



# **AUSTRALIAN ECONOMY**

## **WHERE IS IT AND WHERE IS IT GOING?**

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## A surprising degree of ambivalence ...

- The Australian Economy seems to be doing well, against the subdued global economic background. The prospect of 3%+ growth this year and next, inflation under control, relatively low unemployment, 21 years of consecutive growth, etc.
- Still, the sentiment is surprisingly weak, as the terms of trade (ToT) boom has led to a two-speed economy. How worried should one be about the Australian economy? In the near term and over the medium term?

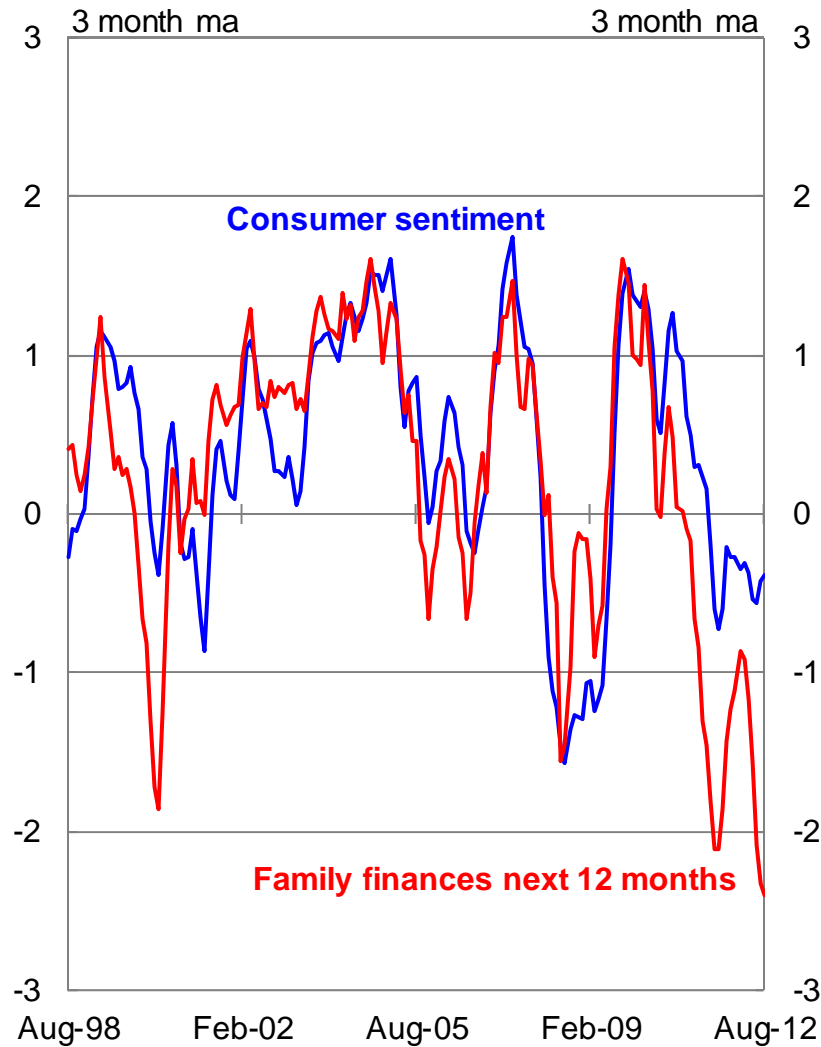
# Australia among the least pessimistic AEs

- Gallup Poll, 2011, “lives will be worse in five years”, in %

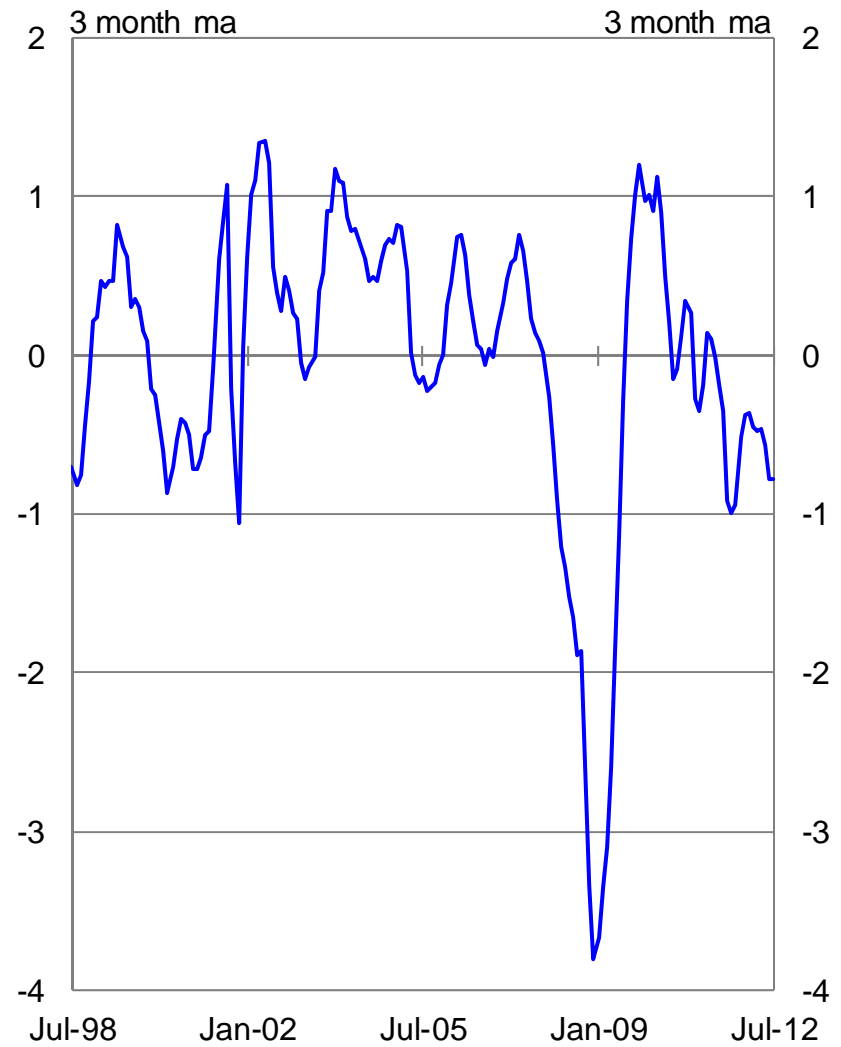
Greece	42	US	15
Portugal	32	Italy	14
Japan	30	Korea	13
Singapore	26	Canada	12
Taiwan POC	21	Netherlands	12
Spain	21	New Zealand	12
Germany	19	<b>Australia</b>	<b>12</b>
France	17	HK SAR	11
UK	15	Denmark	11
		Sweden	10

But getting increasingly more pessimistic  
in the recent past ...

**Consumer confidence**



**Business confidence**



- Allianz Future Optimism Index

**Future of the Economy: Optimism Index for all Australians**

Optimism Index	Nov 10	Jan 11	Mar 11	May 11	July 11	Sep 11	Nov 11	Jan 12	Mar 12	May 12
Future of the Economy	21	13	15	8	11	10	11	8	5	1

**Future of the Economy – Optimism Index by State of residence**




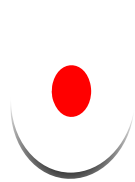



	Nov 10	Jan 11	Mar 11	May 11	July 11	Sep 11	Nov 11	Jan 12	Mar 12	May 12
NSW	23	17	14	6	14	6	10	8	6	2
Vic	18	15	22	9	18	10	11	3	5	2
Qld	16	8	6	4	3	7	10	4	1	-5
SA	23	1	17	13	10	14	7	4	9	-1
WA	31	16	16	20	10	27	15	27	15	4

# Is the growing pessimism warranted?

- It should be recognized that Australia has been doing remarkably well over the past years, especially among AEs, under a consistent and skillful management of economic policies. Excessive pessimism is not warranted in this regard.
- Over the medium term, however, Australia faces a challenge in positioning itself well in the rise of Asia. Here, Australia needs to make further efforts to benefit from Asia's dynamism.

# Where is the RoW going?

## WEO Real GDP Growth Projections *(percent change from a year earlier)*

	 World	 U.S.	 Euro Area	 Japan	 Brazil	 India	 China
<b>2012 (Jul 2012)</b>	<b>3.5</b>	<b>2.0</b>	<b>-0.3</b>	<b>2.4</b>	<b>2.5</b>	<b>6.1</b>	<b>8.0</b>
2012 (Apr 2012)	3.5	2.1	-0.3	2.0	3.0	6.9	8.2
2012 (Sep 2011)	4.0	1.8	1.1	2.3	3.6	7.5	9.0
<b>2013 (Jul 2012)</b>	<b>3.9</b>	<b>2.3</b>	<b>0.7</b>	<b>1.5</b>	<b>4.6</b>	<b>6.5</b>	<b>8.5</b>
2013 (Apr 2012)	4.1	2.4	0.9	1.7	4.1	7.3	8.8
2013 (Sep 2011)	4.5	2.5	1.5	2.0	4.2	8.1	9.5

Source: IMF, *World Economic Outlook*.

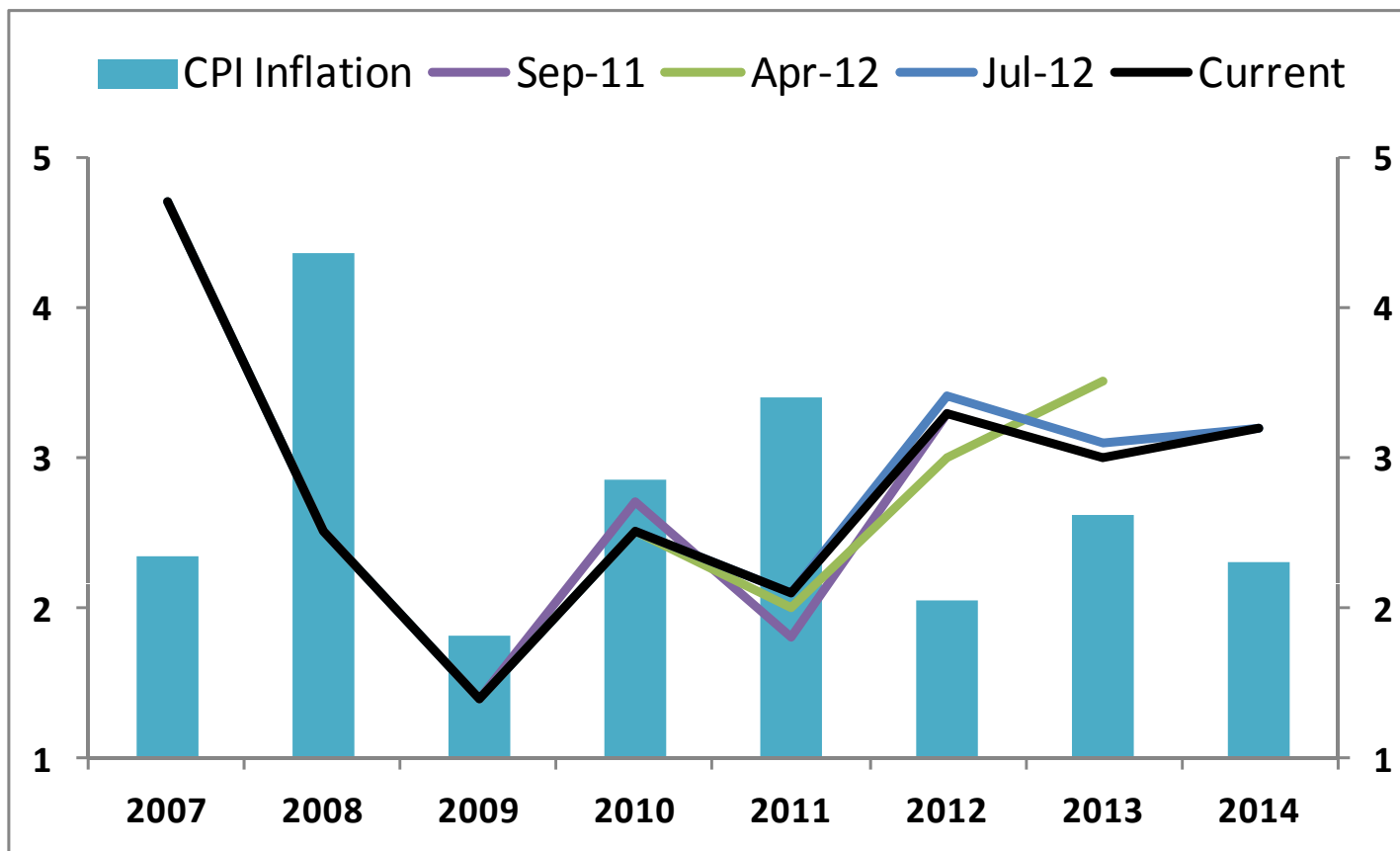
## Important assumptions behind projections

- Decreasing spreads in Europe through some progress on policies; capital flight from periphery to core to be prevented.
- US fiscal cliff to be averted, while ensuring medium-term sustainability.
- Major EMs' simultaneous slowdown notwithstanding, China expected to achieve soft-landing with policy support.
- Significant downside risks.



# Australian economy; our projections

- Growth and inflation

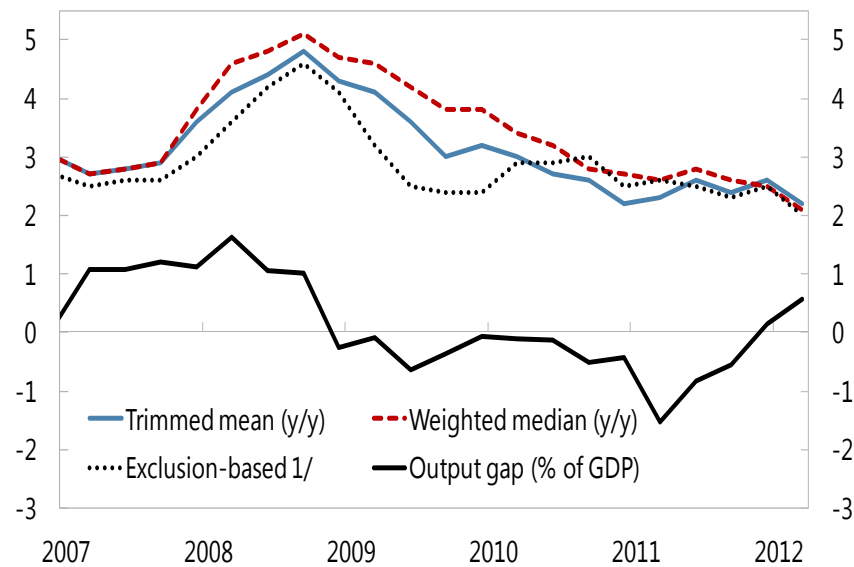


# Is the macro policy setting appropriate?

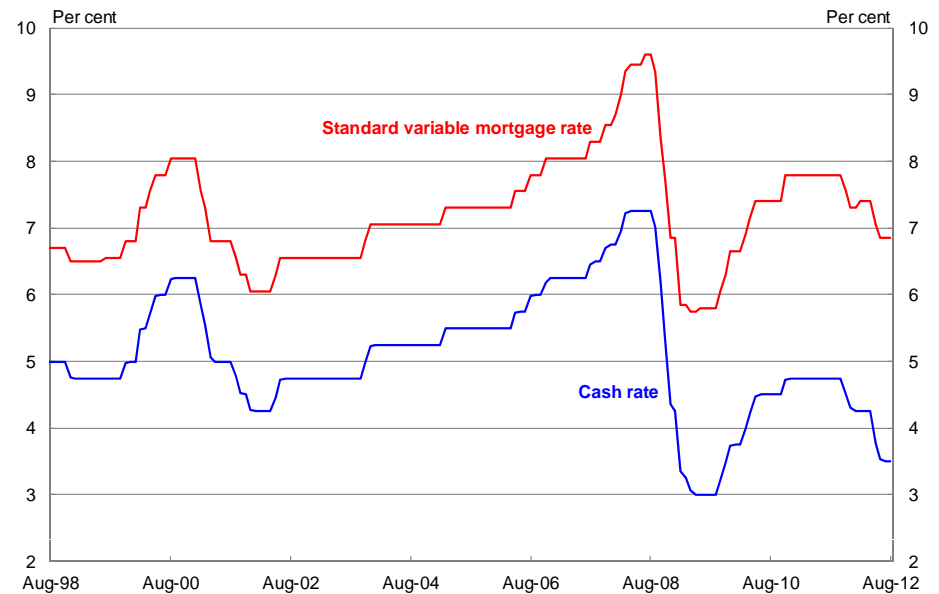
- With the output gap broadly closed and inflation moderate, macro policy as a whole should be neutral.
- But monetary policy has been easing.

## Underlying Inflation and Output Gap

(In percentage points)



## Interest rates



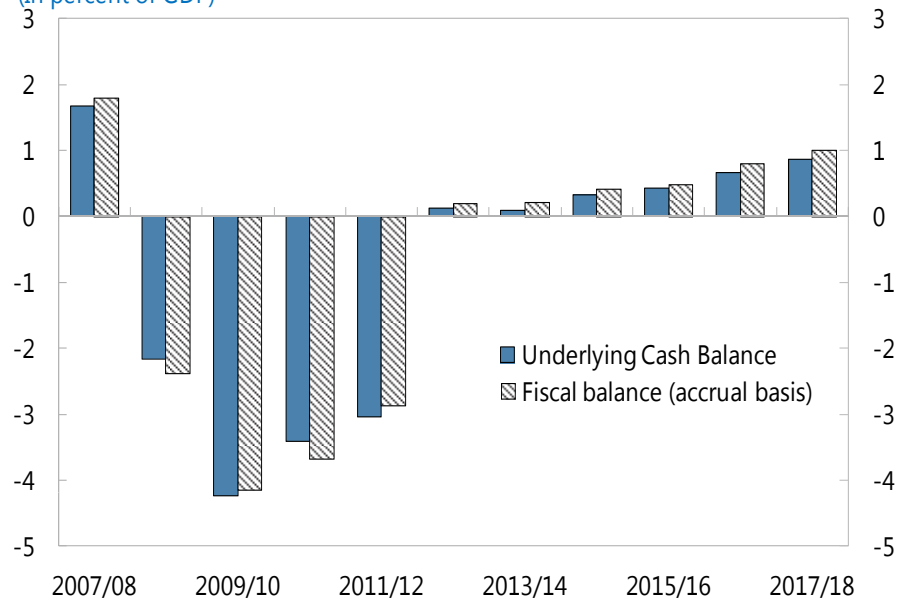
1/ Excludes fruit, vegetables, automotive fuel, and deposit & loan facilities.

Sources: Reserve Bank of Australia; IMF staff estimates.

- On the other hand, fiscal policy is expected to be tightened.

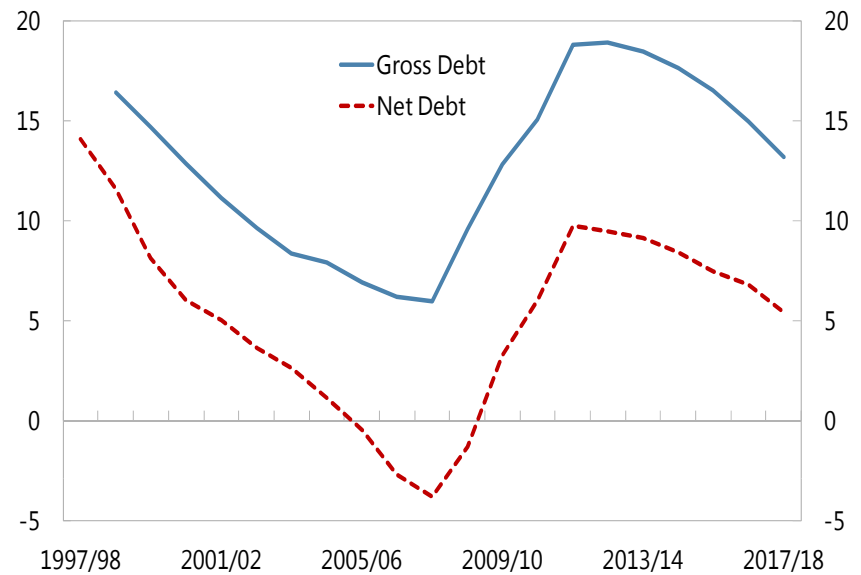
### Commonwealth Government

(In percent of GDP)



### Commonwealth Government - Debt

(In percent of GDP)



## The combination of easier MP and tighter FP makes sense since ...

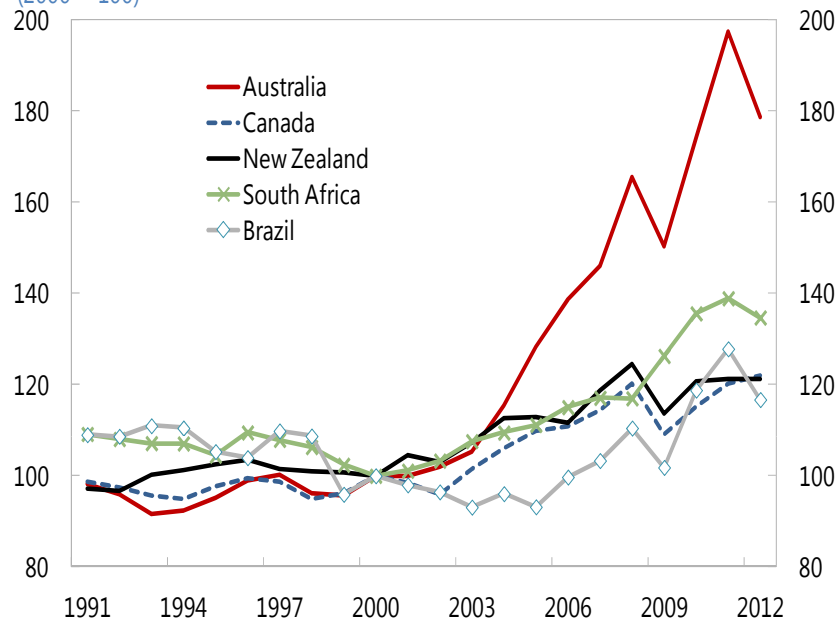
- ... together they lower domestic interest rates, reduce interest rate differentials with the RoW, and ease upward pressure on the exchange rate.
- The planned 3% of GDP fiscal adjustment is very large, especially at a time of high global uncertainty. Wouldn't there be a risk of breaking growth momentum?
- “Not for now” is our assessment for several reasons. But caution and flexibility are needed going forward.
- If a global risk materializes, ample policy space is available, both MP and FP.

# Implications of the Resource Boom

- Australia's ToT gains are exceptionally large, and are putting upward pressure on the exchange rate.

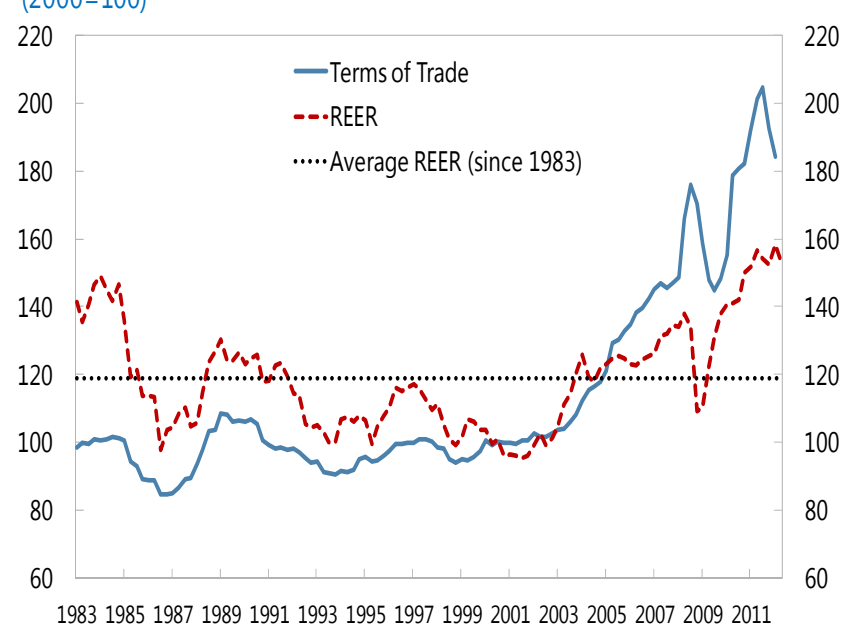
## Terms of Trade, Goods and Services

(2000 = 100)



## Australia: Real Effective Exchange Rate and Terms of Trade

(2000=100)

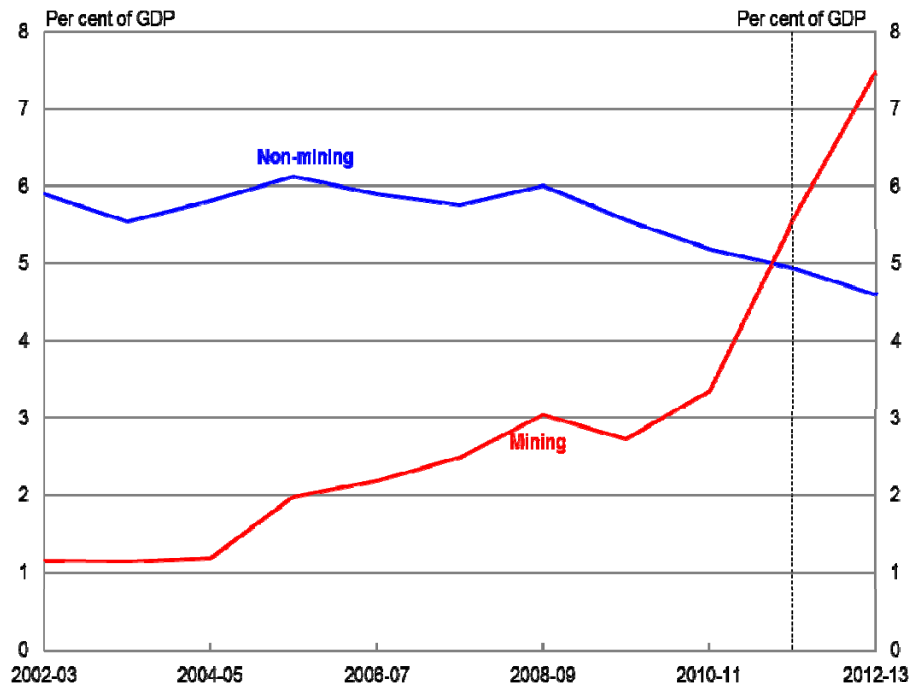


Sources: ABS; and IMF staff estimates.

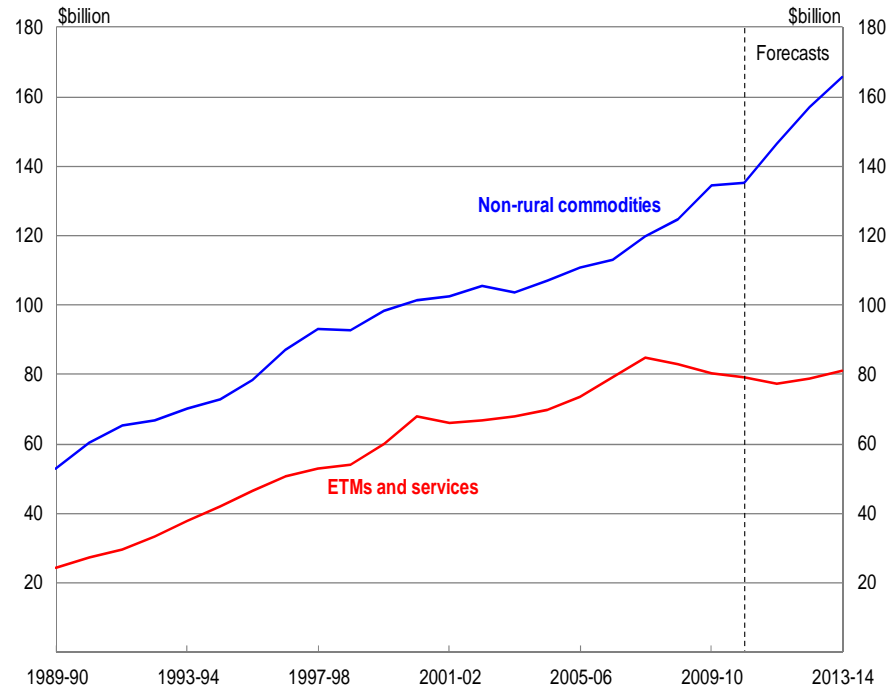
# A blessing or a misfortune?

- Unquestionably a blessing, but with a major side effect of creating a two-speed economy.

## Investment intentions



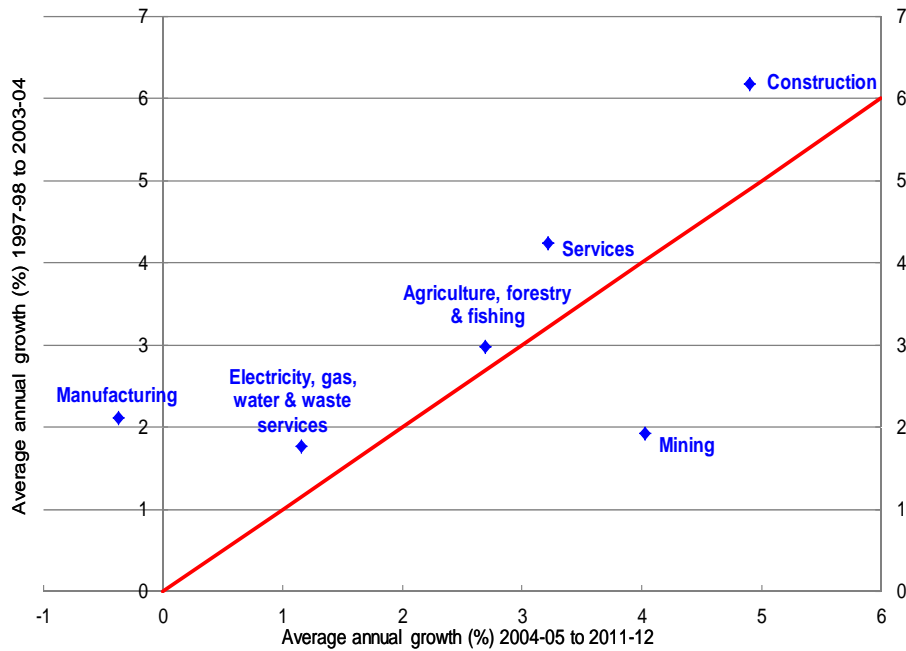
## Export volumes



# A potential vulnerability, too

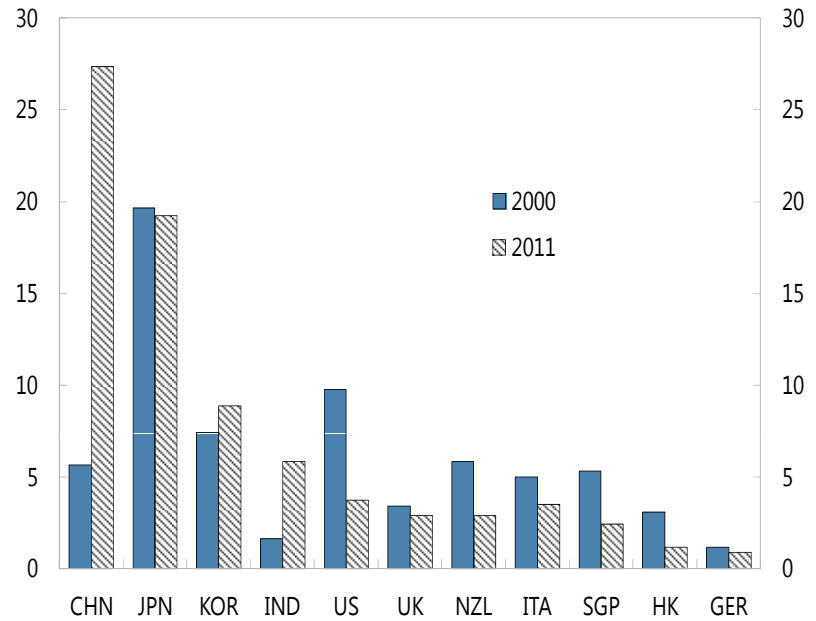
- Concentration of the source of growth ...

### Changes in output growth



### Exports by Destination

(In percent of total)



# Cyclical problems

- Asymmetric shocks hit the Australian economy, in both directions, due to; a) high volatility of commodity prices; and b) concentration of investment in time and space.
- The economy's flexibility is tested in absorbing these shocks. The floating exchange rate will continue to play its role in moderating aggregate shocks (with a recent caveat). But it cannot absorb shocks asymmetric to industries/regions.
- In light of this, labor market mobility/flexibility and the redistributive power of the commonwealth government may be important.



# Medium-term structural adjustment

- If mineral prices remain high on average, that will affect Australia's economic structure over the medium term. How best can Australia adjust? More broadly, how best can Australia position itself in Asia's century?
- General principles; Take advantage of gains from trade, which depend on "differences" of Australia from rising Asian countries. Differentiate your products from competitors and establish a positive brand image.
- Attention should be paid not only to Asia's strengths, but also to its weaknesses, because opportunities may be found in helping Asia overcome its challenges.



Thank you !