

Current State and Forecast of Australia Marco-Economy

Yiyu Zhou

*Building 7, jiading campus, Shanghai University, 20 chengzhong road, jiading district, Shanghai,
201800, China*

zhouyiyuzyy@163.com

Keywords: Australian economy, Australian consumer spending, Government spending, Australian investment

Abstract: This report first describes the current Australian economy affected by the G20 summit and the inauguration of President Donald John Trump. The report shows five factors, which affected the Australian national GDP: Consumptions, Investments, Government Expenditures, Export, and Import. According to these factors, the report forecasts the future economic growth in 2018. This report will use macroeconomics indicators (GDP, Inflation, Unemployment Rate) to predict the future monetary policy, which the Reserve bank will take to change the Australian cash rate.

1. Introduction

G20 summit is aimed to push industrialized countries and emerging market to seek for cooperation and promote the continuing growth of the international economy. Also, as President Donald Trump has demanded a shake-up of the WTO caused the international economy flexible during this period. The factor above causes the Australian economy turns to fluctuate during 2017-2018 (Tom 2018). According to figure 1, the GDP has increased in 2017. The unemployment rate is reducing, and the inflation is going up after an extended period low in a previous year. The first part of the report will focus on the current situations of the Australian economy using the expenditure approach of Keynesian Model. Individually, there are five components of GDP which include expenditures of consumptions, investments, government expenditures, export and import which will be discussed in the following report. The second part will predict the future cash rate changes controlled by the Reserve Bank of Australia and will provide an analysis of monetary policy by using AD/AS model to achieve a new equilibrium (when real GDP equal to the potential GDP).

2. An outline of situations and forecast of the Australian economy in 2018

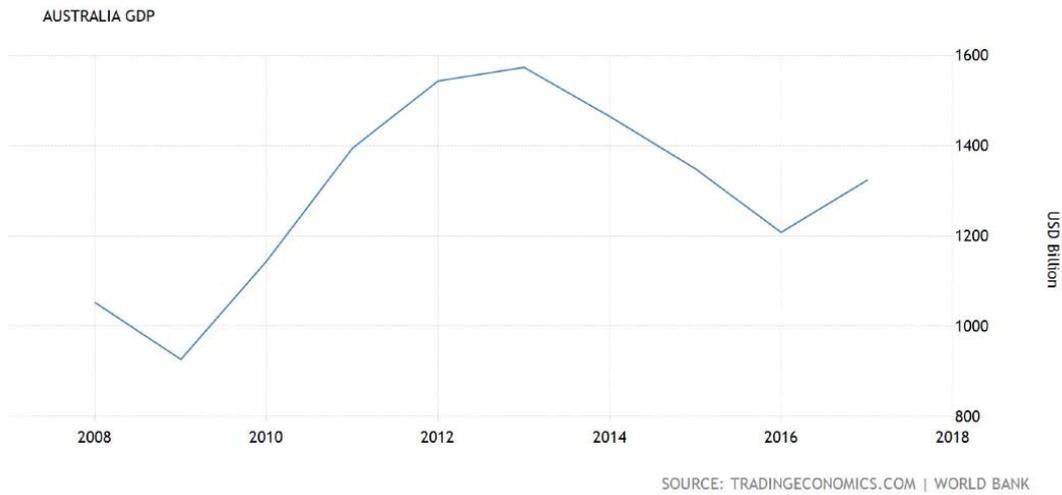


Figure 1. Australia GDP (Trading Economics 2018)

2.1 Consumption

As Figure 2 shows, Australian Consumer spending continually increased until 2018. The Australian disposable personal income increased to 297,957 AUD Million in the first quarter of 2018 which is the peak of Australian disposable personal income from 2015 as shown in figure 3(Trading Economics 2018). Therefore, the Australian households have larger consumption capacity in 2018. The figure 4 indicates that the Australia government created 415,000 jobs in 2017, which is also a significant activity to help towards increasing Australian consumer spending (Commonwealth of Australia 2018). As shown in both figures, there is a positive correlation between the disposable income and consumptions rates the in Australia. The growth of the consumption is synchronized with the income during the previous three years.



Figure 2. Australian Consumer Spending(Trading Economics 2018)



Figure 3. Australian Disposable Personal Income(Trading Economics 2018)

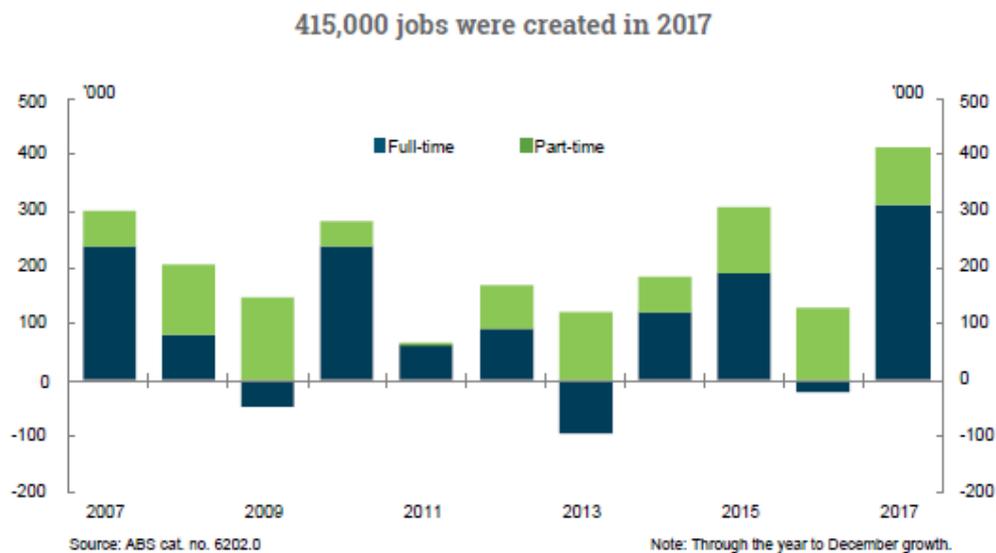


Figure 4. Australian Jobs in 2017 (Commonwealth of Australia 2018)

2.2 Investment

Due to the increase of Australian GDP, investment increases in Australia. The non-mining investment has grown about 12.5% than last year. However, the mining investment has reduced less than previous year as shown in figure5 (Commonwealth of Australia 2018). Business confidence is one of the most critical indicators of investment. Since 2016, the business confidence of the Australia business is markable growth. The non-mining business investment is great to increase, especially in building & structures investment as shown in figure 6(Commonwealth of Australia 2018). However, though 2016 the mining investment confidence decrease, Australian business begins to make more non-mining investments because the business confidence of non-mining becomes stronger than the previous (Commonwealth of Australia 2018). This action can cause the national GDP growth. The tax rate is also a key component.

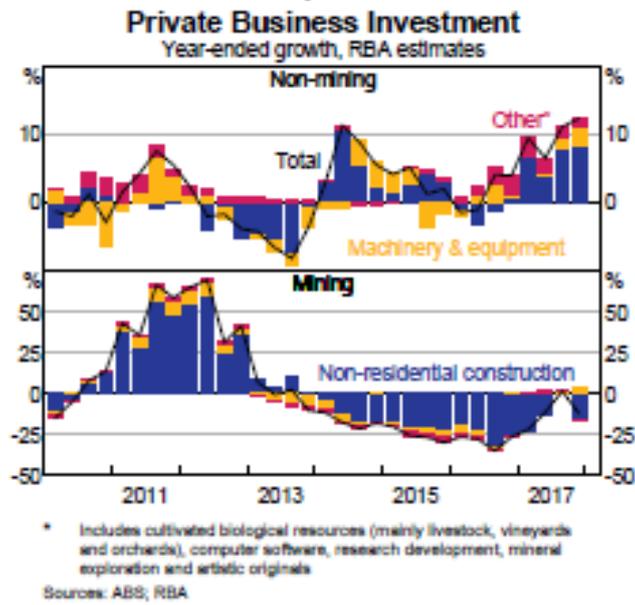


Figure 5. Private Business Investment (Commonwealth of Australia 2018)

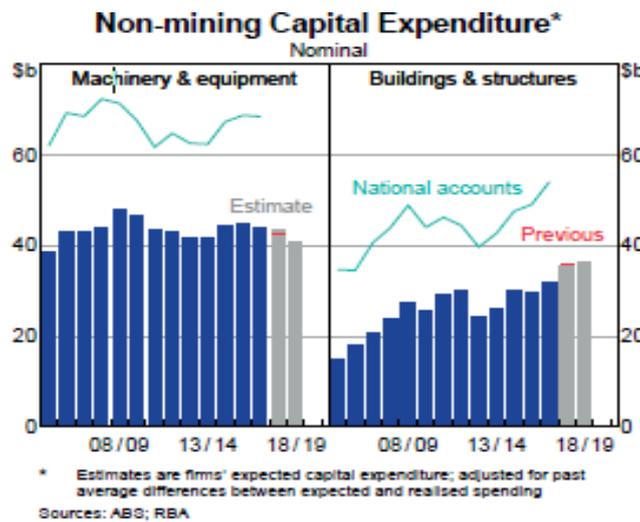


Figure 6. Non-mining Capital Expenditure (Commonwealth of Australia 2018)

From the figure 7, Australia keeps at 30% of the tax rate in the past decades, which is 5% lower than that of the United States (Trading Economics 2018). If the country has a great plan on cooperation tax of a country, it can help companies to ease their burden and help the country attract a large number of new investments to support the growth of the GDP.

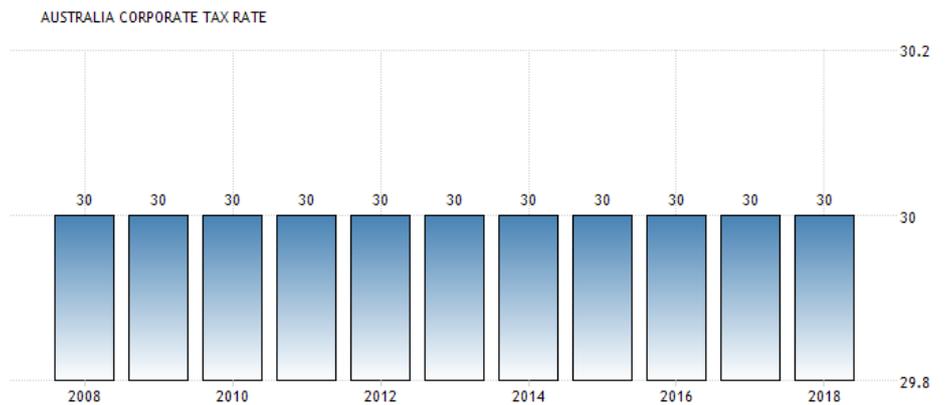


Figure 7. Australian Corporate Tax Rate(Trading Economics 2018)

2.3 Government

Government spending is an important variable that can drive the economy. The government debt to GDP ratio is an indicator of government spending. This indicator helps the government to decide the percentages of GDP that the government put into the economy as government intervention. In figure 8 below, the Australian government debt to GDP ratio has risen steadily during the past ten years. It arrived at the highest point which is 41.9% in 2017(Trading Economics 2018). During 2018, the total government spending increased by about 4.2% compared to the expenses in 2017 which is estimated to be \$488.6 billion. During 2018, there is a large part of the expenses spent on social security and welfare, health and other purposes. Meanwhile, the government also spends a huge amount to create more jobs in the labor market and encourage business to provide more job opportunities at the same time (Commonwealth of Australia 2018).



Figure 8. Australia Government Debt to GDP(Trading Economics 2018)

2.4 Import (M)

The import of Australia has increased in 2017. Import is the intensive portion supporting the growth of the economy. Therefore, commodities, especially iron ore, will slow down in the coming period, while low-cost producers will increase supply (Secretary's department, 2018). This results in a falling of the commodity prices during the time. Therefore, the terms of trade will decline during the medium term.

Consistent with the improvement of the domestic economic situation, imports increased by about 7% in 2017 (Secretary's department, 2018). Import growth has a broad base, with consumption, capital, intermediate, and increasing of service imports, especially the growth of commercial & investment. Those are much higher than others expenditure components, resulting in an increase in imports over the past year. (Figure 9)

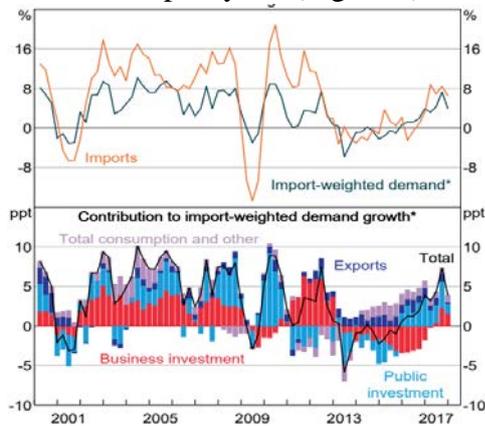


Figure 9. (Secretary's department, 2018)

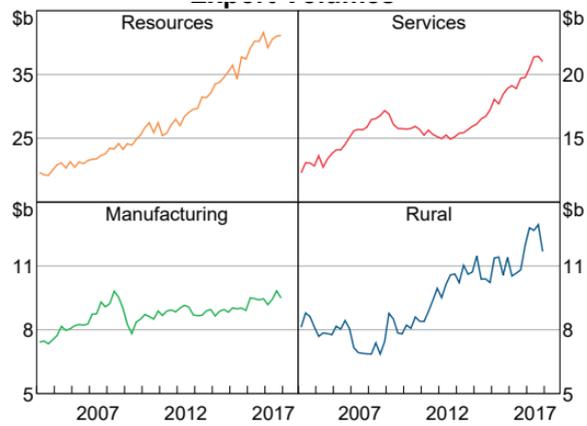


Figure 10. (Secretary's department, 2018)

2.5 Export (X)

The export of Australia in the last quarter of 2017 temporarily declines which has led to the export supplying factors coming in to resolve the decline in 2018. Export growth is expected to increase in 2018 and 2019 as additional LNG (Liquefied Natural Gas) production goes online, and growth support services and exports of manufactured goods continue to grow. In December, although the exports contracted, there was a growth of about 1% from 2017 (Figure 10) (Secretary's department, 2018). Crop exports were particularly weak this quarter due to adverse weather conditions that led to a decline in cereal and other crop production; and because of temporary factors, the coal exports fell done in the December quarter.

Non-resource export growth in 2017 was driven by service exports, which increased by about 6%. Education and tourism exports keep growing fast and the service export growth over the past five years (Secretary's department, 2018). The growth in education exports in recent years reflects the strong growth in the number of students in a range of countries, including China and India (Secretary's department, 2018). In recent years, the growth of tourism exports has been quite extensive, and the contribution of Chinese tourists has been remarkable. (Figure 11)

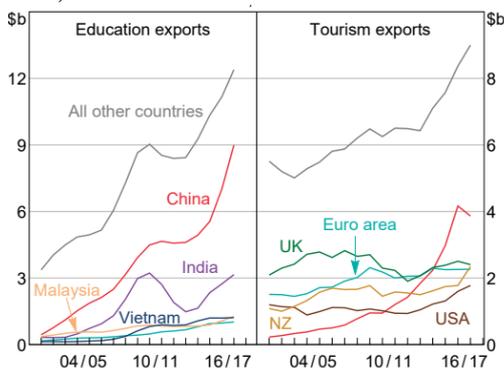


Figure 11. (Secretary's department, 2018)

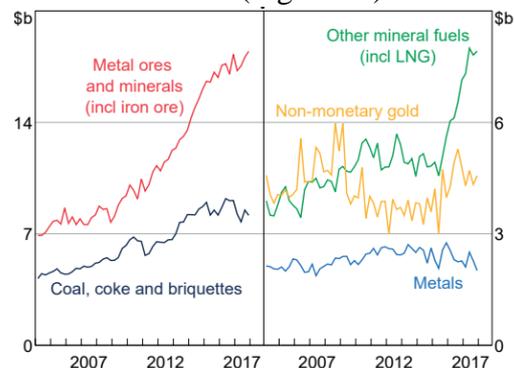


Figure 12. (Secretary's department, 2018)

2.6 Net Export (X-M)

Based on the description of the import & export in 2017, the net export declined slightly, making the aggregate expenditure decrease.

Due to the good growth prospects of Australia's major trading partners, the service export momentum is expected to keep growing. Resource exports maintained at a high level in 2017. LNG exports continued to grow, up to 20% in 2017 (Secretary's department, 2018). Iron ore exports increased slowly, and coal exports declined (Figure 12) (Secretary's department, 2018). In recent years, with the additional production capacity on the line, resource exports have grown strongly. With the rise of existing LNG projects and the completion of other projects, it is expected to increase further in the next few years. Iron ore exports are willing to increase slightly in the coming years as the productivity of major miners increase. Although resource exports will reach the record levels, they have not made any further substantial contribution to GDP growth since then. In recent years, the increase in resource export revenues has led to a shift in the trade surplus and a reduction in the current account deficit. However, the recent trade surplus has slowed down as the volume of imports has increased and the overall export growth has slowed. The continued net foreign debt position of Australia and the rest of the world mean that the net income balance is still at a loss.

3. The prediction of cash rate which controlled by the central bank of Australia

According to Part1, there is a recessionary gap in the Keynesian AE model in the Australian economy. An Aggregate Demand (AD) and Aggregate Supply (AS) model (figure13) will be utilized to illustrate the current situation and the analysis the future actions of Reserve Bank of Australia (RBA) established. The RBA needs to take monetary policy actions to cover the recessionary gap which is the expansionary monetary policy.

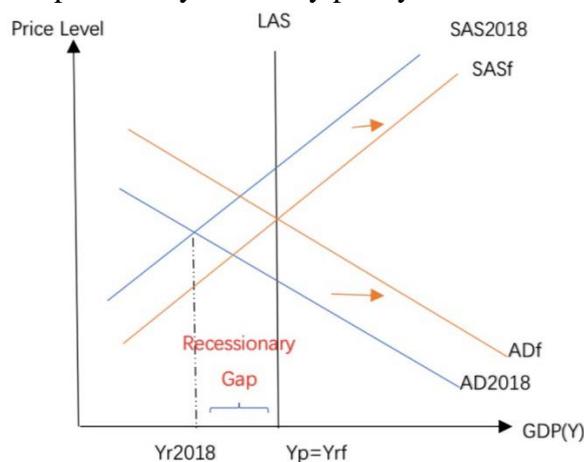


Figure 13. AD-AS model

From the figure 13, the Australian real GDP is below the potential GDP; the potential GDP is the Australian economy at full employment. Thus, RBA will use the expansionary monetary policy to reduce the cash rate.

3.1 GDP

When the cash rate decreases, households will spend more money on consumption. For example, when banks' interest rates of savings reduce, citizens will choose to spend more money either on

consumption or investment instead of saving the money in the bank. Once the cash rate decrease, the Australian exchange currency rate will decrease which makes more overseas demand and less import of Australia. The above factors will impact AD shift to the right. In the short term, the price level and GDP will increase.

3.2 Unemployment

During the recessionary gap, the rate of unemployment is high, which will make the wage rate go down. Reduction in the purchasing power leads to a decrease in the price of raw materials. In turn, the low cost of production supports increased production, and the amount of supply factories are willing to make with the prevailing market price. Thus, the short aggregate supply will shift rightward. In the short term, as the figure- shows, the price level will decrease while the GDP will increase. The expansion of the cash rate will make companies or businesses to provide more jobs for the labor force. In other words, the unemployment will go down.

3.3 Inflation

However, though the expansionary monetary policy will make the Aggregate Demand (AD) and Aggregate Supply (AS) increase and stimulate economic growth, the price level remains unchanged as evident in the figure illustrating that the rise in the AD and AS will push the economy into a new equilibrium where the GDP is higher, and the price level remains the same.

4. Conclusion

Based on the current situations in Australia, this report focuses on five variables including consumption, investment, government expenditure, export, and import. According to the analysis from part 1, the real GDP growth was slightly lower than the potential GDP. Therefore, this report uses AD/AS model by reducing cash rate to eliminate the recessionary gap. When the cash rate decreases, the expenditure on consumption, investment and net export go up which stimulates demand and possesses a positive effect on GDP and price level. At the same time, the expansionary policy will help reduce the unemployment rate. On the other hand, the lower wage rate will cut the firms' cost that can increase aggregate supply. In the end, the intersection creates a new equilibrium with a higher GDP, and the price level remains unchanged in the long run, leaving the real GDP equal to the potential GDP. The cash rate changed by the Reserve Bank of Australia maintains the price stability and facilitates macroeconomy at full employment.

References

- [1] Commonwealth of Australia 2018, *Budget 2017-18 Overview*, viewed 29 August 2019 <https://www.budget.gov.au/201819/content/sections/overview/downloads/Budget_2018-19_Budget_Overview.pdf>.
- [2] Secretary's department 2018, *Statement on Monetary Policy*, Reserve bank of Australia publish, Australia <https://online.uts.edu.au/webapps/blackboard/execute/content/file?cmd=view&content_id=_3035550_1&course_id=_36279_1>.
- [3] Tom, M., 2018, *UPDATE 1-Mexico still preparing for U.S. car tariffs, backs WTO reform*, viewed 29 August 2018, <<https://www.cnn.com/2018/07/31/reuters-america-update-1-mexico-still-preparing-for-u-s-car-tariffs-backs-wto-reform.html>>.
- [4] Tradingeconomics.com, 2018, *Australia Consumer Spending 1959-2018 | Data*, viewed 29 August 2018, <<https://tradingeconomics.com/australia/consumerspending>>.
- [5] Tradingeconomics.com, 2018, *Australia Corporate tax rate 1959-2018 | Data*, viewed 29 August 2018, <<https://tradingeconomics.com/australia/corporate-tax-rate>>.
- [6] Tradingeconomics.com, 2018, *Australia Disposable Personal Income 1959-2018 |Data*, viewed 29 August 2018, <<https://tradingeconomics.com/australia/disposable-personal-income>>.

[7] *Tradingeconomics.com, 2018, Australia GDP 1959-2018 | Data, viewed 29 August 2018, <<https://tradingeconomics.com/australia/gdp>>.*

[8] *Tradingeconomics.com, 2018, Australia government debt to gdp 1959-2018 | Data, Viewed 29 August 2018, <<https://tradingeconomics.com/australia/government-debt-to-gdp>>.*