

ECONOMIC OUTLOOK

- The global outlook has not changed much since PEFO, but the downside risks have increased substantially.
 - Growth is holding up well in China and the other emerging economies, but there is an increased risk that the recovery could stall in the advanced countries.
- The Australian economy is performing solidly, and is expected to grow roughly around trend this year and a bit stronger next year, broadly in line with the PEFO forecasts. The private sector is now driving growth.
- The fiscal and monetary stimulus is being withdrawn. The withdrawal of the fiscal stimulus started to detract from growth from the March quarter this year; interest rates are now back to normal. The exchange rate has risen substantially since PEFO, partly due to the tightening of monetary policy, and this is helping to moderate growth.
- The economy is now quickly returning to full capacity.
 - The unemployment rate is close to 5 per cent and is forecast to fall further;
 - Inflation is still close to the upper end of the RBA's target band, and inflation pressures are likely to emerge over the next couple of years.
- The 'mining boom' is expected to be a key driver of growth in coming years. There is strong demand for our commodity exports (particularly iron ore and coal) from Asia, the terms of trade is around record highs, investment intentions are very strong (particularly in mining) and bulk commodity exports are expected to strengthen.
- The macroeconomic forecasts that will appear in MYEFO are still being finalised following today's CPI release. In broad terms however:
 - GDP growth is likely to be broadly in line with the Budget (and ES/PEFO) forecasts, growing at above-trend rates: the economy has held up well and the transition from public to private sector led growth is progressing as we expected;
 - the unemployment rate over the next couple of years may end up being a little lower than expected at Budget: employment growth continues to very strong and, with the economy expected to grow above trend, the unemployment rate is likely to continue to fall;
 - inflation pressures over the next couple of years are likely to be a little higher than we anticipated, as the economy moves quickly back to full capacity and the labour market tightens;
 - the terms of trade are likely reach around record levels this year, underpinned by high iron ore and coal prices, with the growth in 2010-11 and subsequent decline in 2011-12 broadly in line with what we expected at Budget (and a little weaker than at the time of the Economic Statement and PEFO).
 - Nominal GDP, which is important for revenues, is likely to grow strongly this year, underpinned by the sharp rise in the terms of trade, and broadly in line with Budget. The growth rate should slow in 2011-12 as the terms of trade declines.

FISCAL OUTLOOK

- The Government is preparing the Mid-year economic and fiscal outlook (MYEFO).
- The purpose of the MYEFO – as defined by the Charter of Budget Honesty – is to publish information to enable an assessment of the Government’s fiscal performance against its fiscal strategy.
- The Government’s deficit exit strategy remains as published at the last Budget:
 - holding real growth in spending to 2 per cent a year until the budget returns to surplus;
 - allowing the level of tax receipts to recover naturally as the economy improves,
 - : while maintaining the commitment to keep taxation as a share of GDP below the 2007-08 level of 23.6 per cent on average.
- In preparing the MYEFO and the coming Budget, the Government is focussing on:
 - election commitments;
 - commitments to the Independents and Greens;
 - urgent proposals, such as the new arrangements for the detention of families of IMAs; and
 - savings proposals to the extent required to offset new spending proposals.
- The Government is still working on which proposals are finalised in time for the MYEFO and which are worked up for delivery in the coming Budget.
 - this is taking into account the advice of the responsible portfolio ministers on the appropriate implementation of commitments.
- Treasury and Finance are still preparing the estimates to be published in the MYEFO.
 - however - at this stage - we expect the fiscal outlook to remain broadly unchanged from PEFO with the budget returning to a small surplus in 2012-13 and 2013-14.
 - The stronger economy and the stronger exchange rate will be taken into account in preparing the fiscal estimates
 - : The stronger exchange rate can be expected to reduce projected tax collections given the impact on the revenue of Australian exporting and import competing sectors, but this will be partly offset by the reduction in the cost of imports, particularly Defence equipment.