October 2022
Federal Budget White Paper

A budget for the times

Last night Federal Treasurer Dr Jim Chalmers delivered a prudent budget, consistent with the need to keep expenditure expansionary but with the intention of limiting any additional inflationary pressures.

Treasury is now forecasting a more difficult outlook for the Australian economy.

It now expects GDP growth to decline to only 1.5% in 2022/23, unemployment to rise to 4.25% and for inflation to remain elevated for the next 3 years.

The primary focus of the budget was to address cost of living pressures.

Despite higher tax revenues, the Government has opted to hold onto some of the savings and pursue family-oriented policies that align with the RBA's goal of bringing inflation back down to its target 2–3% range.

Who wins?

Against a backdrop where economic growth is slowing, but where the fiscal position remains strong, the budget targeted spending in four key areas:

1. the cost of living;
2. parental and childcare support;
3. infrastructure; and
4. health, education and community services.

Companies that are exposed to the housing sector stand to gain due to the government's ambitious goal of building approximately 200,000 affordable homes per year for the next 5 years starting in mid-2024.

Who loses?

This budget did not propose any major long-term reforms that structurally alter the Australian economy. As noted by many, the budget was conspicuous for defining the problem yet unsure in signalling the solution.

Some modest spending supports environmental restoration and research, with a targeted boost to infrastructure and tax breaks for electric vehicles to encourage cleaner transportation. However, there is little to promote a substantial transition to a more sustainable economy in the near term.

In addition, there will be no cash handouts via direct intervention. A cut to the fuel excise will not be reinstated, and cost of living supports will only be adjusted via indexation, as opposed to immediate payments.

What is clear is that this is a very targeted budget.

It aims to address the government's long-term debt position, which supports Australia's AAA credit rating, but does not provide any large-scale fiscal relief.

From an investment perspective we don't see this budget as providing a major boost for the equity market aside from housing and to a lesser extent infrastructure. Further, we don't see this providing much additional support for the A$ which is now reliant on interest rate (and to a lesser extent growth) differentials.

By way of summary, we review the major policy initiatives below:

Personal taxation

- **No changes to personal income tax**: As expected the Federal Budget did not contain any measures announcing changes to personal income tax. This includes:

    - no changes to the Stage 3 tax cuts which will take effect from 1 July 2024, and
    - no extension of the Low and Middle Income Tax Offset, which ended 30 June 2022.

    The Treasurer did however state that we need to have a broader discussion as to the type of society we wish to be. With ongoing expenditure outstripping tax revenue, what we have today is simply unsustainable.

    The non-renewal of the Low and Middle Income Tax Offset will see many working Australians $1,500 worse off. It was hoped that immediate cost of living pressures may have seen this initiative extended for 12-months, but alas this was not the case.

- **Helping enable electric car purchases:** For purchases of battery, hydrogen, or plug-in hybrid cars with a retail price below $84,619 (the luxury car tax threshold for fuel efficient vehicles) after 1 July 2022, fringe benefits tax and import tariffs will not apply. Note: Employers will still need to account for the cost in an employee's reportable fringe benefits.

- **Digital currencies will not be taxed like foreign currencies:** The Government will introduce legislation which confirms that digital currencies will continue to be excluded from the Australian income tax treatment of foreign currencies. This maintains the current tax treatment of digital currencies, including capital gains tax treatment where they are held as an investment.

Home ownership

- **Housing affordability measures**: A key focus of the Budget were measures to help individuals secure housing. This is expected to occur largely via the Housing Accord - which looks to will bring federal, state and local governments together to work on housing affordability and homelessness. Measures announced include:

- A commitment to the **'Help to Buy' scheme** which will support first home buyers to buy a home with the Federal Government being a part owner, resulting in a lower balance to be funded by the individual themselves.
- A **Regional First Home Buyer Guarantee** from 1 October 2022 which, similar to the existing First Home Deposit Guarantee scheme, is expected to provide up to 10,000 first home buyers with a guarantee over their mortgage, removing the need for lenders mortgage insurance.

Superannuation

- **Expanding eligibility to downsizer measures**: Legislation has been introduced to reduce the downsizer eligibility age from 60 to 55. This measure will take effect from the first quarter after passing into law, which is expected to be 1 January 2023.
- **SMSF and tax residency:** The Government confirmed its intention to continue with the 2021/22 Budget measure of extending the temporary trustee absence period from two years to five years and removing the 'active member' test. These changes will help SMSFs continue to maintain their Australian tax residency even while members are overseas and allow them to continue to contribute to their funds even if they become non-tax residents.
- **Three-year audit cycle for SMSFs not proceeding**: Originally announced as part of the 2018/19 Budget, it was confirmed the current Government will not proceed with this measure.

Social Security

- **Childcare subsidy changes**: As part of a package of reforms to encourage parents to return to the workforce, the maximum childcare subsidy from 1 July 2023 will increase to 90% for families earning less than $80,000. For every $5,000 earned over this threshold the subsidy will reduce by 1% - reducing to zero for incomes $530,000 or above.

  The higher rate of subsidy for families with multiple children in care will continue under its current arrangements, ceasing once the eldest child reaches six years old or has been out of care for 26 weeks.
- **Paid parental leave increases:** Announced before the Budget, from 1 July 2024 the Paid Parental Leave Scheme will increase the maximum period of leave by two weeks each year - reaching a maximum of 26 weeks by 1 July 2026.

  Further, from 1 July 2023 both parents will be able to access leave at the same time or enter into more flexible arrangements than currently available under the limited Dad and Partner Pay limits (requiring 12 weeks leave be taken on a continuing basis). The paid parental leave income test will also be extended to include a $350,000 family income test, which can be used to help families who do not meet the individual income test.
- **Reducing assessment of former home proceeds:** For individuals on social security benefits, the temporary assets test exemption of home sale proceeds is to be extended from 12 months to 24 months. Additionally, these proceeds will only be deemed to earn a return at the lower deeming rate (currently 0.25% per annum) for this period. Note: This exemption only applies to the portion of the proceeds expected to be used in a new home purchase.
- **Work Bonus deposit for older Australians:** Announced as an outcome from the Jobs and Skills Summit, age pensioners and veterans over service pension age are expected to receive a one-off credit of $4,000 into their Work Bonus income bank. The Work Bonus typically offsets $300 per

fortnight of income earned from employment or self-employment activities, allowing pensioners to receive a higher age pension whilst still working.

- **Increased income thresholds for Commonwealth Seniors Health Card:** The Government has committed to increasing the income thresholds for the Commonwealth Seniors Health Card to $90,000 for singles and $144,000 combined for couples.
- **Deeming rate freeze:** The Government has also confirmed its intention to retain the current deeming rates until at least 30 June 2024.
- **Plan for cheaper medicines:** From 1 January 2023, the general patient co-payment for Pharmaceutical Benefits Scheme treatments is expected to reduce from $42.50 to $30.

Other

- **Philanthropy**: The Government will amend the tax law to specifically list Australians for Indigenous Constitutional Recognition as a deductible gift recipient (DGR) for donations made from 1 July 2022 to 30 June 2025.

  The government will also extend the listing of Australian Women Donors Network as a DGR for 5 years for gifts made from 9 March 2023 to 9 March 2028.

  Taxpayers can continue to claim an income tax deduction for $2 or more paid to recognised DGR's.
- **New cyber measures:** The budget provides $31.3 million in additional funding to assist agencies with fewer resources.
- **Improving the integrity of off market share buybacks:** The Government will improve the integrity of the tax system by aligning the tax treatment of off-market share buy-backs undertaken by listed public companies with the treatment of on-market share buy-backs. This measure will apply from announcement on Budget night.
- **Depreciation - reversal of self assessment for intangible assets:** The Government will not proceed with the measure to allow taxpayers to self-assess the effective life of intangible depreciating assets, announced in the 2021-22 Budget. Reversing this decision will maintain the status quo – effective lives of intangible depreciating assets will continue to be set by statute. This will avoid the potential integrity concerns with the previously announced measure and contribute to budget repair.
- **Infrastructure:** The budget will allocate $9.6B towards several nationally significant infrastructure projects including

  - **Freight highway upgrades**: $1.5B allocated for upgrading important highways that facilitate freight including the Tanami, Dukes, and Augusta highways, among others.
  - **Suburban Rail Link in Victoria**: $2.2B for the rail system that will connect every major rail line (and the airport) together in Victoria.
  - **Electrification of public transport in WA**: $670M to manufacture more electric powered buses and battery charging technology in WA.
  - **Western Sydney roads**: $300M for the development of road linkages in Western Sydney to foster efficient travel of passengers and freight before the new airport opens in 2026.
  - **NBN**: A $2.4B investment into the NBN to extend the network to 1.5 million more homes.

Financial Markets | Synopsis

This budget clearly reverses the pro-growth agenda that was set out earlier in the year by the former Government and instead adopts more conservative fiscal policies given the elevated inflationary backdrop and the need to move in the same direction as the RBA.

Traditionally, budgets don't have a major or prolonged impact on the equity market, and we don't see the current combination of policies as anything different. Few households or businesses are likely to feel worse off, but, simultaneously, few will feel much better as any cost-of-living adjustments are quickly absorbed.

We doubt the budget will lift sentiment or confidence in the outlook and in turn it is unlikely to drive households or businesses to raise investment, employment or consumption to any large degree.

The intention of the budget is to support areas of weakness - particularly around social security - than to provide a strong lift in aggregate demand. Similarly, we believe consumers are more likely to hold onto any gains given ongoing uncertainty around the growth and inflation outlook.

For the bond market, the budget provides some confidence that the Government will not fritter away the gains from high commodity prices even during a time when growth is weak. This reduces inflationary pressures from expansionary fiscal policies, helping keep bond yields relatively supressed and more at the whim of global developments. We think the same can be said for the A$ which is being driven lower by a relatively muted inflation and interest rate outlook in Australia compared to other advanced economies.

For the equity market, outside of a boost to earnings, we see no reason to think that this budget will have any material impact on the risk premium and/or valuations. This would imply that the forces which have been driving the market throughout the past 6 months (rising bond yields and slowing earnings growth) will remain intact without much of an offset by fiscal policy.

As mentioned from the outset the budget was prudent and one for the times.

As a nation, we face fiscal challenges both immediate and structural. Our past response of kicking the can down the road has come to an end and the time has arrived for us to have a conversation and for some hard decisions to be made.

Whilst the government is to be commended for defining the problem, what remains unclear is if it will be capable and brave enough to design and execute a workable solution. Time will tell.

If you would like to discuss how this budget impacts you specifically, please feel free to contact our office on 9999-4100.

Until we speak again, stay well

The Innate Wealth Team