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AUSTRALIA

PRIME MINISTER

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ECONOMIC STATEMENT

Throughout this year, the Government has had one clear goal in front of it. That goal is a sustainable economic recovery - a recovery which will lead Australia towards sustained economic growth, and increasing employment opportunities. A pre-requisite for achieving that goal is the control of inflation. The dominant goal of our whole economic strategy has been - and remains - directed to the control of inflation.

In this statement, I want to set the measures of the last two weeks in the context of that strategy. A realistic assessment of the impact of those measures must take into account the effects of policies already implemented during the last year. These policies have already achieved a slowdown in the rate of inflation and in the growth of wages and salaries.

The increases in each of the last three quarters in the Consumer Price Index were lower than any increase for two years, leaving aside the effects of Medibank. In the September Quarter, the increase was 2.2%, the lowest since the March Quarter 1973.

Components of the Index show very encouraging trends - other price indicators have also been encouraging. For example, the price index for materials used in house building rose by 0.5 percent, in October - the lowest increase since November 1972. Similarly, the price index of materials used in building other than housing increased by 0.4 percent in October - again the lowest increase since November 1972.

Figures published recently show that Australia's rate of inflation is now broadly in line with the OECD average. In fact, the Consumer Price Index expressed as a compound monthly rate of 0.7%, is actually marginally better than the 0.8% for the OECD countries as a whole during September. While other indicators are mixed, there are encouraging signs.

Among these the index of industrial production has firmed since July and in October was 9 percent above its low point in June 1975. Recent figures show that investment spending on new buildings and structures in manufacturing industry is expected to increase by some 31 percent in the half year to December. Some of the distortions inflicted on the economy during 1974/75 are beginning to be corrected. For example, business profitability has grown; the savings ratio has declimed and the shake-out in stocks appears to have run its course.

Despite this progress, we could not put off facing the problem posed by our loss of Reserves.

..2/

On coming to office, the government faced an exchange rate which was already susceptible to speculation and uncertainty. In the weeks immediately following the election in December 1975, several hundred million dollars of private capital flowed out of the country - mainly due to a widespread belief that the Australian exchange rate was over-valued.

In the three months to the end of November 1976, the decline escalated - our Reserves fell by over $700 million, if official borrowings by the government in this period are left to one side. The decline in Reserves continued despite the additional monetary measures of 7 November. The continued outflow of reserves stemmed from the fact that most observers in Australia and overseas believed that our currency was overvalued.

The week before last, the government's official advisers jointly presented two options to the government: overseas borrowing of around $1,000 million or immediate devaluation. The Government looked at these options with a number of facts in mind.

One central fact was the uncompetitive position of Australia's export and import-competing industries. In the last six years wages in Australia's manufacturing industry increased by 130% compared with 53% in the United States, and 70% in West Germany. The Industries Assistance Commission estimated that the general competitiveness of the Australian import competing sector fell some 17% between 1970/71 and 1975/76.

One drastic consequence of this and related factors is that employment in Australian manufacturing industry fell by almost 100,000 between May 1974 and the end of June 1976. There has been a growing tendency for some sections of manufacturing industry to move off-shore to minimise cost disadvantages. This export of jobs had to cease.

These facts were of deep concern to the Government. They could not be ignored. Further, uncertainty about the exchange rate was causing new projects involving overseas investment to be deferred.

There was continuing and growing belief overseas about the inevitability of an Australian exchange rate adjustment. Increasingly, the overwhelming view in international circles was that the Australian exchange rate was overvalued, and that sooner or later an adjustment would have to be made.

Throughout this year the Government has done everything possible to protect the exchange rate, as part of the fight against inflation. Ultimately the point was reached where the rate was no longer sustainable. By the time this decision was unavoidable we had been able to bring each of the other major arms of policy to focus in the fight against inflation. Policies in these areas must now be tightened further.

In all these circumstances the first option of borrowing around $1000 million, including funds from the IMF presented substantial risks. A borrowing of this magnitude would not have ended speculation against the downward movement of the dollar because people were looking as much at the underlying cost position than the balance of payments position.

..3/

To take just one example: as the chief international economist of Morgan Guaranty has said: "You simply lost competitiveness because of the amount of inflation". "This situation has been widely recognised over the last year".

Since Australia only began in the battle against inflation in December last year, further borrowings in the situation which had arisen would not have provided the change in attitudes the government was determined to achieve. Were that the case the strengthening economic recovery would have been threatened and the eventual devaluation or further borrowing could well have been greater.

In these circumstances it would have been nonsense for Australia to have gone to the I.M.F.
The government was not prepared to put Australia in that position.

Once we had made the inevitable decision to devalue there were a number of options open to us on the extent of devaluation and on the form of the new exchange rate system.
(1) We could have moved to a new fixed rate which would, at some future time - perhaps require a further significant alteration in the exchange rate. A move which, as the devaluation demonstrated, is attended by major public concern.
(2) We could have a market determined float which would make fluctuations possible on a daily basis, or (3) We could have an administered and controlled management of the exchange rate.
A further question requiring very careful consideration was the magnitude of the initial change in the rate which would be made.

The choice before us was to make a move which would decisively end further speculation against the downward movement of the dollar, or a move which would leave the way open for speculation about a further devaluation perhaps in the not too distant future.

The government took the view that it was essential to end definitively further speculation against the dollar, and to establish a regime which would in future permit the exchange rate to adjust smoothly to changing circumstances.

The decision to devalue by 17½% was made after full consultation with the government's advisers and on the basis of a technical evaluation of the magnitude required to achieve that result.
The magnitude of the devaluation indicates the seriousness of the cost disadvantages which had been weighing with increasing heaviness on Australian manufacturing industry.

It should awaken all Australians to the serious weakness in our economic situation which will require a concerted national effort to overcome.
It is important that there should be a much wider understanding than now exists, of the implications of adopting a managed regime

In taking this decision, the government has brought Australia more into line with the system adopted by other major trading countries.

It needs to be understood that most major countries have tended to adopt exchange arrangements that permit more flexibility in rates in response to changes in economic circumstances. The experience of a number of countries (including the United States, Germany, Japan and Canada) has clearly demonstrated the important role that a managed exchange

..4/

rate can play in the pursuit of domestic policy objectives. And in this context, it is interesting to note the comments of the I.M.F. in its 1976 Annual Report: "Faced with substantial uncertainty concerning future balance of payments developments and exchange rate patterns, and aware of the persistence of marked differences among national economies, in particular with respect to rates of inflation, interest rates and levels of economic activity, as well as of structural changes, the major industrial countries have continued to permit their currencies to float. Indeed, as underlying economic conditions have continued to differ among countries whose currencies are floating, frequent exchange rate variations have been a major form of balance of payment adjustments".

Some people have expressed surprise that under the new system of a managed exchange rate the first change in the rate should have occurred so soon. I regret to say that this indicates a lack of understanding of the nature of an administered exchange rate.

Suppose that we had adopted a fully floating exchange rate, under which it is not unusual for rates to fluctuate daily. If under such a float the rate had moved upwards on the first day would anyone have suggested that it should not have done so? Of course not. Under the regime we have adopted not infrequent changes are likely to occur in the ordinary course of events. That is delibarate. The regime is designed to avoid the large jumps that have occurred in the past. That is, indeed, the purpose of adopting a managed exchange rate.

The initial decision was taken in the context of the adoption of such a system. Critics of the two percent revaluation are tied to the past. They have not understood the nature of the change which has been made. For example, some critics have asked why all the criteria used by the bank in making decisions about the rate should not be made public.

Such a course would only advance the cause of the speculator. There is no responsible bank in the world which would give the precise grounds on which decisions about changes in the rate would be made, or for those on floating rates, about daily interventions in the market.

As understanding of the new system grows it will be fully accepted. Devaluation inevitably means that a number of other difficult decisions had to be taken.

It is a decision with some inflationary consequences which can only be countered by a tightening of policy in other areas. Devaluation makes it more necessary than ever that the anti-inflation strategy we have pursued throughout this year be persisted with.

In the light of the seriousness of the situation made clear by the devaluation, that strategy will be pursued with renewed intensity. The government has already announced a number of measures designed to counteract to the inflationary impact of devaluation.

On the fiscal side, a review of expenditures aimed at identifying scope for further savings through the deferment of expenditures has been put in hand, through the new Department of Finance. The Government is determined to hold government spending firmly in check. This is essential to reduce the pressure on monetary policy. Let me emphasise that responsible further relief in income tax is dependent on success in this area.

Further to this, in the preparation of forward estimates of expenditure for next year - now under way - Ministers have been asked to identify any increases in existing programmes so that these can be looked at separately in the same way as entirely new proposals.

Keeping a very tight grip on government spending continues one major line of the anti-inflation strategy we have been pursuing with success. It is an unpleasant reality that if we want to beat inflation and restore employment opportunities the pressure on national resources from high government spending and high deficits must be reduced.
There are widespread calls for further tax cuts, and the government in principle accepts this. But if these tax cuts are to be made responsibly, they must be matched by further restraint in government spending.

This year we have shown that we are prepared to take the tough decisions required in this area. We intend to demonstrate that determination again in the coming months.
On the monetary side, action has already been announced to help ensure that monetary conditions do not become accommodating to increased inflation, but at the same time providing adequate funds to underwrite economic recovery. Yields on Treasury notes were raised by 0.5% on 29 November. Subscriptions to the notes have been encouraging - non official holdings are presently at $1,400 million. About half of which is held by the non-bank public.
Subsequent action by the authorities has brought about an adjustment of similar magnitude in yields on short-dated bonds, with consequential adjustment - on a diminishing basis - of yields on other securities. The long term bond rate has been increased by 0.3% to 10.5%. The yield on savings bonds has been increased to 10%. Bank lending will be monitored so as to prevent any increase in inflationary pressures. Normal financing requirements of business will be met.

I should not need to emphasise that wages policy has assumed an even greater importance in the post-devaluation context. To allow the rate of increase in wage settlements to escalate as a result of devaluation would be to negate the beneficial effects which otherwise flow from devaluation for the competitive position of Australian industry and for employment.

The government will therefore be doing everything within its power to ensure that any identifiable effects of devaluation on the C.P.I. do not flow through into wages and salaries.

A number of major measures adopted during this year have been designed to protect potentially disadvantaged groups from the costs of inflation These measures include: the automatic adjustment of pensions for inflation; the family allowance scheme; and full personal income tax indexation. These measures which are of continuing benefit should provide an important support to wage and salary restraint.

There should be a recognition that the important fact to the wage and salary earner should not be gross income, but final real disposable income.

The wages area is one where- as both the Treasurer and I have emphasised throughout the year, the government cannot achieve success on its own. In this area particularly, it will take a commitment by all sections of the community to take up the fight against inflation and to restore employment opportunities.

It is somewhat ironic to recall that we were attacked earlier in the year for arguing as strongly as we did in our first submission to the Arbitration Commission. Even then, there were those who predicted that if the government based its policies on economic commonsense, the result would be confrontation with the unions. Unfortunately, too much credence has been given to the threats of extremist union leaders to create further conflict.

In this area there has been a capitulation to threats instead of recognising economic commonsense. Not enough weight has been given to the great commonsense of the vast majority of rank and file trade union members who know full well the importance of restraint at this time. I believe most are fed up as Australians with the disruptive tactics of a few.

This government will not allow an unreasonable burden in the fight against inflation to fall on any section of the community including wage and salary earners. The government has deliberately taken a number of major measures designed to encourage wage and salary restraint and to protect potentially disadvantages groups from the costs of inflation.

These measures include: the automatic adjustment of pensions for inflation, the family allowance scheme, and full personal income tax indexation. These measures, which are of continuing benefit should provide an important support to wage and salary restraint.

As well the government's submissions before the Arbitration Commission are designed to protect lower income earners. There should be a recognition that the important fact to the wage and salary earner should not be gross income, but final real disposable income. These measures provide a totally reasonable basis for wage and salary restraint.

It is in this total context that the government intends to argue more strongly before the Commission for recognition of the absolute importance of wage and salary restraint. Beyond that we will be taking every step within our power to secure restraint. The Treasurer will, for example, be discussing the impact of wage levels on the State Loan programmes with the Premiers at the Loan Council next week. Quite clearly, with wage restraint, the States can achieve more effective loan programmes.

This again is part of action to tighten the main lines of the strategy we have followed throughout this year. In addition to action on the Budgetary, Monetary and Wages front, action has also been taken on the prices front.

The Prices Justification Tribunal has been asked to pay special attention to price increases consequent on devaluation. This will not be limited to companies technically covered by the Act. The purpose is to ensure that devaluation is not used as an excuse for unjustified price increases.

The Government's legislation regarding the P.J.T. will in fact increase its surveillance capacity and its ability to investigate areas where there is evidence of price abuse. The P.J.T. will report progressively to the Minister, and at the end of three months, the Government will review its request.

In the external area, as a result of the devaluation of the Australian dollar, the Government has examined the Australian tariff. We have not made across the board cuts in tariffs but have acted selectively to reduce inflationary effects arising from the devaluation without negating the improved competitive position that devaluation has brought to Australian industry.

This improvement is greatly needed by Australian industry if jobs are to be created and industries are to be discouraged from going off-shore. Our decisions on tariffs have been the right decisions taken at the appropriate time.

An across the board tariff cut would have been foolish. Selectivity was necessary and it was therefore imperative to take advice. In this case, advice could not be sought until after the devaluation was announced. To have done otherwise would have been imprudent - to say the least - it would have extended the circle of people who knew about the devaluation beyond responsible bounds. Accordingly, the decisions on tariffs had to be taken after the devaluation.

We were fortunate to have before us, IAC recommendations and we acted on those recommendations. The government's decisions affect over 900 of the 2,750 items covered by tariffs, the value of the trade in these items being around $2,000 million.

The reason for the selectivity of the tariff reductions, for our refusal to engage in across the board cuts, is clear. Manufacturing industry has in recent years had its competitive position eroded by rising wage costs, a dollar which was until recently overvalued and the shocks imposed by the Labor Government's 25% across the board tariff cut.

What needs to be understood is that the competitive position of Australian industry had to be restored. Devaluation will achieve that. At the same time, we have sought to reduce the inflationary impact of the decision. Thus following devaluation, the government has acted with respect to each of the major arms of policy.

On monetary policy: adjustments to interest rates on Treasury notes, Australian Savings Bonds, and other government securities. On tariffs: a review of temporary assistance arrangements followed by measures announced to offset the inflationary impact in certain areas. On budgetary policy: a further review of government expenditure aimed at holding real expenditure levels. We will also maintain pressure on the wages front and we have acted to establish conditions in which restraint is possible. We intend to persist with our anti-inflationary strategy in full measure.

In the circumstances that Australia faces, it is disappointing to note that some people who should, by now, know better, continue to promote policies which only add to inflation. The vast majority of people realise that it is no longer possible to spend our way out of inflation and unemployment.

One consistent feature of all the alternatives offered by Labor Party leaders has been the willingness - some might say eagerness - to vastly increase public spending once more, or to pump up the size of the Federal Budget deficit. The Leader of the Opposition some weeks ago urged the Government to adopt measures which would increase the budget deficit by some $1 billion. The Premier of Tasmania followed up with an extravagant 24-point plan. The Premier of N.S.W. outshone both of them with proposals for almost $2 billion more in federal spending. Others have urged, and continue to urge, tax cuts and inflationary spending.

It would seem that these proposals are made in total disregard for their consequences. Each of these proposals, without exception, would be highly inflationary. The over-riding need of this country is to conquer inflation. What the Labor Party is proposing would create yet more inflation. Surely they understand that by now.

Throughout its period in office the Labor Party failed to develop a credible anti-inflationary policy. All its essays in economic policy

..8/

this year have been designed to give a further spur to inflation.

Let me explain in plain terms the effects of increasing the government's deficit in the present context. Every new expenditure means a higher deficit and this must be paid for in some way. Let me explain in plain terms how this can happen. It can be done by the Reserve Bank printing money which adds further to inflationary pressures. Secondly, it can be paid for through higher interest rates, which can lead to a credit squeeze on business, and a loss of job opportunities. Thirdly, it can be met by increased taxes, and noone is proposing that. All these alternatives are inflationary. The clear consequences of further increases in spending are unacceptable. When people propose policies of this kind, they must be prepared to follow through the full consequences of these policies. Unfortunately, this is too often not done. The government rejects these as desirable or viable alternatives. Higher government spending, larger deficits would do nothing whatever to correct the imbalances in the economy, such an approach would: further damage the private sector; increase further government's demands on the nation's resources; it would increase unemployment.

Those who propose to solve our problems through yet higher government expenditures are in fact - whether they know it or not - perpetrating a cruel deception.

Contrast the effects of devaluation. It does not add significantly to the deficit. It will reduce the burdens on thos sectors which have been hardest hit by inflation and which have not been protected by some form of indexed returns, which have not had guaranteed selling prices for their products. It will create conditions where more jobs can be created. It will reduce the reason for Australian companies to move off-shore. Overseas and domestic investment projects will start moving again.

The real possibilities of increased production for domestic industries constitute a substantial benefit from devaluation. Many manufacturing firms are able to expand their currently underutilised capacity.

At present their fixed costs - such as plant and equipment depreciation, capital costs, rent and salaries - represent a high proportion of total costs. In this situation, increases in demand and production can produce quite significant reductions in unit costs.

It is worth recalling the words of the 1975 Jackson Committee Report: "Australian manufacturing industry is in acute financial crisis. Unemployment is high. Factories are running below capacity.....Their profit record and prospects make it hard to raise equity".

The Jackson Report also mentioned the damage caused to manufacturing industry by recent adjustments in the exchange rate and the levels of protection. Our company tax measures have made a contribution to alleviating this situation, but beyond this, devaluation presents an opportunity for much needed relief in the problem areas identified by the Jackson Report. The alternatives to devaluation would have been massive subsidies or even higher tariffs.

Those who criticise the decision to devalue, fail to appreciate the continued thrust for more and more tariff protection which carries its own inflationary impact. In the last two weeks, there has been a remarkable unwillingness on the part of some commentators to assess the decisions objectively in their full ramifications.

..9/

One well known economic commentator writing on the devaluation of the Australian dollar has made the following points. He stated firstly: that "most spectators would have felt the devaluation would have been timed for some time next year. The government, by getting in early before speculative pressures built up, has avoided a haemorraging of Australia's international reserves through capital outflow". Again: "the extent of the devaluation will be sufficient to convince potential foreign investors in Australia that there is unlikely to be any further devaluations". Again: the devaluation "will give a breating space to some Australian industries now suffering from severe import competition". Again: "the economy is running below full capacity, so the extra stimulus to domestic demand and employment will hopefully take up some of the spare capacity....." And finally: "the devaluation will give a fillup to business confidence".

There could be no better description of the positive aspects of the 1976 devaluation. But these comments were made about the 1974 devaluation, which was undertaken in an inflationary context and followed by a number of inflationary measures. The same commentator condemned the 1976 decision neglecting his own earlier arguments - not to mention the complete different policy context within which the 1976 decision has been taken.

Many of the statements being made in recent days about the devaluation are quite out of touch with reality. Wild assertions about interest rates, the availability of credit and exchange rate confusion are not based on a considered assessment of what has actually been occurring.

The information available suggests the transformation to the new interest rate yield curve has been successful. The greater indications of support for the government treasury notes is encouraging.

A cautious observation of the stock market indicates strengthening since devaluation. The government welcomes renewed interest from overseas in portfolio investment. The changes made in the exchange rate have halted speculation against the dollar and the haemorraging of our reserves. The massive inflow of capital that some people have predicted has not occurred.

Much of the criticism failed to understand the changed nature of the regime. This week's adjustment reflects no more than the success of the initial move. Commodity markets have also shown continuing strength. The hysteria and humbug which certain people have tried to create in relation to the last two weeks is not supportable by the evidence to hand. The government condemns it.

The government believes that the movements will be seen as responsible and appropriate.

What a contrast has been provided by some more measured reactions overseas. In accordance with normal practice the executive board of the International Monetary Fund has considered Australia's decision to devalue. The board appreciated the factors behind the decision. All directors who spoke supported Australia's decision to devalue. In addition, the greater flexibility that would be permitted under the new exchange arrangements was welcomed. There was no suggestion that the devaluation could be regarded as a competitive devaluation.

Most international reaction to our measures has recognised the soundness of the decisions which have already been taken. The New York Morgan Guaranty's Chief International Economist described the 17.5% devaluation as a very correct amount and noted the wide recognition of Australia's international uncompetitiveness.

Milton Friedman has observed post-devaluation that "Australia is very well regarded international because now - and this is comparatively rare amongst Western nations at the moment - it appears to be pursuing a mature and steady course".

Our Ambassador to the U.S. has reported that our emphasis on the anti-inflationary objectives accompanying the devaluation is being applauded, and that the devaluation has been seen as removing a significant disincentive to investment in Australia.

In balancing the arms of economic policy, the government considered inflation as the number one priority but we have never contended that it was the only priority. Nor has it ever been argued to my knowledge that it ought to be the only priority.

In a number of decisions, such as the introduction of family allowances, full personal tax indexation, the investment allowance, and the allocation of monies to aboriginal and welfare programmes, the government has moved to help the sectors of the community hit hardest by inflation, and to encourage activity. If inflation had been the only priority then there would have bee no family allowances, no indexation, and no increases in money for social programmes.

There would have been no budget deficit and much more extensive cut backs in government programmes. If inflation were our sole objective we should have had a balanced budget. I do not recall the government being urged to bring down a balanced budget. The reason is obvious. The hardship in the other areas would have been too great.

The fight against inflation, although our dominant objective, cannot be conducted with an utter disregard for its effects on other areas of social policy. The fact that devaluation has taken place does not mean that combating inflation has lost its place as our first priority.

The fact that the government has been forced to take a decision which has some inflationary consequences can no more be adduced as evidence that the anti-inflationary strategy has been abandoned, than the fact that the government did not plan for a balanced budget.

The reverse is the truth.

The devaluation decision requires that we redouble our efforts to get on top of inflation - that there be no let up - that we press ahead with our announced strategy more strongly than ever before.

Let me review the year's major economic decisions. In February, $360 million worth of savings resulting from an expenditure review were announced. In January, decisions were taken to soak in the financial system. In May, a package of fiscal policy decisions was introduced - tax indexation, $2,600 savings to forward estimates, family allowances. In the Budget, spending was held and the deficit contained, monetary guidelines were laid down and strategy for recovery was firmly implemented.

Let me state the main elements of our strategy again. The most rigorous restraint on Government spending to rein in the bloated public sector and free resources to productive private enterprise, the provision of a wide range of incentives to industry to resume expansion and provide employment opportunities. We are seizing every opportunity to emphasise the importance of restraint in wage and salary demands; establishing, through a variety of measures a climate which will make wage and salary restraint possible. This is essential to keep costs down and create conditions in which employment opportunities can be expanded as rapidly as possible.

We always said that this strategy would take time - that it would be a full three year programme. It is the only strategy which is going to work.

Let me state the Government's attitude to inflation so there can be no possible misunderstanding. Inflation is the enemy Australia must defeat. It undermines security, destroys the value of savings and incomes, hinders the expansion of job opportunities, erodes our position in the world, and in the end eats away at the vitality of our institutions and our way of life.

Twelve months ago, Australia, we all know, was in economic disarray. When we came to office were were faced by the worst unemployment since the nineteen thirties, an actual decline in the gross domestic product, a depression in company profits, a decline in business investment to its lowest level in three years, a desperate situation in the farming sector and an inflation rate that was fourteen per cent - higher than it had been a year before and showing no substantive indications of declining.

In the past year, we have focussed the arms of policy on the problem of inflation and have achieved improvement in our position.

The fact that it was not possible to avoid devaluation shows the magnitude of the problems which still fact the Australian economy - and every one of us as Australians.

Some people appear to believe that devaluation was a soft option. Nothing could be further from the truth - it is the hardest option of all.

If we dno not take advantage of the opportunities that devaluation offers us, if we don't bring every weapon o fpolicy to bear on inflation then the future will be a grave one - we may not get another opportunity.

The present situation facing us all - demands a concerted national effort. All Australians, all sectors of the community, have an overrinding national interest in achieving a soundly based economic recovery.

We have made a beginning - and we must not squander our national opportunities and our national strengths.

The Government's measures have been the right ones - but the Government cannot do it alone. In the battle against inflation, we need the support of all Australians.

We need to find a national will and determination to overcome inflation. Too often our institutions seek to sharpen differences in the community - to pursue an adversary relationship with each other for temporary advantage rather than emphasising the common interests we all share.

This is a time when all our institutions, all Australians - businesses, trade unions, all in positions of leadership in the community - must seek to set aside narrow interests in favour of the overriding common interests we all share.

Devaluation should underline for every Australian the seriousness of the problem that confronts us. It also gives us an opportunity that we as a nation cannot afford to lose.

The fight against inflation is a fight we are going to win.

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