Australian Budget & Economic Overview

- Budget very much an election precursor.
- More spending likely. And already deficits for as far as you can see.
- A surprise tax cut for the lowest tax bracket to 14% (from 16%) over 2 years from 2026.
- Budget focus on cost of living (electricity prices), health and some infrastructure.
- No idea what happens post the election.
- Economy slow but improving – forecasts not that different from ours.
- Budget implies a further structural loosening of policy this year and no improvement beyond that. Not likely to scare RBA with rate cuts still coming.

Alan Oster, Group Chief Economist, March 2025

Overall reaction

- **Budget is very much a pre-election one. Large spending in health and cost of living pre-announced. So not a lot new here. The main surprise was the tax cuts, by lowering the bottom tax bracket to 14 % over 2 years from July 2026.**

- **Medium term Budget outlook – even with more spending to come in the election campaign- sees deficits out for many years to come. And the fiscal position has clearly deteriorated this year and fairly neutral thereafter – but no attempt for a recovery thereafter.** Very little on the revenue side to help other than bracket creep.

- Other measures include **some infrastructure and shuffling money into defence in forward estimates.**

- The near term outlook is for a fiscal deficit around \$27.6bn in 2024-25 deteriorating to nearer \$42bn in 2025/26 and around \$37bn thereafter.

- The economy is still very weak and geopolitical uncertainty is very high (especially Trump and tariff related). No one really knows what Trump will do and how others will react. **Business and consumer confidence effects will be critical**. Generally we are just assuming what Trump has announced will be enacted. That might take ¼ of a point off global growth (at 3% not necessarily terrible but….) and modestly increase inflation.

- On that basis, we still see growth increasing to around 2¼% with unemployment around 4¼%. **So, our forecasts are broadly in line with what the Government/Treasury are expecting. We do see core inflation at around 2½% by mid 2025 – so lower than the RBA expects.**

- **Thus, on our analysis the loosening in policy –especially this year- doesn't help the RBA but we are still expecting a series of rate cuts over the next 6-9 months. We still see the terminal cash rate at around 3.1% by early 2026.**

- **Obviously, the big risks are geo-political globally and locally how the consumer and business reacts. Near term risks are on the downside. But medium term we are still comfortable – with the worst probably passed.**

Key Measures

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- **The main surprise was the lowering of the lowest tax bracket from 16% to 14% over 2 years from mid 2026**. A worker on average earnings will get a new tax cut of $268 in 2026–27 and $536 per year from 2027–28, compared to 2024–25 tax settings.

- The main initiatives include the **strengthening of medicare via increased incentives for bulk billing** – preannounced – and likely to cost around $7.9m (but only around $2.4bn over the next 4 years).

- **The cost of living adjustments** – mainly the extension of electricity rebates for 6 months to end 2025. Cost at around $1.8 bn this year. Obviously, this doesn't really impact the core inflation rate but will help headline inflation this year. There is also a women's health package of around $750m.

- As per normal, there **is further infrastructure spending** – but relatively modest by recent years and again back ended. In total worth another $2bn over the forward estimates

- Defence spending marginal. No new money in 10 year spend but around $1bn moved into forward estimates (2026/27 and 2027/28).

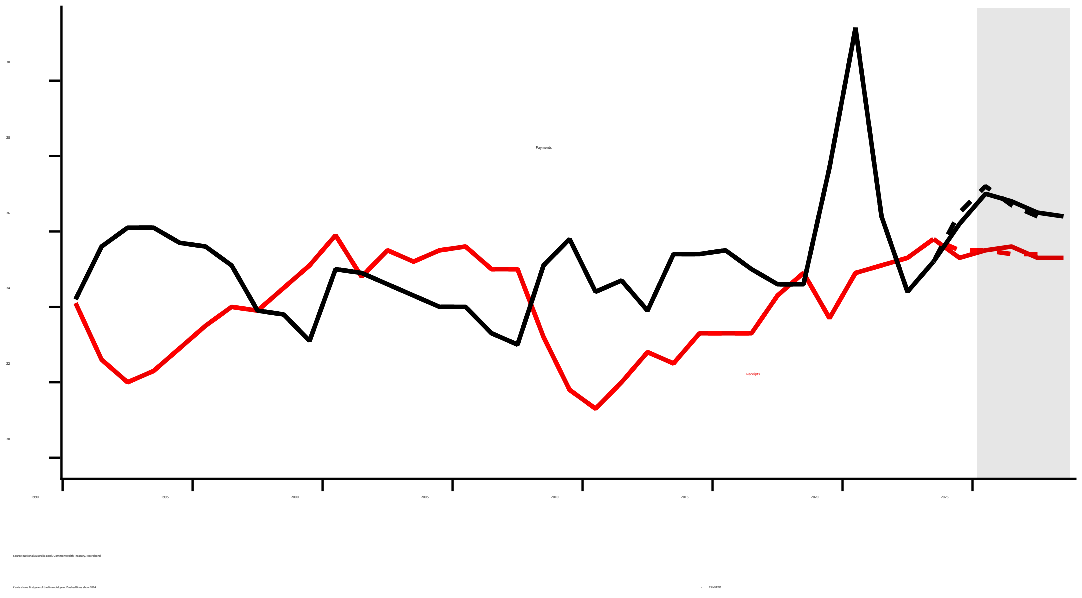
- **And, of course, both sides will have extra election spending.**

- But no substantial real revenue generating measures. But lower commodity prices and wages won't be offset by bracket creep till 2030s.

On underlying cash balance

Now driven by extra expenses.

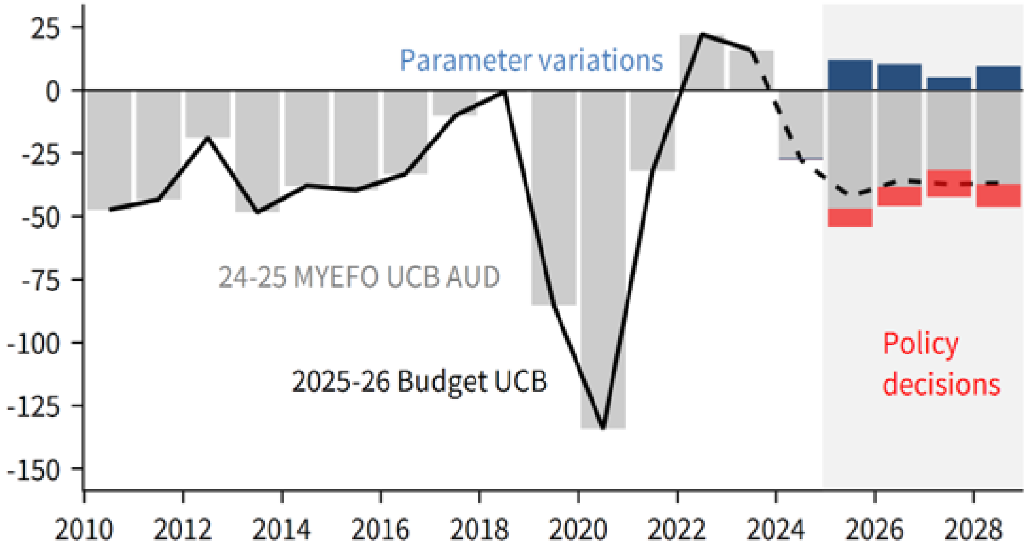
Federal Budget: Receipts & Payments (% GDP)



Reasons for change in the underlying Budget position

Economy improving but not enough to offset extra spending. Commodities prices also not helping.

Reasons for change in underlying cash balance ($b)

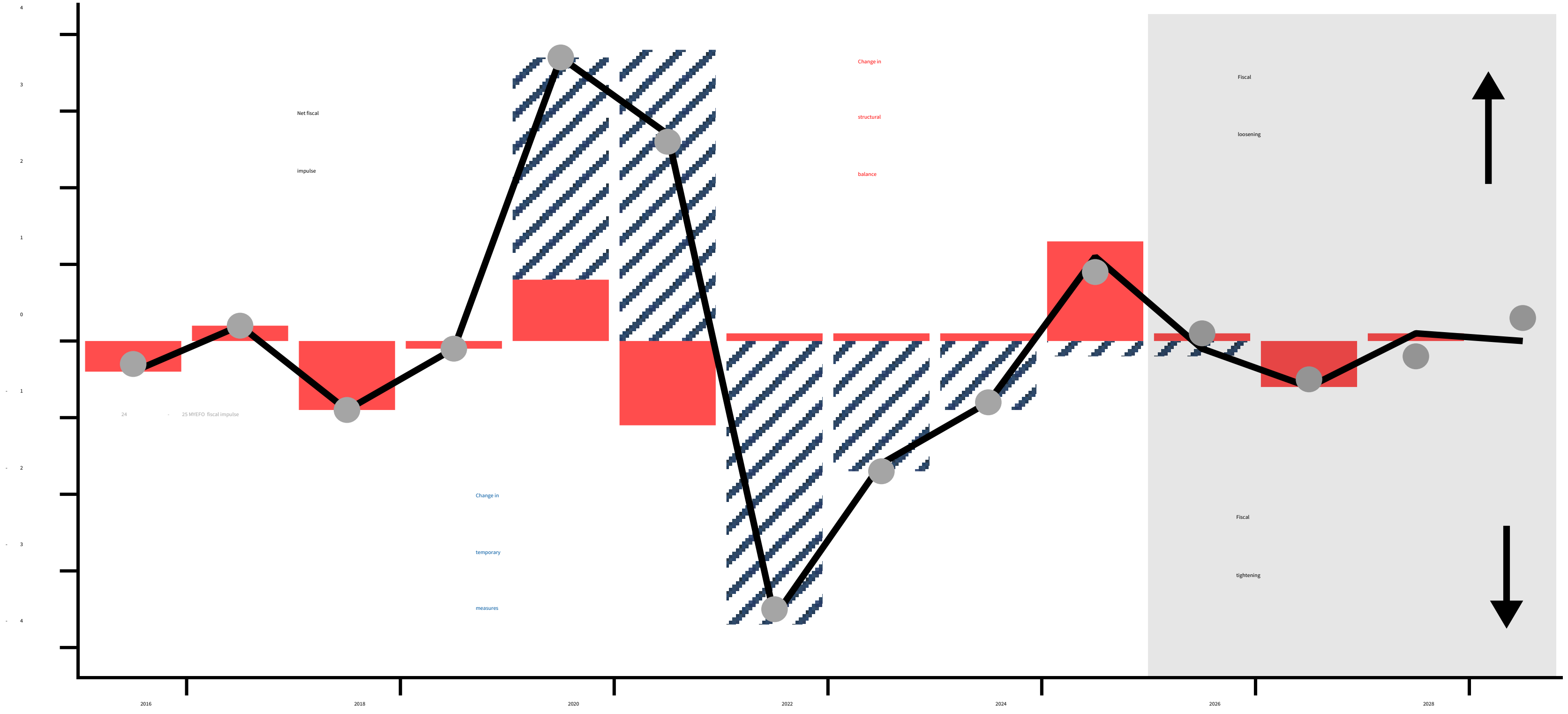


Source: National Australia Bank, Commonwealth Treasury, Macrobond
X axis shows first year of the financial year.

What is the Budget doing to the economy?

Basically, last year saw a significant deterioration in the Budget balance caused by policy/extra spending. No prospects of any recovery any time in the forward estimates. But fiscal impulse broadly stable thereafter.

Federal Budget: fiscal impluse (% GDP)



Source: National Australia Bank, Commonwealth Treasury, Macrobond

X axis shows first year of the financial year.

Global economic forecasts

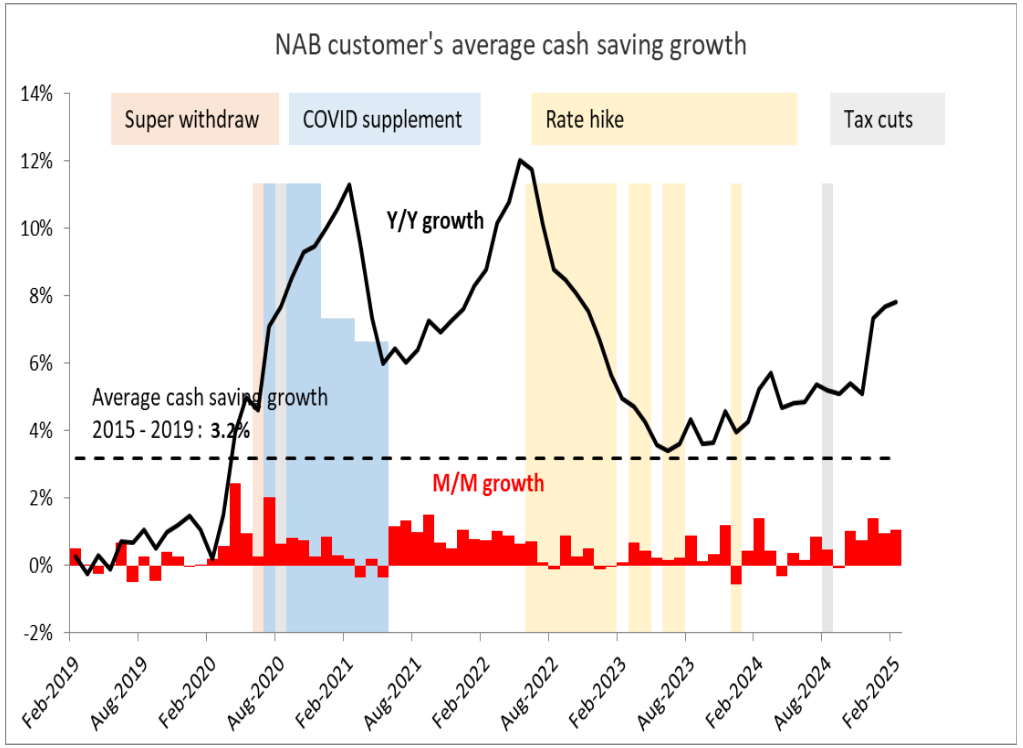
NAB has a slightly more bearish outlook for the global economy. Mainly due to our US view. But not a lot in it given the current global uncertainties.

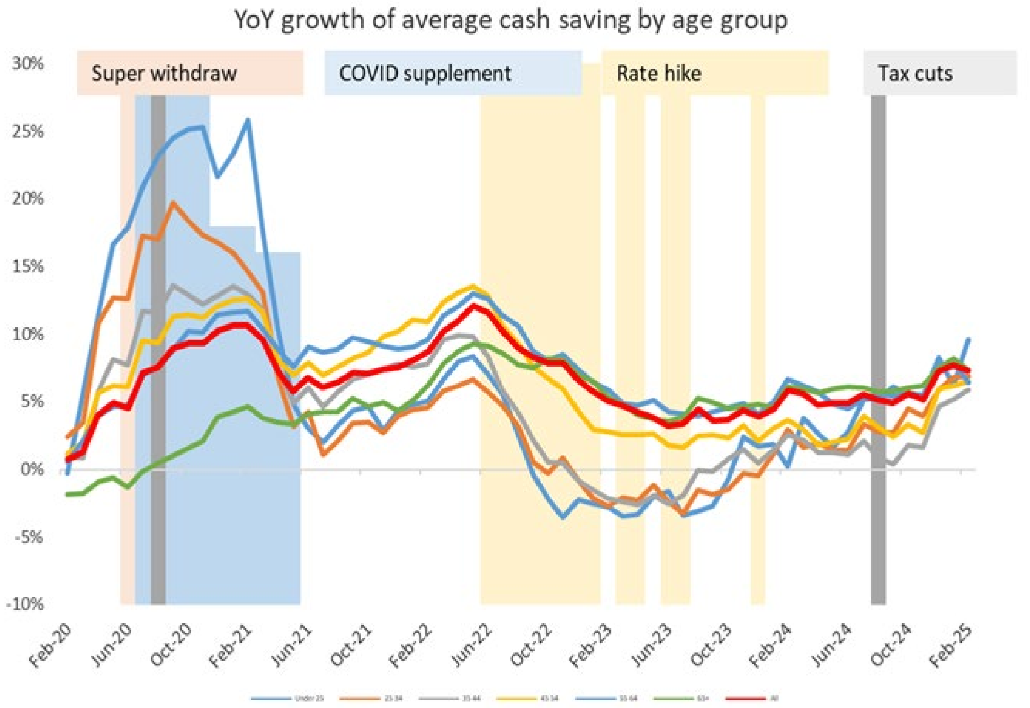
Comparison of Treasury Budget Forecasts and NAB Forecasts

	2025		2026		2027	
	Treasury	NAB	Treasury	NAB	Treasury	NAB
US	2.0	1.8	2.0	1.6	2.0	-
Euro-zone	1.0	1.0	1.3	1.4	1.3	-
Japan	1.3	1.2	1.0	0.6	0.8	-
China	4.8	4.6	4.5	4.2	4.3	-
India	6.8	6.0	6.5	6.2	6.5	-
Other East Asia	4.0	3.6	4.0	3.5	4.0	-
World	3.3	3.0	3.3	2.9	3.3	-
Major trading partners	3.5	3.4	3.3	3.2	3.3	-

And saving rates* generally didn't fall in H2 2024 and up in 2025

Indeed - cash saving higher at top end of the income brackets;
- lower savings growth in mortgage belt (35 -55 years).

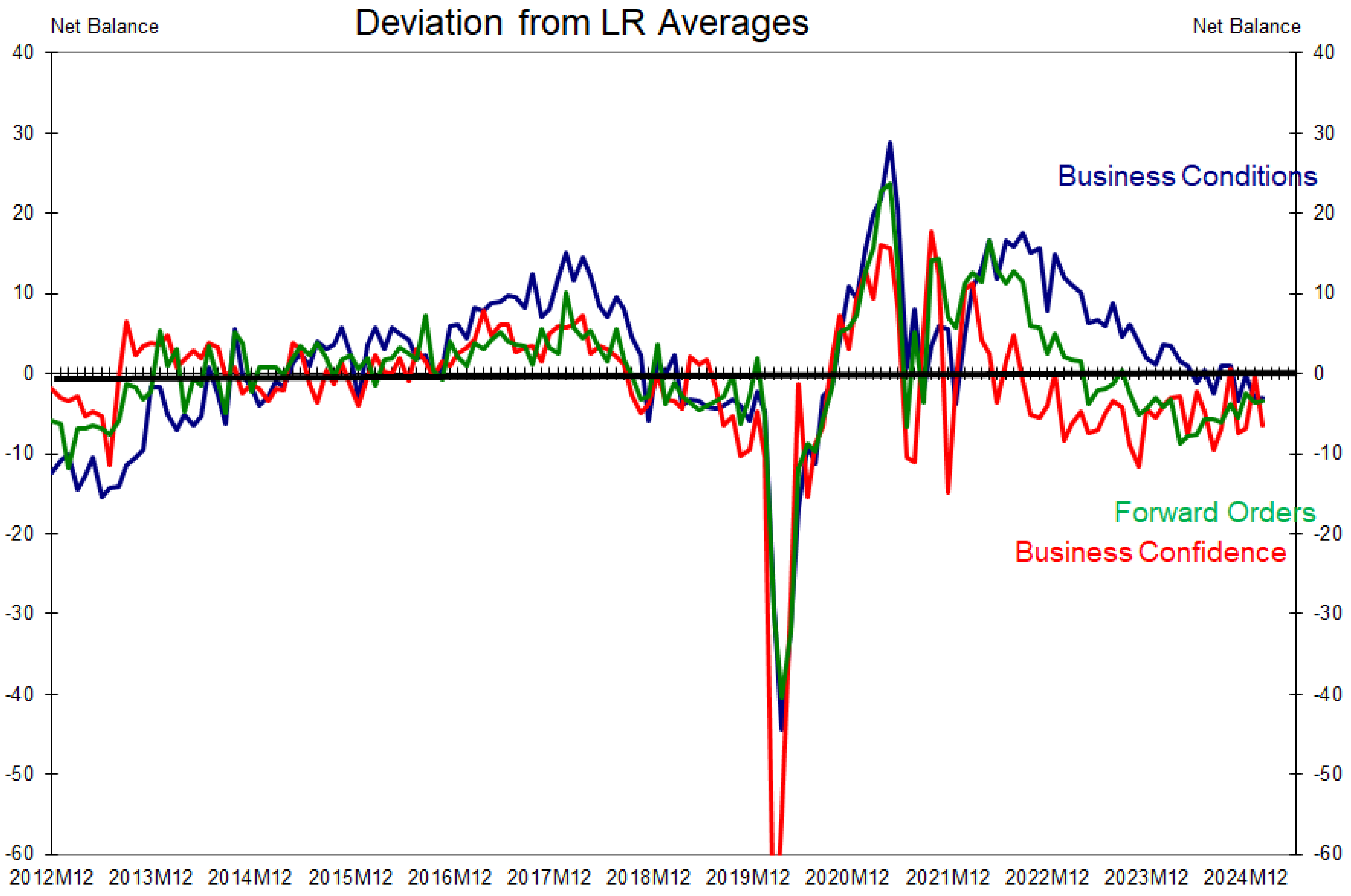




* Saving rates defined as total cash held in accounts (including offset accounts less personal loan balances and credit card balances)

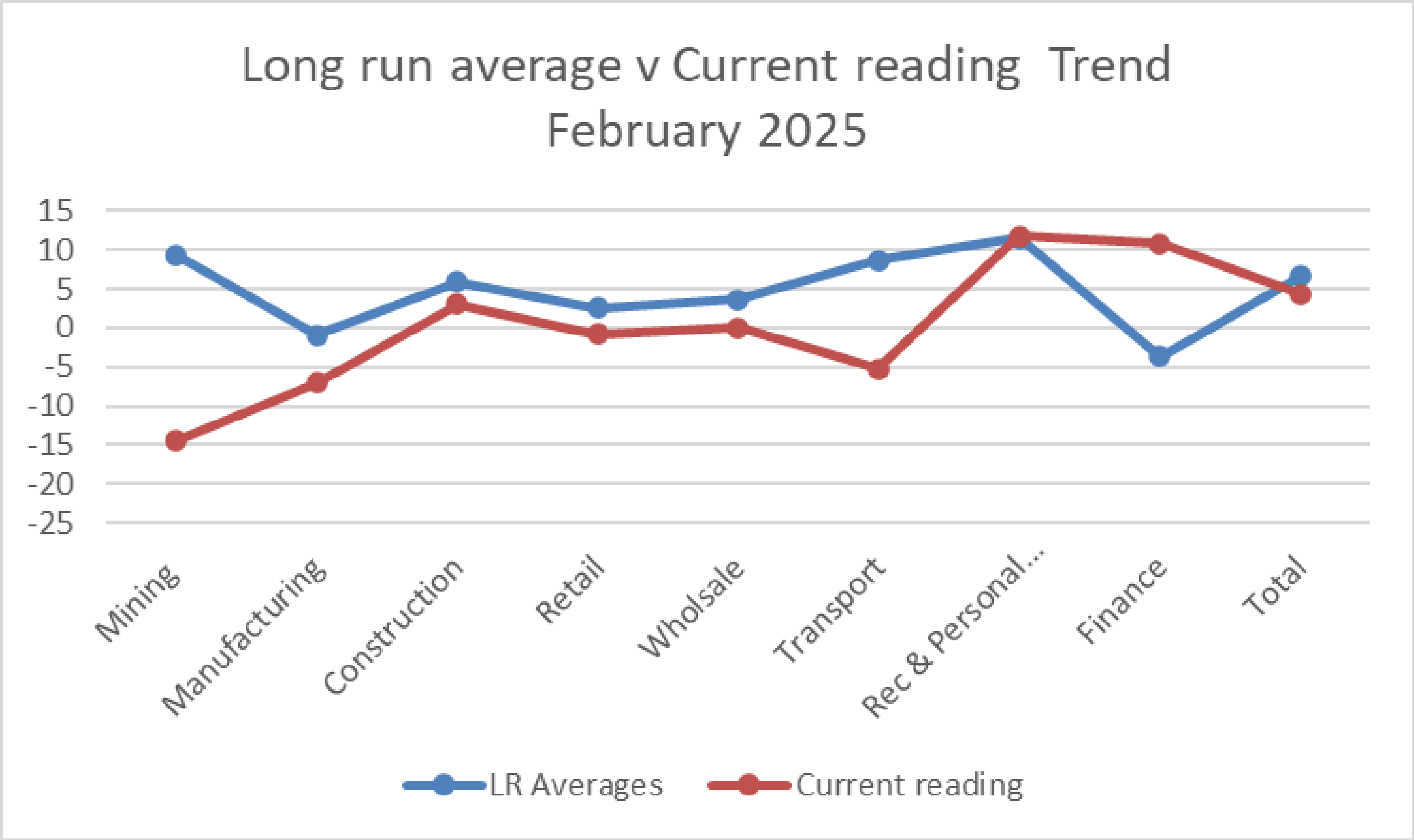
Business Survey shows slowing momentum during the last 12 months and still weak in early 2025

All key measures of activity are back below long run averages. Overall, still ok -but no growth momentum, and some areas of real stress.



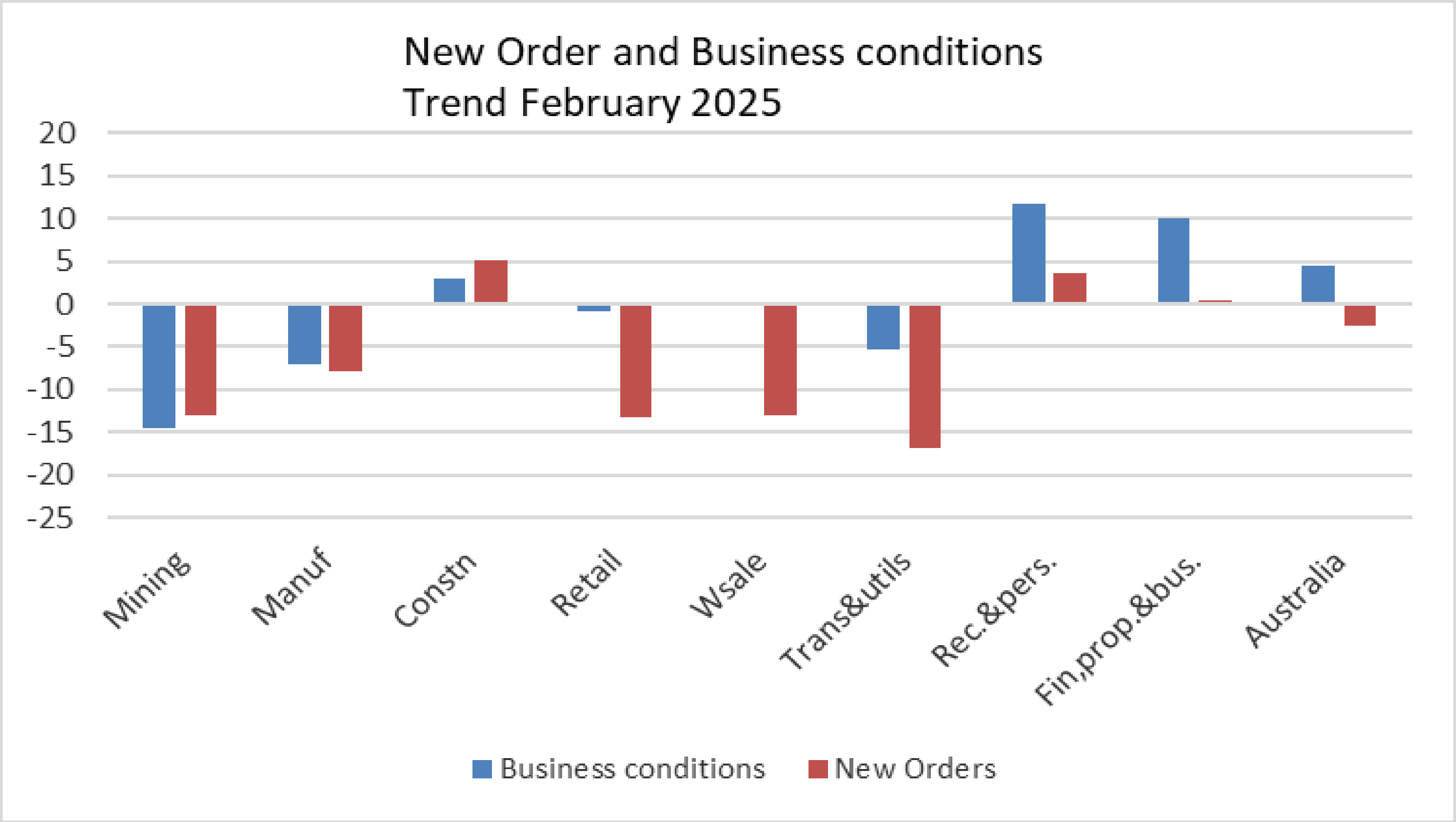
And interestingly compared to long run averages - clearly manufacturing, retail and transport are depressed

Mining volatile but also struggling. As are manufacturing and transport. Services, on average, around long run averages.



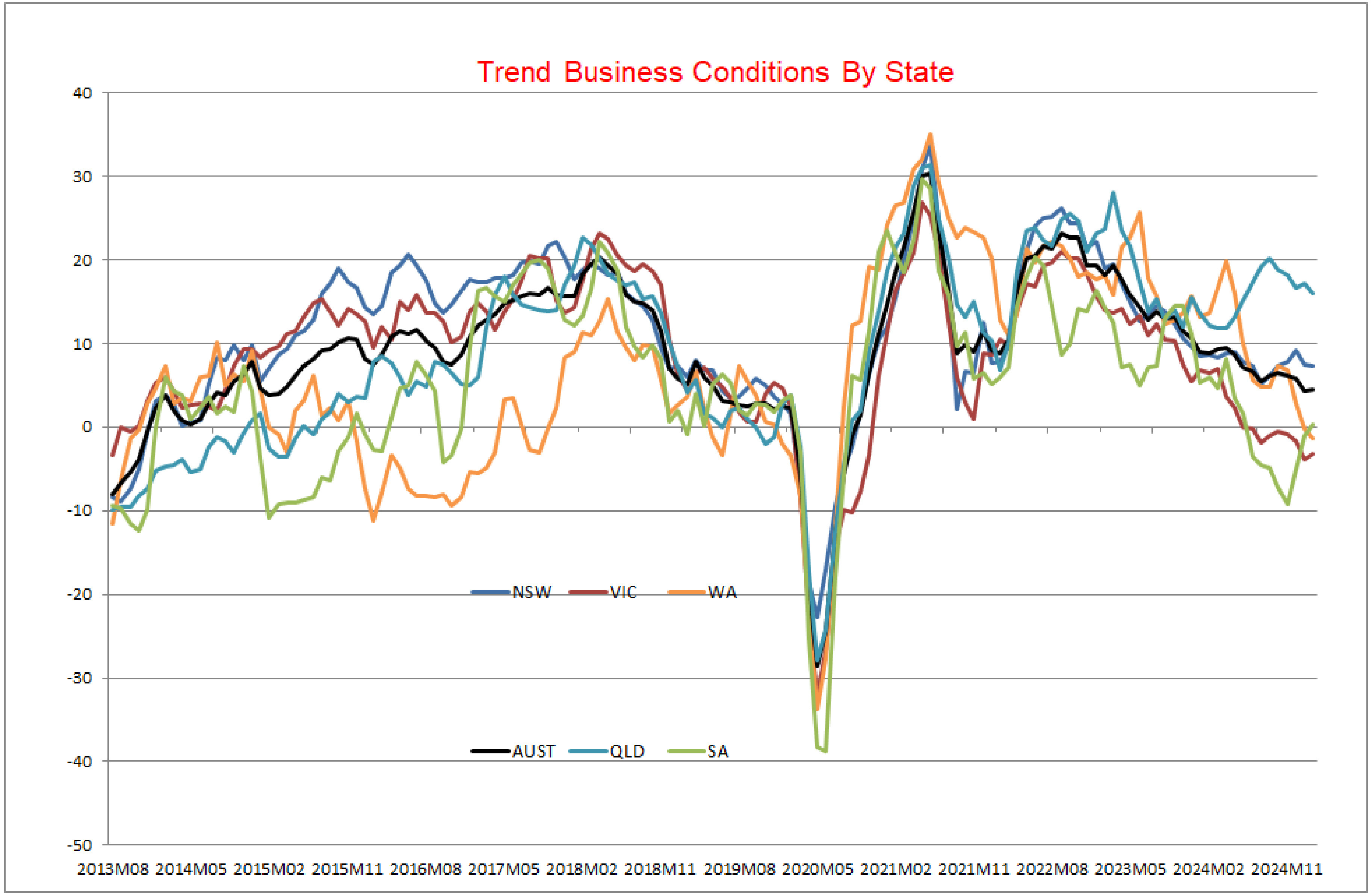
Interesting split for orders across industries

Orders were very weak in mining but can be volatile. Manufacturing and transport now an issue. But retail and wholesale have been weak for ages and not getting better.



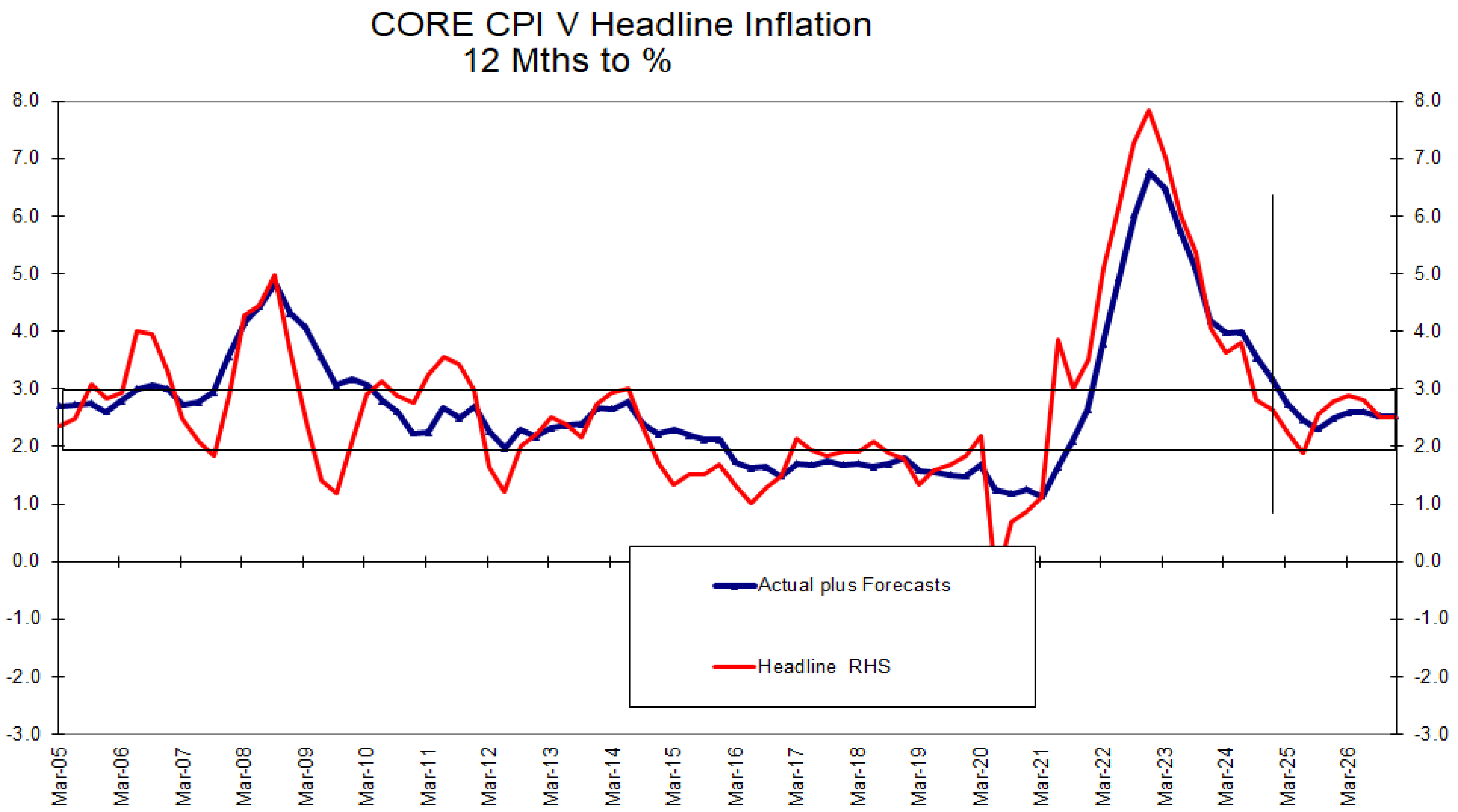
And there are differences across states

Qld still the best. Vic trailing with WA also much weaker, as mining suffers. NSW ok.



Core inflation

Trimmed mean core inflation now at 3.2%, headline much lower at around 2.6%. Headline affected by Govt subsidies – RBA will ignore this. Slower growth will slow inflation but not evenly. Core at 2.5% by mid 2025 and stays there with further rate cuts.



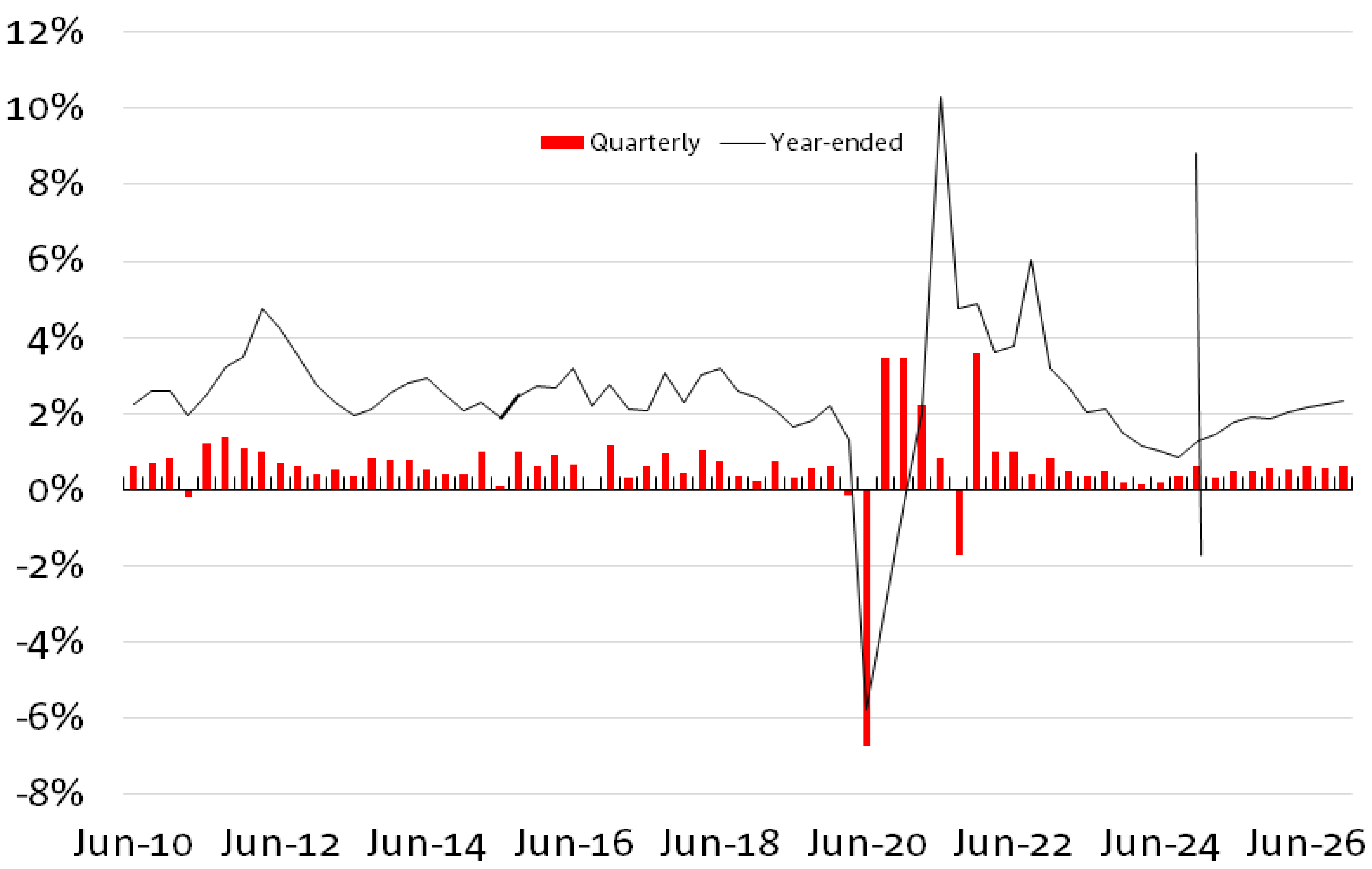
Australian forecasts

Everybody acknowledges that the economy has slowed a lot but may have bottomed in late 2024. However, data so far in early 2025 a touch weaker than expected.

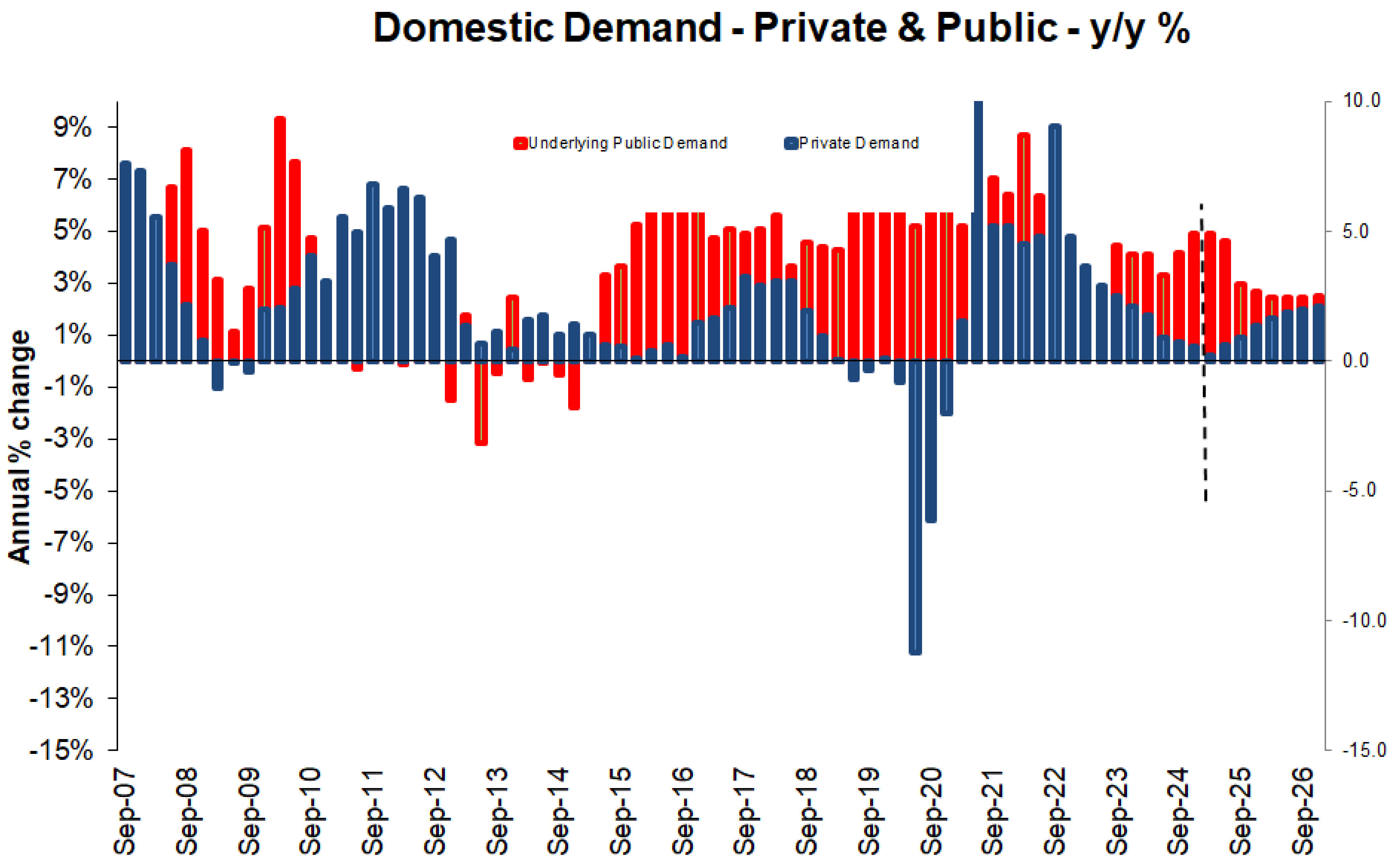
- Fundamentally we are not that different from the Treasury on the economic outlook overall. But we are marginally more worried in the near term.
- We see growth at around 2¼% in 2025 and 2026. Treasury at 2½% for the out years.
- That sees unemployment up to 4.25% by mid/late 2025 – as does the Treasury – and around that rate into the longer run. Again, as does Treasury.
- On inflation/wages. We see current wages growth of around 3.2% being maintained in the out years. For us core inflation (the Trimmed mean) should slow to around 2.5% by mid 2025 and remain there. Treasury only forecasts headline inflation. They are at 2¼% by mid 2025 In essence Treasury uses the Budget measures to cut the near term numbers but find it harder to make progress in the medium term.
- For us the Budget represents a deterioration in the structural fiscal deficit of around 1% over the next few years but that doesn't necessarily rule out RBA cuts. **But clearly RBA in no rush**. The critical variables will be core inflation and the impact of geopolitical concerns on consumer and business behaviour.
- Hence RBA remains very watchful.

Our growth expectations

Economy still very flattish with private sector really struggling. GDP now up 1.3% during 2024. Maybe we have passed the bottom. Around the same rate as December 2023. The outlook for 2025 and 2026 growth will be around trend –around 2.3%.

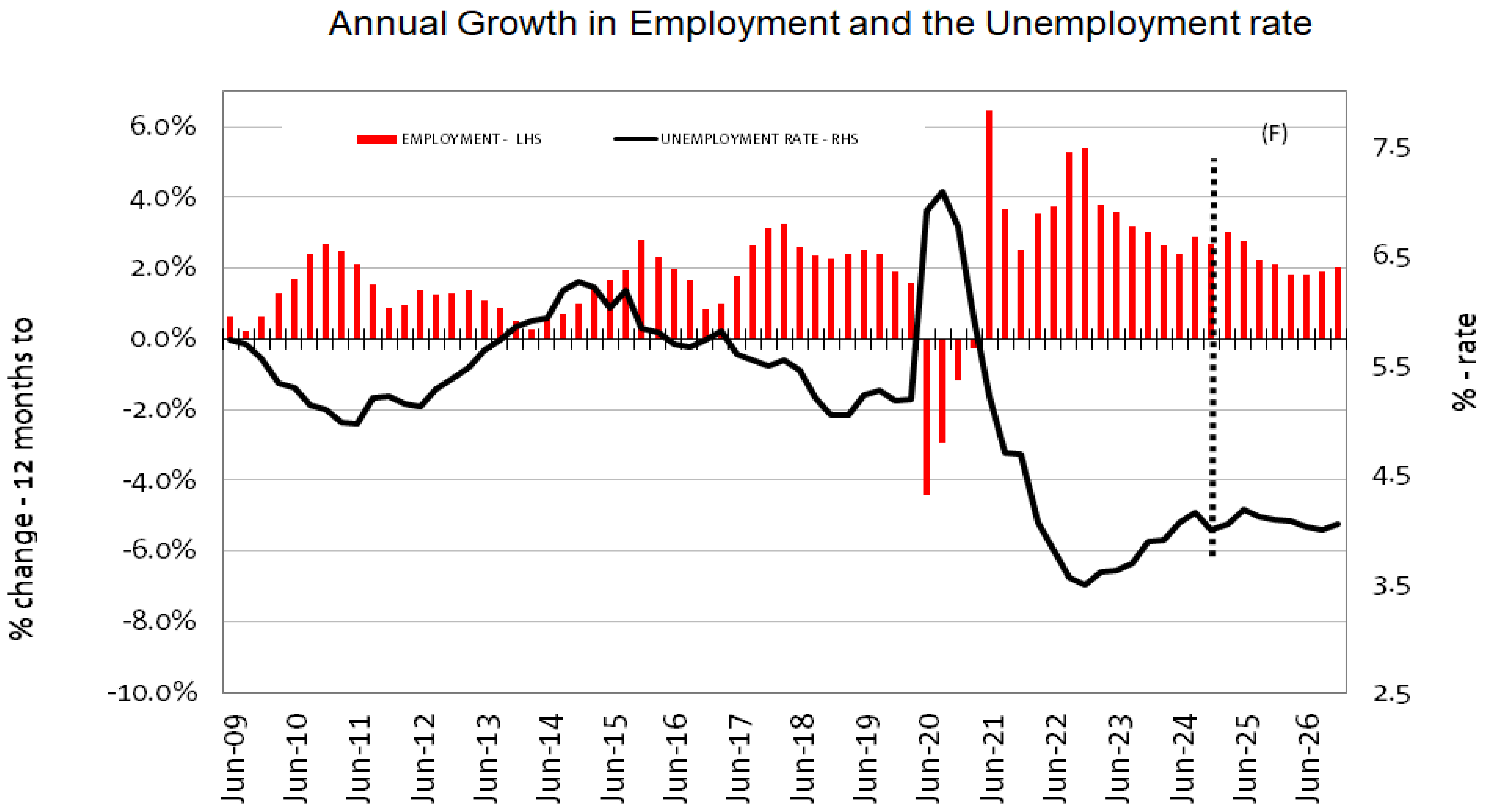


Private sector activity however still very weak



Labour market weakening a touch but still good

Unemployment now around 4% – up from 3.5% in mid 2023. We expect employment growth to continue but not enough to stabilise unemployment. Up to around 4.3% by mid 2025. Then to edge lower in out years.



On RBA

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- RBA has focussed a lot on inflation but as the economy slows and consumer spend remains weak focus moving to a more balanced approach. Unemployment however still low at 4%.

- **Are signs that services inflation is past the worst. And trimmed mean now down to 3.2% y/y.**

- **Critically we see a path where core inflation remains at around 0.6% per quarter during the rest of 2025. That would see y/y trimmed mean inflation around 2½% by the second half of 2025.**

- **But a relatively moderate easing cycle is expected. Roughly 25 points of cuts each quarter in 2025 and into early 2026.**

- **We still see a terminal cash rate around 3.1% by early 2026. Markets are less optimistic with a terminal cash rate of around 3.5%.**

- Medium term economic outlook much better but tough times still with us for a while yet. But getting better during the next 12 months.