August 13, 2020
Approval: 8/20/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/19-1

9:30 a.m., February 21, 2020

1. Australia—2019 Article IV Consultation

Documents: SM/20/40 and Correction 1; and Supplement 1; SM/20/41

Staff: Finger, APD; Duttagupta, SPR

Length: 2 hours, 4 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	B. Jappah (AE), Temporary
M. Raghani (AF)	
	B. Lischinsky (AG)
N. Ray (AP)	
A. Bevilaqua (BR)	
Z. Jin (CC)	
	A. Guerra (CE)
	A. McKiernan (CO)
R. Kaya (EC)	
A. Buisse (FF)	
R. von Kleist (GR)	
	P. Dhillon (IN), Temporary
D. Fanizza (IT)	
T. Tanaka (JA)	
	C. Sassanpour (MD), Temporary
H. Beblawi (MI)	
	R. Doornbosch (NE)
M. Poso (NO)	
	A. Tolstikov (RU), Temporary
	R. Alkhareif (SA)
	K.Tan (ST)
	P. Trabinski (SZ)
S. Riach (UK)	
M. Rosen (US)	

C. McDonald, Acting Secretary
H. Malothra, Summing Up Officer
L. Briamonte, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: H. Finger, I. Hussiada, Y. Kido, E. Loukoianova, M. Nozaki, J. Ostry, Y. Wong, Y. Zhou. Communications Department: B. Walker. Legal Department: K. Kwak. Middle East and Central Asia Department: K. Mathai. Strategy, Policy, and Review Department: R. Duttagupta, S. Kaihatsu, E. Lundback. Executive Director: A. Mozhin (RU). Alternate Executive Director: K. Chikada (JA), N. Heo (AP), D. Ronicle (UK), P. Rozan

(FF), B. Saraiva (BR), F. Sylla (AF), C. White (AP). Senior Advisors to Executive Directors: S. Ahmed (MD), M. Alle (AF), F. Fuentes (BR), P. Harvan (EC), L. Johnson (AP), N. Jost (NE), Z.Mahyuddin (ST), R. Morales (AG), J. Shin (AP). Advisors to Executive Directors: P. Al-Riffai (MI), A. Arevalo Arroyo (CE), S. Buetzer (GR), L. Cerami (IT), O. Haydon (UK), T. Iona (AP), G. Khurelbaatar (AP), H. Koh (GR), P. Mooney (CO), H. Mori (JA), M. Mulas (CE), A. Park (AP), N. Shenai (US), A. Srisongkram (ST), N. Vaikla (NO), J. Al Saud (SA), K. Lok (CC), A. Tola (SZ).

1. AUSTRALIA—2019 ARTICLE IV CONSULTATION

Mr. Ray, Ms. Johnson and Ms. Park submitted the following statement:

Australia has just completed its 28th consecutive year of economic growth. The adjustment to the largest terms of trade shock in Australia's history and the associated huge mining investment boom has run its course. The successful economic transition has occurred in the context of an open, diversified economy with a flexible exchange rate regime, liberalized capital account, flexible labor and product markets, supportive macroeconomic policies, strong institutional arrangements and robust regulatory frameworks.

Australia's economic fundamentals remain sound. The economy continues to show resilience in the face of weak momentum in the global economy, as well as domestic challenges such as the devastating effects of drought and bushfires. While economic growth has slowed, a gradual recovery is expected.

Outlook and risks

Growth in the Australian economy is expected to lift from the growth rates recorded over the past two years. Activity will be affected in the near-term by the impact of the drought and bushfires, and the outbreak of COVID-19, although it is too early for the economic impact to be precisely known. The domestic outlook is supported by a modest lift in global growth as key global risks have eased following the 'phase one deal' between the US and China and the reduced uncertainty over Brexit. Domestically, accommodative monetary policy, recent tax cuts, solid employment growth and a turnaround in mining investment will support activity.

Labor market conditions in Australia remain strong, with employment growth outpacing population growth and, at 2.1 percent through the year to December is running at more than twice the OECD average. Consistent with improved opportunities in the labor market, as well as continued increases in participation by women and older Australians, the headline participation rate has increased to record highs over the past year. Ongoing employment growth is expected to support a modest pick up in wage and consumer price growth. As has been the case in other advanced economies, wage growth in Australia has been slow to respond to improving labor market conditions.

Staff and authorities broadly agree on the outlook and the risks for the Australian economy. The outbreak of COVID-19 represents a new source of uncertainty. It is too early to tell what the impact will be, but given China is a larger part of the global economy and more closely integrated, including with Australia, the international spillovers could be larger than experienced in 2003 with the outbreak of SARS. Domestically, consumption growth remains weaker than expected and continues to be a downside risk.

The bushfires and drought are also weighing on growth. Most of Australia has been affected by a severe drought. 2019 was the warmest and driest year on record for Australia. These conditions have contributed to one of the worst bushfire seasons on record. In addition to the tragic loss of life, the bushfires have caused widespread damage to public infrastructure and private property in affected regions. They have disrupted businesses, including tourism, where the full cost is not likely to be known for some time. The authorities have estimated that the bushfires will reduce Australian GDP growth by around 0.2 percentage points across the December and March quarters. The recovery effort following the bushfires is likely to reverse the negative near-term economic effects of the fires on aggregate activity. Drought conditions are likely to continue to weigh on rural production and exports and the Reserve Bank of Australia (RBA) has forecast this to reduce GDP growth by a quarter of a percentage point in 2020.

Macroeconomic policy settings

The authorities agree with staff that monetary and fiscal policy settings remain appropriate for the current economic conditions. Should an adverse external shock materialize, authorities have both conventional and unconventional monetary policy levers and fiscal space available to respond. The fully flexible exchange rate would also act as a shock absorber to certain adverse external shocks.

Monetary policy was eased in 2019 and is likely to remain accommodative for some time. In recent meetings, the RBA Board has decided to keep the cash rate steady, noting that interest rates have already been reduced to a very low level and there are long and variable lags in the transmission of monetary policy. This decision also reflects a judgement about the balance between the benefits of low interest rates and the risks associated with having interest rates at very low levels. The nature of this balance can change over time and is dependent on the state of the economy. Accordingly, the RBA will continue to monitor developments carefully.

The Australian Government continues to maintain a responsible fiscal stance, while implementing its plan to lift potential growth by boosting productivity through lower taxes, targeted spending and investment in infrastructure. Consistent with the Government's commitment to budget repair, the Commonwealth budget has returned to balance for the first time in 11 years, with the 2019-20 Mid-Year Economic and Fiscal Outlook (MYEFO) projecting a surplus in FY2019-20. The authorities' strong fiscal position has enabled Australia to deal with domestic and international challenges including the devastating drought and bushfires as well as deliver personal income tax cuts. The authorities have provided significant funding to those affected by drought and are continuing to provide immediate relief to families and businesses affected by the bushfires to help communities get back on their feet including through the establishment of a A$2 billion National Bushfire Recovery Fund. The authorities have also established the National Bushfire Recovery Agency to coordinate the national response and recovery efforts and the Prime Minister has sought agreement from the states and territories for a Royal Commission into the season's bushfires. Australia's gross and net public debt levels remain low by OECD standards.

Banking and financial sector

Australia's financial system remains fundamentally sound. Capital ratios for banks are high by both historical and international standards, and the implementation of the framework for loss-absorbing capacity announced by the Australian Prudential Regulation Authority (APRA) will further improve the resilience of the financial system. Insurers' capital ratios continue to be well above their regulatory requirements. Profitability in the banking and general insurance industries remains at healthy levels that are above international peers and the cost of capital.

Household debt remains high, but there are factors which reduce the potential losses for lenders. Housing debt is generally well collateralized. Three-quarters of debt is owed by households in the top 40 percent of the income distribution, who generally have a high capacity to make repayments and are less likely to experience sustained unemployment. The tightening in lending standards for residential mortgages in recent years has appropriately improved the quality of new lending. The removal of thresholds limiting investment and interest-only housing lending should not be seen as a loosening of prudential policy, but rather the removal of temporary measures as improved lending practices became embedded.

There are potential risks from a renewed pick-up in house prices and household borrowing, which continue to be closely monitored by the Australian authorities. Through the Council of Financial Regulators, work is also ongoing to consider what tools might be available – if needed –to address systemic risks, the circumstances in which they might be suitable and any restrictions on their use. Efforts to facilitate housing supply reforms also have a role to play in containing housing price growth.

Australian banks' funding has become more resilient over the past decade, with the share of deposit funding increasing. Wholesale debt still funds around one-third of lending activity and two-thirds of this (20 percent of total funding) is from offshore wholesale debt markets. Australian banks use offshore wholesale funding to diversify their funding sources, access deeper and more liquid markets and borrow for longer terms than they often can domestically. While Australian banks' relatively high use of offshore funding could in principle create vulnerabilities, the risks are appropriately managed. Australian banks fully hedge against foreign exchange risk and mainly use the currency-hedged offshore funding to extend Australian dollar loans. Banks have lengthened the duration of their funding over the past few years, reducing risks associated with rollover or refinancing.

Efforts to enhance the regulatory framework have continued with a renewed focus on improving non-financial risk management. Recommendations from the 2018 FSAP are being implemented as part of a significant reform agenda following the 2014 Financial System Inquiry, the Productivity Commission's review into Competition in the Australian Financial System and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Actions taken by regulators have included a proposed new standard to strengthen remuneration requirements for prudentially regulated institutions and enhancing consumer protection in the financial services industry.

Australian financial regulators are also taking steps to address emerging climate risks. APRA is increasing its scrutiny of institutions' climate risk management. The Australian Securities and Investments Commission (ASIC) has provided updated regulatory guidance on disclosure of climate risk related information to investors. The RBA monitors climate risks as part of its monetary policy and financial stability mandates, including by monitoring the evolving risks to financial institutions.

Structural reforms to foster strong, sustainable and inclusive growth

Australia is committed to the Paris Agreement and the need to take action to reduce global emissions, to mitigate the risk of climate change. The Australian authorities have made it clear that Australia intends to meet its

2030 commitments. Australia is a world leader in renewable energy. Australia is on track for around a third of its electricity needs being met by renewables in the early 2020s. More than 2.2 million Australian households have rooftop solar panels - the highest proportion of households in the world.

Australian authorities note staff's advice that further increases in infrastructure spending could be considered given the IMF's assessment of Australia's fiscal space. Public infrastructure spending is currently at very high levels and the Commonwealth Government announced a bring forward of infrastructure spending in MYEFO. At the current levels of investment in infrastructure by the Commonwealth, State and Territory governments, some capacity constraints and skills shortages are emerging, which would potentially be amplified by a further lift in infrastructure spending. The quality of investment in infrastructure is also important to deliver a boost to potential growth. The Australian Government has processes in place to facilitate high quality investment in infrastructure. Infrastructure Australia works to prioritize and progress nationally significant infrastructure projects that are underpinned by robust business cases.

Australia remains firmly committed to open trade, investment and immigration. The authorities underscore their steadfast commitment to a cooperative multilateral trading framework that promotes openness over protectionism. Australia remains well placed to benefit from its economic diversification and increasing integration into the Asia-Pacific region. Australia is continuing to expand its network of Free Trade Agreements (FTAs), which cover around 70 percent of its total two-way trade, seeking to reach a target of around 90 percent of two-way trade covered by FTAs by 2022. Australia has bilateral FTAs with key trading partners, such as China, Japan, South Korea, the US, and ASEAN nations. FTAs with Hong Kong and Peru recently entered into force, the FTA with Indonesia is expected to enter into force in the first half of 2020, and the FTA with Pacific Island countries, PACER Plus, is also expected to enter into force in 2020. Australia is currently negotiating FTAs with the EU and the Pacific Alliance and has commenced bilateral discussions with the UK. The finalization of the Regional Comprehensive Economic Partnership will further integrate Australian businesses into the world's fastest growing region which accounted for 58 percent of Australia's trade in 2018-19.

Mr. Mojarrad and Mr. Ahmed submitted the following statement:

We thank staff for well-written papers and Mr. Ray, Ms. Johnson, and Ms. Park for their informative buff statement. We broadly agree with the thrust of the staff appraisal.

We commend the authorities for their sound macroeconomic management and strong policy framework that are reflected in a long period of sustained, robust economic growth. As with most other advanced economies, the Australian economic growth is currently below potential, but is expected to recover gradually in near term on the back of easy monetary policy and tax cuts. There are, however, strong headwinds. Weaker global growth prospects, high household debt, and sluggish business investment and private consumption all weigh on medium-term outlook. As the economy is recovering from drought and devastating bushfires, the coronavirus outbreak in Asia is posing additional challenge. Against this background, we agree with staff on the importance of maintaining supportive macroeconomic policies to secure a stronger demand momentum and to boost long-term productivity and potential growth.

The palpable and wide-ranging impact of global climate change is being reflected along a number of fronts in Australia. At the macro level, it is reflected in changing production and investment patterns, and in private spending and public confidence in general. Its broader implications include the availability and pricing of insurance, and generation and distribution of power within the country. These developments in Australia showcase how global climate change could work through various channels in a major economy to influence the economic and financial outcomes in the near term, as well over the medium to long term.

Policy support is essential as long as there is slack in the economy. We are of the view that monetary policy should remain accommodative under the current circumstances and that policy normalization should be triggered by firmer upward pressure on prices. We welcome the Reserve Bank's willingness to provide more monetary stimulus, if needed.

Fiscal policy has also been appropriately supportive. We welcome the infrastructure investment boost as a critical source of demand in near term, as well as the rollout of the National Disability Insurance Scheme. We tend to agree with staff that the economic recovery should be supported by a balanced accommodative macro policy mix, and that the authorities should be prepared to provide additional fiscal stimulus in case downside risks materialize, so not to over-burden the monetary policy, especially given the limited policy space. In fact, the substantial fiscal space could be prudently used for further high-quality infrastructure spending to boost potential growth, without compromising the ability to deal with future shocks.

We take positive note that Australia's financial system remains fundamentally sound. Banks are adequately capitalized and profitable, although they remain vulnerable to high household debt including residential mortgage and are dependent on wholesale funding. We appreciate the authorities' commitment to bolster the resilience of the financial sector, and in particular to implement the recommendations of the Hayne Royal Commission by end-2020. We also take positive note of the good progress achieved in implementing the key recommendations of the 2018 FSAP to strengthen systemic risk oversight of the financial sector.

We welcome the authorities' macroprudential interventions to reduce credit risk and ensure sound lending practices. Against the background of high residential real estate prices and elevated household debt, macroprudential policies should hold the course on the improved lending standards and further strengthen bank resilience by refining the capital adequacy framework. We also see merit in strengthening the macroprudential toolkit to allow for greater flexibility in responding to financial stability risks.

We underscore the need to remain vigilant about housing market developments. While the ongoing correction is helping housing affordability, housing supply reforms remain critical to foster broader affordability and to reduce vulnerabilities.

Finally, we stress that sustained structural reforms will be needed to lift productivity and potential growth. These should focus on continuing to close infrastructure gaps; to foster greater female labor force participation, youth employment, and R&D investment; and to promote the SME sector. In this regard, we welcome the lower corporate tax rates on SMEs and measures to relieve SME financing constraints; investments to modernize vocational education and training; and targeted initiatives to address youth underemployment. However, as noted by staff, there is room to strengthen tax incentives for new investment and innovations in support of growth. A more robust guidance on energy policy would also better inform business investment decisions.

We wish the authorities continued success.

Mr. von Kleist and Mr. Buetzer submitted the following statement:

We thank staff for its informative set of reports with their in-depth analysis of Australia's economic policy challenges. We also thank Mr. Ray, Ms. Johnson, and Ms. Park for their insightful buff statement.

We mostly share staff's conclusions and policy recommendations. Australia's macroeconomic fundamentals are sound, and growth has been remarkably resilient. There are, however, important risks. On the domestic side, risks in the housing sector, a potentially more protracted weakness in private investment, as well as the impacts from the drought and bushfires weigh on the outlook. On the external side, the Australian economy faces several sources of uncertainty related to subdued global growth prospects, U.S.-China trade relations, and the recent COVID-19 outbreak, which may be particularly challenging given Australia's significant exposure to China.

Overall, we broadly support the authorities' views on a data-dependent near-term fiscal and monetary policy mix to support demand. However, staff's assertion of "persistent economic slack" warrants further discussion. In particular, we are wondering about staff's estimates for the output gap which – according to staff – has been negative ever since the global financial crisis in 2009. Given the overall solid and resilient performance of the Australian economy over the past decade, this appears questionable. Overall, we would tend to give some more weight to the influence of structural adjustments in the labor market related to the end of the mining investment boom and subdued productivity growth when explaining lower GDP growth rates and a somewhat higher underemployment rate than before 2009. Additional staff comments on this matter would be welcome.

High household debt, banks' exposure to residential mortgage lending as well as their dependency on wholesale funding could be sources of risk to the financial sector. We take positive note that Australia's banks are adequately capitalized and profitable. However, they remain vulnerable to risks in the housing sector. Given the low-interest-rate environment, we agree with staff that potential risks related to a renewed overheating of housing prices and an increase in mortgage lending need to be closely monitored. We therefore support the authorities' reform efforts to bolster the resilience of the financial sector, especially the strengthened requirement for the total loss-absorbing capacity. In this context, the Australian Prudential Regulation Authority's proposed revision to ensure that enough capital is held against risky assets is welcome. Additional reforms in the housing sector deserve consideration, including staff's recommendations on tax reforms to facilitate supply-side measures, supply side reforms to support affordability, and macroprudential measures to avoid speculative behavior and a renewed overheating.

As outlined by staff, private-sector investment growth has slowed down in recent years, as weaker commodity prices and policy uncertainty have had an adverse effect on investments. In addition, given Australia's exposure to China, a potential renewed escalation in U.S.-China trade tensions could further weigh on investors' sentiment. Therefore, we see some merits in staff's recommendations to strengthen the investment environment through reducing domestic policy uncertainty, easing credit constraints for SMEs, and incentivizing research and development. In this vein, we see merit in staff's proposal to facilitate new investments and innovation through tax reforms.

We support the authorities' fiscal stance. We concur with staff that the consolidated fiscal stance for FY2019/20 is appropriate and commend the authorities for their medium-term fiscal goals. We agree with staff that the authorities need to remain ready to respond in case downside risks materialize.

We concur with staff that efforts to support international cooperation and tackle climate change should continue. We take positive note of staff's recommendation to develop an ambitious national integrated approach to energy and climate change policies. This may help reduce policy uncertainty and catalyze investment. We welcome the authorities' commitment to meeting their Paris Agreement goals and encourage them to consider price-based measures such as an emissions trading scheme or carbon tax.

Mr. Doornbosch and Mr. Jost submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Ray, Ms. Johnson, and Ms. Park for their clear and informative buff statement. We welcome the continuously strong performance of the Australian economy. Sound and predictable fiscal and financial policies, including relatively low public debt levels, as well as strong institutional arrangements have contributed to this success. We welcome the authorities' awareness of downside risks that continue to exist and their commitment and strategies to address them. Overall, we agree with staff's key recommendations. We would like to make a few comments for emphasis.

External Risks and Sound Fiscal Policy

As an open economy, Australia is exposed to a number of external risks, including those posed by trade tensions and recent health related developments in the Asian region. Australia has also been confronted with extreme weather events recently, adversely and significantly impacting economic developments, as the statement of Mr. Ray, Ms. Johnson, and Ms. Park highlights. Here we do not fully agree with staff who qualify adverse weather conditions as "domestic" (vs. "external") in the Risk Assessment Matrix (p.48). We believe, in line with the GRAM, that climate related shocks can be considered external. Staff's comments would be welcome. Given these external exposures, in addition to the domestic ones, including remaining vulnerabilities in the financial sector, keeping fiscal room for maneuver should be part of the risk management strategy. Thus, we fully support the authorities' continued commitment to sound and responsible fiscal policies providing room for maneuver in case risks materialize.

Increasing Growth Potential

During last year's discussion on Australia's Article IV, this chair highlighted the importance of addressing infrastructure bottlenecks. We appreciate the efforts the authorities undertook in this context since then. We also appreciate their acknowledgement that capacity constraints remain a challenge. Similarly, we welcome other policy measures aimed at increasing growth potential, such as improving the business environment and competition, focusing in particular on challenges posed by digitalization. That said, efforts aimed at increasing female participation rates and reducing youth unemployment should be pursued.

Climate Policies and Political Economy

Generally, we believe that credible, robust and predictable climate and energy policies are key to contribute to a steady decarbonization of our economies, inter alia by attracting private capital. We are encouraged by Mr. Ray, Ms. Johnson, and Ms. Park's statement which reassures Australia's commitment to the COP21 agreement. At the same time, and while acknowledging the sensitive political economy of the discussion, we support staff's clear call for continued efforts to tackle climate change in Australia. More generally, we support staff's work on assessing climate policies and giving guidance, and encourage staff to continue doing so, possibly in greater detail, in future reports. We would like to take this opportunity to invite staff to be mindful of the sensitive political economy of the climate debate, inter alia when it comes to energy price increases. A well-balanced communication is of the essence to maximize the impact of the Fund's advice.

Prudential and Monetary Policies

The Australian financial sector is sound and prudential policies have been generally successful. While vulnerabilities should continue to be monitored closely, risks related to housing loans have been reduced since 2017 and increased TLAC will contribute to facilitation of resolution. At the same time, we believe that the existence of prudential policy should not lead monetary policy makers to neglect financial stability issues. In that sense, we welcome statements by the Central Bank Governor in November 2019, acknowledging that "the use of structural and fiscal policies will sometimes be the better approach".

While we endorse staff's view that the current accommodative monetary policy stance has allowed Australia to advance its economic rebalancing, we would like to caution the authorities against further policy rate reductions, as they may no longer have the desired effects and may also reduce the resilience of the financial system through lower profitability, which currently remains at a healthy level. To mitigate the build-up of vulnerabilities, we encourage the authorities to aim at normalizing monetary policy gradually.

We would like to take this opportunity to, more generally, point out that despite easy financial conditions at the global level and more accessible capital market funding, investment has been rather weak in many advanced economies since the Global Financial Crisis. Evidence suggests that uncertainty about the future state of the economy and expected profits play a key role in driving investment decisions, and less so financing conditions (BIS, 2015).

Mr. Rosen, Ms. Senich and Mr. Shenai submitted the following statement:

We thank staff for the report and selected issues papers and Mr. Ray, Ms. Johnson, and Ms. Park for their helpful buff statement. We recognize the tragic toll this season of wildfires has taken on the country and offer our condolences to the people of Australia. We generally agree with staff's overall appraisal and would like to highlight a few areas for emphasis.

Australia is in an enviable position, having experienced 28 consecutive years of economic growth. We concur with staff that the policy mix should remain accommodative, and that the current monetary policy stance is appropriately loose to support domestic demand and inflation expectations. The Australian authorities have long maintained fiscal prudence, with relatively low gross public debt-to-GDP. We therefore strongly agree that the authorities also have fiscal space to support demand and should avoid contracting at the consolidated level in FY2020/21 while also being prepared to enact temporary measures if downside risks materialize.

In addition to macroeconomic policy levers, we concur with staff that structural reforms could be useful to improve business sentiment. In particular, pursuing market deregulation and promoting innovation through R&D support and improving education are important steps. We noted staff's recommendation to introduce well-targeted tax incentives, but caution that incentives in general often become entrenched and are difficult to remove after the end of their usefulness. Can staff elaborate on instances where similar tax incentives have had the desired effects without creating distortions in the long-term?

We commend the authorities for the progress achieved in implementing the 2018 FSAP key recommendations, and for their commitment to implement the comprehensive package of financial reforms recommended by the Hayne Royal Commission. There is a continuing focus in the staff report on the housing sector and its risks to the overall economy and to the financial sector. The report identified downside risks both to falling and to rising prices in the sector, which leaves us questioning what policy options are appropriate where changes in prices in either direction add to risks. We agree with staff that housing policy measures discriminating against non-residential buyers should be replaced by alternative non-discriminatory measures, in-line with the Institutional View on capital flows.

We noticed a lack of consistency in how the topic of trade was treated throughout the program document. The Risk Assessment Matrix classifies the impact of increased trade tensions on Australia as high, but Annex IV notes that Australia has been largely insulated from the effects of trade tensions so far, and the impact of any potential future re-escalation are generally expected to be mild to moderate. Additionally, the RAM note that a de-escalation of trade tensions could weaken Australia's commodity exports to China through trade diversion. We believe that the report should have included consideration of the upside risks to Australia of greater market openness and stronger intellectual property protection that China has committed to under the Phase One Agreement.

Mr. Beblawi and Ms. Al-Riffai submitted the following statement:

We thank staff for their comprehensive report and Mr. Ray, Ms. Johnson, and Ms. Park for their informative buff statement. We deeply regret the loss of lives and the adverse economic impact of the unprecedented drought and bushfires that have plagued Australia since November 2019. Australia's sound macroeconomic fundamentals and policies, anchored by inflation targeting, prudent fiscal policy, and exchange rate flexibility, are supporting the economy's adjustment to commodity and asset price cycles. Nonetheless, global and domestic risks are tilting the outlook to the downside.

Both the Commonwealth and state governments have substantial fiscal space to draw upon should downside risks materialize. We note the difference in opinion between staff and the authorities on the consolidated fiscal stance in FY2020/21. Staff advises an accommodative fiscal stance, whereas the authorities plan to continue their planned near-term fiscal consolidation, since they expect growth to return to potential. We are reassured that should growth forecasts fall short of potential or larger funding requirements are needed for the recovery from the devastation of the ongoing bushfires, the authorities stand ready to adjust their fiscal stance accordingly. The authorities plan to boost spending on infrastructure development. However, we note that both levels of government, Commonwealth and state, are concerned about the risks of capacity constraints slowing the pace of infrastructure investment and increasing the associated cost of. Previously, staff had stated that the public investment management process in Australia is robust and a leading example for other countries. However, since capacity constraints around infrastructure investment have persisted, we would appreciate staff's clarification on how the authorities' plan to address these constraints.

The Reserve Bank of Australia (RBA) has continued its monetary easing, since inflation remains slightly below its target, as a result of ongoing economic slack. We note staff and the authorities' agreement around the merit of continuing an accommodative monetary stance. Specifically, we note that in the case of a severe negative shock, the authorities see merit in combining both a fiscal and a monetary response, including the use of unconventional monetary policy (UMP) measures. We concur with staff that complementing UMPs with targeted macroprudential measures to neutralize the buildup of any pockets of vulnerability from loose financial conditions has its merits.

Banks are well capitalized and profitable, and the authorities have been further enhancing banks' capital framework to strengthen their loss-absorbing capacity and resilience. However, high household debt, exposure to residential mortgage lending, and dependence on wholesale funding pose risks to the system. We welcome the authorities' commitment to implement the recommendations made by the Hayne Royal Commission by end-2020 and look forward to continued progress in implementing the recommendations of the Australian Prudential Regulation Authority's Capability Review, as well as the 2018 FSAP. We, therefore, welcome the establishment of a Multi-Agency Data Collection Committee which aims to review the potential data needs of agencies in a forward-looking manner, as well as explore opportunities to streamline activities associated with the collection and use of data. We look forward to the ratification of the bill currently in Parliament that aims to strengthen AML/CFT frameworks.

We note with concern the recent increase in housing prices and the adverse implications on affordability, especially in the presence of an already inadequate supply of residential housing exacerbated by the recent fall in housing prices and tighter credit supply for developers. Though demand-side measures are important, in the presence of continued strong demand for housing, it is crucial to effectively develop supply-side responses to address affordable housing needs. To that end, we welcome initiatives such as "City and Regional Deals" that aim to integrate transport, housing, and land use polices to create the opportunity for a coordinated action to maximize the value of infrastructure investment. Can staff shed light on the impact of the "City and Regional Deals" initiative on housing supply to date? We encourage the authorities to maintain their vigilance in monitoring developments in the housing market.

We welcome the authorities' continued reform efforts to improve the business environment and competition and positively note their commitment to climate mitigation. Australia is set to exceed its 2020 and 2030 reduction commitments. However, staff states that state governments have separate energy and emissions strategies that are not sufficiently integrated with the Commonwealth's approaches. We, therefore, see merit in staff's recommendation to develop a national and integrated approach to energy and climate change policies and welcome that financial regulators are taking steps to address emerging climate risks.

Mr. Bhalla and Ms. Dhillon submitted the following statement:

We thank the staff for the excellent reports and Mr. Ray, Ms. Johnson, and Ms. Park for the candid buff statement.

Supported by sound economic policies and fundamentals, Australia has continued its near three decade of resilient growth. Even as growth remained below potential, employment grew, and inflation dipped below the target range of 2-3 percent. The outlook hinges on external risks from trade tensions, tightening financial conditions and spillovers of the coronavirus outbreak. Domestically, bushfires could impact consumption and tourism. We appreciate the authorities' recognition of the risks and their viewpoint that it may be too early to know the economic impact of Coronavirus on the economy given that China is its largest trading partner.

A synchronized macroeconomic policy mix remains paramount to manage the growth path. We join staff in supporting that monetary policy remain accommodative to boost domestic demand. We are encouraged by the authorities' responsible fiscal stance to lift potential growth by boosting productivity through lower taxes, targeted spending and ramping up investment in infrastructure. The fiscal actions to address the challenges from the devastating drought and bushfires are notable. The buff has emphasized Australia's commitment to the Paris Agreement, to reduce global emissions to mitigate the risk of climate change and to meet 2030 commitments. Nonetheless, Staff has assessed uncertainty around the climate change mitigation and recommended an ambitious, national, integrated approach to energy policy and climate change. Noting this divergence and against the backdrop of the bushfires, we would have liked to see a deeper analysis of the economic dimension and holistic climate action, including a peer comparison on climate action. Staff comments are invited.

Australian banks have remained capitalized and profitable. With lending concentrated in the housing sector, household debt remains high and vulnerable to exposures of residential mortgage. We welcome the measures taken by the authorities to manage the vulnerabilities and align ourselves with the staff recommendations to bolster the resilience of the financial sector. Weaknesses in the AML/CFT regime, especially the coverage of the regime to include non-financial and business professionals, should be prioritized. Separately, housing affordability has improved even as Australian house prices remain high compared to other Advanced Economies. Moving ahead, could staff offer perspectives on the policy actions planned to address housing supply?

We welcome Australia's commitment to open trade, investment and immigration. The well analyzed selected issues paper has aptly highlighted that slowdown in investments is not unique to Australia. In general, an interplay of uncertain polices, global conditions, trading partners and headwinds have put a drag on the economies. While staff has highlighted diversification of domestic economies for growth, we would like to hear more from staff on the impact of diversification of investment sources, trading partners and supply chains. We invite staff comments. That said, we urge sustained efforts on the structural aspects including fostering business investment, promoting full-time female employment, reducing youth underemployment to catalyze inclusive growth.

With these comments, we wish the authorities the best in their endeavors.

Mr. Jin and Ms. Lok submitted the following statement:

We thank staff for the comprehensive reports and Mr. Ray, Ms. Johnson, and Ms. Park for the insightful buff statement. Underpinned by robust macroeconomic fundamentals and sound policy management, Australia has achieved 28 consecutive years of economic growth. With this strong track record, we believe the authorities can continue to effectively navigate through challenges ahead. We broadly agree with the thrust of staff's appraisal but would like to make some specific comments as follows.

The current macroeconomic policy settings seem appropriate and the authorities should continue to stand ready to act should downside risks materialize. On the fiscal side, the authorities have aptly deployed its policy space in response to challenges including the bushfires. Policies should continue to balance between the need for growth-enhancing spending and preserving buffers against possible adverse shocks. On infrastructure spending, we take positive note that the authorities expect this to remain strong and are enhancing coordination across different levels of government to raise efficiency. While staff see room to step up infrastructure investment further, the authorities have raised concerns about capacity constraints and skill shortages that could be amplified by a further lift in spending. On this, we continue to emphasize the importance of quality over quantity and trust that efforts such as Infrastructure Australia would contribute to ensuring investments are directed towards projects that would deliver optimal outcomes.

The authorities' sound application of prudential policies has helped mitigate risks in the mortgage sector and maintained financial stability more broadly. We welcome the ongoing efforts to further strengthen the banking system, including increasing the total loss-absorbing capacity requirement for domestic systemically important banks. We also take comfort from the fact that good progress is being made on implementing key recommendations from the 2018 FSAP. Going forward, continued vigilance is needed to safeguard against potential vulnerabilities and risks that may arise, such as those that may result from a possible reemergence of rapid housing price growth. On staff's suggestion to prepare for potential use of loan-to-value and debt-to-income limits, we wonder (i) what are the potential distributional effects of using such limits, particularly given housing affordability is already an issue for some cities; and (ii) how do these measures compare to those already in the authorities' toolkit (e.g. limits to the growth in higher risk loans) which have been quite effective in reinforcing sound lending practices and bringing down risks?

Strong structural reform efforts would help foster strong, inclusive, and sustainable growth in Australia. Boosting productivity would require measures on various fronts, including those to enhance infrastructure, induce investment, and increase efficiency. We welcome the authorities' efforts in improving the business environment and competition, as well as their continued strong commitment to international cooperation. Around one year since the Comprehensive and Progressive Agreement for Trans-Pacific Partnership has come into force, could staff comment on the agreement's economic impact on Australia? Going forward, we encourage the authorities to complement existing structural reform efforts with further support for R&D, female labor force participation, and youth employment to raise the economy's potential.

More generally, we wonder if the Fund's recent work relating to political economy challenges has provided insights to staff's policy dialogue with the authorities on topics such as how to tackle the obstacles to implementing tax reform and reduce uncertainty around Australia's climate change mitigation policies. Staff's comments are welcome.

With these remarks, we wish the authorities every success with their policy endeavors.

Ms. Levonian, Ms. McKiernan and Mr. Mooney submitted the following statement:

We thank staff for their report and Mr. Ray, Ms. Johnson and Ms. Park for their useful and timely buff statement. We offer our sincere condolences to the citizens of Australia on the loss of life arising from the recent unprecedented bushfires. The Australian economy continues to recover, with the country completing its 28th consecutive year of economic growth. The country remains vulnerable in its exposure to the Chinese economy, which is currently being impacted by the coronavirus outbreak. In addition, the impact of the devastating bushfires is still being assessed. We agree with the thrust of staff's assessment and offer the following points for emphasis.

We agree with staff that the macroeconomic policy mix should remain accommodative and aim to boost productivity. Given the substantial fiscal space in Commonwealth and State governments, authorities should be prepared to provide additional fiscal stimulus in case downside risks materialize. What is the likely impact of the bushfires, and the associated establishment of a A$2 billion National Bushfire Recovery Fund, on the Commonwealth and State finances in 2020? We welcome the implementation of the authorities' plan to lift potential growth through lower taxes, targeted spending and investment in infrastructure, as outlined in the buff statement.

In case of a more severe negative shock, authorities should not rely solely on additional monetary accommodation, given existing vulnerabilities in the housing market. As the Reserve Bank of Australia (RBA) has already signaled its willingness to provide additional monetary stimulus in 2020, authorities should reflect on the burden of adjustment falling disproportionately on monetary policy to support domestic demand, also bearing in mind risks to financial stability.

We positively note that the banking system remains adequately capitalized and profitable. We welcome the authorities' plan to further enhance banks' capital frameworks to strengthen their resilience, particularly in light of the vulnerabilities from high household debt. We agree with staff that the authorities should complete the resolution policy framework and introduce statutory powers for bail-in. In terms of macroprudential policy, we agree with staff that the toolkit should be expanded in order to implement flexible and targeted responses to systemic risks. As regards AML/CFT, we encourage continued strengthening of the regime by implementing the relevant FSAP recommendations and positively note the bill currently in Parliament that will address barriers to prosecution. We welcome the steps being taken by the Australian financial regulators to address emerging climate risks, as outlined in the buff statement.

We welcome the commitment by the authorities to meet its 2030 emissions targets, and the associated increase in renewable energy generation. However, we agree with staff that an integrated approach to climate change policy would assist in the reduction of policy uncertainty and catalyze green investment in the energy sector and broader economy. Such a comprehensive review of climate change mitigation is needed to make Australia's economic growth more resilient to more frequent natural disasters. We concur with the statement in the Selected Issues Paper that domestic policy certainty assists in the fostering of business investment and, in this regard, we encourage the authorities to ease financial constraints on SMEs, in addition to promoting and refining the R&D regime. We strongly welcome the policy priority of increased female labor force participation, which, while at an historic high, is relatively low compared to other advanced economies, and the associated initiatives such as the Child Care subsidy program and Mid-Career Checkpoint initiative.

Mr. Tan and Mr. Srisongkram submitted the following statement:

We thank staff for the report and Mr. Ray, Ms. Johnson, and Ms. Park for their helpful buff statement. We would like to offer our sympathy to the Australian people on the loss of lives and devastation brought about by the recent bushfires.

The Australian economy continues to record a positive growth trend despite weak global economic momentum. This is attributable to sound economic fundamentals and adept policy management on the part of the authorities. While the economic recovery is likely to continue, there are significant headwinds to growth, including the uncertain impact of the devasting drought and bushfires and the recent COVID-19 outbreak. Against this backdrop, we broadly support most of the recommendations for an accommodative macroeconomic policy mix to support the ongoing economic recovery. We also concur that containing risks associated with high household debt and pursuing structural reforms to uplift productivity remain key policy priorities.

The current fiscal policy stance is appropriate. We commend the authorities for their strong and sustained commitment to budget repair, and positively note that the fiscal space created from these efforts has allowed the authorities to respond swiftly to the drought and bushfires and help the economy to regain its footing. While the available fiscal space may be substantial, the authorities' intent to maintain a responsible fiscal stance and pursue growth-friendly fiscal consolidation is appropriate given the need to preserve buffers for potential downside scenarios, especially given that the full impact of the drought and bushfires and the COVID-19 on the broader economy is still to be ascertained. Meanwhile, we note that infrastructure spending is significant and emerging capacity constraints could be further amplified if not well managed. The authorities should continue with the ongoing infrastructure push, with a focus on quality investments, and stand ready to provide additional stimulus as needed in a severe negative shock scenario.

The decision to pursue further monetary easing, including through UMPs, must be carefully weighed against risks associated with low interest rates. We agree that an accommodative monetary policy stance is warranted by current demand conditions and subdued inflation outlook. We view that the cumulative 75bps rate cut is substantial considering the available policy space. We support the RBA's data-dependent approach and their careful consideration of the trade-offs in pursuing further monetary easing, especially given inherent lags in monetary policy transmission and the effectiveness of further rate cuts which may be limited in a persistently low interest rate environment.

We generally agree with staff's assessment of the financial sector. The Australian banking sector remains fundamentally sound, and the ongoing efforts to strengthen the regulatory framework including the implementation of new TLAC requirements would further bolster its resilience. Risks pertaining to elevated household debt appears to be under control with the recent recovery in house prices and improved lending standards for residential mortgages, the latter of which allowed the authorities to remove temporary prudential measures as clarified by the buff statement. While banks' debt serviceability assessment is integral as a first line of defense, there is merit in strengthening the preparedness of the authorities' prudential toolkit especially as there remain risks from renewed pick-up in house prices and household borrowing. In this regard, we welcome the ongoing work of the Council of Financial Regulators to review available tools.

We welcome staff's effort in reconciling reform recommendations with the political realities in Australia. As discussed in the context of the CSR, tailoring policy options to constraints within a country, especially political economy considerations, is key to improving Fund's traction with the authorities. On climate mitigation, for instance, the high-level approach taken by staff and their suggestion on other alternatives to carbon taxes may be more attuned to the current political climate in Australia, enabling a more constructive engagement with the authorities. At the same time, the authorities' commitment to the Paris Agreement and the progress made towards meeting emission reduction targets through renewable energy are well noted and should be recognized. With regard to tax reforms, other alternatives may need to be considered given that both the proposal to broaden the GST base and reduce CIT for large firms have already been turned down by the current Parliament. Staff's comments are welcome.

Mr. Buisse, Mr. Rozan and Mr. Sode submitted the following statement:

We thank staff for an excellent report and Mr. Ray, Ms. Johnson, and Ms. Park for an insightful buff statement. Australia macroeconomic performance remains solid, supported by sound macroeconomic policies. The country is nonetheless facing a number of downside risks which will require prompt policy responses in case they materialize. In addition, it is essential that Australia designs a comprehensive climate strategy in order to reduce its carbon footprint, as its carbon emissions are a source of both domestic climate risk and significant negative spillovers to the rest of the world. With these key messages in mind, we would like to add the following comments for emphasis:

We agree with staff that the policy mix should remain accommodative in the short run and be ready to accommodate additional expansionary measures in case downside risks materialize. The disanchoring of inflation expectations below the inflation target range is very concerning and call for proactive measures from the authorities. Given ample fiscal space and significant infrastructure needs, the 2020 fiscal stance should remain expansionary. We support staff's call for further monetary easing in case high frequency data confirm the decline of inflation. Has staff evaluated the forward guidance of the RBA and provided recommendations?

We commend the authorities for their progress in strengthening financial supervision and agree with staff that macroprudential regulation should stand ready to be tightened notably to respond to rising risks in the real estate sector. The authorities should prepare to deploy loan-to-value and debt-to-income (DTI) limits, as well as a sectoral CCyB targeting housing exposures. Continued implementation of the recommendations of the 2018 Financial Sector Assessment Program (FSAP) should remain a priority.

While we support staff's call to increase housing supply, we recognized this is a difficult challenge, notably in dynamic urban centers. We commend the authorities for their initiatives that aim to integrate transport, housing and land use polices to strengthen housing supply. We also support staff's call to transition from a housing transfer stamp duty to a general land tax which will promote greater labor and housing mobility. Regarding existing rental subsidies and their potential impact on rents and housing prices, we wonder whether Australia should not focus more on the supply of social housing and whether staff has recommendations from international good practices.

We share staff's view that government should continue to address infrastructure gaps, strengthen the investment environment and innovation capacity, increase female labor force participation and make the tax system more efficient. In addition to the elements discussed in the report, has staff assessed the adequacy and efficiency of social spending in Australia?

While we thank staff for tackling climate change policy challenges in this year Article IV, a more thorough analysis of Australia's mitigation policies is warranted. Australia remains one of the world top carbon emitters per capita and its current climate policies remain largely insufficient to reduce the carbon intensity of its growth model. Due to the large international spillovers of these carbon emissions and to their domestic consequences, designing an ambitious carbon reduction strategy is macrocritical. We strongly encourage staff to provide further analytical inputs to this key challenge and to assess the transition risk for the economy and its financial sector. Using the spreadsheet tool of FAD, could staff assess the current carbon emission trajectory of Australia in a business as usual scenario, compare it with an emission trajectory compatible with keeping global warming under 1.5 degrees Celsius (under fair burden sharing assumptions) and discuss policy gaps to reach such a goal?

Mr. Chodos and Mr. Morales submitted the following statement:

We thank staff for their clear reports and Mr. Ray, Ms. Johnson, and Ms. Park for their useful buff statement. Australia has achieved robust growth rates for 28 years in a row, while maintaining a stable macroeconomic environment. To overcome the recent slowdown in private investment and labor productivity growth, policies to spur private investment and gradually raise economic growth should be integrated into a comprehensive strategy that simultaneously addresses youth underemployment, female labor participation gaps, and climate change challenges.

Australia's GDP growth recovered in 2019 supported by public spending. However, both private consumption and non-mining private investment remained weak. Also, although employment growth was strong thanks to rising female and older labor force participation, unemployment remained above the estimated NAIRU for Australia, while underemployment stayed high. Looking ahead, recent measures including the personal income tax relief and further monetary easing should contribute to boost economic activity. However, the impact of these measures will be partly offset by the unprecedented bushfires that started last November exacerbated by the prolonged drought affecting the country, which would drive down agriculture-related output and would have a non-negligible impact on tourism receipts and retail sales. Against this backdrop, we encourage the authorities to be prepared to promptly adopt additional accommodative policies as needed in the event that declining global trade and disruptions to value chains start to have an impact on the economy.

The expansionary fiscal stance for FY2019/20 is appropriate. Higher-than-expected revenues in FY2018/19 have provided additional fiscal space to deal with immediate challenges, including the damage from the seasonal bushfires. In this regard, we commend the authorities for the provision of significant support to those affected by the drought, including through the establishment of a National Bushfire Recovery Fund to provide relief to affected communities. Looking ahead, fiscal policy should remain growth-supportive, driven by spending on education, healthcare and infrastructure, and the roll out of the National Disability Insurance Scheme (NDIS). On infrastructure spending, we agree with the authorities that public investment should be raised prudently, being mindful of capacity constraints, and ensuring that the quality of investment remains high.

Inflation has remained below its target range for the last few years. While headline inflation was driven by subdued price increases in housing-related items, including rents and utilities, we note that core inflation was even lower than headline inflation in 2019. In addition, the recent pick up in housing prices (8 percent between June and December 2019), apparently has not yet been factored in inflation numbers. Could staff clarify recent inflation trends, elaborating on core inflation developments and on the evolution of inflation with and without including changes in housing prices.

Australian banks are adequately capitalized, and credit risk appears contained. Domestic systemically important banks will continue increasing their capitalization, as they are expected to meet the additional capital requirements introduced by APRA last July by 2024 (additional 3 percent of risk-weighted assets). Also, the share of loans with loan-to-value ratios (LTV) above 80 percent and interest only loans have declined from their peaks. However, we agree with staff that the recent easing of macroprudential thresholds on investors and interest-only loans and the recalibration of mortgage serviceability assessments entails risks that should be carefully monitored by supervisory authorities. On financial policies, we welcome the implementation of FSAP recommendations, highlighted by Mr. Ray, Ms. Johnson, and Ms. Park in their statement. In particular, we commend the authorities for key steps towards strengthening the prudential framework for financial intermediation, including the streamlining of APRA’s enforcement capabilities to achieve its prudential objectives, new standards for remuneration requirements in the financial industry, steps towards increasing transparency of the Council of Financial Regulators, and the introduction of enhanced consumer protections provisions. Moreover, we welcome the authorities' commitment to implement, by end-2020, the recommendations of the 2019 Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry (Hayne Royal Commission).

We encourage the authorities to continue strengthening AML/CFT supervision. Recent experience highlights the need to strengthen oversight of control and compliance, while at the same time ensuring strict enforcement of actions in the event of breaches of legislation and regulations, including on proper risk assessments, record keeping, and adequate due diligence. Moreover, AML/CFT coverage should be expanded to include all non-financial and business professionals.

With these comments, we wish the Australian authorities' success in their policy endeavors.

Mr. Poso and Mr. Vaikla submitted the following statement:

We thank staff for their informative reports and Mr. Ray, Ms. Johnson and Ms. Park for their helpful buff statement. Australia´s open economy, exchange rate flexibility, strong institutional arrangements, and prudent fiscal policy have enabled the authorities to successfully manage the economic transition through the start and the end of the mining boom. While growth is expected to strengthen, external risks are tilted to the downside, including a slow-down of Chinese economy and disruptions related to the coronavirus outbreak. Domestically, risks appear more balanced as the extensive bushfires can hurt tourism and consumption, while the swift recovery of the housing market provides a strong upside risk and could compromise financial stability. Against this background, the authorities' accommodative macroeconomic policy stance is appropriate. However, monitoring housing market developments and mortgage lending standards is encouraged. We share staff's assessment and perception of risks, and broadly agree with their appraisal. We would like to offer the following comments for emphasis.

We welcome the authorities' prudent fiscal stance, which helps to build buffers and safeguard economic growth. We welcome that the government´s budget has returned to balance for the first time in 11 years and the authorities' plans to further consolidate this year. While the mildly contractionary stance poses risks in a below-potential growth environment, we agree with the authorities that a strong fiscal position has enabled Australia to cope with previous and current challenges and enables to safeguard against future ones. A slightly contractionary fiscal stance is also appropriate in the context of recently loosened monetary policy stance still working through the economy and rising real estate prices.

Australia’s banks are profitable and well capitalized, while significant exposure to the real estate sector poses risks. We take positive note that the stricter enforcement of prudential regulations has been effective in reducing riskier mortgage loans and bank´s capital framework has been further strengthened. However, we agree with staff that the Australian banks are vulnerable to high household debt and residential mortgage lending. We agree that the current macroprudential policy stance is appropriate, while the authorities need to stay vigilant and be ready to act. We echo staff˝s recommendation that the authorities should ensure that the easing of macroprudential thresholds on investors and interest-only loans and the recalibration of mortgage serviceability assessments will not lead to a renewed increase in high-risk residential mortgage lending going forward. A more flexible and targeted macroprudential tools, including DTI/DSTI and LTV restrictions, should be further explored to timely address financial stability risks as the housing market recovers.

A stronger supply response would help enhance housing affordability. While the housing market correction has helped housing affordability, continued housing supply reforms remain critical for broad affordability and to reduce macrofinancial vulnerabilities. We therefore encourage the authorities to improve long-term planning and implement local government reforms, as suggested by staff.

Labor market developments. We note that Australia´s unemployment rate exceeds the NAIRU and remains relatively high after an exceptionally long period of positive growth. However, it seems that the unemployment rate is elevated not due to less job offerings, but thanks to increased labor participation, which is near record high levels. Could staff explain the reason behind these developments? We welcome that the female labor participation rate has been in a constant uptrend over the last decade and has now reached a high thanks to the authorities’ initiatives. However, the female labor participation rate is still considerably below that of the male labor force. In this regard, we encourage the authorities to undertake labor market reforms and reduce the cost of childcare to increase full-time employment for Australian women.

Mr. Mahlinza and Mr. Jappah submitted the following statement:

We thank staff for the well-written reports and Mr. Ray, Ms. Johnson, and Ms. Park for their lucid buff Statement. We would offer our sympathy to the Australian authorities on the loss of lives and devastation brought about by the recent bushfires.

Following a period of strong performance, the Australian economy slowed in 2019, on account of softening consumption growth, as well as declines in housing activity and business investment. Going forward, growth is expected to rebound supported by monetary policy easing, continued spending on public infrastructure, recent tax cuts, and the nascent upswing in housing prices. Strong institutions, policies, and regulatory frameworks should help minimize vulnerabilities to domestic and external risks and help raise potential growth. We broadly agree with the thrust of staff's assessment and provide the following comments for emphasis.

We concur that an appropriate mix of accommodative macroeconomic policies is necessary to support recovery. Given the below potential growth and weak inflation expectations, accommodative monetary policy is appropriate. We also concur that the country has fiscal space and encourage the authorities to increase capital spending at both the Commonwealth and states levels, prioritizing projects with higher returns, as well as attendant capacity constraints. We also urge the authorities to internalize capacity constraints in the construction industry as they roll out their infrastructure plan.

We commend the authorities for instituting key macroprudential measures to address housing-related risks. We, however, urge vigilance to the possible risk of overheating of the housing markets and a fast pick up in mortgage lending. We agree that APRA should continue to expand and improve the readiness of the macroprudential toolkit to allow for targeted responses to persistent and new risks. Specifically, we take positive note of ongoing efforts to enhance banks' capital framework and strengthening their loss-absorbing capacity. Further, we commend the authorities' steadfast commitment to implement the recommendations of the HRC by end 2018 and the 2018 FSAP recommendations. In light of the deficiencies recently identified in the AML/CFT framework, we urge the authorities to continue work in expanding coverage of the regime to include all designated financial businesses and professions and to strengthen supervision. In that regard, we welcome the recent bill to amend the AML/CFT framework and look forward to its timely passage.

Structural reforms aimed to improve productivity would be critical to stimulate growth. In this regard, we note that the authorities reform agenda appropriately focuses on supporting jobs and growth through investment in quality infrastructure and innovation. We welcome the establishment of the Deregulation Taskforce, with responsibility to remove impediments to investment and job creation. We are encouraged by efforts to narrow existing gender gaps in the labor market, which yielded positive results over the past year as articulated in the buff Statement. That said, we continue to emphasize the need for tax reforms to enhance efficiency and productivity through a shift from direct to indirect taxes. We welcome the authorities' commitment to meeting the 2030 emission targets and the remarkable progress on the use of renewable energy. We would however appreciate some elaboration on the authorities' take to the call to develop a national integrated policy framework on energy and emission strategies. Staff comments are welcome.

Mr. Fanizza and Ms. Cerami submitted the following statement:

We thank staff for the concise and well-focused papers and Mr. Ray, Ms. Johnson, and Ms. Park for their helpful buff. With an uninterrupted economic growth for 28 years, supported by sound macroeconomic fundamentals and policies, Australia is clearly a success story. Addressing climate change adaption and mitigation needs and fostering innovation will be key to maintaining the economy on a solid growth path. We broadly share staff's appraisal and provide the following comments for emphasis.

Australia has been increasingly exposed to adverse weather conditions that call for decisive action to tackle climate change and manage the transition to a low-carbon economy. The bushfires and drought are weighing on growth through damages to infrastructure and losses to agriculture, tourism, and consumption. The authorities have commendably stepped up recovery efforts through increased funding and the creation of a national agency to coordinate post-disaster assistance. However, there seems to be less clarity over the national strategy to reduce emissions and mitigate climate change risks. Indeed, staff's analysis finds that uncertainty over energy policy has been a drag on private investment, suggesting that greater emphasis on climate change policies at national and state level could spur new sources of economic and productivity growth.

The current accommodative macroeconomic policy mix is appropriate. With economic growth below potential and inflation still subdued, the fiscal and monetary policies should remain expansionary. Despite divergences between staff and the authorities over the need to maintain the expansionary stance over the medium-term, we find reassuring that the authorities are committed to use both monetary tools and the available fiscal space to respond to downside risks. We appreciate staff's analysis of the nominal wage dynamic in Australia. As persistent underemployment, defined as involuntary part-time employment, is one of the main driving factors behind the modest nominal wage growth, we wonder to what extent this phenomenon reflects economic slack or structural factors. The fact that Australian women are disproportionately employed part-time suggests that labor market frictions also play a role, and staff rightly recommend reducing disincentives for women labor force participation. Have staff considered other possible labor market frictions contributing to involuntary part-time employment and discussed with the authorities appropriate mitigating measures?

The recent recovery of the housing market is a favorable development but requires close monitoring. Population growth and favorable financing conditions have supported housing demand and prices, which, although are not yet a cause for concern, need to be closely monitored and mitigated through appropriate macroprudential measures. Supply factors are also exerting upward pressures on house prices. While the authorities are committed to improve house affordability, their efforts appear focused on rental subsidies and financial support to first-time home buyers. Can staff provide more details about the authorities' plan for supporting housing supply?

Mr. Bevilaqua, Mr. Saraiva and Mr. Fuentes submitted the following statement:

We thank staff for the papers and Mr. Ray, Ms. Johnson and Ms. Park for the helpful statement. Over the last two and half decades, the Australian economy have experienced sustained growth, supported by well-timed structural reforms, strong macroeconomic fundamentals and prudent policies. After a notable deceleration in 2019, growth is expected to recover gradually in 2020-21 supported by an accommodative policy mix. Nonetheless, headwinds from soft global economic conditions, the bushfires and the uncertainty associated with the coronavirus outbreak are mounting challenges to growth prospects. Could staff elaborate on the different scenarios of the coronavirus epidemics and the channels through which the Australian economy would be impacted? Under these circumstances, continued policy support and strong commitment to reform implementation will be key to sustain the economic recovery.

The authorities should persevere with the accommodative policy mix to support economic activity. The tax cuts and the planned infrastructure spending will certainly benefit domestic demand in the near term, while maintaining consistency with the medium-term fiscal objectives. Furthermore, with interest rates already at historic low levels, the Reserve Bank of Australia (RBA) have stressed the possibility of extending the “low for long” stance until the economy reaches full employment and achieves the inflation target. However, as private consumption is still recovering and the negative shock of the bushfires continues to propagate, domestic demand could benefit from the government softening its stance on fiscal consolidation in FY2020/21 and using some of the available fiscal space at both the commonwealth and state level to support activity. This could provide more leeway to the RBA and avoid overburdening monetary policy considering the risks associated with an extended low interest rate environment. In this regard, we wonder what would be the Commonwealth leeway to leverage public investment at the state level?

Steady reform implementation and timely macroprudential policy measures have supported financial sector resilience. We welcome the authorities’ commitment to carry out the recommendations made by the Hayne Royal Commission (HRC). Overall, Australian banks remain adequately capitalized and profitable under a robust supervision and regulatory framework. The proactive macroprudential policy stance have prevented excessive risk taking and supported asset quality. In addition, the implementation of the loss-absorbing capacity (LAC) framework announced by the Australian Prudential Regulation Authority (APRA) is expected to improve the resilience of the financial system further. That said, careful monitoring of risks emanating from high household debt remains paramount, along with strengthening the AML/CFT regime and reducing banks’ reliance on offshore wholesale funding, which continues to unduly expose the sector to sudden changes in global financial conditions.

Vulnerabilities from high household debt remain a concern. While household debt in Australia is generally well collateralized, largely owed by upper-income families and with a delinquency rate below international standards, it remains markedly high, hovering around 190 percent of household income. Moreover, non-performing loans (NPLs) in mortgage lending recently reached its highest level in several years. At this time, however, risks from a sustained correction in housing prices have moderated, reducing the potential losses for negative equity variation, while affordability has somewhat improved. That said, authorities have identified potential risks from a resurgence in rapid housing price growth given population growth and rigidities in new housing markets. Against this background we welcome authorities' efforts aimed at expediting reforms in the housing market and implementing measures to improve affordability.

Developing an integrated approach to climate change mitigation and adaptation is warranted. As the world's driest-inhabited continent, wildfires in Australia are considered a regular occurrence. Nonetheless, the prolonged drought and the unprecedented intensity of the current bushfire season have affected agricultural production and exports with significant indirect effects on domestic demand. Amid this calamity, focus on the impact of climate change on the Australian economy has intensified. While Australia is on track to meet its 2030 emissions reduction target on current policies and have engaged in a substantial investment in renewable energy, the development of an integrated approach to energy production, climate change mitigation and adaptation, and macrofinancial stability will help reduce policy uncertainty and contribute to the prospects of faster and more sustainable growth.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

We thank staff for informative reports and Mr. Ray, Ms. Johnson and Ms. Park for their helpful buff statement. Australia's growth is gradually strengthening, supported by public sector demand and net exports. At the same time, inflation remains below the target range, wage growth is weak, and there is persistent slack in the labor market. Australia remains vulnerable to external shocks, including possible slowdown in key trading partners, adverse changes in terms of trade, and rising protectionism. Domestically, climate-related risks became more obvious with the recent drought and catastrophic bushfires, while housing market vulnerabilities remain elevated. In this context, we agree with staff's recommendations that accommodative macroeconomic policy mix is needed to support the recovery and mitigate downside risks. The financial sector resilience should be further strengthened. The structural reform agenda should focus on housing supply reforms, as well as the measures aimed at boosting labor productivity and potential growth.

We commend the authorities for maintaining fiscal prudence. Australia's public debt is one of the lowest among advanced economies, and consolidated budget deficit is below 1 percent of GDP. The authorities are working on achieving fiscal surplus, in line with the Commonwealth's fiscal strategy. However, if return to full employment and inflation target is delayed, and/or in case of an adverse shock, the authorities need to postpone fiscal consolidation and use fiscal room for supportive measures. Public infrastructure investment is a key component of growth in Australia and its expected contraction at the states level may delay the recovery.

The easing of the monetary policy stance in 2019 has been appropriate given below potential growth, labor market slack and subdued inflation. The authorities should maintain accommodative monetary policy until restoring full employment and reaching inflation objectives. In case of stronger demand growth and strengthening labor market conditions, policy normalization should be gradual, taking into account a high share of households with high debt-to-income ratios.

Australian banking system is adequately capitalized and profitable but remains dependent on wholesale funding and is highly exposed to household debt. We agree with staff that a renewed overheating of housing market and pick-up in mortgage lending present a risk in a low-interest-rate environment. While housing loans structure has improved, with reduced share of investor loans and interest-only loans, the easing of macroprudential thresholds on these loans may create risks going forward. These developments need to be closely monitored. The efforts to bolster the resilience of the financial sector should continue, and we welcome the authorities' commitment to implement a comprehensive package of reforms in line with the Hayne Royal Commission recommendations.

Vulnerabilities in the housing market remain high. The underlying factors for high housing demand remain in place, including high population growth and housing market structural rigidities. In this regard, in addition to strengthened macroprudential policies, the authorities are well advised to go ahead with their supply-side housing market reforms to alleviate supply constraints, complemented by targeted tax reforms to optimize housing and land use.

We welcome Australia's commitment to the goals of the Paris Climate Agreement and the country's leadership in the use of renewable energy. We also commend the authorities' commitment to open trade, investment, and immigration. Australia is an active participant in free trade agreements and its network of bilateral trade agreements is expanding. That will help Australia to further diversify the economy and benefit from the global market integration.

With these remarks, we wish the authorities further success.

Mr. Kaya and Mr. Harvan submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Ray, Ms. Johnson, and Ms. Park for their informative buff statement. Following a long period of growth, some of the factors that underpin Australia's success weigh on its economy, and risks are elevated for both the short and medium term. We broadly agree with staff's assessment and add the following comments.

The policy mix remains broadly appropriate. In 2019, monetary policy easing was adopted in the context of the continued gap in reaching the inflation target, and the accommodative monetary stance remains appropriate going forward. We note staff's recommendation to consider using unconventional monetary policies to further support the Australian economy in the event of downside risks intensifying. Fiscal plans for FY2019/20 were already somewhat expansionary before the coronavirus outbreak and a contraction of the fiscal stance had been expected from FY2020/21. Low public debt levels leave sufficient fiscal space as shocks emerge and fiscal policy is supported by a robust institutional framework.

The financial sector remains well-capitalized and resilient, and we encourage the authorities to continue the implementation of the 2018 Financial Sector Assessment Program (FSAP) recommendations. We note the decision to ease some of the macroprudential regulations for interest-only mortgages and investor loans in the context of a housing market downturn. Banks' business models are focused on long-term mortgage loans, while small- and medium-sized enterprises appear to lack adequate access to financing from commercial banks. Staff's recommendations focusing on the supply side of housing seem appropriate. As a lack of competition seems to be part of the problem, we would welcome a further examination of the institutional and market factors favoring household and housing loans. Reliance on wholesale funding remains a vulnerability, although its share is falling. The 2018 FSAP identified weaknesses in the supervision and resolution frameworks, and we encourage the authorities to fully implement the new Financial Accountability Regime. In addition, while the authorities have reacted sufficiently forcefully to recent money laundering cases, we stress the need for strengthening and expanding the coverage of the AML/CFT and to adequately resource it.

We encourage staff to further elaborate on the emerging risks and policy response. Australia's strong trade and tourism links with China have supported growth in the past, but likely render its economy more vulnerable to the current COVID-19 crisis. The growth model has benefited from investment in the mining sector and Australia ranks among the biggest exporters of coal. We support staff's efforts on evaluating climate change policies and would welcome more details on the growth implications of the global transition to a less carbon-intensive energy mix on the Australian economy. We welcome the authorities' continued commitment to the COP21 and their progress on renewable energy generation. We are cognizant of the need for a comprehensive approach in implementing a climate adaptation policy package where regulatory and behavioral nudges might also come before price incentives and will involve both the national as well as subnational levels.

Further efforts are needed to support strong, sustainable, and inclusive growth. We welcome Australia's commitment to open trade and increased investment to address infrastructure bottlenecks in view of the increasing population. We support staff's recommendations to strengthen the business environment, increase full-time female employment, and improve the education system. While we support changing the tax mix, moving to greater reliance on property and consumptions taxes, we are somewhat hesitant on the potential net impact of the targeted tax incentive for businesses, as they also reduce fiscal transparency.

Mr. Alkhareif, Mr. Rawah and Ms. Alzamel submitted the following statement:

We thank staff for the well-written reports and Mr. Ray, Ms. Johnson, and Ms. Park for their helpful buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

It is encouraging to note that Australia's economic fundamentals remain strong and that the economy continues to show resilience in the face of external and domestic challenges. Indeed, achieving more than two decades of consecutive economic growth is commendable, reflecting the authorities' sound macroeconomic management and prudent policies. That said, Australia is facing several challenges including below-potential growth, weakening inflation expectation and continued global downside risks, presenting a strong case for a continued policy support to underpin the economic recovery. Against this background, we agree with staff that the current policy mix is appropriate and should continue to be accommodative including in FY2020/21. Also, we take positive note of the alignment of views between staff and the authorities' regarding the need to deploy additional measures should downside risks materialize.

Efforts to further strengthen the financial sector resilience should continue. In this context, while banks are well capitalized and profitable, they remain exposed to key vulnerabilities. In particular, the elevated household debt, which is among the highest in AEs, the exposure to residential mortgage lending and the banks' reliance on wholesale funding need to be carefully monitored. In this context, we take positive note of the authorities' active engagement to contain the risks of the aforementioned vulnerabilities. Also, we support the efforts undertaken to further strengthening bank' loss-absorbing capacity and encourage the authorities to stand ready to tighten the macroprudential policy stance, if needed, should financial risks increase. Building on the past progress, priority should be given to continue strengthening the AML/CFT framework and implementing policy recommendations under the 2018 FSAP, including further promoting risk oversight and financial crisis management. Regarding the housing market, we note that there has been a limited improvement in housing affordability since 2017, and therefore, we encourage the authorities to step up their efforts towards implementing housing supply reforms and measures to improve affordability.

Finally, accelerating structural reforms is critical to ensure stronger and more inclusive growth. In this connection, priority should be given to reforms aimed at enhancing business environment and competition. We welcome the authorities' efforts towards reducing youth and female underemployment including through the Child Care Subsidy and Mid-Career Checkpoints initiatives as well as modernizing vocational education and training.

With these comments, we wish the authorities all the success in their future endeavors.

Ms. Riach and Mr. Haydon submitted the following statement:

We thank staff for an interesting set of papers, and Mr. Ray, Ms. Johnson and Ms. Park for their informative buff statement.

Australia has a strong economic track record and has just completed its 28th consecutive year of economic growth. Despite elevated risks – both from subdued global growth and domestic factors such as the extensive bushfires – Australian's economic fundamentals remain sound. Mr. Ray, Ms. Johnson and Ms. Park are right to highlight the importance of strong institutional arrangements, a flexible exchange rate regime, a liberalized capital account, and flexible labor and product markets. Nonetheless, structural challenges remain, including slowing productivity growth and the need for an ambitious approach to energy and climate change policies.

The staff report offers some limited discussion of the coronavirus outbreak on the Australian economy. We appreciate that the situation was still developing at the time that the papers were finalized, and that it remains fluid. Australia is clearly exposed to significant potential spillover effects, including reduced demand for its commodity exports, falling tourism, and impacts on its higher education sector. Some commentators have suggested that, coupled with the economic impact of the bushfires, Australia's unbroken run of economic growth could be put at risk. We would be grateful for staff's assessment of this in the context of recent developments.

There was some difference of views between staff and the authorities over fiscal policy in the original report: staff calling for an expansionary stance in FY2020/21, the authorities not seeing the case for a near-term fiscal stimulus. The specifics of this debate may be somewhat out of date by now. As discussed above, a couple of major downside risks to short-term growth have emerged in the last couple of months, and the authorities have already begun to announce fiscal measures in response. Could staff offer an updated assessment of the likely fiscal trajectory over the next year, and their views of the latest fiscal measures put in place by the authorities?

Climate change could have been given greater coverage in the staff report. Australia is one of the top ten largest greenhouse emitters in the OECD and is exposed to significant climate risk. While the authorities project that Australia is on track to meet its 2030 emissions target, the target is relatively unambitious and much more will need to be done beyond 2030. Carbon taxes have certainly proven a contentious political issue in Australia in recent years. While staff should not shy away from making the case for what they see as the first-best solutions, they should take into account domestic political economy considerations in formulating multi-layered advice. We would welcome a broader and deeper assessment of the steps Australia is taking, and could take, to de-carbonize their economy in future staff reports.

Finally, while there has been some welcome improvement in housing affordability compared to the 2017 peak in house prices, the incipient recovery in prices since mid-2019 risks eroding this. Efforts to facilitate housing supply reforms to contain further price increases are certainly warranted. Staff reiterate their assessment that certain housing policy measures discriminating against non-residential buyers, such as state-level foreign purchaser duty surcharges on residential property, are capital flow management measures under the IMF's Institutional View and should therefore be replaced by alternative, non-discriminatory measures. Given these measures have now been in place for some time, we would welcome analysis from staff on their impact on housing affordability. Regardless of broader concerns, it would be a valuable contribution to the wider debate to understand whether or not they have been effective in meeting their stated objectives.

Mr. Tanaka, Mr. Chikada and Mr. Nagase submitted the following statement:

We thank staff for the insightful papers and Mr. Ray, Ms. Johnson, and Ms. Park for their informative buff statement. We commend the authorities for their sound macroeconomic policies which have brought about 28 consecutive years of economic growth. It is assuring that Australia's continued growth has helped the authorities to accumulate considerable fiscal space, which could be mobilized in case external and internal downside risks will materialize. As we broadly concur with the thrust of the staff appraisal, we would like to limit our comments as follows:

We commend the authorities' effort to maintain a prudent fiscal stance while implementing its plan to lift potential growth by boosting productivity. However, we note there is a difference in views between the authorities and staff on the near-term fiscal stance, including governments spending on infrastructure. On this point, as discussed in the G20, quality infrastructure investment is important not only to boost potential growth, but also to build resilience to the climate change and natural disasters. We look forward to further dialogue between the authorities and staff to promote sound fiscal policy which also support potential growth and climate resilience.

Monetary policy should remain accommodative and UMP could become necessary in case of downside risks. On this point, while staff recommends UMP should focus on measures that affect the short end of the yield curve, however the report lists quantitative easing as one of the main policy options. We wonder whether QE could be an effective way to lower short-term interest rates. Moreover, Australia's relatively limited amount of government securities outstanding thanks to its fiscal soundness could limit the extent and impact of QE. We would welcome staff's elaboration on this point.

Australia's financial sector is sound and prudential policies have been generally successful in controlling housing markets and mortgage lending overhear. In addition, we welcome the authorities' progress on implementing the 2018 FSAP key recommendations. However, as staff points out, various risks on the financial sector, including the problems of housing market and household debt, have been increasing. We encourage the authorities for continued vigilance and tighten measures in case of increasing financial risks.

We welcome Australia's strong commitment to open trade, investment and immigration, which in turn have also helped its increasing integration into the Asia-Pacific region. With these comments, we wish the authorities for their further successes.

Mr. Raghani and Mr. Alle submitted the following statement:

We thank Staff for a comprehensive set of papers and Mr. Ray, Ms. Johnson, and Ms. Park for their insightful buff statement. We would also like to offer our sincere condolences and solidarity to the Australian people for the human and economic losses caused by the worst wildfires the country has experienced in decades.

The Australian economy has achieved sustained growth on the back on strong macroeconomic fundamentals and sound policymaking. After a slowdown in the second half of 2018, the authorities' accommodative macroeconomic policies are supporting the recovery amid downside risks. Despite this gradual recovery over 2019, growth is still below potential and supporting it would require domestic policy space in the face of subdued global economic conditions. Tighter macroprudential measures are also warranted in the event of asset price pressures emanating from loose macroeconomic conditions. As they pursue pro-growth fiscal and monetary policies, the authorities will have to step up structural reforms in many areas including boosting productivity growth, enhancing labor markets to promote female labor participation and improving the business environment. We broadly share the staff appraisal and would emphasize a few points.

We encourage the authorities to remain vigilant and prepare responses to the materialization of domestic and external risks. On the domestic front, we appreciate staff's update on the economic impact of the wildfires and on how this tragedy has affected the outlook. The authorities should be commended for their recovery effort and we are pleased to learn from Mr. Ray and his colleagues that this effort is likely to reverse the negative near-term economic effects on aggregate activity. On the external side, we are concerned about the number of channels through which Australia could be affected by risks related to unfavorable developments in China including the recent coronavirus outbreak. The authorities should be encouraged to be proactive vis à vis risks posed notably to tourism activities and exports. Could staff give us an update on the authorities' diversification strategy and smooth reorientation towards new trading partners, which were discussed during the last Article IV consultation?

We share the view that the policy mix should remain accommodative. Headwinds from adverse global conditions give little room for maneuver and the authorities should make good use of fiscal and monetary policies to support growth. In this vein, we welcome the expansionary fiscal stance for FY2019/20 and concur with staff that such stance should be continued over FY2020/21 to firm up the recovery. Furthermore, we are of the view that increasing infrastructure spending would not only support growth, but it would also contribute to productivity gains.

We see the monetary policy easing as a step in the right direction. We also take good note of the consideration of further monetary easing including through unconventional monetary policy measures. In any case, monetary policy should continue to be data-dependent and help anchor upward inflation expectations - seen to remain below the target range over the next one to two years.

While we welcome the adequate capitalization and profitability of the banking sector, we are concerned about vulnerabilities within the sector. The authorities should keep a close eye on the high household debt. We see merit in steps to enhance banks' capital framework and their loss-absorbing capacity, which could prepare the banking system for adverse developments in the housing market. In the same vein, measures should be taken to minimize risks related to external wholesale funding. Macroprudential tools should be targeted and flexible enough to be responsive to the longstanding and emerging systemic risks. In this regard, we see merit in setting loan-to-value ratios, debt-to-income (DTI) limits and a countercyclical capital buffer. Efforts should also be geared at completing the implementation of the 2018 FSAP recommendations, notably the resolution framework, the ban-level resolution plans, and statutory powers for bail-ins. On AML/CFT, we welcome the authorities' introduction of a bill in Parliament to reinforce the framework and remove obstacles to prosecution.

Structural reforms are paramount to lift bottlenecks and support strong growth. The authorities should step up their diversification strategy to boost non-mining investment growth. To this end, a swift implementation of measures identified in government reports is warranted, including the Australia 2030: Prosperity through Innovation report. We welcome among others, efforts to boost R&D, improve SMEs' access to finance, support banks' non-mortgage lending and encourage new investments through tax measures. Further steps to improve labor markets towards increasing female labor participation and reducing youth underemployment would also be welcomed. As well, the authorities should be encouraged in their efforts to boost productivity growth including through investments in education and infrastructure.

With these remarks, we wish the Australian authorities, every success in their endeavors.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We want to thank staff for the excellent set of reports and Mr. Ray, Ms. Johnson and Ms. Park for their comprehensive buff statement. We commend the Australian authorities for the continued implementation of a very strong policy framework that has been reflected in continuous growth. The economy has been resilient in the face of the global slowdown and domestic challenges arisen from the persistent drought. We broadly agree with the staff appraisal and would like to highlight some points for emphasis.

On overall policy, we agree that monetary and fiscal policy stances remain appropriate for the current economic conditions. Looking ahead, conditional on economic growth returning to potential, we support the authorities' plan to continue with fiscal consolidation. We believe that fiscal responsibility has been precisely the basis on which continuous growth has been built. Regarding monetary policy, we fully support the RBA's view on the need for a balanced approach to the benefits and risks associated with interest rates at very low levels vis-a-vis financial stability, as presented in the buff statement. Finally, we concur that when an adverse external shock materializes, there is scope for the authorities to respond using conventional and unconventional monetary policy levers and the existing fiscal space.

We support the view that while macroprudential policy is currently adequate, the authorities must remain vigilant given the persistent high household debt and a potential housing surge. Australia's financial system remains sound but potential risks exist. We commend staff for the comprehensive analysis regarding the housing markets, including the house-prices-at-risk exercise. We take positive note that the authorities are taking measures to address the supply bottlenecks in the housing sector and evaluating what tools might be needed in case systemic risks materialize.

While the authorities face important challenges regarding the ongoing climate-related shocks, we take positive note of their commitment to the mitigation of climate change risks. We welcome the authorities' actions in support of those most affected by the bushfires. Additionally, we note that steps are also being taken to address emerging climate risks in the financial sector. Do the stress tests applied to the banking system include climate-related risks?

Australia has a long tradition of strong investment in infrastructure. Given the high level of infrastructure investment already in place, we agree with the authorities that even when fiscal space is available, care should be taken to ensure that no capacity constraints are reached, and that high-quality investment is preserved.

Finally, we commend the authorities for their strong commitment to open trade, investment and immigration.

Mr. Trabinski and Mr. Tola submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Ray, Ms. Johnson, and Ms. Park for their informative buff statement.

The Australian economy remains in good shape after undergoing a successful economic transition, but domestic and external risks have increased. Both monetary and fiscal policy have proven to be appropriately flexible in the past and macroeconomic fundamentals remain sound. However, risks to the immediate outlook have increased due to the widespread bushfires and the coronavirus outbreak, which add to the risks stemming from a possible renewed escalation of trade tensions.

Monetary and fiscal policies remain appropriate for the time being. We concur with staff that a supportive macroeconomic policy mix of continued monetary policy easing, and moderate fiscal expansion remains appropriate, considering domestic and external risks to the outlook. We share the authorities' stance that fiscal consolidation should continue absent a severe negative shock, since, inter alia, a quick upscaling of infrastructure investments may hamper the effectiveness of additional outlays.

The authorities should stand ready to use macroprudential tools to safeguard financial sector resilience and counteract a possible re-emergence of housing sector vulnerabilities. Careful monitoring of developments and risks in the housing market is particularly important, also given the predominant reliance on bank lending. Should the housing market begin to overheat again, it would be important for the authorities to react in a timely manner by introducing risk-mitigating measures such as loan-to-value and debt-to-income limits, as well as by deploying countercyclical buffers. As pointed out by staff, market pressures could be alleviated by further measures that support housing affordability, such as zoning or city and regional deals on infrastructure development. Transparency and public communication of macroprudential policy – as recommended in APRA's July 2019 Capability Review – would help enhance policy efficiency. Further, we would like to hear staff's view on whether the insurance claims filed as a result of the recent bushfires will have any impact on the solvency and stability of the insurance sector in Australia.

Ongoing structural reforms in the areas of regulation, taxation, and labor market participation are bound to support strong and inclusive growth, while the development of a national, integrated approach to energy policy and climate change mitigation will help provide more clarity for investors. Addressing infrastructure gaps, reinforcing business investment through better SME access to finance and product market deregulation, as well as the already prioritized measures to improve gender equality and reduce youth underemployment will be essential in this context. Further, an integrated approach to energy and climate change mitigation policies would provide investors with more certainty regarding the implementation of internationally agreed objectives. We concur with staff that catalyzing sustainable business investment in Australia and addressing climate change have become essential and we welcome the authorities' policy commitments in this respect.

The Acting Chair (Mr. Zhang) made the following statement:

The subject of this session is on Australia, 2019 Article IV consultation. All Directors issued grays. Let me begin by expressing sympathy to the Australian authorities and people for the devastating impact of the recent bushfires and the drought. As all of you know, Australia has enjoyed a relatively robust and stable macroeconomic performance over the last few years, thanks to sound economic fundamentals and policy management. On the other hand, growth has remained below potential recently, and there are challenges to the near-term outlook, and this includes the devastating effect of the drought and bushfires. The recent outbreak of the coronavirus also poses uncertainties.

All of you highlighted in your grays that the authorities' monetary and fiscal policies remain appropriate. In addition, should adverse external shocks materialize, the authorities have both conventional and unconventional monetary policies (UMPs) and fiscal space available to respond. Obviously, there are other issues related to structural reforms. That also leads us to discuss later this morning, and all of them are key to fostering inclusive and sustainable growth while reducing the greenhouse emissions. It covers quite a range of the issues.

Mr. Ray made the following statement:

Firstly, let me thank you, Chair, for your remarks, and, colleagues, both for your formal condolences and support for Australia through the bushfire's situation. Also, I might say from a personal point of view, mine and my Australian colleagues in the office, for all the support that all of you have shown to us over the past few weeks.

Second, I wanted to put on formal record my personal thanks and acknowledgement of staff but also my authorities' acknowledgement of staff for the extraordinary response to provide assistance to the bushfires recovery effort, which is quite extraordinary. The Australian Treasurer wrote to the Managing Director a couple weeks ago formally to thank staff, but I wanted to put it on record to the Board as well.

Thanks to colleagues for the grays, which raise a few more interesting questions than usual. Let me say two things. One is, Chair, you said Australia has had a robust and stable economic performance for some years. It is not as straightforward as it might look, and we can have a conversation about that.

I wanted to raise climate change because I think that this is an interesting case for thinking about the role of the Fund and also about traction with authorities. A number of you in your grays suggested either the Australian authorities should do certain things or that staff should do certain things. If I said to my authorities that some Board colleagues had asked staff to concentrate more on climate in the next Article IV or one after that or whenever, I expect I would be asked three questions. The first would be why? The second would be what? And the third question that they would ask me is what would the Fund bring, i.e., what is the Fund's comparative advantage? I must say I would have some difficulties in responding to my authorities, and in this case I should point out that my authority in this case would be the Prime Minister, in that it is not clear to me the answer to those three questions in the case of Australia.

In this constituency, it is quite clear that climate is a macrocritical issue for a large number of members of this constituency. In Australia's case, it is not as clear-cut. I think Mr. Buisse in his gray said that mitigation is macrocritical. Well, back when the Australian government was in the first case attempting to introduce an emissions trading scheme (ETS), the

Australian Ministry conducted the largest macro modeling exercise in Australia's history on this question, and they concluded that mitigation was not particularly macro significant, way less than other things I could think about, such as population aging.

Secondly, though, not the what, I think here it is a bit premature to answer that question because we have not yet completed the Comprehensive Surveillance Review, and we have not even seen the draft guidance note from staff on this question, and it is very difficult in those circumstances to know exactly what staff should do.

That then brings me to the question of traction, and I don't think Mr. Von Kleist would mind if I referred to his gray where he suggested that the Australian authorities should introduce a particular policy. He gave them two options. As an economist, I can understand where that is coming from, and it is not actually about mitigation; it is about doing it in a least-cost way. Australia had an emissions trading scheme. The government that introduced it was defeated at the polls by an opposition that had a very clear mandate to appeal the emissions trading scheme, and they did so. There have been two elections where the government has been returned clearly with a mandate not to do precisely what Mr. Von Kleist was recommending, which I can understand, but this is a democracy. So in that world, as policy advisers, as officials, we have to think about how we handle that. I think staff have to think about that very, very carefully. And just a personal observation is I think that Harald Finger and his team have navigated this particular area quite effectively in this Article IV report, and they should be commended for what they have done, which I will do at the end when I get to sum up in a more official way.

Mr. Bevilaqua made the following statement:

I thank staff for the well-written report and selected issues paper and commend the Australian authorities for their strong policy framework and prudent macroeconomic management that has supported an extended expansion cycle while preserving macrofinancial stability. We issued a gray, and I will make two brief comments.

First, it is clear that in staff's baseline, more monetary policy stimulus would be appropriate. The authorities have already expressed their views that they still have some policy space for conventional monetary easing, as needed, and would be willing to resort to unconventional monetary policy measures if negative shocks materialize. I understand that the specific line of action will depend on the nature of the shock and I also take note that the authorities perceive that negative interest rates are not as effective in Australia's context.

As we have discussed in several other opportunities, this is a terrain in which knowledge is still being developed, based on the rich yet relatively recent experience that has been accumulated over the past decade. In a sense, we are still navigating on uncharted waters.

For example, it is still largely unknown what are the long-term impact of negative interest rates on financial stability. Or how best can you bring central bank's balance sheet back to more normal sizes. I appreciate that having to resort to UMP will be imperative only if a risk scenario materializes but given the complexity of the decisions to be taken in a timely manner and under pressure, I strongly advise staff to do its best to stand ready to meet the membership's expectation of the IMF as a trusted advisor on such critical policy matters.

Relatedly, one area in which Australia has been extremely active with successful results so far is in devising and adopting macroprudential policy measures to ensure that the financial system remains resilient in challenging circumstances. Annex VI provides an extensive list of measures taken since December 2014, focusing on housing credit but not restricted to it.

As a result, the banking system in Australia remains strong, albeit with some vulnerabilities related to a declining but still high dependence on wholesale funding and large exposures to housing lending. In spite of the improvements in the housing market, household debt ratios remain very high, both in absolute terms and by international standards.

Therefore, one critical issue to be closely monitored, in case UMPs are adopted, is the possible increase in financial vulnerabilities. A likely impact of unconventional monetary policy easing is a boost in house prices, which will bolster demand through wealth effects. Even if successful in its expansionary objectives, the adoption of unconventional monetary policies may be planting the seeds of enhanced financial fragility, which could become a major issue on the future way to normalization.

I understand that Australian authorities are fully aware of the complexity of those issues and have excelled in their use of a diverse range of policy instruments to cope with them. That said, I believe the Fund should be prepared to be a fresh pair of eyes and a high-quality trusted advisor on issues that are the core of our mandate. With this, I wish the Australian authorities' success.

Mr. Alkhareif made the following statement:

I would like to start, Mr. Chair, by joining you in expressing our deepest sympathies and condolences to the authorities for the losses from the bushfires impact. I also thank staff for the high-quality work and balanced views and policy recommendations, including on climate change issues.

The Australian authorities deserve to be commended for their macroeconomic management and strong policy framework, which has enabled the country to have a continuous growth for over the past 28 years. The authorities have been successful in managing the economy very well. However, Australia, like other economies, faces key challenges, including low productivity growth rate, weaker potential growth, as well as below inflation numbers. In this context, we encourage the authorities to continue the accommodative policy mix, both the monetary and fiscal policy. We also see merit in using part of the fiscal space to use fiscal expansion in the medium term, especially to help lift potential GDP by investing in infrastructure projects.

We take positive note that the financial sector remains sound. Banks in Australia are well capitalized and profitable. We take positive note that the authorities are focused on improving banks' loss-absorbing capacity, which is important during downturns. We encourage the authorities to focus on improving the AML/CFT framework to improve the integrity of the financial sector.

Regarding the housing market, we welcome staff's focus on this issue given that it is important. We take positive note of the authorities' efforts to improve affordability of the housing, especially for new families and young generation. We note the misalignment between staff and the authorities on the measures to implement the tax policy reforms within the housing sector, and we hope that the authorities will have the balanced view on both the supply and demand to address the affordability issues in the housing market. We agree that a proper use of macroprudential measures is very helpful, especially to limit any systemic risks stemming from the housing market.

Finally, on climate change, I very much welcome the remarks by Mr. Ray. I agree that staff have provided a balanced approach, but usually the Fund focus is on certain measures, including the carbon taxation, and I agree with Mr. Ray and others that we should avoid one-size-fits-all policy recommendations. We are encouraged that Australia is committed to the COP21 agreement, and we take positive note of the authorities' commitment to tackle climate change within their domestically determined policies.

The IMF again should consider the domestic political economy consideration when formulating the policy advice. Also, cooperating with other institutions like the World Bank will be important in this area. We wish the authorities continued success.

Mr. Tanaka made the following statement:

I would like to join to express our sympathy for the people in Australia severely affected by the recent bushfires and drought.

We commend the continuous and resilient efforts by the authorities and people in Australia for their sound macroeconomic policies, which have brought about 28 consecutive years of economic growth. In order to sustain this trajectory of economic growth path, at the same time we have to attach importance to accurate observation that headwinds from subdued global growth, climate change risk related to the bushfires, and the uncertainty associated with coronavirus outbreak, are increasing challenges to growth prospects in Australia.

As to the slightly different views on fiscal policy between authorities and staff experts in the staff paper, based upon the emerging downside risks to short-term growth in the last couple months, we understand that the authorities are ready to implement fiscal measures in response. We look forward to further information on fiscal policy measures to support potential growth and climate resilience. On this point, as discussed in the G20, we would like to refer to the point that quality infrastructure investment is important not only to boost potential growth, but also to build resilience to the climate change and natural disasters.

Secondly, I do not fully understand staff's view and position on the housing market. Levels of housing price and housing sales compared with 2017 peak level in the paper, and staff says that they are still lower than 2017 level. My recollection is that 2017 level is a bit of a bubble, and now they are under the process of normalization; so supply-side reforms are necessary at least, but we are not sure from the staff view at what price level and what sales level are desirable and appropriate under the current economic situation.

We welcome Australia's strong commitment to open trade and investment, which in turn have also helped increasing integration in the Asia-Pacific region. With these comments we wish the authorities further success.

Mr. Raghani made the following statement:

Let me also reiterate our heartfelt condolences to the people of Australia for the tragedy and losses caused by the recent bushfires. We issued a gray, and I would like to emphasize some points.

First, like many other chairs, we commend the Australian authorities for the achievements over the past years and for the accommodative macroeconomic policies, which are supporting the economic recovery. In addition to those policies, we welcome actions that are being taken on other fronts to raise growth potential. We would emphasize efforts to reduce domestic policy uncertainty for boosting private sector investment, as well as steps to enhance the business environment are well taken as they appropriately complement the ongoing initiatives to support the development of the private sector, including through incentivizing research and development, easing credit conditions, and encouraging new investment and innovation.

Second, we support the authorities' initiatives to respond to downside risks stemming from several unfavorable global developments. Some of these developments may last. We therefore encourage the authorities to contemplate long-term measures where needed to safeguard exports and tourism sectors notably. In this vein, we take comfort in Australia's participation in regional partnerships, which would help diversify markets for the country's exports.

We express our appreciation of the Australian authorities' commitment to global issues, notably trade liberalization and climate change. On climate change, I would like to echo some points made by Mr. Ray in his oral statement this morning, particularly the fact that while the climate change is key for IMF and for many other institutions, we have to be very careful when it comes to make some recommendations, and it will be critical to take into consideration specificity of countries, and as mentioned by Mr. Alkhareif, political economy consideration. I think that this should be taken into consideration when the staff address some issues not only on climate change, but also on other issues that are relevant.

Mr. Buisse made the following statement:

I will, of course, join everybody to express our sympathy to the losses due to the bushfires.

Australia has continued to perform well despite several headwinds. Of course, there are downside risks, but that is a common feature of most of our economies, so I think the Article IV makes a good job of balancing and offering advice.

To go back to the climate policy issue, I think a number of grays highlighted the need for an additional climate policy assessment. I would join Mr. Ray in saying that we still lack knowledge inside and outside of the Fund to make progress; my strong expectation is that the Comprehensive Surveillance Review and the guidance notes will be very ambitious in this regard. Nevertheless, the economics of climate change is relatively well developed now. The macroeconomics of climate change is clearly lacking. That is really what I would expect the Fund to work on and to bring answers for all of our authorities.

On the macrocritical issue, the complete quote of my gray is that due to the large spillovers of the issue, it is macrocritical because a molecule of CO2 is the same everywhere on the planet. We will get back to this issue quite often I suppose in the next weeks and months.

I would like now to focus on two other points. First, on monetary policy, the document stresses the risk of inflation expectation occurring, so I would be happy to hear staff elaboration on if there is a need for a more proactive monetary policy or fiscal policy to prevent this.

On the housing market, I can’t help myself because it is an issue that is very complicated also in France, so I would strongly support the supply-side measures but call for extreme caution on the demand side because once you have subsidized rent, it is very difficult to take those schemes out. At the same time, it is also very difficult to target schemes for the poorest households. If you end up with only demand-side measures and not the supply side, you only push prices up without doing anything for simplifying the life of the poorest households. We had such a difficult time taking away not-well-targeted demand measures in France, that I would really recommend caution. With that I wish the best for the Australian authorities.

Mr. Doornbosch made the following statement:

I would also like to give our sympathy for the people of Australia and the loss of life as a result of the wildfires. I also would like to thank Mr. Ray for his opening remarks this morning. I think he hits on an interesting question that has broader policy consequences than Australia. I agree this is an interesting case to take as an example. And I very much agree with the remarks just made by Mr. Buisse, and I want to add on that a little bit.

The question is, what is the IMF doing when a country has no ambition or commitment to meaningfully reduce emissions? One way would be to look at the adaptation side and look at the fiscal risk, and I would probably agree with Mr. Ray that for Australia, which is a very rich country, if you take a short-term horizon, one to five years, the impact is probably not going to be macrocritical. Long term, different story. I will come back to that.

On the mitigation side, you could look at transition risk. On the one hand, you could say the transition risk is not that high because there is no real change in the production structure being foreseen by the policies of the Australian government, so rather low. On the other hand, you could see this uncertainty. There is a question mark how long these policies are going to be credible. It is going to be likely that there is going to be a change in government again as in 2014 when there was a big change, so that uncertainty might prevent some companies of doing the investment that they are needing to do. It is hard to judge. I am not sure whether the Fund can provide some guidance on that. What should the Fund do, is the question that Mr. Ray asked; and, of course, when a country has a certain ambition, the Fund could give advice on how to achieve those ambitions and look at the fiscal policies, how they could do that in a least-cost way. If a country has not such an ambition, I think that is even more reason to take a close look.

I think, one, the Fund should look at the transition risk. If a country keeps locking in infrastructure that is likely to have a very short life, going to be depreciating more quickly, that might become a macrocritical risk. The more important reason is to look because of the spillover effects of the policies. If you look at the Australian policies, they are consistent with more than 4 degrees Celsius increase in global temperatures. If you look at what that means in terms of the impact over a longer horizon, so not one to five, which is the normal timeframe for IMF surveillance, of course, it means a large negative impact on agricultural yields leading to food shortages. It means mass coral bleaching, probably death of most of the coral. It means sea level rise, threatening small island states, more tropical sea claims. And

Chapter 3 of the WEO did a good job of October 2017 in documenting the macrocritical impact of these effects. I think because of the spillover effects—of course, you cannot look at these policies every year as the IMF—but I do think that on a regular basis, the Fund should play a role in sort of indicating what the macrocritical impact of these policies are for other countries, not only for Australia.

Mr. Rosen made the following statement:

Before beginning I would also like to express the United States' condolence to the people of Australia as they deal with the bushfires, and we are pleased to hear they are largely extinguished.

Overall, the economy is an outstanding success and has had pretty healthy growth for almost three decades. Staff has Australia growing in the future at a sustainable rate faster than most advanced economies, which is impressive. As Ms. Levonian and others have contended, we agree with staff's assessment that the authorities have both fiscal and monetary space for further accommodation if downside risks materialize, and we view UMP as potentially appropriate, though we recognize potential limitations given the relatively small public debt stock.

We welcome the authorities' focus on implementing the 2018 FSAP recommendations and moving ahead with financial reforms related to the recommendations on the Hayne Commission.

On potential growth and structural reforms, as Mr. Merk and others have highlighted, we recognize that there is a robust debate on Australia's potential growth and size of the output gap. Regardless of the estimate of the output gap, we can agree that even faster than already impressive sustainable growth rates would yield dividends to Australia and the region and potentially address slack in the labor force. We urge the authorities to consider further steps at market deregulation and promoting innovation and training to boost productivity and enhance further potential and realize growth.

On housing, I do agree with Mr. Buisse's comments on the risks of subsidizing housing and the difficulties of removing them.

Finally, we fully agree with Mr. Ray's comments on the role of the Fund relating to climate change. The Fund needs to be cautious in its approach to advice on this issue, and as Mr. Alkhareif said, should cooperate with the World Bank and not reinvent the wheel when it comes to climate change. I understand Mr. Doornbosch's analysis of climate change relating to Australia, but I think the issue is how does the Fund really take that and analyze these issues from a macroeconomic perspective to really draw insightful conclusions? And I am not sure whether we have the models or the capacity to do that at this stage.

Mr. Poso made the following statement:

Let me also express our deepest sympathies on the losses resulting from drought and the bushfires. As we have issued a gray, I will focus only on a few points.

The Australian economy has witnessed an unparalleled long period of economic growth among developed economies. More recently, the authorities have successfully managed the economy through the end of the commodity cycle, thanks to prudent macroeconomic policies.

Now the widespread bushfires and the coronavirus outbreak are testing the economy's resilience. I agree with staff that external risks are clearly tilted to the downside, with deeper-than-expected downturn in China being the most prominent one. Overall the authorities' policy response appears adequate. Monetary policy has reacted swiftly to the decrease in inflation expectations. There is no urgent need to implement additional measures, as the exceptionally low real policy rate is still feeding through to the wider economy. Outcome-based rather than calendar-based forward guidance is a key monetary policy instrument going forward.

Considering the recent deep rate cuts, the expected closing of the output gap, and the additional spending related to the bushfires, the recommendation to continue longer with an accommodative fiscal stance may be premature. One can see merit in keeping the powder dry until there are clear signs of downside risks materializing.

While the unemployment rate has remained higher than the NAIRU, it has been affected by rising labor market participation, which in itself is a positive development for potential growth. While external risks are tilted to the downside, there are upside risks domestically stemming from favorable financing conditions and the renewed tightening of the housing market, potentially endangering financial stability. Therefore, I agree with staff that the authorities should continue developing the macroprudential toolkit and stand ready to tighten the macroprudential policy stance if, for instance, high-risk residential mortgage lending increases again.

Finally, let me conclude by thanking staff for the well-chosen topic for the selected issues paper. The paper highlights how dominant a role global uncertainty plays in dampening business investment in an uncertain economy.

Mr. Trabinski made the following statement:

We share the thrust of staff appraisal enclosed in the report, and I would like to offer two more comments in addition to our gray.

First, on the banking sector, we welcome the authorities' strong efforts to enhance regulatory and supervisory frameworks by implementing the 2018 FSAP recommendation as a part of financial sector reform agenda. We nevertheless emphasize the existing vulnerabilities in the housing sector related to high housing demand and the potential overheating of the real estate sector. We therefore encourage the authorities to stand ready to strengthen the macroprudential policies and step up with the supply-side reforms to alleviate supply constraints. Here we would like to encourage the authorities to consider tailored tax reform aimed at optimizing the use of land and to improve data collection on housing transactions by nonresidential buyers that would help quantify the overall impact of foreign demand on house price acceleration.

Second, as many other Directors, we support the authorities' ongoing efforts in introducing structural reforms, specifically those aimed at removing infrastructure bottlenecks and addressing underemployment of youth and women. We welcome the progress achieved in terms of increasing the infrastructure spending, and we take note of the existing capacity constraints in this field.

Regarding the underemployment, we welcome the authorities' objective to securing long-term funding for labor force reskilling, and we encourage them to explore broader educational reform that would help update the labor force skills. This, connected with tailored R&D spending, would have positive long-term impact on the economy.

Finally, I couldn't agree more with Mr. Ray's comment on climate change policy advice, which always should be tailored to country-specific needs. With this, let me express condolences and solidarity with the people of Australia in the context of last month's bushfires.

Ms. McKiernan made the following statement:

First, let me join others here today in expressing the condolences of Ireland and our Chair to the citizens of Australia on the tragic loss of life. We have issued a gray, so I will keep the remainder of my intervention very brief. We agree with Mr. Tan that tailoring policy options to constraints within a country, especially political economy considerations, is key to improving traction of Fund advice with the authorities. We certainly welcomed the staff tailoring of the advice in this report, particularly in relation to macroprudential measures and also the climate change considerations and I think here bearing in mind what Mr. Ray said. But I would also very much like to support the comments of Mr. Buisse regarding the work that the Fund can do going forward to give much greater clarity on how a suite of options, tools, models, considerations, et cetera, can help all of our authorities to learn better how to inculcate climate change considerations into their policy development regardless of the starting conditions. With that, we wish the Australian authorities the best with their endeavors.

Mr. Von Kleist made the following statement:

Like others, we would like to express our sympathy and condolences to the Australian people. I would like to focus my remarks on your oral remarks. Just two points on democracy.

I think among democratically elected governments, there is a very small minority which would say getting reelected at any cost is the right way to go. I think most democratic governments tread this fine line between what is popular and what is right. And in that sense, even though one might have strong popular support for certain things, if you as a government see it is not the right thing to do, you need to change things. I think governments have the duty to lead by information, by building support within the population for difficult choices. In that sense, this argument, we were reelected, so what we are doing is right, is not an absolute one. It is a relative one. Germany is a good example. We had a complete turnaround in climate policy in the last year. We have coal mining regions in Germany, and these coal mining regions are either the East, which are struggling anyway, or in the West of the country, also struggling sort of old industry areas, coal and steel, those areas in Europe, not just in Germany, but in Europe generally, which are struggling, so people are saying “no, we cannot really shut down the coal mines because that is the only economic basis left”, and we still did it because there was a complete turnaround in voter sentiment. We now have a long-term plan which goes into the 2030s, and in the end there is a very, very broad consensus that we need to stop doing this, and we need to change.

The second example, and I think more important maybe for today's discussion, is what should the Fund do? I attended the staff mission to Germany, and we had these discussions on the Fund's advice on carbon taxation, and actually even though I think there are many very knowledgeable people in the German government on these issues, they were really thankful for the FAD staff to give them their advice because FAD on the carbon taxation has experience now from I think 136 countries on how to do things, how to do things better. The situation in Germany is not easy. We have the European framework, and then we have the German framework; we have the emissions trading; we have the carbon tax, all those things. We trade a lot, so we have this question of what do you do with border training? So very complex issues, and still the Fund advice was very, very thankfully received.

So I think the Fund obviously is not the climate guru of the world. I think there is no discussion on that, but I think the Fund has areas of expertise where being a global institution and gathering information of how people do it can prevent people from trying to reinvent the wheel every time around. We were very thankful about the advice. We want to work closely together with FAD to develop our own things in that context, and I think that is what the Fund should do, focus on the areas of expertise which are within our mandate and have a big impact there, and everything else somebody else should do. I think we have an important role to play at the Fund.

Mr. Guerra made the following statement:

Let me start with the issue of climate, and in this I join Mr. Doornbosch in calling for the IMF to have a role in this issue. I believe that the questions posed by Mr. Ray are very relevant, and precisely we should address them. We should go into them. We will be looking for a comprehensive discussion in the context of the CSR process.

Regarding this report, we felt that there was a good balance in the analysis related to climate change. Also, we want to stress that climate change is a global issue. So if a country suffers from a climate-related event, a hurricane, floods, the increasing level of the sea, it does not mean that they are, let's say, the culprits of the global climate change. This is a global enterprise. The IMF will also have to deal not only in the bilateral but also in the multilateral arena precisely with issues like the fiscal policies that Mr. Von Kleist just addressed.

On the second issue that I wanted to touch upon on fiscal and structural and infrastructure investment, with the permission of Mr. Buisse allow me to quote Napoleon that used to say, "slowly because we are in a hurry". The Australian authorities have during many years a good record of good policy implementation. If there is fiscal space, if there is monetary space, it does not mean that it has to be used. They are clearly stating that what they believe in their path, in their projections, they are going to reach potential growth; and they are clearly stating that in case it is needed, they will introduce good policy advice. They will introduce the measures using that fiscal and monetary space.

On the issue of monetary policy, in our gray we strongly supported the central bank's position that we also have to look at low interest rates in a balanced way. Low interest rates can be reflected as an additional risk in the financial sector, as Mr. Bevilaqua just said, particularly in the housing sector, so we have to be watchful.

Finally, a request to Mr. Ray. Please send our sympathy to your authorities for the losses of these fires, and also convey our appreciation of this chair for your leadership on the issues of open trade and of the investment agenda.

Mr. Jin made the following statement:

Like others, we would like to offer our sympathy to those affected by the recent bushfires and wish Australia a speedy recovery from the devastation caused. We have issued a gray but would like to make a couple of additional remarks.

We commend the authorities for their robust macroeconomic policy management and the strong institutional arrangements, which have contributed to an impressive track record of growth in the last 28 years. We also welcome Australia's continued commitment to international cooperation and support for multilateralism. Looking ahead, there are increased uncertainties to Australia's outlook, including the recent outbreak of the COVID-19, but we generally expect a short-term and one-off impact from the outbreak. We take positive note that the Australian authorities stand ready to respond in case downside risks materialize, and there is policy space to do so. That said, we caution that any further monetary easing should take due consideration of the potential risks to financial stability that may arise.

Looking ahead, we trust that the Australian authorities will continue to navigate through challenges effectively and foster strong, sustainable, and inclusive growth. We look forward to further efforts to mitigate climate change risks, as well as measures to boost potential growth. We hope staff can support these efforts through providing policy advice that is well tailored to the country's context. With these remarks, we wish the authorities all the best.

Mr. Fanizza made the following statement:

First of all, let me join my colleagues in saying that we are very sorry for what happened. It has been a tragedy really. I would like to thank the staff for the excellent papers that they have prepared for discussion and for the pragmatic approach they are conducting in difficult issues.

Australia has done very, very well. I have issued a gray, and I am not going to repeat anything which is in the gray. Like everybody else, my focus was on climate change. I would say this is a quite interesting discussion taking place here, because I was struck by the fact that the report says that the authorities are on track to reach the objective for 2030 in terms of CO2 emission reduction and then the perception that you have on the price. I see Bloomberg talks about the Australian government, says it is still pro-fossil fuel. There is clearly a gap in perception that does not help in that. The reason why I believe that actually climate issues could be discussed by the Fund in the context of the Article IV discussion is because it would be a great opportunity for the Australian authorities to fully express their reason and do a PR campaign to improve the image and listen to the Fund, that it can without being expert, could focus on macroeconomic implication of the story.

I do not like the ideological contraposition. It is not very useful if you say you should do as much as possible to fight climate change. On the other side, we would say, no, we believe that carbon is good and that is because it is cheaper. That is not useful because I do not think the Australian position is that one. It must be very much more elaborated, and that is an opportunity to make it better known and discuss it. The issue has become so prominent, and the tenor of the discussion has showed us that everybody is looking at the country and these policies in the country, particularly after what has happened. My point is that the Australian authorities should not miss this opportunity to make their voice heard on what they do.

Mr. Tan made the following statement:

Australia has enjoyed 28 years of consecutive growth. I do know and notwithstanding Mr. Ray's humble remarks earlier, the authorities deserve credit for their track record of sound policy management. We issued a gray and we just emphasize a few points this morning.

Firstly, we agree with the measured approach by staff and the authorities in considering a coordinated fiscal and monetary policy response if warranted by adverse shock and calibrating precise response carefully based on the nature of the shock. On monetary policy specifically, we are of the consensus that the commodity stance remains appropriate and should be data dependent. The report seems to suggest UMP measures as the first port of call besides fiscal ones in case downside risks materialize. Echoing Mr. Doornbosch's gray that the existence of prudential policies should not lead monetary policymakers to neglect financial stability issues, we would advocate some caution here, not just because of what is known as the potential buildup of financial stability risks from UMP, as highlighted in Directors' comments, but importantly, what we do not yet fully understand of the side effects of the UMP and related policies. Hence, we see the authorities' approach in weighing the tradeoffs and considering both conventional and unconventional policy levers as a sensible one. We take positive note of the remaining space for conventional policy to provide support as needed.

On climate change, we find the discussion to be timely, and we understand the general call for greater coverage in future staff reports. This is a relevant issue for the country and is also a tricky one for Australia and for other countries alike and based on what we have heard today, for the Fund as well to match its ambition on this issue with its in-house capabilities to do so. Hence, we see the importance in tailoring and framing such dialogue between staff and the authorities with great care and conscious awareness to consider country-specific political economy factors and to avoid overly specific one-size-fits-all prescriptions. In this regard, we appreciate staff's efforts in striking the right balance in the context of this consultation, which bodes well for policy traction and country ownership in future iterations as staff and the authorities build an understanding to deepen the analysis where appropriate.

Lastly, we welcome the authorities' strong commitment to open trade and international cooperation and recognize the role that Australia plays in promoting economic integration in the Asia-Pacific region.

The staff representative from Asia and Pacific Department (Mr. Finger), in response to questions and comments from Executive Directors, made the following statement:[1]

> First on behalf of the staff team, we would like to express our sympathies for the losses in the context of the drought and the bushfires.
>
> Just to set the stage, the Article IV mission and the policy discussions took place in December, so that was before the worst of the bushfires and also before the coronavirus outbreak, so that does affect things a bit, but we have updated the report to capture these and other recent developments through early February. Since the report was issued, the bushfires have decreased significantly in strength following heavy rains and even flooding in some areas.
>
> The coronavirus outbreak poses increasing downside risks, in our view, given Australia's economic linkages with China; and needless to say, we are monitoring the developments closely. Related to this, there has been a marked decline in some of the commodity prices for the last few weeks, and if that is sustained, it will also have an impact on Australia's external position.
>
> Turning to the questions and the points raised in the grays and the discussion here today, and in addition to the written answers we circulated yesterday, let me focus on a few topics, including the impact of the reduced policy uncertainty in the trade area on Australia, housing market issues, fiscal and monetary policy, and climate change.
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> Beginning maybe with the trade policy uncertainty, there has been a clear reduction in the trade policy uncertainty in the context of the Phase 1 trade agreement between the U.S. and China, and that is a positive factor, of course, for the global economy and for Australia as well. It is an important factor underpinning the expected gradual recovery of the Australian economy, and its impact is reflected in staff's baseline projections, which we updated after the mission.
>
> The impact of a potential reescalation of trade policy uncertainty or of trade diversion related to the managed trade aspects of the Phase 1 agreement both represent downside risks from the baseline. In both of those cases, the impact would depend in part on China's policies; and the nature of China's policy stimulus in a reescalation scenario would matter as, for example,

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

enhanced infrastructure investment in China may lead to additional demand for steel and thereby imports of iron ore and coal from Australia. Whereas if the stimulus in China were mainly targeted at consumption in China, that would have a much more limited beneficial effect on Australia.

Likewise, if we look at the managed trade aspects of the Phase 1 agreement, depending on how that is being implemented, that may have a smaller or larger impact on its imports from Australia. We have factored in a limited impact of trade diversion into the baseline forecast, but there are downside risks if Australia's exports to China are more significantly affected than we expect based on our initial assessment.

Turning to housing, it is important to note that we are not trying to target a specific level of house prices or specific growth rate, but I think it is key to avoid both steep declines in housing prices but also steep increases. The recovery is still fairly nascent. It has only been going since August of last year, so it is a bit early to draw conclusions. Turnover and credit are still low, and we certainly do not yet see a significant pickup in risk-taking from the structure of the loans that are being extended. Nonetheless, it will be important to watch this closely. Affordability has remained an issue even during the period of the fall since between 2017 and the middle of last year, and that is becoming worse again now, of course, with the relatively fast price increase. We agree that supply-side measures that help improve the housing stock and new construction will be quite important.

Turning to the policy mix and fiscal policy, we do think that the accommodative stance should continue also in the next fiscal year, FY2020-21, given the still fragile economic recovery and the new headwinds from the bushfires and coronavirus and other things. Australia does have significant fiscal space, and we believe it would maintain adequate buffers also if the planned state-level consolidation next fiscal year is reconsidered, as we recommend. That said, we do agree with the merits of maintaining an overall sound fiscal position and ample fiscal space for any future potential larger shocks.

Regarding monetary policy and whether more proactivity is needed there, we have to watch inflation expectations, whether there is a deanchoring. They have fallen below the target band, so it is important to pay close attention, but a lot of stimulus is already being put into the pipeline through the fiscal expansion this fiscal year and the three policy rate cuts, which take more time to fully feed through into the economy. So, on balance, we think that the stance is appropriate at the moment, but we had quite significant discussions also about what would be the right response if downside risks materialized, and in that case, clearly we would agree that more fiscal and monetary stimulus would be appropriate.

Turning to structural areas and particularly climate change, this is an issue into which the Fund has been gradually and continuously expanding. Both the grays and the discussion here clearly signal that there is a lot of interest and also provide us with valuable suggestions for further analysis in the area. As Mr. Ray and others have mentioned, the area is quite sensitive, and political economy considerations are quite paramount in dealing with it and navigating it.

Let me say that Australia is engaged in climate mitigation and has put in place a number of policies in support of emissions reduction; but the plans at the moment do not include any price-based measures, as we discussed in the report. And what is targeted under the Paris Agreement, after factoring in the carryover from past overperformance, is a 4 percent reduction from current levels, and so there is quite an active debate around the level of ambition in Australia, as some Directors have mentioned, and that is leading to policy uncertainty, particularly in the energy sector.

We at the staff level will look forward to engaging also in the future in this area, and let me stress we will do so in the context of the evolving Fund-wide guidance so we can ensure that the coverage is also evenhanded across the various Article IV teams and across the membership.

In closing my remarks, I would like to take the opportunity to thank the Australian authorities for the close policy dialogue. I would also like to thank Mr. Ray, Ms. Johnson and Ms. Park for their ongoing close involvement and excellent support.

The staff representative from Strategy, Policy, and Reform Department (Ms. Duttagupta) made the following statement:

Let me briefly summarize the work that is the broader work that is underway on climate change. As was already noted by many Directors here, staff is working on an approach to systematically address the issue. The topic is being covered in depth in the ongoing Comprehensive Surveillance Review, and Directors will recall from the midpoint note, climate change was identified as a salient, long-term trend that will characterize the macrofinancial landscape going forward in the next ten years. And the upcoming final paper will also elaborate further on how the newly identified surveillance priorities need to address the effect of several slow-moving but definitive trends, such as climate change, into the Fund's work through the standard macroeconomic policy channels so that we deliver on our stability mandate. This will all obviously need to take into account many other factors, country-specific circumstances, where we have expertise and where we do not, and therefore relying on and drawing on external expertise, another area that the CSR will talk about.

Harald already mentioned we are working separately on guidance, and in terms of the immediate next step, there will be a briefing on climate issues, integration of these issues in surveillance, in early April or in the spring. Thank you.

The Acting Chair (Mr. Zhang) made the following statement:

As the staff mentioned, the issue of climate change is one we must deal with Fund-wide. You heard from staff about the progress that has been made so far, and how it will be integrated into the surveillance work as part of an ongoing process, so you will hear more on that.

Mr. Ray made the following concluding statement:

I am always amused at the risks being tilted to the downside. I am waiting to come into this room to discuss some report which says that they are not. I have been looking at Fund reports for more than 30 years, and I have not yet found one, so I am waiting for it. But I do not disagree; and in Australia's case, the risks tend to come from outside Australia, with the possible exception of real estate more broadly. I will come to that.

One of the things that happens is Australia is a small open economy, and as Harald just noted, prices tend to adjust quite quickly, and they tend to move faster than both quantities but also policy. And the particular price in Australia that tends to adjust quite quickly is the exchange rate. That is something that always needs to be thought about when we are thinking about a shock.

Secondly, as colleagues have noticed and staff has said and the authorities agree, they have both considerable fiscal and monetary policy space. Just a word on fiscal. The first line of defense on fiscal is just to allow the automatic stabilizers to work, and in Australia's case, those stabilizers tend to be quite strong.

The second thing that the authorities have done and may well do some more of is introduce some measures that help support, for example, bushfires victims and reconstruction. And then beyond that, there would be a question about whether or not a discretionary fiscal stimulus was warranted, and I think that the general view of colleagues is the same as staff and the authorities; that while they stand ready, that is probably not where we are.

On housing, first of all, I fully agree with Mr. Buisse on the question of a lot of policy, which its objective is to support affordability, particularly for low-income households, tends to do the opposite because it pushes up prices because it is on the demand side; so I fully agree with his characterization of the challenges.

On macroprudential policy, though—first of all, I should say that in the Australian context, the authorities watch the housing sector with enormous detail because of its importance to what character it has in the economy.

Second, non-macroprudential policy, I think this is another area where we just need to be a bit careful that we are not jumping to a particular policy solution, where we can agree on the objective and then work out the appropriate policy solution. So here a number of colleagues recommended loan-to-valuation and debt-to-income ratios.

Now these tools are potential in the authorities' toolkit, and they have been considered in the past. The issue is that in the last episode when macroprudential tools were brought in, the focus there was on investor and interest-only lending, and LVR or DTI limits would disproportionately affect first-home buyers and new borrowers without affecting investors. I think this is a case where again we needed to be a little bit careful but let's agree with the objective and think about what the appropriate policy tool is given the particular circumstances rather than running to a tool, which brings me to climate.

First of all, I just wanted to respond to Mr. Doornbosch and stress that the Australian authorities are committed to their commitments under COP21. The issue in Australia is how to get there, and that, speaking personally, an economist would say that the current path is relatively expensive, but that is a choice that authorities make often on a whole range of policies. I think we have to be a little careful. For example, carbon tax or an ETS are a way to get there rather than the objective.

Second, it is not true that there is not a carbon price in Australia. Indeed, in Australia there are many carbon prices, and that may actually be the policy issue.

The third comment that I would make is that Australia is a federation, and there is a lot of activity on climate change that occurs at the state level. This is a point Ms. Pollard made in the U.S. context last year very well, and it is something which the mission team have pointed to in their report, and I think that is why they are going with the recommendations that they are.

The third thing is that the private sector is also relevant here, and they may well and are in taking mitigation measures themselves. I think it is a more complex and nuanced situation than some might have suggested, and I just wanted to correct that. That said, as everyone has commented, it is not straightforward, partly because of the nature of Australia.

Australia is a large country. It is roughly the same size as the lower 48 in the United States with 25 million people. So Canadians nearly all live within a 100 kilometers of the U.S. border. Australians, more than 85 percent of them live within 50 kilometers of the coast, probably for similar reasons that Canadians live where they live. It means that, for example, Australia does not have one energy grid, but the eastern seaboard energy grid is the longest energy grid in the world; and therefore the fact that Australia has managed the transition to a large amount of distributed generation in the last few years is actually an engineering success and something that is not always picked up. The other thing about it is it means that Australia has relative transport intensity. The Sydney-Melbourne route is the second largest passenger route in the world. The Brisbane-Sydney route is in the top 20, and we have the largest per capita road network in the world, most of which is not sealed, and that brings with it all sorts of issues around transport. That is just to mention one thing that needs to be taken into account.

I think this is a very complex field, and I want to stress that the Australian government remains committed to its COP21 commitments. The question is how they get there and what is beyond, which is also an active debate both publicly and in policy circles. This chair strongly supports the development of a guidance note, and we are glad to hear it is on track.

I wanted to repeat my thanks to Mr. Finger and the team for what was a very successful staff visit and ongoing engagement. The engagement post the staff visit has been complicated by events, and I think the team is to be commended on how they have handled that and tried to get the position on where Australia is to the Board in the most up-to-date manner possible, and I think they should be congratulated on that. I would just like to take this opportunity, because I did not get to do it last time because he had not announced that he was going, is to thank the previous mission chief, Thomas Helbling, with whom I worked very closely over the last 30 years or so, and he did an absolutely outstanding job on Australia in my experience and also was just a tremendous person to engage with, and he was very patient in explaining to me some macroeconomics that I probably should have known better about. But he explained it very patiently in his very, very gentle and considerate way, and I was very, very grateful for that. So thank you.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the sound macroeconomic management and strong policy frameworks, which have underpinned the resilience of Australia's economy. Nevertheless, Directors noted that downside risks to the near term economic outlook remain elevated and have recently increased amid the coronavirus outbreak. Directors expressed sympathy for the devastating effects of the droughts and bushfires.

Directors highlighted that the near term macroeconomic policy mix should remain accommodative. They welcomed the expansionary fiscal policy stance in FY2019/20, driven by tax cuts and additional infrastructure spending. Considering Australia's output gap and substantial fiscal space, Directors generally recommended that a contractionary fiscal stance expected in FY2020/21 should be avoided, including by maintaining state level infrastructure spending at current levels. However, some Directors underscored the need to preserve fiscal buffers to guard against potential downside risks.

Directors supported the current monetary policy stance. They highlighted that maintaining data dependent accommodative monetary policy will be helpful to support the recovery of domestic demand. Directors agreed that, should downside risks materialize, the authorities should be ready for a coordinated response, including using fiscal stimulus jointly with both conventional and unconventional monetary policy measures.

Directors agreed that the current macroprudential policy stance remains appropriate. Given the risk of renewed overheating of housing markets in a low interest rate environment, they encouraged the authorities to continue improving the readiness of their macroprudential toolkit.

Directors welcomed that Australian banks remain adequately capitalized and profitable. They supported the authorities' plans to further enhance banks' loss absorbing capacity and implement the recommendations made by the Hayne Royal Commission. Directors emphasized that reform priorities should include encouraging a further lengthening of the maturity of banks' wholesale funding, implementing the APRA Capability Review's recommendations, reinforcing financial crisis management arrangements as highlighted in the 2018 FSAP, and strengthening the AML/CFT regime.

Directors underscored that housing supply reforms remain critical for restoring affordability. They highlighted the importance of more efficient long term planning, zoning, and local government reform, along with a focus on infrastructure development.

Directors encouraged the authorities to step up structural reforms to support strong and inclusive growth. Reform efforts should focus on strengthening business investment, supporting SMEs' access to finance, pursuing product market deregulation, and introducing well targeted tax incentives. Further increasing infrastructure spending, while focusing on the quality of investment, would also help boost potential growth. Directors recommended steps to promote innovation, increase full time female employment, and reduce youth underemployment. They welcomed the authorities' efforts to support cooperation in international trade and investment. Directors generally encouraged the authorities to develop an ambitious, national, integrated approach to energy policy and climate change taking into account domestic political economy considerations. This would help reduce policy uncertainty and catalyze business investment in Australia.

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

Australia is an Article VIII member, and no decision is proposed. The 2019 Article IV consultation with Australia is hereby concluded.

APPROVAL: August 20, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***Could staff elaborate on the different scenarios of the coronavirus epidemics and the channels through which the Australian economy would be impacted?***

- The primary impact of the coronavirus outbreak appears to be a drop-in tourism arrivals and potentially education services for Chinese students, due to travel restrictions between Australia and China. Staff's baseline projection incorporates an estimate of these effects based on the information available as of early February. If the outbreak prolongs, the negative growth impact would be larger.
- The outbreak is also expected to lead to a near-term decline in Chinese demand, likely affecting Australia's merchandise exports. In particular, a drop in Chinese demand for iron ore, coal, and LNG could negatively affect Australia's commodity export volume and terms of trade. By contrast, potential disruptions in global supply chains would be expected to have a relatively smaller impact on Australia given its limited integration with the global supply chains.

2. ***The staff report offers some limited discussion of the coronavirus outbreak on the Australian economy. We appreciate that the situation was still developing at the time that the papers were finalized, and that it remains fluid. Australia is clearly exposed to significant potential spillover effects, including reduced demand for its commodity exports, falling tourism, and impacts on its higher education sector. Some commentators have suggested that, coupled with the economic impact of the bushfires, Australia's unbroken run of economic growth could be put at risk. We would be grateful for staff's assessment of this in the context of recent developments.On the domestic front, we appreciate staff's update on the economic impact of the wildfires and on how this tragedy has affected the outlook.***

- The authorities have estimated that the bushfires would reduce GDP by about 0.2 percentage points in 2019:Q4 and 2020:Q1, which is in line with staff's assessment and reflected in the report. Staff also agrees that rebuilding efforts, partly supported by the National Bushfire Recovery Fund and other spending such as A$1 billion by New South Wales for local infrastructure, would boost growth later in the year and continuing into 2021.
- Staff has marked down growth by 0.1 percentage point in 2020 on account of economic consequences of the coronavirus outbreak, based on information available

in early February 2020. This is reflected in the Staff Report. The projection will be reassessed as more clarity about the severity of the outbreak emerges.

3. ***Australia has also been confronted with extreme weather events recently, adversely and significantly impacting economic developments, as the statement of Mr. Ray, Ms. Johnson, and Ms. Park highlights. Here we do not fully agree with staff who qualify adverse weather conditions as "domestic" (vs. "external") in the Risk Assessment Matrix (p.48). We believe, in line with the GRAM, that climate related shocks can be considered external. Staff's comments would be welcome.***

- Staff would characterize adverse weather conditions affecting the current drought and bushfires that are mentioned in the Risk Assessment Matrix as predominantly domestic risks. That said, broader and related risks raised in the G-RAM, such as a higher frequency and severity of natural disasters, clearly have a global component in the context of climate change.

4. ***We are wondering about staff's estimates for the output gap which – according to staff – has been negative ever since the global financial crisis in 2009. Given the overall solid and resilient performance of the Australian economy over the past decade, this appears questionable. Overall, we would tend to give some more weight to the influence of structural adjustments in the labor market related to the end of the mining investment boom and subdued productivity growth when explaining lower GDP growth rates and a somewhat higher underemployment rate than before 2009. Additional staff comments on this matter would be welcome.***

- Staff uses a multivariate filter model to estimate Australia's potential output, against which the output gap is measured. The model incorporates subdued total factor productivity growth since the early 2010s and a pickup in recent years in employment growth due to higher labor force participation.
- Our estimate suggests that the negative output gap emerged post-GFC and widened as a result of the end of the 2012−14 mining investment boom. The gap narrowed during 2015−18 but widened again in 2019 mainly due to below-trend growth. Staff's estimate of the output gap also accounts for the persistent and higher level of underemployment and continued below-target-range inflation in the last few years.

Fiscal Policy

5. ***A couple of major downside risks to short-term growth have emerged in the last couple of months, and the authorities have already begun to announce fiscal measures in response. Could staff offer an updated assessment of the likely fiscal trajectory over the next year, and their views of the latest fiscal measures put in place by the authorities?***

What is the likely impact of the bushfires, and the associated establishment of a A$2 billion National Bushfire Recovery Fund, on the Commonwealth and State finances in 2020?

- The two main changes in the fiscal trajectory are:
- The bushfires, which have added close to 0.2 percent of GDP to spending at the Commonwealth (the National Bushfire Recovery Fund of A$2 billion, to be spent over 2020 and 2021) and state levels (A$1 billion in New South Wales for infrastructure reconstruction, to be spent over 2020 and 2021). These are accounted for in the staff's baseline forecasts.
- Increased uncertainty around corporate income tax collection, but with no changes to the baseline forecast at this point. Firms may have fewer taxable profits, depending on the extent of the impact of the coronavirus outbreak on China's economy and its imports of Australian iron ore and coal.

6. ***Since capacity constraints around infrastructure investment have persisted, we would appreciate staff's clarification on how the authorities plan to address these constraints.***

- The different State governments, as well as the Commonwealth, have held discussions on the sequencing of projects to reduce the need for the same resources in different locations. These discussions have also encouraged the continued use of public-private partnerships at the state level, especially in New South Wales and Victoria. Plans for some projects have also been reworked to minimize delays in project execution.

7. ***We wonder what would be the Commonwealth leeway to leverage public investment at the state level?***

- The Commonwealth government carries out infrastructure projects that are across states or can contribute to the existing City Deals (such as that for the Western Sydney development, which includes a new airport). The Commonwealth can bring forward or speed up certain projects. In such cases, it needs to coordinate with the states and be mindful of actual or potential capacity constraints.
- States themselves can increase their own public investment envelopes, especially in the larger states such as New South Wales and Victoria, which have significant needs (in the expanding cities of Sydney and Melbourne) and strong budgetary positions.

8. ***With regard to tax reforms, other alternatives may need to be considered given that both the proposal to broaden the GST base and reduce CIT for large firms have***

already been turned down by the current Parliament. Staff's comments are welcome.

- The reduction of CIT rates was defeated during the previous parliament. It has not been rejected by the current government (Prime Minister Morrison was Treasurer during the previous attempt), so the government could revisit this issue. Staff acknowledge the political difficulties in broadening the GST base, including that it will require agreement with the states and that adverse distributional consequences should be addressed.

9. ***Can staff elaborate on instances where tax incentives have had the desired effects without creating distortions in the long-term?***

- While the international experience with tax incentives is generally mixed, they can be effective particularly in advanced economies and if targeted at small and new firms, for example in Canada, the Netherlands, Norway, and the United Kingdom (Fiscal Monitor, April 2016). Studies point to generally better results in countries with stronger investment climates and highlight the benefits of administering tax incentives in a transparent manner, closely monitoring the amount of foregone revenue, and carrying out periodic reviews of the incentives' effectiveness.

Monetary and Exchange Rate Policies

10. ***Could staff clarify recent inflation trends, elaborating on core inflation developments and on the evolution of inflation with and without including changes in housing prices?***

- CPI inflation excluding volatile items has hovered below 2 percent since 2016 and stood at 1.7 percent as of 2019:Q4. Inflation in the housing component, which mainly comprises new dwelling purchases and rent, has been well below average inflation, although this has begun to unwind in the last quarter. Inflation excluding the housing component was around 2.2 percent in 2019:Q4, above headline inflation of 1.8 percent.

11. ***We support staff's call for further monetary easing in case high-frequency data confirm the decline of inflation. Has staff evaluated the forward guidance of the RBA and provided recommendations?***

- Australia has used forward guidance effectively as a monetary policy tool since the GFC, clearly laying out in its "Statement of Monetary Policy" its reasoning for its decisions, and whether it has a bias towards raising or lowering interest rates in the future. While the RBA currently assesses that "monetary policy is very likely to remain accommodative for some time," staff has discussed with the authorities options for strengthening such guidance in case downside risks materialize, potentially including calendar- or outcome-based guidance.

12. ***While staff recommends UMP should focus on measures that affect the short end of the yield curve, the report lists quantitative easing as one of the main policy options. We wonder whether QE could be an effective way to lower short-term interest rates. Moreover, Australia's relatively limited amount of government securities outstanding thanks to its fiscal soundness could limit the extent and impact of QE. We would welcome staff's elaboration on this point.***

- If needed in a downside scenario, UMP would likely be most effective on the shorter end of the curve, as both consumer (mortgage) and corporate debt tend to be on variable interest rates. In addition to quantitative easing, which can be effective if targeted at relatively short maturities though may not be practical at the very short end of the curve, staff discussed with the authorities options such as mildly negative policy rates and targeted conditional lending operations to banks. The precise policy option would likely depend on the nature of the shock, and the fact that there is only a limited amount of government securities for purchase would be part of any concrete policy considerations in a downside scenario.

Financial Sector

13. ***On staff's suggestion to prepare for potential use of loan-to-value and debt-to-income limits, we wonder (i) what are the potential distributional effects of using such limits, particularly given housing affordability is already an issue for some cities; and (ii) how do these measures compare to those already in the authorities' toolkit (e.g. limits to the growth in higher risk loans) which have been quite effective in reinforcing sound lending practices and bringing down risks?***

- Instruments such as loan-to-value and debt-to-income limits could have a wider impact relative to tools such as caps on interest-only or investor loans, as the latter forms of lending have so far not reemerged markedly in the current upswing.
- While we have not studied potential distributional consequences of macroprudential policies in detail, it is conceivable that loan-to-value or debt-to-income limits could disproportionally affect people in relatively lower income or wealth quantiles.
- Measures to improve housing affordability could help mitigate the potential distributional effects of such limits. The authorities are operating programs to help first home buyers through first-home buyers' grants and a new First Home Loan Deposit Scheme that provides loan guarantees to lenders.

14. ***We note that steps are also being taken to address emerging climate risks in the financial sector. Do the stress tests applied to the banking system include climate-related risks?***

- APRA will transition to annual industry stress testing for large authorized deposit taking institutions from 2020 (from previously a comprehensive industry stress test conducted on a three-year cycle). A key supervisory initiative for 2020 is to develop a climate change stress test, as part of APRA's actions to both uplift stress testing capabilities and strengthen the financial sector's understanding and management of climate change financial risks.

15. ***We would like to hear staff's view on whether the insurance claims filed as a result of the recent bushfires will have any impact on the solvency and stability of the insurance sector in Australia.***

- Insurance claims related to the bushfires are expected to rise beyond A$1.7 billion based on estimates from the Insurance Council of Australia. To put this into context, the hailstorms in Sydney and NSW in late December 2018 generated insured losses of A$1.4 billion and the Townsville flooding in early-2019 resulted in losses of A$1.3 billion.
- Preliminary assessments by rating agencies suggest that Australian insurers should be able to withstand losses from the 2019/2020 bushfire season, aided by strong capital positions and support from reinsurance protection.

16. ***As a lack of competition seems to be part of the problem, we would welcome a further examination of the institutional and market factors favoring household and housing loans.***

- Australian banks have oriented their business model towards real-estate lending in recent decades, with residential mortgage forming about 60 percent of loans. One contributing factor is the slower business investment growth in the post-GFC period and hence the overall lower demand for business credit. In addition, factors such as the pronounced increase in housing prices in the 2010s, the predominately variable interest rate structure in housing credit, and collateralized lending imply that housing loans are of relatively lower risk and higher profitability.

Housing Markets

17. ***The report identified downside risks both to falling and to rising prices in the sector, which leaves us questioning what policy options are appropriate where changes in prices in either direction add to risks.***

- Both rapidly falling and rising housing prices can exert risks to macrofinancial stability. The amplification of the economic impact of shocks through household debt channels and the adverse feedback loops between real estate values, bank loan portfolio, and economic activity could be issues of concern. Macroprudential policy could play an active role in addressing emerging financial stability risks.

- In this context, in case of rapidly rising housing prices, macroprudential policies should tighten while in the case of rapidly falling housing prices, they should be relaxed as deemed appropriate. At the current juncture, macroprudential policy is appropriate in Australia, and the authorities should stand ready to tighten should excessive risk-taking behavior emerge.

18. ***While the authorities are committed to improve house affordability, their efforts appear focused on rental subsidies and financial support to first-time home buyers. Can staff provide more details about the authorities' plan for supporting housing supply?***

Regarding existing rental subsidies and their potential impact on rents and housing prices, we wonder whether Australia should not focus more on the supply of social housing and whether staff has recommendations from international good practices.

Could staff offer perspectives on the policy actions planned to address housing supply?

- The Government's plan for housing affordability includes measures to unlock supply, create the right incentives, and improve outcomes for those most in need. A variety of measures were announced as part of 2017−18 and 2018−19 budgets to improve outcomes across the housing spectrum.
- Measures to boost the supply of housing include providing A$1 billion through the National Housing Infrastructure Facility (NHIF) to fund critical infrastructure that will speed up the supply of housing, releasing suitable Commonwealth land for housing development and specifying housing supply targets in a new National Housing and Homelessness Agreement (NHHA) with the states. The National Housing Finance and Investment Corporation (NHFIC), set up in 2018, operates the Affordable Housing Bond Aggregator to provide long-term, low-cost finance for housing providers to increase affordable rental housing.

19. ***Can staff shed light on the impact of the "City and Regional Deals" initiative on housing supply to date?***

- Housing has been a priority in City and Regional Deals, partnerships between Commonwealth, state, and local governments to improve transport infrastructure. Seven City Deals and one Regional Deal have been signed since 2016, and six more (four City and two Regional) are currently under preparation. Given long planning and development lags, the first reviews of the City Deals initiative are due to commence this year.

20. ***Staff reiterate their assessment that certain housing policy measures discriminating against non-residential buyers, such as state-level foreign purchaser duty surcharges on residential property, are capital flow management measures under the IMF's Institutional View and should therefore be replaced by alternative, non-discriminatory measures. Given these measures have now been in place for some time, we would welcome analysis from staff on their impact on housing affordability.***

- Limited data availability on housing transactions by non-residential buyers constrain a systematic analysis to quantify the impact of foreign demand on house price acceleration. That said, the current upswing in prices does not appear to be driven primarily by foreign demand. Housing affordability and underlying housing shortages should ultimately be addressed through housing supply measures.

Structural Reforms

21. ***In addition to the elements discussed in the report, has staff assessed the adequacy and efficiency of social spending in Australia?***

- According to OECD data, Australia's public education spending (4.8 percent of GDP) is close to the OECD average, while education outcomes as measured by PISA test scores are slightly higher than the OECD average.
- Australia's public health spending (9.1 percent of GDP) and health outcomes as measured by life expectancy are slightly higher than the OECD average.
- Australia's public spending on income support to the working age population (4.3 percent of GDP) and social services (excluding health) (2.8 percent of GDP) are slightly higher than the OECD average (4.0 percent of GDP and 2.3 percent of GDP, respectively).

22. ***We note that Australia´s unemployment rate exceeds the NAIRU and remains relatively high after an exceptionally long period of positive growth. However, it seems that the unemployment rate is elevated not due to less job offerings, but thanks to increased labor participation, which is near record high levels. Could staff explain the reason behind these developments?***

- Rising labor force participation by female and elderly workers has contributed significantly to Australia's strong employment growth. According to research by the RBA, the rising female labor force participation may reflect working mothers' need for additional sources of income, their desire to develop career and skills, and improved access to childcare. The rising labor force participation by the elderly could be due to improved health and ongoing increases in the retirement age of the pension system.

23. ***Have staff considered other possible labor market frictions contributing to involuntary part-time employment and discussed with the authorities appropriate mitigating measures?***

- In previous discussion with authorities, staff noted frictions such as skill mismatches that hinder the adjustment of reallocation of labor. Staff also noted that active labor market policies for labor force re-education and skill upgrades are funded at relatively low levels. Efforts are under way to secure long-term funding, including through a levy proposed to maintain the Skilling Australians Fund. The education system should also support the transition toward non-mining sources of growth, at a rate commensurate with the needs of the growing population, with needed updates in labor force skills underpinned by long-term strategies and longer-dated resource commitments.

24. ***Around one year since the Comprehensive and Progressive Agreement for Trans-Pacific Partnership has come into force, could staff comment on the agreement's economic impact on Australia?***

- The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) covers over 10 percent of global GDP and, in addition to merchandise trade, also advances integration in areas such as services and digital trade. The CPTPP came into effect at the end of 2018 for an initial group of seven countries, including Australia, while four other countries are still seeking domestic approval.
- Based on preliminary data, Australia has experienced an increase in trade with some CPTPP partners in 2019. For example, Australia's merchandise exports to Vietnam grew by 21.6 percent in 2019 (compared to 13.7 percent overall). That said, many other factors may have contributed to this result and, with only one year in force, it is still too early to fully assess the CPTPP's impact.

25. ***Could staff give us an update on the authorities' diversification strategy and smooth reorientation towards new trading partners, which were discussed during the last Article IV consultation?***

- In addition to Australia's participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, staff welcomes the authorities' pursuit of the Regional Comprehensive Economic Partnership (RCEP), which is being negotiated between Australia, China, Japan, Korea, New Zealand and the 10 members of ASEAN. The RCEP aims to liberalize trade, improve quality and environmental standards, and foster labor mobility throughout much of Asia and the Pacific.

26. ***While staff has highlighted diversification of domestic economies for growth, we would like to hear more from staff on the impact of diversification of investment sources, trading partners and supply chains. We invite staff comments.***

- Australia's trade and investment linkages have been evolving. In particular, China's share in Australia's foreign trade has increased from 10 percent in 2005 to 30 percent in 2018. Although Australia's participation in global value chains is relatively limited, it contributes through resource exports to China. Foreign direct investment to Australia continues to be dominated by advanced economies, although investment from emerging economies such as China, Malaysia and Thailand has been gradually growing over the past ten years.

Climate Change

27. ***The buff has emphasized Australia's commitment to the Paris Agreement, to reduce global emissions to mitigate the risk of climate change and to meet 2030 commitments. Nonetheless, Staff has assessed uncertainty around the climate change mitigation and recommended an ambitious, national, integrated approach to energy policy and climate change. Noting this divergence and against the backdrop of the bushfires, we would have liked to see a deeper analysis of the economic dimension and holistic climate action, including a peer comparison on climate action. Staff comments are invited.***

- Australia is a resource- and carbon-intensive economy and among the ten largest greenhouse gas emitters in the OECD, accounting for more than 1 percent of projected global greenhouse gas emissions. Following earlier reductions, emissions have been gradually rising again in recent years, and Australia decided to apply a carryover from past overperformance to its 2030 Paris emissions target, enabling the country to meet its target on a decline in emissions by cumulatively 4 percent from projected 2020 levels.
- Among other climate change mitigation policies, Australia has put in place successful incentives for solar power generation, operates the Emissions Reduction Fund to incentivize mitigation initiatives, and invests in infrastructure that will allow for greater use of renewables in the power generation mix. That said, Australia currently does not operate or plan to put in place price-based measures such as a carbon tax or an emissions trading system. The public debate in Australia around the level of ambition in its climate change mitigation policies has added to policy uncertainty in the energy sector.
- The Fund is steering in the direction of greater coverage of climate-related policies in Article IV consultations, and staff guidance is currently under preparation that would enable staff to deepen the coverage of climate-change-related issues in an evenhanded way across the Fund membership.

28. ***We welcome the authorities' commitment to meeting the 2030 emission targets and the remarkable progress on the use of renewable energy. We would however appreciate some elaboration on the authorities' take to the call to develop a national integrated policy framework on energy and emission strategies. Staff comments are welcome.***

- State governments have separate energy and emissions strategies, and targets are not sufficiently integrated with the Commonwealth's plans. The authorities stressed their commitment in the area of climate change mitigation, projecting that Australia would meet the 2030 target. They acknowledged that policy certainty is important in the energy sector and noted that developments are under way to support new investment in the sector.

29. ***We wonder if the Fund's recent work relating to political economy challenges has provided insights to staff's policy dialogue with the authorities on topics such as how to tackle the obstacles to implementing tax reform and reduce uncertainty around Australia's climate change mitigation policies. Staff's comments are welcome.***

- Staff have included the political economy dimension in the policy discussions with the authorities. For example, while recommending broadening the GST base to make the tax system more efficient, staff recognized the potential adverse distributional consequences of the reform and emphasized making its impact less regressive, including by strengthening targeted cash transfers. For climate change policies, since carbon taxes could be difficult in light of political economy considerations, staff has proposed that other approaches could be explored, such as a "feebate system."

30. ***Using the spreadsheet tool of FAD, could staff assess the current carbon emission trajectory of Australia in a business as usual scenario, compare it with an emission trajectory compatible with keeping global warming under 1.5 degrees Celsius (under fair burden sharing assumptions) and discuss policy gaps to reach such a goal?***

- Noting that model predictions are subject to significant uncertainty and rely on a number of assumptions, using the spreadsheet model, the October 2019 Fiscal Monitor estimated that a carbon tax rate of $75 per ton—which could lead to 2°C warming if applied globally—could reduce Australia's CO_2 emissions by 30 percent in 2030 compared with a business-as-usual scenario. The 1.5°C warming would require a higher carbon tax rate.

31. ***We support staff's efforts on evaluating climate change policies and would welcome more details on the growth implications of the global transition to a less carbon-intensive energy mix on the Australian economy.***

- As a commodity exporter, Australia is exposed to shifts in global demand for fossil fuels. Australia is the world's largest exporter of metallurgical coal and second largest exporter of thermal coal and gas. In 2018, these three exports account for over one-quarter of goods and service exports and around 6 percent of GDP. Declining demand and prices for coal and LNG would negatively affect the mining industry, economic growth, exports, and fiscal revenue. Australia's dynamic and diversified economy, a flexible exchange rate, and significant fiscal space would be among the mitigating factors.