August 2009
IMF Country Report No. 09/248

Australia: 2009 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion;

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Australia, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 23, 2009, with the officials of Australia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 22, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 5, 2009 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

AUSTRALIA

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Australia
(In consultation with other departments)

Approved by Mahmood Pradhan and Tamim Bayoumi

July 22, 2009

- **Discussions:** Canberra, Melbourne, and Sydney, June 12–23, 2009, with Treasurer Wayne Swan, Reserve Bank of Australia Governor Glenn Stevens, other senior officials, and representatives from labor unions, financial, and business sectors.

- **Team:** Mr. Brooks (head), Mr. Hunt, Ms. Edison, Ms. Tumbarello (all APD), and Mr. Takats (MCM). Mr. Pradhan (APD) joined the mission from June 19–23, and Mr. Legg (OED) participated in the discussions.

- **Focus of mission:** Policies to cushion the domestic impact of the global recession, preserve macroeconomic and financial stability, and reduce external vulnerability.

- **Selected Issues papers analyze** the impact of the fiscal stimulus on GDP; and bank, corporate, and household sector vulnerabilities.

- **Past surveillance:** For policy issues discussed in the 2008 Article IV consultation, see: http://www.imf.org/external/np/sec/pn/2008/pn08123.htm.

- **Exchange rate:** Australia maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions other than restrictions notified to the Fund in accordance with Decision No. 144-(52/51). The de facto exchange rate arrangement is free floating.

- **Official development assistance:** 0.33 percent of national income in 2008/09.

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EXECUTIVE SUMMARY

Following a prolonged expansion, reflecting sound macroeconomic policies and favorable terms of trade, global events have slowed Australia's economic growth well below trend. Declining commodity prices, tightening credit conditions in global capital markets, and slowing world growth have reduced activity. However, the downturn has been milder than in most other advanced countries. This is because of strong commodity exports, a flexible exchange rate, a healthy banking sector, and a timely and significant policy response.

The near-term outlook for growth is weak and highly uncertain. Aggressive policy action is expected to limit the decline in real activity to ½ percent in 2009, despite lower commodity income and rising unemployment. Growth is projected to pick up to about 1½ percent in 2010, led by government spending. Uncertainty about the strength and timing of the recovery in Australia's trading partners poses the main risk in the outlook.

The easing of monetary policy since late 2008 was appropriate, as is the current stance of monetary policy. The substantial stimulus in train, and signs of recovery in consumer and business confidence, should help support domestic demand. However, staff and the authorities agreed that if the outlook for growth and inflation weakens, there is scope to cut the policy rate further.

The sizable fiscal stimulus underway will continue to boost activity. In addition to the stimulus measures, the weaker outlook for growth and commodity prices is projected to shift the underlying cash balance into a deficit of almost 5 percent of GDP in 2009/10. Staff and authorities agreed that, given the low level of public debt, there is scope for further fiscal stimulus, if the outlook for growth weakens. However, staff advised that monetary policy should be the first line of defense, as it remains effective.

Staff welcomed the authorities' objective to return to budget surpluses over the medium-term. The authorities agreed that if trend growth or the terms of trade are not as high as assumed in the budget, further restraint on spending would be needed to return to surpluses over a horizon consistent with the authorities' objective.

Australia's banks have coped well with the turmoil so far, largely because of robust supervision and regulation. Banks remained profitable and raised private equity capital in early 2009, but were exposed to significant risks from sizable short-term wholesale funding. The introduction of the wholesale funding and retail deposit guarantees and RBA actions to provide sufficient liquidity helped maintain financial sector stability.

Staff commended the authorities' plan to undertake further stress tests for banks, and advised the use of more extreme stress scenarios than in the 2006 FSAP. Staff's preliminary analysis suggests that potential losses from a sizable downside shock would not reduce the capital of large banks below the regulatory minimum. Staff also welcomed the authorities' ongoing work on crisis preparedness that will help strengthen financial stability.

I. Introduction

1. **Australia was in a strong economic position at the onset of the global recession.** Sound macroeconomic policies and structural reforms, together with a stable external environment, delivered 17 years of continuous economic growth. National income was boosted in recent years by a commodity price boom, which pushed the terms of trade to its highest level in more than half a century. The expansion reduced unemployment to historical lows, but put pressure on prices as productive capacity became stretched. The Commonwealth government had eliminated its net debt, and corporate and bank leverage were relatively low.

2. **The turmoil sparked by the collapse of Lehman Brothers in September 2008 had an immediate impact on Australian markets.** Key commodity prices fell sharply, domestic money markets came under stress, and offshore funding tightened. As a result, the currency depreciated and equity prices plunged.

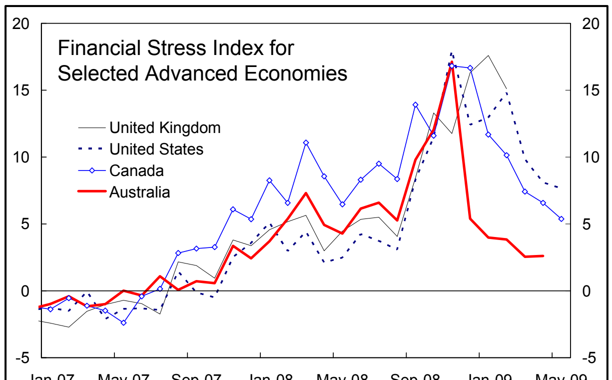
3. **However, the crisis has not hit real activity in Australia as hard as in many other advanced economies.** In part, this reflects limited higher-tech manufacturing and robust commodity exports to China.

4. **Economic activity was also shielded by the authorities' timely and significant policy response.** Monetary policy remains effective, as large cuts in the policy rate passed through to lending rates, while the sound banking system helped avoid a sharp contraction of credit. The flexible exchange rate has provided a buffer for export incomes. In addition, a sizable fiscal stimulus is being delivered, supporting domestic demand.

5. **Nonetheless, the crisis highlighted some vulnerabilities and the near-term outlook remains highly uncertain.** Both household debt (at over 150 percent of disposable income in 2008) and short-term external borrowing (at over 50 percent of GDP in 2008) are high by advanced country standards. Unemployment has increased, but less so than in many other advanced countries.

II. The Impact of the Global Crisis

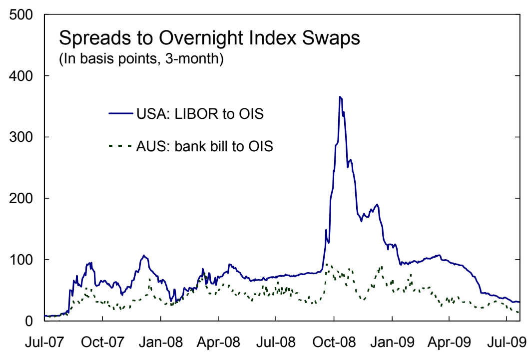
6. **The global financial crisis increased spreads and volatility in Australian financial markets.** Short-term money market spreads and Credit Default Swap (CDS) spreads for banks and corporates widened significantly in late 2008, but have since recovered some lost ground (Figure 1). A financial stress index, which summarizes market volatility, spiked in late 2008, but has since eased back below levels in Canada, the United Kingdom, and the United States. Equities and the currency fell sharply, as did business and consumer confidence.



Source: World Economic Outlook.

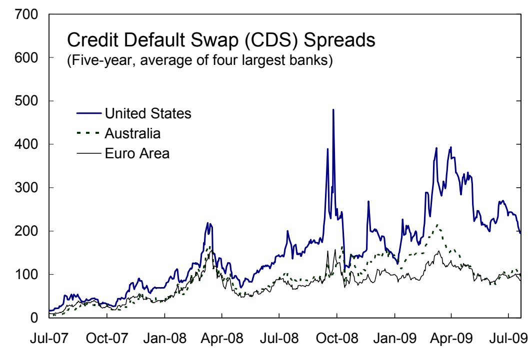
Figure 1. Australia: Impact of the Global Crisis on Domestic Financial Markets

Money market strains have been less than in the U.S….



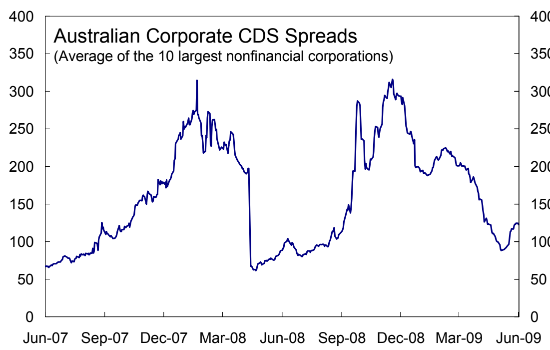
Sources: Reserve Bank of Australia;

…bank CDS spreads widened in early 2009, but have since eased.



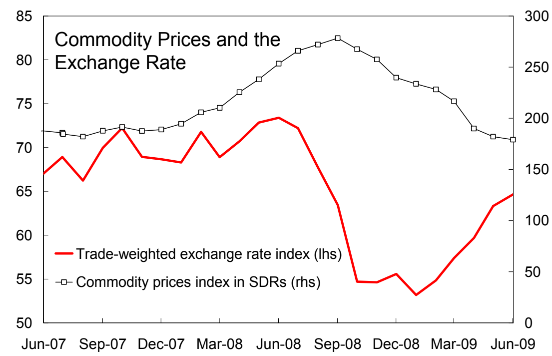
Sources: Reserve Bank of Australia; Bloomberg.

Corporate CDS spreads followed a similar path…



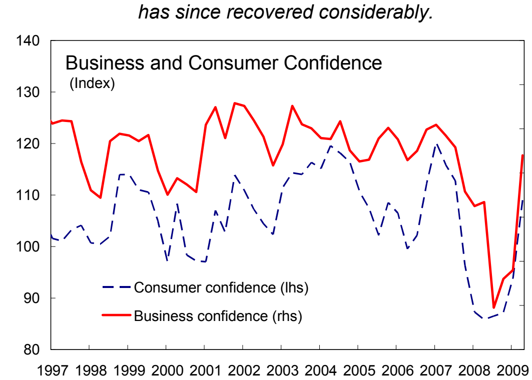
Source: Bloomberg.

…the exchange rate depreciated as commodity prices declined.



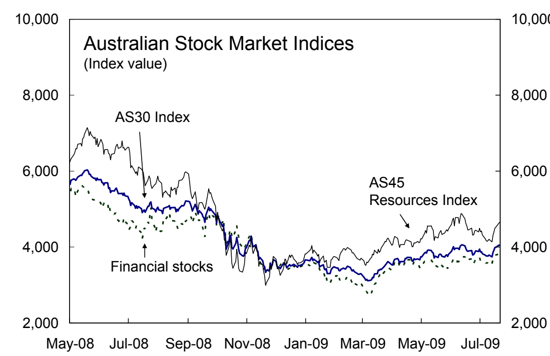
Source: Reserve Bank of Australia.

Confidence fell sharply in late 2008 but has since recovered considerably.



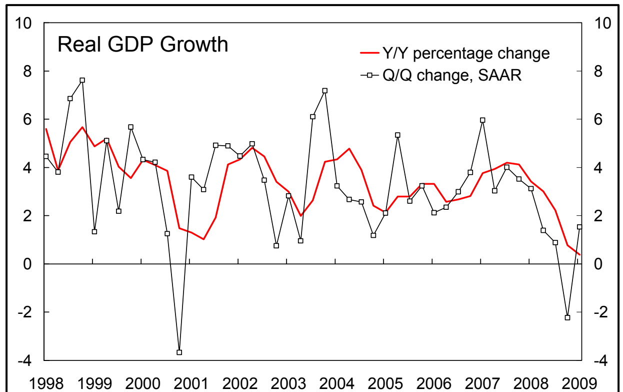
Sources: Westpac-Melbourne Institute; National Bank of Australia.

The stock market also fell sharply in 2008.



Sources: Reserve Bank of Australia; Bloomberg.

7. **Economic growth has slowed as a result of the crisis.** Real GDP growth eased to 2.3 percent in 2008 and 1½ percent in 2009 Q1 (saar), well below trend (text figure, Figure 2, Table 1). Negative wealth effects from falling equity and house prices, compounded by tumbling consumer and business confidence, led to a contraction in domestic demand. Business investment fell by 23 percent in 2009 Q1 (saar). However, net exports increased as imports declined and export volume growth remained positive in 2009 Q1 because of strong commodity shipments, especially to China. On the production side, manufacturing value added fell sharply, as in many advanced countries, but with manufacturing comprising less than one-tenth of total output, the hit to overall GDP growth was less than elsewhere. Recently, consumer and business confidence measures showed signs of a recovery, but investment intentions remain weak.



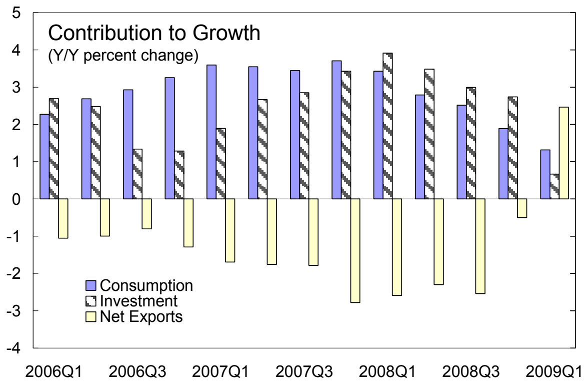
Source: Australian Bureau of Statistics.

8. **Capacity pressures have abated and inflation has moderated quickly, to within the policy target band.** After increasing steadily since 2000, capacity utilization declined sharply over the last year, and the unemployment rate rose by almost 2 percentage points from its trough in early 2008 (Figure 3). Prices have responded quickly, with headline, nontradables, and tradables inflation decelerating markedly. Moreover, upward pressure on tradables prices from currency depreciation was more than offset by lower energy prices and growing spare capacity. Headline CPI inflation, at 1½ percent year-on-year in the June quarter, is now below the Reserve Bank of Australia's (RBA) target band of 2–3 percent inflation, on average, over the cycle. Inflation expectations reacted swiftly to the sharp turnaround and wage demands showed signs of moderating.

9. **The RBA cut its policy rate sharply as the outlook weakened.** Since September 2008, the RBA reduced the policy rate by 425 basis points to 3 percent. Most of this fall has been reflected in floating mortgage interest rates, which apply to the bulk of Australian mortgages (Figure 4). Business lending rates have also fallen markedly, but by about 150 basis points less than the cash rate.

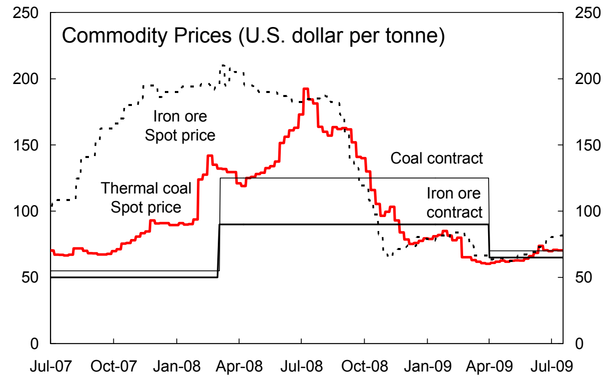
Figure 2. Australia: Impact of the Global Crisis on the Real Sector

Growth slowed in late 2008 as the global crisis hit…



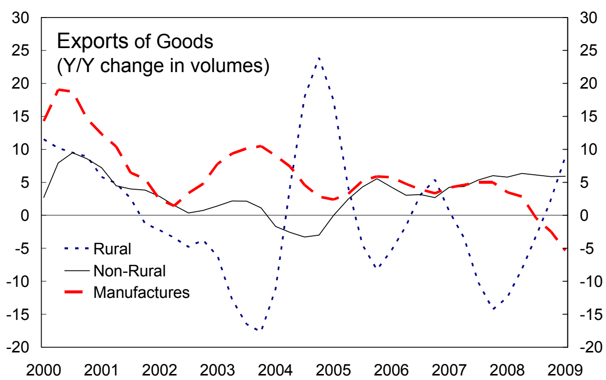
Source: Australian Bureau of Statistics.

…spot prices for two key commodity exports fell sharply in late 2008, and contract prices have reset at lower levels…



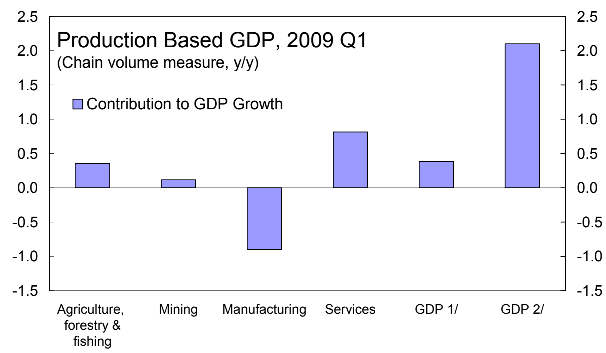
Sources: RBA; Bloomberg; and IMF staff estimates.

…but commodity export volumes continued to grow.



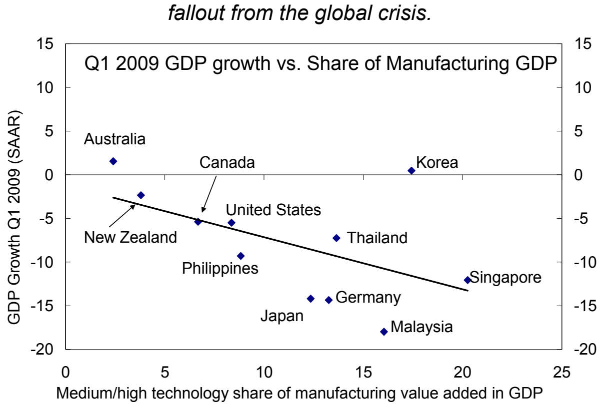
Source: Australian Bureau of Statistics.

Manufacturing fell sharply in 2009 Q1, but other sectors continued to grow…



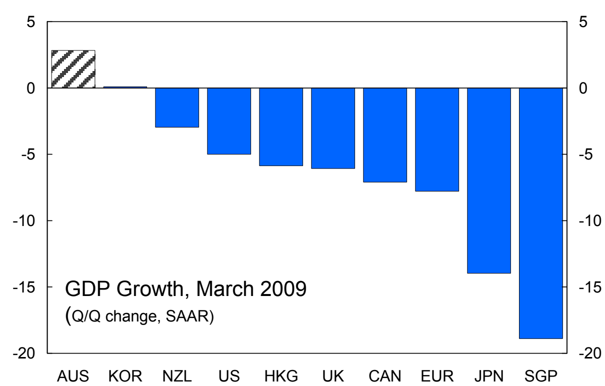
Source: Australian Bureau of Statistics.
1/ Production based GDP year-on-year growth.
2/ Average of production, income, and expenditure, year-on-year growth.

A relatively low share of manufacturing in GDP, has limited the fallout from the global crisis.



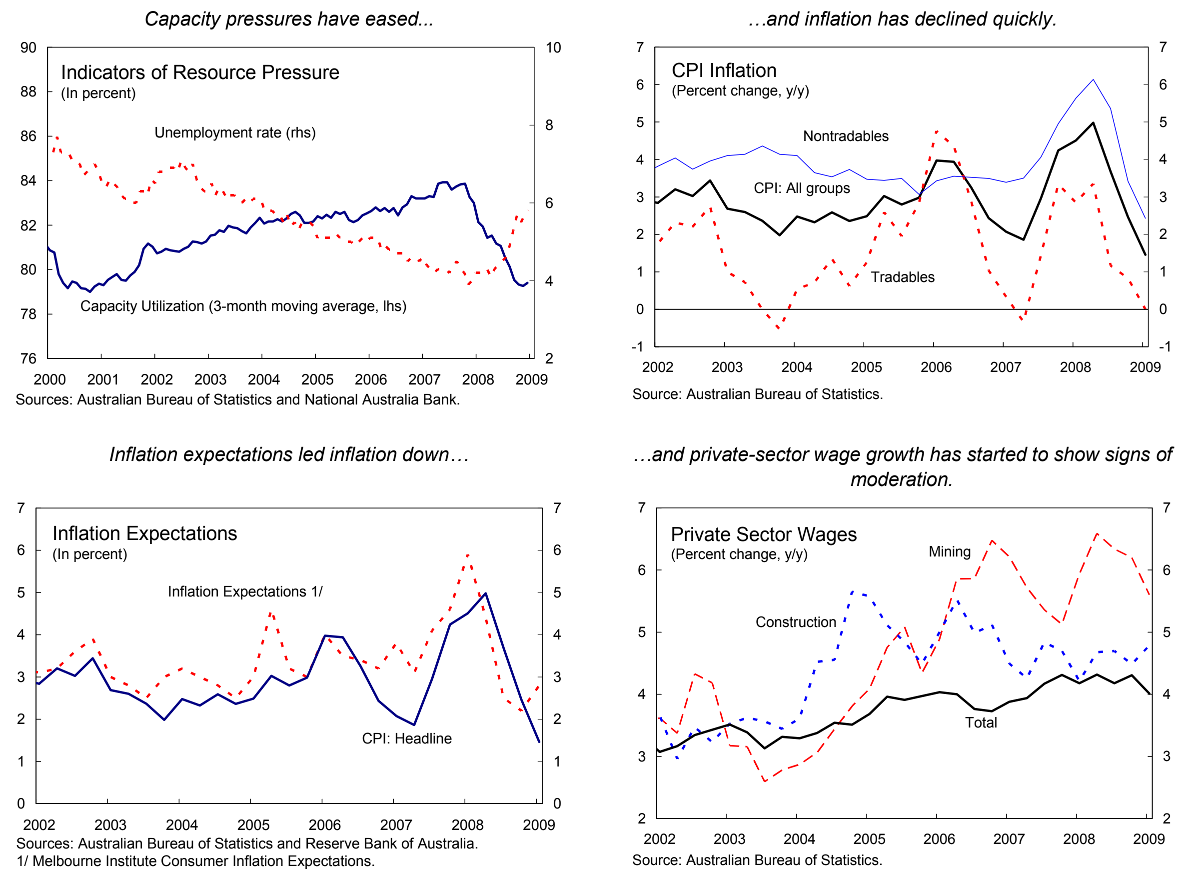
Source: UNIDO database.

Growth was positive in 2009 Q1 unlike most other advanced economies.

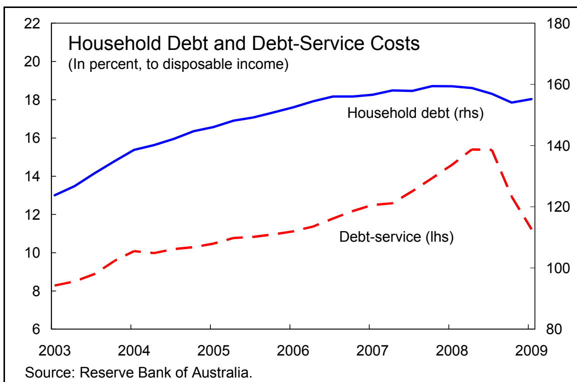


Sources: WEO; and Fund staff calculations.

Figure 3. Australia: Inflationary Pressures Dissipate



10. **Credit growth has slowed in recent months reflecting both demand and supply factors.** Mortgage rate reductions and a temporary increase in the first-time homebuyers' subsidy underpinned demand for housing credit, but business and other personal credit growth contracted (text figures). Households and businesses are pulling back on spending plans, while banks have tightened their credit standards. Household debt-to-income has declined slightly since mid-2008, but the household debt-service ratio has fallen further because of the large drop in mortgage interest rates.



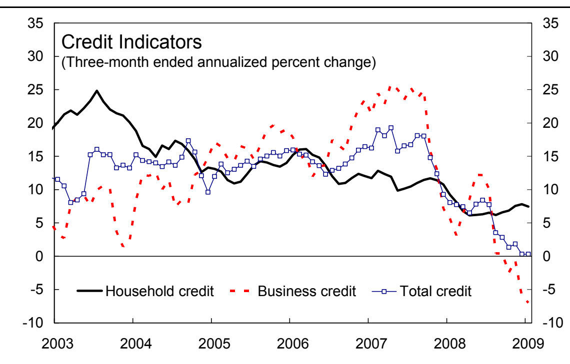
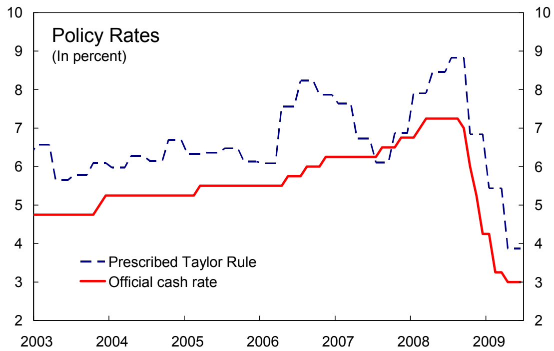


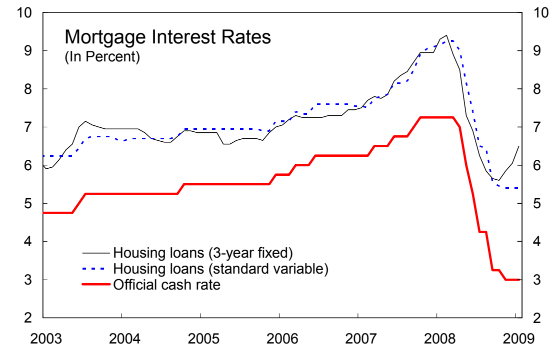
Figure 4. Australia: Monetary Easing

The policy rate was lowered broadly in line with that prescribed from a simple Taylor Rule…



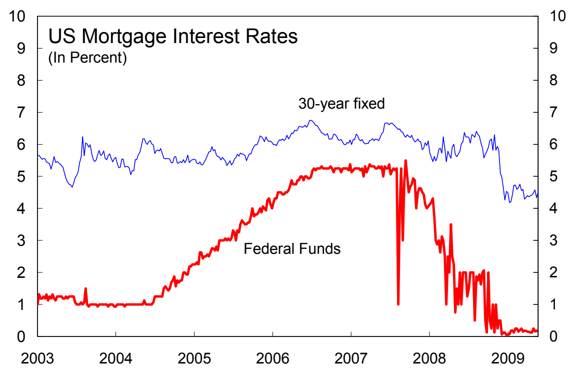
Source: Reserve Bank of Australia.

…and the decline has largely passed through to mortgage rates…



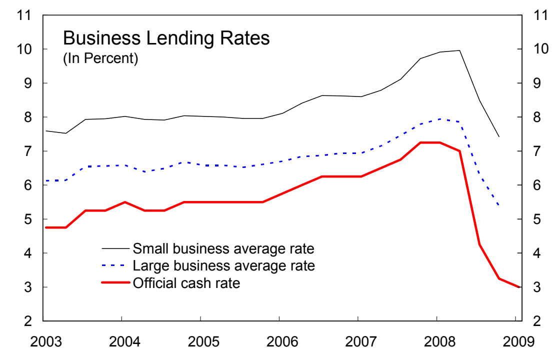
Source: Reserve Bank of Australia.

…unlike the situation in some other countries like the U.S.



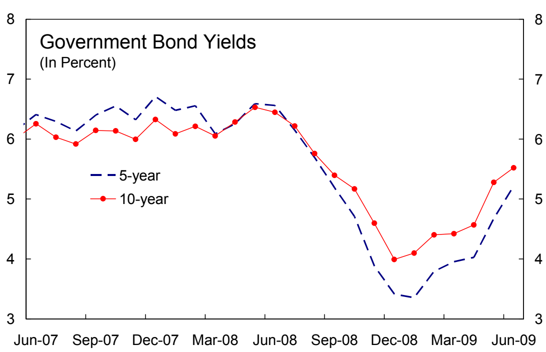
Source: Bloomberg.

Business lending rates also fell.



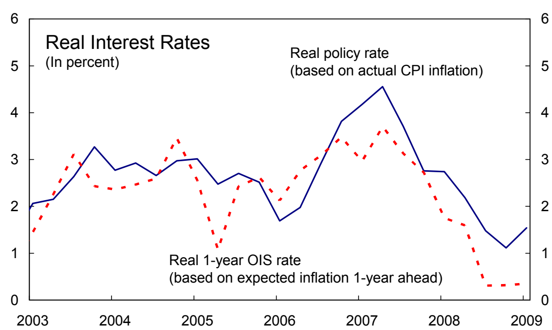
Source: Reserve Bank of Australia.

Government bond yields dropped sharply in late 2008, but have risen in recent months.



Source: Bloomberg.

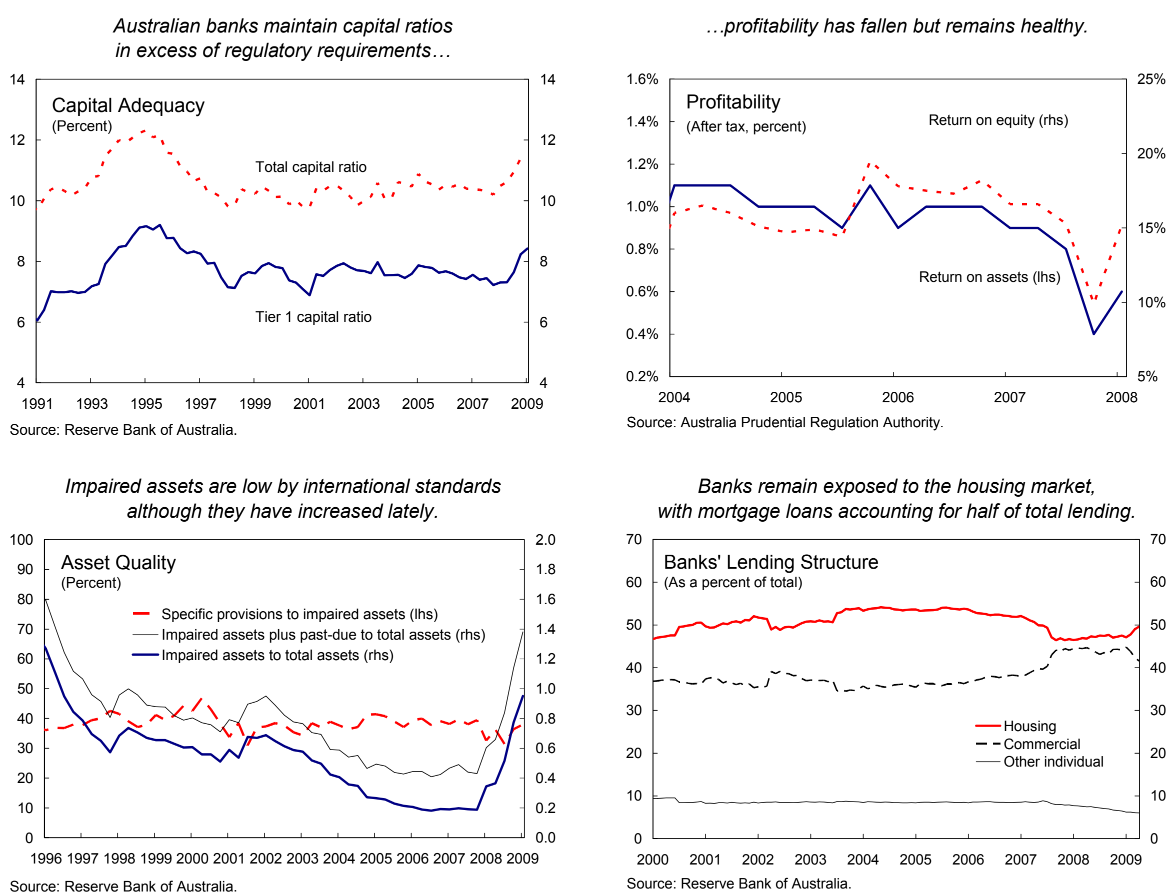
Real interest rates have declined.



Sources: Reserve Bank of Australia, Melbourne Institute, Bloomberg, and Fund staff estimates.

11. **Banks were in a healthy position at the onset of the turmoil.** They reported strong profit growth before the crisis hit, with returns on equity of 15–20 percent (Figure 5). A conservative approach by regulators and supervisors meant that banks had relatively low leverage and high capital adequacy ratios, with Tier 1 capital ratios of 7–8 percent in 2007. Moreover, the "four-pillar policy," which does not allow the four large banks to merge, played a role in limiting risky behavior. Asset quality of smaller banks is somewhat weaker than that of the large banks, but these banks still appear sound.[1] Banks had limited exposure to securitized assets and investment vehicles holding structured finance products in Australia and overseas.[2]

Figure 5. Australia: Impact of the Global Crisis on Domestic Banks



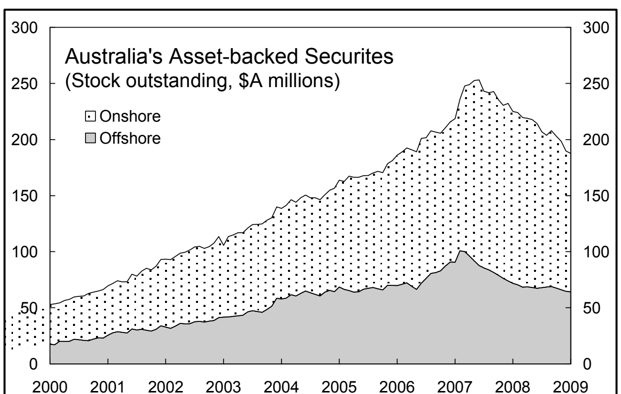
[1] See accompanying Selected Issues paper on "Australian Bank and Corporate Sector Vulnerabilities."

[2] Low-doc mortgages comprise 7 percent of total mortgages, and nonconforming (the equivalent of sub-prime and written by nonbanks) an additional ½ percent of total mortgages.

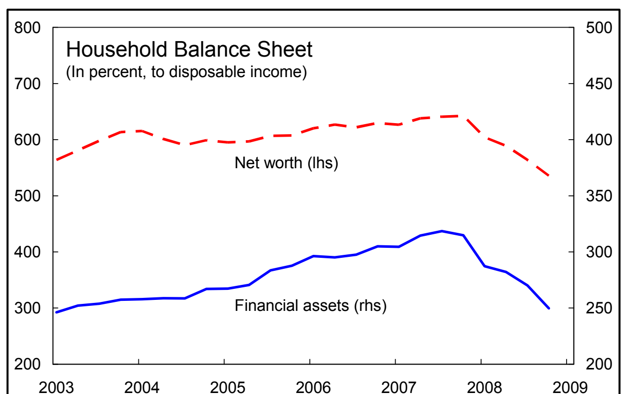
12. **Although bank asset quality is declining, capital buffers are being increased.** Past due loans and impaired assets have risen, but only to 1½ percent of assets in March 2009, and profitability has fallen, reflecting increased provisioning for bad debt. Most importantly, even in the midst of the crisis, large banks have been able to raise common equity from private investors and strengthen their capital positions in anticipation of further bad loans. This has improved their Tier 1 capital ratios to over 8 percent.[3]

13. **On the liability side, the swift introduction of deposit and wholesale funding guarantees helped maintain confidence in banks.** About half of banks' funding comes from the wholesale market, and access was disrupted after the Lehman collapse. The establishment of wholesale funding guarantees in October 2008 enabled banks to raise $A 140 billion in longer-term funding in the subsequent seven months. However, rollover risks remain. Staff estimate that financial institutions' short-term external debt (on a residual maturity basis) was about $A 400 billion (35 percent of GDP) in March 2009. The authorities also introduced the Financial Claims Scheme in October 2008 that provided a guarantee for retail deposits up to $A 1 million (see Appendix I for details).

14. **The broader financial sector was hit hard by the crisis.** Securitization activity fell sharply after the initial turmoil in 2007, and effectively shutdown post Lehman, with very little activity in recent months (text figure). The dislocation of securitization markets resulted in greater concentration of lending with the four large banks. The fall in equity prices reduced returns at superannuation and managed funds, contributing to a fall in household financial assets by more than 60 percent of household disposable income in 2008 (text figure), while general insurers' profits declined owing to more difficult underwriting conditions.



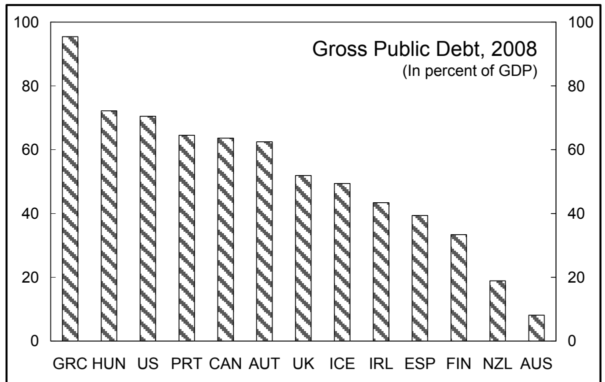
Source: Reserve Bank of Australia.



Source: Reserve Bank of Australia.

3 The bulk of Tier 1 capital is common equity and other measures of capital adequacy have improved in the past year, as detailed in the accompanying Selected Issues paper on "Australian Bank and Corporate Sector Vulnerabilities."

15. **The government reacted quickly to the crisis by providing a sizable fiscal stimulus and allowing the automatic stabilizers to work—shifting the fiscal balance into deficit.** The Commonwealth government ran surpluses of around 1–1¾ percent of GDP in the six years to 2007/08 that, along with asset sales, eliminated its net debt and reduced gross public debt to low levels by advanced country standards (text figure). For 2008/09, an underlying cash deficit of 2.7 percent of GDP is estimated, as the downturn hit tax revenues and the government implemented stimulus measures (Table 2, Figure 6). In addition, states and public corporations continued to increase their investment spending, which pushed the consolidated nonfinancial public sector deficit to 5¾ percent of GDP in 2008/09 (Figure 6).



Source: World Economic Outlook; and Fund staff calculations.

16. **The current account deficit narrowed to close to 4 percent of GDP in 2008.** The improvement reflected large increases in commodity contract prices negotiated in early 2008 for iron ore and coal exports (Figure 7). These contracts are being renegotiated with prices expected to fall by 30–60 percent, bringing them back to just over 2007 levels. The income deficit declined because of a fall in interest and dividend payments to foreign investors. As a result, the current account deficit narrowed further in 2009 Q1 to less than 2 percent of GDP. Recently, the deficit has been financed by a more balanced mix of equity and debt inflows than in the past five years. Net foreign liabilities stabilized at about 60 percent of GDP over the past two years.

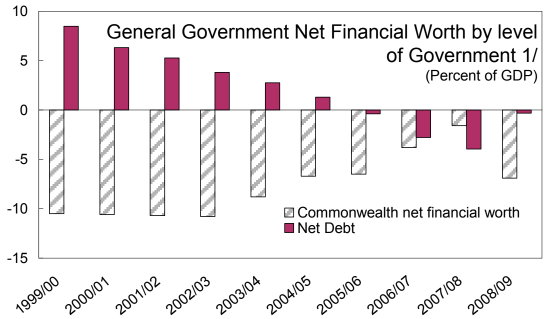
III. Policy Discussions

17. **Discussions focused on the economic outlook and policies to cushion the domestic impact of the global recession and preserve macroeconomic and financial stability.** In particular, key topics included:

- maintaining the appropriate monetary policy stance;
- delivering the fiscal stimulus and preserving medium-term fiscal sustainability;
- maintaining financial stability; and
- reducing external vulnerabilities.

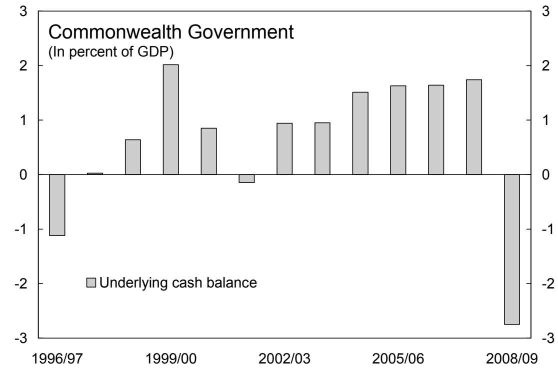
Figure 6. Australia: Fiscal Accounts

A string of surpluses eliminated net debt and improved net financial worth…

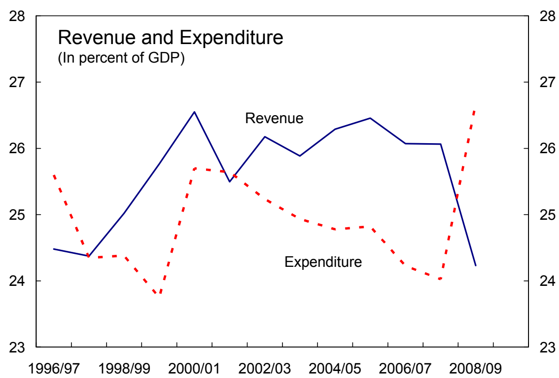


Source: Reserve Bank of Australia.
1/ Net financial worth is equal to total financial assets less total liabilities (including superannuation).

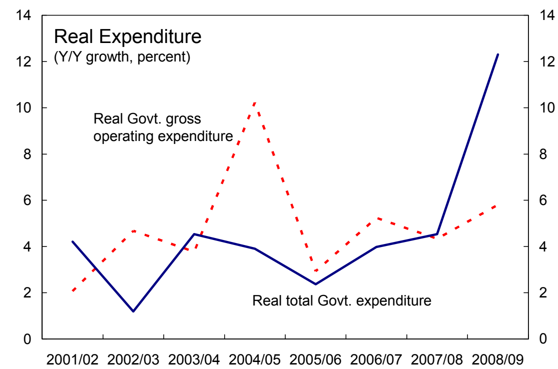
…but the economic slowdown and fiscal stimulus resulted in a large shift in the balance in 2008/09.



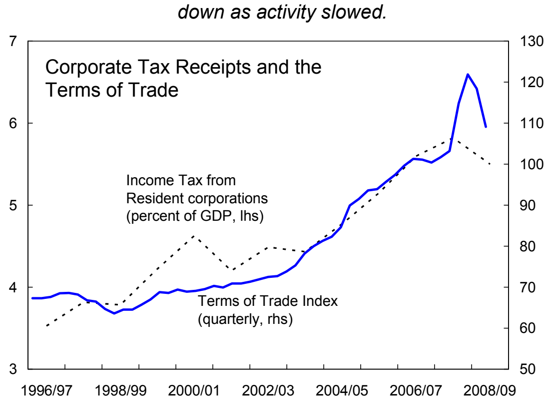
Revenue fell in 2008/09 as the economy slowed…



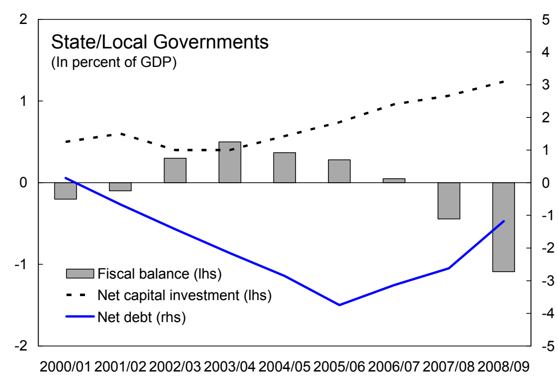
…while expenditure rose sharply in real terms.



After rising with the terms of trade, corporate tax receipts turned down as activity slowed.



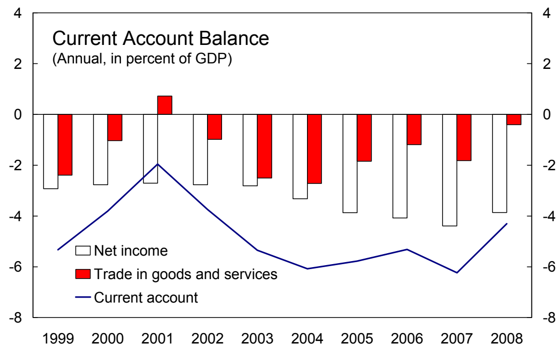
State governments also shifted into deficit in recent years.



Sources: Australian Bureau of Statistics; and Fund staff estimates and projections.

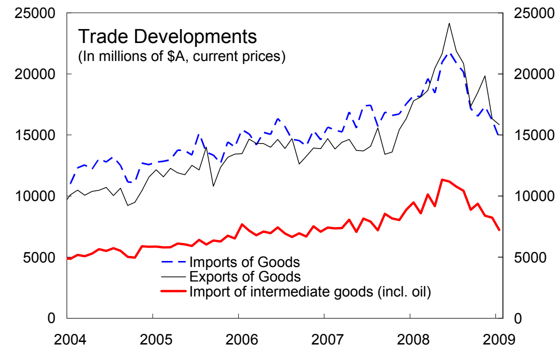
Figure 7. Australia: External Developments

The current account deficit narrowed with the deficit in trade in goods and services shrinking.



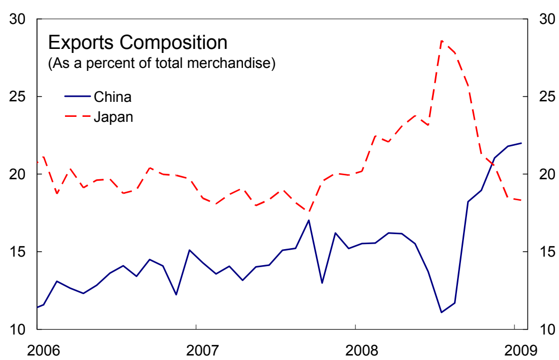
Sources: ABS Times Series database; and Fund staff estimates.

Exports and imports declined sharply since mid 2008.



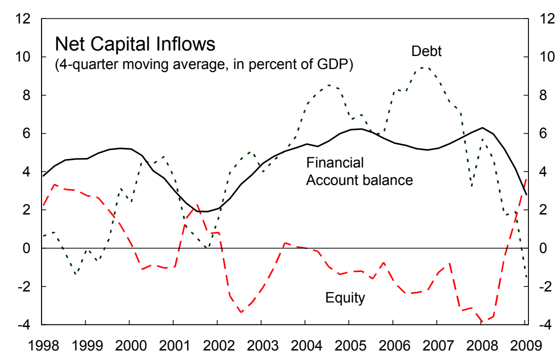
Source: Reserve Bank of Australia.

Strong demand from China supported exports.



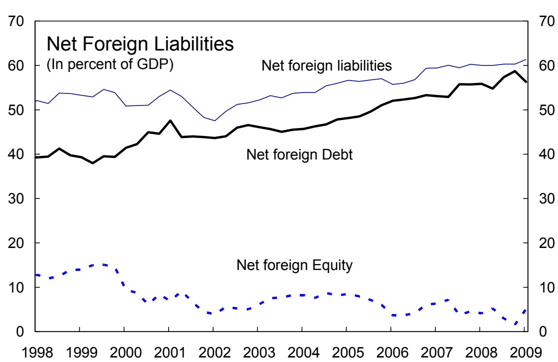
Source: Haver Analytics.

Capital inflows remain sizeable with an increase in equity inflows.



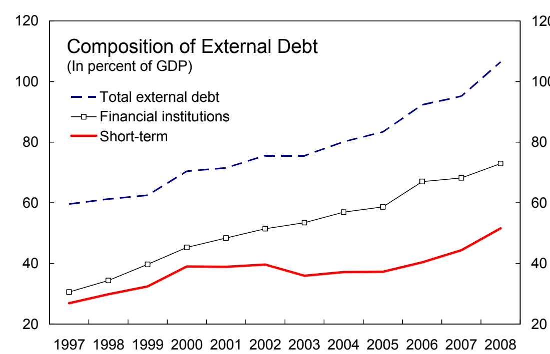
Source: Australian Bureau of Statistics.

Net foreign liabilities stabilized at around 60 percent of GDP.



Source: ABS Times Series Database.

While gross external debt increased to more than 100 percent of GDP.



Sources: Australian Bureau of Statistics; and Fund staff calculations.

A. The Outlook

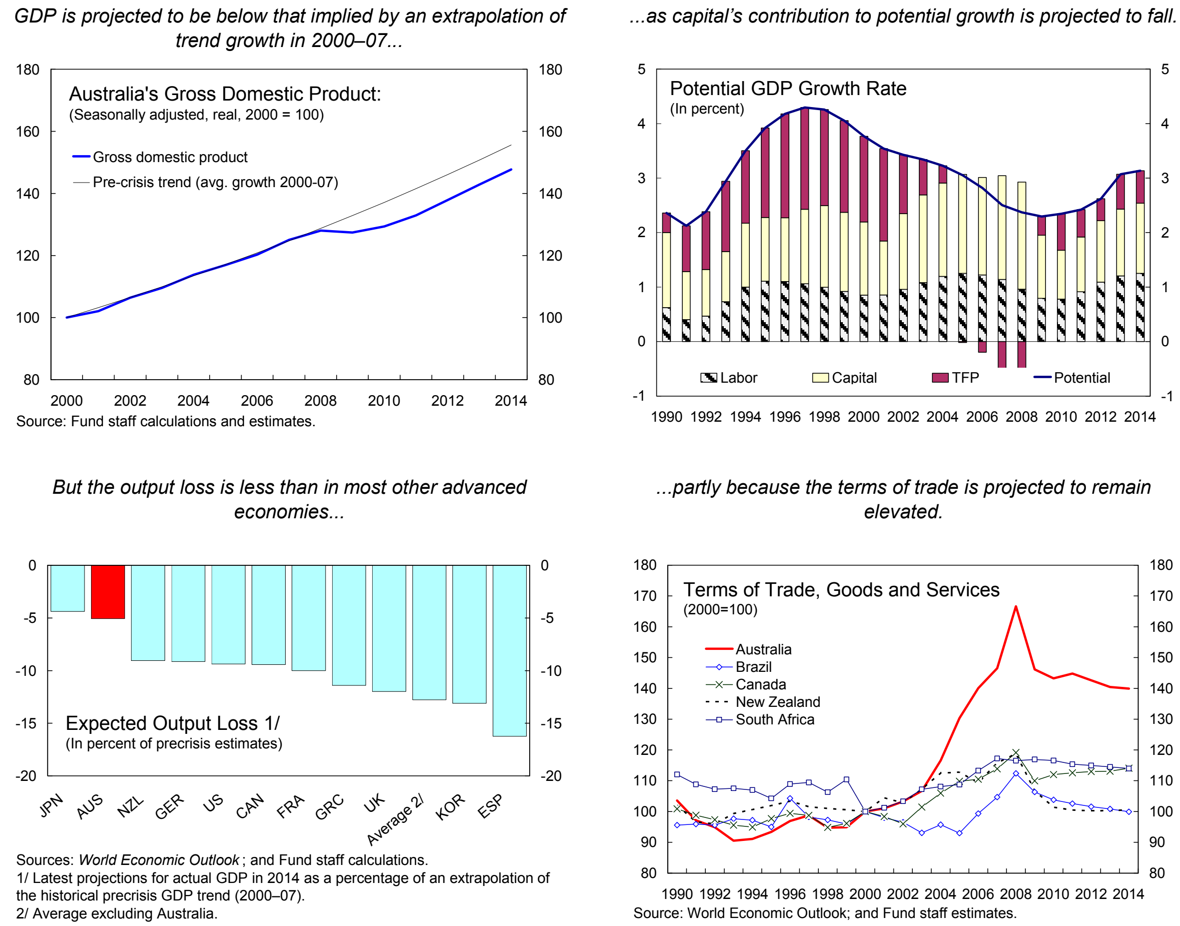
18. **The near-term outlook for growth is weak.** Aggressive policy action is expected to limit the decline in activity to ½ percent in 2009. Staff's baseline forecast envisages a contraction in domestic demand as external shocks spill over into consumption and investment. Rising unemployment, low asset prices, high debt levels will weigh on household spending plans, despite lower interest rates. As a result, private consumption is projected to be stagnant. Private investment is expected to fall sharply, as corporate profitability is affected by the fall in demand and lower commodity export prices.

19. **The recovery will likely be slow.** Growth is projected to reach 1½ percent in 2010, led by government spending on infrastructure, as households and businesses continue to deleverage. Output will likely remain below potential in coming years. This will reduce core inflation and raise the unemployment rate to 7½ percent in 2011. The current account is projected to remain in deficit, with net foreign liabilities relative to GDP rising, as Australia will remain an attractive destination for foreign investment, especially in the resource sector.

20. **Staff projects a lower level of potential output as a result of the global recession.** By 2014, GDP is projected to be about 5 percent lower than implied by the precrisis trend (Figure 8). This loss results from weaker export prospects and higher cost of capital, but it is substantially less than losses projected for most other advanced countries. In part, this reflects high investment in the resource sector in recent years that will increase productivity over the medium-term as projects come on stream. Moreover, despite the fall in export prices this year, the terms of trade is projected by staff to remain more than 40 percent above the average for the 1990s, because of demand for commodities from fast-growing Asian economies.

21. **The risks are evenly balanced, but the outlook is highly uncertain.** On the downside, the world economy could take longer to recover, with significant spillovers to Australia through commodity sector incomes, external demand, and international capital markets. Domestically, a sharper-than-expected deterioration in banks' asset quality, possibly stemming from lower house prices, could constrain credit and deepen the downturn. A high-impact tail risk would be a decline of investor confidence in banks or the sovereign. However, this is highly unlikely given low public debt and Australia's track record of sound macroeconomic policies. On the upside, a key risk is stronger-than-expected demand from China. A further upside risk is that domestic and foreign economies could be more responsive than expected to the considerable policy stimulus currently in place.

Figure 8. Australia: Potential Output



22. **The authorities broadly agreed with staff's views on the near-term outlook and risks, but they considered staff's medium-term growth projections too pessimistic.** The latest official projections (May 2009 Budget) show a faster recovery, with growth reaching 4½ percent by 2011/12 and a smaller permanent output loss in the medium term. They argue that potential growth will not fall significantly given the absence of a domestic banking crisis, robust demand for commodities, and high immigration expected over the next few years.

B. Monetary Policy

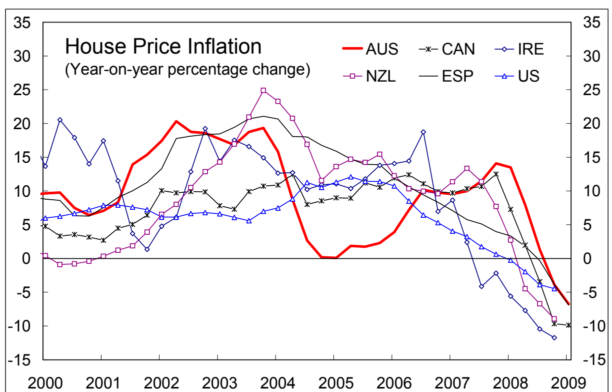
23. **Staff and the authorities agreed the current stance of monetary policy is appropriate, as earlier cuts in the policy rate will continue to support domestic demand.** The RBA has kept rates on hold in recent months given the substantial fiscal and monetary stimulus in train and signs of a recovery in consumer and business confidence. The policy rate is currently below that implied by a simple Taylor Rule and staff's forecast for inflation in 2010 is just under 2 percent.

24. **If the outlook for growth and inflation worsens, staff and the authorities concurred that there is ample scope for further cuts in the policy rate.** A downside scenario of lower global demand and higher risk premia on Australian assets would spill over to the domestic economy through weaker commodity prices, growth, and inflation (Box 1). In this scenario, a cut in the policy rate and a depreciation of the currency would ease financial conditions and cushion the impact on Australia.

25. **The authorities agreed with staff on the need to be more cautious than normal in tightening in view of the fragile state of the global economy.** Although the risk of deflation is more limited in Australia than elsewhere, the associated output costs could be severe. Therefore, the return of the cash rate to neutral should wait until there are clear signs that a sustainable recovery is underway.

26. **The monetary transmission mechanism has not been impaired in Australia and staff and authorities considered that unconventional monetary policy measures are unlikely to be needed.** Nonetheless, staff suggested that the authorities consider how such measures could be implemented if required. Some measures have been taken already to help resuscitate residential mortgage back securities (RMBS) and asset backed commercial paper (ABCP) markets, with government planning to buy about $A 8 billion in RMBS securities.[4]

27. **The authorities and staff agreed that the inflation-targeting framework provides a robust nominal anchor.** Over the last several years, which witnessed the largest boom in Australia's commodity prices in half a century, wage growth remained relatively stable, suggesting well-anchored medium-term inflation expectations. Moreover, the flexibility embodied in the target of 2–3 percent inflation, on average, over the cycle has allowed the RBA to take a wide range of factors into account, and thereby contain the buildup of potentially destabilizing imbalances. In particular, the RBA noted that the tightening of monetary policy in 2003 was partly in reaction to the sharp increase in house prices, owing to concerns about wealth effects, and that the tightening had been more effective in containing house price inflation compared with some other advanced economies (text figure).



Source: OECD database.

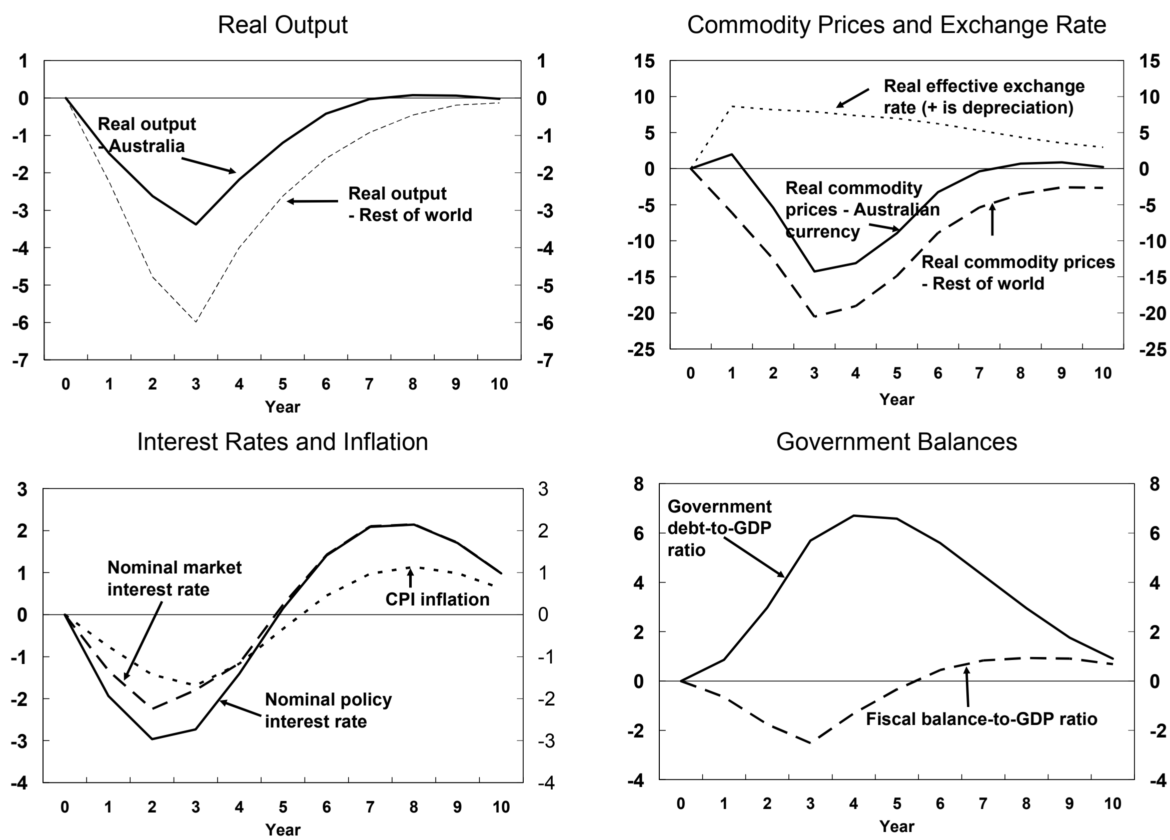
[4] The stock of residential mortgage-backed securities (RMBS) and asset-backed commercial paper (ABCP) outstanding was about $A 160 billion in March 2009, about 40 percent below the peak of mid 2007, but is small compared with total financial sector credit of $A 1,900 billion.

Box 1. Australia: Slower World Recovery

The IMF's Global Integrated Monetary and Fiscal Model (GIMF) has been used to estimate the impact on Australia of a slower-than-expected world recovery. In this scenario, shocks to investment and consumption are used to proxy an intensification of the global financial crisis. The shocks reduce growth in the world outside Australia by roughly 2 percentage points in each of the first three years. This weaker growth is assumed to increase home bias in investment and consumption goods outside Australia. Smaller shocks to investment and consumption are also applied to Australia. In addition, the scenario assumes a temporary increase in Australia's currency risk premium of almost 200 basis points, with half of that flowing through to Australian market interest rates.

The shock reduces the level of real GDP in Australia by 3 percent after three years. In addition to the direct impact of weaker external demand, slower world growth reduces commodity prices by roughly 20 percent, lowering private incomes and weakening domestic demand in Australia. However, the impact on the Australian dollar price of commodities is buffered by depreciation in the real exchange rate. With weaker growth reducing inflation, the policy rate declines by almost 300 basis points. In part, the large policy rate cut is necessary because a portion of the cut is not passed through to lending rates owing to a rise in the risk premium. Assuming that nominal government spending remains at baseline, but that revenues decline with nominal GDP, the fiscal balance moves into deficit for five years, driving government debt up by almost 7 percent of GDP at its peak.

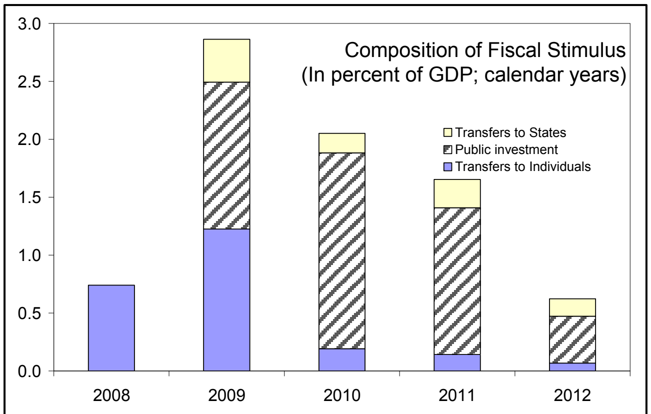
In Percent or Percentage Point Deviation From Baseline



Source: Global Integrated Monetary and Fiscal Model simulation.

C. Fiscal Policy

28. **With low public debt and a transparent medium-term fiscal policy framework, the authorities were able to deliver a sizable fiscal stimulus—above the G20 average.** Discretionary measures taken since September 2008 include 0.8 percent of GDP in 2008, 2.9 percent of GDP in 2009, and 2 percent of GDP in 2010. The measures centered on temporary transfers to almost 40 percent of the population and temporary increases in infrastructure spending (text figure). In addition to policy measures, the weaker outlook for growth and commodity prices is projected to shift the Commonwealth fiscal balance to a deficit of about 4¾ percent of GDP in 2009/10 (Figure 9).



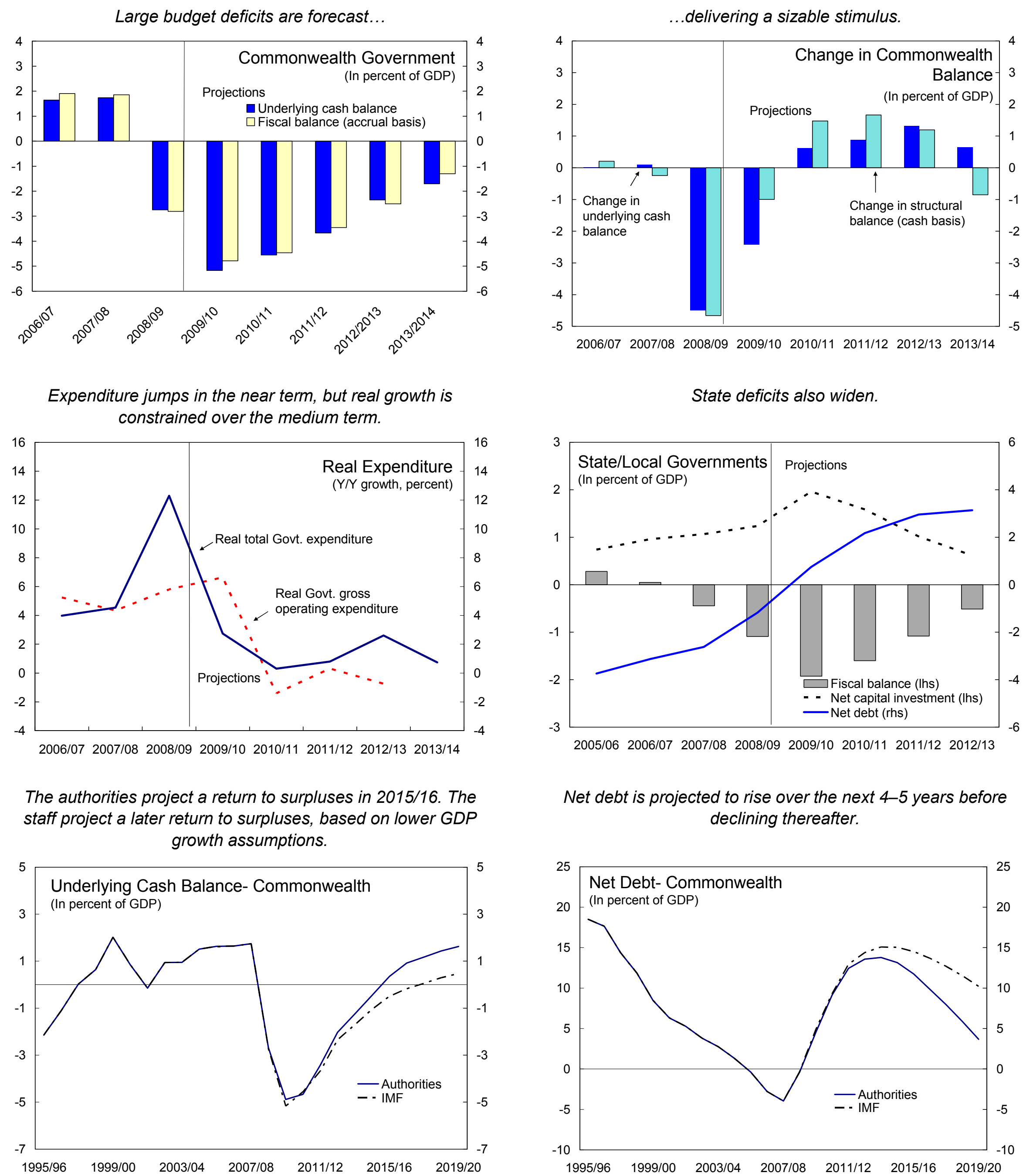
Source: Australian authorities.

29. **Staff commended the quick implementation of fiscal stimulus and noted that the shift into deficit was justified in current circumstances**. Staff estimates suggest that the stimulus will raise real GDP by about 3 percent relative to baseline in 2009 and 2010, before dissipating in outer years.[5] The transfers to households had an immediate impact on activity that helped underpin confidence. The increase in public investment will continue to support activity in the near term, while addressing infrastructure shortfalls. The stimulus payments to state governments are also in line with the Commonwealth and State governments' reform agenda that focuses on investing in education, health and transportation infrastructure to raise productivity while harmonizing regulations across states.

30. **Staff and authorities agreed that, given low public debt, there is scope for further fiscal stimulus, if the outlook for growth weakens.** However, staff advised that monetary policy should be the first line of defense, as it remains effective and because additional fiscal stimulus would increase government debt further. If growth were slower than expected in the near-term, automatic fiscal stabilizers should be allowed to work fully. Staff analysis suggests that the impact on growth is highest for public investment spending. However, transfers targeted to low-income households have a faster yet still large impact, and could be the most suitable measure if a prompt demand impetus is required.

[5] Using the IMF's GIMF model, the accompanying Selected Issues paper evaluates the impact of the fiscal stimulus on GDP. Alternative calibrations of the model give a range for the cumulative impact on GDP of 5¼–12¾ percent over the five years 2008–12.

Figure 9. Australia: Fiscal Forecast



Sources: Australian Bureau of Statistics; and Fund staff estimates and projections.

31. **The authorities' reaffirmed their medium-term fiscal strategy that focuses on three objectives:**

- achieving budget surpluses, on average, over the medium term;
- keeping Commonwealth tax revenue as a share of GDP, on average, below the 2007/08 level (24.6 percent); and
- improving the government's net financial worth over the medium term.

32. **The government has adopted a deficit exit strategy consistent with its broad medium-term fiscal objectives.** Once GDP is growing above its trend rate, the authorities intend to take action to return the budget to surplus by limiting real growth in spending to 2 percent per year and allowing tax receipts to increase through fiscal drag. Based on the authorities' growth projections, the underlying budget balance would return to surplus by 2015/16 and remain in surplus through 2019/20. As a result, Commonwealth government net debt would peak at almost 14 percent of GDP in 2013/14 before falling below 4 percent of GDP by 2019/20.[6] The authorities consider that the increase in net debt is prudent in the current economic circumstances, as net debt is projected to remain low relative to both the peak of the past 40 years (18½ percent of GDP) and to other advanced economies.

33. **Staff welcomed the authorities' fiscal strategy and the intention to return to surpluses in the medium term.** Staff projects a return to surpluses by 2017/2018, assuming a lower GDP growth rate than the authorities but that their spending plans are maintained. On this basis, staff projects Commonwealth government net debt to be peak at about 15 percent in 2013/14 before falling to 10 percent of GDP by 2019/20. While the staff's projected increase in debt is somewhat higher than projected by the authorities, it is less than expected for many other advanced countries. This would leave Australia in an enviable fiscal position by international standards (Figure 10).

34. **Staff welcomed plans to contain expenditure and allow tax receipts to increase, but noted that further fiscal adjustment may be needed.** The current global environment implies considerable uncertainty about Australia's medium-term prospects. If trend growth or the terms of trade are not as high as assumed, government revenue would be negatively impacted. In such circumstances, further fiscal adjustment would be needed to return to

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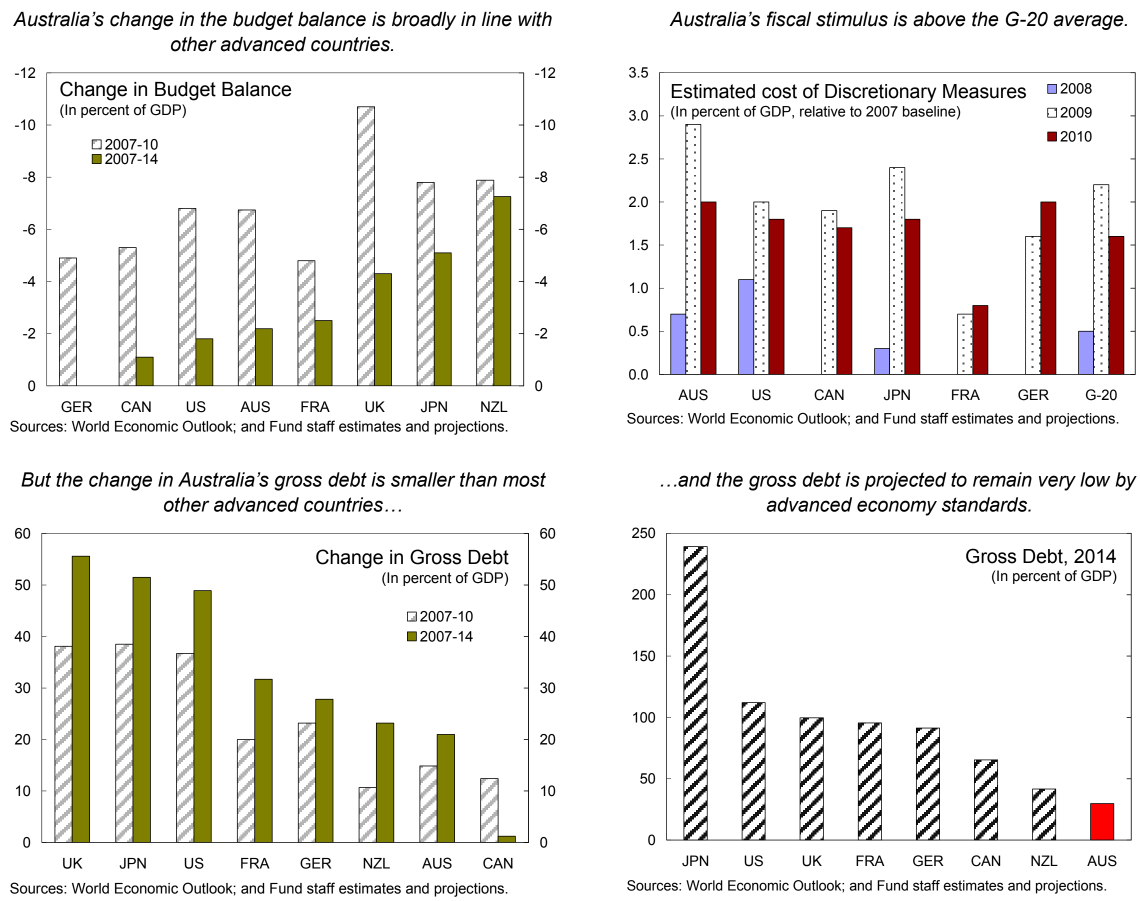
[6] This strategy is consistent with the Charter of Budget Honesty, which requires the government to specify "fiscal policy actions that are temporary in nature, adopted for the purpose of moderating cyclical fluctuations in economic activity, and indicate the process for their reversal." The Charter was introduced into law in 1998 and does not prescribe quantified fiscal targets, which are laid out separately in the Government's fiscal strategy. The Charter requires government "to manage financial risks faced by the Commonwealth prudently, having regard to economic circumstances, including by maintaining Commonwealth general government debt at prudent levels."

Figure 10. Australia: Comparison of Fiscal Outlook



surpluses at a horizon consistent with the government's medium-term objective. In particular, the growth of real spending would need to be constrained below the 2 percent annual rate envisaged in the budget, once growth has recovered. Staff advised that if revenue is higher than currently expected, the authorities should strive for an earlier return to surpluses.

35. **Although government debt is projected to remain relatively low, several factors argue for continued prudence.** While the probability is extremely low, the government may need to assume additional debt on behalf of the banks should they be unable to rollover their significant short-term external liabilities. Guarantees on banks' deposits and wholesale funding as well as state-government debt, presents an additional, although again similarly low probability risk. Relatedly, servicing government debt could become more expensive if increased global supply drives up sovereign debt yields, as seen in recent months. Returning to lower debt levels would put Australia on a firmer footing to respond to future shocks. Looking further out, while some pension and health care reform has been included in the

budget, remaining longer-term pressures from aging and rising health care costs argue for more policy action.

36. **State governments are projecting higher cash deficits and increased debt levels**. Staff noted that this highlights the importance of maintaining fiscal restraint at the Commonwealth level over the medium term, given the new guarantee of state debt.

37. **The authorities reiterated their commitment to maintaining debt at prudent levels over the medium term.** They considered that the downside risks to revenue were limited, but stated that they would cut expenditure if necessary to achieve their medium-term fiscal objectives. Should revenue exceed budget projections, they would save excess revenue to return to surpluses earlier than envisaged.

D. Domestic Macro-Financial Linkages and Preserving Financial Stability

38. **The linkages between high household debt and bank balance sheets are a key domestic vulnerability**. Australian household debt is relatively high by advanced country standards and staff analysis suggests that house prices are overvalued by 0–20 percent.[7] A fall in house prices and a jump in unemployment could lead to further household deleveraging and an increase in bank's impaired assets. In turn, higher provisioning for losses could constrain bank credit growth and deepen the downturn. However, the risks of a sharp fall in house prices is limited given strong immigration flows and improved affordability because of lower mortgage rates. Moreover, less than 10 percent of owner-occupiers with mortgages belong to the high risk group—those with a debt-service ratio over 30 percent and a loan-to-value ratio greater than 80 percent. Staff's preliminary analysis suggests that potential further losses from a sizeable downside shock that would increase mortgage and corporate defaults sharply would not reduce large banks' capital below the regulatory minimum.[8]

39. **Staff commended the Australian Prudential Regulation Authority (APRA) for regularly stress testing the banking sector and advised that banks be required to undertake more extreme stress tests than in the past.** The tests should be undertaken jointly with their subsidiaries, to assess vulnerability of their capital and liquidity positions to a sharp jump in unemployment, a drop in house and commodity prices, and a disruption to

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[7] See accompanying Selected Issues paper on "Australian Household Vulnerabilities."

[8] The accompanying Selected Issues paper examines bank and corporate sector vulnerabilities.

wholesale funding.[9] Prudential judgment should be used to assess adequacy of banks' capital buffers, in light of stress tests, and capital requirements raised if necessary.

40. **The authorities reiterated their commitment to continue monitoring and stress testing banks' capital position.** They noted that banks are now required to conduct regular stress tests under Basel II. Moreover, a recent mission from the IMF's Monetary and Capital Markets Department gave a very positive assessment of Australia's Basel II implementation (Box 2).

41. **The planned introduction of new liquidity guidelines is welcome.** Recognizing the increased importance of liquidity and rollover risks associated with short-term liabilities, banks have started to increase medium-term funding. However, liquidity positions should continue to be based on prudentially enforced liquidity guidelines. The stability benefits of strengthening liquidity positions and reducing rollover risks justify likely increases in funding costs.

42. **Staff underlined the importance of further crisis preparedness planning, especially for liquidity or solvency problems in major banks in Australia and New Zealand.** Staff welcomed ongoing close cooperation with New Zealand authorities, including the visit by APRA to New Zealand in February 2009 for on-site credit book inspections of the large banks. Most importantly, a framework is being developed for resolving stress in an Australian or New Zealand bank.

43. **Exit strategies from policy measures introduced during the financial crisis are, appropriately, being considered.** Staff recognized that the risk-pricing element of the wholesale funding guarantee provides a natural exit strategy once markets normalize. The authorities plan to review options for guarantees to retail deposits, including changes to the new Financial Claims Scheme that covers deposits of less than a million dollars. Key recommendations of the 2006 FSAP have been implemented, as summarized in Appendix II.

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[9] The stress tests should take account of possible spillovers from New Zealand and United Kingdom subsidiaries of Australian banks that are equivalent to about ⅓ of Australian GDP (mostly in New Zealand). Australian banks have limited exposure to the U.S., Euro area, and the rest of the world. A Selected Issues paper for the 2009 New Zealand Article IV consultation examined the vulnerabilities of the four large Australian bank subsidiaries operating in New Zealand (IMF Country Report No. 09/146, May 2009). The paper concluded that a sharp worsening of asset quality would be needed to reduce bank capital below the regulatory minimum. While such a large increase in defaults is unlikely, the risks of such an outcome have jumped in the past year as the outlook for the global and local economies has worsened.

Box 2. Australia: Basel II Implementation

The Australian Prudential Regulation Authority (APRA) implemented the Basel II framework in 2008. The major banks, representing nearly 70 percent of banking industry assets, adopted the advanced approaches for credit, market and operational risk. At the request of the authorities, an IMF mission from the Monetary and Capital Markets Department visited Sydney in May 2009 to assess Basel II implementation. This box summarizes the assessment of the mission.

The mission found that APRA followed a rigorous process in implementing the Basel II framework. APRA has allocated sufficient resources prior to the Basel II start date and the outcome has been robust implementation. The mission noted that adequate resources will be needed to ensure that banks continue to meet these requirements on an ongoing basis.

The authorities adopted a more conservative approach in several cases than required by the Basel II framework. Most importantly, a 20 percent loss given default (LGD) floor was adopted for residential mortgages that comprise over half of the large banks' loans, which is higher than the Basel II 10 percent floor. In addition, higher risk weights were required for certain residential mortgages under the standardized approach. Moreover, reduced risk weights, which are permissible in the Basel II framework's standardized approach, have not been introduced for retail lending. Furthermore, banks' capital requirements under the advanced approaches continue to be subject to the 90 percent floor of the Basel I capital requirement, instead of the 80 percent floor applicable in the second year. APRA has also exercised caution in other choices regarding the framework, such as requiring banks using the advanced approaches to hold capital against interest rate risk in the banking book.

The mission pointed to few areas where APRA could build on initiatives already underway to enhance its supervision of banks' risk management. APRA should continue to undertake increasingly complex work, such as drill down reviews of banks' economic capital models and stress testing practices. The mission recommended increased Pillar 3 disclosures by second-tier banks and a re-assessment of the operational risk approach applicable to their operations.

E. Australia's External Vulnerability

44. **A range of indicators suggest that the currency is broadly in line with fundamentals (Box 3)**. The fall of the exchange rate from mid 2008 to early 2009 was driven by a decline in commodity prices and the loosening of monetary policy (Figure 11). The currency is free floating and fluctuates considerably because of the importance of commodity exports. The authorities agreed that the currency is broadly in line with fundamentals.

45. **Staff forecasts the current account deficit to be around 3½ percent of GDP in 2009.** The trade deficit is expected to narrow slightly in 2009, as the decline in the terms of trade is offset by lower imports and continued strong commodity export volumes. The income balance is projected to narrow by about ½ percent of GDP in 2009 because of lower interest and dividend payments. The current account deficit is forecast to be around the lower end of the norm of 4–5 percent of GDP over the medium-term, assuming that the terms of trade remains well above the average of the past 10 years (Table 3).

46. **Australia's sizable short-term external debt is a key macro-financial risk in the current global environment.** Short-term debt (on a residual maturity basis) comprises almost half of external debt and is relatively high by advanced country standards (Figure 12). Most of the short-term debt matures in 90 days or less, and almost 70 percent of total external debt is held by financial institutions. The proposed liquidity guidelines for banks should encourage less reliance on short-term wholesale funding. Moreover, if banks face problems rolling over external debt, they have access to the RBA's new liquidity facilities, including discounting mortgages. In such circumstances, the resultant increase in Australian dollar liquidity would lead to a depreciation of the exchange rate.

47. **The authorities noted that recent experience suggests limited problems with rolling over short-term external debt.** The bulk of Australia's short-term debt was rolled over between June 2008 and March 2009, despite the most intense turmoil in international capital markets in decades (text table). The depreciation of the currency was helpful in this regard, as Australian banks and corporates reduced their external debt in U.S. dollar terms while increasing external debt in domestic currency terms.

Australia: External Debt

(End of Period)	June-08	Dec-08	Mar-09
Gross external debt	1,100	1,260	1,227
(Expressed in A$ billions)			
Of which: Short term	524	610	595
Gross external debt	1,059	873	844
(Expressed in US$ billions)			
Of which: Short-term	504	423	409
Memorandum item:			
US$/A$ (end of period)	0.96	0.69	0.69

Sources: Australian Bureau of Statistics and Fund staff estimates.

Box 3. Australia: Equilibrium Real Effective Exchange Rate

Staff estimates suggest that the Australian dollar is broadly in line with fundamentals. These estimates are based on the macroeconomic balance (MB) approach, the equilibrium real exchange rate (ERER) approach, and the external sustainability (ES) approach.

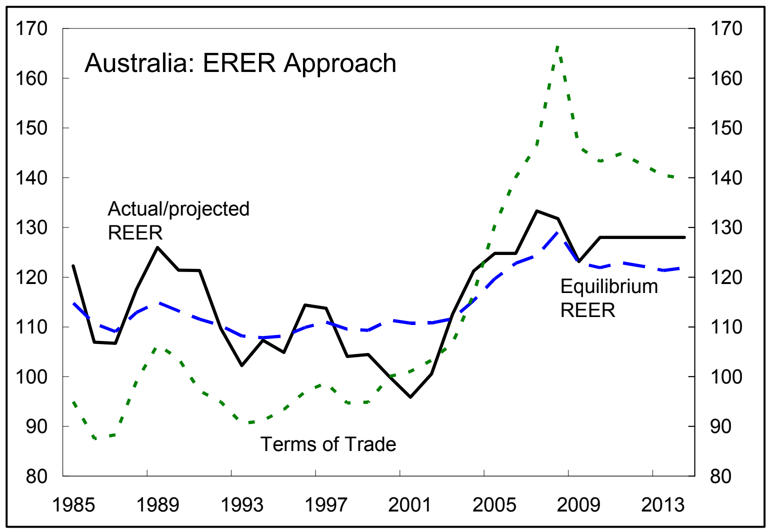
Exchange Rate Assessment: Baseline Results 1/

	Current Account/GDP		REER
	Norm	Projection 2/	Overvaluation
Macroeconomic balance 3/	-4.5	-3.9	-3.8
Equilibrium real exchange rate 4/	...	...	4.9
External sustainability 5/	-2.4	-3.9	9.2

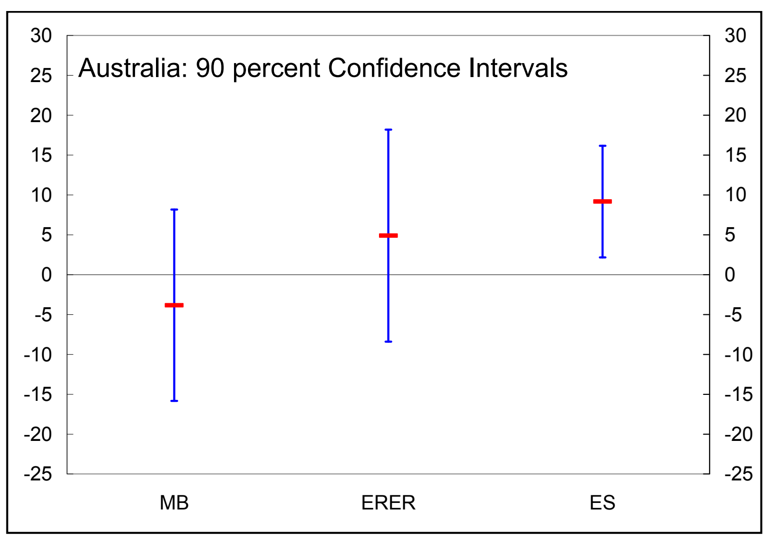
Sources: IMF staff estimates.

1/ All results are expressed in percent.
2/ Staff projection of the underlying CA/GDP in 2014.
3/ Based on semi-elasticity of CA/GDP with respect to the REER of -0.16
4/ Overvaluation is assessed relative to the average for June 2009.
5/ Based on an assumed nominal growth rate of 5.5 percent.

The MB estimates suggest that the equilibrium current account deficit is about 4½ percent of GDP, reflecting relatively high population growth. Staff's projected current account deficit is broadly in line with the norm. This implies a small undervaluation of about 4 percent.



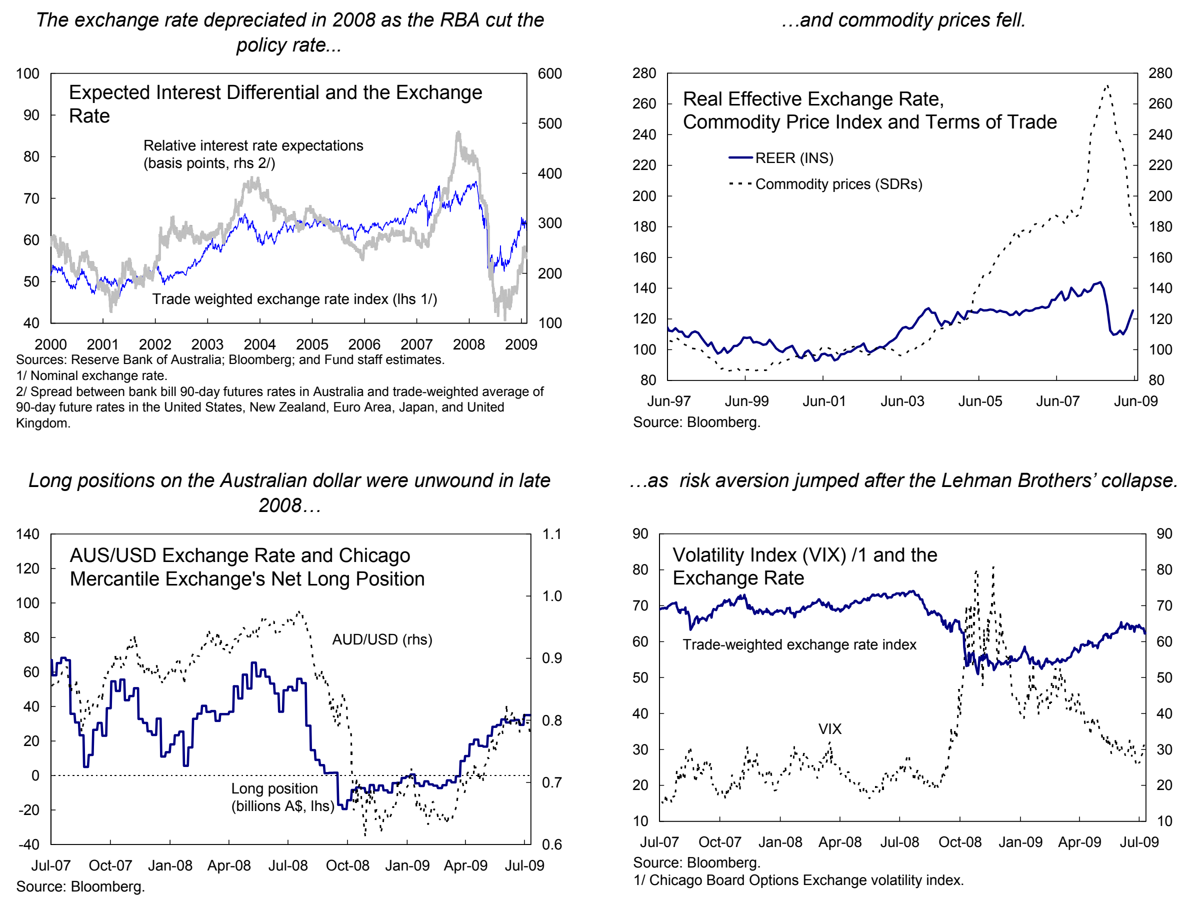
The ERER estimates suggest a small overvaluation. The model attempts to explain the Real Effective Exchange Rate (REER) on the basis of the terms of trade, relative productivity, and relative government consumption. Using an estimate of the June 2009 level for the REER as the base, the equation suggests an overvaluation of about 5 percent in 2014, assuming a weakening of the terms of trade in 2009.



The ES approach implies an overvaluation of less than 10 percent, assuming that net foreign liabilities (NFL) stabilize at the norm estimated by the model of about 46 percent of GDP over the medium-term. However, the predicted NFL is mainly explained by the fixed effect, which casts doubt on the model. A smaller overvaluation of less than 5 percent would result if we assume NFL stabilizes at the end-2008 level of 60 percent of GDP.

The estimates are subject to considerable uncertainty, as shown by the wide range of the confidence intervals. Further discussion of the models and the uncertainty surrounding the analysis is presented in the IMF Working Paper (WP/09/07), *Australia and New Zealand Exchange Rates: A Quantitative Assessment,* by H. Edison and F. Vitek.

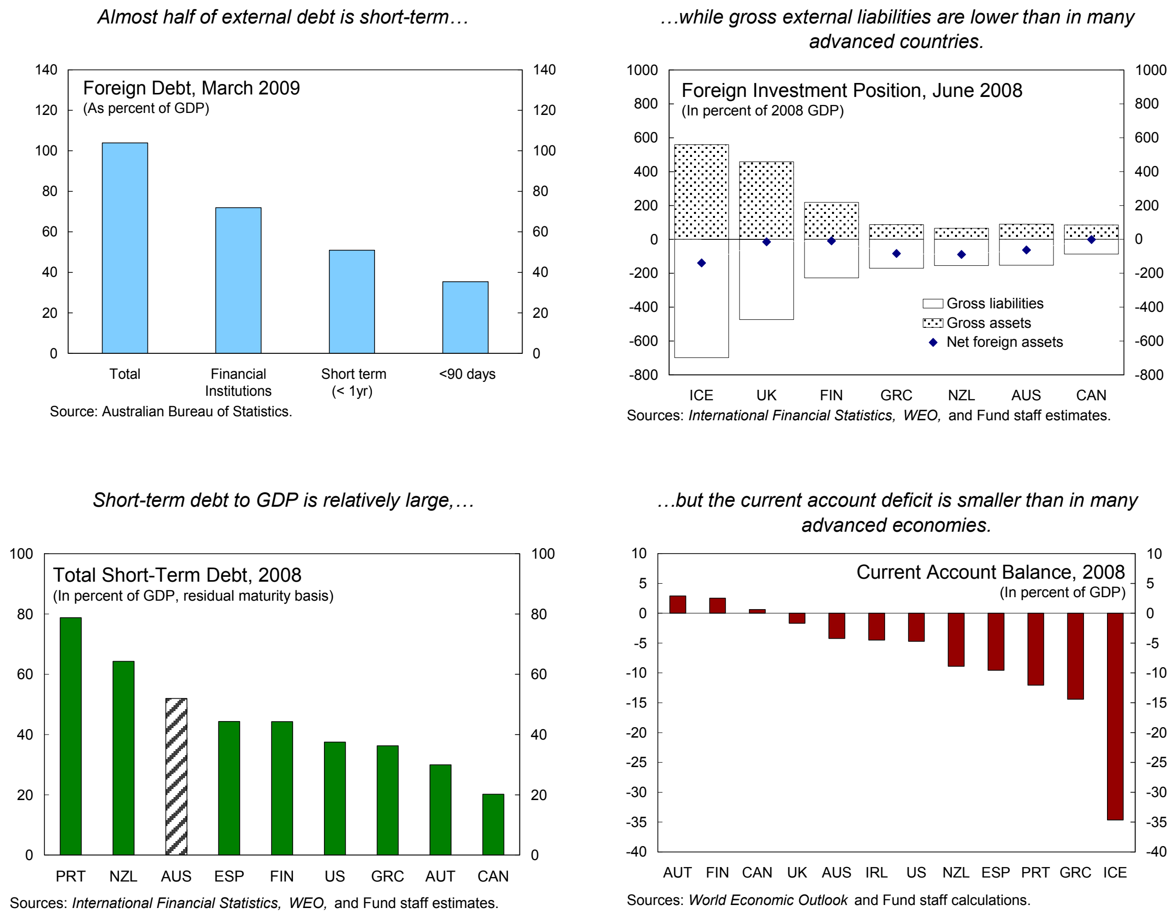
Figure 11. Australia: Exchange Rate Developments



48. **Staff projects an increase in net foreign liabilities to 70 percent of GDP by 2014, assuming current account deficits of about 4 percent of GDP are sustainable.** With relatively attractive returns to investment in Australia, owing to high commodity prices and expected strong demand from China and other Asian economies, financing the deficits should be feasible. Moreover, Australia's current account deficits largely reflect high investment rather than low saving, and should be sustainable as long as investment leads to growth in export capacity, especially in the resource sector.[10] More limited access to foreign capital markets than assumed by staff would lower investment, with negative implications for potential growth.

[10] "Australia's Large and Sustained Current Account Deficits: Should Consenting Adults be Trusted?" IMF Country Report No: 06/373 (10/2/06).

Figure 12. Australia: External Position



49. **The staff and authorities agreed that there are a number of factors mitigating the vulnerability stemming from external debt.** These include the limited currency risk associated with the foreign debt, the sound banking system, and the robust macroeconomic policy framework. Moreover, while Australia's net foreign liabilities are sizable, gross external debt relative to GDP is lower than in many advanced countries. Almost 40 percent of gross foreign debt is in Australian dollars, with half of the remainder in U.S. dollars (Tables 4, 5, and 6). Survey data suggests the bulk of the foreign-currency-denominated debt is hedged against currency risk.

IV. Staff Appraisal

50. **The authorities' timely and significant macro policy response cushioned the domestic impact of the global financial crisis.** However, growth has fallen well below trend and the near-term outlook remains weak and highly uncertain. Growth is projected to pick up in 2010, led by government infrastructure spending. Should the global turmoil intensify, Australia is in a strong position to react by delivering further macroeconomic policy stimulus.

51. **The RBA's earlier reductions in the policy rate were appropriate, as is the current stance of monetary policy**. The substantial fiscal and monetary stimulus in train, and signs of recovery in consumer and business confidence, should help support domestic demand. However, if the outlook for growth and inflation weakens, the RBA has scope for further cuts in the policy rate. Unconventional monetary policy easing measures are unlikely to be needed, but the authorities should consider how such measures could be implemented if required. The RBA should exercise more caution than normal in tightening, given the fragile state of the global economy. The inflation targeting framework is relatively flexible and has been successful in anchoring medium-term inflation expectations.

52. **The flexible exchange rate has been a helpful buffer.** The depreciation of the currency sustained exporter incomes as the U.S. dollar price of commodity exports fell sharply in late 2008. A range of indicators suggest that the currency is now broadly in line with fundamentals.

53. **Quick implementation of targeted and temporary fiscal stimulus is providing a sizable boost to domestic demand in 2009 and 2010.** Moreover, the shift of the budget into deficit is appropriate in current circumstances, given low public debt by advanced country standards. There is scope for further fiscal stimulus if the outlook for growth weakens, although monetary policy should be the first line of defense, given that it remains effective. The government's commitment to return to surpluses and achieve a positive budget balance, on average, over the medium term is commendable. However, further fiscal adjustment may be needed to achieve this objective if trend growth and the terms of trade are lower than assumed.

54. **Banks' healthy starting position and the prompt policy response to the global crisis helped preserve financial stability, but some vulnerabilities remain.** On the liabilities side, despite relatively good regulation and supervision, banks were exposed to significant risks from short-term wholesale funding. The introduction of the wholesale funding and retail deposit guarantees and RBA actions to provide sufficient liquidity helped maintain financial sector stability. But banks must continue to manage carefully their short-term offshore debt and the planned introduction of new liquidity guidelines should encourage less reliance on short-term wholesale funding. On the asset side, non-performing loans could rise further (albeit from a low base) as unemployment increases and growth remains weak.

Banks have increased provisioning against such losses and raised equity from private capital markets in early 2009.

55. **APRA regularly undertakes stress tests and in the future these tests should be based on more extreme scenarios than used in the past.** Prudential judgment should be used to assess the adequacy of the banks' capital buffers, and capital requirements raised if necessary. The ongoing work on crisis preparedness will be important to prepare for the unlikely event of liquidity or solvency problems in major banks in Australia and New Zealand.

56. **Australia's current account deficit and sizable short-term debt are vulnerabilities in the current global environment.** In the past, Australia has readily financed its current account deficit, but global capital markets and the availability of capital have become more challenging. A further tightening of credit conditions would likely result in a fall in investment, with negative implications for potential growth. Nonetheless, Australia remains a relatively attractive destination for investment, especially in the resource sector. The currency risk associated with the external debt is mitigated by widespread foreign exchange hedging.

57. It is proposed that the next Article IV consultation cycle with Australia take place on the standard 12-month cycle.

Table 1. Australia: Selected Economic Indicators, 2006–10

Nominal GDP (2008): $A 1,183 billion (US$1,012 billion) — Quota (in millions): SDR 3,237
GDP per capita (2008): US$47,204 — Population (December 2008): 21.6 million
Unemployment rate (June 2009): 5.9 percent

	2006	2007	2008	2009	2010
				Proj	
Output and demand (percent change)					
Real GDP	2.8	4.0	2.3	-0.5	1.5
Total domestic demand	3.1	5.9	3.8	-3.3	0.4
Private consumption	3.2	4.3	2.2	0.5	-0.5
Total investment	5.1	9.5	9.1	-10.5	-1.7
Net exports 1/	-0.8	-1.7	-1.5	3.2	0.8
Inflation and unemployment (in percent)					
CPI inflation	3.5	2.3	4.4	1.6	1.5
Unemployment rate	4.8	4.4	4.2	6.3	7.4
Saving and investment (in percent of GDP)					
Gross national saving	21.6	22.3	24.3	22.2	22.2
General government saving	4.7	4.8	4.3	2.8	1.0
Private saving 2/	16.9	17.6	20.0	19.4	21.2
Gross capital formation	26.6	28.2	28.6	25.7	25.7
Fiscal indicators (cash basis, in percent of GDP) 3/					
Receipts	26.5	26.1	26.1	24.2	23.9
Payments	24.8	24.2	24.0	26.6	28.8
Underlying cash balance	1.6	1.6	1.7	-2.7	-5.1
Fiscal balance (accrual basis)	1.6	1.9	1.9	-2.8	-4.7
Net debt	-0.4	-2.8	-4.0	-0.4	4.8
Money and credit (end of period)					
Interest rate (90-day bill, in percent) 4/	6.4	7.2	4.2	3.2	…
Treasury bond yield (10-year, in percent) 4/	5.9	6.3	4.0	5.4	…
M3 (percent change) 4/	12.9	22.5	15.0	15.0	…
Private domestic credit (percent change) 4/	14.3	17.2	7.7	5.2	…
Balance of payments (in percent of GDP)					
Current account	-5.3	-6.2	-4.3	-3.4	-3.4
Of which: Trade balance	-1.3	-2.0	-0.4	-0.3	-0.1
Terms of trade (percent change)	7.5	4.6	13.3	-12.1	-1.5
External assets and liabilities (in percent of GDP)					
Net external liabilities	59.4	60.3	60.3	65.8	67.8
Net external debt	53.3	55.7	58.8	60.4	62.2
Gross official reserves 4/	6.9	2.8	4.0	4.1	...
Net official reserves 4/	3.1	3.3	4.1	4.1	...
Exchange rate (period average)					
U.S. dollar/Australian dollar 4/	0.75	0.84	0.85	0.80	…
Trade-weighted index 4/	63.0	67.5	66.4	61.7	…
Real effective exchange rate 5/	124.7	133.3	132.1	120.2	…
Memorandum Item:					
Nominal GDP (in billions of Australian dollar)	1,004	1,087	1,183	1,170	1,197

Sources: Data provided by the Australian authorities; and Fund staff estimates and projections.

1/ Contribution to growth.

2/ Includes public trading enterprises.

3/ Fiscal year ending June 30, Commonwealth Budget.

4/ Data for 2009 are for latest available month.

5/ IMF, Information Notice System index (2000 = 100).

Table 2. Australia: Fiscal Accounts, 2004/05–2012/13 1/
(In percent of GDP)

					Est.	Projections 2/			
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Fiscal accounts on an accrual basis 3/									
Commonwealth government									
Revenue	27.0	27.0	26.9	26.8	24.7	24.7	24.1	24.7	25.2
Tax	25.6	25.4	25.1	25.3	...	...	...	...	...
Income tax	18.2	18.2	18.1	18.4	...	...	...	...	...
Individuals and other withholdings	12.1	11.8	11.2	11.1	...	...	...	...	...
Indirect and other tax	7.5	7.2	7.0	6.9	...	...	...	...	...
Nontax	1.4	1.6	1.8	1.5	...	...	...	...	...
Expenditure	25.7	25.2	24.8	24.7	27.1	28.9	28.0	27.6	27.3
Salaries and wages	1.3	1.3	1.3	1.3	1.3	1.5	1.4	1.3	1.2
Goods and services	5.0	5.0	4.9	4.6	4.8	5.4	5.1	5.1	4.9
Current transfers	17.0	16.7	16.2	16.2	17.9	18.0	17.9	18.0	18.0
Other expenses	2.3	2.2	2.4	2.6	3.0	4.1	3.6	3.2	3.2
Net capital investment	0.1	0.3	0.2	0.2	0.4	0.5	0.5	0.5	0.4
Fiscal balance 4/	1.2	1.6	1.9	1.9	-2.8	-4.7	-4.4	-3.4	-2.5
State, Territory, and local government balance	0.4	0.3	0.0	-0.4	-1.1	-1.9	-1.6	-1.1	-0.5
Public nonfinancial corporations balance 5/	-0.3	-1.0	-0.1	-1.1	-1.6	-1.6	…	…	…
Nonfinancial public sector balance	1.3	1.0	0.8	0.1	-5.7	-8.0	…	…	…
Fiscal accounts on a cash basis									
Commonwealth government									
Receipts (including Future Fund earnings)	26.3	26.5	26.1	26.1	24.2	23.9	23.6	23.9	24.5
Payments	24.8	24.8	24.2	24.0	26.6	28.8	27.8	27.3	26.6
Future Fund earnings	…	0.0	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Underlying cash balance 6/	1.5	1.6	1.6	1.7	-2.7	-5.1	-4.5	-3.6	-2.3
Memorandum items:									
Commonwealth government net debt 7/	1.3	-0.4	-2.8	-4.0	-0.4	4.8	9.2	12.8	14.2
Nominal GDP (in billions of Australian dollars)	898	967	1,046	1,132	1,195	1,169	1,230	1,290	1,373
Real GDP growth (in percent)	2.8	3.0	3.3	3.7	0.8	-0.3	2.8	3.0	3.9

Sources: Commonwealth of Australia: *Budget Strategy and Outlook, 2009–10; a* nd Fund staff estimates and projections.

1/ Fiscal year ends June 30.
2/ Expenditure projections as presented in the *Budget Strategy and Outlook, 2009–10* , staff projections for revenue and balances.
3/ Accrual data are reported on a consistent basis with *Government Financial Statistics* (*GFS*).
4/ The fiscal balance is equal to revenue less expenses and net capital investment.
5/ The consolidated Commonwealth, state, and local governments.
6/ Underlying cash balance equals receipts less payments, and excludes earnings of the Future Fund.
7/ Includes Future Fund assets that are kept in cash and debt instruments.

Table 3. Australia: Medium-Term Scenario, 2008–14

	Average		Projections					
	1998–2007	2008	2009	2010	2011	2012	2013	2014
Real economic indicators (percent change)								
GDP	3.6	2.3	-0.5	1.5	2.8	3.7	3.7	3.4
Total domestic demand	4.7	3.8	-3.3	0.4	2.4	3.4	3.3	2.9
Private consumption	4.0	2.2	0.5	-0.5	1.2	2.6	2.7	2.4
Government consumption	3.2	3.7	2.1	2.2	2.4	2.3	2.0	2.0
Total investment	6.5	9.1	-10.5	-1.7	4.5	5.6	5.1	4.4
Private sector	10.5	8.6	-15.5	-5.8	6.0	6.9	6.3	5.3
Business	8.6	13.8	-19.4	-11.3	7.4	7.8	8.4	7.0
Dwelling	3.8	2.5	-7.1	5.0	3.6	5.3	2.4	2.0
Public sector	4.2	12.0	16.1	14.2	-0.3	1.5	1.1	0.8
Net exports 1/	-0.8	-1.5	3.2	0.8	0.4	0.4	0.4	0.6
Output gap	0.2	1.3	-1.4	-2.2	-1.9	-0.8	-0.3	0.0
CPI inflation	2.8	4.4	1.6	1.5	2.2	2.6	2.5	2.5
Unemployment rate (percent)	6.0	4.2	6.3	7.4	7.5	6.2	5.7	5.0
Saving and investment (percent of GDP)								
Gross national saving	20.6	24.3	22.2	22.2	22.5	22.5	22.8	23.2
General government saving	4.1	4.3	2.8	1.0	1.4	2.2	3.4	3.8
Private saving 2/	16.5	20.0	19.4	21.2	21.1	20.3	19.5	19.3
Of which: Household	5.9	7.2	5.8	6.9	8.0	8.5	8.9	9.5
Gross capital formation	25.3	28.6	25.7	25.7	26.1	26.6	26.9	27.0
Of which: Private fixed investment	21.0	24.1	21.1	19.6	20.2	20.8	21.3	21.6
Commonwealth budget (percent of GDP) 3/								
Receipts (cash basis)	25.8	26.1	24.2	23.9	23.6	23.9	24.5	24.9
Payments (cash basis)	24.8	24.0	26.6	28.8	27.8	27.3	26.6	26.3
Underlying cash balance 4/	1.0	1.7	-2.7	-5.1	-4.5	-3.6	-2.3	-1.7
Fiscal balance (accrual basis)	0.9	1.9	-2.8	-4.7	-4.4	-3.4	-2.5	-1.7
Net debt	5.1	-4.0	-0.4	4.8	9.2	12.8	14.2	14.9
Balance of payments (percent of GDP)								
Balance on goods and services	-1.5	-0.4	-0.1	0.2	0.7	0.7	0.7	1.1
Balance on income and transfers	-3.3	-3.9	-3.3	-3.6	-4.3	-4.7	-4.8	-4.9
Current account balance	-4.8	-4.3	-3.4	-3.4	-3.6	-4.1	-4.1	-3.9
Trade in goods and services (percent change)								
Export volume	3.0	3.9	1.4	3.2	5.6	5.8	6.4	6.3
Import volume	8.2	10.3	-11.9	-0.3	4.0	4.3	4.7	4.2
Terms of trade	4.1	13.3	-12.1	-1.5	1.2	-1.6	-1.5	-0.4
Export price	4.0	22.2	-16.0	-0.5	5.7	1.6	0.5	-0.6
Import price	-0.1	7.6	-4.6	1.4	4.5	3.2	2.0	-0.3
External liabilities								
Net external liabilities (percent of GDP)	54.7	60.3	65.8	67.8	68.1	68.2	68.7	68.9
Net external interest (percent of exports)	9.5	10.3	12.6	13.6	15.7	17.6	17.6	17.9
Net foreign debt	45.9	58.8	60.4	62.2	62.5	62.6	63.0	63.2
Memorandum item:								
Nominal GDP (in billions of Australian dollar)	806.1	1,183	1,170	1,197	1,258	1,334	1,410	1,489
Partner country GDP growth	4.1	2.7	-1.8	2.6	4.3	4.8	4.8	4.6

Sources: Data provided by the Australian authorities; and Fund staff estimates and projections.

1/ Contribution to growth.
2/ Includes public trading enterprises.
3/ Fiscal year basis ending June 30.
4/ Underlying cash balance equals receipts less payments, and excludes Future Fund earnings.

Table 4. Australia: Balance of Payments, 2005–09
(In percent of GDP)

	2005	2006	2007	2008	Proj. 2009
Current account balance	-5.8	-5.3	-6.2	-4.3	-3.4
Goods balance	-1.9	-1.3	-2.0	-0.4	-0.3
Exports	15.0	16.5	15.6	18.9	16.0
Imports	-16.9	-17.8	-17.6	-19.3	-16.2
Net services	0.1	0.1	0.1	0.0	0.1
Total credits	4.4	4.4	4.4	4.5	4.1
Total debits	-4.3	-4.3	-4.3	-4.5	-4.0
Net income	-3.9	-4.1	-4.4	-3.9	-3.2
Of which: Net interest payments	-1.8	-2.1	-2.4	-2.4	-2.5
Of which: Net equity income	-2.1	-1.9	-1.9	-1.4	-0.6
Net transfers	-0.1	0.0	0.0	0.0	-0.1
Capital and financial account	5.9	5.4	6.2	4.3	3.5
Capital account	0.2	0.2	0.2	0.2	0.2
Financial account	5.7	5.1	6.1	4.1	3.2
Direct investment transactions (net)	0.8	0.6	3.0	1.1	0.3
Equity (net)	-0.9	-1.0	1.2	-0.5	0.4
Debt (net)	1.8	1.6	1.9	1.6	0.0
Portfolio investment transactions (net)	4.5	6.7	-2.4	2.8	4.7
Equity (net)	-0.8	-1.7	-4.0	2.6	3.2
Debt (net)	5.2	8.4	1.6	0.2	1.5
Financial derivatives (net)	-0.2	0.2	-1.3	0.2	-0.3
Other transactions (net)	0.6	-2.4	6.7	0.0	-1.5
Net errors and omissions	-0.2	-0.1	0.0	0.0	0.0
	(Assets and liabilities at end-period)				
Net external liabilities	57.0	59.4	60.3	60.3	65.8
Net external equity liabilities	6.0	6.1	4.5	1.6	5.4
Foreign equity investment in Australia	51.5	57.3	61.6	43.6	…
Australian equity investment abroad	-45.5	-51.2	-57.1	-42.0	…
Net external debt	51.0	53.3	55.7	58.8	60.4
Net public sector	1.0	0.3	3.8	6.4	…
Net private sector	50.0	53.1	52.0	52.4	…
Gross external debt	83.4	92.3	95.2	106.5	…
Of which: Australian dollar-denominated	30.1	33.4	38.3	40.4	…
Gross external lending	-32.4	-39.0	-39.5	-47.8	…
Short-term net external debt (residual maturity basis)	19.2	19.1	24.9	25.5	…
Short-term gross external debt	37.3	40.3	44.4	51.6	…
Short-term gross external lending	-18.0	-21.2	-19.4	-26.1	…
Memorandum items:					
Gross official reserves (in billions of Australian dollars)	59.0	69.6	30.5	47.5	…
Gross reserves in months of imports	3.6	3.8	1.5	2.0	…
Gross reserves to ST FX denominated debt (percent)	24.6	23.6	9.7	12.2	…
Net interest payments to exports (percent)	9.1	10.2	12.1	10.3	…

Sources: Data provided by the Australian authorities; and Fund staff estimates and projections.

Table 5. Australia: Balance of Payments in U.S. Dollars, 2004–08
(In billions of U.S. dollars)

	2004	2005	2006	2007	2008
Current account balance	-38.9	-41.1	-40.1	-56.8	-43.6
Goods balance	-17.9	-13.7	-9.9	-17.8	-3.6
Exports	87.0	106.8	124.7	142.4	191.4
Imports	-105.0	-120.4	-134.6	-160.2	-195.1
Net services	0.5	0.6	0.9	1.2	-0.4
Total credits	28.5	31.0	33.1	40.4	45.4
Total debits	-27.9	-30.5	-32.2	-39.2	-45.9
Net income	-21.3	-27.6	-30.8	-39.9	-39.1
Of which: Net interest payments	-11.0	-12.6	-16.1	-22.1	-24.3
Of which: Net equity income	-10.0	-14.9	-14.4	-17.4	-14.0
Net transfers	-0.2	-0.4	-0.3	-0.3	-0.4
Capital and financial account	39.6	42.1	40.6	56.9	43.2
Capital account	1.1	1.2	1.7	1.6	2.0
Financial account	38.5	40.8	38.9	55.3	41.2
Direct investment transactions (net)	27.1	6.0	4.4	27.6	11.0
Equity (net)	22.5	-6.7	-7.5	10.7	-5.6
Debt (net)	4.6	12.7	11.9	16.9	16.6
Portfolio investment transactions (net)	16.7	31.9	50.9	-21.6	28.5
Equity (net)	-35.1	-5.4	-12.9	-36.6	26.2
Debt (net)	51.8	37.3	63.8	14.9	2.3
Financial derivatives (net)	-2.2	-1.6	1.8	-11.9	1.8
Other transactions (net)	-3.1	4.4	-18.3	61.2	-0.1
Net errors and omissions	-0.4	-1.2	-0.6	0.1	0.5
	(Assets and liabilities at end-period)				
Net external liabilities	379.1	391.0	471.8	577.5	494.5
Net external equity liabilities	55.0	41.2	48.1	43.5	12.9
Foreign equity investment in Australia	373.2	353.1	455.2	590.6	357.5
Australian equity investment abroad	-318.2	-311.8	-407.1	-547.1	-344.6
Net external debt	324.1	349.8	423.7	534.0	481.7
Net public sector	10.7	6.9	2.1	36.0	52.3
Net private sector	313.4	342.9	421.5	498.0	429.4
Gross external debt	542.8	571.7	733.5	912.1	873.3
Of which: Australian dollar-denominated	192.4	206.7	265.2	367.0	331.4
Gross external lending	-218.7	-221.8	-309.8	-378.1	-391.6
Short-term net external debt (residual maturity basis)	121.9	132.0	152.0	239.1	208.8
Short-term gross external debt	251.7	255.6	320.6	425.4	422.9
Short-term gross external lending	-129.7	-123.6	-168.5	-186.4	-214.1

Sources: Data provided by the Australian authorities; and Fund staff estimates.

Table 6. Australia: Indicators of External and Financial Vulnerability, 2004–08
(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008
External indicators					
Real exports of goods (percent change)	3.8	2.4	3.3	2.5	3.2
Real imports of goods (percent change)	14.2	9.9	8.2	11.1	10.3
Terms of trade (percent change)	9.3	11.7	7.5	4.6	13.3
Current account balance	-6.1	-5.8	-5.3	-6.2	-4.3
Capital and financial account balance	6.2	5.9	5.4	6.3	4.3
Of which:					
Net portfolio investment	2.6	4.5	6.7	-2.4	2.8
Net direct investment	4.2	0.8	0.6	3.0	1.1
Total reserves (in billions of U.S. dollar)	36.9	43.3	55.1	26.9	32.9
In months of imports of goods and services	3.2	3.6	3.8	1.5	2.0
Total net reserves (in billions of U.S. dollar)	19.5	21.0	24.3	31.6	33.3
Net international investment position	-56.0	-57.0	-59.4	-60.3	-60.3
Of which:					
Net external public sector debt	1.6	1.0	0.3	3.8	6.4
Net external private sector debt	46.3	50.0	53.1	52.0	52.4
Net interest payments to exports (in percent)	9.5	9.1	10.2	12.1	10.3
Nominal effective exchange rate (percent change)	7.5	2.5	-1.2	6.8	-1.6
Financial market indicators					
General government gross debt (percent of GDP)	12.0	11.0	10.1	9.8	11.7
Interest rates (percent)					
3-month T-bill	5.5	5.6	6.0	6.7	7.0
3-month interest rate spread vis-à-vis U.S.	4.1	2.4	1.1	2.2	5.6
10-year government bond	5.6	5.3	5.6	6.0	5.8
Capital adequacy					
Regulatory capital to risk-weighted assets	10.5	10.4	10.4	10.2	11.4
Tier I capital to risk-weighted assets 1/	7.6	7.6	7.4	7.2	8.2
Asset quality 2/					
Impaired assets to total assets	0.3	0.2	0.2	0.2	0.8
Specific provisions to impaired assets	41.4	37.1	39.1	39.5	36.3
Loans composition (share of total)					
Public sector	2.2	1.5	1.4	1.3	1.8
Individuals	62.1	62.3	60.4	54.6	54.0
Housing loans	53.6	53.8	51.9	46.7	47.5
Investor housing	18.4	18.2	17.2	15.4	15.3
Commercial lending	35.7	36.3	38.2	44.1	44.2
Financial intermediaries	7.8	7.5	8.8	12.8	13.5
Nonfinancial sector	27.9	28.7	29.4	31.3	30.7

Sources: Data provided by the Australian authorities; and Fund staff estimates.

1/ Tier I capital includes issued and fully paid common equity and perpetual noncumulative preference shares, and disclosed reserves.

2/ Q4 quarterly data.

APPENDIX I. AUSTRALIA: POLICY RESPONSES TO THE GLOBAL FINANCIAL CRISIS

Monetary Policy	Cash rate target cut by cumulative 425 basis points to 3 percent since September 2008.
Liquidity Support	The Reserve Bank of Australia (RBA) extended the list of securities used as collateral in repo operations to include residential mortgage-backed securities, commercial paper, and asset-backed commercial paper. Furthermore, the RBA extended the maturity of repos to one year. The RBA established a US$30 billion swap line with the US Federal Reserve Bank in September 2008, initially through January 2009 and later extended to October 2009. The government announced that it would purchase up to $A 8 billion of residential mortgage-backed securities.
Funding Guarantees	Under the Financial Claims Scheme, total deposit balances up to and including $A 1 million per customer held in eligible authorized deposit taking institution (Australian-owned and subsidiaries of foreign-owned banks, but not branches) are guaranteed. Deposits over $A 1 million can also be guaranteed for the same fees as applied for wholesale funding. The scheme became effective in October 2008 and will remain in place until October 2011. Eligible authorized deposit taking institutions can secure guarantees for their existing or new wholesale funding for a fee ranging from 70 to 150 basis points depending on the credit rating of the institution.
Financial Regulation/ Supervision	The authorities enhanced supervision of credit rating agencies and research houses. In September 2008, the Australian Securities and Investments Commission (ASIC) banned covered short selling of financial and nonfinancial stock. In December 2008, the government passed legislation to ban all naked short selling in Australia (subject to any exemption put in place by ASIC). The ban on covered short selling of nonfinancial stocks was lifted in November 2008. The ban on covered short selling of financial stocks was lifted in May 2009. The RBA is working with industry representatives to improve disclosure of securities lending activity.

APPENDIX II. AUSTRALIA: FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP): KEY RECOMMENDATIONS OF THE 2006 FSAP AND UPDATE ON THE PROGRESS OF IMPLEMENTATION[1]

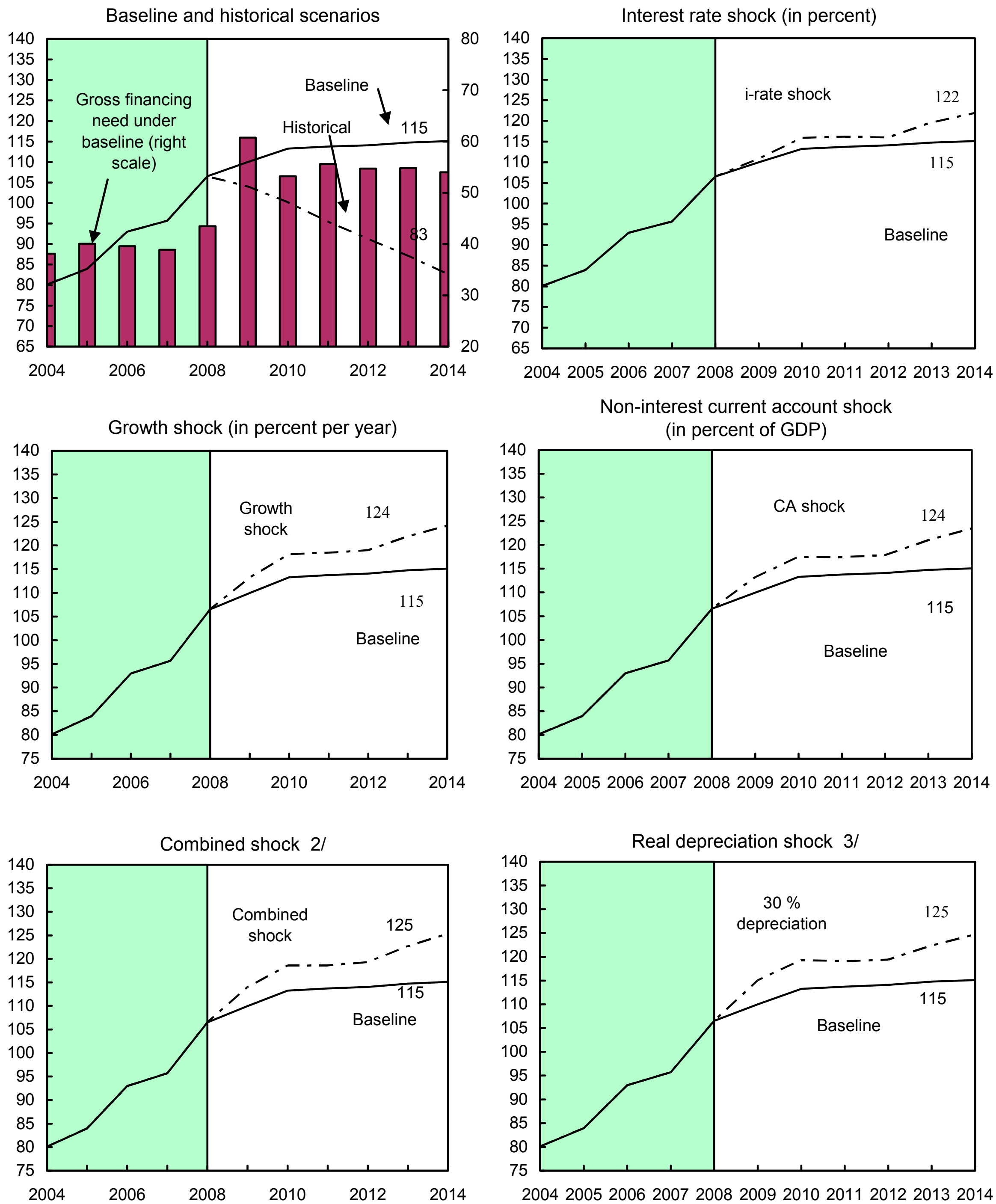
Issue	Key Recommendations	Progress of Implementation
Banking	Continue to ensure strong risk management practices, including through regular stress testing.	The Basel II framework came into effect in January 2008, with regular stress testing forming an important element of the framework. Five banks were approved to adopt the internal ratings based approach with respect to credit risk, and advanced measurement approach (AMA) for operational risk.
Failure Resolution and Crisis Management	Continue to develop a formal process to manage the failure of individual institutions and more widespread crises.	The government introduced in October a Financial Claims Scheme (FCS) intended to provide depositors in a failed ADI with timely access to the first $A 1 million of their funds, and policyholders of a failed general insurer with a right to have claims met. The legislation also included broader crisis management arrangements, enhancing regulators' ability to deal with a distressed ADI or general insurer.
Supervisory Capacity	Ensure that the supervisory agencies have adequate resources and flexibility.	In the 2007/08 Budget, APRA received additional funding over a four-year period to improve its staff capabilities. In October 2008, to manage issues associated with the global financial crisis, the Government provided additional funding to APRA of $A 45.5 million over four years. The government has also enhanced APRA's flexibility by removing the requirement to obtain ministerial consent before taking administrative actions. The Australian Securities and Investments Commission (ASIC) also received substantial funding increases over recent years.
Cooperation with New Zealand Regulators	Build on the progress made within the Trans-Tasman Council on Banking Supervision to improve coordination in crisis management.	Legislative changes formalizing a requirement on regulators in the two countries to be alert to each other's interests in times of stress came into force in both countries in December 2006. The work of the Trans-Tasman Council now focuses more on the practical aspects of coordination in crisis management.
Insurance	Push ahead with Stage II reforms (e.g., capital management, reinsurance documentation, corporate government standards, disclosure requirements).	APRA is harmonizing prudential requirements, including capital adequacy, between life insurance, general insurance, and banking sectors. From July 1, 2008, all Direct Offshore Foreign Insurers operating in Australia must be authorized by APRA and subject to Australia's prudential regime. Discretionary Mutual Funds are now subject to rigorous and compulsory information collection.
AML/CFT	Give high priority to make the appropriate legislative and operational arrangements in the AML/CFT area.	The AML/CFT Act was adopted in December 2006. The first tranche of reforms covered the activities of financial service providers, gambling services and bullion dealers. Implementation is now complete. The second tranche of legislative and regulatory reforms, intended to capture designated non-financial businesses and professionals is planned is under consideration by the Government. Legislation has been implemented facilitating information exchange between the Australian Transaction Reports and Analysis Centre (AUSTRAC) and APRA.

Source: IMF Staff.

[1] A detailed discussion and a full list of recommendations can be found in the Financial System Stability Assessment (*IMF Country Report No. 06/372*).

Appendix III. Australia: External Debt Sustainability: Bound Tests [1/]

(Gross external debt in percent of GDP)



Sources: International Monetary Fund, country desk data; and Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009. This scenario assumes foreign exchange hedging covers 79 percent of foreign currency debt, consistent with the findings of a survey by the Australian Bureau of Statistics, as reported in "Australia's Foreign Currency Exposure and Hedging Practices," RBA Bulletin, December 2005.

INTERNATIONAL MONETARY FUND

AUSTRALIA

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department

July 22, 2009

Contents Page

ANNEX I. AUSTRALIA—FUND RELATIONS
(As of June 30, 2009)

I. Membership Status: Joined: August 5, 1947; Article VIII

II. General Resources Account:	**SDR Million**	**Percent Quota**
Quota	3,236.40	100.00
Fund holdings of currency	2,665.22	82.35
Reserve position in Fund	571.66	17.66

III. SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	470.55	100.00
Holdings	112.49	23.91

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund[1] (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	**2010**	**2011**	**2012**	**2013**
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.71	1.36	1.36	1.36	1.36
Total	0.71	1.36	1.36	1.36	1.36

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Exchange Rate Arrangement. Australia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange system that is free from restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions that are maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). The exchange rate is independently floating, but the Reserve Bank of Australia retains discretionary power to intervene. There are no taxes or subsidies on purchases or sales of foreign exchange.

VIII. Restrictions on Capital Transactions. Australia maintains a capital transactions regime that is virtually free of restrictions. Two main restrictions on foreigners require: authorization for significant ownership of Australian corporations; and approval for acquisition of real estate.

IX. Article IV Consultation. Australia is on the 12-month consultation cycle. The 2008 Article IV consultation discussions were held during June 23–July 1, 2008, the Executive Board discussed the staff report (IMF Country Report No. 08/312) and concluded the consultation on September 10, 2008.

X. FSAP Participation. The FSAP missions took place during November 30–December 14, 2005, and March 26–April 12, 2006. The FSSA (including financial sector ROSCs), the Detailed Assessment of Observance of Standards and Codes, and the Technical Note on Investor Protection, Disclosure, and Financial Literacy, were published as Country Reports No. 06/372, No. 06/415, and No. 06/437, respectively.

XI. Fourth Amendment. Australia has accepted the Fourth Amendment to the Articles of Agreement.

Annex II. Australia: Statistical Issues

Data provision is adequate for surveillance. Australia subscribed to the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). In recent years, the Australian Bureau of Statistics (ABS) has taken several initiatives to further improve the quality of the data, such as including the prices of financial services in the CPI and developing new measures of labor underutilization.

In September 2006, STA met with officials from the ABS, the Australian Prudential Regulation Authority, and the Reserve Bank of Australia to encourage the reporting of monetary data using the standardized report forms (SRFs) introduced in October 2004. The SRFs provide for accounting data to be broken down by instrument, sector, and currency.

Table of Common Indicators Required for Surveillance
(As of July 2, 2009)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	07/2/09	07/2/09	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	05/09	06/10/09	M	M	M
Reserve/Base Money	05/09	06/10/09	M	M	M
Broad Money	05/09	06/10/09	M	M	M
Central Bank Balance Sheet	05/27/09	06/10/09	W	W	W
Consolidated Balance Sheet of the Banking System	05/09	06/30/09	M	M	M
Interest Rates[2]	07/2/09	07/02/09	D	D	D
Consumer Price Index	Q1 2009	04/22/09	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2007/08	6/09	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	04/09	07/1/09	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	04/09	07/1/09	M	M	M
External Current Account Balance	Q1 2009	06/02/09	Q	Q	Q
Exports and Imports of Goods and Services	05/09	07/02/09	M	M	M
GDP/GNP	Q1 2009	06/03/09	Q	Q	Q
Gross External Debt	Q1 2009	06/10/09	Q	Q	Q
International Investment Position[7]	Q1 2009	06/02/09	Q	Q	Q

1 Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2 Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3 Foreign, domestic bank, and domestic nonbank financing.
4 Consists of the central government (including budgetary, extra budgetary, and social security funds) and state and local governments.
5 Including currency and maturity composition.
6 Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
7 Includes external gross financial asset and liability positions vis a vis nonresidents.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/101
FOR IMMEDIATE RELEASE
August 7, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Australia

On August 5, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Australia.[1]

Background

Australia was in a strong economic position at the onset of the global recession. Sound macroeconomic policies and structural reforms, together with a stable external environment, delivered 17 years of continuous economic growth. National income was boosted in recent years by a commodity price boom, which pushed the terms of trade to its highest level in more than half a century. The Commonwealth government took advantage of the favorable environment and eliminated its net debt. Banks were also in a healthy position at the onset of the turmoil, with returns on equity of 15–20 percent. Further, a conservative approach by regulators and supervisors meant that banks had relatively low leverage and high capital adequacy ratios.

The turmoil sparked by the collapse of Lehman Brothers in September 2008 had an immediate impact on Australian markets. Key commodity prices fell sharply, domestic money markets came under stress, offshore funding tightened, the currency depreciated, and equity prices plunged.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

However, the crisis has not hit real activity in Australia as hard as in many other advanced economies owing to limited higher-tech manufacturing, robust commodity exports, and an effective policy response. The 425 basis point reduction in the Reserve Bank of Australia's policy interest rate since September 2008 has been largely passed through to lending rates, while the sound banking system helped avoid a sharp contraction of credit. The flexible exchange rate has provided a buffer for export incomes. In addition, a sizable fiscal stimulus is being delivered, supporting domestic demand.

Nonetheless, the crisis highlighted some vulnerabilities and the near-term outlook remains highly uncertain. Both household debt (at over 150 percent of disposable income in 2008) and short-term external borrowing (at over 50 percent of GDP in 2008) are high by advanced country standards. Unemployment has increased, but less so than in many other advanced countries. Aggressive policy action is expected to limit the decline in activity to ½ percent in 2009. The recovery will likely be slow, with growth of 1½ percent projected for 2010, led by government spending on infrastructure, as households and businesses continue to deleverage.

Executive Board Assessment

Executive Directors commended the authorities for their timely policy response, which has effectively cushioned the impact of the global financial crisis on the Australian economy. The sizable fiscal and monetary stimulus, a flexible exchange rate, and a resilient banking sector should underpin a sustained recovery. Australia is in a strong position to deliver further macroeconomic policy stimulus if needed.

Directors noted that the near-term outlook for growth is weak and subject to high uncertainties in global financial markets. Australia's persistent current account deficit, sizable short-term external debt, and worsening households' balance sheets were seen as vulnerabilities. While a number of factors are at play to mitigate these vulnerabilities, including the robust supervisory framework and the widespread hedging against currency risk, vigilance continues to be required.

Directors welcomed the Reserve Bank of Australia's early reductions in the policy rate and supported the current monetary policy stance. They saw room for further policy rate cuts, as the first line of defense in the event that the outlook for growth and inflation weakens. Directors noted that unconventional monetary policy easing measures, though unlikely to be needed, should remain in the authorities' toolkit. They agreed that the flexible inflation-targeting framework has been successful in anchoring medium-term inflation expectations.

Directors considered that the flexible exchange rate policy provides a helpful buffer against external shocks. The depreciation of the currency helped sustain export incomes as the U.S. dollar price of commodity exports fell sharply in late 2008. Directors noted the staff's assessment that the Australian dollar in real effective terms is broadly in line with medium-term fundamentals.

Directors welcomed the targeted, temporary fiscal stimulus, which is expected to support domestic demand in 2009 and 2010. Given low public debt, they generally considered that there remains scope for further fiscal stimulus if warranted by circumstances, while stressing the need to exercise prudence in light of the contingent liabilities associated with exceptional support provided to the financial sector. Directors welcomed the government’s commitment to a deficit exit strategy, aimed at returning the budget to surpluses over the medium term. They recognized, however, that further fiscal adjustment could be needed to achieve this objective if trend growth and the terms of trade are lower than assumed.

Directors observed that the banking sector entered the global recession from a position of strength, and that banks have subsequently increased provisioning against rising nonperforming loans. Noting that banks are exposed to risks from short-term wholesale funding, they welcomed the planned introduction of new liquidity guidelines to encourage banks to reduce reliance on this source of funding. Directors encouraged the authorities to remain vigilant to house price adjustments and to monitor banks’ property exposures closely.

Directors commended the Australian Prudential Regulation Authority for regularly stress testing financial institutions. It will be prudent to conduct future stress tests based on more extreme scenarios, and to raise capital requirements if necessary. Directors welcomed the ongoing work on crisis preparedness in the unlikely event of liquidity or solvency problems.

Australia: Selected Economic Indicators, 2006–10

Nominal GDP (2008): $A 1,183 billion (US$1,012 billion) Quota (in millions): SDR 3,237
Unemployment rate (June 2009): 5.9 percent

	2006	2007	2008	2009	2010 Proj
Output and demand (percent change)					
Real GDP	2.8	4.0	2.3	-0.5	1.5
Total domestic demand	3.1	5.9	3.8	-3.3	0.4
Private consumption	3.2	4.3	2.2	0.5	-0.5
Total investment	5.1	9.5	9.1	-10.5	-1.7
Net exports 1/	-0.8	-1.7	-1.5	3.2	0.8
Inflation and unemployment (in percent)					
CPI inflation	3.5	2.3	4.4	1.6	1.5
Unemployment rate	4.8	4.4	4.2	6.3	7.4
Saving and investment (in percent of GDP)					
Gross national saving	21.6	22.3	24.3	22.2	22.2
General government saving	4.7	4.8	4.3	2.8	1.0
Private saving 2/	16.9	17.6	20.0	19.4	21.2
Gross capital formation	26.6	28.2	28.6	25.7	25.7
Fiscal indicators (cash basis, in percent of GDP) 3/					
Receipts	26.5	26.1	26.1	24.2	23.9
Payments	24.8	24.2	24.0	26.6	28.8
Underlying cash balance	1.6	1.6	1.7	-2.7	-5.1
Fiscal balance (accrual basis)	1.6	1.9	1.9	-2.8	-4.7
Net debt	-0.4	-2.8	-4.0	-0.4	4.8
Money and credit (end of period)					
Interest rate (90-day bill, in percent) 4/	6.4	7.2	4.2	3.2	…
Treasury bond yield (10-year, in percent) 4/	5.9	6.3	4.0	5.4	…
M3 (percent change) 4/	12.9	22.5	15.0	15.0	…
Private domestic credit (percent change) 4/	14.3	17.2	7.7	5.2	…
Balance of payments (in percent of GDP)					
Current account	-5.3	-6.2	-4.3	-3.4	-3.4
Of which: Trade balance	-1.3	-2.0	-0.4	-0.3	-0.1
Terms of trade (percent change)	7.5	4.6	13.3	-12.1	-1.5
External assets and liabilities (in percent of GDP)					
Net external liabilities	59.4	60.3	60.3	65.8	67.8
Net external debt	53.3	55.7	58.8	60.4	62.2
Gross official reserves 4/	6.9	2.8	4.0	4.1	...
Exchange rate (period average)					
U.S. dollar/Australian dollar 4/	0.75	0.84	0.85	0.80	…
Trade-weighted index 4/	63.0	67.5	66.4	61.7	…
Real effective exchange rate 4/ 5/	124.7	133.3	132.1	120.2	…

Sources: Data provided by the Australian authorities; and IMF staff estimates and projections.
1/ Contribution to growth.
2/ Includes public trading enterprises.
3/ Fiscal year ending June 30, Commonwealth Budget.
4/ Data for 2009 are for latest available month.
5/ IMF, Information Notice System index (2000 = 100).