Victorian Budget
2023/24

Doing What Matters

Strategy and Outlook

Budget Paper No. 2

Presented by Tim Pallas MP
Treasurer of the State of Victoria

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Government

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for the information of Honourable Members

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CHAPTER 1 – ECONOMIC AND FISCAL OVERVIEW

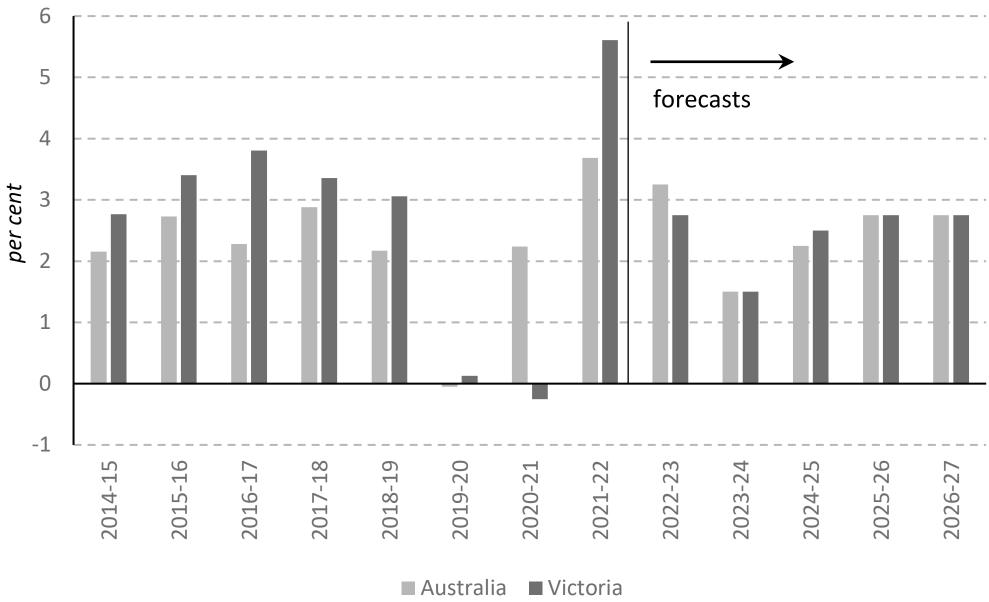
RECORD-BREAKING JOBS PERFORMANCE AND A GROWING ECONOMY

The Victorian economy is delivering strong employment outcomes and economic growth. Real gross state product (GSP) per person is expected to be 5.0 per cent higher in 2022-23 than it was in 2018-19, the last full year before the COVID-19 pandemic. The rate of unemployment is below 4 per cent as it has been for most of the past year – which hasn't happened for nearly 50 years – and underemployment is at multi-decade lows.

The economy is expected to remain healthy in 2022-23, with real GSP forecast to grow by 2.75 per cent. This follows growth of 5.6 per cent in 2021-22 which was the highest of all the states and well above national real gross domestic product (GDP) growth.

While Victoria's economy has recovered following the pandemic, it is now navigating a challenging period with high inflation, rising interest rates, and weakening national and global growth. However, the Victorian economy's strong foundations mean that most households and businesses are well positioned to meet these challenges. On average, Victorian households have accumulated significant savings over recent years, and business balance sheets are also strong in aggregate. Nonetheless, rising living costs are putting pressure on households, and real GSP growth is expected to slow to 1.5 per cent in 2023-24 as high inflation and interest rates weigh on the economy, although unemployment is expected to remain low. Later in the forward estimates, economic growth is expected to strengthen as inflation eases and interest rates decline (see Chart 1.1).

Chart 1.1: Real economic growth, actual and forecast, Victoria and Australia



Sources: Australian Bureau of Statistics; Commonwealth Treasury; Department of Treasury and Finance

The Government's Jobs Plan, announced as part of the *2020-21 Budget*, included a target to create 400 000 new jobs by 2025. The strength of Victoria's economy means that this Jobs Target has been met more than two years early. Employment growth has been built on strong economic fundamentals and aided by a recovery in population growth as migration flows increased following the pandemic. Employment has grown by almost 440 000 since its trough in 2020, to almost 3.6 million employed workers, and is forecast to continue to grow strongly in 2022-23 before easing in 2023-24.

The unemployment rate is below 4 per cent as it has been for most of the past year – which hasn't happened for nearly 50 years. The unemployment rate is forecast to increase somewhat in 2023-24 as higher interest rates and inflation weigh on economic growth. Nevertheless, over the forward estimates the unemployment rate is expected to remain historically low.

Employment growth has been broad-based, with all groups of Victorian workers benefitting from the strong economy. The share of working-age women in employment is near a record high and youth unemployment, at 8.3 per cent in the year to April 2023, is the lowest on record. Victorians living in regional cities and rural communities have been among those who have benefitted, with the regional unemployment rate very low at 3.7 per cent. The strength of the labour market has also meant that many Victorians who would like to work more hours are getting the opportunity to do so. The underemployment rate, which captures those who have a job but would like to work more hours, is around the lowest it has been in 20 years.

Inflation has risen over the past year and the Reserve Bank of Australia has sharply increased interest rates in response. These developments are adversely impacting many Victorians, with those on low incomes in particular facing rising cost-of-living pressures. By delivering a strong economy and jobs growth, the Government has ensured that Victorian households and businesses are as well placed as possible to meet this challenging environment.

STRONG FINANCIAL MANAGEMENT

Prior to the COVID-19 pandemic, the Government demonstrated its strong financial management by adhering to a robust fiscal framework, including consistent operating surpluses and maintaining debt at a sustainable level, while delivering improved services and infrastructure to meet the needs of a growing population.

However, over the past three years, the pandemic severely impacted the state's financial position and outlook. The Government prioritised the use of its balance sheet to support the Victorian community, Victorian households and the economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

As first outlined in the *2020-21 Budget*, the Government developed a fiscal strategy to manage the extreme circumstances the state was facing and to provide the foundations for recovery. It involved a four-step plan to support Victorians through the pandemic and to restore the budget position over the medium term. The four-step plan provided a clear framework:

- **Step 1**: creating jobs, reducing unemployment and restoring economic growth
- **Step 2:** returning to an operating cash surplus
- **Step 3:** returning to operating surpluses
- **Step 4**: stabilising debt levels.

Recent economic indicators have shown that this strategy is working, with the economy rebounding strongly. Economic activity is above pre-pandemic levels, and the labour market is even stronger than before the pandemic. Given this improvement, the Government is now implementing strategies to improve the state's financial position and manage the increase in debt in a sustainable manner.

Supporting the Government's four-step fiscal strategy, the *2023-24 Budget* includes a new COVID Debt Levy to offset the cost of measures introduced by the Government in response to the pandemic over the past three years. The Levy is temporary and targeted. It will have two components: the payroll component will levy additional payroll tax on large businesses with national payrolls above $10 million a year; and the landholdings component will decrease the tax-free threshold for general land tax rates, while fixed charges and land tax rates will also be adjusted. The Levy will end on 30 June 2033.

In addition, the Government is continuing to take steps to improve the efficiency and effectiveness of departmental spending and ensure expenditure is consistent with key service delivery priorities.

As a result of these necessary revenue and savings measures, the *2023-24 Budget* forecasts an improvement in the state's key fiscal aggregates by the end of the forward estimates.

Progress towards achieving the Government's fiscal strategy

The first step – creating jobs, reducing unemployment and restoring economic growth – is progressing well, with strong employment outcomes and robust economic growth. The unemployment rate is below 4 per cent and the Government's Jobs Target has been met more than two years early.

The second step in the Government's fiscal strategy, returning to an operating cash surplus, means the State is generating sufficient cash inflows to exceed its cash outflows on operating activities, a key pillar of fiscal sustainability. The Government continues to forecast an operating cash surplus from 2022-23 onwards, an improvement on the cash surpluses when compared with the *2022 Victorian Pre-Election Budget Update* (PEBU).

The third step, returning to an operating surplus, is important as this is where the Government generates sufficient revenues to not just cover its cash expenditure, but also support the ongoing replacement of existing assets. The Government is forecasting an operating surplus of $1.0 billion in 2025-26, an improvement from PEBU. The operating surplus is then forecast to increase to $1.2 billion in 2026-27.

There has also been progress in the fourth step in the strategy, stabilising net debt. The improvements to the Government's operating cash position have flowed through to net debt, which is expected to be $3.7 billion lower by June 2026 compared with PEBU. The Government remains committed to stabilising net debt as a percentage of GSP over the medium term.

Financial position

The net cash flows from operating activities for the general government sector is forecast to be in surplus by $0.8 billion in 2023-24 before increasing to $6.5 billion in 2025-26, an improvement from PEBU. The operating cash surplus is then forecast to remain at $6.5 billion in 2026-27. This demonstrates the Government's commitment to strong financial management despite the challenges over the last three years.

The net result from transactions for the general government sector is forecast to be in deficit by $4.0 billion in 2023-24, before improving to an estimated surplus of $1.0 billion in 2025-26, an improvement of $0.2 billion from PEBU. The operating surplus is then forecast to increase to $1.2 billion in 2026-27.

Total revenue for the general government sector is expected to be $83.0 billion in 2022-23, an upgrade of $1.5 billion from PEBU, before increasing to $89.3 billion in 2023-24. Revenue growth is then expected to average 3.8 per cent a year over the forward estimates, reaching $99.9 billion in 2026-27.

Total general government sector expenditure is expected to be $93.3 billion in 2022-23, a reduction from $96.8 billion in 2021-22. This reduction reflects the targeted and short-term nature of initiatives to fund the public health response and support the economic recovery. Expenditure is then expected to grow by an average of 1.9 per cent a year over the forward estimates, reaching $98.7 billion in 2026-27.

Table 1.1: General government fiscal aggregates

	Unit of measure	*2021-22 actual*	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Net result from transactions	$ billion	(13.8)	(10.3)	(4.0)	(1.1)	1.0	1.2
Net cash flows from operating activities	$ billion	(8.9)	2.9	0.8	4.3	6.5	6.5
Government infrastructure investment (a)(b)	$ billion	18.7	22.5	22.4	20.6	18.6	16.9
Net debt	$ billion	100.0	116.7	135.4	151.2	162.2	171.4
Net debt to GSP (c)	per cent	19.4	20.6	22.6	23.9	24.4	24.5

Notes:

(a) Includes general government net infrastructure investment and the estimated construction costs of public private partnership projects.

(b) Includes the estimated private sector construction-related expenditure associated with the North East Link held in the public non-financial corporations (PNFC) sector.

(c) The ratios to gross state product (GSP) may vary from publications year to year due to revisions to the Australian Bureau of Statistics GSP data.

Government infrastructure investment (GII) is expected to average $19.6 billion a year over the budget and forward estimates, reflecting the continuation of Victoria's Big Build. The Government continues to deliver capital investments aimed at supporting jobs and improving productivity and the quality of public service delivery. The new investment focuses on delivering the Government's election commitments alongside existing projects. Over the forward estimates, GII will begin to return towards pre-COVID levels.

Net debt is expected to be $116.7 billion at June 2023 and $171.4 billion by June 2027. As a proportion of GSP, net debt is projected to be 20.6 per cent at June 2023 and 24.5 per cent by June 2027. This compares with a forecast 24.6 per cent net debt to GSP ratio by June 2026 as outlined in PEBU.

Interest expense as a share of total revenue is expected to average 7.1 per cent a year over the budget and forward estimates. The Government's debt management strategy aims to reduce the State's exposure to interest rate movements by ensuring that a large proportion of existing debt is raised in long-term fixed rate bonds.

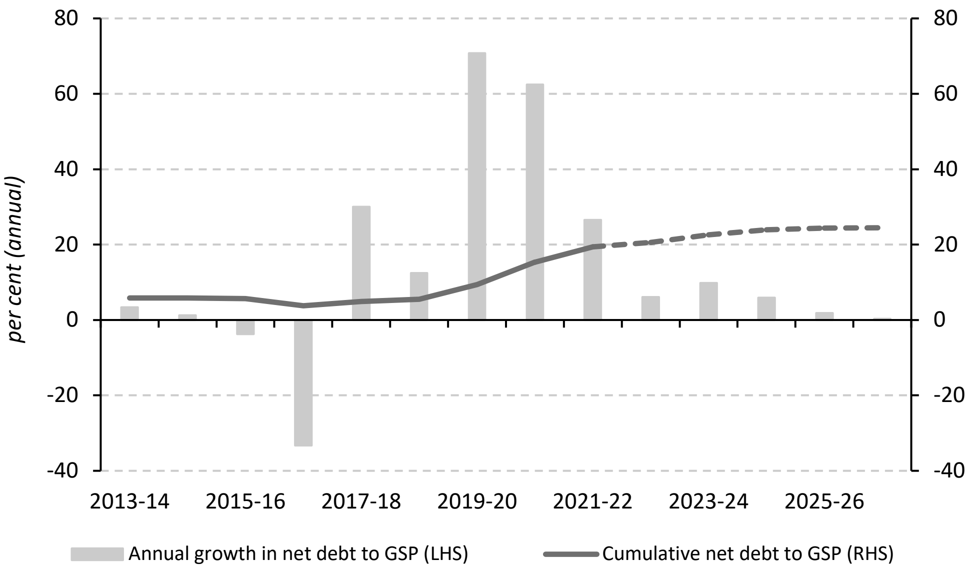
Debt stabilisation strategy

Step 4 of the fiscal strategy is to stabilise the growth in net debt. This step involves progressively improving the operating cash flow surpluses while growing the economy. These surpluses will fund a higher proportion of capital expenditure, reducing the reliance on borrowings.

The net debt to GSP ratio is a measure of the size of the state's debt compared to the size of the economy. By comparing what the state owes with what it produces, the net debt to GSP ratio provides an indication of the state's ability to service its debt.

Chart 1.2 shows that the annual growth rate of net debt to GSP increased across the three years from 2019-20 due to the impact of the pandemic. While both net debt and net debt to GSP are still projected to rise over the forward estimates, the rate of growth slows from 2022-23 and will continue to reduce further over the medium term.

Chart 1.2: Annual net debt to GSP growth [(a)(b)]



Notes:

(a) The decrease in 2016-17 largely reflects the receipt of proceeds from entering into a medium-term lease over the operations of the Port of Melbourne.

(b) The increase in 2019-20 reflects the impact of accounting standards changes. The step change increase in net debt includes the requirement to classify operating leases as debt and the treatment for service concession arrangements, including certain public private partnerships.

Box 1.1: Plan to offset the impact of COVID debt

Governments around the world increased public spending to respond to the impact of COVID-19 and protect lives, livelihoods and national economies. In Victoria, this included using the Government's balance sheet to support the Victorian community, which led to a necessary increase in debt.

Victoria's pandemic emergency response measures generated direct benefits by protecting public health and helping to keep Victorians in work. The outcome resulted in the State being in a better position to reap the benefits through its economic recovery and ensure Victorians were not left behind.

In the *2020-21 Budget*, the Government announced a four-step fiscal strategy to restore the State's finances over the medium term. This included creating jobs, reducing unemployment, and restoring economic growth in the first step, followed by returning to an operating cash surplus and operating statement surplus in Steps 2 and 3, and then by stabilising debt levels in Step 4. The Government is well progressed in implementing these steps, with Steps 2 and 3 maintained in this budget and Step 4 remaining on track to be achieved over the medium-term.

A subset of the State's debt was accumulated by incurring one-off expenditure and offering tax relief to directly respond to the pandemic, which can be designated as 'COVID debt'. The value of this debt is estimated to total $31.5 billion in expenditure incurred by the State for activities primarily delivered between 2019-20 and 2022-23. This COVID debt covered a range of response activities with major expenditures incurred in:

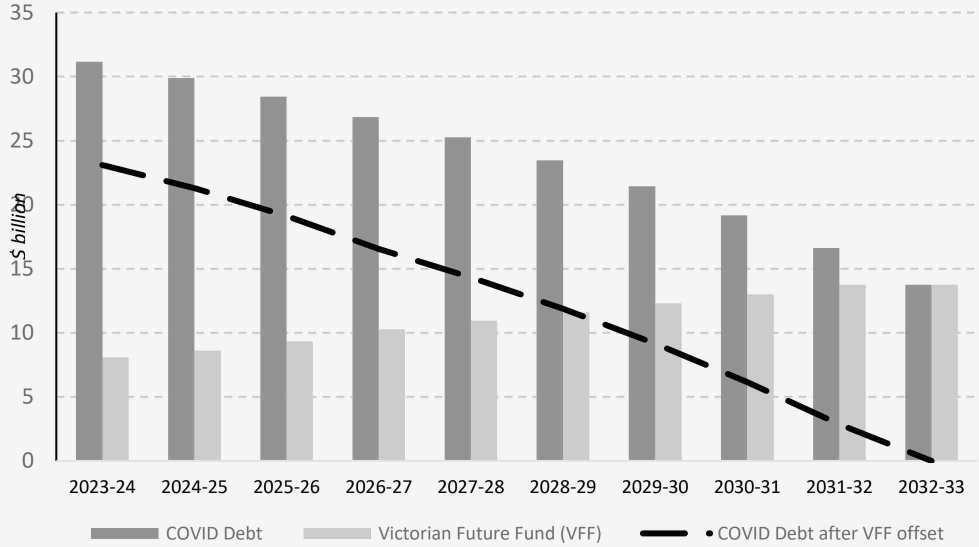
- supporting the health system to restrain and respond to the spread of COVID-19 rapidly and effectively, by delivering $10.7 billion on health-related services and programs
- helping businesses survive and recover, by delivering more than $11 billion in business and economic support.

The Government's strategy of reinforcing the State's health system and protecting the economy created strong foundations to manage the impact of the pandemic and ensured the economy could rebound quickly when restrictions eased. Since then, growth in Victoria's GSP has been strong, unemployment is low and the share of Victorians with a job is around a record high.

With the economy in a strong position, the *2023-24 Budget* announces the implementation of a new COVID Debt Repayment Plan to take the next step in improving the State's financial position.

The COVID Debt Repayment Plan will raise an equivalent amount of funds, including interest on this debt, to offset the impact of the COVID debt over the next 10 years. This will be achieved by introducing new savings and a time-limited and targeted COVID Debt Levy, and by using the growing Victorian Future Fund (VFF) established last year.

Chart 1.3: COVID debt profile over 10 years following the COVID Debt Repayment Plan[(a)]



Note:

(a) COVID debt represents the closing balance including the impact of revenue raising measures, savings initiatives and interest expenditure associated with the debt in that financial year. Revenue and savings initiatives are those announced in Budget Paper No. 3, 2023-24 Budget, Chapter 1. The Victorian Future Fund refers to its balance, after accounting for additional contributions, income, capital gains and interest costs associated with contributions to the Fund. Financial years denote the position as of the end of June of that financial year.

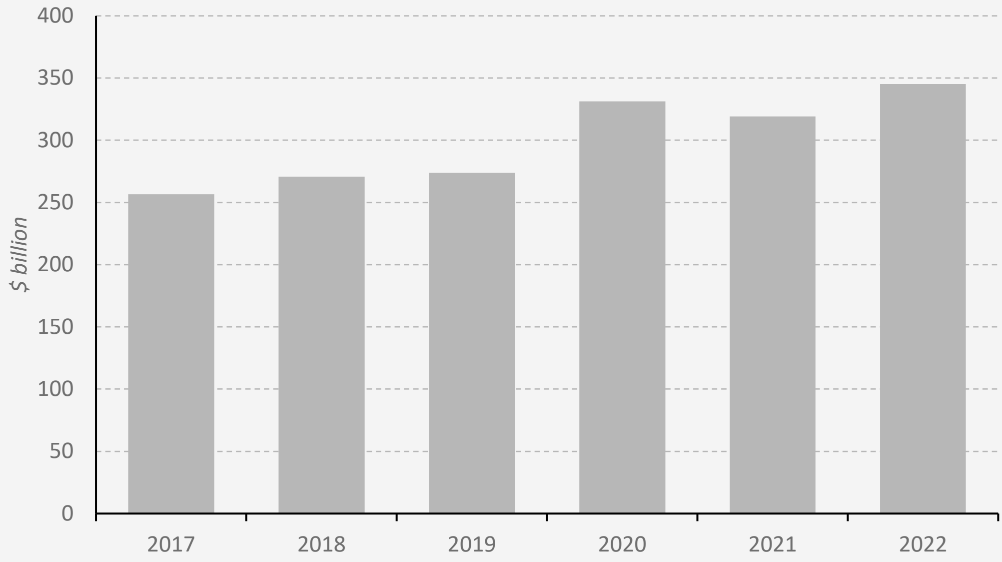
The COVID debt was issued when interest rates were at record lows. The Treasury Corporation of Victoria locked in these low rates by primarily issuing long-term bonds (at varying maturities). It would not make sense to directly repay these bonds now, because they were issued at low rates and because the debt won't mature for many years. Rather, these measures mean that the Government will borrow less than planned at the current, higher interest rates to fund the Big Build. After 10 years net debt is estimated to be where it would have been, from these measures and the VFF, had the COVID debt not been incurred.

The COVID Debt Repayment Plan recognises that the nature of the COVID debt was incurred for essential short-term emergency response measures that involved one-off expenditure being financed through low borrowing rates. By offsetting the impact of the COVID debt, the plan ensures the budgetary impact of such one-off expenditures will be balanced over the longer-term budgetary and economic cycle. Once completed, the plan will mean that the state's balance sheet is returned to investments that generate productive capacity enhancing infrastructure and programs, which produce long-term economic and financial benefits to the state.

The necessary levy and savings measures in this budget are being implemented in a balanced and fair way, targeted at those with the greatest capacity following the pandemic to contribute to offsetting the impact of the COVID debt. For example, the payroll component of the Levy is targeted at larger businesses. Nationally, total business profits over 2020 to 2022, excluding the mining sector, were $995.5 billion, which is 24 per cent higher than in the preceding three years (see Chart 1.4). Business profit margins were also higher than usual across this period.

The Levy will sunset in 2033 once the impact of the COVID debt is scheduled to be fully offset. In addition, expenditure efficiencies will rebalance the size of the Victorian Public Service (VPS) back towards pre-pandemic levels without directly affecting frontline service delivery.

Chart 1.4: Business gross operating profits, excluding mining, Australia



Source: Australian Bureau of Statistics

This plan continues the process of repairing the State's financial position after the impacts of COVID.

Longer-term objectives and targets

The *2023-24 Budget* reflects the Government's long-term financial management objectives as set out in Table 1.2. These have been updated in response to the current economic environment and the Government's focus on jobs to support sound longer-term fiscal management.

Table 1.2: Long-term financial management objectives

Priority	*Objective*
Sound financial management	Victoria's finances will be managed in a responsible manner to provide capacity to fund services and infrastructure and support households and businesses at levels consistent with sound financial management.
Improved services	Public services will improve over time.
Building infrastructure	Public infrastructure will grow steadily over time to meet the needs of a growing population.
Efficient use of public resources	Public sector resources will be invested in services and infrastructure to maximise the economic, social and environmental benefits.
A resilient economy	Increase economic resilience by supporting an innovative and diversified economy that will unlock employment growth, long-term economic growth and productivity in Victoria.

Progress towards these long-term financial management objectives is supported by the measures and targets in Table 1.3. These measures and targets have been updated to better reflect the current economic and fiscal conditions.

Table 1.3: Financial measures and targets

Financial measures	*Target*
Net debt to GSP	General government net debt as a percentage of GSP to stabilise in the medium term.
Interest expense to revenue	General government interest expense as a percentage of revenue to stabilise in the medium term.
Superannuation liabilities	Fully fund the unfunded superannuation liability by 2035.
Operating cash surplus	A net operating cash surplus consistent with maintaining general government net debt at a sustainable level.

SUMMARY OF INITIATIVES

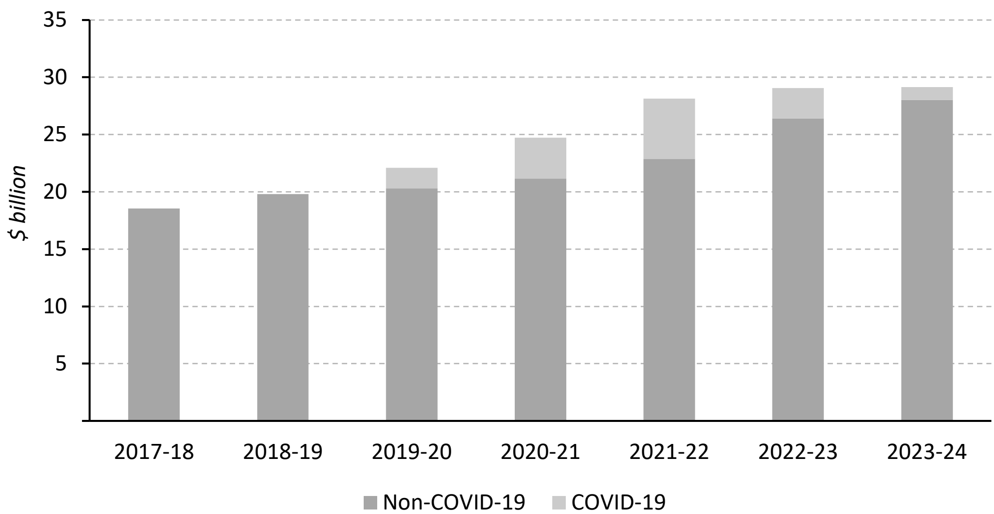
The Government remains focused on meeting the needs of the Victorian community, with this budget building on its demonstrated commitments and record of delivery over the past eight years. Since the *2020-21 Budget*, the Government has responded to the COVID-19 pandemic through a comprehensive health response and *Jobs Plan*, supported health system recovery through the *Pandemic Repair Plan* and responded to other emergencies such as the 2022 floods.

The *2023-24 Budget* continues this record of delivery by providing $15.4 billion in output spending over five years and investing $9.3 billion TEI in new and improved assets, which includes progressing the implementation of the Government's election commitments outlined in *Labor's Financial Statement 2022*. Initiatives in this year's budget support the next stage in rebuilding the health system, prioritise the creation of local jobs by reviving the State Electricity Commission (SEC), build a world-class education system, grow and improve the state's transport networks, and support communities across the state.

Healthcare

Since 2014, the Government has invested more than $54 billion in Victoria's healthcare system, and the *2023-24 Budget* continues to invest in the health system to meet increasing demand and the future health needs of Victorians.

Chart 1.5: 2017-18 to 2023-24 health expenditure(a)(b)



Notes:
(a) This includes expenditure within the Department of Health and its predecessor departments pre-machinery of government changes.
(b) Presentation is based on Classification of the Functions of Government (COFOG) data.

An extra $4.9 billion is provided in this budget to maintain and improve critical health infrastructure, boost healthcare services and support the state's healthcare workforce.

Recognising that hospitals are vital to the healthcare system's ability to meet the needs of patients, this budget invests $320 million in the Hospital Infrastructure Delivery Fund to undertake detailed design and planning for seven new and upgraded hospitals. A further $969 million will treat more than 300 additional patients at any point in time, including at the Royal Children's Hospital, Albury Hospital and Wonthaggi Hospital, ensuring facilities are patient-ready with physical capacity.

The budget includes $201 million to grow Victoria's health workforce, by improving nurse-to-patient ratios in emergency departments and introducing incentives for medical graduates to work as general practitioners, or in the public health system as nurses or midwives. To support emergency care, $201 million in funding will be provided to boost ambulance services, $46 million to train the next generation of paramedics, and $30 million to build a new ambulance station in Armstrong Creek.

This year's budget supports women's health. This includes $65 million for additional laparoscopies, $58 million for 20 new women's health clinics and a dedicated clinic for Aboriginal women, and $50 million to increase access to public fertility care. The budget also invests $86 million to help parents with their newborn babies, including access to Maternal and Child Health services, establishing two new parenting centres and continuing to support the Baby Bundle program.

Improving access to primary care will help more Victorians get the right care at the right time. This budget invests $81 million to expand specialist forensic mental health services for Victorians.

Older Victorians are being cared for in this year's budget. $162 million is invested for better aged care services for regional Victorians, building three new public facilities in regional Victoria to support residents with complex needs. $42 million is also invested to ensure public sector residential aged care services maintain nurse-to-patient ratios, and continues the Residential in Reach program, providing high-quality care to vulnerable older Victorians.

The Government continues to act on the recommendations of the Royal Commission into Victoria's Mental Health System. Building on the Government's previous investment of $5.7 billion over the past three budgets, this budget includes $157 million for critical bed-based services, $77 million to begin work on three new Local Services and kickstart planning on another 20 Local Services, $53 million for Stage 3 of the redevelopment of the Thomas Embling Hospital, and the rollout of the new *Mental Health and Wellbeing Act*.

The Government is prioritising early intervention programs to help steer at-risk populations away from serious health and other crises, reducing future fiscal pressures and significantly improving wellbeing outcomes. Reflecting this, the *2023-24 Budget* includes $421 million for nine health initiatives focused on early intervention that are expected to generate more than $460 million in economic and fiscal benefits over the next decade.

Box 1.2: Early Intervention Investment Framework

The Government implemented the Early Intervention Investment Framework (EIIF) in the *2021-22 Budget* to improve outcomes for Victorians while reducing pressure on acute services – and reinvesting avoided costs back into future EIIF initiatives.

The Government has invested over $1.5 billion through the EIIF over the past three budgets, including $677 million as part of the *2023-24 Budget*, which represents the largest investment to date.

The funding provided under the EIIF as part of the *2023-24 Budget* will provide early assistance to Victorians across the health, education, community services and criminal justice systems. These initiatives will change people's lives for the better and are anticipated to provide around $1 billion in fiscal and economic benefits over the next decade, including avoided costs of state service usage and higher workforce participation, lower welfare payments, and lower out-of-pocket healthcare costs.

There are 22 EIIF initiatives in this budget, which include:

- expanding the forensic community mental health workforce to support adults with serious mental health needs who are in contact, or at risk of coming into contact, with the justice system
- delivering a Housing First response, along with multidisciplinary support, for young people leaving residential care
- addressing the causes of offending, reducing future justice demand
- identifying and supporting early school leavers who are lost or disengaged from the education and training system, through enhancing pathways to complete year 12 and supporting data infrastructure.

See Budget Paper No. 3 Appendix C *Early Intervention Investment Framework* for more information on EIIF initiatives.

Reviving the SEC

The Government is investing an initial $1 billion to re-establish government-owned energy, which will assist Victorians with lower power prices, support jobs in the renewable energy sector, and help Victoria achieve net zero emissions by 2045. An additional $44 million will help prepare the SEC for its new role with a presence in Morwell and Melbourne.

This budget provides $19 million for 10 000 students to undertake work experience placements in the clean energy sector and other priority areas. A further $116 million will be invested to build and operate six new Tech Schools across the state and establish a Clean Energy Equipment Fund. Through the Building Better TAFE Fund, $50 million will also fund a TAFE Clean Energy Fund, supporting new and upgraded facilities to improve workforce skills and capacity in the clean energy sector.

Growing the economy

The Government will reform land transfer duty for commercial and industrial properties, encouraging Victorian businesses to invest, expand and create more jobs. The transition away from stamp duty for commercial and industrial properties will occur after the next sale, with an annual property tax applying after a transition period of 10 years. This reform will not affect current owners of commercial and industrial properties, as the property will only be subject to the new arrangements once it transacts. The estimated cumulative increase in the size of the Victorian economy resulting from this reform is up to $50 billion in net present value terms.

The *2023-24 Budget* will promote economic growth through supporting local industries, with $21 million for a Manufacturing and Industry Sovereignty Fund and support for Victorian businesses to access the Commonwealth's $15 billion National Reconstruction Fund. Victoria's mRNA industry continues to grow, and this budget invests an additional $12 million to assist sovereign mRNA manufacturing in the state.

Victoria's creative and cultural events attract many visitors to the state and boost local economies. This budget will invest $35 million to support live music and community broadcasting, including around 10 000 gigs through grants for musicians and $23 million to expand the Major Events Fund.

Building on the successes of the Free TAFE initiative, this year's budget includes a number of initiatives to invest in training and upskilling Victorian workers. This includes $186 million to expand the eligibility criteria for Free TAFE and other subsidised training courses and $90 million to meet the expected demand for training. In addition, up to $90 million will be provided for TAFEs to continue delivering high-quality teaching and learning outcomes, provide access to training across Victoria, and deliver student support services. $170 million is also provided for five TAFE projects through the Building Better TAFE Fund to ensure Victorians have access to state-of-the-art training facilities.

To support economic growth, business insurance duty will be abolished over a 10-year period, with a business likely to save around $3 200 on professional indemnity insurance or $2 400 on fire and other special risk insurance cumulatively over that time.

Education

The *2023-24 Budget* provides $2.1 billion for upgrading, maintaining and building schools, bringing total investment to more than $14.9 billion over the past nine years.

This budget invests a further $1.7 billion for the Best Start, Best Life and Three-Year-Old Kinder reforms, bringing the total investment to date to $6.2 billion. This includes funding to provide Free Kinder, build up to 100 new kindergartens, deliver 35 new government-owned and operated Early Learning Centres and progressively transitioning four-year-old kindergarten to Pre-Prep. This investment continues the rollout of Three-Year-Old kinder, with new kindergarten facilities and providing Victorian children access to between 5 and 15 hours of play-based learning a week.

The Government is investing $618 million to build nine new local schools, an additional stage at two recently-opened schools, and planning and early works for three more new schools. The budget also provides $235 million to support the educational and social needs of children and young people with disabilities and additional needs and expands on the Outside School Hours Care program for families of children with disability.

The budget seeks to improve learning outcomes by reducing barriers to engagement for students and their families. This includes $169 million to help cover the costs of school camps, excursions and sporting trips, and $105 million to continue programs that deliver school breakfast, affordable school uniforms and glasses for kids. Furthermore, $205 million is invested to support and develop more world-class teachers together with $40 million to develop lesson planning and curriculum material to give more students access to the best teaching and reduce workload for teachers.

Transport

The *2023-24 Budget* continues the Government's commitment to maintaining Victoria's road network by locking in an investment of at least $6.6 billion over 10 years for road asset management, including on flood recovery and road maintenance and renewal works across the state. A further $694 million will deliver upgrades to key roads and intersections – reducing travel times in major growth areas such as Altona Meadows, Wyndham Vale, and Bacchus Marsh. There is further investment to improve safety for drivers, pedestrians, and cyclists.

The Government is also investing more in public transport across Victoria to improve reliability, performance and accessibility. This includes $650 million to upgrade the Melton line and $339 million to prepare the Metro Tunnel for opening, $60 million to enable the deployment of Next Generation Trams on routes 57, 59 and 82 by 2025, and a $36 million investment to deliver Victoria's Bus Plan – including the commencement of the transition to zero-emissions buses in new Metropolitan Bus Service Contracts from 2025.

Box 1.3: Road maintenance and renewal

The *2023-24 Budget* continues the Government's record road maintenance investment with a 10-year and additional $2.8 billion commitment, responding to the October 2022 floods and providing long-term funding certainty, to make the State's roads safer for longer.

All-in-all, this will see at least $6.6 billion invested in road asset management on Victoria's road network over the next 10 years.

Combining output and asset funding in 2023-24, the Government will spend $770 million in road asset management – more than 35 per cent higher than the annual average of the previous decade from 2010-11 to 2019-20 ($567 million).

The scale and quality of this investment is yielding returns in the regions again in 2022-23, with expected performance meeting or exceeding performance measure targets for road quality measures on roughness, cracking and rutting.

The Government is prioritising efforts to rebuild the State's road network following the 2022 floods in the immediate-term. In the long-term, this funding commitment provides a strong foundation, to continue to support a safer and more efficient Victorian road network.

Fair and resilient communities

The *2023-24 Budget* is delivering initiatives to help relieve some of the pressure on Victorian households from the rising cost of living. This includes $400 million for another round of the Power Saving Bonus and $190 million to cap regional public transport fares at the same price as metropolitan fares.

In addition, $141 million is being invested to install air conditioners across more than 40 high-rise public housing towers, as well as $23 million for free period products in public places across the state. $42 million is being invested to recognise Victorian veterans and their families for their service, including funding to introduce the Victorian Veterans Card. The Government is also providing $10 million to offer free vehicle registration for eligible apprentices and tradespeople.

The Government is investing $201 million to deliver new and upgraded community sport and active recreation infrastructure, including continuation of the Local Sports Infrastructure Fund and the Country Football and Netball Program. This budget also invests $13 million to build new and upgrade existing dog parks and $7.4 million to upgrade parks and facilities in locations across Victoria. Funding is also provided to keep entry free for children under 16 years of age at Melbourne Zoo, Healesville Sanctuary, Werribee Open Range Zoo, and Kyabram Fauna Park on weekends, public holidays and during school holidays.

This budget also provides funding to support Victoria's multicultural communities, including $40 million to continue the Multicultural Community Infrastructure Fund, and $17 million to upgrade and revitalise business and cultural hubs in Victoria's multicultural precincts, provide grants to multicultural trader associations, and for scholarships to help train staff to fill jobs in these precincts. $12 million is also provided to help communities celebrate festivals and events, and $6 million to fund anti-vilification campaigns to counter discrimination and prejudice against Victoria's Jewish and Islamic communities.

Since the *2019-20 Budget*, the Government has invested $3.1 billion in the child protection and family services system and is continuing to build on this in the budget with an additional $895 million investment. This includes $548 million to meet demand for residential care placements, provide more access to therapeutic support and continue providing targeted packages to prevent entry into residential care, as well as $140 million to reduce Aboriginal overrepresentation in child protection and family services through culturally appropriate care.

$68 million will deliver a Housing First response – including housing and multidisciplinary support services for those rough sleeping and experiencing homelessness. $33 million will also support young people with complex needs leaving residential care and other settings with three years of multidisciplinary support and access to housing.

Box 1.4: Housing assistance

Following unprecedented investments in recent years that supported access to housing during the pandemic and kick-started Victoria's social housing growth, the Government is continuing to provide a range of supports for Victorians across the housing spectrum from homelessness and social and affordable housing to renting and home ownership.

The historic $168 million From Homelessness to a Home package in 2020 used a Housing First approach to support Victorians experiencing homelessness into secure housing. The *2023-24 Budget* includes $100 million for two early intervention initiatives focused on avoiding homelessness, with early intervention expected to change people's lives for the better and generate more than $180 million in economic and fiscal benefits over the next decade.

Funded in the *2020-21 Budget*, the $5.3 billion Big Housing Build is delivering more than 12 000 social and affordable dwellings, the largest single increase in Victoria's history, to provide much needed housing and stimulate the economy. Beyond the Big Housing Build, an ongoing pipeline of social housing is supported through the $1 billion Social Housing Growth Fund. Finally, the *2022-23 Budget* expanded the low interest loans and government guarantee program to $2.1 billion, with a plan to support another 6 000 new social and affordable dwellings in coming years.

Victoria is leading the nation in the emerging build-to-rent (BTR) sector, where large-scale residential developments are held and managed by a single entity and rented out long-term, providing greater security of tenure. The Government offers eligible BTR developments a 50 per cent reduction on the taxable land value for land tax for up to 30 years and a full exemption from Absentee Owner Surcharge over the same period.

The Government is also supporting Victorians to purchase their own home. In October 2022, the Government invested an additional $1.1 billion in the Victorian Homebuyer Fund (VHF), building on its initial $500 million investment. Almost 3 500 households have now settled into their new home purchased through the VHF.

First home buyers are exempt from paying stamp duty if they buy a property for $600 000 or less, with concessions available for properties valued up to $750 000. In 2022, almost 40 000 stamp duty concessions and exemptions totalling over $700 million were provided to Victorians. The First Home Owner Grant also provides eligible first home buyers $10 000 to help them purchase a newly constructed home. Over 13 000 grants valuing over $150 million were provided in 2022.

The budget continues the Government's commitment towards ending family violence, with a further $117 million to support family violence victim survivors and deliver perpetrator intervention programs. Funding includes Aboriginal-led sexual assault services, men's behaviour change programs, and financial support and case management for victim survivors of family violence.

To support Victoria's emergency services, this budget provides $34 million to upgrade emergency services facilities, including CFA stations, VICSES facilities, Life Saving Victoria facilities and marine rescue resources. It further invests $40 million for Forest Fire Management Victoria firefighters and funding to maintain strategic fuel breaks. $2 million is provided to further support reform of the Emergency Services Telecommunications Authority, and additional investment to deliver a new computer system to support emergency services Triple Zero call-taking and dispatch functions.

Initiatives that continue to strengthen the health, wellbeing, social and economic outcomes of LGBTIQ+ Victorians are also funded in this budget. This includes $9.7 million to expand the Rainbow Tick program, $8 million for a LGBTIQ+ Community Grants Program, and $4.5 million to pilot the Pride in Ageing program.

The budget is also investing around $2.7 billion in initiatives that directly address women's needs and work towards improved outcomes for women. This includes initiatives that support women's health and wellbeing, and strengthen women's workforce participation and representation.

The Government is continuing to deliver on commitments to Victoria's ongoing Treaty process with First Nations' Peoples, as required under the *Advancing the Treaty Process with Aboriginal Victorians Act 2018*. As part of the $475 million in this budget for programs and services that seek better outcomes for and with the Aboriginal community, $138 million is provided to support the State and the First People's Assembly of Victoria to prepare for and enter Treaty negotiations. This budget is the largest whole of government Aboriginal Affairs budget investment since the *2015-16 Budget*.

Over the past nine years, the Government has invested $2.4 billion to protect Victoria's environment. The budget is providing $84 million to keep backing land conservation programs and to support the Environment Protection Authority, $11 million to upgrade visitor facilities and infrastructure in the You Yangs (Wurdi Youang) and Serendip Sanctuary, $10 million to establish a Green Links fund for the revegetation and regeneration of waterways, $9.3 million for not-for-profit and community veterinary clinics, pet shelters, and animal rescue and rehoming organisations and $9.2 million for wildlife protection programs.

Rural and regional Victoria

The *2023-24 Budget* invests more than $5 billion in regional Victoria. This builds on the $36 billion in funding previously announced by the Government since December 2014.

Regional Victorians will benefit from boosts to Victoria's health and aged care system. This includes $50 million to continue operating local public health units across regional Victoria, and $162 million to build three new public sector residential aged care facilities in Cohuna, Maffra and Numurkah, delivering better aged care service for regional Victorians.

The Government is providing $32 million to retain and attract teachers across regional Victoria, including an allowance for pre-service teachers to undertake placements in regional and remote schools. $11 million will provide scholarships to encourage final year speech pathology and occupational therapy degree students, and students undertaking a Certificate IV in Disability, to work in regional Victoria.

The budget is investing $601 million to build another 23 new Victorian-made VLocity trains, boosting the reliability and capacity of our regional network. In addition, $219 million is provided to deliver additional train services across Victoria, including extra weekend services on major regional train lines.

$32 million for the Go Fishing Victoria program including expansion of the Arcadia and Snobs Creek fish hatcheries, $27 million for recreational boating infrastructure improvements and to develop a new boating facility at Tarago Reservoir, and $3.9 million to halve camping fees at national and state parks to encourage more Victorians to visit regional areas.

This budget will support economic growth in regional centres through a range of initiatives. $7.2 million is provided for the Latrobe Valley Authority's operations, supporting the management of economic transition in the region. Additional initiatives funded through this allocation include continuing the Ladder Step-Up and Inclusive Employment programs to promote economic and community development in Gippsland, and $6 million to support the delivery of planning works and infrastructure in the Bendigo Regional Employment Precinct. The Tiny Towns Fund will also provide $10 million in grants to eligible local organisations and councils in towns with fewer than 5 000 people.

Building on the $1.2 billion funded since 2015-16, the Government is providing $31 million to back producers in the food and beverage industry, through the continuation of grant programs. An additional $17 million is invested for enhanced biosecurity protections.

Recovery continues following the devastating floods of 2022. The Government is investing more than $677 million to meet the emergency response and recovery needs of flood-affected communities. This includes early intervention and psychological services to support the mental health of communities affected by floods and disasters, support to councils for flood recovery programs, continuing the communications program on flood recovery, and covering emergency services response costs. Additionally, there will be repairs to the Victorian State Emergency Services Emergency Hubs at Rochester and Heathcote, replacement of the flood impacted Rochester Police Station and support to councils to undertake secondary impact statements. Funding was also provided for additional flood recovery support programs that are yet to be agreed with the Commonwealth on eligibility for cost sharing.

CHAPTER 2 – ECONOMIC CONTEXT

- Victoria's economy is experiencing strong growth, with gross state product well above pre-pandemic levels.
- Around a record share of working-age Victorians are employed and demand for labour is very strong. The unemployment rate, which is forecast to average 3.75 per cent in 2022-23, is at historically low levels.
- The economic outlook remains positive, although growth over the coming year will be tempered by higher interest rates and high inflation. Real economic growth is forecast to slow to 1.50 per cent in 2023-24, following estimated solid growth of 2.75 per cent in 2022-23. The unemployment rate is forecast to rise moderately but remain low.
- High inflation is a challenge to the Victorian economy, as it is nationally and globally. Initially, the pick-up in inflation was driven by pandemic-related supply chain disruptions and compounded by Russia's invasion of Ukraine, though high price growth is now evident across a broad range of goods and services. The Reserve Bank of Australia, along with many other countries' central banks, has sought to contain this sharp rise in inflation by lifting interest rates sharply. Inflation, which has likely peaked, is forecast to decline gradually over coming years.
- The risks to Victoria's economy include uncertainty around the outlook for household consumption, which is anticipated to be supported by a strong labour market and high aggregate savings but tempered by high inflation and interest rates, as well as geopolitical conditions.

VICTORIAN ECONOMIC CONDITIONS AND OUTLOOK

The Victorian economy is delivering strong economic growth. Gross state product (GSP) is estimated to be more than 8 per cent larger in 2022-23 than it was in 2018-19, before the COVID-19 pandemic. The rebound in activity has led to a very strong labour market. Since September 2020, the Victorian labour market has added almost 440 000 jobs, with three out of four of these being full-time positions. In 2022-23, the unemployment rate is expected to average a historically low 3.75 per cent, with the underemployment rate also around a 20-year low.

However, inflation has risen sharply over the past year, both domestically and globally, which has led to cost-of-living pressures for Victorian households. This inflation was initially driven by pandemic-related supply chain disruptions, due partly to strong consumer demand, and later compounded by Russia's invasion of Ukraine. However, inflation pressures are now evident across a broader range of goods and services. These trends are also apparent across many major developed economies, and have prompted central banks, including the Reserve Bank of Australia (RBA), to raise interest rates sharply to seek to contain inflation.

The RBA began raising interest rates in May 2022, taking official interest rates from 0.10 per cent to 3.85 per cent in 12 months. As a result of high inflation and higher interest rates, economic activity is expected to moderate over the coming year, led by weaker household consumption, with Victoria's GSP growth forecast to moderate to 1.50 per cent in 2023-24, before gradually rising in later years.

Nonetheless, the Victorian economy is forecast to keep growing and creating jobs. Growth in 2023-24 will be supported by a strong labour market and the large pool of savings that many households accumulated during the COVID-19 pandemic. These will continue to underpin consumer spending, although real consumption growth will be tempered by higher living costs. Business investment intentions are elevated, and there is a substantial pipeline of both private and public construction projects that will continue to support economic activity over the coming year. In addition, the ongoing recovery of international migration, including the return of international students, will underpin solid population growth that will support overall spending and activity.

Table 2.1 sets out the economic forecasts for the *2023-24 Budget*. Although risks associated with the COVID-19 pandemic have eased, the economic forecasts remain subject to a high degree of uncertainty. Risks to the outlook are discussed later in this chapter.

Table 2.1: Victorian economic forecasts [(a)]

	2021-22 actual	*2022-23 forecast*	*2023-24 forecast*	*2024-25 forecast*	*2025-26 projection*	*2026-27 projection*
Real gross state product	5.6	2.75	1.50	2.50	2.75	2.75
Employment	3.9	3.50	0.75	1.00	1.75	1.75
Unemployment rate [(b)]	4.3	3.75	4.25	4.50	4.75	4.75
Consumer price index [(c)]	4.0	7.00	4.25	2.75	2.50	2.50
Wage price index [(d)]	2.4	3.50	3.50	3.50	3.25	3.25
Population [(e)]	1.1	1.90	1.90	1.80	1.70	1.70

Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Notes:

(a) Percentage change in year-average terms compared with the previous year, except for the unemployment rate (see note (b)) and population (see note (e)). Forecasts are rounded to the nearest 0.25 percentage points, except for population (see note (e)).
The key assumptions underlying the economic forecasts include interest rates that broadly follow market economists' expectations; an Australian dollar trade-weighted index of 61.6; and oil prices that follow the path suggested by oil futures.

(b) Year average.

(c) Melbourne consumer price index. The Commonwealth's CPI forecasts included in its 2023-24 Budget are 6 per cent over the year to June 2023 and 3.25 per cent over the year to June 2024. Differences in magnitude between the Victorian and Commonwealth forecasts are largely presentational, mainly reflecting that growth rates in year-average terms and in over-the-year terms are not comparable.

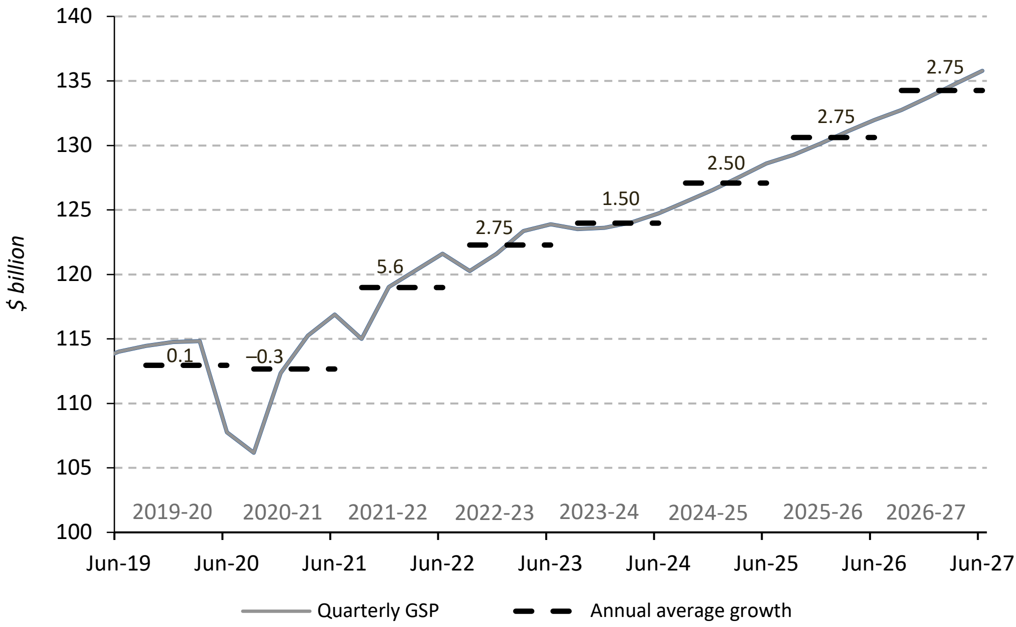
(d) Wage price index, Victoria (based on total hourly rates of pay, excluding bonuses).

(e) Percentage change over the year to 30 June. Forecasts are rounded to the nearest 0.1 percentage point.

Gross state product

Victoria's GSP is forecast to grow by 1.50 per cent in 2023-24. This follows an expected increase of 2.75 per cent in 2022-23 and very strong growth of 5.6 per cent in 2021-22, as the economy recovered from the COVID-19 pandemic (see Chart 2.1).

Chart 2.1: Real Victorian GSP levels and annual growth rates, estimated actuals and forecast [(a)(b)]



Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Notes:

(a) The quarterly GSP estimates are derived by the Department of Treasury and Finance. The Australian Bureau of Statistics only publishes annual GSP estimates.

(b) The figures above annual average lines refer to the annual average growth rate, in per cent.

High-intensity rainfall and flooding in October–November 2022 significantly affected communities in some regions of Victoria, and weighed on overall economic growth in the first half of the year (see Box 2.1).

Box 2.1: The economic impact of flooding in Victoria

Sustained heavy rain over the east coast of Australia from mid-October 2022 caused significant flooding in river systems in northern Victoria, affecting many regional communities. Rainfall from the same weather event also led to flooding of the Maribyrnong River, affecting suburbs in Melbourne's inner west. The impact of these flooding events on local communities has been significant.

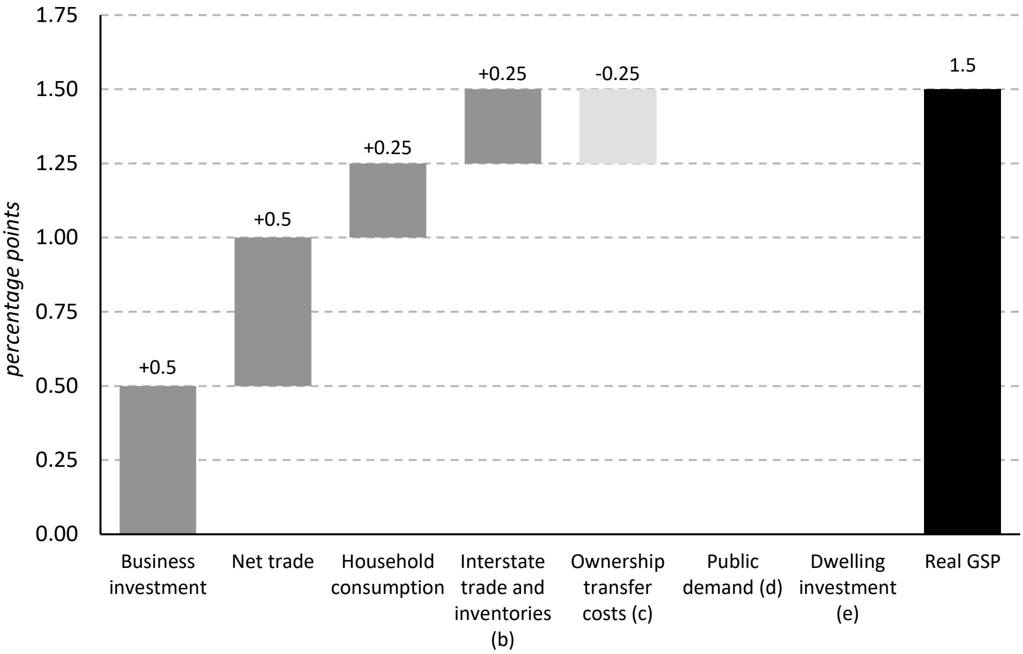
The gross economic cost of these floods in affected regions is estimated at about $900 million in 2022-23, or about 0.2 per cent of GSP, with losses concentrated in Victoria's agriculture industry (noting this estimate does not incorporate the significant social or environmental costs of the floods, including the negative effects on wellbeing and mental health). About 5 per cent of all Victorian farmland was affected by the flooding, mainly curtailing production of fruit, milk and broadacre crops. Businesses in affected regions were also impacted by the loss of trading days and local tourist arrivals. Construction activity was also affected by poor weather.

While floods led to economic losses in some parts of the state, heavy rain benefited some other agricultural regions of Victoria, notably the Mallee and Wimmera. These regions account for more than 60 per cent of the area planted to wheat and barley across the state. Taking into account the agricultural losses relating to floods, and the good growing conditions in some other parts of the state, the Australian Bureau of Agricultural and Resource Economics and Sciences forecasts a record harvest in Victoria's overall winter crop, an increase in output of 21 per cent compared with the previous year.

Over the medium term, recovery and reconstruction of communities and business is likely to contribute to economic activity. This includes increased spending by households and businesses to replace damaged items, the repair and rebuild of damaged homes, and an increase in government spending to repair infrastructure. The recovery and rebuild is being aided by government support, with assistance for flood-affected households, businesses and local governments.

Household consumption is forecast to make a small contribution to GSP growth in 2023-24 (see Chart 2.2), following two years of strong growth as spending recovered from an extended period of pandemic-related disruptions. High inflation, higher interest rates and increased consumer caution are expected to weigh on demand in 2023-24. However, low unemployment, solid wages growth and substantial levels of savings should continue to support consumption.

Chart 2.2: Forecast contributions to real GSP growth, 2023-24 [(a)]



Notes:

(a) Rounded to nearest 0.25 percentage points. Real GSP is per cent growth. Totals may not sum due to rounding. Not shown is the GSP statistical discrepancy, which also contributes to the GSP result.

(b) The balancing item includes interstate trade and inventories, as well as a balancing item statistical discrepancy.

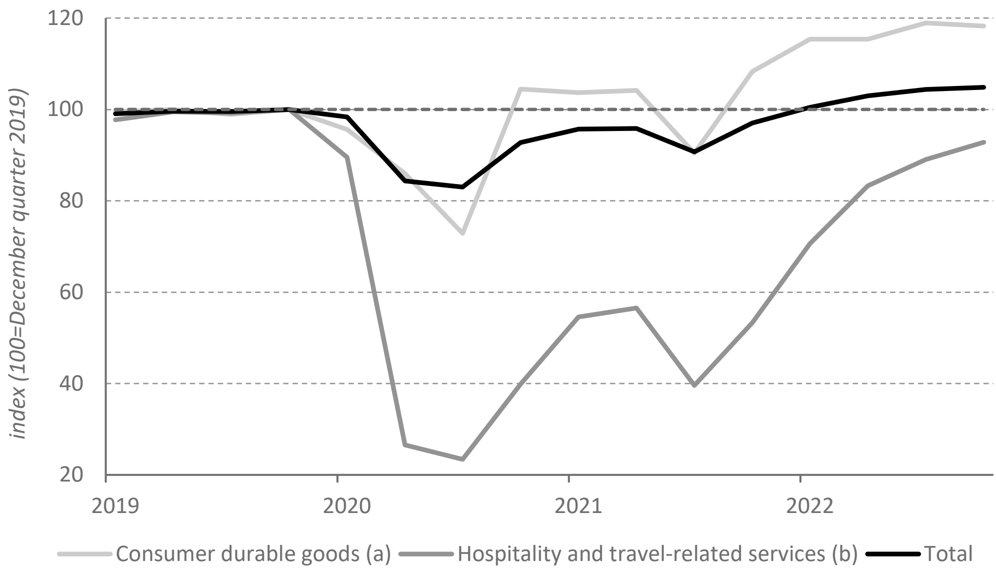
(c) Ownership transfer costs: taxes or services that enterprises incur on acquisition and disposal of assets.

(d) Public demand includes Commonwealth, state and local government spending, and comprises both consumption and capital investment expenditure. In unrounded terms, public demand is forecast to contribute 0.12 percentage points to real GSP growth in 2023-24.

(e) In unrounded terms, dwelling investment is forecast to contribute –0.03 percentage points to real GSP growth in 2023-24.

Consumer spending grew very strongly over 2022, rising by about 8 per cent, although growth moderated in the second half of the year. Following a shift towards spending on durable goods during the COVID-19 pandemic, consumption of discretionary services in 2022 – such as meals out, travel and recreation services – was particularly strong as consumption patterns normalised (see Chart 2.3). More timely indicators of spending suggest this pattern continued into early 2023.

Chart 2.3: Household consumption, total and by selected component



Source: Australian Bureau of Statistics

Notes:

(a) Includes clothing; household goods; and purchase of vehicles.

(b) Includes accommodation, cafes and restaurants; transport services; and net interstate expenditure.

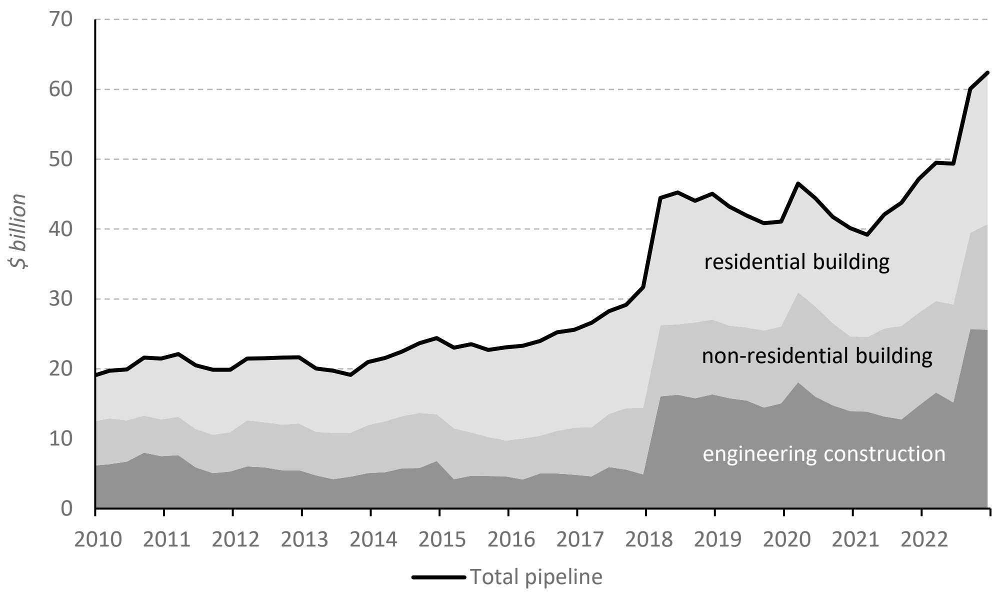
A solid labour market is expected to support household incomes and spending over 2023-24. Elevated levels of household savings accumulated during the pandemic should also support consumption (see Box 2.3). Nevertheless, ongoing high inflation is weighing on consumers' real incomes, and rising interest rates are putting downward pressure on many households' disposable incomes (after meeting interest costs). Recent declines in asset prices may also cause consumers to become more risk-averse and reduce spending on discretionary items.

The outlook for spending is subject to a high degree of uncertainty. Spending has proved resilient to date in the face of cost-of-living pressures. Further, while the rate of household saving has declined from high levels during the pandemic, households in aggregate are still adding to their savings. Aggregate household balance sheets are therefore in a strong position. While there are some households finding current conditions financially challenging, other households may feel comfortable in drawing down on considerable savings to fund ongoing spending. In addition, while surveys point to low consumer confidence overall, consumers remain confident in the labour market outlook. Coupled with continued solid income growth, this could lead households to spend more than expected.

However, the full effect of the cumulative increases in interest rates to date is yet to be felt in mortgage payments. Many consumers are on low fixed rate mortgages which will roll over onto much higher variable rates over 2023, particularly in the June and September quarters. This will have a significant impact on the disposable incomes of some households, and may weigh on aggregate consumer spending more than expected. The RBA notes that most of these borrowers have accumulated savings during their fixed loan term to help deal with the adjustment to higher repayments, although some borrowers could be vulnerable.

Dwelling investment, which reached its second-highest level on record in 2021-22, is forecast to decline modestly in 2023-24, making a very small negative contribution to GSP growth. Higher interest rates and lower prices for existing dwellings have dampened demand for new housing, as is evident in a recent decline in building approvals. This very small decline in construction activity is expected to follow a larger fall in 2022-23, which in part reflects delays in activity in the first half of the year due to materials and labour shortages, and weather-related disruptions. However, there remains a large pipeline of residential construction work to be completed (see Chart 2.4) following a surge in building approvals during 2020-21, which were supported by then record-low interest rates and government incentives. This pipeline will support construction activity, aided by a gradual easing of supply constraints. From 2024-25, dwelling investment is forecast to return to growth.

Chart 2.4: Total Victorian construction pipeline



Source: Australian Bureau of Statistics

Business investment is forecast to grow solidly in 2023-24, building on strong growth in 2022-23. Business conditions remain above average, and businesses' utilisation of their available productive capacity remains near a record high. Reported investment intentions by surveyed firms remain elevated despite declining business confidence. The outlook is also supported by a large pipeline of both non-residential and engineering construction projects (see Chart 2.4). In the near term, higher input costs and ongoing material and labour shortages may continue to constrain construction activity.

Public demand is forecast to make a modest positive contribution to Victoria's GSP growth in 2023-24, after an expected detraction from growth in 2022-23 as temporary pandemic-related spending wound down. A strong pipeline of government infrastructure and social housing projects will continue to underpin high levels of public investment.

Net trade in goods is expected to make a positive contribution to GSP in 2023-24. After a period of elevated goods consumption, the demand for imports of goods is expected to moderate as consumer spending patterns normalise after the COVID-19 pandemic, and as firms wind down inventories built up in recent years to mitigate supply chain risks. Meanwhile, exports of goods are forecast to grow strongly over the year after favourable agricultural conditions and a highly productive winter crop in 2022, notwithstanding the impacts of the October–November floods on some producers (see Box 2.1).

Net trade in services is likely to detract from growth in 2023-24, with strong services imports, notably overseas travel, expected to exceed growth in services exports in the year. Victoria's international services trade began to recover in 2022-23 after the reopening of national borders from late 2021, and the number of international students in Victoria has doubled since that time. Services imports are expected to continue experiencing strong growth as Victorians increasingly resume international travel for work, leisure, and education. Services exports are also expected to grow strongly, led by further demand from international students.

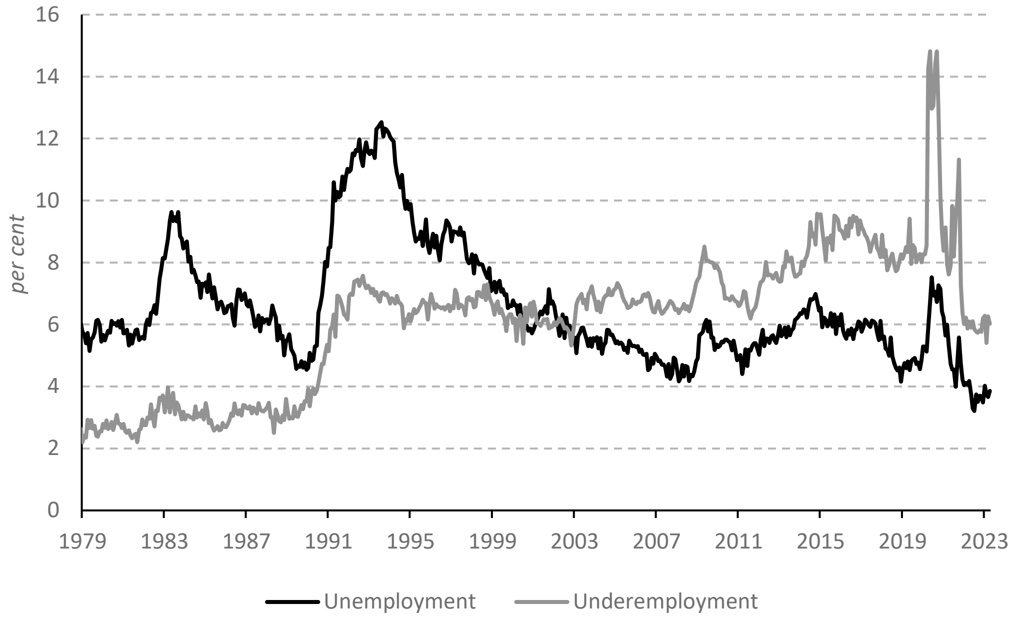
OTHER ECONOMIC INDICATORS

The labour market

Labour market conditions have been strong over the past year. Demand for labour is very strong and the supply of labour has increased following the reopening of national borders. Employment is estimated to grow by 3.50 per cent in 2022-23, following growth of 3.9 per cent in 2021-22. The share of working-age Victorians in employment has risen to around record high levels, and the unemployment rate has fallen below 4 per cent for the first time since 1974. At the same time, there has also been a large decline in the underemployment rate, which is around a 20-year low (see Chart 2.5).

Employment growth has been led by full-time positions, with full-time jobs comprising around 75 per cent of the almost 440 000 jobs created since September 2020.

Chart 2.5: Unemployment and underemployment rates



Source: Australian Bureau of Statistics

Forward indicators of labour demand, such as job advertisements and job vacancies, have eased but remain at very high levels (see Chart 2.6). This is expected to support continued growth in employment in the near term.

Chart 2.6: Job vacancies [(a)]

Source: Australian Bureau of Statistics

Note:

(a) Not seasonally adjusted. The ABS did not collect job vacancy data between May 2008 and November 2009.

With employment already at a high level relative to the size of the workforce, and with economic growth moderating, employment growth is forecast to slow to 0.75 per cent in 2023-24. Although the unemployment rate is forecast to rise, from 3.75 per cent in 2022-23 to 4.25 per cent in 2023-24, this will still be very low by historical standards. Prior to 2021-22, the annual unemployment rate had not been this low for almost 50 years.

Later in the forecast period, employment growth is expected to pick up alongside stronger GSP growth and in line with an increase in the working-age population. The unemployment rate is projected to gradually rise from low levels to a rate consistent with stable inflation within the RBA's target band.

Prices

Inflation has risen significantly over the past year, both domestically and globally. Annual price growth in Melbourne reached 8 per cent in December 2022, its fastest rate of growth since 1990, while easing in March 2023 but remaining high at nearly 7 per cent. High inflation is leading to cost-of-living pressures for all Australians (see Box 2.2). The RBA has lifted interest rates rapidly over the past year to ensure that this surge in inflation is only temporary. Some households appear well-placed to manage these rising living costs – having experienced strong income growth and increasing their savings significantly in recent years – although many low-income households face rising financial challenges (see Box 2.3). Inflation is expected to have peaked and is forecast to decline gradually over coming years as supply disruptions ease and higher interest rates curb aggregate demand.

Inflation was initially driven by global supply chain disruptions, and higher commodity prices due to Russia's invasion of Ukraine. However, high inflation is now being driven by price rises across a broad range of market goods and services. Businesses have been able to pass on higher costs in an environment of strong consumer demand, contributing to this broad-based inflation.

Recent developments in international and domestic energy markets will affect inflation over the coming year. Wholesale gas and electricity prices rose significantly over 2022, partly due to the impact of Russia's invasion of Ukraine on global commodity prices. Disruptions to coal-powered electricity generation in the Australian National Electricity Market, which reflected maintenance issues and fuel supply constraints, also contributed to higher prices. Wholesale electricity prices have since eased, although the higher prices observed over 2022 will be passed on to consumers this year, leading to expected strong growth in retail electricity prices in 2022-23. The Government's Power Saving Bonus is currently easing cost-of-living pressures. Further, the Commonwealth's Energy Price Relief Plan – which includes a temporary cap on wholesale gas prices and targeted bill relief delivered in partnership with states and territories – is expected to moderate retail energy price inflation.

Inflation is expected to moderate gradually over the forecast period as overall business cost growth eases and domestic demand is constrained by higher interest rates. There are signs that price pressures have now begun to ease. Along with the easing in consumer inflation in the March quarter 2023, more timely survey measures of price pressures in Australia have fallen, and global shipping costs have declined from their highs in early 2022.

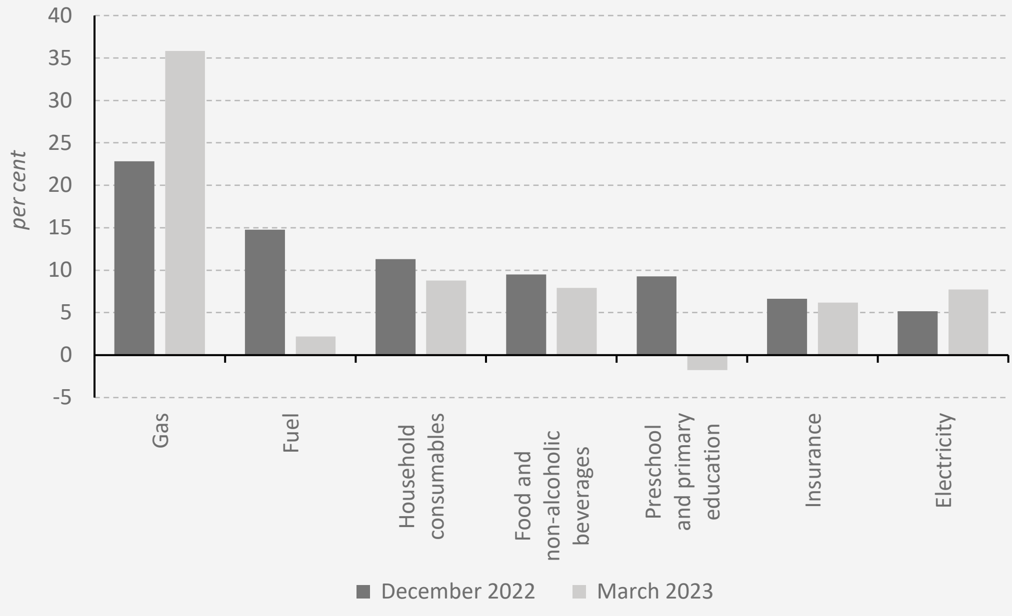
Overall, inflation is forecast to average 7.00 per cent in 2022-23, before easing supply chain disruptions and slower global and domestic economic growth reduce price growth over the forward estimates. Inflation is forecast to decline to 4.25 per cent in 2023-24 and 2.75 per cent in 2024-25, before returning to 2.50 per cent, in the middle of the RBA's target band, in 2025-26.

Box 2.2: Victorian cost-of-living pressures

A sharp rise in consumer prices, and associated increases in interest rates, over the past year or so are affecting Victorian and Australian households. Consumer inflation, as measured by the consumer price index (CPI), rose to a peak of 8 per cent over the year to December 2022. Inflation eased somewhat over the year to March 2023, although it was still high at nearly 7 per cent, and the outlook for national inflation remained sufficiently elevated for the RBA to raise the cash rate further in May.

Overall, prices for non-discretionary consumer items rose at a broadly similar rate to the CPI. But prices for some items rose more quickly: over 2022, food prices rose by 10 per cent, household consumables by 11 per cent, fuel prices by 15 per cent, gas by 23 per cent and electricity prices rose by 5 per cent. Together, these items make up about one-fifth of consumption expenditure for low and middle-income households. Prices for these and several other non-discretionary items continued to rise over the year to March 2023 (see Chart 2.7). Gas prices rose strongly in the March quarter, bringing annual price growth to 36 per cent. Electricity prices are expected to rise strongly later in 2023, as higher wholesale prices in 2022 flow to consumer prices with a lag.

Chart 2.7: Annual price growth of selected non-discretionary consumer items, Melbourne, December 2022 and March 2023



Source: Australian Bureau of Statistics

Housing costs are a major expense for most Victorian households. For the 29 per cent of Victorian households who rent, rental costs account on average for around one-quarter of their total household spending. Low vacancy rates are driving substantial price rises: advertised rents in Melbourne have increased by 25 per cent over the year to March 2023, after declining in 2020 and 2021. However, rents for both new and existing Melbourne rentals, as measured in the CPI, have risen at a lower overall rate, up by 3 per cent over the year to March. In regional Victoria, advertised rents have risen by 37 per cent over the past three years.

For the approximately one-third of Victorian households with a mortgage, interest payments have also risen sharply – in line with the RBA's increases in the cash rate. Nationally, households are now paying more than 4 per cent of gross household income in dwelling interest expenses (see Chart 2.8). The RBA estimates that, as previous increases in the cash rate continue to be passed on to borrowers, total scheduled interest and principal repayments will rise to nearly 10 per cent of aggregate household disposable income by the end of 2024. However, many borrowers have been making additional repayments that bring their total repayments close to this level already, meaning the average Australian mortgagor would not need to increase their total repayments to meet these rising interest rates.

Chart 2.8: Dwelling interest expenses (share of gross household income), Australia

Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Wages

Victorian wages are estimated to grow by 3.50 per cent in 2022-23 and are forecast to grow by a further 3.50 per cent in 2023-24. This is considerably stronger than growth recorded in recent years following the COVID-19 pandemic, and is also stronger than was recorded in the five years leading up to the pandemic. Economic expansion, a tight labour market and high inflation have contributed to higher wages growth. A larger than usual increase to minimum and award wages by the Fair Work Commission also supported wages growth in the second half of 2022.

Wages growth has been uneven across wage-setting processes. Increases have been strong for private sector jobs on individual arrangements, which are most sensitive to labour market conditions, and for those on awards. By contrast, wages in enterprise bargaining agreements, which may last up to four years or more, have grown at a slower rate.

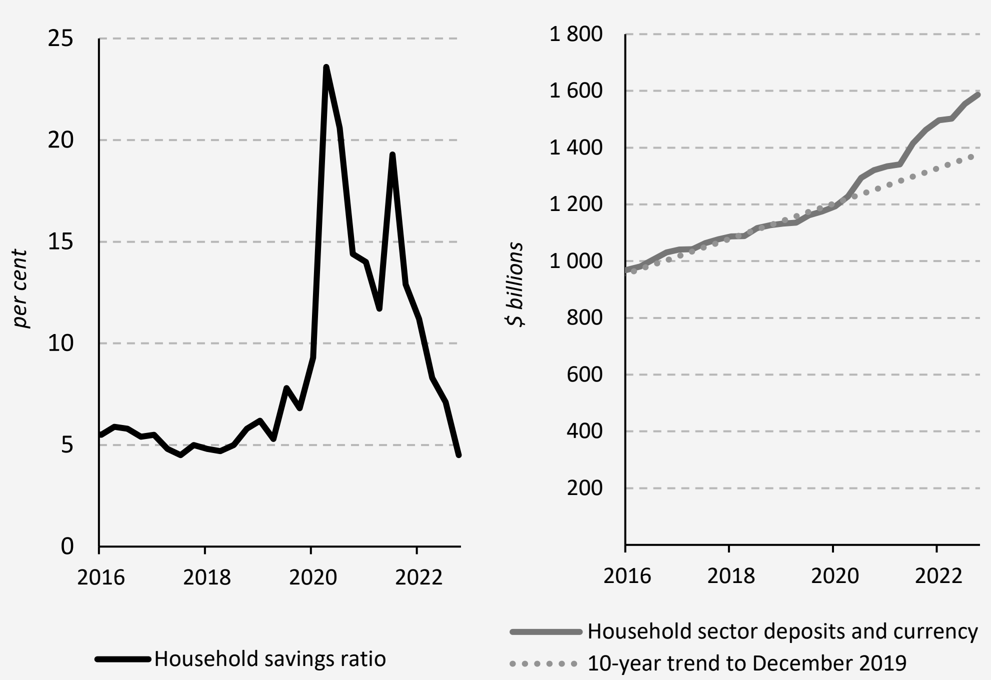
The RBA's business liaison program, and business surveys, also report an increase in private sector wages amid tight labour market conditions. In its May 2023 *Statement on Monetary Policy*, the RBA noted that firms it surveyed reported wages growth had been around 4 per cent in recent months, with wages growth above pre-pandemic rates in all industries. Businesses' expectations for wages growth over the next 12 months have recently moderated, though, with firms citing factors such as softening business conditions, increased internal focus on cost control and improved availability of labour.

Box 2.3: Household savings

Households overall saved around one-fifth to one-quarter of their income during certain periods of 2020 and 2021, and while the share of income that households are saving has fallen from these very high rates, households continue to add to their savings (see Chart 2.9). Household incomes rose in 2020 and 2021, partly due to government support payments. At the same time, spending opportunities were limited. The RBA estimates that about $300 billion of 'excess' savings have been accumulated across Australia since early 2020. Total household deposits (including mortgage offset accounts but not including prepayments available in mortgage redraw facilities) have risen to nearly $1.6 trillion (see Chart 2.9).

Nonetheless, some households are finding cost-of-living pressures particularly challenging. Lower-income workers, particularly those facing rising rental costs, are finding rising consumer prices more difficult to manage than most other households. The RBA recently noted that increased demand for community services has primarily come from renters. Borrowers on lower incomes and with relatively new loans, who have had less time to build savings buffers, will also likely need to adjust their spending more than other households.

Chart 2.9: Household savings ratio and household deposits, Australia [(a)]



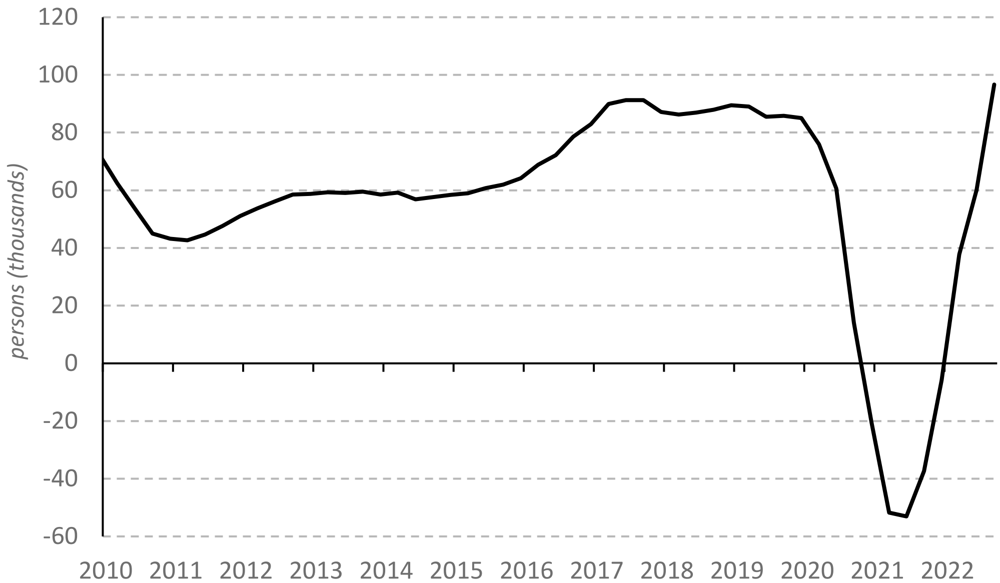
Sources: Australian Bureau of Statistics; Department of Treasury and Finance
Note:
(a) The household savings ratio is the ratio of net savings to net disposable income.

Population

Victoria's population growth was strong in the decade leading up to the COVID-19 pandemic. However, the closure of national borders following the onset of the pandemic had a significant negative impact on population growth, with Victoria's population falling over 2020-21. Following the reopening of Australia's borders, population growth began to recover strongly over 2021-22. Further strong growth is expected in the medium term, with population growth forecast to be above its long-term trend rate from 2022-23 to 2024-25.

Net overseas migration was the largest driver of Victoria's population growth for more than a decade before the pandemic. Australia's border restrictions, which came into effect in March 2020, led to a net outflow of overseas migrants from June 2020 to September 2021 as departures of foreign students and workers outpaced very low levels of migrant arrivals. With national border restrictions easing from November 2021, the inflow of migrants, particularly foreign students, increased strongly and by late 2022 had returned to around its pre-pandemic level (see Chart 2.10).

Chart 2.10: Net overseas migration growth [(a)]



Source: Australian Bureau of Statistics

Note:
(a) Four-quarter rolling sum.

AUSTRALIAN ECONOMIC CONDITIONS AND OUTLOOK

The Australian economy has performed well over the past year, led by strong growth in consumer spending and public demand. The economy grew by 3.7 per cent in calendar year 2022, although the rate of growth slowed in the second half of the year due to the impact of high inflation and rising interest rates.

In its *2023-24 Budget*, the Commonwealth forecast the Australian economy to grow by 1.5 per cent in 2023-24. This follows expected growth of 3.25 per cent in 2022-23. High inflation and rising interest rates are the main drivers of the lower growth outlook for 2023-24, with weaker growth expected in household consumption and dwelling investment. A deterioration in the global economic outlook is another factor behind the weaker growth forecast for 2023-24.

Despite this, the outlook for the labour market remains positive. The Commonwealth forecasts employment to grow by 1 per cent through the year to the June quarter 2024, up from a forecast of 0.75 per cent in its *2022-23 Budget* in October, supported by stronger migration. The unemployment rate is expected to rise modestly over this period, to 4.25 per cent, although this is still comfortably below its pre-pandemic rate of over 5 per cent.

Ongoing strength in the labour market is expected to contribute to a further pick-up in wages growth. The Australian wage price index rose by 3.3 per cent over the year to the December 2022 quarter, and the Commonwealth forecasts it will grow by 4 per cent over the year to the June quarter 2024. This would be the highest rate since 2009.

Inflation, while expected to have peaked, is forecast to remain high over the coming year. Global supply chain disruptions are easing, with fuel and international shipping costs continuing to fall from recent peaks. Domestic capacity constraints are now the main driver of higher prices. The Commonwealth forecasts inflation will be 3.25 per cent by the June quarter 2024, down from an estimated 6 per cent in the June quarter 2023.

INTERNATIONAL ECONOMIC CONDITIONS AND OUTLOOK

The global economy also faces high inflation and sharply rising interest rates. Financial stability concerns, following banking problems in the United States and Switzerland in recent months, present another challenge to growth. In its April 2023 *World Economic Outlook*, the International Monetary Fund (IMF) forecast global economic growth to slow to 2.8 per cent in 2023, following estimated growth of 3.4 per cent in 2022. This is weak by historical standards, with world growth over the two decades to 2019 averaging nearly 4.0 per cent a year. Global headline inflation is expected to have peaked in 2022 at 8.7 per cent, but is forecast to remain high at 7.0 per cent in 2023.

Table 2.2: Summary of IMF's global economic growth forecasts [a][b] (per cent)

	2021 actual	2022 estimate	2023 projection	2024 projection
World output	**6.3**	**3.4**	**2.8**	**3.0**
Advanced economies	**5.4**	**2.7**	**1.3**	**1.4**
United States	5.9	2.1	1.6	1.1
United Kingdom	7.6	4.0	–0.3	1.0
Euro area	5.4	3.5	0.8	1.4
Japan	2.1	1.1	1.3	1.0
New Zealand	6.1	2.4	1.1	0.9
Emerging market and developing economies	**6.9**	**4.0**	**3.9**	**4.2**
China	8.5	3.0	5.2	4.5
India	9.1	6.8	5.9	6.3
ASEAN-5 [b]	**4.0**	**5.5**	**4.5**	**4.6**

Sources: IMF, World Economic Outlook*, April 2023*

Notes:
(a) Not all countries or regions are listed in the table.
(b) The ASEAN-5 economies are Indonesia, Malaysia, Philippines, Singapore, and Thailand.

Across major advanced economies, the IMF expects growth in the United States to be below-trend at 1.6 per cent in 2023 and 1.1 per cent in 2024, as higher interest rates increasingly take effect (see Table 2.2). Growth in the euro area is expected to be a modest 0.8 per cent, due to the impact of rising interest rates and inflation. The United Kingdom is forecast to contract by 0.3 per cent in 2023 as high inflation weighs on household consumption. Japan is expected to grow by 1.3 per cent in 2023, supported by ongoing monetary policy stimulus.

Following China's zero-COVID policy, which contributed to relatively weak growth estimated at 3.0 per cent in 2022, authorities began to relax pandemic restrictions in late 2022. The IMF forecasts China's economic growth will rise to 5.2 per cent in 2023, supported by the reopening of the economy and additional monetary and fiscal stimulus, which is particularly aimed at the real estate and construction sectors.

RISKS TO THE VICTORIAN OUTLOOK

Risks to Victoria's economic outlook are greater than normal. In terms of upside risks, Victoria's tight labour market could lead to a larger than anticipated rise in household consumption, with stronger employment and higher than expected wages growth further boosting household income. Coupled with high levels of household savings, consumer spending could, in aggregate, hold up better than expected over the coming year.

On the downside, inflation is still high and there is uncertainty around how persistent this will be, with implications for the RBA's monetary policy. Although inflation has likely peaked, it is expected to take some time to return to the RBA's target band. Ongoing high inflation could raise expectations of future inflation, which may become self-sustaining as workers and businesses build these higher expectations into wage bargaining and price-setting behaviour. Such a scenario could lead the RBA to raise interest rates further, or leave rates higher for longer, which would weigh on economic activity and employment growth.

The current high level of interest rates could also weigh on consumers more than expected, as the rise in interest rates to date has not yet fully flowed through to mortgage repayments. This is particularly the case for the large number of borrowers who will transition from expiring fixed rate home loans at low interest rates onto much higher interest rates over coming months. While a strong labour market and substantial savings have most of these borrowers well-placed to absorb higher interest payments, an increased number of households may experience financial stress.

Meanwhile, risks to the global outlook also appear tilted to the downside. Inflation in major global economies remains high, and its persistence could result in further monetary tightening from major central banks, which would result in weaker economic activity and labour market outcomes. Additionally, the continuing conflict between Russia and Ukraine, and the potential for further escalation, could further destabilise energy prices and elevate geopolitical tensions. The emergence of banking problems in the United States and Switzerland presents a further risk, particularly if conditions in the global banking system and financial markets deteriorate significantly further, spilling over to weaker global growth. Appendix A *Sensitivity analysis* quantifies the economic and fiscal impact of a downturn in the Victorian and Australian economies, driven by a greater than expected slowdown in consumer spending and weaker investment.

CHAPTER 3 – SUSTAINING ECONOMIC GROWTH

SUSTAINING GROWTH BY BUILDING ON VICTORIA'S STRENGTHS

Victoria's economy approaches the national and global challenges of high inflation and interest rate increases from a position of strength. Growth in real gross state product (GSP) was the highest of the states in 2021-22 and is expected to remain strong in 2022-23. The unemployment rate is below 4 per cent as it has been for most of the past year – which hasn't happened for nearly 50 years. Rates of employment and labour force participation are around record highs. This strong economic performance and outlook is further outlined in Chapter 2 *Economic context.*

This healthy outlook is built on Victoria's solid economic foundations. These include a skilled workforce, world-class economic and social infrastructure, a regulatory system that protects consumers and citizens from harm, and a liveable state that attracts workers and investment. Chapter 2 *Economic context* outlines positive population growth and business investment forecasts that reflect these foundations.

At a time of global economic uncertainty, it is important to strengthen the foundations of economic growth. At a time of cost-of-living pressures, it is important to help grow Victorians' incomes. These are the fundamental, real-world goals that underpin what economists mean when they talk about productivity: better jobs, stronger businesses, higher incomes. These are the Government's goals for the post-pandemic Victorian economy.

In the *2023-24 Budget* the Government is investing in innovation, skills, transport infrastructure, better regulation and land use planning, higher quality and more efficient public services and committing to a more efficient tax system. These actions will help sustain economic growth and support Victorian households and businesses in the face of cost-of-living pressures.

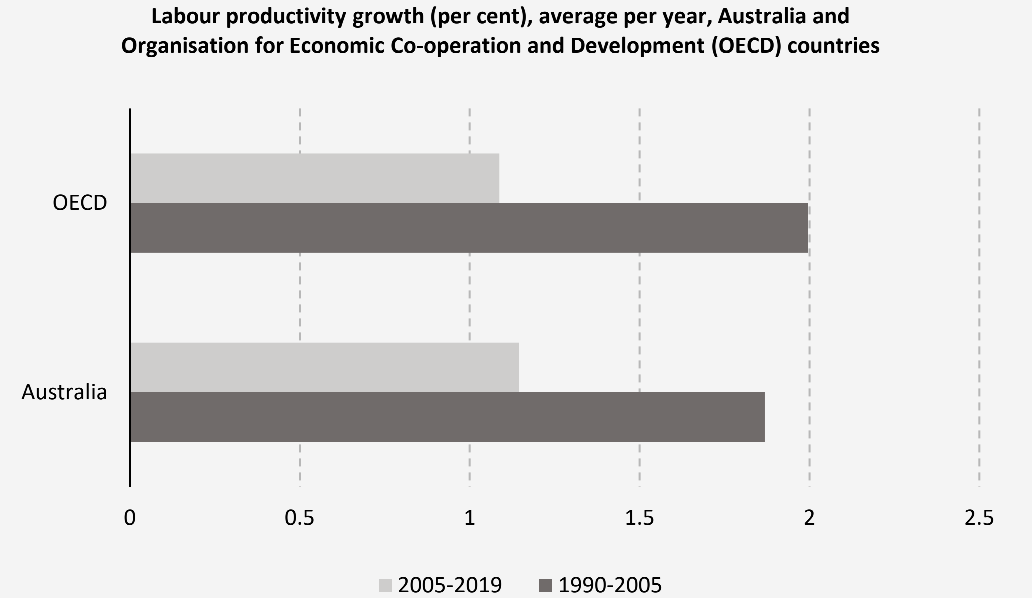
The Government's commitment to boosting growth will be cemented with the establishment of an Economic Growth Commissioner with the goal of developing and advising on opportunities to drive more sustainable economic growth and higher living standards in Victoria.

Chart 3.1 Economic growth agenda

Box 3.1: Economic growth to create higher living standards for Victorians

Growth in wages and economic activity has slowed in high-income countries since 2005 relative to the 1990s and early 2000s. Chart 3.2 shows that, across advanced economies, growth in output per worker fell from around 2.0 per cent per year between 1990 and 2005 to 1.1 per cent per year between 2005 and 2019. Australia's experience has been in line with this global trend, with output per worker falling from 1.9 to 1.1 per cent over this same period.

Chart 3.2: Growth in output per worker



Source: OECD
Note: Includes the average of 24 of 38 OECD member countries' growth rates, due to data availability.

Producing goods and services more efficiently is not just prized by economists as an improvement in productivity. More importantly, getting more output from workers and businesses is the key driver of higher real wages and living standards. A small difference in the annual pace of efficiency improvements can, over time, have a big impact on living standards. For example, if between 2005 and 2019 output per worker had kept growing at the same rate as it did from 1990 to 2005, average real Victorian yearly wages would have been $6 600 higher by 2019.

There are a number of different ways workers' output and therefore living standards can increase.

By using more skills – There are lifelong skills benefits from increasing the early learning years for children, such as through the Best Start, Best Life and Three-Year-Old Kinder initiatives, as it accelerates childhood development and improves equity in educational outcomes. Supporting lifelong learning can also help mid-career workers thrive in a changing economy. For example, the Digital Jobs for Manufacturing program provides businesses with grants for their employees to develop in-demand skills like robotic process automation and data analytics.

By using better equipment – Upgrading to new energy-efficient and more reliable equipment can reduce businesses' carbon emissions and costs as well as increase output per worker. For example, the Victorian Energy Upgrades program provides incentives for businesses to reduce their energy use, with the average business saving $3 700 a year on energy bills. That is money they can invest in new products or equipment, growing their business.

By adopting better ways of working – Technology and process improvements provide new ways for businesses to operate more efficiently. For example, hybrid working for office workers can reduce place-based restrictions on employment, allowing for better employer-employee matches. Hybrid working can also support increased worker output without eating into family or leisure time by reducing or eliminating commuting time.

By producing new, more valuable products or services – Start-ups create new and better products and services, which grow exports and jobs from and in Victoria. LaunchVic provides support to help unlock private investment and grow Victorian start-ups, including through the Alice Anderson Fund, supporting female-led startups, where every dollar is matched by three dollars of private investment.

By moving into jobs or industries that create more valuable products and services – For example, between February 2020 and February 2023 professional, scientific and technical services and financial and insurance services industries grew by 63 000 Victorian workers. Many workers were better off as these industries pay above-average wages.

Governments also support these pathways to higher economic output by providing a health system that supports a healthy workforce, encouraging innovation among businesses and research institutions, providing essential transport and energy infrastructure, and ensuring regulations – that protect and give confidence to consumers – are as streamlined and easy to abide by as possible.

Actions to reduce carbon emissions and reach net zero by 2045 and support adaptation in the built and natural environments will help secure Victoria's long-term prosperity and competitiveness, and safeguard the State from the effects of climate change.

INVESTING IN GROWTH

A more efficient tax system

The Government is getting on with significant tax reform, including gradually abolishing some of the state's most inefficient taxes.

To encourage Victorian businesses to invest, expand, and create more jobs, the Government will undertake a landmark reform: transitioning from stamp duty to an annual property tax for commercial and industrial properties.

Stamp duty adds to the cost of purchasing property. Its application to commercial and industrial properties impedes growth and productivity as it discourages businesses from investing in property to grow their operations and employ more workers. This reform will:

- encourage businesses to expand or set up in the best location, for example close to their customers or where there is a growing workforce
- support businesses to invest in buildings and infrastructure
- promote more efficient use of commercial and industrial land.

The estimated cumulative increase in the size of the Victorian economy resulting from this reform is up to $50 billion in net present value terms.

The transition away from stamp duty for commercial and industrial properties will occur after the next sale, with the annual property tax applying after 10 years. Current commercial or industrial property owners will be exempt – the transition will only apply to those choosing to buy commercial or industrial property in the future. Work is underway to finalise details of the reform with announcements to be made by the end of 2023 and the new system to come into effect from 1 July 2024.

Reforming stamp duty has been recommended by numerous inquiries over recent decades; the Victorian Government is getting on and doing it.

To support business dynamism in the Victorian economy, in a first for any state in Australia, business insurance duty will be abolished over a 10-year period, with a business likely to save around $3 200 on professional indemnity insurance or $2 400 on fire and other special risk insurance cumulatively over that time. Over the first three years alone this will save businesses more than $275 million.

Insurance taxes can distort business decision making and can lead to under or non-insurance, costing the Victorian economy more than $100 million a year. These costs include fewer businesses surviving major setbacks, such as losses associated with the COVID-19 pandemic and natural disasters that have affected Australia in recent years.

To make things easier for small businesses, from 1 July 2024, the payroll tax free threshold will be lifted from $700 000 to $900 000. This will result in 4 200 fewer businesses paying the tax. Another 22 000 businesses will pay a reduced amount – saving up to $9 700 per year each.

The payroll tax-free threshold will be lifted again, to $1 million, from 1 July 2025, meaning a further 1 500 businesses will become exempt. Going forward, the payroll tax free threshold will be phased out for larger business, to ensure this support is well targeted.

These payroll tax changes will reduce compliance costs and distortions, and boost the competitiveness of the state's tax system for thousands of smaller businesses.

Box 3.2: Interstate comparison of state government revenue

The most recent ABS Government Finance Statistics shows Victoria remains one of the lowest revenue raising states when three key revenue sources are considered: taxation revenue, royalty income and grants from the Commonwealth. Accurate comparisons of revenue should consider the revenue impost and the available revenue to each state.

While Victoria raises very little revenue from royalty income (less than $1 for every $200 of taxation), resource-rich states raise nearly equal amounts of royalty income and taxation revenue. Comparisons that exclude royalty income are therefore halving the revenue burden imposed by some jurisdictions.

For more than a century, Commonwealth grants to states and territories have played an important role in equalising the fiscal capacities of each state and territory to deliver services, including by addressing inequities in revenue raising capacity. Any fair comparison of state and territory revenue must take account of this source of revenue and the equalisation it provides.

When comparing state government revenue from these three revenue sources over 10 years from 2012-13, Victoria has remained at either the lowest or second lowest revenue state in each year. Even if the 2021-22 data were adjusted for the indicative per capita impact of revenue decisions taken in this budget, Victoria would still be lower than New South Wales and the second lowest state. Over the last decade, Victoria has raised an average of $410 per person per year less than New South Wales, or around $2.6 billion less per year.

Promoting innovation and developing stronger industries

With the proportion of Victorians in work currently around a record high, a key driver of future economic growth will be producing more valuable goods and services with the existing workforce. Encouraging business growth in future-focused industries, such as advanced manufacturing and renewable energy, will help create high-wage jobs and support sustainable economic growth.

Home to leading Australian universities and research institutions, Victoria has access to the talent, capability and resources to innovate and develop new high-tech products and services for export and domestic markets.

The Government, through the $2 billion Breakthrough Victoria initiative, has identified five future-focused industries to provide additional investment and support, including advanced manufacturing, agri-food, the clean economy, digital technologies, and health and life sciences.

Through the *2023-24 Budget*, the Government is further building on Victoria's strengths in the mRNA and advanced manufacturing sectors, including vaccine manufacturing partnerships with Moderna and with BioNTech (in-principle), to continue to grow Victoria's export potential in these high-value sectors. This budget provides $12 million for mRNA Victoria to continue to support the delivery of major sovereign mRNA manufacturing facilities in the State.

A further $21 million is provided to establish a Manufacturing and Industry Sovereignty Fund and provide support for businesses to access the Commonwealth's $15 billion National Reconstruction Fund, and a $15 million Industry R&D Infrastructure Fund will incentivise private industry investment into research and development.

The continued transition to a net zero emissions economy will provide new opportunities in growing and emerging green industries.

The Government is accelerating investment in renewable energy in partnership with industry by investing an initial $1 billion to bring back the State Electricity Commission, helping Victoria meet its renewable energy targets and lowering Victorians' energy bills. The Government is also providing $16 million to establish two worker training centres for the emerging offshore and onshore wind industry, and the hydrogen industry.

The Government is also providing $7 million to improve the regulatory framework for the minerals and extractives industry, and accelerate decisions for additional earth resources developments.

Keeping Victoria moving

Continued investment in transport connections will help people commute to work and study, shop, and access services that they need. It will also enable goods to move to and from manufacturers, retailers, consumers and export destinations, while reducing pollution and carbon emissions.

This budget builds on the transport network upgrades underway or completed – such as level crossing removals, the North East Link and road upgrades across Melbourne and regional Victoria – to tackle congestion and make it easier, safer and quicker to travel. Ongoing work on Victoria's Big Build, including Metro Tunnel and Suburban Rail Loop, will provide significant new capacity for Melbourne's rail network to connect Victorians across the city.

This budget invests a further $694 million to upgrade key roads and intersections in major growth areas and regions, improving network efficiency and road safety, while reducing travel times.

The Government is providing $36 million to deliver Victoria's Bus Plan, including maintaining and improving bus networks in growing communities to help Victorians get to work, study or recreation.

The Government is also investing to support efficient, less emissions-intensive movement of goods by providing $3.5 million to maintain the Mode Shift Incentive Scheme in 2023-24 to encourage the transfer of freight from road to rail.

The Government is also providing $190 million to cap regional fares at the same price as metropolitan daily fares, including regional myki passes. This will help tackle congestion on roads and further support emissions reduction by encouraging public transport use. The initiative will also promote economic opportunity by reducing the costs for Victorians taking regional public transport to go to work, connecting with family and friends, or accessing vital healthcare.

Growing a skilled Victorian workforce

A skilled workforce is one of Victoria's most important foundations for economic growth. High job vacancy rates and low unemployment reflect the health of Victoria's economy. However, this tight labour market does present a constraint on the pace of economic growth.

The *2023-24 Budget* responds to this challenge with investments that support Victorian workers to increase their skills, take on high-quality jobs and grow their wages. Continuing to invest in lifelong learning will equip today's students with the right skills for tomorrow's jobs, upskill workers in line with technological change, and provide Victorian industry with a steady pipeline of skilled workers.

The Productivity Commission's recent *Advancing Prosperity* report highlighted the importance of lifelong learning for an agile and adaptive workforce. Better educated workers also tend to produce more and are more highly paid – the Productivity Commission found that around one-fifth of the increase in Australia's output per worker in recent decades was due to rising skill levels.

Making it easier for Victorian workers to upskill and reskill helps businesses access the critical workforce they need to grow, and empowers workers to move to higher-paying jobs.

The Government is expanding access to training by providing $186 million to make it easier for returning students to access subsidised training courses including Free TAFE through eligibility criteria amendments.

Complementing this investment in training, the Government is also helping secure Victoria's future trade workforce, by providing more support to apprentices to stay in work and build their skills. This budget's initiatives include $4 million to develop and deliver an apprentice mental health training program for apprentices, and $1.5 million to support the establishment of an Apprenticeships Taskforce with employee, union, and industry representatives. In addition, $10 million is being provided to expand the motor vehicle registration discount for eligible trade apprentices from 50 per cent to 100 per cent.

The Government is also investing in a productive and engaging education system by providing curriculum support to teachers. This will enable teachers to spend less time planning, and focus their efforts on providing high quality teaching to students. In this budget, the Government is providing $40 million to develop lesson planning and curriculum materials to support government school teachers and deliver better outcomes for students.

To support parents of young children to return to the workforce or increase their hours, the Government is providing Free Kinder for Victoria's three and four-year-olds, saving families each year, with up to $2 500 in 2023.

In addition, upgraded migration forecasts outlined in Chapter 2 *Economic Context* reflect Victoria's healthy economy and excellent liveability. High-skilled migrants will support economic growth and share knowledge with local workers. The in-demand skills of high-skilled migrants also help boost average Victorian wages by skewing Victoria's employment composition in favour of higher-paying jobs and industries.

Better regulation and planning to make it easier to do business in Victoria

Regulation reform makes doing business easier – with clearer rules, easier approvals and lower costs. It also gives consumers confidence to buy products and services knowing they will be safe, and their rights protected.

Streamlined regulation allows businesses to focus more of their time and resources actually producing goods and services, as well as investing in research and development. Streamlined regulation also makes it easier for new businesses to enter an industry, increasing competition and providing better products – and better value – to customers.

In this budget, the Government is continuing to make it easier to do business by providing $38 million for a whole of government work program across regulators and councils to reform regulations for the benefit of Victorian businesses and customers.

These actions build on the success of existing initiatives such as the Business Acceleration Fund and the Regulation Reform Incentive Fund, which will deliver over $300 million in savings each and every year, including time savings of more than 280 000 days each year, from a $50 million investment. Just as one example, a project to digitise parts of the assessment and rating process for early childhood services is saving more than 13 000 days of staff time across the sector each year.

Good land use planning enables businesses to locate near workers and customers, reducing commuting times and supporting industry growth. It also enables Victorian families to live near good jobs, high-quality services, and build community connections.

The Government is supporting enhancements to the planning system to meet demand for commercial and residential land, by providing $23 million to support planning legislative reform, including continuation of the Development Facilitation Program to accelerate assessments of development projects. $9 million is also provided to implement Plan Melbourne, which will support housing growth around existing infrastructure, as well as a further $3.5 million to continue delivering Precinct Structure Plans to unlock housing supply across Victoria.

Higher quality and more efficient public services

Public services such as health and education enable Victorians to live healthy, rewarding, safe lives and contribute to the economy. They also represent over 20 per cent of Victoria's economic activity. Making these services more effective and efficient makes a huge contribution to a stronger economy and is an example of government leading from the front by improving its own services. For example, the 100 000 Lives program funded in the *2021-22 Budget* has provided people living with heart disease with better evidence-based care after they leave hospital, as well as more support to self-manage their condition. This is reducing preventable hospital readmissions for people living with heart diseases, and enabling them to spend more time at home.

This budget invests $677 million in 22 early intervention initiatives to provide earlier assistance to Victorians before their needs escalate, building on more than $800 million previously funded through the Early Intervention Investment Framework (EIIF). These EIIF initiatives will lead to better health and social outcomes for vulnerable Victorians and their communities. They will also ease demand for government services such as hospitals, homelessness services and prisons and are anticipated to generate economic and fiscal benefits of around $1 billion over the next decade.

This budget's EIIF initiatives include:

- $91 million to establish three new Mental Health and Wellbeing Locals, plan for 20 additional services, and to continue delivery of other mental health and wellbeing supports. These new services will be accessible and locally based and will provide integrated mental health treatment and wellbeing supports delivered by a multidisciplinary team
- $42 million to continue to provide high-quality care to vulnerable older people, while also maintaining an uplift to the Residential in Reach program. This helps reduce avoidable emergency department presentations and demand on ambulance services
- $33 million to deliver a Housing First approach for around 225 young people with complex needs exiting residential care and other settings. Young people will be supported towards independence through three years of multidisciplinary support and access to housing
- $20 million to enhance data infrastructure to identify and support early school leavers lost or disengaged from the education and training system, and to improve pathways for young people to complete school.

To respond to growing demand for ambulance services across Victoria, the Government is investing $201 million to improve the efficiency of the emergency services system by improving Ambulance Victoria's operations and ambulance response times. One element is the Victorian Virtual Emergency Department, which frees up ambulances by enabling non-urgent patients to be virtually assessed by emergency doctors and nurses in their own home.

CHAPTER 4 – BUDGET POSITION AND OUTLOOK

- The *2023-24 Budget* outlines the improvement in the Government's fiscal position by the end of the forward estimates compared with the *2022 Victorian Pre-Election Budget Update* (PEBU), as the Victorian economy consolidates its recovery from the pandemic.
- This is a significant achievement considering the challenges all Victorians have faced over the past three years and delivers on the Government's clear fiscal strategy first set out in the *2020-21 Budget*.
- The net cash flows from operating activities for the general government sector is forecast to be in surplus by $0.8 billion in 2023-24, increasing to $6.5 billion in 2026-27, demonstrating the Government's commitment to strong financial management.
- The net result from transactions for the general government sector is forecast to be in deficit by $4.0 billion in 2023-24, before improving to an estimated surplus of $1.0 billion in 2025-26. The operating surplus is then forecast to increase to $1.2 billion in 2026-27.
- Net debt is projected to be $162.2 billion by June 2026, an improvement of $3.7 billion compared with the forecast in PEBU, and is projected to be $171.4 billion by June 2027.
- Government infrastructure investment (GII) is expected to average $19.6 billion a year over the budget and forward estimates, reflecting new infrastructure investment and the continuation of Victoria's Big Build.
- The Victorian Future Fund has been established by the Government to support the state's debt stabilisation strategy.
- A COVID Debt Repayment Plan, including a COVID Debt Levy, has been established to offset the impact of COVID debt over 10 years.
- Interest expense as a share of total revenue is expected to average 7.1 per cent a year over the budget and forward estimates.
- The Government is on track to fully fund the state's unfunded superannuation liability by 2035.

This chapter outlines the budget position of the general government sector. The Budget takes into account the financial impacts as at 8 May 2023 of all policy decisions made by the Government, as well as other information that may have a material impact on the financial statements, unless otherwise stated, along with the recognition of material financial updates for funding agreements able to be assessed for inclusion from the *2023-24 Commonwealth Budget* released on 9 May 2023. This chapter also reconciles and explains any movements since PEBU that affect the estimated net result from transactions.

GENERAL GOVERNMENT SECTOR

Overview

Over the past three years, the COVID-19 pandemic severely impacted the state's financial position and outlook. The Government prioritised the use of its balance sheet to support the Victorian community, Victorian households and the economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

As first outlined in the *2020-21 Budget*, the Government developed a fiscal strategy to manage the extreme circumstances the state was facing and provide the foundations for recovery. It involved a four-step plan to support Victorians through the pandemic and to restore the budget over the medium term. The four-step plan provided a clear framework:

- **Step 1:** creating jobs, reducing unemployment and restoring economic growth
- **Step 2:** returning to an operating cash surplus
- **Step 3:** returning to operating surpluses
- **Step 4:** stabilising debt levels.

Recent economic indicators have showed this strategy is working, with the economy rebounding strongly. Economic activity is above pre-pandemic levels, and the labour market is even stronger than before the pandemic.

This budget provides $15.4 billion over five years in new output spending and invests $9.3 billion TEI in new and improved assets, which includes implementation of the Government's election commitments outlined in *Labor's Financial Statement 2022* (LFS).

This year's budget also includes prudent financial management measures to improve the state's financial position following necessary borrowings undertaken to directly respond to the pandemic. Supporting the Government's four-step fiscal strategy, a new temporary and targeted COVID Debt Levy will be introduced with two components: the payroll component will levy additional payroll tax on large businesses with national payrolls above $10 million a year; and the landholdings component will decrease the tax-free threshold for general land tax rates, while fixed charges and land tax rates will also be adjusted. The Levy will end on 30 June 2033.

In addition, the Government is continuing to take steps to improve the efficiency and effectiveness of departmental spending and ensure expenditure is consistent with key service delivery priorities.

As a result, the *2023-24 Budget* is forecasting an improvement in the state's key fiscal aggregates by the end of the forward estimates when compared with PEBU, released in November 2022.

The net cash flows from operating activities for the general government sector is forecast to be in surplus by $0.8 billion in 2023-24 before increasing to $6.5 billion in 2025-26, an improvement from PEBU. The operating cash surplus is then forecast to remain at $6.5 billion in 2026-27.

The net result from transactions for the general government sector is forecast to be in deficit by $4.0 billion in 2023-24, before improving to an estimated surplus of $1.0 billion in 2025-26. The operating surplus is then forecast to increase to $1.2 billion in 2026-27.

Table 4.1: General government fiscal aggregates

	Unit of measure	*2021-22 actual*	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Net result from transactions	$ billion	(13.8)	(10.3)	(4.0)	(1.1)	1.0	1.2
Net cash flows from operating activities	$ billion	(8.9)	2.9	0.8	4.3	6.5	6.5
Government infrastructure investment (a)(b)	$ billion	18.7	22.5	22.4	20.6	18.6	16.9
Net debt	$ billion	100.0	116.7	135.4	151.2	162.2	171.4
Net debt to GSP (c)	per cent	19.4	20.6	22.6	23.9	24.4	24.5

Notes:
(a) Includes general government net infrastructure investment and the estimated construction costs of public private partnership projects.
(b) Includes the estimated private sector construction-related expenditure associated with the North East Link held in the public non-financial corporations (PNFC) sector.
(c) The ratios to gross state product (GSP) may vary from publications year to year due to revisions to the Australian Bureau of Statistics GSP data.

Total revenue for the general government sector is expected to be $83.0 billion in 2022-23, an upgrade of $1.5 billion from PEBU, before increasing to $89.3 billion in 2023-24. Revenue growth is then expected to average 3.8 per cent a year over the forward estimates, reaching $99.9 billion in 2026-27.

Total general government sector expenditure is expected to be $93.3 billion in 2023-24 and grow by an average of 1.9 per cent a year over the forward estimates, reaching $98.7 billion in 2026-27. Total expected expenditure includes the impact of all relevant Government decisions, including those relating to service delivery and savings.

Government infrastructure investment (GII) is expected to average $19.6 billion a year over the budget and forward estimates, reflecting new infrastructure investment and the continuation of Victoria's Big Build.

Net debt is expected to be $116.7 billion at June 2023 and $171.4 billion by June 2027. As a proportion of GSP, net debt is projected to be 20.6 per cent at June 2023 and 24.5 per cent by June 2027.

Interest expense as a share of total revenue is expected to average 7.1 per cent a year over the budget and forward estimates.

BUDGET AND FORWARD ESTIMATES OUTLOOK

Table 4.2 summarises the operating statement for the general government sector. A comprehensive operating statement is presented in Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector*.

Table 4.2: Summary operating statement for the general government sector [(a)] ($ million)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Revenue and income from transactions						
Taxation	30 546	31 501	34 877	36 683	38 490	40 366
Dividends, TER and interest [(b)]	1 442	2 117	2 904	2 130	2 313	2 371
Sales of goods and services	5 645	6 068	6 111	6 441	6 419	6 497
Grants	41 805	39 804	41 751	43 227	45 888	46 765
Other revenue and income	3 586	3 462	3 617	3 304	3 382	3 902
Total revenue and income from transactions	**83 023**	**82 952**	**89 260**	**91 785**	**96 491**	**99 901**
% change		*(0.1)*	*7.6*	*2.8*	*5.1*	*3.5*
Expenses from transactions						
Employee expenses	32 239	33 850	35 280	35 929	36 984	38 272
Superannuation [(c)]	4 392	4 178	4 489	4 591	4 663	4 851
Depreciation	4 308	4 813	4 890	5 032	5 342	5 551
Interest expense	2 869	4 071	5 566	6 273	7 150	7 981
Grant expense	25 063	18 992	16 962	16 209	16 324	16 314
Other operating expenses	27 943	27 373	26 091	24 812	24 989	25 728
Total expenses from transactions	**96 814**	**93 278**	**93 277**	**92 846**	**95 452**	**98 697**
% change		*(3.7)*	*(0.0)*	*(0.5)*	*2.8*	*3.4*
Net result from transactions – net operating balance	**(13 791)**	**(10 326)**	**(4 017)**	**(1 060)**	**1 039**	**1 204**
Total other economic flows included in net result [(d)]	**290**	**(214)**	**(369)**	**(306)**	**(181)**	**(197)**
Net result	**(13 501)**	**(10 541)**	**(4 387)**	**(1 366)**	**858**	**1 007**

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Comprises dividends, income tax and rate equivalent revenue and interest.

(c) Comprises superannuation interest expense and other superannuation expenses.

(d) This typically includes gains and losses from the disposal of non-financial assets, adjustments for bad and doubtful debts and revaluations of financial assets and liabilities.

Revenue outlook

Total revenue for the general government sector is forecast to reach $83.0 billion in 2022-23 before increasing by 7.6 per cent to $89.3 billion in 2023-24. This higher growth in 2023-24 includes the introduction of the new COVID Debt Levy. Total revenue is then expected to grow by an average of 3.8 per cent per year over the forward estimates, reaching $99.9 billion in 2026-27.

Taxation

Taxation revenue is forecast to be $34.9 billion in 2023-24 and grow by an average of 5.0 per cent per year over the forward estimates. Growth in taxation revenue is primarily driven by growth in the state's three largest tax lines – payroll tax, land tax and land transfer duty.

- Revenue from payroll tax is expected to be $8.0 billion in 2023-24, then increase by an average of 4.6 per cent per year over the forward estimates. Victoria's payroll tax revenue forecast has been revised up compared with PEBU, largely driven by a stronger outlook for the Victorian labour market, with the share of working-age Victorians in employment rising to around record high levels. The conclusion of the New Jobs Tax Credits initiative in 2023-24 contributes to a subsequent increase in payroll tax revenue.
- Revenue from land tax is expected to be $6.1 billion in 2023-24 and grow by an average of 3.7 per cent per year over the forward estimates. This reflects an expected moderation in the growth of land values, consistent with the dampening effects of monetary policy decisions on dwelling prices in 2022.
- Revenue from land transfer duty is forecast to be $7.4 billion in 2023-24, following a decline of 20.7 per cent in 2022-23. The decline in revenue is driven by falling settlement volumes which are impacted by higher borrowing costs and subdued sentiment. Victorian dwelling prices are expected to decline over 2023 before resuming growth in 2024, with land transfer duty revenue forecast to increase by an average of 8.4 per cent per year over the forward estimates.
- Revenue from the COVID Debt Levy is estimated to be $2.0 billion in 2023-24 and grow by an average of 4.9 per cent per year over the forward estimates to $2.3 billion in 2026-27. The Levy has two components:
  - from 1 July 2023, businesses with national payrolls above $10 million a year will pay additional payroll tax
  - from 1 January 2024, the tax-free threshold for general land tax rates will decrease, while fixed charges and land tax rates will also be adjusted.

  The COVID Debt Levy will end on 30 June 2033. Budget Paper No. 3, Chapter 1 *Output, asset investment, savings and revenue initiatives* contains further details on the components of the Levy.
- Revenue from the Mental Health and Wellbeing Levy is estimated to be $912 million in 2023-24 and is expected to grow by an average of 5.5 per cent per year over the forward estimates, broadly in line with expected growth in the payroll tax base.

- Revenue from gambling taxes is forecast to be $2.6 billion in 2023-24 and grow by an average of 4.8 per cent per year over the forward estimates.
- Revenue from motor vehicle taxes is expected to be $3.4 billion in 2023-24, reflecting indexation of registration fees and growth in new car prices. Revenue from motor vehicle taxes is forecast to increase by 5.2 per cent per year over the forward estimates.
- Revenue from insurance taxes is expected to be $2.0 billion in 2023-24, largely driven by growth in insurance premiums. Insurance tax is expected to grow by an average of 2.9 per cent per year over the forward estimates.

Dividends, income tax equivalent and interest

Dividends and income tax equivalent revenue is projected to be $1.3 billion in 2023-24 and reduce to $1.2 billion by 2026-27.

Note 1.2.2 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector* contains further details of dividends and income tax equivalent revenue by sector.

Interest revenue is received on the cash and deposits held by the Government. Total interest is expected to increase to $1.6 billion in 2023-24 due to the higher surplus estimated to be maintained in the Centralised Banking System (CBS) before the Victorian Future Fund is invested through the Victorian Funds Management Corporation (VFMC) during that year. Interest revenue is then forecast to moderate to $1.1 billion by 2026-27.

Sales of goods and services

Revenue generated by the sales of goods and services is expected to increase to $6.1 billion in 2023-24 and grow by an average of 2.1 per cent a year over the forward estimates, reaching $6.5 billion in 2026-27.

Grants

Total grant revenue is expected to be $41.8 billion in 2023-24 and increase by an average of 3.9 per cent a year over the forward estimates, reaching $46.8 billion in 2026-27.

Victoria's GST revenue is expected to be $19.8 billion in 2023-24, and then grow by an average of 5.6 per cent per year over the forward estimates. Victoria's GST revenue forecast is driven by an improved outlook for the national GST pool corresponding with strength in national GST collections over the first half of 2022-23. Victoria's national population share is also forecast to increase in 2023-24 after muted growth in 2022-23, largely driven by an increase in net overseas migration.

Victoria's no-worse-off relativity remained steady in 2023-24, with strong mining revenues in mining states offsetting Victoria's lower cost for delivering services. Ongoing strength in commodity prices and expected population share growth continue to support the no-worse off relativity over the forward estimates.

Other revenue and income

Other revenue and income includes fines, royalties, donations and gifts, assets received free of charge and other miscellaneous revenues. Other revenue and income is expected to be $3.6 billion in 2023-24, followed by an average growth of 2.6 per cent a year over the forward estimates.

Budget Paper No. 5, Chapter 4 *State revenue* contains further details of expected movements in the major categories of general government revenue.

Expenses outlook

Total expenses for the general government sector are forecast to reach $93.3 billion in 2023-24 and increase by an average of 1.9 per cent a year over the forward estimates to $98.7 billion in 2026-27.

Moderation of expenditure growth over the forward estimates supports the Government's fiscal strategy to achieve an operating surplus by 2025-26 and beyond.

- Employee expenses (including superannuation) are forecast to be $39.8 billion in 2023-24. Average growth over the forward estimates of 2.7 per cent a year is forecast, consistent with the requirements of service delivery and enterprise bargaining agreements.
- Depreciation expense is forecast to grow to $4.9 billion in 2023-24 and by an average of 4.3 per cent a year over the forward estimates to $5.6 billion by 2026-27. Growth in depreciation is broadly in line with continuing high levels of investment in infrastructure.
- Interest expense is forecast to grow to $5.6 billion in 2023-24, and to $8.0 billion by 2026-27, as the Government increases borrowings to continue significant levels of infrastructure investment under Victoria's Big Build. Interest expense as a share of total revenue is expected to average 7.1 per cent a year over the budget and forward estimates.
- Grant expenses are forecast to fall to $17.0 billion in 2023-24, largely reflecting the tapering of pandemic support initiatives over the previous years. Grant expenses are then expected to decline further by an average of 1.3 per cent a year over the forward estimates.
- Other operating expenses are forecast to fall to $26.1 billion in 2023-24 as expenditure commitments attributable to the pandemic response reduce. Other operating expenses are then expected to decline further by an average of 0.5 per cent a year over the forward estimates.

Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector* contains further details of major components of expenditure incurred by the state towards the delivery of services.

Reconciliation of estimates with PEBU

Relative to PEBU, the net result from transactions has been revised down by $0.4 billion in 2023-24, down by $0.4 billion in 2024-25 and up by $0.2 billion in 2025-26 (Table 4.3).

Table 4.3: Reconciliation of estimates with PEBU [(a)] **($ million)**

	2023-24 budget	*2024-25 estimate*	*2025-26 estimate*
Net result from transactions: *PEBU*	**(3 615)**	**(639)**	**870**
Policy variations			
Revenue policy initiatives	2 264	2 669	2 648
Output policy initiatives [(b)]	(4 432)	(2 261)	(2 268)
	(2 167)	**408**	**381**
Economic/demographic variations			
Taxation	(228)	23	133
Investment income [(c)]	443	93	110
	215	**117**	**243**
Commonwealth grant variations			
General purpose grants	954	1 074	1 307
Specific purpose grants [(d)]	(402)	(823)	(970)
	552	**251**	**337**
Administrative variations			
Contingency offset for new policy initiatives [(e)]	400	700	1 100
Other administrative variations	598	(1 897)	(1 892)
	998	**(1 197)**	**(792)**
Total variation since *PEBU*	**(402)**	**(421)**	**169**
Net result from transactions: *2023-24 Budget*	**(4 017)**	**(1 060)**	**1 039**

Notes:

(a) *Figures in this table are subject to rounding to the nearest million and may not add up to totals.*
(b) *This is represented in Table 4.4 as the* 2023-24 Budget *output policy initiatives.*
(c) *Comprises dividends and income tax and rate equivalent revenue.*
(d) *Reflects the change in grant revenue as per Note 1.2.4 of Budget Paper No. 5, Chapter 1* Estimated Financial Statements for the general government sector *less associated expense movements.*
(e) *Represents releases from the funding not allocated to specific purposes contingency associated with* 2023-24 Budget *new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1* Estimated Financial Statements for the general government sector.

Policy variations

Policy variations reflect specific initiatives by the Government that have a fiscal impact and are related to a new policy or represent a change in the Government's existing policy position since PEBU.

The *2023-24 Budget* funds $15.4 billion in new output initiatives over the five years to 2026-27 which includes implementation of the Government's election commitments outlined in LFS. Table 4.4 shows the impact of the new output initiatives in this budget from 2023-24 to 2026-27.

Details of specific new output and revenue policy initiatives are contained in Budget Paper No. 3, Chapter 1 *Output, asset investment, savings and revenue initiatives*.

Table 4.4: Net impact of the *2023-24 Budget* new output initiatives [(a)] ($ million)

	2023-24 budget	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
New output initiatives	**4 787**	**3 085**	**2 474**	**3 045**
Less:				
Reprioritisations and revenue offsets [(b)]	561	529	487	489
Adjustments [(c)]	(513)	(383)	(1 041)	(900)
Savings [(d)]	307	679	760	823
***2023-24 Budget* output policy initiatives**	**4 432**	**2 261**	**2 268**	**2 632**
Less: contingency offset for new policy [(e)]	400	700	1 100	400
Net impact	**4 032**	**1 561**	**1 168**	**2 232**

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) This includes the reprioritisation of resources previously allocated to departments and revenue offsets.
(c) Primarily incorporates the net impact of the specific creation and release of contingencies held for decisions made but not yet allocated.
(d) Includes output savings only.
(e) Represents releases from the funding not allocated to specific purposes contingency associated with 2023-24 Budget *new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1* Estimated Financial Statements for the general government sector.

Economic and demographic variations

Since PEBU, Victoria's taxation revenue has been revised down by $0.2 billion in 2023-24, and up slightly in 2024-25 and 2025-26, largely due to a fall in land transfer duty offset by an increase in payroll tax and land tax.

Commonwealth grants variations

Commonwealth general purpose grants (or GST grants) have been revised up by $1.0 billion in 2023-24, $1.1 billion in 2024-25, and $1.3 billion in 2025-26 compared with PEBU. Forecasts for the national GST pool have been upgraded, principally reflecting elevated receipts to March 2023. The outlook for Victoria's GST sharing relativity has improved from PEBU after accounting for new data in the Commonwealth Grants Commission's *GST Revenue Sharing Relativities – 2023 Update*, and ongoing strength in commodity prices.

Net changes to specific purpose grants have decreased the operating result by an average of $0.7 billion a year from 2023-24 to 2025-26 compared with PEBU. The movements primarily reflect the state's rephasing of some existing infrastructure grant revenue expected from the Commonwealth to match state capital expenditure profiles.

Administrative variations

Other administrative variations are expected to increase the operating result by $0.6 billion in 2023-24 and decrease it by $1.9 billion in 2024-25 and $1.9 billion in 2025-26 compared with PEBU. The variations since PEBU include:

- adjustments to the provisions for decisions made but not yet allocated that are outlined in Note 1.3.5 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector*
- adjustments to the expected profile of grants from the public financial corporations (PFC) sector
- an increase in the net superannuation interest expense on the state's defined benefit superannuation liability from 2023-24 due to the combined impact of changes in valuation assumptions and the deferral of superannuation top-up payments
- a decrease in interest expense since PEBU mainly due to a broader decline in the Treasury Corporation of Victoria (TCV) bond yields as markets factor in the impact of domestic and global monetary tightening cycles on the economy.

Capital expenditure

Government infrastructure investment (GII), which measures investment funded by the Government and estimated private sector construction related expenditure on public private partnership projects, is expected to average $19.6 billion a year over the budget and forward estimates.

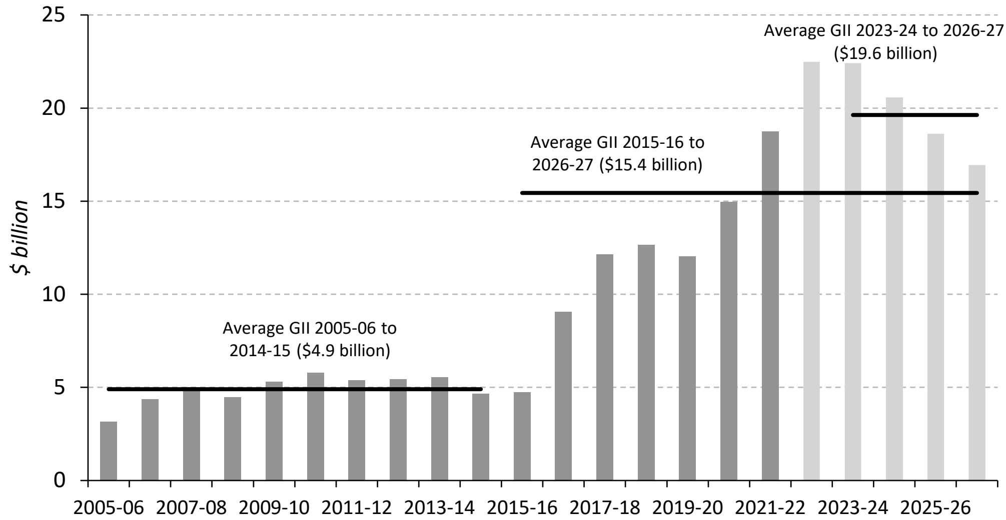
This includes investments in health, housing, education, transport and cultural precincts, as well as major productivity-enhancing projects such as North East Link, Metro Tunnel, West Gate Tunnel, Suburban Rail Loop and Level Crossing Removal Program.

The Government continues to deliver capital investments aimed at supporting jobs and improving productivity and the quality of public service delivery. New investment focuses on delivering the Government's election commitments alongside existing projects.

Further information on the Government's infrastructure investment, and how it will support jobs and the economy, is available in Budget Paper No. 4, Chapter 1 *State Capital Program 2023-24*.

Budget Paper No. 3, Chapter 1 *Output, asset investment, savings and revenue initiatives* provides details of new individual asset initiatives committed since PEBU.

Chart 4.1: Government infrastructure investment [(a)(b)(c)]



Notes:
(a) Includes general government net infrastructure investment and the estimated cash flows for public private partnership projects.
(b) Includes the estimated private sector construction-related expenditure associated with the North East Link held in the PNFC sector.
(c) Excludes the impact of the medium-term lease over the operations of the Port of Melbourne and the divestment of Victoria's share of Snowy Hydro Limited.

Net debt

Net debt is projected to be $116.7 billion at June 2023 and is forecast to increase to $162.2 billion by June 2026. This is an improvement of $3.7 billion compared with the forecast in PEBU. Net debt is then forecast to be $171.4 billion by June 2027.

As a proportion of GSP, net debt is projected to increase from 20.6 per cent in June 2023 to 24.5 per cent by June 2027.

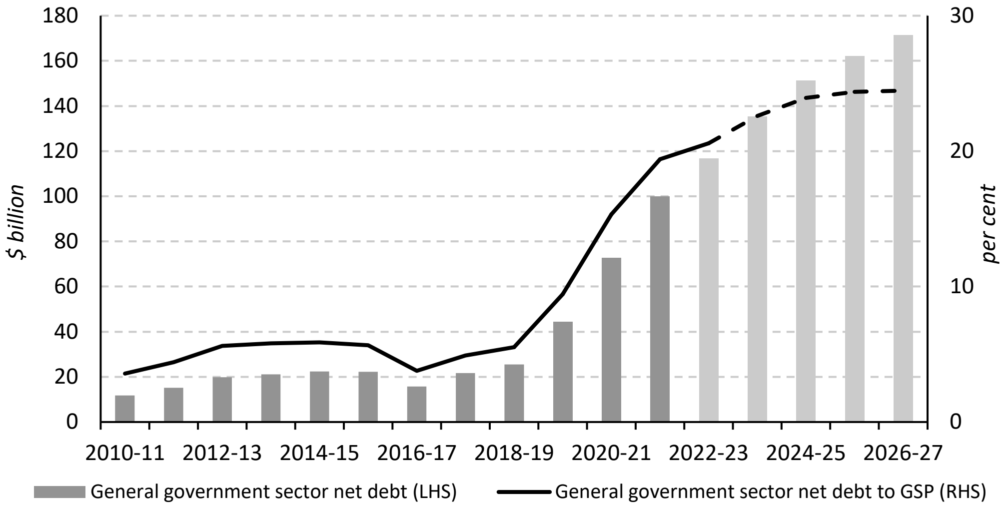
Expenditure in response to the COVID-19 pandemic over the past three years was targeted to allow required services and economic support to assist recovery while maintaining steps two and three of the fiscal strategy.

Throughout the pandemic, the Government prioritised the use of its balance sheet to support the Victorian community and economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

Stabilising net debt as a percentage of GSP – the last step in the Government's fiscal strategy – is an important medium-term objective for the Government. Chart 4.2 outlines the movements in general government net debt levels and the net debt to GSP ratio since 2010-11. It highlights the impact of the pandemic with debt rising across the three years from 2019-20.

While net debt to GSP is still projected to rise over the forward estimates, the rate of growth has slowed and is expected to stabilise over the medium term.

Chart 4.2: General government net debt to GSP



With the economy in a strong position, the implementation of the new COVID Debt Repayment Plan is designed to take the next step in improving the state's financial position. The plan recognises that the COVID debt was incurred for essential short-term emergency response measures that involved one-off expenditure. By offsetting the impact of COVID debt, the plan ensures the budgetary impact of such one-off expenditures will be balanced over the longer-term budgetary and economic cycle. Once completed, the plan will mean that the state's balance sheet is returned to investments that generate productive capacity enhancing infrastructure and programs, which produce long-term economic and financial benefits to the state.

The Victorian Future Fund (the Fund) was established by the Government to support the state's debt stabilisation strategy. It was established using proceeds from the VicRoads Modernisation Joint Venture and will initially serve to offset the impact of the COVID debt.

The Fund will be managed by the VFMC, the state's specialist investment agency, by implementing a diversified investment strategy designed to deliver returns that exceed the savings that would otherwise have been achieved. These excess returns are expected to, over time, improve the state's operating result and net debt position.

The investment returns from the Fund will be quarantined and returned to the Fund so that its balance will grow over time. Further investments will be allocated to the Fund in the future through proceeds from designated government land sales and a proportion of future budget surpluses once net debt stabilises. The Fund is projected to have a balance of around $12.0 billion by the end of the forward estimates.

The application of cash resources for the general government sector (as shown in Table 4.5) outlines the annual movements in net debt.

Table 4.5: Application of cash resources for the general government sector [(a)] ($ million)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Net result from transactions	**(13 791)**	**(10 326)**	**(4 017)**	**(1 060)**	**1 039**	**1 204**
Add back: Operating cash flows not recognised in the net operating balance [(b)]	4 934	13 219	4 846	5 321	5 491	5 274
Net cash flows from operating activities	**(8 857)**	**2 892**	**829**	**4 261**	**6 530**	**6 478**
Less: Total net investment in fixed assets [(c)]	**14 845**	**17 929**	**18 750**	**18 998**	**17 300**	**15 874**
Surplus/(deficit) of cash from operations after funding net investment in fixed assets	**(23 702)**	**(15 037)**	**(17 921)**	**(14 737)**	**(10 770)**	**(9 396)**
Less:						
Leases and service concession arrangements [(d)]	2 447	2 388	2 450	963	437	149
Other movements	1 094	(700)	(1 653)	70	(186)	(313)
Decrease/(increase) in net debt	**(27 244)**	**(16 725)**	**(18 718)**	**(15 770)**	**(11 020)**	**(9 231)**

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Includes depreciation, prepayments and movements in the superannuation liability and liability of employee benefits for the year, and the progressive unwinding of the grant of a right to the operator liability.

(c) Includes total purchases of plant, property and equipment, and net capital contributions to other sectors of government net of proceeds from asset sales.

(d) Includes most operating leases which are now required to be recognised as lease liabilities. It also includes the financial liabilities relating to public private partnership projects including the High Capacity Metro Trains, the Metro Tunnel, the new Footscray Hospital, the Frankston Hospital Redevelopment and the Western Roads Upgrade.

Unfunded superannuation liability

The Government is on track to fully fund the state's unfunded superannuation liability by 2035. Note 1.6.3 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector* shows information on the reported superannuation liability.

FISCAL RISKS

This section discusses a number of risks which, if realised, are likely to impact on the state's financial position and budget outcomes.

Details of specific contingent assets and liabilities, defined as possible assets or liabilities that arise from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, are contained within Budget Paper No. 5, Chapter 6 *Contingent assets and contingent liabilities*.

General fiscal risks

Risks to Victoria's economic outlook remain elevated and the forecasts are subject to uncertainty.

A key risk is the outlook for inflation, both domestically and globally. While inflation is expected to moderate, it remains relatively high and there is uncertainty about how persistent this will be, with implications for the Reserve Bank of Australia's monetary policy as well as that of other major central banks. The extent to which monetary policy needs to respond to high inflation has implications for economic activity and employment growth. A related uncertainty is how much further wages growth will increase amid an ongoing tight labour market.

Another uncertainty is the outlook for the global economy. Global risks remain tilted to the downside, as high inflation and global monetary tightening weigh on prospects for economic growth. Further, conflict continues between Russia and Ukraine, which has the potential to further destabilise energy prices. Geopolitical tensions in multiple regions, including the Asia Pacific and Europe, also continue to contribute to uncertainty. Weaker global growth would slow demand for Victoria's goods and services exports.

The Government's forecast revenues, expenses and borrowings are predicated on a series of assumptions, including those related to the global economy. If these assumptions do not eventuate, the actual financial outcomes may differ from the Government's current budget.

Appendix A *Sensitivity analysis* contains information on the impact of variations in the macroeconomic outlook on the Government's key fiscal aggregates. This includes a scenario of a downturn in Victorian and Australian economies, driven by a greater than expected slowdown in consumer spending and weaker investment.

Further detail on the economic outlook and risks to the outlook is included in Chapter 2 *Economic context*.

State taxes

State tax forecasts are primarily modelled on the relationships between taxation revenue and projected economic variables. As a result, the main source of uncertainty to state taxation estimates is unforeseen changes in the economic outlook.

Risks to Victoria's revenue outlook remain elevated. Domestic and global inflation and the potential for further interest rate increases will weigh on consumers' real incomes and may put further downward pressure on consumption.

In contrast, Victoria's labour market conditions have been strong over the past year, with unemployment rates below 4 per cent for the first time since 1974. Stronger employment and higher than expected wages growth could bolster household income and larger savings buffers provide an upside risk that consumer spending, in aggregate, holds up better than expected over the coming year.

Property-related taxes

Revenue from property-based taxes, such as land tax and land transfer duty, is subject to unique risks and historically has been volatile as property markets can exhibit large cycles typically related to changes in interest rates and/or changes in sentiment.

Property-related taxes face significant uncertainty due to market conditions. Higher borrowing costs and persistent subdued sentiment in the market have led to a decline in the dwelling price forecast. While labour market conditions and strong rental price growth provide support for the property market, tight credit conditions are expected to be the dominant force throughout 2023 and present a risk to revenue from land transfer duty in the near term. Although a recovery in transaction volumes is expected toward the end of 2023, uncertainty in property market prices and volumes present a risk to revenue.

Relatively low levels of activity in the residential property market in recent quarters have supported dwelling prices, and residential land valuations. There is uncertainty about how prices for residential property will evolve as transaction volumes recover, which will affect the trajectory for future land revaluations.

In non-residential land valuations, the industrial sector has shown resilience during 2022, supported by continued demand for warehousing and distribution sites, while commercial land valuation growth is expected to remain positive, although uncertainty in growth expectations of retail, office and hotel sectors remains a key risk in the near term.

Interest expenses

The state's debt portfolio is made up predominantly of fixed interest debt which means that most of the interest expense on existing debt is not exposed to movements in interest rates. However, approximately 10 per cent of this debt matures each year and must be refinanced at the current market interest rate. The interest expense on the refinancing along with new borrowings and a small proportion of floating rate notes in the portfolio are subject to changes in interest rates.

The interest rate forecasts used in the estimates for interest expenses are based on the forward interest rates that are derived from the yield curve for the TCV bonds that are traded in financial markets. Currently the TCV yield curve is upward sloping, implying that future interest rates will be higher than current interest rates. Consequently, the interest expense estimates assume that the average interest rate on new and refinanced borrowings will increase over time.

Employee expenses

Employee expenses are the state's largest expense. Two important determinants of employee expenses are wages growth and the number of employees. Wages growth is primarily driven by enterprise bargaining agreements, which are subject to the Government's Wages Policy. This has recently been adjusted to better reflect the current economic context, allowing a 3 per cent per annum increase to wages (up from 1.5 per cent), plus a limited cash payment. Other factors contributing to projected employee expenses include the anticipated composition and profile of the workforce.

Demand for government services

Another key uncertainty is whether growth in demand for government services will exceed or be lower than current projections. This can occur, for example, as a result of higher than forecast population growth or expenditure in response to unforeseen events such as natural disasters, including bushfires and floods.

The estimates incorporate contingency provisions to mitigate the impact of expenditure risks that may be realised during the next four years. The contingency provisions are sized to allow for the likely growth in Victoria's population and the derived increased demand for government services.

Note 1.3.5 and Note 1.3.6 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector* discloses general government output and asset contingencies not allocated to departments.

Capital program risks

The Government continues to deliver capital investments aimed at supporting jobs and improving productivity and the quality of public service delivery. New investments focus on the Government's election commitments alongside existing projects in delivery. Over the forward estimates, the capital program will begin to return towards pre-COVID levels.

Victoria's Big Build coincides with a period of unprecedented growth in construction across Victoria and nationally. The high level of demand for skills and resources is placing significant pressure on the construction market and supply chain, resulting in capacity challenges and escalation in the price of materials and labour. The Government is implementing strategies to respond to market constraints. Initiatives such as free TAFE, Big Build apprenticeships and wider use of modern construction methods such as offsite and modular construction seek to improve productivity and address skills shortages.

Specific fiscal risks

Commonwealth schools funding

In June 2017, the Commonwealth Government passed amendments to the *Australian Education Act 2013* to implement a new national school funding model. In mid-2019, Victoria signed the National School Reform Agreement and an accompanying bilateral agreement, which will nominally expire on 31 December 2024 following a one-year extension. Estimates of funding required to acquit the Schooling Resource Standard target each year are subject to indexation and based on student number and profile projections. Expenditure targets are finalised towards the end of, or after, each school year based on actual student data, plus national price indexes, creating a risk that the Victorian and Commonwealth targets differ from the funding allocated that year.

Commonwealth health funding

Under the 2020-25 Addendum to the National Health Reform Agreement (NHRA), the Commonwealth co-funds public hospitals by contributing 45 per cent of the cost of eligible activity, with the Commonwealth's contribution capped at a growth rate of 6.5 per cent compared with the previous year's contribution.

Victoria's public hospitals continue to experience significant cost pressures due to COVID-19, including the costs of furloughing staff, personal protective equipment, and broad infection control measures. Previously, additional costs related to COVID-19 were shared between the Commonwealth and states and territories under the National Partnership on COVID-19 Response.

With the ceasing of the National Partnership agreement on 31 December 2022, the Commonwealth's contributions to COVID-19 cost pressures are limited to annual price increases as determined by the Independent Health and Aged Care Pricing Authority (IHACPA). IHACPA has made assumptions to determine the National Efficient Price (NEP). These assumptions may dampen the true costs of healthcare delivery, increasing the risk that Commonwealth funding will not be sufficient to meet the 45 per cent share of COVID-19 costs. Further, should any large-scale public health response be required for a future COVID-19 outbreak, there is currently no funding mechanism for the Commonwealth to contribute to the response.

Victorian contribution to disability funding

The bilateral agreement outlining Victoria's contribution to the National Disability Insurance Scheme (NDIS) nominally expires in July 2023. Under the agreement, Victoria's contributions have been indexed at 4 per cent annually since the agreement commenced in July 2019, with a total contribution of $2.9 billion in 2022-23. Negotiation of the new bilateral agreement is expected to commence at the conclusion of the current NDIS Review (expected around October 2023). Further, the Commonwealth has indicated that it may not continue reimbursing states and territories from 2024-25 for their NDIS costs under the National Partnership on DisabilityCare Australia Fund (DCAF) Payments. Under this National Partnership, Victoria's payment from the Commonwealth will be $280 million in 2023-24. Both the bilateral agreement and continuation of the DCAF payments are contingent on the outcomes of the NDIS Review currently underway.

Victoria's GST revenue

Victoria's GST revenue is broadly determined by three key factors:

- the amount of GST collected by the Commonwealth (the national GST pool)
- Victoria's GST relativity
- Victoria's share of the national population.

National GST pool

The outlook for the national GST pool has improved following the rebound in calendar year 2022 as the economy recovered from the pandemic. The key risk to the profile is the uncertainty of high inflation and the current monetary tightening cycle. Ongoing high inflation could lead to further rises in interest rates or delay monetary easing. This would weigh on the disposable income of households further than expected and impact aggregate spending which would slow the growth in the GST pool. Further uncertainty in the national GST pool forecast is driven by changes in spending patterns during COVID. The proportion of consumption subject to GST rose during COVID, against the trend pre-COVID. There is heightened uncertainty about the persistence of this pattern.

GST relativities

The national GST pool is shared between states and territories based on relativities determined annually by the Commonwealth Treasurer, which are informed by the recommendations of the Commonwealth Grants Commission.

These relativities are based on the relative fiscal capacity of each jurisdiction and are influenced by differences in revenue bases and costs of delivering services. Relativities are sensitive to a broad range of factors, including demographics, infrastructure needs, developments in property markets and global commodity prices (particularly for iron ore, thermal coal and coking coal). Uncertainty in these factors pose risks for Victoria's GST revenue.

Population

In the early stages of the COVID-19 pandemic, Victoria's national population share decreased due to a net outflow of Victorian residents to other states and restrictions on overseas migration. Victoria's population share projections are subject to uncertainty as interstate and overseas migration patterns evolve.

Additionally, there is further uncertainty as net international migration has begun to increase in Australia. Victoria has traditionally received more international migration than its population share and this is likely to increase Victoria's population growth compared with other states. If Victoria's population growth is higher than forecast compared with other states, then Victoria's share of GST could increase. Conversely, should other states have higher population growth than expected compared with Victoria, this could negatively affect Victoria's GST revenue.

Commonwealth no-worse-off guarantee for GST entitlement

In 2018, the Commonwealth changed the GST distribution system, introducing:

- a minimum GST revenue sharing relativity (relativity floor) of 0.70 commencing in 2019-20, supported by transition payments from the Commonwealth and facilitated within the GST distribution from 2022-23, rising to 0.75 from 2024-25
- a small, permanent boost to the GST revenue pool from 2021-22, funded from additional Commonwealth funding
- the transition of the GST distribution system from full equalisation (so called equalising to the strongest state) to 'reasonable' equalisation, based upon the fiscal capacity of the stronger of New South Wales or Victoria.

During a six-year transition period commencing in 2021-22, each state and territory is entitled to receive additional Commonwealth financial assistance to ensure it is no worse off compared to its GST entitlement had full equalisation been maintained. The no-worse-off guarantee is only legislated until the end of the transition period in 2026-27, posing a fiscal risk to states and territories. The Commonwealth's *2023-24 Budget* indicates that without the guarantee, Victoria would lose $7.0 billion over the years 2022-23 to 2026-27. Actual impacts may be greater than reported in the Commonwealth's budget as it is based on the simplistic assumption that its estimates of no-worse-off payments are reduced by 50 per cent in 2026-27.

Further information on the potential impact of a failure to extend the no-worse-off guarantee is presented in Box 4.3 of Budget Paper No. 5, Chapter 4 *State revenue*.

Victoria continues to work with other state governments and the Commonwealth to ensure Victoria receives its fair share of GST.

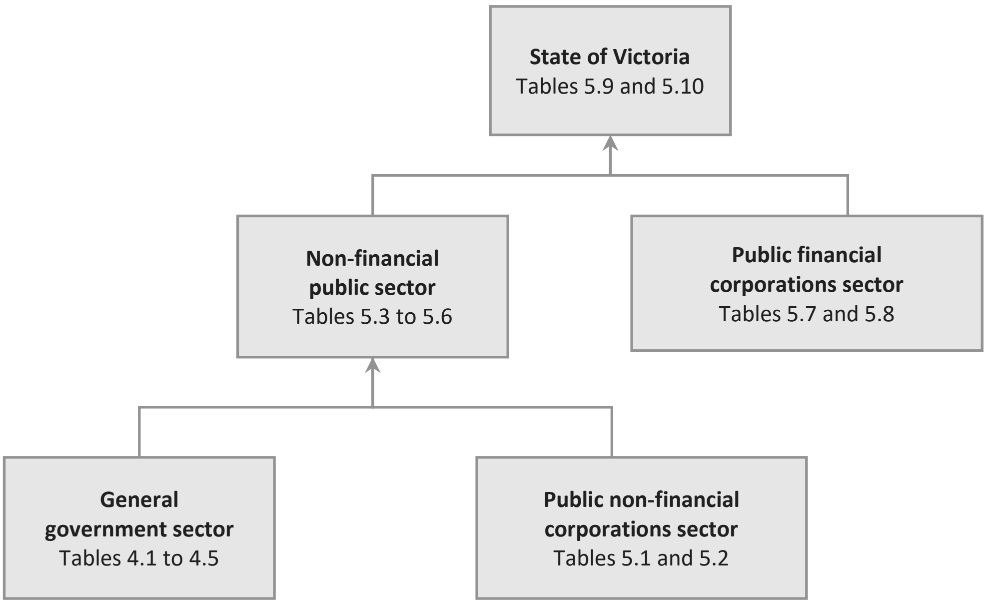
CHAPTER 5 – POSITION AND OUTLOOK OF THE BROADER PUBLIC SECTOR

- The net result from transactions of the public non-financial corporation (PNFC) sector is expected to improve from a deficit of $295 million in 2023-24 to a surplus of $114 million in 2026-27. Once non-cash items, such as depreciation and movements in liabilities for employee benefits are removed, the operating cash flow surplus of the PNFC sector is expected to average $1.6 billion a year over the budget and forward estimates period.
- The net result from transactions of the non-financial public sector (NFPS), which includes both the general government and the PNFC sectors, is expected to improve from a deficit of $5.5 billion in 2023-24 to a deficit of $109 million by 2026-27. This improvement is primarily driven by the general government sector, for which revenues are expected to grow faster than expenses over the budget and forward estimates.
- The net result from transactions of the public financial corporation (PFC) sector is expected to remain stable over the budget and forward estimates, with an average deficit of $3 billion a year, while the net result for this sector is expected to average a deficit of $862 million a year. The net result is significantly more favourable than the net result from transactions due to other economic flows which primarily relate to unrealised capital gains on the investments held by the State's insurance agencies and movements in deferred tax assets.
- The net result from transactions of the State of Victoria, which combines the general government, PNFC and PFC sectors, is projected to improve from a deficit of $9.2 billion in 2023-24 to a deficit of $3.3 billion in 2026-27.
- A range of savings and efficiency initiatives will be implemented by the PNFC and PFC sectors. Any distributions to government from individual entities, which can take the form of dividends, capital repatriations, grants, or reduced funding, will be progressively implemented from 2023-24.
- As a proportion of gross state product (GSP), NFPS net debt is estimated to average 28.4 per cent over the budget and forward estimates.

This chapter provides an overview of the activities of the broader public sector, comprising:

- the NFPS, which consolidates the general government and the PNFC sectors. The general government sector is discussed in Chapter 4 *Budget position and outlook*. The PNFC sector comprises a wide range of entities that provide services that are primarily funded by user charges and fees. The main services provided by PNFCs include water, housing, and transport
- the State of Victoria, which consolidates the NFPS and the PFC sector. PFCs can be categorised into two broad types: those that provide services to the general public and businesses (such as WorkSafe Victoria, the Transport Accident Commission, Breakthrough Victoria and State Trustees Limited), and those that predominantly provide financial services to other government entities (such as the Victorian Funds Management Corporation, Treasury Corporation of Victoria (TCV) and the Victorian Managed Insurance Authority).

The following chart shows the relationship between the various sectors of the State and indicates the relevant tables that disclose the data on these sectors within this budget paper.



PUBLIC NON-FINANCIAL CORPORATIONS SECTOR

Tables 5.1 and 5.2 summarise the operating statement and financial position for the PNFC sector. A comprehensive operating statement and balance sheet are presented in Budget Paper No. 5, Chapter 2 *Supplementary uniform presentation framework tables.*

Table 5.1: Summary operating statement for the PNFC sector [(a)] ($ million)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Revenue and income from transactions						
Interest income	10	112	125	93	91	91
Dividend income	51	32	32	33	33	33
Sales of goods and services	6 823	7 245	7 361	7 795	7 940	8 115
Grants	3 009	2 458	2 013	1 558	1 545	1 509
Other revenue and income	810	743	715	717	740	766
Total revenue and income from transactions	**10 703**	**10 589**	**10 246**	**10 195**	**10 349**	**10 516**
% change	*-15.1*	*-1.1*	*-3.2*	*-0.5*	*1.5*	*1.6*
Expenses from transactions						
Employee expenses	1 593	1 736	1 701	1 637	1 594	1 628
Superannuation [(b)]	156	163	168	175	183	188
Depreciation	1 938	1 934	2 006	2 079	2 138	2 260
Interest expense	804	868	984	1 084	1 157	1 228
Grant expense	527	657	460	382	326	327
Other operating expenses	4 739	5 181	4 970	4 522	4 545	4 517
Other property expenses	233	222	252	251	259	255
Total expenses from transactions	**9 989**	**10 761**	**10 541**	**10 132**	**10 202**	**10 402**
% change	*-15.9*	*7.7*	*-2.0*	*-3.9*	*0.7*	*2.0*
Net result from transactions	**714**	**(172)**	**(295)**	**62**	**147**	**114**
Total other economic flows included in net result	(2 934)	(1 194)	(5 580)	(6 378)	(14 068)	(3 411)
Net result	**(2 220)**	**(1 366)**	**(5 875)**	**(6 315)**	**(13 921)**	**(3 297)**

Notes:

(a) *This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5, Chapter 2* Supplementary uniform presentation framework tables*. Figures in this table are subject to rounding to the nearest million and may not add up to totals.*

(b) *Comprises superannuation interest expense and other superannuation expenses.*

PNFC sector total revenue and income from transactions is forecast to remain stable, slowly rising over the budget and forward estimates. This is primarily driven by the progressive increase in sales of goods and services, property sales forecast by Development Victoria and improved revenue estimates for the water authorities. Higher sales of goods and services is offset by reduced grants received for Homes Victoria.

PNFC sector total expenses from transactions is also forecast to remain largely stable over the budget and forward estimates period.

Overall, the net result from transactions of the PNFC sector is projected to improve from a deficit of $295 million in 2023-24 to a surplus of $114 million in 2026-27. This reflects the sector's and broader economy's recovery from the peak of the COVID-19 pandemic. On average, over the budget and forward estimates, metropolitan water authorities are projected to report an average surplus of $346 million a year.

Other economic flows for the PNFC sector largely reflect the derecognition of the rail assets under AASB 16 Leases at nominal value. Budget Paper No. 5, Chapter 1 Estimated Financial Statements contains more information on this arrangement. Other economic flows are expected to be negative $5.6 billion in 2023-24 before improving to $3.4 billion in 2026-27. Over the budget and forward estimates, other economic flows are expected to average a negative $7.4 billion a year.

Table 5.2: Financial position of the PNFC sector [(a)] **($ billion)**

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Assets						
Total financial assets [(b)]	4.9	3.7	3.3	3.1	3.2	3.3
Total non-financial assets [(c)]	113.9	119.8	126.0	131.7	137.7	142.6
Total assets	**118.7**	**123.5**	**129.3**	**134.8**	**140.9**	**145.9**
Liabilities						
Borrowings	19.3	22.2	24.8	27.1	29.1	31.7
Other provisions	9.7	9.6	9.5	9.4	9.7	9.6
Other liabilities [(d)]	12.0	12.1	13.6	13.5	13.4	13.5
Total liabilities	**41.0**	**43.9**	**47.9**	**49.9**	**52.2**	**54.8**
Net assets	**77.7**	**79.5**	**81.4**	**84.9**	**88.7**	**91.1**

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Financial assets include cash and deposits, advances paid, investments, loans and placements, receivables, and investments accounted for using the equity method.
(c) Land, buildings, infrastructure, plant and equipment, and other non-financial assets.
(d) Other liabilities consist of payables, employee benefits, deposits held and advances received.

The PNFC sector is projected to report a net asset position of $81.4 billion in 2023-24, before increasing to $91.1 billion in 2026-27. This is primarily due to capital investment to be undertaken by the metro water authorities, the State Tolling Corporation and Homes Victoria. The increase in total assets is partly offset by an increase in borrowings to fund a high proportion of the capital works to be undertaken by the water authorities and progressive recognition of the service concession liability for the State Tolling Corporation as part of the North East Link project.

NON-FINANCIAL PUBLIC SECTOR

This section provides a summary of the key performance indicators for the NFPS by combining the PNFC sector and the general government sector, noting that adjustments are made for transactions between the two sectors.

The net result from transactions of the NFPS is forecast to be a deficit of $5.5 billion in 2023-24, improving to a deficit of $109 million in 2026-27. This improvement is largely driven by the general government sector for which the net result from transactions is forecast to improve from a deficit of $4 billion in 2023-24 to a surplus of $1.2 billion in 2026-27 due to revenue, on average, growing at a faster rate than expenditure over the budget and forward estimates.

Table 5.3: Summary operating statement for the non-financial public sector [(a)] ($ million)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Revenue and income from transactions						
Taxation	30 099	31 043	34 407	36 374	38 174	40 044
Dividends, income tax equivalent and interest [(b)]	728	1 414	2 054	1 255	1 390	1 455
Sales of goods and services	11 976	13 049	13 165	13 924	14 038	14 266
Grants	41 818	39 790	41 724	43 172	45 819	46 695
Other revenue and income	4 396	4 151	4 277	3 966	4 066	4 613
Total revenue and income from transactions	**89 018**	**89 447**	**95 627**	**98 691**	**103 487**	**107 072**
% change	*17.5*	*0.5*	*6.9*	*3.2*	*4.9*	*3.5*
Expenses from transactions						
Employee expenses	33 759	35 500	36 896	37 478	38 487	39 808
Superannuation [(c)]	4 548	4 341	4 657	4 767	4 846	5 039
Depreciation	7 116	7 666	7 866	8 214	8 684	9 010
Interest expense	3 259	4 428	5 979	6 790	7 744	8 650
Grant expense	22 421	16 951	15 153	14 748	14 803	14 828
Other operating expenses	31 987	32 091	30 542	28 977	29 165	29 845
Total expenses from transactions	**103 091**	**100 977**	**101 093**	**100 973**	**103 730**	**107 180**
% change	*12.4*	*-2.1*	*0.1*	*-0.1*	*2.7*	*3.3*
Net result from transactions	**(14 073)**	**(11 530)**	**(5 466)**	**(2 282)**	**(243)**	**(109)**
Total other economic flows included in net result	(903)	(256)	(393)	(334)	35	(231)
Net result	**(14 976)**	**(11 786)**	**(5 859)**	**(2 616)**	**(208)**	**(340)**

Notes:
(a) *This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5, Chapter 2* Supplementary uniform presentation framework tables. *Figures in this table are subject to rounding to the nearest million and may not add up to totals.*
(b) *Comprises dividends, income tax and rate equivalent revenue and interest.*
(c) *Comprises superannuation interest expense and other superannuation expenses.*

Application of cash resources

Table 5.4 shows the net cash flows from operating activities of the NFPS is projected to increase from a surplus of $1.6 billion in 2023-24 to a surplus of $8.1 billion by 2026-27. This is aligned with the fiscal strategy first set out by the Government in the *2020-21 Budget* and discussed in Chapter 4 *Budget position and outlook*. The surplus net cash flows from operating activities fund 7.2 per cent of the projected net investment in fixed assets in 2023-24 with this expected to increase to 42.3 per cent by 2026-27. The remaining investment in fixed assets is largely funded by borrowings.

Overall, once non-cash items, such as depreciation, are removed the PNFC sector is projected to record an average operating cash flow surplus of $1.6 billion a year over the budget and forward estimates. The metropolitan water authorities are the primary contributors to this surplus.

Table 5.4: Application of cash resources for the non-financial public sector [(a)] ($ million)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Net result from transactions	(14 073)	(11 530)	(5 466)	(2 282)	(243)	(109)
Add back: operating cash flows not recognised in the net operating balance [(b)]	7 158	15 948	7 114	7 921	8 266	8 246
Net cash flows from operating activities	**(6 915)**	**4 418**	**1 648**	**5 639**	**8 024**	**8 138**
Less: Total net investment in fixed assets [(c)]	**18 274**	**22 211**	**22 747**	**22 712**	**20 269**	**19 216**
Surplus/(deficit) of cash from operations after funding net investments in fixed assets	**(25 189)**	**(17 793)**	**(21 099)**	**(17 073)**	**(12 245)**	**(11 078)**
Less:						
Leases and service concession arrangements [(d)]	3 027	3 466	2 566	1 241	1 044	1 022
Other movements	(225)	(336)	374	152	(100)	(261)
Decrease/(increase) in net debt	**(27 991)**	**(20 924)**	**(24 039)**	**(18 466)**	**(13 189)**	**(11 839)**

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Includes depreciation, prepayments and movements in the superannuation liability and liability of employee benefits for the year, and the progressive unwinding of the grant of a right to the operator liability.

(c) Includes total purchases of plant, property and equipment, and capital contributions to other sectors of government net of proceeds from asset sales.

(d) Includes most operating leases which are now required to be recognised as lease liabilities. It also includes financial liabilities relating to public private partnerships including the High Capacity Metro Trains, the Metro Tunnel, the new Footscray Hospital, the Frankston Hospital Redevelopment, the Western Roads Upgrade, North East Link – Primary Package (Tunnels), and the Homes Victoria Ground Lease Model Projects 1 and 2.

Infrastructure

Table 5.4 also provides estimates of the net investment in fixed assets which represents investments in infrastructure that are not funded by the NFPS operating surplus or the proceeds of fixed asset sales. The total net investment in fixed assets by the NFPS is projected to average $21.2 billion a year over the budget and forward estimates.

In addition to infrastructure projects under development in the general government sector, as outlined in Budget Paper No. 4, Chapter 2 *General government capital program*, the main infrastructure projects in the PNFC sector, are:

- investment in transport infrastructure and rolling stock to meet patronage growth and improve network performance. This includes the new regional and metropolitan trains, Next Generation Trams, Metro Tunnel infrastructure works and stabling and maintenance facilities for rolling stock
- investment to deliver the North East Link – Primary Package (Tunnels) by the State Tolling Corporation
- various water and sewer related infrastructure projects, such as the Western Treatment Plant 5W NRP Project, Water for a growing North, Rollout of digital water meters, South Melbourne Sewerage Capacity Upgrade, and upgrade to the Gisborne Recycled Water Plant and the Goulburn Murray Water's Water Efficiency project.

Further details on these projects are contained in Budget Paper No. 4, Chapter 3 *Public non-financial corporations capital program*.

Non-financial public sector net debt and net financial liabilities

Table 5.5 details the NFPS net debt and superannuation liabilities. It shows that net debt is expected to increase from $161.4 billion at 30 June 2024 to $204.9 billion by 30 June 2027. As a proportion of GSP, NFPS net debt is expected to increase from 26.9 per cent at 30 June 2024 to 29.2 per cent at 30 June 2027. The increase in net debt is predominately due to additional borrowings required by the general government sector to fund the State's infrastructure investment program.

The NFPS superannuation liability, which primarily resides in the general government sector and relates to the former State Superannuation Fund, is projected to increase over the budget and forward estimates. The key drivers of this increase are discussed in the State of Victoria section of this chapter.

Overall, the net financial liabilities to GSP ratio is projected to increase from 37.1 per cent in 2023-24 to 37.7 per cent in 2026-27.

Table 5.5: Non-financial public sector net debt and net financial liabilities [(a)] ($ billion)

	2021-22 *actual*	2022-23 *revised*	2023-24 *budget*	2024-25 *estimate*	2025-26 *estimate*	2026-27 *estimate*
Assets						
Cash and deposits	12.8	21.0	13.0	13.6	14.4	15.2
Advances paid	0.6	1.1	0.8	0.7	0.6	0.6
Investments, loans and placements	4.2	5.2	14.7	16.2	18.1	20.3
Total	**17.6**	**27.3**	**28.6**	**30.5**	**33.1**	**36.1**
Liabilities						
Deposits held and advances received	1.6	1.6	1.6	1.6	1.6	1.6
Borrowings	132.5	163.0	188.3	208.8	224.6	239.5
Total	**134.1**	**164.6**	**189.9**	**210.4**	**226.1**	**241.0**
Net debt [(b)]	**116.4**	**137.4**	**161.4**	**179.9**	**193.0**	**204.9**
Superannuation liability	19.8	21.8	21.9	21.9	22.2	22.4
Net debt plus superannuation liability	**136.2**	**159.1**	**183.3**	**201.8**	**215.3**	**227.3**
Other liabilities (net) [(c)]	30.7	39.6	39.0	38.1	37.6	36.8
Net financial liabilities [(d)]	**166.9**	**198.7**	**222.3**	**239.9**	**252.8**	**264.1**
						(per cent)
Net debt to GSP [(e)]	22.6	24.2	26.9	28.5	29.0	29.2
Net debt plus superannuation liability to GSP [(e)]	26.4	28.1	30.6	31.9	32.4	32.4
Net financial liabilities to GSP [(e)]	32.4	35.1	37.1	38.0	38.0	37.7
Net debt plus superannuation liability to revenue [(f)]	153.0	177.9	191.7	204.5	208.0	212.2

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Net debt is the sum of borrowings, deposits held and advances received less the sum of cash and deposits, advances paid, and investments, loans and placements.

(c) Other liabilities include other employee entitlements and provisions and other non-equity liabilities, less other non-equity financial assets.

(d) Net financial liabilities is total liabilities less financial assets (excluding investments in other sector entities).

(e) The GSP-based ratios may vary between publications due to revisions to the Australian Bureau of Statistics GSP data.

(f) This is the sum of the NFPS net debt and superannuation liability as a proportion of NFPS total operating revenue.

Table 5.6 shows several indicators of financial sustainability for the NFPS over the budget and forward estimates.

The operating cash flow surplus to revenue ratio is an indication of the extent to which the cash generated from operations can be used to fund infrastructure. This ratio increases from 1.7 per cent in 2023-24 to 7.6 per cent by 2026-27 largely due to the improvement in the general government sector operating cash position.

The ratio of gross debt to revenue, which indicates the overall debt burden, is estimated to be 198.6 per cent in 2023-24 and increase to 225.1 per cent in 2026-27. The NFPS interest expense to revenue ratio, which is a measure of the state's debt service burden, is also expected to increase over the budget and forward estimates period. This increase is driven by increases in debt and the higher interest rate environment.

Table 5.6: Indicators of financial sustainability for the non-financial public sector

(per cent)

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Operating cash flow surplus / (deficit) to revenue	(7.8)	4.9	1.7	5.7	7.8	7.6
Gross debt to revenue [(a)]	150.6	184.0	198.6	213.2	218.5	225.1
Interest expense to revenue	3.7	5.0	6.3	6.9	7.5	8.1

Note:
(a) Gross debt includes borrowings, deposits held and advances received.

PUBLIC FINANCIAL CORPORATIONS SECTOR

Tables 5.7 and 5.8 summarise the operating statement and financial position for the PFC sector. A comprehensive operating statement and balance sheet are presented in Budget Paper No. 5, Chapter 2 *Supplementary uniform presentation framework tables*.

Table 5.7: Summary operating statement for the PFC sector [(a)] **($ million)**

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Revenue and income from transactions						
Interest income	2 473	3 695	5 094	6 132	7 125	8 119
Dividend income	3 052	1 722	1 879	2 005	2 514	2 696
Sales of goods and services	5 675	6 120	7 793	8 133	8 493	8 871
Grants	516	377	25	27	29	31
Other revenue and income	21	20	22	24	25	28
Total revenue and income from transactions	**11 737**	**11 936**	**14 813**	**16 322**	**18 186**	**19 746**
% change	*18.9*	*1.7*	*24.1*	*10.2*	*11.4*	*8.6*
Expenses from transactions						
Employee expenses	451	529	545	554	561	574
Other superannuation	41	50	52	54	55	57
Depreciation	88	83	85	85	86	86
Interest expense	2 469	3 379	4 810	5 872	6 844	7 829
Grant expense	641	129	1 150	583	734	816
Other operating expenses	8 746	10 473	11 315	11 948	12 730	13 484
Other property expenses	780	314	8	9	40	36
Total expenses from transactions	**13 217**	**14 957**	**17 965**	**19 105**	**21 050**	**22 881**
% change	*0.3*	*13.2*	*20.1*	*6.3*	*10.2*	*8.7*
Net result from transactions	**(1 480)**	**(3 022)**	**(3 152)**	**(2 783)**	**(2 864)**	**(3 135)**
Total other economic flows included in net result	16 936	154	1 808	1 966	2 285	2 427
Net result	**15 456**	**(2 868)**	**(1 344)**	**(817)**	**(579)**	**(709)**

Note:

(a) *This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5, Chapter 2* Supplementary uniform presentation framework tables. *Figures in this table are subject to rounding to the nearest million and may not add up to totals.*

Total revenue and income from transactions in the PFC sector is projected to increase by an average of 10.1 per cent a year over the forward estimates. These increases are largely due to higher premium revenue, dividend income and realised capital gains for the State's insurance agencies, along with increased interest income for TCV. There is a more significant increase in 2023-24, of 24.1 per cent, largely due to WorkSafe's average premium rate increasing from an average of 1.272 per cent of remuneration in 2022-23 to an average of 1.8 per cent from 2023-24. This impacts income from the sales of goods and services in Table 5.7.

PFC sector total expenses from transactions are expected to increase by an average of 11.3 per cent across the budget and forward estimates to $22.9 billion in 2026-27. This increase in expenditure is largely due to increased claims expenses of the State's insurance agencies, which are shown in other operating expenses in Table 5.7, and higher interest expenses for TCV.

When combined, these impacts result in the PFC sector's net result from transactions improving slightly from a deficit of $3.2 billion in 2023-24 to a deficit of $3.1 billion in 2026-27. However, this excludes some significant drivers of the PFC sector's performance. The net result, which includes other economic flows such as capital gains on the investments held by the State's insurance agencies, movements in deferred tax assets, and risk margins and claims handling expenses, provides a more meaningful indication of the projected financial strength of the PFC sector. Other economic flows for the PFC sector are expected to average a gain of $2.1 billion a year over the budget and forward estimates such that the PFC sector net result averages a deficit of $862 million a year.

In 2021-22 and 2022-23, other economic flows for the PFC sector also include revaluations that reflect actual market movements for the financial year to date. Given recent market movements have had a net favourable impact on the PFC sector, higher gains are currently reported in both periods. The gain or loss that is ultimately reported for 2022-23, and future financial years, will vary in accordance with actual market experience for the year.

Table 5.8: Financial position of the PFC sector (a) **($ billion)**

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Assets						
Total financial assets (b)	161.1	192.1	227.0	251.7	272.1	290.4
Total non-financial assets (c)	3.8	4.1	4.2	4.4	4.4	4.4
Total assets	**164.9**	**196.2**	**231.2**	**256.1**	**276.4**	**294.8**
Liabilities						
Borrowings	107.3	139.7	173.6	195.8	213.1	228.1
Other provisions	44.6	46.3	49.5	52.9	56.6	60.4
Other liabilities (d)	3.1	3.0	2.6	2.6	2.6	2.6
Total liabilities	**155.0**	**188.9**	**225.7**	**251.3**	**272.2**	**291.1**
Net assets	**9.9**	**7.3**	**5.5**	**4.7**	**4.2**	**3.7**

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Financial assets include cash and deposits, advances paid, investments, loans and placements, receivables, and investments accounted for using the equity method.
(c) Land, buildings, infrastructure, plant and equipment, and other non-financial assets.
(d) Other liabilities consist of payables, employee benefits, deposits held and advances received.

The PFC sector is projected to report a net asset position of $5.5 billion in 2023-24 with this decreasing, by an average of $590 million a year, to $3.7 billion in 2026-27. This reduction is primarily driven by increases in TCV's borrowings and the outstanding claims liabilities of the State's insurance agencies, partly offset by increases in TCV's loans receivable from the NFPS, increases in deferred tax assets and increases in the cash and investments held by the State's insurance agencies, TCV and Breakthrough Victoria.

The reported net result and net asset position of the PFC sector are impacted by the accounting convention adopted for TCV whereby its fixed interest rate loans to government clients are measured at book value, while its borrowings are reported at market value. This approach enables TCV's loans to be consolidated with the borrowings of the general government and the PNFC sectors but, for the PFC sector in isolation, it creates a mismatch between the value of TCV's assets (which are at book value) and its liabilities (which are at market value). This difference, which is estimated to be around $8.1 billion at 31 March 2023, is eliminated when TCV's loans to government clients are consolidated in the whole of State accounts. Note that in TCV's own accounts, both assets and liabilities are reported at market value.

The PFC sector's net asset position is also significantly impacted by changes in Commonwealth Government bond yields which, in accordance with Australian accounting standards, underlie the discount rate used to value the State's insurance agencies' outstanding claims liabilities.

STATE OF VICTORIA

Table 5.9 shows the operating results for the State. The net result from transactions is projected to improve from a deficit of $9.2 billion in 2023-24 to a deficit of $3.3 billion in 2026-27. This improvement is primarily due to general government sector revenues growing faster than expenses over the forward estimates which is explained in Chapter 4 *Budget position and outlook*. When other economic flows are included, the state's net result improves from a deficit of $8.1 billion in 2023-24 to a deficit of $1.2 billion in 2026-27.

Table 5.9: Operating results – State of Victoria [(a)] **($ million)**

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Revenue and income from transactions						
Taxation	30 080	31 019	34 383	36 350	38 149	40 018
Dividends and interest [(b)]	3 754	3 401	3 901	3 799	4 493	4 770
Sales of goods and services	16 462	17 773	19 198	20 230	20 627	21 151
Grants	41 224	39 676	40 663	42 682	45 153	45 868
Other revenue and income	4 417	4 171	4 299	3 990	4 091	4 641
Total revenue and income from transactions	**95 936**	**96 040**	**102 443**	**107 052**	**112 514**	**116 448**
% change	*17.3*	*0.1*	*6.7*	*4.5*	*5.1*	*3.5*
Expenses from transactions						
Employee expenses	33 638	35 486	36 623	37 199	38 197	39 512
Superannuation [(c)]	4 589	4 391	4 709	4 820	4 901	5 096
Depreciation	7 203	7 749	7 950	8 299	8 769	9 096
Interest expense	3 712	4 681	6 287	7 142	8 124	9 050
Grant expense	21 952	16 607	15 237	14 833	14 862	14 805
Other operating expenses	40 097	41 667	40 872	39 887	40 797	42 168
Total expenses from transactions	**111 192**	**110 582**	**111 678**	**112 181**	**115 650**	**119 727**
% change	*11.1*	*-0.5*	*1.0*	*0.5*	*3.1*	*3.5*
Net result from transactions	**(15 255)**	**(14 542)**	**(9 234)**	**(5 129)**	**(3 136)**	**(3 279)**
Total other economic flows included in net result	15 823	(491)	1 171	1 372	2 236	2 105
Net result	**568**	**(15 033)**	**(8 064)**	**(3 757)**	**(900)**	**(1 174)**

Notes:

(a) *This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5, Chapter 2* Supplementary uniform presentation framework tables*. Figures in this table are subject to rounding to the nearest million and may not add up to totals.*

(b) *Comprises dividends and interest.*

(c) *Comprises superannuation interest expense and other superannuation expenses.*

Table 5.10 shows that the state's net assets are projected to increase over the budget and forward estimates, from $201.6 billion in 2023-24 to $227.3 billion by 2026-27. While total assets are expected to increase by $90.7 billion over the budget and forward estimates, this is partly offset by a $65 billion increase in liabilities.

The state's financial assets are estimated to increase from $104.1 billion in 2023-24 to $125.3 billion by 2026-27 and non-financial assets, including infrastructure, are estimated to increase from $422.6 billion in 2023-24 to $492.1 billion by 2026-27. Total liabilities are projected to increase from $325.1 billion in 2023-24 to $390.1 billion by 2026-27, largely due to borrowings increasing from $199.9 billion in 2023-24 to $254.4 billion by 2026-27.

Other liabilities are also projected to increase, from $101.6 billion in 2023-24 to $111.7 billion by 2026-27, largely due to growth in the value of the outstanding claims liabilities reported by the State's insurance agencies.

The superannuation liability is also projected to increase slightly, from $21.9 billion in 2023-24 to $22.4 billion in 2026-27. This is mainly due to the value of benefits that are expected to accrue over this period, as reflected in the superannuation expense from transactions, exceeding the sum of expected investment income and employer contributions. The value of benefits accruing over the budget and forward estimates period primarily relate to the current service cost for members of the Emergency Services Defined Benefit Scheme, which remains open to new operational emergency services personnel, and interest expense on the liabilities of the former State Superannuation Fund. This exceeds employer contributions due to the deferral of $3 billion of top-up payments from the State over this period consistent with the Government's election commitment 'Defined benefit liability management', as published in *Labor's Financial Statement 2022*. This amount will now be paid beyond the forward estimates period while still maintaining the 2035 full funding objective.

Table 5.10: Financial position of the State of Victoria [(a)] **($ billion)**

	2021-22 actual	*2022-23 revised*	*2023-24 budget*	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Assets						
Total financial assets [(b)]	84.5	97.3	104.1	111.3	118.4	125.3
Total non-financial assets [(c)]	380.5	403.3	422.6	453.3	471.0	492.1
Total assets	**464.9**	**500.6**	**526.7**	**564.5**	**589.5**	**617.4**
Liabilities						
Superannuation	19.8	21.8	21.9	21.9	22.2	22.4
Borrowings	136.5	171.0	199.9	222.5	239.4	254.4
Deposits held and advances received	1.7	1.7	1.7	1.7	1.6	1.6
Other liabilities [(d)]	87.2	98.3	101.6	104.7	108.2	111.7
Total liabilities	**245.2**	**292.8**	**325.1**	**350.8**	**371.4**	**390.1**
Net assets	**219.8**	**207.8**	**201.6**	**213.7**	**218.0**	**227.3**

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Financial assets include cash and deposits, advances paid, investments, loans and placements, receivables, and investments accounted for using the equity method.

(c) Non-financial assets include inventories, non-financial assets held for sale, land, buildings, infrastructure, plant and equipment, and other non-financial assets.

(d) Other liabilities consist of payables, employee benefits, contract liabilities and other provisions.

APPENDIX A – SENSITIVITY ANALYSIS

The *2023-24 Budget* relies on forecasts and judgements about the economic, operating and financial conditions for the Victorian general government sector. Uncertainty in these conditions, for example as a result of international developments and other risks to the national economy, may cause the actual results to differ from budget projections.

This sensitivity analysis explores the impacts of variations in the macroeconomic outlook on key fiscal aggregates of the general government sector using two alternative approaches.

The first approach quantifies the fiscal impacts of a scenario involving simultaneous variations in economic parameters that represent key risks to the economic outlook described in Chapter 2 *Economic context*. This scenario was selected to cover a plausible shock that could affect Victoria over the budget period, and the modelling takes account of linkages between key international, Australian and Victorian economic aggregates.

The modelled outcomes are intended to be used as a guide and care should be exercised in interpreting the results. In particular, economic shocks tend to be idiosyncratic in nature, with the modelled scenario unlikely to completely reflect any future shock that could occur. Departures from this scenario would likely result in different impacts on the budget. Furthermore, the modelled results of the shocks do not incorporate any policy responses to the shocks and their subsequent effects on the economic or fiscal outlook.

The second approach considers the fiscal impacts of independent variations in major macroeconomic parameters, holding constant all parameters other than the indicator of interest. This analysis may be useful for assessing the impact on fiscal aggregates of a forecast error in a single economic parameter. In practice, economic variations rarely occur in isolation, and scenario analysis is likely to be more appropriate to illustrate the fiscal impacts of an economic environment materially different from that presented in the budget papers.

FISCAL IMPACTS OF VARIATIONS TO THE ECONOMIC OUTLOOK

This scenario component of the sensitivity analysis quantifies a key risk identified in Chapter 2 *Economic context* and presents how this risk might affect the state's economic and fiscal aggregates.

The scenario considers a downturn in Victorian and Australian aggregate demand, partly due to uncertainty around the trajectory for interest rates and inflation. In the scenario, risk aversion and falling wealth are assumed to constrain discretionary consumption among households, leading to a higher savings rate. Downward pressure on consumer confidence and consumption also leads to lower utilisation of capital and lower business investment, relative to the base case outlined in Chapter 2 *Economic context*.

The economic impacts of the scenario have been modelled using VURMTAX, a computable general equilibrium model developed by the Centre of Policy Studies at Victoria University. The results of the scenario are analysed as a deviation from the 'business as usual' base case, which reflects the central economic forecasts outlined in Chapter 2 *Economic context*.

The changes in economic variables resulting from the modelled shocks are then mapped into estimated revenue and expenditure impacts using elasticities that describe the historical relationship between fiscal outcomes and major macroeconomic parameters in Table A.1.[1]

Scenario: A domestic economic slowdown

Consumer spending, both in Victoria and nationally, has remained resilient as the economic effects of the COVID-19 pandemic have unwound, supported by significant savings accumulated by households and businesses during the pandemic. The outlook for household spending is, however, uncertain. While households, in aggregate, are still adding to their savings, high inflation and rising interest rates have caused a decline in household wealth. As discussed in the risks section of Chapter 2 *Economic context*, declines in real incomes and asset prices, and an increase in risk aversion as higher interest rates cause economic growth and the labour market to soften, may weigh further on income growth and constrain household confidence.

Were this to transpire, households may increase their precautionary savings by further limiting their consumption on discretionary goods and services. This would result in a weaker outlook for consumer spending than in the base case. In this environment, business confidence and investment are also likely to be weaker, reflecting lower consumer demand for goods and services. This scenario explores the implications of lower national household and business confidence and spending, which disrupts both the Victorian and Australian economies.

[1] The Department of Treasury and Finance maintains a set of elasticities covering the relationships between major economic parameters and revenue and expenditure lines, including superannuation, and dividends and income tax equivalents from the public financial and non-financial corporations.

Lower consumer confidence leads consumers to increase precautionary savings, which weighs on their spending both in Victoria and nationally. In the scenario, household consumption falls by 0.64 per cent relative to the base case in 2023-24. A fall in business confidence also leads businesses to delay some investment. In the scenario, lower demand results in a reduction in capital utilisation among firms, which is modelled as a decline in the productivity of the capital stock. This lowers the incentive for businesses to invest. This, along with lower business confidence, results in a 0.68 per cent fall in Victorian investment relative to the base case in 2023-24.

In the scenario, the trade balance improves, as imports, which are influenced by the fall in domestic household consumption and investment, decline by more than exports, which are supported by foreign demand. This partly offsets the negative impacts on gross state product (GSP) of the falls in consumption and investment.

The shocks to household consumption and investment collectively reduce Victoria's GSP by 0.48 per cent in 2023-24, 0.35 per cent in 2024-25, 0.13 per cent in 2025-26 and by 0.12 per cent in 2026-27 compared with the base case. The peak economic impact occurs in 2023-24, when consumer and business confidence effects are assumed to have a significant role in lowering household consumption and business investment (see Chart A.1). Later in the forecast period, as these confidence effects dissipate, consumption and investment largely recover.

Government consumption is assumed to remain unchanged. In the scenario there is no further discretionary fiscal expenditure assumed to occur in response to the shock. In practice, governments and the Reserve Bank of Australia (RBA) may intervene to mitigate the shock's impacts.

Subdued domestic activity lowers the demand for labour, with employment 0.39 per cent lower than the base case in 2023-24. The unemployment rate is also 0.36 percentage points higher than in the base case, owing to the higher level of spare capacity in the labour market. This in turn places downward pressure on wages. Weaker domestic activity puts downward pressure on consumer prices in the near term, though this is partly offset by a weaker currency that leads to higher import prices.

Table A.1 summarises the economic effects of this shock.

Chart A.1: Scenario impact on select variables

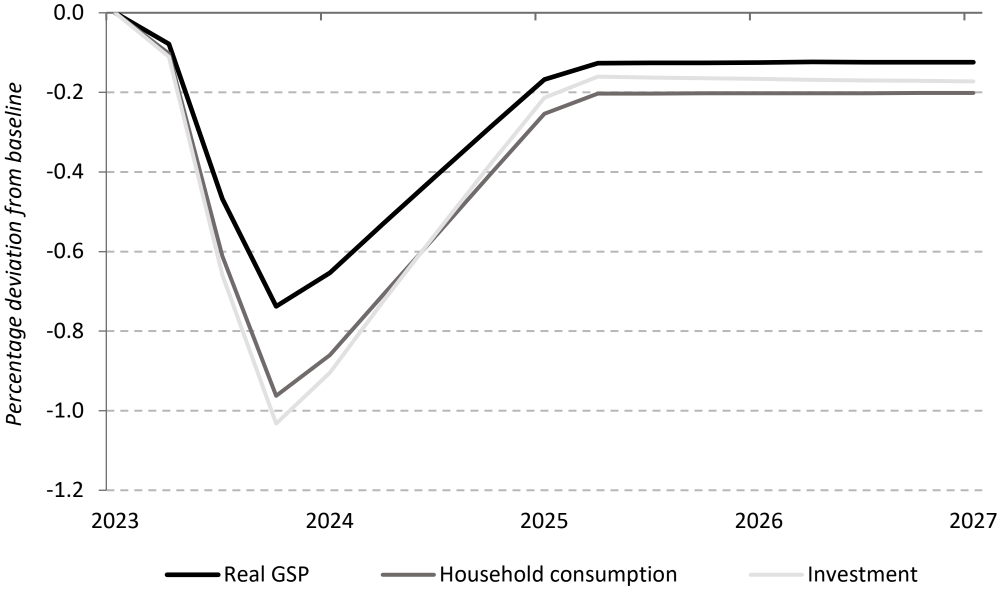


Table A.1: Projected economic impact of a domestic economic slowdown [(a)] (per cent)

	2023-24 estimate	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Real GSP	(0.48)	(0.35)	(0.13)	(0.12)
Employment	(0.39)	(0.23)	(0.03)	(0.03)
Consumer price index	(0.07)	(0.01)	0.03	0.03
Wage price index	(0.16)	(0.27)	(0.24)	(0.24)

Note:
(a) Figures reported are the change in the level of each parameter relative to the baseline forecasts as presented in Chapter 2 Economic context*.*

The shock has a negative fiscal impact on the state's finances (see Table A.2). Lower domestic consumer demand and investment lead to lower property related taxation revenue, including land transfer duty and land taxes. Payroll tax revenue also falls due to lower growth in employment and wages. Reduced consumption leads to a smaller national GST pool – and hence lower GST grant revenue for Victoria. As a result, income from transactions is lower over the forward estimates.

Expenses from transactions are also lower in the scenario relative to the base case, mainly due to lower public sector wage costs, which lowers employee expenses. These estimated impacts on expenses reflect the assumed relationship between private and public sector wages in the model: namely that public sector wage growth corresponds to private sector wage growth in the medium to long term. The decrease in expenses is partly offset by higher interest expenses due to a higher level of debt (resulting from revenue falling by more than expenses in the scenario).

Table A.2: Projected fiscal impact of a domestic economic slowdown [(a)] ($ million)

	2023-24 estimate	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
Income from transactions	(318.6)	(266.2)	(114.2)	(118.1)
Expenses from transactions	(14.8)	(33.6)	(44.4)	(49.5)
Net result from transactions	**(303.7)**	**(232.6)**	**(69.8)**	**(68.5)**
Other economic flows	(1.0)	(0.6)	0.1	0.1
Net result	**(304.8)**	**(233.2)**	**(69.7)**	**(68.5)**
Net debt (cumulative)	**304.8**	**537.9**	**607.6**	**676.1**
Net debt to GSP ratio (percentage point difference)	0.05	0.09	0.09	0.10

Note:
(a) Figures may not add due to rounding.

SENSITIVITY TO INDEPENDENT VARIATIONS IN MAJOR ECONOMIC PARAMETERS

Table A.3 presents the sensitivity of financial aggregates where the levels of key economic parameters are 1 per cent (or, for interest rates, 1 percentage point) above the forecast for each year of the budget and forward estimates, holding all else constant.

The impacts shown are broadly symmetric; that is, the estimated fiscal impacts would apply approximately equally in the opposite direction where there is a decrease in the parameter. Differences may arise to the extent that the impact on income tax equivalent income may not be symmetric because that line item is subject to a floor of zero, and the impact on dividends may be affected by some entities facing caps on the share of profits that can be returned to the general government sector.

Table A.3: Sensitivity of key fiscal aggregates to selected indicators being 1 per cent higher than expected from 2023-24 [(a)(b)(c)(d)(e)] **($ million)**

	2023-24 estimate	*2024-25 estimate*	*2025-26 estimate*	*2026-27 estimate*
GSP				
Income from transactions	135	148	157	159
Expenses from transactions	2	(5)	(12)	(21)
Net result from transactions	**134**	**153**	**169**	**180**
Net debt	**(134)**	**(286)**	**(455)**	**(635)**
Employment [(f)]				
Income from transactions	128	136	141	148
Expenses from transactions	357	374	397	423
Net result from transactions	**(230)**	**(238)**	**(256)**	**(276)**
Net debt	**230**	**468**	**724**	**999**
Consumer prices [(g)]				
Income from transactions	295	316	329	281
Expenses from transactions	266	251	250	255
Net result from transactions	**28**	**65**	**79**	**26**
Net debt	**(29)**	**(95)**	**(175)**	**(201)**
Average weekly earnings [(h)]				
Income from transactions	131	139	144	151
Expenses from transactions	3	(3)	(10)	(18)
Net result from transactions	**128**	**142**	**154**	**169**
Net debt	**(128)**	**(270)**	**(424)**	**(593)**
Total employee expenses				
Income from transactions	..	44	150	164
Expenses from transactions	360	382	407	434
Net result from transactions	**(360)**	**(338)**	**(257)**	**(270)**
Net debt	**360**	**698**	**956**	**1 226**
Domestic share prices [(i)]				
Income from transactions	..	0	1	2
Expenses from transactions	..	..	..	..
Net result from transactions	**..**	**0**	**1**	**2**
Net debt	**(7)**	**(19)**	**(33)**	**(50)**
Overseas share prices [(i)]				
Income from transactions	..	1	2	4
Expenses from transactions	..	..	..	..
Net result from transactions	**..**	**1**	**2**	**4**
Net debt	**(17)**	**(45)**	**(78)**	**(117)**
Property prices				
Income from transactions	185	197	211	224
Expenses from transactions	(4)	(13)	(23)	(36)
Net result from transactions	**189**	**210**	**234**	**260**
Net debt	**(193)**	**(407)**	**(647)**	**(911)**

	2023-24 estimate	2024-25 estimate	2025-26 estimate	2026-27 estimate
Property transaction volumes				
Income from transactions	71	78	85	90
Expenses from transactions	(1)	(5)	(9)	(14)
Net result from transactions	**72**	**82**	**94**	**104**
Net debt	**(72)**	**(155)**	**(248)**	**(352)**
Interest rates (j)				
Income from transactions	119	151	185	423
Expenses from transactions	306	727	982	1 243
Net result from transactions	**(187)**	**(576)**	**(797)**	**(819)**
Net debt	187	582	1 182	1 794

Notes:

(a) Variations are applied to the economic variables effective from the first day in the budget year (1 July 2023). It is assumed that each variable's growth rate matches that under a no-variation scenario for the forward estimates period. This implies that the level of all economic variables (other than interest rates) is 1 per cent higher in level terms in each year of the budget and forward estimates. Interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates.

(b) A positive number for income from transactions denotes an increase in revenue. A positive number for expenses from transactions denotes an increase in expenses (and hence a reduction in the net result from transactions). A positive number for the net result from transactions denotes a higher surplus or smaller deficit. A positive number for net debt denotes a higher level of net debt in the relevant year compared with a no-variation scenario.

(c) Only reasonably quantifiable impacts have been included in the analysis.

(d) Figures may not add due to rounding.

(e) Estimates of net debt are approximately equal to the cumulative impact of the net result from transactions. The difference between the cumulative net result from transactions and net debt is due to non-cash expenses.

(f) A shock to employment is assumed to impact payroll tax revenue. Both public and private sector employment levels are assumed to be 1 per cent higher across the four years, with the shares of full-time and part-time employment held constant; the rise in public sector employment increases general government sector employee expenses.

(g) Estimates assume that higher consumer prices flow through to government operating expenses, such as the purchase of supplies and consumables and the purchase of services. For simplicity, these estimates make no assumptions about agencies' administrative actions or government policy responses to mitigate the effects of higher inflation on aggregate spending. It is assumed an increase in consumer prices within the budget year does not affect employee entitlements.

(h) A positive shock to average weekly earnings increases the expenses of public financial and non-financial corporations and reduces the general government sector's income from dividends and ITEs.

(i) The smaller impact on the net result from transactions, compared with the impact on net debt, reflects that only the income component of the State's investment return (and not the capital gain) is recorded on the operating statement.

(j) Interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates. The fiscal impact is based on the portion of government debt that would change value due to being refinanced, as well as new debt issuance.

STYLE CONVENTIONS

Figures in the tables and in the text have been rounded. Discrepancies in tables between totals and sums of components reflect rounding. Percentage changes in all tables are based on the underlying unrounded amounts.

The notation used in the tables and charts is as follows:

n.a. or na	not available or not applicable
1 billion	1 000 million
1 basis point	0.01 per cent
..	zero, or rounded to zero
tbc	to be confirmed
ongoing	continuing output, program, project etc.
(x xxx.x)	negative amount
x xxx.0	rounded amount

Please refer to the **Treasury and Finance glossary for budget and financial reports** at dtf.vic.gov.au for additional terms and references.

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