The Significant Shift in Australia's Balance of Payments

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Abstract

Over recent years Australia has seen a large shift in its external accounts. In contrast to long-running deficits, the current account balance has now been in surplus for over two years, supported by record trade surpluses. The corollary of this is that the level of national savings has surpassed investment and Australia has become a net exporter of capital. This article examines these changes and highlights some key trends that are associated with this shift. These include the decline of foreign direct investment following the end of the mining boom, as well as an increase in purchases of foreign equities by Australian superannuation and investment funds. These developments have contributed to a significant decline in Australia's net foreign liability position as a percentage of GDP, which is at its lowest levels in a number of decades.

Introduction

The balance of payments is a statistical statement that summarises the economic transactions of an economy with the rest of the world for a specific time period. It divides transactions into two broad accounts: the current account; and the combined capital and financial account. In essence, the current account captures the net flow of money that results from Australia engaging in international trade, while the combined capital and financial account captures Australia's net change in ownership of assets and liabilities. These broad accounts are often referred to as the 'two sides' of the balance of payments (RBA 2022).

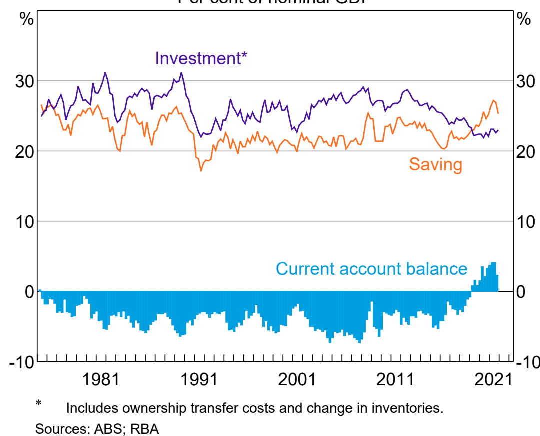
In recent years, Australia's current account position has shifted from a long history of deficits to being in surplus, reflecting the largest trade surpluses on record. Over the three decades from the early 1980s, Australia ran current account deficits equivalent to around 4 per cent of nominal GDP. This was largely due to a surplus of attractive investment opportunities in excess of Australia's capacity to fund those via domestic savings, and so funding was sourced from overseas. At times, these deficits

have been the source of much economic debate about the sustainability of Australia's macroeconomic growth.[1]

While the current account balance is the sum of the trade balance and the net income balance, it is also equal to the difference between national savings and investment. This relationship is helpful for understanding how developments in the domestic economy relate to changes in the external accounts. Unlike in the past, Australia's economy now generates savings in excess of domestic investment, and the current account is in surplus (Graph 1).

As a result of saving exceeding domestic investment, Australia is now a net lender to the rest of the world. This is recorded as a capital outflow, and the capital and financial account is now in deficit (Graph 2). The composition of Australia's capital flows has also changed significantly in the past decade or so. Some recent (and probably temporary) factors related to the COVID-19 pandemic have contributed to these trends.

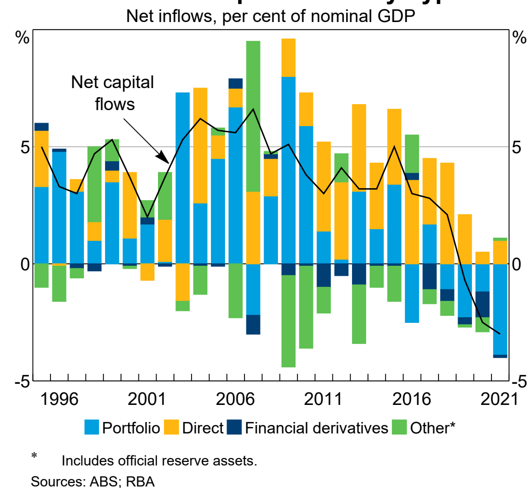
This shift to a capital and financial account deficit (net capital outflow) has contributed to a decline in Australia's net foreign liabilities – the total amount we owe foreigners less what foreigners owe us – which are at their lowest levels as a per cent of nominal GDP in a number of decades (Graph 3). The primary reason for this decrease in net liabilities has been the widening of Australia's net foreign equity asset position, while net foreign debt has remained little changed.

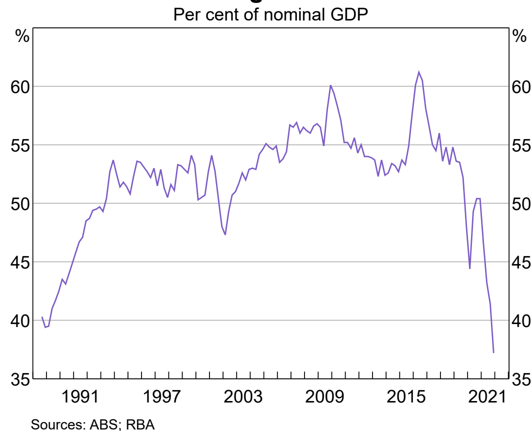


This article highlights some key trends that are associated with the development of a current account surplus in Australia. First, it examines the perspective of national saving and investment. It then focuses on the nature and extent of this change across the components of the current account and the combined capital and financial account.

Setting the scene through saving and investment trends

Investment in the Australian economy has historically been greater than saving, and as a corollary Australia has run current account deficits (Bishop and Cassidy 2012).[2] Historically, saving as a per cent of nominal GDP was similar to other advanced economies, while investment was





relatively high, particularly over the decade or so from the early 2000s (Graph 4).

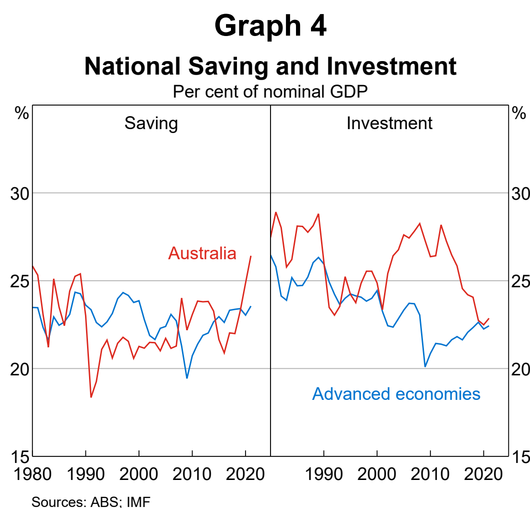
The relatively high level of investment in Australia over this period was associated with the investment phase of the mining boom, which attracted foreign capital. Companies in the resource sector expanded their productive capacity substantially in response to high commodity prices. By contrast, the investment share of GDP in other advanced economies declined over a similar period, particularly after the onset of the global financial crisis, and has remained low for a number of years (ECB 2017).

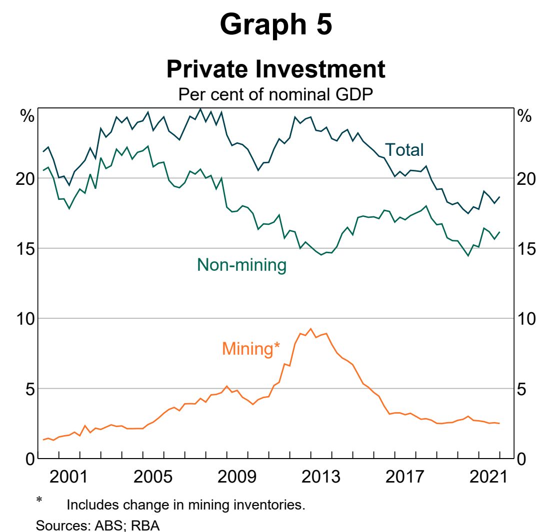
More recently, the investment share of GDP in Australia has declined to levels similar to those in other advanced economies. This largely reflects a decline in mining investment as the investment phase of the mining boom came to an end as well as a longer-run decline in the non-mining business investment share of output (van der Merwe *et al* 2018) (Graph 5). Meanwhile, housing-related and public sector investment has maintained a fairly steady share of output.

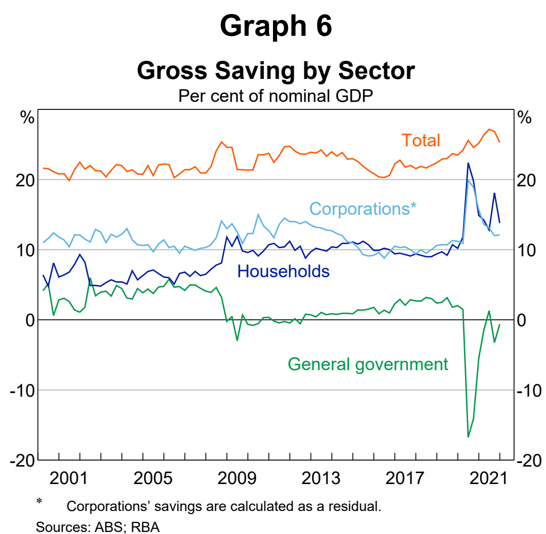
In addition, national saving has risen over recent years and now exceeds national investment. An upward trend was evident prior to the pandemic. This partly reflected the increase in commodity export revenues that occurred as a result of new production capacity following the mining investment boom, as well as a large improvement in Australia's terms of trade. These factors raised Australia's national income, part of which was saved. It also reflects a large increase in saving by the corporate and household sectors during the pandemic (Graph 6). The increase in household saving was associated with health-related activity restrictions reducing consumption opportunities, and a boost to incomes from government support measures. The rise in private sector saving was partly offset by a decline in (and indeed negative) government saving; the extraordinary fiscal policy measures put in place by federal and state governments to support incomes and employment during the pandemic led to a large increase in government deficits.

The current account perspective

Australia's current account balance shifted into surplus in mid-2019 for the first time since the 1970s







(Graph 7). Developments in the trade balance have been the main driver of this shift. After being in deficit for most of the previous four decades, the trade balance has been mostly in surplus since late 2016; it increased to its highest level on record at around 7 per cent of nominal GDP in the September quarter of 2021.

As mentioned above, this shift in the trade balance was primarily driven by the end of the mining boom – specifically the move from the investment phase to the production phase. The relative price of exports also rose over that time; the terms of trade are currently around 50 per cent higher than their trough in 2016, primarily reflecting large increases in iron ore, LNG and coal prices.

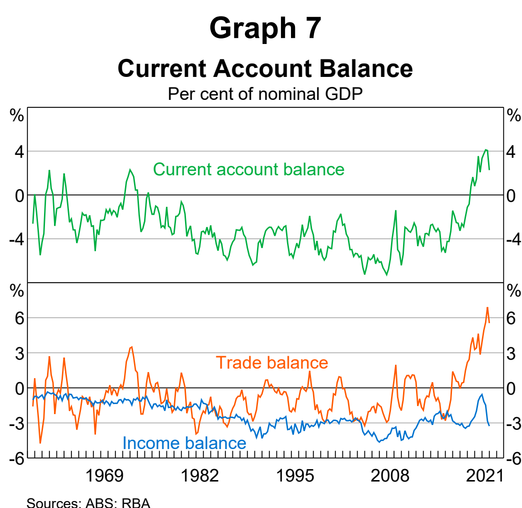
The other part of the current account is the net income balance. Since Australia's foreign liabilities are larger than foreign assets, Australia's payments are larger than its income received – accordingly, Australia has a net income deficit. The net income deficit narrowed over the few years prior to the pandemic mainly because the payments Australia made on its debt decreased as global interest rates declined (Graph 8). Interest rates paid to Australians that hold debt issued by foreigners likewise declined, but the stock of these assets is smaller than the stock of debt liabilities, so this decline was more than offset by the decrease in debt liability payments. After the onset of the pandemic the net income deficit narrowed further as Australian companies implemented dividend freezes and income outflows declined. However, the net income deficit has widened once more as dividend payments resumed.

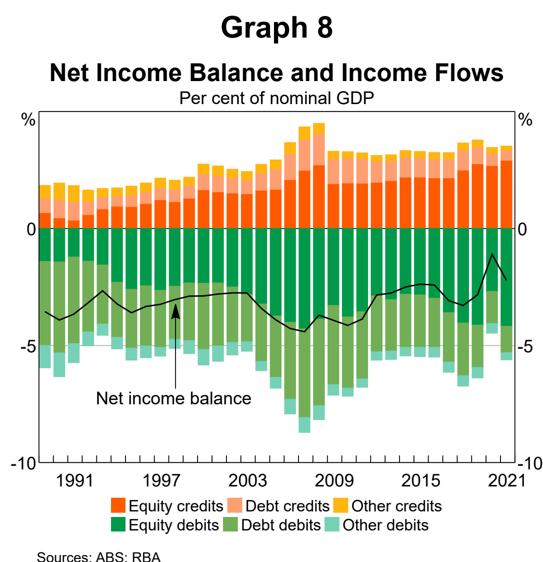
The financial account – the other side of the coin

Australia's history of current account deficits has meant it has sourced capital from the rest of the world in net terms. This inflow of capital has meant Australia has historically run a capital and financial account surplus. However, since 2019, when domestic savings became greater than investment, Australia has recorded a deficit on the capital and financial account (net capital outflows). These net outflows do not imply a lack of attractive investment opportunities in Australia – in fact, investment is at a similar level to other advanced economies, and there are still gross inflows of foreign investment (Graph 9). Rather, these developments reflect the outcomes of saving and investment decisions by all sectors of the Australian economy, which are influenced by the prices of assets and liabilities in different markets.

As such, there are three key factors that have contributed to Australia's shift to a net exporter of capital:

1. **The decline in investment from very high levels following the end of the mining investment boom.** In the financial account, this was reflected in a large decline in foreign direct investment (FDI) inflows. For the decade before 2018, net FDI inflows were equivalent to around

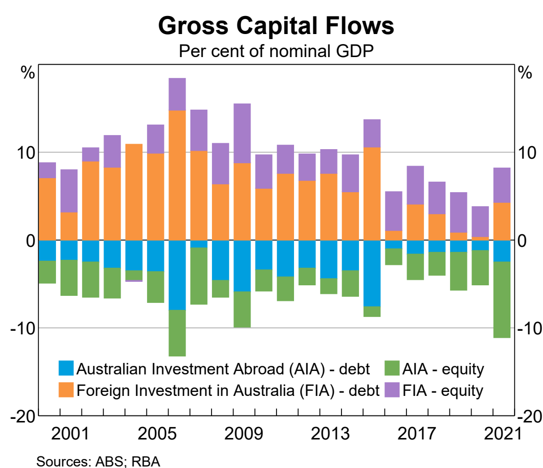




3 per cent of nominal GDP – a large share of which went to the mining sector. More recently, net inflows have declined to around 1 per cent of nominal GDP. The pandemic has added to this downward trend, reflecting the broader decline in FDI flows across the world (UNCTAD 2021).

2. **Mining companies now reinvest less of their earnings.** As export revenues have increased over recent years, mining companies have instead paid out larger dividends to an investor base with a relatively high share of foreign ownership. This change from reinvesting earnings (which are recorded as an income outflow in the current account and a financial inflow in the financial account) to dividend payments (shown as an income outflow) has contributed to equity outflows (Black, Chapman and Windsor 2017).
3. **The continued expansion of the superannuation sector.** The superannuation sector has grown substantially and there has been an increasing trend towards investment in equities, including foreign equities, as investors have moved out of other asset classes with lower returns, such as cash and fixed income. Reflecting this, portfolio equity outflows have increased over the past five years or so, as superannuation funds have increased the share of foreign equity assets in their portfolios (APRA 2021). In the past, portfolio equity outflows were more than offset by inflows of equity from FDI; however, more recently Australia has recorded a net outflow of equity as FDI inflows have declined and portfolio equity outflows have increased.

Graph 9



Some of the significant policy responses by the Australian Government and the Reserve Bank of Australia during the pandemic are also evident in the financial account. In 2020, there were large capital outflows related to the decline in the stock of the banking sector's offshore debt. In part, this reflected access to low-cost funding domestically, including through the Reserve Bank's Term Funding Facility, as well as a decline in credit growth. As a result, banks did not need to borrow in offshore markets and the outstanding offshore debt decreased by around 20 per cent in 2020 compared with the year prior. There were also large inflows of debt capital related to foreign purchases of Australian federal and state government debt in 2020. These inflows were the result of the government issuing a large amount of debt to fund the fiscal policies that supported incomes and employment during the pandemic.

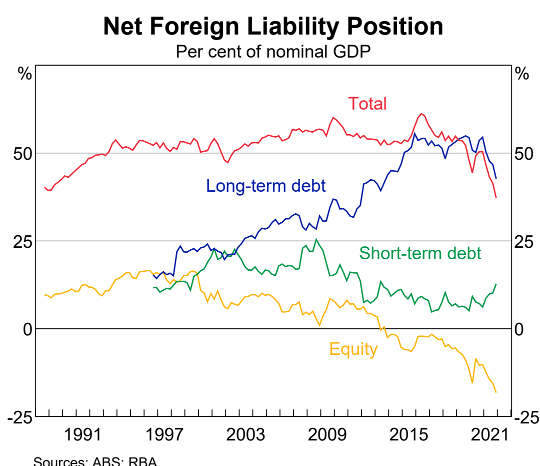
Net foreign liability position

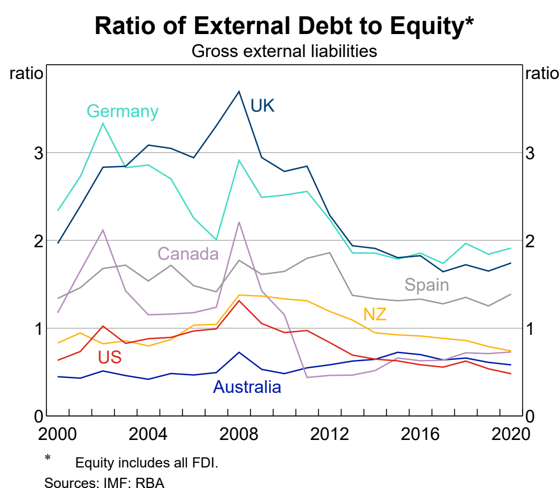
The net foreign liability position is the stock of debt and equity that Australia owes to foreigners less how much foreigners owe Australia; it represents the accumulation of Australia's net capital inflows over many years, as well as changes in the value of the stock of assets and liabilities. Historically, Australia's net borrowing from overseas increased its net foreign liability position and most offshore borrowing was in foreign currency. This led to debate about the level of Australia's external debt and its sustainability, as the extent of that debt measured in Australian dollars would increase whenever the exchange rate depreciated (Tease 1990). However, since the 1990s, most of Australia's foreign debt has either been borrowed in, or hedged back into, Australian dollars, thereby mitigating the exchange rate risk, particularly for the banking sector (Berger-Thomson and Chapman 2017).[3]

Australia's net foreign liability position has decreased over recent years (Graph 10). After

peaking in 2016 at just above 60 per cent of nominal GDP, it has declined to below 40 per cent of nominal GDP – its lowest level since the 1980s – consistent with the growing pool of domestic savings available to finance investment. The ratio of Australia's external debt to external equity has also been relatively low compared to other advanced economies; this is because much of the external financing of the mining boom was in the form of equity (Graph 11). As such, the composition of external liabilities means Australia should be less exposed to volatility in global funding conditions than if external debt was higher (Jacobs 2019).

The gross stock of external assets and liabilities has continued to grow as the Australian economy has become more integrated with global capital markets (Jacobs 2019). As discussed below, the composition of Australia's debt and equity positions has also changed significantly over the past three decades.



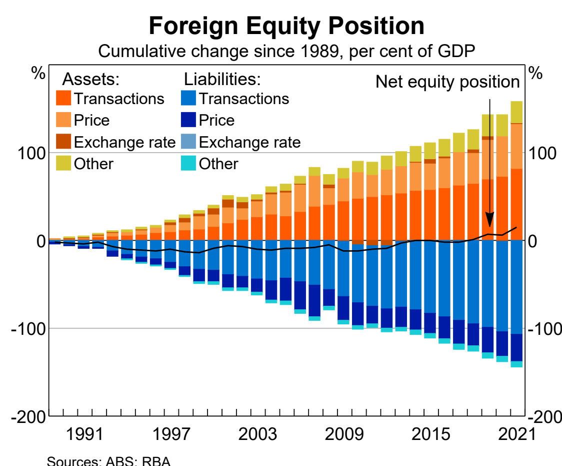


Equity

Underlying the decline in Australia's net foreign liability position has been the increase in Australia's net foreign equity assets. Since 2013, Australians have increasingly owned more foreign equities than foreigners own of Australian equities (Graph 12). This is in contrast to the net equity liability position recorded for most of Australia's history. The increase in net foreign equity assets has been driven by the net asset valuation effect (foreign equities have outperformed Australian equities) and other measurement changes.[4] The ongoing accumulation of foreign equity assets by Australia's superannuation sector, as discussed above, has also partly offset foreign purchases of Australian equities (Debelle 2019).

Debt

Australia's net debt liability position, as a share of nominal GDP, has remained fairly steady over the past five years or so. Over recent decades there has been a shift from short-term to long-term debt, facilitated by foreign investors purchasing Australian Government debt (Debelle 2019). Also, following the global financial crisis, regulatory changes such as Basel III provided an incentive for banks to reduce their use of short-term wholesale funding from offshore. Long-term debt reduces risks around having to roll over this funding during periods of heightened stress in financial markets (Jacobs 2019).

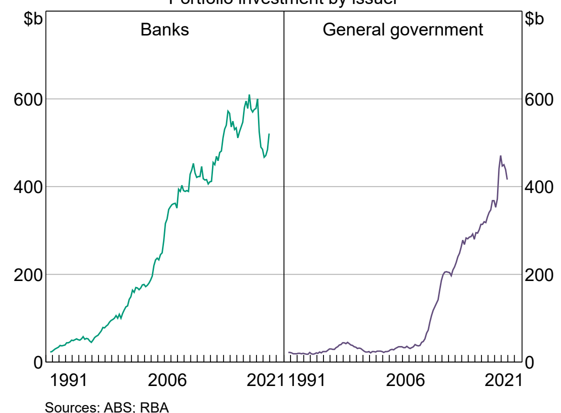


Responses to the COVID-19 pandemic have seen some changes to the composition of foreign debt liabilities. A large share of Australia's foreign-owned debt is issued by the banking sector (Graph 13). Prior to the pandemic, Australian banks' foreign portfolio debt liabilities had increased steadily as they chose to access international markets for around one-fifth of their total funding (Bellrose and Norman 2019). Since March 2020, the stock of Australian banks' foreign debt liabilities has declined to levels of around five years ago (as discussed above). Only recently have Australian banks started to return to international markets to raise funding in similar amounts to before the pandemic.

The stock of government debt owned by foreign investors has increased by around 20 per cent since March 2020, suggesting that foreign demand for Australian Government debt remains strong. While foreign ownership of government debt has increased, the large volume of issuance in this period means that the share of foreign ownership remains relatively low.

Conclusion

Australia's balance of payments and external position provide a useful lens through which to view changes in the domestic and global economy. As savings have exceeded investment over the past few years, the current account shifted from a deficit to a surplus. This followed the end of the investment phase of the mining boom as production came on line. Higher domestic savings throughout the pandemic have also contributed to this shift. Australia is now a net exporter of capital, as excess savings led to portfolio equity outflows and banks reduced their offshore borrowing, and the capital and financial account has shifted from a surplus to a deficit. ✠



Endnotes

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[1] For detail on this discussion, see Belkar, Cockerell and Kent (2007); Debelle (2011).

[2] Saving is a flow measure (rather than stock).

[3] The updated Survey of Foreign Currency Exposure will provide some insights into these implications later in the year.

[4] Other changes include adjustments in asset and liabilities positions not due to transactions or revaluation effects (e.g. reclassifications, holding gains or losses, and debt cancellation). For more detail, see IMF (2013).

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