BULLETIN

21 June 2024

States adding substantively to fiscal impulse and to near term uncertainty

Budget season has largely come and gone. The Federal government and most state governments (with the notable exception of Tasmania) have released their 2024-25 budgets. While the makeup of budgets differed, there were a few commons threads. The tight squeeze on household budgets from elevated inflation, bracket creep and higher interest rates has seen governments provide additional temporary, and in some instances permanent, cost-of-living support. This has been spearheaded by the Federal government's $300 electricity rebate for every household, which will be topped up by additional electricity rebates in certain states, including Queensland and Western Australia. Some state governments are also providing support through more innovative mechanisms, such as vouchers for student expenses and sporting enrolments, cheaper public transport, and the freezing of indexation of fees, including for car registrations.

Governments are also responding to the pressures emanating from a rapidly growing population by investing more in transport, health and housing infrastructure, as well as providing additional recurrent funding for health, education and other front-line services. And budget aggregates are increasingly being updated to reflect higher delivery costs (labour and non-labour), which usually take time to flow through budget estimates.

Compared to the mid-year updates released late last year, recurrent expenses across state budgets have increased by around $54.3bn over the four years to 2026-27 (or around 1.6% of GDP). When Federal government expenses are included, total expenses have increased by $100.2bn (2.5% of GDP) over the same period. Capital spending (which sits outside recurrent operating expenses but still makes its way to the broader economy) is also expected to increase by $20.5bn in net terms over the next four years ($13.3bn driven by states). In some states, capital projects were pushed back and even scrapped, but this has been more than offset by new projects and increased funding for projects already on the books.

To be sure, higher than expected nominal income on the back of elevated commodity prices and strong growth in payrolls, as well as improved stamp duty revenues driven by the resurgence in house prices, have delivered a combined revenue windfall of around $38.5bn (1.0% of GDP) across state budgets over the four years to 2026-27 and $68.5bn (1.5% of GDP) when the Federal budget is included. While much of the windfall has been underpinned by the factors listed above, some of the increase was supported by new tax measures announced by some states, including NSW, Queensland and Victoria.

We have clearly reached the part of the cycle where revenue upgrades have become insufficient to fully cover spending pressures. And we knew this was coming. The strong growth in nominal income due to elevated commodity prices, elevated inflation and the record bounce-back in the population growth shows up in government revenue first, particularly in contemporaneous taxes such as personal income tax and GST.

The impact on the payments side lags. Governments have to explicitly decide to deliver more infrastructure and public services, and higher delivery costs take time to be updated (in some instances, for example capital work projects, they need to negotiated, agreed and then updated). Migrants only gain access to subsidised public services and social assistance after having been in Australia for an extended period, but pay income tax from their very first day of employment. These lagged impacts are likely to continue to affect fiscal positions over the next little while.

Given this, focusing on changes from update to update only gives a partial picture of aggregate fiscal settings. The same can be said for just looking at just one level of government. We know that the Federal government has benefited the most from elevated commodity prices and the incredible growth in hours worked and population increases over 2022 and 2023. However, states are responsible for delivering infrastructure, public health services and public schooling where demands have increased due to the growing population. Given these interactions, looking at the national fiscal position is more informative.

National fiscal impulse

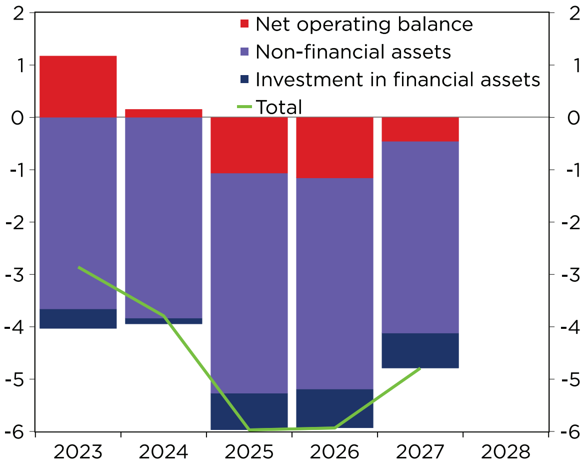
The national fiscal impulse looks at how the change in net government spending is contributing to growth in demand and wider economic activity.

Net government spending includes recurrent spending (on public services such as medical care, hospitals and schools) and capital spending (both on budget and off budget through financial assets) net of revenue (such as personal income tax, land tax and stamp duties). The change in net government spending will either contribute to, or detract from, growth in aggregate demand and, therefore, economic activity.

Firstly, we find that the national fiscal impulse (across Federal and state governments) is expected to contribute to growth in aggregate demand in 2024-25, by around 2.2 percentage points (ppts) of GDP. This is driven by higher spending on the public services required to cater for the larger population, as well as investment in infrastructure. This is larger than the growing fiscal impulse recorded in 2009-10 during the Global Financial Crisis (GFC), when the national net operating deficit deteriorated from 1.9% of GDP to 3.3% of GDP.

National fiscal position

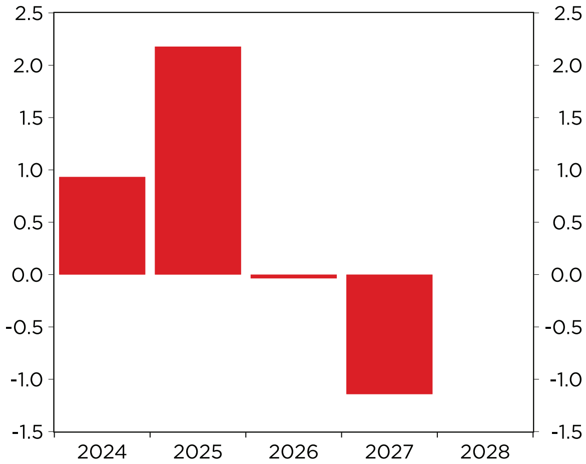
% of nominal GDP



Source: ABS, Federal and States budget papers, Macrobond, Westpac Economics. General government operating balance and non-financial public sector investment. Financial years.

National fiscal impulse

% of nominal GDP



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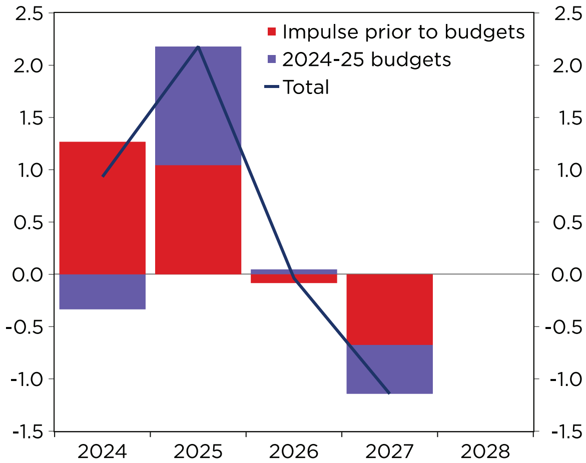
The national fiscal impulse in 2024-25 is around 1.2 ppts of GDP larger than prior to the recent 2024-25 budgets. The 2023-24 impulse is a little smaller, given higher than expected commodity prices and, therefore, company tax receipts, and delays in capital works which flow into 2024-25.

Another way to think about this is prior to the 2024-25 budgets, the cumulative national fiscal impulse was expected to contribute around 2.2 ppts of GDP to growth in demand over 2023-24 and 2024-25. Post the 2024-25 budgets, the impulse is now expected to be around 3.1 ppts over these two years.

National fiscal impulse

% of nominal GDP

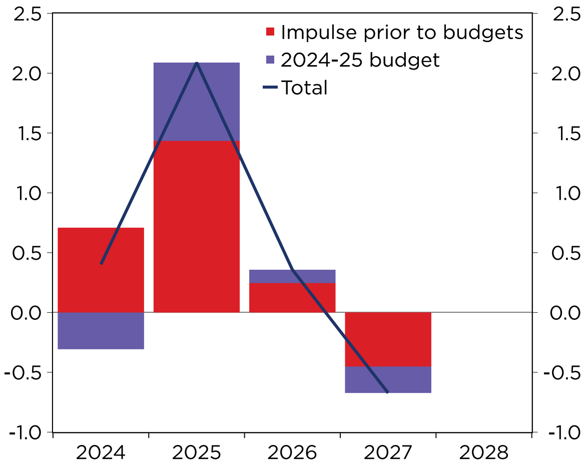


Source: ABS, Federal and States budget papers, Macrobond, Westpac Economics. General government operating balance and non-financial public sector investment. Financial years.

When it comes to the drivers of the change in 2024-25, the larger impulse in 2024-25 has been driven roughly equally by Federal and state governments.

Federal fiscal impulse

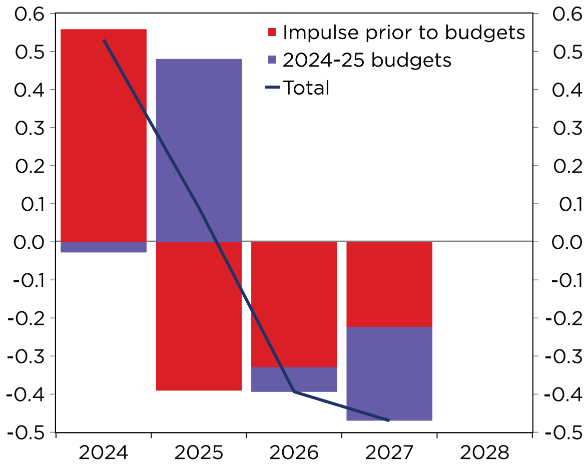
% of nominal GDP



Source: ABS, Federal and States budget papers, Macrobond, Westpac Economics. General government operating balance and non-financial public sector investment. Financial years.

State fiscal impulse

% of nominal GDP



Source: ABS, Federal and States budget papers, Macrobond, Westpac Economics. General government operating balance and non-financial public sector investment. Financial years.

While the impulse looks at the change in net government spending and, therefore, the contribution to growth in aggregate demand, it is also noticeable that the size (or level) of government has increased. For example, in 2024-25 expenses are expected to be around 1.0 ppts of GDP larger than before the recent 2024-25 budgets.

Are settings appropriate?

The question is not whether fiscal settings are less restrictive and more accommodative, they unambiguously are more accommodative. The question is whether the impulse is appropriate given where we are in the economic cycle.

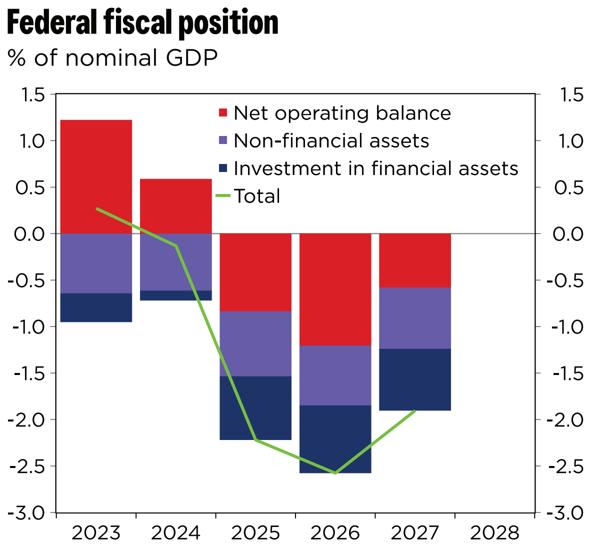
We know that there are significant headwinds hitting the economy. Household budgets are being squeezed and the global economy is clearly slowing. This has seen economic growth in Australia slow to a virtual standstill.

The picture going forward is set to become even more mixed. Some of these headwinds are moderating (inflation is moderating and interest rates have stabilised). But some of the tailwinds we have seen over the last two years will also be easing, most notably the surge in population and employment growth.

The growing fiscal impulse will be an additional support. But it adds to inflation risks, particularly in areas where there are existing capacity constraints, such as the construction sector. If the concerns around persistent price pressures continue, this may add to the risk that interest rate relief is delayed.

Pat Bustamante, Senior Economist

Appendix: breakdown by level of government



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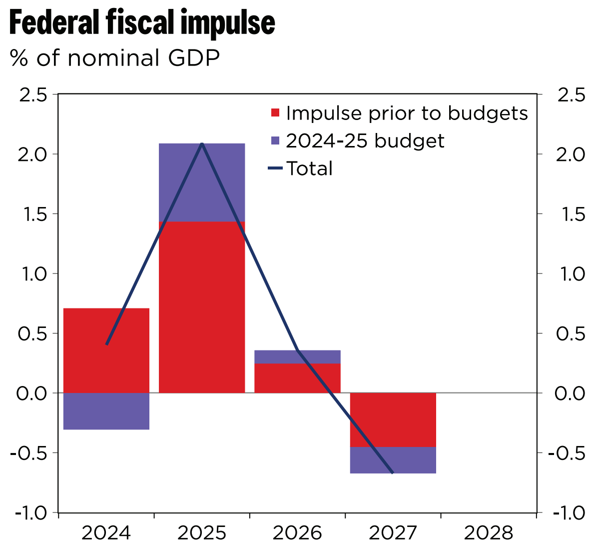

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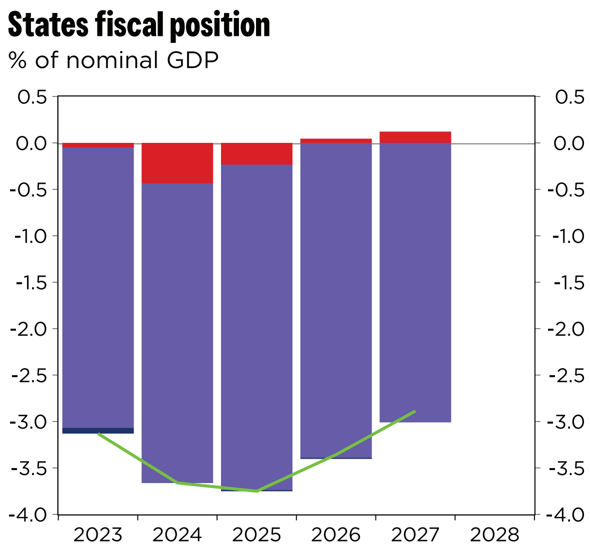

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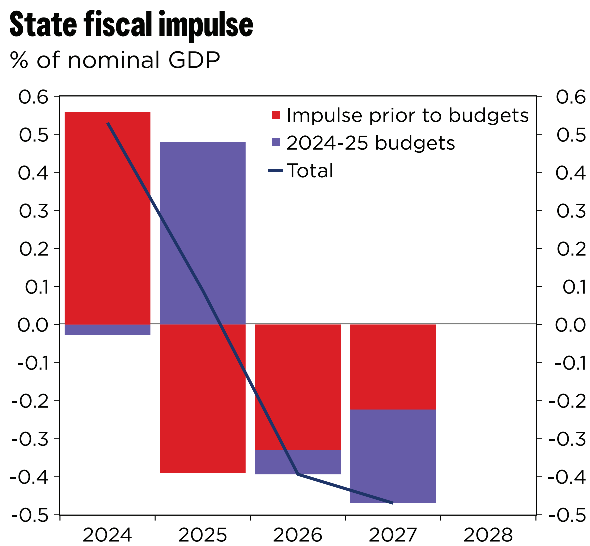

Source: ABS, Federal and States budget papers, Macrobond, Westpac Economics. General government operating balance and non-financial public sector investment. Financial years.

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