



**Australia:**  
**RECENT ECONOMIC DEVELOPMENTS**

Key facts

- Head of Government: Prime Minister Scott Morrison (Liberal Party).
- Minister of Finance: Mathias Cormann (Liberal Party).
- Treasurer: Josh Frydenberg (Liberal Party).
- Governing coalition: center-right Liberal-National coalition (77 of 150 seats in the House of Representatives and 35 of 76 seats in the Senate).
- Expected date of next general elections: by May 2022.
- Governor of the Reserve Bank of Australia: Philip Lowe (since September 2016).

Suggested Topics of Discussion:

- What are the prospects for the Australia government's *planned income tax cut package* in the Australian parliament? How about the Australian government's *proposed infrastructure spending*?
- How prolonged and severe will the *ongoing housing price correction and credit squeeze* in Australia be, and how might it affect Australian fiscal policy?
- In a speech in May, RBA Governor Philip Lowe emphasized the importance of infrastructure investment and tax relief for the Australian economy.<sup>1</sup> How responsive are fiscal policymakers to *recommendations from monetary policy authorities*?

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<sup>1</sup> See Philip Lowe, "Address to the Economic Society of Australia," May 21, 2019, available at: <https://www.rba.gov.au/speeches/2019/sp-gov-2019-05-21.html>

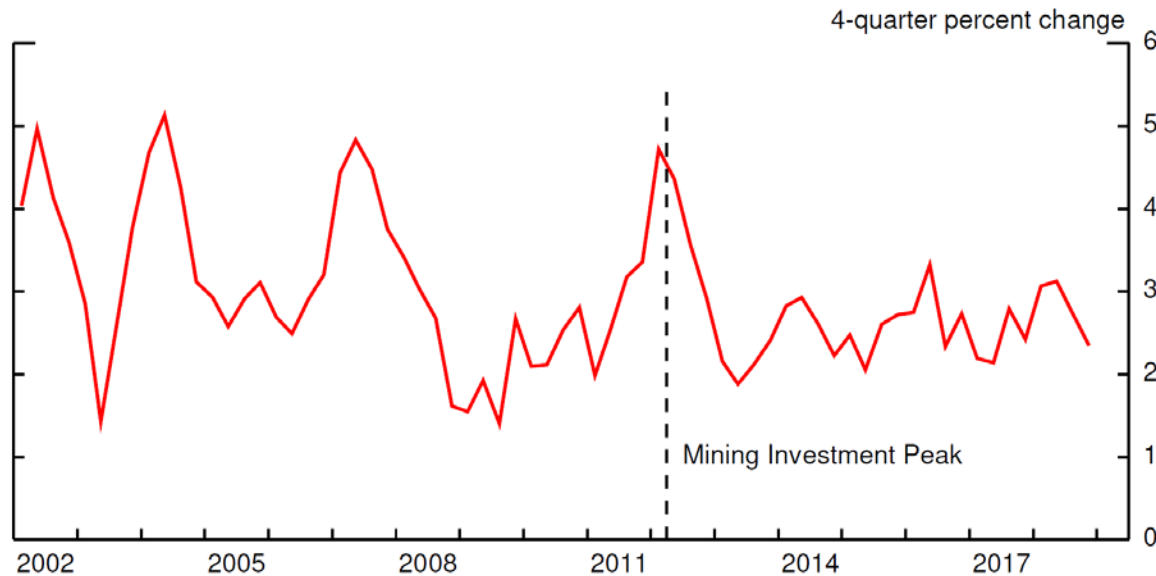
## Political developments and fiscal policy

- **Prime Minister Scott Morrison's Liberal-National coalition secured a surprise victory in the May 18 federal election**, winning a third term with a majority government in the House of Representatives. The Liberal-National coalition ran on a platform of tax cuts and fiscal responsibility, while the opposing Labor party - which pollsters had favored to win - focused on inequality and climate change. Morrison, who has been Prime Minister since August 2018, is Australia's sixth prime minister since 2007 and is the Liberal-National coalition's third head since it came to power in 2013.
- **Fiscal sustainability has become a key government priority following the sharp deterioration of Australia's fiscal position in the aftermath of the global financial crisis.** The general government net-debt-to-GDP ratio has risen from about 0 percent in 2007-08 to almost 20 percent in 2018-19, mostly due to stimulus programs enacted in 2008 and 2009.
  - Australia's federal deficit has been trending downward in recent years. After rising to 4.2 percent of GDP in 2009-10, the federal underlying cash deficit was just 0.2 percent of GDP in 2018-2019. Further, the federal Budget presented in April by Treasurer Josh Frydenberg projected in 2019-20 a positive federal underlying cash balance for the first time since the global financial crisis, and an upward trend in the cash balance thereafter. Accordingly, the Treasury expects net-debt-to-GDP to fall to 0 percent by 2029-30.
  - The Treasury also announced the government's continued commitment to income tax cuts and infrastructure investment in the Budget. In early July, Morrison plans to bring his coalition's \$158 billion income tax cut package to the federal parliament.
- **The Australian government has become concerned with China's growing presence in the country's economy and politics.** Since 2018, the Australian parliament has banned foreign interference in domestic politics, outlawed industrial espionage for a foreign power, and barred major Chinese telecommunication companies from helping to build Australia's new telecommunications network. Australia has also created a \$2 billion financing facility for countries in the Pacific (dubbed the 'Pacific step-up' program) in light of China's growing economic influence in the region via its Belt and Road Initiative.

## Economic activity

- **Australian real GDP growth has moderated since a mining boom ended in 2012.** Real GDP growth has averaged around 2½ percent in the past few years, near most estimates of its potential growth rate. Most recently, Australian GDP growth slowed to below potential in the second half of 2018, in part due to weak household consumption growth.

## Real GDP Growth



- **Recent data on economic activity have been disappointing.** Real GDP growth ebbed to 0.7 percent (a.r.) in the fourth quarter of 2018 from 1.1 percent in the third, reflecting falling private investment and a weak housing sector. The near-term outlook is tenuous: retail sales, business confidence, consumer confidence, private capital expenditures, and both manufacturing and services PMIs fell in the first quarter. That said, labor markets remain relatively tight, the manufacturing PMI has remained at a level indicating expansion, and the services PMI returned to a level indicating expansion in the second quarter.
- **China is an important trading partner for Australia.** Australian exports to China have increased over the past decade and currently account for about one-third of Australia's total exports; exports to the United States currently account for just four percent of Australia's total exports. Trade tensions between China and the United States continue to threaten the Australian economy, as do political tensions between China and Australia, with some analysts interpreting recent delays to Chinese customs clearance of Australian imports as retaliation against the Australian government's hardening stance against China.

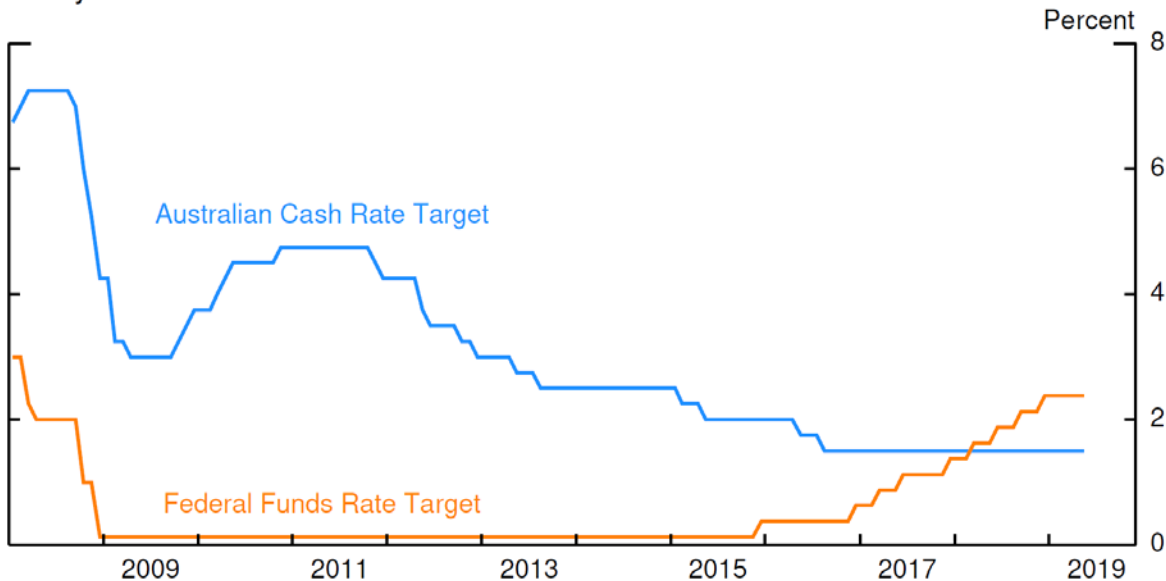
## Labor market

- **The unemployment rate has been trending downward since late-2014, albeit with a recent upswing.** The unemployment rate rose from 4.9 percent in February, a 7-year low, to 5.2 percent in April. The Reserve Bank of Australia believes the unemployment rate will remain near 5 percent through 2021 before edging lower in 2022.
- **The labor force participation rate (for the population aged 15+) trended upward through 2016 and 2017,** and has been relatively stable since. The labor force participation rate ticked up to 65.8 percent in April, returning to its January 2018 peak.
- **Following a rapid drop between 2013 and 2014, wage inflation has only recently started to show a sustained increase above 2 percent.** That said, real wage growth has been consistently low; in the first quarter of 2019, real wage growth broke 1 percent for the first time since 2012.

## Monetary policy

- **The Reserve Bank of Australia (RBA) has held its main policy rate, the cash rate, at a record low of 1.5 percent since August 2016.**
  - In a speech on May 21, Governor Philip Lowe said the RBA “will consider the case for lower interest rates” at its June 4 meeting, explaining that a rate cut “would support economic growth and bring forward the time when inflation is consistent with target.”
  - Lowe also noted that the main factor causing Australia’s growth to sputter is slow household consumption growth, owing to falling house prices and weak income growth. As a result, Lowe emphasized the importance of tax relief for strengthening household consumption.

Policy Interest Rates

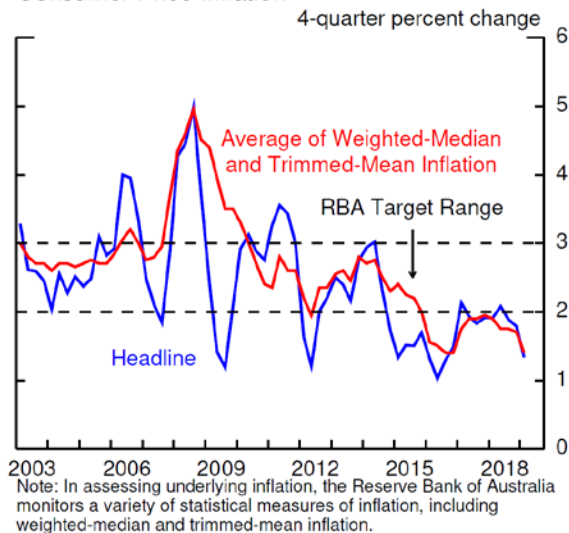


- **Since the early 1990s, the RBA has been setting the cash rate in order to meet a medium-term inflation target.**
  - In 2016, Australia’s government and the RBA reaffirmed their support for the longstanding arrangement that the appropriate target for the country’s monetary policy is an inflation rate of 2–3 per cent, on average, over time.
  - According to a 1959 law, the RBA’s “duty is to contribute to the stability of the currency, full employment, and the economic prosperity and welfare of the Australian people.”

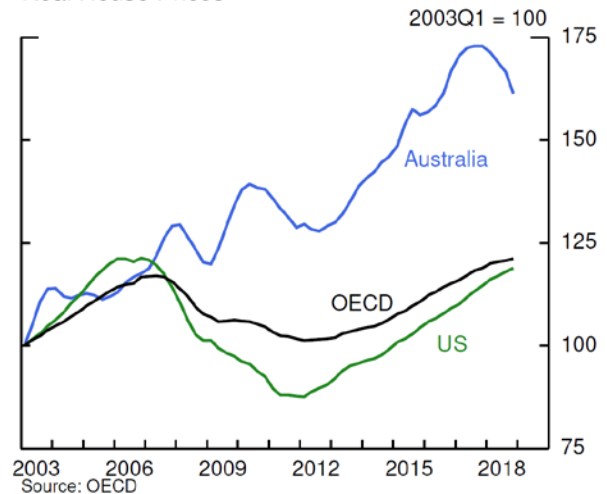
## Inflation

- **Inflation has fallen below the bottom of the RBA’s 2 to 3 percent target range.** Headline inflation was 1.3 percent on a 4-quarter basis in the first quarter of 2018, with underlying inflation only a touch higher. In a speech on May 21, Governor Lowe said the RBA expects headline inflation to temporarily rise in the near term due to petrol prices and then moderate to around 2 percent in 2019 and 2020.

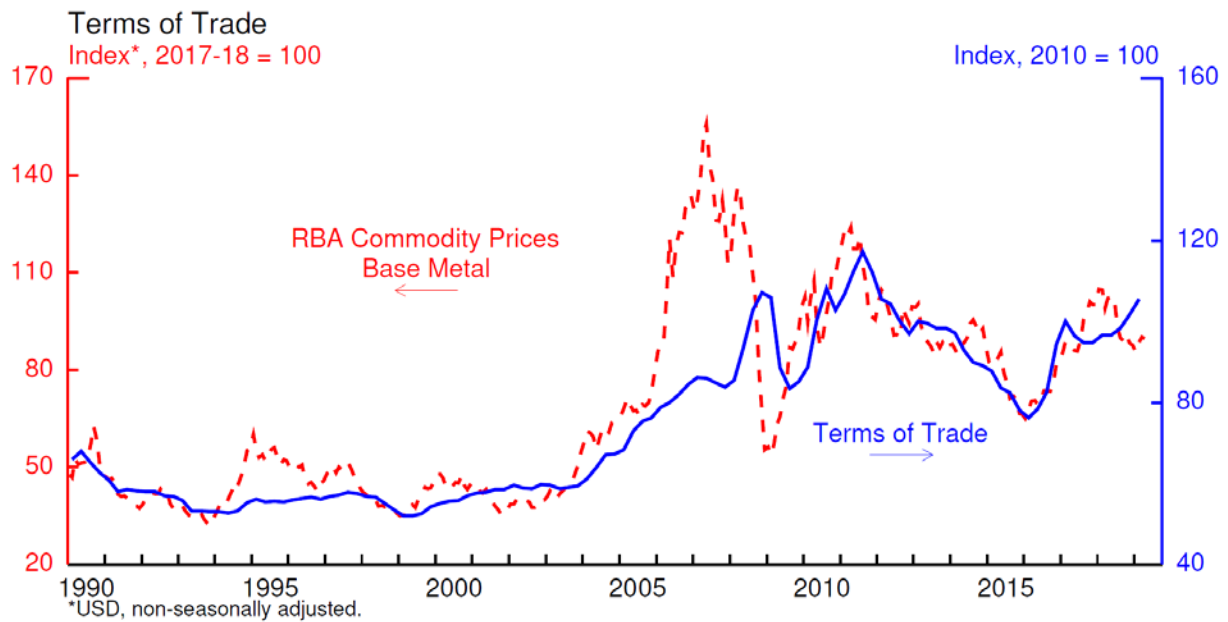
Consumer Price Inflation



Real House Prices



- House prices have been undergoing a correction after years of rapid increase.** Following a 50-percent increase in nominal house prices since the beginning of 2012, prices started falling for the first time in over 5 years in the first quarter of 2018. House price inflation has varied significantly across regions, and has been highest in Sydney and Melbourne. Accordingly, the correction in housing prices has varied across cities; while Melbourne and especially Sydney have seen prices decrease, house price inflation in Hobart continues to trend upwards. Analysts generally agree that the correction is still underway; in a speech on May 21, Lowe said the RBA expects the housing market to stabilize over the period ahead.
  - The Australian Prudential Regulation Authority (APRA) imposed supervisory measures in 2014 and 2017—including caps on both loans to residential investors and interest-only loan issuance—to reduce financial stability risks. Due to the housing price correction, the APRA began to relax these caps last year, and most recently proposed reducing the floor on serviceability calculations for residential mortgages.
- Australia's terms of trade have moved roughly in tandem with global commodity prices.** The terms of trade – the ratio between export and import prices – reached a historical high in 2011 as coal prices soared following severe flood damage to the domestic mining sector amid a recovering global economy. However, the terms of trade deteriorated significantly from 2012 to 2016 due to declining commodity prices as Chinese demand started to weaken. In 2016, the terms of trade began rising once more along with commodity prices. In a speech on May 21, Lowe said the terms of trade ratio continues “to surprise on the upside” and is supporting the outlook for the Australian economy.



### Financial markets

- **The Australian dollar (AUD) is currently trading at 1.4 per U.S. dollar.** Year to date, the AUD has depreciated 1 percent against the U.S. dollar.
- **The Australian equity price index, ASX200, has experienced low returns relative to global financial markets.** Analysts attribute this underperformance to the moderation of the mining industry, the relatively low weight of the information technology sector in the ASX200, and ongoing issues in the Australian economy (such as sluggish wage growth and increased restrictions in the housing market).

