Appointed as Austrade’s Chief Economist in September 2013, Mark Thirlwell has been tracking global economic trends since he joined the Bank of England’s International Divisions in 1990, where he worked as part of the Whitehall Economists Subgroup, coordinating the forecasting of major emerging markets across the Bank, Treasury, the FCO and other key stakeholders.

Mark subsequently joined J P Morgan as a Vice President in Economic Research with responsibility for Central Europe.

He later served as Senior Economist at Australia’s Export Finance and Insurance Corporation (EFIC), working on sovereign risk with a particular focus on East Asia.

Before joining Austrade, Mark was the inaugural Director of the Lowy Institute’s International Economy Program and a Fellow at the Institute’s G20 Studies Centre. Mark was one of the original research team that helped establish the Lowy Institute as one of Australia’s leading think tanks. Mark is also a Visiting Fellow at the Australian National University’s National Security College.

Mark has degrees in economics from Cambridge and Oxford Universities and a postgraduate qualification in applied finance from Macquarie University.
The basic theme of today’s presentation: Since start of current century, and in particular over the past decade, Australia’s comparative advantage, and hence export profile, has been reshaped in fundamental ways. Now, some of the key drivers of that earlier change are themselves morphing, with significant implications for our export prospects.

The charts above capture arguably the single biggest global force that has influenced Australia’s export performance over this period: the onset of rapid catch up growth in emerging economies in general, emerging Asia in particular, and in China above all.

The first panel is a great McKinsey graphic which emphasises (1) the unprecedented speed and (2) the unparalleled scale of this ‘Great Convergence’ when viewed in historical perspective.

The second panel shows the catch-up process in action: around about the start of the current century, a sizeable growth gap opens up between advanced economies on the one hand and emerging and developing economies on the other. The rapid growth in the latter also increasingly powers global growth over this period.

Note that the onset of the GFC disrupts growth performance, but not the catch-up process.
Catch-up growth of this magnitude and pace is resource-intensive, and triggered what came to be known as a commodity super cycle. That had profound implications for Australia, with the price of our resource exports more than tripling over the decade to 2012. That in turn powered a huge investment surge, with the share of resource investment in our GDP quadrupling, from two to eight per cent.

There were also fundamental consequences for our international competitiveness, as measured by the REER. The resource boom triggered a sustained period of REER appreciation, influencing the allocation of resources within the economy. Some very interesting work by the RBA finds that the REER was 44 per cent higher in 2013 than it would have been in the absence of the boom.

Note: The current version of the RBA’s commodity price index shown here captures 21 major commodities exported by Australia which together accounted for more than 90 per cent of Australian commodity exports as of 2011/12. The idea of using an SDR index is to capture the impact of changes in demand and supply in global markets by reducing the influence of changes in any particular exchange rate. The Australian dollar (A$) index then captures the domestic current price received by Australian commodity exporters. This is a product of the global price and the A$ exchange rate. So, for example, recent falls in the world price of commodities such as iron ore and coal have been partially offset by a depreciation of the A$ (which works to increase the A$ equivalent received by the local exporter).
The shift in global growth patterns, the commodity super cycle and the sustained and sizable REER appreciation together helped transform both the direction and the composition of Australia’s exports.

In terms of the direction of trade, there was a dramatic rise in the share of exports going to East Asia, from about 49 per cent in 2003-04 to about 70 per cent by 2013-14. Of course, exports to China drove that story, with China’s share of the total increasing from about eight per cent in the earlier period to almost 33 per cent by the later period, or about A$107.6 billion out of a total of A$331 billion of goods and services exports that year.
The critical importance of China can also be seen in the outsized contribution to export growth it made over the course of 2013-14.

Last year, total exports of goods and services increased by about A$29 billion. Exports to China alone increased by more than A$22 billion. By way of contrast, exports to the whole of the ASEAN-10 (the second largest source of growth in exports that year) only increased by about A$3 billion over the same period.
The change in the direction of exports was closely associated with a shift in the composition of those exports.

In particular, there was a big increase in the share of exports accounted for by minerals and fuels, which increased from around 25 per cent in 2003-04 to about 51 per cent by 2013-14, or about A$167 billion of the A$331 billion of total exports of goods and services that year.
Exports of iron ore (to China!) have been a key part of the story. Of the A$29 billion increase in exports in 2013-14, about A$17 billion was an increase in exports of iron ore and concentrates.

Again, can compare to the second largest contributor, which was natural gas, at about A$2 billion.

Note: Other ores are mainly lead, zinc and manganese
Previous charts showed how Australia’s export mix has been transformed by global trends and our adjustment to them over the past decade. But what do those same trends look like now?

One important difference relates to global growth, which is now more fragile and significantly lower than the pre-crisis trend.

Beyond that, the ‘growth gap’ between advanced and emerging economies has narrowed dramatically – although it is still there. That probably reflects a combination of at least two factors:

1. The international economic environment has become less friendly to catch-up growth.

2. Growth models are changing in the emerging world, particularly in China, where Beijing is trying to shift from an investment-intensive growth model to a more consumption-driven model.

Those changes are important. That’s because the early, investment-intensive phase of catch-up growth tends to be a particularly resource intensive one. While consumption-led growth will tend to give a relatively bigger role to different items, including food and to services.
Those shifts in the growth profile PLUS the supply-side consequences of a global resource sector investment boom that has expanded capacity dramatically have together produced substantial falls in commodity prices.

At the same time, and after a lag which probably reflected the extreme monetary policy settings across much of the developed world, the nominal value of the dollar and hence the REER have also started to fall.

In both cases, the adjustment to date has not unwound all of the previous increases. Even so, the changes are substantial, and indicate a significant shift in some of the key forces that have underpinned Australia’s export performance.

So, what comes next?

Note: Line on second panel shows post-float average for real exchange rate.
Well, despite all these changes, we think that our key regional trading partners are likely to continue to maintain that status.

That said, it's also plausible that the large degree of concentration in our current export profile might seem some reversal in coming years - with recovery in the United States, growth picking up in India, and a stronger trade performance with ASEAN.
Resources will also continue to be an important part of the Australian export story. In fact, all of that new resource investment will see volumes increase, including in particular in the LNG sector.
In addition, however, we think that a consumption-driven growth model will be good news for food and beverages, with Australian exporters leveraging our reputation as a clean, green and safe source of agricultural and food exports. Already, nine of our top ten export markets are located in East Asia and the Pacific, where food demand is forecast to continue to expand dramatically over coming decades.
Likewise, we see strong prospects for the tourism sector, helped both by strong regional demand and a more competitive exchange rate.

Australia saw record tourism expenditure in 2013-14, lifted by strong Asian market demand, as well as robust demand from traditional markets such as the UK and US.

The forecast by TRA to 2017-18 is strong, with China, India and other Asian economies predicted to drive much of this anticipated growth.
Education is another important area of international strength, with Australia the fourth most popular destination for students choosing to study overseas.

Indicators for both education and tourism suggest a lift from the decline in the currency over recent months.
So we think that this new international environment offers Australian businesses some significant opportunities. But it also comes with some challenges attached. In part, these are a reflection of a volatile global trading environment, characterised by sluggish growth, unprecedented policy settings and ongoing currency adjustment. But it’s also the case that exporters of food and services often have to face relatively tougher trade and other barriers than do resource exporters. That’s because food and services tend to be sensitive politically, and often involve a host of ‘behind-the-border’ issues.

In this context, Australia’s growing network of FTAs has an important role to play in terms of securing enhanced market access. Australia now has FTAs in place with eight of our top ten trading partners, covering more than two-thirds of our total trade.

Note. Date for ASEAN agreement is for Indonesia, the 12th and final signatory. We also have an FTA with Chile (not shown).
In conclusion, while we think it’s still going to be a challenging time to be an exporter – when hasn’t it been in recent years? – we also think it’s going to be an exciting one, with some significant opportunities for Australia.