Bank of Melbourne

Federal Budget 2014-15

A business focus

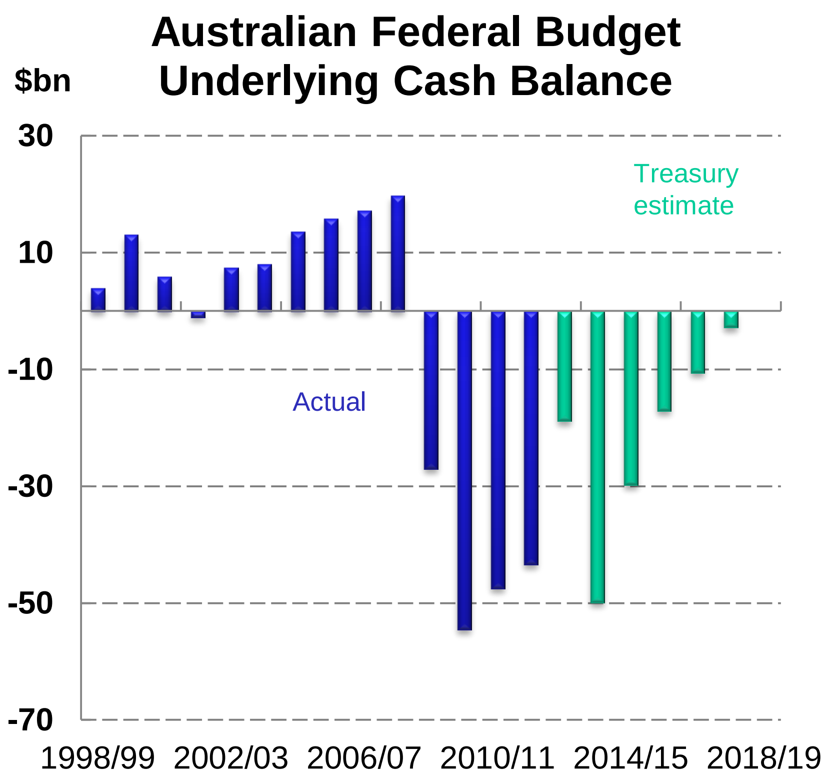
Bank of Melbourne Economics

May 2014

Outline

- The Federal Government released its Budget for 2014-15 on May 13.
- One of the key priorities of this year's Budget was to put the Budget on a more sustainable path.
- The road to surplus is a difficult one.
- This year's Budget introduced a $12 billion cut in spending and $5 billion in revenue initiatives over the next 4 years.
- Most businesses have fared well in the Budget.

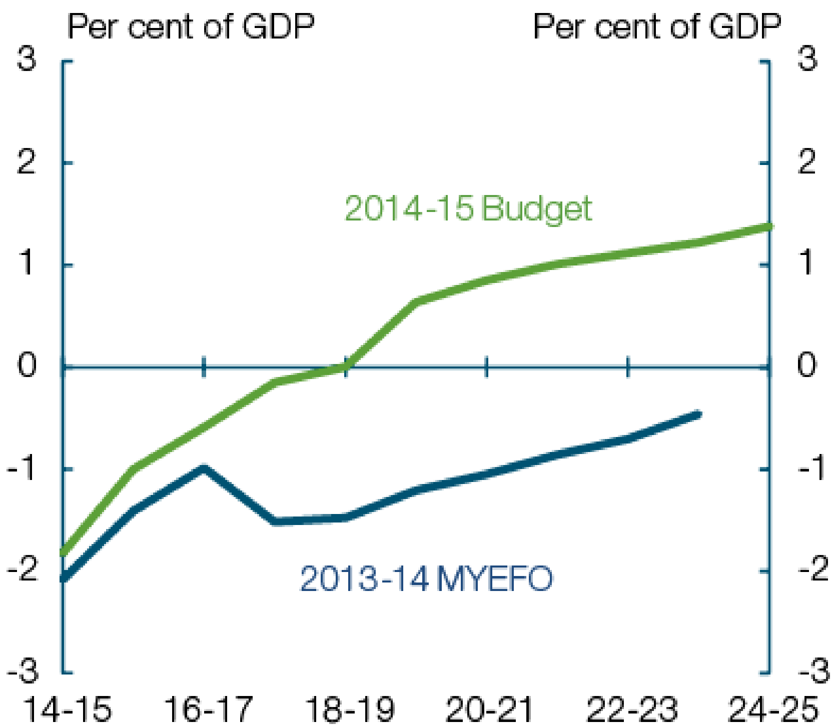
The Bottom Line



- **The Government is forecasting that the deficit will fall from $49.9bn in 2013-14 to $29.8bn in 2014-15.**
- **The Budget is expected to be in surplus by 2019-20.**
- **The government has undergone belt-tightening to achieve this goal.**
- **Spending cuts and increases in government revenue are drags on economic growth, but some “budget repair” was needed.**

A Growing Issue

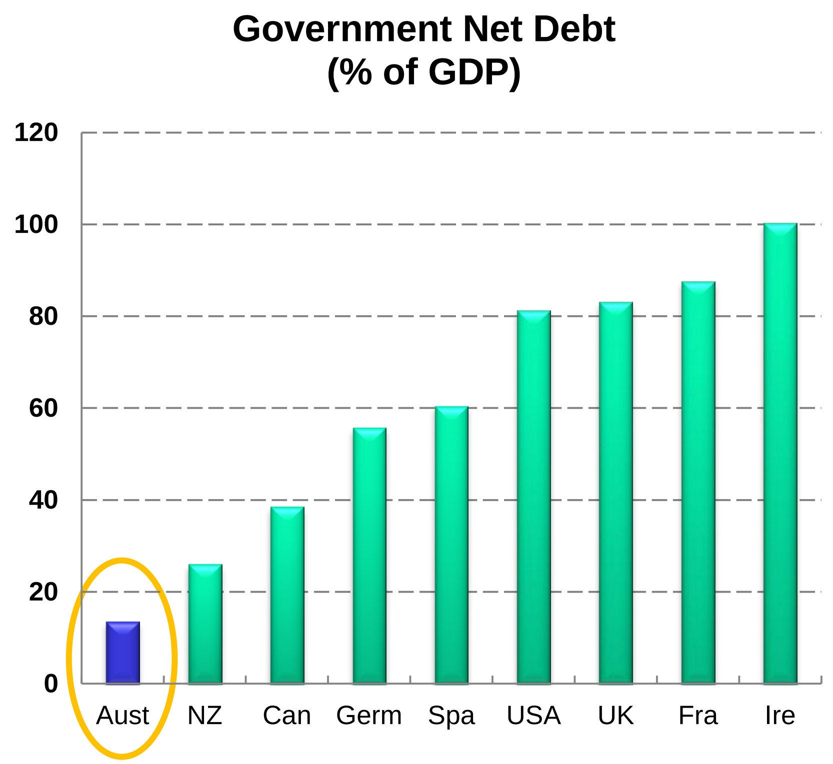
Underlying Cash Balance



Source: Treasury

- **Ideally, the budget should be in balance on average over the course of the economic cycle.**
- **Australia does have a structural fiscal problem.**
- **There was a need to put government finances on a more sustainable path.**
- **An ageing population will put further strain on the budget down the track.**

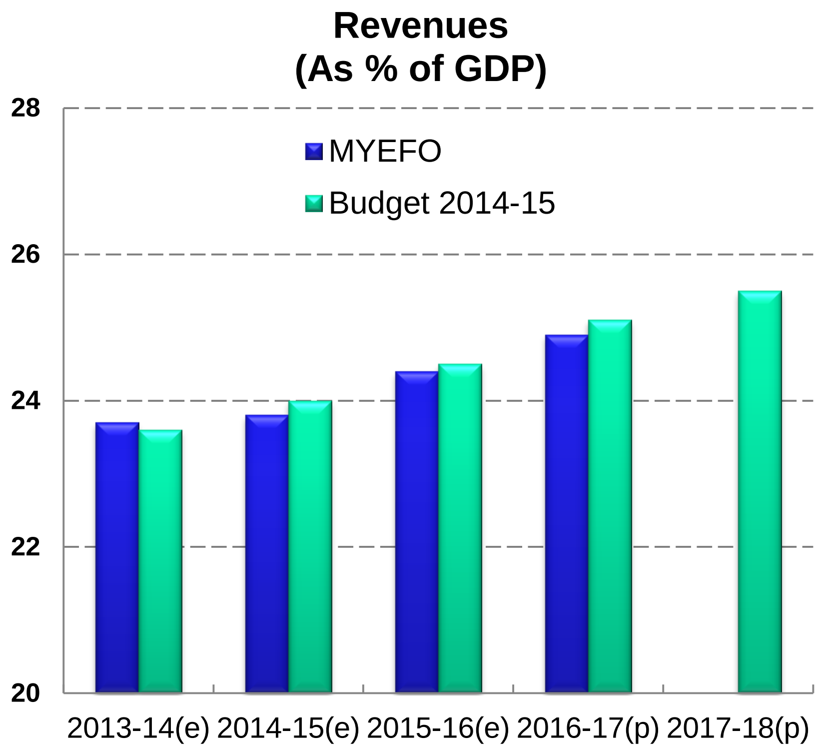
But it’s not a “Budget Crisis”

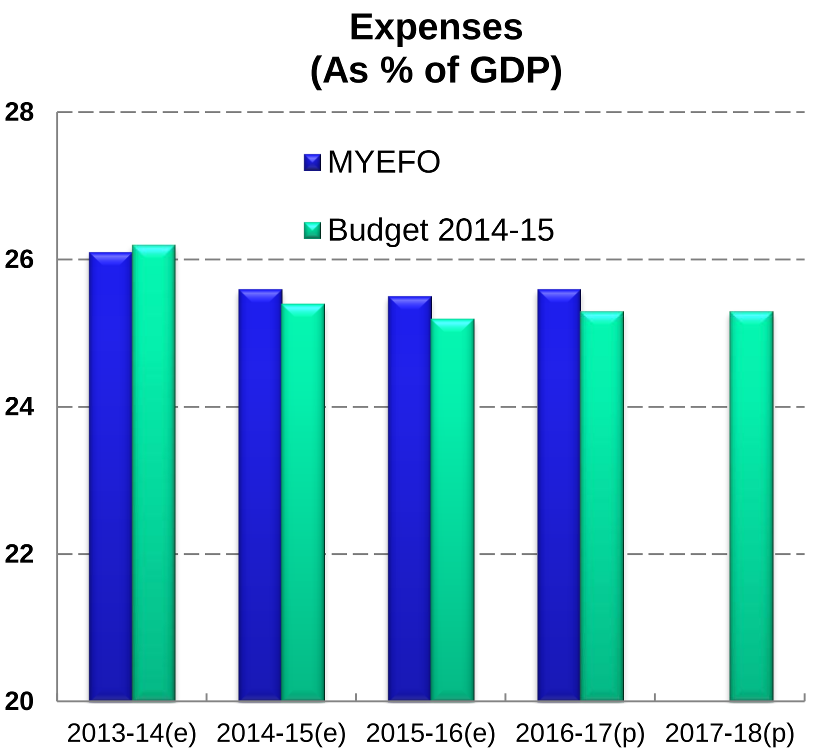


- By developed world standards, Australia’s public finances are in an enviable position.
- Government expects net debt to peak at 14.6% of GDP in 2016-17, well below the OECD average of 50%.
- Australia maintains a triple-A credit rating.

The Path to Surplus

- Fiscal consolidation has meant tax increases and spending cuts.
- Revenues are higher and expenses are lower since the Mid-Year Economic & Fiscal Outlook (MYEFO).





Key Initiatives Affecting Businesses

Company Tax

- From 1 July 2015, the company tax rate will be cut from 30.0% to 28.5%.
- A 1.5% Paid Parental Leave Levy will apply to large companies leaving smaller businesses better off.

Productivity

- From 1 July 2014, up to $10k will be provided to employers hiring a job seeker aged 50 or over.
- Paid parental leave to be introduced from 1 July 2015 with a cap on annual income of $100k.

Fuel Excise

- Biannual indexation will be reintroduced from 1 August 2014.

Infrastructure

- $11.6bn for infrastructure
  - $2.9bn for Western Sydney.
  - $5bn 'asset recycling' for the States.
  - $3.7bn in Infrastructure Investment Program.

Education

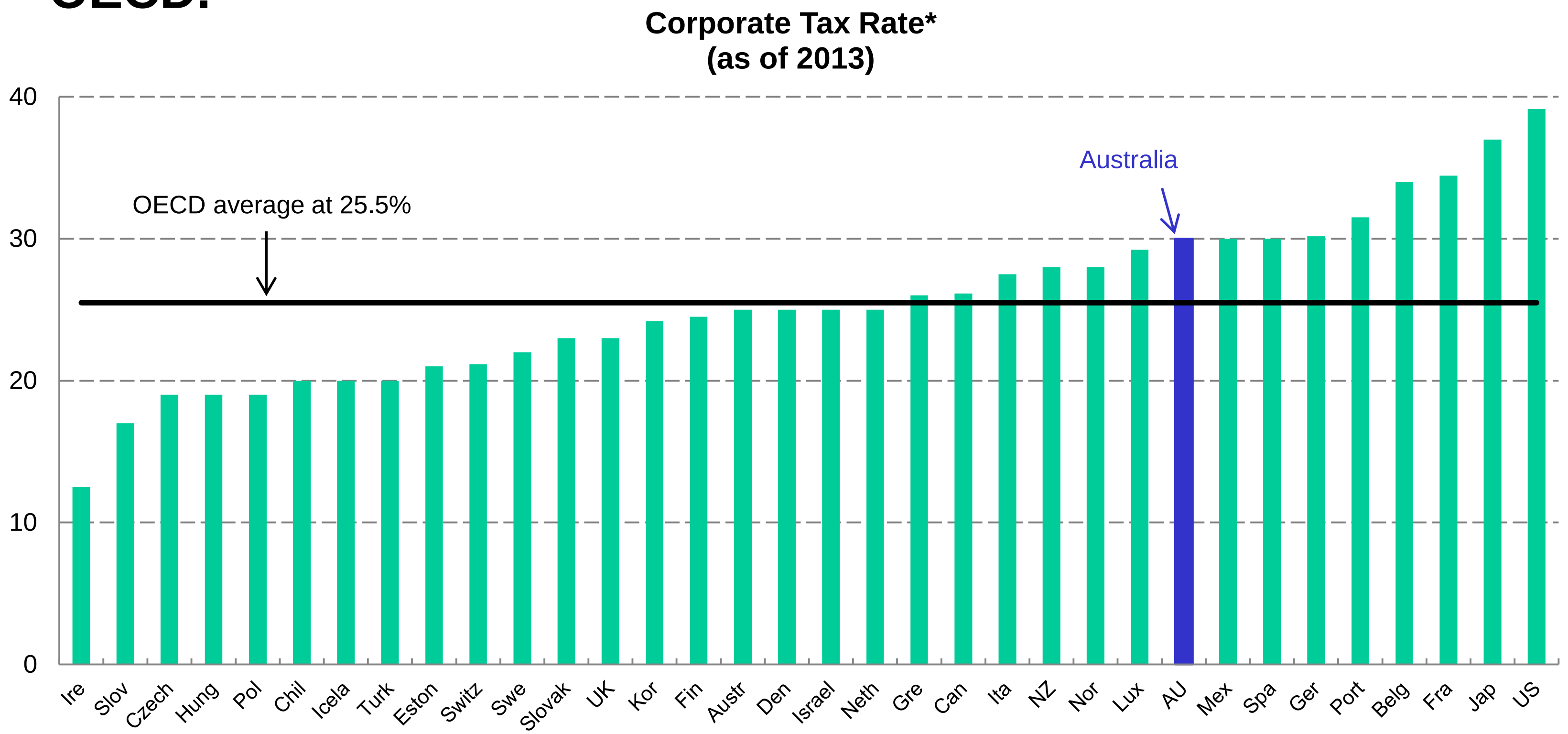
- University fees will be fully deregulated from 1 Jan 2016.

Healthcare

- A $7 co-payment for visits to the GP.
- Establish Medical Research Future Fund to cost $0.3bn over four years with the aim of reaching $20bn by 2020.

Corporate Tax Rate

- **Australia has one of the highest corporate tax rates in the OECD.**



Source: OECD
** Combined corporate tax rate from different levels of government*

Corporate Tax Rate to Be Cut

- The headline act for business in this year's Budget was the cut in the corporate tax rate. It will be cut from 30.0% to 28.5% from 1 July 2015.
- The reduction in company tax would assist in closing the gap with other OECD countries.
- The cut in the company tax rate will benefit up to 800,000 small and medium-sized businesses (SMEs).
- For larger businesses, the cut in the corporate tax rate will help offset the cost of the Paid Parental Leave Levy (applying to companies earning more than $5mn in taxable income).

Infrastructure – a Business Boon

- The $50bn spend on infrastructure by 2020 ($11.6bn coming from the Infrastructure Growth Package) will provide much needed improvement to road, rail and ports around the country (even if not all of it is new).
- It will also create employment and boost long-term productivity.
- NSW is a major beneficiary (almost $15bn).
- Queensland ($13bn) and Victoria ($7.7bn) are also set to receive notable funding.

Fuel Excise Indexation to Bite

- Indexation was scrapped in 2001.
- It will be reintroduced and apply twice a year from 1 August 2014.
- The petrol excise is currently 38 cents per litre.
- If we assume that inflation will average the middle of the Reserve Bank's medium-term target band (i.e. 2.5% per annum), then the petrol excise will rise from 38 cents a litre to 42 cents a litre in 2017-18.
- The petrol excise is 25% of the total price of petrol at the pump.
- Cost of fuel will hurt consumers and those businesses with significant fuel costs. Some of these businesses may be able to pass on the cost to consumers.

Other Initiatives for Businesses

- The Government intends to follow through with the commitment to axe the carbon and mining taxes.
- $200mn to boost the Export Finance & Insurance Corporation's capital base and $50mn boost to the Export Market Development Grants programme to assist in accessing export markets.
- A $50mn Manufacturing Transition Grants Programme to assist businesses in transitioning to competitive industries and provide innovative opportunities for growth.
- $155mn growth fund to support regions facing pressures due to motor vehicle manufacturers closing.
- $484mn for the new Entrepreneurs' Infrastructure Programme to assist SMEs accessing Government programmes.
- $476mn for an industry skills fund – aims to deliver close to 200,000 training places and training support services. This program in part will be funded by cuts to 10 existing training programmes.
- Target of reducing regulatory compliance costs by $1bn per year.

For Small Businesses

- Existing Office of the Australian Small Business Commissioner to be transformed into a Small Business and Family Enterprise Ombudsman.
- A new $2.8mn unit will also be set up to provide government advice on contracts and to ensure small businesses are not disadvantaged as part of Commonwealth departments' tendering and procurement processes.
- Small business will be provided with protection from unfair contract provisions with big businesses, ensuring they're not disadvantaged, under a $1.4mn scheme.
- Small businesses avoid the 1.5% levy for the parental leave scheme. Only large companies face the levy (those with taxable incomes of $5 million or more).
- $525mn for a Restart Scheme for mature age workers. Subsidy of up to $10,000 over 2 years for employers who hire workers aged 50 or over and have been on unemployment benefits or a disability support pension for 6 months.
- Scrapping schemes to support apprentices and instead providing a Trade Support Loans Programme which will provide apprentices with financial assistance of up to $20k over a 4-year apprenticeship.

Not All Businesses Will Benefit

- A number of clean energy and technology initiatives by the previous government are to be scrapped.
- Reduced funding for various science & research agencies, including the CSIRO and funding will cease for the NICTA from 2016.
- Reduced funding for industry grant programmes.
- Cessation of start-up and development programmes such as Commercialisation Australia, Innovation Investment Fund and Enterprise Connect among other programmes.

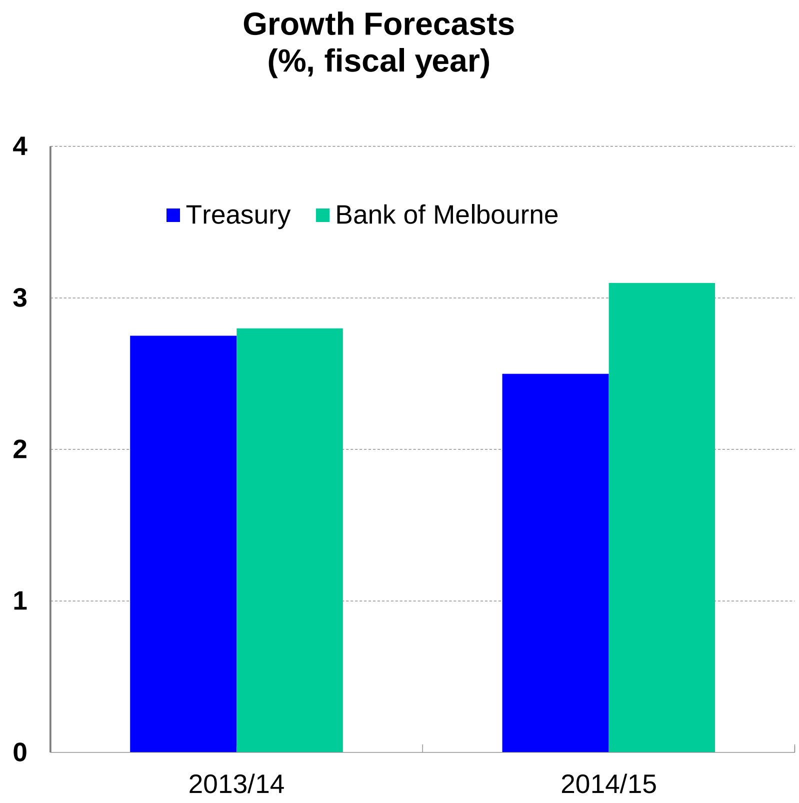
Some Industry Winners

- **Manufacturing and Trade**
  - $50mn committed towards the Manufacturing Grants Program, which will aim to help businesses transition to competitive industries.
  - A further $155mn has been allocated to support regions affected by recent closures of car manufacturers.
  - Manufacturers could also benefit from the govt's one-off $200mn capital payment to the Export Finance & Insurance Corp.
- **Construction and Engineering**
  - Will benefit from the infrastructure package, worth $11.6bn.
- **Defence**
  - Government outlined its plans to lift defence spending to 2% of GDP within a decade. Government to bring forward $1.5bn in defence spending, which was slated for 2017-18.

Some Industry Losers

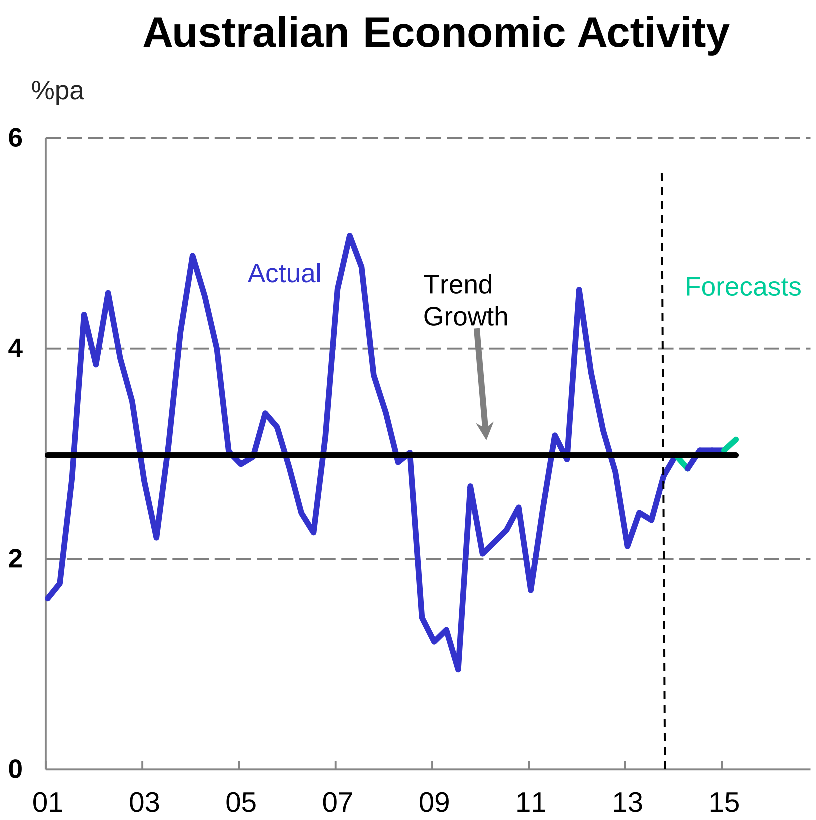
- **Health and Education**
  - Government set to cut a combined $80bn from the health and education sectors by 2024-25 by changing indexation arrangements and removing funding guarantees for public hospitals.
  - The health sector will also be affected by the government's decision to introduce a $7 Medicare co-payment for GP visits; most of the money raised will be invested in a new Medical Research Future Fund to be worth $20bn in a decade.
  - University fees to be fully deregulated, although some universities are in support of the scheme.

Economic Forecasts in the Budget



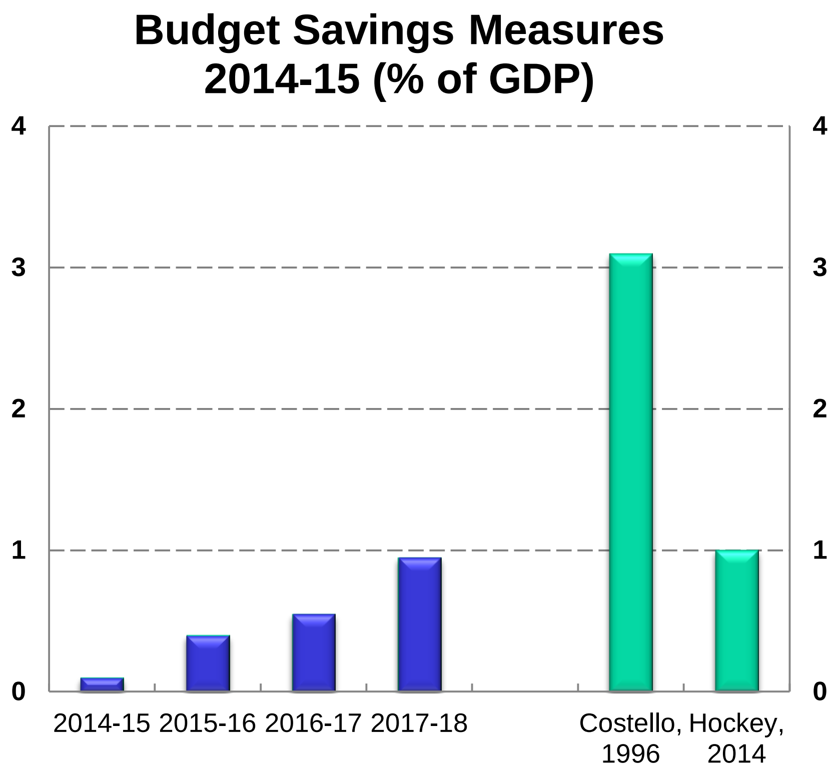
- **Treasury's growth forecast is conservative for 2014-15.**
- **It implies a risk that next year's Budget outcome will turn out better than expected.**

Fiscal Squeeze Will be a Drag



- Economic growth is below trend, but a recovery is underway.
- We expect the cuts to government spending to detract from growth.
- However, it should not derail the recovery.

Fiscal Tightening Back-Loaded



- **Net policy decisions are modest over the next two years.**
- **Most fiscal tightening will kick in later - appropriate in this stage of the economic cycle.**
- **The projected return to surplus in 2019-20 will take 12 years, if achieved. It compares with 5-7 years for earlier consolidation phases.**

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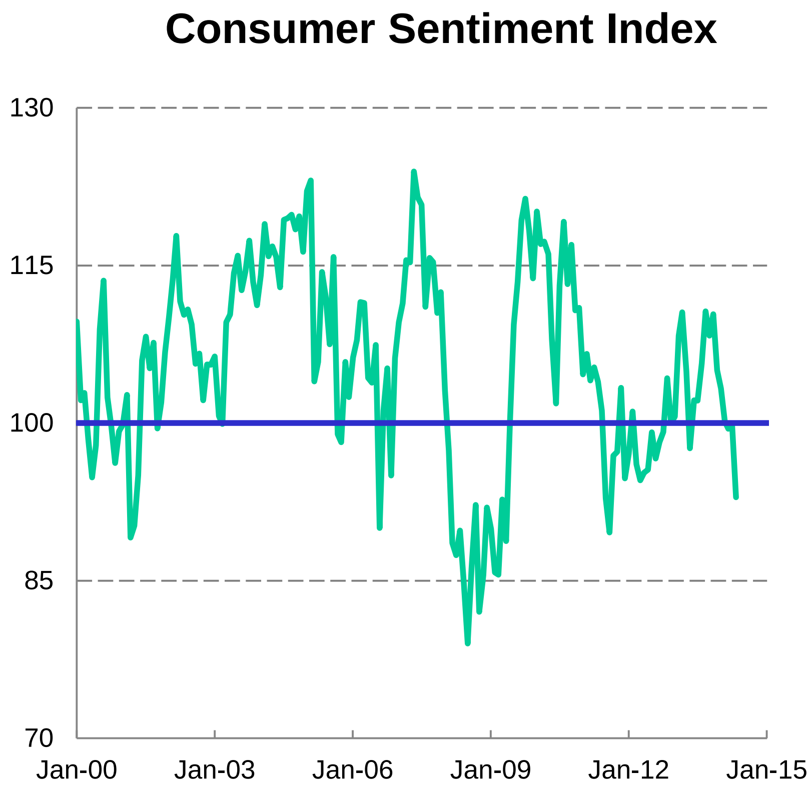
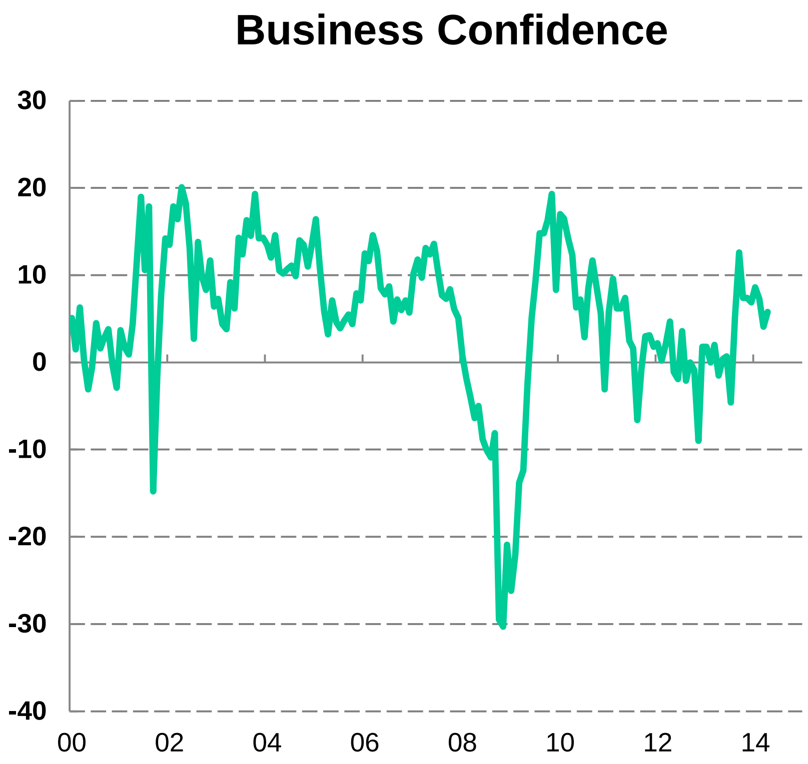
Confidence is Important



Source: Melbourne Institute & WBC

- **Consumer confidence has fallen in response to the Budget. History tells us this is not unusual, so the next run of sentiment readings will be more critical as a guide.**
- **The risk remains that cuts to household income could hurt consumer spending and temper the economic recovery.**

But Businesses Have Fared Well

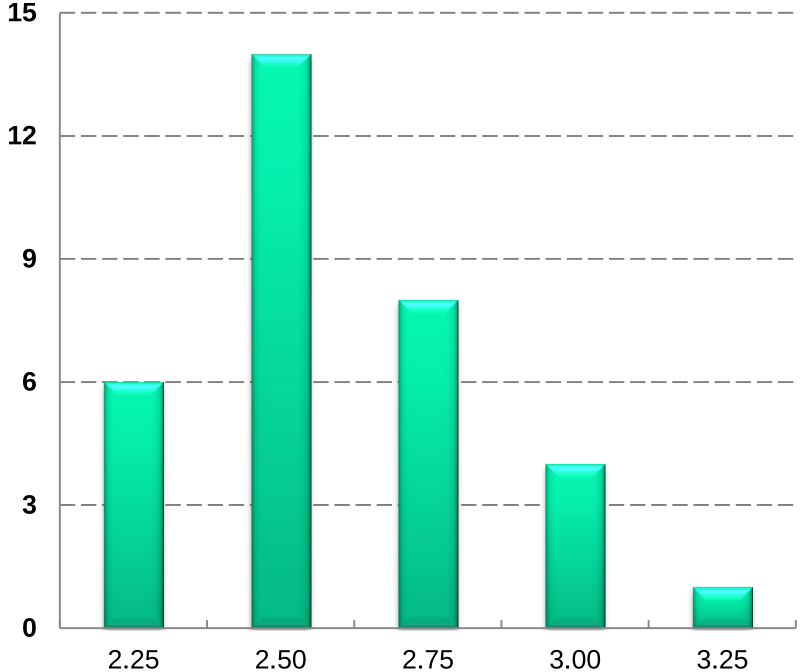


Source: NAB

- **The proposed corporate tax cut to 28.5% should be a positive for business confidence, particularly for SMEs.**
- **Additional infrastructure spending will also provide a boost.**
- **But sales growth determines a company's ability to spend and expand. Sales demand is linked back to consumer confidence.**

Implications for Interest Rates

Where Will the Cash Rate Be at the End of 2014?



Bloomberg survey of 33 economists as at 9 May 2014

- **The cash rate is currently at 2.50%.**
- **We expect the domestic recovery will result in a lift in interest rates at the end of the year by the RBA.**
- **But the potential impact on growth and spending from the savings measures in the Budget could mean the RBA will delay hiking rates until next year.**

Challenge for the Budget - the Senate

- One of the key challenges with this year's Budget is "selling" it. The composition of the new Senate means some of the Budget's proposals will face a difficult time passing through Senate.
- Federal-State relations might also come under strain because the Federal Government has passed on a greater financing burden to the States for health and education.

Senate Composition From 1 July 2014	**Seats**
Coalition	33
Australian Labor Party	25
Greens	10
Palmer United Party (PUP)	3
Democratic Labor Party	1
Independent – Nick Xenophon	1
Motoring Enthusiasts Party	1
Liberal Democratic Party	1
Family First	1
Senate	**76**

The Detail

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