

SUR/83/45

CONFIDENTIAL

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The Chairman's Summing Up at the Conclusion
of the 1983 Article IV Consultation with Australia
Executive Board Meeting 83/162, November 23, 1983

The Executive Directors noted that Australia's economic situation had undergone a marked transformation since the last consultation, when Australia was enjoying a period of rapid economic growth; re-emergence of inflation and an acceleration of wage increases eventually had made the pace of economic activity unsustainable. Directors noted that weak world trade and commodity prices and a severe drought had combined to push the economy into a deep downturn and had led to an unprecedented rise in unemployment.

Directors noted that the new Government's economic strategy, centered around an expansionary fiscal policy, underpinned by a compact with the trade unions, was an ambitious effort in promoting both a recovery of activity and a gradual deceleration of the rate of inflation. Although many Directors saw the case for having recourse to an incomes policy, especially in the Australian context of strong and independent trade unions, they believed that the Government's strategy entailed serious risks for the period beyond the next 12 months or so. A number of Directors emphasized that excessively expansionary financial policies might put the incomes policy under severe strain and put much of the burden of price and incomes moderation on monetary policy.

Directors expressed considerable concern about the very rapid increase in the public sector borrowing requirement. Noting that the expansionary stance of fiscal policy stemmed almost entirely from a very rapid rise in public spending, they stressed that determined efforts at expenditure restraint were essential in order to reduce the structural component of the deficit. Many Directors were apprehensive that a failure to rein back the fiscal deficit might crowd out private sector activity and push up interest rates and exchange rates, thus undermining the basis for a sustained recovery.

Directors fully endorsed the authorities' view that it is the private sector that must provide the desired expansion of employment opportunities. They also agreed with the authorities that a reduction in real wages and improved business profitability were essential to realize these opportunities. They accordingly emphasized the importance of achieving and safeguarding a reduction in real wages. In the view of several Directors, full wage indexation should not become a permanent feature of policy.

Directors also emphasized the pivotal role of monetary policy in ensuring a sustained reduction in the rate of inflation. While noting with satisfaction the recent decline in the rate of inflation to within a single digit, Directors felt that it was no cause for complacency, since inflation was still well above the level of Australia's main trading partners.

In the recent past the improvement in business confidence, among other things, had stimulated large capital inflows, but this development had tended to interfere with the conduct of monetary policy as the authorities had not always succeeded in offsetting the impact of these inflows on the money supply, causing monetary growth to exceed the target set by the authorities. Directors noted the willingness shown by the authorities in recent months to let the exchange rate appreciate. While some Directors were concerned at the effect of an appreciating exchange rate on competitiveness, there was general agreement that a determined effort to restrain monetary growth was essential to sustain the progress made in reducing inflation. A few Directors noted the recent and prospective rise in Australia's external indebtedness.

Finally, while deploring the rising trade barriers faced by Australia's agricultural exports in overseas markets, Directors stated that Australia's own interests would be best served by a gradual reduction in the extensive protection accorded to the manufacturing sector and urged the authorities to resist any measures to intensify protection.

Directors commended the authorities for increasing their ODA and welcomed the prospective early repurchase in respect of last year's drawing under the buffer stock financing facility.

Several Directors noted the long delay since the last consultation and welcomed the intention to hold the next Article IV consultation with Australia on the standard cycle.