

# [Hsc term 1](https://assignbuster.com/hsc-term-1/)

HSC economics topic 1: AUSTRALIA??™S PLACE IN THE GLOBAL ECONOMY 2010TRENDS IN AUSTRALIA??™S TRADE PATTERNDirection of trade- the countries with which Australia exports to and imports fromComposition of trade- refers to the type of goods and services that Australia trades with other countries+ Australia??? s main merchandise exports are primary goods (coal, goal, minerals).

+ Australia??™s main merchandise imports are manufactures goods (cars, computers??¦)THE BALANCE OF PAYMENTBOP summaries all of Australia??™s international transactions that result from the importing and exporting G/S and financial flows(investment & income)Transactions are categorized as either CREDITS (capital inflow ??“ positive) or DEBITS (capital outflow ??“ negative)Summarised into 2 main accounts in the BOP, either Current account or the Capital and financial AccountThe current accountShows the capital flows from all exports(X) and imports (M) of G&S, income and current transfers. Net goods = exports income received ??“ payments for importsBalance => X= MSurplus => X> MDeficit => X inflow of income Foreigner invests in Australia => Outflow of incomeNet income = income credits ??“ income debitsNet current transfer = payout on insurance, foreign aid not used to build infrastructure and pensions from foreign govt. CAD = Credits (inflows) Debits (Outflows)THE CAPITAL AND FINANCIAL ACCOUNTConcerned with the financial assets and liabilities (the money flows from international borrowing, lending and purchase of assets(shares & property))Recorded as credits and debits2main account Capital Account & financial AccountCapital AccountPeople migrating in & out of AustraliaForeign aid used to build infrastructurePurchase & sale of intellectual property (e. g.

patents, copyrights, trademarks & franchise)Financial account shows transactions in assets and liabilitiesIncludes direct, portfolio investment, other investment and reserve assets. Financial account consistently shows positive surplus balance(foreign liabilities > foreign assets) Draws savings from the rest of the world to financial the deficit on the current accountBALANCE ON THE CAPITAL AND FINANCIAL ACCOUNT = CAPITAL ACCOUNT BALANCE + FINANCIAL ACCOUNT BALANCE + NET ERRORS AND OMISSIONS. BOP sums to zero (current account = capital & financial account). BALANCE OF PAYMENTS = THE BALANCE ON THE CURRENT ACCOUNT + THE BALANCE ON THE CAPITAL & FINANCIAL ACCOUNT + NET ERRORS AND OMISSION. FOREIGN LIABILITIES AND THE BALANCE OF PAYMENTSNet foreign liabilities = Australia??™s total financial obligations to foreigners ??“ the obligations of foreigners to AustraliaLiabilities include; Net foreign debt = money owed by Australians to foreigners ??“ money owed by foreigners to AustraliansNet foreign equity = total value of assets(lands, shares..) in foreign ownership ??“ total overseas assets owned by AustraliansEquity does not add to debt, relates to investment.

Australians does not need to repay=> find another person/group to purchase their investment=> get money back. Equity investment can create a larger CAD=> increased foreign debt/ if the investment earns a profit=> the payment for the income is recorded as a debit in net income sections. A larger CAD => increased need for overseas funds which can be either in the form of equity or debt. Borrowing does add to foreign: borrower must repayment of loans plus interest=> called debt servicing???.

If not repaid quickly=> increase the size of debt. High CAD and a high foreign debt create a ??? vicious cycle??? referred to as a ??? debt trap??? scenario. High CAD=> borrowing of overseas funds or sale of Australian assets=> interest payments& dividends payment leads to outflow of capital this is recorded as a debit in the current account ??“ net income => higher CAD.

NFD and net foreign equity can be measured by comparing them to GD( as a % of GDP)Foreign debt is currently above 50% of GDP which creates serious problems for the BOP due to the accumulation of interest. LINKS BETWEEN THE KEY BALANCE OF PAYMENTS ACCOUNTS AND CATEGORIES. The first link is that the 2 ??? accounts??? add up to zero (i.

e. the CAD is equal to the capital & financial account surplus KFAS) (allowing for the net errors and omissions)Australia has a floating exchange rate (i. e. the value of AUD is determined by demand and supply). This also ensures a balance will occur as the demand for the AUD should be equal to the supply of the AUD and therefore the CAD should equal the KFAS write me my essay Demand for AUD + Exports(X)+ Income credits(Y credits)+ Capital inflow (K inflow)+ X +Y credits + K inflowSupply of AUD+ imports (M)+income debits (Y debits)+capital outflow (K out flow)+ M+Y debits + K outflow X + y credits + k inflows (demand for AUD) = M + Y debits + K outflows (supply of AUD)M ??“ X + Y debits ??“ Y credits = K inflows ??“ K outflowsCURRENT ACCOUNTCapital and Financial Account Another linkage is between the capital & financial account and the net income section of the current account. As foreign capital flows into Australia, the income that is received flows out and is recorded in the net income section. Increasing capital inflows will create an increasing CAD through the net income section.

Increase in the size of the CADIncrease in the size of the NID VICIOUS CYCLE increase in the k inflows and NFDIncrease in the % repayments or Dividend payments to foreign investorsTHE CONSEQUENCES OF A HIGH CADThe growth of Foreign liabilities. Increased servicing costs. Volatile exchange rates. Economic growth constrained. Contractionary economic policy. Loss of international investor confidence.

TERMS OF TRADE The TOT shows the relationship between the prices Australia receives for its exports and the prices that it pays for its imports. This relationship can have a significant impact on the performance of the BOP. The export price index shows a proportional change in the level of export prices. The import price index shows a proportional change in the level of import prices.

TOT index = (export price index)/(import price index) x 100Improvement when X prices > M prices so the same volume of exports will buy a greater volume of importsDeterioration when M prices > X prices so the same volume of exports will buy a smaller volume of importsStructural changeStructural change refers to changes in the types of goods and services produced in an economy and the methods of production used to produce them. Structural change will impact on the performance of the CAD. THE BOP PERFORMANCEThe BOP is an indicator of economic performance. They often influence confidence of investors and consumers. Australia??™s CAD is very poor compared to other advanced industrialized. The CAD is best measured as a % of GD. It allows for measurement between economies and across time.

It is considered high if it reaches 6% of GDP. CAD is affected by both cyclical factors and structural factors. EXCHANGE RATESExchange rates are a measure of value of one currency against another. Exchange rates can be determined in a number of ways: Fixed Exchange Rate SystemManaged Flexible PegFloating Exchange The demand and supply of currency is affected by: SpeculatorsTrade flowsIncome flowsInvestment flowsSupply and demand is also affected by: InflationReal interest ratesTOTClimatic factorsIncrease in foreign debtInternational economic conditions. Trade weight index (TWI): the TWI gives an indication of how the value of the Australia dollar is moving against all currencies in general. It measures the value of the AUD against the currencies of Australia??™s major trading partners compared with a base yr. EXCHANGE RATE SYSTEMSFixed exchange rate system (prior to 1976)Exchange rate is set by the Govt or it??™s agency and is ??? fixed??? to the value of another currencyGovt maintains exchange rate by buying and selling foreign currency/gold reserves in exchange for $A.

Downward movement in the value of the currency is called devaluation. Upward movement in the value of the currency is called revaluation. Managed flexible peg (Aust Nov 1976 ??“ Oct 1983)RBA set the price of the $AUD each day at 9am and that was the value it was traded at during the day. Currency movements are??? pegged??? to changes in a predetermined currency of index.

Greater flexibility than a fixed exchange rate. Floating exchange rate system (Aust post 1983)Exchange rate set by the forces of supply and demand.??? Clean float??? when there is no govt intervention in its determination??? Dirty float???, RBA intervenes in exchange rate determination to stabilize currency fluctuations. ( buy and sell currency to appreciation or depreciation of the AUD)Can cause inflation cost-push inflation and depreciation inflation (i. e.

a depreciation of the currency => increased prices of imports)PROTECTION IN AUSTRALIAReducing protection the Govt aims to: Improve domestic industries international competitivenessEncourage efficient use of resources in industries in which Australia has a competitive advantage. Increased choice/variety of goods and a improved standard of livingThe effects of protection removalThe effects of protection removal on individualsIndividuals should benefit from reduced protection in their role as consumers as the prices of G&S are cheaper, there is a wider variety of G&S and the quality of G&S improves=> improved living standard. Innovation is encouraged=> new and better goods and servicesThe effects of protection removal on firms: Inefficient and uncompetitive import competing industries fail. Lower protection encourages international competitiveness. Attraction of new technology at lower prices. The effects of protection removal on GovtA reduction in Govt revenue due to the removal of tariffs and Govt spending due to removal of subsidies.

Increase in Govt spending due to the assistance required from increasing unemployment benefits and the requirement of retraining programs for the unemployed. Other effects may include: short term ??“ poor trade performance and worsening CAD due to the BOGS. Long term ??“ improved international competitiveness and a fall in the CAD as exports increase.