

The 2017-18 [Mid-Year Economic and Fiscal Outlook \(MYEFO\)](#) is another reminder - if one is needed - that the relationship between the budget and the economy runs in both directions. While we mostly ask the question, “how will the budget affect the economy?”, this update shows the economy can also have (and has often had) a significant impact on the the budget.

The highlights of this year’s MYEFO, as far as the government is concerned, are the A\$9.3 billion improvement in the underlying cash balance over the four years to 2020-21 (compared with what had been forecast in the May budget), and the consequential A\$11 billion reduction in the forecast peak in net debt (from A\$366 billion to A\$355 billion) in that year.

These improvements are the result of revisions to economic assumptions and other so-called “parameter variations” since the budget, which in total have improved the four-year bottom line by more than A\$11 billion. The biggest of these came from reductions in payments to people with disabilities, students, single parents and age pensioners (totalling A\$4.6 billion over four years) due to lower-than-expected recipient numbers.

Read more: [*Budget update shaves growth and wage forecasts but is brighter about the deficit*](#)

Personal income tax cuts seem possible

There is no additional detail in MYEFO regarding the government’s [foreshadowed personal income tax cuts](#) ahead of the next election. But if the forecast surplus for 2020-21 of A\$10.2 billion is credible, then there’s arguably some scope for the government to fund personal income tax cuts beginning in that year.

Although the cost of more significant tax cuts would escalate substantially over the medium term, there is actually more scope for these cuts than generally realised (provided the government succeeds in keeping growth in spending under control).

That's because the projected moderate surpluses, averaging about 0.5% of GDP out to 2027-28, incorporate an arbitrary assumption that taxation revenue will be capped at 23.9% of GDP. If that assumption wasn't made, the projected surpluses would rise to 1.6% of GDP by 2027-28.

In dollar terms that would imply a surplus of around A\$55 billion, compared with one of around A\$15 billion if the surplus were only 0.5% of GDP. Over the period 2021-22 to 2027-28, relaxing the assumption that tax revenues are capped at 23.9% of GDP results in almost A\$90 billion of additional budget surpluses. This is over and above what is projected with that "tax cap" in place.

Presumably, some of those "additional surpluses" are absorbed, in the government's internal figuring, by the promised phased reduction in the company tax rate for businesses turning over more than A\$50 million per annum by 2025-26 - which according to the last publicly available estimate would reduce revenues by some A\$65 billion over ten years.

However, that would still leave a considerable amount "left over" to pay for personal income tax cuts, and allow the government to continue to project surpluses of around 0.5% of GDP out to the second half of the next decade.

That's assuming, of course, that we are able to clock up 36 years of uninterrupted economic growth, and that all the other projections come to pass, including for a return to more "normal" rates of wages growth.

Economic indicators in MYEFO

Treasury has revised downwards its forecast for economic growth in the current financial year, from 2.75% to 2.5%. Partly offsetting this is stronger growth in public spending, which is now forecast to rise by 4% in real terms in 2017-18, up from 2.5% at the time of the May budget.

This reflects faster growth in both government spending (on the NDIS) and investment (NBN and state government infrastructure investment). The forecast for business investment has also been upgraded, from flat at budget time to growth of 2%, the result of both stronger growth in non-mining business investment and a smaller decline in mining investment.

Government budget update saved by higher than expected economic figures

Written by Saul Eslake, Vice-Chancellor's Fellow, University of Tasmania

This is largely the result of a downward revision to the forecast for growth in household consumption spending which has been lowered from 2.75% to 2.25%: and this carries over into a 0.25 percentage point reduction in the forecast for 2018-19, to 2.75%. Even these require a further decline in the household saving rate.

The forecast for dwelling investment spending has turned around from 1.5% growth to a decline of 1.5%, with the “softening in dwelling investment occurring slightly earlier than expected”.

Longer term, the government is still anticipating that economic growth will average 3% per annum from 2018-19 through 2023-24, by which time all the “spare capacity” in the labour market will have been absorbed. That is, the unemployment rate will be down to 5% and underemployment (workers not being able to get enough hours at work) returned to more normal levels.

The longer-term projections also assume that wages growth accelerates significantly from 2019-20. This represents the greatest risk to the government's promise of a return to surplus by 2020-21.

Saul Eslake does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

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