IMF Country Reports 21/255

Australia: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Australia

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 21/255

AUSTRALIA

December 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR AUSTRALIA

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 2021 Article IV consultation with Australia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 22, 2021 consideration of the staff report that concluded the Article IV consultation with Australia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 22, 2021, following discussions that ended on September 23, 2021, 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 November 5, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Australia.

The document listed below has been separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with Australia

FOR IMMEDIATE RELEASE

Washington, DC – December 6, 2021: On November 22, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Australia.

Australia's economy has weathered the pandemic comparatively well. Underpinned by sound macroeconomic fundamentals, large-scale fiscal and monetary policy support helped lift the economy out of its first recession in three decades in the wake of the initial COVID-19 waves in 2020. Economic activity recovered to well above pre-pandemic levels by the second quarter of 2021, faster than in most other advanced economies, with adverse distributional consequences remaining contained. New outbreaks related to the Delta variant since June 2021 have posed new challenges, with a sizable loss in economic activity in the third quarter of 2021 and some regions, sectors, and workers disproportionately affected.

Australian banks have remained liquid and well-capitalized, and household and corporate balance sheets proved resilient. Surging house prices have raised concerns around affordability and financial vulnerabilities, and the authorities have tightened macroprudential policy.

Quickly rising vaccination rates offer a pathway to a new normal as the country gradually lifts restrictions and reopens its borders. Accommodative fiscal and monetary policies should soften the near-term economic impact and lay the foundation for post-lockdown recovery, with economic growth expected at 3.5 and 4.1 percent in 2021 and 2022, respectively. Temporary factors have pushed headline inflation to the top of the Reserve Bank of Australia's 2-3 percent target range. Underlying inflation has remained lower and should gradually rise toward the mid-point of the target range.

Uncertainty around the economic outlook remains high, linked to the pandemic's trajectory. Renewed domestic outbreaks that would slow economic activity and delay the reopening constitute important downside risks to growth, as does COVID-19's impact on Australia's trading partners. By contrast, effective containment of the pandemic during the reopening could restore sentiment more quickly, with a faster recovery in household consumption and business investment. Other risks pertain to prolonged global supply chain disruptions, tighter global financial conditions, geopolitical tensions, a house price correction, and climate-related events.

[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.

Executive Board Assessment[2]

Executive Directors agreed that Australia's sound pre-crisis macroeconomic fundamentals and effective policy response helped cushion the pandemic's impact and have supported the recovery. Directors encouraged accommodative and agile macroeconomic policies in the near term given the downside risks and uncertainty, complemented with structural reforms to boost productivity to lay the foundation for a sustainable, inclusive, and green recovery.

Directors commended the strong fiscal support provided in the context of the pandemic and noted that Australia continues to have substantial fiscal space. They supported further stimulus should downside risks materialize and stressed the need to ensure adequate support to vulnerable workers and businesses, including through active labor market policies. They generally encouraged tax reforms to gain efficiency, with a few Directors highlighting the case for rebalancing the tax system away from direct taxes towards indirect taxes.

Directors agreed that accommodative monetary policy has been instrumental in supporting the economic recovery. They underscored that monetary policy should remain data-dependent and well communicated, with policy normalization calibrated to the strength of the recovery and expected inflation. If inflationary pressures become more persistent, an earlier tightening may be warranted, while, conversely, additional support can be deployed in case downside risks materialize.

Directors welcomed the authorities' commitment to continued reforms for enhancing financial sector resilience, including recently announced reforms to the bank capital framework and the financial market infrastructure. They encouraged further efforts in addressing rising financial risks from climate change and cyber-attacks, and underscored the importance of further strengthening the AML/CFT regime.

Directors underscored that surging house prices and elevated household debt raise concerns around increasing financial vulnerabilities and welcomed the recent macroprudential measure to mitigate emerging risks. They emphasized the need to closely monitor lending standards and tighten macroprudential policy further if risks continue to build. Directors also noted heightened concerns of housing affordability and encouraged the authorities to implement supply-side reforms to help alleviate the issue.

Directors welcomed the recently adopted target to reduce greenhouse gas emissions to net zero by 2050 and Australia's commitment to increase investment in developing and deploying low-emissions technologies. They encouraged fast progress toward the net zero goal within a comprehensive policy framework. In that context, a number of Directors saw merit in a broad-based carbon price as an efficient policy option, while a few others considered technology-based approaches more feasible within the range of possible measures.

Directors encouraged reforms to reinvigorate productivity growth and support a sustainable and inclusive recovery. Efforts should continue to focus on advancing the deregulation agenda, supporting digitalization, enhancing innovation and competition. They expressed appreciation for the authorities' continued support for an open trade environment.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1. Australia: Main Economic Indicators, 2016-2026

(Annual percent change; unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Projections					
NATIONAL ACCOUNTS											
Real GDP	2.7	2.4	2.8	1.9	-2.4	3.5	4.1	2.6	2.6	2.6	2.6
Domestic demand	1.8	3.0	2.7	1.2	-2.6	4.5	4.7	2.9	2.7	2.7	2.7
Private consumption	2.7	2.4	2.5	1.2	-5.8	3.3	6.3	4.5	3.9	3.5	3.3
Public consumption	5.1	3.9	4.2	5.8	7.1	2.7	-0.8	-1.5	-0.2	0.3	0.4
Investment	-2.4	3.6	2.2	-2.5	-3.0	9.4	6.6	2.9	2.5	3.1	3.0
Public	13.9	10.8	3.1	3.1	1.2	10.3	5.8	-0.7	-1.2	0.1	0.5
Private business	-11.9	4.0	2.2	-1.1	-5.3	4.8	7.4	4.8	4.5	4.7	4.3
Dwelling	8.0	-2.1	4.3	-7.1	-5.3	11.2	5.4	2.8	2.2	2.9	2.8
Net exports (contribution to growth, percentage points)	1.5	-0.8	0.3	1.0	0.4	-1.5	-0.5	-0.3	-0.1	-0.1	-0.1
Gross domestic income	2.7	4.9	3.3	3.3	-2.5	7.7	2.9	2.6	2.5	2.5	2.5
Investment (percent of GDP) 1/	24.6	24.3	24.1	22.5	22.3	23.2	24.0	24.0	23.9	24.0	24.0
Public	4.8	5.1	5.1	5.2	5.3	5.5	5.7	5.5	5.3	5.1	5.0
Private	19.7	19.1	18.9	17.5	17.1	17.6	18.3	18.5	18.6	18.8	19.0
Savings (gross, percent of GDP)	20.8	22.0	21.9	23.3	24.6	26.8	25.4	24.5	23.8	23.6	23.5
Households	9.9	9.2	8.6	8.9	15.9	13.6	11.8	10.3	9.7	9.4	8.9
Non-financial corporations	9.6	10.2	9.9	11.2	17.0	13.9	14.5	14.5	14.3	14.4	14.6
S-I balance (percent of GDP)											
Households	0.6	0.2	-0.1	1.3	8.3	5.4	3.3	1.8	1.2	0.8	0.4
Non-financial corporations	-1.6	-0.6	-0.9	0.9	7.2	3.5	3.6	3.6	3.4	3.5	3.7
Potential output	2.4	2.3	2.4	2.3	1.3	1.4	1.8	2.6	2.6	2.6	2.6
Output gap (percent of potential)	-0.9	-0.8	-0.4	-0.7	-4.3	-2.3	0.0	0.0	0.0	0.0	0.0
LABOR MARKET											
Employment	1.8	2.3	2.7	2.3	-1.5	2.9	1.5	1.4	1.4	1.8	1.7
Unemployment (percent of labor force)	5.7	5.6	5.3	5.2	6.5	5.2	4.8	4.7	4.7	4.7	4.7
Wages (nominal percent change)	1.9	1.8	2.1	2.3	1.6	2.0	2.5	2.7	3.0	3.1	3.1
PRICES											
Terms of trade index (goods, avg)	80	92	95	104	103	123	115	114	114	113	113
% change	-0.5	14.5	3.1	9.1	-0.3	18.7	-6.3	-0.4	-0.5	-0.5	-0.3
Iron ore prices (index)	85	103	101	135	156	247	195	195	195	195	195
Coal prices (index)	66	89	107	78	59	129	125	107	105	105	104
LNG prices (index)	85	83	112	62	50	156	145	105	105	105	105
Crude prices (Brent; index)	69	85	112	101	66	105	104	99	96	93	92
Consumer prices (avg)	1.3	2.0	1.9	1.6	0.9	2.6	2.3	2.2	2.4	2.4	2.4
Core consumer prices (avg)	1.7	1.6	1.6	1.6	1.2	2.7	2.1	2.2	2.4	2.4	2.4
GDP deflator (avg)	1.0	3.6	2.2	3.4	0.7	5.0	1.1	2.0	2.1	2.2	2.2
FINANCIAL											
Reserve Bank of Australia cash rate (percent, avg)	1.7	1.5	1.5	1.2	0.3	0.1	0.1	0.5	1.0	1.7	2.5
10-year treasury bond yield (percent, avg)	2.3	2.6	2.6	1.4	0.9	1.5	1.9	2.5	2.8	3.0	3.0
Mortgage lending rate (percent, avg)	5.4	5.2	5.3	4.8	4.5	4.5	4.7	5.0	5.6	6.1	6.3
MACRO-FINANCIAL											
Credit to the private sector	5.6	5.2	4.7	2.5	2.1	7.0	5.0	3.9	3.1	3.1	3.0
House price index (eop)	141	148	140	144	149	178	189	197	202	205	208
% change	7.7	5.0	-5.1	2.5	3.6	19.8	6.2	4.1	2.5	1.6	1.5
House price-to-income, capital cities (ratio)	4.7	4.7	4.4	4.3	4.2	4.9	4.9	4.9	4.8	4.6	4.5
Interest payments (percent of disposable income)	8.7	8.8	8.9	7.0	5.8	5.6	6.0	6.5	7.4	8.1	8.1
Household savings (percent of disposable income)	5.1	4.3	3.6	4.4	13.8	11.8	9.0	6.7	5.8	5.2	4.6
Household debt (percent of disposable income) 2/	179	184	186	186	180	187	188	186	181	176	171
Business credit (percent of GDP)	51.5	50.1	50.3	48.9	50.2	48.1	47.8	47.8	47.7	47.9	48.0
GENERAL GOVERNMENT (percent of GDP) 3/											
Revenue	34.8	34.6	35.6	35.7	34.5	35.5	33.7	33.4	33.8	34.0	34.1
Expenditure	37.4	36.8	36.8	36.9	42.1	44.5	41.6	37.4	37.0	36.6	36.4
Net lending/borrowing	-2.6	-2.2	-1.3	-1.2	-7.6	-9.1	-8.0	-4.0	-3.2	-2.6	-2.3
Commonwealth only	-2.3	-1.7	-0.5	-0.1	-4.8	-6.6	-5.0	-3.0	-2.4	-2.1	-2.0
Operating balance	-1.4	-0.8	0.5	0.9	-5.4	-6.8	-5.5	-1.7	-1.1	-0.5	-0.2
Cyclically adjusted balance	-2.4	-2.0	-1.2	-1.1	-6.9	-8.3	-7.4	-4.1	-3.2	-2.7	-2.3
Gross debt	39.5	41.0	41.2	42.0	52.7	59.4	66.4	67.2	67.3	66.4	65.1
Net debt	23.5	22.9	23.6	24.4	32.1	34.9	42.2	44.5	45.0	44.6	43.5
Net worth	46.0	50.2	49.9	41.0	34.6	26.7	27.2	24.3	24.7	24.5	23.6
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.3	-2.6	-2.1	0.7	2.7	3.8	1.4	0.5	-0.1	-0.3	-0.5
Export volume	6.9	3.4	5.1	3.4	-10.1	-1.0	5.5	7.6	3.8	2.1	2.0
Import volume	0.1	7.9	4.0	-0.9	-13.4	6.8	8.3	9.6	4.6	2.7	2.5
Net international investment position (percent of GDP)	-57.7	-55.5	-54.2	-47.3	-49.9	-39.4	-36.1	-34.0	-32.5	-31.3	-30.4
Gross official reserves (bn A$)	74	85	76	84	56	...	...	...	...	...	
MEMORANDUM ITEMS											
Nominal GDP (bn A$)	1,702	1,807	1,900	2,002	1,969	2,141	2,253	2,357	2,469	2,589	2,716
Percent change	3.7	6.1	5.2	5.4	-1.7	8.7	5.2	4.6	4.8	4.9	4.9
Real GDP per capita (% change)	1.1	0.7	1.3	0.4	-3.3	3.4	3.8	1.7	1.3	1.3	1.4
Population (million)	24.4	24.8	25.2	25.6	25.7	25.7	25.8	26.1	26.4	26.8	27.1
Nominal effective exchange rate	90.9	93.6	90.0	86.3	86.0	...	...	...	...	...	...
Real effective exchange rate	90.9	93.7	89.9	86.0	85.4	...	...	...	...	...	...

Sources: Authorities' data; IMF World Economic Outlook database; and IMF staff estimates and projections.

1/ Includes changes in inventories.

2/ Reflects the national accounts measure of household debt, including to the financial sector, state and federal governments and foreign overseas banks and governments. It also includes other accounts payable to these sectors and a range of other smaller entities including pension funds.

3/ Fiscal year ending June.

INTERNATIONAL MONETARY FUND

AUSTRALIA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

November 5, 2021

KEY ISSUES

Context. Strong health and economic policies allowed for quick economic recovery from initial COVID-19-related lockdowns in 2020. Renewed outbreaks and lockdowns have created setbacks since mid-2021, with disproportionate impacts on some regions, sectors, and workers. Accommodative macroeconomic policies have been instrumental in cushioning the economic impact.

Outlook and risks. With gradual relaxation of restrictions enabled by rising vaccination rates, the economy is expected to resume its recovery, achieving growth rates of 3.5 and 4.1 percent in 2021 and 2022, respectively. With the anticipated recovery from the lockdowns, underlying inflation should rise gradually toward the mid-point of the 2-3 percent inflation target range. Given the unpredictable trajectory of the pandemic, risks are tilted to the downside in the near term, but broadly balanced beyond that.

Policy recommendations:

- **Macroeconomic policies** should remain appropriately accommodative and agile in the context of a quickly evolving economic environment. Fiscal policy should continue to support vulnerable households and affected businesses as needed and, in case downside risks materialize, consider additional stimulus to soften the pace of planned consolidation. Monetary policy should be data-dependent, calibrating the pace of normalization to the strength of the expected recovery and inflation.

- **Macroprudential policy** should continue to focus on financial risks from surging house prices and elevated household debt. Additional tightening should be considered if risks continue to build.

- **Structural policies** should center on improving productivity performance and the inclusiveness and sustainability of the recovery. Priorities include promoting innovation and competition, supporting housing affordability, reducing uncertainty in climate change mitigation policies, and pursuing tax reforms to shift from direct to indirect taxes.

Approved By
Jonathan D. Ostry (APD) and Stephan Danninger (SPR)

Virtual consultations took place from September 7-23, 2021. The mission team comprised: Harald Finger (head), Kenichiro Kashiwase, Yosuke Kido, Siddharth Kothari, Elena Loukoianova, and Longmei Zhang (all APD). Angelia Grant, Chris Becker, and Laura Johnson (all OED) joined the discussions. Ioana Hussiada and Nadine Dubost assisted in the preparation of this report.

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CONTEXT

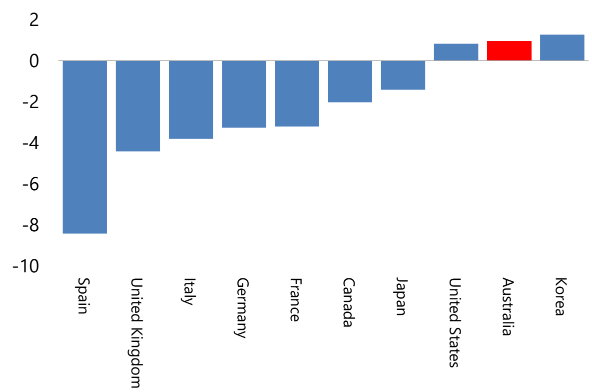
1. **Australia entered the pandemic with sound macroeconomic fundamentals but growth below potential.** Mining investment had stabilized following years of adjustment after the mining boom, and housing prices had just started rising following the 2017-19 decline. The economy was supported by sound macroeconomic management, including prudent fiscal policy, an inflation targeting framework, and exchange rate flexibility. However, growth remained below potential, and inflation undershot the Reserve Bank of Australia's (RBA) target range. Despite generally strong fundamentals with low government debt and a well-capitalized banking sector, some structural vulnerabilities remained. These included slowing labor productivity growth, high household debt, and elevated banking sector loan concentration in residential mortgages.

FAST RECOVERY, INTERRUPTED BY NEW OUTBREAKS

A. Recent Developments

2. **Australia successfully managed its initial exposure to COVID-19 with strong health and economic policies.** A swift public health response, focused on suppressing infections through testing, contact tracing, social distancing, and tight border restrictions, allowed for fast containment of the two initial COVID-19 waves in 2020 (Box 1). Together with large-scale fiscal and monetary policy support, this enabled fast economic recovery from an initial sharp decline in activity in 2020H1. By 2021Q2, output had recovered to well above pre-COVID levels, faster than in most other advanced economies. Adverse distributional impacts of the initial waves were contained, with employment ratios among women, youth, and lower-educated groups initially affected disproportionately but then recovering quickly.

Activity Had Recovered More Quickly Than In Most Major Advanced Economies
(Real GDP, percent change, Q2 2021 vs Q4 2019)



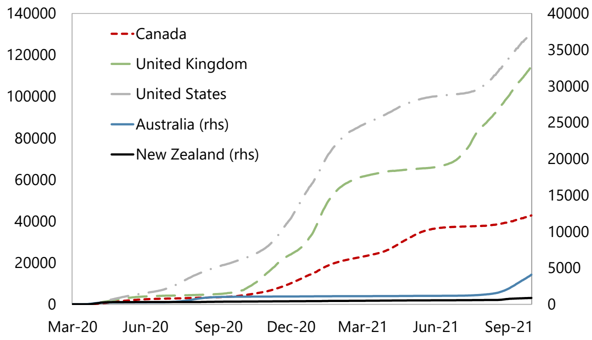
Sources: WEO and IMF staff estimates.

3. **The 2021 outbreaks have posed fresh challenges and set back economic activity in the near term.** Renewed outbreaks since June 2021, driven by the highly contagious Delta variant, have proven much harder to contain. Necessary regional lockdown measures, affecting more than half of the population, have adversely affected economic activity, with disproportionate impacts on services and construction. While the headline unemployment rate has remained low, alternative measures, which account for a decline in the labor force participation rate and an increase in zero-hours workers, have deteriorated, with long-term unemployment remaining high. Casual jobs, female, youth, and lower-educated workers have been disproportionately affected.

Figure 1. COVID-19 Outbreaks and Their Labor Market Impact

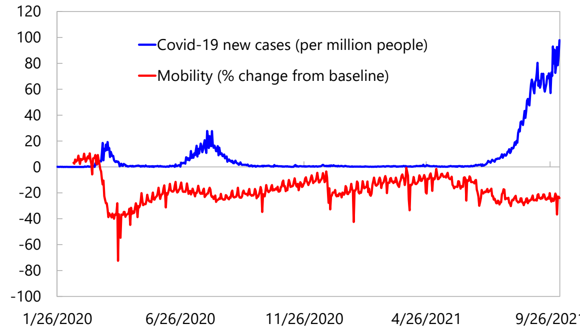
Initial Success in Suppressing COVID-19

(COVID-19 infections per million residents)



Source: Our World in Data.

Renewed Outbreaks Prove Harder to Contain 1/

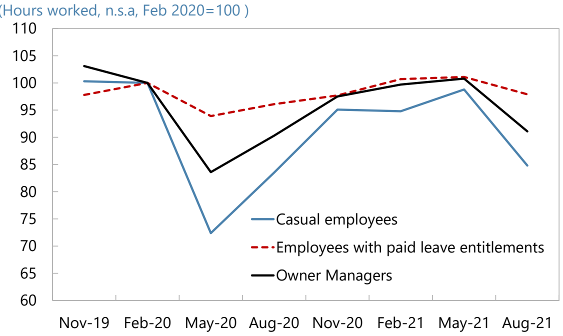


Sources: Our World in Data, Google Mobility Data.

1/ Mobility is simple average of retail and recreation, supermarket and phamacy, public transport, and workplaces.

Hours Worked Declined, With a Larger Impact on Casual Jobs

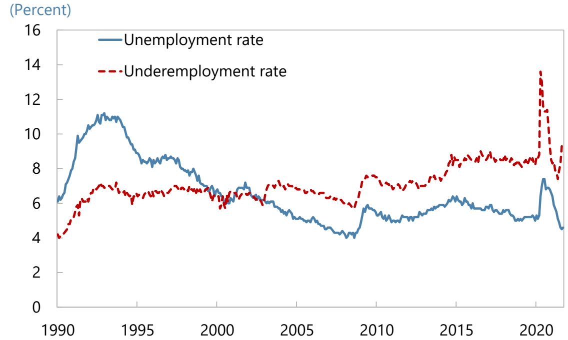
(Hours worked, n.s.a, Feb 2020=100)



Source: ABS.

Unemployment Rate Remains Low Despite Recent Lockdowns

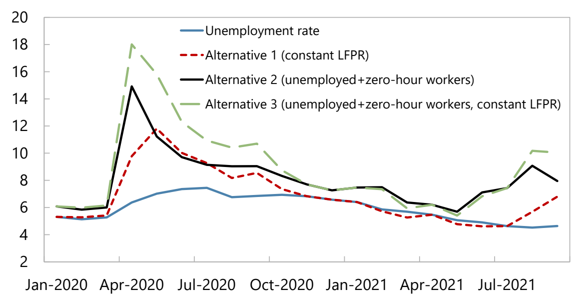
(Percent)



Source: ABS.

Alternative Measures of Unemployment Deteriorated 1/

(Percent)

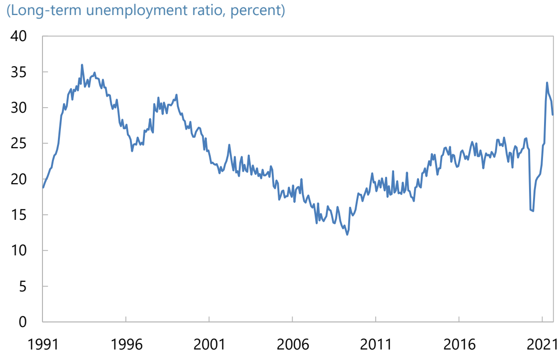


Sources: ABS and IMF staff estimates.

1/ For Alternatives 1 and 3, a constant labor force participation rate at 66 percent is used. Alternatives 2 and 3 count zero-hour workers (no work available, or reasons other than leave, health issues, weather and work arrangement) as unemployed.

Long-Term Unemployment Remains High

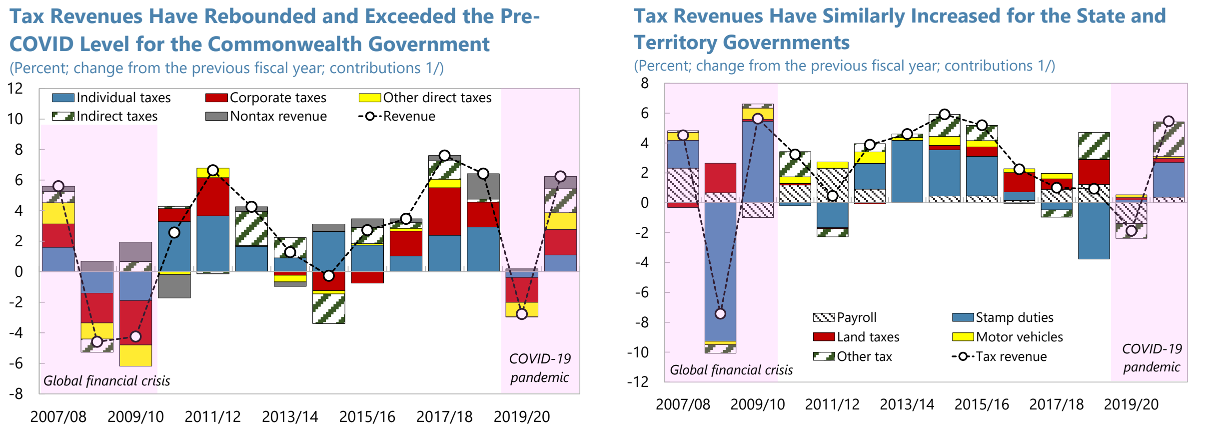
(Long-term unemployment ratio, percent)



Source: Haver Analytics.

4. Large-scale fiscal support has been instrumental in mitigating declines in activity and enabling recovery. Fiscal stimulus implemented since the onset of COVID-19 has been sizable (about 20 percent of GDP through FY2024/25), supporting individuals and businesses (Box 2).[1]

- The initial response in 2020 centered around the JobKeeper wage subsidy program (4½ percent of GDP), together with other significant support for businesses and vulnerable households (for example, income support for welfare recipients and subsidized childcare). Stimulus measures were calibrated to the pace of the recovery, and nearly 60 percent of the stimulus expired by end-FY2020/21. With the fast economic recovery through 2021Q2, tax revenues recovered to well-above pre-COVID levels, and the fiscal deficit peaked at around 9 percent of GDP. Employers' mandatory pension contribution rate rose from 9.5 to 10 percent in July 2021.[2]



Sources: ABS; Haver Analytics; and IMF staff calculations.
1/ Based on CPI-adjusted series. Fiscal year runs from July to June.

- Following the June 2021 outbreaks, Commonwealth and state/territory governments have implemented new support measures, including the COVID-19 Disaster Payment program that compensates for lost work hours for individuals, broadly in line with the previous JobKeeper payments but paid directly to individuals to improve targeting. New support for affected businesses has also been established, partly contingent on maintaining employment relationships. As announced earlier, these measures are phasing out since the full vaccination rate of the eligible population has reached 70-80 percent in affected regions.

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[1] Australia's fiscal year runs from July to June.

[2] The minimum contribution rate ("superannuation guarantee") is scheduled to further increase in annual increments to 12 percent by FY2025/26 to provide adequate income security during retirement.

Three Pillars of Support During the Renewed Lockdowns in 2021H2 1/

Pillar 1. The COVID-19 Disaster Payment Program: Support to Individual Workers

Aim:	Trigger:	Payments:
The program pays a lump sum payment to workers who lost hours of work due to a COVID-19 state public health order (trigger).	• COVID-19 hotspot • *Declared by the Commonwealth Government when a region has a lot of people with COVID-19 or poses a risk of COVID-19 infections.* • Lockdown • Movement restrictions	Hours of work lost: (A) 8-20 hours • A$450 per week (B) More than 20 hours • A$750 per week (C) Welfare recipients who lost more than 8 hours • A$200 per week (top up)

Cost Sharing:

Commonwealth declared hotspots	Outside hotspots:
The Commonwealth Government covers the full payments.	The state or territory government of the jurisdiction covers the payments.

Pillar 2. State-Administered Business Support Programs

Eligibility: Varies across the programs and is generally anchored on declines in turnover. The JobSaver Payment program in New South Wales (NSW) requires maintaining staffing levels as of July 13, 2021 (when the program was introduced), or from the day before the fortnight that the business first experienced the required delcine in turnover. Other business support programs in NSW and other jurisdictions are not linked to maintaining employment relationships.

Payments: Vary by the jurisdiction, the type of business, and the size of payroll.

Cost sharing: The Commonwealth Government provides joint funding for the cost of the programs agreed with the respective state or territory governments.

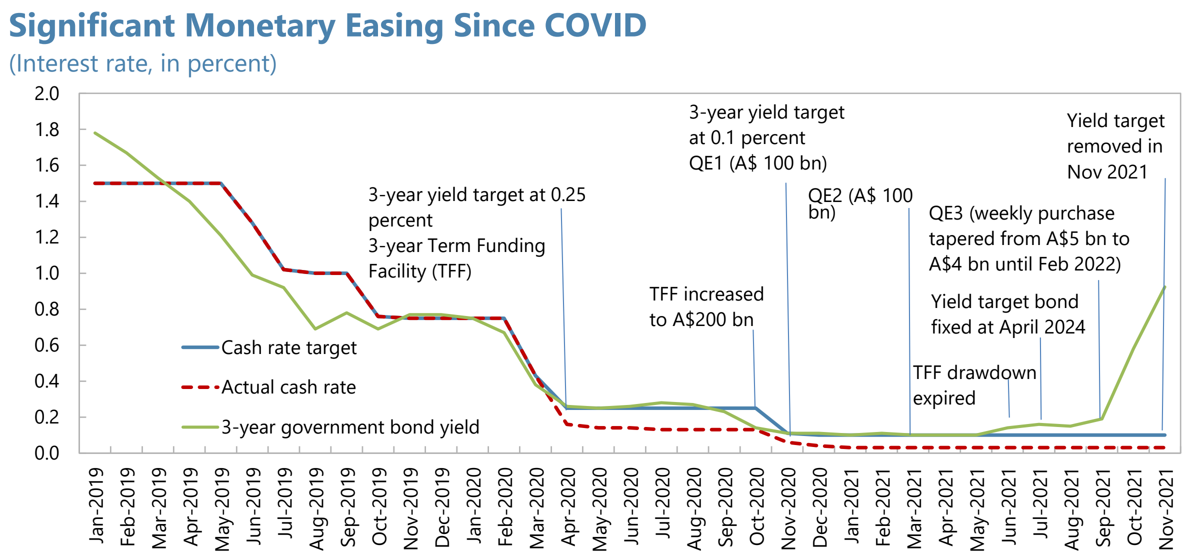
Pillar 3. The Pandemic Leave Disaster Payment Program

Eligibility: Individuals who cannot earn income because they must self-isolate, quarantine, or care of someone with COVID-19.

Payments: A$1,500 for each 14-day period.

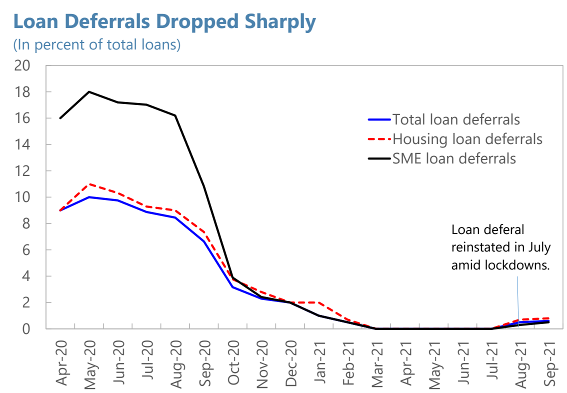
1/ At end-September 2021, the Commonwealth Government announced to phase out the support programs as the full vaccination rate reaches 70-80 percent targets in affected regions. The Pandemic Leave Disaster Payment program will continue until end-June 2022.

5. **Accommodative monetary policy, including unconventional measures, has enabled a recovery of private demand** (Box 3). The RBA successively cut the cash rate target from 0.75 to 0.1 percent in March-November 2020, introduced a 3-year yield target, and offered banks up to A$213 billion (9.7 percent of GDP) in three-year funding under the Term Funding Facility (TFF). In November 2020, a large-scale asset purchase program was put in place until September 2021, subsequently extended to February 2022, with weekly purchases tapered from A$5 billion to A$4 billion (assets worth A$230 billion, or 11.7 percent of GDP, have been purchased to date). Together, these measures compressed bond yields and led to significant reductions in firms' and households' borrowing costs (Figure 5). The TFF drawdown period expired in June 2021. The yield target bond was fixed from July 2021 onward, letting the targeted maturity decline over time, and the yield target was abandoned in November 2021, reflecting the economic recovery and progress towards the inflation target.



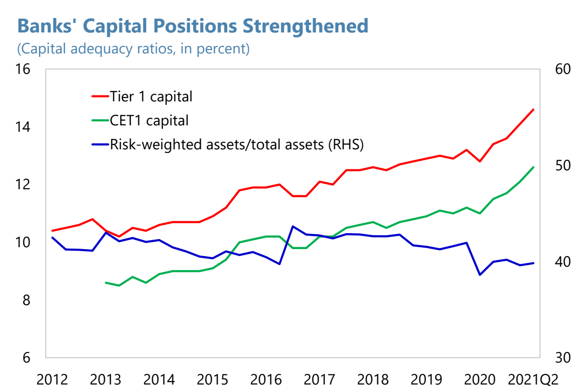
Sources: RBA and IMF staff estimates.

6. **Regulatory concessions facilitated credit flows in the economy.** The Australian Prudential Regulation Authority (APRA) introduced regulatory support for temporary loan deferrals, maintained the counter-cyclical capital buffer (CCyB) at zero, and imposed temporary bank dividend payment restrictions. Implementation of Basel III reforms was postponed to January 2023. Most loans resumed payments by the deferral program's end in March 2021. In response to recent lockdowns, APRA reinstated the program during July-September 2021 with loan deferrals for up to three months, but the take-up was limited, partly reflecting strong household and firm balance sheets.



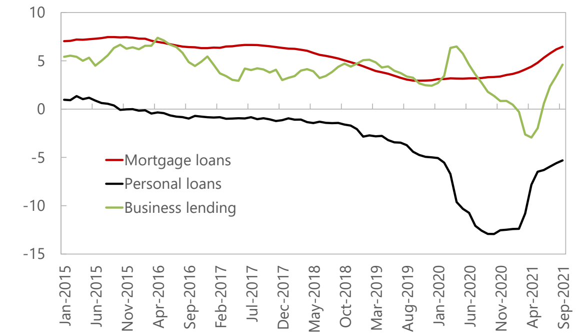
Source: APRA.

7. **Banks have remained liquid and well-capitalized, although concentration risks have increased.** The tier-1 capital ratio increased from 13.2 percent pre-COVID to 14.6 percent in June 2021. The non-performing loan ratio has been edging up since regulatory concessions ended but remains low at 1.1 percent. Profitability fell early in the pandemic but recovered recently. Liquidity is ample, and near-term funding risks have receded as the RBA's TFF greatly reduced banks' offshore wholesale borrowing needs. However, concentration risks have increased during the housing boom, with mortgages accounting for 63 percent of bank loan portfolios.



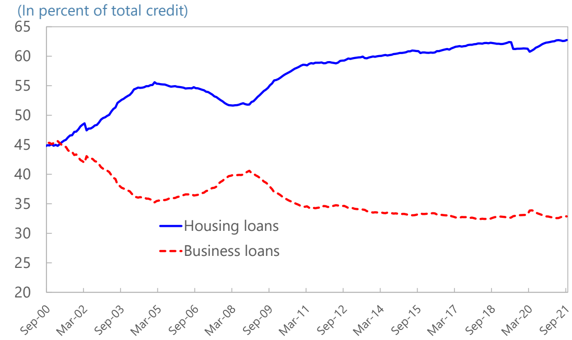
Source: APRA.

Strong Housing Credit and Recovering Business Lending
(In percent, yoy change)



Sources: RBA and IMF staff estimates.

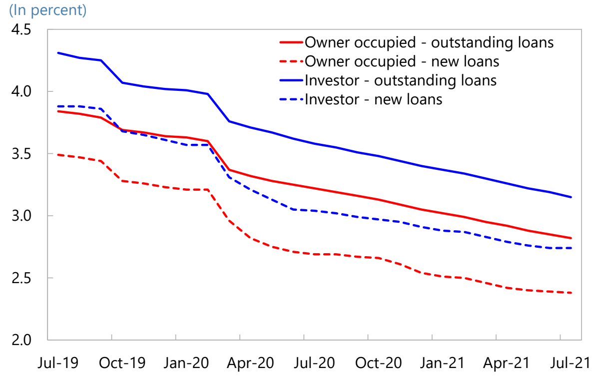
Bank Lending Is Increasingly Concentrated in Housing Loans
(In percent of total credit)



Sources: RBA and IMF staff estimates.

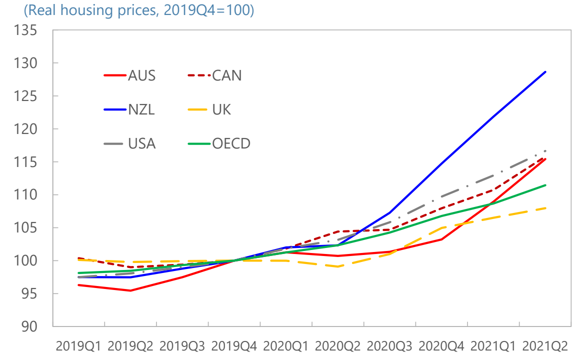
8. **The housing market is booming, reflecting low interest rates and strong fiscal support.** Following initial weakness driven by the 2020 lockdowns, housing prices have rebounded strongly (21.6 percent y/y in October 2021), reflecting low mortgage rates, the fast economic recovery, HomeBuilder grants to eligible owner-occupiers (with caps on income and house prices), government income transfers, and temporary stamp duty exemptions in a few states. The pandemic has strengthened housing demand outside of major cities and for single-family houses (Box 4).

Mortgage Rates Are at Historical Lows
(In percent)



Source: Australia Bureau of Statistics.

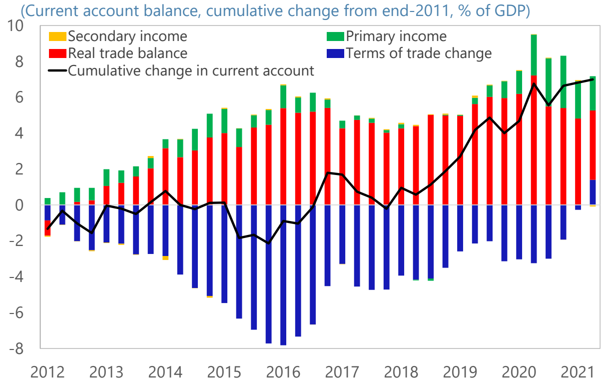
Housing Prices Surged Amid Monetary Easing
(Real housing prices, 2019Q4=100)



Source: OECD.

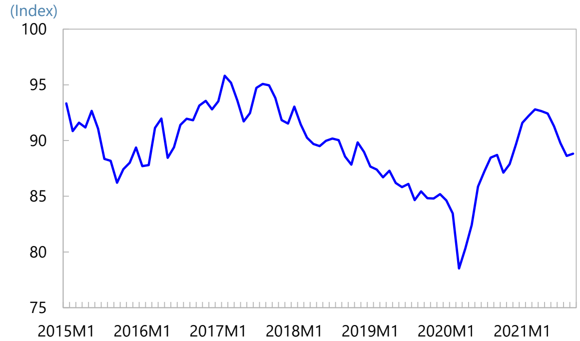
9. **The external position in 2020 was broadly in line with fundamentals and desirable policies** (Annex I). The current account (CA) balance surged to 2.7 percent of GDP in 2020 on pandemic-related temporary factors (lower income payments on external liabilities and an improved travel balance). The exchange rate first depreciated and then recovered in 2020H1, reflecting global risk aversion, and continued to appreciate in the second half of the year, supported by the strong domestic recovery. A sharp rise in commodity prices led to a further increase in the CA surplus to 3.7 percent of GDP in 2021H1 and supported the exchange rate. However, the renewed lockdowns, a decline in Australian yields relative to other advanced economies, and lower iron ore prices have put downward pressure on the Australian dollar in recent months. The new SDR allocation (SDR 6.3 billion, about 0.5 percent of GDP) will likely be held as international reserves or channeled to vulnerable countries.

The Current Account Surplus Has Hit Record Highs
(Current account balance, cumulative change from end-2011, % of GDP)



Sources: Haver Analytics and IMF staff calculations.

REER Has Recovered, Supported by Strong Commodity Prices
(Index)



Source: IMF IFS Database.

B. Outlook and Risks

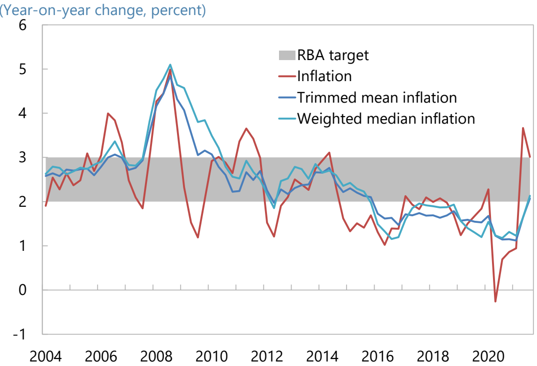
10. Despite near-term headwinds, the economy is expected to resume its recovery. Following a slow start, the national vaccination campaign accelerated significantly in 2021Q3, and the authorities' strategy has shifted toward opening up and living with COVID-19 once a sufficient share of the population has been vaccinated.[3] This offers a path out of lockdowns starting in the current quarter, enabling an ensuing economic upturn, although high uncertainty remains given the possibility of rapid changes to the economic outlook. As restrictions are eased, household consumption is expected to strengthen, with savings declining (Annex II). Large-scale tax incentives (temporary full expensing with loss carry-back) are envisaged to stimulate business investment. Border reopening will support tourism and education exports, though some Australian private demand will be diverted to tourism imports. Overall, GDP is projected to grow by 3.5 percent in 2021 and 4.1 percent in 2022. Relatively quick recovery is anticipated also in the labor market, reflecting continued, high underlying labor demand as evidenced in the high volume of job advertisements.

11. Underlying inflation is expected to increase gradually, remaining within the 2-3 percent inflation target range. Base effects from temporary free childcare in 2020, a rebound in fuel prices, and supply disruptions have pushed headline inflation to the top of the target range. While uncertainty remains, the spike in headline inflation is expected to be temporary, and measures of underlying inflation have remained significantly lower. With some increase in inflation expectations recently and the anticipated recovery from the lockdowns, underlying inflation is projected to rise gradually toward the mid-point of the RBA target range.

[3] The authorities formulated a National Plan to Transition Australia's National COVID-19 Response, aiming to ease restrictions mainly on vaccinated people once the full vaccination rate for the eligible population reaches 70 percent and relaxing restrictions further after the rate reaches 80 percent. In line with this strategy, the New South Wales and Victoria governments began relaxing restrictions on October 11 and 21, respectively. On November 1, international border restrictions for fully vaccinated Australian citizens and permanent residents were relaxed.

Inflation Has Been Pushed to the Top of the Target Range Due to Temporary Factors

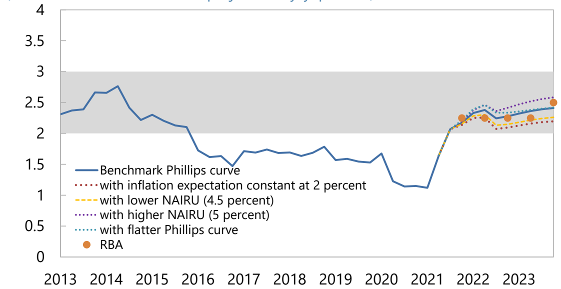
(Year-on-year change, percent)



Sources: ABS, RBA.

Underlying Inflation Is Expected to Rise Gradually

(Trimmed mean inflation and projections, y/y, percent)



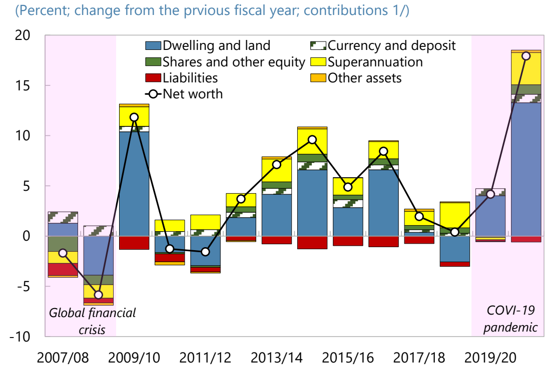
Sources: ABS, RBA, and IMF staff calculations

1/ Phillips curve is based on quarterly annualized trimmed mean inflation and includes lagged inflation, inflation expectation (2yr market expectation), and the unemployment rate gap. RBA projection is from August 2021 SMP. For 2021Q3 and Q4, the unemployment rate is adjusted for a decline in the labor force participation rate.

12. **Despite improvements in household and corporate balance sheets, business insolvencies may rise.** Household net wealth and corporate profits have increased, supported by fiscal stimulus and the strong recovery through 2021Q2. Firms' leverage ratios have declined as new equity issuance was facilitated by temporary capital-raising measures. The business insolvency rate has dropped sharply during the pandemic due to temporary support measures but is likely to increase, particularly for SMEs in hard-hit sectors, as these measures expire (Box 5).

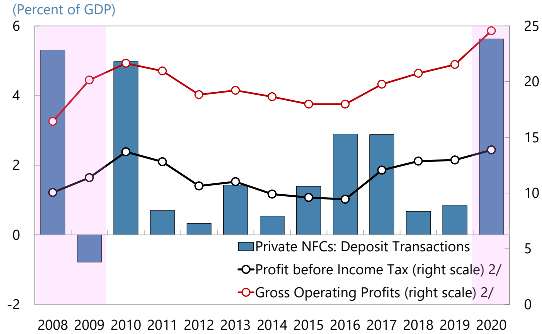
Household Net Wealth Has Gained During the Pandemic

(Percent; change from the prvious fiscal year; contributions 1/)



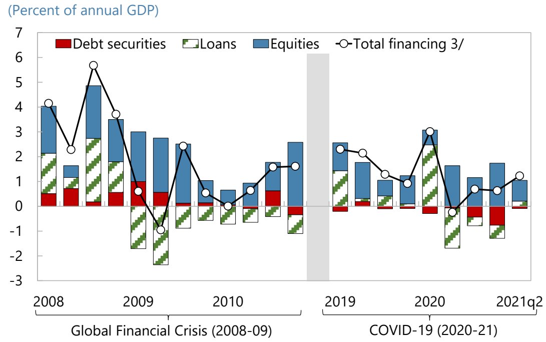
Corporate Profits Increased to a Record Level, with Ample Liquidity in Bank Deposits

(Percent of GDP)

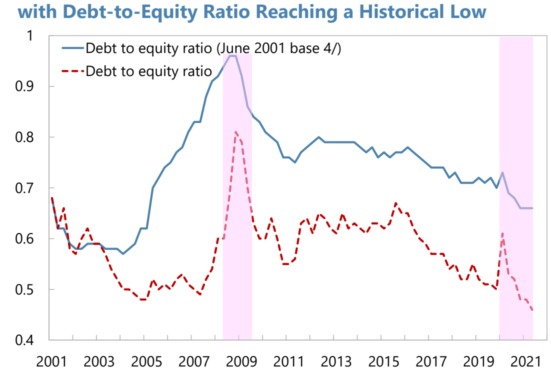


Private Nonfinancial Corporations Started Delevaraging, While Issuing Equities to Meet Liquidity Needs

(Percent of annual GDP)



Capital Raising Relief Measures Contributed to Deleveraging, with Debt-to-Equity Ratio Reaching a Historical Low



Sources: ABS; Haver Analytics; and IMF Staff calculations.

1/ Based on CPI-adjusted series. Fiscal year runs from July to June.

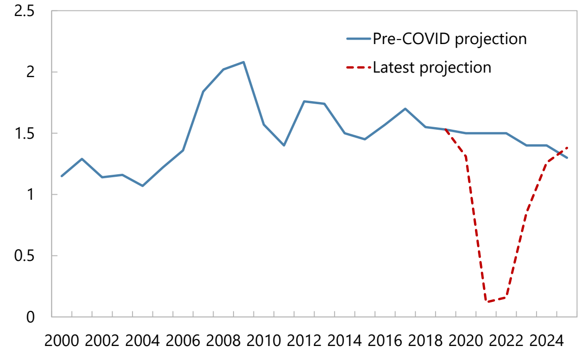
2/ Based on the Quarterly Business Indicators Survey. Total amounts are adjusted to exclude financial and insurance services.

3/ Derivatives and other accounts payable of the liability account for the residual.

4/ The underlying series are adjusted for price changes by the Australian Bureau of Statistics (ABS).

13. Reduced migration due to prolonged border restrictions is expected to create a lasting, adverse impact on production capacities. With collapsed immigration flows (which typically account for about 60 percent of population growth), the working age population is expected to remain well below pre-pandemic projections, reducing production capacities. Nevertheless, the loss in per capita output is expected to be limited, given the projected strength of the economic recovery and the pandemic's limited impact on corporate balance sheets.

Border Closure Is Affecting Population Growth
(Annual population growth rate, percent, year ending June)



Source: Center for Population, Australian Government.

14. Risks to the outlook are tilted to the downside in the near term, but broadly balanced beyond that (Annex III).

- Near-term downside risks center around the pandemic, with the Delta variant posing challenges in Australia and elsewhere. Other downside risks include prolonged global supply chain disruptions, a tightening of global financial conditions, geopolitical tensions, a housing market correction, climate-related risks, and risks from trade restrictions by China (Box 6).

- Upside risks include a faster recovery in household consumption and business investment, supported by strong household and business balance sheets, and a rise in commodity prices.

C. Authorities' Views

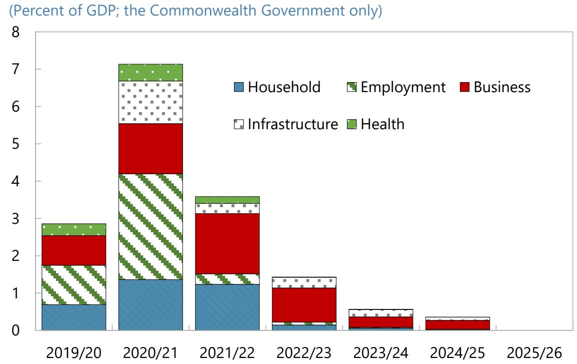
15. The authorities broadly agreed with staff's assessment and emphasized that, despite the near-term headwinds, the economy would recover relatively quickly as restrictions are lifted. They expected that economic activity would recover as the country phases out lockdown measures in line with the rising vaccination rate, as outlined in the National Plan to Transition Australia's COVID-19 Responses. The authorities concurred with staff that uncertainty around the near-term outlook remained high as the country transitions to living with COVID, and emphasized that the slowdown in population growth due to border restrictions will likely have a sizeable impact on potential output in the near and medium term. While acknowledging high uncertainty, the RBA expected a gradual pick-up in underlying inflation in its central scenario given that wage growth remained weak despite labor market tightening before the recent lockdowns. The authorities agreed with staff's external sector assessment and noted that movements in the Australian dollar were in line with interest rate differentials between Australia and other major economies, and commodity price developments. The authorities also stressed that aggregate household and firm balance sheets strengthened as a result of policy responses and that the financial system remained resilient.

NAVIGATING THROUGH CONTINUED UNCERTAINTY

16. The additional support provided since the recent lockdowns limits the degree of fiscal withdrawal. Prior to the new lockdowns, a sizeable negative fiscal impulse was in train for FY2021/22 as nearly 60 percent of pandemic-related support expired in FY2020/21. The new measures announced after the June 2021 outbreaks add about 1¾ percent of GDP in fiscal support, substantially softening the degree of fiscal adjustment in the current fiscal year. That said, currently announced fiscal plans imply a sizable negative fiscal impulse for FY2022/23, and the authorities' fiscal strategy intends to begin rebuilding fiscal buffers once the economic recovery is secured and the unemployment rate is at or below pre-crisis levels.

Almost 60 Percent of Fiscal Support Measures Expired in FY2020/21

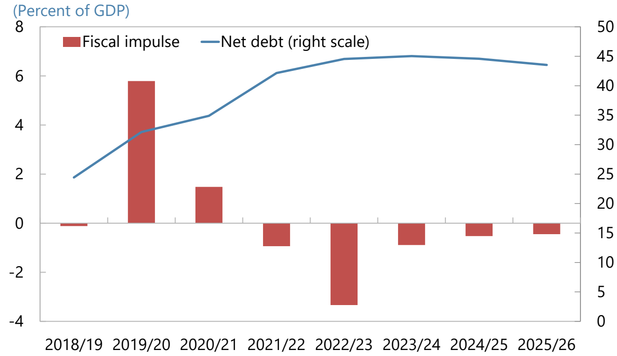
(Percent of GDP; the Commonwealth Government only)



Sources: Authorities' data; and IMF staff calculations.

Fiscal Space Remains Available for Additional Stimulus, with Net Debt Stabilizing Over the Medium Term

(Percent of GDP)

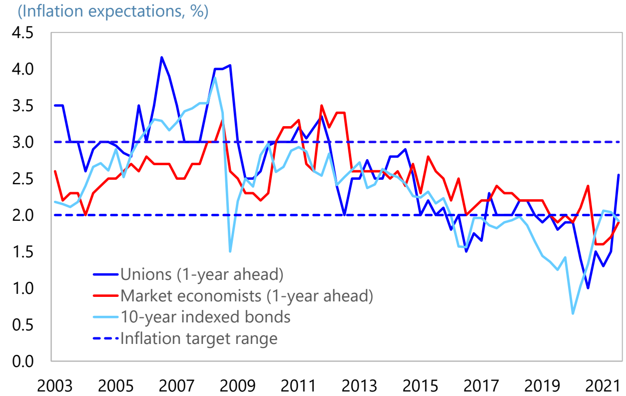


Sources: Authorities' data and IMF staff projections.

17. Monetary policy is expected to remain accommodative and data dependent. With the nominal policy rate close to zero, the real rate has turned markedly negative amid rising inflation expectations. Additional stimulus is being provided via the RBA's ongoing asset purchase program. The RBA's current forward guidance indicates that actual inflation needs to be sustainably within the 2-3 percent target band before rate hikes, and that, in the RBA's central scenario, underlying inflation was forecast to be no higher than 2½ percent by end-2023.

Inflation Expectation Has Risen Towards the Target Range

(Inflation expectations, %)



Source: RBA.

Staff's Views

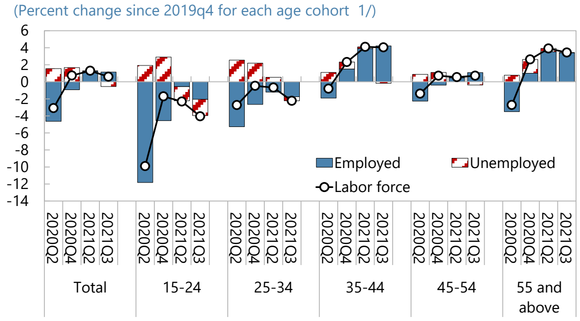
18. Fiscal and monetary policies should remain accommodative and agile. Last year's large-scale fiscal support strengthened household and business balance sheets and will support private demand as current lockdowns and related uncertainty ease. The newly added fiscal measures further

soften the pace of policy support withdrawal in the current fiscal year and will bolster the expected recovery. This fiscal path seems appropriate. Despite tapering of bond purchases, closure of the TFF drawdown window, and abandoning of the yield target, monetary policy remains very accommodative, and support should only ease in line with the expected closing of the output gap and rising inflation. Additional fiscal and monetary support should be deployed if easing of the new lockdowns is delayed to an extent that endangers the expected recovery.

19. Fiscal policy should continue to support vulnerable households and businesses. The COVID-19 Disaster Payment program and business support grants, functioning like automatic stabilizers, provide appropriately targeted support to affected workers and businesses. With an accelerated pace of vaccinations, the Commonwealth Government announced a sunset clause to phase out the support programs, contingent on the full vaccination rates reaching 70-80 percent targets. If economic or health downside risks materialize, the authorities should provide additional targeted fiscal support, including reorienting the automatic stabilizers, with discretionary support for businesses contingent on maintaining employment relationships.

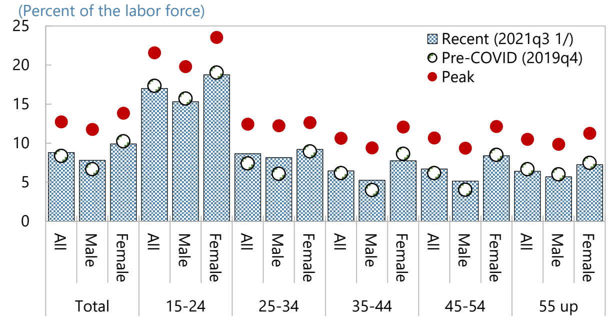
20. Active labor market policies (ALMPs) remain important to support vulnerable groups. While headline unemployment figures show significant labor market recovery, they mask disproportionate impacts of the pandemic on states with renewed lockdowns and on contact-intensive industries. In particular, employment among 15–34-year-olds has been affected the most, with some young workers dropping out of the labor force in the recent months. While past budgets introduced several measures to support an inclusive recovery, the renewed outbreaks call for monitoring the effectiveness of ALMPs and strengthening them where needed to ensure adequate support for disproportionately affected groups, including those facing underemployment or long-term unemployment, as well as casual workers. While wage subsidies to support apprentices and trainees have been extended with high take-up, the JobMaker Hiring Credit program has played a relatively minor role thus far. This program should be reviewed and reinstated, particularly if the labor market recovery is slow, to incentivize more widespread take-up to increase employment and skill development for retention. Scaling up programs for career support to find jobs and acquire training should be also considered.

The Lockdowns Created Disproportionate Impacts on Labor Force Across Different Age Cohorts
(Percent change since 2019q4 for each age cohort 1/)



Sources: Haver Analytics; and IMF staff calculations.
1/ The data for 2021Q3 is based on the average of July and August.

Underemployment Remains Elevated for Youth and Women, and Above Pre-COVID Levels for Men
(Percent of the labor force)



Sources: Haver Analytics; and IMF staff calculations.
1/ Based on the average of July and August.

21. **Fiscal policy should continue to ensure a durable transition from public to private demand in FY2022/23.** The Commonwealth Government's fiscal stance has become contractionary since end-FY2020/21, following the expiration of the JobKeeper program and other supportive measures. State/territory and local governments aim to return to operating surplus by FY2023/24. As stimulus measures continue to expire, the economy will face a sizable, negative fiscal impulse in FY2022/23. Governments should remain vigilant and ready to implement additional measures if needed to entrench the transition. Even after the large fiscal support implemented in the wake of the pandemic, Australia maintains substantial fiscal space given its low pre-pandemic debt levels, and public debt sustainability remains robust (Box 7 and Annex IV). The timing and pace of future consolidation need to be calibrated to the strength of the underlying economic recovery and communicated to reduce policy uncertainty.

22. **Monetary policy should remain data-dependent in a highly uncertain environment.** Accommodative policy settings will be important during the lockdowns and ensuing recovery. The timing and pace of policy normalization should be calibrated in line with the strength of the recovery. Depending on evolving economic conditions, the sequence of policy normalization should likely entail further tapering and ending asset purchases before raising the policy rate, and eventually unwinding asset holdings. Clear communication, stressing the state-contingency of forward guidance, will be important for a smooth transition. In case of stronger-than-expected underlying inflation and/or economic activity, monetary stimulus should be withdrawn more quickly than implied under the baseline. Conversely, if downside risks materialize, the RBA has space to provide additional support by expanding asset purchases, reinstating term funding facilities, and/or introducing negative rates. In light of the changing global environment and an expansion of central bank toolkits, a review of the monetary policy framework, as conducted in many peer central banks, would be good practice to ensure that the RBA's framework remains up to date.

Authorities' Views

23. **The authorities assessed the current policy mix as appropriate.** Given the large uncertainty associated with the virus trajectory, the authorities agreed that policy needs to stay nimble and ready to adjust accordingly. They saw the current level of support as sufficient given the state of the economy and noted that further measures could be deployed if the current lockdowns became more persistent and had a larger impact on the broader economy.

24. **The authorities underscored that fiscal policy needs to remain accommodative and state dependent.** Sizable fiscal stimulus has helped maintain jobs, safeguard the wellbeing of Australians during the height of the pandemic, and steer the economy back quickly and strongly. Fiscal policy was seen as appropriately targeted to provide support to vulnerable households and businesses. Confronted by the spread of the Delta variant in 2021H2, the new fiscal measures, functioning like automatic stabilizers, were assessed as providing appropriate support. The announced plan to phase out the new fiscal measures contingent on vaccination progress was seen as appropriate and would help anchor public expectations regarding these programs. The authorities felt that remaining fiscal measures through FY2024/25 were broadly appropriate to underpin the recovery.

25. Labor market disruptions were seen as less severe than initially feared, with ALMPs playing important complementary roles to limit scarring risks. The authorities emphasized the importance of the JobKeeper program in limiting output and job losses in the context of the 2020 outbreaks. They noted that, following the swift labor market recovery through 2021Q2, the impact of new lockdowns was less severe but uneven across affected states and businesses. They stressed the importance of continued implementation of existing, targeted ALMPs, including apprenticeship and training subsidies and tailored support for job seekers to acquire necessary skills, find jobs, and facilitate more efficient matching. The authorities underscored the importance of closely monitoring the effectiveness of these ALMPs and their readiness to strengthen them if needed to support an inclusive recovery.

26. The Commonwealth Government indicated that it aims to rebuild fiscal buffers only once the economic recovery is well secured. The Commonwealth Government stressed its fiscal strategy of achieving a secure economic recovery and an unemployment rate that is back to its pre-crisis levels or lower before embarking on rebuilding its policy buffers. The authorities underscored a comprehensive approach to implement the strategy by not mechanically assessing the unemployment rate alone. The authorities concurred with the staff assessment that the Commonwealth Government maintains substantial fiscal space, and hence additional stimulus can be deployed if downside risks materialize in the living-with-COVID-19 environment. While most of the state/territory and local governments aim at returning to operating surplus by FY2023/24, it would take longer for the Commonwealth Government to achieve a balanced budget, with more gradual withdrawal of the underlying fiscal stimulus.

27. The RBA emphasized that monetary policy would remain accommodative. The RBA stressed that wage growth had remained sluggish and inflation was not expected to be sustainably in the target range before 2024 in its central scenario. It concurred with staff's view that there remains unusually high uncertainty around the virus trajectory and persistence of international supply bottlenecks. The RBA would continue to emphasize the state dependency of its forward guidance but noted that the public would always tend to focus on the calendar-based implication of that. The RBA noted that, if downside risks materialized, it maintained scope for further policy accommodation, potentially including additional asset purchases and further provision of term funding. Negative interest rates were seen as the least preferred option given similar outcomes could be achieved with other policy options. Conversely, should underlying inflation rise faster than expected, the RBA was prepared to reduce its monetary stimulus faster than assumed under the central scenario. The authorities were open to reviewing the monetary policy framework in light of fast-changing global and domestic macroeconomic settings and changes in the monetary policy toolkit. A decision on a review would be made by the Commonwealth Government.

ENHANCING FINANCIAL SECTOR RESILIENCE

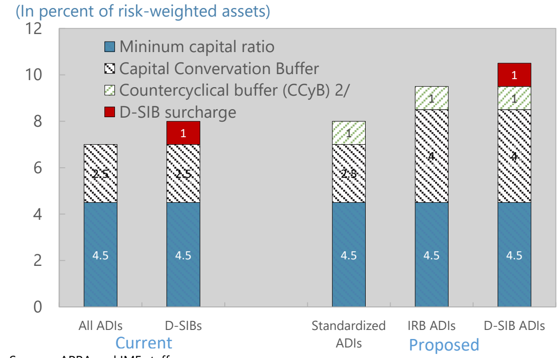
28. The government has approved major financial market infrastructure reforms. In line with the FSAP recommendations (Annex V), the reforms will enhance the licensing, supervisory, and enforcement powers of the Australian Securities and Investments Commission (ASIC) and the RBA.

The RBA will be granted crisis management and resolution powers over Australian clearing and settlement facilities.

29. The authorities are revising the bank capital framework to make it more flexible, risk-sensitive, and competition-enhancing. The proposed framework will increase the risk weights for high-risk mortgages and lower the risk weights for SMEs, with a view to addressing banks' concentration risks in mortgages.[4] Under the proposed framework, the CCyB's default level will be set above zero and the capital conservation buffer for internal ratings-based (IRB) banks will be raised. To enhance competition, a capital floor for IRB banks will be introduced, and a simplified regulatory framework will be applied to smaller banks.

30. New regulations on superannuation funds, climate, cyber risks, and open banking have been introduced. The government has introduced new regulations on the superannuation funds to improve efficiency, transparency, and accountability. APRA has released guidance on managing the financial risks of climate change, covering governance, risk management, scenario analysis, and disclosure, and is conducting vulnerability assessments of climate risks for large banks. The Council of Financial Regulators (CFR) has established a new framework for financial institutions' cyber resilience. In addition, the government has initiated the open banking initiative, allowing customers to transfer bank data to third parties. Efforts have also been taken to strengthen the AML/CFT regime, including by reforming the AML/CFT Act.

Higher Bank Capital Buffers Required 1/
(In percent of risk-weighted assets)



Sources: APRA and IMF staff.
1/ Requirement on CET1 capital.
2/ The CCyB is currently set at zero percent. The default level of CCyB will be 1 percent in the new framework.

Staff's Views

31. The authorities have made commendable efforts in advancing financial sector reforms despite the pandemic. The proposed bank capital framework has the potential to lean against banks' concentration in housing loans, a long-standing vulnerability, facilitate SME lending, and enhance competition within the banking system. The proposed financial market infrastructure reform is a step forward in strengthening regulation, supervision, and crisis management of the sector. Recent initiatives on climate and cyber issues are welcome as related risks are becoming increasingly prevalent. The superannuation reform will strengthen the efficiency and consumer focus of the industry. Measures that have been taken in recent years to strengthen the AML/CFT regime are welcome, although there remains a need to further expand its coverage to include non-financial and business professionals, such as accountants, lawyers, and real estate agents.

[4] The revision of SME risk weights will align them more closely with Basel III standards.

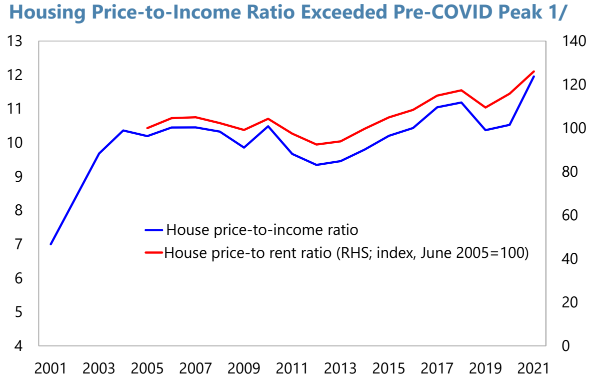
Authorities' Views

32. The authorities stressed their commitment to continued financial sector reforms. They emphasized the importance of enhancing financial sector resilience and the government's intention to push ahead with reforms steadily, in line with the FSAP recommendations (Annex V) and planned implementation of Hayne Royal Commission Inquiry reforms. They considered recent, announced reforms to the bank capital framework and financial market infrastructure as milestone legislative changes to strengthen the financial sector's resilience. They stressed that the superannuation fund reform will safeguard the financial interest of fund members. They also highlighted that increasing efforts will be needed to address rising risks from climate change and cyber-attacks. On AML/CFT, the authorities highlighted the importance of crypto assets, both in terms of risks and opportunities. In relation to expanding the regime to cover high-risk services provided by designated non-financial businesses and professions (DNFBPs), the approach is to consider where policy and regulatory changes can make the most impact within the broader context of transnational serious and organized crime. A consideration of the regulation of the DNFBPs forms part of a longer-term strategy.

MANAGING HOUSING RISKS AND RESTORING AFFORDABILITY

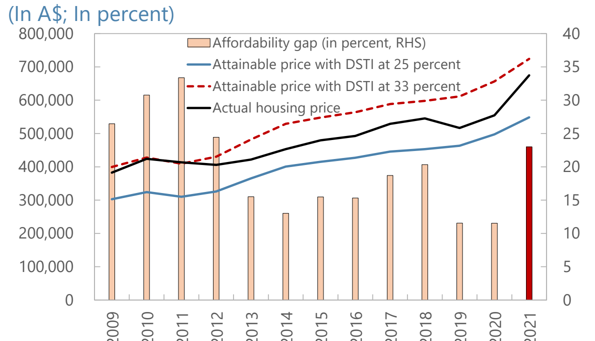
33. Housing affordability has deteriorated, and financial risks are building. The housing price-to-income and price-to-rent ratios have risen and exceed pre-COVID peaks. The affordability gap has widened. Housing credit growth is accelerating, reaching 6.5 percent (y/y) in September, driven by owner-occupiers (8.7 percent), with investor loans picking up from a low base (2.4 percent). The risk profile of new loans is deteriorating, as the share of borrowers with high debt-to-income ratios surged from 16 percent pre-COVID to 22 percent.

Housing Price-to-Income Ratio Exceeded Pre-COVID Peak 1/



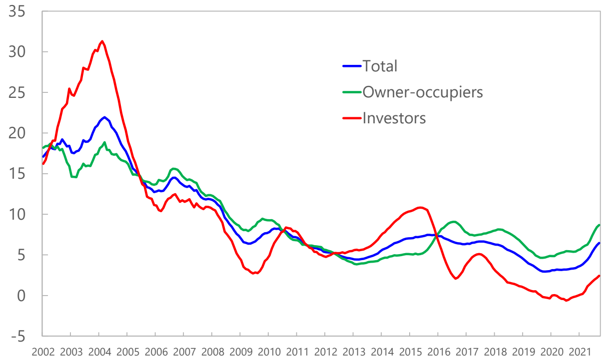
Sources: CoreLogic; ABS; and IMF staff calculations.
1/ Median value of dwellings to gross household disposable income per capita.

Affordability Gap Widened During the Pandemic
(In A$; In percent)



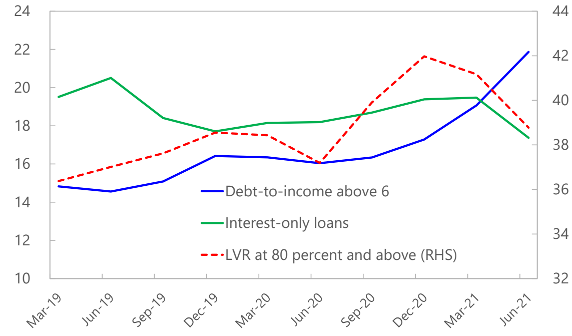
Sources: Corelogic and IMF staff estimates.
Note: The affordability gap is estimated using household disposable income per capita (two income earners per household), a debt service to income ratio (DSTI) of 25 percent, and a loan-to-value ratio of 80 percent.

Housing Credit Expansion Is Led by Owner-Occupiers
(In percent, yoy)



Source: Reserve Bank of Australia.

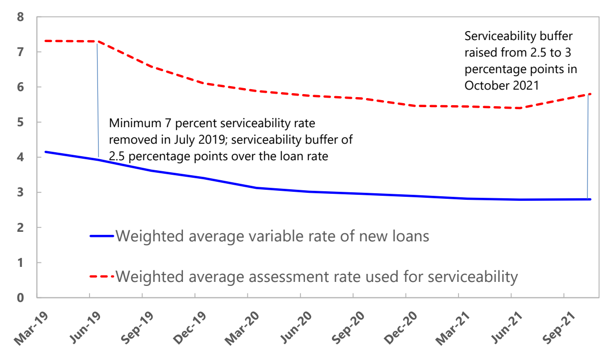
Riskier Loans Are Rising
(In percent of new housing loans)



Source: APRA.

34. **Macroprudential policy has responded to the changing risk environment.** In October 2021, APRA raised the minimum serviceability buffer from 2.5 to 3 percent, requiring lenders to use the higher interest rate spread in assessing borrowers' ability to service their mortgage loans, thereby strengthening their repayment capacity in case of shocks, such as rising interest rates or income loss.

Interest Serviceability Buffer Increased
(In percent)



Source: APRA.

Staff's Views

35. **The recent tightening of macroprudential policy is appropriate, and additional measures should be considered if financial-stability risks continue rising**. While the surge in house prices has been driven largely by owner-occupiers taking advantage of low mortgage rates and fiscal support programs, high debt-to-income mortgages are on the rise amid elevated household debt, and investor demand has begun to increase from low levels. Lending standards should be monitored closely. With about 70 percent of mortgages at variable rates, borrowers are exposed to rate increases with the expected monetary policy normalization in the medium term. Further macroprudential tightening may be warranted if housing debt continues to outpace income growth and the rise in housing prices leads to increased riskiness of mortgage lending. Options include instituting portfolio restrictions on debt-to-income (DTI) and loan-to-value ratios (LVR), with DTI restrictions likely more effective in curbing investor demand, while LVR restrictions would affect more liquidity-constrained owner-occupiers, in particular first home buyers.

36. **Housing structural reforms are critical for supporting affordability.** Supply-side reforms, including more efficient planning, zoning, and better infrastructure, could improve housing supply. Commonwealth and state/territory governments should consider providing more financial incentives for local governments to streamline zoning regulations and improve infrastructure. Promoting flexible work arrangements could allow workers to move away from capital cities, improving

affordability. In addition, governments should focus on providing targeted fiscal support for low-income households and expand social housing. This could be complemented by tax reforms to discourage leveraged housing investment.

Authorities' Views

37. **The authorities stressed that rising risks in home lending motivated the recent macroprudential tightening.** They noted that, while lending standards have generally remained prudent, rapid credit growth that outpaces household income growth could build financial vulnerabilities, while the strength of the house price cycle could give rise to more risk-taking and potential erosion of lending standards. They underscored that they would continue to closely monitor trends in residential mortgage lending and were prepared to take further measures if needed. They confirmed that other policy instruments, including DTI and LVR restrictions, could be deployed if necessary. The authorities thought that tax policy was not the right tool to address potential speculative behavior in housing markets, as negative gearing and the capital gains tax discount apply across investments and investments in residential housing are relatively highly taxed, and that macroprudential policy should instead be employed as needed to address financial stability risks.

38. **The authorities agreed that housing supply reform would be important to improve affordability**. They highlighted that the Commonwealth has provided funds to support state and local governments in infrastructure provision and concurred that more could be done to promote zoning and planning reforms to boost housing supply. Additional targeted support could also be provided to low-income households to address affordability issues, and the authorities concurred that adequate provision of social housing remained important.

PROMOTING HIGH, SUSTAINABLE, AND INCLUSIVE GROWTH

39. **Continued structural reforms are essential for tackling the longstanding productivity slowdown and ensuring an inclusive recovery**. Australia compares favorably to peers on product market efficiency and has an open trade environment. However, productivity growth slowed significantly leading up to the pandemic, falling below the OECD average. Productivity-enhancing investments have declined, and measures of competition have deteriorated (Box 8). While income inequality is slightly above average among advanced economies, the comprehensive policy response to the pandemic has likely limited its impact on inequality. Wealth inequality has been lower than in peers but is likely to rise with the housing boom (Annex VI).

40. **Energy and climate change policies remain challenging areas.** Australia has made progress in reducing greenhouse gas emissions by improving the emissions profile of land use and increasing the share of renewables in electricity generation. In October 2021, Australia announced a net zero emissions target for 2050. To date though, emissions intensity remains one of the highest among advanced economies, and coal continues to account for about half of electricity production,

higher than in most OECD peers.[5] The authorities' projections indicate that Australia will meet its Paris Agreement mitigation target for 2030, although a summary of independent assessments in the UN Emissions Gap Report 2021 suggests that some uncertainty remains (Annex VII).[6] The authorities are focused on a technology-based approach to reducing emissions rather than a broad-based carbon price.

Staff's Views

41. Promoting innovation and competition are priorities for raising medium-term growth, while timely implementation of infrastructure projects can support the short-term recovery and alleviate growth constraints.

Innovation and digitalization: Recent reforms that made the R&D tax incentive more generous are welcome. Working towards better targeting the incentive to young firms, including by reducing its administrative burden, can further boost innovation. There is also scope for scaling up government spending in R&D and further incentivizing university-business collaboration. The swift implementation of the government's Digital Economy Strategy will help to build skills and infrastructure, including for SMEs and the regions.

Competition: While Australia compares well to peers on product market regulations, scope remains to streamline the administrative burden on start-ups and simplify regulations. Reforms to the insolvency framework for SMEs and greater digitization of government-business interactions are welcome steps in this direction. The implementation of automatic mutual recognition of occupational licenses across jurisdictions will help boost competition, though scope remains to widen the occupations and jurisdictions covered by the policy. Reducing financing constraints for SMEs and promoting other sources of finance, such as venture capital, can improve resource allocation.

Infrastructure: The recent increase in infrastructure spending will help close the infrastructure gap. The priority is to overcome capacity constraints to ensure timely implementation of infrastructure projects.

42. Tax reforms can help promote efficiency. A longstanding recommendation is for Australia to reduce its relatively high share of direct taxes by lessening the corporate income tax burden and relying more on indirect taxes, especially the goods and services tax. This could improve the

[5] Australia is also the world's largest coal exporter (accounting for almost 40 percent of world exports in 2020) and a major exporter of natural gas, which could give rise to long-term challenges as the global energy sector restructures. At the same time, significant reserves of key metals needed for the energy transition may help offset the external shock.

[6] The authorities project a 30 percent decline in emissions by 2030 compared to 2005 levels under current policies, and a 35 percent decline in a technology-sensitive scenario, thus meeting the Paris Agreement's NDC target of a 26 to 28 percent reduction. According to the United Nations Emissions Gap Report 2021, one of four independent studies shows Australia meeting its Paris Agreement target. However, the report's findings should be interpreted with caution as it was finalized before the authorities' latest projections were available and some of the independent studies may not reflect the full impact of the COVID-19 shock on emissions.

efficiency of the tax system without reducing aggregate revenues. The impact of this reform should be made less regressive through targeted cash transfers. Transitioning from a housing transfer stamp duty to a land tax can promote labor mobility and provide a more stable revenue stream for states and territories. In addition, housing policy measures discriminating against non-residential buyers, such as state-level foreign purchaser duty surcharges on real estate, should be replaced by alternative, non-discriminatory measures, such as a general surcharge on vacant property or surcharges on all investor-owned housing transactions.[7]

43. **Australia's efforts to support the rules-based international trading system are welcome.** Australia has strengthened its network of multilateral and bilateral free-trade agreements, and its strong support for the WTO is helping to buttress the rules-based international trading system. The country recently amended its foreign direct investment framework to safeguard national security.[8] The issuance of guidance for implementing the new framework and the authorities' intention of judicious use of this policy are welcome and will help ensure that the FDI approval process remains simple and transparent.

44. **Supportive labor market policies and education reforms can ensure an inclusive recovery.** The government has introduced several initiatives to tackle inequities, including increased funding for aged care and the National Disability Insurance Scheme, reforms to the childcare subsidy to promote female labor force participation, and release of a gender budget aimed at reducing gender gaps. Strengthening active labor market policies where needed can ensure adequate support to disproportionately affected groups, including the underemployed, the long-term unemployed, and casual workers. Enhancing programs for retraining, career support, and job search can help in this regard. Continued reforms in the education sector can improve education outcomes which have deteriorated in recent years and ensure equal opportunities.

45. **An integrated framework for climate change policies can reduce uncertainty and catalyze environmentally friendly investment.** Meeting the Paris Agreement's temperature goals will require significant global effort, and in this context Australia's recent commitment to net zero emissions by 2050 is welcome. Achieving this goal will require strong policy ambition, credible medium-term targets consistent with the net zero goal, and a comprehensive policy package. Australia's commitment to increase investment in the development of low-emissions technologies is welcome. While politically challenging, implementing broad-based carbon pricing, along with measures to mitigate transition risks for impacted industries and regions, would be the most effective way to achieve emissions reductions and complement the investment strategy. It would also minimize risks to Australian exports from carbon border adjustments. While less efficient than a broad-based carbon price, alternative regulatory reforms can be considered, including enhancing

[7] In April 2020, Tasmania raised tax surcharges on foreign buyers from 3 to 8 percent for residential properties and from 0.5 to 1.5 percent for primary production facilities, with the intention to raise revenue and ensure market access by Tasmanians. Foreign purchaser tax surcharges constitute capital flow management measures under the IMF's Institutional View. See the 2017 and 2018 Article IV Staff Reports.

[8] The Foreign Investment Reform (Protecting Australia's National Security) Act 2020 introduced a new national security test requiring approval for foreign investments in 'sensitive national security business' regardless of the value of the investment.

the Emissions Reduction Fund's Safeguards Mechanism, and employing sectoral policies aimed at reducing emissions, including in energy generation, transportation, and agriculture. Finally, to facilitate assessment of climate and transition risks and foster better allocation of capital, ASIC can further improve standardized disclosures of exposure to climate-related risks for large, listed companies.

Authorities' Views

46. The authorities agreed on the need to reignite productivity growth by enhancing competition and innovation. They noted that unlike R&D spending, broader measures of innovation activity have not declined in Australia, that the newly introduced Patent Box will promote innovation, and that an ongoing review of the administration of the R&D tax incentive will identify ways to reduce compliance costs. The authorities emphasized their commitment to promoting digitalization and improving the competitive environment, with significant progress having been made through the Digital Economy Strategy and the whole-of-government approach to the deregulation agenda spanning across ministries and agencies. They highlighted several initiatives that facilitate more SME lending (SME Recovery Loan Scheme, Business Growth Fund, lowering risk weights on SME loans) and venture capital funding (for example, Venture Capital Limited Partnership) and agreed that addressing supply bottlenecks will be key to ensuring timely delivery of infrastructure projects. The authorities also reiterated their commitment to an open, rules-based international trade system and a transparent FDI regime, including by using the new FDI national security rules judiciously.

47. The authorities agreed that tax reforms can improve efficiency but noted that there was no strong community acceptance of this. Any change to the GST requires the support of all states and territories, and legislation to lower the corporate tax rate for large firms had failed to pass in parliament. State governments were generally supportive of shifting from stamp duties to land taxes but noted that significant near-to-medium term revenue losses from such a reform posed challenges.

48. The authorities highlighted the reforms undertaken to ensure an inclusive recovery. They noted that income levels of the lower quartiles had increased in 2020 due to government support. They also emphasized a range of policies aimed at assisting disadvantaged groups like the long-term unemployed, including more generous wage subsidies through the JobActive Program, greater funding for training and apprenticeships, and the planned reform of employment services for job seekers, employers, and providers. They also noted efforts to improve the education system through increased funding and an ongoing review into teacher education.

49. The authorities' reiterated their commitment to meet climate mitigation targets by focusing on a technology-based approach to reducing emissions. They highlighted their track record in meeting mitigation targets and were confident of achieving the 2030 target. They emphasized the fast rollout of renewable energy, especially small and mid-scale solar installation. They also highlighted the increased ambition in the recently released Long-Term Emissions Reduction Plan, including the net zero emissions target for 2050. The Technology Investment

Roadmap, which articulates the development and deployment of low emissions technologies between now and 2030, continues to be the cornerstone of the strategy.

STAFF APPRAISAL

50. Amid high uncertainty, Australia's economy is expected to begin recovering from recent lockdowns. Strong health and economic policies supported quick recovery from lockdowns in 2020. While the renewed outbreaks since mid-2021 triggered by the Delta variant have proven harder to suppress, recent progress in the vaccination campaign offers a pathway to a new normal. As restrictions ease, the economy is projected to recover from a marked decline in activity in 2021Q3, and underlying inflation is expected to rise gradually toward the mid-point of the 2-3 percent target range. That said, the outlook remains highly uncertain, contingent on the trajectory of the pandemic, with near-term risks tilted to the downside.

51. Appropriately accommodative and agile macroeconomic policies should soften the near-term economic impact and lay the foundation for post-lockdown recovery. Fiscal and monetary support should stay nimble in the highly uncertain environment, and additional coordinated stimulus should be provided if downside risks materialize.

52. Fiscal policy should remain agile and entrench inclusive, private sector-led growth. Unprecedented fiscal support in the context of the 2020 outbreaks was instrumental in enabling swift economic recovery. Recent economic setbacks from renewed lockdowns show a continuing need for fiscal policy to support a durable handover from public to private demand. The newly announced fiscal support measures in the context of the recent outbreaks have been broadly adequate and appropriately targeted. Closely monitoring the effectiveness of active labor market policies and strengthening them if needed will be important to ensure adequate support to vulnerable workers and businesses.

53. Substantial fiscal space is available to implement further stimulus if downside risks materialize. With the accelerated pace of vaccinations and easing of COVID-19 restrictions, the authorities are phasing out the pandemic-triggered automatic stabilizers. Given continued high uncertainty as Australia transitions to living with COVID, the authorities should stand ready to implement additional fiscal support as needed.

54. Monetary policy should remain data-dependent in the current, highly uncertain environment. Unprecedented monetary easing in 2020 was very helpful in supporting the economy. Recent steps toward policy normalization, including tapering of bond purchases, expiry of the TFF drawdown period, and abandoning the yield target, have been appropriate, reflecting the economic outlook. The timing and pace of further policy normalization should be calibrated in a gradual and well-sequenced manner in line with the recovery and expected inflation. Clear communications, stressing the state-contingency of forward guidance, will be important for a smooth transition. If inflationary pressures become more persistent, an earlier tightening would be warranted. Conversely, if downside risks materialize, the RBA has sufficient policy space to deploy additional support.

55. **Financial sector reforms have progressed well and should continue to enhance resilience against financial risks.** APRA's proposed revisions to the bank capital framework will make it more flexible and risk-sensitive while supporting competition. It will also help address banks' high concentration in mortgage lending, a longstanding structural vulnerability. Recent reforms in financial market infrastructure are important to enhance the resilience of the financial sector. Continued efforts in addressing climate and cyber risks will be essential to ensure financial resilience in a changing environment. The AML/CFT framework should be further strengthened by expanding coverage to relevant non-financial and business professionals.

56. **Growing imbalances in the housing sector require comprehensive policy efforts.** Surging house prices raise concerns around financial vulnerabilities and housing affordability. The recent increase in the interest serviceability buffer is welcome in addressing emerging risks. Lending standards should be monitored closely, and further tightening of macroprudential policy may be needed if risks continue to build. This should be complemented by supply-side reforms to address affordability issues. In particular, Commonwealth and state/territory governments should consider providing more financial incentives to local governments to improve zoning, planning, and infrastructure provision. More targeted support should be provided to low-income households, and social housing should be expanded. Tax reforms to discourage leveraged housing investment by households could help dampen investor demand in residential real estate.

57. **An integrated, comprehensive climate policy framework can reduce uncertainty, catalyze investment, and speed up emissions reduction.** Australia has made progress in reducing greenhouse gas emissions and has committed to step up investment in developing and deploying low-emissions technologies. Australia's recent commitment to achieve net zero emissions by 2050 is welcome. Achieving the goal will require fast progress within a comprehensive policy framework. A broad-based carbon price, coupled with measures to mitigate transition risks for impacted regions and industries, could complement the investment strategy and reduce emissions in a cost-effective way. If the political economy does not allow for a price-based strategy, alternative regulatory approaches can also be considered, including specific policies to curb emissions in the energy, transportation, and agricultural sectors.

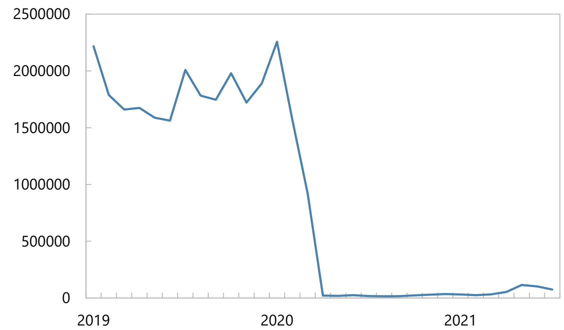
58. **Reigniting productivity growth and supporting an inclusive recovery will require a strong focus on structural reforms.** The authorities should continue advancing the deregulation agenda, supporting the digital economy, and enhancing competition, including by reducing financing constraints for SMEs. Promoting innovation and overcoming supply constraints to ensure timely implementation of infrastructure projects will also help. Rebalancing the tax system away from direct taxes towards indirect taxes, while offsetting the negative distributional effects of the latter, can enhance efficiency. Recent reforms to childcare subsidies and increased funding for aged care and the National Disability Insurance Scheme will help render the recovery inclusive. Australia's continued support for an open trade environment, including through reforms at the WTO, is very welcome.

59. **It is recommended that the next Article IV consultation be held on the standard 12-month cycle.**

Box 1. Australia's Health Response to the COVID-19 Pandemic

Australia responded to COVID-19 with timely lockdowns and strict border restrictions. Soon after COVID-19 threat emerged in March 2020, the government introduced strict border closure and implemented a mandatory self-isolation program required for returning Australians, later changed to official quarantine facilities. State governments closed non-essential services, and the number of new COVID-19 cases quickly fell from the initial peak recorded in late March 2020. Since then, the country has experienced recurrent local outbreaks, including a second wave in 2020, but successfully contained them with timely lockdowns, large-scale testing, and contact tracing.

International Borders Have Been Nearly Closed
(Number of international arrivals)

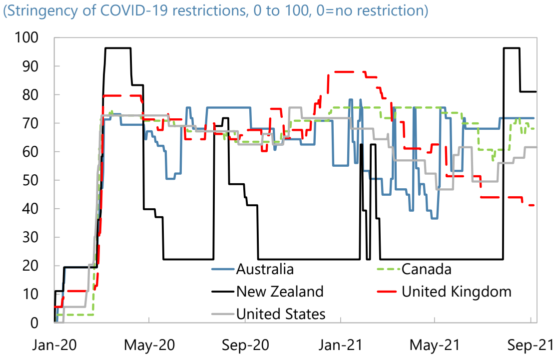


Source: Haver Analytics.

Renewed outbreaks linked to the contagious Delta variant pose challenges. Since late June, the economy has been facing renewed regional outbreaks, which put more than half of the population under lockdown by mid-July. The prolonged lockdowns in New South Wales and Victoria have adversely affected economic activities, with disproportionate impact on services (including hospitality) and construction.

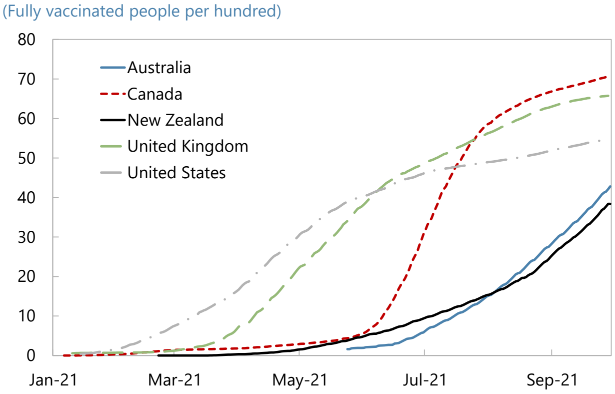
With recent progress in vaccination campaign from a slow start, the government strategy has shifted toward living with COVID-19. Vaccination started in late February, slower than other advanced economies, but the pace accelerated in the third quarter, with 73.4 percent of eligible adults (16+) fully vaccinated, and 86.8 percent having received at least one dose of vaccine as of October 26. Going forward, the government plans to phase out lockdown measures once 70-80 percent of eligible population are fully vaccinated, in line with the National Plan. New South Wales and Victoria began easing restrictions on October 11 and 21, 2021, respectively, after the regional vaccination rates hit 70 percent. On November 1, 2021, international travel restrictions for fully vaccinated Australian citizens and permanent residents were relaxed.

Restrictions Have Been Tightened to Control Outbreaks
(Stringency of COVID-19 restrictions, 0 to 100, 0=no restriction)



Source: Our World in Data.

The Vaccine Campaign Has Accelerated After a Slow Start
(Fully vaccinated people per hundred)



Source: Our World in Data.

Box 2. Unprecedented Fiscal Stimulus, Calibrated to the Pace of Economic Recovery

The Commonwealth, state and territory governments have respectively put together stimulus packages, amounting to around 20 percent of 2020 GDP (above the line) in total. Nearly 60 percent of the stimulus (mostly expenditure measures) have been already implemented by end-FY2021, which has limited socio-economic damage brought about by the pandemic. New measures implemented in the context of the 2021H2 lockdowns (1¾ percent of GDP) are anticipated to phase out by end-2021. Most of the remaining stimulus comprises revenue measures, designed to support household consumption and business investment. The remaining expenditure measures target job creation, training, support for vulnerable industries, health care and infrastructure. In addition, the Commonwealth Government put in place loan guarantee and recovery loan schemes, and other below-the-line financial assistance for SMEs, amounting to nearly 2 percent of GDP.

(A) Major support measures already expired:

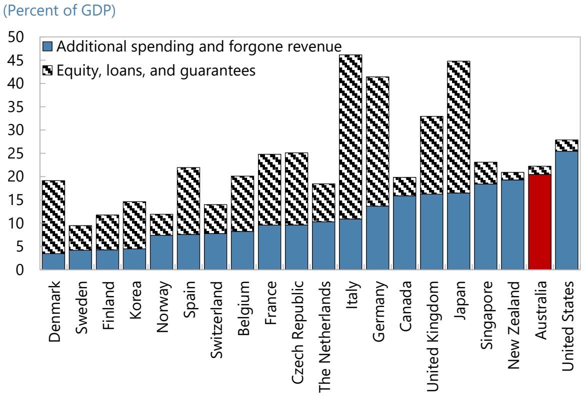
Households: Payments to support households, including the Coronavirus Supplement (a top-up payment to eligible welfare recipients) and one-off payments to eligible welfare recipients and concession card holders, and HomeBuilder grants (applications closed in April 2021, but payments continue until end-April 2023).
Employment: JobKeeper wage subsidies, with benefits contingent on maintaining employment relationships; JobMaker Hiring Credit (employers' access for new hires closed in October 2021, but payments continue for 12 months), and some other active labor market policies (ALMPs).
Businesses: Cash flow support for businesses, payroll tax deferrals.

(B) Remaining support measures (major items):

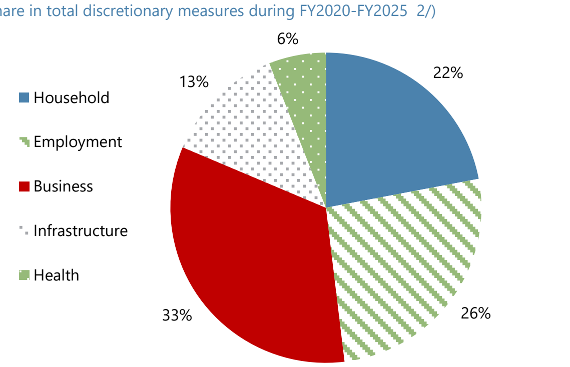
Revenue (3.7 percent of 2020 GDP):
Households: Retain the low and middle income tax offset (LMITO) until June 2022.
Businesses: Temporary full expensing and loss carry-back for businesses.

Expenditure (4¾ percent of 2020 GDP):
Households: COVID-19 Disaster Payment and Pandemic Leave Disaster Payment programs, income support system, Housing Package.
Employment: Wage subsidy for apprenticeships and trainees, and other ALMPs.
Businesses: State-administered business support programs, cash flow support, stimulus for vulnerable industries (e.g. aviation, tourism, arts).
Health and Infrastructure: Vaccination and pharmaceutical benefit programs, road safety and other infrastructure programs.

Discretionary Fiscal Measures are Among the Largest 1/
(Percent of GDP)



The Stimulus by the Commonwealth Government Accounts for the Most Part, Led by Support for Businesses and Jobs
(Share in total discretionary measures during FY2020-FY2025 2/)



Sources: Authorities' data; Haver Analytics; Country Fiscal Measures in Response to the COVID-19 Pandemic since January 2020, July 2021, IMF; and IMF staff calculations.
1/ The data for Australia incorporates additional measures incorporated in the 2021-22 budgets of the Commonwealth, state and territory governments, as well as new measures implemented during the second half of 2021.
2/ Includes both expenditure and revenue measures of the Commonwealth Government only.

Box 3. Key Monetary and Liquidity Facilities Under COVID-19

Facility	Objective	Terms and Duration
Open Market Operations (OMO)	Provide liquidity and support market functioning	Open market operations expanded in size and to longer-term tenors, with the range of eligible collaterals broadened.
FX Swaps	Provide dollar liquidity to financial institutions	Temporary FX swap line between RBA and US Federal Reserve, allowing RBA to access up to $60 bn and lend to financial institutions via repo.
Term Funding Facility (TFF)	Provide stable and low-cost funding to banks to reduce the cost of borrowing for businesses and households, and encourage business lending, in particular to SMEs.	A$213 billion of three-year funding with the drawdown expired in June 2021, priced at 0.1 percent (0.25 percent before November 2020).
3-Year Yield Target	Anchor the 3-year government bond yield to lower the borrowing cost for businesses and households	The 3-year government yield target was set at 0.25 percent in March 2020 and lowered to 0.1 percent in November 2020. In July 2021, the target was changed from applying to the bond closest to 3-years maturity to being fixed at the April 2024 bond, with the implied maturity of the yield target declining over time. Government bonds purchased in the secondary market as required to support the target and, in the early stages of the pandemic, to address dislocations in government bond markets. The yield target was abandoned in November 2021.
Bond purchase program	Lower longer-term interest rates and the exchange rate	Outright purchase of A$200 bn of government bonds (including state and territory governments) of around 5-10 year maturity in the secondary market from November 2020 until September 2021, extended to mid-February 2022 with weekly purchase tapered from A$5bn to A$4bn.
Forward Guidance	Anchor interest rate expectation in the medium-term to lower the borrowing cost for businesses and households	Cash rate will not be hiked until actual inflation is sustainably within the 2-3 percent target, with the central forecast for underlying inflation being no higher than 2½ percent by end-2023.

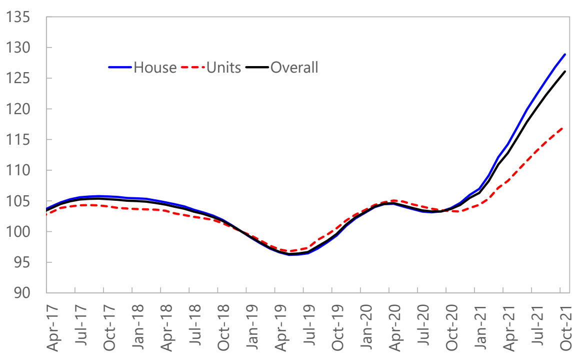
Source: RBA.

Box 4. Housing Market Trends During the Pandemic

The housing market is booming, buoyed by low mortgage rates and fiscal support. In contrast to previous housing booms, the pandemic has resulted in unique housing market trends, as evidenced in the divergence between houses and units market, capital cities and regionals, and a diminished role of foreign buyers.

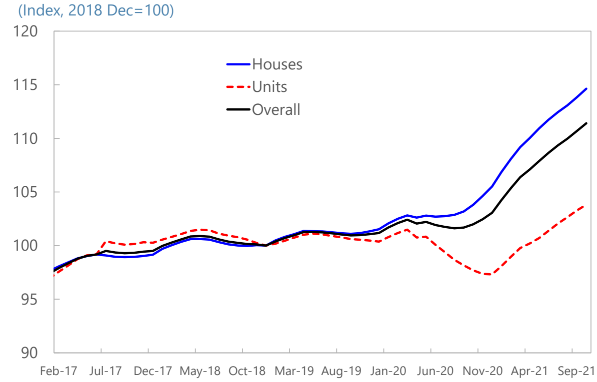
Diverging trend between houses and apartments. The pandemic has led to a marked shift of household preference from apartment buildings to houses, reflecting demand for larger spaces for teleworking and low-density space to mitigate infection risks. As a result, prices of detached houses and units have diverged significantly, with house prices surging 24.2 percent yoy, while prices for apartment units rose 13.3 percent yoy in October. Similarly, rental rates for houses rose by 12 percent from the pre-COVID level, while apartment rents have only recovered to pre-COVID levels in recent months.

Diverging Prices of Detached Houses vs Units
(Index, 2018 Dec=100)



Sources: Corelogic and IMF staff estimates.

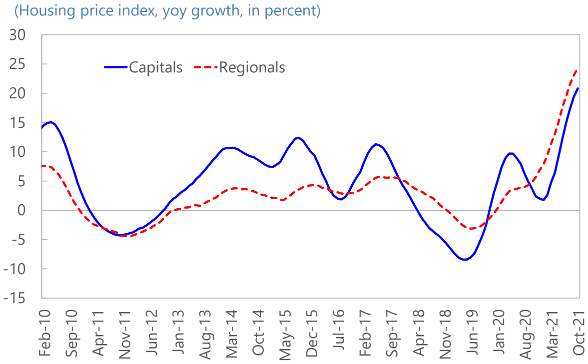
Rental Rates Diverged Between Houses and Units
(Index, 2018 Dec=100)



Sources: Corelogic and IMF staff estimates.

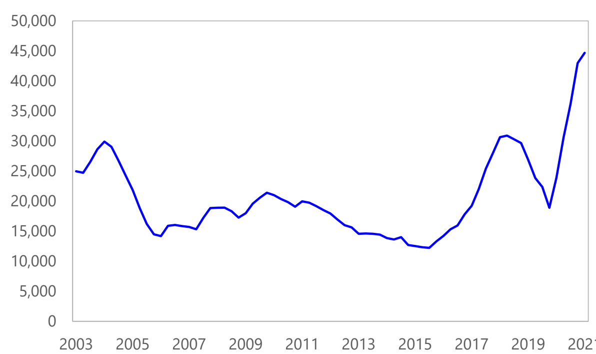
Regional cities led the housing boom, while capital cities have been catching up more recently. Historically, capital cities, such as Sydney and Melbourne, were more prone to housing booms, while prices in regional cities have been relatively more stable. Since the pandemic, net migration from capital to regional cities has driven up housing demand and led to rapid increase in regional housing prices. In contrast, housing prices in capital cities were muted until early 2021.

Regional Cities Led The Housing Boom
(Housing price index, yoy growth, in percent)



Sources: Corelogic and IMF staff estimates.

Net Internal Migration to Regional Australia
(In number if persons; 4-quarter moving sum)



Sources: Australia Bureau of Statistics and IMF staff calculations.

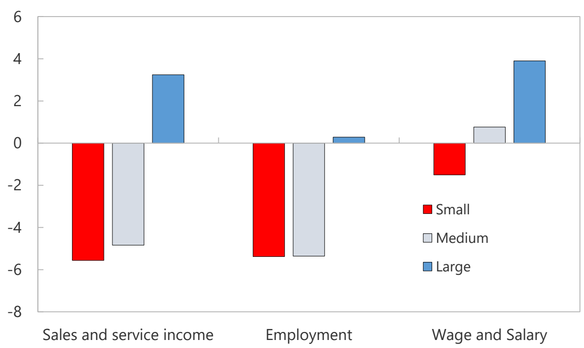
Foreign buyers played a limited role given the border closure. Demand from non-residents contributed to previous housing booms in Australia, with the share of foreign buyers ranged from 10 to 16 percent of total new purchases. Since 2015, when various states introduced and gradually increased additional stamp duty for foreigners, demand has weakened notably. Since the pandemic, with the international border closure, foreign buyer's share has plunged to below 2 percent.

Box 5. SMEs During the Pandemic

SMEs were disproportionately affected during the pandemic. Retail sales and employment of SMEs dropped sharply in 2020, compared to large firms. This partly reflected that SMEs are concentrated in the contact-intensive sectors, such as cafes, restaurants, arts and recreation. With the resumption of economic activities, SME sales have recovered, though recent lockdowns have imposed renewed pressures.

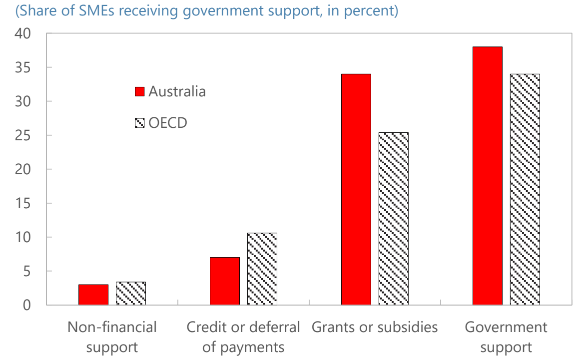
The government has provided significant support to SMEs. Both fiscal and monetary policies have provided support for SMEs, through grants, direct subsidies, and by promoting SME lending . Overall, OECD data suggests that 38 percent of SMEs have accessed some form of government relief measures, higher than the OECD average of 33.4 percent.[1]

Small Firms Have Been Hit Harder During the Pandemic
(Sales, employment, and wage growth by firm size, in percent)



Sources: ABS and IMF staff estimates.

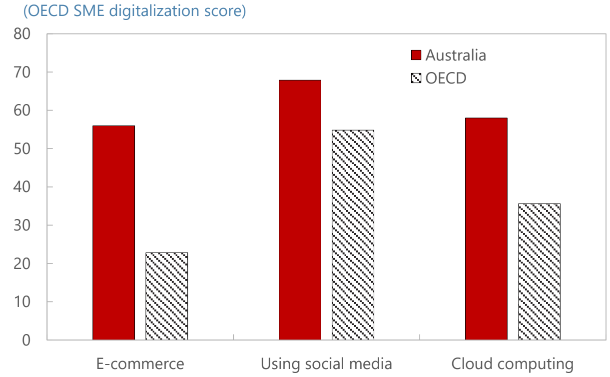
Strong Government Support to SMEs During COVID
(Share of SMEs receiving government support, in percent)



Source: OECD.

The pandemic may have a scarring impact on SMEs, while strong digitalization could provide opportunities. With the withdrawal of temporary government stimulus and debt relief measures, the SME bankruptcy rate is expected to increase. To facilitate the exit of SMEs, the government has revised the small business insolvency regime, including new debt restructuring and simplified liquidation processes. In the meantime, the stronger economic recovery in the first half of 2021 in Australia and a higher degree of SME digitalization may alleviate the scarring impact compared to other countries. The government's recent open banking initiative may also address the long-standing difficulty of SME financing by boosting lending by non-bank service providers.

SMEs Resilience Boosted by Digitalization
(OECD SME digitalization score)



Source: OECD.

1/ The Australian Statistics Bureau business survey indicates more than half of SMEs received government support in July 2020.

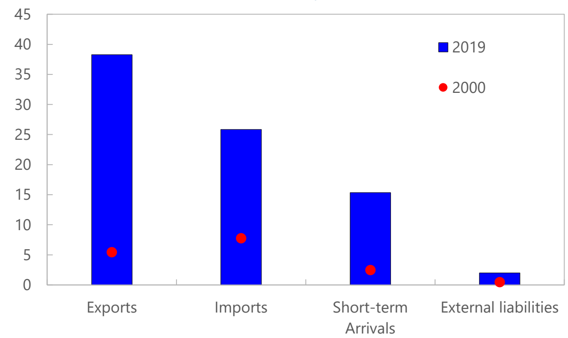
Box 6. China-Australia Relations and their Macroeconomic Impact

Over the past two decades, China has become Australia's largest trading partner. China is now the largest destination for Australian exports (accounting for about 40 percent of total exports) as well as the largest source of imports (accounting for about 25 percent of total imports). In 2019, China overtook New Zealand to become the largest source of short-term visitor arrivals into Australia, reflecting higher tourism and student arrivals. By contrast, financial flows between Australia and China remain limited—Chinese investment only accounts for about 2 percent of Australian foreign liabilities.

Diplomatic relations between the two countries have deteriorated in recent years. Both countries have taken actions that have also impacted economic relations, including the imposition of import restrictions and the cancellation of high-level economic dialogues and initiatives. Restrictions placed by China on selected Australian exports have reduced bilateral trade in these sectors, but with only limited effects on the aggregate economy. China has imposed restrictions on various imports from Australia, including coal, barley, wine, rock lobsters, cotton, selected meat suppliers and some wood products. For coal, by far the largest sector subject to restrictions, exports to China have been diverted to other markets with only a limited decline in aggregate export volumes. In some other sectors where exports to China were a significant portion of total exports before restriction were imposed (e.g., rock lobsters, where China accounted for about 90 percent of Australian exports), export volumes remain depressed. However, as these sectors are relatively small, the macroeconomic impact has been limited.

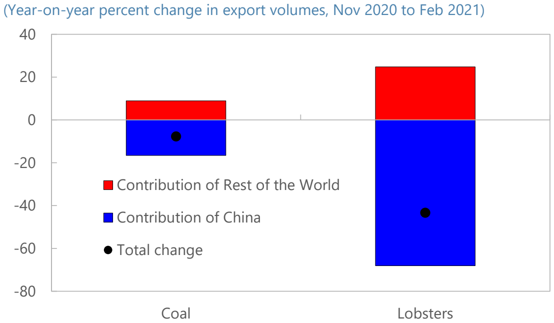
A further deterioration of economic relations poses downside risks. Due to border closures, uncertainty remains regarding future tourism and student arrivals, including from China. And while latest trade data continues to show record high aggregate exports to China despite sectoral restrictions, a further deterioration of relations could adversely impact Australian exports and growth going forward.

Trade Flows With China Have Increased Significantly
(China's share in selected external indicators, percent)



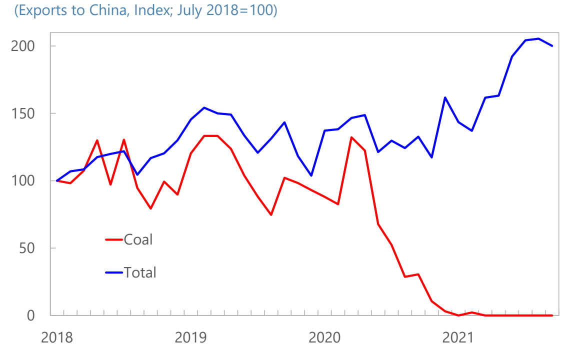
Source: ABS.

Chinese Trade Restrictions Have Impacted Sectors Differently
(Year-on-year percent change in export volumes, Nov 2020 to Feb 2021)



Sources: Comtrade and IMF staff calculations.

Exports to China Remain High, Despite Sectoral Restrictions
(Exports to China, Index; July 2018=100)



Sources: ABS, DFAT, and IMF staff calculations.

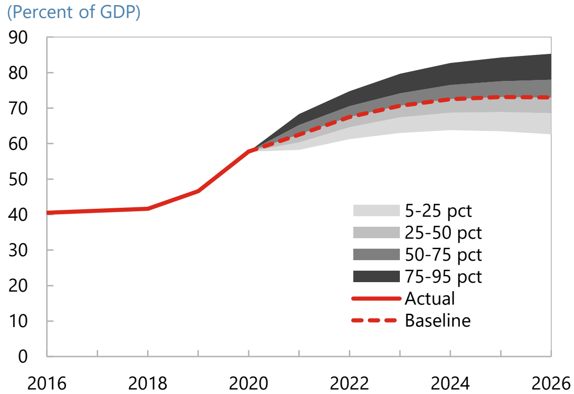
Box 7. The Sovereign Risk and Debt Sustainability Framework: An Application to Australia[1]

This box summarizes the results of several tools of the Fund's forthcoming sovereign risk and debt sustainability framework for market access countries, using a preliminary calibration of the new framework. Overall, staff's judgment is that the risk of sovereign stress is low.

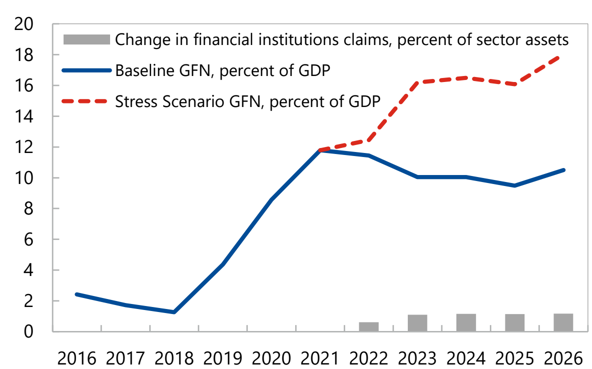
Risk of Sovereign Stress			
	Mechanical signal	Final assessment	Comments:
Overall		Low	Assessment reflects mitigating factors: the strength of institutions, the depth of the capital market, credible macroeconomic policies with stabilizing roles by the Reserve Bank of Australia.
Near term	Low	Low	
Medium term	Low	Low	
GFN:	Low		
Fan chart:	Low		
Stress-test:	*N.A.*		
Long-term		*N.A.*	

Medium-term risks are also estimated to be low, with a low debt rollover risk, as indicated by the signal from the gross financing needs (GFN) analysis. This low GFN risk is driven by the wide capacity of the financial sector and domestic capital markets to meet increased financing needs under the baseline and an extreme, generalized stress scenario (assuming a higher share of short-term debt issuance at 40 percent of new debt on average during 2022-2026, with low growth and an elevated interest rate). The fan chart tool also signals a low risk of debt not stabilizing in the medium term. These mechanical signals give an overall risk rating of "low" for the medium-term, consistent with Australia's low level of net debt (compared to other major advanced economies) and its credible fiscal framework and institutions.

Debt Fanchart
(Percent of GDP)



Gross Financing Needs

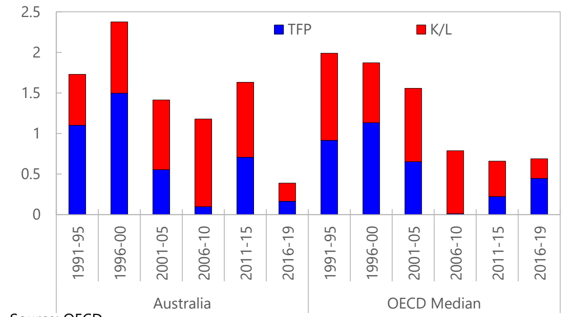


[1] See Review of the Debt Sustainability Framework for Market Access Countries, IMF Policy Paper 2021/003.

Box 8. Australia's Productivity Slowdown[1]

Productivity growth in Australia has slowed. Most advanced economies witnessed a decline in labor productivity growth after the Global Financial Crisis. While Australia initially avoided a slowdown, in part due to the mining boom, productivity growth has weakened significantly in recent years and has fallen below the OECD median. Lower total factor productivity growth and a smaller contribution from capital deepening (as investment rates have fallen) have contributed to the decline in productivity growth. The slowdown has been broad-based, with productivity growth in many sectors decreasing.

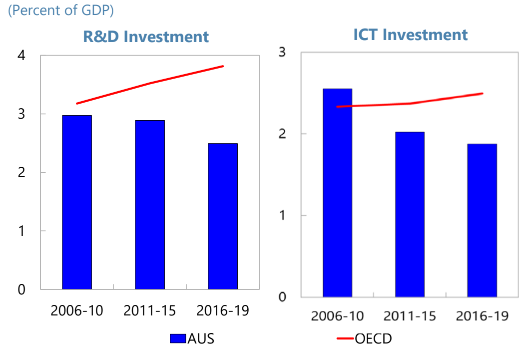
Labor Productivity Growth in Australia Has Slowed
(Percent)



Source: OECD.
Note: Chart shows the contribution of total factor productivity (TFP) growth and increase in the capital to labor ratio (K/L) in explaining the growth of labor productivity.

Productivity-enhancing investments, especially in R&D and information and communication technologies (ICT), have declined. Investments in R&D declined from about 3 percent of GDP in 2010 to less than 2.5 percent of GDP in 2019, falling below the OECD median. While R&D expenditure by universities has been maintained and remains comparable to that of peers, lower spending by businesses and the government drove the decline. Some broader measures of innovation however, such as the share of firms undertaking innovative activities, have performed better. Investment in ICT has also fallen below the OECD median. Empirical analysis using cross-country industry level data suggests that R&D and ICT investment are especially beneficial for productivity growth, and that closing the gap between Australia and the OECD median in these investment categories can be associated with an increase in productivity growth of about 0.05 to 0.1 percentage point in the medium-term.

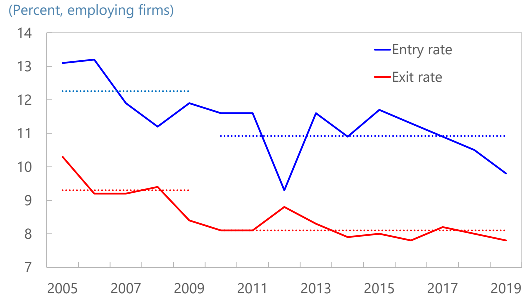
R&D and ICT Investment Rates Have Declined
(Percent of GDP)



Source: OECD.

Measures of competition have also weakened in Australia, broadly in line with global trends. Estimates of markups and market concentrations have trended upwards in recent years, and the rates of firm entry and exit remain below pre-GFC levels. Other de-jure measures of product market regulation also suggest scope for reducing the administrative burden for start-ups and simplifying regulatory procedures, thereby supporting better resource allocation and productivity growth.

Firm Entry and Exit Rates Have Declined
(Percent, employing firms)



Source: ABS.
Notes: Dotted lines show the average entry and exit rate for the period 2005 to 2009 and 2010 to 2019.

A number of other factors could also be contributing to the weak productivity performance. In addition to spillovers from weak global productivity growth, financial constraints for SMEs has been a long-standing concern, potentially preventing productive firms from growing. Infrastructure gaps have also been large, though the recent step up in public spending should help close the gap. Given the growing share of non-market services (for example, health care, education), enhancing their productivities will be essential.

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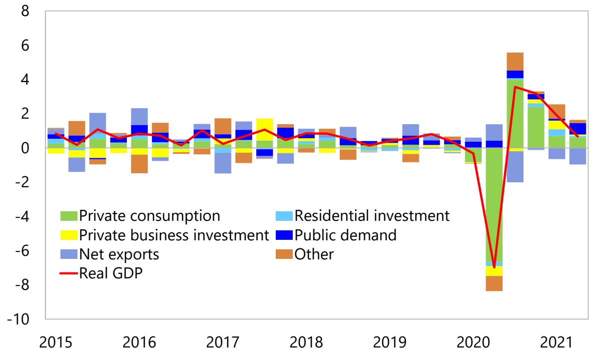
[1] Based on an accompanying Selected Issues Paper by Y. Kido and S. Kothari, "Reigniting Productivity Growth in Australia."

Figure 2. The Australian Economy Has Been Facing Headwinds After a Strong Recovery

The economy had rebounded strongly after the lockdown in 2020Q2…

GDP Growth Decomposition

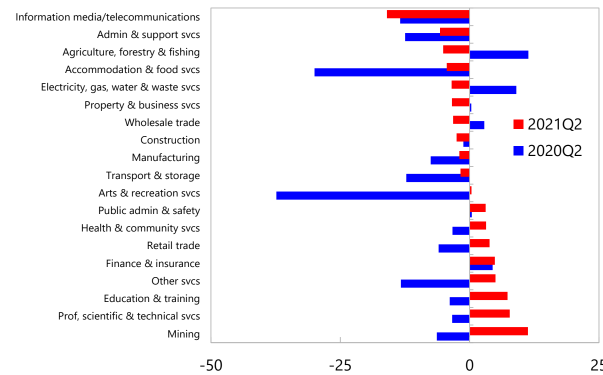
(Contributions to q/q growth, %)



…with a recovery in severely affected services

Employment by Industry

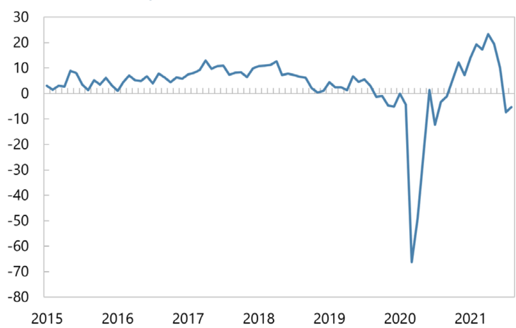
(In thousand persons, seasonally adjusted, % change from 2019Q4)



But renewed outbreaks likely led to a sizeble economic contraction in 2021Q3…

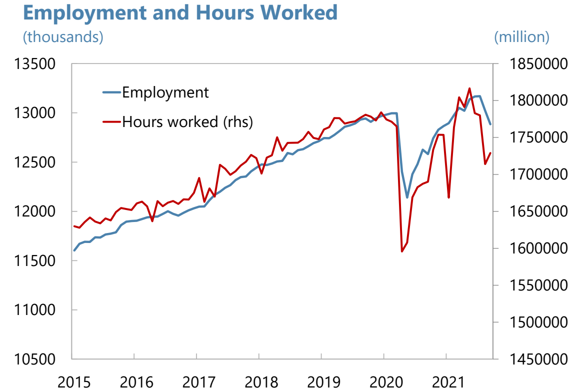
Business Confidence

(NAB Business Survey, net balance)



…with adverse impacts on labor market.

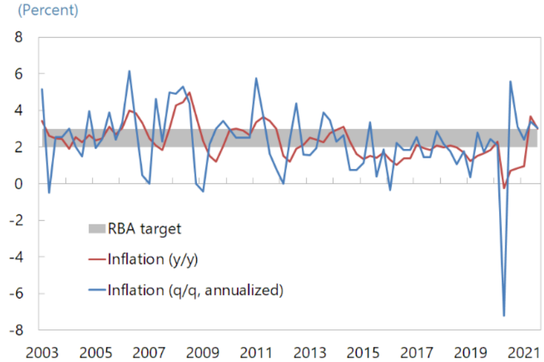
Employment and Hours Worked



Inflation has been volatile and pushed to above the RBA target range due to base effects and supply disruptions.

Inflation

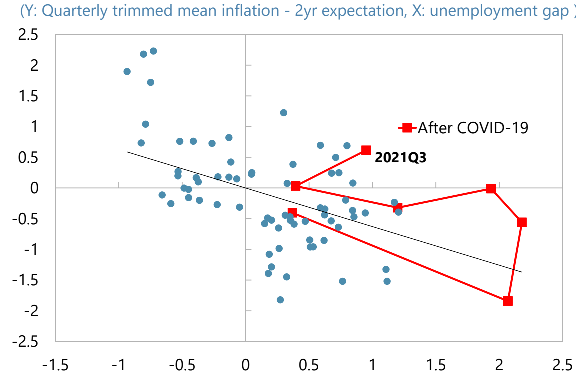
(Percent)



Underlying inflation has reached above what labor market slack would predict.

Phillips curve: trimmed mean inflation and slack 1/

(Y: Quarterly trimmed mean inflation - 2yr expectation, X: unemployment gap)



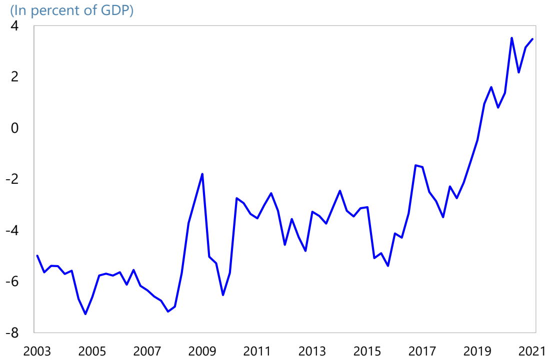
Sources: ABS; Haver Analytics; RBA; and IMF staff calculations.

1/ Unemployment gap is defined as actual unemployment less NAIRU. For 2021Q3, the decline in the participation rate is controlled for.

Figure 3. Temporary Factors and Terms-of-Trade Drive Current Account to Record High

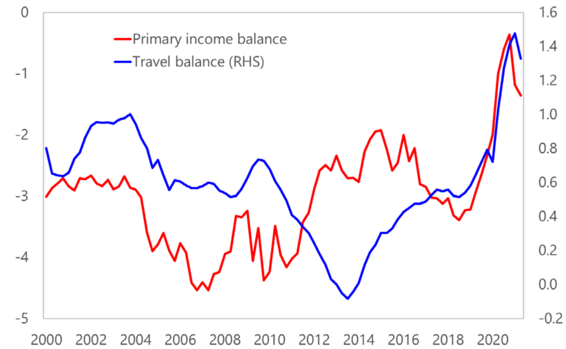
The current account has moved to a record surplus, driven in large part by temporary factors related to COVID-19…

Current Account Balance
(In percent of GDP)



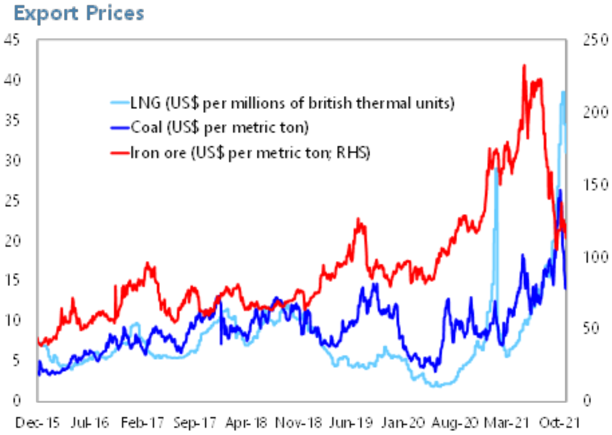
…including a surge in the primary income and travel balances…

Primary Income and Travel Balance
(In percent of GDP)



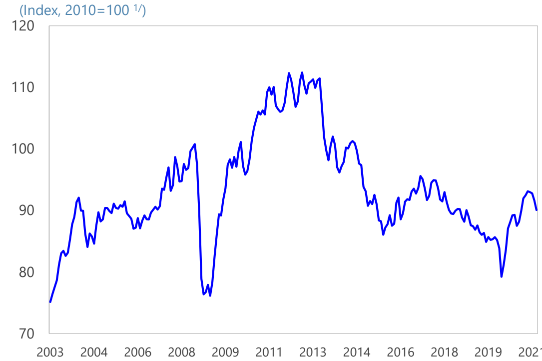
…and a recent spike in prices of Australia's main commodity exports…

Export Prices



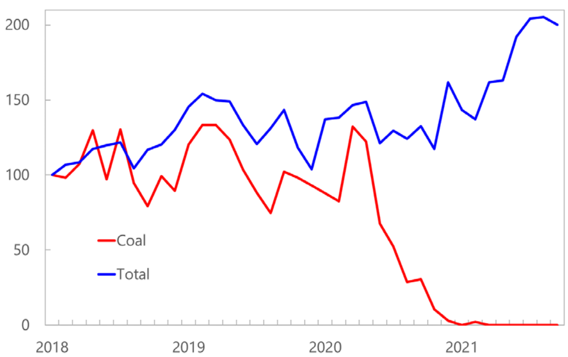
…which, along with the quick recovery, has supported the exchange rate.

Nominal Effective Exchange Rate
(Index, 2010=100 [1/])



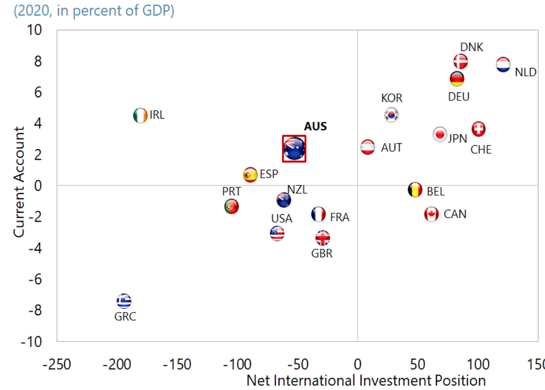
Overall exports to China remain resilient despite the imposition of restrictions in some sectors

Exports to China
(Index; July 2018=100)



The net external liability position remains high compared to peers.

External Position in Comparison
(2020, in percent of GDP)



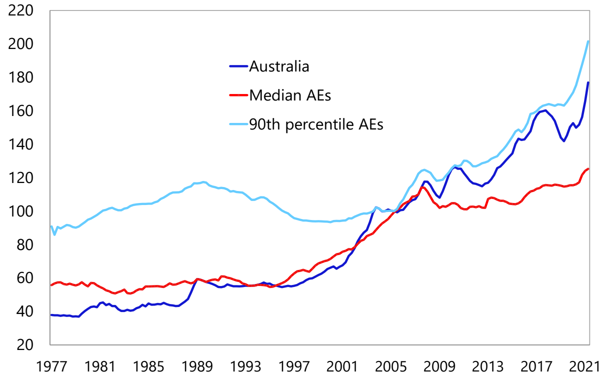
Sources: Australia's Merchandise Exports and Imports; Haver Analytics; IMF, World Economic Outlook; and IMF staff calculations.

[1/] An increase indicates an appreciation of the Australian Dollar.

Figure 4. The Housing Market is Booming

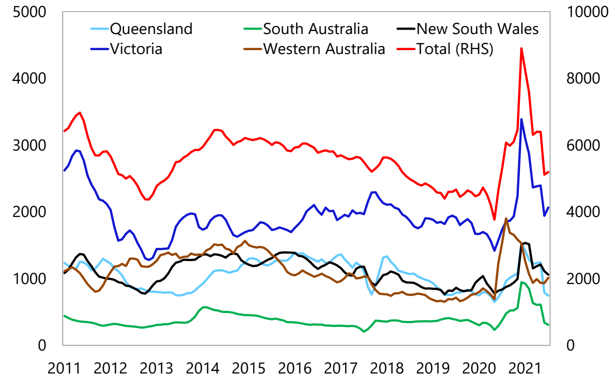
Housing prices have increased rapidly following the previous market downturn.

Real House Prices
(2005=100)



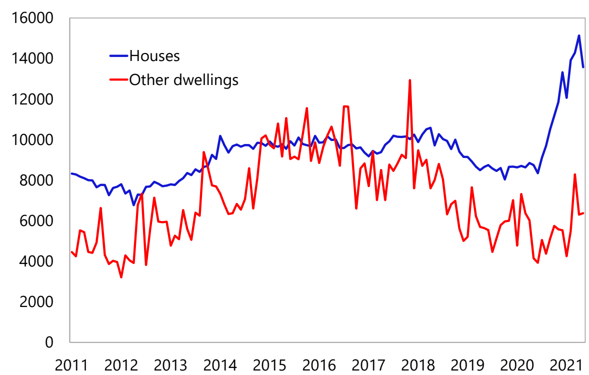
Housing sales surged, then retreated in recent months amid lockdowns.

New Home Sales
(Detached houses units, SA, 3-month moving average)



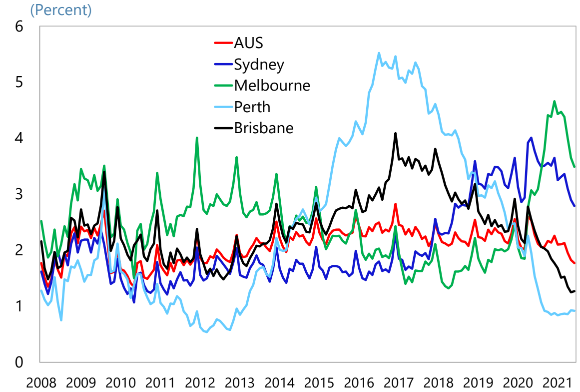
Building approvals for houses surged in comparison to apartments, reflecting shifts in household preference since the pandemic.

Dwellings Approval
(Units, sa)



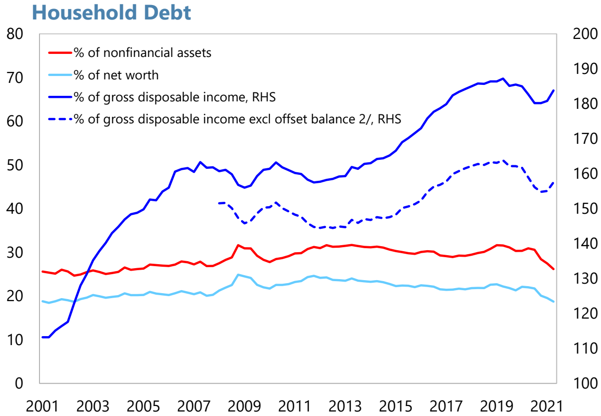
The rental market is improving, while the vacancy rate remains elevated in Melbourne.

Residential Rental Vacancies
(Percent)



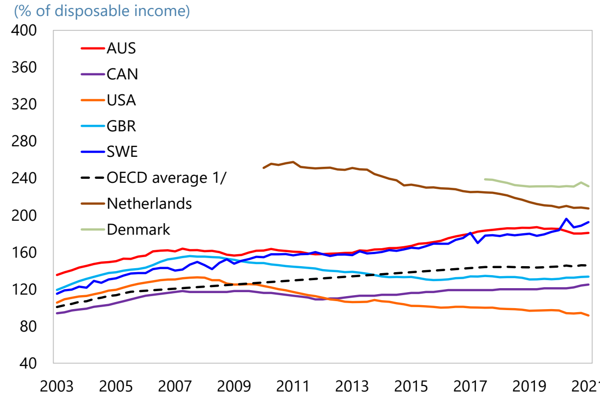
The household leverage ratio declined in 2020, but started to pick up recently…

Household Debt



…and continues to be among the highest in OECD countries.

Household Debt
(% of disposable income)

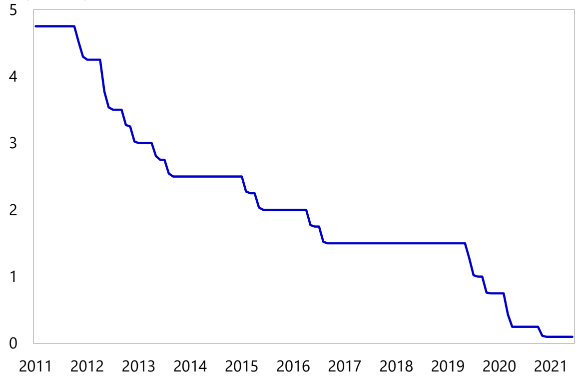


Sources: OECD, RBA, Haver Analytics, and IMF staff estimates.
1/ Based on a limited number of countries due to the lack of data.
2/ Offset accounts are deposit accounts that are linked to mortgage loans such that funds deposited into an offset account effectively reduce the borrower's net debt position and the interest payable on the mortgage.

Figure 5. Monetary Policy Eased Substantially

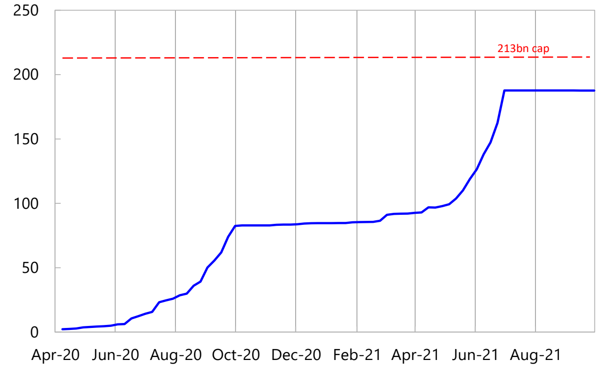
In response to the pandemic, the RBA cut the cash rate target to 0.1 percent…

Policy Rate
(In percent per annum)



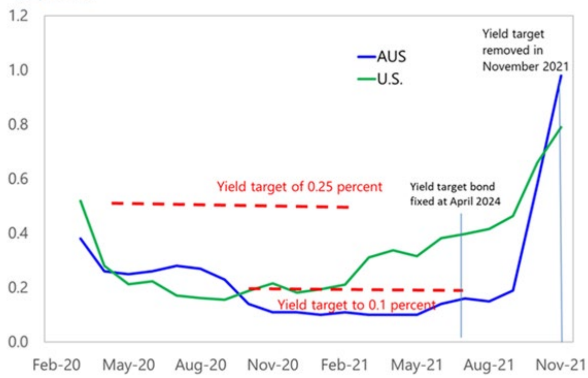
…and offered up to A$213bn low-interest term funding to banks, with A$188 bn drawdowns.

Term Funding Facility
(A$ billion, cumulative)



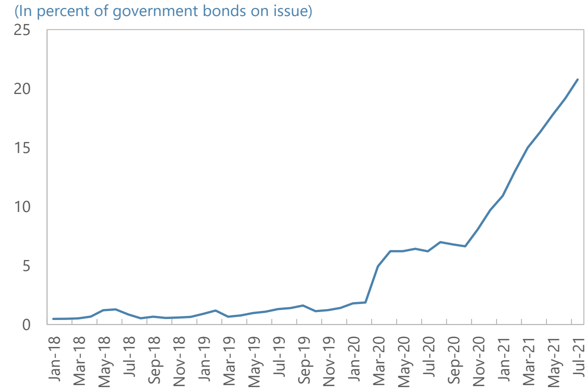
The yield target insulated 3-year government yields from global developments until the fixing of the target bond, and the yield target was lifted in November 2021

3-year Government Yields
(In percent)



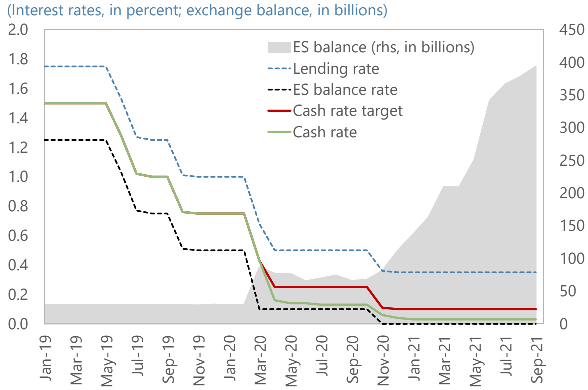
The RBA holdings of government bonds surged, reflecting the yield target and large-scale asset purchase program.

RBA Government Bond Holdings
(In percent of government bonds on issue)



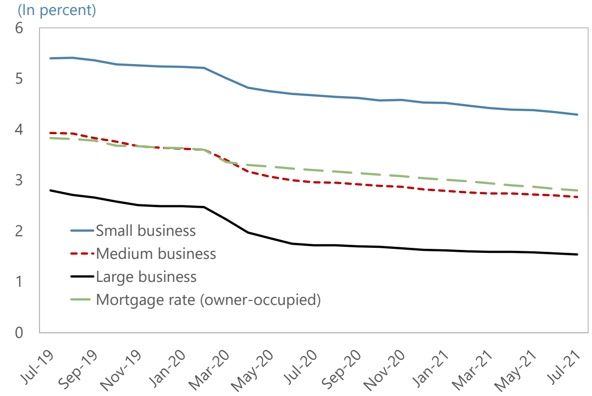
The cash rate is close to zero amid ample liquidity in the financial system…

Overnight Interest Rates and Exchange Settlement Balance
(Interest rates, in percent; exchange balance, in billions)



… and borrowing costs of households and businesses fell significantly.

Lending Rates
(In percent)

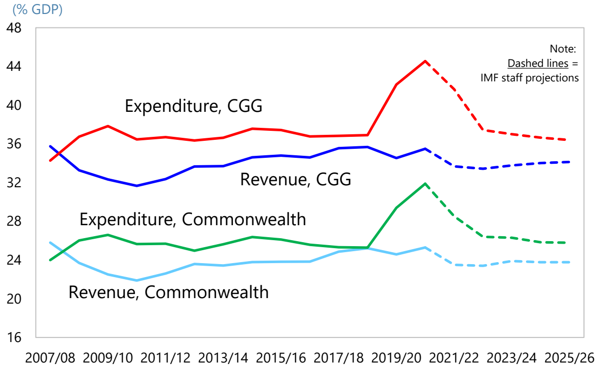


Sources: Reserve Bank of Australia; Haver Analytics; and IMF staff estimates.

Figure 6. Public Sector Balance Sheet Remains Resilient Despite Unprecedented Stimulus

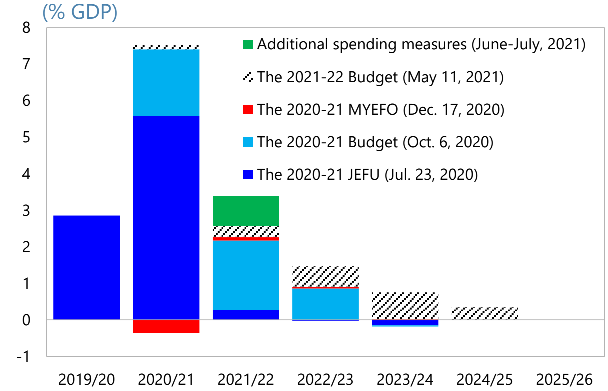
Significant increases in expenditure have been driven by the Commonwealth Government…

Consolidated General Government (CGG) and Commonwealth Government Revenue and Expenditure
(% GDP)



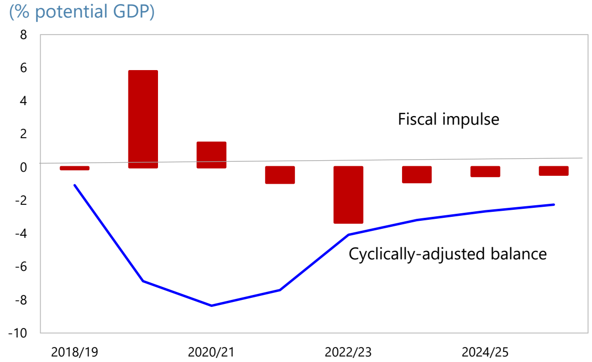
…and its budgets continue to add stimulus measures to support the recovery.

Economic and Health Measures 1/
(% GDP)



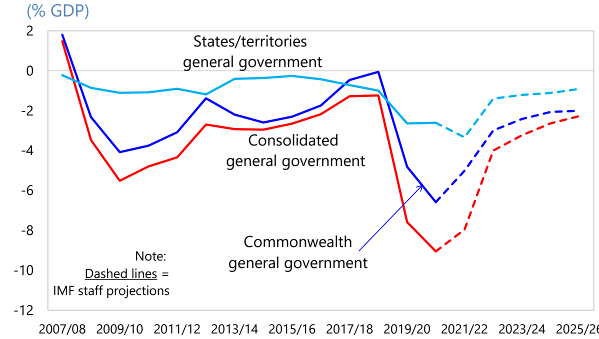
Stimulus was front-loaded, and nearly two thirds have been already withdrawn…

Cyclically-adjusted Balance and Fiscal Impulse
(% potential GDP)



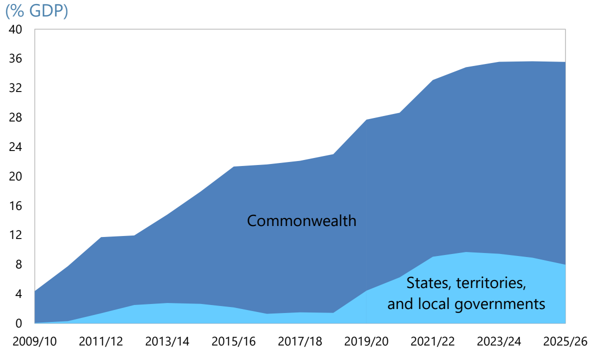
…and the deficit is projected to gradually decline over the medium term.

Fiscal Balances
(% GDP)



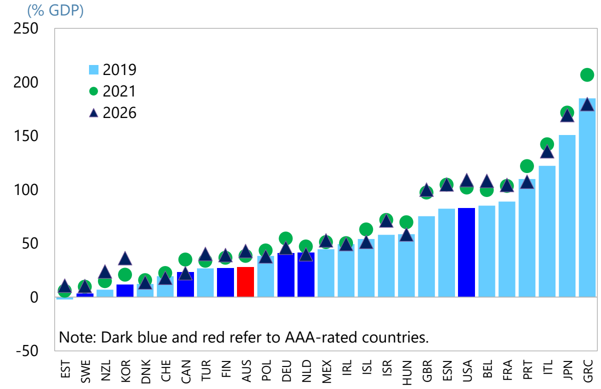
Net public debt is projected to incrase but stabilize over the medium term…

Net Public Debt
(% GDP)



…and its peak remains low, compared to other advanced economies.

Net Public Debt
(% GDP)



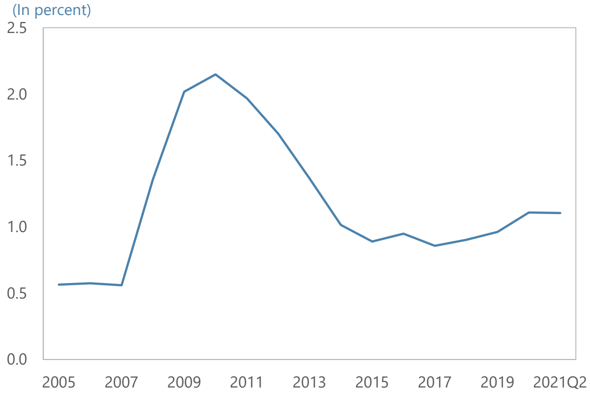
Sources: Commonwealth and state/territory Treasuries, the 2021-22 budgets; IMF, *World Economic Outlook*; and IMF staff estimates and projections.

1/ Based on the 2020-21 July Economic and Fiscal Update (JEFU), the 2020-21 Mid-Year Economic and Fiscal Outlook (MYEFO), and the 2020-21 and 2021-22 budgets.

Figure 7. The Banking Sector Remains Strong

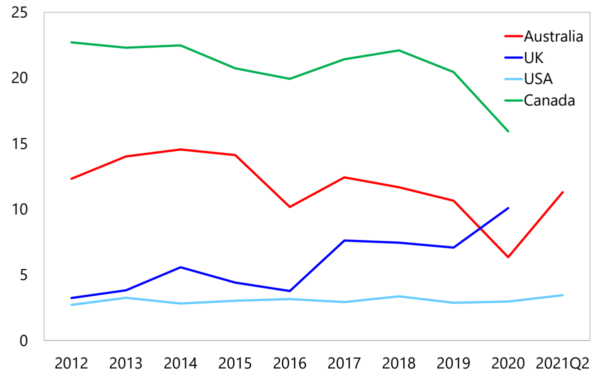
The NPL ratio increased less then expected during the pandemic…

The NPL Ratio Rose Modestly
(In percent)



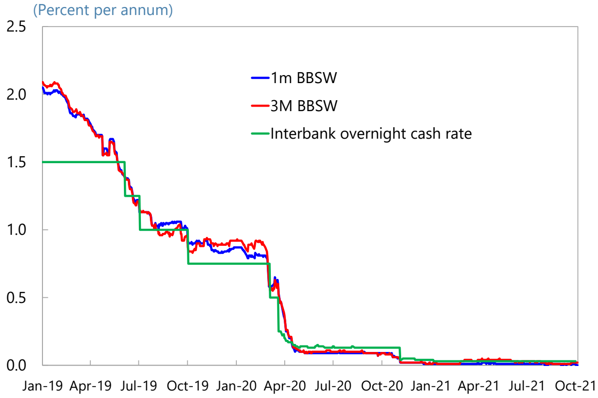
…and bank profitability is recovering.

Return on Equity
(In percent)



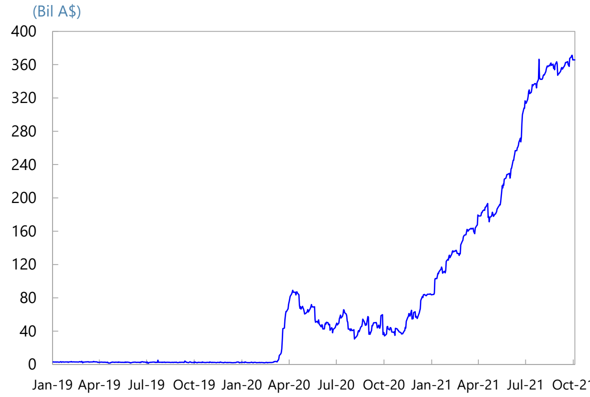
Shoter-term wholesale funding rates are close to zero…

Bank Bill Swap Rates
(Percent per annum)



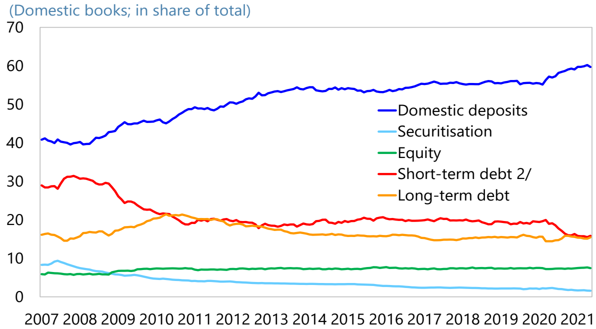
…with ample liquidity reflected also in banks' surging account balances at the RBA.

Exchange Settlement Balances
(Bil A$)



Funding risks have declined with rising bank deposits and the term funding facility provided by the RBA.

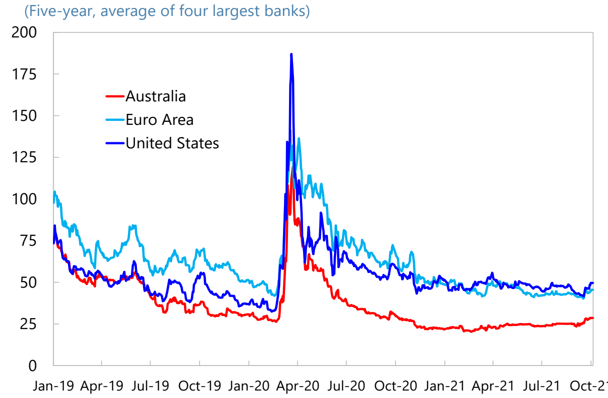
Banks' Funding 1/
(Domestic books; in share of total)



Source: Reserve Bank of Australia.
1/ Adjusted for movements in foreign exchange rates.
2/ Includes deposits and intragroup funding from non-residents.

Market-perceived bank default risks are back to the pre-COVID level.

Credit Default Swap (CDS) Spreads
(Five-year, average of four largest banks)

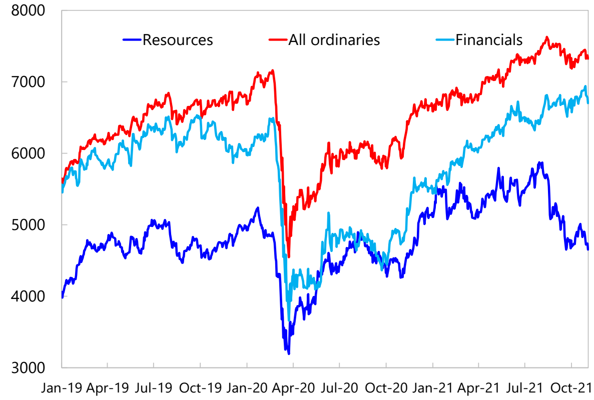


Sources: Bloomberg and IMF staff calculations.

Figure 8. Financial Market: Low Yields and Rising Equities

Australian equity prices rebounded strongly after the initial sharp drop in the pandemic, while retreating recently.

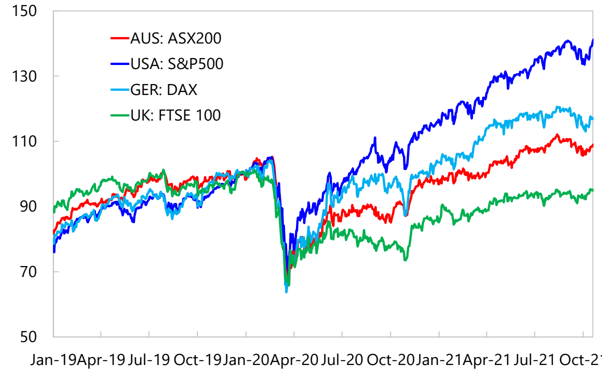
Australia: Stock Market Indices



The stock market boom was less pronouced compared to other advanced economies.

Advanced Economies: Stock Market Indices

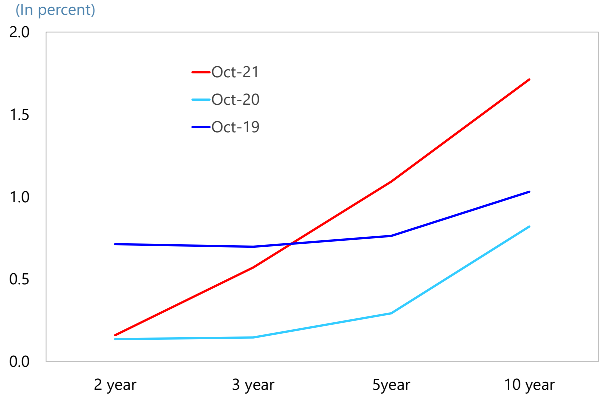
(End-2019=100)



Shorter-term government bond yields remain low ...

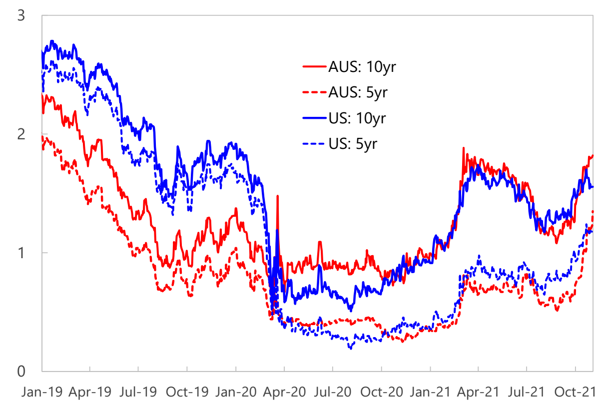
Australia Commonwealth Yield Curves

(In percent)



...while longer-term yields have moved up in line with global developments.

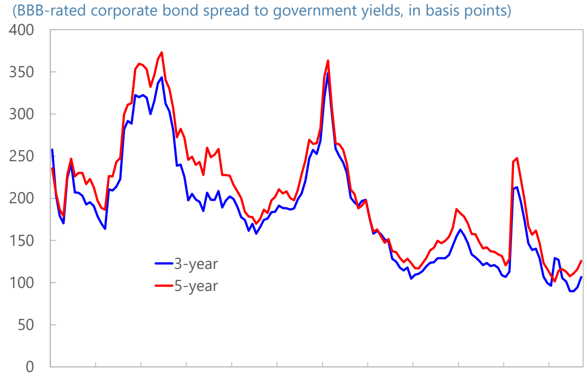
Government Bond Yields



Corporate bond speads fell.

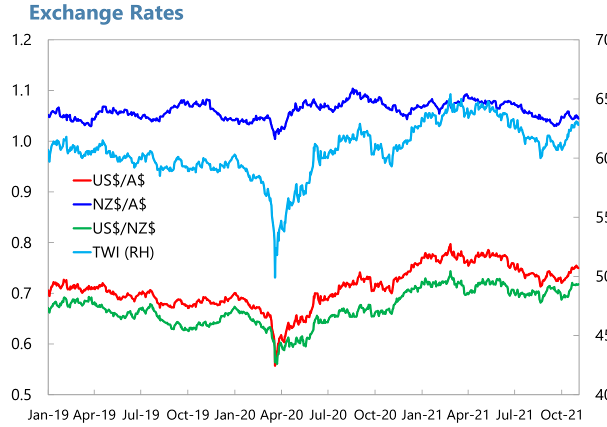
Non-Financial Corporate Bond Spreads Fell

(BBB-rated corporate bond spread to government yields, in basis points)



The exchange rate weakened recently, following the surge in the early pandemic.

Exchange Rates



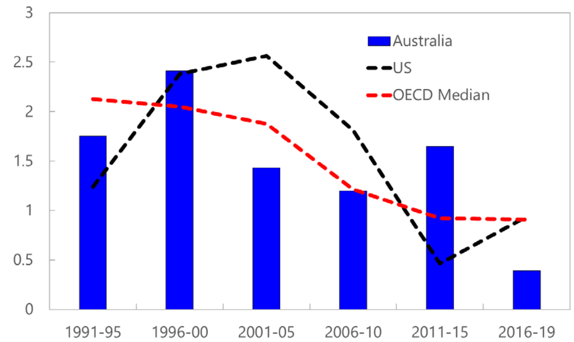
Sources: Reserve Bank of Australia, Bloomberg, and IMF staff calculations.

Figure 9. Australia's Macro-Structural Position Highlights Issues Predating the Pandemic

After an extended period of steady performance, labor productivity growth in Australia has slowed significantly…

Labor Productivity Growth

(percent)

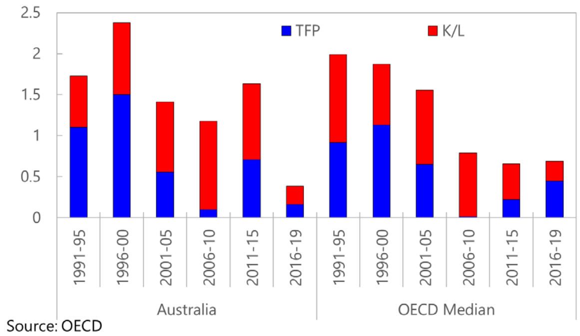


Source: OECD

…driven by lower TFP growth as well as a smaller contribution from capital deepening.

Labor Productivity Growth, Role of TFP & Capital Deepening

(percent)

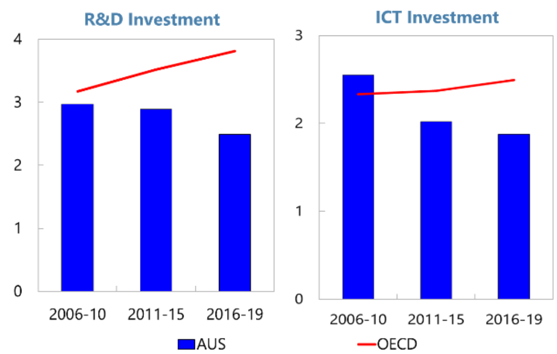


Source: OECD
Note: Chart shows the contribution of total factor productivity (TFP) growth and increase in the capital to labor ratio (K/L) in explaining the growth of labor productivity.

R&D and ICT investment declined, potentially contributing to the productivity slowdown,…

R&D and ICT Investment

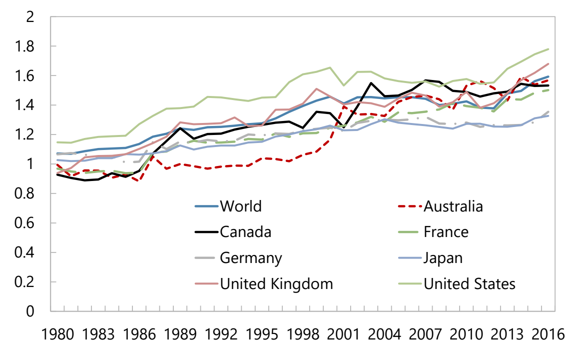
(percent of GDP)



Sources: OECD

…and measures of competition, such as markups, have also deteriorated.

Markup trends

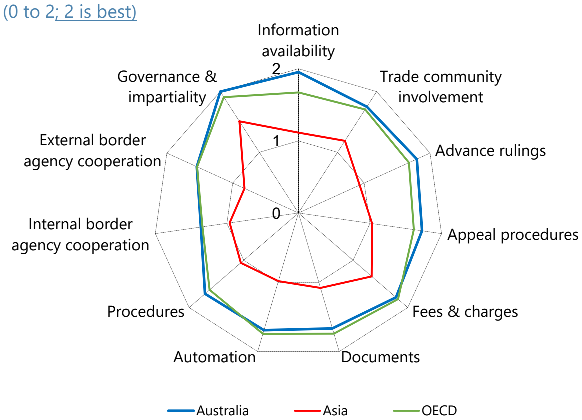


Sources: De Loecker 2020

That said, Australia's trade environment remains open and conducive to growth.

Ease of Conducting Trade

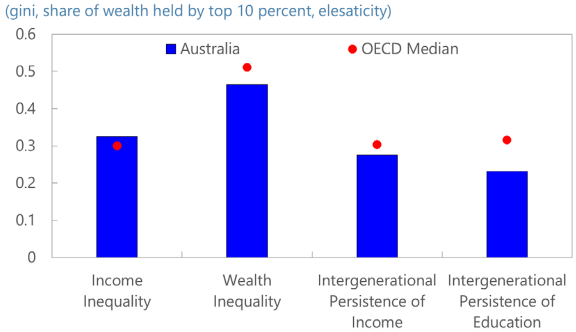
(0 to 2; 2 is best)



While income inequality is relatively high, wealth inequality and inequality of opportunity are below those of peers

Measures of Inequality

(gini, share of wealth held by top 10 percent, elesaticity)



Sources: OECD; Global Database on Intergenerational Mobility
Notes: Income inequality: gini coefficient; wealth inequality: share of wealth held by top 10 percent; intergeneration persistence: coefficient of regressions of parents outcome on childrens outcomes.

Sources: OECD Stat; De Locker and Eackout (2020); OECD Trade Facilitation Indicators; Global Database on Intergenerational Mobility.

Table 1. Australia: Main Economic Indicators, 2016-2026

(Annual percentage change, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
							Projections				
NATIONAL ACCOUNTS											
Real GDP	2.7	2.4	2.8	1.9	-2.4	3.5	4.1	2.6	2.6	2.6	2.6
Domestic demand	1.8	3.0	2.7	1.2	-2.6	4.5	4.7	2.9	2.7	2.7	2.7
Private consumption	2.7	2.4	2.5	1.2	-5.8	3.3	6.3	4.5	3.9	3.5	3.3
Public consumption	5.1	3.9	4.2	5.8	7.1	2.7	-0.8	-1.5	-0.2	0.3	0.4
Investment	-2.4	3.6	2.2	-2.5	-3.0	9.4	6.6	2.9	2.5	3.1	3.0
Public	13.9	10.8	3.1	3.1	1.2	10.3	5.8	-0.7	-1.2	0.1	0.5
Private business	-11.9	4.0	2.2	-1.1	-5.3	4.8	7.4	4.8	4.5	4.7	4.3
Dwelling	8.0	-2.1	4.3	-7.1	-5.3	11.2	5.4	2.8	2.2	2.9	2.8
Net exports (contribution to growth, percentage points)	1.5	-0.8	0.3	1.0	0.4	-1.5	-0.5	-0.3	-0.1	-0.1	-0.1
Gross domestic income	2.7	4.9	3.3	3.3	-2.5	7.7	2.9	2.6	2.5	2.5	2.5
Investment (percent of GDP) 1/	24.6	24.3	24.1	22.5	22.3	23.2	24.0	24.0	23.9	24.0	24.0
Public	4.8	5.1	5.1	5.2	5.3	5.5	5.7	5.5	5.3	5.1	5.0
Private	19.7	19.1	18.9	17.5	17.1	17.6	18.3	18.5	18.6	18.8	19.0
Savings (gross, percent of GDP)	20.8	22.0	21.9	23.3	24.6	26.8	25.4	24.5	23.8	23.6	23.5
Households	9.9	9.2	8.6	8.9	15.9	13.6	11.8	10.3	9.7	9.4	8.9
Non-financial corporations	9.6	10.2	9.9	11.2	17.0	13.9	14.5	14.5	14.3	14.4	14.6
S-I balance (percent of GDP)											
Households	0.6	0.2	-0.1	1.3	8.3	5.4	3.3	1.8	1.2	0.8	0.4
Non-financial corporations	-1.6	-0.6	-0.9	0.9	7.2	3.5	3.6	3.6	3.4	3.5	3.7
Potential output	2.4	2.3	2.4	2.3	1.3	1.4	1.8	2.6	2.6	2.6	2.6
Output gap (percent of potential)	-0.9	-0.8	-0.4	-0.7	-4.3	-2.3	0.0	0.0	0.0	0.0	0.0
LABOR MARKET											
Employment	1.8	2.3	2.7	2.3	-1.5	2.9	1.5	1.4	1.4	1.8	1.7
Unemployment (percent of labor force)	5.7	5.6	5.3	5.2	6.5	5.2	4.8	4.7	4.7	4.7	4.7
Wages (nominal percent change)	1.9	1.8	2.1	2.3	1.6	2.0	2.5	2.7	3.0	3.1	3.1
PRICES											
Terms of trade index (goods, avg)	80	92	95	104	103	123	115	114	114	113	113
% change	-0.5	14.5	3.1	9.1	-0.3	18.7	-6.3	-0.4	-0.5	-0.5	-0.3
Iron ore prices (index)	85	103	101	135	156	247	195	195	195	195	195
Coal prices (index)	66	89	107	78	59	129	125	107	105	105	104
LNG prices (index)	85	83	112	62	50	156	145	105	105	105	105
Crude prices (Brent; index)	69	85	112	101	66	105	104	99	96	93	92
Consumer prices (avg)	1.3	2.0	1.9	1.6	0.9	2.6	2.3	2.2	2.4	2.4	2.4
Core consumer prices (avg)	1.7	1.6	1.6	1.6	1.2	2.7	2.1	2.2	2.4	2.4	2.4
GDP deflator (avg)	1.0	3.6	2.2	3.4	0.7	5.0	1.1	2.0	2.1	2.2	2.2
FINANCIAL											
Reserve Bank of Australia cash rate (percent, avg)	1.7	1.5	1.5	1.2	0.3	0.1	0.1	0.5	1.0	1.7	2.5
10-year treasury bond yield (percent, avg)	2.3	2.6	2.6	1.4	0.9	1.5	1.9	2.5	2.8	3.0	3.0
Mortgage lending rate (percent, avg)	5.4	5.2	5.3	4.8	4.5	4.5	4.7	5.0	5.6	6.1	6.3
MACRO-FINANCIAL											
Credit to the private sector	5.6	5.2	4.7	2.5	2.1	7.0	5.0	3.9	3.1	3.1	3.0
House price index (eop)	141	148	140	144	149	178	189	197	202	205	208
% change	7.7	5.0	-5.1	2.5	3.6	19.8	6.2	4.1	2.5	1.6	1.5
House price-to-income, capital cities (ratio)	4.7	4.7	4.4	4.3	4.2	4.9	4.9	4.9	4.8	4.6	4.5
Interest payments (percent of disposable income)	8.7	8.8	8.9	7.0	5.8	5.6	6.0	6.5	7.4	8.1	8.1
Household savings (percent of disposable income)	5.1	4.3	3.6	4.4	13.8	11.8	9.0	6.7	5.8	5.2	4.6
Household debt (percent of disposable income) 2/	179	184	186	186	180	187	188	186	181	176	171
Business credit (percent of GDP)	51.5	50.1	50.3	48.9	50.2	48.1	47.8	47.8	47.7	47.9	48.0
GENERAL GOVERNMENT (percent of GDP) 3/											
Revenue	34.8	34.6	35.6	35.7	34.5	35.5	33.7	33.4	33.8	34.0	34.1
Expenditure	37.4	36.8	36.8	36.9	42.1	44.5	41.6	37.4	37.0	36.6	36.4
Net lending/borrowing	-2.6	-2.2	-1.3	-1.2	-7.6	-9.1	-8.0	-4.0	-3.2	-2.6	-2.3
Commonwealth only	-2.3	-1.7	-0.5	-0.1	-4.8	-6.6	-5.0	-3.0	-2.4	-2.1	-2.0
Operating balance	-1.4	-0.8	0.5	0.9	-5.4	-6.8	-5.5	-1.7	-1.1	-0.5	-0.2
Cyclically adjusted balance	-2.4	-2.0	-1.2	-1.1	-6.9	-8.3	-7.4	-4.1	-3.2	-2.7	-2.3
Gross debt	39.5	41.0	41.2	42.0	52.7	59.4	66.4	67.2	67.3	66.4	65.1
Net debt	23.5	22.9	23.6	24.4	32.1	34.9	42.2	44.5	45.0	44.6	43.5
Net worth	46.0	50.2	49.9	41.0	34.6	26.7	27.2	24.3	24.7	24.5	23.6
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.3	-2.6	-2.1	0.7	2.7	3.8	1.4	0.5	-0.1	-0.3	-0.5
Export volume	6.9	3.4	5.1	3.4	-10.1	-1.0	5.5	7.6	3.8	2.1	2.0
Import volume	0.1	7.9	4.0	-0.9	-13.4	6.8	8.3	9.6	4.6	2.7	2.5
Net international investment position (percent of GDP)	-57.7	-55.5	-54.2	-47.3	-49.9	-39.4	-36.1	-34.0	-32.5	-31.3	-30.4
Gross official reserves (bn A$)	74	85	76	84	56	...	...	...	...	...	
MEMORANDUM ITEMS											
Nominal GDP (bn A$)	1,702	1,807	1,900	2,002	1,969	2,141	2,253	2,357	2,469	2,589	2,716
Percent change	3.7	6.1	5.2	5.4	-1.7	8.7	5.2	4.6	4.8	4.9	4.9
Real GDP per capita (% change)	1.1	0.7	1.3	0.4	-3.3	3.4	3.8	1.7	1.3	1.3	1.4
Population (million)	24.4	24.8	25.2	25.6	25.7	25.7	25.8	26.1	26.4	26.8	27.1
Nominal effective exchange rate	90.9	93.6	90.0	86.3	86.0	...	...	...	...	...	...
Real effective exchange rate	90.9	93.7	89.9	86.0	85.4	...	...	...	...	...	...

Sources: Authorities' data; IMF *World Economic Outlook* database; and IMF staff estimates and projections.

1/ Includes changes in inventories.

2/ Reflects the national accounts measure of household debt, including to the financial sector, state and federal governments and foreign overseas banks and governments. It also includes other accounts payable to these sectors and a range of other smaller entities including pension funds.

3/ Fiscal year ending June.

Table 2. Australia: Fiscal Accounts, 2015/16-2025/26
(In percent of GDP, unless otherwise indicated)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
						Est.			Projections		
CONSOLIDATED GENERAL GOVERNMENT OPERATIONS 1/											
Revenue	**34.8**	**34.6**	**35.6**	**35.7**	**34.5**	**35.5**	**33.7**	**33.4**	**33.8**	**34.0**	**34.1**
Tax revenue	27.9	27.6	28.6	28.7	27.8	28.7	27.1	27.3	27.6	27.8	27.9
Direct taxes	20.2	20.2	21.1	21.4	20.5	21.1	19.6	19.7	20.1	20.2	20.3
Individual and withholding	14.5	14.2	14.4	14.5	14.4	14.3	13.1	13.3	13.7	13.7	13.8
Corporate	5.7	5.9	6.7	6.8	6.1	6.7	6.5	6.4	6.4	6.5	6.5
Indirect taxes	7.7	7.5	7.5	7.3	7.3	7.6	7.5	7.5	7.6	7.6	7.6
Of which: GST	3.6	3.5	3.5	3.3	3.2	3.6	3.4	3.4	3.4	3.4	3.4
Non-tax revenue	6.9	7.0	6.9	7.0	6.7	6.8	6.6	6.1	6.1	6.2	6.2
Expenditure	**37.4**	**36.8**	**36.8**	**36.9**	**42.1**	**44.5**	**41.6**	**37.4**	**37.0**	**36.6**	**36.4**
Expense	36.1	35.4	35.0	34.8	39.9	42.3	39.2	35.1	34.8	34.5	34.3
Employee expenses	8.7	8.5	8.5	8.5	8.9	8.5	8.2	7.9	7.7	7.7	7.7
Other operating expenses (excl. depreciation)	10.1	10.3	10.5	10.8	11.6	12.2	12.6	11.5	11.2	10.9	10.6
Transfers	12.0	11.4	11.0	10.6	14.4	16.4	13.0	10.1	10.1	10.1	10.1
Interest (excl. superannuation)	1.5	1.4	1.4	1.3	1.3	1.4	1.4	1.7	1.9	1.9	1.9
Other	3.9	3.8	3.7	3.6	3.7	3.9	4.0	4.0	4.0	3.9	3.9
Net acquisition of nonfinancial assets	1.3	1.4	1.8	2.1	2.2	2.2	2.5	2.3	2.2	2.1	2.1
Of which: Gross fixed capital formation	2.9	3.3	3.5	3.7	3.7	4.0	4.6	4.4	4.3	4.1	4.1
Operating balance	-1.4	-0.8	0.5	0.9	-5.4	-6.8	-5.5	-1.7	-1.1	-0.5	-0.2
Primary balance	-1.2	-0.8	0.1	0.1	-6.3	-7.7	-6.6	-2.3	-1.4	-0.7	-0.3
Net lending (+)/borrowing (-)	**-2.6**	**-2.2**	**-1.3**	**-1.2**	**-7.6**	**-9.1**	**-8.0**	**-4.0**	**-3.2**	**-2.6**	**-2.3**
CONSOLIDATED GENERAL GOVERNMENT BALANCE SHEET											
Liabilities	**78.4**	**74.6**	**75.7**	**82.7**	**95.6**	**99.9**	**96.8**	**95.9**	**94.8**	**92.9**	**91.4**
Gross debt	39.5	41.0	41.2	42.0	52.7	59.4	66.4	67.2	67.3	66.4	65.1
Commonwealth	30.4	32.3	32.3	33.2	40.7	44.7	48.5	49.0	49.5	49.1	48.9
States, territories and local governments	9.1	8.7	8.8	8.8	11.9	14.7	17.9	18.1	17.9	17.3	16.2
Other liabilities	38.9	33.6	34.5	40.7	42.9	40.4	30.4	28.7	27.4	26.5	26.3
Assets	**124.4**	**124.8**	**125.6**	**123.7**	**130.2**	**126.6**	**124.0**	**120.2**	**119.5**	**117.4**	**115.0**
Financial assets	50.0	51.8	52.3	51.1	54.8	51.9	50.7	48.8	48.8	48.0	46.7
Other assets	74.4	72.9	73.3	72.7	75.5	74.7	73.3	71.4	70.7	69.4	68.4
Net financial worth	**-28.4**	**-22.8**	**-23.4**	**-31.7**	**-40.9**	**-48.0**	**-46.1**	**-47.1**	**-46.0**	**-44.8**	**-44.7**
Net debt	**23.5**	**22.9**	**23.6**	**24.4**	**32.1**	**34.9**	**42.2**	**44.5**	**45.0**	**44.6**	**43.5**
Commonwealth 2/	21.3	21.6	22.1	23.0	27.7	28.6	33.1	34.8	35.6	35.7	35.6
States, territories and local governments	2.2	1.3	1.5	1.4	4.4	6.2	9.1	9.7	9.5	8.9	8.0
Net worth	**46.0**	**50.2**	**49.9**	**41.0**	**34.6**	**26.7**	**27.2**	**24.3**	**24.7**	**24.5**	**23.6**
Commonwealth	-25.1	-22.6	-23.1	-28.4	-33.7	-35.1	-30.8	-31.9	-32.0	-32.1	-32.3
States, territories and local governments	71.1	72.8	73.0	69.4	68.2	61.8	57.9	56.2	56.7	56.7	55.9
MEMORANDUM ITEMS											
Cyclically adjusted balance (in percent of potential GDP)	-2.4	-2.0	-1.2	-1.1	-6.9	-8.3	-7.4	-4.1	-3.2	-2.7	-2.3
Fiscal impulse (change in CAB; in percent of potential GDP)	-0.2	-0.5	-0.8	-0.1	5.8	1.5	-0.9	-3.3	-0.9	-0.5	-0.4
Change in real revenue (percent)	2.5	3.8	5.7	4.3	-2.9	5.5	-2.6	3.0	2.7	3.3	2.5
Change in real primary expenditure (percent)	0.9	2.2	1.7	3.9	17.3	11.4	-8.5	-4.6	0.7	0.5	1.8
Commonwealth general government 3/											
Revenue	20.3	20.2	21.3	21.7	21.3	21.7	20.0	19.9	20.4	20.2	20.2
Expenditure	22.6	21.9	21.7	21.7	26.1	28.2	25.0	22.8	22.8	22.3	22.2
Net lending (+)/borrowing (-)	-2.3	-1.7	-0.5	-0.1	-4.8	-6.6	-5.0	-3.0	-2.4	-2.1	-2.0
States, territories and local governments 4/											
Revenue	14.0	13.8	13.8	13.4	12.7	12.9	13.2	13.1	13.1	13.3	13.4
Expenditure	14.1	14.0	14.3	14.4	15.3	15.5	16.3	14.2	13.9	13.9	13.8
Net lending (+)/borrowing (-)	-0.1	-0.2	-0.6	-1.0	-2.6	-2.6	-3.1	-1.1	-0.8	-0.5	-0.3
Commonwealth transfers to subnational governments	6.6	6.8	6.8	6.7	6.7	7.0	6.9	6.9	6.8	6.6	6.6
Of which: General revenue assistance	3.6	3.6	3.6	3.5	3.3	3.6	3.6	3.5	3.5	3.5	3.5
Nonfinancial public sector capital stock	103.2	99.8	100.4	98.4	101.5	105.1	104.0	102.3	102.0	100.5	99.4
GDP (in billion A$)	1,661	1,763	1,849	1,952	1,984	2,067	2,179	2,310	2,407	2,531	2,651

Sources: Authorities' data and IMF staff estimates and projections.

1/ Accrual basis; GFS. Comprises the Commonwealth, and state, territory, and local goverments.

2/ Includes Future Fund assets.

3/ Excludes general revenue assistance to states and territories from revenue and expenditure.

4/ Excludes Commonwealth payments for specific purposes from revenue and expenditure.

Table 3. Australia: Balance of Payments, 2016-2026

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Projections					
Current account	-3.3	-2.6	-2.1	0.7	2.7	3.8	1.4	0.5	-0.1	-0.3	-0.5
Balance on goods and services	-0.8	0.5	1.2	3.5	3.7	5.4	3.5	2.8	2.5	2.2	2.0
Exports of goods and services	19.8	21.5	23.1	24.8	22.1	23.6	22.7	23.0	22.8	22.3	21.9
Exports of goods	15.2	16.7	18.2	19.7	18.5	20.8	19.6	18.9	18.5	18.0	17.7
Of which: Resources	8.8	10.5	12.0	13.4	12.4	15.1	13.3	12.1	11.8	11.5	11.3
Exports of services	4.6	4.7	4.9	5.1	3.6	2.8	3.2	4.1	4.3	4.3	4.2
Imports of goods and service	20.6	20.9	21.9	21.2	18.3	18.2	19.3	20.1	20.3	20.1	19.8
Imports of goods	15.7	16.0	16.7	16.0	15.4	15.9	16.1	15.7	15.4	15.3	15.1
Imports of services	4.9	5.0	5.2	5.2	2.9	2.4	3.2	4.5	4.9	4.8	4.8
Primary income, net	-2.4	-3.0	-3.2	-2.8	-1.0	-1.5	-1.9	-2.1	-2.4	-2.4	-2.4
Interest payments	-1.2	-1.2	-1.3	-1.0	-0.7	-0.6	-0.8	-1.0	-1.2	-1.2	-1.2
Equity income	-0.8	-1.4	-1.5	-1.3	0.0	-0.7	-0.9	-0.8	-0.8	-0.8	-0.9
Secondary income, net	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Capital and financial account											
Capital account, net	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, net	3.0	2.8	2.1	-0.7	-2.3	-3.7	-1.4	-0.5	0.1	0.4	0.6
Direct investment	3.6	2.8	4.3	2.1	0.6	1.3	1.5	1.9	2.2	2.3	2.4
Equity	3.0	2.6	4.1	2.6	0.9	0.9	1.3	1.4	1.7	1.7	1.8
Debt	0.7	0.2	0.2	-0.5	-0.3	0.4	0.2	0.4	0.4	0.5	0.6
Portfolio investment	-2.5	1.7	-1.1	-2.3	-1.0	-3.1	-0.6	-0.6	-0.6	-0.9	-1.0
Equity	-0.4	-1.2	-3.1	-2.5	-1.2	-3.3	-1.4	-1.5	-1.6	-1.7	-1.8
Debt	-2.1	2.9	2.0	0.1	0.2	0.2	0.8	0.9	0.9	0.8	0.8
Financial derivatives	0.3	-1.1	-0.5	-0.3	-1.2	-0.4	-0.6	-0.5	-0.4	-0.3	-0.3
Other investment	2.2	0.1	-1.4	0.1	-1.9	-0.7	-1.6	-1.3	-1.0	-0.6	-0.5
Reserve assets	-0.6	-0.7	0.8	-0.2	1.3	-0.8	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	0.3	-0.2	0.0	0.2	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET											
Net international investment position 1/	-57.7	-55.5	-54.2	-47.3	-49.9	-39.4	-36.1	-34.0	-32.5	-31.3	-30.4
Equity, net	2.3	2.9	5.5	11.5	10.2	14.8	14.2	13.6	12.8	12.2	11.7
Assets	69.7	72.9	73.9	85.2	86.7	89.6	91.1	90.4	91.0	90.7	90.8
Liabilities	67.4	69.9	68.4	73.7	76.5	74.9	77.0	76.8	78.2	78.5	79.1
Debt, net	-60.0	-58.5	-59.7	-58.8	-60.1	-54.2	-50.2	-47.6	-45.3	-43.5	-42.1
Assets	66.6	60.7	62.5	63.9	69.2	58.0	59.0	58.5	58.9	58.7	58.8
Liabilities	126.6	119.2	122.1	122.7	129.3	112.2	109.2	106.1	104.2	102.2	100.9
External assets (gross)	136.3	133.6	136.4	149.1	155.9	147.6	150.1	148.9	149.8	149.4	149.6
Equity	69.7	72.9	73.9	85.2	86.7	89.6	91.1	90.4	91.0	90.7	90.8
Debt	66.6	60.7	62.5	63.9	69.2	58.0	59.0	58.5	58.9	58.7	58.8
External liabilities (gross)	194.0	189.1	190.6	196.4	205.7	187.0	186.2	182.9	182.3	180.7	180.0
Equity	67.4	69.9	68.4	73.7	76.5	74.9	77.0	76.8	78.2	78.5	79.1
Debt	126.6	119.2	122.1	122.7	129.3	112.2	109.2	106.1	104.2	102.2	100.9
Of which: foreign currency, hedged	43.6	36.1	39.3	40.6	36.6	29.9	29.1	28.3	27.8	27.2	26.9
A$-denominated	57.7	59.3	58.4	57.6	66.8	59.8	58.3	56.6	55.6	54.5	53.8
Short-term	43.7	40.0	40.4	37.9	40.0	37.0	36.0	35.0	34.4	33.7	33.3
MEMORANDUM ITEMS											
Gross official reserves (bn A$)	74	85	76	84	56	...	...	...	...	...	...
In months of prospective imports	2.3	2.5	2.2	2.8	1.7	...	...	...	...	...	...
In percent of short-term external debt	9.9	11.8	10.0	11.0	7.1	...	...	...	...	...	...
Net official reserves (bn A$)	58	57	62	63	61	...	...	...	...	...	...

Sources: Authorities' data and IMF staff estimates and projections.

1/ NIIP figures as a percent of GDP for 2020 differ from those reported in Annex I. Before computing ratios, Annex I converts NIIP stocks to USD using end-of-period exchange rates while GDP is converted to USD using average exchange rates. Table 3 computes ratios based on AUD numbers reported by ABS.

Table 4. Australia: Selected Financial Soundness Indicators of the Banking Sector
(Year-end, unless otherwise noted, in percent)

	2014	2015	2016	2017	2018	2019	2020	2021Q2
Capital Adequacy								
Regulatory capital to risk-weighted assets	12.2	13.8	13.7	14.6	14.8	15.7	17.6	18.4
Regulatory Tier I capital to risk-weighted assets	10.6	11.8	11.4	12.4	12.7	13.1	14.0	14.5
Capital to assets	5.4	6.2	6.5	6.9	6.9	7.4	8.0	8.3
Large exposures to capital	100.8	80.1	76.5	70.4	72.7	83.1	65.9	60.3
Nonperforming loans net of loan-loss provisions to capital	9.3	7.3	7.6	6.9	7.5	7.6	7.7	7.6
Asset Quality								
Nonperforming loans to total gross loans	1.0	0.9	0.9	0.9	0.9	1.0	1.1	1.1
Sectoral distribution of loans to total loans								
Residents	92.9	90.5	92.2	93.3	93.1	93.9	93.5	94.6
Deposit-takers	0.1	0.1	0.1	0.2	0.2	0.2	0.0	0.0
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.8	3.1	3.3	3.4	3.6	2.7	2.7	2.8
General government	0.3	0.3	0.3	0.2	0.2	1.0	0.9	0.8
Non-financial corporations	23.2	22.7	23.0	23.0	22.9	22.9	22.8	23.0
Other domestic sectors	66.6	64.3	65.5	66.5	66.2	67.1	67.1	68.0
Nonresidents	7.1	9.5	7.8	6.7	6.9	6.1	6.5	5.4
Earnings and Profitability								
Return on assets	1.2	1.5	0.8	1.2	1.4	1.0	0.4	0.7
Return on equity	22.9	23.8	12.4	17.3	20.0	13.2	4.9	8.8
Interest margin to gross income	65.9	59.4	82.5	71.3	64.9	74.3	88.2	88.6
Noninterest expenses as a percentage of gross income	47.1	42.8	53.8	47.5	44.7	52.6	64.5	62.3
Liquidity								
Liquid assets to total assets	17.1	17.6	18.2	18.5	18.7	16.5	20.2	21.4
Liquid assets to short-term liabilities	40.2	39.7	41.2	40.1	41.9	34.2	37.0	36.5

Source: IMF, Financial Soundness Indicators (FSI) database.

Annex I. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The increase in the CA surplus recorded in 2020 reflects in large part temporary factors associated with the COVID-19 shock. While considerable uncertainty remains, the CA is expected to return to a deficit in the medium term as domestic demand picks up and temporary factors unwind.

Potential Policy Responses: Policies that promote domestic demand can contribute to maintaining the current account balance close to its norm. The substantial monetary policy easing and fiscal stimulus implemented in response to the COVID-19 shock were appropriate to support the economy and protect vulnerable households and firms. The policy priority in the period ahead should be to maintain adequate policy support until the recovery is firmly entrenched. The continued accommodative fiscal and monetary policy stance will support domestic demand and contribute to the narrowing of the CA surplus while keeping the external position in line with fundamentals.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. Australia's NIIP declined to −54.3 percent of GDP in 2020 from −46.8 percent of GDP in 2019 as valuation changes from the Australian dollar's appreciation offset the effect of the CA surplus. Although nearly one-half of Australia's gross liabilities are debt obligations, more than one-half of the liabilities are denominated in domestic currency, while assets are in foreign currency. Foreign liabilities are composed of about one-quarter FDI, one-half portfolio investment (principally banks' borrowing abroad and foreign holdings of government bonds), and one-quarter other investments and derivatives.

Assessment. The NIIP level and trajectory are sustainable. The structure of Australia's external balance sheet reduces the vulnerability associated with its high negative NIIP. With a positive net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector's net foreign currency liability position is mostly hedged, the maturity of banks' external funding has lengthened since the global financial crisis, and the Term Funding Facility implemented after the COVID-19 shock reduced banks' dependence on foreign funding. Despite the recent increase in debt, the government's balance sheet remains strong and can provide credible support in a tail risk event in which domestic banks suffer a major loss.</td></tr>
<tr><td>2020 (% GDP)</td><td>NIIP: −54.3</td><td>Gross Assets: 169.8</td><td>Debt Assets: 46.3</td><td>Gross Liab.: 224.1</td><td colspan="2">Debt Liab.: 103.9</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. While Australia has historically run CA deficits, averaging about 3 percent of GDP between 2014 and 2018, the CA balance switched to a surplus of 0.7 percent of GDP in 2019 and rose further to 2.7 percent of GDP in 2020. The increase in surplus in 2020 largely reflects temporary factors related to the COVID-19 shock, including a sharp increase in the primary income balance (an improvement of 1.8 percent of GDP relative to 2019 and the highest-recorded balance as a percent of GDP since the mid-1970s), a collapse in travel services imports, including tourism, while (especially education-related) travel services exports declined by less, relatively strong demand for Australian commodities, and an increase in commodity prices of Australia's main exports late in the year. The current account surplus increased further in the first half of 2021, largely reflecting the significant rise in iron ore prices, Australia's main commodity export. While there is considerable uncertainty, the CA is expected to gradually return to a deficit over the medium term, albeit at a level lower than the historical average.

Assessment. The EBA model estimates a cyclically adjusted CA surplus of 2.6 percent of GDP compared with a CA norm of −0.1 percent of GDP, suggesting a model-based CA gap of 2.7 percent of GDP. However, in the IMF staff's view, two adjustments are warranted to the cyclically adjusted CA balance: (1) an adjustment of −0.5 percent of GDP to reflect temporary factors related to the COVID-19 shock, mostly due to an increase in the travel services balance; and (2) an adjustment of −1.3 percent of GDP to reflect temporarily lower dividend payments on FDI and portfolio liabilities. Taking these adjustments into consideration, the IMF staff-adjusted CA gap is in the range of −0.1 to 1.9 percent of GDP, with a midpoint of 0.9 percent of GDP.</td></tr>
<tr><td>2020 (% GDP)</td><td>CA: 2.7 | Cycl. Adj. CA: 2.6</td><td>EBA Norm: −0.1</td><td>EBA Gap: 2.7</td><td>COVID-19 Adj.: −1.8</td><td>Other Adj.: 0.0</td><td>Staff Gap: 0.9</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. Australia's REER depreciated by 0.8 percent in 2020 compared with the 2019 average and is about 5 percent lower than its 2015 level. However, the average depreciation in 2020 masks substantial volatility over the course of the year. The REER depreciated in the first half of the year amid the rise in global risk aversion. The second half of the year saw a significant appreciation, with the fourth quarter of 2020 average REER being close to 4 percent higher than that of the fourth quarter of 2019 due to a rise in commodity prices of Australia's main exports and a relatively quicker recovery in economic activity in Australia compared to the rest of the world. The REER appreciated further in the first half of 2021, but has depreciated in recent months amid renewed lockdowns, a decline in Australian yields relative to other advanced economies, and lower iron ore prices. As of July 2021 the REER was up by about 5 percent relative to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of −4.5 percent (applying an estimated elasticity of 0.2). The EBA REER level model points to an overvaluation of 9.8 percent, while the REER index model points to a slight undervaluation of 2.1 percent. Overall, the IMF staff assesses the REER gap to be in the range of −8 to 2 percent, with a midpoint of −3 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. The financial account recorded net outflows in 2020, reflecting the sizable CA surplus. While net FDI inflows continued (though at lower levels on account on lower inflows amid the COVID-19 shock), these were offset by net portfolio outflows (mainly reflecting outflows from the financial sector as banks were able to replace foreign borrowing with funding from the central bank using the Term Funding Facility), other net outflows, and derivative outflows (where both inflows and outflows increased significantly, with net outflows of about 1.2 percent of GDP). Net outflows continued in the first half of 2021, with large net equity outflows offsetting continued FDI inflows.

Assessment. Vulnerabilities related to the financial account remain contained, supported by a credible commitment to a floating exchange rate.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">Background. The currency has been free floating since 1983. The central bank has not intervened in the FX market since the global financial crisis.

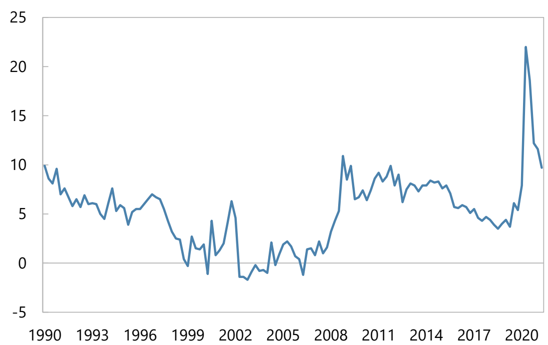
Assessment. The authorities are strongly committed to a floating regime, which reduces the need for reserve holdings. Although domestic banks external liabilities remain sizable, they are either in local currency or hedged, so reserve needs for prudential reasons are also limited.</td></tr>
</table>

Annex II. Drivers of Household Savings After the Pandemic

1. **Like many other economies, the household saving ratio in Australia increased sharply during the lockdown.** The net household saving ratio peaked at 22 percent in the second quarter of 2020 and remained above pre-COVID levels as at the second quarter of 2021.

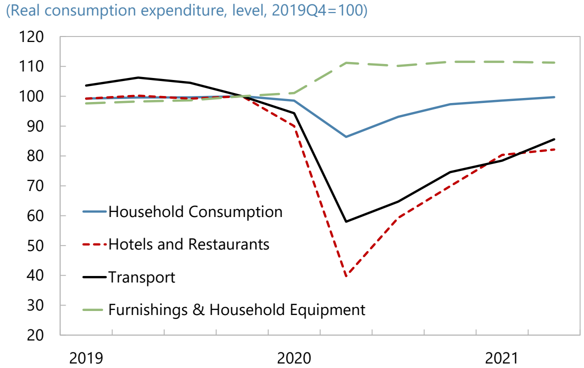
2. **Household savings are driven by a number of factors.** Households will adjust the amount savings depending on expectation of their future income, and consumption may not fully react to a temporary increase in income. Households will likely accumulate precautionary savings if uncertainty increases, and may reduce consumption if weak asset prices undermine their net wealth. Finally, COVID-related restrictions are likely to limit consumption opportunities and force households to save.

Household Savings Have Increased After the Pandemic
(Net household saving ratio, percent)



Source: ABS.

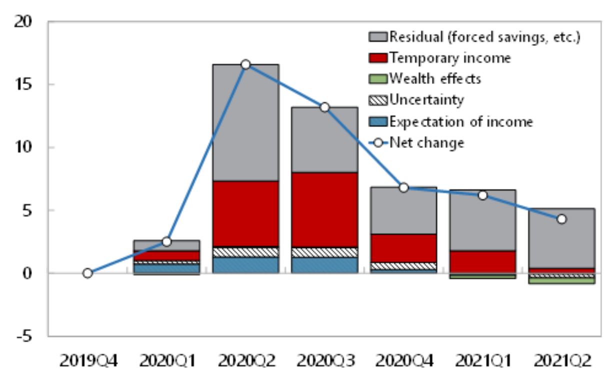
COVID Restrictions Reduced Spending in Services
(Real consumption expenditure, level, 2019Q4=100)



Source: ABS.

3. **A parsimonious model is employed to explain the recent increase in the household saving ratio.** A saving ratio model that incorporates standard drivers of household saving, including expectation of income, net household wealth, uncertainty, and a temporary income ratio (share of income other than compensation of employees to disposable income) is estimated using pre-COVID data.[1] The increase not explained by these factors may be attributed to COVID-related restrictions.

Heightened Savings Were Due to Restrictions and Other Factors
(Change in the net household saving ratio from 2019Q4, percentage points)



Source: IMF Staff Estimates.

[1] For similar models, see Mody, A., Ohnsorge, F. and Sandri, D., "Precautionary savings in the Great Recession", *IMF Economic Review*, Vol. 60, 2012, pp. 114-138, and Dossche, M., and Zlatanos, S. (2020). "COVID-19 and the increase in household savings: precautionary or forced? "ECB Economic Bulletin Boxes, *6*.

4. The increase in household savings is explained largely by forced savings due to restrictions and a temporary increase in income boosted by transfer measures. The lockdown measures and border restrictions prohibited households from consuming some services, leading to forced savings. In addition, household consumption was less responsive to temporary increases in income from fiscal transfers, which contributed to an accumulation of savings. Other factors, such as deterioration of income expectations and heightened uncertainty also contributed to accumulation of savings during the acute phase of the pandemic.

5. The drivers of household savings reflect important policy implications. The household saving ratio is expected to remain elevated in the near term due to the COVID-related restrictions, but will likely decline as they are relaxed, adding a momentum of recovery. The household saving ratio is also expected to decline as the sources of income shift to labor income along with a pickup in wage growth. While transfer measures have provided an important lifeline during the acute phase of the pandemic, household consumption, on average, tends to be less responsive to a temporary increase in income. Going forward, keeping transfer measures well-targeted to affected workers and vulnerable people will be essential.

Estimated Parameters of the Saving Ratio Model

Dependent Variable: Net Household Saving Ratio	
Expection of Income	-0.1284***
	(0.041)
Uncertainty	0.0064
	(0.0045)
Uncertainty (-1)	0.0072*
	(0.0038)
Net Household Wealth-to-Income (-1)	-0.0064*
	(0.0036)
Temporary Income Ratio	1.271***
	(0.13)
Constant	-23.57***
	(2.63)
Adj. R-squared	0.836
Sample Period	1997Q2-2019Q4
Number of Observation	91

Note: Expectation of Income is obtained from ANZ-ROY Morgan and uncertainty is obtained from Economic Policy Uncertainty. Temporary income ratio is the share of income other than compensation of employees in net household disposable income. Heteroskedasticity and autocorrelaton consistent standard errors are reported in parenthesis. *** and * indicate that parameters are statistically significant at 1 and 10 percent levels, respectively.

Annex III. Risk Assessment Matrix

	Source of risks	Likelihood	Time horizon	Impact	Policies to reduce impact
				Conjunctural Shocks and Scenarios	
	Global resurgence of the COVID-19 pandemic	**M**	Short to medium term	**M** Delays in border reopening will affect tourism and migration flows. Weak external demand from trading partners will adversely affect exports.	Extend existing fiscal support to the severely affected services, combined with accommodative monetary policy. Press ahead with faster vaccine rollout to reduce health risks associated with border reopening.
	Rising commodity prices amid bouts of volatility	**M**	Short term	**M** Australia benefits from high commodity prices, but volatility could increase uncertainty and impact the business environment	The exchange rate will act as a stabilizer. Unwind fiscal stimulus, accompanied by monetary policy response, as needed.
	De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia	**M**	Short to medium term	**M** Tighter financial conditions due to de-anchoring of inflation expectations in the U.S. will adversely affect asset prices, household consumption, and investment.	Expand monetary easing, combined with fiscal policy loosening.
				Structural Risks	
	Intensified geopolitical tensions and security risks	**H**	Short to medium term	**M/H** Geopolitical tensions in selected countries/regions may cause economic/political uncertainty, higher volatility in commodity prices, and lower confidence, with potential spillovers to Australia, including through international trade.	Combined monetary and fiscal policy easing. Continued pursuit of open market policies for trade.
	Higher frequency and severity of natural disasters related to climate change	**M**	Short to medium term	**M** Stronger and more frequent economic disruptions, including recurrence of severe droughts, bushfires, and heavy rainfalls.	Strengthen preparedness and resilience in vulnerable regions. Mitigate the economic impact on affected regions through disaster-related government programs.
				Domestic Risks	
	Local COVID-19 outbreaks and subpar/volatile growth	**H**	Short to medium term	**H** Setbacks to the recovery from economic disruptions related to domestic lockdown measures. Uncertainty will adversely affect household consumption and business investment. Knock-on effects on the housing sector could affect credit quality.	Implement targeted fiscal stimulus in a timely manner with use of fiscal space, while maintaining an accommodative monetary policy stance. Expedite vaccine rollout to reduce health risks. Calibrate macroprudential policies to the balance of risks.
	Faster resumption of consumer and business confidence	**M**	Short term	**M** Relaxation of restrictions and improved sentiment could boost household consumption and business investment at a pace faster than expected.	Wind down remaining fiscal stimulus measures earlier, with normalization of monetary policy brought forward.
	Unsustainable growth in the housing market triggering an eventual correction	**M**	Short to medium term	**H** A further amplification of the housing cycle could lead to a build-up of financial vulnerabilities that could have severe effects on growth, residential investment, private consumption, and households' and banks' balance sheets in the event of a downturn, potentially triggered, for example, by a change in risk sentiment or a tightening of financial conditions.	Tighten macroprudential policy to address financial stability risks, with supply-side reforms to restore housing affordability. In case of a downturn, easing monetary policy with loosening fiscal policy will help cushion its impact, with measures to facilitate mortgage debt restructuring.

Annex IV. Public Debt Sustainability Analysis

The fiscal response to the COVID-19 outbreaks has been unprecedented, raising gross general government debt to 58 percent by 2020, with the projection peaking at around 67 percent of GDP by 2023 before stabilizing. [1] *The debt trajectory is sensitive to the underlying macro-fiscal assumptions of GDP growth, primary balance, and interest rate. The high share of non-resident holdings (nearly all in the Australian dollar) of government securities could constitute a potential vulnerability but is mitigated by Australia's strong institutions and credible policy frameworks. Well-coordinated fiscal and monetary policies that promote a durable economic recovery will minimize risks to the debt outlook, underpinning debt sustainability.*

1. Background. Commonwealth, state, and local governments have implemented unprecedented economic and health support packages to safeguard the wellbeing of Australians and enable a durable and inclusive economic recovery. With latest additions introduced since the 2021-22 budgets, the total stimulus amounts to around 20 percent of 2020 GDP for FY2019/20-FY2024/25. Nearly 60 percent of the stimulus has been already implemented by end-FY2020/21 (ended June 2021), including A$89 billion (4½ percent of GDP) for the JobKeeper wage subsidy program, the largest economic support program in Australia's history.

2. Fiscal space. Australia had substantial fiscal space prior to COVID-19. Despite the sizable output loss and fiscal stimulus related to the pandemic, Australia still maintains substantial fiscal space. Gross public debt is projected to stabilize in the medium term and remain well below the 85 percent of GDP benchmark. Australia maintains favorable market access and strong institutions with credibility on fiscal policy implementation, further supporting this assessment.

Baseline Scenario

3. Macroeconomic assumptions. Bolstered by the economic stimulus measures, favorable commodity market developments, and wealth effects from domestic housing markets, real GDP growth is projected to reach its potential level by 2022 and normalize thereafter at around a historical growth average of around 2½ percent. Inflation, measured by the GDP deflator, is projected to pick up in the medium term but to remain contained, as inflation expectations are expected to remain well-anchored by forward-looking monetary policy.

4. Debt trajectory. After sizable withdrawal of stimulus at end-FY2020/21, the governments will continue to wind down the remaining discretionary measures gradually. It would take longer for the primary deficit to fall sufficiently to stabilize gross public debt. Nevertheless, favorable interest rate-growth differentials help maintain debt servicing costs low and lead the underlying debt dynamics toward stabilization. Gross public debt is projected to peak at 67 percent of GDP by 2023 and then start to decline as a ratio to GDP.

[1] General government includes the Commonwealth, state/territory, and local governments.

5. Realism. Past forecast errors for key macroeconomic variables (real GDP growth, primary balance, and GDP deflator) were largely in normal ranges compared internationally.[2] In contrast, the projected adjustment of the cyclically adjusted primary balance (CAPB) falls into the top quartile of historical adjustments across countries. However, it reflects the size of past discretionary fiscal stimulus implemented in response to COVID under unique circumstances and the pace of its withdrawal commensurate with the underlying economic recovery.

Risk Assessment

6. Vulnerabilities. The share of gross public debt (all denominated in Australian dollars) held by non-residents has increased since the pandemic, reaching 36 percent in 2020 (or 21 percent of GDP). Given Australia's sound fiscal and monetary policy frameworks, strong institutions, and triple-A sovereign rating, foreign demand for Treasury securities is expected to remain high, also supported by the strong economic recovery.

Alternative Scenarios and Macro-Fiscal Stress Tests

7. Alternative scenarios. Under the historical scenario, gross public debt continues to increase over the medium term. The scenario, capturing underlying macroeconomic developments during the past decade (2011-2020), is characterized by low productivity growth. It also assumes a high real interest rate, up by 220 basis points from the baseline over the medium term. Although the average primary deficit is somewhat lower than in the baseline, debt servicing costs as well as gross financing needs continue to increase over the projection horizon due to the interest rate-growth differential. If the governments maintained stimulus measures without winding them down, as assumed under the constant primary balance scenario, gross public debt and financing needs would continue to grow more acutely than in the historical scenario.

8. Stress tests. The underlying public debt projection is sensitive to an interest rate shock, which is consistent with the implications of the alternative scenarios above. When the real interest rate on new issuance of debt increases by nearly 570 basis points in 2022 and onwards,[3] the gross public debt-to-GDP ratio continues to increase over the medium term, adding 6 percentage points of GDP relative to the baseline by 2026. The shock raises debt servicing costs, thereby requiring additional gross financing needs but below the 20-percent-of-GDP threshold to signal a risk. When this shock is combined with other macro-fiscal shocks (which individually yield benign impacts), its propagation is amplified, raising gross public debt by 12 percentage points of GDP by 2026, and steepening the trajectory of gross financing needs over the medium term.

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[2] Forecast errors of the primary balance in Australia is based on conversion of fiscal-year to calendar-year based values where fiscal year (FY) runs from July to June. For example, the error in 2019 shows the difference between actual and projection in FY2019/20 and FY2020/21 where the latter is influenced by impacts of the COVID-19 pandemic.

[3] This assumes an extreme event, based on a distribution of observed values of effective interest rate in Australia during 2011-2020, calculated based on the ratio of interest payments to gross public debt.

Annex IV. Figure 1. Australia: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario –

(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

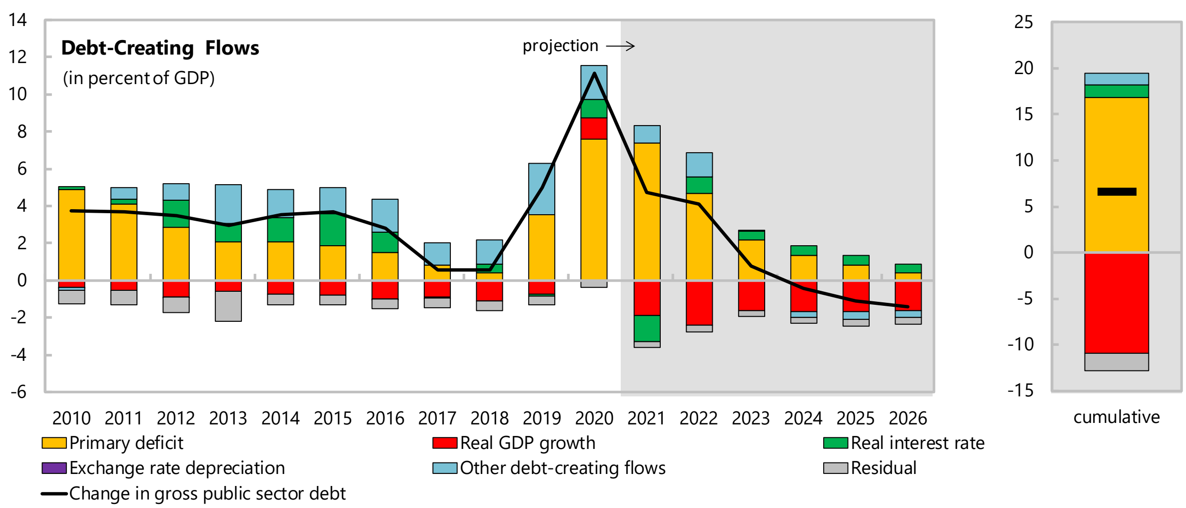
	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	33.0	46.6	57.7	62.5	66.6	67.3	66.9	65.8	64.3
Public gross financing needs	3.1	4.4	8.7	11.9	11.5	10.0	9.7	9.0	9.9
Real GDP growth (in percent)	2.7	1.9	-2.4	3.5	4.1	2.6	2.6	2.6	2.6
Inflation (GDP deflator, in percent)	1.9	3.4	0.7	5.0	1.1	2.0	2.1	2.2	2.2
Nominal GDP growth (in percent)	4.7	5.4	-1.7	8.7	5.2	4.6	4.8	4.9	4.9
Effective interest rate (in percent) [4/]	4.8	3.2	2.9	2.6	2.6	2.8	3.0	3.0	3.1

As of September 30, 2021

Sovereign Spreads:		
5Y CDS (bp) 3/		16
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AAA	AAA
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.8	5.0	11.1	4.7	4.1	0.8	-0.4	-1.1	-1.4	6.6	
Identified debt-creating flows	3.5	5.4	11.5	5.0	4.4	1.1	-0.1	-0.8	-1.1	8.5	
Primary deficit	2.3	3.5	7.6	7.4	4.7	2.2	1.3	0.8	0.4	16.8	-1.5
Primary (noninterest) revenue and grants	33.2	34.0	35.6	34.0	33.1	33.3	33.6	33.8	33.9	201.6	
Primary (noninterest) expenditure	35.5	37.6	43.2	41.3	37.8	35.5	34.9	34.6	34.3	218.5	
Automatic debt dynamics [5/]	0.0	-0.9	2.2	-3.3	-1.6	-1.2	-1.2	-1.2	-1.1	-9.5	
Interest rate/growth differential [6/]	0.0	-0.9	2.2	-3.3	-1.6	-1.2	-1.2	-1.2	-1.1	-9.5	
Of which: real interest rate	0.8	-0.1	1.0	-1.4	0.9	0.5	0.5	0.5	0.5	1.4	
Of which: real GDP growth	-0.8	-0.8	1.1	-1.9	-2.4	-1.6	-1.7	-1.7	-1.6	-10.9	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.2	2.7	1.8	1.0	1.3	0.1	-0.3	-0.4	-0.4	1.2	
Residual, including asset changes [8/]	-0.7	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

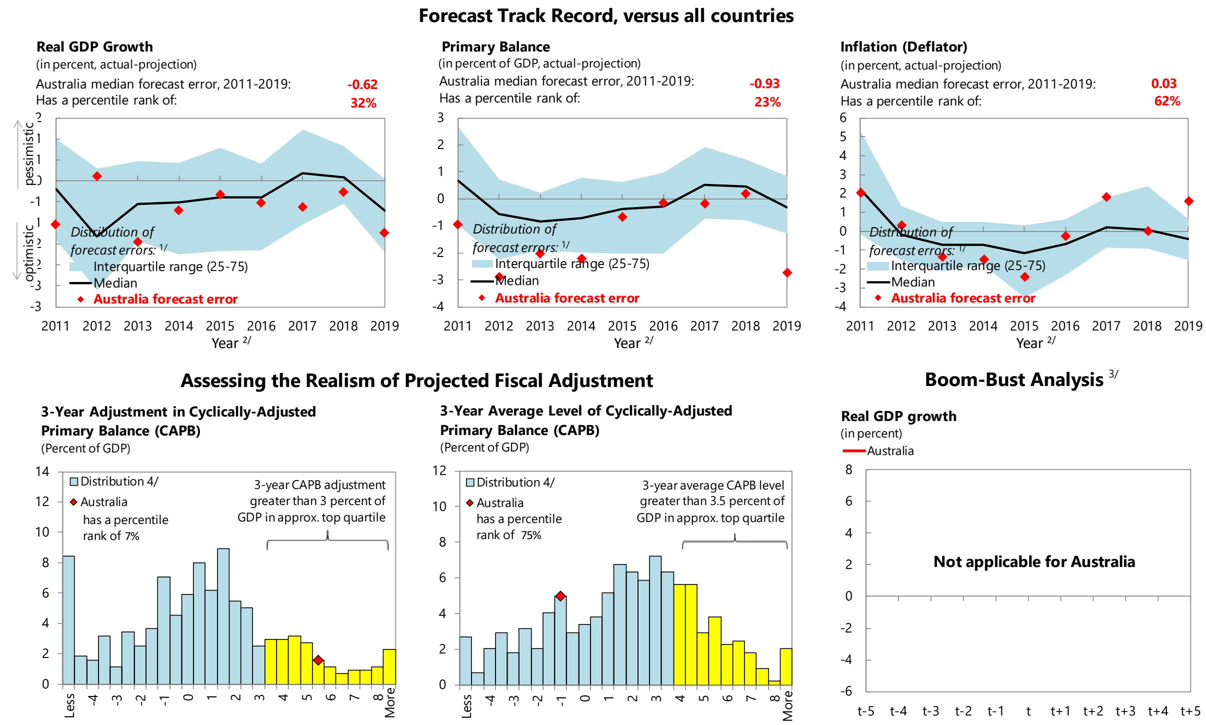
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex IV. Figure 2. Australia: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Australia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

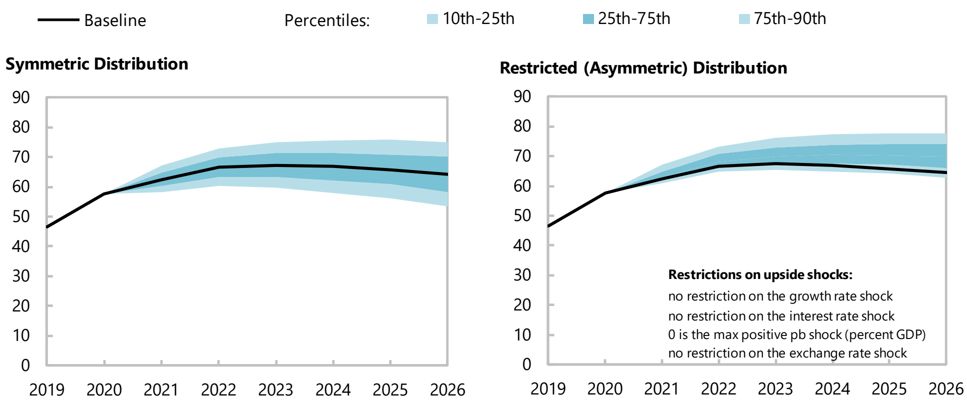
Annex IV. Figure 3. Australia Public DSA – Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

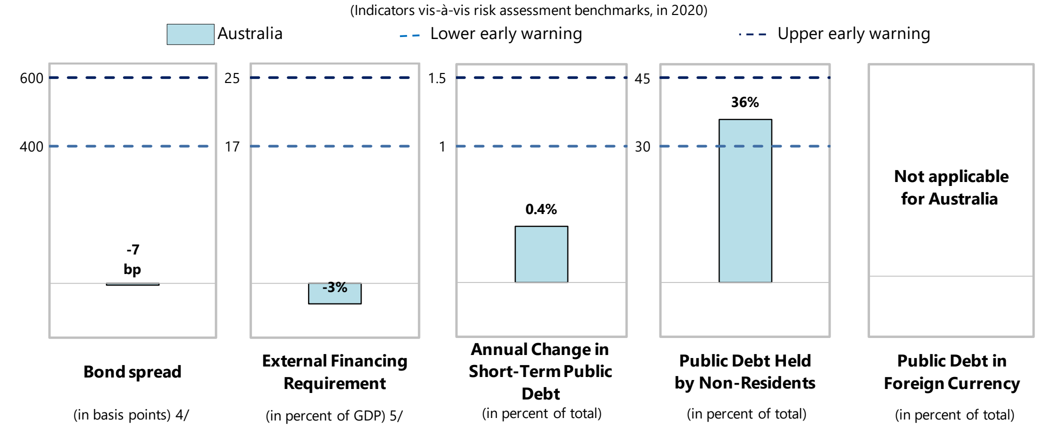
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 02-Jul-21 through 30-Sep-21.

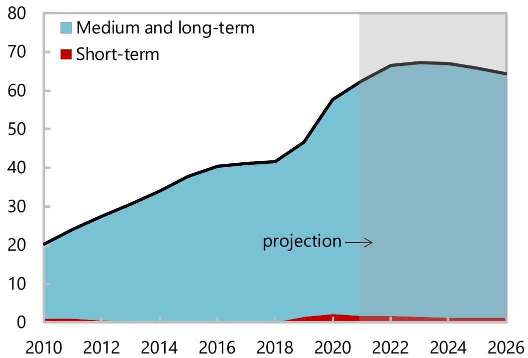
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex IV. Figure 4. Australia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

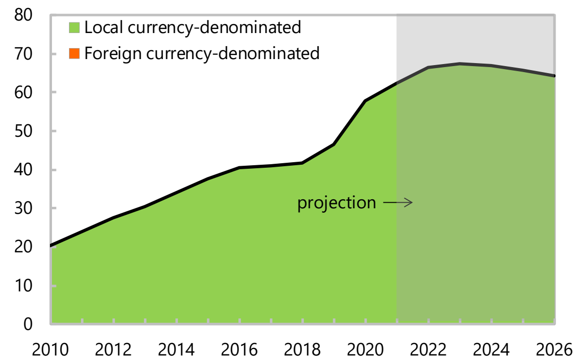
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

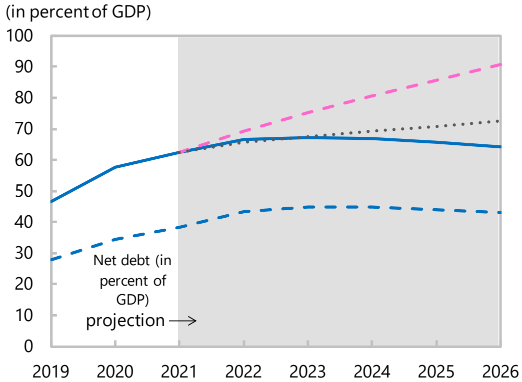


Alternative Scenarios

Baseline Historical Constant Primary Balance

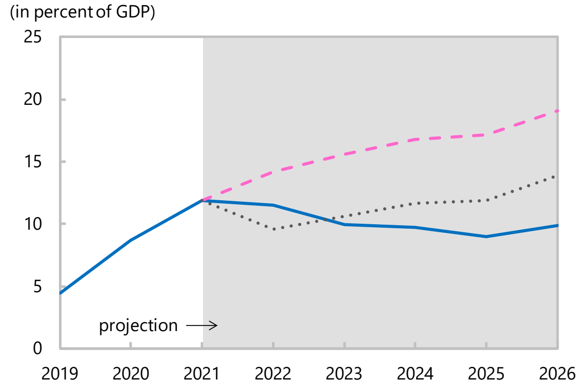
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

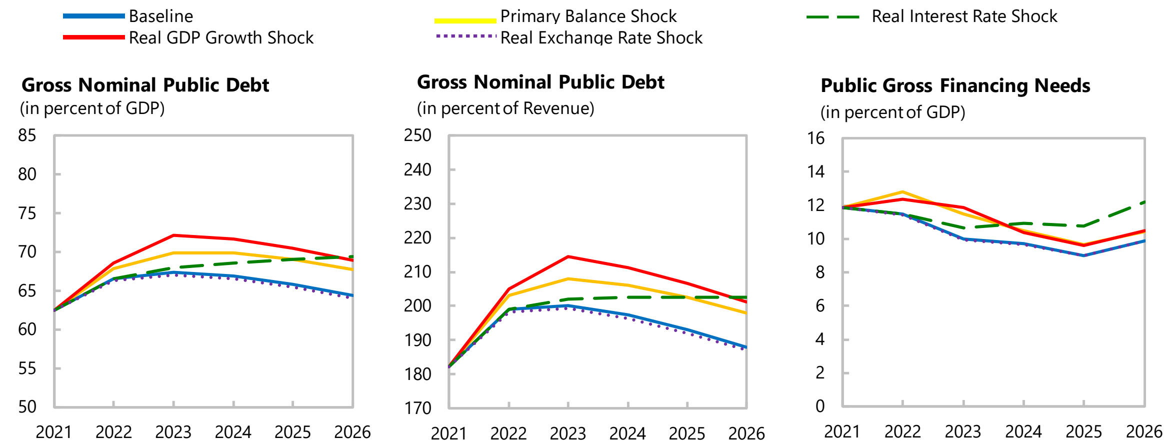
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	4.1	2.6	2.6	2.6	2.6
Inflation	5.0	1.1	2.0	2.1	2.2	2.2
Primary Balance	-7.4	-4.7	-2.2	-1.3	-0.8	-0.4
Effective interest rate	2.6	2.6	2.8	3.0	3.0	3.1
Constant Primary Balance Scenario						
Real GDP growth	3.5	4.1	2.6	2.6	2.6	2.6
Inflation	5.0	1.1	2.0	2.1	2.2	2.2
Primary Balance	-7.4	-7.4	-7.4	-7.4	-7.4	-7.4
Effective interest rate	2.6	2.6	2.7	2.8	2.9	2.9

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	2.1	2.1	2.1	2.1	2.1
Inflation	5.0	1.1	2.0	2.1	2.2	2.2
Primary Balance	-7.4	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	2.6	2.6	3.2	3.6	4.0	4.2

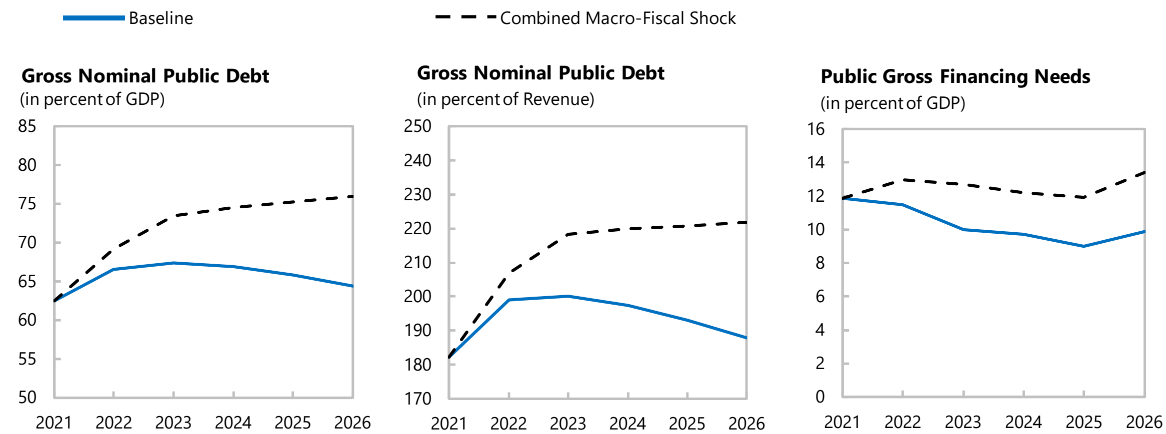
Source: IMF staff.

Annex IV. Figure 5. Australia Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	3.5	4.1	2.6	2.6	2.6	2.6
Inflation	5.0	1.1	2.0	2.1	2.2	2.2
Primary balance	-7.4	-6.0	-3.4	-1.8	-1.1	-0.6
Effective interest rate	2.6	2.6	2.8	3.0	3.1	3.1
Real Interest Rate Shock						
Real GDP growth	3.5	4.1	2.6	2.6	2.6	2.6
Inflation	5.0	1.1	2.0	2.1	2.2	2.2
Primary balance	-7.4	-4.7	-2.2	-1.3	-0.8	-0.4
Effective interest rate	2.6	2.6	3.8	4.7	5.4	5.9
Combined Shock						
Real GDP growth	3.5	2.4	0.9	2.6	2.6	2.6
Inflation	5.0	0.6	1.6	2.1	2.2	2.2
Primary balance	-7.4	-6.0	-3.6	-1.8	-1.1	-0.6
Effective interest rate	2.6	2.6	3.8	4.8	5.5	6.0

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	3.5	2.4	0.9	2.6	2.6	2.6
Inflation	5.0	0.6	1.6	2.1	2.2	2.2
Primary balance	-7.4	-5.5	-3.6	-1.3	-0.8	-0.4
Effective interest rate	2.6	2.6	2.8	3.0	3.1	3.1
Real Exchange Rate Shock						
Real GDP growth	3.5	4.1	2.6	2.6	2.6	2.6
Inflation	5.0	1.6	2.0	2.1	2.2	2.2
Primary balance	-7.4	-4.7	-2.2	-1.3	-0.8	-0.4
Effective interest rate	2.6	2.6	2.8	3.0	3.0	3.1

Source: IMF staff.

Annex V. Financial Sector Assessment Program Update

Recommendation	Time Frame	Developments and Implementation
Banking and Insurance Supervision		
Strengthen the independence of APRA and ASIC, by removing constraints on policy making powers and providing greater budgetary and funding autonomy; strengthen ASICs enforcement powers and expand their use to mitigate misconduct (Treasury, APRA, ASIC).	ST	**In process.** ASIC's industry funding model, under which it recovers regulatory costs from industry and charges fees for service, has been in place since the 2017-18 financial year. The Australian Government has also made a number of changes to ASIC's enforcement powers: (i) on April 6, 2019, ASIC was granted a product intervention power. ASIC has already used this power in the area of short-term credit, binary options, and CFDs; and (ii) on February 18, 2019, Parliament passed legislation to significantly increase penalties for corporate and financial sector misconduct. On February 6, 2020, Parliament passed legislation to strengthen ASIC's licensing and banning powers and enhance ASIC's investigatory capability. On December 10, 2020, Parliament passed legislation to enable ASIC to designate enforceable code provisions in approved codes of conduct which, if breached, may attract civil penalties; and establish a mandatory code of conduct framework for the financial services and consumer credit industry through regulations, with the ability to designate certain provisions as civil penalty provisions. The Government enacted legislation in December 2020 to enhance ASIC's regulatory and supervisory tools by strengthening breach reporting requirements for financial service and credit licensees. APRA was provided A$150 million in additional funding in the 2019-20 Federal Budget, which was further expanded in the 2020-21 and 2021-2022 Budgets.
Enhance APRA's supervisory approach by carrying out periodic in-depth reviews of governance and risk management (APRA).	ST	**In process.** APRA has built the capability to undertake in-depth reviews of governance and risk management. On November 19, 2019, APRA released its information paper *Transforming Governance, Culture, Remuneration and Accountability: APRA's Approach,* outlining APRA's plan to strengthen policy frameworks, sharpen supervisory practices, and share insights. APRA has concentrated its efforts on following up issues identified from the program of risk governance self-assessments undertaken by financial institutions across all regulated

Recommendation	Time Frame	Developments and Implementation
		industries in 2018, with a focus on a small number of large financial institutions that needed to substantially lift efforts to address risk governance deficiencies and undertake activities set out in remediation plans to APRA's satisfaction. Conducting in-depth reviews, both regulated-institution specific and industry wide, of governance and risk management, is a key part of APRA's supervisory approach to transforming the Governance, Culture, Remuneration and Accountability (GCRA) of regulated institutions—an important priority in APRA's Corporate Plan. APRA has rolled out its new Supervision and Risk Intensity (SRI) model, which has increased the focus on governance, risk management, board and senior management. The SRI model captures assessments of the risk management frameworks, board and management under the risk categories GCRA, Business and Central Functions, and Risk and Compliance Functions. APRA is also reviewing the prudential standards for governance and risk management and intends to consult on the revision of *Prudential Standard CPS 510 Governance* and *Prudential Standard CPS 220 Risk Management* in 2022.
Strengthen the integration of systemic risk analysis and stress testing into supervisory processes (APRA, RBA).	I	**In process.** APRA has rolled out its new Supervision Risk and Intensity (SRI) model, which incorporates an External Factors category covering macro and systemic risk for each industry. In addition, the capital section of the SRI model requires supervisors to consider the results of recent stress tests in determining the appropriate rating of capital. The transition to the SRI model started in October 2020 and was completed in June 2021. In response to a rapidly deteriorating operating environment triggered by the financial and economic impacts of the COVID-19 pandemic, APRA increased its stress testing activities across all regulated industries and analyzed results under a range of scenarios to identify potential vulnerabilities, including regulated institutions that may be at a heightened risk of failure. Collaboration with the RBA in modeling scenarios and comparing results also increased. The stress tests have allowed APRA to target its regulatory attention and contingency planning. APRA also developed a nimble and more frequent program of stress testing and has used this information as a key input to inform its regulatory activities. Stress testing guidance to integrate stress testing into the supervisory process is also under development.
Financial Stability Analysis		
Commission and implement results of a comprehensive	MT	**In process.**

Recommendation	Time Frame	Developments and Implementation
forward-looking review of potential data needs. Improve the quantity, quality, granularity and consistency of data available to the CFR agencies to support financial supervision, systemic risk oversight and policy formulation (CFR agencies).		A Multi-Agency Data Collection Committee has been established which includes APRA, ASIC, RBA, Treasury, and the Australian Bureau of Statistics. The Committee is reviewing the potential data needs of agencies in a forward-looking way to identify data gaps and exploring opportunities to streamline activities associated with the collection and use of data to improve the quantity, quality, granularity and consistency of data available to support the CFR agencies to perform their functions and exercise their powers, and allow for a unified and strategic approach to data across the agencies. The Committee has endorsed a work program that includes regularly reviewing a list of programs to close identified data gaps. A new data collection solution for APRA and all reporting entities, APRA Connect, launched in September 2021. Data collected by APRA is used for prudential supervision, statistical publications and shared with other agencies. APRA's new data collections are structured to contain granular data, requiring less transformation and manipulation by reporting entities, and a greater ability for APRA to reuse the data. APRA's pipeline of new and amended data collections across industries includes: (i) new tactical and strategic collections capturing relevant data for credit activities of ADIs; (ii) new strategic collections to support the implementation of the Basel 3B reforms applicable to ADIs from January 2023; (iii) new data collections to support better insights relating to APRA's prudential standards about remuneration and operational risk and additional non-financial risk data collections; and (iv) enhancements to existing data collections to reflect forthcoming changes in the capital framework for insurers.
Enhance the authorities' monitoring, modeling, and stress testing framework for assessing solvency, liquidity and contagion risk. Draw on the results to inform policy formulation and evaluation (CFR agencies).	ST	**In process.** Since the onset of COVID-19, APRA has undertaken a number of stress tests based on a range of scenarios designed to assess the resilience of the banking system and insurance industries to a continually evolving economic outlook, with an emphasis on severe downside risks. APRA has developed a nimble and more frequent program of stress testing and has used this information as a key input to inform its regulatory activities, such as banking capital policy development. APRA has further continued to build the functionality of its internal stress testing modeling to enable it to challenge industry

Recommendation	Time Frame	Developments and Implementation
		stress test submissions and to more nimbly stress test output to internally generated stress testing scenarios. APRA and RBA stress testing teams engage directly to share and build stress testing model capabilities. APRA is moving towards greater frequency and depth of stress testing for ADIs. This includes transitioning in 2020 to annual stress testing of large ADIs. APRA also plans to test resilience to broader scenarios, including the impacts from operational and climate change financial risks. APRA is undertaking a Climate Vulnerability Assessment (CVA) of large ADIs in 2021-22. This is a joint CFR initiative and has three key objectives: to assess potential financial exposure to climate risk. to understand how banks may adjust business models and implement management actions in response to different scenarios. to foster improvement in climate risk management and stress testing capabilities.
Encourage further maturity extension and lower use of overseas wholesale funding (APRA).	I	**In process.** • Banks' offshore funding is kept under close scrutiny by the CFR agencies. The CFR discussed banks' offshore funding at its September 2019 meeting. Its post-meeting statement noted that banks manage their risks from offshore borrowing through currency hedging and holding foreign currency liquid assets, and that there are various other factors mitigating the risks. The CFR welcomed the progress that the banks had made in lengthening the maturity of their offshore term debt over recent years and indicated that a further lengthening of the maturity of offshore borrowing would reduce the rollover risk for banks and the broader financial system. Australian banks' overseas wholesale funding is currently lower than in recent history given their use of the RBA's TFF. The TFF closed to new drawdowns in June 2021, and banks' overseas issuance is expected to pick up as they refinance maturing TFF debt through to June 2024. The refinancing task is assessed to be sizeable but manageable.
Systemic Risk Oversight and Macroprudential Policy		
Raise formalization and transparency of the CFR and accountability of its member agencies through publishing meeting records as well as publication and presentation of	I	**In process.** The CFR has taken a number of steps to increase transparency, including: (i) publishing a statement following regular CFR meetings since December 2018; (ii) increasing coverage of the CFR's work in the RBA's *Financial Stability Review* (released bi-

Recommendation	Time Frame	Developments and Implementation
an Annual Report to Parliament by CFR agency Heads (CFR agencies).		annually); and (iii) updating the CFR website to be more informative about the role and work of CFR. The Government has established the Financial Regulator Assessment Authority, which will report on the effectiveness and capability of ASIC and APRA. The Authority does not have the power to direct the regulators, assess single cases or decisions, or deal with complaints about the regulators.
Undertake a CFR review of the readiness to apply an expanded set of policies to address systemic risks, including data and legal/regulatory requirements; and address impediments to their deployment (CFR agencies).	I	**In process.** The Housing Market Risks Working Group, under the CFR, actively considers risks to the financial system as well as appropriate policies to address potential risks. The group continues to work on what tools might be available were they needed at some point in the future, the circumstances when they might be suitable, and any restrictions on their use (e.g., data availability).
Commission analysis by the CFR member agencies on relevant financial stability policy issues, including: policies affecting household leverage; as well as factors affecting international investment flows and their implications for real estate markets (CFR agencies).	MT	**In process.** The CFR actively considers the impact of policy changes on financial stability. The Housing Market Risks Working Group frequently reports to the CFR on any risks in the housing market. The RBA participated in a Committee on the Global Financial System working group which studied property price dynamics and, in particular the influence of international investors. Its report was released in February 2020.
Financial Crisis Management and Safety Nets		
Complete the resolution policy framework and expedite development of resolution plans for large and mid-sized banks and financial conglomerates, and subject them to annual supervisory review (APRA, Treasury).	ST	**In process.** APRA is developing recovery and resolution planning prudential standards and associated practice guides. APRA plans to release the draft standard for consultation later in 2021. As the potential impacts of COVID-19 emerged, APRA accelerated its resolution preparedness by developing simple, credible resolution playbooks for all high-risk regulated entities that could be readily implemented. APRA's internal readiness to execute a resolution continues to progress, with specific live case examples driving significant enhancements to the resolution operating model. Work on major bank resolution planning is ongoing (including through the CFR and Trans-Tasman Council on Banking Supervision (TTBC)), with advanced preparations for the inaugural entity-specific Crisis Management Group (CMG) to be held in 2021, having been delayed in 2020 by COVID-19. Given the risks in the external environment during 2020/21, APRA accelerated its recovery planning program of work to drive improvements in entity-led planning across all regulated sectors. In relation to banking, APRA has provided feedback on 'fire drills'

Recommendation	Time Frame	Developments and Implementation
		conducted by the largest ADIs to test the credibility of their recovery plans in a severe stress scenario and their readiness to use recovery options. APRA provided smaller ADIs with thematic feedback on their recovery plans. APRA has used recovery plans to inform its playbooks for higher risk entities.
Extend resolution funding options by expanding loss-absorption capacity for large and mid-sized banks and introduce statutory powers (APRA, Treasury).	ST	**In process.** On November 8, 2018, APRA released a discussion paper outlining its proposed changes to the application of the capital adequacy framework for ADIs to support orderly resolution in the unlikely event of failure. These changes follow the Australian Government's 2014 Financial System Inquiry recommendation to APRA to implement a framework for minimum loss-absorbing and recapitalization capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of ADIs and minimize taxpayer support. In early July 2019, APRA released its final position, requiring the D-SIBs to lift Total Capital by three percentage points of RWA by January 1, 2024, and has an overall long-term target of four to five percentage points of loss absorbing capital. Requirements for the mid-sized banks will be settled as part of resolution planning.
Advance mutual understanding between the Australia and New Zealand resolution authorities on cross-border bank resolution modalities, through the Trans-Tasman Banking Council (TTBC) (CFR agencies).	ST	**In process.** The TTBC, comprised of Australian and New Zealand authorities, continues to discuss and develop mutual understanding of matters relating to cross-border financial stability and bank resolution. To increase awareness of the role of the TTBC, statements were released following the meetings of the Heads in November 2019 and December 2020. APRA continues to work closely with members of the CFR and TTBC on crisis preparedness related work. After the onset of the COVID-19 pandemic, inter-agency engagements have become more frequent. Discussions have focused on sharing observations on emerging risks, stress testing and developing strategies for responding to potential distress. Commencing in 2021, APRA, in conjunction with the RBNZ, will be establishing entity-specific Crisis Management Groups to allow for development and evaluation of detailed entity-specific, cross border resolution strategies.
Financial Market Infrastructure		
Strengthen independence of RBA and ASIC for supervisory oversight, enhance enforcement powers and promote compliance with regulatory requirements.	I	**In process.** The CFR released a consultation paper in November 2019 on proposed enhancements to Australia's FMI regulatory regime. This included proposals for enhanced powers for ASIC and the RBA to support their supervision of FMIs, their ability to take action to address any identified deficiencies, and

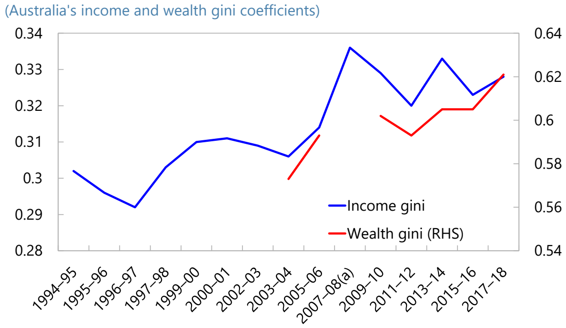
Recommendation	Time Frame	Developments and Implementation
		the transfer of a range of licensing and supervisory powers from the Minister to ASIC and the RBA. Following feedback from stakeholders, the CFR provided recommended changes to the Government. The Government announced it would proceed with the reforms in June 2021, which will enhance the supervisory and licensing powers of ASIC and the RBA and streamline and clarify certain regulatory powers.
Finalize the resolution regime for FMIs in line with the FSB Key Attributes (RBA, ASIC, Treasury).	ST	**In process.** The CFR released a consultation paper in November 2019 on proposed enhancements to Australia's FMI regulatory regime. This included a proposal to establish a resolution regime for domestic clearing and settlement facility licensees. Following feedback from stakeholders, the CFR recommended to the Government the implementation of a resolution regime in Australia. The Government announced in June 2021 that it would proceed with FMI regulatory reforms, including the establishment of a resolution regime for clearing and settlement facilities. The regime will allow the RBA to intervene in a distressed clearing and settlement facility in order to ensure that the facility's critical services continue to operate. The regime will be supported by a $5 billion standing appropriation, with Ministerial agreement, to provide temporary funding to a clearing and settlement facility if that were necessary to ensure continuity of services.
Anti-Money Laundering / Countering the Financing of Terrorism (AML/CFT)		
Expand the AML/CFT regime to cover all designated non-financial businesses and professions (DNFBPs) and strengthen AML/CFT supervision by: improving data collection and risk analysis; increasing oversight of controls and compliance; and undertaking more formal enforcement action in the event of breaches (Department of Home Affairs, Treasury, AUSTRAC).	I	**In process.** Since October 2019, AUSTRAC has published its ML/TF risk assessment of Australia's mutual banking sector (including mutual banks, credit unions and building societies), the junket tour operations sector and Australia's non-bank lending and financing sector. On 6 September 2021, AUSTRAC finalised four ML/TF risk assessments relating to Australia's banking sector. This includes Australia's major banks, other domestic banks, foreign subsidiary banks in Australia and foreign bank branches in Australia. In April 2019, AUSTRAC implemented a program of regulatory monitoring and alerting, which analyses extensive data holdings to generate alerts that may indicate non-compliance with legislation. This capability has resulted in AUSTRAC swiftly engaging with reporting entities. During the 2020-21 financial year, AUSTRAC finalised 32 compliance assessments across a range of sectors and 11 of these were in the banking sector.

Recommendation	Time Frame	Developments and Implementation
		AUSTRAC has taken formal enforcement actions against reporting entities for breaches of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act). AUSTRAC issued a remedial direction to Australian Military Bank Ltd on 3 May 2021, issued an infringement notice to State Street Bank and Trust Company in September 2020, and applied to the Federal Court of Australia in November 2019 for a civil penalty order against Westpac. From June 17, 2021, reforms to the AML/CTF Act came into effect. The reforms clarify obligations regarding customer due diligence before providing a designated service, involve changes to strengthen the protections for correspondent banking relationships, expand the circumstances in which reporting entities can rely on a third party for customer identification and verification, and expand the exceptions to the prohibition of tipping off.
I Immediate (within 1 year); ST Short term (within 1-2 years); MT Medium term (within 3-5 years).		
Sources: IMF (2019), Australia, Financial Sector Assessment Program—Financial System Stability Assessment; and the Australian authorities.		

Annex VI. Inequality in Australia: Pre-COVID Trends and Impact of the Pandemic

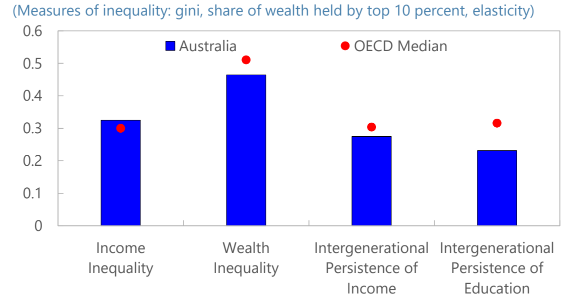
1. **While income inequality is high in Australia compared to other advanced economies, wealth inequality and inequality of opportunity are below those of peers.** After trending upwards since the early 1990s, income inequality stabilized after 2005-06 at levels slightly above the OECD average, in part reflecting lower levels of redistribution through taxes and transfers. Wealth inequality has also increased in recent years, potentially reflecting higher house prices, though the level of wealth inequality remains below that of peers. Australia also compares favorably to OECD advanced economies on other metrics of inequality of opportunity, such as the intergenerational persistence of education and income outcomes.

Income Inequality Has Plateued, Wealth Inequality Is Rising
(Australia's income and wealth gini coefficients)



Source: ABS.
Note: Estimates of income Gini presented for 2007–08 onwards are not directly comparable with earlier estimates due to the improvements made to measuring income introduced in the 2007–08 cycle.

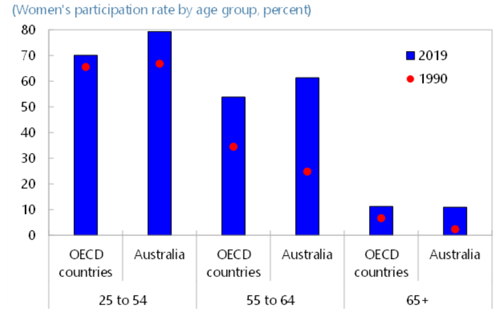
Income Inequality Is Relatively High, but Inequality of Opportunity Is Below That of Peers
(Measures of inequality: gini, share of wealth held by top 10 percent, elasticity)



Sources: OECD; Global Database on Intergenerational Mobility.
Notes: Income inequality: gini coefficient; wealth inequality: share of wealth held by top 10 percent; intergeneration persistence: coefficient of regressions of parents outcome on childrens outcomes.

2. **Progress has also been made in recent years in reducing the gender gap in participation.** The aggregate participation rate increased by 2.3 percentage points between 1990 and 2019, reflecting an increase in participation among women and people aged 55 and over. The gender gap in participation declined to about 10 percentage points in 2019, less than half the level recorded in 1990. Participation among women aged 55 to 64 has increased particularly sharply, rising from 25 percent in 1990 (well below the OECD median) to 61 percent in 2019 (well above the OECD median).

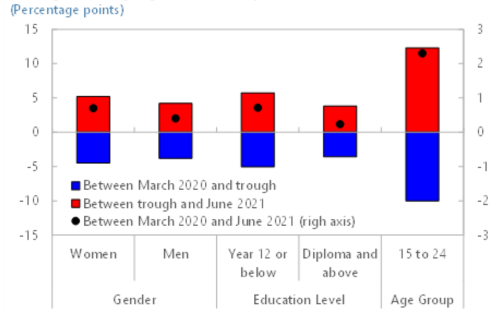
Women's Participation Has Increased Above Peers
(Women's participation rate by age group, percent)



Sources: OECD Stats and IMF staff calculations.

3. **The comprehensive policy response and the subsequent recovery have likely limited the impact of the pandemic on inequality.** While data on income inequality is not available for the pandemic period, labor market data suggest that traditionally vulnerable groups (women, lower educated people, and youth) were initially hit hard by the crisis in the first half of 2020 but

Change in Employment to Population Ratio
(Percentage points)



Sources: ABS and IMF staff calculations.

saw a full recovery before the recent lockdowns. In particular, employment as a share of population plummeted in the first half of 2020, but recovered to above pre-pandemic levels for most of these groups. Underemployment among youth and women also declined below pre-COVID levels, though remains high by international standards. Mirroring the experience from last year, the recent lockdowns have also hit vulnerable groups harder.

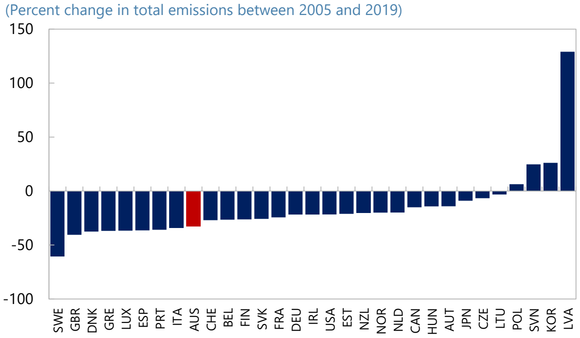
Annex VII. Climate Change Mitigation in Australia

Australia is using a diverse set of policy tools to meet mitigation targets, focusing on a technology-based approach to reducing emissions rather than a comprehensive carbon price. Meeting the temperature goals set out in the Paris Agreement will require strong policy action toward Australia's 2050 net zero emissions target.

A. Recent Trends in GHG Emissions

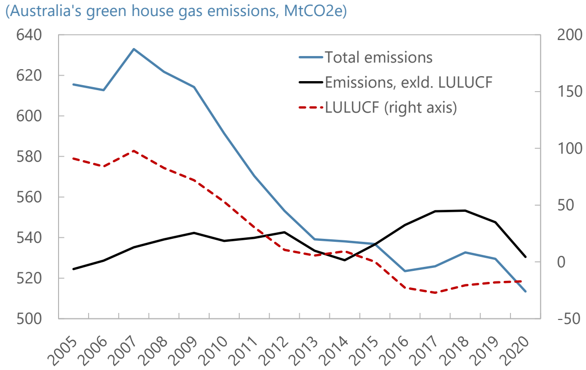
1. After peaking in 2007, total GHG emissions have declined in Australia, driven largely by lower land use, land-use change and forestry (LULUCF) emissions. Estimated emissions in 2020 were 511.5 MtCO2e, about 21 percent lower than peak emissions recorded in 2007. In per-capita terms, emissions in Australia have fallen by more than the OECD average. The LULUCF sector has seen a significant decline in emissions from 89 MtCO2e in 2005 to -25 MtCO2e in 2020.[1] By contrast, non-LULUCF emissions rose by about 5 percent between 2005 and 2018 (declines in electricity, agriculture, waste and industrial processes emissions were offset by increases in other sectors), before declining to close to their 2005 level in 2020, in part due to the impact of the COVID-19 shock on economic activity and travel.

Per Capita Emissions Have Declined More Than the OECD Average
(Percent change in total emissions between 2005 and 2019)



Source: OECD database, greenhouse gas emissions.

Decline in Emissions Is Driven by Lower LULUCF Emissions
(Australia's green house gas emissions, MtCO2e)



Source: Department of Industry, Science, Energy and Resources.

2. While total emissions are well below those of the largest emitters, emissions intensity in Australia is one of the highest among advanced economies. Australia was the 15th largest GHG emitter in 2018, accounting for 1.3 percent of global emissions. Emissions in per-capita and per-GDP terms remain well above the OECD average.

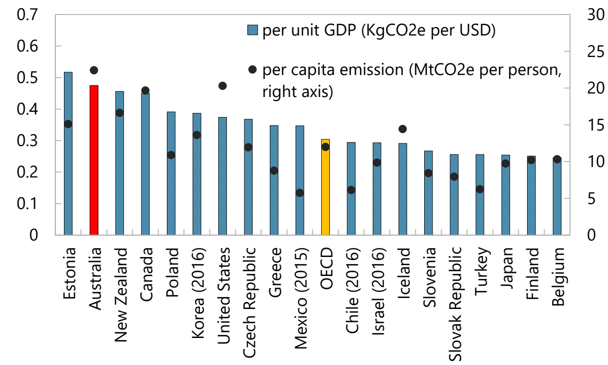
3. Despite recent progress, renewables remain a smaller share of electricity generation than in OECD peers. Energy industries contributed 38 percent of Australian emissions in 2018,

[1] LULUCF emissions include all anthropogenic fires. Non-anthropogenic natural disturbances (including bushfires) and the subsequent recovery are modelled to average out over time. While Australia includes LULUCF emissions in their Paris agreement targets, many countries exclude these emissions given the difficulty in measuring and modelling them.

followed by the transport sector which accounted for a further 18 percent of emissions. Progress has been made in improving the fuel mix in electricity generation, with the share of coal declining from over 80 percent of generation in 2000 to about 54 percent in 2020, though it remains high compared to OECD peers. The share of renewable sources has increased from 9 percent to about 24 percent, meeting the Commonwealth renewables target set for 2020. Australia has made particularly quick progress in deployment of solar technology, including small- and mid-scale solar installation, where capacity more than doubled between 2018 and 2020. However, the share of renewables in electricity generation remains below the OECD average.

Australia's Emissions Intensity Is High Compared to Peers

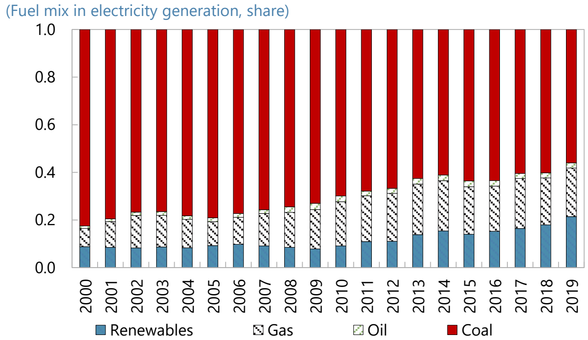
(Emissions intensity, KgCO2e per USD, MTCo2e per person)



Source: OECD.

Share of Renewables in Electricity Generation Has Increased

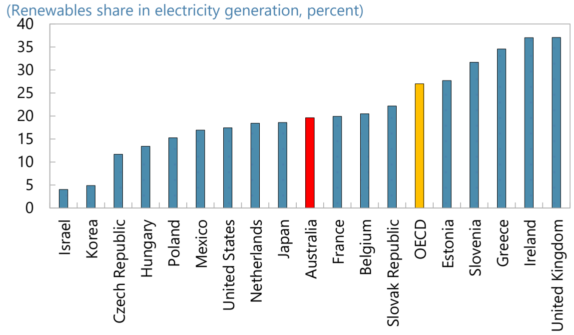
(Fuel mix in electricity generation, share)



Source: Our World in Data.

Share of Renewables Remains Low Compared to OECD Peers

(Renewables share in electricity generation, percent)



Source: OECD.

B. Climate Mitigation Policies in Australia

4. Australia is using a diverse set of policy tools to meet mitigation targets, focusing on a technology-based approach to reducing emissions rather than a comprehensive carbon price. The main policy initiatives include:

- **The Technology Investment Roadmap**, which is expected to channel at least A$20 billion of Commonwealth investment into the development and deployment of low emissions technologies between now and 2030. Annual **Low Emissions Technology Statements** are expected to guide, track and measure the impact of investments in new technologies under the Roadmap. The first technology statement, released in September 2020, identified five priority technologies: (i) clean hydrogen, (ii) energy storage, (iii) low emissions steel and aluminum production, (iv) carbon capture and storage, and (v) soil carbon.

- **The Emissions Reduction Fund/Climate Solutions Fund (ERF/CSF)** is a voluntary scheme under which businesses can undertake eligible projects to cut emissions and earn Australian Carbon Credit Units (ACCUs). ACCUs can either be sold to the government via reverse auctions or in the secondary market to the private sector. About 66 million tons of emissions reduction has been delivered under the ERF/CSF since 2015 and the government has provided additional financing to the scheme to fund future abatement. ACCU prices have increased in recent months, reflecting private sector demand. The ERF is complemented by the **Safeguards Mechanism,** which requires Australia's largest emitters to keep net emissions below a baseline so that gains under the ERF/CSF are not reversed elsewhere.

- **The Australian Renewables Energy Agency (ARENA) and the Clean Energy Finance Corporation (CEFC)** fund investments in clean energy, with ARENA usually providing grants focused on R&D and early deployment, while the CEFC makes commercial investments. Increased funding was provided to these agencies in September 2020.

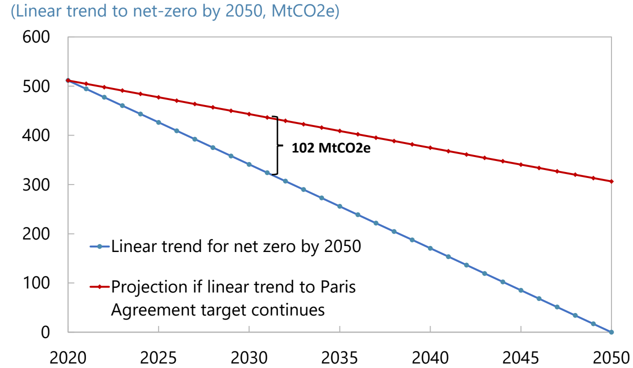
- **Other policies** aimed at reducing emissions include energy efficiency measures at the state and Commonwealth level, state renewable energy targets (no Commonwealth level target has been set after the achievement of the 2020 target) and the Small-Scale Renewable Energy Scheme (which is an uncapped program through 2030 that incentivizes individuals and small businesses to install eligible small-scale renewable energy systems).

C. Paris Agreement Targets and Goals

5. The authorities' projections indicate that Australia will meet its Paris Agreement mitigation target for 2030. Australia's nationally determined contribution (NDC) under the Paris Agreement commits to a 26–28 percent reduction in GHG emissions below 2005 levels. The latest assessment from the authorities projects a 30 percent decline in emissions by 2030 under current policies, and a 35 percent decline in a technology-sensitive scenario, thus meeting the Paris Agreement target. However, a summary of independent studies reported in the United Nations Emissions Gap Report 2021 indicates that emissions reduction might fall short of the target. As the UN report was finalized before the authorities' latest projections were available, and as some of the independent studies may not reflect the full impact of the COVID-19 shock on emissions, its findings should be interpreted with caution.

Pathway to Net-Zero Needs Step-Up in Emissions Reduction

(Linear trend to net-zero by 2050, MtCO2e)



Sources: DISER and IMF staff calculations.

6. Meeting the temperature goals set out in the Paris Agreement will require significant global effort, including from Australia. Cutting net GHG emissions to zero by mid-century is often considered to be a prerequisite to achieving the Paris Agreement goal of keeping the increase in average

temperatures to well below 2 degrees Celsius compared to pre-industrial levels. In this context, the Commonwealth Government's recent commitment to achieve net zero emissions by 2050 is welcome. Assuming a linear path to net zero would require emissions to be cut to 341 MtCO2e by 2030, which is equivalent to a 45 percent reduction relative to 2005 levels, significantly larger than the current target.

7. **Achieving the net zero target will require credible medium-term targets within a comprehensive policy framework.** Australia's commitment to step up investment in developing low emissions technologies is welcome, though is likely to deliver emissions reductions only in the long term. Implementing a broad-based carbon price, along with measures to mitigate transition risks for impacted industries, while politically challenging, can complement the investment strategy and deliver significant emissions reduction in the short and medium term. Having a clear price signal as a key feature of the policy framework has several advantages, including: (i) it can help achieve emissions reduction in a cost-effective manner by promoting across-the-board behavioral responses to reduce emissions, including by redirecting investment towards clean technologies; (ii) if implemented through a carbon tax or an auction-based emissions trading system, a carbon price can raise significant revenues, generating resources to mitigate the impact on those adversely impacted by the transition; and (iii) it can minimize risks to Australian exports from carbon border adjustments. If carbon pricing is not feasible, alternative regulatory reforms can be considered, including enhancing the Emissions Reduction Fund's Safeguards Mechanism, and employing sectoral policies such as feebates for power generation or electric cars. Investment in charging infrastructure, and a continued push on renewables can further accelerate emissions reduction. Finally, new regulations on disclosure of climate risks for banks and listed companies are welcome. To facilitate assessment of climate and transition risks and foster better allocation of capital, ASIC can further improve standardized disclosures of exposure to climate-related risks for large, listed companies.

AUSTRALIA

November 5, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of September 30, 2021)

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

General Resources Account:

	SDR Million	Percent Quota
Quota	6,572.40	100.00
Fund holdings of currency (exchange rate)	4,767.84	72.54
Reserve tranche position	1,804.82	27.46
Lending to the Fund		
New Arrangements to Borrow	51.98	

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	9,382.52	100.00
Holdings	9,587.32	102.18

Outstanding Purchases and Loans: None

Financial Arrangements: None

Type	Date of Arrangement	Expiration Date	Amount Approved **(SDR Million)**	Amount Drawn **(SDR Million)**
Stand-By	May 1, 1961	September 5, 1961	100.00	0.00

Projected Obligations to Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/interest	0.00	0.16	0.16	0.16	0.16
Total	0.00	0.16	0.16	0.16	0.16

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

Exchange Rate Arrangement. Australia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and

transfers for current international transactions and multiple currency practices, 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). Both the de jure and the de facto exchange rate arrangements are classified as free floating, but the Reserve Bank of Australia retains discretionary power to intervene. There are no taxes or subsidies on purchases or sales of foreign exchange.

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.

Article IV Consultation. Australia is on the 12-month consultation cycle. The 2019 Article IV consultation discussions were held during December 5-13, 2019. The Executive Board discussed the staff report and concluded the consultation on February 21, 2020 (IMF Country Report No. 20/68).

FSAP. The 2018 FSAP missions were held during June 6-26 and August 29-September 14, 2018. The findings were discussed with the authorities during the Article IV consultation discussions in November 2018 and were presented to the Executive Board for discussion alongside the Article IV staff report on February 4, 2019 (IMF Country Report No. 19/54). The previous FSAP Update was discussed by the Executive Board on November 12, 2012 (IMF Country Report No. 12/308).

STATISTICAL ISSUES

Data provision is adequate for surveillance. Australia has subscribed to the Special Data Dissemination Standard (SDDS) since April 1996, and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Australia implemented all the recommendations of the first phase of the G-20 Data Gaps Initiative (DGI), with the exception of semi-annual reporting of Coordinated Portfolio Investment Survey (CPIS) data. Australia also participates in the second phase of the DGI but has no plans to adhere to the SDDS Plus. In recent years, the Australian Bureau of Statistics (ABS) has taken several initiatives to further improve the quality of the data, such as issues relating to seasonal adjustment of unemployment and employment statistics. Adding monthly inflation data to the suite of statistics would assist surveillance.

I. Assessment of Data Adequacy for Surveillance
Real Sector. GDP is compiled on a quarterly basis in current prices and chained volume terms, with timely, regular publication in the first week of the third month after the end of a quarter. Based on the 2008 SNA, GDP is derived by income, expenditure, and production approaches, with their estimates aligned annually based on supply and use tables, which are incorporated in published quarterly estimates 17 months after the reference period. Seasonal and trend estimates are also published. According to the ABS, Australia's implementation of the 2008 SNA standards reflect local conditions and requirements, with departures from the standards relatively minor and not affecting the cross-country comparability of national accounts information. The compiling methodology and the departures from 2008 SNA recommendations are disseminated to the public in detail. The Consumer Price Index (CPI) is published only quarterly (rather than monthly) in the month following the end of a quarter, based on almost 900,000 separate price quotations collected each quarter, together with a breakdown by categories and geographical locations, as well as various analytical series. Since 2018, the CPI expenditure weights have been updated annually. The ABS also publishes quarterly producer, trade, wage cost, living cost and residential property price indices.
Fiscal Sector. The ABS provides annual data (operating statement, balance sheet, government expenses by function, taxation revenue and non-financial assets reconciliation) on the general government and its Commonwealth (central), state/territorial and local government subsectors following the Government Finance Statistics Manual 2014 (GFSM 2014) recommendations, publishing data from 10 years back (with or without revision) on a fiscal year (July-June) basis. It is published roughly 10 months following the fiscal year end, preceded by data on a provisional basis at the time of the budget (usually in May, based on data from 3 months prior to fiscal year end). The Commonwealth, State and Territorial governments also provide data on a timely basis for their respective public sectors that complies with the ABS implementation of the GFS on an accrual basis and the Australian Accounting Standards (AAS). They are presented using the

Uniform Presentation Framework to enhance comparability among states and territories, and with the Commonwealth. They are provided on a monthly basis (with a one-month lag), with an annual statement published within 4 months of the fiscal year end, and are also part of the budgets and mid-year reviews of their respective governments.

The provided data enable adequate assessment of the impact of fiscal policy measures on Australia's economic performance.

Monetary and Financial Sectors.

The Reserve Bank of Australia (RBA) publishes monthly and quarterly data on a broad range of financial variables for financial institutions, the payments system, money and credit statistics, and household and business finances. Most data are monthly, quarterly for banking lending, and weekly or daily series for open market operations, exchange and interest rates.

Monetary and Financial Statistics: The RBA reports monthly monetary and financial statistics (MFS) to the IMF Statistics department based on the standardized report forms. While MFS for Australia are broadly in line with the concepts and definitions of the *IMF's Monetary and Financial Statistics Manual* (2000), the scope of the other financial corporations' sector data could be improved by also including insurance corporations, pension funds, and other financial institutions. The ABS, the Australian Prudential Regulation Authority, and the RBA are reviewing some of their MFS reporting forms with the aim to increase the quality and granularity of source data and to meet the G-20 Data Gaps Initiative (DGI-2) recommendations.

Financial Sector Surveillance: The RBA reports all core financial soundness indicators (FSI) for deposit takers except for the FSIs on the "net open position in foreign exchange to capital" and 21 of the 28 encouraged FSIs for other sectors on a quarterly basis.

Financial Access Survey: Australia reports data on several series and indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External Sector. The ABS publishes the Balance of Payment (BOP) and International Investment Position (IIP) statistics based on the IMF's Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6). Comprehensive data reporting systems support the accuracy and reliability of the external sector statistics. The statistics are disseminated quarterly and published in the first week of the third month after the end of the reference quarter. The BOP and IIP data are consistent and reconcilable with national accounts, monetary, financial and external debt statistics. Historical time series date back to 1959.

Table of Common Indicators Required for Surveillance
(As of October 6, 2021)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[8]
Exchange Rates	10/6/21	10/6/21	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	8/21	9/30/21	M	M	M
Reserve/Base Money	8/21	9/30/21	M	M	M
Broad Money	8/21	9/30/21	M	M	M
Central Bank Balance Sheet	9/29/21	10/1/21	W	W	W
Consolidated Balance Sheet of the Banking System	8/21	10/1/21	M	M	M
Interest Rates[2]	10/6/21	10/6/21	D	D	D
Consumer Price Index	Q3 2021	10/27/21	Q	Q	Q
Revenue, Expenditure, and Balance – General Government[3]	Q2/21	8/30/21	Q	Q	Q
Revenue, Expenditure, and Balance – Central Government	Q2/21	8/30/21	Q	Q	Q
Composition of Financing[4] – General Government	Q2/21	8/30/21	Q	Q	Q
Composition of Financing[4]– Central Government	8/21	10/1/21	M	M	M
External Current Account Balance	Q2/21	8/30/21	Q	Q	Q
Exports and Imports of Goods and Services[5]	8/21	10/4/21	M	M	M
GDP/GNP	Q2/21	9/1/21	Q	Q	Q
Gross External Debt[6]	Q2/21	8/30/21	Q	Q	Q
International Investment Position[7]	Q2/21	8/30/21	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Consists of the central government (including budgetary, extra budgetary, and social security funds) and state and local governments.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The Australian Bureau of Statistics will suspend the publication of monthly data on services exports and imports, starting from January 2022.
[6] Including currency and maturity composition.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Angelia Grant, Alternate Executive Director for Australia
Laura Johnson, Senior Advisor to Executive Director,
and Chris Becker, Advisor to Executive Director
November 22, 2021

Australia has not been spared the economic fallout from the COVID-19 pandemic, experiencing the biggest global economic shock since the Great Depression. Australia has managed impressive health outcomes and provided crucial economic lifelines to households and businesses. A fast economic recovery followed the initial COVID-19 outbreaks, with employment and real GDP surpassing their pre-pandemic levels ahead of any other major advanced economy by 2021Q1. While the Delta variant created setbacks, the emergency economic support provided by the Government has underpinned the strong bounce back in spending and employment observed through partial economic indicators. With vaccination rates one of the highest across the world and authorities safely easing restrictions, Australia is well placed to continue to recover and meet any economic challenges that lie ahead.

Outlook and risks

The Australian economy has shown remarkable resilience in the face of the pandemic. The economy is recovering after the interruption caused by the Delta outbreaks and is showing signs that spending and employment have bounced back strongly as restrictions continue to ease. Headline inflation has picked up, primarily driven by increases in the cost of new dwellings and fuel. Increases in global demand along with difficulties in supply chain adjustments have also impacted prices of certain goods such as furniture and motor vehicles. Underlying inflation also picked up in the September quarter. The RBA expects underlying inflation to remain around 2¼ percent for much of the forecast period, rising slightly towards the end of 2023. Labor market outcomes have surpassed expectations and employment levels more than recovered the losses seen through the pandemic prior to the recent Delta outbreaks. Employment, hours worked and participation fell due to associated lockdowns, but recent data points to a strong recovery as restrictions ease. The outlook for the economy remains positive, with risks around the potential disruption from further COVID-19 outbreaks mitigated through high vaccination rates.

Australia took early and strong measures to suppress COVID-19 outbreaks. The Commonwealth, States and Territories imposed various lockdowns, the international border was closed, and strict quarantine rules were put in place. Australia has one of the lowest death rates from COVID-19 as a share of the population in the world. The national vaccination rollout has made considerable progress and Australia has fully vaccinated around 80 percent of the population aged 16 years and older, with almost 90 percent having received one dose. Lockdown restrictions have gradually eased and from 1 November, partial reopening of the international border occurred along with the beginning of phased removal of quarantine requirements for vaccinated travelers. The opening of borders is crucial for the recovery in the tourism and tertiary

education industries and will see the return of skilled migrants to fill skill shortages in some industries.

<u>COVID response</u>

Australia entered the pandemic from a position of economic and fiscal strength, enabling the authorities to respond decisively with unprecedented economic support. The Government's significant fiscal policy response has been central to Australia's economic performance with immediate temporary, targeted assistance to households and businesses providing crucial lifelines to support the economy. The economic recovery has also been supported by a number of complementary policy actions taken by the RBA. The Government, RBA, and Australia's financial regulators are working collaboratively to ensure a coordinated response to the pandemic and are revising policies to respond to the economic environment and transition economic support as the recovery takes hold.

Existing budget and fiscal flexibility has been utilized to respond to the evolving impacts of the pandemic. The Government revised its fiscal strategy to reflect the changed economic circumstances stemming from the COVID-19 recession and the need for additional support for the economy throughout the pandemic. Once Australia secures the recovery and unemployment is back to its pre-crisis levels or lower, the focus will shift to strengthening Australia's fiscal position and rebuilding fiscal buffers by stabilizing and reducing debt over time through growing the economy and ongoing fiscal discipline. This shift will be determined by a comprehensive assessment of the economy and labor market, and not the unemployment rate alone. Importantly, Australia remains just one of nine nations to hold a AAA credit rating from the three leading ratings agencies.

Australia's response to COVID-19 has been swift and, while some fiscal support measures have been phased out, measures remain in place to support a strong private sector led economic recovery. Many of the fiscal measures made use of existing programs and strong automatic stabilizers. The introduction of the landmark JobKeeper Payment – a wage subsidy program which successfully supported around four million Australians in their job – was a critical element of the Government's response. As the economy has strengthened, the JobKeeper Payment has been phased out. Other notable support measures provided in response to the initial shock included cash flow boost payments for employers, insolvency relief for businesses, loss carry-backs and an increase in the instant asset write-off threshold. For individuals and households, the Government provided one-off stimulus payments to certain welfare recipients, instituted a temporary Coronavirus Supplement for certain welfare recipients and brought forward planned and added additional personal income tax relief. Following the recent COVID-19 outbreaks, the Commonwealth, State and Territory governments implemented new support measures, including the COVID-19 Disaster Payment.

Monetary policy remains highly accommodative. The RBA is committed to not raising interest rates until actual inflation is sustainably within the 2 to 3 percent target range. The

authorities currently do not see this objective being met until 2024 under the central forecast. The RBA has provided monetary policy support by cutting interest rates, purchasing government bonds, targeting the yield on the 3-year government bond, and a term-funding facility for the banking system. Reflecting the improved economic conditions, the RBA recently scaled back the pace of bond purchases and discontinued the yield target for the April 2024 bond. The RBA is committed to open, transparent and accountable communication. The authorities are open to considering a review of the monetary policy framework.

The financial system has been resilient to the effects of the pandemic. Banks have had ample access to funding. They were quick to provide loan repayment deferrals for customers, and a sharp rise in non-performing loans has not eventuated. Capital buffers are sound and bank profitability recovered more quickly than expected. There are risks from the housing sector, but these risks continue to be closely monitored by the authorities. Recently, the prudential regulator increased the interest rate serviceability buffer on home loans by 50 basis points from 2.5 percent to 3.0 percent to address risks in home lending at a time of historically low interest rates. The authorities supervise the financial system under an umbrella of cooperation between the Treasury, RBA, prudential regulator, and securities regulator. This framework has served Australia well throughout the pandemic. The authorities are comfortable with the flexibility and success of the current framework. Further, the prudential regulator is revising the bank capital framework to make it more flexible, risk-sensitive, and competition-enhancing, new guidance on cyber risks has been introduced, and guidance on managing the financial risks of climate change is expected to be released before the end of 2021. Efforts have also been taken to strengthen the AML/CFT regime, and regulation of designated non-financial businesses and professions will be considered as part of a longer-term strategy.

Looking ahead: beyond the pandemic

The Australian authorities are focused on putting incentives in place for a strong, sustainable and inclusive private sector led economic recovery. The Government's economic plan will see Australia through the pandemic, secure economic recovery and job creation, and set Australia up to deal with future challenges. The Government is continuing to provide targeted support to Australian households and businesses to ensure they emerge stronger on the other side of the pandemic. The Government is also building skills for the future that will also encourage greater participation in the labor market, while also taking comprehensive action to guarantee the provision of high-quality and sustainable services to support the most vulnerable. The authorities agree with staff that adequate provision of social housing remains important, noting that the States and Territories have policy responsibility for the provision of social housing.

The Government is prioritizing growing a bigger, highly skilled workforce with a suite of measures to train and reskill the workforce to drive the recovery and reduce unemployment. The JobTrainer Fund is targeted to youth, school leavers and the unemployed and enables them access to free or low-fee courses equipping them for work in areas of shortages, including aged care, IT and childcare. This is in addition to the jobactive Program, the

Government's employment service to help people into work and help employers find the right staff for their business. The jobactive Program includes wage subsidies for disadvantaged groups like the long-term unemployed. The Boosting Apprenticeship Commencements wage subsidy supports businesses to take on new apprentices or trainees, which will help build a pipeline of skilled workers to support a sustained economic recovery. The authorities are closely monitoring these programs and stand ready to adjust them if required.

Australia is committed to the Paris Agreement with a target to achieve net zero emissions by 2050 and Australia is on track to exceed its 2030 emissions reduction target. Australia's recently released Long-Term Emissions Reduction Plan outlines how Australia will harness low emissions technologies to meet its net zero commitments and continue to supply reliable and clean energy. The Plan is backed by Government investment of $20 billion to support the commercialization of low emissions technologies including clean hydrogen, energy storage, carbon capture and storage, ultra-low-cost solar, low carbon materials, and soil carbon. Adaptation is also critical. The recently released National Climate Resilience and Adaptation Strategy positions Australia to anticipate, manage and adapt to climate change. It delivers a national framework for collaboration with the private sector in identifying projects that will meet the needs of the future, improved climate information services, and practical initiatives to protect Australia's environment and economy. This includes national assessments of climate impacts and adaptation progress, and independent monitoring and assessment of progress over time.

Boosting productivity through tax reforms and targeted spending and investment to create a dynamic and competitive economy is at the heart of Australia's economic plan. While several advanced economies have recently announced increases in taxes, Australia continues to announce and implement reforms to the tax system to reward aspiration, boost labor supply, increase investment and drive productivity. Reforms to enhance the R&D tax incentive along with the introduction of a patent box will encourage domestic commercialization of innovation. The Personal Income Tax Plan will implement the largest change to the personal tax system in over two decades ensuring that 95 percent of Australians face a marginal tax rate of no more than 30 percent. Small businesses now face a tax rate of 25 percent (down from 30 percent in 2015-16) and the unprecedented business investment incentives remain in place to the end of 2022-23 further boosting investment and creating jobs. Australia remains committed to building the infrastructure the economy needs and has announced additional infrastructure investments across a 10-year pipeline. The Government will also invest in a Digital Economy Strategy to build on existing investments and harness the opportunities from the pandemic. A modern digital economy will help create more jobs, improve productivity, and enhance the day-to-day experiences of Australians. The authorities also continue to advance their deregulation agenda and remain committed to an open, rules-based international trade system and a transparent FDI regime.