



Government remains determined to achieve surplus Mid Year Economic and Fiscal Outlook

- **Surplus forecast maintained.** The Federal Government has stuck by its forecast of a budget surplus this year. The Government is targeting a surplus of \$1.1 billion, down modestly on the \$1.5 billion surplus forecast made in the May budget.
- **More budget savings.** The Government has announced measures to boost the budget bottom line by \$1.4 billion this year and a further \$8.9 billion in the following three years. Included are changes to private health rebates, payments to businesses for apprentices, payments to schools and universities as well as a reduction in the baby bonus are amongst measures.
- **Revenue measures.** Included are changes to Visa Application charges; changes to concessional fringe benefit tax treatment of some benefits; introduction of monthly pay as you go instalments for large companies.
- **Few changes in economic assumptions.** The Government has modestly trimmed forecasts for economic growth, employment growth and inflation.

FORECASTS				
	2012/13	2013/14	2014/15	2015/16
Cash balance - Budget	1.50	2.00	5.30	7.50
Cash balance - Mid Year	1.10	2.20	3.30	6.40
Real GDP - Budget	3.25	3.00	3.00	3.00
Real GDP - Mid Year	3.00	3.00	3.00	3.00
Employment - Budget	1.25	1.50	1.50	1.50
Employment - Mid Year	1.00	1.25	1.50	1.50
Unemployment - Budget	5.50	5.50	5.00	5.00
Unemployment - Mid Year	5.50	5.50	5.00	5.00
Inflation - Budget	3.25	2.50	2.50	2.50
Inflation - Mid Year	3.00	2.25	2.50	2.50
Nominal GDP - Budget	5.00	5.25	5.25	5.25
Nominal GDP - Mid Year	4.00	5.50	5.25	5.25

Source: Budget Papers

What does it all mean?

- It remains a stretching forecast, but the Government is by no means abandoning its goal of getting the budget back into balance. While the goal of reducing the budget deficit is laudable, it is by no means essential for Australia to push its accounts back into surplus. Still, if the Government is unshaking in its resolve to achieve a small surplus, it means that the Reserve Bank will have to maintain easy monetary policy settings. We continue to pencil in a 25 basis point rate cut at the November RBA Board meeting.

Craig James – Chief Economist (Author)

(02) 9118 1806 (work); 0419 695 082 (mobile), (02) 9525 2739 (home) | craig.james@cba.com.au; Twitter: @CommSec

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- The Government is effectively applying some modest jawboning on the Reserve Bank to keep rates low: *“with fiscal policy focussed on the medium term, monetary policy should play the primary role in managing demand to keep the economy growing at close to capacity consistent with achieving the medium-term inflation target.”*
- The enormity of the Government's task has to be highlighted – no Government has achieved a turnaround of the magnitude expected for the budget accounts – over 3 per cent of GDP – since the early 1950s.
- The big question for the Reserve Bank and Government concerns the responsiveness to rate cuts. If the RBA has to cut rates to offset fiscal tightening, what is the guarantee that consumers and businesses respond as they are supposed to. Cash rates have fallen from 4.75 per cent to 3.25 per cent with little boost to spending or borrowing.

	Estimates			
	2012-13		2013-14	
	Budget \$b	MYEFO \$b	Budget \$b	MYEFO \$b
Receipts(a)	368.8	367.0	392.5	392.6
Per cent of GDP	23.8	24.0	24.0	24.3
Payments(b)	364.2	363.2	387.3	387.8
Per cent of GDP	23.5	23.8	23.7	24.0
Future Fund earnings(c)	3.0	2.7	3.2	2.7
Underlying cash balance(d)	1.5	1.1	2.0	2.2
Per cent of GDP	0.1	0.1	0.1	0.1
Revenue(a)	376.1	373.7	402.2	403.2
Per cent of GDP	24.2	24.4	24.6	25.0
Expenses	376.3	375.0	398.5	397.9
Per cent of GDP	24.3	24.5	24.4	24.7
Net operating balance	-0.2	-1.3	3.7	5.3
Net capital investment	-2.7	-2.5	1.0	1.0
Fiscal balance	2.5	1.2	2.6	4.3
Per cent of GDP	0.2	0.1	0.2	0.3
Memorandum item:				
Headline cash balance	-8.7	-7.3	-6.8	-7.9

What do the figures show?

- The Federal Budget is projected to be in surplus by \$1.1 billion in 2012/12 with modest surpluses building in the “out-years”.
- The Government expects the economy to grow by around 3 per cent this year, down from 3.25 per cent expected at the time of the May Budget.
- Real growth of payments (spending) in 2012/13 has been revised to show a decline of 4.4 per cent, compared with a 4.3 per cent decline estimated at Budget time.
- In nominal terms the Government is projecting receipts to lift by \$37.7 billion or 11.2 per cent this year with payments to fall by \$4.3 billion or 1.1 per cent. A budget deficit of \$45.4 billion in 2011/12 is expected to be turned into a surplus of \$1.1 billion in 2012/13.
- Receipts are revised down by \$1.8 billion since Budget time with payments reduced by \$1.1 billion and Future Fund earnings reduced by \$300 million.
- Policy decisions since the Budget have had the effect of boosting the projected surplus by \$1.41 billion while “parameter variations” (basically economic assumptions) have had the effect of worsening the bottom line by \$1.87 billion.

Policy decisions - revenue

- “a phased introduction of monthly pay-as-you-go (PAYG) instalments for large companies in Australia. This measure is estimated to raise \$8.3 billion on an underlying cash basis over four years;
- provision of \$390 million funding to the Australian Taxation Office (ATO) for further compliance activities to continue to target profit shifting and high wealth individuals and to focus on outstanding income tax lodgements in the micro and small business segments increasing cash receipts by \$1.6 billion over four years;
- changes to the operation of lost superannuation account provisions to help reunite these accounts with their owners and preserve the value of lost accounts. There will be an increased number of lost superannuation accounts transferred to the Australian Taxation Office (ATO) which will be given additional funding to implement this measure and to use their data matching resources to match lost accounts with active accounts. Importantly, this will help keep money in the superannuation system to support individuals' retirement savings. The Government will pay interest on all unclaimed superannuation monies reclaimed from the ATO and these accounts will not be subject to erosion from account fees. The measure will result in increased net receipts of \$738 million over four years;
- removing the concessional fringe benefits tax treatment for in-house fringe benefits accessed by way of salary sacrifice arrangements. This measure is estimated to raise \$445 million over four years;
- reducing the period of time that banks and other deposit taking and life insurance institutions hold unclaimed moneys from seven to three years increasing receipts by \$300 million in 2012-13; and

- targeted increases to a number of Visa Application Charges from 1 January 2013 increasing receipts by \$52 million in 2012-13 (\$520 million over four years). The changes to visa application charges will apply to skilled graduates, partners, working holiday makers and temporary overseas workers."

Policy decisions – increase to payments

- "funding for the Government's Dental Health Reform package which includes initiatives to: establish a Child Dental Benefits Schedule; support the provision of dental health services to adults who rely on the public dental system; and support dental infrastructure and workforce initiatives and redirect the Medicare Teen Dental Plan to offset the package. These measures, which are expected to increase payments by \$1.8 billion over four years, are broadly funded by savings in other health-related programs;
- funding of \$111 million in 2012-13 (\$497 million over four years) as part of the Government's response to the Report for the Expert Panel on Asylum Seekers, including increases to the Humanitarian Program of an additional 6,250 places per annum from 2012-13, and increases to the Family Reunion Stream of the Permanent Migration Program by 4,000 places. The estimated costs of establishing regional processing centres in Nauru and Manus Island, Papua New Guinea are included in MYEFO in the Contingency Reserve but cannot be published as the contracts to build these facilities are currently subject to commercial negotiations;
- funding of \$39 million in 2012-13 (\$325 million over four years) for the Tasmanian health system to address challenges caused by Tasmania's ageing population, high rates of chronic disease and constraints in their health system; and
- funding to the international contribution to the sustainment of the Afghan National Security Forces (ANSF) with an impact of \$154 million over two years from 2014-15. Australia's contribution is part of international efforts to help sustain and support the ANSF beyond the transition of security responsibility in Afghanistan to the Afghan government."

Policy decisions – cuts to payments

- "a reduction and movement in funding to a number of grant programs across a range of Government portfolios by \$157 million in 2012-13 (\$89 million over four years);
- slowing the rate of funding increases for Sustainable Research Excellence by maintaining funding at the 2012 level for the 2013 calendar year, then increasing funding over the three years to a maximum amount of \$300 million in 2016. This will decrease payments by \$79 million in 2012-13 (\$499 million over four years). Funding will then be indexed annually from 2017 by the Higher Education Indexation Factor;
- discontinuing the \$1,500 standard commencement incentive, and reducing the standard completion incentive to \$1,500, for employers of part-time and casual apprenticeships in non-National Skills Needs List occupations, decreasing payments by \$19 million in 2012-13 (\$277 million over four years). This will apply immediately for all commencing apprentices. Employers of ongoing apprentices will continue to be eligible for incentives under the previous arrangements until 30 June 2013;
- changes to the calculation of the Government's contribution to private health insurance, which will now be calculated using commercial premiums as at 1 April 2013 and then indexed annually by the lesser of CPI or the actual increase in commercial premiums. This will be used to determine an individual's private health insurance rebate. This decision will take effect from 1 April 2014 and will decrease payments by around \$700 million over three years from 2013-14;
- removing the PHI Rebate on the Lifetime Health Cover loading component of PHI premiums decreasing payments from 1 July 2013 and

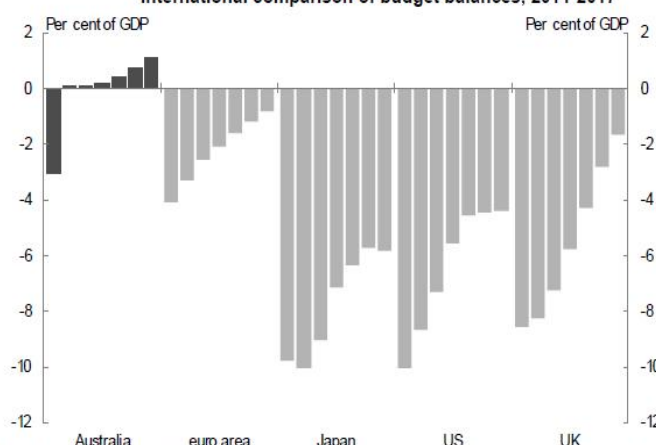
Delivering fiscal reprioritisation^(a)

	Estimates		Projections		Total
	2012-13	2013-14	2014-15	2015-16	
	\$m	\$m	\$m	\$m	\$m
Effect of policy decisions since Budget					
Spends	-716	-1,422	-1,875	-2,056	-6,069
Saves	2,127	6,543	3,792	3,953	16,415
Total effect of policy decisions since Budget	1,411	5,121	1,917	1,897	10,346
Add Contingency Reserve offsets to policy decisions (b)	10	20	44	44	119
Net budget impact of policy decisions	1,421	5,141	1,961	1,941	10,465

(a) Underlying cash basis.

(b) Includes the revenue provision for the signing of the Malaysian Free Trade Agreement.

International comparison of budget balances, 2011-2017



Note: Australian data are for the Australian Government general government sector underlying cash balance and refer to financial years beginning 2011-12. Data for all other economies are total government and refer to calendar years beginning 2011.

Source: IMF Fiscal Monitor October 2012 and Treasury.

reducing payments by around \$390 million over three years;

- reducing the baby bonus rate from \$5,000 to \$3,000 for second and subsequent children from 1 July 2013 reducing payments by \$461 million over three years;
- extending the Trade Training Centres in Schools program to 2018-19, rephrasing funding to evenly distribute projects over the life of the program. This rephrasing reduces payments by \$305 million over four years, with overall funding over the life of the program remaining unchanged; and
- ceasing Facilitation Funding for universities from 1 January 2014 reducing payments by \$270 million over three years from 2013-14."

What is the importance of the economic data?

- The Mid Year Economic and Fiscal Outlook is presented by the Government around October-December each year. The report is an update on how the Federal Budget is tracking and is therefore an update on the fiscal policy stance of the Government.

What are the implications for interest rates and investors?

- Interest rates will have to stay low and most likely fall further for the Government to achieve its goal of a budget surplus.
- We question the pre-occupation of achieving a budget surplus at all costs. While the goal is to laudable, if consumers and businesses remain reluctant to spend or borrow in response to rate cuts, then the fiscal tightening may have unintended negative effects of the economy and on the very task of achieving a surplus.

Craig James, Chief Economist, CommSec

Work: (02) 9118 1806; Home: (02) 9525 2739; Mobile: 0419 695 082; Twitter: @CommSec