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Government Relations

Barton Deakin Brief: Mid-Year Economic and Fiscal Outlook 2016-17

19 December 2016

Today, the Treasurer the Hon Scott Morrison MP and Minister for Finance Senator the Hon Mathias Cormann released the Mid-Year Economic and Fiscal Outlook 2016-17 (**MYEFO**). The release of the MYEFO is mandated by the Charter of Budget Honesty and provides an update on the fiscal and economic outlook from the May Commonwealth Budget 2016-17.

Updated fiscal outlook

The fiscal position is forecast to improve over the forward estimates period with the underlying cash balance projected to return to surplus in 2020-21. This is in line with the 2016 Pre-election Economic and Fiscal Outlook report (**PEFO**).

Net debt is projected to peak at 19.0 per cent of GDP in 2018-19 and then decline over the medium term. The underlying cash deficit is expected to fall from $36.5 billion (2.1 per cent of GDP) in 2016-17 to $10.0 billion (0.5 per cent of GDP) in 2019-20. Similarly, the fiscal deficit is expected to improve from $41.5 billion (2.4 per cent of GDP) in 2016-17 to $6.4 billion (0.3 per cent of GDP) in 2019-20.

Since the 2016 PEFO, Government payments have reduced from 25.8 per cent of GDP to 25.2 per cent of GDP in 2016-17 and remain at that level over the forward estimates. Payments over the four years to 2019-20 are now expected to be $16.5 billion lower than anticipated at the 2016 PEFO. Spending decisions taken since the 2016 PEFO, including those taken to implement the Government's election commitments, improve the budget by $2.5 billion over the forward estimates. The Government has also legislated over $22 billion of budget repair measures since the election.

Government receipts, although growing, are expected to be affected by softer domestic prices and slower wages growth. Expected tax receipts (excluding new policy) have been revised down by around $3.7 billion in 2016-17 and $30.7 billion over the four years to 2019-20 since the 2016 PEFO. Recent higher iron ore and coal prices are expected to improve corporate profitability in the mining sector in 2016-17, which is expected to provide some support to tax collections in 2017-18. However, this will be offset by the impact of weaker growth in aggregate wages and non-mining profits across the forward estimates.

Updated domestic economic outlook

Real GDP is forecast to grow by 2 per cent in 2016-17, partly reflecting the decline in GDP in the September quarter 2016. Economic growth is expected to pick up to 2.75 per cent in 2017-18 as the detraction from mining investment eases. The outlook for nominal GDP growth is being affected by inflation and wages growth which are expected to be slower than forecast at PEFO. However, the prices of some of Australia's major commodity exports have risen considerably, which is expected to improve nominal growth in the near term. On balance, it is expected that nominal GDP growth will be stronger than PEFO in 2016-17 but below PEFO in 2017-18 as commodity prices decline from recent levels. Commodity prices remain a key uncertainty to the outlook for the terms of trade and nominal GDP.

Business investment is forecast to fall by 6 per cent in 2016-17 and to be flat in 2017-18. This reflects large forecast falls for mining investment of 21 per cent in 2016-17 and 12 per cent in 2017-18. The impact of this decline in mining investment on the economy is expected to diminish over the forecast period. In line with the transition in the Australian economy, non-mining business investment is expected to rise moderately over coming years. Business conditions in the non-mining sector remain above average and borrowing costs remain low.

The unemployment rate has declined since its recent peak of 6.3 per cent in July 2015 and is forecast to remain around 5.5 per cent in the June quarters of 2017 and 2018. While the unemployment rate has fallen, the underemployment rate has remained elevated. These developments suggest that spare capacity remains in the labour market.

International economic outlook

The Government's outlook for global growth remains uncertain. Global growth is forecast to pick up from 3 per cent in 2016 to 3.25 per cent in 2017 and 3.5 per cent in 2018. This is in part due to higher forecast growth in the United States and some East Asia economies in 2017 and 2018.

Australia's major trading partners are forecast to continue to grow at a stronger pace than the global economy, at a rate of 3.75 per cent in 2016 and 4 per cent in 2017 and 2018. This is a slight downward revision from the 2016 PEFO, reflecting weaker than expected outcomes in the first half of 2016, including below average growth in East Asia economies.

Global economic growth has been below expectations for some time. The global economy has been characterised by low productivity growth and weak trade growth but relatively low unemployment rates. Further, inflation has been subdued. Uncertainty about the outlook remains elevated and business investment remains weak. In China, a challenge is posed in progressing structural reforms needed to sustain growth while managing the risks associated with debt accumulation and excess capacity in parts of the economy. In addition, there are uncertainties regarding the impact of monetary policy normalisation in the United States. Risks also remain in Europe, including banking sector fragility in the euro area and uncertainty around the impact of Brexit. The recent support for protectionist sentiments and measures could place further pressure on global growth. Thus the global economy continues to pose risks for the domestic outlook, with uncertainty across both advanced and emerging market economies.

Major policy decisions taken since PEFO

Policy decisions since the 2016 PEFO have reduced total receipts by $325 million in 2016-17 and increased total receipts by $464 million over the forward estimates period. The Government has announced it will:

- No longer proceed with 2014-15 Budget measure to establish the Asset Recycling Fund (ARF) and will close the Building Australia Fund and Education Investment Fund. Infrastructure commitments that were to have been met from the ARF will continue to be funded through existing legislative and appropriation mechanisms.
- Provide additional funding will be provided for the Infrastructure Investment Programme for 75 infrastructure projects across Australia, which is expected to increase payments by $42 million in 2016-17 ($813 million over four years to 2019-20) and establishing the Building Better Regions Fund, ($298 million over three years to 2019-20).
- Provide funding to deliver important community infrastructure projects across Australia, which is expected to increase payments by $62 million in 2016-17 ($541 million over four years to 2019-20). This measure delivers on the Government's election commitment with the majority of the projects delivered through the Community Development Grants Programme;
- Continue funding for Commonwealth water functions, which is expected to increase payments by $398 million over three years to 2019-20;
- Restore funding for the Australian Renewable Energy Agency, which is expected to increase payments by $553 million over three years from 2017-18 ($800 million over five years to 2021-22). This was part of a range of policy amendments that secured the passage of the Budget Savings (Omnibus) Bill 2016.
- Delay the commencement of the 2015-16 MYEFO measure Medicare Benefits Schedule — changes to diagnostic imaging and pathology services bulk billing incentives until 1 July 2017 to allow for further consultation. This measure is expected to increase payments by $198 million in 2016-17 ($200 million over four years to 2019-20).
- Expand the Department of Human Services' fraud prevention and debt recovery capability, which is expected to achieve savings of $2.1 billion over four years to 2019-20.
- Cap the amount of funding available in the wage subsidy pool of the jobactive program for those aged 25 years and over, which is expected to decrease payments by $329 million over four years to 2019-20.

- Provide $141 million over four years for new and amended listings on the Pharmaceutical Benefits Scheme and the Repatriation Pharmaceutical Benefits Scheme, as well as $7.1 million over four years for new and amended items on the Medicare Benefits Schedule and Veterans' Benefits.
- Prevent the distribution of franking credits where a distribution to shareholders is funded by particular capital raising activities. This measure will address the issues raised by the Australian Taxation Office (ATO) in Taxpayer Alert TA 2015/2: Franked distributions funded by raising capital to release credits to shareholders.
- Increase the value of the Commonwealth penalty unit from $180 to $210, with effect from 1 July 2017. The value will be indexed every three years in line with the CPI with the first indexation occurring on 1 July 2020. This measure is estimated to have a gain to revenue of $90.0 million over the forward estimates period.
- Amend the Superannuation Reform Package announced in the 2016-17 Budget. From 1 July 2017, the Government will lower the annual non–concessional contributions cap to $100,000 and will limit the eligibility to make non-concessional contributions to individuals with a total superannuation balance of less than the superannuation transfer balance cap, currently set at $1.6 million. Eligible individuals under 65 will continue to be able to bring forward up to 3 years of non–concessional contributions, maintaining flexibility for individuals to grow their retirement savings by accommodating lump sum contributions. This replaces the lifetime non-concessional contributions cap announced in the 2016-17 Budget. To offset the cost of this change, the Government is not implementing changes to the contribution rules for people aged between 65 and 74 and has also deferred the commencement of the catch up superannuation contributions measure until 1 July 2018.
- Terminate of the Green Army program, achieving savings of $224.7 million over four years from 2016-17.
- No longer proceed with the commercialisation of the Australian Securities and Investments Commission (**ASIC**) Registry functions given final bids received did not deliver a net financial benefit for the Commonwealth.

Free Trade Agreement Negotiations

The 2016-17 MYEFO also includes new provisions for a number of Free Trade Agreements (FTAs) for which negotiating mandates are in place being:

- FTA with the Gulf Cooperation Council (GCC).
- India FTA — Comprehensive Economic Cooperation Agreement (CECA).
- Pacific Agreement on closer economic relations (PACER) plus.
- Regional Comprehensive Economic Partnership (RCEP).
- Australia's accession to the World Trade Organisation (WTO) Government Procurement Agreement (GPA).

- Indonesia Australia Comprehensive Economic Partnership Agreement.

Specific measures will be published once the agreements have been formally signed.

Pre-Budget submissions

As part of the budget process, the Minister for Small Business Michael McCormack has called for pre-Budget submissions from individuals, businesses and community groups on their views regarding priorities for the upcoming 2017-18 Budget. From February to April 2017 the Government will develop the 2017-18 Budget against the background of the Government's political, social and economic priorities. Pre-budget submissions are a key way for businesses and the wider community to have their views fed into the budget process at an early stage. In our experience a well prepared pre-budget submission has multiple uses in conversations with government.

Further information

To access the full MYEFO document in full, click here.
To view the media release from the Treasurer and the Minister for Finance on the 2016-17 MYEFO, click here.
To access Barton Deakin's Brief on the 2016-17 Budget, click here.

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