Mid-Year Economic and Fiscal Outlook

2023-24

13 December 2023

Fiscal discipline welcome, but more frugality needed

Despite Australia's economy slowing, the Commonwealth's revenue projections have been revised up by a whopping $64 billion over four years, as strong jobs and population growth, unindexed personal income tax brackets and strong company tax collections (especially from ongoing high commodity prices) push up taxes.

As in the past two Budgets, the Government has chosen to use most of the projected improvement to lower its forecasts for the upcoming underlying cash deficits and the debt profile.

The Government also extended some infrastructure project funding over a longer period – though it has put more money into others in the near-term to meet inflated construction costs. The overall impact on total infrastructure spending over the next four years was minimal.

The improved bottom line is substantial. Just two years ago, when the 2021-22 mid-year budget was published and COVID-19 measures were still needed, it was inconceivable that the $85 billion deficit projection for the current financial year would effectively 'disappear' – especially given the economic forecasts were much stronger then.

But as the budget has improved, inflation has worsened – and this is the ongoing battle the Government is fighting, along with the Reserve Bank of Australia.

In this fight, more could have been done by being tougher in cutting measures that would have improved the bottom line beyond those offered up by the higher windfalls. This is politically difficult, but, as we argued when the 2022-23 and 2023-24 Budgets were released, they would have made the Reserve Bank's job easier – and spared mortgaged households some pain.

State governments are proving to be prolific spenders. As the Commonwealth was releasing its Budget update, so too was the Queensland Government. Its infrastructure profile was increased by a substantial $7 billion over four years. Not helpful in the fight against inflation. Commonwealth and state spending is equally as potent in bidding up prices in the economy.

With the economy expected to grow by only 1.75 per cent in 2023-24, the Government's window to pull back spending and assist the Reserve Bank is limited. Delays in tough spending decisions mean they could land at the wrong time.

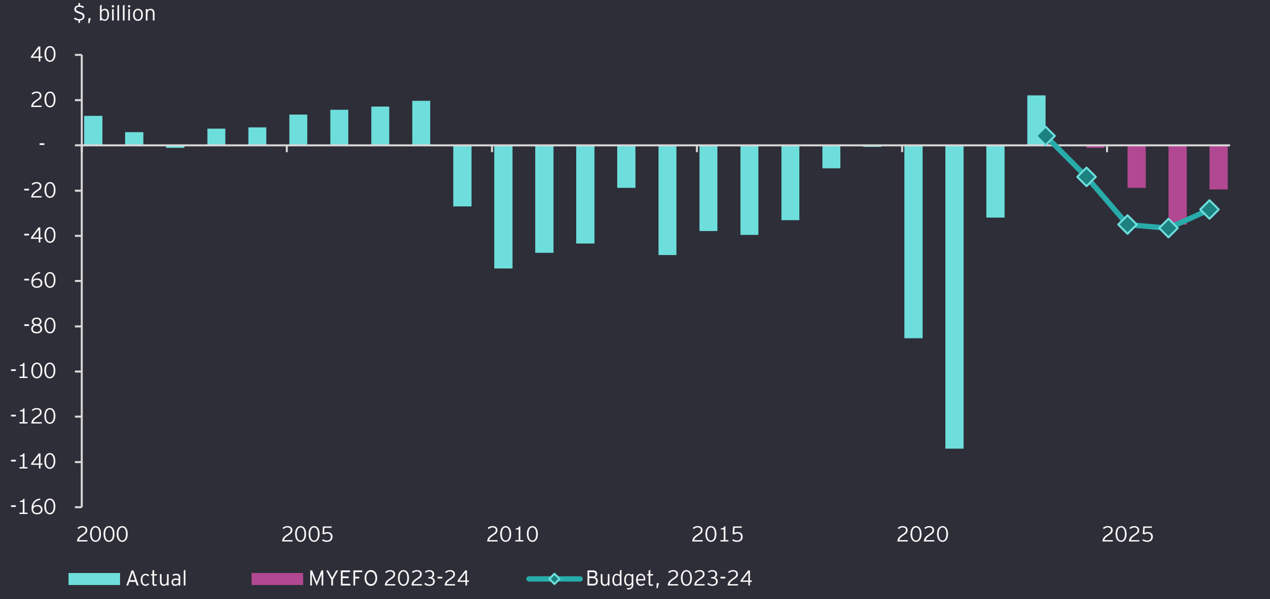
So, we give the Government some credit for being more inflation aware in this Budget update – but we encourage it to go further in May, especially with Stage 3 tax cuts planned for July 1.

Cherelle Murphy | EY Oceania Chief Economist
13 December 2023

A further improvement in the fiscal position

The underlying cash deficit is expected to be $1.1 billion in 2023-24, compared to an estimated $13.9 billion deficit at the time of the 2023-24 Budget. The deficit is forecast to deteriorate in 2024-25 and 2025-26 before improving again slightly to $19.5 billion by 2026-27. The deficit projections represent a cumulative improvement of $39.5 billion over four years, compared to the forecasts in the 2023-24 Budget.

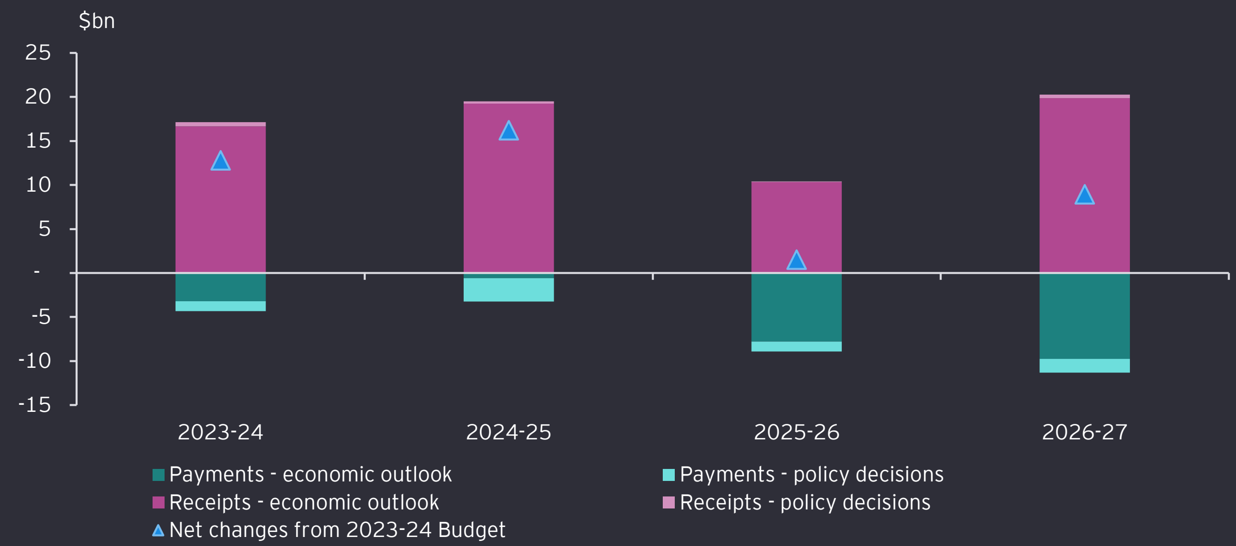
Underlying cash balance



Source: Budget data, EY, ABS

The substantial improvement in the forecasts for the underlying cash balance follows from a significant upward revision to receipts, only slightly offset by an upward revision to payments. The surge in tax receipts forecasts is due to a stronger-than-anticipated labour market, and higher than anticipated commodity prices. Payment forecasts are higher because of both new policies introduced since the 2023-24 Budget, and economic changes which require higher government spending.

Impact of receipts and payments on the underlying cash balance; changes from 2023-24 Budget



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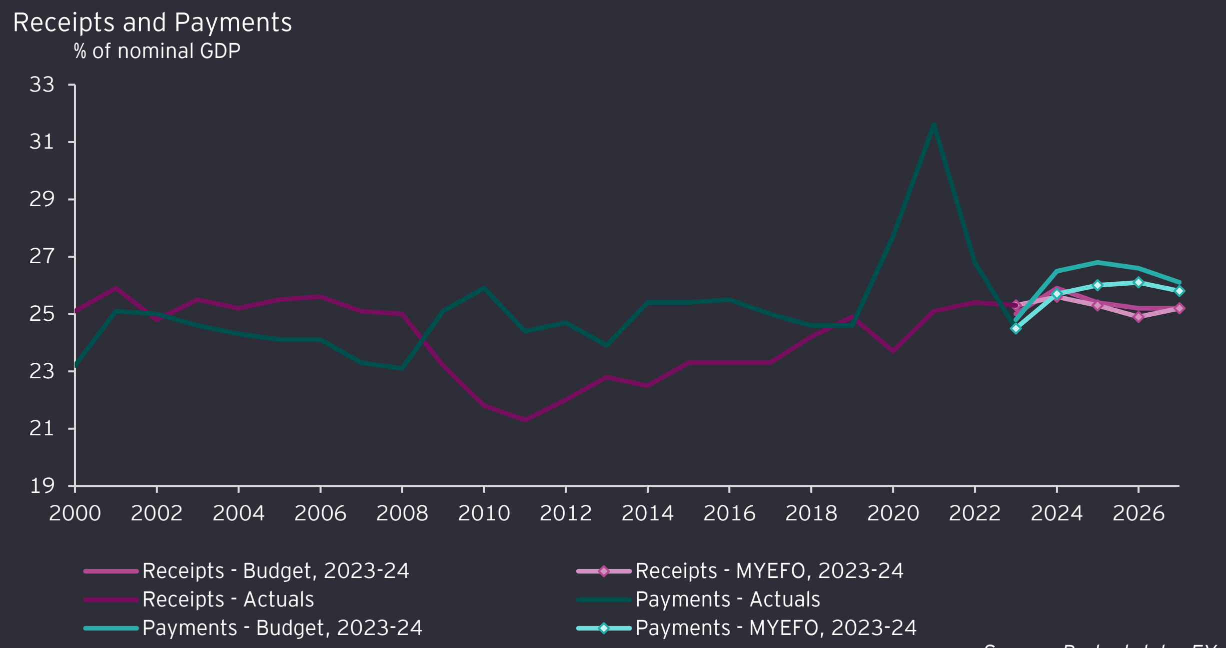
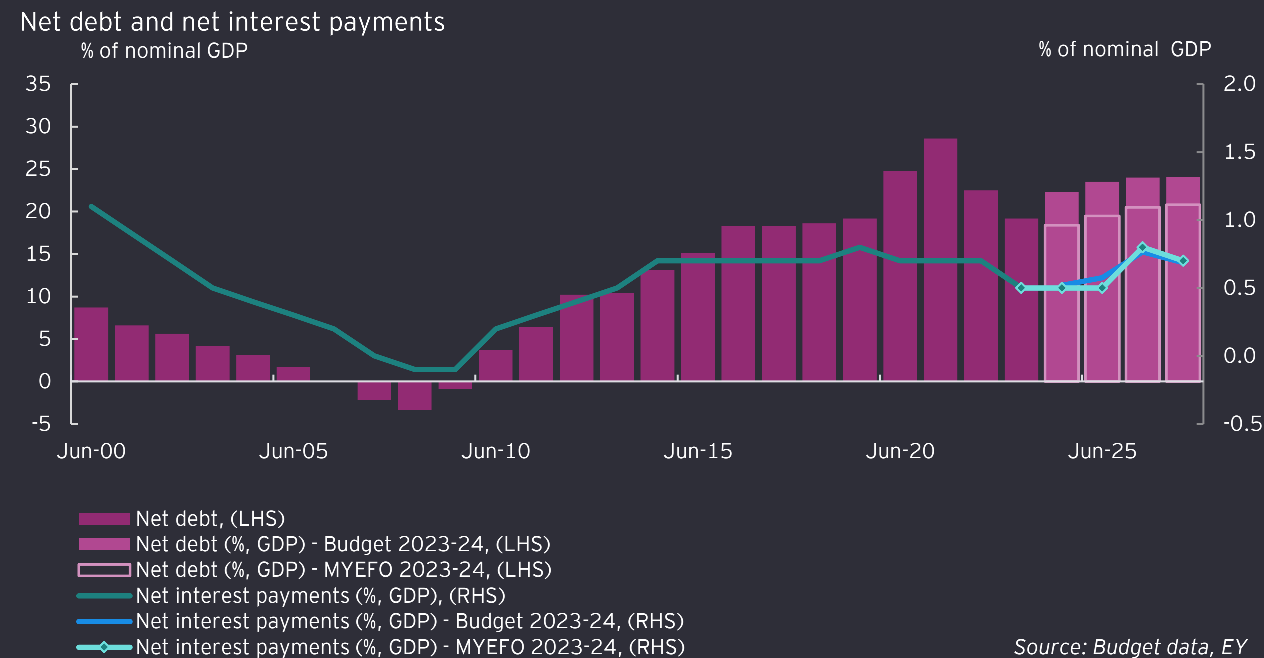


Source: Budget data, EY

The improvement in the underlying cash balance flows through to the outlook for net debt. This is expected to be lower in 2023-24 at $491.1 billion than the $574.9 billion expected in the 2023-24 Budget. Net debt is forecast to be over $320 billion lower over the forward estimates compared to the 2023-24 Budget.

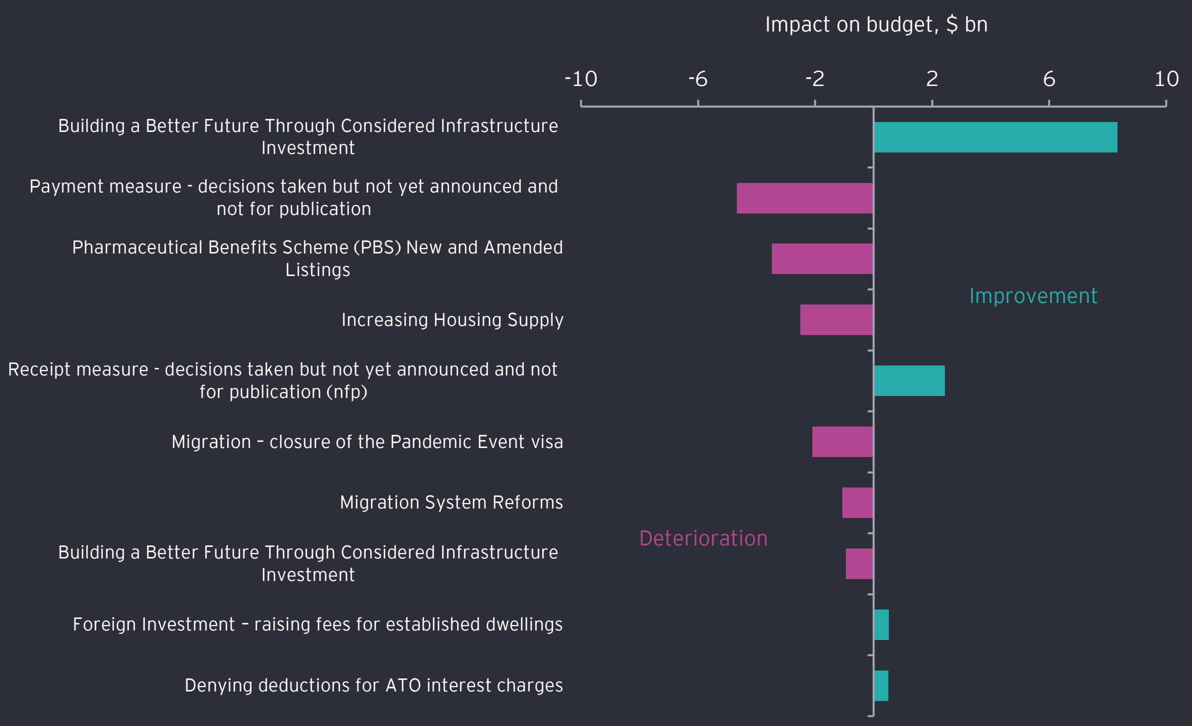
However, because interest rates are higher than at the Budget in May, it will be more expensive for the government to service that debt compared to the Budget forecasts. The 10-year Commonwealth Government bond yield, for example, rose from an average of 3.6 per cent in May this year to around 4.4 per cent in November. Interest repayments are expected to grow by an average 11.7 per cent over the projection period compared to 8.8 per cent at the Budget. It means MYEFO forecasts a rise in net interest payments from $12.7 billion in 2023-24 to $21.9 billion in 2026-27.



Source: Budget data, EY

New policies focus on strengthening essential services and unlocking greater housing supply

Top 10 policy decisions from the 2023-24 MYEFO, payment and receipt measures, 2022-23 - 2026-27



Source: Budget data, EY

A modest upgrade to GDP growth and inflation

Growth estimates for 2023-24 were revised higher in MYEFO to 1.75 per cent, compared to 1.5 per cent at Budget. While consumption growth is much weaker, the economy has been supported by population growth and strong business and public investment.

Forecasts for inflation were revised 0.5 percentage points higher in the near term to 3.75 per cent by the June quarter 2024, with higher global oil prices the main driver. Treasury expects inflation to moderate quicker than the Reserve Bank, falling to 2.75 per cent in 2024-25 rather than the end of 2025.

The unemployment rate and wages forecasts have remained unchanged from the 2023-24 Budget. The unemployment rate is projected to increase to 4.25 per cent in the June quarter next year and to 4.5 per cent the following year. Annual wage growth is expected to be at 4.0 per cent in the June quarter next year before moderating to 3.25 per cent in the following year. The expected end point in the unemployment rate is higher compared to the Reserve Bank's forecast of 4.3 per cent in June 2025 and wages growth is expected to moderate quicker compared to the Reserve Bank's forecast of 3.7 per cent in June 2025.

The Budget entails a substantial upward revision in net migration in the short term, which is now expected to be at 375,000 this financial year, rather than 315,000. This follows a slight downward revision in 2024-25 of 10,000, but nevertheless net migration is expected to remain elevated at 250,000 (above the 5-year pre-pandemic average of 234,000).

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