Parliamentary
Budget Office

5 October 2022

National fiscal outlook: as at 2022-23 Budgets

Overview

- With all state and territory 2022-23 Budgets now released, the Parliamentary Budget Office (PBO) has consolidated the forecasts from these budgets with the Australian Government's budget – released in March 2022 – to provide an aggregated outlook for the national fiscal position.
- Together, the budgets reflect an economy that is continuing to rebound from the COVID-19 pandemic, despite the war in Ukraine and other international events, natural disasters and supply chain issues. The stronger-than-expected economic recovery has improved the National fiscal outlook (NFO) compared with our previous NFO in December 2021.
- National net debt has been revised down over the forward estimates, partly owing to revaluations due to higher interest rates (see Box 1). However, the cost of issuing new debt has increased, despite expected deficits being smaller than previously forecast.
- Overall, the fiscal position remains sustainable, but risks remain, particularly the implications of higher inflation and interest rate expectations.

The NFO brings together all state and territory budgets with the Australian Government budget, to give a national overview of the aggregate fiscal position.

The national budget balance – the difference between revenue and expenses – is expected to improve over the forward estimates, with smaller deficits each year relative to our 2021 NFO[1]. Revenue is higher compared to the previous forecast, leading to an improvement in the budget balance, despite higher spending. The higher revenue forecasts are driven by stronger economic and labour market conditions at the time of the Australian Government's March 2022-23 Budget, compared with what was expected at the 2021-22 Budget in May 2021.

National net debt is forecast to increase as a share of GDP over the forward estimates due to ongoing borrowing driven by budget deficits. Compared to the previous NFO, national net debt is considerably lower, driven by both smaller deficits and a fall in the market value of debt (Box 1). Nonetheless, National net debt remains at historically high levels as governments continue to carry debt built up from the economic impact of the COVID-19 pandemic and the associated temporary stimulus measures.

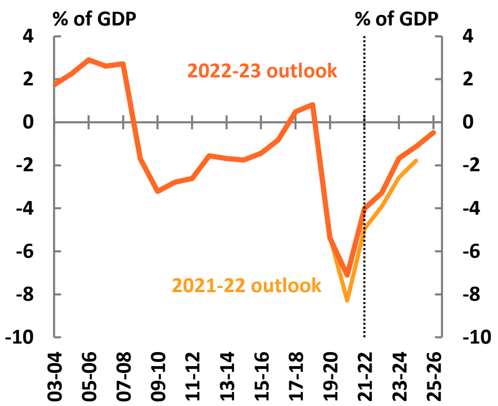
National public debt interest payments are expected to increase over the forward estimates period, in line with higher interest rates on new debt.

A complementary product, the *2022-23 National fiscal outlook: At a glance*, provides a graphical snapshot of the Australian Government, state and territory budgets in addition to the national aggregates. An upcoming budget explainer on indexation will examine the inflation impacts on indexation payments. A more detailed discussion of the Australian Government trends and risks will be contained in the upcoming *Beyond the budget 2022-23: Fiscal outlook and scenarios* report.

[1] For the purposes of this report, the 'budget balance' refers to the net operating balance. The 2021-22 National Fiscal Outlook was published on 2 December 2021.

What does the national fiscal position look like and how has it changed since the 2021-22 National fiscal outlook?

National net operating balance

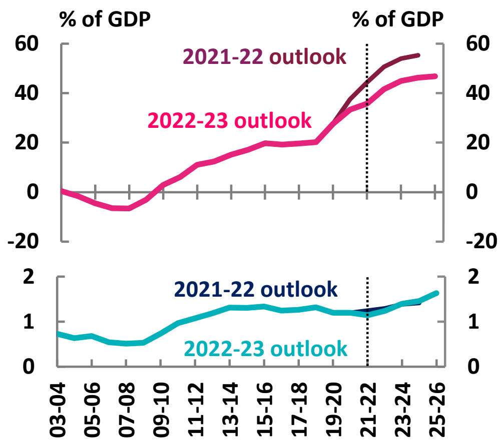


The **national net operating balance**[2] – the difference between revenue and expenses – is forecast to improve from a deficit of 4% of GDP ($92 billion) in 2021-22 (the first forecast year for these budgets[3]) to a deficit of 0.5% of GDP ($13 billion) in 2025-26 as the economy recovers from the COVID-19 pandemic.

This year's aggregated budgets saw national revenue revised upwards by $84 billion for 2021-22 and national expenditure revised upwards by $70 billion, when compared to the previous NFO in 2021.

The higher-than-expected revenue means the forecast national net operating balance is slightly better than was previously expected.

National net debt (top) and public debt interest payments (bottom)

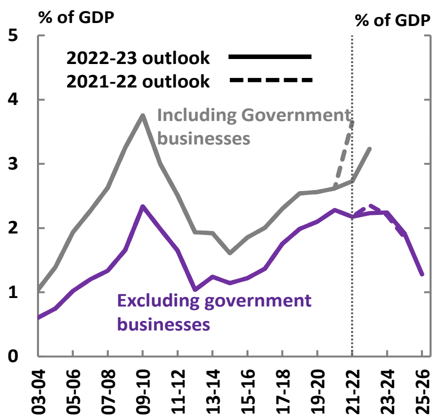


The continued operating deficits mean that **national net debt** is forecast to increase from 36% of GDP ($820 billion) in 2021-22 to 47% of GDP ($1,223 billion) in 2025-26.

Compared to our previous NFO, forecast national net debt has improved, being revised downwards by $126 billion for 2021-22 and by $172 billion for 2024-25. The improved outlook is due to a combination of the improved net operating balance, such that governments are required to borrow less, and a downwards revaluation to the market value of government securities, due to higher interest rates (Box 1).

National public debt interest payments are forecast to rise from 1.1% of GDP ($26 billion) in 2021-22 to 1.6% of GDP ($43 billion) in 2025-26. This is $3.7 billion higher across the period 2021-22 to 2024-25 than forecast at the previous NFO, despite the improvement in the debt position. Higher interest payments are mostly attributable to increased expected interest rates across the forward estimates when compared to the 2021-22 Budget.[4]

National net capital investment



National net capital investment[5] – largely spending on infrastructure such as roads, schools and hospitals – has been revised down from 2.5% of GDP ($52 billion) to 2.2% of GDP ($50 billion) in 2021-22 compared to the previous NFO and is forecast to continue to fall to 1.3% of GDP ($33 billion) in 2025-26.

Several states, including New South Wales have pushed out their timing for investment in 2021-22, particularly for infrastructure projects.

[2] The net operating balance is equal to revenue less expenses and does not include the purchase and sale of assets. See the PBO's online glossary for further definitions of budget terms.
[3] All of the budgets were released before the end of 2021-22, mostly in May 2022, except for the ACT Budget, published on 2 August 2022.
[4] Australian Government, *2022-23 Budget*, Statement 6: Debt Statement, p. 195.
[5] Excluding government businesses. Government businesses are included in the state discussions because forecasts are available. In contrast, the national figures exclude government business because forecasts for Australian Government businesses are not available beyond the budget year.

Box 1: Revaluation of net debt

National net debt is lower than reported in the previous NFO, mainly because of changing market prices associated with rising interest rate expectations.

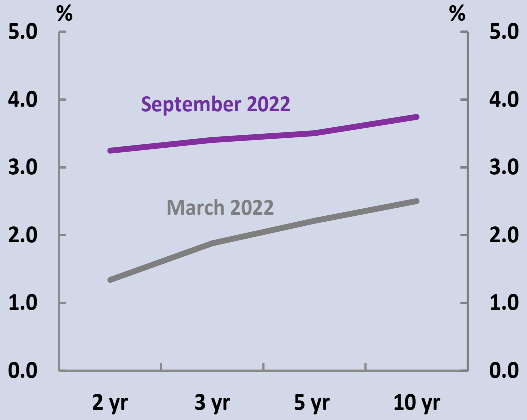
Net debt – financial liabilities less assets – is a widely used measure of a government's financial position.[6] A key component of liabilities is government securities, which are effectively loans to the government. The value of government securities is determined by the current 'market value' (as opposed to the value when first issued), and this value changes over time.

Government securities (most of which are bonds) are generally issued with associated fixed interest payments (known as 'coupons'); this might be, for instance, 2%, such that the holder of a $1000 bond would receive $20 per year. Securities are typically purchased by central banks and large investors such as superannuation funds, who wish to store wealth while receiving a return on their investment. Securities are regularly resold to other investors on the 'secondary market' after their original issue from the government, with the coupon payments remaining fixed. After a set period of time, often 3, 5, 10 or 20 years, the bond is redeemed by the government, paying the owner the amount of the original issuing 'face value' of the bond - $1000 in the earlier example.

When interest rates rise, existing securities which were issued with low coupon rates are less attractive to investors, so their price on the secondary market falls. A lower market value of government securities means that the value of net debt falls.

Importantly, because government securities last for several years, their market value depends on *expected* future interest rates. Investors require different rates of return, known as 'yields', for government securities based on where they expect interest rates to be in the future. A 1-year bond may have a lower expected return than a 5-year bond because the market expects interest rates to progressively rise over the next 10 years, leading to the upward slope of lines in Chart A. The relationship between the time period of the security and the yield is called the 'yield curve', which changes shape as interest rate expectations vary.

Chart A: Yields on Australian Government Securities



Note: Yield has been interpolated from government securities in the secondary market.
Source: Reserve Bank of Australia

Since the release of the March 2022 Australian Government Budget, the Reserve Bank of Australia's cash rate has increased from 0.1% to 2.6% as of 4 October 2022, with yields on securities also rising. A comparison of yield curves for March 2022 and September 2022 shows that investors now require higher yields, meaning the value of existing securities on the secondary market has fallen (Chart A). As a result, national net debt may be revalued down even further in the upcoming Australian Government budget update than presented in this document. State net debt is also affected by market revaluations but as Australian Government debt makes up around three quarters of the national debt, any change in the price of Australian Government securities has the largest impact.

While higher interest rates reduce the value of government debt, they also increase the borrowing cost for future deficits, which can become detrimental to the national fiscal position if deficits are large or persistent.

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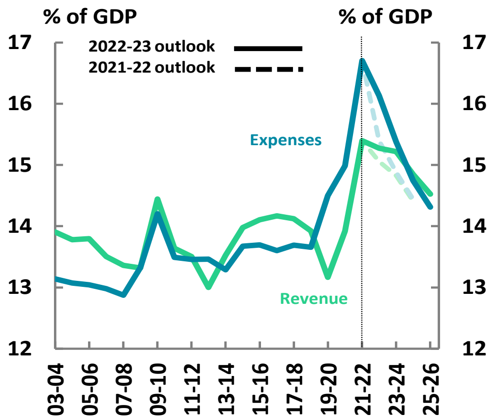
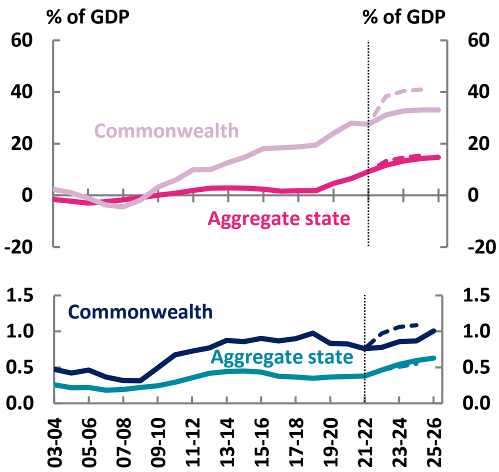
[6] Net debt is the sum of selected financial liabilities (including government securities, loans, deposits held, and other borrowings) minus the sum of selected financial assets (including cash and deposits, advances paid, and investments).

What do state trends look like compared to the 2021-22 National fiscal outlook?

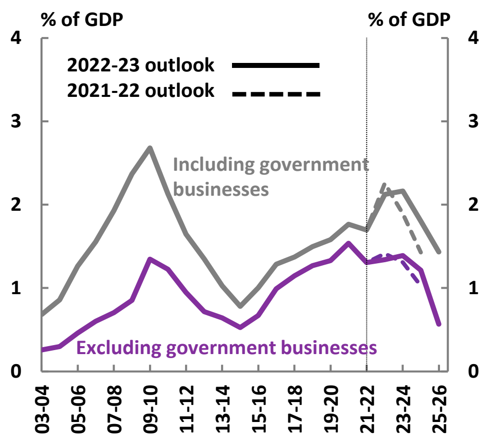
State revenue and expenses



State net debt (top) and public debt interest payments (bottom)



State net capital investment



Aggregate state expenses are forecast to reduce from 16.7% of GDP ($383 billion) in 2021-22 to 14.3% of GDP ($374 billion) in 2025-26, as temporary spending on COVID-19 support measures unwinds. When compared to the previous NFO, expenses are forecast to be $121 billion higher over the next few years as governments fund additional expenditure measures such as universal pre-kindergarten in New South Wales and Victoria.

Aggregate state revenue is forecast to fall from 15.4% of GDP ($353 billion) in 2021-22 to 14.5% of GDP ($380 billion) in 2025-26 as the economy continues to strengthen from the pandemic. Compared to the previous NFO, state revenue is forecast to be $104 billion higher over the next few years, largely due to the better-than-expected recovery from the pandemic in most states.

Aggregate state net debt is forecast to increase from 9.2% of GDP ($211 billion) in 2021-22 to 14.8% of GDP ($386 billion) in 2025-26, with many state governments forecasting net operating deficits for most of the forward estimates.

Compared to the previous NFO, aggregate state net debt has been revised downwards and is $14 billion lower in 2024-25 as improved operating deficits in each year reduce borrowing requirements.

Aggregate state public debt interest payments are forecast to increase slightly across the forward estimates. Interest payments are expected to rise from 0.4% of GDP ($9 billion) in 2021-22 to 0.6% of GDP ($16 billion) in 2025-26, due to a projected increase in net debt over the forward estimates.

Aggregate state net capital investment (including government businesses) is forecast to increase to 2.2% of GDP ($51 billion) in 2023-24 before moderating to 1.4% of GDP ($37 billion) in 2025-26.

Compared to the previous NFO, the timing for aggregate state net capital investment has been pushed further into the future. The shift has been largely driven by supply chain bottlenecks and increased infrastructure costs, which have forced some states to reprofile their infrastructure delivery timeframes.

Further information on the data sources and method used in this report are available in the separate technical appendix. Additional data to those cited in this report is available at the [PBO data portal](#).

This report was authored by Rose Xu, Lynette Yap and Kate Wagner, with the benefit of comments from John Clark and Karen Whitham. The contents of the report are the sole responsibility of the Parliamentary Budget Office.