Euler Hermes Economic Research

Country Report

Australia

No more boom, but no gloom

General Information

GDP	USD1520.608bn (World ranking 12, World Bank 2012)
Population	22.68 million (World ranking 51, World Bank 2012)
Form of state	Federal Parliamentary Democracy (Commonwealth)
Head of government	Anthony John "Tony" ABBOTT
Next elections	2016, Senate and House of Representatives

Strengths

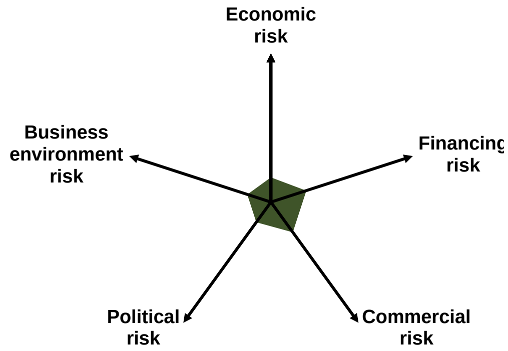
- Large natural resource endowments
- Strong infrastructure and business environment
- Proximity with Emerging Asia
- Strong economic performance

Weaknesses

- Dependent on Chinese demand and commodity prices
- Highly vulnerable to change in climate
- External vulnerabilities stem from chronic current account deficit

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
China	36%	1	20%	China
Japan	18%	2	10%	United States
South Korea	7%	3	8%	Japan
India	4%	4	5%	Singapore
United States	4%	5	5%	Germany

By product (% of total)

Exports		Rank		Imports
Iron Ores	20%	1	9%	Crude Oil
Coals	13%	2	8%	Cars And Cycles
N.E.S. Products	11%	3	7%	Refined Petroleum Products
Natural Gas	8%	4	4%	Pharmaceuticals
Non Ferrous Ores	7%	5	4%	Construction Equipment

Sources: ADB, Chelem (2012)

A fast growing advanced economies

Australia is part of the selected club of advanced countries which went through the Global Financial Country without going into recession (with South Korea and Israel). Over the past 20 years, the country enjoyed significant growth, compared to the other advanced economies with long term growth averaging 3% (while it was +1.6% for the advanced economies). In 2014, the country is set to record its 23rd year of growth.

Heading to sub-trend pace of growth in 2015

GDP growth for the whole year of 2014 is expected to increase to +2.9% (from +2.3% in 2013). However this does not reflect a full fleshed recovery but a strong Q1 figure due to strong rise in resource exports. Indeed, recent figures point to a deceleration in activity. GDP increased by a muted +0.5% q/q in Q2 after a strong Q1 (+1.1% q/q). This slowdown was the result of a negative contribution from net exports (-0.9pps q/q) due to weak demand from China and slowing mineral prices impacting mining production (-1.4% q/q). Domestic demand acted as a cushion however but remains below trend with final consumption expenditures and investment rising by a limited +0.5% q/q and +0.3%, respectively.

In the coming quarters, we do not anticipate a driver for a strong acceleration. Demand from its main partner, China is expected to decelerate further as induced by the weak industrial production figures (+6.9% y/yin August from 9%) and mineral prices remain weak. On the domestic side, the economy is going through a difficult adjustment. First, the mining investment boom is coming to an end as most large energy project are completed, and the country has to find other growth drivers. Second, fiscal consolidation is accelerating. Accordingly, leading indicators point to weak growth in activity. Consumer confidence decreased for the seventh consecutive month in September and this is exacerbated by rising unemployment rate (12 year high in Q2 at 6.4%). Business confidence is weak reflecting the cautious stance by companies concerned about demand.

In 2015, the deceleration should be visible with a sub-trend pace of growth (+2.7%). It will reflect mainly further deceleration of the demand from China (GDP growth at 7.4%), a lackluster rise in non-mining investment as business remain cautious amid moderate rise global demand (GDP growth below 3% in 2014 and 2015), the end of the resource investment boom and further fiscal consolidation.

Monetary policy stance: on accomodative mode

Monetary policy is based on an inflation targeting framework. The goal is to achieve an inflation rate of 2-3% growth on average over a cycle. The target is set as a medium term objective to allow flexibility for the policy makers.

The current RBA stance is dovish and will likely keep that stance until H1 2015. The policy rate was kept at a record low for twelve months in September (2.5%) to boost economic activity. Inflation is at the top of the target band (+3% y/y in Q2) but leading indicators suggest decreasing inflationary pressures amid weak demand and weak mineral prices. In that context, further cuts are possible in the coming quarters, especially if leading indicators were to indicate further slowdown (GDP growth below 0.3% q/q).

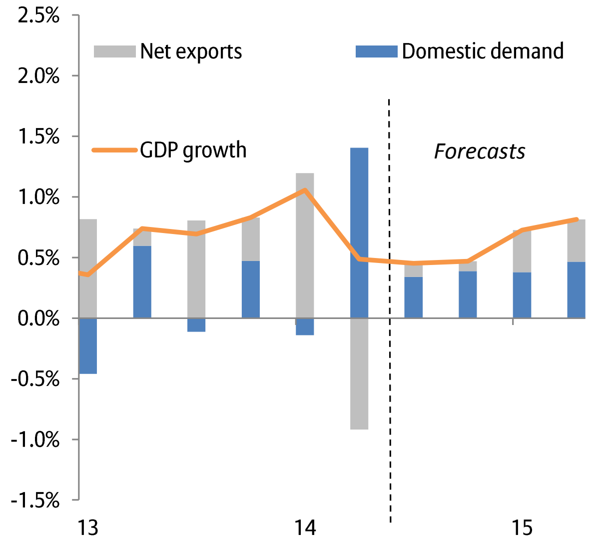
Key economic forecasts

Australia		2012	2013	2014	2015
GDP		3.6	2.3	2.9	2.6
Consumer Spending		2.6	2.0	2.3	2.1
Public Spending		2.9	1.1	1.1	0.1
Investment		8.5	-1.4	0.0	2.0
Stocks	*	-0.5	-0.4	0.2	0.3
Exports		5.8	6.6	6.3	4.6
Imports		6.4	-2.0	0.6	1.7
Net exports	*	-0.1	1.8	1.3	0.7
Current account	**	-65	-51	-42	-32
Current account (% of GDP)		-4.4	-3.3	-2.6	-1.9
Unemployment rate		5.2	5.7	6.1	6.0
Inflation		1.8	2.4	2.7	2.5
General government balance	**	-56	-57	-54	-51
General government balance (% of GDP)		-3.7	-3.7	-3.4	-3.0
Public debt (% of GDP)		27.2	28.8	31.3	33.1
Nominal GDP	**	1502	1555	1612	1692

Change over the period, unless otherwise indicated:
*contribution to GDP growth
**AUD bn

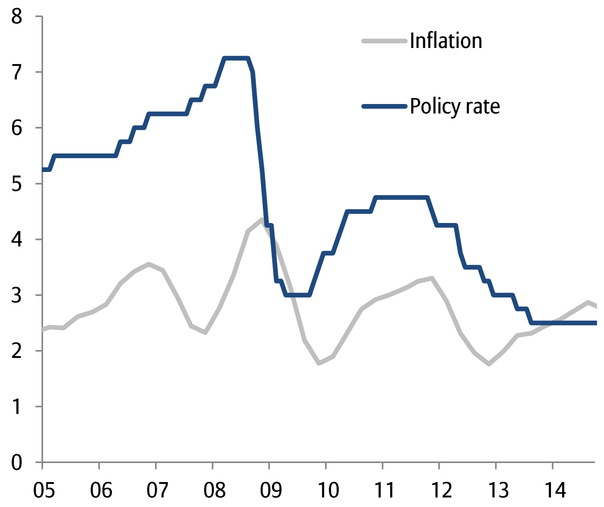
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

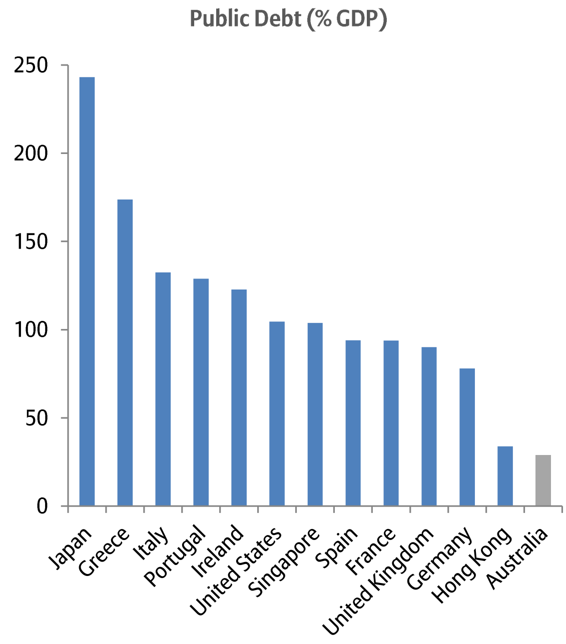
Policy rate and inflation



Sources: National sources, IHS, Euler Hermes

Public finances: accelerating fiscal consolidation put pressures on growth

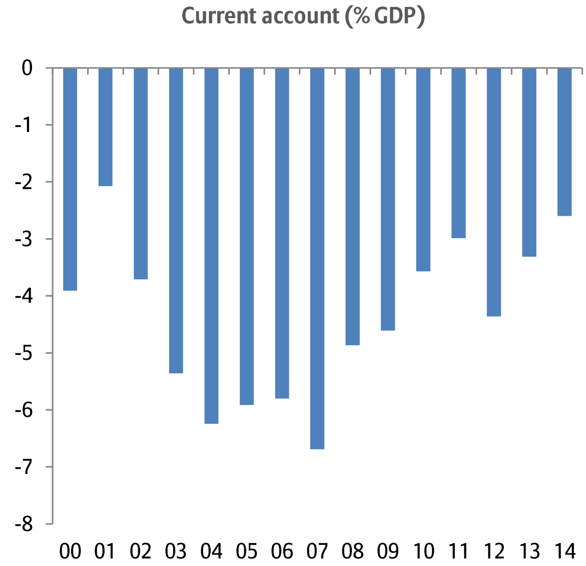
Public finances remain healthy by international standards, although less so due to accommodative fiscal policy over the past years. The current public debt position remains far below 60%, but the trajectory is less so. General government net lending decreased from a surplus in FY2007 (1.5% GDP) to a relatively large deficit (-3% GDP) since 2009. General government debt to GDP ratio tripled between FY2007 and FY2013. Facing such rise, the government decided to set austerity measures to achieve a 1% surplus in the medium term. Accordingly, the 2014 Federal budget includes: rise in income tax, cuts to family tax benefits, cuts to public sector employment, cuts to industry programs (USD850 mn) and resumption of petrol tax indexation. The whole package should represent savings worth USD15 bn (1% GDP) over the next three years. We do not expect domestic demand to be hit dramatically as monetary conditions will likely remain favorable; exports of resources should act as a cushion and the non-mining sector is set to prove resilient. Private consumption, in particular, without further monetary stimulus, should record a limited 0.4%/0.5% q/q growth in Q3 and Q4 2014.



Sources: IMF, IHS, Euler Hermes

Current account deficit to narrow but at a slow pace

The country has long history of chronic current account deficit. However, these imbalances has been exacerbated over the past years 10 years, with large current account deficit (-3% GDP). This mainly reflected: (i) the strong rise in investment inflows following the mining investment boom; (ii) a strong rise in the income balance deficit due to rising interest and dividends paid to foreign investors. In 2014 and 2015, this vulnerability is expected to moderate. The completion of energy investment projects and the end of the mining boom will lead to a deceleration in investment. Moreover, the trade balance is set to improve gradually driven by a deceleration in imports reflecting domestic demand slowdown and less demand for capital goods, the strengthening of resources exports.



Sources: National sources, IHS, Euler Hermes

External debt to remain under control

External debt to GDP ratio is elevated (more than 60% GDP) but should be sustainable. Exports are expected to strengthen, and GDP growth although below trend will remain strong. Low public external debt allows Australia some leeway, especially compared to other advanced economies. Main risk is related to currency swings due to the end of the quantitative easing in the USA.

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2014-09-17
Country Risk Analyst:
Mahamoud Islam
mahamoud.islam@eulerhermes.com