SUR/08/97

September 15, 2008

The Acting Chair's Summing Up
Australia—2008 Article IV Consultation
Executive Board Meeting 08/79
September 10, 2008

Executive Directors agreed with the thrust of the staff appraisal. They commended the Australian authorities on their impressive economic management in the fiscal, monetary, and structural areas, which has spurred a sustained and long-lasting economic expansion. Looking ahead, Directors considered that the sound macroeconomic framework should permit Australia to weather the global downturn and contain inflationary pressures.

Directors welcomed the authorities' confirmation of their strong commitment to the inflation targeting framework, which has served Australia well and will contribute to anchoring medium-term inflation expectations and facilitating a lasting reduction in price pressures. They noted that the Reserve Bank of Australia (RBA) had responded to the buildup in inflationary pressures in recent years through a substantial tightening of monetary policy. More recently, against the backdrop of the global financial turmoil, the tightness of the financial markets, and the evolution of economic conditions, the RBA moved to a less restrictive monetary policy by reducing the cash rate. Directors welcomed this action and the authorities' readiness to follow a cautious monetary policy aimed at achieving the 2-3 percent inflation target range over time, based on a continuous assessment of prospects for demand and inflation in the period ahead. Wage and price developments in particular will require careful monitoring, taking into account the high core inflation and pressures stemming from the commodity price boom.

Directors welcomed the support that prudent fiscal policy is providing for monetary policy. They noted that the reduction in public spending growth in the latest budget will help reduce inflation, and the intention to save any further positive revenue outcomes in 2008/09 will allow the automatic stabilizers to work. Looking ahead, if growth and revenues are stronger than expected, Directors recommended that the surplus be allowed to exceed budget forecasts until it is clear that inflation will decline. They agreed that, to the extent that the improvement in the budget balance is structural and associated with permanently higher commodity prices, there should be scope to reduce taxes or increase spending over the medium term. Directors welcomed the establishment of three new funds for longer-term spending on health, education, and infrastructure, with contributions to come from the 2007/08 and 2008/09 surpluses.

Directors regarded the flexible exchange rate policy as appropriate, and observed that the currency appreciation in recent years had eased inflation pressures. Directors noted the staff's assessment that, with the recent depreciation, the Australian dollar is now broadly in line with medium-term fundamentals. They observed that wider current account deficits and the accumulation of external liabilities have increased external vulnerability in recent years. However, Directors considered that vulnerability will be contained as the associated high rates of investment contribute to export capacity, and as the medium-term external current account deficit narrows to its historical norm.

Directors considered that the banking system is sound, but that some vulnerabilities remain. They commended the authorities' timely and fitting response to the credit market turmoil, with the RBA providing liquidity support and the Australian Prudential Regulation Authority intensifying its monitoring of banks. Directors noted that the banking sector remains profitable and well capitalized. However, they encouraged the authorities to monitor carefully the sector's vulnerability to rollover risks arising from short-term wholesale funding and to the risks associated with the large indebtedness of the household sector. Directors commended the authorities for the progress in implementing the 2006 FSAP recommendations, including the strengthening of the failure resolution and crisis management framework. They also welcomed the planned introduction of liquidity guidelines to reduce the risk of disruptions arising from loss of access to offshore funding.

Directors encouraged the authorities to take advantage of the positive macroeconomic performance to advance structural reforms. They considered that, if implemented fully, the broad reform agenda should enhance the flexibility of the economy and lift productivity and labor force participation.

It is expected that the next Article IV consultation with Australia will be held on the standard 12-month cycle.