Federal Budget 2024-2025 Implications

> "The story of Australia is more than a tale of challenges we have endured. And in our future, we must strive for more than muddling through or making do. This Budget shows we are realistic about the pressures people face now – and optimistic about the future. It reflects our biggest ambitions and our highest aspirations – To make Australians the primary beneficiaries of a world of churn and change."
>
> HON DR JIM CHALMERS MP, TREASURER

Treasurer Jim Chalmers delivered his third Federal Budget on Tuesday 14 May 2024 (the Budget).

The Budget aims to *"help people under pressure today – and invests in the promise and potential of the more prosperous future we can make together".* It prioritised easing cost-of-living pressures, building more homes and strengthening the care economy, while considering inflationary concerns and a slowing growth outlook. It also laid the long-term foundations for Australia's future competitiveness and productivity.

This Wealth matters focuses on announcements most relevant to Mutual Trust clients.

Investment insights relevant for Mutual Trust clients

Investment outlook – higher-for-longer rates underpinned by fiscal stimulus

Implications: This Budget does not change our outlook for investment markets, but rather reiterates Mutual Trust's view of higher-for-longer interest rates. The Budget reinforced inconsistencies between monetary and fiscal policies, adding to the uncertain economic backdrop. We believe the expansionary nature of this budget will make it challenging for the Reserve Bank of Australia (RBA) to cut interest rates in the near-term, while inflationary pressures persist.

Overall, this Budget is likely to be expansionary for the economy, with a near-term boost to household incomes from Stage 3 tax cuts and $7.8 billion in near-term spending initiatives to provide some relief from higher cost-of-living (e.g. energy price support for all Australians, HECS debt reduction, cheaper medicines, Commonwealth Rent Assistance).

The Budget estimates the cost-of-living initiatives will potentially help reduce inflation by around 0.75% this year, for example through lower energy prices. However, we expect a considerable portion of the money saved from these initiatives will be redirected back into the economy, especially given the currently low household savings rate (3.2% versus a peak of 24.1% during the pandemic), therefore stimulating demand. Pending the actual impact on CPI data, this could make the RBA's decision regarding potential rate cuts in the near-term more difficult, as monetary policy may need to be tighter for longer to offset the expansionary fiscal initiatives announced in this Budget.

At the start of this year, Mutual Trust anticipated the RBA may not cut rates during 2024, despite weakening economic growth – at the time, our view was contrary to market expectations for forthcoming rate cuts (as outlined in Quarterly Outlook: Equities in full bloom). *This Budget reiterates our view of higher-for-longer interest rates.*

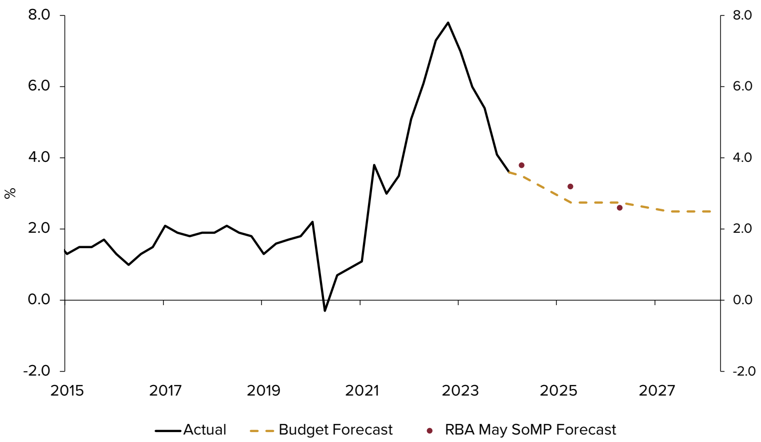
Inflation remains above the RBA's target range of 2% to 3%. Annual CPI rose 3.6% at the end of the March quarter, with further progress reducing inflation stalling.

There are important inconsistencies between the RBA and Federal Government policies and economic forecasts, particularly around inflation, adding to ongoing uncertainty:

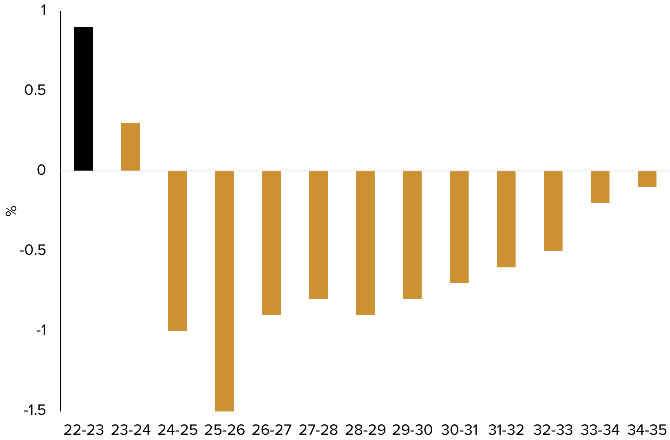
- The RBA last week upgraded its near-term forecast for annual inflation to 3.8% in the June quarter (previously forecast 3.3%) and expects it to remain there for the rest of 2024 (these forecasts were made before the Budget was released).
- This compares to the Budget estimates for inflation to fall between the 2% to 3% range by the end of this year – this is optimistic in our view.

Looking ahead, sizeable budget deficits over the next four years are expected from higher spending and investments in future growth to support and develop domestic industries. Over the coming years, this global trend is likely to sustain inflationary undercurrents until meaningful productivity gains materialise.

Consumer Price Index (%) – RBA versus the Budget forecasts



Forecast Budget Deficit / Surplus (Underlying cash balance as % of GDP)



Australian Equities supported by fiscal stimulus, while critical mineral producers benefit

Implications: Given the expansionary nature of the Budget, we believe it is modestly positive for equity markets, although anticipate limited material changes to earnings expectations across ASX-listed companies. A key consideration is whether the Budget will exert pressure on the RBA to defer rate cuts, or even tighten monetary policy further, which in the longer-run would be negative for equities.

The Budget is supportive for the retail sector, given nearly $26 billion from Stage 3 tax cuts will begin to flow into the economy from 1 July. Together with the energy bill rebate, this will provide some support for lower-income households to manage their mortgage payments better and is therefore mildly positive for the banking sector.

New housing investment measures and fast-tracked visas for migrants to work in housing construction are also positive for the building materials and residential property sectors of the ASX.

The Budget proposed an estimated $7 billion in tax incentives for critical minerals production from 2027/28. This may provide some benefit for resource companies involved in this area, including lithium, nickel and rare earths producers.

Although housing affordability remains in focus, supply shortages will continue

Implications: While the measures included in the Budget are a step in the right direction, the target to build 1.2 million new homes by 2029 is, in our view, ambitious. The 10% increase in Commonwealth Rent Assistance will provide limited relief to housing costs in the short-term, however the under-supply in new homes will continue to place pressure on the housing component of inflation in the longer-term. In the meantime, the reinforcement of the government's commitment to social housing provides greater confidence for private capital looking to invest in this relatively new market.

Housing affordability and supply is a major issue for both Federal and State Governments, so it was no surprise the Federal Government announced $11.3 billion in funding for housing – directed toward crisis and transitional accommodation for women and children fleeing domestic violence, and youth, as well as infrastructure needed for the construction of new homes. A further $9.3 billion will be allocated to a five-year National Agreement on Social Housing and Homelessness to provide support for homelessness, crisis support and to build and repair social housing. However, it is unclear how much of the funding is new and how much has been redirected from existing programs.

There is a significant undersupply of skilled workers in the construction and infrastructure sectors to perform the work required. Earlier in May, the government announced $91 million to fund 20,000 fee-free TAFE places to boost the number of skilled workers. While initiatives to increase labour supply to the sector are welcomed, they are unlikely to significantly reduce the competition for labour from government-funded infrastructure projects, placing ongoing upward wage pressure for the industry.

Vision for a future made in Australia – laying the foundations for future prosperity

Implications: We continue to seek investment opportunities across all asset classes and industries which are best leveraged to long-term structural change. We reiterate our preferred mineral exposure is copper, with major domestic companies such as Rio Tinto Ltd (copper 8% of earnings and projected to grow to 40% by the end of the decade) and BHP Group Ltd (copper 25% of earnings) being well-placed to benefit over the long-term. We also see select opportunities across those asset classes supporting technology, infrastructure and mining services companies.

A key feature of the Budget includes funding and tax incentives towards various programs supporting a new Future Made in Australia Act, allocating $22.7 billion over the next decade, and progressing commitments made last year towards renewable energy solutions.

The focus of the Act is to support and develop domestic industries, particularly in areas of green energy and advanced manufacturing, and enhance Australia's long-term growth trajectory. Initiatives include business tax incentives to attract foreign investment, strengthening defence capabilities, financial support for domestic solar panel production, and investment into critical minerals, quantum computing and decarbonisation projects. The Budget included a 10-year funding package to fully map the Australian continent, including key resources under the soil and seabed, designed to help uncover more mineral deposits and help guide future infrastructure and planning decisions.

> "Australia's journey in becoming an alternative supplier of critical minerals and moving up the supply chain through mineral refining and processing is in its infancy. While Australia is uniquely positioned to benefit from the vast opportunity, the road to success will take significant investment, innovation, collaboration and, importantly, time."
>
> SIMONE ROUSE, PARTNER – HEAD OF PORTFOLIO SOLUTIONS & RESPONSIBLE INVESTMENT

While the potential upside to the Australian economy over the long-term is significant, so too are the hurdles to delivering the outcome (as outlined in Foresight: Of *critical* importance). For example, Australia typically doesn't offer a cost advantage versus other economies (for example, in solar panel manufacturing).

In our view, Australia needs to be clear about where its comparative advantages realistically lie before subsidising certain industries. Meanwhile, the rest of the world is also evolving their policies and strategic support mechanisms, influencing the relative attractiveness and complexity of investments in these areas.

Tax insights relevant for Mutual Trust clients

> "Apart from confirming the Stage 3 tax cuts, tax hasn't been a significant lever for the Federal Government in the 2024/5 Budget. The focus is on tax compliance for individuals and high wealth private groups. This strengthens the case for taxpayers to maintain a robust tax governance framework."
>
> GEORGE PSARRAKOS, PARTNER – TAX ADVISORY

Confirming Stage 3 personal tax rates from 1 July 2024

The Federal Budget confirmed the previously announced changes to the Stage 3 tax cuts, which were modified to ensure that all taxpayers will receive a tax cut from 1 July 2024.

Under the changes, the new tax rates and income thresholds (excluding the 2% Medicare levy) for resident taxpayers are:

Resident tax rates and income thresholds from 2024-25

Taxable income ($)	Tax payable ($)
0 - 18,200	Nil
18,201 - 45,000	Nil + 16% of excess over 18,200
45,001 - 135,000	4,288 + 30% of excess over 45,000
135,001 - 190,000	31,288 + 37% of excess over 135,000
190,001+	51,638 + 45% of excess over 190,000

For foreign tax residents, the new tax rates and income thresholds are:

Foreign resident tax rates and income thresholds from 2024-25

Taxable income ($)	Tax payable ($)
0 - 135,000	30%
135,001 - 190,000	40,500 + 37% of excess over 135,000
190,001+	60,850 + 45% of excess over 190,000

12-month extension to the $20,000 instant asset write-off for 'small businesses' until 30 June 2025

Businesses with an aggregated annual turnover of less than $10 million will continue to be able to access an immediate deduction for the assets costing less than $20,000 and installed ready for use by 30 June 2025 for another 12 months. The asset threshold applies on a per asset basis so businesses can instantly write-off multiple assets.

Assets valued at $20,000 or more can be added to a small business simplified depreciation pool and depreciated at 15% in the first income year and 30% in each subsequent year thereafter.

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Strengthening tax compliance

The Government proposes several measures which extend and fund the ATO's tax compliance and collection, including:

- **Personal income tax compliance program:** this is an ATO program focussed on the overclaiming of deductions (including short-term rental properties), incorrect reporting of income and inappropriate tax agent influence.
- **Tax Avoidance Taskforce:** responsible for pursuing key tax avoidance risks, with a focus on multinationals, large public and private businesses and high-wealth individuals.
- **Lost Revenue and Fraud:** a new taskforce to counter attempts to obtain fraudulent refunds and increasing the time from 14 days to 30 days for the ATO to notify that it will retain a BAS refund under review.

Strengthening the foreign resident capital gains tax (CGT) regime

Currently, foreign tax residents are generally only taxable on capital gains realised on direct investments in Australian real property and non-portfolio interests in 'land rich' companies or unit trusts. The Government intends to clarify and broaden the types of assets captured under these rules for CGT events arising from 1 July 2025. Presumably, the changes will still be limited to assets that have a 'close economic connection to Australian land'.

All capital gains of an Australian resident discretionary trust distributed to a foreign tax resident continue to be taxable at up to 45%, irrespective of whether or not they relate to Australian real estate.

To improve compliance with the foreign resident CGT withholding rules, foreign vendors of 'land rich' entities will need to notify the ATO of sales exceeding $20 million prior to a transaction being executed. Currently, the rules operate on a "self-assessment" basis, whereby a vendor assesses whether their sale is taxable Australian property or not.

If you have any further questions about the Federal Budget and how it impacts you or your family, please contact your Advisor or Relationship Manager to discuss your specific circumstances.

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