

Box C: The Impact of the World Economic Slowdown on Australia

There has been much discussion of the effect of the Asian economic slump on the Australian economy. To date, the main direct impact has been seen in reduced exports to east Asia. Less easily quantifiable is the potential impact on Australia of the broader world slowdown now expected by official forecasters. This box provides a perspective on the economic downturn, by outlining channels through which the Australian economy is being affected, and comparing the overall external slowdown with previous episodes.

Channels of influence

Export quantity effects

Exports to Asia fell towards the end of 1997 and in the first few months of 1998. By mid 1998, exports to the initial crisis economies – Thailand, Korea, Indonesia, Malaysia and the Philippines – were one third or more below the level where they might have been had trend growth of the previous five years continued. In addition, exports have declined to other Asian countries which were not immediately part of the crisis, but which were subsequently affected, such as Hong Kong, Singapore, China and Taiwan.

The decline in sales to Asia has been partly offset by increased sales elsewhere, including the United States and Europe. The diversion of exports was particularly pronounced for resources, where growth in volumes over the past year has not slowed at all, and has been higher than the average for the 1990s. Exports of manufactures and services have been hit, with the result that total non-rural exports (excluding gold) have declined over the past year.

Terms of trade effect

The loss of sales to Asia accounts for only part of the loss to Australians from the deterioration in international trading conditions. In foreign currency terms, lower prices are being achieved for the bulk of Australia's exports to all destinations. This amounts to a fall in Australia's terms of trade – that is, the purchasing power of Australia's exports in terms of imports has declined. Between mid 1997 and the September quarter of 1998, the terms of trade is estimated to have fallen by about 4 per cent. This lowers the purchasing power of national income.

The absolute fall in commodity prices has been more than offset by the decline in the exchange rate, so that in Australian dollar terms export prices have in fact risen. In other words, the income loss which arises from a decline in the terms of trade has been passed on to users of imports.

Indirect effects

There are also potential indirect effects of the external changes. Lower income growth, occasioned by lost exports and lower terms of trade, can be expected to result in lower growth in aggregate demand, and therefore some further reduction in growth in domestic output compared with what otherwise would have occurred. It is likely these forces are beginning to affect the economy now. There is also the possibility of confidence effects, should business or households abruptly curtail their spending plans independently of current income. So far, these effects appear to have been quite minor, though confidence could remain vulnerable to further deterioration in

external conditions. Working in the other direction, the increase in the relative price of imports should induce substitution away from imports and towards domestic import-competing goods and services, adding to domestic output.

Historical comparison

Graph C1 and Table C1 compare this episode with previous downturns in world economic growth over the past two decades, using a number of different benchmarks. The current downturn in world economic growth, as estimated by the IMF, is of comparable size to that in the early 1990s but is somewhat less than that in the early 1980s or mid 1970s. This estimate reflects the weakness in east Asia and Japan as well as an assumed moderate decline in growth in the United States. The decline in growth in Australia's particular group of trading partners is much more substantial than anything seen in the past two decades. However, the resilience of the economy to date suggests that it is global growth, rather than growth in trading partners, which is of

most importance. Both the decline in the terms of trade and the fall in commodity prices to date are less than those of the previous three episodes, noticeably so for the terms of trade. Exports have declined in volume terms by a little more over the past year than in the two preceding episodes, though the fall in the early 1980s was much larger. ↗

Graph C1



Table C1: External Shocks to the Australian Economy
Peak to trough change; per cent

Episode	Terms of trade	RBA commodity price index (SDRs)	Export volume growth ^(a)
1. Early 1980s	-13.3	-	-12.2
2. Mid 1980s	-15.5	-29.7	-1.9
3. Early 1990s	-14.4	-23.1	-1.4
4. Late 1990s to date	-4.0 ^(b)	-18.1	-3.6 ^(b)

(a) Lowest annual rate of growth of non-rural export volumes (excluding gold) reached during episode.

(b) Estimate to the September quarter 1998.