JBWere

The CIO View

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Putting Wealth To Work For Generations

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The CIO View – 2024/25 Federal Budget

JBWere View

The Treasurer handed down his third Budget tonight and delivered a second consecutive surplus for the 2023/24 financial year. However, the good news is short lived; structural challenges force the budget into deficits across the forecast horizon. There is little in the Budget that addresses this issue, nor Australia's lacklustre productivity performance. In the short-term, the Budget places fiscal and monetary policy at cross purposes given the stance of fiscal policy is clearly expansionary.

Key Points

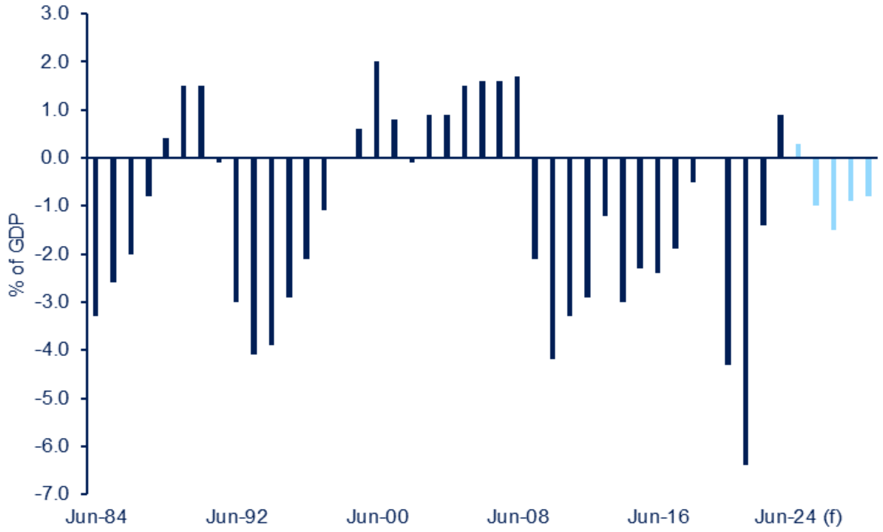
- The 2024/25 Budget is centred around two key themes – cost of living relief and the "Future Made in Australia" initiative. These themes relate to the realities of the domestic political context – a Federal election sometime in the next year and an electorate still struggling with cost of living pressures – as well as the realities of the global geo-political context, now defined by a focus on economic sovereignty, nationalism and supply chain security.
- Key measures for households in the Budget include the Stage 3 tax cuts, rental and energy bill assistance and a freeze on PBS co-payments. Elsewhere, there is additional funding for housing and infrastructure and $23bn over a decade for the Future Made in Australia program.
- The Budget forecasts a modest surplus for the current financial year, but a return to deficits throughout the forecast horizon. In this context, the disappointment in the Budget is a lack of willingness to tackle the longer-term challenges facing Australia and our fiscal outlook, namely the need for comprehensive tax and spending reform and measures to lift productivity growth.
- For financial markets, there are some takeaways: **1)** the Budget underscores the "higher for longer" narrative for front-end rates, given it is unlikely to lower core inflation measures and also adds to aggregate demand in the economy; **2)** all else equal, this may provide some near-term support to the currency, given expectations of easing in other G10 economies; **3)** sectors such as Consumer Discretionary, Real Estate, Materials and Communication Services should benefit from the Budget; but **4)** if Treasury's forecasts for slower nominal GDP growth are realised in coming years, this may suggest some downside to earnings expectations for the ASX200.
- For more details and analysis of tonight's Budget, please also see ***Federal Budget 2024 | Business Research and Insights (nab.com.au)***

The fiscal context

The government has delivered a surplus this financial year, but the structural influences on the budget result in deficits across the forecast horizon

Treasurer Jim Chalmers handed down his third Budget as Federal Treasuer tonight. As expected, **the government has delivered a $9.3bn surplus for the 2023/24 financial year** (an improvement from the $1.1bn deficit forecast in December's MYEFO). While this is the second consecutive Budget surplus, the good news ends here, with deficits forecast for the remainder of the forecast horizon (**Chart 1**). This reflects the structural deficit embedded in Australia's fiscal outlook, driven by spending on defence, the NDIS, interest payments on government debt and aged care and health.

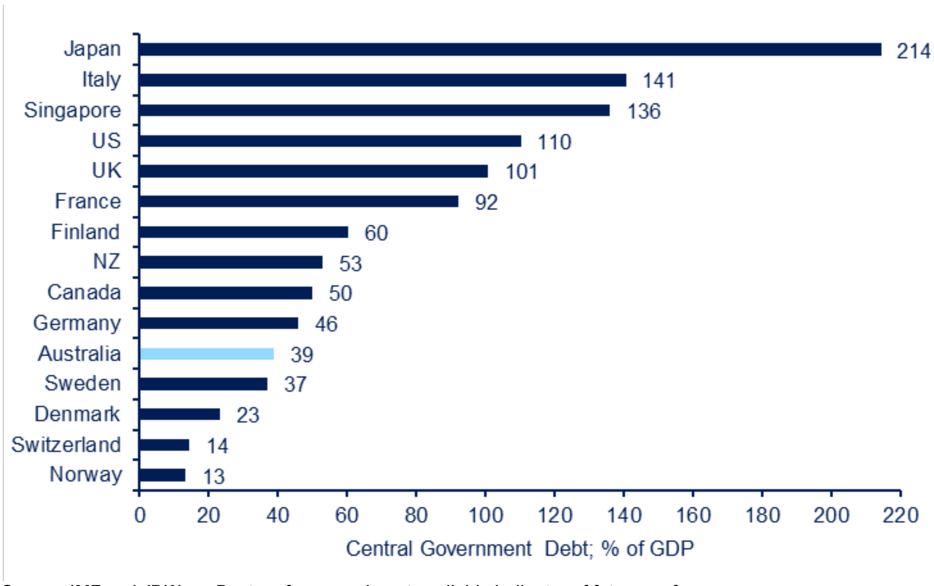
Chart 1: Budget balance as a % of GDP, actual and forecast (light blue bars)



Source: Commonwealth Treasury and JBWere. Past performance is not a reliable indicator of future performance.

The government's starting point from a fiscal perspective is in relative terms, good. As **Chart 2** shows, Australia's debt to GDP ratio is relatively low compared to other developed economies.

Chart 2: In stock terms, Australia's government debt compares favourably (data are for 2022)



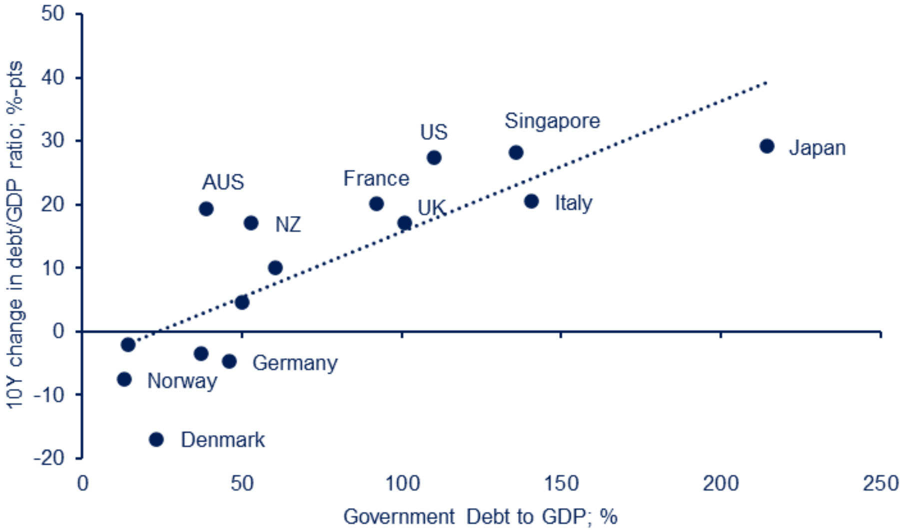
Source: IMF and JBWere. Past performance is not a reliable indicator of future performance.

However, **Chart 3** illustrates the real issue – while our stock of government debt relative to the size of the economy is relatively modest, the flow aspect is not so favourable. **Australia's debt/GDP ratio has increased by 19.4%-pts over the last decade, a similar increase to**

While the stock of Federal government debt in Australia is relatively low, the flow dynamics are less favourable

that seen in the UK, France, Italy and New Zealand (but not as large as the US, Singapore or Japan).

Chart 3: But in flow terms, we have doubled the stock of debt in a decade…



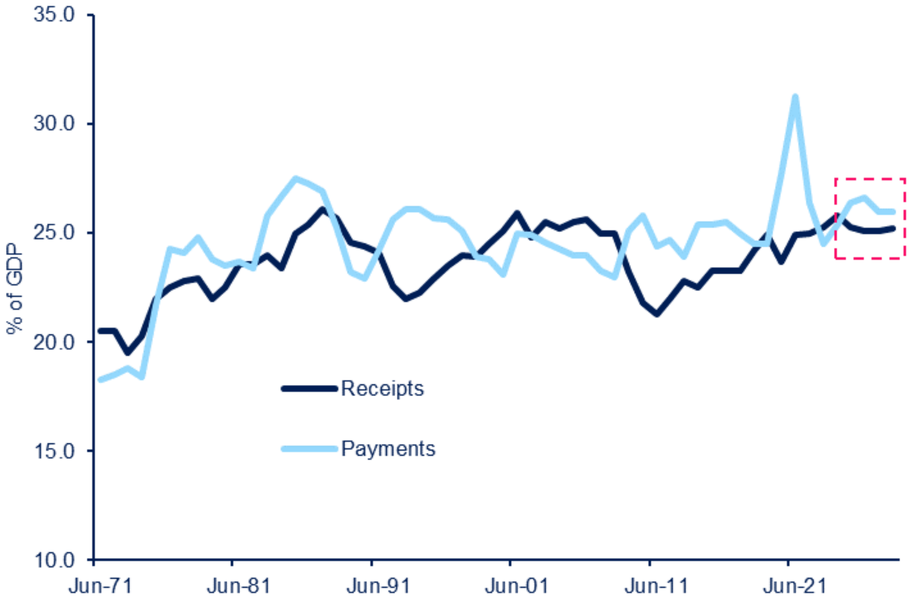
Source: IMF and JBWere. Past performance is not a reliable indicator of future performance.

The unfavourable flow dynamics of Australia's fiscal situation speak to the need for structural budget repair – which will require both comprehensive tax and spending reform and measures to enhance productivity growth. This Budget makes no inroad to either of those challenges; but while Australia's fiscal situation remains relatively strong and we run a current account surplus (ie an exporter of capital to the rest of the world), governments of any political persuasion probably wouldn't view difficult tax and spending reform as politically appealing nor an immediate priority.

Payments are structurally higher than receipts throughout the forecast horizon…

Nonetheless, the forecasts for revenue and spending in the outyears (**Chart 4**) reflect the fundamental fiscal problem – **spending is ramping up in the outyears just when the country's ability to pay for it is diminishing.**

Chart 4: Payments vs. receipts (forecasts in box)



Source: Commonwealth Treasury and JBWere. Past performance is not a reliable indicator of future performance.

The majority of Budget initiatives focused on cost of living relief and the Future Made in Australia policy

Key details

The two key planks of the Budget are cost of living relief for households and the "Future Made in Australia" initiative. These reflect both near-term (domestic) and longer-term (global) imperatives. A list of key measures announced tonight includes:

- Stage 3 income tax cuts
- Rental assistance and subsidies for power bills
- Cheaper medicines (via freezes on PBS co-payments)
- Restructuring the Higher Education Loan Program
- Extension of the eligibility for the existing higher base rate of JobSeeker Payment to single JobSeeker Payment recipients with an assessed partial capacity to work
- Initiatives to encourage Build to Rent developments, regulations to ensure provision of more student accommodation, additional funding for State governments to encourage additional housing supply and more social and affordable housing
- Further funding for infrastructure, including $16.5bn over 10 years from 2024–25 for priority road and rail infrastructure projects across the country
- A $22.7bn investment over the next decade to build a "Future Made in Australia"
- Establishment of a National Interest Framework to identify priority industries[1] and guide investments associated with these industries
- Extension of the instant asset write-off scheme
- Broadening access to tertiary education, placement support
- Superannuation guarantee equivalent payments on Government-funded Paid Parental Leave

Slower GDP growth, lower inflation, lower commodity prices and lower net migration underpin the Budget forecasts

Treasury's economic forecasts see lower growth and lower inflation relative to the forecasts contained in the RBA's *Statement on Monetary Policy* (released last week). The government forecasts headline inflation of 2.75% by mid-2025 (RBA forecast 3.2%). At a top down level, this difference reflects the impact of rental, PBS and energy bill subsidies (the RBA was not privy to this information when its forecasts were released). There is less discrepancy in the growth forecasts, but the RBA's numbers are slighly higher through the forecast horizon. Unsurprisingly, the RBA has slightly lower unemployment rate forecasts (4.3% at June 2025 vs. the government's forecast of 4.5% at June 2025).

Commodity prices are expected to decline, reaching their long-term levels in March 2025.

Net migration numbers are higher in the short-term relative to forecasts a few years ago, but lower in coming years (**Table 1**).

Table 1: Net migration forecasts

	22/23 Budget	Actual	24/25 Budget
2022/23	400000	528500	n/a
2023/24*	315000	n/a	395000
2024/25	260000	n/a	260000
2025/26	260000	n/a	255000
2026/27	260000	n/a	235000

Source: Commonwealth Treasury and JBWere. Past performance is not a reliable indicator of future performance. *For the current financial year, net migration for the first three months was 145.2k.

[1] Defined as renewable hydrogen, green metals, low carbon liquid fuels, critical minerals (processing and refining) and manufacturing of clean energy technologies.

Market Impact

It has been some time since FX and bond markets reacted to the release of a Federal Budget. In large part, this is because many of the Budget initiatives are released ahead of time, but also because fiscal policy has played a less important role in managing the cyclical ups and downs of the economy in recent years. Tonight was no different – FX and bond markets were broadly unchanged in the wake of the Budget's release.

Equity markets

It might be a long bow to draw implications for the equity market from the Budget, but there are a couple of frameworks which at least historically, have proven informative. The first relates to the strong relationship between earnings growth and nominal GDP. To the extent fiscal policy can influence nominal GDP growth in the short-run (cyclical decisions) and in the long run (structural decisions designed to boost trend GDP), then it matters for equity investors and their assessment of medium-term earnings growth. Indeed, a simple regression shows that since 2010, nominal GDP growth can explain around 80% of the variation in 1Y ahead EPS estimates for the ASX200. **Chart 5** shows a line graph of these two series.

Treasury's nominal GDP forecasts suggest some modest downside for ASX200 earnings estimates

Chart 5: To the extent that fiscal policy matters for both short-run and longer-run growth rates of nominal GDP, it matters for earnings growth too

Source: Bloomberg, ABS and JBWere. Past performance is not a reliable indicator of future performance. Dashed lines are Commonwealth Government forecasts (nominal GDP) and Bloomberg consensus forecasts (EPS).

We can see from the dark blue line that the consensus expects earnings growth to accelerate from here. If we take the government's economic forecasts for nominal GDP growth over the next few years, we can see that it troughs later than earnings growth. Relative to market expectations, the government's forecasts for nominal GDP growth suggest that consensus estimates for earnings growth are perhaps a little elevated. If the historical correlation between the two series in the chart above persists and the government's forecasts are realised, then the 2024 Budget outlook may suggest some modest scope for earnings growth downgrades.

What does the budget mean for individual sectors within the ASX200? On a more granular level, the increase in cost-of-living relief should provide some modest short-term support for the **Consumer Discretionary** sector. We remain overweight this sector in our JBWere Balanced Australian equities portfolio.

The higher forecasts for population growth and initiatives around housing supply should continue to benefit the construction sector and eventually, infrastructure. This underscores our sector overweights in **Communication Services, Real Estate and Materials** in our JBWere

Balanced Australian equities portfolio. There is clearly considerable investment in key industries as part of the Future Made in Australia initiative, likely to be focused in the **Materials** and **Energy** sectors of the ASX200. However, the long-term nature of this spending suggests few near term implications for these sectors.

Interest rate markets

The budget reinforces the "higher for longer" narrative for front end rates

The two arms of economic policy, monetary and fiscal, are both important for the level and change in interest rates. Monetary policy sets the overnight cash rate, which tends to anchor the level of front-end yields. And with the introduction of quantitative easing (QE) into the RBA's toolkit in recent years, it can be argued that monetary policy also exerts influence over longer-end yields too, at times. Fiscal policy plays a part in this process through a couple of channels: **1)** influencing the overall level of aggregate demand in the economy, which is relevant to the outlook for front-end yields; and **2)** influencing the gross supply of ACGBs (Australian Commonwealth Government Bonds), by virtue of the size of the government deficit that is funded in public markets.

We have already noted the strong likelihood that the Budget may add to aggregate demand in the short-term, given cost-of-living measures. All else equal, this could pressure front-end yields higher, at the margin, given the market is currently reluctant to price in the chance of further rate hikes from the RBA.

From a supply perspective, we note that the government is forecasting bonds on issue to be broadly as forecast in MYEFO ($1bn by June 2026). Looking at **net issuance for the year ahead**, bonds on issue rise by a modest $30bn in the coming financial year.

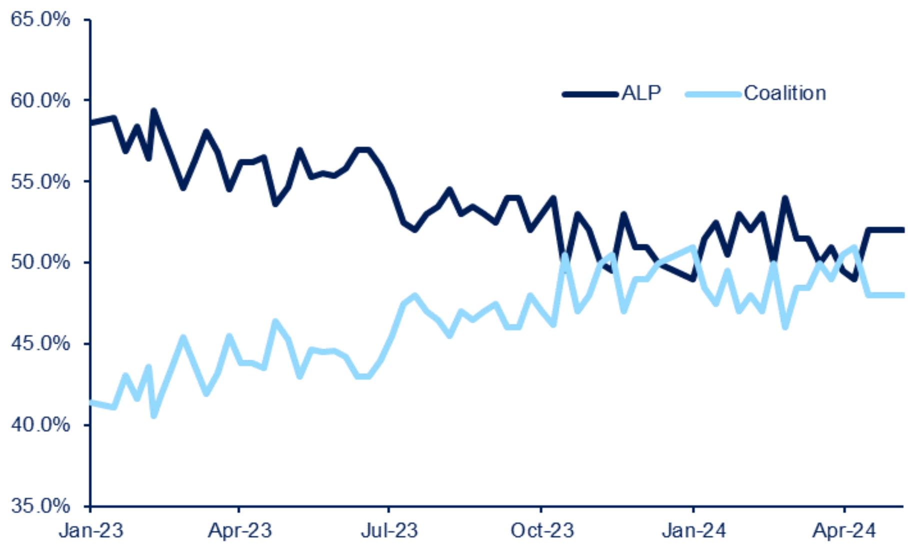
The political context

There are 2 important political contexts for the Budget: domestic and global.

Not surprisingly, the domestic political context and global geo-political environment are strong influences on the Budget

The domestic political cycle references the fact that the next Federal election needs to be held in the coming 12 months. So while this Budget is not necessarily a pre-election budget (there's likely scope for one more budget before the next election should the government elect to go full term), the Treasurer and Prime Minister would have had one eye towards the next election as they debated the contours of tonight's Budget. This is especially so given that polling shows a slim two-party preferred lead to the LNP opposition at present.

Chart 6: Heading into the Budget, the ALP had a small lead over the L-NP Coalition (two-party preferred vote)



Source: Roy Morgan and JBWere. Past performance is not a reliable indicator of future performance.

This context helps to understand why the focus of the Budget has been on households and the cost of living issue. **However, the political complexity lies in being seen to address the cost of living issue without making the RBA's disinflationary efforts more challenging. We are not sure the government has necessarily delivered on both of these fronts in the Budget**. While subsidies for rent and utlility bills will reduce headline inflation, there are three important caveats: **1)** they may do little to shift core inflation measures, which is ultimately what the RBA focuses upon; **2)** they are temporary; and **3)** they boost household disposable income, which runs contrary to the RBA's stated objective of lowering aggregate demand. **So it wouldn't be a stretch to say that fiscal and moentary policy are at cross purposes, at least in the short-run**.

The other aspect to the domestic political context is housing. The chronic shortage of housing, driven by elevated population growth (2.5%oya as at Sep-23) and much lower growth in the dwelling stock (1.5%oya as at Dec-23) means that an economic issue has now become political, thanks to affordability constraints on home ownership and rising rents. In this Budget, there is additional funding ($6.2bn) for housing initiatives; but given capacity contraints in the construction sector, the obvious risk is that the supply doesn't come fast enough to ease voter concern.

Future Made in Australia trades off the potential costs of inefficient resource allocation against the potential benefits of greater national economic sovereignty

The second context is the global geo-political backdrop, which in previous research, we have characterised as consequence of multi-decade regime change. This is the driver of the government's "Future Made in Australia" initiative, the key longer-term centrepiece of this Budget. While this policy choice has been challenged as a misguided return to the industry policy of "picking winners", this criticism ignores the significant shift in global geo-politics and the need to de-carbonise economies.

Governments find themsleves in a world in which issues of national sovereignty, friend-shoring, expansion of domestic industrial and manufacturing capacity and supply chain security are key drivers of policy in many countries at present. Believers in neo-classical economics might not find these policies appealing, but in a world of geonomics - where economics gets regularly subjugated by geo-politics - such policies are now part of the Treasurer's self described "new economic orthodoxy".

There is no doubt the times are suited towards a Labour government which is clearly happy to intervene more directly in markets and to play a role in resource allocation across the economy. But in the end, much of economics is about trade-offs. Tonight, the Treasurer is implicitly asking the Australian people to accept the costs associated with a likely more inefficent allocation of resources across the economy in order to derive the potential benefits of a nationalist set of economic policies in a much changed world. But at a time when productivity growth has stalled and upside to Australia's terms of trade is very limited, the country has no room for policy error – weaker productivity growth, declining real incomes and higher inflation are not a recipe for ongoing electoral support.

Conclusion

In conclusion, we would make the following observations:

- Budgets are more a political document than an economic document, especially when the next election looms. As such, it is not surprising to see the key initiatives in the Budget target near-term domestic imperatives (cost of living relief) and longer-term global challenges (national economic security etc.)
- However, this Budget does little to address the longer-term economic and fiscal challenges facing Australia in the form of low (or no) productivity growth and a strucutral budget deficit. Large spending commitments (NDIS, Defence, Aged Care etc.) are locked in at a time where there is little upside for commodity prices nor increased tax take.

- For financial markets, there are some top level takeaways: **1)** the Budget underscores the “higher for longer” narrative for front-end rates, given it is unlikely to lower core inflation measures and also adds to aggregrate demand in the econony; **2)** all else equal, this may provide some support to the currency, given expectations of easing in other G10 economies; **3)** sectors such as Consumer Discretionary, Real Estate, Materials and Communication Services should benefit from the Budget; but **4)** forecasts of slowing nominal GDP growth may suggest some downside to earnings expectations for the ASX200.

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