



The Great Crunch of 2015: Fiscal Repair & Income Recession?

Commonwealth & State Government 2014-15 Mid-Year Budget Bulletin

Date: 11th November 2014

This is an abridged version of the 2014-15 Mid-Year Budget Bulletin, which is available to our subscribers. The publication is usually released two weeks before each Commonwealth Budget and around the release of the MYEFO. The Bulletin is not to be used for any reason without our express permission. To be included on the distribution list for future Macroeconomics releases please email: enquiries@macroeconomics.com.au. While Macroeconomics endeavours to provide reliable analysis and believes material it presents is accurate, it will not be liable for any party acting on such information.

For any enquiries about this document, please contact:

Stephen Anthony

T: 02 6198 3345

E: stephen.anthony@macroeconomics.com.au

Copyright © 2014 by Macroeconomics

ABN: 901 2887 8535



The full version of the Commonwealth & State Government 2014-15 Mid-Year Budget Bulletin can be purchased at our website on a subscription basis. Please contact our office manager during business hours on (02) 6198 3345 or by emailing enquiries@macroeconomics.com.au.

*The forecasts and projections contained in the Budget Bulletin are subject to unavoidable statistical variation. While all care has been taken to ensure that statistical variation is kept to a minimum, care should be exercised whenever using this information. Also, our forecasts and projections only take into account information that was available to **Macroeconomics** up to our forecasting round in mid-October 2014 and so findings may be affected by the release of new information. Should you require clarification of any material, please contact us.*



Table of Contents

EXECUTIVE SUMMARY	VII
INTRODUCTION: BEST WISHES FOR TREASURER HOCKEY	1
Report Card on Hockey's First Budget	1
Replacing \$11 Billion in Spending Cuts.....	5
Bottom-line for State & Territory Governments	6
Summing Up the Budget Outlook for All Governments	7
1. FEATURE: MANAGING AN INCOME SLOWDOWN	9
1.1 Recognising an Income Recession	9
1.2 Managing an Income Recession	11
1.3 Targeting a Productivity Agenda: Economic & Regulatory Levers.....	11
1.4 Targeting the Productivity Agenda II: Transparency Levers	12
1.5 Targeting the Productivity Agenda III : Fiscal Levers	14
2. COMMONWEALTH GOVERNMENT	16
2.1 Introduction.....	16
2.2 Economic Outlook	16
2.3 Budget Outlook.....	18
2.4 Structural Budget Position.....	21
2.5 Fiscal Stimulus	23
2.6 Savings Record	24
2.7 Infrastructure Investment Plans.....	24



3. STATE GOVERNMENT OVERVIEW	25
3.1 Budget Bottom-line for State Governments.....	25
3.2 Structural Drivers of State Deficits	26
3.3 Best Performed Fiscal Managers	28
3.4 Business Investment Trends	30
4. NEW SOUTH WALES GOVERNMENT.....	31
4.1 Introduction.....	31
4.2 Economic Outlook	32
4.3 Budget Outlook.....	32
4.4 Fiscal Stimulus	33
4.5 Savings Record	33
4.6 Infrastructure Investment Plans.....	34
5. VICTORIAN GOVERNMENT.....	35
5.1 Introduction.....	35
5.2 Economic Outlook	35
5.3 Budget Outlook.....	36
5.4 Fiscal Stimulus	37
5.5 Savings Record	37
5.6 Infrastructure Investment Plans.....	38
6. QUEENSLAND GOVERNMENT	39
6.1 Introduction.....	39
6.2 Economic Outlook	40
6.3 Budget Outlook.....	40
6.4 Fiscal Stimulus	42
6.5 Savings Record	42



6.6	Infrastructure Investment Plans.....	42
7.	WESTERN AUSTRALIAN GOVERNMENT	43
7.1	Introduction.....	43
7.2	Economic Outlook	43
7.3	Budget Outlook.....	44
7.4	Fiscal Stimulus	45
7.5	Savings Record	45
7.6	Infrastructure Investment Plans.....	46
8.	SOUTH AUSTRALIAN GOVERNMENT.....	47
8.1	Introduction.....	47
8.2	Economic Outlook	49
8.3	Budget Outlook.....	49
8.4	Fiscal Stimulus	51
8.5	Savings Record	51
8.6	Infrastructure Investment Plans.....	51
9.	TASMANIAN GOVERNMENT	52
9.1	Introduction.....	52
9.2	Economic Outlook	52
9.3	Budget Outlook.....	53
9.4	Fiscal Stimulus	54
9.5	Savings Record	55
9.6	Infrastructure Investment Plans.....	55
10.	AUSTRALIAN CAPITAL TERRITORY GOVERNMENT	56
10.1	Introduction.....	56
10.2	Economic Outlook	57

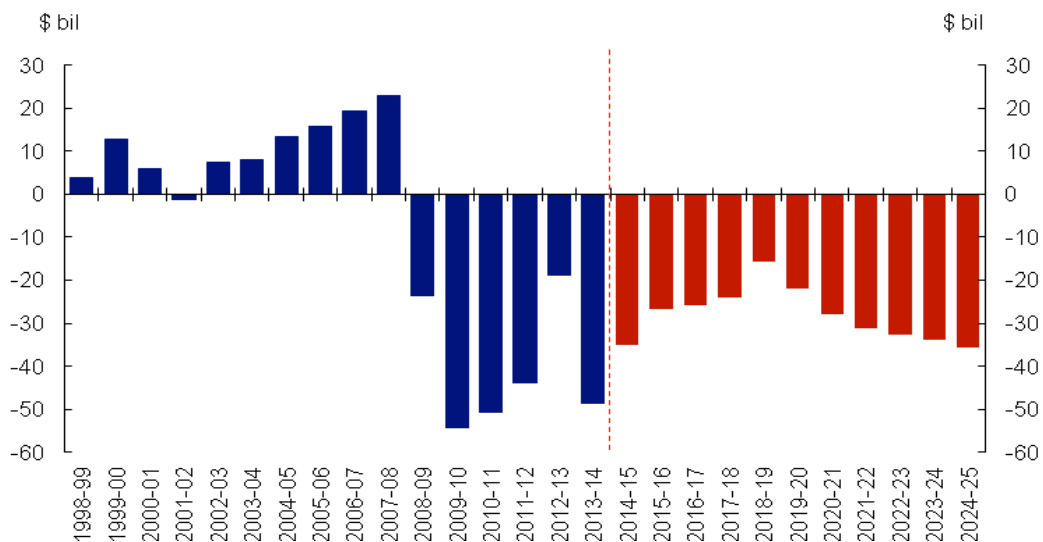


10.3	Budget Outlook.....	57
10.4	Fiscal Stimulus	59
10.5	Savings Record	59
10.6	Infrastructure Investment Plans.....	59
11.	NORTHERN TERRITORY GOVERNMENT	61
11.1	Introduction.....	61
11.2	Economic Outlook	61
11.3	Budget Outlook.....	62
11.4	Fiscal Stimulus	63
11.5	Savings Record	64
11.6	Infrastructure Investment Plans.....	64
	APPENDIX A: DETAILS OF SUGGESTED BUDGET SAVINGS	65



Executive Summary

Macroeconomics 2014-15 Mid-Year Budget Bulletin tells the story of brave Treasurer Joe Hockey and his first Budget facing the fiscal challenges of the nation head-on. A document containing many worthwhile savings measures, it has instead produced confidence-sapping political deadlock. There are now around **\$11 billion** in annual budget savings by 2017-18 held up in the Senate. In addition, the Treasurer faces up to **\$10 billion** in unfavourable parameter variations annually by 2017-18. This is the mining boom unwinding, causing an income slowdown due to the interaction of falling commodity prices and sub-trend real activity, perhaps even exacerbated by the confidence-sapping budget deadlock. Down are both earnings for businesses and wages growth for households, resulting in a reduced revenue take. Not even bracket creep will help return the Budget to surplus with such low wages growth. Right now it appears a return to budget surplus is unlikely anytime soon but at least the fiscal repair job is now well underway after a decade of waiting.



Source: Macroeconomics' estimates and Budget Papers.

The real problem with the first Hockey Budget is that it is seen as **UNFAIR**. It imposes too much of the adjustment burden up to 2017-18 on the disadvantaged - rather than wealthy Australians who would benefit most from a resurgent economy driven by structural budget repairs. This has allowed a veritable Greek chorus of budget criers - otherwise-known as the fiscal girly men - to howl down the best aspects of the document, for instance: (i) reforming age pension indexation; (ii) tightening family tax benefit B eligibility; and (iii) ending of senior health card benefits. The Treasurer should focus on a few major savings battles that are worth winning and abandon the rest which are political death by 1000 cuts (health co-payments, tighter eligibility for unemployed benefits, uni funding etc.) Any savings shortfall can be funded by winding back superannuation concessions.



Treasurer Hockey must be incredibly strategic over the next few years to balance the task of fiscal repair with generating rising incomes for Australians. This is because the real economic **CRUNCH COMMETH** in 2015. A reversal of the mining boom will see a steep reduction in mining investment from the peak level circa 2012-13 which will shave up to one percentage point off real activity, on average, in 2014-15 and 2015-16. Falling commodity prices will shave up to a further $\frac{1}{2}$ of one percentage point from nominal GDP growth and hence 'incomes growth' on average in 2014-15 and 2015-16. Third, the combined impact of the concurrent tightening of Commonwealth and State fiscal policy could reduce growth in excess of $\frac{1}{2}$ of one percentage point in each year. This could have been even larger but Treasury Hockey backdated most of the key structural indexation savings announced on Budget night so as not to saddle the economy with a large fiscal contraction while the mining boom is unwinding. However, all other drivers of domestic activity (household consumption and investment, non mining business investment and exports) will have to work harder to make up for this shortfall.

An encouraging story is that many State Governments are making a good fist of getting their fiscal house in order. We expect six of eight State and Territory budgets to be running sustainable net lending cash budget surpluses in the next three years. Right now they may have a combined GFS cash deficit of around **\$10 billion** in 2014-15, but should finish with very small combined surpluses of **\$700 million** in 2017-18.

Jurisdiction	You Say	We Say
NSW	-2,996	-1,354
VIC	-439	-1,154
QLD	-2,356	-3,562
WA	-1,622	-2,867
SA	-298	-258
TAS	21	-10
ACT	-556	-477
NT	-642	-334
Total	-8,888	-10,016

Source: 2013-14 State Budgets Review and Macroeconomics' estimates.

Below is a detailed examination of the Australian Government and States budget forecasts in advance of the release of the Commonwealth mid-year update. We provide an update of the Commonwealth Budget position post the 2014-15 Budget including our understanding of budget savings achieved and other policy changes. We include a feature article which focuses on the appropriate policy responses to an income slowdown.