



# The Australian economy after the GFC

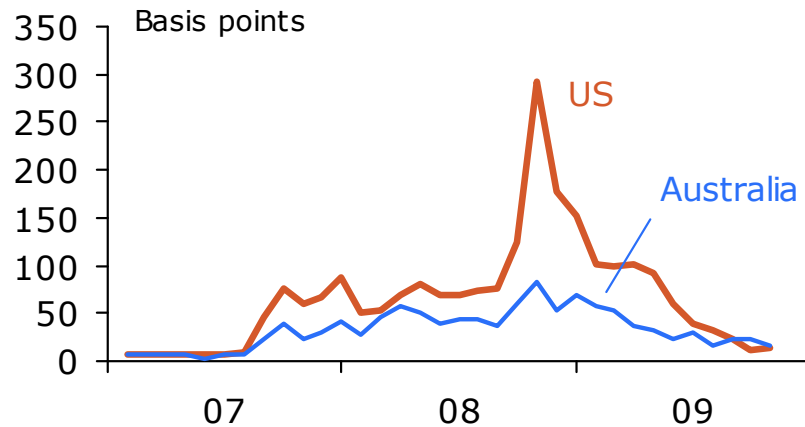
**Presentation to  
Economics Society of Australia  
(NSW Branch)**

**Sydney  
10<sup>th</sup> November 2009**

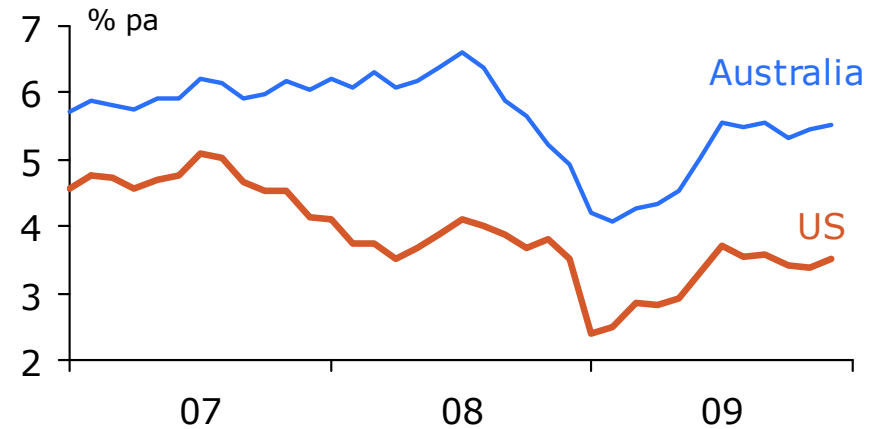
**Saul Eslake  
Program Director – Productivity Growth**

# The 'good news' is that the global financial crisis is just about over

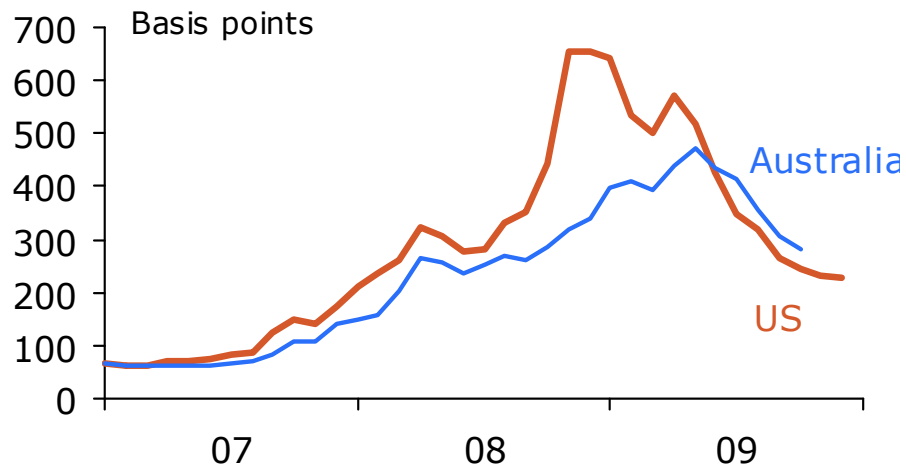
## Bank wholesale funding cost spreads



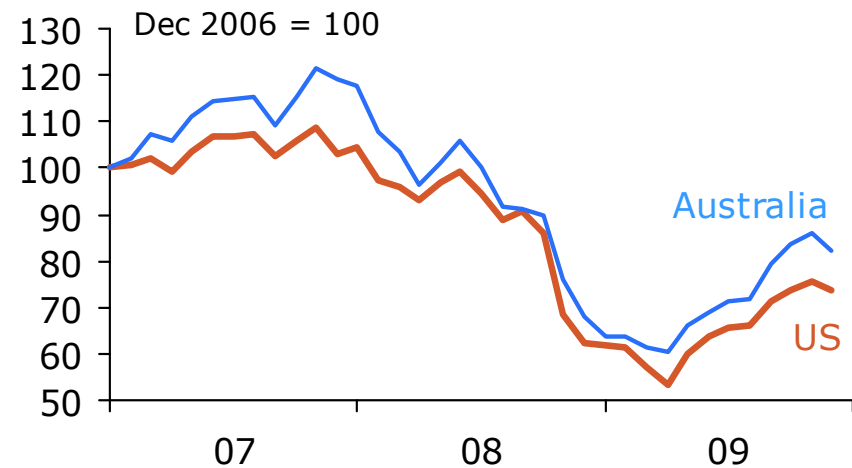
## 10-year government bond yields



## A-rated corporate bond yield spreads



## Share prices

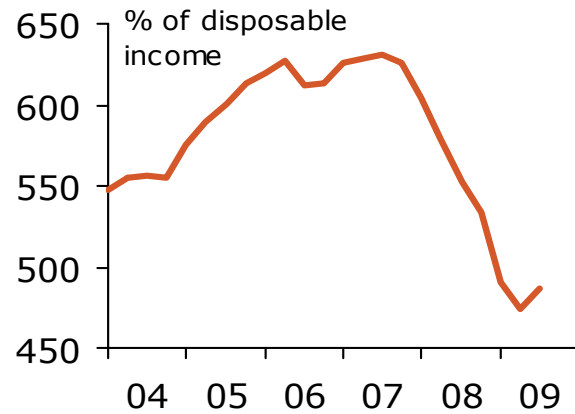


Note: Bank wholesale funding cost spreads are between 3-month inter-bank borrowing rates and 3-month overnight index swap rates. Corporate bond yield spreads are over corresponding government bond yields. Sources: Bloomberg LP; Thomson Reuters Datastream; RBA.

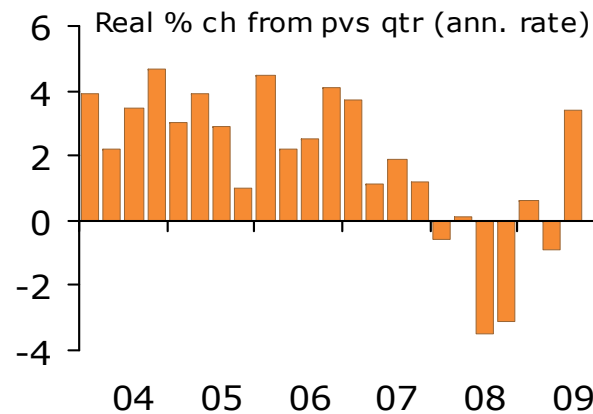
# The US economy is no longer contracting, but it's still very fragile

## Financial crisis and recession in the US

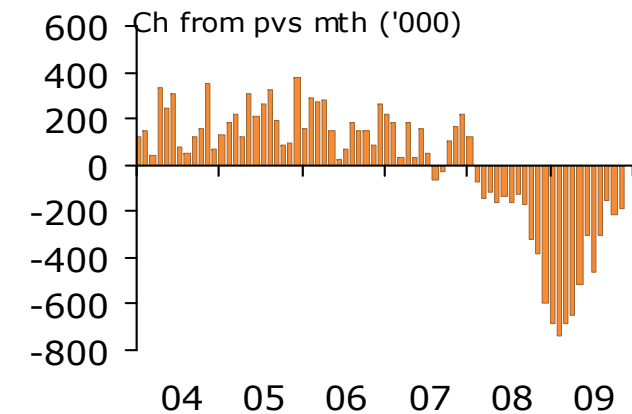
### Household net worth



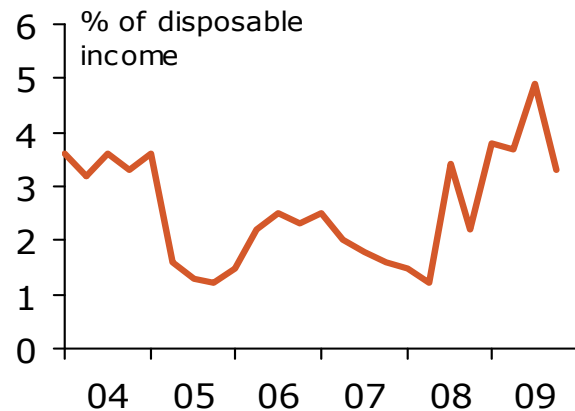
### Household spending



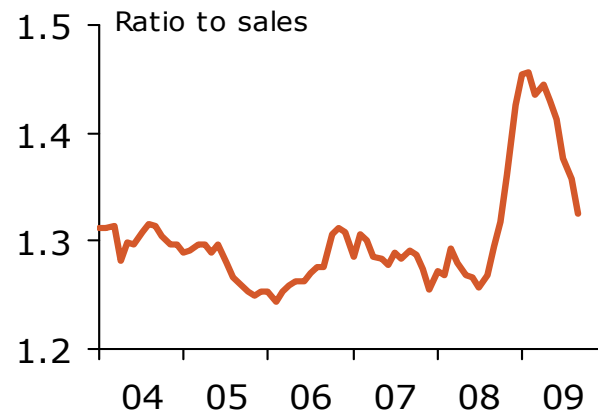
### Employment



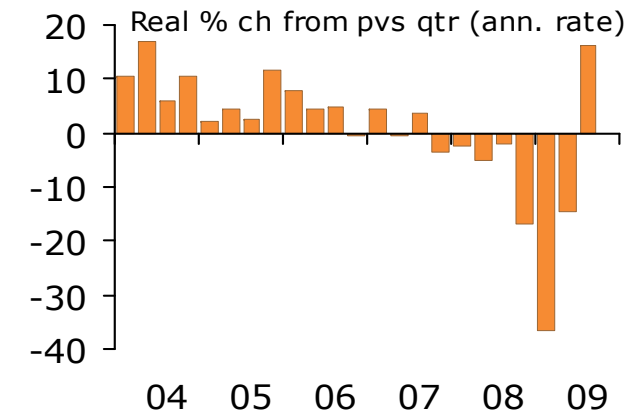
### Household saving



### Business inventories



### Imports

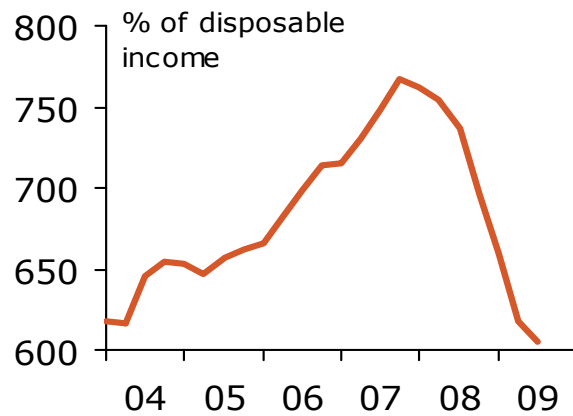


Source: US Bureau of Economic Analysis; US Federal Reserve; US Commerce Department

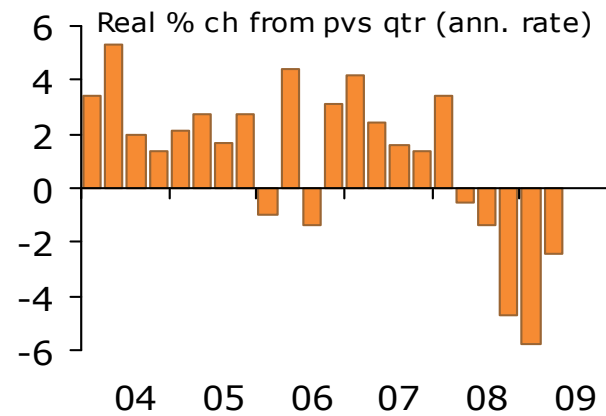
# The UK economy is still contracting ...

## Financial crisis and recession in the UK

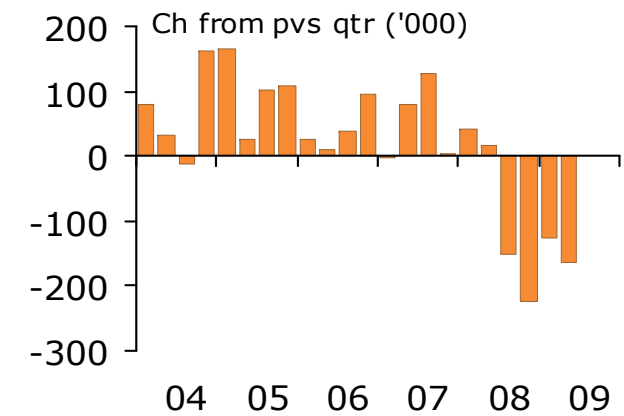
### Household net worth



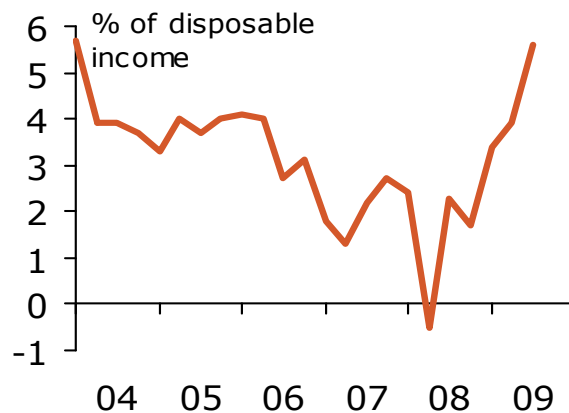
### Household spending



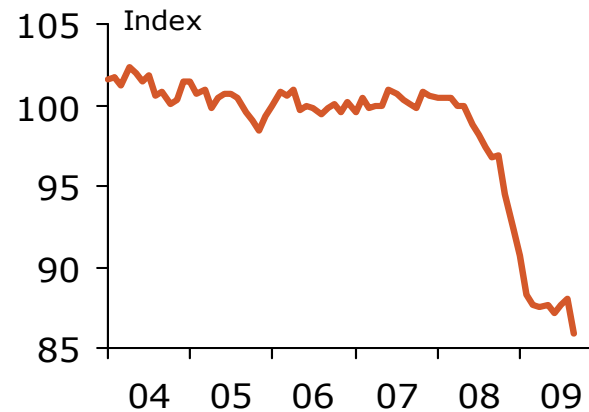
### Employment



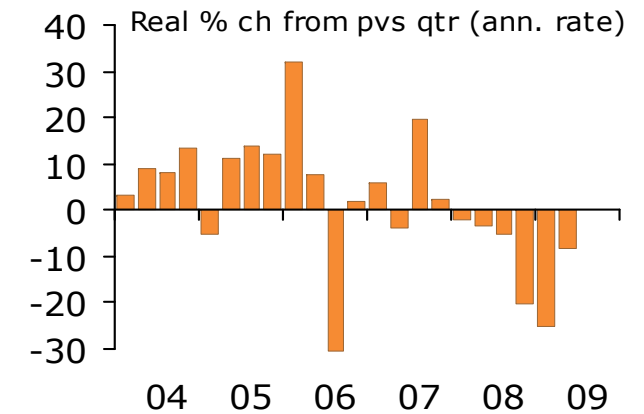
### Household saving



### Manufacturing production



### Imports

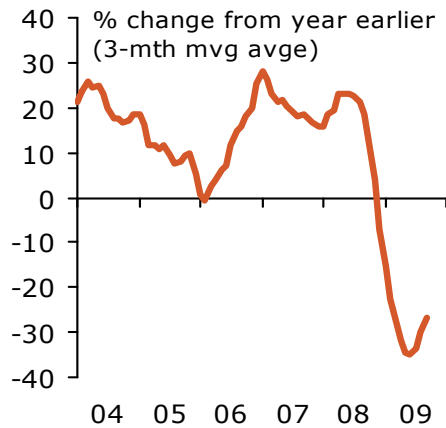


Source: UK Office of National Statistics.

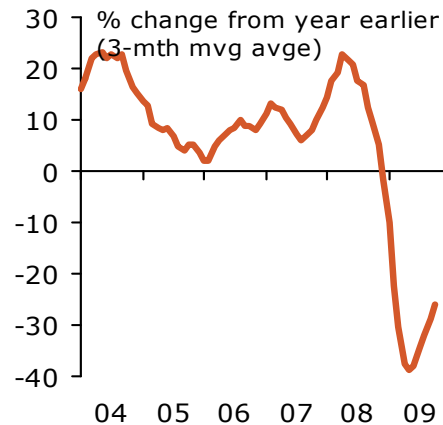
# The slump in trade turned a North Atlantic financial crisis into a global economic downturn ... that part is now over

## European and East Asian economies – merchandise exports

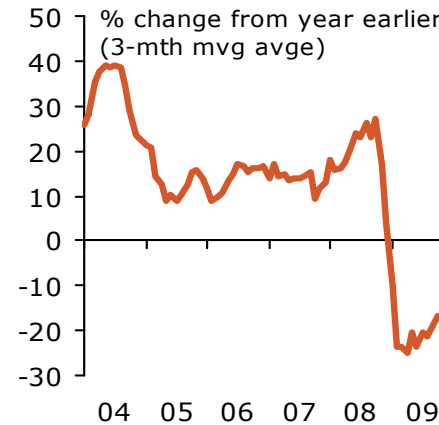
### Germany



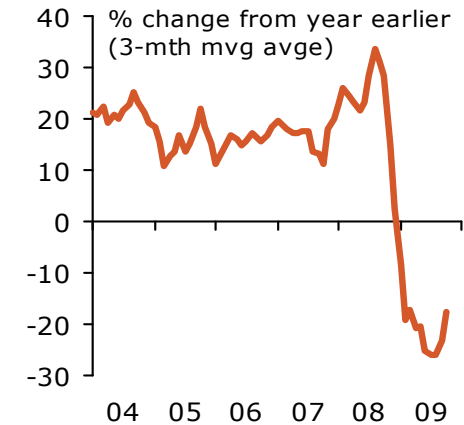
### Japan



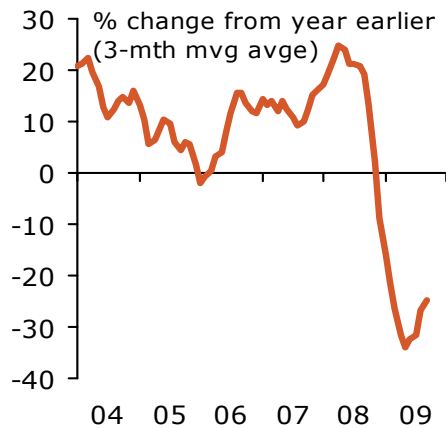
### Korea



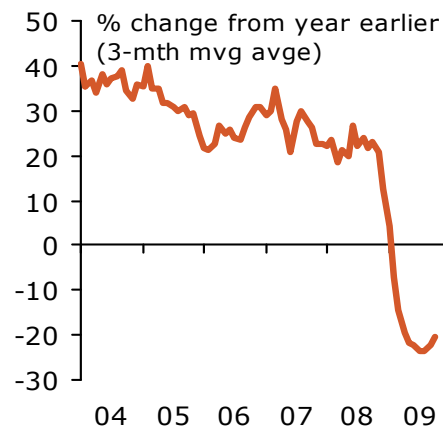
### Thailand



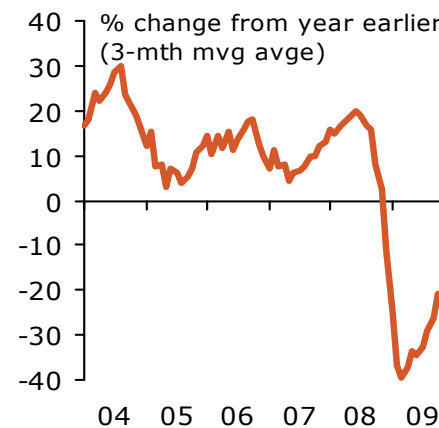
### France



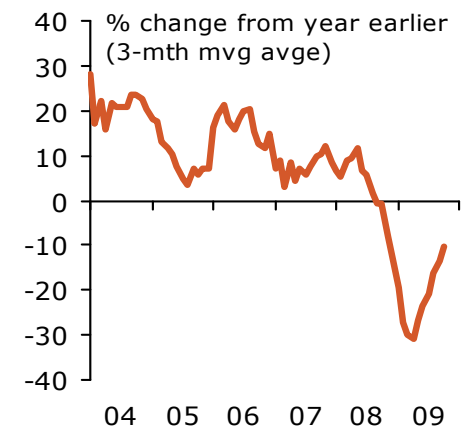
### China



### Taiwan



### Singapore

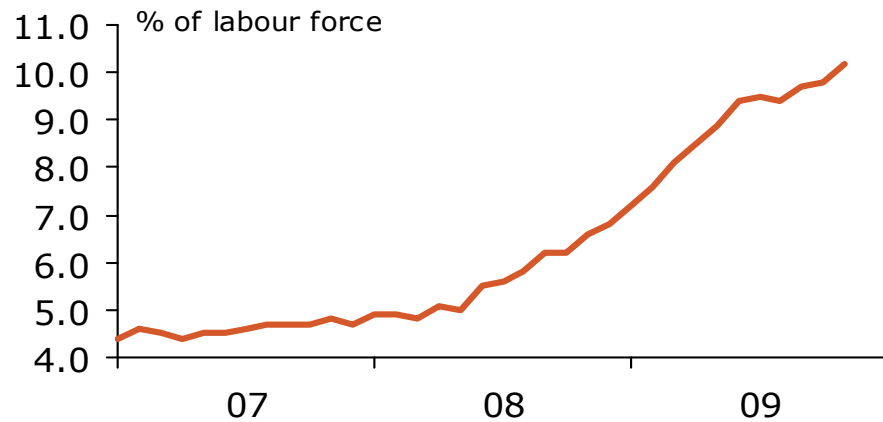


Note: all data in US\$. Sources: National statistical agencies; Datastream; CEIC; ANZ.

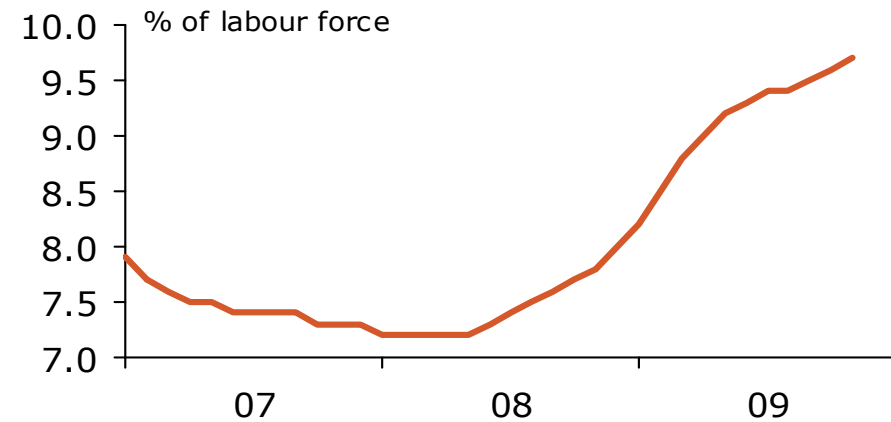
# Unemployment is still rising in major 'advanced' economies, and may continue to do so for some time

## Major advanced economies – unemployment rate

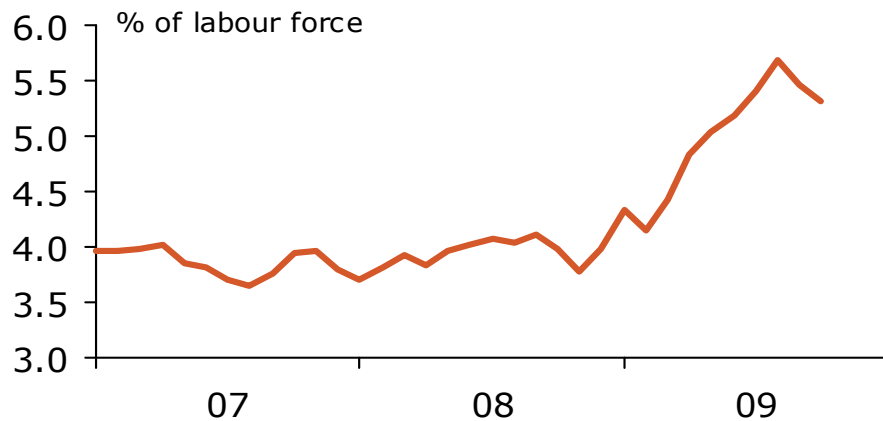
### United States



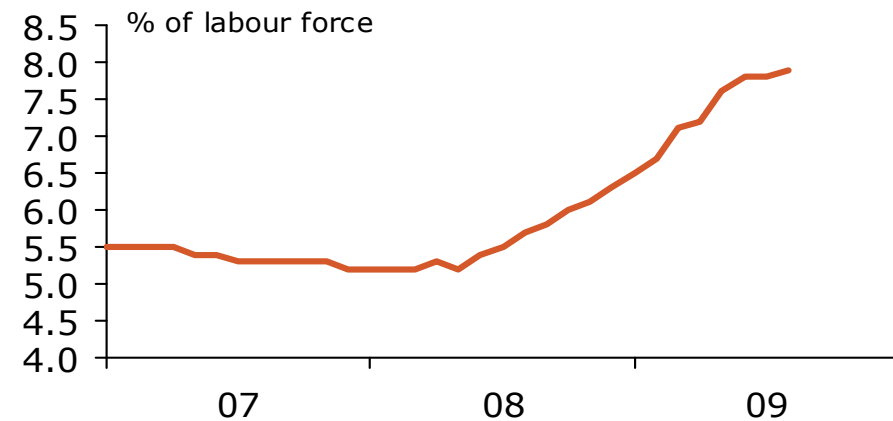
### Euro area



### Japan



### United Kingdom

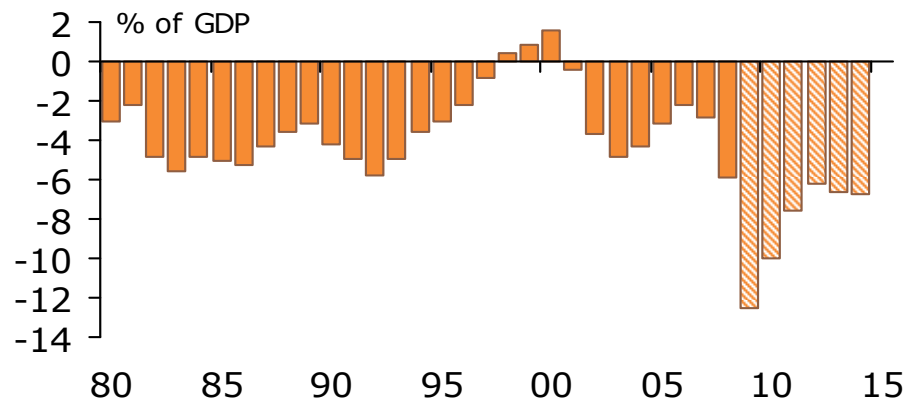


Sources: US Bureau of Labor Statistics; Japan Statistics Bureau; Eurostat; UK Office of National Statistics.

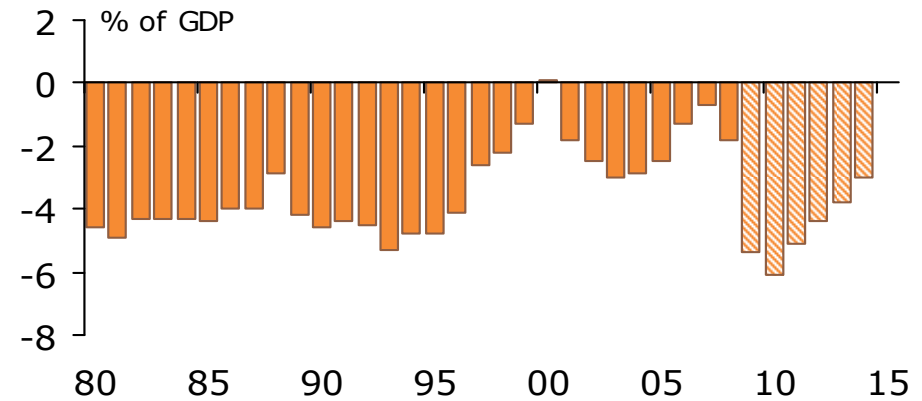
# Dealing with the financial crisis and its economic consequences has left major advanced country governments with very large budget deficits ...

## Budget balances – major advanced economies

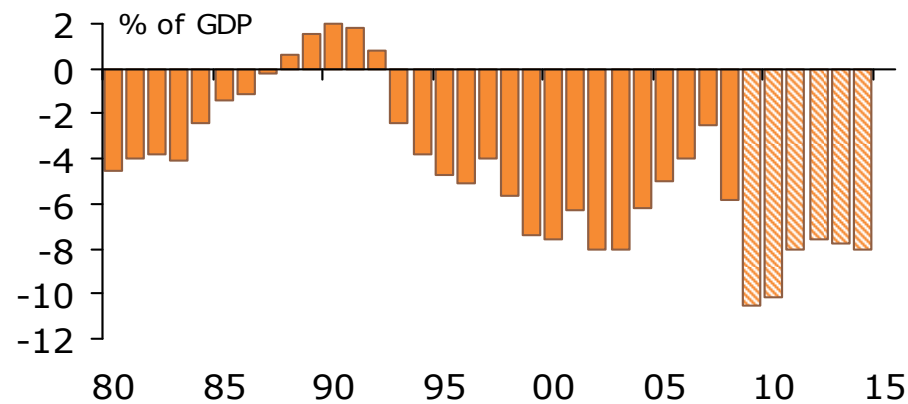
### United States



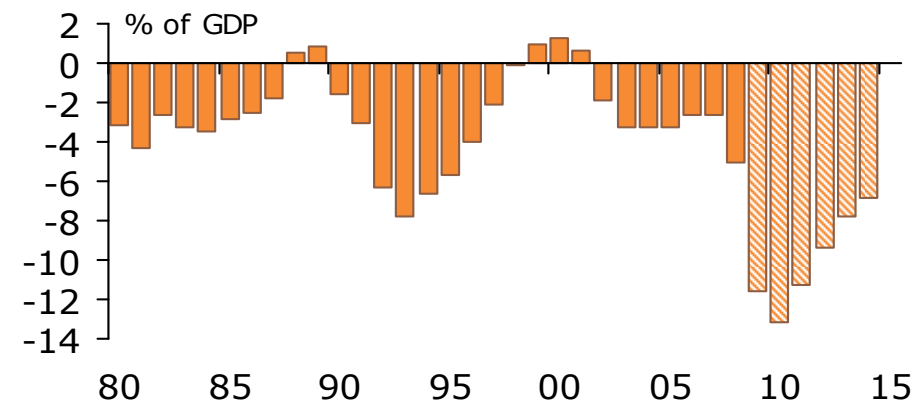
### Euro area



### Japan



### United Kingdom

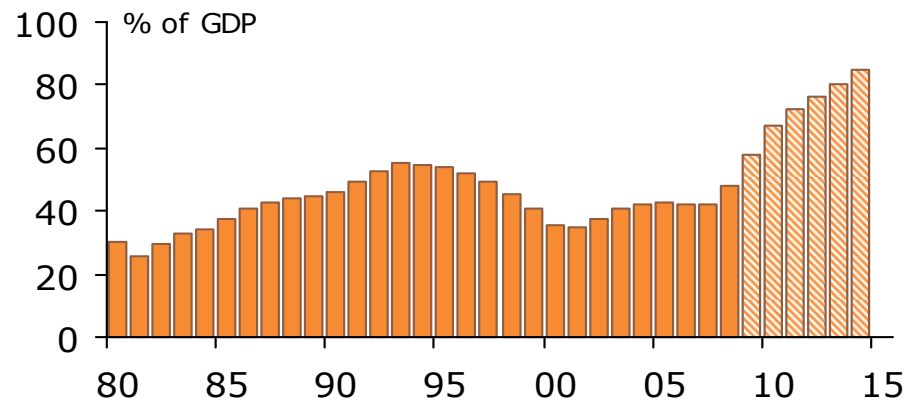


Source: IMF World Economic Outlook database (October 2009) and Corinna Economic Advisory calculations

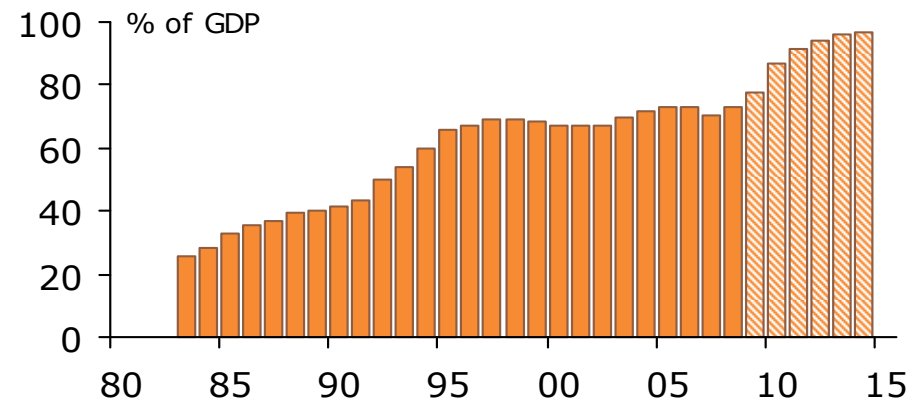
## ... and levels of public debt relative to GDP unseen, in most cases, since the end of World War II

### Net public debt – major advanced economies

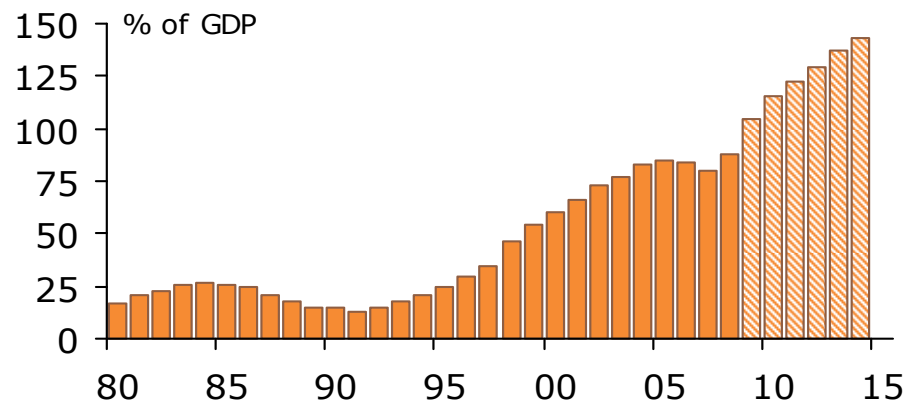
#### United States



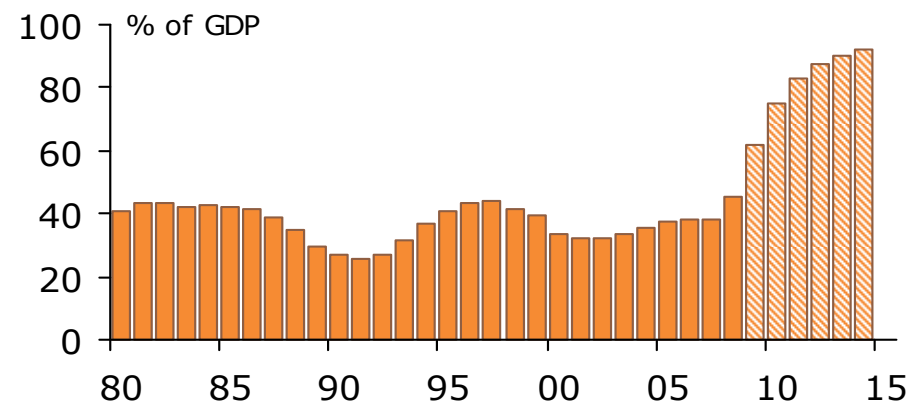
#### Euro area



#### Japan



#### United Kingdom



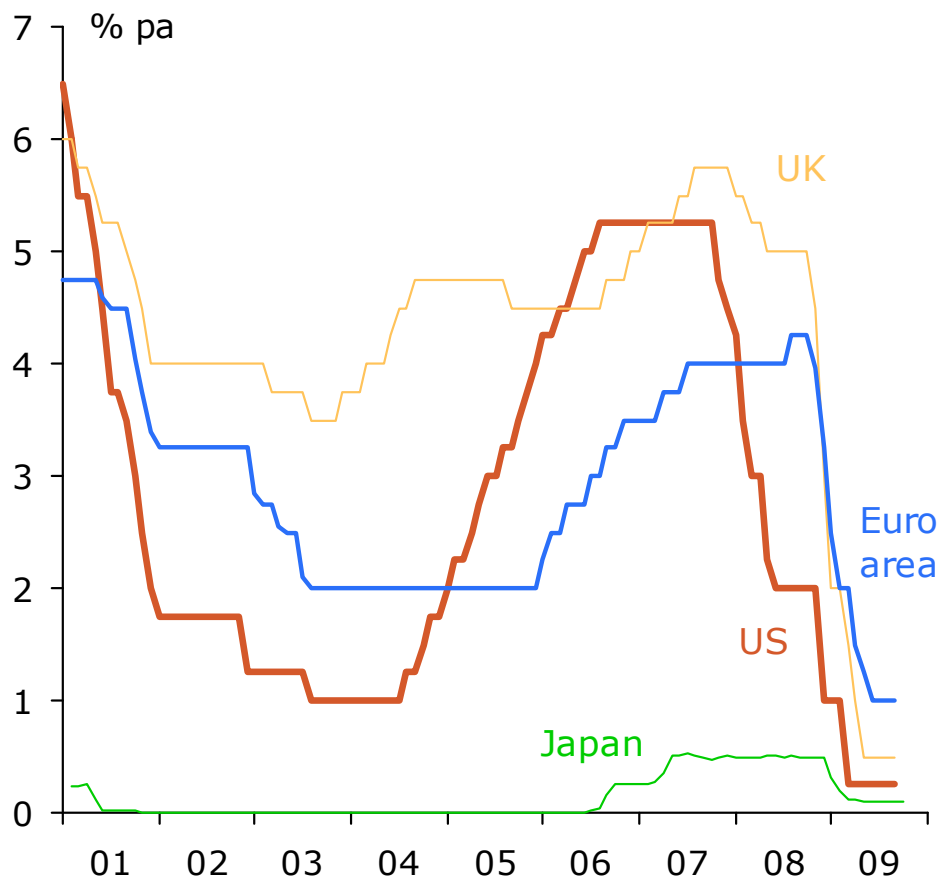
Note: euro area figures are for three largest economies (Germany, France and Italy).

Source: IMF World Economic Outlook database (October 2009) and Corinna Economic Advisory calculations

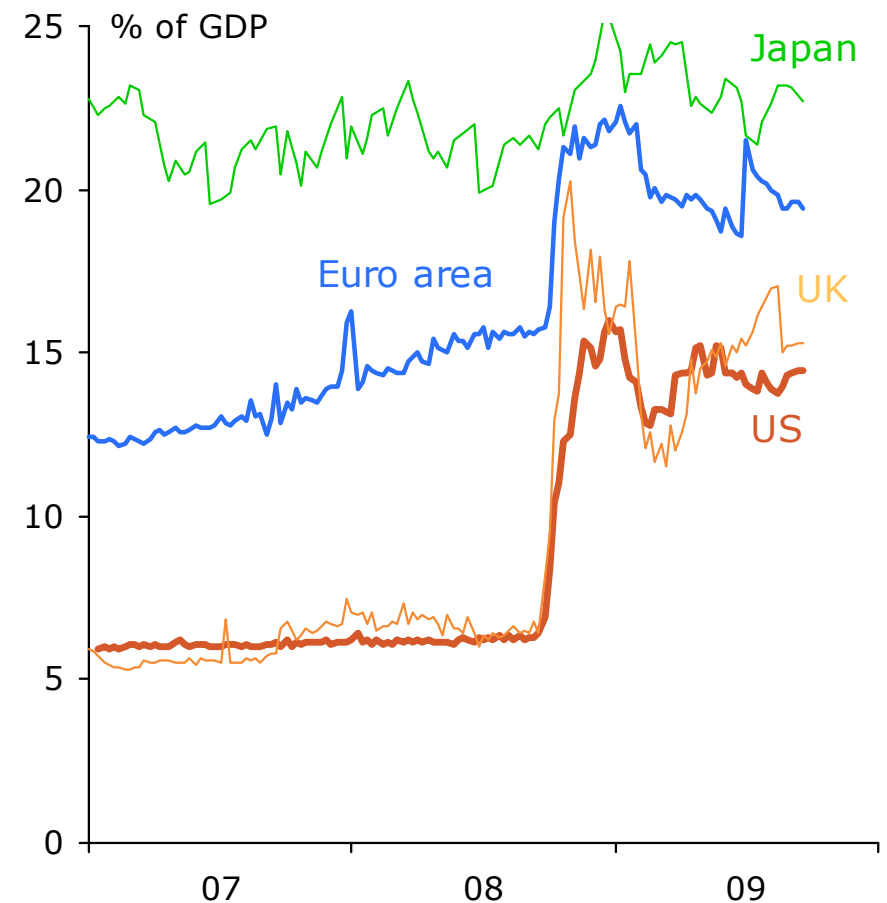
# Central banks in the major advanced economies are likely to keep monetary policy settings loose for an extended period

## Monetary policy responses to the financial crisis

### Monetary policy interest rates



### Central bank balance sheets

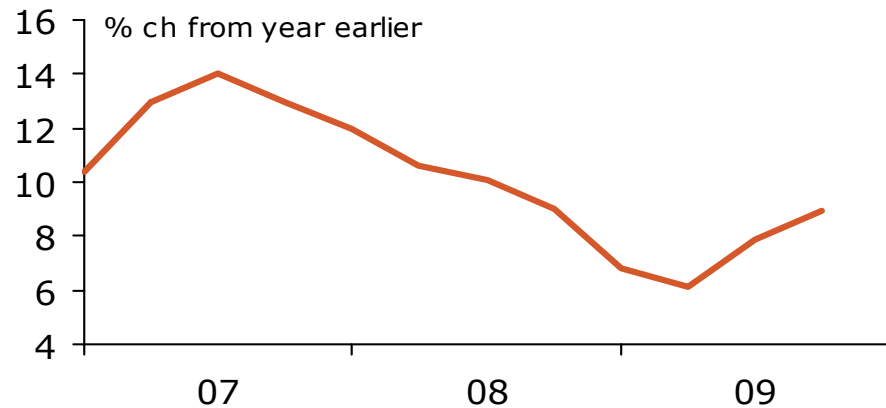


Sources: US Federal Reserve; Bank of Japan; European Central Bank; Bank of England; IMF *World Economic Outlook* October 2009.

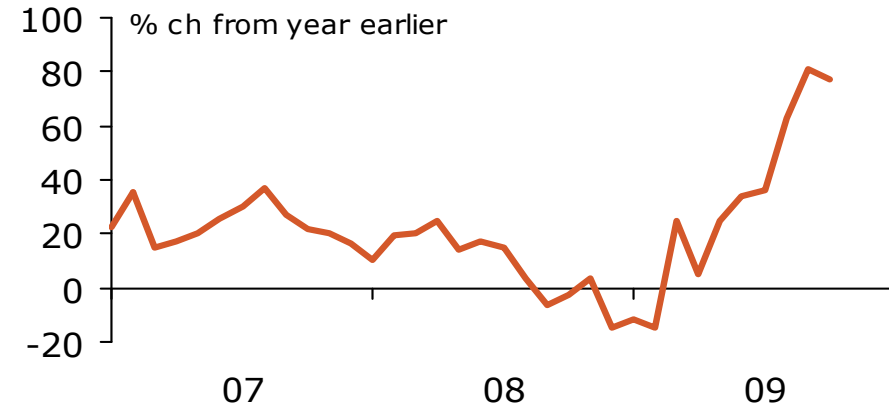
# China's economy has rebounded smartly, as policy measures have boosted domestic demand even though exports have remained weak

## China: selected economic indicators

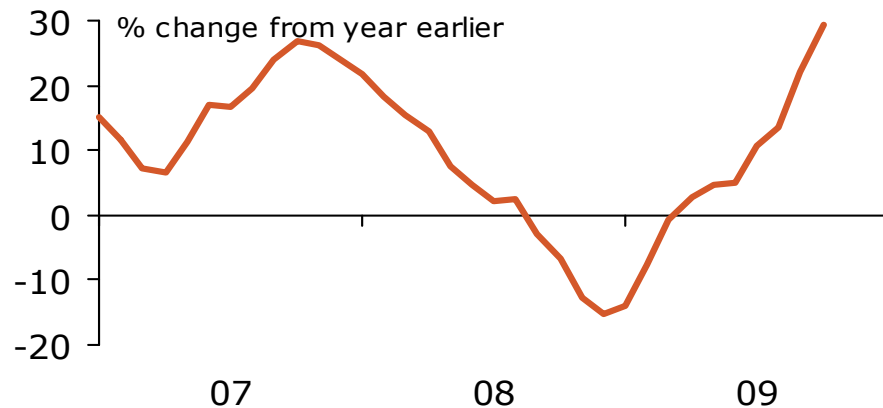
### Real GDP



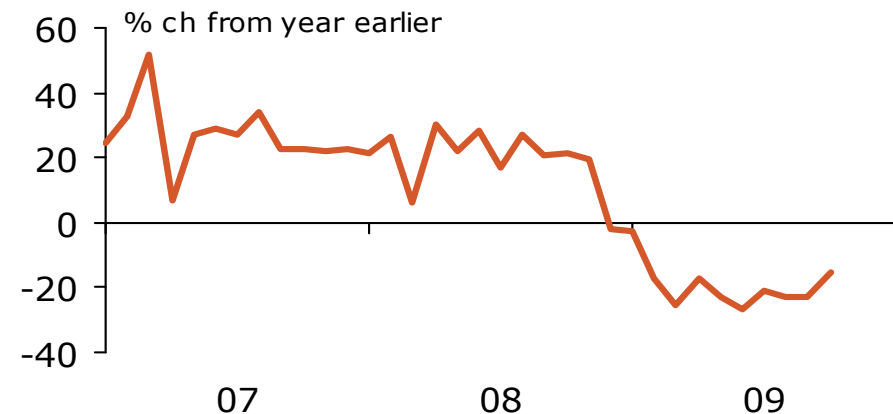
### Motor vehicle sales



### Construction activity index



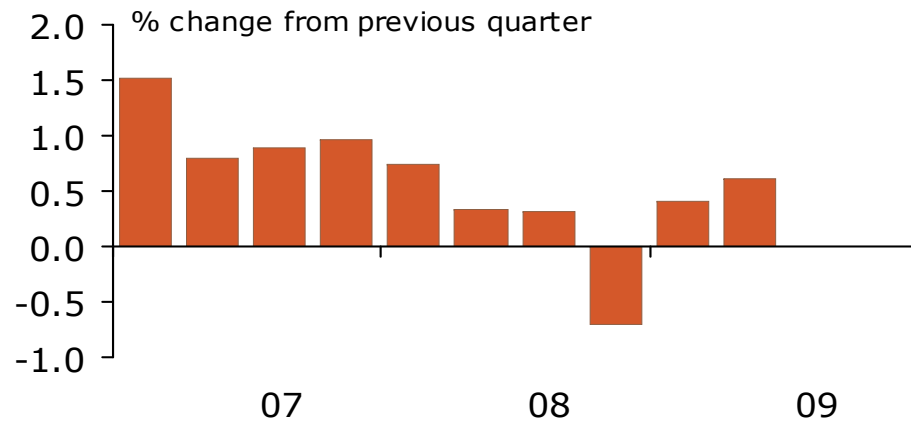
### Merchandise exports



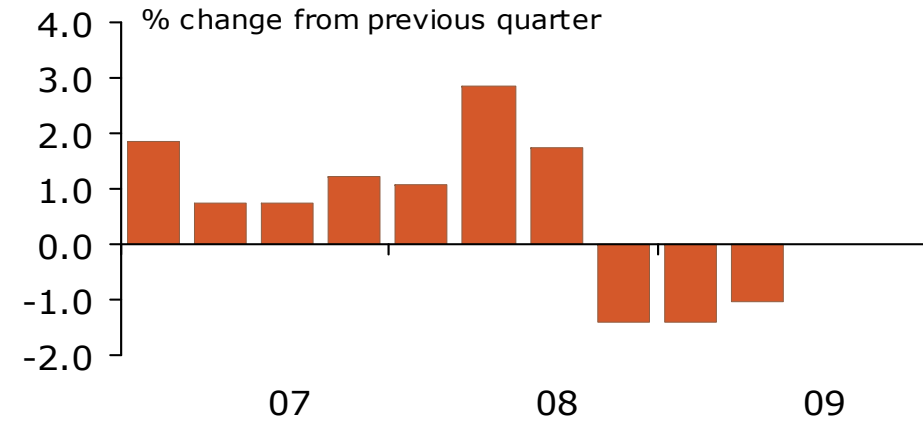
Sources: China National Bureau of Statistics; UBS Asia; China Association of Automobile Manufacturers.

# Australia has so far avoided a recession by the most commonly-used definition (although not by all the others)

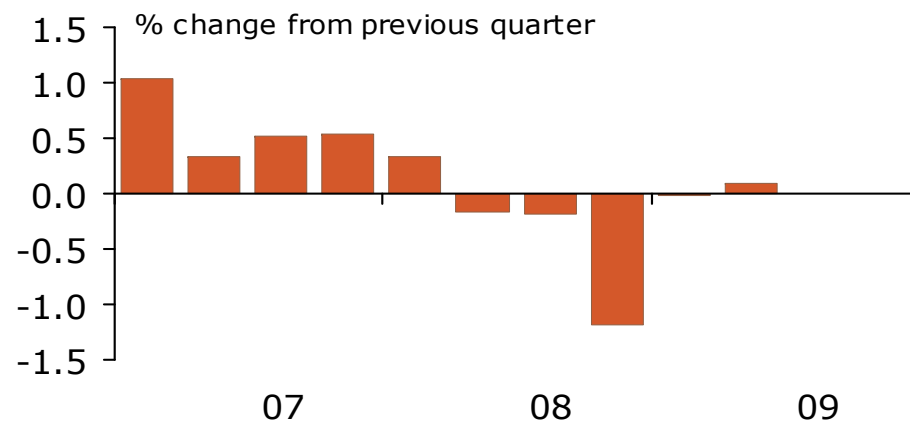
## Real gross domestic product (GDP)



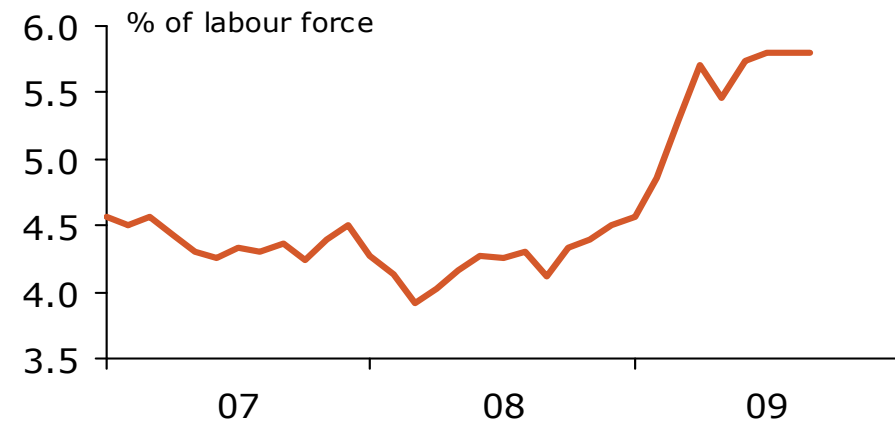
## Real gross domestic income (GDI)



## Real per capita GDP



## Unemployment rate

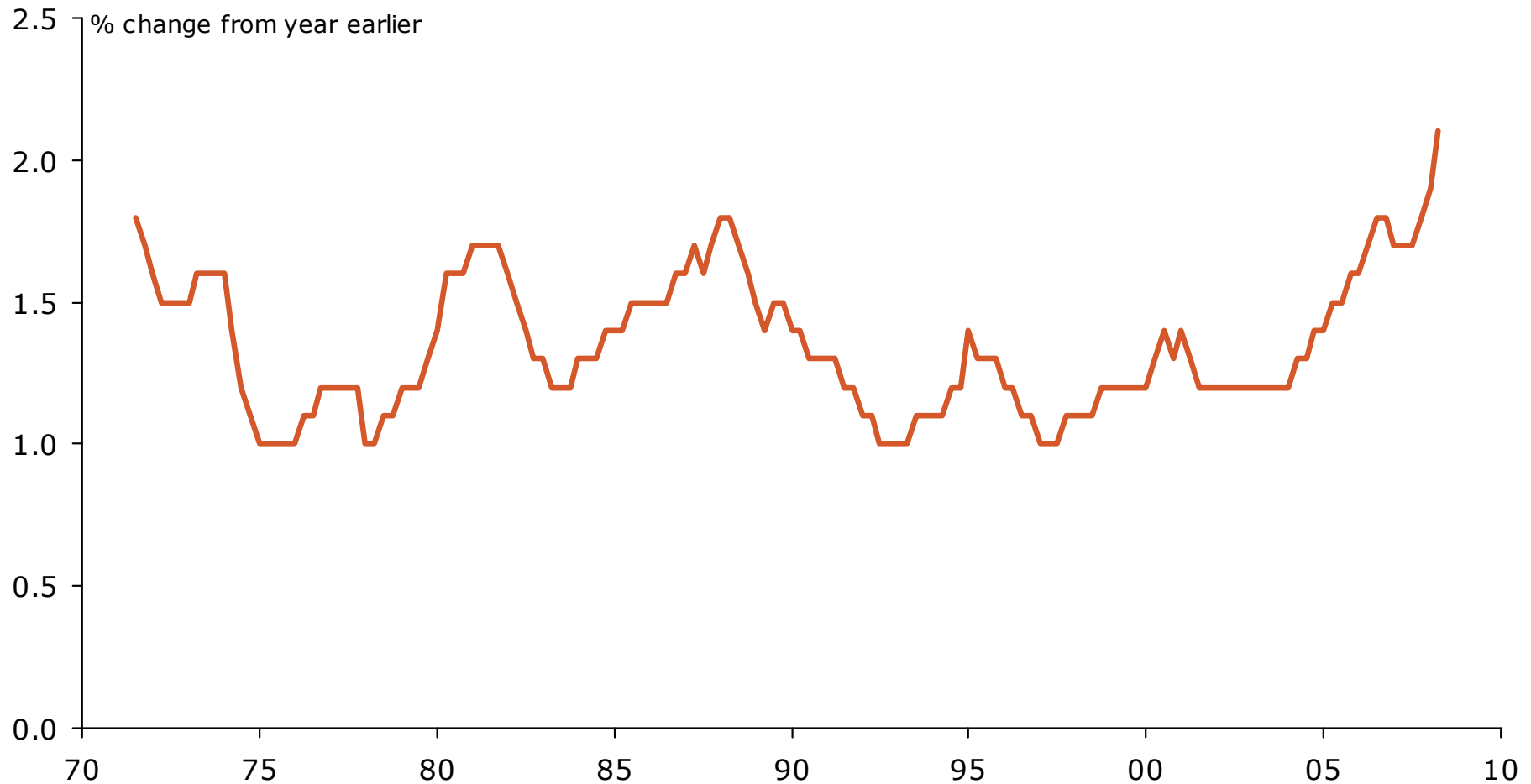


Note: Real gross domestic income is real GDP adjusted for changes in the terms of trade (export relative to import prices). ABS.

## Fastest population growth in almost 40 years has boosted measured economic growth (though also added to unemployment)

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### Estimated resident population



Source: ABS.

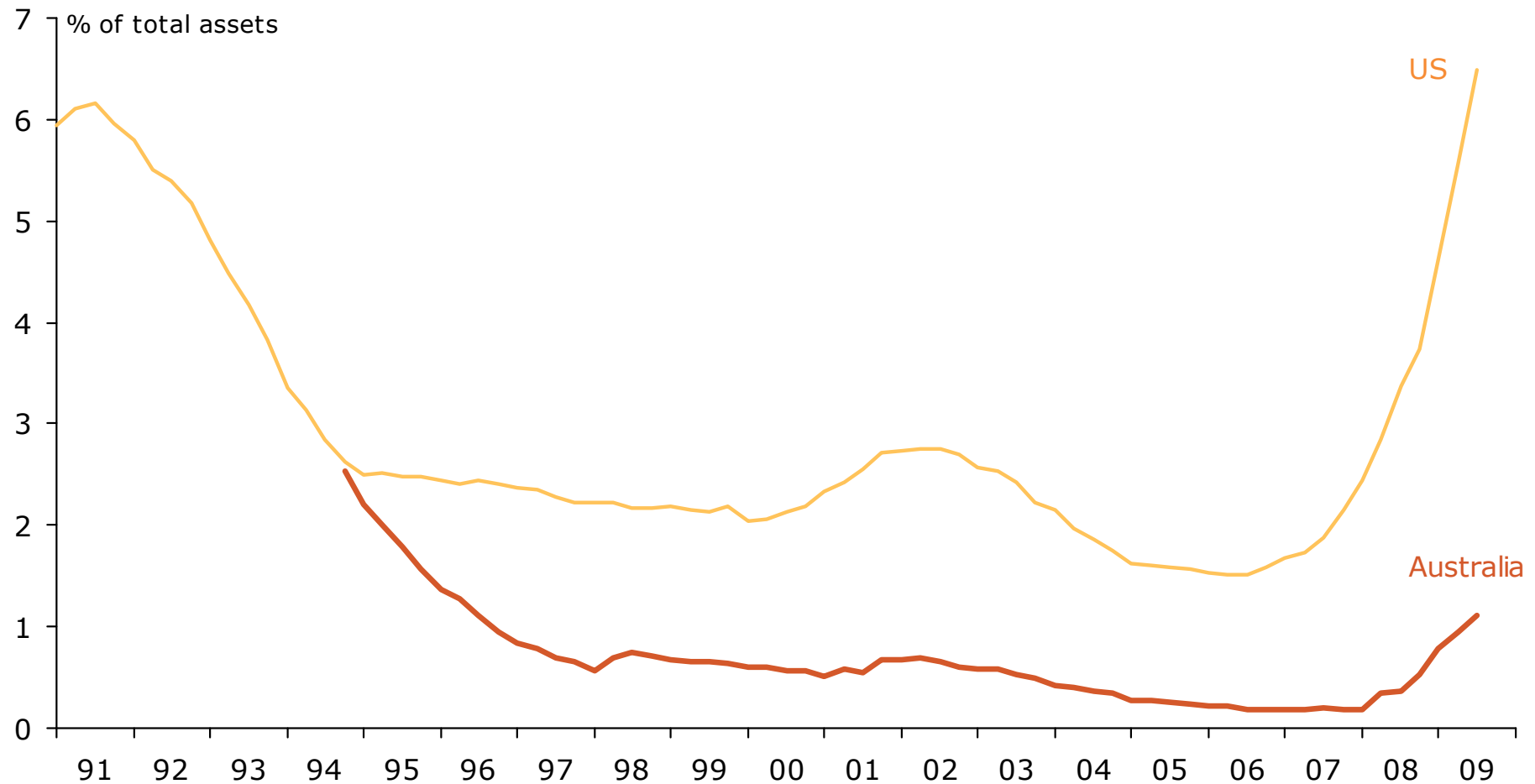
## Why did Australia have such a 'good crisis'?

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- Australia had very few of the vulnerabilities which lay at the heart of the crisis in the US and the UK
  - banks had far less exposure to 'toxic assets' and were more closely and diligently supervised
  - elevated house prices the result of fundamental excess of demand over supply, rather than dodgy lending
- Australia has very limited exposure to the contraction in trade triggered by the financial crisis
  - US and Europe account for just 15% of Australia's exports
  - manufactured goods account for only 20% of Australia's exports
  - 70% of Australia's exports go to Asia – and most of that into Asian domestic demand rather than Asian exports
- Australian authorities responded quickly and effectively to the exposures which we did have
  - substantial cuts in interest rates flowed through quickly to end-borrowers
  - fiscal policy measures were large, timely, explicitly designed to support spending and employment, and didn't raise serious doubts about fiscal sustainability

## Australian banks have had much less exposure to 'toxic assets' and other write-downs than US banks

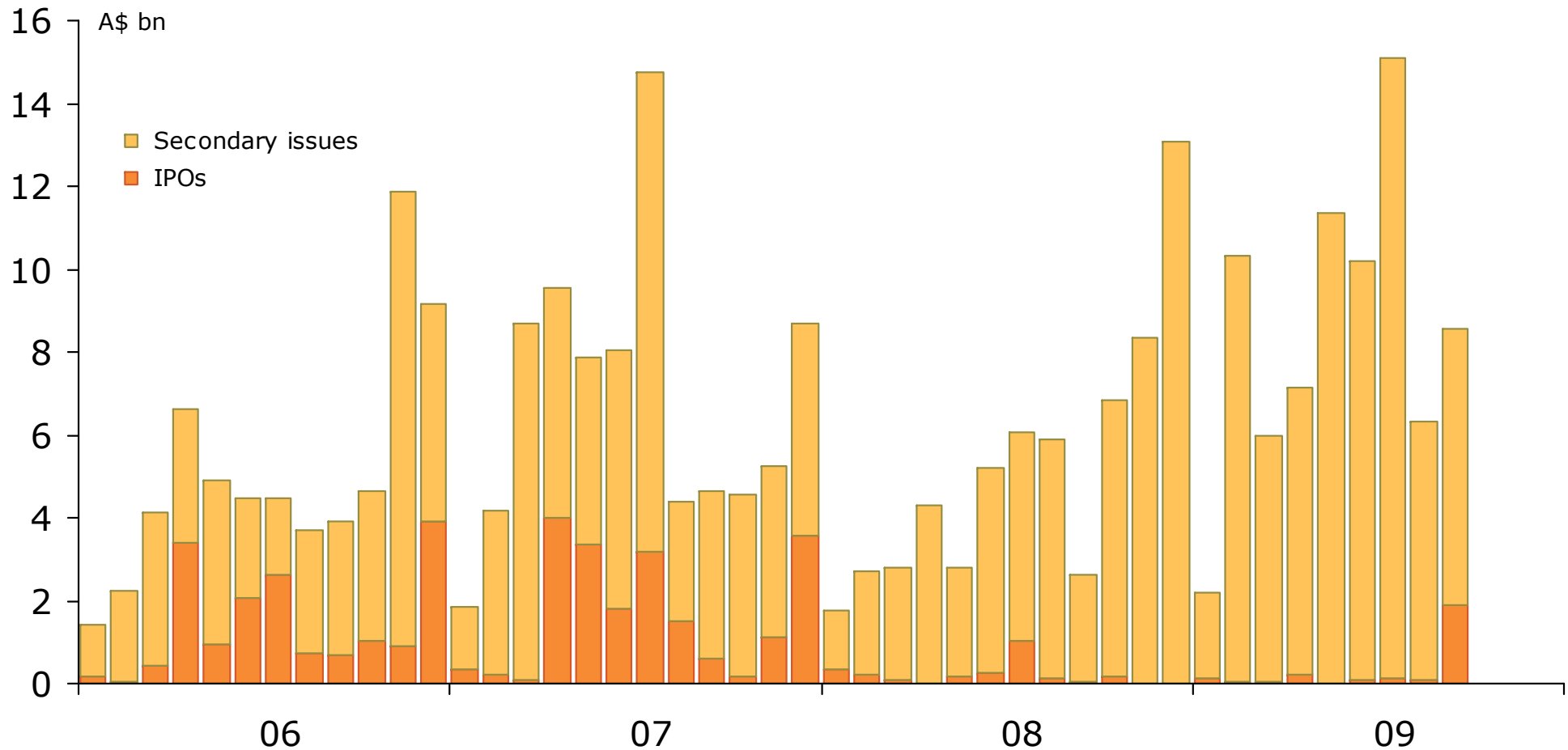
### Australian and US banks – impaired or delinquent assets



Sources: Australian Prudential Regulation Authority; US Federal Reserve Board.

# Australian listed companies have raised over A\$100bn of equity capital since the collapse of Lehman Brothers

## Capital raisings by Australian listed companies

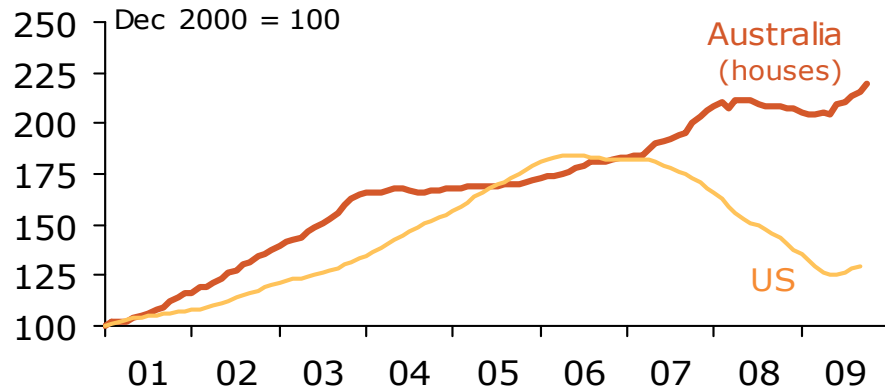


Source: ASX.

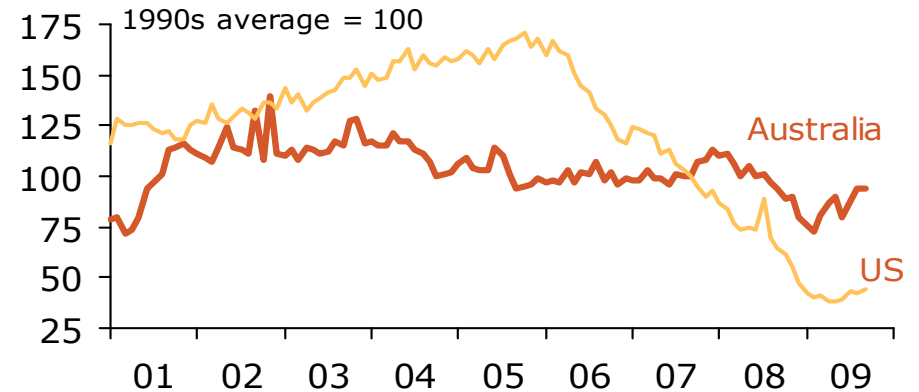
# Australia has not had a housing 'bust' – reflecting a persistent shortfall of supply relative to demand and an absence of 'forced sellers'

## Australian and US housing markets

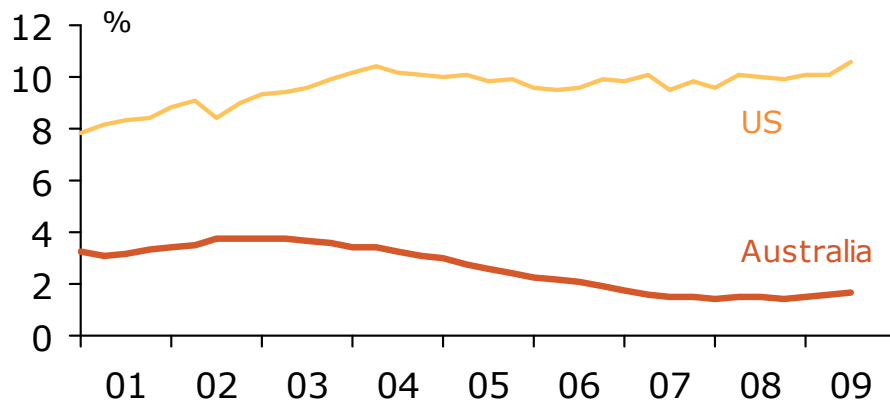
### House prices



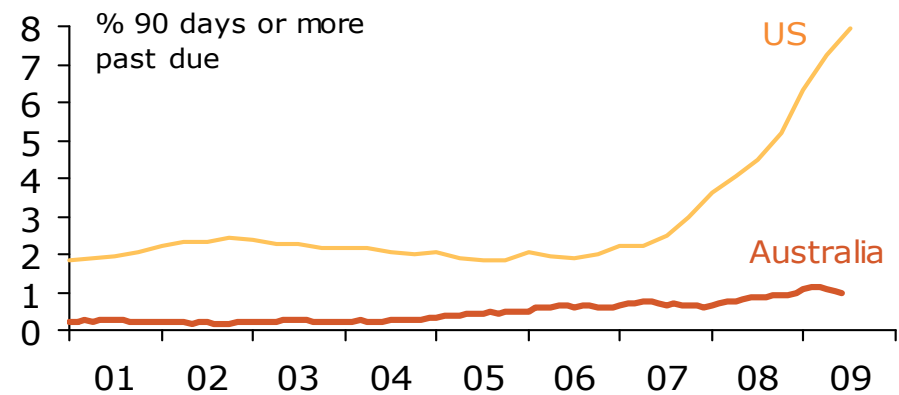
### Residential building approvals



### Rental vacancy rates



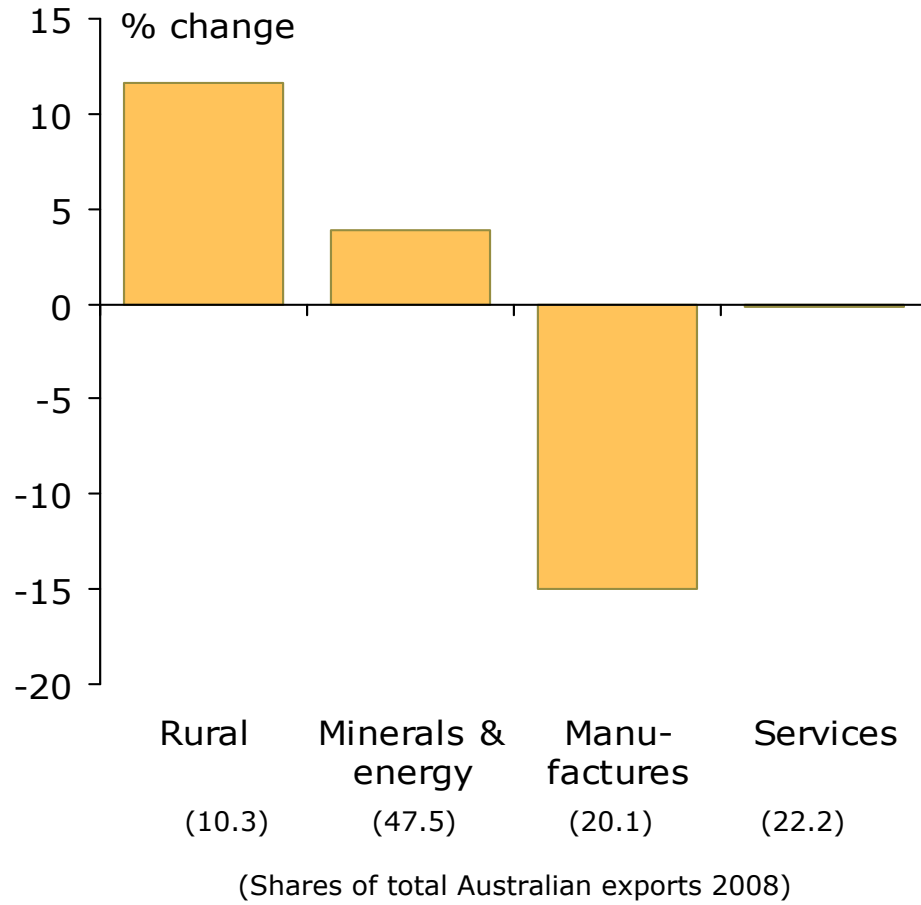
### Mortgage delinquency rates



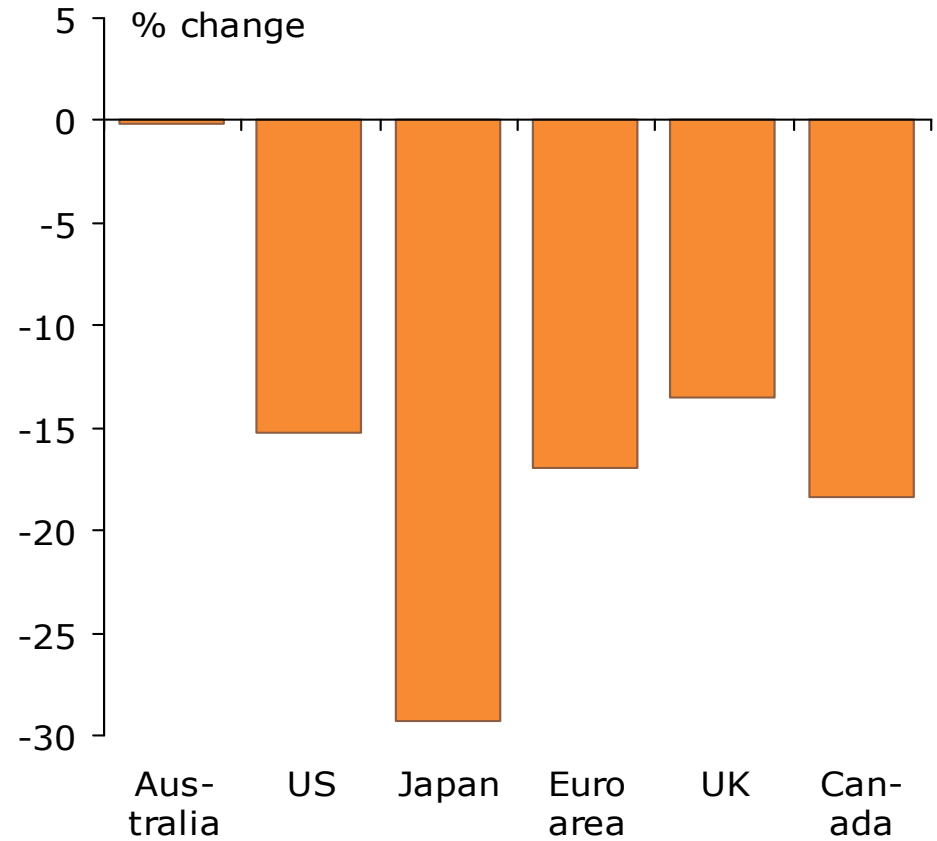
Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: Residex; S&P; Real Estate Institute of Australia; Mortgage Bankers' Association of America; ABS; US Commerce Department; US National Realtors' Association.

# Australia's exports weren't much affected by the collapse in global trade in manufactured goods

**Change in the volume of Australian exports, year to June quarter 2009**



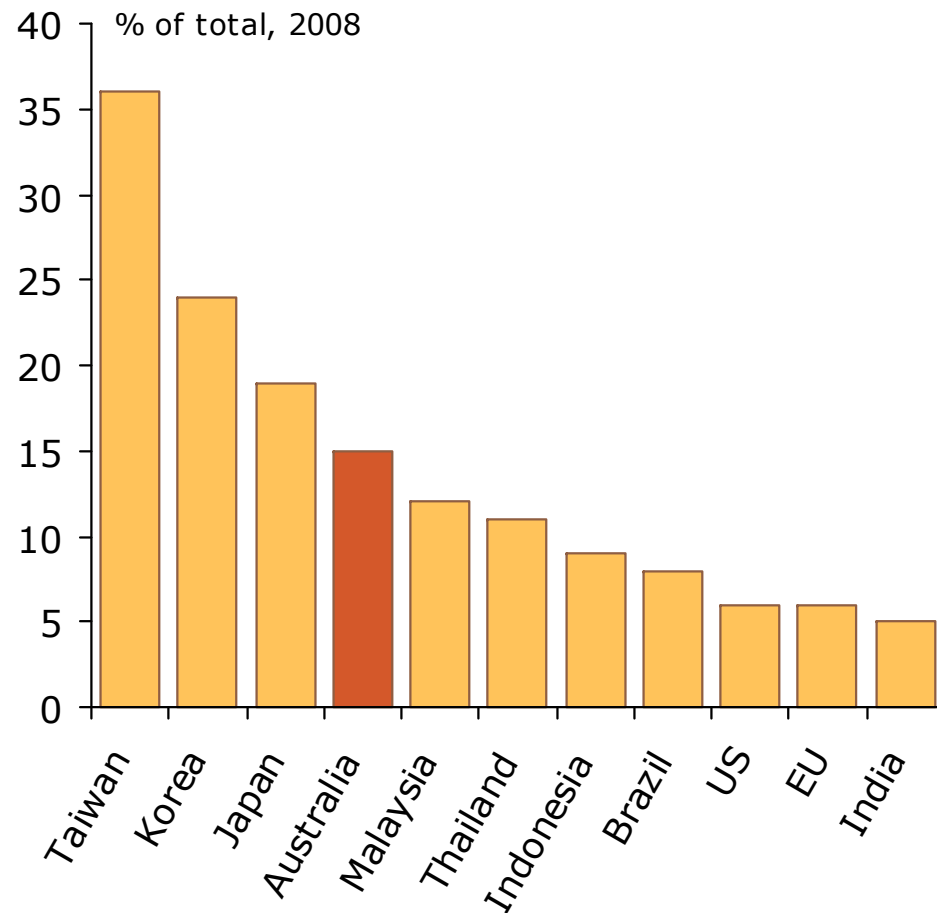
**Change in the volume of total exports, year to June quarter 2009**



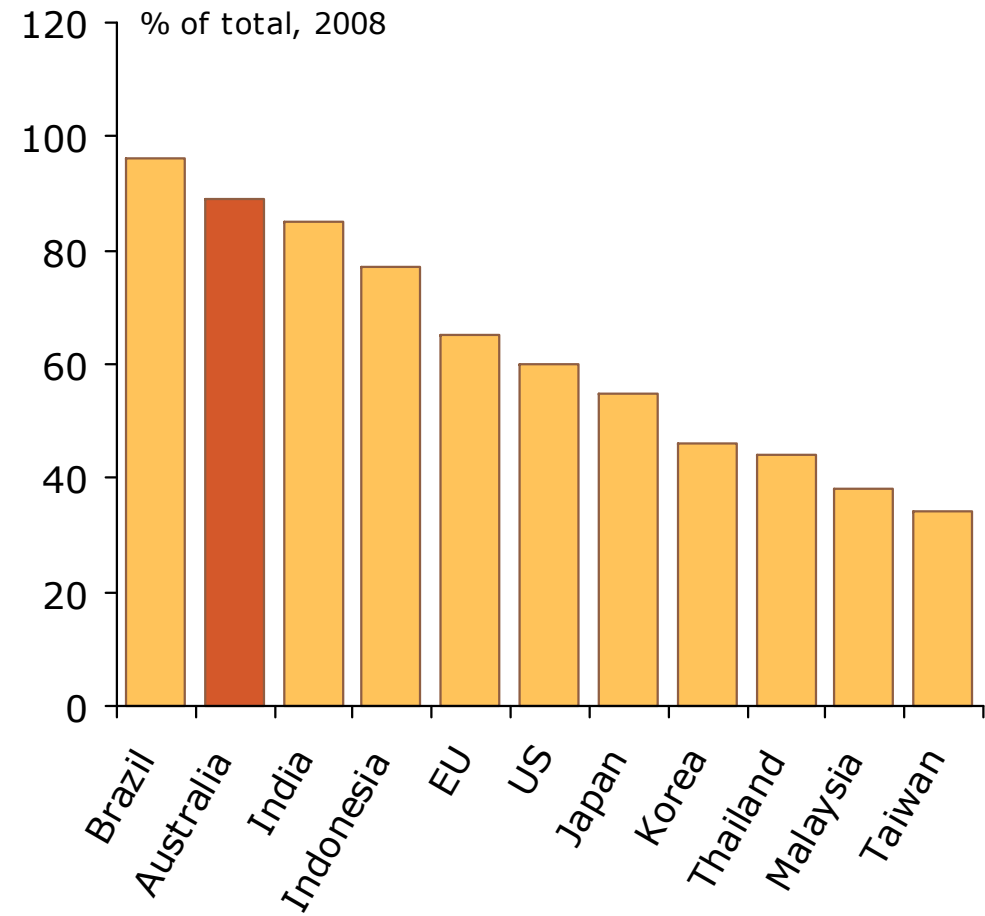
Sources: ABS; equivalent national statistical agencies in other countries.

## Australia is better placed than most countries to benefit from a domestic demand –led rebound in China's growth

**Exports to China as a share of total exports**



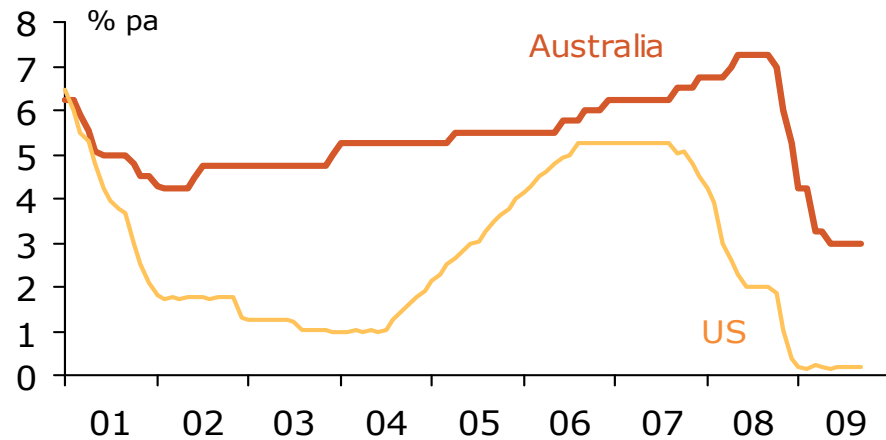
**Share of exports to China that are for China's 'domestic' use**



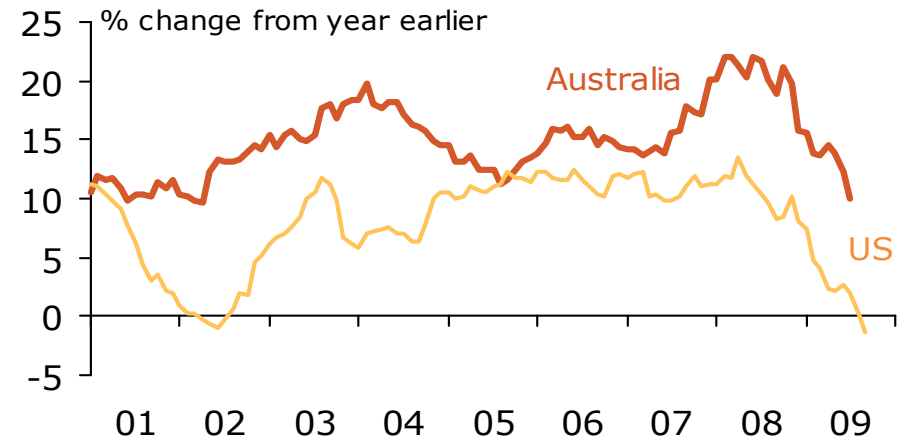
Source: Tao Wang, 'Who benefits the most from China's growth recovery', UBS Investment Research, 20 August 2009.

# Monetary policy has worked more effectively in Australia than in the US and other countries

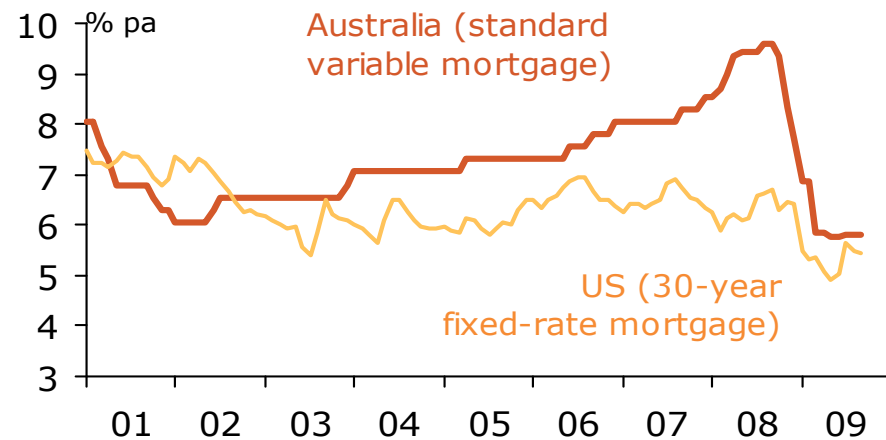
## Official interest rates



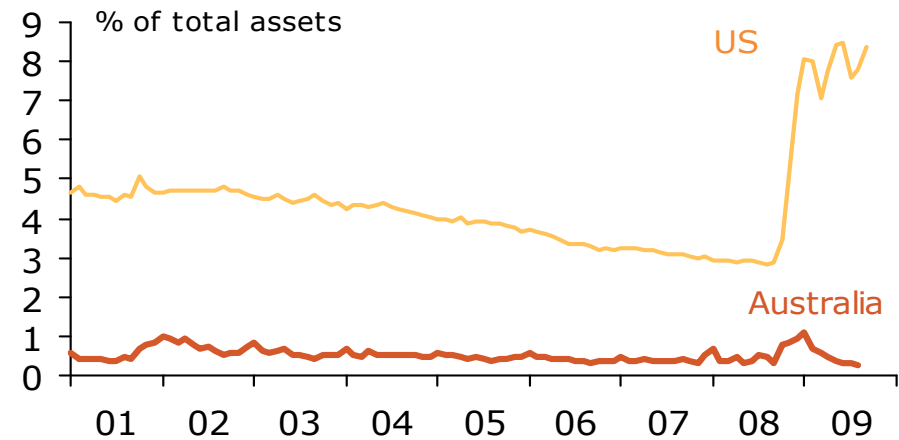
## Bank lending



## Most common mortgage rates



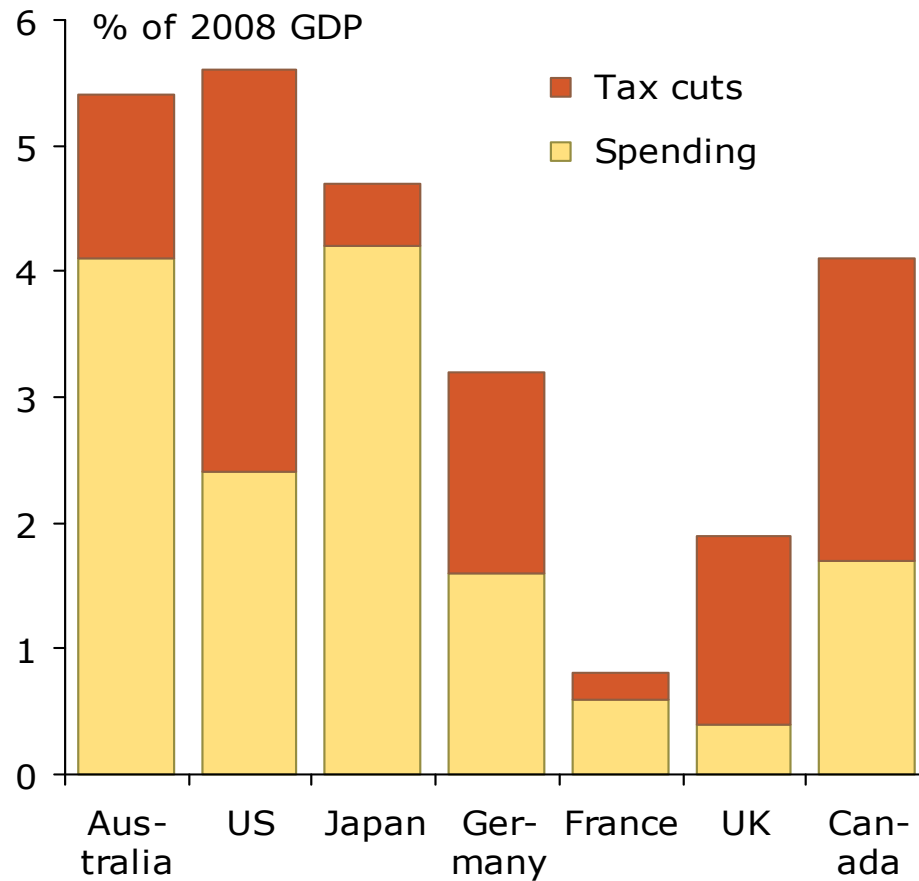
## Bank cash holdings



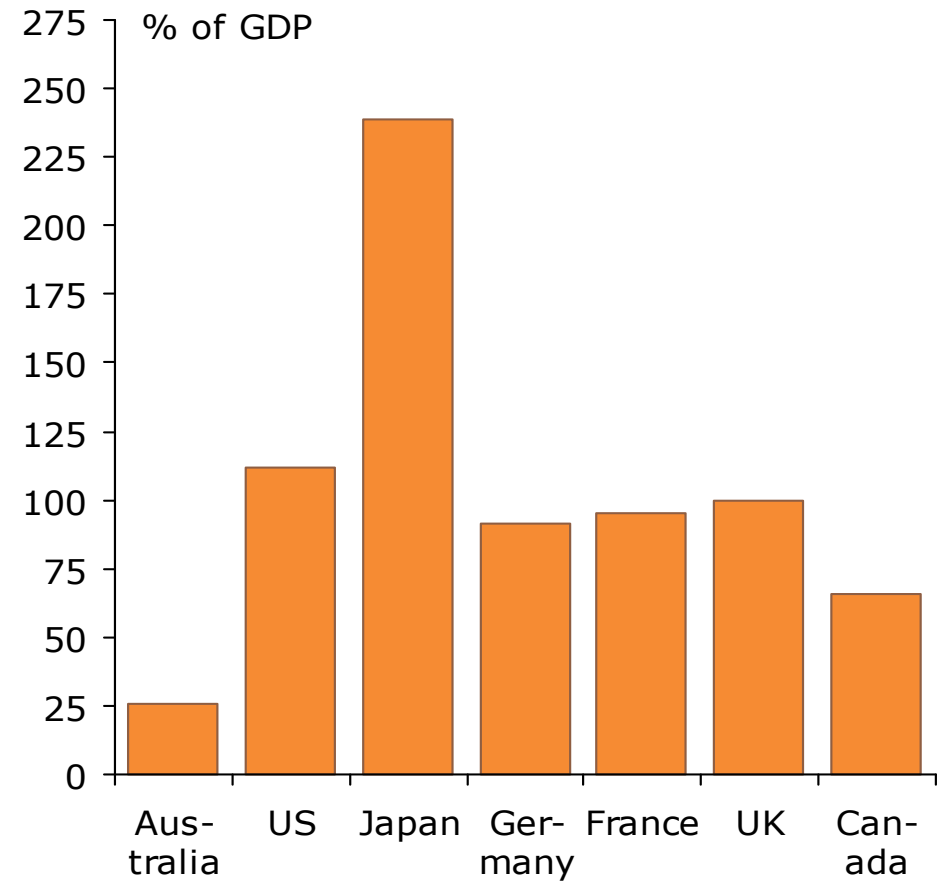
*Note:* 'Cash' includes deposits with the central bank. US banks are subject to required to hold cash reserves against their transactions account balances and thus typically hold a higher proportion of their assets in cash than Australian banks which are no longer subject to such requirements. *Sources:* RBA; US Federal Reserve; Datastream.

## Australia has been able to apply a relatively large fiscal stimulus while leaving its public finances in relatively good shape

### Fiscal packages 2008-10



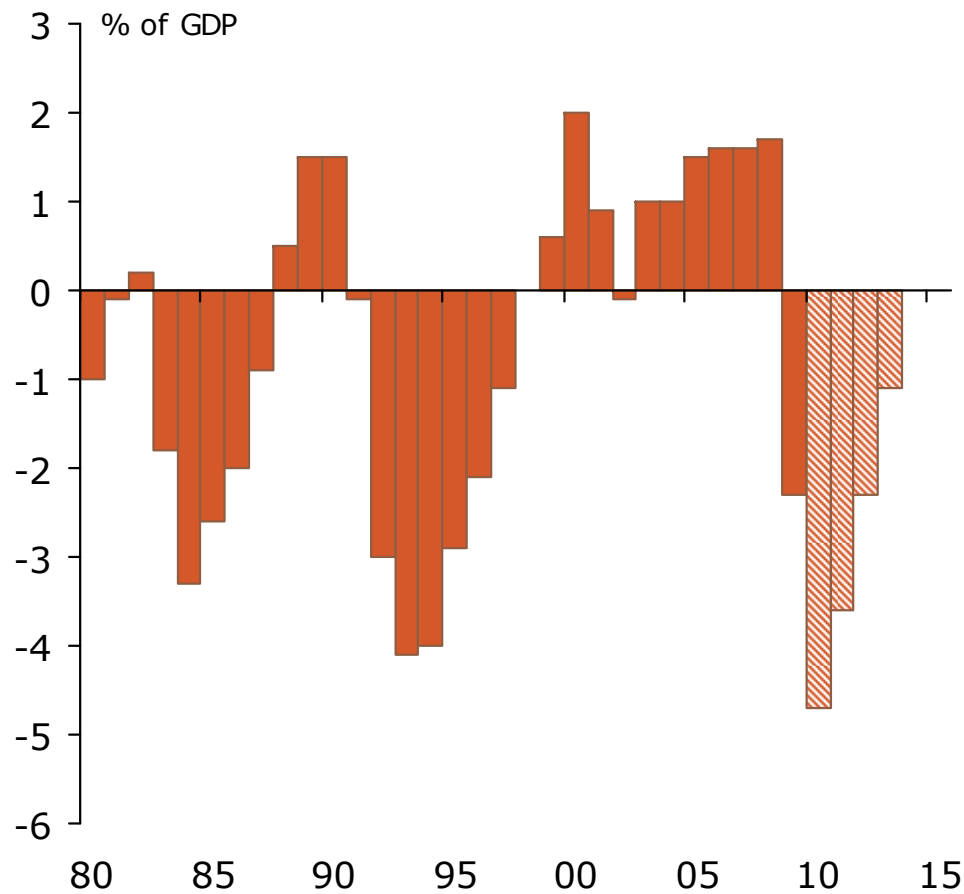
### Gross public debt, 2014



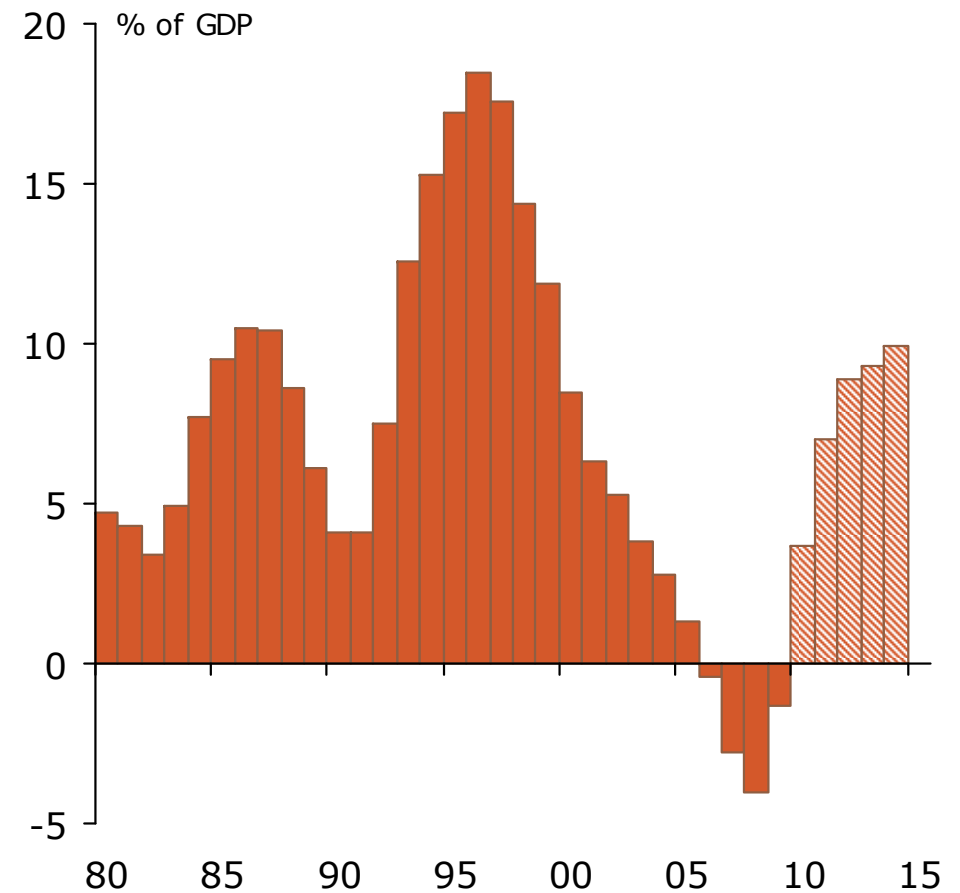
Sources: OECD, *Economic Outlook* No. 85 (June 2009), Table 1.7; IMF Staff Position Note, *The State of Public Finances: A Cross-Country Monitor* (July 2009), Appendix Table 1.

# Australia could implement a large fiscal stimulus without casting doubts about sustainability because of the strong starting position

## Australian Government budget 'underlying cash balance'



## Australian Government budget net debt

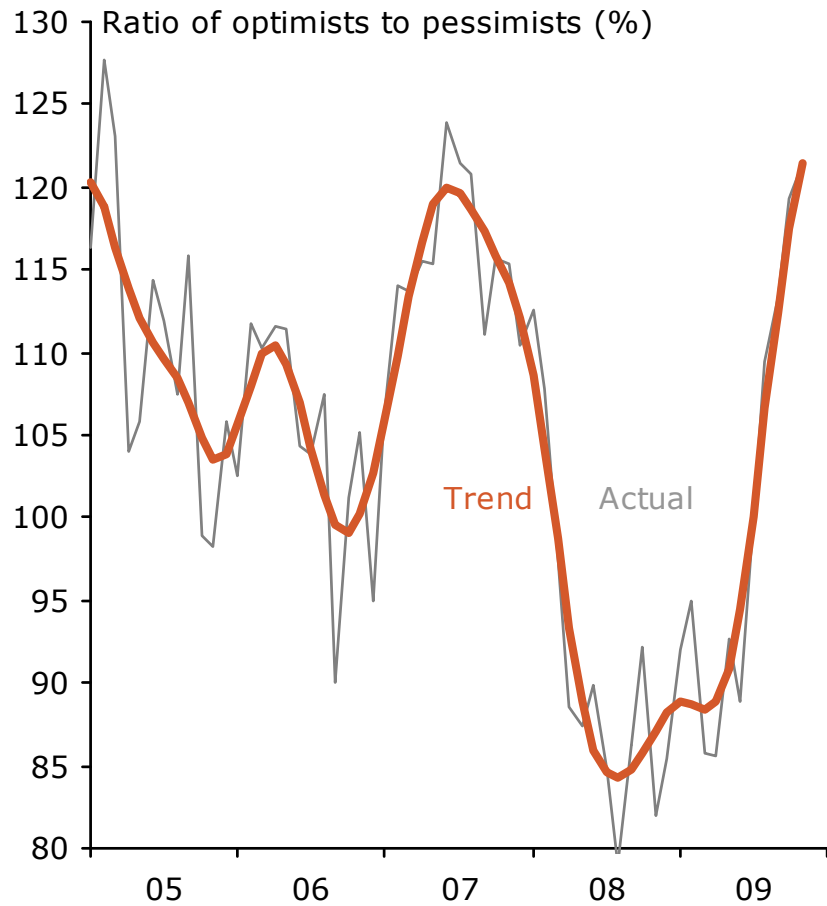


Sources: 2009-10 Mid-Year Economic and Fiscal Outlook (November 2009)

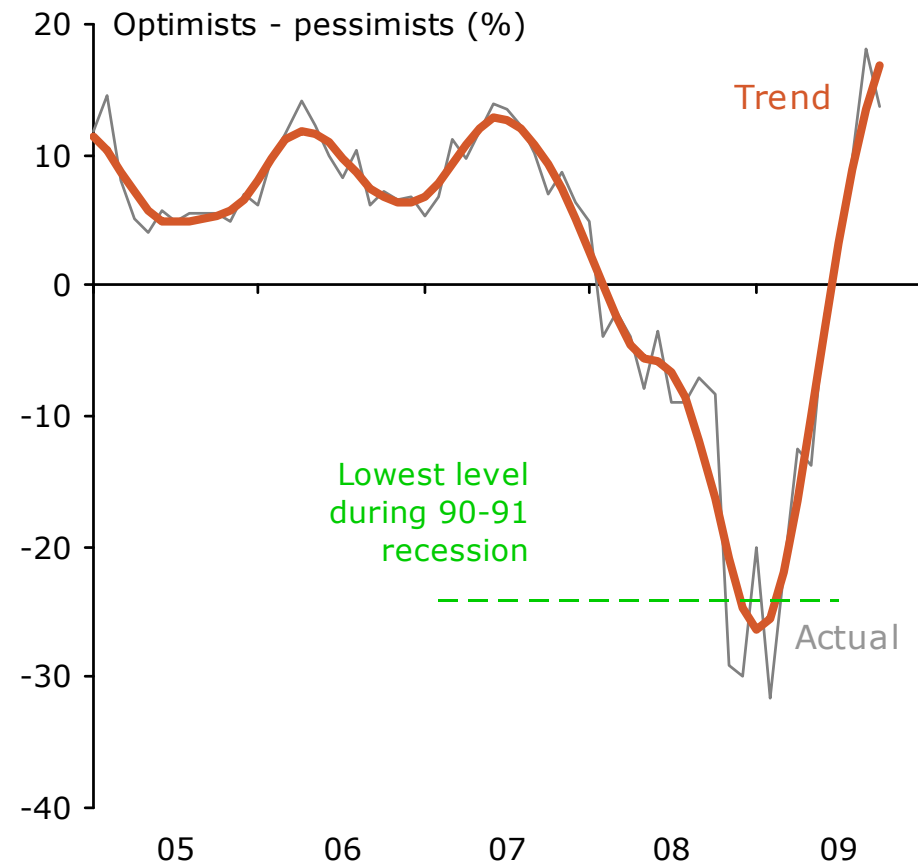
# The monetary and fiscal stimulus had a substantial positive impact on business and consumer confidence

## Survey measures of consumer and business confidence

### Consumer confidence



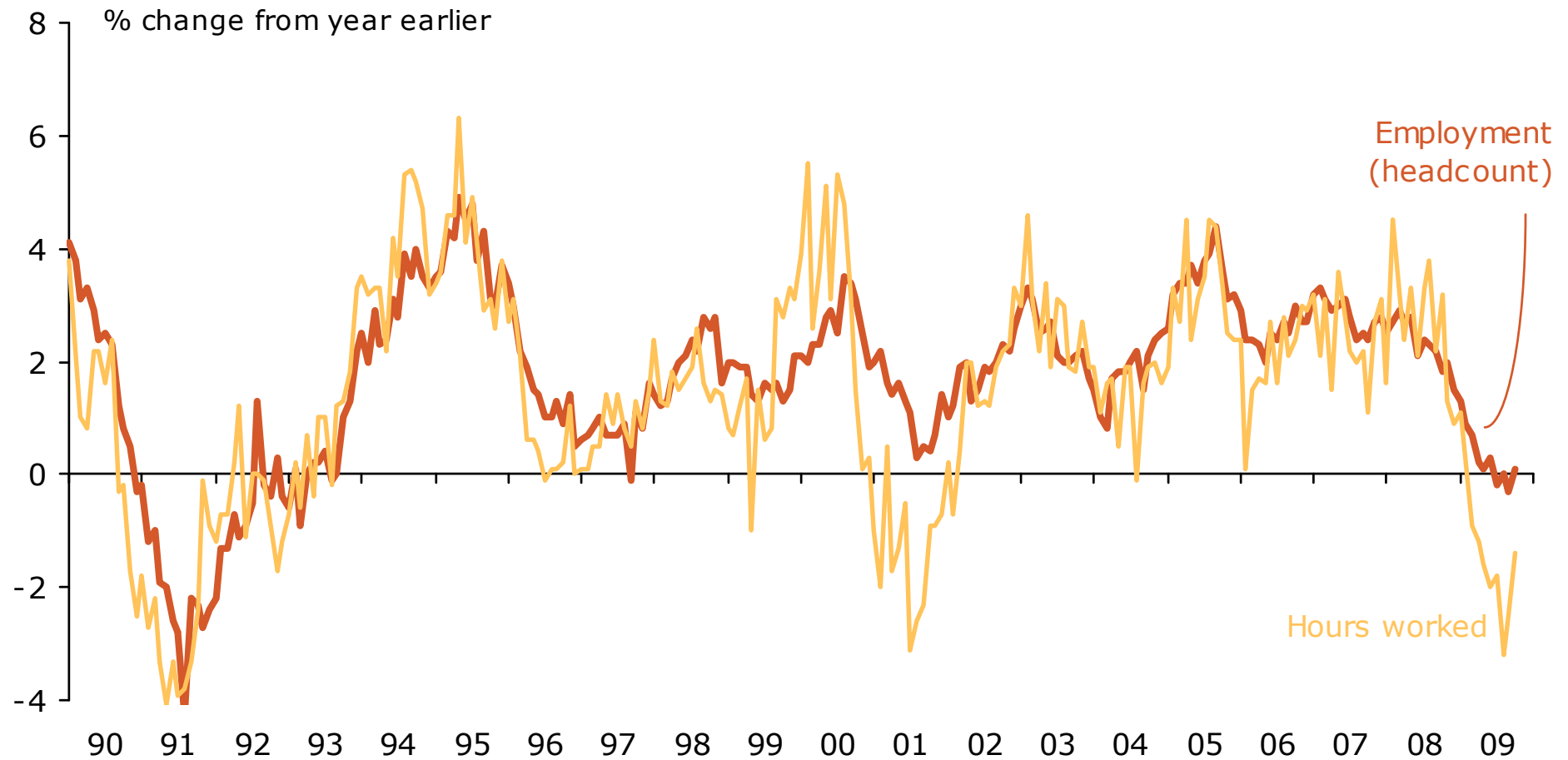
### Business confidence



Sources: Westpac-Melbourne Institute; National Australia Bank.

**It encouraged employers to believe the downturn would be mild, thus making them willing to 'hoard labour', keeping unemployment down**

### Headcount and hours worked

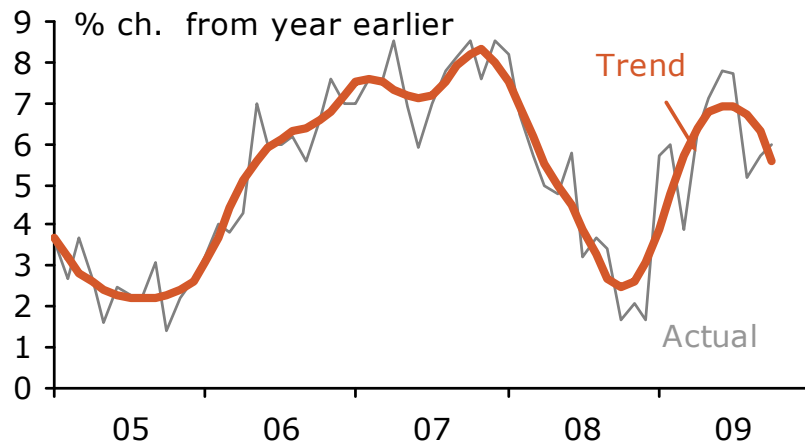


Source: ABS.

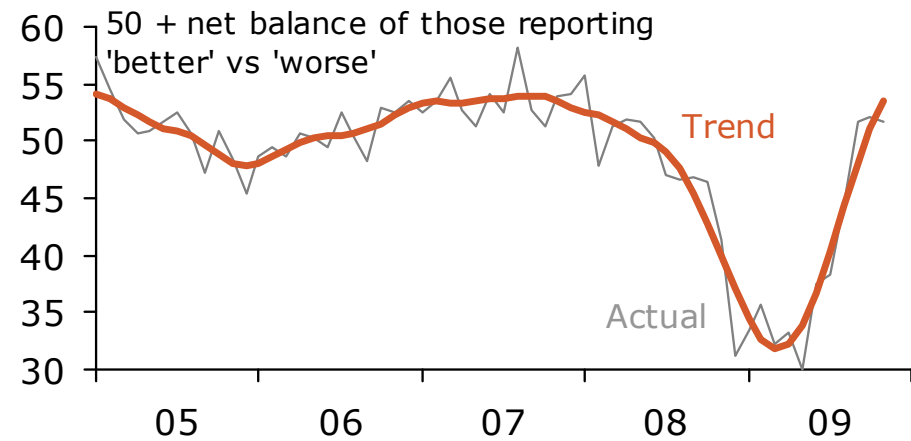
# Economic activity is holding up reasonably well even as fiscal stimulus begins to fade and monetary stimulus starts being withdrawn

## Selected indicators for the Australian economy

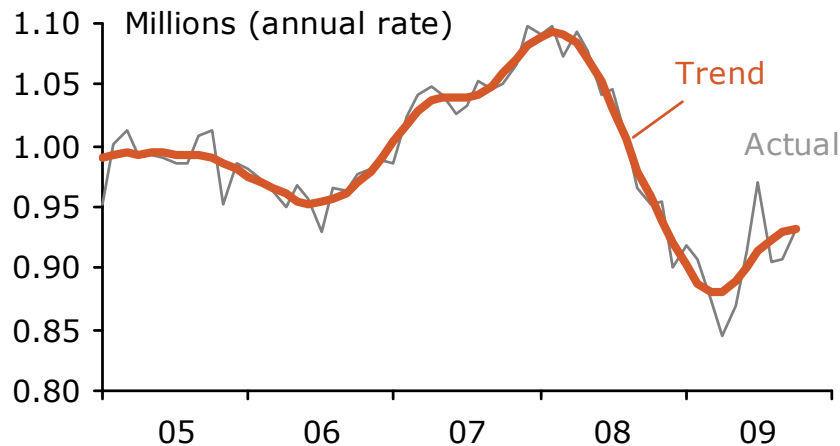
### Retail sales



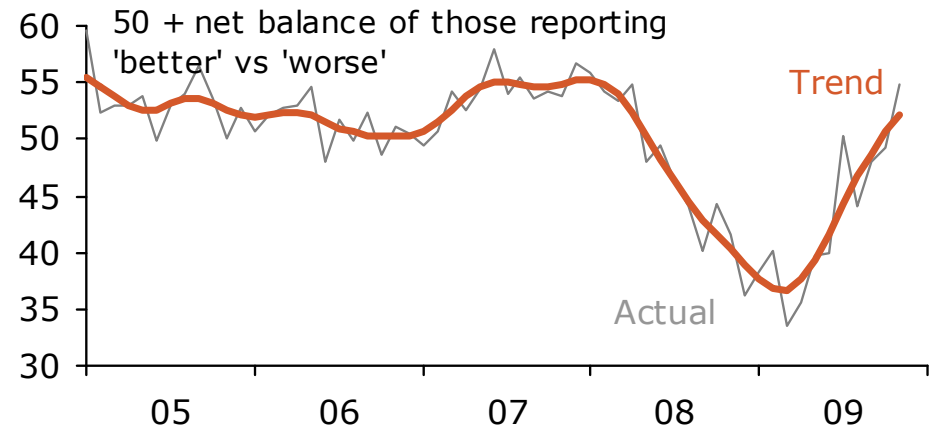
### Purchasing managers index - manufacturing



### Motor vehicle sales



### Purchasing managers index - services

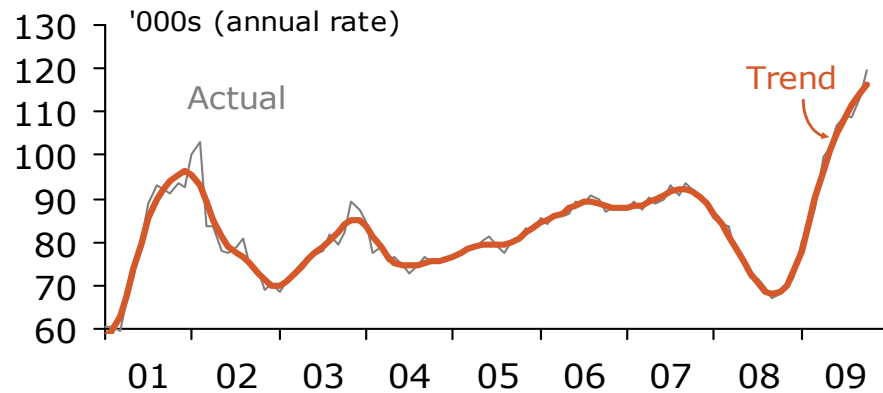


Sources: ABS; Australian Industry Group

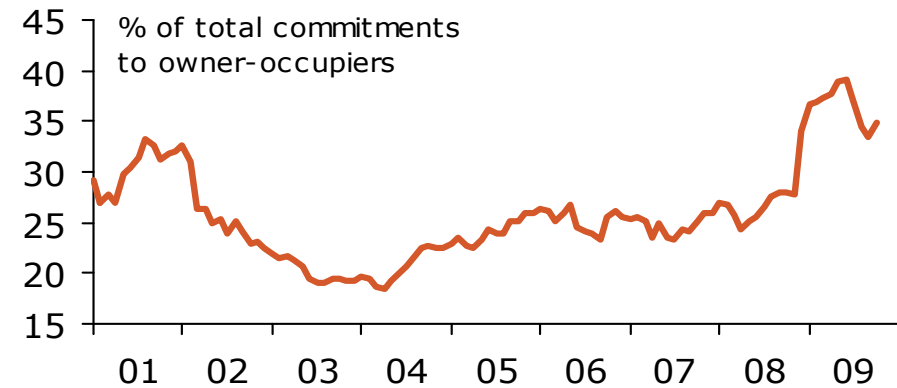
# Borrowing for housing has rebounded strongly – and seems to be no longer wholly dependent on first-time buyers

## Housing finance commitments

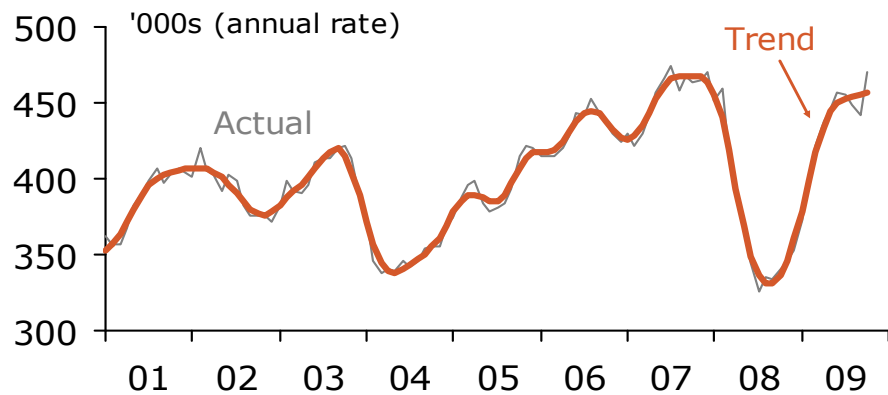
### New owner-occupied dwellings



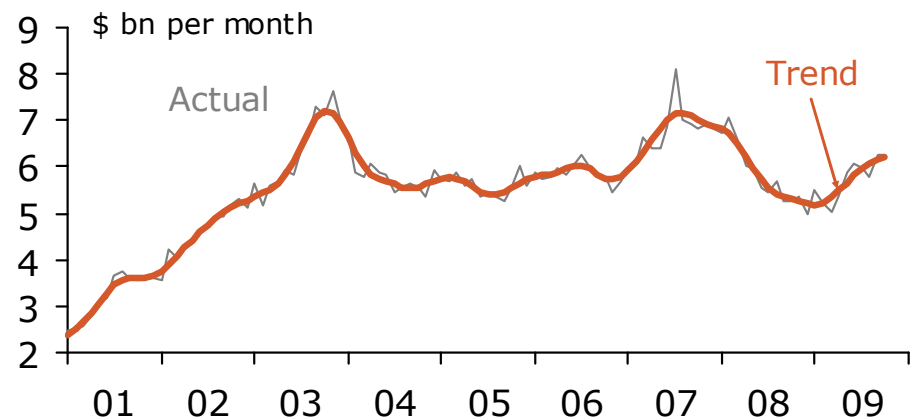
### First-time buyers



### Existing owner-occupied dwellings



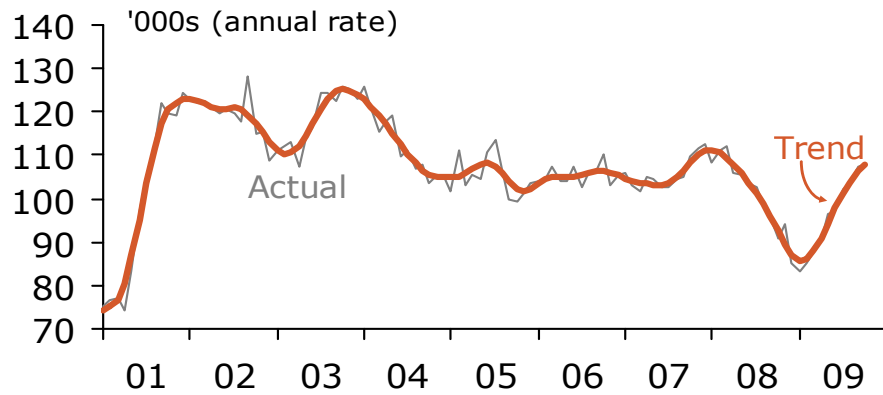
### Investors



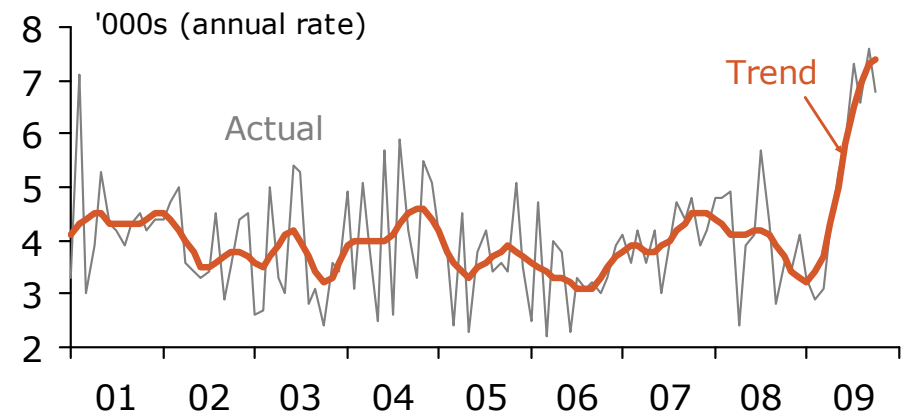
# Housing starts will likely exceed 150,000 in 2010 – but that’s still a long way short of what is required

## Residential building approvals

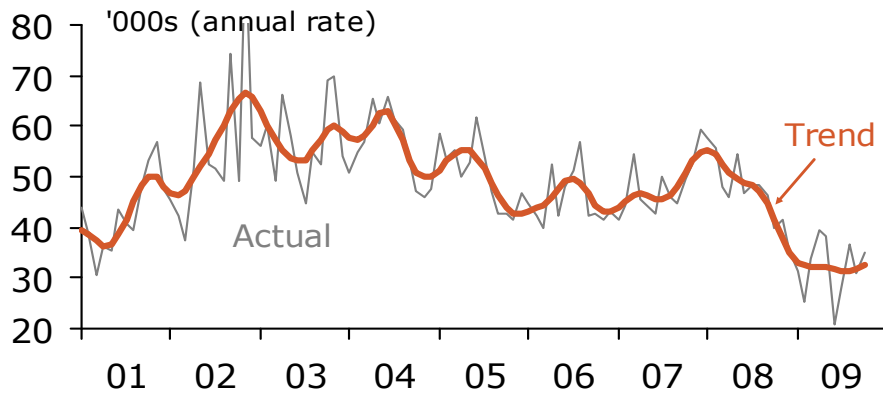
### Private sector houses



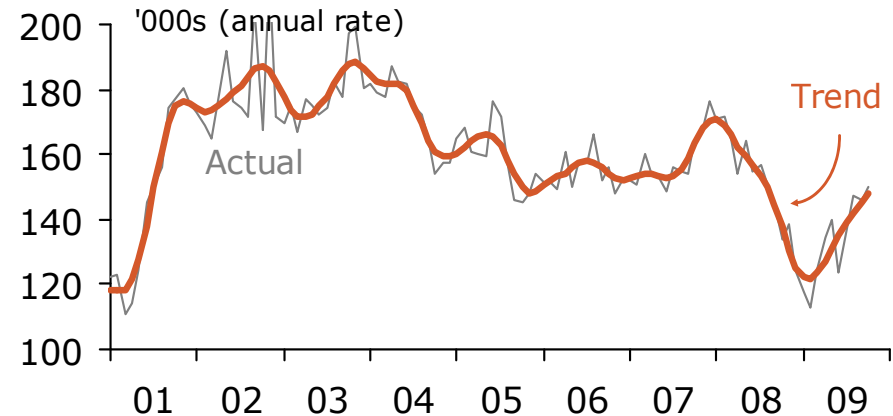
### Public sector dwellings



### Private multi-unit dwellings



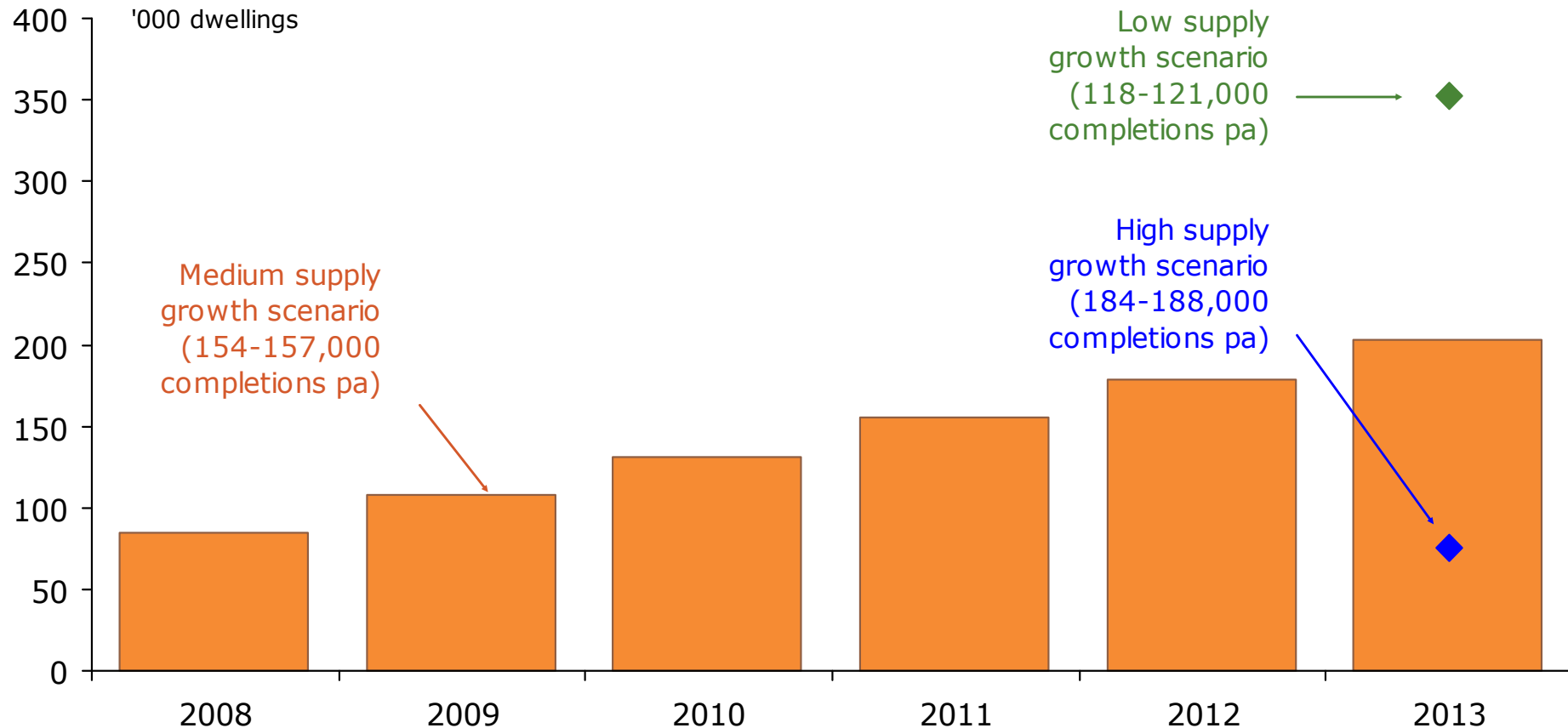
### Total dwellings



Source: ABS.

## Housing completions need to exceed 180,000 per annum for several years to make meaningful inroads into the housing shortage

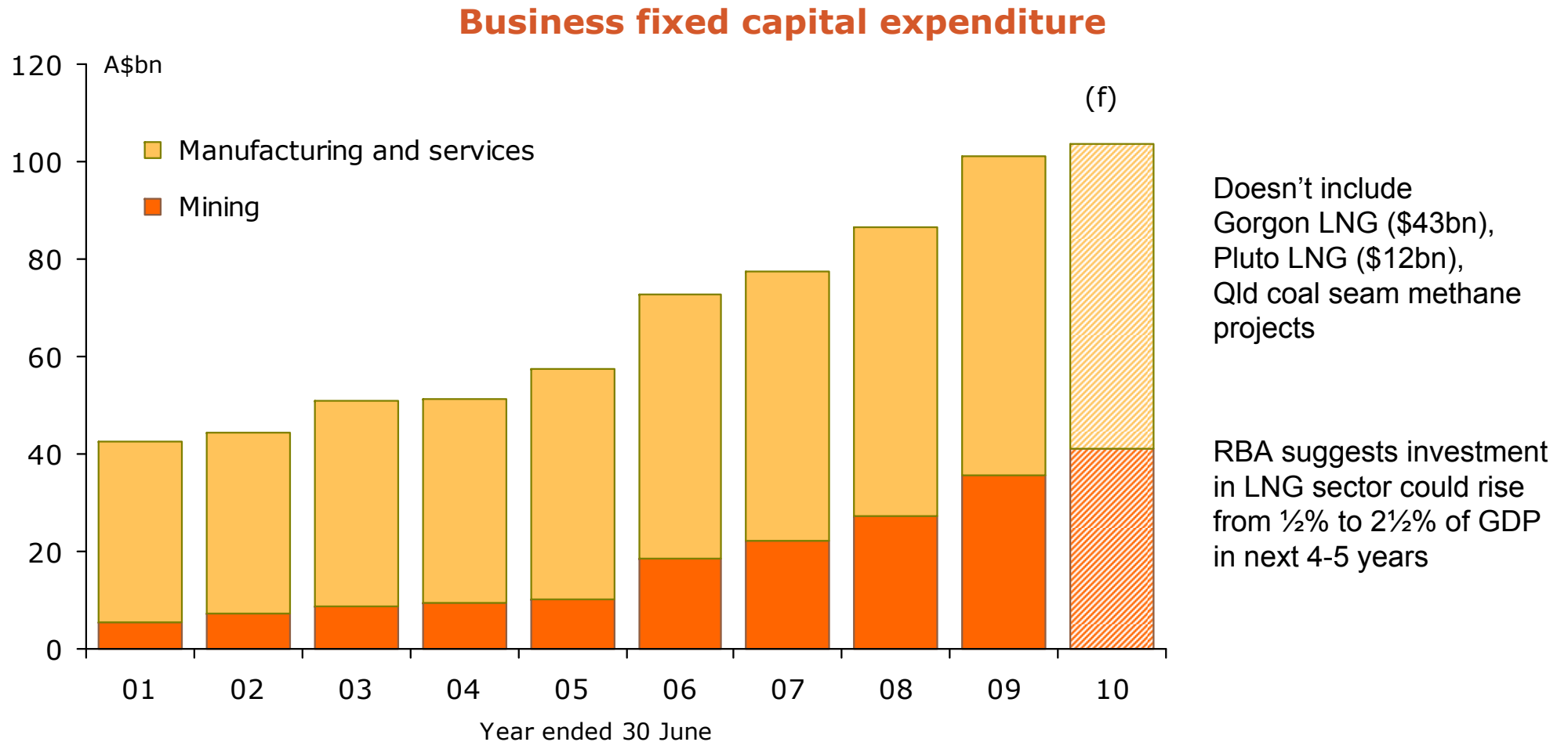
### Australia's housing shortage



*Note:* Estimates of housing shortage as at June 2008 based on numbers of homeless 'sleeping rough' or with relatives and friends, marginal caravan park residents and number of dwellings required to lift rental vacancy rates to 3%. Projections based on medium-term underlying demand scenario which assumes annual growth in the number of households of 152-156,000 per annum.

*Sources:* National Housing Supply Council *State of Supply Report 2008*.

## Business are still planning increased capital expenditure in 2009-10 despite the uncertain economic outlook

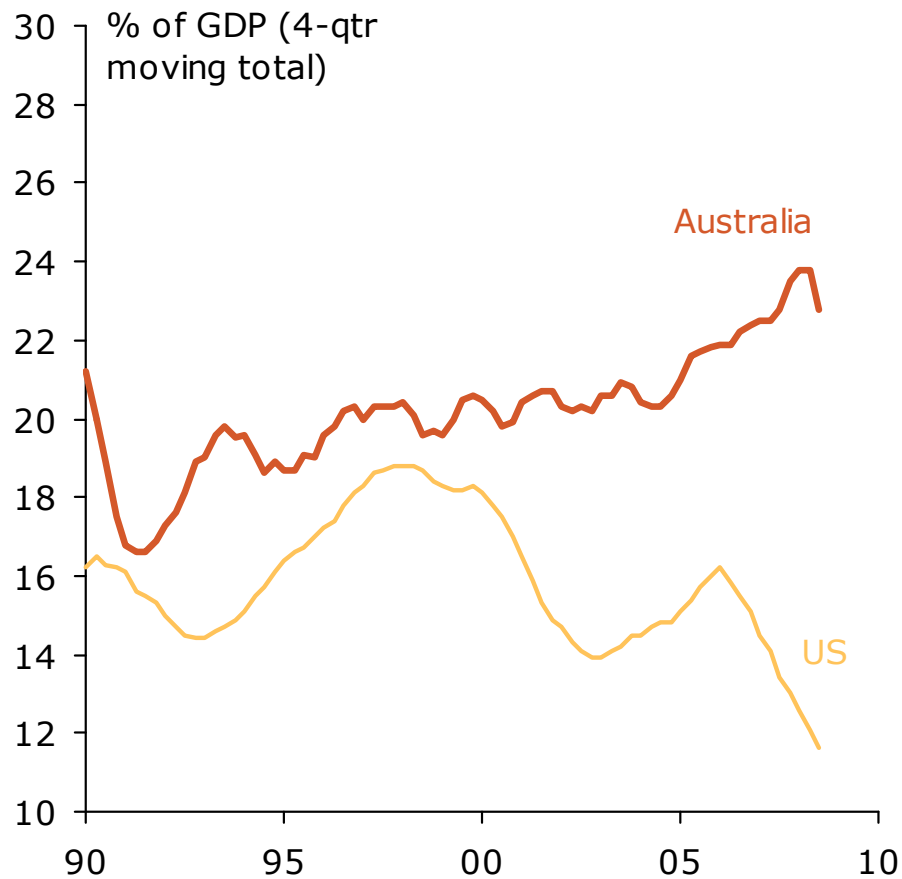


(f) Forecast for 2009-10 based on investment intentions reported to the ABS June quarter 2009 capital expenditure survey and assuming that those intentions are 'realized' to the same extent that they have been, on average, over the five years to 2008-09.  
Sources: ABS; Grattan Institute.

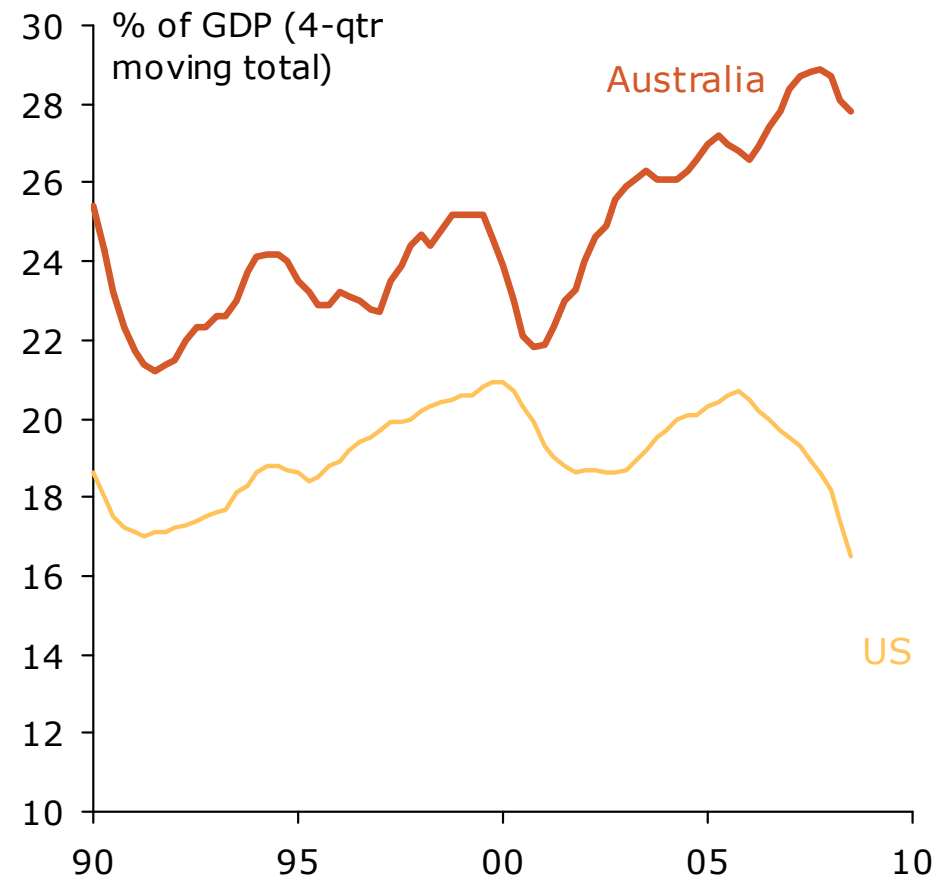
# Australia's large current account deficit is the result of high and rising investment, not low and declining saving

## Australia and United States – gross saving and investment

### Gross saving



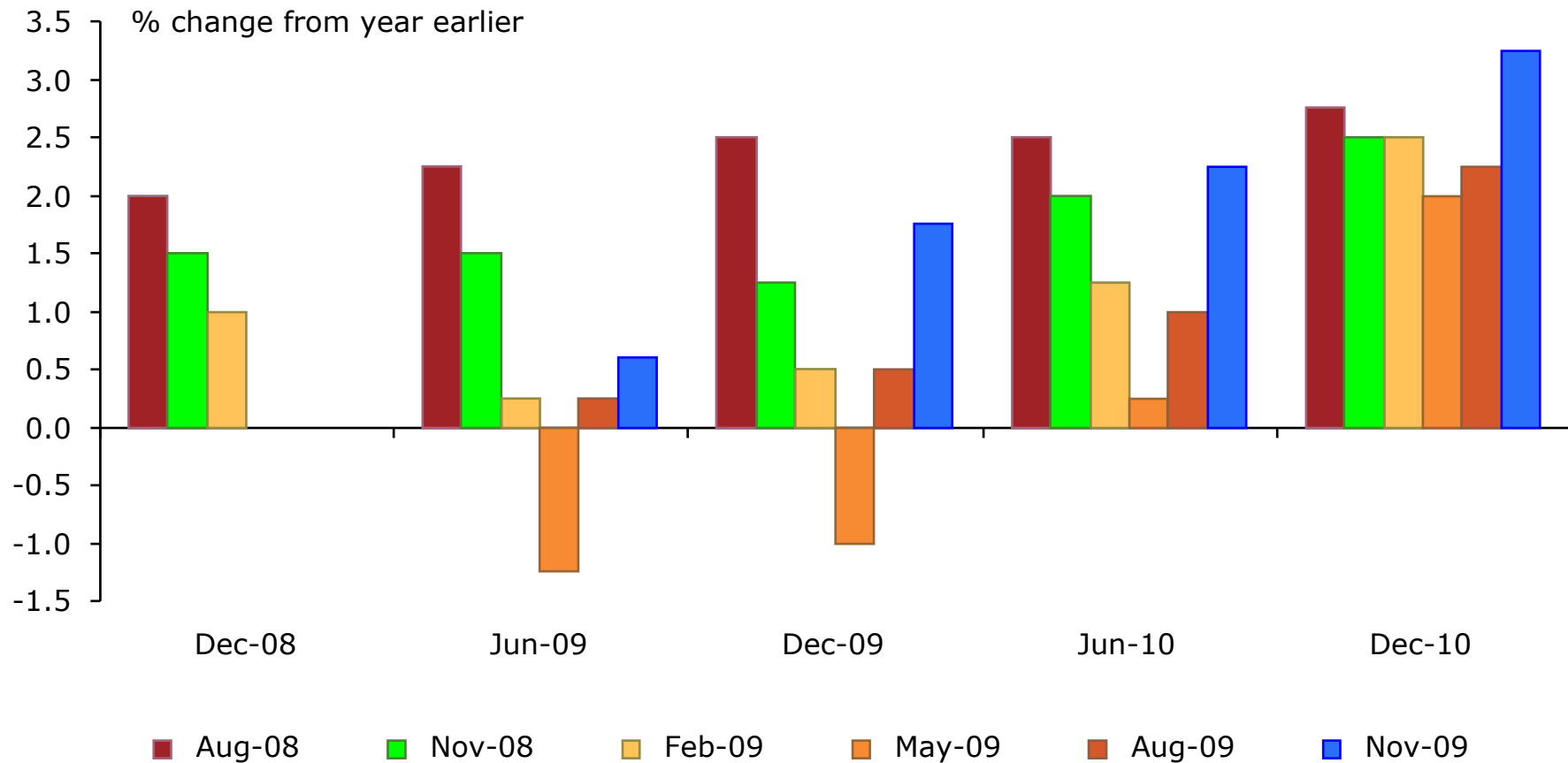
### Gross investment



Sources: ABS; US Bureau of Economic Analysis; Grattan Institute.

## Reserve Bank forecasts for economic growth have been revised up substantially since the middle of the year

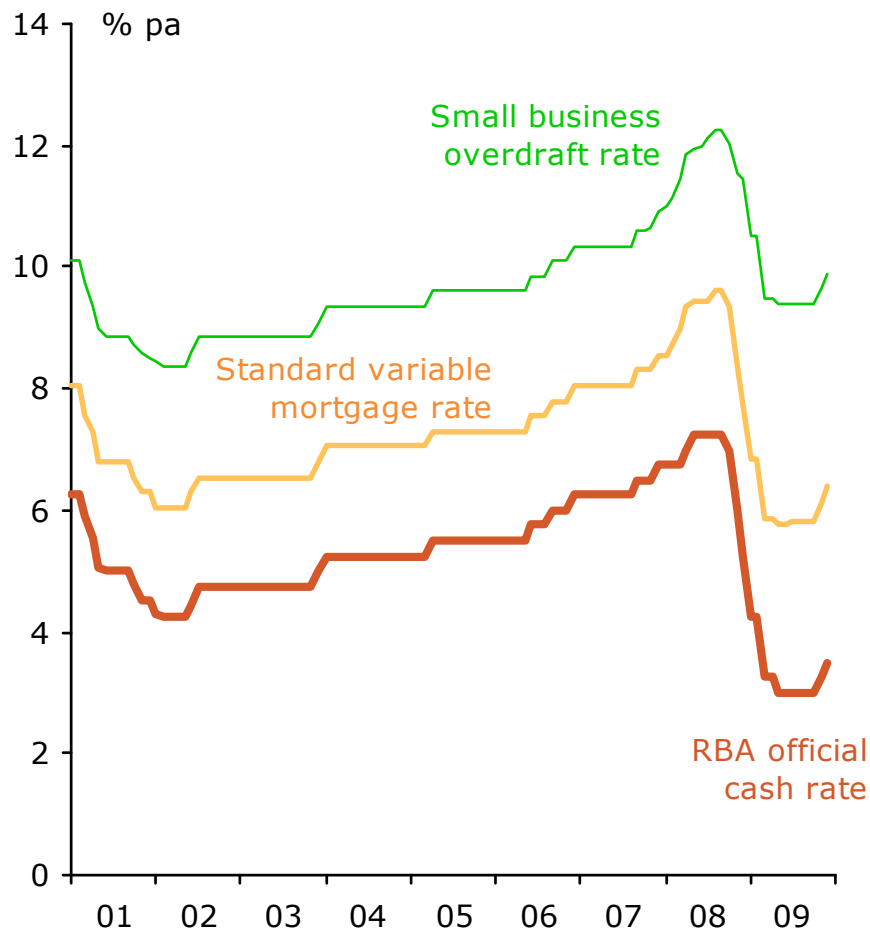
### Successive Reserve Bank forecasts of real GDP growth



Sources: Reserve Bank of Australia, *Statement on Monetary Policy*.

## Interest rates have now started to rise – and that’s a ‘good thing’, because it’s yet another sign that the economy is recovering

### Australian interest rates



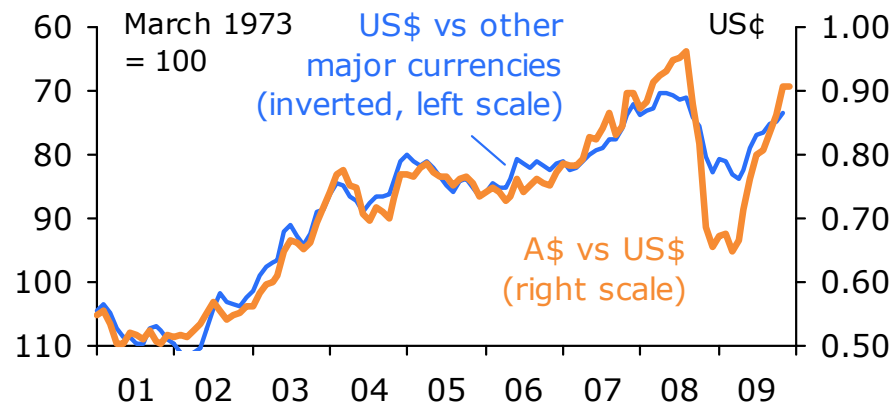
Source: RBA.

- The RBA took the cash rate down to 3% (the lowest in 49 years) in circumstances where it thought that the global financial crisis would push Australia into recession
- As it has turned out Australia has experienced a much less severe downturn than anticipated – and the RBA now thinks growth will be ‘close to trend’ through 2010
- Hence the need for rates to remain at the level reached earlier this year has diminished, while the risks associated with keeping them there have risen
- As a result the RBA has now begun ‘gradually lessening the stimulus provided by monetary policy’
- With the spread between the cash rate and rates borrowers actually pay having widened by 100-225 bp since mid-2007, ‘neutral’ monetary policy probably implies a cash rate in the 4-5% pa range, not the 5-6% range regarded as ‘neutral’ before the financial crisis

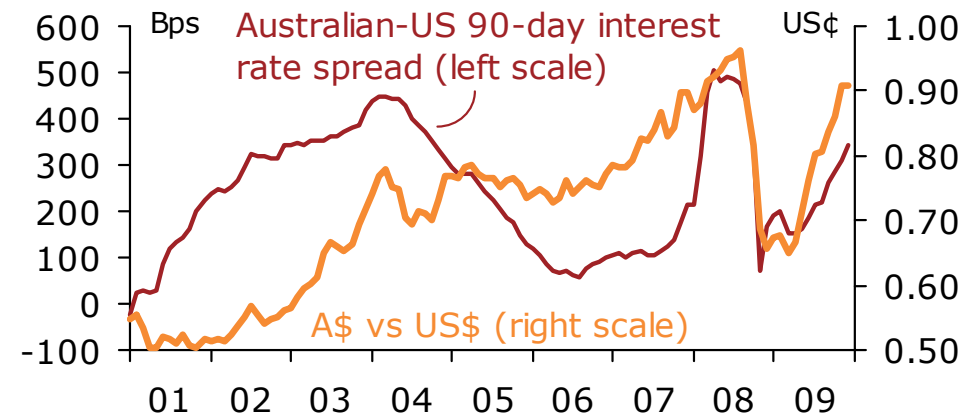
# The A\$ has resumed its pre-GFC upward trend and (unless there's an abrupt slowdown in China) will likely eventually reach parity with the US\$

## Key influences on A\$-US\$ exchange rate

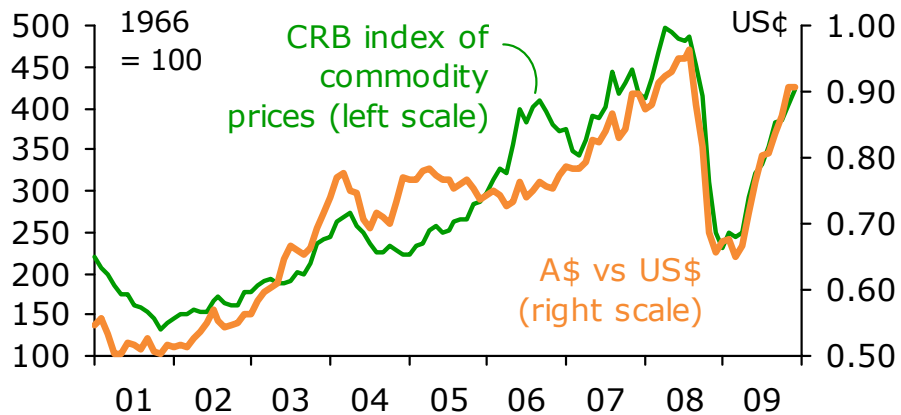
### Value of US dollar



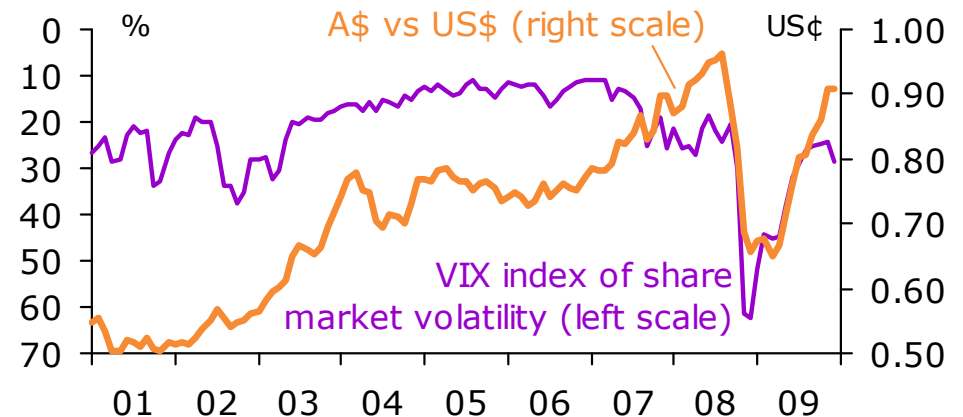
### Interest rate spreads



### Commodity prices



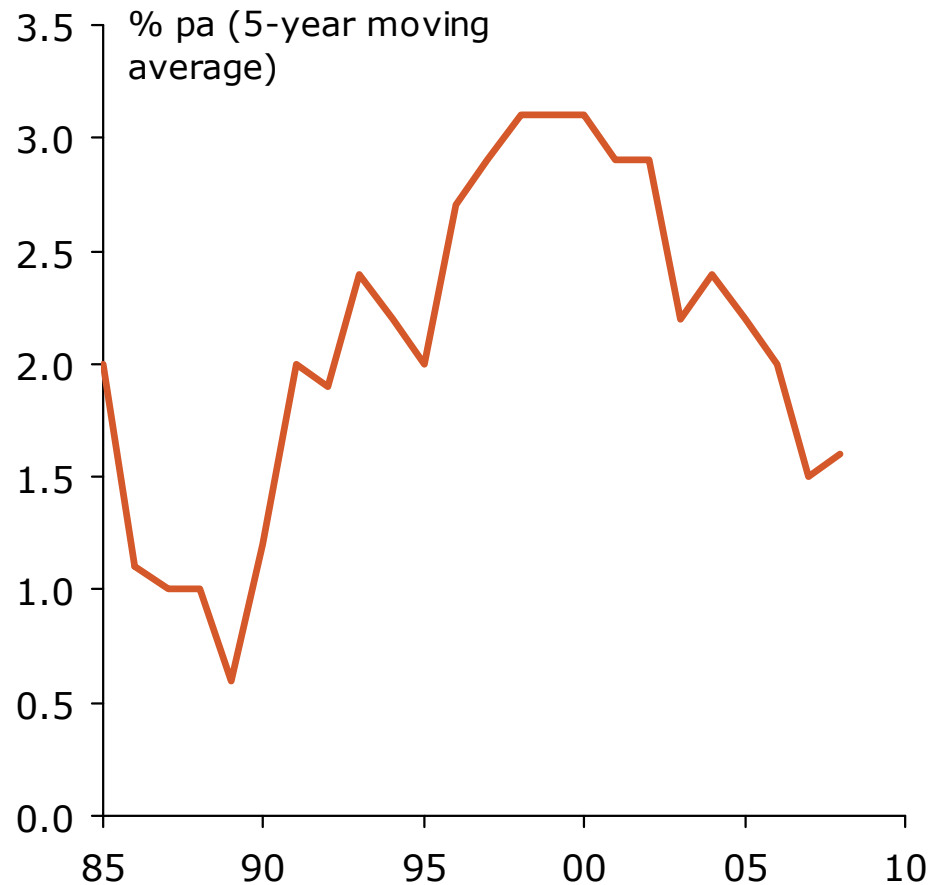
### Share market volatility



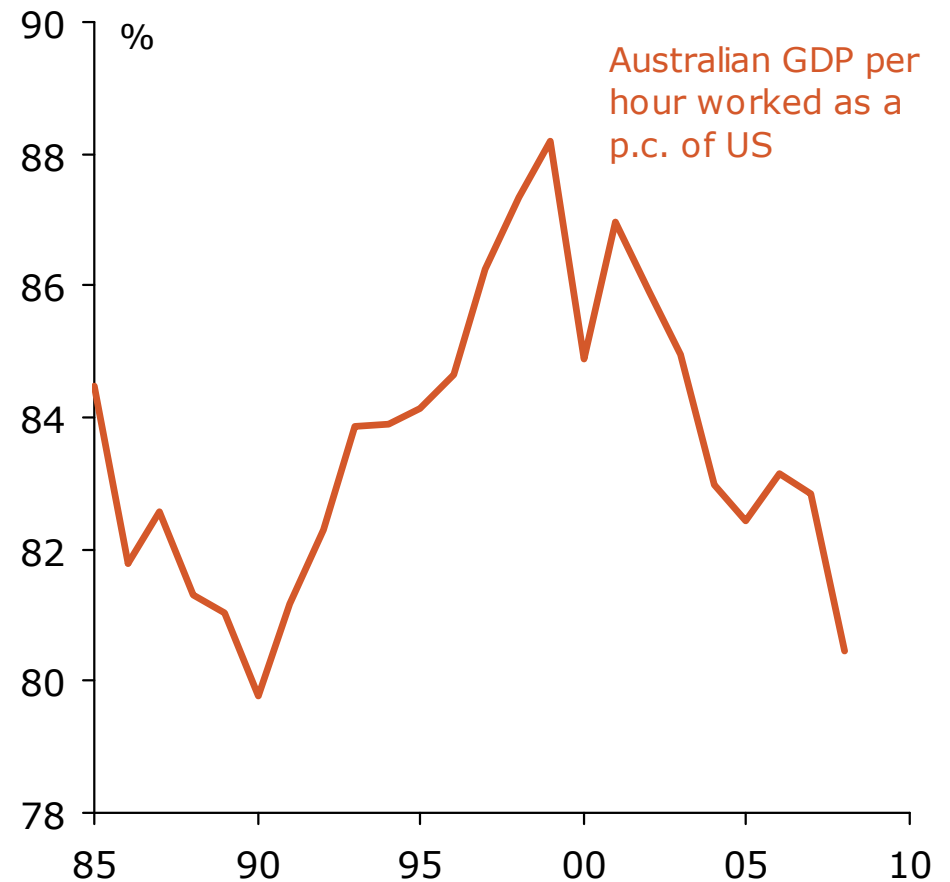
Sources: Thomson Reuters Datastream; Reserve Bank of Australia; US Federal Reserve.

# Australia's productivity performance has deteriorated significantly over the past decade

## Labour productivity growth



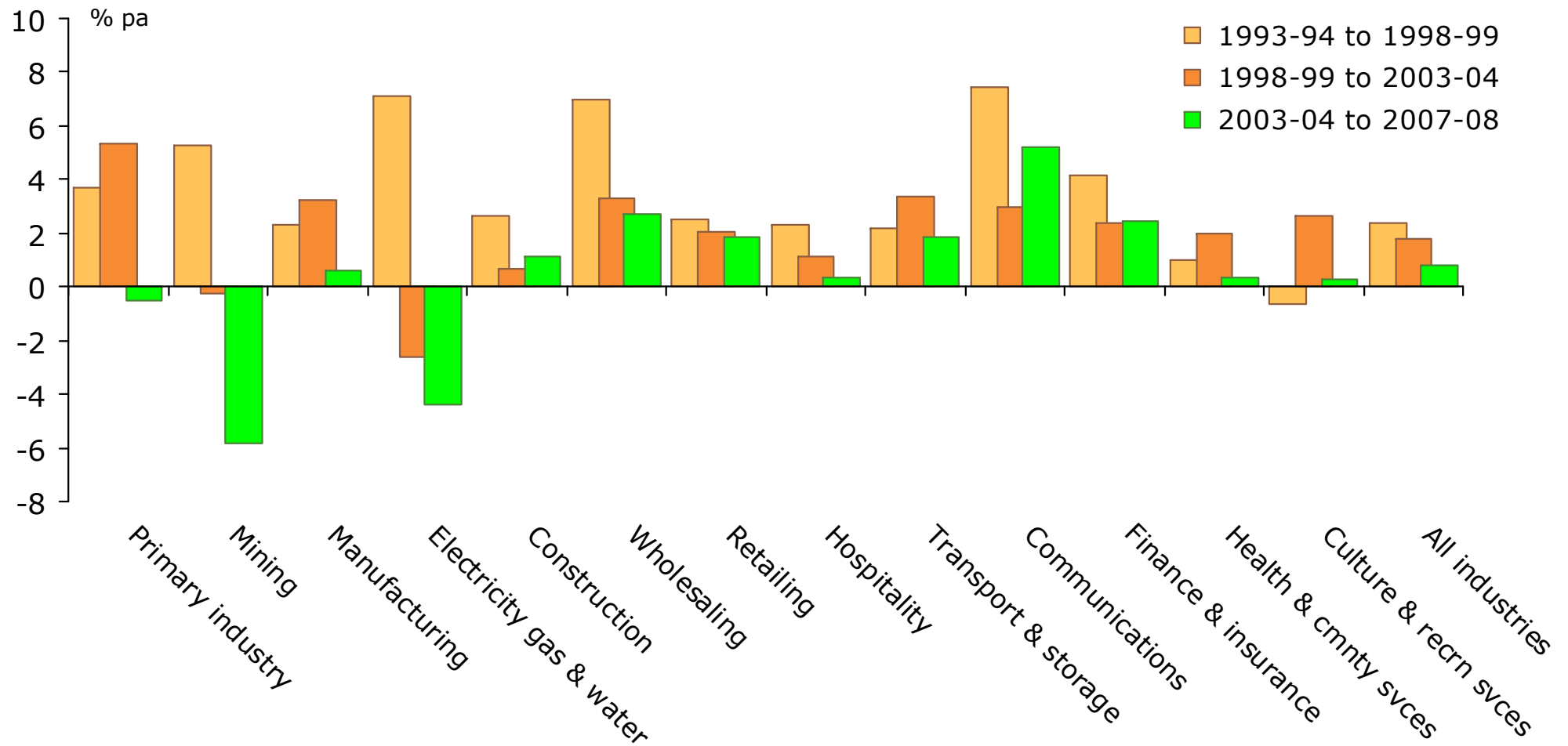
## Labour productivity level



Note: Labour productivity growth in the first chart is for the non-farm market sector; in the second is for the whole economy.  
Sources: ABS; The Conference Board & Groningen Growth and Development Centre *Total Economy Database* (June 2009)

## The productivity slowdown is partly due to peculiar developments in mining and utilities – but has occurred in almost all sectors

### Labour productivity growth by sector



Note: Periods depicted are intervals between growth cycle peaks as identified by ABS. Productivity estimates not available for the property & business services, education, government administration & defence and personal & other services sectors. Source: ABS.

## Some issues and challenges for Australia

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- The apparent resumption of the 'resources boom' after a milder-than-expected slowdown means that some of the pre-GFC stresses will re-emerge
  - skills shortages and infrastructure bottlenecks will again be key issues
  - but the budget surpluses which pre-crisis had been seen as available for dealing with these challenges have disappeared
  - Australia will continue to need to attract large capital inflows from overseas to finance investment
- Elevated commodity prices, relatively high interest rates and strong capital inflows will keep the A\$ well above its post-float average
  - putting additional pressure on non-resource trade-exposed sectors (manufacturing, agriculture, tourism and education), raising political concerns about 'two-speed economy' etc.
- Australia will be more vulnerable than most advanced economies to any abrupt economic slowdown in China
- The GFC (and the regulatory response to it) will have lasting consequences for the cost and availability of credit (not necessarily a bad thing)
  - more stringent capital and liquidity requirements on banks (and possibly additional constraints on leverage) will increase banks' costs, which they will recoup from customers (given reduced competition)
- More rapid population growth, though generally welcomed by business, will add to some of the strains associated with the resources boom
  - increased congestion, additional demands on urban infrastructure, heightened pressure on housing costs and prices