J.P.Morgan

Economic Research

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Australian Economic Update

Government's fiscal stimulus package

The Australian Government today announced another significant fiscal stimulus package worth up to 4% of GDP, following last October's initial announcement than the fiscal purse strings were being loosened. Back in October, the Government "gave back" a total of A$10.4 billion (1% of GDP), mainly in the form of bonus welfare payments paid in December. There since has been a series of other initiatives totalling close to A$40 billion, although "new" spending probably is considerably lower.

Today's stimulus package is worth A$42 billion spread over several years, (worth roughly 4% of GDP, including a 0.5% boost in the current fiscal year). The key measures include:

- Targeted grants to low- and middle-income households. The one-off payments of A$950 will be directed to eligible workers earning A$100,000 or less, students, drought-afflicted farmers, and families with children;
- a A$28.8 billion rise in infrastructure spending. Spending is to be directed at local community infrastructure, defense housing, schools, and roads, building or upgrading a building in every one of the nation's 9,540 schools, and the construction of more than 20,000 new social and defence homes;
- a temporary business investment tax break for small and general businesses buying eligible assets; and
- the provision of free ceiling insulation for around 2.7 million Australian homes.

Belatedly, Government officials have acknowledged that the Commonwealth Budget position has slipped into deficit. Alarmingly, this admission stems mainly from a collapse in revenue, and does not take into account the latest stimulus measures or the massive increase in welfare payments that now is certain as the jobless rate climbs towards double figures. Until this week, the official Budget forecasts, released just two months ago, showed modest surpluses over the forward estimates period. Now, the Government forecasts that the Budget already has slipped into "temporary" deficit. Previous recessions, however, illustrate clearly that Budget deficits will be anything but "temporary".

In a sombre press conference yesterday, the Prime Minister indicated that revenues had plunged A$115 billion over the four year forward estimate period - this is mainly owing to a colossal hole being punched in company tax receipts as corporate profits plunge. The revised official forecast, released today, is that the Budget now will be in deficit by A$22.5 billion in the year ended June 2009. Our forecast is that this fiscal year's deficit will be larger at close to 3% of GDP. Similarly, our forecast that the Budget deficit will be around 5% of GDP in the year ended June 2010 dwarfs the official deficit forecast of roughly 3.5% of GDP. The ballooning deficit means Commonwealth Government bond issuance will double to A$100 billion, perhaps more.

As expected, the Government has dramatically re-worked the official forecasts for the real economy. The new forecasts show only a small expansion of 0.75% in the economy in the year ended June 2010 (down from the unrealistic 2.25% rate of expansion expected back in November), compared to our forecast for GRP growth of 0.3%. Our forecast is that Australia's economy is in recession and that GDP will contract 0.5% in CY 2009 - the Government was never going to admit that the economy had toppled into recession. That said, the Government now expects the jobless rate to rise to 7% in 2010 (our forecast for the unemployment rate is much higher at 9%) as employment contracts.

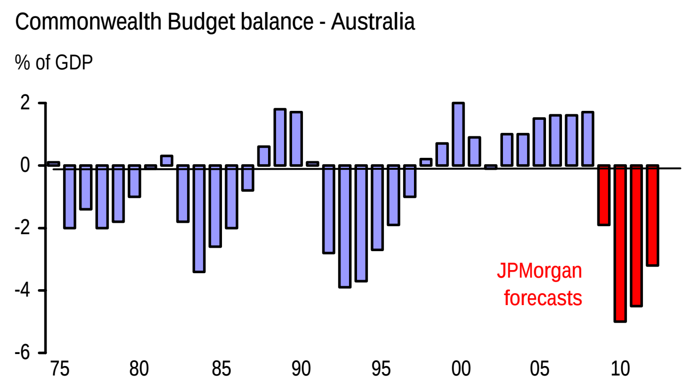
What impact will the latest fiscal fiddling have? In the near term, not much, although some of the one-off payments to families will end up boosting spending. Industry surveys, though, indicate that only around one third of the bonus welfare payments delivered in December was spent by households - most was saved, given away to struggling family members, or used to pay down debt. The weakness in confidence and asset prices since then, coupled with the avalanche of bad news from offshore, means households now probably are even less inclined to spend windfalls than they were last year. Indeed, the savings rate already has spiked up as anxious households boost precautionary savings to prepare for the approaching economic hurricane.

Today's announcement of new publicly-funded infrastructure programs is worthy - not long ago, most corporates were complaining about the serious bottlenecks in ports, road, rail, and water and power supply - but is unlikely to produce much economic "spark" in the near term. Getting the various state governments to agree on a coordinated way forward on new spending plans, for example, will be like herding cats. The Government seems to have gone cold on delivering more personal tax relief (there already are personal tax cuts in the pipeline for July), which may have delivered more immediate bang for the taxpayers' buck.

All of this supports the case for the Reserve Bank to announce another bold reduction in the cash rate target later this afternoon. We are sticking with our view that the RBA will slash the cash rate another 100bp to 3.25% - this will be the lowest cash rate in the modern era of monetary policy, which started in 1990 with the establishment of the cash rate target, and the lowest base rate since the 1960s. The recent accumulation of bad news means the dominant risk today is that the RBA cuts by more than 100bp.

Government forecasts

	2008-09(f)	2009-10(f)	2010-11(f)	2011-12(f)
Balance - $billion	**-22.5**	**-35.5**	**-34.3**	**-25.7**
Balance - % of GDP	-1.9	-3.5	-3.1	-2.2
Change - % of GDP	*-3.9*	*-1.6*	*0.4*	*0.9*
Fiscal policy stance	**Looser**	**Looser**	**Tighter**	**Tighter**



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