

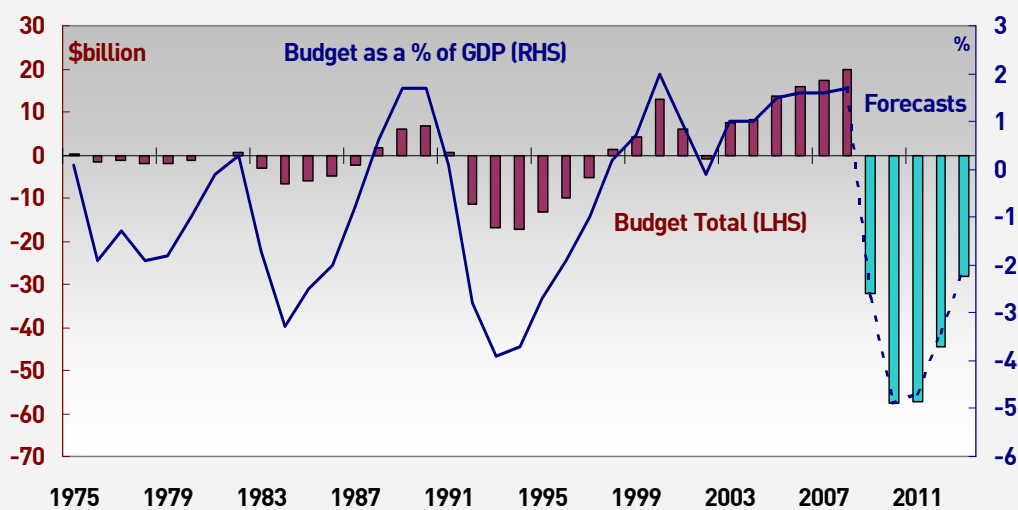
BUDGET SNAPSHOT

Australian Budget 2009-10

Wednesday, 13th May 2009

The Budget Outcome

- The Government has announced a record budget deficit, after ten surpluses in the last 11 years. The 2008-09 deficit is estimated at \$32.1bn (or 2.7% of GDP) and is expected to expand to a record \$57.6bn (or 4.9% of GDP) in 2009-10.
- There were few surprises as most of the detail in the budget had already been leaked to the media ahead of budget night.



Data Source: Federal Budget, ABS

This budget, as expected, is highly expansionary. Monetary policy works well during recessions without a global financial crisis. But when a financial crisis is involved, then fiscal policy along with monetary policy is more effective in combating contractionary forces.

Over the next four years, the deficits will total \$219bn. The budget is not forecast to return to surplus until 2015-16, which is consistent with what we've seen in past global recessions]. The government is relying heavily on a return to above-trend economic growth rates to deliver the budget back to surplus in this time frame. But economic forecasts this far out can be subject to a high degree of variability. The cost savings in this budget in outer years have been reasonably limited, but we can expect budget cuts in future years when the economy returns to shape.

Last night's budget was framed against a difficult economic backdrop. A collapse in revenues due to the economic downturn and stimulus measures to deal with the global credit crisis are largely responsible for pushing the budget into the red. Revenues will be written down by \$23bn in the current year to \$296bn (or 2.6% of GDP), the biggest hit to income since the Great Depression. Over the next four years, revenues are estimated to be down \$210bn.

The Government had already delivered two stimulus packages (December 2008 and February 2009), totalling \$52 billion in the past eight months. This budget continued the initiatives aimed at trying to limit the impacts of the global credit crisis on the economy. New policy initiatives in this year's budget total around \$29bn over the next four years. One of the centrepieces of the budget was the \$22bn spend on infrastructure, designed to help jobs growth and boost productivity.

Pensioners, students, first-home buyers and parents to be are among the biggest beneficiaries of this year's budget while high-income earners are among the losers (see below under spending and cost saving measures).

(2) Economic Forecasts

In terms of the growth and inflation forecasts for 2009-10, there isn't a great divergence between the Treasury and the Reserve Bank's projections. Treasury has downgraded its GDP and inflation forecasts as widely expected, reflecting

weaker-than-expected international and domestic economic activity since the last estimates. These downgrades are in line with downward revisions delivered by key economic bodies in recent months. Against the current economic climate, both Treasury and the Reserve Bank are more focussed on the risks to growth (rather than to inflation).

In terms of GDP, Treasury expects growth to stall this financial year, which is a sharp turnaround from the forecast of 2.75% made in last year's budget. Treasury expects the economy to then contract by 0.5% in the next financial year. A recovery is forecast in 2010-11 when GDP is projected to be 2.25%. Treasury expects the Australian economy to begin a recovery by June 2011.

In terms of the inflation outlook, Treasury expects inflation to continue to undershoot the RBA's 2-3% target in the next two financial years (estimates are 1.75% for 2009-10 and 1.50% for 2010-11).

Consumer spending is expected to be sluggish and business investment to contract 18.5% in the next financial year. That would be its largest fall since the early 1980s (when Australia was in a recession).

The weaker economic picture has led Treasury to revise up their projections for the unemployment rate. Treasury expects the unemployment rate to move up to 6.0% this financial year (from 5.4% currently) and then to move up to 8.25% in 09-10 and peak at 8.5% in 2010-11 before falling as the economy recovers. It compares to our expectation for a peak in the unemployment rate of 8-9% next year. Without the stimulus packages, the Government notes that the unemployment rate would have peaked at around 10%.

The Government's economic projections print slightly below consensus forecasts and our own projections for economic growth. The Government's forecasts for business investment, in particular, appear weak. Meanwhile, with inflation expected by Treasury to undershoot the RBA's target band in the next two years and unemployment rates to move up to the highest they have been since 1997, it implies more scope for monetary policy easing. The Reserve Bank has, however, said that the current stance of monetary policy, along with the hefty fiscal initiatives, is providing "significant" support to domestic demand ahead. So we believe that any potential rate cuts will be delivered sparingly with long pauses in between moves.

Budget aggregates^(a)

	Actual	Estimates			Projections	
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Underlying cash balance (\$b)(a)	19.7	-32.1	-57.6	-57.1	-44.5	-28.2
Per cent of GDP	1.7	-2.7	-4.9	-4.7	-3.4	-2.0
Fiscal balance (\$b)	21.0	-32.9	-53.1	-56.0	-41.8	-30.3
Per cent of GDP	1.9	-2.7	-4.5	-4.6	-3.2	-2.2

Excludes expected Future Fund earnings.

(3) Spending Measures

- The centrepiece of the budget is an additional \$22bn spending on major infrastructure projects (includes roads, metro rail, ports, universities and energy efficiency)
- The stimulus packages are expected to lift the level of GDP by 2.75% in 2009-10 and 1.50% in 2010-11.
- It is expected to support up to 210,000 jobs. The Government notes that without these stimulus measures, the unemployment rate could peak at 10.0% and not 8.5%.

The major expenditure items from the budget are listed below.

Infrastructure (to support jobs in the near-term and production in the medium term):

- \$3.4bn for roads, \$4.6bn for rail and \$389m for ports and freight
- Other:
 - \$4.5bn on new Clean Energy Initiative – comprising on three new core elements: a \$2.0bn investment over nine years in carbon capture and storage projects, a \$1.5bn investment over six years in a new Solar Flagships program and a new independent renewable energy innovation body (Renewables Australia)
 - \$3.2bn from health and hospitals fund to modernise hospitals and upgrade cancer facilities
 - \$2.7bn on tertiary education, research and innovation
 - \$2.5bn to be spent over five years to drive hospital and health workforce reform
 - Partnering with the private sector to build the \$43bn National Broadband Network over eight years
 - An additional \$1.3bn is being committed to enhance national security and border protection

Welfare:

- Aged pensioners receive pension increases.
- Single pension to rise by \$32.49 per week and couple pension to rise by \$10.14 per week
- This pension reform will cost a hefty \$14bn over four years and is regarded as the most expensive initiative in the Budget.
- A new \$600 a year carer supplement for all Carer Payment recipients

Tax Cuts:

- The promise to cut taxes announced in last year's budget was retained with the Government to deliver tax cuts from July 1. It intends to deliver the next instalment of tax cuts from July 2010.
- Lower tax cuts will support consumer spending while at the same time continuing to boost workforce participation and productivity
- Tax cuts, however, may not be as effective in the current environment as households may be more inclined to save rather than spend

Table 7: Personal income tax rates(a)

	From 1 July 2008		From 1 July 2009		From 1 July 2010	
	Taxable income	Per cent	Taxable income	Per cent	Taxable income	Per cent
Residents	\$0-\$6,000	Nil	\$0-\$6,000	Nil	\$0-\$6,000	Nil
	\$6,001-\$34,000	15	\$6,001-\$35,000	15	\$6,001-\$37,000	15
	\$34,001-\$80,000	30	\$35,001-\$80,000	30	\$37,001-\$80,000	30
	\$80,001-\$180,000	40	\$80,001-\$180,000	38	\$80,001-\$180,000	37
	> \$180,000	45	> \$180,000	45	> \$180,000	45
Non-residents	\$0-\$34,000	29	\$0-\$35,000	29	\$0-\$37,000	29
	\$34,001-\$80,000	30	\$35,001-\$80,000	30	\$37,001-\$80,000	30
	\$80,001-\$180,000	40	\$80,001-\$180,000	38	\$80,001-\$180,000	37
	> \$180,000	45	> \$180,000	45	> \$180,000	45
Medicare levy for singles(b)	\$0-\$17,794	Nil	\$0-\$17,794	Nil	\$0-\$17,794	Nil
	\$17,795-\$20,934	10% of > \$17,794	\$17,795-\$20,934	10% of > \$17,794	\$17,795-\$20,934	10% of > \$17,794
	> \$20,934	1.5	> \$20,934	1.5	> \$20,934	1.5
Low Income Tax Offset		Amount		Amount		Amount
	\$0-\$30,000	\$1,200	\$0-\$30,000	\$1,350	\$0-\$30,000	\$1,500
	\$30,001-\$60,000	less 4% of > \$30,000	\$30,001-\$63,750	less 4% of > \$30,000	\$30,001-\$67,500	less 4% of > \$30,000
	> \$60,000	Nil	> \$63,750	Nil	> \$67,500	Nil

This table includes legislated changes to tax rates and thresholds. The low income tax offset does not include the additional amount that will be provided under household assistance arrangements for the introduction of the Carbon Pollution Reduction Scheme from 1 July 2011.

Housing (has been a ray of light amid the gloom in the economy due to the FHOG):

- The First Home Owners Grant (FHOG) will be extended for an additional six months.
- But it will be gradually rolled back and ceased entirely by the end of this period.
- The grant will be maintained at the current levels until September 30 this year
- Thereafter (from October 1 to December 31) that for new homes would be reduced to \$14,000 and that for existing homes will be lowered to \$10,500

Small Business:

- Small business and general tax breaks increased from 30% to 50% on the cost of eligible assets ordered between 13 December 2008 and 31 December 2009 and installed by 31 December 2010

Education:

- This year's budget places a greater focus on higher education
- \$491m will be provided to universities to uncap the number of places at public universities from 2012. This measure will be delivered to add 50,000 new students by 2013
- A boost of \$2.7bn in funding for tertiary education, research and innovation

Jobs Support:

- \$1.5bn for the Jobs and Training Compact, providing education and services to support young people (including training/education places in Nation Building projects), retrenched workers and local communities
- To enhance participation with 18 weeks of Paid Parental Leave

Defence

- \$1.3bn is being committed to enhance national security and border protection

(4) Costs Savings Measures

- The government notes that the global recession has stripped around \$210bn from expected tax receipts over the next four years.
- These wipe out the tax receipt windfalls from the terms of trade boom since the 2005-06 Budget.
- Weaker global growth prospects last year, via its impact on asset and commodity prices, had caused losses in capital gains and company tax receipts. But the deeper financial crisis over September/October caused revenue losses to become far more significant and broadly based to include individuals' income tax receipts.
- Cost savings amount to \$22.6bn or so over four years

Some of these cost saving measures include:

Tax subsidies for private health insurance:

- Cut from 1 July 2010.
- Income earners earning more than \$120k per annum will have the subsidy cut from the current 30% to nil.
- Those earning between \$90k and \$120k will see the subsidy drop to 10%.
- Those earning between \$75k and \$90k will have the subsidy cut to 20%.

Tax breaks cut for retirement savings:

- The government will restrict the tax break currently given to people who pay a portion of their salary direct into retirement savings.
- Amount of savings eligible for the concession will be halved to \$25k for those aged under 50 and halved to \$50k for those older than 50 years of age.

Employee Share Schemes:

- Only employees with a taxable income of less than \$60k are now eligible for tax concessions under the scheme. Previously it was open to all employees.

Welfare:

- The pension age is to be increased to 67 years by 2023. This measure will be phased in and begin to take effect from 2017.

Immigration:

- The Government will reduce the migrant intake target by 7,000 to 108,000 next year (in March it had cut it by 18,500)
- Overall, there has been a 20% reduction in immigration levels since 2008-09
- Most of this reduction will be endured by skilled workers, which will be a negative for productivity
- Lower population growth could help ease tight rental vacancy rates

Medicare Levy Surcharge Changes:

- The Medicare Levy Surcharge will be increased incrementally from 1% to 1.5% for singles earning more than \$90k and for couples earning more than \$180k. Those earning above \$120k will pay the full surcharge of 1.5%.

(5) Financial Market Impact

Bonds

- Commonwealth borrowing will hit \$309bn by 2013 and net debt will rise to peak at \$188bn (13.6% of GDP) in 2013-14. This is a sharp shift from -0.4% of GDP in 2008-09, but still remains low compared to other key economies around the world.
- The current account deficit is forecast to return to 5-6% of GDP, which is just below recent cyclical peaks.
- Rating agencies have expressed their comfort with current existing ratings for Australia post the Budget.
- There is limited detail in the Budget papers on the funding program behind the borrowing estimates.
- Securities issuance will rise to \$169.9bn by June 2013, of which \$133bn is Treasury bonds and notes of at least \$10bn.
- Treasury fixed coupon bond issuance is expected to be \$60bn in 2009-10 after a further \$9.5bn in the remainder of 2008-09. The bulk of the issuance will be into existing bond lines, with at least one new (2022) Treasury Bond planned. This will likely take most of the existing lines to around \$13bn, from \$6-7bn currently.

Shares

- The infrastructure spending measures should benefit industrial and transport companies.
- The extension of the first-home-owner's grant should give building-materials stocks a boost and those companies involved in residential development.
- Health stocks (private-health insurers and private-hospital operators) may be adversely affected by the changes to the private-health insurance rebates.
- Companies specialising in superannuation investment (fund managers) may be adversely affected by the cut in tax breaks on retirement savings.
- The lift in the pension may help lift consumer spending marginally, benefiting consumer-discretionary spending. However, it is likely to be negated by cost-saving measures contained in the budget directed at high-income earners and also affecting some middle-income earners.

Australian dollar

- Typically, budget deficits are a downward influence on the currency over the medium to long term. The shorter-term impact is more muted. The budget is forecast to move back into surplus in seven years time, but this projection may be optimistic.

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