



TREASURER'S ECONOMIC NOTE

Welcome to the latest edition of my economic note. On Wednesday I was in Hobart and joined with the Premier of Tasmania, David Bartlett, to visit one of the countless small businesses that the Rudd and Bartlett Governments have worked with to stimulate the economy and protect jobs and businesses from the worst impacts of the global recession. It's great to see the way employers and employees have got behind economic stimulus in Tasmania, with the State's unemployment rate now 0.1 of a percentage point below the national average. Small businesses and tradies across Tasmania have had the benefit of stronger demand because of essential investment in infrastructure. Indeed, 70 per cent of our stimulus is direct investment in infrastructure such as roads, rail and ports. Across Tasmania, this includes \$878 million for 598 Building the Education Revolution projects in 276 schools, \$125 million for the construction of 512 social housing dwellings, and \$35.5 million brought forward for the Brighton Bypass.

Tasmania will also be the first state to receive the roll-out of superfast internet from the National Broadband Network. The communities of Smithton, Scottsdale and Midway Point will be the first to receive optical fibre broadband connections – and internet 100 times faster than most get now – with services due to be switched on later this year. Ultimately, the National Broadband Network will reach all of the 6,316 computers being installed by the Rudd Government in some 103 schools throughout Tasmania.

Business Confidence

Last week's NAB Quarterly Business Survey found that business confidence strengthened further in the December quarter of 2009 and is now at its highest level since December 1994. NAB Chief Economist Alan Oster said that "government stimulus programs, rises in equity and property markets and an improvement in actual business outcomes all appear to have helped confidence." It's heartening to see that off the back of economic stimulus, business confidence is now at a level it hasn't been for more than 15 years. This confidence is underpinning ongoing investment and job creation in the face of still considerable challenges in the global economy.

Business conditions also improved further in the December quarter, and are now at their highest level since March 2008. Conditions improved broadly across almost all sectors, with finance, property services, residential construction and construction services performing the best. Mr Oster said that "it seems likely that government infrastructure spending and the First Home Owners Boost were contributing to the improvement in most of these sectors." The survey noted that there are now signs that businesses are making plans to spend more on buildings and equipment, with capital expenditure plans for the year ahead finally responding to the improvement in confidence and contributing to what will likely be a moderate recovery in investment during 2010.

Impact of Economic Stimulus

A report put out by the OECD last week made it clear that fiscal and monetary stimulus in Australia "have in no small part shielded businesses and citizens from the initial damaging impacts of the global recession." It said that "although the global recession has not spared Australia, its impact appears to have been less severe than in most other OECD countries." The OECD noted that the Australian economy recorded positive growth (year on year) in the first half of 2009, outperforming other OECD economies, which contracted on average by 4.75 per cent. It also estimates that "employment in Australia in 2010 will be between 1.4 and 1.9 percentage point higher than it would have been without the stimulus measures adopted." The OECD cautioned that "the withdrawal of fiscal stimulus will have to be carefully planned in terms of its timing, taking into account the significant uncertainties still surrounding future macroeconomic developments."

In a speech last week, RBA Assistant Governor Philip Lowe talked about the two-speed global recovery, the resilience of the Australian economy, and the moderation of inflation in Australia. He noted that the world

economy has moved back from the edge of a precipice, in large part due to the strong policy response of governments and central banks around the world. He explained that “these responses provided the public with the assurance that policy makers would not stand idly by. Collectively, they were sufficient to interrupt the corrosive cycle of falling confidence undermining spending, then feeding through to even lower confidence and even lower spending.” Mr Lowe went on to say that “the pick-up in the global economy has, however, been quite uneven. In the advanced economies, the recovery to date has been weak, especially in light of the very large contractions in output that occurred. In contrast, in Asia the bounce back has been much stronger, with many of the economies in the region growing solidly and operating with much less spare capacity. Looking forward, this two-speed world is likely to continue for some time yet.”

Mr Lowe also discussed the general resilience of the Australian economy, noting that “amongst the advanced economies, Australia is the only one to have avoided a negative year-ended growth rate during the global downturn.” He said that the better than expected performance of the labour market “has been important in underpinning a high level of confidence in the community. In turn, this has helped short circuit what could have been a damaging dynamic – that is, rising unemployment feeding through to weak confidence and lower incomes, in turn feeding through into lower spending and a further increase in unemployment.” Mr Lowe’s comments about the global and domestic economic landscape highlight that Australians have good reason to be confident in our future, but have no cause for complacency.

Monetary Policy

Reserve Bank Governor Glenn Stevens appeared before the House of Representatives Standing Committee on Economics on Friday. He noted that current challenges included the two-speed nature of the global recovery and the increasing focus on sovereign creditworthiness, and pointed out that “in terms of fiscal sustainability, Australia’s position is, by any measure, very strong indeed.” Turning to monetary settings, the RBA Governor said that “monetary policy must ... be careful not to overstay a very expansionary setting”, and that a lessening of monetary stimulus over time “is a normal experience in an economic expansion: as economic activity normalises interest rates do the same”.

Last week’s report from the OECD said that the raising of official interest rates by the Reserve Bank “after the period of very expansive monetary policy adopted in response to the financial crisis ... reflects the relatively favourable trends experienced by the economy over the recent period and the reduction of the large global downside risks which prevailed until mid-2009.”

Investment in RMBS and Wholesale Funding Guarantee

Last week we received some welcome news with AMP announcing that it is reducing its basic variable home loan interest rate for new loans by 10 basis points, attributing the cut to the Government’s investment in the Australian RMBS market. AMP’s rate decision is good news for family budgets, and means more competitive pressure on the big banks. AMP Managing Director and Chief Executive Craig Dunn wrote to me about their decision, saying that “this reduction in interest rates has only been possible because of the improvement to the securitisation markets flowing on from the Government’s support.” It was also encouraging to read Mr Dunn’s statement that “we are also hopeful that we will be further able to reduce our rates in the coming months, as we gear up our operations in light of ongoing improvements in the securitisation market.”

The Government’s direction to the Australian Office of Financial Management to invest up to \$16 billion in Australian residential mortgage-backed securities (RMBS) has supported competition in Australia’s mortgage market, enabling smaller lenders to lend at competitive interest rates and maintain a higher level of lending than would otherwise have been possible during the global financial crisis. As Australia recovers from the global recession and official interest rates move from their emergency 1967 levels, the Government will continue to do whatever we can to boost competition in the banking system.

In a speech last week, RBA Assistant Governor Guy Debelle noted that “securitisation markets have ... begun to show some signs of life from the end of last year. There have been sizeable RMBS issues by ME Bank, Bendigo and Adelaide, Westpac and most recently AMP and Bank of Queensland.” He said that “the spreads on the recent RMBS issues are only a bit higher than those on the recent unguaranteed issues by the major banks of equivalent maturity, and the gap is narrowing. This means that RMBS is again beginning to provide a competitive source of funding, particularly for the regional banks (which pay higher spreads on their debt issues) and non-bank lenders which had both previously depended more on this source of funding.”

Mr Debelle’s speech also touched on the Government’s decision to withdraw the wholesale funding guarantee at the end of March. He said that it reflected “the improvement in market conditions and the continued strength of the Australian banking system”, explaining that “as risk aversion has dissipated, and spreads have narrowed, there has been an increase in unguaranteed issuance. For some months now, for the major banks, the cost of issuing unguaranteed debt, particularly at shorter maturities has been no higher, and often lower, than the cost of issuing guaranteed debt once account is taken of the guarantee fee. ... [T]his has led to an increase in unguaranteed issuance and a decline in guaranteed issuance. That is, the price mechanism works.”

Consultative Forum on Mature Age Participation

Before heading off to Thursday night’s Community Cabinet at Ballarat High School, I attended the first meeting of the Consultative Forum on Mature Age Participation in Melbourne. Australia’s mature age participation rate is 58.9 per cent, putting us in 13th place in the OECD and below comparable countries like the US, UK, Canada and New Zealand. Senior Australians have vast experience and expertise to contribute to the national economy and should be able to work as long as they choose – not forced out of the workforce because of prejudice or bad policy. The Consultative Forum on Mature Age Participation was announced by Minister for Employment Participation Mark Arbib and I with the release of the 2010 Intergenerational Report a few weeks ago, as part of the new \$43.3 million Productive Ageing Package. The Forum is all about coming up with ideas on how we can remove barriers to workforce participation by senior Australians. The Forum brings together representatives for seniors, employers, workers, employment services and age discrimination, and will focus on issues like employer and community attitudes towards mature age people, age-based discrimination, re-skilling and career transitions, mentoring, suitability of training, and retaining the expertise of older workers.

Coming Up

After spending last week on the road, today I’m travelling to Canberra for another week of Parliamentary sittings. The resumption of Parliament allows the Government the opportunity to debate in the Senate the fiscal savings legislation that will deliver the Government’s reform to the Private Health Insurance Rebate. This reform is critical to ensuring the long-term sustainability of the health budget and will realise savings of around \$2 billion over the next four years and approximately \$9 billion over the next decade. This reform has been designed to maintain membership in private health insurance and to end subsidies to the most well off Australians. Membership will be almost entirely maintained due in part to the increase in the Medicare Levy Surcharge for high-income earners – providing them with an incentive to stay insured. Treasury estimates that 99.7 per cent of Australians with insurance will maintain their private hospital insurance. Making tough decisions like these is critical to the long-term sustainability of our budget and our health system.

Wayne Swan

Treasurer of Australia

Sunday 21 February 2010

www.treasurer.gov.au

www.economicstimulusplan.gov.au