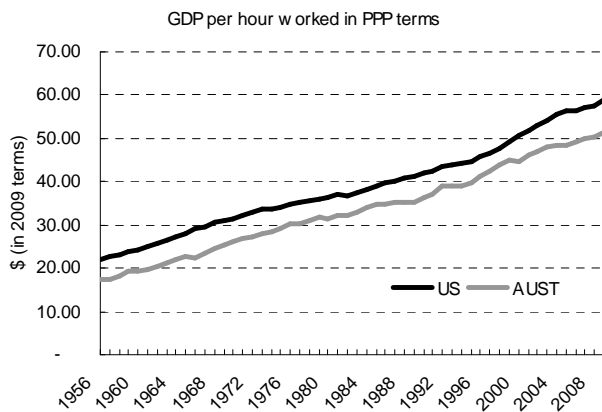


Current Economic Issues

Observations, ideas and commentary on economic issues

The gap: Australia's labour productivity relative to the United States....

Chart of the week: Labour productivity – Australia and the United States



- The United States is regarded as being at the 'frontier' of productivity performance. Hence, it is worth comparing Australia's labour productivity performance relative to the US.

- The chart shows that labour productivity (measured as GDP per hour worked) for Australia has been consistently below that of the US over the long-run (since the mid 1950s).

- If anything, the gap has widened in recent years and in 2009, Australia's labour productivity is approximately 85% of the US level.

- Research suggests the underlying causes of this gap over the long-run include a relative lack of innovation in Australia's economy including technology 'readiness'; a less efficient labour market; and less investment in education and training.
- Clearly if productivity is to do more of the 'heavy lifting' as Australia's population ages, then labour productivity levels will need to be raised.

China's policy dilemma and the adverse consequences for the Australian economy

- China's central bank is adding more liquidity into the economy as it continues to intervene in the foreign exchange market to prevent its currency from appreciating against the US dollar amid strong capital inflows. Reflecting this, money supply rose 19% in November from a year ago.
- Thus, China's attempt to support its exporters has hamstrung its efforts to rein in inflation and endangered a campaign to shift the economy toward domestic demand. The way China resolves this policy dilemma will have significant repercussions on Australia's economic outlook.
- China could unpeg its currency from the US dollar and allow it to appreciate strongly, thus freeing the central bank to use its tools to quell inflationary pressures. This will hurt Chinese exporters and even lead to higher unemployment. However, it will satisfy the US, which has repeatedly urged China to revalue its currency, claiming that China's currency is substantially undervalued against the US dollar, giving the Chinese exporters an unfair advantage over the American exporters.
- Alternatively, China could leave the exchange rate regime unchanged and deploy credit controls and supply-side policies, such as increasing the supply of essential food items from its emergence stockpiles, to control inflation. This will displease the US and create more tensions between the two countries.

- Some US policymakers have proposed imposing tariffs on Chinese imports. This could channel the demand for foreign goods to domestic resources and help to ease unemployment in the US. However, the imposition of trade sanctions on China could prompt China to retaliate and ultimately lead to a global “trade war”.
- In other words, if China chose the second policy option described above, then China could face trade sanctions and protectionist sentiments could rise worldwide. Chinese exports to the US will decline and Chinese manufacturers will significantly cut back production. This will derail the resources boom in Australia.
- The Australian economy will also be jeopardised even if China chose the first policy option described earlier. Research has shown that a 10% appreciation in China’s currency could cause Chinese exports to contract by up to 20%. Also importantly, China’s imports of intermediate goods and final goods, especially those from the other Asian economies, could drop 6% and 17%, respectively.
- Given that Australia’s export destinations are mainly in Asia, a drop in intra-Asia trade could significantly lower the demand for Australia’s overall exports.
- The future of the Australian economy is clearly heavily influenced by policy decisions in China. In order to successfully navigate the uncertain global economic environment, Australian businesses will have to focus on the basics, such as improving cost competitiveness, in order to maintain and/or gain market share in the global economy.

The ABS advocates a move to monthly inflation data

- The Australian Bureau of Statistics (ABS) has proposed that Australia compile and publish monthly inflation data. The ABS emphasised that a monthly inflation indicator, such as a monthly consumer price index, would assist in the timely assessment of inflation trends and allow for more timely adjustments of interest rates by the Reserve Bank of Australia (RBA) to contain inflationary pressures.
- Australia is the only country within the Group of Twenty (G20) that does not have a monthly inflation indicator.
- The ABS proposal has received widespread support from the RBA and market participants.
- The Treasury has welcomed the proposal, but added that the increased funding (an initial \$6 million, followed by an annual \$15 million) requested by the ABS has to be considered through the regular budget processes.