This challenge must be managed alongside gradually increasing pressure on the budget from commitments such as the Gördie education mandate and those of the National Disability Insurance Scheme. Then the government wants to add about $50 billion to the resources boom in a year to defence. On current policies, the ageing of the population will add between a tenth and a fifth of a percentage point of GDP to public deficits every year until the middle of the century. And the corporate tax base continues to be corroded by the globalisation of tax evasion and avoidance.

Sooner or later an atomic approach to the budget must be made and, whether or not we remove or restrain deductions or reducing expenditures, they’ll put downward pressure on economic activity.

There is some uplift from export volumes – growth a bit over 6 per cent in the year to December. This comes mainly from resources. The lift in exports over the past year was driven by an exceptionally good season, to be followed by much worse if El Nino conditions in winter and spring follow the hot and dry summer and early autumn. Resource exports contribute much more to output as measured in the national accounts than to domestic economic activity, income and employment. Housing, consumption and the loosening of the budget since the change of government have contributed to recent growth in domestic demand but can’t do this at current prices for long without exacerbating vulnerability to future shocks.

The optimist sees all in this of a rebalancing of the economy. The cautious note or it’s unlikely to be a sustainable rebalancing until there’s a return to substantial expansion of investment and output in trade-exposed industries beyond resources. In my book, *Deg Days: Australia After the Boom*, I identified five possible approaches to restoring full employment and robust growth: Business as Usual; Austerity; Budget Stimulus; Productivity Growth; and Real Depreciation.

*Deg Days* favoured Real Depreciation supported by Productivity Growth as the best strategy to restore high employment and sustained growth. A real depreciation of 20 to 40 per cent from the levels of March 2013 would be required. And for the fall in the dollar to lead to a sustained improvement in competitiveness, the price effects of currency depreciation can’t be passed through into domestic incomes and overcharged. Depreciation of the currency would be secured in the first instance by easing domestic relative to international interest rates, the tightening of lending to the housing sector and a fall in the dollar.

The budget must be a bigger challenge than generally understood. The deficit is large now, and that’s before the fall in the terms of trade and business investment.

The terms of trade were less than halfway into the huge adjustment from the giddy heights of 2011. The fall in iron ore and base metal prices so far this year has large implications for government revenue, and may end the flirtation with what is left of the pipeline of new mine developments. The economy has just stopped off the edge of the resources investment cliff and it is a long way down to the bottom. The emergence of an eastern Australian LNG export industry is lifting domestic gas prices several fold over a few years, raising costs for industry and households at a time when competitiveness and living standards are under pressure.

Structural changes in the budget must be made, and they’ll put downward pressure on economic activity.

The Government has removed tax credits and introduced paid parental leave, the new policies would lead to further deterioration. The servicing of increasing debt becomes more difficult with the rise in interest rates that eventually follows economic recovery in the rest of the developed world. (New Zealand raised rates this week.)

Corporate tax revenues from resources are declining with capital deductions from the boom in resources investment – and will do for several years. The policy changes implemented so far by the new government have accelerated to something like a net $2 billion a year over the forward estimates, if we exclude the capital contribution to the Reserve Bank. If other policies are implemented as announced, the replacement of the carbon laws and introduction of paid parental leave will lead to an additional budget deterioration of $10 billion a year or more. Other new policies would lead to further deterioration.

Depreciation is more likely to be politically feasible and economically successful if the necessary expenditure restraint is shared equitably across the community.

For the time being Australia has Business as Usual with a bit of Budget Stimulus. There is some basis to believe in the Growth and Productivity measures, with the Gördie education mandate and the National Disability Insurance Scheme. The Treasury has almost certainly missed its target of $50 billion to the resources boom in a year for defence. There is the Gördie education mandate and the National Disability Insurance Scheme.

The Gördie education mandate and the National Disability Insurance Scheme.

On structural reform, we have been warned action will be delayed and slow. Early reliance on domestic demand from housing, consumption and government deficits to support rising economic growth is unlikely to be consistent with sustainable external accounts in the years ahead. Growth in export volumes over the past year is actually a step down from the average rate of growth in export volumes in the two decades before the resources boom. It sits alongside a powerful secular tendency for productivity growth in services to lag behind goods and services to rise with deepening integration into the international economy. The Gördie education mandate and the National Disability Insurance Scheme.

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