

PART 1: OVERVIEW

The 2013-14 Mid-Year Economic and Fiscal Outlook (MYEFO) delivers on the Government's commitment to provide a comprehensive and transparent picture of the Commonwealth's financial and economic position.

The budget position has deteriorated significantly since the 2013 Pre-Election Economic and Fiscal Outlook (PEFO). Budget deficits totalling \$123 billion are now expected across the forward estimates, with a \$47 billion deficit expected in 2013-14 – 3.0 per cent of Gross Domestic Product (GDP). Without policy change and taking no remedial action, budget deficits would be projected in each and every year to 2023-24.

This is an unsustainable fiscal position and the Government is committed to taking the hard decisions to live within its means. The 2014-15 Budget will outline the fiscal strategy to return the budget to surplus and pay down debt.

Table 1.1: Budget aggregates

	Estimates					
	2013-14			2014-15		
	Budget	PEFO	MYEFO	Budget	PEFO	MYEFO
Underlying cash balance(\$b)(a)	-18.0	-30.1	-47.0	-10.9	-24.0	-33.9
Per cent of GDP	-1.1	-1.9	-3.0	-0.6	-1.5	-2.1
Fiscal balance(\$b)	-13.5	-25.5	-41.8	-6.3	-22.1	-31.5
Per cent of GDP	-0.8	-1.6	-2.7	-0.4	-1.3	-1.9
	Projections					
	2015-16			2016-17		
	Budget	PEFO	MYEFO	Budget	PEFO	MYEFO
Underlying cash balance(\$b)(a)	0.8	-4.7	-24.1	6.6	4.2	-17.7
Per cent of GDP	0.0	-0.3	-1.4	0.4	0.2	-1.0
Fiscal balance(\$b)	6.0	1.8	-18.8	10.8	7.8	-14.5
Per cent of GDP	0.3	0.1	-1.1	0.6	0.4	-0.8

(a) Excludes expected net Future Fund earnings.

The deterioration in the underlying cash balance since the 2013 PEFO is \$16.8 billion in the 2013-14 financial year and \$68.1 billion over the forward estimates. This is in addition to the \$33.1 billion deterioration in the budget position between the 2013-14 Budget and the 2013 PEFO.

The total underlying cash deterioration over the forward estimates since the 2013-14 Budget is \$101.2 billion.

In accrual terms, the fiscal balance is expected to be a deficit of \$41.8 billion (2.7 per cent of GDP) in 2013-14 and \$14.5 billion (0.8 per cent of GDP) in 2016-17.

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The deterioration in the budget position since the 2013 PEFO reflects two key factors:

- the softer economic outlook; and
- essential steps to address unresolved issues inherited from the former government.

Firstly, a softening in the economic outlook has resulted in significantly lower nominal GDP, which has largely driven the reduction in tax receipts by more than \$37 billion over the forward estimates. The softer economic outlook, coupled with changes in demand-driven programmes, has also increased payments across the forward estimates.

The Australian economy will continue to transition from resources-investment led growth to broader sources of growth over the forecast period. However, the transition is now forecast to be slower than at the 2013 PEFO. While the fall in resources investment is expected to be sharper than previously forecast, the recovery in the non-resources sector is expected to be more gradual.

As a result, real GDP is forecast to grow at a slower rate of 2½ per cent in 2014-15, compared to 3 per cent in the 2013 PEFO. With domestic prices and wages also forecast to be softer than at the 2013 PEFO, nominal GDP has been revised down significantly.

Table 1.2: Major economic parameters ^(a)

	Forecasts		Projections	
	2013-14	2014-15	2015-16	2016-17
Real GDP	2 1/2	2 1/2	3	3
Employment	3/4	1 1/2	1 1/2	1 1/2
Unemployment rate	6	6 1/4	6 1/4	6 1/4
Consumer Price Index	2 3/4	2	2 1/2	2 1/2
Wage Price Index	2 3/4	2 3/4	4	4
Nominal GDP	3 1/2	3 1/2	4 3/4	4 3/4

(a) Year average unless otherwise stated. Employment, wages and the consumer price index are through the year growth to the June quarter in 2013-14 and 2014-15. The unemployment rate is the rate for the June quarter.

Source: Treasury projections.

Secondly, essential steps have been taken to address unresolved issues inherited from the former Government, which have contributed to the deterioration in the budget position since the 2013 PEFO.

These steps include providing the Reserve Bank of Australia with a grant to strengthen its capacity to withstand future shocks (\$8.8 billion), addressing the funding shortfall from the former Government's inadequate provisioning for its policy relating to offshore processing of illegal maritime arrivals (\$1.2 billion), restoring education funding for Students First — A fairer funding agreement for schools (\$1.2 billion), Commonwealth provisioning in the Contingency Reserve and relevant revenue heads related to unfunded superannuation of New South Wales universities, and removing

the uncertainty associated with the backlog of nearly 100 announced but unlegislated tax and superannuation measures (\$2.9 billion).

The MYEFO takes account of all of the Government's election commitments with the exception of the saving associated with the 12,000 headcount reduction in the public service. The Government remains committed to streamlining the public service, but will review the timing and approach to implementing its commitment in view of the expected headcount reduction required by the former government's efficiency dividends and associated measures. Further decisions on the public service headcount will be taken in light of the findings of the National Commission of Audit.

Other policy decisions since taking office include providing \$995.7 million over six years to fund eight infrastructure projects that were to be funded from the former Government's Regional Infrastructure Fund. These productivity-enhancing infrastructure projects will be co-funded by the states and territories without the failed minerals resource rent tax.

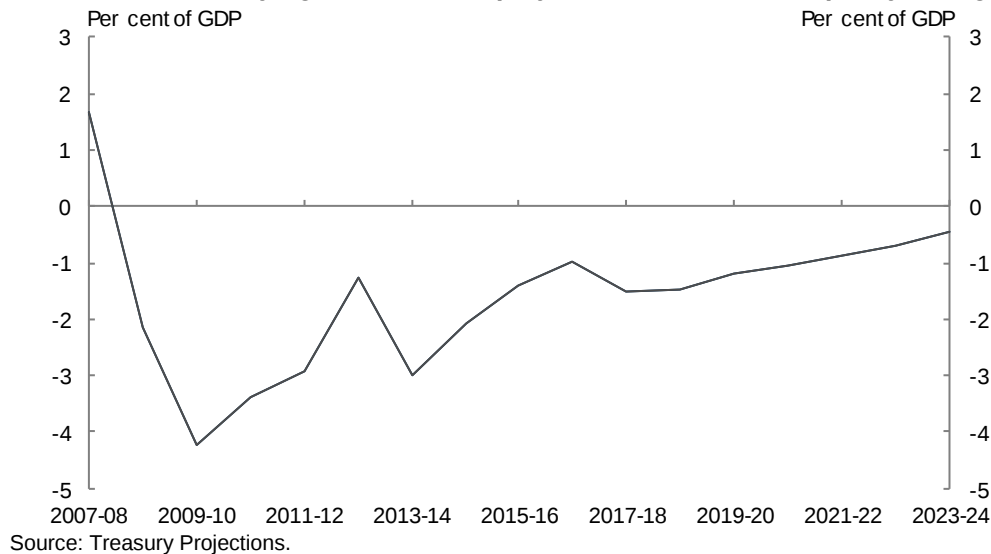
The deterioration in the budget position over the forward estimates is mirrored by a marked deterioration in the projected budget outlook over the medium-term. Without any policy changes, the budget is projected to be in deficit in each and every year to 2023-24 and Commonwealth Government Securities on issue would reach \$667 billion (around 26 per cent of GDP) in 2023-24.

Projected deficits across the medium-term are the result of strong spending growth driven by increasing demand for Government services, particularly health. The former Government's projections of a surplus of 1 per cent of GDP were underpinned by an assumption that real spending growth would be limited to 2 per cent per annum when growth was at or above trend until that surplus target was reached. Actual average real spending growth over the five years to 2012-13 has been almost double that at around 3.5 per cent.

The 2013-14 MYEFO projects the expected annual average real growth rate in spending over the medium-term, after the forward estimates, to be 3.7 per cent. With this underlying spending growth, the budget would remain in deficit even if tax as a share of GDP was allowed to grow through fiscal drag (such as income tax bracket creep) with no tax cuts for another 10 years.

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Chart 1.1: Underlying cash balance projected to 2023-24 if no policy change



The Government is taking concerted action to avoid an unsustainable fiscal deterioration unfolding. The weaker fiscal and economic outlook highlights the imperative to focus on policies that enhance productivity, improve efficiency and eliminate wasteful spending, reduce the regulatory burden on businesses and individuals, and reduce the size of government.

There are two related goals: fostering economic growth, and returning the budget to surpluses. Stronger economic growth will assist in returning the budget to surplus and sustainable fiscal policy will promote good macroeconomic outcomes.

The Government is committed to returning the budget to sustainable surpluses that build to at least 1 per cent of GDP by 2023-24.

An essential element in putting in place sustainable fiscal policy settings is the National Commission of Audit, established by the Government to assess the role and scope of government and the efficiency of government spending. The Commission of Audit will be guided in its work by the principles that government should:

- live within its means;
- have respect for taxpayers in the care with which it spends every dollar of revenue; and
- do for people what they cannot do, or cannot do efficiently, for themselves, but no more.

Living within our means requires the elimination of waste, but it will also require people to adjust to reductions in some spending to which they have become

accustomed. Only in this way will the Government be able to sustainably fund the policies that are needed now and in the future.

The Government has already commenced the process of identifying savings by reversing some of the poor decisions taken by the former Government to yield savings of around \$1.1 billion over the forward estimates.

The MYEFO also demonstrates the Government's commitment to greater transparency and includes a revised economic projection methodology and assumption.

- It introduces additional information compared to past budget documents, including detailing the headline cash balance, the inclusion of confidence intervals for forecasts, and a structural budget balance discussion.
- A comprehensive Debt Statement detailing current and projected Commonwealth Government Securities on issue is included at Attachment F.
- It incorporates a revised assumption for the unemployment rate over the projection period and a new methodology for projecting the terms of trade over the medium-term. To better align the projected unemployment rate for 2015-16 and 2016-17 with the assumption for real GDP and the output gap, the unemployment rate is now assumed to remain at its last forecast level of 6¼ per cent in the two projection years. The new methodology for projecting the terms of trade involves a more detailed assessment of volumes and prices for major export categories.

