



Australian Budget 2014

Deficit of \$29.8bn, 1.8% of GDP in 2014/15

Deficit to narrow.

Overview

The Government forecasts that the budget deficit will narrow from 3.1% of GDP in 2013/14 to 0.2% of GDP in 2017/18. Revenues are projected to rise by 1.9% of GDP over four years, as expenses decline by 1.1% of GDP. Arguably the improvement in the budget over the four years strikes the right balance between the impact of fiscal consolidation on the economy and sustainable structural reforms. The annual pace of consolidation is 0.6% of GDP, after abstracting from a one-off payment to the RBA in 2013/14.

From higher starting point.

The likely deficit for the current financial year is \$49.9bn, 3.1% of GDP. That exceeds the forecast in the December Mid-Year Economic & Fiscal Outlook (MYEFO) by a small margin of \$2.9bn. Receipts have surprised to the downside by \$1.4bn, payments have surprised to the upside by \$1.1bn and new policies added around \$0.5bn to spending.

Receipts to build.

The deficit moderates to \$29.8bn, 1.8% of GDP, in 2014/15, a \$4.1bn improvement on the MYEFO forecast, in part due to an upside surprise on receipts of \$2.4bn. The deficit improves to \$17.1bn in 2015/16, to \$10.6bn in 2016/17 and then shrinks to \$2.8bn in 2017/18.

Savings broad in scope.

Net new savings measures in 2014/15 are modest at \$1.7bn. Savings measures become more significant in the following years, totalling: \$5.9bn (0.4% of GDP) in 2015/16; and \$10.4bn (0.6% of GDP) in 2016/17. Savings over the three years to 2016/17 total \$18bn (1.0% of GDP), with measures on the outlays side accounting for 70% of the total. The budget documents advise that there are further savings of \$18.5bn in 2017/18. The Government's savings are widespread in their scope, including measures that impact: payments to households; industry assistance; payments to the states; the size and scope of government agencies; as well as measures on the revenue side. See below for more detail on key measures and their budgetary impact across the forward years.

Surplus in sight, in medium term.

The Government sets out a medium-term strategy, with a key guiding principle to build towards a surplus of 1% of GDP by 2023/24. The budget report notes that the budget is projected to be at balance in 2018/19 and in a strong surplus of 1.4% of GDP in 2024/25. This figuring assumes that taxes are not allowed to grow beyond the average of 23.9% of GDP.

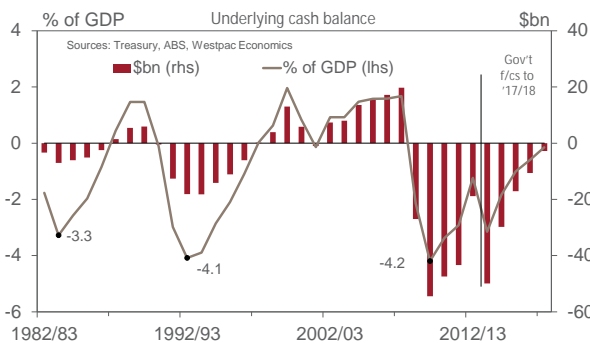
Upside risks for economic projections.

The economic forecasts underpinning the fiscal projections appear to be credible. That said, we see the risks skewed to the upside in the 2014/15 year. Nominal GDP is forecast to expand by 4.0% in 2013/14, but growth slows to a sluggish 3.0% in 2014/15 as the terms of trade declines by a forecast 6.75%. Nominal GDP growth improves to 4.75% in 2015/16, a still modest pace by historical standards, then lifts to 5.0% in the years of 2016/17 and 2017/18. See below for a discussion of the economic outlook.

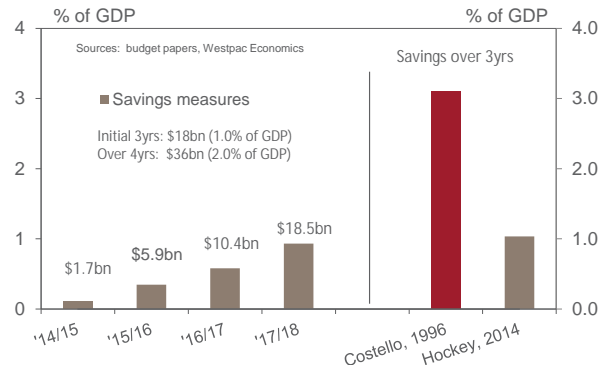
Debt very manageable.

The Commonwealth Government's net debt position remains extremely manageable. Net debt is forecast to rise from 10.0% of GDP in 2012/13 to 14.6% of GDP in 2016/17; it then narrows to 14.0% of GDP in 2017/18. In dollar terms, net debt rises from \$153bn in 2012/13 to \$261bn in 2016/17, with the 2016/17 forecast some \$19bn lower than in MYEFO. The stock of Commonwealth Government Securities on issue at June 2014 is expected to be \$320bn (some \$10bn higher than anticipated in MYEFO), rising to a forecast \$360bn by June 2015 (unchanged from MYEFO) and then to \$430bn by June 2017 (also unchanged from MYEFO).

Federal budget: \$29.8bn deficit in 2014/15



Savings measures: Budget 2014



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Budget 2014 – key numbers

	2012/13(a)	2013/14	2014/15	2015/16	2016/17	2017/18
GDP	2.6	2.75	2.50	3.00	3.50	3.50
Nominal GDP	2.5	4.00	3.00	4.75	5.00	5.00
Unemployment (Jun qtr)	5.6	6.00	6.25	6.25	6.00	5.75
Cash balance, \$bn *	-18.8	-49.9	-29.8	-17.1	-10.6	-2.8
% of GDP	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2
Revenue, % GDP	23.1	23.0	23.6	24.0	24.4	24.9
Expenses, % GDP	24.1	25.9	25.3	24.8	24.7	24.8
% chg, real #	-3.2	8.9	-1.7	0.4	2.1	2.6
Net debt, \$bn	153.0	197.9	226.4	246.4	261.3	264.2
% of GDP	10.0	12.5	13.9	14.4	14.6	14.0

* Underlying cash balance; # deflated by CPI

Sources: ABS, Budget papers, Westpac Economics

Major policy initiatives in Budget 2014

AUDbn	'14/15	4 yrs	Comment
Savings measures			
Foreign Aid	1.2	7.6	Freeze on nominal outlays for two years, then CPI indexation.
Medicare	0.3	6.4	\$7 co-payment for 70% of existing services (eg GP visits, pathology, imaging).
Education	0.8	6.6	Higher Ed instit to set own fees from Jan 1 2016, new indexation for schools.
Welfare	0.8	8.5	Freezing of indexation eligibility thresholds, reduced eligibility for FTB-B (income from \$150k to \$100k, no kids >6), Work for the Dole after 6mths job search.
Pensions & seniors	0.5	3.5	Indexing pension to CPI, not wages, pension age to 67 in '23 and 70 in '35.
Hospitals	0.2	1.8	Removing of funding guarantees, lower State grants, new indexation method.
Other	0.1	1.4	Local Govt Assistance index'n freeze, Efficiency Dividend, Indigenous Affairs.
Total	3.9	35.7	
memo			
Public service job losses	n/a	16,500	Claims 14,500 are a holdover from the previous Government.
Revenue measures			
Temporary budget repair levy	0.6	3.1	2% levy imposed on those whose taxable income is \$180,000 or above.
Fuel excise indexation	0.2	2.2	To be reintroduced from 1 August 2014.
Tax offsets abolished	0.0	1.1	Mature age and dependent spouse offsets to be abolished.
Reduced R&D tax incentive	0.1	0.6	Reducing the rates of refundable and non-refundable tax offsets.
Total	0.8	6.6	
Spending measures			
Infrastructure	1.6	10.1	State asset recycling initiative; road & rail bottlenecks; and Western Sydney.
Emissions reduction fund	0.1	1.1	To fund direct action to reduce carbon emissions.
Higher education reform	0.0	0.7	Financial support for those studying diplomas and other sub-bachelor courses.
Korean Free Trade Agreement	0.1	0.6	Hoped to provide boost for many Australian industries.
Medical Research Future Fund	0.0	0.3	Expected to grow to \$20bn by 2020; provide \$1bn per year from 2022/23.
Total	2.4	16.0	

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Economic outlook

Growth to remain sub-trend ...

... at 2.5% in 2014/15 ...

... with sustained softness in nominal GDP growth ...

... as mining investment and terms of trade continue to decline.

Global backdrop has improved ...

... and household demand firmer ...

... but prospects for business investment weak.

A conservative view on external conditions?

The economy

The Government expects the Australian economy to continue growing at a below trend pace in 2014/15 returning to near trend growth in 2015/16 but with continued pressure on incomes as further commodity price declines weigh on Australia's terms of trade. The outlook for real growth is unchanged from December's MYEFO but the near term forecast for nominal income has been downgraded.

Real GDP growth is forecast to hold at 2½% in 2014/15, rising to 3% in 2015/16. Both figures are unchanged from the MYEFO. However the composition has shifted a little with an improved outlook for private consumption and dwelling investment offset by weaker business investment and a smaller net export contribution to GDP growth.

The sustained softness in nominal income growth that has emerged over the past 2yrs is expected to continue. Nominal GDP growth is forecast to recover only marginally, from 2.5% in 2012/13 to 4% in 2013-14, easing back to 3% in 2014/15. It has averaged 6½% over the last 20yrs. A further substantial decline in Australia's terms of trade is central to that view with a further 6¾% fall forecast for 2014/15. Domestic price pressures are also expected to remain weak: CPI inflation is expected to hold at 2¼% in 2014/15 with the broader 'gross non-farm product deflator' measure of economy-wide inflation up just ½%.

The themes to the outlook are familiar with the economy moving from a mining-led expansion to growth driven by non-mining sectors. Falling mining investment and a declining terms of trade are key drags through the transition that are expected to persist until at least 2015/16.

The international backdrop is seen as having gradually improved since 2013 and risks are viewed as more balanced but still weighed to the downside. Global growth is forecast to lift from 3% in 2013 to 3½% in 2014 and 3¾% in 2015, led by an improved performance in the advanced economies. Growth across Australia's major trading partners is expected to be 4¾% reflecting the higher exposure to fast-growing economies in Asia, although at 7¼%, growth in China is expected to be slow by its standards.

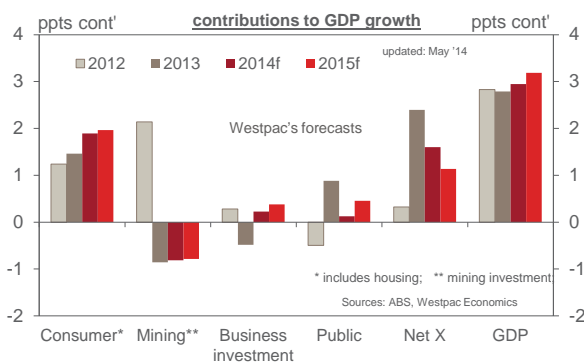
Domestically, the household sector is showing a clearer response to low interest rates. Forecasts for growth in consumer spending (2½% in 2013/14 and 3% in 2014/15) and dwelling investment (3½% in 2013/14 and 7½% in 2014/15) have both been revised up from the MYEFO. Rising household wealth is expected to support demand in the face of constrained income growth – the unemployment rate is expected to edge up to 6¼% by June 2015 and wages growth is forecast to remain subdued at 3%yr.

Business investment is forecast to decline as falling investment in the resources sector (new engineering construction down 13% in 2014/15 and a further 20½% in 2015-16) combines with subdued investment in other sectors. The latter is expected to show more of a pick-up in 2015/16 but is a major source of uncertainty.

Australia's external performance is set to improve. Exports are forecast to rise 5½%yr led by 8% growth in non-rural commodity exports. Net exports are expected to add 1¾ppt, 1ppt and 1¼ppt to growth in 2013/14, 2014/15 and 2015/16.

Overall the Government's forecasts for domestic demand are in line with our own. However, we are more positive on the external contributions to both real and nominal growth in 2014/15 with a stronger net export contribution to real GDP growth and stabilising terms of trade reducing this drag on incomes.

Australian growth – moving above trend in 2016



Government & Westpac forecasts: 2014/15

	Government	Westpac
World GDP (2015)	3.75%	3.7%
Aust GDP	2.50%	3.0%
Consumption	3.00%	3.0%
Housing	7.50%	7.0%
Investment	-5.50%	-4.0%
Exports	5.50%	7.5%
Unemployment	6.25%	6.1%

Sources: RBA, Bloomberg, Westpac Economics

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Forecasts: the Government & Westpac

	Actual		Government (yr average)		Westpac (yr average)	
	2011/12(a)	2012/13(a)	2013/14	2014/15	2013/14	2014/15
Private consumption	2.5	2.0	2½	3	2.6	3.0
Dwelling investment	-2.2	-0.1	3½	7½	2.5	7.0
Business investment*	22.3	6.1	-4	-5½	-4.0	-4.0
Private demand*	6.0	2.8	1¼	1½	1.2	2.6
Government*	2.1	-1.4	1¾	1½	-1.8	1.4
Final demand	5.1	1.9	1½	1½	1.3	1.6
Stock contribution ppts	0.1	-0.3	-¼	¼	-0.3	0.2
GNE	5.0	1.6	1¼	1¾	1.0	1.8
Exports	4.7	6.0	5½	5½	6.7	7.5
Imports	11.4	0.5	-3	2	-3.5	1.5
Net exports contribution ppts	-1.3	1.2	1¾	1	2.2	1.4
GDP	3.6	2.6	2¾	2½	2.8	3.0
Nominal GDP	5.6	2.5	4	3	4.5	5.0
Employment (Jun qtr)	1.3	1.2	¾	1½	1.0	1.4
Unemployment rate (Jun qtr)	5.1	5.6	6	6¼	5.8	6.1
Participation rate (Jun qtr)	65.2	65.1	64¾	64½	64.7	64.7
CPI (Jun qtr)	1.2	2.4	3¼	2¼	3.1	2.3
WPI (Jun qtr)	3.8	2.9	2¾	3	2.6	3.0
Terms of trade	0.5	-9.8	-5	-6¾	-3.0	0.0
Current account, % of GDP	-3.2	-3.7	-3¼	-4	-2.5	-2.0

* business investment and government spending excluding the effect of private sector purchases of public sector assets.

	2013(a)	2014	2015	2013(a)	2014	2015
World growth	3.0	3½	3¾	3.0	3.1	3.7

Macroeconomic variables – recent history

Monthly data	2013							2014			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Employment '000	14.3	-6.5	-7.0	3.7	5.5	15.6	-23.5	21.0	49.3	22.0	14.2
Unemployment rate %	5.7	5.7	5.8	5.7	5.8	5.8	5.9	6.0	6.0	5.8	5.8
Westpac-MI Consumer Sentiment	102.2	102.1	105.7	110.6	108.3	110.3	105.0	103.3	100.2	99.5	99.7
Retail trade %mth	0.2	0.2	0.5	1.1	0.4	0.7	0.7	1.1	0.3	0.1	-
Dwelling approvals %mth	-5.4	9.5	-0.4	16.1	-1.8	-0.7	-1.3	6.9	-5.4	-3.5	-
Private sector credit %ann	3.0	3.2	3.3	3.3	3.4	3.7	3.8	4.1	4.3	4.4	-
Trade balance AUDbn	-0.67	-1.71	-0.87	-0.76	-0.74	-0.35	0.01	1.12	1.26	0.73	-

Budget trends

Chart 1.

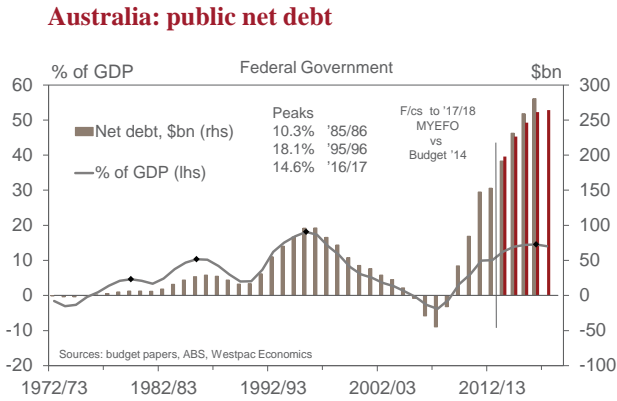


Chart 2.

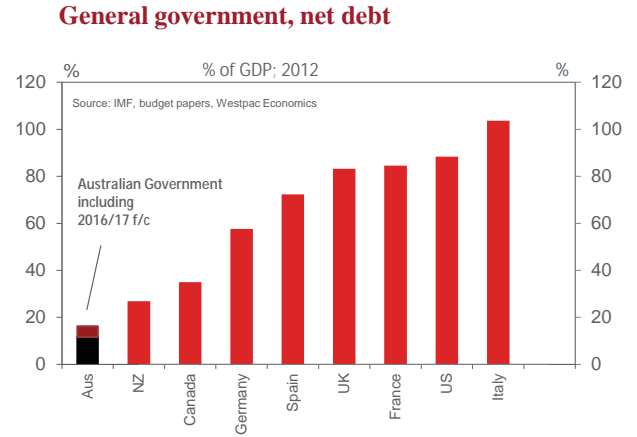


Chart 3.

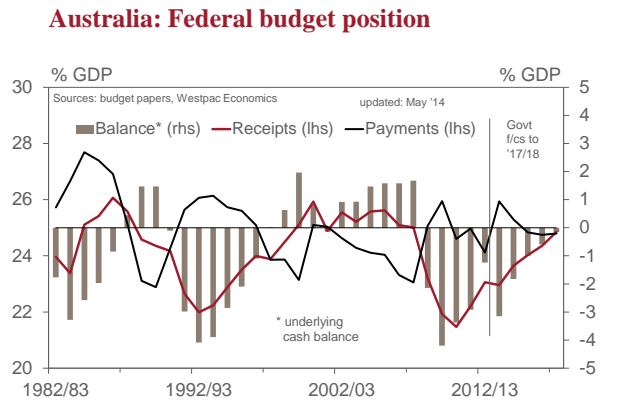


Chart 4.

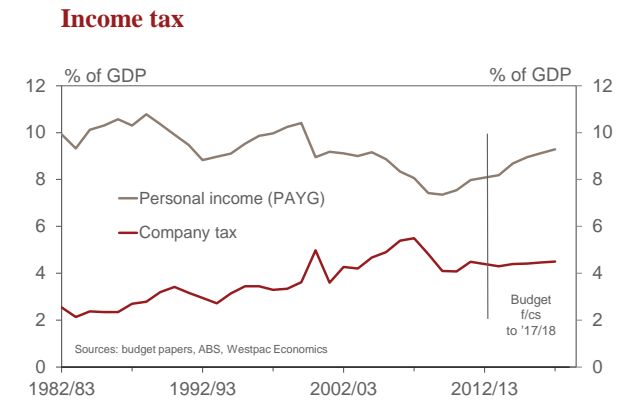


Chart 5.

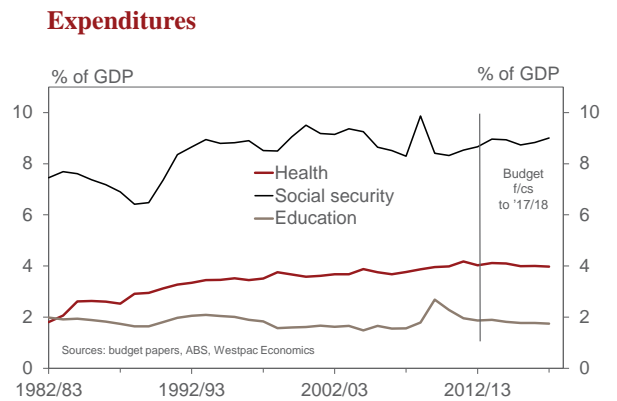
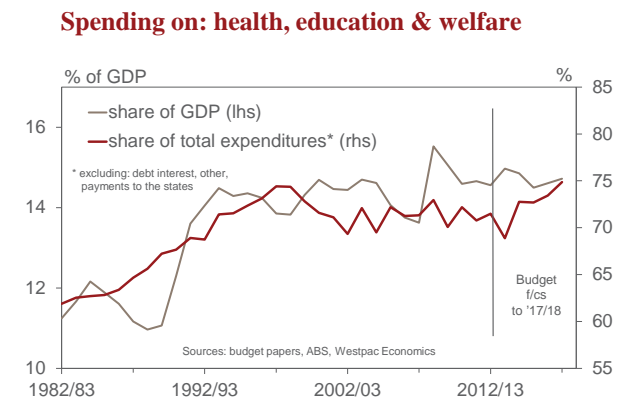


Chart 6.



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