agribusiness

FEDERAL *Budget* 2016

What the Federal Budget means for Agribusiness

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ABOUT NAB AGRIBUSINESS

NAB is Australia's leading agribusiness bank and has been supporting Australian farmers for around 150 years. NAB employs more than 600 agribusiness banking specialists in 109 metropolitan and regional locations Australia-wide.

With their local and industry knowledge, our Agribusiness team understands the unique financial and environmental needs of farmers and businesses beyond the farm gate – whether they provide inputs into agriculture, process, distribution or market primary produce.

NAB also has a specialist Agribusiness Asia Desk to help Australian farmers make the most of the rapid growth in demand for high quality produce in Asia.

FEDERAL BUDGET OVERVIEW

Our Group Economics view

Alan Oster, Group Chief Economist, NAB

This Budget clearly has a political as well as economic dimension – and in particular is framed against the assumption of an upcoming election. As such, it's really an exercise in selected refocusing outlays and receipts to achieve the Government's focus of growth and jobs – but achieved within a realpolitik framework of burden sharing and keeping debt at sustainable (AAA) levels. The current environment means there is little scope for large structural reforms. And with a Budget not likely to get back to surplus by 2020-21 – and then only marginally – it clearly remains vulnerable to the vagaries of the economic cycle.

Key measures are largely as signaled in recent days. On improving the 'equity' theme, the Budget raises the 32.5% personal income threshold from \$80k to \$87k to help offset some effects of bracket creep; imposes tougher rules on top end superannuation (lowering the threshold for the higher tax on super from \$300k to \$250k and imposing annual and lifetime caps on extra super contributions); and eases the tax treatment of super for lower to middle income contributors. Also on the equity theme is stricter enforcement of multi-national tax (essentially a 'Google tax' with diverted income to be taxed at 40%).

On the 'adding to growth' theme is business tax cuts (from 28.5% to 27.5% for small and middle business with the turnover threshold raised to \$10m. Thereafter the turnover limit is progressively raised until all businesses are on the rate by 2023-34. The rate then falls to 25% in 2024-25. There is an extra benefit in that the investment tax write off has been extended for an extra year. That said, the size of the short-term cuts are limited (around \$5.3bn over four years) – and our modeling suggests very small short-term benefits. There is also extra money for infrastructure (\$5bn); extra money for health (\$2.9bn); and education (\$1.2bn – albeit much less than full Gonski). Also helping to repair the Budget bottom line is the (12.5%) increase in tobacco taxation.

Outlays remain under 26% of GDP before moving a touch lower in the long run. By way of context, outlays peaked at around 27% during the GFC stimulus and before that around 23% of GDP. Revenue still does most of the repair job on the Budget balance, with a combination of policy and economic recovery. Overall net debt peaks a touch higher in 2019 at 19.2% (previously 18.5%) and starts to edge lower thereafter. Rating agencies have been much more guarded in their reaction than usual. As set out in the Medium Term Economic Outlook, the Budget would represent a slight drag on economy going forward (around 0.5% per year) and as such is probably doable.

Of course the Budget may not be the final word on medium-term fiscal sustainability given the forthcoming election campaign. Our bottom line is there is not a lot of scope for pulling more 'rabbits from the hat'. And that Budget repair will be a long and difficult slog given the economic environment. We are more cautious in 2018-19 forecasts.

Fiscal outcome

Estimates of the underlying cash deficit are slightly larger at A\$39.9bn (2.2% of GDP) in 2015-16 and \$37.1bn (2.4% of GDP) in 2016-17 (slightly below market expectations – but near the viewpoint of NAB). The projected deficit then moves down through the out-years with an eventual return to surplus in 2021-22.

Economic outlook

There is little fundamental difference between Treasury and NAB's economic forecasts in the next few years. A sharp increase in commodity export volumes, offset by subdued domestic demand, remains the common theme. However, NAB forecasts become notably more pessimistic as we move into the forward projections (from 2018-19) reflecting significant headwinds as LNG exports reach their peak and dwelling construction reduces. Over the forward estimates, expectations for the unemployment rate are similar, easing to around 5.5% in the short-term before stabilising. On the nominal GDP forecasts, NAB and Treasury expectations are similar in 2016-17 (around 4.25%) but the Treasury's 2017-18 forecasts are more optimistic.

Financial markets

There was little discernible market reaction to the Budget. Ratings agencies have been circumspect in their initial reaction to the Budget, choosing instead to allow more time for analysis.

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Key initiatives

The 2016-17 Budget includes a number of measures for agriculture, relating to water and drought, infrastructure, innovation and trade as well as revenue and savings measures.

Water and drought

- $2bn in concessional loans (10 year period from 1 July 2016) to establish the National Water Infrastructure Loan Facility. Loan recipients will make interest only payments for up to the first five years, and have a further 10 years to repay the principal and any additional interest.
- $9.5m for the National Water Infrastructure Development Fund to fund water infrastructure feasibility studies in northern Australia, with the cost being met by redirecting funds from the Rural Research and Development for Profit program.
- $7.1m to fund additional Rural Financial Counsellors who will provide free financial advice to farmers in drought-affected areas.

Transport infrastructure

- Up to $593.7m in additional equity to the Australian Rail Track Corporation over three years from 2016-17 for land acquisition and pre-construction works on the Melbourne to Brisbane inland rail project.
- $220m for the Murray Basin rail project, upgrading grain lines in western Victoria, matching the Victorian Government contribution.

Innovation and trade

- $50m over four years to the Australian Grape and Wine Authority to promote wine tourism and Australian wine overseas.
- $15m over four years for a carp control program.
- A two-year pilot program to improve access for farmers to training and information about co-operatives collective bargaining and innovative business models, with the costs being met from existing departmental resources.

Revenue and savings measures

- A reduction in the Wine Equalisation Tax (WET) rebate cap from $500,000 to $350,000 on 1 July 2017, and to $290,000 on 1 July 2018 and tighter eligibility criteria from 1 July 2019.
- Savings of $9.2m to the Managing Farm Risk Program, with a means test limiting eligibility to farm businesses with annual revenue of less than $2m.
- An extra $2m annually from changes to agricultural levies from 1 July 2016, including:
  - a mandatory levy of $0.50 per tonne on all hay and straw prepared for export, replacing a voluntary levy, cessation of various deer levies and custom charges from 1 July 2016.
  - an increase in the Emergency Plant Test Response Levy for growth of private plantation logs. An increase in the citrus levy by $1.50 per tonne.

NAB's view

The 2016-17 Budget delivers a modest set of initiatives for agriculture, reflecting a subdued overall revenue environment.

The 2.5% corporate tax cut for small businesses will benefit many farmers, and with the drought continuing to bite in many parts of the country, the additional $7.1m to fund additional Rural Financial Counsellors is very welcome.

The National Water Infrastructure Loan Facility has the potential to provide new investment in water infrastructure. However, funding for the scheme is spread over 10 years and is dependent on states and territories choosing to proceed with projects. Furthermore, with the states already able to borrow at rates not significantly higher than the Commonwealth, it remains unclear whether the scheme provides substantial incentives to invest.

Additional equity for the Australian Rail Track Corporation for inland rail is a good start, although the project will require several billion dollars to construct and this funding has so far not been forthcoming.

The inland rail project has been under development for several years and found strong support from the National Farmers' Federation. The project would use a

Industry reaction

The National Farmers' Federation had a mixed reaction to the Budget. While it welcomed the 2.5% tax cut for small business, there was disappointment over insufficient funding to commence construction on inland rail (despite welcoming the cash injection) and concern that the backpacker tax issue remains unresolved.

National Farmers' Federation President Brent Finlay says: "There were literally thousands of farming families, agricultural businesses and tourism operators who were desperately hoping the backpacker tax, in its current form, would be abandoned in tonight's Budget. It is now time for the Government to respond to the risk imposed on the sector by a measure that will chase working holiday makers away from Australia and, in the process, decimate the agricultural workforce."

The National Farmers' Federation's pre-Budget submission sought a number of measures in the Budget, including improved funding for forecasting at the Bureau of Meteorology, funding for Landcare, the construction of the inland rail project from Melbourne to Brisbane and a compromise for the 'backpacker tax' at 19%.

combination of new and existing (upgraded) rail lines to create an inland freight route from Melbourne to Brisbane via Parkes, bypassing Sydney and substantially improving service levels and journey times.

The Budget provides $220m for the Murray Basin rail project, matching the contribution from the Victorian Government. The project will upgrade Mildura and four associated branch lines primarily used to haul grain in north-west Victoria. Without additional funding, Victoria's grain rail network faced serious maintenance shortfalls and threatened viability.

The backpacker tax remains a major issue for the industry. The 2015-16 Budget introduced a measure to remove the tax-free threshold for tourists on working holidays (i.e. backpackers) from 1 July 2016 in favour of a flat tax rate of 32.5%. The National Farmers' Federation reports that backpackers make up around 25% of Australia's agricultural workforce.

The move also caused concern in the labour intensive horticultural industry that it will be increasingly difficult to source labour, increasing costs for the industry, which ABARE forecasts will exceed $10bn in 2016-17. The Budget has not amended these measures and the flat tax rate will go ahead on 1 July 2016.

Important NAB information