Failure to implement desperately-needs reform sets up Australia for a crisis.

6/4/15 by Bruce Baker for clients of Puzzle Financial Advice

This is one of the big things that worry me about the future of Australia. The urgent, and tough decisions that need to be taken, to manage the major challenges that Australia faces, are not being taken.

The week of 17th March saw events in Canberra, seem to condemn Australia to very tough times ahead. If you read David Murray's comments below, this seems to include a Aussie credit crisis.

On Monday's AFR, Warwick McKibbin (**attachment** 1) correctly said:-

- "The problem is the choice of the status quo is not an option, except at enormous cost to future generations of Australians. The world is changing and Australia can either be part of an exciting era of global transformation or it can descend into decades of high unemployment and economic, social and environmental dislocation."
- "Since the early 1990s the world has been transformed by the emergence of large, developing countries into the global economy." "The income generated in Australia from the boom in China temporarily disguised the nature of the shock Australia faced and enabled successive Australian governments to avoid making the hard decisions on structural adjustment." "Not only is Australia suffering the end of the commodity boom, but it still has to deal with the structural shock that the rest of the world has been failing to grapple with for nearly two decades."
- http://www.afr.com/opinion/keeping-the-status-quo-is-no-longer-an-option-20150315-144i4e 16/3/15

Then on Tuesday/Wednesday, Tony Abbott decided it seems that he did not have the political skills to achieve budget and economic reform ….. so he has given up all attempts to achieve the needed reform. Not good enough for Australia. (**Attachment** 2.) http://www.afr.com/opinion/editorials/tony-abbott-loses-the-budget-plot-20150319-1m2xrd 19/3/15

- 'As Mr Abbott was making his Australia Day announcement of a knighthood for Prince Philip, The Australian Financial Review was urging the Prime Minister to "demonstrate that he and his government are serious about getting the nation's budget back on the rails in order to underpin a growth economy, well-paid jobs and continued national prosperity, even though it will involve short-term pain". But then came the stunning defeat of the LNP government in Queensland and the shock of the February vote to spill Mr Abbott's Liberal Party leadership. **Since then, Mr Abbott has progressively retreated on budget repair. Now, his budget rhetoric has become bizarrely and alarmingly sanguine**. **This week, he has fallen back on the oldest form of political denial: declare victory and walk away from the problem.** The intergenerational report shows "no cause for alarm because we have got the budget under control and manageable", Mr Abbott said without irony on Wednesday. The "currently legislated" fiscal path that he pointed to in the intergenerational report does get close to budget balance in 2019-20, assuming that nothing goes wrong with the economy in the meantime. But, rather than being a clear path back to surplus, it then veers back into a deeper deficit that would reach 6 per cent of GDP by 2054. And that feeds into a net public debt that would grow to more than 50 per cent of GDP by then, up from previous forecasts that it would peak at 17 per cent of GDP in the next few years.'

Sadly, the problem has not gone away.

- Retired senior public servants have been urging the politicians to fix the problem.
- The business community has been demanding economic reform.
- But the government has given up and is in denial.

Here are some of the latest calls for action.

- **“Don't wait until it's too late to fix budget, Stevens tells Abbott”** AFR 20/3/15 http://www.afr.com/news/policy/budget/dont-wait-until-its-too-late-to-fix-budget-stevens-tells-abbott-20150320-1m40qp (Third **attachment**)
  - ‘The Reserve Bank of Australia has joined a growing number of calls by business leaders and economists for the government to stay the course on meaningful budget repair or face the consequences when debt blows out. "We're not on the correct path for the long run and we need to get onto a better path," RBA governor Glenn Stevens said on Friday. Mr Stevens was backed by the head of the government's audit commission, Tony Shepherd, who insisted Canberra take early and measured steps to reinforce the budget against a future economic downturn. Speaking amid a growing perception the government was dropping the ball on meaningful budget reform, Mr Shepherd said now was the time to make "sensible incremental adjustments rather than wait for Armageddon", when severe cuts would fall on the most vulnerable.’

- “David Murray says debt politics makes Australia's AAA credit rating 'vulnerable'” AFR 25/3/15.
  - http://www.afr.com/business/david-murray-says-debt-politics-makes-australias-aaa-credit-rating-vulnerable-20150325-1m6d47
    - 'The politicisation of the Commonwealth government's debt position poses a threat to the nation's AAA credit rating, leaving the economy vulnerable to future financial crises, the chairman of the financial system inquiry David Murray says.
    - As the Abbott government backtracks on its warnings of "a budget emergency", Mr Murray said he was frustrated that the importance of strengthening the nation's fiscal position, which is a key defence in protecting an economy reliant on foreign funding, was being ignored.
    - "The thing that bothers me most is we are just not able to have a debate about how debt and deficit should work through cycle given the character of our economy," Mr Murray said on Tuesday.
    - "We felt the issue of resilience in the system had to be very clearly addressed. When you are a prolific borrower from the rest of the world, as we are, you have to be of high quality to make sure you can sustain that position and keep confidence among your creditors."
    - Mr Murray said the outlook for government deficit was unclear and poorly communicated, which could reduce the level of comfort of the credit rating agencies' AAA credit ratings.
    - "Getting that working well and clearer shared values around that could only help us… but [now] everyone is left guessing….that does leave our AAA rating vulnerable, because the ratings agencies take a forward looking view, not a today view."
    - A cut to the government's AAA credit rating would result in a lowering of the major bank's credit rating, potentially increasing the cost of and reducing access to foreign capital - which they rely for funding.'

    - '"To deal with this, if it's all too hard, I don't know about you and how you were brought up in business or your academic life or anything you do, but you don't just throw your hands up in the air and say, 'I can't do anything about it'.
    - "If it gets too hard, do we revert to what some other countries have done, and that is to put a quantitative addition on the capital because on the IMF's list of net foreign liabilities in the world and assets, we rank number 27 out of 29. Fact of life."

        - While banks have resisted calls to be better capitalised, Mr Murray said this was a key line of defence against a crisis. The panel had weighed up the cost of the capital structure for banks versus the cost to the community of a crisis - and it was a "very easy calculation to make".'

- "Ross Garnaut predicts much lower iron ore price” 6/4/15
    - http://www.afr.com/markets/commodities/metals/ross-garnaut-predicts-much-lower-iron-ore-price-20150406-1mf2br
        - 'Chinese steel production has peaked and will fall by more than 25 per cent over the next decade and a half, according to prominent economist Ross Garnaut, a drop that would undermine Australia's entire iron ore industry, cost billions in tax revenue and reduce the living standards of most Australians.'
        - 'Deloitte Access Economics partner, Chris Richardson said he backed Professor Garnaut, who remained well-connected in China, and said the implications for Australia were significant given its dependency on China. "We have wrong-footed the Australian economy: we bet the house," he said. Mr Richardson said for every dollar the iron ore price fell below forecasts, national income fell by abut $800 million and tax revenues declined by between $250 million and $300 million annually. The federal government's plans to return the budget to surplus within a decade look increasingly bleak.'