The Australian Economy

By Justin Kelley

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Preface

Want to know some facts … economic facts. Well this book will give you a blast of facts. This book will look at the economic history of the land down under: Australia. This involves taking a glance at its past history and present economic condition. Australia is the appropriate nation to look at as its the one I reside in. If you had read my previous book titled *"A Beginner's Guide To Economics And Investing",* you would of discovered that that book was mostly about the United States. So, if you seek some economic facts about Australia, well look no further then to this book.

Introduction

As most of the introductory stuff had already been covered by the preface I will keep this introduction short. Australia is a country with a strong economy heavily focused on mining. This young nation has has a short history from the first penal colony to the gold rush to the Mining Boom with many ups and downs. However, Australia also has some economic history during the 50,000 years or so this land was ruled by the Aboriginals. Australia now faces the challenges of a crashing mining sector, housing bubble and an aging population. This nation, as history has shown, tends to fare much better then other Western nations during downturns.

The Outline

This book will be structured into the following specific main chapters:

Economic Terminology

This chapter will give the reader some basic economic terminology to help them understand some economic concepts that may come up in this book.

Overview of the Australian Economy

Here we will provide an overview of Australia on areas such as economy, geography and demographics and the concept of globalisation will be explained.

The Past

This chapter will act as a summary of Australia's history. This involves the time before the Europeans came to Australia, the British arrival to Australia, the Australian Gold Rush and the 20th century.

The Present

The following chapter will discuss the details of the more recent events transpiring in Australia right now. This includes the housing boom, the Mining Boom and Australia's relationship with China.

Economic Terminology

Supply and Demand

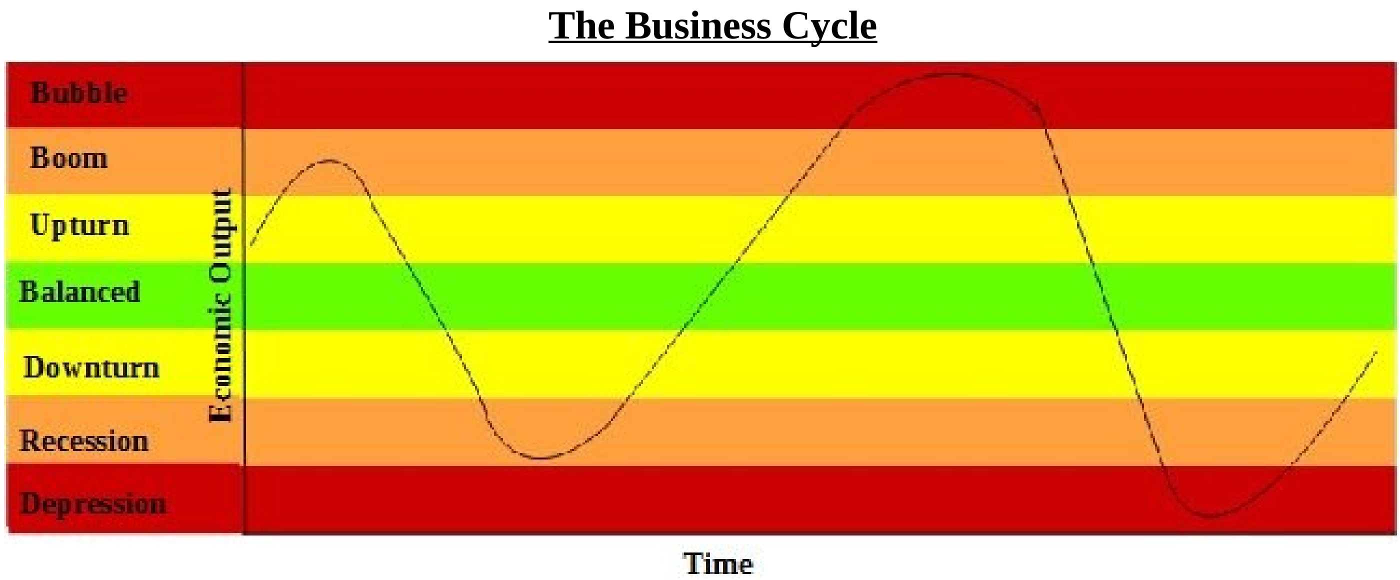
This is a fairly basic principle. The supply and demand of goods, services, assets and money is the foundation of economics. Supply and demand effects prices. More demand then supply means higher prices and less demand then supply means lower prices.

The Business Cycle

The business cycle is the booms and busts in an economy. The economy fluctuates between booms and busts from the change in economic activity. Below is a table that displays the common characteristics of booms and busts.

Characteristic	Booms	Busts
Level of economic output	High	Low
Level of consumer spending	High	Low
Rate of inflation	High	Low
Interest Rates	High	Low
Wages	Increases	Decreases
Unemployment	Low	High

The fundamentals of supply and demand results in busts having lower inflation and booms having higher inflation, but this doesn't always happen. A bust can be inflationary or deflationary. An inflationary bust is a result of excessive currency creation (expanding the currency supply causes inflation) and can lead to a hyperinflation like the one in Weimar Germany. The inflation will erode away one's debt obligations. A deflationary bust occurs when there is too much cheap credit. This credit (or debt) goes away via repayments or defaults and the currency supply contracts causing a deflation. A deflation like the Great Depression leads to lower prices and a smaller GDP and those in debt are wiped out. This chart below shows the business cycle. The further a nation goes to a boom, the further they will have to go into a bust.



Bulls and Bears

A bull is a raise in an asset class and a bear is a drop in an asset class. For example, if the stock market went from 800 to 1,200, it's a bull market and if the stock market went from 1,200 to 800, it's then a bear market.

The Monetary System

The monetary system is how the government of a nation provides money to its economy. This includes the type of money used and how it is managed. Most countries like the United States have a debt-based monetary system that uses a fiat currency. The banking structure involves a central bank and commercial bank. Money is created by the central bank and that money flows from the central bank to the commercial banks to individuals and businesses. Australia's monetary system is also like this with the Australian Dollar being its fiat currency and the Reserve Bank of Australia being its central bank.

Currency vs Money

Money like gold and silver are a store of value and currency like banknotes or cheap metal coins aren't a store of value. Money retains its value and currencies lose value overtime. A Weimar Germany banknote is worthless and a gold coin from Ancient Greece still retains its value. A fiat currency is a currency backed by confidence, which loses its value over time.

Currency Supply Measures

The following are different measures used to calculate the size of a currency supply. The more broader measures tend to be higher value and more long-term assets that are harder to liquidise (turn into cash and be used in transactions).

M0: This is the most liquid type of currency, like cash and assets that can be easily converted to cash.

M1: This includes M0 and currency that can be easily converted to cash.

M2: Includes M1 and currency that is harder to liquidise like short-term deposits.

M3: Includes M2 and currency that is really hard to liquidise like long-term deposits. This is the most broadest measure used by most nations, but some nations like the United Kingdom use M4, which is the most broadest measure used.

Gross Domestic Products (GDP)

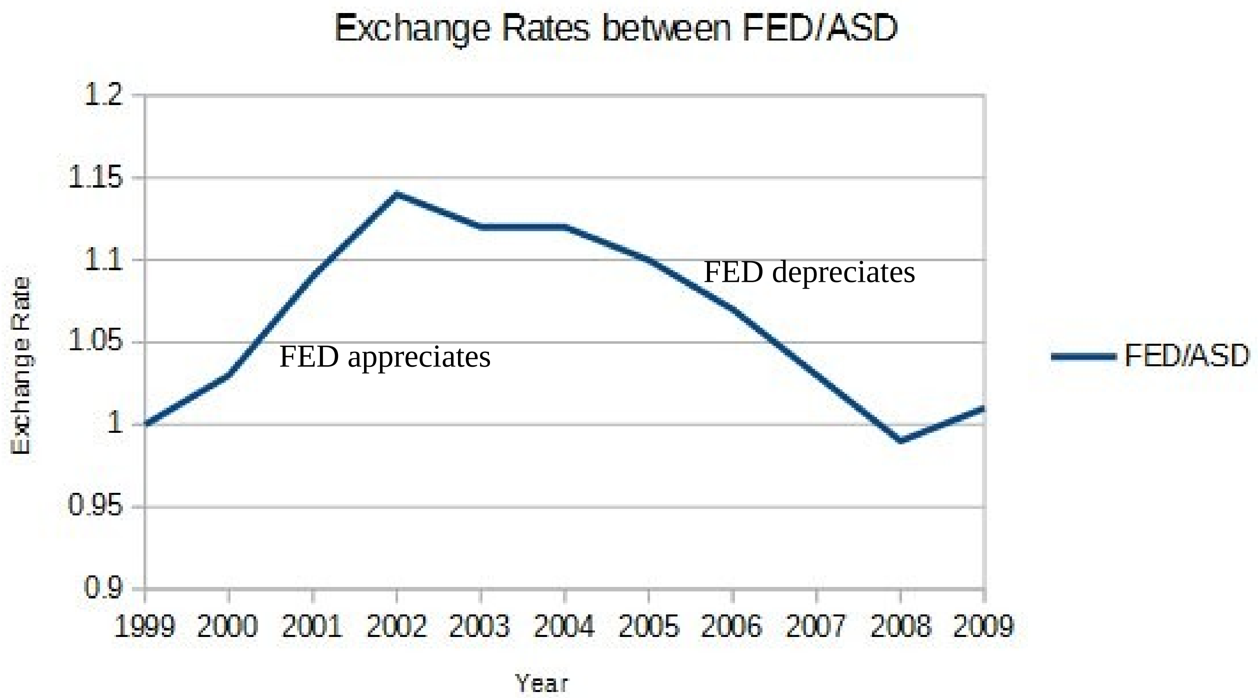
This is the total value of a country's economy. This includes production and consumption of goods and services, trade, investment and government expenditure.

Markets

A market is where buyers and sellers exchange goods and services. However in economics you will find that the term market is used to refer to certain areas like stocks. This is where the market just relates to that area like the stock market is the buying and selling of stocks. When just referring to the markets this is a reference to the entire economy.

The Exchange Rates

These are the rates of exchange between the currencies around the world, which are often called the foreign exchange rates. These measure the value of one currency to another, such as a rate of USD$0.72 per AUD$1, which means you can get 72 US cents for 1 Australian Dollar and USD$1 for AUD$1.39. When a currency such as the AUD increases against another like the USD, it is appreciating and when it loses value, the currency is depreciating. Below is a visual example of two fictional currencies.



When a currency appreciates imports are cheaper and exports are more expensive and when a currency depreciates, imports are more expensive and exports are cheaper.

Important People, Organisations and Facts

Governor Phillip: Governor of the first British penal colony (Sydney) on Australia. He came to Australia on the First Fleet in 1788.

Reserve Bank of Australia (RBA): This is the central bank of Australia and is responsible for controlling Australia's interest rates and currency supply. A central bank is a private entity separate from a government and is owned by private individuals. The Federal Reserve in the United States for example is owned by shareholders that it pays a dividend of 6%, as outlined in the Federal Reserve Act on their website, "*In General. After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders of the bank shall be entitled to receive an annual dividend of 6 percent on paid-in capital stock."*[1]

The RBA is owned by the Commonwealth of Australia as outlined on their website, *"The Bank is a body corporate wholly owned by the Commonwealth of Australia."*[2] Elizabeth II is known to be the head of the Commonwealth and this would apply to other monarchs. In a video, AussieMatters, states on how these monarchs are funded by banks and rich individuals and so, the RBA is indirectly owned by these banks and rich individuals.[3] Also, some of the RBA's profits are paid to the Commonwealth as stated on their website under the Reserve Bank Act 1959, "T*he net profits of the Bank in each year shall be dealt with as follows: ...the remainder shall be paid to the Commonwealth."*[4] The other share of the profits is saved or put into a fund. Therefore, the RBA is linked to rich individuals and a share of its profits go to them.

Federal Reserve Bank: This is the central bank of the United States.

Bernie Fraser: Governor of the RBA from 1989 to 1996.

Ian Macfarlane: Governor of the RBA from 1996 to 2006.

Glenn Stevens: Current Governor of the RBA.

Some Prime Ministers (PMs) of Australia: a Robert Menzies (1939-1941, 1949-1966), Harold Holt (1966-1967), Bob Hawke (1983-1991), John Howard (1996-2007), Julia Gillard (2010-2013), Kevin Rudd (2007-2010, 2013), Tony Abbott (2013-2015), Malcolm Turnbull (2015-present)

Fiat Currency: As stated later in this book, the Australian Dollar was removed from the gold standard in 1933 and became a fiat currency. This means the Australian Dollar is no longer backed by gold, but by confidence.

Overview of the Australian Economy

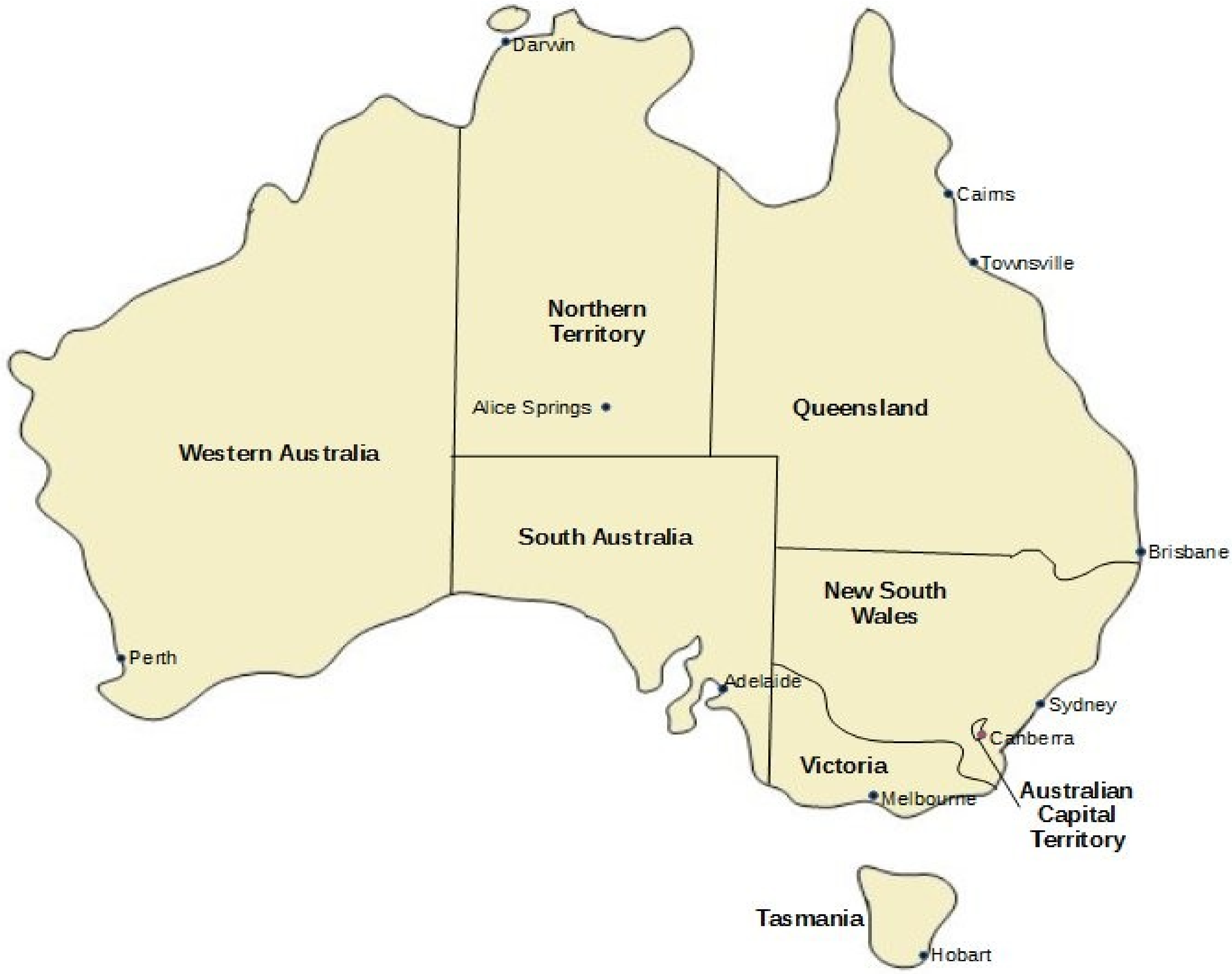
Australia has one of the largest economies in the world, which is fairly strong with a big mining and agriculture sector. This country had fared well throughout the 2008 Financial Crisis because of its Mining Boom, but is now facing a recession as that boom has ended. Australia like most developed nations has a large service sector with this sector making up 69% of Australia's GDP according to the Mundi index. The economic situation of a country is determined by several factors such as demographics and geography. Below is a run down of Australia.

Geography

Population: 23 million (2015)
Size of Country: 7.7 million Km^2
Population Density: 3 people/Km^2

Australia is a very hot and barren country with the centre being desert and the coastline being fertile. The population is mostly on the coast and as a dry country, Australia has to deal with droughts. Since the population is so far spread, costs for transportation and road maintenance is high.

Map of Australia



The Australian Economy

Demographics

Median Age: 37.3 years (2015)
Median Income: AUD$58,000 before tax (May 2015)

Australia's multicultural population is mostly living in urban areas with 4.3 million of them living in Sydney alone. This country also has a problem with an aging population with there being an increasing number of older people. However Australia's problem with an aging population is much less then that of other countries like Japan, Germany and the United States (US). As a population ages, there will be fewer young people to enter the workforce and to support the older people and this will seriously hurt an economy.

Economy

GDP: US$1.45 trillion (2015), which is is lower then the year before, US$1.56 trillion (2014) according to the World Bank Group
Currency: Australian Dollar (AUD)
Balance of Trade: -US$3.3 billion (October 2015)
Australian Dollar to US Dollar Exchange Rate: 0.72 US Dollar (December 2015)
Unemployment Rate: 6% (December 2015)
Inflation: 2% (December 2015)
Consumer Price Index (CPI): 108 points (December 2015)

Government Budget

Government Budget Deficit: AUD$44 billion (2015 fiscal year)
National Public Debt: US$417 billion (December 2015)
Debt per Capita (Person): US$17,000 (December 2015)
Debt as a Percentage of GDP: 26% (December 2015)

Industry

Australia largest industries are mining (Mining Boom), agriculture (not as large any more) and property (Due to housing bubble). Manufacturing still plays a role, but has been on a decline since the 1960's and as most Western nations, Australia's economy is mostly based on the service sector. Australia is a major exporter of metals such as gold, silver, natural gas, coal and iron ore and China is its main trading partner. Australia faces recession and falling exports due to China's recession.

Australia in a Global Economy

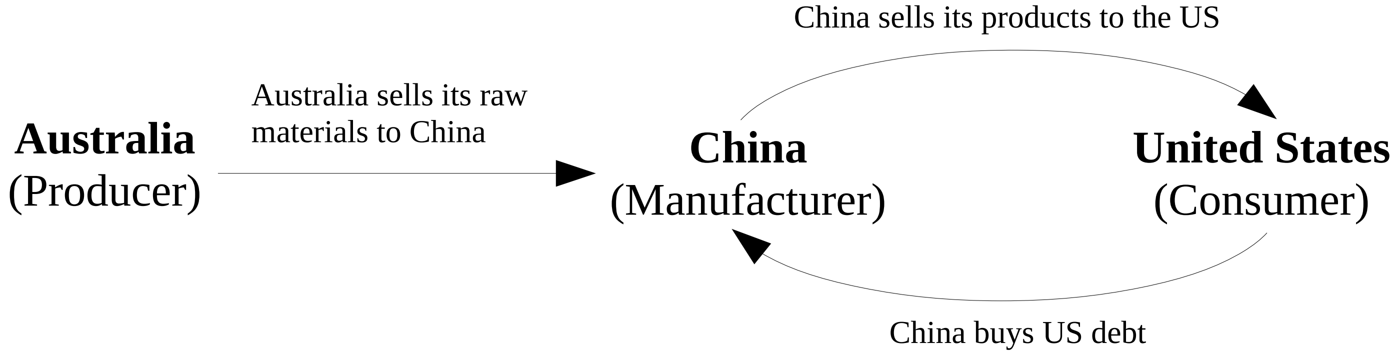
People can buy products and communicate with others from overall the world. Investors can trade investments like stocks over the world. Australia was effected by the crash of the US housing bubble in 2008. All of this is possible due to globalisation. Globalisation involves removing trade barriers between nations, faster global communication and the integration of economies. Globalisation has allowed many things to be possible such as international organisations and businesses and it has improved the global economy as a whole. Despite this, globalisation does makes the global economy more vulnerable to downturns. Individual economies are now more dependent on each other. Globalisation was the reason the US housing crisis in 2008 caused the world economy to go into a downturn.

A Chain Reaction

Another example the impact globalisation has is when Thailand unpegged the Thai baht, which started a chain reaction that brought Long Term Capital Management (LTCM) to its knees. The unpegging of the Thai baht caused the 1997 Asian financial crisis and then the 1998 Russian Financial Crisis and Default that caused Long Term Capital Management to meltdown. LTCM was a company that traded in options (a type of derivative) and thought that their trading methods carried little to no risks. However their risk calculations were off and their mistake almost caused the global financial system to freeze up.

Australia (Provider), China (Manufacturer) and the United States (Consumer)

The way globalisation integrates economies can be seen with Australia, China and the United States with these countries having a close economic relationship. Australia as the producer sells its raw materials such as iron ore and coal to China, who then manufacturers this into consumer goods, which are then sold on to the US. China buys US debt to depreciate the Chinese Yuan to make exporting their goods cheaper. Around a third of Australian exports go to China and so where China goes, Australia follows suit, which was why Australia went into recession after China went into recession. This relationship between these nations will be discussed in further detail latter in this book.



A Global Economy

As globalisation has reshaped the world economy, one can't study economics by just looking at one country. They have to look at the whole economy. No longer can a nation stay completely in isolation and be unaffected by foreign events. An economist will not only have to look at local economic events and policies, but also foreign ones in order to make conclusions about the state of a particular economy.

History of Globalisation

In ancient and medieval times the Europeans, Chinese and American natives were all almost in isolation. The economic conditions in Europe did not impact the economic conditions in the Americas. They all could live in their own little world. At this stage in history, globalisation was almost non-existent and it would take centuries before it really started to develop.

For most of history, the development of globalisation was slow until nations started exploring and setting up colonies around the world. This was the first stage of globalisation. This stage saw the expansion of the empires like the Spanish and British Empires and the increase of international trade. Now, events in Europe would impact America such as the Thirty Years' War of 1618-1648 causing war in the Americas.

The second stage of globalisation occurred during the 19^{th} and early 20^{th} centuries. The world was becoming more interconnected with countries over the world engaging in trade and diplomatic relations with each other and international investment was now easier.

But World War One (WWI) and World War Two (WWII) put the brakes on globalisation. In WWI, the British closed their stock exchange for a year and liquidity (ability to meet obligations, borrow money and sell assets in the short-term.) dried up. The development of globalisation wouldn't be back on track until the 1960's.

From the 1960's onwards, the track to globalisation just exploded with the deregulation of markets, removal of trade barriers, rise of international organisations and more frequent and faster trading of financial instruments like stocks. This third stage of globalisation also saw the rise of a global monetary system. Globalisation at this point caused international trade and economic growth to boom, but also increased the frequency of economic downturns. Now, the world has become one giant interconnected economy and if humans do start colonising other planets, we would see globalisation on an interplanetary scale.

The Past

It's often thought that the Australian economy began when the First Fleet with Arthur Phillip in 1788 established the first British penal colony in Australia. This was when the economic growth really took off, but an economic system had existed before that event with the Aboriginals. So, the economic history of Australia spans many thousands of years with the last few centuries seeing the most activity.

The Need for Speed

When looking at economics at a historical standpoint it becomes evident that as technology progresses and the economy becomes more complex the faster events transpire. Hardly any change took place during the 40,000 year span of Aboriginal life on Australia and then the European colonisation escalated the pace of economic progress. In a few centuries a basic economy turns into a thriving national economy. Today the rate of economic progress is staggering with new advancements or events taking place almost daily.

Pre-1788

Before the Europeans came, Australia was ruled over by the many Aboriginal nations that Australia was divided among. These nations ruled Australia over 40,000 years and they had a bartering economic system. With all societies some form of economic system had to exist. For the Aboriginals it was the basic bartering system.

What is Bartering

For those that don't know, bartering is the exchanging of goods between people. I give you a cow and you give me two sheep in exchange. Bartering has the problem of being slow, cumbersome and each party had to have something the other party wanted. These shortfalls in bartering limited the level of economic development for a bartering economy and the adoption of money is needed for economic progress.

Not Just Goods

The Aboriginals are known for their culture that is associated with the Dreaming and story telling. Well, Aboriginals traded in more then just the average goods and services. They also traded in songs, dances, stories and art. As these things involved connection to the land and the Dreaming they had a value of their own and so could be traded too.

Ores and Shells

The types of goods Aboriginals bartered in included mined ores and shells. Ores like red ochre from South Australia and Greenstone from Mount Isa and Cloncurry were mined and used to make tools like stone axes.

Trade Routes

The Aboriginals had a system of trade routes that lead to particular trade centres where commodities like spear, shields, fish hooks, stone axes, shells and ores were traded. The importance of the trade routes for Aboriginals extended further then just for trading commodities. The trade routes were also used to maintain law and relationships between tribes.

The trading centres could be used to resolve disputes, have meetings and share information on the Dreaming. The social aspect of the trade routes helped tribes to gain respect for each other by understanding their cultural differences and the rights and responsibility of each tribe.

The First Colony

Port Jackson (today Sydney, New South Wales (NSW)) on January 26, 1788 saw the First Fleet with Governor Phillip establish the first penal colony of NSW. The British declared ownership of Australia via terra nullius (meaning that the land never had been previously owned) and the European colonisation of Australia began. The Australian Economist Noel George Butlin would call this colony a *"bridgehead economy"* when discussing that this penal economy was the starting point for the creation of a very big and strong economy and country.[5]

Establishment

The colony (Sydney) was at first meant to be at Botany Bay, but moved as this area was infertile. The fleet brought with them many supplies along with 1,000 convicts as settlers. These prisoners were sent to Australia to deal with prison overpopulation back in England. The colony would fair poorly with a weak economy in it's first few years. This was for the following reasons:

- The European seeds didn't grow in Australia and food shortages developed
- The colony was far from England and difficult to resupply
- Small colonies like this one have difficulties
- The British ignored the colony, because they were busy with the Napoleonic Wars

For the colony to survive they had to establish agriculture, which become the foundation of the early Australian economy. The governors had originally been the main drivers for the economy by providing most of the supplies like money and management for the economy. But in the 1800's the private sector (non-government sector of economy, which is run and owned by private individuals) finally started developing with the government owned public sector becoming a smaller proportion of the overall economy. During the early 1800's more land was given to the private sector and the variety of skills for the colony increased as a greater number of convicts and migrants arrived.

The Monetary Systems

Rum, which was first brought to NSW in 1792 on the *The Hope*, was the first currency used by the colony and it wasn't until 1813 when coinage started circulating in the form of Spanish silver dollars. By 1829, this was replaced by a monetary system similar to the British Pound, Shilling and Pence monetary system. Australia issued it's first own currency in 1910, which was the Australian Pound and in February 14, 1966, Australia established the Australian Dollar.

Colonising the Country

Throughout the 19th century, the colonisation of Australia by Europeans went from one colony: *Sydney* to towns and cities all over the country. The economy was mainly agriculture with most of the people being farmers. Explorations further into Australia such as the crossing of the Blue Mountains in 1813 allowed people to go find more land to build farms on. As the century dragged on, the manufacturing and mining sectors started to become a greater part of the economy.

More Time

As the agricultural sector became a smaller part of the economy, the other sectors could develop and more advancements could be made to improve living standards in Australia. This is because farming takes up a lot of time and with a large percentage of the population being farmers means that there is little room for innovation. The Industrial Revolution increased agricultural production and so allowed people to move into other areas and so you see agriculture contributing only a little to an advanced economy.

So, Australia needed to improve its agricultural production to further their economic growth and this required technological advancement and the develop of infrastructure. With providing food to a growing population no longer a problem, the banking, mining and manufacturing sectors could expand.

Colonies

Besides NSW, other colonies were also established. Many of the first colonies were military outposts with convicts and it would be years after establishing these outposts that proper colonies were established. In 1826, a military outpost was established in Western Australia (WA) out of fear that the French would colonise that area and Perth was founded in 1829. South Australia (SA) started with the South Australian Land Company in 1831 and in 1834 legislation was passed to set up a colony there. John Oxley had chosen Moreton Bay to be the first colony in Queensland in 1824 and Tasmania was first settled by the British in 1803. The British had failed several times to colonise the Northern Territory NT) state of Australia due to poor management and the environment and it wasn't until 1869 when the first successful colony, Darwin was founded. Victoria was settled in 1803 at Sullivan Bay and was made a separate province from NSW in 1851.

The capital state cities in Australia became the main colonies set up in those areas. The order of founding these cities were: Sydney (1788), Hobart (1804), Brisbane (1824), Perth (1829), Melbourne (1835), Adelaide (1836) and Darwin (1860). The separate colonies would have their own laws and government until they became one nation in 1901. For reference to these colonies and states, the map of Australia seen earlier in this book is displayed on the next page.

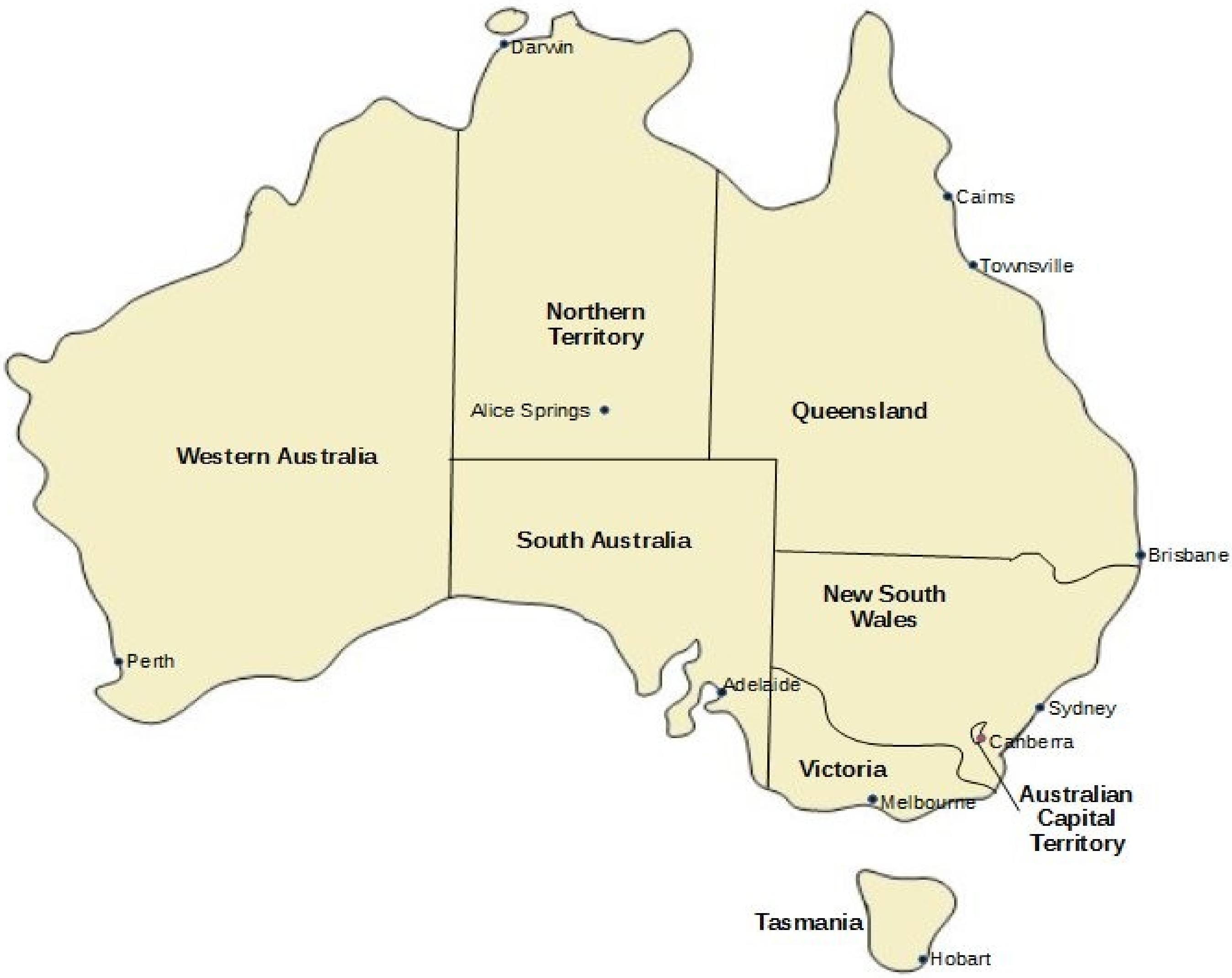
Boom and Bust

Every economy goes through a cycle from boom and bust. This includes Australia too. The Australian economy experienced its first major economic depression during the 1840's. The English recession in 1839 and low wool prices in Britain caused a crash in the agriculture industry in Australia and agriculture was big for Australia during that time. This along with speculation led to lower demand, credit defaults and less British Investment in Australia. The Australian colonies found themselves running a deficit and they increased taxes to refinance in 1845 and they encouraged immigration, but more people led to further unemployment. The Gold Rush and the rise in wool prices finally brought the depression to an end. The Gold Rush would be a long-term boom that was followed by another depression in 1890. This depression would last three years and was a banking crisis with many banks being forced to close. People that had their currency in banks or had borrowed were devastated. This depression saw the vanishing of large amounts of credit and this caused a contraction of the currency supply.

Deflationary and Inflationary Downturns

There are two types of downturns: inflationary and deflationary. Inflationary downturns are associated with high inflation or hyperinflation and come about due to a loss of confidence in the currency in circulation or excessive currency creation. An inflationary downturn sees the currency supply expanding and prices rising. Deflationary downturns are associated with a deflation and prices drop and the currency supply contracts. A deflationary downturn normally comes in the form of cheap credit vanishing under a rash of defaults, which is what contracts the currency supply.

<u>Map of Australia</u>



Consequences for Aboriginals

The European arrival and settlement of Australia lead to the displacement of the Aboriginal populations already living there. They were driven away and crippled by the many new diseases the Europeans brought with them and there were also disputes between the Aboriginals and the Europeans.