PART 1: OVERVIEW

Despite a deteriorating global economy over 2014, the Australian economy continues to grow solidly, with strong growth in areas such as exports and housing investment.

Moving into 2015, growth will be further supported by historically low interest rates, the recent depreciation of the Australian dollar and lower energy prices. The Government is executing its Economic Action Strategy to deliver a stronger and more prosperous economy with greater opportunities next year and beyond.

A key component of this Strategy is the continued roll out of over $50 billion of infrastructure investment. These investments have already begun and include major projects across the nation that will reduce congestion, improve productivity and create jobs. The Government's investment in infrastructure also includes incentives of $5 billion through the Asset Recycling Initiative, which will catalyse over $38 billion in new infrastructure. In total, the Infrastructure Growth Package will lead to over $125 billion of new productive infrastructure over the next decade.

The business environment has improved since 2013 and costs for all Australians have been reduced as a result of the abolition of the Carbon Tax and the Minerals Resource Rent Tax. The abolition of these taxes will encourage investment and job creation. The Government has also removed the uncertainty created by nearly 100 announced but unlegislated tax and superannuation measures dating back 12 years.

The Government has successfully concluded landmark negotiations on free trade agreements with Korea, Japan and China. These are world-class, comprehensive agreements that substantially liberalise our trade with major markets, delivering significant benefits to Australian exporters, farmers, manufacturers and consumers. Starting next year and developing in the coming years, they will provide enormous opportunities for Australian business to expand in the region, particularly for the providers of services to cater for the demand of the growing Asian middle class.

In 2014, the Government removed around 57,000 pages of government regulation and legislation and cut around $2 billion of red tape for businesses, community organisations, and individuals, with further reductions to come in 2015. These red tape reductions are easing the costs and complexity of doing business.

The Government has accelerated environmental assessments and approvals for over 300 major new projects worth over $1 trillion for Australia and these projects are now getting underway.

The Medibank Private Limited Share Offer was successfully completed this year, surpassing expectations and returning $5.7 billion in proceeds to be re-invested in job-creating infrastructure.

Repairing the Budget

Most importantly, in 2014 the Government commenced the critical task of repairing the budget.

The 2014-15 Budget outlined an ambitious structural reform agenda designed to drive economic growth and create jobs. It also took major steps towards ensuring the Government lives within its means, returns the budget to surplus and pays down debt.

The Government has made considerable progress. The majority of Budget measures have now been implemented. As a result, the budget position is fundamentally stronger than it would have been under the unsustainable trajectory of debt and deficits left behind by the former Government. Compared with the projection of $667 billion in debt inherited just over a year ago, the 2014-15 Mid-Year Economic and Fiscal Outlook (MYEFO) shows the Government on track to reduce this by nearly $170 billion. In addition, budget deficits are still forecast to reduce steadily over the forward estimates and beyond.

However, since May, two key factors have primarily driven the $43.7 billion deterioration in the budget over the forward estimates: the impact of the economy on tax receipts and payments; and the impact of the Senate's decisions.

Primarily as a result of the collapse in iron ore prices by over 30 per cent and weaker than expected wage growth, tax receipts have been revised down by $31.6 billion. Government payments have also been affected. Delays in passing legislation and negotiations with the Senate have cost the budget more than $10.6 billion over the forward estimates, keeping debt and interest payments higher for longer.

An underlying cash deficit of $40.4 billion is now expected in 2014-15 (2.5 per cent of GDP), narrowing to a deficit of $11.5 billion (0.6 per cent of GDP) by 2017-18. This reinforces that there is much more work to do and budget repair will take time.

Table 1.1: Budget aggregates

	Estimates			
	2014-15		2015-16	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance($b)(a)	**-29.8**	**-40.4**	**-17.1**	**-31.2**
Per cent of GDP	-1.8	-2.5	-1.0	-1.9
Fiscal balance($b)	**-25.9**	**-39.8**	**-12.2**	**-27.2**
Per cent of GDP	-1.6	-2.5	-0.7	-1.6
	Projections			
	2016-17		2017-18	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance($b)(a)	**-10.6**	**-20.8**	**-2.8**	**-11.5**
Per cent of GDP	-0.6	-1.2	-0.2	-0.6
Fiscal balance($b)	**-6.6**	**-17.8**	**1.0**	**-5.0**
Per cent of GDP	-0.4	-1.0	0.1	-0.3

(a) Excludes expected net Future Fund earnings.

Update to the economic outlook

Overall, the outlook for real GDP growth is unchanged since Budget. Real GDP is forecast to grow at 2½ per cent in 2014-15, before increasing to near-trend growth of 3 per cent in 2015-16. This reflects the expectation of solid growth of real activity in the economy continuing.

However, the changes to the economic outlook since the Budget are driven by the sharper than expected fall in the terms of trade, including significant falls in prices of iron ore and coal, and weaker wage growth. While the forecasts for solid real GDP growth are unchanged, the prices we receive for our production have declined significantly. Accordingly, nominal GDP growth in 2014-15 is expected to be weaker than forecast at Budget, at 1½ per cent. This would be the weakest nominal GDP growth in a financial year in over 50 years.

Table 1.2: Major economic parameters(a)

	Forecasts		Projections	
	2014-15	2015-16	2016-17	2017-18
Real GDP	2 1/2	3	3 1/2	3 1/2
Employment	1	1 3/4	2	2 1/4
Unemployment rate	6 1/2	6 1/2	6	5 3/4
Consumer price index	2 1/2	2 1/2	2 1/2	2 1/2
Wage price index	2 1/2	3	2 3/4	3
Nominal GDP	1 1/2	4 1/2	5 1/4	5 1/4

(a) Year average unless otherwise stated. Employment, the wage price index and the consumer price index are through the year growth to the June quarter in 2014-15 and 2015-16. The unemployment rate is the rate for the June quarter.
Source: Treasury projections.

Iron ore prices have unexpectedly fallen by over 30 per cent since the Budget. MYEFO assumes a free-on-board iron ore price of US$60 per tonne over the next two years, which compares with a spot price of US$95 at Budget. The fall in iron ore prices has led to company tax receipts being revised down by $2.3 billion in 2014-15 and $14.4 billion over the forward estimates.

At the same time weaker wage and employment growth are expected to lower individuals' income tax receipts by $2.3 billion in 2014-15 and $8.6 billion over the forward estimates. Weaker wage and employment growth will also increase payments for existing government programmes.

Excluding policy changes, total taxation receipts have been revised down by $6.2 billion in 2014-15 and $31.6 billion over the forward estimates. This brings the total writedown in tax receipts since the Government was elected to over $70 billion.

To avoid detracting from economic growth, the Government has let the impact on the budget from sharply lower iron ore prices and slower wage growth flow through to the bottom line, rather than taking decisions to cut expenditure dramatically or increase tax.

Impact of the Senate

The other key driver of the deterioration in the budget position since May has been the impact of delays in the passage of key legislative measures and outcomes of negotiations with the Senate.

Considerable progress has been made in implementing the 2014-15 Budget. Around 75 per cent of the over 400 measures in the Budget have already been implemented. Included in these measures are some of the Government's largest decisions to repair the budget, such as the reduction in Official Development Assistance ($7.9 billion over five years) and changes to welfare and social services totalling $2.7 billion.

The Government is committed to negotiating constructively with the Senate on Budget measures, but there is a cost of delay. The delay in passing legislation to allow Budget measures to commence has already cost the budget $3.4 billion. These delays are hampering progress towards budget repair and result in debt and associated interest payments staying higher for longer than would otherwise be the case.

The cost to date of completed and ongoing negotiations with the Senate totals $7.2 billion over the forward estimates. These costs are primarily a result of changes required to: repeal the Minerals Resource Rent Tax and associated spending ($6.6 billion); amend the higher education reforms announced in the Budget; and implement the re-instalment of Temporary Protection Visas.

This brings the total cost to the budget of Senate delays and negotiations to $10.6 billion over the forward estimates.

Notably though, the budget costs associated with the Minerals Resource Rent Tax repeal package were fully offset by the end of 2023 by the decision to delay the increase in the superannuation guarantee rate until 1 July 2021. The repeal of the Minerals Resource Rent Tax and other related measures will save the budget over $10 billion over the forward estimates and around $50 billion over the next decade.

The Government remains committed to budget repair and to successfully negotiating the structural reform measures announced in the 2014-15 Budget through the Parliament.

Around $33.9 billion of measures that improve the budget position also remain subject to the passage of legislation. Over $5 billion in measures that were policies of the former Government are yet to secure passage through the Parliament. If these measures are not passed, the projected improvement in the budget position will be further weakened.

New policy decisions

Fiscal discipline has been maintained and, setting aside negotiations with the Senate, the Government has improved the budget position over the forward estimates by $3.2 billion as a result of policy decisions in MYEFO.

The spending decisions that have been taken since the Budget primarily respond to changes in the international security environment, or reflect the commitment to drive growth and support a strong economy.

The Government has responded to a rapidly changing security environment, investing around $1.3 billion to keep Australians safe and secure. To counter the threat of home-grown terrorism, security and law enforcement agencies have been given $631.4 million in extra resources to track, disrupt and prosecute Australians involved in violent extremism, both at home and overseas. Operations in Iraq are addressing the enduring threat of terrorism at a cost of $306.4 million.

The Government has also taken further steps to build a stronger, more prosperous economy. This includes the finalisation of the Japan-Australia Economic Partnership Agreement. It also includes the Industry Innovation and Competitiveness Agenda with key decisions such as the reinstatement of important incentives for entrepreneurship through Employee Share Schemes and the establishment of five new sector specific Industry Growth Centres. MYEFO also includes funding for the Global Infrastructure Hub, a key outcome of Australia's G20 presidency, to facilitate greater infrastructure investment and collaboration between governments, the private sector and international organisations.

Building on measures in the 2014-15 Budget, the Government has also agreed to a third tranche of Smaller Government reforms with a further reduction of 175 bodies. This supplements firm action to restrain the size of government by achieving necessary wage restraint and reducing the size of the public service.

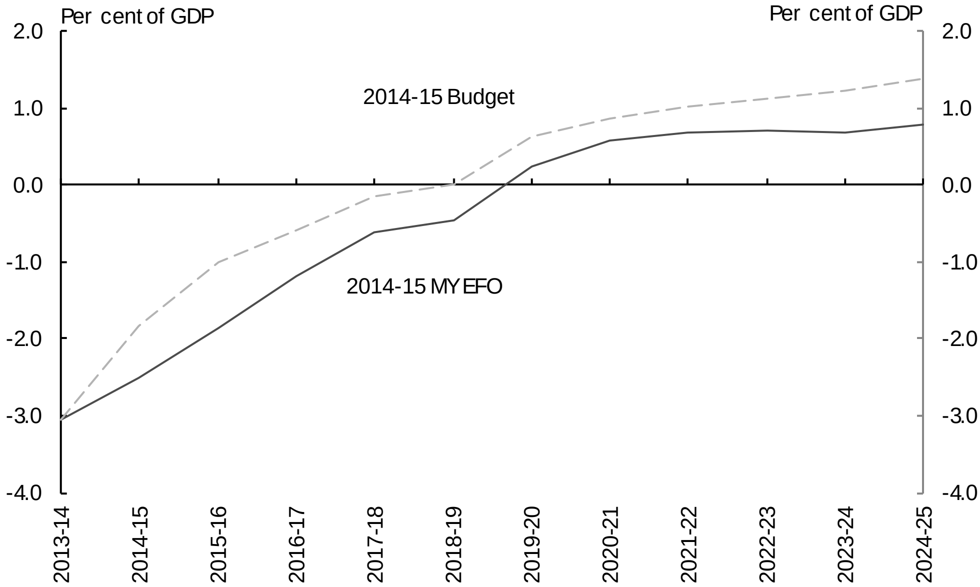
Medium term outlook

The 2013-14 MYEFO showed that, without action, the budget would not return to surplus for a decade, and debt would reach $667 billion by 2023-24 and still be rising.

Despite the deterioration in the fiscal outlook over the forward estimates, the medium-term outlook for the budget is considerably better than a year ago. Debt is now projected to be nearly $170 billion lower than it would have been by 2023-24 and to be falling.

The underlying cash balance is projected to reach surplus in 2019-20, with the surplus reaching 0.8 per cent of GDP by the end of the medium term, including future tax relief being incorporated from 2020-21. This remains a considerable improvement from the 2013-14 MYEFO projections.

Chart 1.1: Underlying cash balance projected to 2024-25



Notes: The underlying cash balance excludes Future Fund earnings and payments. A tax-to-GDP cap of 23.9 per cent is applied on 2014-15 Budget and 2014-15 MYEFO projections.
Source: Treasury projections

The Government remains committed to its objective of building a stronger economy and achieving surpluses, which build to at least 1 per cent of GDP by 2023-24. While budget repair is underway, there is more work to do to deliver on this commitment.

While there are positive signs of the Australian economy strengthening and transitioning towards broader-based drivers of growth, there is still much work to be done and budget repair will take time.

The path of fiscal consolidation and policy settings will be considered comprehensively as part of the normal annual Budget process. The Government is determined to work with the Australian people to build a strong and prosperous economy and take advantage of the many opportunities that will build Australia's future.