more give, less take

nab

Federal Budget 2013

What the Federal Budget means for Infrastructure

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Federal Budget overview

Our economists' view

Alan Oster, Group Chief Economist, NAB

What a difference a year makes. Gone is the political rhetoric on the importance of gaining international credibility by getting a surplus no matter what. Rather, the focus is very much on a fairly timid initial approach that doesn't see a balanced Budget till 2015/16 or a surplus till 2016/17. In short, a Budget that is more in line with a "soft economy" – even if the Government doesn't describe it as such.

The Budget effectively takes nothing to the economy in the near term (compared to detraction from growth of nearly 1½% this year). From a structural viewpoint nearly all of the heavy hitting is from the revenue side and most is done in the out years. That said, the Budget is helping to repair some structural problems via:

- scrapping last year's welfare increases (last year's so called spreading the benefits of the mining boom – around $2.5bn over the estimates) and the baby bonus
- increasing the Medicare levy to help fund national disability reform (the largest saving at $11.5bn over the estimates)
- tightening offshore tax arrangements including Offshore Banking Units (a hefty $4.2bn over the estimates) and acknowledging the lower carbon price ($3.4bn over the estimates).
- measures to reduce funding costs of schooling (out of universities etc at $2.6bn) and measures to introduce PAYG systems for large tax payers.

The main expenditure items (within the estimates period) are more infrastructure ($3.1bn) school building ($2.9bn) and disability care ($1.9bn but ramping up in the beyond estimates period).

NAB's real activity forecasts are very similar to Treasury's – albeit we are a touch weaker in 2012/13 and we also have unemployment a touch higher. Of more concern, we are significantly lower for nominal GDP – which is important because this was the main cause of revenue under prediction in recent years. We are also slightly weaker for the global outlook. For more details, see Economic and Financial Outlook.

The real risks to the Budget probably revolve around how much of the package will see the light of day post the election. Also, the Budget expenditures are very much back ended which raises the question of just in what state the economy will be in 2016/17 and beyond. Finally even this modest fiscal retraction will possibly be at risk if election spending fires up. At least in that context Australia's debt position remains very strong in an international context with debt levels very low – albeit they are possibly moving towards the lower end of the remaining AAA economies. For more details, see Bond Issuance and Net Debt.

Overall then a budget for a softer economy but one that is very political in nature (as probably was inevitable in present circumstances).

Fiscal Outcome

The underlying cash deficit for 2012/13 is estimated at $19.4 billion (1.3% percent of GDP). The Budget maintains large deficits of $18 billion in 2013/14, and $10.9 billion in 2014/15, before moving into a marginal surplus of $800 million in 2015/16.

Economic Outlook

The Government's economic outlook is broadly in line with recent RBA forecasts, and only slightly stronger than NAB's. However, the Government's outlook for nominal GDP is substantially stronger than ours, at 3¼% in 2012/13 compared to our 2.1%, and 5% in 2013/14 compared to our 4.2%. Over estimating nominal GDP was the reason why revenues were overestimated in recent years – and this is clearly a concern. The Government and NAB both have growth of 2.7% and 3% for 2013/14 and 2014/15. However, we are weaker in 2012/13 (at 2.7% v the Governments 3%) largely slower near-term public sector demand and a sharper pace of decline in the terms of trade. The Government expects unemployment to rise to around 5¾% by mid 2014, while NAB expects it to edge towards 6%, reflecting our weaker view on growth. The Government, RBA and NAB share very similar views on the outlook for underlying inflation, which is expected to remain well within the RBA's 2-3% target band over the forecast horizon. Given the structural adjustment occurring in the economy at present, as well as softness in labour market conditions, we still believe the economy would benefit from another 25 bp rate cut this year (November); this would take the RBA's cash rate to 2.50%. However, further deterioration in labour market conditions could see earlier action and possibly more than one cut. For further details, see the Economic and Financial Outlook.

Financial Markets

Beyond the economic/fiscal outlook, for bond investors the two main considerations from tonight's Budget are: 1) the Government's debt programme for 2013/14, and 2) any implications for Government's stable AAA credit rating. The market reaction to the Budget was negative, with the $A quickly falling ½ a cent to under 0.9950. The reasoning was less to do with the detail of the Budget and more that investors saw a string of deficits indicating the economy remains weak. The bond market was little moved.

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

Infrastructure

Through our relationship with Infrastructure Partnerships Australia, NAB is excited to share additional commentary and analysis on the Federal Budget relating to the Infrastructure sector, led by Brendan Lyon, CEO, IPA

Key initiatives:

- An additional $24 billion funnelled into nation-building infrastructure.
- Key urban public rail projects include the Melbourne Metro rail project ($3 billion) and Brisbane's Cross River Rail project ($715 million).
- Investment in urban roads, including an allocation for the WestConnex motorway in Sydney ($1.8 billion), as well as the gateway North upgrade in Brisbane ($718mn), widening the M80 Ring Road in Melbourne ($525 million) and the South Road upgrade in Adelaide ($448 million).
- Regional areas also benefited with spending on the Bruce Highway and an upgrade to the Midland Highway in Tasmania over 10 years.
- Other investments projects include upgrades to the Warrego Highway in Queensland and the Perth-to-Darwin National Highway (Swan Valley Bypass) in Western Australia.
- An extra $12.9 million was set aside to connect more local councils to the National Broadband Network.

NAB's view:

Infrastructure spending was a key component of the 2013 budget. A major focus of this investment seeks to address some of the problems associated with population growth and urban growth so there is a heavy focus on urban rail and roads.

The infrastructure sector has done well compared to other areas, but the second round of the Nation Building program is modest in comparison to the first phase, with around half of the funding beyond 2017 (of the $24 billion of funding commitments, only $13.5 billion is allocated in the forward estimates to 2016/17).

In addition, the overall size of the next phase in the Nation Building program has been reduced through a $2 billion reduction in the Regional Infrastructure Fund, largely a result of revenue shortfalls from the Minerals Resource Rents Tax (MRRT). The Government also plans to save $44.3 million over 4 years from other cost savings on existing projects.

Finally, some of these projects also contain conditions around funding which may serve to frustrate the delivery of the funded projects. For example, the government's $3 billion pledge towards building the $8 billion Melbourne metro project is contingent on matching funding from the State government (investment in the Brisbane Cross River Rail also requires State funding support). The WestConnex investment is also subject to conditions including no new tolls to be applied to existing roads.

Brendan Lyon, CEO, IPA

The 2013 Budget saw the Government bring forward the second round of its Nation Building funding program, with a headline figure of $24 billion over five years.

The second phase of the Nation Building Program is timed to follow concurrently from the first phase of the program which finishes at the end of the 2013-14 Budget year. The first phase of the program totalled $36 billion over six years. Of the $24 billion of funding commitments included in the Nation Building Program, only around $13.5 billion is allocated in the forward estimates to 2016-17, with remaining funding falling outside the current Budget horizon.

The most substantial commitment is the funding for the F3-M2 project in Sydney. The Commonwealth's investment alongside the State has reportedly tipped the economic case to allow for the project's swift procurement and delivery. Greater clarity is expected on this project in the near future.

Headline projects to be funded under Nation Building phase two include:

- Melbourne Metro - $3 billion contingent on matched funding from the Victorian Government, flagged for delivery as an availability Public Private Partnership (PPP), with the Commonwealth Government also noting an additional provision to support future availability payments;
- Brisbane Cross River Rail - $715 million contingent on matched funding from the Queensland Government, flagged for delivery as a PPP, with the Commonwealth Government also noting an additional provision to support future availability payments;
- F3-M2 Motorway in Sydney - $400 million contingent on matched funding from the NSW Government and agreement on commercial terms with the private sector proponent;
- M4 and M5 Extensions/Upgrades (WestConnex) - $1.8 billion subject to conditions including that no new tolls are applied to existing roads and that the solution provides direct links to the CBD and Port Botany; and

- Queensland's Gateway Motorway upgrade being widened to six lanes between Nudgee Road and the Deagan Deviation - $718 million conditional on no new tolls being imposed.

On taxation, the Budget confirms the uplift allowance, preserving the real value of tax losses for investment in nationally significant infrastructure projects. The thin capitalisation regime is to be tightened by changing all safe harbour limits and extending a worldwide gearing test to inbound investors, subject to a Board of Taxation Review and industry consultation. The Budget also includes a range of measures to tighten the corporate tax base by targeting debt loading, dividend washing, exploration expenses and consolidated groups.

In-line with the Infrastructure Finance Working Group Report (IFWG), a new advisory function will be established within the Treasury to provide guidance on the most appropriate financing structures to bring large, complex infrastructure projects to market.

The Budget's commitment to co-fund availability payments for major projects, alongside the states, is a welcome announcement and a mature response to one of the key recommendations of the Infrastructure Finance Working Group's report.

While the infrastructure sector has done comparatively well compared to other portfolio areas, the second round of the Nation Building program is modest by comparison to the first phase, with much of the capital beyond the forward estimates, or containing conditions around funding which may serve to frustrate the delivery of the funded projects.

Analysis

While the 2013 Federal Budget makes some important project funding commitments, around half of the money is beyond the forward estimates.

The commitment to co-fund PPP availability payments for major transport projects is a welcome signal of a growing awareness among national policymakers that additional assistance is required to support state projects. The co-funding of availability payments was a key recommendation of the Infrastructure Finance Working Group's report, which was released to the Government last year.

The most immediate project outcome is likely to be the procurement of the F3-M2 motorway project in Sydney's north. The project, with matching capped commitments of $400 million from the Commonwealth and NSW Governments, with the balance of the circa $3- 4.2 billion project reportedly funded by Transurban through its unsolicited bid.

The Commonwealth's support has moved the needle on this project, which is a major missing link in Sydney's motorway network.

However, it is disappointing that there was no support for Melbourne's East West road link, a project that was recommended by Sir Rod Eddington and a consensus project for Melbourne's economy.

While industry (and everyone else) needs to be realistic about what is possible in the current economic environment, Canberra retains substantial capacity for additional funding within its AAA rating, estimated by Infrastructure Partnerships Australia at circa $140 billion.

No matter how well intentioned, business cannot bank funding commitments that are beyond the horizon of the Commonwealth's own budget strategy, nor can the nation's commuters and businesses enjoy the benefits that would flow from a greater level of national investment.

The commitments which rule out tolls on existing sections of Sydney's WestConnex and Queensland's Gateway North project should also be reconsidered. These projects are of a substantial scale and the Commonwealth's funding alone leaves a substantial gap.

On the WestConnex project, the Government has offered NSW 10 per cent of the project's cost, with conditions that leave the other 90 per cent effectively unfunded. This year, more than any other, shows that we need all funding options on the table if we are going to see more and better infrastructure delivered.

It is hard to understand the policy case against user contributions to these projects, a point that has been well expressed by Infrastructure Australia.

Nevertheless, the firm commitment of $13.5 billion is welcome, amid a very constrained budget context. Undoubtedly, business will also be closely watching the Opposition's address in reply to the Budget, on Thursday evening and will also be closely monitoring other policy and project announcements from both major parties in the lead up to September's election.

Important information

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