Chapter 3

Australia's current account – key issues

At some point, net external liabilities to GDP have to stop rising. They cannot go on going up forever, but it is far from obvious how much further net external liabilities to GDP could rise.[1]

Background

3.1 This section of the report explores a number of key issues relating to Australia's current account which were raised in submissions to the Inquiry, and discussed during the Round Table held in Canberra on 15 August 2005.

3.2 The economists who participated in the Round Table were:

- Professor Ross Garnaut, Professor of Economics, Division of Economics, Research School of Pacific and Asian Studies, Australian National University;
- Dr David Gruen, Chief Adviser (Domestic), Macroeconomic Group, Department of the Treasury;
- Mr John Hawkins, Manager, Domestic Economy Division, Department of the Treasury;
- Mr Anthony Pearson, Head of Australian Economics, ANZ Banking Group;
- Mr Michael Potter, Director of Economics and Taxation, Australian Chamber of Commerce and Industry; and
- Dr Richard Simes, Vice President, CRA International (appearing in a private capacity).

3.3 Evidence presented by Mr Pat Conroy, National Projects Officer of the Australian Manufacturing Workers Union (AMWU) at the public hearing in Sydney on 16 May 2005 was also considered in the context of this chapter.

3.4 At the conclusion of the Round Table, the Chair invited each participant to make concluding remarks. The concluding remarks are set out in full in Appendix 4 to this report, as they are a good summation of the views expressed.

3.5 The key issues which were considered during the Inquiry are expressed as a series of questions in this chapter.

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1 Dr David Gruen, Department of the Treasury, *Proof Committee Hansard*, 15 August 2005, p. E2.

What has been driving the Current Account Deficit?

3.6 There was general agreement in the evidence received by the Committee that the household sector has been the main driver behind the Current Account Deficit (CAD) in recent years.[2]

3.7 Professor Garnaut expressed it this way:

> The biggest single cause of a large current account deficit is the decline in household savings, which I think most economists … would attribute above all else, directly and indirectly, to the extraordinary wealth effects of our housing boom, which is large by our historical standards and large by world standards. It led Australian households … to think that they were very wealthy and very comfortable, and that they could comfortably go through a period of higher consumption expenditure and low, zero or negative savings …[3]

3.8 Dr Gruen also believes that the present CAD is attributable to the household sector. He said:

> In the last 25 years it is only in the last couple of years that the household sector has run a savings-investment imbalance of the order of the size of the current account. I think it is reasonable from that perspective to say that it is the household sector where, if you like, you can explain why the current account has been as large as it has recently. I think it is reasonable to say that that is largely a consequence of savings-investments decisions by the household sector.[4]

3.9 Likewise, Mr Conroy identified households as the driver of economic growth in recent years:

> The growth in household debt has been the driver of Australia's economic growth over the last eight years and in particular the last two years.[5]

3.10 But Mr Pearson said that he preferred to look at the CAD from a trade perspective. He attributes the present high CAD to an 'acceleration of import growth since 2001, particularly in volume terms, but in particular there has been flatness in the volume of exports'. That meant a widening trade deficit which fed into a high

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2 See also the discussion on the saving/investment perspective of the current account in paras 2.21 to 2.26 in Chapter 2.

3 *Proof Committee Hansard*, 15 August 2005, p. E4.

4 *Proof Committee Hansard*, 15 August 2005, p. E8.

5 *Official Committee Hansard*, 16 May 2005, p. E13.

CAD. However, he considered that the breaking of the drought would lift agricultural exports and higher prices for minerals and energy can also be expected to lift exports.[6]

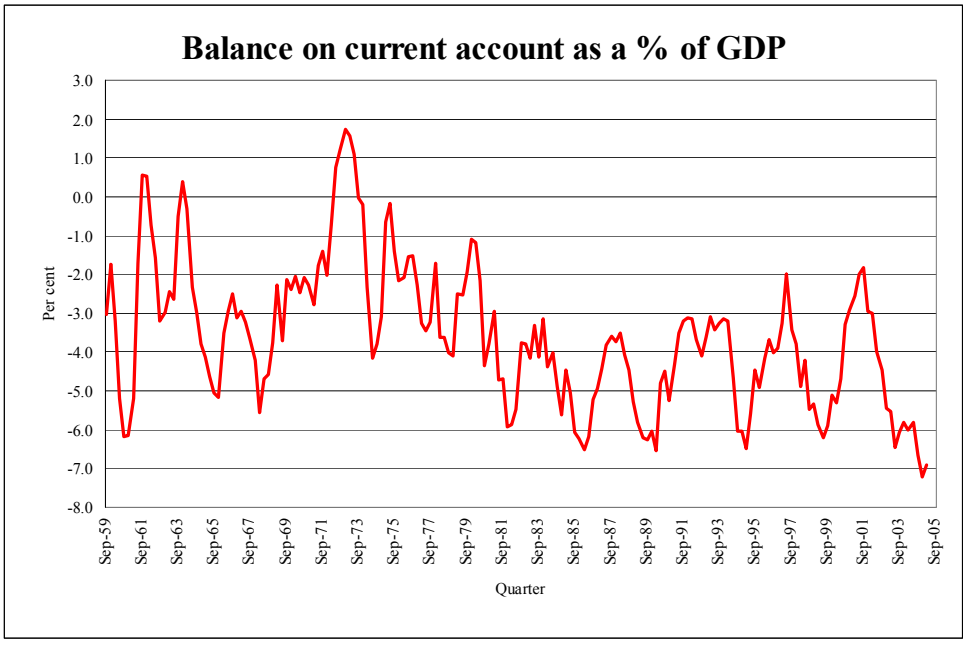
What is the outlook for Australia's current account?

3.11 At the Round Table discussion Dr Simes expressed the view that the average of the CAD is moving up to a new and higher level. He said:

> My assessment of the numbers is that, after some of the things in the system work their way through, we are probably looking at the average of the current account deficit to GDP increasing from around 4½ per cent to maybe between five and six per cent.[7]

3.12 Figure 3.1 shows the wide fluctuations over the last 45 years in the balance of the current account when expressed as a percentage of GDP. As discussed in Chapter 2, the current account has been in continuous deficit since 1973 and the deficits appear to be increasing in size, both in dollar terms and as a percentage of GDP.[8]

Figure 3.1: Balance on current account as a percentage of GDP



Sources: ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0) and *National Income Expenditure and Product* (Cat. No. 5206.0)

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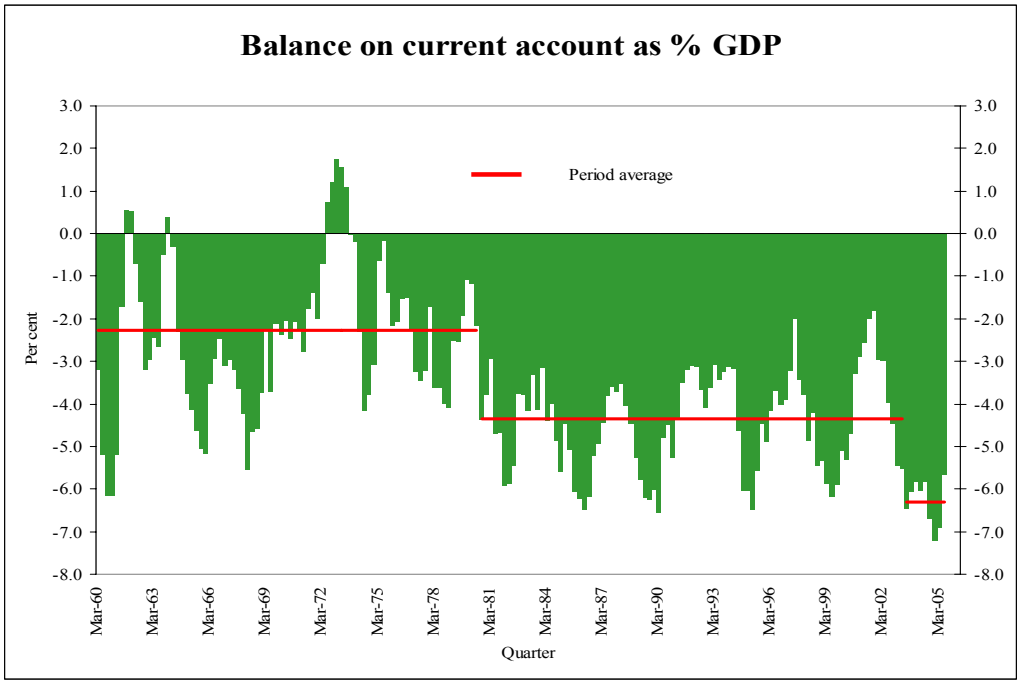
6 *Proof Committee Hansard*, 15 August 2005, p. E6.

7 *Proof Committee Hansard*, 15 August 2005, p. E6.

8 See Table 1 and Figures 1 & 2 in Chapter 2.

3.13 A way of looking for trends is to identify if there have been periods which have involved a quantum shift. Figure 3.2 suggests that since 1960 the CAD has experienced two periods involving quantum shifts, with a possible third period starting in 2003.

Figure 3.2: Balance on current account as a percentage of GDP, showing period averages



Source: ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0) and ABS, *National Income Expenditure and Product* (Cat. No. 5206.0). Bars show quarterly results based on original figures.

3.14 Figure 3.2 shows that in the period 1960 - 1980 the CAD averaged 2.4 per cent of GDP. There was a quantum shift to a new level for the period 1981 - 2002, during which the CAD averaged 4.4 per cent of GDP. Figure 3.2 speculates that in 2003 Australia may have taken another quantum step up, to a period when the CAD could average around 6 per cent of GDP per annum.

3.15 During the second 'step' period shown in Figure 3.2 (1981 - 2002) the quarterly CAD was less than the average of the previous period in only two quarters - in the June 2001 quarter (2.0 per cent), and in the September 2001 quarter (1.8 per cent). All the other quarters in the second period recorded current account deficits which were above the 2.4 per cent average for the 1960 - 1980 period.

3.16 There have been several periods since 1960 during which the CAD has exceeded 5 per cent for more than three consecutive quarters. These periods were:

Table 3.1: Periods of consecutive quarters when the CAD exceeded 5% of GDP.

Period	Number of consecutive quarters the CAD exceeded 5% of GDP
June 1960 – March 1961	4
December 1981 – June 1982	3
June 1985 - September 1986	6
December 1988 - March 1990	6
September 1994 – June 1995	4
September 1998 - March 2000	7
December 2002 – present (June 2005)	11

Source: ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0)

3.17 These periods of high CAD appear to be occurring more frequently and for longer.

3.18 The CAD of 5.7 per cent in the June 2005 quarter means that the CAD has now been over 5 per cent of GDP for eleven consecutive quarters (including the new record of 7.2 per cent set in the December 2004 quarter). The average of the CAD for the last 11 quarters was about 6 per cent.[9]

3.19 Mr Conroy opined that the recent current account deficits would have been higher except for the record terms of trade. He said:

> The only reason that the 2004 and 2005 current account deficits have not attracted as much concern as the ones in the mid-80s is due to the record high terms of trade. Had the terms of trade stayed at their 1990s average, the external deficit would now be 10 per cent, not 6.75 per cent, of GDP … These historic terms of trade cannot last and serve to conceal the true nature of Australia's external imbalance.[10]

3.20 Professor Garnaut made a similar point when he said that the recent high levels of CAD would have been even higher except for a fortuitous combination of events - Australia's very high terms of trade and very low international interest rates. He said:

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9 The OECD countries which appear to have CADs of roughly this magnitude are Iceland, Hungary, Greece, the Czech Republic and New Zealand, with the USA not far behind. OECD *Economic Outlook*, No. 77 June 2005, Annex Table 51.

10 *Official Committee Hansard*, 16 May 2005, p. E13. Mr Conroy's comments on the impact of the terms of trade are based on an article in the Australian Financial Review on 6 December 2004, *Beware the terms-of-trade elephant* by Mr Barry Hughes, who is described as an economic consultant to Credit Suisse and other groups.

> There are a couple of features of that big number [CAD of 7.2%] … it has occurred at a time of historically extremely high terms of trade … a time of unusually low global interest rates so that the financing demands of the large external liabilities are less severe than they would be in normal times for international interest rates. If international interest rates were near the average of the last 20 years, rather than historically extremely low, then that would add possibly a couple of per cent to the current account deficit.[11]

3.21 Dr Gruen disagreed as to the level of risk posed by future increases in international interest rates:

> In terms of servicing the foreign debt, I do not think that global interest rates are all that relevant. The ABS did a survey in 2001 of the hedging practices of Australian companies. They have just redone this survey and the results will be published later in the year. When the first survey was done, the ABS was given the answer that 77 per cent of the value of foreign currency denominated debt was hedged back to Australian dollars. That is more than three-quarters. If you hedge foreign currency debt back to Australian dollars, you effectively pay Australian interest rates. I do not know the results of the more recent survey, but, if that is a reasonable reflection of the situation as it is now, the servicing of Australia's foreign debt is largely in Australian interest rates, and a change in global interest rates has a relatively small effect on that.[12]

3.22 Mr Hawkins supported that assessment by Dr Gruen:

> … while we have large net external liabilities to GDP, as had some of the East Asian countries, we are much less vulnerable to a large movement in the exchange rate, because, as David [Gruen] commented earlier, we are not in a position where all our debt is in foreign currency and unhedged. A significant amount of our debt is in Australian dollars and a significant amount of the debt that is not is either hedged in financial markets or naturally hedged through the export flows that companies which have borrowed have.[13]

3.23 But Professor Garnaut cautioned that currency hedging is not risk-free:

> … I think we should not become too complacent about a high proportion of our foreign debt being hedged against currency risk, because there are specific terms to those hedging contracts and when they come to an end they have to be recontracted. And if there is any deterioration in our circumstances—in interest rates, perceptions of capacity to repay the debt of Australian entities or currency risk—then that will affect the terms on which the hedges are rolled over. So that can mean that a problem is phased

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11 *Proof Committee Hansard*, 15 August 2005, p. E3.

12 *Proof Committee Hansard*, 15 August 2005, p. E8. The ABS report referred to is expected to be published during October 2005.

13 *Proof Committee Hansard*, 15 August 2005, p. E14.

in, if things turn against us, but it does not mean to say that you avoid the problem altogether.[14]

Is there a link between offshore borrowing and the current account?

3.24 Offshore borrowing by banks and other financial institutions has increased in recent years.[15] The RBA estimates that the major Australian banks now consistently source around 25 per cent of their liabilities offshore.[16] This suggests that approximately $50 billion per year of funding is sourced from overseas.[17]

3.25 Although offshore borrowing as a transaction is recorded on the capital account (the counterpoint to the current account), is there a link between offshore borrowing and the current account? For example, could a large inflow of funds exert upward pressure on the value of a currency?

3.26 The Committee did not receive any direct evidence of a possible relationship between large inflows of offshore funds and the current account, but it would like to see Treasury undertake further research in this area.

Committee views

3.27 The Committee agrees that the driver of the CAD in recent years has been the household sector which has gone on a spending spree.

3.28 There is evidence that the household sector is now more cautious than a couple of years ago. Household consumption increased by 3 per cent in 2004-05, well below its long-term average. In contrast, business investment increased about 12 per cent and appears to be replacing households as the main driver of economic growth.[18]

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14 *Proof Committee Hansard*, 15 August 2005, p. E34.

15 Between the September 2000 quarter and the March 2005 quarter gross foreign liabilities (other than direct investment liabilities) of financial corporations increased 60%, from $303 billion to $487 billion. As at the March 2005 quarter depository corporations represented 72% of the total. ABS *Balance of Payments and International Investment Position*, cat. 5302.0.

16 RBA, *Financial System Stability: some current observations*, address by John F Laker, Assistant Governor (Financial System), 16 May 2003, p. 4.

17 Table B03 *Banks – liabilities* in the RBA Bulletin indicates that as at 30 June 2005, the banks had overseas liabilities of $275 billion, an increase of $29 billion over the previous financial year.

18 The 2004-05 figures on household consumption and business investment are from the July 2005 publication of ABS *National Income, Expenditure and Product*, Cat. 5206.0.

3.29 The Committee does not agree with Treasury's view that there has been no obvious trend in the balance on current account. The evidence clearly suggests a long-term trend towards larger deficits.

3.30 Could we be in the beginning of a new and higher 'step' level for a CAD averaging around 6 per cent of GDP, as implied in Figure 3.2?

3.31 The long-term trend in the CAD warrants close monitoring by the Government. What would it mean for Australia if the CAD averages around 6% of GDP over an extended period? At what level does the CAD become unsustainable? The Committee believes that such questions need to be asked, researched and debated so that appropriate policy responses can be identified and adopted as required.

3.32 An intriguing issue is that of a possible relationship between the inflow of offshore borrowing and the current account. Can capital inflow of such dimensions exert upward pressure on a currency, with all the consequences of a higher-than-normal currency? Does it matter that much of the overseas borrowings by the financial sector have been for unproductive purposes, unlike corporate borrowings that would increase productivity and exports? Are these borrowings keeping the currency at levels that make it difficult for the export sector to compete in overseas markets? The Committee would like to see more research to clarify whether such linkages exist and their significance.

Recommendation 1

The Committee recommends that Treasury undertakes more analysis related to the longer-term outlook for the current account, and publishes its findings to enhance public understanding and discussion.

Is the present level of Australia's net foreign liabilities a problem?

3.33 Australia's foreign liabilities have been increasing for many years, both in value and as a proportion of GDP, but do they pose a major risk to the economy at this stage? Table 3.2 shows details of Australia's net foreign debt and net foreign equity positions since 1980.

Table 3.2: Australia's net foreign liabilities[19]

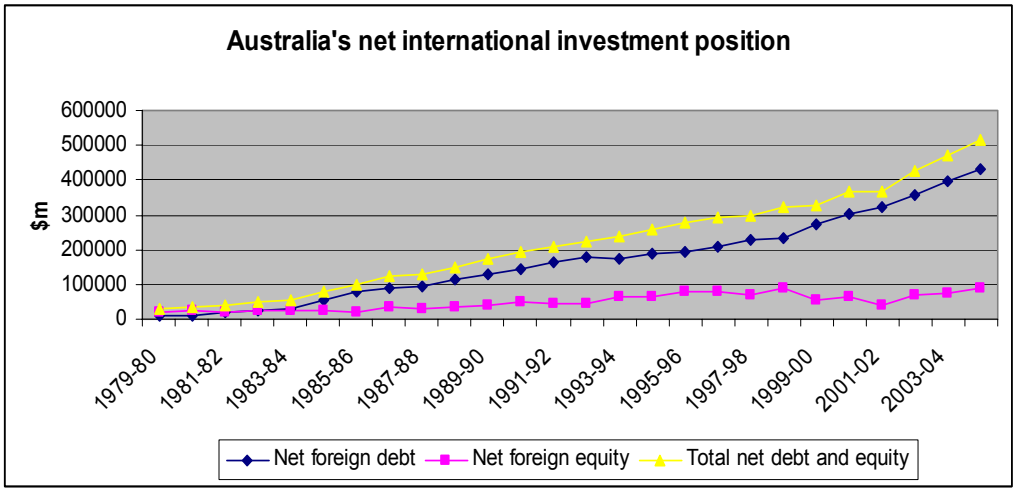
	Net foreign debt			Net foreign equity			Total net foreign liabilities
As at 30 June	Net foreign debt $b	% of total net foreign investment %	% of GDP %	Net foreign equity $b	% of total net foreign investment %	% of GDP %	$billion
1980	-7.9	29.0	6.1	-19.4	71.0	15.1	-27.4
1985	-53.1	67.2	23.5	-25.9	32.8	11.5	-78.9
1990	-130.8	75.7	34.0	-42.0	24.3	10.9	-172.8
1995	-190.8	74.7	40.6	-64.7	25.3	13.8	-255.5
2000	-272.6	82.9	43.7	-56.1	17.1	9.0	-328.8
2005	-430.0	83.2	49.8	-86.9	16.8	10.1	-516.8

Sources: ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0); ABS, *National Income, Expenditure and Product* (Cat. No. 5206.0)

3.34 Most of the foreign investment coming into Australia now is in the form of debt (borrowings) rather than equity investment, as shown in Table 3.2 and graphically in Figure 3.3. As at June 1980, 29.0 per cent of foreign investment came into Australia in the form of borrowings and 71.0 per cent was in the form of equity investment in Australian companies. By June 2005 the proportions had reversed with 83.2 per cent coming in as borrowings and 16.8 per cent coming in as equity investment.

[19] Also referred to in ABS publications as the 'net international investment position'. The term 'net foreign investment' is also sometimes used. This report generally uses the term 'net foreign liabilities'.

Figure 3.3: Australia's net international investment, by debt and equity.



Source: ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0).

3.35 Table 3.3 shows the major sources of foreign debt (borrowings) in the last four calendar years. Note that this is total or gross foreign debt, whereas the amounts in Table 3.2 are for net foreign debt.

Table 3.3: Major sources of foreign debt (borrowing) in Australia, calendar years

Country	2001	2002	2003	2004	2001	2002	2003	2004
	As at 30 December, $ billion				% of total			
UK	123.8	150.8	155.3	179.1	24.3	26.2	25.4	25.6
USA	114.4	136.7	159.0	165.1	22.5	23.7	26.0	23.6
International Capital Markets	90.0	94.7	98.4	137.9	17.7	16.5	16.1	19.7
Unallocated	25.6	26.9	33.1	50.3	5.0	4.7	5.4	7.2
Japan	33.6	32.3	27.2	25.7	6.6	5.6	4.5	3.7
Belgium / Luxembourg	9.0	7.3	10.9	17.7	1.8	1.3	1.8	2.5
Hong Kong	26.1	29.6	21.0	16.8	5.1	5.1	3.4	2.4
Singapore	22.8	20.8	17.6	15.0	4.5	3.6	2.9	2.1
Total all countries	508.6	575.5	611.4	699.2	100	100	100	100

Source: ABS, *International Investment Position, Australia: Supplementary Country Statistics 2004* (Cat No. 5352.0)

3.36 These figures raise the question whether lenders in Japan, Hong Kong and Singapore could be losing confidence in Australia (perhaps because of the consistently high current account deficits we have recorded in recent years?). Fortunately the biggest lenders to Australia, the UK and USA, do not appear to share these concerns.

3.37 As at 30 June 2005, official (i.e. government) gross foreign debt liabilities (borrowings) totalled $32.4 billion while official foreign debt assets and reserve assets totalled $64.1 billion. So the government sector is in surplus.[20]

3.38 As at 30 June 2005, of Australia's total gross foreign liabilities $275.8 billion was repayable in Australian dollars (38.9%) and $433.4 billion was repayable in foreign currencies (60.1%).[21] Borrowings in US dollars represented 56 per cent of total foreign currency borrowings as at 30 June 2005.[22]

3.39 The Round Table considered various aspects of Australia's foreign liabilities. Mr Hawkins pointed out that on several counts Australia's foreign debt did not pose major problems:

> There are three aspects that people consider in looking at whether or not a debt is a problem. One aspect is the public-private ratio, and the fact that ours is predominantly private is better than it being predominantly public. The second aspect is the currency in which the debt is denominated. In the classic cases of countries having debt crises, all of the debts have been in foreign currencies. In Australia's case, quite a lot of our debt is in Australian dollars or is hedged one way or another. The third aspect is the maturity structure of the debt. Ours is around the OECD average. It is certainly not all short-term debt, as has been the case in some countries that have had a crisis.[23]

3.40 However, Professor Garnaut pointed out that having predominantly private sector debt is not risk-free:

> I am not seeking to draw a parallel between Australia and any of the East Asian countries that went into crisis, but until right on the point of the crisis, in the main, those economies had consenting-adult deficits, mainly driven by debt-funded assets booms in the private sector. We are taking comfort from the consenting-adults view of debt and the fact that it is in the private sector. There have been lots of circumstances in other countries where that has looked like a comfort for a while and then quite quickly has

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20 RBA Bulletin, Table H6. On 24 September 2005 the Australian Financial Review reported that the Commonwealth Government recorded an underlying cash surplus of $13.6 billion in 2004-05. *Budget surplus swells by $4.4 bn,* AFR, 24 September 2005, p. 5.

21 RBA Bulletin, Table H4. The proportion of gross borrowings in Australian dollars fluctuates but has always been below half of the total. The highest proportion - 45.3% - was recorded at 30 June 1997.

22 US dollar loans usually represent between half and two-thirds of total foreign currency loans.

23 *Proof Committee Hansard*, 15 August 2005, p. E33.

> ceased to be a comfort. Even in our own history, the most severe depression we ever had, in the 1890s, followed the deflation of a private sector asset boom: the great housing boom of the late eighties, which extended into 1890 and then collapsed, which was greatest in Melbourne but had Australia-wide ramifications in the early 1890s. It was not principally a problem of government debt, and yet the consequences were severe.[24]

3.41 On the question whether equity is better than borrowings Mr Pearson commented:

> There is no 'right' form of foreign capital inflow. Debt is not 'bad' and equity is not 'good'. Remember, if you go back in the political debate in Australia there was a time when people did not want to have equity, because they thought that was 'selling off the farm', and the alternative was to have debt. Neither is better or worse. They have different servicing obligation characteristics and different ownership characteristics, which are neither good nor bad. They are just different.[25]

3.42 Professor Garnaut observed:

> On the question of debt versus equity, if the concern that we have about an unusually large current account deficit is that, in certain circumstances, it would make us vulnerable to the need for painful adjustment, selling off a lot of equity leaves us less vulnerable than selling off a lot of debt, because if our economy comes upon harder times then the equity that foreigners hold loses value; foreigners share in that adjustment.[26]

3.43 Mr Hawkins indicated that the maturity structure of the debt is about average for the OECD economies,[27] and Mr Pearson provided the following detail:

> On the question of foreign debt, the latest figures up to the March [2005] quarter were that there is about $370 billion of gross foreign debt in risk liabilities of more than one year's maturity. The total outstanding is about $690 billion. That is, more than half have more than one year's maturity.[28]

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24 *Proof Committee Hansard*, 15 August 2005, p. E4. The term 'consenting-adults deficit' describes a deficit which is made up of largely private sector debt and the foreign lenders who are providing the money seem to be quite willing to lend as much as is required.

25 *Proof Committee Hansard*, 15 August 2005, p. E34.

26 *Proof Committee Hansard*, 15 August 2005, p. E35.

27 *Proof Committee Hansard*, 15 August 2005, p. E34.

28 *Proof Committee Hansard*, 15 August 2005, p. E35.

Servicing Australia's foreign liabilities

3.44 The financing of a deficit on the current account produces an increase in foreign liabilities.[29] Dr Gruen commented that, while net foreign liabilities as a proportion of GDP cannot increase indefinitely, he did not see the present circumstances as posing a particular threat to Australia. He said:

> As a consequence of that [current account deficits], net external liabilities as a proportion of the size of the economy have been gradually rising. But, again, that has been true for 20 years, and I do not think there are any magic numbers here. At some point, net external liabilities to GDP have to stop rising. They cannot go on going up forever, but it is far from obvious how much further net external liabilities to GDP could rise. I do not think it indicates emerging structural problems in the economy. In the broad, I think it is a continuation of something that we have seen for an extended period.[30]

3.45 Debt service ratios provide an indication of the ability of a country to service its foreign liabilities. Table 3.4 shows how Australia's debt service ratios have changed since 1990.

Table 3.4: Debt service ratios, 1990 - 2005

June quarter	Net interest payments to exports, %	Net income[31] payments to exports, %	Net interest payments to GDP, %	Net income payments to GDP, %
1990	19.6	25.0	3.1	4.0
1993	12.2	16.5	2.2	3.0
1996	11.5	19.7	2.3	3.9
1999	9.4	16.5	1.8	3.1
2002	8.9	12.8	1.9	2.8
2005	9.5	19.2	1.8	3.6

Source: RBA Bulletin, *Australia's service payments on net foreign liabilities*, Table H7.

3.46 The figures in Table 3.4 show that net interest payments as a percentage of export earnings almost halved between 1990 and 2002, but that ratio is now edging up. The early 1990s was a period of very high interest rates, and Australia obviously benefited from the significant fall in interest rates in subsequent years (see Figure 3.4 below).

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29 Appendix 3 has an explanation of the relationship between the CAD and net foreign liabilities.

30 *Proof Committee Hansard*, 15 August 2005, p. E2.

31 Net income payments comprise net interest payments plus net payments of dividends and reinvested earnings.

3.47 However, the ratio of net income payments as a percentage of exports is again getting uncomfortably close to 20%. This ratio reflects both interest payments and dividend payments and reinvested earnings. Foreign shareholders appear to be reaping the benefits of their equity investments in Australian companies.

3.48 The high ratings given to Australia by the international rating agencies suggest that they continue to regard Australia's debt service ratios as manageable, despite the sharp increase in the net income payments ratio in the last 3 years. On this point Professor Garnaut commented:

> We have been able to finance the large current account deficit because the international financial markets, the various sources of capital - equity and debt—and other instruments of capital transfer have not formed a view that the Australian deficit is unsustainable.[32]

3.49 Later in the discussion Dr Gruen made a similar point:

> The reason we were re-rated back up to AAA by the rating agencies, even though the current account deficit remained large, was precisely because their view about the rest of the economy was that it was more resilient and that it was performing well based on a wide range of other factors.[33]

3.50 Mr Potter made the observation that the international rating agencies are experienced judges of risk:

> What else, other than the international ratings agencies, can we use to indicate independently that it [a high CAD] is a problem? Saying it is at historical highs does not really indicate anything much.[34]

3.51 Mr Conroy commented:

> The AMWU believe that foreign debt is not a problem as long as foreigners are happy to hold Australian debt - which they have been in recent years because of Australia's AAA credit rating and high interest rates relative to the rest of the world[35].

3.52 But Mr Conroy went on to caution that the differential between Australian and US interest rates would decrease as US rates go up. That will put pressure on the Reserve Bank to lift Australian interest rates with potentially dire results for the local economy.

3.53 As we have seen with movement of the net income payments ratio, debt service ratios can change quickly if economic circumstances change. Figure 3.4 shows that international interest rates have been at historical lows, but some rates are

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32 *Proof Committee Hansard*, 15 August 2005, p. E4.

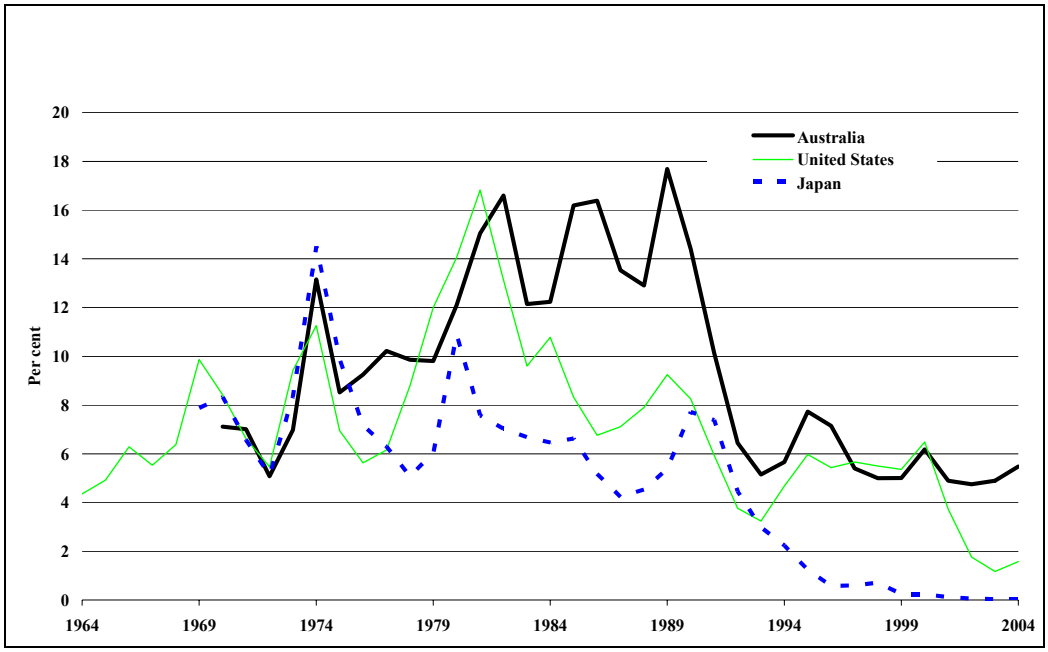
33 *Proof Committee Hansard*, 15 August 2005, p. E31.

34 *Proof Committee Hansard*, 15 August 2005, p. E32.

35 *Official Committee Hansard*, 16 May 2005, p. E13.

now showing signs of moving up. That trend is already starting to be reflected in the higher interest payments ratios shown in Table 3.4. There is little to suggest the net interest payments ratio will not worsen in the foreseeable future.

Figure 3.4: Short term interest rates, Australia, USA and Japan, 1964 – 2004



Source: RBA Bulletin datastream

3.54 The recent upturn in US and UK interest rates is evident in Table 3.5, which shows the movement in interest rates in seven countries since 2000.

Table 3.5: Short term interest rates, selected countries, 2000 - 2005

Country	Calendar year annual average %					Month of June 2005, %
	2000	2001	2002	2003	2004	
USA	6.5	3.7	1.8	1.2	1.6	3.2
UK	6.1	5.0	4.0	3.7	4.6	4.8
Japan	0.2	0.1	0.1	0.0	0.0	0.0
Germany	4.4	4.3	3.3	2.3	2.1	2.0
EU av.	4.8	4.4	3.5	2.6	2.6	2.6
Canada	5.7	4.0	2.6	3.0	2.3	2.6
Australia	6.2	4.9	4.8	4.9	5.5	5.7

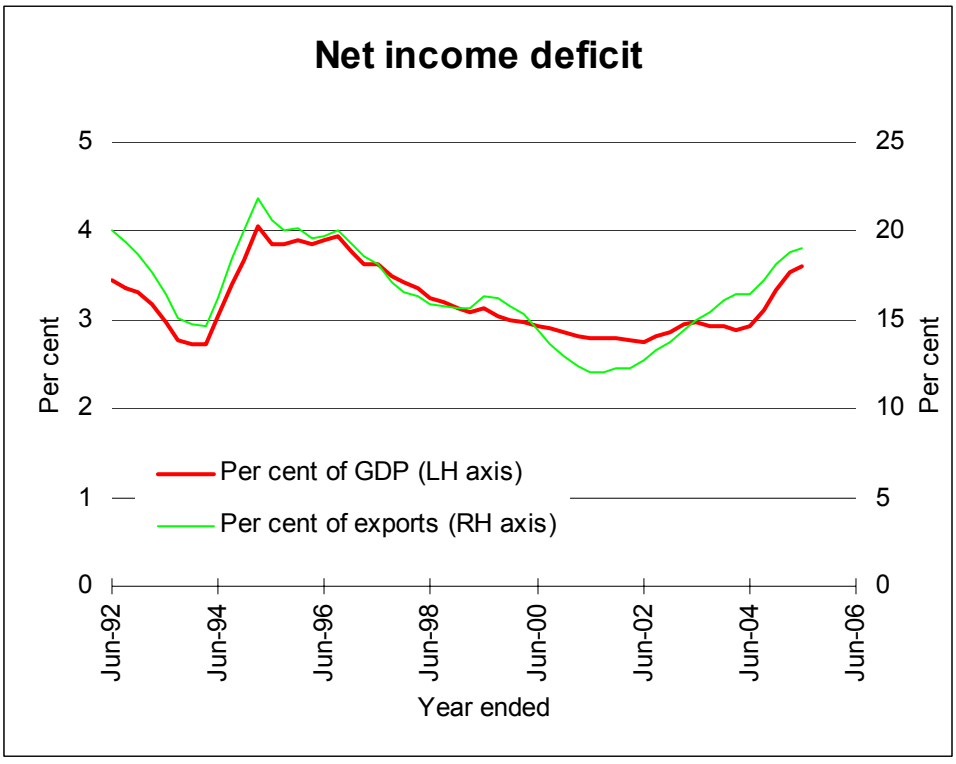
Source: RBA Bulletin datastream

3.55 Low international interest rates have benefited Australia. For example, while Australia's net foreign debt increased by $257 billion between June 2000 and June 2005, net interest payments to service the debt only went from $14.6 billion in 2000-01 to $15.4 billion in 2000-05, as shown in Table 3.6 below.

Committee views

3.56 The May 2001 edition of Treasury's Economic Roundup bulletin contained an article titled *'The net income deficit over the past two decades*'. The article found that the net income deficit had shown steady improvement (i.e. decrease) since the mid-1990s, which augured well for Australia's future ability to finance its foreign liabilities. However, that trend of steady improvement in the net income deficit between 1996 and 2002 has not continued, with the trend reversing and the net income deficit sharply worsening in the last year as shown in Figure 3.5.

Figure 3.5: Net income deficit as a percentage of exports and of GDP



Sources: ABS, *International Trade in Goods and Services* (Cat. No. 5368.0) - for export data; ABS, *National Income, Expenditure and Product* (Cat. No. 5206.0) - for GDP data; *Reserve Bank of Australia Bulletin*, Table H7 - for net income payments

3.57 Table 3.6 shows Australia's net foreign liabilities (debt and equity) and the amounts used to service those liabilities over the last six years. The Committee notes with concern that the net income balance has deteriorated sharply, from -$18.2 billion in 2000-01 to -$31.2 billion in 2004-05.

Table 3.6: Net foreign liabilities and their annual servicing amounts, $billion

	Net foreign debt, as at 30 June	Net interest payments over 12 months	Net foreign equity, as at 30 June	Other net income payments over 12 months	Total net income balance over 12 months
1999-2000	-272.6	-13.4	-56.1	-4.8	-18.2
2000-01	-302.5	-14.6	-63.1	-4.1	-18.7
2001-02	-324.2	-13.6	-41.0	-5.7	-19.3
2002-03	-357.9	-11.6	-70.3	-9.9	-21.5
2003-04	-394.7	-12.5	-75.8	-11.2	-23.7
2004-05	-430.0	-15.4	-86.9	-15.8	-31.2

Source: Derived from RBA monthly bulletin, Tables H5 and H7.

3.58 This deterioration is also reflected in the debt service ratios shown in Table 3.4 and shown graphically in Figure 3.5, above. After several years of improving ratios, net income payments as a percentage of exports jumped from 12.8 per cent to 19.2 per cent in three years. Over the same period net income payments as a percentage of GDP rose from 2.8 per cent to 3.6 per cent

3.59 While these figures are still below the highs reached in the December 1990 quarter (26.5 per cent and 4.3 per cent respectively), the Committee considers that recent trends are worrisome.

3.60 The Committee is puzzled by the sharp increase in the category 'other net income payments' (basically, dividends and reinvested earnings paid to foreign equity holders). Most commentators suggest that this is a result of the very high corporate profits earned in Australia in the last couple of years, but can that be the whole story behind a four-fold increase in just five years (from $4.1 b in 2000-01 to $15.8 b in 2004-05)? Such a dramatic change begs for a clearer explanation by Treasury.

3.61 The Committee received conflicting evidence in relation to the likely impact of movements in international interest rates on the income balance. Professor Garnaut believes that if international interest rates go back to historical average levels, that would have a significant impact on Australia's income balance and possibly add a

couple of points to the CAD. However, the Treasury representatives (Dr Gruen and Mr Hawkins) argue that hedging of foreign borrowings by Australian banks has greatly reduced the risks posed by higher international interest rates.[36]

3.62 The Committee considers that it would be useful for Treasury to undertake some modelling of various scenarios (such as a rise in international interest rates, and a fall in the terms of trade), to ascertain what impact such changes would have on the current account. The results of that research should be published to facilitate understanding and debate on this important issue. The Committee is concerned at recent trends, and believes that it would be useful for Treasury to regularly publish detailed analyses of developments in the trade balance and income balance.

Why are exports important?

3.63 Exports are important because, together with imports, they make up the trade balance. If exports grow faster than imports, the trade balance improves and there is a likelihood that the current account deficit may decrease. However, if export growth is slower than import growth, then the deficit in the trade balance widens which puts pressure on the current account.

3.64 So, two key issues to consider are the prospects for a better performance by exports in the future, and whether it is realistic to hope for regular trade surpluses.

3.65 After matching import growth for most of the 1990s, export growth slowed in 1997. It then grew rapidly, to such an extent that in 2000-01 exports actually exceeded imports. But since that time export growth has again fallen behind import growth.[37]

3.66 Figure 3.6 shows how exports have performed. After solid growth through the 1990s they grew very quickly during 1999-2001. However, they declined in 2002 and 2003 and are only now picking up again due to higher prices of mineral and energy exports.

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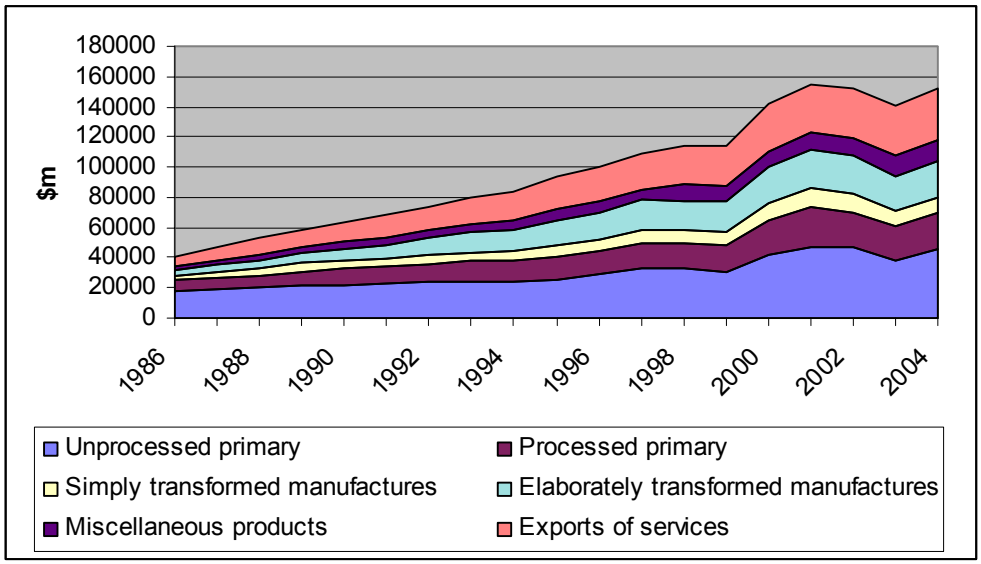
36 See discussion in paras 3.21 to 3.23.

37 See Figures 4 and 5 in Chapter 2 for details of Australia's imports and exports of goods and services 1971 – 2005.

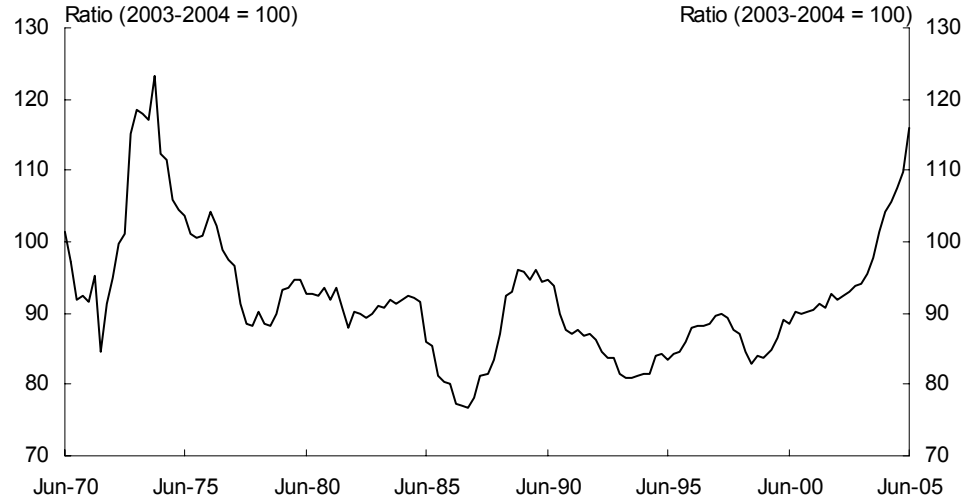
Figure 3.6: Exports of Goods and Services



Sources: Department of Foreign Affairs and Trade (DFAT), *Exports of Major Commodities Time Series*; DFAT, *Exports of Primary and Manufactured Products Australia*; ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0)

3.67 The commodity boom has pushed up the price of exports relative to imports with the result that Australia's terms of trade are at 30 year highs as shown in Figure 3.7. The terms of trade are expected to settle back to more normal levels in the next few years.

Figure 3.7: Terms of trade, quarterly



Source: Australian Bureau of Statistics cat. no. 5206.0.

3.68 A rise in the terms of trade adds to real national income. According to Treasury's submission: 'While real GDP expanded by 1½ per cent through 2004, the rise in the terms of trade meant that real national income grew by almost 3 per cent'.[38]

3.69 If export prices are so high, why have export revenues not accelerated? The Treasury submission provides one explanation:

> There is currently very strong demand for our resource exports. This is reflected in high prices for these exports, but so far there has been little rise in export volumes. This is partly due to firms underestimating the strength of global demand and the lags associated with expanding capacity. Furthermore, the diversity of ownership of the various linkages between mines and ships has made coordination of improvements to transport and port facilities difficult. Nevertheless, there is a substantial amount of investment currently under way, which should allow significant expansion in these exports in coming years.[39]

3.70 While Treasury is confident that export volumes for resource exports will pick up shortly, it is less sanguine in relation to exports of manufactures for the following reasons:

> The volume of manufactures exports has been weak for some time. This reflects maturing of the sector, the appreciation of the Australian dollar, growing sophistication of Asian competitors and perhaps some diversion of production as a result of high domestic demand.[40]

3.71 The export of Elaborately Transformed Manufactures (ETMs) and Services both grew strongly from the mid-1980s to late 1990s, increasing their share of total exports and increasing their contribution to GDP. However, both have slowed significantly in recent years, as shown in Figures 3.8 and 3.9.

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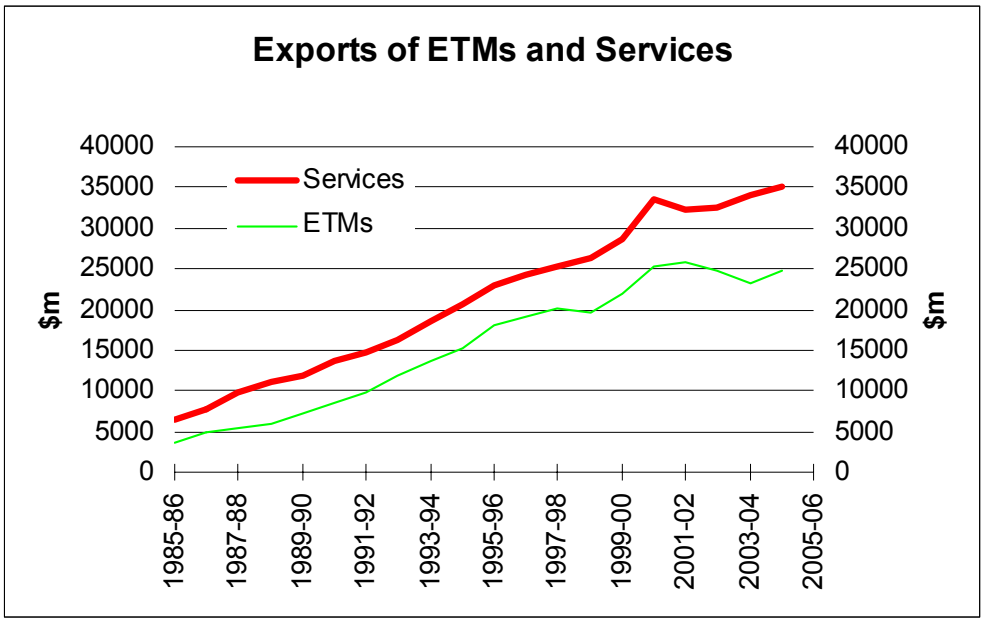
38 The Treasury, *Submission 13*, p. 4. The ABS announced the national accounts figures on 7 September 2005. In seasonally adjusted terms, GDP increased by 1.3% in the June quarter. Very strong growth in the terms of trade (up 5.8%for the June quarter and 11.5% for 2004-05) is reflected in strong growth in real net national disposable income of 3.1% in the June quarter with a total of 4.3% for 2004-05. ABS Cat. 5206.0

39 *Submission 13*, p. 3.

40 *Submission 13*, p. 3.

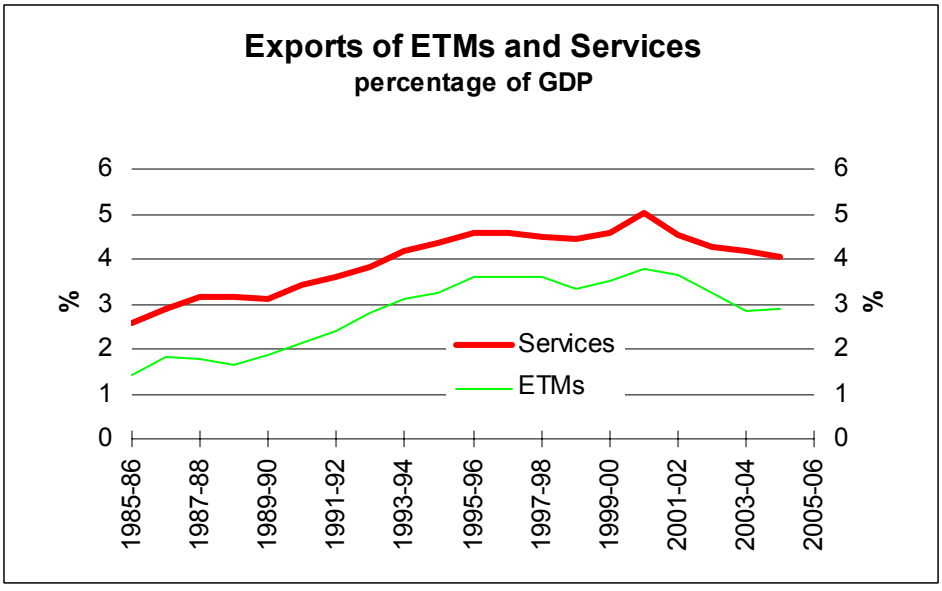
Figure 3.8: Exports of Elaborately Transformed Manufactures and Services



Sources: Department of Foreign Affairs and Trade (DFAT), *Exports of Major Commodities Time Series*; DFAT, *Exports of Primary and Manufactured Products Australia*; ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0)

3.72 The declining contribution to the economy made by exports of ETMs and services since about 1997 is apparent when they are shown as a percentage of GDP, as in Figure 3.9.

Figure 3.9: Exports of ETMs and Services as a percentage of GDP



Sources: Department of Foreign Affairs and Trade (DFAT), *Exports of Major Commodities Time Series*; DFAT, *Exports of Primary and Manufactured Products Australia*; ABS, *Balance of Payments and International Investment Position* (Cat. No. 5302.0)

3.73 In Australia high terms of trade normally reflect high commodity prices, and the exchange rate usually moves in sympathy with the terms of trade. That means exports become relatively more expensive and over time tend to fall, while imports become relatively cheaper and tend to rise. Receipts for exports of commodities reflect the higher export prices, but manufactured products and services feel the impact of the higher exchange rate and tend to fall.

3.74 Professor Garnaut pointed out that a number of periods of economic prosperity ended when there was a sharp fall in the terms of trade - as a result of which the exchange rate falls, inflationary pressures increase, interest rates rise, investment falls, and government revenue (and expenditure) falls. He said:

> I am not predicting a large and sudden retreat of the terms of trade, but one has to recognise that it is historically normal to get these corrections, so it is one of things that we should turn our minds to. If that were accompanied by a lift in global interest rates, increasing the cost of servicing our external debt, it would put an additional burden on our external accounts.[41]

3.75 Dr Simes noted that exports of ETMs and services grew quickly from the mid 1980s to the late 1990s, due to a combination of factors such as the low exchange rate; the removal of tariffs which made local firms more internationally competitive; and the intensified engagement with Asia. But the situation has changed:

> If you look at the situation today, we have got a much more open economy - that is, the imports to GDP is much higher than it was then [in the 1980s] … it is hard to conceive of a scenario where we are going to get a lot of mileage from the rural sector … it is hard to see a situation where we get a long-term big boost from the mining sector also. A lot of the big boost we have at the moment is coming off the terms of trade … the focus needs to come back to … do something a bit more proactive on manufacturing and services.[42]

3.76 Mr Hawkins pointed out that the greater diversity of Australia's exports makes us less vulnerable. While Professor Garnaut agreed with that assessment, he called for a careful analysis of the reasons for the recent slowdown in exports of ETMs and services. He said:

> It is very important to the diminution of vulnerability in future that we understand that slowdown [in exports]. My thoughts would go not to new interventions by government to artificially increase incentives to those sectors but to understanding the barriers of various kinds that have emerged to continued rapid growth in services and manufacturing exports.[43]

3.77 Mr Potter agreed with Professor Garnaut – 'I understand what you are saying: we should not be looking at industry specific measures to artificially promote a sector,

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41 *Proof Committee Hansard*, 15 August 2005, p. E5.

42 *Proof Committee Hansard*, 15 August 2005, p. E16.

43 *Proof Committee Hansard*, 15 August 2005, p. E17.

but we might want to look at industry-specific barriers to those particular industries. I think that is absolutely correct.' [44]

3.78 Mr Conroy saw innovation as the key to increasing exports of ETMs:

> We believe that if we increase innovation in the industry, and in manufacturing in particular, it will increase our long-term competitiveness and our exports because we could then compete with Asian countries not on the price of labour - which we can never win - but on the price of our innovation and keeping ahead of the curve.[45]

Committee views

3.79 It seems to the Committee that there is little prospect that Australia's net income balance will improve over the short-to-medium term. If anything, the deficit on the income balance is likely to worsen given the combination of rising net foreign liabilities and rising US and UK interest rates. So if there is to be a significant improvement in the CAD it will most likely have to come from the trade balance. But how realistic is such an expectation?

3.80 For the trade balance to have a significant impact on the CAD, exports must consistently grow faster than imports. The ideal situation would be for Australia to run a trade balance surplus on a regular basis.

3.81 The Round Table noted that the short term prospects are for strong growth exports, driven by high export prices for minerals and energy and increased export volumes as infrastructure capabilities are expanded. But if China's extraordinary growth falters, that scenario could quickly change.

3.82 Most of the discussion focused on the need to improve the export performance of ETMs and services, which had stalled in recent years.

3.83 The Committee agrees that exports of ETMs and services must perform well if there is to be a medium-to-long term improvement in the trade balance. Unfortunately the Round Table did not have sufficient time to consider possible strategies to achieve that goal but in any case that is the role of the Australian Trade Commission (Austrade).[46]

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44 *Proof Committee Hansard*, 15 August 2005, p. E17.

45 *Official Committee Hansard*, 16 May 2005, p. E17.

46 Austrade is part of the DFAT portfolio. It has a wide network of over 100 offices in 50 countries, which is a major commitment of resources by the Government. Other Government agencies involved include the Department of Foreign Affairs and Trade in relation to trade policy; and the Department of Industry, Tourism and Resources in relation to industry policy.

3.84 Austrade is the Government's export promotion agency. Its focus is on the export of ETMs and services, as commodities are internationally traded goods and exports of commodities basically look after themselves.

3.85 Austrade's priority for the last 5 years has been to double the number of exporters. To achieve that goal Austrade has concentrated its efforts on small-to-medium sized companies. Realistically, such companies will make very little difference to Australia's overall exports for many years to come. Large companies, with the necessary financial and management resources, are the only ones which can make a significant impact. Australia needs to nurture manufacturers and service companies which export $10 million per annum, not $10 000.

3.86 The recent falling off of export growth suggests that Austrade should urgently re-assess its priorities.

3.87 The Committee urges Austrade to develop strategies which will increase the export of ETMs and services on a sustainable basis. Exports as a whole, and in particular ETMs and services, need to grow at a faster rate than imports for the next few years if there is to be any chance for the CAD to achieve a significantly lower average level.

Recommendation 2

The Committee recommends the Government develop new strategies to promote the export of Elaborately Transformed Manufactures and services to underpin a long term improvement in the balance of trade.

What are the links between household debt, imports and the CAD?

3.88 The overall aim of this Inquiry was to explore possible links between household debt, demand for imported goods and the current account deficit (CAD). One of the specific terms of reference was to look at 'the extent to which demand for imported goods by Australian households contributes to the current account deficit'.

3.89 Mr Conroy saw a direct link between household consumption and imports and the CAD. He said:

> The explosion in the current account deficit in the last five years has been driven by an increase in imports. It is not about borrowing more to fund capital expansion here; it is about borrowing more and buying more consumer goods. If you look at the growth rates in the last eight years, consumer goods have risen by about 140 per cent and capital good imports only by 70 per cent, so what is happening is that Australians are buying more and more consumer goods from overseas. This is part of an underlying structural problem here in that we are not funding productive

investment; we are borrowing now to purchase goods and we will pay for it later …[47]

Households and the CAD

3.90 There is a direct link between household debt and the current account deficit. As discussed in Chapter 2, from a savings/investment perspective, household debt has been the principal contributor to the CAD in recent years.[48]

3.91 The official or government sector is now a net lender (that is, the government sector is in overall budget surplus). The private sector is made up of corporations and households. Corporations have traditionally been heavy borrowers but in the last couple of years they have become net lenders as high profits have exceeded investment. In contrast, households have traditionally been net lenders but in recent years they have become net borrowers. Since about 2000-01 household spending/debt has been the main driver of the current account deficit.

Imports and the CAD

3.92 There is also a direct link between imports and the CAD in the sense that imports are part of the trade balance which, in turn, is a major component of the current account - see discussion on the trade balance in paragraphs 2.10 to 2.20 in Chapter 2.

Households and imports

3.93 One could reasonably expect a link between households and imports, particularly imports of consumption goods. Households consume both domestically produced goods and services, and imported goods and services. These might be direct purchases of imported televisions or cars or indirect purchases of, for example, kitchen appliances if a house they buy is fitted with imported kitchen appliances.

3.94 Figure 3.10 shows the result of plotting the movement of household liabilities against imports of consumption goods in the period 1987-88 to 2003-04, both measured at constant prices. Superficially, the graph suggests a strong linear relationship between these two variables (reflected in the high regression coefficient of 0.9711). However, it would be premature to read too much into this graph without further research to more definitely establish the causal links.

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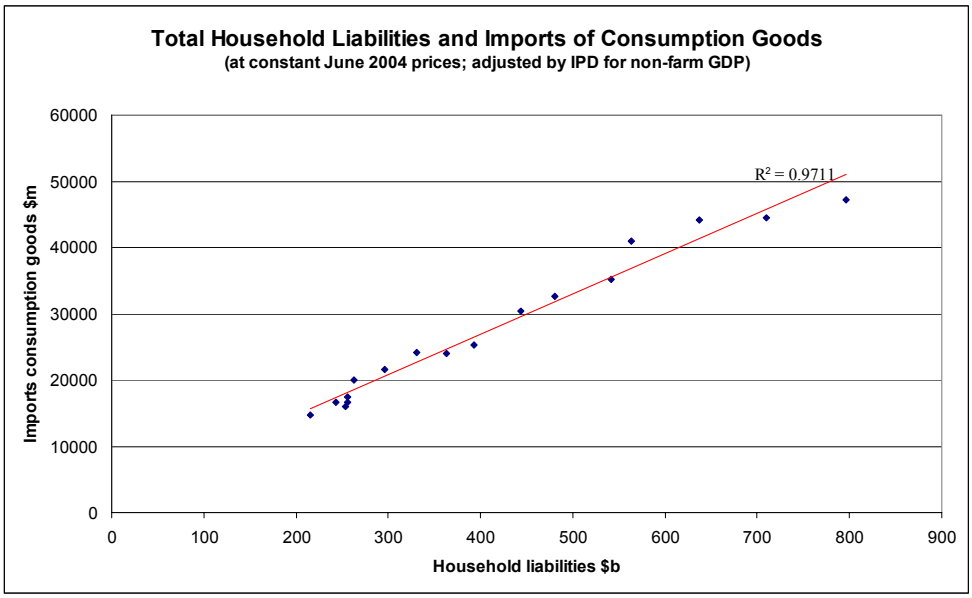
47 *Official Committee Hansard*, 16 May 2005, p. E15.

48 See discussion in paras 2.21 to 2.26 in Chapter 2.

Figure 3.10: Statistical correlation between household liabilities and imports of consumption goods

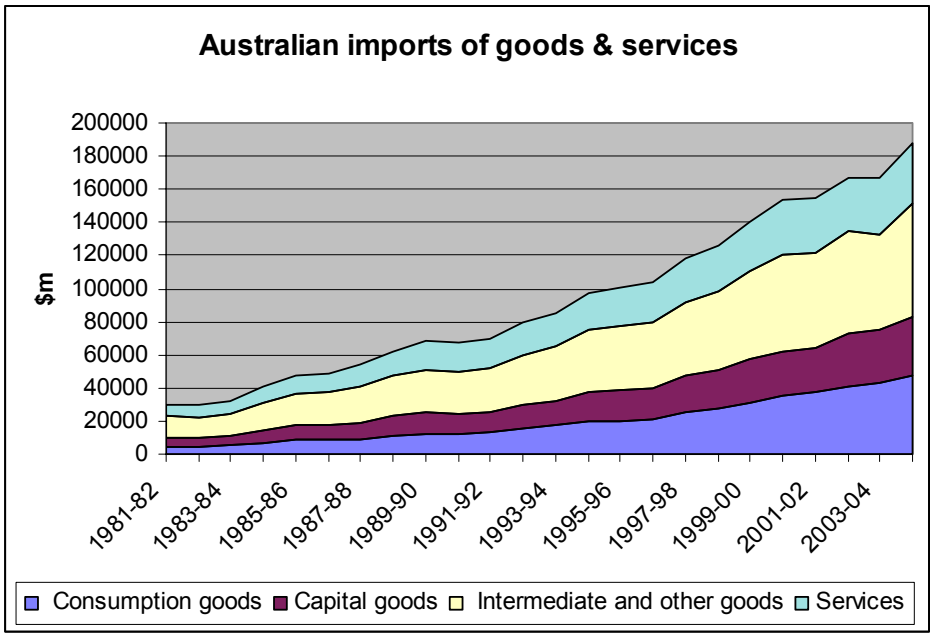


Sources: ABS, *Financial Accounts* (Cat. No. 5232.0) - for total household liabilities; ABS, *National Income Expenditure and Product* (Cat No. 5206.0) - for the implicit price deflator for non-farm GDP; ABS, *International Trade in Goods and Services* (Cat. No. 5368.0) - for imports of consumption goods.

3.95 Imports of consumption goods have grown strongly in recent years, driven by strong consumer demand. Strong Asian competition and an appreciating Australian dollar have helped to keep prices of imported manufactured goods relatively low.

3.96 Figure 3.11 shows how imports of goods and services have increased since 1981-82, and Figure 3.12 is a representation of how the major components of total imports have changed. This shows that imports of consumption goods have increased at a faster rate than the other components, thus increasing their share of total imports of goods and services.

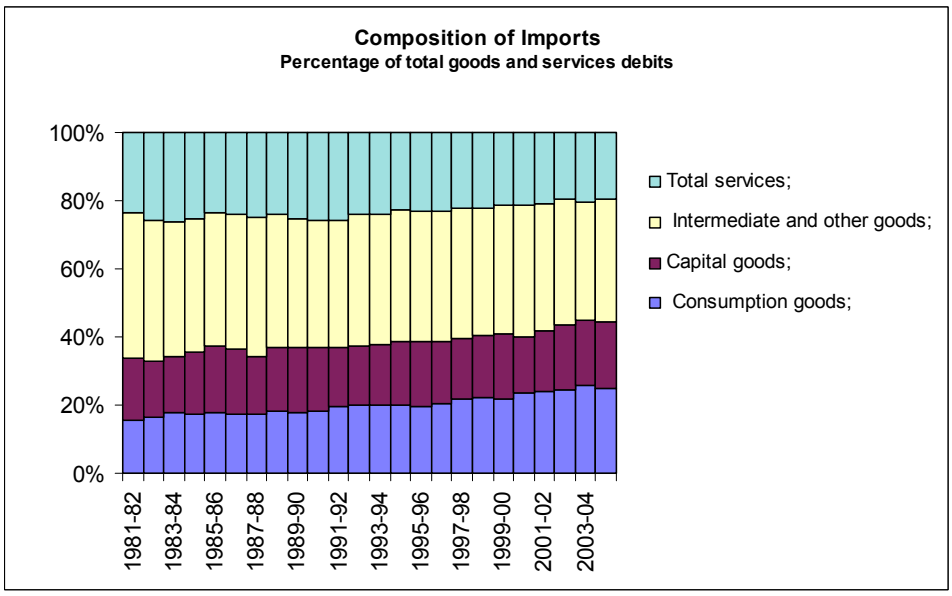
Figure 3.11: Imports of goods and services, by major components



Source: ABS, *International Trade in Goods and Services* (Cat. No. 5368.0)

3.97 Figure 3.12 shows the percentage of total imports represented by its four components: consumption goods; capital goods; intermediate goods; and services. Consumption goods have increased their share of the value of total imports of goods and services from 16 per cent in 1981-82 to 25 per cent in 2004-05, largely at the expense of intermediate goods and services.

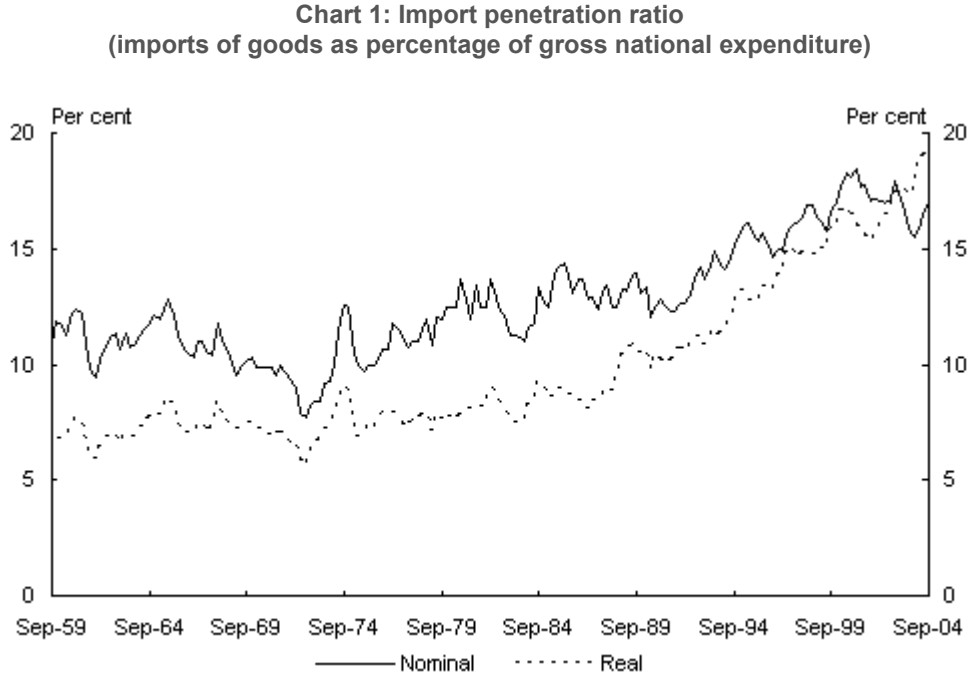
Figure 3.12: Composition of imports of goods and services, percentage of total



Source: ABS, *International Trade in Goods and Services* (Cat. No. 5368.0)

3.98 A recent Treasury study examined the question: 'Why have Australia's imports of goods increased so much?'[49] The study noted that imported goods increased their share of nominal domestic demand from about 11 per cent in the 1960s to about 17 per cent in 2004, as shown in Figure 3.13, below.

Figure 3.13: Import penetration ratio (imports of goods as a % of GNE.



Sources: Australian Bureau of Statistics, *Balance of Payments and International Investment Position*, cat. 5302.0 and *National Income Expenditure and Product*, cat. 5206.0.

3.99 Treasury identified rising incomes and falling relative prices for imports as the key factors behind increased imports. In the last 10 years growth in household spending exceeded growth in income, with the short-fall made up from a combination of decreasing savings and increasing debt.

3.100 The study concluded:

> Over the past decade the volume of imported goods grew by an average rate of 9 per cent a year, while real Gross National Expenditure grew by 4½ per cent. While a large part of the fast growth in imports can be explained by rising incomes and falling relative prices, other factors such as changes in tastes and specialisation have also played an important role.[50]

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49 'Why have Australia's imports of goods increased so much?', *Treasury Economic Roundup*, Summer 2004-05.

50 'Why have Australia's imports of goods increased so much?', *Treasury Economic Roundup,* Summer 2004-05, p. 43.

Committee views

3.101 The Committee concludes that there are a number of linkages between households and imports and the CAD, some more direct than others.

3.102 The import penetration ratio (Figure 3.11) suggests that imports represent a growing share of consumption. At least some of that would be at the expense of local manufacturing. That is an unfortunate fact of life in an increasingly globalised world. Communication and access are much easier today. Australian consumers demand access to an ever-wider range of products in quality and price, and that expectation can not be denied. The growth of imports would be of less concern if exports as a percentage of GDP were also growing, which is not the case, as shown in Figure 3.9.

What are the risks of a persistently high CAD?

3.103 In the December 2004 quarter the CAD set a new record of 7.2% of GDP. A number of economists pointed out that this record was reached during a period when Australia's terms of trade were the highest in 30 years (which should have improved the trade balance), and when international interest rates have been low (which should have improved the income balance). One could reasonably have expected this to be a period of relatively low current account deficits, instead of a period when new records were being set.

3.104 The Treasury submission points out that the CAD has fluctuated between 3 and 6 per cent over the last 20 years, commenting:

> Fluctuations in the CAD are not a bad thing. They are a means by which Australia smoothes consumption in the face of income shocks, such as the Asian crisis. That is, the CAD, like the exchange rate, acts as a buffer or shock absorber between domestic demand and global developments.[51]

3.105 The Round Table discussed the question of whether a high level of CAD is necessarily bad, and the risks involved.

3.106 Dr Gruen saw the record deficit of 7.2% as a natural part of the wide fluctuations which have characterised the CAD over the last 20 years. He said:

> The Australian current account deficit has cycled between about two and seven per cent of GDP for 20 years now and has averaged just under five per cent of GDP for 20 years … in the last several years we have seen both the highest ratio to GDP and the lowest. My characterisation of the situation would be that we have seen quite big cycles in the current account but no obvious trend over that period. As I say, it has been around 5 percent - I

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51 The Treasury, *Submission 13*, p. 2.

> think the average is 4.75 per cent - of GDP for 20 years and there have been quite big cycles around that.[52]

3.107 On the other hand, both Professor Garnaut and Dr Simes expressed concern at recent levels of the CAD. Professor Garnaut commented:

> Having a current account deficit of seven per cent of GDP does not prove that you have a big problem or crisis coming, but it should be a warning bell that you should look very carefully at what is generating it and at whether or not the things that are generating it are sustainable. It is an unusual figure for Australia and very unusual in the world, especially amongst developed countries … in earlier periods when it has gone up to that level it has been followed by quite severe adjustment problems. That does not prove that it is a problem now but it should get us thinking. [53]

3.108 Dr Simes described his misgivings about a CAD of recent proportions on several occasions during the Round Table, in the following terms:

> To me, a high current account deficit is a signal of something not quite right and it is something that … you should be cautious about.[54]
>
> …
>
> I think the size of the current account deficit is such that it is symptomatic of an underlying problem and should be a source for doing something about it. Again, because of the robustness of the financial markets and the rest of it, I have tried to say that there is no need to do anything quickly; it is more medium-term structural policies that we should be looking at.[55]
>
> …
>
> Why is a larger current account deficit a problem? Unless it is lifting the level of production - unless it is getting into investment and increasing the base - there is an issue for longer-term economic welfare for the next generation et cetera. To me it is symptomatic that we are not optimising our long-term economic welfare.[56]
>
> …
>
> There is no right and wrong level about the current account deficit in the first place. I am concerned that we have been at 4½ per cent of GDP for 20 years, and it looks like it is edging up. I would prefer it to be coming down … the current account deficit is too high today and looks like it is going to settle at an average level which is uncomfortably high over the next, say,

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52 *Proof Committee Hansard*, 15 August 2005, p. E2.

53 *Proof Committee Hansard*, 15 August 2005, p. E2.

54 *Proof Committee Hansard*, 15 August 2005, p. E5.

55 *Proof Committee Hansard*, 15 August 2005, p. E31.

56 *Proof Committee Hansard*, 15 August 2005, p. E33.

> five years or whatever, without policy adjusting it or doing something about it.[57]

3.109 Mr Conroy asserted that the high level of household debt in Australia posed three specific threats to the economy:

> The first is a recession induced by household demand evaporating to service debts. The second comes from the large external imbalance caused by the debt-induced current account deficit and spiralling foreign debt levels. The final risk to the economy originates from a misallocation of resources caused by the housing bubble and the consumer debt explosion reducing the long-term competitiveness of the Australian economy.[58]

3.110 Mr Conroy felt that the Australian economy is vulnerable not only to recession caused by a collapsing consumer demand but also to a change in the international sentiment regarding the Australian economy.[59] Professor Garnaut sounded a similar cautionary note: 'the views of international markets can change rather quickly.'[60]

3.111 The Round Table discussed various risks facing the private sector. Dr Gruen advised that in the aftermath of the Asian crisis Treasury has kept a close eye on the liabilities of the private sector. He said:

> There has been much more careful analysis by regulatory authorities of the sorts of liabilities in the private sector that could ultimately cause systemic problems. The lesson from the Asian crisis is that those are exactly the sorts of things you have to look at carefully. That is precisely what we have done … if one is going to have a consenting-adults view about the current account it is extremely important to take a view about possible shocks that could lead to systemic problems. In the Asian crisis case economists were not very good at predicting it. With the benefit of hindsight, we are much better at predicting things.[61]

3.112 The Round Table considered whether a sharp fall in house prices would impact on the ability of households to make their loan repayments. On this point, Dr Simes said:

> My view is that it is not only the fact that you have a large proportion of the population who are not in debt and who can support the others; it is also that the financial sector is attuned to providing credit et cetera in a fairly smooth way. Given that most of this debt is secured against a house and is

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57 *Proof Committee Hansard*, 15 August 2005, p. E33.

58 *Official Committee Hansard*, 16 May 2005, p. E13.

59 *Official Committee Hansard*, 16 May 2005, p. E13.

60 *Proof Committee Hansard*, 15 August 2005, p. E4. The Reserve Bank of Australia also sounds a cautionary note: '… the pre-conditions are in place for quite abrupt swings in sentiment and a disruptive snap-back in pricing.' RBA, *Financial Stability Review*, September 2005, p. 2.

61 *Proof Committee Hansard*, 15 August 2005, p. E14.

> being serviced by regular income, the real problem is only going to arise if you have a sharp lift in unemployment, not just if house prices fall.[62]

3.113 Both Dr Gruen and Mr Potter referred to a recent APRA[63] survey which found that the major banks could comfortably accommodate a 30 per cent slump in housing prices.

3.114 Dr Simes thought there is a low risk that interest rates would go to levels which would result in severe unemployment and have a major impact on the ability of households to service their debts. On the other hand, if foreign investment is withdrawn Dr Simes said that the exchange rate would respond appropriately to restore balance:

> If foreign investment is withdrawn, the adjustment will be through the exchange rate - that is, foreign money will be available at a price and it will be the exchange rate that does the buffering, as we saw in the Asian financial crisis, if you like. That will be manageable unless you have a system in the price-wage interactions where it is going to get into ongoing inflation, and that is hard to see in the current structure of the economy or for the next five years. You could not rule that coming back into play at some point, but it is a long way off.[64]

3.115 The Round Table discussed the adverse impact on local manufacturers of large fluctuations in the exchange rate within relatively short periods, as happened about 5 years ago, when the exchange rate went down to US$0.49 and then moved up to US$0.80. That kind of wide fluctuation puts considerable stress on local manufacturers as they endeavour to adjust to rapidly changing circumstances.

3.116 Dr Gruen agreed that this had put pressure on domestic manufacturers but said that a floating exchange rate is essential to sound economic management:

> The recent period … moving from US49c to something close to US80c, is not very usual. We have been in an extremely unusual circumstance of going from being viewed as the old economy in 2001 to this huge rise in the terms of trade, and the currency has gone with it. Given that the terms of trade are something that we get dealt largely by the rest of the world, allowing the currency to move with them may have sectoral implications that some people [manufacturers] would not like but, in terms of the stability of the overall economy, it is a huge advance on the last time we had a huge terms-of-trade rise like this, which was in 1973-74. The Australian economy did not cope well with that. We ended up with a big rise in inflation and a lot of other things as well. Nothing has only good

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62 *Proof Committee Hansard*, 15 August 2005, p. E10.

63 APRA – Australian Prudential Regulation Authority, which is part of the Treasury portfolio.

64 *Proof Committee Hansard*, 15 August 2005, p. E10.

> sides, but my judgement is that this is a much better way of allowing the economy to adjust than the alternatives.[65]

3.117 Dr Gruen reinforced the importance of a floating exchange rate by describing the important but adverse role fixed exchange rates played in the Asian financial crisis. He said:

> … it came as a rude shock to everyone when the Asian countries went into severe recessions. We discovered that they were running either fixed exchange rates against the US or effectively fixed exchange rates against the US. It was perhaps not realised that the financial health of most of the economies, not only the financial system but also the non-financial system, was inextricably tied to this exchange rate policy. In other words, once the currency depreciated significantly, the unhedged foreign borrowings in the companies and the financial system bankrupted large parts of the economy.[66]

3.118 Mr Conroy believes that manufacturing sector has suffered because interest rates have been kept artificially high so as to attract the funds required to meet excessive household consumption. This has pushed up the exchange rate, which has made imports relatively cheaper and hurt local manufacturers and exporters. He said:

> The reliance on capital inflow to fund consumer debt has adversely affected the manufacturing sector … it has crowded out direct foreign investment in manufacturing by forcing interest rates and exchange rates to be higher than would otherwise have been the case … it has allowed unsustainable growth in domestic demand resources which would otherwise have been allocated for manufacturing expansion … [and] Governments continue to believe that high and sustained economic growth can be achieved by letting the finance sector drive the economy … [they] no longer believe in the importance of manufacturing.[67]

What could improve the CAD?

3.119 The Round Table discussed various ways in which the CAD could be brought back to lower levels.

3.120 Professor Garnaut believes the CAD will eventually self-correct, but questioned the economic and social cost of leaving such adjustment solely to market forces. He commented:

> There is a sense in which there cannot be a long-term current account deficit problem because in its nature it is self-correcting. Indonesia and

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65 *Proof Committee Hansard*, 15 August 2005, p. E8.

66 *Proof Committee Hansard*, 15 August 2005, p. E13.

67 *Official Committee Hansard*, 16 May 2005, p. E14.

> Thailand had current account deficits in 1996 that some people thought were worrying. They had large current account surpluses by late 1998 and 1999, so there is a sense in which there was no current account deficit problem because it was self-correcting. The problem was the consequences of the adjustment that the economy had to go through.
>
> So the issue we are talking about is not really a problem of whether the current account deficit will adjust or whether in the end whatever deficit is there will be financed - by definition it will be. The question is: what will the process of adjustment be and what stress will that place on government budgets, on unemployment and on economic activity - or, to put it another way, will it give us a recession like similar adjustments have in the past?
>
> So the questions in the end become ones of vulnerability to circumstances changing and forcing adjustment and of our capacity to handle without excessive pain the adjustments that will be necessary.[68]

3.121 There was general agreement that the cooling-off of the housing boom would diminish the 'wealth effect' on households which, coupled with rising interest rates (and, more recently, rising fuel prices) would in turn reduce household spending and borrowing. Dr Gruen expressed it as follows:

> Their [Reserve Bank] latest estimate … is that in the 18 months to the December quarter 2003 house prices in Australia went up 29 per cent. Over the last 18 months they went up by exactly nothing …the consequences of that for the savings and investment balance of the household are going to be very substantial. So I think there are self-correcting forces in play in the Australian economy which should move us in the direction of smaller current account deficits.[69]

3.122 Professor Garnaut supported this assessment:

> You cannot have your households dis-saving forever, with that being balanced by ever-increasing asset values - in this case, bubble housing values. We are going through an adjustment now, as the housing boom has reached a plateau … Over time, one would expect that to significantly bring down consumption and raise saving rates.[70]

3.123 Although Dr Simes considered the high level of the CAD to be of concern, he does not see a crisis situation yet. He said that there are several reasons why the level of the CAD may come back to a lower level—for example, through a slowdown in economic demand and activity induced by a fall in the terms of trade; or a reduction in house prices; or if foreigners withdraw capital leading to a fall in the exchange rate. He expressed the belief that the financial sector is strong enough to absorb such adjustments. He concluded:

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68 *Proof Committee Hansard*, 15 August 2005, p. E10.

69 *Proof Committee Hansard,* 15 August 2005, p. E9.

70 *Proof Committee Hansard*, 15 August 2005, p. E4.

> The current account is an issue and something we should be acting to address, but we can do it over the medium term, and we should be looking at medium-term policy changes either related to savings or to exports.[71]

3.124 An increase in national savings would enable more of Australia's investment to be financed from domestic savings rather than by borrowing overseas, thus improving the income balance of the current account. Additionally, if exports grow faster than imports, the trade balance is improved. Enhancing domestic savings and lifting export growth helps the current account.

3.125 Dr Simes suggested looking at 'superannuation and the like',[72] and recommended raising the superannuation contribution rate from 9 to 15 percent.[73]

3.126 Mr Pearson commented on the impediments that limit the amount of superannuation people are prepared to take out. He felt that, before increasing the contribution rate, more should be done to remove the impediments to superannuation such as the taxes and the residual benefit limits.[74]

3.127 Mr Potter disagreed and argued that targeting superannuation would not be an appropriate policy response to address the level of CAD. He said:

> We think that super policy should be driven on its own merits, not because of the effect it has on national savings. I will separate it into two issues. You can either have the government investing in people's super - that is one possibility - or increase people's compulsory contributions. On the first one, if the government puts more money into people's super then that actually reduces the fiscal balance, so you may end up with no benefit to national savings. You might have an increase in the amount in people's super accounts, but a reduction in the government deficit and you would only be a little bit better off. On the other hand, you could, for example, increase the compulsory component of superannuation. We do not think that is such a good idea because, in a sense, super is like a payroll tax. I think the last thing that businesses want is to have is an increase in payroll taxes.[75]

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71 *Proof Committee Hansard*, 15 August 2005, p. E6.

72 *Proof Committee Hansard*, 15 August 2005, p. E15.

73 *Proof Committee Hansard*, 15 August 2005, p. E27.

74 *Proof Committee Hansard*, 15 August 2005, p. E27.

75 *Proof Committee Hansard*, 15 August 2005, p. 17.

Are the self-correcting mechanisms working?

3.128 A recent article in *The Economist* pointed out that a number of self-correcting mechanisms appeared to have 'jammed' and were no longer working as they were supposed to according to conventional economic theory. The article gave three examples, based on the USA whose CAD is forecast to exceed 6 percent of GDP in 2005 (i.e. a deficit of over US$800 billion).

> Firstly, in theory a rapidly rising CAD should cause investors to demand higher interest rates to compensate them for the increased risk of currency depreciation. Dearer money then helps to dampen domestic spending and thus trim the external deficit. This is what happened when America's CAD exploded in the first half of the 1980s. Real bond yields rose, cooling domestic demand. Along with the cheaper dollar, this helped to reduce the deficit. This time, however, the adjustment mechanism has jammed: real American bond yields have fallen not risen over the past few years, partly because Asian central banks have been eager to buy US Treasury bonds to prevent their currencies from rising. So long as low bond yields continue to support America's housing bubble and hence strong consumer spending, they will block any significant reduction in the CAD.
>
> Secondly, in the past a rapid rise in consumer borrowing and spending would cause a central bank to push up interest rates to curb inflation. Today, however, inflation is held down by cheap goods from China and other low-wage economies, and inflationary expectations are well anchored thanks to the credibility of central banks. As a result, central banks have been able to hold interest rates below the growth in nominal GDP (the income from which debts must be serviced) for a prolonged period. This has, in effect, lifted any constraint on credit growth, allowing a bigger build-up of private sector debt.
>
> Thirdly, a broken circuit is apparent between interest rates and growth. Sluggish economies with low inflation require lower real interest rates than economic sprinters. Yet despite its faster growth, America's real bond yields are lower than Japan's and about the same as in the euro area. Yields are arguably too low for America but too high for Germany and Japan, causing the growth gap to persist. [76]

3.129 The article describes interest rates and bond yields as the traffic lights of the global economy: they tell economies when to go and when to stop. The market would punish economies where governments or households borrow recklessly with higher bond yields, prompting them to tighten their belts. Prudent economies would be rewarded with lower real rates. But today financial markets are doing a poor job as economic watchdogs: in particular, America's profligacy is being subsidised rather than punished.

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76 'Traffic lights on the blink?', *The Economist*, 20 August 2005, p. 49.

3.130 In a closed economy, according to the article, if a government increases its budget deficit it must pay higher interest rates to persuade domestic investors to hold more bonds. But if it can tap global savings, it can borrow more cheaply because a smaller rise in rates is needed to attract the required funds. Even so, an efficient international capital market is supposed to ensure that capital is allocated to the most productive use. Yet much of the recent inflow of foreign money into America is not financing productive investment, but a housing bubble and a consumer binge.

3.131 A possible explanation is that, with interest rates low everywhere, investors are hungry for any sort of yield. This has made them more willing to buy high-yield bonds, and has pushed down the spread that riskier borrowers must pay compared with safer borrowers. When financial conditions tighten, investors are sure to become more discriminating again.

3.132 The article concludes by warning that when the inevitable correction comes, it will be all the more painful because of the large imbalances which have developed.

3.133 The Committee acknowledges that the focus of the article in *The Economist* was the USA, but notes the many apparent similarities with the situation in Australia, with its big increase in household consumption and debt and the related housing boom of 2002-04.

3.134 A study by the US Federal Reserve Board in 2000 of a number of countries found that self-correcting mechanisms should kick in when a CAD reaches about 5 per cent of GDP:

> A typical adjustment occurs after the current account deficit has grown for about four years and reaches about 5 percent of GDP. The results from previous episodes suggest that reversals involve a real depreciation of 10 to 20 per cent and slow real income growth for a period of about three years. Real export growth, declining investment, and an eventual levelling off in the net international investment position and in the budget deficit-GDP ratio are also likely to be part of the adjustment.[77]

3.135 A speech in May 2004 by Edward Gramlich, Governor of the US Federal Reserve Board, focused on the sustainability of rising trade and budget deficits.[78] These issues are now attracting much more detailed analysis and debate in the USA, as they should be in Australia.

3.136 Australia has now had a CAD of over 5 per cent of GDP for 11 consecutive quarters, and the expected correction in the exchange rate has not taken place. Could this be a practical example of the 'jamming' referred to by *The Economist* (above)?

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77 CL Freund, 'Current account adjustment in industrialised countries', *International Finance Discussion Papers, No. 692, Federal Reserve System*, December 2000, pp. 17-18.

78 *Budget and trade deficits: linked, both worrisome in the long run, but not twins*, Speech by E M Gramlich, Governor Federal Reserve Board, 14 May 2004.

3.137 In another warning that global imbalances need watching, the International Monetary Fund's World Economic Outlook bulletin released in September 2005 warns that the USA's growing trade and budget deficits are unsustainable and will put great stress on global financial markets unless action is taken to bring them back into line.[79]

3.138 The Governor of the Reserve Bank of Australia, Mr I J Macfarlane, believes that there are some early signs of a return to normality, even if they are small and the process likely to be long. He points to the policy of the US Federal Reserve to gradually move up interest rates and China's abandonment of its fixed parity to the US dollar as key initiatives to support his thesis.[80]

Is there a need for policy changes?

3.139 The Round Table discussed the need for further reforms to enable the economy to readily respond to adjustments resulting from the CAD's fluctuations. They identified two areas deserving additional attention - reforms to raise productivity and initiatives to lift exports.

3.140 Professor Garnaut commented:

> There is a sense in which this set of circumstances tells us that we are living beyond our sustainable means. That might not be a terrible thing if we are given the chance to adjust gradually and pull in our belts a bit - the household sector spends a bit less, gradually, over a number of years - so we haul things back into a sustainable shape. But, one way or another, we have to reduce the rate of growth of expenditure relative to growth in the productive capacity of the economy. The more we can raise average productivity through productivity-raising reform and the issues that have been raised about better utilising underutilised labour in our economy - and there is a lot of it - and the more we can remove barriers to skills training and so on, the less we have to reduce our living standards to make the adjustment.[81]

3.141 He continued:

> …a large current account deficit requires, amongst other things, an adjustment over time. It has to involve some relative shift of resources from domestic sectors of the economy to international sectors, producing exports or import-competing products. The more successful we are in raising productivity, removing barriers to efficient performance of our potential

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79 IMF World Economic Outlook, September 2005. Some economists have estimated that it would take a real depreciation of 30% in the US$ to eliminate the USA's current account deficit, WEO, Chapter 1, p. 72.

80 *What are the global imbalances?* Speech by Mr Macfarlane to the Economic Society of Australia on 28 September 2005.

81 *Proof Committee Hansard*, 15 August 2005, p. E26.

> export industries, the less the external adjustment has to take the form of a crude reduction in living standards. I think that is the link between productivity-raising reform in all its forms and the current account deficit.[82]

3.142 Dr Simes agreed with the desirability for productivity-raising reform, although he cautioned that the impact on the current account of such reforms is unclear:

> This is related to what Ross [Garnaut] is saying. What he is saying is that, the more the benefits from microeconomic reform or whatever, the less pain we have with the adjustment. My understanding of the empirical literature, though, is that we have not seen a direct causation shown between microeconomic reform as such and the current account. You would hope that, given some of the points that Ross is raising, that would be there. We want microeconomic reform, more productivity growth et cetera in any case.[83]

3.143 In response Dr Gruen said that productivity-enhancing reforms should be undertaken for their own direct benefits (such as enhancing productivity, raising living standards and increasing the flexibility of the economy) rather than for any indirect impacts they may have on the current account. He pointed out that if such reforms make Australia appear an even better place to invest, they could result in a higher CAD.[84]

3.144 Dr Simes (and Prof Garnaut) believes that fiscal policy should be such that in periods of high revenue (e.g. due to high terms of trade) the Government should budget for larger-than-normal surpluses. These surpluses should be saved for use in years when revenue falls, or used to enhance productivity in areas of national importance such as education and training.

3.145 Dr Gruen responded that 'the general government sector in Australia has been in surplus for eight years in a row, with an average surplus of about one per cent of GDP. That is a significantly tight fiscal policy…'[85]

3.146 Professor Garnaut agreed that the Government's overall fiscal policy had been appropriate, but added:

> I think we would be less vulnerable to a large deterioration in the terms of trade if, in the early period after a big improvement in the terms of trade, we ran a bigger than average surplus and then ran that down in tax cuts or other productive ways when the terms of trade retreated, or when we had realised that the China boom is not a short-term boost to minerals and energy prices but is there forever. In that case, once we know that - and we do not know it

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82 *Proof Committee Hansard*, 15 August 2005, p. E26.

83 *Proof Committee Hansard*, 15 August 2005, p. E26.

84 *Proof Committee Hansard*, 15 August 2005, p. E31.

85 *Proof Committee Hansard*, 15 August 2005, p. E28.

> yet - we can absorb it then into our permanently higher expenditure levels. But the prudent thing is to run larger surpluses when you have boosts in revenue that are temporary or that may turn out to be temporary.[86]

3.147 Dr Gruen questioned the suggestion that proactive policy changes are required to address the high CAD. He said:

> I think one has to be encouraged by the market's view of Australia in a range of circumstances. There was the Asian crisis, when you might have imagined that a country that was running a large current account deficit would be treated with suspicion. We experienced precisely the opposite and were treated as a safe haven. There was the period in 2000 when all things 'new economy' were regarded as the bee's knees and we were very much out of favour. The currency fell, but there was no sign of difficulty in funding the current account. Is it possible at some point in the future that the market will lose confidence in us? I guess you would have to say it is possible, but the experience that we have suggests that, in a range of circumstances where you might have wondered how we would go, we have actually done fine. The adjustment mechanisms which you would hope would help - namely, the exchange rate falling and allowing an improving export position - have done what you would have wanted.[87]

3.148 Mr Conroy proposed seven initiatives to move the economy from one which is driven by consumer debt to one based on exports of knowledge-intensive manufactured goods:

> … prudent economic management and solid economic fundamentals; acceleration of the growth of business investment in R&D; increased greenfield foreign direct investment; greater import replacement; an increase in exporters and the extension of the capacity of existing exporters; investment in supporting physical, social, R&D and environmental expenditure and infrastructure; and increased levels of private equity investment, especially venture capital.[88]

Committee views

3.149 In theory, when the CAD gets too high self-correcting market forces are triggered. Interest rates will tend to rise (slowing economic growth); the exchange rate will tend to fall (making imports more expensive and exports cheaper); the trade balance will improve; and as a result the CAD will improve.

3.150 In practice, however, other factors can delay or inhibit these market forces. The article in *The Economist* referred to earlier describes the apparent 'jamming' of

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86 *Proof Committee Hansard*, 15 August 2005, p. E29.

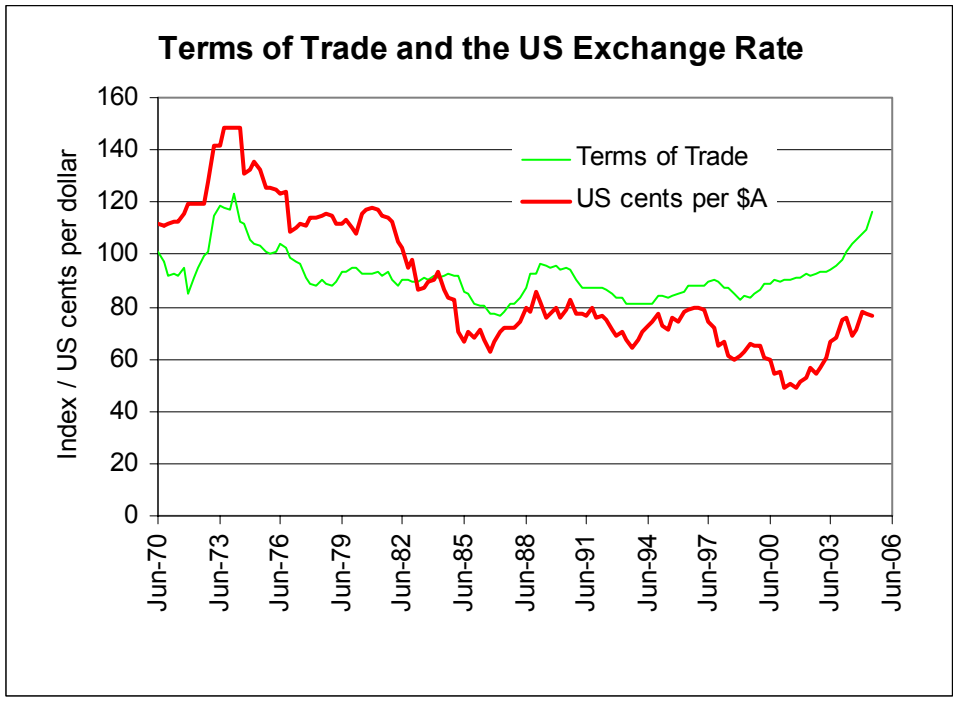
87 *Proof Committee Hansard*, 15 August 2005, p. E28.

88 *Official Committee Hansard*, 16 May 2005, p. E14.

self-correcting mechanisms. That seems to have been Australia's case recently - despite recording a CAD of over 5 percent of GDP for eleven consecutive quarters the exchange rate continues at a relatively high level, in response to high terms of trade and a continuing large inflow of money.

3.151 Figure 3.14 shows how the A$ / US$ exchange rate has moved relative to the terms of trade. The two graph lines have tended to be in rough synch, until recent years. Could this widening gap indicate the opposing forces of the terms of trade and the CAD at work?

Figure 3.14: Comparison of the terms of trade and the A$ / US$ exchange rate.



Sources: RBA, *Daily Statistical Release* for exchange rates; ABS, *Balance of Payments and International Investment Position*, Cat. 5302.0 for terms of trade.

3.152 The CAD has retreated, at least temporarily, from its record level of 7.2 per cent in the December 2004 quarter, due mainly to higher export receipts from high export prices of minerals and energy commodities. Export volumes are also picking up. So the trade balance should show some improvement in coming quarters. However, the income balance is expected to deteriorate as net interest payments, and net dividends and reinvested earnings continue to rise reflecting higher international interest rates, and high corporate profits in Australia.

3.153 The Round Table discussed, briefly, the need for greater domestic savings and faster export growth as ways to improve the current account. Facilitating superannuation was identified as a means of increasing savings, but there was no time to consider other possible alternatives.

3.154 The Committee noted recent Government policy initiatives which will enhance superannuation - specifically, the removal of the superannuation surcharge and the extension of the co-contribution scheme.

3.155 The Committee believes that these changes represent a good start, and urges the Government to take further initiatives to increase the attractiveness of superannuation as a preferred form of savings.

3.156 The Committee received a range of opinions as to the risk posed by a persistently high level of CAD. Treasury said that the high level was part of the normal fluctuations in the CAD and as long as we could readily borrow the required funds, it did not represent a major problem. On the other hand, Professor Garnaut and Dr Simes sounded a note of caution and concern.

3.157 After reviewing the evidence presented to this Inquiry, the Committee has formed the opinion that Australia's large and persistent current account deficits may be an indicator of underlying imbalances in the economy. The precise level of risk they pose to Australia's future economic well-being can be debated, but there seems no doubt that they do present a risk. This risk needs to be closely monitored, but more than that the Committee believes that it is time for the Government to take proactive action.

3.158 The Committee is particularly concerned at the trend towards a higher average level of CAD, perhaps to around 6 percent of GDP. The Committee accepts that Australia will continue to run deficits in its current account, but feels that a deficit of around 2 per cent of GDP would make us much less vulnerable than one of 6 per cent.

3.159 The Committee would be much more comfortable if the current trend towards higher average deficits was reversed, and believes that the Government should introduce policies which will lead to a lowering in the average CAD over the medium-to-long term.

3.160 The Committee would like to see more debate and discussion in Australia on this important topic. The Treasury is the obvious government agency to take the lead in this area.

3.161 While the current account is discussed in Budget Statements and similar documents, there seems to be infrequent in-depth analyses produced by Treasury on this important subject. An examination of the publications on the Treasury website indicated that the last in-depth research on aspects of the current account was published in the Centenary Edition of Treasury's quarterly Economic Roundup bulletin, in May 2001.[89]

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[89] Treasury website www.treasury.gov.au accessed on 12 September 2005. Treasury's submission to this Inquiry appeared in the June 2005 edition of *Economic Roundup*. The article in the May 2001 edition of *Economic Roundup* was titled 'The net income deficit over the past two decades'.

3.162 Treasury's Economic Roundup bulletin of August 2004 contained an article titled *Might the United States continue to run large current account deficits?* That is the type of analysis the Committee would like to see more of, but focused on Australia's own current account situation and the risks it might represent to the economy.

3.163 In fact, the Committee suggests that an in-depth analysis of developments in Australia's current account be an annual feature article in the Economic Roundup bulletin. Questions which should be analysed on a regular basis include:

- What would it mean for Australia if the CAD averages around 6% of GDP for the next few years?
- Is there a level at which the CAD becomes unsustainable?
- What are the options for improving the long-term average of the CAD?
- What lessons can we learn from other countries such as Canada?
- What would be the effects on the Australian economy of possible shocks such as a terrorist attack or an energy crisis?
- What would the implications for the economy be of large and unexpected falls in business and/or consumer confidence, and what factors could trigger such falls?
- What would be the impact of a sharp downturn in international demand for Australia's exports of minerals and energy?

3.164 The Treasury should also take more opportunities to publicly discuss issues related to developments in Australia's current account.[90] The Committee recognises that Treasury's task in managing the economy is not an easy one, but the precautionary principle demands that it fully considers a wide range of possible scenarios.

Recommendation 3

The Committee recommends that the Government introduces policies designed to bring about an improvement in the medium-to-long term average of the current account deficit, including improving domestic savings and increasing the diversity and international competitiveness of the export sector

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90 For example, Treasury presented a paper to the ABE Forecasting Conference on 14 December 2004 titled 'Australia's medium-term challenges'. Key challenges for Australia identified in the paper include labour productivity, household debt, and exports. The paper also contained a discussion of the USA's current account deficit - but curiously not our own.