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AUSTRALIA'S RESPONSE TO THE CRISIS

Avoiding the global recession

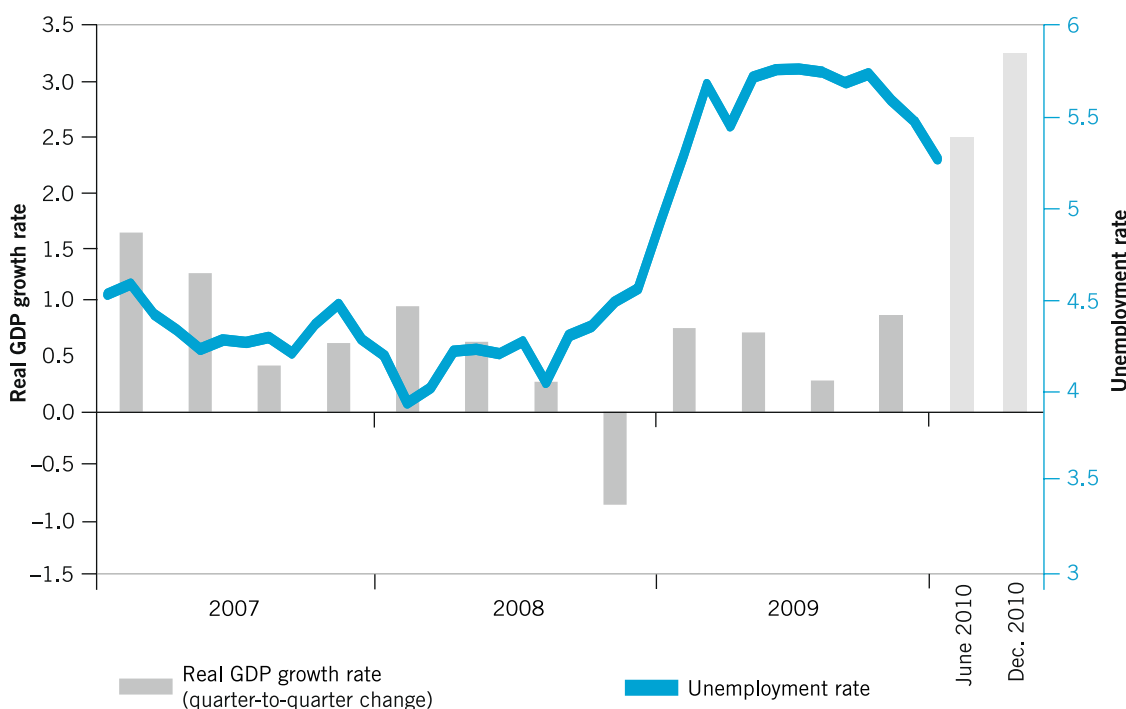
The Australian economy entered the global financial crisis from a strong base, having experienced 16 years of economic expansion. Gross domestic product (GDP) grew by 3.7 per cent in the 2007–2008 financial year (ending June 30) and the unemployment rate stood at 4.2 per cent. The government had a substantial fiscal surplus and space for the stimulus measures introduced after the onset of the crisis.

Australia's economy has performed better than other advanced economies since the beginning of the crisis, recording modest growth when others were

experiencing a deep recession. The country avoided a recession, with only one quarterly decline in GDP, a 0.9 per cent drop in the fourth quarter of 2008. The Australian economy grew by 1.4 per cent in 2009 despite the global economic contraction, and quarter-to-quarter growth picked up to 0.9 per cent in the fourth quarter (figure1).

Growth has been driven by the government's swiftly introduced and substantial stimulus measures, along with China's robust demand for Australian commodities. The country's banking sector has also proved healthy. Recent data point increasingly to a recovery in private sector demand.

Figure 1. Monthly unemployment rate and quarterly real GDP growth rate, 2007–2009 and 2010 forecasts (percentage)



Source: Bureau of Statistics and Reserve Bank of Australia information. Seasonally adjusted data. Forecasts for 2010 refers to annual growth up to June and December 2010.

The labour market appears to have strengthened considerably, with almost 200,000 additional jobs created between August 2009 and February 2010. As of February 2010 the national unemployment rate stood at 5.3 per cent, a decline of 0.5 percentage points from its recent high in July 2009. This has led to suggestions that the unemployment rate may have already peaked at a relatively moderate level of 5.8 per cent, which would represent a considerable achievement, especially given earlier expectations.

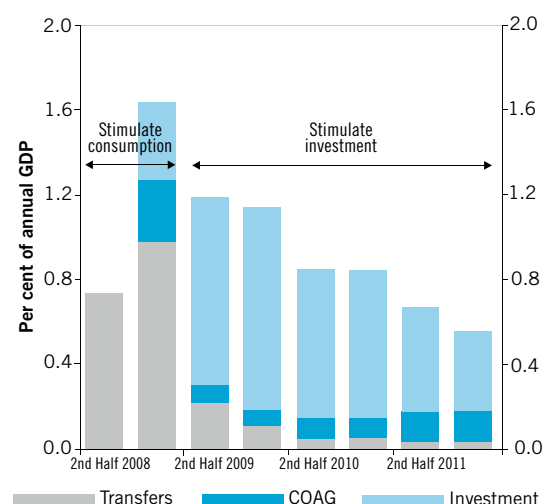
Much of the contraction in labour demand in 2008–2009 took the form of declines in average working hours rather than increases in unemployment. Recent trends suggest the jobs market has stabilized and a significant proportion of these new jobs (60 per cent) are fulltime. These trends and other indicators have prompted several independent economic observers to suggest that the labour market has passed a turning point and consequently incomes, consumption expenditure and aggregate demand may strengthen more than anticipated in the government's November 2009 official forecasts.

Stimulus measures bolster growth

The fiscal stimulus involved successive packages, beginning with the Economic Security Strategy in October 2008. The government's stimulus contained a wide variety of measures which can be summarized under three broad phases: one-off cash payments to low- and middle-income groups, which were rapidly disbursed and had an almost immediate impact on consumption expenditure, retail sales and economic growth; relatively rapid investments in social infrastructure, including schools, health and housing; and

major new investments in economic infrastructure that are more medium term in nature. Some aspects of the second and third components mentioned above have been implemented through increased grants from the federal government to state governments through what is known as the Council of Australian Government (COAG).

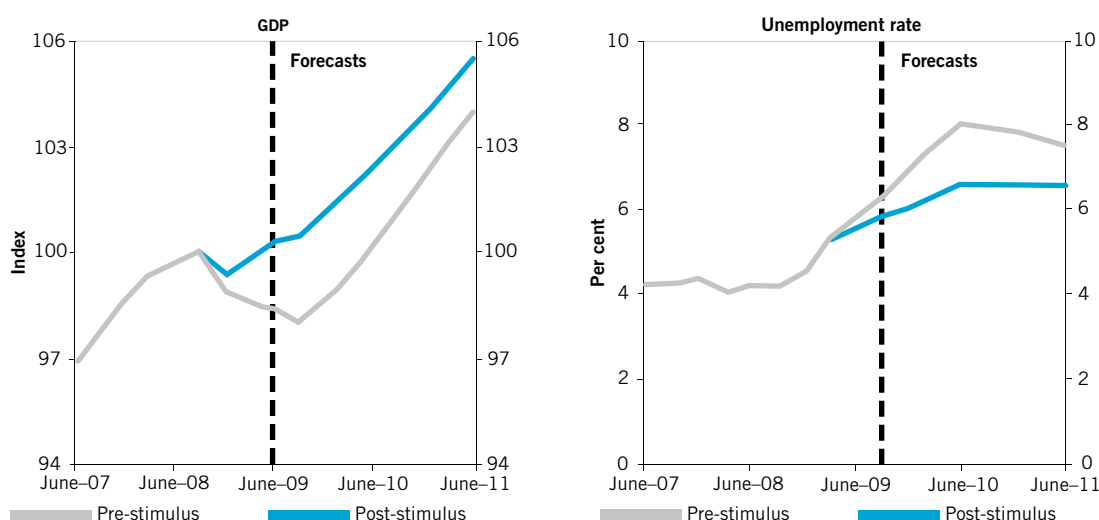
Figure 2. Allocation of the stimulus



Source: Australian Treasury, *Budget Overview 2009–10*, May 2009.

Figure 2 summarizes the magnitude, broad composition and time frame over which the different fiscal measures were expected to have an impact on the economy. The fiscal stimulus is estimated to have added about 1 percentage point to GDP growth in 2008–2009 and is expected to add about 1.5 percentage points in 2009–2010 (figure 3).¹

Figure 3. Impact of the stimulus



Source: Australian Treasury, *Mid-Year Economic and Fiscal Outlook*, 2009–2010, November 2009.

There was considerable social dialogue concerning the stimulus measures. In November 2008 the Treasurer invited the public to submit ideas for the 2009–2010 Budget. The Australian Council of Trade Unions and various employers' organizations as well as welfare and community associations responded positively to this invitation and broad-ranging consultations took place.

Support for low-income groups

A key feature of the Australian response to the crisis has been the emphasis on increasing the disposable incomes of low- and middle-income groups, which tend to spend a large proportion of their incomes. This approach is in line with the main aspects of the ILO Global Jobs Pact, which emphasizes income-led growth and improvements in the social protection floor.

The initial substantive fiscal response to the global financial crisis was an A\$10.4 billion package of measures announced in October 2008. This package was tightly targeted at sectors of the economy showing particular weakness in the early stages of the downturn – household consumption and dwelling investment. In the second quarter of 2008, household consumption expenditure had recorded its first decline in 15 years. This package included one-off additional payments to pensioners of A\$1,400 for singles and A\$2,100 for couples. (Australia has a targeted, means-tested public pension scheme with flat rate benefits funded by general taxation. This is supplemented by private contributory pensions or what is called “superannuation” in Australia). The package also included additional payments of A\$1,000 to eligible persons providing care to the aged or disabled and for each child in families receiving the Family Tax Benefit, which is a means-tested transfer payment received by low- and middle-income families.

This package was expected to generate significant multiplier effects as the payments were timed to be received by cash-strapped families in the lead-up to the year-end holiday period, thus limiting the likelihood that the funds would result in increased savings. In Australia, as in other advanced economies, consumption expenditure comprises about 60 per cent of GDP and has important implications for other areas of expenditure, including private investment. At the time of its announcement the government projected that the strategy would boost real GDP growth by between 0.5 and 1 per cent over a period of several quarters.²

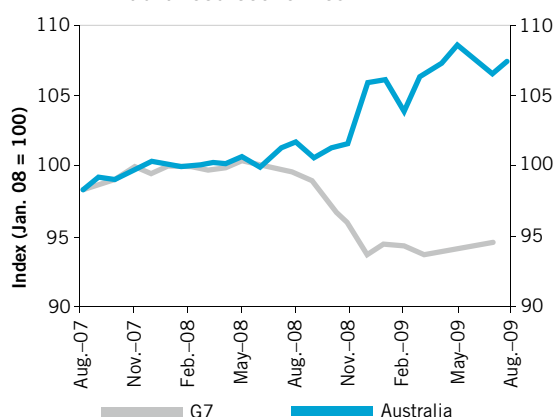
In early February 2009 the government announced the Nation Building – Economic Stimulus Plan, comprising A\$42 billion in measures. This included over A\$12 billion to fund a range of additional one-off transfer payments targeted at a variety of low- and middle-income groups. Well over half the population of Australia received payments of just under a thou-

sand dollars as part of this initiative. These one-off increases in transfer payments were supplemented by major revisions to the aged pension system and other social security benefits announced in May 2009, which resulted in substantial permanent increases in welfare payments. The net impact of these revisions will be to increase expenditure on pensions and related social security payments by A\$14.4 billion over the next four years.

The increases in transfer payments, along with reduced interest rates resulting from monetary easing, helped retail sales remain buoyant in Australia when economic and employment growth were at their weakest. Cash payments to households supported the retail sector over the first half of 2009. In the second half of 2009, retail trade exhibited stable growth, with trend turnover growing by 0.4 per cent each month. This contrasted sharply with retail spending trends in other advanced economies (figure 4).

The stimulus measures, and in particular the direct payments to low- and middle-income households, have also had a significant impact on business and consumer confidence. Consumer confidence has recovered strongly from about mid-2009 and has been well above its long-term average level for about half a year while business confidence is at its strongest level in over seven years.

Figure 4. Retail trade in Australia and major advanced economies



Source: Australian Treasury, Mid-Year Economic and Fiscal Outlook, 2009–10, November 2009.

Investing in the future

The effects of the first stage of the stimulus packages, involving increased transfers, are abating. But the second and third phases of the stimulus, involving significant investments in what was colloquially referred to as “shovel ready” social infrastructure projects and longer term nation building projects such as roads, rail networks and energy conservation, are under way. One crucial aspect of the social infrastructure projects involves an A\$16.2 billion investment in school infra-



structure and maintenance. The programme, known as Building the Education Revolution, was announced as part of the Nation Building – Economic Stimulus Plan. It includes resources to build or upgrade libraries and halls in every eligible primary school in the country; to expand significantly the number of secondary schools with science laboratories and language learning centres; and to ensure every eligible Australian school has resources to undertake minor refurbishments and maintenance. Further substantial investments in universities and tertiary education were provided in the 2009–2010 Budget.

While it is widely recognized that focusing fiscal stimulus measures on physical infrastructure projects can generate significant economic multiplier effects, such activities suffer from the drawback of a time lag between when decisions are taken and jobs are created. In Australia the investment in education infrastructure appears to be taking place in a timely manner. Following the announcement in February 2009, the first set of projects was approved by April and construction was under way by June. This provided swift support for jobs in the labour-intensive construction industry, many of which are in small to medium-sized businesses. By the third quarter of 2009 the impact of this investment was reflected in economic data, with public investment increasing by 6.4 per cent.

This stimulus-linked public investment helped to offset a decline in private investment in the same quarter. In the fourth quarter, investment spending was also supported by increased stimulus-related public investment. Public investment spending rose by over 10 per cent in the fourth quarter, underpinned by a 13 per cent rise in state and local government investment. This was largely driven by the government's stimulus spending, particularly on education infrastructure. Public investment contributed 0.6 per cent to growth in the quarter. This particular stimulus measure is expected to continue to exert a direct positive impact on the level of output and jobs over the next two years. In general, investment in education can help to bolster productivity and economic potential in the longer term.

Outlook and challenges

Australia's economic performance since the onset of the global economic and financial crisis has been stronger than anticipated by many observers. The unemployment rate has remained moderate and employment levels have rebounded in recent months. Major forecasters have revised their predictions to show higher GDP growth and lower unemployment rates, reflecting better than expected domestic conditions and a stronger outlook for the global economy. The Reserve Bank of Australia in early February 2010 projected economic growth of 2.5 per cent in the 2009–2010 financial year ending in June 2010 and 3.25 per cent in the 2010 calendar year.

To date, much of the impetus for Australia's growth has come from fiscal and monetary stimulus, but recent data provide further evidence that a private sector recovery is starting to take hold, with private sector demand picking up as the stimulus is progressively withdrawn. The outlook for private business investment is improving, as business confidence has rebounded and profitability is slowly recovering.

The tentative global recovery is also flowing through to increased demand for Australia's exports. Export volumes increased by 1.7 per cent in the fourth quarter of 2009, underpinned by increased demand for non-rural exports, and the terms of trade rose by 2.9 per cent.

While the near-term outlook for Australia is positive, it does depend upon the global economy strengthening as expected. There is also the challenge of ensuring that the withdrawal of stimulus measures does not dampen demand.

¹ Australian Treasury: *Mid-Year Economic and Fiscal Outlook, 2009–10*, November 2009.

² Australian Treasury: *Mid-Year Economic and Fiscal Outlook, 2008–09*, November 2008.