Bank of Melbourne

Wednesday, 15 May 2013

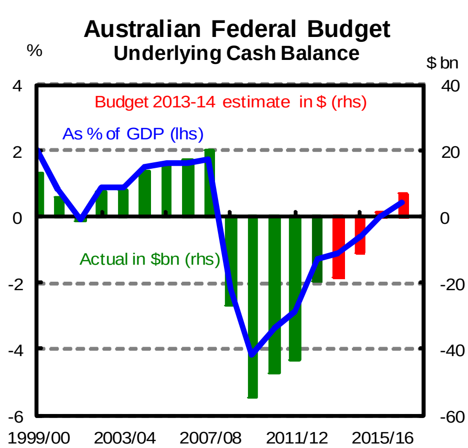
Federal Budget 2013-14

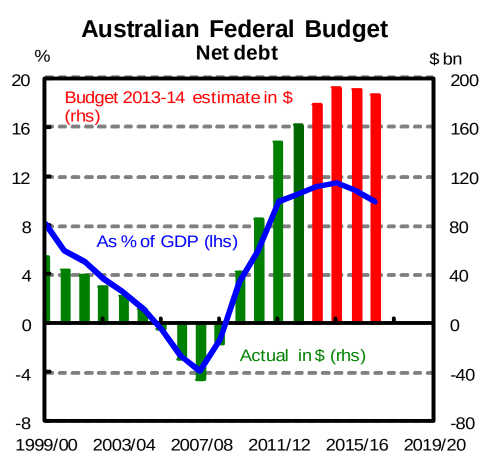
The Commonwealth Government is a significant part of the Australian economy. In 2013-14 it expects to raise $376bn in revenue and spend around $392 bn. The bulk of its spending goes towards social security, health, education and defence.

Last year the government sought to bring the Budget back into surplus by June this year. Sadly, it was overly optimistic in its revenue forecasts while continuing to lift spending. The net result will be a deficit in 2012-13 of around $19.4bn. This is still a sizable reduction on the deficit of $43.4bn in 2011-12 and amounts to a record fiscal consolidation of 1.7% of GDP.

The 2013-14 Budget again charts a course towards a surplus but does so with more conservative estimates of revenue and a slower pace of spending growth. If the budget forecasts are achieved, 2013-14 will see a deficit of $18.0bn and a return to surplus will occur in 2016-17.

There is a clear understanding within the parliament that spending cannot exceed revenue on an ongoing basis. Most agree that a rapid return to surplus – or the extreme austerity path – would be unhelpful. Disagreement arises over how the burden of adjustment should be achieved. Who should wear any increase in taxation? What (if any) government spending should be cut and what size of government do we really want? In broad terms, everyone will be given the opportunity to express their views in September – one way or another.





Spending

In this Budget, the government has forecast spending to increase 6.5% in 2013-14, as it focuses on investment, ranging from the national disability insurance scheme (DisabilityCare Australia), increased investment in schools funding, infrastructure spending, as well as increased defence spending.

The Government has budgeted for one of the biggest social policy reforms, the national disability insurance scheme, DisabilityCare Australia. Funding for this initiative will cost $19.3bn over seven years, which represents $14.3bn in total new investment. Funding will be supported by a ½ percentage point increase in the Medicare levy.

Broad ranging changes to Australia's school funding arrangements, through the National Plan for School Improvement will cost $9.8bn over six years from 2014-15. This will aim to provide greater equity and consistency in school funding and more assistance for schools providing education to students from disadvantaged backgrounds. Additionally there will be a $1.1bn investment in early childhood education and spending of just under $1bn in Commonwealth supported places in further study.

Infrastructure investment represents a significant part of the new spending in the 2013-14 Budget. It commits $24bn over six years in public transport and roads, including regional highways. The two key rail projects are the $3bn Melbourne Metro and the $715mn Brisbane Cross River Rail. Roads include $1.8bn for Sydney Motorways and $400mn for the F3-M2 link, $718mn for the Brisbane Gateway North Upgrade, $525.1mn for the M80 Ring Road widening in Melbourne and $448mn for the South Road Upgrade in Adelaide. Spending also includes a $4.1bn upgrade to the Bruce Highway in Queensland. The major projects are conditional on State funding.

Other increased spending measures in the Budget include programmes to improve Australia's innovativeness, productivity and competition worth $1bn, support for jobseekers in the transition to work (worth $300mn over 4 years) and increased spending on health, including improving cancer prevention, detection, treatment and research ($226mn over four years) and new listings or amendments to the Pharmaceutical Benefits Scheme ($691mn). Defence spending increases slightly to $113bn over the next four years (compared to last year's forecast of $103bn over four years).

A saving in the Budget is the removal of the baby bonus, which was $5000. It is to be replaced with a payment of $2000 for the first child and $1000 for each subsequent child, but with tightened income eligibility. Other savings include deferring a rise in foreign aid and health spending measures.

It was announced in the Budget that the Superannuation Guarantee would increase from 9 to 12 per cent from 1 July 2013 to 1 July 2019. It is expected that this will increase the pool of superannuation savings by more than $500bn by 2037. The government will also abolish the maximum age limit on the Superannuation Guarantee, increasing the incentive for those aged 70 and over to remain in the workforce. This has no impact on this Budget, but in the long term will help to reduce spending, as more Australians are able to provide for their own retirement.

Revenue

The government was expecting revenue to rise by 11.8% in 2012-13 as it introduced new taxes. As it turns out, revenue in 2012-13 will rise by 'only' 6.2% to $350.4bn. In last night's budget, the government now expects revenue to grow by 7.3% in 2013-14. Like all forecasts, it will be subject to the winds of economic change!

Having fallen marginally in 2012-13, the government expects company tax to rise by 8.6% in 2013-14. It hopes to achieve this despite forecasting modestly weaker economic growth. The growth in company tax will be driven by a move to monthly pay-as-you-go instalments, announced last December, which results in a one-off 'bring forward' of payments.

Tax receipts from individuals are expected to rise by 8.9% following a rise of 5.7% in 2012-13. The increase is based on growth in wages and employment. The increase in the Medicare levy to fund the National Disability Insurance Scheme will not hit receipts until 2014-15. Individual tax refunds, which reduce tax revenue and grew by 4.7% in 2012-13, are expected to grow only 0.2% in 2013-14. This will assist revenue growth.

Revenue from the goods and services tax (GST) is passed onto the States. In 2012-13 it will raise $47.7bn increasing by 5.5% in 2013-14 to $50.3 bn. The government is assuming slightly stronger consumption by households.

The resources rent tax was initially expected to raise $7.2bn in 2012-13. It raised $0.2bn and is now expected to raise $0.7bn in 2013-14. The carbon tax broadly met revenue expectations in 2012-13 raising $4.2bn. A further $6.3bn is expected in 2013-14, however revenue expectations beyond 2013-14 are lower by over $1bn per year.

In its efforts to lift revenue in 2013-14 and beyond, the government has introduced a range of new measures including closing accounting loopholes in the areas of corporate tax and offshore banking, targeting deductions for mineral exploration, and imposing cost recovery for import processing undertaken by Australian customs.

In summary, revenue projections for 2013-14 appear broadly plausible but will depend on the pace of economic growth, job creation and commodity prices. If these falter, so too will revenue.

Economic Parameters

The economic forecasts are broadly similar to those of the Reserve Bank (RBA) published in last week's Statement on Monetary Policy. Treasury is estimating growth of 3.0% and 2.75% for 2012-13 and 2013-14 respectively, close to trend. Our forecasts are only slightly below Treasury's for 2012-13 and slightly above for 2013-14.

The real GDP growth forecasts are reasonable. However, lower commodity prices have weighed on the value of incomes or more specifically on corporate profits. These incomes are reflected in nominal GDP, which is expected to grow by just 3.25% in 2012-13 following growth of 5.0% in 2011-12. Nominal GDP growth is then expected to return to 5.0% growth in 2013-14 and 2014-15. The pickup in "incomes" over this period would seem optimistic given Treasury appears to expect a further decline in commodity prices and for the Australian dollar to remain high (assumed at US$1.03). However, these forecasts remain highly uncertain and will depend on the strength of the global economic recovery.

Treasury's forecasts for employment growth are more cautious than our own, and expect the unemployment rate to stay higher for longer. The inflation forecasts are in line with RBA forecasts and a touch below ours. (See page 4 for detailed forecasts).

Conclusions

The government has outlined a slower and more realistic path towards a Budget surplus. It does this by trimming its spending growth and seeking ways to lift revenue. As it attempts to achieve a surplus by 2016-17, the government aims to lift revenue from both the household and the corporate sectors.

By avoiding the 'austerity path' the Budget may lift consumers' confidence as their worst fears are not met. At the same time, spending on education, health and infrastructure provides some hope for better economic activity in the future. The path chosen by the government should also reduce pressure on the Reserve Bank to sustain reasonable economic growth.

The national disability insurance scheme is to be applauded but full implementation is still a few years off. Extra funding for education is welcome although there remain disputes about how to best allocate the funds.

It is unlikely that Australia will lose its AAA credit rating following the Budget. While government debt will rise, it remains well below the threshold for a ratings downgrade and well below levels seen across most other nations.

The Budget seems unlikely to generate much excitement across the households and businesses of the nation. It was well described as housekeeping with the promise of better things to come.

Forecasts (% Change on Previous Year)	2012/13	2013/14	2014/15	2015/16
Real Gross Domestic Product (GDP)*:				
Budget	3.00	2.75	3.00	3.00
RBA Statement on Monetary Policy	3.00	2.00-3.00	2.50-3.50	-
Our Forecast	2.90	3.00	3.00	-
Unemployment Rate (%)**				
Budget	5.50	5.75	5.75	5.00
RBA Statement on Monetary Policy	-	-	-	-
Our Forecast	5.60	5.40	5.30	-
CPI (Headline) ***				
Budget	2.50	2.25	2.25	2.50
RBA Statement on Monetary Policy	2.25	2.00-3.00	2.00-3.00	-
Our Forecast	2.70	2.50	2.50	-

*Real GDP forecasts are year average. **The unemployment rate is for the June quarter. *** Through the year growth rate to the June quarter

Contact Listing

Chief Economist

Hans Kunnen
kunnenh@bank of melbourne.com.au
(02) 9320 5854

Senior Economist

Josephine Heffernan
heffernanj@bankofmelbourne.com.au
(02) 9320 5751

Economist
Janu Chan
chanj@bankofmelbourne.com.au
(02) 9320 5892