RECOMMENDATIONS OF THE TREASURY FORECASTING REVIEW

The Review has made a number of recommendations, outlined below, to improve Treasury's forecasting methodology and process, while noting, as context, the need to ensure that resources are appropriately prioritised across the Department.

Recommendation 1: Given the importance of information on economic conditions obtained from business liaison — and the capacity of this source to inform the forecasts — Treasury should investigate with the Reserve Bank of Australia more formal channels through which to exchange insights from their respective programs, such as during the quarterly joint forecasting rounds (without compromising the confidentiality of liaison contacts). Similarly, Treasury should also investigate whether further information can be drawn from the Australian Taxation Office's liaison with large corporate taxpayers for revenue forecasting purposes.

Recommendation 2: A detailed assessment of the role, and appropriate type, of Treasury's macro econometric model was beyond the scope of this Review. However, the Review believes it is important to embed the redeveloped TRYM model into the economic forecasting process, both as a complement to the existing forecasting framework and to facilitate analysis of the impact of shocks to the domestic economy.

Recommendation 3: Treasury should examine the feasibility of constructing a micro simulation model for forecasting personal income tax, as is the practice in the United States and United Kingdom.

Recommendation 4: Treasury should publish technical documentation that describes the data and the conceptual and econometric basis of models used for economic and revenue forecasting. A number of official agencies overseas have published technical documentation of their forecasting models.

Recommendation 5: Treasury should include in the Budget papers a high level review of the economic forecast errors (nominal and real GDP) for the previous financial year, as a complement to the existing discussion of revenue forecasting errors.

Recommendation 6: Reviews of Treasury's forecasting performance should be undertaken at least every five years to examine the causes of forecast errors and to help identify areas in which Treasury's forecasting methodology could be improved. These Reviews should be overseen by an independent external reference group.

Recommendation 7: Treasury should invest relatively more resources in understanding and forecasting GDP deflator growth and its components, in particular, commodity prices, and hence in nominal GDP growth.

Recommendation 8: Scenario analysis is useful as a way of assessing the risks around the economic and revenue forecasts. Simulation models have an important role to play in this regard and further development of Treasury's suite of models may be required to deliver this capability, including in relation to the international economic outlook.

Recommendation 9: Treasury should give further consideration to the appropriate balance between the top-down versus bottom-up approaches to forecasting revenue.

Recommendation 10: Treasury, in conjunction with the ABS as necessary, should explore further ways of improving the current methodology for forecasting corporate tax, and also consider alternatives to the current methodology, which could perhaps be used to complement existing approaches.

Recommendation 11: The technical specialist with deep financial market experience employed by Treasury should be tasked with improving the accuracy of the technical assumptions for equity and housing prices that are used to generate the capital gains tax revenue forecasts.