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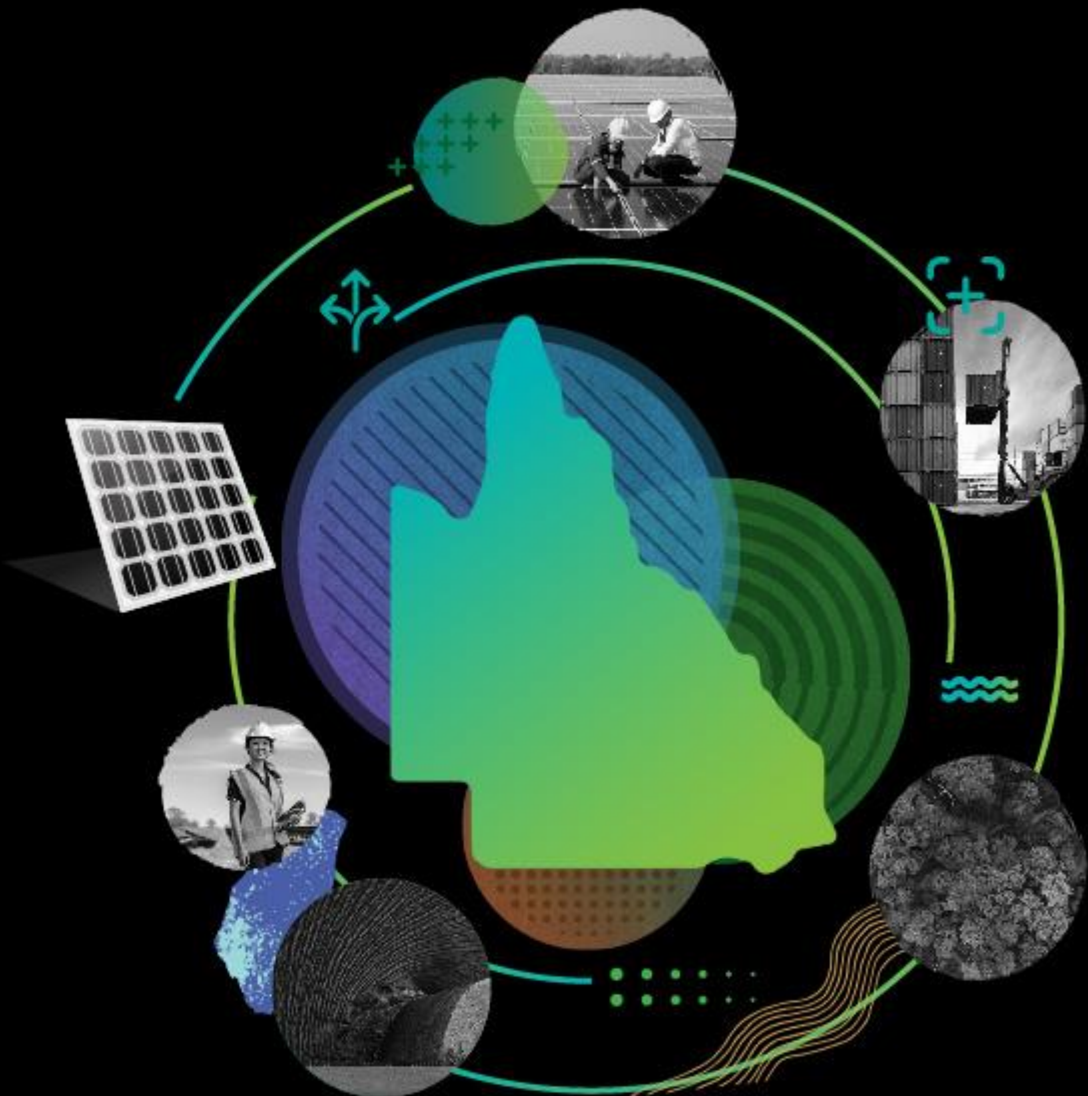

Queensland Budget 2024-25

An election budget that calls for long-term vigilance

June 2024

Deloitte
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ECONOMIC OUTLOOK

Reducing technical inflation, new spending and Queensland consumers to the economic rescue – did anyone say "election"?

Budgets handed down in an election year are always a pitch to voters, and this is true of any government. No doubt Queensland households have felt the impacts of cost pressures and it's within the Government's fiscal mandate to address this as they see fit. But addressing this while maintaining record spending and finding minimal savings raises long-term fiscal risks.

Governments can easily fall into this trap. And in Queensland it is even easier to fall in love with spending when coal royalties sustain a reliable revenue base – for now.

This points to important questions on long-term fiscal capacity, a concept that is plaguing all governments. Fiscal capacity is critical and needed to solve big policy problems like housing, energy, the Olympics and to be prepared for any major shocks. Elections, fiscal restraint and reforms will likely never be a trio, but in the current economy they should be.

Higher inflation? That's Miles away

The Government's cost-of-living package shows it is squarely focused on the short-term. By Treasury's forecasts, cost-of-living pressures will be eased – but don't expect it to last long.

Subsidies are expected to cut consumer price index (CPI) growth to 2% over 2024-25 – a percentage point less than estimated in last year's Budget. However, inflation won't stay down for long, with prices expected to rise 3.25% in 2025-26, as households again are forced to spend more for the things the Government covered in 2024-25.

Efforts to tackle inflation will also be complicated by skills shortages in the labour market and the nation-wide Stage 3 tax cuts, with forecasters currently uncertain about their cumulative effects.

A lopsided ledger raises questions over debt

The Government expects to recover from its 'deliberate' deficit by 2026-27, two years later than the last projection. New spending and higher project delivery costs have tipped expenses $14 billion higher over the three years from 2024-25, while softening commodity prices are expected to lower royalty earnings. To cover this shortfall, net debt is projected to grow from $12.2 billion (2.6% of GSP) in 2023-24 to $59.8 billion (11.4% of GSP) in 2027-28.

Fiscal discipline needs to be front of mind for Queenslanders

The increasing ratio of debt to GSP should be at the forefront of the Government's considerations around its future fiscal strategy. While debt is not forecast to reach levels seen in other states, managing debt allows governments to use fiscal capacity to address significant policy problems.

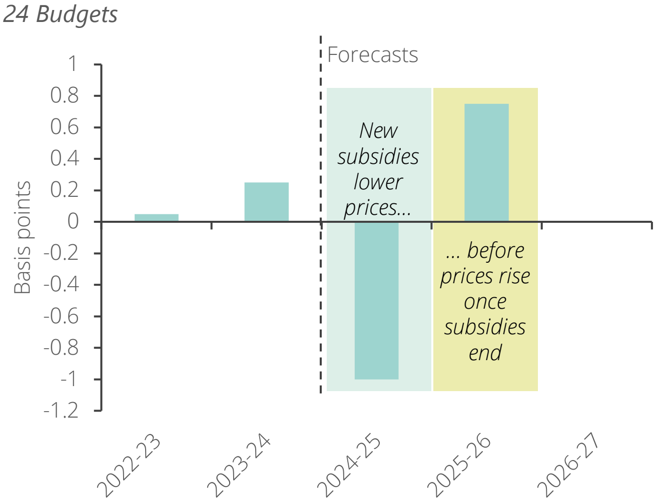
Managing debt depends on the return to surplus in 2026-27. A Taskforce has been charged with finding $3 billion in new savings over the forward estimates, while growth in household consumption is forecast to lift tax receipts. These ingredients for budget recovery, however, are far from guaranteed:

1. New savings: Saving $3 billion will require employee expense growth to halve on historical averages. This will be challenging especially given the no public sector job losses promise. The savings Taskforce must chase reform and be disciplined if it is to keep the Budget from slipping into structural deficit.
2. Consumption growth: The recovery in household consumption is far from guaranteed. If cost-of-living pressures do not ease as expected, consumption may not grow in line with the forward estimates – making the debt reduction task that extra bit harder.

Of course, these are not the only uncertainties around the Government's fiscal position. Project delivery costs may continue growing, or royalties could be higher than expected. Both have occurred in recent budgets and would have implications for debt management. Nevertheless, vigilance around the return to surplus will be needed to ensure the Government is prepared to address policy challenges and confront uncertain economic times.

Chart 1: Down, then up again

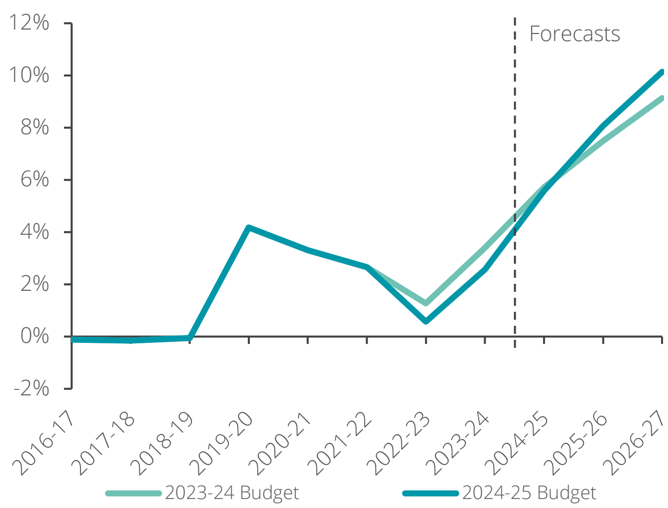
Difference between inflation estimates from 2024-25 and 2023-24 Budgets



Source: Queensland Treasury, 2024-25 Budget

Chart 2: A steep climb

Net debt as a % of GSP in the 2024-25 and 2023-24 Budgets



Source: Queensland Treasury, 2024-25 Budget

SHORT-TERM MEASURES

With a clear eye to the October election, the Budget commits $3.7 billion in one-off cost-of-living measures. But spending is easy; saving is hard.

The centrepiece of the Budget is a $3.7 billion package to reduce cost-of-living pressures, which will deliver temporary support over the 2024-25 financial year.

What's included in the cost-of-living package?

New funding includes $2.5 billion in electricity bill relief, $435 million toward reducing the price of car registration, $150 million for 50-cent public transport fares, and a range of other measures including zero indexation on fees and charges, and funding for children's sport and school lunches.

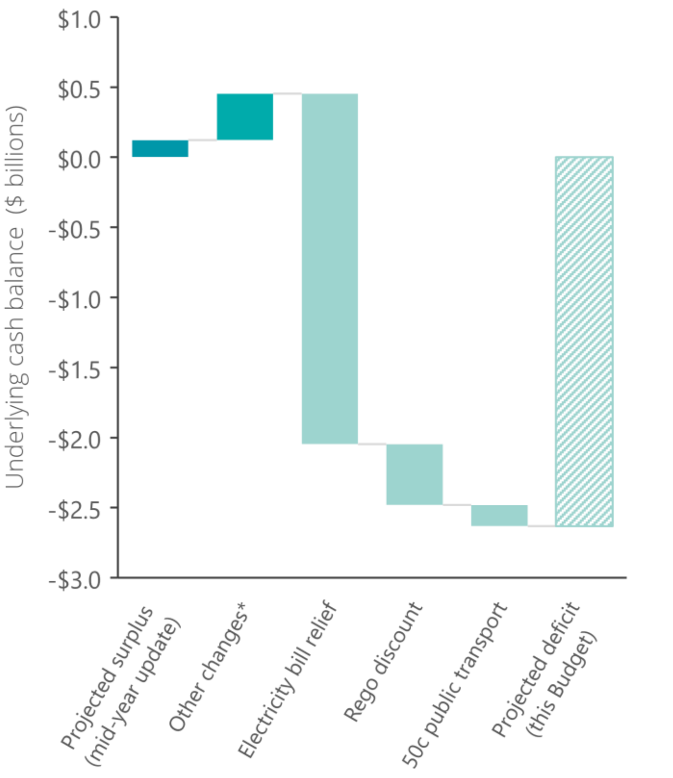
How does this aim to help Queenslanders?

Recent cost-of-living pressures are driven by a combination of stagnant productivity growth and the acute impacts of inflation. By targeting the final prices paid by households, this package therefore represents an attempt to treat the symptoms, rather than the underlying cause.

Accordingly, understanding the impact of the newly-announced measures calls for consideration of their broader effects – including on the overall inflation outlook.

Chart 3: Where the surplus went

How cost-of-living measures stack up against the deficit †



Source: Queensland Treasury, 2024-25 Budget

*Other changes captures the net impact of revisions to revenue and expense measures, including royalty and tax receipts, budget savings, and new spending.

† Chart 3 is an indicative representation of change in budget position. Figures may not sum precisely due to rounding and spillover of funding across financial years.

Reducing inflation in some areas... may raise it in others

Budget forecasts estimate that the cost-of-living package, coupled with Commonwealth support, will collectively reduce headline inflation by 1.25% in 2024-25. This short-term reduction will be achieved by directly subsidising goods and services included in the CPI basket.

However, a deliberate design feature of this package – giving money back to households – spells trouble for inflation elsewhere in the economy. As Premier Steven Miles explained about the car rego discount:

> "This initiative will save the 5.7 million light car owners here in Queensland hundreds of dollars over the 12 months – dollars that could be spent on groceries, rent, the mortgage, or put into savings".

With a national household savings ratio of just 1.1%, it can be expected that the cost-of-living package will result in the same amount being spent on other essentials. This could keep inflation higher for longer, as reflected in the Government's own long-term forecasts.

Flow-on effects could also include upward pressure on interest rates, with the only mitigating factor being an economy slowing faster than anticipated. Against this backdrop, households may wonder if they are better off under the Government's package, or under lower inflation and lower rates.

When all you have is a chequebook...

So, why would a government sacrifice a surplus – typically a good news story in an election year – for spending that may backfire?

There are several possible explanations:

1. Workings of the federation: With interest rates set nationally, Queensland will be hoping that other states and territories don't raise *their* spending by as much, allowing the cost-of-living package to sneak through. However, with all governments facing the same incentives, this sets up a prisoner's dilemma that is likely to see similar measures announced across the board.
2. Affordability concerns: The Government considers it is giving targeted relief to people that need it – effectively justifying the measures as giving Queenslanders what they want. However, knowing the disproportionate impact of inflation on younger and disadvantaged cohorts, this argument may not stand scrutiny if the national position forces the RBA's hand.
3. It's a policy choice: In advance of the election, the Government may expect voters to appreciate cash-in-hand support more than they blame the Government for higher inflation if it eventuates. Following this logic, the cost-of-living package is well-explained (at least in part) by a simple policy choice.

CAPITAL INVESTMENT FOR LONG TERM PROSPERITY

The Budget provides substantial investment in the energy sector, But good design and implementation will be the difference between productivity enhancing initiatives or a waste of taxpayer dollars.

Queensland's Big Build is set to continue, with total capital investment of $27 billion in 2024-25. Big-ticket projects sit in the energy and transport sectors, whose combined capital spending comprises over 70% of total capital investment in this Budget. The Budget also includes record growth in health spending but notably lacks significant investment in Olympic infrastructure.

A future made in Queensland

Queensland is investing substantially in energy when compared to previous budgets, with a total capital allocation of $8.7 billion in 2024-25. This represents a massive 52% increase in capital expenditure on energy projects from 2023-24, which might finally give the energy transition the government-backed momentum it requires.

There are numerous energy projects receiving funding, spanning energy generation, transmission, and storage. The funding will enable a considerable increase in Queensland's renewable energy generation capacity and improve renewable energy security, which is required to support green industrial transformation opportunities.

The expansion of Queensland's renewable energy capacity will support the outcomes of the *Queensland Energy and Jobs Plan*, which identifies Queensland's pathway to delivering clean energy out to 2035.

Are we missing an Olympic-sized opportunity?

A notable exclusion from the 2024-25 Budget is sizable spending on Olympic and Paralympic infrastructure. Approximately $27 million of capital funding has been allocated to the Minor Venues Program in the 2024-25 Budget, while further funding has been allocated for the preparation of additional project validation reports and to establish the Games Venue and Legacy Delivery Authority.

It appears that this Budget is not revealing any changes to the Miles Government's decision to peel back on Olympic infrastructure and abandon larger investments in stadium development – a decision that invited significant scrutiny and left many wondering what Queensland's Olympic legacy will be.

Is a growing health budget sustainable?

The 2024-25 Budget is headlined by record growth in health spending of 10.6% - well exceeding the average growth of 6.9% we've seen over recent years. The spending includes capital allocations for expansions to many of Queensland's largest hospitals and the development of new hospital and medical facilities, as well as targeted measures aimed at addressing the gap in gender health inequity.

While few Queenslanders will argue that investing in health is not money well spent, the growth in spending raises questions around the sustainability of such investments.

Queensland's health expenditure, even after accounting for inflation, is growing at a rate that far exceeds population growth. In fact, it is growing seven times faster than forecast population growth in 2024-25. Further, growth in health spending has consistently outpaced both GSP and population growth in previous years.

With an ageing population and increasing prevalence of chronic health conditions among Queensland's population, demand for health infrastructure and services is only expected to grow going forward. Without innovation and movement toward alternative models of care, Queensland is at risk of reaching unsustainably high health expenditure in future years.

What does this infrastructure investment mean for the budget deficit?

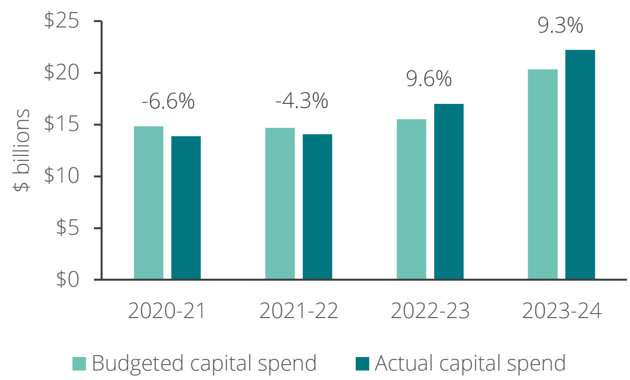
A large infrastructure spend has been generally offset in the short-term by higher royalty and tax receipts. However, as Queensland seeks a path back to surplus after this year's cost-of-living measures create a $2.6 billion budget deficit, containing infrastructure spending - and cost blowouts - will be crucial to staying the course

Recently, high inflation years have been subject to significant cost blowouts on infrastructure. The cost increase between the forecast and actual infrastructure spend allocated in the 2023-24 Budget indicates a staggering 9.3% cost overrun on last year's capital spend – a value that well exceeds price inflation in the construction sector. Further, capital allocations in the 2024-25 Budget have already been adjusted upward to account for increased costs on several headline projects. If these trends continue, we may see a notable increase in capital expenditure over the forward estimates period.

With an already increasing debt-to-GSP ratio in Queensland, there is an argument to closely monitor capital spend over the course of this Budget and in future years, particularly if the Government wish to return to surplus in 2026-27. Every additional dollar of government debt increases the burden of today's budget stimulus on future generations of Queenslanders.

Chart 4: Cost increases drive capital spend

Variance between budgeted and actual capital spend



Source: Queensland Treasury, 2020-21 to 2024-25 Budgets

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