



# Federal Budget 2008/09

**what it means for financial planning strategies, the economy and markets**

**“stable budget in volatile times”**

## **Snapshot**

- personal income tax rate cuts confirmed in the Budget
- Baby Bonus wound back for high income earners
- salary sacrifice superannuation contributions will be taken into account in determining the superannuation co-contributions, government income support payments for people below Age Pension age and child support
- the Commonwealth senior's health card income test will include gross income from superannuation income streams and income which has been salary sacrificed to superannuation
- the underlying cash surplus is forecast to be a whopping \$21.7 billion underpinned by large tax dividends flowing from the resources boom. New budget savings decisions have broadly offset new spending decisions. The surplus is being squirreled away in three new funds, the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund, which from 2009-10 will be used to fund investments in education, infrastructure and health.
- economic growth is forecast to slow from 3 ½% to 2 ¾% in 2008-09. Inflation is forecast to be 3 ½%, above the Reserve Bank's 2-3% medium-term target but move back within target by the end of 2009.

**Tuesday 13 May 2008**

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# what it means for financial planning strategies

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This section outlines the key financial planning opportunities and impacts.

## tax rates 2007-08 and beyond

In fulfilment of pre-election promises, on 14 February 2008 the Government introduced a Bill to reduce personal income tax rates and these were confirmed in the Budget (rates for residents shown).

Tax thresholds for 2007-2008	
Income Range pa	Tax
\$0 - \$6,000	0%
\$6,001 - \$30,000	15%
\$30,001 - \$75,000	\$3,600 + 30%
\$75,001 - \$150,000	\$17,100 + 40%
\$150,000 +	\$47,100 + 45%

Tax thresholds for 2008 - 2009 (revised from 2007 budget)	
Income Range pa	Tax
\$0 - \$6,000	0%
\$6,001 - \$34,000	\$0 + 15%
\$34,001 - \$80,000	\$4,200 + 30%
\$80,001 - \$180,000	\$18,000 + 40%
\$180,000 +	\$58,000 + 45%

Tax thresholds for 2009-2010	
Income Range pa	Tax
\$0 - \$6,000	0%
\$6,001 - \$35,000	\$0 + 15%
\$35,001 - \$80,000	\$4,350 + 30%
\$80,001 - \$180,000	\$17,850 + 38%
\$180,000 +	\$55,850 + 45%

Tax thresholds for 2010 - 2011	
Income Range pa	Tax
\$0 - \$6,000	0%
\$6,001 - \$37,000	\$0 + 15%
\$37,001 - \$80,000	\$4,650 + 30%
\$80,001 - \$180,000	\$17,550 + 37%
\$180,000 +	\$54,550 + 45%

The Government has an aspirational tax goal over six years for personal income tax to reduce to three marginal rates – 15%, 30% and 40%. In addition, the tax-free threshold is intended to increase to \$20,000 by 2012-13.

### Low Income Tax Offset (LITO)

The maximum amount of LITO will also increase as follows:

- ~ from \$750 to \$1,200 in 2008 - 2009
- ~ to \$1,350 in 2009 - 2010
- ~ to \$1,500 in 2010 - 2011

### indicative income tax savings

Income (pa)	Tax	Tax Saving	
	2007 - 2008	2008 - 2009	2009 - 2010
\$35,000	\$5,075	\$1,050	\$300
\$55,000	\$11,925	\$800	\$300
\$80,000	\$20,300	\$1,100	\$150
\$100,000	\$28,600	\$1,100	\$550
\$150,000	\$49,350	\$1,100	\$1,550
\$200,000	\$72,600	\$2,600	\$2,150

Tax calculations include LITO, Medicare levy, savings shown per year (ie not cumulative).

### new effective tax-free thresholds

Year	Tax-Free Threshold	LITO Cut Off
2007 - '08	\$11,000	\$48,750
2008 - '09	\$14,000	\$60,000
2009 - '10	\$15,000	\$63,750
2010 - '11	\$16,000	\$67,500

Based on marginal tax rates and LITO only, assumed LITO reduction 0.04/\$1 > \$30,000

New withholding schedules will be calculated so that low and average income earners will receive half the LITO benefit through their regular pay rather than all of the offset as a lump sum following lodgement of their tax returns.

### tax-free thresholds: children's income

This is the amount of unearned income children can now have without paying tax.

Year	Tax-Free Threshold
2007 - '08	\$1,666
2008 - '09	\$2,666
2009 - '10	\$3,000
2010 - '11	\$3,333

Based on child tax rates 2007 - '08, LITO as above.

### tax-free thresholds for senior Australians

The income thresholds at which senior Australians (of Age Pension Age) will begin to have a tax liability will increase due to the increase in LITO and is as follows:

Year	Single	Each Member of a Couple
2008 - '09	\$28,867	\$24,680
2009 - '10	\$29,867	\$25,680
2010 - '11	\$30,685	\$26,680

The relevant Medicare Levy thresholds will also increase so that Senior Australians do not pay Medicare Levy until they pay tax.

**tax rates: non-residents**

In the same Bill introduced on 14 February 2008, the Government proposed to change non-resident income tax rates as follows:

<b>Tax thresholds for 2007-'08</b>	
<b>Income Range pa</b>	<b>Tax Rate</b>
\$0 - \$30,000	29%
\$30,001 - \$75,000	30%
\$75,001 - \$150,000	40%
\$150,000 +	45%

<b>Tax thresholds for 2008 - '09</b>	
<b>Income Range pa</b>	<b>Tax Rate</b>
\$0 - \$34,000	29%
\$34,001 - \$80,000	30%
\$80,001 - \$180,000	40%
\$180,000 +	45%

<b>Tax thresholds for 2009-'10</b>	
<b>Income Range pa</b>	<b>Tax Rate</b>
\$0 - \$35,000	29%
\$35,001 - \$80,000	30%
\$80,001 - \$180,000	38%
\$180,000 +	45%

<b>Tax thresholds for 2010 - '11</b>	
<b>Income Range pa</b>	<b>Tax</b>
\$0 - \$37,000	29%
\$37,001 - \$80,000	30%
\$80,001 - \$180,000	37%
\$180,000 +	45%

**Medicare levy surcharge and private health insurance**

Changes to the Medicare levy surcharge thresholds announced in the media prior to the budget were confirmed.

Taxpayers without adequate private hospital insurance may be liable for the surcharge. The Medicare levy surcharge is an additional 1% on top of the Medicare Levy and is calculated on a taxpayer's taxable income and reportable fringe benefits (plus certain other trust income and ETPs, and rental and other investment losses).

Medicare levy surcharge will now apply to those without adequate private hospital insurance where income exceeds \$100,000 for a single person or \$150,000 for a couple (previously \$50,000 and \$100,000 respectively). The surcharge applies to the sum of the taxpayer's whole taxable income and reportable fringe benefits as soon as the threshold is exceeded.

A taxpayer aged 30 or over who does not have the minimum level of private hospital cover is subject to an additional insurance premium of 2% for each year of non-cover if the taxpayer subsequently takes out or re-instates private hospital cover.

A taxpayer is able to opt out of private hospital cover for up to 2 years (over age 30 lifetime limit) without the penalty (surcharge may still apply) and this two years may be extended if the taxpayer is overseas.

A private health insurance tax offset of 30% applies to private hospital insurance (and ancillary benefits) premiums. This tax offset can either be deducted from the gross premium or claimed as a tax offset through the taxpayer's tax return.

With the increase in the thresholds, certain taxpayers may choose to opt-out of private hospital cover. This could apply more to the under 30's who would not be subject to the 2% pa premium penalty applying to periods of non-cover. Health Fund members should consider the potential impact of loss of "lifetime rating" and potential difficulties in obtaining cover in later life if delaying or opting out of private hospital cover, and the added cost.

#### **employee share schemes — election requirements**

The employee share scheme rules will be improved to ensure that income from these schemes is correctly reported. The changes will apply to shares and rights acquired from 1 July 2008.

Currently, a taxpayer may elect to be assessed on discounts provided on shares or rights in the income year the shares or rights are granted. If an election is not made, taxation of the discount (which includes gains on shares and rights) is deferred until a later time, such as when restrictions on the shares or rights are lifted.

The election procedures will be changed so that the value of the discount where it exceeds \$1,000 is included in assessable income if a taxpayer elects to be assessed up-front. Where the amount is not included in the taxpayer's tax return, the taxpayer will be taxed under the deferral option. The Commissioner retains the power to allow a taxpayer an extension of time to make the election.

Unless this measure improves reporting and monitoring obligations, we cannot see any change to the way in which the employee share scheme rules currently operate.

#### **managed funds – non-resident investors**

The Government will replace the current non-final withholding tax on managed fund distributions received by non-resident investors with a final withholding tax.

Currently, non-resident investors in Australian managed funds are subject to a 30% withholding tax on Australian sourced income (other than interest and dividends which are subject to separate final withholding taxes). This withholding tax is not a final tax liability and investors are required to lodge an Australian income tax return and pay additional income tax if necessary.

This will be replaced by a final withholding tax relieving investors of the need to lodge an Australian tax return in respect of this income (although in practice many of these investors didn't lodge Australian tax returns.)

From 1 July 2008, the 30% rate will be reduced to 22.5%, however this reduction will only apply to residents of countries with which Australia has effective exchange of information agreements (these countries will be specified by regulation and will presumably include all countries with which Australia has double tax agreements).

This will still be a non-final withholding tax and investors will be able to claim deductions against distributions, however, a maximum rate of 22.5% will apply to net managed fund distributions. The 30% rate will remain for residents of other countries.

It is proposed that the withholding tax become a final tax liability (i.e. no deductions may be claimed but no tax return will be required from 1 July 2009). The applicable rates will be as follows:

Countries with which Australia has effective exchange of information agreements:

- ~ 2009/2010: 15%
- ~ 2010/2011 and later years: 7.5%
- ~ Other countries: 30%

As stated above, Australian sourced interest and dividend income will remain subject to final withholding taxes as follows:

- ~ Interest 10%
- ~ Franked dividends nil
- ~ Unfranked dividends:
  - o Paid to treaty country 15%
  - o Paid to non-treaty country 30%

This measure will make investment in Australian managed funds by non-residents more attractive due to lower withholding tax rates and relief from the need to lodge an Australian tax return.

#### **increase in luxury car tax**

Also announced in the media prior to the actual Budget is a proposed increase in luxury car tax. The tax applies where the GST inclusive price of a car exceeds \$57,123 (2007 - 08).

The tax rate is to increase from 25% to 33% and applies to the excess price above \$57,123 (GST exclusive).

#### **Fringe Benefits Tax changes**

The rules have been tightened for the following FBT concessions:

- ~ The FBT exemption for work-related items (e.g. laptops and personal digital assistants) purchased after 7.30pm on 13 May 2008 will only be available where the items are used primarily for work purposes and will be limited to one item of each type per employee per year.
- ~ From 7.30pm on 13 May 2008, meal card arrangements will no longer be exempt from FBT. Balances on existing meal cards will remain exempt from FBT provided they are used by 31 March 2009.

For items purchased after 7.30 pm on 13 May 2008, employees will be unable to claim depreciation on the work-related percentage of FBT exempt items. For items purchased before that time, employees will be unable to claim depreciation for the 2008/09 and later income years. This effectively removes depreciation claims for FBT exempt items.

#### **Baby Bonus**

On 1 July 2008 the Baby Bonus will be increased to \$5,000 and indexed yearly.

From 1 July 2009 the Baby Bonus will only be available where family income in the six months from the birth of the child is less than \$75,000 (annualised \$150,000 (indexed

yearly)). In addition, the Baby Bonus will be paid in fortnightly instalments over 6 months for all recipients.

Income test used is adjusted taxable income, which adds back amounts salary sacrificed to superannuation and investment and rental losses.

#### **education tax refund**

Parents who receive Family Tax Payment Part A will be able to claim a yearly 50% refund for education expenses (eg fees, books, uniforms, computers, software) up to:

- ~ \$750 for each child attending a primary school (maximum refundable offset of \$750 per child per year) and
- ~ \$1,500 for each child attending secondary school (maximum refundable tax offset \$750 per child, per year).

Depending on the number and age of children, Family Tax Benefit Part A eligibility may cease when family income is over \$97,845 (higher cut out thresholds apply for more and/or older children).

#### **increase in child care tax rebate**

The Child Care Tax Rebate will increase from 30% to 50%. The cap on the amount paid each year will rise from \$4,354 to \$7,500 per child. The rebate will now be paid quarterly instead of yearly which assists family cashflow. The Child Care Tax Rebate is in addition to any Child Care Benefit payable.

#### **child care benefit**

Only higher income families (earning more than \$108,434 pa) currently receive the minimum rate of Child Care Benefit. This will be abolished for families using approved care after 1 July 2008. Previous minimum rate recipients may still be eligible for the increased Child Care Tax Rebate (as above).

#### **Family Tax Benefit Part B**

From 1 July 2008 Family Tax Benefit Part B will only be paid to families where the principal earner has an annual income up to \$150,000. This threshold will be indexed yearly. Family income is now defined under the extended definition which includes amounts salary sacrificed to superannuation and adds back investment and rental losses. (Currently income of the principal earner is excluded from assessment of eligibility for FTB Part B.)

#### **National Rental Affordability Scheme**

The Government is encouraging the construction of affordable rental housing. The Scheme will provide \$8,000 annually for 10 years to investors for each new dwelling that is rented out to low income tenants at least 20% below the market rate.

#### **Means testing of government support expanded**

From 1 July 2009, the definition of "income" used to determine eligibility for government support programmes will be expanded to include:

1. **Salary sacrifice superannuation contributions** will be taken into account in determining superannuation co-contributions, government income support payments for people below Age Pension age, child support and family assistance.

Employees will no longer be able to make salary sacrifice superannuation contributions to qualify for, or increase their entitlement to the co-contribution. This measure creates a level playing field with self employed persons who are currently unable to increase the co-contribution by making a personal deductible contribution. For people aged 60 or over who work full-time and who implement a transition to retirement strategy to reduce tax (whereby they live off their allocated pension payments and salary sacrifice their wage to superannuation), may no longer qualify for, or increase their entitlement to the co-contribution.

In addition, employees will no longer be able to reduce their child support obligations via salary sacrifice superannuation contributions.

2. **Net financial investment losses and net rental property losses** will be taken into account in determining SATO, Medicare levy surcharge and dependency tax offsets. Currently, net rental property losses are included in the definition of adjusted taxable income for the purposes of the Commonwealth Seniors Health Card, child support, family assistance programs, some parental income tests and loan repayment obligations under the Higher Education Loan Program. Adjusted taxable income will be expanded to include net financial investment losses.
3. **Reportable fringe benefits** will be taken into account in determining SATO, dependency tax offsets and pensioner tax offset.

#### **Commonwealth Senior's health card income test amended**

The Commonwealth senior's health card income test will now include gross income from superannuation income streams from a taxed source (e.g. public offer super funds such as iAccess Allocated Pension) and income which has been salary sacrificed to superannuation. This measure is designed to increase fairness by ensuring that all income received by seniors is treated in the same way regardless of whether from superannuation, managed funds, or interest from bank accounts.

#### **payments to seniors and carers**

The Budget announced further bonus payments to seniors and carers.

#### **Seniors**

The Seniors Concession Allowance payable to holders of Seniors Concessions Health Card and certain Veterans' Affairs Gold Card Holders will be increased from \$218 to \$500.

The Utilities Allowance will increase from \$107.20 to \$500 p.a. for singles (and couples combined). This will be extended to other Centrelink beneficiaries including Disability Support Pension and Carer Payment.

A tax-exempt Seniors Bonus of \$500 will be payable to recipients of pensions including Age Pension and veterans' pensions.

#### **carers**

Recipients of Carer Payment will receive \$1,000 and recipients of Carer Allowance will receive \$600 for each eligible person they care for. The payments will be tax-free.

#### **proposed first home saver accounts scheme modified**

The first home saver account scheme proposed in a consultation paper released in February 2008 has been amended. The first home saver account allows individuals to contribute up to \$75,000 (indexed annually) towards the purchase of their first home.

Earnings in the account will be taxed at 15%. Individuals will be able to withdraw amounts from the account without tax consequences provided that they contribute at least \$1,000 in four separate financial years.

Individuals who open an account will receive a government contribution of 17% on the first \$5,000 contributed annually.

Major changes to the scheme include:

- ~ replacing the previously announced \$10,000 annual contribution cap with an overall contribution cap of \$75,000 (indexed annually)
- ~ removing the requirement for individuals to contribute \$1,000 to commence the account
- ~ clarifying that the four-year rule for tax-free withdrawals applies from the start of the financial year rather than the date that the account was established; and
- ~ allowing individuals a 14-day cooling off period in which to change their mind about their account.

Whilst the commencement date of the scheme has been delayed until 1 October 2008 to enable account providers more time to develop products, individuals will still be entitled to a government contribution on the first \$5,000 of personal contributions in 2008/09.

## what it means for the economy

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The Government is forecasting a combination of below trend growth and higher inflation over the next year.

- ~ Australian growth is expected to slow to 2.75% in 2008-09 from 3.5% in 2007-08 (ref Chart 1). The slowdown is driven by moderating private and public sector demand and weaker net exports. The income generated from an expected 16% rise in Australia's terms of trade due to soaring commodity prices is expected to cushion the economy from the effects of more noticeable slowdown in the US, Japan and Europe. For the 3 years from 2009-10, Australia's growth is projected to be 3%.
- ~ Inflation, which increased by 4.2% over the year to March 2008, is forecast to rise by 3.5% in 2008-09, easing back to 3.25% by June 2009 (ref Chart 2). Budget projections assume inflation could fall back to the middle of the 2-3% band targeted by the Reserve Bank of Australia (RBA) in 2009-10.
- ~ The unemployment rate reached a 33 year low of 4.0% in February 2008, significantly lower than the 5.0% rate forecast in last year's Budget. Labour market tightness and anecdotes of rising skilled labour shortages run the risk of adding to wages pressures although the Government expects a weaker labour market to contain wages growth to rates experienced in recent times. The unemployment rate is forecast to rise to 4.75% by June 2009. Pockets of labour market tightness, particularly in resource related areas, are expected to persist.
- ~ Business investment has been supported by high corporate profits over the past year. The Government is forecasting that investment will remain firm in 2008-09, partly as a consequence of existing capacity constraints. However, higher interest rates, tighter credit conditions and uncertainty in global markets are expected to have more of a dampening effect as the year progresses.
- ~ Australia's current account deficit is expected to narrow to 5% of GDP in 2008-09 under the influence of a strong rise in the terms of trade which is forecast to produce a small trade surplus.
- ~ The Australian Dollar has risen 13.2% against the US Dollar and remained relatively unchanged against the Yen and Euro over the year to 30 April 2008. The Budget measures are unlikely to have an immediate impact on the Australian Dollar, which continues to be supported by the strong terms of trade and attractive yields in interest rate markets.
- ~ In a world of increased uncertainty, international investors should gain comfort from Australia's large Commonwealth fiscal surpluses. It is planned to use these surpluses to establish three funds that will support long-term infrastructure investments in education, health, transport and communications. This will enhance the economy's growth potential over the medium to long-term.

## budget economic forecasts

Indicator	Estimate 2007-08	Forecast 2008-09	Projection 2009-10	Projection 2010-11
Real GDP (%)	3.5	2.75	3.0	3.0
Employment (%)	2.5	1.25	1.25	1.25
Unemployment rate (%)	4.25	4.5	-	-
Inflation (%)	4	3.25	2.5	2.5
Wage price index (%)	4.25	4.25	4	4
Current account deficit (% of GDP)	6.25	5.0	-	-
Budget cash surplus/deficit (\$A billion)	16.8	21.7	19.7	19.0

source: 2008-09 Budget Papers, Statement Nos. 1, 2 and 3

Chart 1

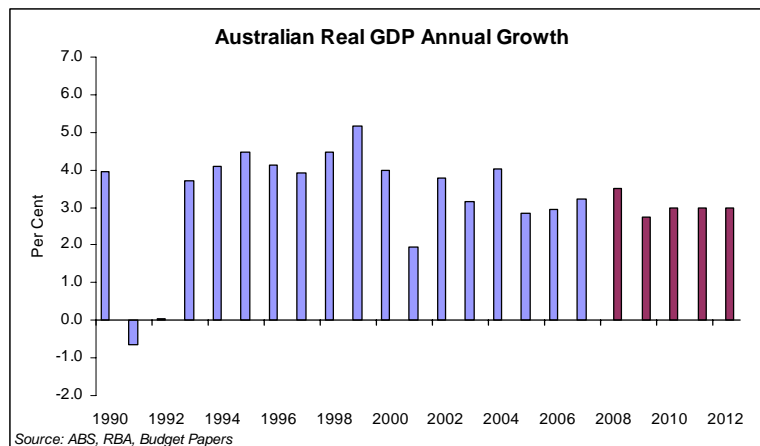
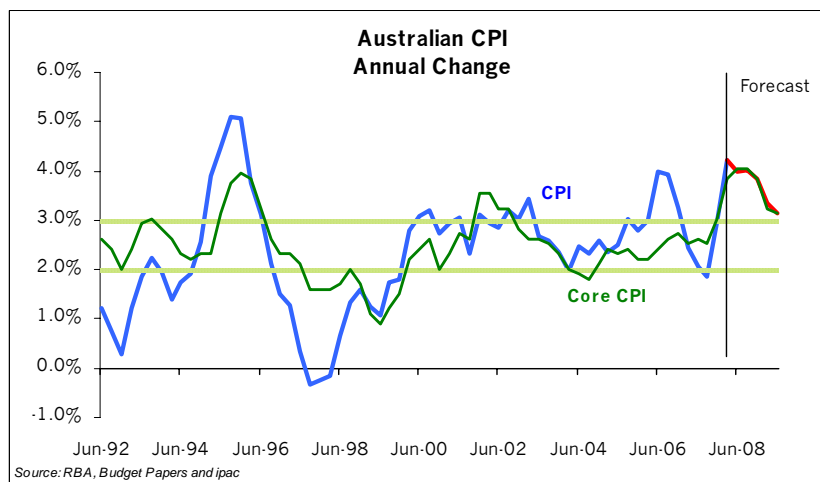


Chart 2



# what it means for markets

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## monetary policy and cash rates

- ~ In its Quarterly Statement of Monetary Policy in May, the RBA stated that domestic demand will need to slow significantly if inflation is to track back towards its target range of 2-3%. There are signs this is starting to occur, and budget measures to contain growth in government spending will contribute to this process, albeit moderately. In addition, the Government has identified A\$7.3 billion in savings over the year ahead to broadly offset the stimulatory impact of its new spending decisions.
- ~ The Federal government's inflation forecasts are slightly lower than those published by the RBA. The RBA expects annual CPI inflation to remain slightly above 4% throughout 2008 before gradually declining through 2009. The annual inflation rate is not forecast to move back inside the 2-3% medium-term target band before 2010. In contrast, government economic projections assume inflation will average 2.5% in 2009-10.
- ~ The task of setting budget and monetary policies has been complicated by recent liquidity strains in global financial markets, particularly credit markets, and the considerable uncertainties surrounding the outlook for global and Australian growth. Sentiment is still fragile but the declining threat to growth is allowing the RBA to refocus on the fight against inflation. Expectations for a further boost to incomes from the strong rise in the terms of trade, and slow progress in moderating inflation suggest the RBA is likely to maintain its current restrictive monetary policy for an extended period.

## fixed interest

- ~ Fixed interest markets tend to warm to slowing growth but fear the risk of higher than expected inflation. Consequently, the economic outlook contains mixed messages for the domestic fixed interest market.
- ~ To a large extent, the fixed interest markets have discounted the Government's economic outlook with the Budget economic assumptions broadly in line with the market consensus. The prospect of higher inflation in the short-term and the maintenance of restrictive monetary policy settings should underpin short term bond rates.
- ~ Long-term rates are subject to a broader set of factors, being more influenced by inflationary expectations and developments in global capital markets. Consequently, the outlook for longer-dated bonds remains more uncertain and the near-term impact of the Budget should be minimal. A potential tug of war between higher inflation and slower growth suggest the potential for volatile but rather directionless market conditions.

- ~ Large budget surpluses mean that new bond issuance is only undertaken to maintain an active treasury bond market. With A\$5.1 billion of bonds due to mature in 2008-09, a modest issue of A\$5.3 billion of new bonds is expected to maintain a stable supply of government debt.
- ~ Whilst the impact of the Budget on fixed interest markets is expected to be limited, the recent sharp widening in credit spreads as a consequence of the re-pricing of risk in financial markets, appears to once again be offering some potentially interesting investment opportunities, particularly for shorter dated securities. Spreads on most fixed interest securities are now well above historic averages.

## **shares**

- ~ Typically, the performance of shares has been more constrained when inflation is rising. On this occasion, however, shares seem better placed to withstand increases in inflation, as long as it is not extreme and does not become embedded. Provided any increases can be quarantined from feeding into stronger wages growth, corporate margins should be able to withstand the risk of inflation. The more serious challenge to margins is if the slow-down in demand and activity growth ends up being more severe than currently anticipated.
- ~ The economic outlook underpinning the Budget presents different challenges for various sectors of the Australian share market. With the RBA focused on slowing domestic demand, interest rate sensitive sectors more heavily exposed to the domestic economy seem more likely to be adversely affected. At the other extreme, materials and energy company earnings appear to be strongly underpinned by high commodity prices and may provide something akin to an inflation hedge. Companies delivering sustainable, more predictable, earnings streams may also be better positioned in the current climate.
- ~ The planned transfer of the bulk of the 2007-08 and 2008-09 budget surpluses to three new funds - the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund - will provide a significant boost to the financing of Australia's long-term infrastructure needs in the transport, communications, education and health sectors. The Government initially expects to allocate A\$40 billion to these funds and make contributions from future surpluses. While of no immediate impact to markets, it should provide longer-term support to industries in the building and construction, communications and engineering sectors and may be of longer-term benefit to companies with particular expertise in managing infrastructure projects.
- ~ A combination of capacity constraints, slowing demand, rising inflation and a restrictive monetary policy presents a more challenging business environment. Share markets are likely to experience noticeable volatility in the year ahead as fiscal and monetary policies work towards a more sustainable, non inflationary, growth path. Following the sharp price declines experienced by the Australian share market in the first quarter of 2008, valuations are quite reasonable and appear to be making some allowance for an extra degree of downside earnings risk beyond that currently forecast by the market consensus.

### **property**

- ~ Overall, the budget should have little material impact on the performance of listed property.
- ~ Following pronounced weakness in the listed property sector in the December and March quarters, property valuations now appear more reasonable. There are early signs that listed property trust market conditions are beginning to normalise, and the sector appears to be looking for opportunities to reduce gearing in response to the difficulties encountered by the more highly leveraged managers.

## **what it means for you**

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