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Queensland 2009-10 Budget Review

16 June 2009

- In today's 2009-10 Budget, the Queensland government is forecasting budget deficits from 2008-09 onwards. The deficit is forecast at $1.945bn in 2009-10 and is expected to peak at $4.090bn in 2011-12.
- The Budget is not expected to return to surplus until 2016-17, although this does not include the impact of announced asset sales.
- Government revenue estimates have been hit hard by the weaker local and global economic environment and the resultant impact on taxation revenues (including from the GST) and mining royalties.
- Expenditure measures in the Budget largely centre around the $18.2bn capital works program (which will be partly funded by Federal Government plans). A number of savings initiatives have also been implemented, most notably the abolition of Queensland's Fuel Subsidy Scheme and public sector efficiency measures.
- Queensland's economic growth is forecast to fall sharply to just ½% in 2008-09, followed by a small contraction of ¼% in 2009-10 before recovering to positive growth of 2¾% in 2010-11.
- The rise in Queensland's net debt, combined with estimates for weaker than expected revenues will see the net financial liabilities to revenue ratio climb from 57% in 2008 to 155% in 2013. Asset sales should help see this ratio improve in the medium term however.
- Queensland has the largest of the State's borrowing programs and domestic bonds on issue ($44bn). However, moves to put the Budget on a path more consistent with a return to a AAA rating in this update should see QTC spreads continue to perform reasonably well.
- The State has made a commitment to regain the AAA rating by 2013. S&P have noted in light of today's Budget this is achievable, but requires "greater clarity on the timing of and proceeds of asset sales, and confidence that the state will deliver a structural improvement in its operating position."

Table 1 Key budget forecasts

$m	2008-09 Forecast	2009-10 Forecast	2010-11 Forecast	2011-12 Forecast	2012-13 Forecast
Net operating balance	-574	-1,954	-3,459	-4,090	-3,290
Revenue	35,874	37,192	37,029	38,100	40,431
Expenses	36,447	39,146	40,488	42,191	43,720
Cash surplus/defict	-4,144	-6,838	-7,516	-5,335	-2,924
Net borrowing	4,014	7,954	9,079	6,792	4,540
Gross borrowing	10,765	18,775	27,898	34,707	39,234
Net debt	-17,808	-10,672	-2,796	2,749	5,901

Source: ABS, Victorian Department of Treasury and Finance

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In the red

In today's 2009-10 Budget, the Queensland Government has forecast a **net operating deficit** of $574mn in 2008-09, followed by a deficit or $1.954bn in 2009-10 and deficits of between $3bn and $4bn for the following three years ($3.459bn in 2010-11, $4.090bn in 2011-12 and $3.290bn in 2012-13).

The budget is not expected to return to surplus until 2016-17, although the large scale **asset sales** announced by the state government on 2 June 2009 are not factored into these Budget estimates. The asset sale program is estimated to deliver around $15bn in sale proceeds as well reducing related capital investment by $12bn over the next 5 years. The government envisages these sales will take place over the next three to five years, depending on the timing of the recovery in financial markets. Hence it is possible that the Budget will return to surplus earlier than the 2016-17 timeframe put forward. Indeed, the Queensland government's revised fiscal principles aim to achieve a net operating surplus by no later than 2015-16.

The **cash balance** is also expected to be in significant deficit through the entire forecast period, reflecting the cash impact of the weaker net operating budget position and higher capital purchases.

Operating deficits for 2008-09 and 2009-10 are smaller than estimated in February, due to extra revenue coming from the federal government for use on specific purposes including infrastructure spending, with no offsetting expenses in those years. Operating balances for 2010-11 and 2011-12 have been revised down significantly however, with larger deficits forecast as a result of lower revenue estimates.

Indeed, weaker global and domestic growth is taking a big hit to projected government **revenues** for the entire forecast horizon. Underlying estimates for taxation, royalties (particularly from coal) and GST revenues have been revised down by a total of $15bn for the four years between 2008-09 and 2011-12. In 2009-10, government revenue is forecast at $37.192bn (including $7.66bn from GST payments), a reduction of $786bn from 2008-09.

There are no significant taxation or royalty increases in this Budget, although a number of measures announced in February will commence from 1 July 2009. There will however be a small negative impact on revenues stemming from new payroll concessions for employers hiring apprentices, higher transfer duty exemptions for first home buyers purchasing vacant land and an instalment payment option for land tax liabilities.

On the **expenditure** side, the centrepiece of the budget is an $18.2bn capital works program (see below for further details). As in NSW, this will be partly funded by the Federal Government's 'Nation Building and Jobs Plan', 'Education Revolution' and other funding plans, although a number of other savings initiatives have also been implemented. These include the abolition of the Queensland Fuel Subsidy from 1 July 2009 (saving around $2.4bn over 4 years), further public sector efficiency measures, reform to the local government grants and subsidy program, a new public sector wages policy for certain employees and changes to the state government's procurement policy.

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Debt to rise, but asset sales may prompt reassessment of state's credit rating

The Queensland government, like others, will undertake a significant capital expenditure program to invest in infrastructure and support state economic growth. The expenditure program is estimated at over $18.2bn, a 12.8% increase on 2008-09 spending. The jump in capital expenditure will result in a rise in net borrowings of $7.9bn. Total government borrowings will reach in excess of $28.3bn in the forward estimates period. As a result of increased borrowing and negative investment returns the state's net debt position will move from negative $10.6bn to positive $5.9bn by 2012-13.

Standard & Poor's report that the rise in net debt, combined with estimates of weaker than expected revenues over the next four years will see the net financial liabilities to revenue ratio climb from 57% in 2008 to 155% in 2013.

However, with asset sales expected in coming years, net financial liabilities may fall sharply bringing the above ratio down to around 120%. A better than expected outcome from the economy, asset sales and revenues (or combination of all) could push the ratio towards 100-110% which could potentially prompt an upward reassessment of the state's credit rating.

Economic Forecasts

The Queensland budget foreshadows a marked slowdown in the state economy in coming years. After outperforming the Australian economy on the back of the commodities boom in recent years the reversal in commodities prices and global growth slowdown is now weighing heavily on the state economy. Gross state product (GSP) is anticipated to slow sharply to just ½% in 2008-09 and register a small contraction of ¼% in 2009-10. The state is expected to achieve solid, but still below trend, growth of 2¾% in 2010-11 before returning to a longer term average above 4%p.a. in the subsequent 2 years. This set of growth forecasts is consistent with Federal budget estimates for a solid recovery in the Australian economy to above trend growth by 2011-12.

The slowdown this year and next is consistent with the current weakness of Queensland's major trading partners and the slowdown across the broader Australian economy. The relatively high exposure to the very weak economies in Japan and Korea via coking coal exports will see the net export contribution to growth fall markedly. Falling coal prices will also detract significantly from the state's income. Further, business investment, much of which is related to the resources sector, will contract sharply in coming years down 17% in 2009-10 and a further 8% in 2010-11.

As a result, the unemployment rate is tipped to rise to over 7% in 2010-11 as the economy slows - a rate not seen since 2002. This may be slightly optimistic given the Federal government tipped unemployment to reach 8.5%. To May, the Queensland unemployment rate, at 5.4% is only marginally under the national average of 5.7%. Employment growth is anticipated to contract ¾% in 2009-10 adding to unemployment. However, the unemployment rate is also being exacerbated by the state's strong population growth and relatively high participation rate. Softer wage growth combined with weaker employment outcomes will see household consumption growth fall to just ¾% in 2009-10, yet is still slightly more solid than the national outcome.

With population growth expected to remain strong, dwelling investment is predicted to make a sharp turnaround to record in excess of 20% growth in 2010-11 before a broader domestic recovery occurs in the years following. The Queensland economy is well placed to take advantage of the recovery in the global economy, in particular that of Asia, and it is anticipated to begin to record solid trade figures in out-years of the forecast period. Business investment is then anticipated to rebound as a result supporting a recovery in the labour market, into 2012-13.

Table 1 QLD economic forecasts

	2007-08	2008-09 (f)	2009-10 (f)	2010-11 (f)	2011-12 (p)	2012-13 (p)
Real gross state product (GSP)	4.9	½	-¼	2 ¾	4½	4¾
Employment	2.4	2 ¼	-¾	1¼	2½	2¾
Unemployment rate	3.7	4¼	6½	7¼	6¾	6½
CPI inflation (a)	4.1	3 ¾	2 ½	2 ½	2 ½	2¾
Wage price index	4.2	4¼	3½	3¼	3½	3¾
Population	2.4	2 ½	2¼	2	2	2

All forecasts year-average with the exception of the CPI
(a) year-ended
Source: ABS, QLD Treasury

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Infrastructure spending continues, but many cuts elsewhere

In line with the Federal Budget's priorities this year, the Queensland 2009-10 Budget centres on an $18.2 billion capital works program for roads, rail, ports, utilities, schools, hospitals and housing. According to Queensland Treasury, this will create an extra 127,000 jobs. The bulk of this will be spent on roads ($3.5bn), other transport ($3.8bn) and electricity generation ($3.2bn), with smaller portions for education-related capital works ($1.8bn), health infrastructure ($1.2bn), public housing ($1.4bn) and water sources ($1.1bn). As in NSW, part of this program will be funded from the Federal Government's 'Nation Building and Jobs Plan', 'Education Revolution' and other funding plans.

Queensland's funding in support certain key industries is also being boosted:

- An extra $22.5mn is allocated to industry-related infrastructure projects in the North West, aiming especially at the LNG industry in the Bowen Basin,
- an extra $36mn over 3 years for Tourism Queensland's tourism promotions, plus $1.8mn for facilities for 'driving travellers' (toilets and picnic grounds).

In a nod to climate change and the new 'green' industries, this Budget creates a state 'Green Army' of work placements for 3,000 unemployed people, allocates $15mn (over 4 years) to small business energy saving measures, and delivers up to 200,000 heavily subsidised solar water systems to householders (costing only $100 to $500 for eligible households). Other specific 'green' projects being supported in the Budget include Ergon Energy's Birdsville Geothermal power station ($4.3mn), the Mackay Sugar Cogeneration Project ($9mn), CSIRO's SolarGas project ($7.5mn) and coastal geothermal energy exploration ($5mn).

As in NSW, the building industry has been supported with measures to promote new home construction, mainly in the form of increases in the threshold land purchase values for tax savings on vacant land purchases.

Unlike NSW, Qld has cut expenditure elsewhere in order to continue the capital works program, with $5.4 bn to be raised through asset sales and public sector 'efficiencies', including in local government. The government efficiency target has been raised from $100mn to $200mn per year. For local governments, their street lighting subsidy, will cease on 30 June 2009 (saving $6.6mn in 2009-10).

Of particular note for householders, Queensland motorists will be hit harder, with the abolition of the fuel subsidy and increased car registration fees. The abolition of the fuel subsidy will raise over $550mn per year, while car registration will cost an extra $183mn per year and rising. Traffic offence fines will also rise, with the penalty unit (used to calculate fines) rising from $75 to $100 and netting an additional $33mn per year. In other increases, tax rates on casino gaming machines will rise by 10%, netting an estimated $36mn per year and rising. And a land tax surcharge of 0.5% will be introduced on land worth more than $5mn, netting an estimated $93mn per year and rising.

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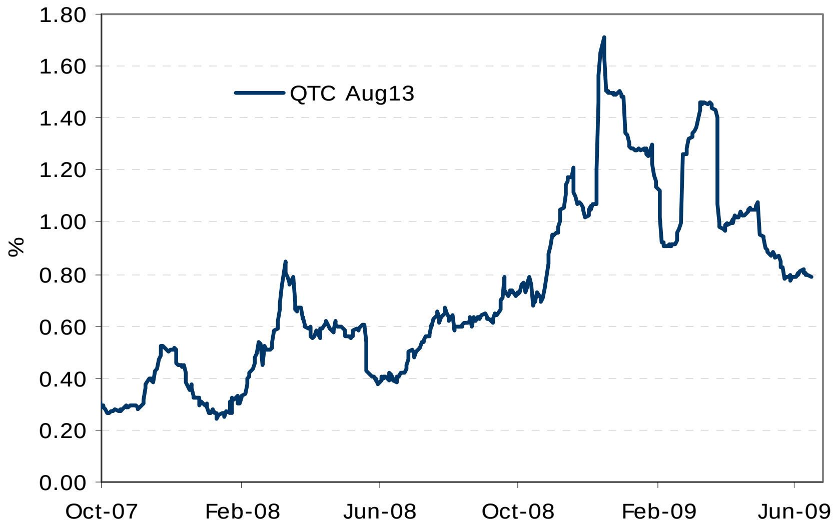
Queensland still faces borrowing challenges.

The numbers on the Budget deficits, capital spending plans and borrowing programs remain large. Queensland has the largest of the State's borrowing programs and domestic bonds on issue ($44bn). However, recent moves to put the Budget on the path to levels more consistent with a return to a AAA rating in this update should see QTC spreads continue to perform reasonably well.

The State has made a commitment to regain the AAA rating by 2013. S&P have noted in light of today's Budget this is achievable, but requires "greater clarity on the timing of and proceeds of asset sales, and confidence that the state will deliver a structural improvement in its operating position." The Budget estimates that net financial liabilities to total revenues ratio will be 117% at the end of the 2009-10 financial year and to fall to around 130% after asset sales are completed (S&P estimate that this could fall to 120%). It was a move above the 100-110% level that triggered the downgrade to the state's AAA rating in February.

Figure 1: QTC spread to ACGB



Source: ANZ & Bloomberg

The half-year update from QTC put the annual borrowing program at $16.0bn. Capital outlays for 2009-10 are estimated at $18.2bn, up $2.1bn from outlays over '08-09. We will get an update on the borrowing program from QTC tomorrow.

The $1bn improvement in the Budget outcome for this fiscal year compared to the forecast in the mid-year review (-$574m versus -1.6bn) could see a modest improvement to this figure in the near-term, but the major challenge of the Budget lies in addressing key financial ratios over time as highlighted above.

Queensland has today provided guidance on the take-up the government guarantee on debt. They intend to use the guarantee on bonds from the June-11 issue out to the Jun-21 issue (from 1-year to 15-years), but not the May-10 bond. And they intended to apply the guarantee to future bond lines while reserving the right to issue non-guaranteed bonds.

There is some mild uncertainty surrounding the possible delay of the legislation in Parliament ahead of the winter recess. But the decision to take up the option at a cost of just 5bps more than the AAA states highlights there is still scope for some further narrowing of spreads once we get details of the borrowing program and some clarity around the government debt guarantee.

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