18 December 2024

AUSTRALIAN MYEFO UPDATE BULLETIN

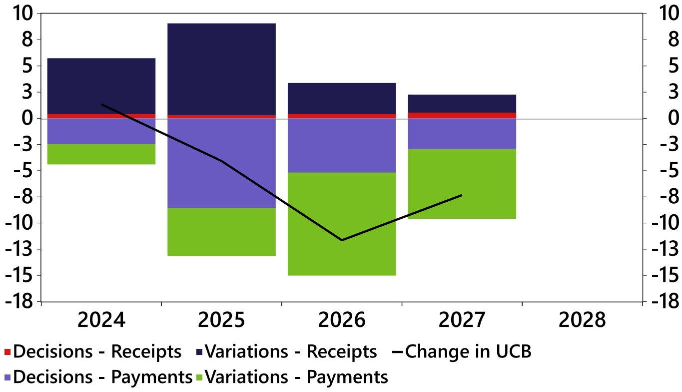
Deficits are forecast to worsen across the estimates by a cumulative $21.7bn. Public borrowing to reach 6½% of GDP by 2025-26.

Key points

- Compared with the May budget, the underlying cash deficits are forecast to worsen across the forward estimates by a cumulative $21.7bn. Both policy changes ($17.5bn) and estimates variations ($4.2bn) underpin the deterioration. Off budget spending is also forecast to increase by a cumulative $12bn across the forward estimates.
- We estimate that elevated commodity prices have delivered an unprecedented revenue windfall of $120.9bn over the three years to 2024-25. As these temporary windfalls fade, the 2025-26 deficit is expected to be $4.0bn worse than forecast coming out of pandemic in the 2022 PEFO, revealing the extent on the increased structural spends.

Revision to UCB since the 2024-25 Budget

By variation type, $billion



Source: Budget documents, Macrobond, Westpac Economics

- The national fiscal impulse is expected to remain unchanged at around 2¾ppts of GDP in 2024-25 but increase to around ½ppt of GDP in 2025-26 (up from ¼ppt before the 2024-25 MYEFO). Total public borrowing will increase to around 6½% of GDP in 2025-26, in line with the emergency level borrowings recorded during the GFC.

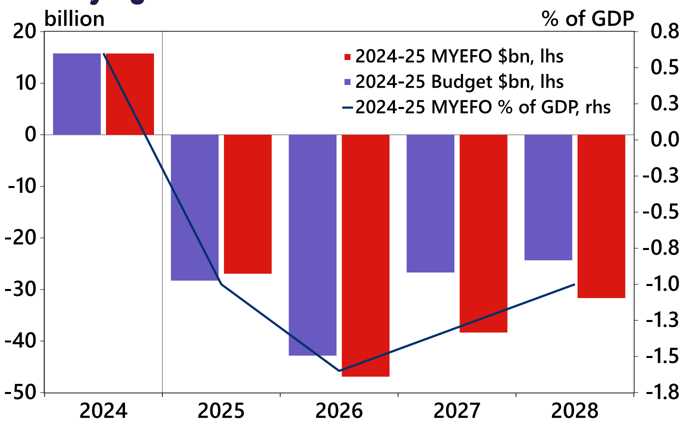
Surpluses left in the rear-view mirror

Pat Bustamante
Senior Economist, Westpac Group

The underlying cash balance is expected to fall deeper into the red as temporary revenue windfalls fade and the fiscal automatic stabilisers kick in, revealing the extent of the increased structural spending.

As we expected (preview available here), there was a slight improvement in the 2024-25 budget position, with the underlying cash deficit getting larger in the outer years of the forward estimates period. The underlying cash balance is forecast to move from a surplus of $15.8bn in 2023-24 to a deficit of $26.9bn in 2024-25 and $46.9bn in 2025-26, remaining in the red across the forward estimates period.

Underlying Cash Balance

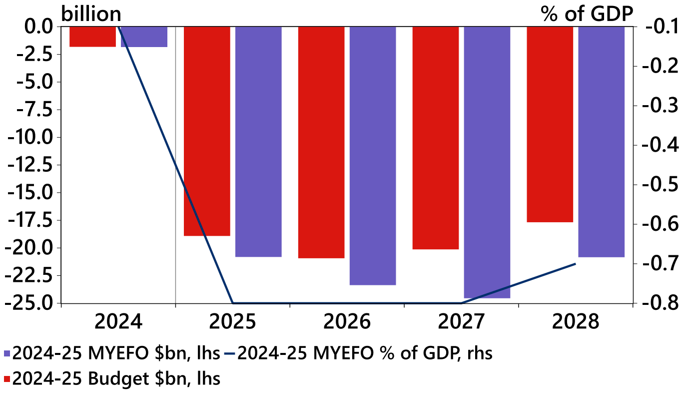


Source: Australian Department of the Treasury, Macrobond, Westpac Economics

The Federal government is also forecasting a substantial lift in off budget spending, moving from $1.9bn in 2023-24 to $20.8bn in 2024-25, increasing to $24.5bn in 2026-27.

Off budget spending

Net cash flows from investment in financial assets for policy



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

The size of the revenue windfalls have been unprecedented but are now fading...

High nominal income growth on the back of elevated commodity prices, strong wages growth and high inflation, along with record population growth have combined to deliver a budget windfall of $252.1bn over the six years to 2027-28, since the October 2022 budget.

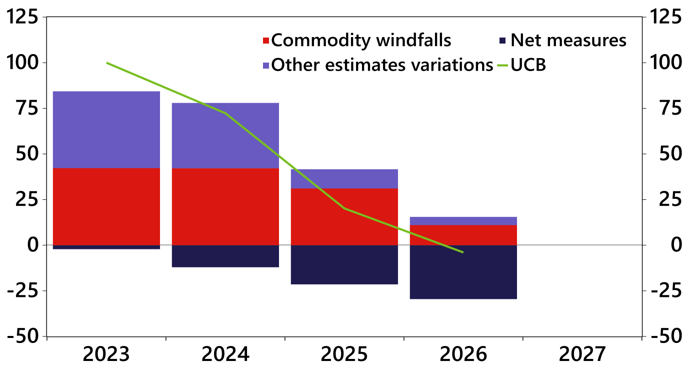
We estimate that elevated commodity prices alone have delivered a windfall of around $120.9bn over the three years to 2024-25, compared with the Treasury estimates in the 2022 Pre-election Economic and Fiscal Outlook (PEFO).

Elevated commodity prices not only increase mining revenue and therefore taxable income, they also have non-linear impacts. Higher prices saw LNG exporters run down their stock of capital losses more quickly than previously expected, moving into a significant taxable position in 2022-23 for the first time since the mining investment boom, further boosting government revenues.

As commodity prices ease, wages growth moderates and the economy only gradually recovers, these temporary windfalls will become a thing of the past. At the same time, the gradual easing in labour market conditions will likely see unemployment benefits and other social assistance payments increase, further weighing on the bottom line.

In fact, for the first time since the pandemic, estimates variations (or changes to the bottom line driven by the economy) in the 2024-25 MYEFO are expected to worsen the bottom line across the forward estimates by a cumulative $4.2bn.

Revisions to UCB since 2022 PEFO



Source: Budget documents, Macrobond, Westpac Economics
*Total may not add due to surprises in the Final Budget Outcomes.

Revealing the extent of the increased structural spends.

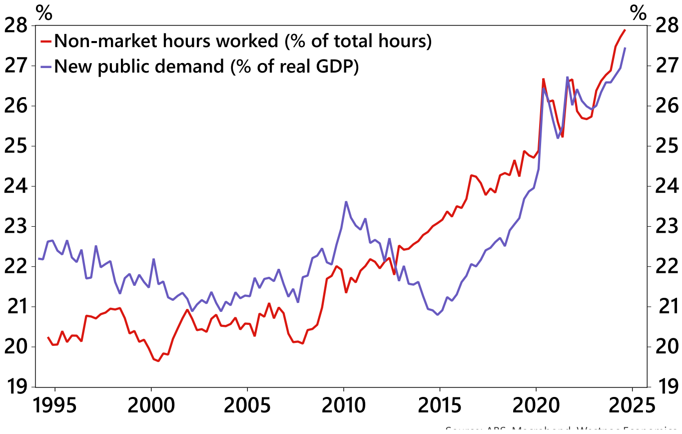
Since the October 2022 policy changes have increased spending by $123.6bn over the six years to 2027-28, with increased discretionary spending amounting to an additional $40.6bn in 2025-26 alone. This includes additional spending on cost-of-living measures, health care, infrastructure projects, and grants to states and local governments under national partnership agreements.

This increased spending has been partly offset by policy changes that are expected to increase revenue by $46.1bn (including by providing the ATO with additional resources to increase tax revenue) and the estimates variations mentioned above.

Despite these revenue windfalls, the 2025-26 deficit is expected to be $4.0bn worse than forecast coming out of pandemic in the 2022 PEFO, revealing the extent on the increased structural spends.

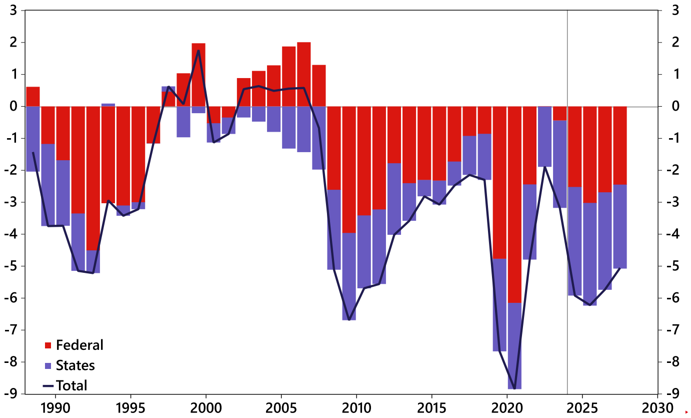
While this spending has so-far been masked by these temporary estimate variations, new public demand in the National Accounts directly capture the higher structural spending. This has resulted in new public demand (including Federal and state spending) increasing from an average of around 22.5% of real GDP in the decade before the pandemic, to a record high of 27.5% of GDP in the September quarter 2024. This has also seen the non-market (healthcare, education and public administration/safety) share of total hours worked across the economy increase to a record high of around 28%. The national fiscal impulse is expected to remain unchanged at around 2¾ppts of nominal GDP in 2024-25 but increase to around ½ppt of GDP in 2025-26 (up from ¼ppt before MYEFO). Total public borrowing will increase to around 6½% of GDP in 2025-26, in line with the emergency levels recorded during the GFC. As a result, gross and net debt as a share of the economy have deteriorated compared with the May Budget.

The expansion in public demand



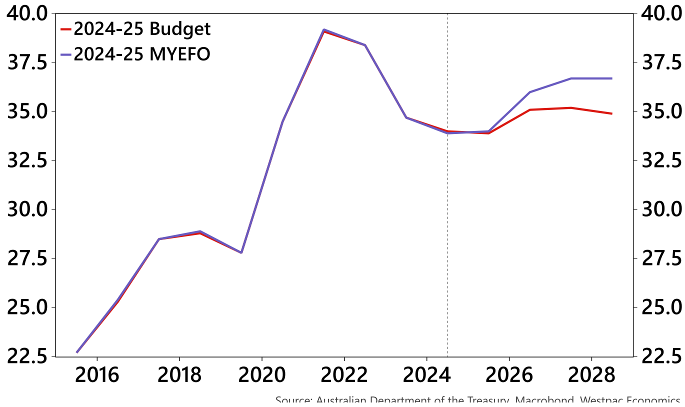
Net government borrowing

By level of government, % of nominal GDP



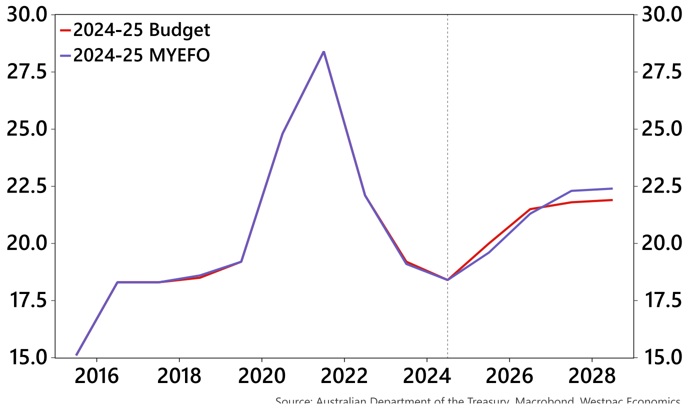
Gross Debt

% Share of GDP



Net Debt

% Share of GDP



Downside risks remain

Notwithstanding the deterioration in today's mid-year update, there are further downside risks given the lags in updating fiscal estimates to reflect current conditions. This is consistent with Treasury's analysis in budget documents which shows that forecasting errors tend to be positively correlated (see here). This means that upside surprises tend to be followed by further upside surprises (i.e. during the terms of trade boom) and vice versa (i.e. during the post GFC period).

What happens over the medium term?

Bracket creep and a further increased reliance on personal income tax will help reduce the structural deficit over the medium term, with the tax to GDP ratio likely increasing beyond 23.9%. As noted in the MYEFO, total receipts as a share of GDP have been revised higher a and are expected to reach 26.8% of GDP by 2034–35.

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