Australian Federal Budget Update
2012/13 budget surplus: $3.1bn up from $1.0bn

- **The Australian Federal Government updated their economic and budget forecasts. This is timely with reports that the announcement of an election is imminent.**
- **The Government remains committed to returning the budget to surplus in 2012/13, as was the case on Budget night, 11 May.**
- **The 2012/13 underlying cash budget surplus is now forecast to be $3.1bn, up from $1.0bn at Budget time. That provides the Government with some scope for modest new policy measures ahead of an election.**
- **The economic growth forecasts underpinning these fiscal forecasts appear credible in our view. Although, we would stress that the budget position is sensitive to terms of trade surprises.**
- **A key focus in this Statement is some additional detail on the new mining tax, the Minerals Resource Rent Tax (MRRT), and how that impacts the budget relative to the originally proposed Resource Super Profits Tax (RSPT). The net impact of the new arrangements is a $1.5bn reduction in revenue over the forward estimates, as indicated by the Government on 2 July. The new information is that the policy change reduces revenue by $7.5bn while there is a $6bn offset from higher commodity price forecasts.**
- **Economic conditions in 2009/10 are proving to be a little stronger than anticipated, while the Government has lowered forecast real GDP growth for the following two years largely in recognition of more cautious consumer spending.**
- **Real GDP growth is forecast to be 2.25% in 2009/10 (up 0.25%), 3.00% in 2010/11 (down 0.25%) and 3.75% in 2011/12 (down 0.25%). By comparison Westpac expects a little more growth in 2010/11 and a little less in 2011/12. Differing views on the timing of the housing cycle contributes to this profile variation.**
- **The more critical forecast, from a revenue perspective, is nominal GDP. Here, the Government is now more optimistic for this year and next reflecting a higher terms of trade. See table 2 for more details. Again, we view the revised forecasts as credible, but highlight the volatility of global commodity prices is a major risk factor.**
- **The Government recognises that the terms of trade is likely to decline at some stage in the future, forecasting a 4.5% fall in 2011/12, as commodity supply responds.**

Table 1

Underlying cash balance ($bn)

	10/11	11/12	12/13	13/14
July update	–40.4	–10.0	**3.1**	4.8
% of GDP	–2.8	–0.7	0.2	0.3
Budget, May	–40.8	–13.0	**1.0**	5.4
% of GDP	–2.9	–0.9	0.1	0.3

Sources: Budget papers, Westpac Economics

Table 2

Key forecasts		**2009/10**	**2010/11**	**2011/12**
Real GDP	July	2.25	3.00	3.75
(% chg)	Budget	2.00	3.25	4.00
Nominal GDP	July	3.25	9.25	5.25
(% chg)	Budget	2.75	8.50	5.75
Terms of trade	July	–3.00	17.00	–4.50
(% chg)	Budget	–3.75	14.25	–3.75
Westpac's forecasts				
Real GDP		2.3	3.5	3.3
Nominal GDP		3.5	9.2	5.7
Terms of trade		–2.0	16.5	flat

Sources: Budget papers, Westpac Economics

There were no major surprises in the Government's Statement from an economic or fiscal perspective. On current policy settings and on the current economic outlook, the budget is set to return to surplus in 2012/13 - as forecast on Budget night.

If achieved, the net debt position of the Commonwealth Government is very manageable. Net debt is forecast to peak at just 6.0% of GDP in 2011/12 ($89.2bn, little changed from the Budget night forecast of $90.5bn). This peak in net debt is well below the 1990s cycle peak of 18.0% of GDP. By way of international comparison, the net debt position of the major advanced economies is expected to reach 94% of GDP in 2015.

The Government is committed to holding annual real growth in spending to 2% of GDP until the budget returns to surplus. On current policies, real payment growth is 1.4% in 2010/11, –1.1% in 2011/12, 1.5% in 2012/13 and 1.8% in 2013/14.

- The Government could lift spending in the 2010/11 year by around $2bn and still be consistent with the 2% cap. Although, note that the 2010/11 estimate is dependent upon the final outcome for expenditure in 2009/10.

In terms of the economic growth forecasts, the upgrade to the 2009/10 real GDP number to 2.25% and the upgrades to the terms of trade forecasts for this year and next brings the Government's numbers broadly into line with our current forecasts (see table 2).

The budget position is sensitive to surprises on the terms of trade – as apparent in this Update, with the surprise on the high side.

- The recent cooling of conditions in China will need to be closely watched. Indeed, spot iron ore prices are already reflecting the slowdown in China construction with falls of 20–25% being recorded.

The Government is now a little less optimistic on real GDP growth prospects for 2010/11 and 2011/12, nudging the forecasts down to 3.0% (-0.25%) and to 3.75% (-0.25%), respectively. There is now a recognition that consumer spending is likely to be a little more subdued in this cycle than in the past, a theme that we have highlighted for some time.

- The Government's consumer spending forecasts for these two years have been trimmed to 3.00% (–0.5%) and to 3.75% (–0.25%), respectively.

- Housing construction activity is forecast to be 5.50% in 2010/11 (–2%) and to be 5.50% in 2011/12 (+1%). Westpac's forecasts differ, with the expectation that activity will be more front loaded (+14% in 2010/11) given the recent jump in starts (up 24% in the three quarters to March), and then cooling to 2% growth in 2011/12 as the impact of recent rate rises impacts.

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