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Federal Budget 2014-15

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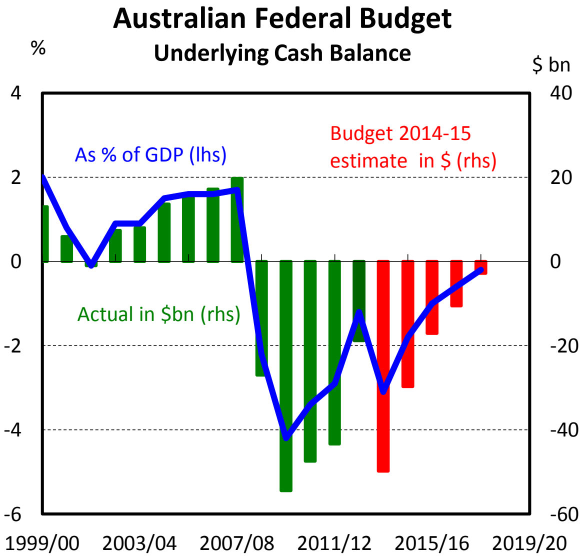
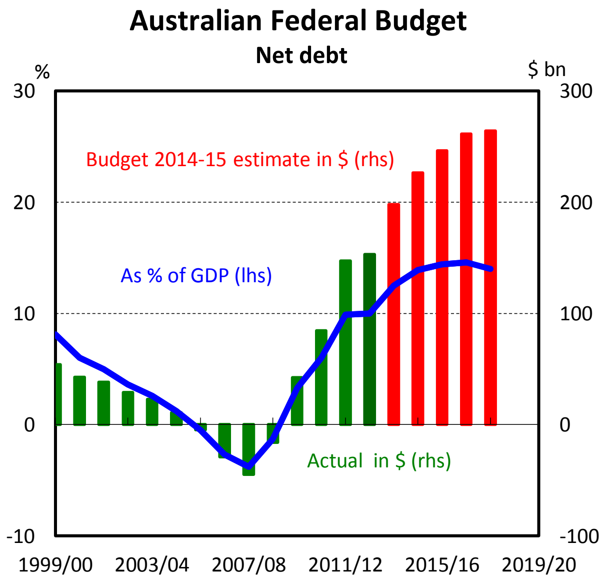
- **Given the modest pace of growth in the economy, the government has not tightened its belt as drastically as many had feared. Spending cuts and increases in revenue will act as a drag on the economy, but they are not expected to halt ongoing economic growth.**
- **While we argue that Australia does not face a Budget 'crisis' in the short term, some tightening was required to avoid ever larger deficits in future years.**
- **The Budget is full of measures it hopes will lift productivity and change attitudes.**
- **A large question mark hangs over the impact of the Budget on consumer confidence and therefore spending. While a rate hike from the RBA remains possible in late 2014, it may be delayed until 2015, particularly if consumers react by sharply reducing consumption.**





The Commonwealth Government is a significant part of the Australian economy. In 2014-15 it expects to raise $385.8bn in receipts and make payments of around $412.5 bn.

This year's Budget has been framed with a view to reducing the government's deficit from $49.9bn in 2013-14 to just $2.8bn by 2017-18. To move towards its aim, the government has introduced both short-term and longer-term measures. While we argue that Australia does not face a Budget 'crisis' in the short term, measures were required to avoid ever larger deficits in future years.

Given the modest pace of growth in the economy, the government has not tightened its belt as drastically as many feared. The recently released National Audit Commission Report contained recommendations that, as yet, have not been acted upon. While the spending cuts and increases in revenue will act as a drag on the economy, they are not expected to halt ongoing economic growth.

The Budget is full of measures it hopes will lift productivity and change attitudes. When assessing the multitude of changes, each must by measured by these standards.

There is some effort by the Government to stimulate shorter-term economic activity and job creation, as well as longer term productivity. The Government has placed an emphasis on infrastructure and a 1.5% cut in the company tax rate will assist smaller companies who will not face the paid parental leave levy.

Spending

Spending cuts were a major feature of the Budget. The government is expecting spending to decline 0.1% in 2014-15 from the previous year, which include cuts to public sector jobs, reducing government agencies and cuts to transfer payments. Meanwhile, any increased spending measures appear to have the aim in increasing productivity.

Major savings measures include:

- Reduced international aid (official development assistance or ODA), which will reduce spending by $601mn in 2014-15 and $7.6bn over five years to 2017-18.

- Changes to Family Tax Benefits – The Family Tax Benefit is to be maintained at the same rate for two years, which is expected to save an additional $397mn in 2014-15 and $2.6bn over the four years to 2017-18. An additional $211.2mn of savings over four years will be achieved by removing the Family Tax Benefit Part A per child add-on.

  The Family Tax Benefit B is now limited to families whose youngest child is younger than six years from 1 July 2015 and will save $1.9bn over five years. The threshold for eligibility has also now been reduced. The Primary earner income limit has been reduced from $150,000 to $100,000 per annum. This measure is expected to save $1.2bn over four years.

- Concessions for seniors will be reduced by terminating the National Partnership Agreement on Certain Concessions for Pensioners Concession Card and Seniors Card Holders and will achieve savings of $303.6mn in 2014-15 and $1.3 billion over four years.

  The Commonwealth Seniors Health Card will now include untaxed superannuation income in the eligibility assessment. However, the income limits to the Commonwealth Seniors Health Card will be indexed to the CPI from September 2014. The Senior Supplement for holders of the Commonwealth Seniors Health Card will no longer apply from 20 September 2014.

- Stricter income support for job seekers under 30 – From 1 January 2015, those claiming Newstart Allowance and Youth Allowance will need to demonstrate job search and participation in employment services support for six months before receiving payments.

- Higher education programs were also affected. The income threshold for repayments under the Higher Education Loan Program (HELP) has been lowered, and is estimated to be $50,638 in 2016-17. This change is estimated to provide savings of $3.2bn over four years from 2014-15.

Major spending initiatives were centred on boosting workforce productivity and boosting infrastructure spending via the States.

From 1 July 2014, a $10 000 payment will be provided to employers who hire a job seeker aged 50 years or over. Payments will commence after the worker has been employed for at least 6 months and will be paid in instalments until after 24 months of employment. The Government has budgeted $16.7mn for 2014-15 and $304.1mn over four years.

The Government estimated a significant $125 billion on infrastructure investment in the pipeline, but this amount includes investment spending across all levels of government (including State and local) as well as from the private sector. The Government's total investment in transport infrastructure is estimated to be $50 billion by 2019-20, and new commitments for infrastructure investment was limited to just $3.7bn over the five years from 2013-14.

An additional infrastructure initiative however, provides $5.0bn over five years to 2018-19, dubbed Asset Recycling Initiative. It provides incentives for State and territory governments to sell assets and to reinvest the proceeds in infrastructure. The incentive payment is set at 15% of the sale price of the asset paid in two instalments.

Little detail was given in the Budget on the Paid Parental Leave scheme other than it would be funded by a 1.5% company levy and the payment threshold was to be reduced from $150,000 to $100,000 per annum. These measures have previously reported that they will be introduced from 1 July 2015.

Revenue

The government was expecting receipts to rise by 7.3% in 2013-14. Receipts in 2013-14 will now rise by a smaller 3.5% to $363.5bn.

Last night's budget showed receipts for 2014-15 are now expected to surprise on the upside by $2.4bn, compared to the MYEFO estimates, at a total of $385.8bn. This represents growth of 6.1% in 2014-15 compared to 2013-14, although as evidenced by the previous year, this may be subject to change as the year unfolds. The upward revision to tax receipts is due to policy changes.

The government expects company tax receipts to rise by 5.3% in 2014-15 and 5.3% again in 2015-16, driven by expectations of stronger corporate profitability. This follows a smaller 0.5% increase in company tax receipts in 2012-13.

Tax receipts from individuals are expected to rise by 9.2% in 2014-15, following a rise of 4.8% in 2013-14. The strong rise in 2014-15 reflects the introduction of the "Temporary Budget Repair Levy" and an increase in the Medicare Levy. Outside of policy changes, expectations of modest wage growth will weigh on growth of individual tax receipts.

Revenue from the goods and services tax (GST) is passed onto the States. In 2013-14 it will raise $51.0bn increasing by 5.8% in 2014-15 to $54.0bn. The government is assuming slightly stronger consumption by households.

In an effort to get the fiscal balance on a more sustainable footing, the government has introduced a "Temporary Budget Repair Levy" on incomes over $180,000 for three years, starting in 2014-15 (that is from 1 July 2014 to 30 June 2017). It is estimated that this will impact 400,000 taxpayers. Of all the revenue initiatives in this budget, the "Temporary Budget Repair Levy" will have the largest impact on the bottom line. The levy is expected to raise $3.1bn over the four years of the Budget forward estimates period. The top marginal tax rate (including the levy) is 47%, for income over $180,000. The increase in the Medicare

Levy from 1.5% to 2.0% kicks off from 1 July 2014, as announced in the previous Budget, and takes the effective top marginal tax rate to 49% from that date.

As an ageing population raises expenditures, there will be greater pressure on government finances. This is a long term structural problem facing Australia and other developed nations and it will require a long-term solution, rather than a three-year levy.

The government will reintroduce the biannual indexation of fuel excise from August 1st, 2014, removing the freeze on indexation of fuel excise which has been in existence for 13 years, following its introduction by the Howard Government in 2001. This will raise $2.2bn over four years. The revenues raised from the indexation of the fuel excise will be used to fund additional road infrastructure.

The Budget introduced a $7 co-payment for visits to the GP, pathology and imaging services, as well as an increase of $5 in pharmaceutical prescription drugs. The measures will net a saving of $6.4bn over four years. The government announced it would establish a Medical Research Future Fund to be funded by the co-payment and prescription fee increase, at a cost of $0.3bn over the four years.

In additional measures the government will remove tax offsets for seniors and dependent spouses, saving $1.1bn over four years.

The government confirmed it would cut the company tax rate by 1.5 percentage points, from 30.0% to 28.5% from 1 July 2015. This was designed to offset the cost of the Government's Paid Parental Leave Levy (1.5%) for large companies, although with the reduction in the company tax rate medium-sized and smaller businesses (around 800,000 of them) will be better off.

In summary, revenue projections for 2013-14 appear achievable, but as always, will depend on the pace of economic growth, the Australian dollar, commodity prices and job creation.

Economic Parameters

The economic growth forecasts used in the Budget are towards the lower limit of the range of forecasts published last week by the Reserve Bank of Australia (RBA). It cannot be argued that the government is relying upon overly optimistic economic forecasts to move the Budget back towards surplus. Indeed, we expect modestly stronger economic growth than the forecast in the Budget.

Given the slow pace of economic growth over the next two years, the government expects inflation to remain contained and unemployment to edge higher. Both the RBA and the government expect inflation to exceed 3.0% during 2014-15 but to move back into the 2-3% range in 2015-16.

Implications for the Outlook and Interest Rates

A large question mark hangs over the impact of the Budget on consumer confidence. If consumers react by sharply reducing consumption, economic growth will remain well below trend. Similarly, if businesses react positively by hiring labour and lifting investment economic growth will be enhanced.

At first blush, the Budget measures will act to modestly restrain economic growth. This would assist in keeping inflation at bay and cause the Reserve Bank to continue on its path of keeping official interest rates at historically low levels. While a rate hike remains possible in late 2014 it may be delayed until 2015.

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