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CEO INSTITUTE: FEDERAL BUDGET ANALYSIS

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The information in this presentation is of a general nature and does not represent advice.

Forecasts are subject to unavoidable statistical variation.

This presentation only takes into account information available to me up to the date of this presentation.

SHOULD WE BELIEVE THE BUDGET?

- **THE ECONOMIC OUTLOOK: IS THE BUDGET TOO OPTIMISTIC?**
- **THE BUDGET OUTLOOK: WILL THE SURPLUSES BE ACHIEVED?**
- **THE BUDGET & TAXATION: ARE THE TAX CUTS REAL?**



THE ECONOMIC OUTLOOK

IS THE BUDGET TOO OPTIMISTIC?

SHORT-TERM FORECASTING MODEL

- **WORLD AND AUSTRALIAN MODULES**
- **EMPHASISES RELATIONSHIP BETWEEN FINANCIAL MARKETS AND ECONOMY**
- **DESIGNED FOR QUARTER-BY-QUARTER FORECASTS TO 3-YEAR HORIZON**
- **ESTIMATED WITH QUARTERLY DATA FROM 1990Q1 TO 2019Q1**
- **VECTOR AUTO-REGRESSION MODEL (VAR): DATA-ORIENTED**
- **BROADLY SIMILAR IN NATURE TO DUNGEY AND PAGAN (2000, 2009)**
- **USEFUL CROSS-CHECK ON SHORT-TERM FORECASTS OF MACRO-ECONOMETRIC MODELS, WHICH HAVE MORE ECONOMIC STRUCTURE, DETAIL**

WORLD MODEL

Country-weighted variable	Trend treatment (simple characterisation)
10-year govt bond rate (US, UK, Japan, Germany)	random walk
real GDP (9 major trading partners)	deterministic trend with slower growth post GFC
CPI (10 major trading partners)	stochastic trend
3-month LIBOR (US, UK, Japan, Germany)	co-integrated with 10-year govt bond rate
real MSCI world share price index (advanced economies)	deterministic trend

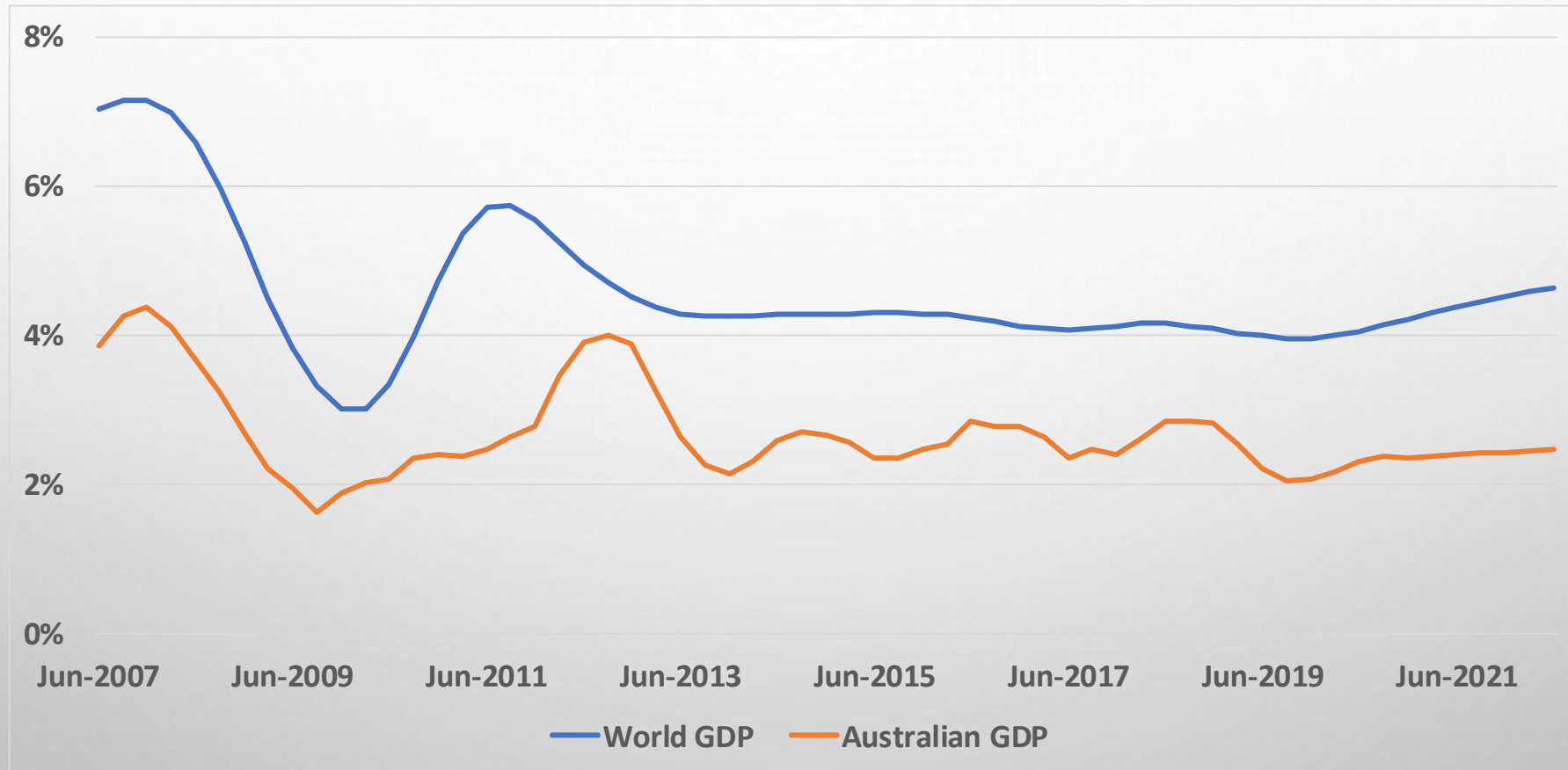
AUSTRALIAN MODEL

Variable	Trend treatment (simple characterisation)
real GDP	deterministic trend with slower growth post GFC
CPI	stochastic trend
unemployment rate	stationary relative to NAIRU
90-day bill interest rate	co-integrated with 3-month LIBOR
real ASX200 share price index	deterministic trend
real TWI exchange rate	stationary

MODEL STRUCTURE

- **WORLD MODULE**
 - EACH WORLD VARIABLE DEPENDS ON LAGGED VALUES OF ALL WORLD VARIABLES
- **AUSTRALIAN MODULE**
 - EACH AUSTRALIAN VARIABLE DEPENDS ON LAGGED VALUES OF ALL AUSTRALIAN VARIABLES AND CURRENT VALUES OF ALL WORLD VARIABLES
- **THE IDEA OF THIS ATHEORETIC APPROACH IN VAR MODELS IS TO LET THE DATA SPEAK**

GDP GROWTH TO BE WEAKER IN 2019/20



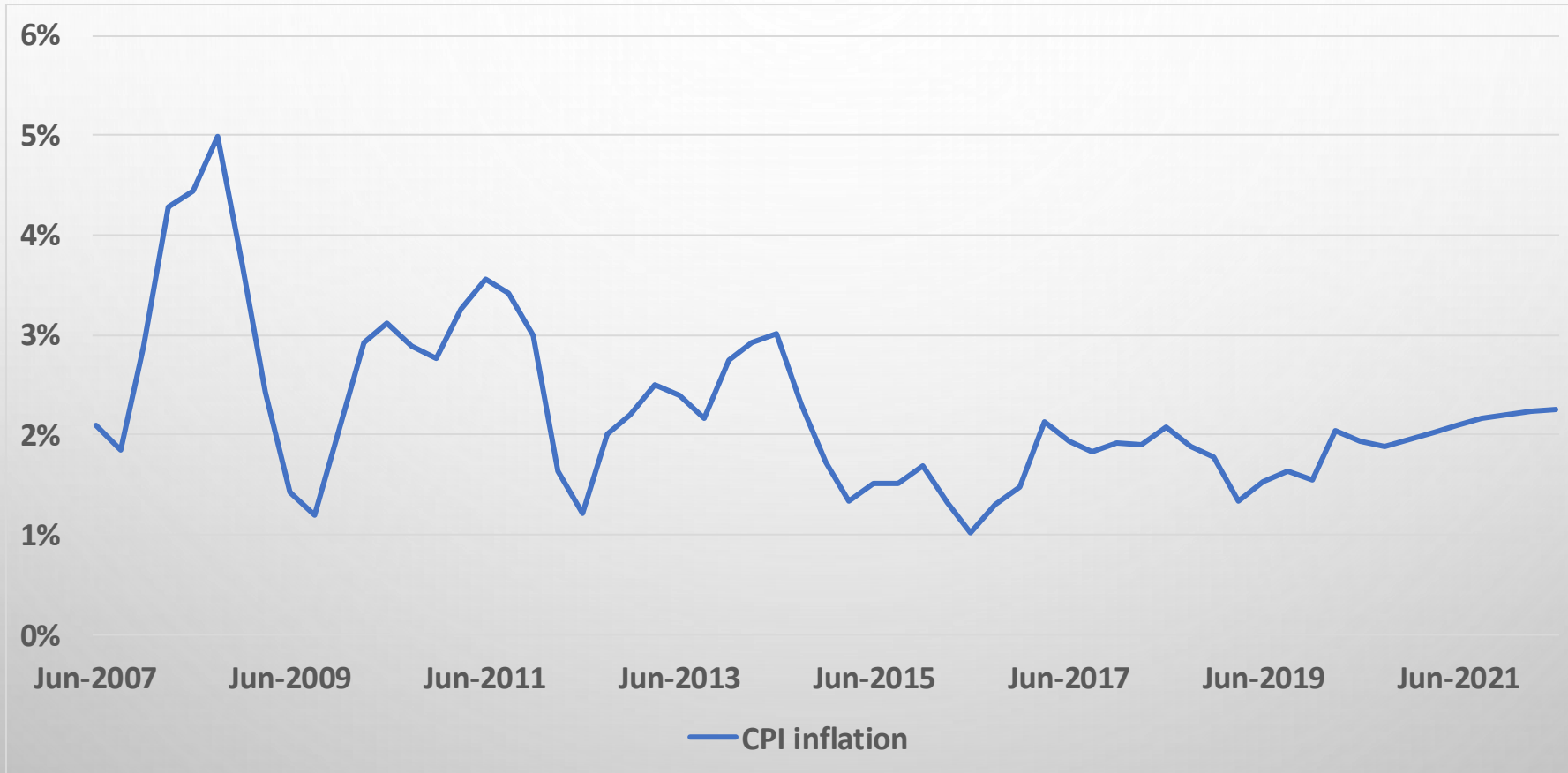
Source: VAR Model

UNEMPLOYMENT RATE TO RISE A LITTLE



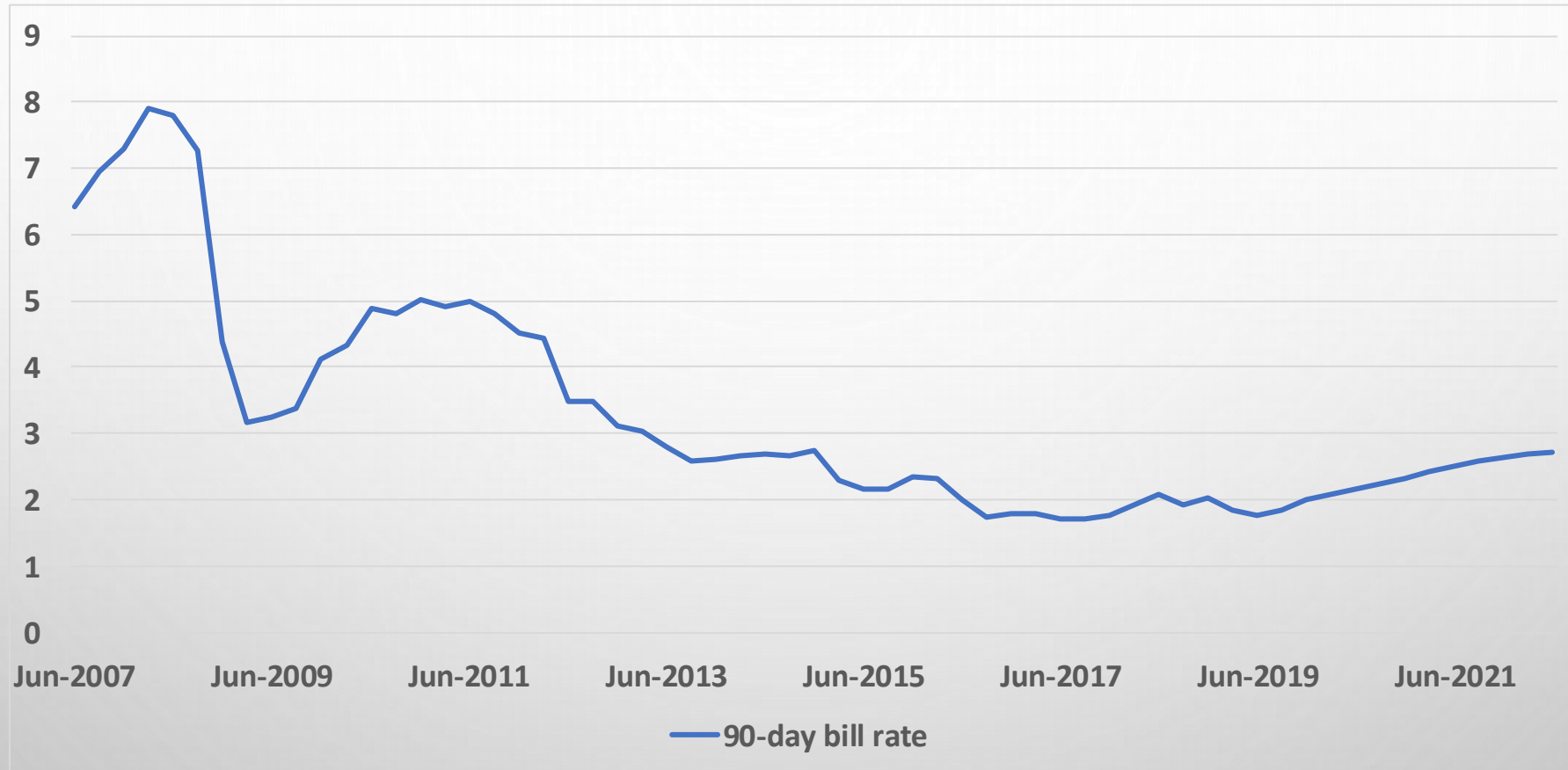
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INFLATION TO EDGE UP



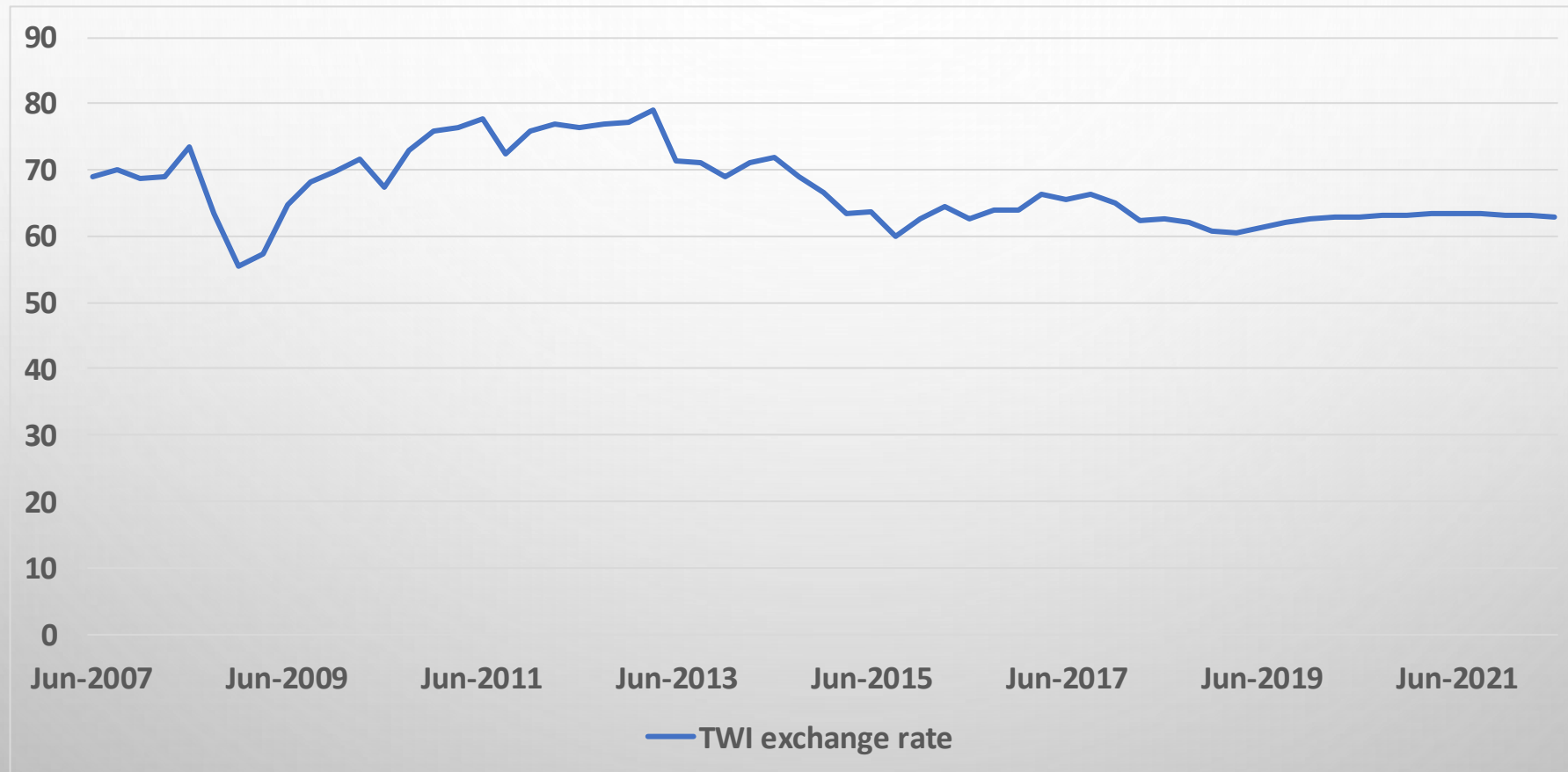
Source: VAR Model

INTEREST RATES TO RISE BUT REMAIN LOW



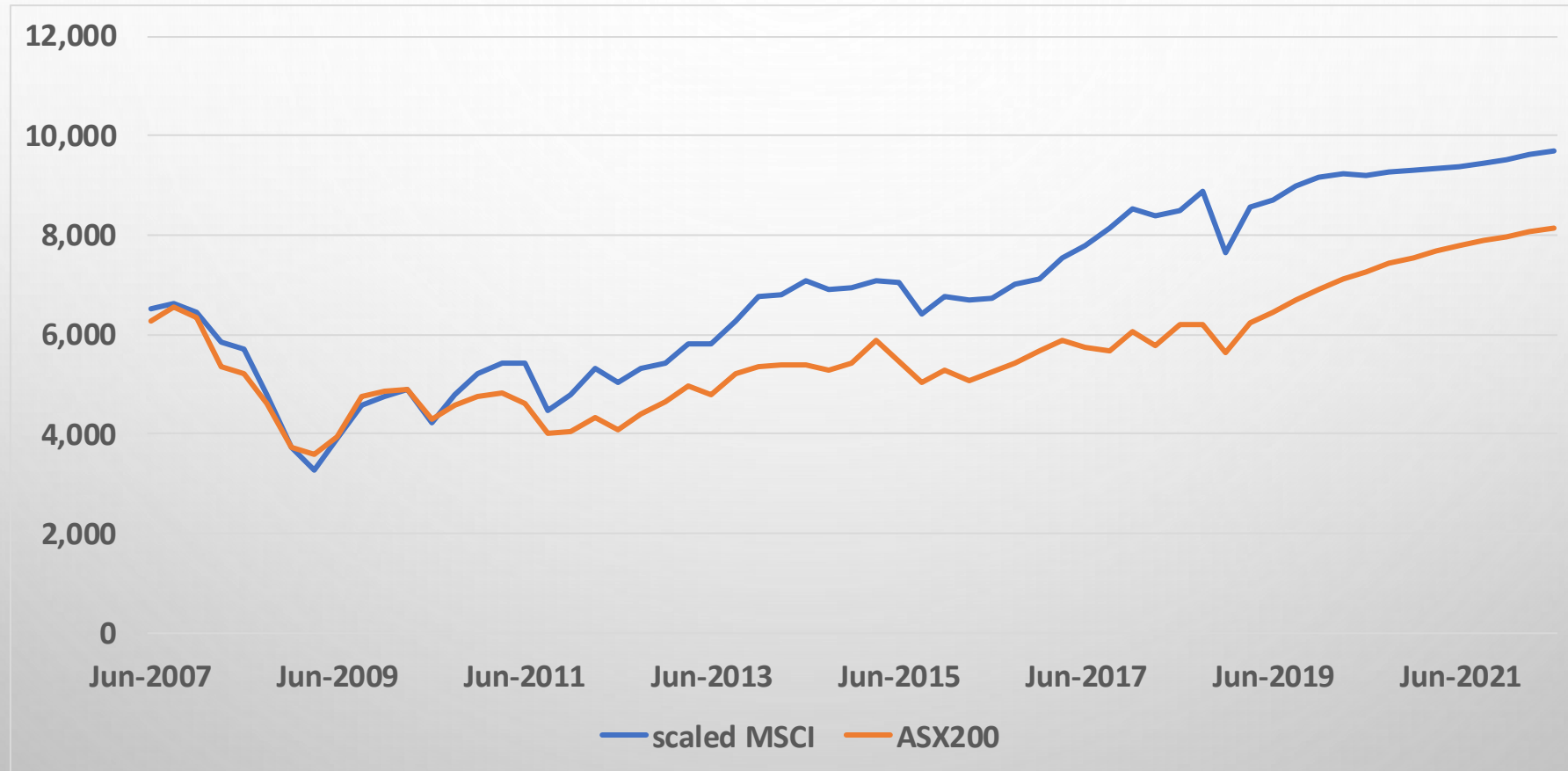
Source: VAR Model

SIMILARLY FOR THE AUSSIE \$



Source: VAR Model

SHAREMARKET OUTLOOK SOLID



Source: VAR Model

COMPARISON OF FORECASTS

	Budget	Budget	CM	CM
	19/20	20/21	19/20	20/21
GDP growth	2.75%	2.75%	2.3%	2.4%
Unemployment Rate	5	5	5.4	5.4
Inflation	2.25%	2.5%	1.9%	2.1%

- **TREASURY EXPECT NORMAL GROWTH DESPITE HOUSING DOWNTURN**
- **HENCE THEY EXPECT STABLE UNEMPLOYMENT**
- **AND INFLATION RISING TO MIDDLE OF RBA TARGET BAND BY 2020/21**

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THE BUDGET OUTLOOK

WILL THE SURPLUSES BE ACHIEVED?

PROJECTED SURPLUSES <1% OF GDP

	2018/19	2019/20	2020/21	2021/22
\$bn	-4.2	7.1	11.0	17.8
% of GDP	-0.2	0.4	0.5	0.8

**IF ECONOMIC GROWTH IS WEAKER THAN BUDGET FORECAST AS I EXPECT,
THE BUDGET WILL ALSO BE WEAKER.**

PROJECTED SURPLUSES ARE SMALLER

	Budget	Budget	CM	CM
	19/20	20/21	19/20	20/21
\$bn	7.1	11.0	5.6	6.5
% of GDP	0.4	0.5	0.3	0.3

CM ESTIMATES ADJUST THE BUDGET SURPLUSES FOR CM ESTIMATES OF WEAKER GDP GROWTH. THIS IS DONE USING THE BUDGET SENSITIVITY ANALYSIS FOR WEAKER HOUSEHOLD CONSUMPTION IN BUDGET STATEMENT NO.7



THE BUDGET & TAXATION

ARE THE TAX CHANGES REAL?



PERSONAL INCOME TAX BURDEN

- **IN THE BUDGET ESTIMATES, THE SHARE OF PERSONAL INCOME TAX IN GDP IS INFLUENCED BY TWO MAIN FACTORS**
 - THE ANNOUNCED TAX CUTS REDUCE THE SHARE
 - BRACKET CREEP INCREASES THE SHARE
- **THESE TWO EFFECTS BROADLY CANCEL OUT. THAT IS, IN BROAD TERMS THE TAX CUTS RETURN BRACKET CREEP**
- **SPECIFICALLY, PERSONAL INCOME TAX IN 2022-23 IS PROJECTED TO BE 11.9% OF GDP, BROADLY UNCHANGED FROM 11.8% OF GDP IN 2018-19**
- **SIMILARLY, TOTAL TAX IS PROJECTED AT 23.8% COMPARED TO 23.7% IN 2018-19**

PERSONAL INCOME TAX AND TOTAL TAX: % OF GDP



Source: Budget 2019-20, Statement No. 4

BELIEVING THE BUDGET

- **THE ECONOMIC OUTLOOK: IS THE BUDGET TOO OPTIMISTIC?**
- **PROBABLY A LITTLE**
- **THE BUDGET OUTLOOK: WILL THE SURPLUSES BE ACHIEVED?**
- **PROBABLY, BUT THEY MAY BE SMALLER THAN PROJECTED**
- **THE BUDGET & TAXATION: ARE THE TAX CUTS REAL?**
- **NO, ONLY GIVING BACK BRACKET CREEP**

OTHER TALKING POINTS

- **PEFO ECONOMIC FORECASTS ARE THE SAME AS THE BUDGET FORECASTS**
- **ALP'S PROPOSED TAX CHANGES:**
 - NON-REFUNDABLE FRANKING CREDITS
 - NO NEGATIVE GEARING DEDUCTION FOR ESTABLISHED DWELLINGS
 - LOWER CAPITAL GAINS DISCOUNT

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