

F. ECONOMIC SCENARIO ANALYSIS

The 2025-26 Budget relies on forecasts and judgements about the future of the economy, based on information available at the time of preparation. These forecasts are subject to inherent uncertainties, such as changes in behaviours, evolving relationships between variables, and unexpected events or shocks.

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

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

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

F.1 Impact of variations in key forecast assumptions

The economic impact of the scenarios below was modelled using the Centre of Policy Studies (CoPS) Victoria University Regional Model Tax (VURMTAX-GREEN)¹ and is presented as deviations from baseline forecasts. Revenue impacts use a combination of VURMTAX-GREEN and internal NSW Treasury estimates.

Scenario 1: Global conditions lead to a 100 basis point fall in the cost of capital

Business investment is a crucial source of economic growth and prosperity. When businesses invest, they spend money on capital goods like new machinery, buildings, technology and research and development. This spending advances the productive capacity of the economy and directly creates jobs in sectors like construction and manufacturing.

The cost of capital plays an important role in determining the amount of investment that is undertaken within an economy. The cost of capital represents the minimum rate of return (or hurdle rate) that a business or investor needs to earn in order to both cover the cost of financing and justify undertaking an investment.

¹ VURMTAX is a dynamic computable general equilibrium model of Australia's six states and two territories, with each region modelled as an economy in its own right. See Adams, Philip, Dixon, Janine and Horridge, Mark (2015), 'The Victoria University Regional Model (VURM): Technical Documentation, Version 1.0', CoPS/IMPACT Working Paper Number G-254 for more detail on the model.

In this scenario, it is assumed that an event occurs which causes the cost of capital to fall by a combined 100 basis points over two years, which is gradually unwound over the following years. In the current global environment, one potential, plausible event could stem from the impact of higher tariffs on the United States (US) economy. For example, modelling of the impacts of US tariffs undertaken by Giesecke and Waschik (2025)² indicated that a contraction in US real investment could reduce global demand for financial capital, thereby creating an excess of global savings which would lower required rates of return. A similar outcome could occur if current elevated levels of policy uncertainty in the US negatively impact the 'safe haven' status of the US economy, prompting foreign capital to seek out alternatives.

This could see an increase in financial capital flowing to Australia, thereby lowering the cost of capital.

Impact on the NSW macroeconomy

A lower cost of capital in Australia makes investment more attractive, increasing real investment in New South Wales by almost 5.0 per cent relative to the baseline after two years.

While higher investment involves the deployment of capital, it also increases employment to support that investment. The resulting increase in household incomes in turn helps boost household consumption. In the longer run, the additional capital accumulation leads to slower rates of additional investment, which starts unwinding the short-term impacts on economic activity.

Higher domestic demand increases imports and the current account deficit. Meanwhile an influx of foreign capital and higher wages puts upward pressure on the real exchange rate, weakening international competitiveness and exports, contributing further to the current account deficit.

The positive impact from higher consumption and investment in this scenario is relatively large in the near-term, although the overall impact on gross state product (GSP) is muted somewhat by weaker net exports. Real GSP rises above baseline in 2025-26 and then increases further in 2026-27.

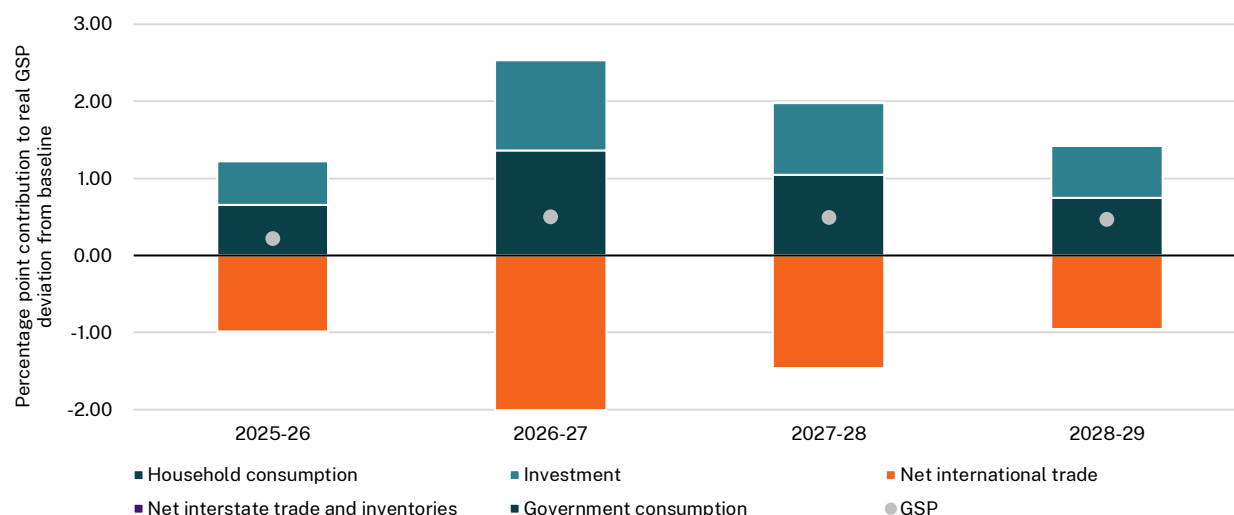
Table F.1: Effect on major NSW economic parameters from a lower cost of capital^(a)

Financial year estimate ^(a)	2025-26	2026-27	2027-28	2028-29
State final demand	1.3	2.6	2.0	1.5
Gross state product	0.2	0.5	0.5	0.5
Employment	0.2	0.4	0.3	0.2
Unemployment rate	(0.3)	(0.6)	(0.3)	(0.2)
Consumer price index (Sydney)	0.1	0.3	0.3	0.2
Household Disposable Income	1.3	2.9	2.2	1.6
Productivity	0.0	0.1	0.2	0.3

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

Source: Victoria University Regional Model and NSW Treasury

² Giesecke, J., & Waschik, R. (2025). *Economic Analysis of U.S. Tariffs Announced in March-April 2025 (Updated to reflect reciprocal tariff pause and increased China tariffs)*. Centre of Policy Studies Working Paper No. G-353, Victoria University. Retrieved from <https://www.copsmodels.com/ftp/workpaper/g-353.pdf>

Chart F.1: Impact on NSW domestic activity from a lower cost of capital

Source: Victoria University Regional Model and NSW Treasury

The additional capital accumulation prompts a gradual lift in labour productivity, which along with the stronger Australian dollar (AUD), helps to keep inflation pressures somewhat contained in the face of much stronger domestic demand and a tighter labour market. However, the level of prices still rises above the baseline scenario where the cost of capital is unchanged.

Revenue impact on the Budget and over the forward estimates

Under this scenario, stronger domestic economic activity flows through to higher tax collections across most categories of government revenue. Payroll tax is supported by a boost in employment in the medium-term. Stronger property prices contribute to increases to transfer duty and land tax revenue. The State's GST revenue also increases, bolstered by robust consumer spending and dwelling investment. Royalties revenue is down over the forward estimates due to a stronger AUD/USD exchange rate.

Table F.2: Effect on major revenue parameters^(a)

Financial year estimate ^(a)	2025-26 \$m	2026-27 \$m	2027-28 \$m	2028-29 \$m
Payroll tax	27	108	146	170
Transfer duty	187	410	322	235
Land tax	0	51	164	247
Royalties	(71)	(135)	(93)	(54)
GST revenue	277	603	464	341
Total revenue	420	1,037	1,003	939

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

Source: VURMTAX-GREEN model and NSW Treasury

Scenario 2: A positive shock to real wages in New South Wales

Real wage growth is fundamentally important for improving living standards and overall economic well-being. By increasing the purchasing power of workers, rising real wages allows households to purchase more goods and services and increase savings. When real wages grow sustainably, it can lead to job creation without contributing to inflationary pressures elsewhere in the economy.

However, for the economy as a whole, higher real wages can only be paid out of higher aggregate output. Thus, long-run real wage growth is tied to the growth of labour productivity.

In this scenario, we assume an unexpected increase in real wages in New South Wales which is not met with a commensurate increase in productivity. Specifically, real wages for all workers are assumed to increase permanently by 1.0 per cent relative to baseline. Real wages in other states are unchanged.

Impact on the macroeconomy

Under this scenario, the model predicts that productivity rises by a quarter percentage point relative to baseline (less than real wages), raising unit labour costs. The small positive impact on productivity reflects a shift in firms' preferences towards capital as labour becomes relatively more expensive, increasing capital deepening (a component of labour productivity).

The increase in real wages relative to productivity increases the cost of labour to businesses in New South Wales. In response, businesses reduce their demand for labour, which leaves employment around 0.5 per cent lower over the forecast years.

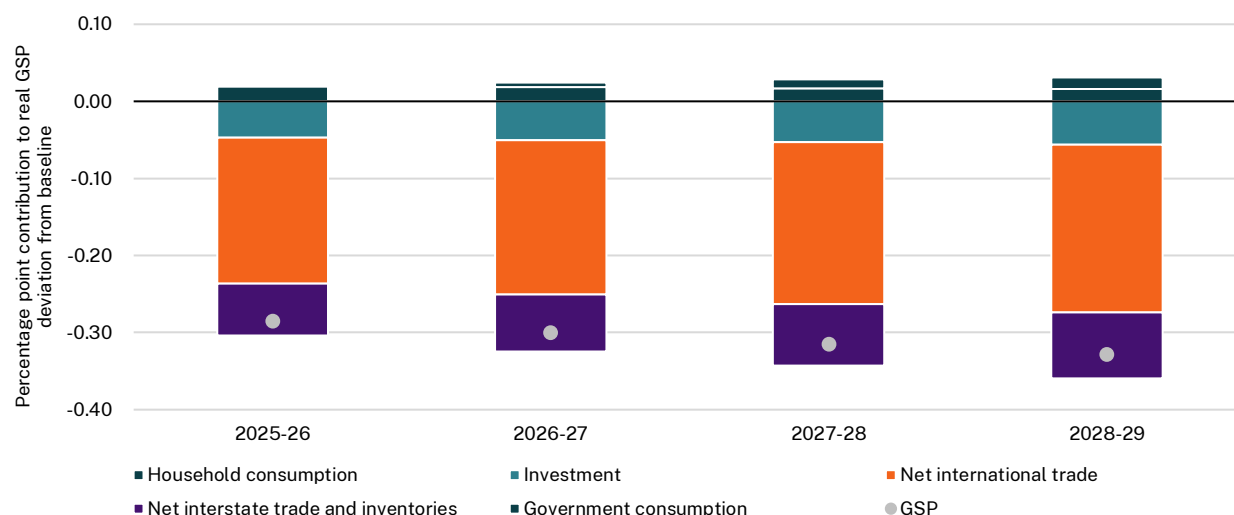
Businesses may also pass on the additional cost, with CPI inflation up by around 0.5 per cent relative to baseline. Although an increase in real wages might have been expected to lift household consumption (as discussed above), the net effect when accounting for factors such as lower employment, leaves real household consumption broadly unchanged. The net impact on state final demand is relatively muted. However, there are larger impacts on GSP as a real exchange rate appreciation weighs on net exports.

Table F.3: *Effect on major NSW economic parameters from real wage shock^(a)*

Financial year estimate ^(a)	2025-26	2026-27	2027-28	2028-29
State final demand	(0.0)	(0.0)	(0.0)	(0.0)
Gross state product	(0.3)	(0.3)	(0.3)	(0.3)
Employment	(0.5)	(0.6)	(0.6)	(0.6)
Unemployment rate	0.7	0.7	0.7	0.8
Consumer price index (Sydney)	0.5	0.5	0.5	0.4
Household Disposable Income	0.5	0.5	0.5	0.5
Productivity	0.3	0.3	0.2	0.2

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

Source: Victoria University Regional Model and NSW Treasury

Chart F.2: Impact on NSW domestic activity from a real wage shock

Source: Victoria University Regional Model and NSW Treasury

Revenue impact on the Budget and over the forward estimates

Despite the economic effects, this scenario results in a modest increase in tax collections for the Government across several categories of government revenue. An increase in labour income over the forecast horizon, as higher nominal wages offset lower employment, leads to additional payroll tax collections. Residential and commercial transfer duty collections are marginally higher, with broader inflationary pressures increasing nominal housing prices, offset by weaker demand due to lower employment. Coal royalties fall, consistent with lower exports. The State's GST revenue increases very slightly, reflecting a marginal increase in the NSW population share.

Table F.4: Effect on major revenue parameters^(a)

Financial year estimate ^(a)	2025-26 \$m	2026-27 \$m	2027-28 \$m	2028-29 \$m
Payroll tax	153	158	164	169
Transfer duty	16	12	7	1
Land tax	0	7	22	32
Royalties	(3)	(5)	(7)	(9)
GST revenue	1	6	11	14
Total revenue	167	178	197	207

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

Source: VURMTAX-GREEN model and NSW Treasury