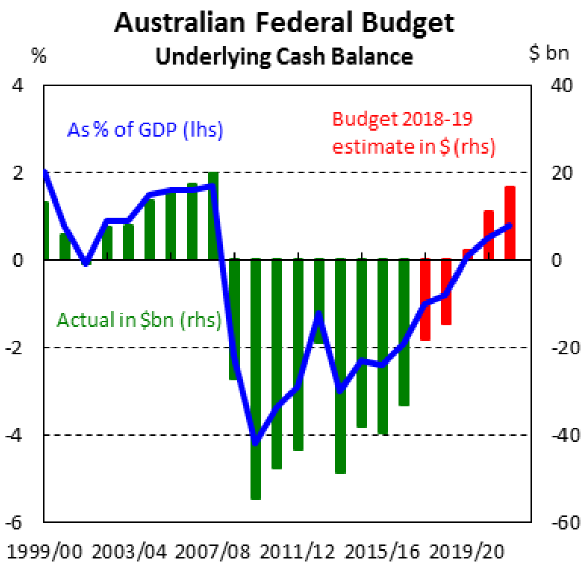
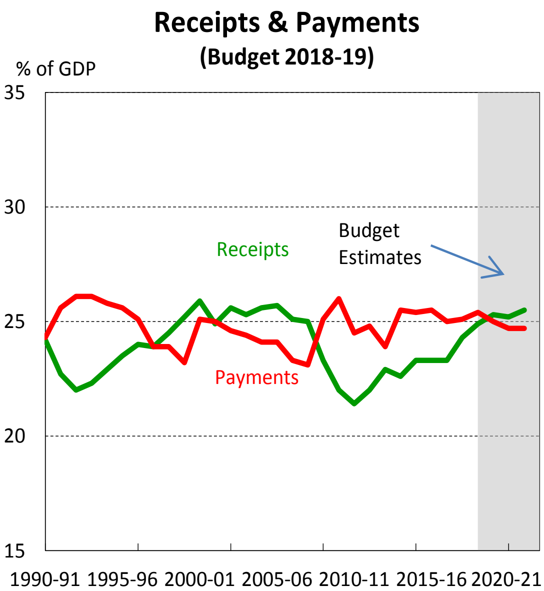
Budget 2018-19 - Economy Steals the Show

- **There are improvements to the bottom-line, driven by very strong revenue growth.**
- **The Budget is forecast to be back in the black a year earlier – in 2019/20.**
- **Personal income tax cuts are the centrepiece of this year's Budget.**
- **Infrastructure spending remained a dominant theme.**





Budget Outcomes

The Government forecasts an underlying deficit of $14.5 billion (-0.8% of GDP) in 2018-19. It is $6.0 billion better than the previous estimates contained in the Mid-Year Economic and Fiscal Outlook (MYEFO). Further, it will be the smallest deficit since the global financial crisis (GFC).

The forecasts for the underlying Budget balances to 2020-21 have also improved. Across the four years, the improvement total $11.0 billion from the previous estimate.

Moreover, the Budget is now expected to be back in the black one year earlier – in 2019-20.

The economy was the star of the show tonight. The government's bottom line was boosted by strong tax revenue growth due to stronger economic activity. The stronger-than-expected domestic and global economy boosted commodity prices, jobs and company profits. Higher tax receipts for the government coffers were the end result. More Australian companies ran out of tax-deductible losses from the 2008 GFC, causing them to pay more company tax.

Revenues grew by 9.7% in 2017/18, which is the strongest increase in seventeen years.

The higher revenues flowing to the government have paved the way for tax cuts. The plan to cut personal income tax cuts was the centrepiece in this year's budget.

The tax cuts are about helping to protect against bracket creep and also are likely to have voters top of mind with a Federal election due by 19 May 2019.

The tax cuts should help consumer confidence and spending. But the reform happens over quite a long time of seven years; we could see three elections in this time.

As the tax cuts will be phased in over a period of time, the cost in the earlier years is limited, helping ensure the Budget returns to surplus in 2019-20.

The government has prioritised income tax cuts over larger surpluses over the medium term, shelving a prior Coalition government commitment to deliver surpluses equivalent to 1% of GDP.

The tax cuts also help to ensure that taxes do not rise above the "self-imposed" cap of 23.9% of GDP.

Infrastructure remained an ongoing big part of 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 rise from 18.3% of GDP in 2016-17 to a peak of 18.6% of GDP in 2017-18.

Credit Rating

Australia is in an elite club of nations with a sovereign credit rating of AAA. This rating has been in danger ever since S&P attached a negative outlook to Australia in July 2016, suggesting a downgrade remains a possibility.

Tonight's Budget should give ratings agencies a degree of comfort, ensuring no change to the ratings. It should be noted that in mid 2017, S&P added the Sydney and Melbourne housing markets to its list of concerns.

Economic Forecasts in the Budget

In 2017-18, the Australian economy has performed better than anticipating, underpinning the better Budget position.

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

The largest single tax is on wage and salary earners and the wages assumptions stand out as the most optimistic economic assumption underlying the budget projections. We believe there is a risk wages could fall short of Treasury's forecasts.

Wages growth has been subdued, despite strong jobs growth. The latest data showed the wage price index grew near a record low pace of 2.1% in the December quarter.

The government is projecting a lift in wages growth to 2.25% in 2017-18, which could be within reach. But then Treasury expects wages growth to rise by 2.75% in 2018-19 and 3.25% in 2019-20 and 3.50% in 2020-21. The wage forecasts from 2018-19 may not come to fruition.

The other key economic forecasts in the Budget appear reasonable. However, some forecasts are subject to considerable volatility, especially commodity prices. It means there is some uncertainty attached to the forecasts for the terms of trade and nominal GDP outlook.

	Actual		Estimates		Projections		
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	Total (a)
Underlying cash balance ($b)(b)	**-33.2**	**-18.2**	**-14.5**	**2.2**	**11.0**	**16.6**	**15.3**
Per cent of GDP	-1.9	-1.0	-0.8	0.1	0.5	0.8	
Net operating balance ($b)	**-32.1**	**-12.6**	**-2.4**	**8.6**	**19.6**	**27.4**	**53.2**
Per cent of GDP	-1.8	-0.7	-0.1	0.4	0.9	1.3	

(a) Total is equal to the sum of amounts from 2018-19 to 2021-22.

(b) Excludes expected net Future Fund earnings before 2020-21.

	Outcomes		Forecasts		Projections	
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Real GDP	2.1	2 3/4	3	3	3	3
Employment	1.9	2 3/4	1 1/2	1 1/2	1 1/4	1 1/4
Unemployment rate	5.6	5 1/2	5 1/4	5 1/4	5 1/4	5
Consumer price index	1.9	2	2 1/4	2 1/2	2 1/2	2 1/2
Wage price index	1.9	2 1/4	2 3/4	3 1/4	3 1/2	3 1/2
Nominal GDP	5.9	4 1/4	3 3/4	4 3/4	4 1/2	4 1/2

(c) Year average growth unless otherwise stated. From 2016-17 to 2019-20, 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.

What Does the Budget Mean for Households?

Consumers received tax cuts and the plan to lift the Medicare levy was scrapped, delivering what should be a boost to consumer confidence and household budgets.

Personal Income Tax Cuts

There is a planned shake up of the personal income tax system. These tax cuts will help address bracket creep. Bracket creep is where inflation pushes people into higher tax brackets.

Tax cuts will be phased in over a period of time, limiting the cost in the earlier years. Over the forward estimates period of 2018-19 to 2021-22, the Personal Income Tax Plan will reduce tax receipts by $13.4 billion. Media reports indicate Treasurer Morrison confirmed that the personal income tax cuts would cost $140 billion over ten years.

The tax cuts are not “mammoth” over the Budget forward estimates period, but beyond this period the size of the tax cuts jumps sharply.

Personal income tax cuts will be targeted at low and middle-income Australians from 1 July 2018.

A new tax offset will provide up to $200 for those on incomes of up to $37,000 rising to $530 for those on incomes of between $48,000 and $90,000 for 2018-19 to 2021-22. The tax relief will taper down for those on incomes of between $90,000 and $125,000. This new tax offset is in addition to the existing Low Income Tax Offset (LITO), which will increase from $445 to $645 from July 1 2022.

Income tax cuts will be delivered by raising the threshold for two of the tax brackets.

The upper threshold for the 32.5% tax bracket will increase from $87,000 to $90,000, from 1 July, 2018. The upper threshold for the 32.5% tax bracket will then rise from $90,000 to $120,000 from 1 July, 2022. At the same time the upper threshold for the 19% bracket will increase from $37,000 to $41,000.

From 1 July 2024, the number of income tax brackets will be reduced from five to four, in a move that benefits higher-income earners. The upper threshold for the 32.5% bracket will be increased, from $120,000 (and currently $87,000) to $200,000, removing the current 37% bracket. The same marginal tax rate will then apply to incomes of between $41,001 and $200,000. The top marginal tax rate for incomes over $200,000 will remain at 45%.

le 3: New personal tax rates and thresholds 2018–19, 2022–23 and 2024–25

Rate (%)	Current tax thresholds Income range ($)	New tax thresholds From 1 July 2018 Income range ($)	New tax thresholds From 1 July 2022 Income range ($)	New tax thresholds From 1 July 2024 Income range ($)
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 - 41,000	18,201 - 41,000
32.5	37,001 - 87,000	37,001 - 90,000	41,001 - 120,000	41,001 - 200,000
37	87,001 - 180,000	90,001 - 180,000	120,001 - 180,000	-
45	>180,000	>180,000	>180,000	>200,000
Low and middle income tax offset	-	Up to 530	-	-
LITO	Up to 445	Up to 445	Up to 645	Up to 645

This tax reform remains piecemeal. The personal income tax cuts ideally need to be complemented by a broader and comprehensive structural reform of taxation that makes our tax base more stable and does not penalise growth, investment or incentives. This is now an undertaking for another day.

For Older Australians

The Budget introduces a one-year work test exemption which will allow recent retirees to make voluntary contributions to superannuation for a year after they finish working. This initiative is for people aged 65-74 years with superannuation balances below $300,000.

The Pension Work Bonus Program will increase and expand. This allows seniors to earn an additional $300 per fortnight without it affecting their pension. It will also be extended to include the self-employed.

The Pensions Loans Scheme will expand to allow all retirees of Age Pension age, not just part-rate pensioners, to borrow against the value of their own home.

For Younger Australians

The Budget includes modest changes to superannuation rules to assist young people. This involves capping passive fees, banning exit fees and the Australian Taxation Office actively tracking inactive (lost) superannuation accounts.

Medicare Levy

The previously announced planned increase in the Medicare levy (due to start in July 2019) was scrapped. The levy was due to rise 0.5 percentage points to 2.5% in July 2019 to help fund the National Disability Insurance Scheme (NDIS). The scrapping of this plan will cost $12.8 billion over 2018-19 to 2021-22.

The government is now able to fund the NDIS without the levy. Treasurer Scott Morrison has confirmed the extra 0.5% increase from next year is no longer needed thanks to better than expected revenue, despite it being a key measure of the 2017 Federal Budget.

What Does the Budget Mean for Businesses?

Businesses were not the biggest winners out of this year's Budget, but there were some key measures.

Small businesses with turnover less than $10 million will get an extension of the immediate tax deduction for assets costing up to $20,000 to 2018-19. The tax incentive was due to end 30 June, 2018.

Over the last few years, the Turnbull Government has persisted with pushing through a corporate tax cut to 25% for all companies, but this has continued to face opposition in the Senate. The Government indicated that it remains committed to fully implement this plan.

So far, passed legislation involves a tax cut for firms with a turnover of up to $50 million; these firms will see the tax rate fall from 30% to 25% by the 2026-27 financial year.

The government is still keen to give tax cuts to large companies. The government delayed putting the remainder of the legislation to the vote in the Senate just before Easter when it became clear it didn't have sufficient numbers from the crossbench to pass it.

Among other initiatives, spending on infrastructure projects will be beneficial for businesses. The public spending on infrastructure is spilling over to private investment.

Other Key Budget Initiatives

Infrastructure:

Recent Budget outcomes have placed a heavy emphasis on infrastructure given the positive impact on productivity, jobs and boost to spending. This year's Budget is no exception. New spending of $24.5 billion is being allocated for transportation projects. These projects are off balance sheet, but will impact debt levels.

New spending on infrastructure includes:

- $1.5 billion in **New South Wales**, including:
    - $971 million for the Pacific Highway Coffs Harbour Bypass
    - $400 million for the Port Botany Rail Line Duplication
- $7.8 billion for **Victoria**, including:

- $5 billion has been allocated for the Melbourne-Airport Rail Link. This project will still require funding from the Victorian State Government.
- $1.8 billion for the North East Link
- $475 million for Monash Rail

- $5.2 billion for **Queensland** including:
  - $3.3 billion for the Bruce Highway
  - $1 billion for the M1 Pacific Motorway
- $1.8 billion in **South Australia** including $1.4 billion for North-South Road Corridor projects
- $2.6 billion in **Western Australia**
- $461 million in **Tasmania**
- $100 million for the Monaro Highway upgrade in the **Australian Capital Territory**
- $280 million in the **Northern Territory**

Infrastructure spending also includes a $1 billion Urban Congestion Fund to tackle urban congestion in cities.

Health:

The Budget measures include funding worth $1.4 billion over five years from 2017-18 for new and amended listings on the Pharmaceutical Benefits Scheme (PBS). This includes medicines for spinal muscular atrophy, breast cancer, refractory multiple myeloma, relapsing-remitting multiple sclerosis and the prevention of HIV.

The government is introducing free whopping cough immunisations for pregnant mothers from 1 July 2018. Furthermore, there will be a new national public education campaign about vaccination.

There will be additional funding for mental health helpline Lifeline of $33.8 million. This funding will help Lifeline reach more people.

Funding for the Royal Flying Doctor Service will increase to improve delivery and availability of health services in rural and remote areas.

Environment:

The Budget will boost spending on the environment with a $0.5 billion package to help protect the Great Barrier Reef. Most of this funding will be delivered this financial year.

Defence:

A Defence Export Strategy aimed at making Australia a major exporter of defence equipment to support jobs across the Defence industry supply chain. There will be $20 million each year to support defence exports.

Aged Care:

The Budget is delivering an extra 14,000 home-care package places for elderly people who wish to remain in their own home for longer. There are currently more than 104,000 elderly Australians on the waiting list for home-care places. The demographic profile of Australia means this waiting list is likely to get bigger over time without any policy changes. An extra 13,500 residential aged-care places and 775 short-term restorative places will also be provided.

Research & Development:

There were changes to the Research and Development Tax Incentive (R&DTI) to better target spending. For companies with turnover of $20 million or more, the government is introducing a new R&D premium to align with the degree of R&D expenditure. A cap of $4 million will also be imposed on cash refunds.

Science & Research:

The Budget announces investment in Australia's national research infrastructure facilities, which will total $393.3 billion over five years.

There is also $4.5 million allocated over four years to encourage more women into education and careers in science, technology, engineering and mathematics.

Another initiative is $1.3 billion for a National Health & Medical Industry Growth Plan. It includes $500 million over 10 years for the Genomics Health Futures Mission and an extra $707.3 million for the Frontier Health & Medical Research program, expanded clinical trial programs and other medical research programs.

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