FEDERAL Budget 2017

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Federal Budget Overview

Our Group Economics View

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As expected, the centerpiece of this Budget is increased infrastructure spending, a new Housing Affordability plan, Gonski 2.0 and increased emphasis on the Operating Fiscal Balance (‘good’ versus ‘bad’ deficits). What was not expected was the new tax on banks liabilities—and at $6bn over the next four years it is not small. It is too early to say how banks will react.

On infrastructure, key elements include: the second Sydney Airport; the Melbourne to Brisbane rail freight line; Snowy Mountain funding; regional growth connectedness initiatives; and extra spending on hospitals. The package is valued at around $75bn over the next 10 years. For smaller business (up to turnover of $10m pa) the $20k instant write-off has been extended.

The Housing Affordability Package includes on the supply side: release of more Government land; tax incentives for private investment in affordable housing; establishing a new Government body to provide cheaper finance for community housing; a levy of $5k pa on vacant foreign owned housing; and seniors are allowed to transfer $90k into super from the sale of family homes to encourage downsizing. First home owners (FHOS) are now allowed to access voluntary contributions to super ($15k pa with a cap $30k) as a way of getting a deposit quicker. To the extent these measures are aimed at raising supply, they will clearly help—it is less obvious that boosting FHOS’s ability to build a deposit will do anything other than add to house price pressures.

Elsewhere, the Government has given up on ‘zombie’ measures of over $13bn currently stalled in the Senate. New initiatives in this space include Gonski 2.0 (an extra $18.6bn in school funding over the next decade) on a needs-based model; a university fee hike of 7.5%; higher repayments on government education loans; and a 2.5% efficiency dividend on universities.

The Health package includes the phased unfreezing of Medicare rebates for doctor visits and reduced costs for medicines. NDIS is now fully funded via a Medicare levy increase of 0.5% to 2.5% in mid-2019.

There is now going to be a one-stop shop for bank complaints and registration of senior bank executives and possible deregistration together with large fines for bad behaviour.

The government is emphasising the Net Operating Balance—effectively the Underlying Cash Balance less net investment on the government’s balance sheet—which returns to surplus a year earlier in 2019-20. We have no objection to separating government debt into ‘business as usual’ spending from ‘productivity enhancing investments’.

The key of course is whether the investment really is ‘productivity enhancing’. That said, all debt has to be repaid. We (and the rating agencies) will continue to focus on the Underlying Cash Balance. In the ‘Medium Term Economic Outlook’, our view is that the Budget implies a further slight drag on growth near-term but a sharp drag thereafter.

We are much more cautious on 2018-19 forecasts and beyond. The economy in our view will be running nearer 2.5% than 3%+ by then. And we are very sceptical about the wages forecasts—and hence nominal GDP estimates. As such, we don’t believe the medium term fiscal projections—and hence the credibility of the fiscal profile. This Budget will be popular, but from an economic perspective, if it looks too good to be true, it probably is.

Fiscal outcome

The underlying cash deficit is expected to fall from $37.6bn to $29.4bn in 2017-18, then rapidly improves to $2.5bn in 2019-20—and achieves a surplus of $7.4bn in 2020-21. The Net Operating Balance, is however, expected to fall more aggressively (as extra government investment kicks in) to around $10.8bn in 2018-19 and achieves balance a year earlier in 2019-20.

Economic outlook

There is little fundamental difference between Treasury’s and NAB’s economic forecasts in 2017-18—both around 3%. From slow start in H1 2017 the economy will accelerate as lagged effects of higher commodity prices flow through to profits, LNG export volumes accelerate and the construction (apartment) cycle peaks. That said, domestic demand remains subdued. NAB’s forecasts are notably more pessimistic as we move into the forward projections (from 2018-19) as near term positives start to unwind and the construction cycle turns down. Our expectations for the unemployment rate are similar, stabilising around 5.75% in the near-term before edging lower to 5.5% in the out years. We forecast nominal GDP growth of 3.3% in 2018-19 (the Government has 4%). The Government’s nominal GDP numbers then accelerate further—heightening our skepticism. The Government’s wages growth forecasts in particular, of 3% in 2018-19 and up to 3.75% by 2020-21, appear very optimistic.

Financial markets

There was little discernable market reaction to the Budget. That said, banks suffered as news of the new tax leaked out earlier in the day. Ratings agencies will clearly be looking at the underlying cash balance projections and their sustainability. It is equally unclear how they will see the new bank tax and what it means for growth and risk.
KEY INITIATIVES & NAB’S VIEW

There are a wide range of initiatives in this year’s Federal Budget. We’ve broken it down for businesses by sector – and here’s a helpful overview of what’s most important.

Small businesses – key initiatives

• The $20,000 asset immediate write-off is to be extended for another 12 months and will now end in June 2018, after which Treasury says the threshold for immediate deductibility will revert back to $1,000.

• A National partnership on Regulatory Reform will allocate $300m over two years from 2017/18 to States and Territories that remove unnecessary regulatory barriers and restrictions on competition, with a particular focus on regulatory reform that benefits small business.

• A levy on employers hiring foreign workers on certain skilled visas will finance a new Skilling Australians Fund. Around $1.5bn will be spent over four years from 2017/18 in training that prioritises apprenticeships and traineeships for occupations in high demand, growth sectors, occupations with high reliance on skilled migrants and to focus on training in regional and rural areas. The program should support 300,000 people in training over four years.

NAB’s view

• Although it has only been able to get tax cuts for businesses with turnover up to $50m through the Senate so far, the Government remains committed to the comprehensive business tax cuts outlined in last year’s Budget.

• While business should be pleased with the progress that has been made in lowering taxes and increasing the number of businesses eligible for concessional taxes, there is still plenty of unfinished business to fill out an ongoing reform agenda.

• The multiplicity of turnover thresholds governing just who can access certain small business tax concessions looks set to remain a source of complexity and contention. We can expect the issue to return next year.

• The absence of any mention of payment times and practices disappointed some business leaders, but the Budget may not be the best place to consider how to respond to the Small Business Ombudsman’s report on existing payment arrangements.

Health – key initiatives

• The Medicare levy will be increased from 2.0% to 2.5% of taxable income from July 2019, raising an additional $8.2bn over the forward estimate period.

• The National Disability Insurance Scheme (NDIS) will be a major recipient of this additional revenue. In total, the NDIS will receive $9.1bn in 2019-20 and 2020-21 to ensure it is fully funded.

• The government will unfreeze Medicare Benefits Schedule (MBS) indexation, phased over coming years. Bulk billing GPs will receive indexation from July 2017, all other GPs and specialist consultations from July 2018, specialist procedures and allied health practitioners from July 2019 and certain diagnostic imaging from July 2020. This measure will cost $1.0bn over four years.

• A new five-year agreement with Medicines Australia will produce cost savings for the Pharmaceutical Benefits Scheme (PBS). This includes a series of agreed price reductions on a range of medicines, with total savings of $1.8bn over five years.

• Community pharmacies will receive an additional $225m over three years to compensate for lower than forecast prescription volumes and the impact of price reduction policies.

NAB’s view

• The healthcare industry should be seen as a major beneficiary of this budget – with the government providing a more stable environment for the sector than has been the case in the recent past.

• The phased resumption of indexation for Medicare Benefit Schedule services reduces uncertainty for healthcare providers, and provides a stronger platform for business planning. Lifting the freeze should also provide benefits for patients.

• Healthcare budget measures remain focused on the short term. With an ageing population, more people are visiting the doctor more often and their conditions are increasingly chronic in nature. As a result, the demands upon GPs to help these patients manage their conditions have also risen. The budget also lacks investment in preventative health – which could also generate substantial savings; by reducing the need for more expensive care.

• A modern healthcare sector must embrace innovative technology and digital solutions complimented by a shift in the public mindset focusing on preventative initiatives.
KEY INITIATIVES & NAB’S VIEW

Education – key initiatives

• **Universities** will pay a 2.5% efficiency dividend in 2018 and 2019. They will also be subject to measures to ensure greater transparency and accountability.

• Increased fees will be phased in from 2018 to 2021, with a 1.8% rise in each year lifting to a 7.5% increase by 2021. This means that the share of fees paid by students will rise from 42% to 46%, with the Government’s contribution falling from 58% to 54%.

• Commencing July 2018, the compulsory HELP repayment threshold will be set at $42,000 (from the current $55,000), with a 1% repayment rate rising to 10% when income rises to $119,882 and above.

• The Government expects to save $2.8bn over three years from these measures.

• For **schools**, the Government will provide an additional $18.6bn in funding in the next 10 years.

• All school sectors will receive more funding, with average increases of around 4.1% per student across Australia. From 2018 to 2027, funding will grow at an average annual per-student rate of 5.1% for government schools, 3.5% for Catholic schools and 4.1% for independent schools.

• Funding for schools will be distributed through a needs-based funding model, and will include a base amount for all students with loadings to address disadvantage.

NAB’s view

• Additional funding measures will benefit the schools sector as a whole, but some will benefit more than others. Under the ‘fairer schools funding model’, lower fee independent and government schools – especially in currently under-funded states such as NSW, VIC and QLD – look to be the big winners. Catholic schools face a challenge to their traditional funding model (“system weighted average”) as the Government implements an integrated funding model for all schools regardless of system.

• The Government estimates that about 4,500 schools will receive a funding boost of about 5% pa. In contrast, approximately 353 schools are expected to experience a funding loss in real terms.

• In the tertiary sector, universities are facing funding cuts of around $2.8bn in the next three years, while students will be facing higher payment burdens.

Agribusiness – key initiatives

• The 2017-18 Budget provides a number of new measures for agriculture, although by far the biggest of these is the $8.4bn announcement to build the Inland Rail project—a mix of new and upgraded railway stretching from Melbourne to Brisbane. This investment should fully fund the project, previously estimated to cost around $10b (earlier budgets have allocated over $1bn to the project). The project will commence construction in 2017-18.

• The Government will provide $28.5m to establish the Regional Investment Corporation (RIC) to administer $4bn in concessional loans (already budgeted), including the $2bn National Water Infrastructure Loan Facility and the $2bn Farm Business Concessional Loan Scheme.

• The Regional Growth Fund (RGF) will invest $472m over the forward estimates in regional infrastructure projects. This includes $272m for grants and $200m to the Building Better Regions Fund.

• Landcare will see more certainty in its funding levels, although previous cuts will not be fully restored.

NAB’s view

• The Inland Rail project is clearly the major feature of this budget for the agriculture sector. The contribution exceeds expectations—rumours prior to Budget were based on around $1bn of funding being forthcoming, but the Budget sees $8.4bn committed, enough to build the whole project.

• Inland Rail will cut freight journey times from Melbourne to Brisbane with a more direct route (bypassing Sydney) and higher line speeds, improve efficiency with double stacking and higher axle loadings and provide much improved supply chains for parts of inland NSW.

• Farmers will be among biggest beneficiaries of the project, giving grain growers (and other agricultural sectors) greatly expanded options for getting their freight to port efficiently, cheaply and quickly. The project’s proximity to Toowoomba’s Wellcamp Airport will also expand air freight connections.
KEY INITIATIVES & NAB’S VIEW

Infrastructure – key initiatives

• Overall, the Budget includes a headline $70bn figure for infrastructure investment from 2013-14 to 2020-21 (up from $50bn last year).
• The Commonwealth will make a $5.2bn equity investment in WSA Co (a government-owned company) to build the first stage of the Western Sydney Airport at Badgerys Creek. The airport is expected to be completed by 2026 (first stage).
• An equity investment of $8.4bn in the Australian Rail Track Corporation (ARTC) to build the Inland Rail project a mix of new and upgraded railway stretching from Melbourne to Brisbane. The project will commence construction in 2017-18.
• The Commonwealth has announced its commitment to a 50% increase in its generation capacity of the Snowy Mountains Hydroelectric Scheme.
• $1bn to fund infrastructure in Victoria, including $500m over three years from 2017-18 for regional rail, including the Geelong, Gippsland and North East lines. The remainder will be spent on projects agreed with the Victorian government.
• A $1.6bn Western Australian infrastructure package, including a number of road upgrades for Perth and regional WA as well as the Perth Metronet project. $1.2bn of this funding was previously earmarked for the cancelled Perth Freight Link project.

Housing – key initiatives

• Direct assistance for first home buyers by allowing voluntary superannuation contributions of up $15,000 per year (capped at $30,000) to be withdrawn for a deposit, along with associated deemed earnings. Withdrawals will only be allowed from 1 July 2018. Couples can both use the scheme and combine their savings for a deposit. Contributions and earnings will be taxed at 15% (rather than marginal tax rates) and withdrawals taxed at the individual marginal tax rate less a 30% offset.
• Older Australians (65 and over) will be allowed to contribute downsizing funds into superannuation (up to $300k, in addition to contributions permitted under existing rules and caps). Only applicable to principal residence owned for 10 or more years.
• Additional supply side measures including: working with the states regarding supply targets and zoning reform; a $1bn National Housing Infrastructure Facility to work with states and territories to fund deals with local governments to remove infrastructure impediments to developing new homes and apartments on selected sites; and releasing Commonwealth government land.
• New rules for foreign investors including: ownership in new developments limited to a maximum of 50% for foreign developers; and an annual foreign investment levy of at least $5,000 on all future foreign investors who fail to either occupy or lease their property for at least six months each year.
• Social/affordable housing measures including replacing the existing National Affordable Housing Agreement with a new National Housing and Homelessness Agreement with an additional $375m of Commonwealth funding. This will be worked out with the states. In addition, establishment of a National Housing Finance and Investment Corporation (NHFIC) to operate as an affordable housing bond aggregator. Finally, tax incentives for private investment in community housing.

NAB’s view

• This Budget represents a departure from recent history, with new funding for major projects delivered through the injection of new equity rather than simply grants to the states for road and rail. Given strong population growth and deferred spending in many areas (especially rail), more spending is very welcome indeed.
• The nature of projects being funded by the Commonwealth also represents a significant change. The decision to directly build the second Sydney airport is a radical departure from earlier policy, which saw airports privatised.
• The additional equity funding for Snowy Hydro likewise represents a major change. Since the creation of the National Electricity Market in the 1990s, Australian governments have moved away from being directly involved with the ownership and operation of the electricity system.
• The move towards a 10-year cycle for infrastructure planning and spending should provide better guidance for planning and delivery of projects. The $10bn National Rail Program has the potential to provide greatly improved rail infrastructure for Australia’s cities – benefitting road and rail users alike.

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