

Shades of Black: the economy after the Budget

Prepared for
Financial Executives International of Australia

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CommonwealthBank

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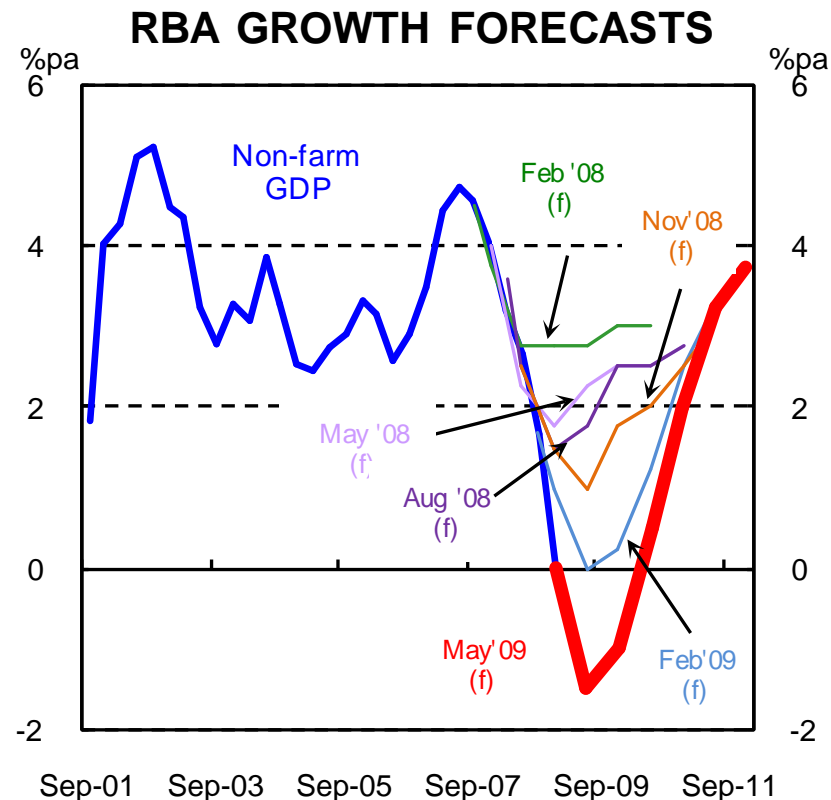
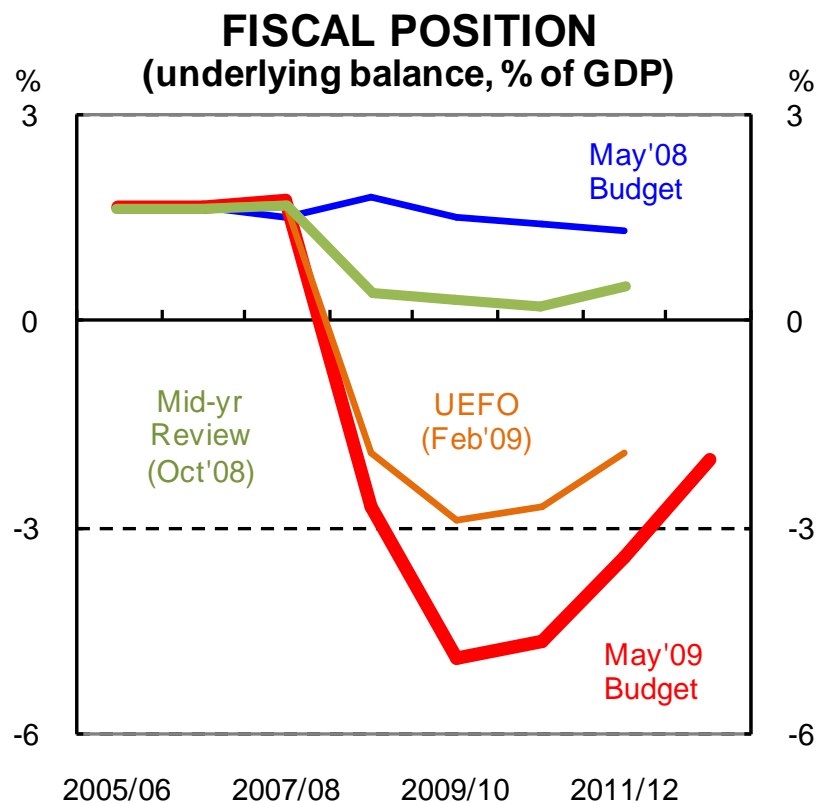
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Budget Projections

Red ink

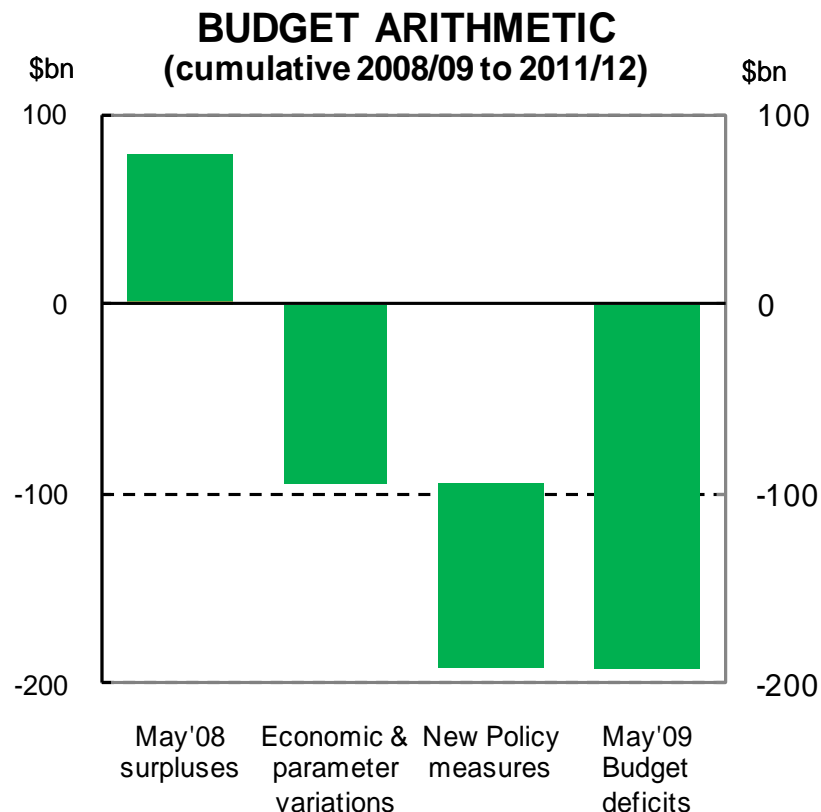


- Budget projections have been through a process of continued downgrade since the 2008 Budget.



The Budget Arithmetic

The path to bigger deficits



- Budget parameters downgraded significantly over the last year as the economy slowed.
- Cyclical downturn impact and other parameter shifts cost \$173bn out to 2011/12.
- New policy measures over the next four years worth \$97bn partly “funded” by means testing and winding back other concessional tax treatments.



Scoring The Budget

Market reaction



Scoring The Budget

Optimal fiscal policy rules

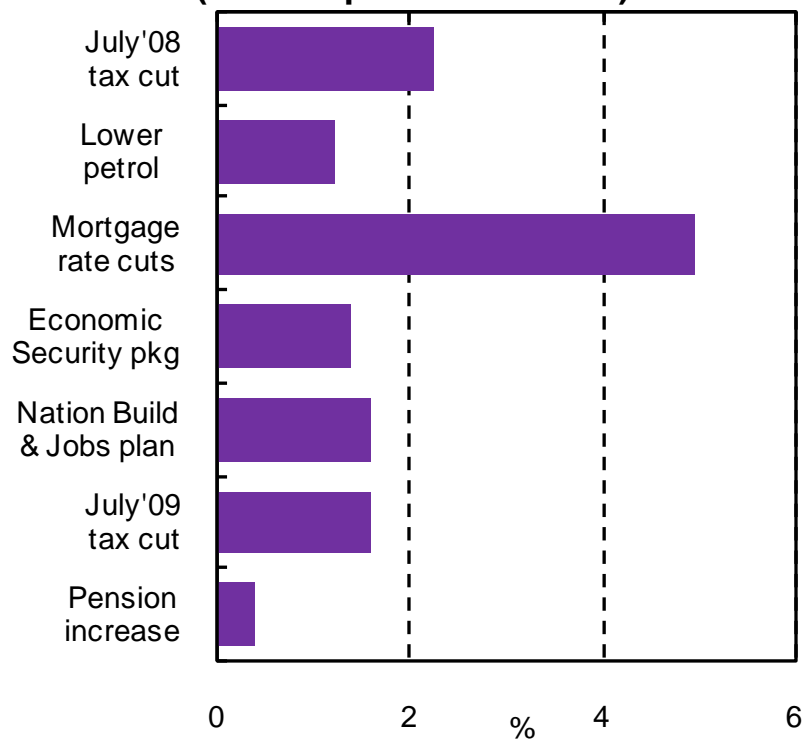
Fiscal Policy Rules	Australian Budget Concordance
Allow automatic stabilisers to work	✓
Implement short-term stimulus measures (the 3 T's – timely, targeted and temporary)	✓
Employ a range of stimulus measures given the uncertainty on transmission channels in current environment	✓
Implement measures to improve productivity and deal with longer-run fiscal issues (the 3 P's – population, participation and productivity)	✓
Be prepared to do more if necessary	✓
Preserve public debt sustainability – fiscal policy becomes less effective as debt levels rise	✓
Pursue measures to improve consumer and business confidence	✓
Have an exit strategy for the withdrawal of fiscal stimulus	Could have done more



Scoring The Budget

Short run: the three T's

HOUSEHOLD SPENDING STIMULUS (% of disposable income)

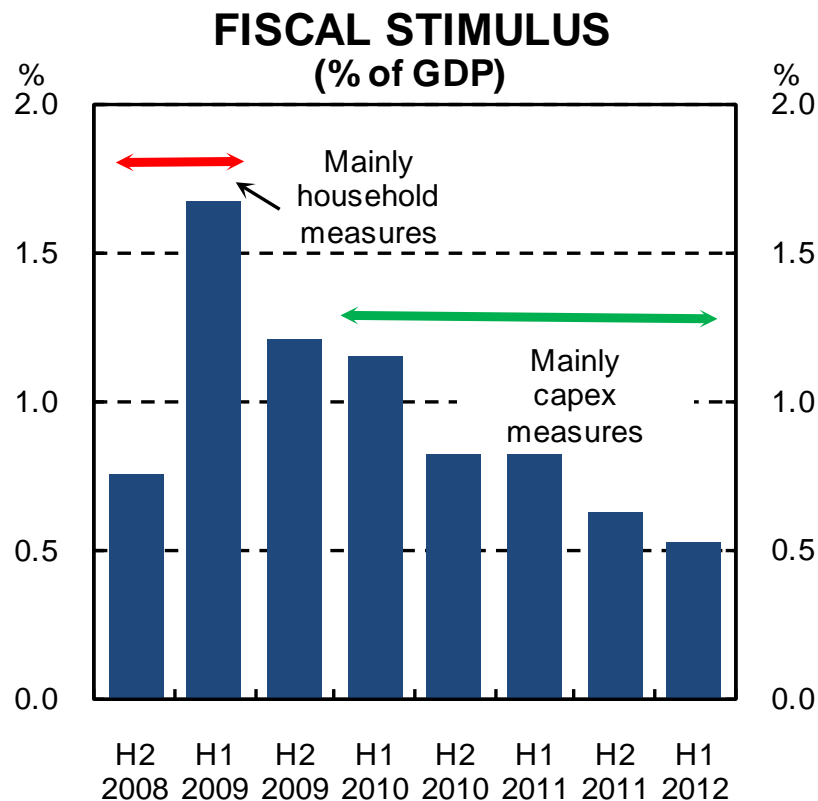


- The *design* of fiscal policy is as important as the *size*.
- The optimal stimulus policy is based on the 3 T's – timely, targeted and temporary.
- The use of cash handouts delivered to households with a high propensity to spend is a appropriate (timely & targeted).
- Ditto the 1st home owners grant.
- The decision to not repeat the cash handouts and scale back the 1st home owners scheme is appropriate (temporary).



Scoring The Budget

Long run: the three P's

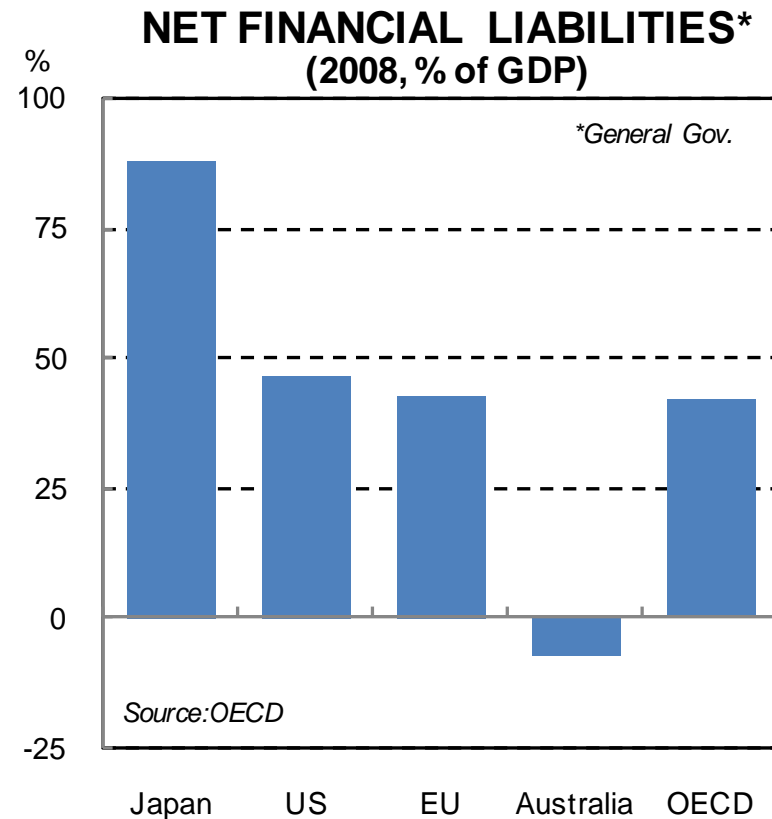
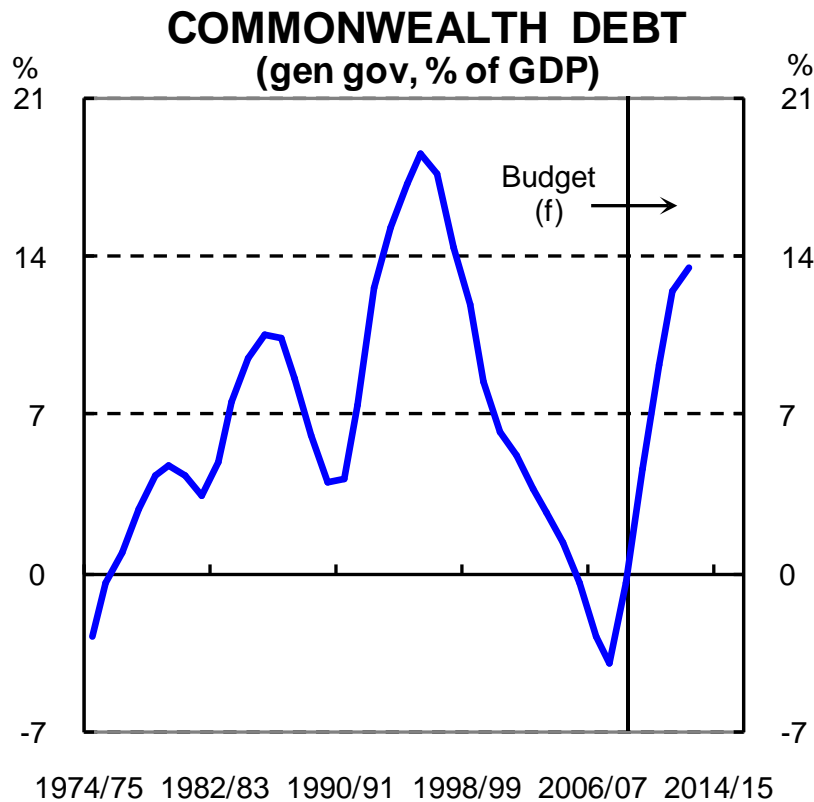


- The three variables that influence longer-run developments are *population, participation, productivity*.
- Population growth slower because immigration intake cut.
- Participation higher because qualifying age for pension progressively lifted to 67 years and introduction of paid parental leave.
- Productivity benefits from expanded infrastructure.



Scoring The Budget

Public debt sustainability

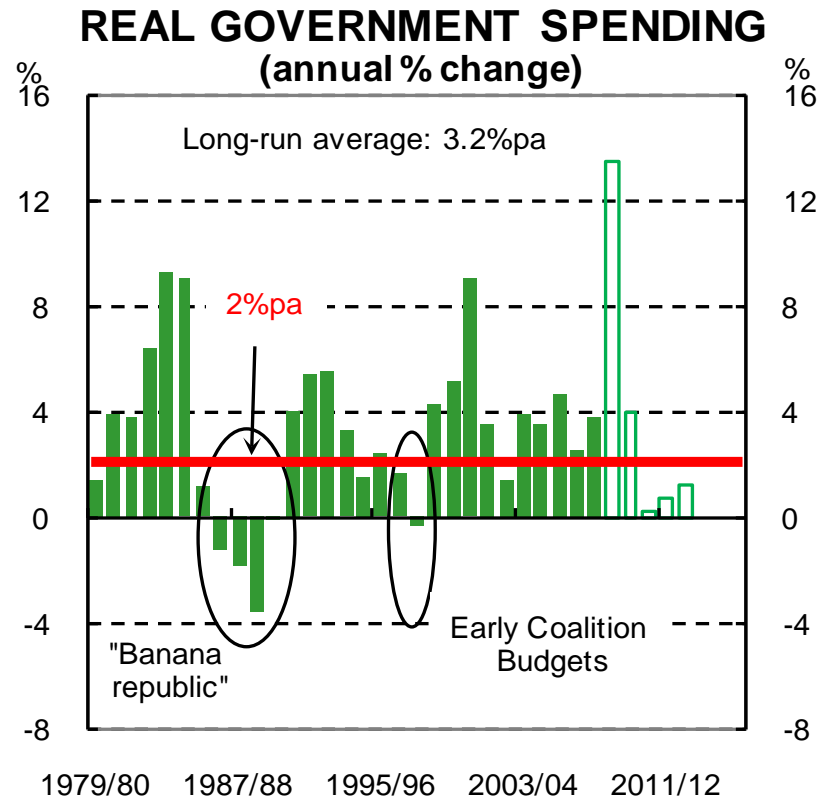
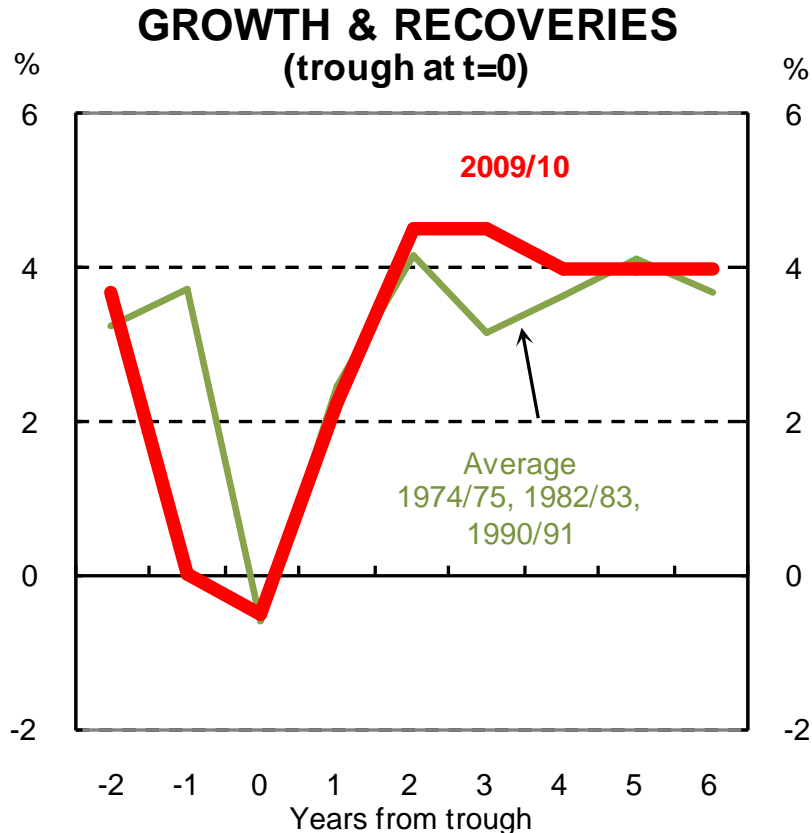


- Fiscal policy becomes less effective as public debt increases.
- Debt is set to rise but the starting point is low and the peak is modest on any global comparison.



Scoring The Budget

Exit strategy



- Exit strategy based on a cyclical upturn and real spending growth held at 2%pa.
- Recoveries after financial crises tend to be weak and 2% spending target is soft.

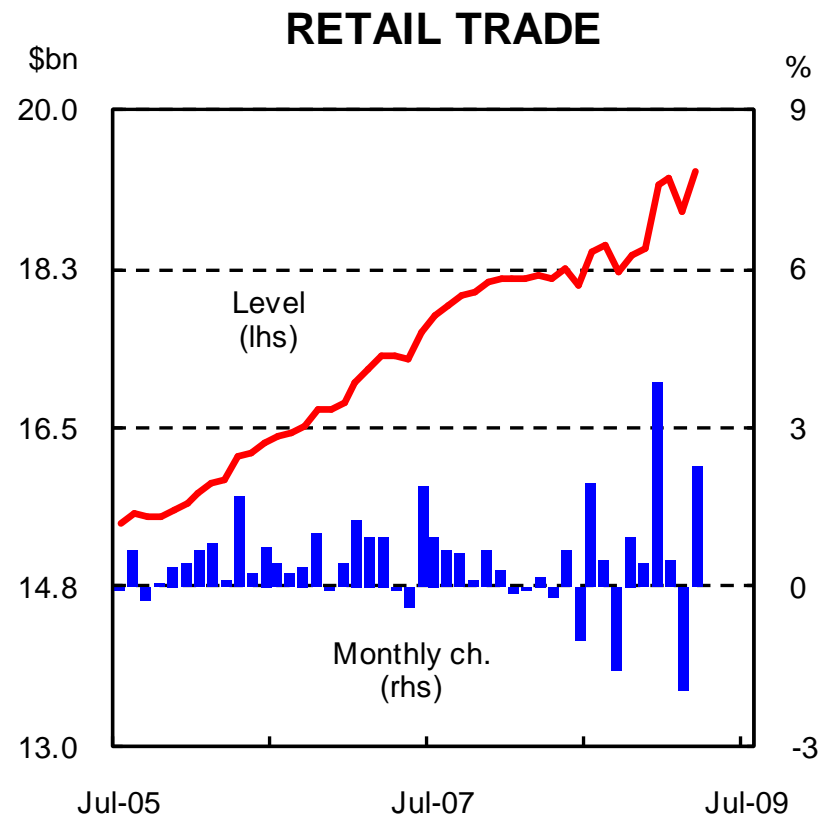
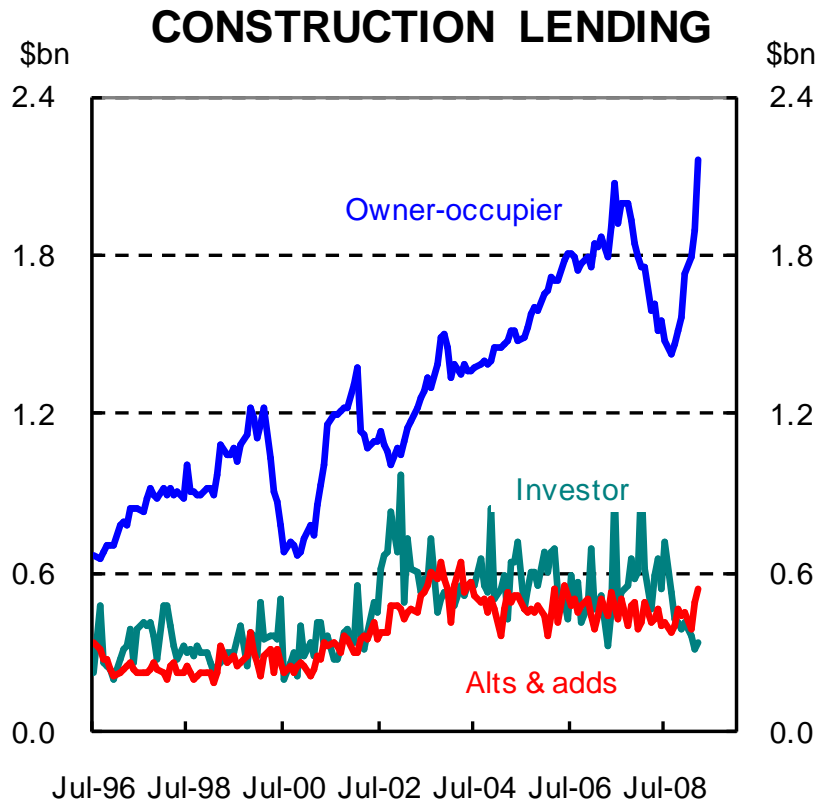
Budget Forecasts

	2008/09 (e)	2009/10 (f)	2010/11 (f)
Real GDP (% ch)	0	-1/2	2 1/4
<i>Of which:</i>			
H/hold consumption (% ch)	1	-1/4	1 3/4
Dwelling Investment (% ch)	-2 1/2	0	11 1/2
Business Investment (% ch)	2 1/2	-18 1/2	3 1/2
Public demand (% ch)	5	7 3/4	-1/2
Ch in inventories (contrib)	-1 1/2	1/4	3/4
Net exports (contrib)	1/4	3/4	-1/2
CPI (% ch to June)	1 3/4	1 3/4	1 1/2
Wage Price Index (% ch)	4 1/4	3 1/4	3 1/4
Employment (% ch)	-1/4	-1 1/2	1/2
Unemployment rate (% at June)	6	8 1/4	8 1/2
Current A/c def (% GDP)	-3	-5 1/4	-5 3/4



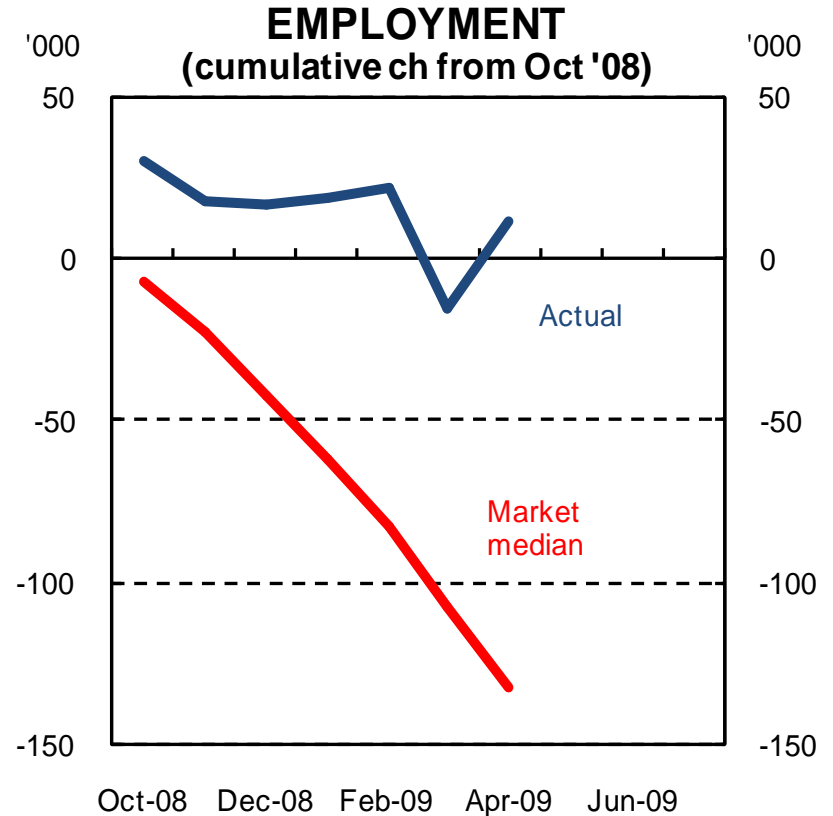
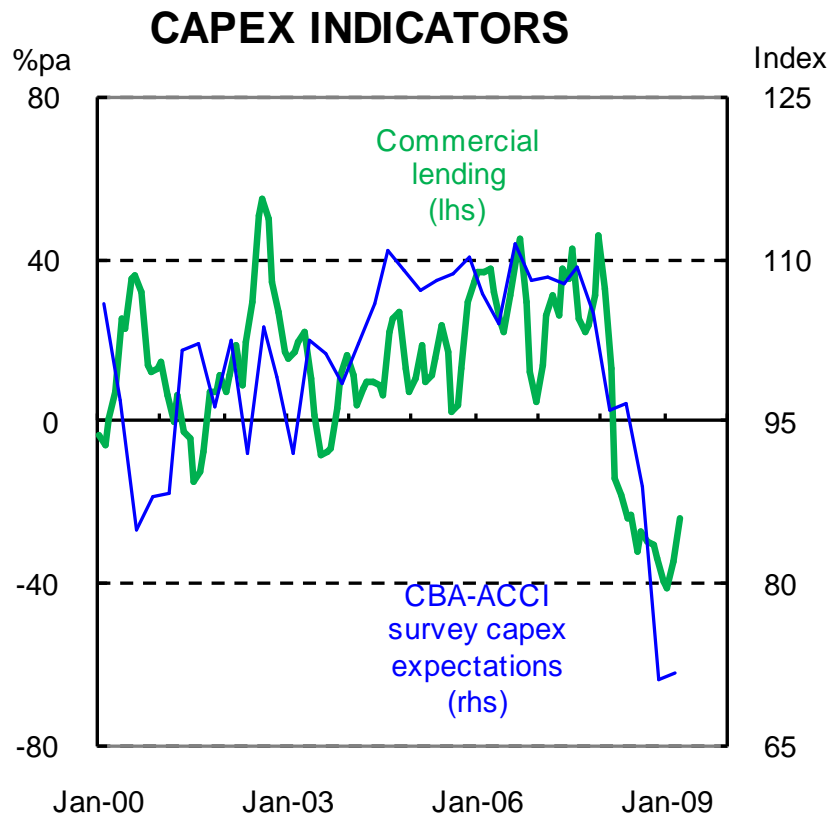
Budget Forecasts

Economic policy is working



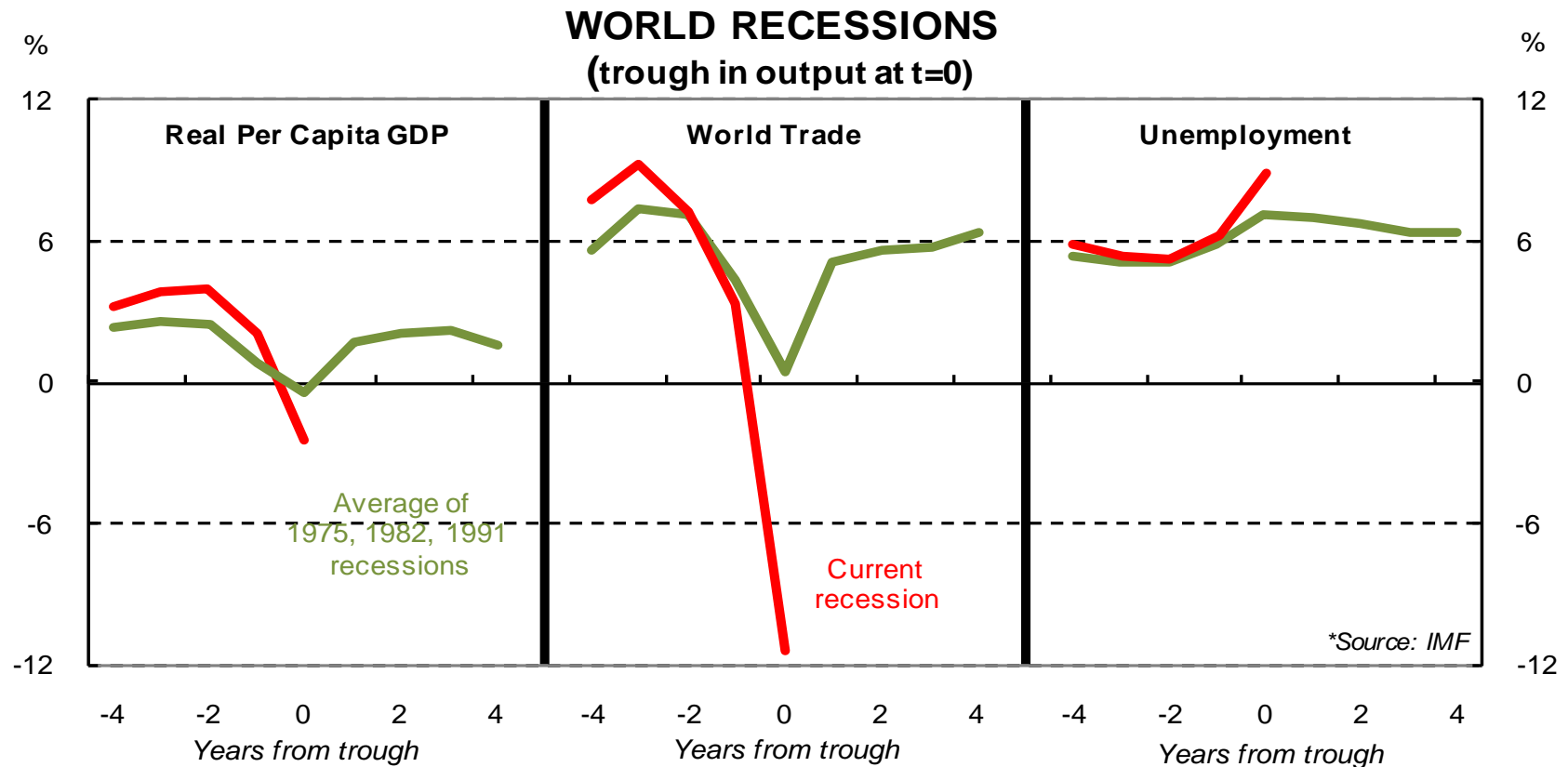
Budget Forecasts

Perception vs reality



The Global Backdrop

Ugly

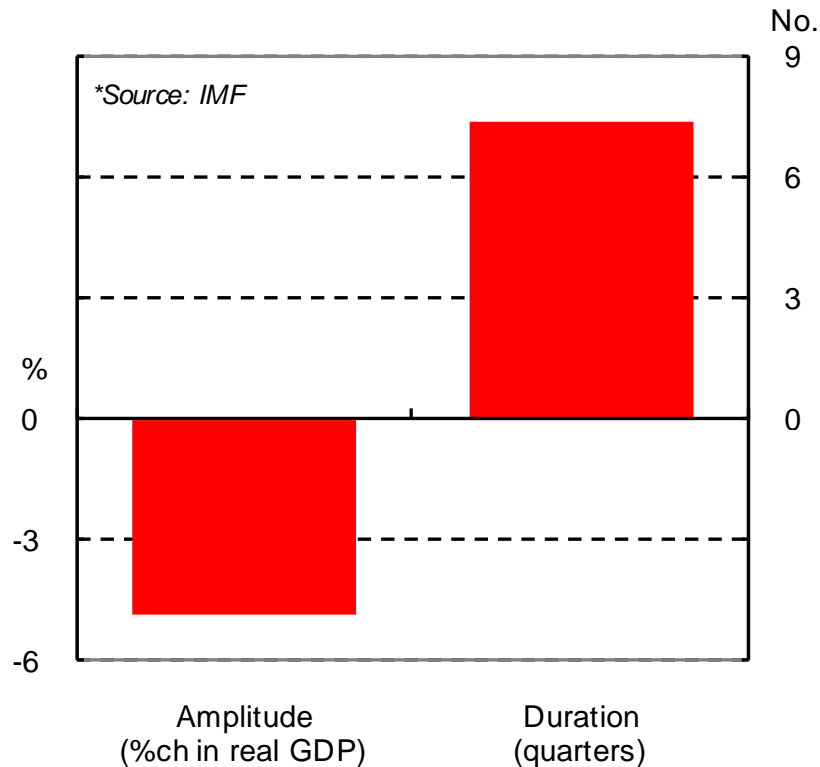


- The current recession is more severe than those recorded in 1975, 1982 or 1991.

Financial Crises & Recessions

Longer & deeper

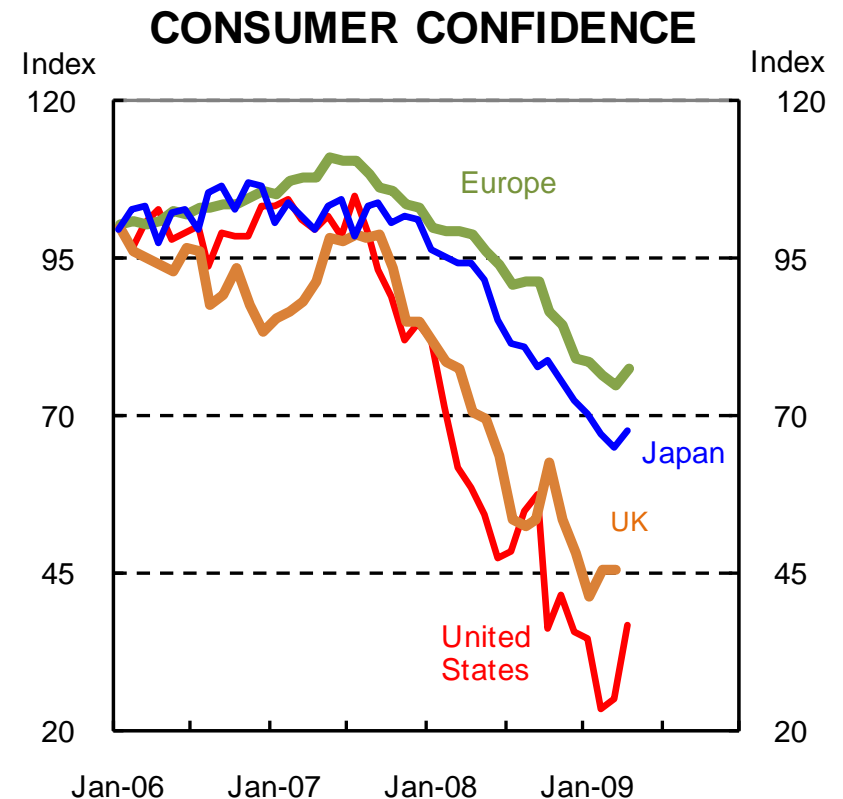
SYNCHRONISED FINANCIAL CRISES



- **The current recession is associated with a financial crisis and is widespread across economies.**
- **Risks lie with a deeper downturn, partly because it will probably be longer.**

Financial Crises & Recoveries

Green shoots?



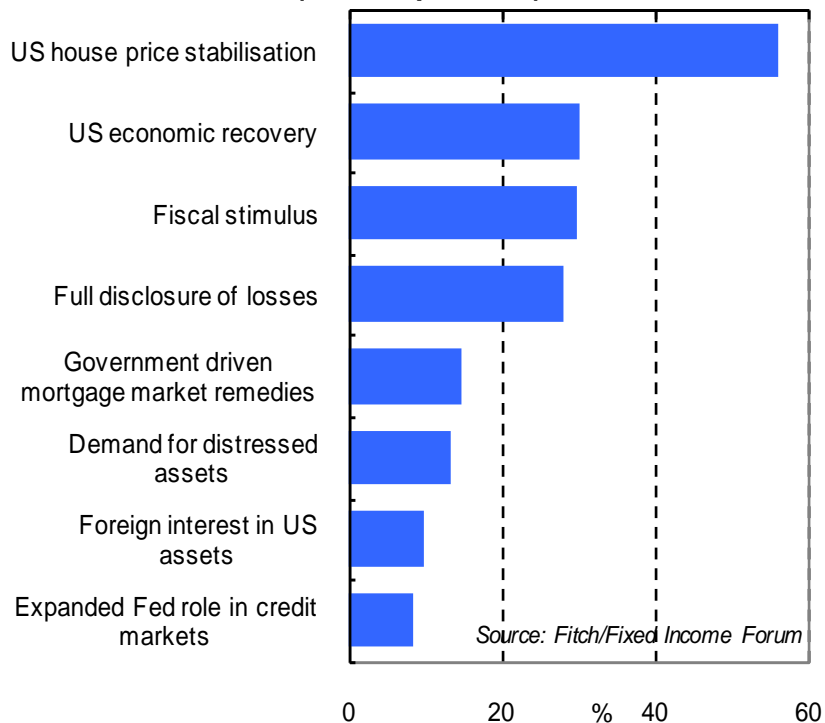
- The current crisis is a crisis of confidence.
- So look to confidence indicators for early signs of stabilisation.



Financial Crises & Recoveries

Confidence: the weakest link

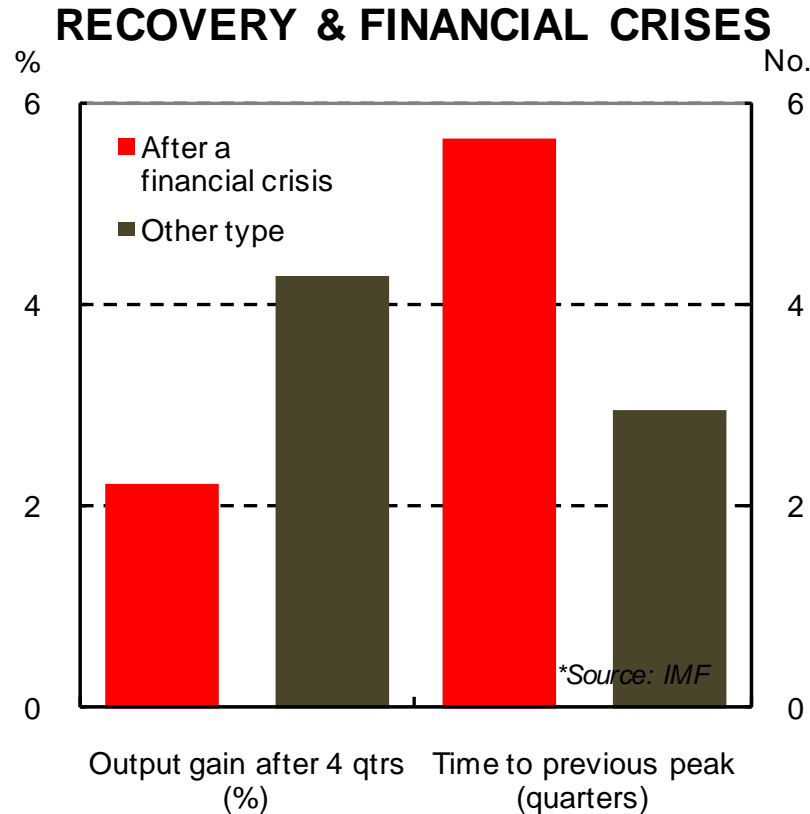
CRITICAL FACTORS FOR MARKET STABILITY (% of respondents)



- **Key lesson from this crisis is the importance of “confidence” – once lost hard to restore.**
- **A Fitch survey identified the factors that market participants regard as essential to restoring market stability (and confidence).**
- **Market participants want some certainty that all the bad news is on the table and an end to the downward spiral in asset prices.**
- **Policy “credibility” also needed.**

Financial Crises & Recoveries

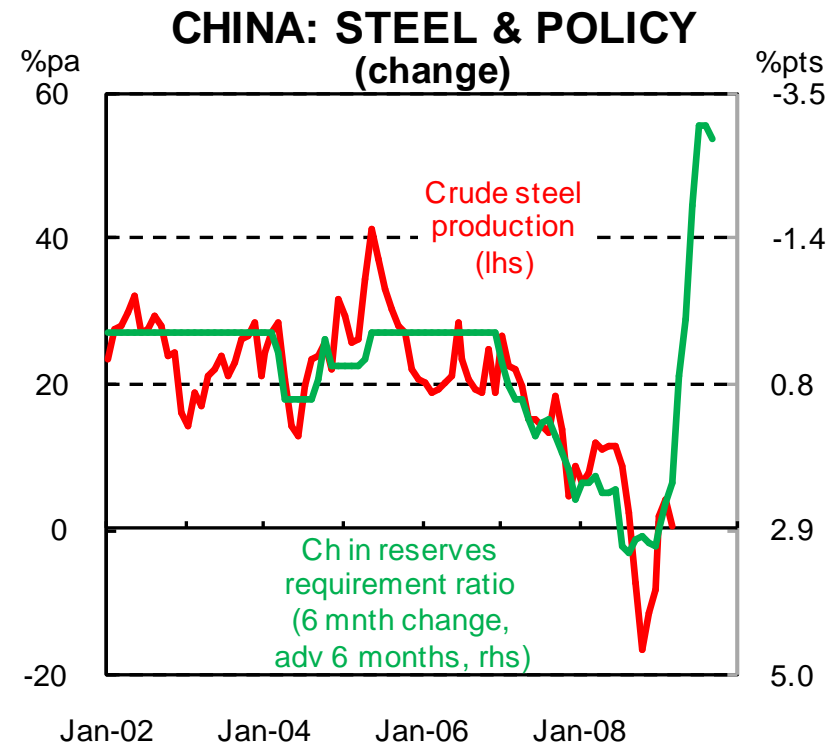
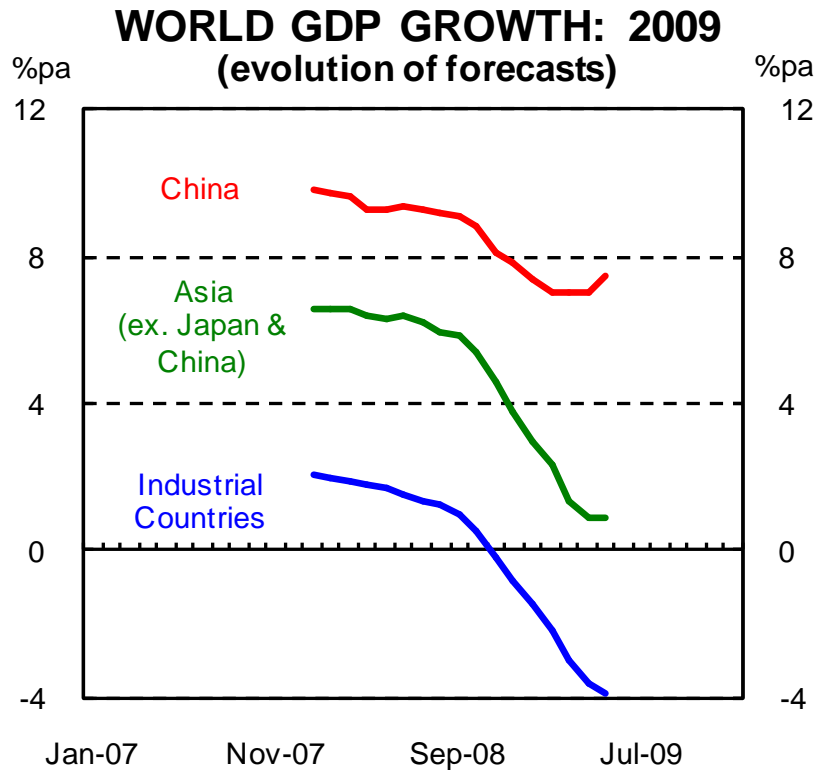
What do recoveries look like?



- The same factors that tend to lengthen and deepen downturns associated with financial crises also tend to mute subsequent recoveries.
- The time taken to return to previous peaks is typically longer.

Global Recession & Australia

Composition matters

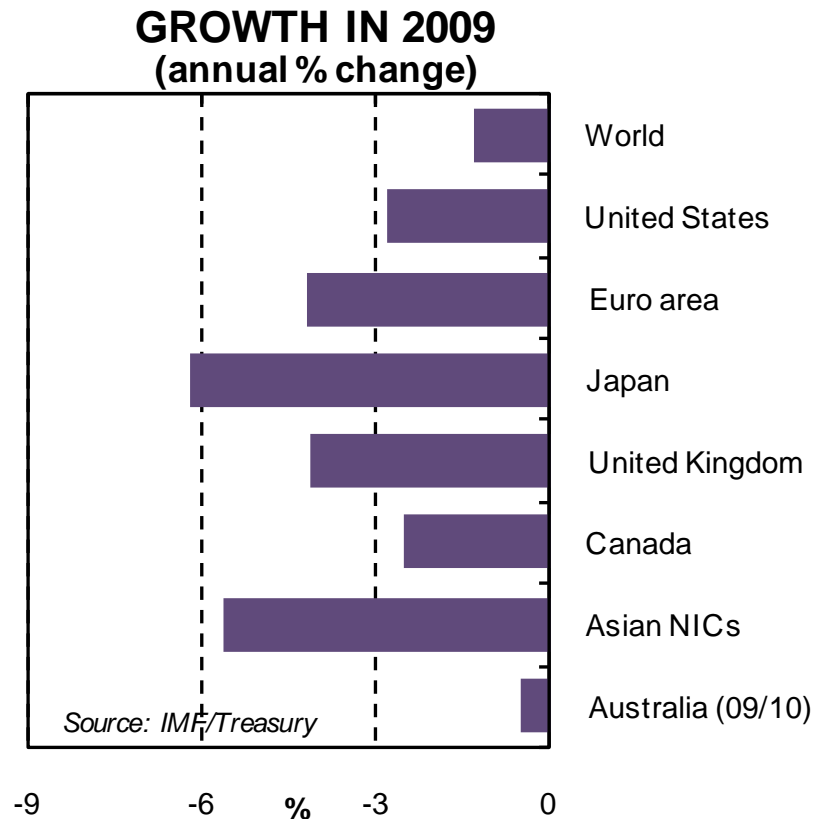


- Growth in all our major trading partners revised lower.
- But our greater exposure to emerging Asia has helped limit the damage.



CBA View

Shades of black



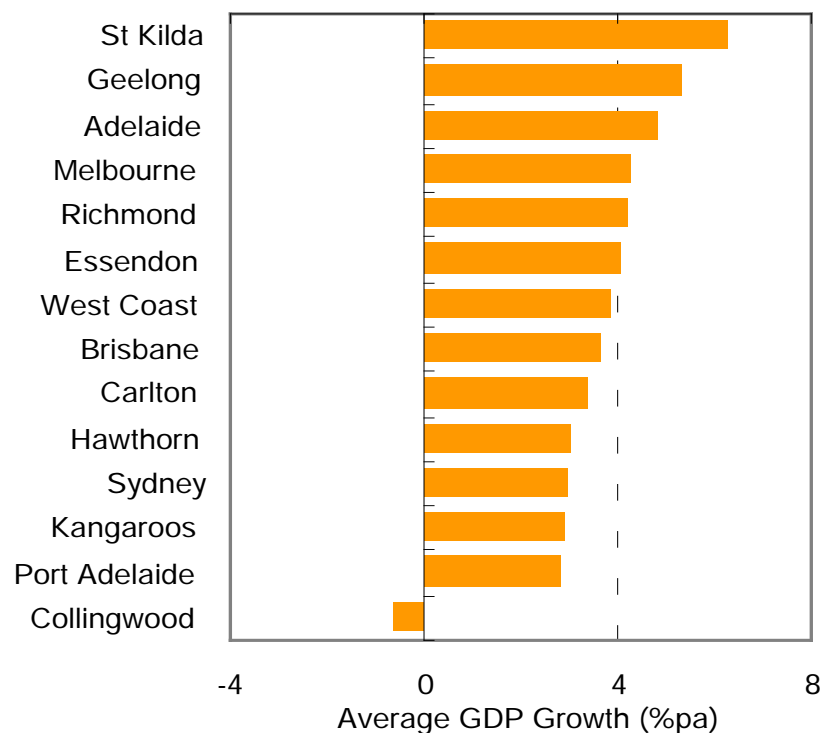
- The Australian economy has gone into reverse – a very weak outcome in an absolute sense but one that looks quite good on a relative basis.
- Chance of doing better than Budget forecasts.
- Some protective factors at work:
 - stronger financial system;
 - less housing stress;
 - favourable demographics;
 - the capex pipeline;
 - the rural bounce;
 - the lower AUD;
 - economic policy still works.



Sport & The Economy

AFL & the economy

PREMIERSHIPS & GROWTH



- Wins by non-Melbourne teams do the most to support activity.
- 2008: Geelong v Hawthorn – did the right team win?
- 2009: Budget forecasts pricing in a Collingwood win?
- 2009: Go the Saints!

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