AUSTRALIAN INDUSTRY GROUP

Ai Group Briefings
Federal and State Budget Updates 2013/14

In December 2013, the Commonwealth Government and the State Governments of NSW, Victoria, Queensland, South Australia and Western Australia all released their mid-year Budget updates for 2013-14. All of these updates showed a weaker economic outlook from here, with the Commonwealth Government and some states showing a deterioration in revenue projections and in forward deficits as well (see table 1).

Table 1: Commonwealth and State Government operating balances, 2013-14

Government	Surplus/deficit, $mn	Change from forecast in last Budget, $mn
NSW	-2,500	-656
Vic	+221	-2.7
Qld	-7,600	+60
SA	-955	-44
WA	+437	+51
Commonwealth	-47,000	-16,900 (since PEFO)

Sources: AFR, MYEFO and state Budget Updates.

Commonwealth Government Mid-Year Budget Update (MYEFO) 2013-14

The Australian Treasurer released the 2013-14 Mid-Year Economic and Fiscal Outlook (MYEFO) on 17 December. The update highlights a substantial deterioration in the budget balance since the Treasury's Pre-Election Economic and Fiscal Outlook (PEFO) in August. The cash deficit will now widen to $47.0 bn in 2013-14 (from $30.1 bn) and $33.9 bn (from $24 bn) in 2014-15. If no further policy changes were made, the Government expects this worsening outlook would mean deficits throughout the forward estimates period ($24 bn for 2015-16 and $17.7 bn for 2016-17).

This fiscal outlook frames the size of the savings task needed for the next full Budget in May, particularly with the Commission of Audit due to report on a wide of savings options by the end of March 2014. The challenge for the Government is to quickly craft a sensible strategy to repair the serious underlying budgetary weaknesses while stimulating investment and providing a basis for employment growth over the next couple of years. This will require tough decisions and it will also require the cooperation of the parliament. As the Treasurer has said, all options should be on the table. While the Commission of Audit will provide a range of alternative measures to be considered in the context of the 2014-15 Budget, the major parties could make immediate contributions to an improved outlook. The Opposition should clear the way for a lift in business investment by ending the uncertainty and supporting the repeal of the carbon tax. The Government should reconsider its plans to impose a levy on businesses to fund a gold-plated parental leave scheme that today's budget outlook shows we cannot afford.

MYEFO Economic Outlook

Economic expectations in the MYEFO are far more pessimistic than in the PEFO in August. It has been apparent for some time that conditions in the broader economy are holding back key non-mining sectors which are in no position to compensate for the end of the boom in mining-related investment and the falling prices received from our commodity exports. Recovery in these sectors now holds the key to a pick-up in employment growth, a strengthening of the general economy and a recovery in revenue collections and the budgetary outlook.

Real GDP growth expectations for 2013-14 is unchanged from PEFO at a below-trend 2.5%, but GDP growth in 2014-15 has been revised down by ½ a percentage point to 2.5%. This is mainly due to a weaker outlook for household consumption and non-dwelling construction activity (particularly mining investment). Real GDP growth is then forecast to return to trend levels of around 3% p.a. from 2015-16, as mining exports pick up.

More importantly for Government revenues, nominal GDP forecasts were revised down significantly in MYEFO throughout the forecast period. In particular, slower growth in output and employment means individual income tax will be down $20.4bn over four years and company tax will be down by $180mn in 2013-14 and $7.1bn across the four years to 2016-17. Wages growth outlook is also weaker over the next four years.

In the labour market, Treasury now expects national employment to grow by just 0.75% in 2013-14 (previously 1%) and 1.5% in 2014-15. The unemployment rate will climb to 6.25% in in 2014-15 and then remain there for several years. Workforce participation is assumed to be 0.5 percentage points lower than it was in the August PEFO, reflecting the strong trend for people to drop out of the workforce instead of actively seeking work. Either way (unemployed or not participating), these people will be out of work, without an income and without means to spend or invest. This helps to explain the weaker consumption outlook for households (just 2% growth expected in 2013-14 and 2.75% growth in 2014-15).

Table 2: key economic forecasts, MYEFO 2013-14

	Forecasts		Projections	
	2013-14	2014-15	2015-16	2016-17
Real GDP	2 1/2	2 1/2	3	3
Employment	3/4	1 1/2	1 1/2	1 1/2
Unemployment rate	6	6 1/4	6 1/4	6 1/4
Consumer Price Index	2 3/4	2	2 1/2	2 1/2
Wage Price Index	2 3/4	2 3/4	4	4
Nominal GDP	3 1/2	3 1/2	4 3/4	4 3/4

(a) Year average unless otherwise stated. Employment, wages and the consumer price index are through the year growth to the June quarter in 2013-14 and 2014-15. The unemployment rate is the rate for the June quarter.

MYEFO policy changes that will affect industry and businesses

The Treasurer announced around 20 major spending changes in today's MYEFO. Many of these relate to the forthcoming repeal of the carbon emissions tax and the minerals resources rent tax. This will include programs such as the clean technology program, the steel transformation plan and the clean energy skills package (saving a combined total of $5.3bn).

Outside of these two key policy areas, the following funding changes may have an impact on your business. Many of these changes were previously announced as election commitments.

- **Export Market Development Grants** funding will increase by $50mn over four years, as announced prior to the election.
- The **Automotive Transformation Scheme** will be cut by $500mn over four years, as flagged prior to the Federal election.
- The **Industry Innovation Precincts** program will be cut by $26mn over 4 years. $10mn will be saved by discontinuing the **Manufacturing Technology Innovation Centre**.
- The **National Workforce Development Fund for high technology manufacturing** will not proceed, saving $35.6mn in 2 years.
- **Trades Training Centres** will cease, saving $986mn over five years. These supported entry-level trades training in schools. Ai Group is particularly concerned that the end of the Trade Training Centres program from 2014-15 will limit important access to appropriate training facilities for many secondary school students. Apprenticeship intakes in the traditional trades are worryingly low and every effort must be made to ensure secondary students can access trade-related training and are encouraged to pursue a career in the trades.
- **Building Stronger Communities Fund** ($528mn) and **community infrastructure grants** ($45mn) will not proceed, mainly affecting smaller regional projects. These will be partly replaced by a new community development fund ($342mn over 4 years).
- Increase in **personal insolvency fees** from 1 Jan 2014, worth $25mn over 4 years.
- The $10m **Digital Business Kits** program is being retained, including Ai Group's kit for SME manufacturers, but one of the ten kits will not proceed, saving $0.5m over four years.
- **New NBN-enabled business models** will not proceed, saving $1.3mn.
- **Australian Research Council** funding worth $103mn over four years will be redirected to other (mainly medical) research programs. This will reduce ARC funding available to non-medical academic research projects. ARC Centres of Excellence will also receive $10mn less in funding over four years.
- **Australian Building and Construction Commission** re-established. Funding confirmed for the re-establishment of this body, at a cost of $35mn over four years.
- The **Experience + Jobs Bonus** program for unemployed people (worth $11.1mn over four years) and the **Mature Age Participation** program (worth $10.7mn over two years) will cease, as will **Tasmanian forestry workers assistance** ($2.4mn). These will be replaced with a **Job Commitment Bonus** for the long-term unemployed (worth $157mn over the next five years), separate **Relocation Assistance** ($16.6mn over five years) and a **Seniors Employment Incentive** program ($197.5mn over five years).
- Delayed investment in the **Murray-Darling Basin** water use and infrastructure program, taking $551mn beyond the Budget estimates.
- **LaTrobe Valley** economic diversification program cut by $9.6mn over 6 years.

Also this week but separately to the MYEFO, the Commonwealth Government announced **a $100mn package of assistance for Victoria and South Australia** in response to the recent decision of General Motors Holden to put an end to automotive assembly operations in Australia in 2017. The Government's will also undertake a short review of the impact on the Victorian and South Australian economies from the expected slowdown in automotive assembly. These are the states where the decisions by Ford and General Motors Holden to phase out manufacturing operations in Australia will be most keenly felt. These reviews and the $100mn growth fund announced to date will assist in encouraging new businesses investment and the development of new opportunities domestically and globally for manufacturing and related industries.

NSW mid-year Budget update 2013-14

The NSW 2013-14 Half-Yearly Review (released on the 13th December 2013), highlighted a slightly softer near-term economic outlook for NSW and a weaker fiscal outlook than at the time of the NSW Budget in June 2013.

The NSW Budget in 2013-14 is now forecast to be in deficit by $2,546 million, a deterioration of $656 million on the previous Budget estimate. Across the forward years (2014-15 to 2016-17), the Budget result is now expected to worsen by around $1,182 million. This weaker fiscal position reflects lower aggregate revenues (most evident in lower payroll tax revenue, but partially offset by higher stamp duty receipts) and an upward revision to aggregate expenses (largely due to higher superannuation liabilities).

Reflecting downward revisions to global and domestic economic growth, the outlook for the NSW economy is now slightly weaker compared with the June 2013 Budget forecasts. Both NSW demand and output growth forecasts have been revised down modestly in both 2013-14 and 2014-15 (see Table 3). NSW Gross State Product growth is forecast to remain below-trend rate of 2½% p.a. in 2013-14 and 2014-15. This is ¼ of a percentage point lower for both years in comparison with the 2013 Budget forecasts.

NSW domestic demand (SFD) growth is expected to pick up from the slow growth rate of 2012-13 (just 1.7% p.a.), but remain slightly below trend in 2013-14 (2¼% p.a.) and 2014-15 (2¼% p.a.). These forecasts are below the 2013 Budget projections of 3% p.a. in both years and reflect the expectation of softer household consumption growth and subdued business investment. Positive contributions to state growth are expected from stronger dwelling investment, increased State government investment and an improved outlook for net exports of goods and services.

Consistent with the softer activity projections, the near-term outlook for employment growth has been revised downward, resulting in unemployment rates of 6% in 2013-14 and 6¼% in 2014-15 compared to 2013 Budget forecasts of 5½% for both years.

Table 3: NSW Government economic forecasts, Budget and mid-year update

	2012-13	2013-14		2014-15		2015-16 and 2016-17	
	Outcome	Budget Forecast	Revised Forecast	Budget Forecast	Revised Forecast	Budget Projection	Revised Projection
Real State Final Demand	1.7	3	2¼	3	2¼		
Real Gross State Product	1.8	2¾	2½	2¾	2½	2¾	2¾
Employment	1.7	1¼	1	1¼	1¼	1¼	1¼
Unemployment Rate[(b)]	5.2	5½	6	5½	6¼		
Sydney CPI[(c)]	2.6	2	2½	2½	2	2½	2¾
- through the year to June quarter[(d)]	2.6	2½	2¾	2½	2		
Wage Price Index	3.1	3¼	2¾	3½	3	3½	3½
Nominal Gross State Product	2.9	5¼	3¼	5¼	4		

(a) Per cent change, year average, unless otherwise indicated
(b) Projections are in year average terms
(c) Year average, per cent
(d) 2013-14 forecasts include a ¼ percentage point impact from the increase in tobacco excise; 2014-15 forecasts include a ¾ percentage point impact from the abolition of the carbon tax.

Victoria mid-year Budget update 2013-14

The Victorian Government published its budget update on 13 December which showed:

- The Net Operating Surplus for 2013-14 is almost unchanged (at $221.8m) from the Budget estimate. The forward estimates surpluses are forecast to be slightly higher and increasing to $2.7bn in 2016-17.
- The unchanged headline fiscal balance came in spite of a downgrade in projected taxation revenues, notably payroll and gaming taxed. The Government announced new revenues to meet the taxation shortfall, most notably an expansion in the congestion charge to areas north and south of the CBD from 2015. Businesses in these areas will now pay an annual fee of $950 per non-residential parking space.
- Other Budget measures included increases to public transport fares, a new levy on its poker machines, and a levy on Crown Casino.
- Net Debt has been revised down by a touch to 22.7% of GSP in 2013-14 (from 23%) before peaking in 2014-15 and tapering off afterwards.
- Government infrastructure investment in 2013-14 is revised down by $0.3bn since the Budget to $5.8bn before peaking at $7.2bn in 2014-15 and drop sharply afterwards. This reflects delays in current project spending.
- Growth in gross state product (GSP, the state equivalent of GDP) for 2013-14 has been revised down to 2.0% (from 2.25% in the Budget) and is expected to return to 2.75% from 2014-15 and afterwards.
- Employment growth in 2013-14 was downgraded to 1.0% (previously 1.5% in Budget) then expected to return to 1.5%p.a. or above from 2015-16 and onwards.

- The unemployment rate for Victoria is expected to be 6% for 2013-14 (up from 5.5% estimated in the Budget). It is then forecast to gradually decline over the forward estimates. This unemployment rate is lower than the expected national average of 6.25% over this period and may be overly optimistic.

Queensland mid-year Budget update 2013-14

In the mid-year Budget review was released by the Queensland Government on 18 December:

- Queensland's deficit for 2013-14 was almost unchanged at $3.77bn ($3.76bn in the Budget in June). The 2014-15 surplus was revised down marginally to $1.9bn ($2.1bn in the Budget) and the 2015-16 surplus was roughly unchanged at $2.03bn. The 2016-17 surplus was revised marginally lower to $1.5bn from $1.7bn. Revenue is expected to grow by an annual average of 6.5% p.a. over the next four years (up slightly from 6.4% p.a. in the Budget), while expenditure is expected to grow by an annual average rate of 3.1% p.a. (up significantly from 2.6% p.a. average over four years in the June Budget). Much of the increase on both sides is due to increased revenue from the Commonwealth and increased expenditure in education as a result of the 'Gonski' education funding agreement and nets out equally. Other changes in expenditure are due to ongoing expenses for natural disaster recovery.
- Projected net debt was revised modestly lower since the June Budget, to a peak of $41bn (12% of GSP). Queensland is Australia's most indebted state and the Treasurer flagged the need for asset sales to reduce this debt. Queensland's gross infrastructure spending is expected to decline by 28% between 2013-14 and 2016-17, but this could change if asset sales free up capital for new projects.
- Queensland's GSP growth forecasts are unchanged since the June Budget, with 3.0% growth expected in each of 2013-14 and 2014-15, rising to 6% in 2015-16 and moderating again to 4.75% in 2016-17. This lumpy growth profile reflects the expected timing of large LNG and coal projects which will boost state export earnings substantially from 2015. In the populous South-East, the lower Australian dollar is likely to provide a positive impetus to Queensland's large tourism industry. There are also some signs of recovery in the Queensland housing market, with both housing finance and building approvals picking up in response to low interest rates and improved housing affordability.

South Australia mid-year Budget update 2013-14

The South Australian Government released its Mid-Year Budget Review on 3 December, which showed:

- The final outcome for 2012-13 was a net operating deficit of $948 million, an improvement of more than $350 million since the Budget that was handed down in June 2013. However, the fiscal outlook has deteriorated, with $243 million write-down to the state's operating balance over the forward estimates since the June budget. The projected deficit for 2013-14 has deteriorated by a further $44m to be forecasted deficit of $955mn.

- This owes to a weaker outlook for tax and GST revenues, which were downgraded by $213mn across the forward estimates. The worsening budget situation comes despite an unexpected $221m boost to revenues over the forward estimates, largely driven by grants, sales transactions and dividends from government-owned SA Water.
- The SA Government are still forecasting a return to surplus in 2015-16 of $303mn, although this is $72mn lower than the surplus of $375mn forecast at the Budget.
- The State's key economic forecasts have also worsened since June 2013, with Gross State Product, State Final Demand and employment growth all revised down over the forward estimates. State economic growth has been revised down from 2.5 per cent to 2.25 per cent for 2013-14. Employment and growth forecasts also remain subdued, with employment growth revised down from 1 per cent to 0.25 per cent.
- Expenditure of $197 million over three years for rail investment has been returned to the budget after the Federal Government cancelled its funding of the Gawler electrification and Tonsley line works.
- Of concern, the Mid-Year Budget Review also shows an upward revision to the number of public servants over the forward estimates, increasing 1067 since Budget to 81,473 full time equivalent positions. The government said the increase was the result of a "correction" to reported staffing levels from the Department of Health, with 452 jobs planned to be axed in Health now remaining on the books.
- While the fiscal outlook over the forward estimates has deteriorated since Budget, the State's net debt has improved over the forward estimates owing to the stronger starting position from the 2012-13 outcome. General government-sector net debt is estimated to be $6.6 billion in 2013-14, which is $310 million lower than projected in June Budget. Net debt will peak at $9.39bn in 2015-16, an improvement from the $9.45bn peak projected in June.

Western Australia mid-year Budget update 2013-14

In the mid-year Budget review published by the Western Australian Government this week:

- There was a small increase in the expected net operating surplus for 2013-14 to $437m (compared to $386m surplus in the August budget). In 2014-15 a net deficit of $123m is expected ($148m in the August Budget) and in 2015-16 a surplus of $10m is expected ($16m in the August Budget).
- Revenue growth is expected to average 4.5%p.a. over the four years to 2016-17 (up from 4.3% in the August Budget). The upward revision to revenue expectations is due to higher iron ore royalties and higher GST revenues. Expenditure growth is expected to average 4.5% p.a. over the four years to 2016-17 (unchanged from the Budget). Expenditure has been reduced in public sector procurement and local government roads but has increased in health and education due to stronger population growth.

- GSP growth is expected to moderate from a strong year in 2012-13 (5.1% real GSP growth) to 3¼% in 2013-14 and 2½% in 2014-15, before speeding up to 3¾% again in 2015-16 and 2016-17 (unchanged from the August Budget). This largely reflects the timing of the state's LNG and iron ore site expansions.
- The unemployment rate is expected to rise to 5½% in 2014-15 from 5.0% in 2013-14. Slower population growth and a decline in the participation rate (currently very high) are also projected, which will help to reduce the impact of slowing employment growth over the next four years.
- Gross infrastructure spending estimates have been lowered, largely in response to the State's need to reduce debt and regain its AAA credit rating (it was downgraded to AA+ by S&P in August following the Budget). This will reduce gross capital spending to $5.5bn by the final years of the forward estimates (2016-17) compared to the August budget estimate of $6.8bn for 2016-17. These investment savings will be achieved through deferring some large infrastructure projects, including the MAX light rail project in Perth, the opening of which will be delayed by four years until 2022 at a saving of $432m. A reduction in Housing Authority, Water Corporation and Main Roads investment programs will save a further $995m over the next three and a half years.
- A review of Government assets will consider the sale of assets including the Utah Point common-user berth at Port Hedland, the Kwinana Bulk Terminal and the Kaleeya hospital site in Perth.
- Public net debt will be around $1.5bn lower than in the August Budget. Net debt is expected to peak at around $29bn in 2015 (10% of GSP). This debt reduction and the asset sale program are both aimed at recovering the state's AAA credit rating.