Ian Macfarlane: Recent major developments in the Australian economy

Talk by Mr Ian Macfarlane, Governor of the Reserve Bank of Australia, to the World Economic Forum Asia Pacific Economic Summit Melbourne, on 11 September 2000.

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It is a pleasure to be speaking before the World Economic Forum again. I have done so before in Hong Kong and Singapore, and I am proud that I can now add Melbourne to the list. It is also very pleasing that the Forum has successfully expanded beyond its Davos base, and made the Asia Pacific region an important part of its operations.

In the short time I have available tonight, I would like to outline some of the major developments in the Australian economy over recent years, and then say a few words about the outlook. Where possible, I will compare our performance to that of other countries. Inevitably, I will make a number of comparisons with the United States as it is the yardstick by which everyone’s performance seems to be judged these days.

I will take as my starting point a comparison of economic growth rates of developed countries over the most recent decade (Column 1 of Table 1). These figures from the OECD show that except for Ireland, which is a very special case, the Australian growth rate has been higher than for any comparable OECD country. For me, the interesting thing about this table is that this is the first decade in my working life where Australia has figured in the top half of the table, let alone being virtually in the top position.

Incidentally, these figures cover the whole decade and so include a recession for each country, usually in the early part of the decade. This holds the average growth rates down. Another approach would be to look at growth rates during current expansions. Up to the current quarter, our expansion has lasted 37 quarters and averaged growth of 4.1% per annum: the comparable figures for the United States are 38 quarters and 3.7% per annum.

If we turn to an international ranking of inflation rates over the past decade (Column 2 of Table 1), Australia finishes in the middle of the field, with an average inflation rate of 2.3% per annum. This is a huge improvement on recent decades, but, of course, virtually every country has shown a significant improvement. There are a number of factors behind this improvement, but one I would like to mention today is our monetary policy regime. Like a number of countries in the above list, Australia has a monetary policy regime which is based on the trilogy of an inflation target, an independent central bank and a floating exchange rate.

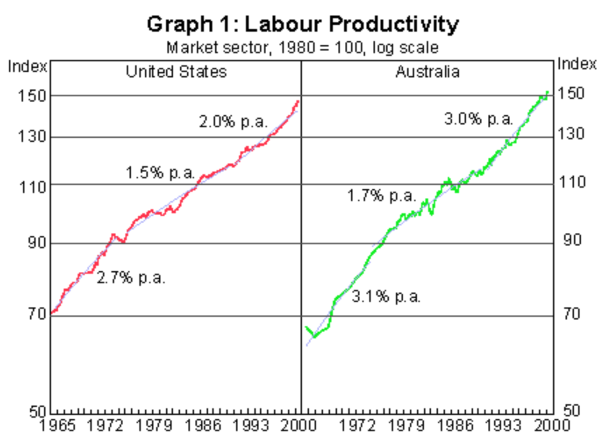
An important factor behind our good growth and low inflation has been our productivity performance. Here, if we use the simplest measure of productivity, which is labour productivity, the pattern in Australia is very similar to the pattern in the United States (Graph 1): strong growth in the 1960s, a flattening out in the 1970s and 1980s, followed by a pick-up in growth in the 1990s. But the pick-up in the 1990s in Australia has been more pronounced than in the United States. We have gone from growth of 1.7% per annum to 3.0% per annum, whereas the United States went from growth of 1.5 er cent per annum to 2% per annum.

I do not want to suggest that this means we have higher productivity than the United States; remember we are only talking here about rates of change of productivity. The fact that we have been able to speed up more than they have is, in large part, because we were starting from a lower base.

Incidentally, the OECD recently completed a study called “Is There A New Economy?” in which it looked at similar calculations to the ones I have shown above for a range of countries. It found that out of the 29 OECD economies, only six had achieved a higher trend growth of GDP per capita in the 1990s compared with the 1980s. They were the United States, Australia, Ireland, Denmark, Norway and the Netherlands.

Table 1
Real GDP growth and consumer price inflation
Average annual rate (since 1990)

Country	GDP	Country	GDI
Ireland	6.3	Japan	1.0
Australia	3.5	France	1.8
Norway	3.3	New Zealand	1.9
United States	3.3	Switzerland	2.1
Netherlands	2.9	Denmark	2.1
New Zealand	2.6	Finland	2.1
Canada	2.5	Canada	2.2
Spain	2.5	Belgium	2.3
Germany	2.2	Australia	2.3
Belgium	2.2	Netherlands	2.5
Denmark	2.1	Norway	2.5
United Kingdom	2.1	Germany	2.5
Finland	1.8	Ireland	2.6
France	1.7	Sweden	2.9
Japan	1.5	United States	3.0
Italy	1.5	United Kingdom	3.5
Sweden	1.4	Italy	3.8
Sweden	1.0	Spain	4.0
Source: OECD			



Whilst I am on the subject of productivity, I want to make two general points:

- The first is the obvious one which I have made on numerous occasions that the main reasons behind the pick-up in productivity growth have been structural changes made over the past 15 years in the Australian economy which have increased flexibility and competitive pressures. These changes include:

  - further tariff reductions;
  - financial deregulation;
  - labour market deregulation;
  - privatisation; and
  - a more stringent regime of competition policy.

  It has not been easy to put these changes in place, even though there has been for most of the decade considerable bipartisan political support for change. Inevitably, compromises have had to be made and, viewed in isolation, some of the individual changes do not look to be all that thorough-going. But taken together, I think the total is larger than the sum of the individual parts. Of course, one aspect of the economy that was not reformed during the period covered by these calculations was the tax system. But that finally changed a couple of months ago when a Goods and Services Tax was introduced to replace the old wholesale sales tax and to take some of the weight off income taxes.

- The second point about productivity I want to make concerns the new economy/old economy divide. Some people tend to judge a country's technological sophistication by, for example, the number of listed companies in the IT sector. Although Australia has a number of companies that fit this description, about 70 or so in fact, their combined share of the stock market is not large by international standards. But that is only one measure of technological sophistication. Another equally important one is the country's willingness to embrace new technology. This may be a better guide to productivity improvements than focusing only on the IT sector. I have two measures of the spread of technology:

  - The first is Internet usage as a percentage of the population, which shows Australia in a relatively high position among the countries compiled by the Consulting Group, NUA (Table 2).
  - A measure that is more specific to the business sector is the number of e-commerce servers per head of population. On this measure, Australia is second only to the United States (Table 3).

Table 2
Internet usage
(per cent of population)

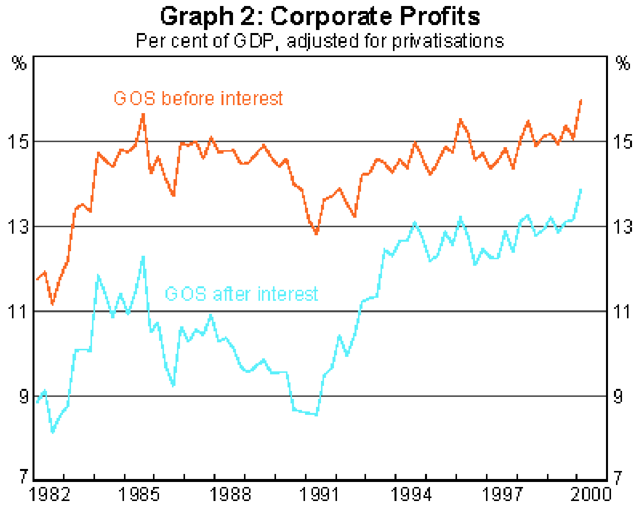
Norway	50
United States	45
Sweden	44
Canada	43
Finland	38
Australia	36
Denmark	36
Netherlands	29
UK	27
Switzerland	23
Slovenia	23
Austria	23
Taiwan	22
South Korea	21
Belgium	20
Germany	19
Japan	17
Italy	16
Ireland	16
New Zealand	16

Source: nua.ie. Most data from late 1999-early 2000 surveys

Table 3
E-Commerce servers

Country/region	**Servers per million population**	
	July 1998	March 2000
United States	55	170
Australia	35	119
New Zealand	25	93
Switzerland	22	92
Canada	31	87
Scandinavia	14	58
UK	12	55
Other EU	5	22
Japan	3	15
Korea	3	3

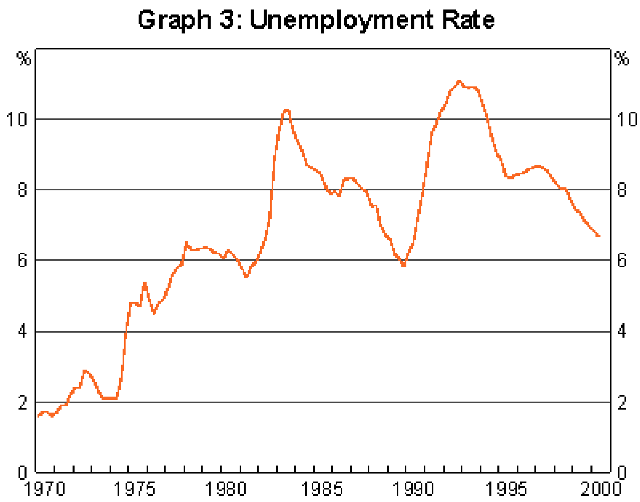
Source: www.netcraft.com and OECD



So, in terms of willingness to adapt to new information technology, Australia would get a very high score. This, along with the measures I mentioned earlier, helps to explain why there has recently been such a significant lift in the rate of growth of productivity.

A big lift in productivity growth has a beneficial effect on many areas of the economy. A lot of it is passed through to consumers and, in the process, this makes it easier to maintain low inflation. Some of it can also make businesses more profitable, which is, after all, the incentive that drives much of the efforts towards improving productivity in the first place. The two broadest measures of corporate profits as a percentage of GDP in Australia have been trending up over the past decade, with profits after interest showing a much sharper rise than profits before interest, again another indirect benefit of a low inflation (Graph 2) decade.

With good growth and good profitability, businesses have been keen to hire staff. As a result, employment has grown strongly and the unemployment rate continues to decline (Graph 3). Again, a comparison with the United States is interesting - during our expansion, the unemployment rate has fallen by 4.8 percentage points compared with a fall of 3.7 percentage points for the United States. The fact that their level of the unemployment rate, at 4.1%, is lower than ours, at 6.4%, is due to their lower starting point, in part a result of the relatively mild nature of their early 1990s recession.

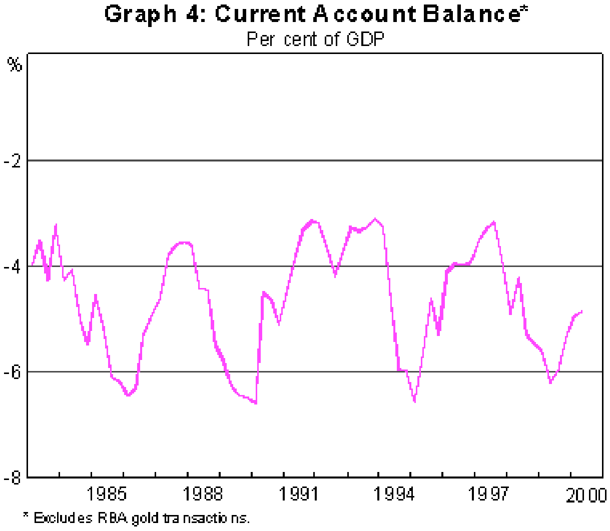


There are two other things I wish to touch on before concluding. The first is the exchange rate, which has attracted a lot of attention and soul searching this year. It is surprising that in an economy showing the medium-term characteristics I have just outlined, the exchange rate is so weak. If we refocus our attention to the immediate period, the puzzle is, if anything, greater. We have an economy growing at well over 4%, and probably more like 5%, with exports rising rapidly in the context of the strongest world growth for a decade, rising commodity prices and high corporate profitability.

Why markets are placing such a low valuation on the Australian dollar is not a question I can easily answer, any more than I can answer why valuations in some equity markets seem so high relative to normal. These things can occur for periods in markets. They eventually come out right in most cases, but it can take some time, and in the meantime the effect can be uncomfortable, unhelpful and even damaging. For my part, I think that an important contributing factor this time is that markets underestimated (and are still underestimating) the Australian economy's underlying strength. The coincidence of a strong world economy plus a low Australian dollar is virtually unprecedented, and is one of the several reasons why we at the Reserve Bank have been confident in the strength of the Australian economy.

The influence of the world economy has been quite expansionary for Australia over the past year, most notably in the form of a 28% increase in exports. This has been the result of both strong volume growth and rising prices. Even with substantial growth in imports, the foreign balance is now making a good contribution to Australian growth and, at the same time, reducing the current account deficit (Graph 4).

Graph 4: Current Account Balance*



The reduction in the current account deficit from 6% of GDP a few quarters ago to 4.9% now may not look to be a big story. However, what is unusual about it is that it has occurred at a time when the Australian economy has been growing strongly. In all other instances where a turnaround of this size has occurred, a major cause has been a slowdown or contraction in the Australian economy (and consequent fall in imports). On this occasion, the manner of the improvement in the current account portends much better for the future.

Conclusion

We are now in the tenth year of our current expansion, and are in much better shape than in the mature phase of previous expansions. This year is an eventful one in that it contains a number of one-off occurrences such as the Y2K changeover, the introduction of the GST and, in a few days, the Olympic Games. These events have the effect of adding to demand and of shifting it around from month to month and quarter to quarter. This is making a number of indicators of the economy more difficult to read than normal, but I do not think it alters the overall assessment that this is an economy which retains a fair bit of momentum, and where the economic fundamentals, both here and abroad, are continuing to provide a stimulus to growth.