



Australia rising to the challenge of difficult economic times

November 2008

HIA Economics Group
79 Constitution Ave
CAMPBELL ACT 2612

Ph: 02 6245 1393
Fax: 02 6245 1444
Email: economics@hia.com.au
Web: <http://economics.hia.com.au>

Key Points:

- Australia is better placed than most advanced economies to weather what is a ferocious global financial storm.
- We examine here a number of positive factors for Australia, while recognising that even with our nation well-placed, if we avoid recession it will have been a very close call.

The unraveling of the global financial system since early September is an event of immense proportion. It is bad for our businesses because it shakes consumer confidence - every second headline households read or hear seems to contain the word 'crisis'. All is not lost, however, and Australia possesses a number of factors in its favour.

Let's look at some positives:-

- Australia entered this difficult time as one of the strongest economies in the Western world.
- Australia's four major banks are in the top tier of global rankings and are in extremely healthy shape by international standards.
- Australia is one of only two countries to respond quickly and decisively to global developments (the other country being the United Kingdom). It might not have been perfect, but action was important and it happened.
- Australia can take interest rates much lower than they currently are, something many other countries, especially the United States, aren't in a position to do.
- The Federal Government had the money to announce a \$10.4 billion fiscal (spending) package on October 14. It won't and can't make everything rosy again, but it will put a floor under consumer and business confidence leading into Christmas.
- The government's package includes a tripling of the First Home Owners Grant (FHOG) to \$21,000 for new dwellings, potentially a big boost to the new home building industry.

Australia is a small, open economy that has proved very resilient to a number of shocks over the last decade, the largest two being the Asian financial crisis

(there's that word again) in the late 1990's and the 'tech wreck' of the early 2000's. The magnitude of the current situation will prove to be a far more testing time.

While HIA's assertion, made many months ago now, that interest rates were raised too high has been proven correct, the current fragile state of economic conditions is largely not of our own doing. A highly inept set of responses to the sub prime mortgage debacle (which originated by lending money to lots of people who weren't fit to borrow) by the Bush Administration, an ill-conceived bail out plan by U.S. Treasury Secretary Henry Paulson, a botched response to bank failure in Ireland, and a slow and uncoordinated response to a growing banking problem in Europe, have combined to bear principal responsibility.

When it comes to combating the global financial situation Australia has adopted a three pronged attack. All three prongs have direct implications for businesses in the residential sector and for Australian households.

Firstly, interest rates are coming down. The Reserve Bank of Australia (RBA) lowered interest rates by 2 percentage points over September – November (from 7.25 per cent to 5.25 per cent) and there are more cuts to come. This is a big plus that Australia possesses – the ability to keep cutting interest rates.

Secondly, the Federal Government has announced a 'financial security' package in the form of \$10.4 billion worth of government spending. The policy is a well designed, short term package to help ease the pain that Australian households and businesses are feeling from the global turmoil.

For the residential sector the most important government spending initiative is the tripling of the FHOG for the purchase of new dwellings. This \$1.5 billion initiative (which requires the signing of a contract by June 30, 2009) will firstly boost confidence and secondly lift new home building activity. HIA estimates the policy could generate as many as 15,000 additional new dwellings.

There is also \$4.8 billion for 4 million pensioners, retirees, and carers, \$3.9 billion for 2 million families, \$187 million for 56,000 additional training places, and an accelerated implementation of infrastructure spending (roads, railways, ports, etc).

Lower interest rates and increased government spending will, in the first instance, put a floor under home building activity, house prices, and spending on renovations. Then, as we move through 2009 these policies will also mean a greater number of new housing starts and renovation jobs.

The third prong in the attack is the Federal Government guaranteeing both bank deposits for three years and wholesale deposits of Australian financial institutions (for a fee). The bottom line of this policy is that when global financial markets settle down, there should be more credit available to Australian businesses and consumers than in many other parts of the world. There should be less 'credit rationing' in other words, which will allow the home building sector to achieve a bigger kick from lower interest rates and government spending.

So, we have bank guarantees, falling interest rates, and increased government spending in an economy that is stronger than the United States, Canada, the United Kingdom, Europe, Japan, or New Zealand. The fact that we are in this enviable situation and will still count ourselves lucky to avoid recession is testament to the gravity of the global situation. It is going to be a rocky road for some time to come.