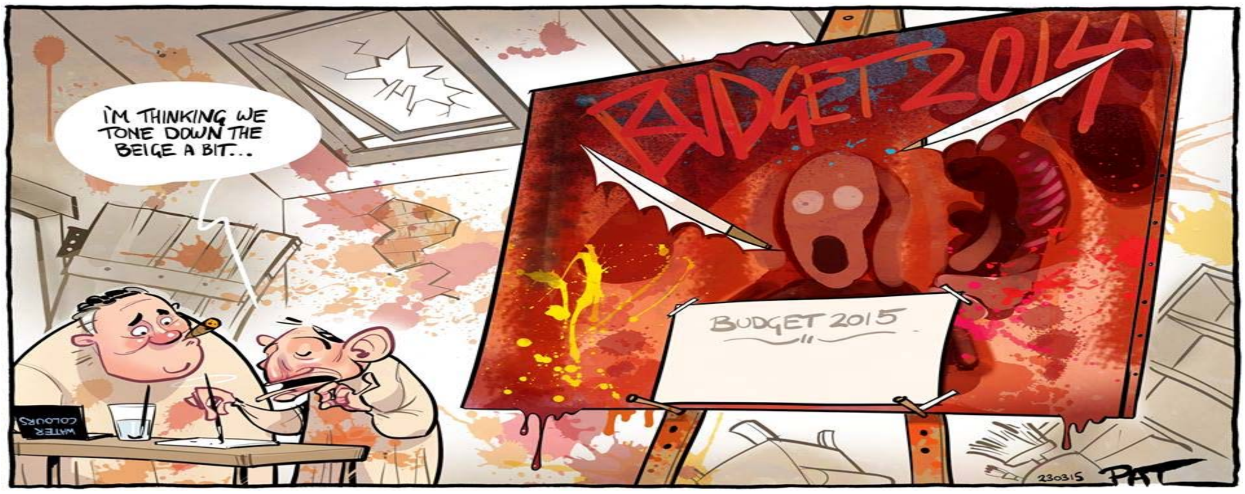
Economics | May 12 2015

Australia's Budget

Federal Budget 2015/16



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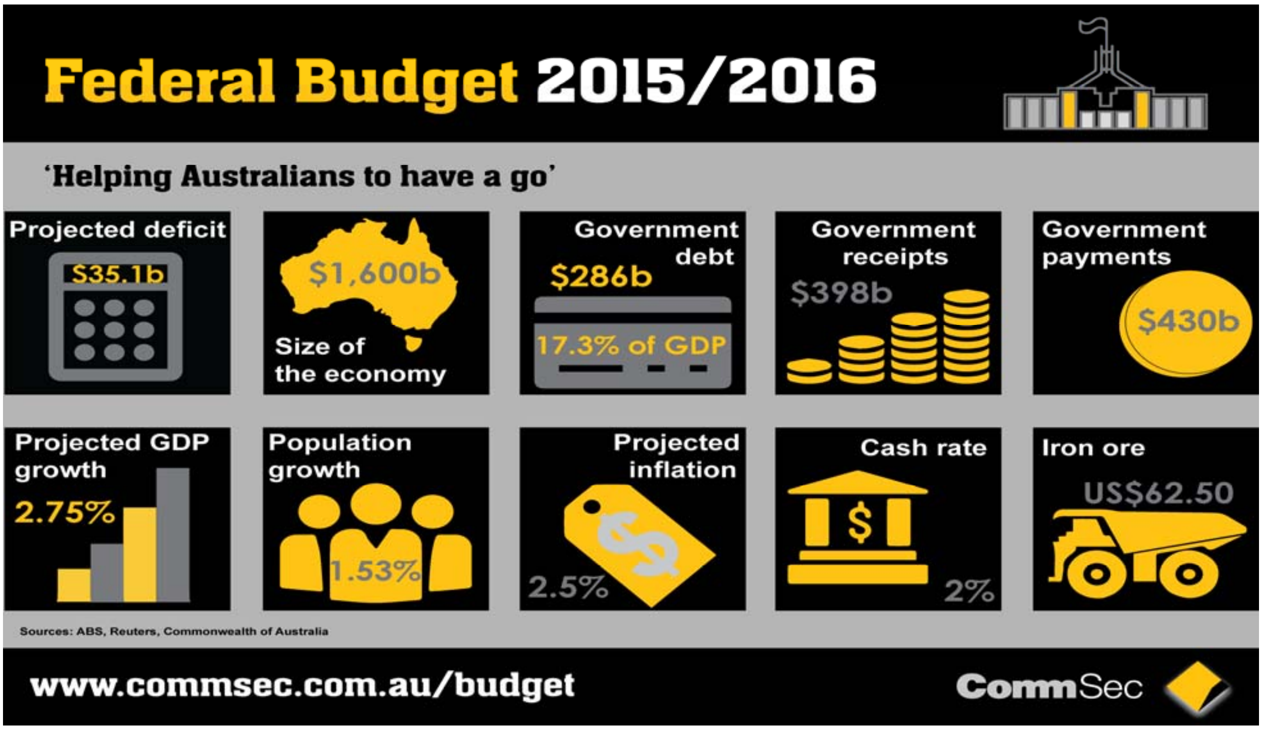

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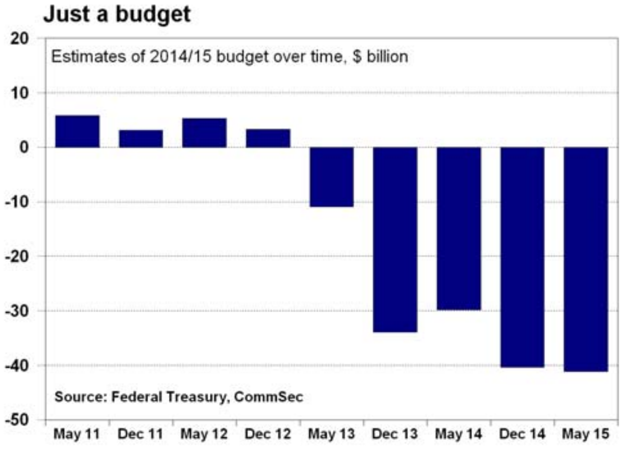
Federal Budget 2015/16:
'Helping Australians to have a go'

Making Sense of it

The Federal Budget is hardly the most riveting document you are ever likely to read. Sure you know it's important, but the problem is that it's a huge document with countless facts, figures and tables. And when it comes to analysis, economists seem to be writing for other economists; and accountants writing for other accountants.



It's always important to remember that it is just a budget, the same that any household or company would prepare. Assumptions are made; forecasts are taken; and events can change.

When the 2014/15 budget was first conceived in May 2011, a surplus of $5.8 billion was projected. Today, a deficit of $41.1 billion is tipped for 2014/15.

And for the Federal Budget then there is the small matter of politics. The Government outlines the measures that it believes are important for the short and medium-term health of the economy. But it doesn't maintain a majority in the Senate. As a result it will need to deal with Labor, The Greens and perhaps minor parties to get the measures through. And this will lead to uncertainty, and perhaps changes, until the measures finally pass through Parliament.

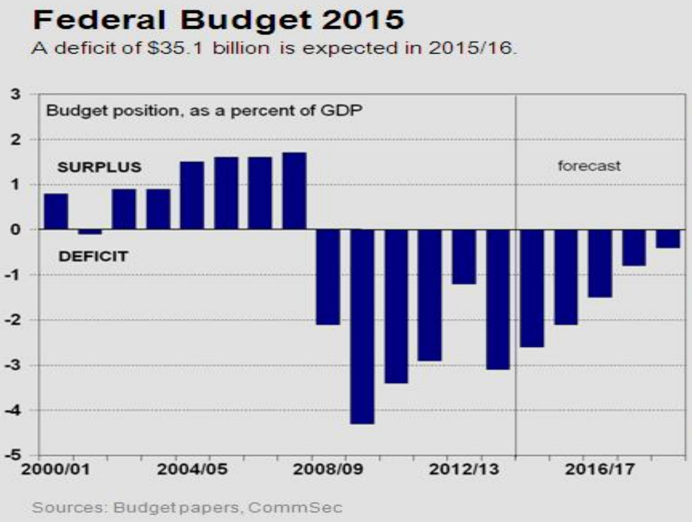
But at the end of the day most people want to know what's in it for them. It doesn't matter whether you are a student, pensioner or CEO of a major company.

So this analysis is different.

Sure, there are the usual tables, graphs, facts and figures. But we reckon that there are only three questions most people want answered and that's where we will be concentrating:

Did the Government get it right?
What does it mean for Australia?
Who are the winners and losers?

1. The Analysis



- Deficit of $41.1 billion (2.6% of GDP) is tipped this year 2014/15.
- Deficit of $35.1 billion (2.1% of GDP) is tipped next year 2015/16.
- Economy expected to growth 2.50% this year and 2.75% next year.
- Net debt to rise to $285.8 billion or 17.3% of GDP in 2015/16.
- Small business tax cut from 30c in the dollar to 28.5c in the dollar from July 1.
- Small businesses will be able to immediately deduct each and every asset valued under $20,000 until June 2017.

Did the Government get it right?

- The short-term goal of the Federal budget is to build confidence. Last year confidence was badly knocked around by the rhetoric of "Budget emergency" and "End of the age of entitlement." A government should go hard in its first budget, but in an environment of weaker-than-normal economic growth and global uncertainties, it probably went a little too far.
- When we analysed last year's budget we noted: "*While the desire to "reboot" the economy is commendable and even advisable from a medium-term standpoint, the "budget emergency" rhetoric has been unduly negative, depressing confidence levels. It remains to be seen whether there is a lasting negative impact on the economy, checking momentum in the economy."*
- In the end, confidence didn't recover and momentum in the economy was checked. It wasn't just the budget, but the lack of agreement between the Government and Opposition parties on budget measures as well as uncertainty on the global economy and the slowdown in China.
- So this budget is about restoring confidence. The Government has used the catch-phrase of **'helping Australians to have a go'**. And that is precisely the right message for the times – reinforcing the stimulus provided by monetary policy and lifting economic momentum.
- But the budget measures need to be quickly implemented and that requires negotiation and agreement between the government and opposition parties. If budget measures don't get passed by the Senate, then the Government hasn't "got it right". It is all about proposing responsible, affordable measures that improve the quality of life for Australians and improve the functioning of the economy. But the measures still need to be agreed and implemented. Opposition parties have a role to play, but in the end it is the Government's role to secure the necessary agreement.
- There is less urgency on reducing the budget deficit in the short-term. And that is right and proper. Fiscal (budgetary) policy needs to support monetary policy in boosting economic momentum in the current environment. The budget deficit still needs to be reduced over time, but – like any business – the smart way is to focus on restraining costs at the same time as boosting revenues. It is much easier to reach the goal of surplus if the economy is growing at a 3.5-4.0 per cent annual rate than 2.5-3.0 per cent.
- The good news is that the budget deficit is projected to narrow in coming years – and it will have a chance of achieving those goals if the economy lifts and drives revenues.
- There is a good balance between short-term and long-term measures. And there is a boost to the economy in the short term and improved budget position in coming years. The hope is that the Senate will give it a chance to work.

What does it mean for Australia?

- In the short-term, much depends on getting budget measures through the Senate. Ongoing failure to implement budget measures risks losing support of foreign investors and puts at risk Australia's AAA credit rating.
- If the federal budget plays its role in working to improve business and consumer confidence, then there is a greater chance of firmer economic growth, meaning lower unemployment.

- The longer-term goal of the Government is the same as it has been for some time – pushing ahead with the **PPP policy** to combat the challenges of an ageing population. PPP is increased labour market participation, increased productivity, and increased population growth. It is an under-stated policy, but has characterised budget policy for a decade.
- Tightening pension eligibility is important from a fairness perspective and the future demands on the budget. Boosting childcare places is important to the goal of raising workplace participation and reducing the reliance on government handouts by Australian families.

Who are the winners? (source: Budget Papers, AAP)

Businesses:

- A $5.5 billion Jobs and Small Business Package will provide major incentives for businesses to invest, hire and grow
- Small (under $2 million annual turnover) incorporated businesses will benefit from a 1.5 percentage point cut in their company tax rate (effective 1 July 2015).
- A 5 per cent tax discount to unincorporated businesses with annual turnover less than $2 million from 1 July 2015 - broadly in line with the 1.5 percentage point tax cut for small incorporated companies. The discount will be capped at $1,000 per individual in an income year, and it will be delivered as a tax credit in their tax return.
- All small businesses will receive an immediate deduction on each and every asset costing less than $20,000 bought between Budget night and 30 June 2017.
- The package includes $375 million aimed particularly at improving opportunities for Australians to get a job and reaching out to disengaged youth.

Families:

- A total of $3.5 billion reform package to make child care simpler, more affordable, accessible and to support return to work;
- $869 million for Child Care Safety Net to assist vulnerable, disadvantaged children.
- $843 million invested in preschool programs.
- $250 million on interim Home Based Carer pilot program (Nannies Trial).

Farmers:

- $250 million for drought concessional loan scheme.
- $35 million for projects in drought hit areas.
- $25 million to manage pests and weeds in drought hit areas.
- $20 million to expand counselling programs for drought hit communities.

Other:

- Fringe Benefit Tax abolished on all portable electronic devices like phones, laptops and tablets used for work

Who are the losers? (Source: Budget Papers, AAP)

Richer retirees:

- Pension reforms - new assets test threshold; wealthier pensioners will lose the pension or have payments reduced.

Multinational Corporations:

- Multinational Anti-Avoidance Law to recover unpaid taxes by large international companies that shift profits overseas.
- GST on digital downloads (Netflix tax) to raise $350 million

Non-for-profit:

- FBT tax cap exemption of $5,000 for meal and entertainment expenses for not-for-profit organisations (save $295 million)

Foreign Aid Beneficiaries:

- Cut of up to $1 billion in foreign aid, with aid spending to Indonesia cut by 40 per cent.

Foreign Investors

- New fee regime for foreign investment in Australia to deliver $735 million in revenue.

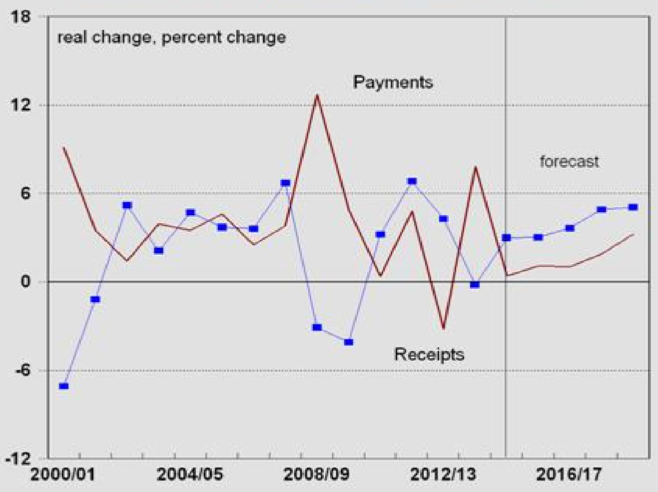
Back packers

- Tax free threshold of $20,000 for foreigners on working holidays removed; saving $5.4 million.

2. Taxing & Spending

Taxing & Spending

Spending growth is tipped to lag revenues to 2018/19.



Sources: Budget papers, CommSec

- Spending (payments) is tipped to grow by just 1.1% in real terms in 2015/16.
- Revenues (receipts) are tipped to rise by 3.0% in real terms in 2015/16.
- Payments total $415 billion this year.
- Receipts total $377 billion this year.
- Receipts to rise to 25.2% of GDP in 2018/19 from 23.5% in 2014/15.
- Payments to fall to 25.3% of GDP in 2018/19 from 25.9% in 2014/15.
- Over the long term, both spending & revenues have grown by around 3.6% a year in real terms .

What is included in the budget?

(*Quotes taken largely in full from Budget papers)*

<u>Supporting small business growth</u>

- The new $5.5 billion Jobs and Small Business package is the biggest small business package in our nation's history.
- The package includes tax cuts for all Australian small businesses, to encourage investment and growth - reducing the tax rate for the more than 90 per cent of incorporated businesses with annual turnover under $2 million. The company tax rate for these businesses will be reduced by 1.5 percentage points to 28.5 per cent. (Effective July 1 2015).
- A 5 per cent tax discount to unincorporated businesses with annual turnover less than $2 million from July 1 2015. This delivers a tax cut of $1.8 billion over the next four years.
- Small businesses will be able to immediately deduct each and every asset costing less than $20,000 that they buy between Budget night and end June 2017.
- Small businesses will also benefit from Capital Gains Tax rollover relief when changing their legal structures but keeping the same owners.
- Measures to help employers take on unemployed job seekers and to help young disengaged youth become job ready.
- To further boost entrepreneurial endeavour, start-ups will be allowed to immediately deduct professional expenses incurred when they start a business.

<u>Families package</u>

- The Government is delivering a $4.4 billion Families Package to give parents more choice and opportunity to work.
- The simplified Child Care Subsidy will be implemented from 1 July 2017 with a single subsidy based on family income, replacing the Child Care Benefit, Child Care Rebate and Jobs, Education and Training Child Care Fee Assistance Programme.
- Families earning around $65,000 or less will receive a subsidy of 85 per cent of their child care fees (up to an hourly fee cap). The subsidy gradually tapers to 50 per cent for families earning around $170,000 or more. There will be no annual cap for families earning less than around $185,000. Families earning around $185,000 or more will have a $10,000 annual cap on the total amount of assistance provided per child per year. This is $2,500 more than the current Child Care Rebate annual cap per child.

2. Taxing & Spending (continued)

What is included in the budget? (Continued)

- The Government will establish a $304 million Community Child Care Fund (CCCF), to support child care providers servicing their local community.
- The Government will spend around $250 million on an Interim Home Based Carer Pilot Programme (Nannies Trial) to extend subsidy support to eligible families using nannies.
- The Government will invest $843 million in the 2016 and 2017 calendar years for preschool programmes across Australia.
- From January 1 2016, the 'No Jab, No Pay' rule will remove all exemptions, excluding those for medical reasons, for access to child care payments and Family Tax Benefit (FTB) Part A end of year supplement

Helping farmers to manage through and recover from drought

- Drought assistance - The Government is committed to supporting farmers who are suffering through the effects of drought.
- Provide $250 million to continue the Drought Concessional Loan Scheme and the Drought Recovery Concessional Loan Scheme for one additional year.
- Provide $25 million from 2015/16 to assist farmers to reduce the impact of pest animals in drought-affected areas.

A vision for the north and our regions

- A new $5 billion Northern Australia Infrastructure Facility which is the first major step in our plan for our great North.
- The Government will partner with the private sector and governments of Western Australia, the Northern Territory and Queensland, to provide large concessional loans for the construction of ports, pipelines, electricity and water infrastructure that will open our Northern frontier for business.
- The Government is delivering on creating a stronger, more competitive Tasmanian economy. The Government has invested $60 million in Tasmanian irrigation schemes and a further $203 million to expand the Tasmanian Freight Equalisation Scheme to include exports

Protecting Australia

- The Government is investing $1.2 billion in new funding for national security in the 2015 Budget, building on the $1 billion in funding announced in the 2014/15 MYEFO.

Fairness in Tax and Benefits

- The Government is providing $87.6 million to the ATO over the next three years to continue the International Structuring and Profit Shifting programme.
- Improving the tax system by ensuring the GST applies to digital products and services imported by Australian consumers will help level the playing field between domestic and international suppliers and ensure that all suppliers pay a fair share of tax.
- The Government is taking action on multinationals that exploit loopholes and artificially structure to avoid paying tax in Australia or elsewhere in the world. This is contrary to the intention of international agreements.
- Approximately 30 large multinational companies are suspected of diverting profits using artificial structures to avoid a taxable presence in Australia.
- On May 2 2015, the Government announced a package of measures to strengthen the foreign investment framework to make sure the rules are enforced.

Identified Savings

The Government has made $11 billion in savings from payments in this Budget over the forward estimates to 2018-19, to pay for new spending of $14.6 billion.

2. Taxing & Spending

Outcome, Payments & Revenues

BUDGET BOTTOM LINE

	2013/14	2014/15e	2015/16f	2016/17f	2017/18f	2018/19f
Underlying Cash Balance - $B	-$48.5	-$41.1	-$35.1	-$25.8	-$14.4	-$6.9
% of GDP	-3.1	-2.6	-2.1	-1.5	-0.8	-0.4
Net Debt - $B	-$202.5	-$250.2	-$285.8	-$313.4	-$323.7	-$325.4
% of GDP	12.8	15.6	17.3	18.0	17.6	16.8

Source: Budget Papers

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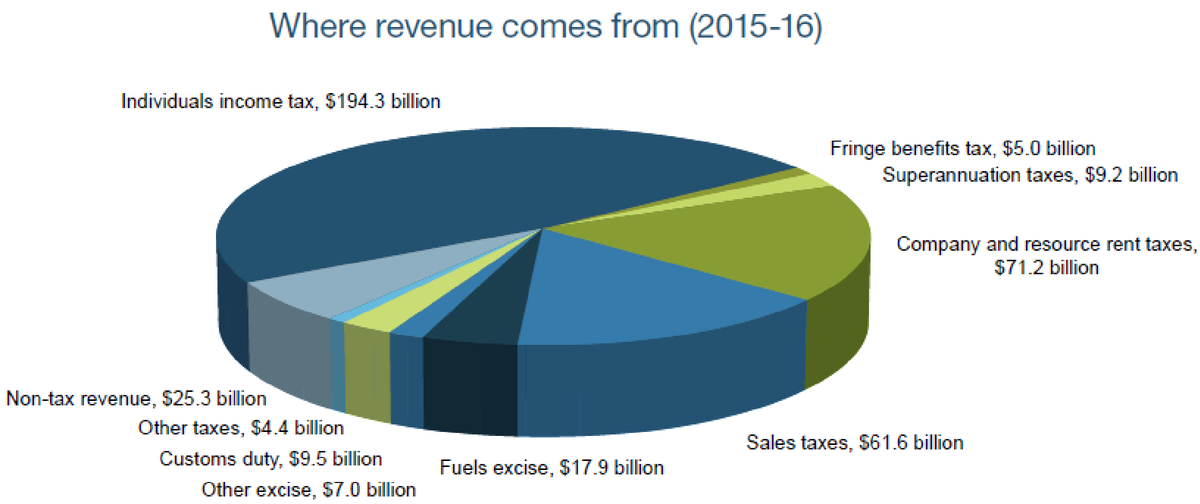
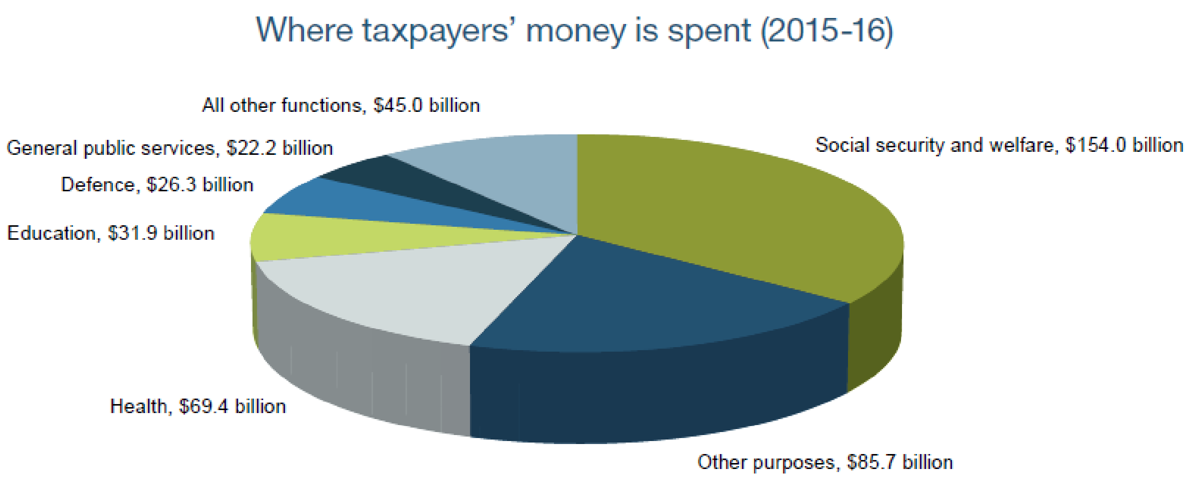




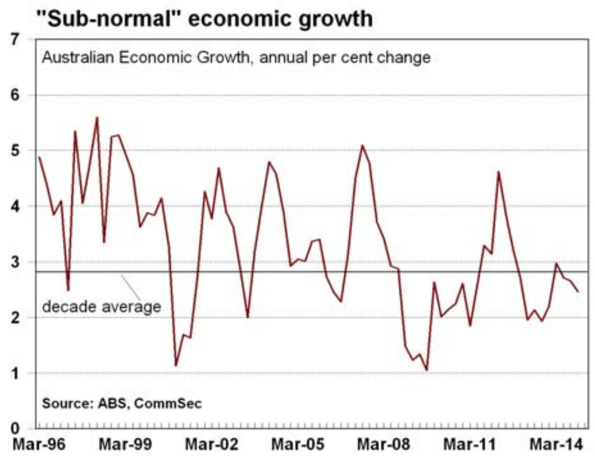
3. The Economy

Economic Assumptions

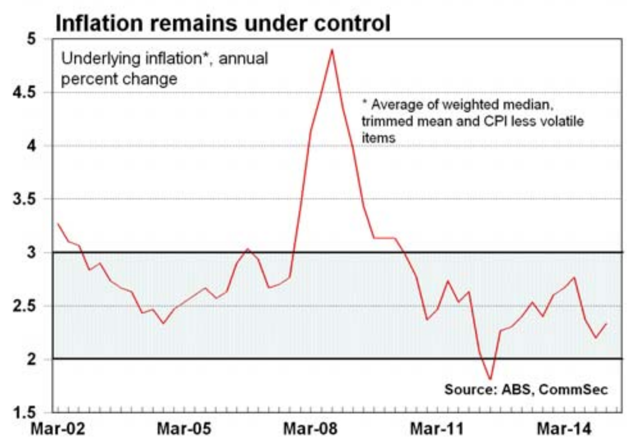
	Last year 2013/14	This year 2014/15	Next year 2015/16	And 2016/17
Economic growth (% change)	2.50	2.50	2.75	3.25
Inflation (% change to June quarter)	3.00	1.75	2.50	2.50
Wages (% change, year to June quarter)	2.50	2.50	2.50	2.75
Unemployment (%, June quarter)	5.90	6.25	6.50	6.25

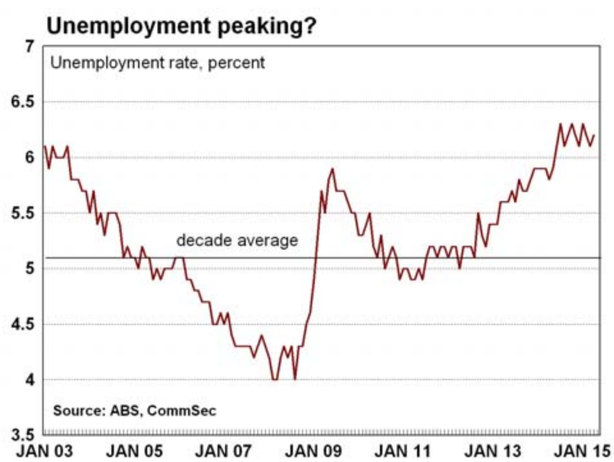
Source: Budget papers, CommSec

Are the economic assumptions reasonable?



- Last year we thought Federal Treasury's economic forecasts were too conservative. Treasury was right, we were wrong – the forecasts largely proved correct.
- The economy was projected to grow by around 2.5 per cent this year with inflation around 2.25 per cent and unemployment at 6.25 per cent in the June quarter 2015. And the forecasts turned out close to the mark
- This year Federal Treasury has again opted for reasonable, if not rather conservative, forecasts.
- In 2015/16, the economy is expected to lift from 2.50 per cent to 2.75 per cent. But with growth still below the normal level of 3.25 per cent, unemployment isn't expected to ease until 2016/17.
- The Reserve Bank currently expects economic growth of 2.25 per cent in 2014/15, 2.25 per cent in 2015 and between 2-3 per cent in 2015/16. Underlying inflation is expected to be between 1.75-2.75 per cent through to June 2017.
- The CBA Group expects a budget deficit of $36.6 billion in 2015/16 (Bloomberg survey average $40 billion; range $28.0-49.3 billion.) Economic growth is tipped at 3.25 per cent in 2015/16 and 2016/17.
- One forecast worth focussing on is the estimate of nominal GDP – the assumption that is important for projected tax receipts. Over the past 15 years nominal GDP has grown on average by around 6.5 per cent a year. In 2013/14 nominal GDP grew by 4.0 per cent. In the last Budget, nominal GDP growth was expected to lift by 3.0 per cent in 2014/15 but the current projection is 1.5 per cent. In 2015/16, Federal Treasury expects nominal GDP to grow by 3.25 per cent and then grow by 5.5 per cent in 2016/17.

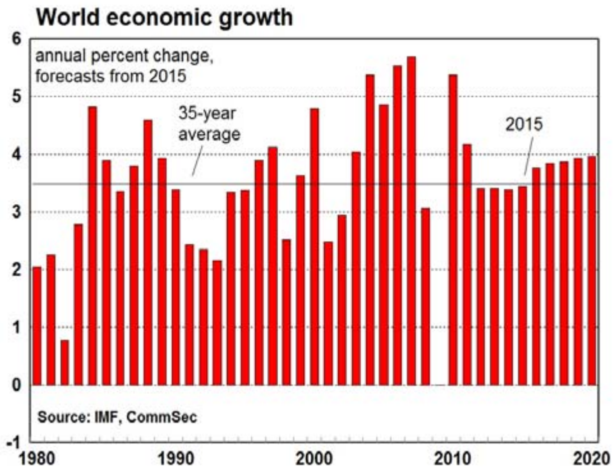


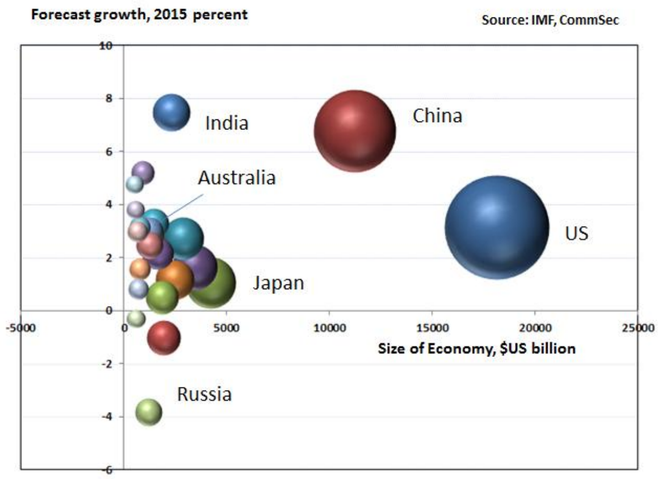


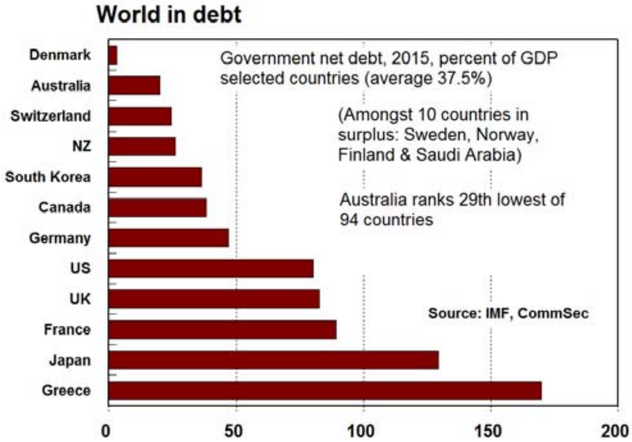
4. Global backdrop

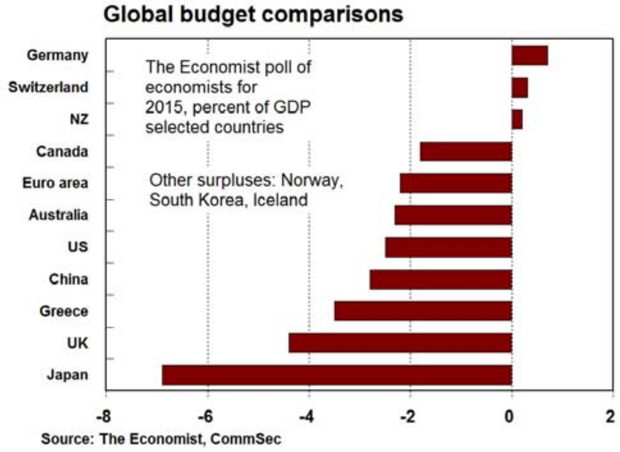
Global economy growing at a near "normal" pace

- In April 2015, the International Monetary Fund (IMF) forecast the global economy to expand by 3.5 per cent in 2015, after growing by 3.4 per cent in both 2013 and 2014. Growth of 3.5 per cent is close to the average growth rate recorded over the past 35 years.
- In 2016, the IMF tips growth of 3.8 per cent. There was no change in the 2015 growth forecast from the previous estimate made in January. But the 2016 forecast for world economic growth was revised up by 0.1 percentage point.
- In essence, the global economic is in good, but not great shape. China continues to provide the greatest contribution to growth, ahead of the US. But, in accordance with its evolution into a global economic power, the pace of economic growth continues to ease. This should come as no surprise – all maturing economies have seen economic growth rates slow over time, including Australia, the US and Japan
- **China** is tipped to grow by 6.8 per cent in 2015 and 6.3 per cent in 2016 after 7.4 per cent growth in 2014.
- The **Euro area** continues to recover with growth of 1.5 per cent expected in 2015 and 1.6 per cent in 2016 after 0.9 per cent growth in 2014.
- But overwhelmingly the focus stays on the **US.** The US economy continues to improve with the IMF expecting growth of 3.1 per cent in both 2015 and 2016. At some point the Federal Reserve will need to lift rates from zero. And when that move occurs, it will have major implications for financial markets.
- Federal Treasury influences the IMF and OECD forecasts for **Australia**. But looking at *The Economist* May 2015 poll of forecasters, the Australian economy is tipped to grow by 2.4 per cent in 2015 and 2.8 per cent in 2016. Australian economic growth will be close to the fastest of major developed economies in 2015.









5. Future Funds and GST

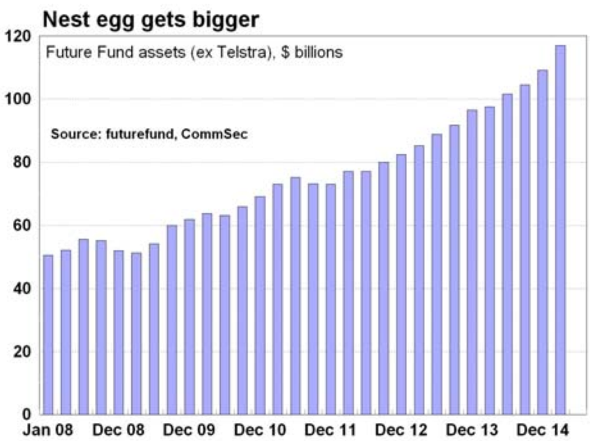
Government investments

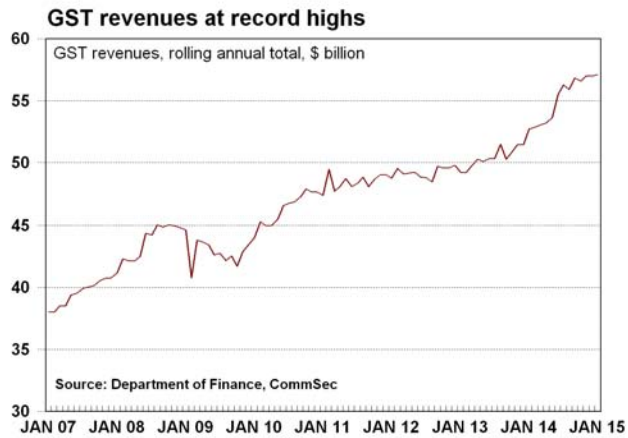
Investing for the future Assets as at March 31 2015	$billion
FutureFund	$116.96
Education Investment	$3.73
Building Australia	$3.59
Health & Hospitals	$1.78
DisabilityCare	$1.65
Source: futurefund	

- The value of all the nation building funds currently stands at $127.7 billion, up from $108.0 billion a year ago.
- The **Future Fund** was set up to provide for the unfunded superannuation liabilities of Commonwealth public servants. As at March 31 2015, the Future Fund stood at $116.96 billion, up $19.4 billion over the past year or 19.9 per cent.
- The **Building Australia Fund** was set aside for *"the creation or development of transport, communications, energy, and water infrastructure and in relation to eligible national broadband matters".* As at March 31 2015, the Building Australia Fund stood at $3.59 billion, down $0.50 billion over the year.
- The **Education Investment Fund** is set aside to make payments for education infrastructure. As at March 31 2015 the Education Investment Fund had assets of $3.73 billion, down $0.14 billion over the year.
- The **Health & Hospitals Fund** was established to enhance the Government's ability to boost our health infrastructure. As at March 31 2015, the Health & Hospitals Fund stood at $1.78 billion, down $0.69 billion over the year.
- The **DisabilityCare Australia Fund (DCAF)** was established to provide support for Australians with significant and permanent disability. The DCAF received its first contribution on November 26 2014. By March 31 2015 the DCAF had received contributions of $1.65bn.

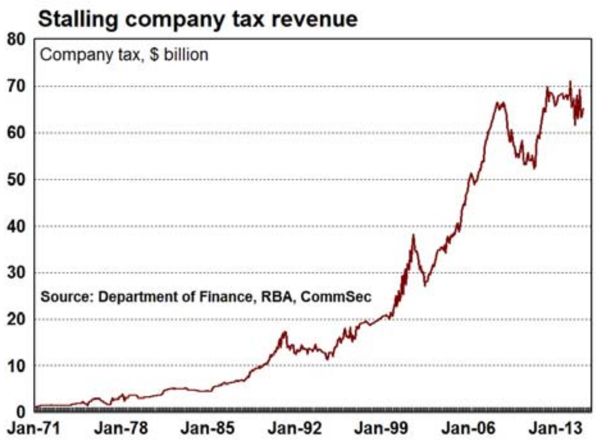
Goods and services tax (GST)

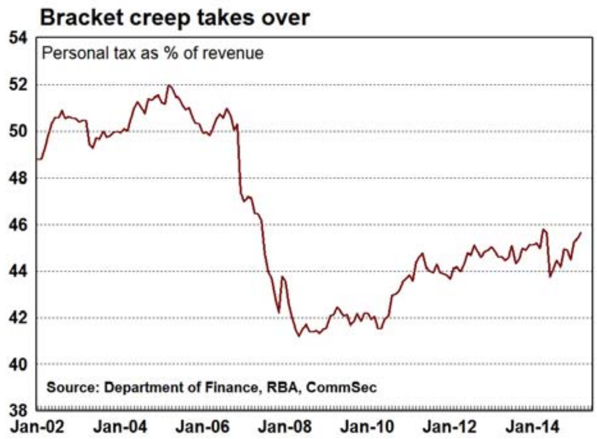
- To some extent this is the "forgotten" tax. Despite the fact that the GST is the third biggest revenue generator behind personal tax and company tax, it tends not to feature in budget analyses. All of the revenue goes to the states and territories so it certainly has a major influence on the ability of governments to spend across the community.
- In the year to March 2015 (latest data), annualised GST receipts were up by 8.5 per cent over the year to a record high of $57.56 billion. Annual growth has averaged 9.3 per cent over the past year, up from 4 per cent in the previous year.
- The Government currently expects GST receipts to rise by 5.6 per cent in 2014/15. underpinned by solid growth in private dwelling investment and property ownership transfer costs.
- GST receipts are expected to grow by 5.6 per cent in 2015/16, in line with rising trend growth in consumption.
- The government notes: *"Since the 2014-15 MYEFO, GST receipts have been revised up $1.6 billion over the four years to 2017/18, partly underpinned by the upward revision to the 2014/15 estimate owing to stronger-than-expected collections, as well as 2015/16 Budget measures including the extension of the GST compliance program and applying GST to digital products and services imported by consumers."*

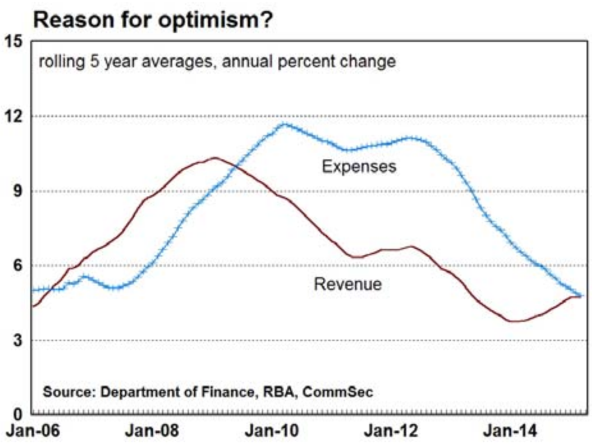


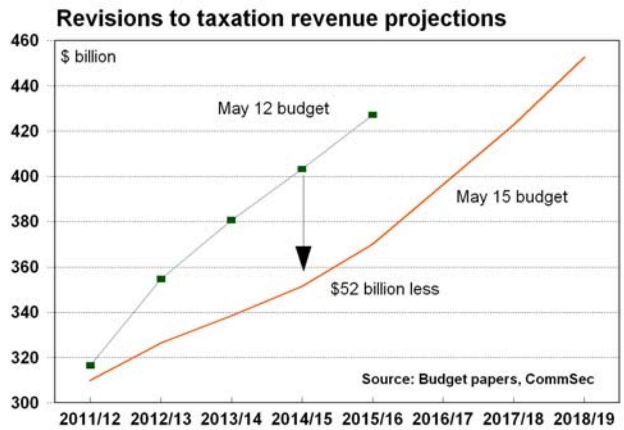


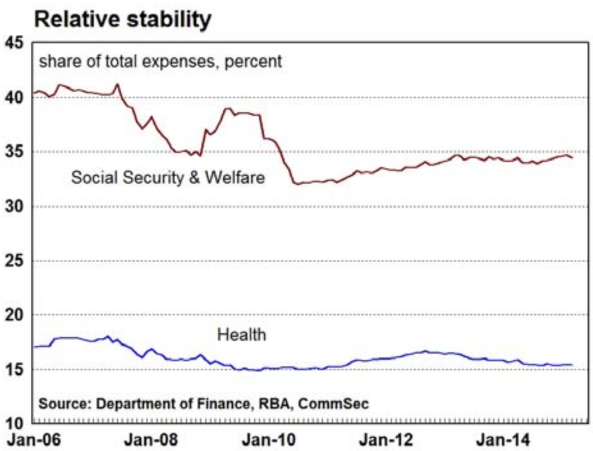
6. Selected Charts

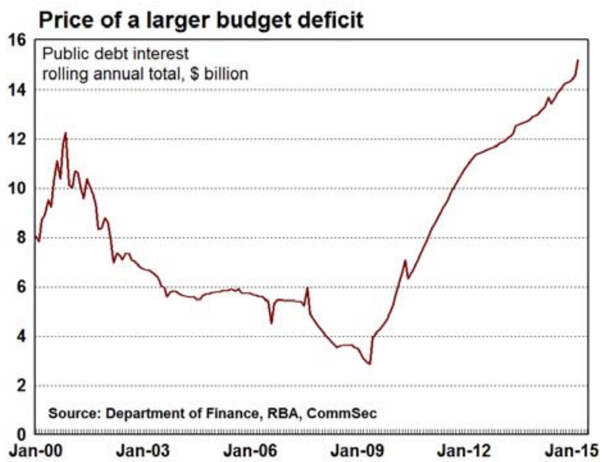












7. Impact – Rates, $A, Shares

Interest rates

- The Reserve Bank cut the cash rate at the April Board meeting but provided no guidance on future moves on interest rates. But it is clear from the forecasts contained in the latest the Statement on Monetary Policy that the Reserve Bank has an "implicit" rather than "explicit" easing bias (that is, bias to cut rates). Forecasts for both economic growth and inflation were trimmed by a quarter of a per cent in the latest Statement.
- The budget has been structured to get people moving – cut taxes for small business, boost childcare and pension payments to those that need them and lift spending across towns and regions. If the budget is successful in lifting confidence and economic momentum then the Reserve Bank can stay on the sidelines for longer.

Australian dollar

- We don't believe the federal budget has major implications for the Australian dollar. Still, that has been the case for probably over a decade now. And an assurance by ratings agency Fitch that Australia's AAA credit rating is unlikely to be at risk for the next two years further muffles any budget impact on the currency.
- Our currency strategists believe that if other rating agencies downgraded the outlook for Australia's AAA rating, at worst the currency would fall US2 cents. There is reportedly good underlying support for Australian federal, state and corporate bonds.
- Fiscal policy has been modestly contractionary, while monetary policy has remained accommodative. And that is set to remain the case. And it is certainly something the Reserve Bank has already factored in. The Reserve Bank has an implicit easing bias, and that should serve to restrain upside for the Aussie dollar.
- If the budget measures are passed by the Senate – and passed quickly – and business and consumer confidence improves, then the Reserve Bank is more likely to change to a "neutral" stance. But those are two big 'ifs'. Still, in such a case the budget would serve to support the Aussie dollar or even drive it higher.
- The more important influence on the Aussie dollar over the next six months will be US monetary policy. When financial markets are confident that the Federal Reserve is set to start the process of hiking interest rates, the US dollar will start to lift, thus causing the Aussie dollar to ease to the low to mid 70s against the greenback.
- CBA group currency strategists tip the Aussie dollar to fall to the range of US70-75 cents in 2016.

Sharemarket implications

- Further assurances by other rating agencies that Australia's AAA credit rating is safe would prove positive for the Australian sharemarket. (Standard & Poor's have indicated that ratings are "not immediately affected").
- The federal budget is attempting to backstop monetary policy and lift economic momentum. The key to higher share prices is stronger revenues and profits. So any success achieved by the budget in boosting economic growth will support the sharemarket.
- The big unknown is the Senate response to the budget measures. So investors must be wary not to over-react to any measures contained in the latest budget.
- The small business tax cut and asset write-off measures should be supportive for the hardware chains, Officeworks, telecommunications providers and business-to-business operations.
- Retailers generally will benefit from measures to assist small business.
- Changes to the cost and affordability of childcare and pensions won't occur until 2016 and 2017 and are contingent on Senate agreement. But companies like G8 Education, Affinity Education, Japara Healthcare and Estia Health are possible beneficiaries.