

LETTER FROM CANBERRA

Happy New Year - January 2024 Edition www.affairs.com.au

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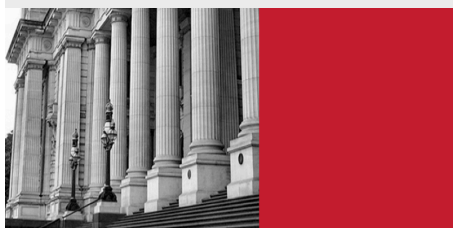
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Editorial

Getting back from Christmas lunch and launching into a tired debate about why January 26th is sacred is part of the fabric of this country. The whole foundation of Australia's post-Christmas news cycle seems to depend on it. The topic continues to be divisive and there are strong arguments on both sides. What do we do?

I get 26 January is seen as Invasion Day. I object to corporates, like Woolworths, ramming this down our throat for commercial gain through the support of ideologies. It is not Woolworths role to try and make us ashamed of who we are and what our country is. To reflect, January 26 marks the day Britain's First Fleet reached Australian shores in 1788, the day is also named 'Invasion Day' by Australians who argue the day should not be celebrated as it marks the beginning of Indigenous Australians land being invaded.

I'm becoming a change the date person. Why? We keep going through this annual argument, its not helping us. Equality, hope and opportunity can be tackled much better by focusing on other key factors. Lets stop arguing about this, lets confront it and talk about it. We need to have a mature debate, pick a date and move on!

In this first edition of Letter from Canberra we run a feature on inflation, the other topic of conversation, the economic predictions at the start of a new year! You can't hide from the reality that the RBA, having pumped the place with cash, has now whacked the brakes on so hard the mortgage will kill you. If you sell stuff offshore your returns are down in volume and price, the cost of business continues to increase and competitive positions are getting harder.

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BOM weather forecasts

VIC has just experienced its wettest start to a year since records began early last century, NSW has seen heavy rainfall and QLD's December average rain was 22% above the mean range. Rain has been gratefully received by farmers and graziers across the country and confidence has returned, but it was not predicted.

Rather, Bureau of Meteorology forecasts warned from as early as March that Australia was tracking towards a hotter and drier El Niño-influenced summer. Recent criticism for failing to predict the recent spate of extreme weather is unfair, and misses far more serious failings of the BOM. Weather prediction is difficult. At best one can hope only to improve probabilities. Extreme events are hard to predict.

The BOM's long term El Niño prediction is a total flop, was made it purely on science or was there an aspect of what some governments and some people wanted to hear? The BOM seems to associate every extreme, or record-breaking, weather event with climate change. This is not a anti-climate change issue, it is about inaccurate forecasting and manipulating data for non-scientific purpose, from an observation network that improves in capability by the year!

The climate section at the BOM does appear to use data and record events for political purposes. Not the short term forecasters, but the catastrophists in the climate department who seem to be running ideologies and social issues! Concerning too is the fact there is now a waiver, to use the BOM app you absolve them of all responsibility for inaccurate forecasting!

Productivity remains low. The debt is crippling us, the current account is a joke and the Auditor-General's report into the billions in waste exposes the calamitous mess government's have got us into. What part of this view have you not read before? This is not to bag the economists and forecasters. But I said the same thing during Covid - you can be too expert, too microscopic, you can have too many spreadsheets and overthink stuff.

In the real world, go to a supermarket, talk to a few trades people, talk to kids looking to make their way in the world. You soon see and feel what's really going on. Is this a shock? It's been a freight train of fiscal ineptitude coming down the track for the past two years. More government stimulus, on more borrowed money, to offset cost of living will not work. Politically it might but its counterproductive, adding to inflationary pressure.

We will talk more about inflation. We are stuck. Yes, it is, or may be, falling slightly. But not enough. We will have low growth and we could go to recession with elevated interest rates for most of the year. We are in deep trouble if the economy slows quickly, or we get more external impact, eg the ongoing supply chain challenges resulting from shipping lines avoiding the Suez canal.

The Federal government has a surplus, not through any government magic! The surplus comes from high commodity prices and increased tax receipts from low unemployment and high migration. For the same reasons we may have another surplus in FY24. We should use this money to reduce debt, we could use it to reduce inflation, pricing and cost of living.

How? Remove the fuel excise, the benefit will spread across communities. It will help cost of living, it will reduce inflationary pressure. Sad to hear that this is not an option because it benefits the rich more than the poor, politics!

Another move is interest rate cuts, but don't hold your breath. There is plenty of evidence that the RBA will be slow and I wouldn't dare suggest that cuts will come closer to the next Federal election! The quest for political power could look to use interest rate cuts to aid re-election!

In fairness, the outlook in Australia is shaped by global forces - including the actions of the US Fed, the price of oil and the state of the Chinese economy - but also some specific local factors such as the big increase in migration (a record 518,000 in the year to the end of June, boosting demand but putting pressure on rents in key capital cities). Australia continues to have a high level of dependence on the mining sector.

I made a few predictions in last year's Letter from Canberra January edition. Scroll down for the report card and a few recommendations for this year....on the record!

Comparative inflation rates & govt outcomes

- Canada's inflation rate is 3.1%,
- The US is also 3.1%,
- The UK is 3.9%,
- Germany is 3.2%,
- Across Europe, inflation averages just 2.4%,
- With my Dutch heritage, I'll throw in Holland at 1.6%,
- Closer to home it's 2.6% in Indonesia,
- 2.8% in Japan,
- 3.2% South Korea, and
- 3.6 % in Singapore.

NZ current inflation is the only one above us at 5.6% - which is very much a domestic policy outcome!

Inflation was a problem overseas, but not anymore and certainly not compared to our inflation levels.

Politicians and government economic advisors love to speak of the need for intervention when there is market failure but never seem to propose retreat when there is government failure.

Government and the groups that feed off it have an interest in maximising the size and scope of activities, and in creating and not solving social problems. Solving problems means fewer jobs and resources within the bureaucratic and political industrial complex. The paradox is that, in government, failure rather than success is rewarded, with increased budgets, headcount and powers. Time for smaller government?

Lets talk inflation

The PM last week said people are "feeling pressure as a result of global inflation". Global inflation? Actually, inflation is back under control in most like-for-like nations around the world. Here, however, it is too high, at 4.3% - due to domestic policy settings.

The CBA Chief Economist Stephen Halmarick attracted a lot of attention just before Christmas, forecasting that the RBA would cut its cash rate by 75 basis points in the second half of 2024, and by another 75 basis points during 2025 (ie, to 2.85%) as a result of inflation falling under 3% by the end of this year, rather than by the end of 2025.

Treasury and the CBA may be right, especially with renewed pressure on global supply chains as shipping companies avoid using the Suez Canal, and the likelihood of further food price increases as a result of the floods in Far North Queensland as well as continuing pressure on housing costs with net migration coming down only slowly from this year's likely total of around 500,000.

The RBA will find itself under pressure to cut rates, even if inflation evolves in line with its forecasts. Lower US rates could combine with high commodity prices to prompt further upward pressure on the AUD, which would help inflation as it brings down the cost of imports such as fuel - assuming oil prices do not escalate from events or supply reductions to benefit yields.

However, commodity prices are likely to decline with forecasts of a slowing Chinese economy - by far and away our biggest trading partner - now confronting a period of uncertainty.

In real terms, the Australian economy grew just 2.1% in the year to September 30, with quarterly growth slowing to just 0.2%. Factoring population growth, the economy surely is going backwards?

Households debt equity ratios are changing. To finance the shortfall, people are drawing down on savings. From a peak of \$237 billion in September 2022, savings now sit at around \$180 billion. While that may sound healthy, bank data suggests a lot of the cash is held by older and wealthier households - mortgage holders remain the most affected by higher interest rates.

There is also a chance, at least according to the central bank, that interest rates could rise again in the new year if inflation remains stubbornly high, this is hard to see! Assuming no political backflip, the stage three tax cuts - which give a tax cut to everyone earning above \$40,000 - will help. Australia remains slow among the top 15 advanced economies in lowering inflation. The question for the RBA is whether this is again being late to the party, or whether there is a bigger structural issue at play.



Taiwan's election result

2024 is the year of the election, the anticipated Taiwan election occurred this weekend. The election gave a third consecutive term to the independence-leaning Democratic Progressive Party (DPP) led by Mr Lai and Vice-President-elect Hsiao Bi-khim, a ticket seen to be favouring strong ties with the United States, Taiwan's most important strategic partner. Mr Lai is likely to continue policies on issues that the US is most concerned about, like relations with China and alignment on defence, technology and the economy.

How will Beijing respond to the election outcome, which is tried to influence? Is China about to impose economic penalties for having found that Taiwan is in violation of its cross-strait trade commitments? It is Beijing that is trying to strangle Taiwan diplomatically and with increasing military intimidation. Any Taiwanese president would stand up against that.

This poses a great challenge to the Albanese government. After the outrageous threats from Chinese ambassador Xiao Qian that Canberra must never speak in favour of Taiwanese democracy, and that if we do such a thing "the Australian people would be pushed over an abyss", the Albanese government must respond to the Taiwan election at the highest level. It will be interesting to hear what we say in response to this election.

How did our 2023 predictions play out? page 1/2

This is the report on our 2023 predictions? We add a few predictions for 2024!

- Inflation will continue rising faster than wages but the Reserve Bank will pause interest rate rises, finally realising they are harming the economy with increases that do not counter supply led inflation.
- Wrong - they kept bumping, now we are thinking that the RBA won't try to get inflation down to its target as quickly as its peers. For 2024 we predict the cash rate will finish the year sitting at 2.85%
- A 1% rise in unemployment will see Australia finish the year with an unemployment rate of 4.5%. As growth slows, the tightness in the labour market is expected to see inflationary pressures diminish as the labour market cools and supply chain bottlenecks ease.
- Wrong - unemployment has remained low albeit easing off signs are now apparent. We finished 2023 with a 3.8% number and a participation rate of 67.1%.
- Vladimir Putin throws more resources, inflicting more violence on Ukrainians. Despite the imbalance of forces, Russia doesn't prevail.
 - Correct - but we all want this to end, hard to see how!
- Global cost of living pressures linked to the Ukraine crisis continue to rise.
 - Correct - an easy call!
- India will beat Australia in February's cricket test series, England wins the Ashes but Australia wins the Test Championship final.
 - India won the test series 2-1, Australia beat India to become World Test Champions and the Ashes was a 2-2 draw.
 - For 2024 we predict NZ will beat Australia in tests this summer, and that Steve Smith will fail as a test opener!
- As flights and travel resume, expect tourist arrivals to go back to a pre-Covid-19 levels - unless a new variant of the virus returns.
 - Mostly correct, capacity is close to 2019 levels, yields are high and pax numbers are recovering. For 2024, likely after Easter, we expect airline ticket prices to drop as economies slow.
- Chinese President Xi Jinping is set to be re-elected to an unprecedented third five-year term at the annual parliamentary session in March.
 - Correct, 12 months ago that looked less likely, the focus now is on the Chinese economy and Taiwan.

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German recession?

Could there be a major recession in Germany, that impacts across Europe? How much of this is geared by loss of competitiveness, supply chain issues and much higher energy costs?

Germany's economy has grown in only two out of the last six quarters. Germany's Bundesbank cut its growth forecasts for the next two years, having previously said it expects the economy to contract in the final three months of 2023. Official data confirmed that GDP declined 0.1% in the third quarter, suggesting Europe's largest economy could now be in a recession, as the country's industry suffers from low global demand for goods, and the economy feels the impact of higher energy prices,

Cheap energy pricing has gone. The export boom to China has ended. Germany has become one of the growth laggards of the eurozone, suffering from still-high inflation, elevated energy prices, interest rates and China's pivot from an export destination to a rival that needs fewer German products. Most of the forecasts are for only a mild recession. But it could get much worse, the German government has been forced to tighten its purse strings by a court ruling last month that enforced a deficit cap, resulting in cuts to green subsidies and spending. Germany may well head into a structural downturn. As the fourth-largest economy in the world, that will impact globally. It will drag down the eurozone, depressing the currency. It could well be that the traditional German economic model is doomed?

How did our 2023 predictions play out? page 2/2

- Kevin Rudd will not see out the year as US Ambassador.
 - Wrong - we now predict he won't be in the role at year's end. We are surprised he did not blow it, yet!
- Tasmania becomes the sole Liberal government in Australia following Labor's rise to power in the 2023 NSW election.
 - Correct - for 2024 this starts to be undone, QLD, the NT and the ACT are up this year. We expect change apart from the basket case that is ACT local politics!
- Underlying fundamentals suggest that property values will rise again come late 2023.
 - Correct - property prices rose by 8.1% in 2023, we forecast further increases this year as demand continues to grow despite the high cash rate.
- Tax reform - the Federal government will lead GST discussions to start a transition from taxes such as stamp duty to consumption driven taxation.
 - TBC - largely because the economy and the politics are not right, yet!

For 2024 we predict that;

- Businesses will continue to spread their risk by diversifying their suppliers and customers.
- Discretionary spend will drop, yields will drop. Travel, hospo, retail sectors will be impacted hard, from Easter through winter.
- Higher mortgage repayments along with fixed-rate loans expiring, rising cost of living, falling real wages and higher taxes due to bracket creep all hammer household budgets and consumption.
- Household debt-equity ratios will keep getting worse. Cost of living pressure has to increase with the ongoing increase in the cost of essentials
- A material step back in brick and mortar retail will impact confidence
- Demand will drop, unemployment will rise to around 4.5%. At some point capital markets, in 2024, will correct
- Energy and fuel costs keep rising
- Multiple construction industry issues and insolvencies as well as ongoing supply chain challenges means "you can't build your way out of a downturn". Governments will continue to spend and borrow, they should do the reverse.
- Competitive positions will worsen, COGS and operating margins will be impacted. It will be a tough year!

CEO focus in 2024

As I am temporarily sitting in the chair again the first task is to form the right agenda - what matters most for 2024?

It hasn't exactly been easy the last few years...a global pandemic, busted supply chains, war, stubborn inflation, political instability and many other disruptions. Any one of these is enough to derail an agenda. Taken together, it's the most difficult operating environment I can remember.

So what is the focus, beyond the even more critical need to manage cost and generate revenues? You need a much stronger view on the macroeconomy, hard landing, soft landing, no change - what will the bigger picture present in your markets?

The energy transition, it is happening with many issues. Go full throttle on net zero, create value from green business decarbonisation.

You need a plan, with scenarios. Where can you go, how will you get there, what are the options and how do you decide and analyse the best strategy? Who are the future leaders, where are the major market triggers and will your current customer cohort provide the bulk of revenues going forward?

The skills shortage remains a national problem. It is a core factor in any business plan and it will add to inflationary pressures throughout the economy. It is further evidence of the extra focus needed on long term competitive positions and operating margins. We all need a proper plan of to work out where we go, knowing COGS will keep increasing.

The PM on the referendum loss and cost of living

Just before Christmas PM Albanese was keen to distance himself from the 61-39% Voice referendum loss, telling a radio audience that the failure to achieve constitutional reform was not a personal loss. "I am not Indigenous so it wasn't a loss to me," the Prime Minister told 2GB. "I do think that it was disappointing for First Nations people but ... they're used to hardship".

Albanese's remarks managed to elicit disbelief across the spectrum, The Australian wrote in its Tuesday editorial, adding that he had missed a golden opportunity to accept responsibility for Labor's electoral woes following the defeat of the referendum and to "reset the political atmospherics for the year ahead".

"Instead, the Prime Minister has refused to accept responsibility and distanced himself from the referendum outcome, while making the boast that tackling the cost-of-living crisis had been his government's greatest achievement for 2023." Really?

Renewable Energy and Roof Top Solar

More generation from household solar panels over clear, sunny days during the holiday period has frequently pushed wholesale prices close to zero or below, causing other generators to switch off until demand for grid power - and therefore prices - recover. It means business cases and existing wind and solar developments are often curtailed well underneath their generating capacity.

This scenario is a further issue within the energy transition to renewable power supply. More variable renewable energy (wind and solar) is needed to displace coal, but RTS [rooftop solar] is impacting viability. An expansion of energy storage will improve this, as will better control of electricity consumption.

Big batteries are emerging as backstops to the energy transition that can help avoid blackouts, balance supply and demand and smooth out volatile prices. Battery energy storage solutions, or BESS, "firm" wind and solar energy by storing energy surpluses and discharging during shortages.

There's an important caveat to this. Big batteries with up to about four hours of storage will increasingly be able to deal with hot summer evening peaks - when everyone comes home and turns on their air conditioners, electric stoves and TVs and demand surges for a few hours. But much longer duration storage will be needed to deal with long winter lulls - periods of low wind and sun that last for days, if not weeks.

There is also battery safety, which is the safest for our climate and which presents the best long term cost of ownership?

Grey divorce

Anecdotally I have heard a number of times that the pressure on housing and rental availability is partly driven by a greater number of relationship breakdowns and, grey divorce!

A survey of more than 1,200 older Aussies has revealed 32% of people aged between 50 and 60 years old have considered separation or divorce and that was up from previous years, according to the data from Australian Seniors. Empty nest syndrome was the main reason for almost half of later-life separations but the strain of financial pressures and retirement adjustments also played a role. According to respondents, the biggest challenges of a grey divorce were asset division, financial instability and emotional impacts.

Changing needs around intimacy, adjusting to retirement and physical health concerns were among the top reasons behind the strain on the relationships of older Australians.

Those who stayed together said they worked on open communication, regular health check ups, getting physically active and picking up shared hobbies and activities. Trust, mutual respect, a sense of humour and emotional intelligence were the main factors for a happy, long term relationship.

According to the survey, 46% of single respondents preferred solo life and 12% had casual relationships. Single people reported less stress, independence, more financial control and personal space as positives.

But six in 10 people struggled with loneliness and the fear of ageing alone. How's this for a conversation starter?

2024 Election Predictions

Nearly half the world gets a vote this year. Here are our predictions after a bit of reading over the break!

The US presidential election in November is almost certain to be 2024's most significant event. Of course, US elections are always consequential given America's power and influence. But what makes this election fundamentally different is that it's likely to be one in which the differences between the major party candidates far outweigh their similarities. Assuming President Joe Biden and former President Donald Trump gain their respective parties' nominations, who wins will matter a great deal, both to the United States and to the world. We predict...President Trump!

The Sunak government will lose the UK general election by a wide margin. If Keir Starmer wins, it'll be because the government self-inflicted a loss over a long time frame!

As India gears up for general elections in 2024, the ruling party of Prime Minister Narendra Modi sits comfortably in pole position as the opposition struggles to play catch up. He will be re-elected.

Maybe not via an election, but sooner or later, a majority of Israelis should lay the blame for the biggest security failure in decades at Prime Minister Benjamin Netanyahu's door. He won't go through an election, instead, members of his Likud Party (which polls say would lose nearly half their seats if elections were held today) will find a new leader to try to salvage their party's reputation. This is also a likely major play to try to end the conflict.

Vladimir Putin may be embarking on a sure-win re-election campaign. The March presidential election results, if the true vote breakdown is disclosed, may be an indicator on whether the Russian public continues to back war in Ukraine.

Indonesia is the fourth-most-populous country, after the US. More than 200 million people are eligible to cast ballots in Indonesia. Turnout is generally much higher in our neighbour's elections, in Indonesia's last presidential election in 2019, 80% of eligible voters participated. Today, President Jokowi is one of the most well-liked leaders in the world, with approval ratings around 80% and an increase in GDP of 43%. Indonesia is one of the fastest growing economies. President Jokowi constitutionally cannot run again after serving two terms, he has not endorsed any candidate but is assumed to be backing his son's run as a vice presidential candidate alongside Jokowi's defence minister, Prabowo Subianto. Prabowo, who previously lost the presidency to Jokowi, belongs to the right-wing Gerindra Party and was a military officer under Suharto. We expect Minister Prabowo to be the next president, but would he go a full one or two terms before Jokowi's son, Gibran Rakabuming Raka, takes over?



What to stream

When you write a list like this it seems like you watch a bunch of TV, in my case I don't think its any more. I just watch less golf because its not the same, I don't watch any free to air TV and the news cycles have been quiet. Instead I have enjoyed these series:

Fool me Once on on Netflix;

The new series of Frasier on Paramount+;

The new series of Reacher on Prime;

Season 3 of Slow Horses on Apple;

The Brigade on SBS, and the BBL!

Cricket continues to see a whole new interest level with my daughter watching and following Australian white ball cricket with me. Some good banter as I support NZ and some reflection on another BBL season where both the Melbourne Stars and the Hobart Hurricanes have failed to make the finals.

We are heading to the MCG tonight to watch these two teams play each other with nothing on the line apart from seeing which one of our teams beats the other! Roll on BBL 2024 and the T20 World Cup!

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January's "what do you think of this?"

Long, dry, hot summer, farmers panicked, selling off stock for next to nothing for fear of running out of feed. But look now: we instead got above-average rain in VIC, NSW and huge parts of QLD. Yet VIC's emergency services minister, Jaclyn Symes, was still babbling about global warming on Tuesday as she toured the floods, saying "there's no doubt that we need to be responding to climate change". Same old story. It's dry; blame global warming. It's wet; blame global warming.

The Freshwater survey finds less than a third of us think the country is heading in the right direction, while slightly more than half think we're going the wrong way. A year ago more people (44%) thought the country was heading in the right direction, while only 42% thought it was the other way round.

Former Tasmanian senator Eric Abetz has confirmed he is seeking preselection ahead of the next state election, which will see an increase in Lower House MPs, up by 10 to 35.

VIC local governments are bracing for fringe groups - including some linked to disruptive and violent protests in council meetings last year - to run candidates in this year's council elections.

Consumer prices in China fell for a third month in December, whilst yearly export figures declined for the first time since 2016. This economic data will do little to address worries the world's second-biggest economy is facing downturn.

Germany and the UK are making history in wind, solar, and emissions. At the same time, their GDP is shrinking due to higher interest rates, weak demand and energy costs.

We should allow that warming is in progress, but, is the long-term threat of climate change dwarfed by the more immediate threat presented by our economic reaction to it? Just a thought, but perhaps the trillions of dollars we've earmarked for adjusting our climate might be better spent on productivity gains and better community outcomes - given around a hundredth of global emissions come from Australia and we are borrowing to reduce that by 40%, eg 0.4%!

The industrial stand-off between ports operator DP World and the union over pay and conditions has escalated with stevedores stopping work. This action continues as we see further and ongoing supply chain challenges!

There are more problems with the Boeing 737 MAX, is there a design issue and does safety need a greater focus?

Thank you for reading.