

## Under supply of capacity and housing to challenge recovery says RBA

Australia's economic future will be challenged by an under-supply of capacity and housing, despite decades of economic reform shielding Australia from the worst of the global downturn, the Reserve Bank of Australia (RBA) says. The nation is entering a new phase of economic expansion with less spare capacity than was thought likely, with unemployment appearing to have peaked at around 5.8 per cent, RBA assistant governor (economics) Philip Lowe says. "The issues we face are, therefore, quite different from those confronting most of the other advanced economies," Dr Lowe told the Urban Development Institute of Australia National Congress on Wednesday. "Elsewhere, the challenge is to get private demand to grow on a sustainable basis so that it can catch up with the supply potential of the economy. "In contrast, for Australia, the main task is to expand the supply side of the economy so that demand can grow solidly without causing inflation to rise." Australia also is facing an under-supply of housing that isn't meeting the demands of a growing population, he said. Australia is likely to devote a higher share of its GDP to housing than has been the case historically, or risk a further adjustment in housing prices and rents to balance supply and demand. Unlike most countries rocked by the GFC, Australia did not have an unsustainable surge in dwelling investment in the middle years of the 2000s resulting in over-supply of housing, Dr Lowe said. He said the rate of increase in dwellings has been below the average of the past 50 years, while population has increased at its fastest pace over the same period. "If we are to build more dwellings, we need to ensure that planning guidelines and infrastructure provision can accommodate this. This will pose challenges for all levels of government. A second challenge was "the capacity of the economy to deal with an increase in dwelling construction at a time when investment elsewhere in the economy is also very high. "If housing construction is very strong at the same time that the resources sector is expanding, there will be competing demands for a range of skilled workers and specialised services. "Managing these competing demands and ensuring the adequate supply of workers with appropriate skills will be a challenge." While challenges remained, three decades of reform by governments and business had honed the Australian economy to weather not just the global financial crisis of 2008, but the 1997 Asian financial crisis. He said the central lesson of the past 18 months was the importance of flexibility in the economy and economic policy to respond to crisis. The RBA slashed interest rates from 7.5 per cent to a 50 year low of three per cent over seven months between September 2008 and April 2009 in response to the international debt crisis. Since then, it has raised the cash rate to four per cent in a series of moves that began in October 2009. "This flexibility, though, did not just materialise out of thin air," Dr Lowe said. "Instead, it was the result of many years of policy reform and hard work by governments and business. "What we have seen recently is the dividend of that hard work, with the economic outcomes over the past year or so reflecting not just the decisions made since late 2008, but also the decisions made in the two to three decades before that." Dr Lowe told the audience in Sydney that business investment in Australia was around 16 per cent of gross national product, close to a 40 year peak, and was

expected to rise over the next two years. “The high overall rate of investment means that the capital stock is increasing at a faster pace than over recent decades, and this should underpin continued growth in the supply potential of the Australian economy. “The fact that investment is high in Australia reflects the high expected return on capital, particularly in the resources sector.”