RECEIPTS

Total receipts in 1984-85 are estimated at $57 203m, an increase of 17.7% over collections in 1983-84. Measures announced since the 1983-84 Budget and in this Budget are estimated to reduce receipts by about $1106m in 1984-85. In the absence of these measures, the receipts estimate would be about $58 309m, 20% higher than in 1983-84. The receipts measures and the estimates are described in detail in Statement No. 4.

The table below provides a summary of estimated receipts in 1984-85 compared with collections in 1983-84:

BUDGET RECEIPTS—SUMMARY

	1983-84		1984-85			
	Actual	Change on 1982-83	Estimate	Change on 1983-84		Proportion of Total Receipts
	$m	%	$m	$m	%	%
Taxation Revenue—						
Income Tax—						
Individuals (net)	24 710	7.6	30 388	5 678	23.0	53.1
Companies	4 383	−8.1	5 380	997	22.7	9.4
Withholding Tax	305	17.8	371	66	21.6	0.6
Special Tax to Recover Evaded Company and Division 7 Tax	252	215.0	200	−52	−20.6	0.3
Sales Tax	4 165	19.3	4 704	539	12.9	8.2
Excise Duty—						
Crude Oil and LPG	3 651	4.7	3 695	44	1.2	6.5
All Other	4 083	23.0	4 352	269	6.6	7.6
Customs Duty	2 395	13.9	2 780	385	16.1	4.9
Bank Account Debits Tax	183	510.0	190	7	3.8	0.3
Other General Taxation	371	12.1	401	30	8.1	0.7
Total Taxation Revenue	44 497	9.0	52 460	7 963	17.9	91.7
Other Receipts	4 112	13.3	4 743	631	15.3	8.3
TOTAL RECEIPTS	48 610	9.3	57 203	8 594	17.7	100.0

Measures announced in this Budget are estimated to cost (net) about $1293m in 1984-85. That cost, however, is partly offset by other measures announced since the 1983-84 Budget and prior to this Budget that are expected to yield additional revenue of about $187m in 1984-85.

Despite the substantial cost to revenue of the revisions to personal income tax scales announced in this Budget, the main receipts growth area in 1984-85 is still expected to be income taxes collected from individuals; these are estimated to increase in 1984-85 by $5678m or 23.0%. As noted above, this partly reflects the full-year effects of the Medicare levy and the Prescribed Payments System but the other components—namely, collections from PAYE and non-PAYE or other individuals—are also expected to contribute significantly to the growth in this item; combined, these latter two sub-items contribute about three quarters of the total growth in collections from individuals.

Reflecting the strong rebound in corporate profitability in 1983-84 and the continued economic recovery expected during 1984-85, collections from company tax, sales tax and customs duties are also expected to contribute heavily to overall receipts growth in 1984-85. Subdued growth in collections is expected from the more narrowly based traditional excises and from crude oil and LPG levies.

STATEMENT No. 2—THE BUDGET AND THE ECONOMY

2

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STATEMENT No. 2—THE BUDGET AND THE ECONOMY

Overview

Following almost two years of decline, the Australian economy rebounded strongly in 1983-84. Important influences were the sizable fiscal stimulus, the breaking of the drought, developments in the stock cycle and generally favourable conditions abroad. As the year progressed, the pick-up broadened, employment grew rapidly and unemployment declined.

Adherence to the new wage fixing framework allowed the emergence from the wage pause to be traversed successfully and inflation fell back to a rate more in line with that of Australia's major trading partners.

Moderate rises in wage costs and expanding output produced a sharp improvement in real unit labour costs and in the share of profits in GNP. Substantial progress was therefore made last year in remedying one of the distortions that has severely hampered the efficient functioning of the Australian economy for more than a decade. The strong growth in employment and the recent apparent improvement in the outlook for business investment are undoubtedly related to this development.

Fiscal and monetary policy outcomes for 1983-84 were much as intended last budget time, a notable break with the performance of the preceding years. Important changes to arrangements in financial markets were made during 1983-84. The exchange rate was floated and almost all exchange controls were removed. More progress towards deregulation of financial markets is in prospect this year.

If favourable developments in domestic wage and price settings and continued growth in the world economy eventuate, the coming year should see a further decline in inflation coupled with strong growth in domestic final demand, including private capital investment, and further strong growth in employment.

Beyond that, sustained growth in the Australian economy will depend heavily on a continuing recovery in private business investment, which in turn requires a reduction in the public sector borrowing requirement to take pressure off financial markets and reduce real interest rates. It will also require continued moderation in labour costs, including on-costs.

Such a recovery process in Australia would be taking place in a world where growth is expected to moderate, financial markets are precariously placed and competitive pressures are becoming increasingly fierce. Australia's domestic economic policies in the years ahead will have to take account of this uncertain and demanding world environment. In that context the evident widening in the current account deficit of the balance of payments—from an already high base—must be taken into consideration.

The 1984-85 Budget has been framed in that context of potentially strong growth although with many uncertainties. The Government has sought a balance between the requirement for more restrained fiscal stimulus and the need to cement the continuing operation of the Prices and Incomes Accord.

Those and other issues are canvassed in the four parts of this Statement. Part I reviews domestic developments in 1983-84, Part II considers the world economy, Part III deals with the Government's policy approach and Part IV assesses the prospects for 1984-85.

PART I: REVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS IN 1983-84

Output and Demand

The latest national accounts estimates indicate that the recession which commenced early in 1982 reached its trough in the June quarter 1983. Since then economic activity has expanded strongly with rapid growth evident in both the farm and non-farm sectors. This is indicated most clearly by growth through the course of 1983-84, which is presently estimated at about 10 per cent for total GDP and about 8 per cent for non-farm product.

These comparisons are drawn on the traditional income-based measure of product and, as shown by Table 1, this outstripped measured expenditure growth for 1983-84 as a whole by around one percentage point and by considerably more when measured through the course of the year. Timing and measurement problems often affect the GDP estimates—particularly the preliminary estimates—during periods of rapid changes in incomes, production and prices, making it difficult to reconcile the income and expenditure estimates. The difference between the two measures on this occasion is, however, unusually large and due allowance should be made for that in interpreting the data.

Other available indicators of production, such as the manufacturing gross product index, and the strong growth in employment are consistent with a large turnaround in output in 1983-84—at least of the order shown by the expenditure-based estimates.

Table 1: Gross Domestic Product (average 1979–80 prices)

	Gross Non-farm Product			Gross Domestic Product	
	Income-based estimate (a)	Expenditure-based estimate (b)	Gross farm product	Income-based estimate (a)	Expenditure-based estimate (b)
	Change on previous period (per cent)				
Year—					
1974-75	1.0	2.2	11.8	1.6	2.8
1975-76	2.1	3.5	8.0	2.5	3.8
1976-77	2.8	3.1	2.6	2.8	3.1
1977-78	1.0	0.6	−2.0	0.8	0.5
1978-79	4.1	4.8	19.4	5.1	5.7
1979-80	2.6	2.8	−11.3	1.6	1.7
1980-81	4.7	3.8	−11.2	3.6	2.8
1981-82	1.8	2.0	15.7	2.5	2.7
1982-83	0.1	..	−20.0	−1.2	−1.3
1983-84	4.1	2.9	36.7	5.7	4.7
Half year (c)—					
1982-83 I	0.7	1.8	−36.9	−2.0	−1.0
II	−1.8	−1.8	−9.7	−2.2	−2.2
1983-84 I	5.2	4.3	105.2	9.4	8.5
II	7.7	4.1	−2.8	7.0	3.6

(a) Income-based estimate as published.
(b) Expenditure-based estimate derived by the subtraction of the statistical discrepancy from (a).
(c) Seasonally adjusted, annual rates.

Table 2: Contributions to Changes in Demand and Supply (average 1979–80 prices)

	Demand: Final domestic demand: Private consumption	Demand: Final domestic demand: Private investment in dwellings	Demand: Final domestic demand: Private investment in non-dwelling construction and equipment (a)	Demand: Final domestic demand: Private final demand (a)	Demand: Public final demand (a)	Demand: Change in stocks: Private non-farm	Demand: Change in stocks: Farm and public authority	Demand: Exports	Demand: Statistical discrepancy	Demand: Total demand	Supply: GDP	Supply: Imports	Supply: Total supply
	Percentage points contribution to growth in total demand or supply(b)												
Year—													
1980-81	1.7	0.4	1.8	4.0	0.9	−0.4	..	−0.9	0.7	4.4	3.1	1.4	4.4
1981-82	2.0	−0.1	0.8	2.6	0.6	..	0.6	0.2	−0.2	3.9	2.1	1.8	3.9
1982-83	0.7	−0.9	−1.4	−1.6	0.9	−1.5	−0.6	0.2	0.1	−2.6	−1.0	−1.7	−2.6
1983-84	1.3	0.2	−1.0	0.5	1.0	0.9	1.4	1.0	0.9	5.7	4.8	0.9	5.7
Half year(c)—													
1982-83 I	0.3	−0.6	−0.8	−1.1	0.6	−0.7	−0.6	0.1	−0.4	−2.1	−0.8	−1.3	−2.1
II	0.1	−0.4	−1.0	−1.4	0.8	−1.4	0.3	−1.0	..	−2.6	−0.9	−1.7	−2.6
1983-84 I	1.0	0.3	−0.6	0.7	0.2	0.7	2.0	0.8	0.4	4.8	3.9	0.9	4.8
II	0.5	0.3	0.2	0.9	0.6	1.7	−1.4	1.3	1.4	4.6	2.9	1.7	4.6

(a) As from the September quarter 1981, the published figures have been adjusted to remove the impact of the sale to the private sector of public sector assets under leaseback and similar arrangements. In this adjustment, estimates of the value of such sales are subtracted from the published estimates of private investment in non-dwelling construction and equipment and added back to the published estimate of public investment expenditure.

(b) Calculated according to the formula $x_t = (a_t - a_{t-1}) \times 100/D_{t-1}$; where x_t is the estimate appearing in the table for period t, a_t is the constant price value of the aggregate concerned in period t and D_{t-1} is total demand or supply in period t−1.

(c) Seasonally adjusted.

In advance of further revisions to the accounts which might lessen the large disparity between the income-based and expenditure-based estimates of product for 1983-84, it would be well to bear in mind the possibility that the income measure is *overstated and the expenditure measure understated. That said, the expenditure* estimates for individual items still provide a useful indication of some of the forces underlying the recovery. These estimates and related indicators are discussed in the following section.[1]

As shown in Table 2, the increase in aggregate demand in 1983-84 as a whole was rather narrowly based, the more substantial contributions coming from stocks, exports and public sector spending.[2] The recovery broadened in the second half of 1983-84 as private business fixed investment increased and the course of private non-farm stock building turned from decumulation to accumulation with a consequent substantial contribution to demand. The increase in aggregate demand in 1983-84 was met largely from domestic production, although imports made an increasing contribution to the growth in total supply as the year progressed.

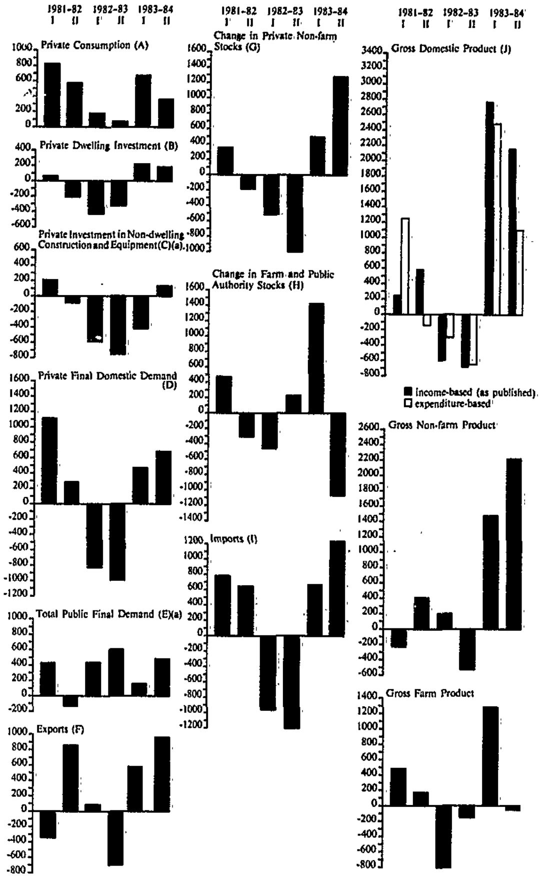
Private consumption expenditure (Chart 1 panel A) increased by 2.5 per cent in 1983-84, rather more slowly than the 4 per cent growth in real household disposable income; the saving ratio therefore increased sharply, from 12.4 per cent in 1982-83 to 13.6 per cent in 1983-84. After adjustment for Medicare[3], personal consumption expenditure grew by 2.7 per cent in 1983-84.

The sharp increase in the statistical measure of household savings is no doubt partly related to the sharp increase in the statistical discrepancy which has its counterpart in 'savings' in the various income and outlay accounts. There are, however, plausible explanations for a large jump in household savings in 1983-84, deriving from the nature and size of personal income growth. There is typically a lag, perhaps averaging of the order of a year, in the response of consumption to sharp movements in income growth, and consumer spending propensities are probably relatively low in respect of some of the incomes which recorded rapid growth in 1983-84.

Wage and salary incomes rose only moderately in 1983-84, though there was an acceleration over the course of the year. By contrast, income of farm unincorporated enterprises rose by 163 per cent, contributing some 2 percentage points to the growth of 11.3 per cent in total household income. Non-farm unincorporated enterprise income, dividend income and interest receipts grew strongly. Cash benefit payments rose rapidly while the increase in direct tax payments was only moderate. Table 3 provides details of real household income and consumption. Table 4 shows the components of household incomes.

1. Unless otherwise noted, values of goods and services are expressed in constant prices with growth rates for half years based on seasonally adjusted data and expressed at annual rates.
2. The large contribution of the statistical discrepancy confuses matters as it is likely that some of this contribution relates to unrecorded expenditure; the most likely candidates are private consumption and government expenditure.
3. The introduction of the Medicare scheme from 1 February 1984 had the effect of transferring certain expenditures on health care, formerly included as private final consumption expenditure, to public final consumption expenditure. This detracted about 0.2 percentage points from private consumption growth in 1983-84.

Chart 1: Growth in Components of Expenditure on Gross Domestic Product
($m, constant 1979-80 prices, seasonally adjusted)



Identities: D = A + B + C; J = D + E + F + G + H − I
(a) Adjusted to remove the effects of the sale of public sector assets to the private sector under sale/leaseback arrangements.

Table 3: Real Household Income, Savings and Consumption (average 1979-80 prices)

	Real household income (a)	Real household disposable income (a)	Saving ratio (b)	Real private final consumption expenditure
	Change on previous period (per cent)		Level (per cent)	Change on previous period (per cent)
Year—				
1974-75	5.8	4.1	17.3	3.1
1975-76	0.9	0.5	15.2	3.1
1976-77	2.4	1.5	14.3	2.5
1977-78	0.8	0.8	14.0	1.3
1978-79	2.2	3.4	14.1	3.3
1979-80	1.3	0.6	12.6	2.4
1980-81	4.4	3.9	13.0	3.4
1981-82	5.4	4.1	13.2	3.9
1982-83	0.1	0.4	12.4	1.4
1983-84	3.1	4.0	13.6	2.5
Half year(c)—				
1982-83 I	−0.7	..	12.5	1.0
II	−2.5	1.7	13.0	0.5
1983-84 I	5.5	5.3	13.8	3.6
II	5.1	3.8	14.6	1.9

(a) Deflated by the implicit price deflator for private final consumption expenditure.
(b) Ratio of household saving to household disposable income.
(c) Seasonally adjusted, annual rates.

Table 4: Household Incomes (Including Incomes of Unincorporated Enterprises)

	Wages, salaries and supplements	Income of farm unincorporated enterprises	Income of other unincorporated enterprises and from dwellings, interest and dividends	Personal benefit payments to residents(a)	Household income	Income tax paid	Household disposable income
	Change on previous period (per cent)						
Year—							
1980-81	16.0	− 14.5	15.8	12.9	14.2	16.6	13.7
1981-82	15.7	− 8.1	18.1	16.3	15.4	21.0	14.0
1982-83	10.7	− 51.9	16.4	22.0	11.3	8.2	11.8
1983-84	6.2	163.0	14.7	17.4	11.3	7.6	12.2
Half year(b)—							
1982-83 I	13.1	− 72.5	16.6	22.9	11.9	6.7	12.7
II	− 0.7	− 16.9	18.4	31.3	6.4	−15.2	11.0
1983-84 I	6.2	754.6	17.6	12.4	14.0	17.0	13.8
II	13.3	− 6.3	9.7	17.0	12.2	21.7	10.7

(a) Includes unemployment and sickness benefits, family allowances, widows', age, invalid and repatriation pensions and other transfers to persons from general government.
(b) Seasonally adjusted, annual rates.

Private dwelling investment (Chart 1 panel B), after declining throughout 1982 and into the first half of 1983, increased exceptionally strongly throughout 1983-84 to be some 23 per cent higher in the second half of the financial year than a year earlier. The main impetus to the upturn in the dwelling industry appears to have come from ready availability of finance from the traditional lending institutions (up 50 per cent), declining mortgage interest rates, the new First Home Owners' Scheme and some upturn in underlying demand, occasioned by demographic and other factors. Compared with the previous upswing (1979-1981), a large proportion of housing finance has found its way into the purchase of new dwellings rather than existing dwellings.

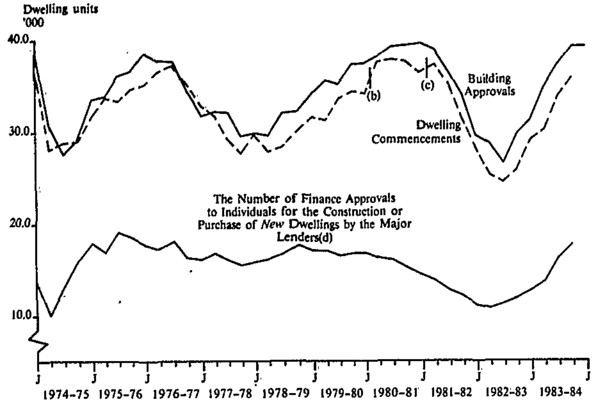
To date there has been little evidence of large scale speculative investment in multi-unit dwellings, a feature of the last housing upswing. Private dwelling commencements in 1983-84 appear to have been of the order of 120 000, up 30 per cent on a year earlier; commencements for private houses increased by about 38 per cent while commencements of private multi-unit dwellings were little changed. The current upswing in housing activity, being based largely on demand for single unit dwellings and financed in the main by traditional lenders, looks more securely grounded than past booms—though the very strength of the upswing could lead to difficulties (house prices and the cost of housing materials have already started to rise sharply in some areas).

Even without further growth in finance and building approvals, a considerable increase in private dwelling investment in 1984-85 is in the pipeline. Total commencements in the second half of 1983-84 appear to have been running at an annual rate of about 145 000, much the same as the peak rate achieved in the 1979-1981 boom; but work done on dwellings in the June quarter 1984 appears to have been some 20 per cent below the peak quarterly rate achieved at the end of 1981. The rate of commencements in the first half of 1984 appears to have been well above both the target set by the Government a year ago and current estimates of trend demand for new dwellings prepared by the Indicative Planning Council for the Housing Industry. There *must be a risk that, as in past housing cycles, very high activity in the dwelling industry* could bring with it a destabilising speculative element. The strength of the current upswing in housing construction activity can be gauged from Chart 2 which shows developments in a number of indicators of dwelling construction activity.

Private business gross fixed capital expenditure[4] (Chart 1 panel C) declined throughout 1982 and 1983 with the demise of the resource investment boom and the onset of the general recession. Business investment fell in 1983-84 by 11.6 per cent, but there appears to have been some pick-up in investment in the second half of the financial year due to strong growth in plant and equipment investment.

4. The published figures have been adjusted to remove sales to the private sector of public sector assets under leaseback and similar arrangements.

Chart 2: Forward Indicators of Dwelling Construction Activity (a)



(a) Quarterly data; seasonally adjusted, thousands of dwelling units.
(b) Break in commencements series due to the change from a census to a survey collection method from the September quarter 1980.
(c) Break in commencements series due to changes in the method of processing survey returns from the September quarter 1981.
(d) Major lenders are defined as savings banks, trading banks and permanent building societies.

Table 5: Private Gross Fixed Capital Expenditure as a Percentage of GDP(*a*)

	Dwellings	Business fixed investment(*b*)			Total(*b*)
		Non-dwelling construction	Equipment	Total	
			(per cent of GDP)		
Average—1960-61 to 1972-73	4.5	3.4	8.6	12.1	16.6
Year—					
1973-74	4.8	3.4	7.9	11.3	16.2
1974-75	3.7	3.2	7.4	10.6	14.2
1975-76	4.0	2.7	7.7	10.4	14.4
1976-77	4.4	2.3	7.8	10.0	14.5
1977-78	4.0	2.4	7.6	10.0	14.0
1978-79	3.8	2.4	8.3	10.7	14.6
1979-80	4.2	2.4	7.5	9.9	14.1
1980-81	4.5	2.9	8.8	11.6	16.1
1981-82	4.3	3.1	9.1	12.2	16.5
1982-83	3.2	2.7	7.9	10.7	13.9
1983-84	3.3	2.0	6.9	8.9	12.2
Half year(*c*)—					
1982-83 I	3.5	2.9	8.3	11.2	14.7
II	3.0	2.6	7.5	10.1	13.1
1983-84 I	3.2	2.0	6.9	9.0	12.2
II	3.4	1.9	6.9	8.9	12.3

(*a*) Based on average 1966-67 prices for 1960-61 to 1972-73 and average 1979-80 prices thereafter.
(*b*) Adjusted, from the September quarter 1981, for the impact of known sales of public sector assets to the private sector under sale/leaseback and similar arrangements.
(*c*) Seasonally adjusted.

This pick-up in business investment occurred at a time when there was still much excess capacity in industry generally. However, as can be seen from Table 5, business investment had fallen to an exceptionally low level by the first half of 1983-84. The previous investment boom was concentrated in resource-based sectors and it may be that many firms outside these areas are operating with ageing capital equipment. The steep rise in output over the course of 1983-84 and the prospect of strong growth in 1984-85 in conjunction with a much improved profits position appears to have encouraged more firms to begin replacing existing equipment and to expand capacity.

Taken together, the growth in private final consumption and the strengthening of private gross fixed capital expenditure led to an acceleration of *private final domestic demand*[5] (Chart 1 panel D) as 1983-84 progressed. In the second half of the year, private final domestic demand was increasing at an annual rate of 3 per cent.

Public final demand[5] (Chart 1 panel E) increased by 4.5 per cent in 1983-84, the same rate as in 1982-83 (though somewhat more slowly, at around 4 per cent, when allowance is made for the impact of Medicare). These data understate the full extent of the fiscal stimulus in 1983-84, which is better indicated by the sharp increase in the total public sector deficit.

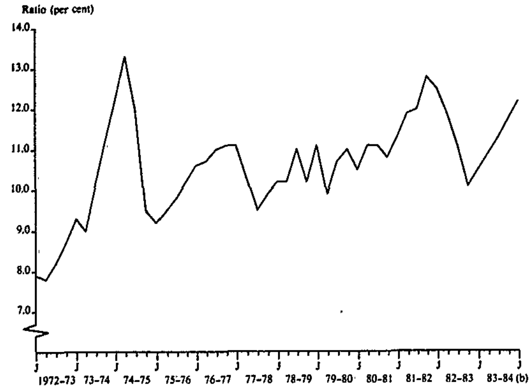
Looking to the components of public final demand, *public consumption expenditure* increased by 4.3 per cent in 1983-84, reflecting increases of 4.7 per cent for the Commonwealth sector and 4.1 per cent for the State and local government sector. These figures are, however, affected by the treatment of defence expenditure[6] and the impact of Medicare. Abstracting from the Medicare impact, State and local government consumption expenditures rose by 3 per cent and total public consumption expenditure by 3.5 per cent in 1983-84. *Public capital expenditure*[5] increased by 5 per cent in 1983-84, reflecting a fall of 2.3 per cent for the Commonwealth sector and an increase of 6.5 per cent for the State and local government sector. Although the estimated increase in State and local government capital expenditure is large, it nevertheless implies a significant element of underspending relative to expenditures foreshadowed in State budgets for 1983-84.

The volume of *exports of goods and services* (Chart 1 panel F) accelerated in 1983-84, growing by 7.2 per cent. Most of the growth for the year as a whole came from non-farm goods although with the ending of the drought there was a rapid rise in farm exports over the course of the year. The recovery in the world economy assisted export volumes as did the coming on stream of a number of resource-based investment projects.

There was a turnaround in the volume of *imports of goods and services* in 1983-84 (Chart 1 panel I), up 5.8 per cent following the decline of 9.7 per cent in 1982-83. Much of the increase in imports in 1983-84 can be explained by the acceleration in domestic demand and changes in its composition but, as shown in Chart 3, the ratio of imports to sales rose sharply during the year. However, if the growth in sales in 1983-84 is underestimated in the present national accounts estimates, then this lift in the import to sales ratio would be correspondingly overstated.

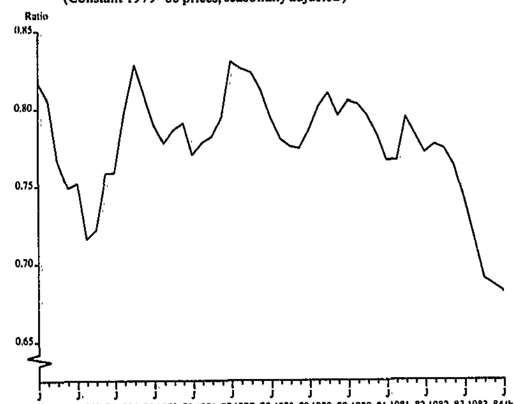
5. The published figures have been adjusted to remove sales to the private sector of public sector assets under leaseback and similar arrangements.
6. For the national accounts, all defence expenditure is classified as current expenditure and is brought to account on a deliveries rather than a payments basis. Abstracting from these influences, Commonwealth current expenditures are estimated to have increased by 9.2 per cent in 1983-84 (on a payments basis).

Chart 3: Ratio of Imports to Sales (a)



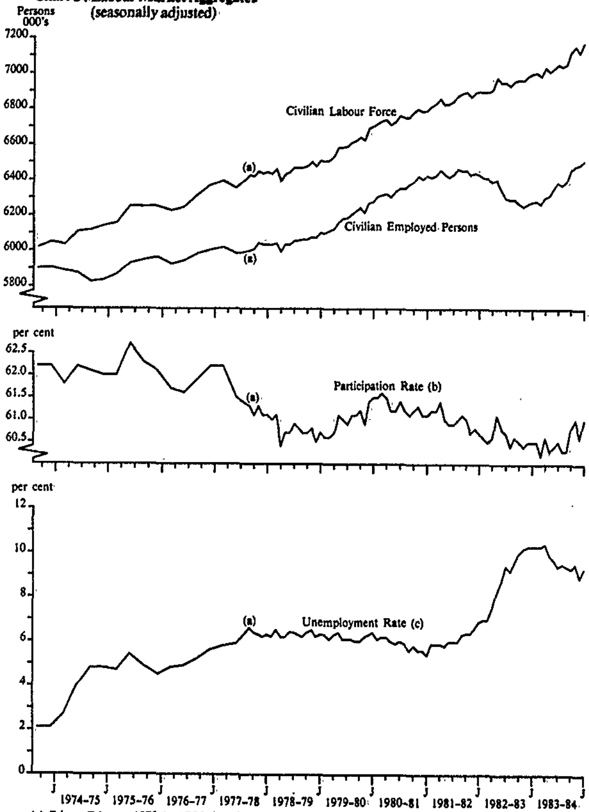
(a) The ratio of imports of goods to sales. Sales are defined as gross non-farm product *plus* imports (excluding petroleum, civil aircraft and government imports) *less* changes in non-farm stocks. Constant (1979-80) price estimates are used.
(b) Quarterly data not available for 1983-84, data shown are for the two halves of the year.

Chart 4: Ratio of Private Non-Farm Stocks to Sales (a)
(Constant 1979-80 prices; seasonally adjusted)



(a) Sales are defined as gross non-farm product *plus* imports (excluding petroleum, civil aircraft and government imports) *less* changes in private non-farm stocks.
(b) Quarterly data not available for 1983-84, data shown are for the two halves of the year.

Chart 5 : Labour Market Aggregates



(a) Prior to February 1978 the ABS Labour Force Survey was conducted in the mid-month of each quarter (February, May, August and November) while from February 1978 the survey has been conducted monthly.
(b) The civilian labour force as a percentage of the civilian population aged 15 and over.
(c) The number of unemployed persons as a percentage of the civilian labour force.

Changes in the rate of *accumulation of stocks* are shown in Chart 1 (panels G and H). The behaviour of non-farm stocks detracted from production growth in 1982-83 as stocks were run down at an accelerating rate. In the first half of 1983-84, the decumulation of stocks slowed down, resulting in some boost to activity levels. The contribution to overall activity was particularly marked in the second half of the year when stock accumulation resumed. Chart 4 sets out the non-farm stocks-to-sales ratio on a half-yearly basis. Despite the growth in non-farm stocks in the second half of 1983-84, they remain at a historically low level in relation to sales. Stock-holding behaviour appears to have been affected by the recession experience and high interest rates and there is some doubt whether the stocks-to-sales ratio will return fully to its pre-recession level.

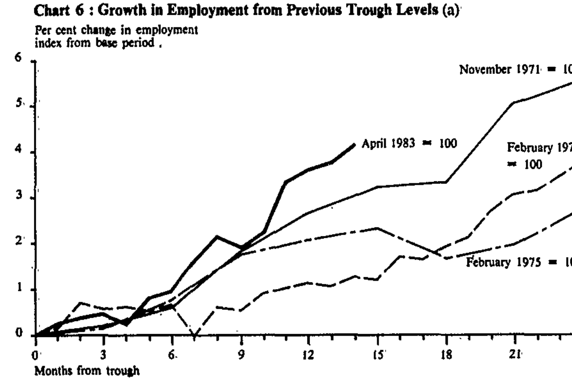
Farm stocks built up sharply in the first half of 1983-84 as rural output rose with the ending of the drought. But stock building slowed in the second half as rural exports increased. For the year as a whole, farm production and stock accumulation made a major contribution to product growth.

The Labour Market

The labour market strengthened considerably in 1983-84 with rapid employment growth and falling unemployment. The recovery period was notable for the sheer size of the increase in employment, the changing industry structure of employment and the changing composition of unemployment.

By June 1984 employment had increased by 257 900 or 4.1 per cent from its trough in April 1983; this increase more than reversing the decline during the recession period (see Chart 5). Employment growth during the present upturn has far out-paced that in other 'recovery' periods since the early 1970s (Chart 6). In part that reflects the

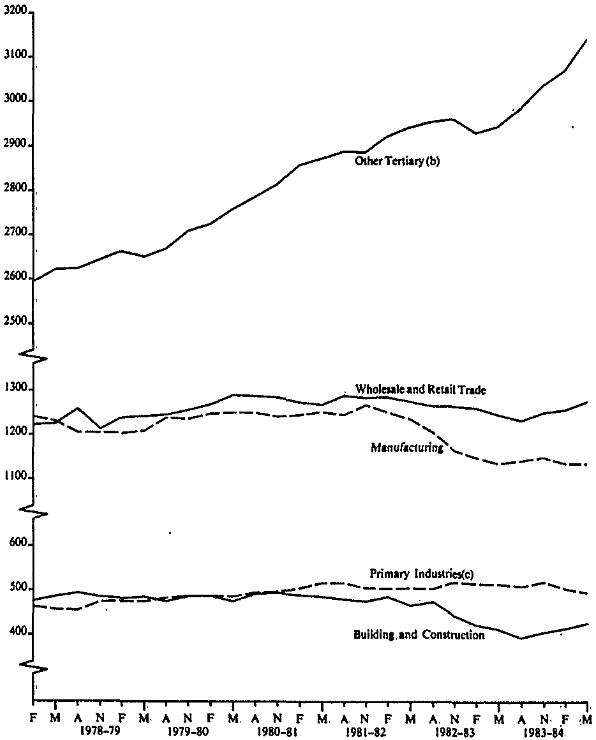
Chart 6 : Growth in Employment from Previous Trough Levels (a)



(a) Seasonally adjusted data.

severity of the shake-out in labour markets during 1982-83 and the subsequent reversal of the factor share imbalance which underlaid that shake-out. In part, it also reflects the nature and size of the pick-up in demand and the diverse impact, industry by industry, of that pick-up.

Chart 7: Employment by Broad Industry Group
(seasonally adjusted (a))



(a) Seasonally adjusted by the Treasury.
(b) Includes electricity, gas and water, transport and storage, communication, finance, property and business services, public administration and defence, community services and recreation, personal and other services industries.
(c) Includes the mining and agriculture, forestry, fishing and hunting industries.

Chart 7 indicates that employment growth has been strongest in the tertiary sector (exclusive of wholesale and retail trade), which no doubt in part reflects the strength of public sector expenditure, both directly and indirectly through publicly-funded services. Employment in building and construction (where the rapid growth of dwelling investment has been the dominant influence) and in wholesale and retail trade has also begun to respond to the improved economic situation. Employment in manufacturing however has remained flat, notwithstanding an increase in manufacturing gross product of 6.1 per cent over the year to the March quarter 1984 (see Chart 8); the implied increase in productivity in manufacturing is indicative of labour-saving initiatives being adopted by an industry under considerable competitive pressure. Table 6 shows employment by industry.

Competitive pressures, the additional on-costs associated with full-time employment and the changing industry pattern of employment may also explain the shift to greater use of part-time employees. As Table 7 shows, the growth of part-time employment was little affected by the recession and it shared fully in the recovery. Between the June quarter 1981 and the June quarter 1984, part-time employment increased by 10.7 per cent whereas despite a strong recovery late in the period, full-time employment was still a little below its June quarter 1981 level.

The labour force expanded steadily throughout the recession and, with the improvement in the labour market, the participation rate has edged up. However, since growth in employment exceeded growth in the labour force, there has been some fall in the unemployment rate. By July 1984 unemployment had fallen to 8.8 per cent of the labour force compared with the peak rate of 10.4 per cent in September 1983 and 10.3 per cent in July 1983.

Chart 8: Quarterly Index of Manufacturing Gross Product
(seasonally adjusted; 1979-80 = 1000)

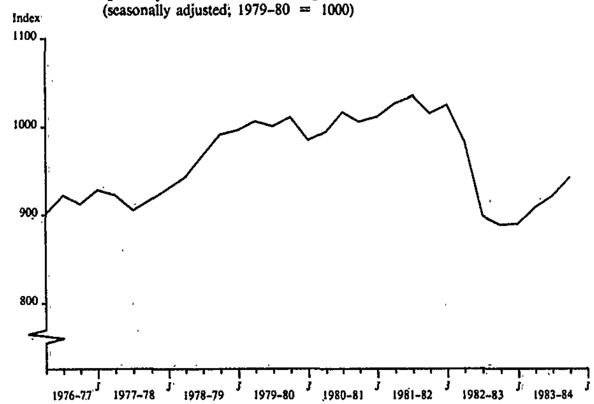


Table 6: Employment by Industry (a)

Industry—	Level 1983–84 '000	1982–83 per cent	1983–84 per cent	Change on a year earlier— May 1983 '000	May 1983 per cent	May 1984 '000	May 1984 per cent
Agriculture, forestry, fishing and hunting	407.8	2.0	−2.1	8.7	2.1	−21.7	−5.2
Mining	98.2	−2.6	2.2	1.0	1.0	2.0	2.0
Manufacturing	1139.3	−6.8	−2.1	−100.2	−8.0	−0.9	−0.1
Food, beverages and tobacco	185.6	2.2	0.5	7.3	4.0	−9.4	−5.0
Metal products	193.5	−10.5	−6.1	−25.6	−11.4	−6.6	−3.3
Other manufacturing	760.2	−7.8	−1.6	−82.0	−9.7	15.0	2.0
Electricity, gas and water	143.0	9.3	2.3	17.1	13.6	7.8	5.5
Construction	409.7	−8.2	−6.3	−53.8	−11.4	14.7	3.5
Wholesale and retail trade	1 254.1	−1.9	−0.3	−28.8	−2.2	29.8	2.4
Transport and storage	363.6	2.3	−0.6	−12.7	−3.4	11.5	3.2
Communication	138.9	−4.1	4.6	−8.6	−6.1	3.3	2.5
Finance, property and business services	596.3	0.9	4.3	−2.5	−0.4	39.8	6.9
Public administration and defence	318.9	1.0	8.2	13.0	4.5	24.8	8.3
Community services	1 086.8	1.4	4.4	6.3	0.6	81.2	7.8
Recreation, personal and other services	412.2	0.7	2.3	−7.7	−1.9	25.4	6.4
Total	6 368.8	−1.6	0.8	−168.1	−2.6	217.7	3.5

(a) Data on employment by industry are available for the mid-month of each quarter only, i.e. for each February, May, August and November.

Table 7: Labour Market Indicators

	Labour Force: Level	Labour Force: Participation Rate(a)	Employment: Wage and Salary Earners(b)	Employment: Employers and Self-Employed(b)	Employment: Part-time	Employment: Full-time	Employment: Total	Unemployment: Full-time	Unemployment: Total	Total Unemployment Rate(c)
	'000	per cent	'000	'000	'000	'000	'000	'000	'000	per cent
Year—										
1979–80	6 600.7	61.0	5 202.7	958.7	971.4	5 221.7	6 193.1	339.0	407.6	6.2
1980–81	6 757.1	61.3	5 341.5	982.0	1 026.9	5 334.3	6 361.2	329.9	395.9	5.9
1981–82	6 863.4	61.0	5 423.6	976.9	1 040.2	5 399.7	6 439.9	352.8	423.4	6.2
1982–83	6 953.8	60.6	5 329.4	962.3	1 086.3	5 242.7	6 329.0	540.5	624.9	9.0
1983–84	7 068.7	60.6	5 373.6	969.8	1 106.1	5 281.9	6 388.0	589.0	680.8	9.6
Change on same period a year earlier (per cent) (d)										
Year—										
1979–80	2.1		2.4	2.7	3.8	2.0	2.3	−1.6	−0.3	
1980–81	2.4		2.7	2.4	5.7	2.2	2.7	−2.7	−2.9	
1981–82	1.6		1.5	−0.5	1.3	1.2	1.2	6.9	7.0	
1982–83	1.3		−1.7	−1.5	4.4	−2.9	−1.7	53.2	47.6	
1983–84	1.7		0.8	0.8	1.8	0.7	0.9	9.0	8.9	
		Rate (per cent)						Level ('000)		Rate (per cent)
Quarter(e)—										
1982–83 Sep.	1.0	60.6	−0.5	1.2	2.6	−1.0	−0.4	412.4	494.0	7.2
Dec.	1.8	60.9	−1.1	−2.1	6.1	−2.6	−1.2	526.7	610.9	8.8
Mar.	1.0	60.5	−2.7	−2.3	6.1	−4.4	−2.7	586.9	668.9	9.6
Jun.	1.4	60.5	−2.7	−2.8	3.0	−3.6	−2.5	629.6	718.1	10.3
1983–84 Sep.	1.6	60.4	−2.1	−2.6	..	−2.3	−1.9	631.2	724.5	10.3
Dec.	1.0	60.4	0.3	0.1	−0.2	0.1	..	593.2	680.0	9.7
Mar.	1.7	60.5	1.6	2.5	1.3	2.2	2.0	571.2	663.2	9.4
Jun.	2.4	60.9	3.5	3.5	6.2	3.0	3.6	564.5	659.3	9.2

(a) The civilian labour force as a percentage of the civilian population aged 15 and over.
(b) Data available for the mid-month of each quarter only, i.e. each February, May, August and November.
(c) The number of unemployed persons as a percentage of the civilian labour force.
(d) Percentage change on a year earlier except for those columns marked otherwise.
(e) Seasonally adjusted.

The classification of unemployment by duration shown in Table 8 indicates some change to the composition of unemployment during 1983-84. Despite the fall in total unemployment, the number of persons who have been unemployed for more than a year continues to rise and the mean duration of unemployment has also risen. This pattern is typical of the early stages of recovery. There is therefore a group of the longer-term unemployed which is still growing and which has not yet been reduced by the general lift in the economy. Long-term unemployment particularly affects the older unemployed. Of the unemployed aged 15 to 24, around 25 per cent have been unemployed for more than a year; for those aged 35 or more the ratio is over 40 per cent and it is even higher for older age groups. The recovery has encouraged people to re-enter the labour force and re-entrants tend to provide the bulk of the increase in employment in any month.

Table 8: Duration of Unemployment

Duration of unemployment (weeks) (*a*)	June— 1978	1979	1980	1981	1982	1983	1984
	persons ('000)						
0 to 4	83.2	78.3	80.4	74.9	95.5	87.6	92.9
4 to 8	58.5	48.0	55.1	48.9	63.6	71.1	66.9
8 to 13	53.2	44.8	49.8	40.3	58.9	72.1	58.8
0 to 13	194.8	171.1	185.4	164.1	217.9	230.8	218.6
13 to 26	73.1	73.9	77.8	63.7	82.0	132.9	102.1
26 to 39	54.6	56.9	59.0	43.6	52.9	121.1	89.7
39 to 52	13.7	16.2	14.3	11.9	16.3	35.6	25.0
0 to 52	336.2	318.1	336.4	283.2	369.1	520.4	435.4
52 to 65	20.7	26.5	24.4	19.0	23.1	56.3	54.0
65 to 104	17.0	21.2	19.8	15.7	19.4	39.8	54.5
52 to 104	37.7	47.7	44.2	34.6	42.5	96.2	108.5
104 +	19.6	27.2	28.7	35.8	40.0	76.5	90.2
Total	393.5	393.0	409.3	353.7	451.6	693.2	634.1
	Distribution (per cent of total unemployment)						
0 to 4	21.1	19.9	19.6	21.2	21.1	12.6	14.7
4 to 8	14.9	12.2	13.5	13.8	14.1	10.3	10.6
8 to 13	13.5	11.4	12.2	11.4	13.0	10.4	9.3
0 to 13	49.5	43.5	45.3	46.4	48.3	33.3	34.5
13 to 26	18.6	18.8	19.0	18.0	18.2	19.2	16.1
26 to 39	13.9	14.5	14.4	12.3	11.7	17.5	14.1
39 to 52	3.5	4.1	3.5	3.4	3.6	5.1	3.9
0 to 52	85.4	80.9	82.2	80.1	81.7	75.1	68.7
52 to 65	5.3	6.7	6.0	5.4	5.1	8.1	8.5
65 to 104	4.3	5.4	4.8	4.4	4.3	5.7	8.6
52 to 104	9.6	12.1	10.8	9.8	9.4	13.9	17.1
104 +	5.0	6.9	7.0	10.1	8.9	11.0	14.2
	Weeks						
Mean duration of unemployment	24.6	29.5	28.5	33.2	30.4	38.8	44.6
Median duration of unemployment	13.0	17.0	15.0	14.0	13.0	24.0	25.0

(*a*) Range of weeks: *m* to *n* is to be read as *m* to *less than n* weeks.

The increase in the demand for labour has brought with it an increase in vacant jobs and greater employer interest in filling positions. The ANZ Bank series on newspaper job advertisements shows that advertised vacancies increased by 63 per cent over the year to the June quarter. As yet there are few reports of labour shortages, and most of those are to do with specific skills in high demand such as computer programmers, foreign exchange dealers and building workers in the A.C.T.

The recovery in the demand for labour has also led to an increase in average hours worked by both full-time and part-time employees, the former being marginally the stronger. In the twelve months of 1983-84 hours worked per employee averaged 34.6 hours compared with 34.2 hours in 1982-83. This increase and the increase in employment itself meant that in the June quarter 1984 total hours worked were some 7 per cent higher than in the June quarter 1983.

Incomes and Labour Costs

Continuing wage restraint combined with increasing production produced in 1983-84 a marked shift of factor incomes towards profits.

Wages began to increase again during the year, after a period of near stability which resulted from the stringency of labour market conditions and the institution of the wage pause towards the end of 1982. The pause came to an end in October 1983 as the first six-monthly indexation increase under the new wage fixing arrangements established by the Conciliation and Arbitration Commission became effective. This increase, and its successor in April 1984, led to a resumption of growth in award wages following their near stability during the nine months of the pause.

Table 9 shows that, although award wages accelerated during 1983-84, the increase for the year as a whole was still below that for 1982-83, which was affected by the large wage settlements in the aftermath of the December 1981 metal industry agreement. Virtually all award wage growth during 1983-84 can be accounted for by the two national wage increases; the recorded increase of 8.9 per cent over the course of the year to end-May 1984 only slightly exceeds the compounded sum of the 4.3 per cent increase in October 1983 and the 4.1 per cent increase in April 1984. This observation is consistent with an impression of near-universal adherence to the 'no extra claims' provisions of the new wage fixing arrangements established by the Conciliation and Arbitration Commission in September 1983 and minimal adjustments to award rates of pay beyond national wage increases. Although some of the large number of claims lodged under the anomalies provision of the new arrangements were resolved by the Federal and State tribunals during the year, these generally involved small numbers of employees and hence very small additions to labour costs in overall terms.

As shown in Table 9, average weekly earnings grew more rapidly than average award rates of pay during 1983-84. This was partly a function of growth in overtime worked as economic activity gathered pace. It probably also reflected compositional changes among wage and salary earners—though full-time adult ordinary-time earnings, which are less subject to these compositional changes, also increased substantially faster than awards.

Table 9 : Award Rates of Pay and Earnings

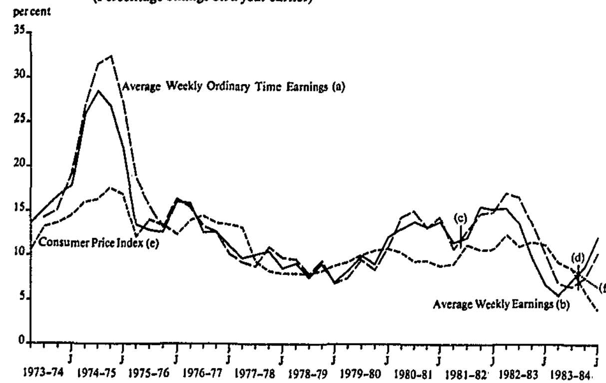
	Award rates of pay: adult wage and salary earners (*b*)	Average weekly earnings (survey basis) — Full-time adult ordinary time earnings (*c*)	Total earnings (*d*)	Total earnings in real terms (*e*)	Average earnings (national accounts basis) (*a*) — In nominal terms	In real terms (*e*)
	Change on previous period (per cent)					
Year—						
1980-81 . . .	11.7	14.2	13.5	3.7	12.9	3.2
1981-82 . . .	12.2	(*f*) 13.4	(*f*) 13.7	(*f*) 3.9	14.1	4.2
1982-83 . . .	10.9	14.2	11.2	−0.1	12.5	1.1
1983-84 . . .	(*h*) 5.1	7.8	8.4	0.4	5.3	−2.4
Half year (*g*)—						
1982-83 I . .	12.0	16.8	10.5	−2.0	15.4	2.4
II . .	3.4	7.1	6.0	−2.9	2.3	−6.2
1983-84 I . .	4.2	6.2	6.8	−1.2	4.7	−3.1
II . .	(*h*) 8.8	11.7	14.2	7.2	9.1	2.4

(*a*) Non-farm wages, salaries and supplements per non-farm wage and salary earner.
(*b*) Growth rates are based on weighted average figures centred on the middle of the period.
(*c*) For the June quarter 1981 and earlier periods the figures are based on estimates of full-time non-managerial adult male average weekly ordinary time earnings derived from payroll tax and other returns for the whole quarter. From the September quarter 1981 the estimates are based on an interim survey of private and government employers and relate to average weekly ordinary time earnings of all adult full-time employees for a pay period around the middle of each quarter. From the December quarter 1983 the estimates are based on a more comprehensive survey of employers.
(*d*) For the June quarter 1981 and earlier periods the total average weekly earnings figures are based on the former payroll tax based series on a so-called 'male units' basis. From the September quarter 1981 the estimates are based on the interim survey and relate to total average weekly earnings for all employees, and from the December quarter 1983, the estimates are based on the more comprehensive survey.
(*e*) Deflated by the implicit price deflator for private final consumption expenditure.
(*f*) Based on links to the former payroll tax based series at the September quarter 1981.
(*g*) Growth rates are at annual rates and use seasonally adjusted data for the average earnings series on a national accounts basis; the award rates of pay series, and the average weekly earnings (survey basis) series are not seasonally adjusted.
(*h*) Data for June 1984 not available. It is assumed that there was no movement in the index of award rates of pay in that month.

It should be noted that the average earnings series is subject to sampling error and, moreover, that the estimates for the two halves of 1983-84 may not be fully comparable because of the introduction of an enlarged sample during the year. Notwithstanding these difficulties with the average earnings series, it seems clear that, like awards, earnings increased more slowly in 1983-84 as a whole than in 1982-83 (see Table 9).

Upward pressure on nominal unit labour costs in 1983-84 was relieved by moderate wages and earnings growth in the first half of the year and by the strong recorded increase in productivity throughout the year. This combination was sufficient to produce near stability in nominal unit labour costs for a time during 1983-84 (see Chart 10)—a most unusual development in recent Australian experience. Although these costs were rising again in the second half of the year, this was at the relatively moderate annual rate, by recent standards, of 5.7 per cent. The containment of nominal unit labour costs has been the major ingredient in the slow-down in inflation over the same period (see Chart 10).

Chart 9: Consumer Prices and Average Weekly Earnings
(Percentage change on a year earlier)

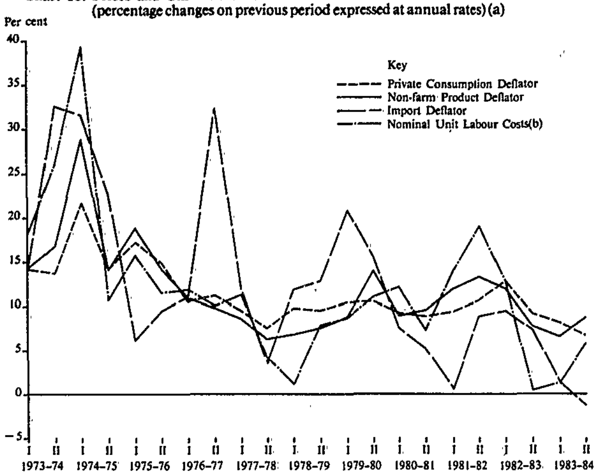


(a) Average weekly ordinary time earnings of all adult full-time employees linked to the 'old' full-time non-managerial adult male average weekly ordinary time earnings series.
(b) Average weekly earnings for all employees linked to the 'old' seasonally adjusted male units series at the September quarter 1981.
(c) Break in earnings series associated with change from payroll tax based earnings series to survey based earnings series.
(d) Break in earnings series at December quarter 1983 because of the introduction of a new survey.
(e) Based on six capital cities consumer price index up to and including the June quarter 1981 and on the eight capital cities index thereafter.
(f) CPI adjusted by Treasury to remove the effect of the introduction, from 1 February 1984, of the new health insurance arrangements under Medicare.

While output prices have also decelerated, they have still outpaced nominal unit labour costs (see Chart 10), thereby producing a sizable fall in real unit labour costs—or to put it another way, a narrowing of the 'real wage overhang' which was present in varying degrees from the mid-1970s onwards and which jumped again in the early 1980s. The fall was most marked through 1983, but there was a further small decline in the first half of 1984. Two measures of real unit labour costs are shown in Chart 11.

The sharp moderation in nominal unit labour costs provided opportunities for a rebuilding of profit margins following the squeeze of 1982. According to the preliminary national accounts, the gross operating surplus of trading enterprise companies increased by 33 per cent in nominal terms, or 24 per cent in real terms (relative to the price deflator for gross non-farm product) in 1983-84. Largely as a result of this, the corporate profit share of non-farm product increased from the very depressed level of 11.9 per cent recorded in the first half of 1982-83 to 15.8 per cent in the second half of 1983-84. Chart 11 shows both this and an alternative measure of the profit share—the latter being for the private non-farm corporate sector, which corresponds to the index of real unit labour costs for the same sector shown in the top panel of the Chart.

Chart 10: Prices and Unit Labour Costs
(percentage changes on previous period expressed at annual rates) (a)

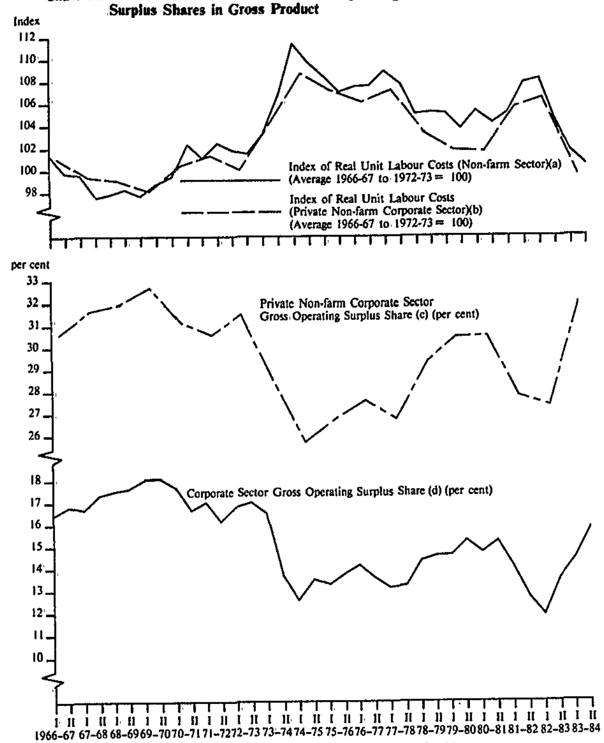


(a) Based on seasonally adjusted data.
(b) Ratio of non-farm wages, salaries and supplements and payroll tax, per hour worked by non-farm wage and salary earners to gross non-farm product at average 1979-80 prices, per hour worked by all persons employed in the non-farm sector.

As is clear from Chart 11, both real unit labour costs and the profit share in 1983-84 moved substantially towards—and on some measures, returned to—the levels typical of the late 1960s and early 1970s. This development has attracted much attention. Caution is required, however, in making strict comparisons with historic norms. As noted by the Statistician, data limitations loom especially large in this area and measurement error can often be high, particularly for the most recent quarters. Given the size of the changes, there is particular uncertainty about the national accounts estimates of corporate gross operating surplus for recent quarters.

It is clear, nevertheless, that an important amelioration of the factor price imbalances which plagued the Australian economy for much of the 1970s and early 1980s did take place in 1983-84. On this score the strong recovery in employment already witnessed and the improving outlook for business investment is consistent with an economy where factor returns are more in line with factor productivity. But investment decisions and decisions regarding the hiring of permanent staff depend not only on the current levels of real wages and profitability but also on expectations about their future course. Sustained growth in investment and employment requires confidence that income moderation will continue and that reasonable profit rates will be maintained.

Chart 11: Real Unit Labour Costs and Gross Operating Surplus Shares in Gross Product



(a) Ratio of non-farm wages, salaries and supplements and payroll tax, deflated by the implicit price deflator for gross non-farm product, per hour worked by non-farm wage and salary earners to gross non-farm product at average 1979-80 prices, per hour worked by all persons employed in the non-farm sector. Based on seasonally adjusted data.
(b) Ratio of wages, salaries and supplements and payroll tax (less employment subsidies) paid by the private non-farm corporate sector to private non-farm corporate sector gross product at factor cost plus payroll tax (less employment subsidies).
(c) Ratio of the gross operating surplus of the private non-farm corporate sector to the gross product at factor cost of the private non-farm corporate sector. The gross operating surplus of the private non-farm corporate sector is defined as the gross operating surplus of non-farm trading enterprise companies and private financial enterprises (less imputed bank service charge).
(d) Ratio of the gross operating surplus of trading enterprise companies and financial enterprises (less imputed bank service charge) to gross non-farm product at factor cost; seasonally adjusted.

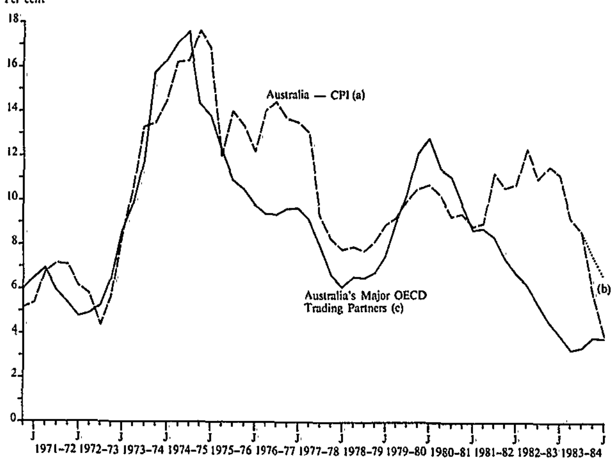
Prices

Australia's inflation rate fell substantially in 1983-84. The CPI in the June quarter 1984 was 3.9 per cent higher than a year earlier; excluding the effects of Medicare, the increase was around 6.5 per cent. The latter figure compares with an increase over the course of 1982-83 of 11.2 per cent.

Inflation has fallen much more sharply than after the previous wage surge in 1974-75. Much of the explanation lies in the more rapid slowing in wages on this occasion. Table 10 provides details of movements in a range of price indicators.

Chart 12 shows that consumer prices in Australia's major OECD trading partners increased by 3.8 per cent over the year to the June quarter 1984 compared with an increase of 6.5 per cent in Australia—a narrowing of the gap between our inflation and that of our major OECD trading partners. Over the half year to the June quarter, the Australian inflation rate fell to 4.8 per cent (annualised) compared with 4.1 per cent for our major trading partners.

Chart 12: International Comparison of Inflation Rates
(Quarterly data, percentage change on a year earlier)



(a) Based on six capital cities consumer price index up to and including the June quarter 1981 and on the eight capital cities index thereafter.
(b) CPI adjusted for the impact of the introduction of Medicare.
(c) Australia's eight major OECD trading partners comprise the United States, Japan, West Germany, France, the United Kingdom, Italy, Canada and New Zealand. Percentage changes are weighted using import and export weights current for each financial year.

Table 10: Prices

	Year				Half year (a)			
					1982–83		1983–84	
	1980–81	1981–82	1982–83	1983–84	I	II	I	II
	Change on previous period (per cent)							
Consumer price index (b)—								
All groups	9.4	10.4	11.5	6.9	12.9	9.8	8.0	1.8
Food (weight of 21.3%) (c)	10.3	8.6	9.1	7.8	10.3	10.9	8.1	4.2
All groups excluding hospital and medical services (weight of 95.7%) (c)	9.4	9.6	10.7	7.8	12.2	9.3	8.1	6.1
Selected State and local government rates and charges	n.a.	25.4	20.8	6.9	22.4	9.0	11.9	−4.3
Implicit price deflators (d)—								
Private final consumption expenditure	9.4	9.5	11.3	8.0	12.7	9.1	8.1	6.7
Private gross fixed capital expenditure	10.4	9.8	11.5	5.0	12.2	8.3	4.2	3.1
Total domestic final demand	10.3	10.3	11.2	7.1	12.3	8.2	6.6	6.8
Non-farm exports of goods and services (e)	6.4	6.6	9.4	3.1	14.8	5.3	4.7	−2.1
Imports of goods and services	8.7	3.8	8.5	2.4	9.4	7.3	1.5	−1.3
Gross non-farm product	10.3	11.5	11.2	7.3	11.9	7.7	6.5	8.7
Gross farm product	7.9	−10.8	−3.3	16.7	−2.3	7.7	29.7	2.7
Gross domestic product	10.1	10.3	10.9	7.2	12.1	7.8	6.3	8.5
Sectoral Indexes—								
Manufacturing industry—								
Materials used in	9.8	1.6	8.1	(f)6.2	6.6	14.8	−0.1	(g)−3.1
Articles produced by	11.1	7.7	9.5	(h)6.6	10.3	8.1	6.0	(i)4.8
Building—								
Materials used in house building	13.6	9.8	9.7	(h)7.7	9.6	7.2	7.2	(i)9.3
Materials used in other building	12.9	11.1	11.6	(h)6.1	12.7	6.3	5.5	(i)6.6

(a) Annual rates.
(b) Weighted average of six capital cities for 1979–80 and 1980–81, eight capital cities data used thereafter.
(c) Weights shown are those used in the tenth series of the CPI.
(d) Half-year calculations are based on seasonally adjusted data.
(e) Exports of non-farm goods and all services.
(f) Average of twelve months to April on preceding twelve months.
(g) Average of six months to April on preceding six months.
(h) Average of twelve months to May on preceding twelve months.
(i) Average of six months to May on preceding six months.

Three measures of price and cost movements in Australia relative to changes in prices and costs in our four major trading partners, adjusted for changes in exchange rates, are provided in Chart 13. Movements in these indexes, which are based on unit wage costs, consumer prices and GDP deflators respectively, reflect changes in the ability of Australian producers to compete with overseas producers in domestic and international markets on the basis of price. The March quarter 1984 estimate based on consumer prices is affected to some extent by the introduction of Medicare.

Australia's international competitiveness, as depicted by these measures, improved during 1982-83 when the depreciation of the exchange rate outweighed the adverse effects on our competitiveness caused by rates of wage and price increase more than double those of our major trading partners. As noted above, during 1983-84 these wage and price differentials narrowed substantially. However, for much of the year an appreciating exchange rate for the $A meant that our international competitiveness declined significantly. During the final three to four months, however, the exchange rate depreciated and, although not all relevant data are available for the June quarter 1984, the competitiveness lost in the earlier part of the year is likely to have been largely regained.

Fiscal Conditions

The Commonwealth Budget deficit in 1983-84 was $7961 million—equivalent to 4.3 per cent of GDP—following deficits of $4473 million (2.7 per cent) in 1982-83 and $548 million (0.4 per cent) in 1981-82. The result in 1983-84 was influenced by the full-year effect of the 1982-83 personal tax cuts; the full-year cost of several expenditure programs introduced by the previous Government; and the initial cost of new expenditure programs—offset to some extent by savings on existing programs—introduced by the present Government. In contrast to the previous year, the large deficit was expected at budget time and the outcome for 1983-84 was relatively close to the budget figures. Receipts were within 0.8 per cent of the budgeted number while outlays were brought in within 0.1 per cent.

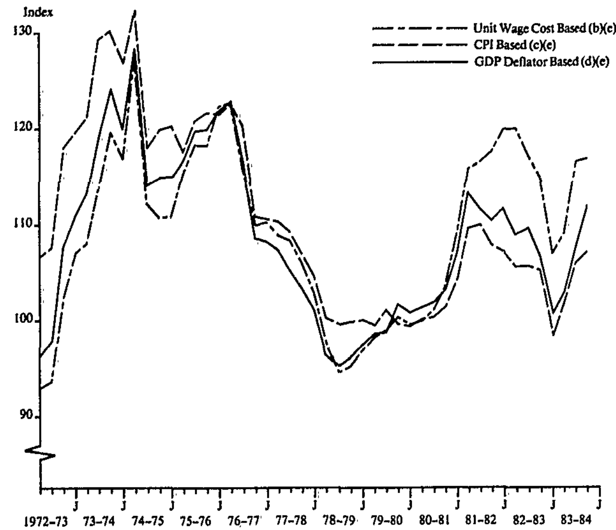
In 1983-84 Commonwealth budget outlays increased by 15.6 per cent, an increase of 7.7 per cent in real terms. Budget outlays represented 30.5 per cent of GDP in 1983-84, a little above the ratio in 1982-83.

Commonwealth budget receipts increased by 9.3 per cent in 1983-84. In real terms, receipts rose by about 1.9 per cent compared with a real decline in 1982-83 and an average annual real increase of around 3.3 per cent over the preceding decade. As a proportion of GDP, receipts fell in 1983-84 to 26.2 per cent. This fall essentially reflected the full year effects of the 1982-83 tax changes and the lagged effect of the depressed profits of 1982-83.

State and local government sector outlays are estimated to have risen by 10.2 per cent in 1983-84 (2.7 per cent in real terms), following a rise of 20.4 per cent in 1982-83 (8.3 per cent in real terms). As a proportion of GDP these outlays declined in 1983-84 after a strong increase the previous year (see Table 11).

State and local government revenues from own sources are estimated to have increased by 11.5 per cent (or 3.9 per cent in real terms) in 1983-84, while Commonwealth payments to the sector increased by 14.3 per cent (or 6.5 per cent in real terms). As a result, total State and local government sector revenues (including transfers and advances from the Commonwealth) are estimated to have increased by 13 per cent in 1983-84, or by 5.3 per cent in real terms.

Chart 13: Indexes of Unit Wage Costs and Prices in Australia Relative to Major Trading Partner Countries — Adjusted for Exchange Rate Changes (1979–80 = 100)(a)



(a) A discussion of these indexes and detailed figures covering the period from the September quarter 1970 to the March quarter 1983 may be found in a Supplement to the *Round-up of Economic Statistics* for July 1983 titled 'International Comparisons of Relative Price and Cost Levels.'
(b) The unit wage cost based index is the ratio of unit wage costs in the non-farm sector of the Australian economy (calculated as the ratio of non-farm wages, salaries and supplements to gross non-farm product) to the weighted average of the exchange rate adjusted unit wage cost indexes estimated for the manufacturing sectors of Australia's major four trading partners. It should be noted that the rate of growth of unit labour costs in the Australian manufacturing sector is, on average, around one percentage point lower than in the non-farm sector as a whole.
(c) The CPI based index is the ratio of the Australian consumer price index to the weighted average of the exchange rate adjusted consumer price indexes of Australia's major four trading partners.
(d) The GDP deflator based index is the ratio of the GDP deflator for Australia to the weighted average of the exchange rate adjusted GDP deflators of Australia's major four trading partners.
(e) The weights used are based on the average share of Australia's imports from the US, Japan, UK and West Germany from 1974–75 to 1979–80. The four countries are the source for about 55 per cent of Australia's imports. Observations are quarterly averages. A rise (fall) on this graph implies a deterioration (improvement) in Australian costs and prices relative to our major four trading partners after adjusting for exchange rate changes.

Table 11: Public Sector Outlays as a Percentage of Gross Domestic Product

		State and local government sector outlays			
		Financed by			
	Commonwealth sector outlays(*a*)(*b*) (per cent) (1)	Commonwealth assistance(*c*) (per cent) (2)	Own funds(*b*) (per cent) (3)	Total(*b*) (per cent) (4)	Total(*b*)(*d*) (per cent) (5)
Year—					
1973-74	24.3	8.1	8.4	16.5	31.4
1974-75	29.2	10.4	9.0	19.3	36.8
1975-76	30.4	11.6	8.4	20.0	37.6
1976-77	30.0	10.7	9.2	19.9	37.9
1977-78	30.9	11.1	9.8	20.9	39.4
1978-79	29.2	10.5	9.6	20.1	37.6
1979-80	28.5	10.0	9.8	19.8	37.2
1980-81	28.4	9.8	10.3	20.1	37.6
1981-82	28.9	9.4	10.6	20.0	38.3
1982-83	31.1	10.0	11.9	22.0	41.8
1983-84	31.7	10.1	11.2	21.3	41.8

(*a*) Budget and non-budget sectors. The latter comprises mainly capital expenditure.
(*b*) If adjustment is made for sale and leaseback transactions with the private sector, the estimates for 1980-81, 1981-82, 1982-83 and 1983-84, the years principally affected, are increased by the following amounts: for the Commonwealth sector by approximately 0.1, 0.2, 0.1 and less than 0.1 percentage points respectively; for the State and local government sector by approximately less than 0.1, 0.7, 0.5 and 0.6 percentage points respectively; and for the total public sector by approximately 0.1, 0.9, 0.6 and 0.7 percentage points respectively.
(*c*) Grants and net advances from the Commonwealth Budget.
(*d*) Net of all transfers between Commonwealth and State and local government sectors. Column (5) is equal to column (1) plus column (4) less column (2) and interest payments between these sectors.

Total public sector outlays are estimated to have increased by 13.3 per cent in 1983-84 or by 5.6 per cent in real terms; as a proportion of GDP they remained steady at 41.8 per cent. Allowing for the effect of sale and leaseback transactions with the private sector, public sector outlays are estimated to have increased by 13.6 per cent in 1983-84, or 5.9 per cent in real terms. As a proportion of GDP they are estimated at 42.5 per cent in 1983-84, about the same proportion as in 1982-83.

The overall State and local government sector borrowing requirement (excluding that portion financed by Commonwealth net advances to the States but allowing for the effect of sale and leaseback transactions) is estimated to have been $6170 million in 1983-84. This amounted to 3.3 per cent of GDP compared with 3.7 per cent in 1982-83 and 3.1 per cent in 1981-82, reflecting increased resort to borrowing by State and local government authorities since the mid-1970s.

The much lower rate of increase in the State and local government sector borrowing requirement in 1983-84 was in part a consequence of reduced borrowings for capital works by State electricity authorities which had increased their borrowings very substantially in the two preceding years. Initially, the expansion in electricity authority borrowings involved increasing resort to forms of borrowing not subject to Loan Council controls including leasing, trade credits and short-term borrowings. Following agreement at the June 1982 Loan Council meeting to remove controls over the amount

Table 12: Public Sector Borrowing Requirement(*a*)

	Commonwealth sector		State and local government sector(*b*)		Total	
	$m	Percentage of GDP	$m	Percentage of GDP	$m	Percentage of GDP
Year—						
1973-74	353	0.7	457	0.9	807	1.6
1974-75	2 516	4.1	929	1.5	3 445	5.6
1975-76	3 527	4.8	448	0.6	3 975	5.4
1976-77	3 029	3.6	1 013	1.2	4 042	4.9
1977-78	3 850	4.3	1 591	1.8	5 441	6.0
1978-79	3 706	3.6	1 899	1.8	5 605	5.5
1979-80	2 489	2.2	2 249	1.9	4 738	4.1
1980-81	1 626	1.2	3 202	2.4	4 828	3.7
1981-82	1 318	0.9	4 688	3.1	6 006	4.0
1982-83	5 344	3.3	6 100	3.7	11 444	7.0
1983-84(*p*)	8 637	4.7	6 170	3.3	14 807	8.0

(*a*) Total public sector outlays less receipts; net advances to other sectors by the public sector are treated as public sector outlays. This measure allows for the effect of sale and leaseback transactions with the private sector. It differs from the measure of net borrowing by the public sector used in Chart 14, which treats net advances as a financing transaction having no impact on the borrowing requirements and which does not allow for the effect of sale and leaseback transactions. The estimates of the magnitude of sale and leaseback transactions as a percentage of GDP for 1980-81, 1981-82, 1982-83 and 1983-84, the years principally affected, are for the Commonwealth sector approximately 0.1, 0.2, 0.1 and less than 0.1 percentage points respectively; for the State and local government sector approximately less than 0.1, 0.7, 0.5 and 0.6 percentage points respectively; and for the total public sector approximately 0.1, 0.9, 0.6 and 0.7 percentage points respectively.
(*b*) The figures for the State and local government sector shown here are net of advances from the Commonwealth Budget; they therefore measure the borrowings undertaken by the sector.
(*p*) Preliminary.

and terms of domestic borrowings by electricity authorities, conventional borrowings by these authorities increased dramatically (although they were, in part, related to the refinancing of existing and, often, short-term debt), while off-program techniques continued to be used by other types of authorities. The lower rate of increase in State and local government sector borrowings also reflected the fact that the increases experienced in the preceding two years were simply not sustainable, in terms either of the real increases in fixed capital expenditure they would have implied or of the ability of the authorities concerned to service the resultant debt burden.

The large Commonwealth Budget deficit and the sustained high investment level by Commonwealth, State and local government authorities, produced a historically high Public Sector Borrowing Requirement in 1983-84.

Monetary Conditions

Monetary policy in 1983-84 aimed to provide an appropriately firm financial framework that would promote an environment of sustainably lower inflation while allowing the expected pick-up in real activity to proceed.

In the 1983-84 Budget Speech, the Treasurer announced the setting of a conditional monetary projection (M3) of 9 to 11 per cent growth over the four quarters to the June quarter 1984. This projection was subject to review in the light of developments during the year; in the event, it was revised to 10 to 12 per cent in December in the light of faster economic growth than had been expected at budget time within a climate of generally restrained wage and price increases.

However, the most notable change in the multiplicity of factors influencing domestic financial developments in the past year was the mid-year decision to move to a floating exchange rate regime. This decision (which is treated in more detail in the final Section of this Part) brought with it a significant change in the links between the domestic and external financial markets.

While, under the managed exchange rate regime, the exchange rate tended to respond over the medium term to the balance of market forces, in the short term there was a tendency for the management of the rate to lean against changes in market sentiment which were perceived to be erratic; but at times did so at the expense of heavy short-term flows of funds across the exchanges. These flows directly affected the liquidity of the financial system and constrained the effectiveness of instruments of monetary policy in curbing the growth of monetary aggregates. At the extreme, offsetting domestic action could have the perverse effect of magnifying such flows.

Under the managed exchange rate, net flows of foreign exchange added substantially to domestic liquidity in the first half of 1983-84. Most of the inflow occurred between September and December, more particularly in November and early December. In late October changes were made to exchange rate management procedures that were designed to reduce the potential for 'within day' speculation against the currency and to give greater weight to market forces; at the same time these changes, and in particular the withdrawal of the authorities from the official market for forward exchange, signalled the likelihood of more extensive moves in the months ahead. Although five bond tenders totalling $6100 million were held between July and November 1983 and net sales of Australian Savings Bonds amounted to $1666 million over the same period, growth of the monetary aggregates continued in excess of the range projected in the Budget.

Interest rates fell during the first half of 1983-84, particularly at the short end. Yields on 90-day bank-accepted commercial bills declined by around 6 percentage points between early July and early December, with the sharpest falls in the first week in December immediately prior to the decision to float. In part, that reflected the additional liquidity coming into the system and in part an attempt by the authorities to keep to a minimum the quantity of available short-term official paper in which short-term speculative inflow of funds could be 'parked'. The result was a decline in interest rates—particularly at the short end—to unsustainably low levels. Meanwhile, the fall in inflation and the reduced borrowing requirement of the private business sector also contributed to some easing in the general structure of interest rates.

The decision to float the exchange rate changed the nature of the links between domestic and international financial markets. From mid-December, there could be little or no recourse by the domestic financial system as a whole to overseas capital markets to meet domestic liquidity needs—although, clearly, individual institutions were still free to borrow and did borrow in overseas markets. While foreign borrowing was largely unhindered, the fundamental change was that the Reserve Bank no longer stood in the market offering to purchase foreign exchange at the prevailing rate. As discussed later in this part Reserve Bank intervention in foreign exchange markets

post-float was minor. Those continuing to draw on overseas markets had, in effect, to find a counterpart other than the Reserve Bank through whom to convert foreign exchange proceeds into $A—thus, as noted, leaving funds in the system as a whole unaffected. The principal sources of liquidity were thereby limited to injections from the budget deficit, from maturing Commonwealth Government securities and from Reserve Bank transactions—thus assisting the monetary authorities to influence monetary conditions during the second half of 1983-84 in a manner more consistent with underlying policy needs.

The large inflows of funds in late 1983 had left a substantial 'overhang' of liquidity in the system by the time the decision to float the dollar was put into effect. With interest rates at artificially low levels and the banking system—in particular savings banks—in a highly liquid state the potential clearly existed for a rate of growth of credit expansion that would not have been helpful to containing inflation. With that concern in mind, the Government approved three Treasury Bond tenders totalling $2550 million during the March quarter. A further Treasury Bond tender, for $1000 million, was held in mid-May following the end of the seasonal rundown in liquidity. The Reserve Bank sold off its forward book and provided the foreign exchange to meet that part of the budget deficit which was expended overseas—both of which approaches also made a useful contribution to siphoning off the liquidity overhang.

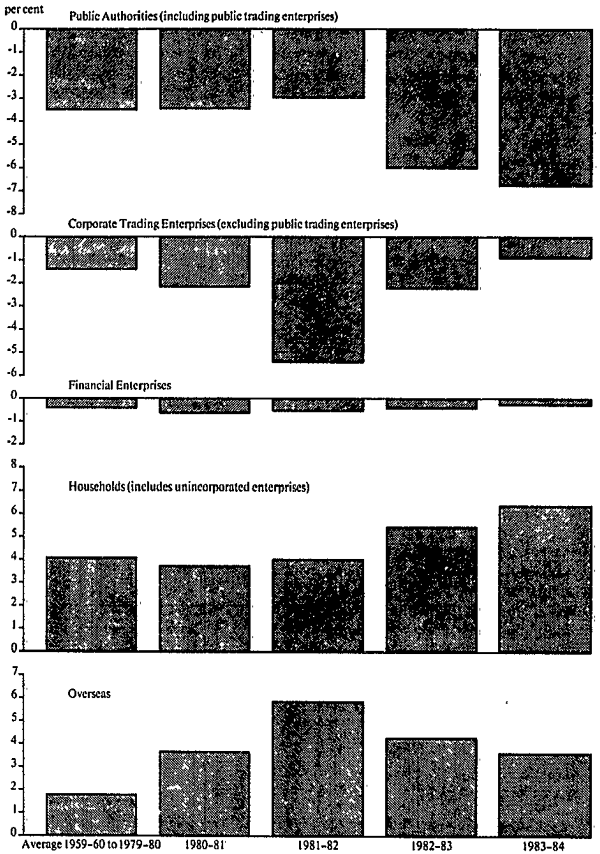
As monetary conditions firmed again, interest rates increased in early 1984 from their previously low levels. With the monetary system as a whole now effectively denied access to overseas funds to help it through the June quarter, preparations for the seasonal rundown began earlier than usual and the yield on 90-day bank-endorsed commercial bills rose by 4.5 percentage points between end-December and end-March. Yields on Treasury Bonds rose by up to one percentage point over the same period. Short-term interest rates subsequently eased from the second half of May, while Treasury Bond yields remained broadly unchanged.

Over the year as a whole, long-term domestic bond yields declined by between 0.9 and 1.4 percentage points to close 1983-84 in the range 13.0 to 14.2 per cent. Since then, yields on long bonds have fallen, by around three-quarters of a percentage point. Comparable yields in the United States, by contrast, rose over the same period from 10.5 to 13.5 per cent. The resulting shift in yield differentials partly reflected an improvement in Australia's inflation outlook and increased concern regarding the medium-term prospects for US financial markets. It also reflected the influence of the floating exchange rate regime, which attenuated the short-term link between domestic and overseas interest rates. The resulting shift in interest rate relativities contributed to a depreciation of the Australian dollar late in 1983-84.

Chart 14 illustrates the net lending and borrowing positions of the major sectors of the economy as a proportion of GDP over recent years. These positions provide some indication of the shift of resources and associated financial flows between various sectors, from which implications may be drawn for conditions in financial markets.

Although economic conditions improved markedly over the course of 1983-84 from the depressed levels evident in 1982-83, borrowings in the capital market remained dominated by the public sector. This reflected a record Commonwealth Budget deficit and sustained borrowing by the State and local government sector.

Chart 14: Net Lending and Borrowing by Sector
(Per cent of Gross Domestic Product) (a)



(a) Based on National Accounts data and Treasury estimates. Positive (upward) bars on these charts represent net lending while negative (downward) bars represent net borrowing.

Preliminary estimates suggest that the borrowing requirement of the corporate sector moderated further in 1983-84, reflecting the subdued level of business investment and the increase in corporate profitability. Household net lending to other sectors increased further in 1983-84, reflecting both rising incomes and an increase in the saving ratio.

For the year as a whole, then, reduced financial demands by the corporate sector and a large rise in household savings enabled the large borrowings by the public sector to be absorbed by financial markets with a reduced call upon the external sector and some reduction in nominal interest rates over the course of the year. The moderation in inflation and, it is to be hoped, inflationary expectations was also conducive to the modest decline in nominal interest rates.

Formation and Absorption of Liquidity

A budget deficit in the first half of 1983-84 of $7.9 billion and, in the same period, a surplus on foreign exchange transactions of $2.6 billion required a substantial borrowing program by the Commonwealth to mop up the resulting flood of liquidity.

Non-official take-up of Commonwealth Government securities (CGS) totalled $9.2 billion in the first half of 1983-84, comprising a net $5.6 billion in Treasury Bonds, $2.5 billion in Australian Savings Bonds (ASBs) and $1 billion in Treasury Notes.

In the second half of 1983-84, liquidity remained broadly unchanged, the budget deficit being in approximate balance. Net official sales of CGS in this period were accordingly small; net Treasury Bond sales of $2.3 billion were offset by $0.6 billion in redemptions of ASBs and the usual seasonal rundown of $2 billion in Treasury Notes. As noted earlier, CGS transactions in the second half of the financial year were directed to reducing the substantial 'overhang' of liquidity in the system, thereby increasing the average maturity of outstanding debt.

For 1983-84 as a whole, the major part of the Commonwealth's borrowing program was met by net sales of $7.9 billion in Treasury Bonds, of which $2.3 billion was purchased by the banks. Net sales of ASBs totalled $1.9 billion despite the sizable redemptions during the latter part of the year. Non-official holdings of Treasury Notes fell by slightly more than $1 billion between June 1983 and June 1984. The average maturity of CGS on issue increased from 4.7 years in June 1983 to 5.3 years in June 1984, reflecting the reduction in the amount of Treasury Notes on issue and a substantial increase in Treasury Bonds held by the non-official sector.

Financial Intermediation

Overall, the pace of financial intermediation increased—though not markedly—in 1983-84. In line with the rebound in economic activity, the growth in nominal GDP accelerated from 6 per cent over the course of 1982-83 to around 18 per cent over 1983-84. This sharp acceleration was not matched by growth in the monetary aggregates.

From the June quarter 1983 to the June quarter 1984 the volume of money, M3, increased by 11.4 per cent; the growth in broad money[7] was 11.3 per cent according to preliminary estimates. As these figures indicate—and as was expected last budget time—there was a sharp increase in the *velocity of money* during 1983-84, reversing the

7. Broad money includes currency in the hands of the non-financial institution private sector plus borrowings from that sector by banks, cash management trusts and the principal categories of non-bank financial intermediaries registered under the Financial Corporations Act.

cyclical decline which had occurred in the preceding year. The increase in velocity reflected moderate growth in most forms of lending, with the exception of a sharp increase in lending for housing and strong growth in other lending to the household sector.

Financial intermediation during 1983-84 continued, therefore, to be heavily influenced by cyclical factors including increased household savings and the sharp reduction in the demand for finance by the corporate sector. As a result, deposits with institutions catering to household savings—including savings banks and building societies—grew strongly, while borrowing from the public by institutions that lend to the corporate sector showed weaker growth.

Table 13 presents borrowing and lending growth rates of the major financial institutions in recent years.

Table 13: Net Borrowing and Lending by Financial Institutions (*a*)
(percentage increase year to quarter)

	1982	1983		1984
	June	June	December	June(*p*)
Borrowing (*b*)—				
Trading banks	14.5	6.8	4.2	7.0
Savings banks	7.5	18.1	23.7	16.4
Building Societies	10.0	12.3	12.9	14.7
Finance Companies	13.9	4.2	−3.3	1.7
Money Market Corporations	41.4	15.9	10.3	17.2
Other NBFIs (*c*)	18.6	26.6	13.6	24.0
Total (*d*)	14.0	11.4	9.9	11.7
of which:				
Banks (*e*)	11.4	12.1	13.2	11.1
Non-banks	18.3	11.5	6.5	12.3
Lending (*f*)—				
Trading banks	15.7	7.2	10.4	11.7
Savings banks	11.5	20.1	17.4	14.7
Building Societies	10.8	9.8	9.5	13.8
Finance Companies (*c*)	15.6	3.9	−1.6	3.6
Money Market Corporations	41.9	16.8	7.2	15.0
Other NBFIs (*d*)	21.8	20.2	16.4	19.5
Total (*g*)	16.7	11.1	8.8	11.8
of which:				
Banks	14.1	11.8	13.0	12.8
Non-banks	19.6	9.8	5.1	11.6

(*a*) Including trading and savings banks, and corporations registered under the Financial Corporations Act (with assets exceeding $5 million). Underlying data are monthly averages; interpolated data are used for savings banks and NBFIs. All figures are percentage increases over the year to the quarter shown.
(*b*) For banks defined as 'total deposits' (excluding external territories); for non-banks defined as 'borrowings from residents' but excluding, where possible, borrowings from related corporations, other non-bank financial intermediaries and banks.
(*c*) Including FCA categories 'credit co-operatives', 'authorised money market dealers', 'pastoral finance companies', and 'general financiers'.
(*d*) The consolidated 'total' is derived from the sum of the two component items by deducting 'cash and bank deposits' of the NBFIs.
(*e*) M3 minus currency and deposits of the non-bank public with the Reserve Bank.
(*f*) Defined for banks as 'loans, advances and bills discounted'; defined for non-banks as the sum of 'loans, advances and deposits that are not marketable securities', 'bills of exchange and promissory notes discounted and held' and 'other assets arising from the provision of finance' (but excluding loans to related corporations).
(*g*) The consolidated 'total' is derived from the sum of the foregoing items by deducting, where possible, lending by banks to NBFIs except authorised dealers. (Lending by banks to authorised dealers is excluded from bank 'loans, advances and bills discounted'.)
(*p*) Preliminary.

The Monetary Aggregates

Factors contributing to monetary growth during 1982-83 and 1983-84 are shown in Table 14, while Table 15 presents growth rates of the various aggregates since 1980-81.

Table 14: Money Formation **(*$* million) (*a*)**

	1982–83	1983–84	1983–84	
			6 months to December	6 months to June
Budget Deficit	4 473	7 961	7 879	82
Foreign Exchange Transactions (*b*)	1 875	1 338	2 596	−1 259
Other (*c*)	−147	487	−335	823
CHANGE IN PRIVATE SECTOR LGS/SRD (*d*)	6 201	9 786	10 140	−354
Less Net Sales of CGS to private sector (*d*)	5 682	8 692	8 988	−296
Other (*e*)	−54	−4	43	−47
CHANGE IN MONEY BASE (*f*)	465	1 090	1 195	−105
Purchases of CGS by banks	1 516	1 682	2 235	−554
Change in bank advances	5 329	5 787	3 116	2 672
Other (*g*)	410	−1 087	−1 200	113
CHANGE IN VOLUME OF MONEY (M3) (*h*)	7 720	7 472	5 346	2 126
Purchases of CGS by NBFIs	296	582(*p*)	732	−150(*p*)
Change in NBFI advances	3 794	5 464(*p*)	2 183	3 281(*p*)
Other (*i*)	−118	−824(*p*)	−172	−652(*p*)
CHANGE IN BROAD MONEY (*j*)	11 692	12 694(*p*)	8 089	4 605(*p*)
Net Sales of CGS to private sector comprising:				
Banks	1 516	1 682	2 235	−554
NBFIs	296	582(*p*)	732	−150(*p*)
Other (*k*)	3 870	6 428(*p*)	6 021	408(*p*)
Change in money base of which:				
Currency held by private sector	548	981	980	1
Deposits of the private sector with the RBA	−84	110	215	−105

(*a*) First five rows of the table are on a last day basis; private LGS/SRD and CGS (excluding IEDs) are measured at face value basis. Remaining figures are on a monthly average basis.
(*b*) Foreign exchange transactions are defined as change in gold and foreign exchange reserves less valuation effects less net overseas raisings by the Commonwealth.
(*c*) Includes miscellaneous accounts of the private sector with the Reserve Bank and miscellaneous factors nec.
(*d*) 'Private' is defined to exclude the Reserve Bank, Commonwealth Trust Funds and State Governments.
(*e*) Timing discrepancy reflecting the difference between the money base measured on a last-day basis and on a weekly average basis.
(*f*) Money base is defined as the private sector's holdings of notes and coin plus deposits of the private sector with the Reserve Bank (including SRD accounts).
(*g*) Other net assets (excluding notes and coin, SRD accounts and other accounts with the Reserve Bank) of banks.
(*h*) Defined as currency of the non-bank private sector plus bank deposits of the non-bank private sector.
(*i*) Other net assets (excluding notes and coin) of non-bank financial intermediaries and cash management trusts.
(*j*) The non-financial intermediary public's holdings of currency and deposits with financial institutions (including trading and savings banks and registered financial corporations excluding 'intra-group financiers' and 'other financial corporations'). Cash management trusts are included from January 1983.
(*k*) Includes a timing discrepancy since the total is on a last day basis.
(*p*) Preliminary.

Table 15: Growth Rates of Selected Financial Aggregates (a) (per cent)

	1980-81	1981-82	1982-83		1983-84	
	June	June	December	June	December	June
Money Base (b)	10.4	12.4	8.8	6.3	10.3	12.1
M1 (c)	11.9	2.1	−0.7	4.7	12.6	10.5
M2 (d)	15.2	14.3	11.3	7.6	6.1	7.8
M3 (e)	12.6	11.5	10.4	11.8	13.2	11.4
Broad Money (f)	15.5	14.0	12.5	11.2	10.0	(p)11.3

(a) Growth rates are for the year to the quarter shown, using quarterly figures based on monthly average data.
(b) Defined as the private sector's holdings of notes and coin plus its deposits with the Reserve Bank (including SRD accounts).
(c) Defined as the non-bank sector's holdings of notes and coin, deposits with the Reserve Bank and current deposits with trading banks.
(d) Defined as M1 plus the non-bank sector's non-current deposits with trading banks. Trading bank deposits held by Commonwealth and State Governments and by other banks are excluded.
(e) Defined as M2 plus the non-bank sector's deposits with all savings banks.
(f) Defined as M3 plus changes in public (non-financial intermediary) deposits with corporations registered under the Financial Corporations Act (excluding 'intra-group financiers', other non-bank financial corporations and retailers) and, from January 1983, cash management trusts. Data are interpolated where necessary to yield average of month figures.
(p) Preliminary.

The *money base* is a measure of the supply of very liquid assets to the financial system. It consists of notes, coins and deposits (including Statutory Reserve Deposit Accounts) with the Reserve Bank. This measure increased by 12.1 per cent over the year to the June quarter 1984, following growth of 6.3 per cent over the previous year.

The *volume of money*, M3, increased by 11.4 per cent over the year to the June quarter 1984, thus falling within the revised conditional projection range of 10 to 12 per cent announced in December 1983. Although annual rates of M3 growth slowed during the second half 1983-84, this outcome was influenced by uneven growth in the previous year as well as policy action to moderate monetary growth following the large injection of liquidity from the external sector prior to the float.

Broad money grew slowly in the first half of the year but accelerated thereafter. By the June quarter 1984, the growth of this aggregate was close to that of M3, suggesting that normal cyclical influences were again the main determinants of relative growth in these aggregates rather than deregulation and re-intermediation which, for a period, had exerted some influence.

Balance of Payments

The current account deficit increased by $0.5 billion in 1983-84 to $6.7 billion. Net apparent capital inflow declined by $0.1 billion from its 1982-83 level to $8.5 billion. Table 16 shows major balance of payments aggregates for recent years. Table 17 shows quantity and price movements relating to trade in goods and services.

The small rise in the overall current account deficit masked sizable and divergent movements in its main components (Chart 15). The balance of trade improved from a deficit of around $1 billion in 1982-83 to a surplus of around $0.2 billion in 1983-84. A 15 per cent rise in export receipts outweighed a 9 per cent rise in import payments. The net invisibles deficit widened, however, increasing by 32 per cent to $6.9 billion, largely because of a sharp rise in servicing payments on the stock of foreign debt and direct foreign investment.

Table 16: Balance of Payments: Main Aggregates ($m, not seasonally adjusted)

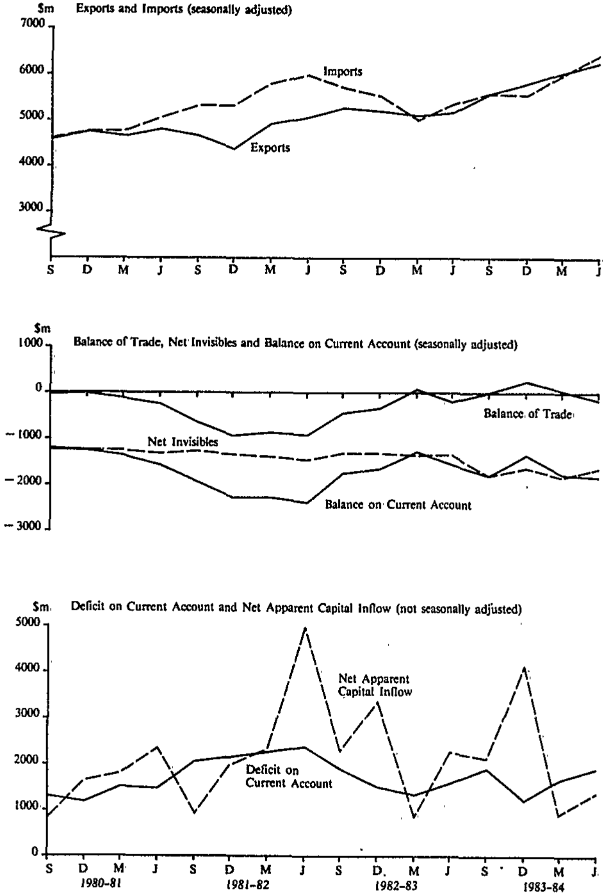
	1981-82 Year	1982-83 Year	1983-84 Year	1983-84 I	1983-84 II
Current account—					
Exports	19 083	20 656	23 725	11 405	12 320
Imports	−22 379	−21 610	−23 494	−11 234	−12 260
Trade balance	−3 296	−954	231	171	60
Net invisibles	−5 519	−5 234	−6 928	−3 297	−3 631
Current account balance	−8 815	−6 188	−6 697	−3 126	−3 571
Capital account—					
Government securities	541	967	998	842	156
Securities domiciled overseas	368	582	361	448	−87
Securities domiciled in Australia	173	385	637	394	243
Other government	−30	−171	−582	−329	−254
Total government capital	511	796	416	513	−97
Trade credit nei	198	−301	−54	108	−162
Foreign investment in enterprises in Australia—					
Undistributed income	238	−511	360	180	180
Other	9 133	9 083	7 584	4 352	3 232
Other private capital and balancing item	90	−444	241	1 105	−864
Net apparent private capital inflow	9 658	7 828	8 131	5 745	2 386
Net apparent capital inflow	10 169	8 624	8 547	6 258	2 290
Net official monetary movements	1 354	2 436	1 850	3 132	−1 282
Current account deficit as a percentage of GDP	5.9	3.8	3.6	3.3	3.9

Table 17: Movements in Exports and Imports at Constant Prices (a)

	1981-82 Year	1982-83 Year	1983-84 Year	1983-84 I	1983-84 II
Volumes					
Rural exports	1.2	−5.3	2.3	5.1	46.6
of which:					
Meat	−3.5	12.2	−26.8	−21.5	−34.0
Cereals	9.6	−28.2	41.7	43.8	402.2
Sugar	−0.1	4.0	−7.0	−18.4	54.4
Non-rural exports	1.4	7.6	12.3	17.6	6.8
of which:					
Mineral fuels	12.1	13.0	22.6	24.1	24.0
Metal ores and minerals	−8.2	3.1	7.4	27.2	2.5
Total exports of goods	1.3	1.8	8.1	12.7	21.0
Total imports of goods	12.4	−10.8	6.1	13.3	25.0
of which:					
Fuels	0.2	−5.6	−23.4	−37.9	56.0
Machinery and transport equipment	15.4	−13.5	3.2	12.7	11.2
Chemicals	10.2	−9.7	19.1	28.4	29.9
Total exports of goods and services	1.0	1.3	7.2	11.8	17.5
Total imports of goods and services	11.2	−9.7	5.8	12.7	14.0
Implicit price deflators					
Exports of goods and services	2.0	6.7	6.1	7.8	−1.4
Imports of goods and services	3.8	8.5	2.3	1.4	6.4
Terms of trade (b)	−1.8	−1.7	3.7	6.3	−7.3

(a) Percentage change on previous period. Half yearly changes are expressed as seasonally adjusted annual rates.
(b) Defined as the implicit price deflator for exports of goods and services divided by the implicit price deflator for imports of goods and services.

Chart 15: Recent Trends in Australia's Balance of Payments
($m per quarter)



Although the dollar value of the current account deficit rose in 1983-84, the deficit as a percentage of GDP declined to 3.6 per cent compared with 3.8 per cent in 1982-83 and 5.9 per cent in 1981-82. As 1983-84 progressed, however, the trend in the current account deficit became adverse; imports were rising even faster than domestic demand and the net invisibles deficit was consistently larger than in the previous year.

Export receipts increased by 15 per cent in 1983-84, reflecting an increase of about 8 per cent in volumes and an increase in prices of about 6 per cent. The main impetus to volume growth came from non-rural exports (particularly iron ore, petroleum, steaming and coking coal and alumina and aluminium). This reflected additions to capacity and greater capacity utilisation in the resource sector, the competitiveness of Australian raw materials production (which was maintained in some instances eg, coal and iron ore, only by cuts in contract prices) and the pick-up in world economic activity. Rural export volumes picked up a little from the previous year. High cereal export volumes in the second half of the year were largely offset by drought-induced falls in the volume of meat and sugar exports.

Average rural export prices were buoyed up by rises in meat and sugar prices. On the other hand, non-rural export prices recorded only a small increase as reductions in contract prices for iron ore and coal largely offset rises in other non-rural prices.

The total value of imports rose by 9 per cent in 1983-84 reflecting an increase in volumes of about 6 per cent and a rise in prices of about 2 per cent. Strengthening domestic demand (including private investment demand) during the course of the year and the turnaround in the stock cycle contributed to this rise, particularly in the second half of the year. Offsetting this was a substantial decline in petroleum imports facilitated by higher levels of domestic production of crude oil.

The net invisibles deficit grew by 32 per cent in 1983-84. Improved corporate profitability resulted in a rise in earnings on direct foreign investment, including higher retained earnings as well as higher profit remittances abroad. The build-up in foreign debt from high net capital inflows in recent years raised interest payments abroad and the rise in imports during 1983-84 increased freight payments abroad.

Total net apparent capital inflow was $8.5 billion in 1983-84, well in excess of the current account deficit. As is evident from Chart 15 this resulted from large private capital inflows in the early months of 1983-84, particularly in the December quarter. These inflows were largely speculative, based particularly on an expectation of a revaluation of the Australian dollar. Net apparent private capital inflow in the six months ending December 1983 was $5745 million, almost double the current account deficit.

Since the floating of the dollar on 12 December 1983, net apparent private capital inflow has been much lower. In the six months ending June net apparent private capital inflow was $2387 million, much the same as the private sector's current account deficit.

Government capital transactions resulted in a net inflow of $416 million in 1983-84 compared with $796 million the year before. The inflow reflected net sales of Commonwealth securities (issued both abroad and in Australia) to non-residents of $998 million, which more than offset an outflow on other transactions, principally prepayments for major items of defence and transport equipment, of $582 million.

At end-June 1984 official reserves stood at $12.4 billion, an increase of $1.7 billion from the level at end-June 1983. Balance of payments transactions increased reserves by $1.9 billion while revaluations (which arise from changes in the value of the $A and in the price of gold) reduced reserves by $0.2 billion. Foreign exchange reserves stood at $8.6 billion at end-June 1984 compared with $6.9 billion at end-June 1983. Reflecting high levels of private capital inflow prior to the float, official reserves at end-December 1983 were $2.6 billion higher than at end-June 1983. During the second half of the year official reserves were run down by $0.9 billion, mainly through the funding of the overseas component of the budget deficit.

Foreign Exchange Developments

Comprehensive measures to deregulate Australia's foreign exchange market were implemented in 1983-84. On 28 October 1983 the Reserve Bank implemented a number of adjustments to Australia's foreign exchange arrangements. They included the decision to substantially deregulate the official forward market (which at that stage accounted for less than 20 per cent of all forward exchange and hedge covering in Australia). At the same time the setting of the official $US/$A rate at the end of the day rather than, as before, at 9.30 a.m. was aimed at stemming 'within day' speculation against the official rate. For a short time thereafter, net foreign exchange inflows subsided.

However, by late November, inflows had again gathered strength. Along with its decision to allow the dollar to float from 12 December 1983 the Government also decided that a major part of the exchange control restrictions, which had been designed principally to support the administered exchange rate arrangements by limiting the opportunities for international capital flows, should be abolished.

At the same time the Reserve Bank announced that it would not generally be intervening in the foreign exchange market, while retaining a discretion to do so. Intervention could be required from time to time to test market trends or to smooth the impact that large transactions might otherwise have on the exchange rate. The Bank also announced that it would be making market purchases and sales of foreign exchange arising from transactions with its clients, including the Commonwealth Government. It would not be aiming to produce any particular exchange rate outcome—although transactions would of course have some effect on the rate.

In view of the heavy net inflows prior to the float and the impact these had on domestic liquidity conditions, the Bank took a number of opportunities subsequently to sell foreign exchange. These included:

- the sale of all of the net $US300 million in forward exchange contracts outstanding when the Bank withdrew from the forward exchange market at the end of October 1983;
- sale of the equivalent of the final proceeds, received in February 1984, of a borrowing in the United Kingdom, undertaken and announced in October 1983; and
- net sales of foreign exchange as a result of the Bank testing and smoothing foreign exchange market conditions.

Since the float, the Bank also funded the Commonwealth Government's foreign exchange needs for the remainder of 1983-84 out of official foreign exchange reserves.

On 10 April 1984 the Treasurer announced the Government's decision to increase the number of foreign exchange dealers by authorising non-bank financial institutions that met certain criteria and agreed to certain conditions to deal in foreign exchange. The Treasurer subsequently announced that some 40 new dealers would be so authorised. In addition, as from 25 June 1984—the day on which the first of the new dealers commenced operations—the previous prohibition on the covering of non trade-related risks (in particular, capital) in the banks' forward market was removed. These decisions were designed to contribute to a deeper and more efficient foreign exchange market.

The decisions to deregulate the foreign exchange market both reflect and respond to the increasing integration of Australia into the international capital market. They should also be seen as part of policy to remove unnecessary ineffective regulation in the interests of greater efficiency.

In response to the large net foreign exchange inflow in the period prior to the float, the $A strengthened steadily during most of the first half of 1983-84. This coincided with a weakening of the US dollar on world markets for some time after August in response to lower US interest rates. On 8 December 1983, immediately prior to the float, the $A stood at $US0.9025 and 81.4 in trade weighted terms, 3.2 per cent and 4.8 per cent higher respectively than at end-June 1983.

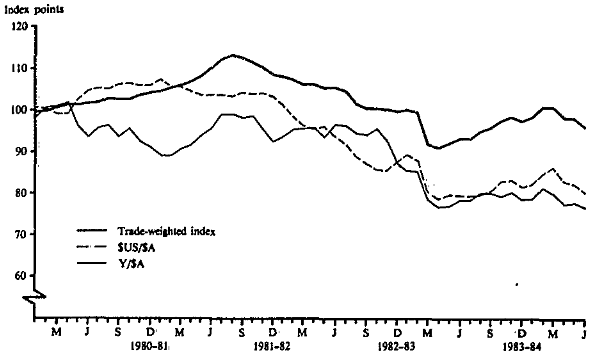
Since the float the $A has, predictably, fluctuated more widely in response to the demand for and supply of foreign exchange. The dollar's variability has not generally, however, been out of line with the experience of other floating currencies over this period—which has been a time of considerable and fluctuating pressures in exchange markets the world over.

As indicated in Chart 16, the $A reached its peak for the post-float period (and for 1983-84) in mid-March, both against the US dollar and on a trade-weighted basis. The main factors underlying the strengthening of the dollar at this time were a weaker US dollar on international markets, increases in domestic interest rates and an apparently improved current account performance.

Between this peak and end-June the $A fell back by 10.8 per cent against the US dollar and by 7.5 per cent on a trade-weighted basis. This substantial weakening has been occasioned largely by the significant rebounding of the US dollar associated with increases in US interest rates and the continued strength of the US recovery. An easing of domestic interest rates associated with the passing of the seasonal tax rundown period has also contributed. The $A also declined significantly over this time against the other major currencies—5.8 per cent against the Yen, 4.5 per cent against the Deutschemark and 3.9 per cent against Sterling.

These considerable changes within the year were, to a large extent, offsetting. Over the year to end-June the $A rose 2 per cent on a trade-weighted basis. There were appreciations against the currencies of two of our major trading partners—the Federal Republic of Germany (7.7 per cent) and the United Kingdom (11.3 per cent)—and more modest depreciations against the US dollar (1.5 per cent) and the Yen (2.3 per cent).

Chart 16: Movements of the Australian dollar against Selected Currencies and in the Trade Weighted Index
(March quarter 1980 = 100)(a)(b)



(a) Upward (downward) movements represent appreciation (depreciation) of the $A against other currencies.
(b) Rates calculated as monthly averages.

PART II: INTERNATIONAL ECONOMIC CONDITIONS AND PROSPECTS

The strengthening in international economic activity, which emerged initially in the United States late in 1982, intensified and became more widely spread during the first half of 1984. For OECD countries as a group, some slowing is expected in the second half of 1984 and in 1985, mainly from an expected reduction in growth in the United States.

Real GNP in the United States is estimated to have risen by 3.7 per cent in 1983 and at a seasonally adjusted annual rate of 8.4 per cent in the first half of 1984. The recovery in the United States was influenced, in the first instance, by falling inflation and tax cuts, and was initially concentrated in a pick-up in personal consumption expenditure and residential investment and a slowing in the rate of inventory decumulation. The strengthening in final sales, which exceeded expectations, together with reduced wage and price inflation and increased business profitability (partly induced by tax cuts), subsequently contributed to a surge in business fixed investment. For 1984 as a whole, real GNP growth in the United States is now forecast to exceed 6 per cent. Growth of that order is not expected to be maintained beyond 1984 and the rate of economic expansion should ease in 1985 as stock building runs its course, as the economy moves nearer to capacity and as high interest rates take their toll of consumption and investment.

In Japan, a modest strengthening in economic activity developed in mid-1983 and real GNP rose by 3.0 per cent for 1983 as a whole. The initial impetus to faster growth came mainly from a boost in export demand which, in turn, was largely a consequence of the strong turnaround in the United States economy and the gain in Japanese competitiveness from the strengthening of the US dollar relative to the Japanese yen. Public fixed investment also made a substantial contribution to the initial recovery in domestic demand. The recovery became more broadly based in the second half of 1983, with strengthening private consumption and investment aided by a decline in real oil prices. Domestic demand now rivals exports as the principal source of growth and GNP is expected to grow by over 4¼ per cent in 1984. The rate of expansion of the Japanese economy is currently forecast to moderate to a seasonally adjusted annual rate of around 3¼ per cent in the first half of 1985.

In Western Europe the recovery is less well developed and more disparate and seems likely to remain fragile until private investment strengthens. A gradual recovery has been under way in the United Kingdom since mid-1981, with the rate of growth of GDP rising to a relatively strong 3.2 per cent in 1983 and edging up further in early 1984 prior to the national coal strike. In the Federal Republic of Germany, negative growth in 1982 gave way to a modest increase in output in 1983. Output there also has recently been adversely affected by a major industrial dispute, now concluded. Even so, of the major European economies, these countries appear to have the best growth prospects in 1984—with real GDP expected to increase by around 2¼ per cent in the United Kingdom and by around 3 per cent in the Federal Republic of Germany. In France, marginal growth was achieved in 1983 and the rate of expansion is expected to remain modest during 1984, while growth in Italy is expected to resume following the decline recorded in 1983. For the smaller OECD industrial countries, real GDP growth is expected to rise from 1.6 per cent in 1983 to around 2¼ per cent in 1984.

For OECD countries as a whole, the rate of real GNP growth is expected to be around 4¾ per cent in 1984 compared with an estimated 2.4 per cent in 1983, but is currently forecast to slow to around 2¾ per cent in 1985.

Real growth in non-oil developing countries is estimated to rise from 1½ per cent in 1983 to 3½ per cent in 1984. For the oil-exporting developing countries, there could be an expansion of around 4¾ per cent in real terms in 1984, following four years of falling GNP (partly reflecting a sharp curtailment of government spending associated with falling demand and prices for OPEC oil during that time). Very recent developments in international oil markets cast something of a cloud over prospects for this group of countries.

The average inflation rate (as measured by private consumption deflators) in OECD countries fell from a peak of 11.1 per cent in 1980 to 7.9 per cent in 1982 and continued to decline to around 5¼ per cent in 1983, reflecting subdued wage settlements, moderate increases in commodity prices and substantial productivity growth.

After two years when sharp falls were recorded, non-oil commodity prices increased, on average, by some 7 per cent (in US dollar terms) in 1983. This rise in commodity prices is, however, considerably weaker than that experienced in the previous (1976-77) economic recovery. The main restraining influences on commodity prices during the present recovery appear to have been the dominance of the strong recovery in the United States (which is generally less dependent than Europe and Japan on imported primary commodities); the earlier build-up of excess productive capacity and stockpiles, the sharp appreciation of the US dollar (which has added to the cost of raw materials in currencies other than the US dollar and had a dampening effect on demand), the general slowing in inflation and the propensity of countries experiencing balance of payments difficulties to cut imports and press exports (including, in both cases, of primary commodities). The high level of real interest rates in the last few years may also have constrained the level of final product inventories and hence the demand for raw materials.

The average price (cif) of crude oil imported into OECD countries declined by 15 per cent in real US dollar terms in 1983. Very recently, spot prices of crude oil have again been under some pressure.

Unit labour cost increases in manufacturing averaged only 1 per cent in the seven major OECD economies in 1983. Given prevailing levels of price inflation and unemployment, wages are expected to continue to show modest growth, at least over the short term, and unit labour costs in manufacturing are expected to be largely unchanged in 1984.

Conditions in 1984 appear conducive to a continuation of the generally more moderate rates of inflation experienced recently. For the major economies, it is expected that inflation will remain around present levels in 1984 and into the first half of 1985. For the smaller industrial countries as a group, a downward trend in inflation is envisaged.

Corporate profits improved in most major economies during 1983 and further increases are expected during 1984. Real wage restraint, lower inflation, improved after-tax profitability and higher rates of capacity utilisation in industry have contributed to increased business fixed investment, particularly in the United States,

Japan and the United Kingdom. This upturn has come in the face of interest rates which have remained high, both nominally and relative to inflation. Elsewhere, however, there is as yet little sign of private investment showing the pick-up necessary for the upswing to be sustained.

Employment has expanded rapidly in the United States, where civilian employment increased by around 6.4 million between the cyclical trough in December 1982 and July 1984. More modest employment growth has been recorded in Japan (where unemployment however has been much lower), while in Europe employment levels have remained largely unchanged. The civilian unemployment rate in the United States fell from a peak of 10.7 per cent in November and December 1982 to 7.5 per cent in July 1984; the general prediction is for a further modest reduction in the period ahead. Little change in the unemployment rate is expected in Japan, where participation rates—particularly for females—have increased; while in Western Europe the slow pace of output and employment growth seems likely to result in further rises in unemployment. It is generally acknowledged that the recovery in output and employment in major Western European economies has been inhibited by a relative lack of flexibility and adaptation in product and factor markets—what has become known as 'Eurosclerosis'. This contrasts, for instance, with the United States.

The strength of recovery in the United States and the exceptionally strong rise in the value of the US dollar have been associated with a record US current account deficit. The deficit, which is stemming more from very rapid import growth than from abnormally low export performance, is expected to widen substantially in 1985. A record Japanese current account surplus is also expected to increase still further in 1985, with more normal current account positions being recorded in most other OECD countries and the current account deficits of the oil-exporting and non-oil developing countries should show some decline. There is, however, a large statistical discrepancy in global estimates of current account balances, and apparent trends in the external positions of major groups of countries need to be interpreted with some caution.

After falling by 2.7 per cent in 1982 and expanding by an estimated 2 per cent in 1983, the volume of world trade is expected to increase by around 7 per cent in 1984 and by 5¼ per cent in 1985.

The OECD expects that the trend toward larger structural budget deficits from 1982 will be reversed during 1984, with an increasing such deficit in the United States being largely offset by fiscal restraint in other major economies and a more uniform trend to restraint than at any time since 1979 in most of the smaller industrial economies. In the years beyond 1985, the fiscal imbalance in the United States might be reduced a little, although attempts to agree on measures to achieve that outcome have met with limited success to date. Overall, budget deficits in the OECD area are expected to remain at a historically high level in relation to both GNP and household savings.

Monetary policy was tightened in the second half of 1983 in the United States, the Federal Republic of Germany and (to a lesser extent) the United Kingdom, as growth in monetary aggregates was brought back towards the upper limits of target ranges. In Japan, monetary policy has remained largely non-accommodating to inflation. For the OECD countries as a whole, monetary policy has generally remained firm and this is expected to continue with the lowering of monetary targets in the United States, the

Federal Republic of Germany, the United Kingdom and France. There is widespread recognition that the errors of the past, when monetary growth has too often been allowed to be overly expansionary in the early stages of recovery, must be avoided this time around.

Following the high levels reached in late 1981, nominal interest rates declined in 1982. While further declines have since been recorded in some countries, interest rates started to rise again in early 1984 in North America and the United Kingdom. In the United States, the surge in private credit demands accompanying the continuing expansion of the economy contributed to a rise in the prime lending rate of around 2 percentage points between March and June 1984. With generally firm, anti-inflationary monetary policies being pursued in the OECD area, and with budget deficits a continuing cause for concern, interest rates within that area are unlikely to show a substantial fall in the near term, if they do not actually rise further.

Although large fiscal deficits apply in nearly all industrial countries, the focus of concern is the present policy mix in the rapidly expanding and influential United States economy. Financial markets the world over remain sensitive to economic conditions and policies in the United States. Particular concerns are harboured about the possible clash of private and public sector credit demands under existing policies, and possible moves to alter monetary policy. Net borrowing by US non-financial sectors (seasonally adjusted) increased from $US395 billion in 1982 to an annualized level of $US557 billion over the six months to May 1984. While the recent tentative steps toward a 'downpayment' on the budget deficit indicate that the authorities are cognizant of the problem, the modest proportions of the package to date (especially as it relates to the period immediately ahead) will lend little, if any, assurance to financial markets in the next year or so. On present policies, the US fiscal deficit will not shrink significantly as recovery proceeds. Accordingly, the stock of public debt must be expected to continue to swell, with potentially grave consequences in terms of future budgetary tensions and strains on financial markets.

The imbalances in domestic US economic policy have international consequences. High US interest rates put enormous strain on heavily indebted developing countries and endanger rescue packages put together to assist the adjustment of those countries in financial difficulty. The domestic economic adjustments which clearly have to be made by many developing and Eastern European countries with debt problems have resulted, and for some time yet must be expected to continue to result, in constrained import capacity and lower rates of economic growth. While the pick-up in demand in the United States and other industrial countries has worked to raise export incomes in debtor countries, the beneficial effects upon debt servicing burdens have been largely offset by the recent further rise in interest rates in the United States and the associated strength of the US dollar (in which a great deal of the debt of these countries is denominated). Many major debtor countries continue to face formidable debt-servicing obligations, notwithstanding the recent rescheduling of large amounts of principal repayments. The easing of international debt problems will depend on continued global economic expansion. But sustained domestic economic adjustment by individual debtor countries, improving market access for debtor countries' exports and an adequate net flow of official and private capital to debtor countries to support the adjustment process will also be necessary.

Fears are also held that, if the necessary adjustment from the present abnormal pattern of exchange rates and current account balances is too precipitate, this could have disruptive consequences and pose threats to international stability, at least in the short term.

For most economies there remains an ongoing need to achieve macroeconomic balance by reducing inflation and budget deficits and ensuring that profitability is adequate to sustain recovery in business investment. But furthering the recovery is not just a matter of redressing macroeconomic imbalances. Policies are also necessary to improve the underlying structure of Western economies, particularly those which appear to have lost the dynamism and flexibility to generate strong growth. The poor employment record of Europe over the past decade, when compared with that of the United States, is an indication of the costs of harbouring market inflexibilities. There is also a need to strengthen the multilateral trading system and remove some of the protective measures—both covert and overt—that have been put in place over recent years. Countries like Australia, which can only gain access to world markets on the basis of relative efficiency, have a particular interest in such reforms.

PART III—POLICIES FOR SUSTAINED RECOVERY

As discussed in other parts of this Statement, the Australian economy rebounded strongly in 1983-84 as it emerged from the recession. While there are risks and uncertainties, the prospects are for a further year of firm growth in 1984-85. Wage increases have moderated and there has been a marked improvement in profits. The rate of inflation has declined towards that of our major trading partners. Employment is increasing strongly and unemployment has declined.

Australia has experienced other periods of strong growth in the past decade or so but none has been sustained for long enough to prevent a progressive increase in unemployment throughout the period. The overall performance of the economy since the late 1960s has been mediocre. Since that time, Australia's average real rate of growth has been only slightly above the much-reduced rate for the OECD as a whole, and somewhat below that average rate when measured on a per capita basis. Australia's unemployment rate has risen in line with that of the OECD region, our rate of inflation has tended to run ahead of the OECD rate, our share of world trade has fallen and so has our per capita income relative to that of many other countries both within the OECD area and outside it.

Australia's economic performance has, of course, been adversely affected by international developments in the past decade including higher inflation, slower growth in world trade, destabilising capital flows and heightened uncertainty. But the below-average performance of our economy has been sufficient to indicate that domestic influences have also played a part. It is the domestic constraints to economic growth over which governments have an influence. Accordingly, the question arises how, this time, the burst of growth might be brought to lead to a better outcome than the several spurts of the past decade or so.

The central elements of an answer to that question were clearly identified by the present Government in its early days of office. The major constraints to sustainable economic growth concern issues such as inflation and the related question of factor-share imbalances (and the way in which those are resolved) and questions of the efficient allocation of resources and the way in which improved efficiency is pursued. Those general rubrics lead into practical policy questions such as the means of obtaining restraint in the growth of wage costs (including the role of the Prices and Incomes Accord and its relationship with fiscal policy); the size of the public sector and of its borrowing requirement; the conduct of monetary policy; and the changing structure of the Australian economy and the effects thereon of both general and specific government policies.

This Part of Statement No. 2 looks briefly at some of those issues.

Prices and Incomes Policy

A key element of the Government's approach to the economy is the comprehensive prices and incomes policy based on the Accord between the Australian Labor Party and the Australian Council of Trade Unions. The policy, which recognises the need for restraint in income claims if there is to be a sustained recovery in economic growth and employment, has several important elements:

- emphasis on a central mechanism for wage determination based on the Australian Conciliation and Arbitration Commission;

- policies and institutional arrangements to influence the determination of non-wage incomes and prices as a complement to the system of wage determination;
- recognition of the many non-wage determinants of living standards, and the influence of government policy on those determinants;
- concern to achieve an equitable distribution of income; and
- much greater emphasis than hitherto on consultation between government, trade unions and employers on economic conditions and policy.

Real wages declined during 1983 as a consequence of the recession, the decline in the bargaining power of the trade unions and the formalization of that decline in the wage pause. Wherever wage pauses or freezes have been instituted, the transition back to 'normal' operating arrangements has involved problems. In Australia's case, however, the introduction of the Accord enabled that process to be entered upon without disruption.

The Accord has been put forward fundamentally as an instrument for achieving restraint when economic recovery proceeds far enough to place wage, price and income setters in a stronger market position to go their own ways. Given the strength of the economic pick-up so far, the Accord has been called upon to perform that task rather earlier than expected. The commitment by nearly all unions not to make extra claims outside the centralised framework has been clearly reflected in the figures for award wages, the growth of which has been confined to the increases flowing from indexation.

Maintaining income restraint over the medium term as recovery strengthens further will provide a continuing test of the Accord's effectiveness.

In that context, however, it should be noted that wages alone do not provide a complete picture of the development of overall labour costs. Non-wage labour costs ('on-costs') have, by all accounts, expanded even more rapidly than wage costs over the past decade or so. The lack of adequate data clouds the picture; but in at least some sectors of the economy, on-costs are now estimated to be about half as much as direct wage costs.

On-costs are, of course, just as inescapable a cost of employing labour, and therefore potentially as much an impediment to more jobs, as wages themselves. It would therefore be a matter for concern if success in holding wages to the path mapped out by the prices and incomes policy were to result in increased upward pressure on the non-wage component of the employment 'contract'.

Aspirations for wider and more generous superannuation cover are relevant in this context, but there are numerous other potential examples all of which fall within the terms of the Accord and are therefore the subject of consultation between the Government and the ACTU.

The deceleration in wages and the associated large reduction in real unit labour costs in Australia has been a most favourable development in terms of transforming the pick-up in the economy into a sustained recovery. It has enhanced the prospect of higher investment and of increased employment attendant upon that investment. The rate of unemployment remains, nevertheless, very high by the standards of the early 1970s, despite a restoration of the balance of factor shares to what pertained at that time. That has, of course, been a very recent development and its full implications for employment are no doubt yet to be seen.

The high rate of unemployment also reflects the major adjustments to the labour force in the recession, the changing structure of the economy and the fact that some workers retrenched from declining industries during the recession have not yet acquired the new skills necessary to regain employment. The relatively low average level of private business investment during the past decade and the associated impact on the (continually ageing) private capital stock have contributed to lower demand for labour. Given the prospect of a fairly strong growth in aggregate demand in the period immediately ahead, employment growth would be stronger and unemployment lower if the recent adjustment in the relative cost of labour were at least maintained. Equally, employment will be stronger the higher the rate of private investment.

From a medium-term perspective, an important issue is that the present approach to wage determination and the emphasis on uniform percentage increases provides little scope for changing wage relativities. This is an inevitable consequence of a wages policy that must place priority on reducing the overall rate of wage increase and inflation in *the economy. The challenge will be to devise and implement adjustments to the system* that allow for greater flexibility in relativities without precipitating an acceleration in the *overall* level of labour costs in Australia such as we have seen in the past.

The Government has put in place a prices surveillance mechanism that recognises *that the best form of price control is generally the effective operation of competitive* market forces. The Prices Surveillance Authority is to focus its activities on areas where effective competition is not present and where price and wage decisions have pervasive effects throughout the economy, consistent with the need to minimise intrusion into business activities. The policy also recognises the importance of adequate profits for increased investment and employment in the private sector.

Fiscal Policy

The Government's basic approach to fiscal policy has been to provide the maximum direct stimulus to demand considered consistent with avoiding inflationary pressures.

At the time of the 1983-84 Budget, with the economy still deep in recession, a substantial fiscal stimulus was considered appropriate—subject to the intention, announced at that time, to reduce the degree of stimulus as private sector demand recovered.

The economy responded strongly in 1983-84, vindicating that initial policy approach. Early in the 1984-85 budgetary processes, therefore, the Government made known its intention to reduce the budget deficit in the forthcoming year.

That fiscal policy objective, however, had to be reconciled with the intention to provide significant taxation reductions to lower and middle income earners and the desire to increase social welfare payments to the genuinely needy.

In framing the 1984-85 Budget, the task of meeting the fiscal policy objective was eased by the unusually strong growth in revenues which this second year of strong recovery will produce: the particular conjuncture of healthy growth in the current year revenue base and lagged effects of those major revenue items—company and other individuals personal income tax—which derive from the very sharp lift in the incomes concerned in 1983-84. As detailed in Statement No. 4, those effects were such as to yield increased revenue, before new measures, of $9.7 billion or 20 per cent in 1984-85.

Beyond that, as noted, scope had to be found for significant personal income tax reductions. The revenue cost of those tax reductions in 1984-85 is about $1.3 billion, reducing the net increase in revenue (before any other measures) to about $8.4 billion or 17 per cent.

Constraining outlays growth to within the limits imposed by that revenue growth while providing for a significant reduction in the budget deficit, was rendered difficult by the extent to which budget outlays have become increasingly 'locked-in' over successive years by processes of indexation, forward commitments and the like.

For 1984-85, two particular items have been of notable importance in terms of their contribution to outlays growth: first, the full-year operation of Medicare which, alone, contributes about 2.2 percentage points of the total 6.1 per cent real growth in outlays; and, secondly, escalating public debt interest payments—the legacy of past budget deficits and their necessary financing—which, in 1984-85, will contribute a further 1.6 percentage points to aggregate outlays growth.

Beyond those two specific items, the full-year cost of other programs introduced in 1983-84 has made a contribution to the overall increase in 1984-85 outlays growth.

Notwithstanding this, outlays are budgeted to rise by 13 per cent in 1984-85, an increase which is lower than the outcome for any year since 1979-80, and follows an increase of 15.6 per cent in 1983-84. In real terms the estimated outlays growth is 6.1 per cent compared with 7.7 per cent in 1983-84 and 6.5 per cent in 1982-83 and the average of 4.6 per cent for the ten years to 1983-84.

In the event, the balancing of fiscal policy objectives with other policy requirements produced a reduction in the budget deficit for 1984-85 of $1.2 billion and in the domestic deficit of $1.6 billion, in line with the basic objective of reducing the total public sector borrowing requirement as that of the private sector expands.

The borrowing requirement of the State and local government sector (excluding Commonwealth net advances to the States) rose from around 1 per cent of GDP in the late 1960s to 3.3 per cent in 1983-84. In recent years, the growth of that borrowing has gone well beyond limits set by Loan Council and, during the early 1980s, authorities made increasing, and increasingly blatant, resort to forms of financing which circumvented Loan Council control.

In 1984, steps were taken to bring all forms of borrowing within a 'global allocation' for all State and local government authorities; a similar approach was agreed in respect of Commonwealth and Territory off-budget authorities. Within that global total, the States have been given considerable freedom over the nature of the borrowing that their authorities might undertake. However, with the taxation advantages of lease-type financing now much diminished, it might be expected that there will be greater resort to conventional borrowing methods.

For 1984-85, the global allocation for State and local government authorities was set at the same money level as in 1983-84, implying some fall in real terms and in proportion to GDP from 3.7 per cent to 3.3 per cent. On the Commonwealth side, the reduction in the budget deficit for 1984-85 will be partly offset by increased borrowings by Commonwealth authorities. In total, the public sector borrowing requirement (PSBR) is estimated to decline from around 8 per cent in 1983-84 to around 7 per cent in 1984-85.

Looking beyond this year, there is a clear need for the PSBR to be further reduced if the economic recovery is to be sustained. Experience this year with the global approach should provide some basis for consideration of how its objectives might be further extended. Not unrelated to that consideration will be the review, in 1985, of the tax sharing arrangements and the study presently under way on the distribution of tax powers between the Commonwealth and State governments. The question of tax reform more generally is also likely to be high on the agenda of governments.

In the end, the perennial problem of controlling the growth of outlays is unlikely to be significantly reduced by any mere institutional arrangements. That problem will remain to be solved primarily by discretionary government action to reduce outlays, to redirect them to areas of greatest need and to improve the efficiency of programs.

Monetary Policy

As discussed in earlier years in this Statement, the long and variable lags with which monetary policy affects the economy suggest that monetary policy should be formulated having regard to the Government's medium-term objectives. While there is legitimate debate regarding the influence of monetary factors on the level of activity and the rate of inflation in the short term, there is broad agreement that, over the medium term, growth of the monetary aggregates is an important influence on the rate of inflation. At the international level, the much faster growth in world liquidity since the late 1960s is seen as one of the more important factors contributing to the sharp acceleration in inflation in the industrial countries since that time, and most countries now regard monetary control as an essential ingredient of anti-inflationary policy. Moreover, there is now general agreement that past errors of monetary laxity have been most damaging in the early stages of recovery. The success of monetary policy in Australia in 1983-84 is the more significant in that context.

As noted in Part I of this Statement, the monitoring of monetary conditions in recent times has been complicated by the deregulation of the banking system and continued financial innovation. Over the past 20 years or so, the non-bank financial sector has tended to grow faster than the more regulated banking sector. More recently, however, the trend towards increased flexibility in domestic financial markets has been associated with deregulation of the banking sector. That process was carried further in the removal from 1 August, 1984 of the maturity controls on deposits of the trading and savings banks. In the immediate future the banks' balance sheets can be expected to grow somewhat faster than normally. How much faster remains uncertain but growth in M3 is likely to be closer to, or even above, growth in broader aggregates such as 'Broad Money' than in the past. This process of potential re-intermediation will occur primarily in the form of competition for short-term deposits. The present holdings of such deposits by merchant banks and, to a lesser extent, permanent building societies and credit unions is very large even in relation to M3. The potential for the M3 measure to be distorted by this process is correspondingly high. Growth in these broader aggregates is largely unaffected by the recent institutional changes and will, therefore, provide an important guide to underlying monetary conditions in the period ahead.

Apart from these immediate considerations relating to re-intermediation, the growing complexity of the financial system (including the high degree of substitution between bank and many non-bank deposits) underlines the need for the authorities to monitor and influence the growth in total borrowing and lending.

Trends in the broader aggregates (and in financial conditions generally) have been closely monitored in recent years, but the main focus of policy has been the growth of the measure M3, reflecting the key role of the banking sector in the financial system. That measure sits toward the middle of the spectrum of monetary aggregates. At one end of that spectrum, there are very narrow aggregates comprising those most liquid assets which provide the underpinning for lending by the banks and other financial institutions. At the other are the broader aggregates such as 'Broad Money' which go beyond what is normally regarded as 'money' but the expansion of which is clearly related to total transactions in the economy.

By controlling the lending capacity of the banks, governments have been influencing liquidity conditions within, and lending by, the financial system as a whole. Control of the growth in bank deposits (and therefore lending) has been based on controlling growth in the Liquid and Government Securities (LGS) assets of the banks—that is, the holdings of cash plus Commonwealth Government securities (CGS), on which bank lending has been based.

The focus on growth of the banks' LGS assets has reflected the historical importance of the liquidity conventions under which CGS holdings are counted as part of a bank's liquidity. Since CGS holdings of the banks are part of what was considered to be the LGS 'fulcrum' of the banking system, the authorities have also had to be concerned with the split in sales of CGS to the banks and the non-bank public. That approach has effectively treated all CGS holdings as being highly liquid. Under a market-oriented system for selling government securities, the banks must necessarily be concerned with the composition of their LGS assets and the costs of converting those securities to cash as the need arises. Control of the banks' balance sheets thus rests more squarely now on control of what has become known as the 'money base'.

Capacity to control the very liquid assets of the banks was considerably enhanced by the introduction in 1982 of the tender system for selling Commonwealth Treasury Bonds. In addition, the Reserve Bank has increasingly operated to influence liquidity conditions through open market operations and its re-discount facility. However, until the floating of the Australian dollar in late 1983, a tightening of the liquidity base could always be relieved by funds brought in from overseas if there were a demand for them at the newly-prevailing interest rates. Neither the primary issue of CGS nor the operations of the Reserve Bank could necessarily be relied upon fully to have their intended effects on the liquidity available to the system.

Under the current exchange rate regime, by contrast, the money base of the financial system cannot be varied by the external transactions of financial institutions. Additions to the money base are now basically determined by the budget deficit, the Government's net CGS sales and transactions of the Reserve Bank with the non-official sector. Given that the private banks and other deposit-taking institutions have to hold (or have ready access to) a certain amount of cash for prudential purposes, operations in CGS now provide a firmer lever for control of the liquidity of the financial system.

Floating of the Australian dollar has, therefore, given the authorities greater scope to conduct an independent monetary policy. However, insulating the domestic economy from destabilising capital flows in this way necessarily means accepting greater fluctuations in the exchange rate. This is not always straightforward; international experience testifies that foreign exchange markets can get out of kilter with the underlying competitive positions of economies.

While external factors can often predominate in the determination of the exchange rate in the short term, the underlying position must necessarily come back to the soundness or otherwise of domestic economic policies. Growth in the monetary aggregates is obviously an important factor in that but it is only one of a number—including fiscal conditions, wage and price developments and structural policies—shaping expectations about the soundness of a currency.

The decision to float the exchange rate in December 1983, together with the concurrent, and in many respects more important, decision to remove virtually all exchange controls, has integrated the Australian economy more closely with the international financial system than ever before in the post-war period. The float has given the authorities much greater scope to influence domestic monetary developments but it has also increased the need for the settings of monetary policy to be—and be seen to be—appropriate. If policies are perceived to be inappropriate this will quickly be reflected in the exchange rate with potentially disruptive effects on domestic economic performance.

The Dynamics of Growth

The commentary above has concentrated on the main elements of macroeconomic policy and prices and incomes policy which are presently the focus of attention and which, in the main, have been central to the formulation of the 1984-85 Budget.

Such policies are always important. It is worth recalling, however, that even in the 1950s and 1960s, when macroeconomic policies were conducted considerably more successfully than in the 1970s and, to date, the 1980s, Australia's economic growth rates generally lagged behind the OECD average.

At the risk of some over-simplification, it can be said that, in the main, this was the result of inappropriate microeconomic policies—excessive regulation (including, needless to say, in the financial sector) and protection in its many guises.

In the end, no amount of manipulation of the instruments of macroeconomic control can transform a non-competitive, inflexible and sluggish economy into one which can generate strong economic growth. The dynamics of growth spring from the ability to adjust to changing circumstances. Regulation and protection can impair that ability. The short-term benefits from increased protection and other forms of assistance distract from more substantial adverse effects over the longer term. Without competitive pressures, industries may have little incentive to pursue productivity gains—and there may be little incentive also for both human and capital resources to move into newer areas of industry. Yet it is precisely the development of newer industries and the restructuring of established ones that is critical to the longer-term health of any economy. As is evident in parts of Australian manufacturing industry, even high and increasing levels of protection cannot guarantee jobs. In the ultimate structural change cannot be avoided; either an industry makes the necessary changes and becomes competitive or it eventually shrinks to insignificance. Attempts to resist the inevitable put at risk the beneficial effects that can and do flow from structural adjustment.

A comparison of the economic performance over the past decade of a number of the newly industrialised countries in the Pacific region with that of some of the more 'mature' economies of the same region should be sufficient to underline the point.

Decisions over the last few years to move steadily towards deregulation of the financial markets and to open them to increased competition will assist the process of change. The current economic upswing provides the opportunity to make necessary adjustments to other elements of policy with the same objective.

PART IV—THE ECONOMIC OUTLOOK

Background

While the turnaround in the Australian economy in 1983-84 was considerably stronger than expected, its pattern was more or less in line with past experience. There were some signs of a broadening in the pattern of demand in the second half of 1983-84 and the recovery process during 1984-85 is expected to build on this as the effects of the less durable cyclical influences wane.

In the main, the pick-up has so far involved bringing back into production previously underutilised resources of labour and capital. But more than that is needed to put the economy firmly on the path of long-term, sustainable growth. Building an ongoing recovery will require an expansion of Australia's productive capacity. The substantial progress made last year in improving corporate profitability and moderating income claims will be helpful in that regard. But there are risks and uncertainties in the sustainability of the process; these are addressed in the concluding section of this Part.

For the moment, it suffices to say that the forecasts set out below, of continued strong growth and declining inflation, are based on the assumption that the challenge of ensuring continued price and cost moderation and of developing further the conditions conducive to expanding business investment will be met in the year ahead.

The Forecasting Framework

The forecasts herein are based on the forecasting framework established by the Joint Economic Forecasting Group. These forecasts—like any others—are conditional on an underlying set of assumptions. Those assumptions deal with what are largely exogenous factors, such as the world economy, rural conditions and policy settings; they have been chosen mainly because they appear plausible but it should be borne in mind that risk is attached to each—and that risk of that kind affects the forecasts as much as any uncertainty about the stability of the behavioural relationships that are taken to underlie the workings of the economy.

In addition, the forecasts must necessarily be based on currently available statistical data which can be subject to substantial revisions and, on occasions, be seen subsequently to have provided an insecure stepping-off point for the forecaster. This fact is of particular importance for 1984-85, given the doubts surrounding profit and wage data for 1983-84 which are central to judgments regarding the outlook for business investment.

It would accordingly be unwarranted to suggest that the forecasts represent anything other than the mid-point of a range of plausible possibilities conditional on the set of assumptions made. The focus of attention in the following assessment should be concentrated on the overall picture, rather than on particular projections for individual items.

Forecasting Assumptions

The main components of the budget estimates as used for forecasting purposes are as follows (figures in parentheses represent corresponding increases in real terms, where appropriate):

- an overall deficit of $6745 million, comprising an estimated domestic deficit of $3877 million and an overseas deficit of $2868 million;

- an estimated increase in total outlays of 13.0 per cent (about 6.1 per cent); and
- an estimated increase of 17.7 per cent (about 10.5 per cent) in total receipts.

The other major assumptions are:

- continuing recovery in world activity. The pace of the recovery could slow somewhat with an expected moderation in growth rates in the North American economies. Real GNP in the major seven OECD economies as a whole is assumed to grow by around 3¼ per cent in 1984-85;
- inflation in the major industrial economies at about the same rate as recorded in 1983-84 (around 4¼ per cent);
- continued successful operation of the Prices and Incomes Accord, with negligible sectional wage increases;
- monetary policy such as to promote an environment of sustainably lower inflation, while allowing the expansion of real activity to proceed;
- an unchanged exchange rate in TWI terms;
- a return to normal seasonal conditions; and
- no major revisions to the existing data base.

General Outlook

Based on those assumptions, the outlook for 1984-85, in summary, would be as follows:

Activity and Output

- a marked strengthening in private sector activity, encompassing firm growth in consumption, an acceleration (from very low levels) in business investment, and continuing strong growth in dwelling sector activity;
- continued strong growth in public sector demand;
- a further large contribution from non-farm stocks as the restocking phase of the cycle continues;
- a run-down in farm stocks;
- a sharp pick-up in exports (especially rural exports) largely offset by a substantial increase in imports;
- continuing strong growth in non-farm product; and
- a moderate decline in farm product.

Labour Market

- strong growth in employment with the increase in year-average terms particularly marked;
- an edging up in the participation rate over the course of the year; and
- a further modest decline in the unemployment rate over the course of the year.

Prices and Incomes

- further easing in rates of price and cost inflation; and
- continuing improvement in corporate profitability and cash flow.

Balance of Payments

- a marked increase in the current account deficit.

Financial Markets

- a reduction in the public sector borrowing requirement; and
- a marked decline in household sector lending and little change in the corporate sector borrowing requirement.

Further comments on the major components of the forecasts are offered below. Expenditure estimates, unless otherwise stated, are in real terms (and, where appropriate, abstract from the estimated effects of sale/leaseback transactions between the public and private sectors).

Activity and Output

The reclassification of certain health expenditures from the private to the public sector associated with the introduction of Medicare affects recorded growth in private consumption expenditure in both 1983-84 and 1984-85. Abstracting from this influence *private final consumption expenditure* is forecast to increase in 1984-85 by much the same as the increase in 1983-84 (about 2¾ per cent). However, as recorded in the national accounts, consumption growth will be somewhat lower (around 2¼ per cent). After increasing strongly in 1983-84 (by 4 per cent) the growth in real household disposable income is expected to slow markedly in 1984-85. Consumer confidence as well as real wage and salary incomes are likely to be boosted by employment growth and decelerating inflation which, in conjunction with the effects of the large rise in real disposable incomes in 1983-84 (which would usually be expected to influence consumption with a lag on average of around one year), should provide a significant stimulus to consumption this year. This would be consistent with the saving ratio declining for the year as a whole to around the average for 1982-83 with the decline over the course of the year being more marked.

The recovery in the *dwelling* sector is expected to broaden as the year progresses to include multi-unit dwellings as well as house construction. As in previous housing cycles, the rapid increase in activity is assumed to spark some speculative element to the demand for housing, particularly for multi-unit dwellings, which would boost the overall level of commencements. But even with little further growth in commencements, *private dwelling investment* is set to increase strongly. While the outlook is somewhat uncertain, growth of around 15 per cent is forecast for private dwelling investment in 1984-85.

A significant feature of the forecasts is the projected turnaround in *business investment* in 1984-85, albeit from a very low base. Private business fixed investment increased in the second half of 1983-84 and, with profit growth strong, inflation declining and demand growing solidly, is forecast to continue to grow. The increase is projected to be around 5 per cent in 1984-85 which assumes that, as in previous recoveries, businesses will revise upwards somewhat their investment expectations as the recovery proceeds (a process already evident in recent statistics from the quarterly surveys). Investment in building and construction is expected to be little changed from 1983-84 while investment in plant and equipment is expected to accelerate over the course of the year.

The forecast for business investment is heavily dependent upon the assumption of continued wage and other industrial moderation, including expectations for the period beyond 1984-85, and of no outbreak of non-wage labour costs. There will clearly be certain areas where specific adverse influences will probably mean a continuing decline in investment. However, the outlook for manufacturing investment outside basic metal products appears to have improved and expectations data point to quite strong real growth in that area.

Public final demand, abstracting from the impact of Medicare, is forecast to increase strongly in 1984-85, at around 5 per cent (4 per cent in 1983-84). Commonwealth current expenditures on a national accounts (deliveries) basis are projected to increase strongly (around 11 per cent) in 1984-85, largely reflecting the timing of deliveries of defence equipment—notably a naval frigate and a number of F/A-18s. Reflecting very strong increases in on-budget capital works and the importation of a number of aircraft by Qantas, Commonwealth capital expenditures could increase by around 18 per cent after a moderate decline in 1983-84 (around 2 per cent).

State and local government expenditure on goods and services is projected to increase more moderately than in recent years. It was agreed at the Loan Council meeting in June, in the context of a global approach to Commonwealth and State authority borrowings and of the slowdown in spending on some major projects by the States, that total authority borrowings by the States in 1984-85 will be about the same in money terms as in 1983-84. Reflecting that, State and local government capital expenditures are forecast to remain broadly unchanged from the historically high levels recorded in 1983-84. The rate of growth in underlying consumption expenditures is expected to be much the same as the average growth of recent years (3 per cent).

The turnaround in *non-farm stocks* made a major contribution (just over 1 percentage point) to product growth in 1983-84. As business enters the restocking phase of the cycle it is forecast that the contribution in 1984-85 as a whole could be even larger. Growth through the year is also expected to be boosted although to a lesser extent than during 1983-84. While this would mean an increase in the stocks-to-sales ratio, it would remain significantly below previous norms, consistent with the view that recent periods of low profits and high interest rates have resulted in a permanent change to stock-management behaviour.

In 1984-85 *farm product* is projected to decline by around 10 per cent. This mainly reflects lower grain production as a result of the assumed less favourable (i.e. more normal) seasonal conditions. *Farm and miscellaneous stocks* are expected to decline in 1984-85 in order to satisfy domestic and overseas demand.

The forecasts point to growth in *non-farm product* in 1984-85 (in year average terms) of around 5 per cent. After allowance for the decline in farm product, GDP growth in 1984-85 would be around 4 per cent. The large size of the statistical discrepancy at the close of 1983-84 makes judgments about growth over the course of 1984-85 difficult, but non-farm product growth of 5 per cent for 1984-85 as a whole would appear to be consistent with an ongoing rate of growth of around 4½ per cent.

Balance of Payments

Exports of goods and services are forecast to grow strongly, perhaps by a little more than 10 per cent in 1984-85. Rural exports are expected to increase particularly strongly with the help of the large stock carryover from the record 1983-84 cereal harvest, a pick-up in the demand for wool and the prospect of a record sugar crop. Non-rural exports are again projected to increase at a rate well above the expected growth in world trade. This reflects the coming on stream of additional capacity in aluminium-related industries, increased petroleum exports and the commencement of LPG and condensate exports from the Cooper Basin. However, by comparison with 1983-84, manufactured exports might be more subdued and growth in coal and iron ore exports could moderate as market diversification becomes more difficult.

Imports of goods and services are forecast to increase sharply (by around 9 per cent) in 1984-85 reflecting an acceleration in final domestic demand to around 4 per cent (from 1.7 per cent in 1983-84), the rebuilding of non-farm stocks, changes to the composition of demand and the lagged effects of the earlier loss of international competitiveness. Growth is expected to be further boosted by the delivery of defence equipment and by airline re-equipment programs.

As always, the likely *balance on the current account* is surrounded by considerable uncertainty. The trade balance could return to a small deficit (reflecting a possible worsening in the terms of trade) after recording a marginal surplus in 1983-84. The net invisibles deficit is expected to continue to widen. As a result, the implied deficit on the current account could increase to around 4 per cent of GDP in 1984-85 (compared with 3.6 per cent in 1983-84).

Private capital inflow could be substantially below levels recorded in 1983-84 despite a rising current account deficit. This reflects the operation of the new foreign exchange arrangements over the whole of the year, and the larger proportion of the current account deficit being financed in 1984-85 by official borrowing abroad, both at Commonwealth and State levels, and by reductions in foreign exchange reserves.

The Labour Market

In the face of an ongoing rate of growth in gross non-farm product of around 4½ per cent *non-farm employment* is forecast to increase by around 2½ per cent over the course of 1984-85 (or by 3½ per cent in year-average terms). Allowing for some modest 'encouraged worker' effect on the participation rate, a variable which has been subject to considerable volatility of late, growth in the *labour force* over the course of 1984-85 would be a little less than that in employment. If so, the measured level of *unemployment* would decline slightly over the year (implying, in year-average terms, a decline of around one percentage point in the unemployment rate). As always, there is a large margin of uncertainty attaching to these labour market estimates.

Incomes and Prices

On the assumption of continued strict adherence to the arrangements now constituting the centralised system of wage fixation—with minimal sectional claims but some allowance for activity-induced increases in hours worked and some delayed impact from the April 1984 National Wage Case decision—the increase in *average weekly earnings* over the course of 1984-85 could slow to around 5½ per cent (compared with more than 12 per cent during 1983-84). In year-average terms this would be consistent with an increase in survey-based average weekly earnings of around 8 per cent. Largely reflecting differences in the historical estimates, average weekly earnings on a national accounts basis—the concept used in preparing budget (PAYE income tax) estimates—could increase by around 7 per cent in 1984-85 following a rise of 5.2 per cent in 1983-84.

With firm monetary policy and the assumed absence of significant sectional wage pressures, the underlying rate of inflation is expected to fall further in 1984-85. The *CPI* is expected to increase by around 5¼ per cent between the June quarter 1984 and the June quarter 1985. This comparison is not affected by the introduction of Medicare. The increase in the *non-farm product deflator* would be around 6¼ per cent in year average terms in 1984-85 (7.3 per cent in 1983-84) and around 6 per cent through the course of the year.

The combination in 1984-85 of strong growth in activity, a solid rise in productivity, decelerating inflation and wages indexed to past CPI movements implies further strong growth in the *gross operating surplus of companies*—though less strong than the rebound in 1983-84 from the deep trough of the year before. Such an outcome would lift the profit share in 1984-85 to around 16 per cent, almost a percentage point higher than in 1983-84 and just below the average for the early 1970s. Mirroring this movement, real unit labour costs would fall further.

Financial Markets

As noted previously, monetary policy has been set with a view to providing growth in the monetary aggregates sufficient to finance continuing strong growth in economic activity, while at the same time maintaining some downward pressure on the rate of inflation. Abstracting from the effects of re-intermediation following the further deregulation of maturity controls on deposits (effective from 1 August 1984), *continuation of the above aim would appear broadly consistent with growth in M3 in* the range of 8 to 10 per cent. The lower deficit, the new foreign exchange arrangements and the financing of the Commonwealth's own foreign exchange requirements in 1984-85 from official borrowing overseas and a modest run-down in official foreign exchange reserves should enable those broad objectives to be met with substantially lower gross bond sales to the non-official sector than in 1983-84.

The *public sector borrowing requirement* is set to fall in 1984-85 as a proportion of GDP reflecting the lower Commonwealth budget deficit and the adoption by the Loan *Council in 1984 of a system of 'global' limits on Commonwealth and State authority* borrowings. The increase in corporate investment spending in 1984-85 is expected to be financed from internal sources—reflecting the recent and projected improvement in corporate cash flow. On present indications there is unlikely to be much change in corporate sector borrowing this year. With the fall in the saving ratio, lending by the household sector would decline markedly in 1984-85. The current account deficit is expected to rise, implying higher borrowing from the external sector. The consequences for interest rates and the exchange rate of the inter-meshing of these sectoral financing needs is difficult to gauge but the reduction in the borrowing demands of government should provide some scope to reduce capital market pressures.

Uncertainties

As mentioned earlier, the assumptions on which the foregoing forecasts are based are plausible ones but a good deal of uncertainty nevertheless attaches to a number of them. In assessing the full range of probabilities those uncertainties must be addressed.

Doubts regarding the wage and price data for 1983-84 have already been mentioned. Looking ahead, there are considerable doubts about the strength and durability of the world recovery and concern that, within Australia, another year of strong growth in activity and profits might place considerable pressure on both the wage-restraint and other aspects of the Accord.

The US economy grew very rapidly (7¼ per cent) over the past year. While the recovery process is proceeding in Japan and parts of Europe, the future performance of the US economy is still of crucial importance for the world economic outlook. Growth in the US has had much momentum behind it but as 1984 proceeds and we move into 1985, that momentum may come under increasing threat from rising interest rates and distortions to exchange rates. The precise impact of any sharp slowing in US growth in 1985 on developments elsewhere in the world is uncertain but it could well be adverse, particularly in the short run. Such a slowing could be expected finally to trigger a downward adjustment to US interest rates and, in association with that, a large depreciation of the US dollar. This would give other countries more room to manoeuvre in their economic policies, but it could also lead to some dislocation. In particular, if the adjustment were too precipitate, the rest of the world could not but be affected by the loss of the demand stimulus now being provided by a swiftly-growing US economy. A country like Australia, whose terms of trade are highly sensitive to commodity prices, would be particularly vulnerable to any major falling off in the level of world economic activity and associated slowing in world trade.

On the basis of the forecasts set out earlier, growth in domestic demand and output in 1984-85 is likely to be rapid, involving strong rises both in profits and employment. A pre-condition for such an outcome is that the Accord is adhered to and that further moderation in wage and salary claims and a continued fall in inflation are achieved. Past Australian experience has been that it is difficult to restrict increases in wages and other employment benefits to those granted by the arbitral authorities in an economy where excess capacity is diminishing and profits are high and rising. The economic essence of the Accord is to make a break with that history so that benefits from continued moderation in labour costs accrue to the community generally and, most notably, those large numbers of Australians still unemployed.

The prime requirement today is an expansion of the productive capacity of the economy, especially in those areas in which Australian resources are most productive. There are risks attached to the outlook for 1984-85; but there is also the potential for achieving further progress towards what has eluded Australian Governments for more than a decade—sustainable economic growth.