Media Note

2 April 2019

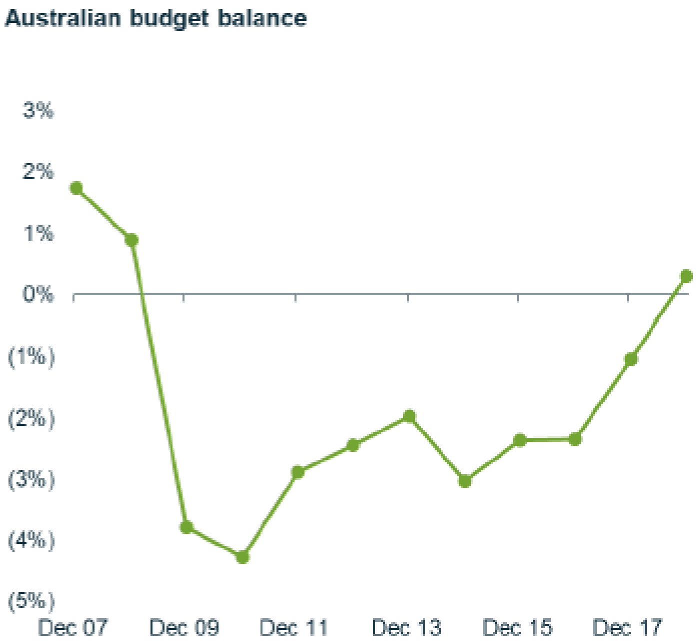
Budget surplus to drive consumption: Martin Currie

The Federal budget is expected to be in surplus for the first time since just prior to the global financial crisis in 2008. Economic forecasters are suggesting a surplus level of around A$15 billion.

Ahead of today's Federal budget, Reece Birtles, Chief Investment Officer, Martin Currie Australia, a Legg Mason Affiliate, says: "The Australian economy should benefit from a tax-cut fuelled fiscal stimulus post the April budget and predicted May election."

Funded by tax bracket creep

He notes: "You can see the projected budget surplus in the following chart.

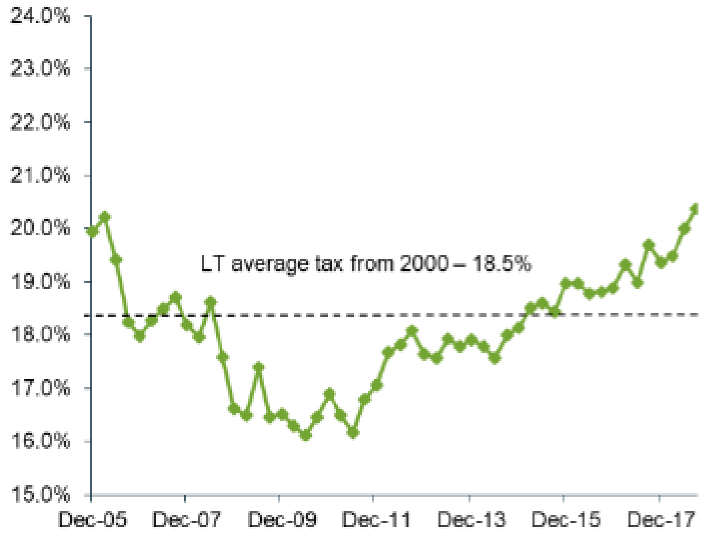


Past performance is not a guide to future returns.
Source: Martin Currie Australia, ABS, Commonwealth of Australia, Factset; As of at 31 December 2018.

This growth has been funded by the very high level of taxation, in particular the strength of tax receipts through 2017 and 2018. The strength has been largely due to bracket creep.

In fact, the government's tax take of pay packets is now 20%, well above the long-term average of 18.5%."

Tax take



Past performance is not a guide to future returns.
Source: Martin Currie Australia, ABS, Commonwealth of Australia, Factset; As at 30 September 2018

Tax take not cost of living inhibiting consumption

Mr Birtles says:

The Government has been very focused on trying to improve disposable income, and thus consumption that is integral to the Australian economy, by reducing cost of living expenditures such as electricity bills.

But, the biggest cost that is inhibiting consumption is in fact the increasing government tax take.

Wealth impact from housing is much less important to economy than income

The media has also been very focused on the belief that house price softness is causing economic weakness.

However, our view is that income growth via wage growth and tax cuts will be a much more significant driver of household expenditure than the relative movement in house prices.

In fact, we have found that the 'wealth effect' from higher house prices was not evident in the early stages of the economic cycle. People didn't spend more when house prices went up, so we think that it's unlikely they have spent less as they fall.

Instead, tax cuts in Australia have typically translated directly into additional consumption, and given wages are also now growing at around 2.5% p.a., the stimulus to consumption could be quite significant in FY 2019-20.

Tax relief is coming

We see that improving the weakness in consumer spending via tax relief should be the Government's main focus for fiscal stimulus over the next 12 months.

The ongoing bracket creep issue provides a very good basis for the Government to fund tax relief for Australian taxpayers.

In the recent Mid-Year Economic and Fiscal Outlook (MYEFO), the Liberal government has made an allowance of A$9.2 billion over three years for "decisions made but not yet announced", and this is very likely to form part of any additional tax cuts.

But irrespective of whoever is in Government post the expected May election, the Australian economy should see a strong benefit from the tax cut fuelled fiscal stimulus.

Source: Martin Currie Australia, ABS, Commonwealth of Australia, Factset; As of at 28 February 2019.

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• Legg Mason's Australian business was established in 1954
• Assets Under Management (AUM) in Australia are AUD$52 billion as at 31 December 2018 (Source: Rainmaker Data. Consists of AUM managed in Australia for Australian and offshore investors and AUM managed offshore for Australian investors)
• Legg Mason Australia was awarded the Money Management/Lonsec Fund Manager of the Year in 2015, 2017 and 2018.

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