Tuesday, 12 May 2015

Federal Budget 2015-16

First Thoughts: A Budget of Rapid Repair?

- Tonight's Budget aims for a deficit in 2015-16 of $35.1bn. This compares with an expected deficit in 2014-15 of $41.1bn. This is not an 'all stops' Budget of rapid repair for good economic and political reasons. But it is a move in the right direction, provided the numbers can be delivered.
- In last year's Budget the government expected a deficit in 2014-15 of $29.8bn. That was revised upward at the Mid-year Review to $40.4bn and now is expected to be $41.1bn. It was not a good year for collecting revenue. Growth in wages and company profits was softer than expected and commodity prices fell sharply.
- So when does the Budget return to surplus? Not until after 2020. In last year's Budget, a result close to surplus was projected for 2017-18. The deficit for 2017-18 is now projected to be $14.4bn. Times have changed and so has the Budget.
- Can we believe the figures? Budget estimates and projections rely on assumptions about the economy and the passage of measures through the parliament. Last year's Budget – which attempted rapid reform, tripped at several hurdles. Economic forecasts were not hit and budgeted savings did not all pass through the parliament. Most that were not passed have now been cancelled, hence the slightly longer path to surplus. In this Budget there were both new savings measures and new spending activity.
- What about the forecasts? The Budget expects wages to grow by 2.5% and for company tax receipts to rise by just 0.3% in 2015-15. In 2014-15 these are expected to rise by 2.5% and 1.1% respectively. In an economy growing at a sub-trend pace and with mining company earnings muted, these are plausible assumptions as are those relating to commodity prices. The St.George forecast for real GDP growth is 2.7% for 2015-16 and nominal growth of around 3.5%. The Budget outcomes for the years beyond 2015-16 appear to rely heavily on better economic growth with nominal GDP forecast to rise by 5.5%.
- How vital is rapid budget repair? Realistically there is no budget crisis and no need to 'butcher' the economy in order to achieve a surplus. Arguably last year's attempt at rapid budget repair dented consumer and business confidence and held back economic activity. Equally realistically, it is prudent to balance the books and build up a surplus or buffer for when times are tough and recession looms. The Tax Reform White Paper due in 2016 should help the process, as might other consultations and deeper analysis. Most people agree on the concept of budget balance but sadly few people want to pay for it.
- Is our AAA credit rating at risk? We doubt it and the Fitch ratings agency said 'no' today. Australia's government debt position is better than many other advanced economies and government debt repayments are not onerous. Private debt levels have increased but only in line with other

advanced economies. The government argues that that a credible trajectory towards surplus lays at the heart of the issue. This is reasonable and Australia will return the Budget to surplus over time.

- <u>Will tonight's Budget restore business and consumer confidence?</u> The Budget itself will likely have little impact on confidence apart from lifting the spirits of those beneficiaries of new spending and tax deductions. Equally it will disappoint those whose agendas have not been accepted. Much will depend on how the politics of the Budget are played out in the media. Bitter political headlines do little to lift confidence.

- <u>What does the Budget mean for economic growth in 2015-16?</u> It's not a 'slash and burn' budget nor is it a 'big spending' budget although the small business tax write-offs should lift spending. One gets the impression that the Budget is an apology for last year, avoiding mistakes and doing the groundwork for the next election – without being an election budget. The outlook for the economy, with or without tonight's Budget, was for growth to be a little below trend and picking up on the back of low interest rates and the 9.2% decline of the AUD (TWI basis) over the past year. That outlook remains intact.

- <u>The Budget and interest rates.</u> The RBA has been hinting strongly that other arms of policy should be doing more to lift economic activity. Monetary policy can only do so much. Contractionary budgets do nothing to lift economic activity in the short-term. With 10 year government bond yields at about 3.00%, it could be argued that now might be a good time for the government to borrow funds on international or domestic markets to finance productivity enhancing infrastructure. With the Budget now in place, the RBA will likely keep the cash rate low and only cut it further if the economy struggles to pick up pace or slips into reverse. We expect the RBA to remain on hold for the remainder of 2015.

- <u>The Budget and the AUD.</u> The initial reaction of foreign exchange market was muted with the AUD having drifted higher all day. It rose from USD 0.7936 at 6.30pm to USD 0.7985 by 9.00pm. The direction of the AUD over the next six months will depend more upon interest rate differentials and commodity prices. We expect the AUD/USD to sit around $US 0.73 by December 2015, driven by the expectation of higher interest rates in the United States and firmer US economic activity.

Budget aggregates and major economic parameters

	Actual	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Underlying cash balance ($b)(a)	-48.5	-41.1	-35.1	-25.8	-14.4	-6.9
Per cent of GDP	-3.1	-2.6	-2.1	-1.5	-0.8	-0.4
Fiscal balance ($b)	-43.7	-39.4	-33.0	-23.4	-9.2	-3.2
Per cent of GDP	-2.8	-2.5	-2.0	-1.3	-0.5	-0.2

(a) Excludes net Future Fund earnings

	Outcomes	Forecasts			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Real GDP	2.5	2 1/2	2 3/4	3 1/4	3 1/2	3 1/2
Employment	0.7	1 1/2	1 1/2	2	2	2
Unemployment rate	5.9	6 1/4	6 1/2	6 1/4	6	5 3/4
Consumer price index	3.0	1 3/4	2 1/2	2 1/2	2 1/2	2 1/2
Wage price index	2.5	2 1/2	2 1/2	2 3/4	2 3/4	3 1/4
Nominal GDP	4.0	1 1/2	3 1/4	5 1/2	5 1/4	5 1/2

(a) Year average unless otherwise stated. From 2013-14 to 2016-17, employment, the wage price index and the consumer price index are through the year growth to the June quarter. The unemployment rate is the rate for the June quarter. The unemployment rate is the rate for the June quarter.

Budget Overview

The 2015 Budget boosts jobs, growth and opportunity

- Supporting small businesses, with annual turnover under $2 million, by cutting small companies' tax rate by 1.5 per cent and giving a 5 per cent tax discount to small unincorporated businesses.
- Encouraging investment by allowing small businesses to immediately deduct each asset costing under $20,000 that is purchased between Budget night and 30 June 2017.
- Reducing red tape and unnecessary regulation for small businesses, and supporting start-ups and entrepreneurship.
- Providing targeted support for young people who have disengaged from work and study and are at risk of long‑term welfare dependency.

Supporting Australian families – a $4.4 billion funding boost

- Delivering a $3.5 billion reform package to make child care simpler, more affordable, accessible and flexible, to support workforce participation.
- Investing $843 million in preschool programmes, to ensure children have a strong start and a bright future.
- Introducing a Child Care Safety Net to provide targeted assistance for genuinely disadvantaged or vulnerable families.
- A two year trial of support for eligible families using nannies.

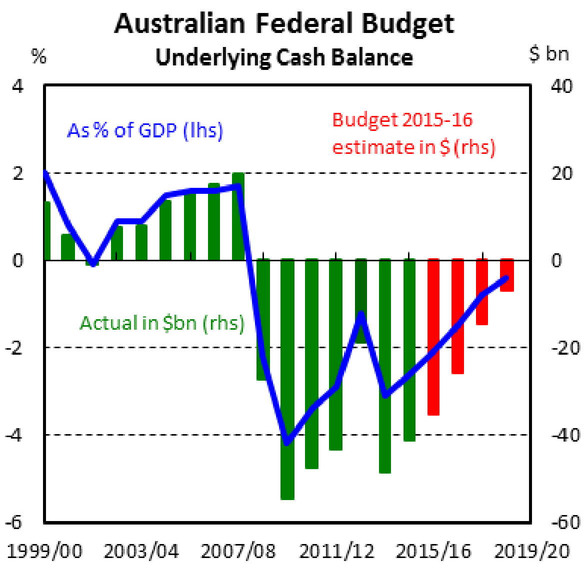
Ensuring fairness of tax and benefits

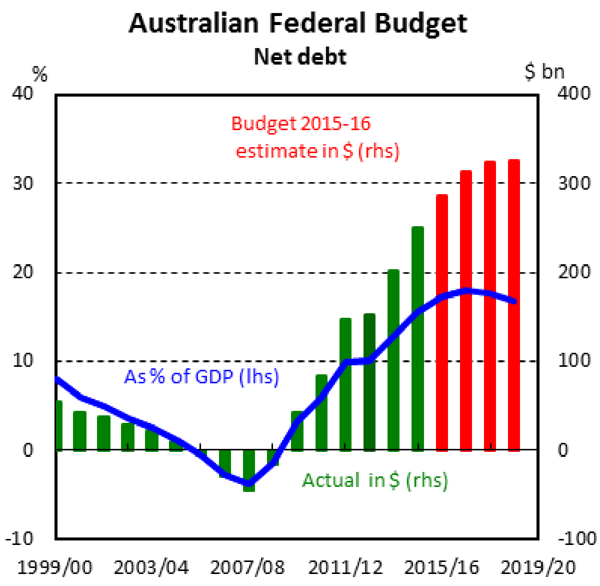
- Ensuring greater fairness in Australia's tax system by implementing the Multinational Anti Avoidance Law to stop companies artificially avoiding tax, and actioning key recommendations of the G20/OECD Base Erosion and Profit Shifting Action Plan.
- Improving the fairness of the tax system by fighting financial crime, extending the ATO's GST compliance programme and capping excessive use of salary sacrificed 'meal entertainment' benefits.
- Strengthening the foreign investment framework to ensure investors play by the rules and that foreign investment is always in our national interest.
- Improving the fairness of benefits by removing double-dipping from Parental Leave Pay for parents who can already access more generous parental leave entitlements from their employer and requiring people who move overseas to continue to repay their Higher Education Loan Programme debt.

Protecting Australia

- Investing $1.2 billion in new funding for national security, building on the $1 billion of funding announced last year.
- Extending and expanding Australia's military operations in Afghanistan, Iraq and the Middle East.

The Key Macro Budget Charts





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