The Global Economy
Micro-Case

Risk Analysis: Australia, April 2009

Revised: May 8, 2009

As a European investor in short-term Australian securities, you have made a fair amount of money over the last decade betting that Australia's high interest rates would not be offset by declines in the value of its currency. You wonder, however, whether it's time to take your money and run.

Having some experience with such situations, you check the Economist Intelligence Unit's Country Data, summarized in Table 1, and Country Risk Service, which reports:

- The exchange rate is flexible, and could move either way against the euro.
- Australia's large net foreign liability position reflects a combination of direct investment in Australian businesses, notably mining, and the carry trade, in which investors purchase AUD-denominated assets in order to benefit from relatively high local interest rates.
- The banking system faces higher financing costs due to global credit conditions, but is stable. Government guarantee of deposits has reduced the risk of failures.

With this information in hand, you how would you assess your risk of continuing to invest in short-term Aussie debt? Would you continue to invest in Australia or look for opportunities elsewhere?

	2002	2003	2004	2005	2006	2007	2008	2009
GDP growth (real)	4.3	3.0	3.8	2.8	2.8	4.0	2.1	–1.6
Inflation	3.0	2.8	2.3	2.7	3.5	2.3	4.4	1.2
Interest rate: short	4.6	4.8	5.3	5.5	5.8	6.4	6.7	2.8
Interest rate: long	5.8	5.4	5.6	5.3	5.6	6.0	5.8	3.3
Investment rate	24.1	25.2	25.5	26.5	26.8	27.8	28.7	
Saving rate	20.1	20.4	20.0	21.3	21.2	21.9	24.3	
Current account	–3.8	–5.5	–6.1	–5.8	–5.5	–6.4	–4.2	–3.5
Govt budget: total	1.3	1.8	1.1	1.5	1.5	1.6	1.8	–3.3
Govt budget: primary	2.9	3.2	2.4	2.7	2.6	2.6	2.7	–2.6
Govt debt	20.1	18.5	17.5	17.0	16.4	15.4	13.9	
Exchange rate	1.84	1.54	1.36	1.31	1.33	1.20	1.19	
Real exchange rate	100	113	121	125	125	133	132	
FX reserves (USD)	21	32	36	42	53	25	31	
FX reserves (months)	2.9	3.7	3.3	3.4	4.0	1.6	1.7	
Net foreign assets	–68	–68	–65	–71	–77	–89	–103	

Table 1: Economic indicators for Australia. Notes: (i) Investment, saving, current account, government budget, government debt, and net foreign assets are expressed as percentages of GDP (ratios multiplied by 100). (ii) Government budget numbers are "balances": positive numbers are surpluses, negative numbers are deficits. (iii) The exchange rate is the Aussie dollar (AUD) price of one US dollar; high numbers indicate that foreign currency is expensive. The real exchange rate is a weighted average across trading partners. The convention is the inverse of the exchange rate: high numbers indicate that local goods are expensive relative to foreign goods. (iv) Foreign exchange reserves are expressed, first, in billions of USD, second, as a ratio to monthly imports. Thus the number 2.9 means that reserves are 2.9 times one month's imports. (v) 2009 numbers are estimates.