Bank of Melbourne

Tuesday, 2 April 2019

Budget 2019-20 – Back in Black

Well I'm back, back

Well I'm back in black

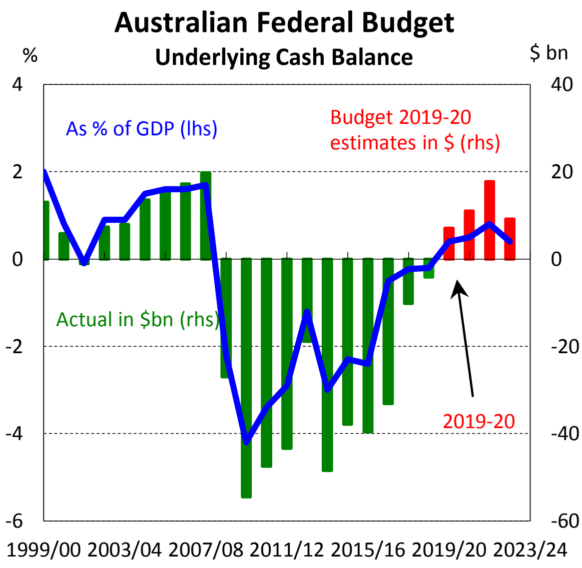
Yes I'm back in black

- **The Federal government expects to deliver the first budget surplus in 12 years in 2019/20. A surplus of $7.1 billion (0.4% of GDP) is expected, which is well up on the previous estimate.**
- **Surpluses are also forecast for the out years, totalling $45 billion over the period to 2022/23.**
- **Personal income tax cuts are a key feature of this year's Budget.**
- **Infrastructure spending remained another dominant theme.**
- **The main initiative for small and medium businesses was the increase, extension and widening of the instant asset write-off.**
- **With an election around the corner, the response from the Labor Party on April 4 will garner more attention than usual.**

The Federal government expects to deliver the first budget surplus in 12 years in 2019/20.

A surplus of $7.1 billion is now expected for 2019/20, which is well up on the previous estimate of $4.1 billion made in December 2018. A budget deficit is still expected for 2018/19, although it has improved from an estimated deficit of $5.2 billion in December 2018 to $4.2 billion in this budget.

AC/DC became famous with its album Back in Black in the 1980s. With an election campaign imminent, we expect a lot of airplay from Treasurer Frydenberg on being "back in black".



The budget is forecast to move back in the black while lifting spending on infrastructure and implementing further cuts to personal income taxes. Both of these plans will help foster growth in the economy by encouraging consumers and businesses to spend more.

The Australian economy has experienced a loss of momentum from the second half of last year. So the stimulus in this budget is welcome and should help foster growth in the economy.

Budget Outcomes

The Government forecasts an underlying surplus of $7.1 billion (0.4% of GDP) in 2019-20. It is $3.0 billion higher than the previous estimate contained in the Mid-Year Economic and Fiscal Outlook (MYEFO). It will be the first surplus in 12 years (i.e. since the GFC in 2007/08).

The projected surpluses increase to $11 billion 2020/21 and $17.8 billion in 2021/22, before easing to $9.2 billion in 2022/23. Across the 4 years to 2021/22, the Federal government is forecasting $45 billion worth of surpluses.

The government is projecting to meet its budget repair target of a surplus of at least 1% of GDP with budget surpluses expected to surpass 1% of GDP from 2026/27.

The government's bottom line has been boosted by strong tax revenue growth and restraint in expenditure. Higher-than-expected commodity prices contributed to higher company profits, delivering company tax revenue to the government. Moreover, jobs growth has been solid and inflation has been softer than expected, which has helped restrain expenditures.

The improved bottom line has paved the way for further tax cuts and another ramp up in infrastructure spending.

The plan to cut personal income tax cuts was the centrepiece in last year's budget and again features heavily this year.

Last year, the government announced a three-step plan for reducing personal income taxes. Tonight, there are a further two changes that involved doubling the tax offset and changing thresholds and tax rates over the longer term.

Infrastructure continued to feature heavily in the Budget. Spending on infrastructure is a pillar of support for the economy, helping both households and businesses by supporting economic activity and jobs growth.

Net debt is estimated to fall from 19.2% of GDP in 2018-19 to 18.0% of GDP in 2019-20 and continue to fall and be eradicated by 2029-30, as the economy moves further into surplus and net debt gets paid down.

Credit Rating

Australia remains in an elite club of nations with a sovereign credit rating of AAA. Ratings agency Standard & Poor's (S&P) raised Australia's credit rating outlook from negative to stable in September 2018, which suggests Australia's sovereign credit rating is unlikely to be downgraded any time soon.

A confirmation that the Budget is expected to return to surplus would ensure that Australia should keep its top rating.

Economic Forecasts in the Budget

Whether the Budget projections will be achieved over the forecast periods depend critically on the key economic assumptions.

The government expects real GDP growth of 2.75% in 2019-20 and again in 2020-21. A lift in growth to 3% is expected in the following year. Our forecasts for GDP growth are lower than this, especially in the next 2 years. The drivers of growth include strong public spending, rising business investment, higher exports and an improvement in consumer spending. A downturn in dwelling investment will offset some of these growth drivers.

This optimism is partly because the government sees consumers as more resilient than we do in the face of high household debt and a deepening housing downturn. The government did flag the risk that house prices "could constrain household spending amid high levels of household debt". The tax cut measures announced tonight could help underpin household consumption, although it is not likely to be enough offset to other negative factors.

The budget projects dwelling investment to record a material 7% drop in 2019/20 with a further 4% decline in 2020/21.

The government remains confident about the outlook for business investment with solid growth expected to continue across non-mining sectors.

The government has downgraded its forecasts for wages growth in 2019/20 and 2020/21 (from 3.00% in December 2018 to 2.75% and 3.50% to 3.25%, respectively). These are less ambitious than in past years and more realistic.

The other key economic forecasts in the Budget appear reasonable. However, some forecasts are subject to considerable volatility, especially commodity prices. In terms of commodity prices, the budget appears cautious; iron ore prices are projected to track back to US$55/t (fob) by March 2020 and coking coal prices back from around US$200/t to US$150/t over the same period.

Inflation rates are expected to get back into the Reserve Bank's 2-3% target band by mid 2020 and reach the middle of the band in mid 2021.

Budget Aggregates and Major Economic Parameters

	Actual	Estimates		Projections		
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Total(a)
Underlying cash balance ($b)(b)	-10.1	-4.2	7.1	11.0	17.8	9.2	45.0
Per cent of GDP	-0.5	-0.2	0.4	0.5	0.8	0.4	
Net operating balance ($b)	-4.0	8.5	12.9	18.2	28.8	20.6	80.4
Per cent of GDP	-0.2	0.4	0.6	0.9	1.3	0.9	

(a) Total is equal to the sum of amounts from 2019-20 to 2022-23. (b) Excludes expected net Future Fund earnings before 2020-21.

	Outcomes		Forecasts		Projections	
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Real GDP	2.8	2 1/4	2 3/4	2 3/4	3	3
Employment	2.7	2	1 3/4	1 3/4	1 1/2	1 1/2
Unemployment rate	5.4	5	5	5	5	5
Consumer price index	2.1	1 1/2	2 1/4	2 1/2	2 1/2	2 1/2
Wage price index	2.1	2 1/2	2 3/4	3 1/4	3 1/2	3 1/2
Nominal GDP	4.7	5	3 1/4	3 3/4	4 1/2	4 1/2

(c) Year-average growth unless otherwise stated. From 2017-18 to 2020-21, employment and the wage price index are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter. The consumer price index is through-the-year growth to the June quarter.
Source: ABS cat. no. 5206.0, 6202.0, 6345.0, 6401.0 and Treasury.

What Does the Budget Mean for Households?

Despite strong employment growth, consumers have been under pressure due to low wages growth, the slowdown in the housing market and high levels of household debt. The improved starting position for the Budget has allowed the government to provide a boost to households while returning to a Budget surplus in 2019-20.

Personal Income Tax Cuts

A key measure for households was an increase in the Low and Middle Income Tax Offset, while tax cuts will also benefit consumers.

(July 2018) Increase Low and Middle Income Tax Offset

- Maximum benefit increased to $1,080 from $530. Base amount raised to $255, from $200.
- Base of $255 for incomes ≤$37,000 and gradually rises to $1,080 for incomes to ≤$48,000. Gradually phases out for incomes from $90,001 to $125,333.
- The Low and Middle Income Tax Offset will be received on assessment after individuals lodge their tax returns for the 2018-19, 2019-20, 2020-21 and 2021-22 income years.

(July 2022) Change threshold on 19% tax bracket and increase Low Income Tax Offset

- Top income threshold of 19% tax bracket increased to $45,000, from legislated $41,000 (currently $37,000).
- Low Income Tax Offset maximum benefit increased to $700, from the legislated $645 (currently $445).
- Withdrawn at rate of 5¢ per $1 between incomes of $37,500 and $45,000, instead of the legislated 6.5¢ per $1 between incomes of $37,500 and $41,000. Phased out from $45,000 to $66,667.

(July 2024) Change structure of tax brackets

- Reduce the 32.5% marginal tax rate to 30%.

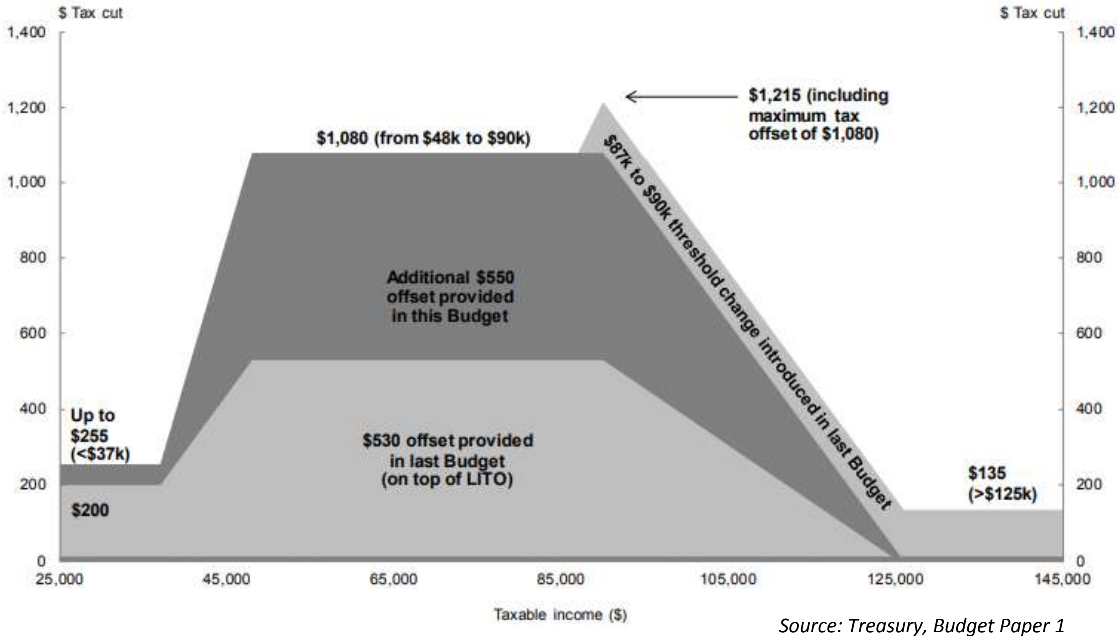
New Personal Tax Rates and Thresholds

Rate (%)	2017-18 tax thresholds Income range ($)	Current tax thresholds From 1 July 2018 Income range ($)	New tax thresholds From 1 July 2018 Income range ($)	New tax thresholds From 1 July 2022 Income range ($)
Tax free	0 - 18,200	0 - 18,200	0 - 18,200	0 - 18,200
19	18,201 - 37,000	18,201 - 37,000	18,201 - 37,000	18,201 - 45,000
32.5	37,001 - 87,000	37,001 - 90,000	37,001 - 90,000	45,001 - 120,000
37	87,001 - 180,000	90,001 - 180,000	90,001 - 180,000	120,001 - 180,000
45	>180,000	>180,000	>180,000	>180,000
Low and middle income tax offset	-	Up to 530	Up to 1,080	-
LITO	Up to 445	Up to 445	Up to 445	Up to 700

Rate (%) From 1 July 2024	New tax thresholds From 1 July 2024 Income range ($)
Tax free	0 - 18,200
19	18,201 - 45,000
30	45,001 - 200,000
45	>200,000
LITO	Up to 700

Source: Treasury, Budget Paper 1

Annual Tax Relief 2018-19 to 2021-22 From The Enhanced Plan



Source: Treasury, Budget Paper 1

The Budget includes a one-off Energy Assistance Payment for over 3.9 million welfare recipients, including age pensioners, people on the Disability Support Pension, veterans, carers and single parents. Single people will receive a cash payment of $75 and couples $125, to assist with energy bills, at a cost of $284 million to the Budget.

Older Australians

Australians aged 65 and 66 years old will be able to make voluntary contributions to their superannuation without having to meet a work test from 1 July 2020. Currently people aged 65 years and older had to satisfy a work test of a minimum of 40 hours over a 30-day period in the financial year.

Medicare Levy

The Medicare levy low-income thresholds for singles, families, and seniors and pensioners have increased at a cost of $250 million over the four years to 2022-23.

What Does the Budget Mean for Businesses?

Businesses were not left out in this Budget's cash splash. The focus was on measures for small businesses.

The small business instant tax write-off threshold for eligible assets has been lifted to $30k, up from $20k last year and $25k announced on 29 January.

It is also expanding the access to the write-off to include more businesses by allowing those with turnover of up to $50 million to access the write-off, up from businesses with turnover of up to $10 million. The expanded eligibility applies from now until 30 June 2020.

Moreover, the government's scheduled cut to the tax rate to 25% for businesses with aggregated annual turnover below $50 million has been brought forward by 5 years to 2021-22.

In August last year, the Coalition government abandoned its commitment to cut the company tax rate to 25% for all companies, and was only able to pass the legislation for companies with $50 million turnover or below.

Other measures that affect businesses include a new skills package to invest $525.3 million in vocational education and training. It is aimed to help up to 80,000 additional apprentices over the next 5 years by giving apprenticeship incentives in occupations facing shortages of skilled workers.

For farmers and regional areas, there is $6.3 billion of assistance and concessional loans for those affected by drought and $3.3 billion to support those impacted by flood.

On energy, there will be $50 million in grants to eligible businesses and community organisations to encourage energy efficiencies.

For exporters, there will be $60 million in funding over three years for the Export Market Developments Grants scheme which benefits small and medium enterprise exporters.

In recent years, the large amount of public infrastructure spending has had positive flow-on effects to businesses. The ongoing commitment to provide significant funding for further infrastructure suggests that this boost for business activity will continue.

These measures are encouraging for businesses at a time when the global economy appears more uncertain and business confidence and conditions have fallen.

Other Key Budget Initiatives

Infrastructure:

The Government will provide $100 billion in infrastructure funding over the next decade.

New commitments include:

- $6.1 billion in **New South Wales**, including:
    - $1.6 billion for the M1 Pacific Motorway Extension to Raymond Terrace
    - $400 million to upgrade the Newell Highway.
- $2.8 billion for **Victoria**, including:
    - $1.1 billion for upgrades of south eastern and northern suburban roads.
    - $700 million for a rail upgrade from South Geelong to Waurn Ponds.
- $2.6 billion for **Queensland** including:
    - $800 million for upgrades to the Gateway Motorway between Bracken Ridge and Pine River.
    - $500 million to ease congestion and improve safety on the M1 from Daisy Hill to the Logan Motorway.
- $1.8 billion in **South Australia**, including $1.5 billion for North-South Road Corridor projects
- $933 million in **Western Australia**, including the Tonkin Highway upgrades and the Albany

Ring Road.

- $68 million in **Tasmania** for the Tasmanian Freight Rail Revitalisation Program.
- $50 million for projects in **Australian Capital Territory** and also a $30 million upgrade of the Kings Highway benefiting the ACT and NSW.
- $60 million in the **Northern Territory** for Tiwi Island Road upgrades.

There are also additional commitments for fast rail projects across NSW, Victoria and Queensland, including $2 billion for a fast rail connection between Geelong and Melbourne.

Further funding is available for:

- The Urban Congestion Fund (extra $3 billion),
- The Local and State Government Road Safety Package ($2.2 billion) and
- Investment in strategic corridors, associated feeder roads and other rural roads across the country ($1 billion).

<u>Migration:</u>

Permanent migrant intake will be cut to 160,000 a year from 190,000 a year for four years from 2019-20. The budget also includes measures to encourage new migrants to move into regional areas, including 2 new regional visas.

<u>Health:</u>

The Strengthening Primary Care package worth $1.1 billion over 4 years includes a $448 million increase in funding to enhance GP care and services to high-need patients and $187 million to increase patient rebates. Other measures include:

- $461 million for youth mental health, including 30 new headspace centres.
- $309 million for diagnostic imaging services.
- $100 million for a comprehensive children’s cancer centre at Sydney Children’s Hospital.
- $60 million for the James Cook University Tropical Enterprise Centre.
- $56 million for research into type 1 diabetes.

<u>Medicare:</u>

The indexation of all remaining GP services items on the Medicare Benefits Schedule (MBS) will be brought forward to 1 July 2019. The freeze on some ultrasound and X-ray diagnostic imaging item MBS rebates will also be lifted from 1 July 2020.

<u>Domestic Violence:</u>

Includes $78 million to provide more housing for women and children fleeing family violence and $82 million to improve and build on frontline services to keep women and children safe. Prevention initiatives worth $68 million will be funded and $64 million for national sexual assault, domestic violence counselling service. $35 million is budgeted for support and prevention strategies for Aboriginal and Torres Strait Islander people.

<u>Financial Regulation:</u>

Post the Royal Commission the budget is providing funding of $600 million for regulators ASIC and

APRA to implement recommendations.

Environment:

A $2 billion Climate Solutions Fund is to replace the Emissions Reduction Fund. In the outer years the budget includes a $1.4 billion capital injection for Snowy Hydro 2.0 and $50.4 million to support feasibility studies into micro-grids in regional and remote communities. A new interconnector between Tasmania and Victoria under the Battery of the Nation/Marinus Link projects is worth $56 million. Funding of $137 million is budgeted for Practical Environment Restoration to support Australia's natural environment. A program to underwrite investment in new generation via a shortlist of 12 projects representing a combined capacity of 3,818 MW, around 7% of the National Electricity Market.

Aged Care:

The More Choices for a Long Life programme worth $679.4 million over 4 years will include $282.4 million to support older Australians who wish to stay at home for longer and extend the Commonwealth Home Support Programme for home support services, like Meals on Wheels.

The budget includes a $320 million general subsidy boost in 2018-19 for residential aged care and 13,500 new residential care places. There is also funding of $282.4 million over five years from 2018-19 for 10,000 more home-care packages.

Education:

The budget provides $453 million to end 2020–21 to extend the National Partnership Agreement on Universal Access to Early Childhood Education for children to attend 15 hours of preschool each week in 2020 before starting school in 2021. The Destination Australia Program provides scholarships for students to study at a regional campus of a university or vocational education training provider at a cost of $93.7 million over 4 years from 2019-20.

What has been the Labor Party's Response?

With an election around the corner, the response from the Labor Party will garner more attention than usual. Indeed, if the Labor Party wins the next election, a second budget this year could be handed down.

In the spotlight is Labor's proposal to limit negative gearing to only newly-constructed homes and existing investment properties and to halve the capital gains tax discount. These changes are slated to take effect on 1 January 2020 if Labor wins the next election.

Other measures announced include tax breaks for institutional investors such as superfunds for building new rental properties by halving the current 30% managed investment trust withholding tax rate.

Another policy of significance is Labor's climate change policy, which involves a higher emissions reduction target of 45% by 2030. It proposes to increase energy sourced from renewables, encourage use of electric vehicles and bring down industrial pollution.

It has been reported that Labor will support the one-off cash payments to households and is likely to support the measures benefiting low to middle-income households.

The Labor Party is due to deliver its formal response to the Budget on Thursday, April 4.

Footnote:
"Back In Black" is the title track off of AC/DC's first album with Brian Johnson. This album is the band's most popular one being sold more than 40 million copies. This song was AC/DC's tribute to their former singer Bon Scott who died five month earlier written by the new vocalist Brian Johnson.
This song was also the first one that Nirvana's Kurt Cobain learned to play when he was 14 years old and got a guitar as a birthday present.

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