October 2006
IMF Country Report No. 06/374

Australia: 2006 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 2006 Article IV consultation with Australia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 9, 2006, 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 August 3, 2006. 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 11, 2006 discussion of the staff report that concluded the Article IV consultation.

The documents listed below have been or will be separately released.

Financial System Stability Assessment
Information Note on Australia's Fiscal Data
Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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Washington, D.C.

INTERNATIONAL MONETARY FUND

AUSTRALIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Australia

Approved by David T. Coe and Carlo Cottarelli

August 3, 2006

- The 2006 Article IV consultation discussions were held in Sydney, Melbourne, and Canberra during June 1–9, 2006.
- The staff team consisted of Messrs. Coe (Head), Beaumont, Mercereau, Rozhkov (all APD), Mr. Ouanès (MFD), and Mr. Rancière (RES). Mr. Murray (Alternate Executive Director) attended the meetings in Melbourne and Canberra.
- The mission met with Treasurer Peter Costello, RBA Governor Ian Macfarlane, RBA Deputy Governor Glenn Stevens (who will become Governor on September 18, 2006), Treasury Secretary Ken Henry, Australian Prudential Regulatory Authority Chairman John Laker, Fair Pay Commission Chairman Ian Harper, Future Fund Chairman David Murray, and other senior officials, as well as representatives from the academic, labor, financial, and business sectors.
- Macroeconomic and structural policies are sound and are consistent with Fund advice. The 2006/07 Budget maintains Australia's robust medium-term fiscal position while introducing tax reforms that will help increase labor participation. Monetary policy has been tightened moderately as the medium-term outlook for inflation edged upwards. An ambitious and wide-ranging structural reform program, the *National Reform Agenda*, was agreed by the Council of Australian Governments in February 2006; in addition, the government's *WorkChoices* legislation, effective from March 2006, will further enhance the flexibility of the labor market. The authorities continue to closely monitor developments in household sector finances and in private external debt. These policies are consistent with Executive Director's recommendations at the conclusion of the 2005 Article IV consultation on August 29, 2005 *(IMF Country Report No. 05/331* http://www.imf.org/external/np/sec/pn/2005/pn05123.htm*)*.
- The exchange rate of the Australian dollar floats and Australia maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions (Annex I).
- Australia publishes an array of high-quality statistics (Annex II).

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EXECUTIVE SUMMARY

Economic growth is strengthening, stimulated by the highest terms of trade in three decades. After 14 years of economic expansion there was a modest slowing in 2005 following a welcome cooling of the housing market. But strong global growth has boosted Australia's export commodity prices, contributing to high business investment that is expected to underpin solid growth in exports in the medium term, while also resulting in a larger than normal external current account deficit and rising net foreign liabilities.

Past experience suggests that much of the terms of trade improvement will, sooner or later, be reversed. Hence the authorities allow for a significant decline in commodity prices in their medium-term fiscal projections. Nonetheless, commodity prices could fall more sharply if global growth were to slow significantly, although there is also the possibility that commodity prices remain high for longer than expected.

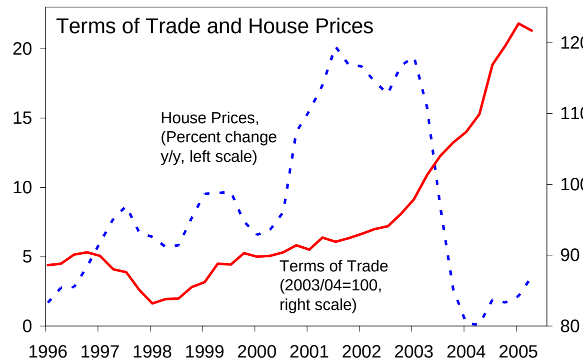
Macroeconomic policies are well positioned in the event of shocks. Monetary policy has been tightened appropriately and a further tightening may eventually be needed. A flexible monetary policy response to potential external shocks, including commodity price swings, will help to cushion growth while preserving low inflation. The fiscal position is projected to remain in surplus in the medium term, providing a substantial buffer against shocks; the surplus should be allowed to exceed budget targets if growth and revenues are stronger than expected.

The FSAP finds that the financial sector is healthy and financial supervision is sound. To promote robust risk management practices by financial institutions the authorities intend to conduct further stress tests, and they are reviewing the regulation of banks' liquidity. The authorities' initiative to ensure the legal foundations for the resolution of failed institutions is important to help underpin the resilience of the financial system during a crisis.

Now is the time to press ahead with implementing reforms to lift productivity and participation over the next decade. The recent surge in revenues provides resources that should be used to spur the implementation of reforms that, by sustaining strong economic growth, will help ensure that Australia is better placed to address the challenges of an ageing population and rising healthcare costs.

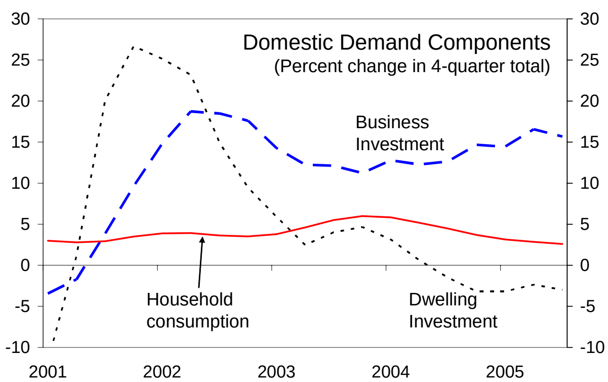
I. Booming Commodity Prices are Shaping Economic Developments[1]

1. **Australia is enjoying the most favorable terms of trade in three decades, immediately on the heels of a house price boom.** House prices rose by over 60 percent in 2001-03, but this was followed by a welcome cooling of the housing market in the past 2½ years. At the same time, Australia's terms of trade have risen by over 30 percent during the past three years as strong global growth, especially in China, has driven up prices for commodities such as iron ore and coal. Rising company profits, particularly in the resources sector, have also boosted equity prices to record highs.

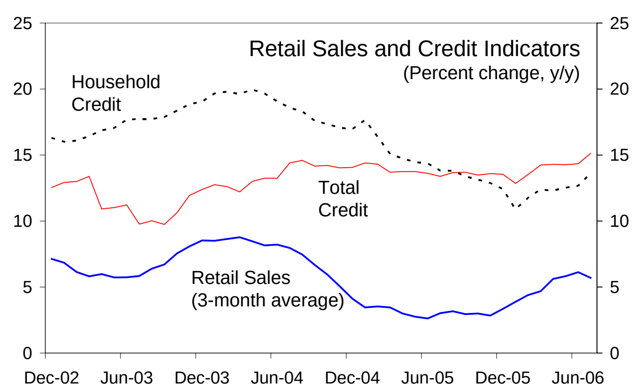


Source: Australian Bureau of Statistics.

2. **As a result, strong business investment helped cushion the slowing of real GDP growth in 2005 to 2½ percent.** High profits and capacity utilization, and the low relative price of capital goods, drove growth in business capital spending of 16 percent in 2005, with investment particularly strong in the resources sector (Table 1). This partly offset a decline in consumption growth and the modest fall in dwelling investment that followed the cooling of the housing market. Nonetheless, consumption shows signs of strengthening in 2006 and household credit growth has also picked up modestly, suggesting that any needed adjustment in household balance sheets may already be largely complete.[2]



Source: Australian Bureau of Statistics.



Source: Australian Bureau of Statistics and Reserve Bank of Australia.

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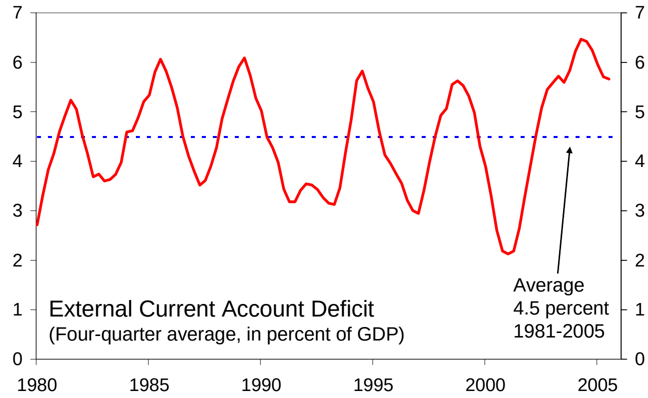
[1] Background on Australia's sustained economic expansion since 1992, and the related structural reforms and reforms of the macroeconomic policy framework, is provided by IMF Country Report No. 05/331.

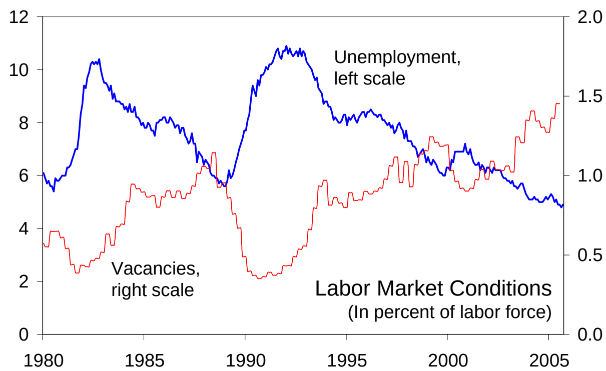
[2] This conclusion is consistent with the preliminary results of a forthcoming working paper, which finds that consumption was close to its estimated long-term equilibrium in late 2005. It also finds that consumption "overshoots" in response to changes in housing wealth, with a peak impact after one year some 60 percent larger than the long-run effect. An unwinding of this overshooting after the housing boom was a key factor dampening consumption growth in 2005.

3. **High investment and a strong currency kept the external deficit around 6 percent of GDP.**[3] The trade deficit narrowed owing to higher export prices but the improvement was held back by slow growth in export volumes owing to unfavorable weather, the appreciated exchange rate, and temporary disruptions of transport infrastructure for commodity exports (Table 2). Strong imports of capital goods kept overall import growth relatively high. Moreover, the investment income balance deteriorated, primarily because about half of the booming resource sector is foreign owned. External financing continued to rely on portfolio inflows, principally through offshore bond issues by the major banks in a range of international markets, with a weighted average maturity of around four years. Net foreign liabilities reached a new high, at 60 percent of GDP, but the ratio of net interest payments to exports remained low at 9 percent.[4]



Source: Australian Bureau of Statistics

4. **Unemployment has fallen to the lowest level in 30 years, but there has been little generalized wage pressure.** The unemployment rate fell to 4.9 percent in June as employment growth strengthened. Wage rises have picked up in the construction and mining sectors where employment growth has been strongest, but average private sector wage growth has risen relatively modestly, to 4 percent (y/y) in March 2006 from 3½ percent in recent years. Unit labor cost growth rose more significantly because labor productivity growth was unusally low in 2005, but productivity growth recovered in the first half of 2006.



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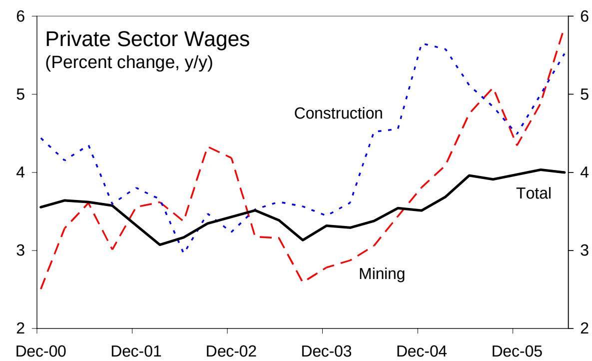

Source: Australian Bureau of Statistics

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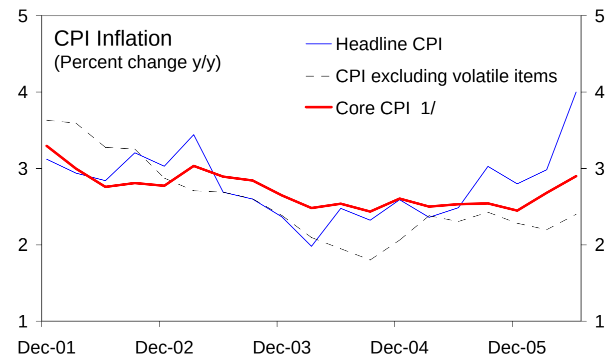
[3] Potential vulnerabilities stemming from Australia's large and sustained external current account deficits are further discussed in Chapter I of the forthcoming selected issues paper. In terms of the saving-investment balance, the rise in total investment to 26½ percent of GDP in 2005 is the main factor accounting for the external deficit being wider than its historical average of 4½ percent of GDP. National saving has been relatively stable at about 20 percent of GDP.

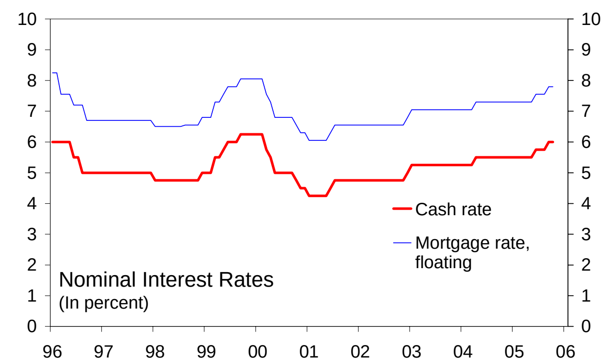
[4] The private sector accounts for virtually all (99 percent) of Australia's net external debt, with most (78 percent) intermediated by private financial institutions.

5. **Headline and core CPI inflation have increased.** Higher prices for oil and fruit helped to boost headline CPI inflation to 4 percent (y/y) in June 2006. Excluding these volatile items, CPI inflation has remained below 2½ percent. Nonetheless, the Reserve Bank of Australia's (RBA) statistical measures of core inflation have risen to just under 3 percent, after being steady for two years at the center of the 2-3 percent inflation target.



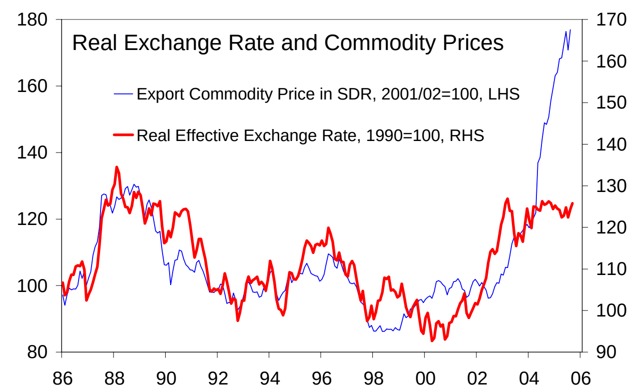
Sources: Australian Bureau of Statistics and Reserve Bank of Australia
1/ Average of weighted median and trimmed mean inflation calculated by RBA.

6. **Monetary policy was tightened**. The RBA hiked the cash rate by 25 basis points in May 2006, the first increase since March 2005, although a tightening bias had been signalled for some time. With resource utilization relatively high, and domestic spending growth expected to be solid, the RBA considered that inflation pressures were building; the RBA also noted that competitive discounting had reduced effective lending rates. A second hike in August took the cash rate to 6 percent.



Source: Reserve Bank of Australia

7. **The Australian dollar has been stable but remains high by historical standards.** In July 2006 the Australian dollar was 11 percent above its 20-year average in real effective terms. The stability of the exchange rate in the past year, in spite of the commodity price boom, may partly reflect a narrowing of interest differentials and, perhaps, expectations of a decline in commodity prices: futures prices for base metals decline by almost half in real terms over the next five years.



Sources: Reserve Bank of Australia and Information Notice System

8. **Net debt of the Commonwealth government was eliminated in April 2006, aided by fiscal surpluses in 8 of the past 9 years.** The underlying cash balance for the 2005/06 fiscal year (ending June) is estimated at 1½ percent of GDP (Table 3), ½ percentage point higher than budgeted. [5] Revenue was higher than projected owing to unexpectedly strong growth in employment, significant capital gains for investors, and rapid growth in corporate profits partly owing to high commodity prices.

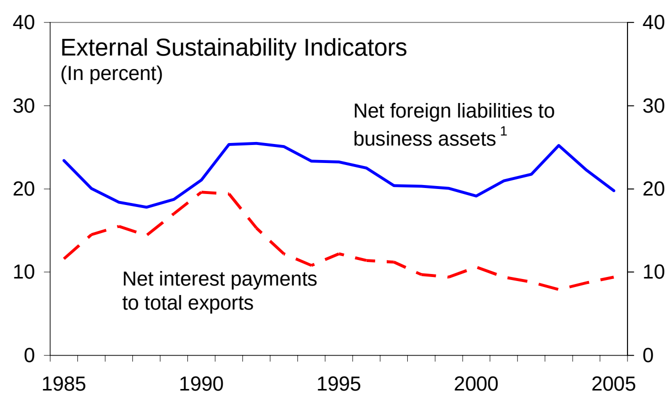
[5] Fiscal data for general government on a GFSM 2001 basis are provided in an Information Note on Australia's Fiscal Data.

II. Report on the Discussions

A. Commodity Prices Could Surprise in Either Direction

9. **Growth is projected to pick up to about 3 percent in 2006 and 3½ percent in 2007.** Domestic demand growth is expected to slow gradually, principally owing to some moderation in business investment growth (Table 4). Consumption growth will likely settle at around 3 percent as the effects of strengthening household incomes are tempered by monetary tightening, slowing growth in wealth, and rising oil prices. Exports are expected to accelerate as resource sector projects come on stream and as agricultural output recovers. Terms of trade increases will also help reduce the trade deficit, but these gains will be partly offset by higher equity income outflows, so the external current account deficit will decline only modestly. Unemployment is expected to remain stable or decline gradually, and core CPI inflation and wage growth are projected to remain broadly stable in 2006 and 2007.

10. **In the medium term, with investment declining only gradually from current highs relative to GDP, net foreign liabilities are expected to keep rising**. Continued robust export growth is expected to help drive real GDP growth averaging about 3¼ percent in the medium term.[6] Owing to expanding global resource supply, export commodity prices are assumed to start declining after a few years, resulting in slowing investment and a narrowing of the external deficit. While net external liabilities could rise to about 70 percent of GDP by 2011, external debt dynamics are reasonably robust to shocks (Table 5 and Figure 7). The authorities continue to monitor Australia's external position closely, and they noted that the private sector's net foreign liabilities had been broadly stable relative to the market value of business assets: the external deficit did not imply that Australia was "consuming its capital."[7] Solid growth in the business capital stock and in exports are expected to underpin external sustainability going forward, and external debt rollover risks are limited by the floating exchange rate, the strong balance sheets of the major banks, and well developed capital markets. Nonetheless, the authorities consider that Australia's relatively high private external indebtedness reinforces the need for sound macroeconomic policies and strong financial supervision.



Sources: Australian Bureau of Statistics and Australian Treasury
[1] Covers the net foreign liabilities and business assets of the private sector.

[6] Analyses of resource sector capital projects by the Australian Bureau of Agricultural and Resource Economics and by Access Economics support the outlook for strong growth in commodity exports in the medium term.

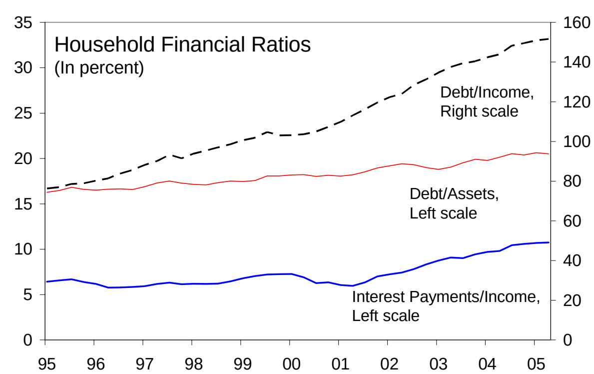
[7] This balance sheet perspective on the external position is elaborated by Guy Debelle, "Comments on Understanding Global Imbalances," June 2006 (http://www.bos.frb.org/economic/conf/conf51/index.htm).

11. **Commodity prices are a source of uncertainty in the medium term.** Past increases in Australia's terms of trade have been followed by global supply and demand responses that have tended to reverse about half of the gains within a few years. The authorities are therefore budgeting on the prudent assumption that coal and iron ore prices revert to historical average levels by 2008/09—implying a fall of about 25 percent in Australia's export commodity prices—while recognizing that there are risks on both sides:

- **Commodity prices could fall more rapidly if global and/or Chinese growth slows**. The authorities explore such a scenario in the 2006/07 Budget, noting that the macroeconomic impact of the current terms of trade boom had been greatly reduced compared with the past. They attribute this change to reforms, such as the floating exchange rate and greater relative wage flexibility, and consider that these structural changes would also facilitate adjustment to future commodity price declines, although GDP growth could still slow significantly.[8] If the global slow down stemmed from a disorderly adjustment in global imbalances the resulting fall in the Australian dollar could be amplified, although this would have relatively little impact on private sector balance sheets owing to extensive foreign exchange hedging.[9]

- **But sustained high commodity prices could also pose challenges.** Owing to the long lead times in resource sector capacity expansion, and the strength of global commodity demand, commodity price declines could take longer to eventuate. While this scenario would be welcome for Australia, it could prolong upward pressure on interest rates and the exchange rate, and result in more divergent growth outcomes across the States.

12. **Risks to consumer spending from the housing market and household balance sheets appear to have further diminished.** House prices increased by 3¼ percent from the end of 2003 until the first quarter of 2006, well below the 14 percent rise in household disposable incomes over this period.[10] Moreover, activity in the housing market has shifted away from investors to owner occupiers, migration inflows have increased, and,



Sources: Australian Bureau of Statistics and Reserve Bank of Australia

[8] These reforms are discussed in Craig Beaumont and Li Cui, "Australia's Adaptation to a Floating Exchange Rate," IMF Country Report No. 05/330 (forthcoming as an IMF Policy Discussion Paper).

[9] In March 2005, 79 percent of Australia's net foreign currency debt was hedged through derivatives: see "Australia's Foreign Currency Exposure and Hedging Practices," *RBA Bulletin*, December 2005.

[10] Regional variation in house prices has been substantial—since the end of 2003, house prices have fallen by almost 10 percent in Sydney whereas they have risen over 50 percent in Perth. A forthcoming working paper uses data on the Australian States to model the linkages between household consumption and housing prices.

unlike past cycles, there is no backlog of excess construction.[11] Hence, while house prices still appear to be elevated relative to rents and incomes, most analysts expect the soft landing will continue. Household indebtedness has continued to rise, with debt reaching 152 percent of disposable income in the first quarter, although debt is equivalent to only one-fifth of household assets. The RBA's March 2006 *Financial Stability Review* found few signs of household financial distress; arrears on mortgages have increased a little from 2004, but at 0.3 percent of outstanding loans they are very low by international standards, and bank credit card arrears also remain low.[12] The authorities attribute the rise in mortgage arrears mainly to a deliberate easing by financial institutions of their conservative credit standards, although an increase in arrears in New South Wales was associated with a rise in bankruptcies.

B. Monetary and Fiscal Policies are Well Positioned

13. **Monetary policy can respond flexibly to potential shocks.** With core inflation expected to remain within 2½ to 3 percent in 2006-07 at the time of the mission, the RBA saw no need to change the monetary stance in the near term, although the recent firming in indicators such as household spending suggested that the next change would be a tightening. Staff agreed that continuing with a pre-emptive approach would reduce the risk that a larger, potentially more disruptive, tightening might be needed later. In the event, the RBA lifted rates in August, reflecting an assessment that economic activity remained strong, and that underlying inflation was likely to exceed previous forecasts. Staff noted that if export commodity prices stayed high in coming years, strong domestic demand may be prolonged, requiring interest rates to be higher than otherwise; with resource shifts already evident between the States, the RBA did not consider that concerns about a "two speed" economy would hinder monetary policy. If, on the other hand, global activity slowed and commodity prices fell, the Australian dollar could depreciate significantly, but the RBA would still have room to cut interest rates if needed because exchange rate pass-through has diminished, and the inflation targeting framework for monetary policy is focused on the medium term.

14. **The Australian dollar is relatively high by historical standards, but it is not clear that the exchange rate is significantly misaligned.** IMF staff estimates the Australian dollar was 5 percent above its multilateral equilibrium in February-March 2006, and the exchange rate on a trade-weighted basis remains close to that level.[13] Given the uncertainty about key fundamentals the authorities consider it difficult to determine whether the currency is misaligned; indeed, the exchange rate was lower than might be expected given the rise in commodity prices. Reduced competitiveness of the manufacturing and services sectors has

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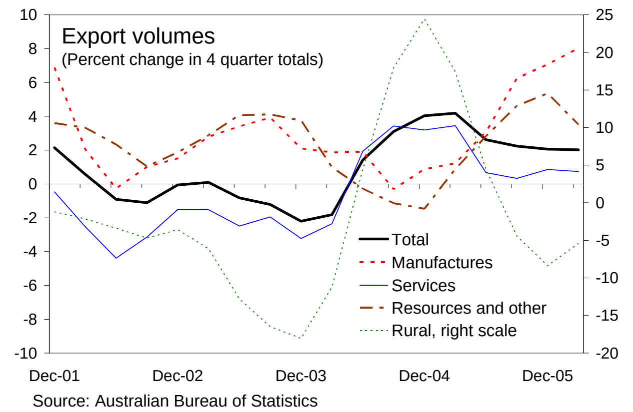
[11] Australia's strong employment growth and migration inflows have had spillover effects on New Zealand's economy, because migration outflows to Australia have risen in spite of an already tight labor market.

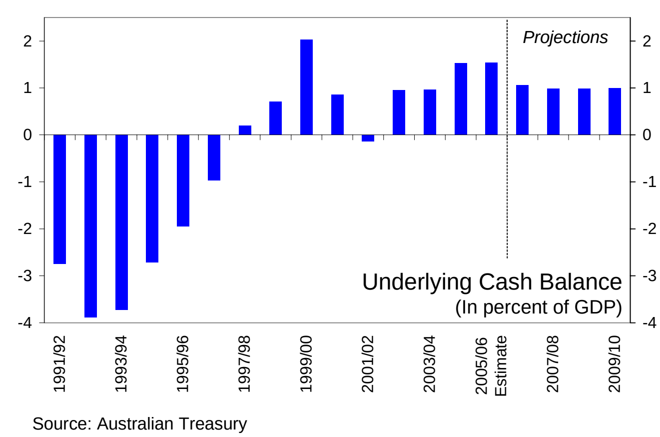
[12] The reluctance to default on mortgages may partly reflect the fact that borrowers remain personally liable for the debt: see Ellis *et al*, 2006, *Housing finance in Australia*, (http://www.bis.org/publ/cgfs26cbpapers.htm).

[13] This evaluation is based on a macroeconomic balance approach (Isard and Faruquee, 1998, *Exchange Rate Assessment: Extensions of the Macroeconomic Balance Approach*, IMF Occasional Paper No. 167).



slowed export growth in recent years, although manufactured exports picked up in 2005. Nonetheless, positive overall export prospects, high investment in the tradable sector, and strong corporate profits indicate that competitiveness is not unduly impaired. Moreover, the projected rise in net foreign liabilities over the medium term need not indicate an exchange rate misalignment because it is driven by particularly high expected returns on investment. While remaining comfortable with the level of foreign reserves, the RBA had taken advantage of the relatively high Australian dollar to accumulate a modest amount of reserves, with negligible effect on the foreign exchange market.

15. **With the high terms of trade supporting economic growth and tax revenue, the government has appropriately targeted larger-than-usual budget surpluses.** [14] Even allowing for a substantial decline in commodity prices, the 2006/07 Budget projects the underlying cash surplus to remain at 1 percent of GDP in the medium term, well above the objective of balancing the budget over the cycle. Compared with the previous budget, and before new policy measures, revenue is projected to be 1½ percent of GDP higher in 2006/07 and in later years.[15] While agreeing that this revision was substantial, the authorities considered that the risks to the revenue projection were evenly balanced because the strength of revenues is broad based, and potentially temporary factors such as high commodity prices were playing a relatively modest role. Stronger revenues allowed the budget to cut personal income tax burdens significantly, to raise allowances for depreciation, to increase the income limits before family benefits begin to taper off, and to make new investments in transport infrastructure.[16]



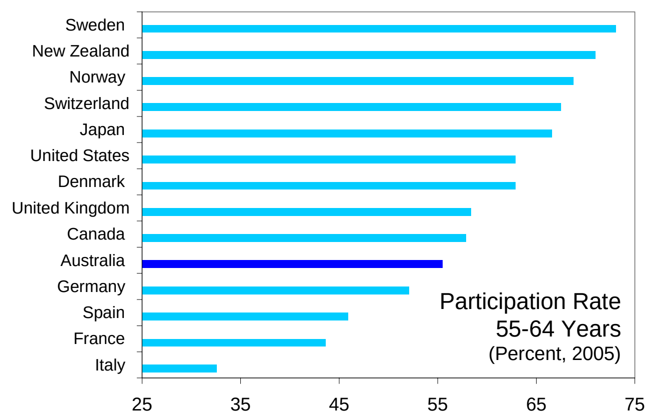
[14] Chapter II of the forthcoming selected issues paper analyzes the fiscal impact of swings in commodity prices, and discusses the appropriate fiscal policy response to commodity price swings.

[15] Following a number of revenue under predictions the authorities revised the revenue projection methodology in the 2005/06 budget to make the projections more elastic with respect to incomes.

[16] The personal tax measures include additional increases in income thresholds for each tax bracket and reductions of 2 percentage points in the top marginal tax rates (formerly 42 and 47 percent).

16. **The 2006/07 budget implies a mild fiscal stimulus.** The fiscal surplus is projected to decline by ½ percent of GDP in 2006/07, but most of this decline reflects tax cuts, which, based on past experience, are generally expected to largely be saved. Hence the 2006/07 budget is not expected to put significant pressure on inflation or monetary policy. Nonetheless, with resource utilization already high, the mission recommended that the authorities limit changes in fiscal policies if revenue again runs ahead of budget estimates in 2006/07, allowing the fiscal surplus to exceed the budget target as was expected to occur in 2005/06. Moreover, if, in coming years, Australia faced a global slow-down, reducing growth and resulting in a large fall in commodity prices, staff noted that the strong fiscal position would allow a temporary move into deficit if needed.

17. **The government is continuing to address long-term fiscal challenges.** The Future Fund announced in the 2005/06 budget has now been established, and it is well placed to invest future budget surpluses (Box 1). To boost incentives to work and save, increase retirement incomes, and reduce the complexity of retirement planning, the 2006/07 budget proposes that benefits from most superannuation (private pensions) funds would become tax free for persons aged over 60. The mission agreed that the proposed reform would increase labor participation among older workers, and encouraged the authorities to provide an assessment of the net long-run fiscal impact of the proposal.



Source: OECD, *Employment Outlook*, 2006

C. Vigilance Remains the Watchword for Financial Supervision

18. **Australia's financial system is healthy, profitable, and resilient to shocks**. The recent FSAP also found that prudential supervision by the Australian Prudential Regulation Authority (APRA) and market conduct supervision by the Australian Securities and Investment Commission (ASIC) are sound, with a high level of compliance with international standards, and at the forefront of best practices in a number of areas. Stress tests did not reveal near-term stability concerns, including in the event of a scenario combining a sharp recession, large falls in both house prices and the exchange rate, and a significant rise in the cost of wholesale funding. The authorities found the FSAP stress tests very useful; building on this exercise, they expect to conduct further stress tests in coming years.

19. **The authorities endorsed the key recommendations of the FSAP (Box 2).** Regarding supervisory capacity, the authorities noted that APRA's resources had been increased in recent years, and that funding arrangements for ASIC were revised in the 2006/07 budget to enhance flexibility. ASIC is comfortable that its resources are adequate; APRA saw moderating turnover among junior staff as the remaining priority to strengthen

supervisory capacity, and was examining this issue within a broader human resource management context. APRA also agreed with the need to ensure suitable risk management by authorized deposit-taking institutions (ADI) that were entering new businesses, noting that supervisors were making assessments of ADI risk management capabilities, and that greater use of differentiated capital requirements was expected in future.

20. **Financial supervision is alert to potential vulnerabilities.** The FSSA highlights that banks face a number of interrelated areas of vulnerability, including heavy exposure to households with historically high debt levels, the elevated level of house prices, an easing in credit standards, and banks' reliance on wholesale funding.[17] APRA had responded to emerging risks by tightening the mortgage insurance requirements for "low doc" loans to qualify for a 50 percent risk weight. To help assess the impact of changing lending standards on housing loan portfolios, APRA is collecting detailed data on banks' mortgage lending to better understand the underlying debt service capacity of households. Regarding wholesale funding, APRA noted that it was an early adopter of a scenario approach to liquidity regulation, and that it had seen ongoing improvement by ADIs in diversifying their funding sources, lengthening maturities, and avoiding concentrations of rollover dates. Moreover, with the goal of promoting further improvements in liquidity management, APRA was undertaking a wide ranging review of liquidity regulation that is drawing on international practices, which the mission welcomed.

21. **To guard against complacency in an environment of sustained favorable financial developments the authorities are embarked on an important initiative to formalize the framework for failure resolution and crisis management.** The authorities are continuing to develop the legal foundations and policy approach of this framework, which by achieving timely and minimally disruptive resolution of failed institutions at the least fiscal cost, will help to sustain the confidence of foreign and domestic investors during a crisis. The mission agreed that the proposed Financial Claims Compensation Scheme would be a useful element of such a framework. The authorities are also seeking to pass legislation to provide APRA with the legal powers needed to deal with a troubled general insurer.

22. **Steps to enhance supervisory cooperation with New Zealand are welcome given the interdependence of the two banking systems.** The Australian and New Zealand authorities recently agreed legislative changes to promote enhanced cooperation between APRA and the Reserve Bank of New Zealand (FSSA, Box 3). The mission fully supported the ongoing discussions to improve the coordination of official responses to a financial crisis.

23. **Legislation to address AMF/CFT issues will be tabled in 2006.** Since late 2003, the government has undertaken an extensive review of AML/CFT legislation, including consideration of the recommendations of the October 2005 FATF mutual evaluation.

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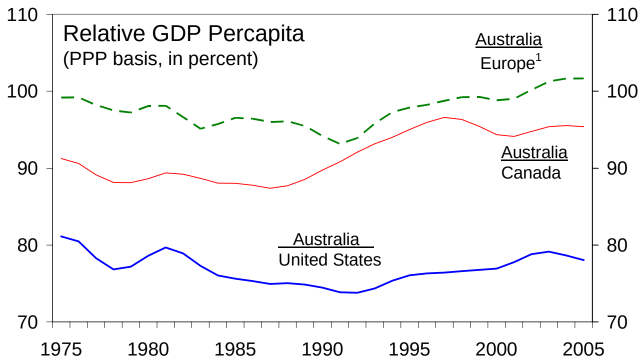
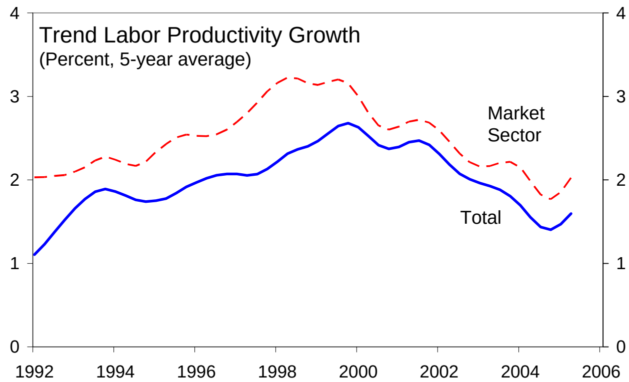
[17] Deposits are one-quarter of bank funding, down from 40 percent of funding in the early 1990s, partly because households have shifted their portfolios following the introduction of mandatory superannuation contributions.

D. Growth Prospects Hinge on Putting Structural Reforms into Effect

24. **Room remains to further lift productivity and incomes.** Australian per capita incomes slipped relative to other advanced economies during the 1970s and 1980s. But there was significant progress to close these gaps in the 1990s because productivity surged in response to wide-ranging structural reforms and ICT-related innovations. However, productivity growth has slowed in the first half of this decade, so Australian incomes have tended to level out relative to other advanced economies, and they remain just over 20 percent below the level in the United States. A recent study estimates that only about half of the difference in productivity levels that underpins this income gap can be accounted for by Australia's remoteness from global markets.[18]



Source: OECD Economic Outlook, June 2006
[1] Simple average of European countries with incomes similar to Australia in 1975 (Austria, Belgium, Denmark, Finland, France, Italy, Netherlands, Sweden, and United Kingdom).



Source: Australian Bureau of Statistics

25. **The new *National Reform Agenda*, agreed by the Council of Australian Governments (COAG) in February 2006, sets out an appropriately ambitious reform program for the decade ahead.** The reform agenda has been broadened to include human capital and regulation issues, which is important since the long-term payoffs from enhancing education, training, and health care are likely to be seen in higher productivity and labor participation. Competition related reforms are at various stages:[19]

- **Export infrastructure:** COAG has agreed a simpler and nationally consistent system of regulation for ports, railways, and other export-related infrastructure, to reduce regulatory uncertainty and compliance costs for owners, users, and investors. The mission urged timely implementation given the large potential for growth in resource sector exports.

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[18] Bryn Battersby, "Does Distance Matter? The Effect of Geographic Isolation on Productivity Levels," *Australian Treasury Working Paper* 2006-03, April 2006.

[19] A summary of the economic importance of further developing markets and appropriate pricing of water, land transport, and electricity is provided in Box 4 of IMF Country Report No. 05/331.

- **Land transportation and electricity:** The Productivity Commission is undertaking an inquiry to identify the optimal methods and timeframes for introducing efficient road and rail freight infrastructure pricing, and the Energy Reform Implementation Group is charged with making proposals to achieve a fully national electricity market. These reports will lay the foundation for the development of action plans in these vital areas.

- **Water:** The National Water Initiative, agreed in 2004, aims to achieve full trading in water rights by 2014. However, water trade is currently mostly limited to within catchments, and key steps to facilitate interstate water trading between New South Wales, Victoria, and South Australia are falling behind the implementation timeframe.

26. **The challenge is to steadfastly implement action plans to achieve these goals.** Australia has an admirable track record of implementing wide-ranging structural reforms over the past two decades even though its Federal structure presents challenges of political coordination (Box 3). Nonetheless, there is a concern that the commodity price boom could dampen the appetite for implementing reform going forward. To realize the large potential benefits from these reforms, the mission encouraged sustained and determined leadership from the Commonwealth government, arguing that this is an auspicious time to accelerate reforms by using some of the recent surge in revenues to spur action. The authorities agreed that timely reform implementation is important, and the COAG meeting in July 2006 advanced the discussion of funding arrangements for the *National Reform Agenda*.

27. **The government is making a concerted effort to expand employment.** The *WorkChoices* reforms of industrial relations came into effect in March 2006.[20] The resulting increases in labor demand may be most evident among small businesses.[21] Employment gains will be reinforced by labor supply increases owing to the tightening of eligibility requirements for Disability Support Pensions and Parenting Payments in the 2005/06 budget, and also to measures in the 2006/07 budget that reduce effective marginal tax rates—which can be as high as 74 percent for some levels of personal income.[22] Maintaining labor market flexibility will be crucial to facilitate smooth adjustment of the economy to potential swings in commodity prices or other shocks.

28. **Australia plans to double its official development assistance**. The 2006/07 Budget sets aside an estimated 0.3 percent of national income for ODA, up from 0.25 percent in 2005. By 2010 Australia plans to double its ODA from 2004 levels, which will continue to be focused on the Asia-Pacific region.

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[20] The main changes are to expand the coverage of the federal jurisdiction, simplify minimum working conditions, establish the Fair Pay Commission to set minimum wages, and limit the coverage of unfair dismissal laws to employers with more than 100 employees.

[21] See Mark Wooden, 2006, "Implications of Work Choices Legislation," *Agenda*, Volume 13, Number 2.

[22] Key measures reducing effective marginal take rates at lower income levels are the increase in the threshold for the 30 percent income tax rate, the expansion of Low Income Tax Offset, a cut in Medicare levies from 20 to 10 percent at low income levels, and the increase in income thresholds for family benefits.

III. Staff Appraisal

29. **Australia's economic performance has been robust and prospects remain bright.** After 14 years of expansion, with only a modest slowing in 2005 following a welcome cooling of the housing market, growth is strengthening again. Strong business investment, owing to high capacity utilization and the highest terms of trade in three decades, is laying the foundation for solid export-led growth in the medium term. However, past experience suggests that much of the terms of trade improvement will, sooner or later, be reversed.

30. **When this happens, or, if there are other shocks, macroeconomic policies are well positioned.** Monetary policy has been tightened appropriately, and, given the relatively high level of resource utilization, a further tightening may eventually be needed to reduce inflation pressures. The Australian dollar is relatively high, but it is not clear that it is significantly misaligned. Flexibility in the exchange rate, and the medium-term focus of monetary policy, continue to provide important cushions against potential external shocks. Australia's fiscal position is enviable: few countries have been able to eliminate net public debt while also providing significant tax cuts. Even after making prudent allowance for a decline in commodity prices the medium-term fiscal outlook is robust, which is another valuable buffer against shocks. The fiscal surplus should be allowed to exceed budget targets if growth and revenues are strong. Although potential vulnerabilities are contained by Australia's sound macroeconomic policies and sophisticated risk management by the private sector, close monitoring of private external debt should continue.

31. **Financial supervision must remain vigilant.** Australia's financial system is healthy and financial supervision is sound, but continuing efforts will be needed to promote robust risk management practices by financial institutions as they enter new businesses and face growing competitive pressures. Hence, APRA's close monitoring of household debt service capacity, plans to conduct further stress tests, the review of liquidity regulation, and efforts to moderate staff turnover are welcome. The authorities' initiative to ensure the legal foundations for timely and minimally disruptive resolution of failed institutions, at the least fiscal cost, is important to help underpin the resilience of the financial system during a crisis.

32. **Now is the time to press ahead with the ambitious *National Reform Agenda* to lift productivity and participation over the next decade.** The reform agenda has been broadened appropriately to include human capital issues, yet implementation is lagging in crucial areas such as trading in water. The recent surge in revenues provides resources that should be used to spur reform implementation. By sustaining strong economic growth, these reforms will help narrow the gap between living standards in Australia and those in the most advanced economies, and better position Australia to address the challenges of an ageing population and rising healthcare costs.

33. It is proposed that the next Article IV consultation with Australia take place on the standard 12-month cycle.

Box 1. The Future Fund

Australia faces significant long-term fiscal challenges that that government aims to tackle principally through structural reforms. By 2045 it is estimated that the annual fiscal balance of the general government will deteriorate by 6½ percent of GDP, with increases in health spending accounting for about 70 percent of this fall.[1] The government's strategy to address this challenge emphasizes structural reforms to lift productivity and labor participation. This approach is facilitated by the relatively gradual ageing of the population in Australia, and the fact that retirement income arrangements rely primarily on mandatory private pensions.

To complement this overall strategy, the Future Fund (FF) was established in April 2006 to cover unfunded public service pensions, which will address about one-tenth of the estimated long-term fiscal gap. While new public service pensions are fully funded, there remains an outstanding liability for earlier pension schemes. The goal of the FF is to cover this liability by 2020, requiring the accumulation of an estimated A$140 billion in assets. The FF will receive inflows from future fiscal surpluses, privatization proceeds, and its own investment income. Outflows from the FF will not begin until 2020, or when the liability is fully covered, and can only be used to meet the pension payments covered by the FF, which are projected to average about 0.6 percent of GDP.

FF assets could grow rapidly in coming years. Seed capital of A$18 billion was provided in May, and around A$12 billion should be added in September after the 2005/06 budget outcome is confirmed. Completing the privatization of Telstra could lift the fund to over A$50 billion. If fiscal surpluses projected in the next three or four years are realized, and assuming the FF earns reasonable returns, it will be well placed to reach its long-term goals.

The FF enjoys substantial flexibility in its investment strategy. The investment mandate adopted in May sets a long-term benchmark average annual real return of at least 4½ to 5½ percent, and puts just two main restrictions on investments. First, the FF is not to hold controlling stakes, so there is a 20 percent ceiling on holdings of any listed company. Second, the FF is to "act in a manner that minimizes the potential to cause any abnormal change in the volatility or efficient operation of the Australian financial markets." The main implication of the latter is that the FF must limit its outright holdings of the relatively small available stock of Commonwealth government bonds. Otherwise the FF is free to set its risk tolerance and asset allocation, such as between domestic and foreign assets. It is envisaged that management of the funds will be contracted out to private managers for some time.

Governance of the FF is consistent with international best practice.[2] The Board of Guardians of the FF was appointed in late March, consisting of the Chairman and six members, all of whom have significant expertise in investment management and corporate governance, and none of whom are government employees. With the FF essentially being a financial subsidiary of the government, the government has retained the right to direct the Board by changing the investment mandate. However, there are strong protections against the misuse of this power—if the Board considers that the new mandate is inconsistent with the basic objectives of the FF it has the right to table a submission to Parliament opposing the change. This transparency should minimize the risk of politically motivated investments, such as in infrastructure projects, while also protecting the capability of the FF to pursue investment strategies with a long-term horizon.

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[1] Australian Productivity Commission, *Economic Implications of an Ageing Australia*, March 2005.
[2] The FF is compared with similar funds in other countries by Li Cui, 2005, "The Future Fund: An International Comparison," Chapter III, IMF Country Report No. 05/330.

Box 2. Key Recommendations of the Financial System Stability Assessment

The following outlines the main recommendations from Australia's recent participation in the Financial Sector Assessment Program. A more detailed discussion and additional recommendations are found in the Financial Sector Stability Assessment (FSSA).

- **Banking:** ***APRA should continue to ensure strong risk management practices including through regular stress testing.*** As authorized deposit-taking institutions (ADI) shift away from real estate lending and into businesses such as SME lending, wealth management, and expansion overseas, the FSSA emphasizes the importance of monitoring and evaluating the capacity of ADIs to manage these new risks, and setting appropriately strong capital requirements. The FSSA also recommends that the authorities build on the experience with the FSAP stress tests by requesting that banks conduct stress tests on a regular basis to further strengthen their risk management capacity.

- **Failure Resolution and Crisis Management:** ***Continue to develop a formal process to manage the failure of individual institutions and more widespread crises.*** Historically, there have been very few failures of financial institutions, and past responses to troubled institutions have been *ad hoc* and relied on provision of official support. Hence, the authorities have begun to develop a comprehensive framework for the resolution of failed institutions and crisis management. The FSSA strongly supports this initiative because it would minimize the likelihood that the government will be forced to resort to costly bailouts to protect systemic stability. The FSSA notes that the main requirement for such a framework is to ensure that the necessary legal powers to implement a speedy and orderly resolution are in place. The proposed Financial Claims Compensation Scheme could be a useful element of such a framework.

- **Supervisory Capacity:** ***Ensure that the supervisory agencies have adequate resources and flexibility.*** APRA has increased staff resources by almost 50 percent since the failure of the HIH Group in 2001, and it has a cadre of experienced senior staff. Nonetheless, turnover among more junior staff is relatively high, which could potentially have adverse affects on its supervisory capacity. Financial institutions will need to put greater emphasis on risk management, especially under Basel II, increasing the demand for these skills. Hence it will be important to ensure that both APRA and ASIC have the financial resources, and flexibility in deploying these resources, that are needed to ensure that sufficiently well-qualified staff are available to meet the challenges of implementing Basel II and effectively implementing principle-based approaches to supervision, especially of the large banks.

Box 3. Achieving Structural Reform in a Federal System

Structural issues are often in the jurisdiction of the Australian States. The Australian Government (or the Commonwealth) has few exclusive powers, and in a large number of areas it can only exercise powers concurrently with the six State Governments, who retain responsibility for all other areas.[1] Nonetheless, the Commonwealth can influence State policies and programs by granting financial assistance on terms and conditions that it specifies. To coordinate their policies, the Commonwealth and State governments meet biannually in the Council of Australian Governments (COAG).

A cooperative approach to structural reforms yielded handsome dividends in the past decade. The National Competition Policy (NCP) was agreed by COAG in 1994 with the goal of promoting efficiency gains through competitive national markets. Implementation of reforms across the levels of government was required to reduce legal barriers to competition, ensure competitive neutrality for government businesses, enhance third-party access to infrastructure, and reform the transport, electricity, gas, and water sectors. It is estimated that the NCP-related reforms raised GDP by 2½ percent in the 1990s.[2]

Successful implementation of NCP reforms was underpinned by political leadership, but also by two factors that may be of interest for other countries:

- **The benefits of reforms were shared through conditional payments to the States.** Part of the benefits of reforms accrue to the Commonwealth through higher income taxes, so “competition payments” were established to recycle these gains back to the States. The actual payments to the States were subject to penalties if reform commitments were not met, as assessed by the independent National Competition Council. While these penalties were usually not large relative to State budgets, in practice they could have significant leverage.

- **The Productivity Commission also assisted reform.**[3] The Productivity Commission provides advice to governments on structural reform, and its legislation ensures independence, openness, and an economy-wide focus. Importantly, its advice is shaped by extensive public submissions in response to draft reports, tending to expose weaknesses in the arguments of vested interests, increasing the awareness of the broader public, and refining the recommendations, thereby promoting consensus on the need for reforms and on the best way forward.

The *National Reform Agenda* will require a broadening of reform cooperation, with a continuing role for Commonwealth funding and for analytical support from the Productivity Commission. The COAG has agreed to establish an independent body, the COAG Reform Council (CRC), to report to COAG annually on progress in implementing the *National Reform Agenda*. If funding is needed to ensure a fair sharing of the costs and benefits of reform, the Commonwealth will provide funding to the States and Territories on a case-by-case basis once specific implementation plans have been developed—plans for transport, energy, and infrastructure regulation are expect to be available in early 2007. The amount of funding will take into account the relevant costs and benefits, and the CRC will draw on the resources of the Productivity Commission in making cost-benefit assessments of the various reform options.

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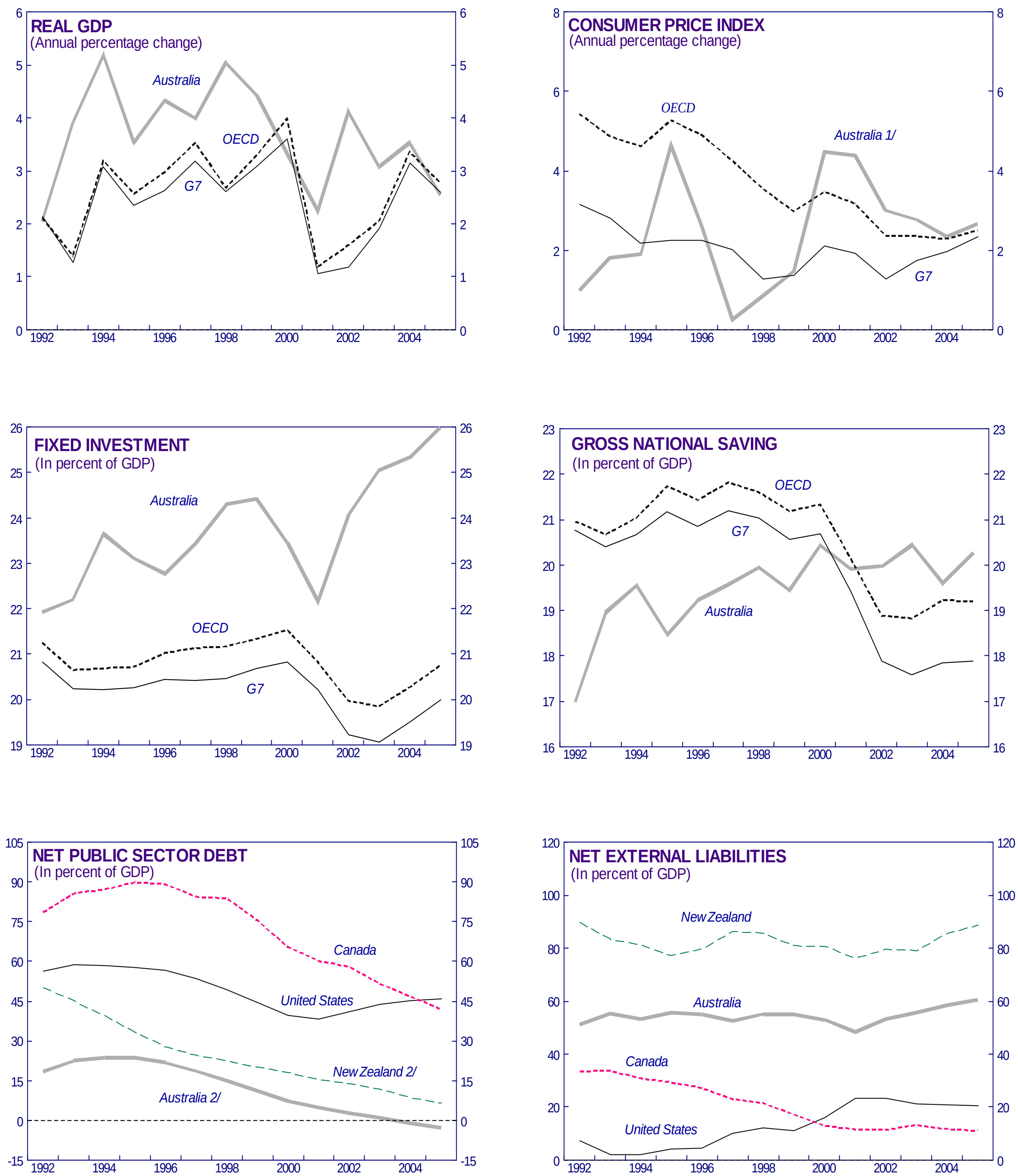
[1] Jonathan Pincus, “Productive Reform in a Federal System,” Roundtable Proceedings, Productivity Commission, April 2006.

[2] *Review of National Competition Policy*, Productivity Commission, February 2005.

[3] Gary Banks, 2005, “Structural reform Australian-style: lessons for others ?” Australian Productivity Commission.

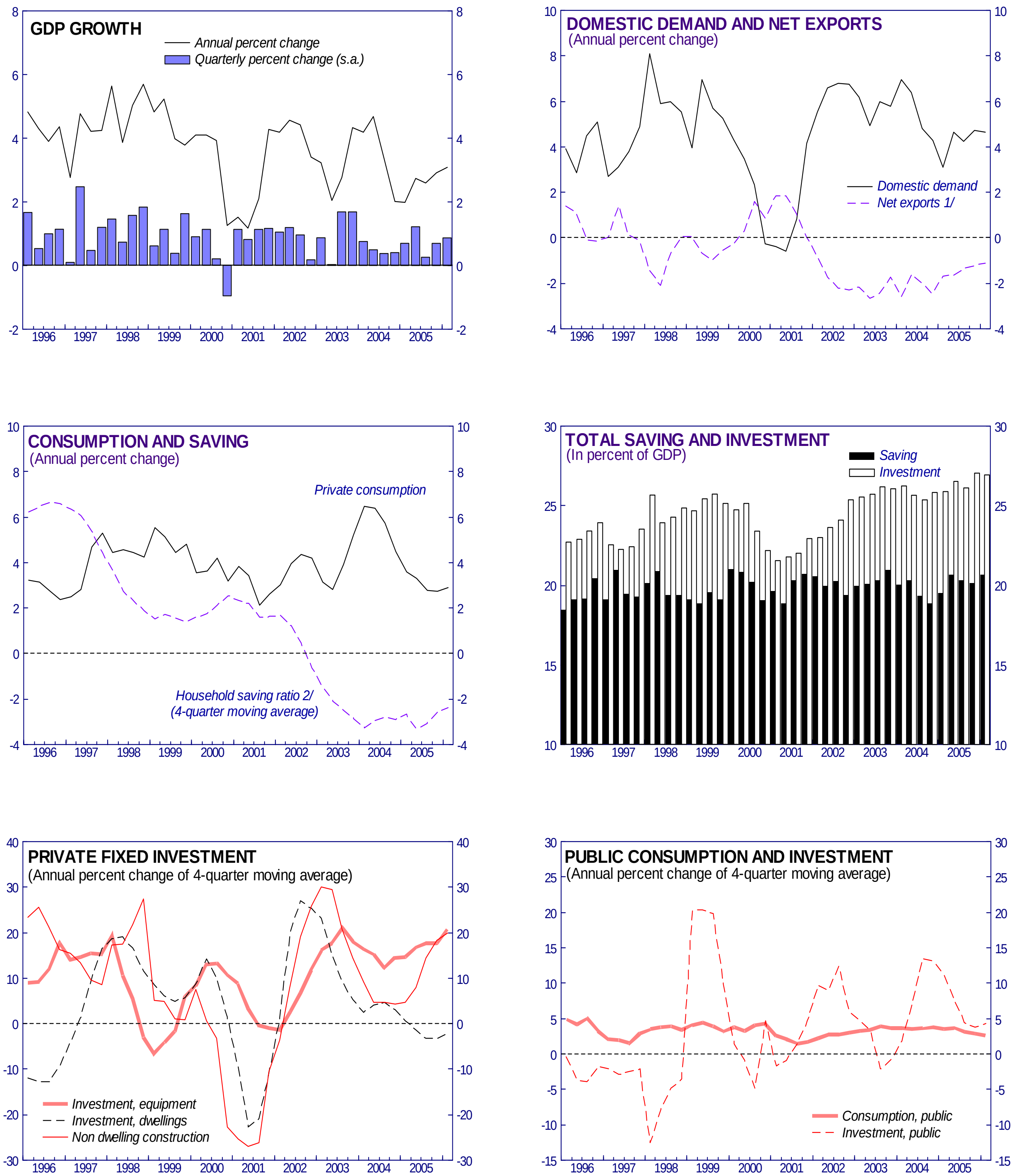
Figure 1. Australia: Comparisons of Macroeconomic Performance, 1992–2005



Sources: Data provided by the Australian authorities; IMF; IFS; WEO; and OECD.

1/ The higher inflation rate in 2000 and 2001 is due to the introduction of the Goods and Services Tax.
2/ Fiscal year.

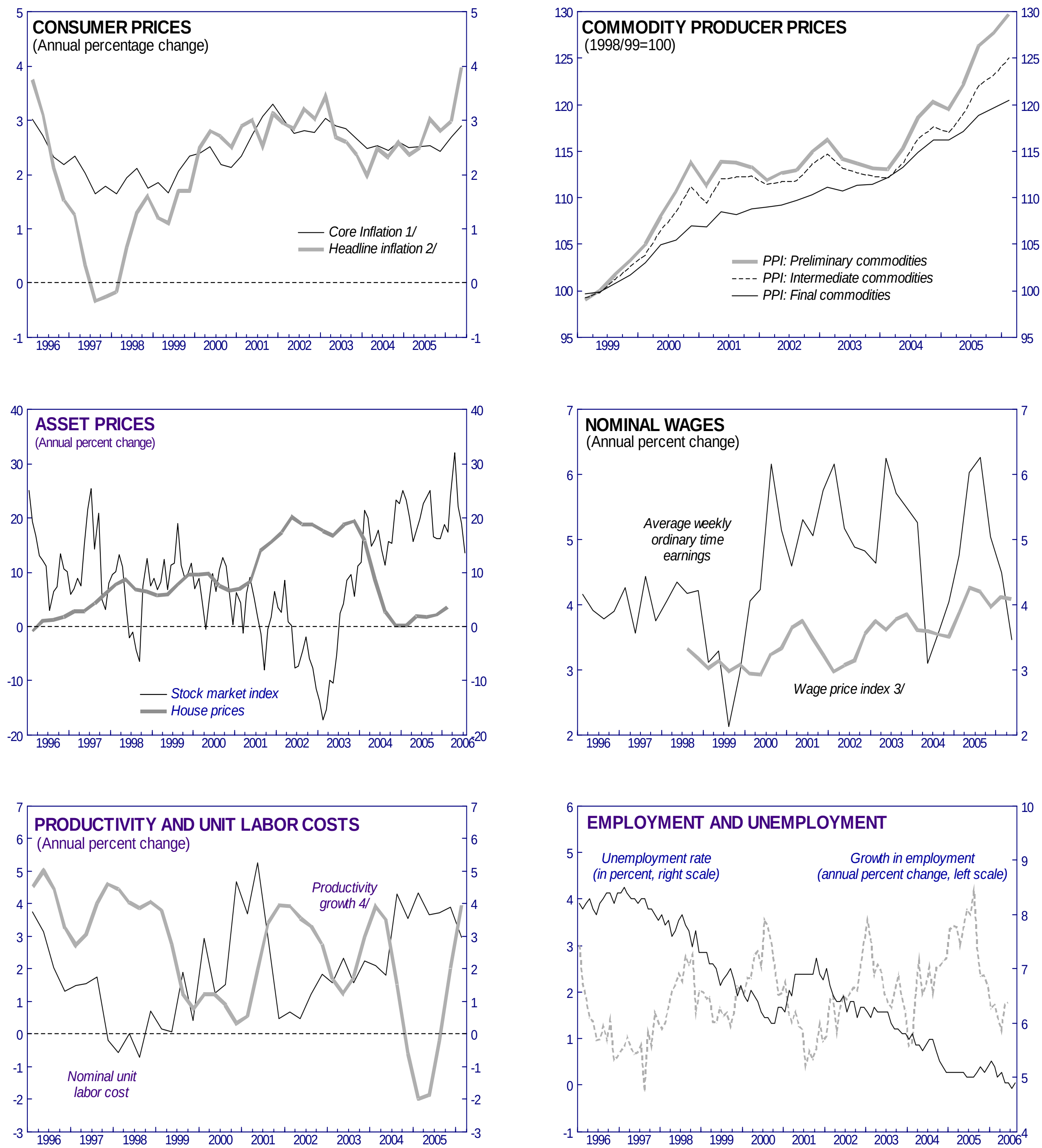
Figure 2. Australia: Real Economic Indicators, 1996–2006



Source: Data provided by the Australian authorities.

1/ Contribution to GDP growth.
2/ Net household saving as a percent of household disposable income.

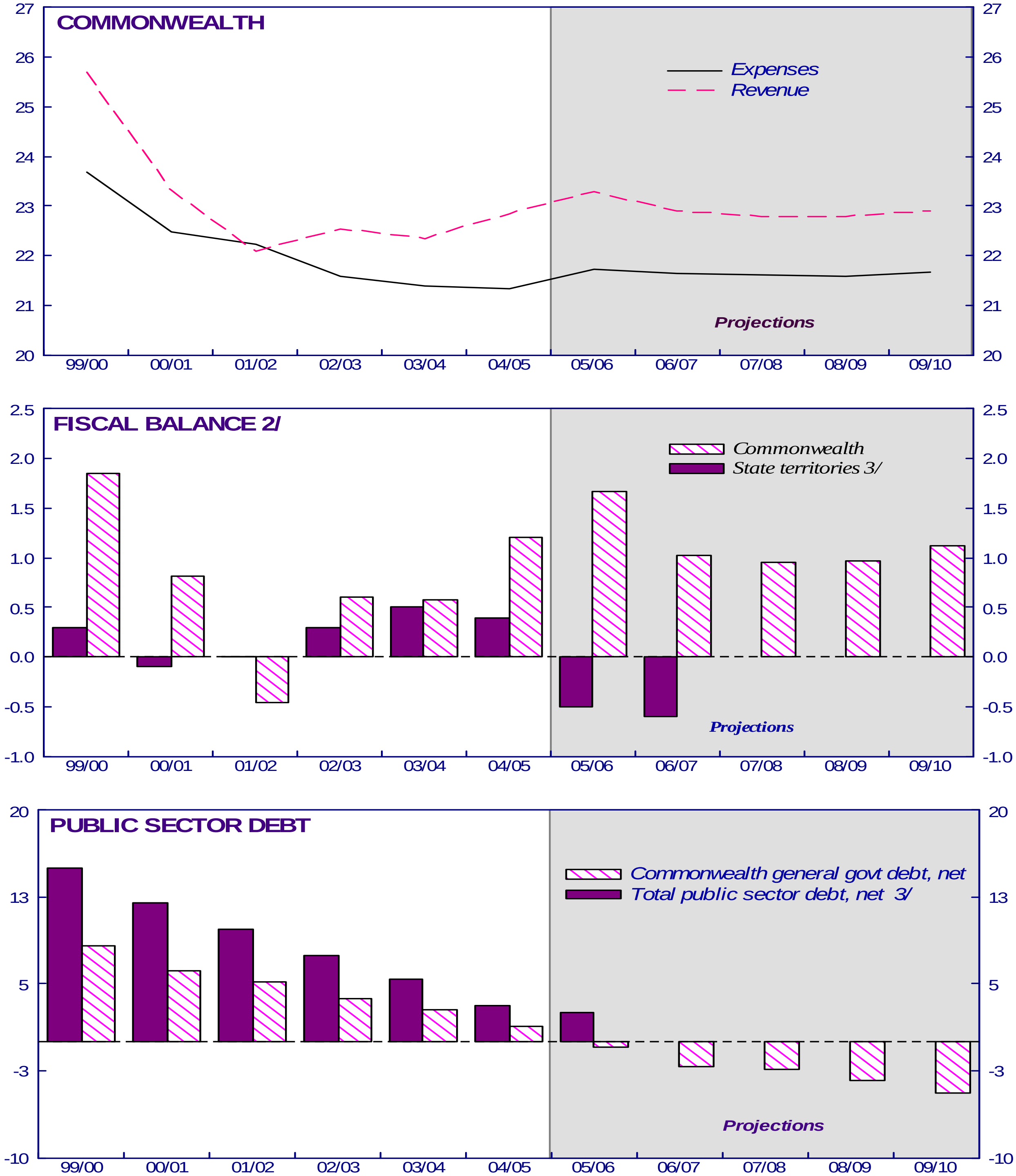
Figure 3. Australia: Inflation and Labor Market Indicators, 1996–2006



Sources: Australian Bureau of Statistics; and Fund staff estimates.

1/ Average of the trimmed mean and weighted median CPI inflation rates calculated by the Reserve Bank of Australia..
2/ Excluding impact of the introduction of GST, as estimated by Reserve Bank of Australia.
3/ The Wage Price Index is only available from September 1997.
4/ Output per hour worked, nonfarm market sector.

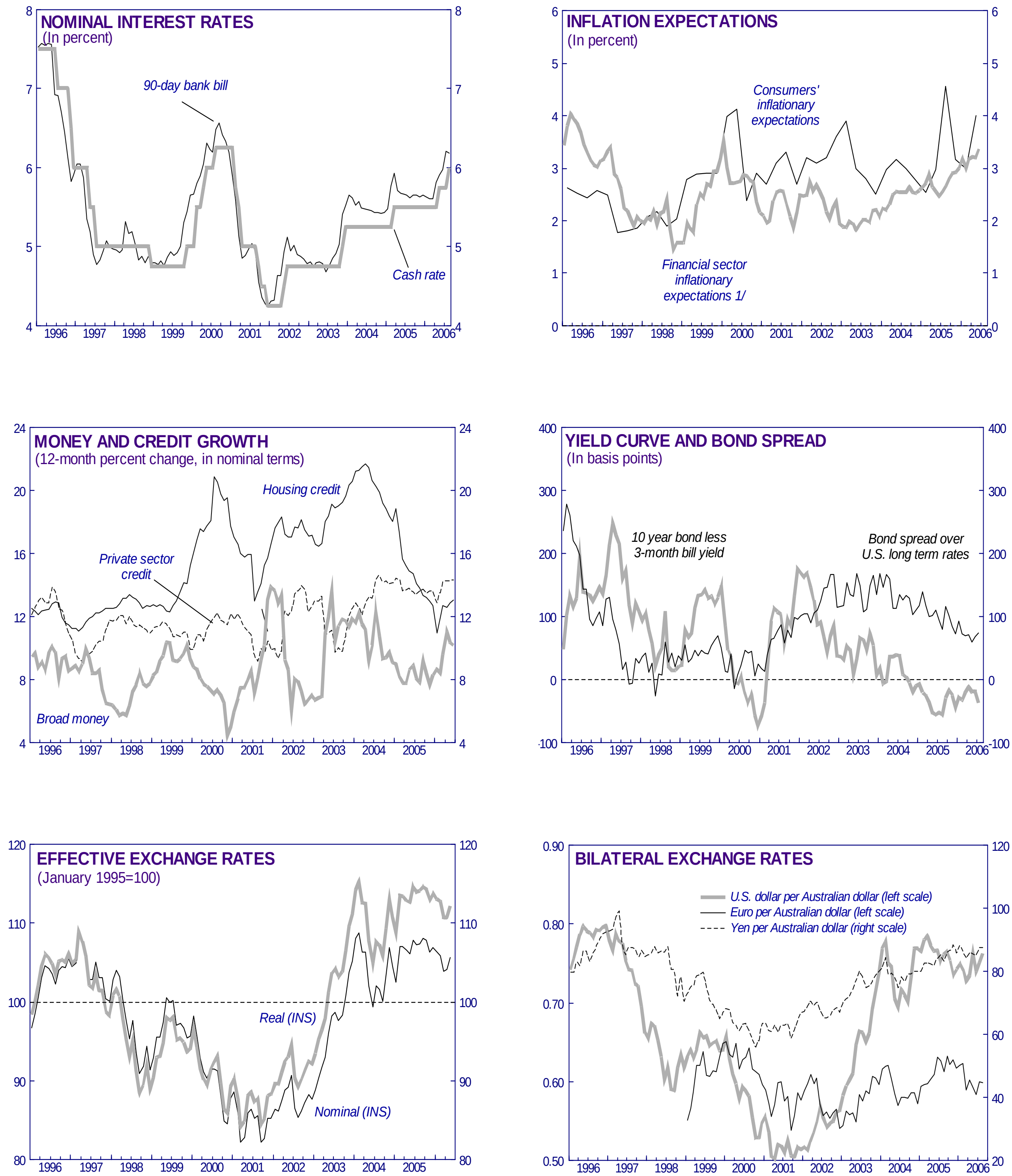
Figure 4. Australia: Fiscal Indicators, 1999/00–2009/10 1/
(In percent of GDP)



Source: Australian budget for 2005/06.

1/ Revenue, expenses, and fiscal balance are on accrual basis.
2/ Fiscal balance is equal to revenue less expenses less net capital expenses.
3/ Data for fiscal balance of state territories are available to 2006/07, and data for total public sector debt are available to 2005/06.

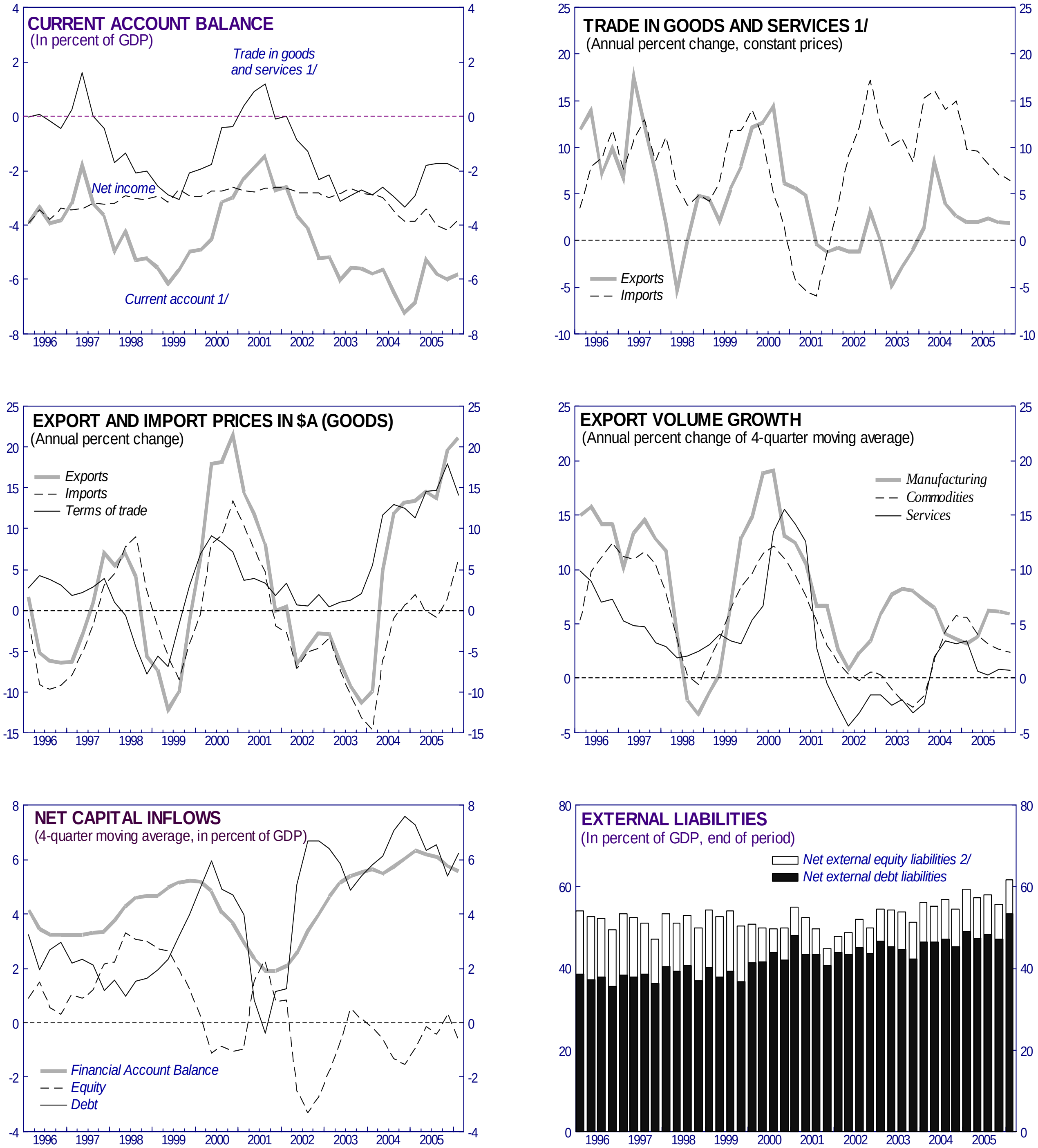
Figure 5. Australia: Monetary Indicators, 1996–2006



Sources: Australian Bureau of Statistics; Reserve Bank of Australia; and Fund staff estimates.

1/ Calculated as the spread between long-term non-indexed and indexed government bonds.

Figure 6. Australia: Balance of Payments and External Liabilities, 1996–2006

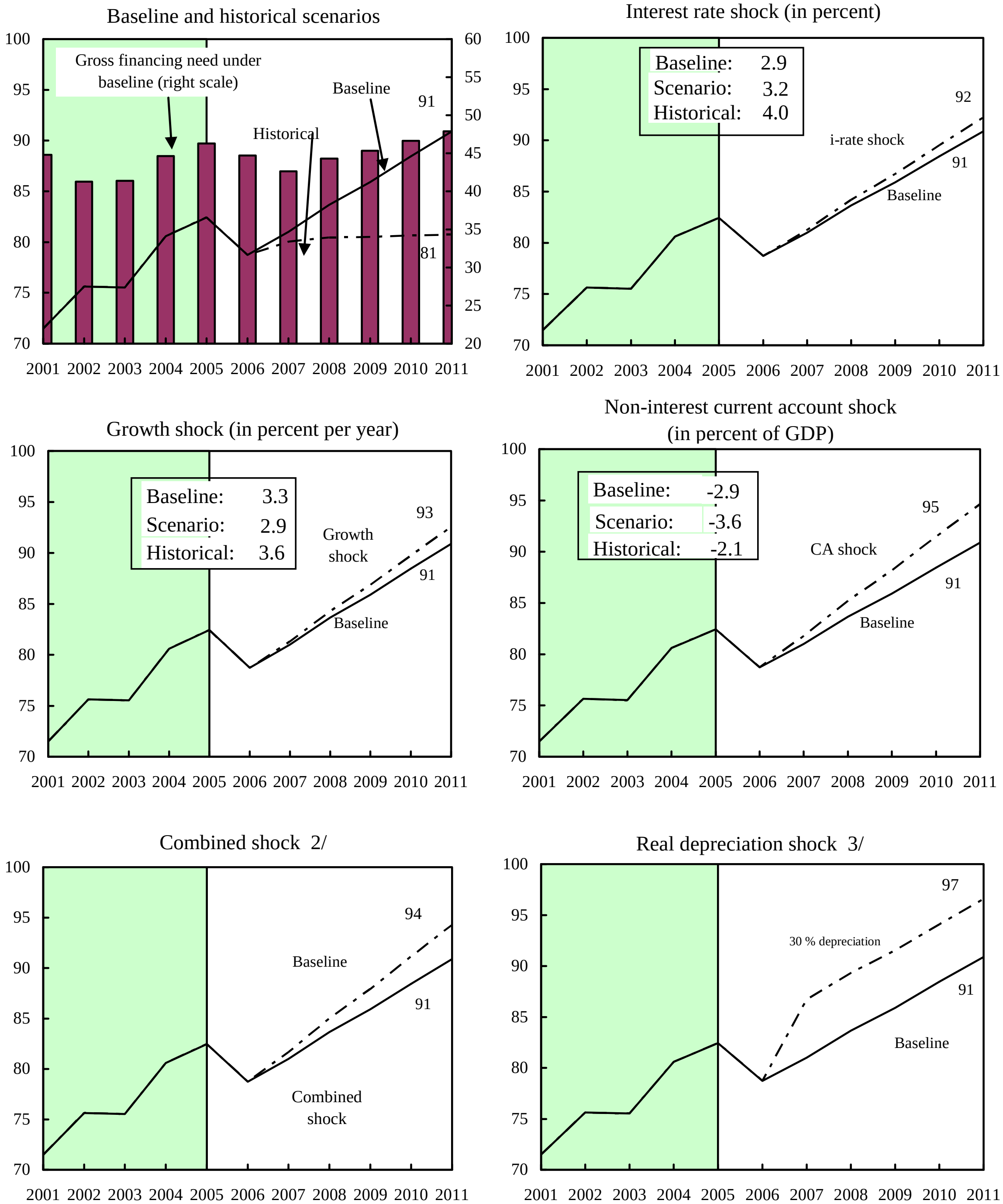


Sources: Australian Bureau of Statistics; and Reserve Bank of Australia.

1/ June 1997 exports include the sale of gold by the Reserve Bank equivalent to 1.5 percent of 1997QII GDP.

2/ Net external equity liabilities are nonresident holdings of Australian equities net of Australian holdings of foreign equity.

Figure 7. Australia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half 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 is 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 2006. This scenario assumes foreign exchange hedging covers 79 percent of foreign currency debt, consistent with the findings of a survey by the Australian Bureau of Statistics, as reported in "Australia's Foreign Currency Exposure and Hedging Practices," RBA Bulletin, December 2005.

Table 1. Australia: Selected Economic Indicators, 2001–06

Nominal GDP (2005): $A 928 billion (US$ 707 billion) — Quota (in millions): SDR 3,236
GDP per capita (2005): US$ 34,714 — Population (2005): 20.4 million

	2001	2002	2003	2004	2005	2006 Proj.
Output and demand (percent change)						
Real GDP	2.2	4.1	3.1	3.5	2.5	3.1
Total domestic demand	1.0	6.4	5.7	5.6	4.2	4.0
Private consumption	3.0	3.8	3.8	5.8	3.0	3.2
Total investment	-3.3	15.7	8.9	7.8	7.4	7.5
Business	-3.4	14.8	14.2	12.1	15.9	11.9
Dwelling	-11.7	25.2	5.9	3.1	-3.2	-3.7
Exports of goods and services	2.2	0.0	-2.2	4.0	2.0	3.6
Imports of goods and services	-4.2	10.7	10.5	15.1	8.6	6.5
Inflation and unemployment (in percent)						
CPI inflation	4.4	3.0	2.8	2.3	2.7	3.5
Unemployment rate	6.8	6.4	6.1	5.5	5.1	5.0
Saving and investment (in percent of GDP)						
Gross national saving	19.9	20.0	20.4	19.6	20.3	21.0
General government saving	2.8	3.5	4.3	4.0	4.6	4.7
Private saving 1/	17.1	16.4	16.2	15.6	15.6	16.3
Gross capital formation	22.1	24.0	25.8	25.8	26.4	26.5
Fiscal indicators (in percent of GDP) 2/						
Receipts 3/	23.3	22.1	22.5	22.3	22.8	23.3
Payments 3/	22.5	22.2	21.6	21.4	21.3	21.7
Underlying balance 3/	0.9	-0.1	1.0	1.0	1.5	1.5
Net debt	6.2	5.2	3.8	2.8	1.3	-0.5
Money and credit (end of period)						
Interest rate (90-day bill, in percent) 4/	4.2	4.8	5.5	5.4	5.6	6.0
Treasury bond yield (10-year, in percent) 4/	6.0	5.2	5.6	5.3	5.2	5.8
M3 (percent change) 4/	14.7	7.1	11.9	9.6	8.1	10.9
Private domestic credit (percent change) 4/	9.8	12.5	12.4	14.1	13.5	14.3
Balance of payments (in percent of GDP)						
Current account	-2.1	-3.9	-5.6	-6.3	-6.0	-5.6
of which: Trade balance	0.5	-1.3	-2.9	-2.8	-1.9	-1.5
Foreign direct investment, net	-1.0	2.3	-1.1	3.8	0.9	…
Terms of trade (percent change)	1.4	2.0	3.2	9.7	12.1	6.5
External assets and liabilities (in percent of GDP)						
Net external liabilities	48.3	53.2	55.6	58.3	60.1	61.6
Net external debt	43.8	46.6	45.7	48.5	50.8	51.2
Gross official reserves 4/	5.2	5.0	5.5	5.5	6.3	6.8
Exchange rate (period average)						
US$/$A 4/	0.509	0.566	0.750	0.769	0.743	0.740
Trade-weighted index 4/	50.2	51.7	63.0	62.8	63.7	62.0
Real effective exchange rate 5/	97.2	101.4	122.4	121.8	125.2	122.2

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

1/ Includes public trading enterprises.
2/ Fiscal year ending June 30, Commonwealth Budget.
3/ Excludes asset sales and other one-off factors; cash basis.
4/ Data for 2006 are for latest available month.
5/ IMF, Information Notice System index (1990 = 100). Data for 2006 are for latest available month.

Table 2. Australia: Balance of Payments, 2001-2006
(In percent of GDP)

	2001	2002	2003	2004	2005	Proj. 2006
Current account balance	-2.1	-3.9	-5.6	-6.2	-6.0	-5.4
Goods and services balance	0.5	-1.3	-2.9	-2.8	-1.9	-1.6
Exports	17.3	15.7	13.4	13.7	15.0	16.4
Imports	-16.8	-17.0	-16.3	-16.5	-16.9	-18.0
Net services	0.1	0.1	0.1	-0.1	-0.1	0.0
Total credits	4.7	4.5	4.2	4.1	4.0	3.9
Total debits	-4.7	-4.4	-4.1	-4.2	-4.1	-4.0
Net income	-2.7	-2.7	-2.7	-3.2	-3.8	-3.6
o/w Net interest payments	-2.0	-1.7	-1.4	-1.6	-1.7	-2.0
o/w Net equity income	-0.7	-1.0	-1.3	-1.5	-2.1	-1.7
Net transfers	0.0	0.0	0.0	0.0	-0.1	0.0
Capital and financial account	2.1	4.0	5.4	6.0	5.8	5.3
Capital account	0.2	0.1	0.1	0.1	0.1	0.1
Financial account	1.9	3.9	5.2	5.9	5.6	5.2
Direct investment transactions: net	-1.0	2.2	-1.6	4.0	0.1	…
Equity (net)	0.3	-0.2	-2.0	3.6	-0.9	…
Debt (net)	-1.3	2.5	0.4	0.4	1.0	…
Portfolio investment transactions: net	1.7	0.1	7.5	2.4	5.1	…
Equity (net)	0.6	-2.8	1.6	-5.7	-0.1	…
Debt (net)	1.1	2.9	5.9	8.1	5.2	…
Financial derivatives (net)	0.1	-0.1	-0.1	0.1	-0.1	…
Other transactions (net)	1.1	1.7	-0.6	-0.6	0.5	…
Net errors and omissions	0.0	0.0	0.2	0.2	0.2	-0.1
	(Assets and liabilities at end-period)					
Net external liabilities	48.3	51.6	53.5	55.5	56.9	57.2
Net external equity liabilities	4.4	5.0	8.0	7.7	6.6	…
Foreign equity investment in Australia	51.4	46.8	50.0	54.7	50.5	…
Australian equity investment abroad	-46.9	-41.7	-42.0	-47.1	-44.0	…
Net external debt	43.8	46.6	45.5	47.9	50.3	52.2
Net public sector	1.5	2.0	0.9	1.6	1.0	…
Net private sector	42.3	44.5	44.6	46.3	49.3	…
Gross external debt	71.5	75.6	75.4	80.1	82.3	…
of which: $A denominated	24.3	26.4	26.5	28.5	29.8	…
Gross external lending	-27.6	-29.0	-29.9	-32.3	-31.9	…
Short-term net external debt (residual maturity basis)	23.0	22.2	17.8	17.9	19.5	…
Short-term gross external debt	38.9	39.6	35.9	37.0	37.3	…
Short-term gross external lending	-15.8	-17.4	-18.1	-19.2	-17.8	…
Memorandum items:						
Gross official reserves (in $A billion)	36.7	38.1	44.3	47.4	59.0	…
RBA outstanding forward contracts (in $A billion)	29.5	25.0	26.4	22.4	30.4	…
Gross reserves in months of imports	2.7	2.8	3.0	2.9	3.2	…
Gross reserves to ST FX denominated debt (percent)	19.4	18.6	21.9	21.5	24.6	…
Net interest payments to exports (percent)	9.0	8.4	8.0	9.2	9.0	9.6

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

Table 3. Australia: Fiscal Accounts, 2001/02–2009/10 1/

	2001/02	2002/03	2003/04	2004/05	Est. 2005/06	Projections 2/ 2006/07	2007/08	2008/09	2009/10
Fiscal accounts on an accrual basis 3/				(In percent of GDP)					
Commonwealth government									
Revenue	22.1	22.4	22.4	23.1	23.3	23.0	22.9	23.0	23.0
Tax	20.5	20.9	21.0	21.7	21.8	21.5	21.5	21.6	21.6
Income tax	16.2	16.8	16.9	18.3	18.6	18.4	18.4	18.5	18.7
Individuals and other withholdings	11.7	11.7	11.8	12.2	12.0	11.5	11.5	11.7	12.0
Indirect and other tax	4.3	4.1	3.9	3.5	3.2	3.2	3.1	3.1	2.9
Non-tax	1.6	1.5	1.3	1.3	1.5	1.4	1.4	1.4	1.4
Expenses	22.7	21.8	21.8	21.9	21.6	21.8	21.9	22.0	21.9
Salaries and wages	1.4	1.4	1.3	1.3	1.3	1.4	1.3	1.3	1.2
Goods and services	4.6	4.7	4.6	5.1	5.1	5.3	5.3	5.2	5.1
Current transfers	13.8	13.2	13.4	13.2	13.0	12.9	13.2	13.4	13.6
Other expenses	2.8	2.6	2.4	2.3	2.1	2.2	2.1	2.1	2.0
Net capital investment	-0.1	0.0	0.1	0.0	0.1	0.2	0.0	0.1	0.0
Fiscal Balance 4/	-0.5	0.6	0.6	1.2	1.7	1.0	0.9	1.0	1.1
State, Territory, and Local government balance 5/	0.0	0.3	0.5	0.4	-0.5	-0.6	…	…	…
								…	…
Public Non-financial Corporations balance	-0.1	-0.1	0.0	-0.3	-1.2	…	…	…	…
								…	…
Non-Financial Public Sector balance 6/	-0.5	1.0	1.2	1.4	0.0	…	…	…	…
Fiscal accounts on a cash basis									
Commonwealth government									
Receipts	22.1	22.5	22.3	22.8	23.3	22.9	22.8	22.8	22.9
Payments	22.3	21.6	21.4	21.3	21.7	21.6	21.6	21.6	21.6
Future Fund earnings					0.0	0.2	0.2	0.2	0.2
Underlying cash balance 7/	-0.1	1.0	1.0	1.5	1.5	1.1	1.0	1.0	1.0
Memorandum items:									
Commonwealth government net debt 8/	5.2	3.8	2.8	1.3	-0.5	-2.2	-2.4	-3.4	-4.4
Commonwealth government net worth 8/9/	-6.6	-6.8	-4.7	-3.6	-2.5	-1.2	-0.2	0.8	1.9

Sources: Commonwealth of Australia: *Budget Strategy and Outlook, 2006-07.*

1/ Fiscal year ends June 30.
2/ Projections as presented in the *Budget Strategy and Outlook, 2006-07.*
3/ Accrual data are reported on a consistent basis with Government Financial Statistics (GFS).
4/ The fiscal balance is equal to revenue less expenses less net capital investment.
5/ The 2006/07 balance includes a A$ 5.2 billion deposit by the New South Wales government into their Liability Management Fund to meet future superannuation contributions. Excluding this transaction, the aggregate state/local cash deficit for 2006/07 is 0.1 percent.
6/ The consolidated commonwealth, state and local governments.
7/ Underlying cash balance equals receipts less payments, and excludes earnings of the Future Fund.
8/ Assumes the sale of the government's remaining shareholding in Telstra in 2006/07.
9/ Includes financial and non-financial assets and liabilities, including unfunded superannuation liabilities to public employees.

Table 4. Australia: Medium-Term Scenario 2005–11

	Average 1995-2004	2005	Projections 2006	2007	2008	2009	2010	2011
Real economic indicators (percent change)								
GDP	3.8	2.5	3.1	3.5	3.2	3.2	3.2	3.2
Total domestic demand	4.5	4.2	4.0	3.4	3.0	2.9	3.0	2.9
Private consumption	4.1	3.1	3.2	3.1	3.1	3.1	3.0	3.0
Total investment	6.1	7.4	7.5	4.2	2.6	2.4	2.7	2.6
Business	10.2	15.9	11.9	5.9	3.5	2.7	2.7	2.2
Dwelling	4.1	-3.2	-3.7	0.2	0.0	1.4	2.7	3.0
CPI inflation	2.7	2.7	3.5	2.9	2.6	2.5	2.5	2.5
Unemployment rate	7.0	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Saving and investment (percent of GDP)								
Gross national saving	19.7	20.3	21.0	21.0	20.8	20.5	20.1	19.7
General government saving	2.6	4.6	4.7	4.4	4.4	4.4	4.4	4.3
Private saving 1/	17.0	15.6	16.3	16.5	16.4	16.2	15.7	15.4
o/w Household	10.3	6.6	7.2	7.9	7.5	7.1	7.2	7.4
Gross capital formation	24.0	26.4	26.5	26.3	25.9	25.5	25.3	24.9
o/w Private fixed investment	20.0	22.2	22.5	22.3	21.9	21.6	21.3	21.0
Commonwealth Budget (percent of GDP) 2/								
Receipts	23.3	22.8	23.3	22.9	22.8	22.8	22.9	22.9
Payments	23.3	21.3	21.7	21.7	21.6	21.6	21.7	21.7
Underlying balance (cash basis) 3/	0.0	1.5	1.5	1.1	1.0	1.0	1.0	1.0
Fiscal balance (accrual basis)	0.4	1.2	1.7	1.0	0.9	1.0	1.1	1.1
Net debt 4/	10.6	1.3	-0.5	-2.2	-2.4	-3.4	-4.4	-5.4
Balance of payments (percent of GDP)								
Balance on goods and services	-1.3	-2.0	-1.4	-1.2	-1.4	-1.4	-1.8	-2.0
Balance on income and transfers	-3.1	-3.9	-4.2	-4.1	-3.8	-3.6	-3.4	-3.2
Current account balance	-4.4	-6.0	-5.6	-5.3	-5.2	-5.0	-5.2	-5.2
Trade in goods and services (percent change)								
Export volume	4.7	2.1	3.6	6.3	5.8	5.8	5.0	4.7
Import volume	8.0	8.6	6.5	5.2	4.4	4.1	3.4	3.0
Terms of trade	2.4	12.1	6.5	0.1	-3.0	-2.3	-3.8	-3.3
Export price	1.7	12.6	8.0	-1.6	-3.3	-2.7	-4.2	-3.7
Import price	-0.7	0.5	1.1	-1.7	-0.3	-0.4	-0.4	-0.5
External liabilities								
Net external liabilities (percent of GDP)	53.4	60.1	61.6	63.4	65.5	67.2	69.2	71.1
Net external interest (percent of exports)	9.8	9.1	9.2	9.6	9.2	9.6	10.3	11.1

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

1/ Includes public trading enterprises.
2/ Commonwealth budget. Fiscal year basis ending June 30.
3/ Underlying cash balance equals receipts less payments, and excludes Future Fund earnings to ensure they are not offset by a weakening elsewhere in the fiscal position.
4/ Assuming the sale of the government's remaining shareholding in Telstra.

Table 5. External Debt Sustainability Framework, 2001-2011
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 6/**
External debt	71.5	75.6	75.5	80.6	82.4			**78.7**	**81.0**	**83.7**	**85.9**	**88.4**	**90.9**	**-1.5**
Change in external debt	1.0	4.1	-0.1	5.1	1.8			-3.7	2.3	2.7	2.2	2.5	2.4	
Identified external debt-creating flows (4+8+9)	2.4	0.1	-6.1	-1.2	-0.6			0.7	0.7	1.5	1.5	1.7	1.6	
Current account deficit, excluding interest payments	-0.6	1.6	3.6	4.0	3.5			3.0	2.9	2.8	2.7	2.9	3.0	
Deficit in balance of goods and services	-0.6	1.1	2.7	2.9	2.0			1.4	1.2	1.4	1.4	1.8	2.0	
Exports	22.1	20.2	17.6	17.8	19.1			19.9	19.6	19.2	18.8	18.1	17.4	
Imports	21.5	21.4	20.3	20.8	21.1			21.3	20.8	20.6	20.3	19.9	19.4	
Net non-debt creating capital inflows (negative)	-0.9	2.9	0.3	2.1	0.6			-0.4	0.0	-0.2	0.2	0.1	0.2	
Automatic debt dynamics 1/	3.9	-4.4	-10.0	-7.3	-4.7			-2.0	-2.2	-1.1	-1.4	-1.4	-1.6	
Contribution from nominal interest rate	2.7	2.3	2.0	2.3	2.4			2.5	2.4	2.4	2.3	2.2	2.2	
Contribution from real GDP growth	-1.8	-2.5	-2.0	-2.0	-2.0			-2.4	-2.6	-2.4	-2.5	-2.7	-2.7	
Contribution from price and exchange rate changes 2/	3.0	-4.2	-10.0	-7.6	-5.2			-2.1	-2.1	-1.0	-1.1	-1.0	-1.1	
Residual, incl. change in gross foreign assets (2-3)	-1.3	4.1	6.0	6.3	2.4			-4.4	1.6	1.1	0.8	0.9	0.8	
External debt-to-exports ratio (in percent)	324.0	374.1	429.5	452.2	432.1			395.8	413.9	435.6	456.1	489.2	523.8	
Gross external financing need (in billions of US dollars) 3/	165.0	170.8	218.5	284.4	328.4			333.3	338.2	365.7	390.1	417.8	446.8	
in percent of GDP	44.8	41.3	41.4	44.6	46.3			44.7	42.6	44.3	45.3	46.7	47.9	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	2.4	3.9	3.3	3.2	2.7	3.6	0.8	3.1	3.5	3.1	3.2	3.2	3.2	3.3
Exchange rate appreciation (US dollar value of local currency, change in percent)	-11.1	5.1	19.9	13.0	3.7	0.8	11.1	-1.5	0.3	-1.0	-0.9	-0.8	-0.8	-0.7
GDP deflator in US dollars (change in percent)	-7.8	8.1	23.4	17.0	8.4	3.5	11.8	2.0	2.8	0.9	1.0	0.8	0.9	1.3
Nominal external interest rate (in percent)	3.6	3.7	3.3	3.7	3.3	4.0	0.7	3.2	3.3	3.0	2.9	2.7	2.6	2.9
Growth of exports (US dollar terms, in percent)	-2.7	3.0	10.9	22.4	19.2	7.4	10.7	9.6	4.7	2.1	2.2	-0.1	0.0	1.8
Growth of imports (US dollar terms, in percent)	-10.0	11.8	21.4	23.4	13.2	7.6	10.3	6.0	3.8	3.0	2.7	2.0	1.7	2.6
Current account balance, excluding interest payments	0.6	-1.6	-3.6	-4.0	-3.5	-2.1	1.5	-3.0	-2.9	-2.8	-2.7	-2.9	-3.0	-2.9
Net non-debt creating capital inflows	0.9	-2.9	-0.3	-2.1	-0.6	-0.1	1.8	0.4	0.0	0.2	-0.2	-0.1	-0.2	-0.1
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2006-10 4/								**78.7**	**80.0**	**80.5**	**80.5**	**80.7**	**80.7**	**-2.7**
B. Bound Tests														
B1. Nominal interest rate is at baseline plus one-half standard deviation								**78.7**	**81.3**	**84.2**	**86.7**	**89.5**	**92.2**	**-1.2**
B2. Real GDP growth is at baseline minus one-half standard deviations								**78.7**	**81.3**	**84.3**	**86.9**	**89.7**	**92.5**	**-1.1**
B3. Non-interest current account is at baseline minus one-half standard deviations								**78.7**	**81.8**	**85.2**	**88.2**	**91.5**	**94.6**	**-1.5**
B4. Combination of B1-B3 using 1/4 standard deviation shocks								**78.7**	**81.7**	**85.0**	**87.9**	**91.1**	**94.3**	**-1.2**
B5. One time 30 percent real depreciation in 2007 7/								**78.7**	**86.7**	**89.3**	**91.5**	**94.1**	**96.6**	**-1.8**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ The implied change in other key variables under this scenario is discussed in the text.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

7/ This scenario assumes foreign exchange hedging covers 79 percent of foreign currency debt, consistent with the findings of a survey by the Australian Bureau of Statistics, as reported in "Australia's Foreign Currency Exposure and Hedging Practices," RBA Bulletin, December 2005.

ANNEX I. AUSTRALIA—FUND RELATIONS
(As of June 30, 2006)

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

II.	**General Resources Account**:	**SDR Million**	**Percent Quota**
	Quota	3,236.40	100.0
	Fund holdings of currency	2,833.48	87.55
	Reserve position in Fund	403.16	12.46
III.	**SDR Department**:	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	470.55	100.00
	Holdings	135.04	28.70
IV.	**Outstanding Purchases and Loans**:	None	
V.	**Financial Arrangements**:	None	
VI.	**Projected Obligations to Fund:**	None	

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 independently 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 2005 Article IV consultation discussions were held during June 8-17, 2005, the Executive Board discussed the staff report (IMF Country Report No. 05/331) and concluded the consultation on August 29, 2005.

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) will be discussed by the Executive Board in the context of the 2006 Article IV consultation.

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

ANNEX II. AUSTRALIA: STATISTICAL ISSUES

Australia publishes a wide array of economic and financial data, which are considered adequate for surveillance purposes. It has 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 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.

Table of Common Indicators Required for Surveillance
(As of July 20, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	07/20/06	07/20/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/06	07/12/06	M	M	M
Reserve/Base Money	05/06	07/12/06	M	M	M
Broad Money	05/06	07/12/06	M	M	M
Central Bank Balance Sheet	05/06	07/12/06	M	M	M
Consolidated Balance Sheet of the Banking System	05/06	07/12/06	M	M	M
Interest Rates[2]	06/30/06	07/13/06	D	D	D
Consumer Price Index	Q1 2006	05/03/06	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2004/05	10/05	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	02/06	04/21/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	02/06	04/21/06	M	M	M
External Current Account Balance	Q1 2006	06/06/06	Q	Q	Q
Exports and Imports of Goods and Services	05/06	07/14/06	M	M	M
GDP/GNP	Q1 2006	06/07/06	Q	Q	Q
Gross External Debt	Q1 2006	06/06/06	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 non-bank financing.
[4] The general government 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).

INTERNATIONAL MONETARY FUND
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FOR IMMEDIATE RELEASE
October 23, 2006

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

IMF Executive Board Concludes 2006 Article IV Consultation with Australia

On October 11, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Australia.[1]

Background

Australia's economic performance continues to be robust and prospects remain bright. The economy is entering its 16th year of expansion, reflecting the benefits of wide-ranging structural reforms and sound macroeconomic policies. After a modest slowing in 2005 following a welcome cooling of the housing market, growth is expected to strengthen once more because strong global growth has lifted Australia's terms of trade to the highest level in three decades. As a result, business investment has risen sharply, laying the foundation for solid export-led growth in the medium term.

Real GDP growth eased to 2¾ percent in 2005 as consumption growth declined and dwelling investment fell modestly following the cooling of the housing market. The slow down was cushioned by rapid growth in business capital spending, with investment being particularly strong in the mining sector. The unemployment rate has fallen to 4.8 percent in recent months, its lowest level in 30 years, but there has been little generalized wage pressure. Nonetheless, resource utilization is relatively high in some sectors and regions, and the Reserve Bank of Australia's (RBA) preferred measure of the core CPI inflation edged up to almost 3 percent (y/y) in June, while headline CPI inflation was 4 percent y/y owing to rising oil and fruit prices.

The external current account deficit was 6 percent of GDP in 2005, exceeding its typical level of

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[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.

about 4½ percent owing to high business investment. The trade deficit narrowed with the rise in export prices, but export volume growth was slow, reflecting unfavorable weather, the appreciated exchange rate, and disruptions of transport infrastructure for commodity exports. More recently, the trade and current account deficits have both eased somewhat.
The Australian dollar has been broadly stable, but remains relatively high by historical standards, at about 12 percent above its 20-year average in real effective terms in September 2006. Net foreign liabilities reached a new high, at 57 percent of GDP, but the ratio of net interest payments to exports remained low at 9 percent.

Monetary policy was tightened modestly, with the RBA raising the target cash rate to 6 percent in two 25 basis point steps in May and August 2006. The fiscal position continues to be robust, with fiscal surpluses recorded in eight of the past nine years. Indeed, the net debt of the Australian government was eliminated in April 2006. The underlying cash balance for the 2005/06 fiscal year was 1.6 percent of GDP, ½ percentage point higher than budgeted owing to strong revenues. The 2006/07 budget targets a fiscal surplus of 1.1 percent of GDP, and projects the surplus to remain at 1 percent of GDP in the medium term.

Growth is expected to pick up to about 3 percent in 2006 and 3½ percent in 2007. Domestic demand growth is expected to slow gradually as investment growth moderates. With mining sector projects scheduled to come on stream, higher exports will help reduce the trade deficit, but the external current account deficit will decline more modestly owing to rising equity income outflows. Unemployment is expected to remain stable or decline gradually, and core CPI inflation and wage growth are projected to remain broadly stable. In the medium term, export commodity prices are assumed to decline significantly owing to an expansion in the global capacity of the mining sector, but there are both upside and downside risks to this outlook.

Executive Board Assessment

Australia’s current economic expansion is now in its sixteenth year and unemployment has fallen below 5 percent for the first time in three decades. Executive Directors commended the authorities on their sound macroeconomic management and continuing structural reform efforts that have underpinned the sustained strong economic performance. Looking ahead, macroeconomic policies are well positioned to face potential external shocks, and Directors were confident that the authorities will press ahead with necessary reforms to address medium-term growth and fiscal challenges.

Directors judged that monetary policy has been tightened appropriately as the medium-term prospects for inflation had risen owing to rising world commodity prices and the relatively high level of resource utilization in some sectors and regions. They noted that further monetary tightening may eventually be needed if domestic demand growth or other factors lead to an increase in underlying inflation pressure. Although the Australian dollar is relatively high by historical standards, Directors saw no clear signs of misalignment given the high level of commodity prices and the prospects for stronger growth in export volumes.

Directors commended Australia’s continued strong fiscal position, observing that the elimination of net public debt by the Australian government was an impressive milestone that few countries have been able to achieve. With the budget expected to remain in surplus in the medium term, Directors endorsed the establishment of the Future Fund to invest these surpluses to help

Australia manage its long-term fiscal challenges. Noting that the current fiscal policy stance is mildly stimulatory at a time of relatively high resource utilization in some sectors and regions, Directors recommended that the fiscal surplus be allowed to exceed budget targets if growth and revenues are higher than expected.

Directors noted that that much of the recent improvement in Australia's terms of trade may eventually be reversed, and that there are also broader downside risks to the global economic outlook in the medium term. Nonetheless, Directors considered that Australia's macroeconomic policies, flexible exchange rate regime, and the robust medium-term fiscal outlook and the medium-term focus of monetary policy provide substantial cushions to help the economy cope with a fall in commodity prices or other shocks. Although potential vulnerabilities are contained and private sector risk management practices are sufficient, Directors recommended that the authorities continue to monitor private external debt closely.

Australia's participation in the Financial Sector Assessment Program was welcomed by Directors, and they endorsed the finding that Australia's financial system is healthy and financial supervision is sound. Nevertheless, with financial institutions entering new businesses and facing growing competition, Directors encouraged the authorities to remain vigilant by promoting robust risk management practices. In this regard, Directors welcomed the close monitoring of household debt servicing capacity by the Australian Prudential Regulation Authority, along with the review of liquidity regulation that is currently underway, and they fully supported the authorities' request to the banks to conduct regular stress tests. They also welcomed the steps taken to enhance supervisory cooperation with New Zealand. Directors emphasized that the authorities' ongoing work to ensure the legal foundations for timely and minimally disruptive resolutions of failed institutions was important to underpin the resilience of the financial system and minimize fiscal cost.

Directors welcomed the agreement between the Australian and state governments on the ambitious *National Reform Agenda* to lift productivity and labor participation over the next decade. They supported the broadening of the reform agenda to include human capital issues such as education, training, and health care. However, Directors recognized that progress on this reform agenda would be challenging, as evidenced by the lagging reform implementation in crucial areas—such as trading in water. Accordingly, Directors urged the authorities to make appropriate use of the resources provided by the recent surge in fiscal revenues to help spur the implementation of reforms. They considered that such an investment in reforms would help sustain strong economic growth and better position Australia to address the challenges of an ageing population and rising healthcare costs.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the 2006 Article IV Consultation with Australia is also available.

Table 1. Australia: Selected Economic Indicators, 2001–06

	2001	2002	2003	2004	2005	2006
Output and demand (percent change)						
Real GDP	2.3	4.1	3.1	3.6	2.7	3.1
Total domestic demand	1.0	6.4	5.8	5.7	4.2	4.0
Private consumption	3.0	3.9	3.8	5.9	3.1	3.2
Total investment	-3.3	15.7	8.9	8.1	7.0	7.5
Business	-3.4	14.8	14.3	12.8	14.4	11.9
Dwelling	-11.7	25.1	5.9	3.1	-3.2	-3.7
Exports of goods and services	2.3	0.0	-2.1	4.1	2.0	3.6
Imports of goods and services	-4.3	10.7	10.5	15.1	8.4	6.5
Inflation and unemployment (in percent)						
CPI inflation	4.4	3.1	2.8	2.3	2.7	3.5
Unemployment rate	6.8	6.4	6.1	5.5	5.1	5.0
Saving and investment (in percent of GDP)						
Gross national saving	19.9	20.0	20.5	19.6	20.2	21.0
General government saving	2.8	3.5	4.3	3.9	4.6	4.7
Private saving 1/	17.1	16.5	16.2	15.7	15.6	16.3
Gross capital formation	22.1	24.0	25.8	25.9	26.5	26.5
Fiscal indicators (in percent of GDP) 2/						
Receipts 3/	23.4	22.1	22.5	22.3	22.8	23.1
Payments 3/	22.5	22.3	21.6	21.4	21.3	21.4
Underlying balance 3/	0.9	-0.1	1.0	1.0	1.5	1.6
Net debt	6.2	5.2	3.8	2.8	1.3	-0.6
Money and credit (end of period)						
Interest rate (90-day bill, in percent) 4/	4.2	4.8	5.5	5.4	5.6	6.2
Treasury bond yield (10-year, in percent) 4/	6.0	5.2	5.6	5.3	5.2	5.5
M3 (percent change) 4/	13.7	7.0	11.7	9.0	8.2	11.8
Private domestic credit (percent change) 4/	9.8	12.5	12.4	14.1	13.5	14.5
Balance of payments (in percent of GDP)						
Current account	-2.1	-3.9	-5.6	-6.2	-6.0	-5.6
of which: Trade balance	0.5	-1.3	-2.9	-2.8	-1.9	-1.5
Foreign direct investment, net	-1.0	2.2	-1.6	4.0	0.1	…
Terms of trade (percent change)	1.2	2.1	3.1	9.8	11.9	6.5
External assets and liabilities (in percent of GDP)						
Net external liabilities	48.3	51.6	53.5	55.5	56.9	57.2
Net external debt	43.8	46.6	45.5	47.9	50.3	52.2
Gross official reserves 4/	5.2	5.0	5.5	5.5	6.3	6.8
Exchange rate (period average)						
US$/$A 4/	0.509	0.566	0.750	0.769	0.743	0.756
Trade-weighted index 4/	50.2	51.7	63.0	62.8	63.7	63.2
Real effective exchange rate 5/	97.2	101.5	122.4	121.8	125.3	124.5

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

1/ Includes public trading enterprises.
2/ Fiscal year ending June 30, Commonwealth Budget.
3/ Excludes asset sales and other one-off factors; cash basis.
4/ Data for 2006 are for latest available month.
5/ IMF, Information Notice System index (1990 = 100). Data for 2006 are for latest available month.