO	Chg.	Budget	MYEFO	Chg.	Budget
Household consumption	5.0	0.25	0.5	-0.25	2.0	2.0	0.0	2.75
Dwelling investment	-3.8	-3.0	-2.0	-1.0	0.0	1.0	-1.0	6.5
Business investment*	8.3	5.5	2.5	3.0	1.0	-0.5	1.5	2.0
Private final demand*	4.2	1.0	0.75	0.25	1.75	1.5	0.25	3.0
Public final demand*	2.4	4.5	2.5	2.0	1.5	0.75	0.75	1.5
Inventories, contribution ppts	-0.1	-0.5	-0.5	0.0	0.25	0.25	0.0	0.0
GNE	3.5	1.25	0.75	0.5	1.75	1.5	0.25	2.5
Net exports, contribution ppts	-0.1	0.75	1.0	-0.25	0.5	0.75	-0.25	-0.25
Exports	6.7	5.0	7.5	-2.5	5.0	5.0	0.0	2.5
Imports	9.3	2.5	4.5	-2.0	4.0	3.0	1.0	4.5
Real GDP	3.1	1.75	1.75	0.0	2.0	2.25	-0.25	2.25
Nominal GDP	9.9	4.75	4.25	0.5	2.75	2.25	0.5	4.0
GDP Deflator	6.5	3.0	2.5	0.5	0.5	0.0	0.5	1.75
Terms of trade	-0.5	-3.75	-6.25	2.5	-7.75	-9.75	2.0	-4.0
Employment (Jun qtr)	3.5	2.25	1.5	0.75	0.75	1.0	-0.25	1.25
Unemployment rate (Jun qtr)	3.6	4.0	4.25	-0.25	4.5	4.5	0.0	4.5
Participation rate (Jun qtr)	66.60	66.50	66.75	-0.25	66.50	66.25	0.25	66.25
CPI (Jun qtr)	6.0	3.5	3.75	-0.25	2.75	2.75	0.0	2.75
Wage price index (Jun qtr)	3.7	4.0	4.0	0.0	3.25	3.25	0.0	3.25
Current account, % of GDP	1.1	1.25	0.5	0.75	-0.75	-2.0	1.25	-2.0
Net overseas migration, '000	528	395	375	20	260	250	10	255

* business investment and government spending excluding the effect of private sector purchases of public sector assets.
^2025/26 economic forecasts not provided in the 2023/24 MYEFO

Table 4: Westpac's Economic Forecasts

	2023–24	2024–25	2025–26		2023–24	2024–25	2025–26
Private Consumption	0.1	1.3	2.6	**Nominal GDP**	4.0	2.6	4.5
Dwelling Investment	-3.4	-3.1	4.8	**GDP Deflator**	2.4	0.9	1.8
Business Investment	5.5	1.7	5.3	**Terms of Trade**	-5.6	-6.9	-3.1
Private Final Demand*	0.9	1.3	3.4				
Public Final Demand	4.3	2.1	2.4	**Employment**	2.3	1.0	1.9
Inventories (ppts cont'n)	-0.6	0.3	0.1	**Unemployment Rate**	4.0	4.5	4.6
GNE	1.2	1.9	3.2	**Participation Rate**	66.6	66.2	66.4
Net Exports (ppts cont'n)	0.6	0.0	-0.4				
Exports	4.4	3.6	4.1	**CPI**	3.7	2.9	2.7
Imports	2.6	4.8	7.0	**WPI**	4.2	3.2	–
Real GDP	1.5	1.7	2.7	**Current Account (% GDP)**	**1.1**	**-0.7**	**–**

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

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