OPINION

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How wrong we have been

Forecasting's recent past is hardly one of lucidity, writes **Paul Higgins.**

As a futurist I am constantly being asked when I think the global financial crisis will be over.

Putting aside the issues of whether recovery to the previous state of the economy is possible or even desirable, my answer is: "I don't know and anybody who tells you they do is lying."

An article in *Business Week* on April 16 said: "In early September 2008, the median growth forecast for the fourth quarter was 0.2 per cent, according to a survey by Blue Chip Economic Indicators. The actual outcome was a 6.3 per cent annualised decline. The Federal Reserve didn't do any better. In July 2008, Fed officials projected unemployment in the fourth quarter of 2008 would end up between 5.5 and 5.8 per cent. The actual number was 6.9 per cent. Their projection for the fourth quarter of 2009 . . . was for a range of 5.2 to 6.1 per cent. Today, with unemployment at 8.5 per cent, most forecasters expect the rate to be nearing double digits by the end of 2009."

The International Monetary Fund has revised its forecasts five times since October. Surely forecasts that have to be revised monthly are not worth doing. Given this history of failed forecasts, you would think that people would readily accept my answer that I do not know. But people cling to the apparent certainty that forecasts give them, even when forecasts are proven wrong again and again.

Qantas' announcement that it will axe up to 1750 jobs gives us a chance to look again at the problems with forecasting from a another angle. The job losses have been blamed on a fall in tourism and a collapse of business travel.

On the inbound tourism front, Tourism and Transport Forum executive director Olivia Wirth has said: "Forward indications from all markets except New Zealand show sharp declines — double-digit declines in movements — over the next six months."

This contrasts strongly with the official view of the Tourism Forecasting Committee, which revised its December 2008 figures on February 24 to forecast a slump of 4.1 per cent in inbound tourism for 2009. Who knows who will turn out to be right? But if we take a closer look at the forecasting record for the Tourism Forecasting Committee, we can see that there have been huge discrepancies between the forecasts and the actual results over the past few years.

The forecast in 2006 for the 2009 calendar year was for 6.617 million visitors, or 1.28 million more than is being forecast at the moment. That is roughly a difference of $4.3 billion in income for the industry.

The actual result in 2007 was 292,000 fewer visitors than had been forecast part way through 2006, with a similar discrepancy between the forecast for 2008 done in 2007 and the actual 2008 result.

Although this is only a 5 per cent discrepancy, these numbers are highly unlikely to rise or fall by 30 per cent, so it is a large discrepancy in the context of what is being forecast.

I am not saying that I could have done any better on these numbers than the forecasting committee. What I am concerned about is the seriousness with which the numbers are taken. The Tourism Research Australia website describes in very serious terms that the forecasts are based on "an iterative process" involving econometric models, senior researchers, senior economists, and industry experts.

In the press release with the October 2005 forecasts, TFC chairman Bernard Salt said: "The forecasts aimed to assist in investment and marketing decision-making for the sector and to assist in the formulation of public policy within the Australian tourism sector at both national and regional levels."

The reality is that these forecasts have not provided such assistance over the past few years. So we need to ask why we are spending money and resources producing them.

I am not picking on the TFC in particular. Examples abound of forecasting not working. You only have to look back over the oil price forecasts of the past five years to find a landscape littered with failed predictions and fallen media heroes who were lauded for their luck in getting it right once and then abandoned just as quickly when oil prices changed.

> **We must accept that forecasting does not work in complex situations.**

There is also research to back up why forecasting does not work. In his seminal research work on forecasting conducted over 15 years (Published as *Expert Political Judgement: How Good Is It? How Can We Know?*), Philip Tetlock shows that experts in all sorts of fields are only slightly better at forecasting than random results generated by computers or, in his more colourful description, only slightly better than monkeys throwing darts at a range of possible answers stuck on a wall.

Basic complexity science explains why this is so. The reality is that if there are a multitude of interacting factors in any system it is inherently impossible to tell what the outcome will be. That makes us very uncomfortable and so we use forecasts to make us feel better — a sort of economic placebo effect.

I would like to end on a note of caution. I am not saying that forecasting should not be used in some circumstances. It is particularly useful in slow-moving and non-complex areas such as age demographics, where we can look forward to see what the age patterns of countries and societies might look like so we can plan infrastructure and budget issues.

But we must accept that it does not work in complex situations and do two things. First, stop wasting money where it does not work; and second, find ways to deal with uncertainty rather than clinging forlornly to forecasting.

Religion may be the opium of the masses, but forecasting is not far behind.

Paul Higgins is a futurist with Emergent Futures (www.emergentfutures.com).

Super requires budget help not hindrance

Superannuation remains an investment in the future, writes **Pauline Vamos.**

Retirees may see the Government give with one hand and take away with the other. PICTURE: GREG NEWINGTON

We may see the Federal Government give to retirees with one hand and take away with the other when it comes to next month's budget.

The superannuation sector has very modest expectations of what might be delivered to fund members when the Treasurer hands down his second budget on May 12. Because of the global financial crisis, the Government just does not have the money to pay for any new big-ticket items in the superannuation area.

However, it is clear that an increase in the age pension is being considered, with possibly a larger increase for single age pensioners. An increase in the single age pension of between $30 and $35 a week has been canvassed by a number of commentators. With the flow through of this, either in whole or part, into the partnered rate for the age pension and into disability and carers' pensions, the additional cost to the Government might be around $3 billion a year. The cost would be more if the increase flowed through into other types of social security payments.

There have been suggestions of some tighter means testing for the age pension, with the possibility of a steeper taper rate — which means the pension phases out faster as you have more income or assets. This will have impact upon self-funded retirees, a group that is already under strain. If the taper rate was increased from the current 40 cents in the dollar from each additional dollar of private income to, say, 50 cents, then the Government might reduce expenditure by over $700 million a year.

Also rumoured is the tightening of means testing of superannuation income-stream products through reducing the amount allowed for return of capital in payments made to retirees.

If the income test were to be tightened in these various ways, then partially self-funded retirees would be facing a double whammy.

For instance, a person receiving a part age pension, together with an income of $10,000 (including a deductible amount of $2000) from an allocated pension could face losing $2000 in the age pension from the tighter provisions. This would exceed the possible $1500 per year increase in the age pension.

Given that the global crisis has already hit partially self-funded retirees through a reduction in their assets and income, a tightening of the means test would be another unwelcome consequence.

Some commentators are suggesting we could see the reinstatement of a maximum limit on draw downs from account-based pensions and annuities.

Currently, retirees can draw down all of the capital at once, tax free.

This is an unlikely budget measure, as reinstating the maximum limits will not gain the Government any tax revenue, will reduce flexibility for self-funded retirees and make them less likely to purchase income-stream products at retirement.

For those who are not yet fully retired and/or are under the qualifying age for the age pension, there is a possibility that the transition to retirement pension arrangements will be modified.

These arrangements were designed to assist those moving into retirement but, in some instances, have been used by individuals in full-time employment in order to reduce their income tax bill. Curtailing this potential for abuse of valuable tax benefits may well be on the Government's agenda.

We hope that there are no other changes or surprises. The superannuation industry invests in the whole economy on behalf of its fund members and it is particularly important at this time that there is certainty regarding the tax benefits provided.

There is more to superannuation policy than just short-term reaction to the global crisis. This was acknowledged by the Government, when it gave Australia's Future Tax System Review (the Henry Review) the task of looking at the adequacy of the retirement-income system and the appropriateness of the current tax arrangements.

The Henry Review is taking a long-term and strategic look at the retirement income system.

So what future changes could we expect?

The Association of Superannuation Funds of Australia has approached this process with a focus on Australia's long-term retirement income system, recognising that it will not mature until 2035. The association considers that a fundamental part of any review of the retirement incomes system should be the setting of a goal for the level of retirement income to be achieved.

The Henry Review affords the opportunity for such a long-term vision to be set, together with specification of implementation steps to be taken.

One obvious option for improving adequacy of retirement incomes is to have a higher contribution rate — perhaps through the compulsory superannuation system (the Superannuation Guarantee) but there also other possible approaches; 12 per cent seems to be the number most of the industry have recommended for the default contribution rate.

We need to further support this by encouraging people to work longer and save for retirement by increasing the tax-free access to benefits to age 65.

There also is a need to remove the tax inequity on superannuation contributions for lower-income earners. The association recommends that the Government should:

- Rebate (via the co-contributions system) the 15 per cent contributions tax on SG and any other pre-tax contributions for low-income earners.
- Expand co-contributions to middle-income earners — for example, lift the lower co-contribution limit from $30,342 to a higher income, such as $50,000 so that it phases out at $80,000.

Clearly, the 2009 budget will necessarily have to reflect current economic and financial realities but it must not be forgotten that money in super is invested in business and infrastructure that sustains jobs. We need to ensure that we continue to encourage Australians to save for their own retirement to alleviate the strain on the public purse by future generations.

Pauline Vamos is chief executive of the Association of Superannuation Funds of Australia.

ANZ turns down the volume to lend report more clarity

CEO says "underlying earnings" are a better measure for banks.

Does a profit by another name smell as sweet? ANZ chief executive Mike Smith may have found out yesterday, when he chose to break profit reporting ranks in two ways, by focusing on underlying earnings that eliminated a swathe of charges, and by comparing ANZ's March-half result primarily with the September half last year instead of the March-2008 half.

He says he's done so because ANZ investors are sick of the real story being obscured by noise. Banks are not seasonal businesses like retailers, he says, and it is their progress from half to half that shows where they are headed and at what pace.

The charges and windfall gains that are included in a bank's statutory profit also produce a snapshot that is so technical and ephemeral as to be basically useless, Smith says. His competitors tend to agree: they strip out about half the abnormals, including gains or losses on asset sales, tax adjustments and hedging gains and losses to arrive at what until now has been the accepted headline profit for banks, so-called "cash earnings".

> **ANZ had five capital markets dealers in Hong Kong in October 2007; it now has 90.**

Smith went further yesterday, removing another four categories, including provisions for possible losses on insured credit default swaps ANZ wrote during the boom on derivatives — including the unholy grail of the financial crisis, credit default obligations (CDOs) — as well as redundancy costs and a potential payout by its funds management joint venture with ING.

On that basis he announced that "underlying earnings" rose by 20 per cent to $1.91 billion compared with the September half, covering ANZ's 26 per cent lower, 46¢-a-share interim dividend payout bill of $993 million almost twice.

Backing out, his methodology produced less attractive numbers, however. Underlying earnings were only 4 per cent higher than in the March half of last year, and ANZ's $1.42 billion statutory profit, which takes on board all short-term variations, was 4.5 per cent above the September half, and 27.8 per cent below the March-2008 half.

Cash earnings were the least flattering of all: at $954 million, they were down 30 per cent against the September half, and down by 43 per cent compared with the March-2008 half, and did not cover the dividend. A day earlier, NAB had reported cash earnings of $2.03 billion that were 9.4 per cent down on the March half of last year, and 20.7 per cent higher than cash earnings in the September half.

The market reaction suggests that in ANZ's case, underlying earnings were ignored: ANZ shares fell about 5 per cent immediately after the early morning profit announcement, and as analyst comments on the result circulated, fell further, to finish $1.23, or 7.4 per cent, lower at $15.40. One of the threads in the analyst commentary was that ANZ was not provisioned well enough for what it and NAB both said would be rising loan defaults this year. ANZ's decision to take about $300 million off its general provision and trim total provisioning compared with September last year from 1.13 per cent of risk-weighted assets to 1.06 per cent was particularly unpopular.

The general provision movement seems unexceptional. It would have followed the reallocation of at least two ANZ exposures — Centro and Opes Prime — to specific provisioning during the half. But with NAB now provisioned at 1.38 per cent, ANZ is making an implicit call about the depth and duration of the recession — it predicts Australia's GDP will only dip 1 per cent this year, and climb by 1 per cent in 2010 — and about the quality of its book: so far, investors aren't convinced.

As for which profit is the best guide — they are all useful.

The best comparison is with the previous half, because it more accurately reveals the trend of the business, and avoids a form of double counting as loan loss provisions mount. Statutory earnings are the best guide to dividend paying capacity, cash earnings are the best guide to current year profitability, and underlying earnings are the best guide to future performance — unless once-off hits threaten the company's existence.

NAB's and ANZ's results featured leaps in trading income that can't be repeated endlessly, but the underlying numbers confirm that the big banks are expanding and solidly profitable.

ANZ's result also shows that Smith's drive into Asia is making progress. He said in mid-December 2007 that he would lift the Asia-Pacific region's share of group net profit from 7 per cent of group profit to 20 per cent by 2012, making it as large as ANZ's New Zealand franchise.

Underlying profit after tax from the Asia-Pacific region rose by 115 per cent in the March half compared with the September half, and at $414 million was within reach of the 24 per cent higher underlying post-tax profit of $494 million that ANZ's New Zealand banking franchise delivered.

About half the gain Asia posted came from trading, and carries the same caveat as bank trading income currently generally carries. And while the Asia-Pacific region contributed 15 per cent of group underlying earnings, its profit share is being boosted as Australia and New Zealand bear the brunt of loan loss provisions.

Some part of the Asian trading income gain and the vast majority of the customer-driven gain is flowing from Smith's Asian push, however. The bank had five capital markets dealers in Hong Kong when he took over in October 2007, and now has 90, for example.

He could vault ANZ's Asian position if he buys all or part of the RBS Asian network that is now on the block — ANZ is shortlisted alongside HSBC and Standard Chartered — but Smith insists he will not overpay for those assets, and has future organic expansion planned in any event, including the creation of 20 new branches in China by 2012 and the acquisition of an Indian banking licence, something Smith said yesterday was close to being approved.

A WEB OF OPINION EDITOR'S PICK

Austerity chic
As the recession has set in, the return to buying cheaper food has been ferocious. *Economist.com*
tinyurl.com/csmxsy

The neuroscience of illusion
Our brains don't see everything – the world is too big, too full of stimuli. So the brain takes shortcuts. Teller, of Penn and Teller, talks to **Jonah Lehrer**, *Wired.com*
tinyurl.com/d2s6by

How conflict is represented in the media
Organisations such as Reporting the World are working to ensure the news gets presented to consumers in a fair, balanced manner. **Jake Lynch** on *On Line Opinion*.
tinyurl.com/cv7f28

Are you addicted to the internet?
People are using the internet to escape their problems and then lying about their use to their friends and family. **Fred Lee** on *WiseBread.com*
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