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Is Australian economy on the decline?

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The news came on June 5 that Australia recorded lower than the expected growth in the quarter ending March. It was just 0.6 percent or an annualised growth rate of 2.5 percent. That was less than the forecasted quarterly growth of 0.8 per cent and annualised 2.7 percent

On June 4, just a day before the news of slow growth, Reserve Bank of Australia (RBA) decided to maintain the same benchmark interest rate of 2.75 percent, which was announced on May 7.

Many expected a further cut, as the decade-long mining boom was already known to be over. The slow-down of the Chinese economy has resulted in a decrease in Australian mineral exports.

There were expectations of an interest rate cut for encouraging non-mining exports and tourism. Reduction in interest rate also results in lower net capital inflows in the expectation of lower returns from holding the Aussie dollar. Hence, it would lead to further fall in the currency. Under the flexible exchange rate regime, a cut in interest rate automatically lowers the value of the currency. Under a fixed exchange rate regime, devaluation is a deliberate action as Fiji did in 2009.

Now as the economic news is bad, there would soon be some fresh calls for RBA to reduce interest rate.

Australia's performance

Compared to performance of other advanced countries, including the United States (US), Australia, the world's 12th largest economy performed better than others. The US grew at an annual rate of 1.8 percent, UK managed only with 0.6 percent last quarter and the EU economy contracted by a full percentage point.

Further, in terms of total value of output produced by Australia (population 23 million), GDP for 12 months up to March 2013 is estimated at Aus $1.5 trillion. Its per capita income is

Aus $64,800 (US$62,200) per capita. That is compared to US$50,700 per capita GDP in the US.

The reasons for RBA decision not to make any further cut are: (i) the Aussie dollar had already fallen from the dizzy heights of 103 US cents to 96 US cents; (ii) the past rate cuts have already affected "interest sensitive areas"; (iii) there have been some signs of increased demand for finance by households; and (iv) trade and consumer spending up, offset by soft business investment.

Fear of more savings?

Though consumers were now seen to be spending slightly more than before the interest rate cut, there were signs of rise in saving attitudes. Savings have been reported to have risen to a high 10.6 percent of disposable income. Being cautious in normal times is understandable.

If they seem to be keener than usual about trying to reduce debt, that is worrisome. As investment spending and construction have remained flat, Australians are fearing a recession of the kind affecting US, Japan and Europe.

When the bubble financed by growing debt burst in 2008, asset prices collapsed and liabilities stayed; and debtors were scrambling for repayment. The main anxiety was and also continues to be the same: minimize debt burden by all means. Profit maximization was only secondary. Consumers and investors would like to save resources to pay for past debts. Banks are reluctant to lend if assets held by borrowers, as collaterals fall in value.

Although monetary easing by the US Federal Reserve have propped up equity prices now and then, the latest indications of likely tapering off of the US bond purchases has added another uncertainty. That explains the volatility in the stock markets all over the world.

Businesses and households are still pre-occupied with repairing their balance sheets by increasing savings or paying down debt. Known as deleveraging, their actions of reducing further consumption and investment decrease aggregate demand. The result is the economy declines further, as one man's expenditure is another man's income.

Australians do not want a recession of the kind, which ravaged Japan for more than a decade,

With cuts in federal government expenditures already in place, reduction in consumer spending, fall in domestic private investment, and decrease in exports and tourist numbers, due to strong currency, are worrying them. On Thursday, Australian Treasury chief, also a member of RBA Board, told a Senate hearing that interest rate should be cut even if Australian dollar falls heavily and creates inflationary conditions, temporarily breaching the inflation target of 3 percent.

The Pacific island countries (PICs), including Fiji, have strong exposure to Australia through trade, tourism and remittances. Declining economic activities in Australia will adversely impact PICs.