

Queensland State Budget 2007-08

Investing in the future

05 June 2007

The Queensland Treasurer has delivered another strong budget for 2007-08. Revenue is expected to be fractionally lower, in part due to a further round of tax reductions totalling \$49 million. Spending will be increased across a range of portfolios and there will be measures to expand trade opportunities and to encourage new industries. Despite this, the budget will remain strongly in operating surplus. There will be significantly increased spending on capital works, including for transport, water and on climate change. State borrowings will increase sharply in 2007-08 and again in 2008-09, but the Queensland balance sheet position will remain very sound and there is nothing to suggest the AAA credit rating will be compromised.

The Queensland economy is expected to maintain its recent strong performance into 2007-08, with growth of the economy and of employment to remain above the national average.

Key Details

The fiscal starting point for this year's budget is strong. The 2006-07 operating surplus is projected to be much higher than forecast at the time of the last budget or at the mid year update – try a surplus of \$2.393 billion versus the mid year estimate of only \$226 million. This reflects massively higher revenues, due to increased tax receipts and higher investment returns. Expenses were also higher but the government was simply unable to spend all the increased cash.

The 2007-08 budget operating surplus is projected at a much more modest \$268 million. The budget is expected to retain an operating surplus above \$200 million in the out years.

Revenues are forecast to be broadly unchanged in 2007-08. This reflects reduced interest income, a result of the return of investment income to the assumed long-term average earnings rate of 7.5%, in combination with reduced revenue from tax equivalent payments. One interesting point is that these reductions in state-sourced revenues are almost entirely offset by forecast increases in Commonwealth grants and tax revenues.

Tax relief of \$49.1 million will be provided in 2007-08. Key changes to taxes include:

- A land tax package, with a 50% cap on the annual increase in land values used for the purposes of calculating land tax liability to be introduced for three years from 1 July 2007; an increase in the tax-free threshold for resident individual land tax payers from \$500,000 to \$600,000 from 2007-08; and an increase in the tax-free threshold for company, trustee and absentee land tax payers from \$300,000 to \$350,000 from 2007-08.
- Harmonisation of payroll tax between jurisdictions from 1 July 2008;
- Duty on the registration of motor vehicles to change from a flat rate of 2% to a rate dependent on the number of cylinders, with the new rate ranging from 2% for electric or hybrid vehicles up to 4% for vehicles with 8 or more cylinders.
- A halving of mortgage duty from 1 January 2008, with full abolition from 1 January 2009.

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Queensland Treasury figures suggest state taxes per capita will remain low relative to other states, with Queenslanders paying on average \$257 less per person per year than the average for the other states and territories.

Spending will be increased by 7% in 2007-08. This will include:

- A 12% increase in funding for health to \$7.151 billion;
- A housing assistance package of \$719 million;
- Additional recurrent funding of \$58.7 million for child protection services;
- Additional recurrent funding of almost \$50 million for the Ambulance Service;
- An additional 200 police.

There will be a massive increase in the capital program, with an increase of 15.6% to \$14.029 billion in 2007-08, with increased funding among other things for transport, water and to address climate change.

Industry initiatives

There are a number of industry-specific initiatives to expand export and trade opportunities and to develop new and emerging industries. These include:

- \$8.3 million in 2007-08 (\$22.2 million over three years) for the Queensland Exploration Development initiative to assist the mining industry;
- Additional funding of \$0.83 million in 2007-08 to finalise the implementation of recommendations from the Review of Queensland Mines Inspectorate;
- Funding of \$12.8 million in 2007-08 to support the Queensland Tourism Strategy.
- Funding of \$31.8 million in 2007-08 for the Western Hardwoods Plan;
- Equity funding of \$300 million to support an advanced clean coal technology;
- Additional funding of \$4.2 million for energy market reforms.
- Initiatives to ease labour shortages in critical industries including \$17.1 million in 2007-08 for 4,250 additional trade training places for emerging and high growth industries, and additional funds to assist people back into the jobs market under the Skilling Queenslanders for Work program.

Queensland government borrowing requirements in line with market expectations

The 2007-08 Queensland Budget outlines the expected net borrowing requirement of the Queensland Government for the next four years. Borrowing in each of the fiscal years out to 2010-11 is likely to be in the order of \$3.6 billion to \$4.3 billion. This is broadly in line with guidance provided by QTC over the past 12 months and as such, should have little impact on QTC bond spreads. We continue to see short end QTC bonds trading at a spread of around 20-25bps over the ACGB benchmark in coming months.

Much of the net borrowing requirement over the next four fiscal years will be used to fund large scale infrastructure projects. In a medium term sense, such investment should enhance the productive capacity of the Queensland economy, and go some way to easing capacity constraints. This should be a positive for the Queensland economy and provide long term support for QTC stock relative to other semi-government bonds.

The current financial year sees the net borrowing requirement at just \$0.7 billion, lower than the \$1.4 billion estimated at the mid-year fiscal and economic review. In the next financial year (07-08), net borrowing is expected to be \$3.6 billion. With \$1.8 billion of the QTC Sep-07 bond maturing, this will take total QTC issuance for the year ahead to over \$5.0 billion. Net borrowing rises to \$4.3 billion in 2008-09 but with no benchmark bond maturity, gross issuance should remain below \$5.0 billion.

We doubt the market will have any problems absorbing forthcoming QTC issuance. Offshore investors continue to exhibit strong demand for high quality \$A fixed income assets, and domestic funds continue to enjoy the reasonable yield pick up offered by QTC bonds to ACGBs for little increase in risk. Furthermore, net ACGB issuance is expected to remain flat in coming years; this should continue to enhance the attractiveness of semi-government paper.

Economic forecasts

The strong economic performance of Queensland in absolute terms and relative to most other states is expected to continue. Economic growth is forecast to remain strong in 2007-08, albeit a little slower than 2006-07's hectic pace, supported by continued strong population growth, strong business investment, a pick up in dwelling investment and buoyant government recurrent and capital spending. Over the medium term growth is projected to return to its long term average, with a slowing in domestic drivers partly offset by an improved trade sector performance.

Employment growth will cool in 2007-08 in line with the slight easing in economic growth, but will remain above the national average. Wage and price pressures are expected to remain at or above the national average.

Figure 1: Queensland economic forecasts

	2005-06 Actual	2006-07 Forecast	2007-08 Forecast	Projections to 2010-11t
Real gross state product	4.4	5.5	5.0	4.5
Employment	2.9	4.75	3.0	2.5
Unemployment rate	5.0	4.0	4.0	na
Consumer price index	3.1	3.0	2.75	2.50
Wage price index	4.4	4.5	4.25	4.0

Source: Australian Bureau of Statistics; WA Department of Treasury and Finance

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