10 May 2017

Budget Update

SUNCORP

Good Times

Treasurer, Scott Morrison, delivered his second Federal Budget, and it was a pragmatic affair with a little of something for everyone. Whilst this budget likely delivers on its purpose, there is a nagging risk at the back of the mind that by attempting to please everyone ultimately leads to disappointment for everyone.

Having learnt from previous year's, that were more crash and bang type budgets, Sco~Mo delivered something distinctly reminiscent to the other side of the political divide. More than a few scribes were squinting at small screens to double-check it was in indeed the Treasurer delivering a big spending, big taxing and big building budget.

The clever part about this budget is that it should be granted a smooth passage through the Parliament, unlike its predecessors complete with $13.5 billion in zombie spending cuts. The downside, though, is voters may have trouble discerning any meaningful policy differences between the two major political parties come the next election (between August 2018 and May 2019).

As widely expected, the budget delivered a suite of big ticket infrastructure projects, amounting to $75 billion over the next ten years. Admittedly, some of this spending relates to maintaining existing road infrastructure, but there are upgrades to road and new investment in rail and airports. The objective is to sustain the economic momentum left by back-to-back booms in mining and housing construction. Just as importantly, such projects should lend support to Australia's regional cities and towns which are suffering from higher rates of unemployment.

The big question is, how did the Treasurer pull the veritable rabbit out of the hat by writing-off $13.5 billion in spending cuts, upping infrastructure spending whilst achieving $7.4 billion a return to surplus in 2020/21?

First, the 2017/18 budget deficit of $29.4 billion was a little larger than most were forecasting in the lead-up to the budget.

Second and more importantly, the economic forecasts that underpin the budget over the next four years are ambitious. For instance, a return to 3% GDP growth and a 3% in wages growth by 2018/19 is questionable given the fact that global GDP growth has been painfully slow to improve and suppressed wages growth is also a global phenomenon. Furthermore, the shifts in full-time to part-time employment act to reduce the tax take.

	Outcomes	Forecasts			Projections	
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Real GDP	2.6	1 3/4	2 3/4	3	3	3
Employment	1.9	1	1 1/2	1 1/2	1 1/2	1 1/2
Unemployment rate	5.7	5 3/4	5 3/4	5 1/2	5 1/2	5 1/4
Consumer price index	1.0	2	2	2 1/4	2 1/2	2 1/2
Wage price index	2.1	2	2 1/2	3	3 1/2	3 3/4
Nominal GDP	2.3	6	4	4	4 1/2	4 3/4

The other significant contributor to the Australian economy has been the rocket higher in bulk commodity prices. Forecasting bulk commodities has been notoriously difficult to forecast due to the fact they are priced in a global marketplace, whereby weather events have dramatic impacts upon prices. The all important spot iron ore price is forecast to return to US$60 a tonne by March next year, but is already trading at that level.

The impressive rebound in commodity prices over the last year affords the Australian economy a relatively comfortable year ahead once government spending is included. But, the mainstay of the domestic economy is household consumption and continued spending is predicated upon rising debts and falling savings.

All the while, the financial markets are signalling that interest rates are moving higher, and in effect a further dampener upon demand.

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