FOR AGENDA

SM/08/265
Supplement 2

September 5, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Australia—Staff Report for the 2008 Article IV Consultation**

The attached supplement to the staff report for the 2008 Article IV consultation with Australia (SM/08/265, 8/11/08) has been prepared on the basis of additional information and is tentatively scheduled for discussion on **Wednesday, September 10, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Australia indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Brooks (ext. 34454) and Ms. Edison (ext. 36946) in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat forthwith; and to the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

AUSTRALIA

Staff Report for the 2008 Article IV Consultation
Supplementary Information

Prepared by Asia and Pacific Department

Approved by Kalpana Kochhar and Tessa van der Willigen

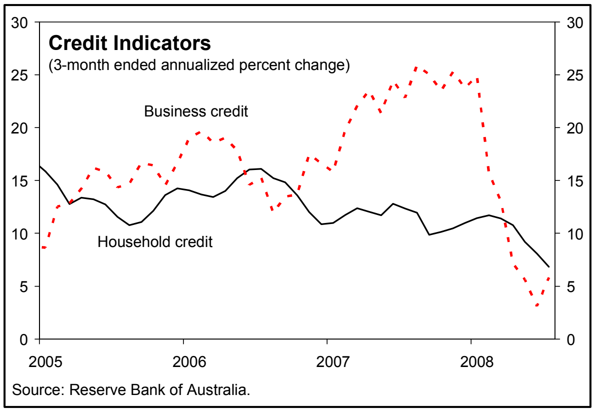
September 5, 2008

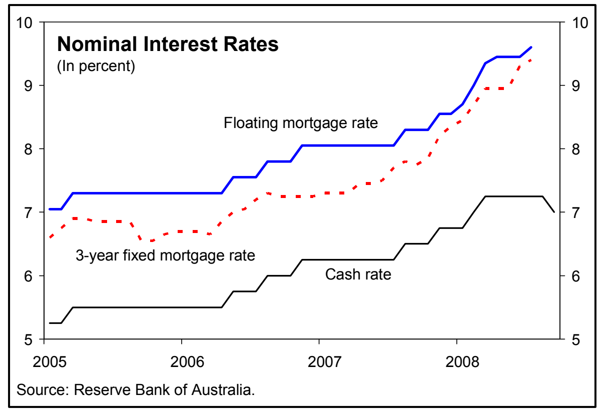
1. This supplement to the staff report summarizes the main developments since the staff report was issued on August 11, 2008.

2. **GDP growth moderated in the second quarter as expected.** Real GDP grew by 1.2 percent in the June quarter in annualized seasonally adjusted terms, reducing growth to 2.7 percent in y/y terms. Household consumption contracted slightly while private investment remained strong. The slowing in GDP growth was in line with staff projections, with growth in household consumption weaker than expected, but exports and private investment stronger than expected.

3. **The staff's real GDP projections remain broadly unchanged, but the risks have become more balanced than characterized in the staff report.** Household demand is likely to be weaker than projected in the staff report, with tight financial conditions offsetting the impact of personal tax cuts. Strong investment and exports, especially in the mining sector, are likely to continue to support growth.

4. **Credit growth slowed sharply in recent months and the global financial turmoil continued to put upward pressure on banks' funding costs.** Credit growth fell from 16 percent y/y in December 2007 to 6 percent in July 2008 (in seasonally adjusted, annualized terms), in response to higher interest rates and tightened credit standards. The financial turmoil continued to put upward pressure on banks' funding costs, with variable and fixed mortgages rates rising further in July.





5. **The Reserve Bank of Australia (RBA) moved to a less restrictive monetary policy stance on September 2, 2008 by reducing its cash rate by 25 basis points to 7 percent.** The RBA noted that financial conditions had become quite tight in recent months, with heightened concerns over credit persisting in international financial markets. The RBA move offsets the tightening in financial conditions in recent months and the RBA continues to forecast inflation to fall below 3 percent in 2010.

6. **In the staff's view, monetary policy remains sufficiently firm to reduce inflation but looking ahead it will be important to take a cautious approach.** Even after factoring in the cut in the cash rate, bank lending rates are more than 150 basis points above mid-2007 levels and credit conditions more generally have tightened considerably. However, given high core inflation and pressures stemming from the commodity price boom and large immigration inflows, the RBA should take a cautious approach to policy adjustment.

7. **The exchange rate has depreciated in the past month as interest rate differentials narrowed and some commodity prices eased.** The Australian dollar has fallen by about 10 percent since June 2008, in nominal effective terms. The recent depreciation was driven by market expectations of an easing in monetary policy and a decline in base metal prices as global growth forecasts were revised downward. The staff report estimated an overvaluation of the Australian dollar of about 10 percent and the recent depreciation brings the currency into line with its medium-term equilibrium level.

8. **The current account deficit narrowed to 4½ percent of GDP in the June quarter.** The trade balance moved into surplus for the first time in six years, due to a sharp increase in export prices for iron ore and coal and a broader pickup in export volumes. The improvement in the trade balance was offset in part by a wider income deficit, as debt service costs and dividend payments increased. Net foreign liabilities were revised down by 4–5 percent of GDP for the past year, and stood at about 60 percent of GDP for June 2008.