Notes for talk by Neil Mackrell, Chief Representative, New York Representative Office, Reserve Bank of Australia to Hofstra University Seminar, New York 23 April 1998

I was very pleased that the School chose to include Australia within the scope of today's seminar about the Asian crisis and the road to recovery. I believe that the Australian case study is a particularly interesting one. In essence, Australia has weathered the Asian crisis rather better than we thought it might in the months immediately following the Thai devaluation in July 1997, but we are not out of the woods yet.

My aim today will be to outline Australian's experience, and the ongoing structural and policy adjustments that we believe have been so important to us during this turbulent period.

Table 1

I would like to start by taking a slightly longer-term view. During the first nine years of the decade of the 1990's, a period which includes some recessionary periods for each of the countries in the comparison, Australia has grown faster than other comparable OECD countries. Only Ireland and Norway have done better, but taken together they are about half the size of Australia and there are some special circumstances about each of them.

Table 2

Of course, these figures are averages over nine years. The next table looks at growth in the latest year (1998) particularly in those countries in Asia and the Pacific Rim.

The story is well known to you by now, but nevertheless the figures do not paint a pretty picture. Many of the countries have experienced an actual contraction in their levels of income. Apart from China, which remains a relatively closed economy, Australia recorded the strongest growth in the region. The real growth rate of 4.7% over the year to last December was a lot stronger than any of us had forecast, particularly given the pressures that were being felt by our trading partners. We had been expecting a noticeable slowdown and we still are, but at this stage we are still raising our growth forecasts for 1999.

Table 3

The other main comparison to draw against economic growth over the 1990's is to look at the rate of inflation. Over the first 9 years of this decade, Australia's inflation rate has averaged 2.8% per year which is slightly higher than the OECD average. But still in the range of 2 to 3% that the Reserve Bank specifies as Australia's inflation target. If the first two years (1990 and 1991) were deleted from that comparison, the inflation rate would be about the average for OECD countries.

Naturally enough, this rather sanguine view of Australia's experience since the Asian crisis began is the net effect of the wide range of actions, reactions and adjustments within our country to the pressures that were brought to bear on us. We do not know with any precision all the reasons as to why the Australian economy has performed so well during such a difficult period (and I note in passing that Dr. Greenspan in recent testimony has expressed similar sentiments about the performance of the United States economy). However, we do think that a lot of the credit can be traced to a range of broad-based and quite fundamental economic and structural reforms which were implemented during the preceding decade. Many of these are on-going reforms that are aimed at further strengthening our institutions and our competitive capabilities.

Macroeconomic policy, particularly monetary policy, and including our exchange rate policy has played a major role in recent times. Fiscal policy reforms have also been important. But the microeconomic influences, many of which show up in heightened competition and greater flexibility, have been very important. They help to explain not only Australia's move to a lower inflation environment but also the economy's growth and resilience in the face of external contraction.

Table 4

Among the more significant areas of microeconomic reforms we could include:

- substantially lower tariffs;
- deregulated financial markets and floating exchange rate;
- stronger prudential supervision of financial institutions;
- a more stringent regime of competition policy;
- privatisation of a lot of public utilities; and

- a good deal more flexibility in wage bargaining.

These have all contributed to making the economy more efficient and more flexible and thereby more competitive and more resiliant. But of course in the short run, they also had their costs. For example, there is always an increase in uncertainty in an economy when change, and at times rapid change, is occurring and there are often job losses involved such as when a large over-staffed utility is privatised. But there are also large benefits which are often undervalued such as cheaper electricity, cars, telephone calls, airline flights, new export industries and new jobs in the competitive industries. Australia has seen both sides of this coin.

Graph 1

Perhaps the best quantitative indicator that these structural reforms have yielded good results is that the economy is now more productive than ever. This graph shows productivity growth for each of Australia's three most recent expansions. It shows that the increase in productivity in the current expansion, at 1.9%, is a good deal better than the figures we had in the expansions of the 1970's or 1980's. The figure here is for multi-factor productivity, a measure of productivity that cannot be increased simply by shedding labor and replacing it with capital. It can only be increased by using labor and capital more productively. Again, there is an analogy to current productivity performance of the US economy.

Table 5

Public finance has been another important aspect in Australia's body of economic reforms; and an area where the reforms were put in place in time to help shield our economy from external pressures. On comparable OECD figures, our budget was in surplus to the tune of ½% of GDP in 1998 and a bigger surplus is expected in 1999.

Table 6

Perhaps a better measure of the long run effect of fiscal policy can be taken from the ratio of general government debt to GDP. This effectively measures the accumulated debt that is needed to finance them. On this measure, Australia's public finance has resulted in the smallest call on capital markets of OECD countries.

Graph 2

Reform of the banking system and its regulatory environment greatly strengthened our financial institutions ahead of the general turmoil in financial markets. This was important in shielding our real economy from much of the financial woes of the last two years. I've tried to summarise this strengthening with one graph which shows the level of impaired assets (or bad loans) held by banks as a proportion of their total assets. As the consequences of the asset boom earlier this decade were unravelled, bad loans reached a peak of 6% of assets in 1992 but it has come down pretty much continuously since that time. At present, the ratio is less than 1% and this is probably about as low as it could reasonably be expected ever to get. In other words, Australia had significant problems in its banking system at the beginning of this decade along with a lot of other countries. But the bad loans were run off relatively quickly and bank balance sheets in Australia have been particularly strong throughout the period of the Asian crisis. New institutional arrangements have also been introduced recently to strengthen further the regulatory environment in which our financial institutions operate.

Graph 3

The subject of the current account deficit and the level of external debt tended to dominate economic discussion in Australia in the 1980's. There were fears that Australia's current account position might be unsustainable. At that time there was a large fall in the real exchange rate and a number of other adjustments had to be made including a substantial tightening in fiscal policy.

With the benefit of hindsight, it is now clear that the situation was not unsustainable. The bottom line of this graph shows that Australia's current account deficit as a percentage of GDP has tended to oscillate between about 3% to a little over 6% over the last two decades. It is obviously very strongly cyclical and on four occasions it widened to around the 6% mark. We have been expecting that it would do the same on this occasion because of the contraction in our traditional export markets and our own relatively buoyant domestic demand. It is somewhat surprising that it has not happened although we would not be surprised if it did happen at some stage. Unfortunately, the only sure way of preventing such an outcome would be to slow the Australian growth rate and nobody wants to do that. It would be poor economic policy, and unhelpful for regional recovery.

Graph 4

This graph shows broadly what has happened to our exports since mid-1997 and it shows that:

- exports to those countries in Asia that were hit initially by the crisis (ASEAN and Korea) have fallen by 16%;
- exports to the rest of Asia have been relatively flat;
- but on the other hand, exports to Europe are up by 18%, to the U.S. by 24%, and to other markets by 13%.

Over the years we have often felt ourselves to be vulnerable because such a high proportion of our exports are commodities. But as we have seen, in the situation of a regional crisis, this can be an advantage.

Graph 5

Let me return to the issue of sustainability of our external position. The level of Australia's foreign debt rose from almost nothing to about 35% of GDP in 5 years in the mid-1980's. This caused a lot of concern at the time as people tended to assume this sharp upward trend would continue. In the event, the sharp rise in this ratio flattened out and it is currently about the same as it was in 1992 and not a lot higher than in the mid-1980's. The mathematics is such that by holding the current account deficit fairly constant as a proportion of GDP, the foreign debt ratio does not rise forever but tends to flatten out at a new level, and this is what has been happening.

Graph 6

A similar pattern shows up in the debt serving ratio.

Exchange rate management is always a topical issue in a country with an open economy such as Australia   To see how the developments have effected our exchange rate, I think it is appropriate to firstly give a medium term perspective before turning to developments since the Asian crisis occurred.

Graph 7

The median term perspective for Australia's exchange rate is summarised fairly well by a graph of the Australian dollar in trade weighted terms. The graph shows that if we look back over the last 20 years or so, there has been only one major change. That was a downward shift in the real exchange rate that occurred in 1985/86 and which I referred to earlier. But since then, while it has moved quite a lot from quarter to quarter and even from year to year, it has been around basically a flat trend.

Graph 8

Looking at the Australian dollar against other major currencies, we get a similar picture. The Aussie dollar against the Yen shows the same pattern but perhaps with a very slight downward slope.

Graph 9

Looking at the Aussie dollar against the US dollar, again the same pattern but on this occasion the long term flat line trend is probably appropriate. Turning now to the more recent developments, over the last two years, the value of the Australian dollar has obviously depreciated. The depreciation against the US dollar looks to be quite pronounced partly because the US dollar has been quite strong; the depreciation in trade weighted terms looks more modest because the Australian dollar has risen against some Asian currencies that have been relatively highly weighted in the index. If we look over the whole period of nearly two years, we think that the Australian currency has behaved in a reasonably exemplary fashion although there were a couple of periods where it threatened to overshoot.

Table 1

Real GDP Growth
Average annual rate (past nine years)

Ireland	6.8
Norway	3.5
Australia	3.2
Netherlands	2.8
United States	2.5
Denmark	2.5
Germany	2.2
Spain	2.2
New Zealand	2.1
Canada	1.9
United Kingdom	1.9
Belgium	1.9
Japan	1.8
France	1.7
Finland	1.3
Italy	1.3
Sweden	1.1
Switzerland	0.8

Table 2

Real GDP Growth: Asia and Pacific
Year to latest

China	9.6
Australia	4.7
United States	4.3
Taiwan	3.7
Canada	2.8
Philippines	-0.2
New Zealand	-0.7
Singapore	-0.8
Japan	-3.5
Korea	-6.8
Hong Kong	-7.0
Malaysia	-8.6
Indonesia	-19.6

Table 3

Consumer Price Inflation
Average annual rate (past nine years)

Japan	1.3
Belgium	1.9
France	2.0
Canada	2.2
Sweden	2.2
Denmark	2.2
Ireland	2.4
New Zealand	2.5
Norway	2.6
Netherlands	2.6
Finland	2.7
Switzerland	2.7
Germany	2.7
Australia	2.8
United States	3.3
United Kingdom	4.0
Italy	4.5
Spain	4.9

Table 4

Areas of Microeconomic Reform

- substantially lower tariffs;
- deregulated financial markets and floating exchange rate;
- stronger prudential supervision of financial institutions;
- a more stringent regime of competition policy;
- privatisation of a lot of public utilities; and
- a good deal more flexibility in wage bargaining.

Graph 1

Total-factor Productivity

1996/97 = 100

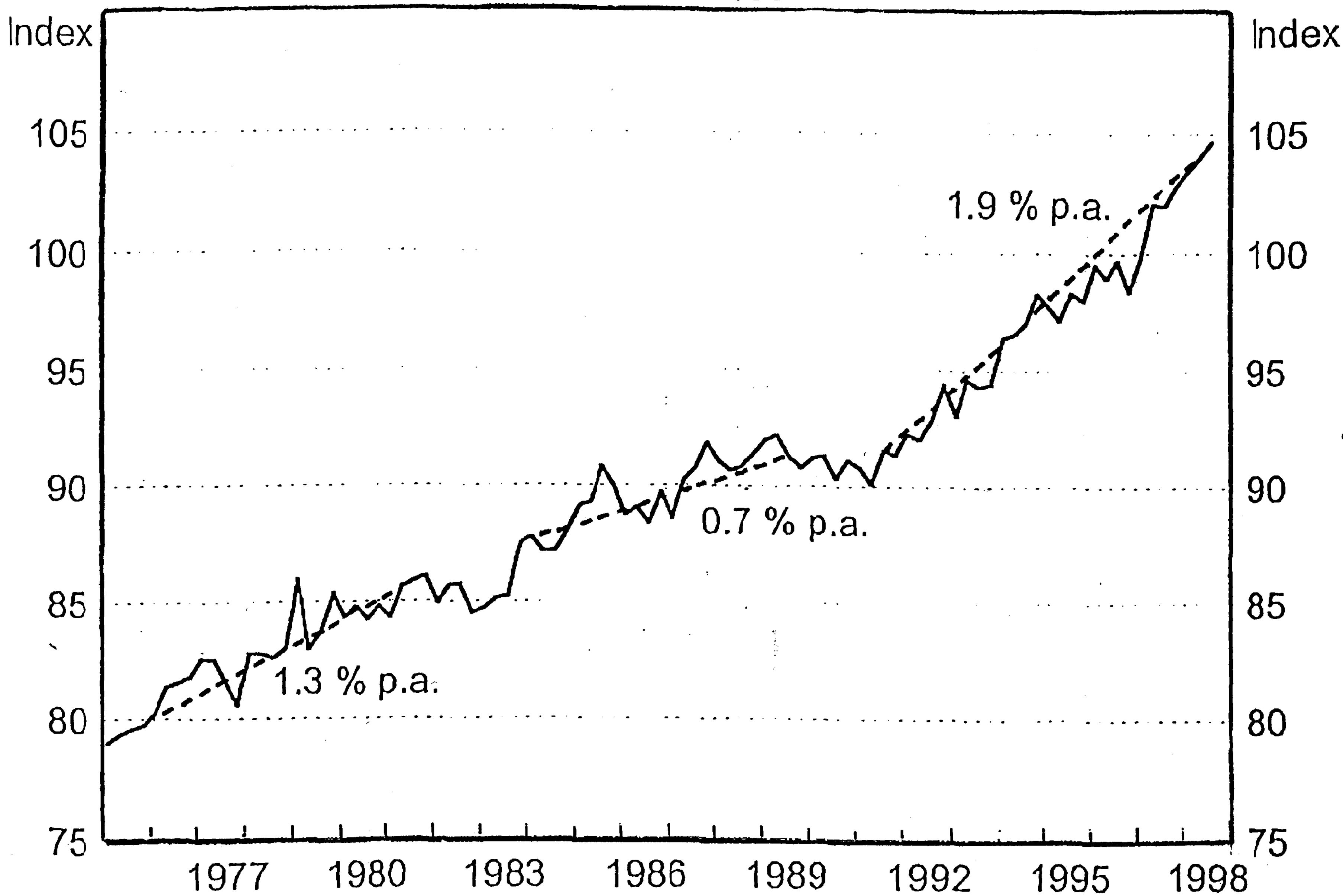


Table 5

General Government Balance
Per cent of GDP, 1998

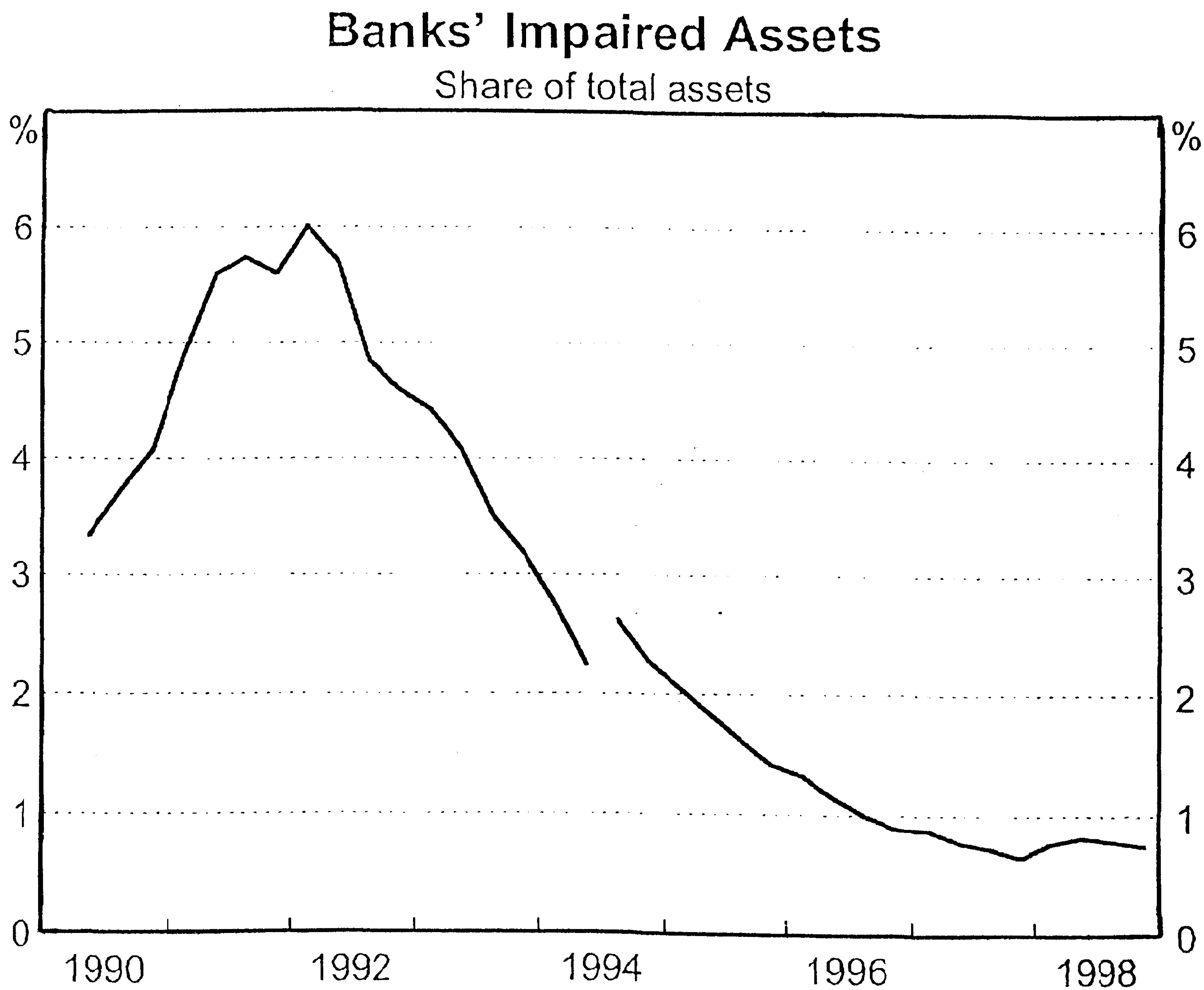
Selected OECD Economies	
Norway	4.4
Ireland	2.5
Canada	2.0
United States	1.6
Sweden	1.2
Denmark	1.0
New Zealand	0.9
Finland	0.8
Australia	0.5
United Kingdom	-0.4
Netherlands	-1.2
Belgium	-1.5
Spain	-1.9
Germany	-2.4
Italy	-2.6
France	-2.9
Japan	-6.1

Table 6

General Government Debt
Per cent of GDP, 1998

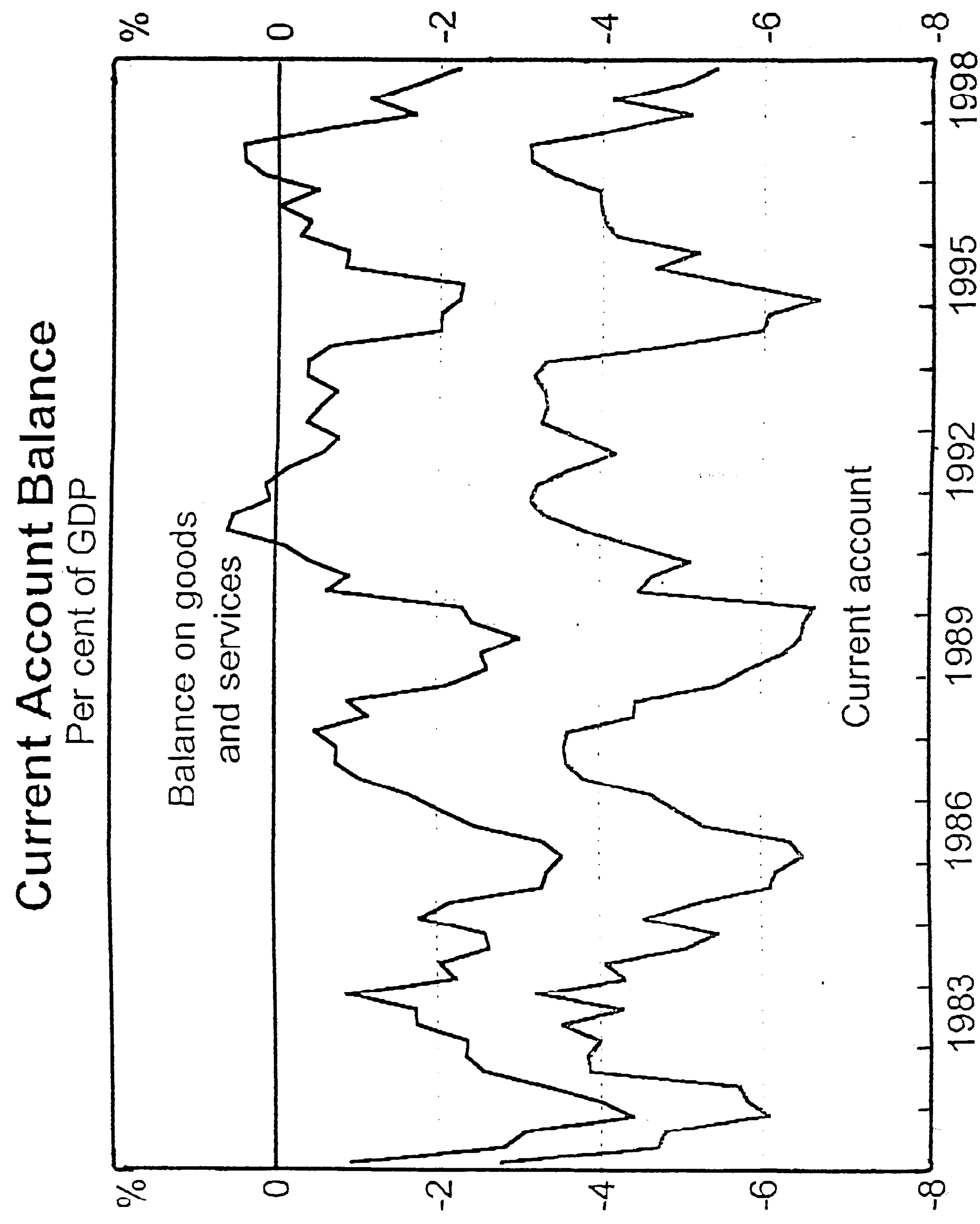
Italy	119.4
Belgium	117.3
Japan	99.9
Canada	90.0
Sweden	73.1
Spain	72.0
Netherlands	67.9
France	66.4
Germany	62.6
Denmark	59.3
Ireland	56.6
United States	57.4
United Kingdom	57.2
Finland	52.5
New Zealand	37.6
Norway	37.1
Australia	37.0

Graph 2



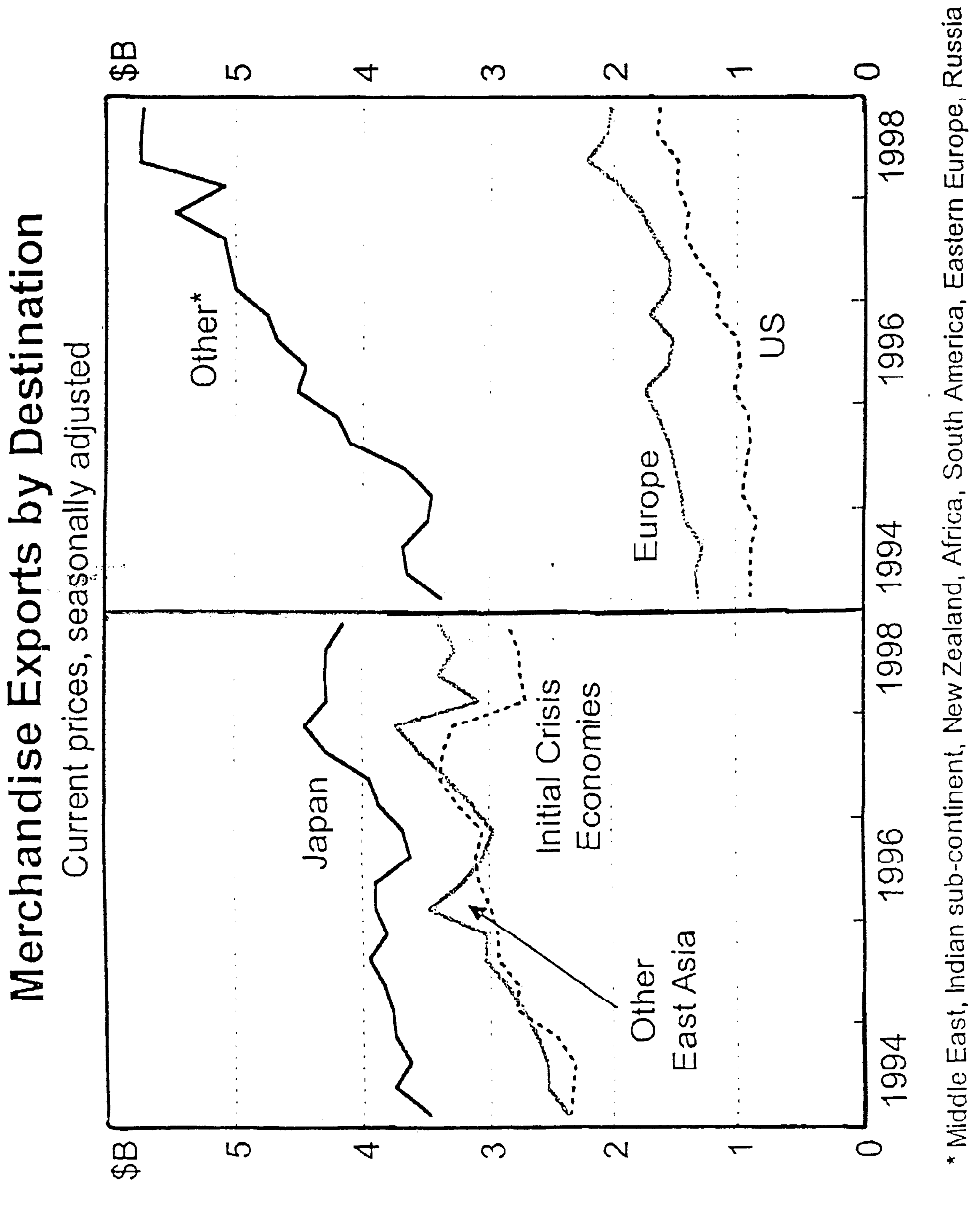
Banks' Impaired Assets
Share of total assets
%
6
5
4
3
2
1
0
1990
1992
1994
1996
1998

Graph 3

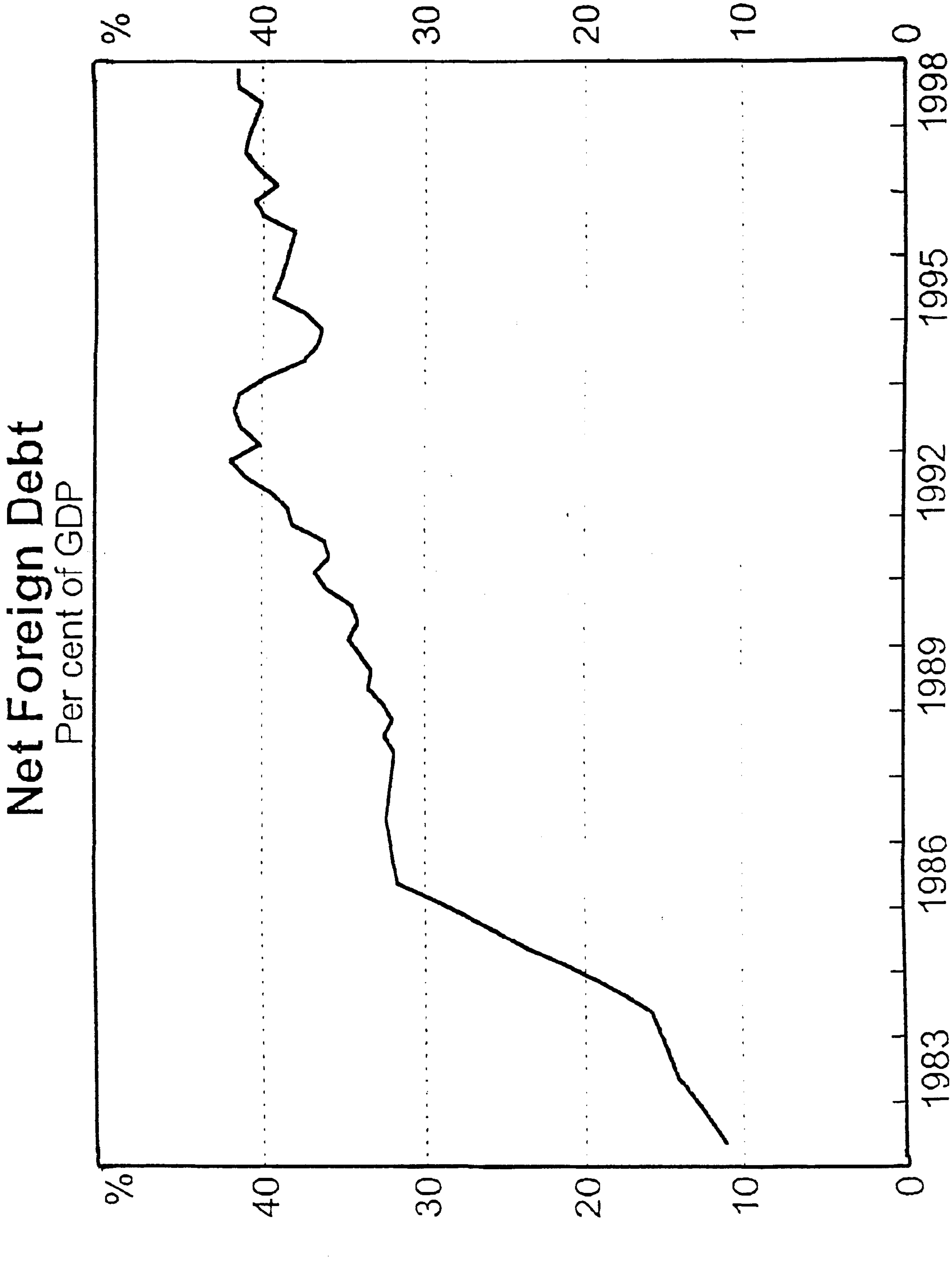


Current Account Balance
Per cent of GDP
Balance on goods
and services
Current account
%
0
-2
-4
-6
-8
1983
1986
1989
1992
1995
1998

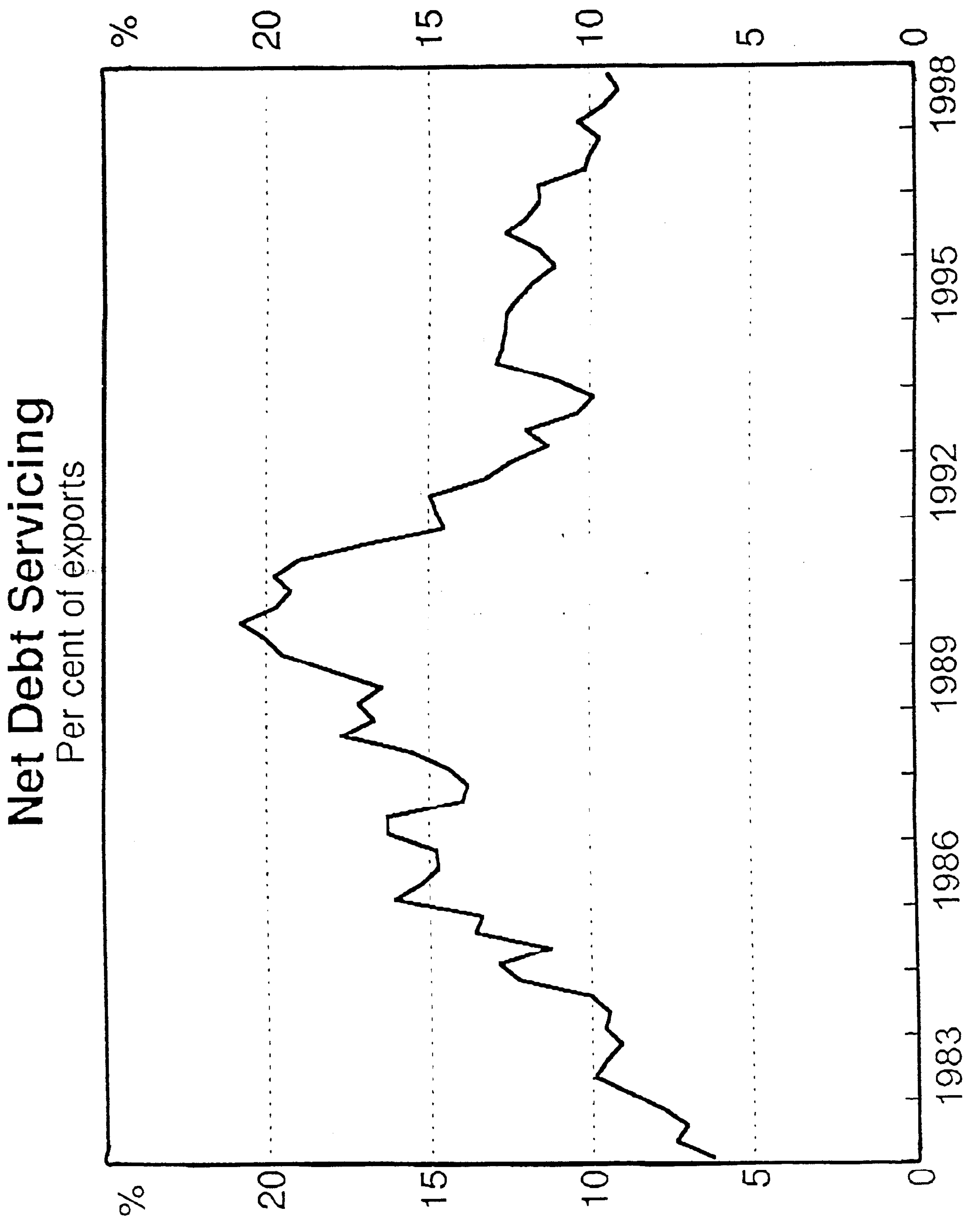
Graph 4


Merchandise Exports by Destination
Current prices, seasonally adjusted
$B
5
4
3
2
1
0
Japan
Other East Asia
Initial Crisis Economies
1994
1996
1998
Other*
Europe
US
* Middle East, Indian sub-continent, New Zealand, Africa, South America, Eastern Europe, Russia

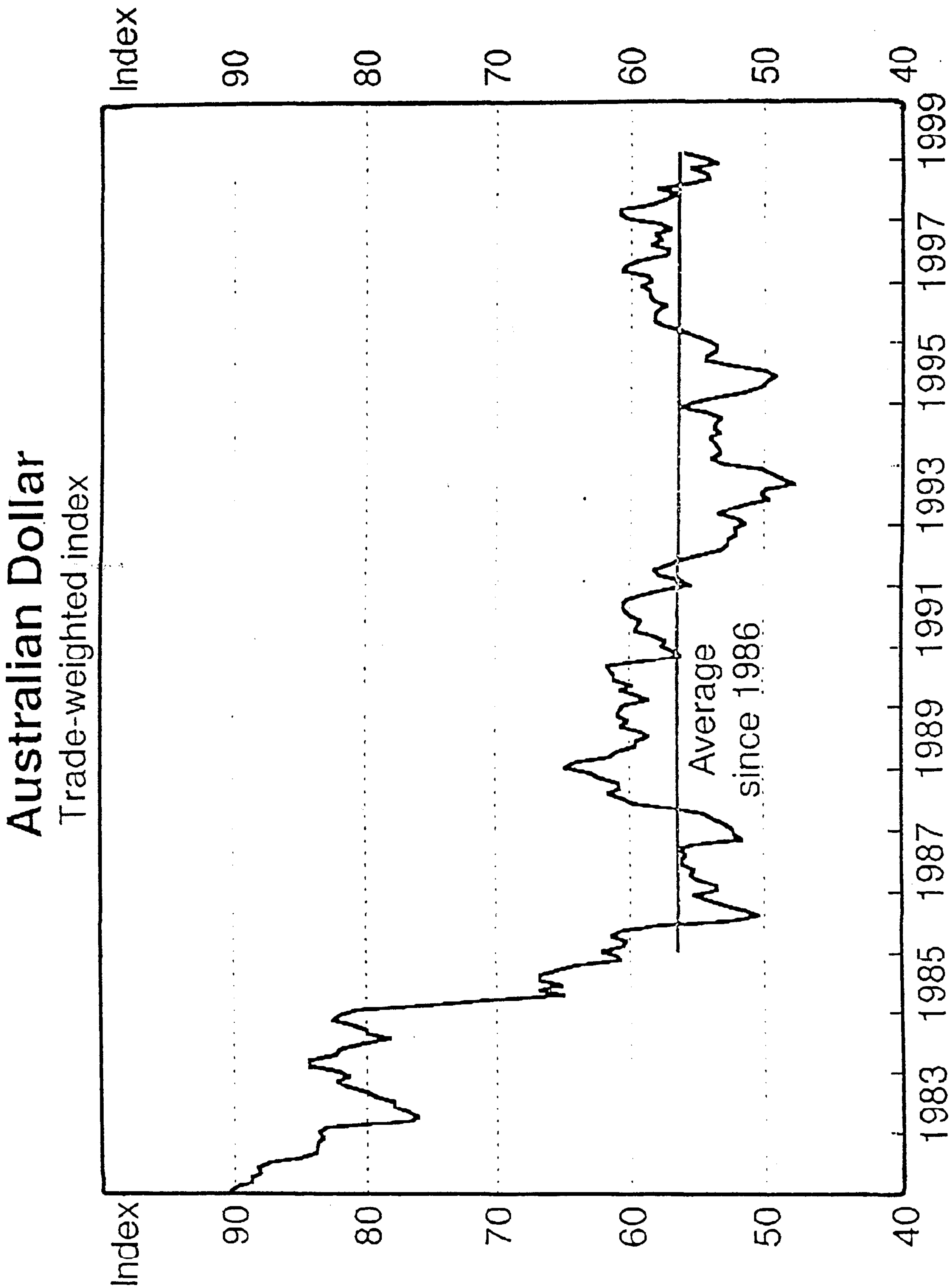
Graph 5


Net Foreign Debt
Per cent of GDP
%
40
30
20
10
0
1983
1986
1989
1992
1995
1998

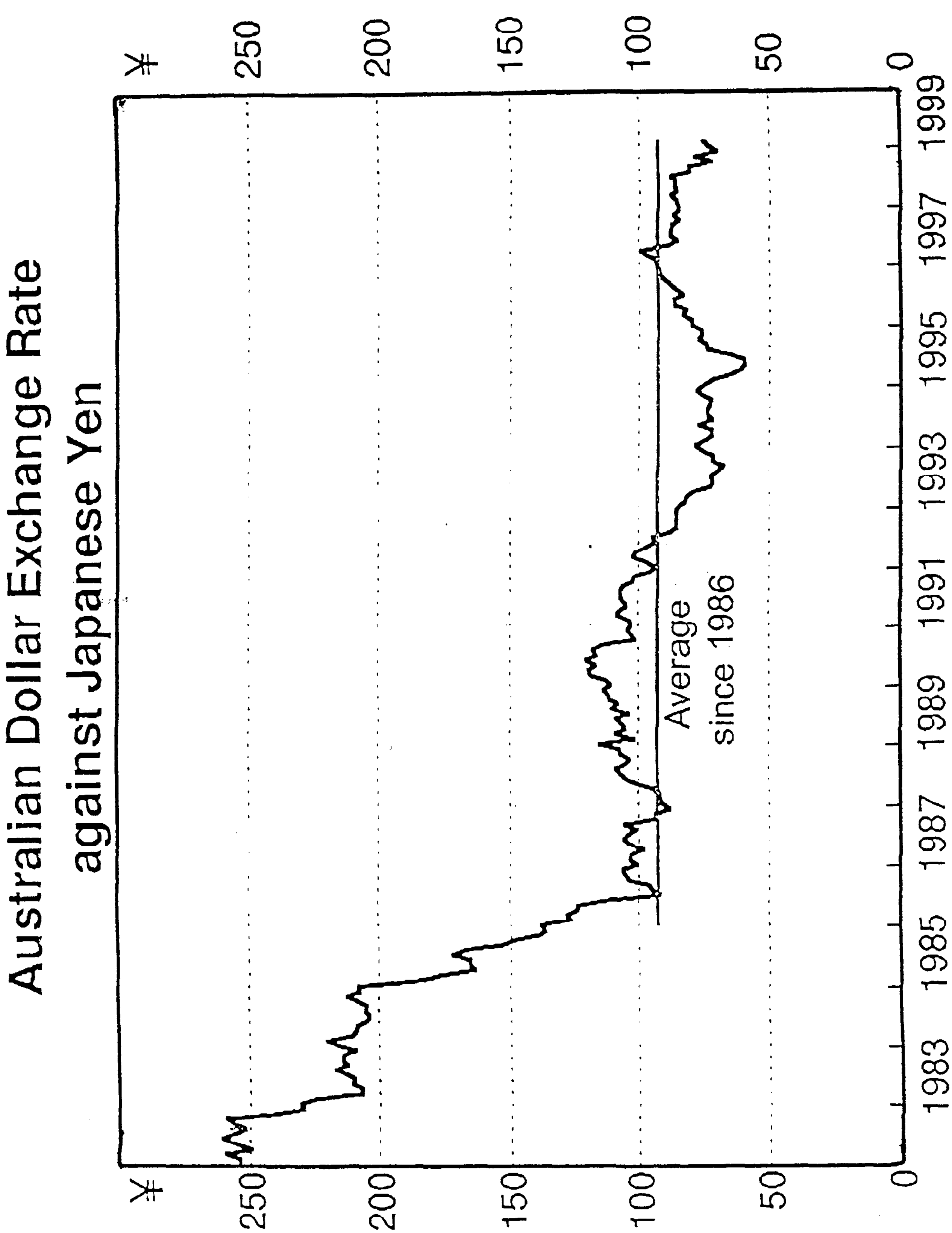
Graph 6


Net Debt Servicing
Per cent of exports
%
20
15
10
5
0
1983
1986
1989
1992
1995
1998

Graph 7

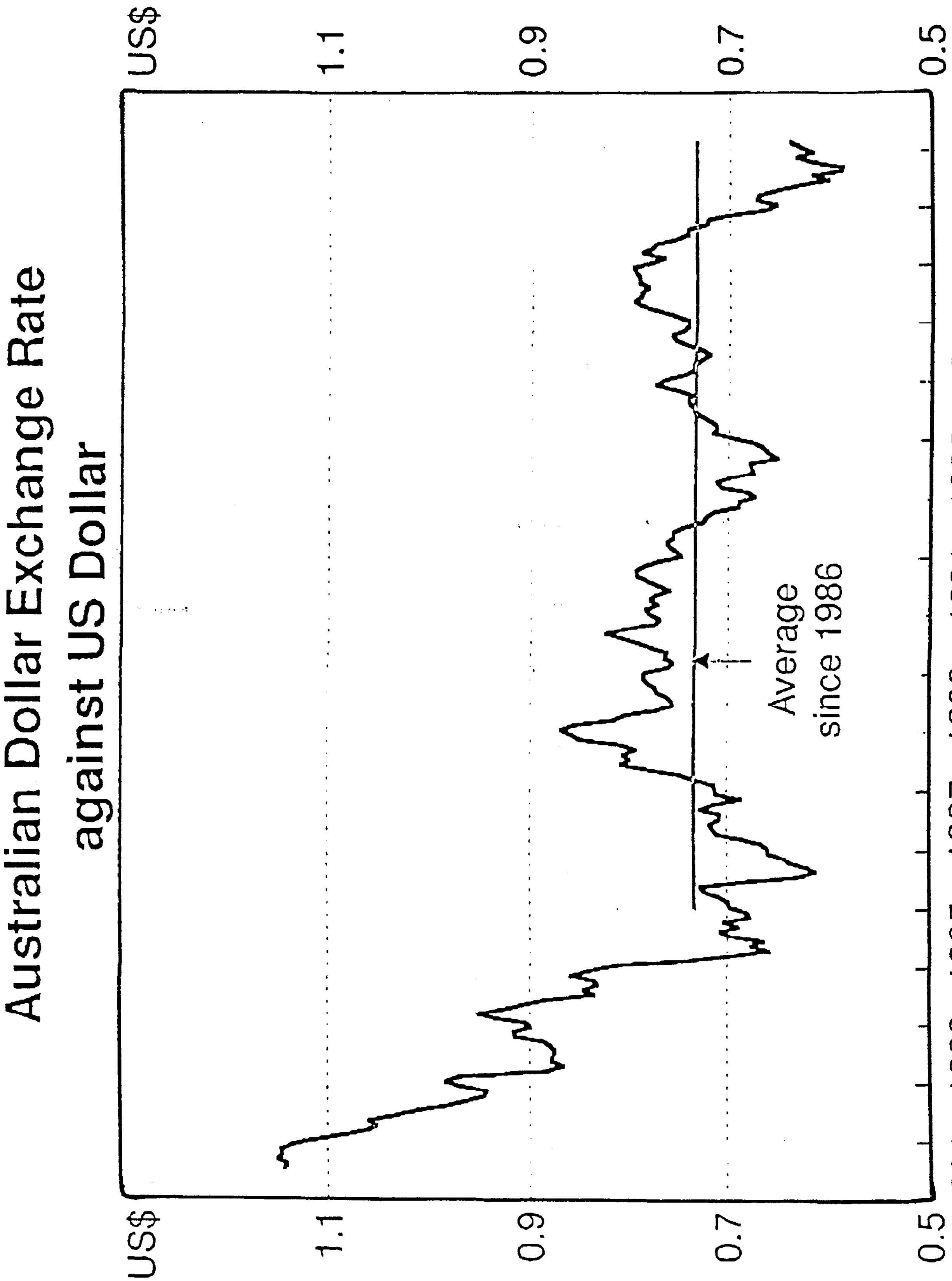

Australian Dollar
Trade-weighted index
Index
90
80
70
60
50
40
Average
since 1986
1983
1985
1987
1989
1991
1993
1995
1997
1999

Graph 8



Australian Dollar Exchange Rate
against Japanese Yen
¥
250
200
150
100
50
0
1983
1985
1987
1989
1991
1993
1995
1997
1999
Average
since 1986

Graph 9


Australian Dollar Exchange Rate
against US Dollar
US$
1.1
0.9
0.7
0.5
Average
since 1986
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999