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Sovereigns

Australia
Credit Update

Australia

Ratings

	Current Ratings
Foreign Currency	
Long-Term IDR	AA+
Short-Term IDR	F1+
Local Currency	
Long-Term IDR	AAA
Country Ceiling	AAA

Outlook

Foreign Long-Term IDR	Stable
Local Long-Term IDR	Stable

Financial Data

Australia

	2008e	2009f
GDP (USDbn)	1,057.8	1,150.2
GDP per head (USD)	50,407	54,216
Real GDP, % change	2.8	3.0
Consumer prices, % change	3.9	3.0
Government debt, % GDP	10.4	8.1
Net external debt, % CXR	268.9	269.2
International Liquidity Ratio	23.3	22.5

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Related Research

- *Australia: Rising Borrowing Costs Constrain Growth Prospects*
- *Commodity Prices Not Immune to Economic Slowdown*
- *Assessing Australia's External Finances*
- *House Prices and Household Debt - Where are the Risks?*

Rating Rationale

- Australia's sovereign creditworthiness is well-supported by the government's longstanding fiscal prudence, structural reform efforts to improve economic efficiency and the central bank's strong inflation-targeting and non-interventionist credentials, which have helped to successfully manoeuvre the economy through previous adverse shocks. These factors place the country in a good position to weather the ongoing global credit crunch, but do not mitigate the risks of a macroeconomic deceleration.
- The government's strict fiscal discipline, public debt reduction efforts and net public external creditor status provide a notable buffer against possible economic disruptions. Australia's general government debt burden of 12.6% of GDP was less than half that of the 'AA' median in 2007, while the net public external creditor position of 16.8% of current external receipts (CXR) is better than the 'AA' median of 10%. Fiscal policy is expected to stay on course, as the new administration has expressed its determination to "embark on a new era of fiscal discipline" via a rigorous review of spending and saving of budgetary surpluses to help the fight against inflation.
- Australia's large current account deficits of 5%-6% of GDP and high net external debt to CXR of 269% in 2008, compared to the 'AA' median net external credit position of 6.3%, remain key constraints of the sovereign's Long-Term Foreign Currency IDR. Australia's deep and robust financial system has enabled extensive foreign exchange (FX) hedging of Australian banks' and corporates' external borrowings to weather abrupt exchange rate volatility but it does not alleviate the rising cost of credit.

Key Rating Drivers

- Both Australian banks and non-financial corporate sectors' re-financing risks have risen, while market-perceived credit concerns on these entities have also increased. Risks to funding liquidity (ie, an intermediary's ability to raise necessary cash to fund its assets) have been pronounced in Australia due to the short maturity of external debt and Australia's high gross external financing requirements.
- Banks have passed on their own higher international wholesale funding costs and more costly domestic bank bill costs to households since H207. This has come at an inopportune time, as households have become more indebted in recent years: indeed, household debt stood at a record high of 160% of household disposable income at end-2007. About 14% of households were estimated to be faced with debt service costs in excess of 40% of disposable income in 2006.
- Higher borrowing costs, tighter lending standards and a marked reduction in access to international capital and wholesale markets will also likely lead to a slowdown in private sector investment activity, weighing down on the overall economic outlook.
- Australia's export base is vulnerable to changes in commodity prices. While the current price trend is positive particularly for coal and iron ore, an unexpected downturn in prices could affect Australia's economic outlook, especially if accompanied by a reduction in global demand.

Key Indicators for Australia

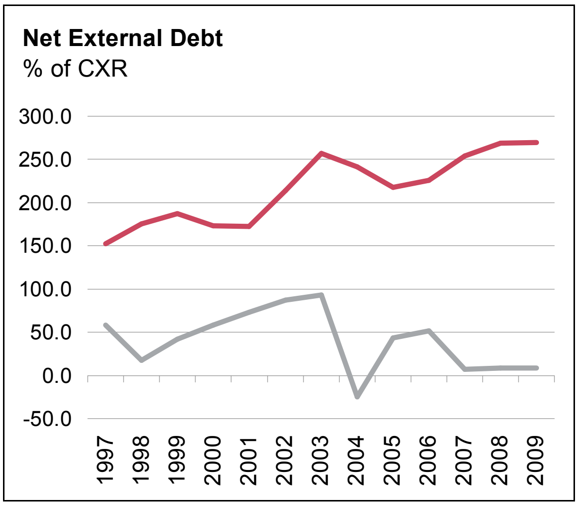
Population (2007): 20.8 million
Population Growth Rate (2002-2007): 1.15% p.a.
GDP (2007): USD908.8bn
GDP per Head at Market Exchange Rates (2007): USD43,786
GNI Per Head at Purchasing Power Parity (2006): USD34,060 (= 77% of USA level)
Modern Sovereign Rescheduling History: None

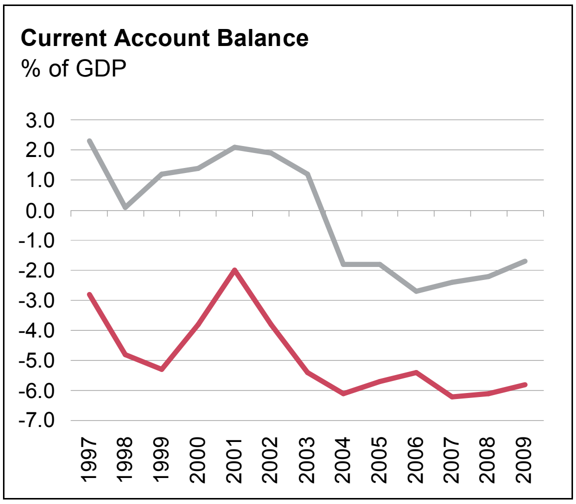
	2003	2004	2005	2006	2007f	2008f	2009f
Domestic Economy and Finance							
Real GDP Growth (%)	3.0	3.8	2.8	2.8	3.9	2.8	3.0
Unemployment (% of Labour Force)	5.9	5.5	5.1	4.9	4.4	4.6	4.8
Consumer Prices (Annual Average % Change)	2.8	2.3	2.7	3.5	2.3	3.9	3.0
Gross Domestic Savings (% of GDP)	23.3	23.5	25.0	25.6	26.0	28.6	30.1
Gross Domestic Investment (% of GDP)	25.8	26.2	26.8	26.8	27.8	29.2	30.6
Short-Term Interest Rate (%)[1]	5.1	5.3	5.5	6.0	6.6	7.2	6.8
Broad Money (% Change Dec to Dec)	7.9	8.7	9.3	5.1	29.8	9.6	8.2
PGK per USD (Annual Average)	1.53	1.36	1.31	1.33	1.19	1.12	1.12
REER (CPI, 2000=100)	112.6	121.2	124.8	124.7	133.3	136.4	132.9
REER: % Change (+ = Appreciation)	11.9	7.7	2.9	0.0	6.8	2.3	-2.5
Public Finances							
General Government Balance (% of GDP)	1.7	0.9	1.2	1.2	1.3	1.2	1.7
General Government Debt (% of GDP)	18.8	17.1	16.9	14.8	12.6	10.4	8.1
General Government Debt Maturities (% of GDP)[2]	1.7	2.5	2.6	1.9	3.1	2.7	2.5
General Government Debt/Revenue (%)	51.8	47.3	46.8	42.0	35.7	29.4	22.7
Interest Payments/Revenue (%)	3.9	3.6	3.1	2.8	2.3	1.7	1.4
Balance of Payments							
Current Account Balance (USDbn)	-28.7	-38.8	-41.0	-41.0	-56.5	-65.0	-66.2
Current Account Balance (% of GDP)	-5.4	-6.1	-5.7	-5.4	-6.2	-6.1	-5.8
Current Account Balance plus Net FDI (USDbn)	-37.9	-13.0	-42.6	-38.1	-58.6	-56.4	-54.5
Current Account Balance plus Net FDI (% of GDP)	-7.2	-2.0	-6.0	-5.0	-6.5	-5.3	-4.7
Gross Financing Requirement (% of Official Reserves)[3]	252.9	228.3	238.4	212.1	217.4	525.1	490.4
Current External Receipts CXR (USDbn)	107.5	133.1	157.8	183.5	216.4	230.4	252.3
Current External Receipts CXR (Annual % Change)	12.7	23.8	18.5	16.3	17.9	6.5	9.5
Current External Payments CXP (USDbn)	136.2	171.9	198.7	224.6	272.9	295.4	318.4
Current External Payments CXP (Annual % Change)	22.4	26.2	15.6	13.0	21.5	8.2	7.8
External Assets and Liabilities							
Gross External Debt (USDbn)	436.6	517.8	543.5	692.4	817.8	908.2	983.7
Gross External Debt (% of GDP)	82.7	80.8	76.2	91.6	90.0	85.9	85.5
Gross External Debt (% of CXR)	406.1	389.0	344.5	377.3	378.0	394.1	390.0
Net External Debt (USDbn)	276.1	321.7	343.0	414.2	548.9	619.6	679.1
Net External Debt (% of GDP)	52.3	50.2	48.1	54.8	60.4	58.6	59.0
Net External Debt (% of CXR)	256.8	241.7	217.4	225.7	253.7	268.9	269.2
Public External Debt (USDbn)	19.2	24.0	25.5	26.1	23.4	22.9	23.2
Public External Debt (% of GDP)	3.6	3.8	3.6	3.4	2.6	2.2	2.0
Net Public External Debt (% of CXR)	-18.4	-14.2	-15.0	-19.5	-16.8	-17.9	-17.7
Public FC Denominated & FC Indexed Debt (USDbn)	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Short-Term External Debt (% of Gross External Debt)	41.0	36.6	35.2	36.3	36.3	36.3	36.3
External Debt Service (% of CXR)	33.3	38.3	41.0	39.1	42.0	47.3	47.8
External Interest Service (% of CXR)	9.4	10.7	11.3	11.7	12.9	15.0	15.0
Liquidity Ratio (%)[4]	21.9	24.8	26.0	25.9	27.3	23.3	22.5
Official International Reserves Including Gold (USDbn)	33.1	36.9	43.1	55.0	26.6	30.4	31.7
Official International Reserves in Months of CXP Cover	2.9	2.6	2.6	2.9	1.2	1.2	1.2
Official International Reserves (% of Broad Money)	6.6	6.5	7.3	8.3	2.8	2.8	2.8

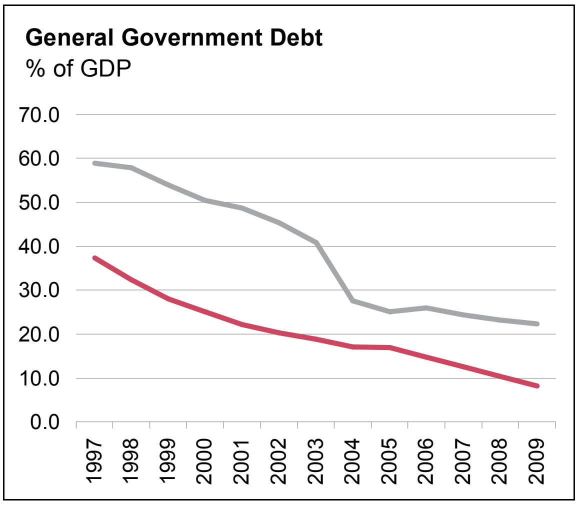
(1) RBA target overnight cash rate.

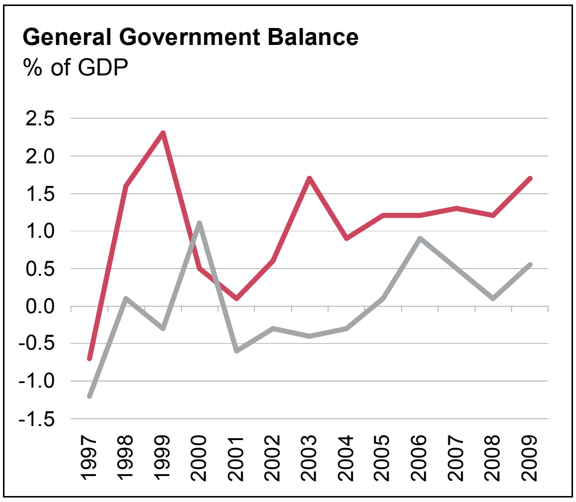
(2) Maturities of medium- and long-term debt during year plus short-term debt outstanding at the beginning of the year.
(3) Current account balance plus amortisation of medium- and long-term debt, over official international reserves.
(4) Official reserves including gold plus banks' foreign assets/debt service plus liquid external liabilities.

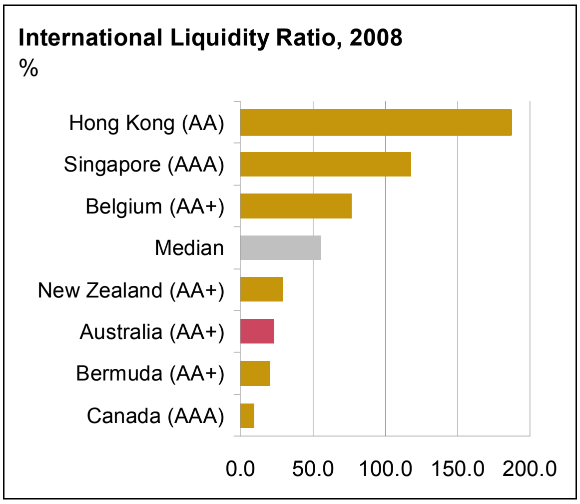
Peer Comparison

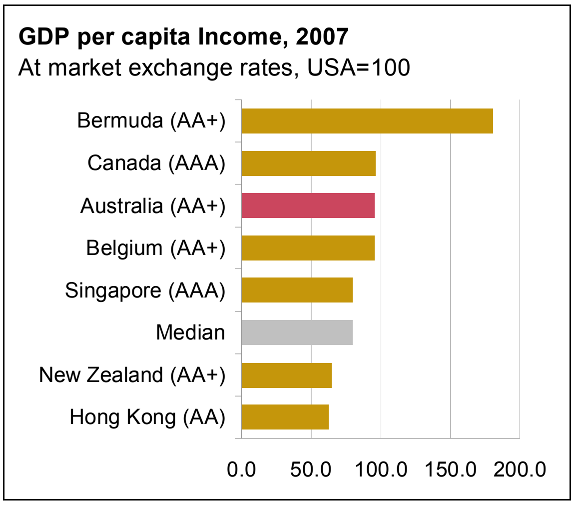












Australia

AA Median

Peer Group

Rating	Country
AAA	Austria
	Canada
	Denmark
	Finland
	France
	Germany
	Ireland
	Luxembourg
	Netherlands
	Norway
	Singapore
	Spain
	Sweden
	Switzerland
	United Kingdom
	United States
AA+	**Australia**
	Belgium
	Bermuda
	New Zealand
AA	Hong Kong
	Japan
	Portugal
	San Marino
	Slovenia

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
4 Feb 2003	AA+	AAA
25 Jan 1996	AA	AAA

Macroeconomic Environment More Challenging [1]

The upswing in the commodities cycle remains supportive of Australia's GDP growth during the current cycle of global economic deceleration. Strong demand from developing Asia for iron ore and metallurgical coal, steel and gold as well as increased mine production capacity, all point to higher resource exports in 2008-2009. The positive terms of trade shock has translated into bumper fiscal revenues for the newly elected Labour government. Together with ongoing tight discipline over fiscal spending, the government will deliver its eleventh successive year of fiscal surplus during 2008-09. The upcoming budgetary stance focuses on supporting the government's long-term objectives of expanding the economy's supply-side capacity via increasing labour participation through tax reform initiatives and boosting infrastructure spending to raise productivity levels. These longer term measures tie in with the authorities' anti-inflationary stance and help to transfer part of the terms of trade boost from commodities to other parts of the economy.

In the near term, Fitch forecasts Australia's economic growth to moderate more sharply from 3.9% in 2007 to 2.8% in 2008, weighed down by weakness in Australia's key domestic demand growth drivers of household consumption and private investment. Refinancing costs and funding liquidity risks have intensified since H207. Banks have passed on some of their own higher wholesale funding costs to households and corporates, and will likely continue to do so if international and domestic liquidity conditions remain tight.

Movements in Official Foreign Exchange Reserves

There was a noticeable rise and fall in Australia's gross official FX reserves position during 2007, which was closely mirrored by a fall and rise in aggregate net short positions in the forwards and futures market in foreign currencies vis-à-vis the domestic currency. Importantly, the Reserve Bank of Australia's (RBA) net official FX reserves position registered significantly less volatility during the period and hovered around the AUD30bn-35bn level.

The changes are explained by a run-up and subsequent reduction in government deposits at the RBA during 1H07. As the central government placed deposits with the RBA during 1H07, the RBA's liabilities rose. On the asset side of the RBA's balance sheet, the RBA temporarily accumulated external assets, thus increasing gross FX reserves. It simultaneously entered into currency swaps arrangements (a forward FX-denominated liability), leaving its net FX position unchanged. When the government withdrew its deposits, the RBA unwound its FX position, reducing gross FX reserves, but again leaving net reserves unchanged.

[1] For the full report, see "Australia: Rising Borrowing Costs Constrain Growth Prospects", May 2008

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