

Australia and the global financial crisis economics essay



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The Global Financial Crisis (GFC) was caused by various factors which impacted the Western world's economies. It resulted from providing too many loans to people who could not afford to repay the loan and the packaging up of loans to on-sell (securitisation in the USA). The greed of consumers, bad investments, rising property prices, the wide spread distribution of income, and the overall poor regulation of monies also contributed. The Australian government takes credit for avoiding this recession by implementing Keynesian theory of fiscal and monetary stimulus by intervening early and a willingness to stimulate the economy. This stimulus was aimed to stimulate aggregate demand through increased consumption and investment expenditure the minority of this stimulus being monetary policy and the majority being fiscal stimulus. However this stimulus when compared to other contributions to change in GDP expenditure was not the major contributor to avoiding the recession. Net exports were the most significant contributor during the GFC. This means that the stimulus did not save Australia from the recession. The net exports contributed greatly but when a consideration is made of all the National Income Measures (NIM) not just the Gross Domestic Product (GDP), Australia did have a mild recession. It is clear that the Global Financial Crisis (GFC) has created a recession not only all over the western world, but in Australia as well and the main contributor to its mildness was Australia's net exports.

The Australian government has used fiscal policies to smooth out the economic fluctuations caused by the GFC and to reduce its impact on consumers. Fiscal policy uses changes in government spending and/or reduces taxes to influence the level of aggregate demand to impact the

general direction of the economy. When Australia was threatened by the global financial crisis, the government took the action of implementing the largest fiscal stimulus in the world (Makin 2010: 5). The government spending was used for infrastructure projects for the purpose of stimulating the workforce during the GFC recession especially when the construction industry is particularly depressed. In addition, the government is spending on transfer payments to people under the Employment Insurance and Welfare programs increase during a recession and thereby providing more support to the level of aggregated demand. These stimulus packages (Government spending) include the Economic Security Strategy, the Nation Building Economic Stimulus, the Nation Building and Jobs Plan and a Nation Building Infrastructure measures which have reached a more than \$55.6 billion (Makin 2010: 5). Most of this funding was targeted to support local jobs throughout Australia by building new projects and facilities that will have lasting benefits across the nation including (ALP 2011). Australia went through the GFC economically with the strongest growth of any advanced economy through 2009 (ALP 2011). With the government stimulating the economy resulting in a multiplier effect, the planned aggregated expenditure increases.

The Australian government also stimulated the economy with the aid of the Reserve Bank of Australia (RBA) to increase the planned aggregated expenditure by the use of monetary policy. The RBA sets the interest rate on overnight loans in the money market which affects other interest rates in the economy to varying degrees, so that the behaviour of borrowers and lenders in the financial markets are affected by monetary policy (though not only by

monetary policy). This can be seen in the figure 1 below as the supply curve shifts to the right which meant that the RBA's influence could be used to reduce the burden of the GFC. This could be done by three measures; the first measure was to provide extended opportunities for the banks to borrow from the RBA. This provided sufficient liquidity for banks to support them through the GFC. The second measure was to provide loans or make direct purchases to support certain markets. This allowed for mortgage-securities to be bought back and provide short-term stabilities. The third measure was the use of guarantees to stabilise markets, support banks in raising debt and to avoid a run on the banking system. This helped to increase the willingness to lend, since lenders were only willing to lend at short maturities. The ability to modify rates at any time provided the RBA with the flexibility to stimulate the economy in a downturn and prevent an overheating boom. Thus in the GFC the decrease in interest rates reduces the cost in borrowing resulting in increased planned aggregate expenditure.

Figure 1: A Monetary Injection and How It Will Affect the Supply and Demand of Money.

The Australian government increased government spending to increase private and public consumption by the use of monetary and fiscal policy to counter the negative contributions from public and private investment. The recorded contribution from direct Australian government consumption to a change in GDP(E) in the December 2008 quarter was actually negative (-0.1 per cent), followed by nil contribution in the March quarter. These were offset by negligible positive contributions from State and Local consumption spending. This was due to the result of administrative delays in

implementing infrastructure spending causing the total public spending not to increase until the end of 2009, but only after the worst of the GFC had passed. During the time of the GFC from the September 2008 to the March 2009 quarters, the main contributors to expenditure were not private and public consumption but net exports which detracted from real expenditure growth in quarters before and after the GFC struck. The strong net export result can be explained by a sustained real exchange-rate depreciation of over 25 per cent in trade-weighted terms during the December 2008 and March 2009 quarters, which made exports substantially cheaper for foreign buyers and imports more expensive for domestic buyers. There was also sustained demand for commodities from key Asian trading partners, including China, over this time. The Australian strong economy can be credited to its net exports rather than government spending, to maintain a positive GDP during the GFC.

Table 2: Contributions to GDP Growth (percentage points per quarter, seasonally adjusted)

Federal Government Consumption

State and Local Govt Consumption

Federal Government Investment

State and Local Govt Investment

Statistical Discrepancy

Real GDP

Jun-2008

0.0

0.1

0.3

0.3

-0.1

0.2

Sep-2008

0.1

0.1

-0.2

-0.1

-0.1

0.4

Dec-2008

-0.1

0.1

-0.2

-0.1

0.0

-0.7

Mar-2009

0.0

0.1

-0.1

0.0

-0.9

0.7

Jun-2009

0.0

0.1

0.0

0.1

-0.3

0.5

Sep-2009

0.2

0.1

0.0

0.2

-0.1

0.3

Dec-2009

0.3

0.1

0.2

0.3

0.0

1.0

Source: Makin, A 2010, " Did Australia's Fiscal Stimulus Counter Recession?: Evidence from National Accounts," pg. 10, A Journal of Policy Analysis and Reform, Vol. 17, No. 2, 2010.

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A recession can be determined when there are two consecutive negative quarters of GDP and also when there is a 1.5% rise in unemployment within 12 months. The nominal GDP fell in the March 2009 and June 2009 quarters implying there was a contraction in national income. The reason the average volume measure of GDP remained positive in the March quarter, while the current price value measure shrank, is that there was a sharp fall in the implicit price deflator (or overall price level), due in no small part to heavy retail discounting of goods for sale at this time. Meanwhile, real GDP per head, the single most important indicator of recession, fell successively over three quarters by a total of 1.3 per cent. The real GDP (E) measure in Table 1 is the only conventional GDP series that did not record at least two consecutive negative outcomes. Average real GDP was not negative for two successive quarters because the GDP (E) measures were sufficiently positive to make GDP (A) positive. Hence, the claim that fiscal stimulus enabled Australia to avoid recession according to the media definition of recession, in the end depends on the nature and robustness of the real GDP(E) measure for the March 2009 quarter. But Australia did have over 1.5% rise in unemployment, 1.1 per cent in the September 2008 and 1.5 per cent in the June 2009, meaning unemployment had a 1.5% rise in unemployment within 12 months meaning Australia had a recession.

Table 1: Conventional Measures of Gross Domestic Product (percentage growth per quarter, trend basis)

Real GDP-Expenditure

Real GDP-Income

Real GDP -Production

Real GDP-Average

Real GDP -

per capita

Nominal GDP

Jun-2008

0.3

0.3

0.7

0.4

0.1

2.8

Sep-2008

0.1

-0.2

0.2

0.0

-0.5

2.1

Dec-2008

0.4

-0.2

-0.2

0.0

-0.5

0.6

Mar-2009

0.7

0.2

-0.2

0.2

-0.3

-0.8

Jun-2009

0.9

0.5

0.1

0.5

0.0

-0.7

Sep-2009

0.9

0.5

0.6

0.6

0.2

0.7

Dec-2009

0.8

0.6

0.9

0. 8

0. 3

2. 2

Source: Makin, A 2010, “ Did Australia’s Fiscal Stimulus Counter Recession?: Evidence from National Accounts,” pg. 8, A Journal of Policy Analysis and Reform, Vol. 17, No. 2, 2010.

The claim that Australia avoided a recession rests on the definition of recession as two consecutive quarters of falling GDP. This definition is popular with media commentators and market economists and is tacitly approved by the Australian Treasury and the Reserve Bank of Australia. However, it lacks support from academic economists and policymakers abroad because it is too narrow. If a consideration is made to all the National Income Measures (NIM) not just the Gross Domestic Product (GDP) indicators of macroeconomic activity can broaden the margin for error that is always subjected to the economy-wide data especially in the face of a major shock such as the GFC, as evidenced by large statistical discrepancies in the national accounts. As shown above in Table 1, two successive quarters of negative growth were recorded in nominal GDP, the real production and income-based measures of GDP, and real GDP per head. The real GDP (E) measure was the only series that did not fall over two successive quarters. Alternative national income series for Australia gleaned from the most recent set of national accounts are included in Table 3, all of which reveal at least two successive negative quarterly outcomes. Though routinely ignored in economic commentary, the real gross and net domestic and national income <https://assignbuster.com/australia-and-the-global-financial-crisis-economics-essay/>

series are especially important measures of Australia's international macroeconomic performance because they reflect the impact of the terms of trade (or ratio of prices received for exports to prices paid for imports) on the economy. Derived by adjusting the volume measure of GDP for changes in the international purchasing power of national income which, in Australia's case, occurs due to fluctuating export commodity prices, these series are broader measures of national economic wellbeing than the standard real GDP measure used in the media definition of recession, which can assist in a more accurate decision whether Australia is in a recession or not.

Table 3: Other National Income Measures (percentage growth per quarter, trend basis)

Real Net Domestic Product

Real Gross Domestic Income

Real Gross National Income

Real Net National Disposable Income

Real Net National Disposable Income per Capita

Jun-2008

0.3

2.2

2.5

2.7

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2. 2

Sep-2008

-0. 3

1. 2

1. 6

1. 5

1. 0

Dec-2008

-0. 4

-0. 3

-0. 2

-0. 5

-1. 1

Mar-2009

-0. 1

-1. 2

-1. 2

-1.8

-2.3

Jun-2009

0.4

-0.5

-0.6

-1.0

-1.5

Sep-2009

0.5

0.3

0.3

0.1

-0.3

Dec-2009

0.4

0.7

0.7

0.6

0.2

Source: Makin, A 2010, “ Did Australia’s Fiscal Stimulus Counter Recession?: Evidence from National Accounts,” pg. 13, A Journal of Policy Analysis and Reform, Vol. 17, No. 2, 2010.

Fiscal policy uses changes in government spending and/or reduces taxes to influence the level of aggregate demand to impact the general direction of the economy. This resulted in a multiplier effect which increased the planned aggregated expenditure that monetary policy also contributed too. But the main contributors to expenditure were not private and public consumption but net exports which detracted from real expenditure growth in quarters before and after the GFC struck. A recession can be determined when there are two consecutive negative quarters of GDP and also when there is a 1.5% rise in unemployment within 12 months. Average real GDP was not negative for two successive quarters because the GDP (E) measures were sufficiently positive to make GDP (A) positive. Hence, the claim that fiscal stimulus enabled Australia to avoid recession according to the media definition of recession. If a consideration is made to all the National Income Measures (NIM) not just the Gross Domestic Product (GDP) indicators of macroeconomic activity, all of which reveal at least two successive negative quarterly outcomes, Australia did have a recession. It then becomes clear that the Global Financial Crisis (GFC) has created a recession not only all over the western world, but in Australia as well. Thereby in the short-run, <https://assignbuster.com/australia-and-the-global-financial-crisis-economics-essay/>

increases in household's discretionary income and increase in spending results in a sudden increase of disposable income to help fight the downturn. The Australian strong economy can be credited to its net exports rather than government spending but government spending did help maintain investment and consuming confidence that help to maintain the flow of monies.