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A Case Study of Australia's Roller Coaster Decade to Manage Inflation: Navigating Economic Ups and Downs

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ABSTRACT

In 2022, due to the global economic slowdown, the Australian economy was also affected by the increasing inflation and hiked cost of living in 2022. It was forecasted to be around 6.4 per cent for the year 2022, but in real times, inflation enlarged above 7 per cent. The Reserve Bank of Australia (RBA) had tackled the inflation challenge by strategically revising its monetary and fiscal policies to hold the inflation pressure under its control.

As a result, several reforms were implemented by the RBA Board to take a tough hand to control the inflation. In every month from May to December, the target rate was raised from a record low 0.1 per cent to 3.10 per cent.

This article is an attempt taken by the authors to investigate the recovery mechanisms handled by the RBA in terms of monetary policy and fiscal policy reforms to take a tough hand at the increasing inflation. Thus, by the untiring steps taken by the RBA in terms of Interest Rate Adjustments, Quantitative Easing (QE), Targeted Spending, Infrastructure Investment and Tax Cuts, the inflation was brought under controlled and stabled state.

Key Words: *Inflation, Monetary Policy, Fiscal Policy, Interest Rate, inflation pressure, Quantitative Easing, Targeted Spending, Infrastructure investment*

Introduction

As same as the global economic scenario, the Australian economy was also affected by the increasing inflation and hiked cost of living in 2022. It was forecasted to be around 6.4 per cent for the year 2022, but in real times, inflation enlarged above 7 per cent. The Reserve Bank of Australia (RBA) had tackled the inflation challenge by strategically revising its monetary and fiscal policies to hold the inflation pressure under its control.

As a result, several reforms were implemented by the RBA Board to take a tough hand to control the inflation. In every month from May to December, the target rate was raised from a record low 0.1 per cent to 3.10 per cent. Consequently, the cost of living had a huge impact due to the increased mortgage rate pressures as a result of higher rates. Particularly, the Australian employees those who had enjoyed the lower interest rates were severely got affected due to the increased interest rates.

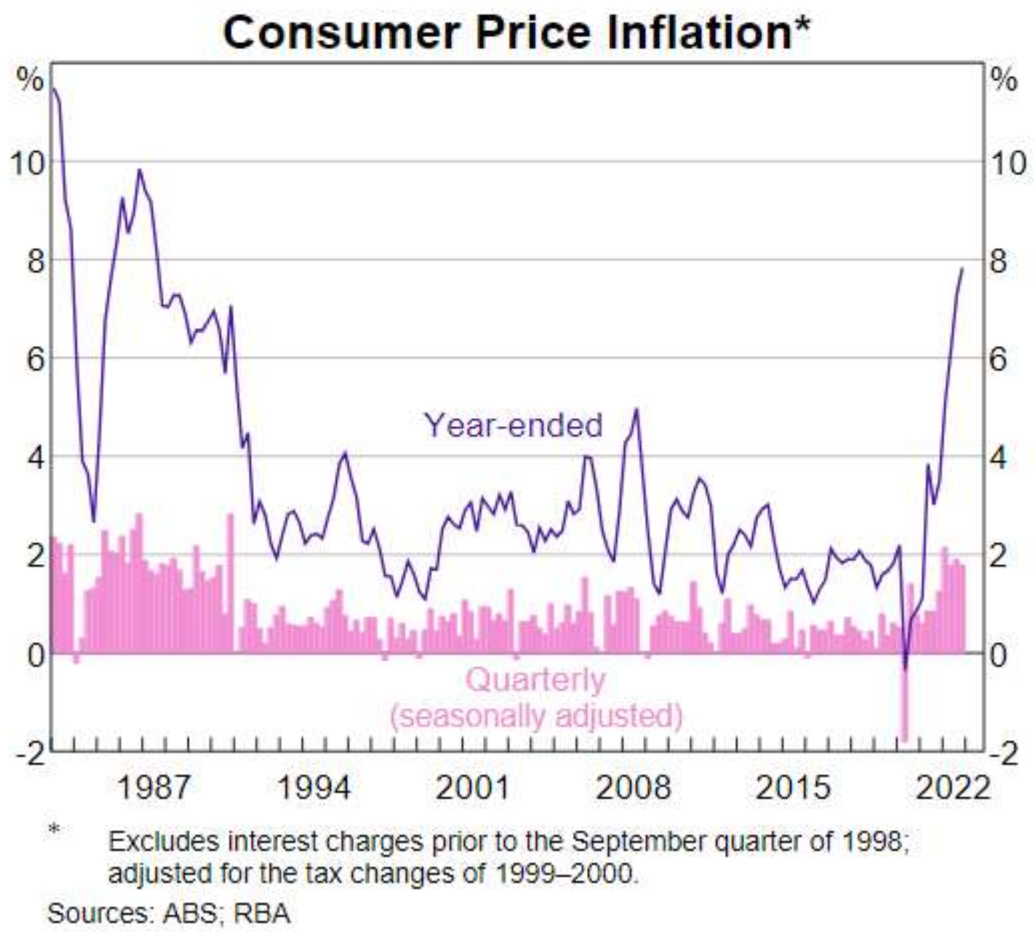
Australia's inflation trajectory since the inception of the CPI can be categorized into four primary phases: (i) The economic impact of the wars such as Korean War (ii) The disinflationary span spanning from 1953 to 1972; (iii) the consistent upward trend in inflation from 1973 to 1990; and (iv) The post implementation phase of inflation measures by the RBA. Bruce Hockman, Chief Economist for the ABS, elucidates that each of these phases reveals a consistent pattern.

Inflation Statistics

Here's a quick overview of Australia's inflation statistics over the past 10 years:

- Average annual inflation rate: 2.4%
- Highest annual inflation rate: 3.8% (June 2022 quarter)
- Lowest annual inflation rate: 0.7% (September 2020 quarter)

Here's a graph showing the annual inflation rate over the past 10 years:



As you can see, inflation has been relatively stable over the past decade, with most years falling within the Reserve Bank of Australia's target range of 2-3%. However, there have been some fluctuations, with inflation rising above 3% in 2021 and 2022 due to factors such as supply chain disruptions and rising energy prices.

Here are some additional statistics for the past 10 years:

- Average quarterly inflation rate: 0.6%
- Highest quarterly inflation rate: 2.1% (March 2022 quarter)
- Lowest quarterly inflation rate: -0.3% (March 2020 quarter)
- It's important to note that these are just national averages. Inflation can vary significantly across different regions and income groups. For example, inflation in major cities like Sydney and Melbourne is often higher than in rural areas.

Current Inflation Statistics in Australia:

- In just one quarter, there was a hike of 1 per cent in the Consumer Price Index (CPI)
- In one financial year, there was a rise in the CPI by 3.6 per cent.
- The most significant price rises this quarter were Rents (+2.1%), Secondary education (+6.1%), Tertiary education (+6.5%) and Medical and hospital services (+2.3%).

Inflation in Australia over the Past 10 Years:

To analyse the type of inflation in Australia over the past 10 years, let's break it down into three periods:

1. Pre-Pandemic (2013-2019):

- ***Inflation rate:*** Relatively stable, averaging around 2.5% per year.

- ***Type of inflation:*** Cost-push inflation. This was primarily driven by rising global commodity prices, particularly energy and resources. Additionally, natural disasters like floods and droughts impacted food prices.
- ***Demand factors:*** Moderate economic growth and low unemployment contributed to some demand-pull pressure, but overall, demand-side inflation was subdued.

2. Pandemic Period (2020-2022):

- ***Inflation rate:*** Initially subdued due to lockdowns and reduced economic activity. However, it started rising sharply from mid-2021, reaching a peak of 7.8% in December 2022.
- ***Type of inflation:*** Primarily cost-push inflation, fuelled by several factors:
    - ***Supply chain disruptions:*** Global lockdowns and logistical bottlenecks led to shortages of various goods and components, pushing prices up.
    - ***Energy price surge:*** Geopolitical tensions and limited energy production capacity caused oil and gas prices to skyrocket, impacting transportation and production costs.
    - ***Wage growth:*** As economic activity recovered, labour shortages emerged in certain sectors, leading to higher wages, which in turn fuelled demand-pull pressure.

3. Post-Peak (2023-present):

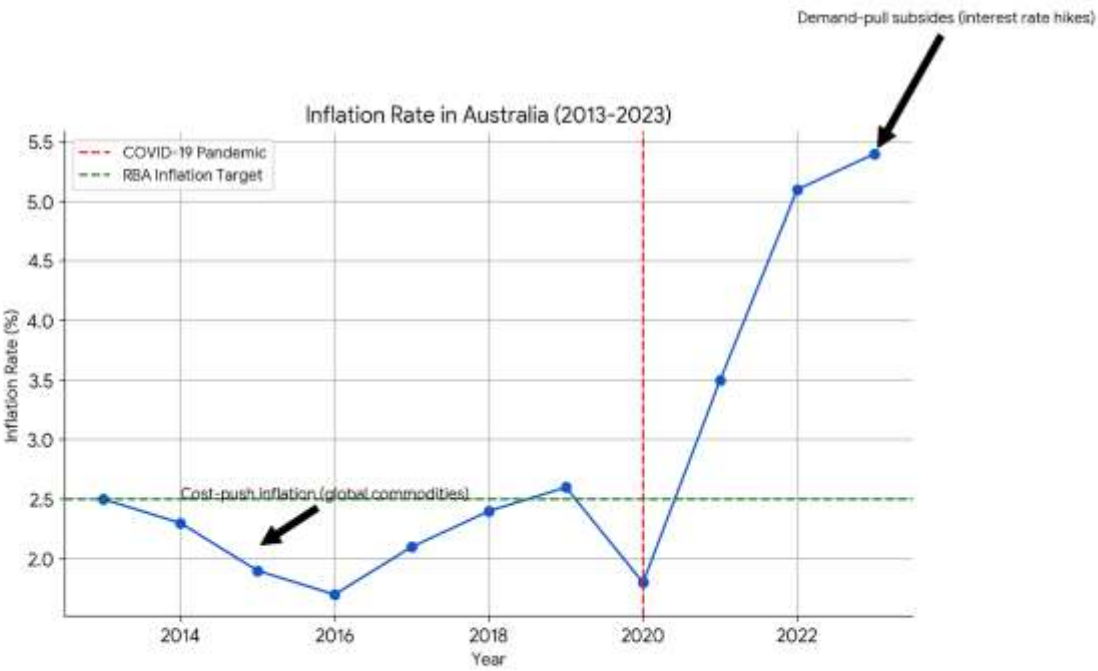
- ***Inflation rate:*** Showing signs of moderation, declining to 5.4% in September 2023.
- ***Type of inflation***: Still primarily cost-push, but with some signs of demand-pull subsiding:
    - ***Easing supply chain pressures:*** Gradual improvement in global supply chains is helping to alleviate shortages and price pressures.
    - ***Moderating energy prices:*** While still high, energy prices have stabilized to some extent.
    - ***Central bank intervention:*** The Reserve Bank of Australia has raised interest rates to cool down demand and combat inflation.

Overall:

- The past 10 years have seen a mixture of cost-push and demand-pull inflation in Australia, with the relative dominance of each type shifting over time.
- The pandemic period was a significant turning point, with supply chain disruptions and energy price surges acting as major cost-push drivers.
- While inflation is currently moderating, the Reserve Bank remains vigilant and will likely continue raising interest rates to ensure inflation returns to its target range of 2-3%.

Additional factors to consider:

- The impact of climate change on extreme weather events and agricultural yields could further exacerbate cost-push inflation in the future.
- The ongoing war in Ukraine continues to pose a risk to energy security and global inflation.
- The effectiveness of government policies in mitigating inflation and supporting economic growth will be crucial in determining the future trajectory of inflation in Australia.



Recovery strategies with specific to Monetary and Fiscal policies

Australia's past decade saw inflation fluctuate around the target range of 2-3%, with periods below and above. The Reserve Bank of Australia (RBA) and the government implemented various monetary and fiscal policies to manage these fluctuations and maintain macroeconomic stability.

Monetary Policy:

- ***Interest Rate Adjustments:*** The RBA primarily uses the cash rate, the rate at which it lends to banks, to influence inflation. Between 2013 and 2019, the RBA kept rates at a record low of 1.5% to stimulate economic growth and counter deflationary pressures. However, as inflation started exceeding the target range in 2021, the RBA began raising rates, reaching 3.1% as of December 2023. This aims to cool demand and dampen inflationary pressures.
- ***Quantitative Easing (QE):*** During the COVID-19 pandemic, the RBA implemented QE, buying government bonds to inject liquidity into the financial system and support economic activity. This unconventional monetary policy measure ended in February 2022 as the economy recovered.

Fiscal Policy:

- ***Targeted Spending:*** During the pandemic, the government implemented temporary fiscal measures like Job Keeper and Jobseeker payments to support individuals and businesses. These programs were gradually withdrawn as the economy recovered.
- ***Infrastructure Investment:*** The government maintained infrastructure spending throughout the decade, investing in roads, rail, and other projects to boost economic activity and create jobs. This aimed to stimulate aggregate demand and counter deflationary tendencies.
- ***Tax Cuts:*** Personal income tax cuts were introduced in 2019, aiming to increase disposable income and encourage consumer spending. However, their impact on inflation was debated, with some arguing they fuelled inflationary pressures.

Conclusion

Over the past decade, Australia's inflation has been a tale of two halves. From 2010 to 2015, things were very much under the control of the Reserve Bank of Australia. But from 2016 onwards, the scenario got changed. Global factors and domestic disruptions pushed inflation above 3%, attaining a peak of 7.8% by December 2022.

This article is an effort to understand the significant recovery strategies handled by Australia to moderate the firmly increasing inflation and to bring it back to a controllable limit. This rollercoaster decade highlights the challenges of managing inflation in a dynamic global environment. As Australia looks ahead, the focus will be on bringing inflation back under control and ensuring long-term price stability.

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