



## 2014-15 Budget

An air of caution permeated thinking on the domestic economic outlook over recent weeks. An apparent loss of upward momentum in retail sales and dwelling approvals together with a stronger AUD challenged some of the more positive projections for domestic economic recovery. And of course, the discussions in the lead up to the 2014-15 Budget further added to the sense of caution. With the new government arguably elected on the premise of being a superior economic and financial manager, the debate centred on how tough the budget would be. **Although it could be argued that Australia's fiscal and financial position was relatively sound and that draconian measures were not required given the still fragile nature of the recovery, there was political and legitimate longer term pressure to implement a meaningful fiscal tightening.** Signalling that the "age of entitlement" was over the government stressed that bold action was required and that the burden would have to be shared to ensure that Australia remained on a sound longer term financial footing.

Back in December the MYEFO revealed that although the budget deficit would shrink over the short term it would begin to widen once again as previously announced spending programs and demographic factors boosted spending. The deficit was projected to widen in 2017-18 and remain in deficit all the way out to 2023-24. **The 2014-15 budget forecasts that the deficit will narrow from 3.1% of GDP in 2013-14 to 0.2% in 2017-18, an annual 0.6% tightening over the next 4 years** (see chart and table on page 2). For 2014-15 the almost \$4bn in net savings spread across Medicare, higher education, welfare, pensions and foreign aid was partially offset by a lift in infrastructure spending. Over the medium term (4 years) almost \$30 bn in savings is shared across foreign aid, Medicare (i.e. the \$7 co-payment), higher education (universities to set their own fees) and welfare (reduced family payments, work for dole). The temporary budget repair levy, the return of fuel excise indexation and a \$10bn infrastructure spending program partially offset these savings.

In terms of the **economic assumptions** upon which the budget is based, the government is projecting weaker than expected growth in 2014-15 but otherwise the forecasts are not too dissimilar to market forecasters. **Nominal GDP is expected to expand by only 3% in 2014-15.** The budget papers contain a section focussing on the risks and sensitivities of budget outcomes to changes in the economic assumptions and one of the key drivers is the terms of trade. **It is a stark reminder of Australia's dependence on the commodity cycle. The terms of trade are expected to decline 6.75% in 2014-15 which, based on the budget papers, would have clipped around 1.5% off nominal GDP growth and underpinned a \$4bn deterioration in the budget balance in 2014-15 and around \$8bn in 2015-16.** On the contrary, a rise in real GDP growth of 1% due to rising productivity and participation rates would improve the budget position by \$3.1bn and \$3.8bn in 2014-15 and 2015-16, respectively.

Finally, the **net debt** position of the Australian government is now projected to peak out at around 14.4% of GDP in 2016-17, an extraordinarily good outcome relative to most major economies (see chart 2) although it has been noted that prior to the GFC Ireland had a net government debt to GDP ratio of less than 20%.

Perhaps the major near term issue in relation to the budget is the **potential impact on consumer confidence.** In the aftermath of the election amidst RBA rate cuts, consumer sentiment climbed. However over recent months it has waned, despite the

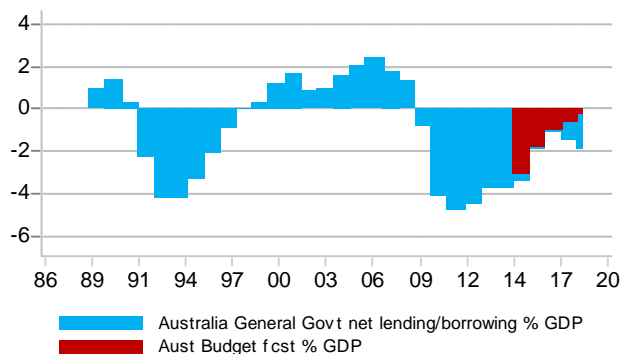
improving domestic data, presumably because of talk around the tough budget. With households shouldering a large part of the burden the risk is that confidence declines and the nascent recovery in consumer spending may be undermined.

**Overall we view the Budget as moderately contractionary in terms of growth but most likely already taken into account by the RBA (and markets). The true risk that Australia faces , and which this Budget is in some way trying to address through the policy flexibility gained by medium term deficit reduction, is a more significant downturn in the terms of trade, most likely as a result of a larger downturn in China.**

Commonwealth Budget position & Key projections					
	13-14 e	14-15 f	15-16 f	16-17 f	17-18 f
<b>Budget Balance</b>					
AUD\$bn	-49.9	-29.8	-17.1	-10.6	-2.8
% GDP	-3.1	-1.8	-1	-0.6	-0.2
<i>as at MYEFO</i>					
AUD\$bn	-47	-33.9	-24.1	-17.7	-28.8
% GDP	-3	-2.1	-1.4	-1	-1.5
<b>GDP growth</b>					
real	2.75	2.5	3	3.5	3.5
nominal	4	3	4.75	5	5

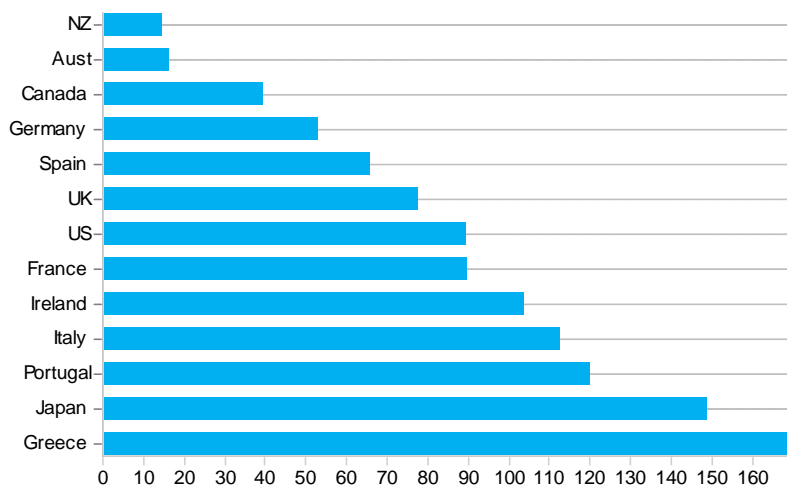
Source: Commonwealth Treasury

**Australia General government net lending/borrowing % GDP**



Source:Commonwealth Treasury , IMF

**Net Government Debt to GDP**



Source:IMF

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