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Contents:

- Australia's Trade and Financial Flow Essay

How we recommend you use our essay plans:

- You can learn the optimal ESSAY STRUCTURE by reading over our essay plans. This is so important to forming a cohesive response and is the FIRST step to getting TOP MARKS.

- You can pick up our TIPS AND TRICKS, such as where to put diagrams and statistics to add depth to your response. When examiners see these little things in your essay, they make a mental 'tick'! Over time you will develop the skills to write an essay full of little 'ticks'.

- While we encourage you to memorise the content in these essay plans, we also recommend you WRITE YOUR OWN essay plans, especially for topics you find difficult.

Q: Analyse the influence of different factors on Australia's trade and financial flows

As a small open economy, Australia has been heavily reliant on the global economy to support its economic performance. The Australian economy primarily interacts with the rest of the world through dynamic trade and financial flows. Global factors such as the international business cycle, trade tensions, interest rates and exchange rates have influenced trends in Australia's trade and financial flows. In particular, the commodities boom of 2003- 2007 and 2011-2012 led to a significant increase in natural resource exports to the Asia pacific region. The trend has continued to persist in 2019. Currently, 65% of Australia's exports are in the natural resources sector, with 66% of total exports headed to Asian economies. Likewise, Australia's financial flows, in both foreign portfolio investment and foreign direct investment, have been heavily influenced by developments in global capital markets.

In the 1960's, most of Australia's trade took place with Europe and North America, reflecting Australia's colonial ties. The emergence of the EU trading bloc, which imposed protectionist policies on Australian exports, and subsequently Japan's industrialisation in the 1980s led to a pivot in Australia's trade strategy. Due to its rich resource endowments, Australia was well positioned to fulfil Japan's demand for iron ore and coal over this period, providing resources crucial for infrastructure development. Since the 1980's Australia has continued to strengthen its relationship with emerging Asian economies through trade agreements such as the China – Australia FTA and the recently enforced "*Comprehensive and Progressive Trans-pacific Partnership multilateral trade agreement*", which provides Australian exporters access to Japanese, Malaysian and Vietnamese agricultural markets. While Asia today accounts for over 66% of Australia's two-way goods and services trade, it is in fact China that dominates the conversation, making up 30% of Australia's total trade.

As Australia's export markets have shifted, so too have the commodities that are exported. During the 1970's, Australia relied heavily on exporting agricultural products due to its competitive advantage in the industry. During this time over 60% of Australia's exports were in rural commodities, hence the phrase that "Australia rode to prosperity on the sheep's back". Today, over 65% of exports are in the natural resources sector with iron and coal making up a combined 30%. From 2013 to 2019, Australia's structural transition to a service-based economy has seen the rise of exports such as tourism, professional services and education, which together comprise 15% of total exports. On the other hand, the composition of Australia's imports has remained relatively steady, comprising mostly of capital machinery goods and fuel (oil).

The international business cycle has played a significant role in shaping the direction and composition of Australia's trade flows. During the early 2000s, strong economic growth in rapidly industrialising Asian economies including China, Asia and Vietnam led to a high level of demand for natural resources

– noticeably, iron ore and coal which were necessary inputs for steel production and infrastructure development. As demand exceeded supply at the time, commodity prices soared. The price of iron ore rose from $32/ton in 2003 to $145/ton by the peak of the commodities boom in 2008. Australia took advantage of rising commodity prices and its natural endowment in minerals by prioritising their export base towards resource commodities.

To take advantage of increased profit opportunities, mining companies such as Rio Tinto and BHP Billiton undertook significant infrastructure investment to expand their productive capacity. To fund their capital expenditure, they relied on a mix of internally generated cash flows and offshore debt (foreign portfolio investment). As these mining companies were 80% foreign owned on average, their reinvestments constituted foreign direct investment inflows. By 2008, foreign debt had grown to 8% of nominal GDP relative to only 3% in 2003.

While the GFC crisis in 2008-09 did not alter Australia's trade flows - due to strong ties with the resilient Chinese economy- the structure of Australia's financial flows was dramatically altered. Driven by the precautionary motive, households increased their savings from a savings ratio of 0% in 2000 to 10% by 2009. The increased national savings and institutional aversion to debt led to a slowdown in the demand for offshore funds. As a result, net foreign debt decreased to less than 1% of nominal GDP by 2019. From 2016 to 2019, APRA introduced new regulatory measures that required financial institutions to strengthen their balance sheets by using more long term debt. This altered Australia's financial flows as preference for short term foreign debt decreased (27% GDP in 2007 to 7% in 2019) and long-term foreign debt increased (30% in 2007 to 55% in 2019).

In 2011 to 2012, China's strong economic growth and continued demand for resource exports prompted a rebound in economic activity. During this period, commodity prices increased to a record high of 155 on the commodity price index. In contrast, the index had peaked at 135 in 2008. With 60% of Australian exports in the natural resources sector, the higher commodity prices meant a greater demand for the $AUD in the Forex market as foreign firms required AUD to purchase Australian exports. This caused an appreciation in the AUD to a record high $1.1 USD by 2011. However, the strong exchange rate further eroded the international competitiveness of non-resource exports such as manufacturing and agriculture in a phenomenon known as the Dutch disease. Australia's manufacturing industry was already under significant pressure as a result of Australia's increasing minimum wage laws and high labour costs. The Dutch Disease led to a subsequent hollowing out of the manufacturing sector, effectively reducing its share in Australia's export base. For example, Australia no longer produces and exports electrical goods.

From 2013 to 2016, the global economy entered a period of slow economic growth and highly expansionary monetary policy. Growth in China had slowed down, resulting in falling commodity prices and lower demand for Australian exports. As foreign investors no longer saw the need to increase productive capacity in Australia's mining sector, mining investment spend declined from 9.5% of GDP in 2012 to 3.5% of GDP in 2017. However, increasing global demand for fuel drove increases in FDI to Australia's LNG export industry. To stimulate global economic growth, interest rates were reduced to zero in the US and the EU. On the other hand, Australia was able to maintain a relatively high interest rate of 2.5% in 2013, as the economy remained buoyed by its exports to China. The interest rate differential between Australia and the global economy made Australian assets more attractive on a risk adjusted basis. As a result, Australia was able to attract a significant amount of financial inflows over this period.

In more recent times, from 2016 to 2019, the recovery of the international business cycle has again shifted Australia's trade and financial flows. Rising global interest rates, characterised by the Federal Reserve's decision to increase rates from 0.75% in 2016 to 2.5% by 2019, have narrowed Australia's interest rate differentials with other economies. This has prompted investors to withdraw their capital from Australia and invest in economies that can provide higher returns. While China's demand for commodities has recovered slightly, it is the emergence of China's consumerist middle class that has had a greater impact on Australia's exports, particularly in the tourism and education sectors. The middle class is expected to be a $600 billion market. The combined expectations of improved living standards and a westernisation of Chinese livelihoods has driven demand for Australian and tourism services. China is now the destination for 18% of total Australian service exports, with the figure expected to grow into the future. Australian service exports now account for 15% of all exports.

In conclusion, Australia's trade and financial flows have changed significantly over time due to both domestic and international influences. As a small open economy, factors such as the international business cycle, exchange rates and interest rate differentials can have a significant impact on the value of both trade and financial flows. Moving ahead, Australia's export industry is expected to remain resource dominated. However, demand from China's middle class may see both a resurgence in agricultural exports such as meat and milk and an increasing role for service exports. On the other hand, the lack of domestic investment opportunities and rising global interest rates may see further decreases in financial inflows. In fact, the accumulation of household savings in superannuation funds, may lead to greater financial outflows as Australians seek higher returns by investing abroad.