

Australia's Budget

Federal Budget 2014/15: *End of the Age of Entitlement?*



Facts & Figures



\$1,555Bn
Size of Australian economy

\$29.8Bn
Projected Budget Deficit 2014/15

\$411Bn
Government payments

\$364Bn
Government receipts

\$197Bn
Government debt: 12.5% of GDP, 2013/14



2.8% Economic growth (normal around 3.0-3.25%)

1.78% Annual population growth 



5.8% Unemployment rate

2.75%  Underlying inflation

12th  Global rank of Australian economy

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Making Sense of it

The Federal Budget is hardly the most riveting document you are ever likely to read. Sure you know it's important, but the problem is that it's a huge document with countless facts, figures and tables. And when it comes to analysis, economists seem to be writing for other economists; and accountants writing for other accountants.

It's always important to remember that it is just a budget, the same that any household or company would prepare. Assumptions are made; forecasts are taken; and events can change!

And for the Federal Budget then there is the small matter of politics. The Government outlines the measures that it believes are important for the short and medium-term health of the economy. But it doesn't maintain a majority in the Senate. As a result it will need to deal with Labor, The Greens and perhaps minor parties to get the measures through. And this will lead to uncertainty, and perhaps changes, until the measures finally pass through Parliament.

But at the end of the day most people want to know what's in it for them. It doesn't matter whether you are a student, pensioner or CEO of a major company.

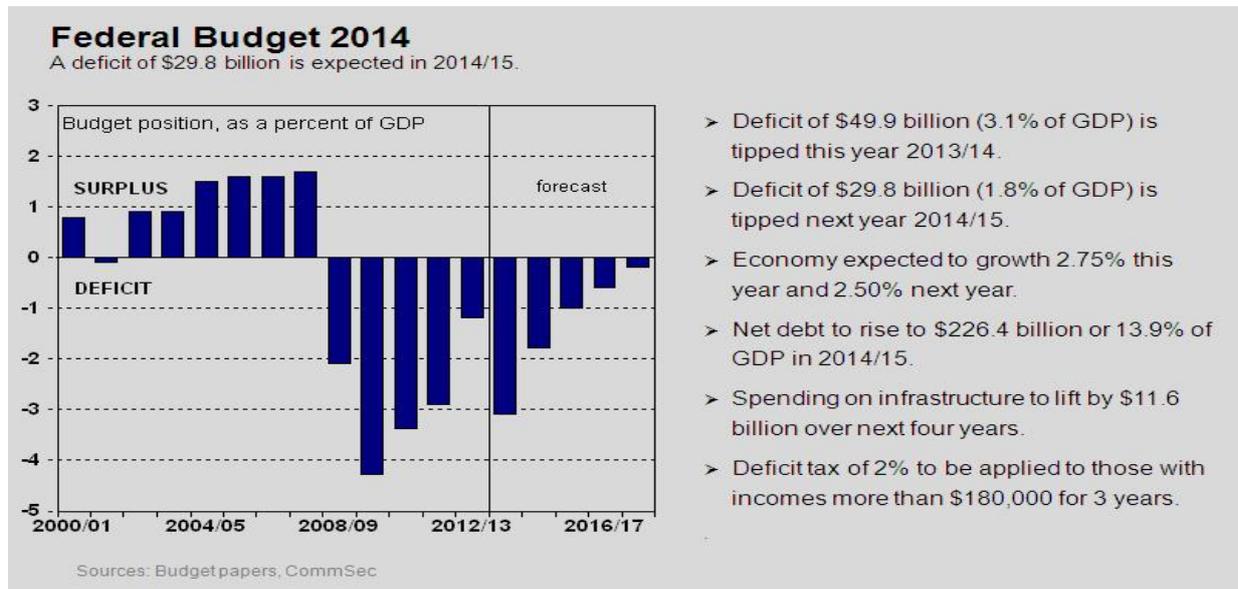
So this analysis is different.

Sure, there are the usual tables, graphs, facts and figures. But we reckon that there are only three questions most people want answered and that's where we will be concentrating:

**Did the Government get it right?
What does it mean for Australia?
Who are the winners and losers?**

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1. The Analysis



Did the Government get it right?

- This is the first Budget by an incoming Government. So you would expect it to be tough. And you would expect the Government would start rolling out its agenda – its plan for the economy.
- All Governments have the same fundamental goals – to live within their means; and to improve the lot of the Australian people. But the way in which the goals are achieved are different. There are different priorities, especially in terms of the tax and spending measures that are adopted.
- The Government believes that urgent action is required to reduce the budget deficit and government debt – both in the short-term and the medium-term. So, similar to Peter Costello in his first Budget in 1996/97, the Government is aiming to markedly tighten fiscal policy. Peter Costello slashed \$5.8 billion from the Budget bottom line in 1996/97 and \$9.8 billion in 1997/98. The Budget was cut from 2.1 per cent of GDP to a small surplus in two years.
- But they were also different and more buoyant times for the economy. The economy grew by 3.9 per cent in 1996/97 and then by 4.5 per cent and 5.0 per cent in the following two years. At best, the economy may grow by 3.5 per cent in the next few years, but more likely by around 3 per cent per annum.
- While the desire to “reboot” the economy is commendable and even advisable from a medium-term standpoint, the “budget emergency” rhetoric has been unduly negative, depressing confidence levels. It remains to be seen whether there is a lasting negative impact on the economy, checking momentum in the economy.
- The spending on infrastructure is also important from a medium-term standpoint. But it also isn't new. If you were to review budgets over the past few years you would have found emphasis being placed on infrastructure.
- The increase in the excise on petrol can be justified on revenue raising grounds, its “green” credentials in boosting demand for public transport and lifting infrastructure spending. But it is regressive in nature. And it complicates monetary policy by boosting inflation. The deficit tax serves little purpose in reducing the Budget deficit and is more of a political, rather than an economic measure.
- Overall, most people won't feel that they have been hit by a sledgehammer, nor will they feel that they have been hit by a feather. There is some pain, some hardship. But most of the impact of policy decisions will be felt in years to come, not now. So after a few days, consumers and businesses will get on with their lives. The real question now is what happens in the Senate with all the major and minor parties set to block key measures.

What does it mean for Australia?

- It means change. There are no pressing fiscal (budget) issues. There is no Budget emergency. But there are medium-term challenges. Australia is ageing and many people feel that they are entitled to receive benefit payments, an aged pension or free/cheap health care no matter their income or circumstances. And the Government is seeking to change that – first, in terms of a change in mentality; and second, in financial terms, but phased in over time.

- So fundamentally the Budget does aim to fundamentally change the way that the economy and society operates. Clearly established principles and practices can't change overnight, but the Government has started the conversation.
- But the Budget isn't just about changes to benefits, allowances and pensions. It isn't just about stream-lining the public service. It is about ensuring that our capital (infrastructure) is being maintained, expanded and improved to ensure the economy can grow and continue to operate efficiently. And that's where the spending on roads comes in.

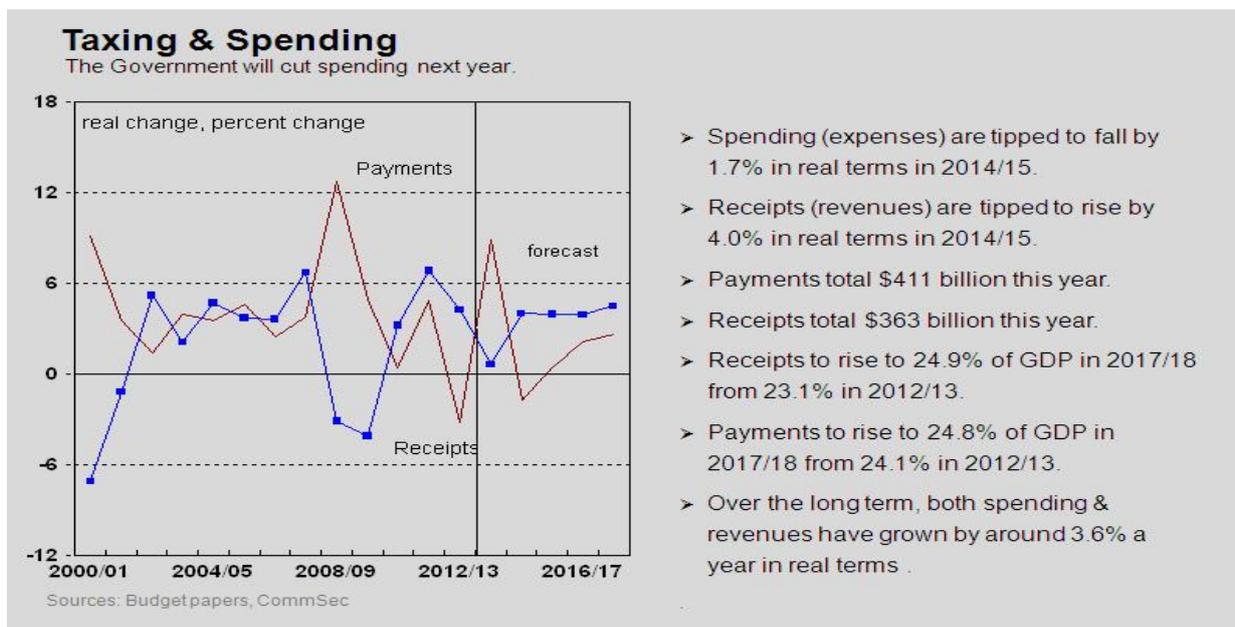
Who are the winners? (source: Budget Papers, AAP)

- Infrastructure: Infrastructure growth package of \$11.6 billion to take government investment to \$50 billion by the end of the decade; Money to drive \$125 billion in spending on new infrastructure; In NSW the \$11 billion WestConnex project to start in 18 months creating 10,000 jobs; In Victoria the \$18 billion East West Link in Melbourne will start before Christmas creating 6,000 jobs; Other projects include Toowoomba Second Range Crossing in Queensland, Perth Freight Link in WA, Midlands Highway upgrade in Tasmania and North South Corridor project in Adelaide
- Schools & Universities: Universities to set own tuition fees from 2016 but existing students keep current arrangements until 2020; Fees repayable after students enter the workforce and earn \$50,000; \$820 million to expand access to higher education. Gonski schools funding
- Private colleges and TAFEs: Government to provide grants to students doing diploma and sub-bachelor courses
- Apprentices: Trade Support Loans up to \$20,000 over four year apprenticeship (replaces tools allowance)
- Older workers: \$10,000 payment for companies employing over-50s who have been on unemployment benefits for six months.
- The disabled: National Disability Insurance Scheme trial site funding.
- State Governments: Bonus paid to states for selling assets and putting money into roads, rail and ports.
- Businesses: Cutting company tax by 1.5 per cent for 800,000 businesses; Exploration Development Incentive to encourage small exploration companies; Reducing regulation and compliance costs on business by \$1 billion a year.
- Single parents: A new supplement for low-income single parents worth \$155 million over four years.
- Medical research: \$20 billion Medical Research Future Fund created.
- Mothers: Paid parental leave scheme from July 2015, albeit reduced to \$100,000 income cap.

Who are the losers? (source: Budget Papers, AAP)

- Tax Payers: People on \$180,000 plus: paying additional 2 per cent income tax for three years.
- Sick people: New \$7 co-payment to see a doctor; Pharmaceutical Benefits Scheme co-payment increased for medicines over \$42.70; states and territories authorised to charge fee for GP-type emergency department visits.
- Families: Payment rates for the Family Tax Benefit will remain at current levels until July 2016; Family Tax Benefit Part B threshold reduced from \$150,000 to \$100,000 (saving \$1.2 billion over four years) and no longer available after youngest child turns six (saving \$1.9 billion over five years); Family Tax Benefit Part A will start to reduce when family income exceeds \$94,316 per year.
- Pensioners: Lift pension age to 70 in 2035; pension increases slowed by indexing to inflation instead of wages.
- Unemployed people: Under 25s to get Youth Allowance, not Newstart; under 30s face six month wait for benefits and must work for the dole.
- Retirees: Untaxed super income included in test for new recipients of Seniors Health Card. Annual seniors supplement abolished from July 1 2014.
- Motorists: increase in petrol excise and indexation reintroduced to raise \$2.2 billion over four years.
- Public service: 16,500 job cuts in next three years.
- Science: Cuts totalling \$147 million over four years at CSIRO, Australian Nuclear Science and Technology Organisation and Australian Institute of Marine Science loses.
- Politicians, senior public servants: One-year pay freeze, gold pass wound back then abolished.
- Poor nations: foreign aid growth cut by \$7.9 billion over five years
- Clean energy: Australian Renewable Energy Agency abolished, saving \$1.3 billion over five years from 2018; \$460 million over three years cut from Carbon Capture and Storage Flagships research program.
- ABC & SBS Funding: Cut by \$43.5 million over four years as a down payment on efficiency study.

2. Taxing & Spending



What is included in the budget?

(Quotes taken largely in full from Budget papers)

All Australians contributing

- Introducing a Temporary Budget Repair Levy on incomes over \$180,000 for the three years from 2014-15.
- Requiring young people to be earning, learning or participating in Work for the Dole.
- Tightening the eligibility for Family Tax Benefit Part B (FTB-B). Low income single parents will be assisted with a new allowance of \$750 per annum for each child aged 6 to 12.
- Indexing pensions to the CPI, rather than wages, from September 2017. Continuing the move by the former Government to increase the age pension age to 67 by 1 July 2023, by further increasing the Age Pension age to 70 by 1 July 2035.
- Indexation of many payments and programmes will be temporarily paused, including: eligibility thresholds for Family Tax Benefit and Newstart; thresholds for the Medicare Levy Surcharge, Private Health Insurance Rebate and most Medicare Benefits Schedule fees; Official Development Assistance funding; Local Government Financial Assistance Grants; and 112 government grant programmes.
- Making the States more accountable for spending and delivery of services by reducing the growth in public hospital and education funding and reducing some Commonwealth payments.
- Establishing a sustainable source of future productivity-enhancing road funding through the reintroduction of indexation of fuel excise from 1 August 2014.

Building Australia's future

- Creating an \$11.6 billion Infrastructure Growth Package, to boost total infrastructure investment by Commonwealth, State and local governments, as well as the private sector, to over \$125 billion by 2019-20.
- Reforms to higher education, including \$820 million to expand access to higher education and removing fee caps on Commonwealth-supported places for new students from 1 January 2016.
- Establishing the biggest medical research fund of its kind in the world, the \$20 billion Medical Research Future Fund. Every dollar of savings from health in this Budget will be invested to build this Fund, until the Fund reaches \$20 billion.
- Incentivising businesses to employ Australians over the age of 50 through the new Restart programme.
- Enhancing the protection of our borders by consolidating operational border protection services into the Australian Border Force. The success of Operation Sovereign Borders has resulted in a \$2.5 billion saving and will provide further savings as expensive detention centres are closed.

2. Taxing & Spending (continued)

What is included in the budget (continued)

Building Australia's infrastructure

- The Infrastructure Growth Package provides an additional \$11.6 billion for infrastructure. This will bring the Government's investment to \$50 billion by 2019-20 which, combined with State and private sector funding, will catalyse over \$125 billion of additional infrastructure investment nationwide.
- The Government has committed an additional \$3.7 billion to upgrade national highways and other key roads and is delivering vital infrastructure through the Western Sydney.
- The Badgerys Creek airport development is expected to create 35,000 jobs by 2035, increasing to 60,000 jobs over time. By 2060, the new airport has the potential to drive an increase in Australia's economic output to almost \$24 billion

Innovation and research

- The Government is establishing the largest medical research fund of its kind in the world — the \$20 billion. Medical Research Future Fund. The Fund will provide significant new funding to medical research in addition to existing funding profiles.
- The National Collaborative Research Infrastructure Strategy will receive \$150 million in 2015-16.
- \$139.5 million will be provided to continue the Australian Research Council (ARC) Future Fellowships Scheme, with a renewed focus on Australian researchers.
- \$92 million will be redirected from the ARC to boost research into tropical health and medicine, dementia and the Antarctic.

Self-reliant, competitive industries

- \$50 million Manufacturing Transition Grants Programme to help businesses transition to competitive industries and drive new and innovative opportunities for growth;
- A \$155 million growth fund will also support regions facing pressures following the announced closures of motor vehicle manufacturers.
- A \$200 million boost to the Export Finance and Insurance Corporation's capital base, and a \$50 million boost to the Export Market Development Grants programme will help more small and medium-sized businesses to access export markets.

Identified Savings

The Government has made \$47.7 billion in savings from payments in this Budget over the forward estimates to 2017-18, to pay for new spending of \$20.0 billion. Savings include:

- Official Development Assistance – reprioritised funding saving \$7.65 billion over the forward estimates.
- Medicare Benefits Schedule – introducing co-payments for general practitioner, pathology and diagnostic imaging services saving \$3.5 billion over the forward estimates
- Higher Education Reform – Expanding Opportunity – Higher Education Loan Program – repayment thresholds and indexation saving \$3.15 billion.
- Family Payment Reform – maintain Family Tax Benefit payment rates for two years saving \$2.6 billion over the forward estimates.
- Family Payment Reform – limit Family Tax Benefit Part B to families with children under six years of age saving \$1.9 billion over the forward estimates.

➤ 2. Taxing & Spending

What is included in the budget (continued)

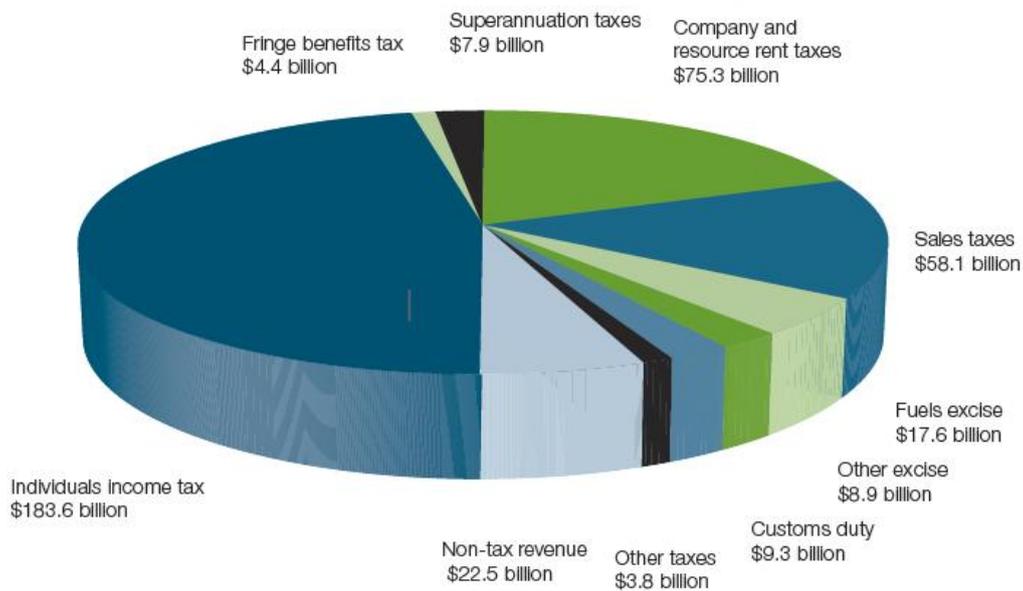
Outcome, Payments & Revenues

BUDGET BOTTOM LINE

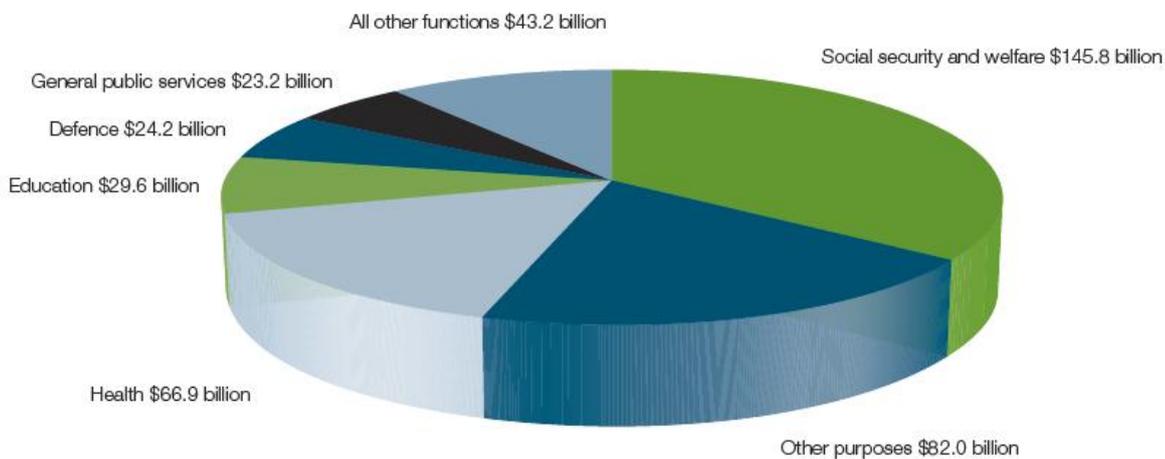
	2012/13	2013/14e	2014/15f	2015/16f	2016/17f	2017/18f
Underlying Cash Balance - \$B	-\$18.8	-\$49.9	-\$29.8	-\$17.1	-\$10.6	-\$2.8
% of GDP	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2
Net Debt - \$B	-\$153.0	-\$197.9	-\$226.4	-\$246.4	-\$261.3	-\$264.2
% of GDP	10.0	12.5	13.9	14.4	14.6	14.0

Source: Budget Papers

Where revenue comes from (2014-15)



Where taxpayers' money is spent (2014-15)



3. The Economy

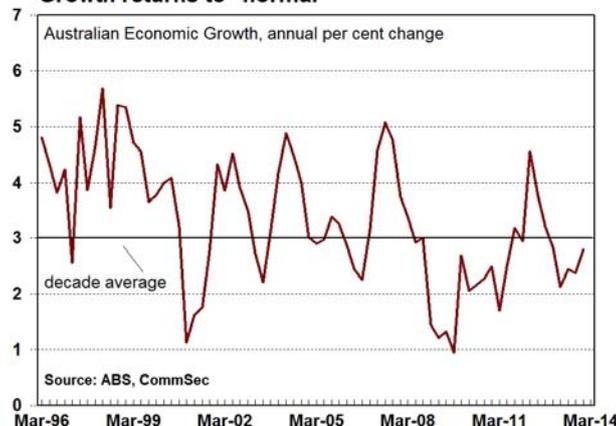
Economic Assumptions				
	Last year 2012/13	This year 2013/14	Next year 2014/15	And 2015/16
Economic growth (% change)	2.60	2.75	2.50	3.00
Inflation (% change to June quarter)	2.40	3.25	2.25	2.50
Wages (% change, year to June quarter)	2.90	2.75	3.00	3.00
Unemployment (% , June quarter)	5.60	6.00	6.25	6.25

Source: Budget papers, CommSec

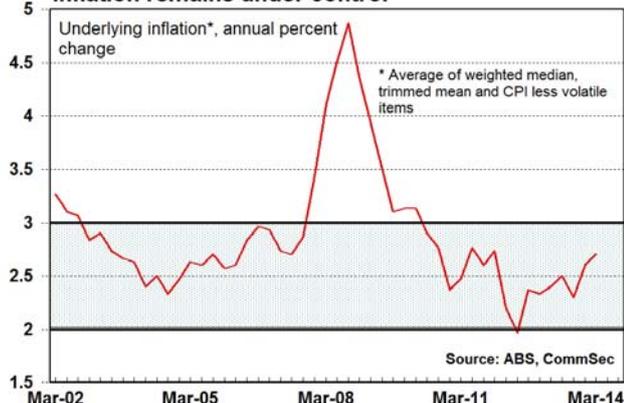
Are the economic assumptions reasonable?

- Federal Treasury hasn't made too many changes to the forecasts outlined in the Mid-Year statement, handed down in December last year. The forecasts are still conservative – we believe too conservative. Still, if the economy turns out better than expected, the Government will be able to claim credit for turning around the Budget quicker than expected.
- Next financial year the economy is expected to slow from 2.75 per cent to 2.5 per cent. As a result, unemployment is seen as a touch higher at 6.25 per cent rather than 6.00 per cent. And the all-important forecast which drives taxation revenues – nominal GDP – has been trimmed to show growth of 3.0 per cent next financial year, rather than the 4.00 per cent expected for this financial year.
- Overall we believe that Federal Treasury is too conservative. Economic growth should be around 3 per cent this year and next. We tip nominal GDP to grow by 4.9 per cent this financial year and by 5.8 per cent in 2014/15. Unemployment should hold between 5.75 per cent and 6 per cent. And we expect inflation to broadly stay in the Reserve Bank's target band – although we are assuming a lift in the cash rate to perhaps 3.5 per cent by the end of 2015.
- As we noted last year, it is the forecast for nominal GDP that could see the budget come unstuck or indeed come in better than expected – the assumption is important for projected tax receipts. Over the past 15 years nominal GDP has grown on average by around 6.5 per cent a year. In the last Budget, nominal GDP growth was expected to lift 3.5 per cent in 2013/14 and then grow 5 per cent in the following two years. In the Mid-Year review, nominal GDP was revised down to 3.5 per cent in 2013/14 and 2014/15. Now the expectation is for 3.0 per cent growth in nominal GDP in 2014/15. Current growth of nominal GDP is 4.8 per cent.

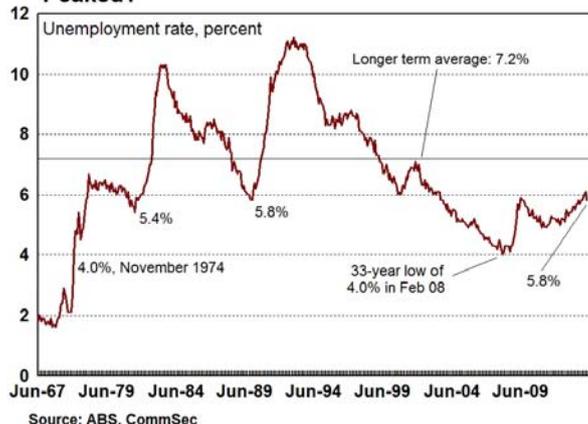
Growth returns to "normal"



Inflation remains under control



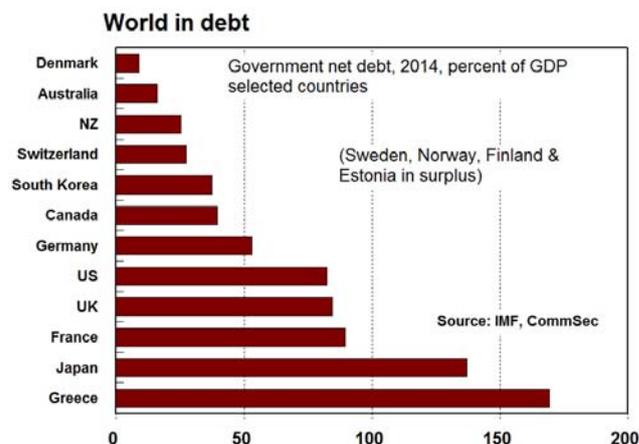
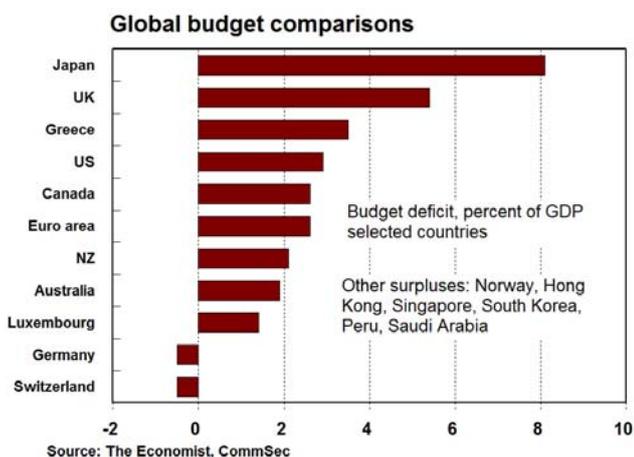
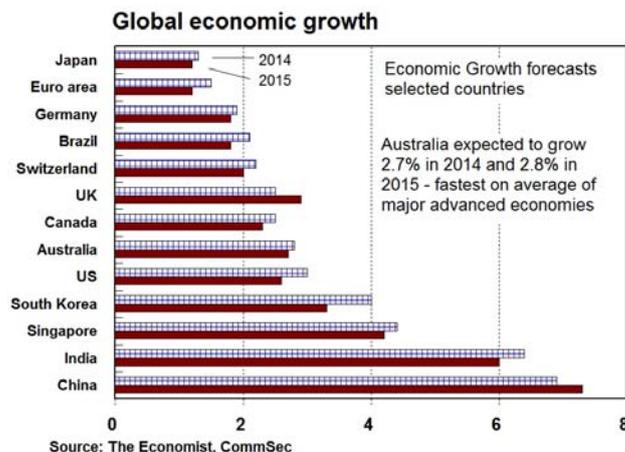
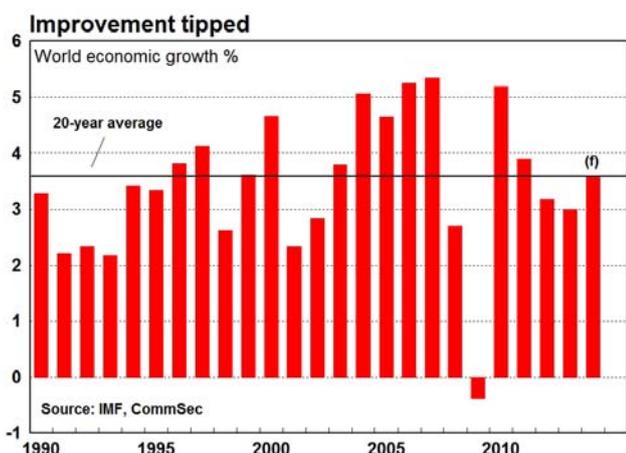
Peaked?



4. Global backdrop

Global economic growth tipped to return to “normal”

- In April, the International Monetary Fund (IMF) slightly trimmed forecasts for the global economy. After expanding by 3.0 per cent in 2013, growth of 3.6 per cent is tipped in 2014 and 3.9 per cent in 2015.
- The forecasts for 2014 and 2015 were both cut by 0.1 percentage points from the January 2014 update. But while the 2014 forecast was trimmed, the new estimates are still not far away from the average growth rate achieved over the past 30 years of 3.5 per cent.
- The major reason for the improvement in global growth, both this year and next, is that Advanced Economies are expected to grow more strongly, up by 2.2-2.3 per cent from 1.3-1.4 per cent in the past two years.
- China continues to lead the way on growth with 7.5 per cent projected this year and 7.3 per cent in 2015. But the US is expected to provide a bigger contribution to global growth, lifting 2.8 per cent in 2014 and 3.0 per cent in 2015.
- Recent news on the global economy has been mixed. The US economy does continue to do well with unemployment falling to a 7-year low of 6.3 per cent. And while the economy seemingly slowed to crawl in the March quarter at a 0.1 per cent annual pace, much has to do with the severe winter weather experienced.
- In China, the economy is broadly growing by around 7.5 per cent as dictated by its authorities.
- In Europe, the European Central Bank is still open to the idea of providing more stimuli to ensure that deflationary tendencies don't take hold in major economies.
- Federal Treasury influences IMF and OECD forecasts for Australia. Looking at *The Economist* poll of forecasters, Australia is expected to grow the fastest of the major advanced economies over the next two years.



5. Future Funds and GST

Government investments

- As noted above, the government is planning to establish a **Medical Research Future Fund**, growing the fund to \$20 billion over six years. The fund will provide significant new medical funding to medical research.
- The value of all the nation building funds currently stand at \$108 billion, up from \$92.2 billion a year ago.
- The **Future Fund** was set up to provide for the unfunded superannuation liabilities of Commonwealth public servants. As at March 2014, the Future Fund stood at \$97.57 billion, up \$12.4 billion over the past year or 14.5 per cent.
- The **Building Australia Fund** was set aside for *“the creation or development of transport, communications, energy and water infrastructure and in relation to eligible national broadband matters”*. As at March 2014, the Building Australia Fund stood at \$4.09 billion, down \$0.93 billion over the year.
- The **Education Investment Fund** is set aside to make payments for education infrastructure. As at March 2014 the Education Investment Fund had assets of \$3.87 billion, down \$0.2 billion over the year.
- The **Health & Hospitals Fund** was established to enhance the Government’s ability to boost our health infrastructure. As at March 2014, the Health & Hospitals Fund stood at \$2.47 billion, down \$0.72 billion over the year.

Investing for the future

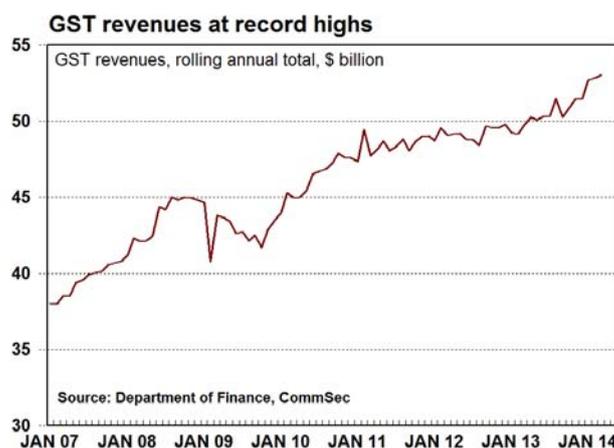
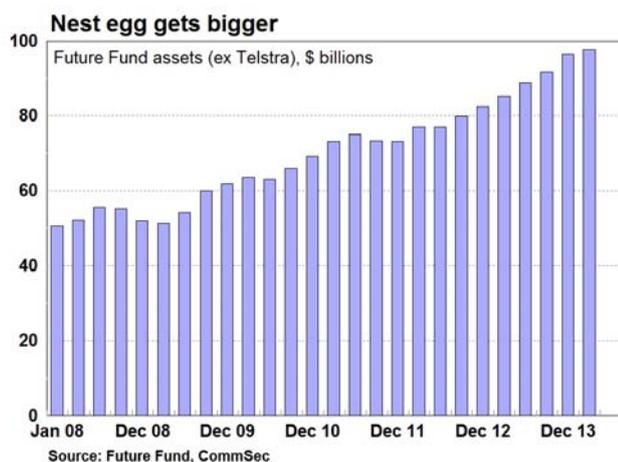
Assets at March 31 2014

	\$ billion
Future Fund	\$97.57
Education Investment	\$3.87
Building Australia	\$4.09
Health & Hospitals	\$2.47

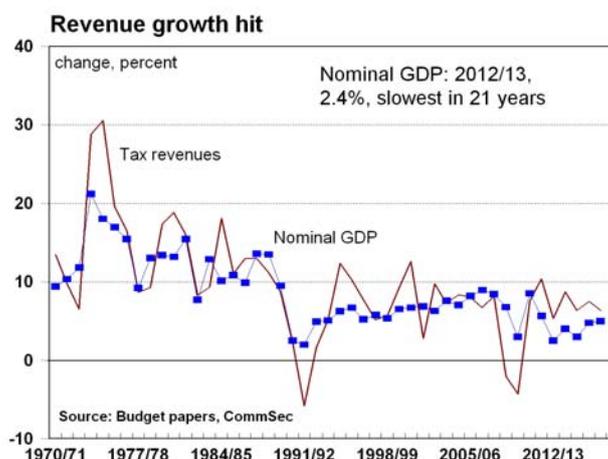
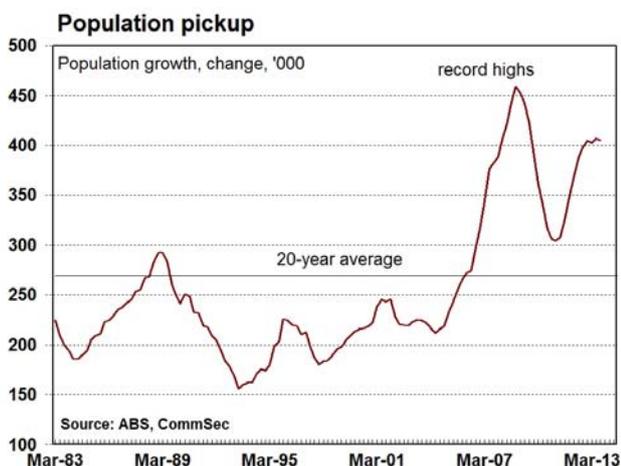
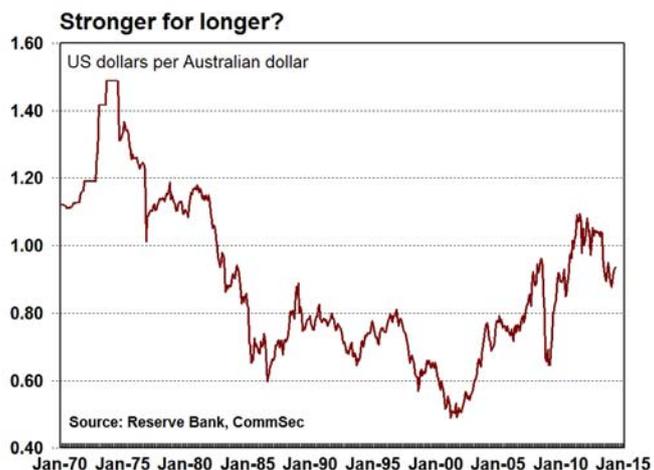
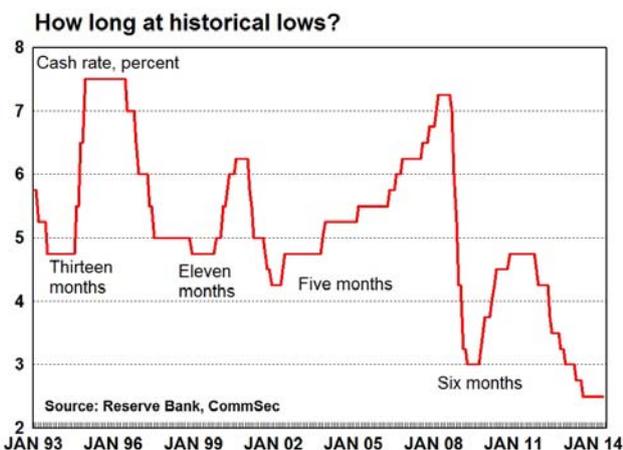
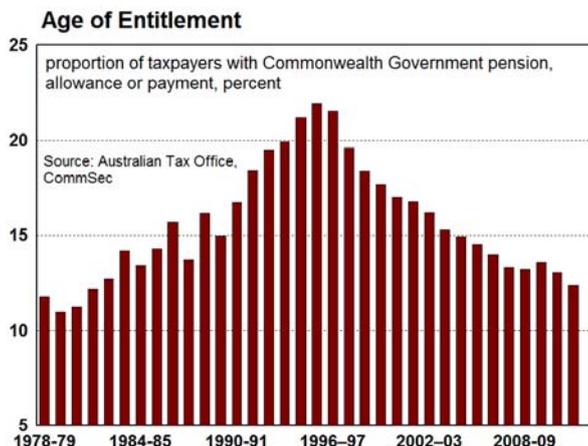
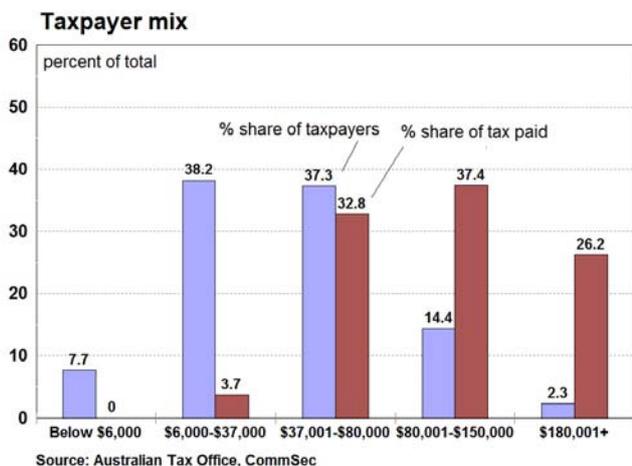
Source: futurefund

Goods and services tax (GST)

- To some extent this is the “forgotten” tax. Despite the fact that the GST is the third biggest revenue generator behind personal tax and company tax, it tends not to feature in budget analyses. All of the revenue goes to the states and territories so it certainly has a major influence on the ability of governments to spend across the community.
- GST receipts hit a peak of \$49.8 billion in the 2012 year before easing to \$49.2 billion the year to February 2013. GST receipts crept higher through to July 2013 before picking up pace with consumer spending late in 2013 and early 2014. GST receipts hit a record high of \$53.1 billion in the year to March 2014 (latest data).
- The Government currently expects GST receipts to rise by 5.0 per cent in 2013/14 (\$2.4 billion), reflecting growth in taxable consumption and dwelling investment as well as increased compliance measures.
- In the projection years, GST receipts are expected to grow by 5.8 per cent (\$3.0 billion) in 2014/15 and 6.1 per cent (\$3.3 billion) in 2015/16 and 6.0 per cent (\$3.4 billion) in 2015/16, in line with rising trend growth in consumption.
- The government notes: *“Since the 2013-14 MYEFO, GST receipts excluding measures have been revised up \$750 million in 2013-14 and \$4.5 billion over the four years to 2016-17 as a result of stronger expected consumption growth.”*



6. Selected Charts



7. Impact – Rates, \$A, Shares

Interest rates

- The Reserve Bank has made it clear that interest rate settings are on hold. If rates were to change in the short term it is still more likely to be a rate cut rather than a rate hike. Much will depend on how the economy reacts to the latest Budget. Certainly consumer confidence has been dented, falling 11 per cent over the past three weeks.
- How will the Reserve Bank react to the Budget? The RBA Governor said in recent testimony: *“to the extent that something in the budget affects the path of aggregate demand in the economy one way or another, assuming that that is of significant magnitude—if you are talking \$1 billion, that is not noticeable in the forecast demand track, but if you are talking \$8 billion or \$10 billion then it is—that obviously has to be built into our outlook on which we base the interest rate decision.”*
- While CommSec expects the Reserve Bank to raise interest rates modestly towards the end of 2014, the risk is that the first rate hike could be delayed into 2015. But certainly monetary policy is ultra-stimulatory at present and a shift towards a more normal rates setting is likely as the recovery gains traction. Notably, economic growth has proved firmer than Reserve Bank forecasts over the past six months.

Australian dollar

- We don't believe there are major implications for the Australian dollar from decisions made in the latest budget. Still, that has been the case for probably over a decade now.
- While fiscal policy is contractionary, monetary policy has remained accommodative. And that is set to remain the case. And it is certainly something the Reserve Bank has already factored in.
- In the short-term the Budget is more likely to keep downward pressure on the Aussie dollar. If the Budget checks momentum in the economy, and the Reserve Bank moves to an “easing bias” (an inclination to cut rates) rather than the current neutral stance, then the Aussie dollar may lose support.
- But overall, we don't expect the economy to be markedly depressed from the Budget measures. And with the global economy healing, job market improving, and with low interest rates boosting home prices and construction, the Reserve Bank may be more likely to turn its attention to higher interest rates, either late this year or early in 2015. We also don't expect the US Federal Reserve to start lifting rates until mid-2015.
- We expect the Aussie dollar to hold between US90c to US97c over the next year (on average the Aussie dollar has fluctuated by around US14 cents a year over the last 30 years).

Sharemarket implications

- **Retailers:** Mildly negative, cuts to family welfare payments, temporary Budget Repair Income Levy, Medicare co-payments and increase in petrol excise will reduce discretionary household funds. Over the near term growth is likely to remain patchy. However given the incentives provided to small, medium and large businesses – particularly around non-mining activity – it is likely to support broad-based business investment and ensure that the unemployment rate may have peaked or is close to it. But Treasury expects consumer activity to actually be weaker than even Reserve Bank forecasts with unemployment to lift. Household spending growth of 2.5 per cent is tipped in 2013/14 and 3.0 per cent in 2014/15.
- **Transport & Construction:** The real winners from tonight's budget. The Infrastructure Growth Package provides an additional \$11.6 billion for infrastructure with spending on rail roads and ports - should support construction and transport stocks.
- **Finance:** Nothing in the budget to hurt growth for domestic banks. In fact banks may benefit from the Reserve Bank being able to keep interest rates low over the medium term. Economic growth should continue to lift overall activity.
- **Miners:** Repealing the mining and carbon taxes will be supportive of the overall mining sector. In addition the Exploration Development Incentive should support and encourage investment for smaller miners.
- **Healthcare:** Medicare co-payments a negative for GP funding. We rate this budget as relatively more negative for Primary Health Care than Sonic Healthcare, given its bulk billing model and relatively larger earnings exposure to medical centres. Likely to be more beneficial for medical research groups.

