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Budget Monitor

Bread and butter, or a budget jam?

11 October 2022

Deloitte
Access Economics

Budget Monitor is a source of independent projections of the Federal Budget, including detailed estimates of future spending and revenues.

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Bread and butter, or a budget jam?

Budget aggregates

Based on policy announcements to the end of September 2022 and updated economic parameters, the underlying cash deficit is estimated to be $60.7 billion in 2022-23, shrinking to $35.7 billion in 2025-26. Net debt is expected to be 27.5% of GDP in 2025-26 compared to 33.1% estimated in the 2022-23 March Budget.

Budget forecasts

$ billion	2022-23	2023-24	2024-25	2025-26
Underlying cash balance % of GDP	-2.5%	-1.7%	-1.5%	-1.3%
Fiscal balance % of GDP	-2.5%	-1.7%	-1.7%	-1.2%
Revenue % of GDP	24.1%	24.5%	24.3%	24.4%
Expenses % of GDP	26.2%	25.8%	25.7%	25.3%
Net debt % of GDP	24.1%	25.4%	26.8%	27.5%

Source: Deloitte Access Economics

Economic drivers

Nominal economic growth will be faster in 2022-23 than the official forecasts assumed, providing an uplift in revenue. However, the economic outlook is softening from a deteriorating international environment.

Revenue

The 2022-23 October Budget is expected to reveal a further $114.4 billion in additional revenue over the next four years as a result of higher commodity prices and higher inflation than was assumed in the official forecasts.

Expenses

Spending is expected to be $68.9 billion higher over the four years, less than the increase in revenue expected over the same period, but enough to keep total spending ahead of total revenue.

Budget backdrop

Make no mistake, the global economy is facing a serious and significant downturn. Just as most economies around the world were emerging from the pandemic, the next global shock has arrived.

Triggered by central banks' response to higher inflation, the effect that Russia's war in Ukraine has had on global energy and food prices, and an international financial system that is bloated by debt and excess liquidity, this looming global downturn represents risk becoming reality.

As a result, the context in which plans for the 2022-23 October Budget are being finalised is complex and uncertain. It's a heady mix of financial market gyrations, policy announcements, data releases and sensationalist headlines, and it means that the margin for policy misstep is minimal.

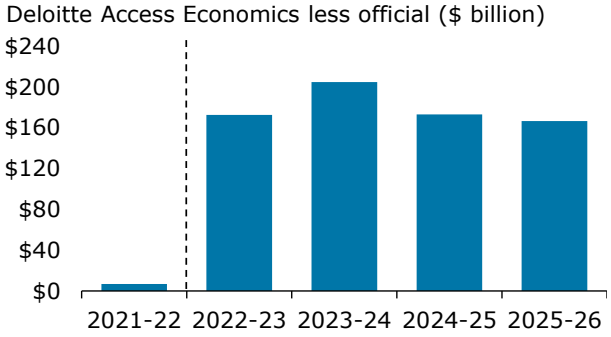
That is a daunting budget backdrop, but one that is made slightly less intimidating by an astonishing improvement in the bottom line over the past two years.

The government's timely and necessary emergency support in response to the pandemic led to massive increases in spending and debt. But the budget has staged a remarkable comeback.

It has been only a little more than six months since the 2022-23 March Budget was handed down by the former government, but the combination of high commodity prices, recovering economic activity and higher inflation helped the budget rake in an unexpected $27.7 billion in additional receipts in 2021-22. Combined with an equally-welcome and unexpected underspend, that saw the 2021-22 underlying cash deficit $47.9 billion less than forecast.

The fact that Australia has emerged from the pandemic with a budget position far healthier than most of our peers owes a lot to the strength of the economic recovery. Remarkably enough there is likely still some more left to bank, with Deloitte Access Economics expecting a further $114.4 billion in additional revenue over the next four years to be revealed in the October Budget on the back of substantial upgrades in the size of the nominal economy (see Chart i).

Chart i Difference in nominal Gross Domestic Product (GDP) forecasts



Source: Deloitte Access Economics, based on Commonwealth of Australia data

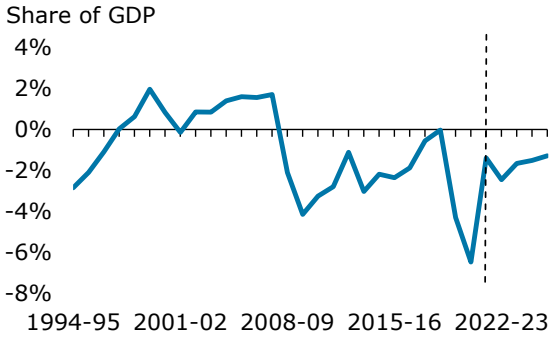
The upswing in revenue is entirely the result of cyclical serendipity – a clear example of passive budget repair. That passivity is serving Australia well for now, as the path back from some very large deficits becomes clearer.

But this is likely to be the last budget to unveil an unanticipated write up in government revenue for the foreseeable future. Continuing to repair the budget from here will require a more active strategy. That means making some difficult decisions. Those decisions will mean navigating the stand-off between 'good policy' and 'good politics' that keeps most Treasurers up at night.

If Australians want the government to continue to fund existing programs, and to meet the cost of a long list of important spending priorities – from aged care and child care, to disability care and defence – they need to be prepared to pay higher taxes over time.

Or Australians could decide that they don't, in fact, want or need some of that spending quite as much as they initially thought they did. Or some combination of the two.

Chart ii Underlying cash balance to GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Realistically, those tough decisions are more likely to be made in later budgets, say in 2023 or 2024, ahead of a 2025 election. The upcoming Budget will be more boring (or "*bread and butter*" as the Treasurer has put it). Watch for a modest set of savings. It's always easier to make cuts to the pet projects of your opponents, and even better when those cuts come years away from an election.

Deloitte Access Economics is looking for the Budget to set a sensible tone for the future – getting Australians primed for a series of modest changes that add up to a more sustainable fiscal position over time – while keeping one eye on near term economic challenges. Sensible changes to prune waste and tighten spending will help to ensure that the Federal Budget is in the best possible shape to aid in a response to a downturn (though admittedly from a less-than-ideal starting position).

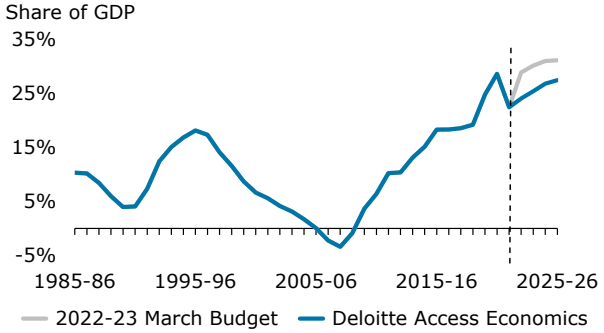
That's a difficult balance to strike. So, when the Treasurer stands up on budget night to deliver both the news of a big improvement in the bottom line and the news of difficult times ahead, he'll be exactly right.

Budget forecasts

Deloitte Access Economics' forecasts for key budget aggregates are shown in Table i. Building on the unexpected strength of revenue in 2021-22, the Budget released in October is expected to reveal a further $114.4 billion in additional revenue over the next four years compared to the forecasts included in the 2022-23 March Budget.

Spending is also expected to be higher, even when only accounting for policy announcements to 30 September 2022, as is done in this report. Cumulative underlying cash deficits are expected to be $45.5 billion lower over the same period, shaving 5.6% off the ratio of net debt to GDP in 2025-26.

Chart iii Net debt to GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Table i Budget projections

	Outcome 2021-22	Forecast 2022-23	2023-24	2024-25	2025-26
Budget aggregates, $ billion					
Revenue (accrual)	**596.4**	**597.1**	**627.5**	**645.1**	**678.3**
% of GDP	26.0%	24.1%	24.5%	24.3%	24.4%
Taxation revenue	**550.4**	**555.2**	**584.8**	**601.8**	**634.6**
% of GDP	24.0%	22.4%	22.8%	22.7%	22.9%
Non-taxation revenue	**46.0**	**41.9**	**42.7**	**43.3**	**43.7**
% of GDP	2.0%	1.7%	1.7%	1.6%	1.6%
Expenses (accrual)	**623.0**	**647.4**	**661.6**	**681.8**	**702.5**
% of GDP	27.1%	26.2%	25.8%	25.7%	25.3%
Fiscal balance	**-35.1**	**-61.6**	**-44.7**	**-44.2**	**-32.5**
% of GDP	-1.5%	-2.5%	-1.7%	-1.7%	-1.2%
Official forecast of fiscal balance	-35.1	-78.8	-58.8	-51.1	-39.8
Difference in fiscal balance	0.0	17.3	14.0	6.9	7.3
Underlying cash balance	**-32.0**	**-60.7**	**-42.5**	**-40.2**	**-35.7**
% of GDP	-1.4%	-2.5%	-1.7%	-1.5%	-1.3%
Official forecast of underlying cash balance	-32.0	-78.0	-56.5	-47.1	-43.1
Difference in underlying cash balance	0.0	17.3	14.0	6.9	7.3
Net cash flows from investments in financial assets[1]	**-1.3**	**-19.0**	**-13.0**	**-20.7**	**-14.6**
Headline cash balance	**-33.3**	**-79.7**	**-55.5**	**-61.0**	**-50.4**
% of GDP	-1.5%	-3.2%	-2.2%	-2.3%	-1.8%
Official forecast of headline cash balance	-33.3	-90.8	-60.4	-57.2	-49.9
Difference in headline cash balance	0.0	11.2	4.9	-3.7	-0.5
Net debt	**515.7**	**595.3**	**650.8**	**711.8**	**762.1**
% of GDP	22.5%	24.1%	25.4%	26.8%	27.5%
Official forecast of net debt (% of GDP)	22.5%	31.1%	32.6%	33.1%	33.1%
Economic forecasts, % growth					
Real GDP	3.9%	3.2%	1.6%	1.8%	2.5%
Employment^	3.3%	1.5%	0.9%	1.1%	1.7%
Unemployment rate*	3.8%	3.9%	4.3%	4.6%	4.6%
Consumer price index^	6.1%	6.4%	3.0%	2.4%	2.5%
Wage price index^	2.6%	3.6%	3.6%	3.3%	3.2%
Nominal GDP	11.1%	7.7%	3.5%	3.7%	4.6%

Rates of growth in all tables (unless otherwise indicated) are 'year average percentage changes' – the percentage change between the year indicated and the prior year. ^Employment, consumer price index and wage price index are through the year growth to the June quarter. *Unemployment rate is the rate for the June quarter. 'Official forecasts' refer to projections in the 2022-23 March Budget. 1 Net cash flows from investments in financial assets for policy purposes. Prior to 1999-00 these flows were known as 'net advances'.
Source: Deloitte Access Economics, The Commonwealth of Australia.

Budget backdrop

Inflation is helping to improve the bottom line, but a worsening global environment presents medium term risks.

This edition of *Budget Monitor*

Budget Monitor provides an independent view on the Federal Budget.

Unless otherwise indicated, the official forecasts shown in this issue of *Budget Monitor* are drawn from the 2022-23 March Budget.

To produce the budget forecasts presented in this report, Deloitte Access Economics has updated the latest budget figures by incorporating:

- Latest actual revenue and spending data for 2021-22, released as part of the Final Budget Outcome (FBO) in September 2022
- The effect of policy decisions announced by the new Government up until 30 September, including those announced during the election campaign
- The effect of changes in economic parameters, including Deloitte Access Economics' latest forecasts and therefore also implicitly capturing any difference between those forecasts and Treasury's view of the economic outlook.

Note that although the Treasurer released some updated forecasts as part of the economic statement in July, the latest, detailed fiscal projections are based on the economic parameters in the 2022-23 March Budget. The fiscal projections in the Pre-election Economic and Fiscal Outlook 2022, released in April, show only minor differences to the 2022-23 March Budget.

The remainder of this backdrop sets the scene for the upcoming Budget across three broad themes: the global economic backdrop, the need for budget repair, and inflation's impact on the cost of living versus the budget.

They are big themes, and they provide a daunting and complex setting for the preparation of the Federal Budget.

The global picture: budgeting on the cusp of a recession

Make no mistake, the global economy is facing a serious and significant downturn. The United Kingdom (UK) and Europe are already in recession, and Deloitte Access Economics' view is that a recession in the United States (US) – while likely much milder than that experienced across the Atlantic – will be almost impossible to avoid.

Closer to home, the world's second largest economy and Australia's most important trading partner (by some margin) is in the midst of its own slowdown. While China's economic data has shown patches of resilience in recent months – household consumption and sales of passenger vehicles are two examples – the outlook is sagging under the weight of a struggling property sector and the zero-COVID policy.

Deloitte Access Economics is also watching emerging markets closely. A synchronised tightening of policy interest rates around the world, combined with higher government bond yields in advanced economies, spells trouble for countries that find global capital elusive at the best of times. The strength of the US dollar is making matters worse, given that many emerging markets service US dollar-denominated debt and rely on commodity imports priced in US dollars.

It is in this context that plans for the 2022-23 October Budget are being finalised. It's a heady mix of global financial market gyrations, policy announcements, data releases and sensationalist headlines, and it means that the margin for policy misstep is minimal.

In that regard, the Treasurer is right that the UK experience of recent weeks offers a cautionary tale. To be clear, Australia's budget position and economic outlook is one that every developed country around the world would envy.

But it is worth pausing to reflect on the reaction to last month's 'mini budget' released in the UK. Three key points regarding the UK Chancellor's statement come to mind.

The first is the surprise. The size of the spending package was one thing – excluding policy decisions announced before 23 September, the so-called *Growth Plan 2022* included a huge £170 billion in new spending commitments – but the scale was matched only by the shock (something that financial markets never react well to).

The second point is a note on inequality. It certainly didn't help that the tax cuts and other decisions announced in the UK unambiguously favoured the wealthy. In fact, it wasn't even subtle. It has been largely missed within the reporting, but in an extraordinary example of political bravery, the plan included decisions to simultaneously abolish the cap on bonuses paid to bankers and require people on government support to seek employment more actively.

And third, as has been widely commented on, the decision to spend so much money flies in the face of the Bank of England's efforts to curb inflation. Having fiscal policy and monetary policy pull in opposite directions is never a good idea, but especially so when inflation is hitting multi-decade highs. This is a difficult balancing act – how does a government provide cost of living relief without further stoking inflation? It's a matter of degrees, and the announcements in the UK clearly overshot the mark.

It's no surprise that financial markets reacted with outrage, and there is nothing new in financial markets viewing politicians of all persuasions with a healthy dose of scepticism.

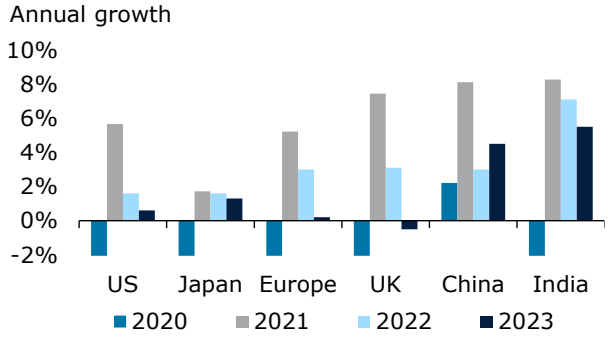
It's hard to see those same mistakes being made in Australia. Is it as simple as that? Or are there broader lessons to heed?

The UK experience is another reminder that the world economy has changed.

That change started after the 2008 financial crisis, when more and more central banks started purchasing government-issued debt in an effort to provide liquidity into financial markets, pumping up asset prices and further reducing long term interest rates in the process.

The onset of the pandemic then ratcheted up that process to another level. At their peaks through 2020 and 2021, central banks in the UK, Europe, Canada and New Zealand all held more than 40% of the stock of their respective governments' outstanding bonds. In Australia, that same peak was around 35%, while in the US the Federal Reserve took the policy a step further, purchasing not only government bonds, but corporate bonds too.

Chart 1 Real economic growth, major economies



Source: Deloitte Access Economics

As Deloitte Access Economics has been telling clients for some time, those unprecedented actions from central banks may have helped to avert an even larger crisis in 2008, but they also risked sowing the seeds of the next financial calamity. Those risks multiplied following the monetary policy response to the pandemic, with financial markets the world over becoming even more addicted to low interest rates, elevated asset prices and the idea that governments and central banks will keep coming to their rescue.

And so, the bigger issue to consider is whether global financial markets just fired a shot across the bow of global policymakers. Markets already hate the fact that central banks are pushing interest rates up a rapidly rising trajectory. Pity the politician who dares to announce a policy that might make that trajectory even steeper.

What are the implications of the global economic environment for the Federal Budget?

Like every good tautology, the statement that "*you can only control what you can control*" is both relevant and true no matter the context. It is particularly relevant and true right now.

The Australian Government can't control whether the economies of the northern hemisphere sink the global economy into recession. Nor can it control how deep that recession may be. But that doesn't mean it should simply watch helplessly from afar.

Budget decisions today should be made with the dangers of a potential global recession front of mind. That means making sensible changes to prune waste and tighten spending, ensuring that the Federal Budget is in the best possible shape to aid in a response to a downturn (though admittedly from a less-than-ideal starting position).

Budget repair: outcome, action or both?

Looking at the pile of debt that the pandemic has left behind, you would be forgiven for concluding that the Federal Budget is a shambles.

The virus did hurt the budget, badly. But it has staged a remarkable comeback. The 2021-22 FBO made that clear when it reported net debt of $515.6 billion (or 22.5% of GDP). The original post-COVID expectation for net debt in 2021-22, released as part of the 2020-21 Budget in October 2020, was $812.1 billion (or 40.4% of GDP). To be fair, a lot of the improvement in net debt in recent months has been due to the fact that government bond yields are rising, so bond prices are falling. Net debt is calculated on the market value of the borrowing.

The point, however, is that while the position of the Federal Budget is not great, it's a lot better than anyone anticipated.

The fact that Australia has emerged from the pandemic with a budget position far healthier than most of our peers owes a lot to the strength of the economic recovery. That recovery has lifted profits – particularly in the mining sector – and taken the unemployment rate to multi-decade lows.

Deloitte Access Economics had long maintained that the best way to fix the budget was to grow the economy – and that's exactly what has occurred. A strong economic rebound from the depths of the pandemic was anticipated. But the extent of the subsequent surge in commodity prices, the strength of the labour market, the faster uptick in wage growth, and the acceleration in price growth in Australia has all been, by and large, unanticipated.

All of those things boost the budget bottom line, and it hasn't taken any hard work from governments of either major party. Indeed, the upswing in revenue that has landed in the Federal Budget's lap is entirely the result of cyclical serendipity – a clear example of passive budget repair.

That passivity is serving Australia well for now, as the path back from some very large deficits becomes clearer. Remarkably enough there is likely still a little more left to bank, with Deloitte Access Economics expecting the October Budget to reveal a further $114.4 billion in additional revenue over the next four years.

However, that passive budget repair will only be able to achieve so much. Waiting for the budget to fix itself will only work for so long.

The time for active budget repair is creeping closer. That is less about where we are now and more about where we are headed.

There is a large and growing list of priorities that will require spending to settle at levels well above where it was before the pandemic. It is great that the government is talking about that list now and highlighting the expected drain on the budget from spending on aged care, the National Disability Insurance Scheme (NDIS), child care, and defence. What needs to come next is a plan to meet those rising costs over time.

That means making some decisions. Ones that require hard choices. If Australians want the government to continue to fund existing programs, and to meet the cost of these priorities and others into the future, they need to be prepared to pay higher taxes over time.

Or Australians could decide that they don't, in fact, want or need some of that spending quite as much as they initially thought they did. Or some combination of the two.

Realistically, those tough decisions are more likely to be made in later budgets, say May 2023 or May 2024, ahead of an early 2025 election.

Watch for a modest set of savings in the Treasurer's first budget. It's always easier to make cuts to the pet projects of your opponents, and even better when those cuts come years away from an election.

Deloitte Access Economics is also looking for the October Budget to set a sensible tone for the future – getting Australians primed for a series of modest changes that add up to a more sustainable fiscal position over time. That conversation is also one that's easier without the looming shadow of an election. Such as now.

Cost of living versus the budget

Cost of living pressures dominated Labor's election pitch and continue to dominate the headlines. Having said a lot about inflation, the government is now under pressure to do something about it.

Paradoxically enough, providing relief against inflation can itself be inflationary. As recent events in the UK show, at a time when the central bank is trying to slow the economy by raising interest rates, it's important that fiscal policy doesn't lean on the accelerator.

That's not an easy juggle, and it's made even harder by a looming slowdown in economic activity. Getting Australians to understand why the government can't do more will take some explaining – fortunately the new Treasurer has already had some practice on that front, refusing to budge on the scheduled end of the 22 cents per litre excise cut at the end of September.

One thing the government won't be explaining in fine detail to the public is the impact of inflation on its revenues.

Because while rising prices are bad news for households, they are a bonanza for the budget.

Think of taxes as being levied against a share of national income. That means that, other things equal, when income rises – for whatever reason – the government tax take rises as well.

'Whatever reason' might be good, such as a lift in labour productivity improving the real wages of Australian workers, or an increase in the price of Australia's exports.

Or it might be bad, such as higher inflation. If taxes are thought of as being a share of the value of all of the spending churning around the Australian economy, it's easy to see why a faster increase in the 'price' of that spending will mean more revenue for government. Bracket creep is part of the story here, too (something that the Stage 3 tax cuts are intended to help manage).

Higher inflation doesn't just lift revenue, it also reduces debt. Not in an absolute sense – the same dollars still need to be repaid – but in a relative one. In a world of higher inflation, a dollar being used to repay a debt today is worth just a little bit less than the dollar that was borrowed yesterday.

It's worth noting that higher inflation is also adding to the cost of governing. Spending on a range of government services is indexed to inflation including pensions, aged care and child care. But the impact of a larger economy and higher prices on revenue dwarfs the resulting extra spending.

Overall, that means higher inflation is a big part of the improved fiscal position that the Treasurer will unveil on budget night.

Economic outlook

Commodity price boost to moderate; global downturn on the way.

The Australian economic outlook

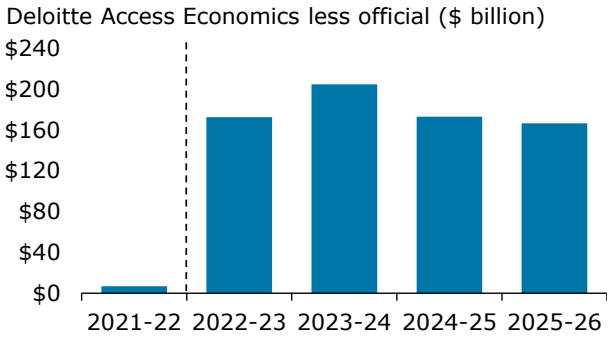
Nominal GDP and the terms of trade

There is nothing better for the federal coffers than a large lift in nominal GDP, and the past year has seen the fastest nominal GDP growth since the late 1980s.

There was always going to be a big post-pandemic bounce in economic growth – that's what comes from stopping the economy and starting it back up again. It's more than that, however. After the hit of the first COVID-19 lockdown in mid-2020, the Australian economy rebounded to be back above pre-pandemic levels before the new calendar year.

Since then, growth in nominal spending – which includes the impact of price growth – has remained strong. Over the past year, Australia's nominal economy was more than 7% larger than it would have been if it had followed the 20-year trend that was evident before the pandemic hit. That continued strength in nominal GDP wasn't anticipated when the 2022-23 March Budget was handed down (largely because of budget assumptions on commodity prices).

Chart 2 Difference in nominal GDP forecasts



Source: Deloitte Access Economics, based on Commonwealth of Australia data

The Budget (and the 2022 Pre-election Economic and Fiscal Outlook) assumed nominal GDP growth of just 0.5% in 2022-23. That was revised up to 5.25% in the Treasurer's *Statement on the Economy* in July.

Deloitte Access Economics now expects nominal GDP growth of almost 8% in 2022-23. While that unexpected growth has done wonders for repairing the budget balance, it won't last. Most of the acceleration in nominal GDP growth has been driven by significant price increases in major Australian exports, while broader price pressures across the economy are now also playing their part.

Energy prices started to rise in mid-2020 reflecting a recovery in demand and tight supply. The prices of oil and gas accelerated higher in the first half of 2022 following Russia's invasion of Ukraine. Sanctions have disrupted Russian oil exports, while bans on imports of Russian coal by some countries and increased demand (in part as a substitute for natural gas) have seen coal prices continue to increase.

The Reserve Bank's index of commodity prices has almost doubled over the last two years. Most of that gain occurred prior to the outbreak of war in Ukraine, but geopolitical tensions have added to prices for coal, gas, and rural commodities in particular.

However, most of that is now old news. As detailed earlier in this edition of *Budget Monitor*, the global economy is on the precipice. As global demand slows, commodity prices will cool from current highs. Yet, that broad statement masks an important, emerging trend – the divergence of the price of energy commodities from the price of non-energy commodities. That divergence, which began in February 2022, has widened in recent weeks, and is expected to continue in the short-term. While supply side shocks and constraints are likely to keep energy prices elevated, a slowing global economy will result in continued weakening of non-energy commodity prices.

Given Australia's mix of exports, that divergence somewhat muddies the outlook for the terms of trade. Even so, Deloitte Access Economics expects a large fall in the terms of trade through the remainder of 2022-23 as the global outlook weakens.

The real economy

The risks to the economy are very real, but Australia is expected to avoid a recession in the near term. Navigating the myriad global and domestic economic challenges won't be easy, but there are still some important positives to note, including the strength of the labour market.

Two topics bear watching closely. The first is the global economic outlook – the deeper the recessions in the US, Europe and the UK, and the less that Chinese growth rebounds after the Communist Party congress, the greater the impact on Australia.

The second is the actions of the Reserve Bank of Australia (RBA). The RBA's determination to crush inflation by rapidly raising interest rates and slowing the economy must be balanced against the risk of causing the misery of a deep recession. The risk of lifting rates too much is now clear, and more caution is required. The reduction in the size of the rate hikes to 25 basis points in October was welcome.

Deloitte Access Economics' own forecasts for interest rates are below the path implied by financial markets. Even assuming a less dramatic lift in rates, Australian economic activity is expected to weaken through calendar year 2023. That slowdown will be led by the housing sector in particular, but more careful consumers and benign business investment will also weigh on growth. Real economic growth in Australia is expected to decelerate from the 3.9% recorded in 2021-22 to just 1.6% in 2023-24. Still, Australia is better placed to weather current global risks than most other advanced economies.

The soft economic outlook is likely to mean the 2022-23 October Budget will be the last to record a large upside surprise in revenue for the foreseeable future. Deloitte Access Economics would suggest tempering any excitement about the improvement to the bottom line that will be unveiled on budget night. The budget may have staged a comeback, but it probably won't last.

Table 1 Australian economic forecasts (% growth)

	History 2021-22	Forecasts 2022-23	2023-24	2024-25	2025-26
Gross domestic product					
Household consumption	4.1%	5.2%	1.2%	1.8%	2.4%
Dwelling investment	2.8%	-6.2%	0.5%	5.2%	
Business investment	5.8%	2.2%	0.8%	1.6%	3.7%
Public final demand	6.6%	3.3%	3.2%	2.8%	2.9%
Gross national expenditure	5.2%	3.0%	1.5%	2.2%	2.9%
Real GDP	3.9%	3.2%	1.6%	1.8%	2.5%
Nominal GDP	11.1%	7.7%	3.5%	3.7%	4.6%
Prices and wages					
Consumer price index^	6.1%	6.4%	3.0%	2.4%	2.5%
Wage price index^	2.6%	3.6%	3.6%	3.3%	3.2%
GDP deflator	6.9%	4.4%	1.9%	1.9%	2.0%
Terms of trade	12.1%	-10.1%	-5.5%	0.7%	0.7%
Labour market and population					
Participation rate*	66.6%	66.8%	66.7%	66.6%	66.7%
Employment^	3.3%	1.5%	0.9%	1.1%	1.7%
Unemployment rate*	3.8%	3.9%	4.3%	4.6%	4.6%
Population	0.7%	1.2%	1.3%	1.3%	1.3%
Net overseas migration (number)	157,520	194,996	205,265	227,748	227,618

Note: Base year for real data is 2019-20. Rates of growth in all tables (unless otherwise indicated) are 'year average percentage changes' – the percentage change between the year indicated and the prior year. ^Employment, consumer price index and wage price index are through the year growth to the June quarter. *Unemployment rate and participation rate is the rate for the June quarter.
Source: Deloitte Access Economics, Australian Bureau of Statistics

Revenue

Cyclical serendipity, not structural strength.

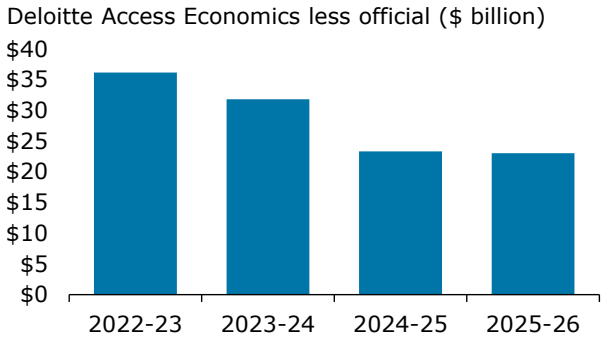
Just as growth in Australia's nominal GDP is breaching record highs, so too is growth in government revenue. Growth in government revenue on a rolling, 12-month basis was last travelling at its current pace back in early 2008 amid the glory days of the mining boom.

This time around it is high energy prices, rising inflation and Australia's robust labour market that are combining to boost tax revenue. This amounts to an extraordinary recovery from the hit taken to the tax take during the worst of the COVID-19 downturn.

The recovery in revenue since the pandemic has helped total revenue in 2021-22 rise to double what it was on the eve of the financial crisis in 2007-08.

Deloitte Access Economics' revenue forecasts compared to the latest official estimates are shown in Chart 3 and Table 2.

Chart 3 Total revenue forecasts compared to 2022-23 March Budget



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Table 2 Accrual revenue estimates ($ billion)

	2022-23		2023-24		2024-25		2025-26	
	Official estimate	***Budget Monitor***	**Official estimate**	***Budget Monitor***	**Official estimate**	**Budget Monitor**	**Official estimate**	**Budget Monitor**
Individuals[1]	270.1	274.7	295.6	299.6	297.1	301.0	315.2	319.8
Company tax	92.2	118.2	89.2	112.6	105.2	121.2	111.6	126.7
Superannuation fund taxes	15.7	15.4	19.4	19.4	20.6	21.3	22.1	23.3
Other income tax[2]	6.0	6.4	6.3	6.4	6.5	6.5	6.7	6.7
Total income tax	**384.0**	**414.7**	**410.5**	**438.0**	**429.4**	**450.0**	**455.6**	**476.5**
GST	82.5	84.7	85.9	87.1	89.9	90.2	94.0	94.4
Excise and customs duty	42.6	43.9	45.1	46.7	47.1	48.4	49.2	50.1
Other indirect tax[3]	11.9	11.9	12.9	13.0	13.0	13.2	13.5	13.6
Total indirect tax	**136.9**	**140.5**	**143.9**	**146.8**	**150.0**	**151.8**	**156.6**	**158.1**
Total taxation revenue	**521.0**	**555.2**	**554.5**	**584.8**	**579.4**	**601.8**	**612.2**	**634.6**
Non-taxation revenue[4]	**40.0**	**41.9**	**41.2**	**42.7**	**42.4**	**43.3**	**43.0**	**43.7**
Total revenue	**560.9**	**597.1**	**595.7**	**627.5**	**621.7**	**645.1**	**655.2**	**678.3**

Note: Official estimate refers to 2022-23 March Budget. 1 Individuals includes gross income tax withholding, gross other individuals less refunds. 2 Other income tax includes fringe benefits tax and petroleum resource rent tax. 3 Other indirect tax includes wine equalisation tax, luxury car tax, Major Bank Levy, Agricultural levies, and other taxes. 4 Non-taxation revenue includes sales of goods and services, interest, dividends and distributions, other non-taxation revenue.
Source: Deloitte Access Economics, The Commonwealth of Australia

Those forecasts show that Deloitte Access Economics expects the surge in revenue to add $114.4 billion to government coffers over the next four years when compared to the forecasts included in the 2022-23 March Budget, released only a little more than six months ago. Most of that gain will come via company tax collections, and there are also upward revisions for personal income tax and indirect taxes.

The outperformance in revenue is terrific news for the budget. However, it's worth remembering the upheaval of the last 30 months. The government ran up debts and deficits in response to COVID-19, and spending on health, aged care and defence (covered in the following chapter) is expected to add to budget pressures in the years ahead.

So, despite the fact that revenue has received a huge boost, it will not surpass government spending in any year in the foreseeable future.

The improvement in the budget is welcome. But the terrific news is also temporary news. It's pure, cyclical serendipity. That is worth keeping front of mind while surveying the extra billions flowing to Canberra, detailed by revenue head over the next several pages.

Individuals and other withholding tax

Gross income tax withholding

The strength of Australia's labour market is supporting upward revisions to the largest single component of tax revenue – income tax withholding. The unemployment rate is around the lowest rate in 50 years, while employment and the participation rate are near record highs. The result is more people earning a salary and paying income tax, and Deloitte Access Economics expects more revenue from gross income tax withholding in each year from 2022-23 to 2025-26 compared to the forecasts in the 2022-23 March Budget.

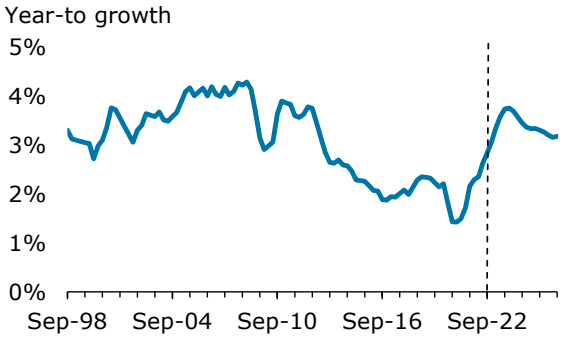
Employment grew faster over the year to June 2022 than what had been assumed in the latest Budget, and some of that momentum has carried into 2022-23. Conditions in the labour market are expected to stabilise, and Deloitte Access Economics forecasts total employment growth to moderate to 0.9% over the year to June 2024. That compares to growth of 1.5% expected in the 2022-23 March Budget over the same period (updated to 1.25% in the forecasts released as part of the Treasurer's economic statement in July).

It's better news further out, with Deloitte Access Economics expecting a pick-up in employment growth through 2025-26. The total *level* of employment currently expected by Deloitte Access Economics in June 2026 is slightly above the level implied by the March Budget.

It's a stronger story for wages over the forward estimates. The Wage Price Index (WPI) grew by 2.6% in the year to June 2022 compared to the budget forecast of 2.75%. But wage growth is expected to pick up from here. Deloitte Access Economics expects growth in the WPI to average 3.4% over the next four years, outpacing the forecasts in the latest Budget over the 12 months to June 2023 and to June 2024, and adding to an overall lift in taxable income.

It's also worth noting that broader measures of wages such as Average Weekly Earnings (AWE) and the national accounts measure of average earnings – that are better indicators of tax potential – are expected to grow at a faster pace than the WPI over the next few years.

Chart 4 Wage Price Index



Source: Australian Bureau of Statistics, Deloitte Access Economics

The largest policy affecting gross income tax withholding is the Stage 3 tax cuts legislated by the previous government (with bi-partisan support) and committed to by the current one. By reducing the marginal tax rate that applies to income over $45,000 to 30 cents, the Stage 3 cuts provide relief to most taxpayers. But by extending that 30 cent rate up to $200,000 – and abolishing the 37 cent rung of the income tax system in the process – the policy primarily advantages high income earners (with Stages 1 and 2 favouring low and middle income earners).

The tax cuts scheduled for 2024-25 maintain the progressive structure of personal income tax. However, weakness in wage gains in recent years means they now over-achieve in offsetting bracket creep.

And they are expensive. The much-quoted $243 billion over nine years costed by the Parliamentary Budget Office (PBO) was only completed a few months ago, but may now be an underestimate given the expected pace of wage gains, particularly in the short term.

There have been plenty of questions asked about the future of Stage 3. There are signs that the Treasurer and Prime Minister may be starting to wobble on a clear election commitment. That would require some explaining, no doubt around how fiscal circumstances have changed.

Underlying the debate is that future tax considerations should focus on good policy – in this case, ensuring that Australia's income tax system is the best it can be, with reference to economists' usual priorities of efficiency, fairness, competitiveness and administrative simplicity, and that tax changes are appropriate for the fiscal conditions of the time.

But politics is different to policy. At this point it is doubtful that the Treasurer's commitment will wane in the October Budget. But beyond? Given they don't take effect until 1 July 2024 there is still plenty of time for the Government to find a reason for the Stage 3 cuts to be repealed or amended, or equally to find some offsetting savings.

Two key points have largely been overlooked in the debate. First, even with the Stage 3 cuts, the share of federal taxation revenue contributed by tax on individuals' earnings (including the Medicare levy) continues to increase over time, and breaches 50% in 2024-25 and 2025-26 (that is, after the cuts come into effect).

And second, even with the Stage 3 cuts, the average income tax rate paid by Australians will climb to a record high over the next few years.

Overall, Deloitte Access Economics' views on employment and wages see the national wage bill growing slightly faster from 2021-22 to 2025-26 compared to the forecasts Treasury factored into the 2022-23 March Budget. The result is that Deloitte Access Economics forecasts income tax withholding to be $10.5 billion higher than the latest official forecasts across the next four years.

Gross 'other individuals' tax

'Other individuals' includes taxes on non-wage incomes such as from unincorporated (often small) businesses, as well as on farm incomes, interest, rent and dividends, plus taxes on some wages and salaries not in withholding tax.

There are several factors that placed upward pressure on 'other individuals' tax collections in 2021-22:

- Farm incomes increased alongside elevated prices and near-record volumes
- More employees received bonuses as employers sought to attract and retain staff
- Dwelling rents grew despite the wider slowdown in dwelling values
- Higher interest rates towards the end of the financial year will lead to higher interest earnings.

Of those factors which added to the 'other individuals' tax take in 2021-22, only higher interest rates are expected to persist into the future. The first half of 2022-23 also saw a lift in dividends paid to shareholders. CommSec has estimated that aggregate ASX200 company dividends paid in September / October 2022 would be almost 17% higher than for the previous reporting period six months earlier.

In general, however, the downturn in the housing market and softer conditions on sharemarkets are set to weigh on this part of the budget via softer capital gains, felt primarily in 2023-24 and 2024-25. Deloitte Access Economics expects 'other individuals' tax to outperform the latest official forecasts by almost $2.0 billion in 2022-23 as a result of the larger nominal economy and the impact on small business profits. That difference is expected to drop to around $1.6-1.7 billion in subsequent years as softer asset prices weigh on capital gains.

Income tax refunds for individuals

Deloitte Access Economics forecasts slightly larger refunds across each year of the forecast period (a net negative for revenue), due to the stronger outlook for the labour market and income tax withholding.

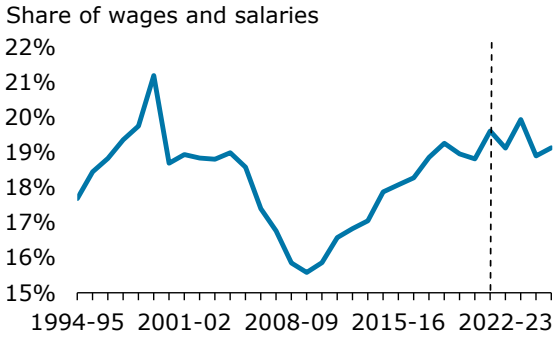
Policy decisions are also affecting the size of refunds over the forecast period, though these effects are already included in the official forecasts. In particular, the extension of the low and middle income tax offset (LMITO) into the 2021-22 financial year will add to refunds in 2022-23.

Total revenue from taxes on individuals

The total tax take from individuals is expected to outperform the latest official forecasts, particularly in 2022-23 thanks to stronger-than-expected wage growth. The outperformance is likely to moderate slightly in 2023-24 and 2024-25 as a result of a weaker economy and softer asset prices, hovering around $4.0 billion higher than official forecasts in those years.

The average rate of personal income tax is expected to almost breach 20% in 2022-23 – the highest rate since 1999-00.

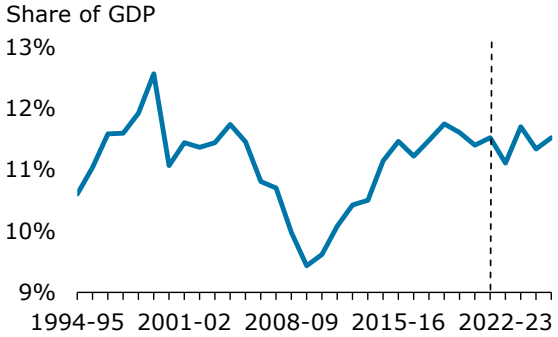
Chart 5 Average rate of personal income tax



Source: Deloitte Access Economics

Although personal tax collections are rising, so too is national income. Deloitte Access Economics' forecasts therefore show little change in collections as a share of the economy, seen in Chart 6.

Chart 6 Taxes on individuals as a share of GDP



Source: Australian Bureau of Statistics, Deloitte Access Economics

Company and other (non-personal) income tax

Company income tax

Company income tax is the key driver of the improvement in the budget bottom line. A record $125.9 billion was collected in 2021-22, up 27.0% on the previous year and $14.4 billion (or 12.9%) more than was anticipated when the Budget was handed down at the end of March.

That took company tax to a new record high share of 22.9% of the total tax take in 2021-22.

The improvement has been underpinned by higher-than-expected commodity prices, including as a result of Russia's invasion of Ukraine, which have seen the profits of Australia's mining sector surge

Compared to the assumptions in the 2022-23 March Budget, as of the end of the September:

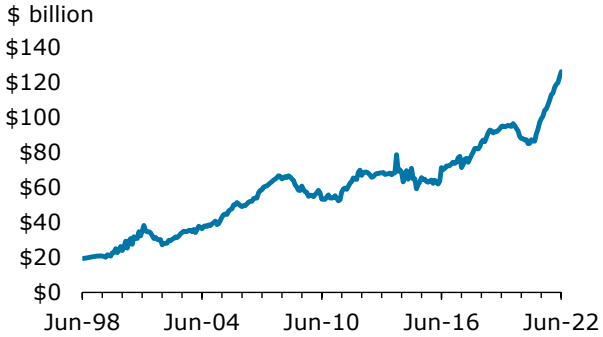
- Iron ore prices are around US$95 per tonne instead of US$55 per tonne
- Metallurgical coal prices are US$275 per tonne instead of US$130 per tonne
- Thermal coal prices are US$435 per tonne instead of US$60 per tonne
- Gas prices – though not published in the budget – have hit a new record high.

But the windfall will be temporary. The question is how quickly and by how much will commodity prices fall.

The good news in the mining industry is offsetting some bad news elsewhere – non-mining company profits fell slightly in 2021-22 as higher costs eroded margins.

This raises some risks for the company tax take when commodity prices and mining profits return to more normal levels. Indeed, Deloitte Access Economics expects those two factors – an easing of commodity prices and modest non-mining profit growth – to cause company tax revenue to slip backward over the next two years.

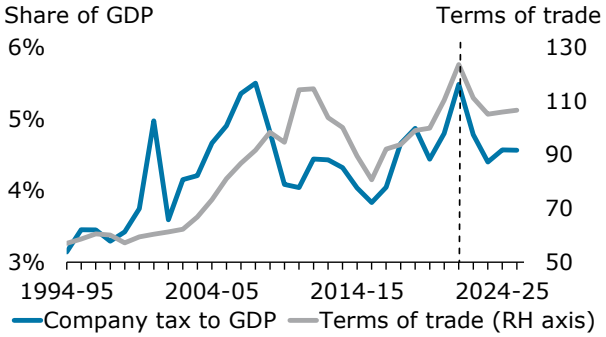
Chart 7 Company tax, rolling 12 month total



Source: Deloitte Access Economics

Those falls in 2022-23 and 2023-24 will take a sizeable chunk out of the company tax take. But they are falls from the record high in 2021-22, and so the upward revision in company tax compared to forecast included in the 2022-23 March Budget is still enormous.

Chart 8 Company tax and terms of trade



Source: Deloitte Access Economics

Deloitte Access Economics forecasts company tax collections to tip an extra $49.5 billion into the budget over 2022-23 and 2023-24, followed by an extra $31.1 billion across 2024-25 and 2025-26.

Fringe benefits tax

The increase in the total compensation of employees – mostly due to wages, but also partly due to employment – has added to forecast fringe benefits tax (FBT) collections.

But this will be somewhat offset by the continued move away from fringe benefits. FBT collections have fallen as a share of total taxes on individuals for decades amid a range of concessions and exemptions, as well as employees opting out. More recently, the increased adoption of hybrid-working arrangements as a result of the pandemic has also made salary packaging less attractive in some instances (for example, cars and parking) and may be reducing the opportunities for entertainment-related fringe benefits.

The result is that Deloitte Access Economics forecasts FBT collections to be in line with official forecasts from 2022-23 to 2025-26, only adding a modest $96 million to revenue in total over that period.

Petroleum resource rent tax

Petroleum Resource Rent Tax (PRRT) collections are expected to be higher in 2022-23 compared to the forecasts presented in the 2022-23 March Budget as a result of the lower value of the Australian dollar compared to the US 72 cent budget assumption.

Thereafter, Deloitte Access Economics' view is broadly in line with the official forecasts as a weakening oil price weighs on resource profits. International oil prices are expected to trend below the US$100 per barrel assumption underpinning Treasury's forecast for the PRRT.

Spot gas prices remain near record highs following Russia's invasion of Ukraine, but most of Australia's LNG is sold on oil-linked contracts. That presents a degree of upside in PRRT collections from 2023-24 given that the price of oil may float higher than both Deloitte Access Economics and Treasury have allowed in the forecasts while the conflict in Ukraine continues for longer without a clear end in sight.

The PRRT also allows companies to deduct the investment cost of projects. These upfront capital costs are large and were incurred within the last decade for many projects. That suggests there will be less upside for PRRT collections relative to a tax on the value or volume of production.

Superannuation fund taxes

Superannuation taxes are levied on contributions to super and earnings from super.

Contributions taxes continue to benefit from growth in the total compensation of employees. That is expected to continue in the near term, with the national wage bill forecast to grow by 7.3% in 2022-23 and 5.7% in 2023-24.

Meanwhile, the minimum super guarantee is also legislated to increase from its current rate of 10.5% to 12% in 2025-26, adding further to contributions (and, therefore contributions taxes).

But the upward pressure on contributions taxes is expected to be more than offset by a fall in earnings taxes.

Super fund earnings draw from a range of markets, but the Australian and key global sharemarkets play an outsized role. These sharemarkets saw an extended run of gains from early 2020 through much of 2021, but have since eased back amid a slowdown in the global economy, elevated inflation, rising interest rates and the energy crisis resulting from Russia's invasion of Ukraine. This is placing downward pressure on asset markets, which will weigh on tax collections from 2022-23.

After doubling in 2021-22 to $26.6 billion, superannuation taxes are forecast to fall back to around $15.4 billion in 2022-23. That fall reflects weaker tax receipts on earnings following the strong returns 2021-22. Super taxes are expected to grow solidly from 2023-24 due to taxes on steadily rising contributions and an assumed return to average returns.

Goods and services tax (GST)

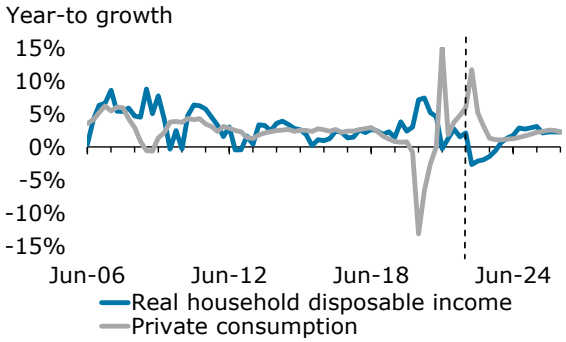
Consumer spending – a key driver of GST revenue – is still leading Australia's economic recovery from the pandemic. However, rapidly rising interest rates, falling house prices and negative economic news has caused sentiment to plummet, and spending is expected to follow suit.

After lifting by 4.1% in 2021-22, continued momentum is expected to drive further growth in consumer spending of 5.2% in 2022-23.

That will support strong growth in GST collections in the current financial year, with a significant share of that consumer spending on goods and services subject to the GST. Higher inflation also means higher GST revenues as the tax is levied on the value rather than the volume of goods sold.

That's where the good news on the GST may come to an end, however. Deloitte Access Economics forecasts consumer spending to grow by just 1.2% in 2023-24, contributing to expected average annual growth of 1.8% over the three years to 2025-26.

Chart 9 Consumer spending and real household disposable income



Source: Deloitte Access Economics

A weaker housing market in response to higher interest rates will also weigh on collections. Deloitte Access Economics is anticipating a fall in dwelling construction activity – a key source of GST revenue – of almost 6.2% in 2022-23, followed by very modest growth of 0.5% in 2023-24. A recovery in residential property construction activity is anticipated in 2024-25 and 2025-26.

As a result of these trends, Deloitte Access Economics expects GST collections to slightly outperform the 2022-23 March Budget forecasts in 2022-23, but for that outperformance to moderate through 2023-24 and 2024-25. The total difference in GST receipts is forecast to be $4.1 billion over the next four years.

The GST will be transferred to the states via outlays. Yet the GST is no longer a dollar-for-dollar transfer following the Morrison Government's deal with Western Australia.

The strong growth in Western Australian state revenues will mean the Federal Government will have to pay far more than the $9 billion over 10 years that was initially planned. That will show up in outlays as well.

Excise and custom duties

Excise duties

Excise duties apply to a range of products, most notably petroleum products, beer, spirits and tobacco.

The excise is paid on the volume of products manufactured in Australia and rates are typically indexed twice a year in line with the Consumer Price Index (CPI).

It's the volume of product sold that primarily drives government excise revenue, but the occasional large change in the rate can have a significant impact.

That just happened, with the previous government halving the excise rate on petroleum products for six months to ease the burden of a rising cost of living for households, costing the budget some $3 billion in revenue.

The pandemic weighed heavily on petroleum excise revenue. Lockdowns meant fewer people driving, while closed interstate borders meant that those who weren't locked down had fewer places to go. That's now well and truly rebounded, with more outings and road-trips, more planes in the air and more Australians shifting from virtual to physical workplaces all contributing to resurgent demand for fuel.

The growth in electric vehicles (EVs) presents a key long-term risk for petroleum excise.

EVs accounted for almost 5% of new vehicle sales in the latest data, with that trend only heading in one direction. The Federal Government has also introduced new FBT exemptions for EVs and removed the import tariff for eligible EVs, while state and territory governments are also setting new targets (including the ACT Government, which will ban the sale of light vehicles with internal combustion engines from 2035).

Overall, total excise duty is forecast to be around $2.4 billion higher over the next four years compared to the forecasts presented in the 2022-23 March Budget, as a result of resurgent demand for petroleum products and a forecast outperformance in petroleum excise (allowing for the reinstatement of the full rate of excise at the end of September 2022).

Customs duties

Customs duties rest on a small base, with around 90% of the value of imports being duty free.

Around one third of customs revenue is derived from passenger vehicles and textiles, clothing and footwear. New passenger vehicle sales are growing at their fastest rate in five years thanks to an ongoing degree of pent-up demand. Meanwhile, spending on clothing and footwear grew at double digit rates over the past year – despite rising cost of living pressures.

A further one third of revenue is raised from excise-equivalent duty on petroleum products, alcohol and tobacco, while the final third of customs revenue is from other products subject to a general tariff rate of 5%.

The outlook for excise-equivalent tobacco duty is only modest owing mainly to declining rates of smoking, though successive governments have considerably increased the rate of duty over time helping to prop up collections.

The growth in nominal goods imports is forecast to broadly track wider economic growth over the next four years, helping customs revenue to tick along.

Deloitte Access Economics forecasts higher customs duty revenue in both 2022-23 and 2023-24 compared to the official forecasts (amid stronger nominal goods imports). That outperformance is expected to partially unwind over 2024-25 and 2025-26 as a result of weaker consumer spending and imports growth.

Other indirect tax

Other indirect taxes include the Major Bank Levy, the Wine Equalisation Tax, agricultural levies and broadcasting fees, as well as all other tax revenues collected by Commonwealth agencies.

At almost $650 million, agricultural levies and charges raked in more revenue in 2021-22 than in any other year since the late 1990s. That near 25-year high in taxes paid highlights the bumper period many farmers have enjoyed despite the disruption of the pandemic.

So, while the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) is forecasting another near-record Australian harvest in 2022-23, and while tight global supply is expected to see soft commodity prices remain elevated, it's unlikely that agricultural levies and charges will surge to even greater heights. Rather, strong (but not record) taxes paid in 2022-23 are expected to be gradually pared back over subsequent years, leaving them above the forecasts in the last Budget.

Most alcoholic beverages are subject to a volumetric excise based on the type of drink and the alcohol content, but wine is taxed separately on a value basis. The volume of alcohol consumed continues to grow, but at much lower rates compared to the peaks seen during lockdowns. This slower growth is expected to continue, with Australians now drinking less alcohol per capita over time. But the value of alcohol consumed remains high as a result of a shift to higher quality. That's a positive for collections of the Wine Equalisation Tax.

Major bank liabilities have reached a new record high in the latest data which will further boost the revenue received from the Major Bank Levy.

Deloitte Access Economics expects other indirect taxes to broadly track the official forecasts in each year to 2025-26, with slightly higher revenue forecast. Around $390 million in additional indirect tax revenue is anticipated over the next four years compared to the forecasts in the 2022-23 March Budget.

Non-taxation revenue

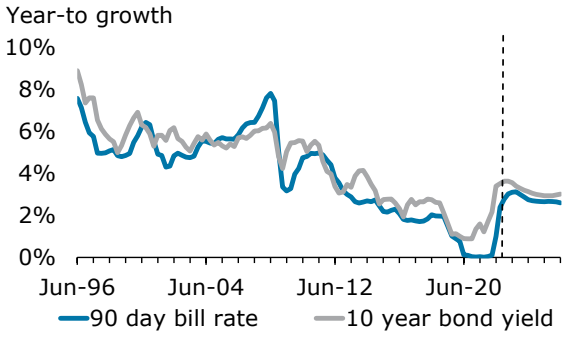
Interest receipts

The Australian Government owes a lot of money, but there are a few debts – and interest payments on those debts – that go the other way. These interest receipts come from the states, cash balances held with the Reserve Bank, other financial assets and on money earned from the Commonwealth guarantee on some of the borrowings of the commercial banks.

Higher interest rates mean higher forecast interest receipts. This is already showing up in the official numbers.

Interest received fell to $3.0 billion in 2020-21 but then picked up to $4.5 billion in 2021-22. Interest received is forecast to reach $5.3 billion by the end of the forecast period in 2025-26, which would be the highest level since 2007-08.

Chart 10 Interest rates



Source: Deloitte Access Economics

Deloitte Access Economics forecasts interest received to beat the official forecasts by $2.9 billion from 2022-23 to 2025-26.

Dividend receipts

The main dividends received by the government are those from the RBA. These dividends are drawn from underlying earnings and realised gains and losses on assets the RBA sells in the market.

The RBA earns an 'inflation tax' by not adjusting the value of dollars it prints over time, while exchanging them for other assets that do rise with the rate of inflation. Elevated bond buying activity during the pandemic has added to the base for this 'inflation tax', while higher inflation has added to the rate. That combination has added upward pressure on this component of RBA earnings.

But rising interest rates also mean the RBA is paying more on the funds banks deposit in exchange settlement accounts. Commercial banks are paying an interest rate of 0.1% on the funds they borrowed from the RBA via the Term Funding Facility in 2020 and 2021, but the same commercial banks receive the cash rate minus 0.1% on their deposits at the RBA. So faster interest rate rises will hurt underlying earnings.

Higher interest rates also spell bad news for asset valuations. The RBA loses money when interest rates go up (the value of bonds varies inversely with yields) and when the Australian dollar rises (because holdings of foreign exchange are worth less when measured in Australian dollars at a higher rate).

That saw the RBA make a huge paper loss of $37 billion in 2021-22, leaving it in negative equity. That equity will need to be rebuilt over time, including via a hit to government revenue. The central bank is not expected to pay a dividend to the government for quite some time, including over the four years to 2025-26.

Elsewhere, dividends from Australia Post are forecast to remain strong amid the continued shift toward e-commerce.

Overall, Deloitte Access Economics expects strong dividend receipts in 2022-23, largely driven by Australia Post. Receipts are forecast to be almost $1.1 billion larger in the current financial year relative to the latest official forecasts.

In later years, the lack of a dividend from the RBA and a weakening economic environment will reduce the expected outperformance in total dividend receipts. In 2025-26, Deloitte Access Economics expects receipts to be slightly below the forecast in the 2022-23 March Budget.

Other non-taxation revenue

Other non-tax revenue includes the sales of goods and services (revenues from the direct provision of goods and services and amounts paid by the states to the Commonwealth for the provision of GST collections), as well as earnings from the Future Fund.

Market movements are likely to weigh on Future Fund earnings, which is one reason why Deloitte Access Economics expects other non-tax revenue to fall modestly in 2022-23 before rising each year from 2023-24 to 2025-26.

Expenses and budget aggregates

Spending to go up, up and away?

Expenses

Overview

There is just one wrinkle in the story about government revenue doubling since 2007-08: spending has increased by more.

That's why no Treasurer has been able to deliver a surplus since Peter Costello and Wayne Swan did it in 2007-08 (though the credit really goes to the former). Josh Frydenberg came closest in 2018-19, missing by 'just' $700 million or so.

It looks very likely that the Costello-Swan double act will continue to hold that particular record for quite some time to come. Because although revenue is already back to matching its pre-pandemic trend, spending is not.

In 2008, a cyclical upswing in commodity prices and nominal GDP saw Canberra's coffers awash with tax revenue, only for the global recession to require swift and sizable spending to support the economy.

The tagline for the fiscal response to the 2008 crisis was, quite appropriately, 'timely, targeted and temporary'.

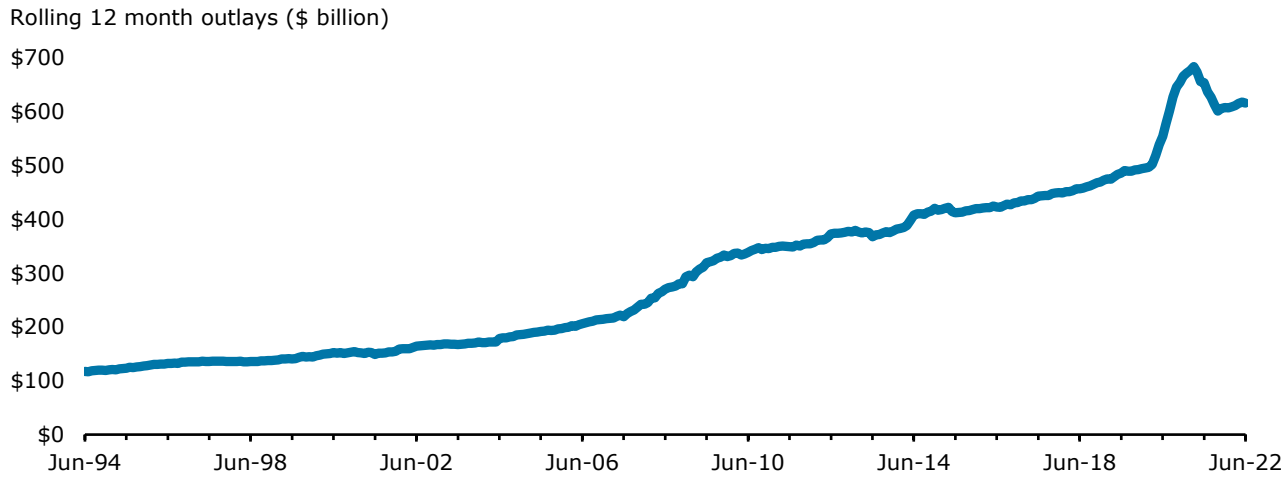
By and large, the spending at the time ticked all three boxes, though a lagging infrastructure spend was one notable exception. The unwinding of the fiscal response to the 2008 crisis coincided with broader demands on the public purse.

Some of that additional spending was the result of bolstering funding for existing programs, and some was the result of funding for new programs in line with the priorities of a first term Labor Government. Then came the increases to health and education, along with the introduction of the NDIS, all of which ensured that federal spending continued a steady upward march, establishing a new post-financial crisis trend.

Fast forward to 2022, and in assessing the more recent COVID-19 experience, Treasury Secretary Steven Kennedy's excellent Sir Leslie Melville Lecture in July introduced a 'fourth T' – tailored – to describe the way fiscal policy should respond to a shock.

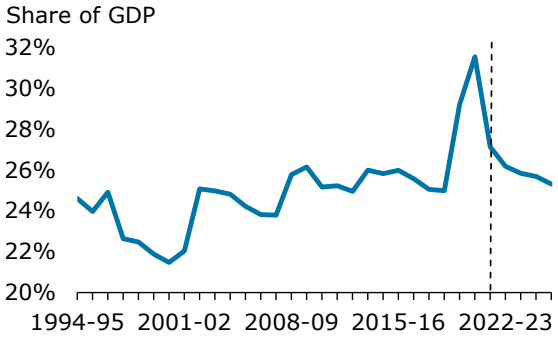
That explains why, for example, JobKeeper was appropriate during the pandemic, but wouldn't have been appropriate in 2008. As Kennedy said, with a nod to Tolstoy, "*every unhappy situation is unhappy in its own way*".

Chart 11 Federal spending, rolling 12 month total



Source: Based on Commonwealth of Australia data

Chart 12 Accrual spending as a share of GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

The fiscal response to the pandemic again (mostly) ticked those important boxes, while the cyclical upswing in revenue since then – and its contribution to a rapidly recovering budget balance – has masked a further structural upward shift in spending.

There are some obvious parallels to 2007-08. A new Labor Prime Minister scores the keys to The Lodge after a decade or so in opposition, only to have a looming global economic crisis potentially undermine the plan for governing.

There are obvious differences too. This time the budget is starting from a weaker position, interest rates are rapidly on the way up, and inflation is hovering at multi-decade highs. That more than complicates a new government's spending plans and first term priorities.

Deloitte Access Economics' *Budget Monitor* does not try to predict government decisions. It takes the net effect of policy decisions already announced and adds the net effect of changes in economic parameters since the last budget (which also incorporates any difference between our view of the outlook and Treasury's own economic forecasts). If we had to take an educated guess it would be that the 2022-23 October Budget will be absent any new, major policy decisions (or be relatively *"bread and butter"* as the Treasurer himself put it). The real action is likely to start happening from May 2023.

By then the global and domestic economic picture may be clearer, and the government will likely also have needed to make some big spending decisions in relation to defence and social security. That means the spending outlook detailed in this issue of *Budget Monitor* is likely underdone, and potentially materially so. We know a structural shift in spending is required, and there are decisions to be made that haven't been made yet.

The net effect of parameter variations and those policy decisions that have been announced are outlined below.

Effect of parameter variations

Differences between Deloitte Access Economics' latest economic forecasts and those in the 2022-23 March Budget provide the basis for adjustments from the official forecasts. The Treasurer's *Statement on the Economy* released in July provided an update of the economic outlook, but the latest complete set of fiscal projections is still based on those in the 2022-23 March Budget.

Current conditions mean that economic parameters have a stronger-than-usual effect on the budget.

The expenses reconciliation in Table 3 shows that given current economic conditions, parameter changes have a more significant effect on budget outcomes than policy changes. In part that is because many of the Government's larger policy decisions show up 'off-budget' (more on that below). Changes in the outlook for inflation are driving the most significant changes to spending – with some spending (notably a range of welfare payments) indexed to inflation. In terms of specific drivers:

- **Activity:** The proxy we usually use for the impact of activity on government spending is unemployment. Things are still looking positive on that front, with the unemployment rate expected to remain below 4.0% throughout 2022-23. However, Deloitte Access Economics is forecasting a faster increase in the unemployment rate than assumed in the 2022-23 March Budget, adding to spending across the forward estimates.
- **Exchange rates:** Differences in exchange rates affect the budgeted cost of interest payments, defence purchases, foreign aid, and embassy spending. Recent moves in the Australian dollar against the US dollar may have been dramatic, but they may also be temporary. And the value of the Australian dollar has held up far better against a broader group of currencies. Deloitte Access Economics expects the Australian dollar to continue to slip further through the remainder of 2022 and into 2023 against the US dollar before regaining some strength,

though will be more resilient against the trade weighted index. The impact on spending relative to the latest Budget is expected to be minimal.

- **Prices:** The inflation picture has shifted sharply since the 2022-23 March Budget, with inflation reaching 6.1% over the year to June 2022 compared to a budget assumption of 4.25%. Deloitte Access Economics' forecasts assume a peak of 7.3% over the year to December 2022, before starting to moderate thereafter. This raises the cost of government spending programs indexed to prices.
- **Wages:** Variations in wages affect outlays both directly (via higher wages for the public service) and indirectly (via programs that are effectively partly indexed to wage costs). Wage growth has returned to pre-pandemic norms and is expected to continue to pick up into 2023. Tight labour market conditions and broader price growth are adding to wage pressures. Deloitte Access Economics' forecasts for wages sit slightly above those in the 2022-23 March Budget, adding to spending over the forward estimates.
- **Interest rates and the budget balance:** The cost of Public Debt Interest (PDI) can vary due to changes in the size of the debt, and changes in the interest rate charged on the debt. While the size of government debt is smaller given improvements in the budget deficit, higher interest rates mean interest costs will add to spending compared to the latest Budget.

Overall, economic parameters – most notably CPI – are expected to add significantly to spending compared to the 2022-23 March Budget. That change is expected to be $13.6 billion in 2022-23, and $56.1 billion in total over the four years to 2025-26.

Effect of policy decisions

Prior to being elected, the new Government outlined a number of significant spending policies, expected to add more than $5.4 billion to spending over the four years from 2022-23. These election commitments were focused in particular across various areas of social policy, including:

- Making child care more affordable and improving aged care (expected to cost $5.2 billion and $2.5 billion over four years respectively)
- Strengthening the Medicare Fund and GP Grants (together costing $1 billion over four years) as well as cutting the general co-payment for the Pharmaceutical Benefits Scheme to $30 (costing $704 million over four years)
- Providing more university places and fee-free TAFE, to add a collective $1.4 billion to spending over four years.

There were some savings announced during the election campaign as well. They included:

- More money for the Australian Taxation Office (ATO) to extend existing tax collection programs, expected to rake in a net gain of $5.2 billion over four years (and a whopping $25.8 billion over the next decade)
- Paring back the use of consultants and contractors by the public service, saving $3 billion over four years

Deloitte Access Economics has leaned heavily on the PBO's costing of Labor's election policies. Those PBO costings also provide some indication of the ongoing hit to the budget beyond the next four years.

The PBO numbers suggest that Labor's election promises will add just $259.7 million to total spending between 2026-27 and 2032-33. That might not sound like much, but keep in mind that is *net* spending.

That means it takes account of offsetting savings measures, some of which are very large indeed. The ATO funding noted above is a case in point, and Labor is also banking on saving a further $8.7 billion on consultants and contractors after 2025-26 and raising almost $7.7 billion from a plan to crack down on tax minimisation by multinationals over the same period.

Then there is the plan to save $1.8 billion over the next decade by reducing government advertising, travel and legal costs, and an assumed $1.5 billion from increasing penalties for anti-competitive behaviour by businesses. It's possible and well intentioned. But Deloitte Access Economics remains to be convinced that all those savings will come to fruition.

Policy decisions made since the May election add a further $3.3 billion in net spending, most of which will go out the door in 2022-23. That includes more money for Ukraine, announced following the Prime Minister's trip to Kyiv in early July, while the Jobs and Skills Summit drew promises to accelerate visa processing times, an

upfront $1 billion to kick start the National Skills Agreement in 2023, and the $1.4 billion cost of extending COVID-19 response measures through to the end of the 2022 calendar year.

Deloitte Access Economics understands the National Skills Agreement funding is in addition to the $3.7 billion earmarked by the former government for the same purpose, and is expected to be spent by the current Government from 2024. (The $3.7 billion had already been placed in the contingency reserve by the former government while trying to reach agreement with the states and territories.)

Table 3 Expenses reconciliation ($ billion)

	Forecast 2022-23	2023-24	2024-25	2025-26
Official accrual spending	628.5	643.8	665.4	686.8
Budget Monitor accrual spending	647.4	661.6	681.8	702.5
Difference on accrual outlays	18.9	17.8	16.5	15.7
Effect of parameter variations (net, including PDI)	*13.6*	*14.2*	*14.5*	*13.8*
Effect of policy decisions (net)	*3.1*	*2.4*	*1.7*	*1.5*
GST adjustment	*2.2*	*1.2*	*0.3*	*0.4*
Effect of parameter variations				
Unemployment	0.2	1.2	1.9	1.4
Exchange rates	0.0	0.0	0.0	0.0
Consumer price index	10.7	11.4	11.2	11.5
Wages	0.3	0.7	0.5	0.0
PDI variation	2.5	0.9	0.9	0.8
Total effect of parameter variations (net)	**13.6**	**14.2**	**14.5**	**13.8**
Effect of policy decisions				
Election commitments				
Agriculture, Environment and Water	0.1	0.1	0.2	-0.1
AG, Defence, Home Affairs, Emergency Management and VA	0.1	0.1	0.2	0.2
Child Care, Education, Skills, Training and Youth	0.6	2.1	2.2	2.2
Climate Change and Energy	0.2	0.3	0.3	0.4
Communications and the Arts	0.0	0.0	0.0	0.0
Families, Social Services, NDIS and Government Services	0.0	0.0	0.0	0.0
First Nations	0.2	0.1	0.1	0.1
Foreign Affairs and Trade	0.2	0.2	0.3	0.3
Health and Aged Care	0.5	0.9	1.8	2.2
Infrastructure	0.0	-0.3	0.0	0.1
Secure Jobs and Industry	0.0	0.0	0.0	0.0
Treasury, Finance, Housing and the Public Service	-1.2	-2.0	-3.6	-4.0
Other	0.0	0.0	0.1	0.1
Subtotal: Effect of election commitments	**0.7**	**1.7**	**1.5**	**1.5**
Subtotal: Effect of policy decisions taken since election	**2.4**	**0.7**	**0.2**	**0.0**
Total effect of policy decisions (net)	**3.1**	**2.4**	**1.7**	**1.5**

Note: Effect of policy decisions taken since election have been identified by Deloitte Access Economics from public sources and include decisions announced to 30 September 2022. While the intention is to include all announcements, the list may not be exhaustive.

In total, policy decisions have added net spending of $8.7 billion over the four years from 2022-23.

Total accrual spending

The overall impact on accrual spending is shown in Table 3 above. Taken together, the net effect of parameter variations and policy decisions, plus an adjustment for the expected change in the distribution of the GST to the states and territories, is that spending is expected to be $68.9 billion higher over the four years to 2025-26. That's significantly less than the $114.4 billion increase in revenue expected over the same period, but it is more than enough to keep total spending levels ahead of total revenue levels and put paid to any suggestion that a surplus is in sight.

Net advances and other matters

Net advances are the final element needed to estimate the headline cash balance. If you were searching for where the cost of some of the new Government's largest policy proposals show up in the budget, look no further.

This area of the budget includes net policy lending (new policy loans, and advances less repayments – such as the accelerated debt repayment of the states), net loans to students under the Higher Education Loan Program (HELP), contributions to international organisations that increase the government's financial assets, plus net equity injections (including asset sales, and some key costs associated with the National Broadband Network (NBN)).

The $5.4 billion over four years in election policy costings mentioned earlier may have felt like a low-ball estimate. Try $40.5 billion. That's the impact on the headline cash balance over the four years to 2025-26 once the borrowing to fund the 'off-budget' vehicles to support several new policies is considered.

Just four policies – Powering Australia (Rewiring the Nation), the National Reconstruction Fund, the Housing Australia Future Fund, and the Help to Buy policies – account for almost $33 billion of that impact, while a further $850 million will come via loans to students associated with the policy to fund 20,000 additional university places. To be clear, the interest associated with this debt is included in the underlying balance, but not the borrowing itself – that part is 'off-budget'.

A digression: 'off-budget' is a misnomer, of course.

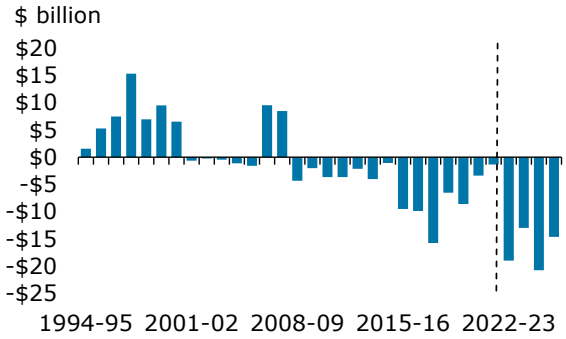
Just as 'off-road' doesn't mean driving in mid-air, 'off-budget' doesn't mean that you can't find the policy in the budget papers. It is better described as 'indirect', 'alternative' or 'balance sheet' financing – the money still appears on the balance sheet and in the headline cash balance, but not in the (typically referenced) underlying cash balance.

The NBN offers a cautionary tale. It was set up to be a commercial entity that would make a commercial return. However, the expected returns on investment haven't materialised.

The decision of the new Government to scuttle any path to privatisation by asking the NBN to reconsider its special access undertaking to the competition regulator, and to keep wholesale broadband prices low, means retaining the entity in public hands "*for the foreseeable future*". That has reopened speculation of a write-down in the carrying value of the government loans on issue to the NBN. The edict to keep wholesale prices low rather than chasing a return more in line with commercial expectations certainly adds to the argument that a write-down should occur.

Deloitte Access Economics understands that a write-down would raise the measured fiscal deficit (and net debt) as government accounting plays catch up with commercial reality, but would not affect the underlying deficit. The write-down would need to be large, and so would be hard to sweep under the carpet. Watch this space.

Chart 13 Difference between the headline and underlying cash balance



Source: Deloitte Access Economics

Another key consideration in net advances and other matters is the rate of repayment of student loan debt. Net loans to students under HELP (previously known as HECS) have been growing since the government freed up entry to higher education. This remains an area of growing concern as the total value of outstanding loans has increased substantially in recent years. The number of older Australians with outstanding HELP loans is also increasing.

Some measures have already been implemented to recover more of this debt. Former students now begin making repayments on their HELP at a lower income threshold, and repayment rates have increased. Australia has also established deals with other countries so that those with a HELP debt who work overseas will also be required to pay back their debt.

Headline deficits have been worse than underlying deficits over the past decade. As seen in Chart 13, that trend will worsen still as a result of the headline balance being asked to do even heavier lifting in carrying the cost of the policies announced by the new Government.

The budget balance

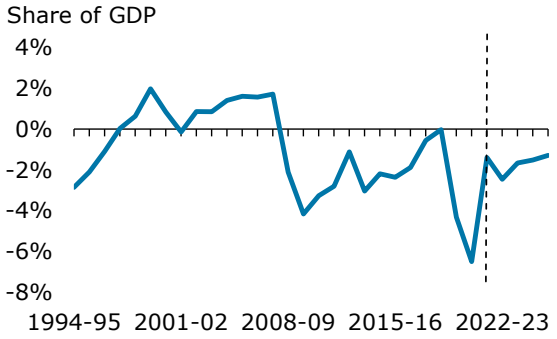
Deloitte Access Economics' overall budget aggregate projections are shown in Table 4 below.

Based on policy announcements to the end of September 2022, the underlying cash deficit is estimated to be $60.7 billion in 2022-23, shrinking to $35.7 billion in 2025-26.

Relative to the 2022-23 March Budget, that represents an improvement in the underlying budget balance of $17.3 billion this year and $45.5 billion over four years. The matching improvements in the headline balance are lower, at $11.2 billion and $11.9 billion respectively – a result of the new Government's embrace of 'off budget' financing for new policy proposals.

The lower deficits are expected to contribute to a significantly lower profile for net debt over the next four years.

Chart 14 Underlying cash balance share of GDP



Source: Deloitte Access Economics

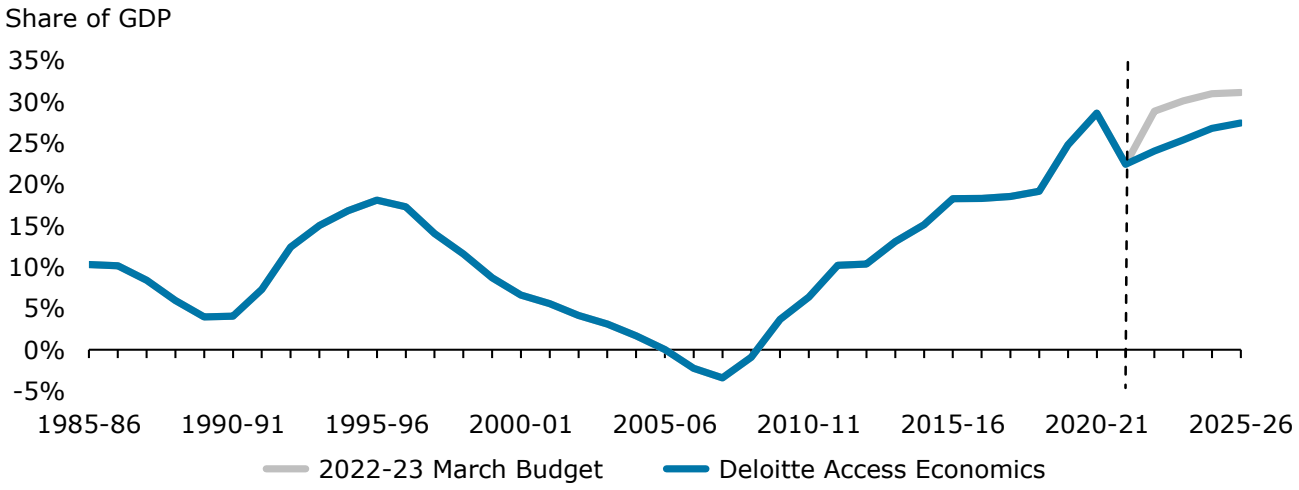
As Chart 15 shows, it now seems that net debt as a share of the economy has peaked, at least for now.

The debt position shown in that chart has been aided by the lower deficits as well as the larger economy, while increases in government bond yields also help (as the value or 'price' of debt already borrowed falls as yields rise).

That's a dramatic improvement from the budget position faced during the pandemic. But it is also entirely just cyclical serendipity. Further improvements in the budget balance from here will be a tough grind, requiring hard decisions and navigating the traditional stand-off between 'good policy' and 'good politics' that keep most Treasurers up at night.

So, when the Treasurer stands up on budget night to deliver both the news of a big improvement in the bottom line and the news of difficult times ahead, he'll be exactly right.

Chart 15 Net debt as a share of GDP



Source: Deloitte Access Economics

Table 4 Overall budget projections

	Outcome 2021-22	Forecast 2022-23	2023-24	2024-25	2025-26
Budget aggregates, $ billion					
Revenue (accrual)	**596.4**	**597.1**	**627.5**	**645.1**	**678.3**
% of GDP	26.0%	24.1%	24.5%	24.3%	24.4%
Expenses (accrual)	**623.1**	**647.4**	**661.6**	**681.8**	**702.5**
% of GDP	27.1%	26.2%	25.8%	25.7%	25.3%
Operating balance	**-26.6**	**-50.3**	**-34.1**	**-36.8**	**-24.3**
% of GDP	-1.2%	-2.0%	-1.3%	-1.4%	-0.9%
Fiscal balance	**-35.1**	**-61.6**	**-44.7**	**-44.2**	**-32.5**
% of GDP	-1.5%	-2.5%	-1.7%	-1.7%	-1.2%
Official forecast of fiscal balance	-35.1	-78.8	-58.8	-51.1	-39.8
Difference in fiscal balance	0.0	17.3	14.0	6.9	7.3
Underlying cash balance	**-32.0**	**-60.7**	**-42.5**	**-40.2**	**-35.7**
% of GDP	-1.4%	-2.5%	-1.7%	-1.5%	-1.3%
Official forecast of underlying cash balance	-32.0	-78.0	-56.5	-47.1	-43.1
Difference in underlying cash balance	0.0	17.3	14.0	6.9	7.3
Net cash flows from investments in financial assets[1]	**-1.3**	**-19.0**	**-13.0**	**-20.7**	**-14.6**
Headline cash balance	**-33.3**	**-79.7**	**-55.5**	**-61.0**	**-50.4**
% of GDP	-1.5%	-3.2%	-2.2%	-2.3%	-1.8%
Official forecast of headline cash balance	-33.3	-90.8	-60.4	-57.2	-49.9
Difference in headline cash balance	0.0	11.2	4.9	-3.7	-0.5
Net debt	**515.7**	**595.3**	**650.8**	**711.8**	**762.1**
% of GDP	22.5%	24.1%	25.4%	26.8%	27.5%
Official forecast of net debt (% of GDP)	22.5%	31.1%	32.6%	33.1%	33.1%

Source: Deloitte Access Economics, The Commonwealth of Australia

1 Net cash flows from investments in financial assets for policy purposes. Prior to 1999-00 these flows were known as 'net advances'.

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