

# **2014-15 Budget & the Economy**

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The information in this presentation is of a general nature and does not represent advice.

Forecasts are subject to unavoidable statistical variation.

This presentation only takes into account information available to Independent Economics up to the date of this presentation.

# Should we believe the budget?

- **The economic outlook:** are brighter times ahead?
- **The budget strategy:** a budget emergency?
- **The budget surplus:** will we get there?

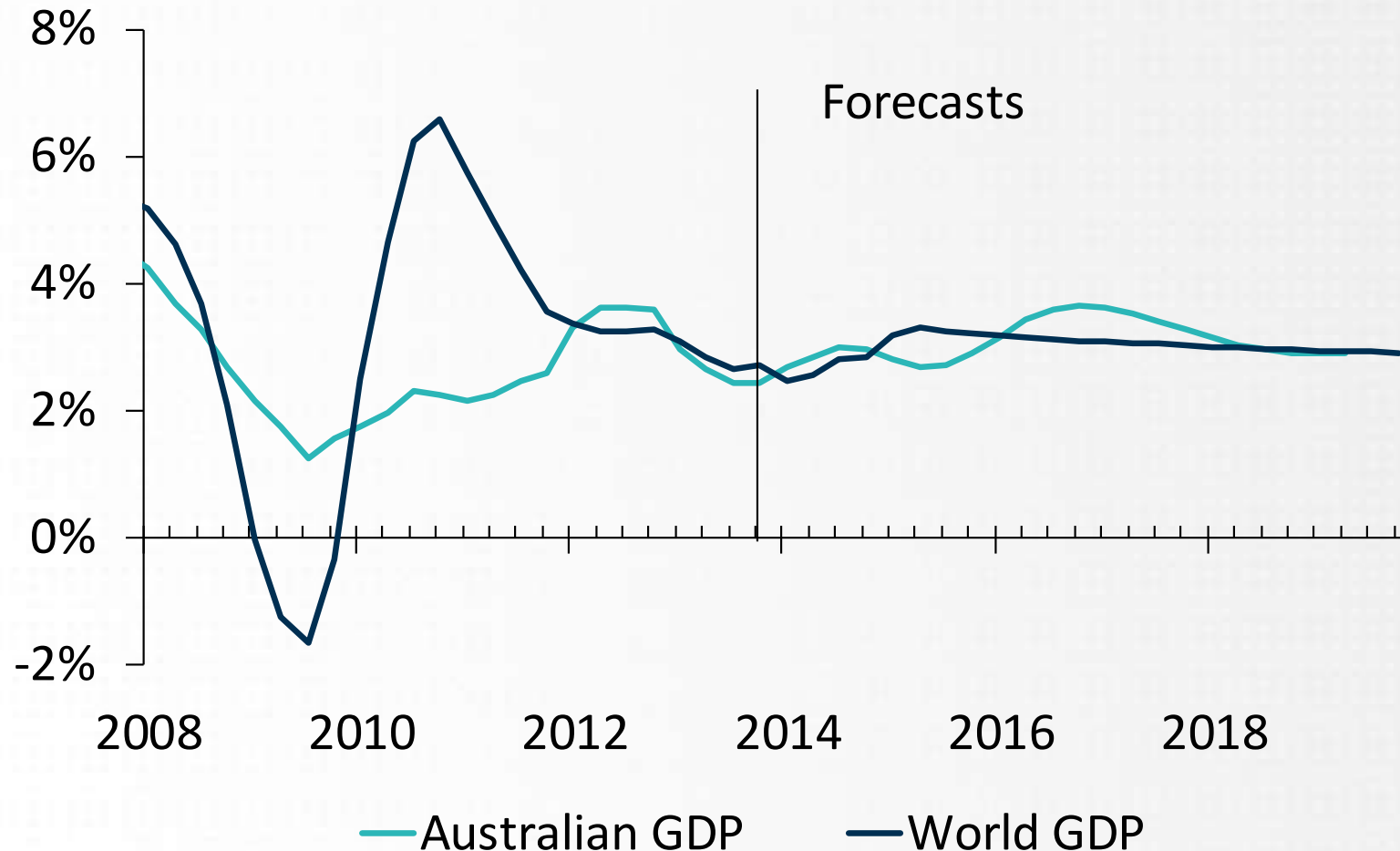
# The economic outlook



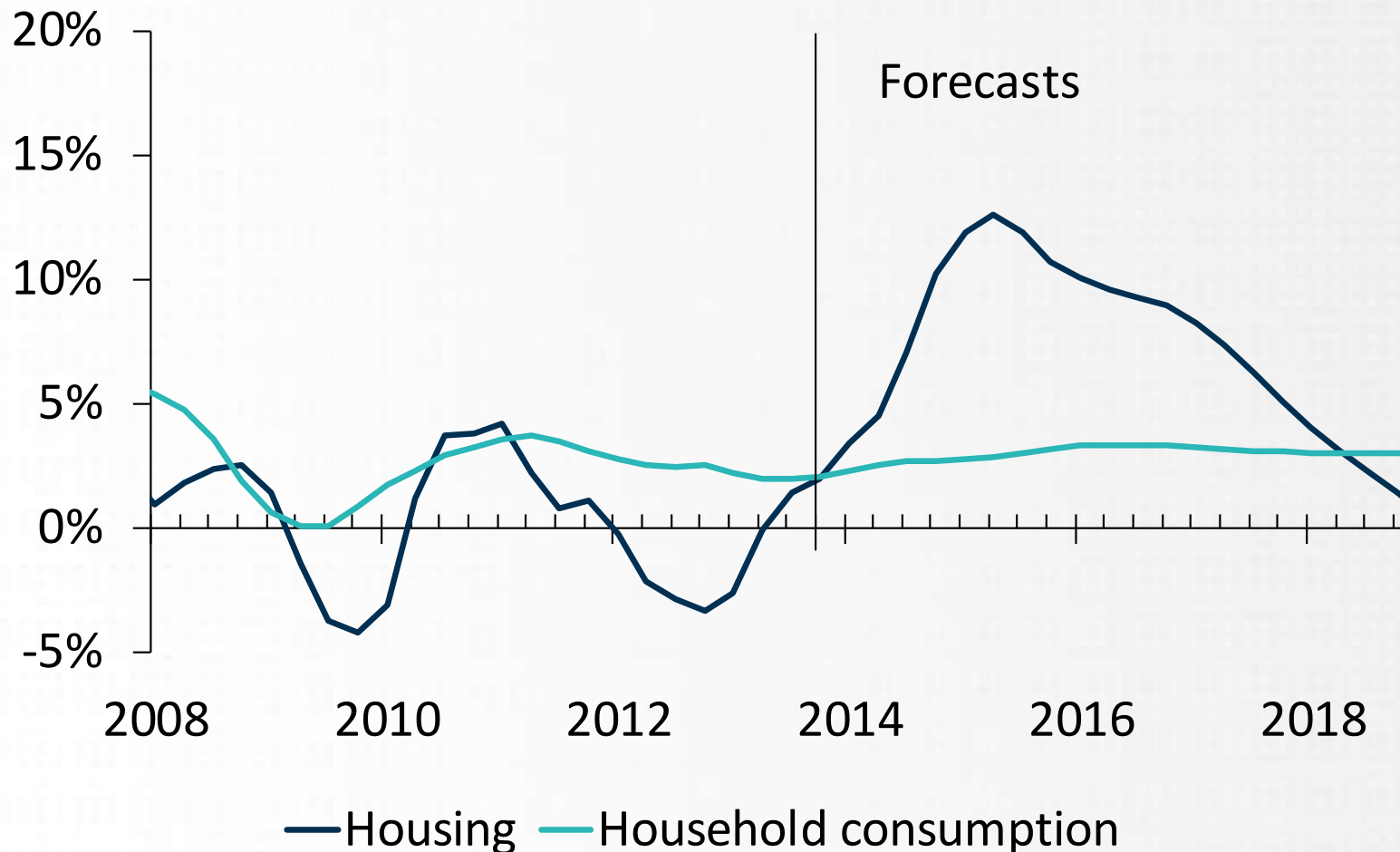
# Independent macro-econometric model

- **Model launched in 2013**
- **Latest in the series of class-leading, macro-econometric models of Australia developed by our team since 1988**
- **Short (to 2016) through to long (to 2050) range forecasts**
- **Analysis of monetary, fiscal and labour market policies**
- **Forecasts at the national, state and industry levels**
- **Generated future scenarios for prospective asset buyers/sellers, the Energy Market Operator, Parliamentary Budget Office**
- **Construction activity forecasts for Master Builders Australia**

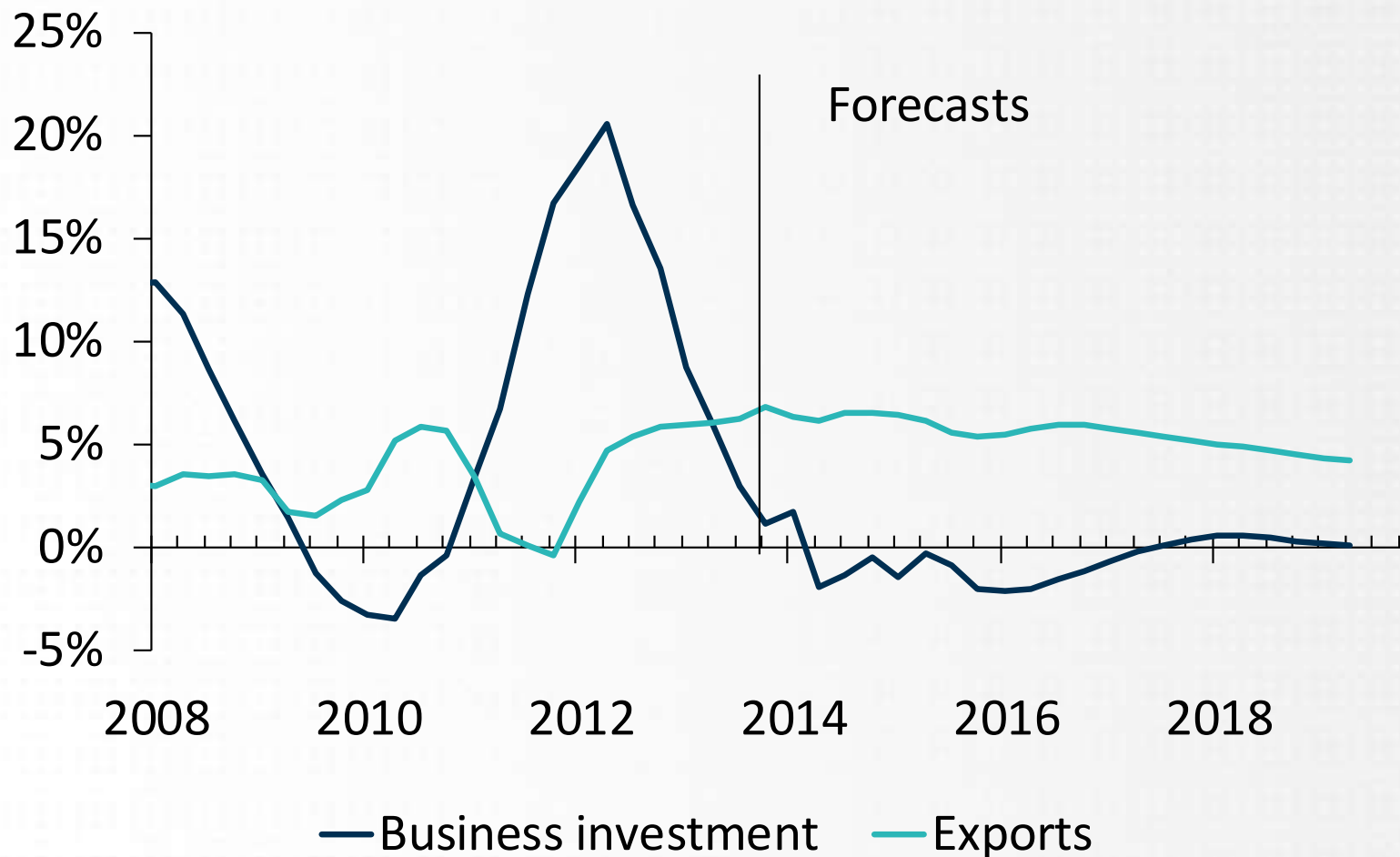
# GDP growth is below trend but set to improve



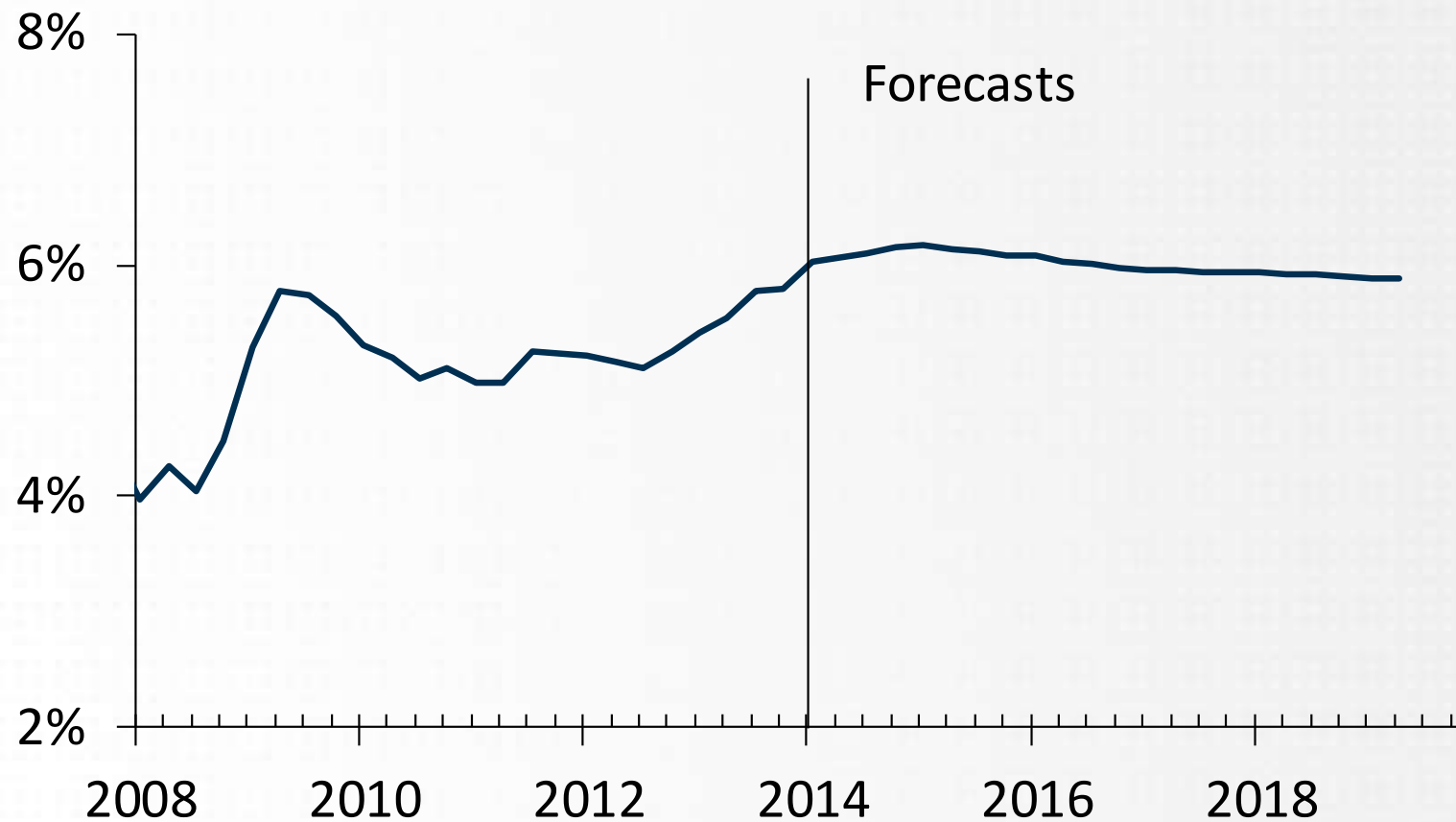
## Housing and consumption picking up



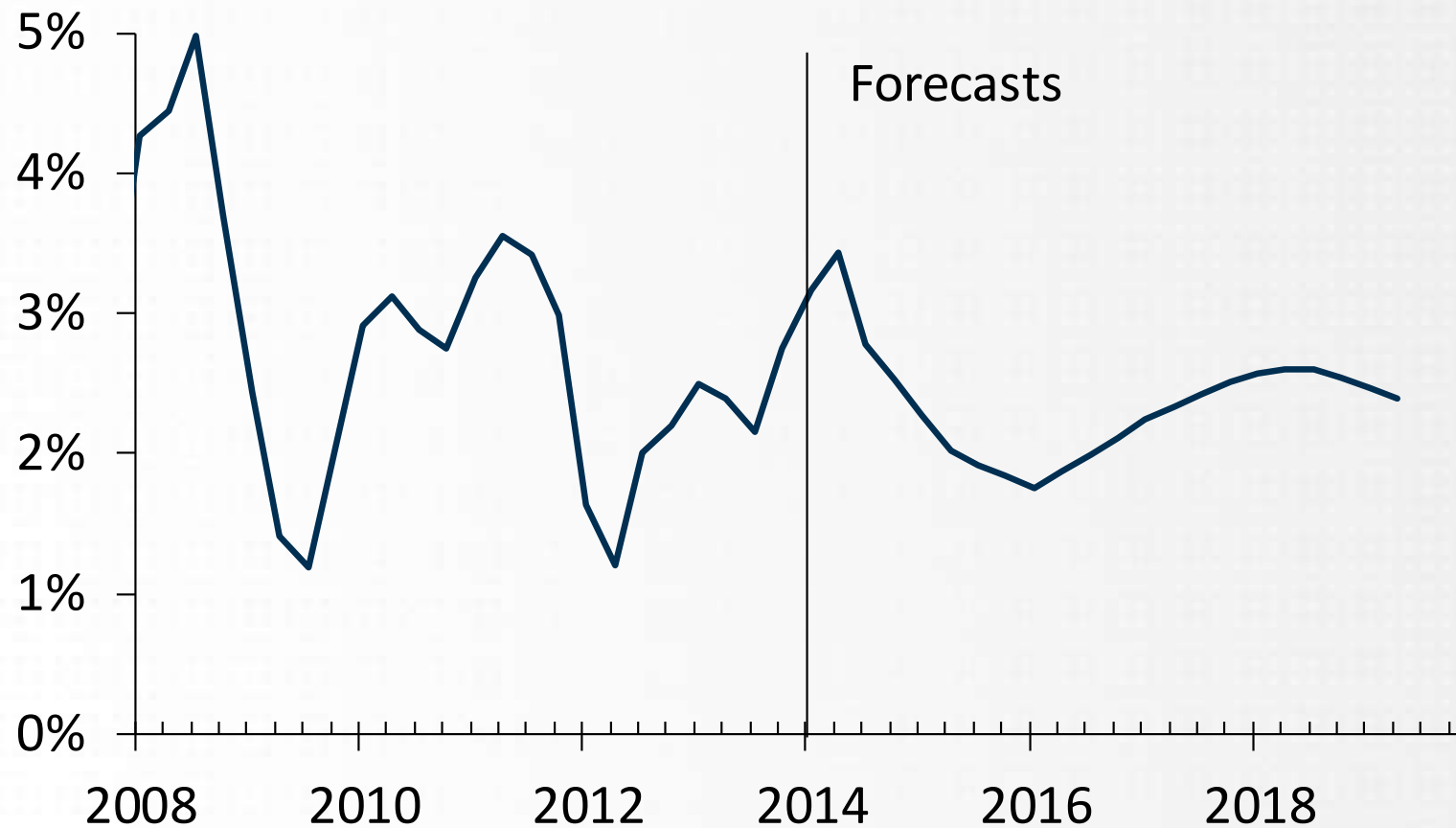
# Mining boom: shift from investment to exports



# Unemployment nearing its peak for this cycle

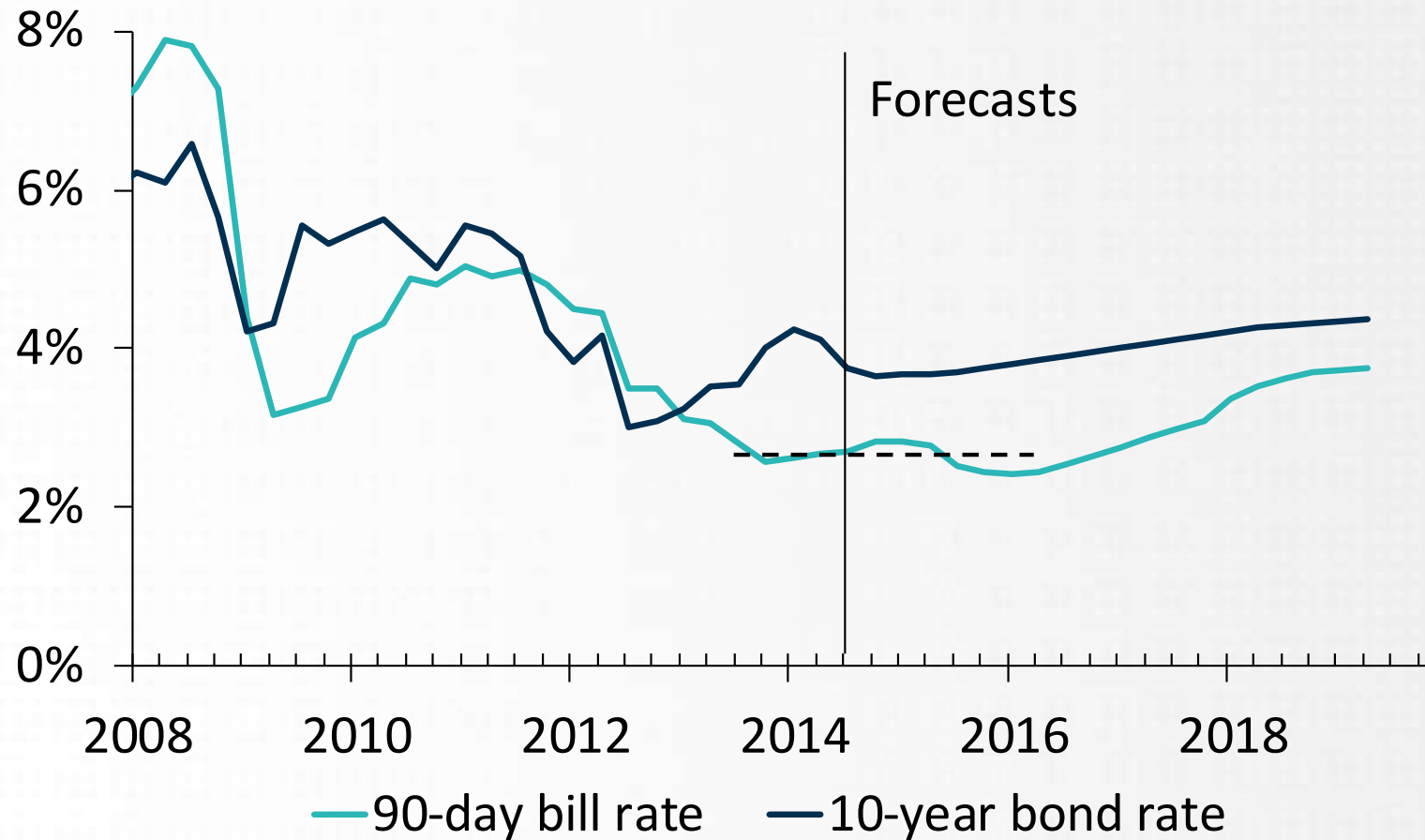


## Inflation set to peak and moderate...

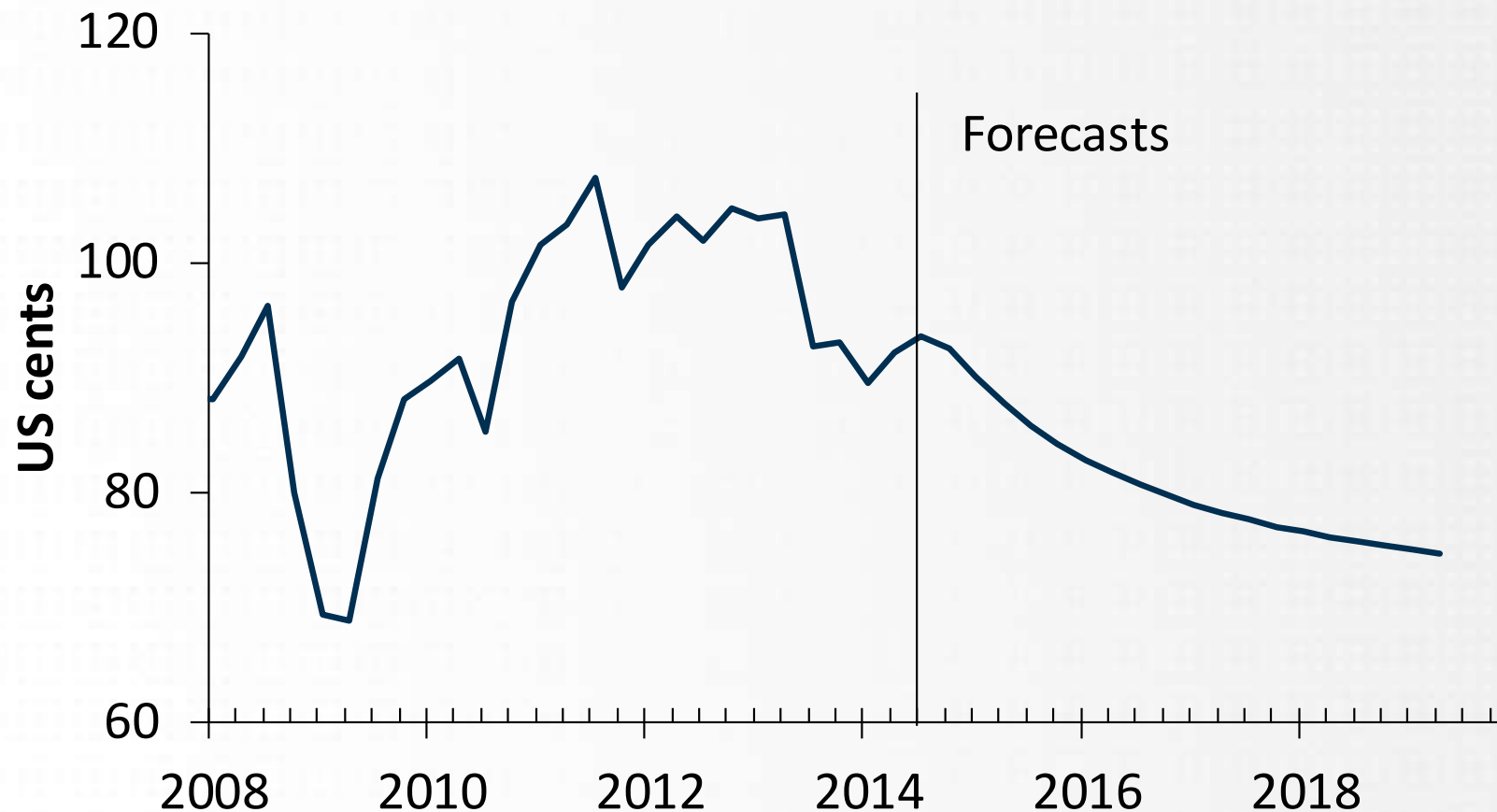


Source: Independent Macro-econometric Model

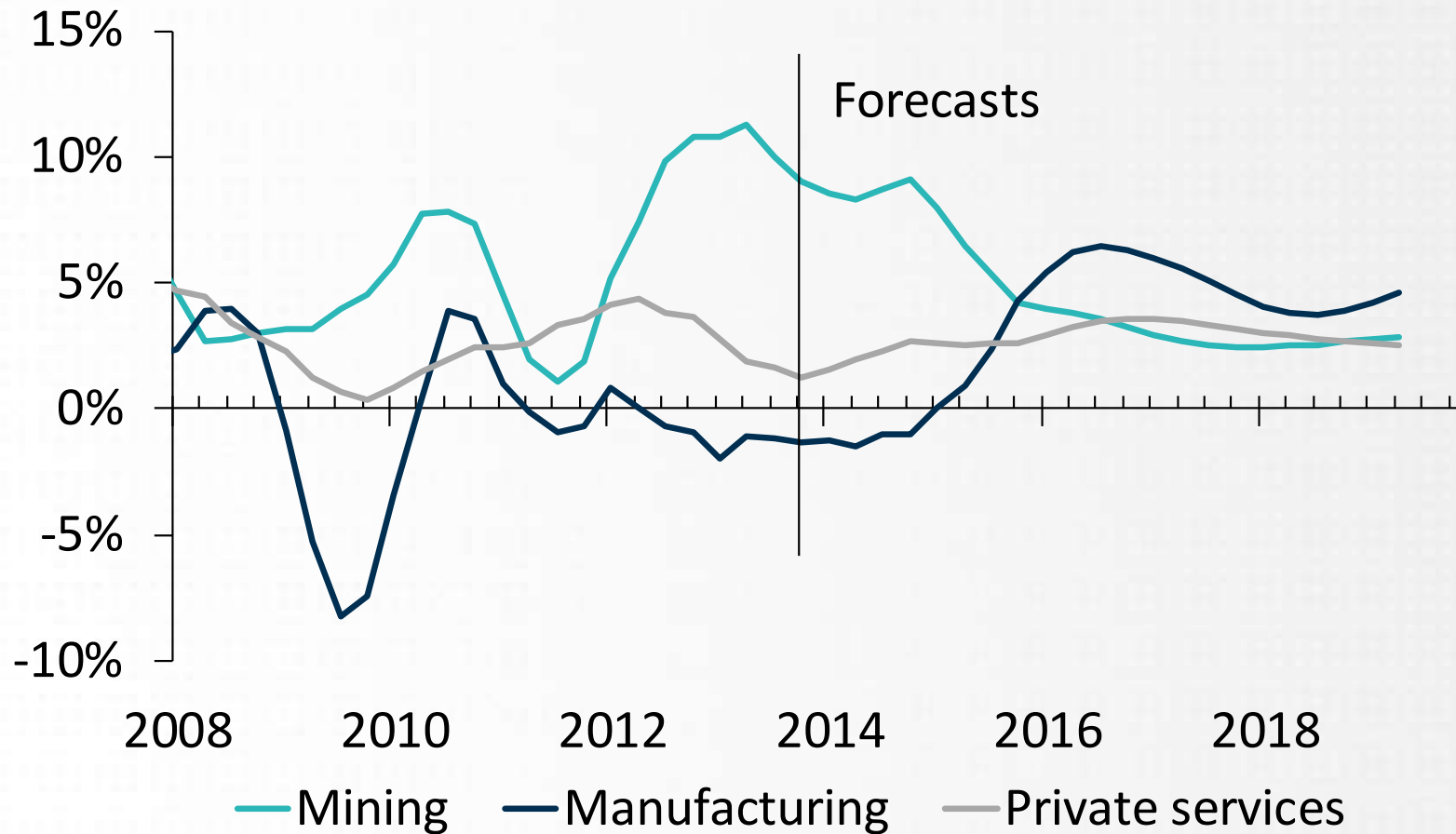
...which means interest rates to stay low for now.



## The AUD continues to depreciate...



## ...allowing manufacturing and services to recover.



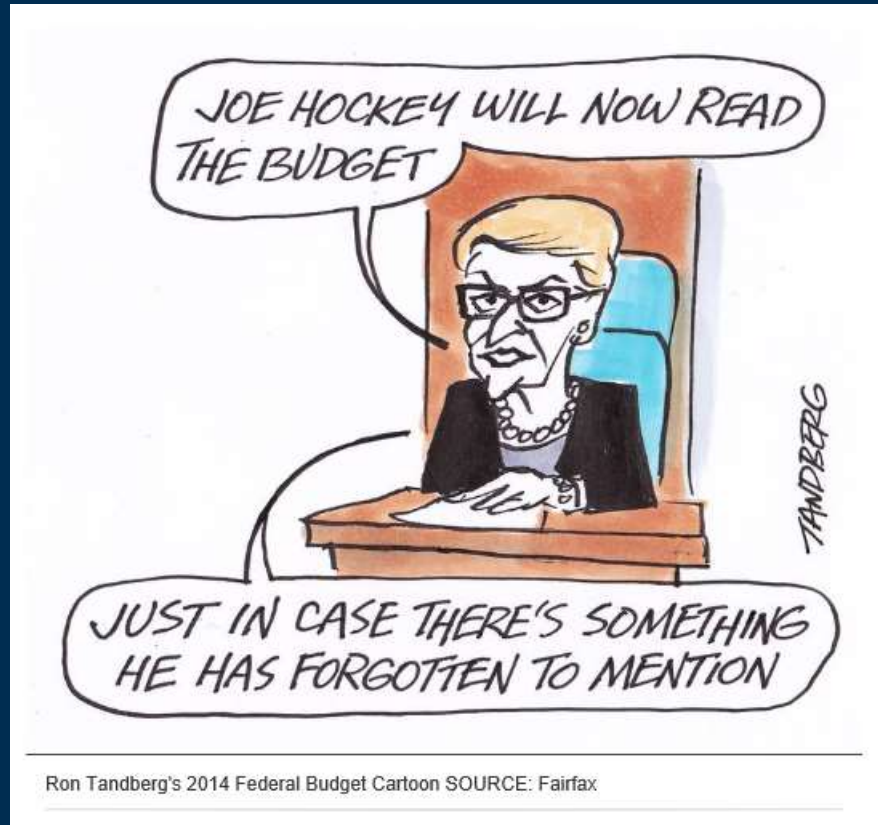
## Comparison of forecasts

	Budget		Independent		RBA*	
	14/15	15/16	14/15	15/16	14/15	15/16
GDP	2.5	3.0	2.7	3.4	2.75	3.25
Unemployment rate	6.25	6.25	6.1	6.0	--	--
Inflation	2.25	2.5	2.0	1.9	3.0	2.5

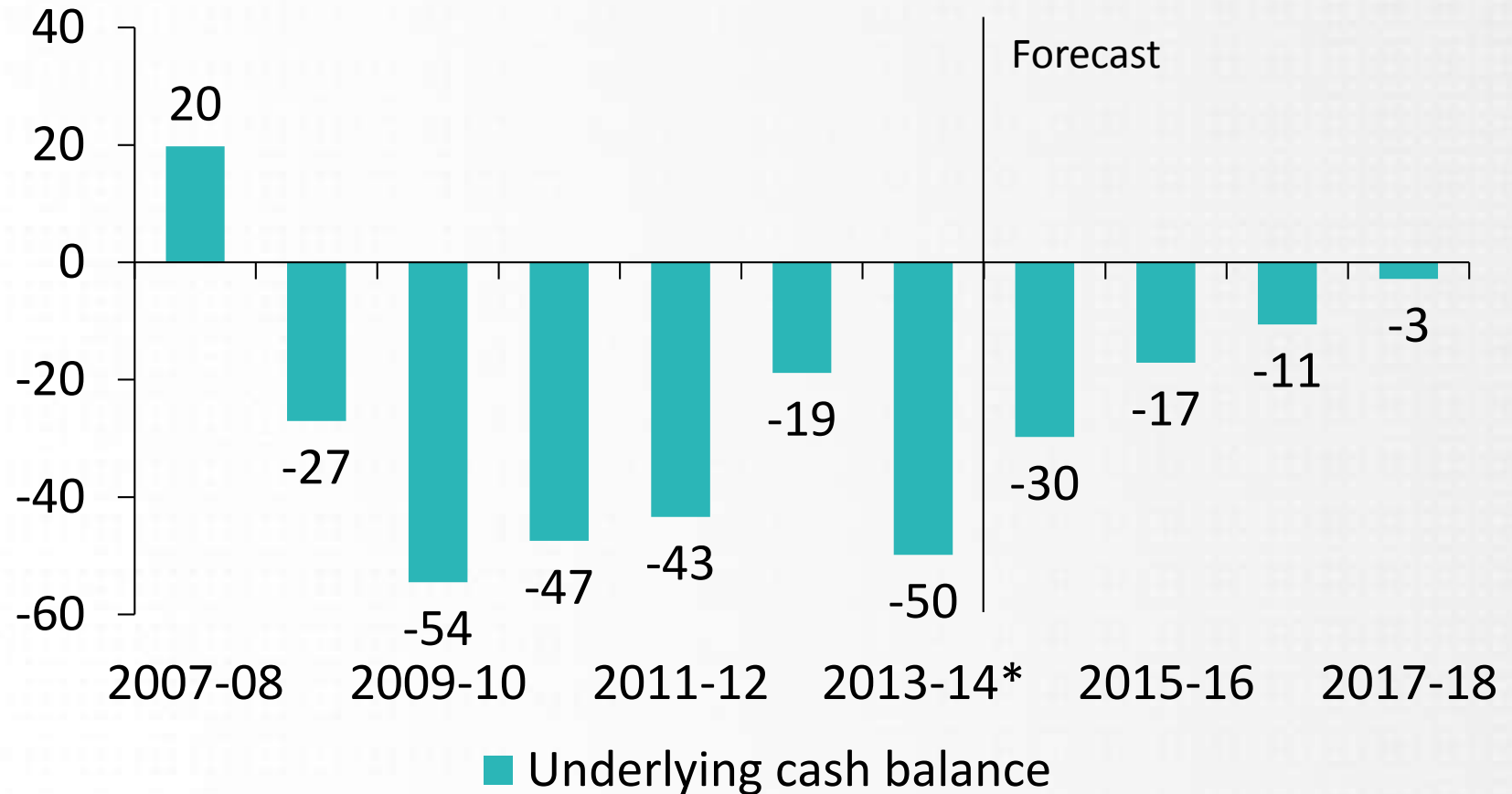
\* Mid-point of RBA forecast band

- **Independent and the RBA expect growth to climb above trend**
- **Treasury expect growth to merely reach trend**
  - Weaker housing recovery
  - Sharper fall in non-residential building
- **Unemployment above long-term rate (5.5%) in the short-term**
- **This will keep inflation low according to Treasury and us**

# The budget strategy



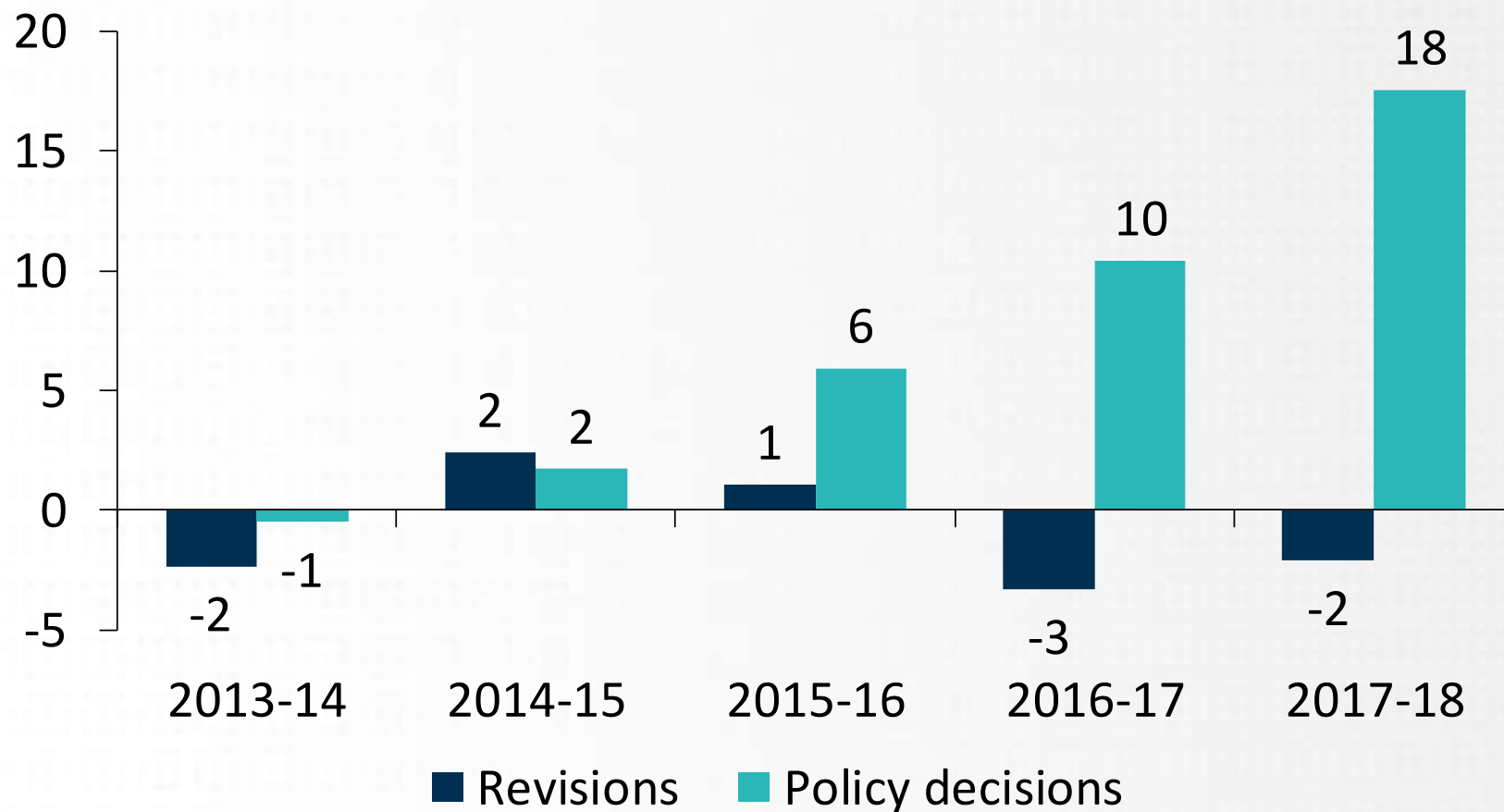
## \$50bn deficit, but heading towards surplus



\* Estimate

Source: Budget 2014-15

## Improvements in underlying cash balance (\$bn)



## Underlying cash balance and fiscal balance (\$bn)

	2013/14	2014/15	2015/16	2016/17
Initial underlying cash balance	-39	-31	-22	-20
Pre-budget policy decisions	-10	-1	-2	-1
Budget policy decisions	-1	2	6	10
Final underlying cash balance	-50	-30	-17	-11
Fiscal Balance	-45	-26	-12	-7

- **Slow path back to budget balance, as budget savings kick in gradually**

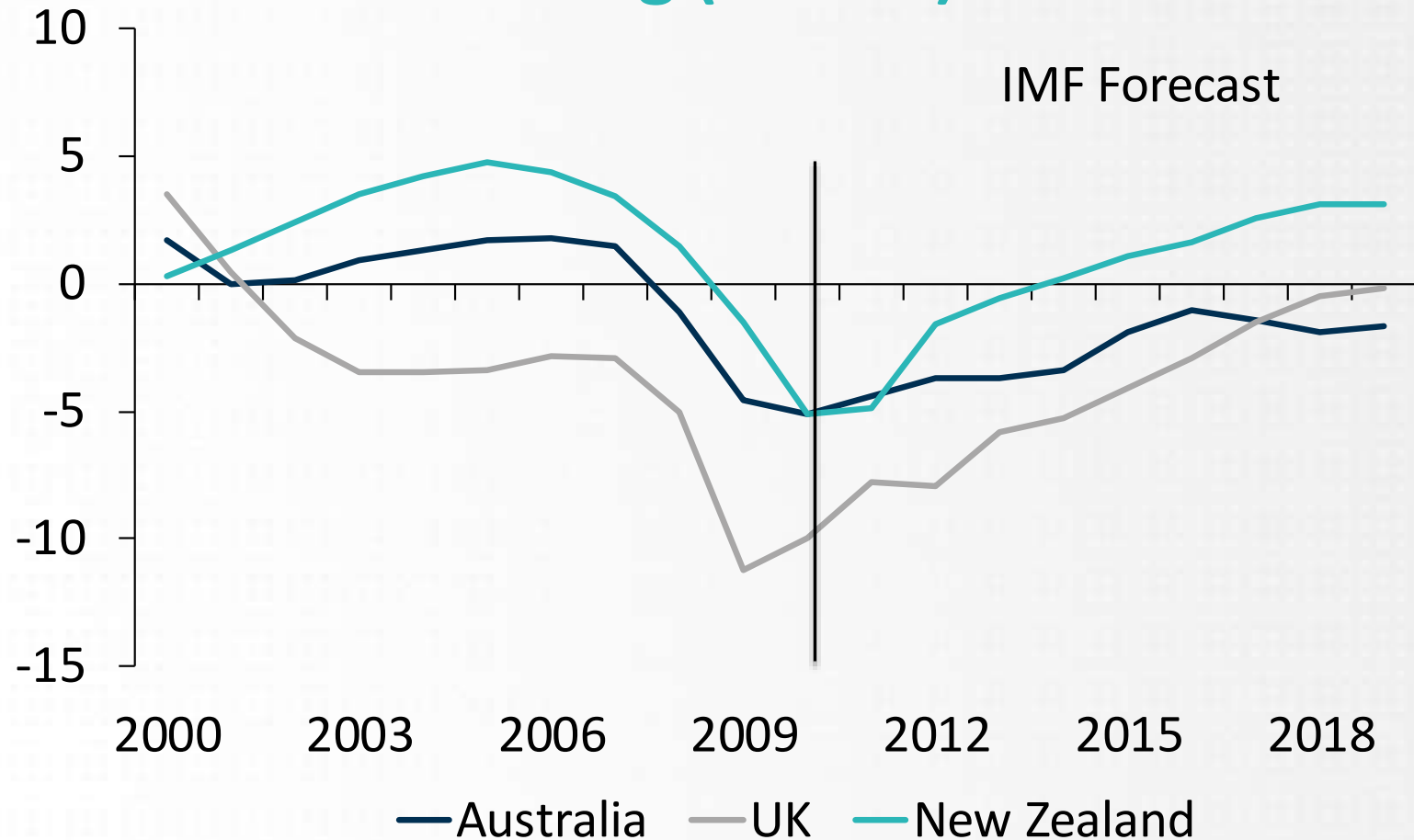
# Policy decisions driving the improvement

	2013/14	2014/15	2015/16	2016/17	2017/18
<b>Revenue</b>					
Medicare - introduction of copayments	0.0	0.0	1.2	1.2	1.2
Temporary levy - high income earners	0.0	0.6	1.2	1.2	0.2
Fuel excise - reintroduce indexation (net)	0.0	0.2	0.4	0.7	0.9
<b>Expenditure</b>					
Foreign aid - cut	0.6	0.6	1.2	1.7	3.5
Family payment reform	0.0	0.4	1.8	2.0	3.3
<b>Other (net saving items)</b>	-1.1	0.0	0.2	3.7	8.4
<b>Policy decisions, net impact on balance</b>	<b>-1</b>	<b>2</b>	<b>6</b>	<b>10</b>	<b>18</b>

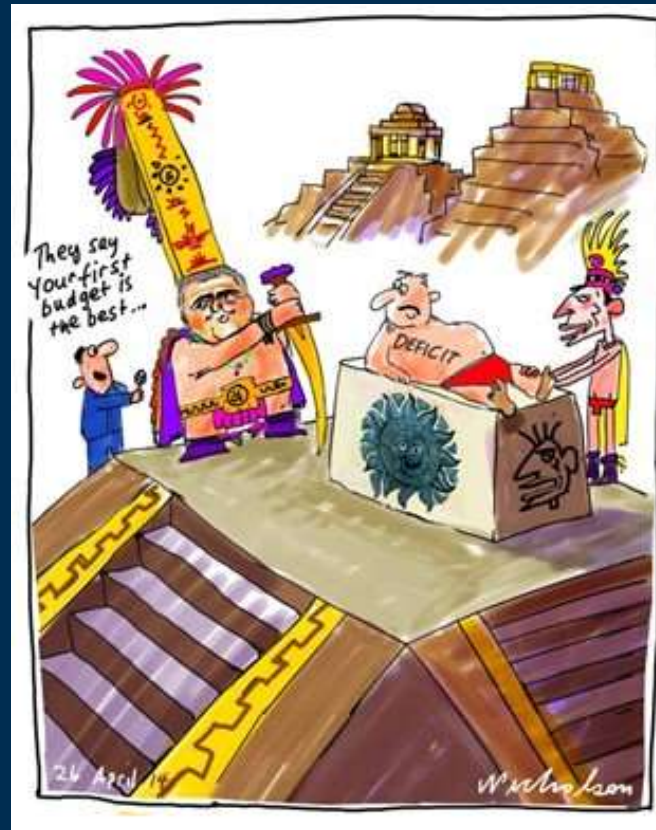
## Do we need a surplus?

- **There is no budget ‘emergency’ today**
  - deficit in 2014/15 is reasonable, given cyclical weakness
- **But there is a budget ‘emergency’ that is emerging tomorrow**
  - population ageing putting upward pressure on spending
  - falling commodity prices weakening revenue
  - state governments relying on inefficient taxes
- **Substantial fiscal repair and long-term reform required**

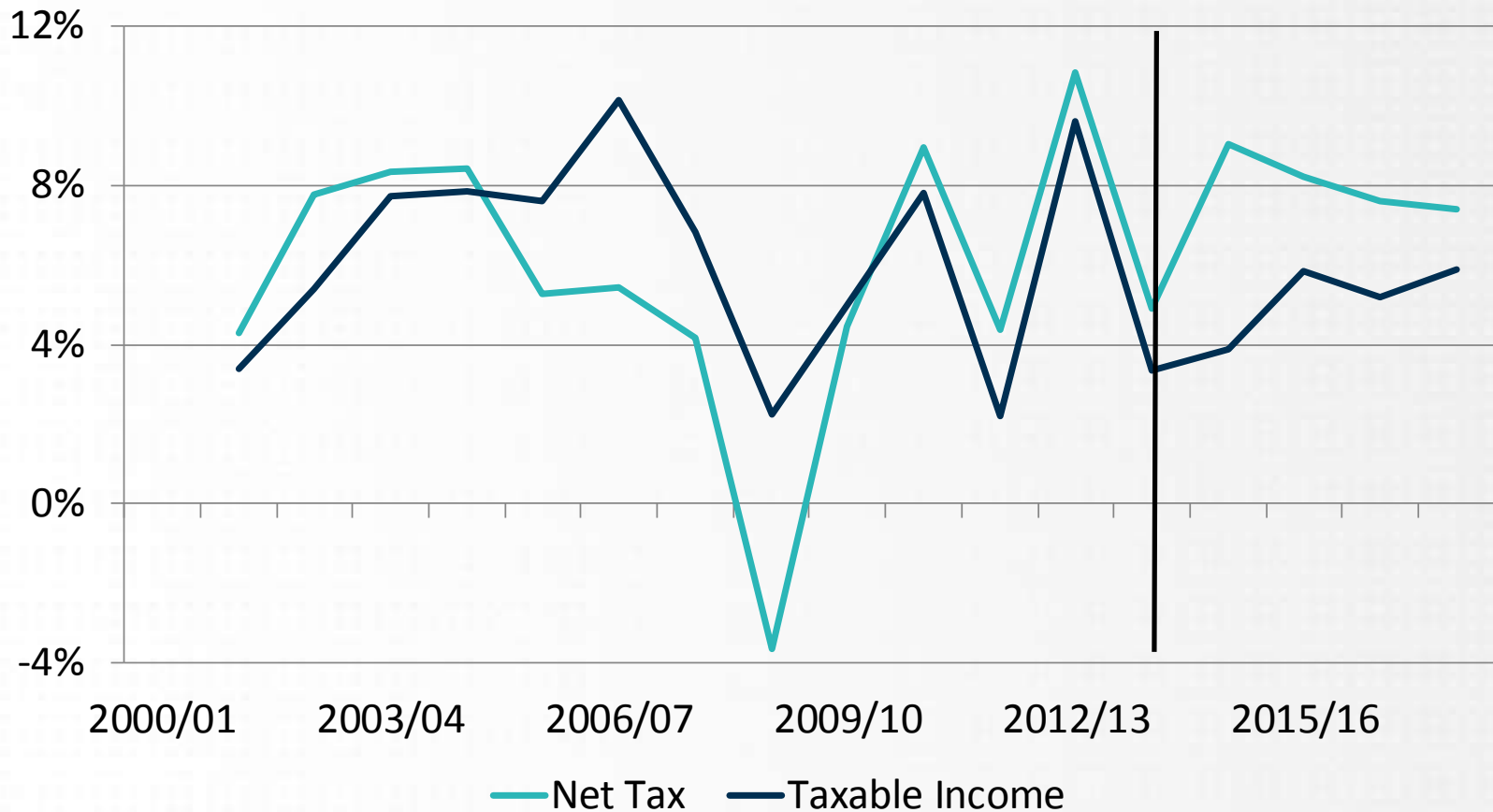
## We are not alone in pursuing fiscal repair... government net lending (% GDP)



# The budget surplus



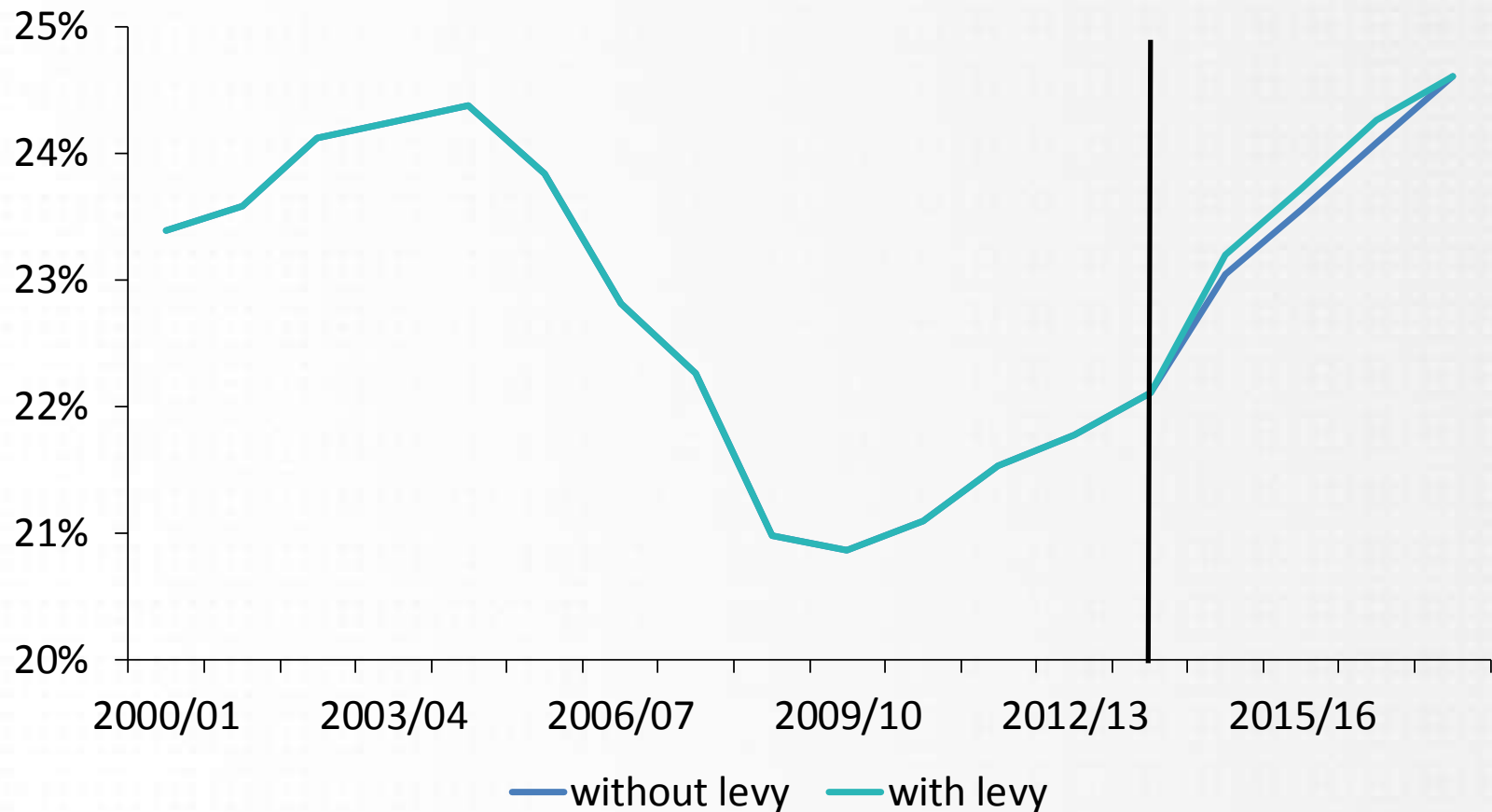
# Growth in taxes to outpace growth in incomes\*...



\* Net tax includes the tax collected under the temporary levy, announced in the budget

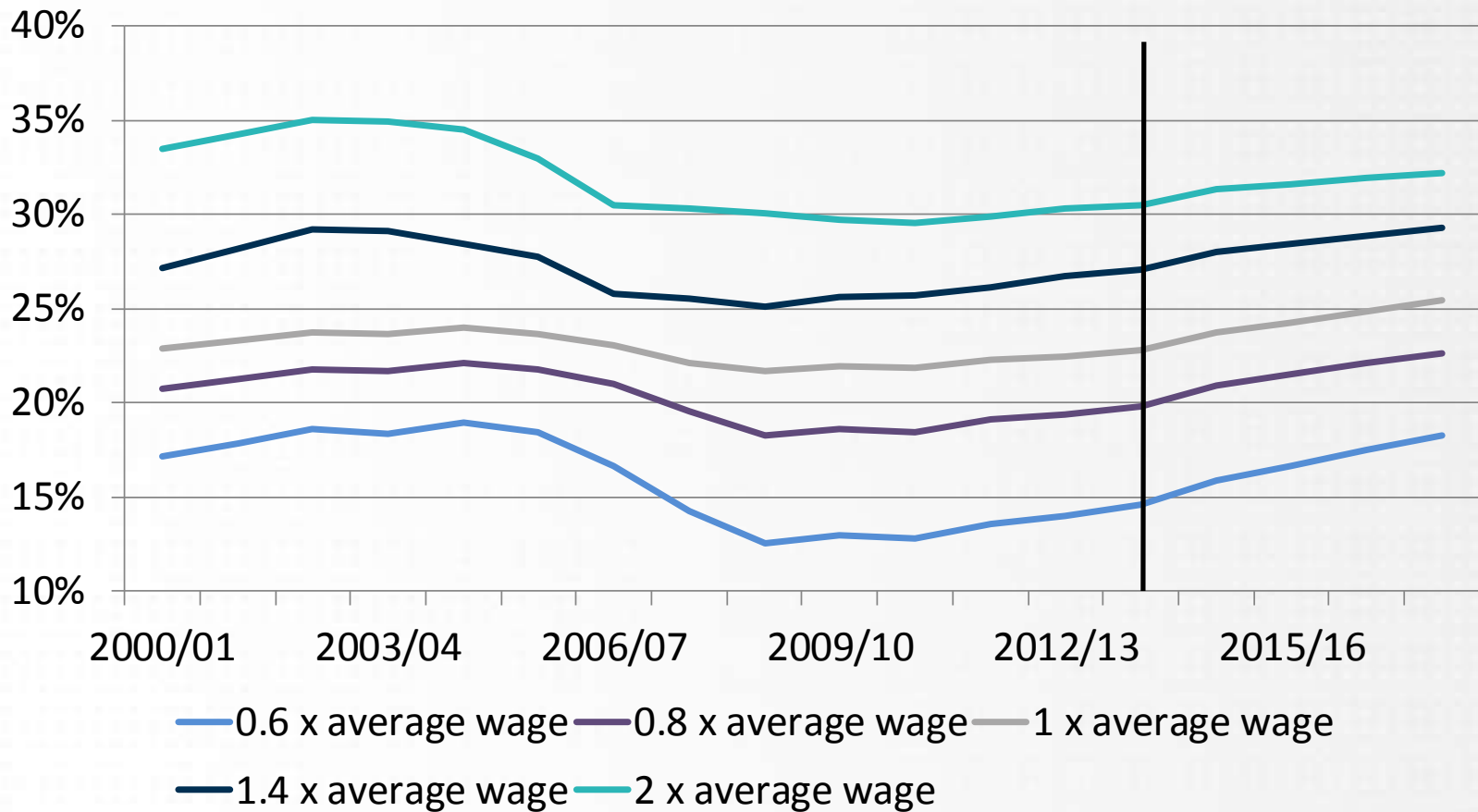
Source: Independent Tax Model, ATO Taxation Statistics

## ...pushing up the average rate of tax...



Source: Independent Tax Model, ATO Taxation Statistics

## ...reversing previous tax cuts for average earners



Source: Independent Tax Model, ATO Taxation Statistics

## **Bracket creep + spending cuts = future surplus**

- **Bracket creep: taxes rise faster than incomes, as wage inflation pushes us into higher tax brackets**
  - Unannounced, automatic increase in average tax rates.
  - No tax cuts since 2012/13 to offset bracket creep, so taxes rise faster than incomes
- **growth in taxes also boosted by Medicare levy increase (last budget) and high income levy (this budget)**
- **bracket creep in the five years to 2017/18 adds \$23bn to 2017/18 Budget balance, measures in this Budget another \$18bn, delivering a projected budget deficit of \$3bn rather than \$44bn**

# Wrap-up



# Believing the Budget

**The economic outlook: are brighter times ahead?**

- **Yes: households & exports to lead recovery; interest rates stay low**

**The budget strategy: a budget emergency?**

- **It is an emerging emergency ... the Budget responds accordingly**

**The budget surplus: will we get there?**

- **Yes: bracket creep and trimmed growth in spending**

**Bitter pills perhaps...but just what the economic doctor ordered.**

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