OPENING STATEMENT FOR SENATE ESTIMATES – DEBT LIMIT

- There has been much discussion over the last week about Treasury's advice on the debt limit, and, indeed, on what I might say today.
- So with the Committee's indulgence I might make a few opening comments.
- The Treasury's advice on debt and the legislative debt limit is based on our latest assessment of the economic and fiscal outlook, which will be updated in light of the September quarter National Accounts released in the first week of December.
- Treasury's advice:
  - takes into account the views of the AOFM on a suitable buffer between the limit and the face value of Commonwealth Government Securities (CGS); and
  - places a premium on the imperative to provide certainty and confidence to financial markets that the Government has sufficient financing to manage its budget.
- As this Committee knows well, I cannot share specific advice, but I can describe in general terms the process that Treasury follows when advising the Government on debt issues.
- The legislative limit did not exist before July 2008. Prior to this date new debt was issued through individual Loan Acts, generally introduced annually with the Budget when required.
  - In the years when the budget was in surplus, there was no net new issuance of debt, with existing borrowing rolled over and the market maintained at around $50 billion, in large part to support the Treasury Bond futures markets.
- The legislative limit was introduced in 2008 and set at $75 billion, when it was decided that an increase in liquidity in the CGS market was desirable. Since 2008:
  - The limit has been increased three times to reach $300 billion to accommodate the impact of accumulated budget deficits on the level of CGS required.

- While the approach taken to increase the debt limit has varied, on the past two occasions (in May 2011 and May 2012) the increase in the debt limit was consistent with the level of debt expected over the forward estimates.
- Increasing the debt limit to more than $400 billion would be consistent with this approach.

• Based on PEFO estimates, the current legislative limit of $300 billion will be reached in December 2013.

  - CGS on issue was projected in PEFO to remain around the $300 billion limit for the remainder of 2013-14, and then to increase over the forward estimates to a peak of $370 billion in 2015-16.
  - While the peak debt level for 2016-17 was not published in PEFO because the information was not available at that time, **a headline cash deficit** in that year **would suggest peak debt in excess of $370 billion**.
  - The AOFM has previously advised that a buffer of $40 to $60 billion above the projected peak debt in any year is prudent to provide headroom for unexpected fluctuations in receipts and payments.
    : Note that this buffer is not in place because the economy may have weakened, but is simply to manage within-year fluctuations.
  - This suggests that a debt limit in excess of $430 billion would be prudent **even if we were totally confident about the economic outlook**.
  - My view is that it would be highly desirable that the increase in the limit is consistent with the increase in debt over the forward estimates and the buffer.

- However, since PEFO:
  - the outlook for investment in the resources sector continues to be for a sharp downturn. In the non-resource sector activity is strengthening only slowly while labour force outcomes continue to be weak and the wage price index is growing at its slowest rate since the March quarter of 2000.
    - : This all suggests an outlook for weaker nominal GDP growth and lower revenues. Lower levels of nominal GDP today imply lower tax collections in dollar terms across the forward estimates, even if our nominal GDP growth rates are unchanged beyond the current year.
  - as it turns out, our early thinking is that future nominal GDP growth is also likely to be weaker than at PEFO, suggesting still larger deficits and hence significantly higher peak debt than the $370 billion figure in the public domain. As I said at the outset, we will not have a firm grasp on these numbers until we finalize our forecasts after the release of the September quarter National Accounts in early December; and
  - as you know the Government has made a decision to provide a grant to the RBA to enable it to restore the Reserve Bank Reserve Fund.
- Together, these developments – a headline cash deficit in 2016-17, a weaker economic outlook, and the RBA decision - suggest a peak in CGS on issue significantly in excess of the $370 billion projected in the PEFO, by extension making the desirable debt limit significantly above $430 billion.
- Treasury has provided advice on a range of options for responding to the projection that the debt limit will be reached.
  - Again noting that I cannot be explicit, as I noted we did not have a debt limit prior to 2008 – that is clearly an option. Alternatively, if a debt limit is to exist, it could be specified as a share of GDP – in which case the dollar amount of the limit would rise over time – or it could be specified in dollar terms.
  - As I noted, we previously anticipated the peak plus the within-year buffer to exceed $430 billion. It is now highly likely that the quantum required will significantly exceed that amount.

- As such, the Government's choice of a \$500 billion limit seems prudent if the Parliament places a premium on ensuring financial market confidence.
- Were we to settle on a debt limit that was less than the anticipated prudent amount, it would be entirely reasonable for financial market participants here and overseas to wonder what might happen when what was clearly inevitable on current pathways came to occur.
- It is up to the Parliament to decide whether this sort of risk is in the national interest, but the May 2012 AOFM minute, which is on the public record, highlights that uncertainty around the Government's ability to undertake debt management would create widespread and potentially serious negative speculation within the investment community.

- The 2013-14 MYEFO will provide full details of the changes to the budget bottom line since PEFO, but as I said, we need to await the September quarter National Accounts in the first week of December before we can settle the final figures.