



A stimulus budget as home building cools

Overview

The centre piece of the Federal Budget 2019/20, brought down by Josh Frydenberg, is the move back to surplus next year which is in line with the schedule projected in last year's budget.

A deficit of \$4.2 billion is forecast for 2018/19, around \$10 billion less than projected a year ago, and no doubt leaves room for additional spending announcements in the lead up to the Federal election. This surplus has been driven by favourable results in increased revenue through resources and lower than forecast unemployment.

A budgeted surplus of \$7.1 billion is expected in 2019/2020. This surplus takes account of a range of additional expenditure measures which include:

1. Income Tax Cuts: Phased in over five years.
2. Infrastructure Expenditure: An increase in the funding of infrastructure to deliver 'faster and safer commutes'.
3. Funding for skills and training: Additional apprenticeship incentive payments of up to \$4,000 for employers and \$2,000 for apprentices.
4. Accelerated Depreciation: Instant asset write off threshold increased from \$25,000 up to \$30,000 and expanded to businesses with a turnover of \$50 million.

The move back to surplus reflects:

- A downward revision to economic growth to just 2.75 per cent for both 2019/20 and 2020/21.
- A significant upward revision to export commodity prices (20 per cent higher than previous estimate) and therefore an improved outlook for the current account.

These economic growth forecasts are a significant downward revision from last year's ambitious targets. They now are more consistent with those released by the Reserve Bank of Australia a month ago and are generally consistent with an optimistic economic outlook.

The impact of this Budget position on interest rates is significant. Below average growth of household consumption has been one of the factors used to argue in favour of a rate cut this year. The timing of income tax cuts on 1 July 2019 combined with an ongoing, albeit modest, growth in wages will see an increase in household disposable income. The impact of the rise in disposable income will boost household consumption faster than a rate cut. For this reason, the RBA is not likely to move ahead of the impact of these tax cuts.

This Budget is aimed at encouraging households to feel more comfortable and therefore encouraging increased consumption. Whether this has the flow on benefits to the housing sector is yet to be seen.



2019-20 Federal Budget

Economic Backdrop & Fiscal Position

This time last year the Government was projecting a budget deficit of \$14.5 billion in 2018/19 and a modest surplus of \$2.2 billion in 2019/20. By December the Budget position had improved and the Mid-year Economic and Fiscal Outlook (MYEFO) shifted the forecast to a deficit of just \$5.2 billion in 2018/19 and a more substantial surplus of \$4.1 billion.

Consistent with expectations, the Budget announced today improved the budget position further. While it will still be several months before we see the final budget outcome for 2018/19, the government now projects a smaller deficit of \$4.2 billion for this year.

The headline number for today's release is the \$7.1 billion surplus projected for 2019/20. This was largely due to stronger revenue from royalties on resource exports as a consequence of a number of key resource prices being significantly higher than forecast throughout the year.

The stronger budget position enables the government greater flexibility when it comes to both revenue measures (i.e. tax cuts) and expenditure measures (i.e. new spending commitments). Key measures relevant to the housing industry are covered in more detail below.

Key Treasury Forecasts underlying Budget 2017-18:

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Underlying Cash Balance (\$ billions)	-10.1	-4.2	7.1	11.0	17.8	9.2
Underlying Cash Balance (Per cent of GDP)	-0.5	-0.2	0.4	0.5	0.8	0.4
Unemployment Rate	5.4	5	5	5	5	5
Inflation Rate	2.1	1.5	2.25	2.5	2.5	2.5
Real GDP Growth	2.8	2.25	2.75	2.75	3	3
Dwelling Investment Growth	0.2	0.5	-7	-4		
Total business investment Growth	6.0	1	5	4.5		
<i>Mining investment</i>	-4.1	-10.5	4	4.5		
<i>Non-mining investment</i>	9.7	4.5	5.5	4.5		

When it comes to the economic outlook, this year's Budget is a more sombre affair than the overly optimistic picture it painted last year. This time last year the Treasury forecasts showed GDP growth getting back to 3 per cent in 2018/19 and staying at that level across the forecast horizon. Indeed, Treasury held on to this outlook right through to late 2018 when MYEFO reaffirmed their expectation for solid economic growth.

With a little more water under the bridge, it is now apparent that economic conditions deteriorated throughout the latter months of 2018 and has remained soft in the early months of 2019. Back in February the RBA made a material downward revision to their economic forecast to reflect the weaker outlook. The Treasury's latest forecast contained within the budget follows the RBA's lead. The Treasury had previously forecast GDP growth returning to 3 per cent in 2019/20, the downgraded outlook shows that it is now projected to grow by 2.75 per cent in both 2019/20 and 2020/21.

The decline in residential building activity is now forecast to be more substantial. This time last year Treasury forecast investment in residential building to grow by 1.5 per cent in 2018/19, this was subsequently downgraded to growth of 1 per cent in MYEFO and further reduced in the Budget to just 0.5 of a percent. The reduced outlook for residential building investment are considerably larger. Treasury forecasts from last year's budget anticipated no change in the level of investment in 2019/20, this forecast was downgraded to a 4 per cent fall in MYEFO and has now been further downgraded to a 7 per cent fall. Such a large decline in residential building activity will weigh heavily on GDP growth.

Last year the Treasury forecast inflation would return to around 2.5 per cent (middle of the RBA's target band) this year and the expectation has been revised down in the Budget to just 1.5 per cent. This downgrade reaffirms the likelihood that any interest rate move being up is greatly diminished.



2019-20 Federal Budget

The labour market outlook is still quite strong, indeed stronger than it was this time last year. The unemployment rate was forecast to hold steady at around 5.25 per cent but it has been consistently below this level for most of the year with the national rate dipping below 5 per cent in February. Treasury's projections show the unemployment rate is expected to hold steady at around 5 per cent across the forecast horizon.

Interestingly, last year the Treasury underestimated the strength of the labour market but overestimated the strength of wage growth. In last year's Budget the Treasury forecast a rapid recovery in wages growth with 2.75 per cent growth in 2018/19 and further growth of 3.25 per cent growth in 2019/20. With little evidence of pressure on wages during 2018 the MYEFO lowered this forecast was lowered to 2.5 per cent and 3 per cent in 2018/19 and 2019/20 respectively. The forecast Budget sees further moderation in wage growth expectations - the forecast for 2.75 per cent growth in 2019/20 still seems optimistic in light of recent data, but it is at least plausible.

In summary, the Budget is in a better position than had been expected a year ago but this is largely attributable to stronger tax receipts due to higher than anticipated commodity prices. Given the volatility of commodity prices this cannot be relied upon to repeat year after year. Beyond this, the Australian economy is facing more challenges in 2019/20 than it was last year. If the economy tracks along as Treasury expect (a plausible forecast) the Budget will be 'back in the black' next year but the risks are skewed to the downside. A surplus is likely but not a foregone conclusion.

Key Budget Measures

1. Income Tax Cuts

The Government has announced changes to income tax brackets that can be separated into two different phases. The first, is expected to take effect immediately and will include a reduction in some income tax brackets in 2018/19. This will have a positive impact on consumer sentiment and help offset households lacklustre expenditure.

This fiscal stimulus will have a similar positive impact as a reduction in interest rates, with the exception that it will be with significantly less lag.

The second changes to income tax brackets are proposed out as far as 2024/25.

2. Infrastructure Expenditure

Capital city congestion is a priority in this year's federal budget, with the government banking on a \$100 billion infrastructure spend over the next decade to ease voter concerns.

Spending on rail and roads are a focus, while the government also plans to establish a body for population policy.

Big-ticket items include the previously announced \$2 billion for a fast train to halve travel times between Melbourne and Geelong, which would rely on the co-operation of the Victorian government. An agency to offer advice on fast rail projects, set to be established from July 1, would cost \$14.5 million over the forward estimates

3. Skills and Training

Additional Identified Skills Shortage Payment

The government will provide \$200.2 million over four years to boost incentives for identified skills needs. This will support up to 80,000 new apprentices over five years in trades of skill shortages. The payment will provide employers a total of \$4,000, in addition to the existing \$4,000 employer incentives for commencement and completion of an apprenticeship and a total of \$2,000 for apprentices at the completion of their training.

Eligible occupations will be reviewed annually to ensure current and expected skills shortages are captured by the scheme.



2019-20 Federal Budget

Training Hubs

From 2018/19 the government will spend \$67.5 million to establish 10 training hubs across Australia in regions with high youth unemployment. The aim is to create better linkages between industry and schools. It is target to improve outcomes for up to 3,000 school students as well as their potential employers.

National Skills Commission

The government will spend \$132.4 million over four years from 2019/20 to set up a National Skills Commission. The Commission will oversee the Commonwealth's annual investment in VET with the aim of long term reform in the VET sector. Long term reform includes developing a nationally consistent approach to the funding of VET qualifications and research new Skills Organisations focusing on future job growth and skills needs.

4. Instant Asset Write-off

The popular instant asset write-off rules will be immediately expanded from Budget night, with the threshold lifting to \$30,000 and applying to multiple purchases. Eligible businesses will also increase from companies with \$10 million to \$50 million.

The instant asset write-off provisions have been a popular announcement in Federal Budgets for at least the past decade. A threshold of \$20,000 has been in place for a number of years and this was extended at in last year's Budget to continue until 30 June 2019.

Early this year the Government announced that the threshold would be increased to \$25,000. The further expansion of the threshold to \$30,000 and a continuation of the program until 30 June 2020 (for businesses with a turnover of less than \$10 million) further entrenches this measure in tax laws.

5. Other Measures

Black Economy - strengthening the Australian Business Number system

The Government will strengthen the Australian Business Number (ABN) system to disrupt black economy behaviour by requiring ABN holders:

- from 1 July 2021, with an income tax return obligation, to lodge their income tax return.
- from 1 July 2022, to confirm the accuracy of their details on the Australian Business Register annually.

The new conditions are intended to make ABN holders more accountable for meeting their government obligations, while minimising the regulatory impact on businesses doing the right thing. Currently, ABN holders are able to retain their ABN regardless whether they are meeting their income tax return lodgement obligation or the obligation to update their ABN details.

Trades Recognition Australia - full cost recovery

The Government will provide \$131.6 million over five years from 2018-19 to streamline and strengthen Trades Recognition Australia's (TRA's) oversight of skills assessments related to migration, employment and licensing purposes. These activities will be fully cost recovered by the collection of fees from individual applicants. Fees will be collected by TRA rather than through Registered Training Organisations, as is currently the case, which will streamline interactions with Government. This will not alter the costs incurred or services provided to individual applicants. Under the revised arrangements, TRA will be responsible for certifying trade skills assessments sought by potential skilled migrants to Australia under the Migration Act 1958. This will ensure that an applicant is able to perform at the required skill level for their nominated occupation in Australia.

Addressing sham contracting

The Government will provide \$9.2 million over four years from 2019-20 (and \$2.3 million per year ongoing) to establish a dedicated sham contracting unit within the Fair Work Ombudsman to address sham contracting behaviour engaged in by some employers, particularly those who knowingly or recklessly



2019-20 Federal Budget

misrepresent employment relationships as independent contracts to avoid statutory obligations and employment entitlements. The unit will more effectively tackle sham contracting by increasing education, compliance and enforcement activities, and dedicating additional resources to investigate and litigate cases.

Conclusion

The legislative passage of these Budget measures will be complicated by the timing of the next Federal Election. Last week Parliament passed a range of supply measures to ensure the smooth operation of government until after the next Federal election.

In most instances these measures will gain the support of the main parties and possibly proceed through Parliament this week. For example, the instant asset write-off threshold of \$30,000 will require legislative changes, despite it taking effect from the time of announcement. These measures are usually not overly contentious.

Other measures have already been legislated, such as income tax cuts from 1 July 2019.

For further information regarding Budget 2019/20, please contact the HIA Economics Team:

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