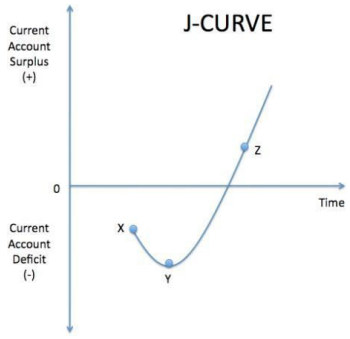
Assess the implications of depreciated AUD on Australia's economy.

Since the floating of the exchange rate in 1983, the Australian dollar's (AUD) value is determined by market forces of supply and demand so for a depreciated AUD, the domestic supply of the dollar must have decreased or the global demand for the dollar increased or the combination of the two. The depreciation of the AUD may have implications on Australia's economy in the form of affecting its BOGS and Terms of Trade, international competitiveness, Balance of Payments, the level of foreign investments and domestic inflation, economic growth, unemployment.

With the slowdown of China's economy through 2013 to 2016, the AUD's value has depreciated significantly as China's demand for the AUD decreased. At the start of 2013, the AUD was valued at US$1.04 and by the end of 2016, the AUD fell to US$0.7. In the ST~~This~~ this depreciation led to decreased export revenue and increased import outflows as consumers and businesses are yet to adjust their volumes, assuming that the import prices of the goods and services are elastic as export prices are inelastic as Australia mainly exports commodities which are price inelastic due to their necessity. The continual deterioration of the terms of trade from 2013-14 (104.6) to 2014-15 (92.8) and again in 2015-16 (87.9) reflects that as the depreciation of the AUD continues, the value of imports will increase faster than the value of exports as import prices rise while export prices are the same causing the terms of trade to deteriorate. These short term impacts of a depreciated AUD can be represented by the J-curve.



The short term period is represented by the interval between point X and point Y which shows a worsening of the Current Account Deficit as BOGS worsens. As the price and volume of exports stay the same in the short term, export revenue will decrease which in shown in Australia's export revenue in their Balance of Payments as in 2013-14 to 2014-15, export revenue decreased by $12 billion, from $331 billion to $319 billion and a further decrease in 2015-16 to $314 billion. Thus in the short-term when the AUD depreciates, the terms of trade will deteriorate as export revenue decreases as the export prices stay the same and imports outflows will increase as domestic consumers have lower purchasing power overseas.

By 2016, the AUD stopped depreciating and started to increase in value. This is represented by the local minima on the J-curve where consumers have started to switch from imports to

Kommentiert [1]: I would suggest including a different topic sentence here. This one doesn't add too much to your intro

Kommentiert [2]: Maybe consider outlining a brief recount of the AUD depreciation

Kommentiert [3]: briefly outline whether the impact was positive on the indicators mentioned here!

Kommentiert [4]: typically we assume that export commodities are inelastic, BUT we cannot make that assumption for all of Australia's exports

Kommentiert [5]: Also saying that export and import prices are elastic/inelastic refers to the price elasticity of supply! You should be referring to the price elasticity of demand :) - in the ST demand is inelastic and in the LT demand is elastic (or depends on the type of good being sold)

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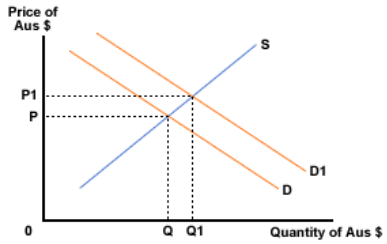
Kommentiert [6]: This represents the start of the long term impact of a depreciation (typically more than 3-6 months - check the timeframe you have for the stats in the above paragraph - I have highlighted)

cheaper domestic substitutes which initiates a decline in import spending and will improve BOGS. The AUD had reached a value of $US0.7 in 2016 before appreciating up to $US0.8 in 2018. This appreciation would also have been caused by an increase in export revenue as overseas consumers spend more on Australian exports as they have more purchasing power so Australian goods and services are relatively cheaper than their domestic counterparts. Export revenue in 2015-16 was at $314 billion which then increased ~~by $59.8 billion~~ to $373.8 billion in 2016-2017 and continued to increase to $470.2 billion by 2018-19. The continual increase in export revenue can be attributed to increased global demand for Australian commodities and services such as iron ores, coal and education which were relatively cheaper than other economies due to the depreciated AUD. The terms of trade would have 3 consecutive years of improvements starting from 2016-17 at 100.6 improving by 10.93% to 111.6 in 2018-19. Export revenue had risen more quickly than import spending which indicates a higher level of international competitiveness. With higher value of exports the demand curve for the AUD would shift outwards from D → D1, showing an increase in demand, establishing a new equilibrium at a higher price (P1) and higher quantity (Q1).



Furthermore, with import spending not increasing as much, the supply of the AUD would not increase as much either which alongside the increased demand will contribute to the appreciation of the AUD. Hence, a depreciation in the AUD in the long-run will increase export revenue and raise international competitiveness shown through improvements in the terms of trade.

Another implication of a depreciated AUD is the increase of foreign investments into Australia. The AUD was valued at US$0.78 in December of 2017 and it depreciated to $US0.7 in December of 2018 and this depreciation contributed to the increase of $240 billion worth of foreign investments into Australia. This is due to investments into Australia being relatively less expensive to overseas investors, incentivising investments which leads to increased financial flows into Australia which is an injection into the economy. Moreover, as the AUD depreciates, overseas assets would become more expensive for domestic investors so this incentivises domestic investment leading to less financial outflows which would lead to less NPY inflows, worsening the CAD. For foreign-owned Australian assets, the 'valuation effect' would decrease the values of income outflows from Australia. However it is negated by hedging, where the foreign investor would prefer the income value to be paid in the AUD as to avoid the depreciation of the AUD devaluing the income paid. This can be seen as 95% of Australian debt is hedged against the AUD showing the hedging negation of the 'valuation effect'. Therefore, the

Kommentiert [7]: ignore the appreciation as you should be focusing on the impacts of a depreciation!!

Kommentiert [8]: should be for services!! (these are price elastic)

Kommentiert [9]: TOT and international competitiveness should not be related as the first is relating to inelastic demand G/S and the latter refers to elastic demand for G/S

Kommentiert [10]: not too relevant

Kommentiert [11]: check ^

Kommentiert [12]: isn't too relevant because Australia has a low domestic savings rate and thus doesn't have much to invest anyways :(

Kommentiert [13]: outline briefly why thee would be less NPY inflows

depreciation of the AUD would worsen the NPY as Australian investments overseas decrease and existing assets will outflow the same value of income.

When the AUD depreciates, overseas goods and services would be relatively more expensive to domestic consumers leading to higher import prices. Furthermore, domestic businesses are pressured to raise their prices as their production costs from overseas are increased leading to cost-push inflation. In 2018, import prices rose by 2.1%, this can be attributed to the rise in prices of inorganic chemicals, rising by 19.7%, leading to higher production costs. In addition, due to the CPI increase imported household items as well as the cost-push inflation, underlying inflation increased to 2.5% in 2018-19. Thus, the combination of a higher CPI of imports and cost-push inflation, domestic inflation increased.

Kommentiert [14]: why do production costs increase?

Kommentiert [15]: nice!

The aforementioned effect of a depreciated AUD on the BOGS, leading to a BOGS surplus will increase economic growth as aggregate demand as BOGS is one of its components. The equation for aggregate demand is C + I + G + (X - M) and with a BOGS surplus, so as (X - M) increases, aggregate demand increases leading to economic growth. This can be seen in 2014-15, when the dollar depreciated from a value of US$0.93 to US$0.79 and recorded a GDP growth of 2.3%. In the following year, the dollar further depreciated to US$0.69 and recorded an increased GDP growth of 2.8%. Hence, a depreciation in the AUD would lead to higher domestic growth rates ~~in the long term~~.

Kommentiert [16]: nice!

The long term effects of the AUD depreciating from 2014 onwards are higher domestic demand for import substitutes as import prices rise so domestic consumers turn to domestic substitutes, as well as there will be higher global demand for Australian exports as overseas consumers will have relatively cheaper prices. A higher domestic demand for import substitutes will lead to a higher demand for labour as it~~labour~~ is a derived demand. In addition to this, with higher global demand for exports, export industries such as mining and services will demand more labour. This can be seen in the long term trend from 2014-2019 as the AUD depreciated from $US0.93 to US$0.67 and the unemployment rate falling from 6.06% to 5.18%. Therefore, a depreciated AUD will decrease the unemployment rate.

Kommentiert [17]: find some stats to show services employment improve!

Kommentiert [18]: nice!

Hence, the depreciated AUD would lead to a BOGS deficit in the short term as import prices rise however in the long term, volume is changed as there will be a higher demand for exports leading to a BOGS surplus. This would lead to higher rates of economic growth and less unemployment however it will raise inflation rates. The depreciated AUD would also instigate the valuation effect, but this will be negated by hedging.

Great essay! Check the comments throughout for feedback. Review the essay after our first lesson back so you get more ideas to consider for this essay (and how you should explain your links)