

Seven charts on the 2017 budget update

Written by Ross Guest, Professor of Economics and National Senior Teaching Fellow, Griffith University

Here's how the budget is looking at the mid-year mark, in seven charts.

The A\$5.8 billion drop in the 2017-18 underlying cash deficit compared with the original May budget is due more to higher revenue than lower spending. Receipts are higher by A\$3.6 billion and payments are lower by A\$2.1 billion.

The higher receipts reflect the stronger economy, which implies higher company tax (up A\$3.2 billion) and superannuation fund taxes (up A\$2.1 billion).

Receipts would have been even higher if not for stubbornly weak wages growth which, despite stronger employment growth, has tended to dampen individuals' income tax receipts. These are in fact down by A\$0.5 billion.

The estimates of GST and other taxes on goods and services remain unchanged since the budget.

The lower payments of A\$2.1 billion are driven by several changes having opposite effects. Some of these are:

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A\$1.2 billion (over four years) lower welfare payments to new migrants due to longer waiting times;

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A\$1 billion (over four years) lower payments to family daycare services due to more stringent compliance checking; and

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A\$1.5 billion (over four years) lower disability support payments due to lower than expected recipient numbers.

There is not much change in the net debt projections relative to those in the 2017-18 budget. Net debt is A\$11.2 billion lower at A\$343.8 billion in 2017-18 (around 19% of GDP). Debt stabilises in 2018-19 and starts to steadily decline thereafter to about 8% of GDP in the next ten years.

The lower deficits as a share of GDP are obviously reducing debt, but one factor tending to increase debt is student higher education loans. These are projected to increase by 32% from A\$44.4 billion to A\$58.8 billion over just the next four years.

The economic outlook continues to be a puzzle. National output of goods and services, real GDP, is expected to grow slightly slower in 2017-18 than the budget forecast – 2.5% compared with 2.75%.

However this is an improvement on the 2% achieved in 2016-17. And it is expected to increase further to 3% in 2018-19.

The economy is being driven by strong global growth and strong domestic business investment. Australia's major trading partners are forecast to grow (meaning real GDP growth) at a weighted average of 4.25% in each of the next three years.

Wages and household consumption are the puzzle – they are not growing as fast as expected from the stronger than expected employment growth (up 0.25% on the budget to 1.75%) and lower than expected unemployment rate (down 0.25% on the budget to 5.5%).

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Household consumption growth is down 0.5% on the 2017-18 Budget forecast to 2.25%. This has in fact become a global phenomenon due to higher costs and job insecurity from the forces of globalisation and automation.

Commodity prices are notoriously volatile and hard to predict, yet they are critical to the budget forecasts because they impact the revenue of resource companies which feeds into company taxes and other taxes.

Iron ore prices are assumed to remain flat at US\$55 per tonne over the forecast period, as in the budget. This forecast is almost certain to be wrong because iron ore prices never stay flat for long – the problem is that we can't say in which direction it will be wrong.

The same applies to thermal coal prices which are assumed to be flat at US\$85 per tonne which is again consistent with the budget forecast.

Australian taxpayers continue to bear most of the burden of budget repair. The government can claim with some justification that their efforts to reduce payments further have been thwarted by the Senate.

Excluding the effect of Senate decisions, new spending has been more than offset by reductions in other spending. The gap between the revenue and payment is reducing at the rate of about 0.6 percent per year.

As a share of GDP payments are expected to be 25.2% in 2017-18, falling to 24.9% of GDP by 2020-21 which is slightly above the 30-year historical average of 24.8% of GDP.

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Wage growth has been revised down from an already low 2.5% in the budget to 2.25% in MYEFO. With the Consumer Price Index forecast to grow at 2%, wages are barely keeping pace with inflation – growing in real purchasing power by only 0.25%.

This provides a meagre compensation for labour productivity growth which is implied to be about 1% in MYEFO. Wage growth is expected to pick up by 0.5% next year to 2.75%.

This is important because it underpins government revenue growth, yet it's brave to expect the deep forces that are keeping wages down in Australia and around the world to turn around and exactly match the 0.5% growth in real GDP expected to occur next year.

New measures since the budget have increased the deficit on both the revenue and expenditure sides of the budget. On the revenue side, for example, higher education changes reduced revenue by A\$76 million and the GST by A\$70 million.

On the expenses side, needs-based funding for schools has cost an additional A\$118 million and improving access to the Pharmaceutical Benefits Scheme costs A\$330 million. The roll-out of the NDIS in Western Australia adds another cost at A\$109 million, and Disability Care Australia at A\$362 million.

Ross Guest 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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