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HD **In a convoluted way, we're buying back the farm**

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Did you know that, at the end of last year, the value of Australians' **equity** investments abroad exceeded the value of foreigners' **equity** investments in Australia by more than $23 **billion**?

It's the first time we've owned more of their businesses, shares and real estate ($891 **billion** worth) than they've owned of ours ($868 **billion**).

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These days in economics there's an easy way to an exclusive: write about something no one else thinks is worth mentioning, the balance of payments. We'll start at the beginning and get to **equity** investment at the end.

Before our economists decided the current account deficit, the foreign debt and our overall foreign liability weren't worth worrying about, we established that, when measured as a percentage of national income (gross domestic product), the current account deficit moved through a cycle with a peak of about 6 per cent, a trough of about 3 per cent and a long-term average of about 4.5 per cent.

Those dimensions were a lot higher in the global era of floating exchange rates than they'd been in the era of fixed exchange rates (which ended by the early '80s). This worried a lot of people, until eventually economists decided the new currency regime meant there was less reason to worry.

This explains why economists haven't bothered to note that for four of the past five financial years, the figure for the current account deficit as a percentage of GDP has started with a 3. And, as we learnt earlier this month, the figure for the year to December was 2.9 per cent.

So it seems clear that recent years have seen a significant change in Australia's financial dealings with the rest of the world. And the consequence has been to lower the average level of the current account deficit.

The conventional way to account for this shift is to look for changes in exports, imports and the "net income deficit" - the amount by which our payments of interest and dividends to foreigners exceed their payments of interest and dividends to us.

The first part of the explanation is obvious: over the past decade, the world's been paying much higher prices for our exports of minerals and **energy**. This remains true even though those prices reached a peak in 2011 and have fallen since then.

On the other hand, the prices we've been paying for our imports have changed little over the period. So, taken in isolation, this improvement in our "terms of trade" is working to lower our trade deficit and, hence, the deficit on the current account.

Next, however, come changes in the quantity (volume) of our exports and imports. Here, over the full decade, the volume of imports has grown roughly twice as fast as growth in the volume of exports. Until the global financial crisis, we were living it up and buying lots of imported stuff. And maybe as much as half of all the money spent on expanding our mines and gas facilities went on imported equipment.

The more recent development, however, is that the completion of mines and gas facilities means enormous growth in the volume of our mineral exports - with a lot more to come. At the same time, as projects reach completion there's a big fall in imports of **mining** equipment. That's a double benefit to the trade balance and the current account deficit.

Turning to the net income deficit, it's been increased by the huge rise in **mining** companies' after-tax profits, about 80 per cent of which are owned by foreigners. Going the other way, world interest rates are now very low and likely to stay low.

Put all that together and it's not hard to see why current account deficits have been lower in the years since the financial crisis, nor hard to see they're likely to stay low and maybe go lower in the years ahead.

The current account deficit has to be funded either by net borrowing from foreigners or by net foreign "**equity**" investment in Australia businesses, shares or real estate.

This means the current account deficit is the main contributor to growth in the levels of the national economy's net foreign debt, net foreign **equity** investment and their sum, our net foreign liabilities.

Historically, our high annual current account deficits worried people because they were leading to rapid growth in the levels of our net foreign debt and net total liabilities.

But looking back over the past decade, and measuring these two levels relative to the growing size of our economy (nominal GDP), there's no longer a clear upward trajectory. Indeed, it's possible to say our net foreign debt seems to have stabilised at about 50 per cent of GDP, with net total liabilities stabilising a little higher.

Over the decades, the level of net foreign **equity** investment in Australia has tended to fall as big Aussie companies become multinational by buying businesses abroad and Aussie super funds buy shares in foreign companies, thus helping to offset two centuries of mainly British, American, Japanese and now **Chinese** investment in Aussie businesses.

But the net total of such **equity** investment is surprisingly volatile from one quarter to the next, being affected not just by new **equity** investments in each direction, but also by "valuation effects" - the ups and downs of various sharemarkets around the world as well as the ups and downs in the Australian dollar.

Between the end of September and the end of December, net foreign **equity** investment swung from a net liability of $27 **billion** to a net asset of $23 **billion**. This was mainly because of valuation effects rather than transactions, so I wouldn't get too excited.

What it proves is that, these days, the value our **equity** investments in the rest of the world isn't very different from the value of their **equity** investments in Oz.

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