

PART 1: OVERVIEW

The economic and fiscal outlook for Australia remains sound and has strengthened since Budget. The Australian economy is expected to grow strongly in 2007-08, notwithstanding increased downside risks to the world economic outlook. Strong fiscal outcomes are forecast and projected across the forward estimates.

In light of this strong economic and fiscal outlook, the Government will provide personal income tax cuts of \$34 billion over the forward estimates period, commencing from 1 July 2008.

An underlying cash surplus of \$14.8 billion is forecast for 2007-08, \$4.2 billion higher than the 2007-08 Budget forecast.

Estimated taxation receipts in 2007-08 have been revised up by \$5.0 billion since the 2007-08 Budget. The higher taxation estimates are driven by stronger forecast growth in employment, higher wages, profits and realised capital gains.

Cash payments in 2007-08 are estimated to be \$1.6 billion higher than the estimate at the 2007-08 Budget. This largely reflects new policy measures announced since Budget, including drought relief to support affected regions, the Northern Territory Emergency Response to assist remote communities and the new Disability Assistance Package to address unmet need in the provision of disability services. These increases are partially offset by lower than expected payments across a range of income support and welfare programmes and slippage in some defence acquisition projects.

Table 1 presents the fiscal and underlying cash balances for 2007-08 and the forward years.

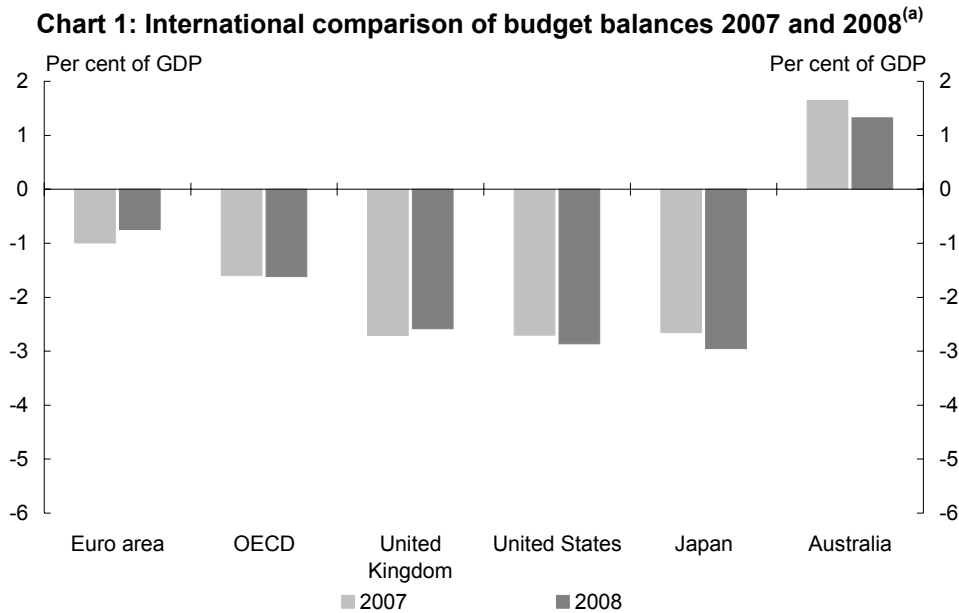
Table 1: Summary of budget aggregates

	Estimates			
	2007-08		2008-09	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance (\$b)(a)	10.6	14.8	12.7	14.4
Per cent of GDP	1.0	1.3	1.1	1.2
Fiscal balance (\$b)	10.0	14.9	11.9	13.6
Per cent of GDP	0.9	1.3	1.0	1.1
	Projections			
	2009-10		2010-11	
	Budget	MYEFO	Budget	MYEFO
Underlying cash balance (\$b)(a)	13.8	17.7	12.4	15.1
Per cent of GDP	1.2	1.4	1.0	1.2
Fiscal balance (\$b)	14.1	18.4	13.7	17.1
Per cent of GDP	1.2	1.5	1.1	1.3

(a) Excludes expected Future Fund earnings.

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The underlying cash surpluses projected for the 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) Source: International data is for the total general government sector, sourced from the latest OECD Economic Outlook, No. 81, May 2007, which contains data up to 2008. Australian data is for the Australian Government general government sector.

In accrual terms, the fiscal balance is expected to record a \$14.9 billion surplus in 2007-08, \$4.9 billion higher than forecast at the 2007-08 Budget.

Further details on the accrual and cash budget estimates are provided in Part 4.

DOMESTIC AND INTERNATIONAL ECONOMIC OUTLOOK

The Australian economy is expected to grow by 4¼ per cent in 2007-08, compared with 3¾ per cent forecast at Budget. The upward revision reflects a broad-based strengthening in growth in the non-farm sector during the first half of 2007, which is expected to be sustained. Growth is forecast to ease to 3½ per cent in 2008-09. The farm sector is not expected to recover fully from drought over the forecast horizon. Farm GDP is forecast to grow by 14 per cent in 2007-08, which is a significantly weaker recovery than seen in previous droughts.

The forecasts have been prepared in an environment of significant turbulence in global financial markets, triggered by rising default rates on sub-prime mortgages in the United States and considerable uncertainty about where the resulting losses ultimately reside. The ongoing implications of this turbulence, while uncertain, clearly introduce

downside risks to the outlook. These events have occurred at a time when there has been significant momentum in the domestic and global economies.

World GDP growth is forecast to be 5 per cent in 2007 and 4¾ per cent in 2008. In comparison with Budget, the downward revision to the outlook for 2008 reflects weaker growth in the United States. The US housing downturn is likely to continue to weigh on its economy during 2007 and 2008.

Australian economic growth is expected to be broadly based. Strong global demand for mineral and energy resources is continuing to support high terms of trade. Business investment is forecast to grow strongly, underpinned by strong ongoing profitability. Growth in export volumes is expected to accelerate as additional capacity comes on line.

Household consumption is forecast to be stronger than at Budget, supported by strong employment growth and solid wage growth. The forecast for employment growth has increased since Budget, in line with stronger economic conditions and rises in immigration and workforce participation. Dwelling investment growth is expected to pick-up significantly in 2008-09.

Despite some near-term strength, wage and inflation pressures are forecast to ease in 2008-09. This reflects an easing in demand pressures and increasing supply flowing from strong and sustained business investment. Moreover, stronger productivity growth is expected to put downward pressure on unit labour costs.

The risks surrounding the world economy are creating uncertainty for the domestic outlook. While strong world growth is expected to support the domestic economy over the forecast horizon, there is a risk that the slowing in US growth will be more pronounced than expected. This would have broader implications for world trade and financial markets. Tighter global credit conditions would be expected to dampen activity in the domestic economy. In addition, a significant slowdown in world growth could result in commodity price falls. Alternatively, stronger outcomes for the domestic economy are possible if turbulence in financial markets continues to unwind in a relatively benign fashion.

Dry weather conditions and low water storage levels continue to pose a downside risk to the outlook for the farm sector. The forecasts take into account the below-average rainfall over winter and the consequent deterioration in yields in cropping regions as reported in the *September quarter 2007 Australian Commodities* by the Australian Bureau of Agricultural and Resource Economics (ABARE). The impact of further dry conditions since the publication of the ABARE report, in particular on the New South Wales wheat crop, has also been taken into account. The usual Budget assumption of average seasonal conditions applies for the remainder of the forecast period. However, there is a significant risk to the farm sector if below-average rainfall persists in many parts of Australia.

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Table 2 presents the major economic parameters used in preparing the *Mid-Year Economic and Fiscal Outlook 2007-08*. The parameters for 2007-08 and 2008-09 are forecasts, while those for 2009-10 and 2010-11 are projections. The projections of economic growth are based on analysis of underlying trends in employment and productivity. As at Budget, iron ore and coal prices are assumed to return to their long-run average level over the two projection years. This is broadly consistent with aggregate non-rural commodity prices retracing almost 50 per cent of their recent gains by the end of the projection period. The projections of inflation are consistent with the medium-term inflation target band.

Table 2: Major economic parameters^(a)

	Forecasts		Projections	
	2007-08	2008-09	2009-10	2010-11
Real GDP	4 1/4	3 1/2	3	3
Employment	2 1/4	1 3/4	1 1/4	1 1/4
Wage Price Index	4 1/4	4 1/4	4	4
CPI	2 3/4	2 3/4	2 1/2	2 1/2

(a) Year-average percentage change.