



TREASURER'S ECONOMIC NOTE

Welcome to this Easter Monday edition of my economic note, coming to you as I head back from Queensland's beautiful Sunshine Coast where I've spent Easter with my family. With the Budget now just five weeks away, it's good to know that the success of stimulus means we approach this Budget from a position of strength. But while most people understand the benefits of higher growth and lower unemployment, what is less well understood is the significant lag between the rebound in the real economy and the recovery of government revenues and the budget bottom line that comes with it. Taking stock of the recovery in this note, I want to deal with revenue issues in some detail as well. I'll also take the opportunity to welcome the PM's appointment of Tony Burke as the new Minister for Population – a really important position which will help us deal with some of the big challenges ahead and continue to raise our quality of life.

Government Revenues

It's always encouraging to see signs of improved company profitability, a stronger share market and better employment outcomes. This is a testament to the resilience of the Australian economy and the effectiveness of the Government's economic stimulus. It's also good news for future government revenues, as stronger outcomes, including in the labour market, impact positively on the budget. But it's important to keep in mind that the weaker outcomes we saw during the global recession will continue to act as a drag on government revenues for some time to come.

Company profitability took a big hit during the global recession. In the year following the collapse of Lehman Brothers, the profits of private non-financial corporations fell by a massive 16.5 per cent. That's the equal weakest result in our history, matching the contraction in profits experienced during the 1990s recession. Those lower company profits will continue to weigh on company tax collections, even as the economy recovers. That's because the accumulated losses that built up during the downturn can be used to offset profits made during the recovery. For example, losses incurred during the early 1990s recession were used to offset company profits for at least the following five years of recovery.

While there has been a rebound in the stock market, the ASX has averaged around 4,500 points through this financial year, still around a third lower than its pre-crisis peak of around 6,800. This fall in asset prices will negatively impact CGT collections not only due to lower gains – and in many cases large losses being made when assets are sold – but also because less assets are sold following a downturn in the market. This negative impact will be felt by the budget with a significant lag, as companies and individuals pay CGT in the financial year after an asset is sold and capital losses are used to offset future gains in a similar way to company losses. You can read more about these impacts on CGT collections in this [article by George Megalogenis](#).

Even with our stimulus keeping an extra 200,000 Australians in work, with obvious benefits for the budget bottom line, the global recession still saw a significant jump in the number of unemployed and a fall in hours worked. Employees generally pay a higher marginal rate of tax on their last hour worked than their first. This means that when average hours worked falls, personal income tax paid on wages and salaries falls by a greater percentage. As people don't submit their tax return until after the end of the relevant financial year, higher unemployment and lower average hours impact on revenues with a lag. For example, weaker employment outcomes in the second half of 2009 won't be felt until the 2010-11 Budget.

Population and Infrastructure

On Saturday the Prime Minister announced that Tony Burke will take on the newly-created position of [Minister for Population](#) in the Rudd Government. It will be great to work with Tony in his new role within the Treasury portfolio. As someone who has lived my whole life in Queensland's south-east corner, I feel very personally about issues of population like those discussed at Tuesday's [Queensland Growth Management](#)

Summit. Born and bred in the Sunshine Coast region and now living in Brisbane's northern suburbs, I've seen first-hand the impact a growing population has on both once-small coastal communities and medium-sized cities. As the Australia to 2050 Intergenerational Report released just a couple of months ago shows, a growing population brings challenges but also opportunities to boost prosperity, improve living standards and help tackle the challenges of an ageing population. The Prime Minister's speech in Melbourne last Monday outlined our plans to build a platform for sustainable growth over the long term, including by building more productive and more liveable cities. If we're going to get the right kind of growth – that raises our standard of living, preserves our environment and improves social cohesion – making sure we have the necessary infrastructure in place is going to be a big part of the story.

The private sector will also have a big role to play in this – a point I made at a BCA dinner on Tuesday. An important source of private funding for infrastructure is going to be the money that people invest through their super funds. That's why we have asked Infrastructure Australia to continue developing our National Infrastructure Pipeline – to give investors the certainty they need in planning for infrastructure investment in the coming years. We've already seen some encouraging examples of this, including the big retail industry superannuation fund REST recently announcing that it is involved in the purchase of WA's Collgar wind farm – a great example of the gains that can be made when government and the private sector work together.

Removal of Wholesale Bank Guarantee

Wednesday marked another important milestone in our recovery, with the closure of the Guarantee of Large Deposits and Wholesale Funding. At a time when global markets were in a state of turmoil, the guarantee helped ensure stability and the flow of credit through our economy. Not only did it mean banks could lend more at lower rates, but it also provided critical support for competition, with our non-major banks and other smaller lenders using it to raise over \$65 billion in cheaper funding. The guarantee's closure on schedule is more evidence that the recovery is going to plan, with a banking sector that is standing on its own feet.

Fiscal Stimulus and China

There's a fair bit of commentary around about the relative importance of fiscal stimulus and strong Chinese demand for our commodities in keeping the Australian economy strong during the global recession. While there is no doubt China's continued growth has played a welcome role during Australia's recovery, and will continue to play a key role in our success into the future, recent analysis by Deutsche Bank also points to "the crucial role that the domestic policy stance has played in Australia's relative resilience compared in particular to our traditional peer countries", and "puts into appropriate context the often-cited significance of resilient Chinese demand for resources as the 'reason' for Australia's success."

The research shows "the resource-oriented states of Western Australia and Queensland shifted from outperformance to underperformance, while the other, relatively more domestically-oriented states, rebounded in line with the exceptionally stimulatory domestic macroeconomic policy setting." They go on to say "the recent underperformance by the resource-oriented states underscores for us that the key to Australia's strong relative performance through the global recession has primarily been domestic policy settings and the resilience of the Australian financial system – and not the role played by Chinese demand".

In 2009, Australia's export volumes overall grew by just 0.6 per cent, compared to average growth of 3.1 per cent for the previous ten years. As a result, export volumes contributed only 0.1 of a percentage point towards our GDP growth of 1.4 per cent in 2009. In contrast, Treasury estimates stimulus measures contributed 2.0 percentage points to GDP growth over the same period.

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