

Managing the End of Australia's China Resources Boom

Ross Garnaut
16 April 2013

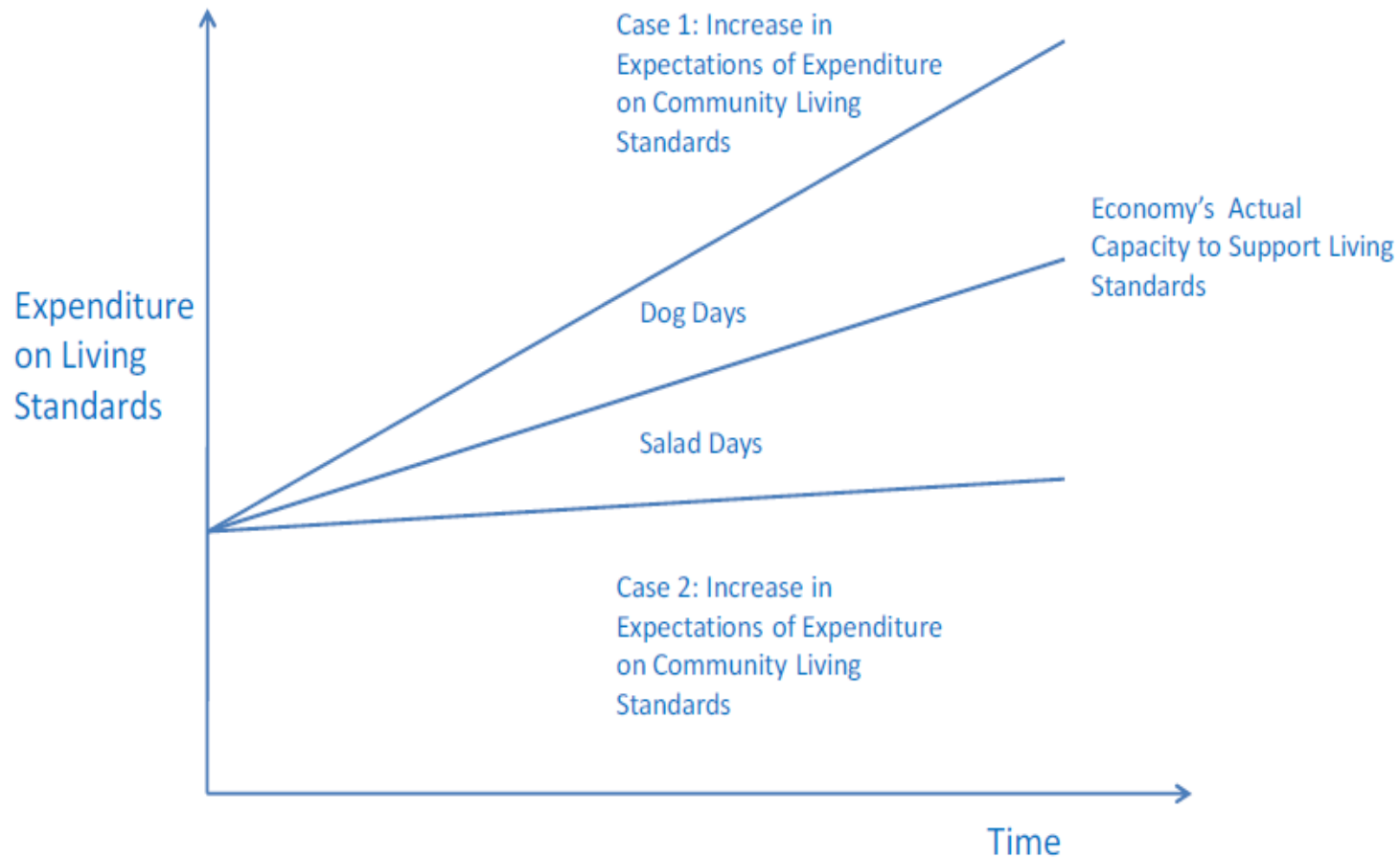
TRADE & DEVELOPMENT SEMINAR
The Arndt-Corden Department of Economics
Crawford School of Public Policy
ANU College of Asia and the Pacific

Speech at the Annual Dinner of the
Economic Society of Australia,
Canberra, December 2005

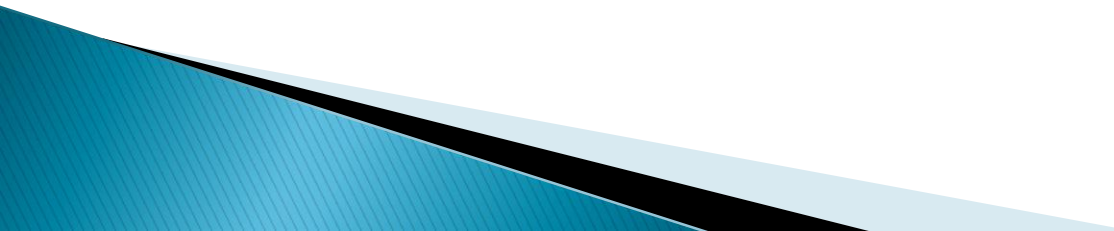
Published as '*Is Macroeconomics Dead? Monetary and Fiscal Policy in Historical Context*', Oxford Review of Economic Policy Volume 21, Number 4, 2005

- ▶ There are salad days of economic policy, when ordinary policy looks good and good policy looks celestial.
- ▶ And there are dog days, when good policy looks ordinary and ordinary policy diabolical.
- ▶ I said that we were then in the salad days but the dog days would come with the end of the resources boom.

The State of Policy Bliss



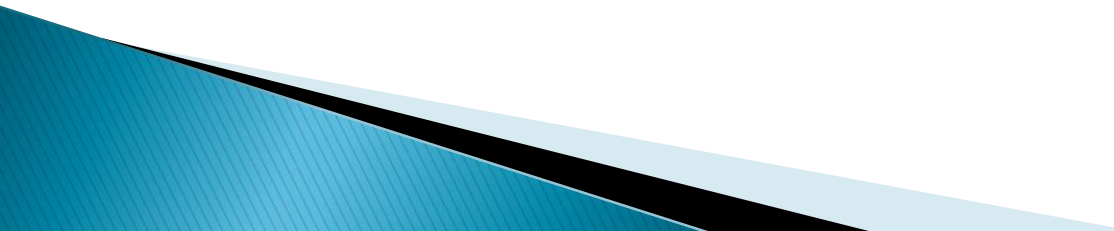
Characteristics of Salad Days:

1. Ratio of employment to population growing
 2. Productivity rising
 3. Terms of trade high and rising
 4. Animal spirits and private investment rising
 5. Foreign accounts and debt allow increased debt
 6. Recent slow growth in living standards and low inflation
- 

Characteristics of Dog Days:

- ▶ Reverse of salad days
- ▶ We were in salad days in the 1990s extending to the Great Crash

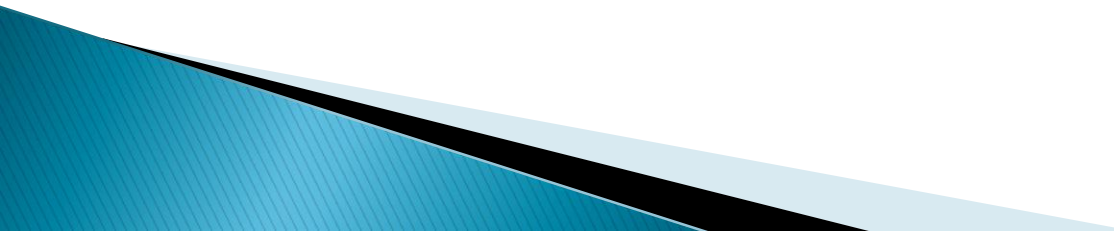
New Golden Rules worked fine in Salad Days

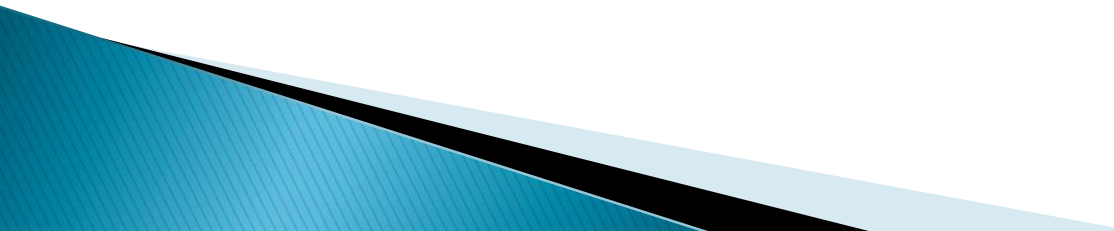
1. Inflation targeting around 'Goods and Services Standard'
 2. Free floating exchange rate
 3. Nearly balanced budgets – small surpluses in prosperity
- 

Conditions changing early twenty first century

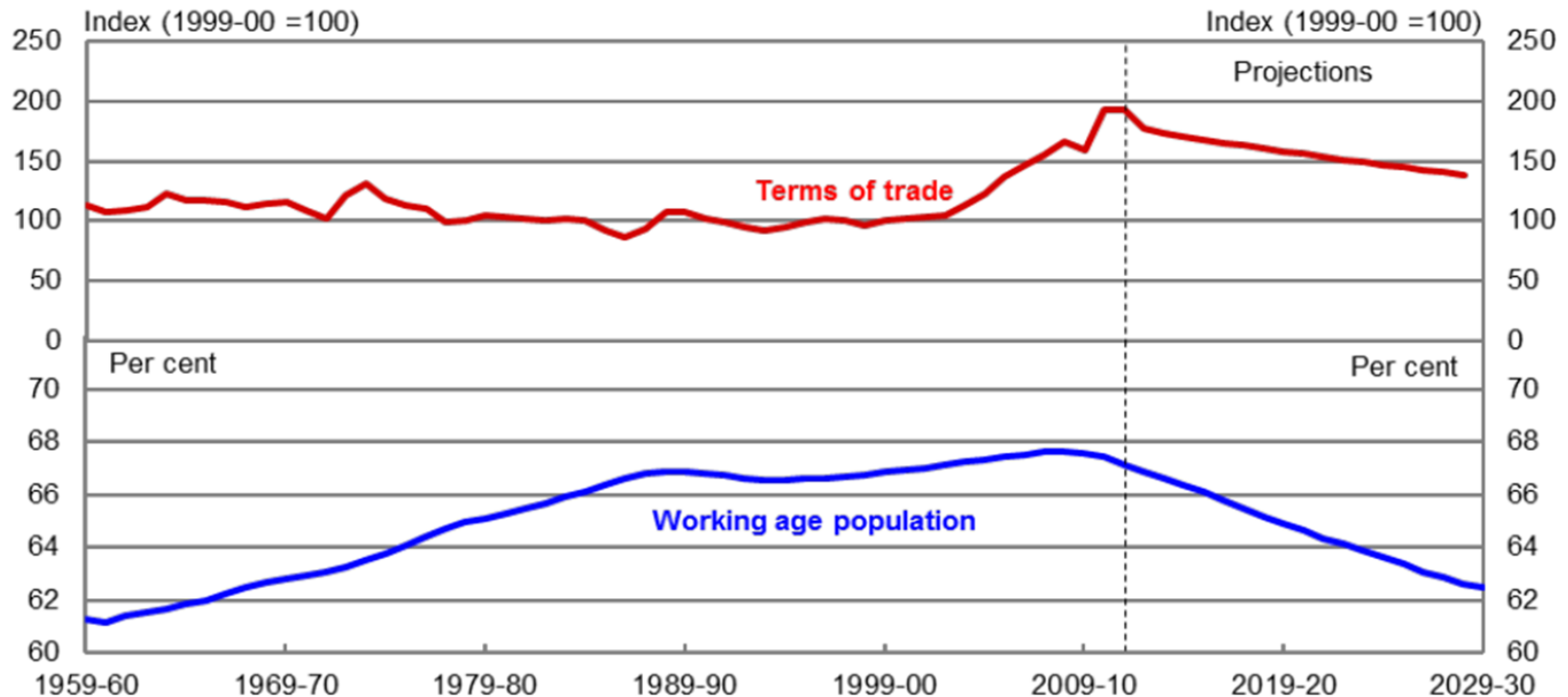
1. Lower productivity growth
2. Employment ratio full
3. New entrenched expectations of rising living standards

Salad Days would have ended early 2000s but for:

1. Housing and consumption boom funded by foreign debt
 2. Unsustainable and would have collapsed like similar booms in Ireland, UK, US and Spain – although challenged earlier in Australia by prudential and monetary policy
 3. Boom extended by China resources boom
 4. Banks still needed Government guarantee of debt in 2008
- 

- ▶ Biggest longest terms of trade boom
 - ▶ Biggest longest resources investment boom
- 

Australia's terms of trade and working age population

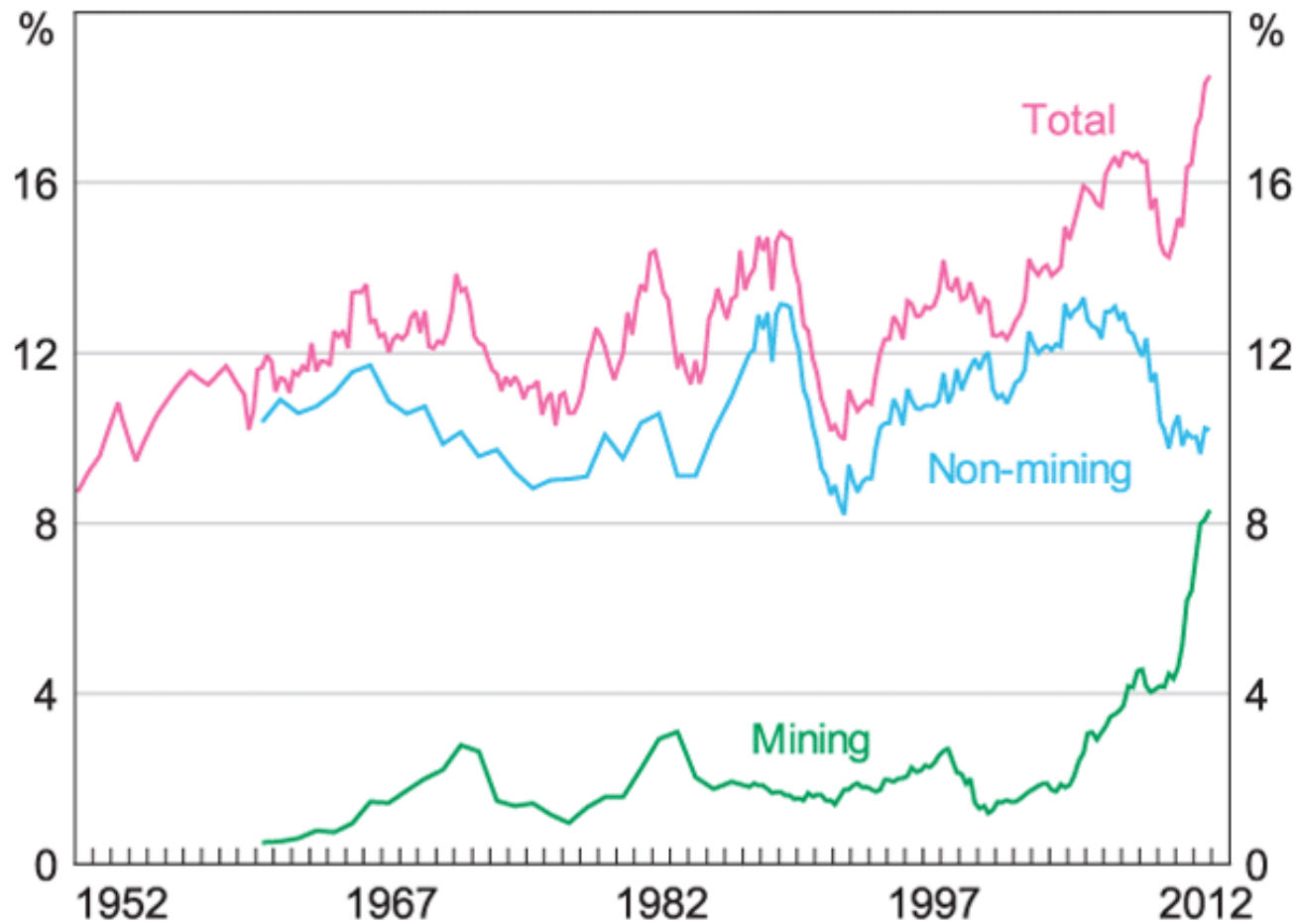


Note: Working age population is persons aged 15-64 as a percentage of total population.

Source: ABS Catalogue Numbers 5206.0, 3101.0, 3105.0.65.001, and Treasury projections from the 2012-13 MYEFO.

Business Investment*

Per cent of GDP



* Excluding cultivated and biological resources investment and the effect of second-hand asset transfers between the private and other sectors

Sources: ABS; Butlin (1977); RBA

- ▶ Productivity stagnated
but incomes rose

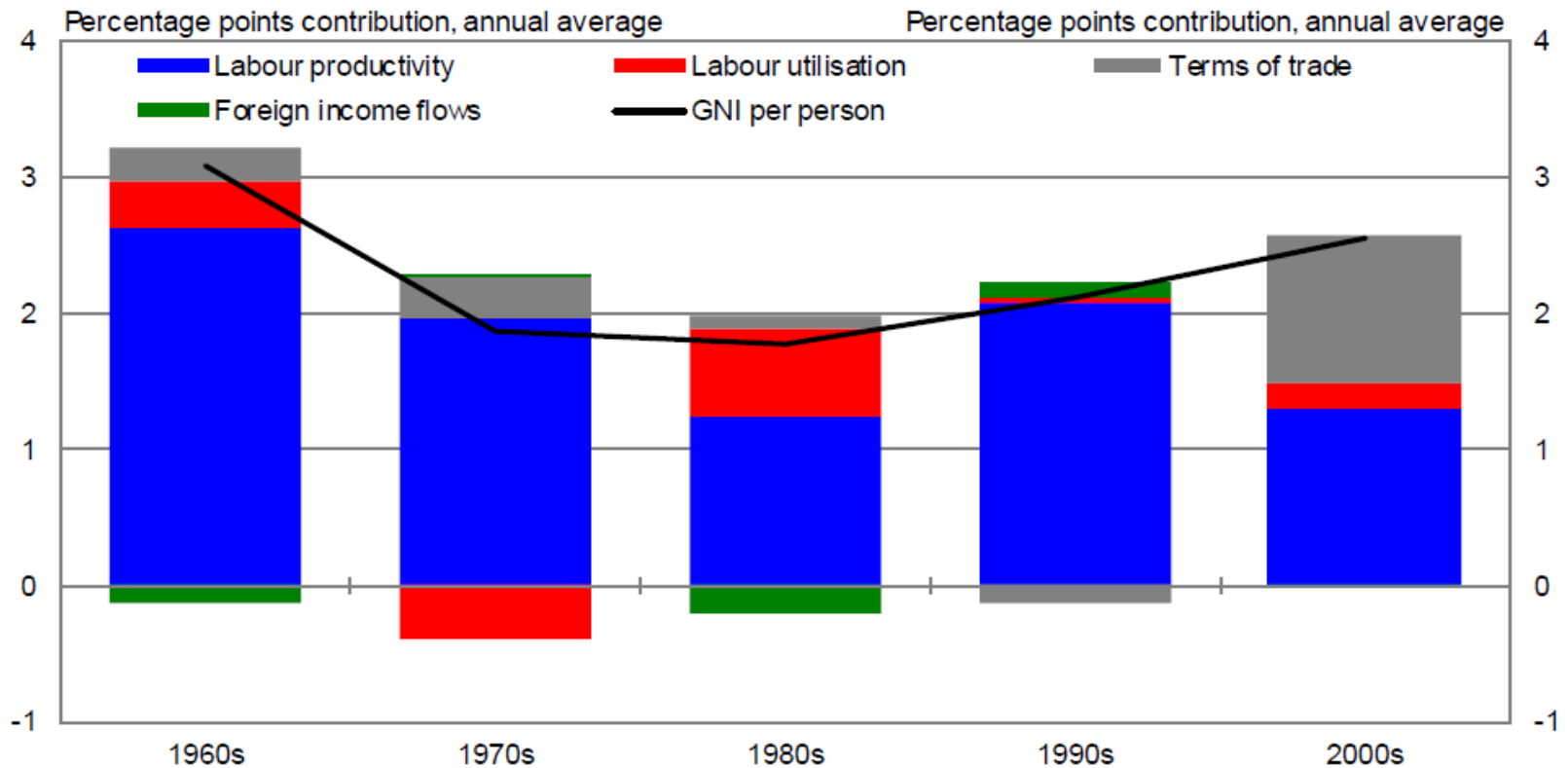
Multifactor productivity(a) in the market sector(b)



Footnote(s): (a) Gross domestic product per combined unit of labour and capital. (b) Reference year is 2009–10 = 100.

Source(s): ABS Australian System of National Accounts, 2010–11 (cat. no. 5204.0)

Contributions to growth in average incomes

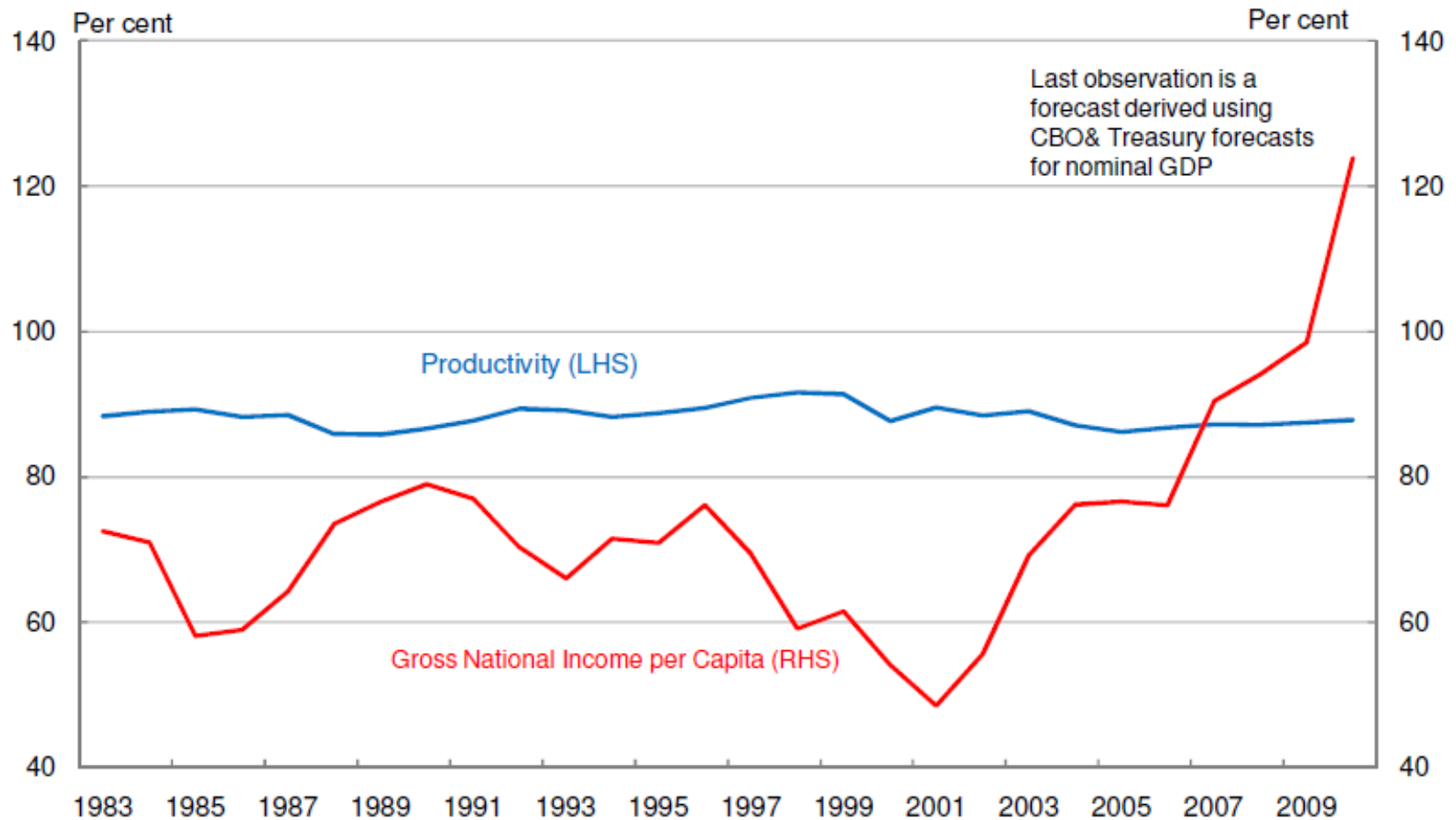


Note: Data for the 2000s are for the twelve years to 2011-12.

Source: Treasury calculations based on ABS Catalogue Numbers 5204.0, 6202.0 and unpublished ABS data.

Labour Productivity & Gross National Income per Capita

(Australia as percentage of the US)



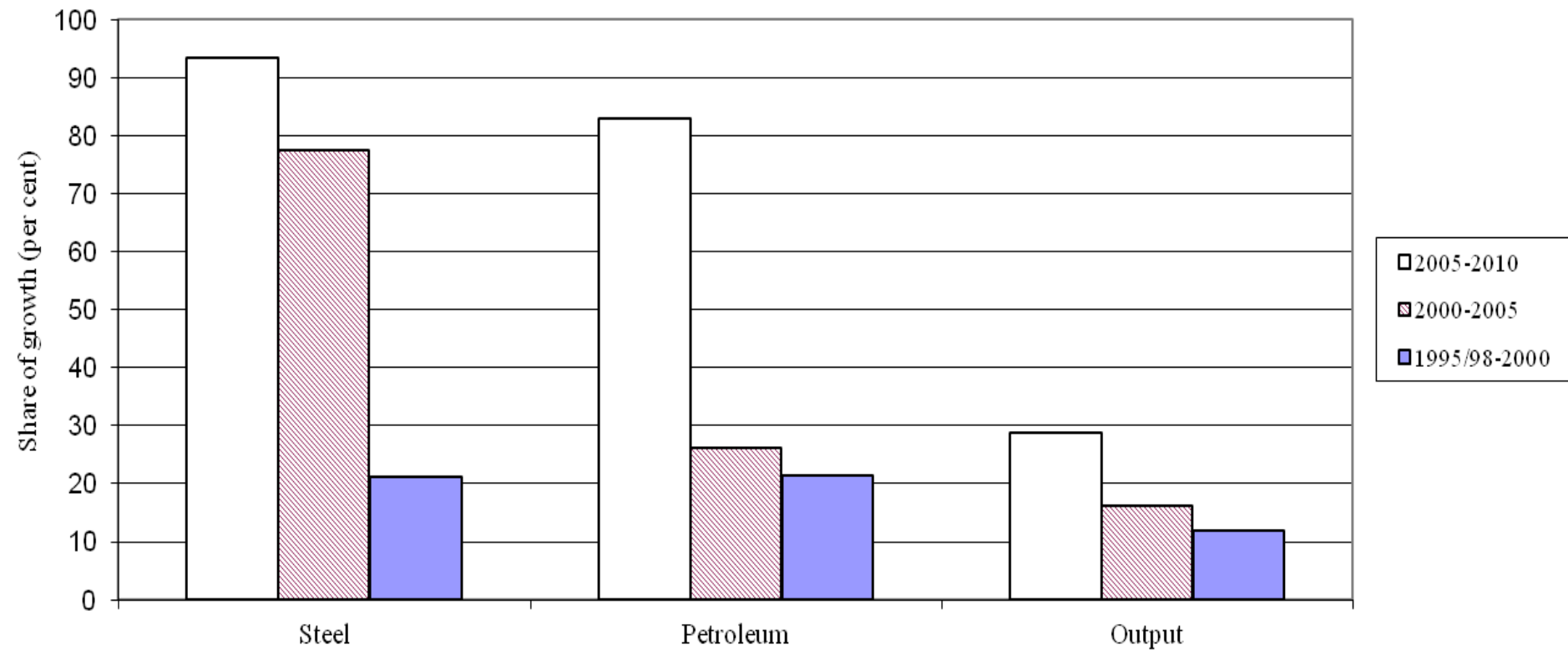
Source: Treasury, * Australian GNI/capita in \$US converted at exchange rate of year concerned

This was a China Resources Boom

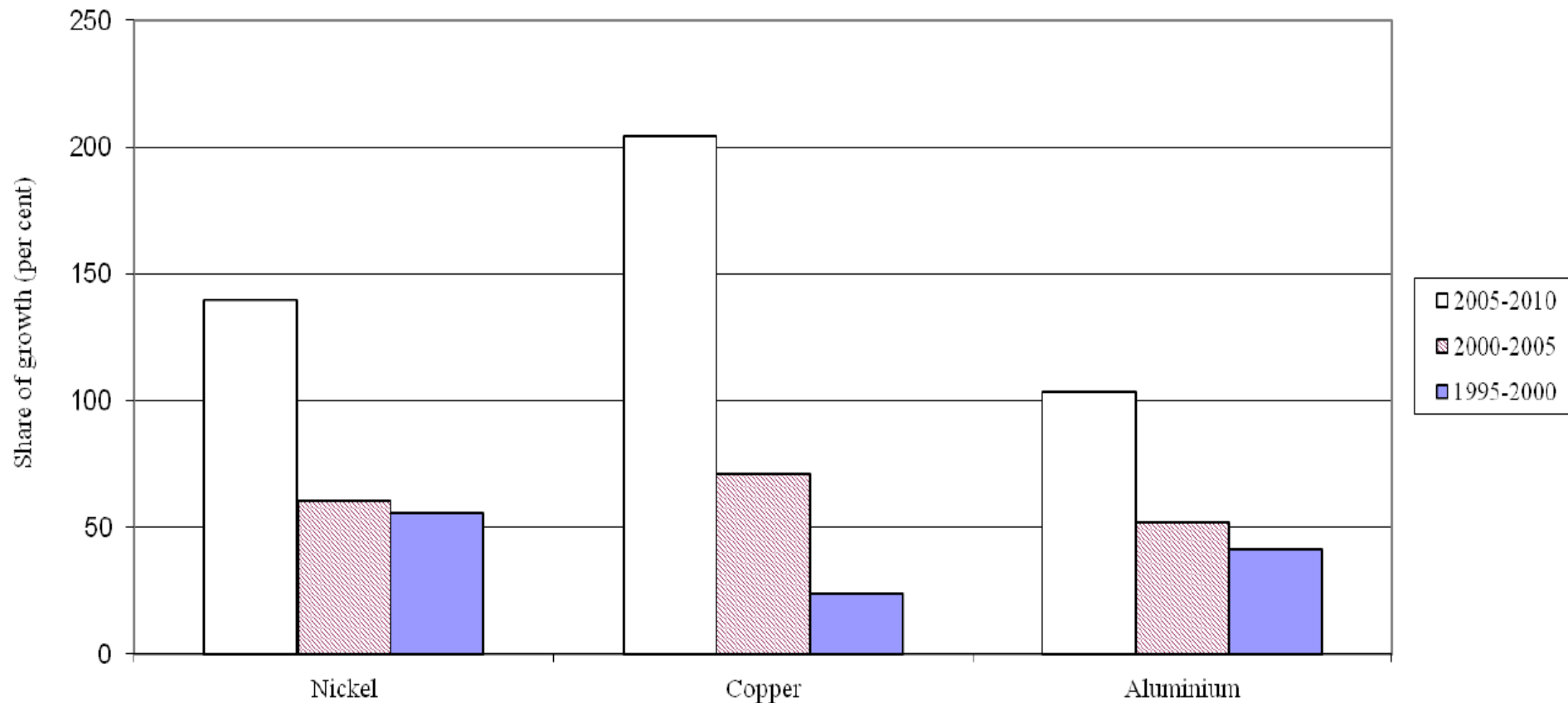
- ▶ Unusual energy and metals intensity of rapid Chinese growth
- ▶ Some similarities with earlier Northeast Asia
- ▶ Very different from Southeast and South Asia



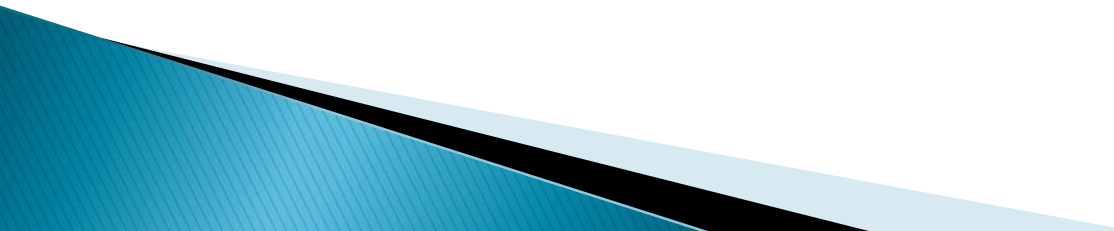
China's shares of incremental world demand for petroleum (1995-2010), and crude steel (1998-2010) , world output (1995-2010)

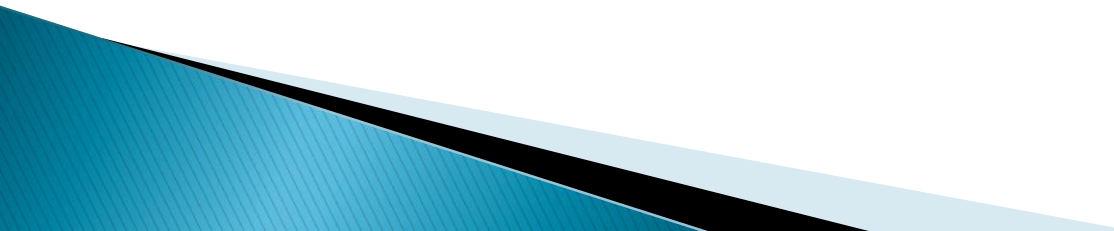


China's shares of incremental world demand for three metals 1995-2010 (per cent)

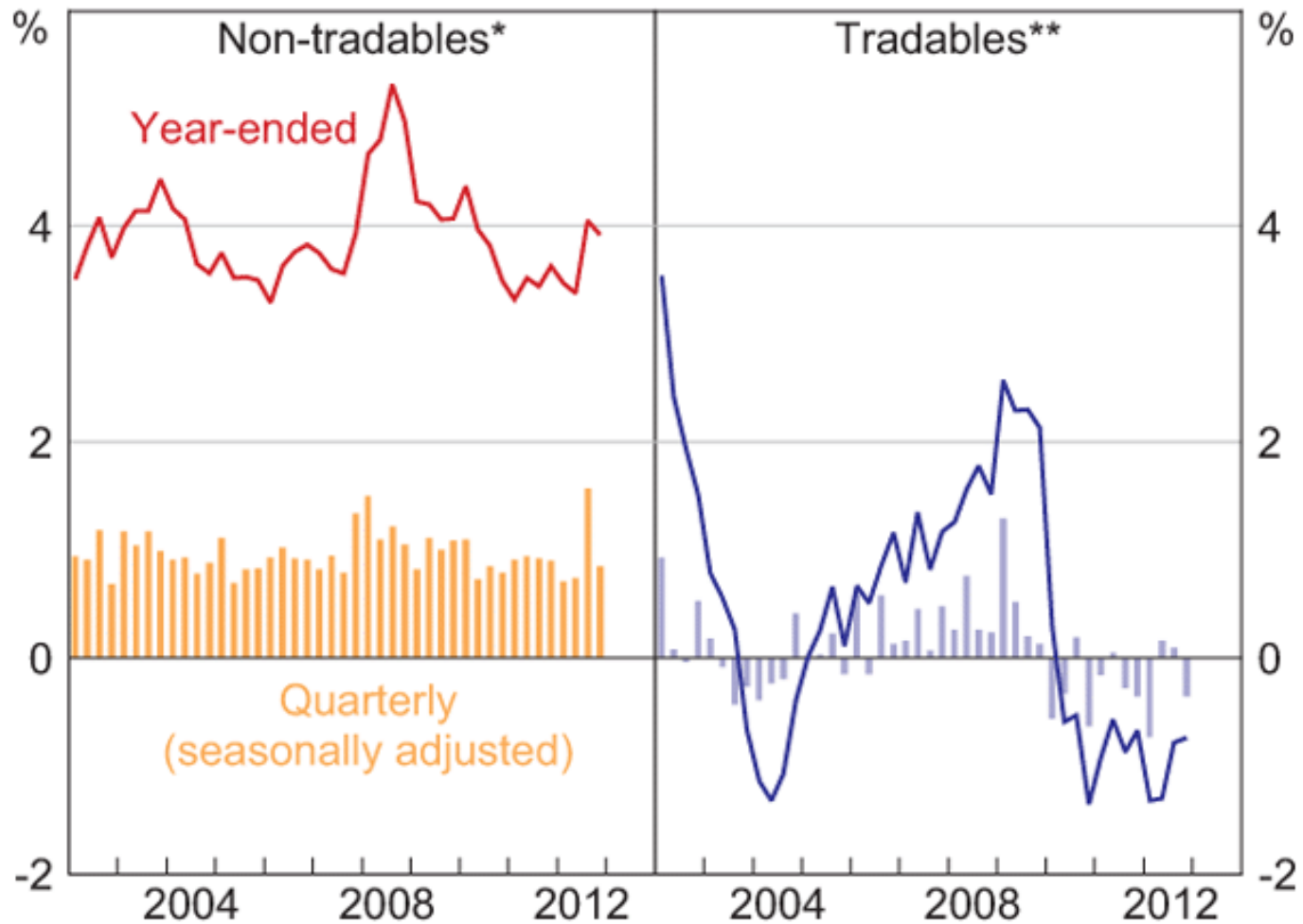


China Resources boom ending

- ▶ Moderate slowing of aggregate growth with declining labour force
 - ▶ Less energy and metals intensity after Lewisian Turning Period
 - ▶ Policy emphasis on consumption, equity, services, environmental amenity reinforces this effect
- 

- ▶ Large fall in terms of trade started and much more to come
 - ▶ Very large fall in resources investment to come
 - ▶ While high real exchange rate and Rybczinski have stunted non-resource tradables
 - ▶ High inflation and nominal dollar against developed countries extreme
 - ▶ Gregory and Rybczinski now exacerbated by QEs and safe haven
- 

Non-tradables and Tradables Inflation

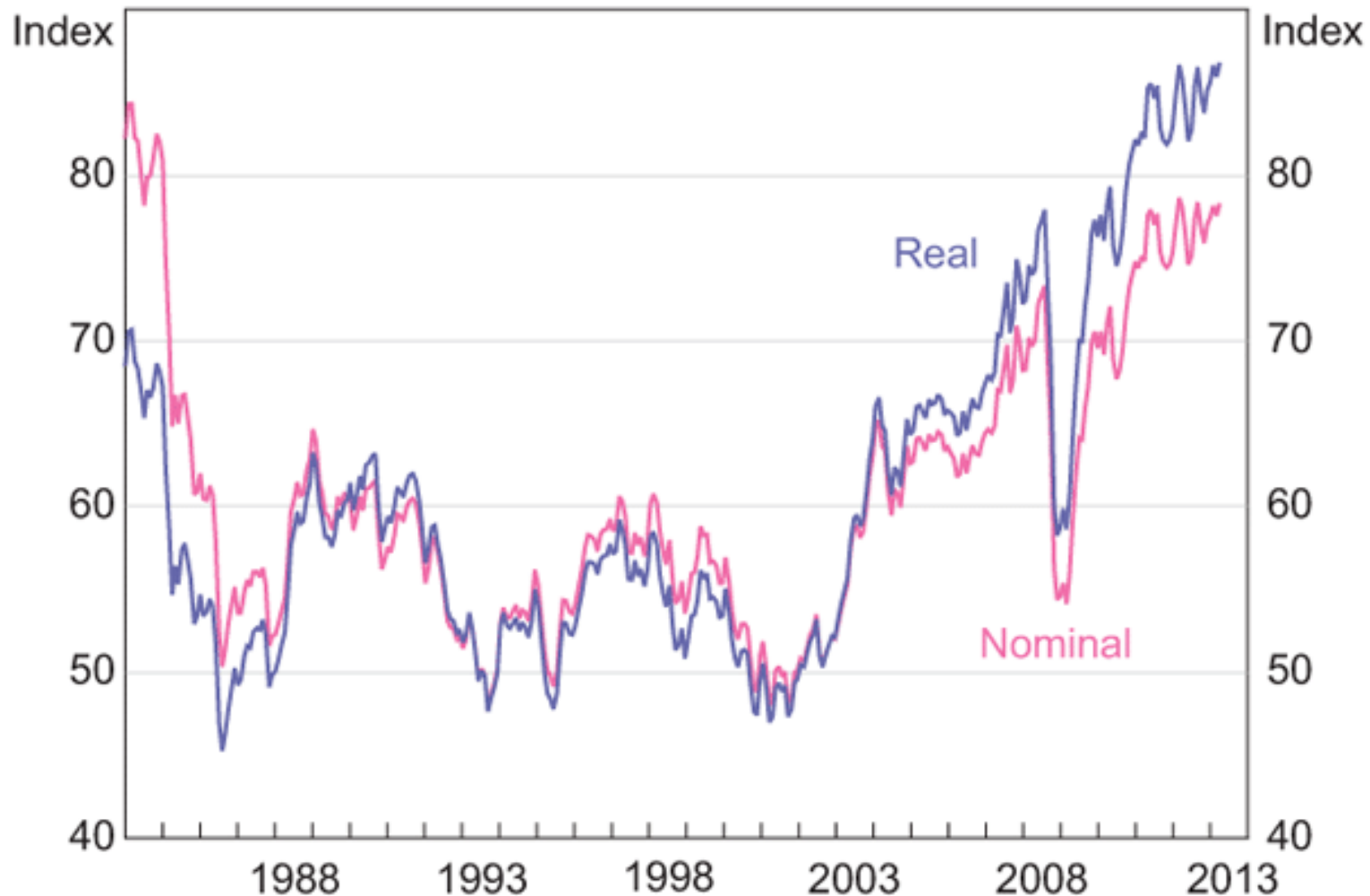


* Excluding deposit & loan facilities to June 2011

** Excluding volatile items (fruit, vegetables & automotive fuel) and tobacco

Sources: ABS; RBA

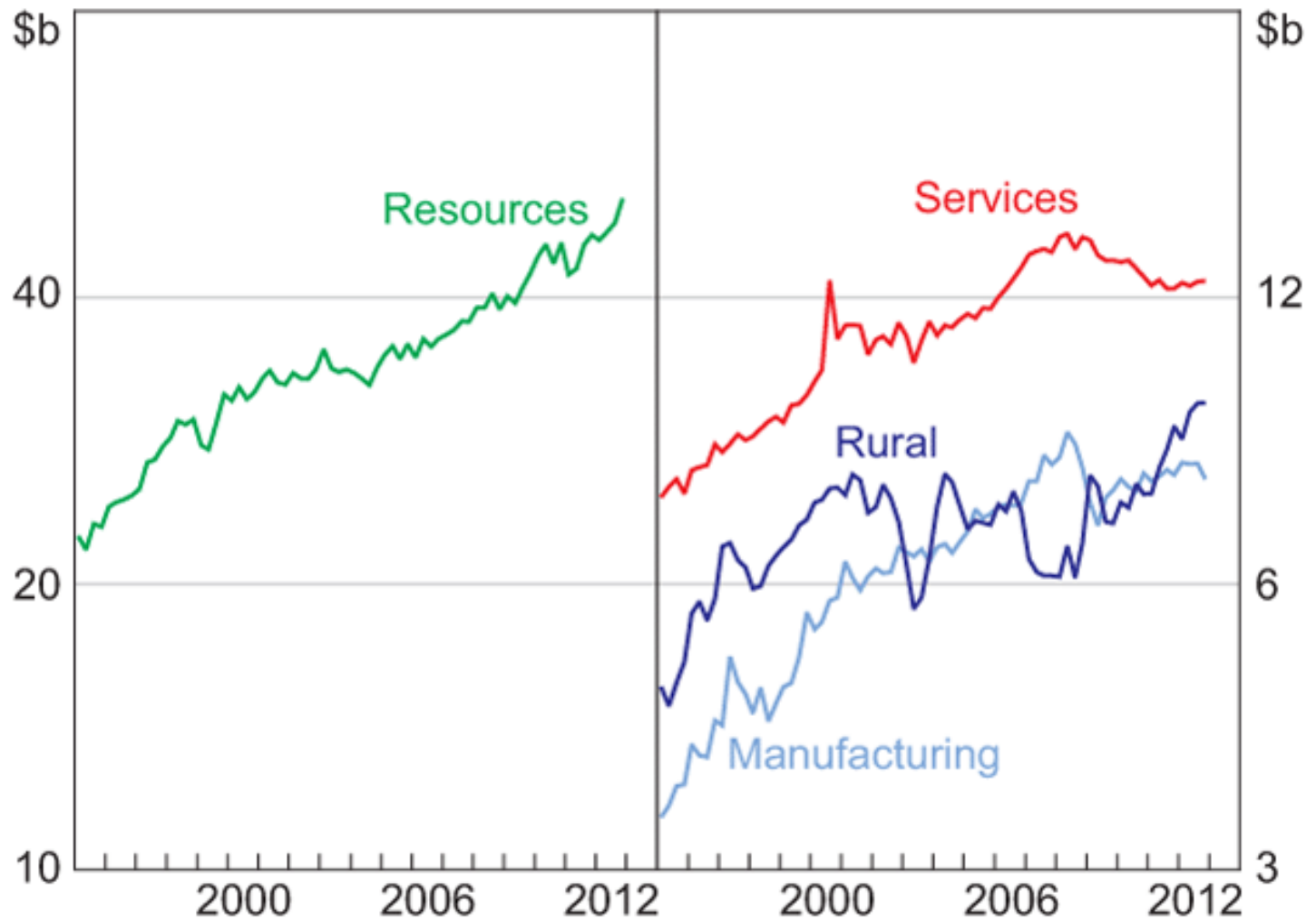
Australian Dollar TWI*



* May 1970 = 100 for nominal; real indexed to equate post-float averages
Sources: ABS; RBA; Thomson Reuters; WM/Reuters

Export Volumes

Quarterly, 2010/11 prices, log scale

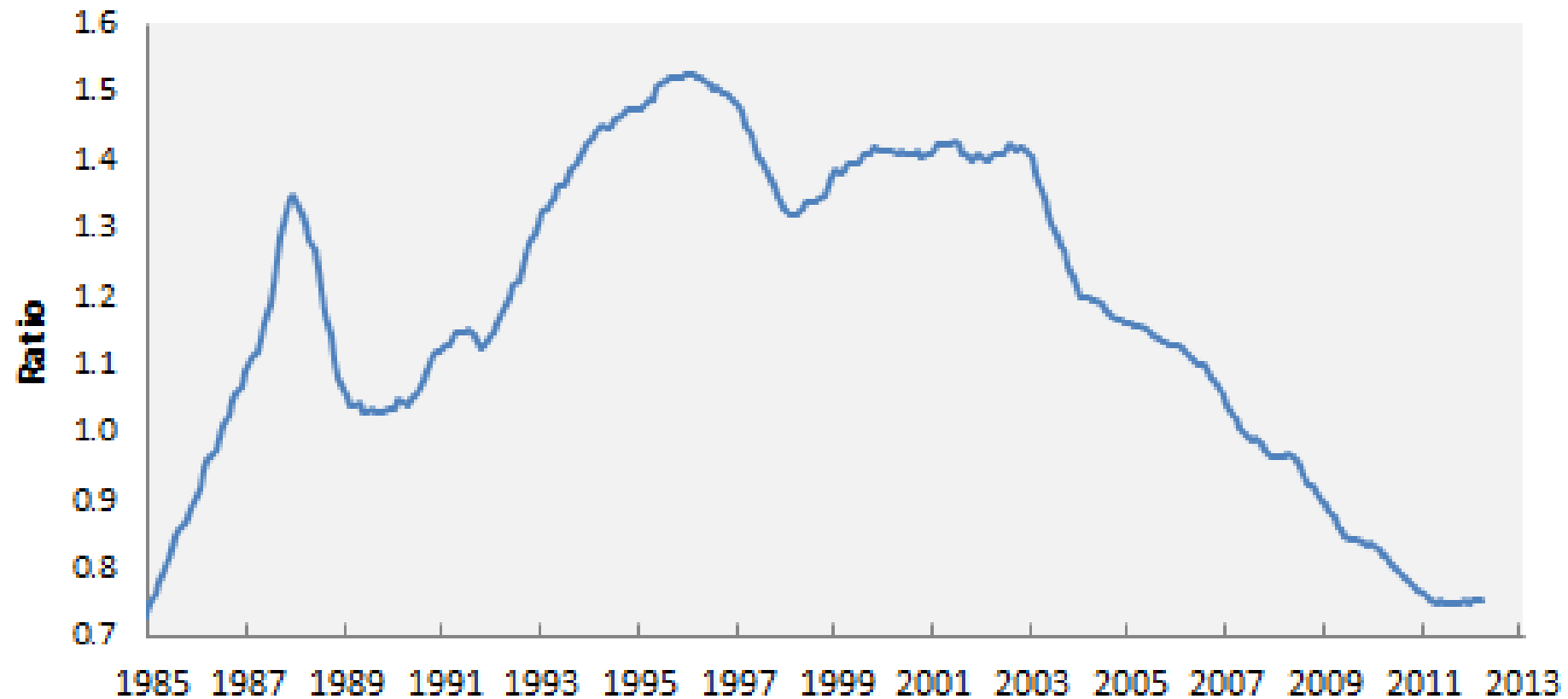


Source: ABS

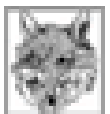
Tourism Levels: Arrivals to Departures (Rolling Annual)

MACRO
BUSINESS
SUPERBLOG

Source: Australian Bureau of Statistics

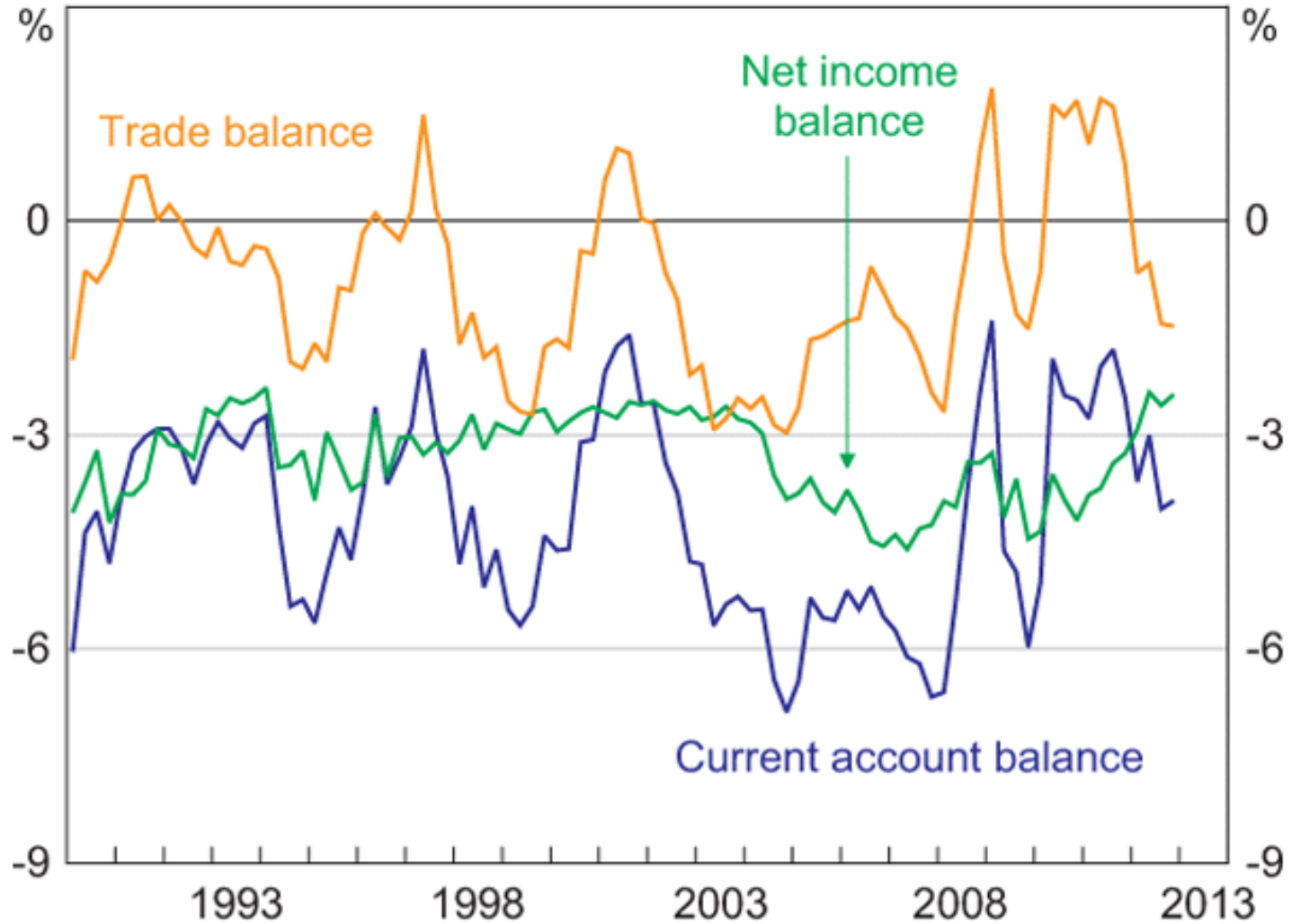


www.macrobusiness.com.au



Current Account Balance

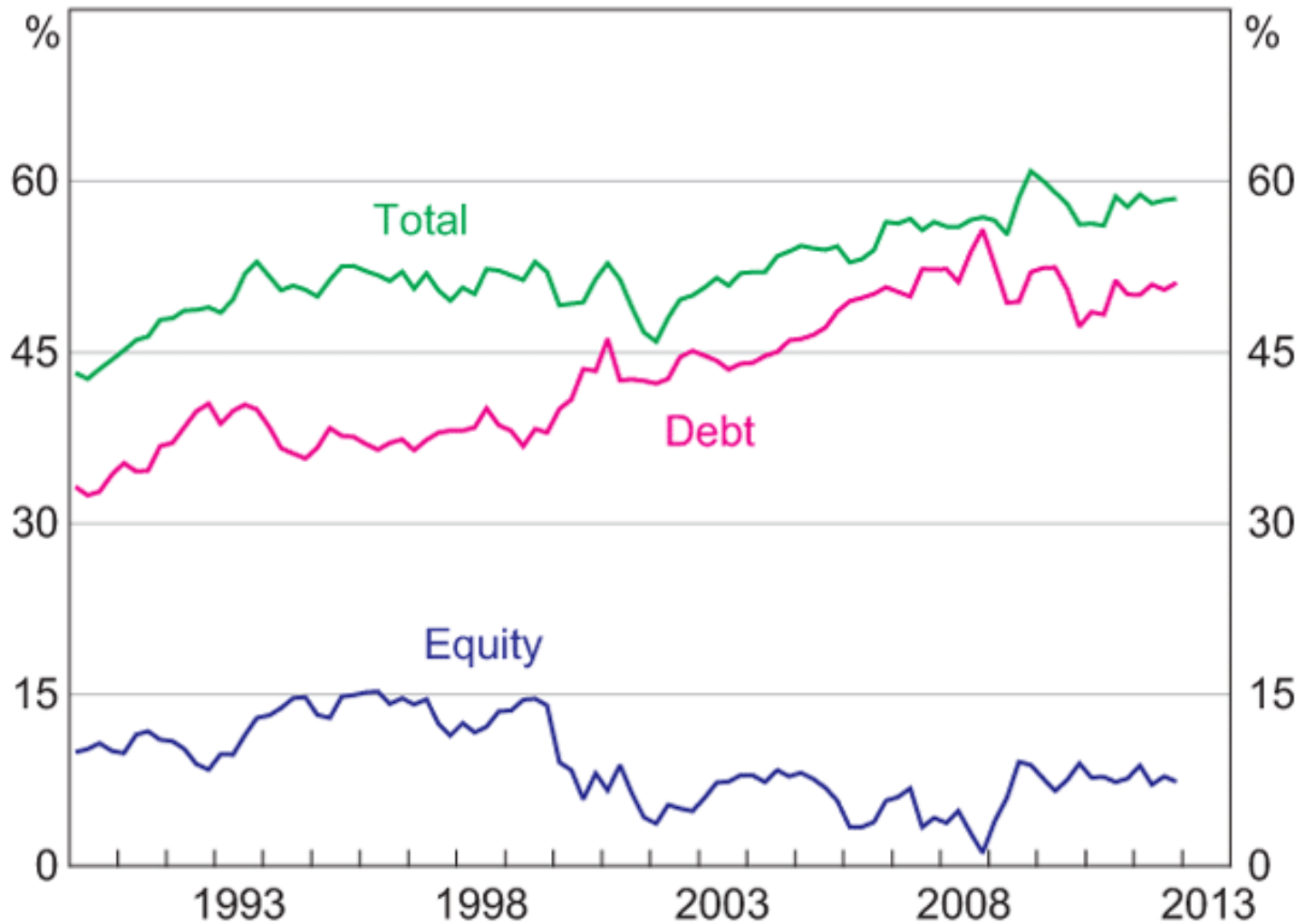
Per cent of nominal GDP



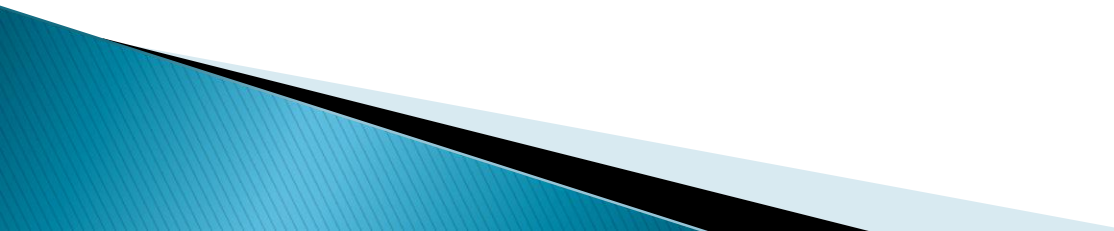
Source: ABS

Net Foreign Liabilities

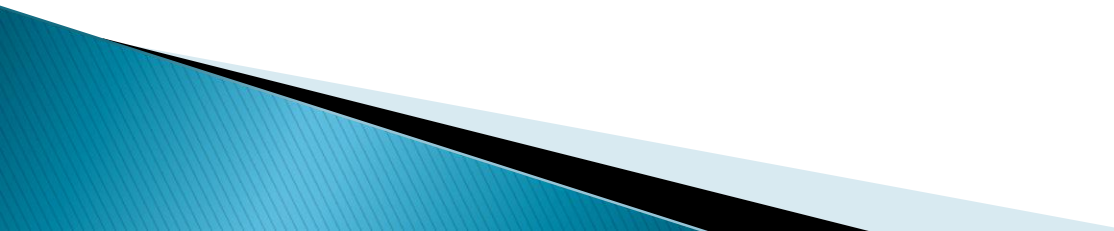
Per cent of nominal GDP

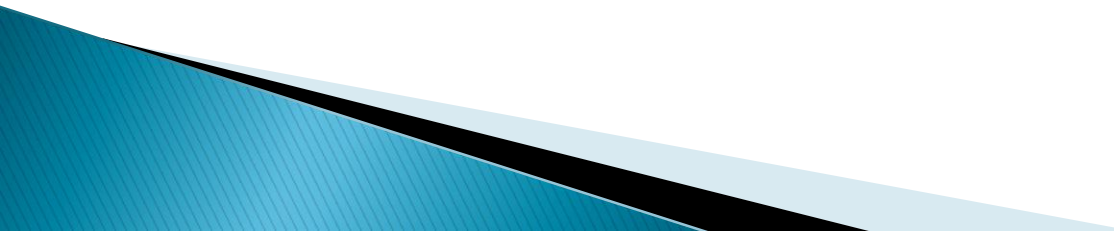


Source: ABS

- ▶ Big recessionary tendency from fall in terms of trade and resources investment
 - ▶ Reflected in much weaker budget and large currency depreciation
 - ▶ Continued application of balanced budget and inflation targeting means deep recession
 - ▶ Correction through fiscal expansion unsustainable externally
 - ▶ Can expand nominal but not real expenditure with big switching to tradables
 - ▶ That means big real depreciation
- 

Will get big nominal depreciation triggered by:

- ▶ fall in terms of trade
 - ▶ falls in resources investment
 - ▶ eventual monetary tightening abroad
 - ▶ our own monetary easing
- 

- ▶ Depreciation will lift inflation above band – need to suspend target through adjustment
 - ▶ While avoiding non-tradables inflation
 - ▶ The big game is to make fall in dollar a real depreciation and to restore strong growth in investment and exports of diversified tradable services and goods
- 

Fall in general living standards and rise in unemployment minimised by:

- ▶ broadly based income restraint
 - ▶ uninhibited pursuit of productivity growth
 - ▶ rational investment in productive infrastructure
 - ▶ removal of entitlement to benefits of bad regulatory policies
 - ▶ efficient taxation of normal business income and rents
 - ▶ even handed taxation of all income
 - ▶ reform of middle class welfare without reducing incentives for participation
 - ▶ economically efficient environmental policies
 - ▶ maintain immigration with high skill content
- 