Chanticleer

Consensus to tackle debt

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Tony Boyd

Australian investors used to the vicious partisan politics of Canberra would be wrong to overlay that perspective on the United States and conclude that Washington will not be able to address its massive fiscal problems.

Michael Thawley, Australian ambassador to Washington from 2000 to 2005 and now political and economic adviser to Capital Group, says it would be misreading US politics to assume the aggressive fighting between Democrats and Republicans will not result in a debt solution.

He says it is not obvious to outsiders but beneath the surface in Washington, which has been his home for the past 12 years, there is a shared understanding of the issues that have to be tackled – in particular, the $US1.125 trillion budget deficit.

Thawley, who is in Australia with half a dozen Capital Group portfolio managers visiting local companies, says that while there are big differences of opinion on how to deal with the US budget deficit, there is a consensus.

Proof of this can be found in all the commissions in Washington that have examined the budget deficit problem, including the Domenici-Rivlin Debt Reduction Task Force, the Simpson-Bowles Commission on Fiscal Responsibility and the bipartisan group of former US senators.

“What you’ll find is that the menus of those commissions are pretty much the same,” Thawley says. “There is an agreement that spending has to be cut, especially entitlement spending, and taxes have to be raised.

“There is broad agreement over the proportions – somewhere between two-to-four to one in favour of spending cuts to tax increases.

“There are differences of opinion over which loopholes or tax deductions should be eliminated, but you can see that people are looking more at means testing, limiting phasing out of some of them, or limiting the income at which deductions can be counted in your tax return.

“I think there is a risk that we underestimate the capacity of the US to produce a sensible solution.

“It may not come as fast as everyone would like but I think an understanding of the broad parameters of budget and tax reform will emerge either in the lame-duck session or early in the new year.”

If Thawley is right, that will be a welcome relief for financial markets that have viewed the looming fiscal cliff as the next potential catalyst for turmoil in global markets.

The fiscal cliff refers to the scheduled tax and spending changes in 2013 that would reduce the US federal budget deficit by about $US600 billion to $US700 billion.

This would trigger a recession in the first half of 2013, leave gross domestic product 2.2 per cent below what it would have otherwise been by the end of the year, and push unemployment to more than 9 per cent, according to strategists at HSBC Global Research.

HSBC does not believe this will happen but says that if it does, the US dollar will collapse, global equities will fall by 15 to 20 per cent, US Treasury bonds will rally to 1.2 per cent and the gold price will soar.

Its preferred scenario is a “muddle through” option, with the deficit only cut by $US200 billion to $US925 billion.

In that case, stocks rise by 10 to 15 per cent and Treasury bond yields remain steady.

Thawley agrees with the current opinion polls predicting a victory for President Barack Obama.

“If you had the election today, President Obama would probably win but the election is probably closer than most people understand from the media,” he says.

Capital Group, which has $1.1 trillion in assets under management globally, including $US5 billion in Australia, is an influential asset manager because it backs up its conviction by taking large positions in stocks.

This means it can hold sway when takeovers or other corporate activity take place.

It is the largest single shareholder in several Australian companies.

High-profile Capital Group shareholdings recorded by Bloomberg include: Qantas, 11.44 per cent; Oil Search, 11.4 per cent; Amcor, 9.5 per cent; Fletcher Building, 9.4 per cent; Coca-Cola Amatil, 6.5 per cent; Treasury Wine Estates, 5.6 per cent; Sydney Airport, 5.6 per cent; CSL, 5 per cent; James Hardie, 5 per cent; and Myer, 5 per cent.

Thawley says Australia is a very attractive destination for the savings of ordinary Americans who want to invest for the long term.

The firm started investing in Australia in 1974 through a fund that was set up to take advantage of the opportunities created by changes in economic and trade relationships.

Thawley, a senior vice-president, has several roles at Capital Group, including sitting on three investment policy committees.

He provides advice on the political and policy context of investment decisions.

One advantage Capital Group has over other international funds managers is that it is privately owned.

Not having shares traded on an exchange means staff are free of the sort of market volatility pressures that can affect investment decision making.

James Packer and KT Lim, who are shareholders in Echo Entertainment, are not the only ones with a strong vested interest in NSW gaming revenues growing strongly.

NSW Treasurer Mike Baird is understood to be ready to run the numbers on a securitisation plan that involves virtually all the state's gaming revenue. This would dwarf his current plan to securitise up to half of the NSW lottery revenues.

The lottery securitisation idea, which is the subject of a scoping study by Macquarie Capital, could raise about $1.5 billion. The results of that study should be known by the end of the year.

However, it is understood Baird is also considering the potential securitisation of NSW's gambling revenue, which is expected to total $1.9 billion in the year to June 2013. That is about 8.5 per cent of tax revenue.

It is believed that based on preliminary estimates, Baird thinks he could raise between $12 billion and $15 billion using various structures. This would have to be handled carefully as the Treasurer would need to balance the loss of revenue with the need for funds to pay for new infrastructure.

One way of managing the impact on budget income would be to gradually securitise gambling tax revenues in packages of about $100 million over a period of several years.

Securitisation experts told Chanticleer that the securitisation of gambling revenues was not dissimilar to the sort of securitisation done in the US of music royalties. A good example is David Bowie's music royalties.

The amount of money raised through a gaming tax revenue securitisation package would depend upon a number of factors, including the life of the securities and the demands made by credit rating agencies.

It is believed Baird's preference is to sell the paper with terms of 10 to 15 years. This may be a little ambitious as there is not much paper sold in Australia with terms beyond 10 years. In the asset-backed securities market, the typical term is five years.

A securitisation expert, Robert Camilleri of Realm Investment House, says anything with a predictable revenue stream can be securitised.

But he says investors would want reassurance about the security and predictability of the revenue stream. He says investors buying a security backed by gaming revenues could find themselves exposed to the vagaries of the gaming licence holders and the impact on gamblers of prevailing economic conditions.

Last night's release from the Basel Committee showing a €19.5 billion ($24.3 billion) shortfall in tier one capital among the world's largest banks says there is plenty of work to do before the world banking system is Basel III compliant. Add in the capital conservation buffer and the shortfall in capital rises to €489.6 billion.

That’s a hefty bill for shareholders in the interests of safer banks.

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