

PART 1: OVERVIEW

The fiscal outlook for Australia remains strong – the underlying cash surplus for 2004-05 is expected to be higher than was the case at the time of the *Pre-Election Economic and Fiscal Outlook 2004* (PEFO) – and surpluses are forecast over the forward years. The Australian economy is expected to record solid growth in 2004-05, although the outlook for real economic activity has been revised down modestly since the PEFO. This reflects weaker than anticipated export growth. However, high export prices are supporting company profits and national income.

An underlying cash surplus of \$6.2 billion is anticipated in 2004-05, an increase of \$900 million since PEFO and \$3.8 billion since the 2004-05 Budget. This largely reflects an increase in estimated cash receipts of \$5.5 billion offsetting an increase in payments of \$1.7 billion.

The increase in estimated cash receipts since Budget is largely driven by higher than expected company profits and stronger than expected employment outcomes. The upward revision reflects the flow-on effect of the stronger than expected receipts outcome for 2003-04 and evidence of continued strength in employment and company profits in collections in early 2004-05.

The increase in estimated cash expenditure since Budget is largely due to the implementation of the Government's election commitments and other new policy measures announced since Budget. Major new initiatives include raising the Medicare Rebate, increasing investment in school infrastructure and increasing assistance to senior Australians.

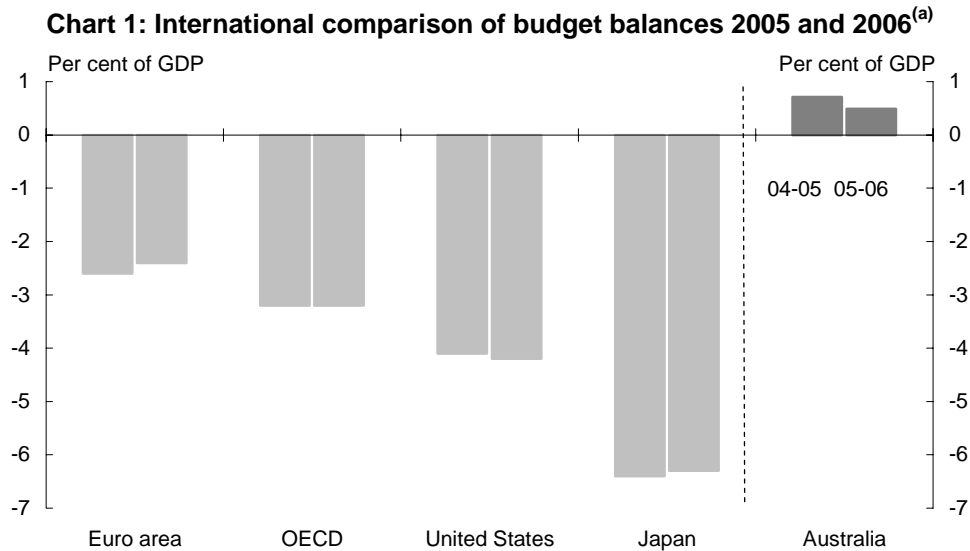
Table 1 presents the fiscal and underlying cash balances for 2004-05 and the forward years.

Table 1: Summary of budget aggregates

| | Estimates | | | | | |
|--------------------------------------|-------------|------------|------------|------------|------------|------------|
| | 2004-05 | | | 2005-06 | | |
| | Budget | PEFO | MYEFO | Budget | PEFO | MYEFO |
| Underlying cash balance (\$b) | 2.4 | 5.3 | 6.2 | 1.6 | 5.1 | 4.5 |
| Per cent of GDP | 0.3 | 0.6 | 0.7 | 0.2 | 0.6 | 0.5 |
| Fiscal balance (\$b) | 0.7 | 3.6 | 4.9 | 0.7 | 4.1 | 3.5 |
| Per cent of GDP | 0.1 | 0.4 | 0.6 | 0.1 | 0.5 | 0.4 |
| | Projections | | | | | |
| | 2006-07 | | | 2007-08 | | |
| | Budget | PEFO | MYEFO | Budget | PEFO | MYEFO |
| Underlying cash balance (\$b) | 3.4 | 6.9 | 5.7 | 4.5 | 7.9 | 7.6 |
| Per cent of GDP | 0.4 | 0.7 | 0.6 | 0.4 | 0.8 | 0.7 |
| Fiscal balance (\$b) | 2.3 | 6.4 | 5.0 | 2.6 | 6.8 | 6.6 |
| Per cent of GDP | 0.2 | 0.7 | 0.5 | 0.3 | 0.7 | 0.6 |

Part 1: Overview

The underlying cash surpluses projected for future years emphasise Australia's sound fiscal outlook at a time when many of the major advanced economies are continuing to experience significant deficits.



(a) International data are for the total general government sector and sourced from *OECD Economic Outlook 76*, December 2004. Australian data is for the Australian Government general government sector.

In accrual terms, the fiscal balance is expected to record a \$4.9 billion surplus in 2004-05, which is up \$1.3 billion since PEFO and \$4.2 billion from the Budget forecasts. The fiscal balance is expected to remain in surplus over the forward estimates.

Further details on the accrual and cash budget estimates are provided in Part 3.

DOMESTIC AND INTERNATIONAL ECONOMIC OUTLOOK

Following a period of strong economic growth, the Australian economy is expected to record solid growth of 3 per cent in 2004-05 and 3¼ per cent in 2005-06. Despite continued robust domestic expenditure, weaker than anticipated export growth has resulted in a modest downward revision to the economic outlook from the PEFO and 2004-05 Budget.

World economic growth prospects remain favourable. The outlook for world and major trading partner growth for 2004 is unchanged from Budget. The forecast for world economic growth in 2005 is slightly lower, reflecting the impact of high oil prices and recent softer than expected economic growth in Japan and the euro area.

Domestic expenditure has continued to grow strongly, although in recent quarters there has been some moderation in consumption and investment. Household consumption is expected to grow at around current rates over 2004-05, supported by strong income growth and high levels of household wealth. With household wealth expected to grow much more slowly than in recent years and high debt servicing payments, consumption is likely to ease back to slightly below average growth rates in 2005-06. Strong profit growth, continued global demand for resources and limited spare capacity are expected to support high levels of business investment over the forecast period. The slowdown in dwelling investment currently underway is anticipated to be relatively muted compared with previous cycles.

Although export volume growth has been weaker than expected, it has picked up in response to the strong world economy and an improvement in farm production in 2003-04. The outlook for exports is for a continued improvement over the forecast period. Given the substantial increase in production capacity flowing from strong investment, particularly in the resource sector, exports are forecast to grow solidly in 2004-05 and at slightly above average rates in 2005-06. The strength of export prices has lifted national income growth.

Employment growth is expected to remain robust, supported by high profits and business confidence. The unemployment rate is forecast to stay at low levels, as is the inflation rate.

The key domestic risks to the Australian economy continue to be related to developments in the housing market and their impact on the rest of the economy. Although an orderly and moderate decline in both housing activity and prices appears underway, a sharper and longer-lived downturn would constitute a risk to the economy. Another key risk is that a further appreciation in the Australian dollar may delay the anticipated rebalancing of economic growth away from domestic to external sources. High oil prices, despite having eased recently, also remain a risk to the domestic outlook, primarily through their impact on global growth and prospects for Australian exports.

Table 2 presents the major economic parameters used in preparing the *Mid-Year Economic and Fiscal Outlook 2004-05*. The parameters for 2004-05 and 2005-06 are forecasts while those for 2006-07 and 2007-08 are projections. The projections of economic growth are based on analysis of underlying trends in employment and productivity. The projections of inflation are consistent with the medium-term inflation target band.

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Table 2: Major economic parameters (percentage change from previous year)^(a)

| | Forecasts | | Projections | |
|------------------|-----------|---------|-------------|---------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
| Real GDP | 3 | 3 1/4 | 3 1/2 | 3 1/2 |
| Employment | 2 | 1 3/4 | 1 1/2 | 1 1/2 |
| Wage Price Index | 3 1/2 | 3 3/4 | 3 3/4 | 3 3/4 |
| CPI | 2 1/4 | 2 1/4 | 2 1/2 | 2 1/2 |

(a) Year-average percentage change.