PARLIAMENTARY RESEARCH BRIEF
A Research note from the Institute of Public Affairs distributed to all Australian parliamentarians

# HOW FEDERAL GOVERNMENT SPENDING INTENSIFIES THE COST OF LIVING CRISIS

Australian families are facing acute and immediate cost of living pressures, due to rapidly rising inflation, energy costs, and rising mortgage repayments. A key cause of rising inflation is debt and deficit government spending.

## Rising government spending will cause a $3,088 annual mortgage repayment hike

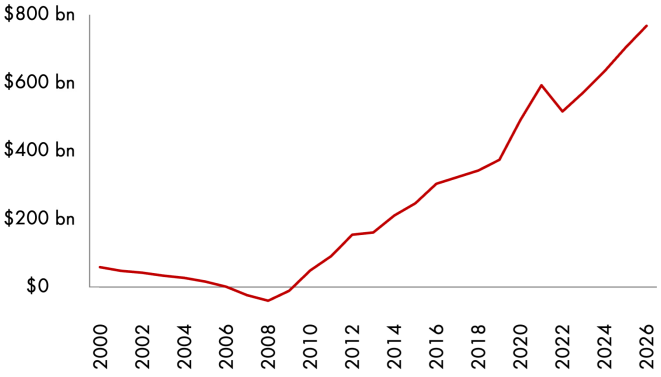
New IPA research examines the relationship between government spending, inflation, and mortgage repayment rates. The key findings are:

- Average annual federal government spending is expected to increase by 4.6% between 2023 and 2026. This equates to contributing to 1.62 percentage points higher inflation every year.
- A 1.62 percentage point increase in inflation will result in household variable mortgage interest rates rising by 0.67 percentage points.
- For households, a 0.67 percentage point increase in the mortgage repayment rate will have an estimated effect of raising monthly mortgage repayments by $257, or $3,088 per year.[1]

## Historically high federal government spending causes inflationary pressures

Federal spending is currently close to a record high, and gross government debt is currently on track to increase from $1 trillion this year to $1.455 trillion by 2030.[2]

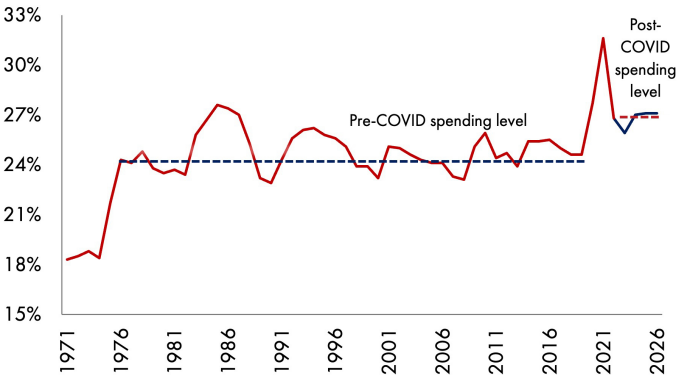
### Chart 1: Federal government net debt




Source: Federal Budget, October 2022

Government spending will be locked in at 27% of GDP through to 2025-26. These spending levels are in part a consequence of the government response to the covid-19 pandemic, when spending increased from $478.1 billion to $616.3 billion between the 2019 and 2022 financial years.[3]

### Chart 2: Federal government spending as a % of Australian GDP




Source: Federal Budget, October 2022

Inflation occurs when government runs persistently high deficits and incurs excessive government debt. According to Hoover Institution economist John Cochrane, a public that expects the government will not pay back its debts will act in ways that drive up inflation now, not in the future. The debt is in effect paid off by devaluing the debt itself, that is, through inflation. This is known as the Fiscal Theory of the Price Level.[4]

## Historically high inflation is punishing Australian families

Recently, inflation in Australia has been at its highest since the inflation target band of 2% to 3% was first established in 1993. By the end of 2022, inflation was at 7.8%. As of March 2023, it remains at 7.0%.[5]

The Reserve Bank of Australia has raised the cash rate target on ten consecutive occasions between May 2022 and March 2023, with a further cash rate target rise at the May 2023 RBA Board Meeting taking it to 3.85%.[6]

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The RBA's actions have caused market interest rates to increase, meaning higher interest rates on overdraft facilities, credit cards, personal loans, and home loans, which have a real and growing impact on family budgets.

## Higher government spending means families pay more on their mortgage repayments

The IPA analysis calculates the association between growth in annual government spending and the relative level of mortgage interest rates on a typical, 30-year variable rate, $600,000 loan, which is approximately the average size for owner-occupier homes.[7]

The analysis finds that a 1% annual increase in federal government spending is associated with a 0.15 percentage point increase in household mortgage rates. For families, this means:

- Between 2020 and 2022, federal government spending increased by 9.6% per year on average. This is associated with a 1.41 percentage point increase in the typical monthly household mortgage rate.

  In dollar terms, this means families paid an extra $554 on the typical monthly mortgage repayment, or $6,643 per year.
- Between 2023 and 2026, federal government spending is protected to increase by 4.6% per year on average. This is associated with a 0.67 percentage point increase in the typical monthly mortgage repayment.

  In dollar terms, this means families will pay an extra $257 on the typical monthly mortgage repayment, or $3,088 per year.

## Australians will pay an extra $10 billion each year in mortgage repayments because of additional government spending

According to the ABS there were approximately 3.2 million households in Australia covered by a mortgage in 2021.[8]

- Multiplying the $6,643 annual increase in mortgage repayments between 2020 and 2022 by the number of these households reveals Australian homeowners paid an estimated extra $21.54 billion more in interest repayments annually because of higher government spending.
- A $3,088 annual increase in mortgage repayments between 2023 and 2026 means Australian homeowners will pay an estimated extra $10.01 billion more in interest repayments annually because of additional government spending.

Australian governments must exercise responsible economic leadership by means of a renewed commitment to fiscal discipline. The federal government must tackle inflation and address the cost of living crisis by cutting spending, eliminating deficits, and reducing debt. This should be done with a view to returning to the zero net government debt level that Australia achieved between 2006 and 2009.

### End Notes

1 Morgan Begg and Kevin You, *Australia's Spending Crisis: Estimating the Effect of Federal Government Spending on Household Mortgage Repayments* (Institute of Public Affairs, 2023).

2 Kevin You and Daniel Wild, *Australia's Debt Disaster: Estimating Repayment Rates on Federal Government Debt by 2030* (Institute of Public Affairs, 2022).

3 Commonwealth Government *Budget Strategy and Outlook: Budget Paper No.1* (October 2022).

4 See John Cochrane, *The Fiscal Theory of the Price Level* (Princeton University Press, 2023); summarised in Begg and You (2023).

5 Australian Bureau of Statistics, 'Consumer Price Index, Australia' (2023): https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release.

6 Reserve Bank of Australia, 'Statement by Philip Lowe, Governor: Monetary Policy Decision' (Media Release No 2023-10, 2 May 2023).

7 ABS, 'Lending Indicators' (January 2020): https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release

8 ABS, '2021 Census All persons QuickStats': https://abs.gov.au/census/find-census-data/quickstats/2021/AUS.

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