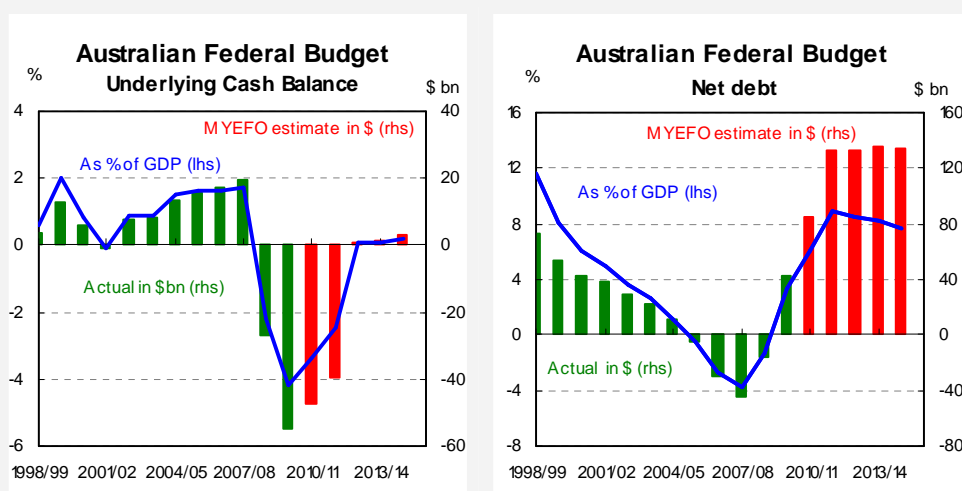


MYEFO 2011-12

Tuesday, 29 November 2011

- The Mid-Year and Economic Fiscal Outlook (MYEFO) revealed downgrades to the budget estimates for both 2011-12 and 2012-13. A budget deficit of \$37.1bn is now expected for 2011-12, larger than the \$22.6bn predicted at the time of the May Budget.
- Reflecting the Government's commitment, a surplus is still expected for 2012-13 but has been revised downwards to \$1.5bn. Previously, the Budget predicted a surplus of \$3.5bn.
- Growth forecasts for 2011-12 and 2012-13 have been revised downwards to around trend growth of 3.25% for both years from 4.0% and 3.75% respectively, in the May Budget. Tax receipts are expected to be more than \$20bn lower over the forecast period, but have been partially offset by net savings through expenditure cuts and other policy changes of \$6.8bn.
- If the Budget outcomes turn out as predicted by MYEFO, the large turnaround from deficit to surplus in 2012-13 of nearly \$39bn will be the largest in decades and will provide a large fiscal drag on growth. This suggests that there will be greater onus on the Reserve Bank of Australia (RBA) to provide stimulus to the economy if the economic backdrop warrants further support.



The Mid-Year and Economic Fiscal Outlook (MYEFO) revealed downgrades to the budget estimates for both 2011-12 and 2012-13. A budget deficit of \$37.1bn is now expected for 2011-12, larger than the \$22.6bn predicted at the time of the May Budget.

Reflecting the Government's commitment, a surplus is still expected for 2012-13 but has been revised downwards to \$1.5bn. Previously, the Budget predicted a surplus of \$3.5bn. To assist in meeting the Government's target, some spending measures have been brought forward while a range of expenditure cuts have been implemented from 2012-13.

Downgrades to economic growth forecasts are largely behind the weaker outcomes. Since the Budget, global economic conditions have deteriorated amid sovereign debt and banking problems in Europe. Growth forecasts for 2011-12 and 2012-13 have therefore been revised downwards to around trend growth of 3.25% for both years from 4.0% and 3.75% respectively, in the May Budget. These forecasts are in line with RBA forecasts published in November.

As a result of weaker growth, tax receipts are expected to be more than \$20bn lower over the forecast period, but have been partially offset by net savings through expenditure cuts and other policy changes of \$6.8bn, including the impact of the "Clean Energy Future" package. The cuts to spending suggest that fiscal policy will be contractionary to growth.

The major policy changes since the Budget have been the introduction of the "Clean Energy Future" package, which involves upfront costs in 2011-12, but is broadly budget neutral in the three years to

2014-15. Other measures include:

- Bringing forward cash payments of \$1.4bn in 2011-12 to accelerate funding for a number of road and rail infrastructure projects. This will provide a net increase in cash payments by \$45mn.
- A one-off increase of 2.5% to the efficiency dividend for most Commonwealth departments and agencies, expecting to reduce cash payments by \$1.5bn over 2012-13 to 2014-15, but have no impact in 2011-12.
- A 20% reduction in funding for relevant Commonwealth agencies and departments, which is expected to reduce cash payments by \$710mn over 2012-13 to 2014-15.
- Reduce the co-contributions that the government matches for eligible personal superannuation contributions, leading to savings of \$660mn over two years from 2013-14.
- Resetting the baby bonus to \$5000 per child from 1 September 2012 and removing the indexation from 1 July 2012. This is expected to deliver a net savings of \$320mn over four years.

If the Budget outcomes turn out as predicted by MYEFO, the large turnaround from deficit to surplus in 2012-13 of nearly \$39bn will be the largest in decades and will provide a large fiscal drag on growth. This suggests that there will be greater onus on the Reserve Bank of Australia (RBA) to provide stimulus to the economy if the economic backdrop warrants further support.

There is a strong possibility that the government's commitment to surplus may not be met. The small surplus indicates there is little room for additional spending or further downgrades to growth.

However, Australia's net debt position remains healthy, expecting to peak at 8.9% of GDP as of 2011-12 and compares very favourably to global standards – the average net debt position of the major advanced economies, the G7, is projected to reach 92.9% of GDP in 2016.

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