2015-16 Federal Budget Briefing

by NAB Group Economics 12 May 2015

National Australia Bank

Comment

The focus of this Budget is very different from last year. Given the political problems of last year's Budget, much focus has been placed on attempting to make this Budget as politically saleable as possible. Also, unlike last year, the Budget is relatively neutral in its impact on the broader economy. Essentially new expenditures have been broadly offset by savings.

More than any Budget in recent memory, most of the key changes were pre-announced / leaked – again to emphasise the "no surprises" focus. Thus the key spends include a $5.5bn small business package (really micro business – i.e. turnover of less than $2m per annum), including tax cuts and more importantly a 5% tax discount applied to other tax payments, immediate write-offs of new assets up to $20000, tax advantages for crowd funding and FBT exemptions to SME electronic purchases. Elsewhere there is $3.5bn spending on childcare incentives (but linked to stalled family tax benefits savings); a new infrastructure fund for Northern Australia ($800m); extra incentives for employment of older Australians; drought spending ($330m); border/terrorism spend ($500m); a payment to offset Western Australia's GST issues ($500m); extra spending on the PBS ($1.6bn) and the reversal of last year's doctor rebate savings.

Equally the savings were well flagged: including a "new law" on cross border profit shifting: GST on intangible/services (Netflix tax); pension savings by lowering the non-home asset threshold to $800k ($2.4bn); tightening of the paid parental schemes (anti double dipping between private and public schemes); the withdrawal of Melbourne East West Link money ($1.5bn) and further public service efficiency dividends.

As set out in the section on the Medium Term Fiscal Outlook, the Budget really is a combination of redirected policy spending broadly offset by substantial increases in revenue to GDP – bracket creep. Outlays broadly grow in line with GDP (which is better than the previous upward trend). Also the economic impact of the Budget on the economy is relatively neutral.

Broadly the Governments forecasts are very similar to NAB's and hence we see the projections as credible. Of course to the extent we have all overestimated growth – especially in a low wage growth and falling commodity price world – the Budget remains open to the disappointments (especially on the revenue line) that we have seen in recent years. But with a credible set of forecasts (and deliberately conservative iron ore price assumption – Treasury $US 48 vis-à-vis NAB's $US60 per tonne) the rating agencies should be relatively satisfied. Equally we would not expect the very negative reaction of consumers to this year's Budget. That said, we would not really expect much of a kick to business confidence – outside of micro business.

Of course the Budget is not the complete current fiscal story. There is still the Tax White Paper to come - the Budget had little on big tax and superannuation questions. Also there is still the debate about what happens to Government's removal of $80bn in state funding for health and education in the out years. And finally, despite the Government's best efforts, what happens in the ensuing political process is unknowable.

Fiscal Outcome

The underlying cash deficit for 2014/15 is estimated at $41.1bn and $35bn in 2015/16 (or 2.1% of GDP and below market expectations – but near NAB's). The projected deficit then moves down to $14.4bn in 2017/18 (0.8% of GDP) with an eventual return to surplus in 2019/20. Basically the reduction in the deficit is driven by returning revenues which rise from 23.9% of GDP in 2014/15 to 25.7% in 2017/18 (accruals basis). Outlays move from 26.1% to 26.0% of GDP in the same period

Economic Outlook

As noted above there is little fundamental difference between Treasury's and NAB's economic outlook. At the margin we are slightly less optimistic in the near term (NAB 2.3% Treasury 2.5% in 2014/15) but slightly more optimistic in 2015/16 (NAB 2.9% Treasury 2¾%). An interesting difference here is our slightly more pessimistic view on business investment. That said the RBA is more pessimistic on 2015/16 growth than either Treasury or NAB. At the margin Treasury has a slightly higher unemployment rate in year average terms in 2015/16 (NAB 6¼% Treasury 6½%). Finally on the critical nominal GDP forecasts (for Budget deficit forecasting) there is little difference between NAB and the Treasury (both around 1½% and 3½% in the next financial year).

Financial Markets

Modest but nonetheless positive market reaction to the Budget. The $A has pushed 30bps higher towards 0.7990, although it was trading higher before the Budgets release. Bond futures improved 2-3 basis points (i.e. yields lower), presumably because the debt program is a little less than expected and the major ratings agencies have been quick to say the Budget doesn't pose any immediate threat to the AAA rating.

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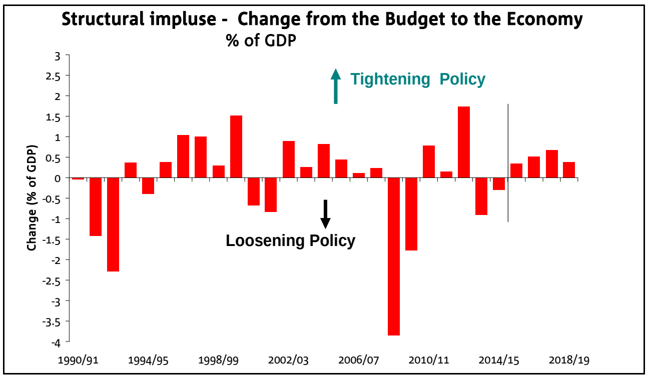
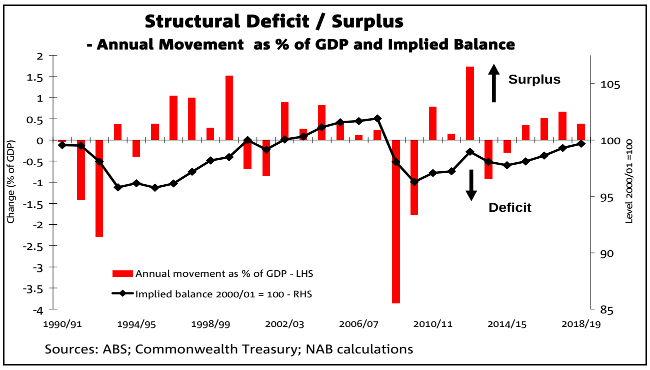
Medium Term Fiscal Context

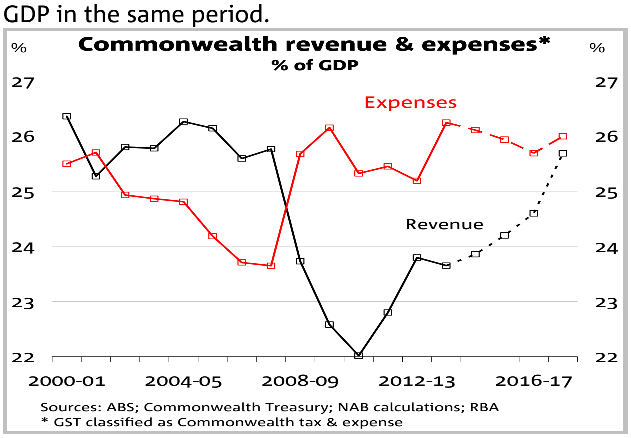
As noted earlier, the Budget does not involve any fundamental policy tightening. Perhaps the best way to show this is using OECD methodology which attempts to show the structural changes of Budget measures by excluding cyclical factors. That is, as the chart below indicates the Budget in 2014/15 looks to have slightly supported the economy (as key savings measures in that Budget did not pass the Senate). Thereafter it mildly detracts from growth in the out years.



Equally the same methodology shows that the Budget is likely to remain in structural deficit for at least the period of the forward estimates.



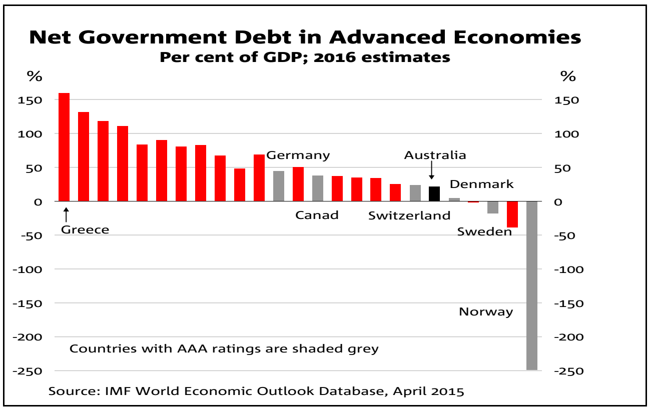
Also the heavy lifting has mainly been done from the revenue side. This is also evident if we look at the Budget "jaws" (i.e. revenue versus outlays as a percentage of GDP. Basically the reduction in the deficit is driven by returning revenues which rise from 23.9% of GDP in 2014/15 to 25.7% in 2017/18 (on an accrual basis). Outlays move from 26.1% to 26.0% of GDP in the same period.



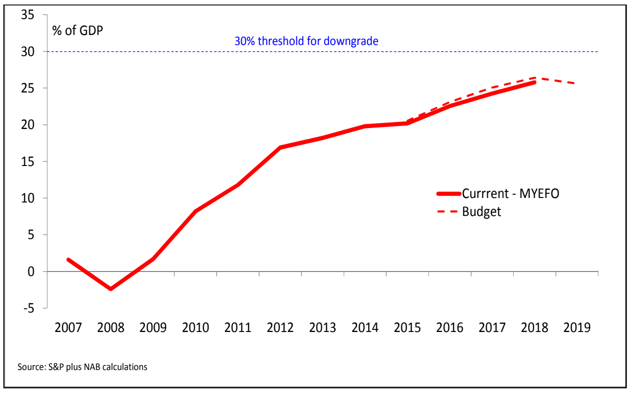
On the credibility of the forecasts, as noted above, we fundamentally have no real differences with similar real GDP forecasts, nominal GDP forecasts and terms of trade. Indeed if anything the Budget is deliberately conservative on the iron ore price ($US 48 vis-à-vis NAB's $US60 per tonne).

Of course to the extent we have all (NAB, Treasury, and most economic commentators) overestimated growth – especially in a low wage growth and falling commodity price world – the Budget remains open to the disappointments (especially on the revenue line) that we have seen in recent years. But with a credible set of forecasts the rating agencies should be reasonably relaxed that a credible path to fiscal repair is being set out.

As the chart below shows Australian Government debt to GDP is relatively low – but is in the middle of the pack for currently AAA rated countries.



Further, while there is still some room before the 30% debt to GDP trigger is reached (a level S&P has flagged as a point of concern for AAA ratings), there is not a lot of room.



The main point from the above is the potential for political gridlock, rather than announced Budgets, that causes the most risk – in a few years- to the AAA rating.

Budget Measures – In Brief

In accrual terms, the fiscal deficit for 2015/16 is estimated to be $33 billion (or 2.0% of GDP). Key highlights of spending and saving measures (those committed within the current Budget period) include:

New Spending Initiatives

Small Businesses

- A $5.5 billion Jobs and Small Business Package essentially made up of three tax-relief measures:

a) Immediate deduction on each and every asset costing less than $20,000 bought between Budget night and 30 June 2017 by small businesses costing around $1.75 billion;

b) A 1.5 percentage point cut in the company tax rate from 30% to 28.5% for businesses with turnover less than $2m (costing around $1.45bn), leading to a two-tiered business tax system; and

c) A 5% tax discount for unincorporated small businesses up to $1000 per annum ($1.8bn).

Agriculture

- To encourage drought preparedness, the Government will provide an immediate tax deduction for water facilities and allow farmers to depreciate over three years capital expenditure on fodder storage assets from 1 July 2016. Additionally, the cost of fencing will be immediately deductible from 1 July 2016.

Infrastructure

- A new $5 billion Northern Australia Infrastructure Facility to provide concessional loans to major infrastructure projects in the North. Of that, $800 million is forecast to be spent during the forward estimate period.

Government Service Delivery

- $255 million for a digital transformation agenda, making government services simpler and easier to use with more online services.

Family

- An additional $3.5 billion over five years on child care assistance, including a new Child Care Subsidy to be introduced from 1 July 2017 and a nannies trial from 1 January 2016.
- Means-tested new Child Care Subsidy will have no annual cap for families with income below $185,000. Disadvantaged families will be supported by the Child Care Safety Net.
- $843 million to extend payments to states and territories for a further two years until December 2017.
- ‘No Jab, No Pay’ rule from 1 January 2016.

Youth Employment

- $330 million to implement a Youth Employment Strategy with specific programmes targeted at young people who have disengaged from work and study, key groups of vulnerable job seekers (including young people with mental health concerns) and early school leavers.

Health

- Reforms to pricing and remuneration across the supply chain under the Pharmaceutical Benefits Scheme. $1.6 billion for new and amended listings on the PBS.
- Distributions of $10 million in 2015-16 from the Medical Research Future Fund.

Aged Care

- From 1 February 2017, funding will be allocated to the consumer based on their care needs.

Defence

- $1.2 billion in new funding for national security, with investment in new intelligence measures, new IT capabilities, and extending military operations overseas.

Revenue Measures

Multinational Company Tax

- A new Multinational Anti-Avoidance Law to strengthen rules on profit-shifting by large multinationals. These include country-by-country reporting requirements by large companies to the ATO, hybrid mismatch arrangements, treaty abuse and compulsory exchange of rulings related to preferential regimes.
- Imposition of GST on imported digital products and services starting 1 July 2017.

Non-profit Organisations

- Introduce a new cap of $5,000 for salary packaged 'meal entertainment' benefits effective from 1 April 2016, which is expected to accrue savings of $295m over the forward estimates period.

Fly-in-fly-out (FIFO)/ Drive-in-drive-out (DIDO) Workers

- Exclude FIFO and DIDO workers from Zone Tax Offset eligibility with estimated savings of around $325m over the forward estimates period.

Foreign Investments

- Enforce stronger compliance by foreign investments and impose more stringent penalties on those breaking the rules.

Higher Education Loan Programme (HELP)

- Impose stricter requirements on Australians residing overseas to repay their HELP debts on an income-contingent basis.

Superannuation

- No new taxes on superannuation.

Saving Measures

Pension

- The Government will achieve savings of $2.4 billion over five years by increasing the asset test thresholds and the withdrawal rate at which pensions are reduced once the threshold is exceeded.
- Government decided not to proceed with the 2014 Budget measure to index pension by CPI.

Family

- Tightening of the Parental Leave Pay Scheme to eliminate double-dipping in private and public schemes by new mothers – expected to save around $1 billion.

Welfare

- $1.7 billion over five years by enhancing the Department of Human Services fraud prevention and debt recovery capability, and improving assessment processes.

Infrastructure

- Savings from the cancelled East West Link Project by the Victorian Government of $1.5 billion.

Economic & Financial Outlook

Global outlook

We expect global growth to remain stuck at a below trend 3¼% in 2015 before accelerating to 3½% next year. Treasury has slightly more optimistic forecasts at 3½% in 2015 and 3¾% for 2016. That said the Australian major trading partner forecasts are broadly similar at around 4½% in the next two years. The differences in the global forecasts largely reflect our more sombre US economic view.

Judging by the experience of the last few years plus the lack of hard evidence that an upturn is imminent, the main risk to the global forecasts lies again on the downside. That would involve yet another postponement of the long-predicted acceleration in global growth.

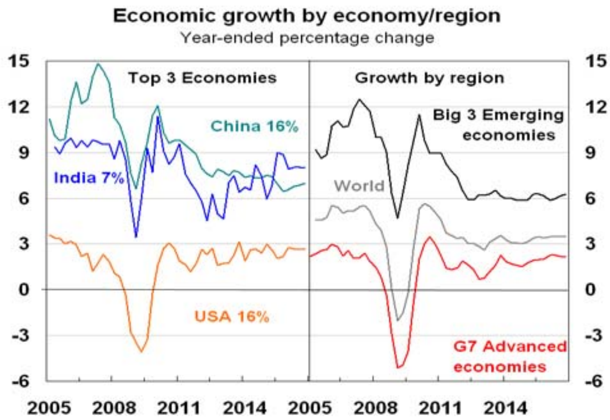
Comparison of Treasury Budget Forecasts and NAB Forecasts

	2015		2016		2017	
	Treasury	NAB	Treasury	NAB	Treasury	NAB
US	3.3	2.5	3.3	2.7	3	2.5
Euro-zone	1.8	1.4	1.8	1.8	1.8	2.1
Japan	1	0.8	1	1.3	0.5	1.3
China	6.8	7.1	6.5	6.9	6.5	6.5
India	7.5	7.7	7.5	7.9	7.5	8.1
Emerging Asia	4.8	4	4.8	4.2	5	4.2
World	***3.5***	***3.2***	***3.8***	***3.4***	***3.8***	***3.5***
Major trading partners	4.5	4.4	4.5	4.5	4.3	4.4

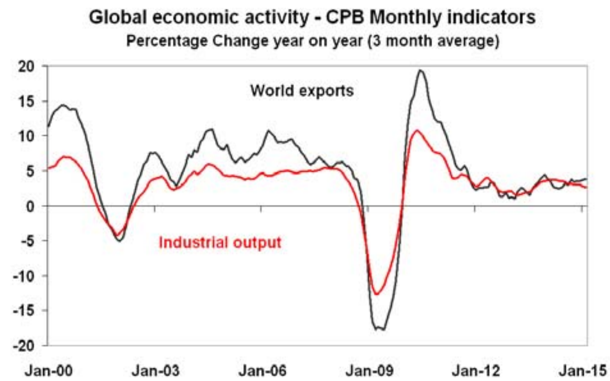
The disappointing outcome for global growth through the last couple of years reflects a loss of momentum in the pace of expansion in the big advanced economies alongside soft global trade growth and falling commodity prices hitting activity in emerging market regions like East Asia and Latin America.

Conditions remain mixed within the group of big advanced economies with signs of an upturn in the Euro-zone, a disappointing start to the year in the US and the Japanese economy still struggling to achieve a sustainable recovery from last year's tax-related hit to demand. Taken overall, growth in the G7 advanced economies should pick up modestly from 2% in 2015 to 2¼% next year.

Activity trends remain equally diverse across the big emerging market economy regions. Recent industrial data shows the Chinese economy (now the largest in the world) continuing its trend slowing but, despite all the concerns over its unbalanced growth model, a hard landing has been averted. The pace of growth in India (3rd largest economy in the world) now exceeds that of China, following a major rebasing of the statistics rather than a clear upward trend in the quarterly data. The Brazilian economy (6th largest in the world) has been under-performing with the level of output through much of 2014 falling below year-earlier levels.

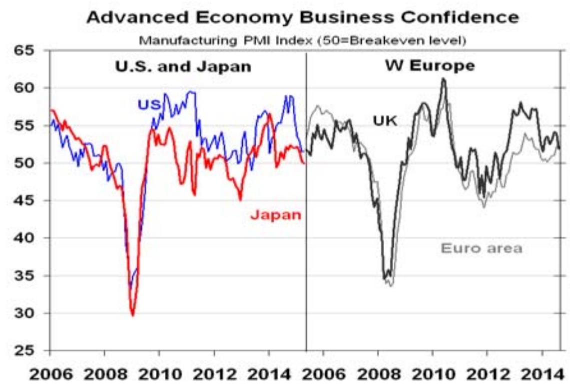


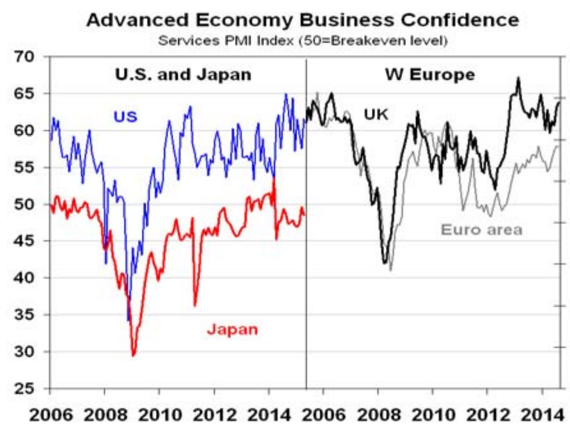
Business surveys and monthly data on trade flows and industrial output give the most up to date indications of the pulse of economic growth. The CPB's global measures of trade and industrial output do not show any sign of an upturn in the early months of 2015.



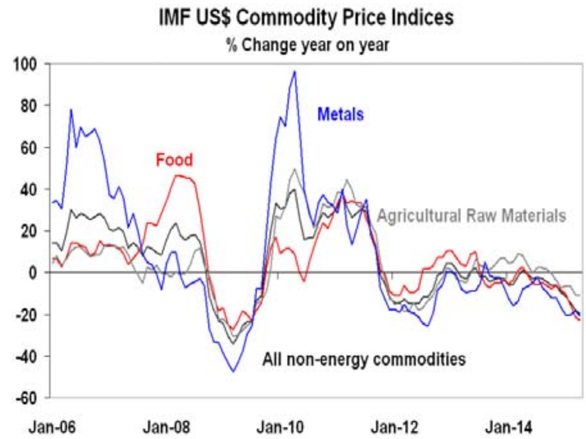
The emerging market economies of East Asia and Latin America are useful indicators of the strength of global demand, given their reliance on exports and commodity sectors to drive growth. Both industrial output and export receipts remained weak in early 2015, although $US appreciation would be holding down the export statistics.

The monthly surveys of purchasing managers (PMIs) are usually among the first measures to show any change in the pace of growth in the big advanced economies. They show activity continuing to pick up in the Euro-zone and solid results still in the UK but the outcomes for both the US and Japan have remained lacklustre, with no clear sign of an acceleration.



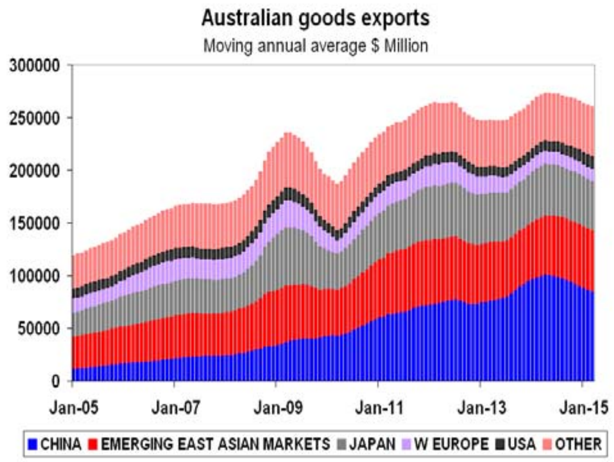


The sluggishness of global growth has held down the rate at which commodity demand is expanding at a time when supply is coming onto the market in response to previously high prices while $US appreciation further dampens commodity prices set in that currency. Although attention in Australia is focused on the steep falls in the $US price of bulk commodities like coal and iron ore, the IMF global index shows a broad-based decline in commodity markets.

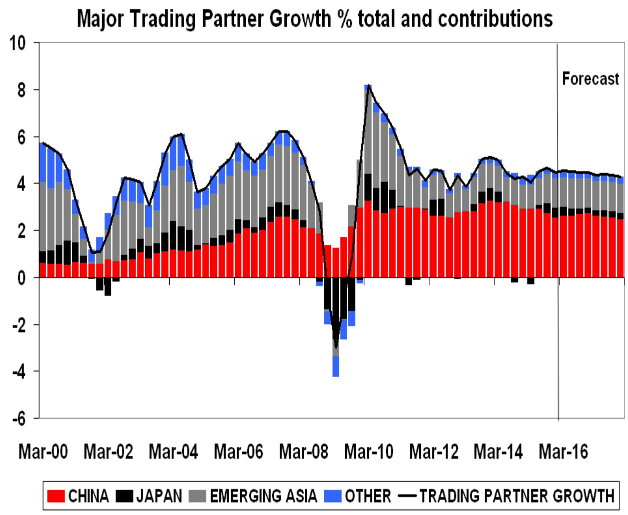


Australia is only one of a number of big global commodity producers to feel the impact of this downturn in global commodities. With the exception of New Zealand during the dairy price boom, all the big Southern Hemisphere commodity producers show similar trends in their $US export earnings.

Given the extent to which the Australian economy is integrated into the East Asian trading system as a commodity supplier, the combination of lower global prices and sluggish growth across much of East Asia (outside China) has resulted in a plateau in $A export values, despite the boost that $A depreciation should provide. The gradual commissioning of big resource projects has and will continue to underpin solid growth in commodity export volumes but the steep decline in world prices is offsetting the effect of that resource output volume boost on export values.



The slowing in forecast Chinese growth has a major impact on the overall outlook for growth in Australia's major trading partners, outweighing the predicted pick-up in regions like Europe which do not feature as prominently among our export markets. As a result, growth in our major trading partners is forecast to remain around 4½% through the next couple of years.



Overall, both Treasury and NAB are expecting a period of lacklustre sub-trend growth, a far better outcome than would have been delivered if any of the risks hanging over the global economy (a Chinese economic "hard landing", break-up of the Euro-zone, entrenched price deflation) had occurred.

Australian Outlook

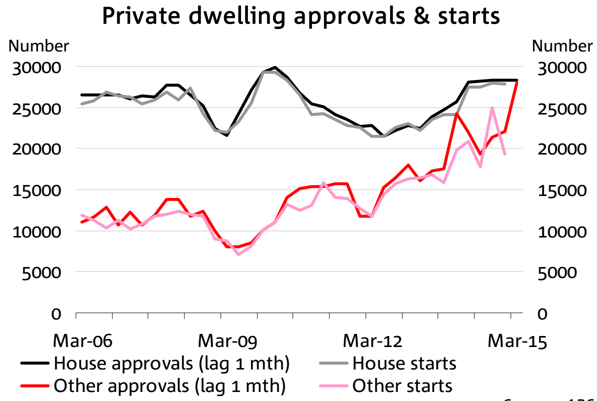
The Commonwealth Treasury's Budget papers contain a set of economic forecasts that present a similar outlook to that expected by NAB – albeit a touch weaker on growth in 2015/16 (Nab 2.9% v Treasury 2¾%). With the upturn in the non mining sector still slow to materialise, unemployment is expected to edge higher. Lower commodity prices combined with weak incomes growth, and cautious business and consumer sentiment will continue to weigh on nominal GDP growth and government revenue.

The big picture in both Treasury and NAB economic forecasts is one of a domestic economy struggling to offset the impact of falling mining investment. While the shift to the next phase of the mining boom – as capital investments become operational and begin to export – is a key driver of this trend, additional factors are also keeping both business and consumers cautious with their spending. As a result GDP has remained below trend in the first half of 2014/15 and unemployment continues to edge up.

Partial indicators have been somewhat mixed of late, but have generally shown signs of a tentative improvement in the non mining sector. Very low interest rates are having a noticeable impact on house prices, although this has been most evident in Sydney and, to a lesser extent, the Melbourne market. That in turn has via wealth effects seen better business conditions and activity levels in the big non mining states

There has also been a strong pick up in investment in dwellings – with expectations of on going growth in this area in the years ahead. Our forecasts are for growth of around 6½% in the current financial year rising to nearer 11% in 2015/16.

Much of the improvement in dwellings has come via the building of new apartments in inner Sydney, Melbourne and to a lesser extent Brisbane. Indeed approvals for apartments (especially 3 storey and above) are now running at the same rate as house approvals – in sharp contrast to the long term trend where housing approvals normally outnumber apartments by a ratio of 3 to 1.

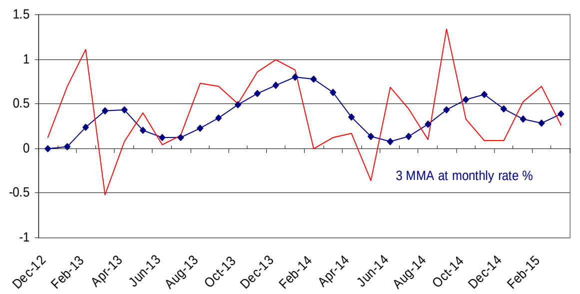


Source: ABS

While investment in dwellings is improving, and can be expected to continue the situation is more complex on the consumer side.

Consumer confidence indicators suggest the February rate cut has done little, with spirits continuing to be weighed down by a soft labour market, weak wages growth and (according to a NAB survey) concerns over the cost of living and government policy. Consequently, recent improvements in retail spending are expected to be shortlived. A further complication is the phasing out of the temporary boost to retail sales in late 2014 from the release of the latest “iPhone”. This is reflected in the chart below contrasting monthly retail sales vis-à-vis the same series on a 3 monthly moving average basis.

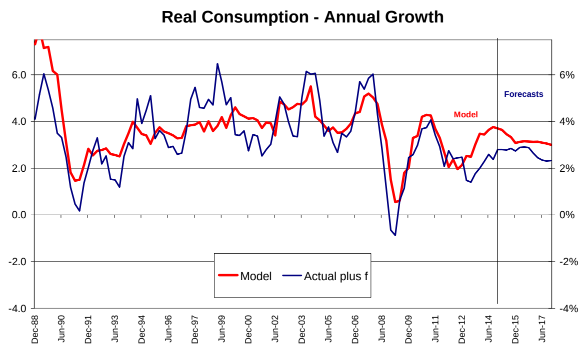
Monthly Retail Sales v 3 Monthly Moving Average - % Change



Low interest rates and subdued wages growth have probably been ingredients supporting corporate profitability and, hence domestic equity prices.

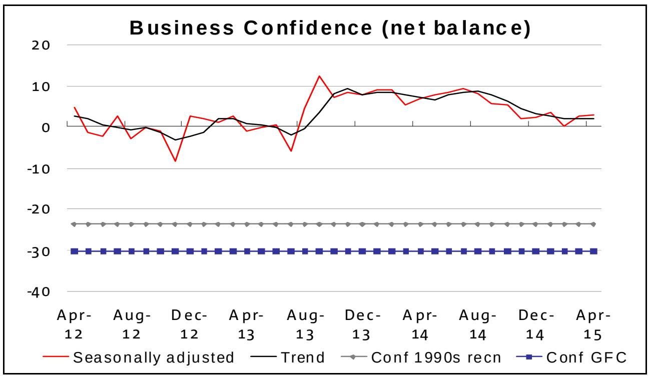
Overall we expect lower interest rates, continued growth in housing wealth and strong equity markets to underwrite some improvements in consumer spending. We generally see the Budget as not fundamentally changing consumers’ tentative behaviour and confidence levels – or at least not leading to a slump in confidence a la last year’s Budget.

Thus we expect consumption growth of around 2¾% in 2014/15 (much the same as the year to December 2014, rising a touch to nearer 3% in 2015/16. That forecast however is significantly below what might have been expected using traditional relationships from incomes, wealth and interest rates (see chart below). In short, the consumer is expected to remain very cautious.

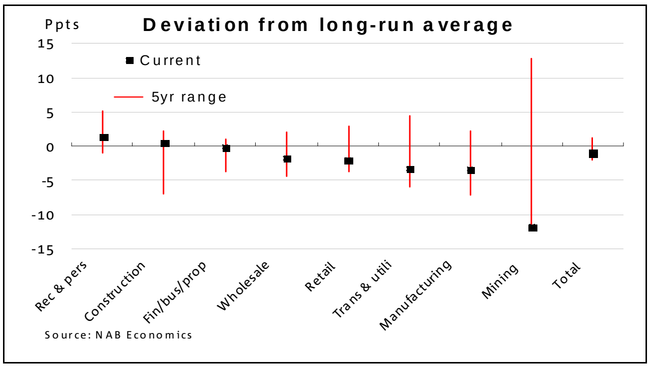


Turning to the business sector, and on a more positive note, there were some tentative signs of improvement in the NAB Monthly Business Survey for March, and while some of the improvements in business conditions were unwound in April, the trend is generally looking more positive. Business conditions eased back in April, but remain consistent with the long-run average for the series. Each component (trading, profit, employment) softened, although trading conditions, and to a lesser extent profits, remain quite positive, while employment dipped back into negative territory.

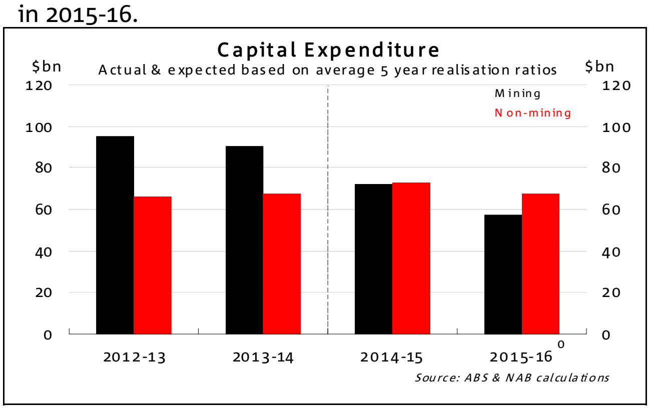
That said there is a degree of softness in the more forward looking indicators such as new orders and business confidence. Unless confidence improves significantly from current levels, it is hard to see a sustained kick in business activity and employment.



Also of concern on the non-mining investment front are continuing levels of capacity utilisation that are well below trend – especially in areas such as manufacturing, retail, and transport (and of course mining)



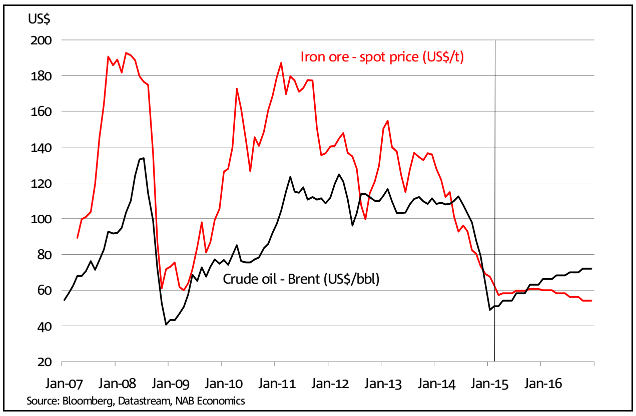
These factors also probably account for a good deal of pessimism in the latest ABS survey on investment intentions suggesting non-mining investment could fall in 2015-16.



At this stage we think the ABS investment survey may be a touch pessimistic – at least in relation to non mining investment. That said, mining investment, given falling commodity prices and a weaker global outlook (including Chinese demand for steel and associated commodities), could well underperform these very subdued expectations. For 2014/15 we expect core business investment to fall by 6.7% in 2014/15 and a further 10.3% in 2015/16. Also another decline in mining investment of 10½% is factored into our 2016/17 forecasts. Federal Treasury has broadly similar expectations.

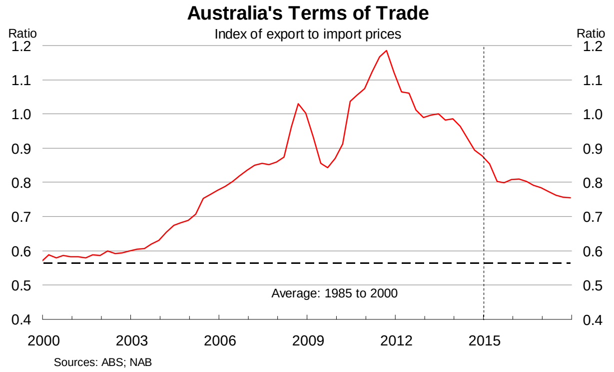
As part of the gradual improvement in the size of the fiscal deficit, we are expecting relatively moderate contributions to growth from public sector demand. In 2014/15 underlying public demand will likely fall marginally (down 0.1%) before increasing by around 1% in 2015/16 and around 1½% in the out years. As part of that, public consumption and investment (excluding sales to the private sector) are both expected to grow by around 1% in 2015/16. Federal Treasury is a touch more optimistic at 1¼% and 1½% respectively.

While commodity export volumes are expected to ramp up over the forecasting horizon - given the surge in iron ore production in the near term and the coming on stream of our LNG export potential – we still expect to see further weakness in commodity prices (in part reflecting the supply response by Australian and other global producers in recent years). That however will be largely offset by our forecast fall in the AUD / USD rate – to around 74c by end 2015 before recovering to the high 70c /low 80c mark into the medium term. Those forecasts would be consistent with iron ore prices around the $60 per tonne mark and oil prices in the mid $USD 70s per barrel.

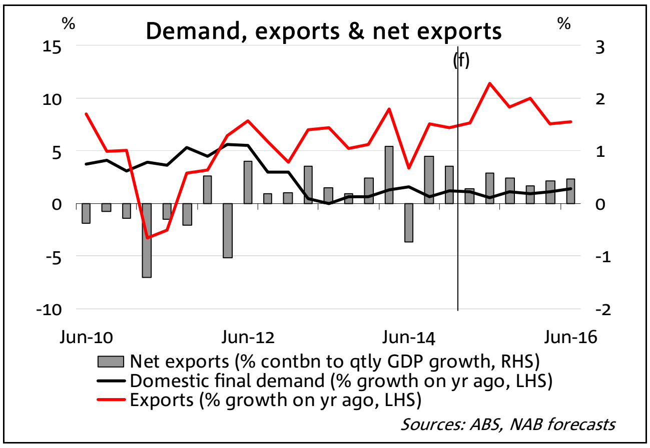


That in turn would see further falls in Australia's terms of trade – falling 11% in 2014/15 and 6% in 2015/16. The latter however is largely a timing effect with the terms of trade basically flat during the course of 2015/16.

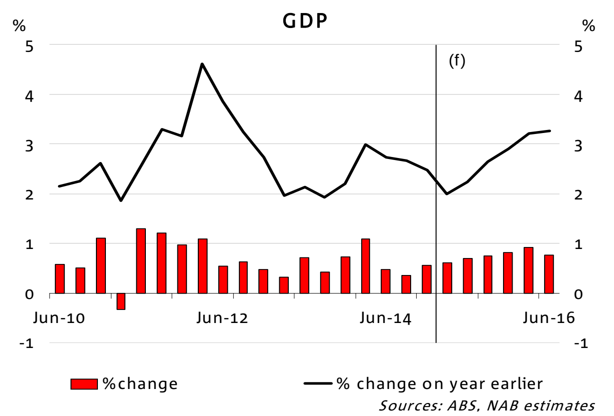
This scenario would have net exports contributing around 2½% to growth during the current financial year and around 1¾ to 2% per annum into the out years GDP outcomes. The terms of trade impacts together with weak wages growth mean nominal GDP will remain weak - with growth this financial year of 1½% rising to near 3% in 2015/16.



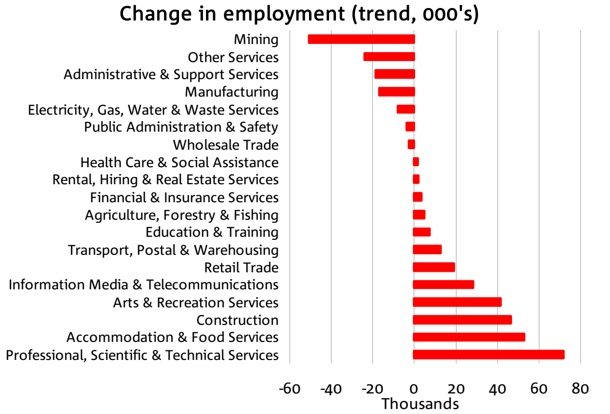
Thus the forecasts continue the recent pattern of reasonable GDP, supported by strong net exports but quite weak domestic demand.



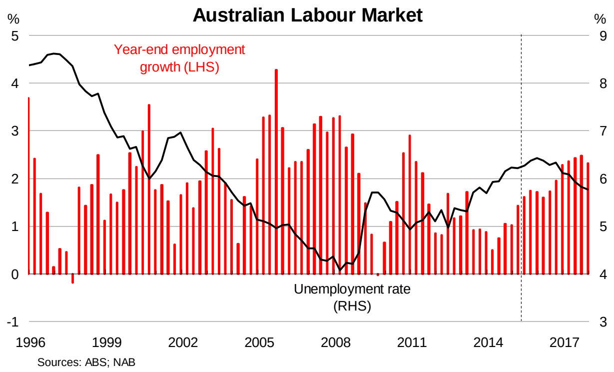
Weighing up all these factors, we see GDP growth remaining below trend in 2015 (but accelerating in 'through the year' terms), as larger contributions from net exports and dwelling investment offset the continuing pull back in business investment – driven by sharply slowing mining investment. Forecasts are fundamentally unchanged – with GDP of 2.3% in 2014/15 and 2.9% in 2015/16. At the margin Federal Treasury has slightly weaker GDP forecasts for 2015/16 at 2¾% but broadly similar forecasts for 2014/15 and the out years



The downturn in mining investment is having a significant impact on the labour market – with flow on effects to the rest of the economy. This is because the resource boom is shifting from labour intensive investment to the capital intensive exports phase. The impact on the labour market has so far been largely offset by improving labour demand in services sectors and areas such as residential construction, but job losses in the mining sector will likely accelerate as mining investment falls further.

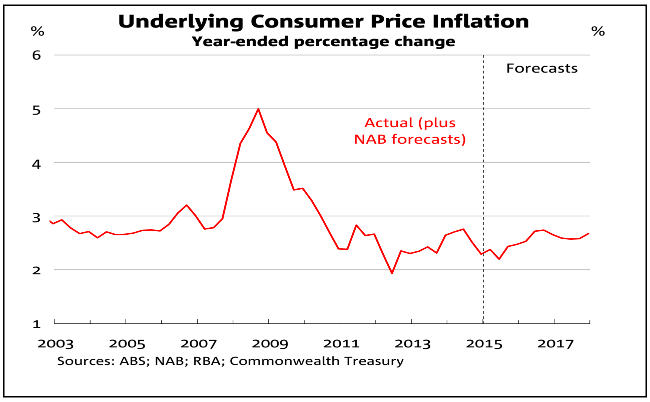


While there is still considerable noise in the labour market indicators, recently some partials such as job ads and vacancies appear to have marginally softened. That said, many of the partials still suggest stronger labour demand than the official employment series, which has also weakened. NAB's employment series (from the Survey), which leads official statistics by around 6 months, suggests some near term softness. For the next 6 months the index is pointing to employment growth of around 170k jobs per annum or around 14k per month – a rate of employment growth that, at the margin, might be insufficient to stabilise the unemployment rate (unless the participation rate falls). Clearly confidence will need to improve before business is prepared to significantly hire. We expect unemployment to peak at 6.4% by end 2015 and remain stubbornly high – still above 6% by end 2016. Treasury expects broadly similar unemployment outcomes

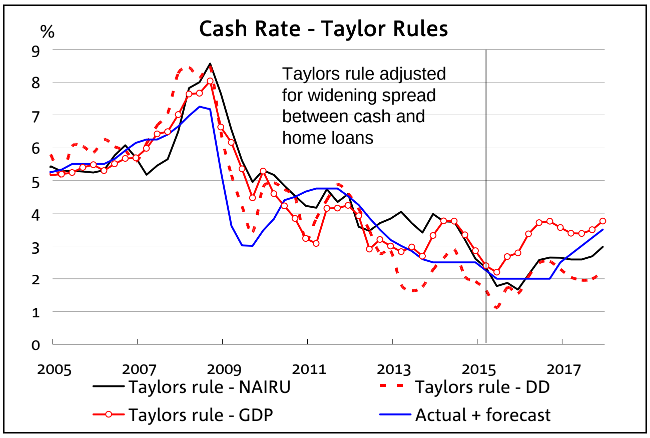


In an environment of higher unemployment and weaker commodity prices (oil prices), it is hard to see inflation being an issue for some time to come. Indeed our core inflation forecasts see inflation going a touch lower in the near term (2.2% during 2014/15) before rising to 2.5% by end 2015 and 2.7% by end 2016.

Broadly NAB and the RBA have very similar core inflation forecasts.



The recent RBA cut was in our view a line ball decision – with the RBA opting to "water the green shoots" rather than delay the timing of an additional cut. While there is still the risk of further cuts, recent improvements in the economy suggest the RBA will pause for some time, with the next move likely to be up (although the timing will be very data dependent). Given our forecasts for activity and inflation, we currently expect the first hike to be very late in 2016. It is also worth noting that we see a much lower peak in the interest rate – at around 3½% by late 2017. Finally as can be seen from the chart below these forecasts are broadly in line with what would be expected from a Taylor's rule approach – especially one based on unemployment (NAIRU).



Australian Economic and Financial Forecasts – National v Federal Budget (a)

	2014-15 (f)		2015-16 (f)	
Annual % Change	**NAB**	**Budget**	**NAB**	**Budget**
Private Consumption	2.7	2¾	2.8	3
Private Investment – Dwelling	6.5	6½	10.7	6½
Underlying Business Investment	-6.7	-5½	-10.3	-7
Underlying Public Final Demand	-0.1	1¼	0.9	1½
Domestic Demand	**0.9**	**n.a.**	**1.2**	**n.a.**
Stocks – Contribution to GDP	0.1	0	0.0	0
GNE	**1.0**	**1¼**	**1.1**	**1½**
Exports	-2.6	5½	7.7	5
Imports	0.6	-3	5.8	-1½
GDP	**2.3**	**2½**	**2.9**	**2¾**
- Non-Farm GDP	2.4	n.a.	2.9	n.a.
- Farm GDP	-3.4	n.a.	1.6	n.a.
Federal Budget Deficit (fiscal balance, $bn)	**-39.4**	**-39.4**	**-33.0**	**-33.0**
Current Account Deficit: % of GDP (-%)	-3.3	-3	-3.2	-3½
Terms of Trade	-11.1	12¼	-6.2	-8½
World GDP (b)	3½	3½	3.7	3¾
End Period				
Wage Price Index	2.4	2½	2.5	2½
Employment	1.6	1½	1.7	1½
Unemployment rate	6.3	6¼	6.3	6½
Underlying CPI	2.2	n.a.	2.7	n.a.
Official Cash Rate	2.50	n.a	3.50	n.a.
10 Year Govt. Bond Yield	4.60	n.a	5.10	n.a.
US cents/$A	0.82	n.a	0.80	n.a.
Trade Weighted Index	67.9	n.a	#N/A	n.a.

(a) Percentage change on previous year, unless otherwise indicated (b) Calendar (f) Forecast

	Dec 2014	Jun 2015	Dec 2015	Jun 2016	Dec 2016	Jun 2017
GDP						
NAB	2.7	2.3	2.3	2.9	3.1	3.0
RBA	2¾	2¼	2¼	2½	3	3¼
Treasury		2½		2¾		3¼
CORE INFLATION*						
NAB	2.3	2.2	2.5	2.7	2.7	2.6
RBA	2¼	2¼	2½	2¼	2¼	2¼
Treasury		n.a.		n.a.		

(a) Year-average percentage change

(b) Year-ended percentage change

Bond Issuance and Net Debt

The Debt Program in 2015/16.

AOFM (the Government's debt management arm) normally gives the detail of expected issuance in the days ahead.

Based on the Budget numbers we estimate the Government's funding task in 2015-16 will be very similar to the current years ask - about $45bn in net terms. It will be however be more in gross terms given the substantial ($36bn) maturing debt in 2015-16.

This is a little less than the market was expecting so should be very manageable. Particularly as Australia is likely to retain its AAA rating – more on this below. Issuance is likely to again be dominated by ACGB's with a smaller contribution for inflation indexed bonds. The face value of Commonwealth Government Securities is expected to be $412bn in 2015-16 (25% of GDP) increasing to 518bn in 2018-19, near 27% of GDP.

The Government intends to sell-down its residential mortgage-backed securities portfolio (RMBS). At April 2015 they had assets worth $4.6bn and they expect to sell these down by the middle of 2016, subject to market conditions.

Net Debt to Peak in 2016/17

The Budget projections see net debt rising to 18% of GDP in 2016-17 before starting to decline modestly. Again, this forecast is a little better than feared but of course the result still needs to be delivered by the economy and the Government.

Credit Rating Agencies Cautious:

While the Government's debt position has deteriorated in recent years, and they acknowledge there remain large medium term fiscal challenges, ratings agencies say they will continue to rate Australia as AAA. But is also clear from their comments that some work will need to be done in the years ahead to keep the AAA rating.

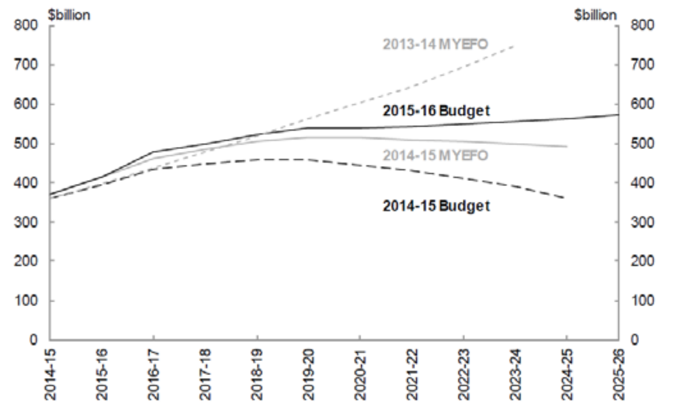
According to a Bloomberg report, Standard and Poor's have said the AAA rating is not "immediately affected by the Budget" but they had some concern about the revenue write-downs that "present a source of downside risk to the budget".

They say "We continue to assume, though, that Australia's long-standing political consensus for prudent public finances will persist, and will ultimately lead to the passage of policy measures that support improving budget outcomes over the medium term".

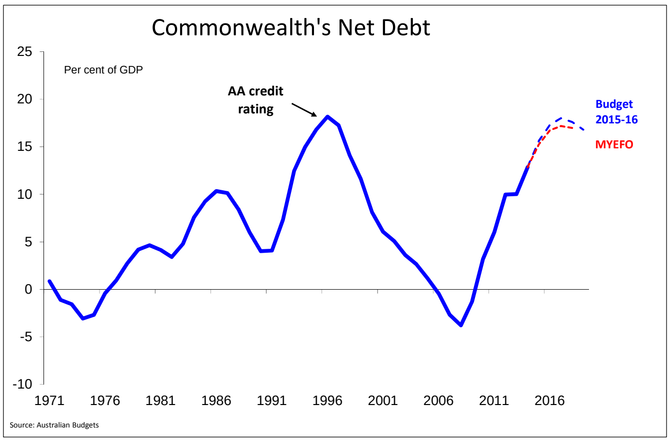
Standard and Poor's rating agency uses an adjusted net debt metric, which encompasses the wider General Government. They have set a threshold for the AAA rating of 30% and we reckon the Budget will stay just below this near 26-27% over the forecast period.

Bloomberg reporting Moody's immediate reaction as "nothing in the Australian Budget to prompt outlook change."

Chart 1: Face value of CGS on issue projected to 2025-26



Note: A tax-to-GDP cap of 23.9 per cent is applied to these projections from 2020-21, except for the 2013-14 MYEFO where the tax cap applies from 2019-20. 2013-14 MYEFO projections were not originally published with a tax cap.
Source: Australian Office of Financial Management and Treasury projections.



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