

Australian Economic Update

Fiscal stimulus package

The Australian government today took another decisive step in response to onset of the global financial crisis by announcing a significant loosening of fiscal policy. The Prime Minister and the Treasurer announced a package of additional spending worth a total of A\$10.4 billion (around 1.0% of GDP). If fully implemented, this will absorb close to half the available Budget surplus of A\$22 billion. The fiscal stimulus package follows the RBA's assertive 100bp rate cut and this week's announcement of the implementation of government guarantees on deposits, wholesale funding issued by financial institutions, and a doubling of the amount of public funds made available to purchase newly-issued residential mortgage backed securities (RMBS).

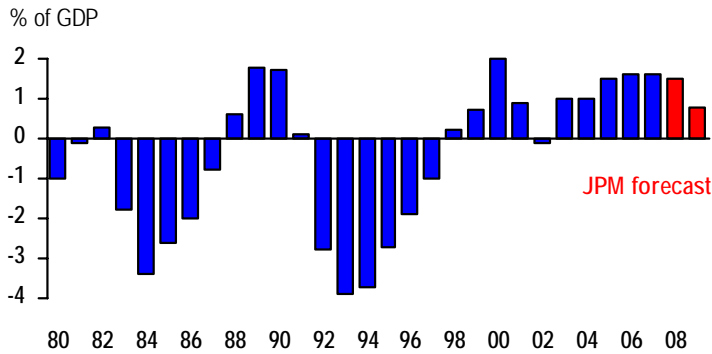
The five main measures announced today, most of which will be applied either immediately or within weeks, included:

- an extra A\$4.8 billion in new payments to the pensioners, via bonus payments, from 8 December; single pensioners will get a bonus payment of A\$1,400; couples will receive A\$2,100. These payments will benefit the elderly, those with disabilities, service veterans, and carers;
- an additional A\$3.9 billion in extra payments to low and middle income families, also from 8 December. Support will be delivered via a one-off payment of A\$1,000 for each eligible child in care - 3.9 million children will be affected;
- a doubling of the first home owners' grant to A\$14,000, effective today and available through to end-June 2009. First time buyers of newly-constructed homes will receive A\$21,000. The total cost of this measure is estimated at A\$1.5 billion. 150,000 first time buyers should benefit;
- an additional \$A187 million allocated to establishing 56,000 new skill training places; and
- an acceleration in the Government's three nation building funds. Ministers will bring development work on projects in education and research, health and hospitals, and transport and communications.

In terms of the impact on monetary policy, at the margin, the announcement of the fiscal stimulus package makes it less likely that the RBA will have to cut the cash rate even more aggressively than we currently forecast; the risks to our cash rate forecast of 4.5% by June 2009 were skewed to the downside. Futures market pricing now implies the RBA will cut the cash rate by 50bp in November - in line with our forecast. Late last week, as equity markets were cratering, market pricing implied the RBA again would slash the cash rate by 100bp on 4 November.

We still expect another 50bp cut in the cash rate on 4 November (with reduced risk of a larger move), and a further 25bp rate cut in December, assuming financial markets have "normalised". We expect an additional 75bp of rate cuts through the first half of 2009, which will take the cash rate target down to 4.5% by mid-2009. The RBA's unexpectedly aggressive rate cut last week signalled that officials no longer are focused on elevated inflation, which will print close to 5% on 25 October, double the mid-point of the RBA's target range. Indeed, RBA and government officials clearly now are much more concerned about the downside risks to economic growth.

Commonwealth Budget position



On the growth outlook, we this week trimmed our GDP growth forecast for Australia for 2009 to just 1.8%, down from 2.5% previously. The risks are to the downside, particularly if there are further downgrades to JPMorgan's global growth forecasts. Consumers will be particularly hard hit (we expect virtually no growth in consumer spending next year) by sagging confidence, tumbling asset prices, tighter credit conditions, still high energy prices, and the weakening labour market. We also forecast that the Budget surplus will be under significant pressure in 2009 from the reversing terms of trade, which will squeeze company tax revenues, and rising welfare payments.

The increasingly depressing economic outlook makes the Government's targeting today of the fiscal stimulus mainly towards "working families" and the disadvantaged look particularly prudent. The Government's long term aim is to improve the economy's sagging infrastructure, but additional payments directly to families put money in peoples' pockets much more quickly. The Government will announce revised fiscal and economic forecasts in the mid-year statement in November. It is becoming increasingly clear, though, the official forecasts for both the surplus and economic growth will be substantially lower than the Government forecast in the Budget back in May.

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