

# Why Australia needs MORE government debt

## Economic research paper

21 October 2010

- While Australia's low net government debt position is seen as a strength, there exists a strong case for MORE government debt in Australia to help fund productivity enhancing infrastructure.
- Some estimates put the infrastructure shortfall in Australia at around \$A600bn. The case could be made for the Commonwealth and States to increase their combined debt level by over \$A200bn, which would increase net government debt from a projected peak near 16% of GDP to a still internationally low level of 30% of GDP.
- The increase in Commonwealth and State bond supply that this implies would likely be met by strong international demand (especially from central banks) and the need for Australian banks to meet new global liquidity requirements.
- The increase in government debt would be unlikely to have a negative impact on Australian interest rates or 'crowd out' the private sector, while the positive benefits to the economy from a ramp up in infrastructure could be substantial.

### Why Australia needs MORE government debt

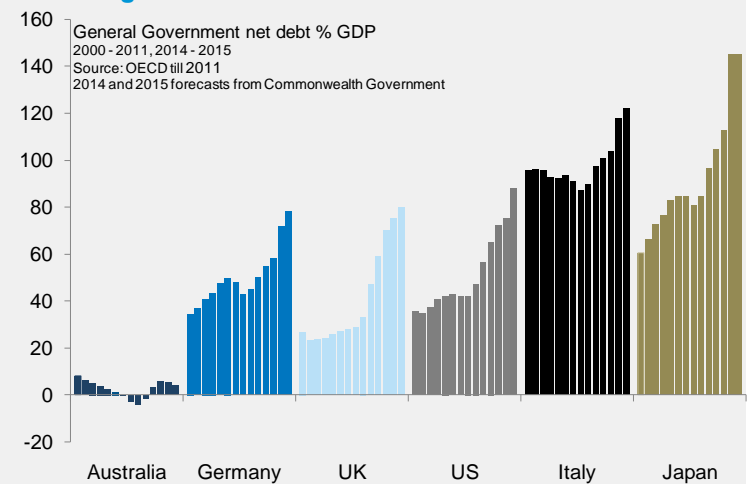
In global financial markets, there is legitimate concern that the level of government debt in many countries is too high. These concerns are either currently impacting on markets, such as in the case of Greece and Ireland, or these concerns are raised in the context of longer-term structural issues, such as in the UK, US and Japan.

This is not the case in Australia. Indeed, we argue in this paper that Australia has a unique opportunity to INCREASE its level of net government debt, both at a Commonwealth and State government level, to help fund much needed productivity enhancing infrastructure.

As shown in Chart 1, Australia's net government debt (ie. Commonwealth government gross debt less assets) is expected to peak at just on 6.0% of GDP in 2012/13 (or just under \$A90bn). This level of net government debt compares with the expected OECD average of a peak of over 90% of GDP in 2015.<sup>1</sup>

Chart 1

### General government net debt as a % of GDP



<sup>1</sup> Source, Economic Statement, July 2010



While it would be wrong to suggest that Australia's net government debt level should be allowed to approach anywhere near the levels currently saddling many OECD nations, it seems clear that **an opportunity exists for Australian governments, both Commonwealth and State, to increase their level of net debt to help fund part of the national need for a meaningful increase in productivity enhancing infrastructure and other assets.**

Indeed, recent reports in the Australian press<sup>2</sup> suggest that the Commonwealth government is looking at some form of infrastructure bond, perhaps with tax benefits, to help provide a source of funds for much needed infrastructure spending.

In addition, there looks to be continued support for maintaining a strong, liquid and efficient Commonwealth Government Securities (CGS) market within the Treasury. In the recently released 'Red Book', provided to the in-coming minority Labor government, the Treasury stated that "consideration will need to be given to what size the (CGS) market will need to be to continue to support the Treasury Bond and futures market once there is no longer a need to borrow to finance the deficit."

It is important to note that the Treasury sees three key positives from maintaining a liquid CGS market:

- 'helping to keep interest rates and the cost of capital low across the economy';
- to 'provide a safe haven for capital during times of instability'; and
- 'having pre-existing market facilities access to capital markets in the event the Government needs to borrow to support a revenue deficit.'

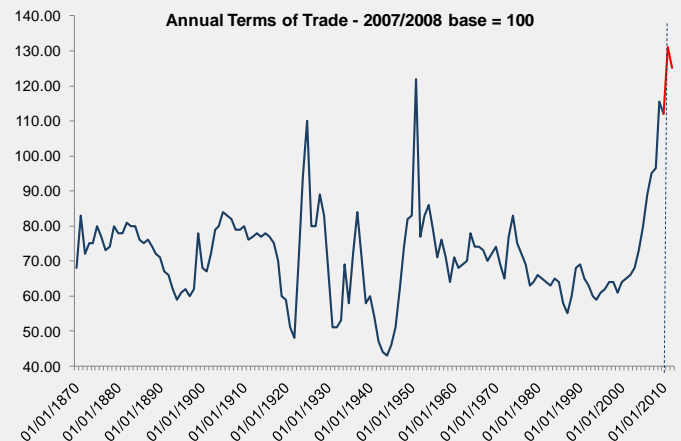
Maintaining a liquid CGS market in a period of budget surpluses raises the obvious question of what to do with the funds the Commonwealth raises in the markets. Here there could be an increased role for the Future Fund, with the net asset position that CGS borrowing would imply being allocated to the Future Fund with the target of re-allocating these funds to critical Australian infrastructure.

### Australia's infrastructure needs

Australia is currently benefiting from the positive impacts of a significant shift higher in our terms of trade (the ratio of export prices to import prices). This increase in the terms of trade is bringing with it substantial flows of income from the global economy into Australia.

Chart 2

### Australia's terms of trade



Source: Commonwealth Treasury

One way to ensure that Australia maximises the opportunities the wealth inflow from the terms of trade increase will bring to us is to ensure that the supply-side of the economy can effectively meet the challenges of managing the inevitable increase in demand, which is already underway. This means, in part, better infrastructure to transport goods, services, capital and labour around the economy and to our trading partners.

This is a theme that has repeatedly been highlighted by the Reserve Bank of Australia (RBA). The RBA is keen to see the supply-side of the economy expand and lift productivity so that the burden of controlling inflationary pressures does not fall solely on monetary policy.

Recently, the RBA Governor<sup>3</sup> stated that even though the RBA expects some decline in the terms of trade in the next year or so "we expect that this high level of relative export prices will add to incomes and spending. We expect ... that resource sector investment will rise further – as we experience the largest minerals and energy boom since the late 19<sup>th</sup> century."

Further, after discussing some potential downside risks, the Governor stated that "if downside possibilities do not materialise, the task ahead is likely to be one of managing a fairly robust upswing. Part of that task will, clearly, fall to monetary policy."

In terms of adjustments to policy - other than monetary policy - that could support the economy through the income effects of the terms of trade boom, we note that Infrastructure Australia<sup>4</sup> has stated "the value of infrastructure to our nation cannot be underestimated. The effectiveness of current and

<sup>2</sup> Australian Financial Review, 14 October 2010

<sup>3</sup> Glenn Stevens, "Monetary Policy and the Regions." 20 September 2010

<sup>4</sup> Infrastructure Australia "Getting the fundamentals right for Australia's infrastructure priorities", June 2010

future infrastructure in meeting economic, environmental and social needs is of critical national importance.”

Infrastructure Australia has identified seven key areas where infrastructure challenges should be focused:

1. transport for our cities (both rail and road);
2. adaptable and resilient water systems;
3. a national energy market (electricity and gas);
4. competitive international gateways (including ports and land transport);
5. a national freight network (road and rail);
6. a national broadband network; and
7. essential indigenous infrastructure.

**The size of the infrastructure challenge**

In their June 2010 report, Infrastructure Australia provided a ‘reform and investment priorities’ list. This list added up to a total capital expenditure of \$A82.85bn. However, this amount did not include the government’s proposed national broadband network (NBN), which has been estimated at up to \$A43bn.

Specific projects that were identified in Infrastructure Australia’s priority list that were ‘ready to proceed’ included the Melbourne Metro rail, Adelaide rail freight, the Federal Highway in NSW and the Pacific highway upgrade in NSW. Other projects classified as having ‘real potential’ included the Brisbane inner city rail, NSW, VIC, SA and WA road projects, water security projects in the ACT and SA, energy projects in WA and freight and port upgrades in QLD, WA, VIC and NSW.

However, this amount of infrastructure spending is only based on Infrastructure Australia’s ‘priorities’ list. Over time, various estimates have been made of the total infrastructure needs of Australia.

The Infrastructure Partnerships Australia<sup>5</sup> group has stated that the nation has an \$A770bn ‘infrastructure shortfall’, with the focus on ‘delivering major freight and passenger transport projects.’

In addition, one of Australia’s major banks<sup>6</sup> has estimated the necessary spend on Australian infrastructure at \$A600bn over the next 6 years – equivalent to around 8% of GDP – just to bring the average age of Australia’s infrastructure back down to its long-run average. The focus of this infrastructure spend is expected to be on roads, energy, water, telecommunications and rail.

It is also important to note that analysis<sup>7</sup> of the 2010/11 State government budgets shows that the States plan to spend \$A52.8bn on infrastructure in 2010/11, a 3.5% increase on 2009/10. The bulk of this expenditure is expected to be in, not surprisingly, NSW and QLD.

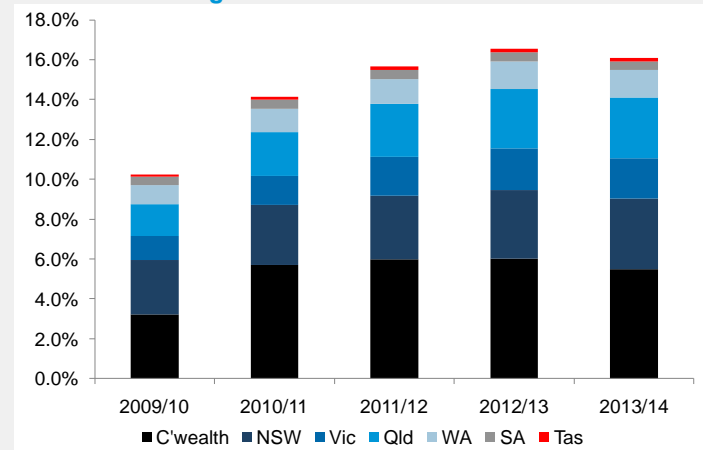
Further, over the four year period from 2010/11-2013/14 the States are expected to spend just under \$A171bn on infrastructure. Part of this expenditure via debt is detailed below.

**Implications for net government debt**

Currently, Commonwealth net debt is expected to peak at just 6.0% of GDP (around \$A90bn) as at June 2013. If, however, we add State government net debt to this, the peak in total government net debt for Australia is estimated at 16.6% of GDP at June 2013, up from 10.2% as at June 2010. In \$A terms, this is an increase in total government net debt from around \$A133bn at June 2010 to just over \$A250bn in 2014.

Of the approximately \$A120bn increase in total government net debt projected in the four years to 30 June 2014, just under \$A76bn will come from the State governments, with an \$A45bn increase from the Commonwealth. As stated above, this \$A76bn increase in State debt in the coming years will help fund part of the projected infrastructure spending of \$A171bn.

Chart 3  
Total Australian government net debt - % GDP



Source: Commonwealth & State Budgets 2010/11 & CFSGAM

Significantly, at 16.6% of GDP, total government net debt in Australia will still remain very low by international standards.

It seems clear, therefore that the capacity exists for Australian governments, at both the State and Commonwealth level, to significantly increase their level of debt to help fund productivity enhancing infrastructure projects.

<sup>5</sup> See Media release from Infrastructure Partnerships Australia, 7 September 2010.

<sup>6</sup> ANZ Research Quarterly, 17 September 2010.

<sup>7</sup> Citi Australia: State of the States, 31 August 2010

One potential target for total government net debt in Australia could be 30% of GDP. At this level Australia's net debt would still be around half of the 60% of GDP level that is considered a stable environment by the international community and would still see Australia's net debt significantly lower than most other OECD nations.

An increase in total Australian government net debt to 30% of GDP over coming years would equate to around an extra \$A220bn in total net debt over the period to June 2014.

While it could well be unrealistic to expect such a significant increase in government net debt over a short period, it could be envisaged that such an increase would be possible over a 10 year period.

Clearly the private sector would still be required to fund the largest share of the nation's infrastructure needs, but an extra \$A220bn from the two levels of government would provide a significant contribution that could be the difference between some important projects going ahead or not.

Indeed, as shown through the global financial crisis, the private sector can go through periods where it is either unwilling or unable to fund major infrastructure projects, either directly or through Private-Public Partnership (PPP) deals. A greater role for the public sector in funding infrastructure at this point in history would seem to be one way to help support the private sector to provide the necessary level of infrastructure for the economy.

In addition, government debt could also be used to fund significant projects that require funding over and above what some governments are currently prepared to spend (ie. the public transport rail network in Sydney is a good example).

It would be critical, however, to ensure that financial markets and investors were clear on the fact that any extra debt raised by the Commonwealth and/or State governments was going to infrastructure projects (not simply to deficit funding). This could be done by either 'branding' the bonds issued as 'infrastructure securities' or providing a clear link between the bonds issued and the projects that were being funded.

**Inter-generational equity considerations**

One of the key factors when considering how best to finance significant infrastructure projects is the issue of inter-generational equity.

When major infrastructure projects are funded out of the government's current revenue, the cost is borne by the tax payer. However, the economic and productivity benefits of significant infrastructure projects have very long-term impacts, spanning many years and a number of generations of tax payers.

It therefore makes good economic sense to have the cost of major infrastructure projects spread out over a number of years. One way of doing this is via debt, with the interest payments on the debt extending over a longer number of years to spread the costs and to deliver more of an equitable match of the economic benefits.

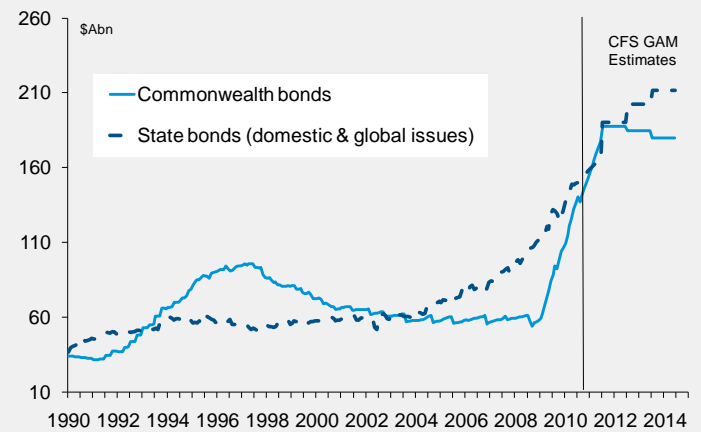
**Implications for bond supply**

As detailed in the chart below, the projections for Commonwealth and State government debt imply a continued significant change in the structure of the Australian government bond market, with State debt to represent a growing share of the government bond market.

From just near \$A136bn on issue at 30 June 2010, Commonwealth bonds are currently expected to peak at just under \$A188bn at June 2012, before declining to near \$A180bn at 30 June 2014.

In contrast, and as shown in the chart, the volume of State government bonds on issue is expected to continue to rise out to 2014, increasing to just under \$A212bn from near \$A150bn currently.

Chart 4  
**Commonwealth and State-govt bonds on issue**

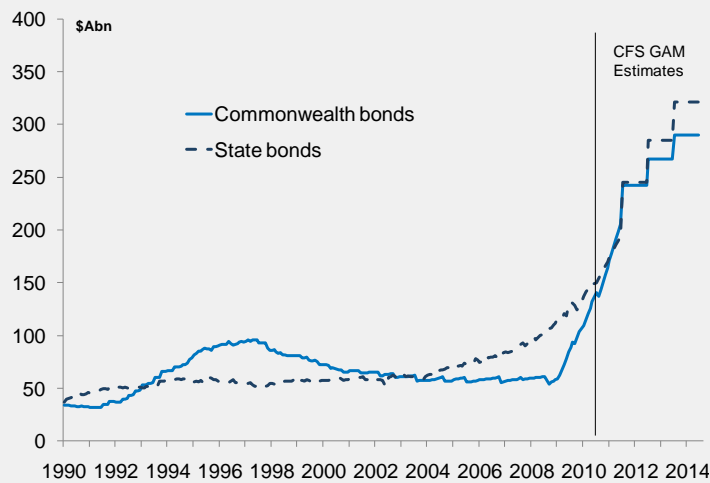


Source: AOFM, State Treasury Corps, Bloomberg, Citi and CFSGAM

An increase in total government debt - over and above the current projects - of \$A220bn in the years ahead would, therefore, lead to a significant increase in the size of the Commonwealth and State government bond markets.

As shown in chart 5 below, rather than peaking at around \$A187bn at June 2012, Commonwealth bonds on issue would rise to around \$A290bn in 2014. For State government bonds the volume on issue would jump to a little above \$A320bn by June 2014, rather than the \$A211bn currently projected.

Chart 5  
Commonwealth & State bonds on issue – A possible scenario



Source: RBA & CFSGAM

If the supply of CGS was to increase as sharply as detailed above, then careful consideration would likely need to be given over the structure of this increased debt.

Currently, the longest dated nominal bond issued by the Commonwealth is the July 2022 – a 12 year bond. With increased debt funding the Commonwealth could look to issue much longer-dated securities, of at least 15 years and perhaps 20 years to help lengthen the maturity profile of its debt and better match the economic life of the infrastructure assets.

For the States, the longest dated nominal bonds currently on issue have a maturity of 2023. The States could also, therefore, look at issuing bonds with a 15 year or 20 year maturity.

In addition, large infrastructure projects could also be funded via increased issuance of inflation index linked bonds (ILBs). Currently the Commonwealth has approximately \$A12.5bn in ILBs on issue, with the longest dated being a 2030 maturity. Some of the States also have ILB's on issue, with NSW and Queensland issuing inflation bonds out to 2035.

An increased focus on greater ILB issuance is likely to be greeted positively by the markets, as these long-dated inflation protected securities are well sort after by end investors.

As detailed below, new global regulations for the banking system and the local interpretation of these requirements are expected to see an increased ownership of government securities by the Australian banks, in some occasions at the expense of bank cross-holdings of shorter-dated securities. The Commonwealth and State governments could, therefore, look at increasing their

issuance and short-dated securities into an environment of increased demand.

Clearly, the level of debt increased detailed above is significant, although illustrative only. While we can take the view that if this extra debt was used to fund productivity enhancing infrastructure then there would be a net positive impact on the economy. We also need to ask ourselves what impact this increase in debt could have on the credit ratings of the Commonwealth and each State and whether there would be any impact on the level of bond yields and, perhaps more importantly, the general level of interest rates in the economy.

### Implications for credit ratings

An extra \$A110bn in debt at the Commonwealth level would see the net debt/GDP ratio peak closer to 13%, rather than 6% over the period to 2014. Even though this would imply a level of net debt a little over twice the current estimate, at 13% of GDP the Commonwealth's net debt/GDP ratio would likely still be comfortably within the AAA limits – especially if the debt was used to fund nationally significant productivity enhancing infrastructure.

The picture at the State level could be, however, a little more complicated. If the States were to borrow an extra \$A110bn in debt over coming years, it could be assumed that the bulk of this would be undertaken by NSW and QLD, followed by VIC and WA. All the States are currently rated AAA, with the exception of Queensland, which is rated AA+.

Given current fiscal and debt fundamentals, it could be anticipated that a significant increase in debt levels among the States may lead to a downgrading in the credit rating of some of the States.

This credit rating downgrade would likely flow from the credit rating agencies desire to see limits on net debt/GDP ratios and the net liabilities to revenue ratio.

As an example, Standard and Poor's<sup>8</sup> have stated that NSW's AAA credit rating would likely be reassessed if the net financial liabilities/revenue ratio were to exceed 120%-130%, from the current projected peak of 113%. For QLD, this ratio is currently expected to peak at 155% in 2013, a level consistent with its lower rating of AA+.

A substantial increase in the net financial liabilities/revenue ratio for States such as NSW (as well as VIC, WA and SA) above the 130% limit would, therefore, likely see credit rating downgrades be implemented. These downgrades could come despite

<sup>8</sup> Standard and Poor's, Ratings Direct, New South Wales, August 30, 2010

the clear economic benefits that would flow from the infrastructure constructed with the debt.

The question is then; would losing a AAA credit rating for a State really matter?

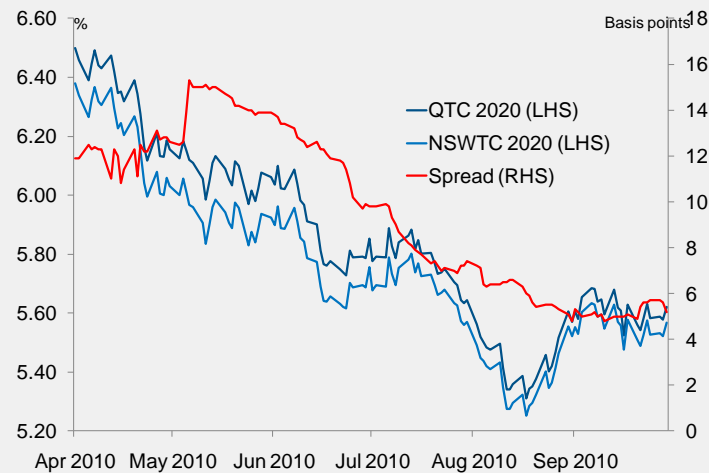
The evidence to date for QLD is that, from an interest rate and financial markets point of view, losing your AAA credit rating does not matter that much (although from a political point of view the implications could be more significant).

One way to look at this is to compare NSWTC guaranteed bonds vs QTC guaranteed bonds (ie, the bonds guaranteed by the State government, not the Commonwealth).

As seen from the chart below, the NSWTC May 2020 bond trades are only at a relatively small margin below the QTC February 2020 bond (currently just on 5bp). This margin has been declining since these bonds were issued at the start of the year (ie. since the Commonwealth announced the end of the guarantee system).

The strong message here is that investors do not seem to be too troubled by the lower credit rating for QLD relative to NSW. Investors appear to remain confident in the liquidity of QTC debt and the sound economic performance that higher infrastructure spending, as well as strong population growth and the resources sector will bring to Queensland.

Chart 6  
NSWTC 2020 vs QTC 2020 bond yields and spread



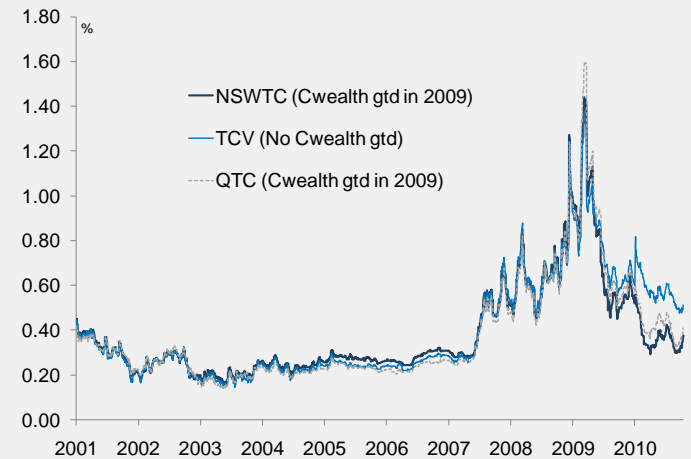
Source: Bloomberg

In addition, as shown in chart 7, State government bond spreads vs Commonwealth have been in structural decline since early in 2009. This was initially in response to the Commonwealth guarantee over State debt, but this system will expire at the end of this year and since early 2010 the States have again been issuing debt with their own guarantee.

While a dramatic increase in State government debt on issue could be expected to have an impact on State/Commonwealth spreads, the clear message from recent years is that the markets value liquidity and depth and if the debt raised is used to help fund productivity enhancing infrastructure then this is a positive for the medium-term economic outlook.

The State governments will need to ensure, however, that they have sufficient revenue flow to spend on the increased level of annual interest payments that the higher level of debt would incur. No doubt the States will look towards income generated from the assets that are built to help with this and, in addition, the State's may seek increased funds from the Commonwealth to help with interest payments where State debt is used to fund nationally significant infrastructure.

Chart 7  
NSWTC, TCV & QTC 10 year spreads to C'wealth



Source: Bloomberg, Citi and CFS GAM

**Implications for interest rates**

One obvious concern for financial markets and borrowers in the economy is that a substantial increase in net debt at the government level could put upward pressure on interest rates for the private sector, as the public sector 'crowded out' demand for private sector credit.

We doubt, however, that this will be a major concern for markets and that the upward pressure on interest rates from higher government debt could be minimal – if at all.

One reason for this is the view that the likely buyers of increased Commonwealth and State government debt do not usually also buy Australian private sector debt – so the danger of 'crowding out' is greatly reduced.

As detailed below, the vast majority of Commonwealth and State government debt is owned by foreign investors, with a large share in the hands of central banks and sovereign wealth funds. In many instances, these foreign buyers are permitted to only invest in government securities and so they do not face the 'public' vs 'private' sector choice.

Secondly, as stated above, international views seem to indicate that it is not until net government debt gets above 60% of GDP that markets become too concerned and raise the level of a sovereigns interest rates.

Locally, a recent research paper from the Commonwealth Treasury<sup>9</sup> looked at the level of net government debt in Australia and the Australia-US real 10 year bond spread.

This research concluded that “results for the period 1990 to 2009 suggest that Australian general government net debt has no impact on the short-run real interest margin and only a small effect in the long run. Further, the estimates suggest that movements in US general government net debt have a considerably larger effect than Australian general government net debt – implying that US influences take greater prominence in explaining the real interest margin.”

A strong case could be argued, therefore, that an increase in Australian net government debt to the levels indicated in this report would likely have a minimal impact on the level of interest rates in Australia – both in an absolute sense and relative to the US.

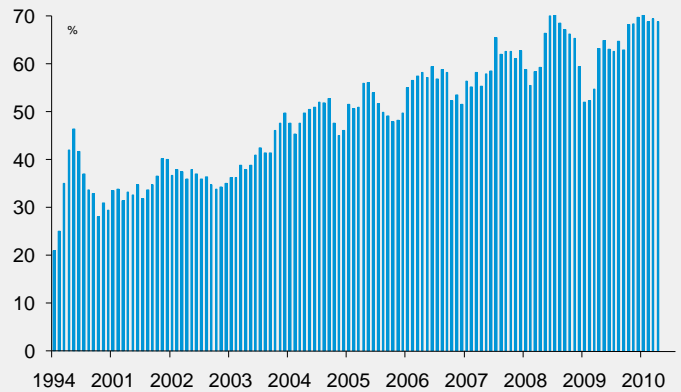
Indeed, it could be argued that over the medium-to-longer term that **an increase in net government debt that was used to help fund productivity enhancing infrastructure could actually put downward pressure on interest rates** as the increased level of productivity created would reduce inflationary pressures in the economy.

**Demand side dynamics**

As can be seen in the following chart, a large majority (ie. just under 70%) of Commonwealth bonds on issue are currently owned by foreign investors. Indeed, foreign ownership of CGS has been above 50% since around 2005.

While statistics are harder to come by, it is also considered that a large share of all State government bonds on issue is also owned by foreign investors.

Chart 8  
Foreign ownership of Commonwealth bonds



Source: RBA

A large share of this foreign ownership of Commonwealth and State government bonds is held by global central banks and sovereign wealth funds. These government investors have, over a number of years, been active buyers of Australian government debt as part of the diversification of their foreign exchange reserves, in some occasions away from the USD.

With the AUD now the fifth most actively traded currency in the world<sup>10</sup> and with Australia increasingly seen as being a good source of liquidity and correlation to the strength of the Chinese economy, the AUD is becoming a larger share of the FX portfolios of many central banks.

Significantly, these central banks and sovereign wealth fund buyers typically only purchase government debt – both Commonwealth and State. There is also significant anecdotal evidence that many central banks around the world are now looking to either begin investing in Australian government bonds for the first time or continue to increase their investments.

As stated, above, therefore, there is limited risk of increased government bond issuance ‘crowding out’ the private sector, as the major foreign buyers of government debt are not looking at private sector alternatives in Australia.

As can be seen in chart 8 below, after stagnating at around 5%-10% for many years, ownership of the Commonwealth bond market by Australian banks jumped sharply at the onset of the global financial crisis, peaking at 28% in June 2009, before drifting back down to 18% in September. This trend was obviously consistent with the banks’ desire for liquidity and depth in their asset holdings, as other less liquid markets became significantly more risky.

<sup>9</sup> Treasury Working Paper 2010 – 4, September 2010 “reconsidering the link between fiscal policy and interest rates in Australia.”

<sup>10</sup> Source: RBA

As noted above, as the dust settles on the global financial crisis it seems clear that there is a significant global trend to tighter regulation of the global banking system that will lead to additional holdings of government bonds by banks around the world, including those in Australia.

As part of the global banking arrangements under the Basel Committee on Banking Supervision (BCBS), Australian banks (ie. all Australian deposit taking institutions, ADIs) that are under the supervision of APRA, will be required to comply with new Liquidity Coverage Ratios (LCR). These ratios are designed to ensure that banks have sufficient assets of high quality and liquidity that could be sold in the event of the need to cover unexpected losses. The implementation of the LCR is expected on 1 January 2015, with an observation period to begin in 2011.

The BCBS rules will be skewed towards government debt as the greatest source of liquidity. For a country such as Australia, where insufficient Commonwealth government bonds exist to satisfy the needs of all ADIs, State government debt will also likely be included in these liquidity requirements.

Even with the addition of State government bonds the RBA has noted<sup>11</sup> that “for Australia and other countries with very low levels of government debt, the definition of Level 1 liquid assets under the LCR is one that is still unworkable, given the low level of public sector securities and other eligible non-bank securities on issue in such countries.”

As at September 2010, the RBA data showed that the Australian banks held just \$A29.5bn in Commonwealth bonds. The banks would also hold a significant volume of State government bonds and supra-national issuance, both of which are also likely to be included in APRA’s definition of ‘liquid’ for the LCR (given the RBA’s concerns stated above).

It has been estimated<sup>12</sup> that, as at as at 30 June 2010, the Australian banks held a total of \$A70bn in Australian government bonds, and that over the four years to June 2014 bank holdings of government bonds will need to increase sharply to \$A162bn as the size of bank balance sheets continue to grow to support the economy.

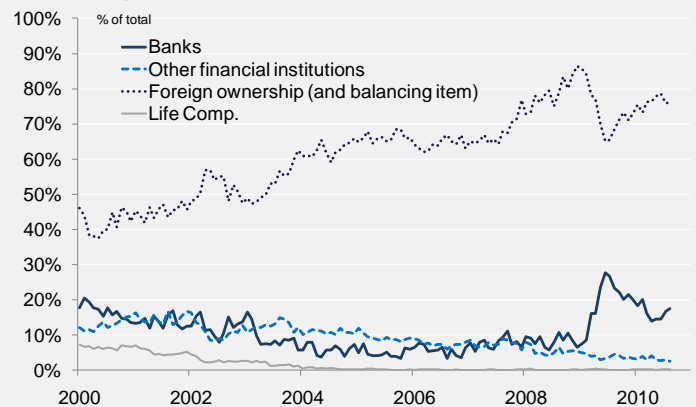
This projected \$A92bn increase in banks holdings of government debt would, therefore, would go a long way to providing a significant source of demand for an increase in government debt issuance.

Indeed, as noted above, the new LCR requirements are not expected to officially come into place until 1 January 2015 and so greater demand for Australian government debt from the local banks could be expected from this time onwards.

Another potential source of demand for increased issuance of Australian government debt is Australian superannuation funds. As at September 2010, only around 2%, or \$A3.7bn, of total Commonwealth bonds on issue were held by ‘other financial institutions’ in Australia, - including superannuation funds.

As uncertainty over the outlook for the global economy remains in place, there could be an increased allocation to fixed interest by Australian superannuation funds, while the ongoing need for long-dated assets to offset long-dated liabilities could also be another potential source of increased demand for government debt in Australia.

Chart 9  
Ownership of the Commonwealth bond market



Source: RBA

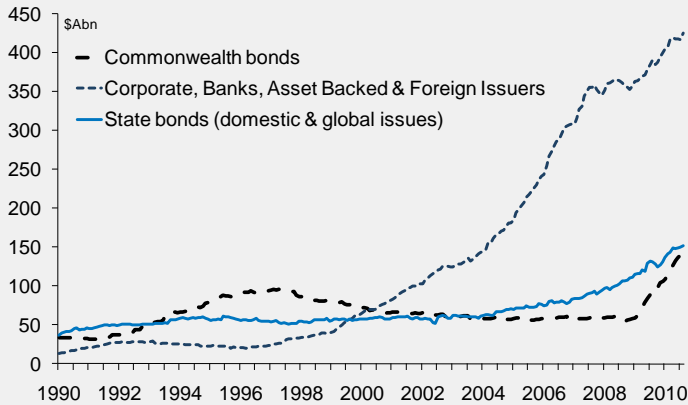
**Implications for private sector demand for credit**

As stated above, a significant increase in the demand for debt by Australian government’s need not ‘crowd out’ the private sector. As shown in chart 9 below, even while Commonwealth and State government debt issuance has accelerated in recent years, the issuance of non-government debt (‘corporate’ bonds) has also been on the rise (with a brief period of limited growth during the worst period of the GFC).

<sup>11</sup> Financial Stability Review, September 2010

<sup>12</sup> Citi “Australia: State of the States”, 31 August 2010

Chart 10  
Australian long-dated securities on issue



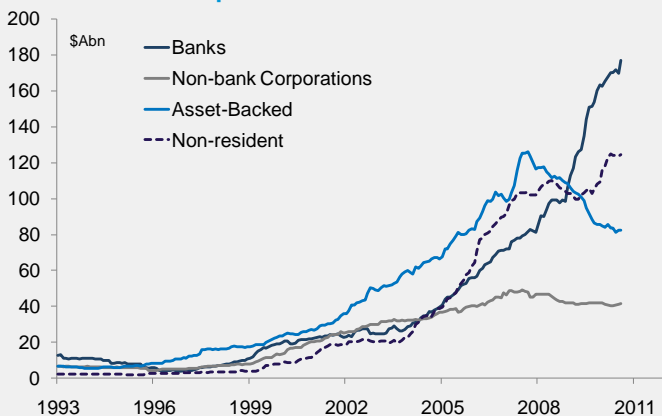
Source: RBA

Looking at the breakdown of all non-government bond issuance, we can see that this issuance is dominated by the Australian banks.

\$A bond issuance by non-resident entities into the Australian market (supra-nationals) has also recently been on the increase, while issuance by non-bank corporate remains minimal and issuance in the asset-backed market continues to decline.

As stated above, it could be argued that much of the demand for any significant increase in Commonwealth and State government debt issuance would come from global financial market participants who are not looking at the Australian corporate bond market as an alternative investment – ie. they are only buyers of government debt.

Chart 11  
Breakdown of corporate bond issuance in Australia



Source: RBA

Next steps

- Based on its current very low level, the case for MORE Australian government net debt can easily be made given the need for a substantial increase in productivity enhancing infrastructure in Australia.
- It also seems clear that the case can be made that any potential substantial increase in supply of both Commonwealth and State government debt could easily be absorbed by financial markets, especially by offshore central banks and sovereign wealth funds and domestically by the major banks and superannuation funds.
- The increase in net government debt is unlikely; therefore, to have a negative impact on the level of interest rates for the private sector, as the degree of 'crowding out' is likely to be minimal.
- Indeed, over the medium term it could be argued that any increase in net government debt that was used to improve the supply side of the economy and increase productivity could in fact place downward pressure on interest rates.
- In recent contact with a range of different domestic investors, the Investment Markets Research team has determined that there is a growing view that Australia needs more infrastructure. In addition, there appears to be a growing willingness to accept the view that this infrastructure should be, at least partly, provided for and funded by the government – especially if the private sector is unwilling or unable to do so.
- For this debate to gather more prominence there needs to be an increased understanding of Australia's government net debt position and a change in attitude that it is reasonable for the Australian government to have a level of net debt consistent with helping to provide the economy with productivity enhancing infrastructure.
- This would clearly require a change in view from government and other political representatives and a more mature debate on the issues.
- However, this could occur with increased consultation with the financial markets community and the providers of infrastructure and an education program among Australians about government debt and the importance of a large infrastructure spending projects.
- Our hope is that by writing this research, we can begin to foster a more mature, intelligent and thoughtful debate about the appropriateness of more government debt and the value it could bring to Australia through helping to fund productivity enhancing infrastructure.

For further information

Stephen Halmarick	Head of Investment Markets Research	+61 2 9303 3030	shalmarick@colonialfirststate.com.au
Belinda Allen	Analyst, Investment Markets Research	+61 2 9303 3110	ballen@colonialfirststate.com.au
James White	Analyst, Investment Markets Research	+61 2 9303 2645	jwhite@colonialfirststate.com.au

**Disclaimer**

Product Disclosure Statements (PDS) and Information Memoranda (IM) for the funds issued by Colonial First State Investments Limited ABN 98 002 348 352, Commonwealth Managed Investments Limited ABN 33 084 098 180, and CFS Managed Property Limited ABN 13 006 464 428 (collectively CFS) are available from Colonial First State Global Asset Management. Investors should consider the relevant PDS or IM before making an investment decision. Past performance should not be taken as an indication of future performance. No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of CFS. This material contains or is based upon information that we believe to be accurate and reliable. While every effort has been made to ensure its accuracy we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them. This material has been prepared for the general information of clients and professional associates of CFS. You should not rely on the contents. To the fullest extent allowed by law, CFS excludes all liability (whether arising in contract, from negligence or otherwise) in respect of all and each part of the material, including without limitation, any errors or omissions.

This material is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render specific advice. It is not an offer document, and does not constitute a recommendation of any securities offered by CFS. No person should act on the basis of any matter contained in this material without obtaining specific professional advice. Colonial First State Global Asset Management is the consolidated asset management division of Commonwealth Bank of Australia ABN 48 123 123 124.

Copyright © (2010) Colonial First State Group Limited.  
All rights reserved.