October 2010
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Australia: 2010 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Australia, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 19, 2010, with the officials of Australia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 12, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 27, 2010 discussion of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

AUSTRALIA

Australia: Staff Report for the 2010 Article IV Consultation[1]

Prepared by Staff Representatives for the 2010 Consultation with Australia

Approved by Mahmood Pradhan and Tamim Bayoumi

October 12, 2010

Key Issues and Recommendations:

- ***Context:*** Australia avoided a recession in 2009 and is recovering on the back of a substantial policy stimulus and strong demand for its mining exports, especially from China.
- ***Growth prospects:*** Real GDP growth is projected to recover to 3–3½ percent in 2010 and 2011, led by commodity exports and investment in mining. Risks are tilted largely to the downside, as the global recovery could stall or renewed financial turmoil could raise the cost of capital. An upside risk is that the mining boom has a larger-than-expected impact on output and inflation.
- ***Focus:*** The discussions centered on the appropriate pace of exit from macro stimulus, managing the mining boom, and addressing vulnerabilities related to household and external debt.
- ***Exit from stimulus:*** Given that a recovery is underway, the mission supported the increase in policy interest rates since late 2009 and planned return to a budget surplus by 2012/13. Ample scope exists to slow the pace of exit or loosen policies in response to a downside scenario.
- ***Managing the mining boom:*** The growing dependence of the economy on mining may amplify the business cycle, which implies that the automatic fiscal stabilizers should be allowed to operate fully. Larger budget surpluses should be run than in the past to help avoid potential overheating and build a buffer against a sharp fall in commodity prices.
- ***Financial sector vulnerabilities:*** The authorities should encourage banks to improve their stress tests and lengthen the maturity of their offshore funding.
- The de facto exchange rate arrangement is free floating (see accompanying Informational Annex).

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[1] This report is based on discussions during July 9–19, 2010, with RBA Governor Glenn Stevens, Treasury Secretary Ken Henry, other senior officials, and representatives from labor unions, financial, and business sectors. The team also held a teleconference call with Treasurer Wayne Swan in September to discuss fiscal policy after the August 21 election. The team comprised Mr. Brooks (head), Mr. Hunt, and Ms. Tumbarello (all APD), and Mr. Bologna (MCM). Mr. Legg (OED) participated in the discussions.

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I. What Explains the Resilience of the Australian Economy to the Global Crisis

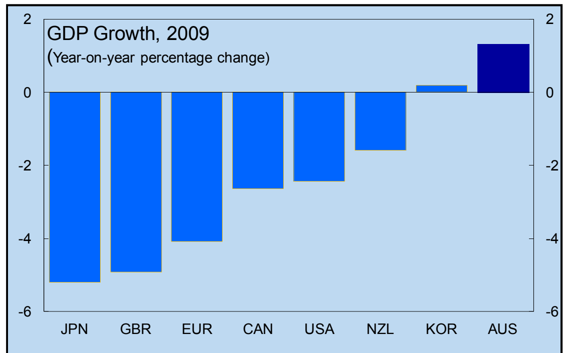
1. **Australia was one of the few advanced economies to escape recession in 2009** (text figure). This reflected growing links with Asia, including strong demand for commodities from China and India, a prompt and significant macro policy response to the global crisis, a healthy banking sector, and a flexible exchange rate (Table 1, Figure 1).

2. **Australia was in a strong position at the onset of the global recession.** Sound macroeconomic policies and structural reform secured 17 years of continuous growth. Unemployment was at historical lows and inflation expectations were well-anchored.

3. **Exchange rate flexibility provided a buffer.** The Australian dollar depreciated sharply at the onset of the crisis as commodity prices fell and risk aversion jumped. Subsequently, the currency appreciated in real effective terms by 35 percent between March 2009 and September 2010, as commodity prices recovered and interest rate differentials widened (Figure 2). Australian financial markets have also largely recovered from the global crisis.

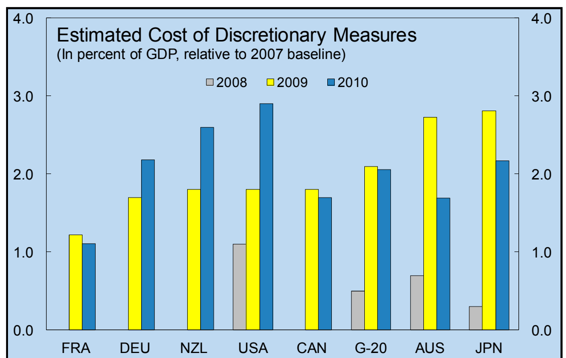
4. **Monetary policy reacted promptly.** In response to the global crisis, the Reserve Bank of Australia (RBA) cut its policy rate from 7¼ percent to 3 percent over the seven months to April 2009. The transmission of monetary policy was very effective, in contrast with some other advanced economies, as the cuts were largely reflected in mortgage and business lending rates.

5. **Fiscal policy also supported activity.** The Commonwealth government ran budget surpluses of around 1–1¾ percent of GDP in



Sources: WEO; and IMF staff calculations.

the six years before the crisis that eliminated its net debt. With considerable fiscal space, the government reacted quickly to the global crisis by providing a fiscal stimulus of 4⅓ percent of GDP in the two years to June 2010, above the G-20 average (text figure). The operation of the automatic stabilizers, in particular the decline in revenue, together with the stimulus, shifted the budget into an underlying cash deficit of about 4 percent of GDP in 2009/10 (Table 2).

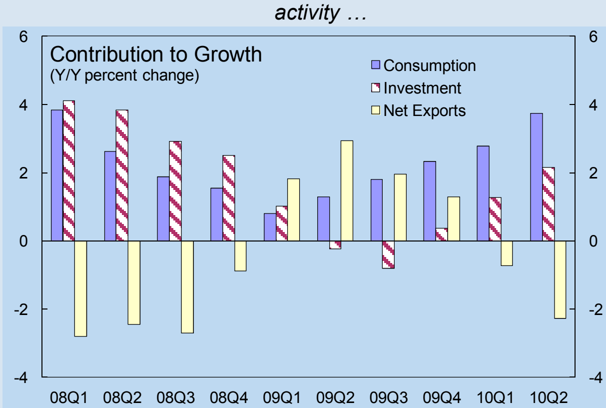


Source: IMF staff estimates.

6. **Australian banks were resilient to the global crisis.** Banks have remained profitable with adequate provisioning and sound asset quality, as nonperforming loans rose to less than 2 percent of assets (Figure 3). Capital adequacy has improved to about 12 percent, after banks raised private capital. The "four pillars policy," which does not allow the four large banks to merge, together with sound regulation and supervision, played a role in limiting risky behavior before the crisis and helped maintain stability, with the Council of

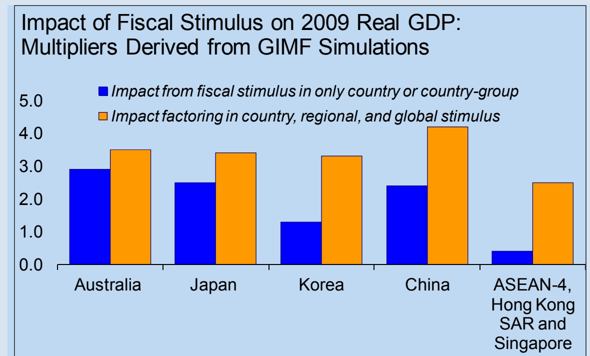
Figure 1. Australia: Resilience to the Crisis

Australia experienced only a mild slowdown in economic activity …



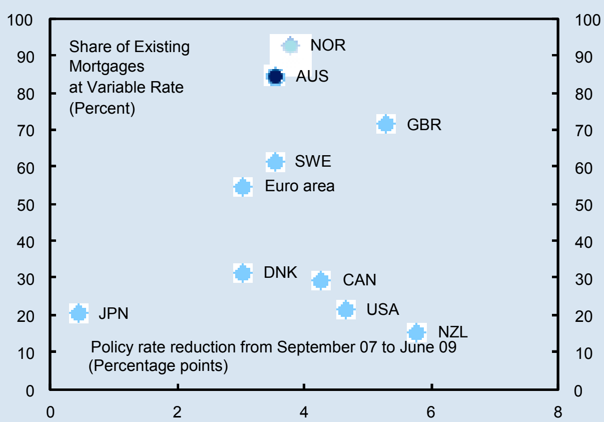
Source: Australian Bureau of Statistics.

… thanks to a substantial fiscal stimulus …

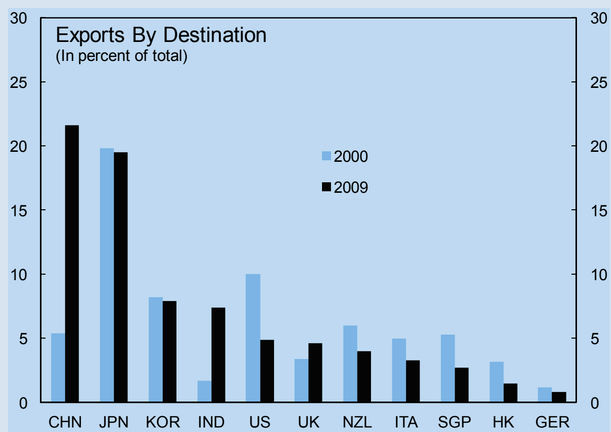


Source: IMF staff estimates.

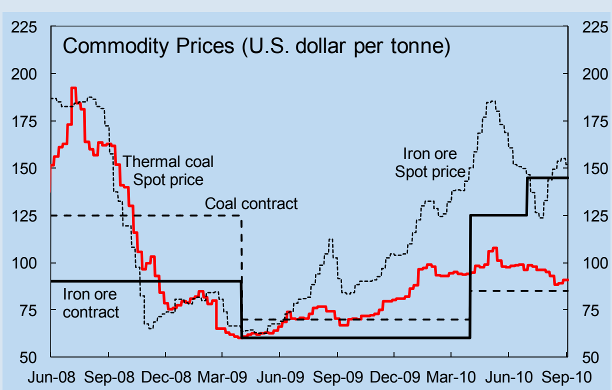
… a 425 bps cut in monetary policy rates which provided quick relief to households, given the dominance of variable-rate mortgages …



… and strong links to Asia where commodities demand held up…

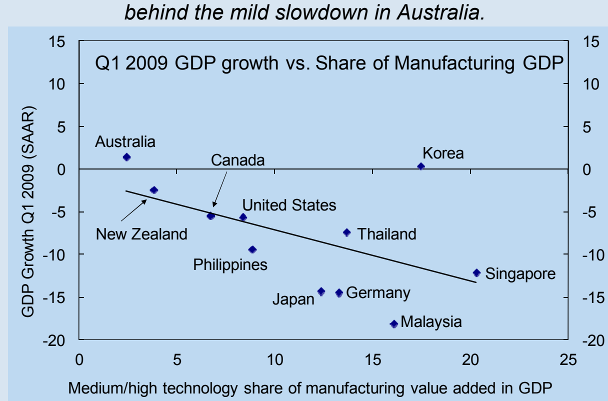


… drove a rebound in prices of two key commodity exports.



Sources: RBA; Bloomberg; and IMF staff estimates.

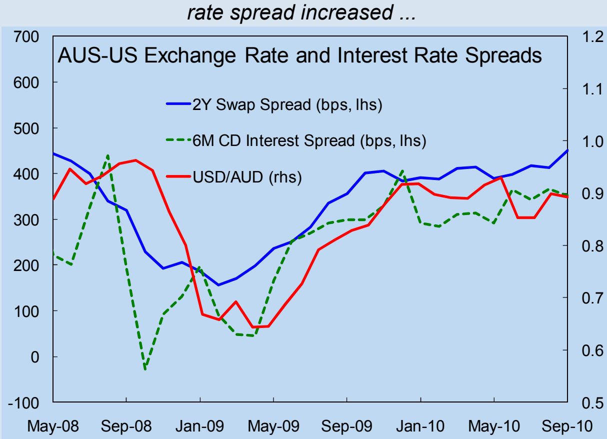
Limited dependence on manufacturing goods was also a factor behind the mild slowdown in Australia.



Source: UNIDO database.

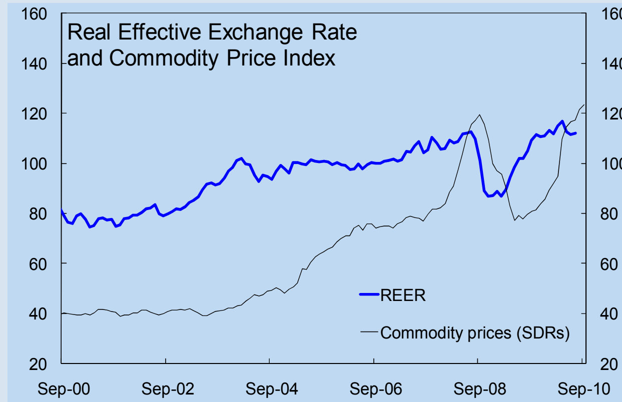
Figure 2. Australia: Exchange Rate and Financial Market Developments

The exchange rate appreciated since early 2009 as the interest rate spread increased ...



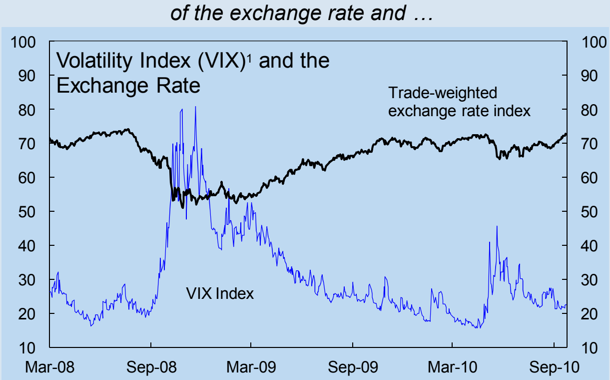
Sources: Bloomberg, Reserve Bank of Australia.

... and commodity prices recovered to near historical highs.



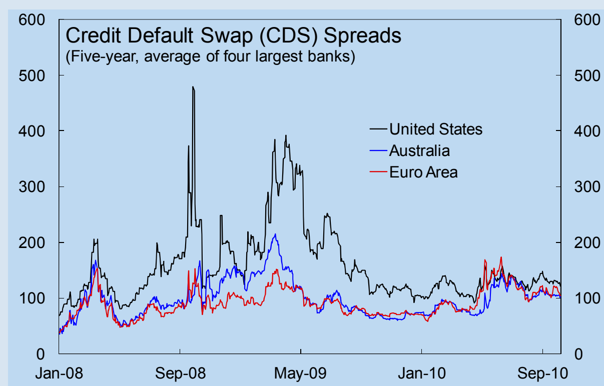
Sources: Bloomberg, INS

Greater risk appetite also contributed to an appreciation of the exchange rate and ...



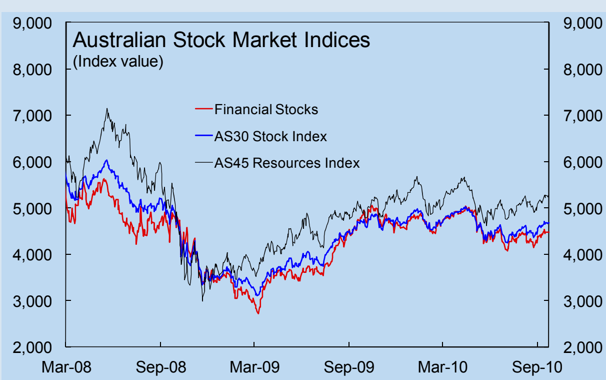
Source: Bloomberg.
1/ Chicago Board Options Exchange volatility index.

... bank CDS spreads narrowed.



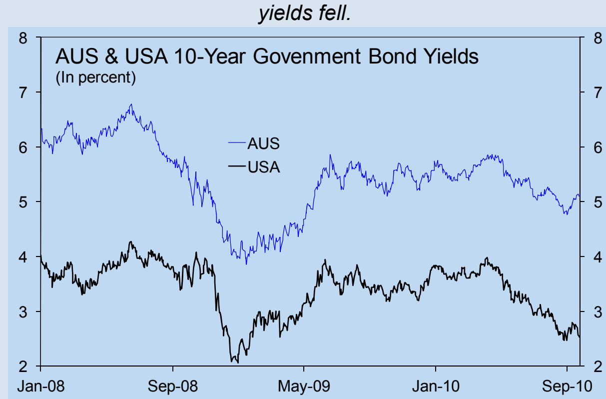
Sources: Reserve Bank of Australia; Bloomberg.

The stock market recovered since 2009.



Sources: Reserve Bank of Australia; Bloomberg.

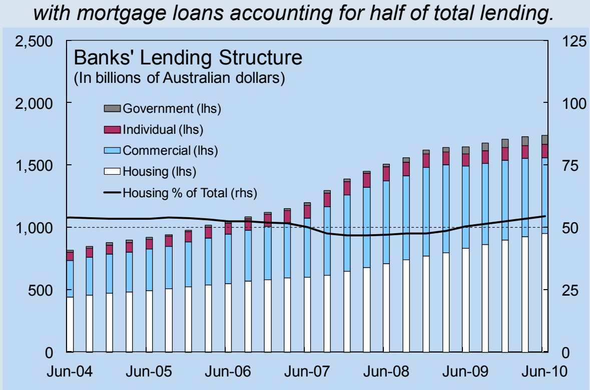
Australian bond yields have fallen since April 2010, as U.S. yields fell.



Source: Bloomberg.

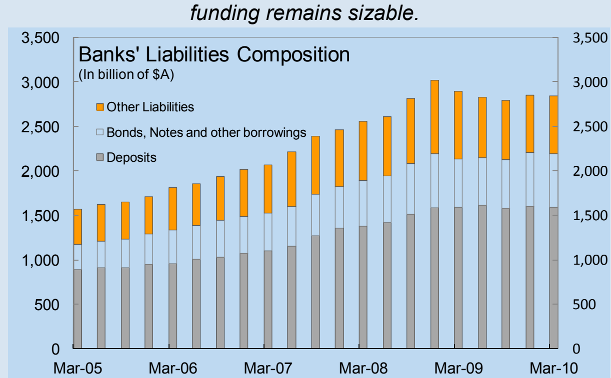
Figure 3. Australia: A Healthy Banking System

Banks' assets consist predominantly of credit, with mortgage loans accounting for half of total lending.



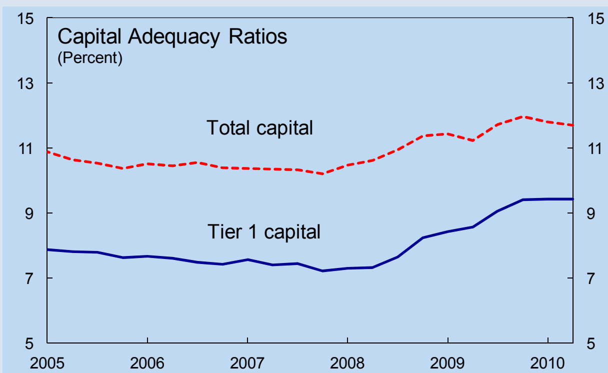
Source: Reserve Bank of Australia.

Banks' liabilities are mainly domestic deposits but wholesale funding remains sizable.



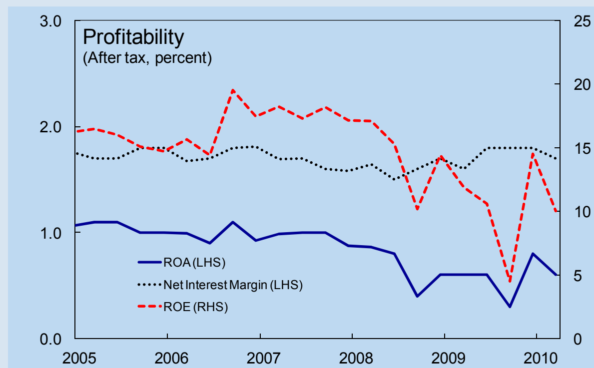
Source: Australia Prudential Regulation Authority.

Bank capital increased …



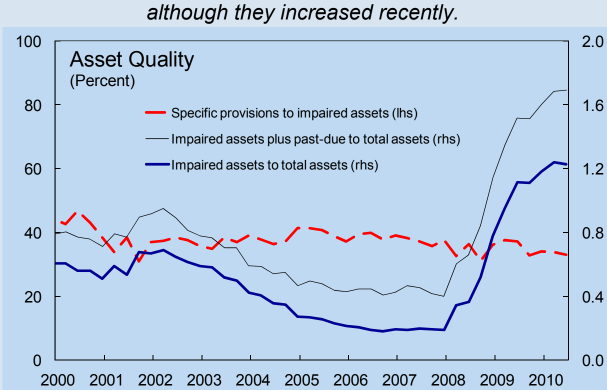
Source: Reserve Bank of Australia, APRA.

… profitability remains healthy…



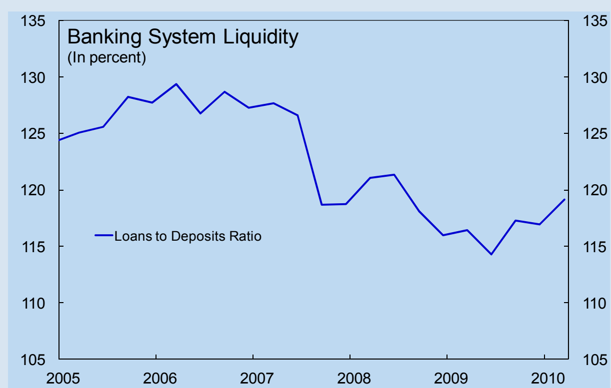
Source: Australia Prudential Regulation Authority (APRA).

… and impaired assets are low by international standards, although they increased recently.



Source: Reserve Bank of Australia.

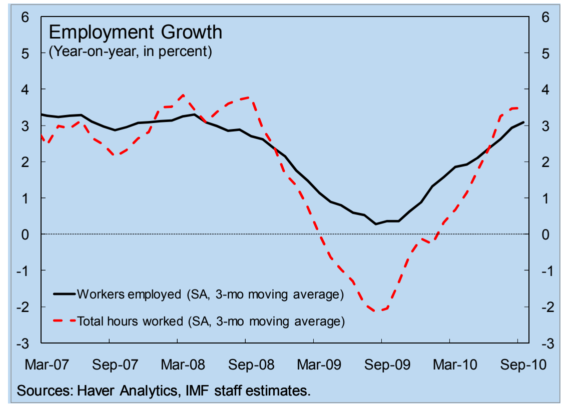
Banks' loans to deposit ratio fell.



Source: Australia Prudential Regulation Authority.

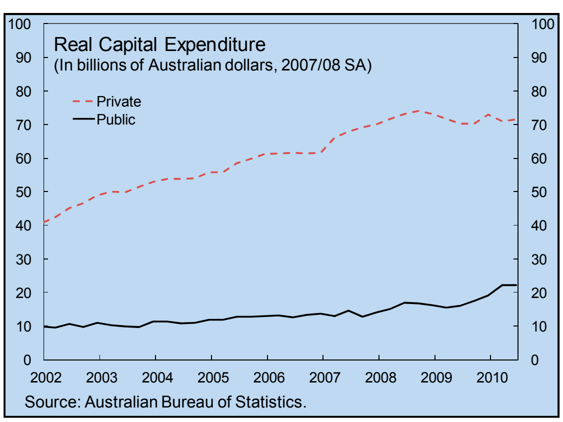
Financial Regulators coordinating the response of the main regulatory agencies to the global crisis. In addition, the government's Guarantee Scheme for Large Deposits and Wholesale Funding for banks introduced in late 2008 helped maintain access to funding. The guarantee was withdrawn for new liabilities in March 2010 as market conditions had normalized.

7. **The labor market proved to be flexible in the face of the shock.** Many employers reduced hours worked rather than laying off staff, given their recent experience of skills shortages. This resulted in a sharper fall in hours worked than employment, and tempered the increase in the unemployment rate, which peaked at less than 6 percent in mid-2009. Employment and hours worked have since rebounded.



A. The Mining Boom and the Beginning of Exit from Stimulus

8. **A mining boom is underway, as commodity prices have rebounded.** Prices for key exports, such as iron ore and coal, are expected to remain high in the near term, based on strong demand from China and India. Private sector investment in mining in recent years has risen, which, combined with public investment and a pickup in household consumption, underpinned activity in the first half of 2010.



9. **Early signs of Inflation pressure are starting to emerge**. While core inflation fell below 3 percent y/y in June 2010 and wage growth moderated, spare capacity is beginning to be used up with the unemployment rate falling to just over 5 percent (Figure 4).

10. **Monetary accommodation has been withdrawn**. In late 2009 it was evident that the economy was recovering and the RBA started to withdraw monetary stimulus, raising the policy rate to 4½ percent in six steps, the most recent in May (Figure 5). The increases in the policy rate have flowed through effectively to both mortgage and business lending rates which have returned close to their 10-year averages. With considerable uncertainty about the global economic outlook, the RBA has kept policy rates on hold in recent months.

Figure 4. Australia: The Re-Emergence of Inflationary Pressures

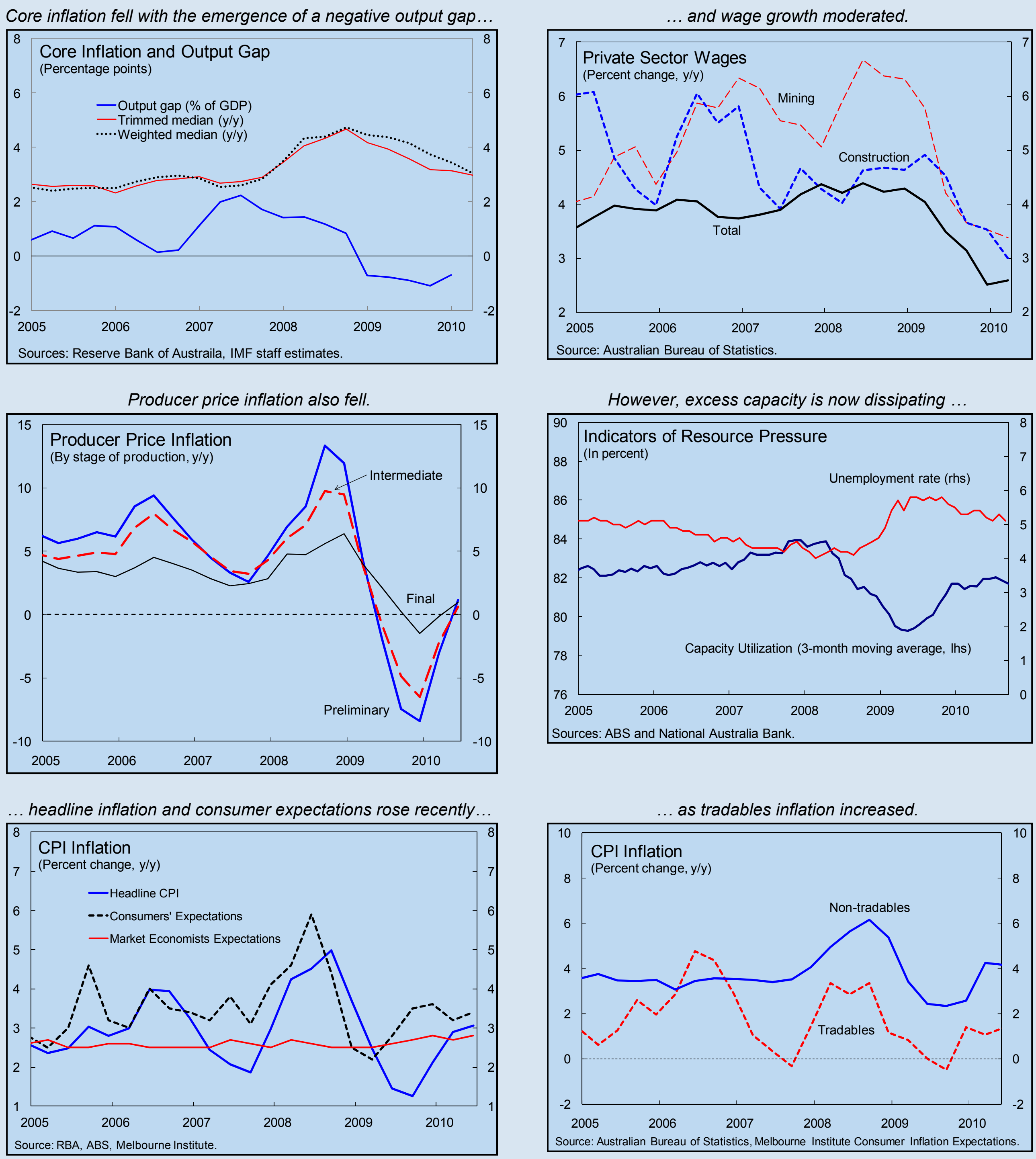
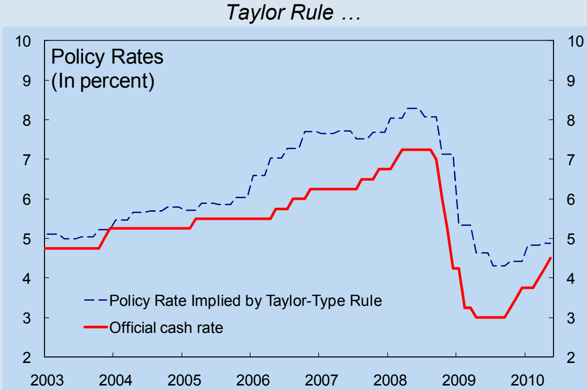


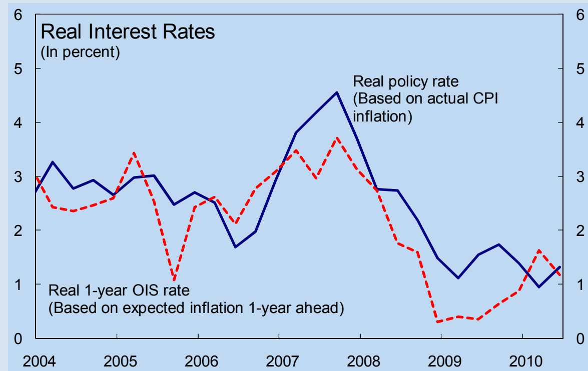
Figure 5. Australia: Withdrawing Monetary Stimulus

The policy rate has risen in line with an estimated Taylor Rule …



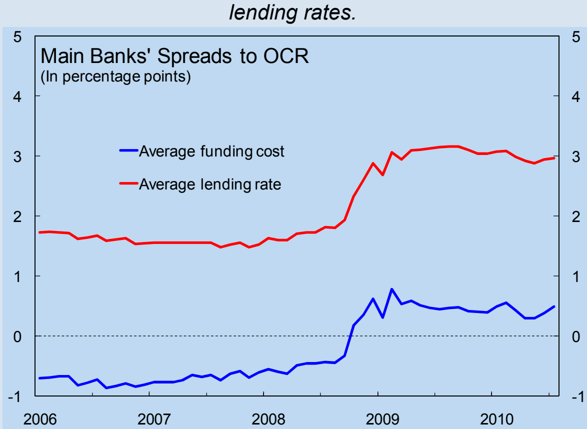
Sources: Reserve Bank of Australia, IMF staff estimates.

… stabilizing real policy rates.



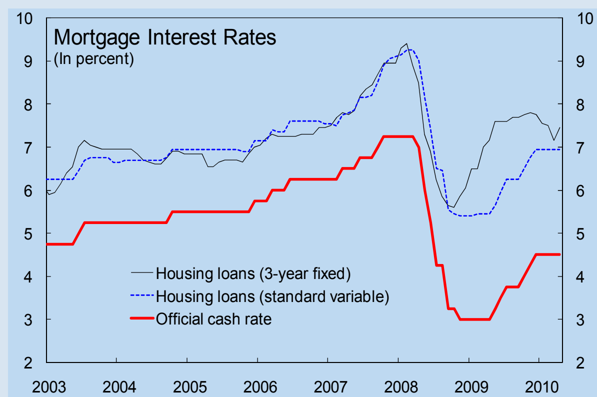
Sources: RBA, Melbourne Institute, Bloomberg, and Fund staff estimates.

The increase in the policy rate combined with higher bank funding costs (relative to the policy rate) have pushed up lending rates.



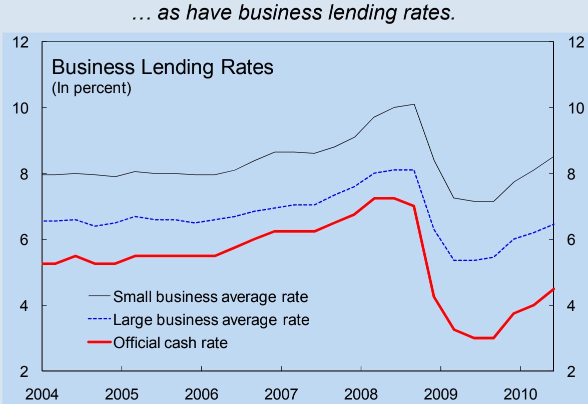
Source: Reserve Bank of Australia

Mortgage rates have risen …



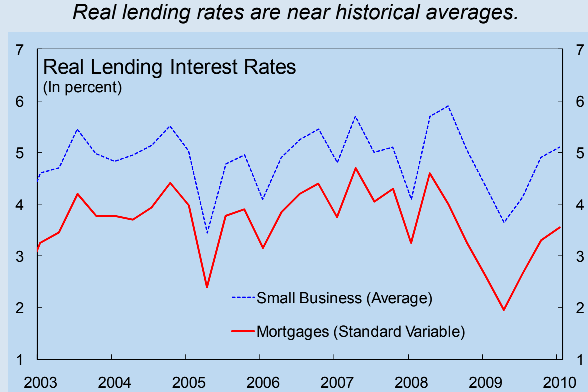
Source: Reserve Bank of Australia.

… as have business lending rates.



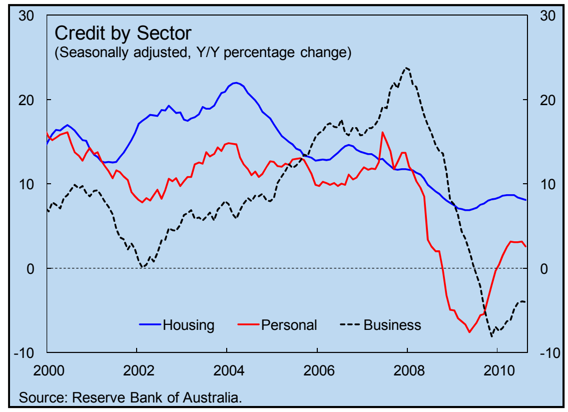
Source: Reserve Bank of Australia.

Real lending rates are near historical averages.

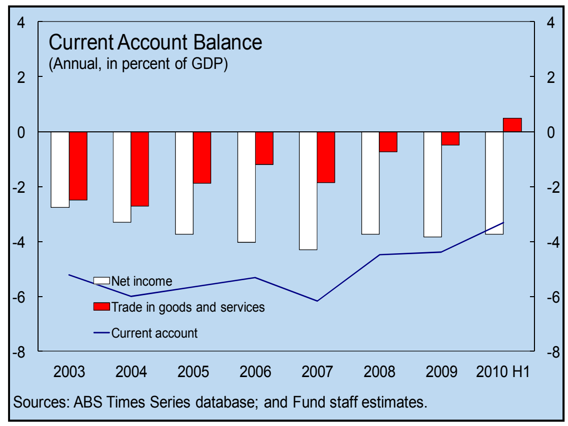


Source: Reserve Bank of Australia.

11. **Credit growth is showing signs of recovery.** The sharp slowing in credit growth following the onset of the crisis was driven by falls in business and personal credit. Mortgage credit growth, while slowing, remained positive, reflecting the introduction of government incentives for first time home buyers and the quick pass through of policy rate reductions into mortgage rates. More recently, personal credit growth picked up, although business credit continues to contract.



12. **Strong commodity demand helped reduce the current account deficit** (Tables 3 and 4). The current account deficit fell to 3⅓ percent of GDP in the first half of 2010, as iron ore and coal exports picked up, and dividend and profits payments declined. Net external liabilities have risen over the past few years to about 60 percent of GDP by mid-2010.



II. Outlook and Risks

13. **The outlook is favorable.** Real GDP growth is projected at 3–3½ percent in 2010 and 2011, with private investment in mining and commodity exports taking over from public demand as the main driver of growth (Table 5). The output gap is expected to close in mid-2011. Despite rising mortgage rates, household consumption will be supported by strong income growth, buoyed by the recent rebound in employment. The terms of trade is expected to rise to historic highs in late 2010, driving a mining boom that is likely to be long lasting, given increasing ties with fast-growing emerging Asia (Box 1). The current account deficit is projected to narrow in the near-term to less than 2½ percent of GDP, due to the jump in the terms of trade. However, the deficit is forecast to widen to about 6 percent of GDP over the medium term, mostly reflecting higher investment in the resource sector, including on LNG projects.[1]

14. **The main risks relate to the global outlook and, in the near term, are tilted largely to the downside.** If the global recovery stalls and Chinese demand for

[1] In Q4 2009, construction began on a massive plant to liquefy natural gas—the Gorgon project—that involves capital expenditure of $43 billion (3½ percent of GDP) over 2009–14.

Box 1. Australia: Increasing Ties with Emerging Asia and Australia's Growth Potential[1]

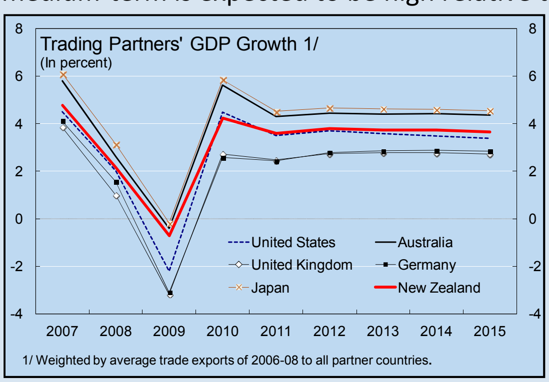
The destination of Australia's exports has shifted dramatically from advanced economies to fast-growing emerging Asia. Over the past two decades, exports to China and India grew by almost 20 percent per annum in U.S. dollar terms while exports to the U.S. and Germany grew by just 3–4 percent annually. As a result, China overtook Japan as Australia's top export destination in 2009. If this trend continues, almost half of Australia's exports will head to China and India by 2015.[2]

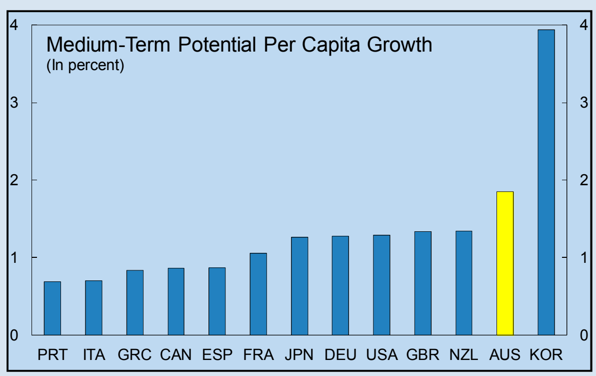
Australia: Major Mechandise Export Destinations
(In percent of total)

	2000 Act.	2009 Act.	2015 Proj.
China	5.4	21.6	33.1
Japan	19.8	19.5	17.4
Korea	8.2	7.9	8.9
India	1.7	7.4	11.3
United States of America	10.0	4.9	3.9
United Kingdom	3.4	4.6	4.1
New Zealand	6.0	4.0	3.8
Taiwan Province of China	5.0	3.3	3.3
Singapore	5.3	2.7	2.7
Hong Kong	3.2	1.5	1.1
Germany	1.2	0.8	0.6
Sum	69.1	78.2	90.2

Strong commodity demand from emerging Asia has pushed Australia's terms of trade to near historical highs. The gain in the terms of trade has been stronger in Australia than in other commodity producing countries since 2003.

Increasing ties with fast-growing emerging Asia is expected to continue supporting Australia's growth potential. Strong demand from Asia would boost investment and capital accumulation in Australia, enhancing production capacity. Partly reflecting this, staff analysis suggests that Australia's potential growth over the medium-term is expected to be high relative to other advanced countries.





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[1] Based on "Potential Growth of Australia and New Zealand in the Aftermath of the Global Crisis" by Y. Sun, IMF WP/10/127.

[2] Assuming Australia maintains its market share of the projected growth in China and India's imports in the range of 20 percent per annum in U.S. dollar terms for 2010–15.

commodities declines, Australia's terms of trade could fall sharply. In addition, concerns about fiscal sustainability in Europe could disrupt global financial markets and push up the cost of capital for Australian borrowers (Box 2). On the domestic front, a fall in house prices and deleveraging by highly indebted households could negatively impact private consumption and slow the recovery. An upside risk is that the mining boom may have a larger-than-expected impact on output and inflation.

Authorities' Views

15. **The authorities agreed with staff's economic outlook, although they viewed the risks as more balanced.** They noted the downside risks from market concerns about the fiscal outlook for some European economies. They also pointed to the risk that the pickup in private demand in Australia may not occur as quickly as expected and drive the recovery when public investment is contracting. The authorities, however, expect strong demand for mineral exports to continue to support the recovery, given urbanization and industrialization in emerging Asia.

III. What is the Right Pace of Exit from the Policy Stimulus?

A. Monetary Policy

16. **Staff supported the removal of monetary stimulus since late 2009, given the improvement in the economic outlook.** Staff also noted that keeping policy rates on hold since May 2010 was appropriate, in light of increased uncertainty about prospects for the recovery. With lending rates in Australia close to ten-year averages and economic activity responding quickly to cash rate adjustments, the RBA has scope to wait for the outlook to become clearer.

17. **Should the recovery proceed as expected and downside risks dissipate, staff advised that monetary policy will need to be tightened further to contain inflation pressures generated by the impact of the mining boom on the wider economy.** In determining the magnitude of the additional tightening, the RBA will need to consider two key factors. First, given the high level of household indebtedness, domestic demand is likely to be more responsive to interest rates than in the past. Second, with inflation projected to remain close to the top of the 2–3 percent target band, the RBA needs to guard against inflation expectations becoming anchored at too high a level.

18. **If world growth falters or global markets come under severe stress because of concerns over European sovereign debt, the RBA is well positioned to respond.** It has ample scope to cut the policy rate and provide liquidity support for banks, which proved effective in the recent crisis.

Box 2. The Potential Impact on Australia of the European Sovereign Debt Turbulence

The IMF's Global Projection Model (GPM) has been used to estimate the potential impact that Europe's sovereign debt crisis could have on the global economy's major regions. Two scenarios are considered. The first is that the direct impact is largely concentrated in Europe with slower activity reflecting the fiscal consolidations required to stabilize financial markets, a mild increase in the Euro area risk premium, and a moderate increase in financial stress. Spillovers outside Europe are limited to trade effects. The second scenario entertains the possibility that global financial markets could become severely disrupted because European fiscal consolidation plans are viewed to be either not credible or not sufficient. The impact on the major world regions under these two scenarios are presented in the table.

Impact of Euro Area Turbulence on GDP Growth
GPM Simulation Deviations from Baseline
(Percent or percentage point)

	2010	2011	2012
	Scenerio1: Limited Impact		
Country/Region			
World	-0.1	-0.3	-0.1
Euro Area	-0.1	-0.6	0.0
United States	-0.1	-0.2	0.0
Japan	0.0	-0.1	-0.2
Emerging Asia	0.0	-0.2	-0.1
Latin America	0.0	-0.1	-0.1
Remaining countries	0.0	-0.3	-0.1
	Scenario2: Significant Disruption		
Country/Region			
World	-0.3	-1.5	-0.3
Euro Area	-0.3	-2.2	-0.9
United States	-0.5	-1.9	0.3
Japan	-0.1	-1.3	-0.9
Emerging Asia	-0.1	-0.9	-0.1
Latin America	-0.1	-0.8	-0.3
Remaining countries	-0.2	-1.1	0.0

These scenarios are used in a small open economy model of Australia to estimate the potential impact that Europe's sovereign debt crisis could have on Australia's macro outlook.[1] The impact on Australia is mild due to the space for policy to respond and the importance of emerging Asia, which is less affected than other regions.[2] However, the output effect is longer lived in Australia because of the impact of commodity prices, which remain below baseline for an extended period due to the persistence in the shock to the level of world demand.

Impact of Euro Area Turbulence on Australia
FPAS Simulation Deviations from Baseline
(Percent or percentage point)

	2010	2011	2012
	Scenerio1: Limited Impact		
GDP growth	0.0	-0.1	-0.1
Output gap	0.0	-0.1	-0.2
Core inflation	0.0	-0.1	-0.2
Commodity prices	-0.4	-1.7	-2.9
Interest rates	-0.2	-0.5	-0.7
Fiscal balance	0.0	-0.1	-0.2
REER	-0.1	-0.3	-0.5
	Scenario2: Significant Disruption		
GDP growth	0.0	-0.3	-0.5
Output gap	0.0	-0.3	-0.8
Core inflation	0.0	-0.1	-0.6
Commodity prices	-0.6	-6.1	-12.4
Interest rates	-0.7	-1.6	-2.4
Fiscal balance	0.0	-0.1	-0.9
REER	-0.2	-0.9	-1.5

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[1] The reduced form-model, the Forecasting and Policy Analysis System (FPAS), describes the behavior of Australia and its relevant rest-of-world. It is an estimated model that includes reactions functions for both monetary and fiscal policy and also incorporates commodity prices.

[2] The GPM countries/regions impacts are weighted using Australia's trade weights to calculate the GDP impact on Australia's external sector.

Authorities' Views

19. **The RBA agreed that if the downside risks to the outlook diminished and further inflation pressures emerged, the policy rate would need to be raised.** They will continue to monitor domestic and external developments closely and set monetary policy to achieve an average rate of inflation of between 2 and 3 percent over the cycle. The authorities were concerned that global market disruptions could arise with some frequency over the next few years. They noted that such disruptions may pose some challenges for monetary policy in Australia, but the flexible exchange rate and removal of earlier monetary policy stimulus has put them in a strong position to respond to a downside scenario.

B. Fiscal Policy

20. **The government's strategy to exit fiscal stimulus is projected to return the budget to a surplus of 0.2 percent of GDP by 2012/13.** With above trend growth forecast, the government intends to achieve this goal by:

- allowing tax receipts to increase through fiscal drag as the economy recovers, while keeping the tax-to-GDP ratio below the 2007/08 level of 23.6 percent on average;
- holding real growth in government spending to 2 percent or less per year until the budget returns to surplus. Once the budget is back in surplus, the government will retain a 2 percent real cap on spending growth, on average, until the budget surplus is at least 1 percent of GDP, currently projected for 2015–16.

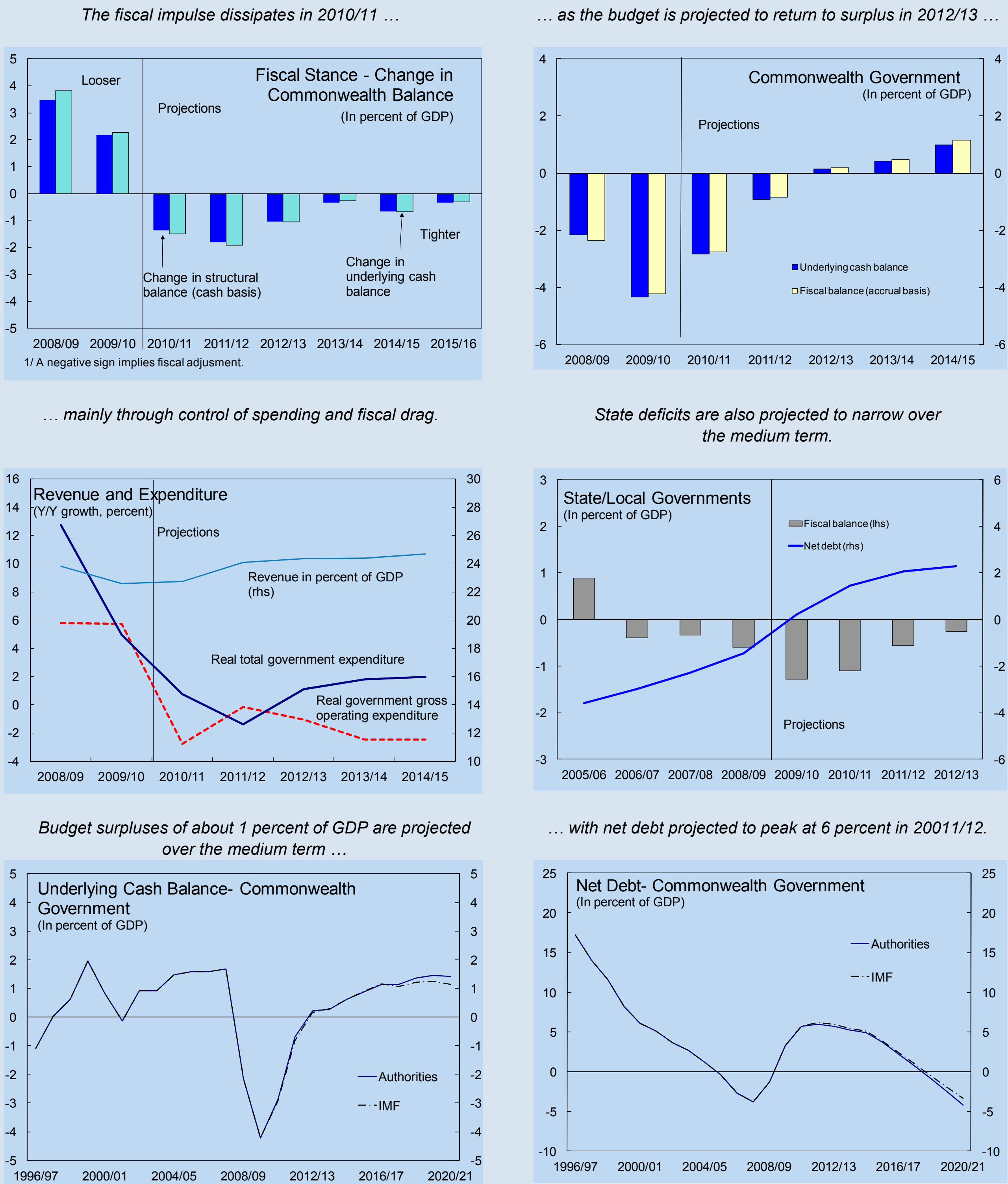
21. **Staff supported the pace of withdrawal of fiscal stimulus, if the economic recovery proceeds as expected.** The exit from the stimulus, which began in 2010, sees Commonwealth government net debt peaking at 6 percent of GDP in 2011–12 (Figure 6). The fiscal adjustment is faster than past consolidations in Australia and exit plans in most other advanced economies (Figure 7). In the event of a downside scenario, staff noted that Australia's fiscal position provides ample scope to allow the automatic stabilizers to operate, and, if needed temporary discretionary measures to be introduced.

22. **Although public debt is projected to remain very low by advanced country standards, returning quickly to budget surpluses as the authorities intend would put Australia in a stronger position to deal with future shocks.** The increased supply of sovereign debt worldwide could eventually put significant upward pressure on funding costs. Maintaining low Commonwealth net debt levels will help contain debt-servicing costs associated with the private sector's external debt and increased public saving could help contain the current account deficit.

Authorities' Views and Plans

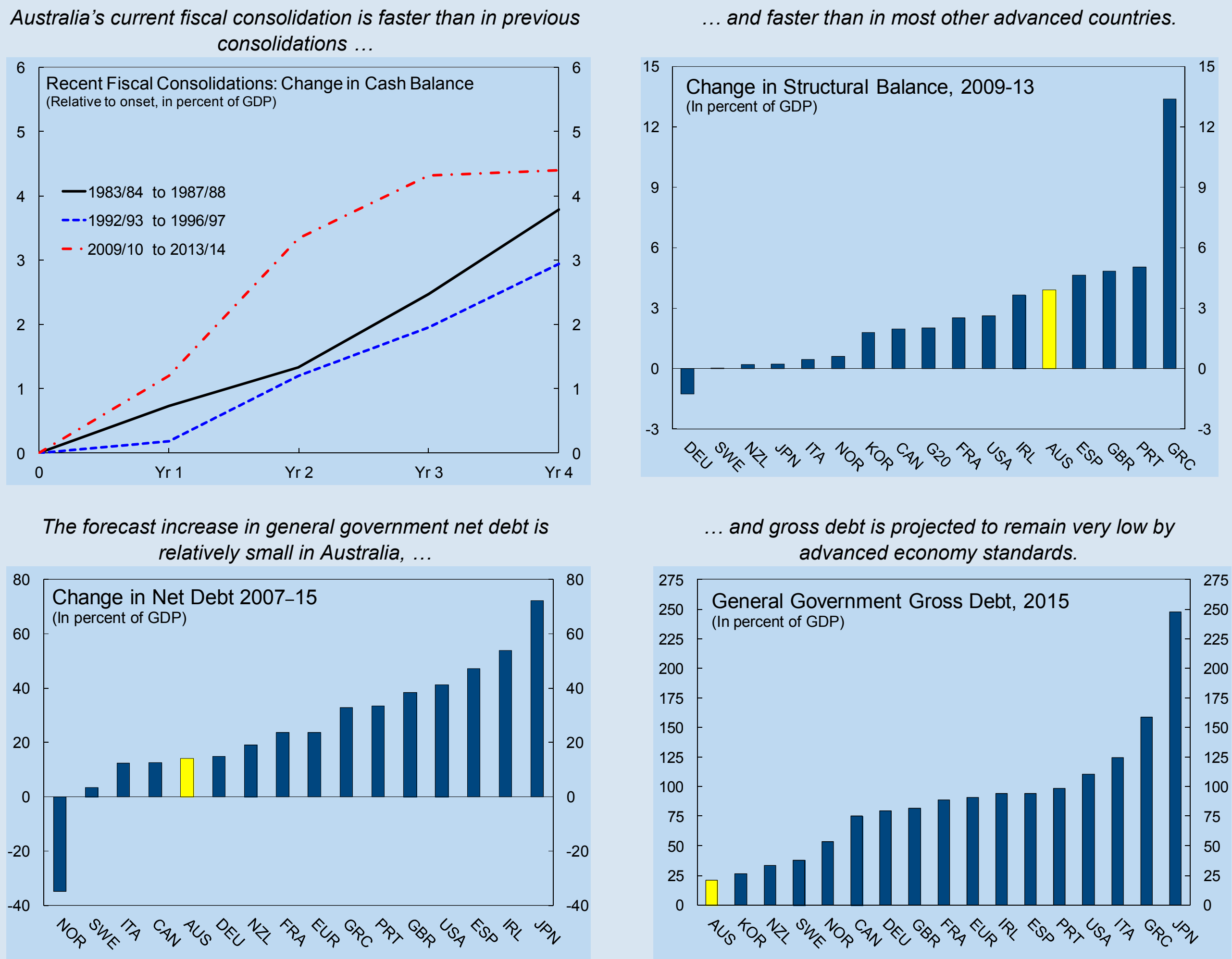
23. **The authorities emphasized that their projected return to surplus by 2012/13 reflects a strong commitment to spending restraint.** They noted that their cap on annual

Figure 6. Australia: Exit From Fiscal Stimulus



Sources: Australian Bureau of Statistics; and IMF staff estimates and projections.

Figure 7. Australia: Comparison of Fiscal Outlook



Sources: WEO, IMF staff estimates.

real spending growth of 2 percent (in years when the economy is growing above trend) is well below average annual real spending growth of 3¾ percent in the ten years prior to the global crisis. They agreed on the benefits of reducing public debt and project Commonwealth net debt to return to zero by 2018/19.

IV. How Should the Mining Boom be Managed?

24. **The mining boom is expected to be long lived, but brings with it vulnerabilities to which policy will need to respond.** Staff analysis suggests a significant dividend for Australia from continued growth in emerging Asia, even with a rebalancing of the drivers of Asian growth toward the non-tradable sector.[2] Sound management of the boom in Australia could permanently raise household incomes, but facilitating a shift of resources to the mining sector without giving rise to inflationary pressures presents a key challenge. Moreover, the growing dependence on mining may amplify the business cycle as the economy will be more vulnerable to swings in commodity demand and make government revenue more volatile.

25. **The framework laid out in the Charter of Budget Honesty requires fiscal policy to contribute to moderating cyclical fluctuations in economic activity and maintain Commonwealth Government debt at prudent levels.** The current government's strategy is to achieve budget surpluses on average over the medium-term, to help moderate the pro-cyclical impact from the terms of trade. However, during the upswing in commodity prices from 2004–2008, budget surpluses were limited to only 1¾ percent of GDP, with cuts in personal taxes and increases in spending providing a fiscal stimulus during this period.

26. **Staff advised allowing the automatic fiscal stabilizers to operate fully.** Faster than expected Asian growth can quickly place significant capacity pressures on the Australian economy. Although the exchange rate would adjust and monetary policy react, allowing the automatic stabilizers to operate fully would help avoid potential overheating. To this end, staff recommended saving revenue windfalls. In addition, this would build a buffer against a sharp fall in commodity prices and permit the automatic stabilizers to operate fully during downturns.

27. **Because of the growing importance of commodity prices for the budget, staff suggested preparing downside scenarios where the terms of trade return quickly to the long-run average.** The budget projects the terms of trade to fall gradually by about 20 percent over the next 15 years as supply comes on stream and settle about 30 percent above the average of the past 20 years. Analyzing the impact of a sharper fall in commodity prices than currently assumed in the budget would illustrate the importance of running larger surpluses during the good

[2] Analysis in the forthcoming working paper by B. Hunt "Emerging Asia's Impact on Australian Growth: Some insights from GEM" suggests that over the next ten years, a 50 percent increase in emerging Asia's real GDP driven by tradable sector productivity growth (which roughly matches emerging Asia's growth gap relative to the rest of the world over the last ten years) would raise Australian GDP by 18 percent. However, should emerging Asia's growth continue to outperform, but become more balanced with productivity growth in both the tradable and nontradable sectors contributing equally, the growth dividend is roughly cut in half.

times to strengthen the fiscal position.[3] A stronger sovereign balance sheet would provide more fiscal space to cushion the impact should the terms of trade deteriorate sharply. Moreover, it would put the budget in a better position to deal with some of the long-term pressures from aging and rising health care costs (Box 3).

28. **Tax reform can also play a key role in allowing Australia to take full advantage of the mining boom.** Staff welcomed the recent review of the tax system, as it provides a comprehensive blueprint for tax reform issues (Box 4). The planned introduction of the mineral resource rent tax (MRRT) in 2012 is a step in the right direction and is to be accompanied by a cut in the company tax rate from 30 to 29 percent, to encourage investment. While the MRRT strengthens the automatic stabilizers in the budget, staff noted that it is less effective in that regard than the original proposal of a super profit tax. Consideration should be given to broadening the coverage of the MRRT to other mineral resources beyond iron ore and coal. Another objective of tax reform should be to facilitate the reallocation of resources so that Australia can fully benefit from improved terms of trade. Staff advised more reliance on consumption-based taxes. This would allow for the elimination of inefficient taxes that impede labor mobility (including stamp duties at the state level) and make room for reductions in federal personal income taxes that would encourage increases in labor supply and saving.

29. **Other structural reforms will be needed to improve the supply response and address infrastructure bottlenecks in the face of the boom.** Reforms underway aim to reduce inconsistent and unnecessary regulation and restrictions on competition across Commonwealth, State and Territory governments. In addition, the Commonwealth government is investing in education and promoting effective regulation and more efficient use of existing infrastructure, and more transparent frameworks for new infrastructure investment decisions.

Authorities' Views

30. **The authorities agreed that the mining boom will test the economy's capacity and note that adjustments have been made so that fiscal policy is playing a key role in managing the boom.** They saw merit in staff's advice to save stronger-than-anticipated revenue in the upswing. They noted that this advice is broadly consistent with the government's strategy of achieving budget surpluses, on average, over the medium term and improving the government's net financial worth. The government's other objective of keeping Commonwealth tax revenues as a share of GDP, on average, below the 2007/08 level (23.6 percent of GDP) may constrain the increase in revenue. However, given that this objective is defined as an average over the medium term it would not present a substantial constraint in the near-term. In strengthening the government's fiscal strategy from balance

[3] The budget presents sensitivity analysis to a 1 percent fall in nominal GDP because of a permanent decline in the terms of trade. Staff initial estimates suggest that a permanent fall in the terms of trade of 20 percent over the next year could reduce nominal GDP by 4 percent relative to baseline, assuming the exchange rate depreciates by 10 percent, and worsen the budget balance in 2011/12 by 1–1½ percent of GDP relative to baseline. These estimates, however, are subject to considerable uncertainty and do not take account of a possible policy response.

to surpluses over the cycle, they also pointed to the political challenges of running larger surpluses than in the past, given pressure to cut taxes when revenue growth is strong. They agreed that analyzing downside scenarios from a sharp fall in the terms of trade may help build political support for larger surpluses to strengthen the government's balance sheet. But they raised concerns about how to manage public assets once Commonwealth net debt is reduced to zero. On tax reform, the authorities noted that increasing consumption taxes would be difficult, as they are perceived as regressive. Further, the government has a clear policy that the GST rate will not be increased or the base broadened.

Box 3: Fiscal Pressures from Aging and Rising Health Care Costs

The "Intergenerational Report 2010" published by the Australian Treasury notes that an ageing population presents significant long-term risks for the economy and the sustainability of government finances. The report projects that government spending on health, age-related pensions and aged care could rise by 5.3 percent of GDP by 2049–50 from the projected low point in 2015–16. Rising health care costs are the largest contributor to this increase, accounting for around two-thirds of the overall increase.

Health: The very high growth rates projected for health spending underscore the need for health reform. The Intergenerational Report emphasizes the need to adjust spending to obtain better value for money rather than simply cutting the budget. In April 2010, the Council of Australian governments, with the exception of Western Australia, reached an agreement on significant reforms to the health system—the establishment of a National Health and Hospitals Network—with a view to improving the delivery and the sustainability of the health system.

Pensions: The government will progressively increase the retirement age from 65 to 67 years beginning in 2017 and revise the means test arrangement to better target the pension to those that are most in need. The government also boosted pension payments, with savings made in other areas of spending. The combination of savings measures means the pension reforms will be fully offset by 2020–21. Nonetheless, government spending on age-related pensions is projected to increase from around 3 percent of GDP in 2009/10 to around 4 percent of GDP in 2050.

While pension and health care reform already undertaken are important steps, further policy action will be needed to contain the public share of costs in these areas. In addition, measures to raise labor force participation and productivity, such as those discussed in the tax review, would help address pressures on the budget.

Box 4. Australia's Tax Policy Reform

Australia's tax review report was released on May 2. The review is designed to provide a framework for policy debate over the next few decades.

The five principles or core criteria underlying the tax reform proposals include:

- *Equity:* the system should be progressive and reduce differences in compliance costs across tax payers;
- *Efficiency:* the tax system should minimize efficiency costs by reducing the number of inefficient taxes—many of which are levied by the States; and maximize its capacity to generate revenues;
- *Simplicity:* the system should be more transparent and be easier to comply with;
- *Sustainability:* on the tax side, the system must be able to meet the revenue needs of the government without recurring to inefficient taxes. On the transfer side, the cost of the system needs to be predictable and affordable in the light of demographic pressures Australia faces. Both must be flexible enough to respond to changing policy challenges and consistent with environmental sustainability; and
- *Policy consistency:* tax and transfer policy should be consistent among the States, and across levels of government, as well as consistent with governments' broad policy objectives.

The overarching objective of tax reform is to promote stronger long-term growth by increasing workforce participation—through appropriate design of tax incentives and transfers—and productivity—through higher business investment, especially in infrastructure.

The main recommendations of the tax review included:

- introducing a rent tax on nonrenewable resources;
- cutting the company tax rate from 30 percent to 25 percent over the medium term to increase business investment, including FDI;
- reducing the complexity of personal income tax, including by introducing a high tax-free threshold with a constant marginal rate for most people; removing stamp duties that are by nature inefficient taxes on land that discourage residence mobility and replacing them with a broad-base land tax;
- enhancing taxes on consumption (excluding the GST) and broadening the consumption tax base. A broad-based cash flow tax could be used to finance the abolition of other taxes, including the payroll tax and inefficient State consumption taxes, such as insurance taxes;
- promoting higher workforce participation through improving support for quality child care, and building clear work incentives into the levels of income support payments.

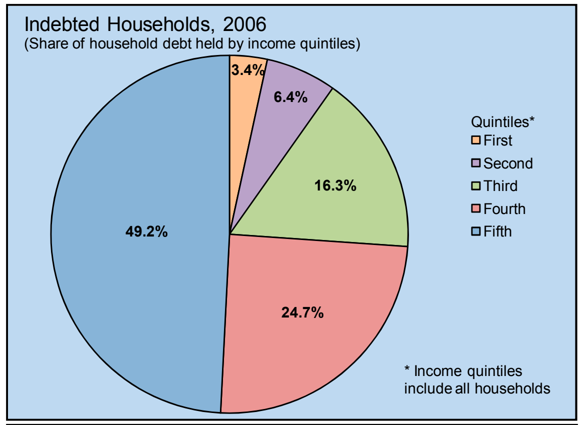
The government has endorsed some of the recommendations, including introducing a mineral resource rent tax on iron ore and coal and cutting the company tax rate from 30 to 29 percent in 2012.

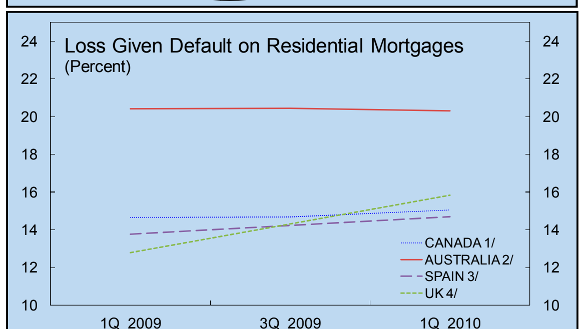
V. How to Maintain Financial Stability and Address Banks' Domestic Vulnerabilities?

31. **Given the relatively good performance of banks in the face of the crisis, staff expressed concern that they may be emboldened to take on riskier strategies.** The global crisis highlighted the need for banks to hold strong capital and liquidity buffers and for supervisors to encourage banks to carefully manage their risks.

32. **A key risk is banks' exposure to household debt of more than 150 percent of households' disposable income.** As in many other countries, household debt has risen over the past decade leading to an increase in debt servicing costs. Household net wealth has also risen, but this was mainly because of a large increase in house prices, which staff analysis suggests are mildly overvalued (Figure 8).[4]

33. **A number of factors, however, limit potential losses from banks' exposure to households.[5]** First, exposure to high-risk mortgages is small, as less than 10 percent of owner-occupiers had mortgages with loan-to-value ratios higher than 80 percent and debt-service ratios greater than 30 percent. Second, debt is mainly held by higher income households, with households in the top two income quintiles holding almost three quarters of household debt (Text Figure). Third, the Australian Prudential Regulation Authority's (APRA) intensive supervision and prudential rules guide banks toward a conservative assessment of risk, including by setting a floor of 20 percent for losses given default on residential mortgages (Text Figure).





Sources: Banks' disclosure statements and IMF staff estimates.
1/ 3 largest banks.
2/ 4 largest banks.
3/ 2 largest banks. Reporting dates 4Q 2008 and 4Q 2009.
4/ 3 banks. Reporting dates 4Q 2008 and 4Q 2009.

34. **APRA's recent stress tests also suggest that banks are resilient to large but plausible shocks.** APRA regularly conducts stress tests, most recently in 2009/10 in cooperation with the Reserve Bank of New Zealand and the New Zealand subsidiaries of Australian banks. A three year macroeconomic scenario was used for the tests, assuming a global economic downturn that results in a 3 percent contraction of real GDP in Australia

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[4] Forthcoming working paper by P. Tumbarello and S. Wang, "What Drives Housing Prices in Australia? A Cross-Country Approach," suggests that Australian house prices were 5–15 percent overvalued in early 2010.

[5] Forthcoming working paper by P. Bologna, "Australian Banking System Resilience: What Should be Expected Looking Forward? An International Perspective."

in the first year, followed by a V-shaped recovery. The scenario also assumed a rise in the unemployment rate to 11 percent, a fall in house prices of 25 percent, and a fall in commercial property prices of 45 percent. The results suggest that none of the banks would have breached the 4 percent minimum Tier 1 capital requirement of the Basel II framework. The weighted average reduction in Tier 1 capital ratios from the beginning to the end of the three-year stress scenario was 3.1 percentage points.

35. **Despite the good results from the stress tests, staff advised the authorities to remain vigilant to emerging risks.** Staff recommended explicitly including funding risk in future scenarios, given banks' sizable short-term external debt. Staff welcomed the authorities' efforts to improve banks' own stress testing capabilities, and suggested that APRA review assumptions regarding probability of default and loss given default in light of recent experience in Australia and elsewhere. Potential risks in the mortgage sector should be examined carefully, especially given high household debt, house price overvaluation, and potential volatility from the mining boom. Staff supported APRA's pro-active approach to supervision, including its intention to extend stress testing beyond the banking system to other financial institutions such as insurance companies.

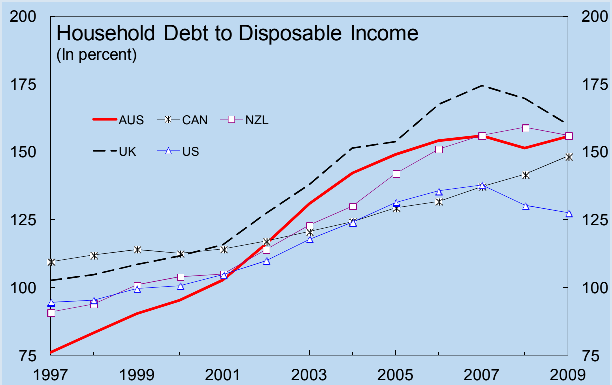
36. **Staff welcomed progress in contingency planning for liquidity and solvency problems.** APRA now closely monitors banks' liquidity and funding plans and the planned Trans-Tasman crisis management exercise with New Zealand is an important step to identify possible challenges in a banking crisis.

Authorities' Views

37. **The authorities agreed on the need for continued vigilance.** On the stress tests, aggregate results have been published, but the authorities see no need to publish individual results given the high level of confidence in banks. The authorities are committed to adopting international enhancements to the quality and quantity of capital held by financial institutions, which is currently being developed by the Basel Committee on Banking Supervision. They noted that Australian banks are unlikely to require significant increases in capital to meet the enhanced requirements as they are already well capitalized, with common equity comprising a significant proportion of tier-one capital.

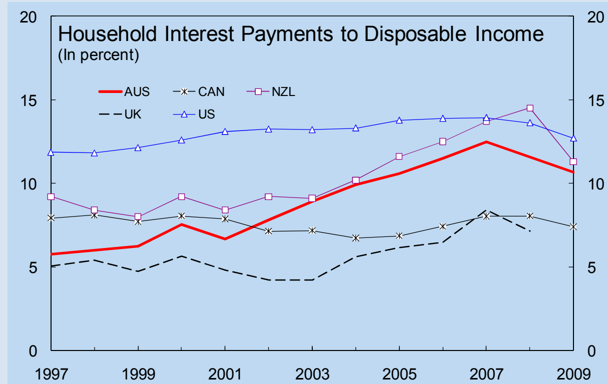
Figure 8. Australia: Household Vulnerabilities

Household debt remains very high …



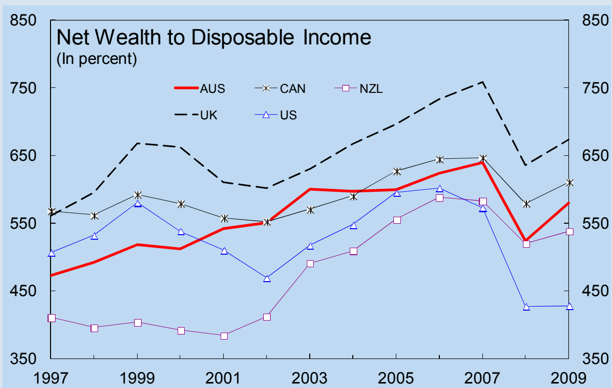
Sources: RBA; RBNZ; Eurostat; Haver ; and IMF staff calculations.

… although debt-servicing costs have declined during the global crisis.



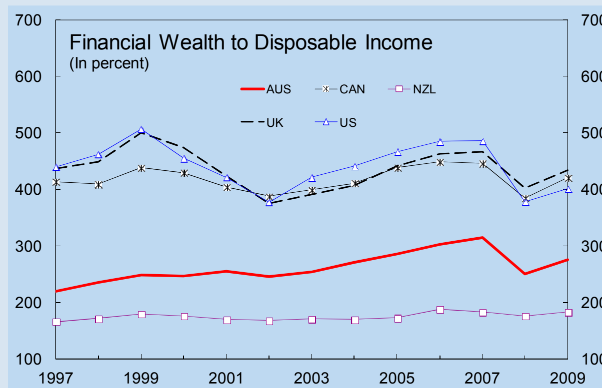
Sources: RBA; RBNZ; Eurostat; Haver; and IMF staff calculations.

Household net wealth position has improved over the last decade …



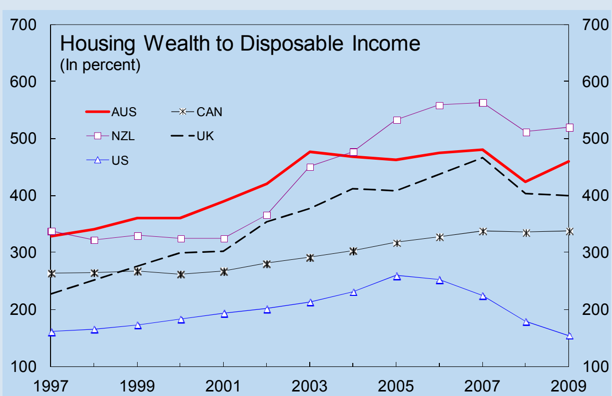
Sources: RBA; RBNZ; Eurostat; OECD; Haver; and IMF staff calculations.

… with financial wealth accounting for a relatively low share…



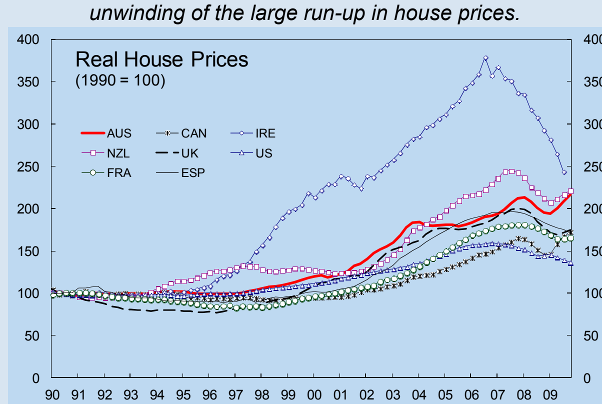
Sources: RBA; RBNZ; Eurostat; Haver; and IMF staff calculations.

… and housing wealth for a large share.



Sources: RBA; RBNZ; Eurostat; OECD; Haver; and IMF staff calculations.

This leaves Australian households vulnerable to a possible unwinding of the large run-up in house prices.



Source: OECD database.

VI. Addressing External Vulnerability

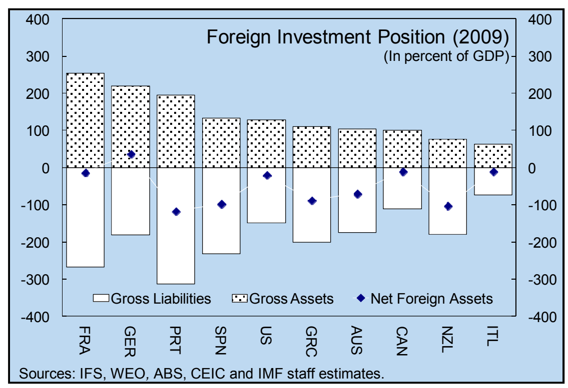
38. **Australia's main external vulnerabilities arise from its relatively high net external liabilities, sizable short-term external debt, and projected widening of the current account deficit.** Staff projects net external liabilities to increase to about 64 percent of GDP in 2015, as the current account deficit widens to 6 percent of GDP.

Australia: External Debt

(End of Period)	Jun-08	Dec-09	Jun-10
Gross external debt	1,103	1,232	1,291
(Expressed in billions of Australian dollars)			
Of which: Short-term	529	523	596
Gross external debt	1,062	1,105	1,100
(Expressed in billions of U.S. dollars)			
Of which: Short-term	509	469	508
Gross external debt	93.4	98.0	99.1
(As percent of GDP)			
Of which: Short-term	44.8	41.7	45.7
Short-term to gross external debt	47.9	42.5	46.2
Memorandum items:			
Gross external debt in Australian do	411	539	557
Of which: short-term	161	215	261
US$/$A (end of period)	0.96	0.90	0.85
NGDP, last 4 qtrs sum. SA, billions	1,182	1,256	1,302

Sources: Australian Bureau of Statistics and Fund staff estimates.

39. **Disruptions in global capital markets could put significant pressure on Australian banks because of their short-term offshore funding.** Short-term external debt for the whole economy remains sizable at 46 percent of GDP in mid-2010, and has not changed significantly since the onset of the global crisis (text table). The short-term external debt comprises almost half of gross external debt and is largely held by financial institutions.[6] A disruption to external funding, such as a pullback by European banks, could raise the cost of capital for Australian banks.[7]



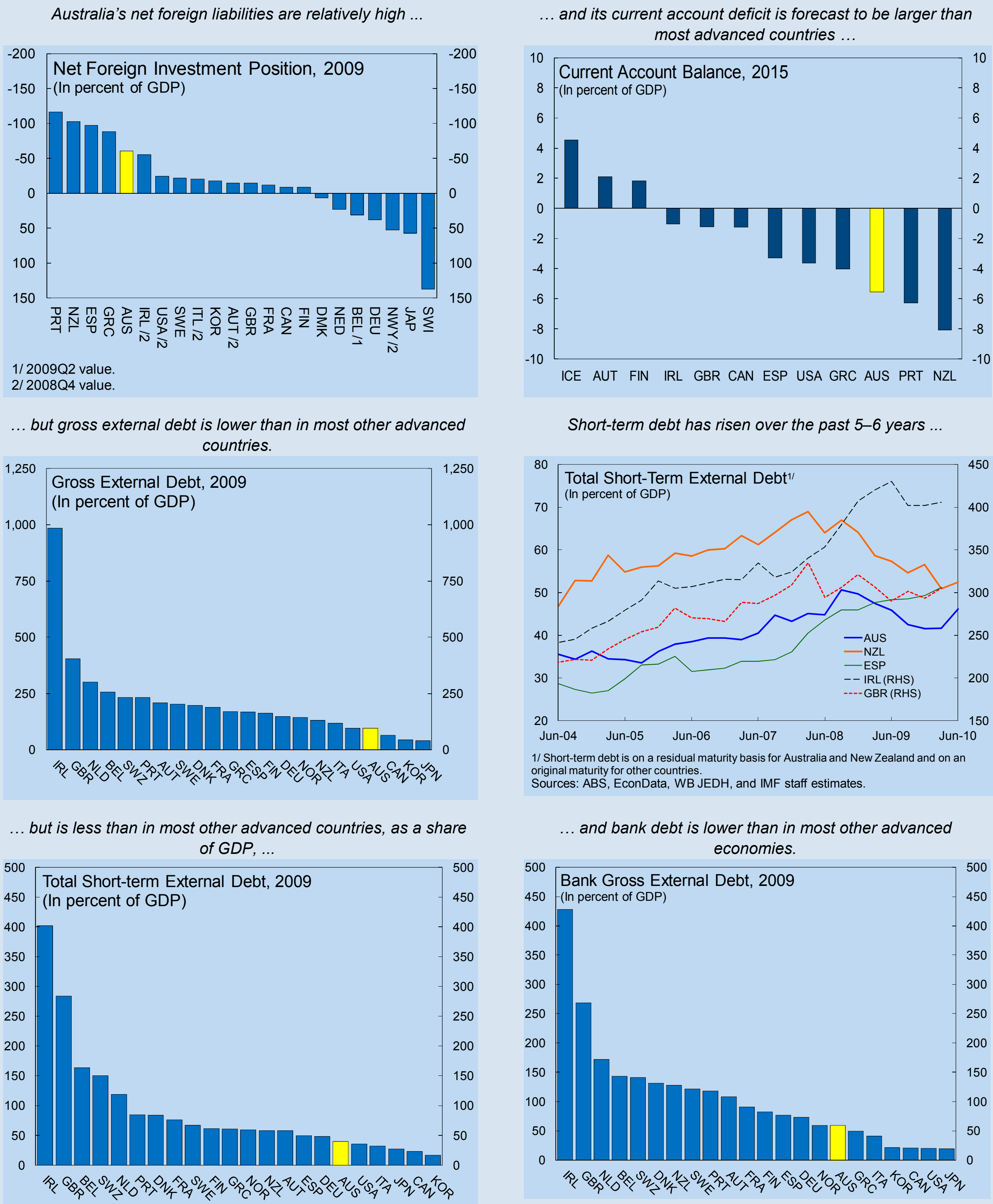
40. **A number of factors mitigate the vulnerabilities.** While net external liabilities are relatively large, gross assets and liabilities are relatively small (text figure). In particular, both gross external debt (99 percent of GDP in mid-2010) and short-term debt are smaller than in many other advanced economies (Figure 9). Moreover, currency risk associated with the debt is limited given that more than 40 percent is in Australian dollars and the bulk of the remainder is hedged. In addition, Australia's current account deficits largely reflect high investment rather than low saving and should be sustainable as long as investment leads to growth in export capacity.

41. **The flexible exchange rate also provides an important buffer.** A disruption to global funding markets would likely lead to a

[6] Data for short-term debt on a residual maturity basis are only available for the whole economy, but private financial institutions comprise about two thirds of Australia's gross external debt, and banks presumably have a similar share of short-term debt.

[7] Funding from European banks was just over US$300 billion at end-2009, about ¼ of gross external debt.

Figure 9. Australia: External Vulnerability



Sources: IFS, WEO, Haver Analytics, WB-IMF-BIS-OECD Joint External Debt Hub, and IMF staff estimates.

depreciation of the Australian dollar, as occurred after the Lehman collapse in 2008. Such a depreciation would reduce the U.S. dollar and Euro funding required to meet banks' desired Australian dollar funding. Also, the relatively small holdings of foreign currency denominated assets by Australian banks would limit banks need for foreign currency funding.

42. **To reduce rollover risk further, staff advised that APRA encourage banks to rely more on medium and long-term funding.** APRA has already taken steps in that direction, including by issuing a discussion paper on liquidity risk in September 2009. The paper emphasizes stress testing and defined a three-month "market disruption" scenario that mainly targets banks resilience to a disruption in access to wholesale funding. APRA put these proposals on hold following the issuance of the Basel Committee liquidity proposals, including a net stable funding ratio, in December 2009.

43. **While the value of the currency is market-determined, staff estimates suggest that the currency is mildly overvalued (5–15 percent) from a medium-term perspective, although these estimates are subject to considerable uncertainty (Box 5).** The overvaluation is likely to be temporary and may dissipate with eventual normalization of interest rates in the United States and other advanced economies.

Authorities' Views

44. **The authorities acknowledged that current account deficits arising from the excess of domestic investment over saving expose Australia to risks from shifts in sentiment among offshore investors.** They noted that foreign investors' willingness to continue funding the current account deficit owes substantially to Australia's strong track record in macroeconomic management, especially its strong fiscal position, structural reform, and sound financial regulation and supervision. Boosting national saving to meet more of the investment needs would help reduce the current account financing risks. Plans to raise the compulsory superannuation contribution from 9 to 12 percent of employee earnings over time and to achieve budget surpluses, on average, over the medium term should help increase national saving.

45. **The authorities agreed on the need for careful assessment of liquidity risks and are committed to the development and adoption of international liquidity standards.** They noted, however, that there would not be sufficient government securities on offer for Australian banks to comply with the proposed Liquidity Coverage ratios using such assets alone. In addition, the Net Stable Funding ratio of the form originally proposed may be challenging for many banking systems, including Australia's and is currently being reworked by the Basel Committee.

VII. Staff Appraisal

46. **The impact of the global crisis was milder than in other advanced economies thanks to strong demand from emerging Asia and decisive policy responses.** A mining boom is driving a strong recovery and growing integration with emerging Asia underpins favorable medium-term growth prospects. But the near-term outlook is clouded by downside risks mainly related to the global economy.

Box 5. Australia's Equilibrium Real Effective Exchange Rate

Staff estimates suggest an overvaluation of the Australian dollar of 5–15 percent, but the estimates are subject to considerable uncertainty, as shown by the wide range of the confidence intervals. The estimates are based on the macroeconomic balance (MB) approach, the equilibrium real exchange rate (ERER) approach, and the external sustainability (ES) approach).

The MB approach estimates the current account deficit norm at almost 5 percent of GDP. The norm estimate is based on a fixed effect of -2.8 percent, with the relatively high population growth contributing -3.0 percent and the relative fiscal balance contributing 0.4 percent. The projected current account deficit is just above this norm, implying an overvaluation of about 7½ percent.

Exchange Rate Assessment: Baseline Results
(In percent)

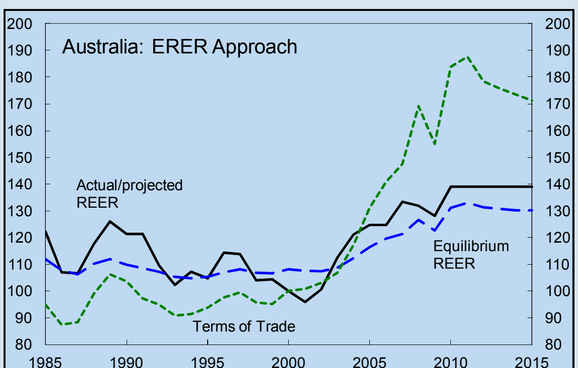
	Current Account/GDP		REER
	Norm	Projection 1/	Overvaluation
Macroeconomic balance 2/	-4.8	-6.0	7.6
Equilibrium real exchange rate 3/	...	...	6.3
External sustainability 4/			
NFL stabilizing at 60 percent of GDP 5/	-3.9	-6.0	13.5
NFL stabilizing at 55 percent of GDP 5/	-3.7	-6.0	14.8

Source: IMF staff estimates.

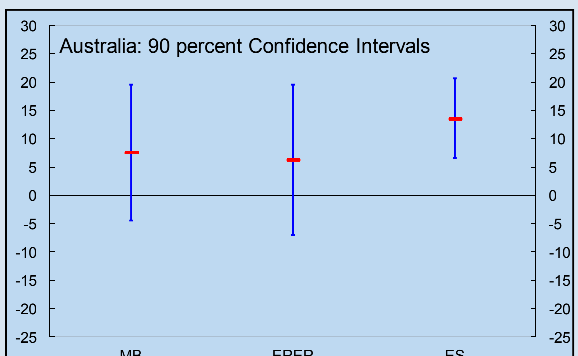
1/ Staff projection of the underlying CA/GDP in 2015.
2/ Based on semi-elasticity of CA/GDP with respect to the REER of -0.16.
3/ Overvaluation is assessed relative to August 2010.
4/ Based on an assumed nominal GDP growth rate of 6 percent.
5/ Assuming a 10 percent depreciation decreases NFL by 3 percent through valuation effects.

The ERER estimates suggest an overvaluation broadly in line with the MB approach. The model explains the REER on the basis of the terms of trade, relative productivity, and relative government consumption. Using June 2010 as the benchmark, the equation suggests an overvaluation of 6 percent, assuming that terms of trade will remain flat over the medium term.

The ES approach implies an overvaluation of about 13½ percent, assuming that net foreign liabilities (NFL) stabilize at the mid-2010 level of 60 percent of GDP. However, to stabilize NFL to 55 percent of GDP—about the average of the past 10 years—the REER would need to depreciate by about 15 percent.



Source: IMF staff estimates.



Source: IMF staff estimates.

47. **The RBA has appropriately unwound earlier monetary policy stimulus**. If the recovery remains on track and downside risks dissipate, monetary policy will need to tighten further to contain inflation pressures generated by the mining boom. However, if the global recovery stalls or international capital markets come under severe stress, the RBA has ample scope to cut the policy rate and provide liquidity support for banks.

48. **The pace of exit from fiscal stimulus is appropriate, assuming the recovery proceeds as expected.** The authorities' plan for a return to surplus by 2012/13 should put Australia in a strong position to deal with future shocks. Ample scope exists to slow the pace of exit or loosen fiscal policy in response to a downside scenario.

49. **The automatic fiscal stabilizers should be allowed to operate fully, given that the growing dependence on mining may amplify the business cycle**. This implies saving revenue windfalls and running larger budget surpluses during upswings than in the past to help avoid potential overheating and building a buffer against a sharp fall in commodity prices. Preparing a downside scenario for the budget in which commodity prices fall sharply may help build political support for running larger surpluses during the good times.

50. **The recent review of the tax system is welcome, including the introduction of the MRRT.** However, consideration should be given to broadening the coverage of the MRRT beyond iron ore and coal. Tax reform should also facilitate the reallocation of capital and labor to the mining sector. More reliance on consumption-based taxes would allow for the elimination of inefficient state taxes and make room for reductions in personal income taxes that would encourage increases in labor supply and saving.

51. **Banks remain sound but the authorities should remain vigilant as banks could adopt riskier strategies.** APRA's regular stress testing is commendable as it has provided a careful assessment of the vulnerabilities banks face. The authorities' efforts to improve banks' own stress testing capabilities is welcome and continued close monitoring by APRA of banks' risk assessment is needed.

52. **The projected increase in the current account deficit to about 6 percent of GDP over the medium term, together with sizable net external liabilities and short-term external debt, present some risks.** The deficits, however, should be sustainable if they continue to be driven by high investment that builds export capacity. But efforts to raise national saving, including through a return to budget surpluses, would help contain current account deficits. Rollover risks associated with short-term external debt could be reduced further by encouraging banks to extend the maturity of their offshore funding.

53. **From a medium-term perspective, the exchange rate is mildly overvalued.** However, the extent of overvaluation is uncertain and is likely to dissipate as interest rates in the United States and other advanced economies eventually normalize.

54. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Australia: Selected Economic Indicators, 2007–11

Nominal GDP (2009): $A 1,255 billion (US$996.4 billion) — Quota (in millions): SDR 3,236.40
GDP per capita (2009): US$45,237 — Population (October 2010): 22.5 million
Unemployment rate (September 2010): 5.1 percent
Main exports: Metal ores and minerals; tourism, coal and coke (fuel).
ODA (2009-10): 0.3 percent of GDP.

	2007	2008	2009	2010	2011
				Proj	
Output and demand (percent change)					
Real GDP	4.8	2.2	1.2	3.0	3.5
Total domestic demand	6.8	3.8	0.5	5.4	4.4
Private consumption	5.2	1.9	1.7	3.3	3.0
Total investment	9.8	9.0	-1.1	8.4	6.1
Net exports 1/	-1.6	-1.7	2.0	-2.1	-0.7
Inflation and unemployment (in percent)					
CPI inflation	2.3	4.4	1.8	3.0	3.0
Unemployment rate	4.4	4.2	5.6	5.2	5.1
Saving and investment (in percent of GDP)					
Gross national saving	23.1	24.7	23.6	25.7	27.2
General government saving	5.1	4.1	2.6	2.1	2.8
Private saving 2/	18.0	20.5	21.0	23.6	24.4
Gross capital formation	28.9	29.1	28.0	28.2	29.5
Fiscal indicators (cash basis, in percent of GDP) 3/					
Receipts	25.0	25.0	23.3	21.9	22.2
Payments	23.2	23.0	25.2	25.9	24.9
Underlying cash balance	1.6	1.7	-2.2	-4.2	-2.9
Fiscal balance (accrual basis)	1.6	1.8	-2.4	-4.1	-2.8
Net debt	-2.7	-3.8	-1.3	3.3	5.8
Money and credit (end of period)					
Interest rate (90-day bill, in percent) 4/	7.2	4.1	4.2	4.3	…
Treasury bond yield (10-year, in percent) 4/	6.3	4.0	5.6	5.6	…
M3 (percent change) 4/	22.7	14.7	5.8	4.2	…
Private domestic credit (percent change) 4/	17.2	7.6	0.8	1.6	…
Balance of payments (in percent of GDP)					
Current account	-6.2	-4.5	-4.4	-2.4	-2.3
Of which: Trade balance (goods)	-1.8	-0.3	-0.5	1.4	1.6
Terms of trade (percent change)	4.6	14.3	-8.3	18.9	2.0
External assets and liabilities (in percent of GDP)					
Net external liabilities	55.9	56.3	61.1	56.9	55.5
Net external debt	51.7	55.0	51.9	50.0	48.7
Gross official reserves 4/	2.7	3.8	3.7	3.2	...
Net official reserves 4/	3.1	3.8	3.7	3.4	...
Exchange rate (period average) 4/					
U.S. dollar/Australian dollar	0.84	0.85	0.79	0.97	…
Trade-weighted index	67.5	66.3	63.2	71.5	…
Real effective exchange rate 5/	131.1	128.9	125.6	139.0	…
Memorandum Item:					
Nominal GDP (in billions of Australian dollar)	1,137	1,252	1,255	1,364	1,459

Sources: Data provided by the Australian authorities; and IMF staff estimates and projections.

1/ Contribution to growth.
2/ Includes public trading enterprises.
3/ Fiscal year ending June 30, Commonwealth Budget. For example, 2011 refers to fiscal year July 1, 2010 to June 30, 2011 which the Australian Government's budget papers denote as budget year 2010.
4/ Data for 2010 are for latest available month.
5/ IMF, Information Notice System index (2000 = 100).

Table 2. Australia: Fiscal Accounts, 2005/06–2014/15 1/
(In percent of GDP)

	2005/06	2006/07	2007/08	2008/09	Projections 2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Fiscal accounts on an accrual basis 2/										
Commonwealth government										
Revenue	26.1	25.5	25.7	23.8	22.5	22.7	24.0	24.3	24.5	24.7
Tax	24.6	24.1	24.2	22.2	20.6	21.3	22.7	23.1	23.2	23.5
Income tax	17.6	17.4	17.7	16.1	14.5	15.3	16.4	17.0	17.3	17.5
Individuals and other withholdings	11.4	10.8	10.7	9.3	9.2	9.2	9.6	9.9	10.1	10.2
Indirect and other tax	6.9	6.7	6.6	6.2	6.1	6.1	6.3	6.1	5.9	6.0
Nontax	1.6	1.5	1.5	1.6	1.9	1.4	1.3	1.3	1.2	1.3
Expenditure	24.2	23.7	23.7	25.9	26.1	25.0	24.4	24.2	23.9	23.7
Salaries and wages	1.2	1.2	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1
Goods and services	4.8	4.7	4.4	4.6	4.8	4.7	4.5	4.5	4.5	4.5
Current transfers	16.1	15.5	15.5	16.7	17.0	16.6	16.6	15.7	15.6	15.5
Other expenses	2.2	2.3	2.5	3.3	2.9	2.5	2.1	2.8	2.6	2.6
Net capital investment	0.2	0.2	0.2	0.3	0.5	0.5	0.3	-0.1	0.2	0.2
Fiscal balance 3/	1.5	1.6	1.8	-2.4	-4.1	-2.8	-0.7	0.2	0.4	0.8
State, Territory, and local government balance	0.9	-0.4	-0.3	-0.6	-1.1	-1.0	-0.6	-0.2	…	…
Public nonfinancial corporations balance 4/	-1.0	-0.8	-1.1	-1.6	-1.5	-1.1	…	…	…	…
Nonfinancial public sector balance	1.0	0.8	0.2	-5.0	-7.8	-5.7	…	…	…	…
Fiscal accounts on a cash basis										
Commonwealth government										
Receipts	25.6	25.0	25.0	23.3	21.9	22.2	23.5	24.1	23.9	24.2
of which taxes	24.1	23.6	23.6	21.7	20.1	20.8	22.1	22.5	22.7	23.0
Payments	24.0	23.2	23.0	25.2	25.9	24.9	24.1	23.8	23.5	23.3
Future Fund earnings	0.0	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3
Underlying cash balance 5/	1.6	1.6	1.7	-2.2	-4.2	-2.9	-0.8	0.1	0.3	0.6
Consolidated general government (Commonwealth and States/Local)										
Underlying cash balance 5/	2.5	1.4	1.7	-2.6	-5.4	-3.8	-1.2	0.0	0.1	0.6
Memorandum items:										
Commonwealth government net debt 6/	-0.4	-2.7	-3.8	-1.3	3.3	5.8	6.2	6.0	5.5	5.1
Consolidated general government net debt	-5.4	-7.3	-7.4	-3.6	3.5	7.2	8.3	8.3	7.5	7.0
Consolidated general government gross debt	10.1	9.4	9.6	13.9	20.4	23.5	24.4	24.2	23.2	22.5
Nominal GDP (in billions of Australian dollars)	1,001	1,091	1,182	1,255	1,300	1,414	1,485	1,568	1,658	1,745

Sources: Commonwealth of Australia: 2010-11 Budget; and IMF staff estimates and projections.

1/ Fiscal year ending June 30.
2/ Accrual data are reported on a consistent basis with *Government Financial Statistics* (*GFS*).
3/ The fiscal balance is equal to revenue less expenses and net capital investment.
4/ The consolidated Commonwealth, state, and local governments.
5/ Underlying cash balance equals receipts less payments, and excludes earnings of the Future Fund.
6/ Includes Future Fund assets that are kept in cash and debt instruments.

Table 3. Australia: Balance of Payments, 2005–09
(In percent of GDP)

	2005	2006	2007	2008	2009
Current account balance	-5.7	-5.3	-6.2	-4.5	-4.4
Goods balance	-1.8	-1.3	-1.8	-0.3	-0.5
Exports	14.5	15.9	15.0	18.1	15.7
Imports	-16.3	-17.1	-16.8	-18.4	-16.2
Net services	0.0	0.1	0.0	-0.4	0.0
Total credits	4.2	4.2	4.2	4.2	4.2
Total debits	-4.2	-4.2	-4.3	-4.6	-4.2
Net income	-3.7	-4.0	-4.3	-3.7	-3.8
Of which: Net interest payments	-1.7	-2.1	-2.4	-2.3	-2.3
Of which: Net equity income	-2.0	-1.9	-1.8	-1.3	-1.4
Net transfers	0.0	-0.1	0.0	0.0	-0.1
Capital and financial account	5.7	5.3	6.2	4.4	4.4
Capital account	0.0	0.0	0.0	0.0	0.0
Financial account	5.7	5.2	6.2	4.4	4.4
Direct investment transactions (net)	0.9	0.7	3.0	1.3	0.8
Equity (net)	0.2	-0.1	1.9	-0.1	2.1
Debt (net)	0.7	0.9	1.1	1.4	-1.3
Portfolio investment transactions (net)	4.5	6.8	-2.2	2.8	7.8
Equity (net)	-0.6	-1.4	-3.7	2.7	0.1
Debt (net)	5.2	8.1	1.5	0.0	7.7
Financial derivatives (net)	-0.2	0.1	-1.1	0.1	-0.5
Other transactions (net)	0.6	-2.3	6.4	0.3	-3.7
Net errors and omissions	-0.1	0.0	0.0	0.1	0.0
	(Assets and liabilities at end-period)				
Net external liabilities	53.8	55.9	55.9	56.3	61.1
Net external equity liabilities	5.7	5.7	4.2	1.3	9.2
Foreign equity investment in Australia	50.8	56.2	59.9	42.4	55.8
Australian equity investment abroad	-45.1	-50.5	-55.7	-41.1	-46.5
Net external debt	48.2	50.2	51.7	55.0	51.9
Net public sector	1.0	0.4	3.7	6.4	5.4
Net private sector	47.2	49.9	48.0	48.6	46.6
Gross external debt	80.9	89.5	91.5	101.9	98.1
Of which: Australian dollar-denominated	29.2	32.5	35.8	38.0	42.9
Gross external lending	-32.7	-39.3	-39.8	-46.9	-46.2
Short-term net external debt (residual maturity basis)	18.1	17.9	23.2	23.5	15.2
Short-term gross external debt	36.2	39.3	43.1	49.2	41.7
Short-term gross external lending	-18.1	-21.3	-19.9	-25.7	-26.5
Memorandum items:					
Gross official reserves (in billions of Australian dollars)	59.0	69.6	30.5	47.5	46.5
Gross reserves in months of imports	3.6	3.8	1.5	2.0	2.2
Gross reserves to ST FX denominated debt (percent)	24.5	23.6	9.3	11.8	15.1
Net interest payments to exports (percent)	9.3	10.4	12.3	10.4	11.5

Sources: Data provided by the Australian authorities; and IMF staff estimates and projections.

Table 4. Australia: Balance of Payments in U.S. Dollars, 2005–09
(In billions of U.S. dollars)

	2005	2006	2007	2008	2009
Current account balance	-41.6	-41.6	-58.6	-47.5	-43.7
Goods balance	-13.6	-9.8	-17.4	-3.4	-4.7
Exports	106.7	124.5	142.4	191.2	156.2
Imports	-120.3	-134.3	-159.8	-194.6	-160.9
Net services	-0.1	0.4	-0.2	-4.2	-0.2
Total credits	30.7	33.0	40.2	44.9	41.9
Total debits	-30.8	-32.6	-40.5	-49.2	-42.1
Net income	-27.6	-31.7	-40.9	-39.5	-38.0
Of which: Net interest payments	-12.7	-16.4	-22.4	-24.5	-22.8
Of which: Net equity income	-14.8	-14.8	-17.4	-13.8	-14.0
Net transfers	-0.3	-0.5	-0.1	-0.3	-0.8
Capital and financial account	42.3	41.4	59.2	46.6	43.5
Capital account	-0.1	0.2	-0.2	-0.4	-0.3
Financial account	42.4	41.2	59.4	46.9	43.8
Direct investment transactions (net)	6.9	5.6	28.7	13.5	8.2
Equity (net)	1.5	-1.2	18.3	-1.4	21.0
Debt (net)	5.4	6.8	10.4	14.9	-12.8
Portfolio investment transactions (net)	33.5	53.1	-20.8	29.5	77.3
Equity (net)	-4.6	-10.7	-35.2	29.1	0.9
Debt (net)	38.1	63.8	14.4	0.4	76.4
Financial derivatives (net)	-1.4	0.7	-10.9	0.8	-5.1
Other transactions (net)	4.4	-18.3	61.2	3.2	-36.4
Net errors and omissions	-0.9	0.0	-0.3	1.2	0.2
	(Assets and liabilities at end-period)				
Net external liabilities	381.7	460.8	560.9	488.5	688.2
Net external equity liabilities	40.1	46.7	42.3	11.4	103.7
Foreign equity investment in Australia	360.2	463.3	600.4	367.8	627.8
Australian equity investment abroad	-320.1	-416.6	-558.1	-356.3	-523.8
Net external debt	341.6	414.1	518.6	477.1	584.5
Net public sector	7.1	3.0	36.8	55.8	60.4
Net private sector	334.5	411.0	481.8	421.3	524.1
Gross external debt	573.6	737.6	917.2	883.8	1104.8
Of which: Australian dollar-denominated	207.4	268.1	359.0	329.6	483.0
Gross external lending	-232.0	-323.5	-398.7	-406.7	-520.3
Short-term net external debt (residual maturity basis)	128.3	147.9	232.9	203.5	171.5
Short-term gross external debt	256.5	323.6	432.0	426.3	469.5
Short-term gross external lending	-128.2	-175.7	-199.1	-222.8	-297.9

Sources: Data provided by the Australian authorities; and IMF staff estimates.

Table 5. Australia: Medium-Term Scenario, 2008–15

	Average			Projections					
	1998–2007	2008	2009	2010	2011	2012	2013	2014	2015
Real economic indicators (percent change)									
GDP	3.6	2.2	1.2	3.0	3.5	3.5	3.3	3.3	3.2
Total domestic demand	4.8	3.8	0.5	5.4	4.4	3.9	3.6	3.6	3.4
Private consumption	4.1	1.9	1.7	3.2	3.1	3.4	3.5	3.4	3.6
Government consumption	3.2	3.3	2.8	4.8	1.2	2.6	2.3	2.0	2.0
Total investment	6.5	9.0	-1.1	8.4	6.1	7.4	6.1	5.5	4.1
Private sector	11.1	6.9	-2.4	4.0	9.4	9.5	7.3	6.5	4.9
Business	8.7	11.0	-2.3	3.0	10.9	11.6	8.1	7.5	5.5
Dwelling	3.8	2.6	-4.5	8.0	6.2	5.6	5.1	3.9	3.5
Public sector	3.3	19.4	4.4	26.7	-5.1	-0.9	1.0	0.8	0.2
Net exports 1/	-0.7	-1.7	2.0	-2.1	-0.7	-0.6	-0.5	-0.4	-0.3
Potential growth	3.5	2.8	2.7	2.6	3.0	3.4	3.4	3.4	3.2
Output gap	0.2	0.6	-0.8	-0.4	0.1	0.2	0.1	0.0	0.0
CPI inflation	2.8	4.4	1.8	3.0	3.0	3.0	2.7	2.5	2.5
Unemployment rate (percent)	6.0	4.2	5.6	5.2	5.1	5.0	4.8	4.8	4.8
Saving and investment (percent of GDP)									
Gross national saving	21.6	24.7	23.6	25.7	27.2	26.3	25.6	24.8	23.7
General government saving	4.3	4.1	2.6	2.1	2.8	4.7	5.5	5.5	5.5
Private saving 2/	17.3	20.5	21.0	23.6	24.4	21.6	20.0	19.3	18.2
Of which: Household	6.4	6.7	8.7	6.6	6.7	6.2	5.9	5.5	5.1
Gross capital formation	26.3	29.1	28.0	28.2	29.5	30.2	30.3	30.2	29.7
Of which: Private fixed investment	21.4	24.6	23.5	21.9	22.9	24.4	25.1	25.5	25.4
Commonwealth budget (percent of GDP) 3/									
Receipts (cash basis)	25.0	25.0	23.3	21.9	22.2	23.5	24.1	23.9	24.2
Payments (cash basis)	24.0	23.0	25.2	25.9	24.9	24.1	23.8	23.5	23.3
Underlying cash balance 4/	1.0	1.7	-2.2	-4.2	-2.9	-0.8	0.1	0.3	0.6
Net debt	5.0	-3.8	-1.3	3.3	5.8	6.2	6.0	5.5	5.1
Balance of payments (percent of GDP)									
Balance on goods and services	-1.6	-0.7	-0.5	1.1	1.1	-0.4	-0.9	-1.4	-1.7
Balance on income and transfers	-3.2	-3.8	-3.9	-3.6	-3.4	-3.5	-3.7	-4.0	-4.3
Current account balance	-4.8	-4.5	-4.4	-2.4	-2.3	-3.9	-4.7	-5.4	-6.0
Trade in goods and services (percent change)									
Export volume	3.1	3.3	0.8	3.5	4.2	4.7	4.5	4.8	4.8
Import volume	8.3	11.6	-8.3	13.5	6.7	6.8	6.0	5.7	5.3
Terms of trade (level)	74.0	109.7	100.5	119.6	122.0	116.2	114.6	113.1	111.6
Terms of trade	4.1	14.3	-8.3	18.9	2.0	-4.7	-1.4	-1.4	-1.3
Export price	4.0	23.0	-10.1	10.0	11.2	-15.3	0.4	0.4	0.4
Import price	-0.1	7.3	-1.8	-7.4	9.0	-11.0	1.9	1.7	1.8
External liabilities									
Net external liabilities (percent of GDP)	52.2	56.3	61.1	56.9	55.5	57.0	58.6	60.9	63.6
Net external interest (percent of exports)	9.7	10.4	11.5	10.5	11.5	14.4	15.8	16.8	18.1
Net foreign debt	43.8	55.0	51.9	50.0	48.7	50.1	51.5	53.4	55.9
Memorandum items:									
Nominal GDP (in billions of Australian dollar)	832	1,252	1,255	1,364	1,459	1,523	1,610	1,701	1,797
Partner country GDP growth	4.1	2.6	-0.4	5.5	4.4	4.5	4.4	4.4	4.4
Real effective exchange rate (period average)	112.2	128.9	125.6	…	…	…	…	…	…
U.S. dollar/Australian dollar	0.66	0.85	0.79	…	…	…	…	…	…
10-year government bond yield	5.7	5.5	5.2	5.6	6.0	6.2	6.5	6.5	6.5
90-day Aus rates (avg.)	5.5	6.7	3.5	4.5	5.3	5.5	5.5	5.5	5.4

Sources: Data provided by the Australian authorities; and IMF staff estimates and projections.

1/ Contribution to growth.
2/ Includes public trading enterprises.
3/ Fiscal year basis ending June 30. For example, 2011 refers to fiscal year July 1, 2010 to June 30, 2011 which the Australian Government's budget papers denote as budget year 2010.
4/ Underlying cash balance equals receipts less payments, and excludes Future Fund earnings.

Table 6. Australia: Indicators of External and Financial Vulnerability, 2005–09
(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009
External indicators					
Real exports of goods (percent change)	2.4	3.1	3.0	2.6	1.5
Real imports of goods (percent change)	9.9	8.1	11.5	10.6	-8.6
Terms of trade (percent change)	11.8	7.6	4.6	14.3	-8.3
Current account balance	-5.7	-5.3	-6.2	-4.5	-4.4
Capital and financial account balance	5.7	5.3	6.2	4.4	4.4
Of which:					
Net portfolio investment	4.5	6.8	-2.2	2.8	7.8
Net direct investment	0.9	0.7	3.0	1.3	0.8
Total reserves (in billions of U.S. dollar)	43.3	55.1	26.9	32.9	30.8
In months of imports of goods and services	3.6	3.8	1.5	2.0	2.2
Total net reserves (in billions of U.S. dollar)	21.0	24.3	31.6	33.3	31.0
Net international investment position	-53.8	-55.9	-55.9	-56.3	-61.1
Of which:					
Net external public sector debt	1.0	0.4	3.7	6.4	5.4
Net external private sector debt	47.2	49.9	48.0	48.6	46.6
Net interest payments to exports (in percent)	9.3	10.4	12.3	10.4	11.5
Nominal effective exchange rate (percent change)	2.4	-1.6	6.1	-1.8	-14.5
Financial market indicators					
General government gross debt (percent of GDP)	10.7	9.8	9.5	11.6	17.6
Interest rates (percent)					
3-month T-bill	5.6	6.0	6.7	7.0	3.4
3-month interest rate spread vis-à-vis U.S.	2.4	1.1	2.2	5.6	3.4
10-year government bond	5.3	5.6	6.0	5.8	5.0
Capital adequacy					
Regulatory capital to risk-weighted assets	10.4	10.4	10.2	11.4	12.0
Tier I capital to risk-weighted assets 1/	7.6	7.4	7.2	8.2	9.4
Asset quality 2/					
Impaired assets to total assets	0.2	0.2	0.2	0.8	1.2
Specific provisions to impaired assets	37.1	39.1	39.5	35.6	34.4
Loans composition (share of total)					
Public sector	1.5	1.4	1.3	1.9	4.0
Individuals	62.3	60.4	54.6	54.6	59.1
Housing loans	53.8	51.9	46.7	48.1	53.0
Investor housing	18.2	17.2	15.4	15.5	16.2
Commercial lending	36.3	38.2	44.1	43.5	36.9
Financial intermediaries	7.5	8.8	12.8	12.7	9.7
Nonfinancial sector	28.7	29.4	31.3	30.9	27.3

Sources: Data provided by the Australian authorities; and IMF staff estimates.

1/ Tier I capital includes issued and fully paid common equity and perpetual noncumulative preference shares, and disclosed reserves.

2/ Q4 quarterly data.

Appendix I. Australia: Unwinding Crisis-Related Monetary Policy Measures

	Measures Taken	Status of Unwinding
Monetary Policy Rate	The Reserve Bank of Australia (RBA) cut its policy rate from 7¼ percent to 3 percent over the seven months to April 2009.	The RBA has increased the policy rate by 150 basis points to 4½ percent in six moves starting in October 2009, the most recent increase was in May.
Liquidity Support and Foreign Exchange Swap Arrangement	The RBA extended the list of securities used as collateral in repo operations to include residential mortgage-backed securities, commercial paper, and asset-backed commercial paper. Furthermore, the RBA undertook a larger share of repos of up to one-year maturity.	
	The RBA established a US$30 billion swap line with the U.S. Federal Reserve Bank in September 2008, initially through April 2009 and later extended to February 2010.	The swap line was used up to early 2009, and expired on February 1, 2010.
	The government announced that it would purchase up to $A 16 billion of residential mortgage-backed securities.	
Funding Guarantees	The Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) was announced by the government on October 12, 2008 and formally commenced on November 28, 2008. The Scheme guaranteed deposit balances up to and including $A 1 million per customer held in an eligible authorized deposit taking institution (Australian-owned and subsidiaries of foreign-owned banks, but not branches) and existing or new large deposits (over $A 1 million) and wholesale funding (for a fee of 70 to 150 basis points depending on the credit rating of the institution). Branches of foreign-owned banks were also included after the Scheme commenced for a fee.	The wholesale funding guarantee was phased out for new liabilities from March 31, 2010, remaining in effect only for the liabilities previously guaranteed for the relevant term. Separate arrangements will continue to apply for deposit balances totaling up to and including $A 1 million per customer per institution until October 2011, when the level of coverage will be revised. Such deposits are guaranteed without charge.

Sources: IMF staff.

Appendix II. Australia: Financial Sector Assessment Program (FSAP): Key Recommendations of the 2006 FSAP and Update on the Progress of Implementation[1]

Issue	Key Recommendations	Progress of Implementation
Banking	Continue to ensure strong risk management practices, including through regular stress testing.	The Basel II framework has been implemented since January 2008, with the five major banks approved to adopt internal models for credit and operational risk. Stress testing is regularly carried out by banks as part of their Internal Capital Adequacy Assessment Process. As part of its supervisory action, APRA thoroughly assesses banks' risk management practices promptly driving enhancements if deemed necessary.
Failure Resolution and Crisis Management	Continue to develop a formal process to manage the failure of individual institutions and more widespread crises.	The government introduced in October 2008 a Financial Claims Scheme (FCS), establishing depositors protection with a limit of $A 1 million in case of a bank's failure (the guarantee applies also to claims of policyholders of a failed general insurer). The Council of Financial Regulators is reviewing the parameters of the FCS, in particular its monetary cap. The Council held a crisis management simulation exercise in 2009. In 2010, legislation was passed to enhance APRA's crisis management powers in relation to distressed banks and general insurers.
Supervisory Capacity	Ensure that the supervisory agencies have adequate resources and flexibility.	In the 2007/08 Budget, APRA received additional funding over a four-year period to improve its staff capabilities. In October 2008, to manage issues associated with the global financial crisis, the government provided additional funding to APRA of $A 45.5 million over four years. The government has also enhanced APRA's flexibility by removing the requirement to obtain ministerial consent before taking administrative actions. The Australian Securities and Investments Commission (ASIC) also received substantial funding increases over recent years. APRA has released a discussion paper that proposes a new supervisory framework for cross-industry financial conglomerates (level 3 groups). The proposed framework seeks to increase APRA's ability to assess and manage the complex risks that may arise in these groups to improve the supervision of prudential entities in these groups.
Cooperation with New Zealand Regulators	Build on the progress made within the Trans-Tasman Council on Banking Supervision to improve coordination in crisis management.	Legislative changes formalizing a requirement on regulators in the two countries to be alert to each other's interests in times of stress came into force in both countries in December 2006. The work of the Trans-Tasman Banking Council now focuses more on the practical aspects of coordination in crisis management with a protocol being agreed with the aim of establishing procedures to jointly deal with a regional banking crisis. A joint crisis management exercise is expected to be carried out in the second half of 2011.
Insurance	Push ahead with Stage II reforms (e.g., capital management, reinsurance documentation, corporate government standards, disclosure requirements).	APRA is harmonizing prudential requirements, including capital adequacy, between life insurance, general insurance, and banking sectors. From July 1, 2008, all Direct Offshore Foreign Insurers operating in Australia must be authorized by APRA and subject to Australia's prudential regime. Discretionary Mutual Funds are now subject to rigorous and compulsory information collection.
AML/CFT	Give high priority to make the appropriate legislative and operational arrangements in the AML/CFT area.	The AML/CFT Act was adopted in December 2006. The first tranche of reforms covered the activities of financial service providers, gambling services and bullion dealers. Implementation is now complete. The second tranche of legislative and regulatory reforms, intended to capture designated non-financial businesses and professionals is planned is under consideration by the Government. Legislation has been implemented facilitating information exchange between the Australian Transaction Reports and Analysis Centre (AUSTRAC) and APRA.

Source: IMF staff.

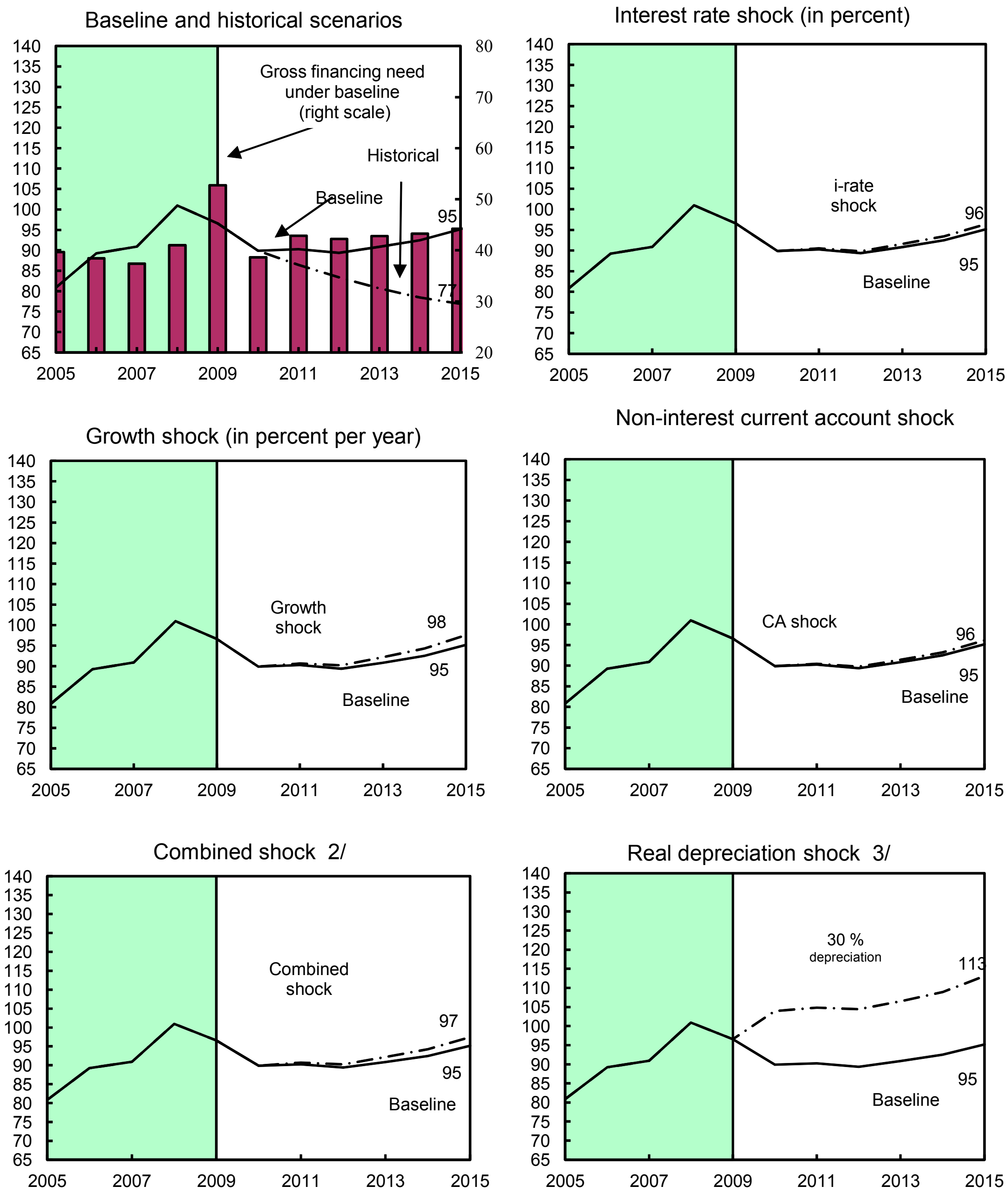
[1] A detailed discussion and a full list of recommendations can be found in the Financial System Stability Assessment (*IMF Country Report No. 06/372*).

Appendix III. Australia: Main Recommendations of the 2009 Article IV Consultation (Consultation Discussions Ended on August, 5, 2009)

Fund Recommendations	Policy Actions
Fiscal policy: Staff noted that there was scope for further fiscal stimulus should the outlook for growth weakened further, although monetary policy should be the first line of defense. If growth were slower than expected in the near-term, staff advised to let the automatic stabilizers fully operate.	With the economy recovering at a faster pace than expected, the fiscal stimulus has started to be withdrawn as originally planned and revenue windfalls have been largely saved.
Staff welcomed the authorities' fiscal strategy and intention to return to surpluses in 2015-16, but noted that further fiscal adjustment may be needed. Growth of real spending would need to be constrained below the 2 percent annual real rate envisaged in the budget. And if revenues were higher than currently expected, the authorities should strive for an earlier return to surplus.	The current fiscal strategy envisages returning to a budget surplus by 2012/13, three years earlier than envisaged. Once the budget is back in surplus, the government will retain a 2 percent real cap on spending growth, on average, until the budget surplus reaches 1 percent of GDP.
Monetary policy: Staff suggested that the RBA exercise caution in tightening in view of the fragile state of the global economy. Staff suggested that if the outlook for growth and inflation weakens, the RBA had scope for further cuts in the policy rate. Staff suggested that the authorities consider unconventional easing monetary policy measures, in the unlikely event that such measures are needed.	As the recovery was stronger than expected the RBA started to withdraw monetary stimulus, raising the policy rate to 4½ percent in six steps, the most recent in May.
Financial sector policy: Staff recommended that in the future stress tests should be based on more extreme scenarios than used in the past. The test should be undertaken jointly with their subsidiaries. Staff recommended that banks continue to manage carefully their short- term offshore debt and the planned introduction of new liquidity guidelines should encourage less reliance on short-term wholesale funding.	APRA conducted stress tests, most recently in 2009/10 in cooperation with the Reserve Bank of New Zealand and the New Zealand subsidiaries of Australian banks.

Sources: IMF staff.

Appendix IV. Australia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: IMF country desk data and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent 1/2 standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2010. This scenario assumes foreign exchange hedging covers 79 percent of foreign currency debt, consistent with the findings of a survey by the ABS, as reported in "Australia's Foreign Currency Exposure and Hedging Practices." RBA Bulletin, December 2005.

INTERNATIONAL MONETARY FUND

AUSTRALIA

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department

October 12, 2010

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ANNEX I. AUSTRALIA—FUND RELATIONS
(As of August 31, 2010)

I. Membership Status: Joined: August 5, 1947; Article VIII

II. General Resources Account:	**SDR Million**	**Percent Quota**
Quota	3,236.40	100.00
Fund holdings of currency	2,540.16	78.49
Reserve position in Fund	696.66	21.53

III. SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	3,083.17	100.00
Holdings	3,098.34	100.50

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund[1] (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2011	**2012**	**2013**	**2014**
Principal	0.00	0.00	0.00	0.00
Charges/interest	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Exchange Rate Arrangement. Australia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange system that is free from restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions that are maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). The exchange rate is free floating, but the Reserve Bank of Australia retains discretionary power to intervene. There are no taxes or subsidies on purchases or sales of foreign exchange.

VIII. Restrictions on Capital Transactions. Australia maintains a capital transactions regime that is virtually free of restrictions. Two main restrictions on foreigners require: authorization for significant ownership of Australian corporations; and approval for acquisition of real estate.

IX. Article IV Consultation. Australia is on the 12-month consultation cycle. The 2009 Article IV consultation discussions were held during June 12–23, 2009, the Executive Board discussed the staff report (IMF Country Report No. 09/248) and concluded the consultation on August 5, 2009.

X. FSAP Participation. The FSAP missions took place during November 30–December 14, 2005, and March 26–April 12, 2006. The FSSA (including financial sector ROSCs), the Detailed Assessment of Observance of Standards and Codes, and the Technical Note on Investor Protection, Disclosure, and Financial Literacy, were published as Country Reports No. 06/372, No. 06/415, and No. 06/437, respectively.

XI. Fourth Amendment. Australia has accepted the Fourth Amendment to the Articles of Agreement.

ANNEX II. AUSTRALIA: STATISTICAL ISSUES

Data provision is adequate for surveillance. Australia subscribed to the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). In recent years, the Australian Bureau of Statistics (ABS) has taken several initiatives to further improve the quality of the data, such as including the prices of financial services in the CPI and developing new measures of labor underutilization.

In September 2006, STA met with officials from the ABS, the Australian Prudential Regulation Authority, and the Reserve Bank of Australia to encourage the reporting of monetary data using the standardized report forms (SRFs) introduced in October 2004. The SRFs provide for accounting data to be broken down by instrument, sector, and currency. In March 2010, a STA mission took place in Sydney and Canberra to prepare the Data Module of the Report on the Observance of Standards and Codes (ROSC) assessment.

Table of Common Indicators Required for Surveillance
(As of October 1, 2010)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	10/1/10	10/01/10	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	08/10	08/06/10	M	M	M
Reserve/Base Money	08/10	9/30/10	M	M	M
Broad Money	08/10	9/30/10	M	M	M
Central Bank Balance Sheet	09/29/10	9/29/10	W	W	W
Consolidated Balance Sheet of the Banking System	08/10	9/30/10	M	M	M
Interest Rates[2]	10/1/10	10/01/10	D	D	D
Consumer Price Index	Q2 2010	07/28/10	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2009/10	9//24/10	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	05/10	07/22/10	M	M	M
External Current Account Balance	Q2 2010	08/31/10	Q	Q	Q
Exports and Imports of Goods and Services	07/10	09/02/10	M	M	M
GDP/GNP	Q2 2010	09/01/10	Q	Q	Q
Gross External Debt	Q2 2010	08/31/10	Q	Q	Q
International Investment Position[7]	Q2 2010	08/31/10	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Consists of the central government (including budgetary, extra budgetary, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Includes external gross financial asset and liability positions vis a vis nonresidents.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with Australia

On October 27, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Australia.[1]

Background

Despite growth slowing due to the global financial crisis, Australia was one of the few advanced economies to escape recession in 2009. This reflected growing links with Asia, including strong demand for commodities from China and India, a prompt and significant macro policy response to the global crisis, a healthy banking sector, and a flexible exchange rate. The labor market also proved to be flexible in the face of the shock.

With the recovery well on track and dissipating spare capacity, policy stimulus is appropriately being withdrawn. The RBA has raised the policy rate to 4½ percent in six steps, the most recent in May. The increases in the policy rate have flowed through effectively to both mortgage and business lending rates which have returned close to their 10-year averages. As originally planned, the fiscal stimulus is being reduced starting in 2010.

A mining boom is underway, as commodity prices have rebounded and the outlook remains favorable. Real GDP growth is projected at 3–3½ percent in 2010 and 2011, with private

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

investment in mining and commodity exports taking over from public demand as the main driver of growth. The terms of trade is expected to rise to historic highs in late 2010, driving a mining boom that is likely to be long lasting, given increasing ties with fast-growing emerging Asia.

The main risks relate to the global outlook and, in the near term, are tilted largely to the downside. If the global recovery stalls and Chinese demand for commodities declines, Australia's terms of trade could fall sharply. In addition, concerns about fiscal sustainability in Europe could disrupt global financial markets and push up the cost of capital for Australian borrowers. On the domestic front, a fall in house prices, which Fund staff assesses could be mildly overvalued, and deleveraging by highly indebted households could negatively impact private consumption and slow the recovery. An upside risk is that the mining boom may have a larger-than-expected impact on output and inflation.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' decisive policy response on the back of sound fundamentals which, together with strong demand from emerging Asia, cushioned the impact of the global crisis. Australia's economic prospects are favorable, driven by a mining boom and increasing integration with emerging Asia, although the near-term outlook is somewhat clouded by the uncertain global environment.

Directors welcomed the Reserve Bank of Australia's (RBA) timely unwinding of monetary stimulus. They noted that if the recovery and economic growth remain on track and downside risks dissipate, monetary policy might need to tighten further to contain inflation pressures. Should the global recovery stall, the RBA has scope to cut the policy rate.

Directors agreed that the pace of exit from fiscal stimulus was appropriate. They commended the authorities' plan to return to surplus by 2012/13 and noted that there is enough fiscal space to slow the pace of exit or loosen fiscal policy in response to a downside scenario. Directors also noted that the automatic fiscal stabilizers should be allowed to operate fully, given that the growing dependence on mining may amplify the business cycle. This implies running larger budget surpluses during upswings to help avoid potential overheating and build a buffer against a sharp fall in commodity prices.

Directors welcomed the recent review of the tax system, including the introduction of the mineral resource rent tax (MRRT). They stressed the importance of broadening the coverage of the MRRT beyond iron ore and coal. Directors noted that more reliance on consumption-based taxes would allow for the elimination of inefficient state taxes and make room for reductions in personal income taxes, and encouraged the authorities to build consensus toward this end.

Directors welcomed the fact that the Australian banks are sound. They commended the Australian Prudential Regulation Authority's (APRA) regular stress testing and the authorities' efforts to improve banks' own stress testing capabilities and to extend stress testing beyond the banking sector. Directors encouraged continued vigilance to risks in the mortgage sector and close monitoring by APRA of banks' risk assessments and strategies.

Directors noted the vulnerabilities arising from the projected widening of the current account deficit and sizable short-term external debt. Efforts to raise national saving, including through a return to budget surpluses, would help contain current account deficits. Directors considered that rollover risks associated with short-term external debt could be reduced further by encouraging banks to extend the maturity of their offshore funding.

Directors recognized that the floating exchange rate has served Australia well and provides an important buffer against external vulnerabilities. They noted staff's assessment that the Australian dollar may be mildly overvalued from a medium-term perspective, while recognizing that the extent of overvaluation is uncertain.

Australia: Selected Economic Indicators, 2007–11

Nominal GDP (2009): $A 1,255 billion (US$996.4 billion) Quota (in millions): SDR 3,236.40

Unemployment rate (September 2010): 5.1 percent

	2007	2008	2009	2010	2011
				Proj.	
Output and demand (percent change)					
Real GDP	4.8	2.2	1.2	3.0	3.5
Total domestic demand	6.8	3.8	0.5	5.4	4.4
Private consumption	5.2	1.9	1.7	3.3	3.0
Total investment	9.8	9.0	-1.1	8.4	6.1
Net exports 1/	-1.6	-1.7	2.0	-2.1	-0.7
Inflation and unemployment (in percent)					
CPI inflation	2.3	4.4	1.8	3.0	3.0
Unemployment rate	4.4	4.2	5.6	5.2	5.1
Saving and investment (in percent of GDP)					
Gross national saving	23.1	24.7	23.6	25.7	27.2
General government saving	5.1	4.1	2.6	2.1	2.8
Private saving 2/	18.0	20.5	21.0	23.6	24.4
Gross capital formation	28.9	29.1	28.0	28.2	29.5
Fiscal indicators (cash basis, in percent of GDP) 3/					
Receipts	25.0	25.0	23.3	21.9	22.2
Payments	23.2	23.0	25.2	25.9	24.9
Underlying cash balance	1.6	1.7	-2.2	-4.2	-2.9
Fiscal balance (accrual basis)	1.6	1.8	-2.4	-4.1	-2.8
Net debt	-2.7	-3.8	-1.3	3.3	5.8
Money and credit (end of period)					
Interest rate (90-day bill, in percent) 4/	7.2	4.1	4.2	4.3	…
Treasury bond yield (10-year, in percent) 4/	6.3	4.0	5.6	5.6	…
M3 (percent change) 4/	22.7	14.7	5.8	4.2	…
Private domestic credit (percent change) 4/	17.2	7.6	0.8	1.6	…
Balance of payments (in percent of GDP)					
Current account	-6.2	-4.5	-4.4	-2.4	-2.3
Of which: Trade balance (goods)	-1.8	-0.3	-0.5	1.4	1.6
Terms of trade (percent change)	4.6	14.3	-8.3	18.9	2.0
External assets and liabilities (in percent of GDP)					
Net external liabilities	55.9	56.3	61.1	56.9	55.5
Net external debt	51.7	55.0	51.9	50.0	48.7
Gross official reserves 4/	2.7	3.8	3.7	3.2	...
Exchange rate (period average) 4/					
U.S. dollar/Australian dollar	0.84	0.85	0.79	0.97	…
Trade-weighted index	67.5	66.3	63.2	71.5	…
Real effective exchange rate 5/	131.1	128.9	125.6	139.0	…

Sources: Data provided by the Australian authorities; and IMF staff estimates and projections.
1/ Contribution to growth.
2/ Includes public trading enterprises.
3/ Fiscal year ending June 30, Commonwealth Budget. For example, 2011 refers to fiscal year July 1, 2010 to June 30, 2011 which the Australian government's budget papers denote as budget year 2010.
4/ Data for 2010 are for latest available month.
5/ IMF, Information Notice System index (2000 = 100).