

Initial assessment of the 2009-10 Federal Budget

ANZ Budget Night dinner

12th May 2009

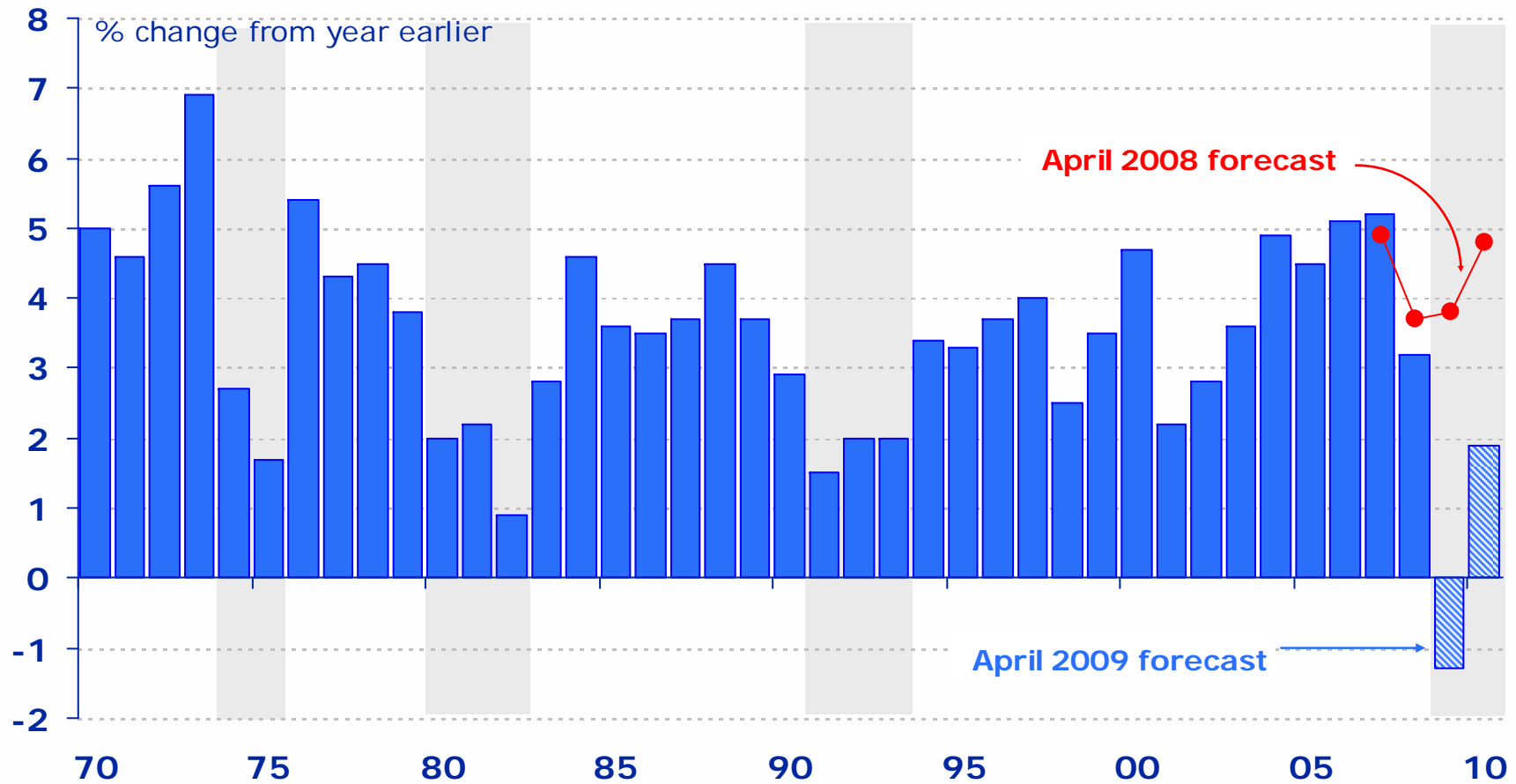
Saul Eslake

with assistance from
Riki Polygenis & Alex Joiner



The Budget has been framed in the context of the first contraction in the global economy since WW2

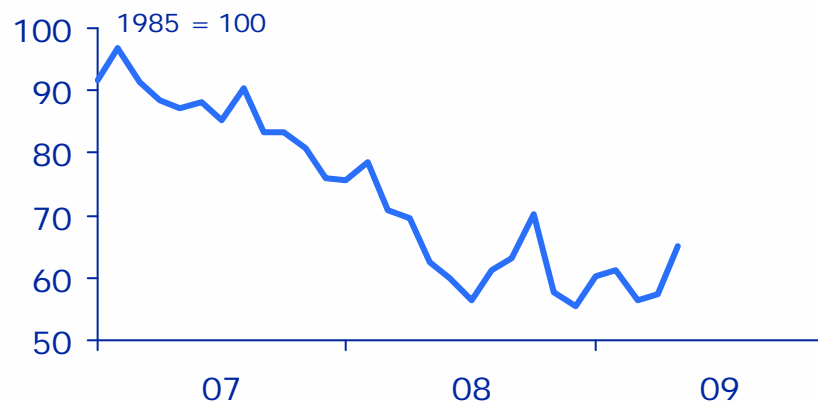
Global economic growth



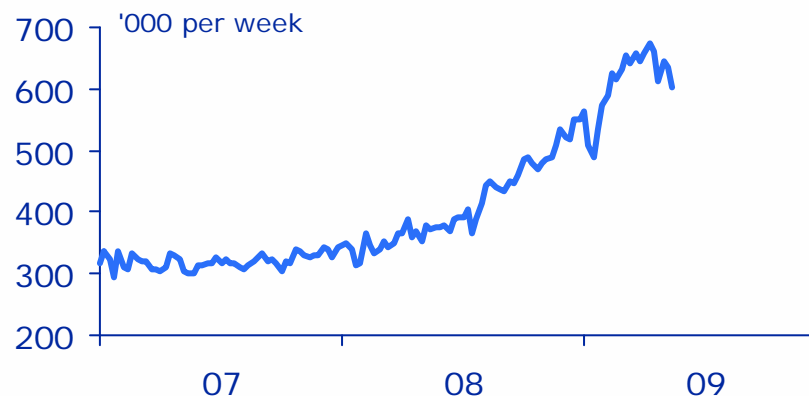
Note: shaded areas denote global recessions.

Recent weeks have brought some evidence that the US economy may be reaching a turning point

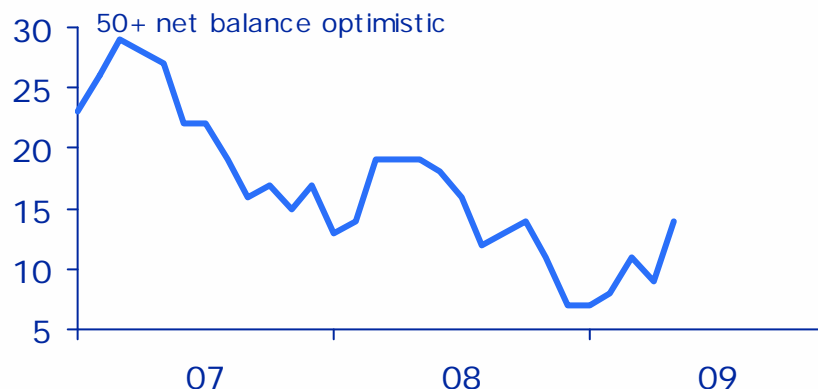
US consumer sentiment



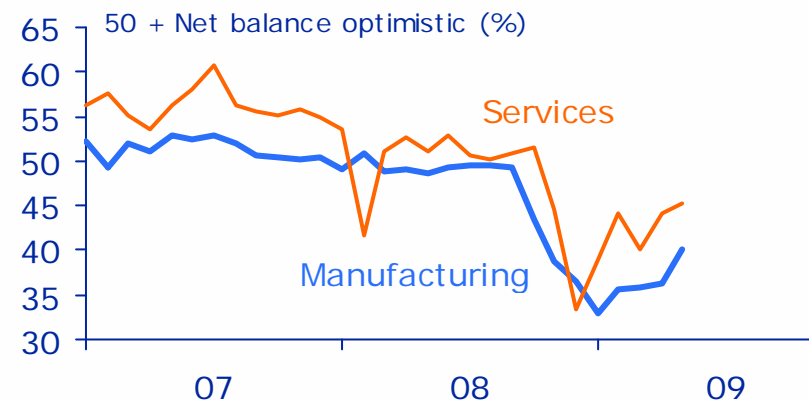
US initial claims for unemployment benefits



US housing market 'buyer traffic'

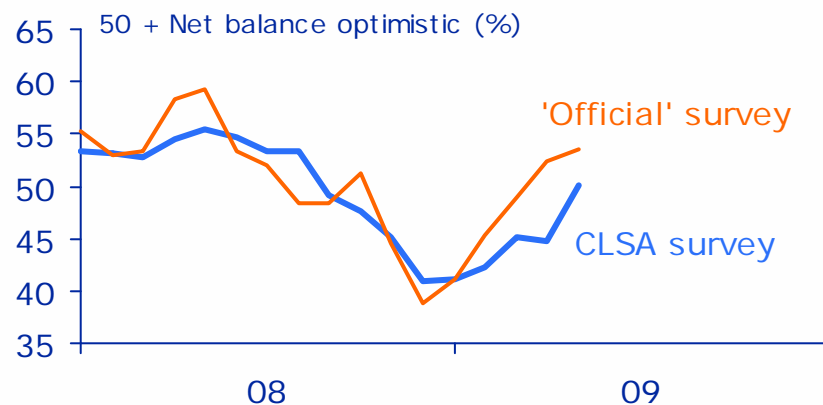


Manufacturing purchasing managers' index

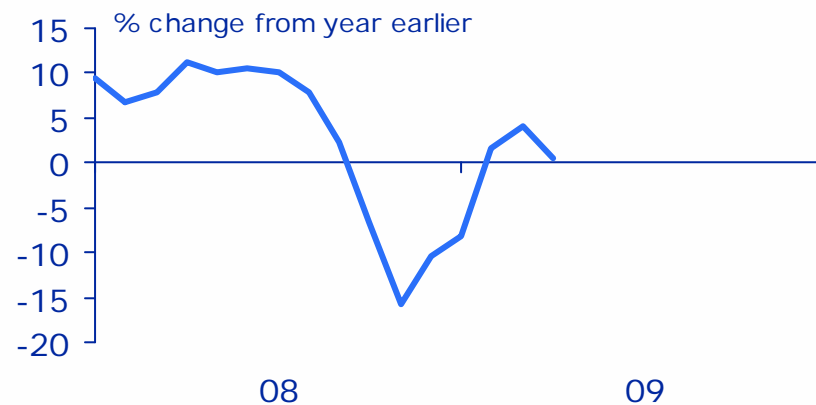


Even more clearly, the Chinese economy appears to be accelerating again

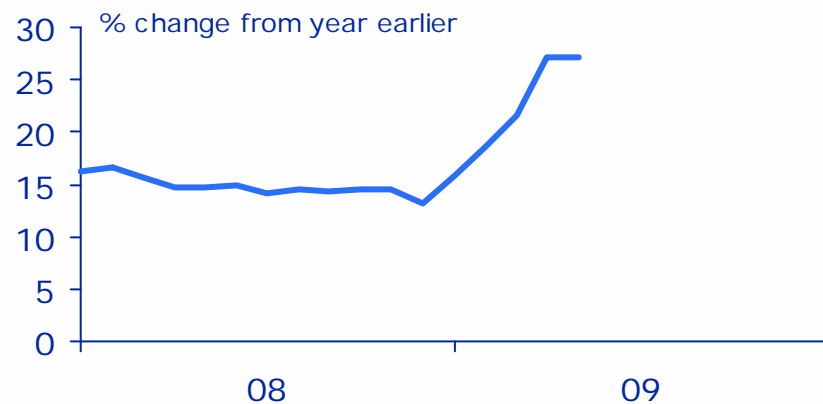
Purchasing managers indices



Steel production



Bank lending



Motor vehicle sales

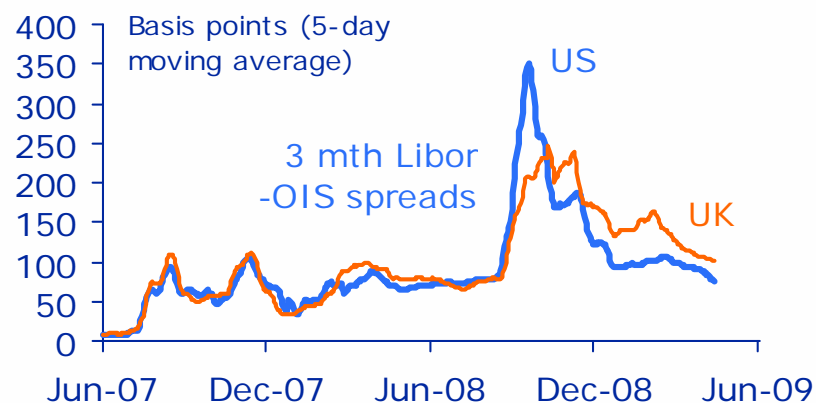


Financial markets appear increasingly confident that the worst is over

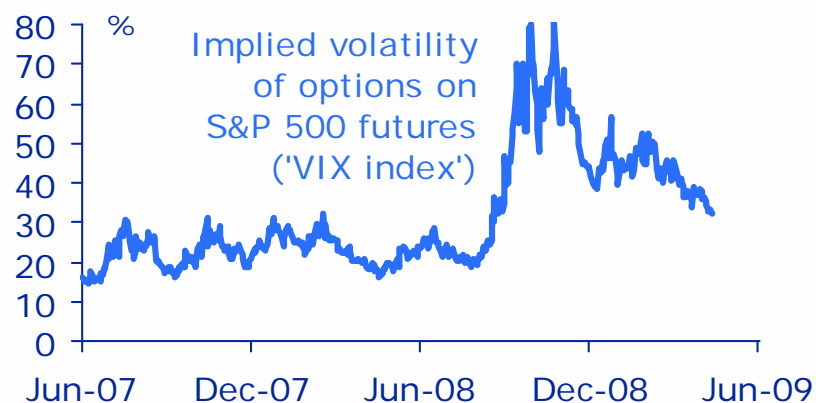
Sharemarkets



Bank funding cost spreads



Sharemarket volatility



Commodity prices



Yet there remain considerable obstacles to a 'typical' global recovery

As the IMF points out in its most recent forecasts -

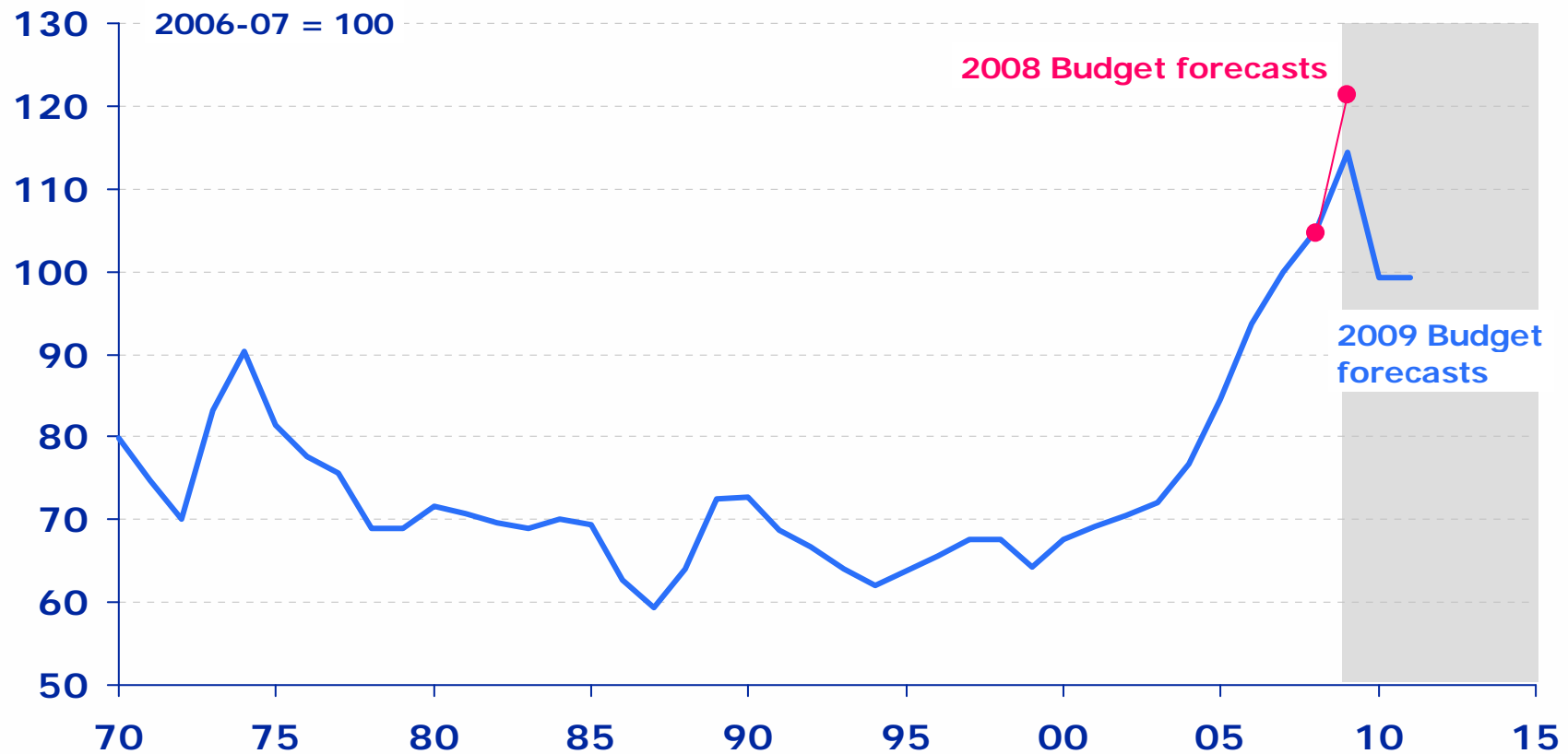
- 'recoveries after financial crises are significantly slower than other recoveries' and
- 'the synchronized nature of the global downturn tends to weigh against prospects for a speedy turnaround'

Moreover, although there is an unprecedented amount of policy stimulus being applied to the global economy -

- governments will be under pressure to raise taxes or cut spending once recovery is under way in order to stabilize public finances
- and central banks may be nervous about the potential inflationary risks associated with current policy settings once the present emergency has passed

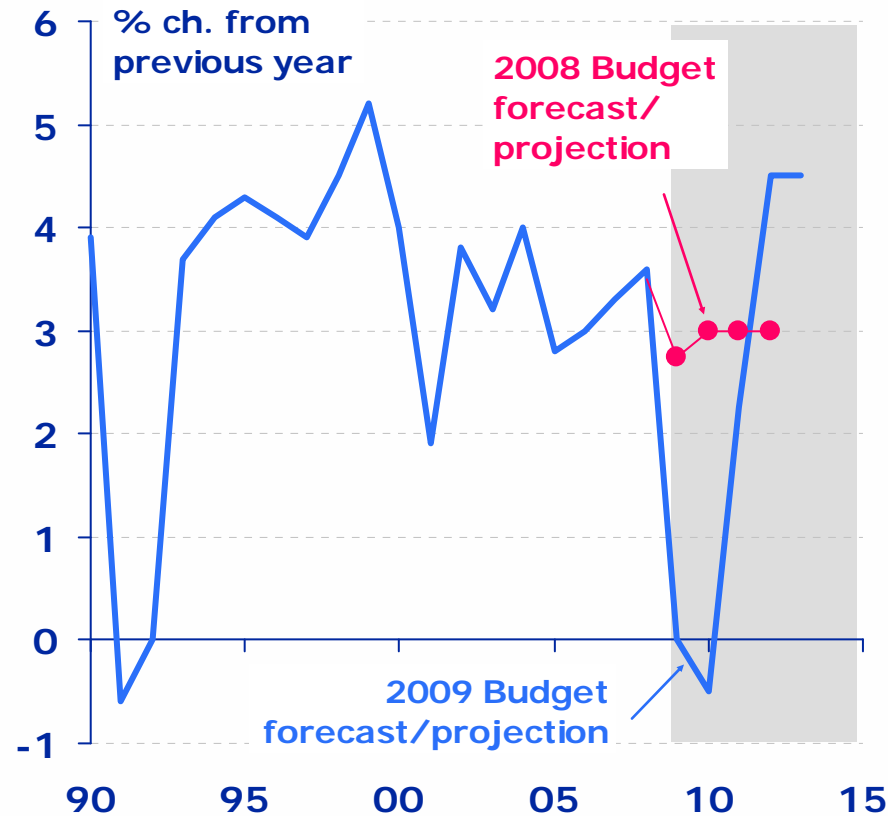
The global recession has put an end, for the time being, to the commodities boom ...

Australia's terms of trade (ratio of export to import prices)



... and pushed Australia into its first recession since the early 1990s

Real GDP growth

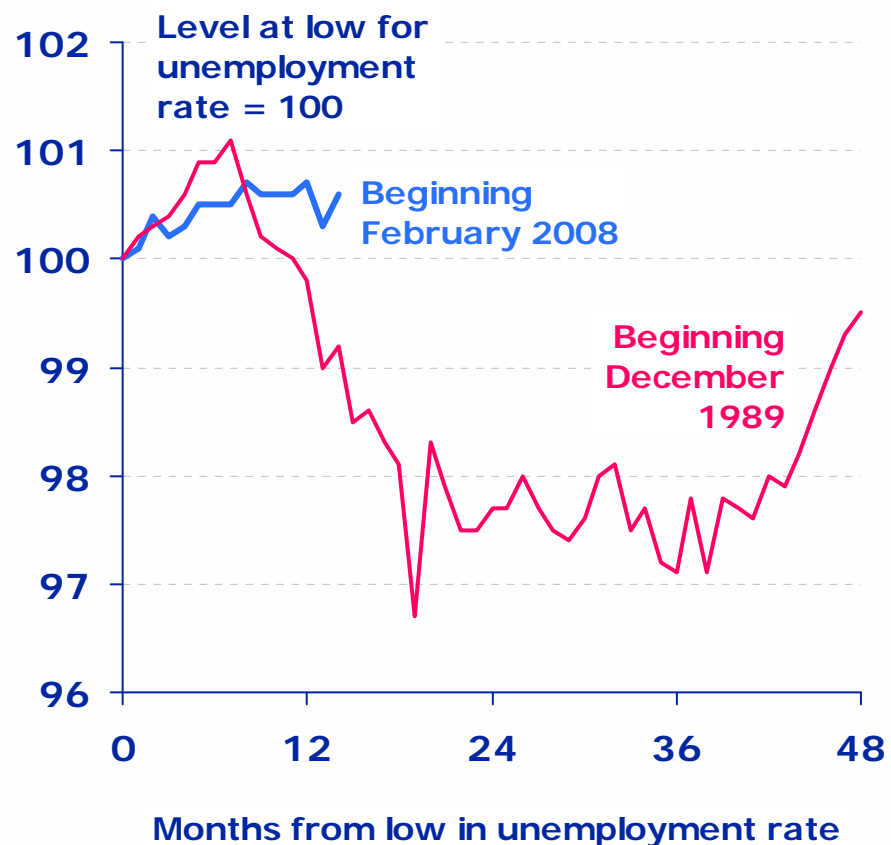


Unemployment rate

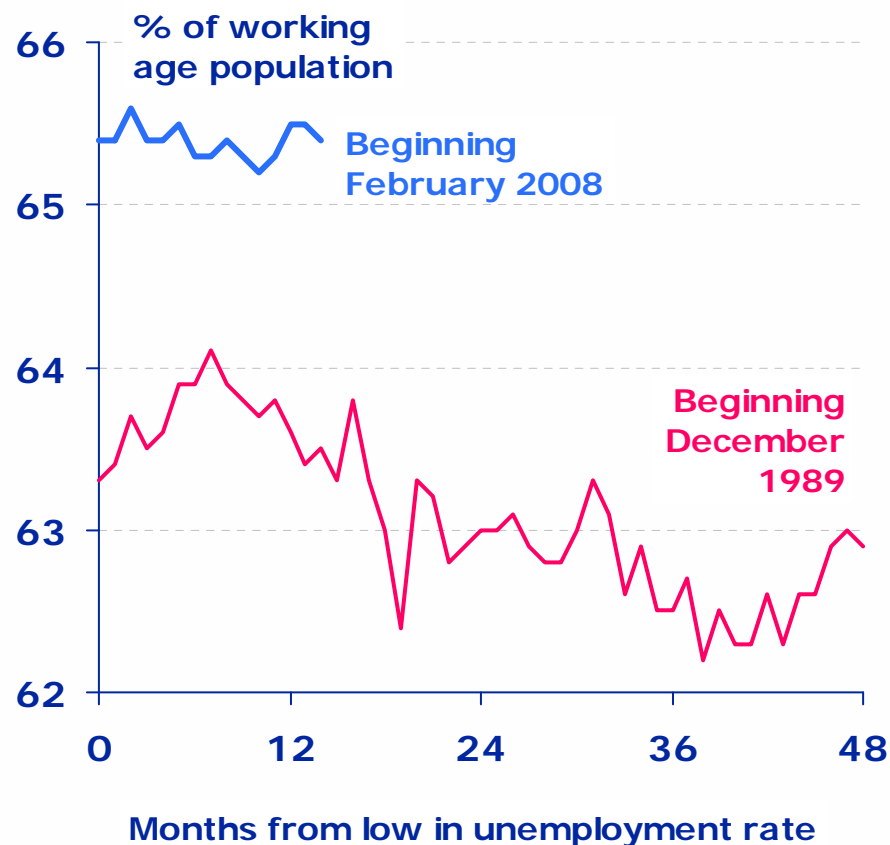


In the current recession, rising unemployment has so far not been driven by falling employment

Employment

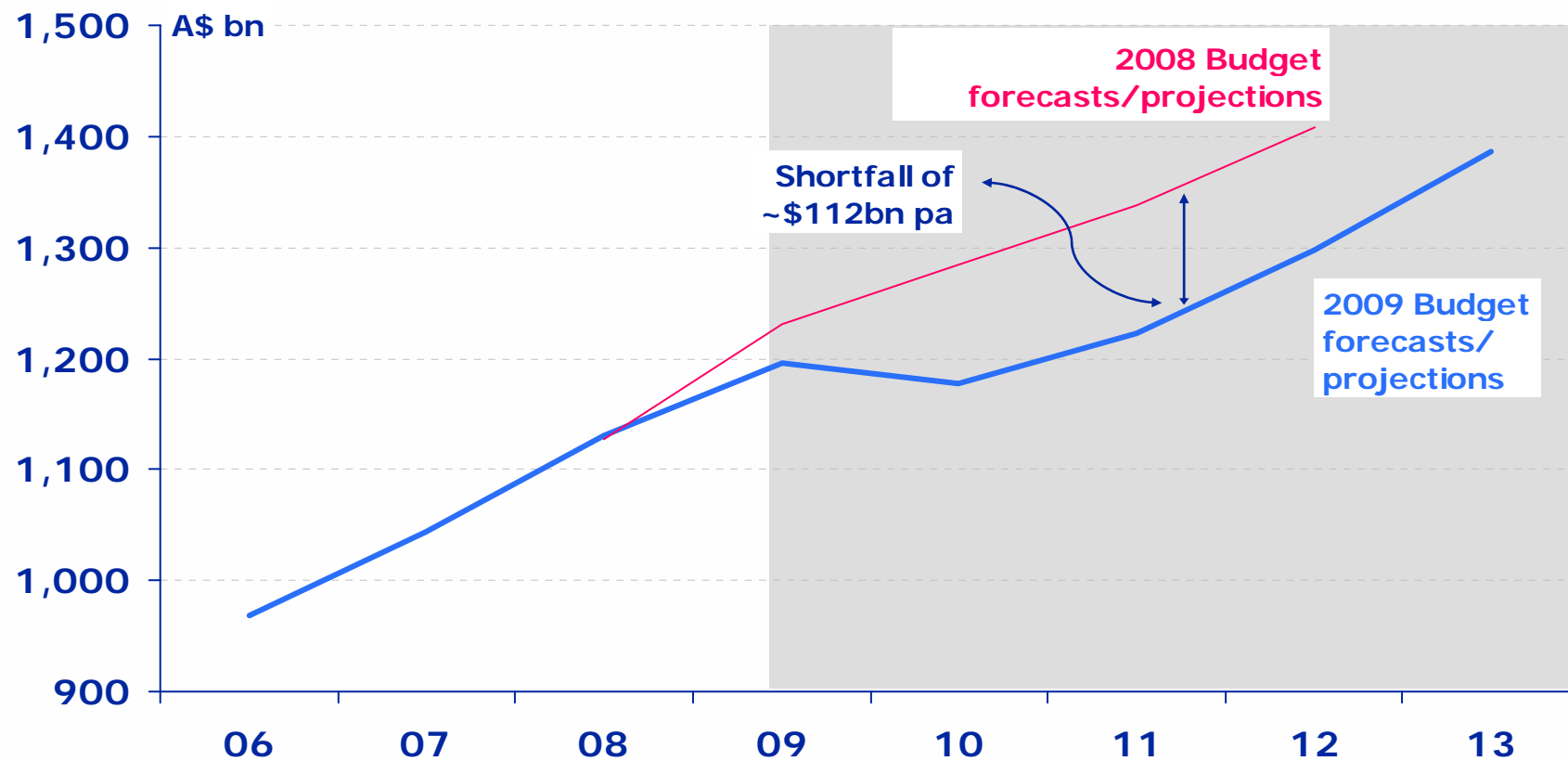


Participation rate



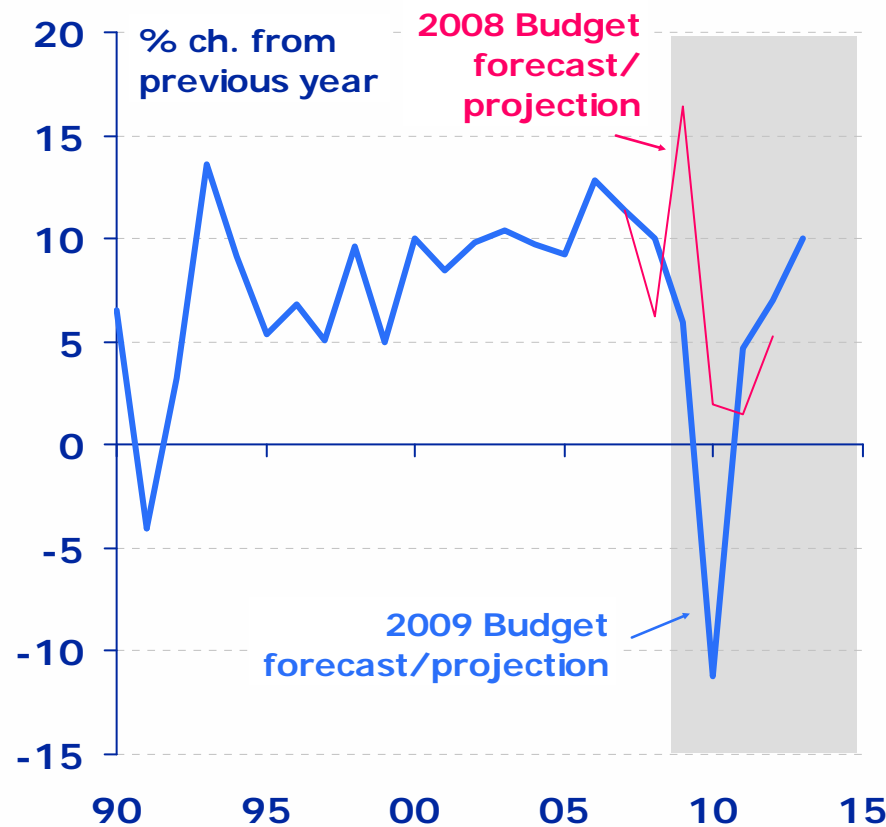
Lower commodity prices and weaker growth have resulted in a significant shortfall in national income

Level of nominal gross domestic product

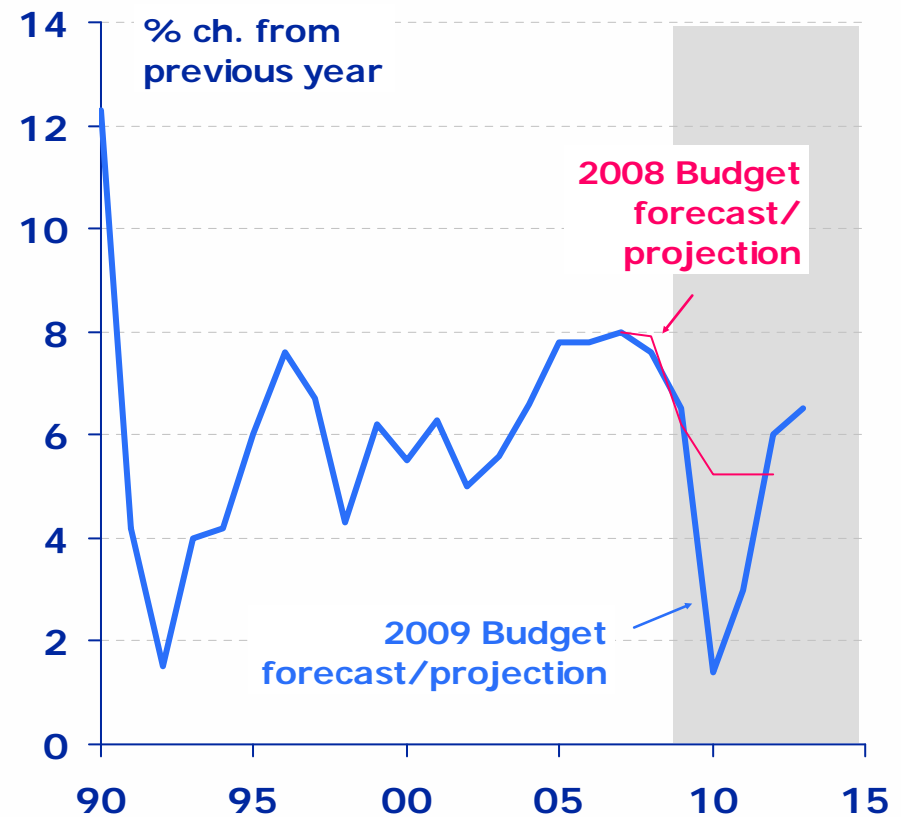


The current recession will be marked by a particularly large contraction in company incomes ...

Corporate gross operating surplus



Non-farm employee compensation

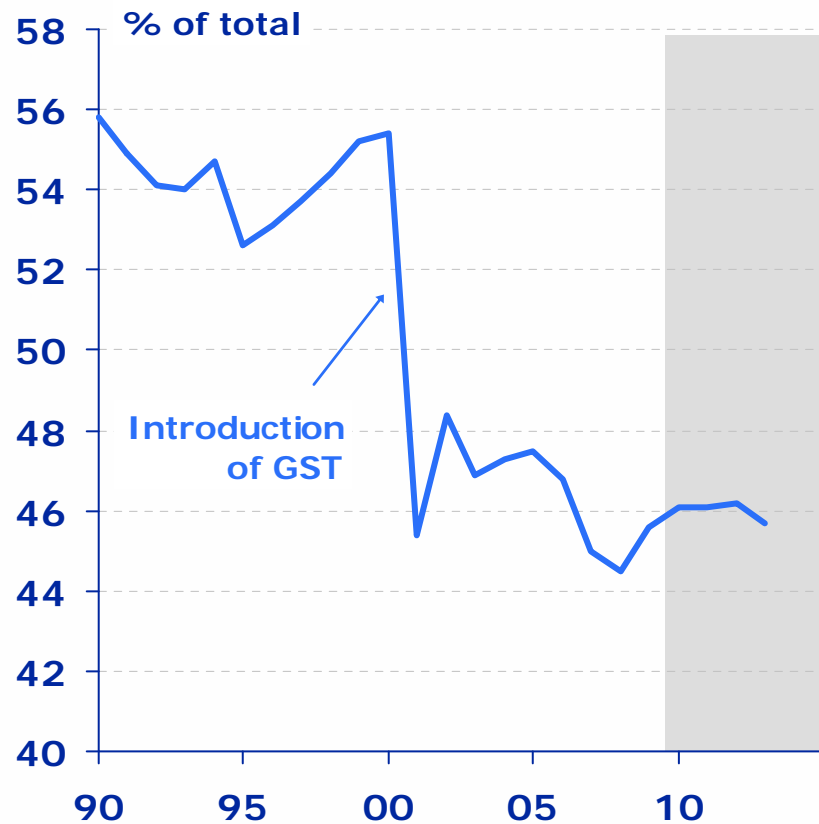


11 *Note:* data are for fiscal years ended 30 June. Corporate gross operating surplus is a national accounts measure of profits before interest, tax and depreciation/amortization.

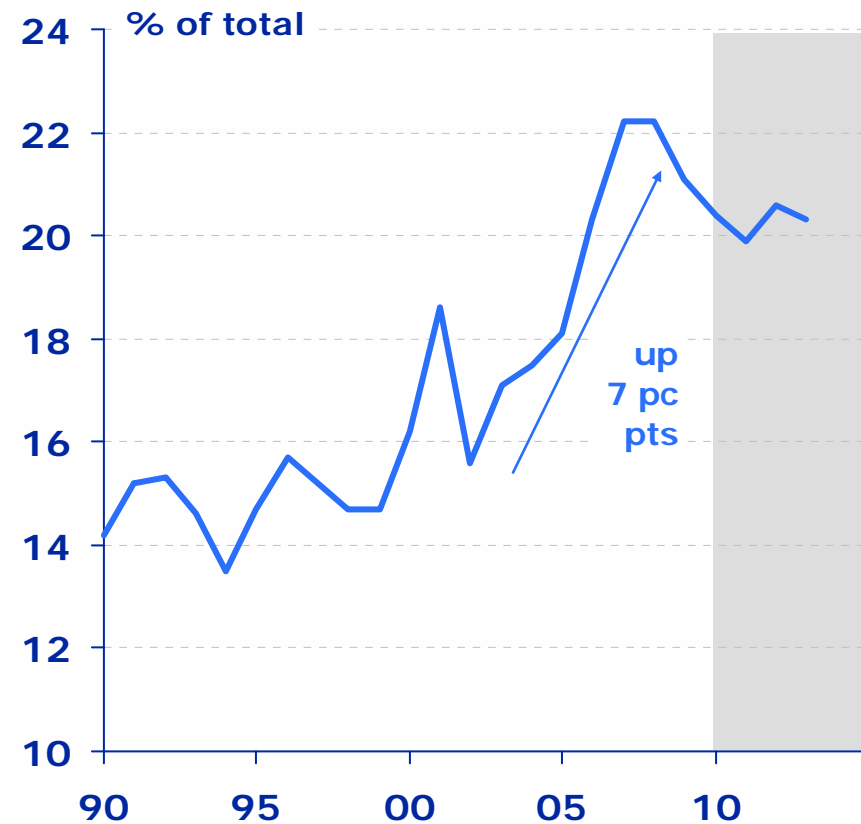
... which is a problem for the Budget because of the increased reliance on company tax in recent years

Shares of total tax collections

Individuals



Companies

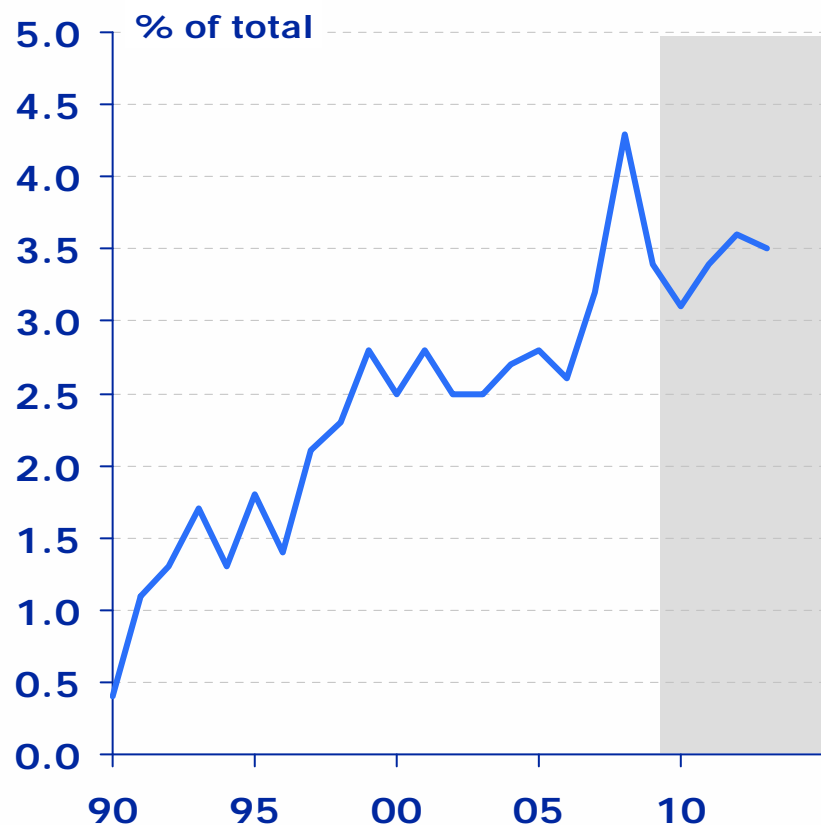


Note: data are for fiscal years ended 30 June.

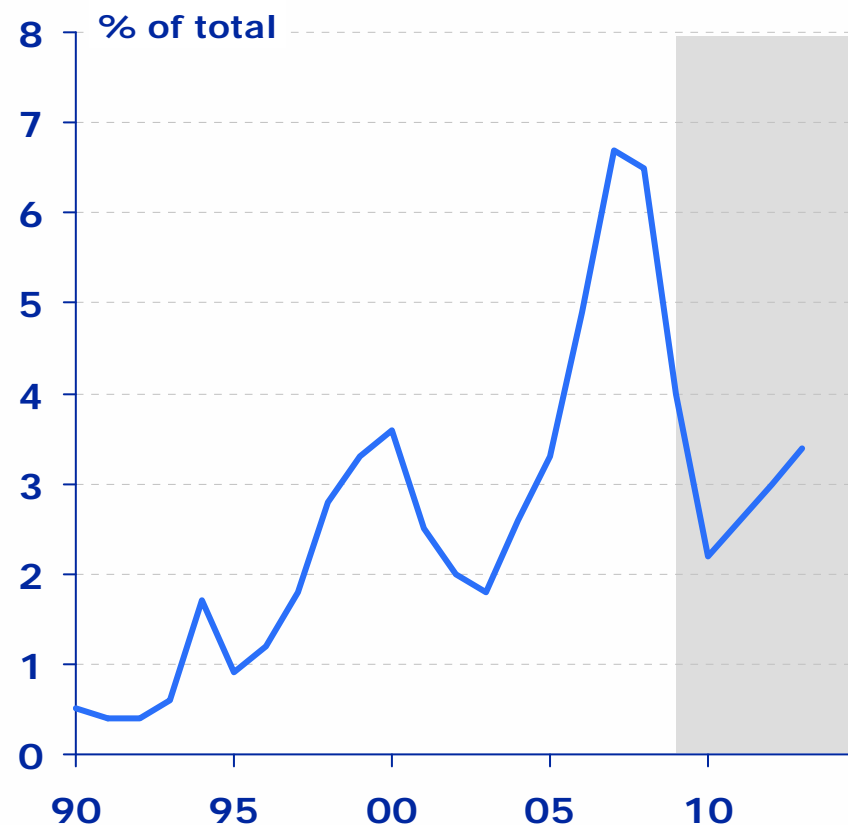
Superannuation fund and capital gains taxes were nice little Budget earners too, while the boom lasted

Shares of total tax collections

Superannuation funds



Capital gains tax

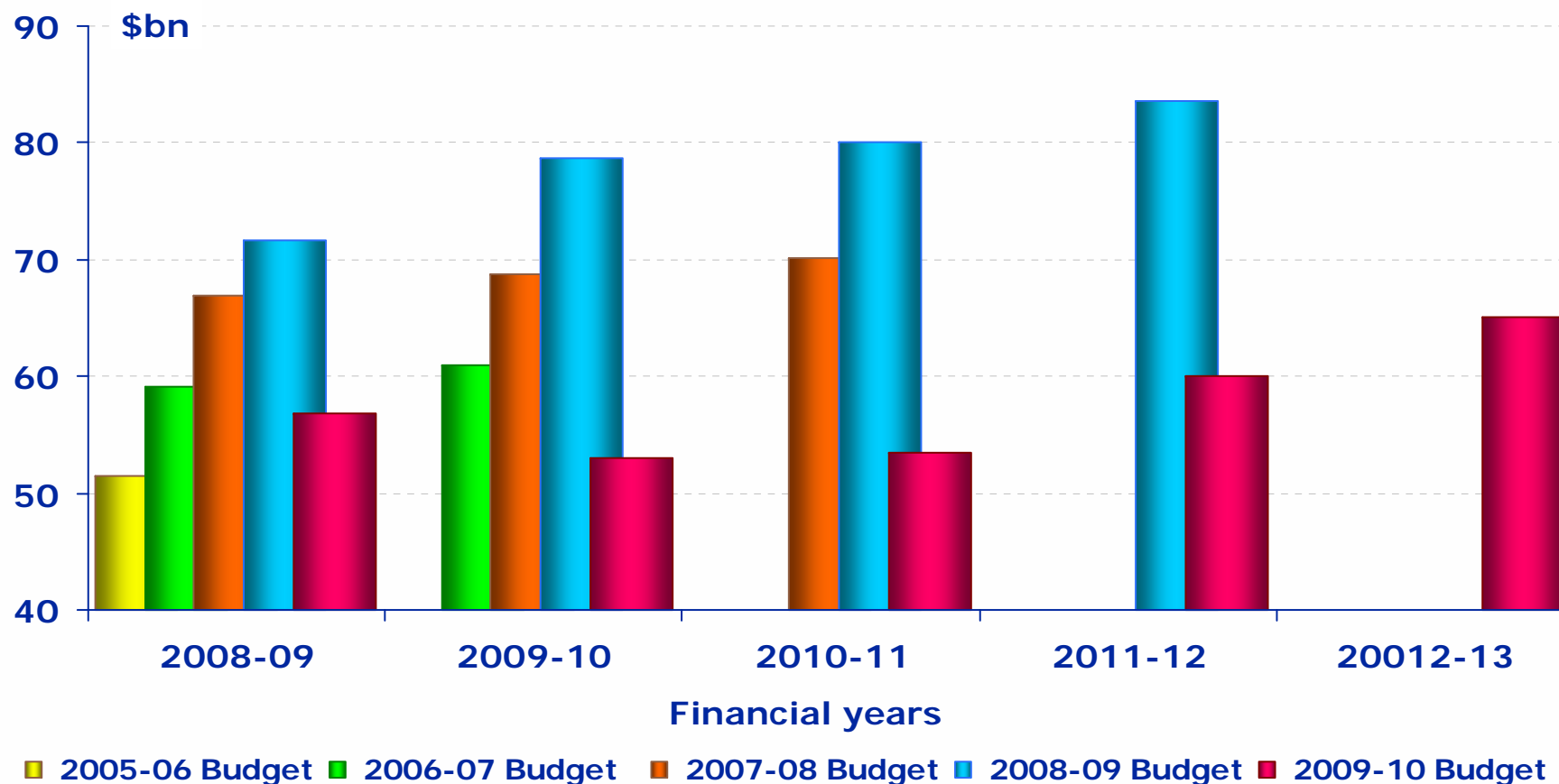


13 *Note:* Capital gains taxes also included in data for individual, company and superannuation fund tax collections. data are for fiscal years ended 30 June.



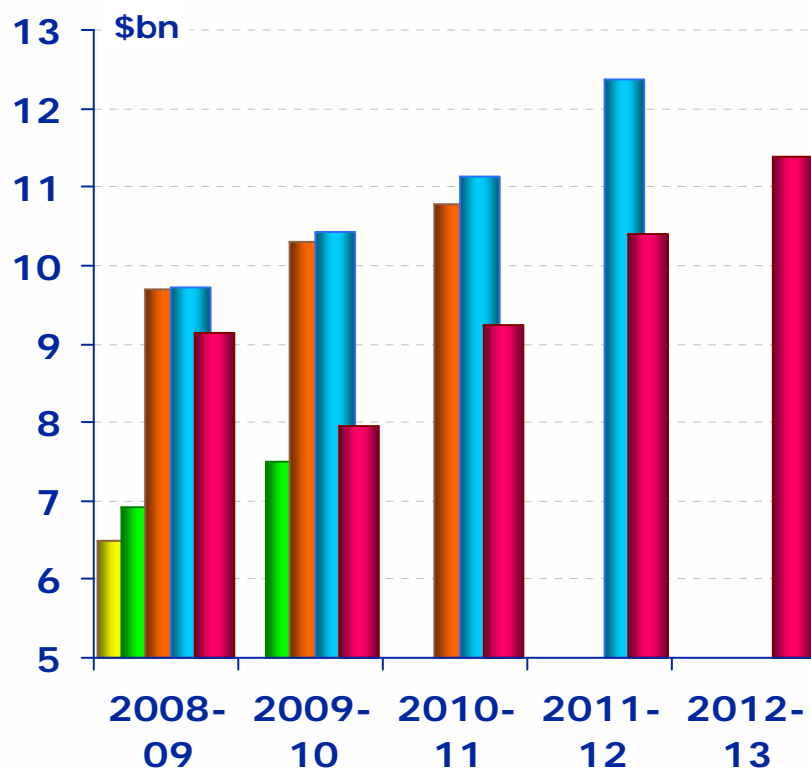
Forward estimates of company tax receipts have been slashed ...

Successive Budget estimates of company income tax receipts

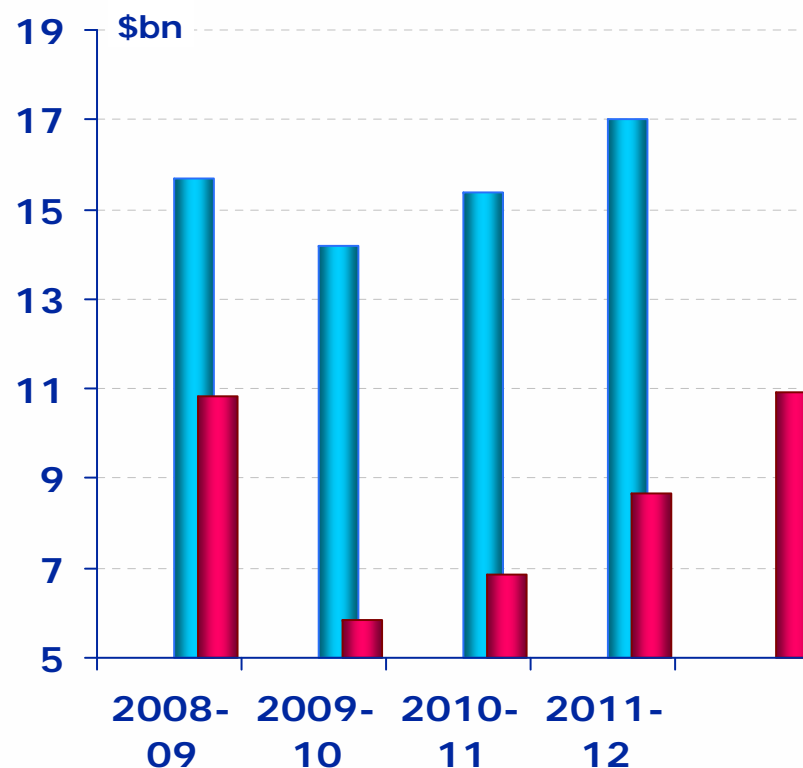


... as have estimates of receipts from taxes on superannuation funds and capital gains

Successive estimates of super fund tax receipts



Successive estimates of capital gains tax receipts

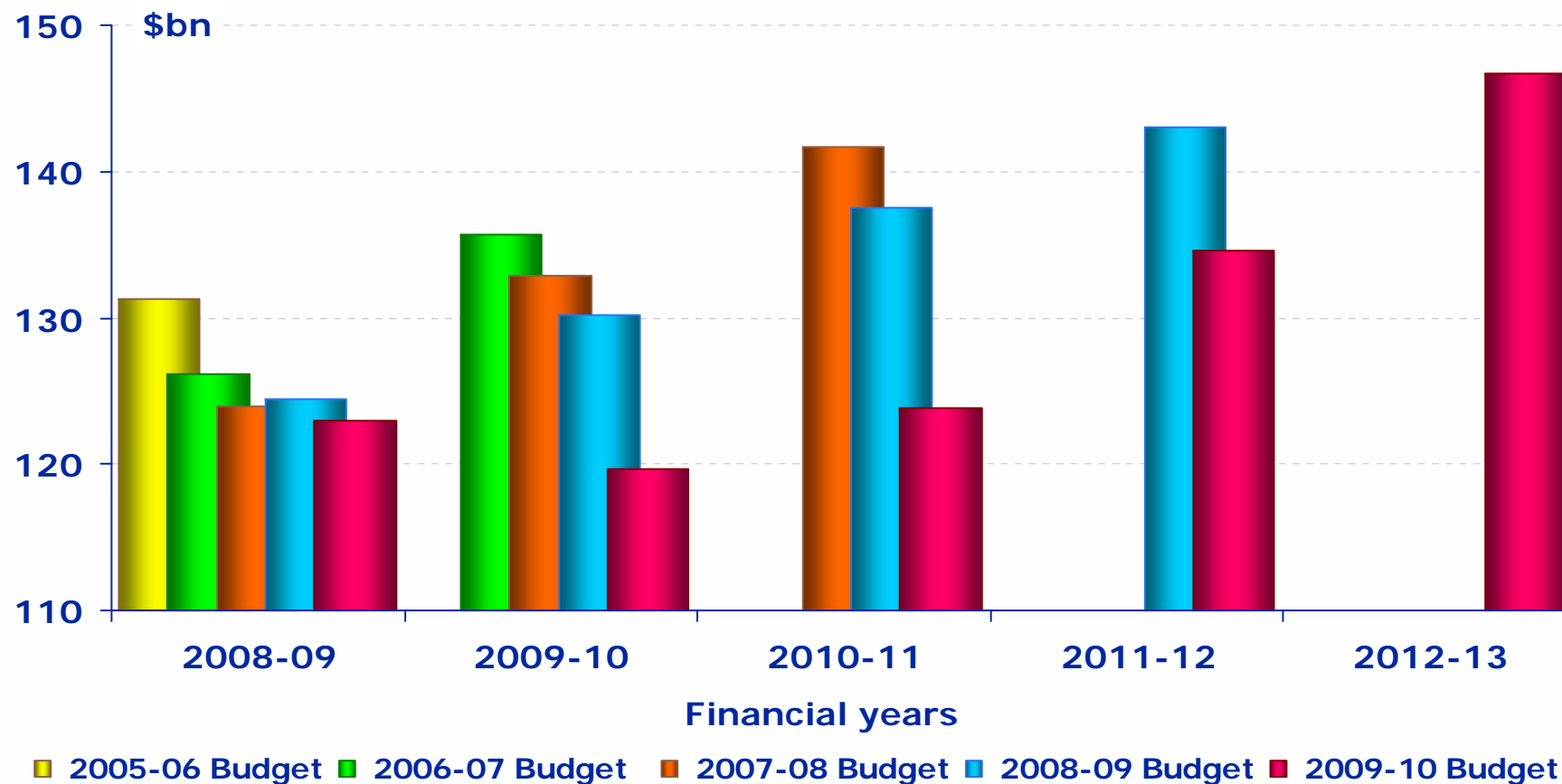


■ 2005-06 Budget ■ 2006-07 Budget ■ 2007-08 Budget ■ 2008-09 Budget ■ 2009-10 Budget

Note: Forward estimates of capital gains tax collections were not published before the 2008-09 Budget.

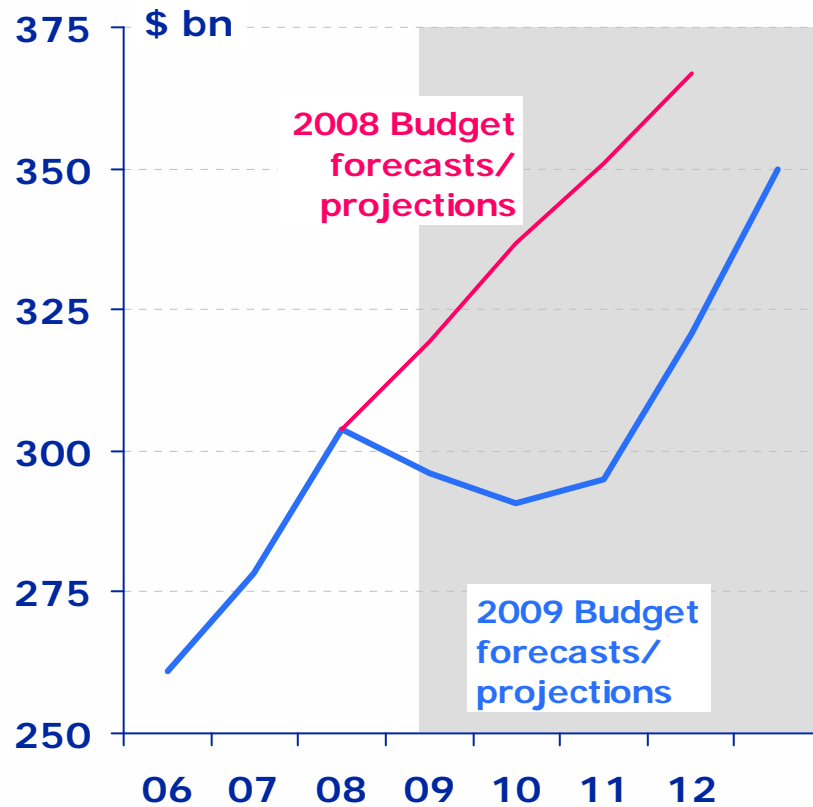
Forward estimates of personal income tax collections have also been lowered, but by relatively less

Successive Budget estimates of individual income tax receipts

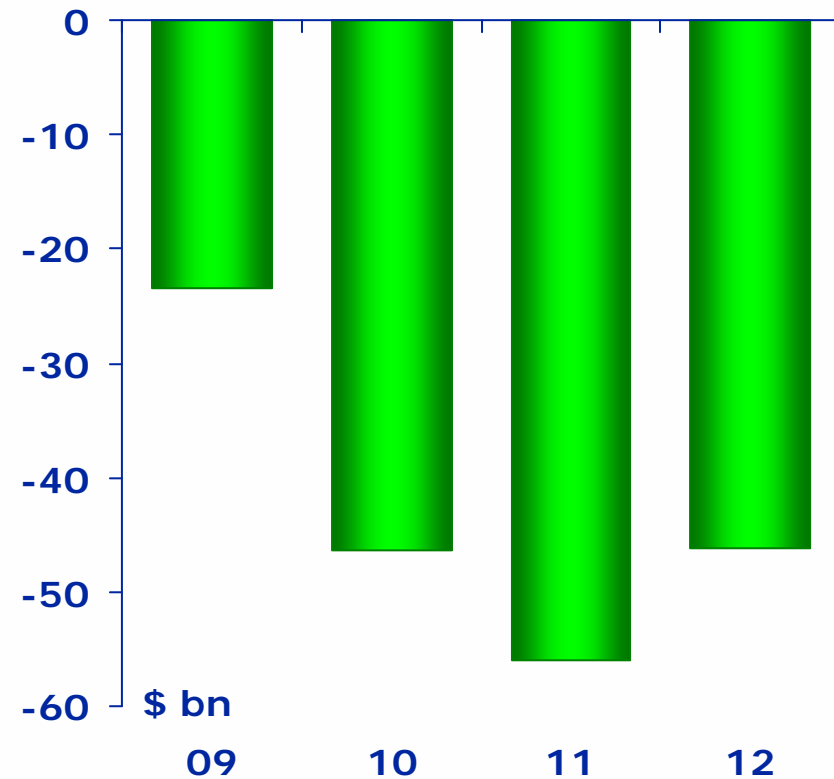


Changed economic circumstances have reduced revenues by a total of \$170 bn over four years

Total revenue



Revenue shortfall between 2008 and 2009 Budgets



Note: 'Revenue shortfall' excludes changes in revenue projections which result from 'policy decisions'. Data are for fiscal years ended 30 June.

The Budget was bound to fall into large deficit even if the Government hadn't provided any stimulus

Sources of movement in forward estimates of the 'underlying cash balance' since last year's Budget

	08-09	09-10	10-11	11-12
As at May 2008	+21.7	+19.7	+19.0	+18.9
'Parameter variations' -				
Up to Feb 2009	-15.1	-35.2	-40.7	-38.8
Since Feb 2009	-5.4	-10.1	-16.7	-11.9
'No policy change' underlying cash balance	1.2	-25.6	-38.4	-31.8

... and for the Government to have sought to prevent the budget from slipping into deficit (by cutting spending or raising taxes) would have made the current downturn worse

Note: 'Parameter variations' are changes in spending or revenue projections arising from changes in economic assumptions, changes in the revenue yield from particular taxes, 'slippage' in implementation of policy decisions, etc. *Source:* Budget Paper No. 1, ANZ calculations.

'Policy decisions' have added to the deficit in the short term but will reduce it over the medium term

Sources of movement in forward estimates of the 'underlying cash balance' since last year's Budget

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Since Feb 2009	-5.4	-10.1	-16.7	-11.9
'No policy change' underlying cash balance	1.2	-25.6	-38.4	-31.8
'Policy decisions' -				
Up to Feb 2009	-29.1	-20.0	-12.6	-6.3
Since Feb 2009	-4.3	-12.0	-6.0	-7.0
As at May 2009	-32.1	-57.6	-57.1	-44.5

Note: 'Parameter variations' are changes in spending or revenue projections arising from changes in economic assumptions, changes in the revenue yield from particular taxes, 'slippage' in implementation of policy decisions, etc. *Source:* Budget Paper No. 1, ANZ calculations.

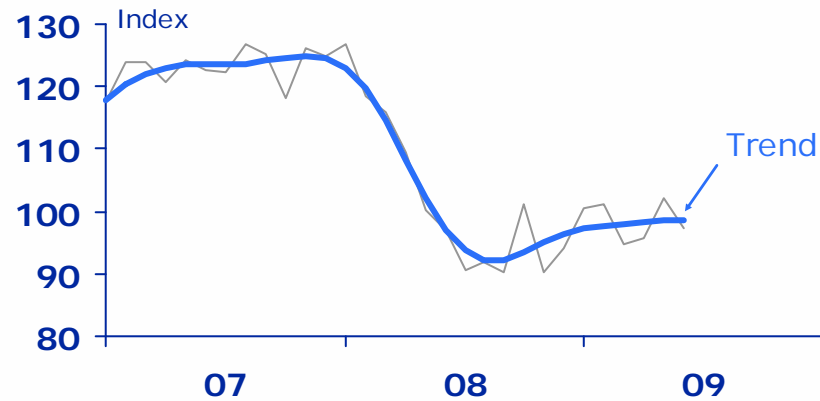
Measures in the Budget amount to a significant shift in strategy from that of the past nine months

The Government has moved on from 'recession avoidance'

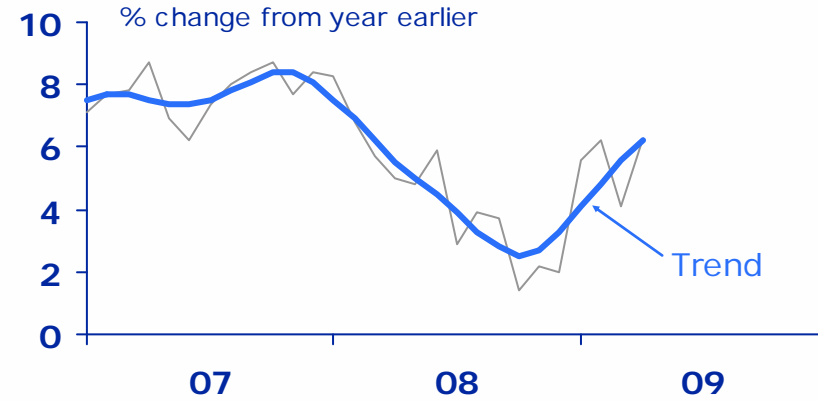
- there are no more 'cash handouts'
- although they produced nothing of lasting value, they did allow Australian households to lift saving (by more than US households) without cutting spending (by as much as US households have done) ...
- ... and they haven't had a lasting impact on the budget (as permanent tax cuts, for example, would have done)

Monetary easing and fiscal stimulus have softened the downturn in the Australian economy

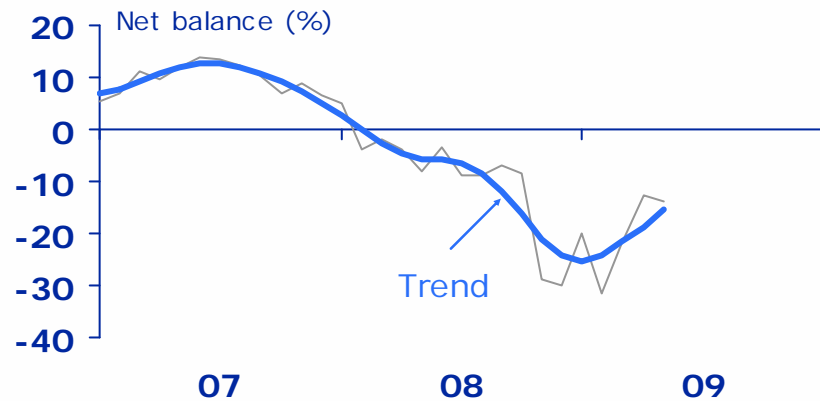
Consumer confidence



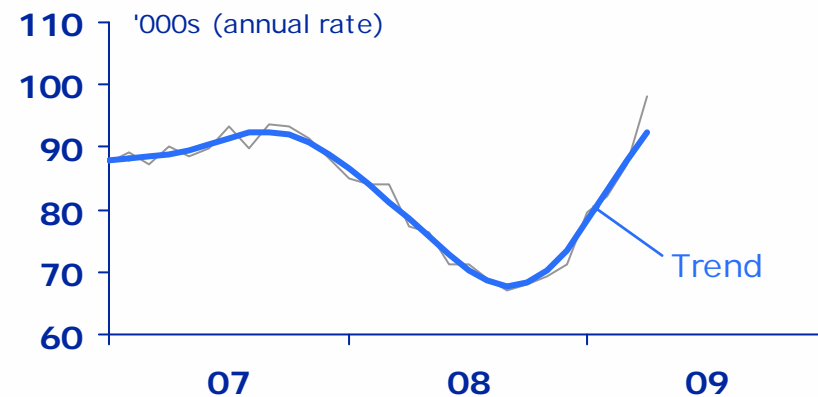
Retail sales



Business confidence



Housing finance commitments*



Measures in the Budget amount to a significant shift in strategy from that of the past nine months

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Instead the focus of measures in this Budget is on -

- some (modest) additional short-term fiscal stimulus
- but which will (hopefully) do more to improve long-run economic growth than the October and February packages
- meeting election and other political commitments
- and measures to ensure that the budget returns to surplus over the medium term, once the need for stimulus has passed

Additional stimulus measures

- **Infrastructure spending**: \$5.6 bn over four years, mostly in transport
 - Estimated to support around 15,000 new jobs per annum
- **Additional spending on training and assistance for retrenched workers**
- **First Home Owner Grant** increase extended until 30 Sep, then phased down to 'normal' level by 31 Dec
- **50% small business tax break** for expenditures on 'eligible assets' such as vehicles and capital equipment installed by December 2010
- **Government claims stimulus packages have boosted GDP by 2¾% in 2009-10 (including ¾ pc pt from measures in this Budget) and 1½% in 2010-11**

Meeting election and other commitments

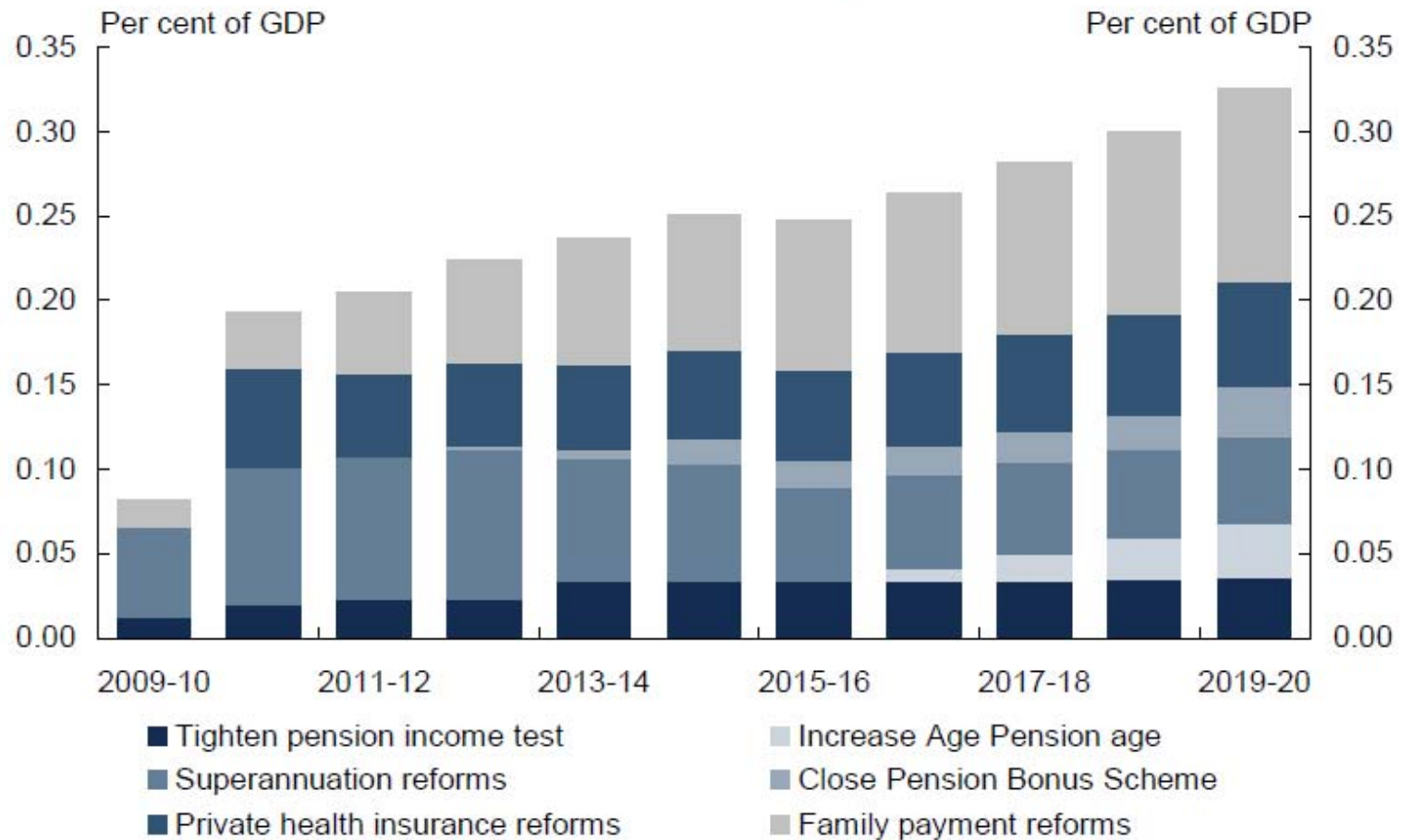
- **Previously legislated income tax cuts untouched**
 - 30% threshold rises from \$34,000 to \$35,000
 - 40% rate (payable on incomes from \$80-180,000) drops to 38%
- **\$32.49 per week increase in single age pension rate and \$10.14 per week for couples**
 - costing \$Ymn in 2009-10, \$5bn over four years
 - no change in other benefit rates
- **Paid maternity leave scheme to commence in 2011**
 - Costing \$731mn over five years
- **Cancer drugs added to Pharmaceutical Benefits Scheme**
 - annual cost \$800mn
- **\$4.5bn 'clean energy initiative' including \$2bn for CCS demonstration and \$1.5bn for solar projects**

Restoring fiscal sustainability over the medium term

- **Means testing of access to a wide range of benefits**
 - private health insurance rebate (with ½ pc pt increase in Medicare levy surcharge for op rate taxpayers without private insurance)
 - Seniors' Benefit card, child care rebate, Family Tax Benefit A
 - only 2% of individual taxpayers have taxable income over \$150,000
- **'Pause' in indexation of eligibility thresholds for Family Tax Benefits for upper income earners for three years**
- **Reduction in superannuation concessions and support**
 - lower cap on salary sacrificed contributions to superannuation
 - maximum government co-contribution for low-middle income earners cut
- **Taxation loopholes closed**
 - deductions for 'hobbies and lifestyle choices' ('non-commercial business losses') eliminated
 - no deferral of tax on discount on employee share issues
 - tax exemption on foreign-sourced income for people offshore for more than 90 days abolished
- **Defence savings of \$2bn over four years**

Announced saving measures build to over ¼ pc of GDP by middle of this decade -

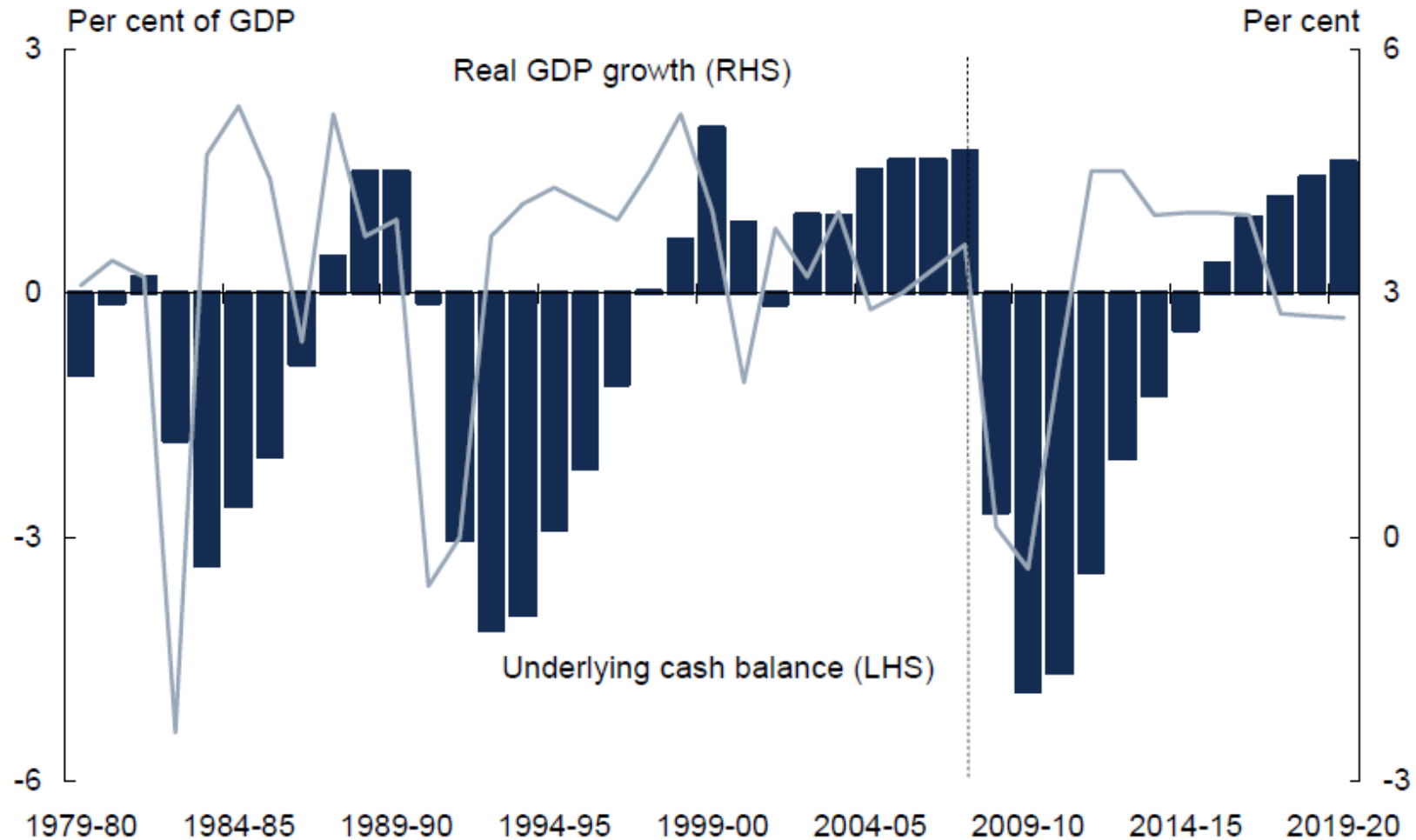
Structural savings measures



Source: Treasury.

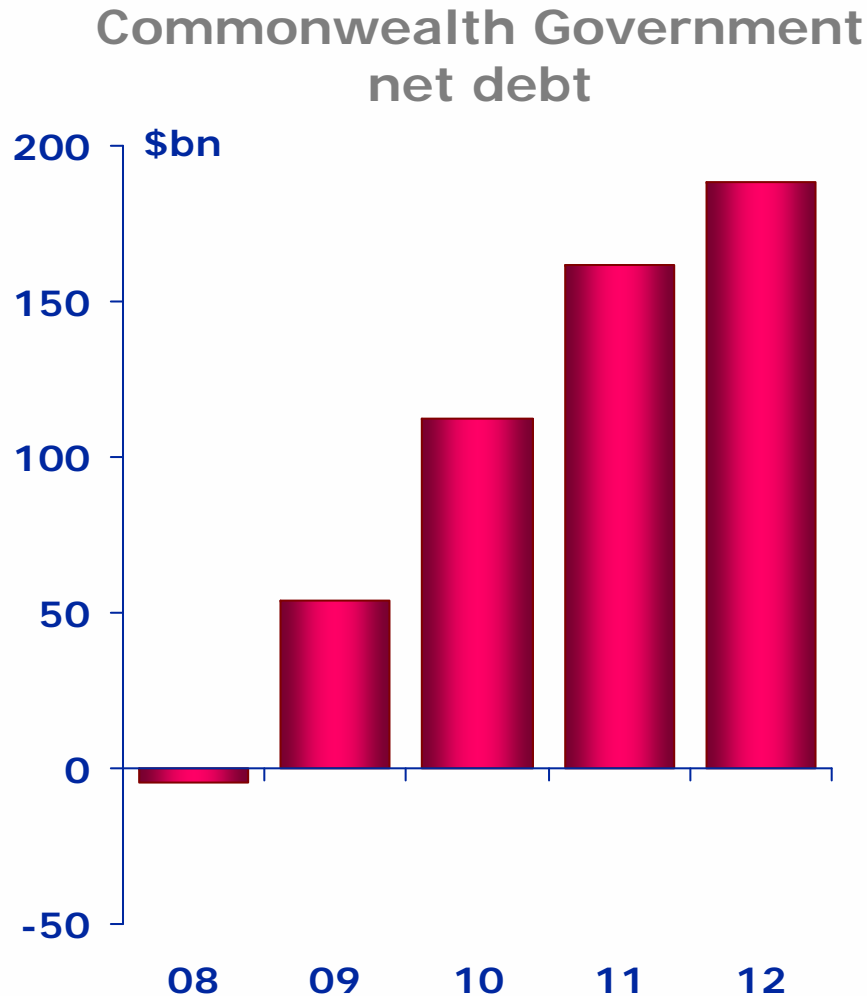
The measures plus stronger growth after 2010-11 will supposedly return the Budget to surplus by 2015-16

Underlying cash balance



Source: 2009-10 Budget Paper No 4.

The large deficits in prospect of necessity imply a large build-up in Government debt

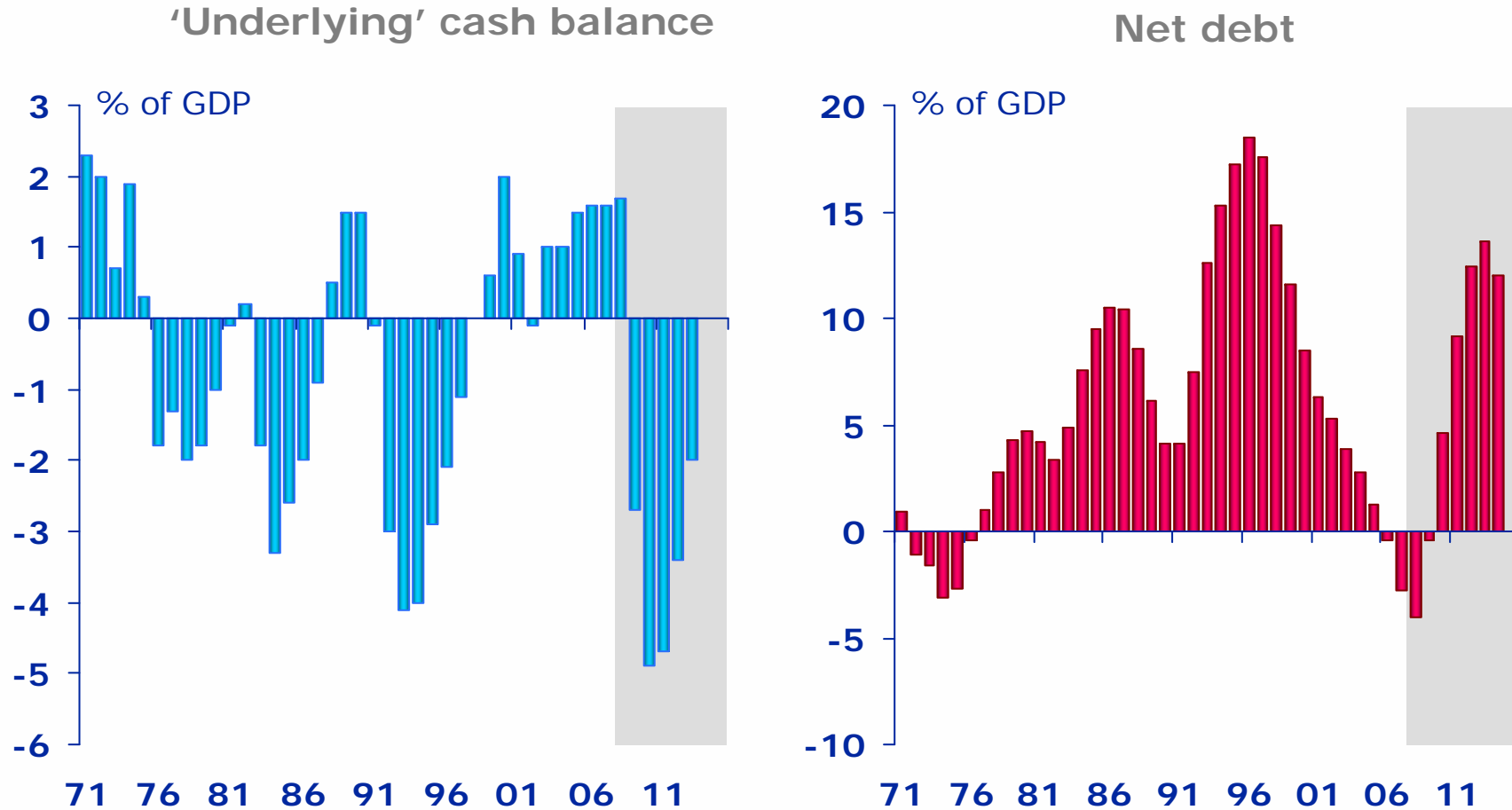


Note: data are as at 30 June.

- Net debt will rise to \$188bn (13.6% of GDP) by June 2013
- Net debt is then expected to return to 3.7% of GDP by 2019-20
- All of the increase in deficit will be funded by increased bond issuance
- This year AOFM will need to borrow \$60bn
 - taking into account maturities this means a gross borrowing program of \$66bn
 - bond and T-note tenders will average \$1.3bn per week
- AOFM will explore issuing inflation linked bonds

The deficits and resulting net debt will be large by Australian historical standards ...

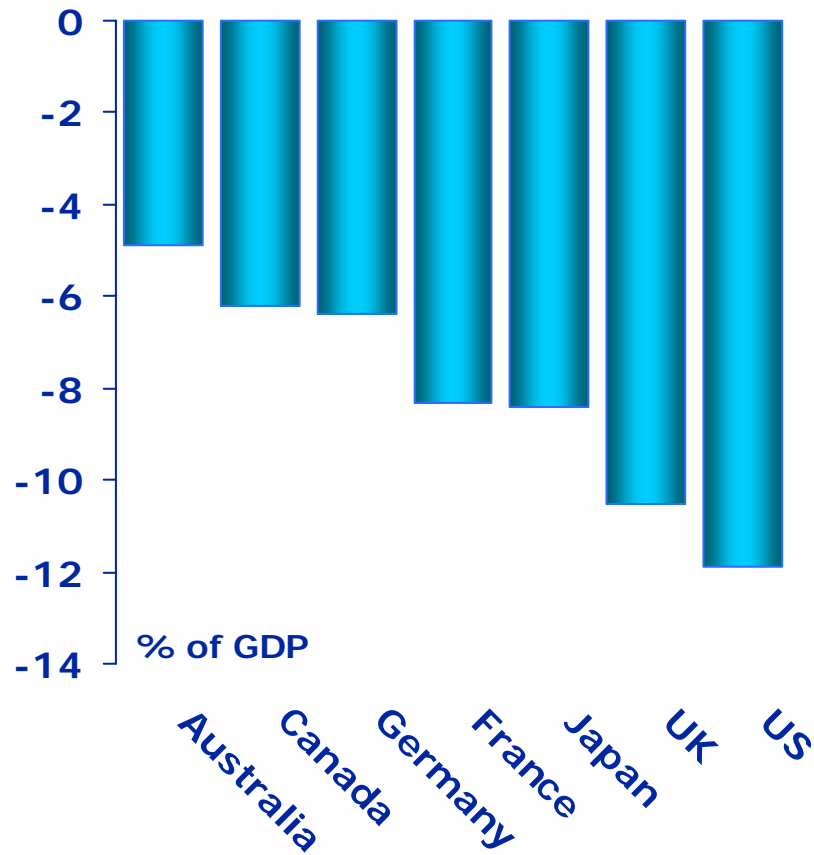
Deficit and debt as percentage of GDP



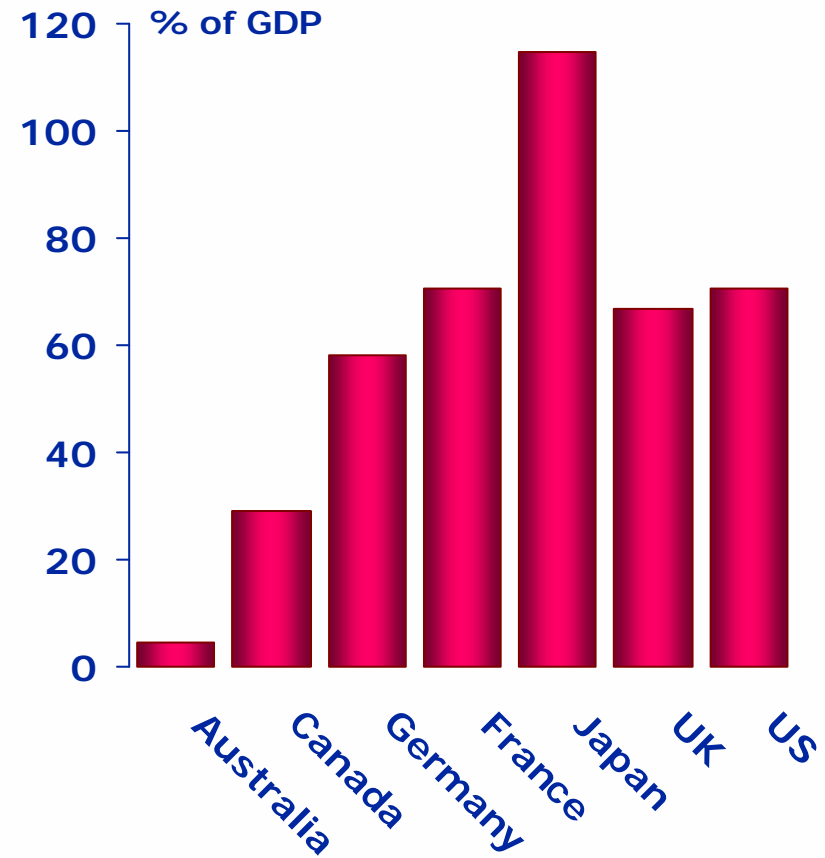
Note: data are for financial years ended 30 June.

... but they are not large by contemporary international standards

2010 'general government financial balance'



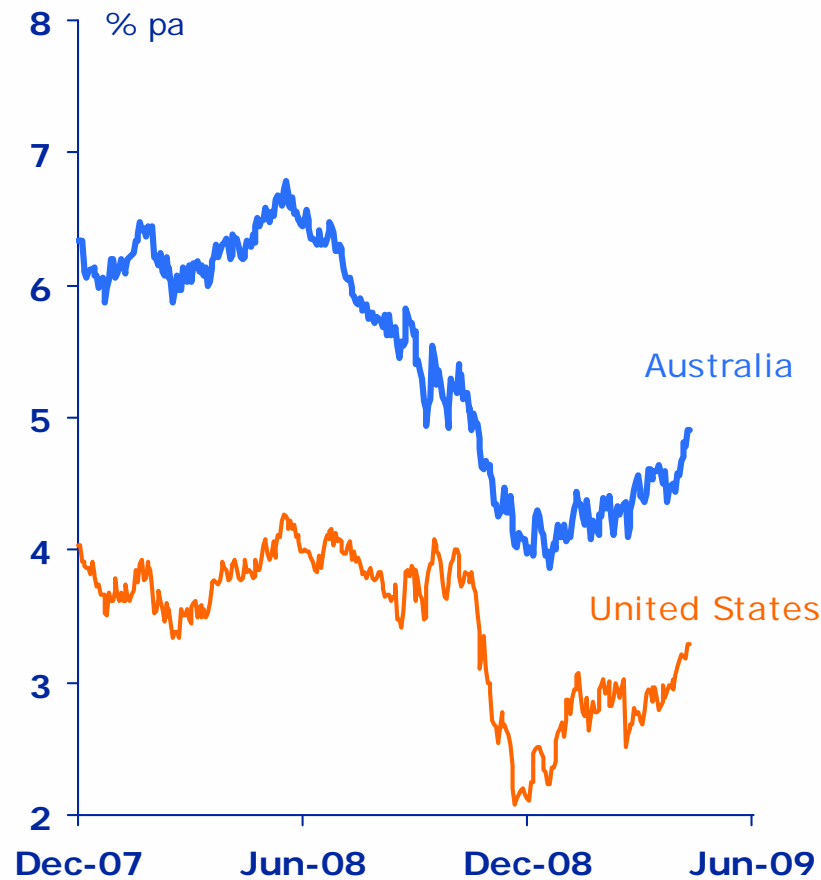
2010 'general government net debt'



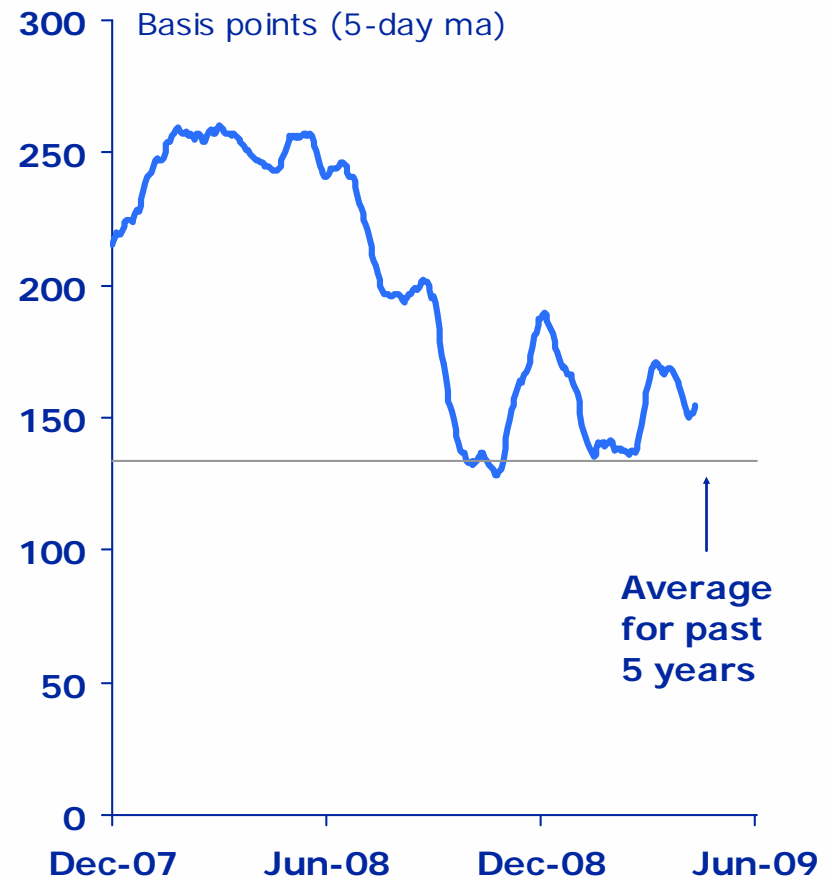
Sources: Budget Statements; OECD; IMF.

Markets don't appear to have any particular concerns about the level of Australian government borrowing

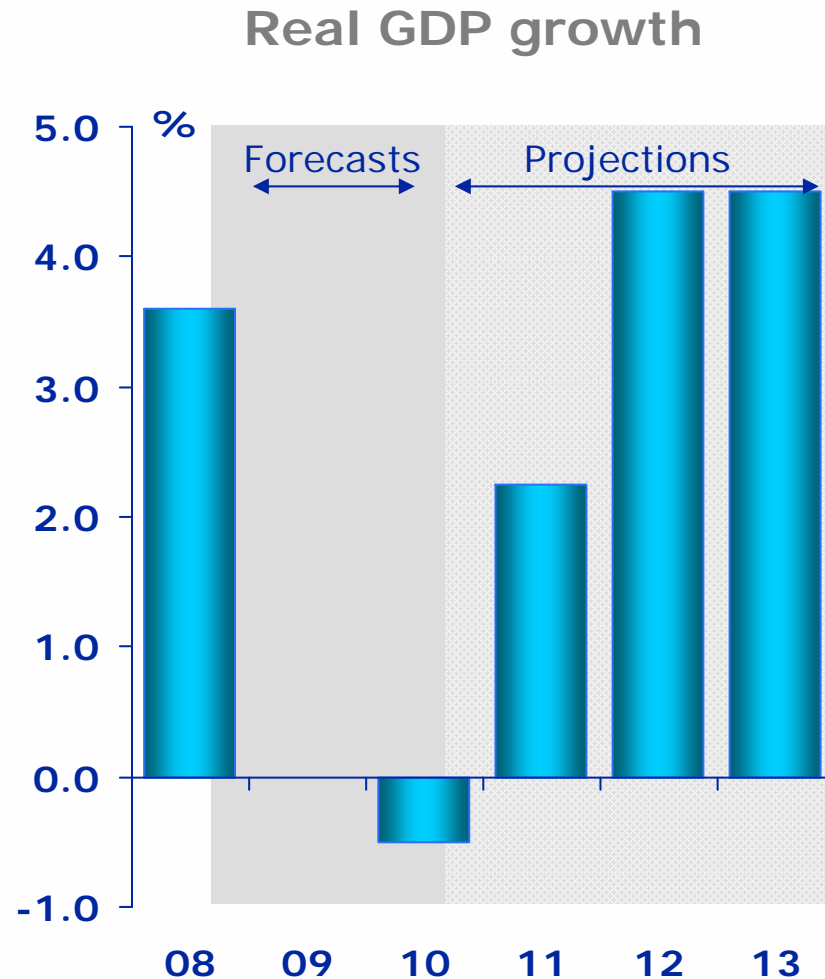
10 year bond yields



Australia-US 10 year bond yield spread



Medium-term projections assume two years of 'above trend growth' after 2010-11

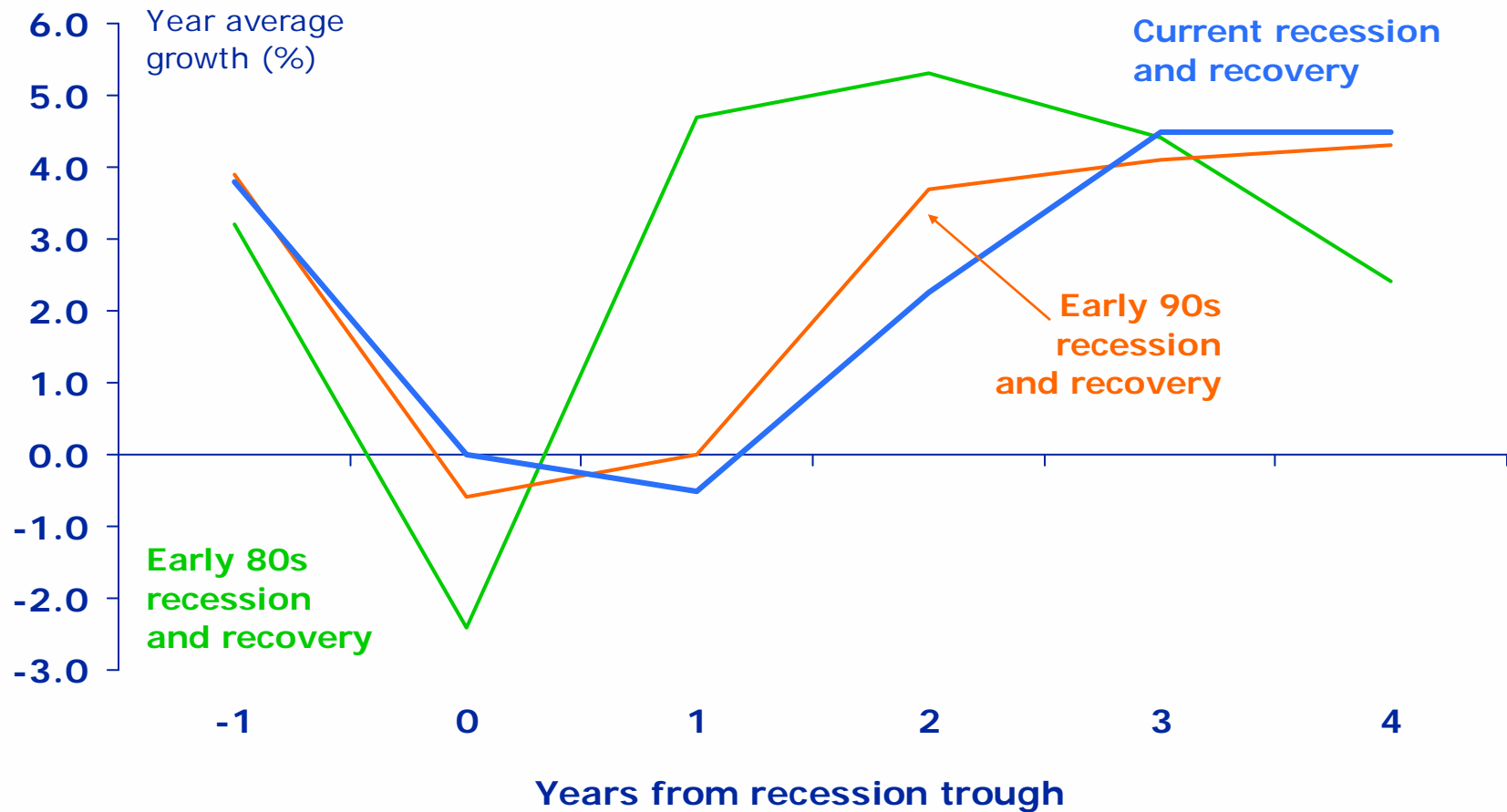


- Traditionally Treasury forecasts growth for the year immediately ahead and then assumes trend growth over the remainder of the forward estimates period
- This year Treasury
 - is forecasting a ½% decline in GDP in 2009-10
 - forecasts 2¼% growth in 2010-11
 - assumes two years of above-trend growth at 4½% pa in 2011-12 and 2012-13

Note: data are for financial years ended 30 June.

History suggests assumption of two years of above-trend growth in 2011-12 and 2011-12 is plausible

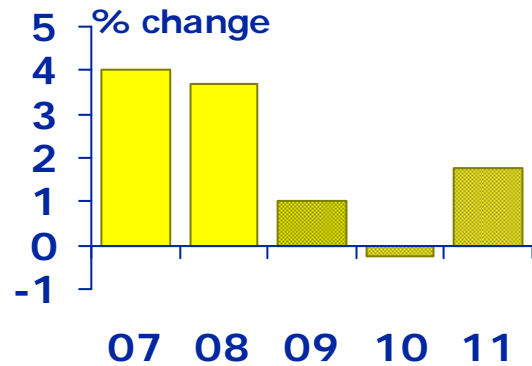
Real GDP growth around recessions



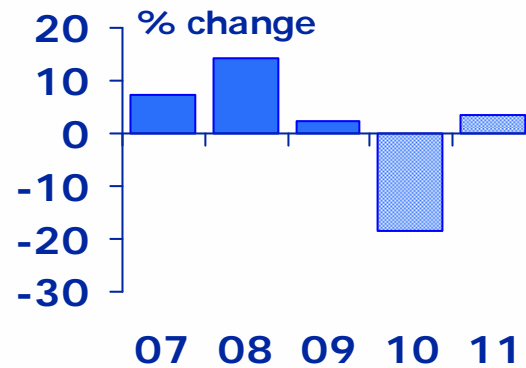
Note: 'Recession trough' is the financial year in which real GDP reached its lowest point .

Weaker investment spending the main drag on economic growth over next two years

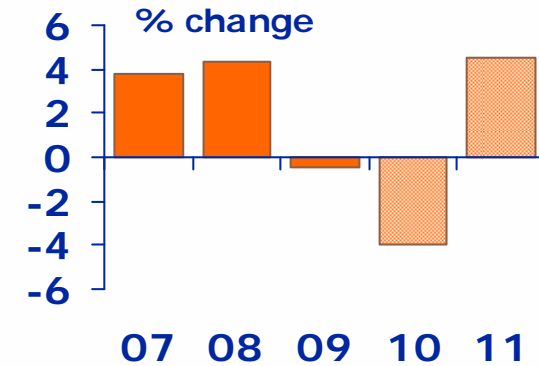
Consumer spending



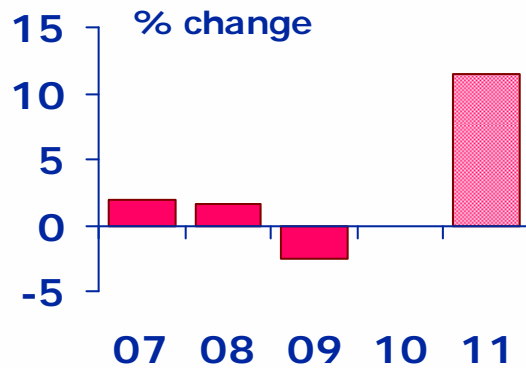
Business investment



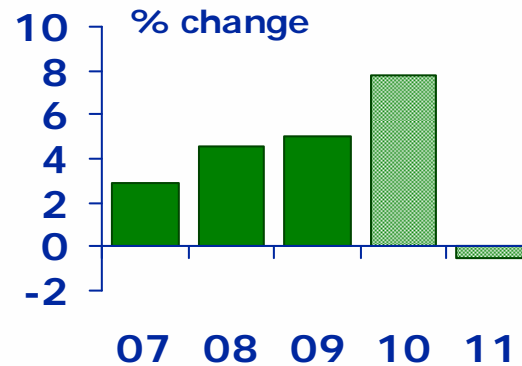
Exports



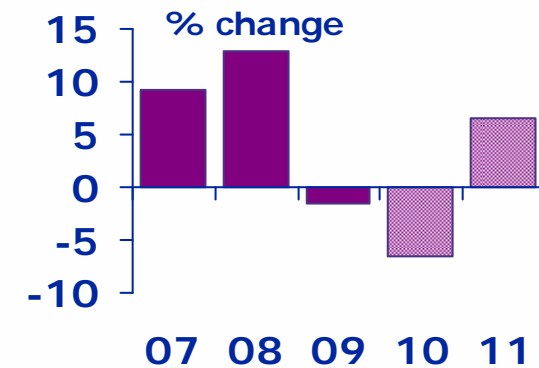
Housing



Public spending



Imports



Note: Charts show real p.c. changes for financial years ended 30 June.

Other key economic forecasts

- **Employment** is expected to decline 1 ½% in 2009-10, then grow by ½% in 2010-11, and 2 ½% pa in each of the two following years
- The **unemployment rate** is forecast to peak at 8½% (~ 1mn people unemployed) by 2010-11, and then decline gradually to 7 ½% by mid-2012
 - rise in unemployment partly reflects much smaller decline in labour force participation rate than in previous recessions
- **Underlying inflation** will decline to 1 ¾% by in the year to the June quarter 2010, then 1 ½% in the year to June quarter 2011
- **Wage inflation** will ease to 3 ¼% in 2009-10 and 2010-11
- **Corporate gross operating surplus** (~ EBITDA) will fall by 11% in 2009-10, recovering by 5% in 2010-11 & 7% in 2011-12
- **Current account deficit** expected to widen from 3% of GDP in 2008-09 to 5¼% of GDP in 2009-10 and 5¾% of GDP in 2010-11
 - largely driven by lower prices for resources exports
 - eventual rebound in imports as domestic demand recovers

Assessment: an appropriate combination of measures for the short and medium term?

- There is nothing wrong with national governments running budget deficits during recessions
- Australia is better-placed than most other Western countries to do so – and the Government's willingness to run deficits has lessened the impact of the global recession
- The stimulus measures in the Budget will have more long-term benefits than the two earlier stimulus packages
- Getting the budget back to surplus by 2015-16 depends on
 - the assumption of above-trend growth in 2011-12 and 2012-13
 - the Government's ability to get measures through the Parliament
 - and its ability to keep spending growth to 2% real over the medium term
- The fiscal consolidation measures (more comprehensive means-testing, closing tax loopholes) are infinitely preferable to the alternative of raising tax rates (as in UK)
 - but more will need to be done in subsequent budgets
- Financial markets should not be disturbed by the Budget