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# Prospects for the global, Australian and Tasmanian economies

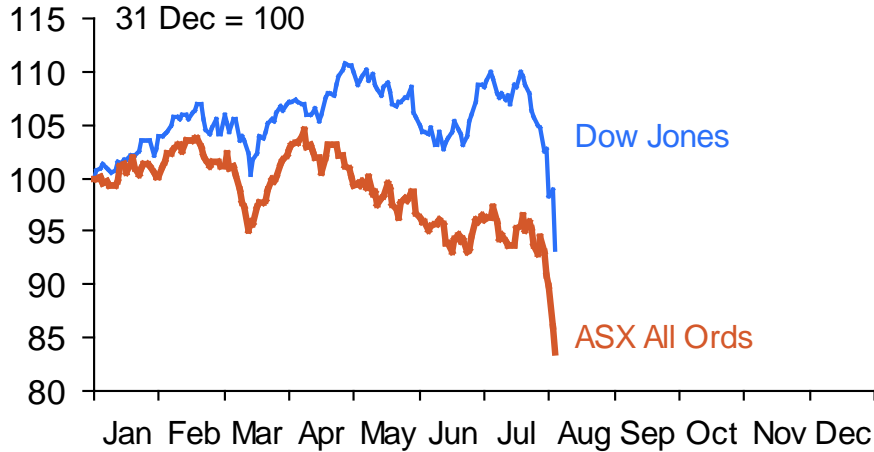
**Presentation to a luncheon hosted by the  
Launceston Chamber of Commerce**

**Launceston Country Club  
9<sup>th</sup> August 2011**

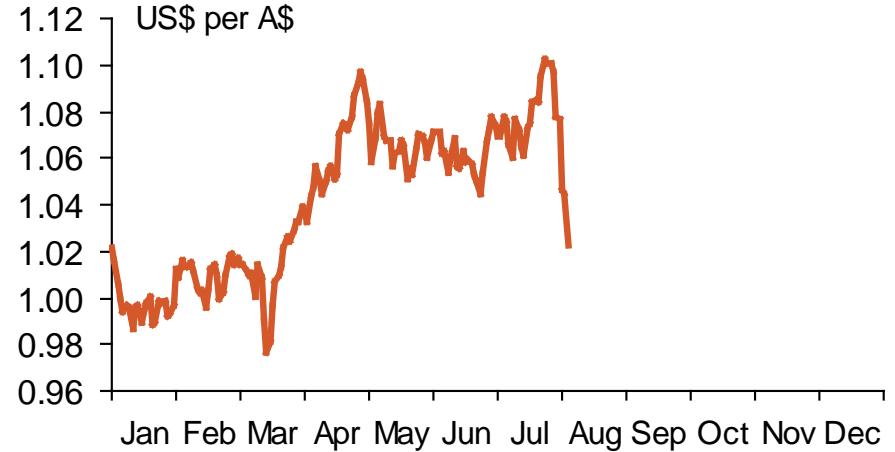
**Saul Eslake**  
**Director, Productivity Growth program, Grattan Institute  
and Advisor, PricewaterhouseCoopers**

# Over the past couple of weeks, financial markets have become extremely nervous once again

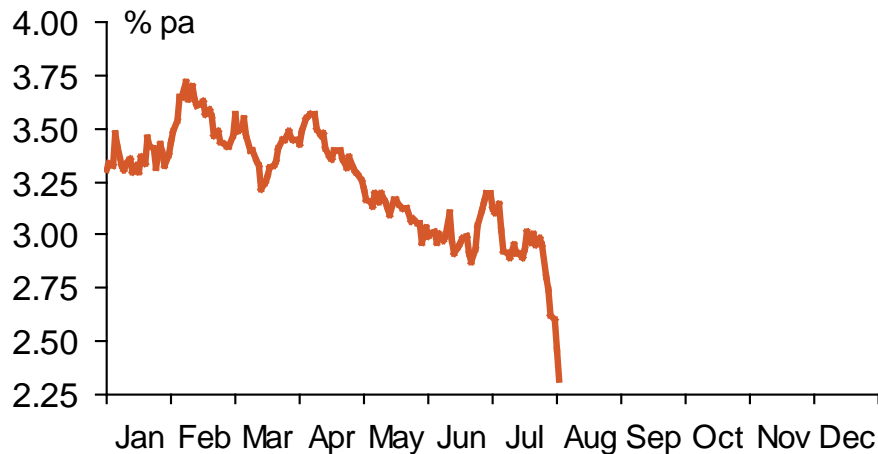
### Stock markets



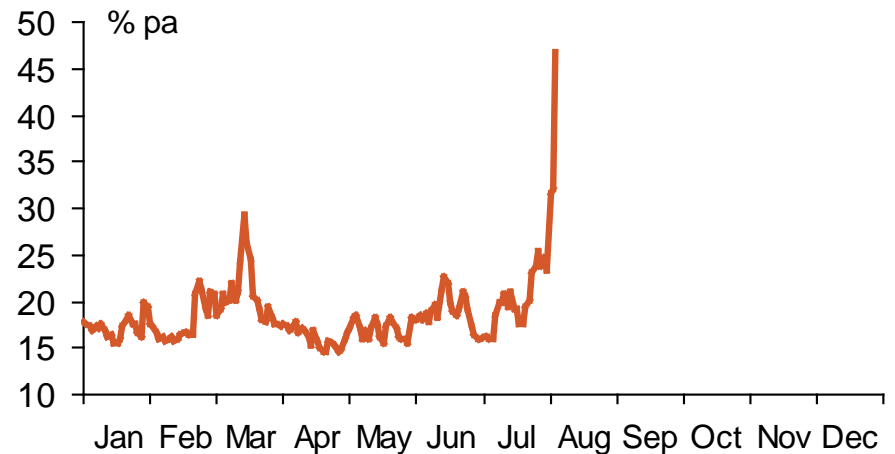
### Australian dollar



### US 10-year bond yields



### Volatility of US share price options ('fear index')



Note: daily data. Source: Thomson Reuters Datastream.

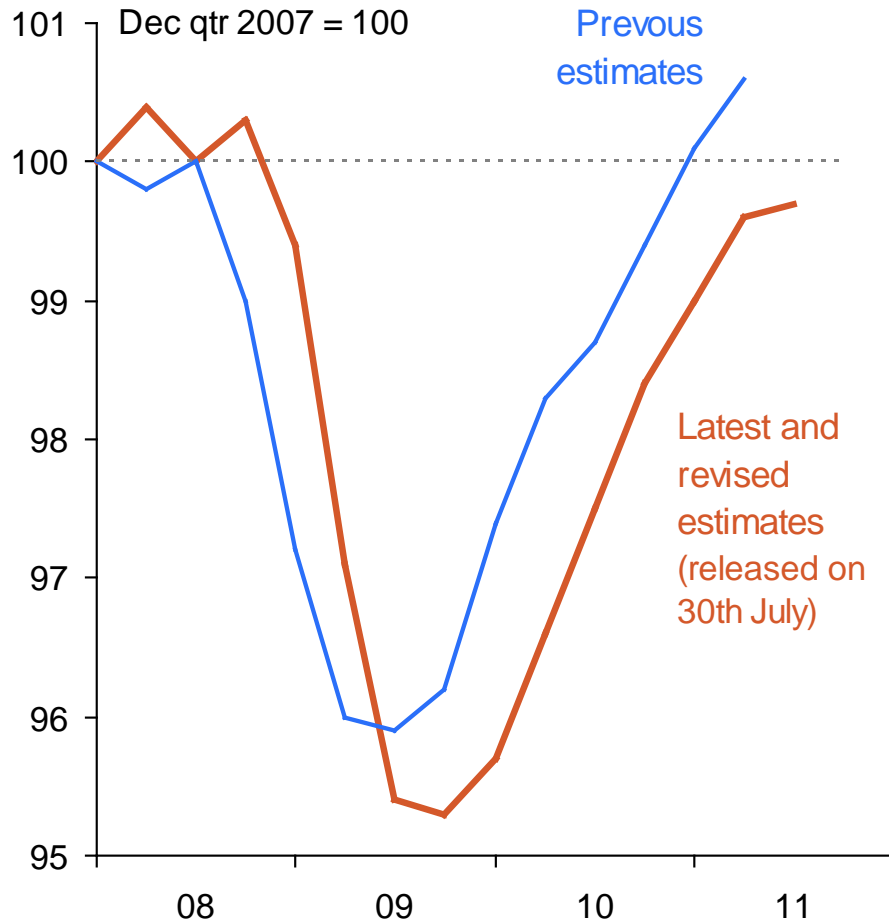
# Financial markets have become increasingly worried about four things ...

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- **The US might be on the cusp of a second recession**
  - although the risk of another US financial crisis is not especially high given that banks (and the corporate sector) are in much better shape than in 2007-08
- **The European sovereign debt crisis might be moving to another, more dangerous phase**
  - although everyone knows that Greece is insolvent, actual default has been staved off (yet again) by the latest bailout
  - however market concerns have now shifted to Italy and Spain – which are too large to be ‘bailed out’ by Germany
  - although not the most likely scenario, a default by either Italy or Spain would become a European banking crisis because of the amount of Italian and Spanish debt held by banks in those (and other) countries
- **If either, or both, of the US and Europe do fall into a second recession, central banks and governments don’t have the means to respond in ‘textbook’ fashion**
  - policy interest rates are already at, or close to, zero
  - and governments are in no position to ‘do’ fiscal stimulus again – indeed, particularly in Europe but also now in the US, they are ‘doing’ fiscal austerity
- **Hence, a second recession on either side of the North Atlantic may be unusually deep and/or prolonged**
  - in some ways like 19<sup>th</sup> century ‘depressions’, before it became the conventional wisdom that governments and central banks could and should do something to ameliorate economic downturns

# The US recession induced by the financial crisis was weaker than previously recognized, and the recovery has been weaker than thought

## Real gross domestic product

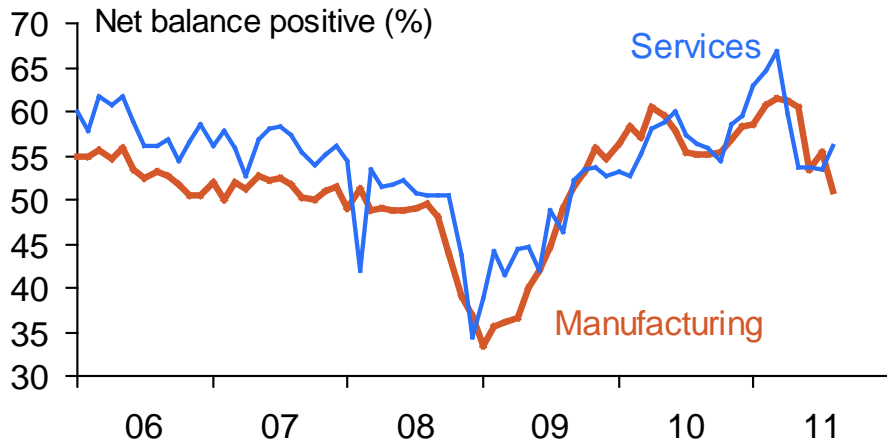


## Unemployment rate

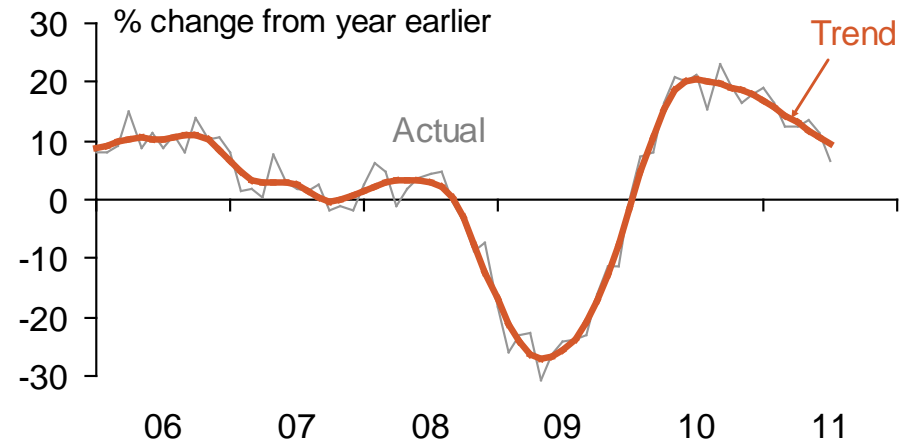


# And the US economy has been softening since the first few months of this year

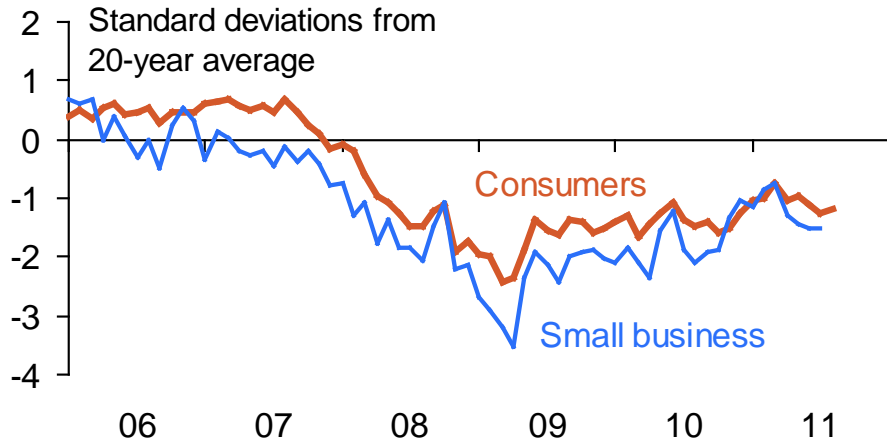
### US purchasing managers' indices



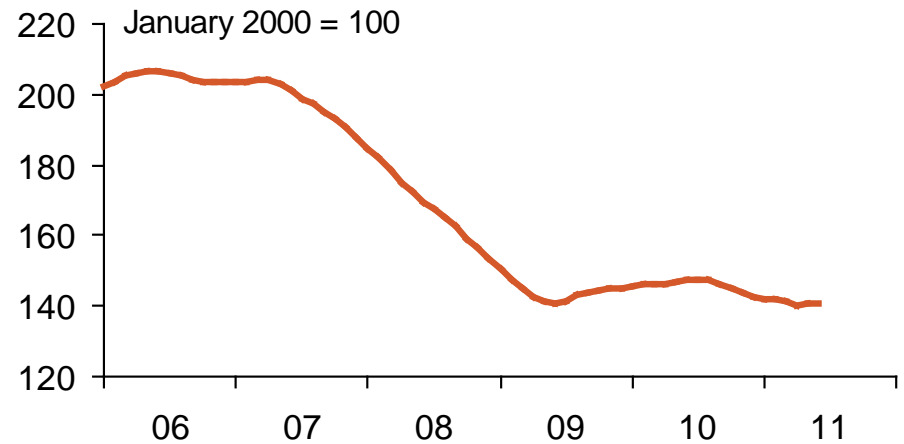
### US orders for capital goods



### US consumer and business confidence



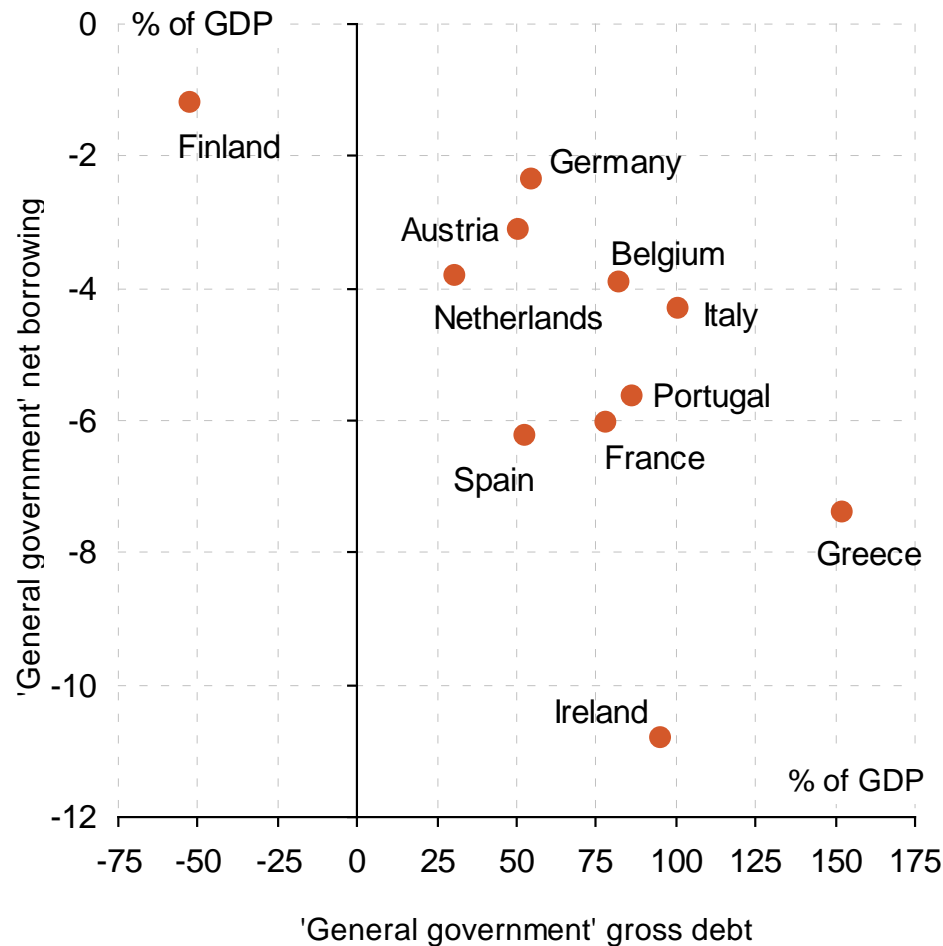
### US housing prices



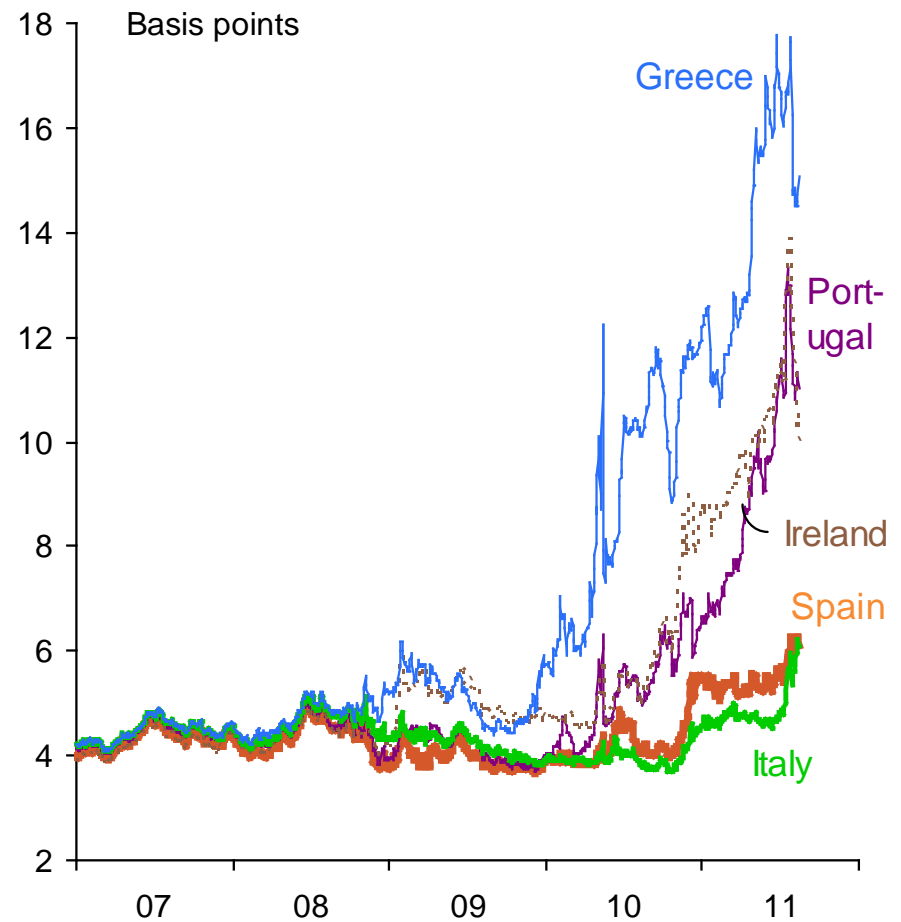
Sources: US Institute of Supply Management; Michigan University; National Federation of Independent Businesses; US Commerce Department; S&P.

# The most recent Greek bailout seems to have calmed markets' fears about Greece – but attention has shifted to Italy and Spain

## Euro area budget deficits and net public debt, 2011



## European 10 year bond yields

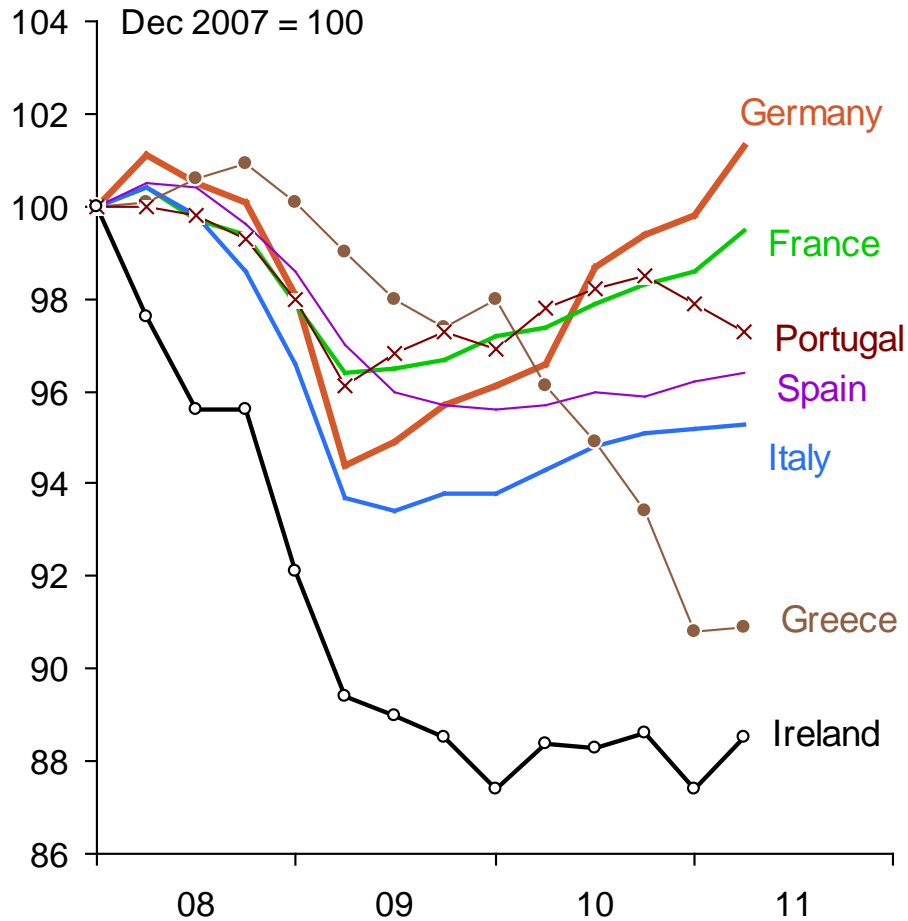


Note: 'PIIGS' refers, not very flatteringly, to Portugal, Italy, Ireland, Greece and Spain.

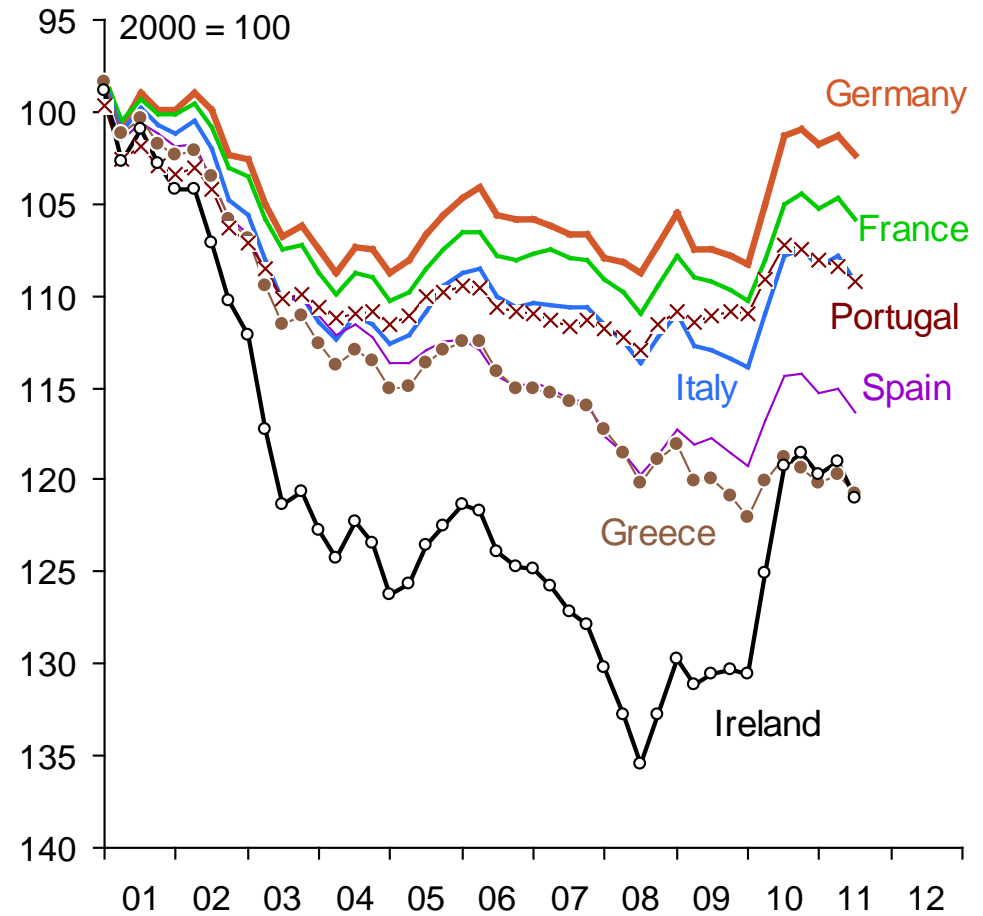
Sources: IMF *World Economic Outlook* database (April 2011); Thomson Reuters Datastream.

# The 'PIIGS' countries need to restore their competitiveness vis-à-vis other Euro area economies in order to regain sustainable growth

## Real gross domestic product



## International competitiveness

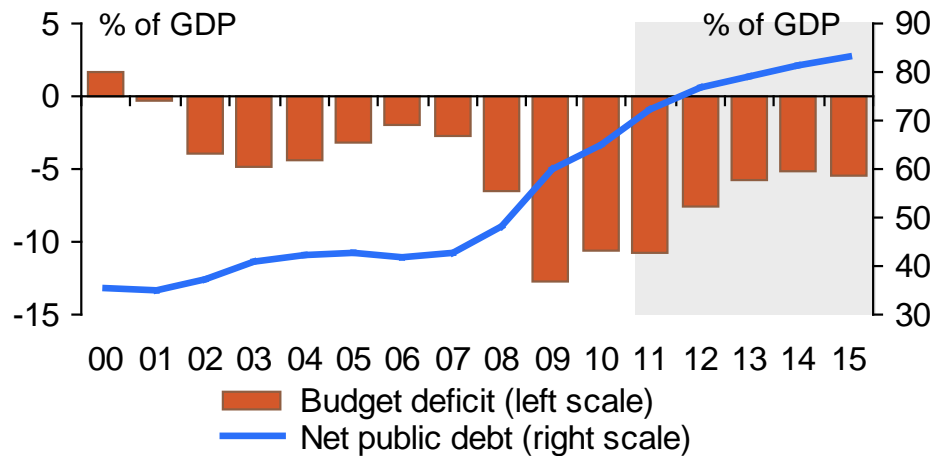


Note: 'International competitiveness is a measure of movements in labour costs and labour productivity relative to other euro area economies.

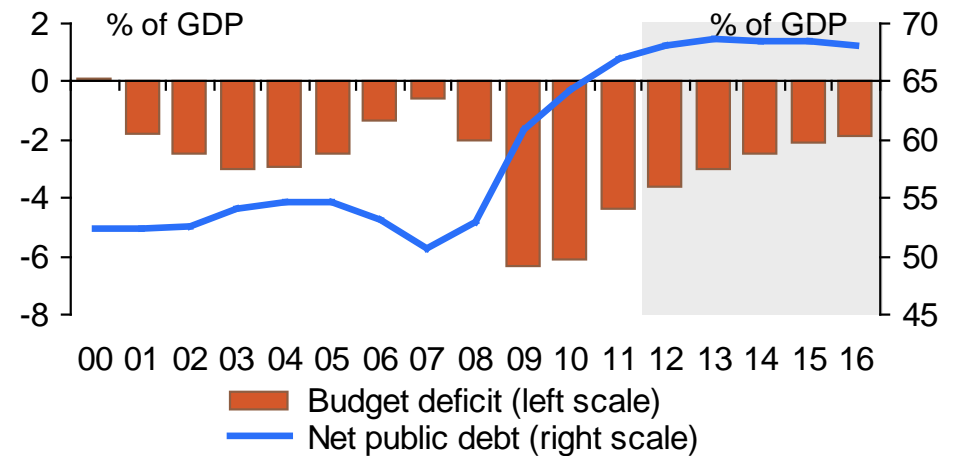
Sources: Eurostat; European Central Bank.

# On either side of the North Atlantic, governments and central banks don't have much 'ammunition' to fight a second recession

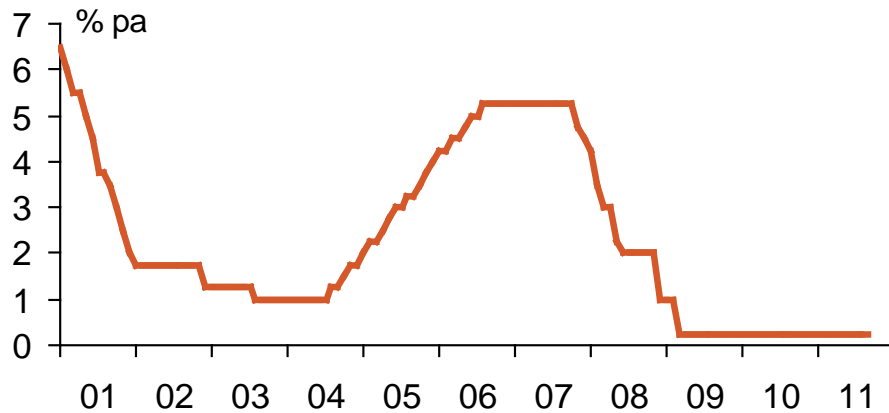
## US public finances



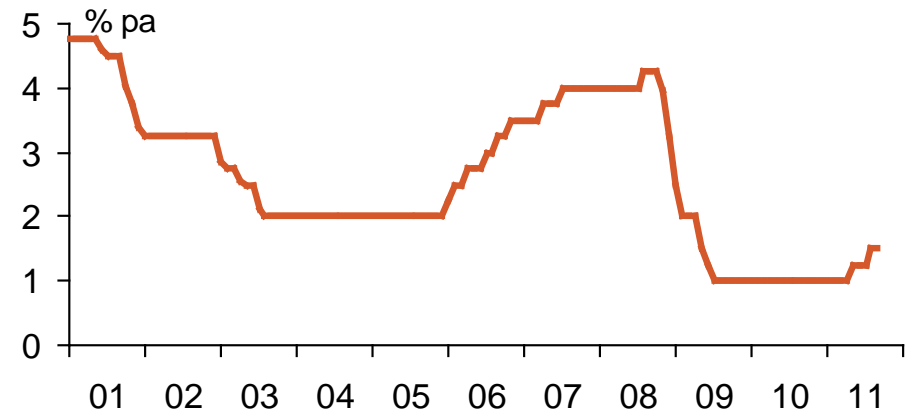
## Euro area public finances



## US policy interest rates



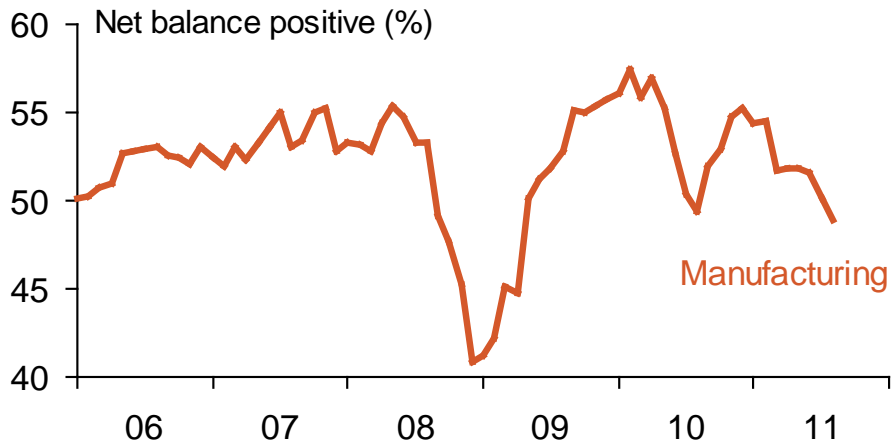
## Euro area policy interest rates



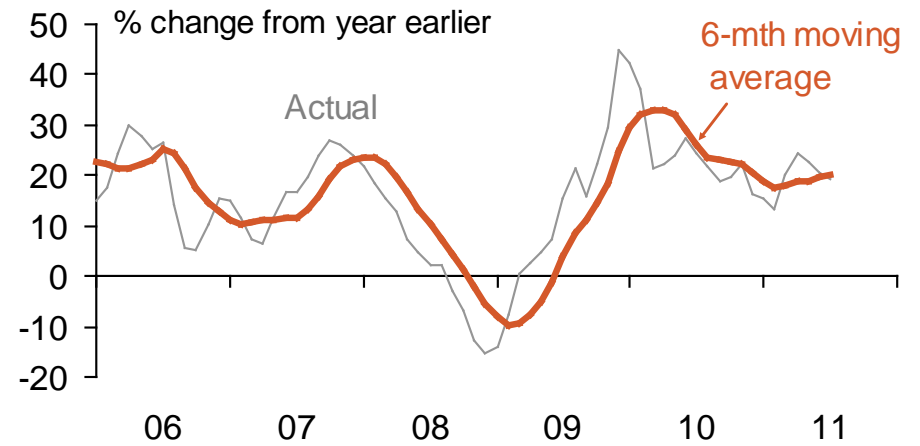


# China's economy is slowing a bit – as the authorities try to quell inflation pressures – but there's no suggestion it's on the cusp of recession

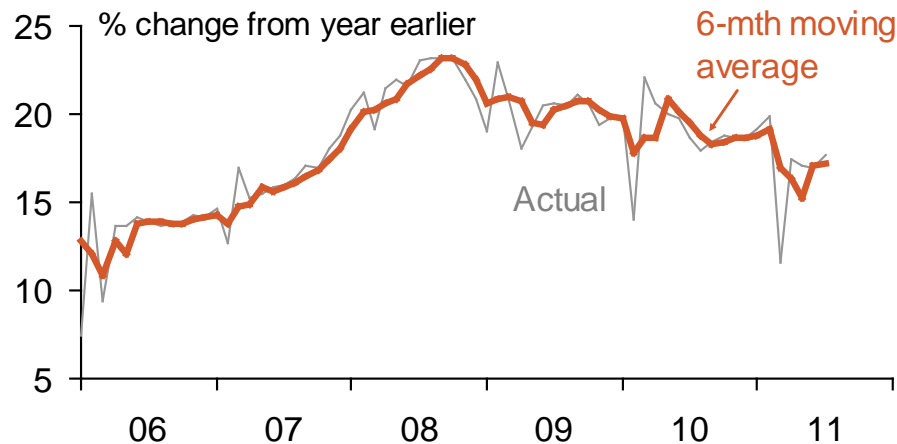
### China purchasing managers' index



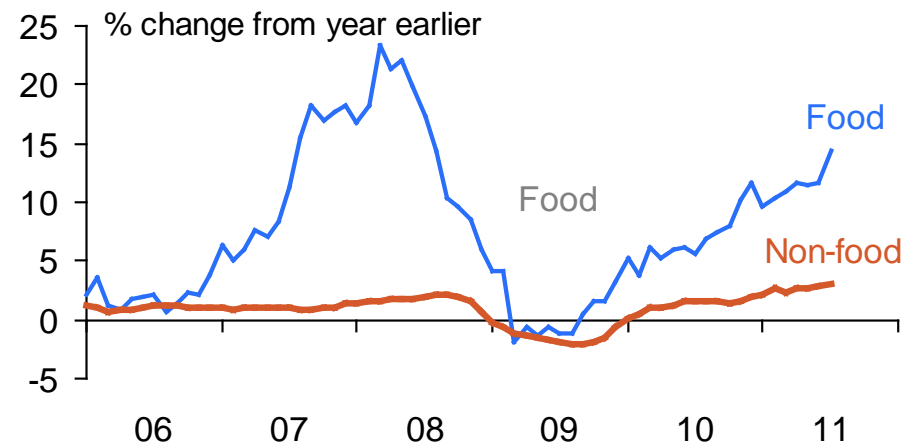
### China construction index



### China retail sales



### China consumer prices

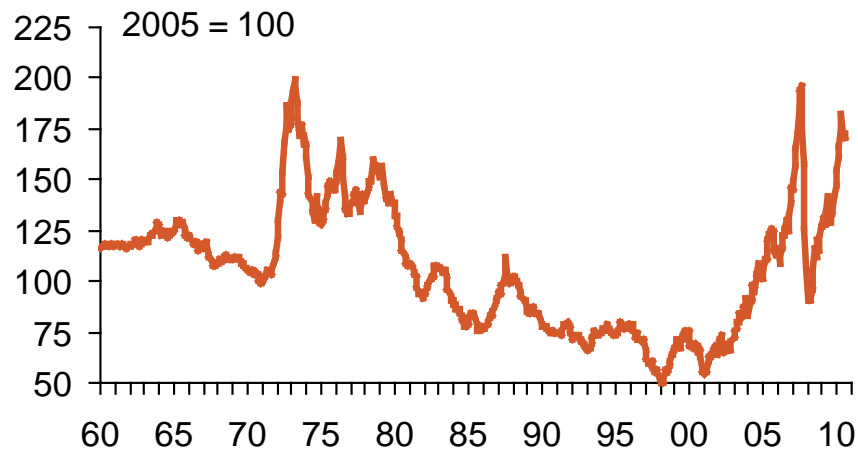


Sources: HSBC; China National Statistics Bureau; UBS Asia.

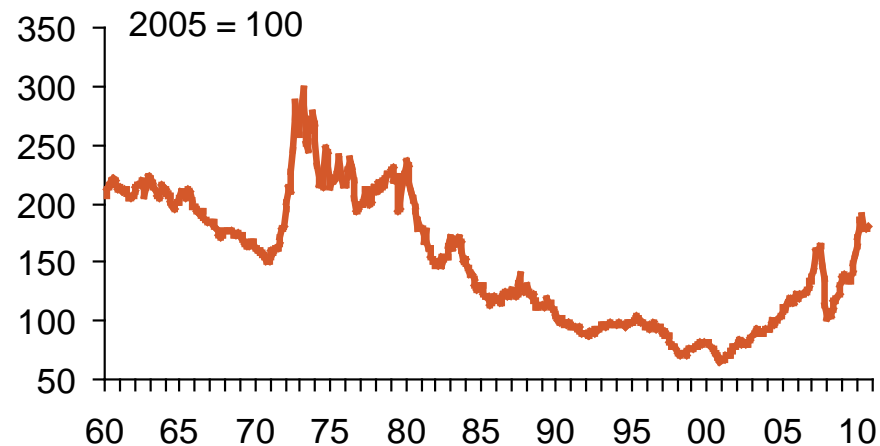
# The long-term downtrend in commodity prices in real terms ended about a decade ago

## Real commodity prices

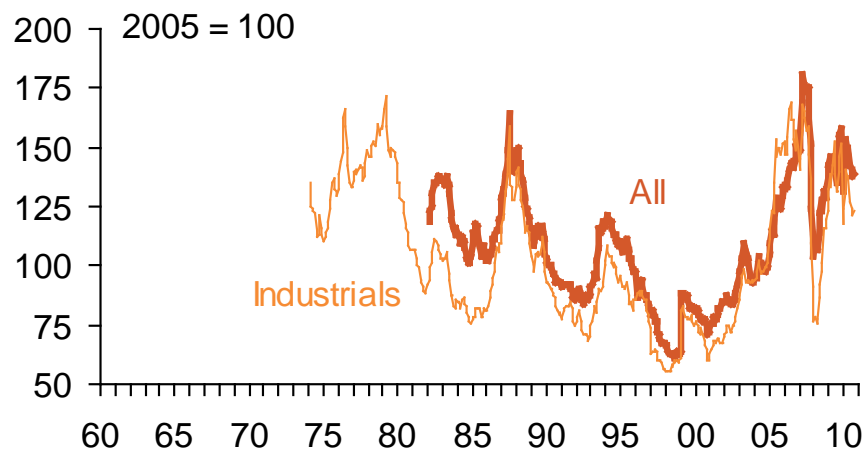
IMF index



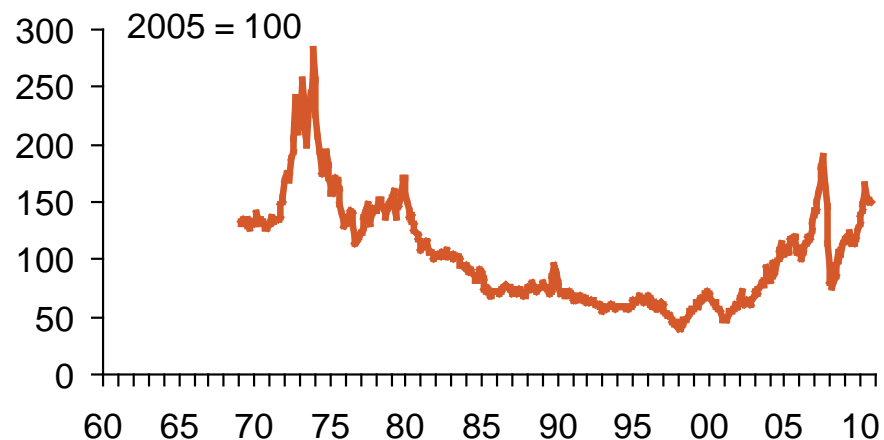
CRB index



The Economist index



Goldman Sachs index

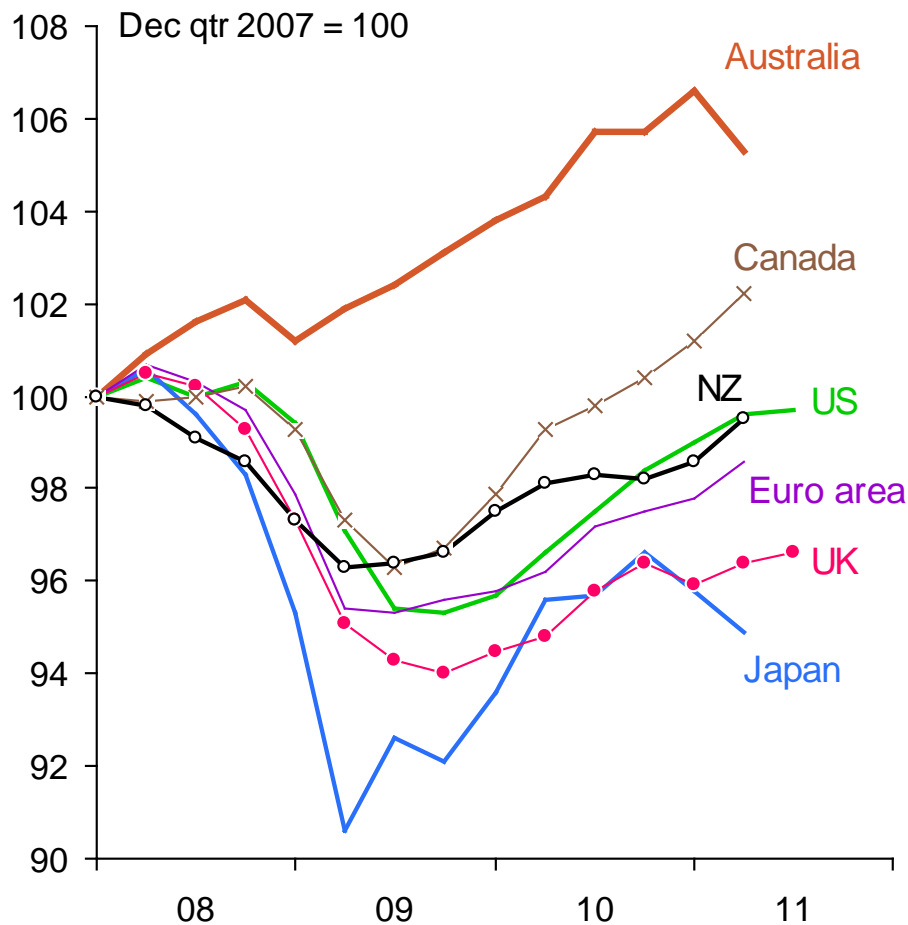


Note: all indexes expressed in US\$ and deflated by US consumer price index, rebased to 2005 = 100.

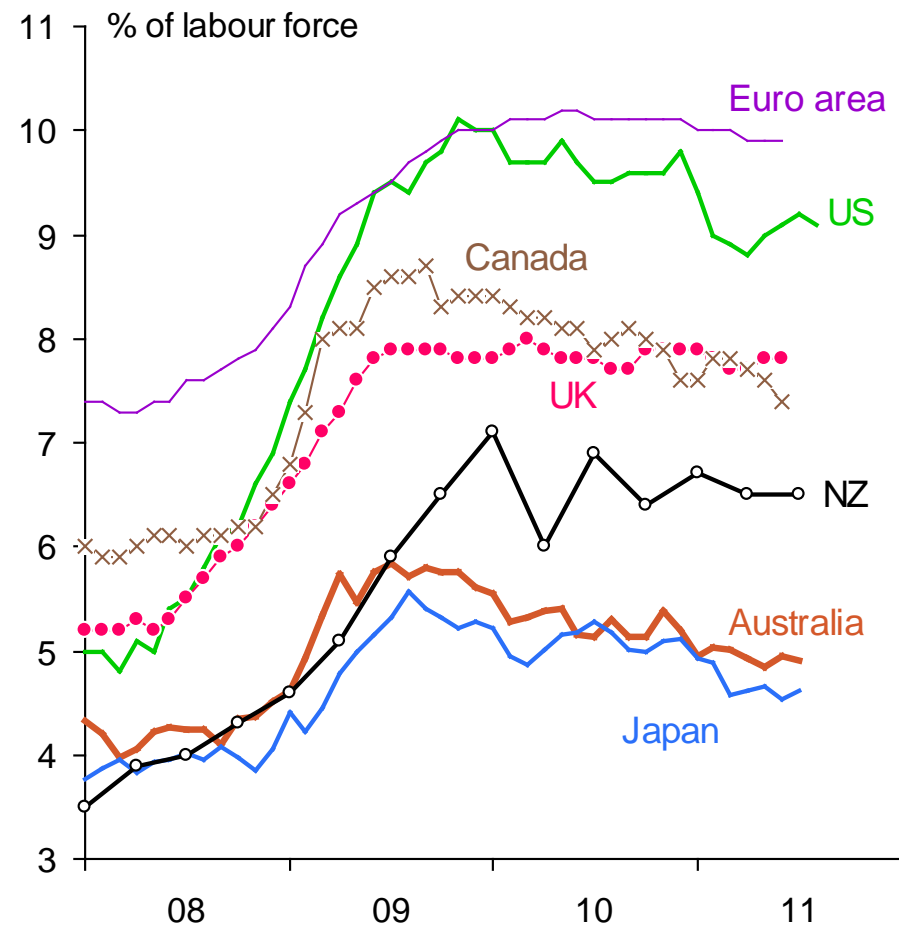
Sources: International Monetary Fund, *The Economist*, Thomson Reuters, author's calculations.

# Australia's economy has continued to perform more strongly than those of other industrialized nations

## Real gross domestic product



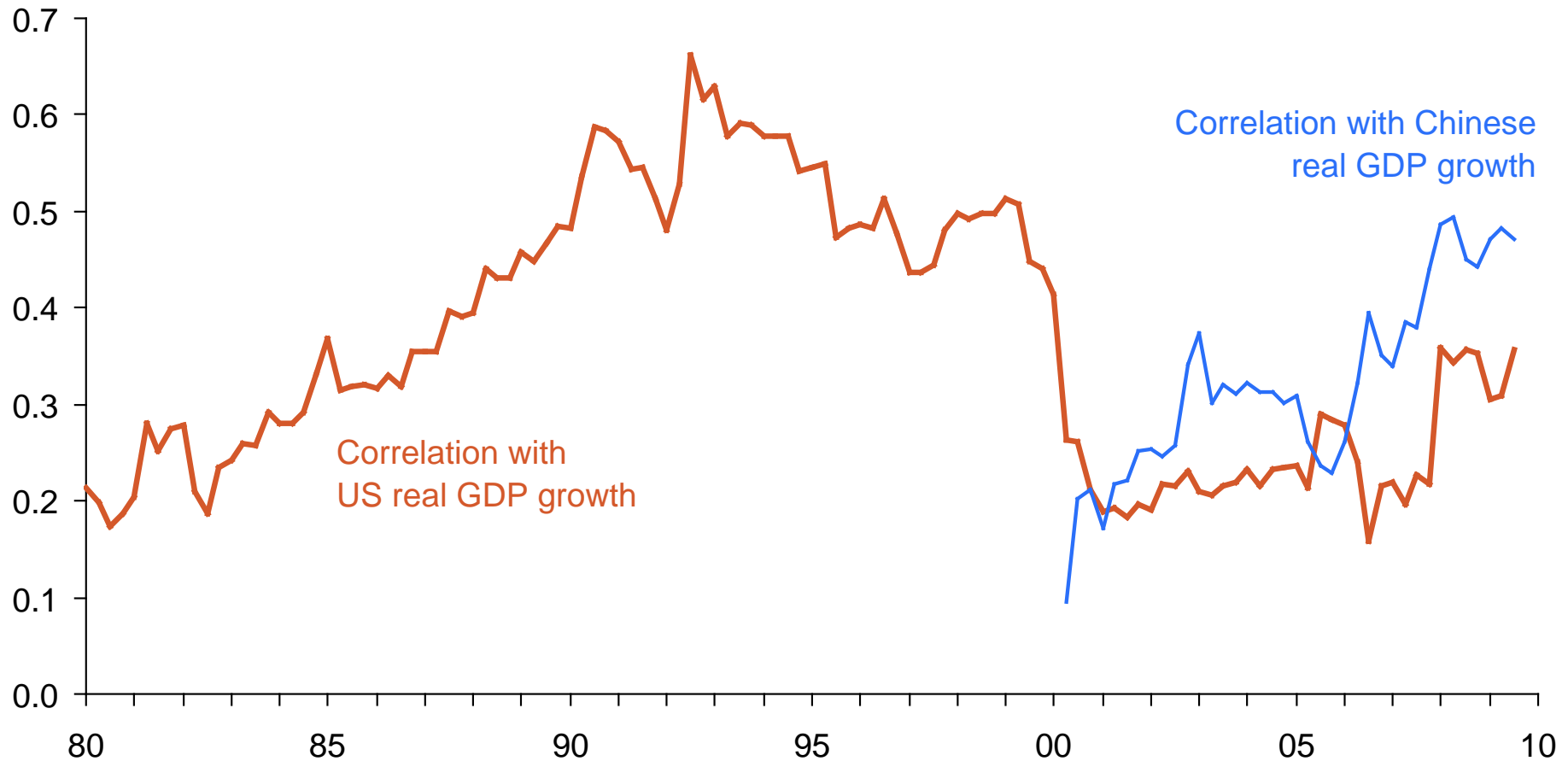
## Unemployment rate



Sources: Australian Bureau of Statistics; US Bureau of Economic Analysis; Japan Economic & Social Research Institute; Eurostat; UK Office of National Statistics; Statistics Canada; US Bureau of Labor Statistics; Japan Home Ministry; Statistics New Zealand..

# Australia's economy is now more closely correlated with China's than with the United States'

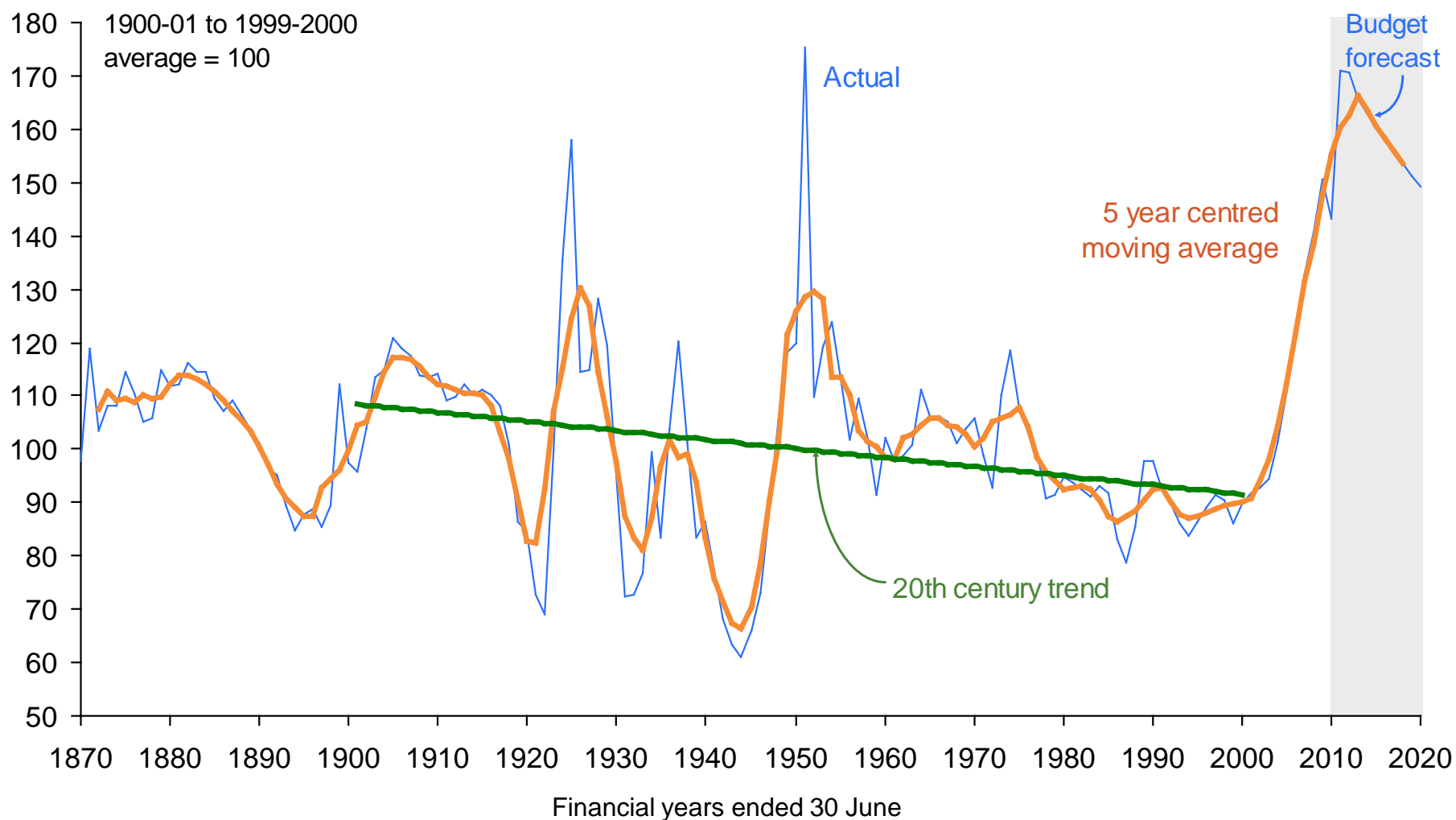
## Correlation between Australian and US-Chinese real GDP growth



Note: correlation is over rolling 10-year periods. Source: Phillip Lowe, Assistant Governor (Economic), Reserve Bank of Australia. "The Development of Asia – Risks and Returns for Australia", Address to Natstats 2010 Conference, Sydney, 16<sup>th</sup> September 2010, available on RBA website.

# Australia's 'terms of trade' are at their highest sustained level in at least 140 years

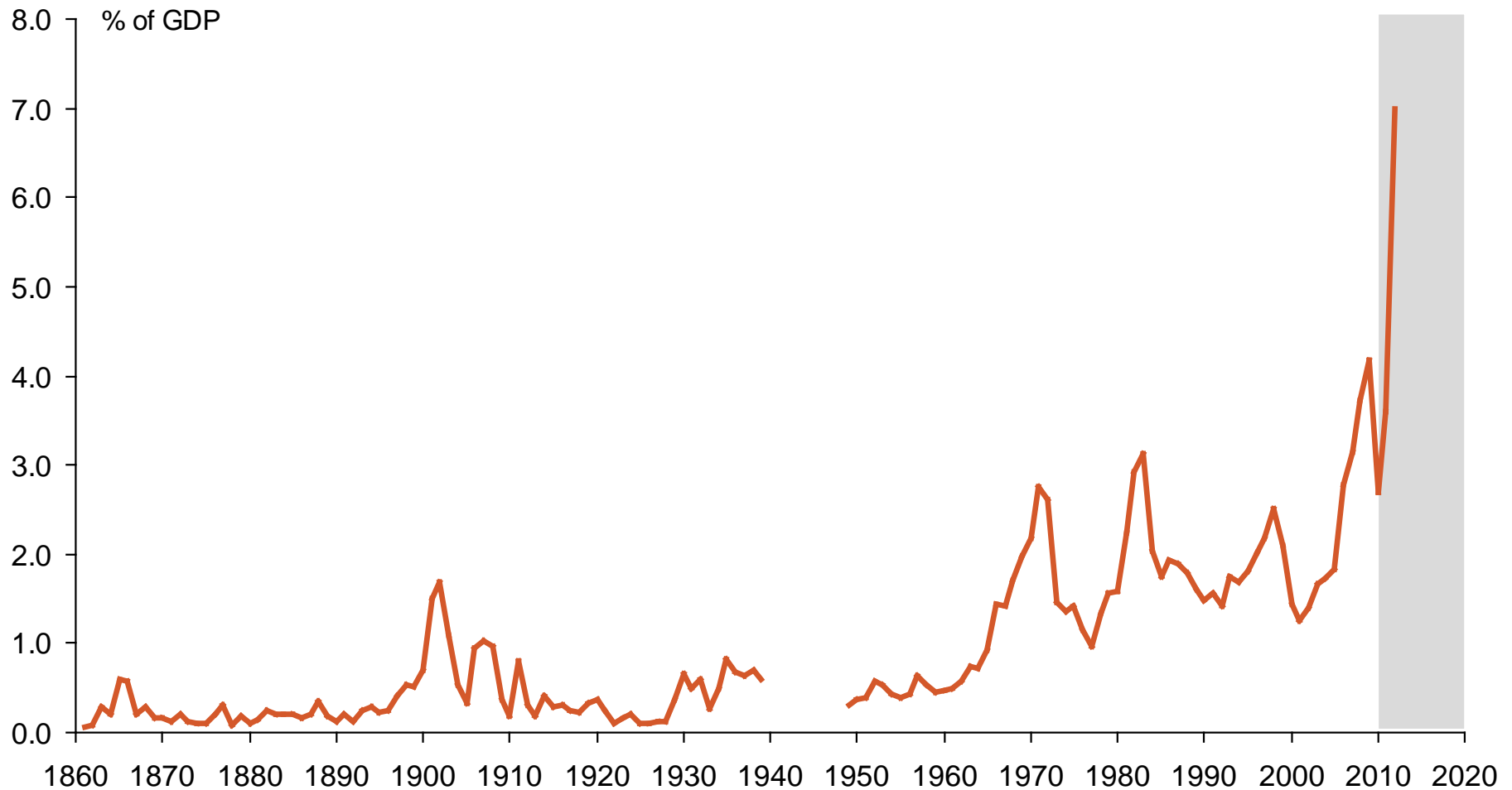
## Australia's 'terms of trade' (ratio of export prices to import prices)



Sources: Glenn Stevens, 'The Challenge of Prosperity', Address to CEDA Annual Dinner, 29<sup>th</sup> November 2010; Martin Parkinson, 'Opportunities, Challenges and Implications for Policy', Address to Australian Business Economists, 17<sup>th</sup> May 2011.

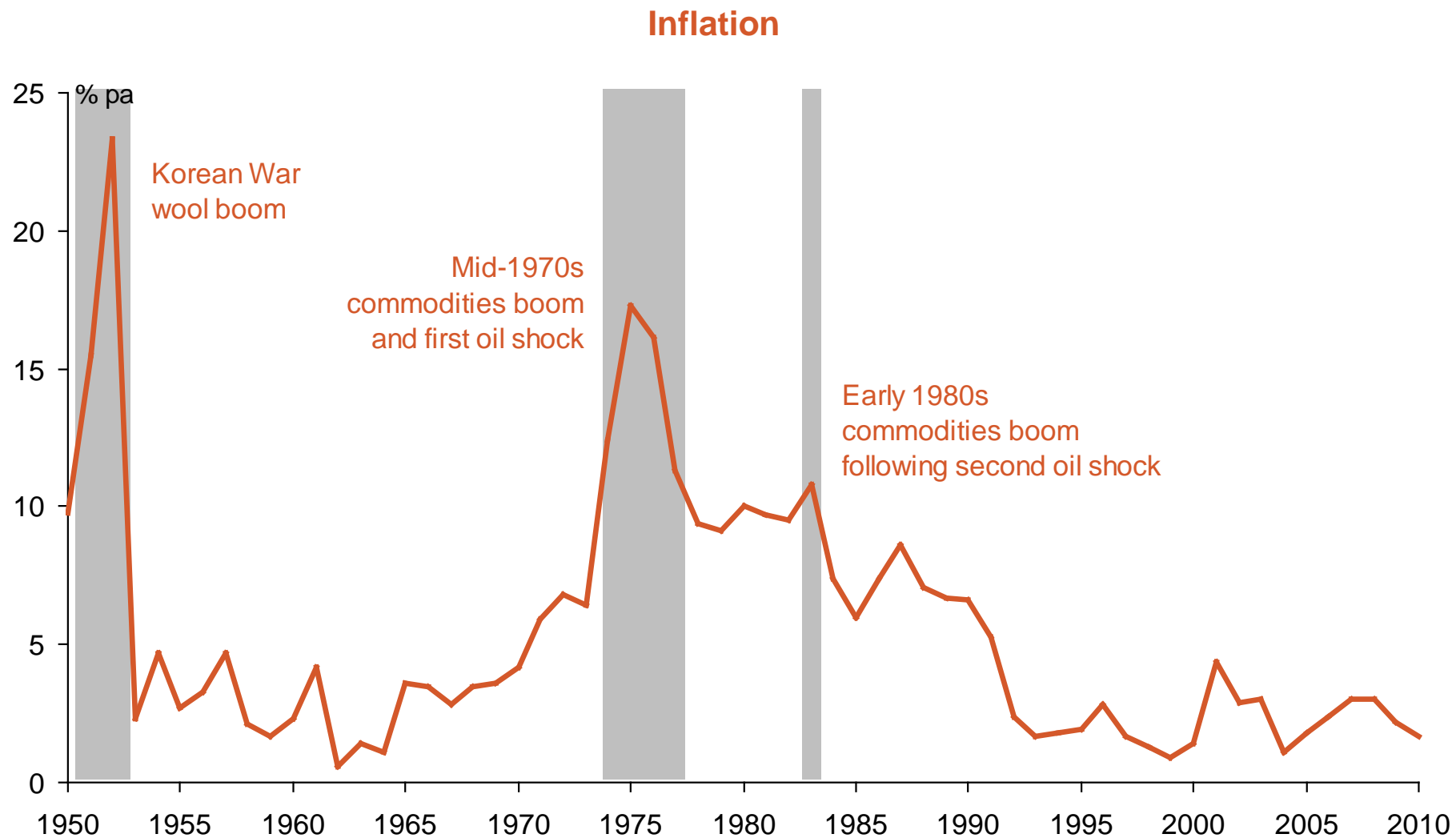
# Mining investment is now larger, as a proportion of GDP, than at any time in the last 150 years

## Mining investment as a share of GDP



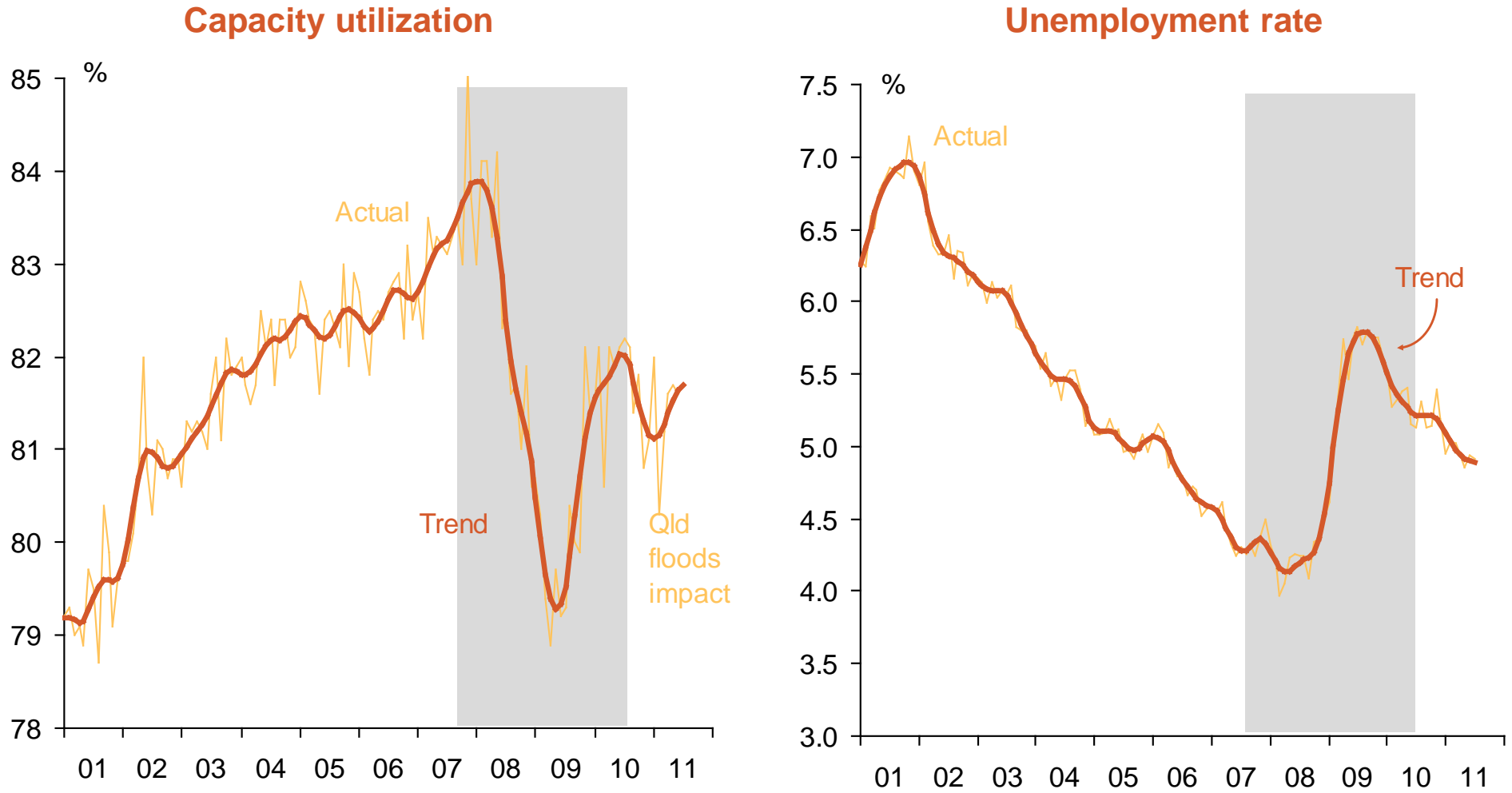
Sources: Ric Battelino, 'Mining Booms and the Australian Economy', Address to the Sydney Institute, 23<sup>rd</sup> February 2010; RBA, *Statement on Monetary Policy*, February 2011, both available on RBA website. Shaded area denotes forecasts based on results of the ABS December quarter survey of capital expenditure intentions (published in May 2011), assuming expectations are realized to the same extent as on average over the past five years.

# Australia's three episodes of double-digit inflation since World War II have co-incided with commodity price booms



Source: ABS.

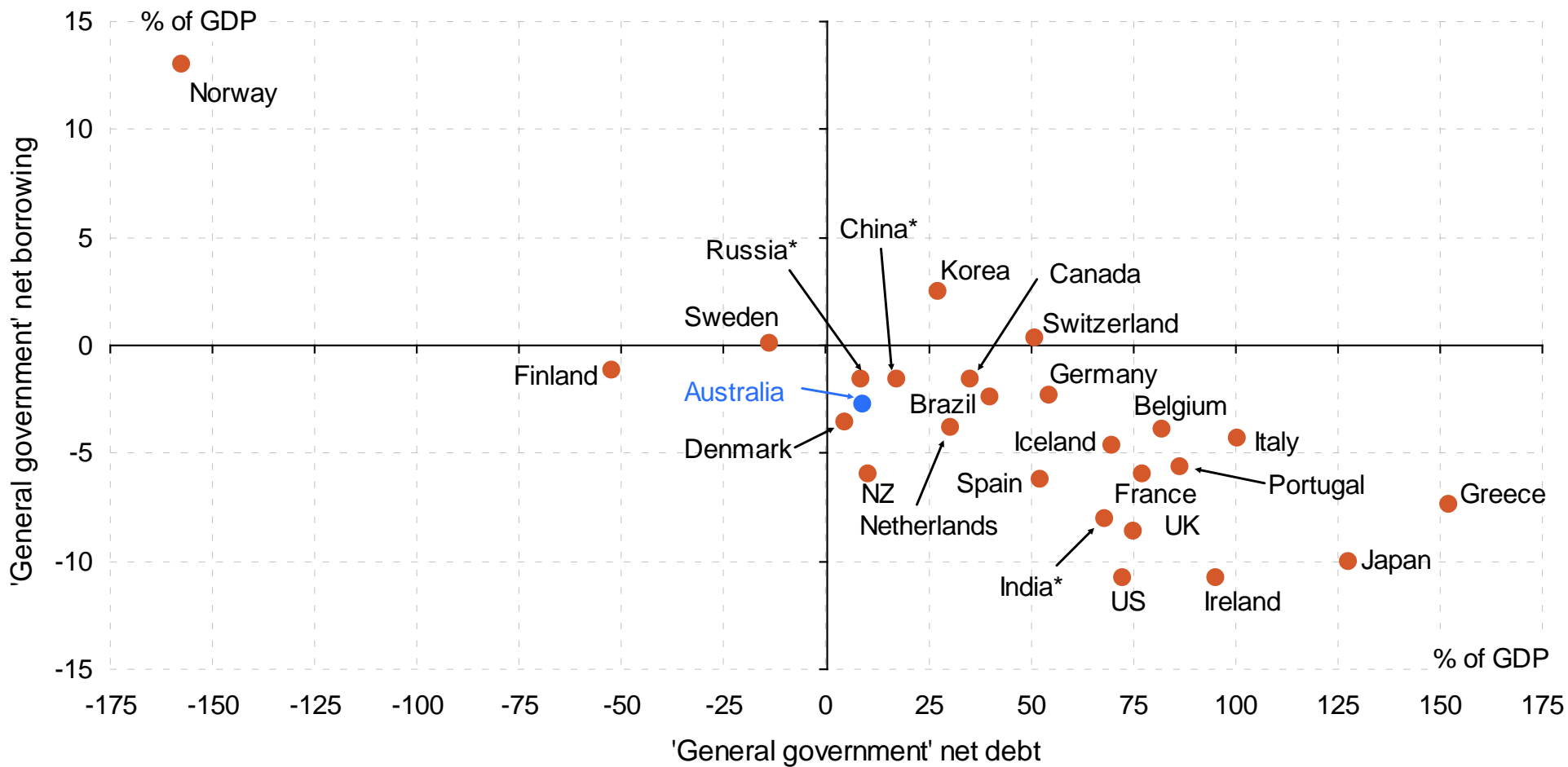
# The 'mining boom' is getting under way again at a time when there's only a small amount of 'spare capacity' in the Australian economy





# Australia does not have a serious public debt problem

## Government borrowing and net debt, 2011

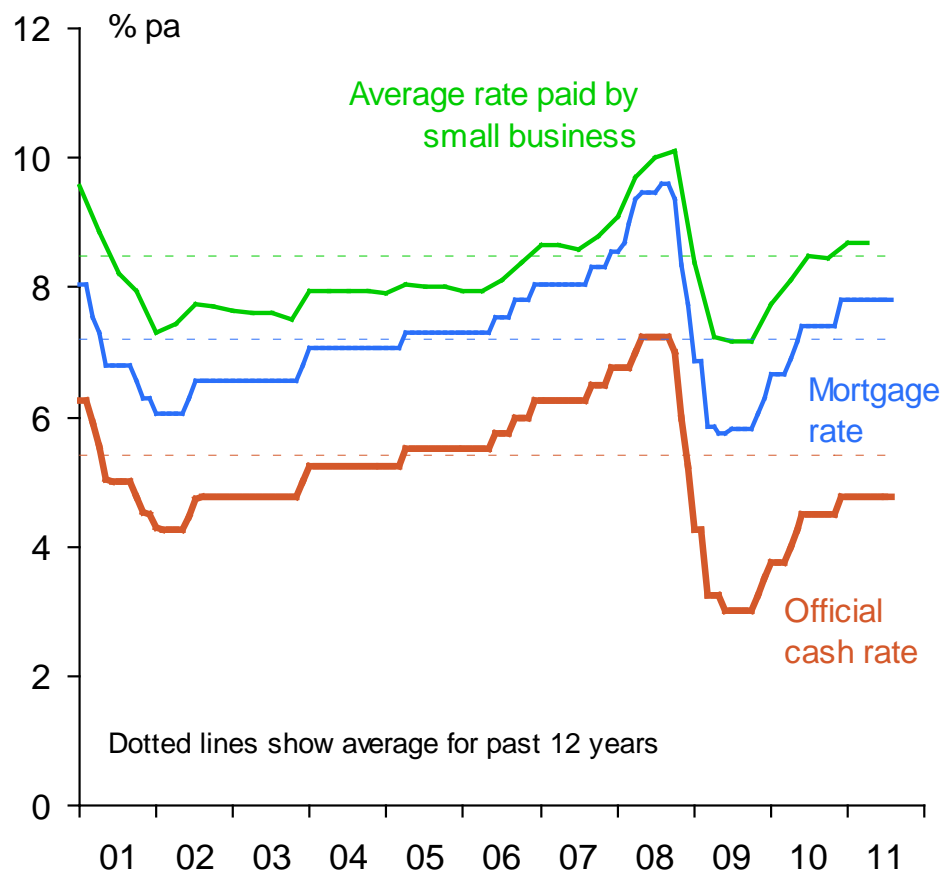


\* Public debt figures for China, India and Russia are gross, not net debt

Source: IMF *World Economic Outlook* April 2011 database except for Australian figures which are from 2011-12 Budget Paper No. 3, *Australia's Federal Relations* Tables E1 & E8 (and which include the State and local government sector but (as with other countries) excludes government business enterprises).

# The Reserve Bank has given itself considerable scope to cut interest rates in the event that the global economy deteriorates sharply

## Australian interest rates

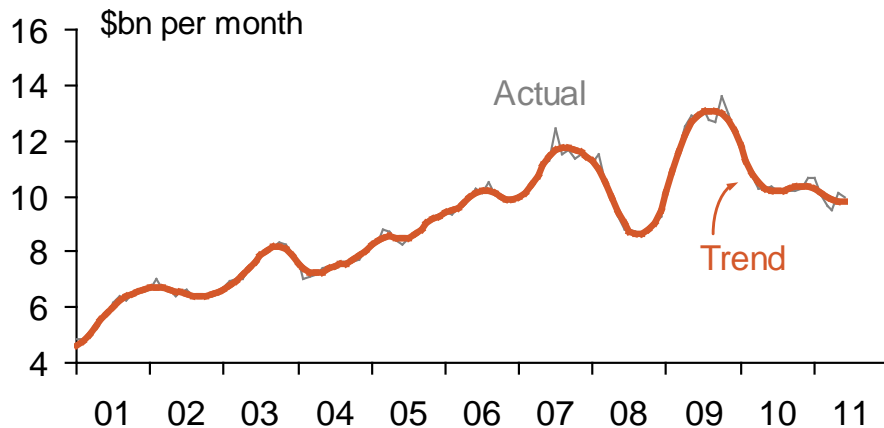


## Household net interest payments

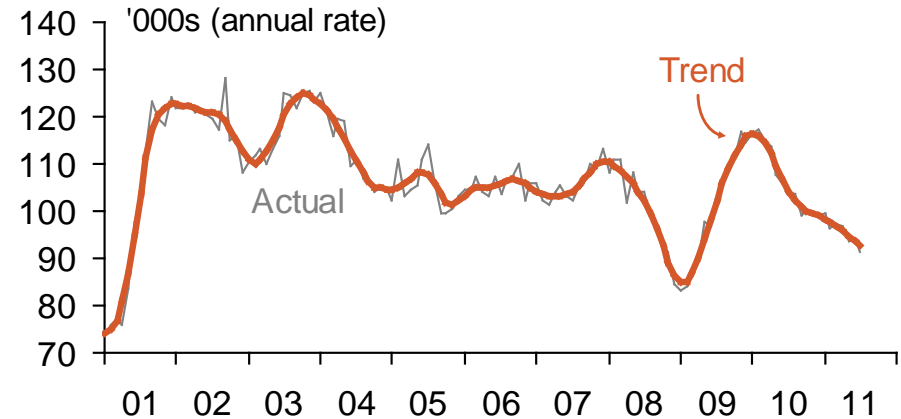


# Housing activity has turned down following the unwinding of boosts to first-home buyer grants and increases in interest rates

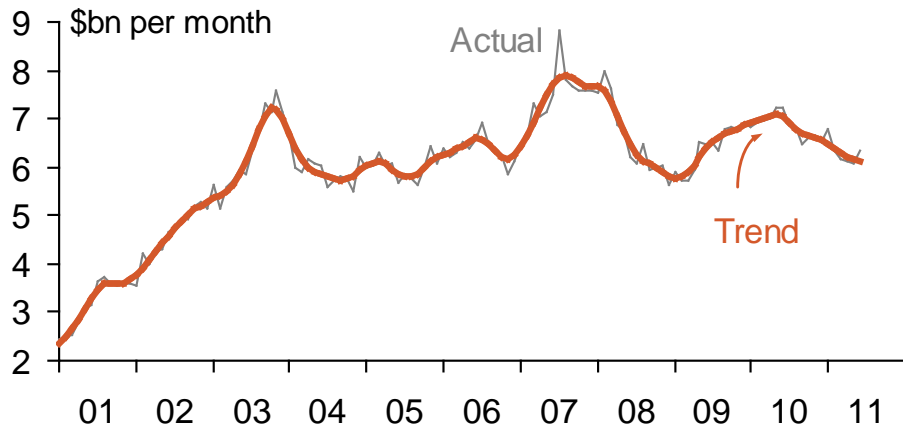
## Housing finance commitments – home-buyers



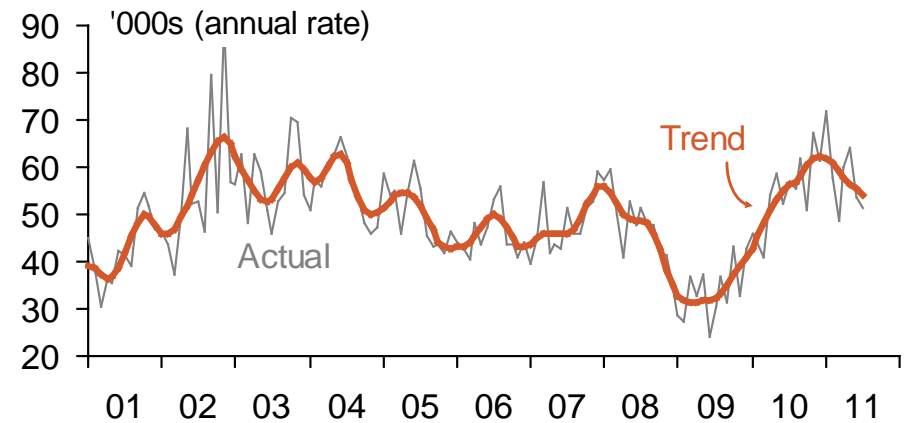
## Residential building approvals - houses



## Housing finance commitments - investors



## Residential building approvals – units etc.

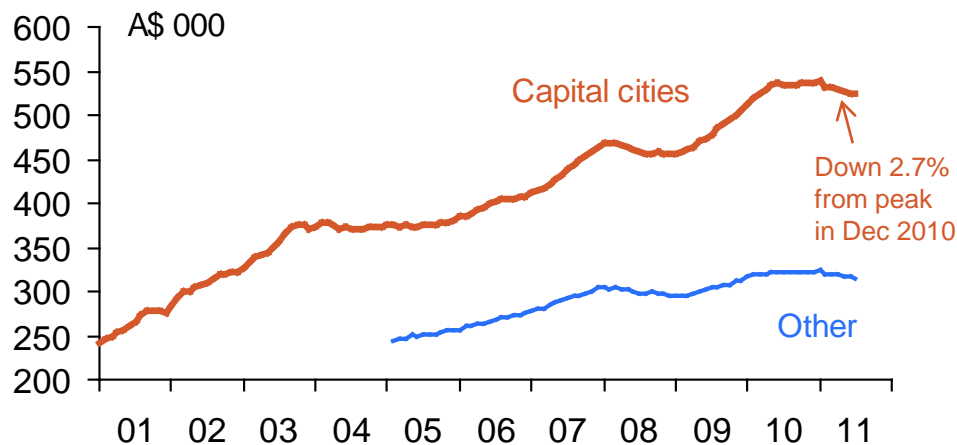


Note: housing finance commitments for owner-occupiers excludes refinancing and alterations & additions.

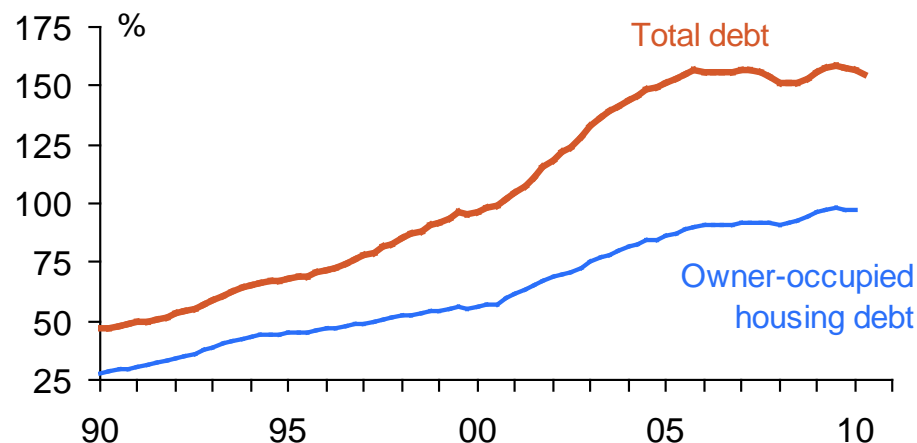
Source: ABS; RP Data – Rismark International.

# Residential property prices have stopped rising, and in most cities have fallen gently – but a US-style housing price crash still looks improbable

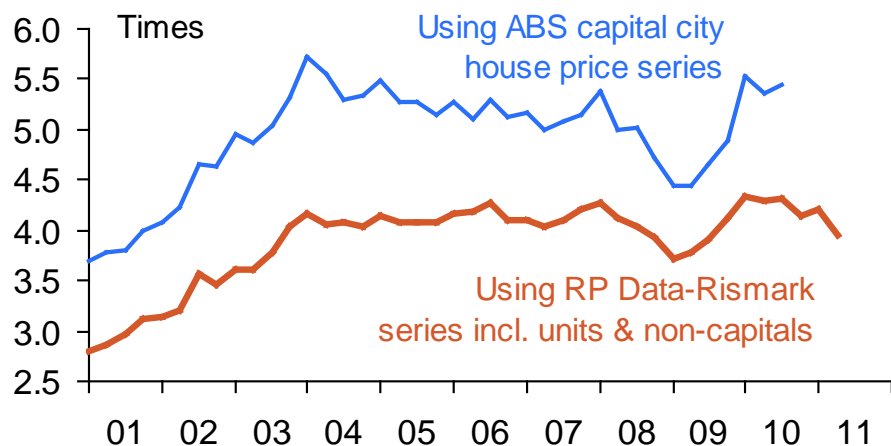
## Australian house prices



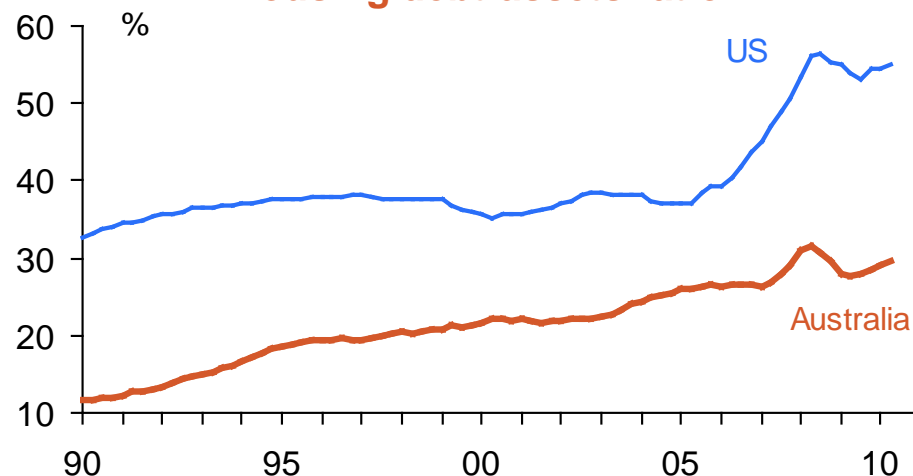
## Australian household debt-income ratio



## Australian house-price-to-income ratio

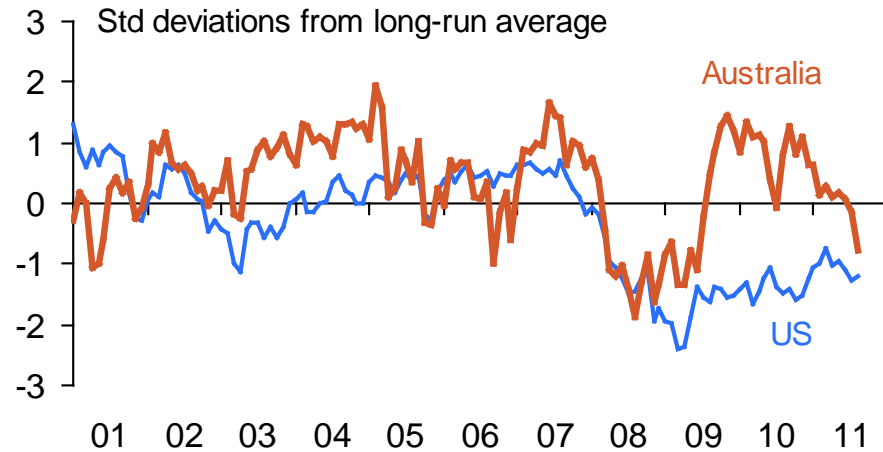


## Housing debt-assets ratio

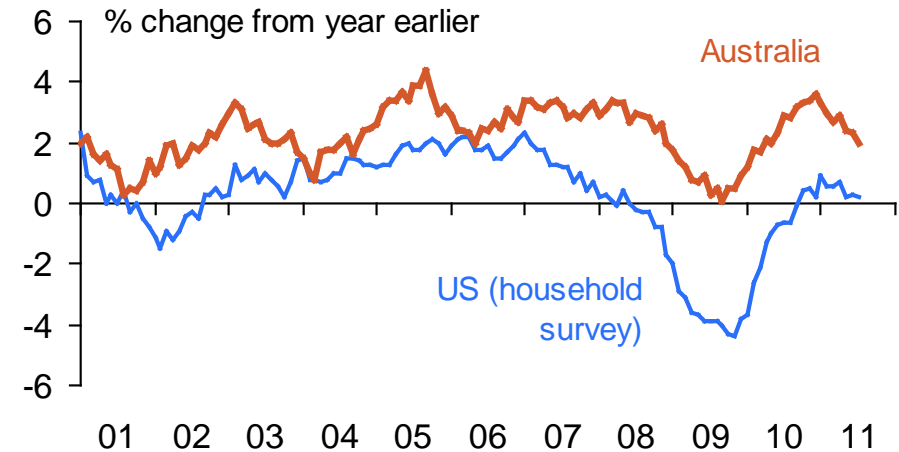


# 'Cautious' Australian households are saving more assiduously than their American counterparts – despite much better 'fundamentals'

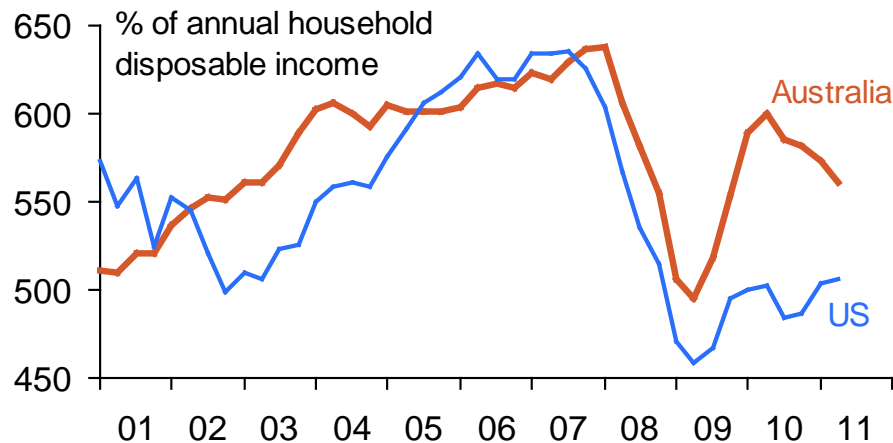
## Consumer confidence



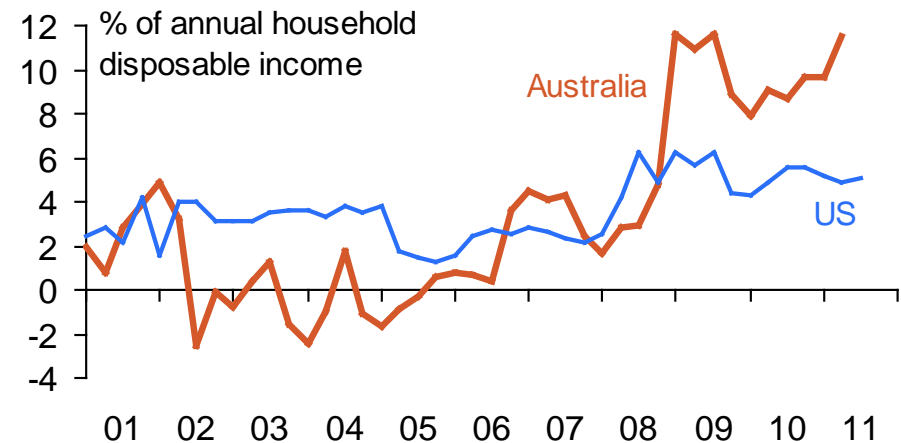
## Employment growth



## Household net worth

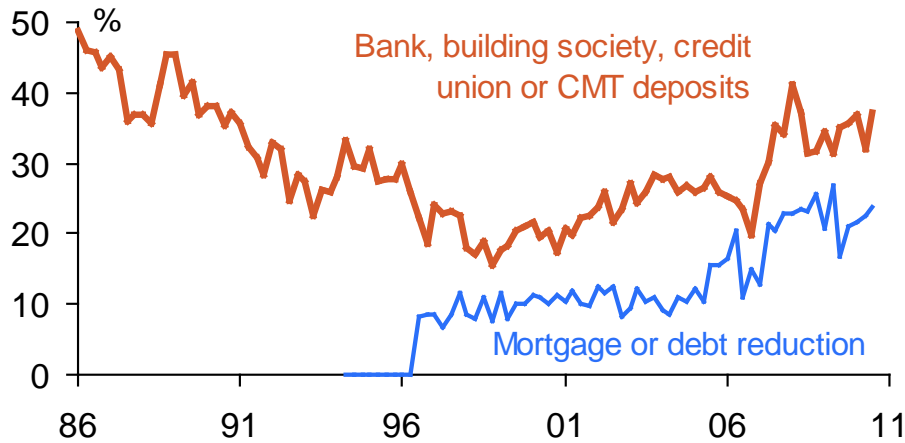


## Household saving rates



# Even though consumers think it's a good time to be buying major household items, they aren't doing it – they're saving instead

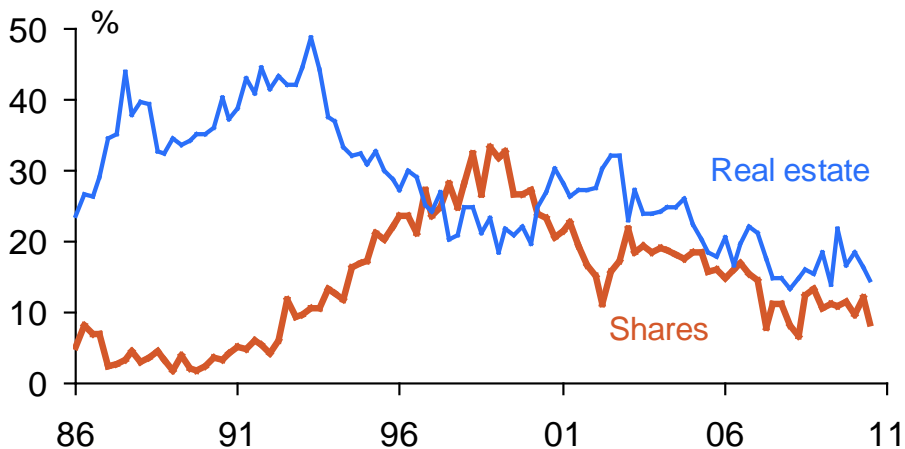
### Consumer opinion on 'wisest place for saving'



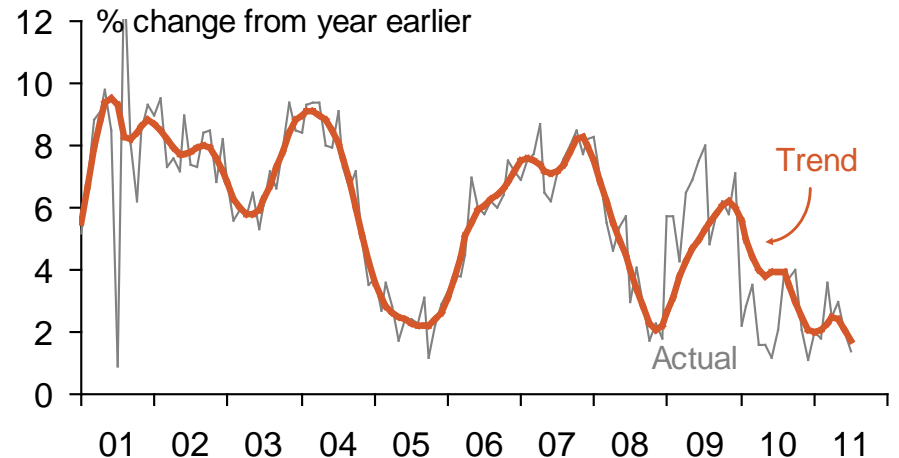
### Consumer sentiment on buying conditions



### Consumer opinion on 'wisest place for saving'



### Retail turnover

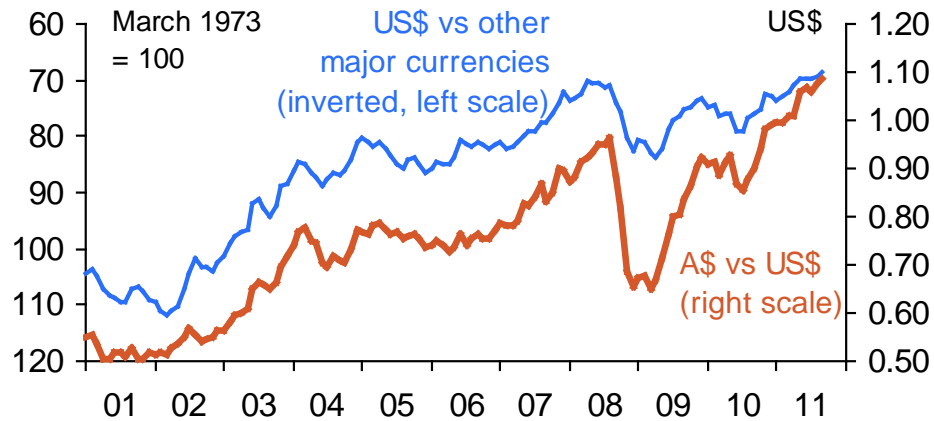


Sources: Westpac-Melbourne Institute consumer sentiment survey; ABS.

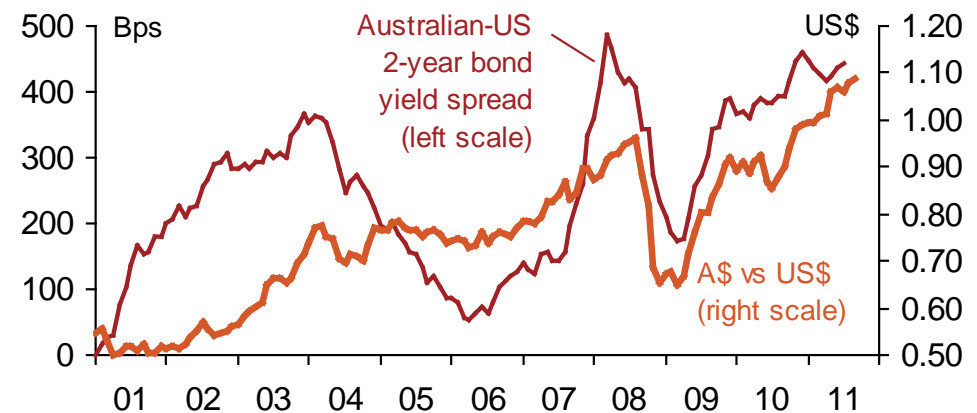
# A weak US\$, high commodity prices, relatively high interest rates and an appetite for currency risk are keeping the A\$ above parity with the US\$

## Key influences on A\$-US\$ exchange rate

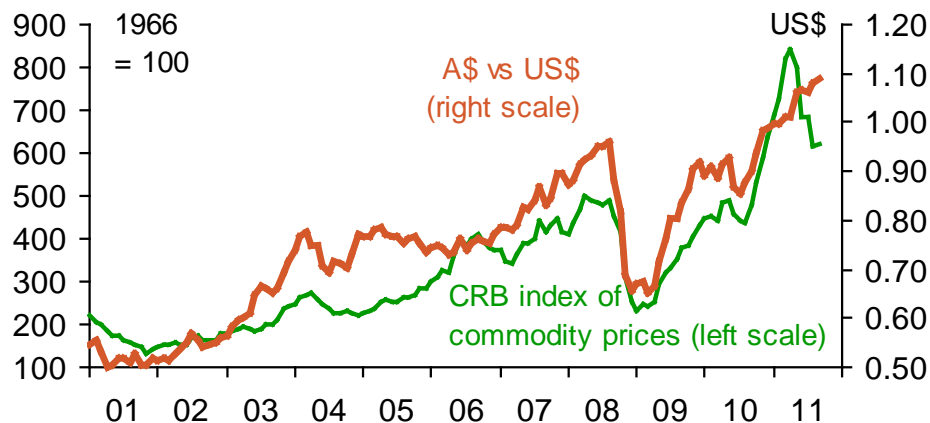
### Value of US dollar



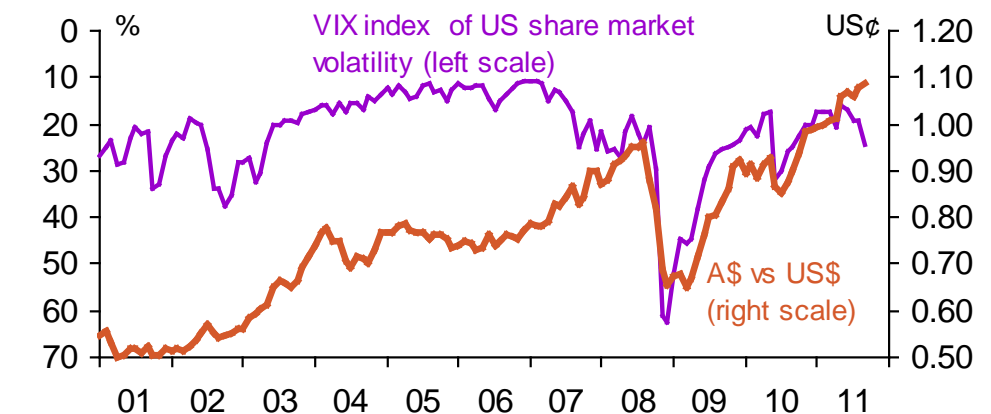
### Interest rate spreads



### Commodity prices

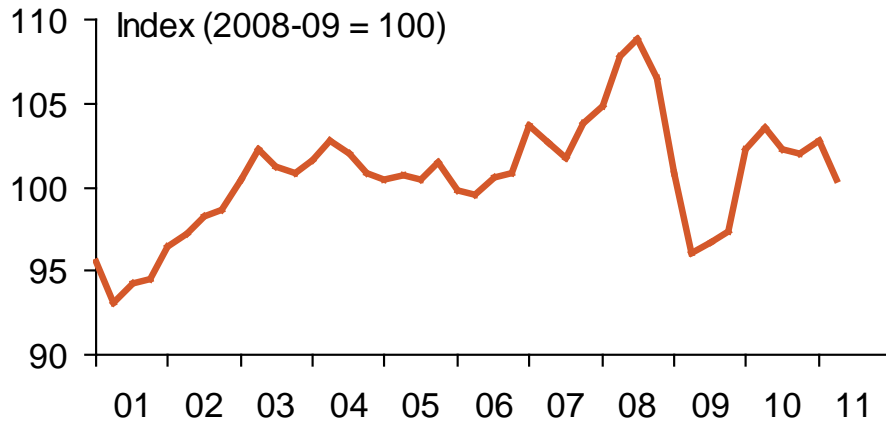


### Share market volatility

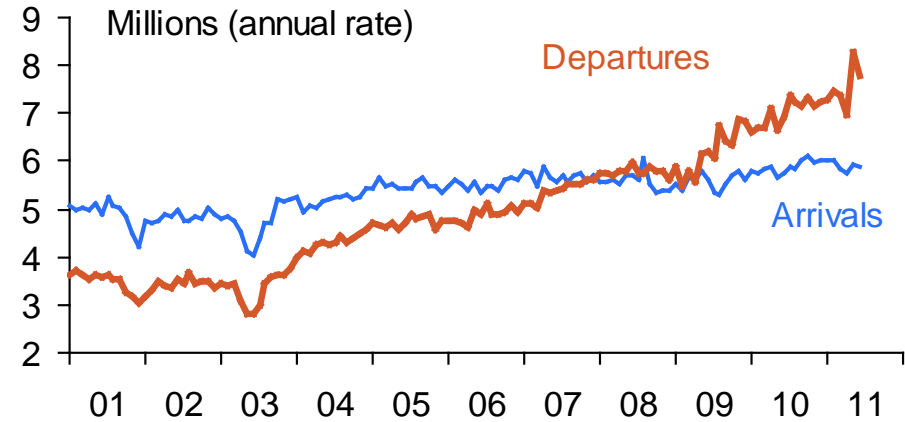


# The strong A\$ is having an adverse impact on 'trade-exposed' non-resource sectors such as manufacturing, tourism and education

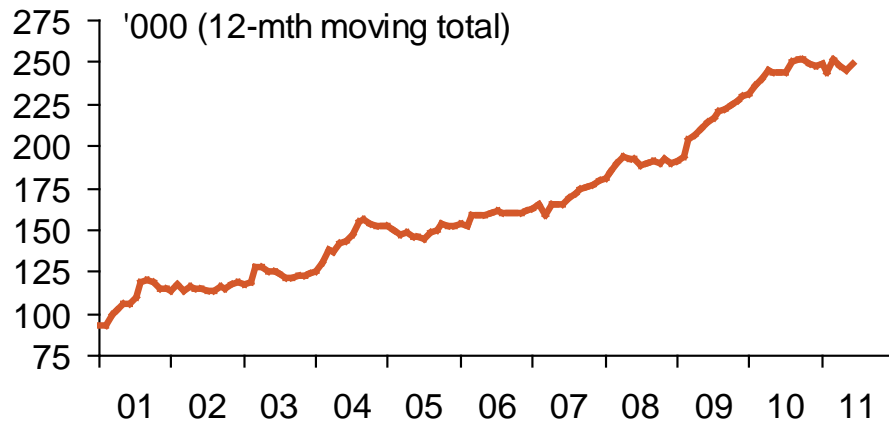
## Manufacturing production



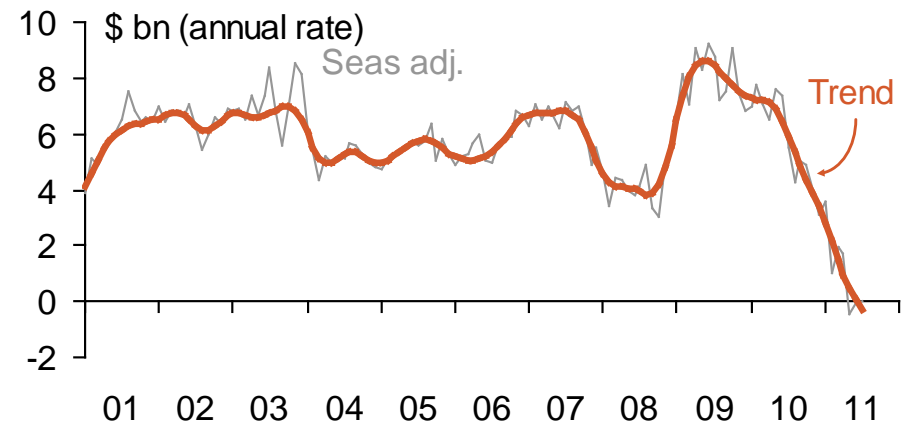
## Short term arrivals and departures



## Net foreign student arrivals



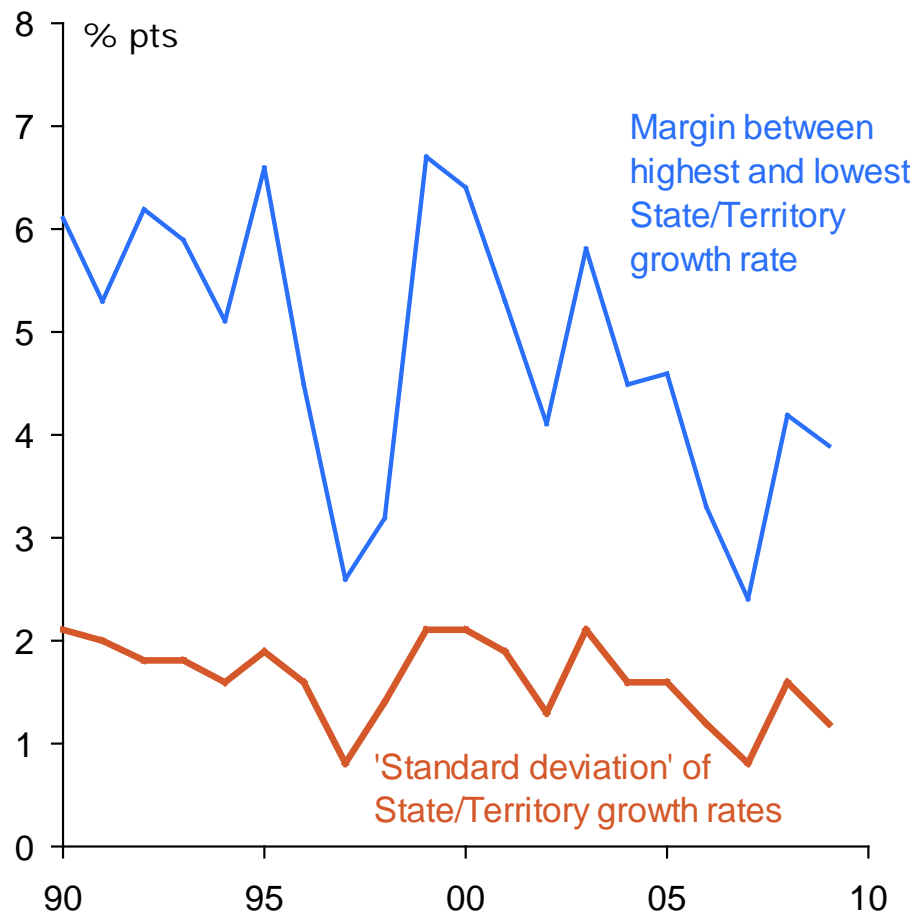
## Balance on tourism-related services trade



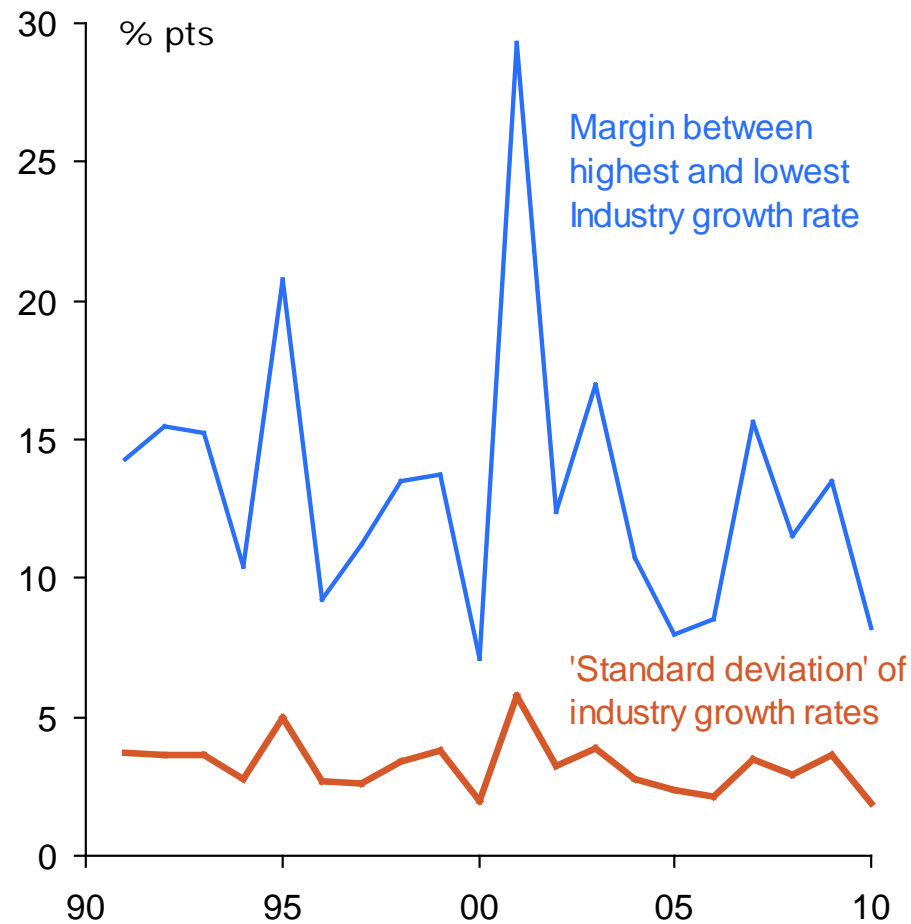


# The 'multi-speed' pattern of economic growth across Australia – by geography and by industry – will persist – but it's hardly anything new

## Dispersion of State and Territory real growth rates

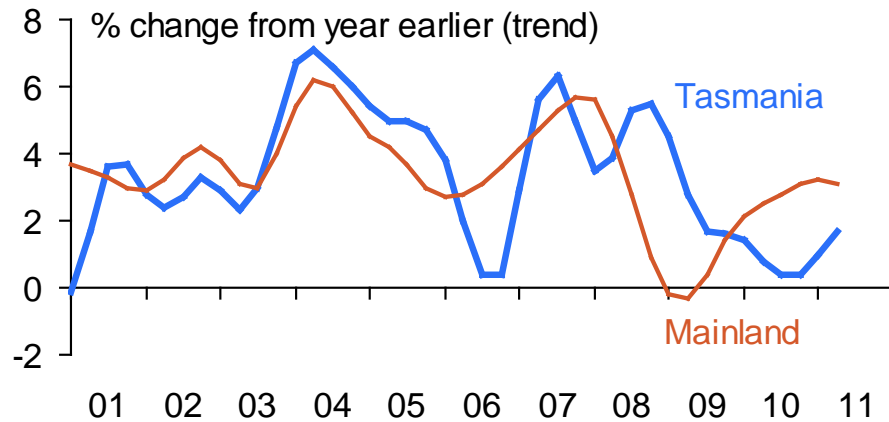


## Dispersion of industry real growth rates

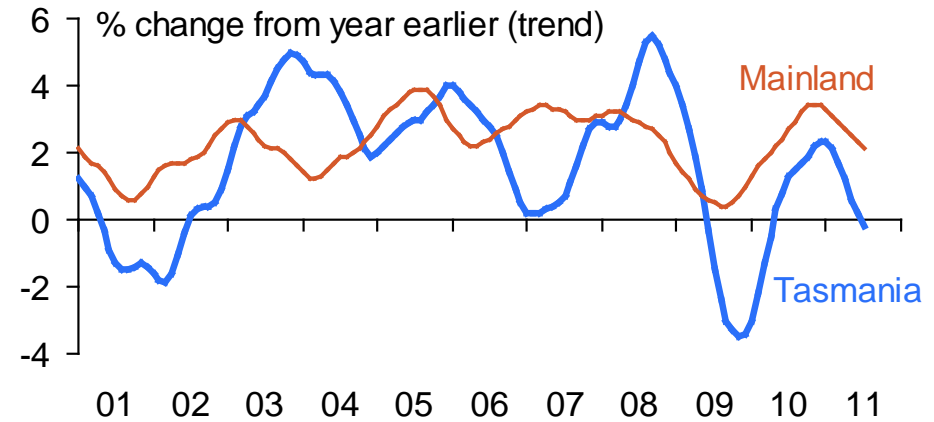


# Tasmania's recovery from the global financial crisis has been weaker than the mainland's, especially as the effects of fiscal stimulus have worn off

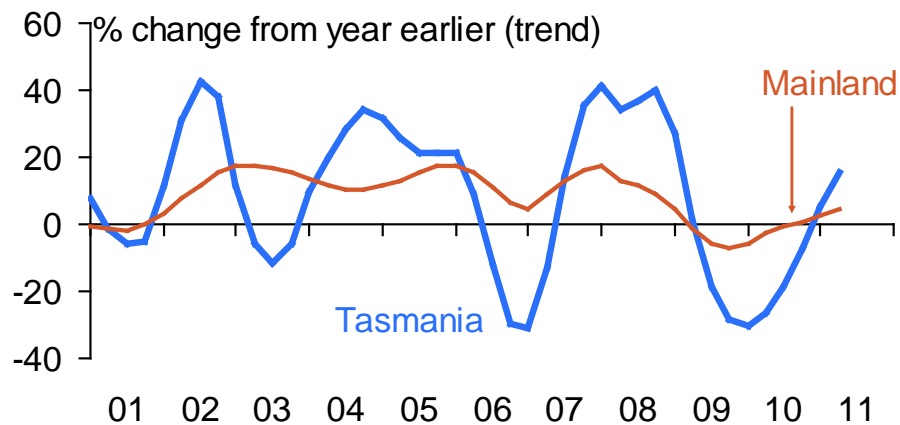
## Consumer spending



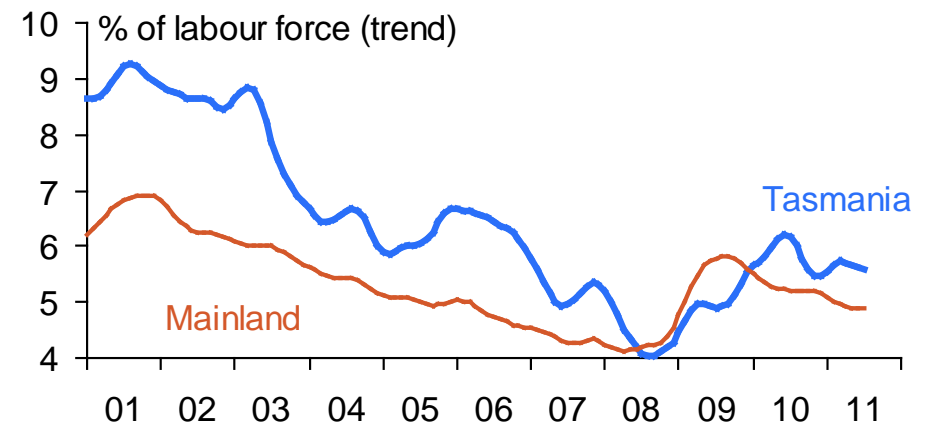
## Employment



## Business investment



## Unemployment rate



# Tasmania's economy is likely to remain in the 'slow lane' of Australia's multi-speed economy

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- **Tasmania has a very small mining sector**
  - mining accounts for 2.2% of Tasmania's economy compared with 10.1% of Australia's
- **Tasmania has an above-average share of many activities which are disadvantaged by some of the side-effects of the resources boom, especially the strong A\$**
  - agriculture, forestry and fishing is 7.3% of Tasmania's economy cf. 2.3% of Australia's (and grains & meat are 'under-represented' in Tasmania's primary industry sector)
  - manufacturing is 12.5% of Tasmania's economy cf. 9.3% of Australia's
  - accommodation & food services is 2.5% of Tasmania's economy cf. 2.2% of Australia's
  - retailing is 5.5% of Tasmania's economy cf. 4.6% of Australia's
  - in total, these 'vulnerable' sectors account for 9.5 percentage points more of Tasmania's economy than they do of the national economy
- **Tasmania's per capita gross State product is \$12,000 or 21% below the national average**
  - although this isn't immediately obvious to Tasmanian households, whose household disposable income is on average only \$1,650 or 4.4% below the mainland average
  - that's because Tasmanians pay \$1,800 (or 30%) less per head in income tax than mainland Australians, on average
  - and receive \$1,200 (or 27%) more per head in social security pensions and benefits than mainland Australians, on average

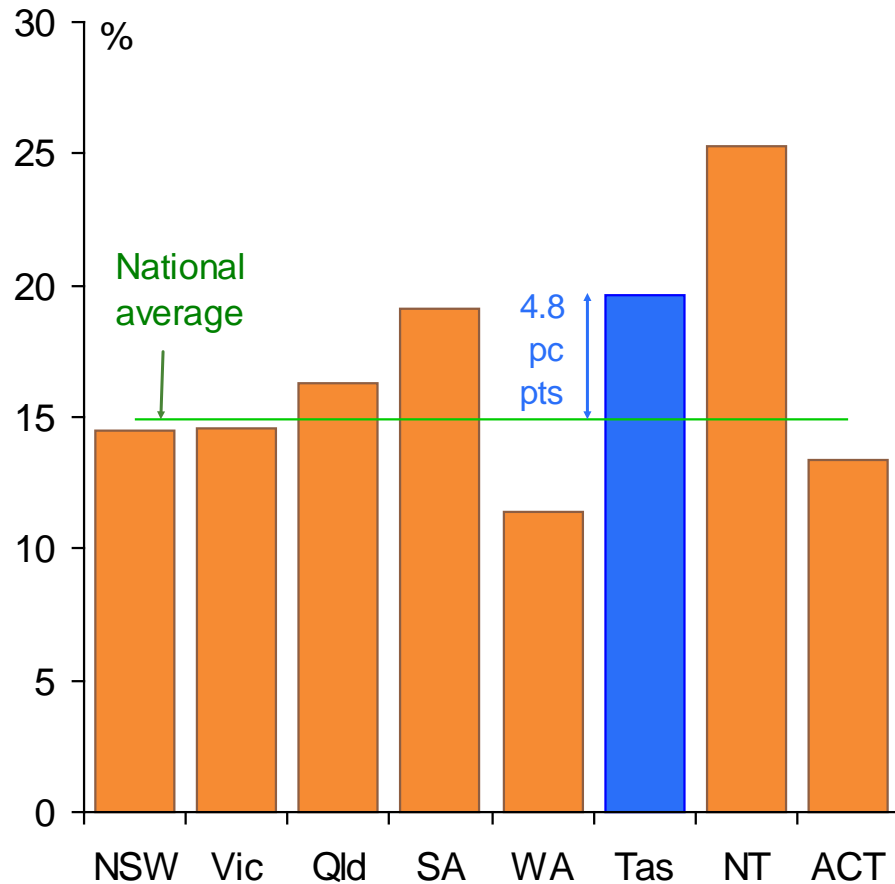
# Why is Tasmania's per capita gross State product \$12,000 or 21% below the national average?

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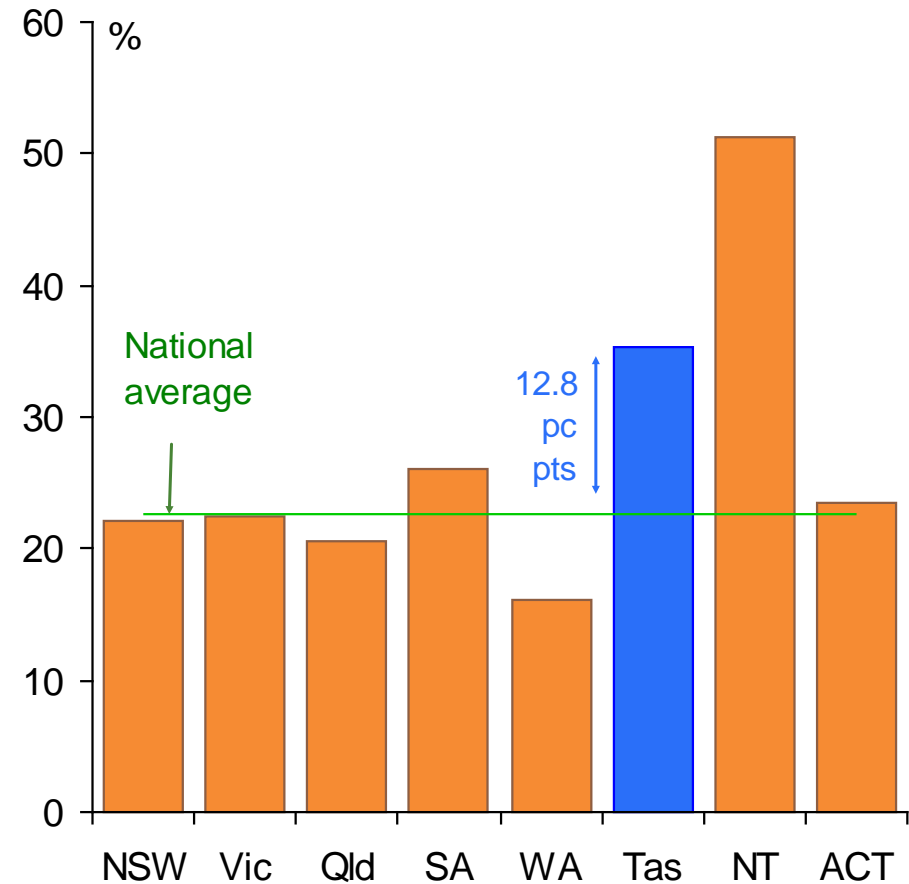
- **\$4,000 (or 33%) of this difference is due to below-average *labour force participation***
  - only 46.4% of working-age (15+) Tasmanians have a job, as against 51% of mainland Australians
  - about half of this difference is due to Tasmania's older-than-average population
  - the other half is due to factors such as an above-average incidence of work-restricting disabilities and below-average levels of educational attainment
  - there are things that can be done about that
- **\$4,500 (or 37%) of this difference is due to lower-than-average *hours worked***
  - Tasmanians with jobs work 1.8 hours per week less, on average, than mainland Australians
- **\$3,300 (or 27%) of this difference is due to below-average *labour productivity***
  - Tasmanians produce \$6.50 (or 9.5%) less by value of goods and services for each hour worked than mainland Australians
  - that's partly because a substantially below-average proportion of Tasmanians work in intrinsically high labour productivity sectors (such as mining and financial services) – and there's not much that can be done about that
  - but it's also because in many industries – including mining, construction, retailing, information & telecommunications services, rental hiring & real estate, professional & technical services, and public administration & safety – the productivity of Tasmanian workers is significantly below that of the same industries on the mainland
  - and there are things that can be done about that

# Tasmania spends proportionately more than other States on service delivery, and is more dependent on the GST than other States

**'General government' 'operating expenses' as a pc of gross State product, 2009-10**



**GST revenues as a share of total 'general government' revenues, 2009-10**

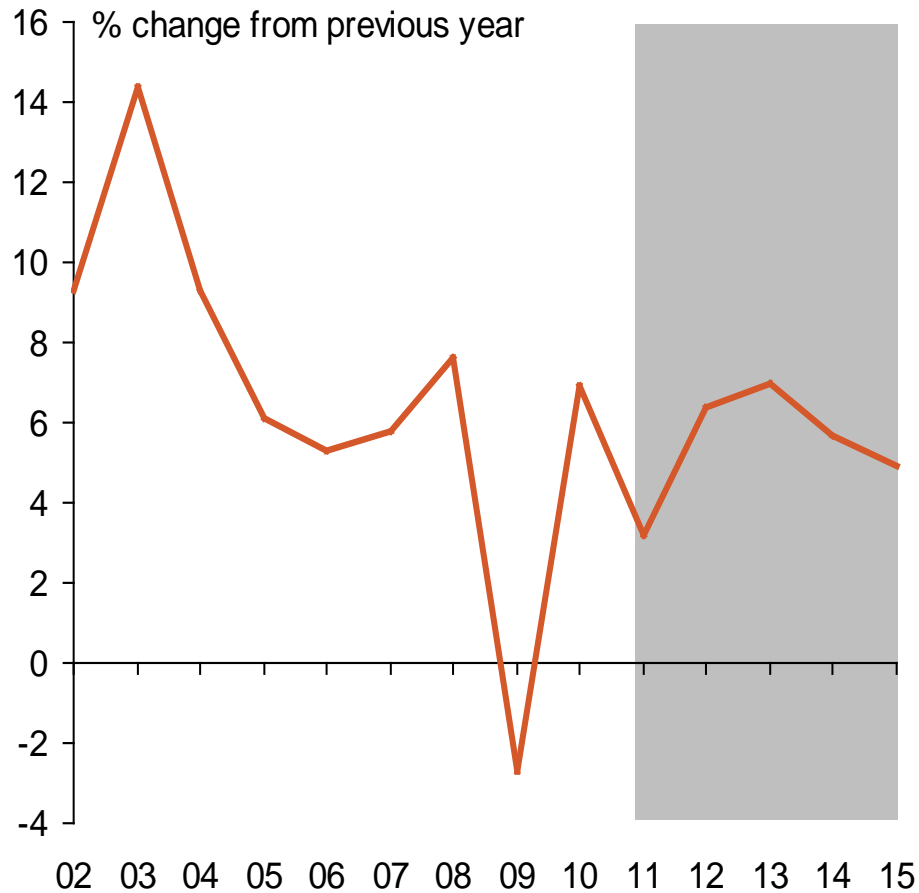


Note: 'general government' means excluding government business enterprises. 'Operating expenses' means excluding capital expenditures.

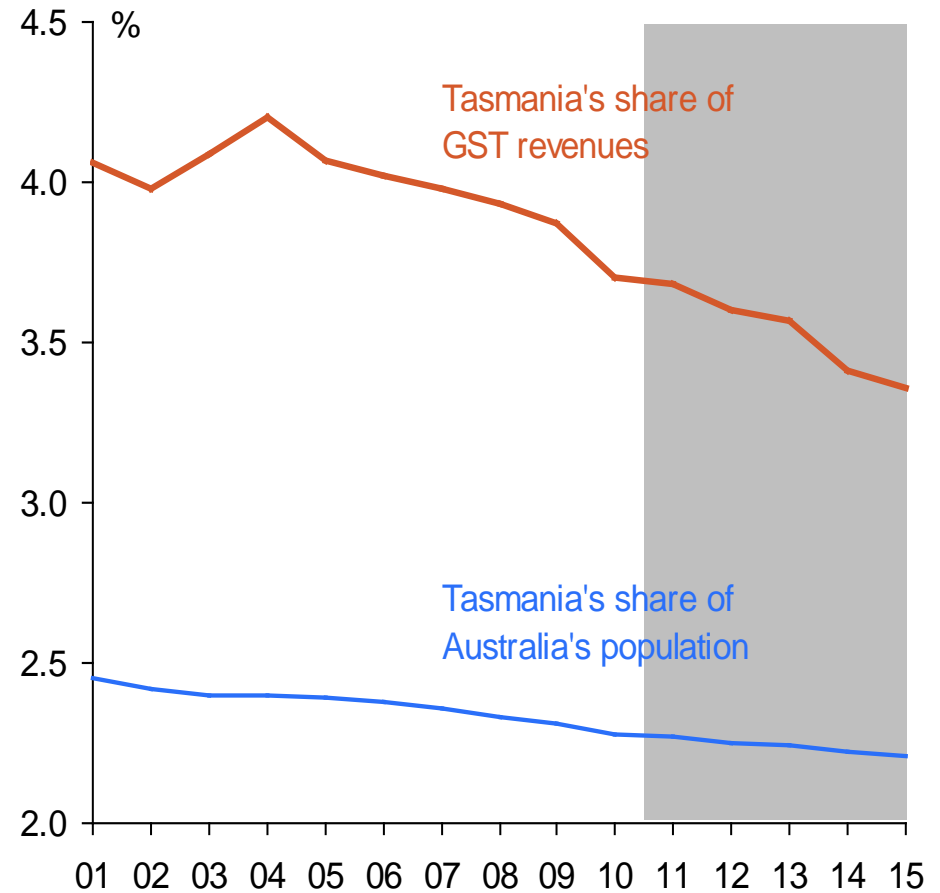
Source: ABS; Commonwealth Budget Papers.

# Growth in GST revenues is slowing (as Australians save more), and Tasmania's share of those revenues is shrinking

## GST revenues

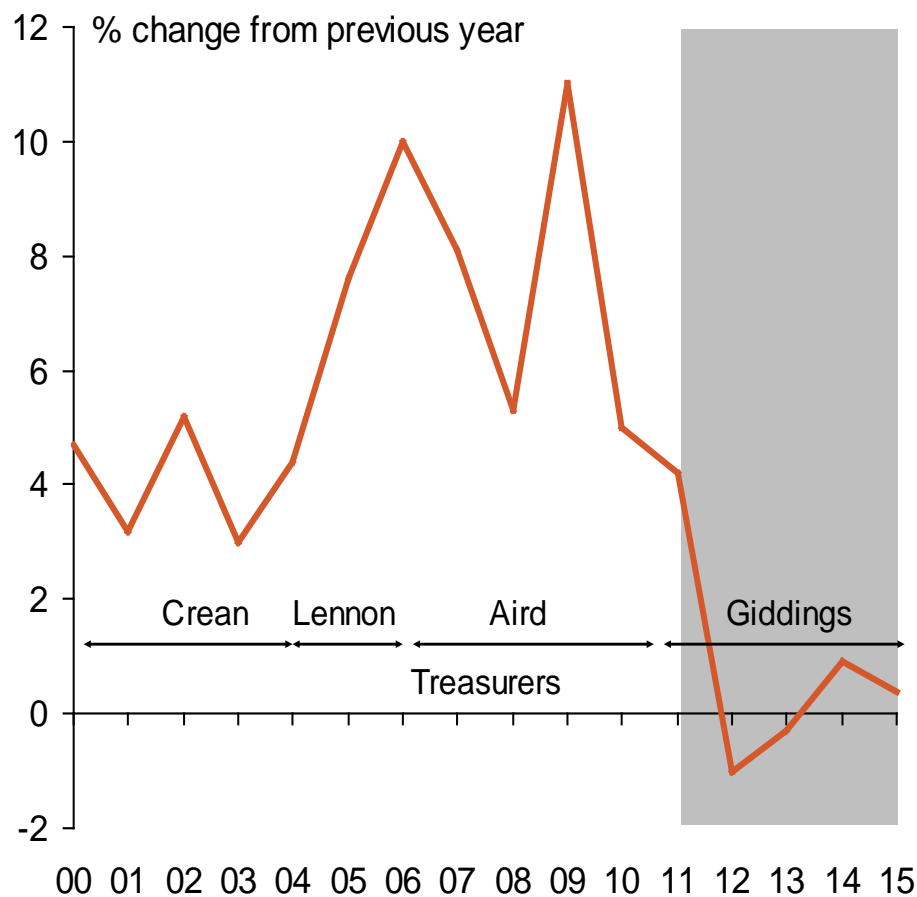


## Tasmania's share of GST revenues and Australia's population

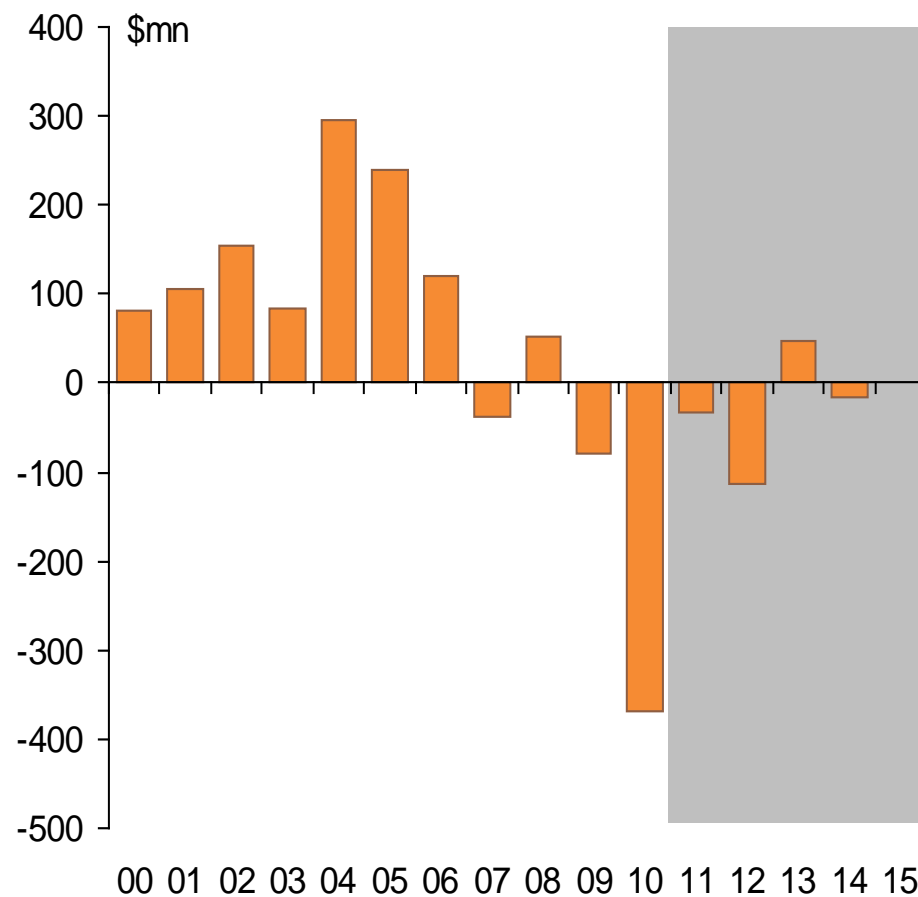


# Discipline over government spending has eroded since David Crean retired as Treasurer, resulting in the budget slipping back into deficit

## General government 'operating expenses'



## General government 'operating balance'

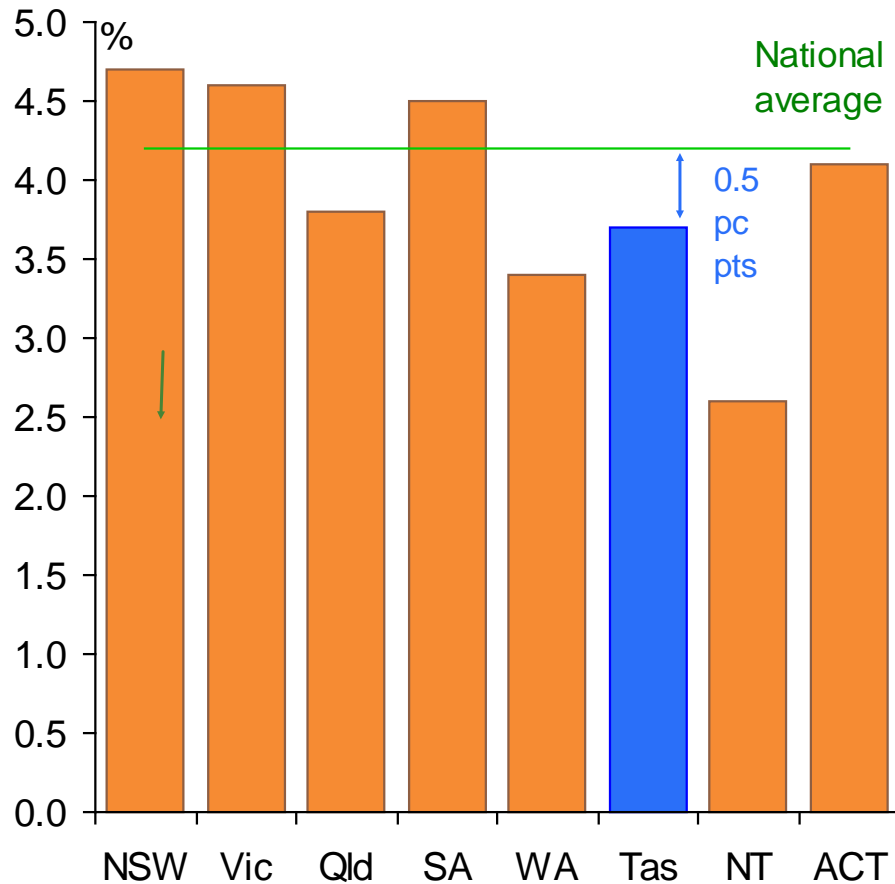


Note: 'General government' excludes GBEs. 'Operating balance' is the difference between revenues and 'operating expenses'

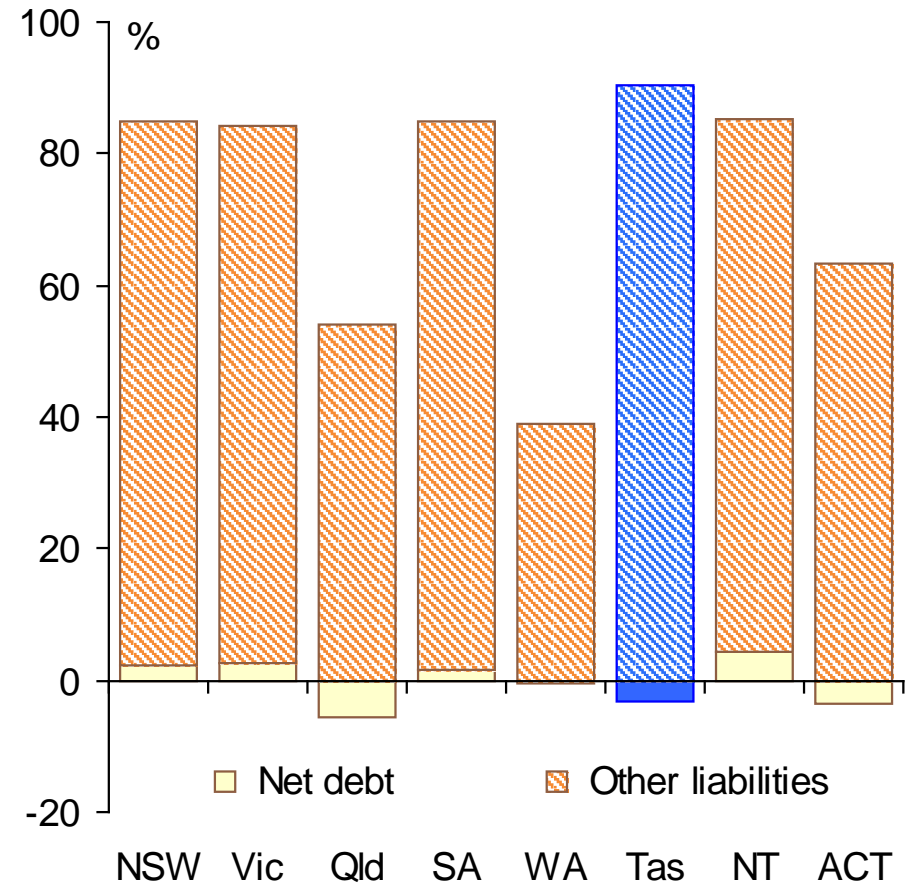
Source: Tasmanian State Budget Papers.

# If Tasmanians don't want to pay more in State taxes, or to start borrowing to pay for services ...

**State taxes**  
as a pc of gross State product, 2009-10



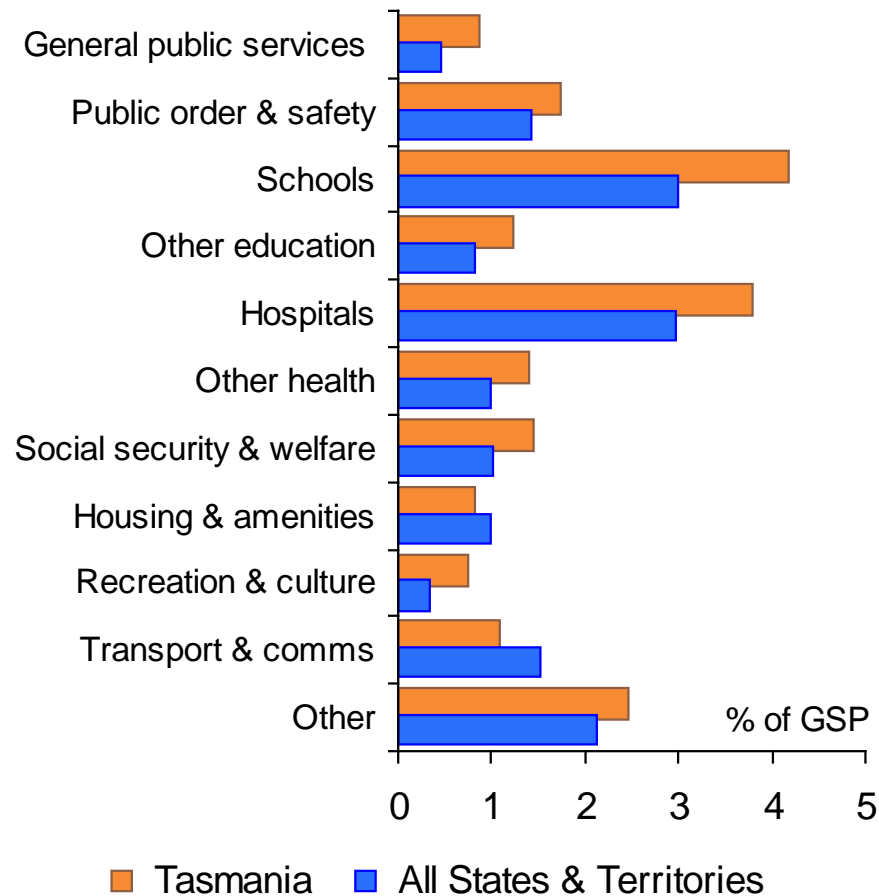
**'General government' liabilities**  
as a pc of gross State product, 2009-10



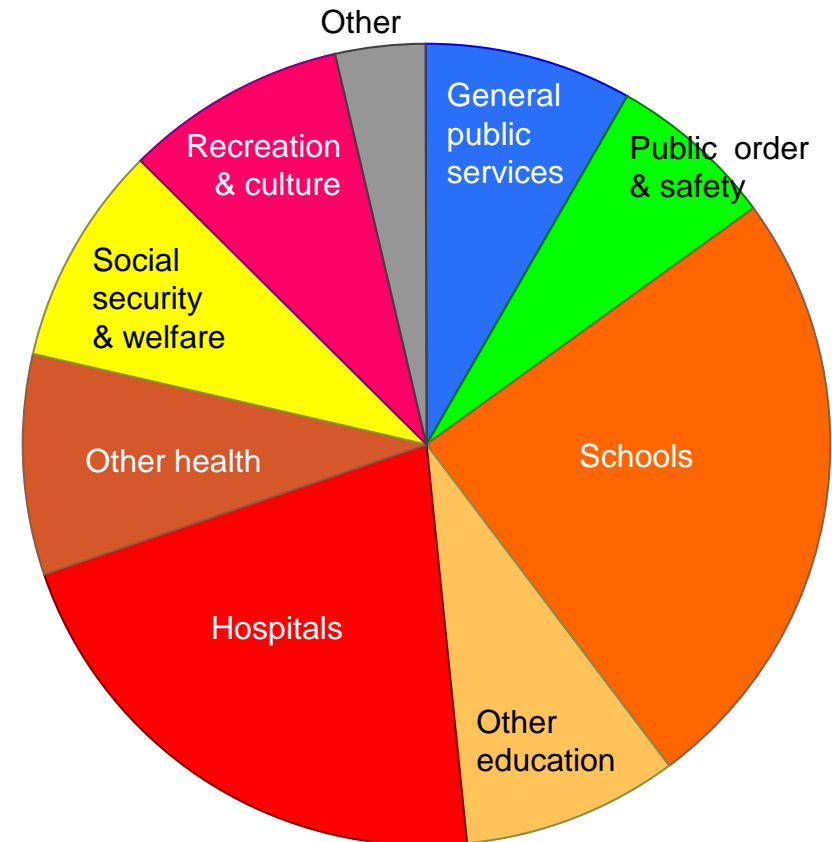


# ... then reductions in recurrent spending are necessary and inevitable

## 'General government' operating expenses as a p.c. of GSP, 2009-10



## Share of amount by which Tasmanian operating expenses exceed national average

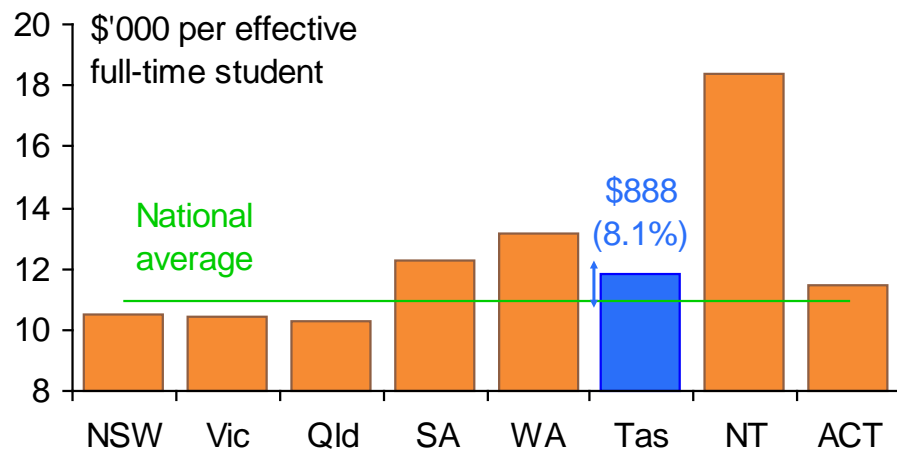


Note: 'Other' includes fuel & energy; mining, manufacturing & construction; other economic affairs; superannuation expenses; and interest. Housing & community amenities, and transport & communications are also included in 'other' in the pie chart (because they are negative there). Source: ABS.

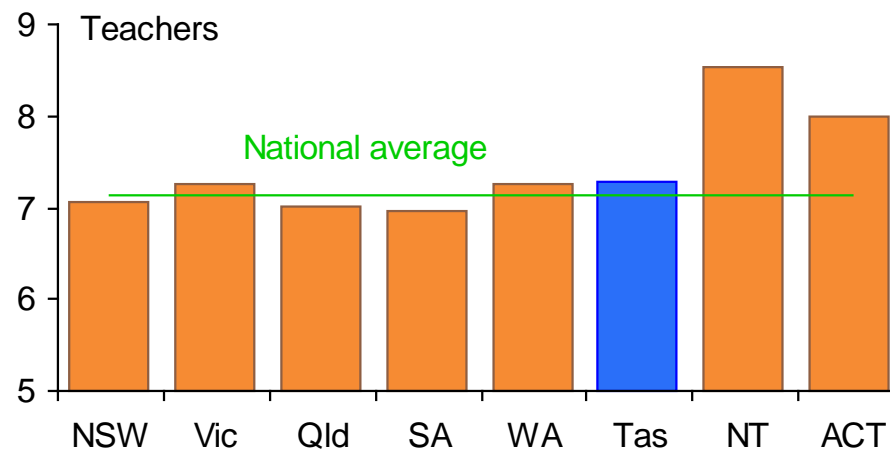
# Tasmania spends 8% more per effective full-time student than the national average – largely because its schools are typically smaller ...

## School education 'inputs' by State and Territory, 2009-10

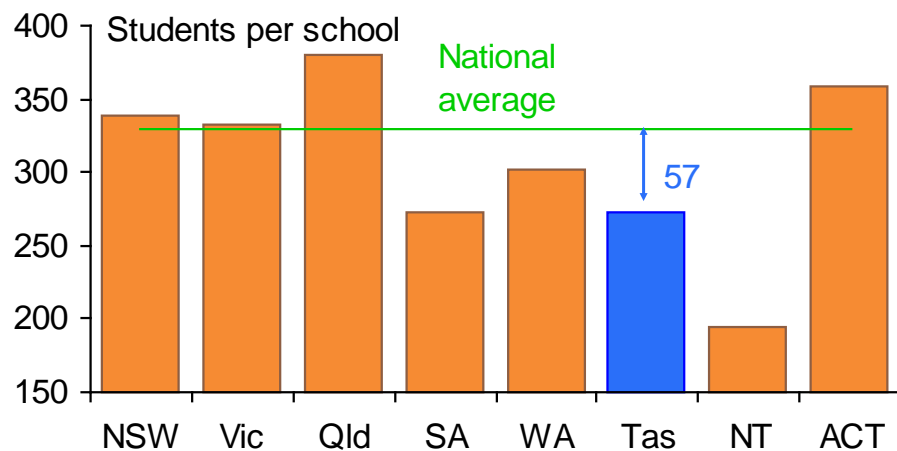
### Spending per full-time student



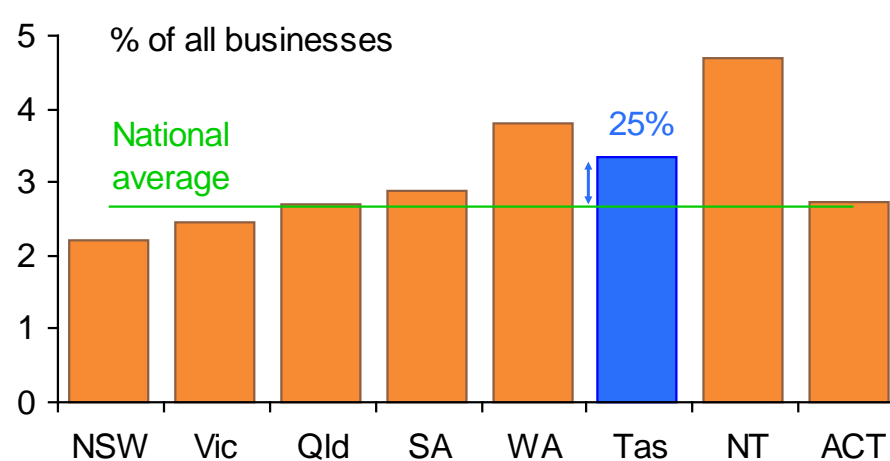
### Teachers per 100 students



### Average school size



### Non-teaching staff per 100 students

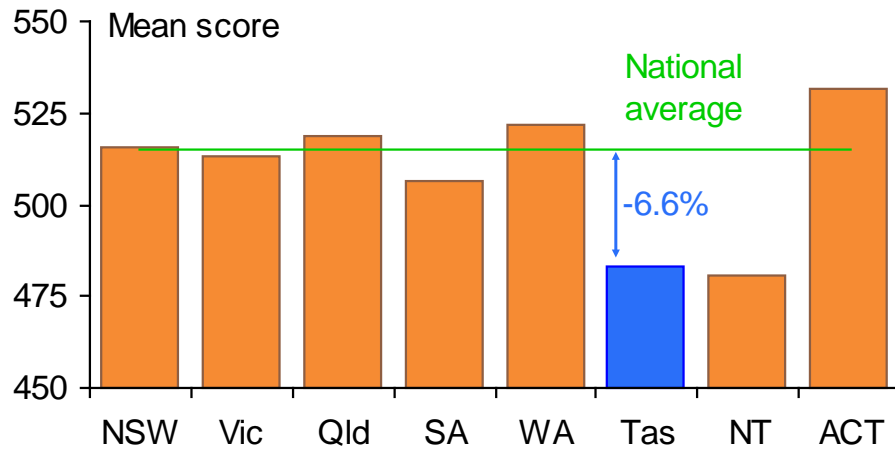


Note: Except for total spending, figures in these charts are for government schools. Source: ABS.

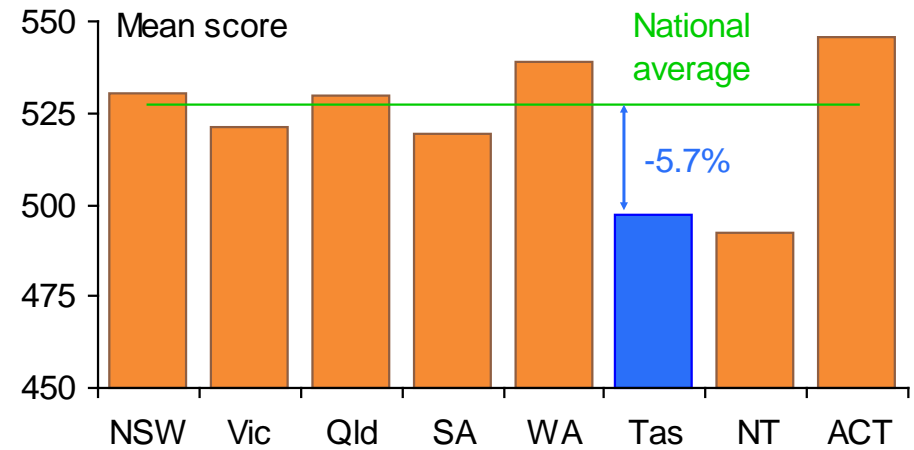
## ... yet for this above-average spending, Tasmania gets below-average results in terms of student outcomes

### OECD Program for International Student Assessment (PISA) scores - 2009

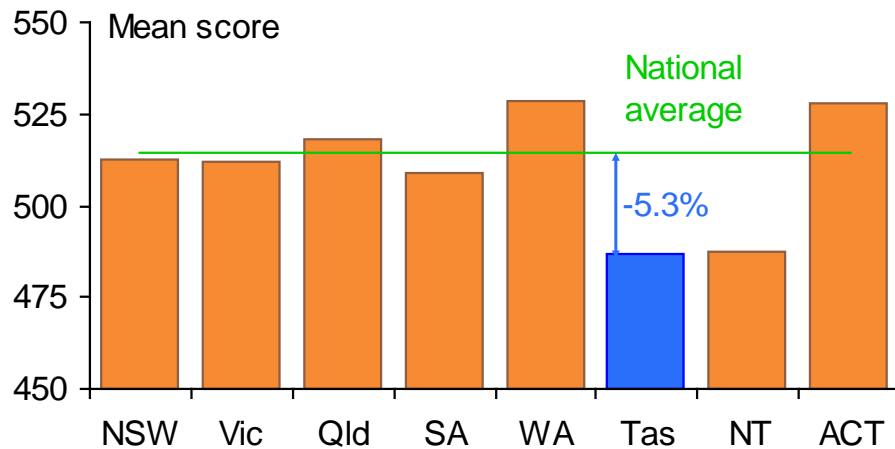
#### Reading literacy



#### Scientific literacy



#### Mathematical literacy



Note: PISA tests are administered to 15-year old students in 65 countries. Source: Australian Council for Educational Research.

- 
- **Financial markets are again in turmoil**
    - reflecting fears that the US and Europe could again be slipping into recession
    - and the reality that if they do, governments and central banks have very few options for cushioning any downturn or promoting recovery
  - **However there's no convincing reason to think that Asia will slip into recession**
    - China's economy is slowing a bit, not a lot
    - Asian demand for Australian commodities is primarily driven by domestic spending, not by Asian exports to the US or Europe
  - **'Mining boom Mark II' is likely to continue**
    - and one of the key challenges facing Australia is how to avoid 'stuffing it up', as we have done with every commodities boom we've had in the last 70 years
  - **Australia is in some ways more vulnerable to an external shock than 4 years ago**
    - in particular, because of slower growth in household spending
    - but Australia remains well-placed to counter any externally-driven downturn
  - **Tasmania is at the wrong end of Australia's 'multi-speed economy' ...**
  - **... and we have our own distinctive set of structural problems**
    - below-average participation in employment and productivity
    - exposure to slowing GST revenues – and reductions in Tasmania's share of them
    - above-average spending on government service delivery – by more than can be explained by Tasmania's small and dispersed population