

Mid-year Economic and Fiscal Outlook 2011-12

ECONOMIC ALERT

29 November 2011

The 2011-12 Mid-Year Economic and Fiscal Outlook (MYEFO) was released today. The MYEFO highlights a weaker near-term economic and fiscal outlook for Australia since the Budget and substantial reductions to government revenues.

Global economic outlook

The deterioration in the global economic outlook means that world GDP is now expected to grow 4 per cent in 2011 and 3.5 per cent in 2012, compared with Budget forecasts of 4.25 per cent in 2011 and 4.5 per cent in 2012. The global recovery remains vulnerable to shocks, most notably emanating from Europe. Growth in emerging economies, led by China, while slowing, is holding up and is forecast to continue to drive global growth. However, a further sharp deterioration in the situation in Europe or the US would be expected to have spill-over effects on the growth performance of emerging market economies.

Australian Economic outlook

The weaker international environment is weighing on Australia's economic outlook, exacerbating existing pressures on some sectors of the economy and driving downward revisions to forecast growth in real GDP and employment since the Budget. Australia's economy is now forecast to expand by 3.25 per cent in 2011-12 and 2012-13, down from the 4 per cent and 3.75 per cent forecasts released in the Budget.

Consistent with the downward revisions to economic growth, the labour market is expected to soften further. Employment growth is expected to reach 1 per cent in 2011-12 and 1.5 per cent in 2012-13, down from the 1.75 per cent forecast for both years in the Budget. The unemployment rate is anticipated to rise and hit 5.5 per cent in 2011-12, remaining at that level in 2012-13.

Household consumption is forecast to grow below trend, increasing 3 per cent in both 2011-12 and 2012-13. This is weaker than expected at Budget, reflecting a slower anticipated pace of employment and wages growth over the forecast horizon. Dwelling investment is forecast to grow slower at 1.5 per cent in both 2011-12 and 2012-13, reflecting the further weakening in building approvals and in line with broader softness in the housing market. New business investment is expected to grow 14 per cent in 2011-12 and 14.5 per cent in 2012-13, reflecting strong forecast growth in resources investment but a weaker outlook for investment in other parts of the economy. Sustained strong demand for Australia's key non-rural commodity exports continues to drive record investment intentions in the mining sector.

With the Australian economy expected to grow at around its trend rate and the unemployment rate forecast to drift up a little, capacity pressures are expected to remain well contained, with forecast wages growth and inflation revised down since Budget. Headline inflation is forecast to increase from 2.25 per cent through the year to the June quarter of 2012 to 3.25 per cent through the year to the June quarter of 2013, including a one-off 0.75 percentage points increase due to the introduction of the carbon price. Underlying inflation is expected to remain well contained at 2.75 per cent through the year to the June quarter of 2013. This includes a one-off 0.25 percentage points addition due to the carbon price.

The introduction of the carbon price is fully accounted for in the MYEFO forecasts and is not expected to have a material impact on the economic outlook. In addition to the one-off increase in headline and underlying inflation, the carbon price is expected to reduce real GDP and employment growth by less than 0.25 percentage points in 2012-13, with no discernible impact on the forecast unemployment rate.

The risks to the outlook remain firmly on the downside. Against the backdrop of a fragile global economy, the sovereign debt crisis in Europe has shaken confidence and financial markets, and poses a significant risk that the global economic outlook could deteriorate quickly. In this environment, Australia's terms of trade could also decline more sharply than currently forecast.

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Table 1: Domestic economic forecasts

<i>Per cent</i>	2010-11	2011-12		2012-13	
		Budget	MYEFO	Budget	MYEFO
Real GDP	2.1	4.0	3.25	3.75	3.25
Employment growth	2.2	1.75	1.0	1.75	1.5
Unemployment rate	4.9	4.75	5.5	4.5	5.5
CPI inflation	3.6	2.75	2.25	3.0	3.25
Household consumption	3.4	3.5	3.0	3.5	3.0
Dwellings investment	2.8	1.5	1.5	3.0	1.5
Business investment	5.7	16.0	14.0	14.5	14.5
Exports of goods and services	0.4	6.5	6.0	5.5	6.0
Imports of goods and services	10.4	10.5	10.0	8.5	9.5

Fiscal outlook

The downward revision to the economic outlook from Budget has reduced tax receipts by over \$20 billion over the forward estimates. Lower employment growth since Budget is impacting on taxes on wages and salaries, and volatile financial markets are affecting equity prices and hence capital gains receipts (see Box 1). The underlying cash deficit is expected to be \$37.1 billion (2.5 per cent of GDP) in 2011-12, returning to a small surplus of \$1.5 billion (0.1 per cent of GDP) in 2012-13. The underlying cash deficit forecast for 2011-12 is \$14.5 billion higher than that anticipated in the Budget, while the surplus projected for 2012-13 is now \$2 billion lower than in the Budget. Table 2 presents the fiscal and underlying cash balances for 2011-12 to 2014-15 (more details in Appendix A).

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Table 2: Budget aggregates

	Estimates			
	2011-12		2012-13	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance(\$b)(a)	-22.6	-37.1	3.5	1.5
Per cent of GDP	-1.5	-2.5	0.2	0.1
Fiscal balance(\$b)	-20.3	-32.4	4.0	4.7
Per cent of GDP	-1.4	-2.2	0.3	0.3
	Projections			
	2013-14		2014-15	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance(\$b)(a)	3.7	1.9	5.8	3.1
Per cent of GDP	0.2	0.1	0.3	0.2
Fiscal balance(\$b)	3.2	4.2	8.5	6.4
Per cent of GDP	0.2	0.3	0.5	0.4

(a) Excludes expected Future Fund earnings.

Net debt is forecast to peak at 8.9 per cent of GDP in 2011-12, higher than previously anticipated. Still, the average net debt position of the major advanced economies (G7) is projected to reach 92.9 per cent of GDP in 2016, more than 10 times higher than the expected peak in Australia's net debt.

Box 1: Pressures on fiscal position

The underlying cash deficit in 2011-12 is projected to be \$37.1 billion, with the increase in the deficit since the Budget largely the result of:

- a downward variation of \$4.8 billion in tax receipts (including GST), predominantly the result of the softer economic outlook as the deterioration in global economic conditions has impacted on asset returns, investment and employment prospects, particularly in the non-mining sector of the economy;
- increased payments of \$2.3 billion under the Natural Disaster Relief and Recovery Arrangements, including an additional advance payment to Queensland to ensure the necessary reconstruction and repair work can happen as soon as possible;
- accelerated delivery of infrastructure projects under the Building Australia Fund and the Nation Building Programs, involving an additional payment of \$1.4 billion; and
- the decision to provide upfront support to households and businesses in the introduction of the Clean Energy Future package which has an impact of \$2.9 billion in 2011-12.

The change in the estimated deficit in 2011-12 is largely the result of variations to tax receipts and government payments as distinct from changes to government policy.

The Government has taken savings decisions of \$11.5 billion over the budget and forward estimates. After paying for the cost of the Clean Energy Future package and all other policy decisions since the 2011-12 Budget, the Government has achieved a net saving of \$6.8 billion in this MYEFO. Table 3 outlines the net budget impact of policy decisions taken since the 2011-12 Budget.

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Table 3: Net budget impact of policy decisions since the 2011-12 Budget

	Estimates		Projections		Total
	2011-12 \$m	2012-13 \$m	2013-14 \$m	2014-15 \$m	
Effect of policy decisions since 2011-12 Budget					
Spends(b)	-2,255	1,027	-589	-827	-2,644
Saves(b)	497	2,150	4,299	4,601	11,548
<i>Clean Energy Future</i> package	-3,102	-368	-352	523	-3,299
Less automatic CPI indexation associated with the <i>Clean Energy Future</i> package(c)	0	48	343	378	769
Total effect of policy decisions	-4,860	2,857	3,701	4,676	6,374
Add Contingency Reserve offsets to policy decisions	59	56	125	169	409
Net budget impact of policy decisions	-4,801	2,913	3,826	4,844	6,783

(a) Underlying cash basis.

(b) Excluding the *Clean Energy Future* package.

(c) This CPI indexation which was published with the *Clean Energy Future* package is an estimates variation, and is therefore not counted in the total effect of policy decisions.

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Appendix A: General Government Sector Budget Aggregates

	Estimates			
	2011-12		2012-13	
	Budget \$b	MYEFO \$b	Budget \$b	MYEFO \$b
Receipts(a)	342.4	336.4	378.5	374.6
Per cent of GDP	23.2	22.6	24.3	23.9
Payments(b)	362.1	370.1	372.1	370.1
Per cent of GDP	24.5	24.8	23.9	23.6
Future Fund earnings	2.9	3.5	2.9	3.0
Underlying cash balance(c)	-22.6	-37.1	3.5	1.5
Per cent of GDP	-1.5	-2.5	0.2	0.1
Revenue(a)	350.0	344.1	383.1	382.8
Per cent of GDP	23.7	23.1	24.6	24.5
Expenses	365.8	371.7	380.5	379.9
Per cent of GDP	24.8	25.0	24.4	24.3
Net operating balance	-15.9	-27.6	2.6	2.8
Net capital investment	4.4	4.8	-1.4	-1.9
Fiscal balance	-20.3	-32.4	4.0	4.7
Per cent of GDP	-1.4	-2.2	0.3	0.3
<i>Memorandum item:</i>				
Headline cash balance	-31.9	-43.3	0.8	-6.4
	Projections			
	2013-14		2014-15	
	Budget \$b	MYEFO \$b	Budget \$b	MYEFO \$b
Receipts(a)	395.9	396.6	415.5	416.0
Per cent of GDP	24.1	24.0	24.0	23.9
Payments(b)	389.2	391.6	406.5	409.5
Per cent of GDP	23.7	23.7	23.5	23.6
Future Fund earnings	3.0	3.2	3.2	3.4
Underlying cash balance(c)	3.7	1.9	5.8	3.1
Per cent of GDP	0.2	0.1	0.3	0.2
Revenue(a)	405.2	407.5	425.8	428.2
Per cent of GDP	24.7	24.7	24.6	24.6
Expenses	399.0	400.6	414.1	418.9
Per cent of GDP	24.3	24.3	23.9	24.1
Net operating balance	6.2	6.9	11.7	9.3
Net capital investment	3.0	2.8	3.2	2.9
Fiscal balance	3.2	4.2	8.5	6.4
Per cent of GDP	0.2	0.3	0.5	0.4
<i>Memorandum item:</i>				
Headline cash balance	0.3	-4.0	3.8	-1.1

(a) Includes expected Future Fund earnings.

(b) Equivalent to cash payments for operating activities, purchase of non-financial assets and net acquisition of assets under finance leases.

(c) Excludes expected Future Fund earnings.