May 2024

May '24 Federal Budget Summary

The Federal Budget this year faced a challenging 'narrow path' of trying to deliver cost of living relief but not adding to inflationary pressures, while also attempting to address the medium-term issues that will still be with us when inflation is back on track. These include:

- Housing affordability
- Lifting productivity in our economy (to achieve sustainable real wages growth)
- The complex global landscape, including security, trade, technology and transition to net zero.

The RBA faced a similar narrow path with its tightening cycle in 2022-23 to combat inflation, trying to lift rates at a pace that would protect jobs while keeping the economy growing - but two years into that cycle the narrow path for monetary policy is overgrown. For fiscal policy it's just as challenging a task: the fiscal path is still just visible, but it's not going to get any easier to traverse.

The second consecutive budget surplus was a good outcome, although doesn't ensure that fiscal policy is working in the same direction as monetary policy. It was mainly driven by another revenue uplift from commodity prices and strong labour markets - so is primarily the impact of the economy on the budget bottom line. The 'fiscal impulse' which risks stickier inflation is best measured not by deficit or surplus, but by the net change to government spending ($9.5b) i.e. the impact of policy changes on aggregate demand. This matters for businesses, as demand will be helped in the short term by the tax cuts; although they won't help with RBA rate cuts, which continue to look further down the path (in 2025). Still it was pleasing (and sensible) that the revenue windfall wasn't spent in areas that would add to inflationary risks.

	Actual		Estimates			
	2022–23 $b	2023–24 $b	2024–25 $b	2025–26 $b	2026–27 $b	2027–28 $b
Underlying cash balance	**22.1**	**9.3**	**-28.3**	**-42.8**	**-26.7**	**-24.3**
Per cent of GDP	0.9	0.3	-1.0	-1.5	-0.9	-0.8
Gross debt (c)	**889.8**	**904.0**	**934.0**	**1,007.0**	**1,064.0**	**1,112.0**
Per cent of GDP	34.7	33.7	33.9	35.1	35.2	34.9
Net debt (d)	**491.0**	**499.9**	**552.5**	**615.5**	**660.0**	**697.5**
Per cent of GDP	19.2	18.6	20.0	21.5	21.8	21.9

Source: Budget Overview

The stage three tax cuts are worth $20b to workers in FY25 which has been estimated as the equivalent of 2 rate cuts (depending how much will be spent vs saved), and they will help to offset the impact of bracket creep. Much more needs to be done to ensure the taxation system is fit for purpose as the economy rapidly evolves - there is a large reliance on personal tax currently to fund growing (necessary) commitments for NDIS, security and housing supply. The tax cuts will help with cost of living and will add to demand (along with various State Budget subsidies), so real household disposable income is forecast to rebound after the tax cuts and as inflation recedes.

Beyond these more immediate implications for household spending, businesses were impacted via:

· The Energy Bill Relief Fund (a $325 rebate to eligible small businesses)

· Instant asset write-off extended to assets up to $20k (for small businesses with turnover < $10m)

· The abolition of 457 'nuisance tariffs' aimed to simplify trade and cut compliance costs

· $288m over 4 years to deliver and expand the Digital ID system

· All up a range of targeted investments and incentives totalling $641m for small businesses.

Housing shortages are a headwind for inflation and risk productivity growth ahead, so the $6.2b 'Homes For Australia' package is a welcome commitment, adding to the Housing Australia Future Fund scheme. Beyond this the subsidies for construction apprentices and fee-free TAFE places will help in the medium term. Workforce shortages in the building and construction industry however remain a current issue.

The $22.7b 'Future Made In Australia' policy aims to help with productivity in the medium term while also addressing climate change by investing in 'an orderly path to net-zero emissions'. This has parallels with the US Inflation Reduction Act, but as noted by the Productivity Commission does risk drawing investment away from more productive areas and competing in crowded global markets. In parallel however, the Future Gas Strategy appears to provide a sensible balance in the green energy transition and will help to keep energy prices down as we transition, while also supporting necessary steel and fertiliser production.

Deglobalisation and technology adoption are two other global factors that will shape the decade ahead, and the $1b funding in the development of 'the world's first fault tolerant quantum computer' via PsiQuantum is an interesting investment in this context. Artificial Intelligence appeared to be supported in much more modest amounts with a $40m AI funding package, primarily to the National AI Centre.

Like previous years the assumptions in the budget greatly underestimate the likely outcomes for bulk commodity prices, but this has been the case for over a decade now: iron ore is (again) budgeted to fall back to US$60/tn! Beyond this, economic forecasts in the budget were more optimistic for FY25 than ours, but similar in the later years - and the details of the budget haven't necessitated any changes to our forecasts below, nor to our expectation that RBA official rates won't change this calendar year.

Budget v BEN	(end of) FY24	FY25	FY26	FY27
GDP growth %	1.75 0.8	2.0 1.9	2.25 2.6	2.5 2.7
Unemployment %	4.0 4.2	4.5 4.9	4.5 5.5	4.5 5.0
CPI (headline) %	3.0 3.1	2.75 3.0	2.75 2.8	2.75 2,7

Source: Budget Overview

In summary, the budget's focus on cost of living via the stage three tax cuts and energy bill rebates will add to household demand, helping businesses who have been struggling from falling household discretionary spending. However, this short-term tailwind may be offset by RBA rate cuts being further down the track, and the lack of genuine structural reform (e.g. tax, super) risks Australia continuing to lag on productivity. This and other offshore factors (e.g. deglobalisation) will make surpluses challenging to achieve in the future, and a higher overall profile for core inflation. Despite this ever-narrowing path, the budget forecasts do match the RBA with respect to real household income picking up next year, and the focus on energy rebates goes some way to explaining the lower Treasury forecast for CPI.

Our AAA sovereign credit rating is safely intact, but serious reform will be needed to drive sustainable real wages growth and to grow the economy to fund necessary spending in the decade ahead.

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