AUSTRALIAN INDUSTRY GROUP

REVIEW OF THE 2014-15 FEDERAL BUDGET

14 May 2014

Key points for business

This year's federal Budget sets some ambitious long-term targets for Government, but it also presents some short-term risks to the Australian economy.

> *"The Government has big fiscal ambitions for this budget and is backing them with decisive steps to put the budget on a firm long-term footing. However, with the economy at a pivot point characterised by fragile confidence; flat lining productivity; and below-trend growth, the budget also carries some risks to Australia's short-term economic health*," Australian Industry Group Chief Executive Innes Willox said.
>
> "*The Government's proposals to rein in spending growth and to reintroduce fuel tax indexation in the face of the undisputed longer-term pressures on Australia's public finances are difficult measures spread across all sections of the community – including businesses. They are, nevertheless, necessary directions if the budget is to be put on a more secure foundation and if the Australian economy is to be made more productive and resilient. In this context the targeted surplus on fiscal balance in 2017-18 is welcome.*"

The centerpiece of this Budget for business is the 1.5% cut to the company tax rate for all businesses. Although this is scheduled to start from 1 July 2015, it is not funded in detail in this year's budget, reflecting the political uncertainty around its introduction. Similarly, the PM's signature Paid Parental Leave (PPL) scheme and the 1.5% PPL levy on 3,000 large businesses to pay for it, are listed in the Budget but are not detailed as revenue or expenditure items for next year.

A 1.5% cut to the R&D tax concession will take effect from 1 July 2014, at an additional cost to business of $550mon over the next four years. This will further erode businesses' capacity to invest in innovation at a time when our economy needs to develop new products, services and processes as it rebalances in the face of declining investment in mining projects and further falls in commodity prices.

Implementing this company tax cut remains important to Australian business in the face of extremely high local costs that impede international competitiveness. Australia is now among the most expensive and least competitive countries in which to do business globally, as assessed by the likes of the WEF, IMF and Productivity Commission, on many relevant measures.

Across key industry and education programs that directly affect business, the key themes of this year's Budget are:

1. Consolidation of existing multiple programmes into single, more streamlined, delivery models; and
2. Reduced funding allocations to existing and replacement programmes.

Ai Group welcomes the streamlining and 'de-cluttering' of Government initiatives. We are however, concerned about the impending cessation of such successful and popular programs as Enterprise Connect (business development) and the longstanding Workplace English Language and Literacy (WELL) program. We are also concerned about the adequacy of funding levels for the new arrangements, given the Government's own outlook.

Ai Group also welcomes the funding commitments provided across a range of key national infrastructure projects. Although the quantum increase in funding is small (just $5bn additional funds allocated to infrastructure investment over the forward estimates), the certainty of commitment is of great value. These projects will help to reduce transport costs for all and to boost productivity in due course. In the short term, they will also add to the pipeline of construction activity, to help fill the 'growth gap' in investment that is opening up in the wake of the recent mining investment boom.

The Government's plan to delay the phased increase in the Superannuation Guarantee (SG) and maintain it at 9.25% from 1 July 2014 has been thwarted by the Senate and the increase to 9.5% already scheduled in legislation will now go ahead from 1 July. The Government's new plan is to freeze the SG for four years before it starts to increase towards a target of 12% by 2022-23, one year later than the Government previously proposed.

On the economic outlook, the Government expects Australian economic growth to remain below average, at around 2.5% p.a. for the next few years. The unemployment rate will rise to 6.25% in 2014-15 and remain there in 2015-16. These forecasts are broadly unchanged from the last set of Treasury estimates (published in the mid-year outlook in December). They represent a reasonable and prudent assessment of the short to medium term outlook, based on current conditions.

Table 1: Key measures affecting business, Federal Budget 2014-15

Measure	Start	$ (est.)	Timing	Impact on business & economy
Business & industry programs				
Direct Action Carbon Plan		+$1.9bn	4 years	Assist with pollution reduction costs
'Entrepreneurs' Infrastructure Programme' commences	1 Jul 2014	+$484.2mn	5 years	Supports small business
End of Enterprise Connect & other development programs	1 Jan 2015	-845.6mn	5 years	↓ investment, ↓ innovation
CSIRO reduced	1 Jul 2014	$111.4mn	4 years	↓ investment, ↓ innovation
Clean Tech & CRC's reduced	1 Jul 2014	-$124.7mn	5 years	↓ investment, ↓ innovation
ATS to cease in 2018	End 2018	-$618.5mn	8 years	$1bn retained in ATS until 2018
Supporting auto jobs axed	No start	-$200mn	2 years	Reduced adjustment assistance
Growth Fund for Vic & SA	1 Jul 2014	+$100mn	4 years	Assist with adjustment costs
Manufac. transition grants	1 Jul 2014	+$50mn	2 years	Assist with adjustment costs
Ethanol Grants abolished	1 Jul 2015	-$120mn	6 years	↑ costs
Cleaner Fuels Grants end	1 Jul 2015	-$156mn	Four years	↑ costs
AREA abolished	2017-18	-$1.3bn	5 years	$1bn retained for legacy projects
Superann. Guarantee to 9.5%	1 Jul 2014	-	4 years	↑ costs
Education and training programs				
Industry Skills Fund	1 Jan 2015	+$476mn	4 years	↑ skills, ↑ productivity
End of 10 skills programs	1 Jan 2015	-$1bn	5 years	↓ skills, ↓ productivity
Apprentice tools for trade	End 2014	-$914.6mn	4 years	↓ skills, ↓ productivity
Trade Support Loans for apprentices	1 July 2014	+439mn	4 years	-
Restart Program	1 July 2014	+$304mn	4 years	↑ jobs
Trade promotion programs				
Tourism Infrastructure Grants	1 Jul 2014	$43.1mn	4 years	↑ investment, ↑ exports
Australia Week in China	2016	2mn	2 years	Promote trade with China
Protection of the Sea Levy cut	1 July2014	$39mn	4 years	↓ costs
New taxes and charges				
R&D tax incentive cut by 1.5%	1 Jul 2014	-$550mn	4 years	↓ investment, ↓ innovation
Cut company tax by 1.5%	On hold			-
1.5% PPL levy	On hold			-
2% deficit levy, over $180k	1 Jul 2014	-$3.1bn	3 years	↓ consumer spending, ↓ jobs
Petrol excise indexation	1 Jul 2014			↑ costs, ↓ consumer spending
Biodiesel fuel excise rise	1 Jul 2016		5 years	↑ costs

Changes to business, education and training programs

The 2014-15 Federal Budget seeks to save money across a large number of Government programs and agencies. Many agencies are earmarked to be abolished, merged or reduced. Some significant changes have been announced for several key business support and assistance programs, including the replacement of a large suite of existing business development programs with a single new '**Entrepreneurs' Infrastructure Programme' (EIP)**. A separate **Grants Program** will also continue to provide a small degree of support for investment and innovation in manufacturing.

In a separate move, the Government announced that the Superannuation Guarantee will rise to 9.5% from 1 July 2014, from the current rate of 9.25%. it will then be frozen for four years to 2018, in order to provide some stability in business costs over this period. From 2018, it will then increase by the 0.5 percentage points per year until it reaches 12% in 2022-23, which will be one year later than in the previous timetable. This SG change is subject to approval by the Senate.

Business investment and innovation programs

The **EIP** will be funded at **$484.2mn over five years from 2013 14**, versus savings of $845.6mn from the existing programs that are being discontinued. The new focus will be to support the commercialisation of good ideas, job creation and lifting the capability of small business, the provision of market and industry information, and the facilitation of access to business management advice and skills from experienced private sector providers and researchers. It will be delivered through a single agency model by the Department of Industry to achieve efficiencies and reduce red tape.

This program will replace the following business development programs, which will cease from 1 January 2015:

- Australian Industry Participation;
- Commercialisation Australia;
- Enterprise Solutions;
- Innovation Investment Fund;
- Industry Innovation Councils;
- Enterprise Connect;
- Industry Innovation Precincts; and
- Textile, Clothing and Footwear Small Business and Building Innovative Capability.

To complement the EIP and to provide a greater degree of support to manufacturers, the Government will provide $50mn over three years for a **Manufacturing Transition Grants Programme** to assist Australian manufacturers transition to higher value manufacturing activities and/or niche activities which result in a new end product and improve competitiveness.

This program will provide grants of $5.0mn to $10.0mn to support activities including: alterations and/or extensions to premises to facilitate a new production process; the acquisition of machinery and equipment required for the new production process; and specialised training in the use and maintenance of the new machinery and equipment.

Overshadowing this Grants allocation however, the Government will achieve savings of $124.7mn over five years by reducing funding for the **Clean Technology (Investment and Innovation)** programs and **Cooperative Research Centres** (CRCs). The Government will save a further $3mn over two years by returning to the Budget unspent funding under various grant programs in the Industry portfolio. The **Plantation Manufacturing Innovation and Investment Fund** will also cease, saving $15.5mn over the next three years.

Also in manufacturing, $1.5mn will be taken out of the remaining year (2014-15) of the **Textiles, Clothing and Footwear Structural Adjustment Programme**, leaving $1mn in place to cover remaining employment assistance commitments.

In a blow to Australia's public sector R&D capabilities, **CSIRO** will face budget cuts worth $111.4mn over the next four years. In a small gain for CSIRO, an additional $65.7mn will be available over the next four years for CSIRO's new research vessel, the *RV Investigator*. Funding for the **Australian Nuclear Science and Technology Organisation** (ANSTO) will be cut by $27.6mn and the **Australian Institute of Marine Science** will lose $7.8mn over the next four years. ANSTO will however, be allocated $22.6mn to develop design options for a national radioactive waste facility.

Emissions and pollution reduction programs for business

- The **emissions reduction fund** is funded for $75.5mn this year, rising to $299.8mn in 2014-15 and $416.9 mn in 2017-18.
- Balanced against this, the **Australian Renewable Energy Agency** (AREA) will be abolished. The Government will achieve savings of $1.3bn over five years from 2017-18 (including $223.3 mn in 2018-19, $455.9mn in 2019-20, $125.4mn in 2020-21 and $131.1mn in 2021-22) by abolishing the AREA and repealing the *Australian Renewable Energy Agency Act 2011*. Funding of $1.0bn over eight years will remain available to support existing priority projects. This measure includes funding of $24.1mn over eight years from 2014-15 for the Department of Industry to manage legacy functions, saving $357mn in 2017-18.
- The **Carbon Capture and Storage Flagships Program** loses $162.9mn in the next four years and a total of $459.3mn by 2019-20. Funding of $191.7mn over seven years will remain available to support existing projects.
- The **National Low Emissions Coal Initiative** loses $16.8mn in funding over the next four years.
- The **Ethanol Production Grants Program** will cease, saving $120mn over the next 6 years.
- The **Cleaner Fuels Grants Scheme** will cease, saving $156mn over the next four years. This is being offset by a cut to excise on biodiesel fuels.

Trade related programs

- Changes were announced to funding arrangements for either the popular **Export Markets Development Grants** (EMDG) or the **Export Finance and Investment Corporation** (EFIC). In a similar move to the company tax rate and the PPL however, no additional funding or dates were attached to these programs in the Budget's detailed expense measures.
- After a successful trade mission to China in 2014, the Government will provide $2.0mn over two years to hold an **Australia Week in China (AWIC) promotional event in 2016**. The AWIC will help to build Australia's reputation in China as a world leading tourism destination and an important trade and investment partner.
- The Government will provide $43.1mn over four years to implement a new **Tourism Demand Driver Infrastructure grants program**. The new programme will provide funding to the States and Territories for infrastructure projects that encourage international and domestic tourism.
- For businesses involved in the import and export of live animals and items subject to biosecurity controls, the Government will move to **full cost recovery for all border biosecurity services**. Fees will commence from 1 July 2014, with fee levels to be set by regulation at a later date.
- For importers and exporters using shipping services the Protection of the Sea Levy (PSL) will reduce from 14.25 cents to11.25 cents per net registered tonne for defined vessels on an ongoing basis from 1 July 2014. This is estimated to reduce revenue by $39.0mn over four years from 2014-15. The PSL was increased from 11.25 cents to 14.25 cents, with effect from 1 April 2010, to recover the pollution-related clean-up costs in excess of the amount paid by the Pacific Adventurer shipowner. It was retained at 14.25 cents in the 2013-14 Budget to allow the Australian Maritime Safety Authority to establish a $10.0mn pollution response reserve and implement the upgrade and modernisation of the national stockpile of oil and chemical spill equipment. These activities are now complete and so the additional funding measure has ceased.

Automotive industry adjustment measures

The **Automotive transformation Scheme (ATS)** will cease from 1 January 2018, to reflect announcements by vehicle manufacturers that they will cease vehicle manufacturing in Australia by the end of 2017. Funding of approximately $1bn over five years from 2013-14 will be available under the ATS to support vehicle manufacturers and supply chain companies. The Government will achieve savings of $618.5mn over eight years from 2013-14 (including $176.7mn in 2018-19, $95.2mn in 2019-20 and $28.6mn in 2020-21) by terminating the ATS on 1 January 2018.

The Government will also not proceed with the **Supporting automotive sector jobs measure** announced in the *Pre-Election Economic and Fiscal Outlook 2013* (PEFO). Funding for this measure was included as a 'decision taken but not yet announced' in the Mid-Year Economic and Fiscal Outlook 2013-14 (MYEFO).

GM Holden's 'next generation' vehicle project is cancelled, providing a further budget saving to Government of $215mn over the next four years.

In response to the end of vehicle assembly in Australia by 2017, the Government will provide $100.6mn over six years from 2013-14 (including $0.5mn in 2018-19) to establish a $155mn **Growth Fund** to support new jobs, investment and economic growth in South Australia and Victoria. The remaining funding ($54.4mn) will be provided by the Victorian and South Australian governments, Holden and Toyota. The Growth Fund includes the following components and Commonwealth contributions:

- $35.8mn over five years to establish the **Next Generation Manufacturing Investment Programme** to support investment in high-value manufacturing in Victoria and South Australia;
- $29.8mn over five years to establish the **Regional Infrastructure Programme** to encourage investment in capital projects outside of manufacturing to support new business opportunities;
- $20.0mn over five years to establish the **Automotive Diversification Programme** to assist component suppliers to transition to new products and markets, including redirecting existing uncommitted funding of $16.9mn from the Automotive New Markets Initiative;
- $15.0mn over two years from 2016-17 to extend the **Automotive Industry Structural Adjustment Programme** to assist automotive workers made redundant to find employment; and
- the **Skills and Training Programme**, funded by Holden and Toyota, to transition automotive workers into new jobs through skills recognition and training.

Fair Entitlements Guarantee (FEG, previously known as GEERS)

This program covers unpaid employee entitlements in the event of insolvency or bankruptcy. From January 1, 2015, the maximum redundancy payment under the FEG scheme will be capped at 16 weeks, in line with the maximum set by the National Employment Standards. Employees seeking to claim an entitlement above the maximum set by the NES will maintain rights as creditors to recoup any outstanding entitlement through the winding up of their employer's business.

From 1 July 2014, indexation of the Maximum Weekly Wage used in calculating entitlements for claimants earning above the Maximum Weekly Wage of $2,451, will be paused until 30 June 2018. The changes will apply only to liquidations and bankruptcies that occur on or after the commencement date.

Industry Skills Fund (ISF)

The Government will provide $476.0mn over four years to establish **the Industry Skills Fund** (ISF) from 1 January 2015 to support the training needs of small to medium enterprises which cannot be readily met by the national training system. Industries targeted will include: health and biomedical products; mining, oil and gas equipment technology and services; and advanced manufacturing, including defence and aerospace.

The ISF is expected to deliver 121,500 training places (providing participants with qualifications, skill sets and recognition of both prior learning and current competencies) and 74,300 support services (including mentoring and foundation skills) over four years. Businesses will be required to make co-contributions towards the cost of training on a sliding scale depending on the size of the enterprise.

The ISF will replace the following ten skills and training programs from 1 January 2015, which were collectively worth $1.0bn over five years from 2013-14. This represents a significant reduction in Government support for workplace skills.

- National Partnership Agreement on Training Places for Single Parents;
- Accelerated Australian Apprenticeships Programme;
- Australian Apprenticeships Mentoring Programme;
- National Workforce Development Fund;
- Workplace English Language and Literacy Programme;
- Alternative Pathways Programme;
- Apprenticeship to Business Owner Programme;
- Productive Ageing through Community Education;
- Australian Apprenticeships Access Programme; and
- Step Into Skills Programme (including additional savings of $0.8mn in 2013-14 by not commencing the programme as scheduled).

Apprenticeships

- The Government will achieve savings of $914.6mn over four years by ceasing **Tools For Your Trade** payments from 1 July 2014. Financial assistance to help apprentices will instead be provided through the Trade Support Loans Programme, to a value of $439mn over the next five years. This will significantly reduce the financial support available to support the cost to young people of undertaking apprenticeships.

Mature age workers

Employers who hire mature age unemployed people (aged 50 years or over, and including disability support pensioners) will be eligible for a payment of up to $10,000, in a new '**Restart' Programme**. This will be additional to other wage subsidies that might apply. Payments will begin after the worker has been employed for at least six months and will be paid in instalments over up to 24 months. This Program will cost around $304mn over the next four years, including $221mn previously allocated to mature age workers in the MYEFO in December.

Defence investment

There were no new investment or spending announcements (increases or cuts) for the Defence portfolio this year. The purchase of 58 F-35 Joint Strike Fighters was confirmed, at a total cost of $12.4bn. A further $1.6bn will be spent on associated support infrastructure for the JSF in NSW and the Northern Territory.

Procurement agency Defence Material Australia will be merged into the Department of Defence, as recommended by the Commission of Audit.

Changes in other business fees and charges

- The Australian Transaction Reports and Analysis Centre's (**AUSTRAC) industry levy** will move to a full cost recovery basis over the next four years. AUSTRAC currently recovers around 53 per cent of its total expenses from industry. Under this measure, industry contributions to AUSTRAC's total expenses will increase to 70 per cent in 2014-15, 90 per cent in 2015-16 and 2016-17, and 100 per cent in 2017-18. The Government will increase revenue by $79.1mn over four years. Only the largest (around 1,029) reporting entities will be required to contribute towards AUSTRAC's expenses. The current $300 base component fee for AUSTRAC's 3,638 smallest regulated entities will no longer be subject to any charge.

Paid Parental Leave (PPL) scheme

- The PPL was included as a headline announcement in this Budget but was not explicitly funded. Instead, it is included in the 'contingency' funding, which suggests that its introduction is not certain. Details of the scheme are not included in the Budget Papers.
- If it is finalised and approved, the PPL will replace the current PLP scheme which pays new mothers who are employees a national Parental Leave Pay, based on the National Minimum Wage. Parental Leave Pay is currently

$622.10 per week (pre-tax) for a maximum of 18 weeks. This is additional to any parental leave or pay entitlements paid by individual employers. Ai Group supports the retention of the current parental leave pay scheme, due to the very high estimated cost of the proposed PPL replacement scheme.

- ATO tax data for 2011-12 (latest available) indicates that just 3.2% of female taxpayers aged 45 years or under who earned some or all of their income from wages and salaries had a taxable income over $100k (127,275 women). Their average income from wages and salaries in 2011-12 was $119,033. Many (but not all) women in this higher income bracket also earned income from other sources. ATO data indicate that as for male taxpayers, women in the higher tax brackets tend to earn more of their taxable income from sources other than wages and salaries (e.g. from businesses, partnerships, trusts or dividends).

Investment announcements

While infrastructure was slated as the centerpiece of the Budget, the amount of additional funding announced in the Budget was relatively small. A total of $6.6bn of new funds were announced, of which only around $5bn will be spent over next five years. This consisted of:

- $3.7bn for major road projects, including the East West Link in Melbourne, WestConnex in Sydney,
- $2.9bn over ten years for the Western Sydney infrastructure plan to develop the area around Badgery's Creek, the site of the new second Sydney airport. Only $1.2bn of this spending will take place in the five years detailed in the budget.

The Budget also redirected $5.9bn of funding from existing measures ($2.4bn from the previous government's *Building Australia Fund* and $3.5bn from the *Education Investment Fund*) into a new **Asset Recyling Fund**, which would be used to top up any funds raised by states privitising public assets. The proceeds from the sale of Medibank Private, which is expected to raise $4bn, will also go into this fund. This money is not committed to any projects.

These measures, along with past Budget announcements, bring the total infrastructure spend to $40bn over the five years from 2013-14 until 2018-19.

Road Projects and total federal funding committed

NSW

- Western Sydney Infrastructure Project (improving roads around Badgery's Creek) **$2.9bn**
- Pacific Highway upgrade (completion of upgrade to dual carriage way by the end of the decade) **$6.7bn**
- M4 and M5 extensions (aka Westconnex) (Concessional loan of **$2bn in addition to existing $1.5bn**)
- M1 to M2 extension (aka Northconnex) **$405mn**
- M1 (previously known as the F3) Productivity Package **$195.8mn**

Victoria

- East West Link stages 1 and 2 (This Budget assigned $1 bn in new funding) **$3bn**
- Princes Highway duplication (Winchelsea to Colac) **$185.5mn**
- Western Highway – Ballarat to Stawell Duplication **$263.4mn**
- St Albans Road Rail Level Crossing **$151mn**

Queensland

- Bruce Highway upgrade (45 new projects) **$6.7bn**
- Gateway Upgrade North **$929.6mn**
- Toowoomba Range Crossing **$1.285bn**
- Warrego Highway **$508mn**

South Australia

- South Road Upgrade **$944mn**

Western Australia

- Perth Airport Gateway **$611.4mn**
- Swan Valley Bypass **$589.7mn**

Tasmania

- Midland Highway **$400mn**

Rail Projects

The Abbott Government significantly wound back spending on rail projects in the mid-year update in December, withdrawing funding for major rail projects across the country.

However this Budget did contain $866mn of new funding for the Perth freight link which links Perth airport and Fremantle port. It also maintained $691.6mn funding for Northern Sydney Freight Corridor, an upgrade of rail between Sydney and Newcastle. It also included $232mn for the Adelaide's upgrade of Goodwood and Torrens Junctions, which will separate interstate freight line from the metropolitan rail network.

Finally, the Budget also included **Hobart International Airport Runway Extension**. This was a $38.0mn commitment over three years from 2014-15 for a runway extension of up to 500 metres and associated capital works.

New taxes and charges

The revenue section of this year's Budget was most notable for its omissions. The 2014-15 Budget did not contain a line item for the **1.5% PPL levy** slated for the country's top 3000 business to fund the PPL, nor did the Budget include the 1.5% point **cut in the company tax rate**. However, these measures together with the cost of the Paid Parental Leave scheme itself have all been rolled into a "contingency item" within this year's Budget. This casts some doubt on the future of the scheme, although Budget material indicated the Government was committed to scheme beginning on July 1, 2015 paying an eligible parent six months' salary capped at $100,000 annual income.

The Government announced $8.7bn of additional revenue measures over the five years, lifting the taxation to GDP revenue to 25.5% in 2017-18, its highest level since 2005 and well above the Abbott Government's ambition of tax at a long-term average of around 24% of GDP.

The main revenue measures affecting business in this year's Budget are:

- Reduction in **Research and Development** tax offset incentives by 1.5 percentage points, effective from 1 July 2014. This will cost business an additional $550.0mn over the forward estimates period.
- Reintroduction of **fuel excise indexation**, with biannual indexation to inflation beginning from August 1 2014. This will raise $2.2bn over the forward estimates. Fuel Tax Credits will increase to offset the impacts of increases in excise for businesses.
- A temporary three-year **deficit levy** of 2% on personal income taxpayers earning more than $180k p.a. levied from July 1, 2014 through until June 30, 2017. This is forecast to raise $3.1bn over the forward estimates, and means a taxpayer earning $300,000 a year will pay an additional $2,400 in tax. In 2011-12 (the latest year for which tax data are available), just 292,735 taxpayers (3% of all taxpayers) earned a taxable income over $180k. 13% of this high-earning group – 38,635 people – earned their income from running a business, a far higher proportion than the 8% of all taxpayers who earned at least some of their income from running a business.
- Abolition of the **Mature Age Worker Tax Offset** from July 1, 2014, which will increase revenue by $760.0mn over the forward estimates period. This incentive was paid to taxpayers born before 1 July 1957. However, the Government say encouraging mature age workers to participate in the workforce can be done more effectively through direct payments or incentives. Around $302mn of the savings will be redirected to the Government's expanded seniors employment incentive payment called **Restart** to support mature age job seekers to re-enter the workforce. From 1 July 2014, a payment of up to $10,000 will be available to businesses who hire a mature aged job seeker, aged 50 years or over who has been receiving income support for at least six months.
- On the positive side for importers, the **Korea-Australia Free Trade Agreements** will cost the budget $635mn over the forwards in foregone lost tariff revenue no longer paid by importers of Korean products.

Economic outlook

Overall, the outlook is for the economy to continue to grow below trend in the short-term before strengthening to above trend growth in the final years of projections in 2016-17 and 2017-18. This economic outlook is slightly more optimistic than the one presented in the Mid-Year Update (Chart 1 and Table 2).

Real GDP is expected to grow by 2.75% in the current financial year, which is still below the trend growth considered to be around 3% but firmer than the 2.5% forecast in December. The upward revision to this year's growth owes to a firmer near-term outlook for the household sector. Treasury says "leading indicators of dwelling investment are consistent with rising activity, while household consumption and retail trade outcomes have improved recently, consistent with gains in household wealth." However, Treasury also note that both resources and non-resource business investment intentions have been weaker than expected dampening growth.

Looking further ahead, real GDP growth is forecast to slow modestly in 2014-15 back to 2.5%, and then return to trend growth of 3.0% in 2015-16, before strengthening to above-trend growth of 3.5% 2016-17 and 2017-18.

Underlying the return to trend growth over the medium-term are continued strengthening in household consumption and dwelling investment, which is forecast to peak at growth rate of 7.5% growth in 2014-15. Business investment is forecast to decline each year through until 2015-16, given continued weakness in non-dwelling construction, while machinery and equipment spending is only forecast to recover in 2015-16.

Public demand is forecast to grow by 1.5% in 2014-15 and by 1% in 2015-16, which represents a significantly smaller than average contribution to overall growth from public demand. Net exports will contribute to growth across the forecast horizon, owing in large part to rising output from resource sector projects. The headline annual pace of fiscal consolidation presented in this Budget is 0.7 per cent of GDP over the forward estimates. However, the fiscal consolidation is only modest in the near-term before rising sharply by the end of the forward estimates.

Nominal GDP forecasts are expected to remain subdued owing to further sharp falls in key commodity prices since the start of the year, together with a further expected decline in terms of trade. Developments within the domestic economy, namely subdued domestic price growth in the absence of wage pressures, will also dampen nominal GDP growth.

The outlook for the labour market is also slightly rosier than the forecasts presented in the December MYEFO. The unemployment rate will rise to 6.0% by June 2014, then lift further to 6.25% by June 2015 where it will be stable through until 2016-17 when it will begin falling to 5.75% by 2017-18. This is contrast to the December forecasts which predicted the unemployment rate would rise to 6.25% and remain stuck there for several years.

Table 2: Major economic forecasts

	Outcomes	Forecasts			Projections	
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Real GDP	2.6	2 3/4	2 1/2	3	3 1/2	3 1/2
Employment	1.2	3/4	1 1/2	1 1/2	2 1/4	2
Unemployment rate	5.6	6	6 1/4	6 1/4	6	5 3/4
Consumer price index	2.4	3 1/4	2 1/4	2 1/2	2 1/2	2 1/2
Wage price index	2.9	2 3/4	3	3	2 3/4	3
Nominal GDP	2.5	4	3	4 3/4	5	5

(a) Year average unless otherwise stated. In 2013-14, 2014-15 and 2015-16 employment, wages and the consumer price index are through the year growth to the June quarter and the unemployment rate is the rate for the June quarter.
Source: ABS cat. no. 5206.0, 6202.0, 6345.0, 6401.0 and Treasury.

The strengthening in the economy together with revenue rises and spending cuts announced in this Budget have led to a sizeable improvement in the fiscal position over the forward estimates (Chart 2). Over the four years to 2017-18, deficits are estimated to total just $60bn, which represents a $43.8bn improvement compared with the 2013-14 MYEFO.

The 2014-15 underlying cash balance is forecast to be $29.8bn (or -1.8% of GDP), an improvement on the $49.9bn deficit in the current year. Over the forward estimates, the budget deficit will narrow each year eventually to a small deficit of $2.8bn (-0.2% of GDP) by 2017-18.

At the mid-year update, the Government projected total debt (Commonwealth Government Securities on issue) would peak at $667bn in 2023-24. In this Budget, Treasury have almost halved the forecast so that debt is now projected to peak at $326bn. This will reduce the cost of servicing debt has on the budget, where net interest payments are expected to peak at $13.1bn in 2018-19 and decline to $6.6bn in 2024-25 (0.2 per cent of GDP). In 2023-24, projected net interest payments have fallen the 2013-14 MYEFO projection of $31.5bn to $8.3bn in this Budget. This is a reduction in net interest costs of $23.2bn.

Chart 1: Australian GDP growth, actual and Budget forecasts

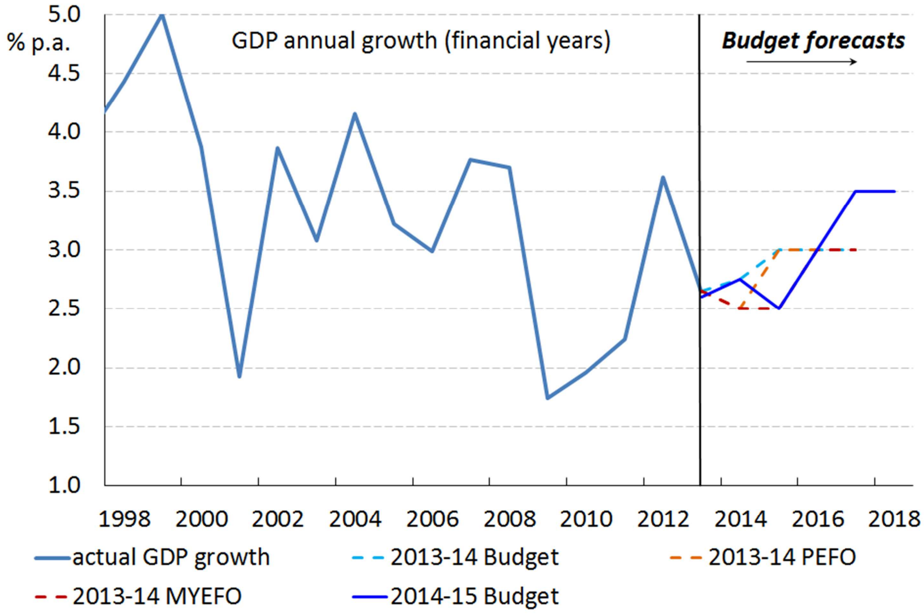
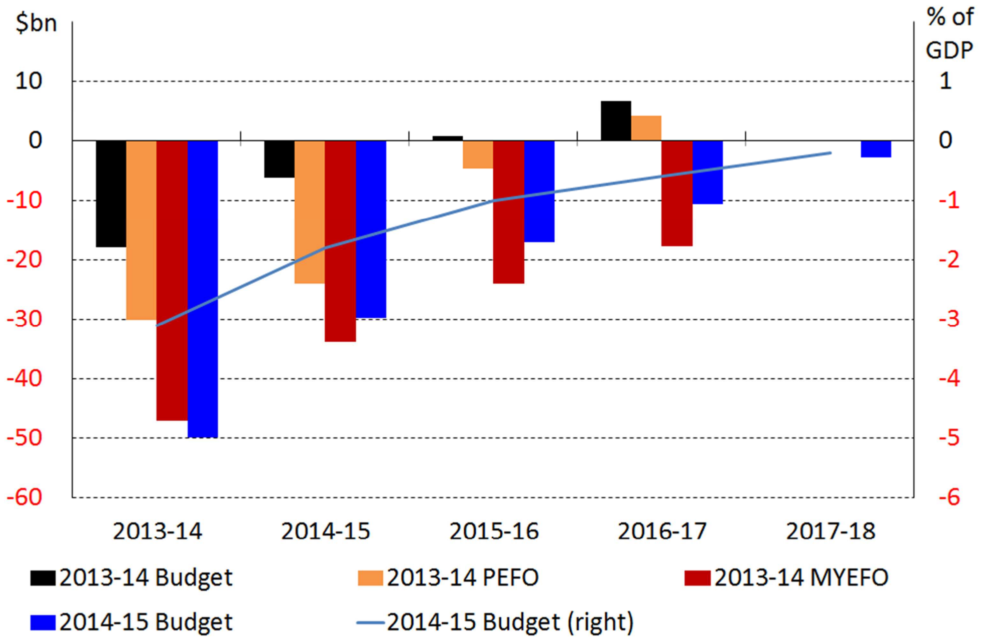


Chart 2: Underlying cash balance, successive Budget estimates



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