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AUSTRALIA

January 2024

2023 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 2023 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 January 8, 2024 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 January 8, 2024, following discussions that ended on November 1, 2023, 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 December 6, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Australia

The documents listed below have been or will be 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 2023 Article IV Consultation with Australia

FOR IMMEDIATE RELEASE

Washington, DC – **January 18, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Australia.

Australia's post-pandemic recovery remained strong. However, growth is weakening on the heels of tighter macroeconomic policies and financial conditions. While inflation has peaked, it remains persistently high. The labor market shows signs of easing, and the positive output gap is narrowing. Increased cost of living is weighing on household consumption. The economy remains resilient in the near term but confronts a sustained slowdown in productivity growth. Risks to the growth outlook are balanced, with upside risks stemming from robust immigration. Financial stability risks remain contained despite pockets of vulnerability and higher risks related to global financial conditions.

Economic activity is projected to further decelerate in the near term, as the tightening of monetary conditions continues to take hold. Growth is expected to slow to around 1.8 percent y/y in 2023 and 1.4 percent y/y in 2024. Faltering private consumption would continue to put a drag on the economy, as households with mortgages bear the brunt of higher interest rates, amidst lower real wages and depleting savings.

Under staff's baseline projections, inflation would decline gradually and return to the RBA's target range in 2026. While external price pressures have abated, leading to an easing in goods inflation, persistence in non-tradeable prices driven by demand pressures will keep inflation elevated. A positive output gap, amidst tight labor markets, would exert price pressures in the near term. In addition, while real wage growth has been negative, the pick-up recorded in recent quarters could delay disinflation. The recent strong net migration inflows are expected to further alleviate labor market tightness but add to demand, especially in the rental market.

Executive Board Assessment[2]

Executive Directors commended Australia's sound macroeconomic policies which ensured strong recovery and resilience. In the context of necessary macroeconomic policy tightening, Directors observed that growth is expected to slow, and inflation is gradually declining, albeit from above the target range. Directors highlighted the importance of continued monetary and fiscal policy coordination to reduce inflation and recommended reforms to promote productivity growth and the green transition.

Directors welcomed the authorities' progress on fiscal consolidation and commitment to debt sustainability. They underscored the need for a tighter fiscal stance to support disinflation. In that context, Directors saw merit in a comprehensive tax reform and highlighted that rebalancing the tax system from direct to indirect taxes, while addressing regressive impacts,

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[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.

would promote greater efficiency. Directors also recognized the measures taken to contain spending growth and underscored the importance of well-targeted support for vulnerable households. Implementing public investment projects at a more measured pace would also support disinflation efforts.

Directors highlighted the potential need for further monetary tightening to achieve the targeted inflation range by 2025 and recommended a data-dependent approach. They welcomed measures taken to bolster financial stability and the swift progress on implementing FSAP recommendations. Directors encouraged continued strengthening of macroprudential decision-making and crisis management and resolution frameworks. They stressed the importance of continued vigilance amidst tight financial conditions.

Noting the renewed increases in house prices, Directors recommended the adoption of additional borrower-based prudential tools. They supported the initiatives to boost housing supply to improve affordability and emphasized the criticality of supportive planning and land-use policies.

Directors commended the authorities for their recent measures to tackle skill shortages and improve labor market outcomes, particularly for women. They stressed the need for further reforms to reignite productivity growth and foster inclusion. They also commended Australia's continued support for multilateral institutions, for an open trade environment and the country's voluntary participation in the review of transnational aspects of corruption.

Directors welcomed Australia's efforts to meet its climate mitigation targets. While highlighting the important role that the Safeguards Mechanism could play in reducing emissions, Directors recognized that meeting the 2030 climate target will be challenging. They thus encouraged the authorities to consider additional efforts to achieve the net zero emission target by 2050. Noting that alternative sectoral policies can help reduce emissions, Directors welcomed the focus on developing sectoral decarbonization plans.

Table 1. Australia: Main Economic Indicators, 2018-2028

(Annual percent change, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
NATIONAL ACCOUNTS											
Real GDP	2.8	1.9	-1.8	5.2	3.7	1.8	1.4	2.0	2.2	2.3	2.3
Domestic demand	2.7	1.2	-2.2	6.0	4.7	1.7	1.2	2.0	2.2	2.3	2.3
Private consumption	2.4	1.1	-5.8	5.0	6.5	1.2	0.8	2.0	2.7	2.9	2.9
Public consumption	4.1	6.2	7.7	5.4	5.2	0.9	0.8	0.9	0.6	0.5	0.6
Investment	2.3	-2.5	-2.8	10.5	1.2	4.0	2.6	3.3	2.9	2.8	2.8
Public	2.7	2.1	-0.6	7.0	3.5	9.0	3.0	2.2	0.9	0.4	0.4
Private business	2.6	-0.8	-3.8	8.9	3.9	6.7	4.0	4.7	4.1	3.9	3.7
Dwelling	4.3	-7.2	-5.6	9.9	-3.5	-2.2	-0.7	1.5	2.5	2.6	2.8
Net exports (contribution to growth, percentage points)	0.4	1.0	0.1	-1.4	-1.6	1.1	0.2	0.0	0.0	0.0	0.0
Gross domestic income	3.3	3.2	-1.9	8.9	5.2	0.1	-0.7	1.8	2.2	2.3	2.4
Investment (percent of GDP) 1/	24.2	22.6	22.3	23.1	23.3	23.8	24.8	25.0	25.2	25.3	25.4
Public	5.1	5.1	5.2	5.0	5.0	5.6	5.9	5.9	5.8	5.7	5.6
Private	18.9	17.6	17.3	18.0	17.7	18.3	18.9	19.2	19.4	19.6	19.8
Savings (gross, percent of GDP)	22.0	23.1	24.5	26.2	24.7	24.4	24.3	24.5	24.6	24.6	24.7
Households	9.3	9.9	17.0	14.6	10.3	8.0	8.2	9.1	8.9	9.5	9.3
Potential output	2.4	2.3	1.3	1.5	1.9	2.0	2.1	2.3	2.1	2.3	2.4
Output gap (percent of potential)	-0.7	-1.0	-4.0	-0.5	1.2	1.1	0.4	0.0	0.1	0.1	0.0
LABOR MARKET											
Employment	2.7	2.3	-1.6	3.1	4.3	2.2	1.1	1.5	1.5	1.7	1.6
Unemployment (percent of labor force)	5.3	5.2	6.5	5.1	3.7	3.7	4.2	4.4	4.6	4.6	4.6
Wages (nominal percent change)	2.1	2.3	1.6	2.0	3.0	4.2	4.1	4.0	3.7	3.6	3.0
PRICES											
Terms of trade index (goods, avg)	83	90	90	109	120	108	96	95	95	95	95
% change	3.2	8.4	0.3	21.4	9.6	-9.9	-11.3	-0.8	-0.1	-0.1	0.2
Iron ore prices (index)	101	135	156	228	174	161	137	124	114	109	105
Consumer prices (avg)	1.9	1.6	0.9	2.8	6.6	5.8	4.0	3.2	2.8	2.7	2.6
Core consumer prices (avg)	1.6	1.6	1.2	2.8	5.7	5.5	3.9	3.2	2.8	2.7	2.6
GDP deflator (avg)	2.2	3.2	0.8	5.6	7.9	1.7	0.7	3.0	2.6	2.6	2.6
FINANCIAL											
Reserve Bank of Australia cash rate target (percent, avg)	1.5	1.2	0.3	0.1	1.6	4.0	4.4	4.0	3.5	3.1	3.0
10-year treasury bond yield (percent, avg)	2.6	1.4	0.9	1.6	3.6	3.9	4.3	4.5	4.4	4.1	4.0
Mortgage lending rate (percent, avg)	5.3	4.8	4.5	4.5	7.3	8.3	8.3	8.1	7.6	7.4	7.4
MACRO-FINANCIAL											
Credit to the private sector	4.7	2.5	2.1	7.4	8.4	7.8	4.1	4.3	4.5	4.5	4.6
House prices (% change)	-5.1	2.5	3.6	23.7	-5.6	7.1	5.1	5.2	5.1	5.2	5.2
House price-to-income, capital cities (ratio)	4.3	4.3	4.2	4.9	4.5	4.9	4.7	4.7	4.7	4.6	4.6
Interest payments (percent of disposable income)	8.9	7.0	5.8	5.2	10.8	13.3	12.6	11.9	11.0	10.4	10.4
Household savings (percent of disposable income)	4.6	5.9	15.5	13.1	7.0	2.9	-5.1	-0.3	2.0	3.3	3.4
Household debt (percent of disposable income) 2/	186	185	179	187	187	193	190	183	182	179	179
Business credit (percent of GDP)	50.4	49.1	50.1	48.9	49.3	52.4	54.1	54.5	55.1	55.6	56.1
GENERAL GOVERNMENT (percent of GDP) 3/											
Revenue	35.6	35.7	34.5	35.0	36.0	36.4	37.3	35.6	35.5	35.1	35.1
Expenditure	36.8	36.9	42.1	44.3	40.0	37.2	39.2	38.0	36.9	36.6	36.3
Net lending/borrowing	-1.3	-1.2	-7.7	-9.3	-4.0	-0.8	-1.9	-2.3	-1.4	-1.5	-1.2
Commonwealth only	-0.5	-0.1	-4.8	-6.9	-1.3	1.1	-0.3	-1.3	-1.0	-0.9	-0.7
Operating balance	0.6	0.9	-5.5	-7.0	-1.5	1.5	0.0	-0.6	-0.2	0.0	0.3
Cyclically adjusted primary balance	0.4	0.5	-5.0	-7.1	-2.8	0.0	0.0	-0.3	0.8	0.7	0.9
Gross debt	41.3	42.2	52.7	58.3	53.5	49.5	54.4	55.3	56.0	56.0	55.2
Net debt	23.7	24.5	32.1	38.0	33.7	27.1	31.3	33.4	34.3	34.3	33.9
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-2.2	0.4	2.2	3.0	1.1	0.7	-0.5	-0.6	-0.6	-0.7	-0.6
Export volume	5.1	3.2	-9.7	-2.0	3.4	8.5	2.6	2.0	2.1	2.2	2.3
Import volume	4.3	-1.1	-12.8	5.4	12.9	4.0	2.2	2.4	2.4	2.4	2.4
Net international investment position (percent of GDP)	-57.0	-50.1	-53.0	-38.3	-38.2	-32.5	-32.3	-31.4	-30.5	-29.7	-29.0
Gross official reserves (bn A$)	76	84	56	81	85	…	…	…	…	…	…
MEMORANDUM ITEMSW											
Nominal GDP (bn A$)	1,894	1,992	1,971	2,189	2,450	2,536	2,591	2,721	2,853	2,995	3,143
Percent change	5.1	5.2	-1.1	11.0	11.9	3.5	2.2	5.0	4.8	5.0	4.9
Real GDP per capita (% change)	1.3	0.4	-2.8	4.9	2.2	0.8	0.2	0.7	1.0	1.1	1.1
Population (million)	25.1	25.5	25.6	25.8	26.3	26.6	26.9	27.3	27.6	27.9	28.3
Nominal effective exchange rate	90.0	86.3	86.0	90.8	90.3	…	…	…	…	…	…
Real effective exchange rate	90.0	86.0	85.3	90.5	90.7	…	…	…	…	…	…

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 2023 ARTICLE IV CONSULTATION

December 4, 2023

KEY ISSUES

Context. Australia's post-pandemic recovery remained strong. However, growth is weakening on the heels of tighter macroeconomic policies and financial conditions. While inflation has peaked, it remains persistently high. Labor market shows signs of easing, and the positive output gap is narrowing. Increased cost of living started to weigh on household consumption. The economy remains resilient in the near term but confronts a secular productivity slowdown. Financial stability risks remain contained although pockets of vulnerability exist and risks of spillovers from global financial conditions have increased since the last Article IV.

Policy recommendations: Short-term policies should focus on navigating the economy to a soft landing, by bringing inflation back to target, while maintaining financial stability. Policy coordination will be critical. Structural reforms must address declining productivity growth and challenges related to ageing and put the economy on the path for a green transition. Harnessing the potential of migration and innovation will be key to long-term prosperity and inclusion.

- **A tighter fiscal policy** is needed to support disinflation. Fiscal policy must strike an appropriate balance between supporting monetary policy—by not adding to inflation pressures—in the near term and the necessary structural transformation over the long term.

- **Monetary policy** should be tightened further to ensure inflation comes back to target earlier than 2026 projected in the baseline. The pace of further tightening needs to be calibrated based on incoming data and should consider the lags in the transmission of the effects of monetary policy.

- **Financial sector policy** should preemptively address stability concerns through macroprudential policies to address pockets of vulnerability. Although non-performing loans (NPLs) remain low, continued vigilance is needed to safeguard financial stability. Australian banks are adequately capitalized with sufficient liquidity buffers to manage near- and medium-term risks.

- **Structural policies** should be centered around promoting productivity growth. Continued investment in digital infrastructure, more direct government funding for research and development (R&D), and more open FDI regime coupled with labor market and tax reforms are among the key structural policies.

Approved By
Anne-Marie Gulde-Wolf (APD) and Anna Ilyina (SPR)

Discussions took place in Canberra, Melbourne, and Sydney during October 18–November 1, 2023. The staff team comprised Abdoul Aziz Wane (head), Pragyan Deb, Klaus Peter Hellwig, Kenichiro Kashiwase, Evan Papageorgiou, and Nour Tawk (all APD). Anne-Marie Gulde-Wolf (APD) joined the closing policy discussions. Robert Nicholl and Tanuja Doss (both OED) joined the discussions. John Spray, Abdullah Alnasser, and Nadine Dubost (all APD) assisted from HQs. Emmanuel Mathias, Yao Deng, and Jonathan Pampolina (all LEG) participated in virtual meetings before the mission.

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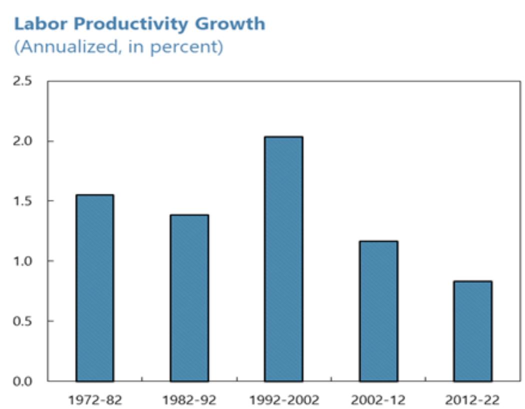
TABLES

ANNEXES

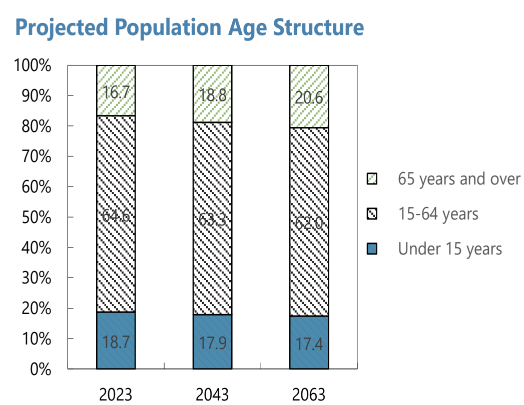
CONTEXT: NEAR-TERM IMBALANCES AMIDST LONGER-TERM CHALLENGES

1. Australia's post-pandemic recovery remained stronger than peers', even as high inflation and tighter financial conditions are weighing on household consumption. The slowdown in households' consumption growth was, however, offset by resilient private investment supported by public investment in transport, health, education, and national defense. Net exports contributed to growth on the back of robust sales of coal and service exports buoyed by inflows of foreign students, migrants, and tourists. As a result, the job market remained tight and inflation more persistent than envisioned. The sizable, positive output gap in 2023 is projected to narrow in the near term. More persistent inflation, de-anchoring of inflation expectations, and external-demand shocks are among the visible risks to the near-term.

2. Longer-term challenges to sustained and shared prosperity are becoming more visible. The economy faces structural challenges from a secular slowdown in productivity growth, population ageing, and climate change, amidst the dislocations from geopolitical fragmentation. The Labor Government has signaled a commitment to "seize the moment" by "rising to the productivity challenge" through evidence-based public policy making. The recently published Intergenerational Report, the 5-year Productivity Inquiry, the Business Council of Australia's report, and the review of the Reserve Bank of Australia (RBA) offer thorough assessments of these challenges. The recommendations of the Independent Strategic Review of the Infrastructure Investment Program (IIP) will help lay the ground for a more sustainable IIP.



Source: OECD.



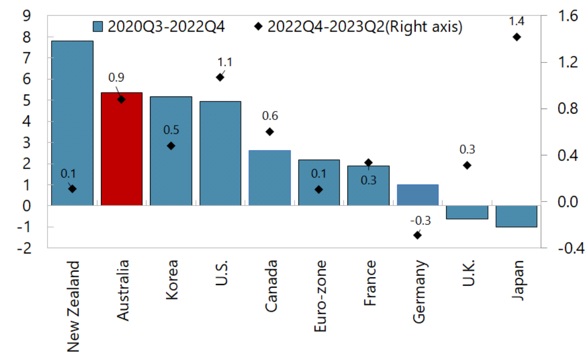
Source: ABS.

A SOFT LANDING REMAINS IN SIGHT

A. Recent Developments Show the Resilience of the Economy

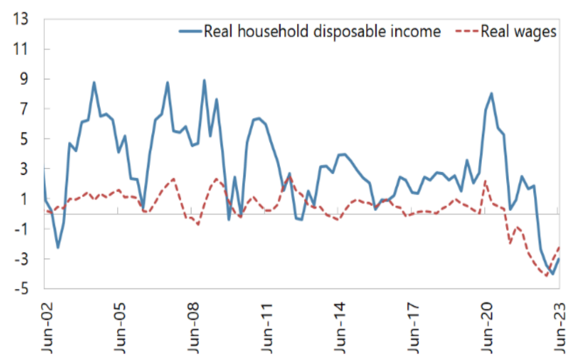
3. After a strong post-pandemic recovery, growth in Australia is slowing, despite pockets of resilience to the engineered softening (Annex I). Economic activity in Australia recovered faster than in most advanced economies (AEs), aided by generous policy support, strong investment, and robust private consumption. Growth decelerated from 3.7 percent (y/y) in 2022 to 2.1 percent (y/y) in 2023Q2, as persistent inflation and elevated interest rates raised the cost of living, while real wages declined. This resulted in a decline of real disposable income and a slowdown in household consumption, retail sales, and domestic demand. Weakness of private consumption was offset by strong business investment, buoyed by temporary expensing implemented during the COVID-19, and by public investments in large infrastructure projects. Net exports contributed to growth, supported by commodities and a bounce-back in services.

After Strong Economic Outturns, Growth Momentum Slows
(Percent change)



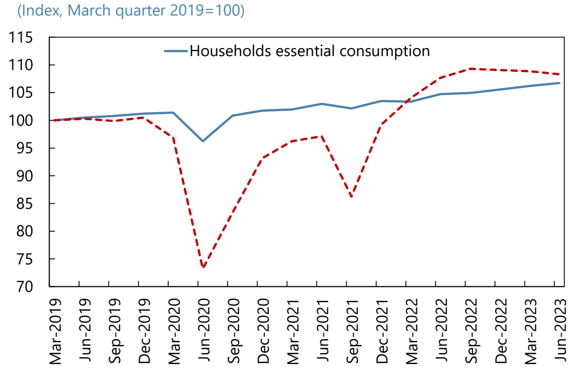
Sources: Haver Analytics., IMF staff calculations.

Real Household Disposable Income Has Contracted
(Percent, y/y)



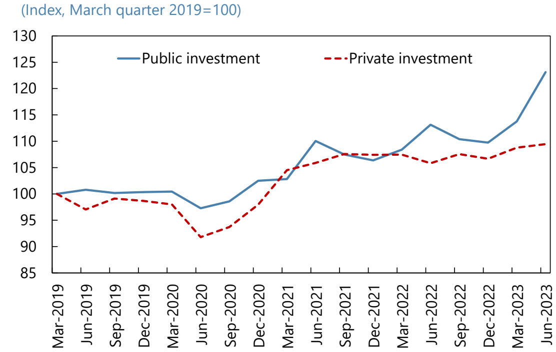
Sources: ABS, CEIC, IMF staff calculations.

Essential and Discretionary Spending
(Index, March quarter 2019=100)



Sources: ABS, IMF staff calculations.

Public and Private Investment
(Index, March quarter 2019=100)

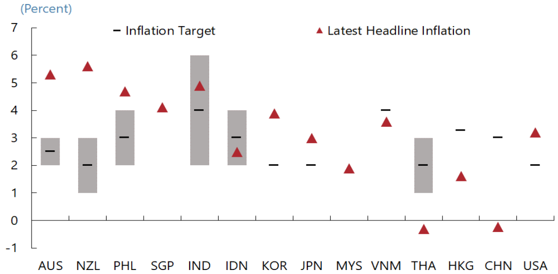


Sources: ABS, IMF staff calculations.

4. **The pace of disinflation remains slow, with strong pressures from services.** Inflation declined to 5.4 percent in 2023Q3 (from a peak 7.8 percent in 2022Q4) but remains above the RBA's 2-3 percent target range for headline inflation. The easing of global supply-chain pressures and a slowdown in domestic demand helped reduce goods inflation, following strong inflationary pressures which built up during the pandemic (Annex II). However, services inflation is high and broad-based, reflecting pressures from insurance premiums linked to weather-related claims, financial services fees in real-estate transactions, petrol prices, and prices for restaurants driven by elevated food and labor costs. Like in other AEs, tight conditions in the rental housing market also led to a significant acceleration in rent inflation (Annex III).

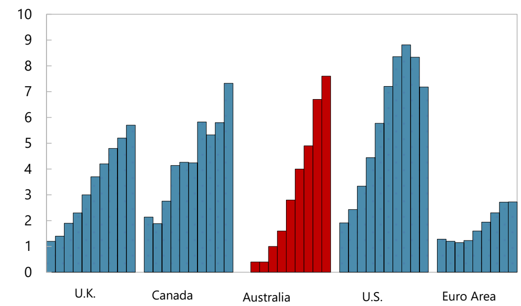
5. **Labor market tightness persists but is showing signs of easing.** The pickup in migration inflows in 2023 lifted population growth (2.2 percent y/y in 2023Q1) and improved the balance between labor supply and demand. As a result, the vacancy-to-unemployment ratio declined, and while the unemployment rate has ticked up, it is still around historical lows (3.6 percent in September 2023), and significantly below the authorities' estimated NAIRU (~4½ percent). Despite historically low labor productivity, wages continue to trend upward, alongside real measures of unit labor costs.

Inflation is Above Target in Most Advanced and Emerging Economies
(Percent)



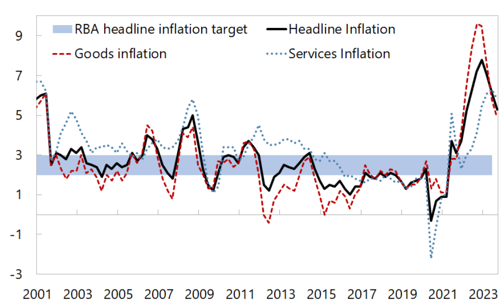
Source: Consensus Forecasts and IMF staff calculations.
Note: Data as of November 13th,2023. Latest inflation and consensus forecasts are for headline inflation. Some countries do not have explicit inflation targeting regimes or target, while target ranges apply to core inflation in some countries.

Rent Inflation is High in Many Advanced Economies
(y/y, 2021Q2 to 2023Q3)



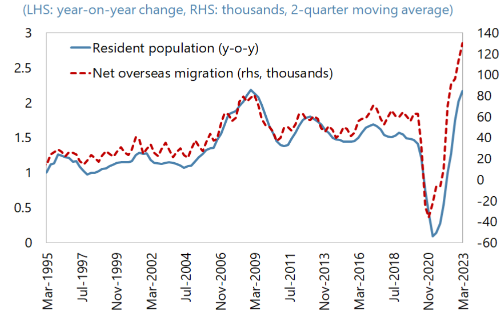
Sources: ABS, FRED, Eurostat, Office for National Statistics, Statistics Canada.

Services Inflation is Persistent
(Year-on-year; percent; seasonally adjusted)



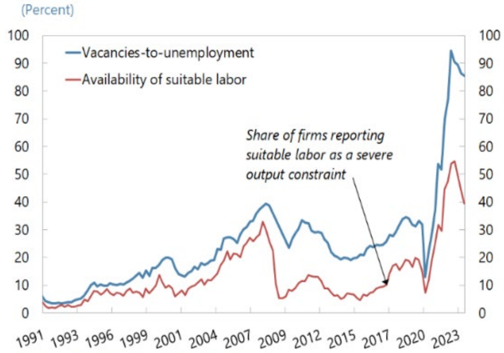
Sources: ABS; and IMF staff calculations.

Migration Inflows Have Been Significant
(LHS: year-on-year change, RHS: thousands, 2-quarter moving average)



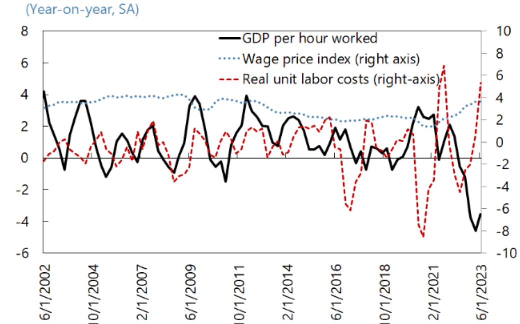
Sources: CEIC, ABS, IMF staff calculations.

Indicators of Labor Market Tightness Have Eased
(Percent)



Sources: ABS; NAB; and IMF staff calculations.

Low Productivity Despite Higher Labor Costs
(Year-on-year, SA)



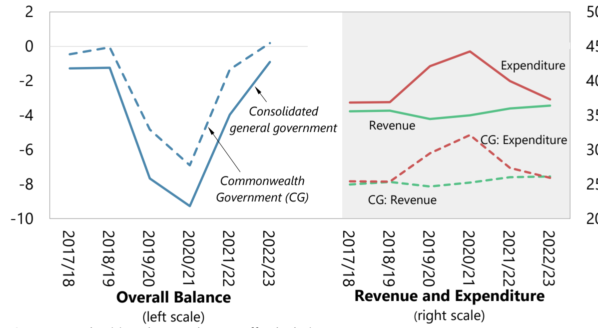
Sources: ABS, IMF staff calculations.

6. **The sizable fiscal consolidation continued in FY2022/23 (ended June 2023), bringing the cyclically adjusted primary balance close to pre-COVID levels.** The Commonwealth and state and territory governments continued to streamline spending while providing new targeted cost-of-living

relief for households and financial support for businesses. Strong labor market and favorable commodity market developments continued to bolster tax revenue. The overall deficit of the consolidated general government further declined to below one percent of GDP, with the Commonwealth Government achieving the first cash-balance surplus in 15 years. In contrast, subnational-level fiscal consolidation moderated, in part due to higher infrastructure spending. Nonetheless, the overall balance at the consolidated level improved more than in other AEs, upholding Australia's substantial fiscal space and keeping public debt sustainable (Annex IV).

Commonwealth Government Achieved A Surplus in 2022/23

(Percent of GDP 1/)



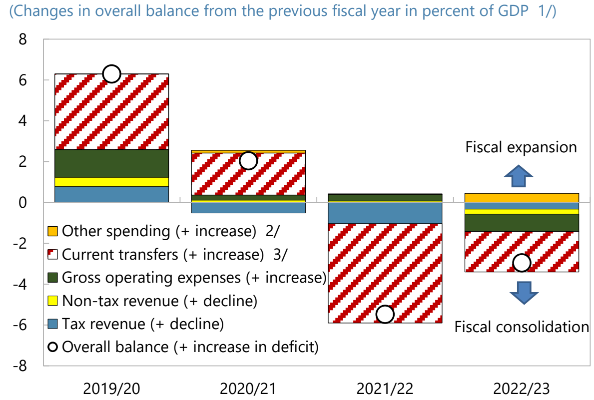
Sources: Authorities' data; and IMF staff calculations.

1/ Solid lines represent consolidated general government, comprising the Commonwealth Government (CG), and state and territory and local governments.

Cyclically Adjusted Primary Balance Is Close to Pre-COVID Levels

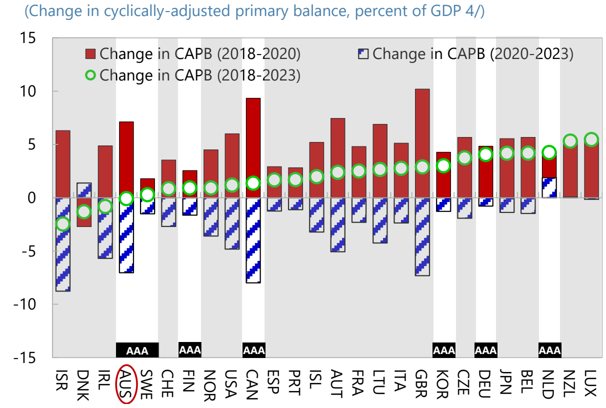
Australia Has Pushed Through Successive Fiscal Consolidation

(Changes in overall balance from the previous fiscal year in percent of GDP 1/)



Consolidation Has Been Sizable and Faster Than Other AEs

(Change in cyclically-adjusted primary balance, percent of GDP 4/)



Sources: Haver Analytics; and IMF staff calculations.

1/ Based on fiscal outturns of the consolidated general government operations.

2/ Includes interest expenses and gross capital fixed formation, among other items.

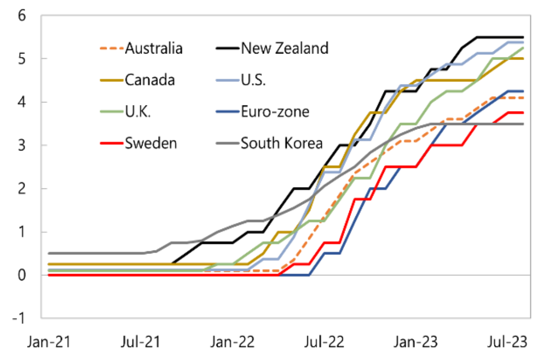
3/ Include grants, subsidies, and other current transfers.

4/ Based on cyclically adjusted primary balance (CAPB). A positive (negative) difference in CAPB shows fiscal expansion (contraction). A bar with solid blue shows countries with a "AAA" sovereign rating for comparison.

7. **RBA has tightened monetary policy significantly to address above-target inflation.** In response to persistent inflation, RBA hiked the policy rate by 25bps in November, after pausing since June to assess incoming data. Cumulatively, the cash rate has risen by 425 basis points since May 2022. Rates are now restrictive and have resulted in a moderation in private sector credit growth and continued tightening of financial conditions, as mortgage rates reset. Medium-term inflation expectations remain anchored and short-term inflation expectations are moderating. Although the pace of tightening has been unprecedented, it has been less so than in some other advanced economies, and at the lower end of what a naïve Taylor rule would imply. Like many other AE central banks, the RBA has opted to let its asset purchase portfolio decline passively through bond maturities.

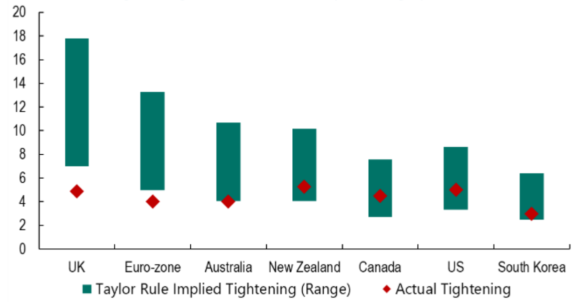
Monetary Policy Has Tightened Rapidly

Australian Policy Rates Have Risen, But Less Than Other AEs
(Selected Advanced Economies, Percent)



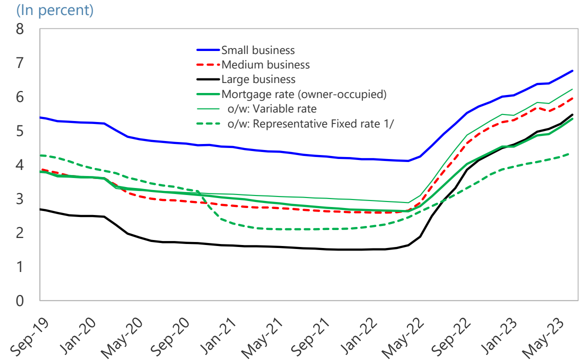
Sources: Haver Analytics

Tightening at Lower-end of Taylor Rule – Implied Rates
(Cumulative Tightening, 2021:Q1–2023Q2, percentage points)

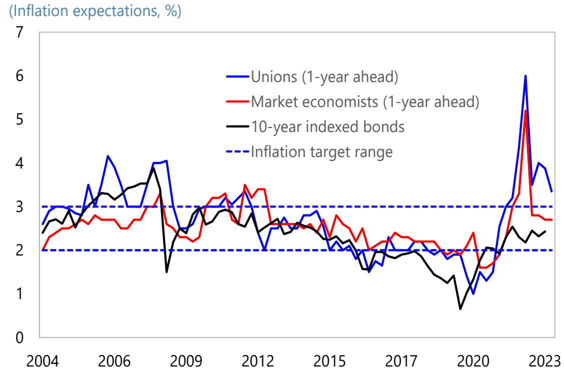


Note: All countries show data up to que second quarter of 2023. Calculations for Taylor Rule implied interest rate are derived from $\Delta i_t = 1/1.5(\Delta\pi_t) + 0.1/0.5(\Delta y_t)$ where π is core inflation rate and y is the output gap. Output gaps were interpolated from yearly to quarterly frequency. Country abbreviations are International Organization for Standardization country codes.

Lending Rates Have Increased With Monetary Tightening
(In percent)



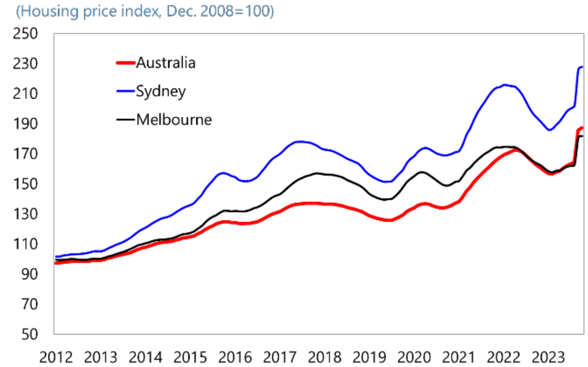
Short-term Inflation Expectations Moderating, Medium-Term Expectations Remain Anchored
(Inflation expectations, %)



Sources: Reserve Bank of Australia; IMF World Economic Outlook, Haver Analytics; and IMF staff calculations.

8. **After correcting in 2022, house prices are increasing again.** Housing prices declined 8 percent peak-to-trough between 2022Q1 and 2023Q1, with falling sales volumes and building approvals. While significant, the decline was less than forecast, and recent data shows an uptick in prices, albeit under thin volumes and weak building approvals. Price gains were initially led by expensive segments in Sydney but have now become broad based across regions and property types. The turnaround reflects stronger demand, given market expectation that policy rate was approaching a peak, higher migration, spillovers from the tightness in the rental market, and limited supply due to capacity constraints in the construction sector.

Housing Prices Are Stabilizing
(Housing price index, Dec. 2008=100)



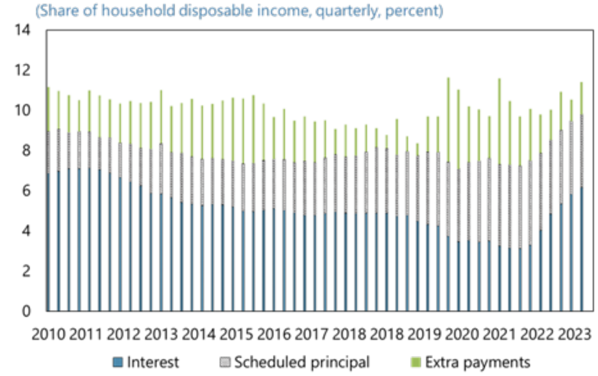
Source: Corelogic.

B. Outlook Remains Robust Despite Increased Headwinds

9. Economic activity is projected to further decelerate in the near term, as the tightening of monetary conditions continues to take hold. Given the lags in the transmission of monetary policy to growth, the bulk of that impact is likely to materialize in 2023 and 2024 (Table 1). Growth is expected to slow to around 1.8 percent y/y in 2023 and 1.4 percent y/y in 2024. Faltering private consumption would continue to put a drag on the economy, as households with mortgages bear the brunt of higher interest rates, amidst lower real wages and depleting savings (**Box 1**). Business investment will remain resilient, but a slowdown in the Chinese property sector would dampen Australia's growth through trade, lowering demand for Australia's key commodity exports, government revenues, and adversely impacting growth more broadly (**alternative scenario, para 12**). Weakness in goods exports will be partly offset by the continuing rebound in tourism flows.

Housing Mortgage Payments

(Share of household disposable income, quarterly, percent)

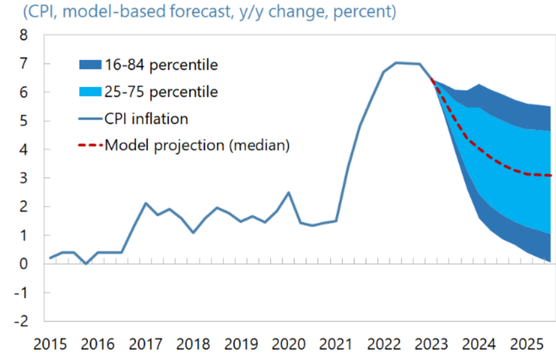


Sources: ABS, APRA, and RBA

10. Inflation would decline gradually and return to the RBA's target range in 2026. While external price pressures have abated, leading to an easing in goods inflation, persistence in non-tradeable prices driven by demand pressures will keep inflation elevated. A positive output gap, amidst tight labor markets, would exert price pressures in the near term. In addition, while real wage growth has been negative, the pick-up recorded in recent quarters could delay disinflation. The recent strong net migration inflows are expected to further alleviate labor market tightness but add to demand, especially in the rental market. As the economy converges to its potential, unemployment is projected to rise to 4.8 percent, and hover around the NAIRU, in the medium term.

Outlook for Inflation Remains Highly Uncertain

(CPI, model-based forecast, y/y change, percent)



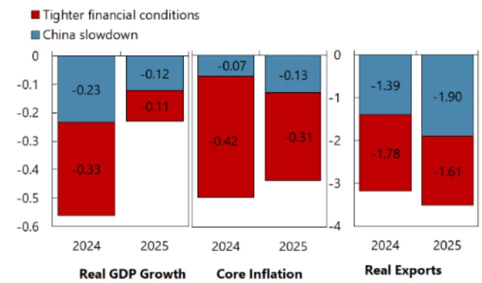
Sources: ABS, IMF staff estimates.

Note: See IMF(2022) Selected Issues Paper for methological details.

11. On a preliminary basis, the external position in 2023 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex V). As commodity prices normalize over the medium term, the trade surplus is expected to decline below 2 percent of GDP, from a record 5.8 percent of GDP in 2022. The current account – in surplus since 2019 due to cyclical factors – is expected to revert to a small deficit in 2023Q4, as net dividend and interest outflows more than offset the trade surplus. Staff estimate that Australia's external position (estimated cyclically adjusted at -0.3 percent of GDP in 2023) continues to be broadly in line with the level implied by medium-term fundamentals and desirable policies (-0.9 percent of GDP). The exchange rate (on REER basis) has remained broadly stable throughout 2022 and 2023H1.

12. Baseline risks to the growth outlook are balanced, with upside risks to inflation (Annex VI). Near-term risks stem from the external environment, and policy miscalibration both domestically and globally. In an alternative scenario with a protracted downturn in China, a distressed property market and weaker imports would dampen Australia's external demand and growth. If inflation remains elevated, fiscal policy should weigh in, with time-bound, well-targeted stimulus measures (e.g., low-income tax offsets) to support inclusive growth. Another risk arises from tighter financial conditions[1] in AEs and Australia: in a scenario with tighter-for-longer financial conditions, persistent output gaps or de-anchored inflation expectations stability and overall growth will be adversely affected. Sticky inflation could risk accelerating wage growth, potentially igniting a wage-price spiral with high and destabilizing inflation expectations. Given that variable rate mortgages make up 80 percent of outstanding housing credit, and those fixed are typically for three years or less, more rate hikes could trigger pockets of household distress, with adverse distributional impacts on low-income households or borrowers who purchased near the top of the housing cycle. Vulnerabilities in the household sector could in turn spillover to Australia's banking system, dampening domestic demand and growth in the medium term. Domestically, high uncertainty surrounds households' behavior: as pandemic-savings are depleted, households may spend less, leading to a greater fall in domestic demand. If risks materialize, coordinated monetary and fiscal action will be needed, including via targeted support to the vulnerable, given substantial fiscal space. Deepening geo-economic fragmentation (Box 2) could lead to commodity price volatility and affect trade and investment flows and growth. Other downside risks include natural disasters from climate change, and cybersecurity risks. Upside risks include an acceleration of housing price increases, which can boost consumer sentiment and household consumption through wealth effects. However, this would add to inflation pressure and exacerbate policy challenges.

Downside Risk Scenario on Australia
(Percentage point difference from the baseline forecast, y/y)



Sources: World Economic Outlook, IMF staff calculations.

Authorities' Views

13. Like staff, authorities expected economic growth to moderate in the near term but avoid a recession. They expected the weakness in household consumption growth from high interest rates and lower real incomes to continue to feed through to the economy, while a strong pipeline for private business and public investment supports growth. They viewed inflation as likely to further decline, returning to the RBA's target in 2025[2], but noted that a number of factors contributed to uncertainty around the speed of disinflation, including volatility in oil prices. They

[1] A scenario of tighter financial conditions incorporates a tightening in financial conditions caused by "higher for longer" policy rates in AEs.

[2] At time of mission, the authorities' views were predicated on the August Statement of Monetary Policy outlook, that was updated shortly after the mission visit.

also noted that, while wage growth was relatively contained despite labor market tightness, continued weakness in labor productivity growth could keep growth of unit labor costs high, adding to inflationary pressures. They agreed with staff's preliminary external sector assessment. The authorities viewed the key uncertainty for the domestic outlook stemming from the response of household consumption to tighter financial conditions. This response depends on households' savings behavior (with the saving rate out of current income having declined but still positive) and the extent to which households draw on their stock of savings to smooth consumption. They also perceived a global slowdown, especially in China, as a main risk to growth and to commodities exports. Though, they noted Australia's mining sector has bolstered its resilience by tapping new markets.

RECALIBRATING POLICY THROUGH TIGHTENING AND COORDINATION

14. The authorities have taken decisive measures to tighten, relative to pandemic-era loose policy settings, but more could be done. Like in many other AEs, output remains above potential, unemployment at record lows, and inflation significantly above target. A rapid pace of public investment execution could fuel demand pressures amidst supply constraints. Policies should therefore play a more active role to manage aggregate demand and ensure a soft landing. A tight monetary stance is warranted to ensure inflation is coming back to target by 2025 and minimize the risk of de-anchoring inflation expectations. As distributional impacts of monetary policy become more visible in the tightening cycle, policy coordination remains key. Fiscal policy should support the RBA's efforts through a tighter overall stance. While ensuring income support measures are well-targeted, all levels of governments need to prioritize infrastructure projects as they tend to generate higher multiplier effects. A more growth-friendly tax structure and measures to improve spending efficiency would help address supply-side constraints.

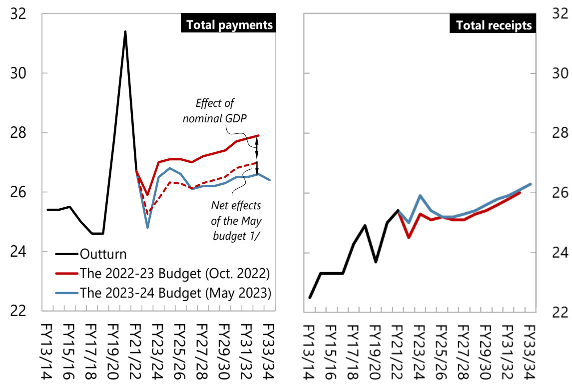
A. Fiscal Policy – Avoid Costly Delays in Addressing Challenges

15. The Commonwealth Government has delivered its commitment for budget repair and committed to further measures. The efforts aimed to put the budget on a more sustainable footing, including through:

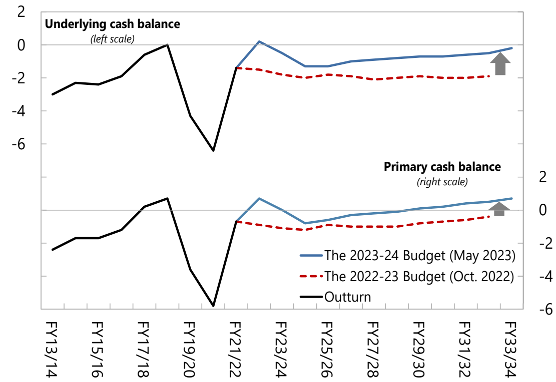
- Saving windfall revenue in FY2022/23. Gross public debt peaked at around 56 percent of GDP, lower than previously estimated delivering savings in interest payments amounting to 3½ percent of 2022 GDP over the next decade.
- Committing to reduce structural spending growth, with a positive primary balance projected by 2030. The 2023/24 Budget upholds the pledge by restraining fast-growing expenditure of the National Disability Insurance Scheme (NDIS) in the context of a Financial Sustainability Framework to limit annual cost growth to less than 8 percent, starting FY2026/27.

Budget Repair Improves the Fiscal Outlook Over the Long Term

Budget Repair Bends Down the Spending Trajectory
(Commonwealth Government; percent of GDP in the respective budgets)

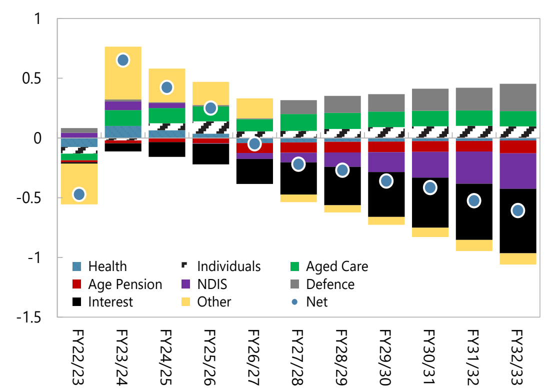


Primary Balance Is Projected to Turn Surplus by 2030
(Commonwealth Government; percent of GDP)

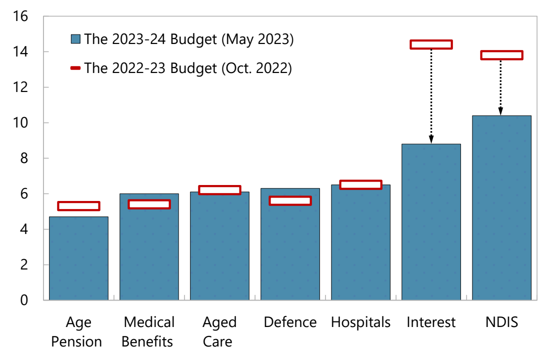


In the Near Term, New Measures Add Spending - Albeit Limited - Relative to the Last Budget

New Measures Add Spending in the Near Term
(Commonwealth Government; percent of GDP; changes relative to the last budget 2/)



Growth in Major Spending Items Over the Next Decade
(Commonwealth Government; average annual growth in percent 3/)



Sources: Authorities' data; and IMF staff calculations.
1/ Net effects reflect new policy decisions and effects of underlying parameters and other variations.
2/ Changes reflect the revisions to the 2023-24 budget in May 2023, compared to the 2022-23 budget in October 2022.
3/ Average growth in spending is calculated over FY2023/24-FY2033/34 for the 2023/24 Budget and FY2022/23-FY2032/33 for the 2022-23 Budget. NDIS accounts for contributions by the Commonwealth Government for participant supports only.

16. The 2023-24 Budget deficit of the Commonwealth Government is manageable. The overall balance is projected to turn back into a small deficit (¼ percent of GDP in FY2023/24) and further deteriorate (to 1¼ percent of GDP in FY2024/25), reflecting the last stage of the personal income tax reforms,[3] which will reduce revenues annually by 1 percent of GDP. Expenditure as a share of GDP is projected to increase with the introduction of cost-of-living relief and other programs targeted to vulnerable

Commonwealth Government:
Cost-of-Living Relief Measures in the 2023-24 Budget

Measure:	Spending (Percent of FY22/23 GDP)	Period
Reduce the Cost of Health Care		
Provide better access and more affordable care by lowering out-of-pocket health costs and reducing the costs of medicines.	0.23	FY22/23-FY26/27
Increase the JobSeeker Payment and Other Eligible Income Support Payments		
The basic rate of eligible working age and student income support payments, including JobSeeker Payment and Youth Allowance will increase by $40 per fortnight. Eligible single Australians aged 55 and over will receive the high basic rate.	0.19	FY22/23-FY26/27
Commonwealth Rent Assistance		
Increase the maximum rates of rent assistance payment by 15 percent to address rental affordability challenges for recipients.	0.11	FY22/23-FY26/27
Expanded Access to Parenting Payment (Single)		
Extend the eligibility for Parenting Payment (Single) to support principal carers with a youngest child under 14 years of age.	0.08	FY22/23-FY26/27
Energy Bill Relief		
Provide a targeted energy bill relief and progress gas market reforms to reduce the impact of rising energy prices on households and businesses.	0.06	FY22/23-FY25/26

Source: Commonwealth of Australia, Budget 2023-24: Budget Strategy and Outlook - Budget Paper No. 1.

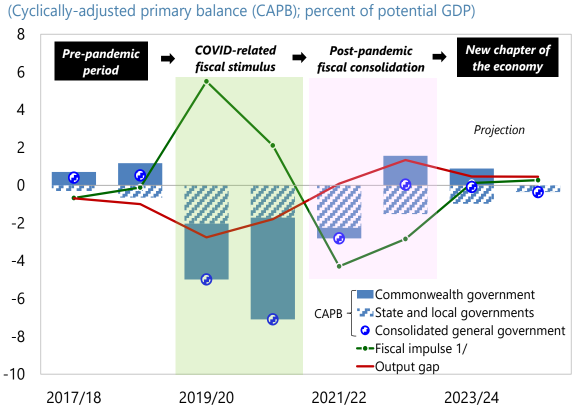
[3] The reforms will remove the A$120,000-180,000 tax bracket, increase the top tax bracket to A$200,000 and reduce the marginal tax rate to 30 percent for those earning between A$45,000 and $200,000.

households and businesses. The new measures are partly financed by modest savings from prioritization of existing programs. The budget is built on conservative commodity price assumptions and envisages small tax-revenue gains from better targeting superannuation tax concessions and reforms to the Petroleum Resource Rent Tax.

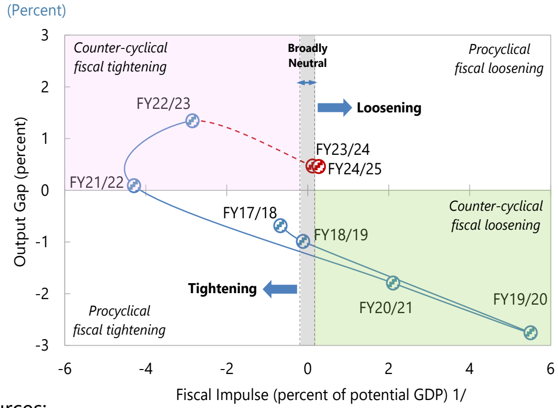
17. Fiscal policy needs to take a tighter stance to support disinflation in the near term and make the economy more productive and greener over the medium term. The cyclically-adjusted primary balance is projected to turn back into a deficit of around 0.1-0.4 percent of potential GDP for FY23/24-FY24/25 and deliver a small fiscal impulse, which will add to domestic demand. As inflation is more persistent than expected, the government needs to maintain fiscal discipline to help contain inflation. Within the envelope consistent with the disinflation objective, the Commonwealth Government, in coordination with state and territory governments, should enhance targeting of income support to vulnerable households disproportionately hit by the tighter monetary and financing conditions. The authorities should prioritize infrastructure projects to support productivity gains and the green transition, while containing high multiplier effects of capital spending and its impacts on wages.

Formulating Fiscal Policies Confronts Headwinds

Slowdowns in Growth Test Fiscal Policy Formulation
(Cyclically-adjusted primary balance (CAPB); percent of potential GDP)



Fiscal Stance Turns "Loosening" With Output Gap Narrowing
(Percent)



Sources: Authorities' data; and IMF staff calculations.
1/ Based on the calculation of cyclically adjusted primary balance in percent of potential GDP.

18. Expenditure policy should focus on improving outcomes and efficiency to contain demand pressures and deliver long-term savings.

- **Reduce demand pressures.** Modest increases in expenditure still add demand pressures in the tight labor market. Capital expenditure projects can add to inflation and wage pressures, given labor and supply shortages in construction. The Commonwealth Government needs to further improve spending efficiency, given the current practice of indexing for inflation on expenditures (Box 3).

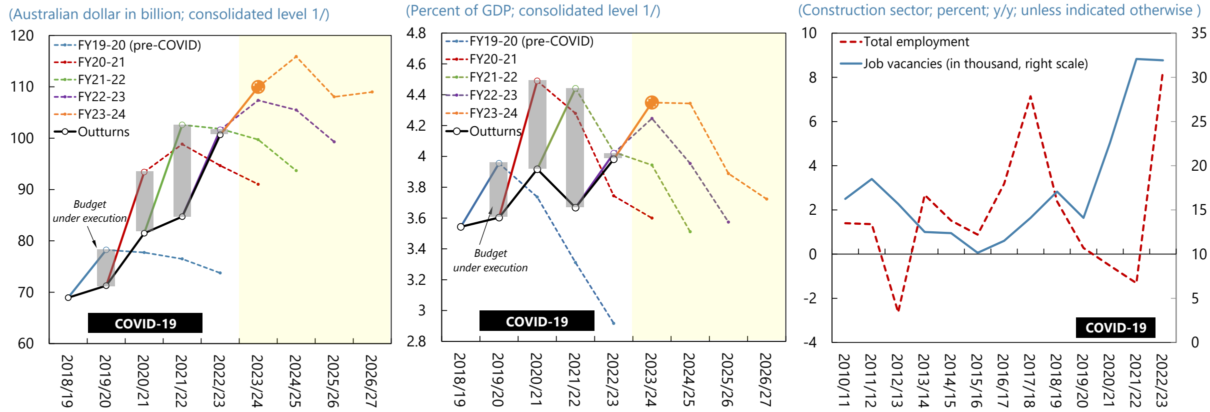
- **Improve outcomes.** Stronger performance-based budgeting will improve outcomes and contain structural spending growth in health, aged care, and the NDIS. The new national wellbeing framework, designed to improve the quality of lives (e.g., based on healthy and sustainable indicators), will turn the focus on achieving outcomes by fostering cooperation across different levels of governments. As such, the delivery of health system, currently run by all levels of government, can become more efficient.

Ramping Up Infrastructure Projects Face Supply Constraints at A Historical Scale

Infrastructure Projects Were Under-Executed During the COVID-19 (Australian dollar in billion; consolidated level 1/)

Projects In Pipeline Have Been Reprofiled For Implementation In Later Years (Percent of GDP; consolidated level 1/)

Nonetheless, Growth In Infrastructure Projects Added To Pressures In Labor Markets (Construction sector; percent; y/y; unless indicated otherwise)



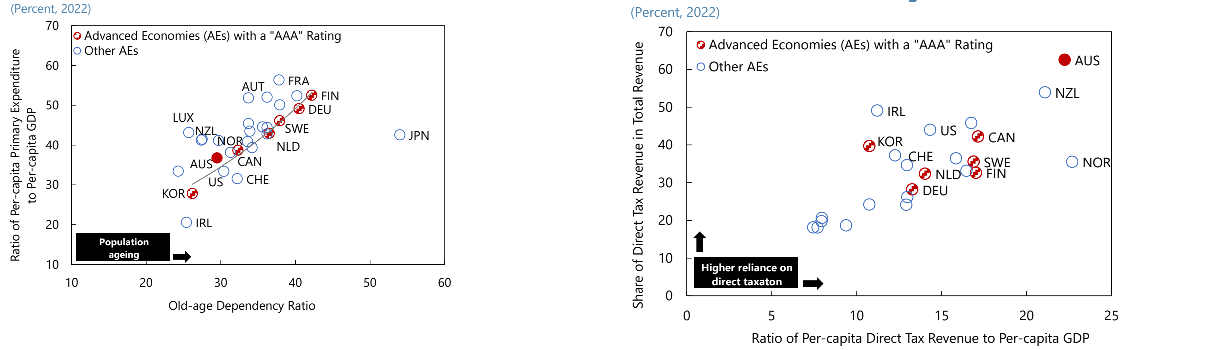
Sources: Authorities' data; Haver Analytics; and IMF staff calculations.
1/ Based on purchases of non-financial assets in budgets published by the Commonwealth Government and state and territory governments during fiscal years (FY) of 2019-20 through 2023-24. The latter include spending by public non-financial corporations.

- **Promote sustainability.** The ongoing NDIS Review will help improve the scheme's design, operations and sustainability.

Rebalancing the Tax Base Is Needed to Finance Priority Spending for Inclusive, Sustainable Growth

Population Ageing Is Set To Raise Expenditure in Australia (Percent, 2022)

Reliance on Direct Taxation Is High in Australia (Percent, 2022)



Sources: Authorities' data; OECD (2023) Old-age Dependency Ratio; and IMF staff calculations.

- **Improve infrastructure governance.** Inefficiencies in public investment processes often undermine potential gains from public investment.[4] Minimizing losses requires improving infrastructure governance at all levels of governments.

[4] A study shows that inefficiencies lead to about 30 percent unrealized potential gains. (See International Monetary Fund, 2015: "Making Public Investment More Efficient.")

19. Comprehensive tax reforms remain indispensable to long-term fiscal sustainability and productivity. High reliance on direct taxation is amplifying challenges of financing health and aged care as population ageing lowers the share of workers and declining productivity growth puts a drag on wages. The 2023 Intergenerational Report underscores the growing dependence on bracket creep in the absence of tax reforms. Addressing these challenges heads-on will avoid costly delays in tax reforms needed for sustained and shared prosperity.

- **Rebalance the tax base and improve equity.** Rebalancing from high direct to underutilized indirect taxes can improve efficiency and generational equity and promote productivity growth.[5] Average income tax rates are high in Australia, and bracket creep will raise tax burden shouldered by workers to finance age-related spending. Rebalancing must be supported by expenditure decentralization and better public service. The regressive impacts should be mitigated by targeted cash transfers and cost-of-living reliefs to vulnerable households.

- **Secure revenues for expenditure decentralization.** At the state and territory level, implementing recurring property taxes in lieu of stamp duties on housing transactions would promote housing affordability, more efficient use of the housing stock, labor mobility, and more stable tax bases over the medium term. Transitional revenue losses, if substantial, could be bridged with higher GST.

- **Reduce tax breaks to strengthen the fairness and sustainability of the tax system.** The 2023-24 budget introduced measures to improve targeting of superannuation concessions. The policy is in the right direction although its scope is limited relative to the size of the forgone revenues. The government should implement additional measures to minimize the tax breaks for the high-income earners, including through limiting concessions to capital gains tax.

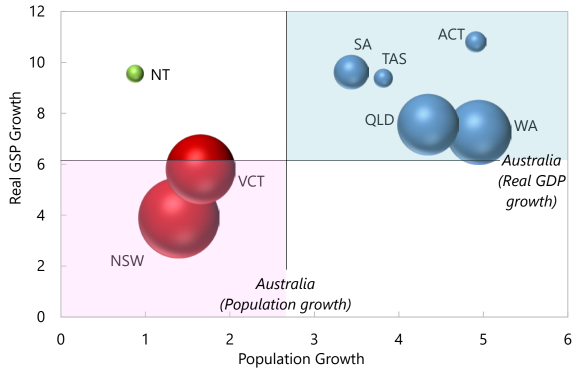
20. Governments across jurisdictions must cooperate to address differential impacts of the pandemic across states and territories and minimize vertical and horizontal imbalances. The pace of fiscal consolidation varies at the subnational level, and uneven post-pandemic recoveries amplify challenges of budget repair for some states. During the pandemic, some states (NSW, VCT) confronted more severe and frequent lockdowns and injected large fiscal stimulus. Favorable commodity market developments disproportionately benefited states with large commodity exporters (WA, QLD), and jurisdictions with strong employment growth (WA, QLD, TAS, ACT) generated sizable gains in tax revenues. Some states (NSW, VCT) introduced new tax-revenue measures (e.g., payroll tax increases) to finance elevated expenditure, in part driven by rising costs of debt services. Monetary policy tightening is impacting their budgets unevenly. These factors created a diverging pace of fiscal consolidation, impacting public balance sheets differently across states and territories. Re-calibrating parameters of the equalization formula to address imbalances will facilitate productivity-enhancing tax reforms at the subnational level and prevent the implementation of distortionary tax measures.

[5] For example, see a report by the Productivity Commission (2023) "5-year Productivity Inquiry: Advancing Prosperity" (link).

Figure 1. Post-pandemic Recoveries Are Uneven Across States and Territories

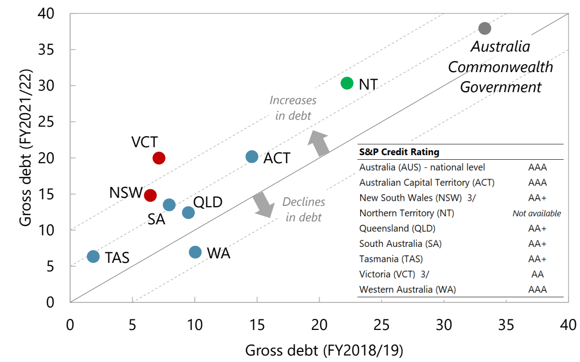
Post-pandemic Recovery Varies Across States and Territories

(Percent, growth in population and real gross state product (GSP), FY2019-FY2022 1/)



Debt Increased Most in States With Limited Population Growth

(Percent of gross state product (GSP) or indicated otherwise 2/)



Sources: Authorities' data; Haver Analytics; and IMF staff calculations.

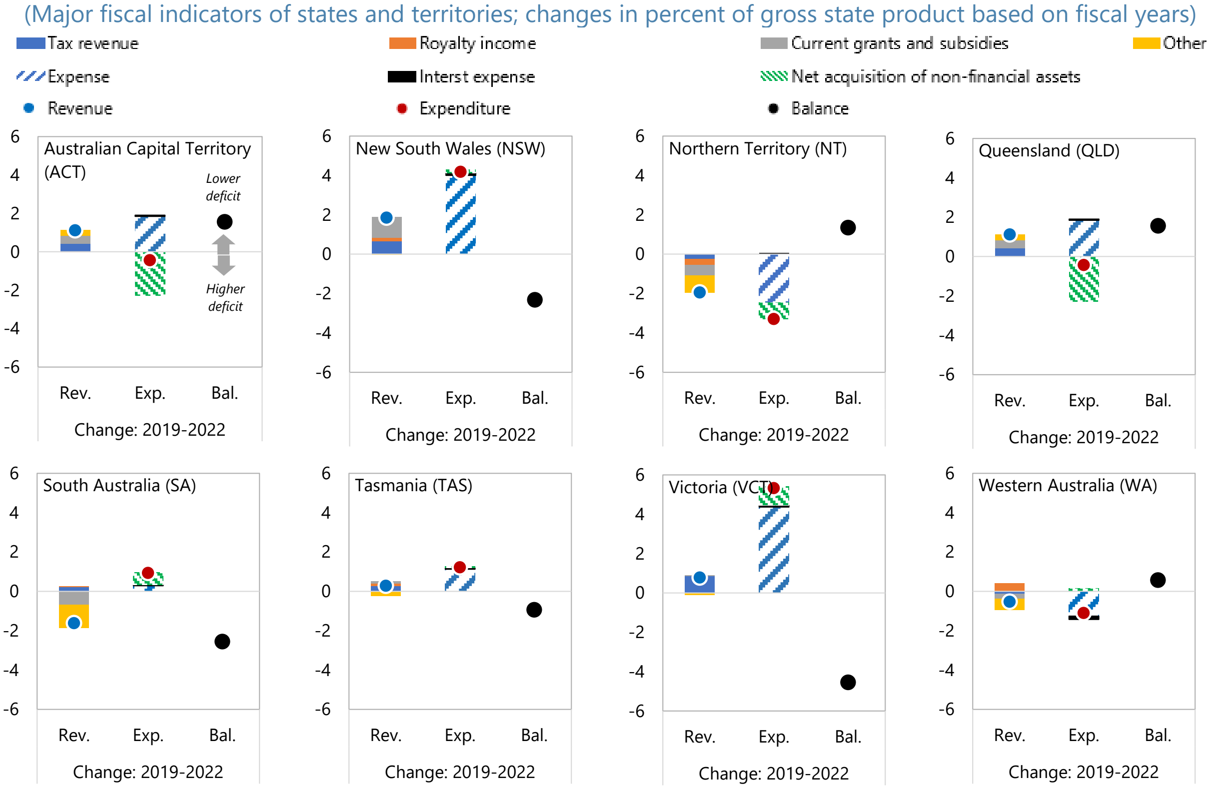
1/ Population is imputed from the underlying GSP per capita. The circle represents the share of each jurisdiction's GSP in Australia's gross domestic product.

2/ Gross debt of the Commonwealth Government is expressed in share of GDP.

3/ New South Wales (NSW) and Victoria (VCT) had a "AAA" rating prior to December 2020.

Figure 2. Pandemic Scars Are Amplified in Some States, Slowing the Pace of Fiscal Consolidation

(Major fiscal indicators of states and territories; changes in percent of gross state product based on fiscal years)



Sources: Authorities' data; Haver Analytics; and IMF staff calculations.

Authorities' Views

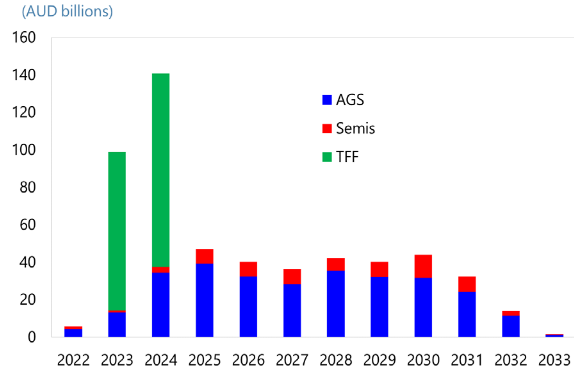
21. Authorities emphasize that fiscal policy should focus on medium-term objectives, including expanding the economy's productive capacity and preserving fiscal sustainability, while supporting monetary policy to address inflationary pressures. They consider that the fiscal stance has not added to the inflationary challenge and that the Government's Economic and Fiscal Strategy ensures fiscal policy is working with monetary policy to stem inflation. In that regard, the Government has banked most of cyclical windfalls from higher commodity prices and a stronger labor market to improve the fiscal position. Cost-of-living reliefs are targeted to address distributional impacts of high inflation in a fiscally responsible way. In addition, the Government will work with the states and territories to better align its infrastructure investment with market capacity, following the Independent Strategic Review of the Infrastructure Investment Program, to reduce cost pressures and improve the sustainability of the pipeline.

22. The Government is committed to medium-term budget repair. The authorities aim to strengthen tax integrity for multinational enterprises, improve the targeting of superannuation tax concessions, and raise the level of tax collected under the Petroleum Resource Rent Tax. These reforms are part of the government's ongoing effort to raise additional revenues, required to fund government spending, while balancing neutrality and equity considerations against broader macro-objectives. Key components of Pillar Two[6] (i.e., a 15 percent global minimum tax and a domestic minimum tax for large multinational enterprises) will be implemented in 2024. Separately, an independent review of the NDIS has been recently completed, and the Government will provide a full response in 2024. Likewise, the Government is expanding program evaluation activities to better target investment in health and aged care programs. The new national wellbeing framework will guide policy decisions and complement the establishment of Australian Centre for Evaluation. The Productivity Commission is responsible for a review of the equalization formula by end-2026 to assess whether the formula is operating efficiently, effectively, and as intended.

B. Monetary Policy

23. Monetary policy has tightened substantially so far. Under the baseline, the cash rate is expected to remain at its current restrictive level of 4.35 percent for some time, with rates projected to stay high until 2025, under staff baseline. The high policy rate will lead to a moderation in private sector credit growth. Continued tightening of financial conditions is also anticipated as mortgage rates reset and low-interest Term Funding Facility (TFF) financing is

Government Bond and TFF Maturities
(AUD billions)



Source: RBA.

[6] Pillar Two is part of the OECD/G20 base erosion and profit shifting project. Please refer to OECD (2021), "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy."

rolled over at sharply higher market rates. Although the expiry of fixed-rate loans has peaked at around 5 percent of outstanding credit in the June quarter, it is expected to continue putting pressures on household finances. Around 880,000 fixed rate loans, with a term of three years or less, taken out during the pandemic at very low interest rates are expected to expire in 2023, followed by another 450,000 loans in 2024. On average, this will result in a 60 percent increase in repayment for such borrowers.[7]

24. More adjustments to the policy mix are recommended to bring inflation to target earlier than 2026 envisaged in the baseline, and ensure expectations remain anchored. Given still high and broad-based non-tradeable and services inflation, a still-positive output gap, and tightness in labor market, there is no scope for a cut in the cash rate in the near term, despite expectations amongst some market participants. However, there remains significant uncertainty with respect to the speed and intensity of monetary policy transmission as the impact of policy rate is expected to peak after 12 to 18 months (Annex III). Rising interest rates have more than doubled household interest payments as a share of disposable income (from 5.2 percent in 2021 to around 11 percent at the end of 2022), projected to reach 13 percent by the end of 2023.[8] This, coupled with high household debt, and the decline in real wages point to relatively strong transmission. By contrast, accumulated savings during the pandemic, albeit declining, point to buffers that could dampen and delay the transmission, depending on households' behavioral responses. A careful assessment of demand pressures and close fiscal and monetary policy coordination is critical to ensure that monetary policy does not disproportionately share the burden of containing domestic demand.

25. Further rate hikes will likely be needed in the absence of supportive alternative policies. Higher policy rates have primarily affected lower income households with mortgages (around 40% of households), adding to their hardship amidst high inflation and cost of living crisis. Businesses have felt less of an impact as evidenced by the still healthy credit conditions, and households who own their homes are set to benefit from a recovery in the housing prices. Alternate tools, such as fiscal policy, must ensure that other sectors of the economy do their part. Going forward, a careful coordination of policies will be key to ensuring an equitable distribution of the burden of adjustment. For example, while greater public capital expenditure at the state level is welcome and needed to fill in the infrastructure deficit, it also has a higher multiplier effect on the economy, especially in the face of supply and labor market shortages. The absence of adequate fiscal-monetary coordination to account for such spillovers could result in an increase in inflationary

[7] The average fixed rates for new owner-occupier loans with terms of three years or less bottomed out at 1.95 percent in May 2021, while average variable rates for new owner occupier borrowers are now 6 percent. The average loan size in May of 2021 was AU$ 549,498 on a 30-year loan term.

[8] This is based on total interest payments by households and total household disposable income. However, an alternate measure, covering 95 per cent of total housing credit, and using gross disposable household income plus interest on dwellings (RBA Table E13), suggest that the interest charged on total housing loans relative to household disposable income, increased from 3.1 percent in March 2022 to 5.8 percent in June 2023.

pressures due to inadequate fiscal consolidation, necessitating further monetary tightening to contain inflation, and resulting in associated adverse distributional consequences.

26. The independent review of the RBA has clearly defined and clarified the dual monetary policy objectives of price stability and full employment (**Annex VII**). While reaffirming the RBA's independence, the review provides welcome proposals to strengthen governance arrangements and decision-making processes. The review's recommendation to retain the Treasury Secretary as part of the Monetary Policy Board to help with effective coordination between the RBA and Treasury is unusual by international standards. In staff's view, alternative arrangements with regular data and information sharing can facilitate timely decision-making and effective monetary-fiscal coordination without the potential risk of undermining RBA autonomy. This is particularly important for establishing sound risk management practice and when crisis intervention becomes necessary.[9] The proposal for a 5-year periodic review of the RBA, in line with the practice in some other central banks, is also welcome. In this regard, the RBA could benefit from a Central Bank Transparency review which can provide better understanding of the rationale for the central bank's mandate and governance, and operations that can anchor public expectations and foster better policies.

Authorities' Views

27. The authorities reiterated their determination to bringing inflation down while continuing to keep employment growing. The RBA noted that the cash rate has been tightened rapidly and is now in restrictive territory. They highlighted that household consumption growth has slowed significantly and is set to remain below trend growth given the lagged effects of monetary policy and other pressures on disposable income. The RBA reiterated its commitment to bring inflation back to target within a reasonable timeframe. This was evidenced by the increase in the cash rate in November 2023, after the cumulative data since August on economic activity, the labor market and inflation had come in stronger than earlier expected. Authorities noted that wage pressures remain contained, despite a tight labor market, and pointed to the lack of evidence of de-anchoring of inflation expectations or wage-price spiral. They, however, agreed that, given supply constraints, reprofiling and better coordination of planned infrastructure spending at the state and territory level was desirable to alleviate inflationary pressures. The authorities welcomed the recommendations of the RBA review and noted that they are in various stages of implementation. They highlighted that the presence of the Treasury secretary on the RBA board has worked well in Australia.

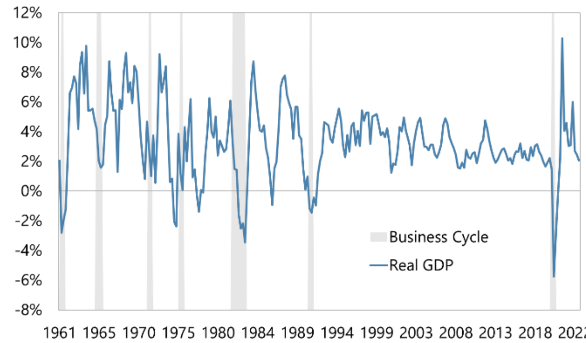
RISKS TO FINANCIAL STABILITY ARE CONTAINED BUT PERSISTENT

28. Financial stability risks appear contained, but persistent and spillover risks from global financial conditions have increased since the last Article IV. Lending conditions have tightened in many advanced economies, including Australia. With the increase in policy rates, credit growth

[9] See "Quasi-Fiscal Implications of Central Bank Crisis Interventions" by Hooley and others (2023).

has slowed. After declining sharply in 2022, commitments for new housing loans have started increasing in 2023, consistent with the pick-up of housing prices and market activity in recent months. Although business credit remains robust, its growth rate has stabilized at well below 2022 peaks. Historical evidence for Australia suggests that business credit tends to lag changes in economic activity and is closely associated with the business investment cycle. While business insolvencies have increased and are now at their pre-pandemic level, this is driven by small businesses and construction firms that do not have sizeable bank loans. Hence banks' non-performing business loans remain very low. An increase in insolvencies amongst medium and large companies could transmit stress to households and other businesses, as they have more employees, larger debts, and interlinkages via trade credits. The negligible share of loans in negative equity however limits the losses to both banks and borrowers in the event of default and corporates interest coverage ratios remain manageable given prudent lending practices. Australian banks are well placed to manage near- and medium-term risks to their loan portfolios with capital levels at historically high levels following the commencement of the capital framework in January 2023. Major banks' capital ratios are in excess of APRA's 10½ percent benchmark and domestic systemically important bank total capital ratios are well above the 18.25 per cent loss absorbing capacity requirement which will come into effect in 2026. IMF's Global Bank Stress Testing (GST) Tool based on public data and stress-testing by the RBA suggests that banks would be able to continue extending credit to households and businesses even if economic conditions were to be materially worse than expected.

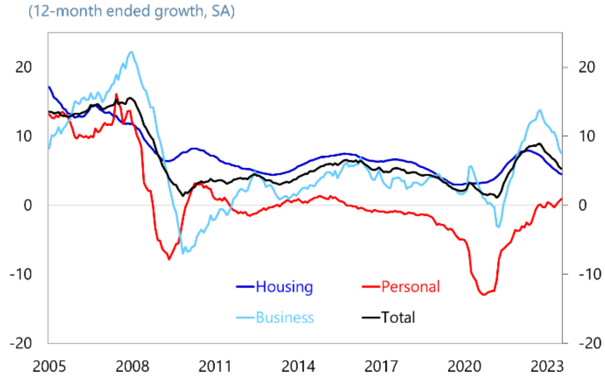
Real GDP Business Cycle
(Real GDP y/y growth, %, Peak to trough by quarter)



Source: IMF staff calculations and Melbourne Institute.

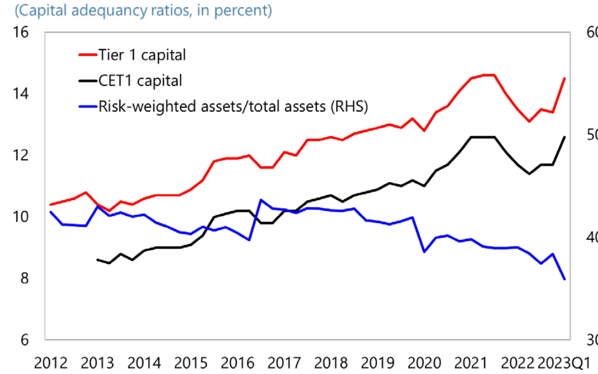
Financial Conditions Have Tightened but Banks are Well Placed to Manage Risks

Credit Growth by Sector
(12-month ended growth, SA)



Source: RBA.

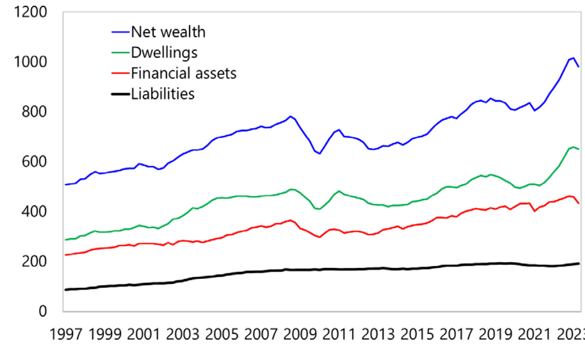
Banks' Capital Positions Remain Strong
(Capital adequancy ratios, in percent)



Source: APRA.

29. The large exposure to housing exacerbates macrofinancial linkages. Weakness in the housing market could dampen consumption since a significant portion of household wealth is in the form of housing equity. But even with the correction, overall prices are well above pre-pandemic levels. Stability risks are limited as the absence of limited recourse mortgages and household's savings in mortgage offset and redraw accounts provides buffers. Pockets of vulnerability may exist amongst lower income households with high debt and low equity, but analysis by the RBA suggests that only about 5 percent of owner-occupier variable rate borrowers will need to draw on savings buffers to meet their essential expenses and scheduled mortgage payments, and of these only about 1½ percent are at risk of depleting their savings buffers within six months. In line with past IMF advice, since October 2021, banks are required to assess new mortgages with a significant buffer of 300 bps above the contracted repayment rate (up from 250 bps earlier). However, given house prices have resumed their upward trend, additional borrower-based tools, such as loan-to-value (LTV) and debt-to-income (DTI) limits, that have been applied successfully elsewhere, should be considered to boost the overall macroprudential toolkit. Macrofinancial risks from the bond and equity markets appear limited at this stage.

Household Net Wealth Has Risen
(In percent of disposable income)



Sources: ABS, RBA.

30. Conditions in commercial real estate (CRE) are difficult, but banks' direct exposures are small. Leasing conditions in Australian retail and office property markets are challenging with high vacancy rates, low rental growth, and higher interest rates weighing on commercial property valuations. However, banks limited and conservative exposures to CRE (6 percent of total assets in aggregate) help contain risks to their lending books. Banks typically only extend commercial property loans at low loan-to-value (less than 65 percent) ratios and require borrowers to have strict debt-servicing capabilities such as ratios for minimum interest coverage and maximum debt-to-assets. Foreign institutional investors (including pension and sovereign wealth funds) are significant holders of Australian CRE market and while domestic non-bank lenders have CRE exposures on slightly riskier terms than banks, systemic risks posed by domestic non-bank lenders is limited by their small share of lending.

31. Banks' liquidity positions are robust, but funding risks could emerge. Banks' holdings of high-quality liquid assets (HQLA) remain at high levels and liquidity coverage ratios (LCRs), at 132 as of 2023Q2 for major banks, are comfortably above regulatory requirements. Although the funding composition of banks have improved over the last few years, with an increase in share of deposits, banks face significant refinancing tasks ahead of the two TFF maturity dates (September 2023 and June 2024) of approximately $130 billion (3 percent of banks' total liabilities), which have increased their exposure to wholesale funding markets. Australian banks have pre-funded some of the expiring TFF financing, with bond issuance in 2022 and 2023 well above their historical average. But the potential for renewed global banking stress as seen in early 2023 is a key risk that that could lead to further tightening in financial conditions with potentially systemic consequences.

Authorities's Views

32. **The authorities have made significant progress in implementing FSAP recommendations.** Legislation was passed to strengthen responsibility and accountability framework for entities in the banking, insurance and superannuation industries which strengthened APRA and ASICs ability to mitigate misconduct. Major progress was made in enhancing APRA's supervisory approach to address governance and risk management and closing gaps in data collection to support robust financial supervision (Annex VIII). In addition, efforts are underway to strengthen macroprudential policy decision-making under the CFR umbrella as well as crisis management and resolution planning.

33. **The authorities saw financial sector risks as contained, despite heightened global uncertainty and a resumption in house price growth.** Authorities noted that Australian banks are well placed to manage near- and medium-term risks to their loan portfolios, given Australian banks are profitable and capital levels are at a historic high following the commencement of the enhanced capital framework in January 2023. Generally low loan-to-valuation ratios also protect lenders against losses in the event of default. Further, the majority of borrowers remain resilient, given the strength of the labor market and sizeable savings buffers, as well as prudent lending standards. The interest serviceability buffer on housing loans was increased to 300 bps in 2021. Authorities did not see the need to implement additional borrower-based tools such as loan-to-value and debt-to-income limits which they saw as less flexible and cannot be tailored to individual circumstances. They agreed that conditions in office and retail commercial real estate are difficult, but banks' direct exposures are small, and developments are being closely monitored by the regulatory agencies. They opined that a sharper-than-expected slowing in growth and increase in unemployment is a source of risk.

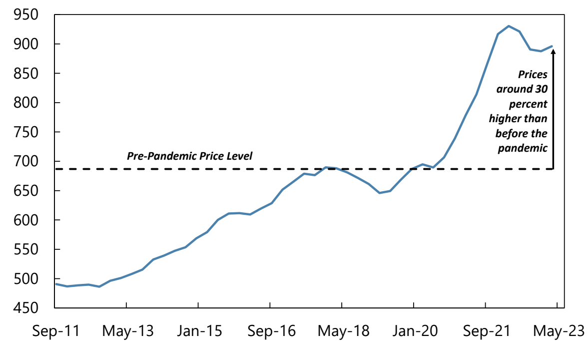
HOUSING AFFORDABILITY REMAINS A CONCERN

34. **Notwithstanding the housing price correction, the affordability challenge has not abated.** The 8 percent peak-to-trough decline in prices did not make a material difference when put in context of the run-up seen during the pandemic, with prices still around 30 percent higher than their pre-pandemic levels. As a result, national dwelling value-to-income ratio has increased from around 6 percent before the pandemic to 7.3 percent in March 2023. Given that housing costs as a share of disposable income in Australia were already high compared to OECD comparators pre-pandemic, and prices are now stabilizing with a moderate pickup likely, affordability concerns remain at the forefront.[10]

[10] Temporary data constraints on house price data prevent a systematic comparison with OECD countries.

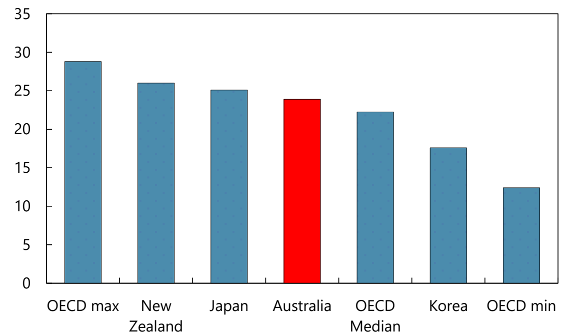
The Housing Price Correction Has Not Alleviated Affordability Concerns

Dwelling Prices Significantly Above Pre-Pandemic Levels
(Mean Price of Residential Dwellings, Thous AU$)



Sources: Australian Bureau of Statistics

Housing Costs Were High Even Before the Pandemic
(Housing and utility share as percent of total expenditure, 2019 or latest)

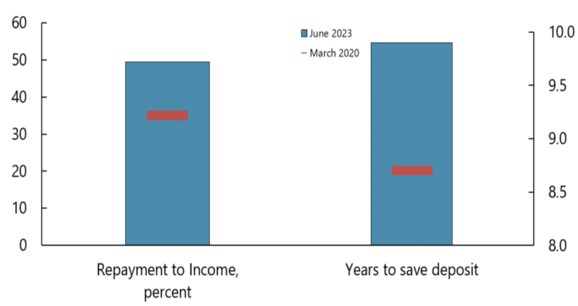


Sources: OECD

35. Rising mortgage payments for homeowners are adding to concerns and making home ownership even more challenging. The period a median household needs to save for a 20 percent deposit, given prevailing house prices assuming it saves 15 percent of its gross annual income, has increased to almost 10 years. This has increased intergenerational equity concerns between households trying to get into the property ladder and those who own their homes with their mortgages paid off. A borrowing capacity approach suggest that median housing prices are 60 percent above the price the median household could afford to finance with a debt service-to-income ratio of 30 percent. The measure shot up in 2022, as interest rates more than offset the decline in dwelling prices.[11]

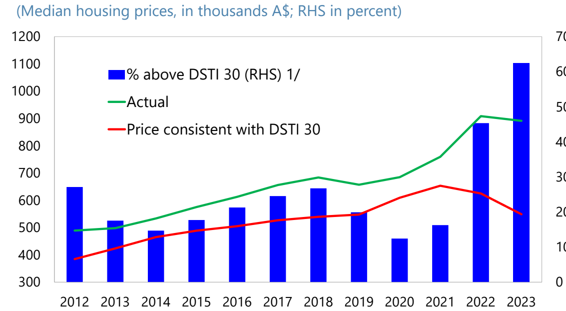
Rising Interest Rates Made Home Ownership More Challenging

Affordability Indicators Have Deteriorated



Sources: Housing Affordability Report; Corelogic; and ANZ.
Note: Repayments assumes mortgage size is 90% of the median home price and is paying the average discounted variable mortgage rate at that time for a term of 25 years.

Mortgage Attainability Is Worsening
(Median housing prices, in thousands A$; RHS in percent)

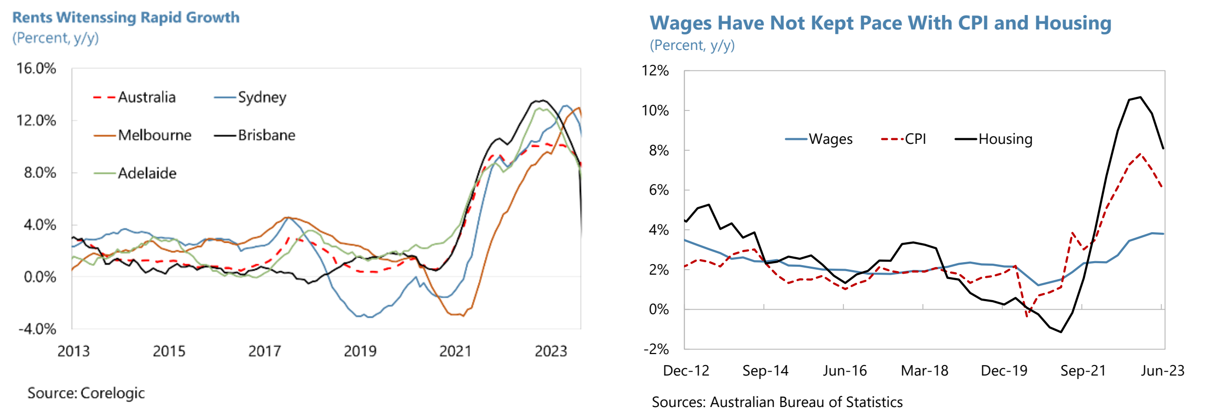


Sources: Haver Analytics; and IMF staff calculations.
1/ DSTI 30 means Debt-service-to-Income ratio of 30 percent, i.e. an average household uses 30 percent of its annual household disposable income on mortgage payments.

[11] Attainability is estimated using average annual household disposable income (end-June). Affordable housing cost is assumed to be in the conventional range of a debt-service-to-household-income ratio (DSTI) of 30 to 40 percent. The mortgage rate is the 1-year fixed average residential mortgage rate (monthly), applying to a principal and interest loan of 30-year maturity. The mortgage is to finance a purchase with up to 80 percent loan-to-value. Actual housing prices are the median value of dwellings in June of each year.

36. Rents have also increased at an unprecedented pace. After averaging around 2.1 percent nationally during the decade before January 2020, the CoreLogic hedonic rental value index reached an all-time high of 10.2 percent in December 2022. Wages have not kept pace and as a result, rental

A Tight Rental Market Is Adding to Pressures



affordability, defined as share of median household income required to service rent on a new lease, has increased from a low of 26.5 percent in September 2020 to 30.8 percent in April 2023, with the corresponding figure hitting 51.6 percent for lower income households. This is reflected in low levels of vacancy (Figure 5). The decline in the share of social housing, capacity constraints and bottlenecks in the construction sector and recent surge in migration have added to pressures amidst limited prospects for a rise in the supply of new housing in the near term.

37. A greater housing stock is needed urgently. The authorities have planned a suite of housing policies, which if implemented, would boost supply, helping affordability. In particular, the AU$10 bn Housing Australia Future Fund policy would fund 30,000 social housing units over the next 5 years and the AU$2 bn Social Housing Accelerator payment will target social homes across Australia. This will add significantly to the current flow of public dwelling completions, but it is small in the context of the total dwelling stock and dwelling completions. The authorities have also announced an ambitious target to build 1.2 million new homes over five years, from July 2024, including through performance-based funding for states and territories. Planned Help-to-Buy and Home Guarantee schemes targeted towards low- and middle-income families can also play a role as supply side measure take time.[12] However, measures such as foreigner surcharge on land taxes in New South Wales and Tasmania are likely to have a very limited role in supporting affordability (see 2021 and 2022 AIV). They are classified as CFM measures under the IMF's Institutional View and should be replaced by non-discriminatory measures.

[12] The Federal government is working with states and territories to deliver the Help-to-Buy Scheme, supporting up to 40,000 low- and middle-income families to purchase a home. The Government will provide an equity contribution to eligible participants of up to 40 percent for new homes and 30 per cent for existing homes. This is in addition to 50,000 households covered under the Home Guarantee Scheme, including more than 6,000 through the new Regional First Home Buyer Guarantee.

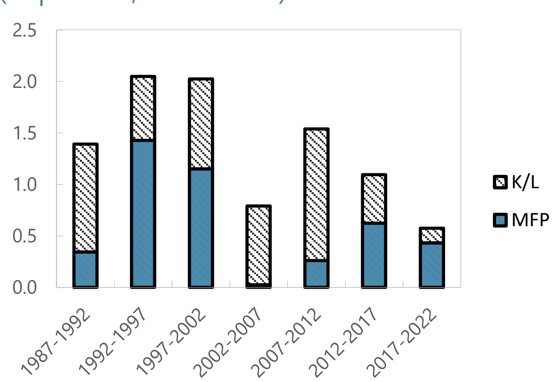
Authorities' Views

38. Like staff, authorities remain concerned about deteriorating housing affordability. They pointed to quickly rising rents and noted that affordability has continued to worsen. They highlighted the need to boost supply, particularly for affordable housing, and pointed to the October 2022 National Housing Accord that brings together states, and territory, local governments, and representatives from the superannuation and construction sectors with a target of delivering 1.2 million homes over 5 years from 2024. However, they noted that reaching this is an ambitious target in the near term as there are labor and material constraints.

JUMP-STARTING PRODUCTIVITY GROWTH AND ADDRESSING CLIMATE CHANGE

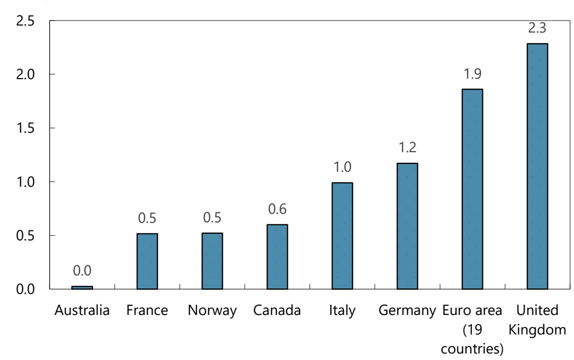
39. Australia's labor productivity growth declined in recent years. Multifactor productivity growth and investment are significantly lower than in the 1990s and early 2000s – apart from a temporary mining-related investment boom in 2005-15. Productivity growth in manufacturing has been particularly low. Slow productivity growth has contributed to a rapid increase in unit labor costs, reducing Australia's competitiveness, so that, as of 2022, the level of Australia's real exchange rate was among the highest in the world. In February 2023, the government's independent Productivity Commission issued its 5-year Productivity Inquiry report, emphasizing the importance of (i) competition as a driver of productivity; (ii) technology adoption, especially ICT, to catch up with the global frontier; (iii) fostering productivity growth in the non-market sector; (iv) building and making the most of a skilled workforce; and (v) minimizing the productivity impact of the transition to net zero. Recommendations are broadly in line with previous Fund advice.[13]

5-Year Growth Rates of Real GDP Per Hour Worked
(In percent, annualized)



Sources: OECD; and IMF staff calculations.

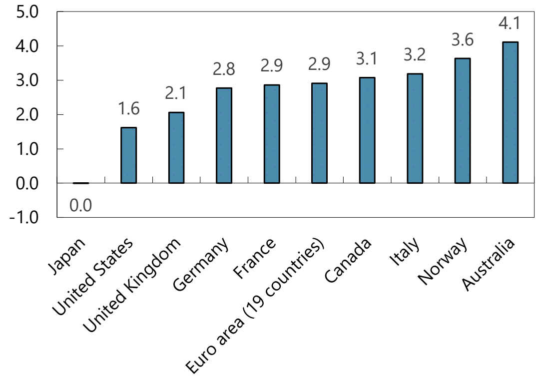
Growth of Real Manufacturing Gross Value-Added Per Hour Worked, 2012-22
(In percent, annualized)



Sources: ABS; OECD; and IMF staff calculations.

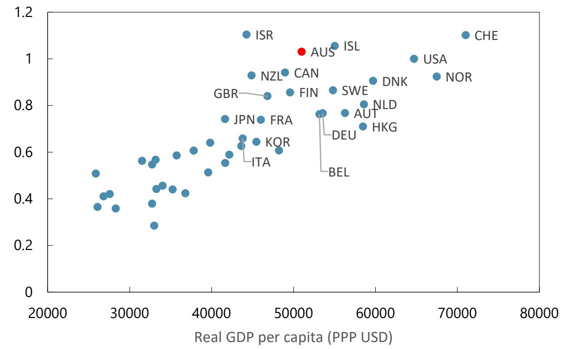
[13] See e.g., IMF Country Report No. 21/256: Australia, Selected Issues.

Growth Rates of Unit Labor Cost[1], 2001-21
(In percent, annualized)



Sources: ABS; OECD; and IMF staff calculations.
1/ exchange-rate adjusted.

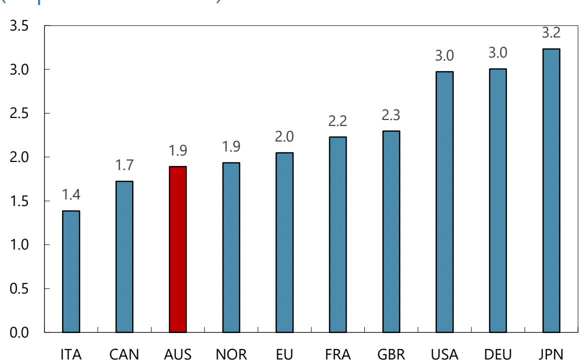
PPP Price Levels, 2022, Relative to U.S.
(In USD)



Source: World Bank.

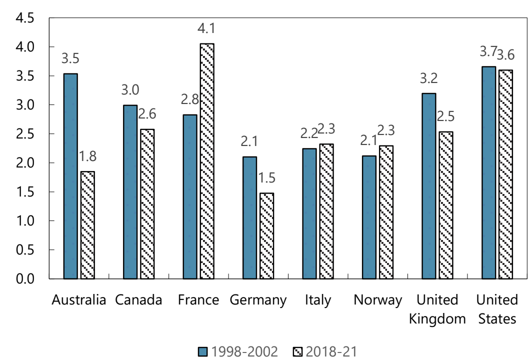
40. Promoting innovation and competition should remain a priority. Spending on R&D is significantly lower as a share of GDP than in Germany, Japan, or the US. Australia's ICT investment, close to the top among OECD countries in the late 1990s, is now significantly below peers. In terms of digital infrastructure, the number of fixed broadband connections per capita is close to the OECD average, but experienced internet speeds are relatively low. While cloud computing technologies are well-established, Australian businesses make less use of data analytics and artificial intelligence. Businesses report that lack of skills, together with lack of knowledge or uncertainty about the gains from new technologies, are among the main impediments to technology adoption. Policies to promote innovation should include continued investment in digital infrastructure, while a more open FDI regime and better labor market integration of skilled immigrants could speed up technology adoption from abroad. The authorities' Competition Policy Review, announced in August 2023, is a welcome initiative.

Average Investment in R&D (2012-22)
(In percent of GDP)



Sources: OECD; and IMF staff calculations.

Average ICT Investment
(In percent of GDP)



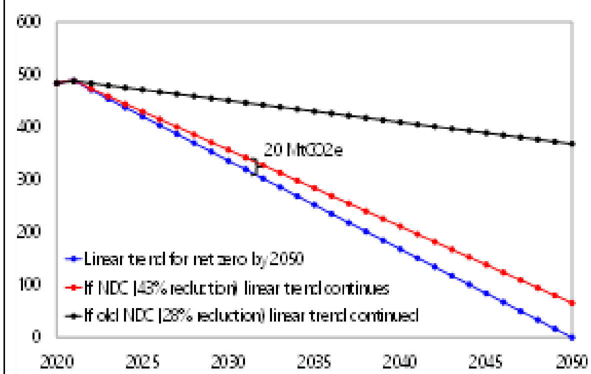
Sources: OECD; and IMF staff calculations.

41. Education and a dynamic labor market are essential for addressing skills shortages and harnessing the full potential of Australia's workforce. Australia has relatively high rates of labor force participation but also relatively high rates of part-time work, especially among women. To reduce barriers to greater workforce participation, the authorities recently increased the childcare subsidy rates. Immigrants have, on average, higher education levels than the Australian-born population, but often face placement challenges.[14] The authorities' efforts to boost vocational training will help reduce skills shortages. Efforts to address declining education outcomes, as indicated by declining test scores, are also needed.

42. Fiscal policy can do more to support growth. A rebalancing of the tax system from direct to indirect taxes would incentivize labor supply and investment. It would also help counteract the strong real exchange rate appreciation experienced over the past two decades and thus support investment in tradable non-mining industries such as manufacturing.

43. Australia's efforts to support the rules-based international trading system and address transnational aspects of corruption are welcome. Australia's continued strong support for the WTO is helping to buttress the rules-based trading system. Continued judicious use of the national security test will help ensure that the FDI approval process remains transparent. The authorities continue to engage public and private sector stakeholders in addressing correspondent banking relationship pressures in the Pacific and facilitating discussion on developing regional solutions. Australia has committed to the IMF's voluntary assessment of transnational aspects of corruption, which is a welcome move. The assessment is reflected in Box 4 (and Annex IX).

Australia's Path to Net-zero Compared to NDCs
(MtCO2e)



Source: IMF staff calculations.

44. Australia is one of the largest greenhouse gas (GHG) emitters, and staff welcomes the authorities' efforts to implement commitments through strengthened policies. The NDC, legislated in 2022, implies a significant emissions reduction, but staff encourages the authorities to be even more ambitious. While politically challenging, an economy-wide carbon price would be the most effective way to achieve net zero, complemented by active labor market policies to support workers adversely affected by green transition. In the absence of a broad-based carbon price, strong sectoral policies, with price signals where possible, can help deliver the needed abatement. In this regard, Australia's new law to reform the Safeguard Mechanism (SM), which covers facilities with annual emissions above 100,000 tons of CO2-equivalent (around 215 emitters accounting for

[14] In addition, immigrant women are less well integrated in the labor force (see, "Regional productivity, local labour markets, and migration in Australia", OECD, 2023).

28 percent of total emissions), is an important milestone.[15] In staff's view, the authorities should consider gradually expanding the coverage of the mechanism to cover a greater share of the economy. Moreover, efforts to safeguard the integrity of carbon offsets (ACCUs) will be key for the functioning of the system. Staff also welcomes the authorities' objective of increasing the share of renewable energy to 82 percent by 2030 and their announcement to impose fuel efficiency standards, as laid out in their National Electric Vehicle Strategy. By contrast, tax incentives for EV purchases are potentially regressive and seem less effective, given supply bottlenecks. Additional policies are needed to achieve the mitigation goals, including through stepping up energy sector investment under the Rewiring the Nation program to help speed up the deployment of renewables. Price signals, such as feebates in the energy and transport sectors, could elicit broad behavioral responses without impacting average prices.

Authorities' Views

45. The authorities agreed that, like in many advanced economies, slowing productivity growth poses challenges. They saw declining dynamism and competition, slower adoption of technologies and ideas, and a slowdown in the growth of trade as key factors behind the productivity slowdown. They generally agreed on the need to increase productivity and noted that the Government is progressing a policy agenda, including through the Council on Federal Financial Relations.

46. The authorities agreed with the need to address skills shortages while improving labor market outcomes, particularly for women. Their recent Employment White Paper lays out a detailed policy agenda in this area. The authorities are also finalizing a Migration Strategy to maximize Australia's ability to respond effectively to present and future labor market challenges and opportunities, with the aim of better addressing skills shortages while making the system simpler, fairer, and more predictable.

47. The authorities acknowledge achieving the 2030 climate target is ambitious but emphasized their commitment to the net zero objective by 2050. They intend to achieve this objective through additional measures, including the development of detailed sectoral emissions reduction plans for electricity and energy, transport, industry and waste, agriculture and land, resources, and built environment. They agreed that an efficient approach – underpinned by competition – will help achieve low-cost abatement, encourage innovation, and provide opportunities for Australian businesses and workers to provide products and services that best

[15] The Safeguard Mechanism sets the "baseline" carbon emissions. Standard annual baselines are determined by multiplying a facility's actual production by an emissions intensity value (based on recent facility-level and industry-wide experience), and a decline rate. To meet their baseline, firms can either reduce emissions or purchase carbon offsets (ACCUs). Key features of the reform include (i) ceilings on aggregate net emissions under the SM, consistent with the national targets codified in the 2022 Climate Change Act; (ii) an automatic reduction of each emitter's baseline net emissions by 4.9 percent annually, with lower reduction rates for the manufacturing sector; (iii) establishing a carbon price by allowing emitters who overperform relative to their baseline to sell (or bank) carbon credits; and (iv) a ceiling on gross emissions, to avoid excessive reliance on carbon offsets. Under the new law, the government provides up to AUD1 billion to support manufacturers and firms exposed to trade in their adjustment.

support an efficient transition. The safeguard mechanism is an efficient market-based approach to abatement in the industrial sector.

STAFF APPRAISAL

48. Australia's economy is expected to further decelerate in 2023 and 2024, while avoiding a recession. Tighter financial conditions and lower real incomes amidst high inflation have dampened household consumption, but strong population growth, resilient labor markets, and strong investment have propped up economic activity. Inflation is projected to decline gradually to the target range in 2026Q1, subject to significant uncertainty. On a preliminary basis, the external position is expected to be broadly in line with medium-term fundamentals and desirable policies. Downside risks to growth stem from a stronger-than-expected decline in household consumption, more protracted growth in China and globally, persistently high inflation, especially in services, and rising geo-economic fragmentation. These risks are offset by possible stronger-than-expected immigration, which will fuel domestic demand.

49. Closer monetary and fiscal policy coordination is needed to bring down inflation faster. Monetary policy has tightened significantly so far, with cumulative rate hikes of 425 basis points since May 2022. The fiscal deficit has contracted at a faster pace than in other advanced economies. Although inflation is gradually declining, it remains significantly above the RBA's target and output remains above potential. Further monetary policy tightening is likely needed to ensure that inflation comes back to the target range by 2025 and minimize the risk of de-anchoring inflation expectations. Continued coordination between monetary and fiscal policy is key to securing more equitable burden sharing. The Commonwealth Government and state and territory governments should implement public investment projects at a more measured and coordinated pace, given supply constraints, to alleviate inflationary pressures and support the RBA's disinflation efforts.

50. Over the medium term, the governments need to reduce structural deficits and promote economic efficiency. All levels of government need to improve expenditure outcomes and contain structural spending growth. The new national wellbeing framework, designed to improve the quality of lives, can turn the focus on achieving better outcomes by fostering cooperation across different levels of governments. Greater expenditure decentralization would enable the governments to implement comprehensive tax reforms, rebalancing the tax system from currently high direct to underutilized indirect taxes and making it more efficient and equitable. Re-calibrating the GST equalization formula can address the differential impacts of the pandemic on fiscal sustainability at the subnational level.

51. Close monitoring of the financial system amidst tight financial conditions will be important. The financial system appears robust, and the increase in banks' required capital buffers is welcome. An expected increase in bank wholesale funding at a time of higher rates and slowing growth may pose some vulnerabilities, although liquidity coverage ratios are well above regulatory minimum requirements. Given the resumption of increase in house prices, staff recommend additional borrower-based tools that have been applied successfully elsewhere. Potential cyberthreats on financial infrastructure require adequate investment, close monitoring, and contingency planning.

52. A greater housing stock is needed. Notwithstanding the housing price correction in 2022, the affordability challenge has not abated, as prices have started increasing again and mortgage payments as a share of disposable income have doubled due to higher interest rates. Rents have also increased at a very fast pace, with strong growth in immigration following the post-COVID re-opening adding to pressures, given housing shortages. The authorities have planned a suite of housing policies which, if implemented, would boost supply. Supportive planning and land-use policies are critical.

53. Reigniting productivity growth and boosting inclusion will require a strong focus on structural reforms. Delivering quality infrastructure to meet policy goals will require further streamlining the infrastructure pipeline and working proactively with the construction sector to overcome capacity constraints. Recent initiatives to tackle skill shortages, including free vocational training, expansion of university capacity, and a temporary increase in migration, are welcome, as are ongoing efforts to implement the findings of the Productivity Commission. Australia's continued support for an open trade environment, including through reforms at the WTO, is very welcome.

54. Australia's continued efforts to meet its climate mitigation targets are welcome and should be supported with strong policy actions. Meeting the 2030 Nationally Determined Contribution target will be challenging. Additional efforts are therefore needed to get back on track to achieve net zero by 2050. A broad-based carbon price, coupled with measures to mitigate transition risks for impacted regions and industries, remains the most cost-effective way to achieve abatement goals. If political economy constraints prevent the adoption of an economy-wide carbon price, alternative sectoral policies, with price signals where possible, can help reduce emissions. In this context, the authorities' plans to develop sectoral emissions reduction plans are welcome.

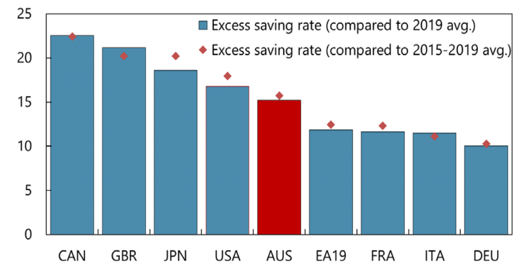
55. Australia's voluntary participation in the review of transnational aspects of corruption is commendable. The review has affirmed the significant progress made by the authorities in strengthening measures to detect foreign bribery, raise private sector awareness, and strengthen engagement with the private sector to address foreign bribery. It has also led to acknowledgement of gaps in the level of foreign bribery enforcement. In addition, the authorities plan to address the facilitation side by strengthening the anti-money laundering framework, particularly in the real estate sector. Through this voluntary exercise and the planned reforms, the Australian authorities are sending a powerful positive signal, which, if followed by other AEs, will help address more systematically transnational aspects of corruption and deliver a better governed world.

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

Box 1. Australia's Saving Rate

The Covid-19 pandemic led to a series of unprecedented economic events. Stringent lockdowns and voluntary mobility restrictions collapsed economic activity. While governments provided large fiscal support to stimulate private demand, households' spending remained subdued at the onset of the pandemic, partly because of unavailability of services during lockdowns and personal safety measures (e.g., social distancing), among other pandemic-related constraints. As a result of lower spending[1] and higher income, household savings increased considerably in many countries, especially in advanced economies.

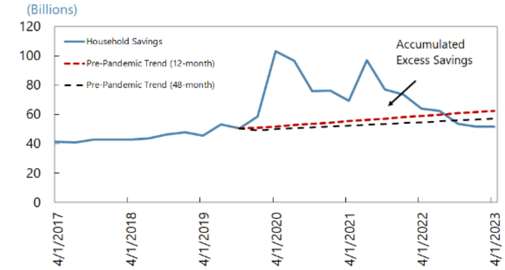
Excess Household Saving Rate Across Advanced Economies
(Percent of gross disposable income)



Sources: Haver Analytics, IMF staff calculations.
Note: Columns refer to the deviation between the peak pandemic saving rate during Covid-19, and the 2019 household saving rate. Diamonds refer to the difference with the 2015-2019 average saving rate.

Like in other AEs, households' savings rose significantly in Australia. The cumulative difference between actual savings and the pre-pandemic trend suggests that between 2020Q2 and 2022Q2, Australian households accumulated over $240-280[2] billion in excess savings. However, as financial conditions tightened and cost of living increased on the back of high inflation, excess gross savings declined, and the saving rate dropped to 3.2 percent in 2023Q2 (from a peak 23.6 percent in 2020Q2), slightly below its long-term average. This supported domestic demand and added to inflationary pressures.

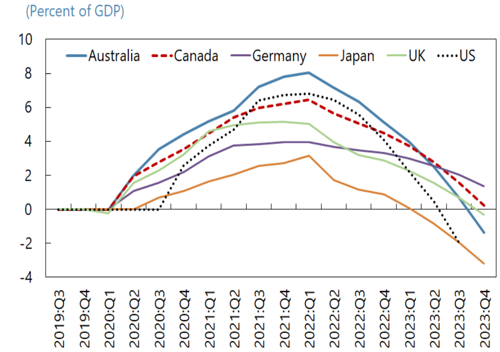
Households Savings Above Pre-Pandemic Trend
(Billions)



Sources: ABS.
Note: Excess savings are calculated as the accumulated difference between actual household savings (households' gross disposable income minus consumption) and the trend implied by data for the 12 (48 months) leading up to the pandemic.

Estimates on when excess savings will be depleted are subject to large uncertainty and are sensitive to the methodology used. Results from an autoregressive (AR (1)) model with a linear time trend[3] suggest that excess savings would be depleted by 2023Q4 in Australia, with other countries like Japan and the US depleting their stock of savings much earlier on in 2023Q1-2023Q2. Meanwhile, other estimates showed that the stock of excess savings may be run through at an even later date: results using a Hamilton filter trend-based measure suggested a depletion of excess savings later in 2024. It is expected that the depletion of excess savings could possibly boost the pass-through of monetary policy tightening to inflation and reduce its lag.

Forecasted Stock of Excess Savings, AEs
(Percent of GDP)



Sources: de Soyres, Francois, Dylan Moore, and Julio L. Ortiz (2023), FEDS Notes. Washington: Board of Governors of the Federal Reserve System.

[1] Household consumption is estimated to have contracted by an average -6 percent in 2020.

[2] While estimates of excess savings can vary depending on the specification of the base comparison year, they have ranged around $AUD 250 billion.

[3] de Soyres, Francois, Dylan Moore, and Julio L. Ortiz (2023). "Accumulated Savings During the Pandemic: An International Comparison with Historical Perspective," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, June 23, 2023, https://doi.org/10.17016/2380-7172.3326.

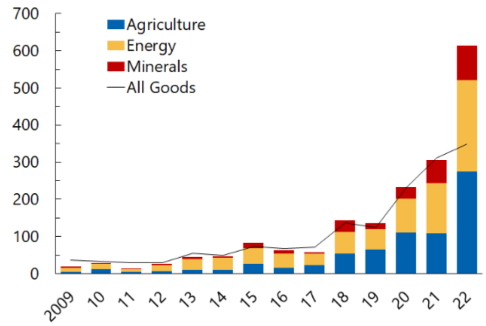
Box 2. Fragmentation in Commodity Markets

Integration in commodity markets, following decades of progress from technological innovation and declines in transport costs, has been reversing in the past years. The disruption in commodity trade following Russia's invasion of Ukraine contributed to surging inflation in 2022 and food insecurity in low-income countries, with positive terms of trade shocks to some countries, including Australia. More recently, re-shoring of supply chains has emerged, driven by geopolitical or national security reasons, including for critical minerals needed for cleaner technologies, semi-conductors, and defense. Indeed, measures restricting commodities trade were far higher in 2022, compared to other traded goods.

Commodities are particularly vulnerable to fragmentation, given their high concentration in a few countries, the short-term difficulty in substituting them with different goods, and their strong demand. Model simulations from the recent World Economic Outlook[1] which assumes a world fragmented into two blocks based on the 2022 UN vote of the war on Ukraine (countries that voted for withdrawal of Russia are included in the "USA-Europe+ bloc), finds that fragmentation in commodity prices can cause large price spikes, with a significant rise in prices of minerals, including cobalt, copper, lithium, iron ore, and nickel. In addition, fragmentation would add significant volatility to commodity prices. The reasons are two-fold: fragmented commodity markets would result in smaller market sizes for countries to trade between each other, making them vulnerable to negative supply shocks. In addition, commodity producers may face incentives to switch geopolitical allegiances, depending on the price of commodities in each market, therefore adding to demand and supply shocks. As a result, geoeconomic fragmentation could reduce Australia's external demand, increase inflation, and increase exposure to volatility if commodity markets become more concentrated.

Number of Trade Interventions, by Sector

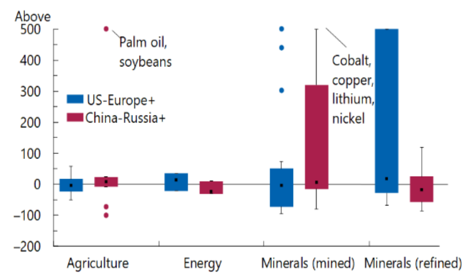
(Index, 2016-2019=100 for All Goods and All Commodities)



Sources: Global Trade Alert Database (adjusted for reporting lag); and IMF Staff calculations.
Note: Trade-liberalizing interventions are excluded from calculations.

Price Changes Due to Fragmentation in Individual Commodity Markets

(Percent)

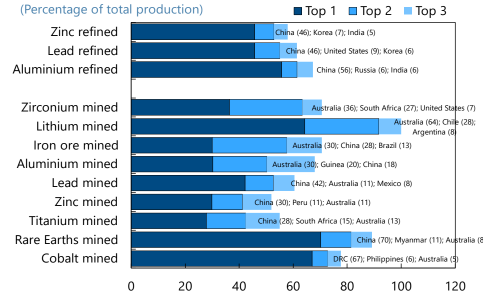


Sources: British Geological Survey; Food and Agriculture Organization of the United Nations; Gaulier and Zignago (2010); International Energy Agency; United States Geological Survey; and IMF staff calculations.
Note: Price effects are capped at 500 percent for readability. "Energy" refers to coal, natural gas, and crude oil. The black squares in the bars represent the median, the bars the interquartile range, and the whiskers the data points within 1.5 times the interquartile range from the 25th or 75th percentile across commodities in the group. The dots indicate outliers. Selected commodities which experience price increases higher than 500 percent are labeled. For the underlying complete information on commodity-specific price changes, see WEO (2023) Online Annex Figure 3.6.1. The bloc including the countries that voted for Russia's withdrawal from Ukraine in the 2022 UN vote is labeled the "US-Europe+ bloc," and the remaining countries are included in the "China-Russia+ bloc."

Gains from higher prices may also not be fully realized for exporters of minerals and metals like Australia. Australia is in the top three producers of many minerals which are essential inputs into multiple global value-chains. However, if confined to trading only in a specific bloc, then supply and demand may be temporarily misaligned. For instance, if mineral demand is concentrated in an opposing bloc, then Australia may end up with excess mineral capacity. Additionally, refining capacity for many of these exported minerals is highly concentrated in a small number of countries. Fragmentation could likely result in significant adjustment costs as new refining capacity would need to be developed.

Share of Top 3 Commodities in World Production

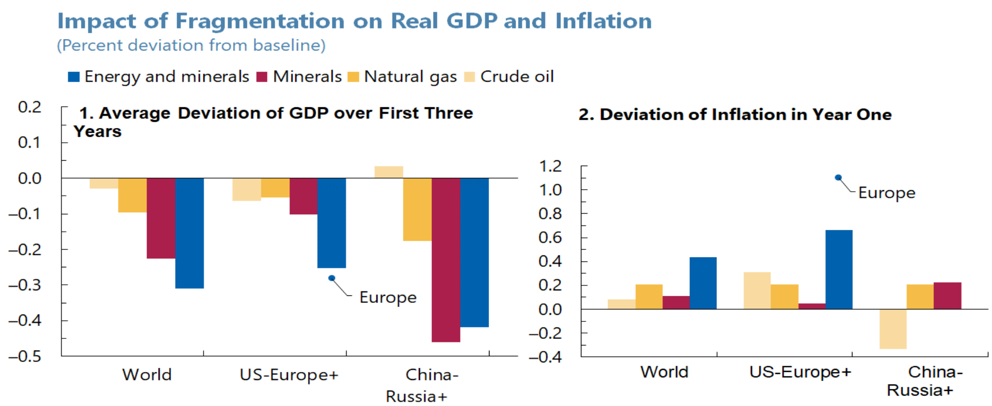
(Percentage of total production)



Sources: WEO 2023

Box 2. Fragmentation in Commodity Markets (Concluded)

Simulations from a dynamic stochastic general equilibrium (DSGE) model where fragmentation is defined as a ban on commodity trade between the two hypothetical blocs find that fragmentation leads to notable global GDP losses and inflation effects. Specifically, fragmentation leads to a) expenditure switching and trade diversions, and b) price-volatility-inducing imbalances between supply and demand, all in the context of rigidities that affect the speed of adjustment of trade (for example, pipelines and other structure that would constrain natural gas diversion). Cross-country evidence suggests Australia could be significantly impacted, as results from the DSGE suggests that fragmentation in energy and minerals can lead, on average, to a -0.3 percent real GDP deviation in 3 years, and a 0.4 percentage point deviation in inflation within a year.



Sources: British Geological Survey; Food and Agriculture Organization of the United Nations; Gaulier and Zignago (2010); Global Macroeconomic Model for the Energy Transition; OECD Inter-Country Input-Output Tables; United States Geological Survey; and IMF staff calculations.
Note: "Energy" refers to coal, natural gas, and crude oil. Region-level results are aggregated to the bloc and world levels using weights based on GDP at purchasing power parity. The bloc including the countries that voted for Russia's withdrawal from Ukraine in the 2022 UN vote is labeled the "US-Europe+ bloc," and the remaining countries are included in the "China-Russia+ bloc."

[1] This box draws on Chapter 3 of the October 2023 World Economic Outlook. For further details see also Alvarez and others (2023).

Box 3. Indexation

Defense as well as social security and welfare (SSW) are among the expenditure lines more sensitive to the headline CPI inflation at the Commonwealth level. Each spending component of the budget for the Commonwealth Government shows varying levels of a linkage to the headline CPI inflation. A parsimonious regression, which controls lagged effects of CPI inflation and episodes of economic downturns, shows one percentage-point (ppt) increase in inflation in the previous fiscal year raises spending in defense and SSW by around 0.9 ppt, respectively. While defense spending is statistically little influenced by episodes of economic downturns, SSW spending comprises social safety net and a number of welfare programs indexed to the headline CPI inflation and other measures (e.g., wage cost indices) affected by CPI, with some payments sensitive to business cycles. Overall, expenditure at the aggregate level rises on average by about 0.6 percent for one ppt increase in CPI inflation in the year before.

Impact of inflation on Key Expenditure 1/

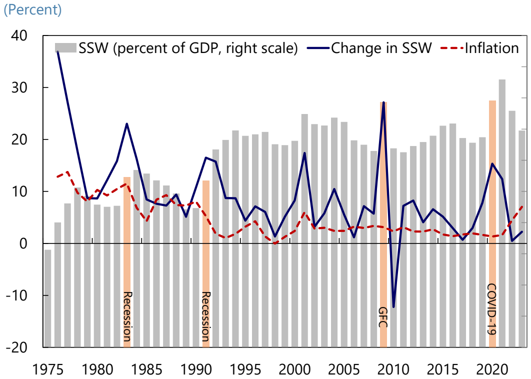
Dependent variable:	Control:	
(Annual change based on fiscal year)	Lagged inflation	Episodes (recessions, GFC, COVID-19)
Expenditure	0.57 (***)	0.071 (***)
Defense	0.86 (***)	0.02
Education	0.57	0.079 (*)
Health	0.08	0.029
Social security and welfare (SSW)	0.89 (***)	0.102 (***)
Expenditure (ex. Defense and SSW)	0.432 (*)	0.058 (**)

Source: IMF staff calculations.

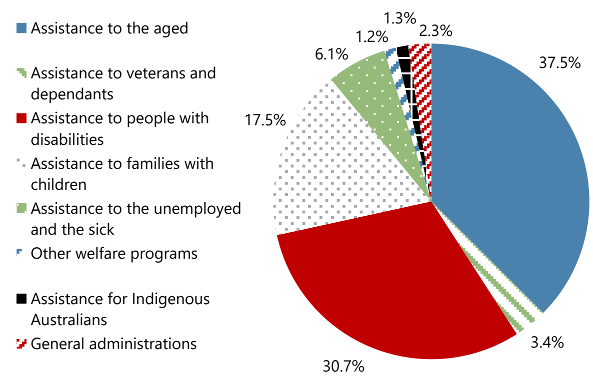
1/ Based on a parsimonious regression that controls effects of lagged inflation and episodes of recessions, global financial crisis, and the COVID-19. The underlying data covers the period of 1976-2022 in fiscal year. Estimated coefficients are reported, with statistical significance at 1 percent level (***), 5 percent level (**), and 10 percent level (*).

SSW was the largest functional expense in 2022-23 and comprises programs projected to grow in the future, with high multiplier effects. Assistance to people with disabilities and the aged are fastest growing spending functions. In particular, the former includes payments for the national disability insurance scheme (NDIS). One-off measures applied to the Aged Care Services program in the 2023-24 budget, including a 15-percent increase in minimum award wages for many aged care workers, is set to increase the spending over the medium term. Spending in SSW programs are poised to increase in the future, driven by demand for services provided by the NDIS and population ageing. The Commonwealth 2023-24 budget shows an increase in SSW spending, reaching 10 percent of GDP in FY2023/24 (up by 1 ppt of GDP from the year before) and staying elevated over the medium term. Given high multiplier effects of social spending programs (relative to defense spending)[1], the Government should closely consider any additional spending indexed to underlying inflation.

Spending on Social Security and Welfare (SSW), 1975-2023
(Percent)



SSW Expense by Sub-function, FY2022/23



Sources: Authorities' data; Haver Analytics; and IMF staff calculations.

[1] See van Gemert, Lieb, and Treibich (2022), "Local fiscal multipliers of different government spending categories." According to OECD, the size of fiscal multiplier for transfers to households is around 0.4 in year 1 and 0.7-0.8 in year 2 in Australia.

Box 4. Transnational Aspects of Corruption[1]

While moderate overall, the risk of Australian businesses engaging in foreign bribery remain material. Out of the 500 largest multinational enterprises (MNE) in the world, nine are headquartered in Australia, with some operating in high-risk sectors and regions.[2] Australia has a moderate-sized outward foreign direct investment position, including to international financial centers. In Australia's Phase 4 evaluation in 2017, the OECD found that Australia had taken steps to improve its framework for detecting and investigating foreign bribery cases, including allocating enough resources to relevant agencies. While further progress has been noted in recent years, the low level of foreign briery enforcement remains a concern. Authorities should continue to enhance enforcement against foreign bribery (Annex IX).

Through the risk of foreign corruption proceeds being laundered in Australia is material, it can be further mitigated by strengthening the anti-money laundering framework, particularly in the real estate sector. The banking sector and foreign investment environment (including the real estate sector) are attractive for laundering illicit proceeds, estimated at billions of Australian dollars. AUSTRAC highlighted that corrupt foreign public officials use similar money laundering methods of organized crime groups. The Commonwealth Attorney General's Department is undertaking public consultations on key AML/CFT reforms, including expanding the regime to certain services provided by designated non-financial businesses and professions such as lawyers, accountants and real estate agents, among others, to strengthen AML/CFT compliance. Public consultations by the Treasury on the establishment of a publicly accessible beneficial ownership register are also welcome developments. The ongoing national risk assessment will provide updates on understanding of risk factors and typologies for laundering of foreign corrupt proceeds.

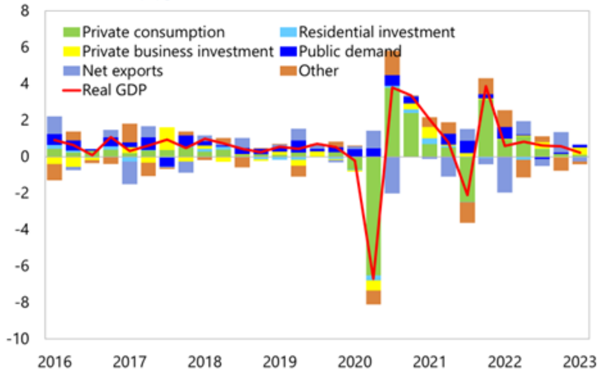
[1] Australia volunteered to have its legal and institutional frameworks assessed in the context of bilateral surveillance for purposes of determining whether it: (a) criminalizes and prosecutes the bribery of foreign public officials; and (b) has an effective AML/CFT system that is designed to prevent foreign officials from concealing the proceeds of corruption. See Annex IX for a detailed analysis.

[2] See OECD-UNSD Multinational Enterprise Information Platform, and International Financial Statistics International Investment Position, Assets, Direct investment [BPM6].

Figure 3. The Australian Economy Has Shown a Strong Recovery

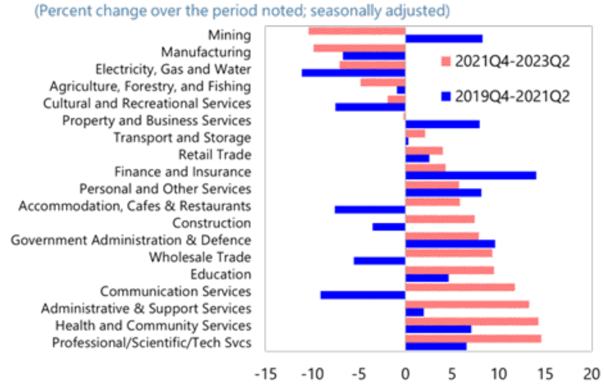
Growth is slowing as tighter financial conditions dampen private consumption…

GDP Growth Decomposition
(Contributions to q/q growth, %)



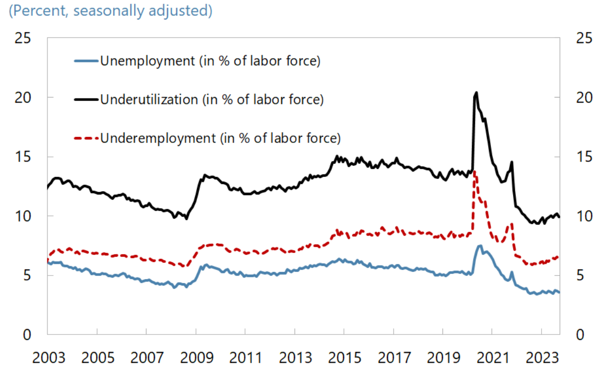
…but the services sector remains resilient.

Employment by Industry
(Percent change over the period noted; seasonally adjusted)



The unemployment rate remains at historical lows, but measures of underemployment have ticked up recently…

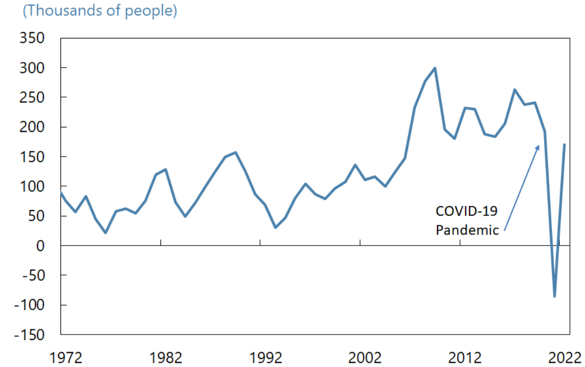
Labor Market Indicators Show Initial Signs of Cooling
(Percent, seasonally adjusted)



Source: ABS.

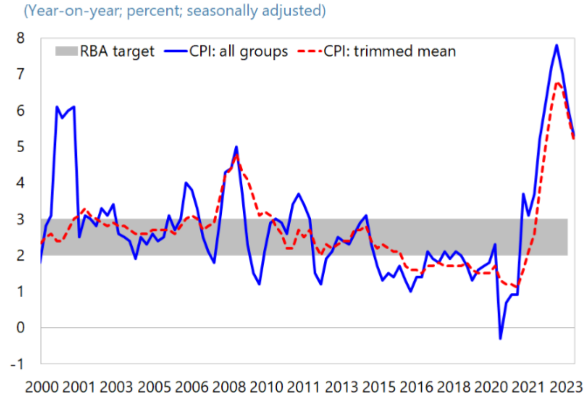
…partly reflecting the resumption of migration flows that are addressing labor supply shortages.

Net Overseas Migration
(Thousands of people)



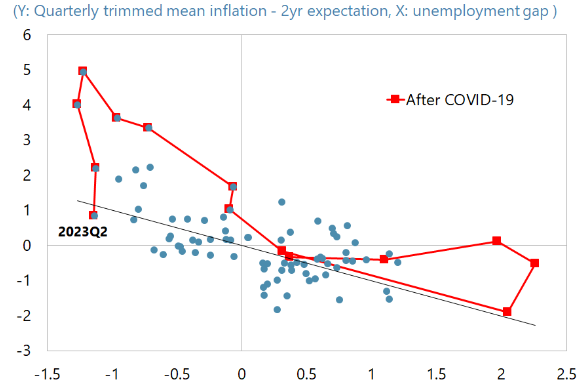
Inflation has decline but remains well above the RBA target range…

Consumer Price Inflation and RBA Target
(Year-on-year; percent; seasonally adjusted)



… in the context of a historically low unemployment gap.

Phillips Curve: Trimmed Mean Inflation and Slack
(Y: Quarterly trimmed mean inflation - 2yr expectation, X: unemployment gap)

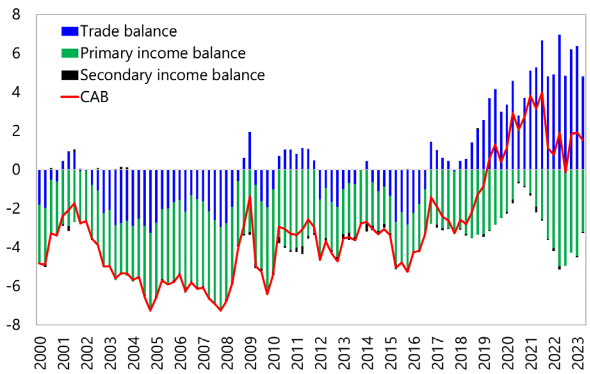


Sources: ABS; Haver Analytics; RBA; and IMF staff calculations.

Figure 4. The External Position Remains Strong, Supported by High Commodity Prices

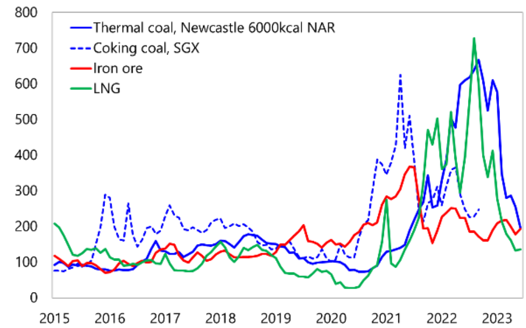
The current account surplus remains high despite a rising income deficit, driven by historically large trade surpluses…

Current Account Balance
(Percent of GDP)



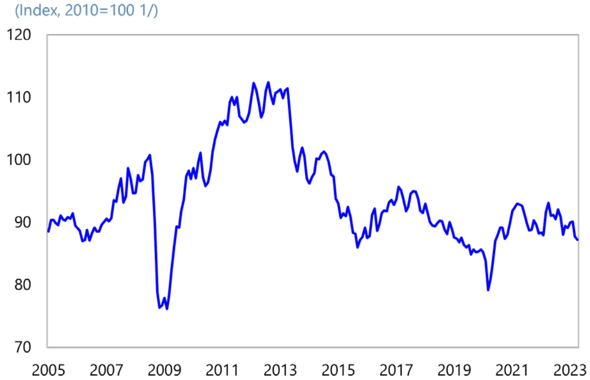
…amidst high commodity prices for Australia's main exports…

Export Prices
(2016=100)



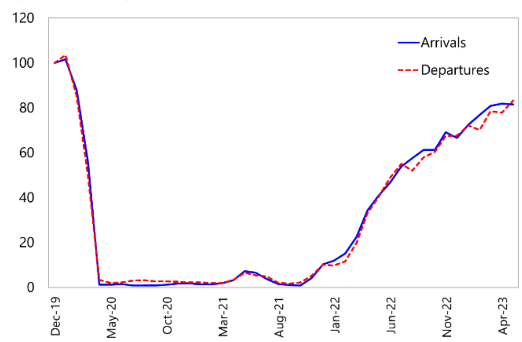
…which has supported the exchange rate.

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



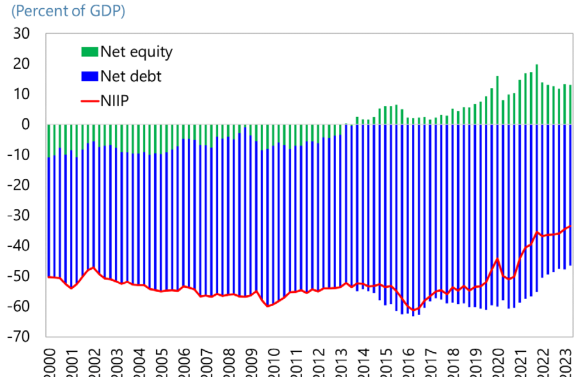
With the opening of borders, tourism flows are gradually returning.

Arrivals and Departures
(Index, 2019=100)



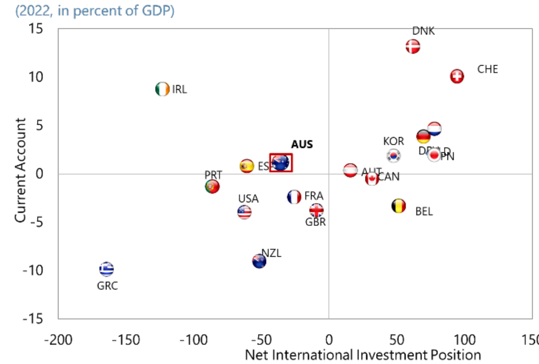
Recent current account surpluses have contributed to an improvement in the net investment position…

International Investment Position, Net
(Percent of GDP)



… though net external liabilities remain relatively high compared to peers.

External Position in Comparison
(2022, in percent of GDP)



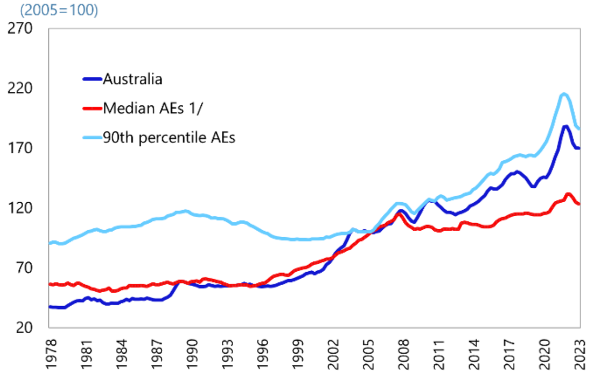
Sources: Australia's Merchandise Exports and Imports; Haver Analytics; IMF, World Economic Outlook; and IMF staff calculations.

1/ An increase indicates an appreciation of the Australian dollar.

Figure 5. The Housing Market Is Consolidating

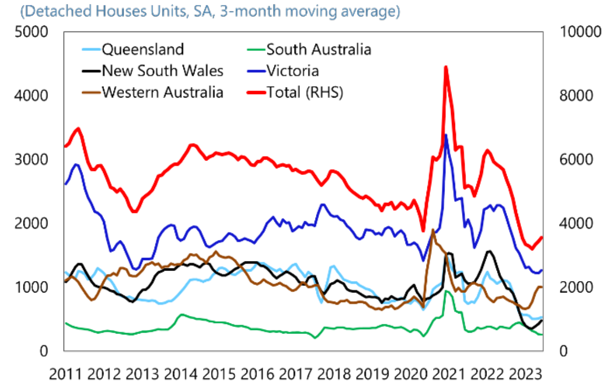
The housing market is showing signs of bottoming out, but prices remain well above pre-pandemic levels.

Real House Prices
(2005=100)



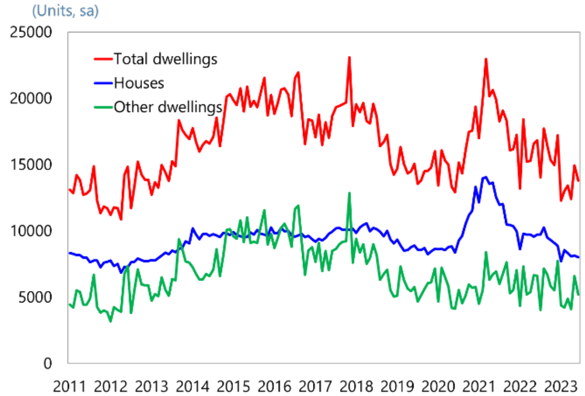
Housing sales have declined and continue to be low…

New Home Sales
(Detached Houses Units, SA, 3-month moving average)



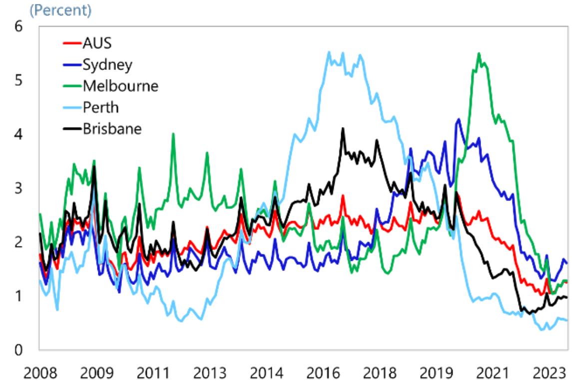
… and building approvals have softened.

Dwelling Approvals
(Units, sa)



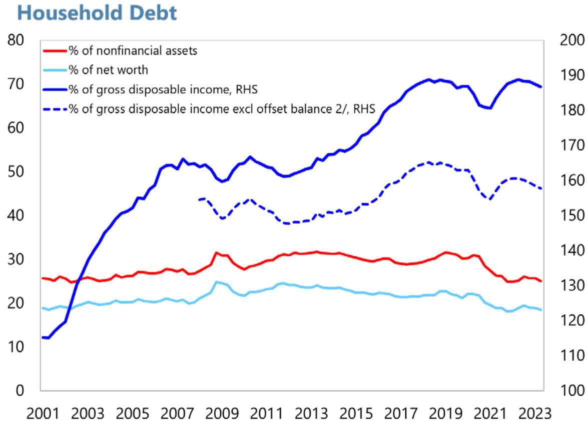
The rental market very strong, with low vacancy rates.

Residential Rental Vacancies
(Percent)



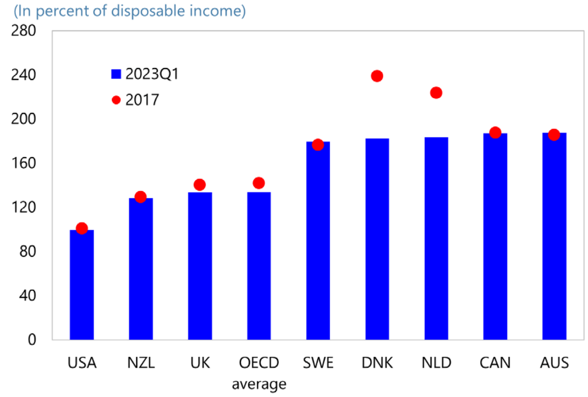
The household leverage ratio picked up again as house prices surged, but offset accounts provide buffers.

Household Debt



Household debt continues to be among the highest in OECD countries.

Household Debt
(In percent of disposable income)

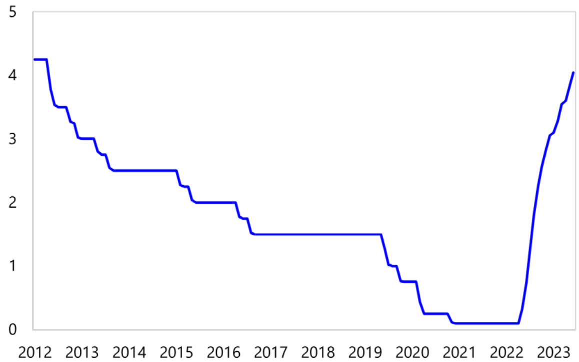


Sources: OECD; RBA; Haver Analytics, and IMF staff estimates.
1/ Based on a limited number of countries due to the lack of data.
2/ Offset accounts are deposit accounts that are linked to mortgage loans such that funds deposited into an offset account effectively reduce the borrower's net debt position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

Figure 6. Monetary Policy Has Begun to Tighten Substantially

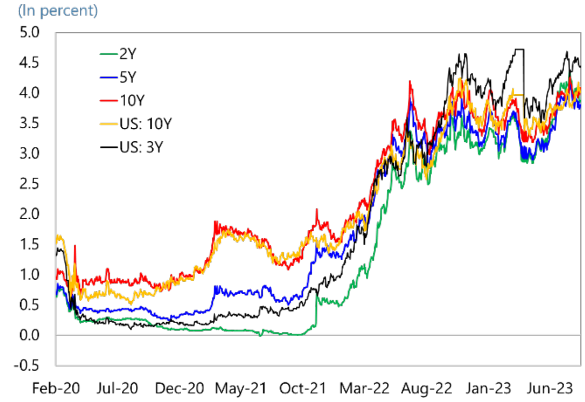
The cash rate has increased rapidly…

Policy Rate
(In percent per annum)



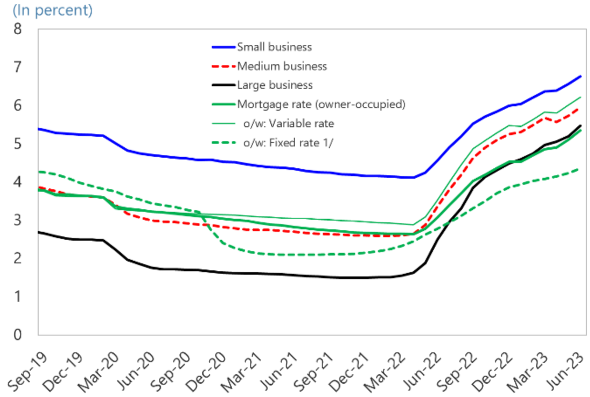
… with bond yields rising in tandem…

Bond Yields
(In percent)



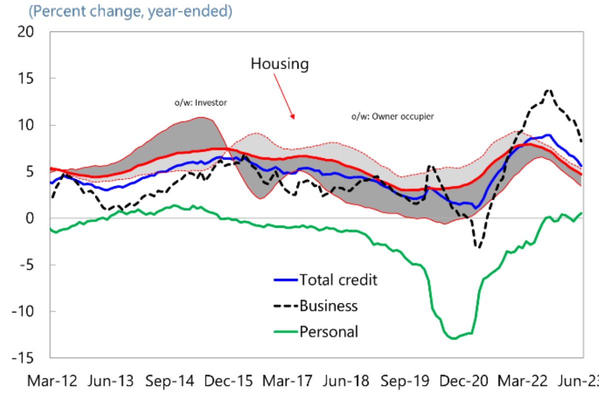
… along with lending rates.

Lending Rates
(In percent)



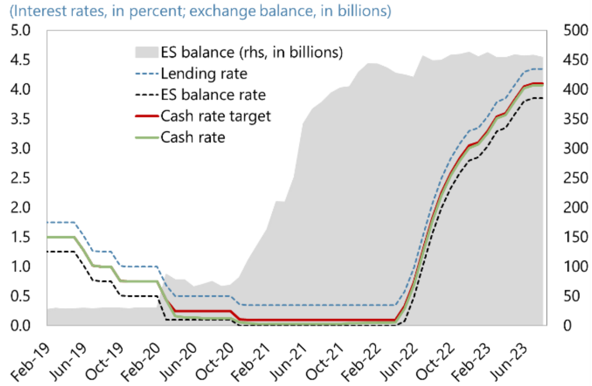
…Credit growth has slowed as well, though business credit remains robust.

Credit Growth by Sector
(Percent change, year-ended)



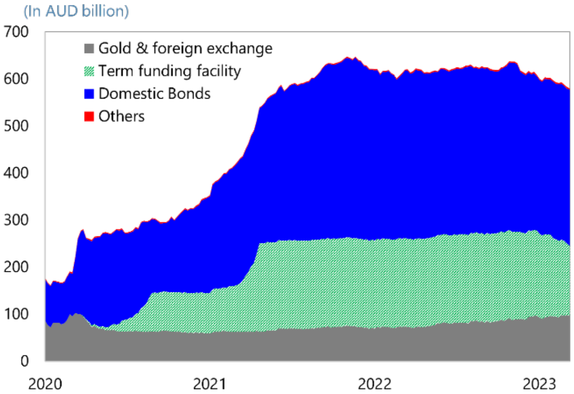
There is sufficient liquidity despite the increase in policy rates.

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



The RBA holdings of government bonds plateaued with the end of the large-scale asset purchase program.

Reserve Bank Assets
(In AUD billion)

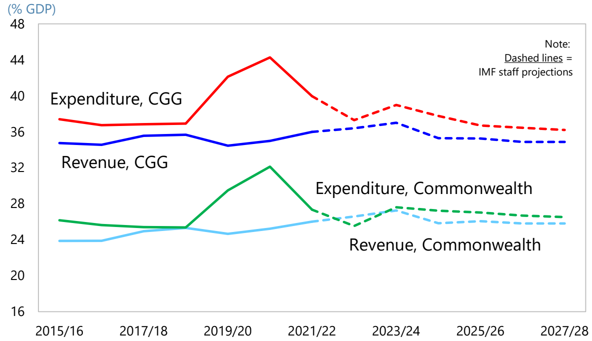


Sources: RBA; Haver Analytics; and IMF staff estimates.
1/ By residual fixed term, greater than 3 years.

Figure 7. The Public Sector Balance Sheet Continues to Improve

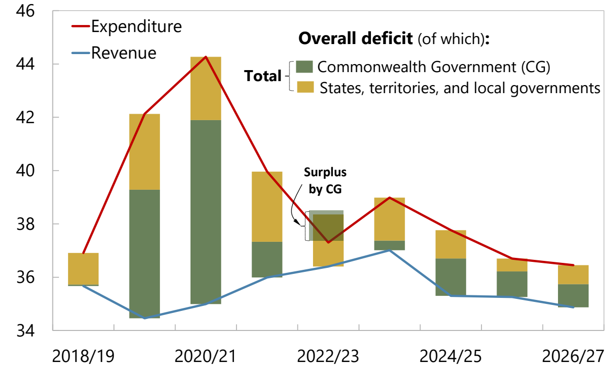
Better-than-anticipated tax revenues led to further fiscal consolidation in 2022/23…

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



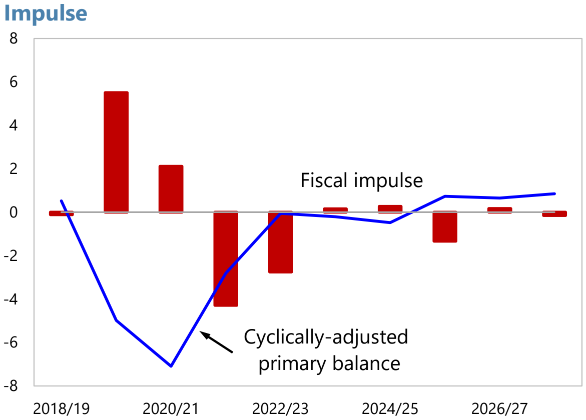
… and the overall balance of the Commonwealth turned surplus for the first time in 15 years.

Consolidated General Government
(Percent of GDP)



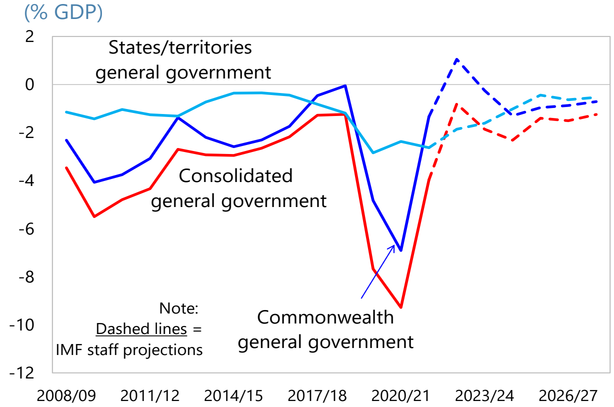
Fiscal stance is projected to turn neutral in the near term, with the primary surplus expected over the medium term …

Cyclically-adjusted Primary Balance and Fiscal Impulse



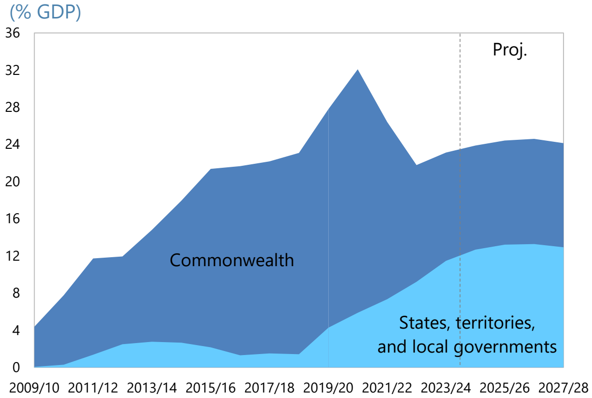
… and it takes longer for the governments to reach balanced budgets due to high interest payments.

Fiscal Balances
(% GDP)



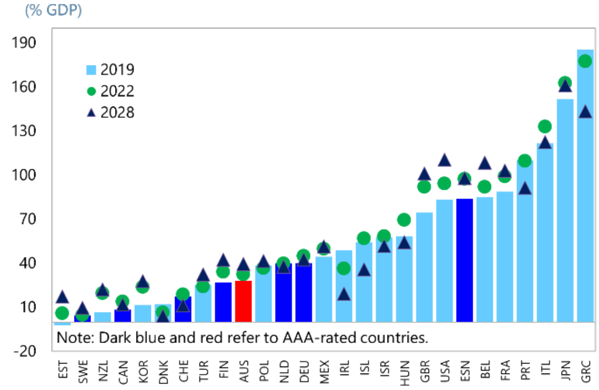
Net public debt has come down with fiscal consolidation, and is projected to stabilize over the medium term …

Net Public Debt
(% GDP)



…and remains low compared to other advanced economies.

Net Public Debt
(% GDP)

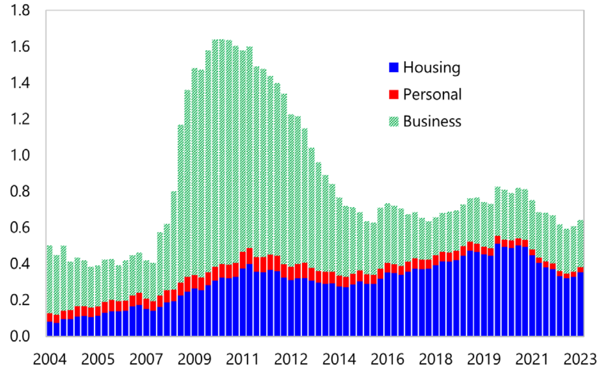


Sources: Commonwealth and State/Territory Treasuries, FY2022/23 budgets; IMF, *World Economic Outlook*; and IMF staff estimates and projections.

Figure 8. The Banking Sector Remains Strong

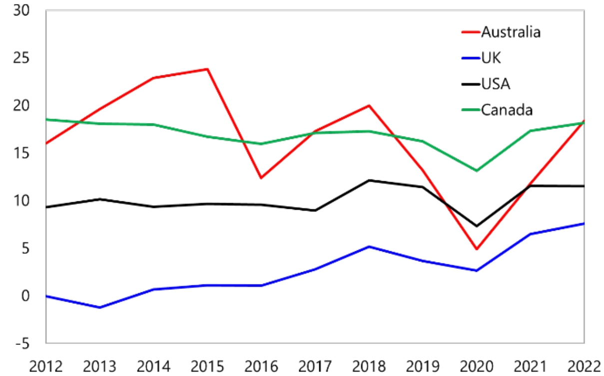
The NPL ratio remain low despite increase in insolvencies…

Banks' Non-performing Household Loans
(In percent of all assets, domestic books)



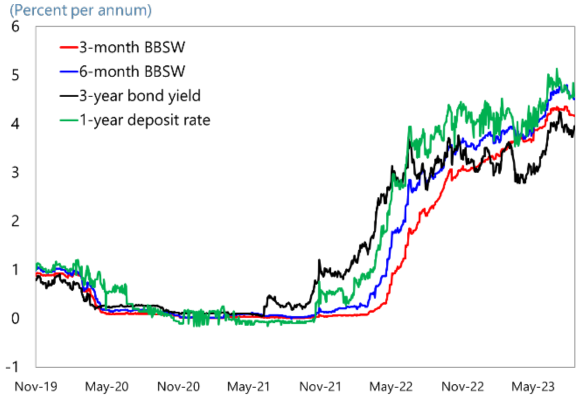
…and bank profitability is recovering.

Return on Equity
(In percent)



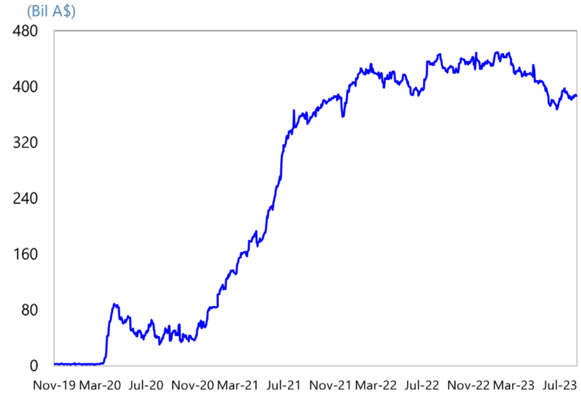
Funding costs have increased rapidly with domestic and global financial tightening…

Banks' Funding Costs
(Percent per annum)



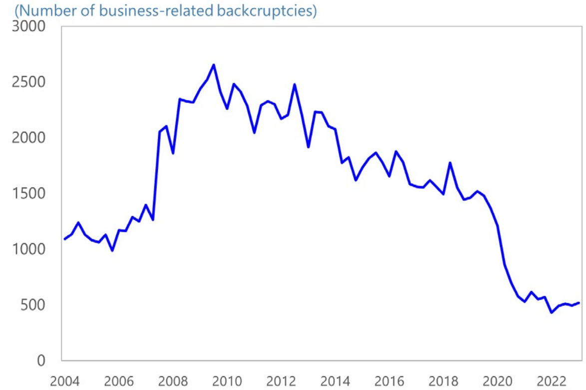
…but there remains ample liquidity reflected also in banks' high reserves balances at the RBA.

Exchange Settlement Balances
(Bil A$)



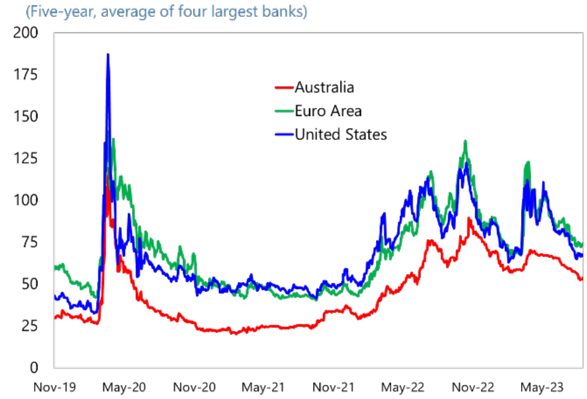
Business bankruptcies have remained low overall when compared with the Global Financial Crisis…

Business Bankruptcy
(Number of business-related backcruptcies)



…and market-perceived bank default risks is contained.

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

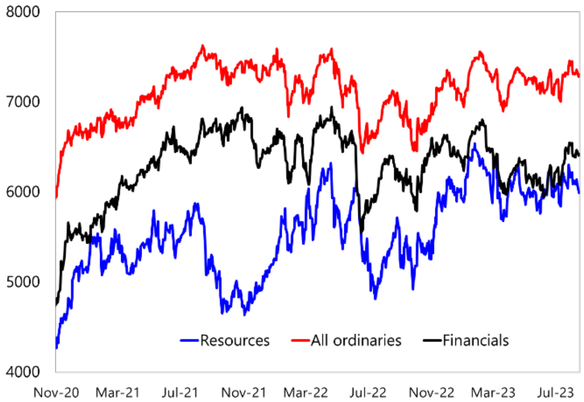


Sources: Bloomberg; and IMF staff calculations.

Figure 9. Financial Market: Tightening Financial Conditions

Australian equity prices have been volatile…

Stock Market Indices



…following global markets.

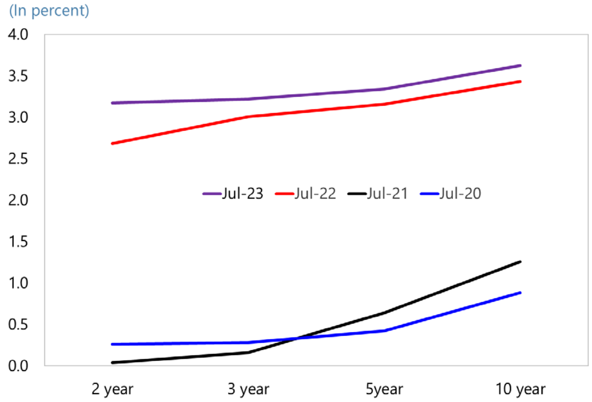
Advanced Economies: Stock Market Indices

(End-2019=100)

The yield curve has shifted upwards and flattened…

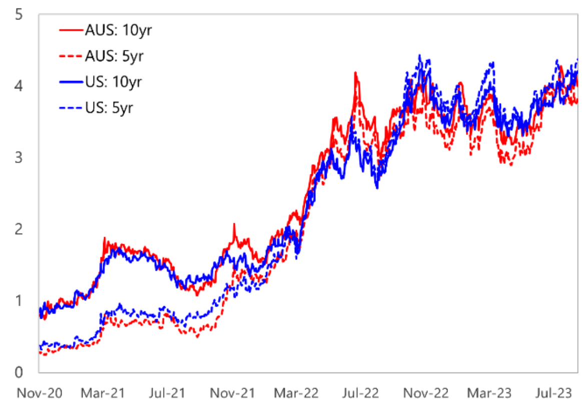
Australia Commonwealth Yield Curves

(In percent)



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

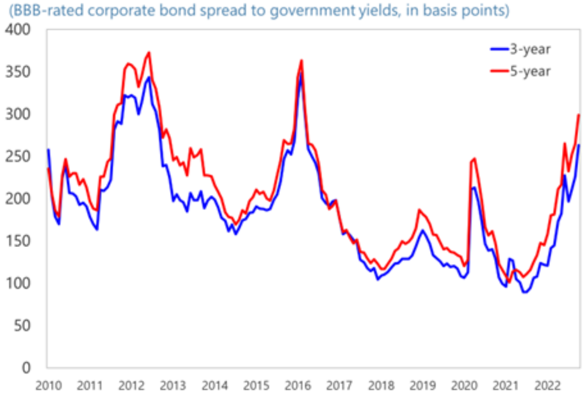
Government Bond Yields



Corporate bond spreads have increased.

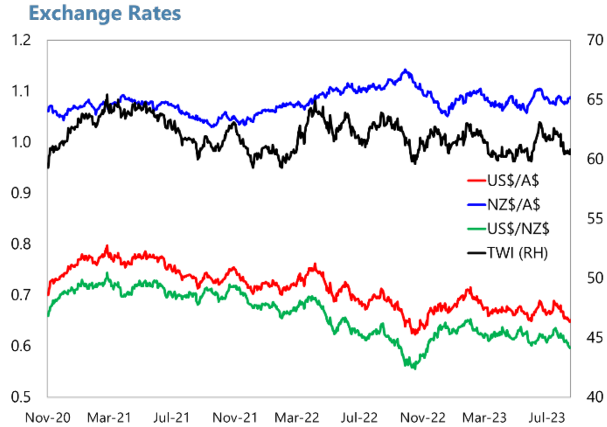
Non-Financial Corporate Bond Spreads

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



The exchange rate weakened against the US dollar but remained steady in trade-weighted terms (TWI).

Exchange Rates



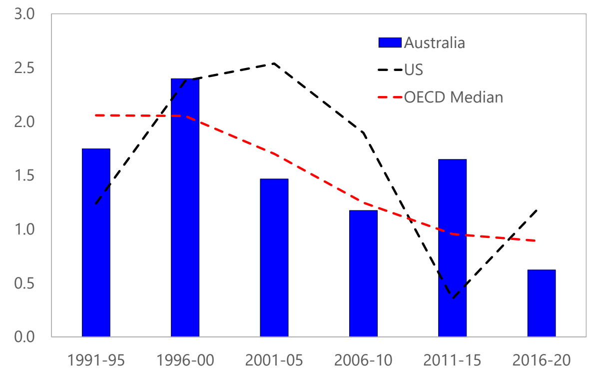
Sources: RBA; Bloomberg; and IMF staff calculations.

Figure 10. 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

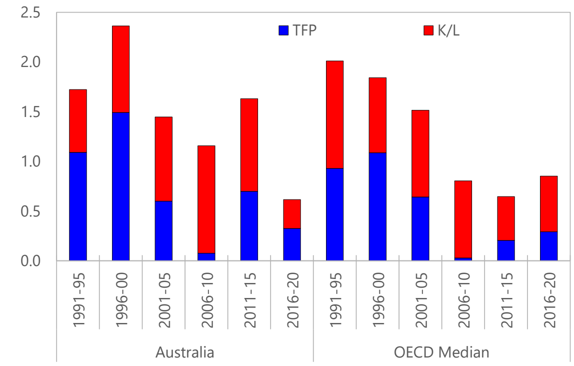
(In percent)



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

Labor Productivity Growth, Role of TFP & Capital Deepening

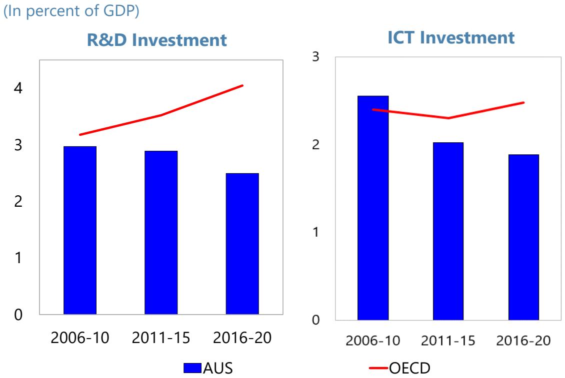
(In percent)



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

R&D and ICT Investment

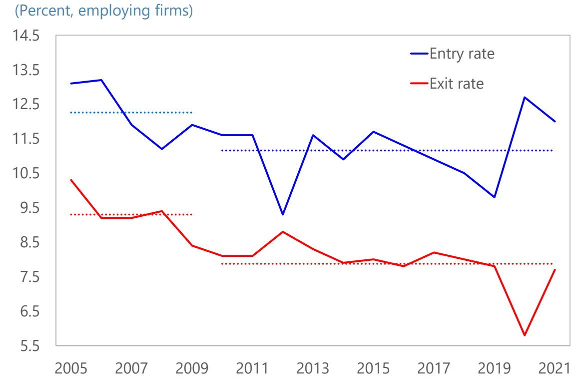
(In percent of GDP)



…and measures of firm dynamism and competition, such as firm entry and exit rates, have also deteriorated.

Firm Entry and Exit Rates 1/

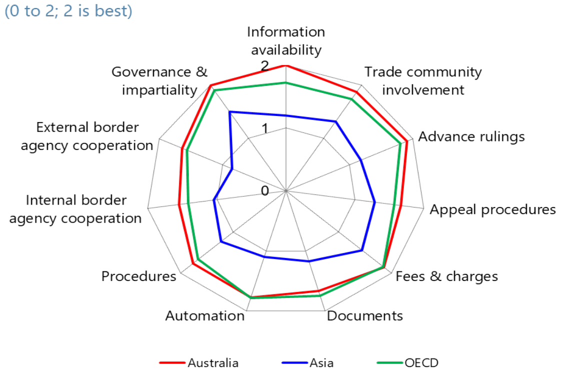
(Percent, employing firms)



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

Ease of Conducting Trade

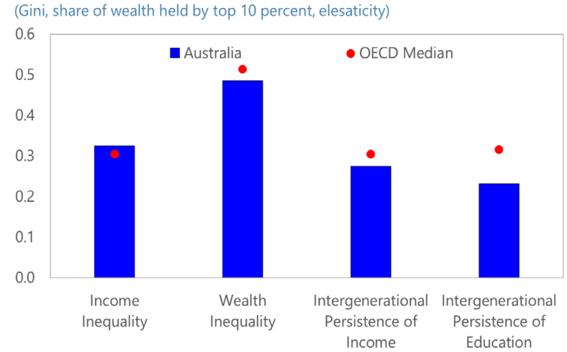
(0 to 2; 2 is best)



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

Measures of Inequality

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



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

1/ Dotted lines show the average entry and exit rate for the period 2005 to 2009 and 2010 to 2019.

Table 1. Australia: Main Economic Indicators, 2018–28

(Annual percentage change, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
NATIONAL ACCOUNTS											
Real GDP	2.8	1.9	-1.8	5.2	3.7	1.8	1.4	2.0	2.2	2.3	2.3
Domestic demand	2.7	1.2	-2.2	6.0	4.7	1.7	1.2	2.0	2.2	2.3	2.3
Private consumption	2.4	1.1	-5.8	5.0	6.5	1.2	0.8	2.0	2.7	2.9	2.9
Public consumption	4.1	6.2	7.7	5.4	5.2	0.9	0.8	0.9	0.6	0.5	0.6
Investment	2.3	-2.5	-2.8	10.5	1.2	4.0	2.6	3.3	2.9	2.8	2.8
Public	2.7	2.1	-0.6	7.0	3.5	9.0	3.0	2.2	0.9	0.4	0.4
Private business	2.6	-0.8	-3.8	8.9	3.9	6.7	4.0	4.7	4.1	3.9	3.7
Dwelling	4.3	-7.2	-5.6	9.9	-3.5	-2.2	-0.7	1.5	2.5	2.6	2.8
Net exports (contribution to growth, percentage points)	0.4	1.0	0.1	-1.4	-1.6	1.1	0.2	0.0	0.0	0.0	0.0
Gross domestic income	3.3	3.2	-1.9	8.9	5.2	0.1	-0.7	1.8	2.2	2.3	2.4
Investment (percent of GDP) 1/	24.2	22.6	22.3	23.1	23.3	23.8	24.8	25.0	25.2	25.3	25.4
Public	5.1	5.1	5.2	5.0	5.0	5.6	5.9	5.9	5.8	5.7	5.6
Private	18.9	17.6	17.3	18.0	17.7	18.3	18.9	19.2	19.4	19.6	19.8
Savings (gross, percent of GDP)	22.0	23.1	24.5	26.2	24.7	24.4	24.3	24.5	24.6	24.6	24.7
Households	9.3	9.9	17.0	14.6	10.3	8.0	8.2	9.1	8.9	9.5	9.3
Potential output	2.4	2.3	1.3	1.5	1.9	2.0	2.1	2.3	2.1	2.3	2.4
Output gap (percent of potential)	-0.7	-1.0	-4.0	-0.5	1.2	1.1	0.4	0.0	0.1	0.1	0.0
LABOR MARKET											
Employment	2.7	2.3	-1.6	3.1	4.3	2.2	1.1	1.5	1.5	1.7	1.6
Unemployment (percent of labor force)	5.3	5.2	6.5	5.1	3.7	3.7	4.2	4.4	4.6	4.6	4.6
Wages (nominal percent change)	2.1	2.3	1.6	2.0	3.0	4.2	4.1	4.0	3.7	3.6	3.0
PRICES											
Terms of trade index (goods, avg)	83	90	90	109	120	108	96	95	95	95	95
% change	3.2	8.4	0.3	21.4	9.6	-9.9	-11.3	-0.8	-0.1	-0.1	0.2
Iron ore prices (index)	101	135	156	228	174	161	137	124	114	109	105
Consumer prices (avg)	1.9	1.6	0.9	2.8	6.6	5.8	4.0	3.2	2.8	2.7	2.6
Core consumer prices (avg)	1.6	1.6	1.2	2.8	5.7	5.5	3.9	3.2	2.8	2.7	2.6
GDP deflator (avg)	2.2	3.2	0.8	5.6	7.9	1.7	0.7	3.0	2.6	2.6	2.6
FINANCIAL											
Reserve Bank of Australia cash rate target (percent, avg)	1.5	1.2	0.3	0.1	1.6	4.0	4.4	4.0	3.5	3.1	3.0
10-year treasury bond yield (percent, avg)	2.6	1.4	0.9	1.6	3.6	3.9	4.3	4.5	4.4	4.1	4.0
Mortgage lending rate (percent, avg)	5.3	4.8	4.5	4.5	7.3	8.3	8.3	8.1	7.6	7.4	7.4
MACRO-FINANCIAL											
Credit to the private sector	4.7	2.5	2.1	7.4	8.4	7.8	4.1	4.3	4.5	4.5	4.6
House prices (% change)	-5.1	2.5	3.6	23.7	-5.6	7.1	5.1	5.2	5.1	5.2	5.2
House price-to-income, capital cities (ratio)	4.3	4.3	4.2	4.9	4.5	4.9	4.7	4.7	4.7	4.6	4.6
Interest payments (percent of disposable income)	8.9	7.0	5.8	5.2	10.8	13.3	12.6	11.9	11.0	10.4	10.4
Household savings (percent of disposable income)	4.6	5.9	15.5	13.1	7.0	2.9	-5.1	-0.3	2.0	3.3	3.4
Household debt (percent of disposable income) 2/	186	185	179	187	187	193	190	183	182	179	179
Business credit (percent of GDP)	50.4	49.1	50.1	48.9	49.3	52.4	54.1	54.5	55.1	55.6	56.1
GENERAL GOVERNMENT (percent of GDP) 3/											
Revenue	35.6	35.7	34.5	35.0	36.0	36.4	37.3	35.6	35.5	35.1	35.1
Expenditure	36.8	36.9	42.1	44.3	40.0	37.2	39.2	38.0	36.9	36.6	36.3
Net lending/borrowing	-1.3	-1.2	-7.7	-9.3	-4.0	-0.8	-1.9	-2.3	-1.4	-1.5	-1.2
Commonwealth only	-0.5	-0.1	-4.8	-6.9	-1.3	1.1	-0.3	-1.3	-1.0	-0.9	-0.7
Operating balance	0.6	0.9	-5.5	-7.0	-1.5	1.5	0.0	-0.6	-0.2	0.0	0.3
Cyclically adjusted primary balance	0.4	0.5	-5.0	-7.1	-2.8	0.0	0.0	-0.3	0.8	0.7	0.9
Gross debt	41.3	42.2	52.7	58.3	53.5	49.5	54.4	55.3	56.0	56.0	55.2
Net debt	23.7	24.5	32.1	38.0	33.7	27.1	31.3	33.4	34.3	34.3	33.9
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-2.2	0.4	2.2	3.0	1.1	0.7	-0.5	-0.6	-0.6	-0.7	-0.6
Export volume	5.1	3.2	-9.7	-2.0	3.4	8.5	2.6	2.0	2.1	2.2	2.3
Import volume	4.3	-1.1	-12.8	5.4	12.9	4.0	2.2	2.4	2.4	2.4	2.4
Net international investment position (percent of GDP)	-57.0	-50.1	-53.0	-38.3	-38.2	-32.5	-32.3	-31.4	-30.5	-29.7	-29.0
Gross official reserves (bn A$)	76	84	56	81	85	...	...	...	...	...	...
MEMORANDUM ITEMS											
Nominal GDP (bn A$)	1,894	1,992	1,971	2,189	2,450	2,536	2,591	2,721	2,853	2,995	3,143
Percent change	5.1	5.2	-1.1	11.0	11.9	3.5	2.2	5.0	4.8	5.0	4.9
Real GDP per capita (% change)	1.3	0.4	-2.8	4.9	2.2	0.8	0.2	0.7	1.0	1.1	1.1
Population (million)	25.1	25.5	25.6	25.8	26.3	26.6	26.9	27.3	27.6	27.9	28.3
Nominal effective exchange rate	90.0	86.3	86.0	90.8	90.3	...	...	...	...	...	...
Real effective exchange rate	90.0	86.0	85.3	90.5	90.7	...	...	...	...	...	...

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, 2018/19-2028/29
(In percent of GDP, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
					Est.			Projections			
CONSOLIDATED GENERAL GOVERNMENT OPERATIONS 1/											
Revenue	**35.7**	**34.5**	**35.0**	**36.0**	**36.4**	**37.3**	**35.6**	**35.5**	**35.1**	**35.1**	**35.1**
Tax revenue	28.8	27.9	28.5	29.6	30.0	31.1	29.7	29.9	29.6	29.6	29.6
Direct taxes	21.4	20.6	21.0	22.7	22.9	23.8	22.4	22.5	22.4	22.4	22.4
Individual and withholding	14.6	14.5	14.3	14.7	14.9	16.0	15.1	15.3	15.5	15.5	15.5
Corporate	6.9	6.1	6.7	8.0	8.0	7.8	7.3	7.2	6.9	6.9	6.9
Indirect taxes	7.4	7.3	7.5	6.9	7.1	7.4	7.3	7.4	7.2	7.2	7.2
Of which: GST	3.3	3.2	3.5	3.3	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Non-tax revenue	6.9	6.6	6.5	6.4	6.5	6.1	5.8	5.6	5.5	5.5	5.5
Expenditure	**36.9**	**42.1**	**44.3**	**40.0**	**37.2**	**39.1**	**37.9**	**36.9**	**36.6**	**36.4**	**36.2**
Expense	34.8	39.9	42.0	37.5	34.9	37.2	36.2	35.7	35.1	34.9	34.7
Employee expenses	8.5	8.9	8.8	8.6	7.7	7.9	7.7	7.6	7.5	7.4	7.3
Other operating expenses (excl. depreciation)	11.6	12.5	12.9	13.0	12.5	12.5	12.0	12.1	11.8	11.8	11.8
Transfers	9.7	13.5	15.5	12.2	10.3	11.5	11.0	10.8	10.6	10.4	10.3
Interest (excl. superannuation)	1.3	1.3	1.2	1.2	1.5	2.0	2.2	2.0	2.1	2.1	2.2
Other	3.7	3.7	3.5	2.5	3.1	3.3	3.2	3.2	3.2	3.2	3.2
Net acquisition of nonfinancial assets	2.1	2.2	2.3	2.5	2.3	1.9	1.7	1.2	1.5	1.5	1.5
Of which: Gross fixed capital formation	3.7	3.7	3.7	3.3	3.8	4.0	4.0	3.7	3.6	3.6	3.6
Operating balance	0.9	-5.5	-7.0	-1.5	1.5	0.0	-0.6	-0.2	0.0	0.3	0.4
Primary balance	-0.4	-6.8	-8.4	-3.2	0.2	-0.3	-0.6	0.2	0.1	0.4	0.6
Net lending (+)/borrowing (-)	**-1.2**	**-7.7**	**-9.3**	**-4.0**	**-0.8**	**-1.9**	**-2.3**	**-1.4**	**-1.5**	**-1.2**	**-1.1**
CONSOLIDATED GENERAL GOVERNMENT BALANCE SHEET											
Liabilities	**83.0**	**95.7**	**97.7**	**84.4**	**78.1**	**82.9**	**82.9**	**83.2**	**82.1**	**81.2**	**80.1**
Gross debt	42.2	52.7	58.3	53.5	49.5	54.3	55.2	56.1	56.1	55.3	54.4
Commonwealth	33.4	40.9	43.8	38.3	34.1	35.1	35.2	35.5	35.3	35.1	34.8
States, territories and local governments	8.8	11.8	14.4	15.2	15.4	19.2	20.0	20.6	20.8	20.3	19.6
Other liabilities	40.8	43.0	39.5	30.9	28.5	28.6	27.7	27.1	26.0	25.9	25.7
Assets	**124.1**	**130.5**	**130.4**	**128.3**	**122.5**	**122.8**	**119.1**	**117.6**	**116.1**	**113.2**	**110.2**
Financial assets	51.2	55.0	54.6	52.7	51.1	49.5	47.9	48.0	48.6	47.2	45.7
Other assets	72.9	75.5	75.8	75.6	71.4	73.3	71.2	69.6	67.5	66.0	64.4
Net financial worth	**-31.8**	**-40.8**	**-43.1**	**-31.7**	**-27.0**	**-33.4**	**-35.0**	**-35.1**	**-33.5**	**-34.0**	**-34.3**
Net debt	**24.5**	**32.1**	**38.0**	**33.7**	**27.1**	**31.2**	**33.3**	**34.3**	**34.4**	**33.9**	**33.2**
Commonwealth 2/	23.1	27.8	32.1	26.4	19.8	20.1	21.2	21.6	21.5	21.4	21.2
States, territories and local governments	1.4	4.3	5.9	7.3	7.3	11.1	12.1	12.7	12.9	12.5	12.0
Net worth	**41.1**	**34.8**	**32.6**	**43.9**	**44.4**	**39.9**	**36.1**	**34.4**	**34.0**	**32.0**	**30.1**
Commonwealth	-28.5	-33.8	-35.3	-25.6	-21.6	-19.5	-20.6	-20.6	-19.4	-19.6	-19.7
States, territories and local governments	69.6	68.5	67.9	69.5	66.0	59.4	56.7	55.1	53.5	51.6	49.8
MEMORANDUM ITEMS											
Cyclically adjusted primary balance (in percent of potential GDP)	0.5	-5.0	-7.1	-2.8	0.0	-0.1	-0.4	0.6	0.5	0.8	1.2
Fiscal impulse (change in CAPB; in percent of potential GDP)	-0.1	5.5	2.1	-4.3	-2.8	0.1	0.3	-1.2	0.2	-0.2	-0.4
Change in real revenue (percent)	4.2	-3.1	5.2	9.2	3.5	-0.1	-1.8	1.4	1.8	2.2	2.4
Change in real primary expenditure (percent)	3.9	17.3	13.4	-10.0	-5.2	4.6	0.9	1.5	1.4	1.4	2.0
Commonwealth general government 3/											
Revenue	21.8	21.4	21.6	22.5	23.0	23.6	22.2	22.3	22.1	22.1	22.1
Expenditure	21.8	26.2	28.5	23.8	22.0	23.9	23.5	23.3	23.0	22.9	22.8
Net lending (+)/borrowing (-)	-0.1	-4.8	-6.9	-1.3	1.1	-0.2	-1.3	-1.0	-0.9	-0.7	-0.7
States, territories and local governments 4/											
Revenue	12.8	11.9	12.3	12.5	12.4	13.7	13.4	13.3	13.4	13.4	13.4
Expenditure	13.7	14.5	14.7	14.9	14.2	14.9	14.0	13.5	13.3	13.2	13.1
Net lending (+)/borrowing (-)	-1.0	-2.7	-2.4	-2.4	-1.8	-1.2	-0.6	-0.3	0.0	0.1	0.2
Commonwealth transfers to subnational governments	6.1	6.0	6.6	7.3	6.8	7.3	7.0	6.9	6.7	6.7	6.7
Of which: General revenue assistance	3.6	3.3	3.6	3.5	3.6	3.8	3.7	3.8	3.7	3.7	3.7
Nonfinancial public sector capital stock	98.7	101.6	100.3	99.4	99.0	103.5	102.7	102.7	100.8	99.8	98.6
GDP (in billion A$)	1,946	1,978	2,080	2,310	2,528	2,528	2,668	2,778	2,928	3,067	3,218

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, 2018-2028

(In percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
Current account	-2.2	0.4	2.2	3.0	1.1	0.7	-0.5	-0.6	-0.6	-0.7	-0.6
Balance on goods and services	1.1	3.3	3.6	5.5	5.8	4.4	2.1	1.9	1.8	1.7	1.8
Exports of goods and services	23.1	24.7	22.1	23.7	27.4	26.1	24.4	23.8	23.6	23.4	23.2
Exports of goods	18.2	19.6	18.5	21.0	24.4	21.7	19.7	19.1	18.9	18.6	18.4
Of which: Resources	12.1	13.3	12.4	14.8	17.8	14.9	14.1	13.3	12.4	11.8	10.9
Exports of services	4.9	5.1	3.6	2.7	3.0	4.3	4.8	4.7	4.7	4.7	4.7
Imports of goods and service	22.0	21.3	18.5	18.2	21.7	21.6	22.3	22.0	21.8	21.6	21.4
Imports of goods	16.7	16.2	15.5	15.7	17.7	17.3	17.8	17.5	17.4	17.2	17.0
Imports of services	5.3	5.2	3.0	2.5	3.9	4.3	4.5	4.5	4.4	4.4	4.4
Primary income, net	-3.3	-2.9	-1.3	-2.4	-4.6	-3.7	-2.5	-2.4	-2.3	-2.4	-2.3
Interest payments	-1.3	-1.0	-0.7	-0.6	-1.1	-1.5	-1.7	-1.5	-1.5	-1.7	-1.7
Equity income	-1.6	-1.5	-0.3	-1.5	-3.2	-1.7	-0.4	-0.4	-0.3	-0.3	-0.3
Secondary income, net	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital and financial account											
Capital account, net	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, net	2.2	-0.3	-2.6	-2.7	-1.0	-0.9	0.5	0.6	0.6	0.7	0.7
Direct investment	4.2	2.2	0.6	1.3	-3.1	-0.4	0.8	1.4	1.6	1.7	1.7
Equity	4.1	2.7	1.1	1.4	-2.6	-0.2	1.0	1.5	1.7	1.6	1.6
Debt	0.1	-0.6	-0.5	-0.1	-0.6	-0.2	-0.2	-0.1	0.0	0.0	0.1
Portfolio investment	-0.8	-2.2	-0.2	-5.1	4.6	-0.9	-0.6	-0.8	-1.3	-1.4	-1.6
Equity	-3.0	-2.2	-0.7	-5.3	2.2	-0.7	-1.4	-1.5	-2.1	-2.2	-2.2
Debt	2.3	0.0	0.5	0.2	2.4	-0.2	0.8	0.7	0.7	0.8	0.6
Financial derivatives	-0.5	-0.3	-1.1	-0.3	-0.3	-0.5	-0.2	-0.2	-0.1	-0.1	-0.1
Other investment	-1.5	0.4	-3.1	2.5	-1.9	1.0	0.4	0.2	0.5	0.6	0.6
Reserve assets	0.8	-0.2	1.3	-1.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	0.0	-0.1	0.3	-0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET											
Net international investment position 1/	-57.0	-50.1	-53.0	-38.3	-38.2	-32.5	-32.3	-31.4	-30.5	-29.7	-29.0
Equity, net	5.5	11.5	8.9	18.1	10.1	14.7	14.8	14.1	13.9	13.8	13.6
Assets	74.0	85.1	84.7	93.7	82.9	85.3	89.0	87.7	88.4	88.1	88.2
Liabilities	68.6	73.6	75.8	75.7	72.8	70.6	74.2	73.6	74.5	74.3	74.5
Debt, net	-62.5	-61.6	-61.9	-56.4	-48.3	-47.2	-47.1	-45.5	-44.4	-43.5	-42.6
Assets	63.5	65.4	70.9	60.9	69.0	67.0	69.9	68.9	69.4	69.2	69.3
Liabilities	126.0	127.0	132.9	117.3	117.3	114.3	117.0	114.4	113.8	112.7	111.9
External assets (gross)	137.5	150.5	155.7	154.6	151.9	152.4	158.9	156.6	157.8	157.2	157.4
Equity	74.0	85.1	84.7	93.7	82.9	85.3	89.0	87.7	88.4	88.1	88.2
Debt	63.5	65.4	70.9	60.9	69.0	67.0	69.9	68.9	69.4	69.2	69.3
External liabilities (gross)	194.5	200.7	208.6	193.0	190.1	184.9	191.2	187.9	188.3	187.0	186.4
Equity	68.6	73.6	75.8	75.7	72.8	70.6	74.2	73.6	74.5	74.3	74.5
Debt	126.0	127.0	132.9	117.3	117.3	114.3	117.0	114.4	113.8	112.7	111.9
Of which: A$-denominated	60.4	59.8	68.7	61.8	61.6	58.7	60.1	58.8	58.5	57.9	57.5
Short-term	43.0	40.9	43.1	43.9	45.1	36.2	37.1	36.3	36.1	35.7	35.5
MEMORANDUM ITEMS											
Gross official reserves (bn A$)	76	84	56	81	85	...	...	...	...	...	...
In months of prospective imports	2.2	2.8	1.7	1.8	1.9	...	...	...	...	...	...
In percent of short-term external debt	9.4	10.3	6.6	8.4	7.7	...	...	...	...	...	...
Net official reserves (bn A$)	62	63	61	84	85	...	...	...	...	...	...

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

1/ NIIP figures as a percent of GDP for 2022 differ from those reported in Annex III. Before computing ratios, Annex III 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: Monetary and Financial Sector, 2018-2028
(Year-end, unless otherwise noted)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
BALANCE SHEET						In billions of A$					
Total assets 1/	4,405	5,464	6,428	6,834	7,326	7,536	7,756	8,121	8,498	8,898	9,314
Currency and deposits	306	76	157	463	491	508	519	545	572	600	630
Securities other than shares	634	825	1110	1031	1099	1138	1162	1221	1280	1343	1410
Loans	3,244	3,521	3,999	3,839	4,251	4,522	4,751	4,973	5,198	5,439	5,693
Claims on government	10	30	31	24	28	29	30	31	33	35	36
Claims on MFI	385	740	997	881	1004	1040	1062	1116	1170	1228	1288
Claims on non-MFIs	2,577	2,607	2,784	2,855	3,086	3,316	3,519	3,679	3,842	4,015	4,199
o/w private sector	2,577	2,607	2,784	2,855	3,086	3,316	3,519	3,679	3,842	4,015	4,199
Claims on non-residents	271	144	187	79	132	137	140	147	154	162	169
Shares and other equity	46	6	5	10	8	8	8	9	9	10	10
Other (w/o residual)	176	409	509	645	781	808	826	867	909	955	1002
Other	176	1037	1157	1491	1477	1360	1315	1374	1439	1506	1571
Total liabilities 1/	4,405	5,464	6,428	6,834	7,326	7,536	7,756	8,121	8,498	8,898	9,314
Capital and reserves	277	291	310	311	318	329	336	353	370	389	408
Borrowing from RBA	88	76	133	204	211	130	88	92	97	102	107
Liabilities to other MFIs	796	592	644	672	703	734	767	802	838	876	915
Deposits of non-banks	2,662	2,735	3,137	3,278	3,425	3,579	3,740	3,909	4,085	4,268	4,460
Debt securities	419	948	833	885	967	1002	1023	1075	1127	1183	1241
Other liabilities	164	821	1372	1483	1702	1762	1800	1890	1982	2081	2183
					In percent of GDP						
Total assets (w/o residual) 1/	233	274	326	312	299	297	299	298	298	297	296
Loans	171	177	203	175	174	178	183	183	182	182	181
Claims on MFI	20	37	51	40	41	41	41	41	41	41	41
Claims on non-MFIs	136	131	141	130	126	131	136	135	135	134	134
					Percent change						
Credit non-bank private sector 2/	4.3	2.4	1.8	7.2	8.3	7.5	6.1	4.5	4.4	4.5	4.6
o/w Household credit	4.3	2.5	2.7	6.9	6.2	5.4	4.0	3.3	3.5	3.7	3.9
o/w Housing credit	4.7	3.0	3.5	7.4	6.5	5.6	4.2	3.4	3.6	3.8	4.0
o/w Owner-occupied housing	6.5	4.9	5.6	9.1	6.9	8.1	5.8	4.6	4.9	5.0	5.2
o/w Investor housing	1.1	-0.4	0.0	4.1	5.5	-0.2	-0.1	0.0	0.0	0.3	0.5
Personal credit	-2.1	-5.0	-12.5	-3.7	-0.1	0.5	0.5	0.6	0.5	0.5	0.5
Business credit	4.7	2.4	0.9	8.4	12.9	11.5	9.9	6.7	6.0	5.9	5.7

Sources: IFS (Other Depository Corporations, Table ODC-2SR) , RBA, APRA, and IMF staff projections.
1/ IFS (Other Depository Corporations, Table ODC-2SR).
2/ RBA (Table D1 Growth in selected financial aggregates).

Table 5. Australia: Selected Financial Soundness Indicators of the Banking Sector
(Year-end, unless otherwise noted, in percent)

	2015	2016	2017	2018	2019	2020	2021	2022Q1	2022Q2	2022Q3	2022Q4	2023Q1
Capital Adequacy												
Regulatory capital to risk-weighted assets	13.8	13.7	14.6	14.8	15.7	17.6	17.6	17.2	17.0	17.8	17.8	19.6
Regulatory Tier I capital to risk-weighted assets	11.8	11.4	12.4	12.7	13.1	14.0	14.0	13.6	13.1	13.4	13.4	14.5
Capital to assets	5.4	5.8	6.2	6.3	6.3	6.6	7.2	6.7	6.5	6.6	6.8	7.0
Large exposures to capital	93.4	91.7	82.7	84.8	99.7	82.7	82.7	85.1	91.3	91.8	89.4	84.2
Nonperforming loans net of loan-loss provisions to capital	7.3	7.6	6.9	7.5	7.6	7.7	7.7	7.3	7.0	6.7	6.3	6.5
Asset Quality												
Nonperforming loans to total gross loans	0.9	0.9	0.9	0.9	1.0	1.1	1.1	1.0	0.9	0.9	0.8	0.8
Sectoral distribution of loans to total loans												
Residents	90.5	92.2	93.3	93.1	93.9	93.5	94.6 1/	...	...	...	...	...
Deposit-takers	0.12	0.12	0.15	0.18	0.24	0.03	0.03 1/	...	...	...	...	...
Central bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00 1/	...	...	...	...	...
Other financial corporations	3.1	3.3	3.4	3.6	2.7	2.7	2.8 1/	...	...	...	...	...
General government	0.3	0.3	0.2	0.2	1.0	0.9	0.8 1/	...	...	...	...	...
Non-financial corporations	22.7	23.0	23.0	22.9	22.9	22.8	23.0 1/	...	...	...	...	...
Other domestic sectors	64.3	65.5	66.5	66.2	67.1	67.1	68.0 1/	...	...	...	...	...
Nonresidents	9.5	7.8	6.7	6.9	6.1	6.5	5.4 1/	...	...	...	...	...
Earnings and Profitability												
Return on assets	1.5	0.8	1.2	1.4	1.0	0.4	0.3	1.3	1.2	1.0	0.9	0.6
Return on equity	23.8	12.4	17.3	20.0	13.2	4.9	11.8	15.9	16.4	17.4	18.4	19.4
Interest margin to gross income	64.8	83.4	63.0	67.8	67.1	74.8	74.8	62.1	63.5	92.9	53.0	-1.5
Noninterest expenses as a percentage of gross income	45.2	56.7	42.1	44.1	46.0	52.0	52.0	43.7	44.4	60.5	33.0	-1.8
Liquidity												
Liquid assets to total assets	17.7	18.3	18.6	18.7	16.5	20.2	20.2	22.8	23.4	25.0	23.7	24.2
Liquid assets to short-term liabilities	39.7	41.2	40.1	41.9	34.2	37.0	37.0	37.4	39.6	40.8	41.2	42.8

Source: IMF, Financial Soundness Indicators (FSI) database.
1/ As of 2021Q2.

Annex I. Previous IMF Policy Recommendations

1. **Sound macroeconomic policies contributed to the post-pandemic recovery and pinning down a transition to a soft landing.** Policies have been broadly consistent with staff's advice. During the pandemic, Australia implemented one of the largest fiscal stimulus packages among AEs. Together with monetary easing, this helped weather the pandemic, pave the way for economic recovery despite repeated lockdowns in 2020 and 2021, and limit economic scarring. All levels of government have subsequently started to consolidate, and the RBA has been lifting the policy rate. Since the last Article IV consultation, further tightening of macroeconomic policies have been implemented to support a durable handover from public to private demand and address inflation.

2. **The pace of fiscal consolidation was well-calibrated to the strength of the underlying economic recovery.** The overall deficit in FY2022/23 further declined, with continued efforts for fiscal consolidation. The Commonwealth Government saved additional tax receipts, generated by favorable terms-of-trade and strong labor market developments, and turned the cash balance into a surplus for the first time in 15 years. This follows the fiscal strategy of budget repair and is in line with staff advice to calibrate the fiscal stance for further consolidation and to support a durable transition from public to private demand. Cyclically adjusted primary balance is now close to the pre-pandemic levels.

3. **RBA has tightened monetary policy appropriately to address above-target inflation** Consistent with staff advice, RBA hiked the policy rate cumulatively by 425 basis points since May 2022. This has resulted in a moderation in private sector credit growth and continued tightening of financial conditions, as mortgage rates reset. The proposal for a 5-year periodic review of the RBA, in line with the practice in some other central banks and staff advice, is welcome.

4. **Financial sector reforms have progressed, and the increase in banks' interest serviceability buffer enhanced resilience during the housing price correction.** Strong bank capitalization provides additional buffers, despite banks' high concentration in mortgage lending. Consistent with staff recommendations, 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 as interest rates increase. Progress is being made in addressing climate and cyber risks, which is essential to ensure financial resilience in a changing environment.

5. **Progress has been made on structural policies, especially in climate change mitigation, though tax policy reforms remain elusive.** The Safeguards Mechanism reform makes greater use of price signals and market mechanisms in achieving emissions reduction, consistent with past staff advice, though a broad-based economy-wide carbon price is still not being considered. The government's focus on education and female labor force participation is also consistent with previous staff recommendations, though the longstanding policy advice of rebalancing the tax structure away from direct taxes to indirect taxes remains difficult to implement.

Annex II. Global Value Chains and Inflation Dynamics in Australia[1]

Globally, and in Australia, estimates suggest pandemic lockdowns had large, significant and persistent effects on inflation via both supply and demand channels. During 2020, lockdown-induced supply-shocks, monetary and fiscal support would have pushed up Australian inflation without offsetting lower downstream demand. In 2021-22, reopening caused an increase in demand which interacted with higher energy prices and transport costs to increase inflationary pressure. Over the pandemic period, approximately 20 percent of Australia's lockdown-demand-induced inflation originated from foreign shocks due to Australia's integrated position in global supply chains. In light of the increasing global variability in climate, trade, and conflict, global demand and supply shocks will continue to be important drivers of Australia's inflation dynamics.

1. **The cause of the rise in inflation has received much attention in policy circles, but the relative importance of different drivers remains an open question.** Conventional explanations for the rise in inflation include fiscal stimulus, accommodative monetary policy, and higher energy prices. A principle alternative explanation is that global supply-chain disruptions gave rise to inflationary supply and demand shocks. This annex considers to what extent do each of these drivers explain the rise and persistence of inflation during the pandemic period. It also considers whether Australia's position in global supply-chains makes it vulnerable to global shocks.

2. **This annex draws on two newly compiled datasets.** First, the annex draws on a novel dataset of producer price inflation from 55 countries (including Australia) constituting 1195 country-sector pairs between 2020-2022.[2] This dataset is harmonized and merged with data on input output linkages from the OECD's World Input Output Table. Second, the annex generates a sectoral lockdown intensity variable. The variable is an interaction of the country-level lockdown intensity with the sector-level ease of working from home.

3. **A Local Projection regressions can be used to study the contemporaneous and dynamic effects of lockdowns and policy stimuli on producer price inflation:**

$$\Delta\, p_{s,t+h} = \sum_{l\in\{0,3,6,9\}} \beta_l^S\, B_{s,t-l}^S + \sum_{l\in\{0,3,6,9\}} \beta_l^D\, B_{s,t-l}^D + \sum_{l\in\{0,3,6,9\}} \beta_l^F\, B_{s,t-l}^{Fiscal} + \sum_{l\in\{0,3,6,9\}} \beta_l^M\, B_{s,t-l}^{Monetary} + controls_{s,t} + u_{s,t}$$

i. where $\Delta\, p_{s,t+h}$ is the change in producer prices in sector s at time t. The four main explanatory variables are defined below, where the "network exposure share" is derived from a macroeconomic model of international production in a networked supply-chain, which can be found in Chau et al. (forthcoming). Lockdown supply shocks $B_{s,t}^S =$

[1] Prepared by Marina Conesa and John Spray drawing on work from Vu Chau, Marina Conesa, Taehoon Kim, and John Spray, forthcoming.

[2] In Australia, 25 sectors are included on a quarterly frequency.

$\sum_k SupplyExposure_{sk}\,\Delta\, lockdown_{kt}$ which combines the intensity of lockdowns in upstream sectors with the degree of supply-exposure.

ii. Lockdown demand shocks $B^D_{s,t} = \sum_c DemandExposure_{sc}\,\Delta\, lockdown_{ct}$ which combines the intensity of lockdowns in downstream sectors with the degree of demand-exposure.

iii. Fiscal stimulus shocks $B^{Fiscal}_{s,t} = \sum_c DemandExposure_{sc}\,\Delta\, FiscalStimulus_{ct}$ which combines the amount of fiscal stimulus in downstream sectors with the degree of demand-exposure.

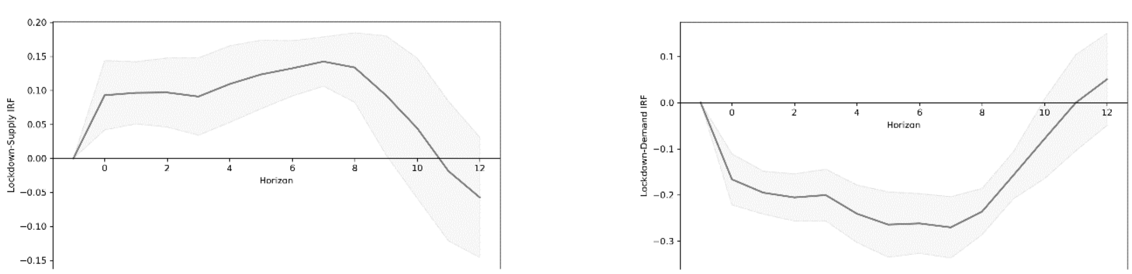
iv. Monetary stimulus shocks $B^{Monetary}_{s,t} = \sum_c DemandExposure_{sc}\,\Delta CentralBankAssets_{ct}$ which combines the change in central bank assets in downstream sectors with the degree of demand-exposure.

Controls include lagged producer prices, maritime transport costs, exchange rates, oil price shocks, and COVID cases. Identification leverages heterogeneous exposure of different industries to shocks. The identification assumption is that the exposure weights (pre-COVID network supply and demand shares) do not predict changes in sectoral inflation rates through channels other than the network of intermediate input trades as laid out in the theoretical framework.

4. **Figure 1 shows that lockdown (and reopening) policies are strong and persistent drivers of global inflation, both through supply and demand channels.** Figure 1 plots the results of local projection regressions for different forward horizons of PPI inflation showing the average effect and 95 percent confidence interval of shocks to lockdown supply $B^S_{s,t}$ and lockdown demand $B^D_{s,t}$, respectively. Panel (a) shows that the contemporaneous effect of a full lockdown of a major supplier that accounts for 50 percent of input costs would lead to an additional 5 percent PPI inflation in the affected sector. Panel (b) shows a sector that sells 50 percent of its output to a locked-down country would experience a 9 percent deflationary impact. For both demand and supply shocks, the effects are both large and persistent – lasting for approximately 10 months.[3]

Figure 1. Impulse Response Functions from Supply and Demand Shocks

(a) Lockdown Supply (b) Lockdown Demand

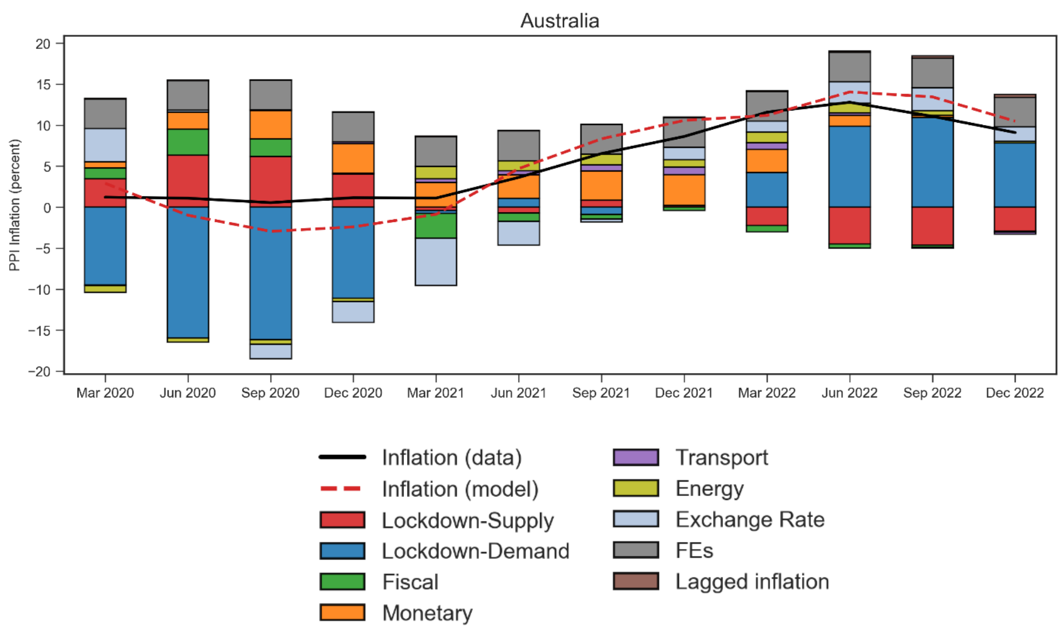


Source: Chau et al. (forthcoming).
Note: figures plot the impulse response functions for the global sample at a monthly frequency.

[3] See paper for robustness checks including differential effects of shocks on inflation at the beginning verses end of the pandemic, the role of network in propagating shocks, and the differential response of Asian countries.

5. Using the empirical model, it is possible to decompose the predicted drivers of inflation in Australia. Figure 2 shows the main predicted positive drivers of inflation in Australia in 2020 were lockdown supply-shocks, followed by expansionary monetary policy and fiscal policy. However, this was more than offset by lower demand due to lockdowns in downstream sectors (blue). In 2021 and 2022 this story begins to reverse as reopening, globally, and in Australia, caused an increase in demand. This interacted with continued accommodative monetary policy, higher energy prices and transport costs to drive up inflation. The findings that demand was the primary driver of the pick-up in inflation deviate from recent research on Australia which found a larger role for supply-shocks in CPI inflation over this period[4] but are consistent with findings from other research into the Asia-Pacific region.[5] Differences in results likely arise from the different methodology as well as different measure of inflation.

Figure 2. Inflation Decomposition in Australia



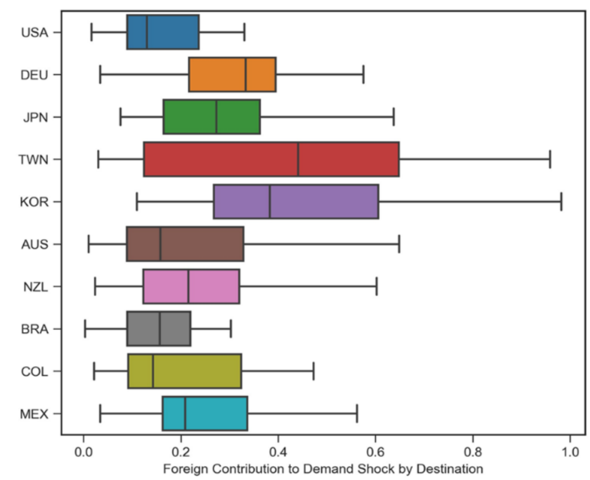
Source: Chau et al. (forthcoming).
Notes: This figure plots the predicted PPI inflation (outcome variable) due to subgroups of variables (contemporaneous and lags): lockdown-supply, lockdown-demand, and fiscal. In each subplot, each variable is aggregated by taking a weighted mean across sectors, with weights proportional to sectoral size (sales).

[4] Beckers, Hambur and Williams, 2023, "Estimating the Relative Contributions of Supply and Demand Drivers to Inflation in Australia"

[5] Redl, 2023, "Monitoring Demand and Supply in Asia: An Industry Level Approach"

6. Australia will remain vulnerable to foreign supply and demand shocks going forward. Figure 3 shows that the foreign contribution to lockdown demand shocks made up 20 percent of the demand shock in Australia. While this is less than some of the large manufacturing countries (e.g. Japan, Korea, Germany), it still represents a significant foreign component of demand-led inflation consistent with Australia's integrated position in global supply chains.

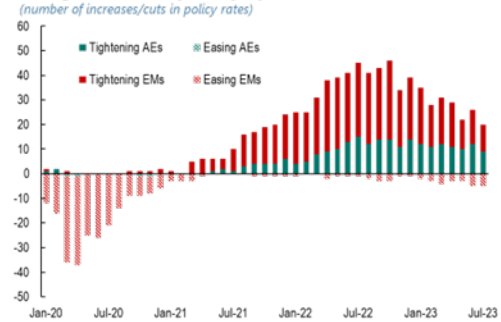
Figure 3. Foreign Contribution to Lockdown Demand Shock



Source: Chau et al. (forthcoming).
Notes: this figure shows the foreign contribution to demand shocks for different countries. A value of 1 would means demand shocks were foreign and zero means all demand shocks were domestic.

Annex III. Monetary Policy Transmission: Cross-Country Evidence[1]

Change in Monetary Policy Cycle
(number of increases/cuts in policy rates)



Sources: Haver and IMF Staff Calculations

1. **After decades of low interest rates, monetary policy has been remarkably active over the last few years – first in supporting economic activity during the COVID-19 lockdowns and then to rein in inflation.** This has reignited interest in the transmission and heterogeneities of monetary policy. The key challenge in understanding monetary policy transmission is to isolate the exogenous response of macroeconomic variables to monetary policy. Deb et. al. (2023) constructs a novel measure of monetary policy shocks for a large set of 33 advanced and emerging market economies spanning three decades to estimate the monetary policy transmission effects into real GDP and consumer prices and explore how these vary across countries and over time.

2. **Monetary policy shocks are identified in two steps.** First, forecast errors in short-term rates are calculated by subtracting interest rate forecasts from realized interest rates. Next, the part of these forecast errors that is orthogonal to the state of the economy is extracted by regressing the forecast errors on changes and forecasts of growth and inflation, as well as other pre-determined macroeconomic variables. The resultant monetary policy shock series are highly correlated with the shocks generated for the U.S. (by Romer and Romer 2004) and the U.K. (by Cloyne and Hurtgen 2016) following a similar approach in the literature. These shocks help solve the price puzzle – the empirically observed rise in prices following a contractionary monetary policy (Sims 1992). While an increase in interest rates is indeed associated with rises in consumer prices, this result is driven by endogeneity, and prices decline following the identified monetary policy shocks that purge out the current and expected state of economy from forecast errors. The findings are similar to analysis by Beckers (2000) for Australia, where he find that while cash rate changes themselves are positively correlated with future inflation, after accounting for inflation forecasts and credit market conditions, higher cash rate reduces inflation and output growth, and raises the unemployment rate.

3. **On average, following a 100 bps monetary policy shock, real GDP declines from its pre-shock path by 0.3 percent within two quarters and the effects remain persistent through 8 quarters.** In line with other models, including RBAs MARTIN model, the response of consumer prices materializes slower, with the effects being significant after the 2nd quarter and reaching its peak around the 6th quarter. While this average effect does not account for episode specific factors and counterfactuals, it nevertheless suggests that that bulk of the impact of RBAs policy tightening in 2022 and 2023H1 will be felt in the coming months. The significance, size, and the pace of the impulse responses are robust to various specifications on how shocks are generated and when controlling for fiscal policy and exchange rate.

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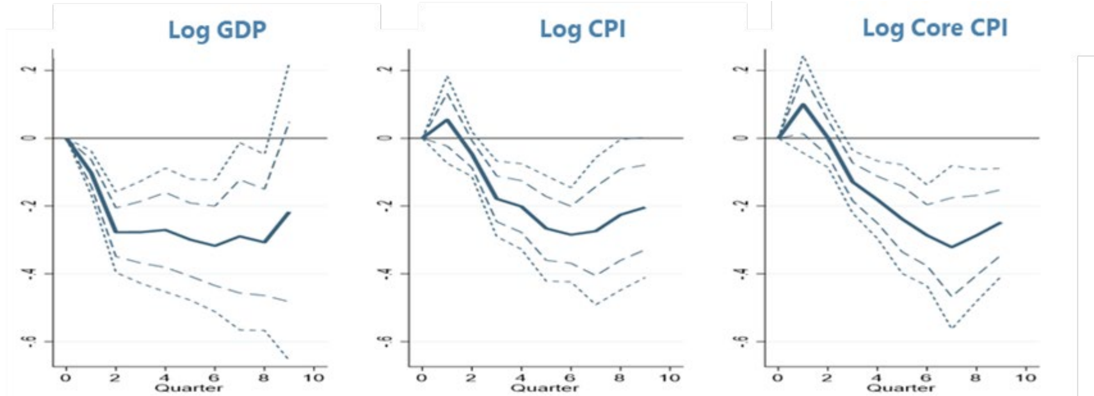
[1] Based on IMF Working Paper, Monetary Policy Transmission Heterogeneity: Cross-Country Evidence by Pragyan Deb, Julia Estefania-Flores, Melih Firat, Davide Furceri, and Siddharth Kothari (2023).

Monetary Policy Transmission into GDP, CPI and Core CPI

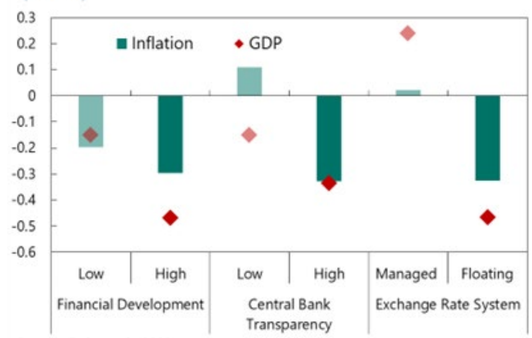


Note: Impulse response function based on local projection methods following Jordà (2005) using an unbalanced panel of quarterly data for 33 countries from 1990 to 2019. Estimates based on the regression $y_{j,t+h} - y_{j,t-1} = \beta_h \mathrm{MP}_{j,t-1} + \sum_{k=1}^{4} \theta_k^Z Z_{j,t} + \alpha_j + \alpha_t + \epsilon_{j,t}$ for different horizons k, where $y_{j,t+h}$is the log real GDP and log consumer price index and MP_(j,t-1) is the lag of monetary policy shocks in country j. The coefficient β_h denotes (percent) response of variables to domestic monetary policy shocks at a horizon of h quarters. The vector contains $Z_{j,t}$ 4 lags of dependent variable and monetary policy shocks. β_h are country fixed effects, included to control for time-unvarying unobservable characteristics, as well as for cross-country differences in average dependent variables. α_t are time fixed effects, which account for common time-varying shocks (e.g., VIX, world energy and food prices). The solid line shows the point estimate for β_h for different horizons k, while the dashed and short-dashed lines are the 68 percent and 90 percent confidence intervals, respectively.

4. **Structural and country-specific factors result in significant variation in monetary policy transmission.** While the average output and price responses do not vary substantially across income levels, there is some evidence of a smaller sacrifice ratio (Dy/Dp) in the case of AEs – smaller impact on GDP for similar effect on inflation. Consistent with the credit channel of monetary policy, transmission is stronger in countries with higher financial development. In addition, higher central bank transparency, measured using data from Dincer, Eichengreen and Geraats (2022), is associated with significantly stronger monetary policy transmission into prices. And unsurprisingly, monetary policy transmission is stronger in countries with floating exchange rate regimes, since fixed and managed regimes close the exchange rate and expenditure switching channel of monetary policy, limiting the response to output and prices. These suggest that transmission in Australia, with high levels of financial development, strong central bank transparency and credibility and a flexible exchange rate system, should have relatively strong monetary policy transmission.

Structural: Monetary Policy Effects On:

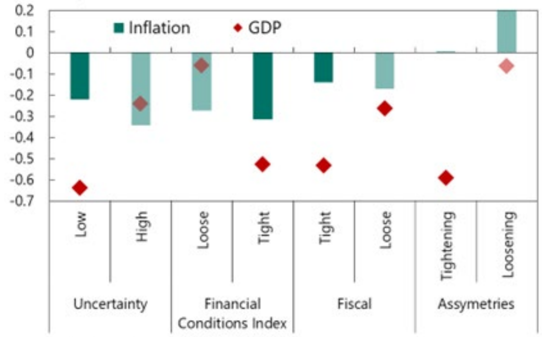
(Percent)



Source: Deb et. al. (2023).
Note: Light shaded areas indicate that results are not significant at 90% CI.

5. **Cyclical factors and supportive complementary policies also play a role.** Transmission is weaker in periods of high economic uncertainty, which is consistent with the findings of Aastveit (2017) and Pellegrino (2021) for the U.S. In addition, transmission is stronger when broader financial conditions are tight. This is particularly true in the case of GDP, but even for inflation, while the magnitude of response is similar, error bands are wider w hen financial conditions are overall loose. Complementary fiscal policy has a similar effect, with a loose fiscal stance associated with weaker monetary policy transmission. These findings confirm the importance of complementary policies, particularly fiscal policy, in supporting the RBA to contain inflationary pressures. There are also asymmetries with regards to the direction of policy change. Contractionary shocks have a much larger effect on GDP than expansionary shocks.

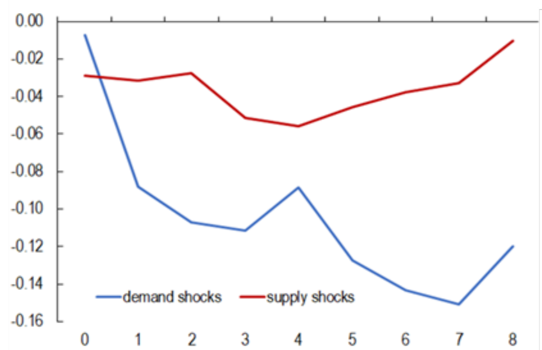
Cyclical: Monetary Policy Effects On:
(Percent)



Source: Deb et. al. (2023).
Note: Light shaded areas indicate that results are not significant at 90% CI.

6. **Finally, the nature of the underlying shock – demand vs supply – has an effect on the overall impact of policy tightening** Estimates of the impact of monetary policy tightening using demand driven and supply driven inflation separately (available from Firat and Hao, forthcoming) show a persistent and significant negative response to tightening in the case of demand driven inflation, but insignificant impact when inflation is supply driven. This is not surprising since monetary policy works primarily through its impact on demand. However, it suggests a larger trade-off and sacrifice ratio with rising role of supply-driven shocks on inflation. This points to the higher than usual policy challenges during the pandemic, when at least initially, supply side factors dominated.

Monetary Transmission when Demand vs Supply Shocks
(Percent)



Source: Deb et al. (2023, forthcoming).

Annex IV. Sovereign Risk and Debt Sustainability Assessment

Sizable fiscal consolidation has continued to help bring the economy to a soft landing. The overall deficit has declined sharply in FY2022/23, delivering a cumulative post-pandemic fiscal consolidation that brought the cyclically adjusted primary balance close to pre-COVID levels. The fiscal stance is projected to turn to moderately accommodative territory in FY2023/24-FY2024/25 before a new fiscal consolidation episode kicks in. With rising debt-servicing costs, gross general government debt[1] is projected to increase in the near term but would stabilize after 2026 at around 56½ percent of GDP. Despite recent exchange rate volatility, demand for the Australian Government Securities (AGS) by nonresidents is expected to remain robust. Rising gross financing needs should be monitored closely, although potential vulnerabilities are mitigated by Australia's strong institutions, policy frameworks, and a deep and liquid capital market.

1. Background. Australia's cyclical position is stronger than in most advanced economies, with a positive output gap and a tight labor market, supported by favorable terms-of-trade developments. Commonwealth and state/territory governments started unwinding stimulus measures in FY2021/22 and continued to do so in FY2022/23 to help bring down inflation, while supporting growth and vulnerable households. The overall fiscal deficit reached 0.8 percent of GDP in FY2022/23, a sharp decline from a record high of 9¼ percent in FY2020/21. Coupled with stimulus withdrawal, cyclical factors and gains in commodity-related windfall revenues also lent support to the sizable fiscal consolidation.

Baseline Scenario

2. Macroeconomic assumptions. The economic expansion is expected to moderate, with growth projected to decline to around 1¾ percent in 2023 and 1¼ percent in 2024 before recovering gradually over the medium-term to around 2¼ percent, consistent with staff's potential output estimates. Inflation has peaked in 2022 and started moderating in recent quarters. It is projected to remain elevated in the near term. The RBA has tightened monetary policy by 425 basis points (cumulative) since May 2022, with its cash rate target at 4.35 percent. Long-term inflation expectations remain anchored. The 10-year Treasury bond yield peaked at around 5 percent at end-October and has since come down to 4¾ percent. The RBA has signaled that further tightening of monetary policy will be data-dependent.

3. Debt trajectory. The pace and the size of fiscal consolidation have been pronounced, with the cyclically adjusted primary deficit in FY2022/23 close to pre-COVID levels. However, the deficit is projected to increase at the consolidated general government level in FY2023/24-FY2024/25[2], with weakening growth momentum and growing debt servicing costs. Gross public debt is projected to

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

[2] In FY2024/25, the deficit is projected to increase, mainly resulting from the already-legislated personal income tax reform, lowering its tax revenue by around 1 percent of GDP, as per the FY2022/23 budget.

increase as a share of GDP in the near term but stabilize over the medium term as fiscal consolidation resumes, and the primary balance improves gradually.

4. Realism. Baseline economic assumptions are generally within the error band observed for all countries. The baseline fiscal projections and implied near-term adjustments are in the upper quartile compared with historical and cross-country experience but are nevertheless realistic given the moderate pace of fiscal consolidation over the medium term.

5. Vulnerabilities. The share of Australian Government Securities (all denominated in local currency) held by non-residents has increased somewhat in recent periods, reaching around 45 percent at end 2023Q2 (or 15 percent of 2022 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. Gross financing needs are projected to increase in the near term as the governments rely more on short-term securities to finance deficit. Overall, risks remain low with deep and liquid capital markets in Australia.

Figure 1. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stress is low, reflecting low levels of vulnerability in the medium-, and long-term horizons.
Medium term	Low	Low	Medium-term risks are assessed as low against a mechanical low signal on the basis of the strength of institutions, the depth of the investor pool, the role of the Australian dollar in the international system, and the credibility of macroeconomic policies in Australia to play a stabilizing role.
Fanchart	Low	…	
GFN	Low	…	
Stress test		…	
Long term	…	Low	Long-term risks are low as aging-related expenses on health feed into debt dynamics and their increase is projected to be limited, compared to other advanced economies with a faster pace of population aging.
Sustainability assessment 1/	Not required for surveillance countries	Sustainable	Primary balance is projected to improve over the medium term at the consolidated level and the debt path stabilize at moderate levels. GFNs will remain at manageable levels with deep capital markets and the role of the Australian dollar. Debt is assessed as sustainable.
Debt stabilization in the baseline			Yes

DSA summary assessment

Commentary: Australia is at a low overall risk of sovereign stress, and debt is sustainable with an AAA sovereign credit rating. The sustained post-pandemic economic recovery, supported by strong labor market and favorable commodity market developments, boosted revenues with Australia's cyclical position stronger than most AEs. Withdrawal of fiscal stimulus has also contributed to sizable fiscal consolidation. Moving forward, the deficit is projected to increase in the near term, but debt is projected to stabilize over the medium term with improvements in the primary balance. Despite high and persistent inflation and monetary policy tightening, medium-term liquidity risks as analyzed by the GFN Financeability Module and long-term risks remain low. Growth in age-related spending is projected to pick up, but its pace is contained relative to other AEs since population aging in Australia is not as acute as in other AEs.

Source: IMF staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2+C39/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

					Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	
				2	Extra budgetary funds (EBFs)	No	Not applicable
				3	Social security funds (SSFs)	No	
				4	State governments	Yes	
				5	Local governments	Yes	
				6	Public nonfinancial corporations	No	
				7	Central bank	No	
				8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
5. Debt consolidation across sectors:		Consolidated		Non-consolidated	

Color code: chosen coverage; Missing from recommended coverage; Not applicable

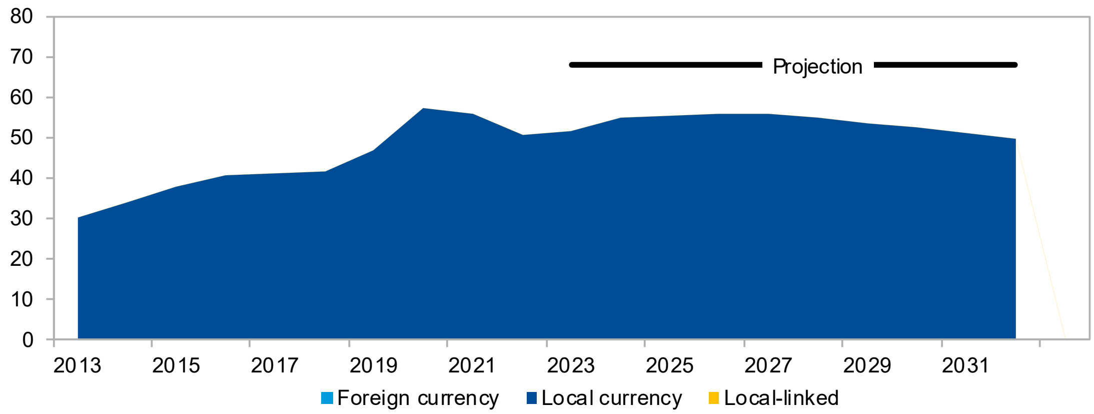
Reporting on intra-government debt holdings

				Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1 Budget. central govt									0
				2 Extra-budget. funds									0
				3 Social security funds									0
				4 State govt.									0
				5 Local govt.									0
				6 Nonfin pub. corp.									0
				7 Central bank									0
				8 Oth. pub. fin. corp									0
				Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes), and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

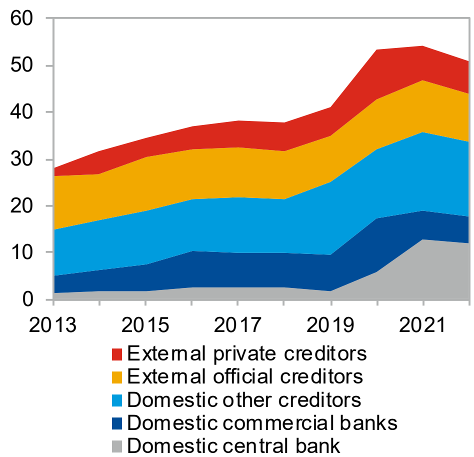
Figure 3. Public Debt Structure Indicators

Debt by currency (percent of GDP)



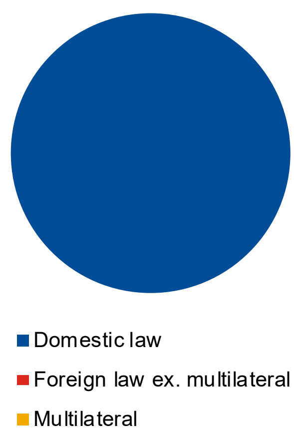
Note: The perimeter shown is general government.

Public debt by holder (percent of GDP)



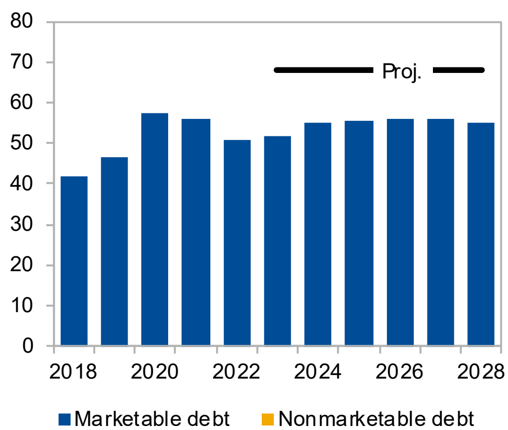
Note: The perimeter shown is general government.

Public debt by governing law, 2022 (percent)



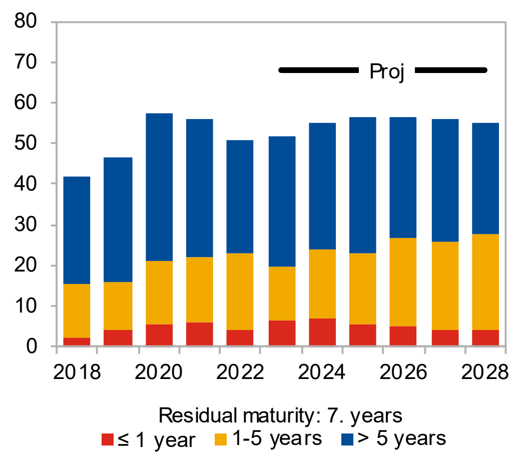
Note: The perimeter shown is general government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is general government.

Public debt by maturity (percent of GDP)



Note: The perimeter shown is general government.

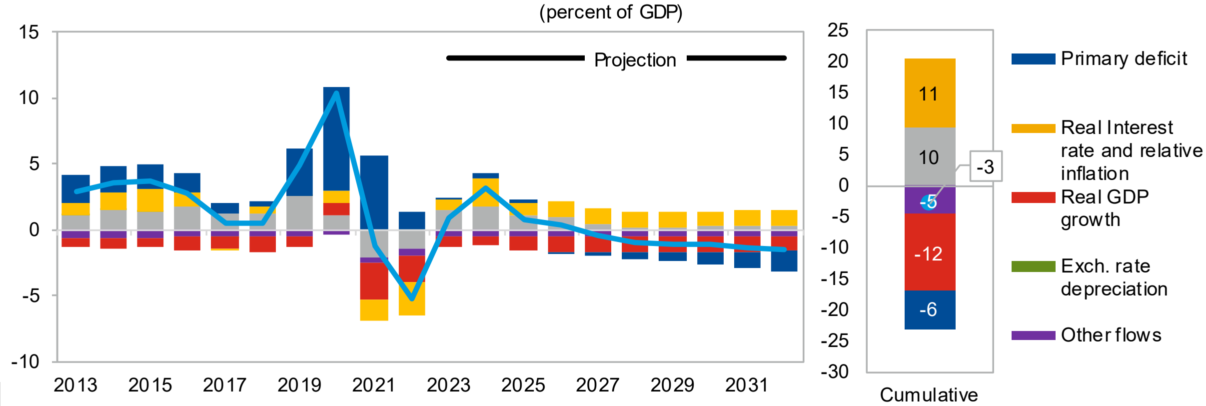
Figure 4. Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	50.8	51.7	54.9	55.7	56.1	55.7	54.8	53.8	52.7	51.4	49.9
Change in public debt	-5.1	1.0	3.2	0.8	0.4	-0.3	-0.9	-1.0	-1.1	-1.3	-1.5
Contribution of identified flows	-3.7	-0.5	1.3	-0.3	-0.6	-0.8	-1.1	-1.3	-1.4	-1.6	-1.8
Primary deficit	1.4	0.0	0.4	0.2	-0.2	-0.3	-0.5	-0.7	-0.9	-1.2	-1.5
Noninterest revenues	35.3	36.3	36.1	35.1	34.9	34.7	34.7	34.7	34.8	34.8	34.8
Noninterest expenditures	36.7	36.3	36.5	35.3	34.7	34.4	34.2	34.0	33.8	33.6	33.3
Automatic debt dynamics	-4.6	-0.1	1.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.1
Real interest rate and relative inflation	-2.6	0.8	2.0	1.0	1.1	1.1	1.2	1.1	1.2	1.2	1.2
Real interest rate	-2.6	0.8	2.0	1.0	1.1	1.1	1.2	1.1	1.2	1.2	1.2
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-2.0	-0.9	-0.7	-1.1	-1.2	-1.3	-1.3	-1.2	-1.2	-1.2	-1.2
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-1.5	1.5	1.9	1.1	1.0	0.5	0.2	0.3	0.3	0.3	0.3
Gross financing needs	7.8	9.4	9.9	10.0	9.0	8.9	8.4	8.9	9.3	9.8	9.3
of which: debt service	6.8	9.8	9.9	10.2	9.6	9.6	9.3	10.1	10.7	11.4	11.2
Local currency	6.8	9.8	9.9	10.2	9.6	9.6	9.3	10.1	10.7	11.4	11.2
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	3.7	1.8	1.4	2.0	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator; percent)	7.9	1.7	0.7	3.0	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Nominal GDP growth (percent)	11.9	3.5	2.2	5.0	4.8	5.0	4.9	4.9	4.9	4.9	4.9
Effective interest rate (percent)	2.7	3.3	4.7	4.9	4.7	4.8	4.7	4.7	4.8	4.9	5.1

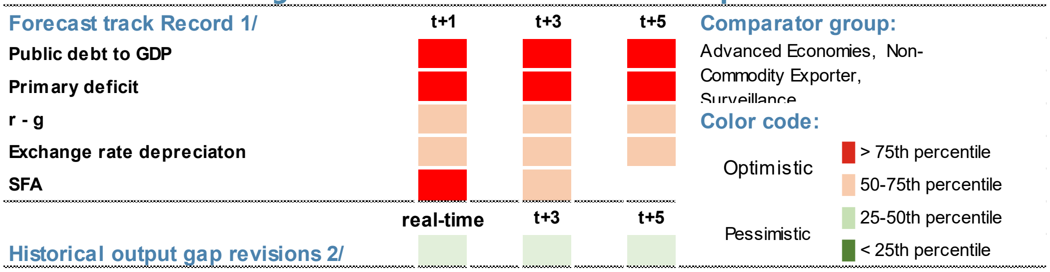
Contribution to change in public debt

(percent of GDP)

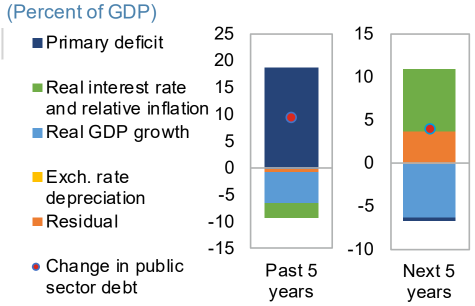


Commentary: Public debt is projected to increase in the near term due to rising debt servicing costs and primary deficits, but stabilize over the medium term as the primary balance turns into surplus, and the economy reaches a steady growth path over the medium term.

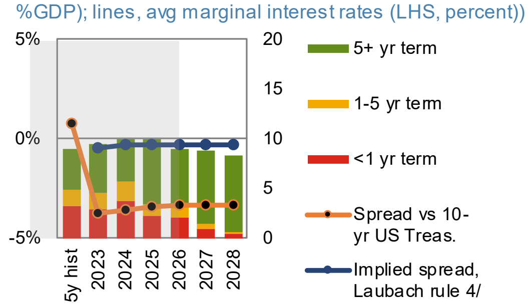
Figure 5. Realism of Baseline Assumptions



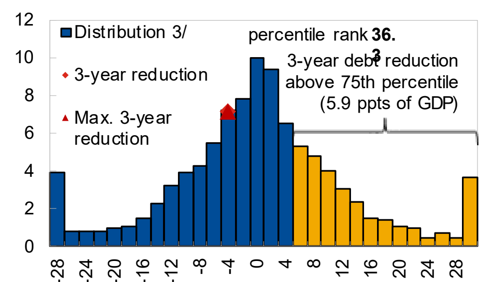
Public Debt Creating Flows
(Percent of GDP)



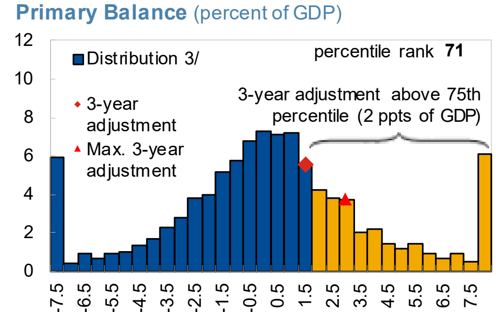
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



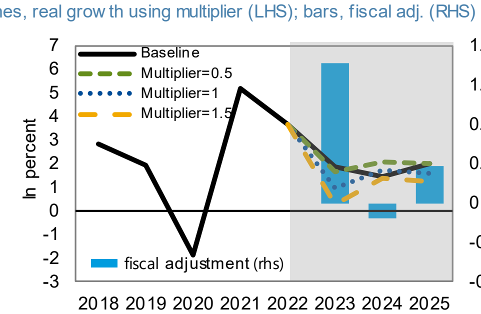
3-Year Debt Reduction
(Percent of GDP)



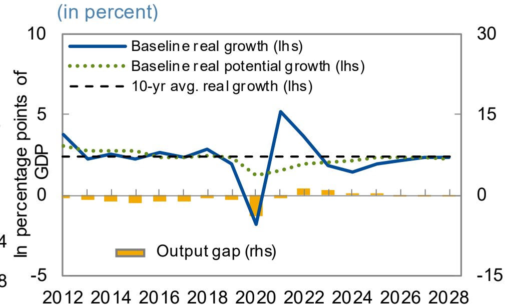
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS)



Real GDP Growth
(in percent)



Commentary: The strong economic recovery raised revenues, outperforming the budgets by a significant margin, and reduced the overall deficit and the debt-to-GDP ratio during the past two fiscal years through FY2022/23 (ended June 2023). The staff projections in the recent years are more closely aligned with the outturns. The primary balance is projected to relapse in the near term but improve over the medium term, and debt is projected to stabilize despite rising debt servicing costs.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates an final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

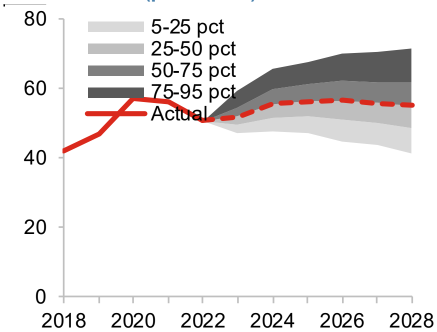
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected the projected debt-to-GDP ratio.

Figure 6. Medium-Term Risk Analysis

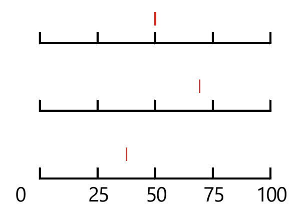
	Value	Contrib [1/]	Percentile in peer group [2/]

Final fanchart (pct of GDP)

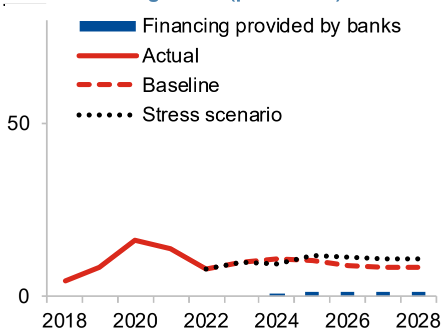


Debt fanchart module

	Value	Contrib
Fanchart width *(percent of GDP)*	30.2	0.4
Probability of debt non-stabilizaiton *(percent)*	19.4	0.2
Terminal debt-to-GDP x institutions index	8.3	0.2
Debt fanchart index (DFI)		0.8
Risk signal: [3/]		Low

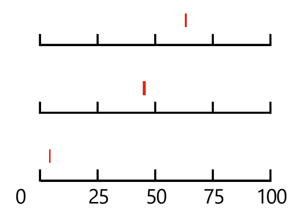


Gross financing needs (pct of GDP)



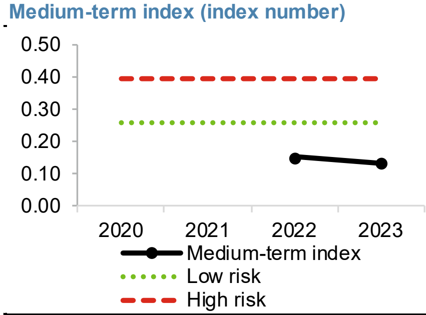
Gross financing needs (GFN) module

	Value	Contrib
Average baseline GFN *(percent of GDP)*	9.3	3.2
Banks' claims on the ge govt *(pct bank assets)*	5.0	1.6
Chg. In banks' claims in stress *(pct banks' assets)*	0.0	0.0
GFN financeability index (GFI)		4.8
Risk signal: [4/]		Low



Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term index (index number)



Medium-term risk analysis

	Value	Norm. Value	Weight	Contribution
Debt fanchart index	0.78	0.17	0.50	0.09
GFN finaceability index	4.79	0.09	0.50	0.05
Medium-term index		0.1		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2023-2028, if stress not predicted: 0.0 pct.

Prob. of false alarms, 2023-2028, if stress predicted: 76.1 pct.

Commentary: A risk of debt not stabilizing in the medium term remains low. Likewise, a debt-rollover risk remians low as indicated by the signal from the gross financing needs (GFN) analysis, driven by the depth of the financial sector and domestic capital markets to meet increased financing needs. The results are consistent with Australia's credible fiscal framework, institutions, and deep capital markets.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is advanced economies, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex V. External Sector Assessment

<table>
<tr><td colspan="6">Overall Assessment: On a preliminary basis – based on data as of end-June and staff projections for 2023H2 -- the external position in 2023 is expected to be broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA surplus is expected to decline from 1.1 percent of GDP in 2022 to 0.7 percent of GDP in 2023, as export commodity prices have declined. In the medium term, the CA is projected to return to a slight deficit as commodity prices further decline, savings return to historical levels, and investment picks up. This assessment is highly uncertain given the lack of full-year data for 2023 and volatility in commodity prices. A more complete analysis will be provided in the 2024 External Sector Report.

Potential Policy Responses: Given the positive output gap and still elevated inflation, fiscal and monetary restraint remains warranted for Australia. While the closing of the output gap will push the current account surplus higher, this should be offset by a decrease in private savings, which are at elevated levels in part due to the large pandemic-related fiscal stimulus. Furthermore, policies that boost investment (executing planned infrastructure investment, streamlining product market regulation, promoting R&D and innovation investment) can also contribute to reducing the CA surplus. Australia's commitment to a floating exchange rate should help keep the external position in line with fundamentals going forward.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="5">Background. Australia's NIIP is projected to improve to -32.5 percent of GDP by end-2023, from -38.2 percent of GDP in 2022, driven by the CA surplus, revaluation effects of foreign equities, and rising interest rates that have reduced the value of external debt. While 61 percent of Australia's gross liabilities are debt obligations, around half of the debt liabilities are denominated in domestic currency, while assets are largely denominated 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 negative NIIP. With a positive net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else being equal. The banking sector's net foreign currency liability position is mostly hedged and the maturity of banks' external funding has lengthened since the global financial crisis. 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>2023 (% GDP)</td><td>NIIP: -32.5</td><td>Gross Assets: 152.4</td><td>Debt Assets: 66.9</td><td>Gross Liab.: 184.9</td><td>Debt Liab.: 114.3</td></tr>
<tr><td>Current Account</td><td colspan="5">Background. While Australia has historically run deficits, the CA balance has been in surplus since 2019, due to an upswing in export commodity prices. After peaking at 3.0 percent of GDP in 2021, the CA balance is projected to decline to 0.7 percent of GDP in 2023. The merchandise trade balance is projected to moderate, from 6.6 percent of GDP in 2022 to 4.4 percent of GDP in 2023, as terms of trade have deteriorated. The trade surplus is nearly offset by a 3.7 percent of GDP deficit in the primary income balance (due to higher dividend payments on Australia's equity liabilities, especially in the mining sector) and a 0.1 percent of GDP deficit in the services balance (as tourism and education service exports have not year fully recovered from the pandemic-related decline). From a savings-investment perspective, the decline in surplus in 2023 is driven by a projected decline in the savings rate from the pandemic-era highs, as well as accelerating public investment. While there is considerable uncertainty, the CA is expected to gradually return to a small deficit over the medium term as commodity prices decline, investment picks up, and savings decline further from still elevated levels.

Assessment. On a preliminary basis, the EBA model estimates a cyclically adjusted CA balance of -0.3 percent of GDP compared with a CA norm of –0.9 percent of GDP, suggesting a model-based</td></tr>
</table>

	CA gap of 0.6 percent of GDP. Hence, the CA is broadly in line with levels implied by fundamentals and desirable policies.						
2023 (% GDP)	CA: 0.7	Cycl. Adj. CA: -0.3	EBA Norm: -0.9	EBA Gap: 0.6	COVID-19 Adj.:	Other Adj.:	Staff Gap: 0.6
Real Exchange Rate	**Background.** In 2023, the Australian dollar depreciated against the US dollar. In real effective terms, the exchange rate has been broadly stable as of end-June and slightly higher than the average level of the past 5 years. **Assessment.** Staff's CA gap implies a REER gap of -3 percent (applying an estimated elasticity of 0.18). The EBA REER level model points to an overvaluation of 24.4 percent, while the index model points to an undervaluation of 8.1 percent. Consistent with the CA gap, staff assesses the REER gap to be in a range of -6 to 0 percent, with a midpoint of -3 percent.						
Capital and Financial Accounts: Flows and Policy Measures	**Background.** The financial account recorded cumulative net outflows in the first half of 2023, reflecting the CA surplus. Net FDI returned to a small deficit in 2023H1 (from a temporary surplus in 2022), which was small relative to the net outflows related to portfolio investment. **Assessment.** Vulnerabilities related to the financial account remain contained, supported by a credible commitment to a floating exchange rate.						
FX Intervention and Reserves Level	**Background.** The currency has been free-floating since 1983. The central bank has not intervened in the FX market since the global financial crisis. Reserve assets have remained stable in 2022. **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. Hence, reserve needs for prudential reasons are also limited.						

Annex VI. Risk Assessment Matrix[1]

Source of Risk	Likelihood	Expected Impact	Policy Recommendations
Monetary policy miscalibration. Amidst high economic uncertainty and financial sector fragility, major central banks pause monetary policy tightening or pivot to loosen policy stance prematurely, de-anchoring inflation expectations, triggering a wage-price spiral and spillovers to financial markets.	Medium	**High.** Policy miscalibration through premature loosening of monetary policy, or a loosening of fiscal policy that undermines monetary policy efforts in curbing inflation. Sticky inflation could risk accelerating wage growth and triggering a wage-price spiral. Higher-for-longer interest rates would trigger pockets of household distress in Australia, given most housing loans are variable rate mortgages.	Policies should remain nimble and data dependent. Monetary policy should focus on the inflation outlook and the output gap, while managing financial volatility through macroprudential and financial stability tools. Fiscal policy should coordinate efforts with monetary policy to reduce price pressures. Communication between central and local governments should be strengthened.
Abrupt global slowdown or recession in China. Sharper-than-expected slowdown in the property sector, unexpected fiscal tightening due to local government financing stress and decline in investment, and/or rising geopolitical tensions disrupt economic activity.	Medium	**Medium**. Sharper-than-expected slowdown in the property sector in China could lead to lower demand for Australia's key exports, including commodity prices like iron ore, which could in turn potentially dampen their prices. Weaker export growth and terms of trade, and lower government revenues, would dampen overall growth.	Combined monetary and fiscal policy easing would be needed to respond to a global recession. The strength of policy reactions should also be dependent on inflation developments. If inflation remains elevated, fiscal policy should weigh in, with time-bound, well-targeted stimulus measures (e.g., low-income tax offsets).
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions would cause commodity price volatility and inflation, disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and	High	**High**. Further volatility from the war can exacerbate trade and financial disruptions, as well as commodity price volatility. While Australia benefits from higher commodity prices, higher import and energy prices can adversely impact inflation, and increase uncertainty.	In case of commodity price volatility and disruption of trade, monetary policy should tighten faster, especially if inflation expectations are on the rise. In case of heightened uncertainty impacting the business environment, fiscal policy can provide targeted support, while not fueling inflation.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 and 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risk	Likelihood	Expected Impact	Policy Recommendations
payment systems, and lead to refugee flows.			
Systemic financial instability. Sharp swings in real interest rates and risk premia, and asset repricing amidst economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing market dislocations and adverse cross-border spillovers.	**Medium**	**Medium**. While Australia's financial sector has proved to be resilient, banking turmoil from the U.S. or Europe could potentially spill over to Australia through a general loss of confidence, or global interlinkages.	Continue to monitor of banks and NBFI's balance sheets. Authorities should be ready to provide liquidity windows in case funding stress arises.
Deepening geoeconomic fragmentation. Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**High**	**High.** Australia would be negatively impacted by the economic and political uncertainty induced by fragmentation, supply disruptions, and a weaker global demand. Commodity price volatility could have knock-on effects on inflation and import prices.	Strengthen the rules-based multilateral trading system and deepen international and regional economic cooperation.
Extreme climate events. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	**Medium**	**Medium.** Australia's exposure to climate events, including the recurrence of severe droughts, bushfires, and floods, puts it at risk from stronger and more frequent economic disruptions.	Fiscal policy easing combined with monetary easing in case of favorable inflation developments; explicitly building in buffers for climate risks in the medium-term fiscal framework.
Cyberthreats. Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	**Medium**	**Medium**. Cyberattacks on critical physical or digital infrastructure could trigger financial instability and disrupt economic activities.	Preventative investment in strengthening defenses and infrastructure to prevent cyberattacks. In case of financial market disruptions, mechanisms that provide fast liquidity should be in place.

Source of Risk	Likelihood	Expected Impact	Policy Recommendations
Insufficient housing supply. An inadequate housing stock can place upward pressures on housing prices and reduce housing affordability	**Medium**	**Medium.** Housing prices in Australia would further increase in the absence of a large improvement in housing supply, especially given higher population growth. Higher housing prices would worsen affordability and inter-generational equity.	Policies should continue to prioritize the increase of housing supply and the share of social housing to meet the growing population's demands, without adding to cost pressures, while helping ease the capacity constraints and bottlenecks in the construction sector.
Faster-than-anticipated execution of public infrastructure projects	**Medium**	**Medium.** The uncoordinated execution of the large pipeline of infrastructure projects across Australian states could result in price pressures, in a context of high labor and non-labor input costs.	Communication and coordination between local authorities and the central government would help ensure that the executed projects are do not add excessively to price pressures.

Annex VII. RBA Review – An RBA Fit for the Future

1. **The Treasurer, The Hon Dr Jim Chalmers, announced an independent Review of the Reserve Bank of Australia on 20 July 2022.** On March 31, 2023, the review panel of independent outside experts[1] submitted its final report that set out 51 specific recommendations under 14 broader headings, grouped into 5 themes. The review endorsed and recommended clarification of the RBAs monetary policy mandate and financial stability role, independence, and core objectives, and had a strong focus on addressing governance, accountability, operational structure and management style, and culture of the RBA. The review supports legislative changes with bipartisan support to achiece the full benefits of its recommendations.

	Five themes
Clear framework	**A clearer monetary policy framework** ▪ Clear monetary policy objectives and toolkit ▪ A well-defined financial stability role
Effective policy decision making	**Stronger monetary policy decision making and accountability** ▪ A more expert Monetary Policy Board supported by better processes ▪ Greater transparency and accountability around decisions
High performing institution	**An open and dynamic RBA** ▪ A more agile and empowering culture ▪ More open and constructive debate **More robust corporate governance** ▪ A new Governance Board to support and oversee management **RBA leaders drive institutional and cultural change** ▪ RBA leaders drive change and are accountable for delivering

2. **The government announced its commitment to implement these recommendations, collaboratively and constructively.** This would involve amendments to the RBA Act to (i) reinforce the RBA's autonomy with respect to the operation of monetary policy; (ii) strengthen the RBA's mandate to clarify that Australia's monetary policy framework will have the dual objectives of price stability and full employment; and (iii) amend the RBA's governance by introducing a Monetary Policy Board as well as a Governance Board to improve decision making and oversight. This is welcome and it is desirable to achieve the planned reforms via legislative amendments as opposed to the alternate roadmap without the amendments outlined in the Review.

3. **In addition, the Treasurer plans to agree with the Reserve Bank Board on a new Statement on the Conduct of Monetary Policy (Statement) before the end of 2023 which will reaffirm the Government's commitment to the RBA's autonomy and support its inflation targeting framework.** It will also set out a common understanding for strengthening decision making, accountability and transparency in monetary policy decisions, in line with the Review's recommendations. The Treasurer will encourage the Council of Financial Regulators to renew the memorandum of understanding to reinforce the authorities' cooperation on promoting financial stability. These proposals are welcome, although the Treasury Secretary as part of the monetary policy decision-making is unusual by international standards. Ideally, monetary policy formulation

[1] The review panel comprised of Professor Carolyn A. Wilkins (Senior Research Scholar at Princeton University and external member of Bank of England's Financial Policy Committee), Professor Renée Fry-McKibbin (Professor of Economics at Australian National University), and Dr Gordon de Brouwer (Secretary for Public Sector Reform and previously Professor of Economics at Australian National University).

should be fully independent of political influence, with other mechanisms used for fiscal-monetary coordination.

4. The RBA has also started working on operationalizing the review, with former Governor Lowe announcing several changes starting from 2024. These include fewer but longer meetings (eight meetings a year instead of eleven currently), with outcomes announced at 2.30pm on the second day of the meeting and the quarterly Statement on Monetary Policy (SMP) released on the same day as the monetary policy decision. The Governor will now hold a press conference after each meeting. Board members will have the opportunity to attend internal staff meetings and oversee the RBA's research agenda. The RBA also announced regular, 5-yearly open and transparent reviews of the monetary policy framework (as opposed to ad hoc at present). Other changes are also planned once the Reserve Bank Act is amended, including the publication of an unattributed vote count; all Board members making regular public appearances to discuss their thinking on the economy and issues related to monetary policy; establishment of an expert advisory group to engage with the Board; and Board papers being published with a five-year lag.

5. The RBA also plans on changes to RBA management. The former Governor announced 360-degree feedback process for all senior leaders; advertisement of more management vacancies externally and increased transparency around internal opportunities for rotations; appointment of a Chief Operating Officer; a review of the risk management framework; and establishment of a separate Communications Department.

Annex VIII. Financial Sector Assessment Program (FSAP) Update[1]

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	**Complete.** • The Government sets ASIC's total budget to fund its regulatory activities, of which ASIC recovers the majority through its industry funding model (IFM) which was established in 2017. Within this total budget, ASIC determines how it allocates its resources to regulate different industry sectors and achieve its statutory objectives. The Government is currently reviewing the ASIC IFM. • ASIC has been provided with significant additional funding since 2019-20 to support the implementation of the Financial Services Royal Commission, as well other measures. • 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. It allows ASIC to temporarily intervene in a range of ways, including to ban financial products and credit products when there is a risk of significant consumer detriment. ASIC has used this power in the area of short-term credit, continuing credit contract, binary options, and CFDs; and (ii) on February 18, 2019, Parliament passed legislation to significantly increase penalties for corporate and financial sector misconduct. (iii) On February 6, 2020, Parliament passed legislation to strengthen ASIC's licensing and banning powers and enhance ASIC's investigatory capability. (iv) 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 regime became effective from January 1, 2021. - enhance ASIC's regulatory and supervisory tools by strengthening breach reporting requirements for financial service and credit licensees. The regime commenced on October 1, 2021

Recommendation	Time Frame	Developments and Implementation
		(v) On September 5, 2023, Parliament passed legislation that imposes a strengthened responsibility and accountability framework for entities in the banking, insurance and superannuation industries and their directors and senior executives (Financial Accountability Regime). ASIC and APRA will have joint responsibilities under this legislation. • The Government sets APRA's total budget to fund its regulatory activities, of which APRA recovers the majority through its Financial Institutions Supervisory Levies (FISLs) levied on APRA-regulated institutions. Within this total budget, APRA determines how it allocates its resources to regulate different industry sectors and achieve its statutory objectives. APRA was provided A$67.3 million in additional funding in the 2021-22 MYEFO to maintain its capacity to respond to risks within the financial system.
Enhance APRA's supervisory approach by carrying out periodic in-depth reviews of governance and risk management (APRA).	ST	**In process.** • APRA has established a dedicated risk team and built supervisor capability to undertake in-depth reviews of governance and risk management and conducts entity-specific and thematic reviews in this area on a regular basis. • Since its November 2019 information paper *Transforming Governance, Culture, Remuneration and Accountability: APRA's Approach*, APRA has concentrated its supervisory efforts on ensuring risk governance deficiencies in a number of financial institutions identified from a program of self-assessments in 2018 are addressed to APRA's satisfaction through remediation plans. The first of these are now complete, leading to removal of capital overlays put in place to address these weaknesses. • This enhanced supervisory approach to addressing risk governance weaknesses is being applied to other institutions which show similar deficiencies. APRA has developed a risk transformation framework to support supervisors in the oversight of entity risk transformation programs. • APRA is reviewing prudential standards for governance and risk management. Policy work to update prudential standard *CPS 510 Governance* is underway and a consultation is expected to be published in early 2024. Prudential standard *CPS 220 Risk Management* will be updated following the governance review. • The enhanced focus on governance and risk management under APRA's Supervision Risk and Intensity (SRI) model has detailed guidance supporting assessment of governance, risk culture, remuneration and accountability (GCRA). This

Recommendation	Time Frame	Developments and Implementation
		ensures weaknesses in these areas in individual entities drives escalation and requires supervisory action to address them. • APRA's focus on organizational resilience has addressed recommendations related to governance, culture, remuneration and accountability made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission). • APRA has strengthened requirements and increased supervision of remuneration, developed and implemented tools to sharpen the supervision of risk culture, and embedded in our approach to supervision and enforcement of the Financial Accountability Regime. Reflecting this, while GCRA will continue to be a major supervisory focus, the initiative of transforming GCRA practices is no longer a headline item in APRA's Corporate Plan.
Strengthen the integration of systemic risk analysis and stress testing into supervisory processes (APRA, RBA).	I	**Complete.** • APRA's SRI model incorporates an External Factors category covering macro and systemic risk for each industry. In addition, macro and industry risks are identified by dedicated Strategic Insights teams, with these risks being captured in Industry Risk registers, overseen by Industry Groups. These risks are considered in the development of Industry Plans, which can result in the conduct of thematic reviews across industries and / or specific entity reviews. • The capital section of the SRI model requires supervisors to consider the results of recent stress tests in determining the appropriate rating of capital. Stress testing is also an input into various supervisory processes including annual Internal Capital Adequacy Assessment Process (ICAAP) reviews, capital reductions, dividend considerations and broader capital settings. A stress testing handbook has been developed to provide supervisors with guidance in assessing stress testing approaches. Supervisors are directly involved in stress testing discussions with their respective entities. • APRA increased its stress testing activities across all regulated industries and analysed 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 Reserve Bank of Australia in modeling scenarios and comparing results also increased. Ongoing development of scenarios to reflect contemporary macro risk, such as high inflation is also incorporated into regular practice. APRA has transitioned to an annual stress testing program for the banking industry. APRA has continued to develop internal stress testing models across

Recommendation	Time Frame	Developments and Implementation
		banking, insurance and superannuation to provide insight and inform supervisory and policy priorities. • APRA is developing a cross industry stress testing framework and systemic risk framework as the next phase of enhancements.
Financial Stability Analysis		
Commission and implement results of a comprehensive 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).	MT	**In process.** • A Multi-Agency Data Collection Committee has been established which includes APRA, ASIC, RBA, Treasury, the Australian Taxation Office, and the Australian Bureau of Statistics. • Specific inter agency data projects are discussed on a needs basis at the Multi-Agency Data Committee with the aim of creating a unified strategic approach to data across these agencies. APRA released discussion papers on APRA's Direction for data collections in 2022 which provides a vision for data collections that are multi-use, deeper and broader, with a greater capacity to be shared with other agencies. • APRA has identified several challenges presented by this approach and the new technologies required to implement it. APRA is in the process of reviewing the pace, sequencing, and priorities of the new collections, while also conducting a review to ensure APRA's data and technology capabilities are aligned with its goals. APRA intends to provide further information on the outcome of the review in early 2024. • While this review is underway, APRA continues to implement a pipeline of new and amended data collections across industries including: updated collections capturing relevant data for Liquidity risk and Interest Rate Risk in the Banking Book, and enhancing existing data collections to reflect forthcoming changes in the capital framework for insurers. • ASIC has built an advanced data collection portal to improve how data is collected recurrently, consistently, safely, and securely. A pilot was conducted in November 2021 with limited entities. Tranche 1 of the Internal Dispute Resolution (IDR) submission was successfully conducted in January 2023 and Tranche 2 successfully completed in August 2023, involving approx. 260 licensees. The next IDR submission period commences in January 2024.
Enhance the authorities' monitoring, modeling, and stress testing framework for assessing solvency, liquidity and contagion risk. Draw on the results to	ST	**Complete.** • APRA undertakes 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

Recommendation	Time Frame	Developments and Implementation
inform policy formulation and evaluation (CFR agencies).		economic outlook, with an emphasis on severe downside risks. The industry stress tests include both a solvency and a liquidity risk component. APRA is engaging with superannuation funds on liquidity stress testing methods. • APRA has further continued to build the functionality of its internal stress testing modeling to enable it to challenge industry 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 has transitioned to annual stress testing of large banks. • APRA is developing a cross industry stress testing framework and systemic risk framework as the next phase of enhancements, which will include exploration of contagion risk between industries. • APRA also undertakes stress testing of resilience to broader scenarios and a broader range of risks, including the impacts from operational and climate change financial risks. APRA undertook a Climate Vulnerability Assessment of Australia's five largest banks in 2021-22, with results published in November 2022. This was a joint Council of Financial Regulator (CFR) initiative which APRA led. • Building on this approach to understanding climate risk, APRA is leading (on behalf of the CFR) a new insurance-focused CVA initiative. The insurance CVA commenced in July 2023, and focuses on the potential for physical and transition climate risks to drive changes in general insurance affordability, specifically home building insurance affordability. The initiative is expected to be completed in FY24-25. APRA is also pursuing an internal initiative focused on the potential for concentrated physical climate risks to impact smaller banks that have regionally specific lending patterns. This initiative is in its early stages: APRA has carried out analysis of physical risk and likely lending patterns to identify smaller entities that may face potential climate concentration risks and has commenced engaging with those entities.
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, and while such funding can create vulnerabilities, they are mitigated in Australia because a sizeable portion of foreign funding is swapped into Australian dollars and used to acquire Australian dollar assets.

Recommendation	Time Frame	Developments and Implementation
		• Australian banks' overseas wholesale funding is currently lower than in recent history given their use of the RBA's Term Funding Facility (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. So far, TFF has been mainly replaced by a combination of customer deposits and long-term debt.
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 an Annual Report to Parliament by CFR agency Heads (CFR agencies).	I	**Complete.** • 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-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 (FRAA). The purpose of the FRAA is an oversight body which will report on the effectiveness and capability of ASIC and APRA. The FRAA conducts reviews of each regulator and completed its inaugural reviews of ASIC and APRA in August 2022 and June 2023, respectively. The FRAA does not have the power to direct the regulators, assess single cases or decisions, or deal with complaints about the regulators. • In 2023, a Government-appointed Review of the Reserve Bank considered macroprudential governance arrangements. The RBA Review included a number of recommendations in relation to transparency, including a recommendation that the CFR MoU be updated to clarify the responsibility of the CRR and each of its agencies. • APRA consults other CFR agencies on macroprudential settings and considers the feedback from them when determining macroprudential policy.
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). • In November 2021, APRA published an information paper setting out its framework for macroprudential policy. APRA's

Recommendation	Time Frame	Developments and Implementation
		paper outlines its policy objectives, macroprudential toolkit and approach to implementing macroprudential policy, including the role of the CFR. APRA has also made changes to APRA's prudential framework to require banks to be operationally positioned to implement specified macroprudential policy measures (e.g., limit higher risk lending) if needed. These changes came into effect from September 2022, and are aimed at improving the transparency, timeliness and effectiveness of future responses to systemic risks. • In February 2023, APRA published an information paper providing an update on APRA's macroprudential policy settings across APRA regulated industries. The paper set out the policy settings and explained the key factors that inform APRA's decision-making, enhancing transparency on macroprudential policy. APRA assessed existing macroprudential policy settings remained appropriate based on the current risk outlook. This paper noted the consultation with CFR agencies by APRA in determining macroprudential policy settings. • The RBA Review released in April 2023 recommended that measures be adopted to enhance cooperation between monetary and macroprudential policies and the CFR agencies are developing new arrangements as part of implementing this recommendation.
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 (CGFS) working group which studied property price dynamics and, in particular the influence of international investors. Its report was released in February 2020. • The RBA is participating in a new CGFS study group on policies to mitigate housing-related risks. The aim of the group is to take stock of recent experience with macroprudential measures targeting housing markets. The group commenced work in October 2022 and will submit its report in September 2023.
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	ST	**In process.** • In May 2023, APRA finalized prudential requirements and guidance for resolution planning with the release of prudential standard *CPS 900 Resolution Planning* (CPS 900)

Recommendation	Time Frame	Developments and Implementation
subject them to annual supervisory review (APRA, Treasury).		& prudential practice guide *CPG 900 Resolution Planning*. The prudential standard commences on 1 January 2024. • In June 2023, the FRAA completed its first review of APRA. The FRAA assessed APRA's effectiveness and capability of its supervision and resolution functions, focusing on superannuation.
Extend resolution funding options by expanding loss-absorption capacity for large and mid-sized banks and introduce statutory powers (APRA, Treasury).	ST	**Complete.** • In November 2018, APRA released a discussion paper outlining its proposed changes to the application of the capital adequacy framework for banks, increasing loss-absorbing capacity (LAC) 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 banks and minimize taxpayer support. • In July 2019, APRA finalized its approach to LAC for banks, including requiring the D-SIBs to lift Total Capital by three percentage points of RWA by January 1, 2024. In 2021, APRA finalized the requirement for the D-SIBs increasing Total Capital by 4.5 percentage points in aggregate. Requirements for the other entities, including mid-sized banks will be determined 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	**Complete.** • APRA has made meaningful progress on the cross-border components of bank-specific resolution Planning with the New Zealand authorities. • APRA, in conjunction with the RBNZ, established the first entity-specific Crisis Management Group (CMG) for a trans-Tasman bank at end-2019. The CMG comprises authorities that are essential to planning or facilitating orderly resolution, including APRA, RBNZ, ASIC, FMA and RBA. The CMG has proven to be an effective forum for the development and evaluation of detailed resolution strategies. The ANZ CMG met in October 2023. • Engagement with the New Zealand authorities via CMGs has become part of APRA's regular resolution planning activities. Once CPS 900 is in force, APRA will look to undertake resolution planning with a broader cohort of the regulated population overtime, which would include detailed resolution planning for other trans-Tasman banks.

<table>
<tr><th>Recommendation</th><th>Time Frame</th><th>Developments and Implementation</th></tr>
<tr><td colspan="3">Financial Market Infrastructure</td></tr>
<tr><td>Strengthen independence of RBA and ASIC for supervisory oversight, enhance enforcement powers and promote compliance with regulatory requirements.</td><td>I</td><td>In process.
• The CFR provided advice to government in July 2020 recommending 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
○ the transfer of a range of licensing and supervisory powers from the Minister to ASIC and the RBA.
• The government announced its support for these reforms in December 2022 and is aiming to consult on draft legislation in coming months.</td></tr>
<tr><td>Finalize the resolution regime for FMIs in line with the FSB Key Attributes (RBA, ASIC, Treasury).</td><td>ST</td><td>In process.
• The CFR provided advice to government in July 2020 recommending enhancements to Australia's FMI regulatory regime. This included a proposal to establish a resolution regime for clearing and settlement facilities operating in Australia.
• The government announced its support for these reforms in December 2022 and is aiming to consult on draft legislation in coming months.</td></tr>
<tr><td colspan="3">Anti-Money Laundering / Countering the Financing of Terrorism (AML/CFT)</td></tr>
<tr><td>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 (Attorney-General's Department, Treasury, AUSTRAC).</td><td>I</td><td>In process.
• On 20 April 2023, the Australian Government announced public consultation on major reforms to Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime. These proposed reforms would extend the existing AML/CTF regime to certain high-risk services provided by DNFBPs, including lawyers, accountants, trust and company service providers, real estate agents and dealers in precious metals and stones.

Undertaking supervision
• AUSTRAC oversees the compliance of more than 17,000 Australian regulated businesses, referred to as reporting entities. These include businesses such as banks and credit unions, non-bank lenders and stockbrokers, gambling and bullion service providers, remittance providers and digital currency exchanges.
• The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act) recognises that reporting entities are the first line of defence in protecting the financial system. The legislative framework creates a risk-</td></tr>
</table>

Recommendation	Time Frame	Developments and Implementation
		based approach placing the onus on reporting entities to identify, mitigate and manage their money laundering/terrorism financing risk. • AUSTRAC adopts a risk-based approach to supervision. Frontline supervision teams conduct targeted assessments and campaigns on the entities of most concern, and make findings of non-compliance, monitor remediation, and refer matter to enforcement. • In addition to this, AUSTRAC has a monitoring and triage function conducted by the Monitoring and Triage team. The team is a centralised capability responsible for the identification and assessment of instances of non-compliance with the AML/CTF Act, AML/CTF Rules and other regulatory risks, and refers matter to the supervisory teams. • AUSTRAC supervisory teams initiated 19 supervisory activities which include compliance assessments and supervisory campaigns. Supervisory activity conducted in 2022-23 focused on a range of businesses including the banking sector, foreign exchange services, virtual assets, remittance services and casino and gaming businesses. These supervisory activities involve engaging with regulated entities to improve AUSTRAC's understanding of the compliance risk and conducting a detailed review of a reporting entities compliance with certain AML/CTF obligations. • AUSTRAC's supervisory teams also manage an increasing number of reporting entities undertaking remediation to strengthen their AML/CTF controls following AUSTRAC regulatory activities. During 2022-23, AUSTRAC monitored 25 remediation activities which were either open from a previous period or were initiated and will continue into future years. • 323 reporting entities are impacted through those remediation engagements. In addition, AUSTRAC's supervisory teams have longstanding engagements with multiple reporting entities that have been undertaking remediation. *Improving data collection and building a picture of compliance risk* • In 2021, AUSTRAC delivered the first strategic assessment of compliance risk – the first of its kind to be produced by AUSTRAC. It provides a consolidated picture of the key compliance concerns across Australia's regulated

Recommendation	Time Frame	Developments and Implementation
		population. This assessment has strengthened AUSTRAC's view of the compliance risk environment, provided an overarching strategic context for our work and feeds information to help with education campaigns. • AUSTRAC continues to harness emerging technology to expand its regulatory capabilities. This is particularly important as AUSTRAC is responsible for regulating over 17,000 reporting entities. AUSTRAC has introduced a data modelling capability to optimise its strategic use of data. The data modelling capability harnesses several data inputs to build an understanding of compliance risk. • 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. • AUSTRAC piloted an enhanced registration model for remitters and digital currency exchanges (DCE) from 01 April 2021- 30 June 2021. Following the success of the pilot, the new model was formally adopted in September 2021. The new model has allowed AUSTRAC to make substantial progress in its ability to identify risk within the registration process, and allows us to understand: the nature, size and complexities of a business, assess an entity's capability to comply with AML/CTF obligations; and identify if there are any criminally complicit individuals seeking registration. • AUSTRAC receives annual reports from regulated (REs) relating to the RE's compliance with the AML/CTF Act, the regulations and the AML/CTF Rules during the reporting period. The information from compliance reports (CR) provides AUSTRAC with a contemporaneous understanding of the compliance maturity of our regulated population. It informs potential regulatory activity and contributes to our risk modelling as a vital component of AUSTRAC's data inputs. It also supports industry education and outreach that improves and supports reporting entities compliance with obligations. • During the 2020-21 financial year, AUSTRAC finalized 31 compliance assessments across a range of sectors, including in the banking sector. *Risk assessments* • AUSTRAC established a strategic intelligence capability in late 2021, to further enhance AUSTRAC's capacity to identify current and emerging AML/CTF threats, and build upon

Recommendation	Time Frame	Developments and Implementation
		AUSTRAC's established risk assessment program. The strategic intelligence capability has completed 21 strategic assessments on a diverse range of current and emerging issues impacting Australia's AML/CTF environment. Topics examined in these assessments include cash hoarding (2 assessments), casinos (3 assessments), Central Bank Digital Currencies, cryptocurrencies/DCEs (4 assessments), labour hire, online payment service providers, corrupt providers of immigration assistance, and sanctions evasion. The strategic intelligence capability has also taken responsibility for the production of Australia's national risk assessments of proliferation financing, terrorism financing and money laundering. Australia's first national risk assessment of proliferation financing was published in December 2022, while the national risk assessments of terrorism financing and money laundering are currently in progress, and are expected to be finalised in the second half of 2023-24. *Education and Guidance* • AUSTRAC supports reporting entities through a comprehensive education and guidance program, tailored to suit their needs and capabilities. During 2022/23, AUSTRAC responded to over 11,000 enquiries via the Contact Centre, published 10 downloadable guidance products, undertook 22 induction workshops to over 850 participants, and completed numerous education visits, including 26 education sessions to the corporate bookmaker sector and 99 visits to the remitter sector. 17 presentations were delivered to industry. *Enforcement (updated to Sep 23)* • AUSTRAC has continued to take formal enforcement actions against reporting entities for breaches of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act). • AUSTRAC applied to the Federal Court of Australia in March 2022 for civil penalty orders against Crown Melbourne Limited and Burswood Nominees Limited (Crown Perth). On 30 May 2023, AUSTRAC and Crown filed joint submissions with the Federal Court of Australia, proposing a $450 million penalty. On 11 July 2023 the Federal Court of Australia ordered Crown to pay the $450 million penalty for its breaches of the Act. • On 30 November 2022, AUSTRAC applied for civil penalty orders against The Star Pty Limited and The Star Entertainment QLD Limited (the Star Entities). On

Recommendation	Time Frame	Developments and Implementation
		7 December 2022, AUSTRAC applied for civil penalty orders against SkyCity Adelaide Pty Ltd (Skycity) • AUSTRAC also accepted enforceable undertakings requiring a range of remedial actions from ING Bank (Australia) Pty Ltd on 23 November 2022; Cash Converters on 17 February 2023; PayPal Australia Pty Ltd on 16 March 2023; and Bank of Queensland Ltd on 30 March 2023.

Annex IX. Transnational Aspects of Corruption

Supply-Side of Corruption[1]

1. In Australia's Phase 4 evaluation in 2017, the OECD found that Australia had taken substantial steps to improve its framework for detecting and investigating foreign bribery cases, and additional reforms have been recently implemented. Australia has made progress in strengthening measures to detect foreign bribery and raise private sector awareness. The introduction of new protections in 2019 to the *Corporations Act 2001* (Cth) for private sector whistleblowers was noted as a significant development in Australia's legal framework. In 2020, Australia established the Bribery Prevention Network, a public-private partnership which aims to support Australian businesses to prevent, detect and address bribery and promote a culture of compliance. Authorities additionally reported the commencement of the *Public Interest Disclosure Amendment (Review) Act 2023* on 1 July 2023, to improve protections for public sector whistleblowers, including Commonwealth contracted service providers and their employees, and more closely align the public and private sector whistleblower protection frameworks where appropriate. Authorities also reported that, following the introduction of the *Best Practice Guideline on Self-Reporting of Foreign Bribery and Related Offending by Corporations* in 2017, the first foreign bribery matter to have involved this Guideline was resolved in 2023. With the establishment of the National Anti-Corruption Commission on 1 July 2023, the Commission will have the power to investigate corrupt conduct by Commonwealth contracted service providers, which may include individuals or businesses that are exposed to foreign bribery risk. Australia also introduced standard Notification of Significant Events clauses into Commonwealth procurement contracts in 2023 which require contracted service providers to notify the procuring entity immediately upon becoming aware of any adverse findings about the provider (including foreign bribery convictions).

2. Australia should take additional steps to fight foreign bribery, in particular in enhancing enforcement against foreign bribery. While acknowledging some positive measures, the OECD Working Group on Bribery in International Business Transactions (WGB) has noted the low level of foreign bribery enforcement given the size of Australia's economy and the high-risk regions and sectors in which its companies operate. Australia has not yet published guidelines to clarify procurement agencies' discretion in relation to debarment of companies or individuals convicted of foreign bribery offences. With regard to international cooperation, it is recommended that Australia, to the fullest extent possible within its legal system, ensures that a broad range of mutual legal assistance can be provided to countries that apply civil or administrative (and not criminal) liability to legal persons for foreign bribery. Regarding sanctions and confiscation as well as liability of legal

[1] Information relating to supply-side corruption in this annex draws on the WGB's Phase 4 Report of Australia (December 2017), the two-year follow-up report (December 2019), the addendum to the follow-up report (2021, with the addendum to the summary and conclusions being adopted in February 2022), and the additional written follow-up report (November 2022). The IMF staff and Australia have provided additional views and information whose accuracy have not been verified by the WGB or the OECD Secretariat, and which do not prejudice the WGB's monitoring of the implementation of the OECD Anti-Bribery Convention.

persons, it is recommended that, where appropriate, the authorities pursue confiscation of bribe payments and benefits derived in foreign bribery cases and proactively pursue criminal charges against legal persons. The Crimes Legislation Amendment (Combatting Foreign Bribery) Bill 2023 (the Bill) was introduced in the Australian Parliament in 2023. The authorities reported that the Bill would strengthen the existing offence for foreign bribery (for which individuals and companies can be liable), and also introduce a new 'failure to prevent' foreign bribery offence for companies. The Bill is largely the same as Schedule 1 of the now-lapsed Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2019 (Cth). The authorities are encouraged to take additional measures to address these issues and other OECD WGB Phase 4 recommendations.

INTERNATIONAL MONETARY FUND

AUSTRALIA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 4, 2023

Prepared By

Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of October 31, 2023)

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)	4,729.47	71.96
Reserve tranche position	1,843.18	28.04
Lending to the Fund		
New Arrangements to Borrow	12.75	

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	9,382.52	100.00
Holdings	9,842.96	104.91

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				
	2023	2024	2025	2026	2027
Principal					
Charges/interest	0.00	0.12	0.12	0.12	0.12
Total	0.00	0.12	0.12	0.12	0.12

[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 Executive Board concluded the 2022 Article IV consultation on January 25, 2023 and endorsed the staff appraisal without a meeting on a lapse-of-time basis (IMF Country Report No. 2023/050).

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 16 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 quarterly 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. While the quarterly CPI is considered to be Australia's key measure of inflation, a monthly publication of a CPI indicator commenced in 2022, reflecting updated prices between 62 and 73 percent of the weight of the quarterly CPI basket. 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 November 14, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	11/13/23	11/13/23	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/23	11/07/23	M	M	M
Reserve/Base Money	09/23	10/31/23	M	M	M
Broad Money	09/23	10/31/23	M	M	M
Central Bank Balance Sheet	11/08/23	11/10/23	W	W	W
Consolidated Balance Sheet of the Banking System	09/23	11/1/23	M	M	M
Interest Rates[2]	11/13/23	11/13/23	D	D	D
Consumer Price Index	Q3 2023	10/26/23	Q	Q	Q
Revenue, Expenditure, and Balance – General Government[3]	Q2/23	10/31/23	Q	Q	Q
Revenue, Expenditure, and Balance – Central Government	Q3/23	10/31/23	Q	Q	Q
Composition of Financing[4] – General Government	Q2/23	10/31/23	Q	Q	Q
Composition of Financing[4]– Central Government	6/23	10/31/23	M	M	M
External Current Account Balance	Q2/23	09/05/23	Q	Q	Q
Exports and Imports of Goods and Services	09/23	11/02/23	M	M	M
GDP/GNP	Q2/23	09/06/23	Q	Q	Q
Gross External Debt[5]	Q2/23	09/06/23	Q	Q	Q
International Investment Position[6]	Q2/23	09/05/23	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] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Robert Nicholl, Executive Director for Australia
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Australia's strong fundamentals have supported the economy through 28 consecutive years of economic growth prior to the pandemic, and a strong recovery since. As an open economy, Australia has consistently promoted and relies on open and rules-based free trade, strong net migration and targeted foreign investment to sustain growth and improve living standards. The return of migration inflows combined with elevated commodity prices supported stronger fiscal and economic outcomes in the second half of 2022-23 than previously forecast. Nevertheless, Australia is not immune to the headwinds slowing global economic growth and the outlook. Domestic economic growth is expected to continue to slow in the near-term as the combination of cost-of-living pressures and higher interest rates continue to dampen demand. And like other advanced economies, Australia also faces longer term challenges associated with an ageing population, weak productivity growth, and managing the climate transition. Authorities are committed to structural reforms, and the rapid and simultaneous withdrawal of fiscal and monetary stimulus following the pandemic recovery has created policy space to maneuver, ensuring that Australia is well-placed to respond to future challenges.

Outlook and risks

Following a strong recovery from the pandemic, Australia's economy is forecast to grow more slowly through 2023-24 as the impact of higher interest rates continues to be passed through. Treasury forecasts growth to fall from 3.1 percent observed in 2022-23 to 1¾ percent in 2023-24, before lifting to 2¼ percent in 2024-25. Near-term growth is expected to be driven by strong public infrastructure and private investment, and to a lesser extent by net exports, including bulk commodity mining exports and the ongoing recovery in tourism and international education exports. Governments at all levels are working through a substantial planned pipeline of public infrastructure projects, while ongoing strong business investment is supported by a large pipeline of construction projects, strong balance sheets and high levels of capacity utilization. Household consumption is expected to soften in 2023-24 due to the combined impact of higher interest rates and high inflation and then lift in 2024-25 when inflation is expected to return to the Reserve Bank of Australia's (RBA's) 2-3 percent target band.

Australia's labor market remains tight and real wage growth is forecast to return from 2024. Rates of unemployment, underemployment and underutilization remain close to the lowest levels observed in decades, while the labor force participation rate is around an all-time high, supported by the strongest rate of female labor force participation on record. Treasury forecasts a return to annual real wage growth from early 2024, with nominal wage growth forecast to remain around 4 percent until the end of 2023-24. Strong labor market conditions are expected to ease, and Treasury forecasts unemployment will rise from current lows to 4¼ percent by the end of 2023-24 and again to 4½ percent by the end of 2024-25.

Authorities broadly agree with staff's assessment of the outlook and the main risks. The balance of risks remains weighted to the downside across a broad range of domestic and external considerations. Domestically sourced risks are associated with weaker or subdued demand if households are adversely affected or if the currently strong business investment starts to unwind, and with natural disasters and extreme climate events. Globally, the full impact of the rapid, synchronized tightening of monetary policies around the world is yet to be felt, but is reflected in expectations of slower future growth. Historically, Australia has greatly benefitted from lower barriers to international trade and investment and is therefore vulnerable to deepening geoeconomic fragmentation, slower growth in major trading partners, and the uncertain duration and magnitude of impacts from conflicts.

Macroeconomic policy settings

The Federal Government's fiscal management produced the first cash balance surplus in over 15 years for 2022-23 and their ongoing discipline has led to substantially smaller forecast deficits over the near term and especially in 2023-24, when inflation pressures are strongest. The main elements of the Federal Government's Economic and Fiscal Strategy are to allow the automatic stabilizers to operate, alongside a commitment to direct the majority of improvements in tax receipts to budget repair and to limit spending until gross debt to GDP is on a downward trajectory. The Federal Government's Mid-Year Economic and Fiscal Outlook (MYEFO)[1] reports that 92 percent of the substantial upgrade in estimated tax receipts since the May 2023 Budget will be saved. The revenue upgrades are due to revised forecasts for higher company and personal income tax receipts, reflecting near-term strength in commodity export prices and higher non-mining corporate profits, and strong employment growth respectively. Cost-of-living support has been better targeted through childcare subsidies, rent assistance and electricity rebates, and Treasury estimates this will reduce headline inflation by ¾ of a percentage point through the year to June 2024.

[1] Released on 12 December 2023, after circulation of staff's report to the Executive Board.

Application of the Strategy has led to a further improvement in the fiscal outlook compared to forecasts in the May Budget. Treasury's forecast of the cash balance for 2023-24 rounds to 0 percent of GDP in the MYEFO, compared to -0.5 percent of GDP forecast at Budget. The cash balance forecast for 2024-25 is now -0.7 percent of GDP, compared to -1.3 percent of GDP at Budget. By restraining spending and returning most of the tax upgrades to the budget, the Federal Government's Economic and Fiscal Strategy continues to ensure fiscal and monetary policy settings are aligned and helps ease inflationary pressures.

The Federal and state governments[2] continue to coordinate on major expenditure items and priority areas including public infrastructure projects, social housing, health services, and delivery of care and support to people with disabilities and the aged. Ongoing labor market tightness and strong private and public demand for construction requires coordination to ensure ongoing alignment with priorities, ameliorate cost pressures and deliver value for taxpayers. Acting on recommendations from a recent independent strategic review, the Federal Government has made changes to the Infrastructure Investment Program to ensure deliverability and ease capacity constraints, while refocusing on nationally significant infrastructure.

Housing affordability remains a concern and authorities are taking steps to increase the stock of housing, as house prices have once again started to climb and rents have also increased. The National Housing Accord between the Federal and state governments set an ambitious target to deliver 1.2 million new, well-located homes over five years from 1 July 2024. The Federal Government has committed additional funding for new and refurbished social housing through the Social Housing Accelerator and the National Housing Infrastructure Facility. It will also establish a competitive grants program open to subnational governments to support ancillary infrastructure to increase housing supply.

At the December 2023 National Cabinet meeting, Federal and state government leaders undertook to strengthen health services, to secure the future of the National Disability Insurance Scheme (NDIS) and to improve the certainty of Federal funding to the states. The NDIS delivers critical supports to many Australians with disabilities but is one of the fastest growing expenditure items for the Federal Government. Informed by the recently released independent review of the NDIS, National Cabinet agreed to rebalance the relative contribution of the Federal and state governments, and to transition the NDIS as part of a broader ecosystem of supports for people with disabilities that will better connect them with mainstream services like childcare and schools. Governments will consider other

[2] 'State' here is used to refer to 'state and territory'.

recommendations from the NDIS Review and the Federal Government will release its full response in 2024.

Monetary policy tightening is working to dampen domestic demand and to slow the rate of inflation. The RBA Board has undertaken a cumulative 425 basis point increase in the cash rate over the current cycle of tightening but held rates steady at its most recent meeting. Estimates of medium-term inflation expectations remain well-anchored and consistent with the RBA's target. The usual transmission of monetary policy has been affected by households' savings buffers built up during the pandemic and the significant share of households that are still on low fixed-rate mortgages. The RBA notes that further monetary tightening may be needed but will monitor developments carefully in light of the heightened uncertainty around the outlook and its evolving assessment of data and risks.

Despite heightened global uncertainty, Australia's ongoing implementation of prior FSAP recommendations combined with continued strength in the banking sector has meant that financial sector risks are largely contained. Non-performing loans remain near decade lows given the strong labor market. Corporate insolvencies have increased back to roughly pre-pandemic levels consistent with the withdrawal of stimulus, and personal insolvencies remain low and below pre-pandemic levels. The RBA's Term Funding Facility, established during the pandemic to provide low-cost three-year funding to authorized deposit taking institutions, continues to wind down and banks are smoothly switching back to alternative sources of funding. While segments of the commercial real estate sector are experiencing similar headwinds to other advanced economies, systemic risks to the Australian economy from emerging stress are judged to be low — Australian banks' exposures to commercial real estate are modest and their lending is generally at low loan-to-value ratios.

Structural reforms

Authorities are committed to reforms that will position Australia to manage future challenges and to incentivize strong, sustainable and inclusive growth. The Federal Government has announced a two-year review of competition policy and issued the first statement of expectations for the independent Productivity Commission to better align its work with the Federal Government's productivity agenda. Furthermore, the Council on Federal Financial Relations is developing a policy agenda for the Federal and state governments to work together to increase productivity. Since the last AIV consultation, reviews of the RBA, the labor market and migration policy settings have been completed, and the Federal Government is considering and responding to the recommendations.

The latest Statement on the Conduct of Monetary Policy issued jointly by the Federal Government and the RBA Board reaffirms the Federal Government's commitment to an independent RBA, clarifies the RBA's inflation and employment goals, and commits to conducting and publishing a formal review of the monetary policy framework and tools every five years. The Federal Government released the RBA Review in April 2023 alongside in-principle agreement to all of its recommendations. Key Review recommendations include the establishment of separate boards for monetary policy and governance of the RBA, the establishment of a Chief Operating Officer, and changes to the frequency of RBA Board meetings, to internal monetary policy processes, and to communications. In early December 2023, the Federal Government and the RBA Board released an updated Statement on the Conduct of Monetary Policy to record their common understanding on key aspects of Australia's monetary policy framework, including the flexible inflation targeting framework and the RBA Board's role in achieving full employment and financial stability. Legislative amendments to formalize the RBA's dual mandate, reinforce its independence, and facilitate the modernization of its structure, have been introduced in Parliament and are expected to pass with bipartisan support.

The recently concluded reviews of Australia's labor market and migration settings will support dynamism and productivity and help to deliver sustained and inclusive full employment. In response to the review of jobs and opportunities, the Federal Government's Employment White Paper Roadmap commits to: improve labor mobility and recognition of skills; partner with state governments to fund vocational centers of excellence; incentivize higher take-up of apprenticeships in key areas of demand; improve incentives to work for income support recipients by allowing them to keep more of their support for longer; and help social enterprises identify and address areas of persistent labor market disadvantage. These reform directions are also advanced in the Federal Government's Migration Strategy, which undertakes to support better targeted and more sustainable migration by: strengthening overall integrity and lifting international education standards; ending policy settings that lead to long-term temporary migration; tackling exploitation of the visa system; and targeting skilled migration to genuine shortages. Migration to Australia has historically made a strong contribution to employment and population growth, has slowed the ageing of the population, and has contributed needed skills.

Australia is committed to the Paris Agreement and is taking action to reduce global emissions to mitigate the risk of climate change. A significant lever for reducing domestic emissions is the Safeguard Mechanism, which is a market-based baseline and credits scheme. The baseline was reformed in 2023 to gradually and predictably reduce each year, to help to ensure that covered facilities contribute to reducing overall emissions in line with

Australia's targets. Emission reductions from this mechanism will be complemented by broader plans to establish an interim target for 2035, and for net zero emissions to be achieved by 2050. Detailed sectoral emission reduction plans for electricity and energy, transport, industry and waste, agriculture and land, resources, and the built environment, are currently in development and will inform these longer-term plans. The Federal Government has also set out a roadmap to transform Australia into a renewable energy exporter to make the best use of Australia's natural advantages, and is investing heavily to modernize the electricity grid, support electrification and meet the national target of 82 percent renewable energy by 2030. Australia recognizes the need for coordinated action on climate and will rejoin and contribute AUD$50 million to the Green Climate Fund, as well as a foundational AUD$100 million to the Pacific Resilience Facility, which is the first Pacific-led, owned and managed community financing facility.