Federal Budget October 2022-23

What it means for SME businesses.

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A note from our Chief Economic Advisor.

A deterioration in the Government's Budget means that some big decisions are needed

Summary

This Budget is all about taking on the short-term priorities for the new Government. And while the Budget shows us the magnitude of the long-term fiscal challenges confronting the country; it does little to immediately address them. That will have to wait until the next Budget in May 2023.

An incoming Government will always re-set the priorities and clear the decks. This political re-set has combined with the substantial change to the economic operating environment to create a very different Budget story to the one we were given in March which foreshadowed large deficits and rising spending year in, year out.

The Treasurer has shown restraint and allowed booming Government revenues to feed into the bottom line rather than be recycled as new spending. This is critical to fighting inflation. The Government should be commended for not seeking to put upward pressure on interest rates.

This Budget isn't inflationary, but in no way is Australian fiscal policy acting to restrain the economy and help rein in inflation. The Federal Government might not be making the RBA's job harder, but they certainly aren't providing a helping hand either.

Key take outs

The Government has implemented its modest election promises and re-set the Budget for the new economic and political environment. However, none of the really important (and difficult) decisions have yet been made. That will have to wait for the next Budget in May 2023.

The Government's main objective was not to add to inflationary pressures in the economy through new spending initiatives. It looks like they have achieved that.

Paid parental leave, more generous childcare funding, and support for new housing supply are all worthwhile initiatives, but none of them do much to change the long-term challenge of structural Government deficits of 2% of GDP (about $40bn a year).

What this means for SMEs

The Government continues to encourage labour supply to alleviate staff shortages experienced by just about all businesses across the country. Fast tracking visas, childcare support and increased funding for TAFE and university places will build on previous initiatives.

The economy is forecast to get inflation under control with a modest increase in unemployment and interest rates. To get the economy back on an even keel without a recession would be a major achievement. The risk is the economy and inflation proving stronger than expected. I believe interest rates have to go higher than the 3.35% cash rate assumption in the Budget.

The big debate on how to get Government finances back into shape will take place over the next six months. We encourage all SMEs to have their say on whether the Government should be trimming spending or raising taxes.

I hope you find the analysis provided in this report helpful to understand the Federal Budget and what it means for the growth of your business.

Warren Hogan
Judo Bank Chief Economic Advisor

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Contents.

Addressing the long-term financial challenges	4
Economic forecasts	5
Alleviating labour shortages	6
Taking pressure off interest rates	7
Tackling cost of living	8
Budget snapshot	9

Addressing the long-term financial challenges.

The big decisions on Government finances will have to wait until the next Budget in May 2023

Summary

It is quite clear that this Budget was part one of two in laying out the Government's new fiscal policy strategy. This was more an economic statement that reassesses the long-term costs of major spending programs and implemented some relatively minor election promises. There were no major policy changes and no real attempt to get the Budget on a sustainable footing.

This Budget was all about addressing the short-term challenges posed by rising inflation and a new Government keen to clear the decks after nine years of Coalition control of Government finances.

In an environment of booming Government revenues, it might have been tempting for a new Treasurer to open the purse strings. But thankfully, he resisted, and allowed the expected deficit for the current year to decline from $78bn to $38bn.

The Treasurer deserves credit for his restraint, but little has been done to address rising spending costs associated with health and aged care, the NDIS and defence.

The Treasurer will argue that cleaning up the books, re-prioritising Government spending and focusing on helping the RBA with its fight against inflation are necessary and critical first steps in the process of addressing these challenges.

The implication of this Budget is that it is the start of a conversation about how we, as a nation, will address the rising cost of Government programs. Do we increase taxes or cut back on spending? Is it a viable strategy to run deficits for a long period of time?

The answers to these questions will have to wait until May next year, and will, hopefully, be the subject of a constructive public debate.

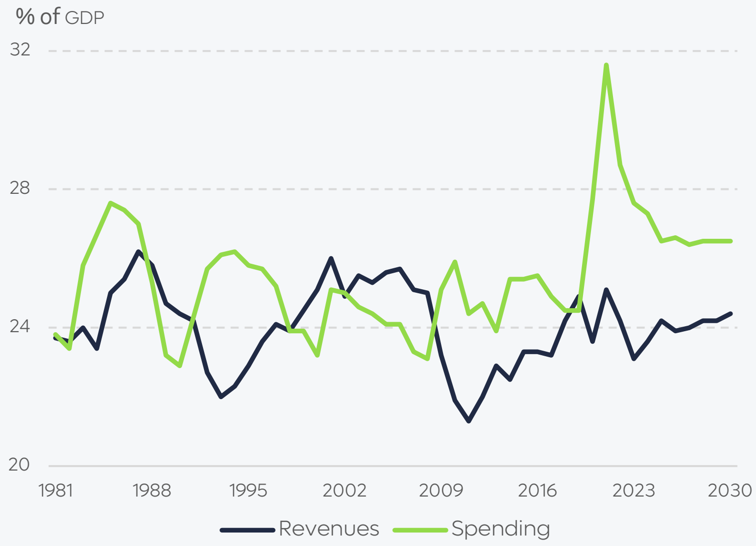
The Government revealed its hand on how it wants to get the Budget back into balance:

"Achieving this will require a national conversation about how the services Australian's need are funded." (Budget Paper No.1)

It appears that the Government wants to see record Government spending matched by higher Government revenues. The conversation is about how to increase revenues and taxes, rather than whether there is any trade off between spending and revenues.

Federal Government revenues and expenses

Australia has a structural Budget deficit of 2% of GDP



Source: Commonwealth Treasury

Economic forecasts.

A mild economic slowdown in 2022/23 is expected to bring inflation under control

Summary

The Government is expecting a soft landing for the Australian economy in 2023/24.

Economic growth is forecast to slow from 3.9% in 2021/22 to 3.25% this year and then 1.5% in 2023/24.

Far from a recession, the economic slowdown will see unemployment increase from a 50-year low of 3.5% to 4.5% in 2023/24 before remaining around 4% over the long term.

Slowing household spending should be enough to bring inflation back into the RBA's target band of 2-3%.

The RBA cash rate is assumed to increase to 3.35% in 2023 and stay there for an extended period. This suggests that there will be two or three more rate hikes over the next six months.

The global economy is expected to slow rapidly in 2023 but if this is a global recession, it is a mild one compared to what we saw in the Global Financial Crisis and at the start of the pandemic.

Population growth is expected to accelerate in 2022/23 as immigration returns to the patterns seen prior to the pandemic.

Key stats

3.25%

Economic Growth in 2022/23

3.75%

Wage Growth in 2022/23

Economic projections

A conservative set of economic projections underpins the Budget

Annual %	2021/22 estimate	2022/23 forecast	2023/24 forecast
USA - GDP Growth	6.5	1.8	1.8
China - GDP Growth	8.0	3.0	3.0
Australia			
GDP Growth	3.9	3.2	1.5
Inflation	6.1	5.8	3.5
Nominal GDP Growth	11.0	8.0	-1.0
Unemployment Rate	3.8	3.8	4.5
Wages Growth	2.6	3.8	3.8

Source: Commonwealth Treasury

What this means for SMEs

If the Government's economic forecasts turned out to be correct, this would be a great outcome for the Australian economy and SMEs. It would be a soft landing that sees inflation brought under control with only a modest rise in unemployment and interest rates.

Australian businesses need to be cognisant of the risks to the Government's optimistic expectations. A stronger economy in the short-term could result in a harder landing later.

The biggest risk is that inflation proves more stubborn than expected and interest rates need to rise to levels that could result in a sharper downturn in economic activity in 2023/24.

Despite widespread labour shortages and historically low unemployment rates, the Government is not expecting a wages breakout.

The business community needs to remain focused on containing labour costs and looking at opportunities to invest in labour-saving technologies. There is a real risk that wages could be stronger than the Government expects.

Alleviating labour shortages.

The Government continues to support the supply of labour into the economy

Summary

The Government is focused on addressing labour shortages through a range of measures including more funding for visa application approvals, increasing childcare support, and new skills and training funding.

Childcare subsidies will increase to up to 90% of costs in some cases. This will cost $1.7bn a year and is expected to increase hours worked by 1.4m a week, the equivalent of an extra 37,000 workers in the economy.

The strategy is wide ranging and builds on the work of the previous Government in trying to increase available people to work from a range of sources including overseas, raising domestic participation, and increasing the effective labour supply through skills enhancement.

The Government will fund an extra 480,000 TAFE places a year and 20,000 university places for disadvantaged Australians, announced as part of the Jobs Summit.

Key stats

471,000

Job vacancies in August this year

$1.7bn

Annual increase in childcare subsidy

Job vacancies

Despite a small dip in August, vacancies remain at high levels

Source: ABS

What this means for SMEs

The business community needs to take a look at how it can leverage new funding initiatives for skills, including how staff can take advantage of free TAFE courses.

Typically, new policy initiatives take time to have an impact on market conditions. Childcare support and fast-tracking visa approvals could be felt quickly.

Looking overseas for workers is a viable option for SMEs now that the Government is focused on visa approvals.

Now is the time for business leaders to be thinking outside the box regarding how to retain and attract workers. Whether it be attracting older Australians back into part time work or upskilling existing staff with free TAFE courses, this is the new world of active workforce management.

Rising temporary and permanent migration will start to feed through to more potential workers, particularly for industries such as hospitality, the arts and recreation.

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Taking pressure off interest rates.

The Budget will not change the expectation that interest rates are heading higher in 2023

Summary

The clear priority for the Government in this Budget has been to take pressure off the economy and inflation by minimising new spending initiatives.

This task has been complicated by an unexpected increase in Government revenues due to a stronger economy and high export prices. Revenues have increased by $57.3bn in 2022/23 alone and are expected to increase by almost $150bn over the next four years.

To the Government's credit, it has showed restraint and limited new spending initiatives to its election promises. With an economy operating at capacity, and the Budget position expected to deteriorate further over the next four years, new spending is not only financially irresponsible, but inflationary.

Most of the new or delayed spending is due to the pandemic, natural disasters and higher health and aged care costs.

Government spending is still rising despite some restraint and is expected to be sustained at higher levels than we have seen in the last 40 years. With a $17bn increase in spending in 2022/23 the Budget is neutral to the economy at best.

Key stats

4.0%

Cash rate implied by markets for mid-2023

3.35%

Cash rate assumption in Budget

Interest rates

The Market expects a further increase in interest rates next year

Source: RBA and ASX

What this means for SMEs

Despite the Government's efforts to show some restraint, interest rates are likely to continue to rise into 2023.

Financial markets are pricing a cash rate above 4% by the end of 2023.

We are operating in a rising Interest rate environment and there is little that this Budget has done to change that in the short term.

Businesses need to be prepared for rates to go higher and likely stay at these higher levels for an extended period.

The Budget has not tightened fiscal policy in any meaningful way. If inflation proves to be stronger than currently expected by most forecasters, then interest rates could continue to rise in 2023 and potentially into 2024.

The good news is that this Budget is not going to tip the economy into recession. A soft landing in 2023/24 will help keep people in jobs and support demand in the economy over the medium term.

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Tackling cost of living.

Support for household budgets focuses on childcare and medicines

Summary

A number of cost-of-living measures have been introduced in the Budget, most of which were announced ahead of time.

Childcare support, cheaper medicines and paid parental leave will help many households with costs.

Childcare support is broad based and generous. This will make it attractive for parents to return to work.

A reduction in the maximum PBS cost from $42.50 to $30 is worth $190m a year to consumers.

New and amended PBS medications will save Australians $1.4bn over four years.

These measures will have immediate effect and will help support households through a period of rising energy and interest costs.

There has been no broad-based direct cost of living relief such as fuel excise reductions. This is presumably because these types of policies are counterproductive, only adding to inflationary pressures in the system.

Key Stats

7.75%

Forecast inflation in Q4 2022

$4.7bn

Increased cost of childcare support

Inflation set to peak in 2022

The key for inflation is how quickly it comes down in 2023

Source: ABS, Treasury

What this means for SMEs

Cost-of-living relief has been targeted at households and will do little to reduce the cost of doing business for SMEs.

There was nothing in the Budget to help households or businesses with rising energy costs. Nor has there been any more clarity on the costs and implications of the longer-term transition towards renewable energy.

Supporting households means supporting customers for many SMEs and every little bit is going to help over the next two years.

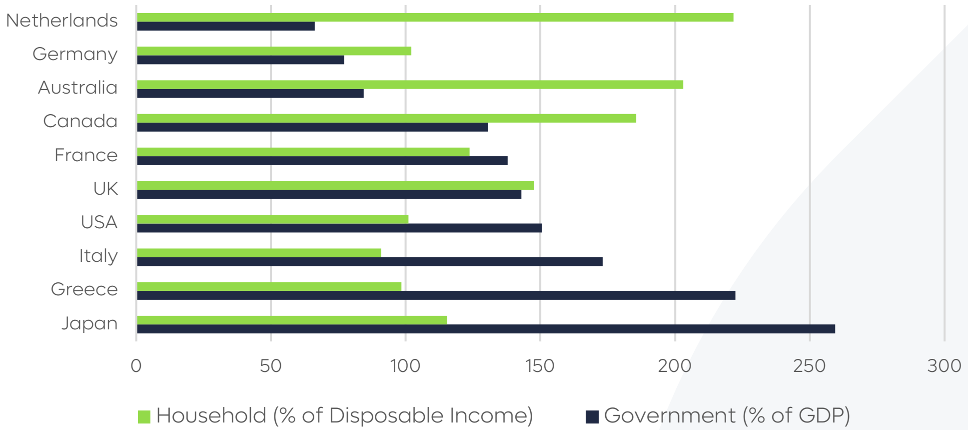
Businesses have been managing through rising costs for well over 12 months. They will need to continue to either mitigate new costs with savings elsewhere and investments in productivity or pass these on to their customers.

There is a risk that rising energy costs in 2022/23, on top of other cost of living pressures, will start to catch up with Australian consumers.

Budget snapshot.

International debt comparison

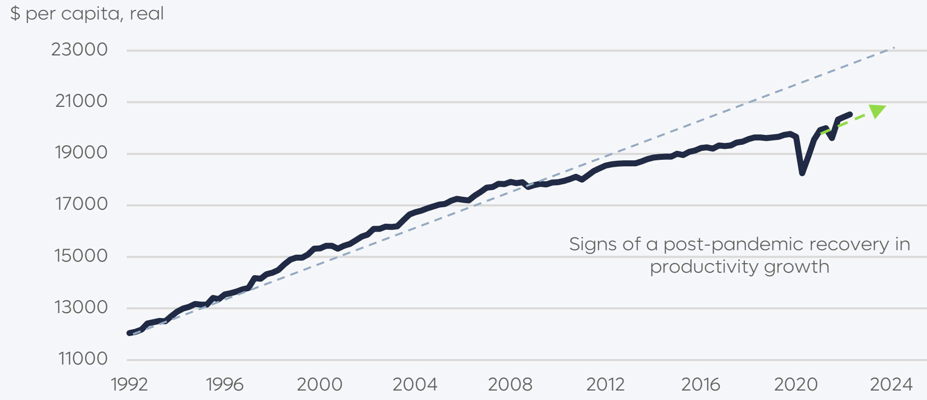
Countries with low government debt tend to have high household debt



Source: OECD

Productivity growth has been soft for a decade

Weak productivity growth holds back GDP per capita over the last decade



Source: ABS
Note: Real GDP per capita, quarterly

Index of commodity prices

Australian commodity prices have fallen 16% from the June 2022 highs but remain 50% higher than pre-pandemic levels

Source: RBA

Unemployment is forecast to remain low

The Government is hoping to lock in low unemployment for the long term

Source: ABS

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