



**Macroeconomic Policy
in 2009**

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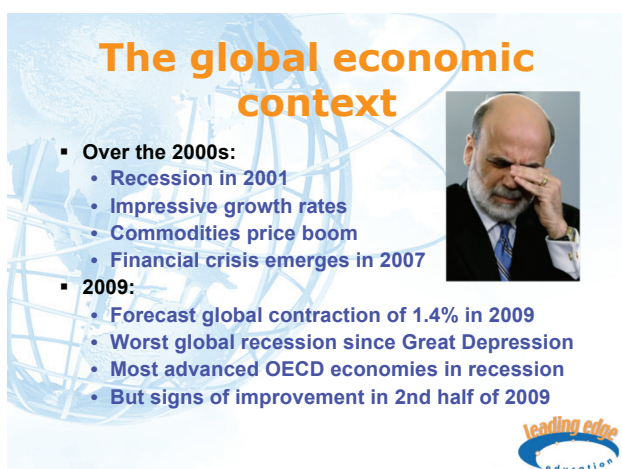




**Economic Policy in
Context**



- Economic context – global and domestic
- Fiscal policy in 2009
- Fiscal policy trends and impacts
- Monetary policy in 2009
- The effectiveness of the macroeconomic policy mix





**The global economic
context**

- Over the 2000s:
 - Recession in 2001
 - Impressive growth rates
 - Commodities price boom
 - Financial crisis emerges in 2007
- 2009:
 - Forecast global contraction of 1.4% in 2009
 - Worst global recession since Great Depression
 - Most advanced OECD economies in recession
 - But signs of improvement in 2nd half of 2009



The Australian economic context

- Over the past two decades:
 - 17 years of sustained growth 1991-2008
 - Low sustained inflation
 - Falling unemployment
 - CAD not impacting on the economy
- 2009:
 - Commodities boom over
 - Slowing growth rates - prospect of recession
 - Rising cyclical unemployment
 - Stronger performance relative to OECD
 - Growth to recover in 2010 but will remain slow




The Policy Mix

- Ongoing uncertainty
- Strong recovery in the Chinese economy and signs of domestic recovery
- Resource price fluctuations

What policy response?

- Expansionary Fiscal Policy
- Expansionary Monetary Policy
- Boost consumer and business confidence
- Microeconomic reform on industrial relations and expanding productive capacity



Fiscal Policy in 2009-10

1. **Support economic growth**
 - expansionary policy to boost aggregate demand
2. **Minimise the rise in unemployment**
 - Reduce cyclical unemployment and hysteresis
 - Alleviate structural unemployment
3. **Boost Australia's productive capacity**
 - skills, productivity and participation
4. **Increased spending on priority areas**
 - infrastructure, education, pension support



The Budget outcome

- **Fiscal deficit of \$53.1 billion in 2009-10**
 - 4.5% of GDP
 - Deficits until 2015-16
 - Smaller deficits relative to OECD average
- **Structural and Cyclical components moving together**
 - Cyclical influences – lower taxation and increased welfare
 - Increase in discretionary spending
- **Highly expansionary fiscal stance**
 - Expenses to grow by 2.4% in real terms
 - Fiscal policy playing lead role during downturns



Key revenue and spending measures



- **Falling taxation receipts**
 - terms of trade to fall by 13.25% in 2009
 - \$210 bn reduction in tax revenue by 2012-13
- **Increased welfare spending**
 - Unemployment benefits rising from \$5.2 bn in 2008 to \$10.1 bn in 2010
- **Increased spending in priority areas**
 - \$22 billion 'National Building Plan' for infrastructure
 - Boost to pension entitlements – pensioners have higher MPC
 - Extension of First Home Owners' Boost
 - Paid Parental Leave to boost workforce participation




Short-term impacts of Fiscal Policy

- **Positive stimulus to growth**
 - boost growth by 0.75% in 2009-10 and 0.5% in 2010-11
 - Impact already felt? March quarter 0.4% expansion
 - RBA has revised outlook – Australia may grow by 0.5% in 2009
- **Reduction of cyclical unemployment**
 - Okun's Law: > 3% economic growth per year to reduce cyclical unemployment
 - Support 210,000 jobs and reduce peak unemployment by 1.5%
 - Minimise **hysteresis**



Long-term impacts of Fiscal Policy

- **Boost sustainable economic growth**
 - Workforce incentives
 - Improve **technical efficiency** and **productive capacity**
 - Lower **structural unemployment** – ‘Jobs and Training Compact’
 - Environment spending for ecologically sustainable development
- **External stability**
 - Budget deficits and ‘**crowding out**’ effect?
 - Elimination of Superannuation Co-Contribution may reduce national savings
 - Infrastructure spending to boost export volumes in future




Monetary Policy in 2009

- **Cash rate at 3% since April – lowest in 45 years**
 - Inflationary pressures easing – headline within band
 - Economic growth slowing
 - Unemployment rising
- **Monetary Policy loosened 5 times since September 2008**
 - Reversing contractionary stance from 2002-2008
- **The RBA is now focused on supporting growth and employment**
 - Inflation forecast to moderate to 1.75% in June 2010
 - Support role to fiscal policy in stimulating economy




MONETARY POLICY: Effectiveness

- **Monetary policy has been effective in achieving 2-3% inflation target**
 - Average inflation rate of 2.9% since 1996
- **Households are highly sensitive to interest rate changes**
 - Household debt 155.5% of incomes
 - Interest payments 8.5% of household income
 - Each 0.25% change in rates changes monthly disposable income by \$50
- **But monetary policy has limitations**
 - Impact time lag: 6-18 months
 - Blunt instrument: impacts upon all the economy
 - Ineffective for addressing structural problems



Monetary Policy in 2009 and beyond

- 'Wait and see' approach – RBA is cautious
 - Australian economy resilient
 - Strength in domestic demand temporary?
 - Advanced economies still in recession
- Factors arguing against further rate decreases
 - Avoid excessive domestic stimulus
 - China and India recovering strongly
 - Interest rates historically low – potential for asset price bubbles
 - Household debt still high



The effectiveness of the macro policy mix

- Resilient Australian economy
 - Unprecedented growth cycle from 1991-2008
 - Cyclical unemployment increasing much slower than expected and below OECD average
 - Policy has cushioned Australia from the GFC
- Long term challenges
 - Too exposed to commodity price fluctuations?
 - External imbalances to worsen – “twin deficits”
 - Slowing productivity growth
 - Rising underemployment



FINIS!

Any Questions?



Best of luck with everything!