

May '26 Federal Budget Summary

The 2026-27 Federal Budget was one of the most anticipated in years after last week's third successive RBA rate hike amid the energy crisis compounding cost-of-living pressures, with the global oil shock adding to inflationary pressures that had already reemerged late last year. Treasurer Jim Chalmers described the Budget as his 'most ambitious yet' ahead of the event and listed **five packages** (detailed below) to deal with the oil crisis, in parallel with issues such as generational inequality (especially around housing affordability) and lagging productivity.

The underlying cash deficit for FY27 was as expected at \$31.5 bn, while last year's forecast for FY26 was improved upon by \$14 bn thanks to the strong rebound in the economy in the second half of 2025. Being a net energy exporter and especially benefitting from higher LNG prices, the fiscal position enjoys a better starting point for FY27 and beyond, but structural deficits of 1% of GDP remain in place as increased spending on defence, renewable energy and housing become embedded. So an improved profile in percentage terms, before 'off budget' expenses-when they are added in (the 'headline cash balance') the deficit is around 2.1% of GDP.

Underlying cash balances: A\$ bn (and % of GDP):

Forecasts	2025-26	2026-27	2027-28	2028-29	2029-30
Budget 25-26, March 2025	-42.1 (-1.5)	-35.7 (-1.2)	-37.2 (-1.2)	-36.9 (-1.1)	n/a
MYEFO 25-26, December '25	-36.8 (-1.3)	-34.3 (-1.1)	-36.2 (-1.1)	-36.0 (-1.1)	n/a
Budget 26-27, May 2026	-28.3 (-1.0)	-31.5 (-1.0)	-31.0 (-1.0)	-34.4 (-1.0)	-25.3 (-0.7)

Source: budget.gov.au, Australian Department of the Treasury

Debt levels remain relatively low by international standards (especially on a net basis) but the rising interest rate and inflation environment for the next few years does make the \$1 Tn in gross debt a political challenge for the government to deal with. Nevertheless our AAA credit rating appears safe based on these forecasts from a fiscal perspective.

Debt projections: A\$ bn (and % of GDP):

Item	2025-26	2026-27	2027-28	2028-29	2029-30
Gross Debt	982.0 (33.1)	1051 (34.0)	1120 (35.2)	1193 (35.8)	1249 (35.6)
Net Debt	556.0 (18.8)	616.6 (19.9)	668.8 (21.0)	725.5 (21.8)	767.8 (21.9)

Source: budget.gov.au

The impact of the budget on inflation, and therefore RBA official cash rates, is likely to get more attention than the size of the deficit or debt levels. Last week's blunt comment from Governor Bullock on Government spending to households - "by giving them more money, it makes it harder to dampen demand" - sets the scene for this debate. The fifth 'package' below details this challenge, but the fiscal impulse isn't just coming from Federal spending- it is also coming from State and Territory Governments. The total budget deficit including all these sources is approaching 5% of GDP, so while much of the LNG windfall has been banked in this budget the RBA would still view fiscal policy as stimulatory, and consistent with our unchanged forecast of one more cash rate hike later in the year.

Most of the budget initiatives had been revealed prior to the formal release, but the five packages with their key announcements are summarised below.

1. Fuel and national security

- Boosting energy sovereignty by manufacturing clean fuels with domestic refining support; increasing fuel reserves (1 billion litres of fuel); a \$7.5 bn Fuel and Fertiliser Security Facility; \$1 bn in interest-free loans under the National Reconstruction Fund for domestic supply chains; and \$31.5 bn for the National Defence Strategy (taking defence spending to 3% of GDP by 2033) via an additional \$14 bn over the next four years as announced last month.

2. Cost of living relief

- Tax cuts from FY28 via a new additional \$250 Working Australia Tax Offset (worth \$6.4 bn) essentially funded by tax reforms detailed below; \$1000 instant deduction for work-related expenses (without receipts); increasing the low-income threshold on the Medicare levy; and increases to paid parental leave and childcare subsidies.

3. Structural tax reform

- Negative gearing (from July 2027) to be limited to new builds; the current CGT discount of 50% to be abolished for houses acquired after today and replaced with indexation (also from July '27) other than for new builds; and a minimum 30% tax on discretionary trusts.

4. Productivity and investment

- Regulatory costs to be cut by \$10.2 bn each year including through planning and housing reform; enhanced regulatory initiatives grid; a range of Productivity Commission recommendations for businesses such as free access to standards; lifting the R&D tax incentive threshold to \$200 m; and further removal of nuisance tariffs while adding venture capital incentives.

5. Savings

- NDIS costs reduced by \$15 bn in FY27 and \$37.8 bn over the forward estimates; removing the age-based private health insurance rebate; infrastructure 'reprioritisation' with the scaling back of projects such as the inland rail; and reducing spending on public sector consultants. In total the package claims to save more than \$70 bn over four years, with the Government declaring they have banked revenue upgrades rather than spending them.

Having sold these packages as addressing housing affordability and generational inequity while dealing with global pressures and poor productivity in our economy, the claim that 75,000 new first-home owners will now be in a position to buy a house in the next decade does pose other questions. What will the changes to taxes on investment properties do to rental costs, or to residential property prices more broadly? And given the opposition will oppose these changes, will they sail through both houses and then stay in place should there be a change in government? Indeed the fact that these reforms appear to constitute 'broken promises' does come with political risks - although traded probabilities of the 2028 election outcome are thus far largely unchanged after the budget.

The budget assumptions use a basecase scenario of the oil price peaking around current levels in mid-2026 before falling to US\$70 / bl next year, but also modelled as analysis of an 'alternative severe scenario' showing the impact of the Middle East conflict persisting into early next year. While that scenario didn't actually include a recession it did assume real GDP growth to slow to just 0.9% and a resulting \$22 bn hit to the budget bottom line. The basecase assumptions (like previous years) were highly conservative for Iron Ore (assumed to fall to US\$60 / tn by year end: once again sand bagging the budget for this highly unlikely outcome, with today's price at US\$110 / tn). The basecase assumptions in the budget appear sensible for the next 6 months, but then (like the RBA's) may be ambitious with respect to labour markets and also inflation, depending on the duration of the war.

Economic forecasts comparison:

Budget v Bendigo	(end of) FY26	FY27	FY28
GDP growth %	2.25 2.2	1.75 1.8	2.25 2.8
Unemployment %	4.25 4.5	4.5 5.3	4.5 5.7
CPI (headline) %	5.0 4.9	2.5 3.3	2.5 3.0

In summary, the budget made a genuine attempt at structural tax reform (albeit likely to be criticised as a broken promise) and did a reasonable job of banking windfall gains from higher commodity prices without materially adding to inflation. Some criticism may be seen via gross debt exceeding \$1 Tn next year, but the net-debt to GDP ratio remains below 20% so our AAA credit rating appears safe. The bigger test will be how materially the budget actually lifts productivity in the economy so that our 'potential output' growth rate can be closer to 3% vs the current 2% growth speed limit. The budget won't prevent another RBA rate hike (most likely in August or November) but it hasn't added to any urgency for the RBA, which will be determined mainly by the path ahead for the price of oil and critically when the Strait of Hormuz fully reopens.

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Things you should know

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