

ECONOMICS

Due to globalisation, changes in the domestic economy are both cyclical and structural. Globalisation is the integration between different countries and economies and the increased impact of international influences on all aspects of life and economic activity. Therefore, Australia's Balance of Payments (BoP) will depend increasingly on both cyclical and structural factors in the domestic economy. These will include changes in exchange rates, domestic growth, Australia's export base and its consequent international competitiveness and the savings and investment gap.

Australia's BoP is a summarized record of all transactions that Australia has with the rest of the world in a given time period. It consists of the current account and the capital and financial account. The current account records the receipts and payments of trade in goods and services, transfer payments and income flows between Australia and the rest of the world. The largest influences on the current account are the Balance on Goods and Services (BOGS), which is net goods and net services combined, as well as the net primary income account. These are the two sections this essay will focus on.

Changes in the domestic exchange rate impacts the BOGS in the current account in Australia's BoP. An exchange rate is the price of one country's currency in terms of another country's currency. The changes in exchange rates will significantly impact the relative prices of Australian imports. A depreciation in the exchange rate will make imports more expensive. This will lead to a reduction in consumer spending in imports that will increase the BOGS. An appreciation in the exchange rate, however, will make the price of imports less expensive. Therefore, consumers will be able to buy more with the same amount of cash they had before and this will worsen the BOGS. During the 2008-09 GFC, the BOGS increase and became a surplus due to a depreciation in the Australian exchange rate. Consumers moderated their spending due to increased economic uncertainty. Nowadays, the BOGS experiences small surpluses or deficits of around 2 per cent of GDP. Appreciation and depreciations in the exchange rate have significant impacts on Australia's BoP.

The structural factor, Australia's export base influences changes in Australia's international competitiveness. Australia has a very narrow export base and its comparative advantage lies in low value added products in the areas of agriculture and mining. On top of this, Australia tends to import high value added products and therefore import payments outstrip export revenue. For example, in the manufacturing sector, Australia has a lack of international competitiveness. Countries such as China can produce products in manufacturing more cheaply. Thus, Australia's lack of competition reduces export revenue compared with import payments and this reduces BOGS. Overall, this will increase the current account deficit, part of Australia's BoP.

A structural factor impacting the net primary income account is the level of domestic savings and investment. Australia is a relatively small economy and more than half of its exports lie in minerals and resources. Australia then must have a large amount of capital investment in order to finance things like research and development and machinery. But, Australia historically has a low level of savings compared to high demand for investment. Therefore, since Australia is an open economy, Australia tends to finance this gap from overseas. However, borrowing leads to increased servicing costs and the sale of equity leads to ongoing commitments to supply profit to owners. Thus, high surplus on the capital and financial accounts (which all the foreign funds go into) will lead to a worsening of the current account deficit. This will worsen Australia's BoP.

Changes in the level of domestic growth will impact the current account deficit in Australia's BoP. A high level of domestic growth will lead to increase household incomes. This will enable consumers to purchase more imports from overseas and this will worsen the BOGS and hence the CAD. However, a decrease or a lower level in domestic growth will lead to a decrease in household income. This will discourage consumer spending and improve the BOGS leading to a smaller deficit or a larger surplus on the current account.

Changes in domestic exchange rates, Australia's narrow export base, the difference between saving and investment and the level of domestic growth all have an impact on Australia's current account. These changes will either lead to an improvement or deterioration of Australia's BoP.