



Federal Budget 2010-11 Overview & Superannuation implications

Private and Confidential

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Section 1: An Overview

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Federal Budget – An Overview

On Tuesday night, Treasurer Wayne Swan handed down his third Federal Budget, delivering on a number of promises to cut spending and stabilise the Australian economy. Here we consider some of the Budget's main points, the anticipated economic backdrop and the Australian market's reaction to the announcement.

1. Key economic points

- The Budget is expected to return to surplus in 2012-13 – three years ahead of schedule.
- Real gross domestic product (GDP) growth is expected to be 2.0% in 2009-10, 3.25% in 2010-11 and 4.00% in 2011-12.
- The unemployment rate (currently 5.3%) is forecast to fall to 4.75% by 2011-12.
- Business investment is expected to strengthen to 7.0% in 2010-11 and rise by 12.5% in 2011-12.
- Inflation is expected to be 3.25% over 2009-10 before falling to 2.50% in 2010-11 and 2011-12.

2. A 'no frills' budget

As it happens, good resolutions make for boring budgets. The big story in this budget is not what it does, but what it doesn't. It doesn't have tax cuts, it has very little new spending and it doesn't have much in the way of spending cuts.

In a sense, this budget didn't give and it didn't take. Perhaps more than any other budget, it essentially left things as they are. Leaving things as they are delivers two benefits to the bottom line. First, it means stimulus spending programs are allowed to run out without being replaced. That's the main reason the government's spending as a share of GDP is forecast to shrink from 26.2% of GDP currently to 23.8% in 2012-13.

Second, leaving things alone means there are no tax cuts. Taxes will rise from 20.2% of GDP to 22.5% in the same three years, primarily because incomes will rise but income tax thresholds will not. Without any formal tax increase, Australians will pay a higher share of their income in tax.

A return to surplus

Arguably the biggest talking point to come out of this year's Budget was the anticipated return to surplus by 2012-13 – three years ahead of previous forecasts. As it stands, Australia should continue to have budget deficits for the next two years. This year's 2009-10 deficit of -\$57.1 billion is expected to improve to -\$40 billion in 2010-11 and then fall sharply to -\$13.0 billion by 2011-12. By 2012-13, that \$13 billion deficit is expected to be an estimated \$1 billion surplus.

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Impact on interest rates

- Given that the Reserve Bank of Australia (RBA) has already begun tightening monetary policy, the sharp narrowing in the budget deficit forecast for the next three years should alleviate some of the upward pressure on interest rates.
- Allowing for the current financial turmoil in European debt markets, as well as assessing the impact of recent Australian interest rate rises, the RBA is likely to slow the pace of rate rises for the remainder of 2010.
- The official cash rate is forecast to be 5.00% by the end of 2010 and 5.50% by the end of 2011.

Major Budget initiatives

The government announced a number of major new initiatives as part of its 2010-11 Budget, including:

- \$4.1 billion for health as part of the recent agreement for a National Health and Hospital network;
- An additional \$1.6 billion for Defence;
- \$1 billion for new rail projects in 2010-11;
- A \$661 million package to provide 70,000 new training places and 22,500 new apprenticeships; and
- \$119 million toward literacy and numeracy skills.

Table 1: Key Budget parameters

| | Actual | Estimates | | Projections | | |
|------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
| Revenue (\$b) | 298.9 | 294.2 | 321.8 | 356.4 | 381.9 | 407.2 |
| Percent of GDP | 23.7 | 22.7 | 22.9 | 24.0 | 24.3 | 24.6 |
| Expenses (\$b) | 324.6 | 343.1 | 354.6 | 364.6 | 381.0 | 398.0 |
| Percent of GDP | 25.8 | 26.5 | 25.2 | 24.5 | 24.3 | 24.0 |
| Net operating balance (\$b) | -25.6 | -48.9 | -32.8 | -8.2 | 0.9 | 9.2 |
| Net capital investment (\$b) | 4.1 | 5.8 | 6.8 | 3.9 | -0.1 | 2.9 |
| Fiscal balance (\$b) | -29.7 | -54.8 | -39.6 | -12.1 | 2.0 | 6.3 |
| Percent of GDP | -2.4 | -4.2 | -2.8 | -0.8 | 0.1 | 0.4 |
| Underlying cash balance (\$b) (a) | -27.1 | -57.1 | -40.8 | -13.0 | 1.0 | 5.4 |
| Percent of GDP | -2.2 | -4.4 | -2.9 | -0.9 | 0.1 | 0.3 |
| <i>Memorandum item:</i> | | | | | | |
| Headline cash balance (\$b) | -31.3 | -59.2 | -48.0 | -14.6 | -2.2 | 4.1 |

(a) Excludes expected Future Fund earnings.

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3. The economic backdrop

The Australian economy has come through the global recession much better than anyone had anticipated a year ago. Australia was about the only country to have had positive GDP growth over the last 12 months, which can be attributed to strong export demand, a sound financial system and rapid and significant economic stimulus. As a result, the RBA was one of the first central banks in the world to start raising interest rates, with the official cash rate rising 1.50% (to 4.50%) since October last year.

A stronger labour market has seen unemployment peak at just 5.8% – well short of the government's previous Budget forecast of 8.5% by 2010-11 – while inflation remains within the RBA's 2-3% target band, albeit at the top end of it. The rebound in business and consumer confidence, coupled with a recovery in the housing market and numerous mining projects support the government's forecasts for GDP growth of around 3.25% in 2010-11 and 4.00% in 2011-12.

Table 2: Major economic parameters

| | Forecasts (%) | | | Projections (%) | |
|-------------------|---------------|---------|---------|-----------------|---------|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
| Real GDP | 2.00 | 3.25 | 4.00 | 3.00 | 3.00 |
| Employment | 2.50 | 2.25 | 2.00 | 1.50 | 1.75 |
| Unemployment rate | 5.25 | 5.00 | 4.75 | 5.00 | 5.00 |
| CPI (inflation) | 3.25 | 2.50 | 2.50 | 2.50 | 2.50 |
| Nominal GDP | 2.75 | 8.50 | 5.75 | 5.50 | 5.50 |

4. Market reaction

Much like last year, the market's reaction to the Budget was relatively subdued, with very little impact on the Australian share market. In fact, the S&P/ASX All Ordinaries Index actually gained 0.6% the following day as investors clearly took the announcement in their stride.

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Implications for Superannuation

The focus of the latest Federal Budget was to deliver a responsible fiscal strategy to return Australia to surplus within three years. While there were no immediate measures to boost retirement savings, the Treasurer did announce a number of superannuation-related changes due to take effect from 1 July 2012. Here we take a closer look at some of these measures and the likely impact they will have on super investors.

Please note that these measures are still only proposals and that legislation must be passed in order for them to be effective.

1. Increase in the Superannuation Guarantee to 12%

The Government has announced that the Superannuation Guarantee – the minimum percentage of earnings that employers must contribute to superannuation on behalf of their employees – will gradually increase from its current rate of 9%, to 12% by 2019.

| Year | Superannuation Guarantee (%) |
|---------|------------------------------|
| 2013-14 | 9.25 |
| 2014-15 | 9.50 |
| 2015-16 | 10.00 |
| 2016-17 | 10.50 |
| 2017-18 | 11.00 |
| 2018-19 | 11.50 |
| 2019-20 | 12.00 |

Implications:

- The government believes this measure will have a significant impact on the retirement savings of most Australians. It projects that a 30-year-old currently earning the average full-time wage will have an additional \$108,000 in retirement savings as a result of the increase in the Superannuation Guarantee.

2. Increase in the Superannuation Guarantee age limit

In addition to the increase in the Superannuation Guarantee rate, the government has also raised the age limit by which an employer is required to make Superannuation Guarantee payments.

Currently an employer is only required to make Superannuation Guarantee payments on behalf of employees up to the age of 70. From 1 July 2013, that age limit will increase to 75.

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Implications

- The Government anticipates that around 33,000 older workers will benefit from this change. If you are aged 70 or older and still working in 2013, you will receive superannuation contributions for longer.

3. Maximum government co-contribution to remain at 100%

In last year's budget, the government temporarily cut the co-contribution matching rate – the amount it throws in for every dollar you contribute to your superannuation – from \$1.50 to \$1.00. This effectively reduced the maximum government co-contribution from \$1,500 to \$1,000 (or from 150% to 100%).

The current co-contribution matching rate of 100% will now remain permanent. The government also said that it will stop indexing the income thresholds for means testing the benefit for the next two years.

Implications

- The government's decision not to index the income thresholds for means testing for the next two years will effectively freeze the income at which you can get the full co-contribution at \$31,920 p.a. and the income at which the co-contribution phases out at \$61,920 p.a. until 1 July 2012.

4. Low income earners to get government contribution of up to \$500

Australians earning less than \$37,000 p.a. will receive a government contribution to their superannuation of up to \$500, paid automatically. The amount payable will be 15% of before tax contributions made on behalf of an employee and capped at a maximum of \$500.

For example, an employee earning \$30,000 p.a. will have a Superannuation Guarantee of \$2,700¹ annually. Therefore, the government contribution will be \$405².

The contribution will be payable on Superannuation Guarantee contributions made from the 2012-13 financial year, and will be paid in the following year.

Note: This example assumes a 9% Superannuation Guarantee paid in 2012-13 for an eligible contribution in 2013-14.

Implications

- This initiative will provide new assistance to around 3.5 million low income Australians who currently receive little or no concession from the existing superannuation system.
- From 1 July 2012, the government will contribute up to \$500 for workers with incomes up to \$37,000 p.a. This means those workers will pay no tax on Superannuation Guarantee contributions in 2012-13.

¹ Superannuation Guarantee of \$2,700 calculation: $30,000 \times 0.09 = 2,700$

² Government contribution of \$405 calculation: $2,700 \times 0.15 = 405$

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5. Before tax contribution limits – helping older Australians ‘catch up’

For employees aged 50 and older with a super balance of less than \$500,000, the before tax contribution limit, i.e. concessional contributions such as the Superannuation Guarantee and salary sacrifice, will be \$50,000 p.a. While the current before tax contribution limit for those over 50 is \$50,000 p.a., this was only ever a transitional arrangement and was set to expire on 30 June 2012.

For workers with over \$500,000 in superannuation, their limit will be \$25,000 p.a. from 1 July 2012.

Implications

- If you are currently aged 50 or older, you can continue to contribute up to \$50,000 p.a. to your superannuation from your before tax income so long as your super balance is under \$500,000.
- This measure will assist older Australians to make ‘catch-up’ contributions ahead of their retirement.

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