Country report

AUSTRALIA

Summary
The Australian economy has weathered the global financial and economic crisis relatively well and the deterioration in the public budget balance is easily accommodated by the low sovereign debt level. Meanwhile, Australia benefits greatly from the strong growth exhibited by the Asian economies as well as the surge in commodity prices.
Areas warranting caution include a strong (further) pickup in household indebtedness (already high in an international perspective) and/or failure to preserve the recent substantial narrowing of the current account deficit (given the heavy international indebtedness of its private sector). This links up intimately with the global commodity price outlook, which seems to have gained in importance as a driver of the Australian business cycle.

Things to watch:

- Household indebtedness and the household saving ratio
- The development of the external deficit
- International commodity price developments

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Australia

National facts		
Type of government	Parliamentary democracy	
Capital	Canberra	
Surface area (thousand sq km)	7,682	
Population (millions)	21.9	
Main languages	English (78.5%)	
	Chinese (2.5%)	
Main religions	Catholic (25.8%)	
	Anglican (18.7%)	
	Uniting Church (5.7%)	
Head of State (president)	Quentin Bryce	
Head of Government (prime-minister)	Julia Eileen Gillard	
Monetary unit	AUD	

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	1243	1.99
Nominal GDP at PPP	881	1.19
Export value of goods and services	263	1.41
IMF quotum (in mln SDR)	3236	1.49
Economic structure	*2010*	*5-year av.*
Real GDP growth	2.8	2.9
Agriculture (% of GDP)	4	4
Industry (% of GDP)	25	27
Services (% of GDP)	71	69
Standards of living	*USD*	*% world av.*
Nominal GDP per head	55991	569
Nominal GDP per head at PPP	39703	340
Real GDP per head	38113	476

Social and governance indicators	rank / total
Human Development Index (rank)	2 / 169
Ease of doing business (rank)	10 / 183
Economic freedom index (rank)	3 / 179
Corruption perceptions index (rank)	8 / 178
Press freedom index (rank)	18 / 178
Gini index (income distribution)	35.2
Population below $1.25 per day (PPP)	N/A

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
Japan	22	China	20
China	19	US	12
South Korea	8	Japan	9
India	7	Singapore	6
Main export products (%)			
Coal			20
Meat & meat products			4
Wheat			3
Main import products (%)			
Intermediate & other goods			45
Consumption goods			30
Capital goods			25
Openness of the economy			2010
Export value of G&S (% of GDP)			21
Import value of G&S (% of GDP)			20
Inward FDI (% of GDP)			2.7

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Australia has weathered the global financial crisis well with activity growth merely falling to 1.3% in 2009 and sharply rebounding to 2.8% in 2010 (1995-2008 average growth was 3½%). The flood in late 2010 and early 2011 will generate no more than a temporary dent in activity (led by mining and agriculture) but raises (rebuilding) activity for the year as a whole (total damage being estimated at AUD 14bn, or 1%-GDP).

Credit quality has remained strong with the number of business failures and private debt restructurings not greatly affected by the global crisis and Australian growth setback. Key to the solid 2009 performance has been the country's proximity to fast-growing Asia. The global upswing in commodity prices during 2010 has only added to this favourable development. Moreover, Australia has managed to translate a substantial part the contraction in its domestic final demand (- ½% in 2009, primarily though a sharp jump in household savings to 10% of disposable income from 0% before the crisis) into a sharp contraction in imports. Indeed, Australia's current account deficit, having averaged 4¾%-GDP in 2000-08, improved to 2½%-GDP in 2010. This has prevented a big drop in domestic production and has somewhat insulated the Australian **labour market** from the brunt of the crisis. Unemployment peaked at 5.8% in 2009 and has declined to 4.9% in March 2011 (compared to a pre-crisis low of 3.0% in February 2008, 5.5% on average during 2000-08). Employment growth has been strong (2.7% in 2010) and although it seems to be losing momentum presently (according to leading indicators), the labour market has by now returned to a tight position. Vacancies are already approaching pre-crisis levels. As a result, **consumers** are fairly confident about the future; about the general outlook and their job prospects. This has resulted in an increase in willingness to purchase big ticket items (hence: probably also a fall in their willingness to save). We have to point out though, that the willingness to purchase houses has not risen, whilst actual house building and home sales activity are still substantially down on the year. Note though, that the development has been no more adverse than during past downturns. Prices have in fact more than rebounded from the modest quarterly declines registered during 2008/09 and in 2010 they rose by 12.6% on the year. The **investment** outlook is starting to look a bit mixed. Fixed investment has benefited from the rapid pickup in domestic demand as well as from the ensuing surge in global commodity prices. However, capacity utilisation rates remain more or less equal to average historical levels whilst profitability indicators are weakening and export indicators suggest a softening of exports growth ahead.

Sound public finances

Australia has among the lowest government debt ratios of all the AAA-rated sovereigns and this is expected to remain so in the foreseeable future. The country entered the global financial crisis with a low gross debt ratio (15%-GDP in2007) and in fact a negative net debt position (i.e. it was a creditor in net terms). Despite the substantial worsening of public finances due to the impact of the crisis on the Australian economy (the government budget recorded a 4½%-GDP deficit in 2009-10 in contrast with an average 2.2% of GDP surplus from 1995 to 2008), net sovereign debt is expected to peak at around 10% of GDP in 2012 according to Moody's. The government's own analysis reveals an ageing related funding gap over the next decades. While this concern and the political willingness to address it is commendable, the Australian ageing 'problem' needs to be seen in the proper perspective. Compared to the OECD average, Australia's old-age dependency ratio is expected to rise to only moderate levels. Its effective mail retirement age (64.8 years, whilst the official retirement age will be gradually raised to 67 from 65) is also below-average (63.9 unweighted OECD average). The same goes for its income replacement rate, two thirds of which is covered for by mandatory private pension schemes. Last but not least, the country boasts an aggregate (private and public) amount of about 90%-GDP worth of pension reserves. Pension concerns should therefore not deflect from the real challenge, which is to reduce the country's reliance on external funding.

Structural challenges

The success of the Australian economic growth model (importance of mining industry with energy-hungry Asia as the main export market) probably comes at the cost of increased volatility (riding the commodity price cycles, thereby facing large shocks when commodity prices drop substantially). Fortunately, the Australian economy is used to volatility, with history showing large swings in the housing market without disrupting the financial sector or the wider economy. Also, macroeconomic policy space to manoeuvre is available (see below). Nevertheless, the growing rate of indebtedness of households (150% of disposable income in 2009, comparable to New Zealand and the UK, for instance) may make the country more vulnerable to adverse shocks going forward. On the public sector side, larger budget surpluses during booms are desirable to compensate for government revenue shortfalls during the busts, but these surpluses may be hard to preserve from a political perspective.

But the major, and deeper-rooted challenge for the Australian economy lies in its structural net international debtor position, breaching 50%-GDP in 2009, surpassed among the OECD family only by the likes of Portugal, New Zealand, Spain and Greece. Granted, the gross debt position is relatively low by international standards and substantially lower than in most small open economies such as the Netherlands, Belgium and Switzerland. But almost half of it is short-term and two thirds of it is held by financial institutions. And that casts a different light on the country's strong fiscal position, namely that Australia needs a strong sovereign to be credibly able to counter the risks posed by the debt accumulated by the private sector. The planned introduction of a mineral resource rent tax (MRRT) in 2012 is a useful start to really address this fragility (increasing public savings during commodity price booms and decreasing them during busts), but, for instance, a widening of the consumption tax base or a hike in the goods and services tax rate (to conserve on imports) do not sit well with the Australian electorate as they are seen as regressive.

Ample policy space available

With its ultra low sovereign debt burden, there is ample fiscal space in Australia. And with monetary policy rates raised to 4.75% in November 2010 (up from a 3% trough in 2009) there is also substantial room to slash rates by a meaningful amount should the need arise. Looking ahead along our baseline scenario, and observing that spread levels on corporate and housing loans remain elevated relative to the pre-crisis situation, substantial further hiking (towards the 7% pre-crisis level for the policy rate) seems unnecessary.

Australia

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	2.6	4.6	2.6	1.3	2.7	2.4	3.2
Consumer prices (average % change pa)	3.5	2.3	4.4	1.8	2.8	3.2	2.9
Current account balance (% of GDP)	-5.3	-6.1	-4.6	-4.4	-2.8	-2.5	-2.8
Economic growth							
GDP (% real change pa)	2.6	4.6	2.6	1.3	2.7	2.4	3.2
Gross fixed investment (% real change pa), Cal Adj	4.5	10.1	7.9	-3.2	5.4	5.4	6.3
Private consumption (real % change pa), Cal Adj	3.4	5.4	1.9	1.0	2.7	2.3	3.6
Government consumption (% real change pa), Cal Ad	3.5	3.3	3.2	1.6	3.5	2.4	1.1
Exports of G&S (% real change pa), Cal Adj	2.3	2.5	4.7	2.8	5.3	3.9	4.9
Imports of G&S (% real change pa), Cal Adj	7.0	12.2	11.5	-9.0	13.2	6.8	7.9
Economic policy							
Budget balance (% of GDP)	1.5	1.7	0.4	-4.1	-3.4	-2.3	-0.6
Public debt (% of GDP)	15	15	17	22	27	28	27
Money market interest rate (%)	5.8	6.4	6.7	3.3	4.3	4.8	5.2
M2 growth (% change pa)	15	30	14	0	3	11	13
Consumer prices (average % change pa)	3.5	2.3	4.4	1.8	2.8	3.2	2.9
Exchange rate LCU to USD (average)	1.3	1.2	1.2	1.3	1.1	1.0	1.1
Recorded unemployment (%)	4.8	4.4	4.3	5.6	5.2	5.2	5.1
Balance of payments (mln USD)							
Current account balance	-41504	-58032	-47786	-43100	-34500	-34200	-39100
Trade balance	-9595	-17783	-4915	-4900	11600	16600	9800
Export value of goods	124914	142421	189058	154800	210800	239800	245900
Import value of goods	134510	160210	193970	159700	199200	223200	236200
Services balance	868	587	-3098	-200	1400	700	-2400
Income balance	-32384	-40547	-39400	-37700	-47000	-51000	-46000
Transfer balance	-393	-288	-373	-300	-400	-500	-500
Net direct investment flows	2481	21110	9170	-3364	8344	9990	8940
Net portfolio investment flows	-21478	-83450	-4968	52000	0	-1000	-9000
External position (mln USD)							
Total foreign exchange reserves	53448	24769	30691	38950	38659	41200	44300
International investment position	-478283	-574602	-499134	-693830	N/A	N/A	N/A
Total assets	660497	883738	702956	1046680	N/A	N/A	N/A
Total liabilities	1138780	1458340	1202090	1740510	N/A	N/A	N/A
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-1.2	-1.9	-0.5	-0.5	0.9	1.2	0.7
Current account balance (% of GDP)	-5.3	-6.1	-4.6	-4.4	-2.8	-2.5	-2.8
Inward FDI (% of GDP)	3.4	4.3	4.5	2.6	2.7	2.9	3.6
International investment position (% of GDP)	-61.0	-60.4	-48.0	-71.3	N/A	N/A	N/A

Source: EIU