

Box A

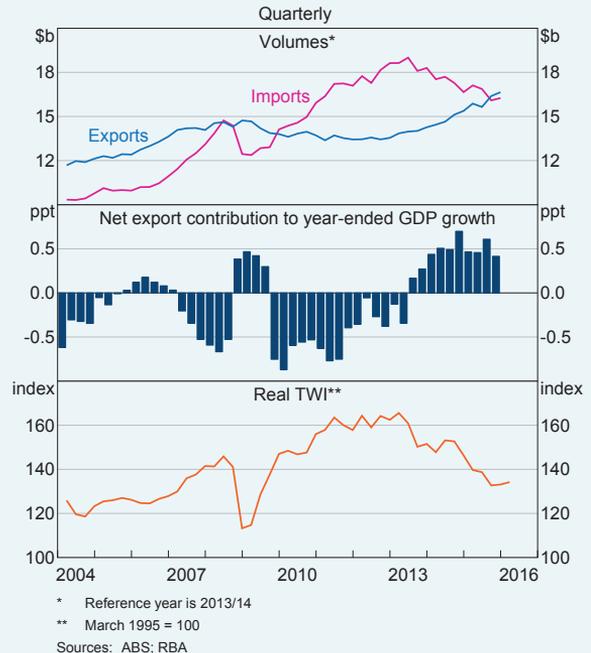
Australian Services Trade

Net service exports have contributed around ½ percentage point to annual GDP growth in Australia over the past couple of years, reflecting a pick-up in service export volumes and a decline in service imports (Graph A1). This follows a period of about four years during which net service exports subtracted from GDP growth, as service export growth was relatively subdued and service import volumes grew strongly. This Box discusses the key drivers of Australia's service exports and imports since the early 2000s and considers the prospects for net service exports over the coming years.

A range of factors affect Australia's services trade, including global demand for services in the case of exports and domestic demand for services in the case of imports. The exchange rate has also been a key driver. The resources boom in Australia was associated with a large appreciation of the Australian dollar.¹ Over the decade to 2013, this contributed to subdued growth in Australia's service exports, which became relatively more expensive in foreign currency terms. Slower growth in global demand since the financial crisis also played a role. Over the same period, the high level of the exchange rate supported strong growth in service imports to Australia, as they became relatively less expensive compared with domestically produced services.

1 The resources boom has had a significant impact on production, demand and prices in Australia. Movements in the Australian dollar are heavily influenced by commodity prices (see Hambur J, L Cockerell, C Potter, P Smith and M Wright (2015), 'Modelling the Australian Dollar', RBA Research Discussion Paper No 2015-12). Large movements in the exchange rate have contributed to the relatively smooth adjustment of the macroeconomy to date. See, for example, Lowe P (2015), 'Managing Two Transitions', Speech at the Corporate Finance Forum, Sydney, 18 May.

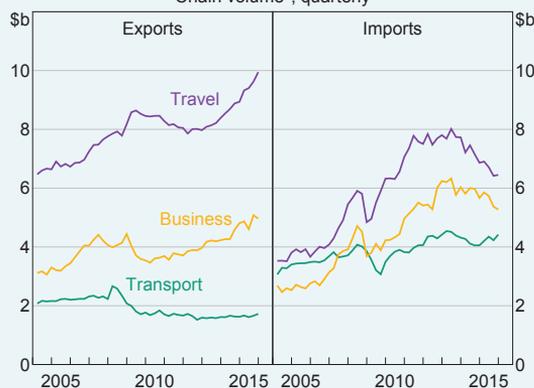
Graph A1
Services Trade



Since 2013, with the decline in commodity prices and mining investment, and the depreciation of the Australian dollar, these trends in services trade have reversed. Australia's exports of services, including education, tourism and business services, have increased over the past few years, while service imports to Australia have declined noticeably (Graph A2).

Trade in travel services, which includes tourism and education, has been particularly responsive to movements in the exchange rate. Exports of travel services have increased significantly in recent years in line with the substantial increase in visitor

Graph A2
Services Trade Components
 Chain volume*, quarterly

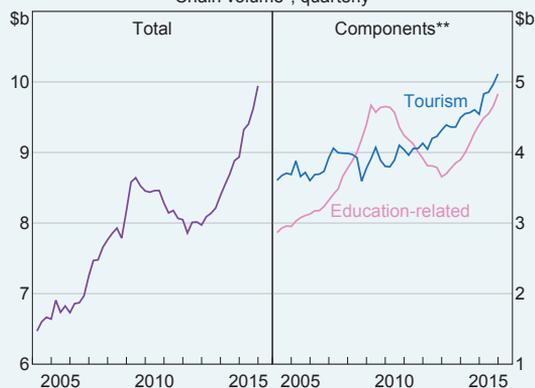


* Reference year is 2013/14
 Source: ABS

arrivals, particularly from China and east Asia.² The spending of foreign visitors in Australia typically responds rapidly to the increase in the purchasing power of foreign currency in Australian dollar terms. The number of visitors appears to adjust more slowly, consistent with the substantial lead time in planning overseas travel. Education exports, which make up around half of travel service exports and capture the expenditure of overseas students studying in Australia, have been a major contributor to growth in travel service exports (Graph A3). While education exports are likely to respond to changes in the exchange rate, they also depend on other factors, such as the perceived quality of educational institutions and changes in migration policies, including requirements for student visas and the ability to use study in Australia as a pathway to permanent migration.³

2 Travel service exports provide an estimate of spending on goods and services by foreigners while they are in Australia, including tuition fees for international students. International transport fares, together with freight services, are included in transport service exports.
 3 For further discussion of the factors affecting demand for education exports, see Productivity Commission (2015), 'Barriers to Growth in Service Exports', Research Report, Canberra. Available at <<http://www.pc.gov.au/inquiries/completed/service-exports/report/service-exports.pdf>>

Graph A3
Travel Service Exports
 Chain volume*, quarterly



* Reference year is 2013/14
 ** Tourism service exports are travel service exports less education-related exports; education-related exports are seasonally adjusted by RBA
 Sources: ABS; RBA

While travel exports have risen substantially over recent years, travel imports have declined by almost as much, as Australians have shifted some of their spending away from international holidays – which have become relatively more expensive – to domestic trips. Growth in the number of Australians travelling internationally has slowed, especially to popular east Asian destinations such as Thailand.⁴ The second largest component of services trade is business services. The depreciation of the Australian dollar has also improved the international competitiveness of Australian business service firms. Consulting, financial and technical services provided by firms in Australia appear to be benefiting from the lower exchange rate, as business service exports have grown steadily in recent years and imports have declined. In the short to medium term, the depreciation is more likely to affect contract-based

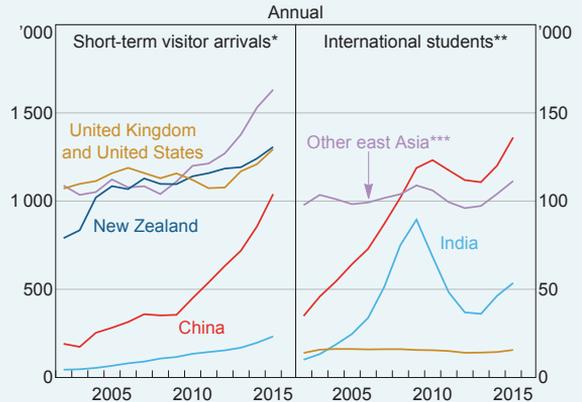
4 For discussion of developments in Australia's tourism industry, with perspectives from the Bank's business liaison program, see Dobson C and K Hooper (2015), 'Insights from the Australian Tourism Industry', RBA Bulletin, March, pp 21-31. See also, Tourism Research Australia (2016), 'Travel by Australians: December 2015 Quarterly Results of the National Visitor Survey', March. Available at <<http://www.tra.gov.au/research/Travel-by-Australians-December-2015-quarterly-results-of-the-National-Visitor-Survey.html>>.

work. However, if the exchange rate remains at lower levels for an extended period, some firms may choose to bring production of services back to Australia that had previously moved offshore to benefit from lower costs.

The east Asian region has been an important source of demand for Australia's service exports. Australia has benefited from its geographical proximity to the expanding middle class in China and the broader east Asian region. The strong growth in service exports to this region over recent years means that east Asia now accounts for about one quarter of Australia's business service exports and almost half of travel service exports. Around half of international students in Australia come from east Asia, and another 10 per cent or so come from India (Graph A4). The increase in travel service exports to the east Asian region has been most dramatic for China; Chinese visitors make up almost 15 per cent of total short-term arrivals, up from less than 5 per cent in the early 2000s.

There is considerable scope for Australian service exports to the Asian region to continue to increase over time. The prospects for further increases in per capita incomes in Asia imply that the demand for Australia's service exports is likely to continue to rise. As households' disposable incomes increase, they tend to consume more services such as education and travel, some of which they will pursue offshore. Similarly, as the region continues to grow, firms in east Asia are likely to demand more business services. Australia is well positioned to capitalise on this demand, although the future growth in Australia's services trade will also depend on the extent of competition, which is likely to be intense, and exchange rate movements, which will affect Australia's price competitiveness. ✎

Graph A4
Visitors and International Students



* Visitors with length of stay less than 12 months; some students are also captured in the short-term arrivals data

** Students studying on an international student visa; New Zealand students do not require a student visa to study in Australia

*** Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand

Sources: ABS; Department of Education and Training; RBA