Appendix 4

Concluding remarks of participants in the Round Table Canberra, 15 August 2005

At the conclusion of the Round Table discussion on 15 August 2005 on issues related to the current account, the Chair invited the six professional economists to make concluding remarks. Their remarks are reproduced in full here, as they provide a good summary of their different viewpoints on the subject of this inquiry.

The economists who participated in the Round Table were (in alphabetical order):

- Professor Ross Garnaut, Professor of Economics, Division of Economics, Research School of Pacific and Asian Studies, Australian National University.
- Dr David Gruen, Chief Adviser (Domestic), Macroeconomic Group, Department of the Treasury
- Mr John Hawkins, Manager, Domestic Economy Division, Department of the Treasury
- Mr Anthony Pearson, Head of Australian Economics, ANZ Banking Group
- Mr Michael Potter, Director of Economics and Taxation, Australian Chamber of Commerce and Industry
- Dr Richard Simes, Vice President CRA International (appearing in a private capacity)

Professor Garnaut:

> When the current account deficit as a share of GDP gets as large as it has recently in Australia, especially when that is at a time of unusually favourable external circumstances—and I have drawn attention to the high terms of trade and the low international interest rates—then it is time to carefully analyse whether we are vulnerable to a deterioration of circumstances. We may be lucky. This may be the first huge increase in the terms of trade in our long history on this island continent which has not suffered a significant reverse, and I hope that that is the case, but we would prepare ourselves better for the possibility of reversal if we were doing a number of the things that have been discussed in this meeting. If, while we are assuring ourselves that the improvement in the terms of trade is permanent, we have governments run larger surpluses; and if, while we are assuring ourselves that the very low international interest rates that Alan Greenspan has described as a conundrum are a permanent feature of the international environment, we are a little cautious in our fiscal policy, and if we run hard to remove the many remaining impediments to high productivity, including in the export industries, then the risks of us

suffering a very painful adjustment, possibly including a recession if international circumstances deteriorate suddenly, will be significantly less.[1]

Dr Gruen:

I do not have much to add, but I will make one point. It is very hard to determine the extent to which Australia's vulnerability has been raised by the rise in net external liabilities. The extent to which that has made us more vulnerable is not at all obvious—to me, at least. I have certainly been surprised by the extent of resilience in the Australian economy over the last decade or so in a series of circumstances which, before they happened, I would have thought would cause us a lot of trouble but did not. If it is the case that the current account or the rise in external liabilities is a problem, then it is very much a medium-term problem rather than a short-term problem, and that makes me wary of tying macro policy to the current account. It seems to me that we have done extremely well by running macro policy with internal balance objectives, and the last time we used the current account as an excuse for running macro policy was in the lead-up to the early nineties recession, which I do not think was a huge success. So I do not think it is sensible to use macro policy to try and respond to the current account. To the extent that one wants to respond to the current account, I think you have to do as Dr Simes has argued, which is to try and do things to the underlying measures of savings—largely savings in the economy. Again, whether you need to do that is an open question, but, if you want to do something about the current account, that is where you should look.[2]

Mr Hawkins:

In a sense you could say that the problem with the current account is something like: you have nothing to fear but fear itself and that the current account becomes a problem if the markets decide it is a problem. I agree with the comments Michael [Potter] made that the indicators are that at the moment the market is not seeing it as a significant problem in Australia. There are reasons to say that our current account—around six per cent of GDP—is not as much of a risk as in past instances of current account deficits of that size because of the counterparts in the savings investment and because of the structure of the net liabilities.[3]

Mr Pearson:

In summing, up we did not address all the questions that were given to us. A lot of the thrust of the questions as we went through them concerned household borrowing, house price booms—things like that. I just want to put things in perspective a bit in that, particularly in terms of the house price phenomenon in Australia over the last seven years, we have not been

1 Prof Garnaut, *Proof Committee Hansard*, 15 August 2005, p. E37.

2 Dr Gruen, *Proof Committee Hansard*, 15 August 2005, p. E37.

3 Mr Hawkins, *Proof Committee Hansard*, 15 August 2005, p. E38.

alone; we have been part of the global phenomenon. In fact, we have not even been a frontrunner by a country mile. We have roughly doubled house prices over seven years. In South Africa, they have gone up 3½ times. Britain and Ireland have had much bigger house price booms than we have. The global phenomenon we have been part of was because of the very low interest rates through 2000, 2001 and 2002. They were put in place to, in a sense, prevent the possibility of global recession in 2001. So we have been through a very unusual period around the world, and we have been part of that global phenomenon. It has not just been an Australian phenomenon, and I think that is worthy of focusing on.

That global phenomenon [housing bubble] is gradually running out of steam. It has pretty much ended in Australia, as we talked about earlier, with the possible exception of Perth. But basically national house prices have, over the last 18 months, been flat and are gradually decelerating generally around the world, with some other exceptions. I am just wondering whether some of these problems that we have focused on as being uniquely Australian and as having emerged recently are in fact part of global phenomena and that they will, to a certain extent, self-correct. I think that global perspective is worthy of some focus.

Having said that, I still believe that the current account deficit in Australia is, in large part, a trade problem, not a capital inflows problem. I believe the capital inflow is a consequence of the trade problem, not the cause of the problem. It appears that, over the last four years in particular, it is the export side that has been particularly weak, rather than that imports have been particularly strong. Imports have certainly been boosted to a certain extent, but the flatness in the volume of exports, I think, is of concern. To that extent, policy measures that could perhaps be directed at that trade side would, I think, help to moderate the current account concerns going forward. But I do believe that in the short term you will find some self-correction as this global phenomenon gradually cools.[4]

Mr Potter:

It has been a very valuable discussion this afternoon, and I thank you for inviting me along. I thank the rest of the panel for their contributions. One of the things I want to leave with the committee is that we do not think that the Australian economy is perfect. There are quite a number of issues around. We have touched on most of those—for example, the capacity constraints and the fact that exports have been reasonably flat until quite recently. Another point I will make is that labour productivity has fallen in the past four quarters, which I think is important, but I would not place too much weight on that because there are some definitional issues in that. There are other things going on, such as oil prices and China.

All of these are important issues that need to be dealt with, but we do not consider that the current account deficit is a problem in and of itself. If it is seen to be an issue, we think it is more a symptom of what is going on in

4 Mr Pearson, *Proof Committee Hansard*, 15 August 2005, p. E38.

> the underlying economy. It could be a symptom of some of those issues that I have just talked about. The two key reasons we think the CAD is not a problem are that, first of all, the rating agencies are saying that Australia is still rated very highly. The second thing is that the risk premium on Australian debt is still within quite manageable levels. I guess the onus of proof really has to be upon those who say the current account is a problem to explain why those measures are wrong and why the market is getting it wrong with assessing Australia's vulnerability.[5]

Dr Simes:

> I think I have indicated that I agree with Ross's [Garnaut] basic point. We should be concerned about the current account as such. I want to make one comment about the questions you asked about household debt. The level of household debt has obviously gone up. It has been associated with household wealth going up—that is, gearing has gone up a lot. If there is any policy response to it, we need to be careful not to undo something that has been really very positive in the economy—that is, financial deregulation has seen access to credit improve a lot; it has increased not only economic efficiency a lot but also equity. If you go back 20 years or more, access to credit was a big concern from an equity point of view—for example, in the Campbell committee report—and we need to make sure that the benefits are not unwound.[6]

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5 Mr Potter, *Proof Committee Hansard*, 15 August 2005, p. E36.

6 Dr Simes, *Proof Committee Hansard*, 15 August 2005, p. E37.