Budget deficit soars to record high

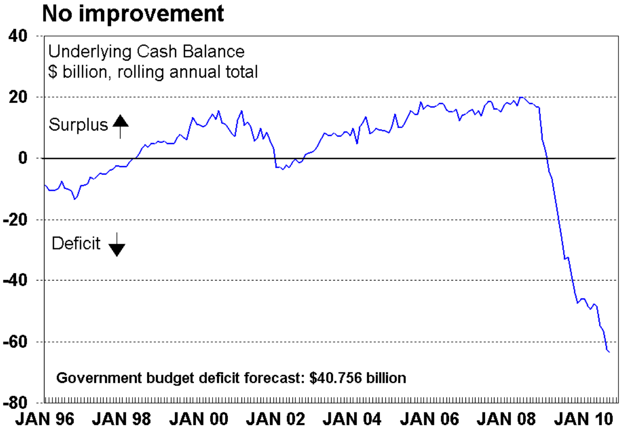
Federal budget

- **The underlying budget deficit hit a record high of $63.3 billion in the twelve months to September 2010, indicating that the Government has plenty of work to do to reach its forecast deficit of $40.8 billion in nine months time. CommSec estimates that the budget deficit equates to 4.9 per cent of GDP, up from 4.2 per cent of GDP in 2009/10.**
- **The budget position is not yet improving with revenues still not showing signs of recovery. Federal Treasury and the Reserve Bank appear to have under-estimated the softness of the economy.**
- **In just under three years, the budget position has deteriorated by a massive $83 billion. Anyone who claims that Australia was unaffected by the GFC needs to look more closely at the budget numbers.**
- **In contrast, and much more encouragingly, GST revenues are also at record highs and are on track to meet the full-year target. GST revenues totalled a record $47.2 billion in the year to September, on track to the 2010/11 target of $50 billion.**

What do the figures show and what does it mean?

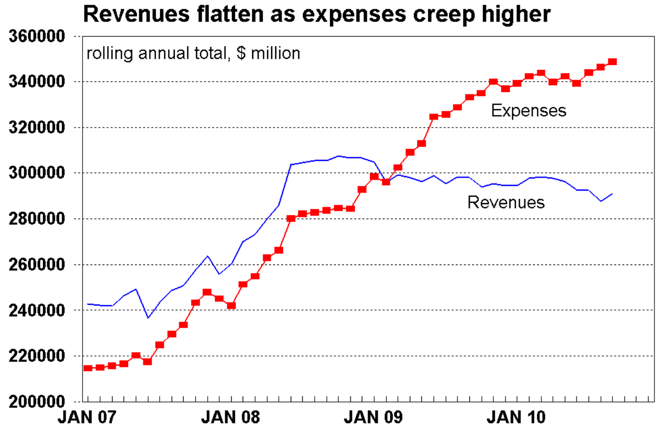
- The Government is persisting with releasing the monthly Budget figures late on a Friday afternoon. The practice hardly exposes the new data to public scrutiny. In the past the curious timing may have signified some embarrassment by both the Coalition and Labor governments at the size of budget surpluses. But now the budget deficit is clearly in the red, and while improvement is expected over the year, it hasn't materialised as yet.
- The Government clearly has no reason to be complacent about the state of the budget. The deficit has hit record highs and much will need to go right in the economy over the next nine months for the full-year deficit target to be hit. The main piece of good news is the fact that budget revenues in September were well up on a year ago although expenses were similarly higher.
- The latest figures show that the underlying budget deficit for the full twelve months to September stood at a record $63,340 million, well above the Government's target deficit of $40,756 million. While the budget is only three months into the fiscal year, it is already clear that the Government has some work to do to hit the full year

No improvement



Source: Dept of Finance & Deregulation, CommSec

Revenues flatten as expenses creep higher



Source: Dept of Finance & Dereg., CommSec

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target. The fiscal balance stands at a deficit of $64,299 million for the 12 months to September and the headline balance is in deficit by $62,205 million.

- In the year to September revenues are down 2.4 per cent on a year ago while expenses are up 4.7 per cent. The Government expects revenues to hit $321.1 billion in 2010/11 but the current annual total is just $290.9 billion. And expenses totalled $348.8 billion over the past year, $5.8 billion short of the full-year target.
- In the three months to September, expenses are almost $10 billion higher than a year ago (up $9.55 billion) while revenues are down by $1.9 billion.
- Interestingly, despite the budget deficit hitting record highs in the year to September, the latest monthly financial statement suggests that the Government is still on track to reach its full-year target. According to the “Budget profile” the underlying budget was targeted to be in deficit by $24,966 million in the three months to September, just below the current deficit of $25,232 million.
- While the Government believes it is still on target, its clear that the budget bottom line will need to improve by over 30 per cent in the next nine months.
- The good news for the states and territories however is that GST revenues are still rising – hitting a record high in the year to September. For the 12 months to September GST revenues hit $47.2 billion, up $4.7 billion or 11.1 per cent on a year ago.
- The Government hasn’t provided a “Budget profile” for GST revenues, but they are tipped to hit $50 billion in the 2010/11 year. On current numbers the target is clearly on track.

What are the implications for investors?

- It’s not clear as yet that the budget figures have turned the corner for the better. The main concern is that revenues are still trending sideways rather than showing signs of repair. Meanwhile government spending is at record highs and showing no signs of stabilising.
- The risk is that both Treasury and the Reserve Bank have under-estimated to softness of the economy. Today’s data showed that lending is barely growing, home prices have fallen over the past three months and home sales have slumped while Toll Holdings have indicated that freight demand has also softened.
- Overall it appears that the economy has hit a flat patch. It may be a touch early for the Reserve Bank to remove its tightening bias, but interest rates surely are going nowhere next week.

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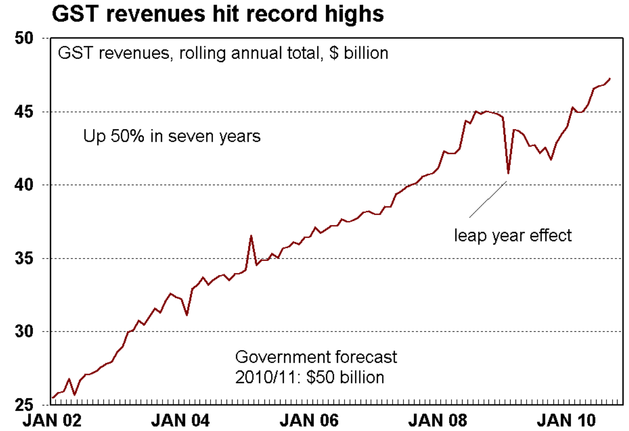

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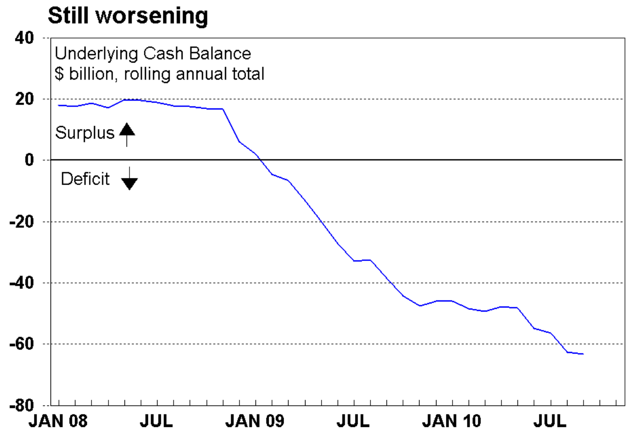

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