SYDNEY GRAMMAR SCHOOL

2019
Trial Higher School Certificate Examination

ECONOMICS

Date: Weds 14th August (AM) **Outcomes Assessed: All**

General Instructions

- Reading Time: **5 minutes**
- Working Time: **3 hours**
- Write using **black pen**
- Write your **candidate number** on the top of each page (or front of each booklet).
- **All** work and this question paper to be collected in **one** bundle.
- Board-approved calculators **may** be used.
- Do **NOT** write in margins – Ask for extra booklets if you need more space for your answers

Structure of Paper & Instructions

- **Total Marks: 100**
- **Section I (20 marks):** Answer all questions in the Answer Booklet provided. Select the alternative A, B, C or D that most fully and correctly answers the question.
- **Section II (40 marks):** Answer all questions in the Answer Booklet provided.
- **Section III (20 marks):** Attempt one question from this section. Answer this question after carefully reading the stimulus material.
- **Section IV (20 marks):** Attempt one question from this section.

CHECKLIST
Each boy should have the following:
1 Question Paper
1 Multiple Choice & Short Answer Booklet
2 Writing Booklets

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SECTION I
20 marks
Attempt questions 1 - 20
Spend no more than 35 mins for this section
Use the multiple-choice answer sheet on the front page of the Answer Booklet for Questions 1 - 20

1. What is the largest component of yearly aggregate demand in the Australian economy?

   (A) Export receipts.
   (B) Investment.
   (C) Consumption.
   (D) Government expenditure.

2. The following table presents information for Countries X and Y.

Country	Population (m)	Working Age Population (m)	Employed (m)	Seeking employment (m)
X	180	100	52	8
Y	240	160	70	8

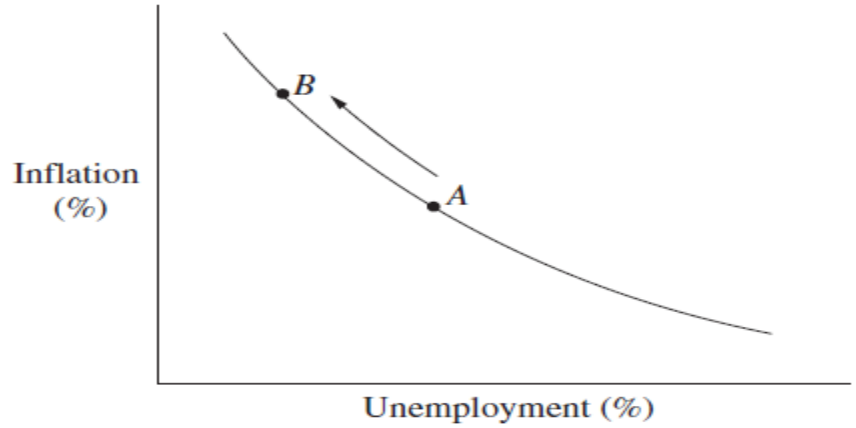
   Which of the following statements is correct?

   (A) Country Y has a lower unemployment rate but higher participation rate than Country X.
   (B) Country Y has a higher participation rate and higher unemployment rate than Country X.
   (C) Country X has a lower unemployment rate but higher participation rate than Country Y.
   (D) Country X has a higher participation rate and higher unemployment rate than Country Y.

3. Which of the following transactions is an example of foreign direct investment for Australia?

   (A) An American bank buying a very small number of shares in an Australian bank.
   (B) An Australian firm buying a machine from overseas.
   (C) An Australian business is bought by a Japanese company.
   (D) An English firm buying a large amount of Australian dollars on the foreign exchange market.

4. The diagram below shows the relationship between inflation and unemployment in an economy in the short term:



Which of the following would not be a likely cause the movement indicated in the diagram?

(A) An increase in consumer and business confidence.
(B) The economy is approaching capacity constraints.
(C) Higher interest rates and lower government spending.
(D) Injections exceeding leakages.

5. What consequence is most likely to arise when the Federal Government runs a budget deficit financed by selling bonds to the private sector in Australia?

(A) Greater government expenditure.
(B) Higher company tax receipts.
(C) Lower terms of trade.
(D) An increase in domestic interest rates.

6. The following question relates to the table below showing hypothetical Balance of Payments data for a country with a floating exchange rate:

B of P Item	**Year 1 ($bn)**	**Year 2 ($bn)**
Financial Account	150	185
Exports	190	80
Capital Account	50	-10
Net Secondary Income	10	15
Imports	70	85
Balancing Item	-10	5

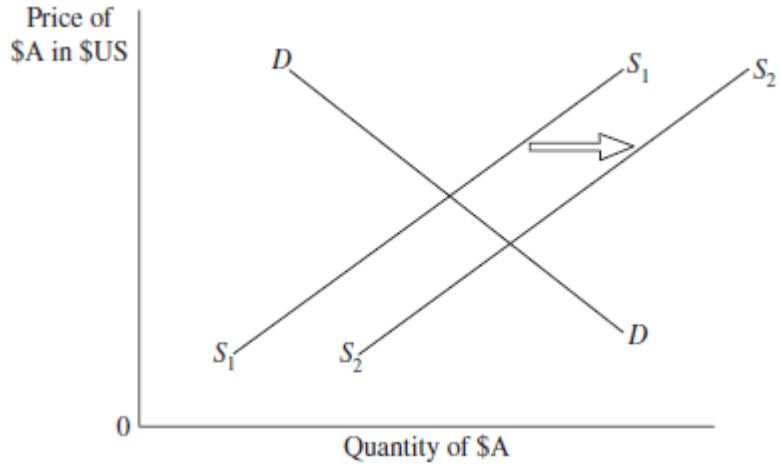
What has happened to the Net Primary Income deficit from Year 1 to Year 2?

(A) It has fallen by more than $120bn.
(B) It has risen by less than $150bn.
(C) It has doubled in size.
(D) It has halved in size.

7. Which of the following conditions would improve Australia's international competitiveness?

(A) Higher domestic interest rates.
(B) A rise in the value of the $A.
(C) An increase in the general level of wages.
(D) Greater decentralisation of the labour market.

8. The following graph demonstrates the interaction of demand and supply conditions for Australian currency under a floating exchange rate regime.



Which of the following would not have caused a shift in the supply curve as shown?

(A) Greater overseas investment undertaken by Australian firms.
(B) More Australians travelling overseas.
(C) An increase in the demand for imports.
(D) The RBA dirtying the float by selling foreign currency.

9. Consider the following table before answering this question.

Year	CPI	Nominal GDP ($bn)
1	110	1000
2	105	1200
3	115	1300

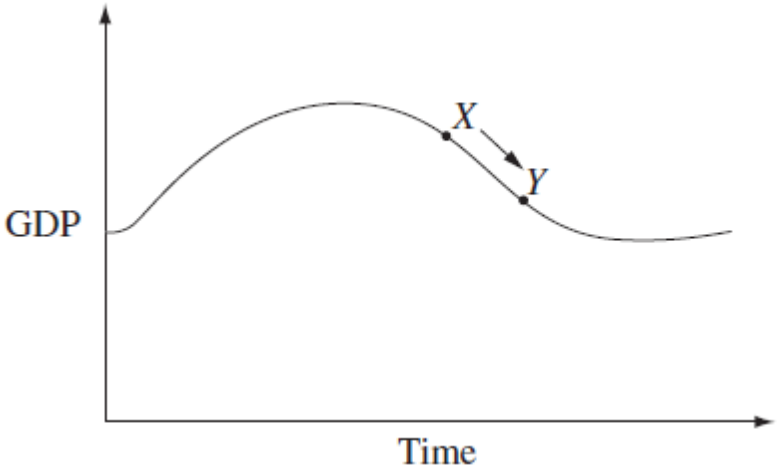
Which of the following statements is true?

(A) Inflation rose to 8.7% in Year 3.
(B) Economic growth was 20% in Year 2.
(C) Inflation was 4.55% in Year 2.
(D) Economic growth was negative in Year 3.

10. How would a loan to an overseas financial institution from an Australian bank be recorded in the foreign country's Balance of Payments?

(A) As a debit on the Capital account.
(B) As a credit on the Capital account.
(C) As a debit on the Financial account.
(D) As a credit on the Financial account.

11. The following graph shows a business cycle for an economy:



What combination of policies would move the economy from X to Y?

	Govt Spending	Monetary Policy
(A)	Increase G relative to T	RBA buys back Govt bonds from banks
(B)	Increase T relative to G	RBA buys back Govt bonds from banks
(C)	Increase G relative to T	RBA sells Govt bonds to banks
(D)	Increase T relative to G	RBA sells Govt bonds to banks

12. How could the Federal Government best reduce frictional unemployment?

(A) Lower rates of income tax.
(B) Expanding the Jobactive network.
(C) Raising the school leaving age.
(D) Offer increased child-care subsidies.

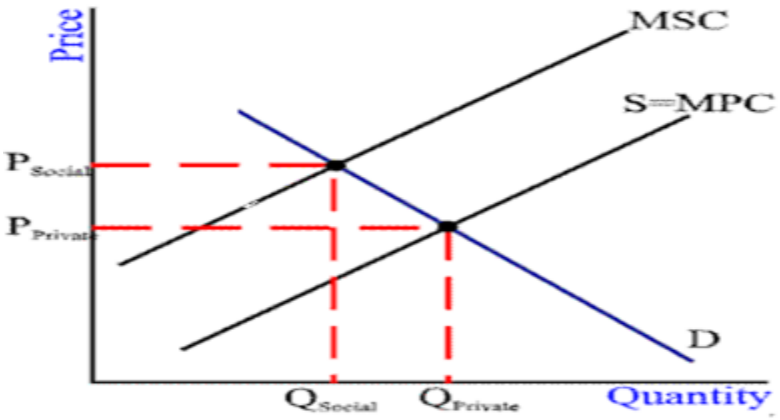
13. Which of the following is an example of an automatic stabiliser?

(A) A reduction in marginal tax rates.
(B) An increase in spending on national infrastructure by the government.
(C) An increase in tax collections due to higher rates of economic growth.
(D) An increase in interest rates due to higher inflation.

14. Which combination of policies would be best to protect a country's industries from import competition in the short run?

(A)	Higher tariffs on imports	Decrease quotas on imports
(B)	Higher subsidies for exporters	Increase quotas on imports
(C)	More export incentives	Lower tariffs on imports
(D)	Decrease quotas on imports	Signing more free trade agreements

15. This question relates to the graph below which shows marginal social costs (MSC) and marginal private costs (MPC) for a particular good produced in Australia:



What implications are there if the government uses market forces to shift the supply curve from MPC to MSC?

	Consumer	Producer	Environment
(A)	Higher Prices	Higher Costs of Production	Decreased negative externalities
(B)	Higher Prices	Lower Costs of Production	Decreased negative externalities
(C)	Lower Prices	Increased Profits	Improve intergenerational equity
(D)	Lower Quantity	Reduced Profits	Worsen intergenerational equity

16. Which of the following is correct in relation to enterprise agreements and awards?

(A) National Employment standards are applicable to awards but not enterprise agreements.
(B) There are more people on awards in Australia than there are on enterprise agreements.
(C) Enterprise agreements are for industries whereas awards tend to be for specific firms.
(D) Enterprise agreements have to pass the BOOT whereas awards do not.

17. The information below relates to changes in the value of the Australian dollar:

Year	US Dollar	Australian Dollar
1	1	0.75
2	1.20	1

What is the effect of this change, ceteris paribus?

	Servicing Costs of Loans Borrowed from the US	US Exports to Australia
(A)	Increase	Increase
(B)	Increase	Decrease
(C)	Decrease	Decrease
(D)	Decrease	Increase

18. The table below relates to data for a hypothetical 3 sector economy:

	Savings	Consumption	Investment
Year 1	200	800	200
Year 2	250	950	250

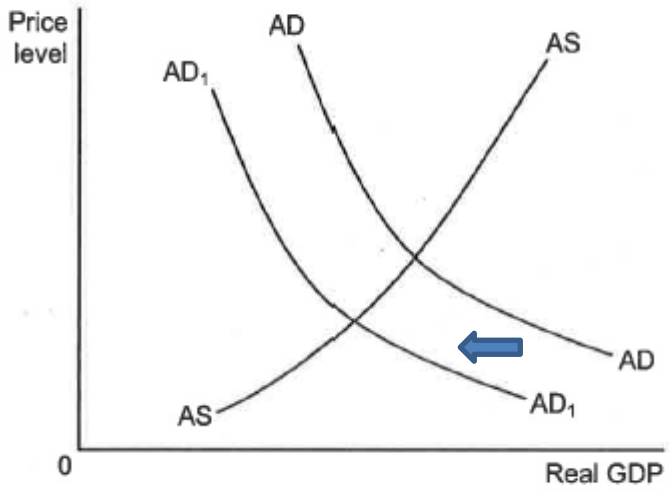
Given the above information, which of the following combinations is correct?

	Level of Income in Year 2	Multiplier in Year 2
(A)	Equilibrium	4
(B)	Disequilibrium	4
(C)	Equilibrium	1.33
(D)	Disequilibrium	1.33

19. Which of the following is a distinguishing feature of the World Trade Organisation?

(A) It provides funds to developing countries for development projects such as building a port.
(B) It allows a member to impose tariffs on another member if the latter does not comply with a directive following a trade dispute.
(C) It encourages the formation of bilateral trade arrangements between nations.
(D) It does not include trade arrangements for intellectual property.

20. The following diagram shows a shift in a country's aggregate demand from AD to AD_1:



Which of the following could have caused this change, ceteris paribus?

(A) Injections rising faster than leakages.
(B) An increase in imports.
(C) Higher wage demands.
(D) Lower productivity.

END OF SECTION I

SECTION II
40 marks

The questions for Section II are contained in the Answer Booklet.
Please complete your answers in the spaces provided.
Marks for each part of the question are as indicated.
Spend no more than 1 hour and 15 minutes on this section.

SECTION II
40 marks
Marks for each part of the question are indicated
Spend no more than 1 hour and 15 minutes on this section
Answer the questions in the spaces provided below

Question 21

(a) Why are public goods considered to be non-rival and non-excludable? (2 marks)

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(b) Using an example, explain why some economists consider the environment as a case of market failure. (4 marks)

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(c) Discuss TWO government policies aimed at improving Australia's environmental sustainability. (4 marks)

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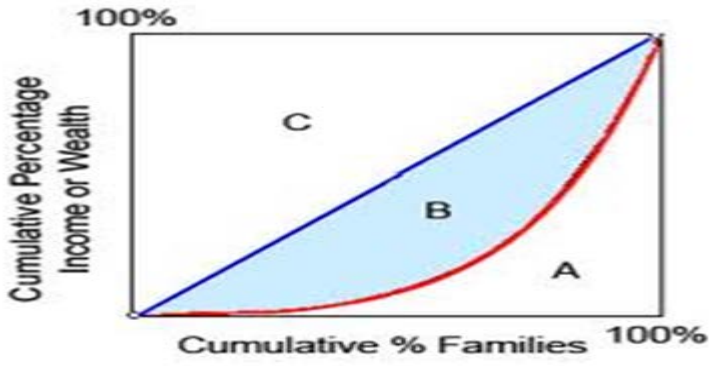
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Question 22

(a) This question is based on the following graph that depicts a Lorenz Curve for a particular country:



If Area A = 60, Area B = 40 and Area C = 100, calculate the gini coefficient for this economy. (1 mark)

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(b) Outline TWO possible causes of an increase in an economy's gini coefficient.
(2 marks)

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(c) Outline THREE benefits of rising inequality in an economy. (3 marks)

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(d) Explain TWO impacts of moving towards a more decentralised labour market.
(4 marks)

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Question 22 (d) continued

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Question 23

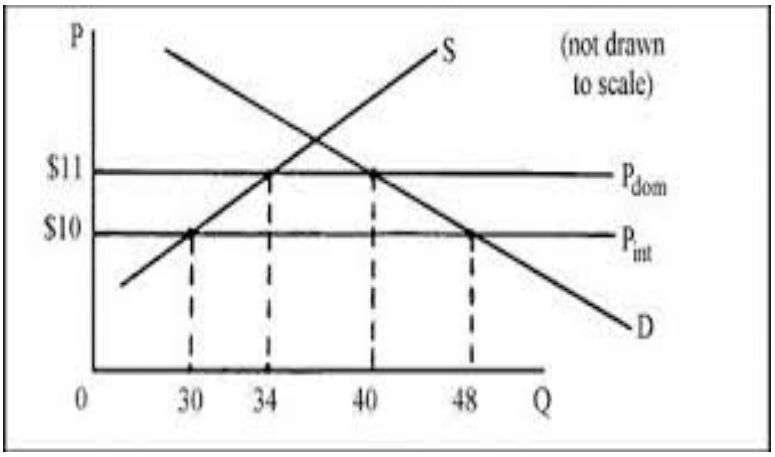
(a) How do 'local content rules' work as a form of protection? (1 mark)

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(b) The following graph refers to the effects of a $1 per unit tariff on an economy with a world price of $10 per unit.



Using TWO pieces of numerical evidence from the graph above, justify the imposition of the tariff. (4 marks)

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Continue overleaf

Q23 (b) continued

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(c) How are the 'terms of trade' calculated for an economy? (1 mark)

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(d) Identify the impacts of a rising terms of trade on the Australian economy.
(4 marks)

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Question 24

(a) Identify ONE measure of economic growth and ONE measure of economic development:

Economic Growth: (1 mark)

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Economic Development: (1 mark)

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(b) For an economy other than Australia, explain how economic development has been promoted in recent times. (4 marks)

Chosen Country: ……..

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(c) Discuss the potential economic conflicts that could arise when a government seeks to achieve strong economic growth. (4 marks)

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Continue overleaf

Question 24 (c) continued

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END OF SECTION II
SECTIONS III & IV ARE BACK ON THE QUESTION PAPER

SECTION III

20 marks
Attempt EITHER Question 25 OR Question 26
Allow at least 35 minutes for this question
Answer your chosen question in a Writing Booklet

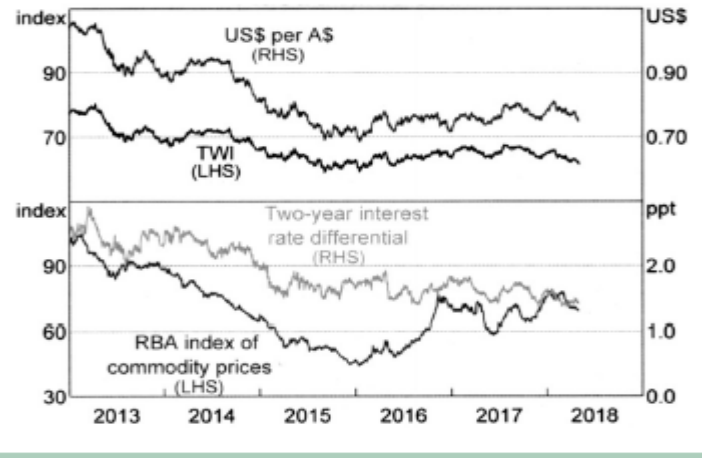
In your answer you will be assessed on how well you:

- Demonstrate knowledge and understanding relevant to the question
- Use the information provided
- Apply relevant economic terms, concepts, relationships and theory
- Present a sustained, logical and cohesive response

EITHER

25. Examine the factors that have influenced the value of the Australian dollar in recent times and the implications for the Australian economy.

Figure 5.1: Relative Exchange Rates for the Australian Dollar 2013-2018

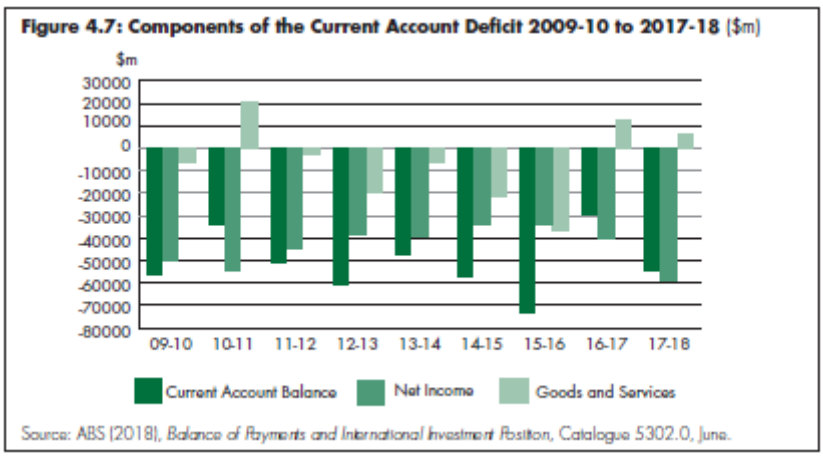


Source: Reserve Bank of Australia (2018), *Statement on Monetary Policy, May.*

> Research by the RBA has identified several causes of the Australian dollar's recent movements. These can be considered as either short-term speculation or longer-term economic factors on which that speculation is based.
>
> *Dixon (Edit), 2018*

OR

26. Examine the factors that have influenced Australia's Balance of Payments in recent times and the implications for the Australian economy.



> In 2018, the IMF highlighted several key contributing factors to Australia's CAD improvement. It calculated that if the CAD stays in a range of 2.5 – 3% of GDP, lower capital and financial inflows will be needed and so net foreign liabilities may be sustained at 55%.
>
> *Dixon (Edit), 2018*

END OF SECTION III

SECTION IV
20 marks
Attempt EITHER Question 27 OR Question 28
Allow at least 35 minutes for this question
Answer your chosen question in a separate Writing Booklet

In your answer you will be assessed on how well you:

- Demonstrate knowledge and understanding relevant to the question
- Apply relevant economic terms, concepts, relationships and theory
- Present a sustained, logical and cohesive response

EITHER

27. Assess the role that microeconomic policies have played in improving Australia's productivity and encouraging structural change.

OR

28. Assess the role that macroeconomic policies have played in achieving internal economic objectives in Australia.

END OF THE EXAMINATION

SGS 2019 TRIAL HSC ECONOMICS
ANSWER BOOKLET FOR SECTIONS I & II

Candidate Number: …….…….....

SECTION I

(1)	A	B	C	D	(11)	A	B	C	D
(2)	A	B	C	D	(12)	A	B	C	D
(3)	A	B	C	D	(13)	A	B	C	D
(4)	A	B	C	D	(14)	A	B	C	D
(5)	A	B	C	D	(15)	A	B	C	D
(6)	A	B	C	D	(16)	A	B	C	D
(7)	A	B	C	D	(17)	A	B	C	D
(8)	A	B	C	D	(18)	A	B	C	D
(9)	A	B	C	D	(19)	A	B	C	D
(10)	A	B	C	D	(20)	A	B	C	D

SGS

SGS 2019 TRIAL HSC ECONOMICS
ANSWER BOOKLET FOR SECTIONS I & II

Candidate Number: .....

SECTION I

(1)	A	B	C	D	(11)	A	B	C	D
(2)	A	B	C	D	(12)	A	B	C	D
(3)	A	B	C	D	(13)	A	B	C	D
(4)	A	B	C	D	(14)	A	B	C	D
(5)	A	B	C	D	(15)	A	B	C	D
(6)	A	B	C	D	(16)	A	B	C	D
(7)	A	B	C	D	(17)	A	B	C	D
(8)	A	B	C	D	(18)	A	B	C	D
(9)	A	B	C	D	(19)	A	B	C	D
(10)	A	B	C	D	(20)	A	B	C	D

2019 SGS Trial-
Short Answer Criteria

Q 21

(a) Why are public goods considered to be non-rival and non-excludable?

Criteria	Marks
Correct definition of both	2
Correct definition of one; or mixed up the definitions of both	1

(b) Using an example, explain why some economists consider the environment as a case of market failure.

Criteria	Marks
Accurate definition of market failure and clear explanation using an example	4
Accurate definition but insufficient link to example	3
Clear example but not linked to concept of market failure	2
General of confused explanation	1

(c) Discuss two government policies aimed at improving Australia's environmental sustainability

	Marks
Two distinct policies with clear explanation of their environmental aim	4
Two policies but explanation of their environmental aim limited	3
One valid policy and explanation; two policies but merely outlined	2
General or confused discussion	1

Q 22

(a) Calculate the Gini coefficient

Criteria	Marks
Correct answer : 0.4	1

(b) Outline two possible causes in an economy's gini coefficient.

Criteria	Marks
Two plausible causes outlined	2
One plausible cause outlined; two plausible causes named	1

(c) Outline three benefits of Y inequality

Criteria	Marks
Three different benefits	3
Two different benefits	2
One benefit; two not clearly outlined	1

(d) Explain two impacts of moving towards a more decentralised labour market

Criteria	Marks
Named and clearly explained two impacts	4
Named and merely outlined two impacts	3
Named and explained one impact; named two impacts but poor explanation	2
Correctly named and explained one impact	1

*Negative impacts – increased inequality, wage dispersion, cost-push inflation at F/E.
Positive impacts – increased productivity, efficient allocation of labour resources, reduced wage inflation, incentives to increase education/training, increased agg S, increased labour mobility.

Q 23

(a) How do "local content rules" work as a form of protection

Criteria	Marks
Clear definition of local content rules	1

(b) Using two pieces of numerical evidence from the graph, justify the imposition of a tariff

Criteria	Marks
Two positives for the protected country, clearly demonstrated numerically	4
Two positives but numerical examples not clearly linked to reasons	3
Two positives but poor numerical example; two numerical examples but poor reasoning	2
Some numerical proof but confusing	1

(c) How are the "ToT" calculated?

Criteria	Marks
Correct answer: Xp / Mp x 100	1

(d) Identify the impacts of a rising ToT on the Australian economy

Criteria	Marks
Briefly examined 4 distinct impacts or two in detail	4
Briefly examined 3 distinct impacts or two in detail but that lacked sufficient depth	3
Briefly examined 2 distinct impacts or more but with errors	2
General or confused discussion	1

Q 24

(a) One measure of economic growth and one of development

Criteria	Marks
Two correct methods of measurement	2
One correct measure of measurement	1

(b) Explain how economic development has been promoted in China in recent times

Criteria	Marks
Briefly examined 4 influences or two in detail	4
Briefly examined 3 distinct influences or two in detail that lacked sufficient depth	3
Briefly examined 2 distinct influences, or more but with errors	2
General or confused explanation	1

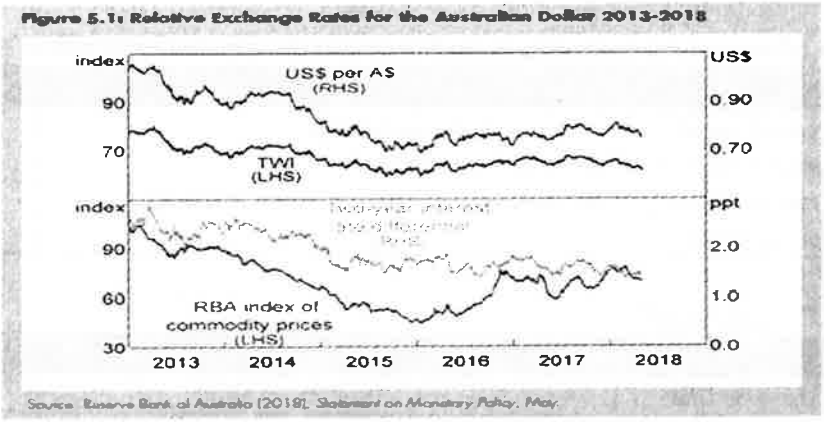
*Economic growth and development are different. If you mentioned growth strategies you need to clearly show how these created economic development.

(c) Discuss the potential economic conflicts that could arise when a government seeks to achieve strong economic growth

Criteria	Marks
Briefly examined 4 influences or discussed two in detail	4
Briefly examined 3 distinct influences or discussed two in but lacked sufficient depth	3
Briefly examined 2 distinct influences, or more but with errors	2
General or confused discussion	1

JDS 24/8/19

25. Examine the factors that have influenced the value of the Australian dollar in recent times and the implications for the Australian economy.



> Research by the RBA has identified several causes of the Australian dollar's recent movements. These can be considered as either short-term speculation or longer-term economic factors on which that speculation is based.
>
> *Dixon (Edit), 2018*

Criteria	Marks
• Demonstrates extensive knowledge to develop a logically sequenced answer that fully examines the factors that have influenced the $A recently **and** the implications for the Australian economy • Uses the stimulus **and** relevant data to support a contemporary & comprehensive examination of the factors and their implications • Integrates economic terms, concepts, issues, relationships and theory in a highly competent manner	17 - 20
• Good use of appropriate knowledge to develop an answer that reasonably considers the factors that have influenced the $A recently **and** the implications for the Australian economy **OR** • Demonstrates extensive knowledge to develop a logically sequenced answer that fully examines the factors that have influenced the $A recently **but** only partially considers the implications for the Australian economy (or vice verca) • Uses the stimulus **and/or** relevant data to support a discussion of the factors and their implications but lacking in terms of depth of analysis • Sound use of economic terms and applies economic concepts and relationships	13 - 16
• Uses correct and usually relevant information to demonstrate some knowledge and understanding of the factors that have influenced the $A recently **and/or** the implications for the Australian economy • The use of economic terms and economic concepts and relationships shows some weaknesses in understanding	9 - 12
• Lacks any development of a suitable response • The use of relevant economic terms, concepts and relationships is absent	5 - 8

MARKER'S COMMENTS:

GENERAL

- **Answer the question SET, not your own!**
- **The DIRECTIVE term is CRITICAL (Assess, Examine, etc)**
- **Introductions should be PLANNED....A minute or two thinking will bring rewards. I CANNOT EMPHASISE THIS ENOUGH!! They set the tone for your response!! There were lots of answers with crossings out, arrows, insertions, etc in the first paragraph!!! They gave me a BAD first impression.**
- **START with a DEFINITION and then refer to the question (or vice verca). They MUST NOT be detailed....short & sweet is the way to go!!**
- **The 2nd para could be an overview of the q with a few general stats**
- **Conclusions should also be short**
- **Whilst most of you provided some stats and examples related to the q, there was nowhere near enough; at least one per paragraph!!**
- **You should refer to the wording of the question about once per page**
- **You should refer to the stimulus at least once but probs two or three times; just write '(stimulus)'**
- **The usual criticism of poor handwriting, lack of paragraphs and long sentences still applies...**

SPECIFIC

Total Scripts: 45; Mean: 16; Median: 16.
Range: 20 marks x 1; 19 x 2; 18 x 8; 17 x 5; 16 x 11; 15 x 12; 14 x 3; 13 x 2; 12 x 1.

- Not many provided a balanced response...***Implications*** were definitely not done as well as ***Factors***
- Too many just wanted to tell me the story of the $A rather than an in-depth ***Examine...***
- I know Volume effect is variable depending on elasticities but say so!
- Also Valuation effect is probs around 0 due to hedging and swapping but you STILL need to go through it!

ANSWERS COULD INCLUDE:

INTRODUCTION (x 2 paragraphs)

- Exchange rate is the value of one currency in terms of another
- Foreign exchanges are traded on the FOREX market which is open 24/7
- AUD is the world's 5th most traded currency,
    - used in 6.9% of all currency trades;
    - 89% of all AUD sold is used to buy USD

- US $111bn of foreign exchange transactions occur daily in the Australian market (3% of global total)
- 95-97% of this total is carried out by speculators hoping to make a profit on their currency trades
- A key concept is the TWI (the value of the AUD against a basket of currencies weighted according to the value of trade (x+m) undertaken between Australia and the relevant country). The TWI is an indicator of how the dollar is moving against all currencies in general. The highest weighting is China at 28% followed by Japan (11%) and then Euro (9.74%) & U$ (9.68%)
- One disadvantage of the TWI is that it doesn't take into account the currency that exports and imports are invoiced. 2/3rds of our exports and half of our imports are priced in USD and therefore the 10% weighting is underplaying the importance of the USD to Australia

FACTORS

$A is a floating exchange rate so fluctuations in its value are due to changing demand & supply conditions (Draw?):

- **Relative interest rates** – When Australia's exceed the rest of the world's, more investment is attracted into Australia, increasing the demand for the A$ and pushing its value A$ up (the 'carry' trade)
- **Relative growth rates** –The world's growth determines our X and our growth determines M. When ours > rest of the world's, the demand for the $A will tend to rise, increasing its value.
- **Terms of Trade** – Traditionally textbooks say that when T of T rise (and volume of X stays the same or falls by less) then foreigners will have to increase their demand for the $A. However, these days it seems that it is the $A which drives changes in the Tof T. For Aust, changes in commodity prices are the key **Marshall-Lerner Condition** suggests that a depreciation of a currency will help the BOGS if PED for X + M > 1 (eg Australia)
- **International Competitiveness** – When ours rises, more X will be bought and so demand for (and hence value of) $A rises
- **Relative inflation rates** – Obviously linked to international competitiveness above…If our inflation rate < rest of world's then more of our X will be bought, thus increasing demand for our $A and increasing its value
- **EXPECTATIONS/CONFIDENCE/TASTES** – Last but by no means least given 95%+ of forex trade is based on these factors. Of course they are derived from all the fundamental issues noted above and if expectations/confidence is rising so will the demand for the $A and its price. The issue of a 'safe haven' currency is important; traditionally it is the U$ but the A$ had a brief spell of some favouritism just post-GFC

IMPLICATIONS
Depreciation

NEGATIVE EFFECTS	POSITIVE EFFECTS
• Australian consumers suffer reduced 'purchasing power' – they can buy fewer overseas produced goods with the same quantity of $A.	• By decreasing the value of the $A in terms of other currencies, Australia's exports become cheaper on world markets and therefore easier to sell, leading to an increase in export income and an improvement in Australia's CAD in the medium term. Australia's experience since the late 1990s suggests that a depreciation can have substantial positive impacts on the CAD because of its boost to the competitiveness of exports.
• A depreciation increases the interest servicing cost on Australia's foreign debt because Australia can buy less foreign currency with its domestic currency with which to pay interest. This increases income outflow on the net income component on the current account and thus increases Australia's CAD.	• Imports will be more expensive, discouraging import spending and potentially improving Australia's CAD. Domestic production of import substitutes should also rise.
• A depreciation will also raise the $A level of foreign debt that has been borrowed in foreign currency as expressed in Australian dollar terms – a phenomenon known as the 'valuation effect'.	• Lower import spending and greater export revenue will increase Australia's growth rate but this may not happen if Australia is unable to replace its imports with domestically produced goods.
• Inflationary pressures in Australia will increase as imports would now be more expensive. This may increase pressure on the RBA to raise interest rates to defend its inflation target.	• A depreciation increases the $A value of foreign income earned on Australia's investments abroad and would cause an improvement in the net primary income component of the CAD.
	• A depreciation will also increase the value of foreign assets in Australian dollar terms – a phenomenon known as the 'valuation effect'.
	• Foreign investors will find it less expensive to invest in Australia, generally leading to greater financial inflows. However, financial inflows may dry up if foreign investors expect the currency to continue falling.

Below is for info only....Just say 'opposite' in your response!

An appreciation

NEGATIVE EFFECTS	POSITIVE EFFECTS
• By increasing the value of the $A in terms of other currencies, Australia's exports become more expensive on world markets and therefore more difficult to sell, leading to a decrease in export income and a deterioration in Australia's CAD in the medium term.	• Australian consumers enjoy increased 'purchasing power' – they can buy more overseas produced goods with the same quantity of $A.
• Imports will be less expensive, encouraging import spending and worsening Australia's CAD. Domestic production of import substitutes is likely to fall.	• An appreciation decreases the interest servicing cost on foreign debt because Australians can buy more foreign currency with Australian dollars. This would reduce outflow on the net primary income component of the current account in future years and help reduce Australia's CAD.
• Higher import spending and reduced export revenue will reduce Australia's economic growth rate.	• An appreciation will also reduce the $A value of foreign debt that has been borrowed in foreign currency – a phenomenon known as the 'valuation effect'.
• Foreign investors will find it more expensive to invest in Australia, generally leading to lower financial inflows. However, financial inflows may continue if foreign investors expect the currency to continue rising.	• Inflationary pressures in Australia will be reduced as imports become cheaper. This is likely to reduce pressure on the RBA to raise interest rates to defend its inflation target.
• An appreciation reduces the $A value of foreign income earned on Australia's investments abroad and would cause a deterioration in the net primary income component of the CAD.	
• An appreciation will also reduce the value of foreign assets in Australian dollar terms – a phenomenon known as the 'valuation effect'.	

Timeline of AUD movements

- **Sometimes big Fluctuations!**
  - eg Banana Republic (80s) & Dot Com Bubble (2001 fell to U$ 0.47)
- **GFC 2007-2008**
  - The A$ crashed virtually overnight from 0.985 to 0.60 within a few weeks as everyone flocked to U$ as a safe haven
- **Post GFC 2008-2011**
  - **The A$ climbed steadily from 0.60 to 1.10 in 2011 due to:**
    - Mining Boom MK 2 – The investment phase
    - Rise in terms of trade (export price index / import price index) as the price of commodities continued to rise
      Peaked in 2011 @ 150 (2013/14 = Base Year of 100)
    - Our i rates > world's as we recovered but others struggled
    - The US economy was floundering plus Euro debt crisis
    - Triple A credit rating here but not elsewhere
    - Considered as a relative 'safe haven' rather than the U$
  - ***Implications of the high A$:***
    - Could afford more imports
      (e.g. Aussies travelling o/s peaked massively)
    - Imported inflation pressures were lower restricting the CPI to 2.25%
    - It encouraged structural change towards mining which is where we have our comparative advantage.
    - CAD grew
    - The possibility of 'Dutch disease'; i.e. manufacturing (esp PMVs), education, tourism all suffered from a high AUD as they couldn't compete; = **STRUCTURAL CHANGE/ RE-ALLOCATION OF RESOURCES**
- **2012-2015**
  - **The A$ fell fairly steadily to U$ 0.70 in 2015 due to:**
    - Slowdown in China's growth to 6.9%
    - Commodity prices falling significantly as the production phase of the mining boom kicks in and so supply has increased by all countries. This also led to big falls in our Terms of Trade back to ~ 100 in 2015
    - America's green shoots of recovery signify a restoration of the economic powerhouse so forex dealers have returned to the U$
    - The interest rate differential has also narrowed somewhat as we have reduced our cash rate to 2% in 2015 from 4.75% in 2011, whilst other countries' (inc US) started to raise theirs
    - Also countries engaged in quantitative easing to support their recoveries and this reduced pressure on their currencies
  - ***Implications of the low A$:***
    - Opposite to above!!

- **2016-2017**
  - **The $A has hovered around U$0.70 to 0.75; ie fairly stable due to:**
    - China's slowdown continues to 6.3%
    - Some recovery in commodity prices and T of T at end of 2017 but not significant enough to impact $A much
    - US continues to recover although has now halted planned i r hikes
    - RBA cuts cash rate to 1.5% in 8/16, further eroding the i r differential
    - QE programs around the world wound back
    - More recently global growth slowing and uncertain forecasts
    - Australia's political uncertainty is not attracting foreign I
    - Australia's growth remains strong (2.8%) and unemp low (5%) but continued v low inflation (1.8%) and wage growth (2.3%) suggests the Aust economy and, therefore A$, is not as attractive as in recent years
  - ***Implications:***
    - Uncertainty!!
    - Volume effect worked in Australia's favour with improvements in BOGS/CAD

- **2018-2019/Current**
  - **The $A has hovered around U$0.70 but fallen to 0.67 at times. Certainly has been a mini-rollercoaster:**
    - Terms of Trade have been higher as iron ore prices increased due to lask of supply as 2 big Brazilian mines close due to dam disasters. This has supported the A$
    - RBA cut cash rates to 1% in June and July which has narrowed the ir differential. Further reduced with the US Fed Reserve starting to lower their I rates. Causing fall in demand for the $A
    - US-China Trade War causing major global uncertainty inc lower growth in those countires and, indeed, globally. Again means downward pressure on $A (See article)
    - Likewise Brexit issue
    - NZ also surprisingly dropped their cash rate by 0.5% to 1% in August 2019. This caused some 'hot money' capital flight from NZ but also from Australia as we are linked to the Kiwis through geography! (See article)
  - ***Implications:***
    - Uncertainty again & awaiting impacts!!

BUSINESS MARKETS AUSSIE DOLLAR

Aussie dollar tumbles to lowest level since GFC as trade war escalates

By David Scutt
August 2, 2019 – 11.42am

The Australian dollar has tumbled in response to an escalation in trade tensions between the United States and China, falling to the lowest level against the greenback in a decade.

The local currency traded at 68.06 US cents by early afternoon on Friday, breaking the lows struck in January 2016 when the currency was hit by market concerns about the strength of China's economy. It had fallen as low as 67.96 US cents earlier in the session.

Excluding a "flash crash" in early January this year, which saw the Aussie fall over 3 per cent in a matter of minutes in holiday-impacted trade, it now sits at levels not seen since March 2009, when markets were stuck in the depths of the global financial crisis.



The Aussie is now at its lowest level since the GFC.
Photo: Tim Wimborne

The plunge was sparked by a series of tweets from US President Donald Trump that said the United States will impose additional 10 per cent tariffs on $US300 billion ($440 billion) worth of Chinese imports entering the country from September 1, adding to the 25 per cent tariffs on $US250 billion in imports already in place.

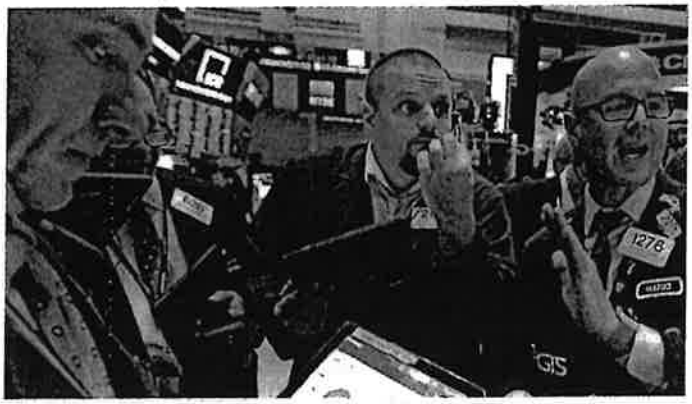
The decision came just a day after the latest trade talks between the United States and China wrapped up in Shanghai without any clear signs of progress.

Richard Grace, chief currency strategist at the Commonwealth Bank, said the Aussie fell in anticipation of slower economic growth in China and the global economy.

"[The Australian dollar] is likely to remain under downward pressure as the ramifications of the trade tensions generate downward revisions to global growth," Mr Grace said in a note.

"This effectively means the US has imposed a tariff on virtually all Chinese goods imports into the US."

RELATED ARTICLE



WALL STREET

Trump's new China tariffs rattle markets: stocks tumble, oil tanks

As a commodity-linked currency closely aligned with the performance of the global economy, especially China, the Aussie is often used by investors to express sentiment towards the outlook for the world's second-largest economy.

The threat posed by additional US tariffs on Chinese imports has raised concerns about the impact on the country's vast manufacturing sector, and potentially China's demand for raw materials.

Reflecting greater concerns about the outlook for economic growth, commodity prices fell sharply, as did government bond yields.

At the same time, the safe-haven yen rose as traders moved out of riskier assets. In that reshuffle, the Aussie also hit the lowest level against the Japanese currency since October 2011.

Fear index jumps

US stocks, having been up as much as 1 per cent earlier in the session, also slumped, with Wall Street's three major indexes finishing the session with losses of between 0.8 to 1.1 percent.

The US VIX index - also known as the fear index as it gauges investors' expectations of unstable times ahead - rose to 2-month highs.

The combination of increased risk aversion and sharply lower commodity prices is not generally one that the Aussie dollar thrives in.

Tapas Strickland, economist at the National Australia Bank, said the next risk is that Beijing will retaliate to the US move.

"It appears Trump has gone all in and is hoping that China buckles under the pressure and caves to US demands. However, in such a scenario there is no way for China to fold without losing face," Mr Strickland said in note.

"It is possible then that China will retaliate with an intensification of non-tariff barriers."

License this article AUSSIE DOLLAR TRADE WARS CURRENCIES

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5



ABC NEWS

Australian dollar slumps to 10-year low after New Zealand central bank rate cut

By business reporter Michael Janda

Updated Wed 7 Aug 2019, 11:56pm

The Australian dollar has hit a 10-year low against the US dollar, after New Zealand's central bank surprisingly cut interest rates by half a per cent — a move which no economist forecast.

While 18 out of 21 economists surveyed by Reuters forecast an interest rate cut, they all expected a 25-basis-point move. Three others expected no change.

The Reserve Bank of New Zealand's official cash rate target is now 1 per cent — the same as Australia's, after the Reserve Bank left local rates on hold on Tuesday.

The surprise super-sized rate cut across the Tasman had flow-on effects for the Australian dollar, which slumped as much as a cent against the greenback, hitting a 10-year low of 66.77 US cents at 1:19pm (AEST) before recovering slightly to 66.98 an hour later.

This is the lowest level for the Australian dollar against the greenback since March 2009, when the economic fallout from the global financial crisis reached its zenith.

CommSec's chief economist Craig James said the lower dollar would come as a relief for the Reserve Bank of Australia and other economic policymakers, even if it may be a headache for Australians travelling overseas.

"The weaker Aussie will increase the attractiveness of Australian goods on the global stage and against imported products," he wrote in a note.

Rabobank's Michael Every saw the RBNZ move as part of the global trade and currency wars, saying "the gloves truly came off" with the bigger-than-expected rate cut.

"Not only that, we got [RBNZ] governor [Adrian] Orr basically promising to do whatever it takes: more rates cuts, negative rates, QE [quantitative easing] — you name it. There will be no keeping the powder dry," Mr Every wrote.

"As a result NZD plummeted below 0.64 [US dollars] like a Kiwi trying to fly; and AUD fell to a decade low below 0.67 like a wombat trying to fly — which is a great analogy for the RBA actually."

The New Zealand dollar fell much further than the Australian dollar, losing about 1 per cent against the weaker Aussie dollar.

'Should we be worried too?'

The reason the Australian dollar fell along with its trans-Tasman counterpart is investors now expect the RBA to follow suit, as it did with rate cuts earlier this year.

"If you want to get ahead of the curve then the RBNZ does this better than most, and is not one to mess around," Pepperstone's head of research Chris Weston wrote in a note.

"One questions if this is a message that they are genuinely worried and, if so, should we be too?"

However, if the RBNZ is "genuinely worried" its post-meeting statement gave little indication.

In fact, if one did not know that it had just cut rates by half a percentage point, someone reading the statement would have thought the RBNZ had left rates on hold.

"Employment is around its maximum sustainable level, while inflation remains within our target range but below the 2 per cent mid-point," the statement noted.

"Recent data recording improved employment and wage growth is welcome."

It was not just current economic conditions that the RBNZ talked up, but also the medium-term outlook.

"In New Zealand, low interest rates and increased government spending will support a pick-up in demand over the coming year," the statement continued.

"Business investment is expected to rise given low interest rates and some ongoing capacity constraints. Increased construction activity also contributes to the pick-up in demand."

'Heightened risk of a larger slowdown in global growth'

The surprise over-sized interest rate cut seems to be an insurance policy against growth slowing, rather than a response to events that have already taken place.

"GDP growth has slowed over the past year and growth headwinds are rising," the statement said.

"In the absence of additional monetary stimulus, employment and inflation would likely ease relative to our targets."

As a small, open, free market, trade-reliant economy — quite a bit like Australia's — New Zealand's central bankers are particularly concerned about the escalation in the trade war.

"The members noted that heightened global uncertainty was reducing investment and suppressing trading-partner growth," they warned.

"This highlighted the risk of a larger or more prolonged slowdown in global economic growth."

So, the RBNZ has doubled up on its rate cut now in order to, it hopes, head off steeper rate cuts later on.

Unlike the RBA announcing two small rate cuts in June and July, then a pause this month with the strong hint of further rate cuts if needed, the RBNZ has effectively said to hell with it.

"The members debated the relative benefits of reducing the OCR [overnight cash rate] by 25 basis points and communicating an easing bias, versus reducing the OCR by 50 basis points now," the meeting record noted.

"They agreed that the larger initial monetary stimulus would best ensure the committee continues to meet its inflation and employment objectives."

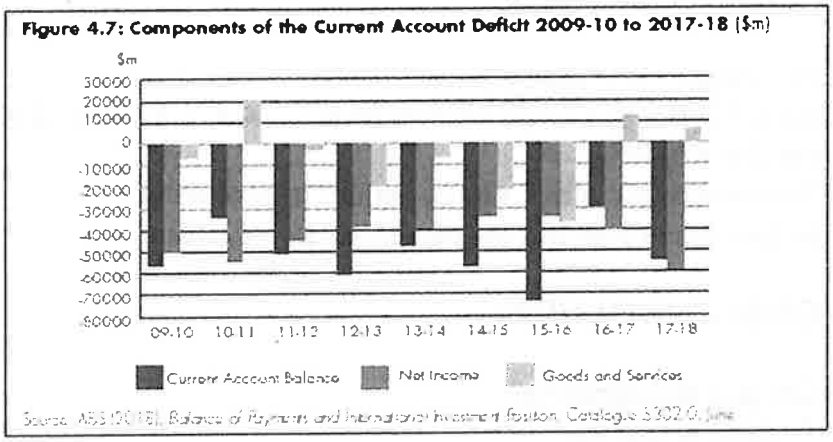
JP Morgan's Ben Jarman said the RBNZ may also be trying to pre-emptively offset the upward effect on interest rates likely to flow from its tougher bank capital requirements — intended to make banks safer and more able to absorb losses — which will be finalised later this year.

"Senior officials have given no quarter in their ambition to sharply raise bank capital requirements (among other reforms), which will likely flow through to mortgage rates," he wrote.

"But there are political constraints in acknowledging this, so one other likely motivation for moving more aggressively now is to use the scapegoat of global interest rates moves, and create some separation from the finalisation of bank capital reforms in 4Q."

Topics: money-and-monetary-policy, currency, economic-trends, australia, new-zealand

26. Examine the factors that have influenced Australia's Balance of Payments in recent times and the implications for the Australian economy.



In 2018, the IMF highlighted several key contributing factors to Australia's CAD improvement. It calculated that if the CAD stays in a range of 2.5 – 3% of GDP, lower capital and financial inflows will be needed and so net foreign liabilities may be sustained at 55%.

Dixon (Edit), 2018

Criteria	Marks
• Demonstrates extensive knowledge to develop a logically sequenced answer that fully examines the factors that have influenced the BoP recently **and** the implications for the Australian economy • Uses the stimulus **and** relevant data to support a contemporary & comprehensive examination of the factors and their implications • Integrates economic terms, concepts, issues, relationships and theory in a highly competent manner	17 - 20
• Good use of appropriate knowledge to develop an answer that reasonably considers the factors that have influenced the BoP recently **and** the implications for the Australian economy **OR** • Demonstrates extensive knowledge to develop a logically sequenced answer that fully examines the factors that have influenced the BoP recently **but** only partially considers the implications for the Australian economy (or vice versa) • Uses the stimulus **and/or** relevant data to support a discussion of the factors and their implications but lacking in terms of depth of analysis • Sound use of economic terms and applies economic concepts and relationships	13 - 16
• Uses correct and usually relevant information to demonstrate some knowledge and understanding of the factors that have influenced the BoP recently **and/or** the implications for the Australian economy • The use of economic terms and economic concepts and relationships shows some weaknesses in understanding	9 - 12
• Lacks any development of a suitable response • The use of relevant economic terms, concepts and relationships is absent	5 - 8
• A response that reflects a standard barely above a non attempt	1 - 4

MARKER'S COMMENTS:

GENERAL

YOU MUST SEE Q25!!!!

SPECIFIC

Total Scripts: 27; Mean: 15.1; Median: 15.
Range: 20 marks x 1; 18 x 2; 17 x 2; 16 x 7; 15 x 7; 14 x 1; 13 x 5; 12 x 2.

- Many ignored the KAFAS
- Many didn't have enough stats, esp re recent improvement
- Many did ***factors*** quite well but ***implications*** poorly done

ANSWERS COULD INCLUDE:

INTRODUCTION (x 2 paragraphs)

- Define B of P, CAD & KAFAS
- 'Balance' due to floating A$ where the demand for the $A always = the supply
- Acknowledgement of factors & implications

PERFORMANCE

A consideration of the size & trends of the CAD, generally as % of GDP, should be made throughout the response. A summary applicable to all external essays follows:

- **CAD**: Cyclical between 3% (now 2%?!) and 6% of GDP.
  Pre 1980s average was around 3%, since mid 80s 4.2%, mid 2000s record high of 6.2% ; 2015/16 4.7%: 2016/17 2.2%; 2017/18 2.9%
- **BOGS**: Cyclical between -1% & +2% - See below
  Reflecting swings in international and our business cycles, fluctuating terms of trade, etc.
- **NPY**: Structural around -3% & -4% - See below
  Reflecting net interest servicing costs and dividends.
- **Net Secondary Y**: Only a very minor influence, usually only around -1% of GDP
  Reflecting higher payments overseas on unconditional aid, insurance claims & more $ sent back to home countries by foreign workers here
- **KAFAS:** Cyclical 2017/18 2.9% - See below
  'Mirror' image of CAD showing either how we have funded it through debt (loans) and equity (shares) and/or the CAD shows how we have 'spent' the KAFAS
- **Capital:** Usually small about 1% GDP – See below
  Reflecting net capital of migrants, transfers of foreign aid for capital purchases and non-produced, non-financial assets (intellectual property rights, etc)
- **Financial:** Usually large surplus between 3% (but more recently 2%) and 6% of GDP – See below
  Reflecting net inflows of direct and portfolio I, loans, RBA asset changes, derivatives, etc
- **Net Foreign Liabilities** (= NFD + NFE) 1980s = 35% of GDP but around 55% for the last decade. Currently it sits at 53% ($953.4bn)

Shows the accumulation of past CADs/KAFAS
Note Net Foreign Equity is currently - 4%; ie we own more foreign assets than foreigners own ours; mainly due to superann funds invested o/seas. It is denoted as a because NFL and NFD are 'positive' as they already have negative connotations (**L**iabilities and **D**ebt)_

Table 4.9: The Balance of Payments for 2015-16, 2016-17 and 2017-18 ($m)

	2015-16	*2016-17*	*2017-18*
Goods Credits	$243,934m	$292,009m	$315,031m
Goods Debits	-$271,761m	-$278,190m	-$302,901m
Goods Balance	-$27,827m	$13,819m	$12,130m
Net Services	-$9,071m	-$1,654m	-$5,911m
Net Primary Income	-$34,199m	-$39,811m	-$59,064m
Net Secondary Income	-$1,731m	-$1,823m	-$1,278m
Balance on Current Account	**-$72,828m**	**-$29,469m**	**-$54,123m**
Capital Account	-$531m	-$762m	-$689m
Financial Account	$76,435m	$25,373m	$52,802m
Direct Investment	$55,242m	$70,827m	$59,555m
Portfolio Investment	-$4,322m	-$1,945m	$9,308m
Financial Derivatives	-$12,248m	-$711m	-$8,446m
Other Investment	$35,368m	-$23,168m	-$16,544m
Reserve Assets	$2,395m	-$19,630m	$8,929m
Balance on Financial Account	$76,435m	$25,373m	$52,802m
Balance on Capital and Financial Account	**$75,904m**	**$24,611m**	**$52,113m**
Net Errors and Omissions	-$3,076m	$4,858m	$2,010m

Source: ABS (2018), *Balance of Payments and International Investment Position*, Catalogue 5302.0, June. Table 30
NB Figures are rounded and may not total

Factors Related to CAD Performance

- IMF suggests 6% of GDP only sustainable in the short run and in the long run should be around 3% to 4%. Relate this to above figures.
- **Cyclical:**
  - Terms of Trade fluctuations have helped and hindered our CAD;
    Late 2011 peaked at highest for 140 years, > double 1980s & 1990s but since have ↓ by 20%+
    Surge driven by Commodities/Mining Boom Mark I (price phase) thanks to demand from China and India boosting national Y but hurting other sectors (services) thro the correspondingly high $A (the so-called 'Dutch Disease')
    Recent boost thanks to fall in supply as Brazilian mines closed after dam collapses
  - International and domestic and business cycles which impact the demand for X and M respectively

- **Structural**:
  - **KEY** structural concern with S-I gap, despite S ratio increasing to 10% after GFC altho falling back now to just 1.5%, as hholds try to maintain C in the face of low wage increases (2.3%)
  - Lack of international competitiveness esp labour costs (China, ASEAN, etc) and productivity (83% of USA worker). Made worse by high $A in immediate post-GFC era (structural change)
  - Narrow X base focussed on resources
  - GFC, Eurozone/Sovereign debt crisis (PIGS), more recently Brexit
  - Focus on Australian X as STMs vs M focussed on ETMs for firms

- **MORE RECENTLY...**
  - Export volumes rose 1% in quarter to 3/19, whereas imports fell by 0.1%
  - Also Terms of Trade improved 3.1% in same period too meaning B of Trade was + $14.3bn (was $5.4bn last year and Dec 2018 quarter was $10.1bn)
  - This meant Net X added 0.2% of the 0.4% rise in GDP in that same period:

The improvement in the Balance of Trade has been accompanied by a narrowing in the Services Account deficit. Ongoing improvement in income from industries such as tourism has resulted in the Service Account deficit narrowing from $1.3 billion in December 2018 to just $0.7 billion in the latest quarter.

However, the deficit on the Income Account remains high and widened last quarter. Over the 3 months to March, the Income Account deficit was $16.5 billion, compared with $15.2 billion in the December quarter. Although low global interest rates would have contained much of the growth in interest payments associated with servicing Australia's foreign debt, a strong pickup in profitability of Australian mining companies could have resulted in higher income payments to foreign shareholders in the form of dividends.

As shown on the table below (which shows annual data), an improvement in the Balance of Trade has more than offset the deterioration on the Incomes Account. As a result, Australia's overall Current Account deficit position has narrowed. The deficit in the year to March of $31 billion was equivalent to 1.6% of GDP.

Current Account Items $B		Year to March 2019		Year to March 2018
Exports	$	358	$	306
Imports	$	(321)	$	(294)
Balance of Trade	$	37	$	12
Services Balance	$	(5)	$	(4)
Balance of Trade in Goods & Services	$	33	$	7
Net Income	$	(64)	$	(57)
Current Account Balance	$	(31)	$	(50)

Source: Australian Bureau of Statistics 5302. Seasonally Adjusted.

There is a need for ongoing capital inflow from overseas to fund the Current Account deficit. To the extent that this inflow is in the form of borrowings (and not equity purchases e.g. of property or shares), it will add to the foreign debt. Australia's net foreign debt has widened from $1,016 billion to $1,099 billion between March 2018 and March 2019. Net foreign debt is now equivalent to 57.3% of annual GDP.

The growth in foreign debt over recent years would have been lower if not for a reduction in the reliance on equity purchases as a funding source. That is, an increased proportion of funding has come in the form of borrowings rather than equity purchases by foreigners. In overseas (e.g. Australians holding overseas shares and properties) than foreigners own in Australia. This is shown on the table below as a net negative foreign liability equivalent to $133 billion.

Foreign Liabilities	$ Billion in March 2019	% of Total
Net Foreign Debt	$1,099	114%
Net Foreign Equity Owing	-$ 133	-14%
Total Net Foreign Liabilities	$ 966	100%

Source: Australian Bureau of Statistics 5302

As indicated on the chart below, Australia's foreign debt, as a percentage of GDP, has fallen from a cyclical peak in mid-2016. The relatively small expansion in the Current Account deficit has enabled the foreign debt to be contained relative to the size of the economy over recent years.



Source: Australian Bureau of Statistics 5302 & 5206.

Currently, the Government sector accounts for 20% of Australia's net foreign debt, with the remaining 80% held by the private sector.

Q7: Contrast the terms "equity financing" and "debt financing" of Current Account deficit positions.

Q8: Describe the factors that have influenced the movement in the size of Australia's Current Account deficit over the past year.

Stats on Australia	Latest	Previous Year
Economic Growth	1.8% (Year to Mar)	3.1%
Inflation	1.3% (Year to Mar)	1.9%
Unemployment	5.2% (May)	5.4%
Employment Growth	2.9% (Year to May)	2.5%
Wage Price Index	2.3% (Year to Mar)	2.0%
Exchange Rate (TWI)	59.5 (21st June)	61.9
Cash Interest Rate	1.25% (June)	1.50%
Current Account Deficit	$31.3 bn (Yr to Mar)	$49.6 bn
Current Acct (% GDP)	1.6% (Year to Mar)	2.7%
Foreign Debt (% GDP)	57.3% (End Mar)	55.7%

Implications of a high CAD/KAFAS include:

- **Growth of NFL**
- **Higher servicing costs** of any increasing NFD leading to possible **debt trap scenario**
- **Higher $A volatility**, thus discouraging foreign I
- **Possible contractionary macro policies** to ↓ demand for M but will also ↓ Y, output & emp
- **Loss of I confidence** and/or **AAA credit rating**
- As a result of all the above there will be a constraint on future growth known as the **balance of payments** constraint
- **The 'Pitchford Thesis'/'Consenting Adults Deficit'**
- ***KAFAS***
  - *Link to NFL through loans (debt) and equity (shares) financing*
  - NFL (=NFD + NFE) are the cumulative result of our CADs
  - Refer to figs above to highlight trends and their corresponding importance
  - Inc debt servicing ratio falling from 20% (1990) to 6.2% (2018)

Benefits of high foreign liabilities	**Costs of high foreign liabilities**
• Increased productive capacity ➡ job creation ➡ ↓ unemp and ↑ innovation • Redresses the I-S imbalance	• NFD: High servicing costs • NFE: ↑ foreign ownership, leading to further outflows as dividends sent back o/seas (40% of ASX & 80%+ of mining companies are foreign owned) • Loss of confidence from international investors • Exchange rate volatility • Debt-trap scenario • Poorer credit rating

It should be noted that a current account deficit is not always seen as a problem. The 'Pitchford Thesis' states that a current account deficit does not matter if it is driven by the private sector, as decisions made by the private sector are based on profitability. Some feel that this theory has held true for the Australian economy, which has had a persistent current account deficit, yet has experienced annual economic growth for the past 20+ years. Foreign capital inflow is, therefore, seen a 'thumbs up' for Australia. Our debt servicing ratio is down and public sector debt is relatively low (peaking @ 18% in 2017/18) and so the indicators are relatively sound, plus we still have our AAA credit rating, unlike most other advanced economies.

Others argue that Australia's CAD must be an issue as it is rising even with the high Terms of Trade experienced in decades. Also the fact that we have had several successive budget deficits in recent years and seem to be having difficulty in reducing them may suggest a longer term problem. The IMF suggests that a CAD of -6% of GDP is only sustainable in the short run and -3% in the long term. A deficit in the current account also implies that the country is a net capital importer. This is certainly NOT necessarily bad as we have always relied on foreign savings for our I, mainly because we are such a small country, but the continued accumulation of substantial foreign debt could become problematic, especially if interest rates increase. This could possibly lead to sudden outflows of funds if confidence declines for whatever reason; i.e. a herd mentality leading to a contagion effect…Debt trap scenario anyone??!!

Trends in the Size and Composition of Australia's Balance of Payments

The size of the current account deficit reflects changes in both domestic and world economic growth. Generally the current account deficit tends to increase when world growth is weaker than domestic growth, leading to a decrease in export income relative to import spending. This may result in a larger goods and services deficit and current account deficit. Conversely when world growth exceeds domestic growth, export income tends to grow more quickly than import spending, leading to a goods and services surplus which can reduce the size of the current account deficit in the balance of payments.

Figure 4.6 shows trends in the current account deficit between 2009-10 and 2017-18. In 2009-10 the current account deficit was -$56b or -4.3% of GDP, reflecting a goods and services deficit of -$4.6b and a larger net primary income deficit of -$50.3b. A major **structural change** occurred in the current account deficit in 2010-11 with Australia recording a large $28.2b surplus in the goods balance, as a result of strong mining exports and higher commodity prices. The surplus on goods and services was $21.3b, which offset some of the -$54.1b net primary income deficit. The current account deficit fell to -$34.3b or -2.3% of GDP. In 2011-12 the current account deficit increased to -$50.4b or -2.8% of GDP due to a small goods and services deficit of -$3b and a large net primary income deficit of -$45b.

Slower world growth in 2012-13 led to lower export income and a deficit in the goods balance of -$6.4b. The high value of the Australian dollar reduced the competitiveness of manufactured exports and service exports such as education and tourism. This resulted in a larger net services deficit of -$13.5b, with the goods and services deficit reaching -$20b. These deficits combined with a net primary income deficit of -$37.9b, and led to the current account deficit rising to -$60.3b, which represented -3.2% of GDP.

In 2013-14 the current account deficit fell to -$47.1b because of a smaller goods and services deficit of -$6.2b and a stable net primary income deficit of -$38.8b. This was due to the peak being reached in mining investment, which led to slower growth in capital imports and no real increase in the remittance of investment income (such as profits and dividends) to foreign investors.

Slower world and Chinese economic growth in 2014-15, led to a 6.6% fall in export income, resulting in a goods deficit of -$13.2b and a net services deficit of -$7.8b. The goods and services deficit of -$21,025m was -$14,795m or 237% higher than the goods and services deficit of -$6,230m in 2013-14. The current account deficit of -$56,979m in 2014-15 was 21% higher than in 2013-14 and represented -3.6% of GDP. The current account deficit of -$56,979m in 2014-15 was financed by a large surplus in the financial account of $58,712m. In 2015-16 the current account deficit increased by 27.8% to -$72,828m (-3.8% of GDP) because of slower world growth, lower commodity prices, falling export demand and a lower terms of trade. Mining exports fell and the goods deficit rose to -$27,827m, and the goods and services deficit to -$36,898m. The net primary income deficit of -$34,199m also contributed to the current account deficit. The current account deficit was financed by a large surplus of $76,435m in the financial account. A major cyclical turnaround in the current account deficit occurred in 2016-17 with stronger world growth leading to higher commodity prices and Australia's terms of trade. This boosted export income and led to a surplus of $12,165m in the goods and services balance. Although the net income deficit was -$39,811m, the goods and services surplus helped to reduce the current account deficit to -$29,469m or -2.1% of GDP. The current account deficit was largely financed by a financial account surplus of $25,373m.

In 2017-18 the current account deficit increased to -$54.1b despite a trade surplus of $12.1b. The large net income deficit of -$59.1b increased the size of the current account deficit to -2.9% of GDP. The current account deficit was financed by a large surplus of $52.8b in the financial account.

The Reasons for Trends in the Current Account Deficit

The causes of Australia's current account deficit are both cyclical and structural. In **cyclical terms**, when the Australian economy grows faster than the world economy, import demand tends to grow faster than export demand, causing the goods and services balance to go into deficit, leading to a higher current account deficit. Also if **world growth slows** as it did between 2014 and 2016, commodity prices for Australia's exports tend to fall, reducing the terms of trade and export income, leading to a larger goods deficit and current account deficit. Conversely, when world growth exceeds Australia's growth rate, export demand strengthens, leading to higher commodity export prices, a higher terms of trade and increased export income. This occurred in 2008-09 and 2010-11 because of **global resources booms** which increased commodity prices and the volume and value of commodity exports. Surpluses in goods and services were achieved in 2008-09, 2010-11 and 2016-17, reducing the current account deficit.

In **structural terms**, the underlying cause of the current account deficit is the size of the net primary income deficit, which is the servicing cost of Australia's net external liabilities. For example, payments of interest, profits and dividends to foreign lenders and investors in 2017-18 led to the net primary income deficit accounting for all of the current account deficit. The trend in **Figure 4.7** shows that between 2009-10 and 2017-18 the net primary income deficit accounted for 45% or more of the current account deficit. Between 2011 and 2016 deficits in the goods and services balance led to much larger current account deficits. In contrast, the surplus of $12.1b in the goods and services balance in 2016-17 reduced the size of the current account deficit from -$72b to -$29.4b.

Foreign Investment in Australia

Successive Australian governments have encouraged the inflow of foreign investment in order to improve Australia's economic performance through access to foreign exchange and foreign capital. Over the past two decades worldwide flows of foreign direct investment have been particularly strong. The growth in foreign direct investment reflects the general relaxation of trade and investment controls together with advancements in information and communications technologies and lower transport costs. Another major driving force of foreign investment has been the growth of global production chains by MNCs.

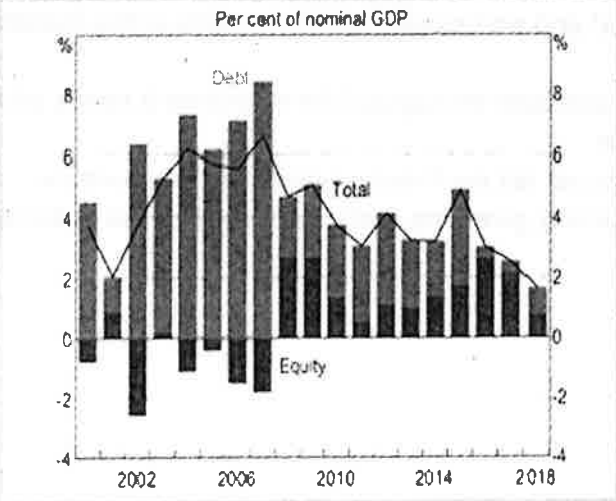
Australia has relied on inward foreign direct investment to meet the shortfall between domestic saving and the level of domestic investment. Foreign investment supplements domestic savings and supports higher rates of economic growth and employment levels, which in turn, improve the standard of living of the Australian community. Foreign investment also plays a key role in making Australian industry more internationally competitive, thereby helping to boost exports and access to new technologies. Inflows of foreign investment also contribute directly to the surplus in the capital and financial account of the balance of payments which finances the deficit in the current account.

The level or stock of foreign investment in Australia according to the ABS (Catalogue 5352.0, *International Investment Position, Australia* 2017) was $3,266.5b for the year ended 31st December 2017. Portfolio investment accounted for $1,769.6b (54%), direct investment for $849.1b (26%), other investment liabilities for $494.8b (15%) and financial derivatives for $153b (5%). Of the portfolio investment liabilities, debt securities accounted for $1,183.1b (36% of foreign investment in Australia) and equity securities for $586.5b (18% of foreign investment in Australia). The leading foreign investor countries in Australia in 2017 were:

- USA $896.9b or 27% of the total
- The United Kingdom $481.4b or 15% of the total
- Belgium $305.3b or 9% of the total
- Japan $219.2b or 7% of the total
- Hong Kong SAR $116.6b or 4% of the total
- Singapore $82b or 3% of the total

The major cost of foreign investment is the repatriation of income in the form of profits, rent, dividends and interest to foreign investors. Total income debits of $100.1b were recorded in the net primary income section of the current account of the balance of payments for the year ending 31st December 2017. The main countries to which income accrued included the USA ($24.9b or 25%); the United Kingdom ($10.8b or 11%); Japan ($10b or 10%); Belgium ($6.7b or 7%); Hong Kong ($2.8b or 3 %); and the Netherlands ($2.3b or 2%). A further cost to Australia of foreign investment is a loss of control over resources and management decisions to foreign companies and individuals. The Foreign Investment Review Board (FIRB) reviews applications for foreign investment projects in Australia to ensure they are in the public interest. **Figure 4.10** shows trends in net private capital flows (i.e. inflows less outflows) in Australia between 2000 and 2018.

Figure 4.10: Net Capital Flows 2000-2018 (% of GDP)



Source: Reserve Bank of Australia (2018), Chart Pack, July.

Q 27 Assess the role of Micro reform in affecting productivity and structural change in Australia

Answers HAD to include:
Micro Policies
Structural change
Productivity
Answers could include:

Current Micro reform:
Infrastructure spending, AD/AS graph, PPC
Current trade policies
Current competition policies
Education initiatives

Previous micro reform
Deregulation
Financial Markets-Including increased competition; floating of $AUD (Impact on industry)
Agriculture
Transportation
Privatisation/corporatisation/Asset recycling
Our structural change from Manufacturing, Agriculture to Mining, to Services
Australia's productivity story
Current productivity issues
Labour Productivity
Total Factor Productivity
Dynamic, Technical and Allocative efficiency in relation to Australian industry

3 parts to the question-

1. **Assess** (what you have to do)
2. **Micro Reform** (the subject you should write about)
3. **Productivity and structural change in Australia** (the scope of the question-what the subject affects)
   You should have acknowledged and addressed ALL three parts of the question.

    1. Use the wording of the question throughout the response-it keeps you focused on the question
    2. Tendency in answers to just tell me theory-relate all to the question
    3. Define ALL terms, especially given the technical nature of the question

Q28 Assess the role that Macro policies have played in achieving internal economic objectives in Australia

1. There are 3 parts to this question, you should incorporate all 3:
   -Assess
   -Macro Policies
   -Internal economic objectives

2. Use the wording of the question. It reminds you to answer the question!
3. Define **all** terms
4. Tell me what the internal objectives are-
   1. Growth
   2. Un
   3. Inflation
   4. Ydist'n
   5. Some people talked about external stability. If you did, you should have related it to achieving internal goals.Tell me the target rates, at some point tell me the current rates!
5. Explain that Macro can't achieve everything. Limitations, conflicts. But explain the limitations of policy in relation to the Australian economy.
   Eg: instead of staying 'Monetary is a blunt tool and therefore doesn't achieve internal economic goals', say, "the state differentials in growth, inflation and Un eg SA vs NSW, make blunt Monetary Policy less successful in achieving its role."
6. Half of Macro is Monetary. Where did the transmission mechanism go? Why didn't most you mention it? If you are assessing the role that MP plays in achieving internal objectives, you would have to talk about the current state of the transmission mechanism, all channels. If you don't know why MP isn't currently playing a successful role in achieving internal objectives, then find out NOW.
7. Clarify your understanding of the current state of MP effectiveness.
8. Use terminology. It will save you time.
9. Explain all theory in relation to real events and characteristics of the Australian Economy.
10. Move beyond just giving a description of what macro policy was happening at what time. More assess the role, than describe macro policy over the last few decades.
Lots of people just gave a run down of policy. To assess the role of Macro in achieving.... You had to say, what and how it is doing what it's doing, as well as what and how it's not doing what its objectives are.
11. Some students talked about the financing of the budget and its impact on external and subsequently internal stability through X rates.
12. Overall, far too many people are just giving a run down of an amazing volume of data on policy settings and characteristics. To achieve a higher mark, this relevant and right information should be used to support your assessment of how well the different arms of policy are achieving their goals.