S&P Global
Ratings

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Research Update:

Outlook On Australia Revised To Stable On Better Fiscal Prospects; Ratings Affirmed At 'AAA/A-1+'

Primary Credit Analyst:
KimEng Tan, Singapore (65) 6239-6350; kimeng.tan@spglobal.com

Secondary Contact:
Anthony Walker, Melbourne + 61 3 9631 2019; anthony.walker@spglobal.com

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Research Update:

Outlook On Australia Revised To Stable On Better Fiscal Prospects; Ratings Affirmed At 'AAA/A-1+'

Ratings:
Foreign and Local Currency |U: AAA/Stable/A-1+
For further details see Ratings List.

Overview

- We expect the general government fiscal position to return to surplus by the early 2020s, as the central government's continued focus on fiscal prudence turns higher revenue collection into better budget performance. We view the government as having significant revenue flexibility to achieve this based on its track record of raising general government revenue faster than the growth of nominal GDP.
- We are revising our outlook on Australia to stable from negative and affirming our 'AAA' long-term and 'A-1+' short-term ratings.
- The stable outlook reflects our expectations that the general government fiscal balance will return to surplus by the early 2020s. We expect steady government revenue growth supported by the strong labor market and relatively robust commodity prices, to be accompanied by expenditure restraint. We also expect property prices to continue their orderly unwind, and that this slowdown won't weigh heavily on consumer spending and the financial system's asset quality.

Rating Action

On Sept. 21, 2018, S&P Global Ratings revised its outlook on the long-term ratings on the Commonwealth of Australia to stable from negative. We also affirmed the 'AAA' long-term and 'A-1+' short-term unsolicited sovereign credit ratings on Australia.

Outlook

The stable outlook reflects our expectations that the general government fiscal balance will return to surplus by the early 2020s. We expect steady government revenue growth supported by the strong labor market and relatively robust commodity prices, to be accompanied by expenditure restraint. We also expect property prices to continue their orderly unwind, and that this slowdown won't weigh heavily on consumer spending and the financial system's asset quality.

We could lower our ratings if we consider that it is unlikely for the general government balance to return to surplus over the next five years. Australia's weak external position means that its other sovereign credit factors, including the fiscal factors, need to be strong to keep the sovereign rating at the highest level on our scale. A stronger fiscal position would also be a strong buffer to absorb the consequences of an abrupt weakening of the housing market and the vulnerabilities that event could bring to financial stability. While our base case is for a soft landing, our ratings could come under pressure if house prices fall sharply and increase risks to fiscal accounts, real economic growth, and financial stability.

Rationale

We consider it more likely that Australia's fiscal position will return to surplus in the early 2020s. The central government currently projects a balanced budget by fiscal 2020 (the year ending June 30, 2020), a year ahead of its earlier expectations. Nevertheless, we expect large infrastructure spending at the state government level to likely keep the general government balance negative till fiscal 2021.

Along with its strong institutions, a credible monetary policy, and floating exchange-rate regime, Australia's public finances traditionally have been a credit strength for the sovereign rating. The fiscal position weakened following the global recession of 2008-2009. The sharp drop in export commodity prices in 2011 sustained downward pressures on public finances, keeping the fiscal balance in deficit.

Flexibility and performance profile: Better labor market conditions and commodity prices have helped to lift government revenue.

- Employment and wage trends over the next few years should continue to support revenue growth.
- External balance sheet is a key credit weakness.

Better labor market conditions and commodity prices have helped to lift government revenues. The resulting boost to income and company taxes have allowed the central government to bring forward its expectations of a budget surplus to 2020 (fiscal year 2019/2020). However, we expect state government infrastructure spending to keep the general government balance in deficit until 2021. On the back of our projections for steady economic growth, employment and wage trends over the next few years should continue to support revenue growth. Although downside revenue risks from commodity prices have receded in the near term, we believe they persist. Our price assumptions for iron ore are similar to that of the budget assumptions, with average prices falling slightly over the next two years. (see "Metals Stay Strong: S&P Global Ratings Raises Its Price Assumptions For Metals Again," published March 9, 2018).

We see little change on the policy front affecting the budgetary position. And the central government's commitment to a return to fiscal surplus reduces the risks of significant increases in planned spending. The aim for budget surplus has been consistent across different ruling parties and leaders; so we do not expect the latest political developments to change our fiscal projections. Even though policies differ, we believe there is strong bipartisan support within parliament to return the budget to surplus. Consequently, we also consider the Australian government to have more willingness and ability to raise revenue than most other sovereigns. The government, for instance, has been able to raise its revenue as a share of GDP over the past seven years despite commodity prices remaining well below the peaks in 2011 over this period.

Our general government fiscal metrics incorporate the federal, state, and local government levels. At the state government level, we expect the aggregate fiscal deficit to widen in 2018 compared with 2017, but to narrow thereafter. This is weighing materially on our forecast of a fiscal deficit in the general government sector. We expect the state governments' use of proceeds from past large asset privatizations to temper the government's debt accumulation. Several smaller planned asset privatizations could reduce government debt accumulation further.

We expect net general government debt to peak at close to 23.3% of GDP in the fiscal year ending June 30, 2020. This is about three percentage points lower than our forecast early this year, an improvement that is mainly due to our more optimistic view of revenue trends over the next few years. Because the central government reports its debt stock in terms of market value, historical fluctuations in the debt ratio also partly reflected changes in interest rates during the period.

We incorporate some off-budget spending in our fiscal outlook. Off-budget spending is mainly in the form of loans, though we do not consider these loans to be liquid assets, and consequently, do not subtract them from gross debt. Low interest rates are helping to keep the general government sector's interest expense burden low, at about 4% of revenues.

House prices have begun to decline recently in an orderly manner, led by the key cities of Sydney and Melbourne. Market observers attribute the slowdown to tighter lending standards at financial institutions. In line with this, we expect bank credit to nongovernment residents to average about 170% of GDP, over the period to 2021. Our forecast includes an increase in the credit-to-GDP ratio in 2019 to 177% due to state-level investment spending growth, but will moderate back toward 170% of GDP by the end of 2021. At the current high levels, we believe that a sustained acceleration of credit growth could lead to vulnerabilities with regard to financial, fiscal, and economic stability.

We consider Australia's economy, while wealthy, resilient, and performing soundly, to be vulnerable to major shifts in international capital flows. The economy carries a high level of external debt, exacerbated by typically high current account deficits, volatility in the country's terms of trade, and a large stock of short-term external debt. However, in our view, the external debt is mostly generated by the private sector and reflects the productive investment opportunities available in Australia, foreign investor confidence in Australia's rule of law, and the high creditworthiness of its banking system. A portion of Australia's external debt has also funded a surge in household borrowing for housing.

Australia's external debt net of the liquid assets of the public and financial sector (our preferred stock measure) is high, at above 230% of current account receipts in 2018. Australia's short-term external debt, which is mostly bank debt, will also remain high, at 135% to 160% of current account receipts during the forecast period.

External current account deficits have narrowed over the past two years. The deficit in fiscal 2018 is likely to be about 2.5% of GDP, down from 4.5% in fiscal 2016. We believe this stronger performance is likely to be temporary, with current account deficits returning to more than 3% of GDP over the next few years, partly driven by weaker export values as commodity prices reverse some of their recent gains. We therefore project current account deficits to remain close to or above 10% of current account receipts, which we consider to be high, and the economy's external debt stock to also remain high.

We expect Australia's external borrowers to maintain easy access to foreign funding. We note that the Reserve Bank of Australia (RBA, the central bank) has maintained a freely floating exchange-rate regime for more than three decades. The Australian dollar represents a little over one-and-a-half percent of allocated international reserves as of March 31, 2018, and the currency is represented in a comparable percentage of spot foreign-exchange transactions. Australia's domestic bond market is deep, and although external borrowing is high, it is mostly denominated in the nation's own currency or hedged.

We consider Australia's banking system to be one of the strongest globally. Along with the resilient and high-income Australian economy, this reflects the low risk appetites of the major banks, which dominate the industry, supported by conservative and proactive regulatory and governance frameworks. However, risks have increased as a result of a long period of high house price inflation and rising household indebtedness, including debt for unincorporated businesses.

We view Australia as possessing a high degree of monetary credibility. This helps the country to attenuate major economic shocks, which could come, for example, from a slump in Australia's property market or a sharp downturn in China's economy. We believe the RBA's success in anchoring inflation expectations would allow it to lower policy interest rates from their current level of 1.50% to support growth, even if the currency were to weaken further, given the historical low pass-through to inflation.

Institutional and economic profile: High-income economy and strong institutions are credit strengths

- The Australian economy is high income, diversified, and has shown consistent growth.
- Australian governments have demonstrated a willingness to implement reforms to sustain economic growth and ensure sustainable public finances.

Australia is a wealthy, diversified, and resilient economy, with GDP per capita of an estimated US$56,500 in fiscal 2019. We believe the economy's resilience and flexibility help cushion government finances from economic shocks and are a major support to Australia's creditworthiness. Australia's high level of wealth derives from strong institutional settings and decades of economic reform, which have facilitated the country's flexible labor and product markets. Australian governments have demonstrated a willingness to implement reforms to sustain economic growth and ensure sustainable public finances, and have a strong track record from managing past economic and financial crises. Institutions are stable and provide checks and balances to power, there is strong respect for the rule of law, and a free flow of information and open public debate of policy issues.

Economic growth remains sound. We estimate headline GDP growth to be around 3% in fiscal 2019. Low nominal interest rates, coupled with pent-up underlying demand, have been encouraging growth in dwelling investment for some time, and the negative effect of the declining mining investment has waned further. Significant currency depreciation up to 2016 spurred services exports, particularly in education and tourism. And while resources investment continues to be weak, resource export volumes is supported as new capacity is brought on line. We expect growth to remain firm during our forecast period, and project real per capita GDP growth to average about 1.3% per year during 2019 to 2021.

Key Statistics

Table 1

Commonwealth of Australia - Selected Indicators (Data as of Aug. 31, 2018)

ECONOMIC INDICATORS (%)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Nominal GDP (bil. LC)	1,496	1,534	1,597	1,621	1,660	1,758	1,851	1,916	2,011	2,103
Nominal GDP (bil. $)	1,542	1,574	1,466	1,349	1,208	1,326	1,440	1,435	1,505	1,602
GDP per capita (000s $)	67.8	68.1	62.4	56.6	49.9	53.9	57.6	56.5	58.3	61.2

Table 1

Commonwealth of Australia - Selected Indicators (Data as of Aug. 31, 2018) (cont.)

ECONOMIC INDICATORS (%)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth	3.9	2.6	2.6	2.4	2.8	2.1	2.7	3.0	2.8	2.9
Real GDP per capita growth	2.1	0.9	1.0	0.9	1.2	0.4	1.0	1.3	1.2	1.4
Real investment growth	11.6	3.1	(1.8)	(3.2)	(3.4)	0.3	3.6	1.9	2.1	2.4
Investment/GDP	27.6	27.8	26.6	26.1	25.3	23.8	24.3	24.4	24.2	24.0
Savings/GDP	24.1	23.9	23.5	22.4	20.8	21.6	21.8	20.9	20.7	20.4
Exports/GDP	21.5	20.0	21.1	20.0	19.2	21.3	21.5	21.7	22.2	22.8
Real exports growth	4.6	5.3	6.0	6.8	6.9	5.4	3.4	7.3	3.3	4.6
Unemployment rate	5.2	5.4	5.8	6.2	5.9	5.7	5.5	5.4	5.3	5.2
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(3.5)	(3.9)	(3.1)	(3.7)	(4.5)	(2.2)	(2.5)	(3.5)	(3.5)	(3.6)
Current account balance/CARs	(13.9)	(16.8)	(12.7)	(15.6)	(19.6)	(8.9)	(9.7)	(13.5)	(13.3)	(13.3)
CARs/GDP	25.1	23.5	24.7	23.8	23.0	24.8	25.3	25.7	26.3	26.7
Trade balance/GDP	0.6	(0.2)	0.7	(0.8)	(1.6)	0.8	0.3	(0.2)	(0.2)	(0.2)
Net FDI/GDP	3.4	3.6	3.5	2.5	3.7	3.9	2.9	2.8	2.8	3.0
Net portfolio equity inflow/GDP	(1.4)	(0.1)	(1.1)	0.6	(0.1)	1.1	0.3	(0.2)	(0.2)	(0.2)
Gross external financing needs/CARs plus usable reserves	230.0	233.3	229.7	254.4	275.5	253.8	231.0	232.2	222.6	217.0
Narrow net external debt/CARs	232.0	236.3	265.3	267.1	317.0	267.7	230.7	232.2	219.7	207.3
Narrow net external debt/CAPs	203.8	202.4	235.4	231.0	265.1	245.9	210.3	204.6	194.0	182.9
Net external liabilities/CARs	214.3	203.3	225.1	210.4	274.2	227.0	214.6	226.3	224.9	222.6
Net external liabilities/CAPs	188.2	174.1	199.7	181.9	229.2	208.5	195.7	199.4	198.6	196.4
Short-term external debt by remaining maturity/CARs	142.5	146.9	147.6	185.4	203.9	180.6	160.6	159.5	145.6	136.5
Usable reserves/CAPs (months)	1.2	1.3	1.4	1.9	1.7	1.5	1.9	1.9	1.7	1.6
Usable reserves (mil. $)	48,332	48,099	58,935	48,274	46,217	62,002	64,673	64,673	64,673	64,673
FISCAL INDICATORS (%, General government)										
Balance/GDP	(4.1)	(2.5)	(3.0)	(2.2)	(2.4)	(2.1)	(1.4)	(1.5)	(0.5)	0.1
Change in net debt/GDP	5.8	1.3	3.4	2.5	3.7	0.2	2.2	2.3	1.2	(0.6)
Primary balance/GDP	(3.0)	(1.3)	(1.7)	(0.9)	(1.0)	(0.8)	(0.0)	(0.1)	0.9	1.5
Revenue/GDP	32.2	33.0	33.1	34.3	34.6	34.4	35.7	36.4	36.6	36.1
Expenditures/GDP	36.3	35.5	36.1	36.5	37.0	36.5	37.1	37.9	37.1	36.0
Interest /revenues	3.5	3.7	4.1	3.9	4.0	3.7	3.9	4.0	4.0	4.0
Debt/GDP	26.5	28.9	32.5	35.9	39.6	41.2	41.4	42.3	41.4	39.1
Debt/Revenue	82.3	87.6	98.1	104.7	114.3	119.8	115.8	116.2	113.3	108.4
Net debt/GDP	11.9	12.9	15.8	18.1	21.3	20.4	21.6	23.1	23.3	21.7
Liquid assets/GDP	14.6	16.0	16.7	17.8	18.3	20.8	19.8	19.1	18.2	17.4

Table 1

Commonwealth of Australia - Selected Indicators (Data as of Aug. 31, 2018) (cont.)										
ECONOMIC INDICATORS (%)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
MONETARY INDICATORS (%)										
CPI growth	2.3	2.3	2.7	1.7	1.4	1.7	2.4	2.4	2.2	2.4
GDP deflator growth	1.8	(0.1)	1.5	(0.8)	(0.4)	3.8	2.5	0.5	2.1	1.6
Exchange rate, year-end (LC/$)	1.0	1.1	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Banks' claims on resident non-gov't sector growth	8.6	4.2	6.3	8.4	9.0	3.7	5.2	6.8	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	148.4	150.7	153.9	164.3	174.9	171.3	171.1	176.5	173.2	170.6
Foreign currency share of claims by banks on residents	2.9	3.8	3.6	4.7	4.3	3.6	4.6	4.6	4.6	4.6
Foreign currency share of residents' bank deposits	3.0	2.9	3.2	3.7	3.9	4.2	3.5	3.5	3.5	3.5
Real effective exchange rate growth	3.6	0.6	(9.6)	(1.5)	(7.9)	5.4	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Commonwealth of Australia--Ratings Score Snapshot	
Key Rating Factors	
Institutional assessment	1
Economic assessment	1
External assessment	6
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	1
Monetary assessment	1

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Financial Institutions - General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Sovereign Ratings History, Sept. 5, 2018
- Sovereign Ratings List, Sept. 5, 2018
- Sovereign Risk Indicators, July 5, 2018. An interactive version is also available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2017 Annual Sovereign Default Study And Rating Transitions, May 8, 2018
- Global Sovereign Rating Trends: First-Quarter 2018, April 11, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, Feb. 22, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Australia		
Sovereign Credit Rating |U	AAA/Stable/A-1+	AAA/Negative/A-1+
Export Finance & Insurance Corp.		
Issuer Credit Rating	AAA/Stable/A-1+	AAA/Negative/A-1+

Ratings Affirmed

Australia	
Transfer & Convertibility Assessment	
Local Currency |U	AAA
Export Finance & Insurance Corp.	
Senior Unsecured	AAA
Commercial Paper	A-1+

|U   Unsolicited ratings.

This unsolicited rating(s) was initiated by a party other than the Issuer (as defined in S&P Global Ratings' policies). It may be based solely on publicly available information and may or may not involve the participation of the Issuer and/or access to the Issuer's internal documents. S&P Global Ratings has used information from sources believed to be reliable based on standards established in our policies and procedures, but does not guarantee the accuracy, adequacy, or completeness of any information used.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.