Moody's

HD **Moody's: Australian growth robust, but some downside risks evident**

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Moody's Investors Service says that Australia's economic growth in 2014 has so far been resilient and expects expansion of 2.6%-3.0% per annum over the next five years. Moreover, Moody's believes that near-term growth appears to be driven primarily by domestic consumption, rather than exports and resource investment.

Moody's conclusions were contained in its just-released credit analysis "Australia", which looks at the country's credit profile in terms of Economic Strength [assessed as "very high (+)"]; Institutional Strength ["very high (+)"]; Fiscal Strength ["very high (+)"]; and Susceptibility to Event Risk ["very low (+)"].

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These represent the four main analytic factors in Moody's Sovereign Bond Rating Methodology. The analysis constitutes an annual update to investors and is not a rating action. Australia is rated Aaa with a stable outlook.

At the same time, Moody's notes that the relative stability of Australia's consumer confidence indicators in the last several years is remarkable, given the headwinds that Australian households have been facing. Most notably, the strong gains in consumer-driven economic activity coincided with rising unemployment and deleveraging in the private sector, although these trends were, nonetheless, counteracted by sustained earnings growth, cheap credit and a positive wealth effect from rising housing prices.

The latter trend poses some medium-term risks as Australia's real **estate** market may be overheating, with both price-to-income and price-to-rent ratios reaching levels well above historical averages. Housing prices continued to rise in Q1 2014 as average year-over-year growth in the eight largest cities inched up to 8.3%, marking the highest growth rate in nearly four years. After considering supply-side constraints, the influx of foreign capital and the fact that monetary policy is set to remain accommodative for the foreseeable future, the housing market appears to be increasingly likely to get caught up in a positive price-feedback loop and eventually could face a correction.

Re-accelerating housing credit suggests that monetary factors, especially record-low interest rates, are playing a prominent role in fueling the housing market trends. In terms of volumes, however, rising housing prices have not so far resulted in a construction boom: **residential** construction activity remains largely in line with demand trends. This, along with still historically low leverage levels, strong mortgage buffers, and well-capitalized banking system, limits the impact of a potential real **estate** market contraction on the broader economy.

The Moody's report further notes that key risks for the banking system - which has a stable outlook -- stem from macroeconomic uncertainties around the conclusion of the investment phase in the resource sector. In the short run, a timing mismatch may cause rising resource exports to fail to fully offset the economic impact of declining capital investment, leading to lower-than-expected economic growth and creating pockets of weakness in the labor market. The effect of the mismatch may be further compounded by deteriorating terms of trade.

Additionally, banks' sensitivity to employment conditions is amplified by the high proportion of household loans in their portfolios and a persistently high level of household leverage. These characteristics are, however, largely mitigated by low loan-to-value ratios, high lending standards, and an only moderate pace of growth in housing credit.

In summary, Australia's Aaa rating is based on the country's very high economic resiliency, very high government financial strength, and low susceptibility to event risk. Such economic resiliency is demonstrated by the country's large size, economic diversity, and track record of solid economic growth. As one of the world's most advanced economies, the country has not only a significant natural resource sector--including minerals, hydrocarbons, and agriculture--but also well developed manufacturing and service sectors. It also demonstrates strong governance indicators. In particular, the framework for fiscal policy is transparent and has consistently kept government debt at low levels.

Subscribers can access the report at https://www.moodys.com/research/PBC_172053.

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