F. ECONOMIC SCENARIO ANALYSIS

The 2024-25 Budget relies on forecasts and judgements about the future of the economy, based on information available at the time of preparation. These forecasts are subject to inherent uncertainties, such as changes in behaviours, evolving relationships between variables and unexpected events or shocks.

This Appendix complements the central economic outlook presented in Chapter 2 The Economy by quantifying some of the key risks to the outlook. It explores the impact of variations in key economic parameters on the economic outlook and general government tax revenues.

These scenarios were selected to cover plausible economic events that could affect New South Wales over the forecast horizon. The modelling takes account of linkages between key international, Australian and New South Wales economic aggregates. By using scenario analysis of this kind, we capture interdependencies within our economy that a partial sensitivity analysis would not capture.

The summary of these results should be interpreted with care because economic events tend to be unique in nature. The scenarios presented in this Appendix are unlikely to completely reflect any future shock to the State economy. Any departures from the specified scenario would likely result in different impacts on the economic and revenue outlook.

F.1 Impact of variations in key forecast assumptions

The economic impact of the scenarios below was modelled using the Oxford Economics (OE) suite of models including the Global Economic Model and Australia in Detail model.[1] The results are presented as deviations from baseline forecasts. The economic results were then used to estimate the revenue impact of the scenarios using NSW Treasury's revenue model.

Scenario 1: Positive economic backdrop spurs business innovation

Productivity is a key driver of economic growth and stronger real wages. Slowing productivity growth was a global phenomenon leading up to the COVID-19 pandemic potentially due to a lack of major economic reforms and the shift to the services sector. More recently, the disruptions from the COVID-19 pandemic along with trade disruptions have also hurt short-term productivity growth in Australia and globally. Combined with a tight labour market, this has resulted in higher labour costs that are partially responsible for keeping inflation above the 2 to 3 per cent target range.

In this scenario, we assess the potential (upside) implications for our forecasts should businesses prove more successful, through investing in technologies and better utilising their existing workforce, in boosting productivity in the near term. This scenario also assumes that improvements in business conditions (including global conditions) provide businesses with the certainty needed to undertake these innovations.

---

[1]   The suite of OE models are whole-of-economy econometric models with linkages through trade, competitiveness, capital markets, interest rates and commodity prices. They are Keynesian in the short run ensuring that shocks to demand generate economic cycles that can be influenced by fiscal and monetary policy. Long-run output is determined by supply side factors including investment, demographics, labour participation, human capital and productivity. Behavioural equations are estimated in error-correction form to model long term equilibrium relationships which are based on economic theory.

The subsequent increase to Australia's economic capacity supports stronger consumption and investment activity without stoking inflationary pressures. This allows the cash rate to fall earlier and faster than expected under the baseline.

Macroeconomic impact on the Budget and over the forward estimates

In this scenario, businesses increase investment in new technologies and their workforce in the near term. Improved productivity lowers unit labour costs and employment increases 0.3 percentage points above baseline in the first two years, leaving the unemployment rate lower. Despite the additional tightening in the labour market, the improved productivity does not flow into average nominal wages as businesses look to contain costs. Higher productivity allows businesses to lower their product prices which increases real wages and sees inflation reaching the Reserve Bank of Australia's 2 to 3 per cent target band earlier than expected.

Improvements in labour productivity support stronger real wages growth through lower prices relative to baseline. This supports real household spending, which alongside improvements in business investment, drives real state final demand above baseline in 2024-25 and 2025-26. Spare capacity in the economy is slowly diminished as the output gap closes with state final demand still 1.0 per cent above the baseline by 2027-28.

The overall impact on gross state product (GSP) in the scenario is muted somewhat by weaker net exports. Real GSP rises above baseline in 2024-25 and 2025-26. This initial boost to real GSP is slowly reduced over the forecast period as global demand moderates. In comparison, domestic conditions hold up relatively well due to domestic productivity improvements.

Table F.1:   Effect on major economic parameters from improved business productivity[a]

Financial year estimate[a]	2024-25	2025-26	2026-27	2027-28
State final demand	1.1	1.5	1.2	1.0
Gross state product	0.9	1.1	0.7	0.4
Employment	0.3	0.3	0.1	0.0
Unemployment rate	(0.3)	(0.4)	(0.1)	0
Consumer price index	(0.8)	(0.7)	(0.6)	(0.6)
Compensation of employees	0.2	0.3	0.1	0.0
Productivity	0.7	0.8	0.6	0.4

(a)   Figures reported are the per cent change in the level of each parameter relative to the baseline. The unemployment rate is in percentage points deviation.

Source: Oxford Economics and NSW Treasury

Chart F.1:   Higher household consumption and investment lift domestic activity
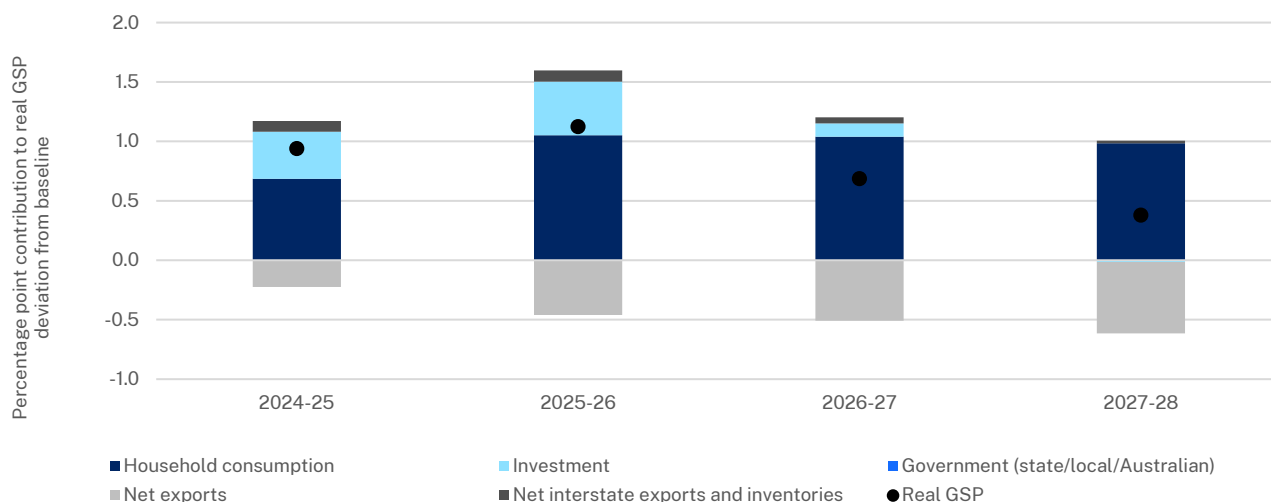
Source: Oxford Economics and NSW Treasury

Revenue impact on the Budget and over the forward estimates

Under this scenario, stronger domestic economic activity flows through to higher tax collections across most categories of government revenue. Payroll tax is supported by a boost in employment in the medium-term. Both commercial and residential transfer duty revenues increase, with transaction volumes and property prices elevated relative to the baseline. Stronger property prices also feed into improvements in land tax revenue. The State's GST revenue also increases bolstered by robust consumer spending and dwelling investment. Royalties revenue is higher in the near term due to higher coal prices as stronger global conditions increase demand for coal, with the impact declining from 2026-27 due to a stronger Australian dollar.

Table F.2:   Effect on major revenue parameters from improved business productivity[a]

Financial year estimate[a] ($, million)	2024-25 $m	2025-26 $m	2026-27 $m	2027-28 $m
Payroll tax	28	48	12	0
Transfer duty	339	758	361	352
Land tax	0	27	105	206
Royalties	22	38	18	0
GST revenue	389	647	577	587
Total revenue	**778**	**1,518**	**1,073**	**1,145**

(a)   Figures reported are the change in the level of each parameter relative to the baseline.

Source: NSW Treasury

Scenario 2: An escalation of geopolitical tensions

The geopolitical environment in 2024 is volatile with the ongoing war in Ukraine, and increased tensions in the Middle East and South China Sea. An escalation in tensions related to any of these factors could have a significant impact on the global economy through both real effects (disrupted trade routes) and global sentiment.

In this scenario, we assess the potential downside implications for our forecasts should geopolitical tensions escalate. This scenario assumes an escalation in geopolitical tensions disrupts global supply chains through interruptions to global trade. Meanwhile, increased fear of conflict causes a deterioration in investor sentiment. Initially, fiscal policy is loosened to support demand in major economies, mitigating near-term weakness. But ultimately the global recovery falters as sentiment deteriorates and asset prices weaken.

The challenging global environment hampers Australian economic activity. Investment and trade are hit hardest, with household consumption facing a more modest growth outlook as unemployment rises. Inflation is lower as the weaker domestic environment puts downward pressure on prices. This offsets the upward pressure on inflation from supply chain disruptions in the near term.

Macroeconomic impact on the budget and over the forward estimates

Worsening investor sentiment against a weaker global backdrop results in a significant pullback in investment activity in New South Wales. The uncertain outlook also reduces demand for labour with the unemployment rate higher, particularly in the near-term.

A weaker labour market, in turn, weighs on households with real consumption declining in the first two years. The pull back in consumer spending and business investment drags real state final demand below baseline in 2024-25 and 2025-26.

Inflationary pressures ease as underlying demand within the NSW economy weakens. Higher global prices due to supply chain disruptions provide a short-term partial offset to the weaker underlying demand. Overall, prices fall below the baseline and remain constrained as economic growth remains below potential.

Weaker global conditions and trade immediately reduce export demand in the NSW economy, and this falls below baseline in 2024-25 before deteriorating further in the following two years. While global conditions stabilise, the decoupling of trade results in a permanently lower level of export demand within the NSW economy, with exports remaining below baseline over the forward estimates.

Overall, real GSP declines below baseline in 2024-25 and deteriorates further in 2025-26. This is driven by weakness in both domestic and global conditions. Interest rate cuts combined with an improvement in real wages support the domestic recovery with state final demand above baseline by 2027-28. However, the ongoing weakness in the global economy results in a weaker net exports position with real GSP remaining below baseline by the end of the projection period.

Table F.3:   *Effect on major economic parameters from an escalation in geopolitical tensions[a]*

Financial year estimate[a]	2024-25	2025-26	2026-27	2027-28
State final demand	(0.7)	(0.7)	(0.2)	0.1
Gross state product	(0.6)	(0.9)	(0.8)	(0.7)
Employment	(0.4)	(0.6)	(0.3)	(0.3)
Unemployment rate	0.4	0.6	0.3	0.3
Consumer price index	(0.5)	(1.3)	(1.7)	(1.9)
Compensation of employees	(0.7)	(1.4)	(1.5)	(1.9)

(a)   Figures reported are the per cent change in the level of each parameter relative to the baseline. The unemployment rate is in percentage points deviation.

Source: Oxford Economics and NSW Treasury

Chart F.2:   *Decoupling of trade results in a lower level of export demand*
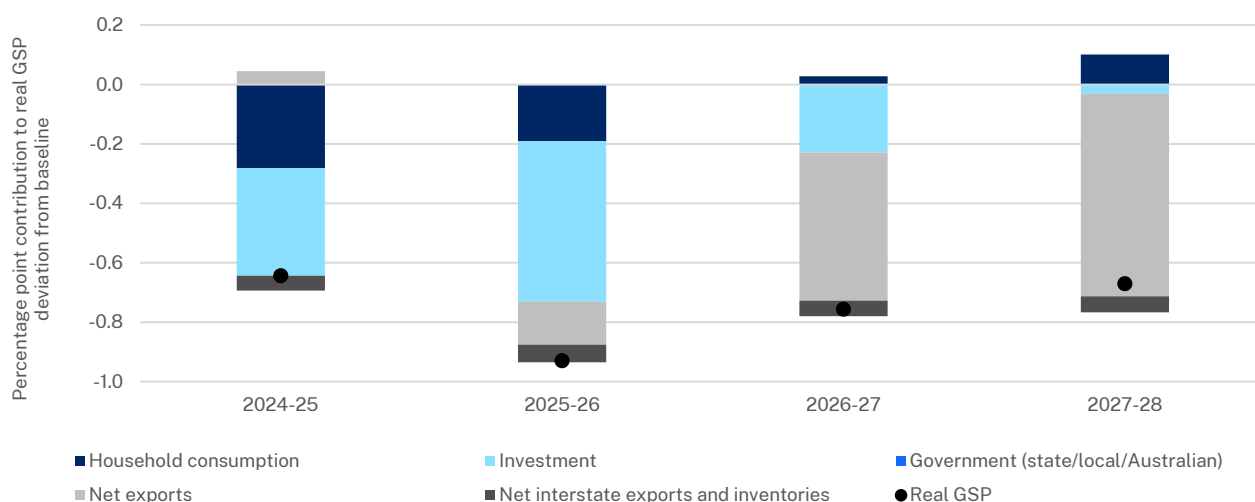
Source: Oxford Economics and NSW Treasury

Revenue impact on the budget and over the forward estimates

The economic downturn results in decreased tax collections across most categories of government revenue. The decline in household consumption and dwelling investment reduces the national GST pool, leading to a decrease in NSW GST revenue. Lower employment and wages over the forecast horizon also leads to lower payroll tax collections. Residential and commercial transfer duty collections are particularly impacted, as housing prices fall and transaction volumes contract. This also flows through to weaker land tax revenue. Coal royalties also fall due to lower levels of export demand.

Table F.4:   Effect on major revenue parameters from an escalation in geopolitical tensions[a]

Financial year estimate[a] ($, million)	2024-25 $m	2025-26 $m	2026-27 $m	2027-28 $m
Payroll tax	(113)	(225)	(255)	(350)
Transfer duty	(535)	(738)	(258)	(233)
Land tax	0	(24)	(95)	(172)
Royalties	(179)	(273)	(252)	(231)
GST revenue	(237)	(380)	(367)	(384)
Total revenue	**(1,064)**	**(1,640)**	**(1,227)**	**(1,370)**

(a)   Figures reported are the change in the level of each parameter relative to the baseline.

Source: NSW Treasury