FEDERAL *Budget* 2016

What the Federal Budget means for Infrastructure

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FEDERAL BUDGET OVERVIEW

Our Group Economics view

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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 Government continues the $50bn investment in infrastructure that started in 2013-14 and ends in 2019-20.
- Western Sydney airport preparatory works will receive $115.1m over two years from 2016-17 for the Badgerys Creek site. Some $26.2m of this is for concept design of rail facilities. The bulk of remaining funding is for specialist advice and planning, site management and security and minor land acquisitions.
- In Western Australia (WA), $490m has been earmarked for the Forrestfield airport link that connects Perth's eastern suburbs to the city. This money was announced in April as a measure to maintain WA's GST share, and is now budgeted.
- The Budget allocates $43.8m over four years to establish the Commonwealth entity called Northern Australia Infrastructure Facility (NAIF), which will administer financing to major projects in northern Australia.
- The Government has committed up to $593.7m over three years from 2017-18 in additional equity to the Australian Rail Track Corporation (ARTC). The equity should assist purchase of land and other preconstruction activities for the Melbourne to Brisbane Inland Rail link. The funding is contingent on an equity funding agreement still to be developed between the Commonwealth and ARTC.
- A National Water infrastructure loan facility of $2bn in concessional loans will go to the states and territories for dams and pipelines over 10 years.
- Reallocation of $1.5bn in funds previously allocated to East-West Link to other Victorian infrastructure projects, including the Western Ring Road ($350m), Murray Basin Rail Project ($220m), rural and regional roads ($345m), urban congestion ($75m) and Melbourne Metro business case ($10m).
- Projects with funding already met from the Infrastructure Investment Program include Perth Freight link ($260m) and Ipswich Motorway ($200m).
- There are savings of $162.7m from uncommitted project contingency, of which the bulk ($150.4m) is achieved in 2019-20.

NAB's view

It's pleasing that the Government has continued to use the Budget to back the Budget Infrastructure program that began in 2013-14. Maintaining the opportunity for part funding via asset recycling is also welcome, also noting that state allocations have not yet been determined.

There is little extra funding allocated for infrastructure in this Budget. There is also a noticeable absence of new projects, and significant reallocation of existing money. Of the money reallocated or committed, $1.5bn was already provided to Victoria in East-West Link funding in 2014. The remainder is met from the Infrastructure Investment Program.

Industry reaction

With the bulk of project funding already allocated, there has been some criticism about a lack of new projects given pre-Budget discussion about urban commuter links to capital cities and costs of congestion.

Criticism was levelled at infrastructure spending that is still road heavy, and limits the potential for smart cities.

The Australian Logistics Council say that rail is critical to boosting Australia's supply chain and they support both the Murray basin and Inland Rail initiatives.

Infrastructure Partnerships Australia (IPA) was pleased to see that the previously allocated funding had been maintained. "The Turnbull Government's sensible funding to support major urban rail projects recognises the massive and growing congestion costs and commute times facing Australia's economy and households," said Brendan Lyon, Chief Executive IPA.

But IPA also called for a continuation of the government's asset recycling program beyond 30 June, noting that the Budget "shows that just a few billion in Commonwealth funding incentives to state governments has unlocked more than $20bn through asset recycling – demonstrating exactly how Canberra can play a more constructive role in infrastructure and economic growth. It's very welcome that the Budget has kept funding at record levels but the resounding success of the asset recycling incentive shows that this program needs to be extended for new state asset sales, beyond 30 June this year".