2022 FEDERAL BUDGET

Comment

Clearly there is as much politics in this budget as economics. With the looming election and the promise by the Opposition of a new budget if elected, there is considerable uncertainty over how many of the announced measures will be implemented. We also don't know what else the Government will announce in the lead up to the election (although the Contingency Reserve which widens to $15.4 bn by 2025/26 is pointing to some further announcements).

That said, the focus of spending was largely as expected. Cost of living measures were a centre piece, including halving the petrol excise for 6 months (worth 22c per litre), an extra $420 on the LMITO, and one-off special payment of around $250 for pensioners and welfare recipients.

Planned infrastructure spending was upped by $17.9bn – largely concentrated on roads and rail. A new Regional Investment package of at least $11bn was announced as well as significant new spending on defense – worth $270bn over 10 years. Elsewhere there were incentives for investment in agriculture, medical manufacturing and digital.

Other measures included tax benefits for SMEs to invest in training and technology and an extension and expansion on home loan guarantees for housing.

Our analysis of the Structural Budget impulse using OECD methodology points to very little structural tightening over the forward estimates – with the structural position improving by only 2% of GDP over the next 3 years. This sees the structural deficit still around 5% of GDP by 2024/25. Indeed, the small reduction in the headline Budget was largely brought about by a better economy – we think more could have been done.

In looking at the near-term trends, the fiscal situation is once again driven by the expense side rather than revenue. Indeed, compared to MYEFO there is little change. See Fiscal Stimulus section.

Overall, we have no problem with the focus on maintaining the support for economic growth but we see the scope for more structural/productivity enhancing measures to have been included. Cutting red tape, tax changes and greater support for renewable energy would have been preferred. That said, as noted above, we recognise the political reality underpinning the Budget. This budget also does not change expectations for monetary policy – i.e., the RBA will move soon to moderately increase rates (we expect that process to start by August this year).

Fiscal Outcome

The underlying cash balance for 2022-23 is estimated at $78bn (or around 3.4% of GDP), while around $47bn or 1.9% of GDP by 2023-24. Net debt is now expected to peak at around 33.1% of GDP by 2024-25 much lower and earlier than previously expected. That said, a return to surplus looks many years away.

Economic Outlook

Both we and the Treasury have similar views on the economic outlook. We see growth of around 3.8% in 2022-23 (Treasury has 3.5%). For 2023-24 we have 2.2% and they have 2.5%. Our expectations for consumption and investment are somewhat more modest in the short term than the Treasury's forecasts, but on the other hand we see unemployment lower for the near term at 3.5%.

Further out, Treasury see unemployment falling to 3.75% in 2023-24 - we are at 3.5% - and then they see unemployment rising back up to 4% in 2024. They also forecast less sustained business investment growth. Regardless, we share a positive outlook for the near term, albeit colored by elevated inflation and ongoing virus and geopolitical risks.

Financial Markets

S&P has indicated that with Australia running a current account surplus in recent years, Australia's AAA rating is secured by a return to a budget deficit of around 2.5% of GDP, which this Budget presents.

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The Key Metrics

	Estimates								
	2021-22(e)		2022-23(e)		2023-24(e)		2024-25(e)		2025-26(e)
	MYEFO	Budget	MYEFO	Budget	MYEFO	Budget	MYEFO	Budget	Budget
Underlying cash balance, $bn	-99.2	-79.8	-98.9	-78.0	-84.5	-56.5	-57.5	-47.1	-43.1
% of GDP	-4.5	-3.5	-4.4	-3.4	-3.6	-2.4	-2.3	-1.9	-1.6
Net operating balance	-91.3	-73.2	-86.0	-67.5	-72.6	-48.2	-53.2	-43.6	-31.6
% of GDP	-4.1	-3.2	-3.9	-2.9	-3.1	-2.0	-2.2	-1.8	-1.2
Net capital investment	11.6	11.1	11.4	11.3	10.9	10.6	8.2	7.4	8.2
% of GDP	0.5	0.5	0.5	0.5	0.5	0.4	0.3	0.3	0.3
Fiscal balance, $bn	-102.9	-84.2	-97.3	-78.8	-83.5	-58.8	-61.4	-51.1	-39.8
% of GDP	-4.7	-3.7	-4.4	-3.4	-3.6	-2.5	-2.5	-2.1	-1.5
Net debt, $bn	673.4	631.5	773.1	714.9	855.9	772.1	914.8	823.3	864.7
% of GDP	30.6	27.6	34.7	31.1	36.8	32.6	37.4	33.1	33.1

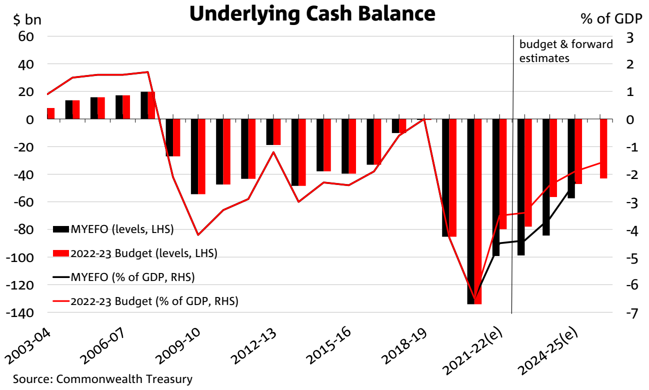
Source: Commonwealth Treasury

The Government's fiscal strategy has shifted from phase one (supporting the economic recovery) to the second phase which aims to stabilise and, ultimately, reduce net debt as a % of GDP. Despite moving to phase 2 of its strategy, as with last year, the Government has taken the improved revenue outlook and used it to fund extra spending and tax reductions, while still banking some of the gains (resulting in a lower net debt profile).

With growth in GDP over time, the phase two debt objective is consistent with sustained cash deficits, meaning the pre-COVID objective of achieving a budget surplus is long gone. Consistent with this, the underlying cash balance is expected to improve over the forward estimates period but remain in deficit (-1.6% of GDP in 2025-26). Similarly, the medium-term projections out to 2032-33 show further improvement in the deficit, but it is still -0.7% of GDP at the end of this period.

While the 2021-22 underlying cash deficit is expected to be well below its 2020-21 level (-3.5% of GDP, down from -6.5%) little of the projected improvement in the cash balance over the forward estimates is expected to occur in 2022-23 (the budget year). As such the projected improvement relies on spending restraint in future budgets as well as the economy remaining on track.

In 2022-23 total payments are expected to remain well above their pre-COVID level, although they are expected to fall due to an easing in pandemic support payments and related costs. However, this is largely offset by a decline in receipts, in part due to policy decisions made in this budget.

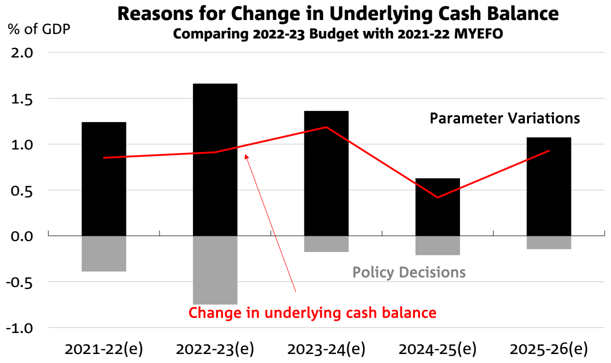


Source: Commonwealth Treasury

Relative to the 2021-22 Mid-Year Economic and Fiscal Outlook, the underlying cash deficit is substantially smaller not only in 2021-22, but over the rest of the projection period.

The improvement against MYFEFO reflects the net positive impact of 'parameter' adjustments. Parameter adjustments include differences in take up rates for various programmes, and changes in revenue projections as the economic outlook changes.

The net parameter improvement mainly comes from the receipts side, reflecting the strength of the economic recovery and the lift in commodity prices. The Budget also assumes that wages growth will lift, providing a boost to income tax receipts. A stronger economy also helps reduce some expenses (lower unemployment benefits) but higher CPI/wage growth increases indexation costs as do other parameter changes (e.g. greater take-up of the NDIS). The stronger economy also increases GST revenue but this is offset by higher payments to the states.



Source: Commonwealth Treasury, NAB calculations

Budget Reconciliation

Underlying cash balance estimates

	2021-22(e)	2022-23(e)	2023-24(e)	2024-25(e)	2025-26(e)
Budget 22-23	-79,821	-77,961	-56,532	-47,108	-43,068
% of GDP	-3.5	-3.4	-2.4	-1.9	-1.6
Policy Decisions					
Receipts	-2,342	-8,351	1,596	602	739
Payments	6,520	8,822	5,732	5,814	4,636
Total	-8,861	-17,173	-4,136	-5,212	-3,898
% of GDP	-0.4	-0.7	-0.2	-0.2	-0.1
Parameter Variations					
Receipts*	26,838	39,534	33,358	23,470	29,601
Payments	-1,449	1,464	1,287	7,898	702
Total	28,287	38,070	32,072	15,573	28,898
% of GDP	1.2	1.7	1.4	0.6	1.1
MYEFO 21-22	-99,247	-98,859	-84,468	-57,469	-68,069
Budget 2021-22	-106,619	-99,266	-79,514	-56,966	n.a.

Source: Budget Papers, NAB calculations. $m except where specified

The (net) improvement to the budget from parameter changes is partly offset by discretionary policy changes, although to a lesser degree than in the last budget. This is most evident in 2022-23 due to some temporary tax relief (fuel excise reduction and cost of living tax offset).

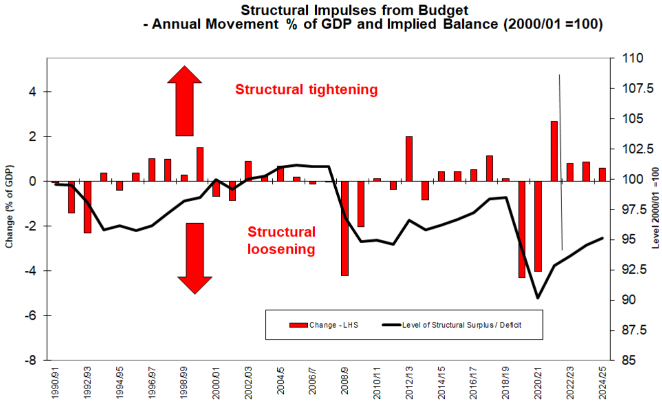
Fiscal Stimulus

Traditionally we use this section to comment on the medium- term Budget outlook and the sustainability of the return to surplus. But again, it is not really relevant in current circumstances where the focus is very much on maintaining the short- term growth momentum.

Instead we have turned to trying to give a better handle on the size of the stimulus involved. To do that we again turn to using an OECD methodology which attempts to show the structural changes of Budget measures by excluding cyclical factors. That is, what the Budget is doing to the economy and excluding what the economy is doing to the Budget.

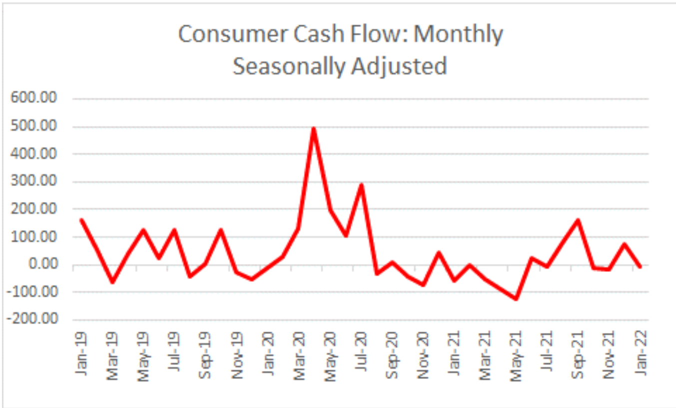
The chart below shows the recent history of virus spending and its withdrawal. Basically after adding around 8% to GDP from policy stimulus that was partly withdrawn last year – mainly Job Keeper.

What is interesting is turning to the next 3 years. Basically, it suggests a very neutral policy response. And as a result, not much if anything is done to improve the Budget policy position outside of the normal automatic stabilisers. Our estimate for the structural deficit 2021/22 is around 7% of GDP but only improves to 5% in 2024/25.

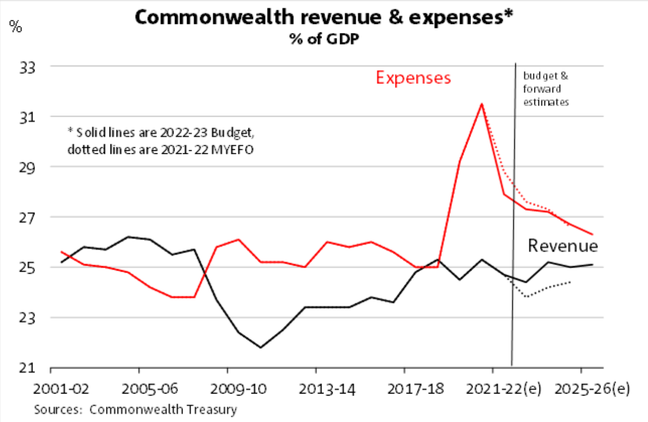


Given the uncertainties re the economy and what will eventually be spent a structural surplus looks unlikely for many years.

Another way to look at the issue of the extent to which the Government's near-term support has underpinned the recovery is to look at household cash flows. The chart clearly highlights the role of Government support during 2020/21. What is interesting however is that the withdrawal of support had significantly impacted consumer cash flows – even if the average saving ratio is high that is mainly held by high wealth individuals and the chart below is a trimmed mean. That clearly puts the emphasis on productivity enhancing reform going forward and the importance of business investment stepping up as consumer demand fades into 2024.

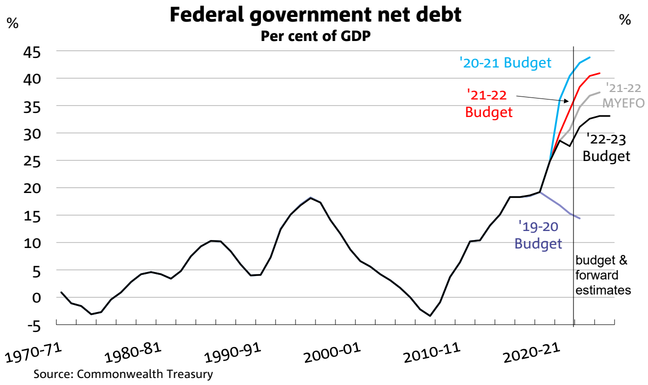


Finally, we look at the Governments "jaws" – that is their revenues v their expenses. As can be seen it is clear that much of deficit and the repair process comes from the expenses line. Indeed, very little has changed in the spending profile from the MYEFO despite all the economic recovery now underway.

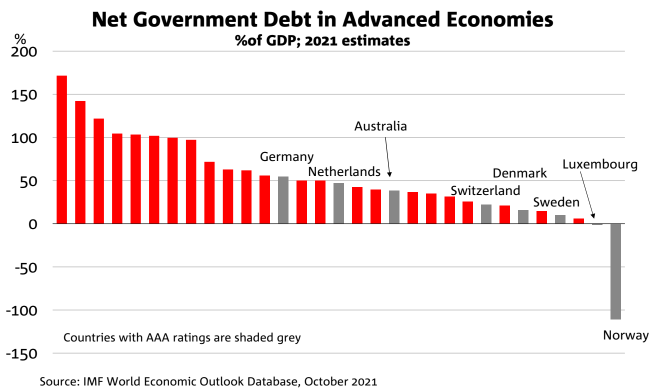


Government Debt

Net debt is expected to peak at 33.1% of GDP in 2024-25. This is a lower peak than expected at MYEFO and continues the run of better-than-expected outcomes since the 2020-21 Budget (the first COVID affected budget). While the Government has used much of the stronger than expected budget performance since then to fund new policy measures, some of these 'windfalls' have been allowed to flow through to a lower net debt profile. That said, it remains the case that net debt is not expected to stabilise until towards the end of the forward estimates period.



While Australian government debt has increased since the start of the pandemic, this has also been the case in many other countries. Pre-COVID-19, Australian government net debt (combined federal and state) as a share of GDP was low by international standards and IMF estimates suggests that this remains the case.



Implications for the Bond Market

The 2022-23 Budget debt statement implies net debt issuance by the Commonwealth during 2022-23 of \$71bn, a \$28bn reduction relative to the 2021-22 MYEFO. Projected outstanding debt at the end of the current fiscal year has been reduced by \$13bn.

There are \$85bn of maturities to refinance during 2022-23, but \$25bn of this is due to a nominal bond maturity in July 2022. In practice, this maturity will have been essentially entirely prefunded by the end of the current fiscal year, so although on face value the gross borrowing program for 2022-23 is \$156bn, in practice it will likely be closer to \$131bn. This is likely going to mean a larger borrowing program next year than will be realised 2021-22.

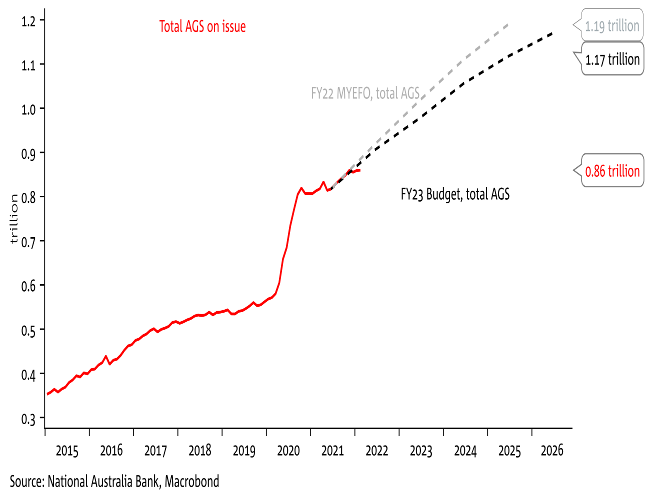
Over the forward estimates, deficits do shrink but the refinancing load begins to increase dramatically. Even with new borrowing projected to decline to \$52bn in 2025-26, the total estimated annual borrowing program remains above \$130bn each year out to at least 2025-26.

Bond Supply Projections

2022-23 Budget	2021-22	2022-23	2023-24	2024-25	2025-26
Year end face value	906	977	1056	1117	1169
Implied net issuance	89	71	79	61	52
Term debt maturities*	16	85	34	79	83
Gross issuance (\$bn)	**105**	**156**	**113**	**140**	**135**

Source: Treasury, NAB

We expect the AOFM to issue a brief update on 30 March, but full details of their 2022-23 plans are unlikely to be released until the next scheduled biennial update in July. The projection of \$906bn outstanding in June 2022 leaves room for about \$40bn of further net issuance this fiscal year, comfortably allowing for the Apr-33 syndication that's been previously announced.



New Budget Measures – In Brief

The budget contains an array of new measures aimed at addressing cost of living concerns, funding rail, road, and other infrastructure projects, new spending on defence, and additional social and industry policy spending. These decisions total around $30.4bn in tax reductions and new spending across the four years to 2025-26.

Cost of living relief

The Budget contains a one-off tax offset of $420 for the 2021-22 income year, available to those earning under $126,000, at a cost of $4.1bn. In addition, there will be a temporary 50% reduction in fuel excise for 6 months, at a cost of $3bn.

The Budget also contains a one-off $250 'cost of living payment', to be paid to pensioners and income support recipients, at a cost of $1.5bn.

Infrastructure and regions

The Budget includes funding for 'priority road and rail projects' at a cost of $17.9bn over 10 years. Water infrastructure projects in regional communities are worth $7.4bn over 12 years, and there is also $1.3bn in new spending on regional communications over 6 years. A new 'regional accelerator program' will cost a further $2bn over 5 years.

The Budget also notes investments in the NT, North and Central Queensland, the Pilbara in WA, and the Hunter in NSW, worth $7.1bn over 11 years, as well as community support related to flooding in Qld and NSW which is expected to total $1.9bn.

Defence

An expansion of cyber and intelligence capabilities will be funded at a cost of $9.9bn over 10 years. Extensive additional commitments have been made defence capability, totaling $270bn to 2029-30, to be met from existing provisions in the defence budget.

Health and social policy

COVID-19 response functions including RATs, PPE, and vaccines are estimated to cost $6bn over 2021-22 and 2022-23. An undisclosed amount will also be spent securing mRNA manufacturing capability.

New listings on the PBS will cost $2.4bn over 5 years. Additional funding to reduce all forms of family, domestic and sexual violence against women and children will total $1.3bn over 6 years. Further spending will go towards mental health and suicide prevention.

Skills and workforce

Funding of $3.7bn over 6 years has been provided for a new National Skills Agreement with the states and territories. The Budget also includes $1.3bn over 5 years for a new apprenticeship incentive and related measures.

There is also additional funding for training and employment support for disadvantaged Australians, as well as 15,000 low and fee-free training places in aged care and support for disability and indigenous employment programs.

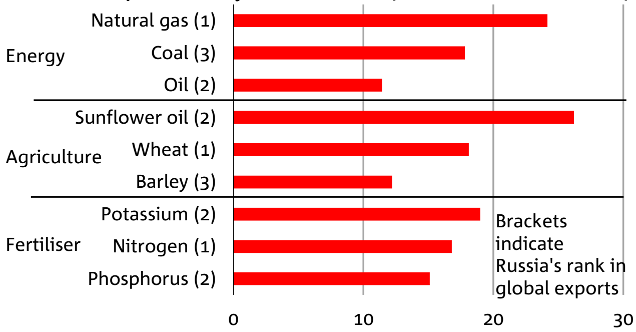
Global Economic Outlook

The global economy grew rapidly in 2021 – up by around 5.9%, the strongest rate of increase since 1973. This growth reflected both base effects (given the steep downturn in activity in the first half of 2020 as a consequence of the COVID-19 pandemic) and the impact of fiscal stimulus and loose monetary policy in major economies.

The near-term outlook for the global economy is highly uncertain, reflecting the fallout from Russia's invasion of Ukraine and the ongoing impact of COVID-19, while various countries continue to remove fiscal and monetary support.

The length of the Russia-Ukraine conflict is inherently uncertain but it has already triggered a surge in energy prices (reflecting Russia's status as a major exporter of oil, natural gas and coal and sanctions that will limit the flows of these commodities). This will negatively impact global economic growth, particularly in energy importing countries. In addition, Russia and Ukraine are major exporters of other commodities, particularly grains, while Russia produces a large volume of globally traded fertilisers. Reduced exports of these products will impact food supplies and drive prices higher, which could cause social and political tensions in lower income countries.

Russian exports of key commodities (% share of world total)



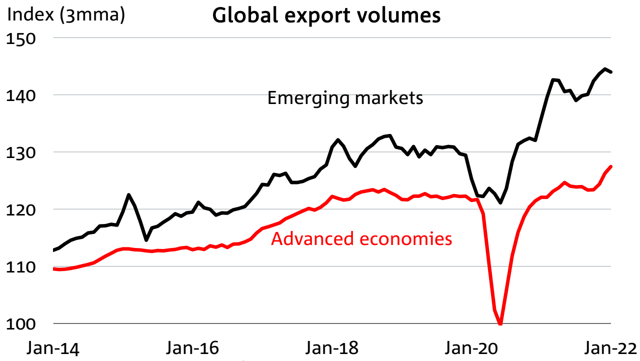
Source: BP Statistical Review of World Energy, UN FAO, NAB Economics

The emergence and rapid spread of the Omicron variant highlights the ongoing risks related to COVID-19. Countries that are highly vaccinated with mRNA vaccines have weathered this wave comparatively well – with the massive surge in case numbers not resulting in the same degree of increase for hospitalisations and deaths as earlier waves. Countries with lower vaccination rates and/or reliance on less effective vaccines (including China) face the ongoing risk of economically damaging lockdowns. Many emerging markets are unlikely to achieve widespread vaccination against COVID-19 until late 2022 through mid-2023.

China's economic growth is particularly dependent on its COVID-19 progress, given its elimination strategy. At the time of writing, Shanghai – the largest city by population – is entering a two-stage lockdown over two weeks, following an Omicron outbreak. China's growth target of 5.5% for 2022 is historically low, but appears ambitious given the headwinds of COVID-19, weakness in domestic consumption and slowing activity in the property sector.

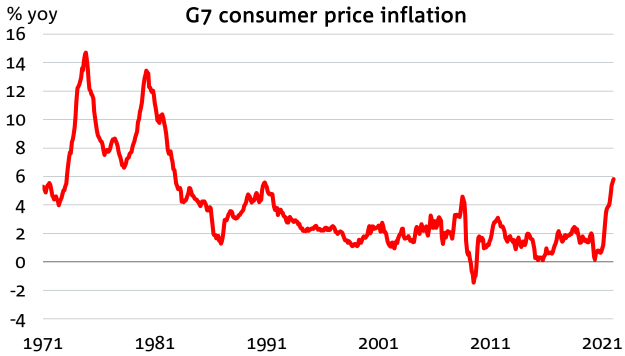
Global supply chains remain disrupted – reflecting the impact of COVID-19 restrictions in various regions, constraints in global shipping capacity and port delays, labour shortages and supply constraints for raw materials and key inputs (such as semi-conductors). Although each of these factors are temporary, they are taking an extended period to resolve and could remain constraints to growth in the near term.

Growth in emerging markets is more trade dependent than advanced economies. Emerging market export volumes were around 21% higher in January 2022 when compared with January 2020 – albeit the trend rate of growth in exports has slowed considerably since April.



Source: CPB, NAB Economics

The supply chain issues have contributed to the surge in global inflation. This has been most evident in producer prices – which increased by around 16% yoy in February 2022 – while consumer prices rose by around 6% yoy. Among the largest advanced economies (G7), consumer prices have risen by their fastest rate since late 1982 (following the fallout from the second oil shock).



Source: Refinitiv, NAB Economics

Across much of 2021, major central banks described inflationary pressure as transitory, however they have backed away from this position in recent months. Markets now expect significant tightening from a range of central banks – led by the US Federal Reserve, which increased rates at its March meeting. We forecast an additional 150 bps of increases in the US this year – which will pressure other central banks (particularly EMs) to also increase rates.

The table below compares NAB's global economic forecasts with that of the Commonwealth Treasury. Overall, we expect the global economy to grow by 3.7% in 2022, before easing to the long-term average of 3.5% in 2023. Overall Treasury's global forecast is similar to NAB's for 2022 and slightly stronger in 2023. Treasury's forecast for China – the world's largest economy (on a purchasing power parity basis) is marginally weaker than NAB's, however their outlook for the United States and India – the second and third largest economies respectively – are stronger in both 2022 and 2023.

Comparison of Treasury Budget Forecasts and NAB Forecasts

	2022		2023		2024
	Treasury	NAB	Treasury	NAB	Treasury
US	3.5	3.2	2.5	2.1	2.0
Euro-zone	3.5	3.2	2.3	2.4	1.5
Japan	2.5	1.9	1.5	1.9	0.5
China	4.8	5.0	5.3	5.5	5.0
India	8.3	7.2	6.5	6.1	7.3
Other East Asia	4.3	4.6	4.5	4.6	4.0
World	3.8	3.7	3.8	3.5	3.5
Major trading partners	4.3	4.3	4.0	4.3	3.8

Australian Outlook

The Budget forecasts a strong rebound for real GDP across 2021-22 and 2022-23, largely in line with NAB's expectations. Headline annual growth numbers largely reflect the recovery of consumption as the impacts of COVID and related health measures have eased, supported by government spending and accommodative monetary policy.

We expect relatively soft growth in Q1 (weighed down by Omicron and flood impacts) followed by a stronger Q2, with average growth in 2021-22 of 3.5% (Budget: 4¼%). Lingering base effects from the Delta-outbreak lockdowns will likely see another strong figure for average growth in 2022-23, despite normalising quarterly figures – we see 3.8% (Budget: 3½%). In the longer term, growth will return closer to trend, with our expectation for around 2.2% in 2023-24 (Budget: 2½%).

A dramatic rise in the terms of trade on the back of elevated commodity prices will see significant nominal GDP growth in 2021-22 (we see 8.7%, Budget: 10¾%). The Budget assumes a rapid fall in the terms of trade will follow, leaving nominal GDP largely flat.

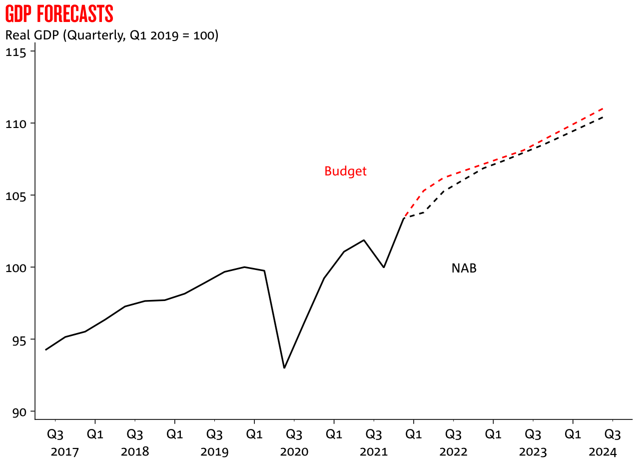
Labour Market and Wages

The strong recovery in activity has driven significant labour market gains, despite significant ongoing disruptions from COVID-19 variants and related health measures. Both employment and participation have strengthened through early 2022 with all states now back above their pre-COVID level of employment. The unemployment rate has now fallen to 4% and looks set to fall further as the recovery momentum continues.

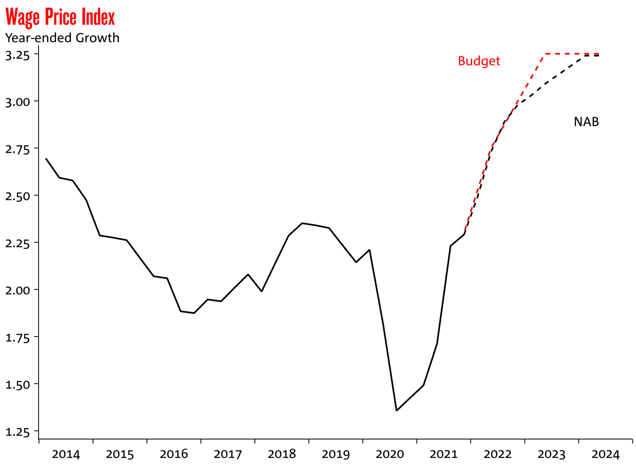
We expect the unemployment rate to fall to around 3.7% in the coming months and settle around 3.5% by the middle of 2023. The Budget forecasts a similar profile, with unemployment around 3¾% in the forecast years – below the Treasury's estimate of the NAIRU (the long-run unemployment rate). The faster-than-expected improvement in the labour market is supporting the Budget with fewer unemployment claimants and more individuals paying income tax, improving the underlying cash balance by an estimated $98.5b over 5 years.

The Budget forecasts net overseas migration to become positive at 41,000 persons in 2021-22, rising to 235,000 by 2024-25 and helping to lift population growth to 1.2% in 2022-23 and 1.3% in 2023-24.

Alongside the tightening in the labour market, we expect wage growth to gradually pick up, from 2.3% y/y in Q4 2021 to around 2.7% by mid-2022 and around 3% from 2022-23. The Budget also points to the likelihood of faster wage growth, forecasting wage growth of 3¼% from 2022-23. The Budget papers also point to a faster pace of growth in the broader National Accounts indicator of earnings.



Source: National Australia Bank, Australian Bureau of Statistics



Source: National Australia Bank, Australian Bureau of Statistics

Business Sector

Businesses have weathered the recent disruptions from the Delta and Omicon virus outbreaks surprisingly well. Despite significant impacts on employment and demand, especially in services sectors, business conditions in the NAB Monthly Business Survey have largely remained above their long-run average and strengthened in February (though the recreation & personal services sector remains in negative territory).

The outlook is also positive, with forward orders and business confidence elevated and (so far) little discernable impact on confidence from the Russia/Ukraine war. Capacity utilisation is back above 82%, and expectations for capital expenditure are elevated in both the NAB Quarterly Business Survey and the ABS capex survey. That could signal a pickup in business investment over the coming year after investment disappointed in Q4 of 2021.

In light of these strong conditions, we see underlying business investment growth picking up to 3.6% on average across 2021-22, strengthening to 8.1% across 2022-23 before normalising to around 5.9% in 2023-24. The Budget forecasts business investment to grow by a slightly stronger 5½% in 2021-22, rising to 9% in 2022-23 but then easing to 1% in 2023-24. This profile would reflect some of the fastest investment growth since 2013.

Still, businesses will have to contend with rising prices, ongoing supply chain challenges, and an expected tightening of financial conditions as the RBA and other central banks normalise monetary policy settings. Finding suitable labour is also a constraint for a growing share of businesses, though this may ease over the year with international borders now fully reopened. The recent rise in commodity prices may also provide a temporary boost to the mining sector and adjacent businesses.

Consumption and Inflation

Large swings in consumption have continued to drive economic growth over the past year, with a significant decline in Q3 2021 due to the Delta-related lockdowns followed by a swift recovery in Q4 – albeit services consumption continues to lag while goods consumption has remained elevated.

The latest data on retail sales, as well as NAB's internal data, suggest the Omicron outbreak had only a limited effect at the start of 2022 with the recovery quickly back on track. More broadly, consumption should be supported by the significant savings accumulated by households through the pandemic period, as well as the effects of a strong labour market and rising wages.

At the same time, elevated inflation will weigh on consumers with headline CPI running at 3.5% over the year to Q4 2021. We expect inflation to rise higher still as global commodity price shocks and ongoing supply chain challenges flow through to prices, with CPI to run at 4.5% in 2021-22 before tapering to a more modest 2.3% in 2022-23.

The Budget contains temporary measures to offset the rise in cost of living, including one-off payments and tax cuts and a temporary cut in fuel excise.

Overall, the Budget forecasts consumption growth of 3½% in 2021-22 and 5¾% in 2022-23, easing to 3¾%. Our outlook is more somewhat more modest, at 3% on average in 2021-22 and 4.9% in 2022-23, normalising to around 2.2% in 2023-24.

Housing

Despite the significant disruption to population growth and activity through the pandemic, both house prices and activity have been strong. With the labour market suffering little ongoing impact from the pandemic, low interest rates have seen strong growth in house prices, while Federal and State government fiscal supports have supported activity.

However, as policy impacts have begun to fade, the housing market has begun to cool. Following a rise of 22% in the CoreLogic 8-capital city house price index in 2021, dwelling price growth has slowed in early 2022. Prices in Sydney and Melbourne have flattened out with recent weekly data showing small declines. Prices in Brisbane and Adelaide have continued to rise (and are still tracking above 1% in monthly terms) but have also slowed from the pace seen in 2021.

Overall, we expect dwelling prices to rise by around 3% in 2022, with a turning point later in the year that will see house prices begin to fall. We see the impact of higher rates driving declines of around 10-15% from peak to trough, with a 10% fall concentrated in 2023.

On the activity side, the Q4 national accounts saw a surprise fall in dwelling investment (down 2.2%) with supply chain and virus-related disruptions weighing on the rebound in NSW and ACT as Q3 lockdowns came to an end. Nonetheless, dwelling investment was up 5.3% over the year after seeing significant support from the government's HomeBuilder program – with alterations & additions up over 9% in the year. While building approvals have pulled back more recently, the large pipeline of work should see high rates of work done maintained in the near-term though supply disruptions may see ongoing impacts.

Overall, we see dwelling investment declining 2.1% in year-average terms in 2022-23, before an offsetting rise in the following year. By contrast, the Budget forecasts a rise of 3.5% in 2022-23, followed by a fall of ½%.

Following the upsizing of the First Home Super saver scheme in the last budget, this year's announcements around housing are more modest. They key being the extension of the New Home Guarantee which was slated to end in June. The extension of the program will see a further 35 000 places for a government guaranteed 5% deposit (with no lenders mortgage insurance) to build or purchase a newly built home. In addition, there will be a further 5000 places for single parents under the same scheme with a 2% deposit. The government has also introduced a regional home guarantee which includes up to 10 000 places for the purchase or construction of a new home in regional areas. As was the case under the previous iteration, eligibility is based on income thresholds of $125k for singles and $200k for couples as well as caps on property prices for each state and territory.

This program is unlikely to have a significant impact on house prices or overall construction trends but has seen significant take up with around 60 000 participants in the scheme since early 2020.

Monetary Policy

Overall, the budget doesn't change our view on monetary policy. The fiscal impulse is broadly as we had expected, with only gradually tightening in fiscal policy so far.

Both fiscal and monetary policy have played a significant role in supporting the economy through the pandemic but with GDP and the labour market having more than recovered both are expected to normalise over coming years. For now, it appears that monetary policy will begin this process first.

While the precise timing of the first hike remains uncertain, it is clear that the RBA will need to begin normalising rates in the near future with both activity and the labour market having more than recovered.

In the near-term the RBA will continue to face inflationary pressure resulting from lingering pandemic supply chain impacts as well as some new impacts from the war in Ukraine – which has pushed up commodity prices and seen further disruptions to transport and some supply chains.

While the RBA should rightly look through much of this transitory pressure the key concern will be whether these price rises become more ingrained through strong inflation expectations in wage bargaining and second round effects. There is some evidence that this is occurring, and price increases are broadening, but for now the RBA remains patient, waiting for a stronger pickup in wage growth.

Nonetheless, we (and the RBA) forecast unemployment to reach multi-decade lows this year, and for underlying inflation to remain within or above the target band through the forecast horizon. With a tight labour market, wage growth is expected to strengthen further, but the speed and magnitude of the response remains highly uncertain, with little experience for policy makers of unemployment rate at 4% and below.

On balance, we see the RBA beginning to lift rates in August (15bps), with 25bp follow-ups in September and November. This would see the target cash rate end the year around 2019 levels (though the traded cash rate is likely to remain below target for some time). We expect a further 3 rises in each of 2023 and 2024, taking the cash rate to around 2.25% by end 2024 and approaching neutral.

In addition to a rise in the cash rate, we see some further tightening in financial conditions over and above these moves with the unwind of QE expected to occur as the RBA's holding of bonds begin to mature and the term funding facility is repaid over the next two years.

The impact of QE unwinding on bond yields is uncertain but likely to only be minor, with the tightening in the RBA's balance sheet largely expected and already factored into pricing.

The end to the term funding facility is likely to see a more significant impact on financial conditions over time as borrowings from the RBA at low rates are repaid.

Budget economic forecasts table

	2021-22 (f)		2022-23 (f)		2023-24 (f)		2024-25 (f)	2025-26 (f)
Annual % Change	**Budget**	**NAB**	**Budget**	**NAB**	**Budget**	**NAB**		
Private Consumption	3 1/2	3.0	5 3/4	4.9	3.3/4	2.2		
Private Investment – Dwelling	5	1.6	3 1/2	-2.1	- 1/2	2.3		
Underlying Business Investment	5 1/2	3.6	9	8.1	1	5.9		
Underlying Public Final Demand	7 1/4	5.8	1 1/4	2.5	1 1/2	2.1		
Domestic Demand	n.a	**4.1**	n.a	**4.3**	n.a	**2.8**		
Stocks – Contribution to GDP	- 1/2	-0.5	1/2	0.1	1/4	0.0		
GNE	4 1/2	**3.6**	5	**4.3**	2 3/4	**2.8**		
Exports	2	-0.5	5	1.2	6	1.8		
Imports	4 1/2	0.5	12 1/2	3.4	7	4.5		
Real GDP	4 1/4	**3.5**	3 1/2	**3.8**	2 1/2	**2.2**	2 1/2	2 1/2
- Non-Farm GDP	n.a	3.1	n.a	3.8	n.a	2.2		
- Farm GDP	n.a	23.9	n.a	4.7	n.a	2.0		
Nominal GDP	10 3/4	**8.7**	1/2	**6.9**	3	**4.8**	5 1/4	5
Federal Budget Balance (fiscal balance, $bn)	**-79.8**		**-78.0**		**-56.5**		**-47.1**	**-43.1**
Current Account Deficit: % of GDP (-%)	-3 3/4	2.7	-3 1/4	2.2	-6	1.7		
Terms of Trade	11	6.6	-21 1/4	0.3	-8 3/4	-0.8		
End Period								
Wage Price Index	2 3/4	2.7	3 1/4	3.1	3 1/4	3.2	3 1/2	3 1/2
Employment	2 3/4	2.3	1 1/2	2.7	1 1/2	1.7	1	1
Unemployment rate	4	3.7	3 3/4	3.5	3 3/4	3.6	3 3/4	4
Underlying CPI	n.a	3.7	n.a	2.9	n.a	2.9		
Official Cash Rate (%) (c)	n.a.	0.1	n.a.	1.3	n.a.	2.0		
10 Year Govt. Bond Yield	n.a.	2.5	n.a.	2.6	n.a.	--		
US cents/$A	0.72	0.73	0.72	0.78	0.72	--		
Trade Weighted Index (d)	60.0	59.9	60.0	63.6	60.0	--		

(a) Percentage change on previous year, unless otherwise indicated (b) Calendar year forecast (c) Budget assumes profile similar to market pricing
(d) End of period (f) Forecast

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