

Media release

Low probability, high impact economic scenarios for Australia

- The Institute modelled “alternative futures” scenarios of stagflation, a major house price correction and adoption by policymakers of Modern Monetary Theory
- All three scenarios are bleak, resulting in a significant recession sometime over the next 15 years
- This “how to” and “what if” guide has wide application to many professionals in many industries to game plan for future shocks

The Actuaries Institute today warned that there are some low probability but plausible scenarios that involve a significant recession within the next 15 years. These scenarios involve policy makers veering off course and burdening businesses and the public with stagflation, mismanaging a collapse in house prices, or excessive government spending.

In its Green Paper, *The Long Run: Low probability, high impact scenarios for the Australian economy and financial markets*, the Actuaries Institute said its analysis identifies plausible “alternative futures” that would result in the economy diverging significantly from current expectations.

Actuaries Institute President Annette King said actuaries regularly consider the long-term outlook for the Australian economy and financial markets as part of their professional work for many different industries. Considering the risks of an organisation’s baseline scenario not unfolding is crucial to managing for uncertainty.

“Scenario analysis is widely used by government, regulators and businesses. It has wide application across all sectors of the economy and allows the impact of myriad factors to be assessed, such as climate change, cyber and pandemic risks – key challenges all organisations are currently facing,” she said.

“Scenario analysis delivers large benefits by investigating potential futures that may be low probability but high impact,” said actuary Hugh Miller, who collaborated on the Green Paper with independent economist Michael Blythe.

“These are the types of shocks that cause the greatest disruption and require the greatest adjustments. Understanding the implications and having a game-plan in place are powerful supports for decision makers,” Dr Miller said.

“Many of these unexpected shocks can produce lasting change,” he added.

“The 9/11 attacks changed the geopolitical backdrop dramatically and permanently. The Global Financial Crisis changed much of the way financial organisations are managed and regulated. The impact of the COVID pandemic is still playing out,” the paper notes.

Dr Miller said the **baseline scenario**, which is the benchmark for the three “alternative futures”, is the only one that avoids a recession with positive although modest GDP growth rates but still involves rising downside risks. This is the central case, or expected path, for the Australian economy and financial markets at this point in time.

Assessing the chance of **stagflation** (high inflation and high unemployment) taking hold, the Green Paper said this is a plausible scenario in the current environment (high energy and food prices, supply chain pressures, strong demand, earlier reflationary policy settings) and clearly the current direction of global risk.

The Institute’s stagflation scenario has expansionary fiscal policy, too loose monetary policy and supply side constraints combining to drive a wage-price spiral. Inflation peaks at around nine percent.

The eventual resolution is a severe recession, including high unemployment and high long-term government bond yields. While long-term parameters eventually settle around the same baseline growth rates, the economy is 5% smaller than in the baseline by the end.

A major **correction in house prices** is another alternative future. This scenario is a perennial favourite, with this scenario based on a 30% drop in dwelling prices which is beyond all current mainstream projections. The price decline is triggered by an overly aggressive Reserve Bank tightening cycle that leads to a cascading effect across the economy and financial system.

Interest in this scenario has been refreshed given the current slowdown in the housing market, high levels of household debt, budget pressures, stagnant wages growth, bank exposures to housing and rising interest rates.

Again, while most key economic variables converge back to the baseline projections towards the end of the scenario, the economy is smaller than in the baseline by the end, this time by 2%. The unemployment rate and debt servicing ratio are crucial variables to watch for this scenario.

The final alternative scenario, adoption of **Modern Monetary Theory**, focuses on achieving full employment by funding government expenditure through creating money rather than issuing debt.

This is a “new paradigm” scenario and although full adoption is unlikely policymakers have moved some way in that direction. The activity benefits of the MMT-driven boom largely evaporate during the subsequent recession.

Ms King said the scenarios outlined in the Green Paper highlight the need for policymakers, advisers and industry to be on alert at all times.

“If under plausible scenarios a business model is found unsustainable, clearly change is required - to the service or product offered, the public policy or regulatory settings in the market, or both,” she said.

The Institute expects this latest Green Paper to be of wide interest. The aim of the Paper, through a collaboration with highly respected independent economist Michael Blythe, is to share insights about scenario analysis and identify some plausible alternative futures. Given the interconnectedness of the economy, the alternative futures in this Paper are likely to be highly relevant for many professionals in many industries.

View the full [report](#).

Hugh Miller and Michael Blythe are available for interview.

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About the Actuaries Institute and the Profession

As the peak professional body for Members in Australia and overseas, the Actuaries Institute represents the interests of the profession to government, business and the community.

Actuaries use data for good by harnessing the evidence to navigate into the future and make a positive impact. They think deeply about the issue at hand, whether it's advising on commercial strategy, influencing policy, or designing new products. Actuaries are adept at balancing interests of stakeholders, clients, and communities. They're called upon to give insight on complex problems, they'll look at the full picture. Actuaries analyse the data and model scenarios to form robust and outcome-centred advice.

Institute of Actuaries of Australia

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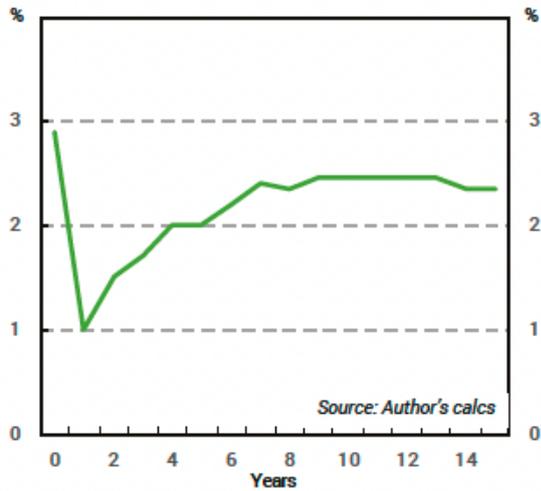
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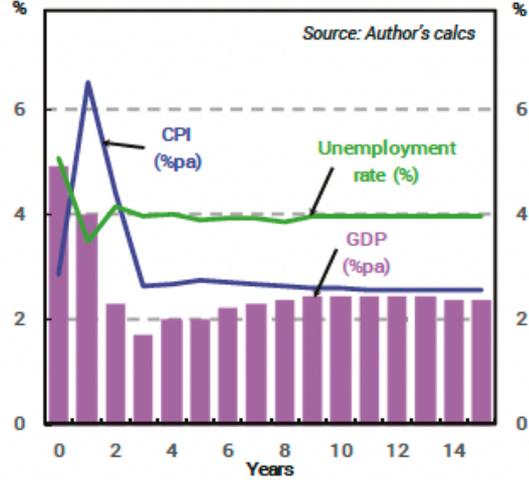
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Baseline Scenario

Baseline: Potential GDP (annual % change)

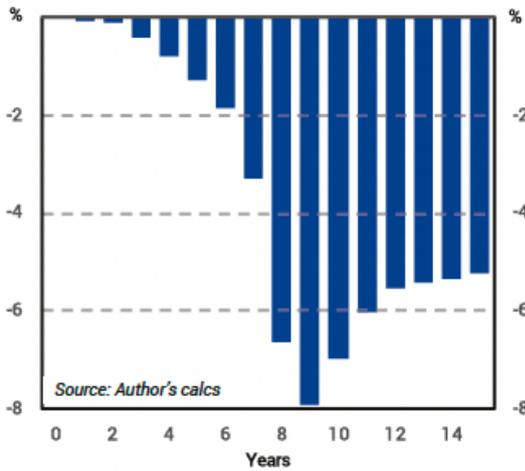


Baseline: Key Indicators

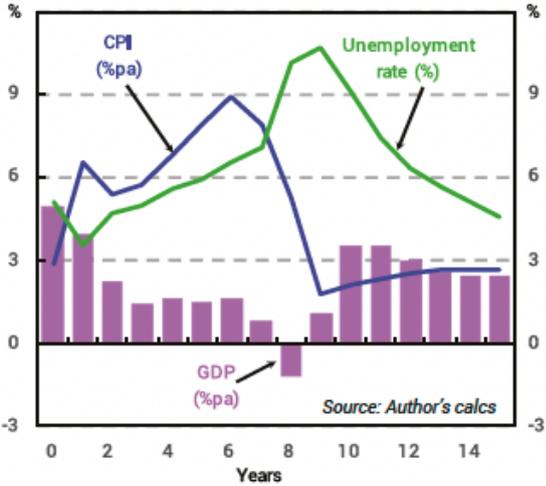


Stagflation Scenario

Stagflation: GDP (deviation from baseline)

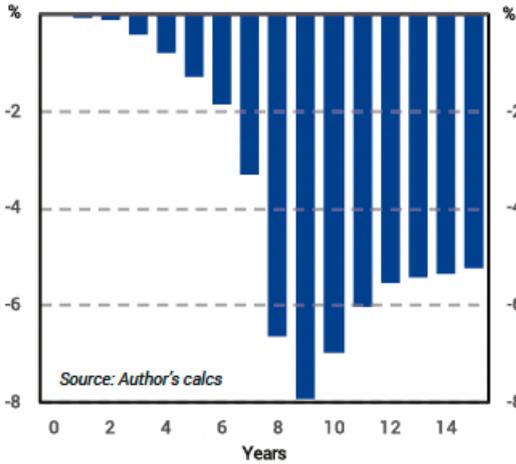


Stagflation: Key Indicators

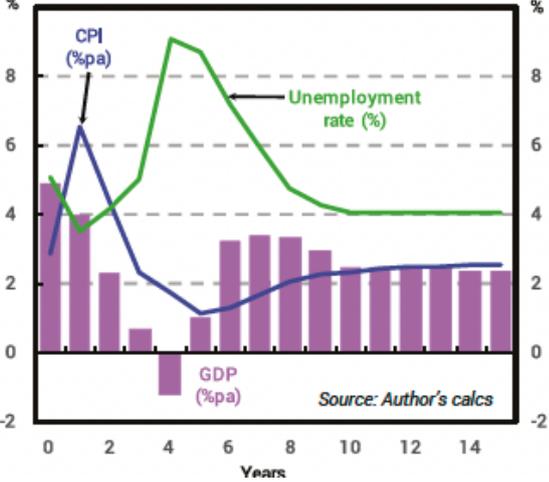


Major House Price Correction Scenario

Housing: GDP (deviation from baseline)

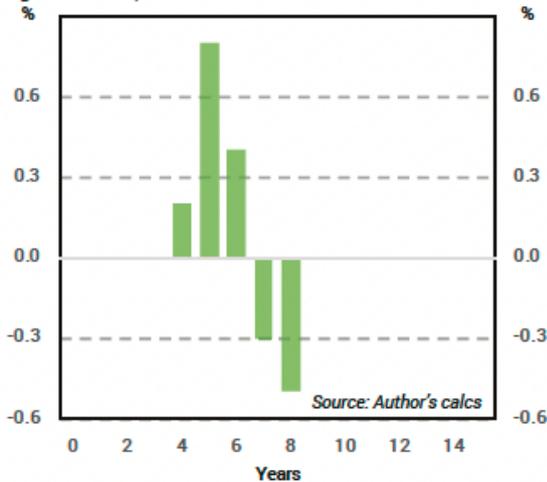


Housing: Key Indicators



MMT Scenario

MMT: Potential GDP (deviation from baseline growth rate)



MMT: Key Indicators

