Deloitte.

Budget Monitor

Soft landing, hard truths

25 November 2024

Deloitte
Access Economics

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

Contents

Executive summary

Soft landing, hard truths

Budget aggregates

Based on updated economic parameters and policy announcements to 13 November 2024 – and assuming no further material increases in spending – Deloitte Access Economics estimates an underlying cash deficit of $33.5 billion in 2024-25. That is $5.2 billion worse than estimated in the 2024-25 Budget. Net debt is expected to increase to 19.9% of GDP in 2024-25, broadly in line with the estimate of 20.0% in the 2024-25 Budget.

Budget forecasts

$ billion	2024-25	2025-26	2026-27	2027-28
Underlying cash balance	-33.5	-46.8	-35.5	-33.2
% of GDP	-1.2%	-1.6%	-1.2%	-1.1%
Fiscal balance	-34.5	-46.6	-35.3	-33.0
% of GDP	-1.3%	-1.6%	-1.2%	-1.1%
Revenue	709.9	731.1	769.6	813.2
% of GDP	25.9%	25.7%	25.8%	26.0%
Expenses	738.1	769.6	795.9	836.6
% of GDP	26.9%	27.0%	26.7%	26.7%
Net debt	546.2	616.4	674.4	727.6
% of GDP	19.9%	21.6%	22.6%	23.2%

Source: Deloitte Access Economics. Forecasts incorporate policy announcements to 13 November 2024 and updated economic parameters.

Economic drivers

A softer economic outlook will weigh on tax collections. The last two consecutive budget surpluses saw a boost from commodity prices and inflation. With commodity prices off their peaks, inflation moderating, and migration cooling, that marks the end of cyclical revenue windfalls. However, a resilient labour market means the expected write-downs are smaller than they would have otherwise been.

Revenue

The 2024-25 Mid-Year Economic and Fiscal Outlook (MYEFO) is expected to reveal $16.4 billion in downward revisions to revenue over the four years to 2027-28, compared to what was forecast in the 2024-25 Budget handed down in May.

Expenses

Parameter variations and policy decisions to 13 November 2024 (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2027-28 by $11.2 billion relative to forecasts in the 2024-25 Budget.

Budget backdrop

Relying on 'unforeseen' revenue upgrades is not a sustainable fiscal strategy. Doing so, however, by adopting conservative commodity price assumptions, has regularly delivered substantial revenue upgrades to the federal budget for much of the last decade.

During the term of the current government, for example, each of the four budget updates that have been published to date have revealed $80 billion in tax revenue upgrades, on average. Those upgrades have been the driving force behind the extraordinary short-term swing from pandemic-induced budget bin fire to the first consecutive underlying cash surpluses in almost two decades.

The government still deserves credit. Most of the 'unexpected' revenue which has flowed into federal coffers over the past two years has been saved rather than spent. That has required fiscal discipline.

More generally, however, over the last two decades both major political parties have fallen short of the standard of fiscal rectitude necessary to ensure the long-term health of the federal budget. The structural budget position – that is, what the budget balance looks like after correcting for the swings and roundabouts of the economic cycle – is in deep deficit, meaning that without cyclically serendipitous commodity price booms, a surplus is out of reach.

This is exactly what is playing out in 2024-25. While Australia appears to have achieved the much-vaunted soft economic landing that policymakers had been seeking, the federal fiscal position is returning to Earth with a thud.

It has already been revealed that the 2024-25 MYEFO will see Treasury downgrade expectations for company tax relative to the forecasts set out in the 2024-25 Budget released in May.

Deloitte Access Economics' forecasts in this edition of *Budget Monitor* go further, predicting an underlying cash deficit forecast for 2024-25 of $33.5 billion compared to the official forecast of $28.3 billion.

If realised, that would represent a deterioration in the budget bottom line of more than $49.3 billion following the $15.8 billion surplus inked in 2023-24. That stunning turnaround in Australia's fiscal fortunes would be the largest nominal contraction in the underlying cash balance on record, excluding the pandemic-hit budget of 2019-20.

Worryingly, there is little to suggest that the situation will right itself in the years to come.

The longer-term pressures facing the Commonwealth's fiscal position have been well documented. Before then, however, the budget will need to navigate the next four years. In the United States, Donald Trump's mandate is impossible to either ignore or deny. Exactly how that mandate is deployed is still a matter of considerable uncertainty. Should substantial tariffs be slapped on imports into the United States, including at rates of up to 60% of goods from China, Australia's budget will not be immune given its reliance on commodity prices via company tax receipts.

The composition of the Australian economy means it will always be more exposed to global commodity prices than most other developed economies. Even so, building a more resilient federal budget with a firmer structural balance and with better safeguards against that commodity price exposure is possible, but it requires change. Chalk that up as another reason why productivity-boosting economic reform and substantive changes to the tax system are desperately needed.

There have been steps in the right direction. Recently announced aged care reforms and the new $900 million National Productivity Fund both represent good policy. It's also been great to hear the Treasurer talk more about Australia's productivity challenge and the need for reform in recent speeches.

The significance of other recent announcements is less apparent, such as the updated Investment Mandate issued to the Future Fund.

Establishing the Future Fund as Australia's sovereign wealth fund was one of the better decisions of government in the last two decades. It is well run, well regarded, well established and highly performing.

Australia's economic institutions like the Future Fund should not remain static. Indeed, as the Federal Treasurer likes to note, they should be regularly "renewed", "revamped", "reformed" and "refocused". But any changes need to be justified and made for a specific reason. And where an institution is, like the Future Fund, performing well, the bar for making changes should be set very high.

It is not obvious that the Federal Government's new Investment Mandate and Statement of Expectations for the Future Fund meets that threshold. In fact, the changes raise more questions than they answer.

The new Investment Mandate requires that the Future Fund has regard to national priorities including supporting an energy transition, increasing the supply of residential housing, and delivering improved infrastructure.

If having regard to these national priorities can be consistent with maximising returns, why has the Future Fund not invested more in these areas in the past?

Equally, if the new Investment Mandate doesn't change the benchmark risk or return, and doesn't strictly require investment in a specific area – in other words, if it changes nothing – then why was it published?

That inherent inconsistency is hard to reconcile. A better explanation of why the Future Fund requires "refreshing and renewing" would go a long way to building broader consensus for the changes put in place by the Federal Government.

More generally, there has been a lack of substantive economic reform in Australia over a period stretching more than two decades. That has resulted in a coddled and cosseted economy bereft of competitiveness and dynamism. Economic and productivity growth are moribund and real incomes are declining, while income, wealth and intergenerational inequality has morphed into a broader schism through Australian society.

The time will come for changes to tax. It must. Economists know that proper tax reform, done correctly, can be good for the economy, good for the prosperity of Australians, and good for the budget.

In the meantime, governments hoping to continue to unveil 'surprise' revenue upgrades year after year will be disappointed.

Australia needs a more sustainable fiscal strategy.

Budget forecasts

Deloitte Access Economics' forecasts for key budget aggregates are shown in Table i.

The highwire budget balancing act confronting the Federal Government has only intensified over the last six months, with weak economic conditions, recalcitrant inflation and a looming federal election ratcheting up the degree of difficulty facing those in charge of the national purse strings.

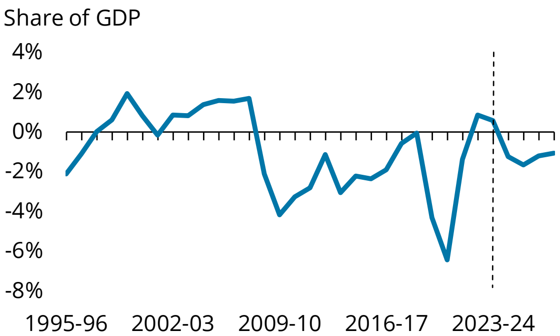
After consecutive surpluses over the past two years, the 2024-25 Budget forecast a sharp turnaround, with a deficit expected in the current financial year.

Deloitte Access Economics' own forecasts, published in this edition of *Budget Monitor*, suggest an even more dramatic snap back to fiscal reality – a product of both write-downs in total tax revenue and spending that will be higher than previously anticipated.

Company tax is peaking as a share of GDP. Company tax revenue fell in 2023-24 and is expected to continue to decline further in the near term. Deloitte Access Economics' forecasts of company tax revenue are a cumulative $18.0 billion below the latest official projections over the next four years, including because Deloitte Access Economics anticipates that the economy will grow more slowly than Treasury has forecast.

In contrast, unexpected strength in the Australian labour market is set to drive a modest revenue write-up to income tax from individuals of $8.2 billion over the four years to 2027-28. The upside surprise on jobs growth is large enough to produce a lift in tax collections even despite the Stage 3 tax cuts weighing on average tax rates. This means write-downs to forecasts of total revenue are smaller than they would have otherwise been.

Chart i Underlying cash balance to GDP



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

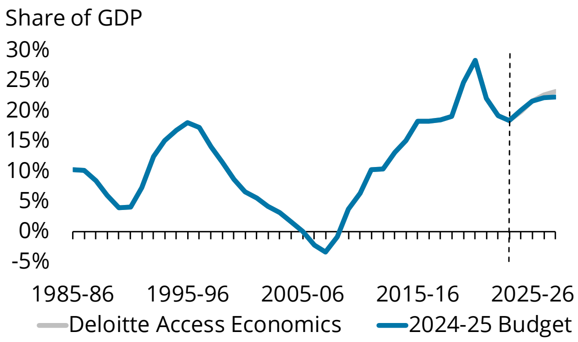
Overall, the softer outlook for the nominal economy compared to the forecasts in the 2024-25 Budget is set to deliver the government $1.6 billion less in revenue in 2024-25, with a cumulative write-down of $16.4 billion over the four years to 2027-28.

Differences between Deloitte Access Economics' latest economic forecasts and those in the 2024-25 Budget – the so-called parameter variations – indicate spending will be $5.8 billion higher than expected in the 2024-25 Budget over the four years to 2027-28. That result predominantly reflects increases in spending due to Deloitte Access Economics' relatively higher inflation forecasts compared to what was included in the latest Budget. Similarly, Deloitte Access Economics is expecting a slightly higher unemployment rate than official estimates over the next four years, lifting spending on unemployment benefits.

At the same time, costs associated with the new policy measures shown in Budget Monitor (only those that have been announced between the 2024-25 Budget and 13 November 2024) are expected to add an estimated $4.0 billion to net spending over the forward estimates, including just over $1.4 billion in 2024-25. With an election due in the next six months, it is likely that will be even higher when the 2024-25 MYEFO is released in December. Taken together, parameter variations and announced policy decisions (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2026 27 by $11.2 billion relative to forecasts in the 2024-25 Budget.

A cumulative deterioration in the underlying cash balance of $26.9 billion over the four years to 2027-28 will mean another upward revision in the forecast for net debt. Net debt is expected to reach 23.2% as a share of GDP in 2027-28, compared to the 21.9% of GDP forecast in the 2024 25 Budget (see Chart ii).

Chart ii Net debt to GDP



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

Table i Budget projections

	Outcome 2023-24	Forecast 2024-25	2025-26	2026-27	2027-28
Budget aggregates, $ billion					
Revenue (accrual)	704.5	709.9	731.1	769.6	813.2
% of GDP	26.4%	25.9%	25.7%	25.8%	26.0%
Taxation revenue	650.4	657.4	678.1	715.1	757.3
% of GDP	24.4%	24.0%	23.8%	24.0%	24.2%
Non-taxation revenue	54.1	52.5	53.0	54.5	55.9
% of GDP	2.0%	1.9%	1.9%	1.8%	1.8%
Expenses (accrual)	685.9	738.1	769.6	795.9	836.6
% of GDP	25.7%	26.9%	27.0%	26.7%	26.7%
Fiscal balance	12.0	-34.5	-46.6	-35.3	-33.0
% of GDP	0.4%	-1.3%	-1.6%	-1.2%	-1.1%
Official forecast of fiscal balance	12.0	-29.3	-42.6	-26.5	-22.0
Difference in fiscal balance	0.0	-5.2	-4.0	-8.8	-11.0
Underlying cash balance	15.8	-33.5	-46.8	-35.5	-33.2
% of GDP	0.6%	-1.2%	-1.6%	-1.2%	-1.1%
Official forecast of underlying cash balance	15.8	-28.3	-42.8	-26.7	-24.3
Difference in underlying cash balance	0.0	-5.2	-4.0	-8.8	-8.8
Net cash flows from investments in financial assets[1]	-1.8	-21.3	-23.3	-22.5	-20.0
Headline cash balance	14.0	-54.8	-70.1	-58.0	-53.2
% of GDP	0.5%	-2.0%	-2.5%	-1.9%	-1.7%
Official forecast of headline cash balance	14.0	-47.2	-63.8	-46.8	-42.0
Difference in headline cash balance	0.0	-7.6	-6.3	-11.2	-11.2
Net debt	491.5	546.2	616.4	674.4	727.6
% of GDP	18.4%	19.9%	21.6%	22.6%	23.2%
Official forecast of net debt (% of GDP)	18.4%	20.0%	21.5%	21.8%	21.9%
Economic forecasts, % growth					
Real GDP	1.5%	1.2%	1.9%	2.5%	2.6%
Employment^	2.4%	1.6%	1.5%	1.4%	1.5%
Unemployment rate*	4.1%	4.5%	4.6%	4.5%	4.6%
Consumer price index^	3.8%	3.0%	2.7%	2.5%	2.5%
Wage price index^	4.1%	3.4%	3.3%	3.2%	3.3%
Nominal GDP	4.3%	2.6%	4.0%	4.6%	5.1%

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 2024-25 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, Commonwealth of Australia.

Budget backdrop

From cyclical serendipity to structural reality.

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 2024-25 Budget.

To produce the budget forecasts presented in this report, Deloitte Access Economics has updated the 2024-25 Budget figures by incorporating:

- Latest actual Commonwealth Monthly Financial Statements data for 2024-25 published by the Department of Finance and available up to September 2024
- The effect of policy decisions announced by the Federal Government up to and including 13 November 2024
- The effect of changes in economic parameters based on Deloitte Access Economics' latest forecasts and therefore capturing any difference between those forecasts and Treasury's view of the economic outlook included in the 2024-25 Budget.

Deloitte Access Economics' latest economic forecasts were published in the September 2024 edition of *Business Outlook* and released on 18 October 2024.

The remainder of this backdrop describes a complex economic and policy context for the release of the 2024-25 MYEFO.

So long, surpluses

Over the past few years, the themes underlying Deloitte Access Economics' *Budget Monitor* commentary have carried a consistent message: relying on 'unforeseen' revenue upgrades is not a sustainable fiscal strategy. That axiom has rarely been more relevant than it is right now.

Ever since Treasury began adopting a highly conservative 'technical assumption' for commodity prices to underpin forecasts of revenue from company tax, governments have reaped the benefits. This general approach has been in place since 2017, following several years of embarrassing company tax over-estimates in the wake of the 2008 financial crisis.

This process has regularly delivered substantial revenue upgrades to governments for nearly a decade. During the term of the current government, for example, each of the four budget updates that have been published to date have revealed $80 billion in tax revenue upgrades, on average. Those upgrades have been the driving force behind the extraordinary short-term swing from pandemic-induced budget bin fire to the first consecutive underlying cash surpluses in almost two decades.

The government still deserves credit. Most of the 'unexpected' revenue which has flowed into federal coffers over the past two years has been saved rather than spent. That has required discipline, particularly given the calls for more cost-of-living support that have reverberated throughout the community during that time.

More generally, however, over the last two decades both major political parties have fallen short of the standard of fiscal rectitude necessary to ensure the long-term health of the federal budget. The structural budget position – that is, what the budget balance looks like after correcting for the swings and roundabouts of the economic cycle – is in deep deficit, meaning that without cyclically serendipitous commodity price booms, a surplus is out of reach.

This is exactly what is playing out in 2024-25.

While Australia appears to have achieved the much-vaunted soft economic landing that policymakers had been seeking, the federal fiscal position is returning to Earth with a thud.

It has already been revealed that the 2024-25 MYEFO will see Treasury downgrade expectations for company tax relative to the forecasts set out in the 2024-25 Budget released in May. Deloitte Access Economics' forecasts in this edition of *Budget Monitor* go further, predicting a worsening of the underlying cash deficit forecast for 2024-25. A deficit of $33.5 billion is anticipated, compared to the official forecast of $28.3 billion.

If realised, that would represent a deterioration in the budget bottom line of more than $49.3 billion following the $15.8 billion surplus inked in 2023-24. That stunning turnaround in Australia's fiscal fortunes would be the largest nominal contraction in the underlying cash balance on record, excluding the pandemic-hit budget of 2019-20.

Worryingly, there is little to suggest that the situation will right itself in the years to come.

The longer-term pressures facing the Commonwealth's fiscal position have been well documented by the Parliamentary Budget Office and in the projections published one Intergenerational Report (IGR) after another. The latest IGR, published in 2023, noted the federal budget's underlying cash balance is expected to deteriorate by almost 3% as a share of the economy over the next four decades.

Before then, however, the budget will need to navigate the next four years. In the United States, Donald Trump's emphatic mandate is impossible to either ignore or deny.

Exactly how that mandate is deployed is still a matter of considerable uncertainty. Should substantial tariffs be slapped on imports into the United States, including at rates of up to 60% of goods from China, Australia's federal budget will not be immune.

The Chinese economy is already reeling from a dislocation of the property market, high debt levels and worsening structural challenges such as a declining population. An enormous glut of tens of millions of unsold residential properties is weighing on prices and undermining housing construction and steel demand. In turn, Chinese demand for Australian iron ore is flagging.

Given its reliance on commodity prices via company tax receipts, the federal budget may well be relatively more exposed to these issues than the Australian economy more generally.

The Department of Industry, Science and Resources currently expects iron ore prices to fall by 12% over the next two years.

The composition of the Australian economy means it will always be more exposed to global commodity prices than most other developed economies. Even so, building a more resilient federal budget with a firmer structural balance and with better safeguards against that commodity price exposure is possible, but it requires change. Chalk that up as another reason why productivity-boosting economic reform and substantive changes to the tax system are desperately needed.

There have been important steps in the right direction. Recently announced aged care reforms and the new $900 million National Productivity Fund both represent good policy, alongside the energy transition reforms that are underway. It's also been great to hear the Treasurer talk more about Australia's productivity challenge and the need for reform in recent speeches.

However, more generally, there has been a lack of substantive economic reform in Australia over a period stretching more than two decades. That has resulted in a coddled and cosseted economy bereft of competitiveness and dynamism. Economic and productivity growth are moribund and real incomes are declining, while income, wealth and intergenerational inequality has morphed into a broader schism through Australian society.

Slowly, belatedly, there has been movement in certain sectors. In housing policy, for example, debate has tipped in favour of YIMBYs at the expense of NIMBYs, while demand-side solutions such as generous first home-owner grants – once the favoured policy of politicians and the electorate alike – are now rightly seen as making a bad situation worse. Unfortunately, that evolution has required a national crisis in the form of a systemic lack of affordable, decent, well-located housing for people of average means.

The time will come for changes to tax. It must. Economists know that proper tax reform, done correctly, can be good for the economy, good for the prosperity of Australians, and good for the budget. But if triggering tax reform requires a crisis of the scale which besets Australia's housing sector, it may be too little too late. In the meantime, governments hoping to continue to unveil 'surprise' revenue upgrades year after year will be disappointed. Australia needs a more sustainable fiscal strategy.

The more the Future Fund changes, the more it stays the same

Establishing the Future Fund as Australia's sovereign wealth fund was one of the better decisions of government in the last two decades. Since its inception in 2006, the Future Fund has generated an average annual return of 7.7%, adding more than $165 billion in value. It is well run, well regarded, well established and highly performing.

Australia's economic institutions like the Future Fund should not remain static. Indeed, as the Federal Treasurer likes to note, they should be regularly "renewed", "revamped", "reformed" and "refocused". But any changes need to be justified and made for a specific reason. And where an institution is, like the Future Fund, performing well, the bar for making changes should be set very high.

It is not obvious that the Federal Government's new Investment Mandate and Statement of Expectations for the Future Fund meets that threshold. In fact, the changes raise more questions than they answer.

The updated Investment Mandate retains the existing benchmark rate of return of at least the consumer price index (CPI) plus 4-5% per annum over the long term. It also retains the same expectation that the Future Fund determines an "*acceptable but not excessive*" level of risk.

Unlike previously, however, the new Investment Mandate requires that the Future Fund has regard to national priorities including supporting an energy transition, increasing the supply of residential housing, and delivering improved infrastructure.

Until now, the Future Fund Board of Guardians has had sole responsibility for determining the investment strategy, as well as the asset and geographic allocation of the portfolio. That is now changing, and the Future Fund is becoming less independent as a result. That is true even though the wording of the new Investment Mandate makes clear that having regard to these national priorities does not require the Future Fund to deviate from its obligations to maximise returns over the long term.

But if having regard to these national priorities can be consistent with maximising returns, why has the Future Fund not invested more in these areas in the past?

Equally, if the new Investment Mandate doesn't change the benchmark risk or return, and doesn't strictly require investment in a specific area – in other words, if it changes nothing – then why was it published?

The Future Fund is large and impressive. But it is dwarfed by the size of Australia's superannuation sector, and global capital markets more broadly. The superannuation sector manages several trillion dollars of assets and has a penchant for investing in long-lived alternatives with stable returns of the sort broadly consistent with the national priorities listed in the new Investment Mandate.

As such, Deloitte Access Economics would argue that there is already sufficient capital available for investments in the national priorities, without requiring the Future Fund to tip in extra. Further, in the case of residential property, additional capital is unlikely to do much to lift the number of new dwellings in the short term given that the constraints which are holding back additional development rest largely on the supply side, with high materials costs, a lack of workers, and poor construction sector productivity.

Like anyone balancing both risk and return, the Future Fund invests in a portfolio of assets. Not all these investments will earn the requisite return – some will earn more, and some will earn less. The expected return is the average. Does the new Investment Mandate encourage the Future Fund to adjust its portfolio to incorporate lower-return investments in national priorities, while taking on higher-return (and therefore higher risk) investments elsewhere such that the overall return is maintained?

These questions highlight that, while keeping economic institutions relevant is a wise and worthy ambition, the specific rationale for the Federal Government's new Investment Mandate and Statement of Expectations for the Future Fund appears elusive.

Reform should seek to bring change. But the explanations of these reforms – from both the Federal Government and the Future Fund – have restated that, ultimately, the risk, return, independence, strategy, portfolio and role of the Future Fund will stay the same.

That inherent inconsistency is hard to reconcile. Indeed, a better explanation of why the Future Fund requires "refreshing and renewing" would go a long way to building broader consensus for the changes put in place by the Federal Government.

An election looms. Will spending surge?

When it comes to putting together a budget, politics matters. Indeed, elections are often a time for popular spending policies aimed at maximising votes. That may be particularly true ahead of a federal election that looks like it will run much closer than many had expected not long ago.

So, will a government that has shown respectable spending restraint over the course of its first term remain disciplined as the political blowtorch is applied? There are reasons to be optimistic, including because there are economic limitations to the amount of spending that can be rushed out the door over coming months.

Indeed, as several recent elections around the world have shown – from the United States, the United Kingdom, France, Japan and India, among others – the politics of inflation is diabolical for incumbents. As such, the balance between spending and inflation will be front of mind heading into an election in the first half of 2025.

Governments have limited options for dealing with elevated price growth. While big spending can help to ease the pain for households, it also fuels the very problem it is trying to fight. At the same time, severely cutting spending can help to take the pressure off inflation, but risks alienating voters who are struggling with cost-of-living pressures the most.

At a minimum, Deloitte Access Economics expects a range of cost-of-living 'relief' to be renewed for the 2025-26 financial year – no political party wants to go to an election with a promise to increase energy bills. And there will be pressure on both the government and the opposition to promise more to support households in what is likely to be a fiercely competitive campaign.

With speculation that the next federal budget will be handed down after the election rather than before, the figures in the 2024-25 MYEFO will take on added meaning for the campaign ahead.

The challenges, however, will come once the election is over, with the difficult task of removing household support (and increasing measured inflation in the process), dealing with emerging deficits, and tackling the longer-term structural issues that remain a challenge for the budget. The possibility of a swelling cross bench and minority government might make those tough decisions even harder.

Economic outlook

The economy's luck runs out.

The Australian economic outlook

The Australian economy is growing at its slowest annual rate – excluding the pandemic – since the early 1990s recession. Inflation and high interest rates have put pressure on many households and businesses, while dwelling investment has been weighed down by a lack of capacity in the construction industry.

Growth in Australia's economy is expected to weaken further this financial year. That's important because it has been the cyclical rebound from the COVID-19 pandemic which has bolstered nominal economic activity, and in turn underpinned a surge in tax revenue over the last two years. That budget boost was never going to be a sustainable or structural.

Nominal GDP growth moderated to 4.3% in 2023-24, below official estimates of 4.75% published in the Budget in May. Deloitte Access Economics expects nominal GDP growth to slow further to 2.6% in the current financial year, before accelerating from 2025-26. This is a gloomier outlook than Treasury is forecasting over the forward estimates.

As a result, Deloitte Access Economics expects the nominal economy to be almost $7 billion smaller on average each year from 2024-25 to 2027-28 compared to the official forecasts, with the bulk of that underperformance in 2026-27 (see Chart 1).

The two consecutive budget surpluses delivered in 2022-23 and 2023-24 were possible thanks to a revenue boost from commodity prices and inflation. That well looks increasingly dry: commodity prices are well off their peaks and are expected to moderate further amid softer demand from China. Inflation was higher in 2023-24 than assumed in the Budget but is expected to continue to moderate from here.

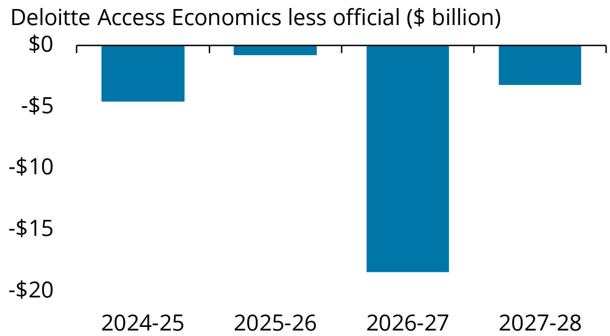
That marks the end of the cyclical revenue windfalls.

A weaker outlook for China's economy adds downward pressure to prices of key Australian commodity exports such as iron ore, with significant implications for tax receipts. China is grappling with underwhelming demand in the short term and broader supply-side challenges in the long term. Exports are likely to come under pressure as several developed economies raise trade barriers to counter China's subsidies for goods such as electric vehicles. Donald Trump's proposal to impose a 60% tariff on Chinese goods would exacerbate the structural slowdown.

A strong fiscal stimulus package in China, if forthcoming, may provide some counterbalance. Additionally, geopolitical tensions, particularly in the Middle East, also run the risk of a producing another supply-side spike of commodity prices. But the broader risks to the global outlook are tilted to the downside. With ongoing conflict in the Middle East and Europe, policy uncertainty in the United States, and China facing structural economic challenges, uncertainty and volatility in the global economy have lifted.

It is worth noting that Treasury's commodity price conservatism has unwound in recent years. Commodity prices are likely to remain above budget assumptions, but that gap will be less marked than in previous years, leaving less room for upgrades to revenue.

Chart 1 Difference in nominal GDP forecasts



Source: Deloitte Access Economics, based on Commonwealth of Australia data. Note: Data shows the difference between the latest Deloitte Access Economics forecasts and the official forecasts published in May 2024.

Some important positives – population and employment growth – have held up better than expected and have continued to support economic growth. That 'people power' has helped to protect the budget, with expected revenue write-downs smaller than they would have otherwise been.

Australia's population increased by 2.3% over the year to March 2024, spurred on by record overseas arrivals and historically low departures. However, population growth has now peaked and is expected to return to pre-pandemic averages by mid-2025. Net overseas migration is starting to slow as the Federal Government's migration policy changes take effect.

The labour market has been surprisingly resilient despite the gradual easing of conditions this year. The unemployment rate remains low, and strong growth in the Australian working age population has aided employment gains.

As a result, personal income tax revenue in 2024-25 – shown elsewhere in this report – is expected to come in ahead of the official forecasts in the 2024-25 Budget. The outperformance in personal income tax revenue is expected to unwind over the forward estimates as growth in the population and demand for labour are expected to ease.

Overall, growth in the Australian economy is forecast to slow to 1.2% in 2024-25 as elevated inflation and interest rates weigh on households and businesses. Growth in the economy is forecast to pick up modestly from 2025-26 as higher incomes support household spending, dwelling investment lifts and government spending adds to demand. While that is anticipated to outweigh the effect of weaker net exports and slower rates of population growth, the gradual pick-up in growth will not be enough to offset the effect of lower commodity prices and company profits that will see write-downs to total revenue come 2024-25 MYEFO.

Table 1 Australian economic forecasts (% growth)

	History 2023-24	Forecast 2024-25	2025-26	2026-27	2027-28
Gross domestic product					
Household consumption	1.0%	1.3%	1.9%	2.1%	2.1%
Dwelling investment	-2.2%	-0.4%	2.0%	7.4%	8.4%
Business investment	5.7%	1.6%	2.2%	2.6%	2.9%
Public final demand	4.4%	3.5%	2.8%	2.7%	2.6%
Gross national expenditure	2.0%	1.8%	2.1%	2.6%	2.7%
Real GDP	1.5%	1.2%	1.9%	2.5%	2.6%
Nominal GDP	4.3%	2.6%	4.0%	4.6%	5.1%
Prices and wages					
Consumer price index^	3.8%	3.0%	2.7%	2.5%	2.5%
Wage price index^	4.1%	3.4%	3.3%	3.2%	3.3%
GDP deflator	2.7%	1.3%	2.0%	2.0%	2.4%
Terms of trade	-6.4%	-5.5%	-1.1%	-1.1%	0.6%
Labour market and population					
Participation rate*	66.8%	67.0%	66.9%	66.8%	66.8%
Employment^	2.4%	1.6%	1.5%	1.4%	1.5%
Unemployment rate*	4.1%	4.5%	4.6%	4.5%	4.6%
Population	2.4%	1.7%	1.4%	1.4%	1.4%

Note: Base year for real data is 2021-22. 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

Revenue write-ups swiftly turn to write-downs.

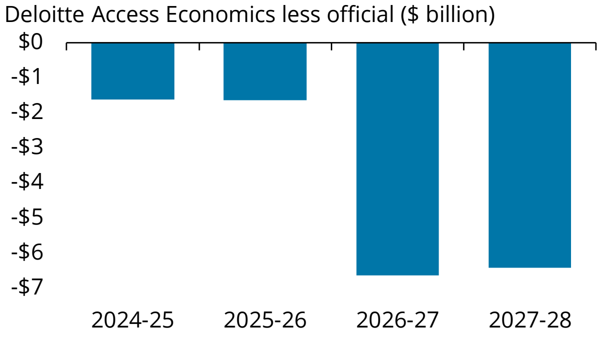
Overview

Unexpected strength in the Australian labour market is set to drive modest revenue write-ups to income tax from individuals from 2024-25. Income tax from individuals is typically a relatively steady tax base, but the upside surprise on jobs growth is large enough to produce a meaningful lift in tax collections even despite the Stage 3 tax cuts weighing on average tax rates.

However, that good news for the budget in relation to taxes from individuals is not expected to be enough to fully offset write-downs across other revenue heads. That's partly because Deloitte Access Economics' view on the nascent economic recovery is not as optimistic as Treasury's. Nominal GDP is forecast to be 0.6% lower than the official figures in 2024-25 before the difference increases to 1.4% by 2027-28.

The softer outlook for the economy will weigh on tax collections. That is particularly true for the more volatile heads of revenue linked to profit. This is expected to see total revenue falling more significantly behind official expectations in 2026-27 and 2027-28.

Chart 2 Revenue forecast compared to 2024-25 Budget



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

Table 2 Accrual revenue estimates ($ billion)

	2024-25		2025-26		2026-27		2027-28	
	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*
Individuals[1]	335.6	339.0	352.7	356.5	374.2	375.0	403.8	403.9
Company tax	141.2	137.8	136	132.2	146.4	140.7	153	147.9
Superannuation fund taxes	19.8	19.0	21.4	20.6	24.2	23.4	23.1	22.7
Other income tax[2]	6.7	6.5	6.1	6.2	5.8	6.2	6.1	6.4
Total income tax	503.4	502.2	516.2	515.5	550.7	545.3	586.0	580.9
GST	92.1	92.3	97.3	97.5	103.1	103.4	109.0	109.5
Excise and customs duty	47.3	46.1	48.9	47.6	50.1	48.8	50.2	48.9
Other indirect tax[3]	16.3	16.7	17.1	17.4	17.3	17.6	17.8	18.0
Total indirect tax	155.6	155.1	163.3	162.6	170.5	169.8	177.0	176.4
Total taxation revenue	659.0	657.4	679.5	678.1	721.2	715.1	763.0	757.3
Non-taxation revenue[4]	52.5	52.5	53.3	53.0	55.1	54.5	56.6	55.9
Total revenue	711.5	709.9	732.7	731.1	776.2	769.6	819.6	813.2

Note: Official estimate refers to the 2024-25 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 downgrades will add to forecast deficits over the forward estimates. With government spending expected to remain at elevated levels for at least the next four years, any slowdown in revenues will put pressure on plans to return to surplus in the medium term.

Overall, Deloitte Access Economics expects the 2024-25 MYEFO to show slim revenue shortfalls of $1.6-1.7 billion in 2024-25 and 2025-26, with those shortfalls growing to $6.7 billion and $6.4 billion in 2026-27 and 2027-28 respectively. Those revisions are modest by the standards of recent budget updates, but are moving in the wrong direction.

Deloitte Access Economics' revenue forecasts are compared to the latest official estimates in Chart 2 and Table 2 on the previous page.

Individuals and other withholding tax

Gross income tax withholding

The single largest component of tax revenue – income tax withholding – continues to be supported by the strong labour market. The unemployment rate has risen only modestly from record lows despite the slowdown in the wider economy. Wage growth is also elevated compared to pre-pandemic averages.

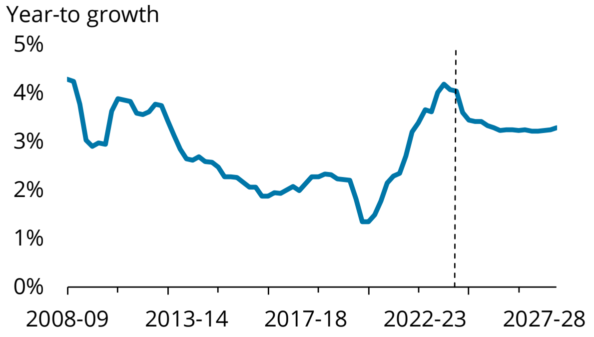
This is happening at the same time as the Stage 3 tax cuts have reduced average tax rates for individuals. Yet the robust labour market has added to the underlying tax base such that overall collections will barely budge in 2024-25. A remarkable achievement given the Stage 3 tax cuts were estimated to cost the budget bottom line approximately $20 billion per year.

Although the labour market has held up relative to previous expectations, conditions are beginning to ease. Employment is expected to grow over the forecast horizon, though at a much slower rate than has been true over the past two years. As labour demand eases relative to supply, the unemployment rate is expected to have increased to 4.5% by the June quarter of 2025.

While wage growth remains above pre-pandemic averages, it has also now peaked. The path ahead is one of decelerating wage growth, particularly as inflationary pressures ease further for businesses.

Deloitte Access Economics' forecast for growth in the total wage bill is a cumulative 0.4% above the official forecasts over the four years to 2027-28.

Chart 3 Wage Price Index

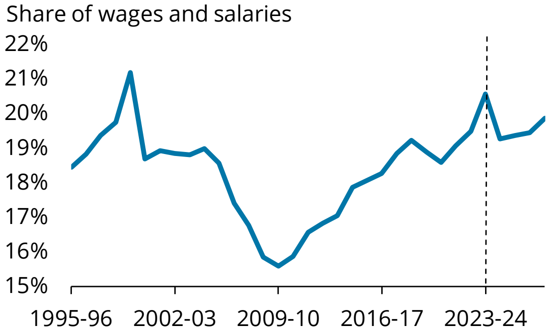


Source: Deloitte Access Economics, Australian Bureau of Statistics

The effects are largest in the next two years before moving more in-line with Treasury forecasts. This will see the size of the write-ups for income tax withholding narrow from 2026-27.

Overall, Deloitte Access Economics anticipates income tax withholding will be a cumulative $11.5 billion higher than the official forecasts over the next four years.

Chart 4 Average rate of personal income tax



Source: Deloitte Access Economics, Australian Bureau of Statistics

As discussed in previous editions of *Budget Monitor*, the income tax cuts are a one-off. With no further policy changes in the pipeline, bracket creep is expected to see the average income tax rate return to where it was in 2023-24 by the end of the decade.

Gross 'other individuals' tax

'Other individuals' taxes are collected on a basket of wages and similar earnings, returns on assets (including interest and dividends) and profits from small businesses. That combination is rather more volatile than PAYG collections and more linked to the economic cycle.

Recent collections under this head of revenue have been strong, reflecting strength in rents, interest income and small business profits.

An interest rate outlook that is 'higher for longer' will be a mixed blessing here. While it will provide some support for interest earnings it will also increase the value of interest deductions for property investors. At the same time, strong growth in rents is expected to continue, particularly in the short term, helping to support collections.

But the pressures of a smaller economy than was expected at budget time will start to bite. Components of tax that rely on business profits will be weaker than expected. Capital gains will start to disappoint, too, reflecting performance in asset markets that relies on business strength and asset valuations.

Forward indicators of dividends are sitting below long run averages at present, and Deloitte Access Economics expects a more challenging environment for profits to see weaker distributions in the out years.

Deloitte Access Economics is forecasting a cumulative $3.1 billion less revenue from 'other individuals' over the four years to 2027-28 than was forecast in the 2024-25 Budget.

Income tax refunds for individuals

For many years governments had used this part of the tax system to hand money back to households. Recent examples included policies such as the Low and Middle Income Tax Offset, loss carry back offsets and deductions for working from home expenses. Yet these temporary measures have now ended. The government is now focused on handing back money in ways that show up on the spending side of the budget, such as energy rebates. Rebates have the added benefit of placing downward pressure on measured headline inflation.

The great gains in employment of late have boosted refunds, because many people started working part way through the year. Australia's PAYG system immediately starts taxing employees as if they worked all year. So, a year with lots of new hirings (or firings), as seen during the pandemic recovery, sees refunds lift the following year. This suggests that the gradual easing of the labour market will add to refunds from 2024-25 with Deloitte Access Economics' forecasts broadly in-line with official estimates.

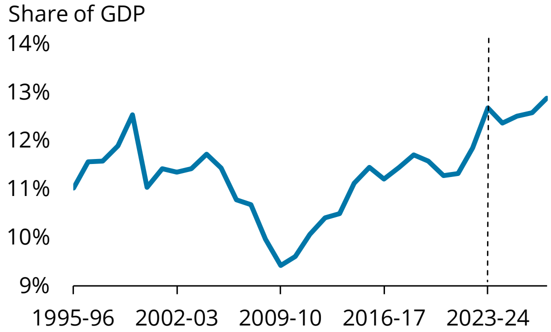
Total revenue from taxes on individuals

A strong labour market is boosting employment, and the resulting lift in the wage bill will show up via taxes on individuals, particularly over the next two years.

Beyond that, a cooling labour market, and weakness in profits and market returns, will drag on collections to leave taxes on individuals broadly in line with official forecasts by 2027-28.

Total revenue from taxes on individuals is forecast to outperform the official forecasts by a cumulative $8.2 billion over the forward estimates.

Taxes on individuals as a share of GDP



Source: Deloitte Access Economics, Australian Bureau of Statistics

Company and other (non-personal) income tax

Company income tax

Company tax is a relatively volatile head of revenue, and where a lot of budget surprises show up.

In recent times those surprises have been positive by design, with conservative assumptions baked into the forecasts to ensure all news is good news.

Yet company tax is peaking as a share of GDP, with a marked slowdown ahead in Treasury's forecasts. There are a range of factors weighing on collections here, including:

- Weak economic growth, elevated interest rates and a slowdown in consumer spending hitting company revenues
- Higher input costs across a range of sectors hurting profitability
- Falling commodity prices putting pressure on mining profits, which remain an important part of the total.

Company taxes fell in 2023-24 and are expected to continue to decline in the near term, before returning to growth in 2026-27.

Commodity prices are likely to come under some pressure as global demand slows under the lagged influence of tight monetary policy.

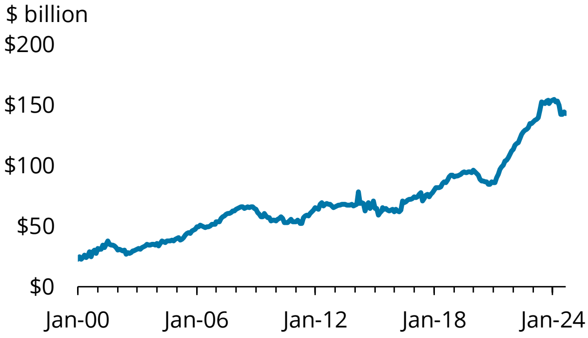
In the 2024-25 Budget, Treasury assumed that the price of iron ore would fall to US$60 per tonne by the March quarter of 2025, while metallurgical and thermal coal prices would reach US$140 per tonne and US$70 per tonne, respectively, over the same period. In contrast, at the same time and over the same period, the Department of Industry, Science and Resources had forecast the prices of iron ore to be 35% higher, metallurgical coal to be 64% higher, and thermal coal to be 87% higher.

Higher-than-expected commodity prices will add to company tax revenues even as companies with a domestic focus struggle. But it is also the case that Treasury's conservatism is rather less marked today than it was a couple of years ago.

Deloitte Access Economics' forecasts of company tax revenue are a cumulative $18 billion below the latest official projections over the next four years, including because Deloitte Access Economics anticipates that the Australian economy will grow more slowly than Treasury has forecast.

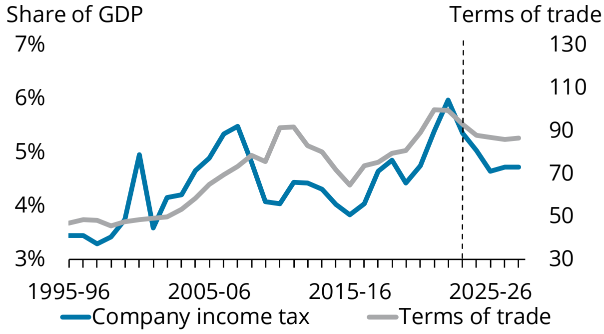
It's also worth remembering that uncertainty around company tax is higher than usual. Corporate fortunes at home are dependent on an uncertain recovery in consumer spending while mining profits will, in part, depend on the offsetting implications of any Trump tariffs and the size and success of any Chinese economic stimulus. That combination means the 2024-25 MYEFO likely won't be the last round of revisions to forecasts.

Chart 5 Company tax, rolling 12 month total



Source: Deloitte Access Economics

Chart 6 Company tax and terms of trade



Source: Deloitte Access Economics, Australian Bureau of Statistics

Fringe benefits tax

Policy change is placing downward pressure on Fringe Benefits Tax (FBT) collections. The Government introduced an FBT exemption for zero or low emissions vehicles (ZLEVs) with a value under the luxury car tax (LCT) threshold. The initial uptake of this scheme was limited by the undersupply of vehicles, the relatively low LCT threshold, and limited knowledge of the scheme among potential purchasers. More recently, the supply of vehicles has improved, with several low-cost electric vehicle brands and models launched in Australia. This has placed downward pressure on the cost of ZLEVs at the same time as the LCT threshold has increased from $85,000 to $91,000, bringing even more vehicle models into the FBT-exempt scheme. These trends are likely to continue, with the uptake of ZLEVs to be further supported by the commencement of the New Vehicle Efficiency Standard from 1 July 2025.

FBT collections are projected to fall in 2024-25 and 2025-26 before recovering somewhat from 2026-27. Deloitte Access Economics' forecasts of FBT collections are a cumulative $1.4 billion above the latest official projections over the next four years.

Petroleum resource rent tax

The petroleum resource rent tax (PRRT) is complex, with a range of operational factors, timing issues and accounting rules influencing collections.

Those intricacies are designed to ensure the tax doesn't hamper the efforts of industry, but recent reforms have effectively been an admission that the old system was too lenient and wasn't delivering enough revenue for government.

The 2023-24 Budget announced that the Government would introduce a 90% cap on the proportion of PRRT assessable income that can be offset by deductions, as well as several integrity measures.

These policy changes are important to understanding the future of PRRT collections, but timing factors and incentives for companies to bring forward deductions into 2023-24 make assessing the results of the change difficult.

Deloitte Access Economics expects some of the temporary factors holding down revenues to persist in the short term, with collections forecast to be $600 million below the official projections in 2024-25 and $250 million below in 2025-26. Deloitte Access Economics forecasts are more in-line with Treasury's across the last two years of the forward estimates.

Superannuation fund taxes

Superannuation taxes are levied on contributions to and earnings from super. Those two components link this head of revenue both to the size of the wage bill and to the performance of asset markets – particularly Australian equities.

Policy changes in this area are adding to collections. The superannuation guarantee rate will increase by 0.5% in both 2024-25 and 2025-26, while a 15% tax on earnings from balances over $3 million is expected to add around $2 billion to annual revenues from 2025-26.

Solid growth in the wage bill means higher contributions will be supporting revenue in the near term, while share market gains over the course of this year have been good enough to ensure earnings taxes are solid.

Still, early signs show 2024-25 might not live up to expectations, and Treasury has set the bar high. Deloitte Access Economics expects a modest shortfall in collections, though that still sees super taxes growing by close to 50% in the year. The current strength in contributions is forecast to moderate, resulting in some further modest disappointments in later years.

Overall Deloitte Access Economics sees superannuation tax revenue $2.9 billion short of Treasury's projections across the forward estimates.

Goods and services tax

Goods and services tax (GST) revenues are closely tied to consumer spending and dwelling construction. This presents a challenge for collections as these components of the Australian economy have struggled over the past year.

Higher prices, a period of weak real wage growth, higher interest rates and subdued consumer confidence have all taken a considerable toll on consumption of late.

One saving grace for revenues is that GST is charged on nominal consumption, meaning ongoing price rises are lifting the size of the tax base to offset some of the weakness in sales volumes.

Still, that combination of factors has seen growth in GST collections slow markedly in 2023-24, finishing below relatively soft expectations.

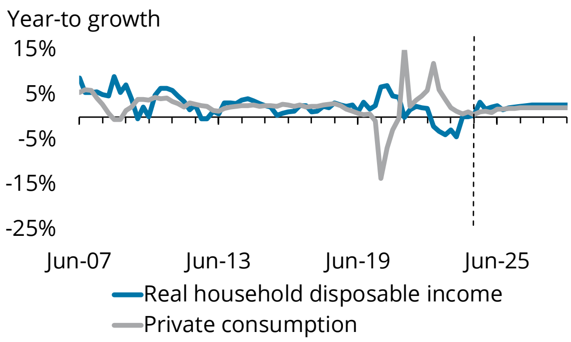
The 2024-25 financial year is predicted to be the toughest for this economic cycle, with growth in GST revenues slowing to just 2.2% – significantly below the average annual growth rate of 6.2% in last decade.

Yet the early trends here are not as bad as feared, and Treasury's forecasts for consumption look to be a little pessimistic. That suggests some modest upside for revenues over the forward estimates.

Overall, GST collections are expected to slightly outpace official estimates over the forward estimates. Deloitte Access Economics' forecasts are a cumulative $1.3 billion above the official figures from 2024-25 to 2027-28.

Of course, GST revenues are immediately handed off to the states. As they also show up on the spending side of the budget the net effect on the bottom line is a wash.

Chart 7 Consumer spending and real household disposable income



Source: Australian Bureau of Statistics, Deloitte Access Economics

Excise and custom 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 per year in line with the CPI. Customs duty – equivalent to the excise duty – is charged where these goods are imported.

Australia has one of the highest taxes on tobacco in the world. The tax per cigarette has increased from around $0.26 in 2010 to $1.37 in 2024 – almost four times as fast as the rise in broader consumer prices over the same period. This has contributed to a surge in illegally imported – and untaxed – cigarettes in Australia. According to the Australian Institute of Health and Welfare, more than one quarter of smokers have used unbranded tobacco. The result is that last year's tax take from tobacco was $5.5 billion short of Treasury's initial forecasts for 2023-24 (made back in late 2020).

A cut, or pause, in indexation rates is unlikely. The price of tobacco remains a key factor reducing the appeal of smoking and minimising the associated negative health outcomes. Yet governments will need to bolster enforcement of the existing regime to ensure the tax base does not erode further. Steps have already been taken, including the appointment of an interim Illicit Tobacco Commissioner, yet this remains a key area of risk for tax collections.

Elevated inflation is flowing through to indexation rates and adding to taxes on petroleum products. Though moderating inflation will result in slower growth in tax collections in 2024-25 compared to the previous financial year. The New Vehicle Efficiency Standard is also weighing on fuel excise receipts over the forward estimates.

Other structural trends are placing downward pressure on excise and excise equivalent customs revenue. This includes the fact that Australians are drinking less (which hurts collections based on volume) and increasingly driving electric and low emission vehicles.

Deloitte Access Economics expects excise revenue to grow in each year of the forward estimates. Yet the rates of growth are forecast to slow as moderating inflation weighs on indexation rates and long-running trends affect collections.

A long history of trade liberalisation means that customs duties are levied on a relatively small base. The abolition of nuisance tariffs will weigh on collections from 2024-25, while the official forecasts include a provision for the stalled Australia-European Union Free Trade Agreement. That sees the tax base for customs duties shrinking further, though strong growth in imports will provide support for duty revenue.

Deloitte Access Economics' forecasts for excise and customs duty revenue are a cumulative $5.2 billion below the official figures over the forward estimates. This is partly due to differences in the outlook for the nominal economy and key revenue heads such as tobacco.

Other indirect tax

Other indirect taxes include the major bank levy, the Wine Equalisation Tax (WET), the LCT, agricultural levies and broadcasting fees, as well as other tax revenues collected by Commonwealth agencies. Collections are forecast to grow strongly in 2024-25 as some of the momentum from 2023-24 carries into the current financial year. Yet the growth in collections is expected to slow over subsequent years.

Revenue from visa application charges is forecast to grow at double-digit rates in 2024-25 as an increase in fees – particularly for students – offsets the effect of fewer migrants arriving in Australia compared to the previous financial year. Smaller gains in visa application charges are expected from 2025-26.

Elsewhere, more modest gains are projected for the major bank levy, agricultural levies will recover from earlier falls as crop yields improve, while higher prices are likely to offset the effect of weaker volumes of wine consumed for WET collections.

The Government has released draft legislation to update the LCT from 1 July 2025. Fuel efficient vehicles (subject to a higher LCT threshold) would be redefined as having a fuel consumption rating of no more than 3.5 litres per 100 kilometers from a previous 7 litres per 100 kilometres.

The indexation rate would also be tied to the motor vehicle purchase sub-group of the CPI rather than the all-groups CPI (which is currently growing at a faster rate). These changes, should they come into effect, would add to LCT revenues from 2024-25.

Deloitte Access Economics expects other indirect taxes to broadly track in line with official forecasts in each year to 2027-28.

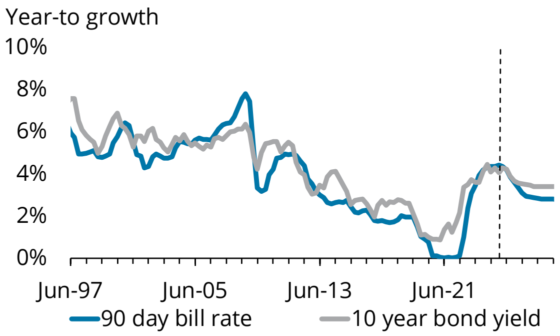
Non-taxation revenue

Interest receipts

The Australian Government owes a lot of money, but it also lends money. Interest receipts on loans by the government are recognised as non-taxation revenue.

These receipts come from the states, cash balances held with the Reserve Bank of Australia (RBA), other financial assets, and on money earned from the Commonwealth guarantee on some of the borrowings of the commercial banks.

Chart 8 Interest rates



Source: Deloitte Access Economics

Interest rates are expected to moderate over the next four years, weighing on interest receipts. Deloitte Access Economics expects a sharper rate cutting cycle compared to Treasury, consistent with the weaker outlook for growth in the economy. Deloitte Access Economics' forecasts for interest receipts are a cumulative $1.7 billion below the official figures over the forward estimates.

Dividend receipts

The RBA was one of the main sources of dividend revenue for the government until the post-pandemic surge in inflation. The increase in interest rates over the past two years has contributed to large accounting losses at the Reserve Bank. This is because the returns for many RBA assets were fixed at low rates in 2020 and 2021, while the cost of liabilities has risen alongside the cash rate.

This situation has improved since the maturation of the Term Funding Facility on 1 July 2024, but the RBA continues to operate with negative equity of around $20 billion. The RBA's view is that this doesn't affect their operations. Yet the RBA's latest annual report flagged the need to rebuild capital by retaining future profits. As a result, the RBA is not expected to pay a dividend to the government for many years.

The Federal Government also receives dividends from their Government Business Enterprises (GBEs). Notable GBEs such as Australia Post and Australian Rail Track Corporation posted losses in 2023-24, offset by profits at Defence Housing Australia, Snowy Hydro Limited and other GBEs.

Deloitte Access Economics expects dividend receipts to grow at an annual rate of approximately 6% over the forward estimates, in line with the official forecasts.

Other non-taxation revenue

Other non-tax revenue includes revenue 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. Collections outperformed official forecasts in 2023-24, in part due to the government's efforts to improve cost recovery. Deloitte Access Economics expects other non-tax revenue to grow modestly, broadly matching official forecasts, over the forward estimates.

Expenses and budget aggregates

From surplus to shortfall

Overview

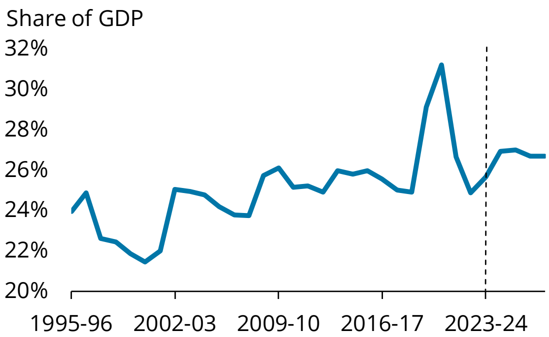
In the May 2024 edition of *Budget Monitor*, Deloitte Access Economics described the scenario confronting the Treasurer as a 'highwire balancing act'. That environment has only intensified over the last six months, with weak economic conditions, recalcitrant inflation and a looming federal election ratcheting up the degree of difficulty facing those in charge of the national purse strings.

Readers seeking evidence of those difficult conditions should look no further than the budget bottom line. After consecutive surpluses over the past two years, the 2024-25 Budget forecast a sharp turnaround, with a deficit expected in the current financial year.

Deloitte Access Economics' own forecasts, published in this edition of *Budget Monitor*, suggest an even more dramatic snap back to fiscal reality. Indeed, following an underlying cash surplus of $15.8 billion in 2023-24, Deloitte Access Economics anticipates that the 2024-25 financial year will see a turnaround of $49.3 billion, resulting in an underlying cash deficit of $33.5 billion.

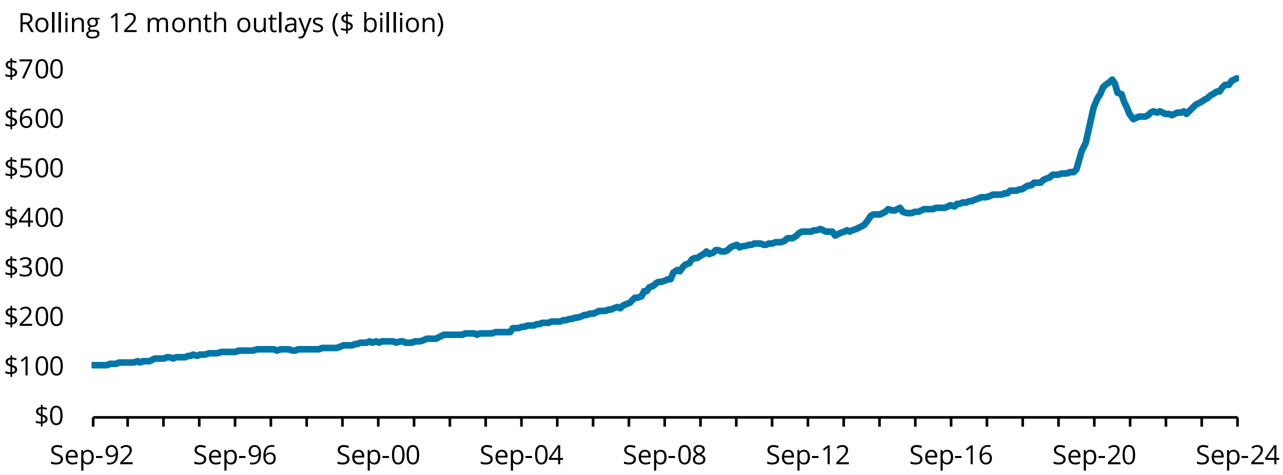
The magnitude of this U-turn illustrates the extent to which the surpluses in recent years were the result of a cyclical revenue upswing rather than structural improvements in the budget. Those surpluses still required fiscal discipline – surprise revenue upgrades were mostly saved rather than mostly spent. But banking on revenue to surpass Treasury's forecast does not make for a sound fiscal strategy.

Chart 9 Accrual spending as a share of GDP



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

Chart 10 Federal spending, rolling 12 month total



Source: Based on Commonwealth of Australia data

The government has aimed to temper spending since the 2024-25 Budget. The Final Budget Outcome for the 2023-24 financial year presented a rosier outlook on spending than was previously predicted. However, the 'savings' that were unveiled included delays in spending commitments rather than genuine reductions in expenditure. As a result, much of this spending is still ultimately expected to occur.

Further spending announcements are also likely to be unveiled as the upcoming federal election draws nearer, though perhaps not to the extent seen in past campaigns. That's because the spectre of above-average inflation and the fear that an additional boost to spending will take a pre-election rate cut off the table will weigh heavily over coming months.

While longer-term fiscal challenges are unlikely to be front of mind for either major party in the lead up to the election, they remain a looming public policy debacle. Across the NDIS, Western Australia's GST top-up deal, defence, welfare, interest costs and more, large and rapidly growing expenditure programs remain a blight on the future of the budget position.

Overall, Deloitte Access Economics expects the underlying cash balance to be cumulatively $26.9 billion worse off over the four years to 2027-28 compared to the forecasts outlined in the 2024-25 Budget.

Expenses

Effect of parameter variations

Differences between Deloitte Access Economics' latest economic forecasts and those in the 2024-25 Budget – so-called parameter variations – provide the basis for some of the adjustments from the official forecasts. The expenses reconciliation is shown in Table 3 below.

The net effect of parameter variations is expected to result in a $5.8 billion increase in spending over the four years to 2027-28 compared to the 2024-25 Budget. The bulk of that increase in spending is due to Deloitte Access Economics' relatively higher inflation forecasts compared to what was included in the latest Budget. Similarly, Deloitte Access Economics is expecting a slightly higher unemployment rate than official estimates over the next four years, boosting government spending in the form of unemployment benefits.

Public debt interest (PDI) is likely to work in the opposite direction. From 2024-25, Deloitte Access Economics' economic forecasts imply a lower path for interest rates than what was assumed in the 2024-25 Budget, reducing the interest cost of government debt. This would save an estimated $1.3 billion on interest payments over the four years to 2027-28 compared to the 2024-25 Budget.

In terms of specific drivers:

- Activity: Deloitte Access Economics uses the unemployment rate as a proxy for the impact of economic activity on government spending. The unemployment rate was 4.1% in 2023-24 and is expected to rise to just above 4.5% over the forward estimates. Deloitte Access Economics' forecast for the unemployment rate is slightly higher than Treasury's from 2024-25 to 2026-27, with the difference widening in 2027-28. This difference adds to government spending.
- Exchange rates: Differences in exchange rates affect the budgeted cost of interest payments, defence purchases, foreign aid, and embassy spending. Deloitte Access Economics' exchange rate forecasts are slightly below Treasury's, leading to a modest increase in spending.
- Prices: Deloitte Access Economics expects inflation to ease to 3.0% over the year to the June quarter 2025. However, this pace of price growth is still higher than the 2.75% anticipated by Treasury at the time of the 2024-25 Budget. Faster price growth results in higher-than-expected spending for the range of payments that are indexed to consumer 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 is expected to be faster than Treasury's forecasts across 2024-25 and 2025-26, though lower across 2026-27 and 2027-28. The net result is for little change in spending over the next four years.
- Interest rates and the budget balance: The cost of PDI can vary due to changes in the size of the debt, and changes in the interest rate charged on that debt. Deloitte Access Economics is expecting lower government interest rates than were assumed in the 2024-25 Budget. That results in lower interest payments than otherwise anticipated.

Table 3 Expenses reconciliation ($ billion)

	Forecast 2024-25	2025-26	2026-27	2027-28
Official accrual spending	734.5	767.3	793.8	833.6
Budget Monitor accrual spending	738.1	769.6	795.9	836.6
Difference:	3.6	2.3	2.2	3.1
Effect of parameter variations (net, including PDI)	*1.9*	*1.2*	*0.9*	*1.8*
Effect of policy decisions (net)	*1.4*	*0.9*	*0.9*	*0.8*
GST adjustment	*0.3*	*0.3*	*0.3*	*0.5*
Effect of parameter variations				
Unemployment	0.1	0.1	0.1	0.9
Exchange rates	0.1	0.1	0.1	0.1
Consumer price index	1.3	1.3	1.4	1.5
Wages	0.4	0.4	-0.1	-0.4
PDI variation	0.2	-0.7	-0.6	-0.2
Effect of parameter variations (net, including PDI)	1.9	1.2	0.9	1.8
Effect of policy decisions				
Agriculture, Environment and Water	0.2	0.0	0.0	0.0
Attorney-General's, Defence, Home Affairs, Emergency Management and Veterans' Affairs	0.3	0.0	0.0	0.0
Child Care, Education, Skills, Training and Youth	0.0	0.0	0.2	0.2
Climate Change and Energy	0.0	0.0	0.0	0.0
Communications and the Arts	0.0	0.0	0.0	0.0
Families, Social Services, NDIS and Government Services	0.0	0.3	0.3	0.3
First Nations	0.0	0.0	0.0	0.0
Foreign Affairs and Trade	0.0	0.0	0.0	0.0
Health and Aged Care	0.7	0.5	0.3	0.2
Infrastructure	0.0	0.0	0.0	0.0
Secure Jobs and Industry	0.0	0.0	0.0	0.0
Treasury, Finance, Housing and the Public Service	0.2	0.2	0.2	0.2
Other	0.0	0.0	0.0	0.0
Total effect of policy decisions (net)	1.4	0.9	0.9	0.8

Note: Effect of policy decisions taken since election have been identified by Deloitte Access Economics from public sources and include decisions announced to 13 November 2024. While the intention is to include all announcements, the list may not be exhaustive.

Effect of policy decisions

The 'better-than-expected' budget surplus in 2023-24 was primarily due to 'lower-than-expected' spending. With an election due in the next six months, it is unlikely that trend will continue. Indeed, several new spending measures have already been announced since the 2024-25 Budget, though not all have been legislated.

Two of the largest measures include aged care reforms and additional funding for ending gender-based violence. The latter has seen $1.3 billion allocated over five years from 2025-26, while the aged care reforms will see an additional $930 million spent over four years from 2025-26. Notably, the aged care reforms will increase spending in the short term, but reduce spending in the long term.

Separately, the Government recently announced a new National Productivity Fund, making $900 million available to states and territories to boost competition and productivity.

The Government has also announced the extension of the Fee-Free TAFE policy. Over the forward estimates, the additional 80,000 TAFE places per year are expected to add around $450 million to spending.

Other significant spending announcements since the 2024-25 Budget include:

- Investment into sporting teams and athletes, including $15.0 million to help fund the 2026 Asian Football Confederation Women's Asian Cup in 2026, along with $283.0 million to elite athletes.
- Funding for mental health services, such as $8.0 million for a youth mental health study and $7.5 million for a Mental Health First Aid Training program.

Costs associated with the new policy measures shown in *Budget Monitor* are only those that have been announced between the 2024-25 Budget and 13 November 2024. These measures are expected to add an estimated total of $4.0 billion to net spending over the forward estimates.

Total accrual spending

The overall impact on accrual spending is shown in Table 3 above. Taken together, parameter variations and policy decisions (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2027-28 by $11.2 billion relative to forecasts in the 2024-25 Budget.

The level of spending unveiled in the forthcoming 2024-25 MYEFO is likely to also include some delayed expenditure carried over from 2023-24. The 2023-24 Final Budget Outcome, released in September 2024, noted lower-than-expected payments to the states and territories across a range of programs, including some $4.2 billion in lower National Partnership agreement payments. Some of that expenditure can be expected to occur in 2024-25 but has not been included in the forecasts published in this edition of *Budget Monitor*.

Net advances and other matters

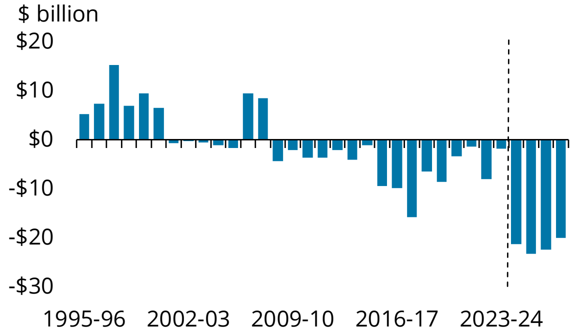
Net advances are the final element needed to estimate the headline cash balance. Headline deficits have been worse than underlying deficits over the past decade. As seen in Chart 11, this trend is expected to deteriorate further in the near term due to governments' growing use of 'off budget' entities to finance large spending promises.

'Off budget' is a misnomer; it means the money appears on the balance sheet and in the headline cash balance, but not in the underlying cash balance.

One example of 'off budget' funding relates to student loans such as the Higher Education Loan Program (HELP) and the equivalent program for vocational education and training students.

The Federal Government's promise to slash the loan balance for students by 20% will wipe some $16 billion in outstanding debt. This decision will affect the headline cash balance, but not the underlying cash balance, with the total fiscal impact depending on factors such as the how much of the $16 billion in debt would have ultimately been repaid.

Chart 11 Difference between the headline and underlying cash balance



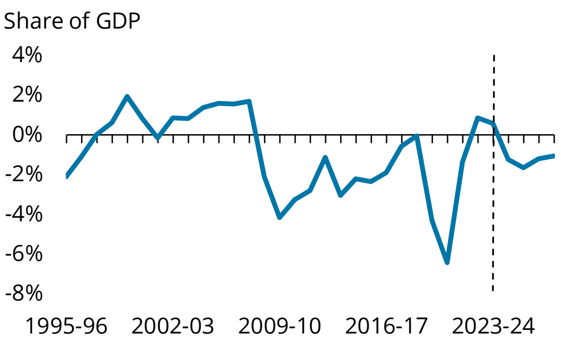
Source: Deloitte Access Economics, based on Commonwealth of Australia data

The budget balance

Overall budget aggregate projections are shown in Table 4 below.

Deloitte Access Economics expects an underlying cash deficit of $33.5 billion in 2024-25, a downgrade of $5.2 billion compared to the anticipated $28.3 billion deficit published in the 2024-25 Budget. The expected downgrade grows to $8.8 billion in each of 2026-27 and 2027-28.

Chart 12 Underlying cash balance share of GDP



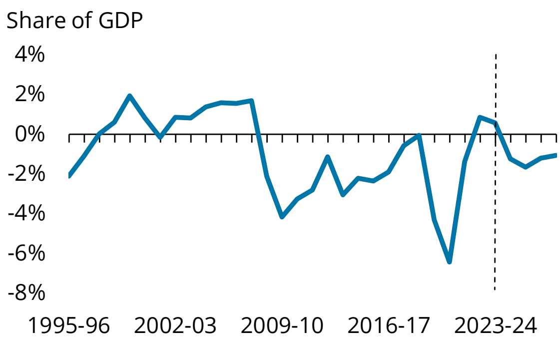
Source: Deloitte Access Economics, based on Commonwealth of Australia data

Over the four years to 2027-28, Deloitte Access Economics expects a cumulative deterioration in the underlying cash balance of $26.9 billion compared to the latest official forecast, resulting in an underlying cash deficit equivalent to 1.3% of GDP on average over that period (see Chart 13).

Net debt as a share of GDP is expected to be broadly in line with official forecasts from the 2024-25 Budget over the first two years of the forecast period. However, Deloitte Access Economics expects net debt to worsen through 2026-27 and 2027-28.

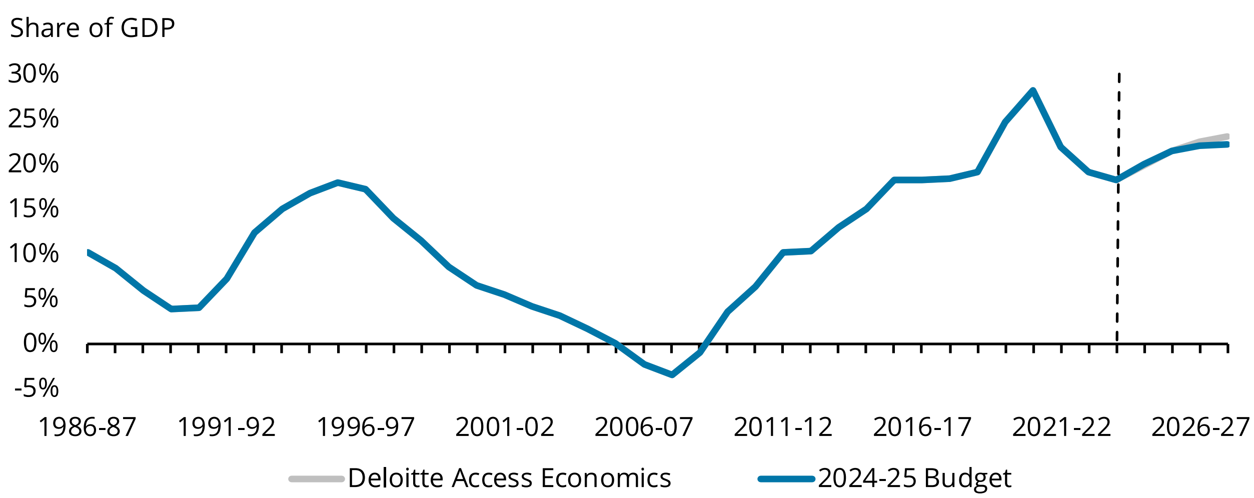
Official forecasts assumed net debt would reach 21.9% as a share of GDP by 2027-28, while Deloitte Access Economics expects this figure to be closer to 23.2%.

Chart 13 Underlying cash balance share of GDP



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

Chart 14 Net debt as a share of GDP



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

Table 4 Overall budget projections

	Outcome 2023-24	Forecast 2024-25	2025-26	2026-27	2027-28
Budget aggregates, $ billion					
Revenue (accrual)	704.5	709.9	731.1	769.6	813.2
% of GDP	26.4%	25.9%	25.7%	25.8%	26.0%
Expenses (accrual)	685.9	738.1	769.6	795.9	836.6
% of GDP	25.7%	26.9%	27.0%	26.7%	26.7%
Operating balance	18.6	-28.2	-38.5	-26.4	-23.4
% of GDP	0.7%	-1.0%	-1.4%	-0.9%	-0.7%
Fiscal balance	12.0	-34.5	-46.6	-35.3	-33.0
% of GDP	0.4%	-1.3%	-1.6%	-1.2%	-1.1%
Official forecast of fiscal balance	12.0	-29.3	-42.6	-26.5	-22.0
Difference in fiscal balance	0.0	-5.2	-4.0	-8.8	-11.0
Underlying cash balance	15.8	-33.5	-46.8	-35.5	-33.2
% of GDP	0.6%	-1.2%	-1.6%	-1.2%	-1.1%
Official forecast of underlying cash balance	15.8	-28.3	-42.8	-26.7	-24.3
Difference in underlying cash balance	0.0	-5.2	-4.0	-8.8	-8.8
Net cash flows from investments in financial assets[1]	-1.8	-21.3	-23.3	-22.5	-20.0
Headline cash balance	14.0	-54.8	-70.1	-58.0	-53.2
% of GDP	0.5%	-2.0%	-2.5%	-1.9%	-1.7%
Official forecast of headline cash balance	14.0	-47.2	-63.8	-46.8	-42.0
Difference in headline cash balance	0.0	-7.6	-6.3	-11.2	-11.2
Net debt	491.5	546.2	616.4	674.4	727.6
% of GDP	18.4%	19.9%	21.6%	22.6%	23.2%
Official forecast of net debt (% of GDP)	18.4%	20.0%	21.5%	21.8%	21.9%

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'.

For more information on Deloitte Access Economics publications please contact us via email or visit us online:

Email: daesubscriptions@deloitte.com.au
Online: https://www2.deloitte.com/au/en/pages/finance/articles/dae-publications-subscribe.html