



Fiscal stimulus in an age of debt: how much stimulus are we planning?

**Economic and social outlook conference
John Daley, CEO, Grattan Institute
20 July 2017**

How much stimulus are we planning?

Projected fiscal tightening has not happened

- Reality has not matched repeated projections of return to budget balance
- Projections for nominal GDP, wages, and revenues were too high

Budget projection methodology makes fiscal plans unreliable

- Asymmetrical projections – risks not evenly balanced
- Assume short economic cycle, and amplify optimism by assuming output gap closed
- Assume the world hasn't changed

So we are stimulating more (and repairing the budget less) than planned

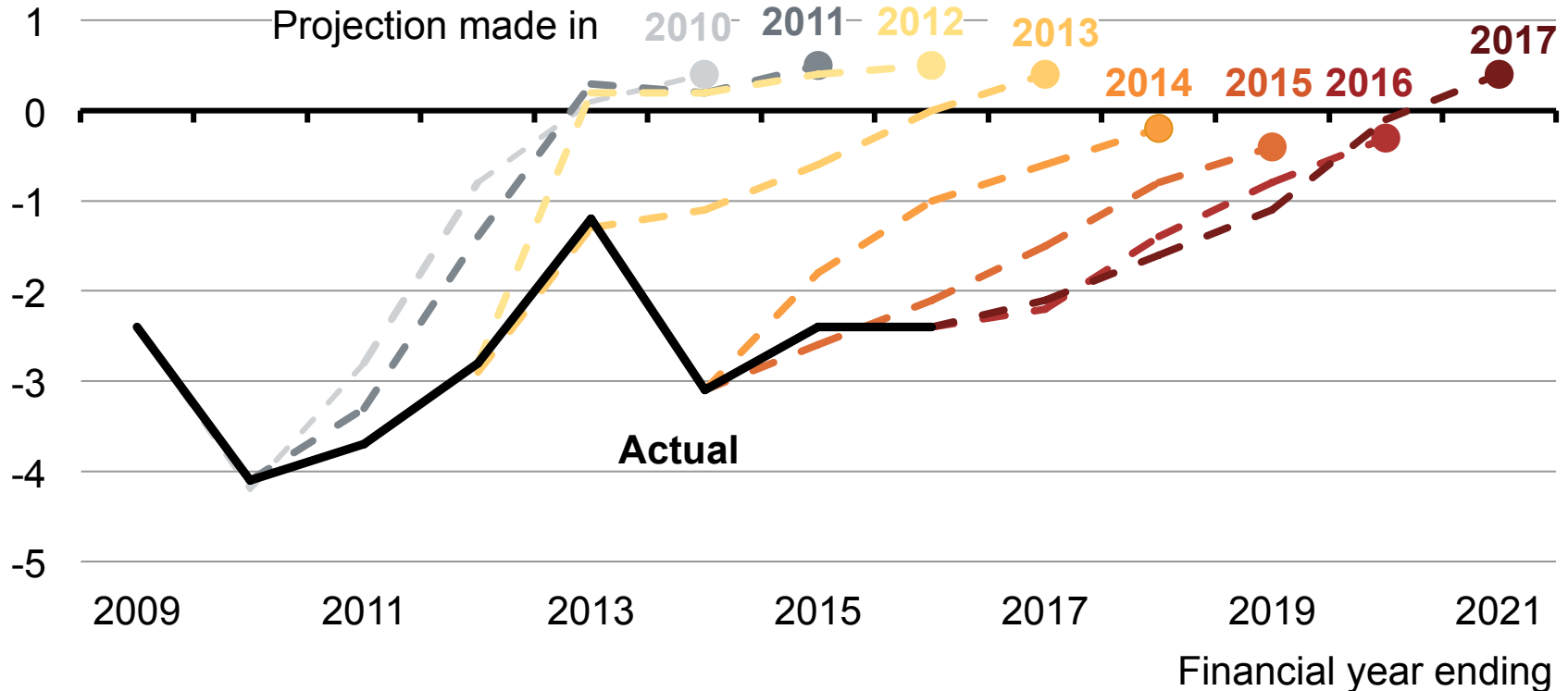
- Budget repair relies on bracket creep rather than measures
- Transport spending remains relatively high
- Governments have forecast-led denial about need for budget repair
- Realpolitik suggests we need a pessimism-generator

Correctives

- More judgement and common sense
- What is trend (over what period)? How long the cycle? Is spare capacity absorbed?
- What are the institutional barriers to change?

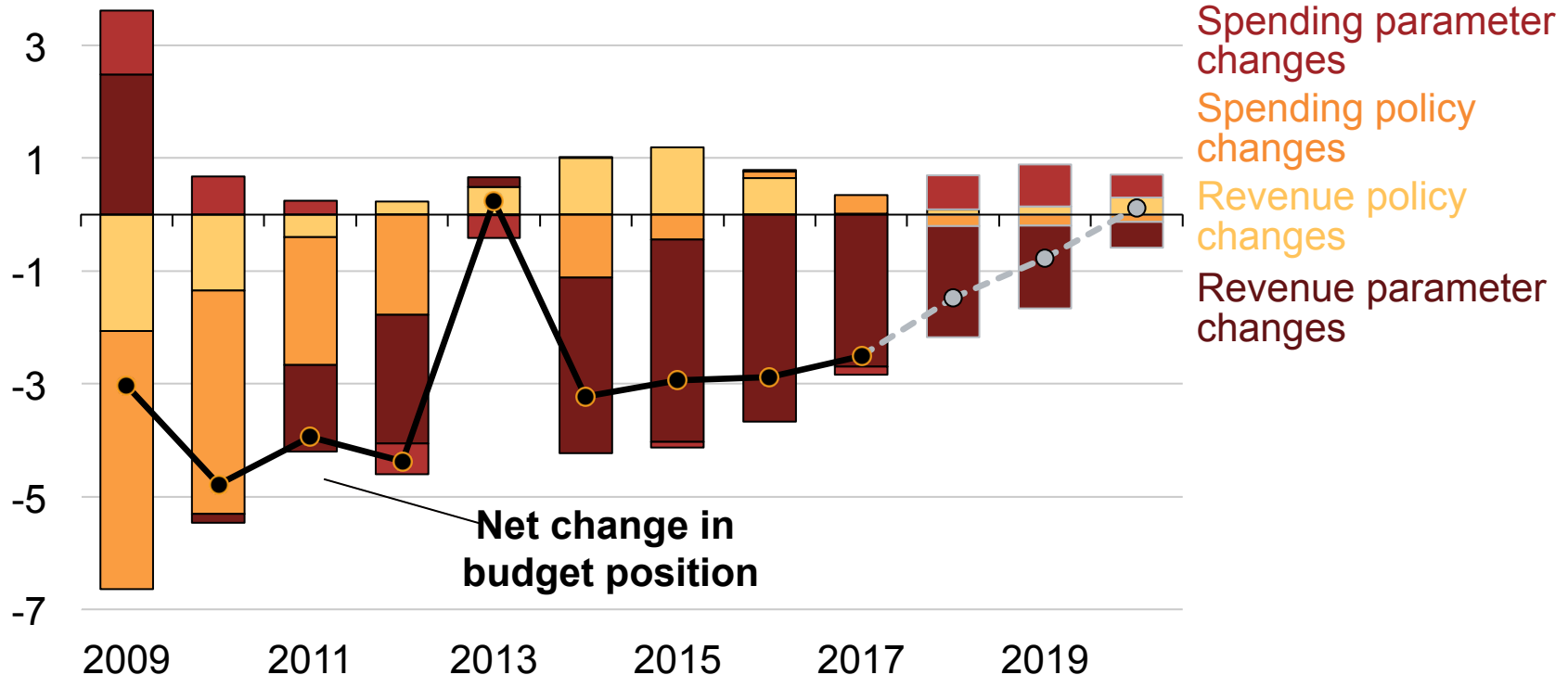
We have been planning (and failing) to tighten for 8 years

Actual and projected Commonwealth underlying cash balance, % of GDP



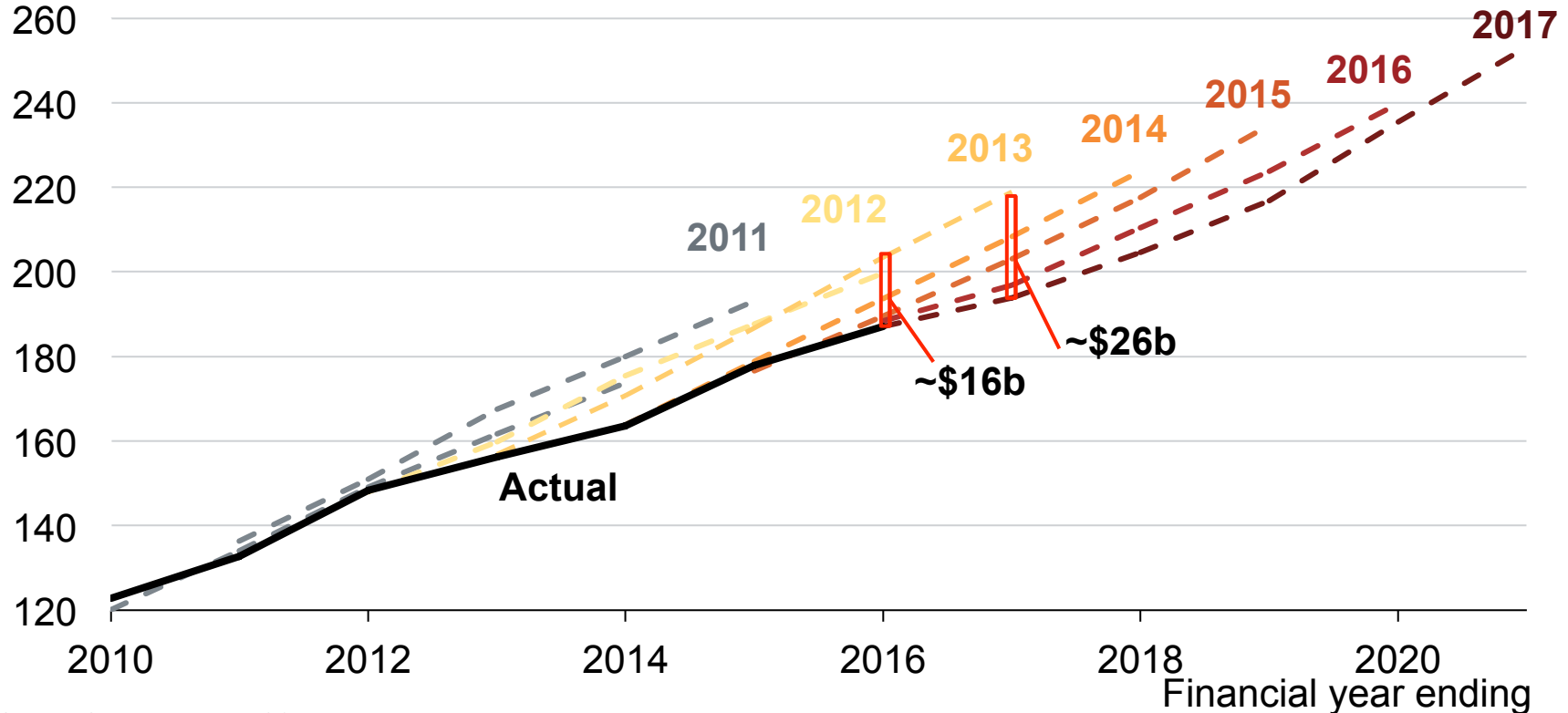
Lack of fiscal tightening mostly due to revenue surprises, not policy choices

Cumulative change in budget outcome from initial projection to reality
or latest, % of GDP



The gap is growing between projected and actual personal income tax

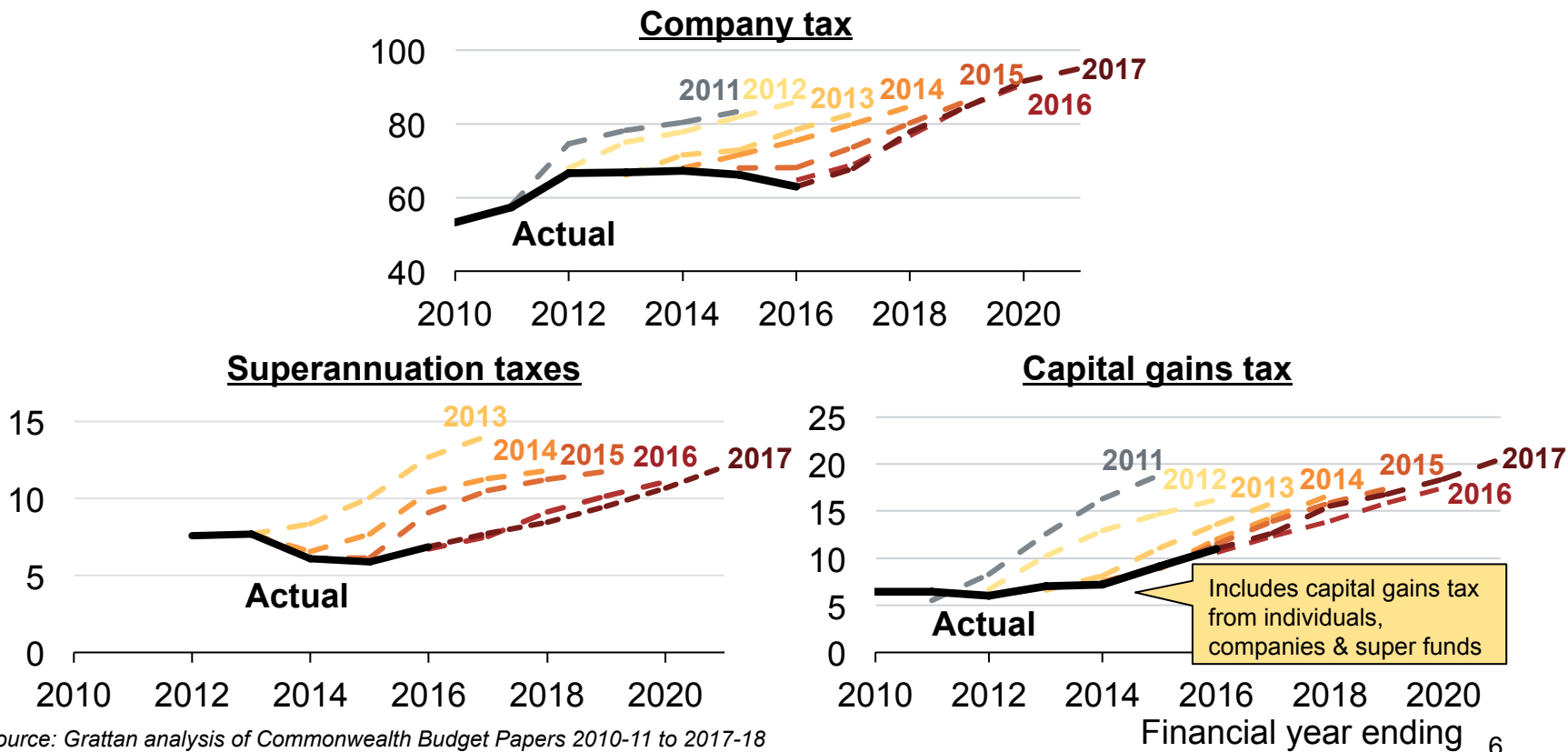
Actual and projected personal income tax receipts, \$ billions



Source: Grattan analysis of Commonwealth Budget Papers 2010-11 to 2017-18

Fiscal projections have also missed for company, super, and capital gains tax

Actual and projected tax receipts, \$ billions



Source: Grattan analysis of Commonwealth Budget Papers 2010-11 to 2017-18

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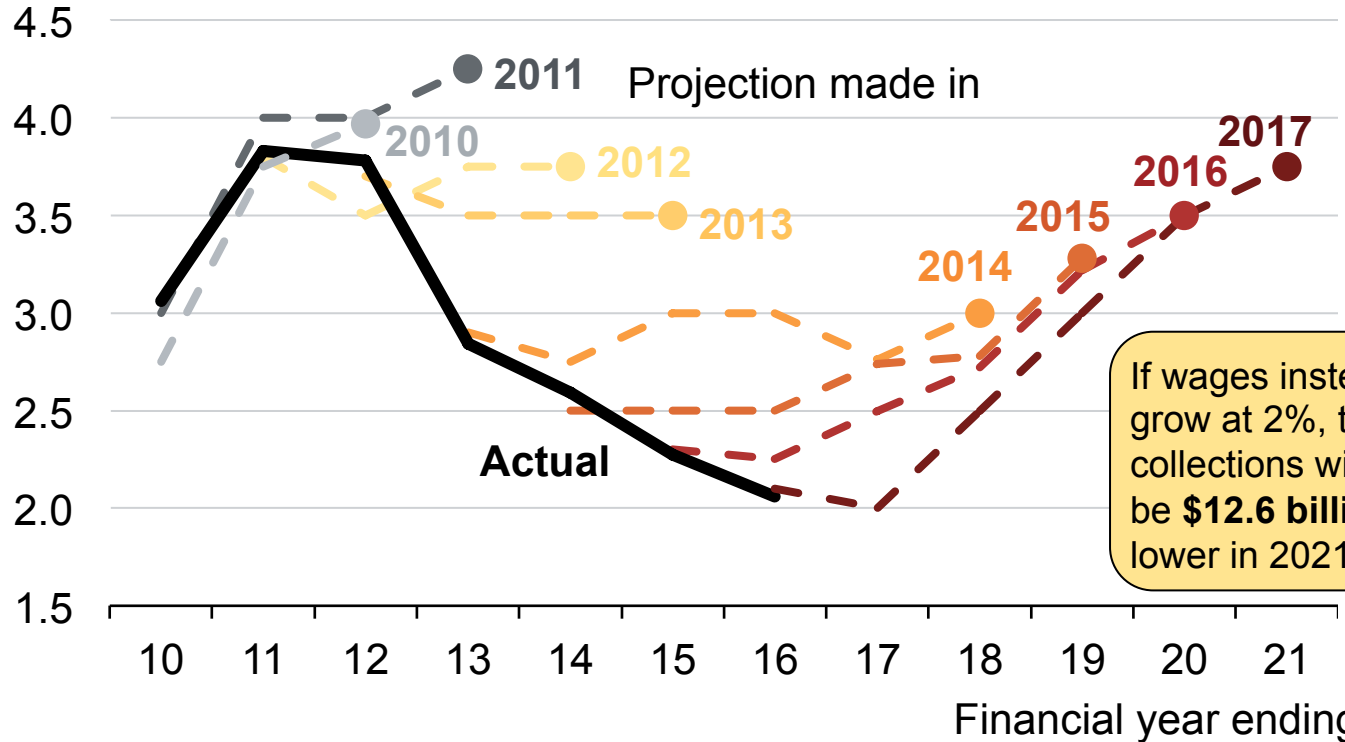
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2017 budget doubles down: increases forecast wage growth as reality goes lower

Actual and projected growth in nominal wages, per cent



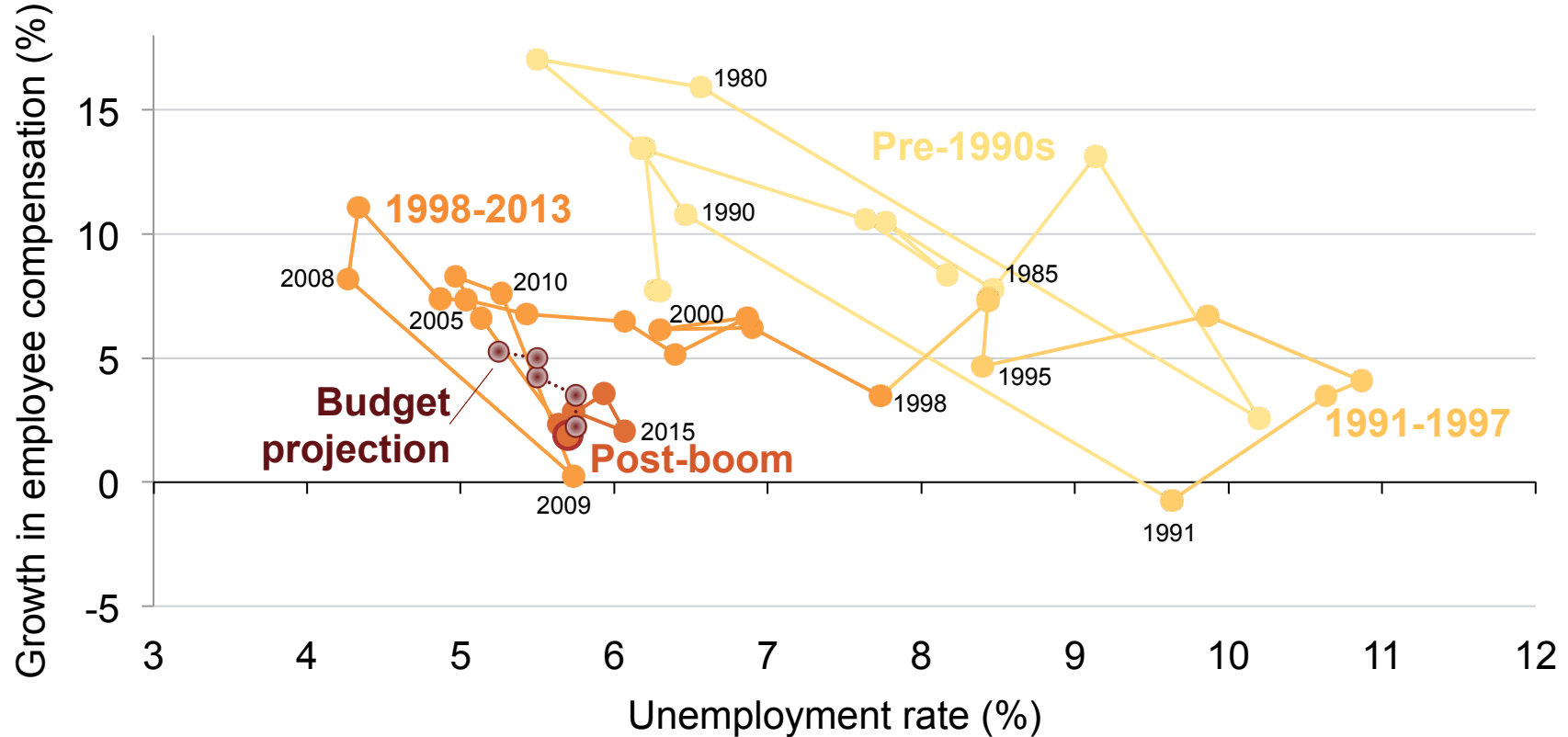
Assumptions:

- Return to trend
- 'Close output gap' =

If currently below trend, then project above trend

If wages instead grow at 2%, tax collections will be **\$12.6 billion** lower in 2021

The disappearing and supposedly reappearing Phillips curve



Notes: Employee compensation is total remuneration of employees including wages, ad hoc bonuses, termination payments and in-kind benefits
Source: Based on NAB analysis of ABS Labour Force data

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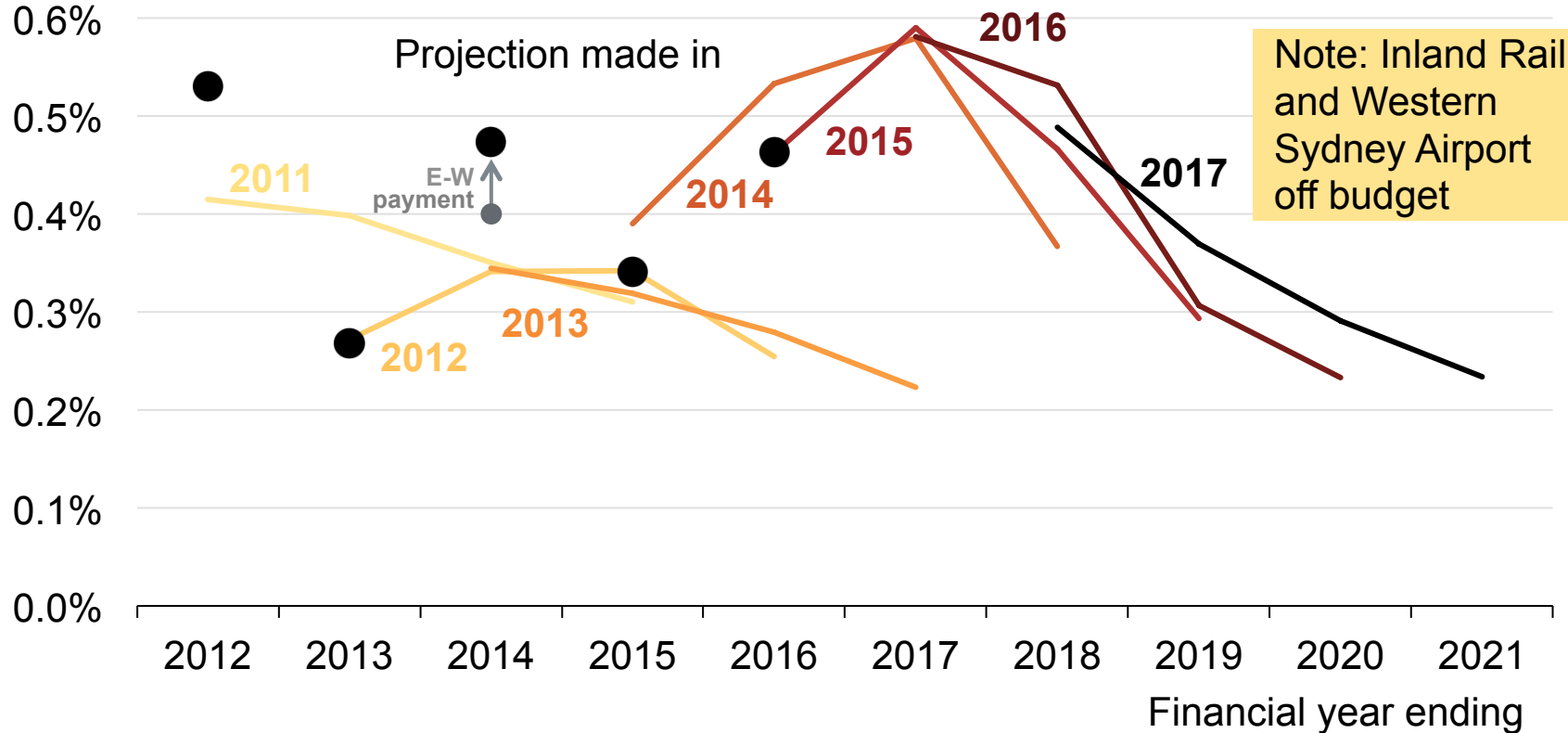
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Commonwealth is planning to increase transport infrastructure spending

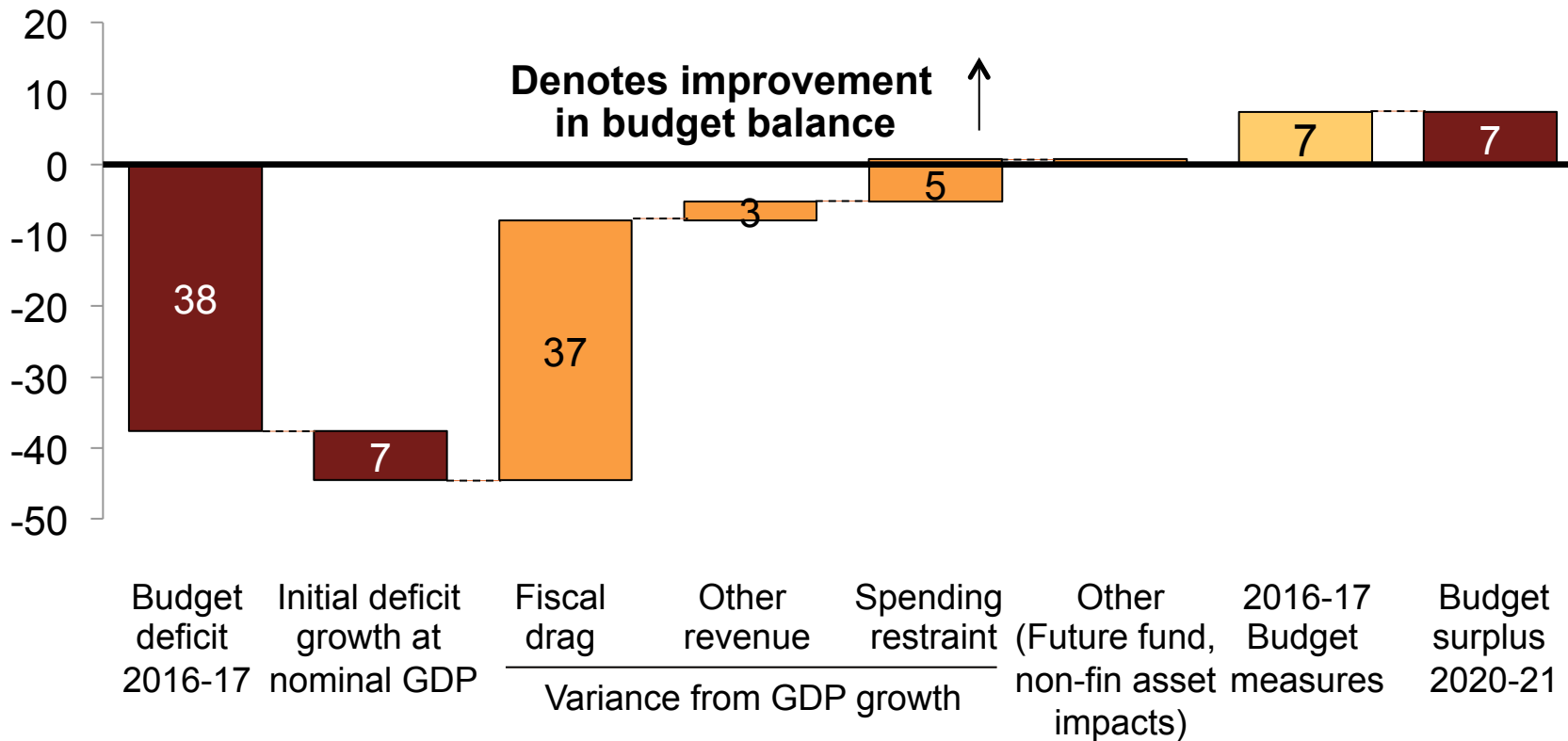
Actual and projected C'wth spending on transport projects, per cent of GDP



Most of the planned structural repair depends on fiscal drag

Budget balance

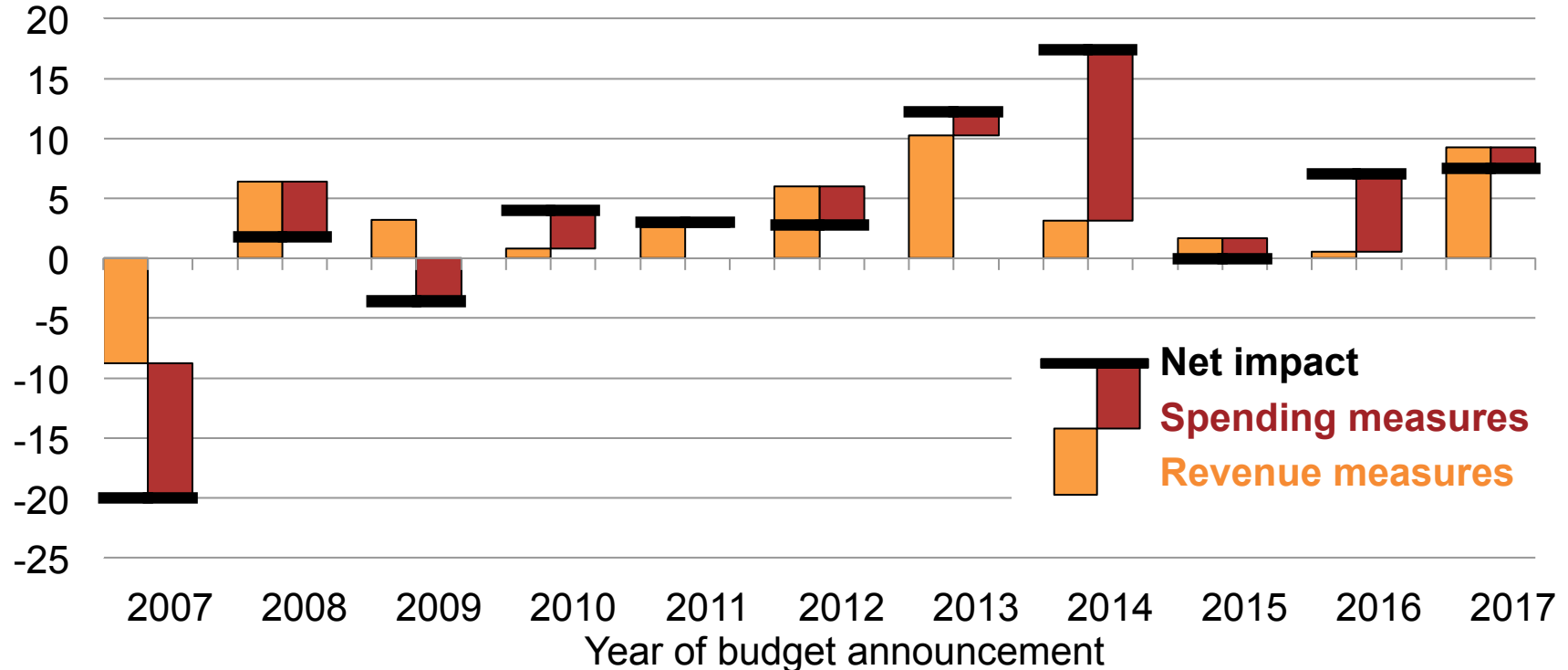
2020-21 budget outcome compared to 2016-17 outcome, \$2017 billions



Budgets have included some structural repair measures, but not many

Contribution of budget measures to fiscal balance at end of four years

\$bn budget measures



Forecast-led denial is a bipartisan affliction

We are on track for surplus in 2012-13, on time, as promised — and this provides the solid foundations for the targeted investments we announce tonight.



This budget keeps us on a sustainable path to bring the budget back to balance.



I can report tonight that despite the headwinds, our timetable back to a Budget surplus is unchanged from last year.



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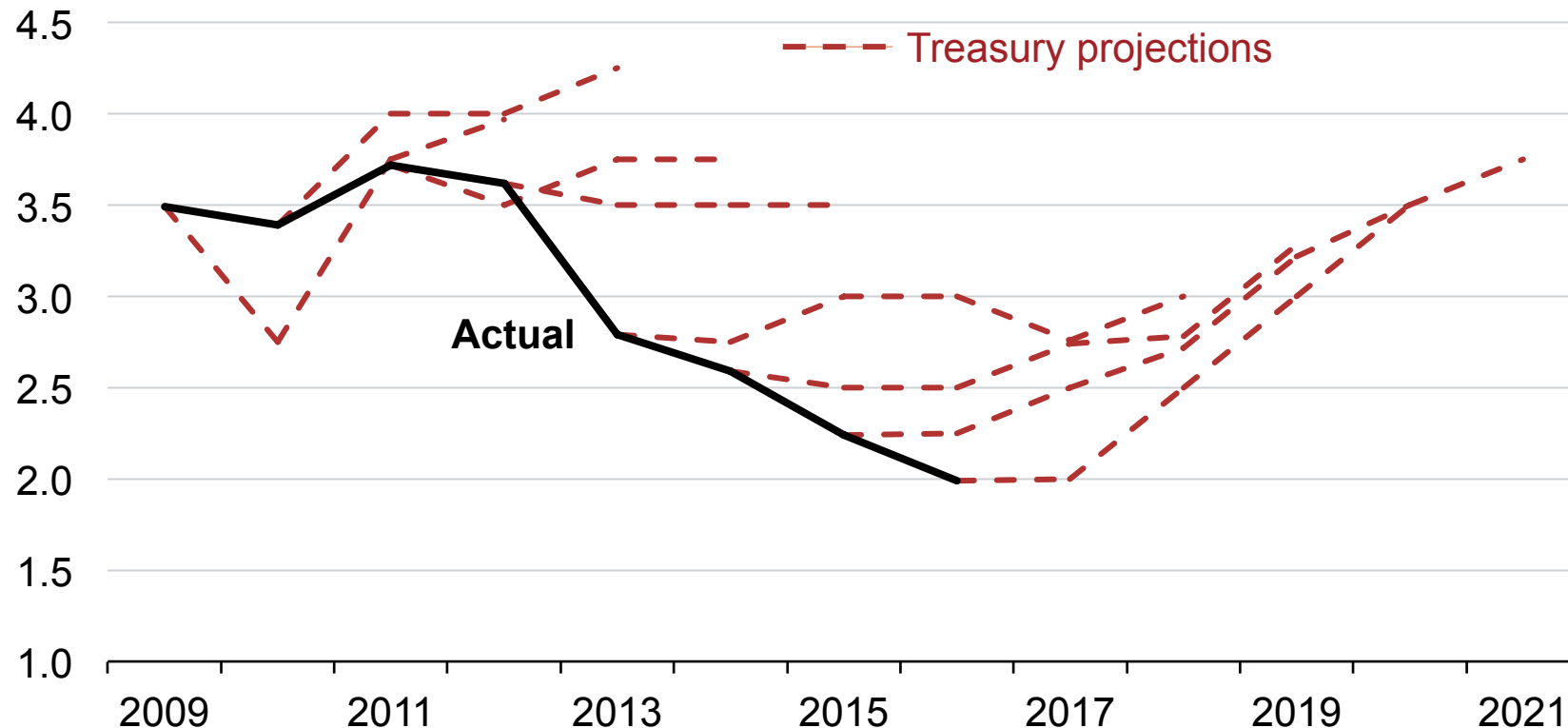
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Reviews have not led to agile reform

	Errors	Forecast model
<i>Review of Treasury macroeconomic and revenue forecasting (2012)</i>	<ul style="list-style-type: none"> Nominal GDP and tax revenue projections: little evidence of bias over two decades BUT forecast errors correlated with economic cycle 	<ul style="list-style-type: none"> Recommended new economy-wide model to be embedded into forecasting
<i>Review of Treasury macroeconomic forecasting capabilities (2015)</i>	<ul style="list-style-type: none"> Too rigorous adherence to models – not enough judgement Risk that short-term forecasts are anchored by long run projections 	<ul style="list-style-type: none"> Endorsed recommendation for economy-wide forecasting model
<i>Review of economic modelling at Treasury (2017)</i>	<ul style="list-style-type: none"> Forecasts should be adjusted based on judgement – views of sectoral experts, surveys, business liaison, views of senior staff Models should use historical evidence of adjustment process rather than mechanical assumption 	<ul style="list-style-type: none"> Endorsed recommendation for economy-wide forecasting model Macro-econometric model should span forecast and projection period

Treasury projections have been optimistic

Nominal wages growth

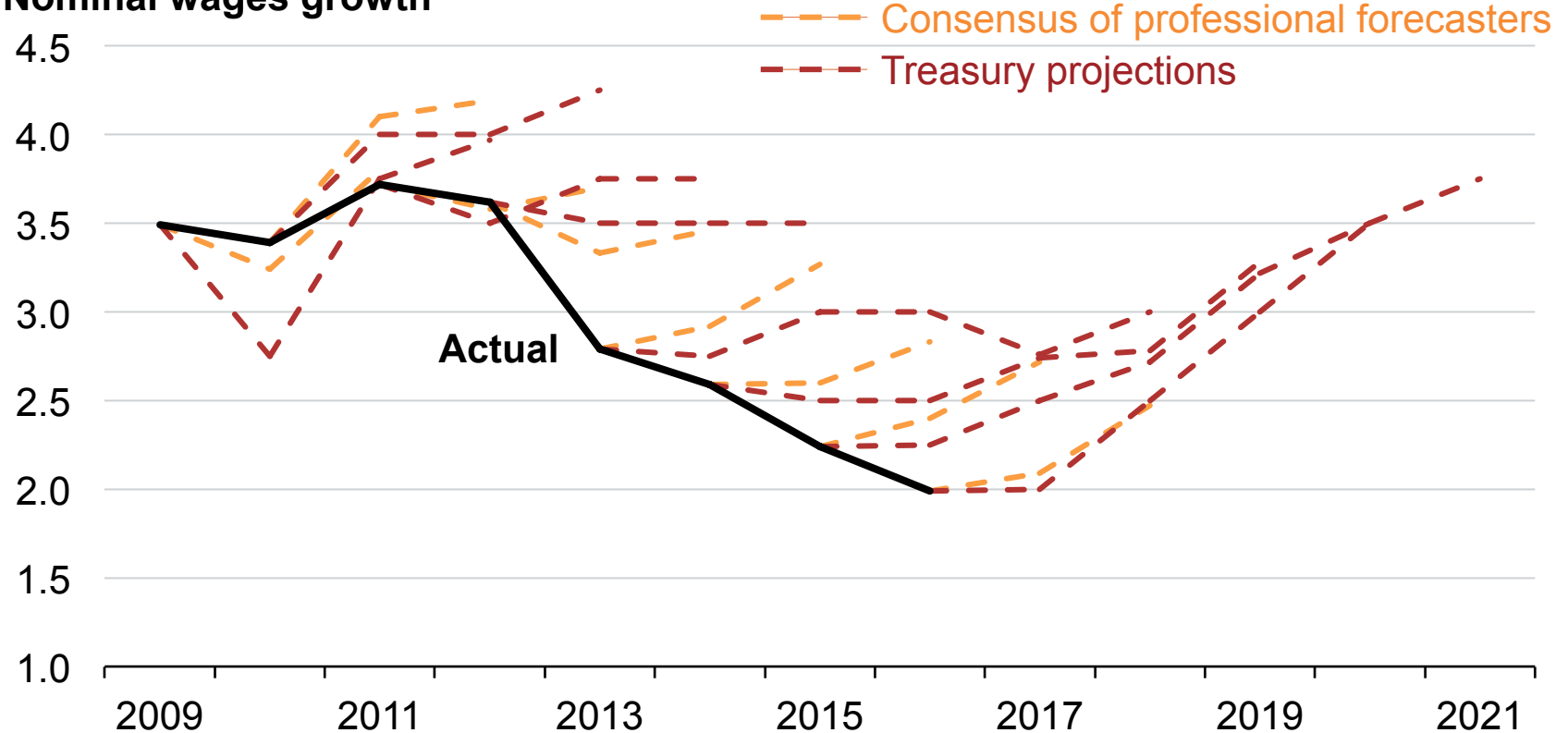


Note: Consensus forecasts as at May each year

Source: Tim Robinson, presentation to Melbourne Economic Forum, Asia Pacific Consensus Forecasts, ABS, Budget Papers, Grattan

... and professional forecasters even more

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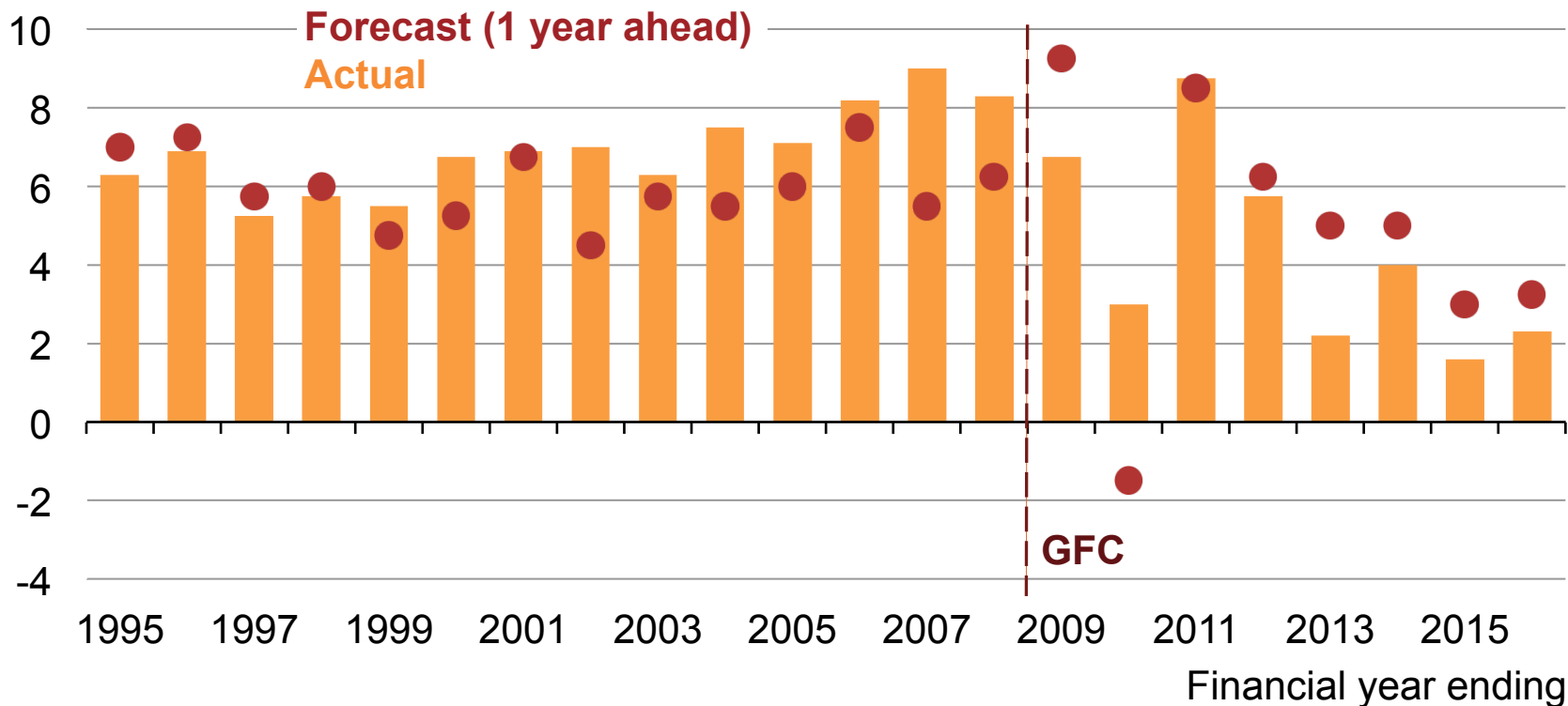
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Supporting material

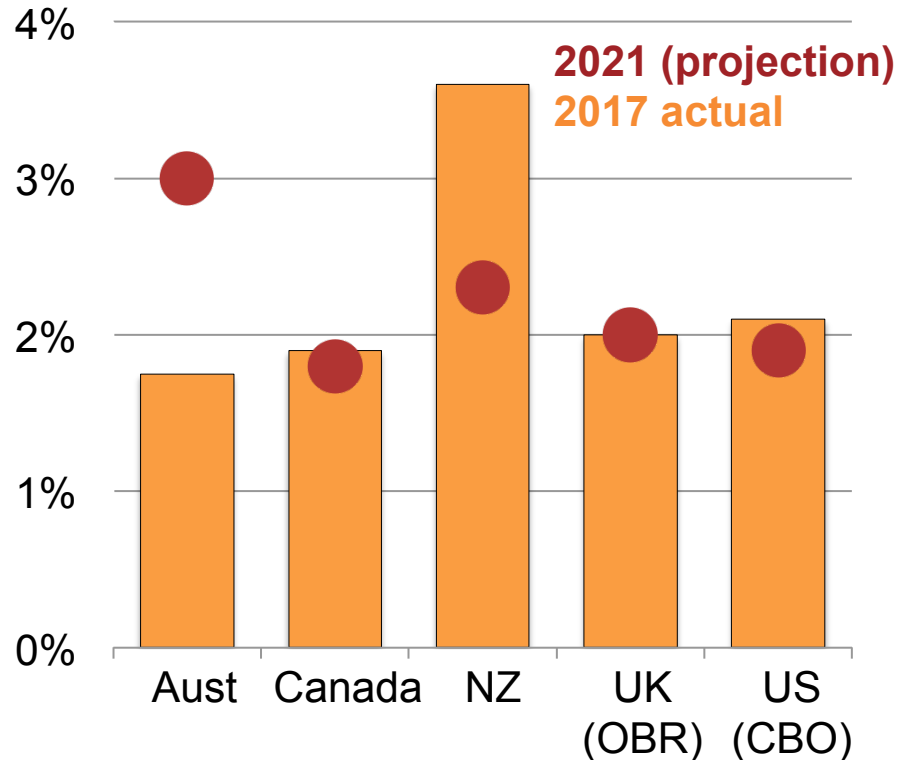
Forecasts consistently over-pessimistic before GFC; over-optimistic after

Actual and forecast nominal GDP growth

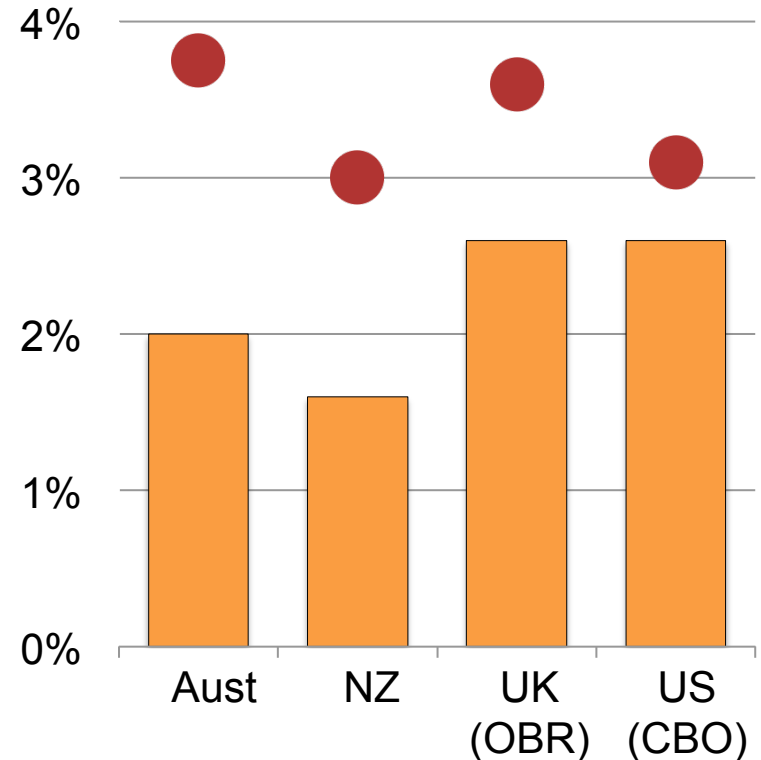


Other nations use more judgement and are less optimistic

Real GDP growth

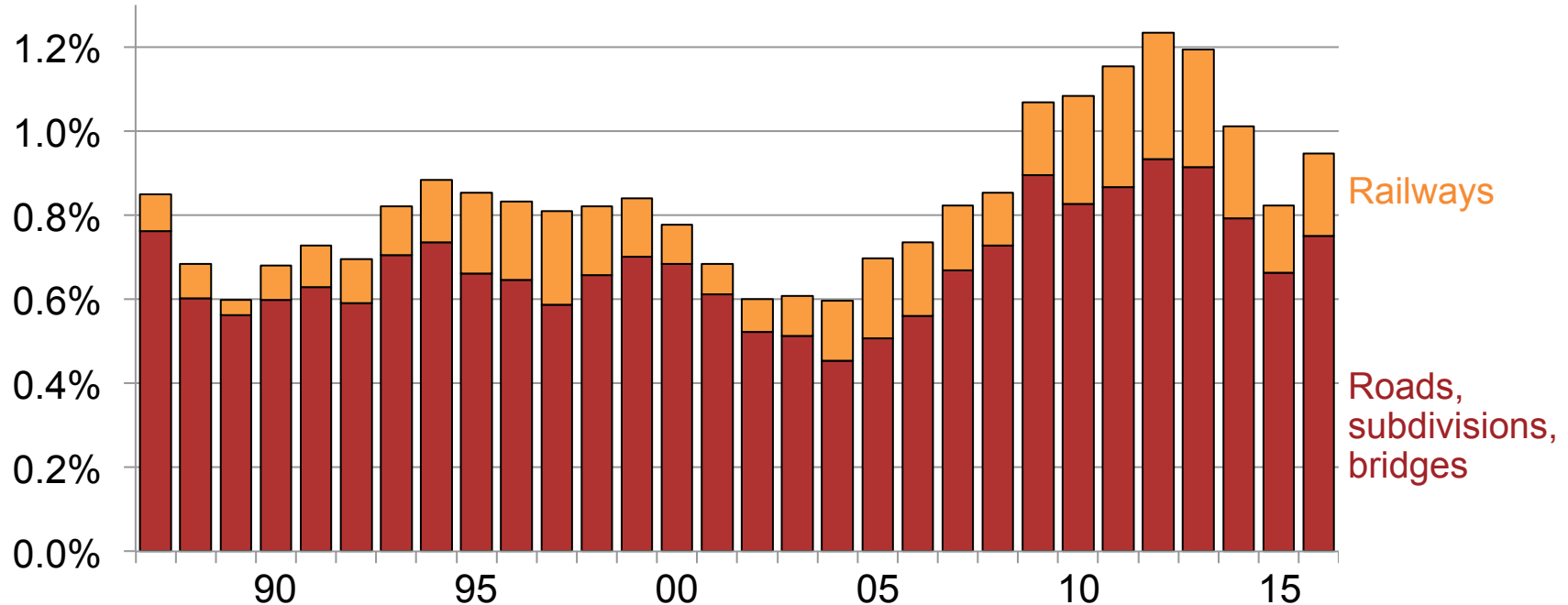


Wages growth



Government spending on transport infrastructure remains at historic highs

Engineering work done for the public sector as a proportion of GDP
Per cent



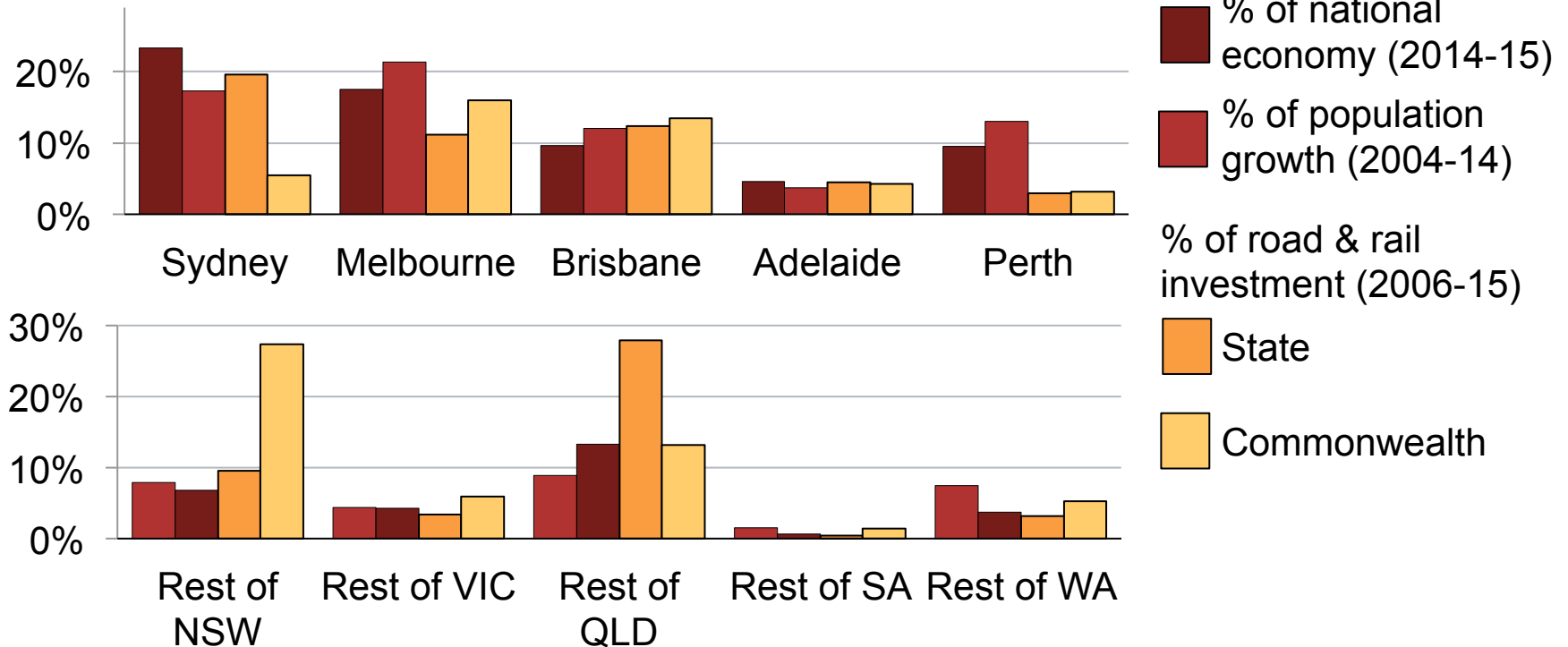
Notes: By financial year. Includes work done by the private sector for the public sector. Does not include ports.

Source: ABS Engineering Construction Activity, Australia, Table 11.

Government transport spending has not targeted growth in economy or population

Size and transport infrastructure spending

% of Australian total



Australia focused on building new infrastructure, rather than maintenance

Transport infrastructure spending as proportion of GDP

