more give, less take

Federal Budget 2014

What the Federal Budget means – Business overview

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Federal Budget overview

Our economists' view

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The 2014 Federal Budget should really be seen as a re-ordering of Budget priorities to fund significant new outlays proposed for years to come – including National Disabilities, Gonski education reforms and Paid Parental Leave commitments – and at the same time put the Budget on a more robust path to balance. With net debt to GDP of around 17% this was never a Budget in crisis – although some medium term challenges had to be addressed. The Government has opted to spread the pain and start straight away.

Much of that pain has been well signalled. That included tightening eligibility criteria for family tax benefits and eligibility rules for unemployment benefits; increased cuts to public sector employment (from 12,000 to 16,500); the merger/abolition of 70 public entities and more privatisation; a deficit tax levy of 2% for those paid more than $180k per year (for three years); cuts to industry assistance programs worth $850m; resumption of petrol indexation (with the proceeds put to road funding); and medical co-payments of $7 per visit (to set up a new medical services future fund); large cuts to hospital payments; and university fee liberalisation (which will increase the cost of some courses). In the longer run, from 2018 Gonski funding will be replaced by an indexation of education funding; the pension age will be raised to 70 years effective from 2035; and the pension assets test will not be indexed for a number of years.

Over the next three years the measures represent significant savings (around $15 billion) – with most of the work done on the revenue side. Effectively our estimates suggest that the Government, in a structural sense, is taking around 0.5% out of growth in each year in the forward estimates. While the tax rises and petrol tax increases are not enough to seriously impact growth, they together with significant transfer cuts, could well have more important effects on confidence.

On the Budget forecasts, NAB is more optimistic on growth (NAB 3% Govt 2.5% in 2014-15). We are more cautious on domestic demand, reflecting a view that public sector demand and/or consumption might be hit harder by Budget announcements. That said, the Government sees unemployment peaking at the same rate as NAB, but staying at that rate longer (all of 2015-16). The Government also anticipates a faster terms of trade fall and, consequently, lower nominal GDP growth. Overall, we see the forecasts as unlikely to overstate the fiscal outcome and indeed they appear marginally conservative.

Clearly this Budget has lots of politics. This is where the main uncertainties will emerge. How many of the measures announced will get through Parliament and how will consumer and business confidence be affected?

Fiscal Outcome

The underlying cash deficit for 2013-14 is estimated at $49.9 billion (3.1% of GDP). The Budget maintains large but shrinking deficits of $29.8 billion in 2014-15, $17.1 billion in 2015-16, and $10.6 billion in 2016-17. The Government has set an objective to return the Budget to 1% of GDP over the medium-term.

Economic Outlook

The Government's economic outlook is softer than recent RBA forecasts, and slightly softer than NAB's forecasts for 2014-15 (NAB is weaker in 2015-16). In 2014-15, the government has forecast real GDP growth of 2.5% (compared with NAB's 3.1%), reflecting a smaller trade balance that more than offsets its stronger expectation for domestic demand. In 2015-16, the Government's forecast is a little stronger (3% compared to NAB's 2.7%) due to an anticipated improvement in domestic demand (NAB is forecasting a further slowing, led by a contraction in mining investment). The Government expects unemployment to rise to around 6.25% by mid 2015, while NAB expects it to peak sooner (at a similar level), before easing to around 6%. The Government, RBA and NAB share very similar views on the outlook for underlying inflation, although the RBA sees larger price pressures in the near term. Each expects inflation to remain well within the RBA's 2-3% target band over the forecast horizon. The structural adjustment occurring in the economy at present remains a real risk to the outlook. Nothing in the Budget changes our view that rates are on hold until late 2015.

Financial Markets

Beyond the economic/fiscal outlook, the Budget was regarded as 'credit positive' by Moody's Investors Service, and supportive of Australia's AAA rating. The market reaction to the Budget was positive, with the $A quickly rising ½ a cent to under 0.938, before retracing. Despite all the concern in the lead up, most measures were well flagged, with no real negative surprises. Overall, the market sees the Budget as a good start towards addressing the looming structural pressures facing government finances.

For more detailed analysis from NAB Group Economics, please visit **nab.com.au/fedbudget**

Key Initiatives

- Lowering the company tax rate to 28.5% for up to 800,000 small and medium sized businesses, to begin 1 July 2015.
- $11.6 billion for the infrastructure sector with highlights including $1.5 billion for East West Link in Melbourne, $2 billion for WestConnex Sydney, and $866 million for Perth Freight Link.
- Corporate Australia will benefit from the removal of the Carbon and Mining taxes.
- $200 million of additional capital to the Export Finance and Insurance Corporation (EFIC) and $50 million increase to the Export Market Development Grants (EMDG) programme.
- The Establishment of an Entrepreneurs Infrastructure Programme worth $484.2 million to focus on commercialising ideas, and small business capabilities and access to information.
- Restart initiative contributing $10,000 over 24 months for employers hiring a person aged over 50 who been unemployed for over 6 months.
- Businesses in health and biomedical, resource technologies, and advanced manufacturing are targeted beneficiaries of the new Industry Skills fund whose objective is to provide specialised training to these sectors at a cost of $476 million over four years, with business expected to make a co-contribution.
- The Federal Government will contribute $100.6 million to the $155 million Growth Fund that has contributions from both Victorian and South Australian State Governments and Holden and Toyota. This program will assist transitioning industry, businesses and individuals affected by the end of car manufacturing through five different programs.

NAB's view:

Cutting the company tax rate from 30% to 28.5% will benefit a considerable number of businesses. However, for the largest 300 businesses this cut is likely to be offset by the Paid Parental Leave Scheme levy. It is also worth noting that the tax cut, the Paid Parental Leave Scheme and levy appear to be in government contingencies suggesting some uncertainty about their implementation.

The infrastructure package is aimed at improving road, rail and air transport links, albeit is heavily weighted towards roads. The construction phase will initially benefit engineering and construction firms as well as those building product suppliers. Improved freight movements and passenger transport should assist productivity and have some impact on wellbeing.

Treasurer Joe Hockey reiterated in his Budget speech that the "age of entitlement" is over, including for business. That said, business was spared the full weight of cuts recommended by the Commission of Audit which included abolishing 17 industry assistance programs, merging two, and reducing funding for four.

On the positive side there is an increase of capital to EFIC and EMDG, and the establishment of the Entrepreneurs Infrastructure programme, however the cessation of some other industry assistance programmes including Commercialisation Australia, the Innovation Investment Fund, Enterprise Solutions and Enterprise Connect (saving $845.6 million over five years), could be detrimental to some businesses.

Moreover, a cut to the Commonwealth Scientific and Industrial Research Organisation (CSIRO) (approximately $111.4 million) could detract from the agency's ability to assist with industry enhancing innovation.

Finally, although the Industry Skills fund provides targeted training, the government is expected to make savings of $1 billion by ceasing 10 other skills and training programmes from 1 July 2015.

Industry comment:

On the whole business welcomed the budget initiatives, as tax cuts and budget measures were largely expected.

"The 2014–15 federal budget is a solid start to putting the fiscal strategy back on track, but there is much more work to do to support growth and deliver a sustainable budget position for the long term," said Business Council of Australia Chief Executive Jennifer Westacott.

"On physical infrastructure, the additional $11.6 billion for the Infrastructure Growth Package to support asset recycling with the states, boost road and rail funding and invest in Western Sydney is a significant investment in the growth of the economy," said Ms Westacott.

However some concerns have been raised relating to the cuts in R&D and Industry assistance.

"Growing the economy requires Australia to adopt a more global mindset and an unprecedented focus on innovation and knowledge infrastructure.

"Some of the cuts to research and development and industry assistance programs are not consistent with this imperative, nor is the constant chopping and changing in the R&D funding arrangements which by their nature need to be long term and predictable".

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