

ETAWA

ECONOMICS REVISION 2024

STEVEN KEMP



Unit 3 Australia & the Global Economy



1. **Australia's international trade (s3)**
2. **Free Trade & Protection (s3)**
3. **Balance of payments (s3)**
4. **Terms of trade (s2)**
5. **Exchange rates (s3)**
6. **Foreign investment**



1

Unit 3



The **KEY MODELS** – use the **demand/supply model** to explain

1. The gains from trade – exports & imports
2. The costs of protection – tariffs & subsidies
3. The exchange rate – AUD

The **KEY ANSWERS** I should know

1. **China**
2. _____
3. _____



2

Australia's Trade



- What are Australia's three main exports (2023)?
 1. _____
 2. _____
 3. _____
- What are Australia's three main imports (2023)?
 1. _____
 2. _____
 3. _____
- Who are Australia's three main trading partners (2023)?
 1. _____
 2. _____
 3. _____
- Australia has ____ FTAs, the most recent with _____

3

Comparative Advantage

Good	Coal (tonnes)	Iron ore (tonnes)
Country A	50	100
Country B	80	320

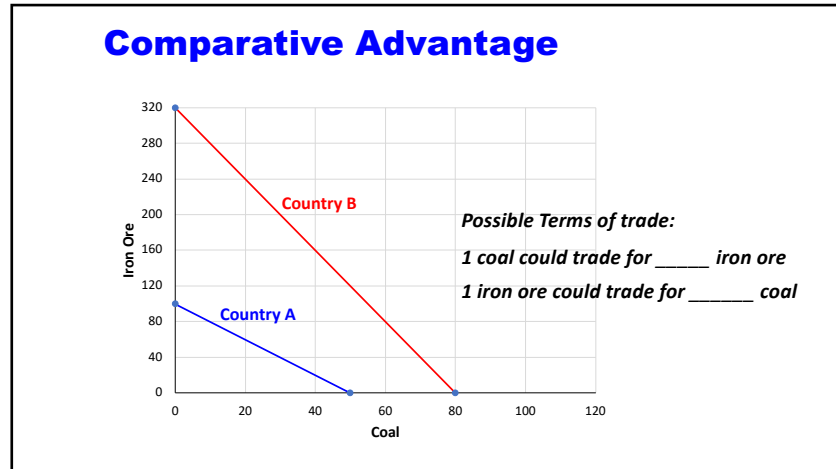
Who has the comparative advantage in each good?

Good	1 Scooter (No. of hours)	1 Bicycle (No. of hours)
Country A	18	6
Country B	24	30

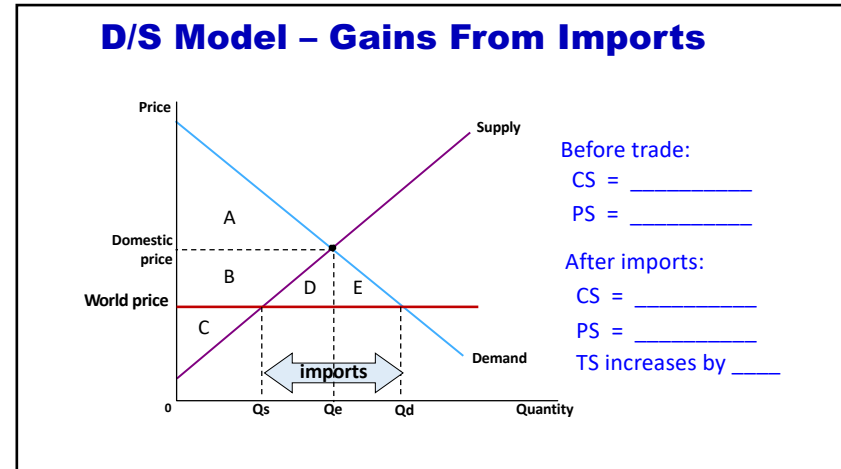


Use the 'criss-cross' method

4



5



6

Protection – Tariffs

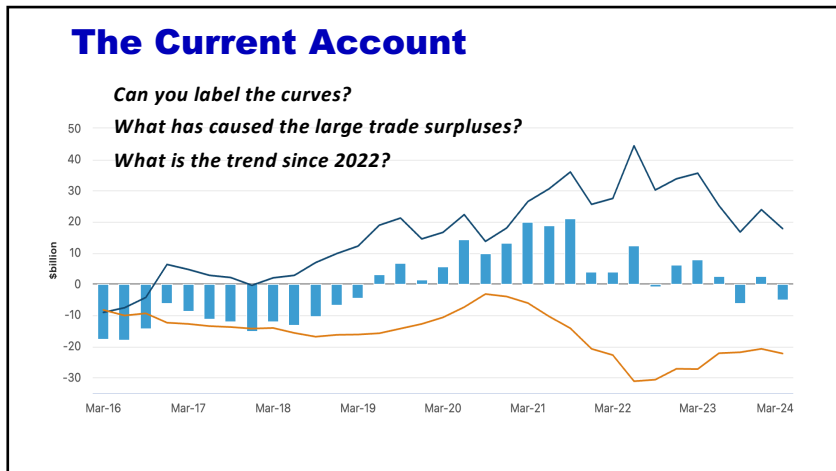
- A tariff is a tax placed on imports – this raises the world price line causing
 - imports to _____
 - domestic production & employment to _____
 - producer surplus to _____
 - consumer surplus to _____
 - total surplus to _____
 - tariffs increase costs to other industries, including export sector, reducing production & _____

7

Protection – Subsidies


- A subsidy is a payment (grant) to domestic industries to reduce costs – this shifts the S curve to the right causing
 - no change to the world price line
 - imports to decrease
 - domestic production & employment to _____
 - producer surplus to _____
 - _____ to consumer surplus
 - total surplus to _____ Why?
 - cost of subsidy is _____ than increase in producer surplus

8



9


The Current Account



- Factors affecting the **trade balance**
 - Commodity prices – if commodity prices increase, the CAB will _____ Why?
 - The business cycle of our trading partners – if China's economy grows faster, the trade balance will _____
 - Australia's business cycle – if our economy grows faster, the trade balance will _____ Why?
 - The value of the \$AUD – if the AUD depreciates the trade balance will _____

10

The Current Account



- Factors affecting the **income balance**
 - Australia's large income deficit is related to our historical reliance on net capital inflow (_____)
 - An increase in capital inflow will _____ income payments and _____ the CAB
 - An increase in capital outflow will _____ income receipts and _____ the CAB
 - An increase in Australia's growth rate will increase business profits which will increase _____ payments and decrease the CAB

11

The Savings-Investment gap

- The CAB = $S - I$
 - Australia's investment is normally greater than its savings: when $I > S$ the current account will record a _____
 - But between 2019-23, $S > I$ so the current account recorded a _____
 - In 2024 the current account is in _____ which means that saving _____ investment
 - If I increases relative to S , the CAB will _____ Why?
 - Because the increase in I will increase _____

12

Terms of Trade

- Australia's terms of trade is calculated as the ratio of its export prices to its import prices.
- $ToT = XPI/MPI \times 100$
- What's the most important category in the XPI? _____
- What's the most important category in the MPI? _____

Period	Export price Index	Import Price Index	Terms of Trade
Mar 2022	103	102	101
Mar 2023	110	108	102
Mar 2024	101	107	



13

Terms of Trade

- Over the past year Aust's terms of trade have _____
- Why? _____
- Is a decrease in the ToT positive or negative for the economy?

- A fall in the terms of trade will
 - _____ the trade balance
 - _____ the AUD
 - _____ aggregate demand (AD)
 - _____ real GDP/national income



14

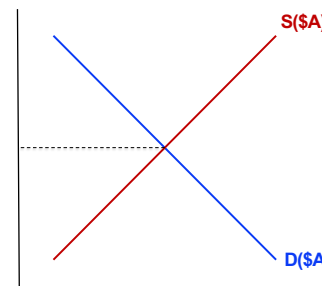
The Exchange Rate \$A

- You need to know
 - What has happened to the \$AUD/\$USD & the TWI during 2023-24
 - Factors driving the \$AUD
 - Effects of a depreciation/appreciation
- Use a *model* to show changes in the \$AUD
- February 2023: **\$US0.71**; **TWI 62**
- February 2024: **\$US0.65**; **TWI 61**



15

The Exchange Rate \$AUD



- How do I label the axes?
- What determines the D(\$A)?
- What determines the S(\$A)?

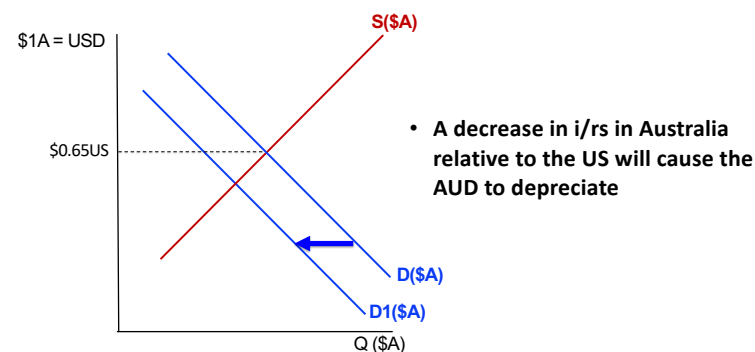
16

Major Influences on the \$A

- **China**
 - If China’s economy grows faster, the \$AUD will _____
 - Which curve will shift? _____
- **Commodity prices**
 - A decrease in commodity prices will _____ \$AUD
 - Which curve will shift? _____
- **Interest rate differential**
 - If Australia’s i/rs fall relative to the US, the \$A will _____
 - Why?
 - Which curve will shift – D(\$A) or S(A)?

17

The Exchange Rate \$AUD



18

Foreign Investment

- Foreign investment & investment are **different** concepts
- Investment refers to **capital investment** – the purchase of _____ capital such as machinery, construction
 - an increase in interest rates _____ capital investment
 - Why?
- Foreign investment refers to **financial investment** – the buying & selling of financial _____
 - shares, bonds, property
 - an increase in interest rates _____ foreign investment Why?

19

The Flow of Foreign Investment

Key learning points

- Foreign investment is recorded in the _____ account
- A financial account surplus = **net capital inflow**
- A financial account deficit = _____
- Foreign **direct**: new business, joint ventures > 10% equity
- Foreign **portfolio**: purchase of shares, bonds < 10% equity
- Which is larger? _____
- What are the income flows associated with foreign investment?
 - 1) _____
 - 2) _____
- Where are these income flows recorded? _____

20

The Stock of Foreign Investment

Key learning points

- The sum of all foreign investment in Australia is called our **foreign** _____
- The sum of all Australian investment in overseas countries is called our **foreign** _____
- Which is larger? _____
- The difference between foreign liabilities and foreign assets = **International investment position**
- The main categories of foreign investment are
 1. borrowing/lending funds – foreign _____
 2. selling/buying assets – foreign _____

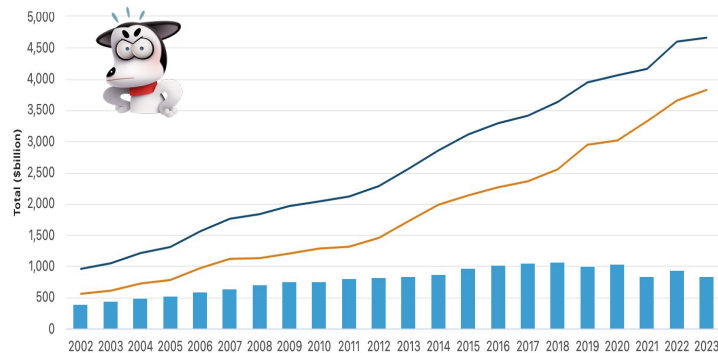
21

International Investment Position

- During 2023, foreign investment in Australia (**foreign liabs**) rose \$63b to \$4,660bn
- During 2023, Australian investment abroad (**foreign assets**) rose \$170.3b to \$3,823bn
- This means that Australia's IIP was a _____ of \$837bn
- Most of the foreign investment into Australia is in the form of foreign _____
- Most of Australia's investment abroad is in the form of foreign _____
- Why does Australia have a net foreign liability (and a net foreign debt)? _____

22

International Investment Position



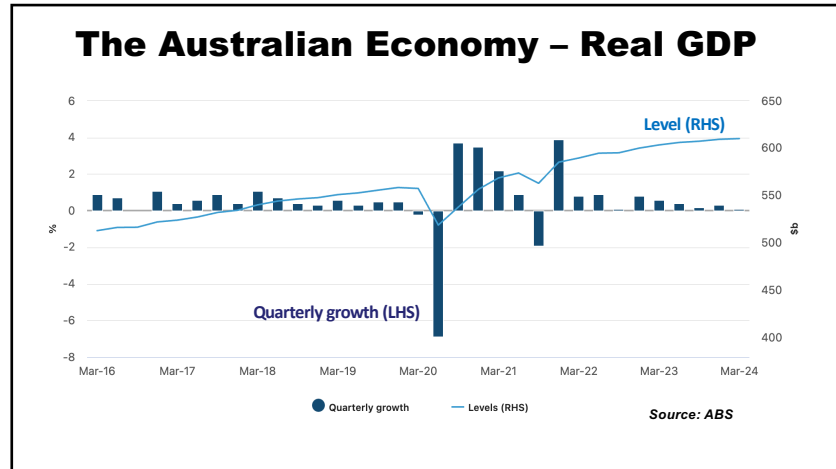
23

Unit 4: Macroeconomics

1. **Macro performance & the business cycle**
2. **The AE model & the multiplier (s2 & s3)**
3. **The AD/AS model (s2 & s3)**
4. **Fiscal policy (s2)**
5. **Monetary policy (s3)**
6. **Labour productivity (s2)**



24



25

Macro Performance

- **Real GDP growth rate**
- **Inflation rate**
- **Unemployment rate**
- *What phase of the business cycle is the economy in?*
- *Evidence?*
- **Turning points** – *what could cause the economy to go from a peak to a contraction?*

26

Unit 4 Models

There are now THREE models:

1. AE MODEL

2. AD/AS MODEL

When should I use the models?

Very important – label the axes correctly

27

Unit 4 Models

3. APF MODEL

- Along PF1, as Labour increases, real GDP increases but at a **decreasing rate**
→ labour productivity _____
- What can shift the APF upwards
→

28

The AE Model

- The components of AE – C, I, G & NX
- The largest component is _____
- The vertical axis: _____
- The horizontal axis: _____
- $mpc =$ _____
- $mpc + mps =$ _____
- Slope of the C & AE functions = _____
- Equilibrium occurs where _____ = total output
- If spending < output, inventories _____



29

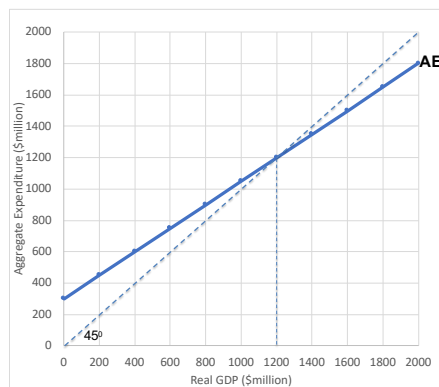
The Multiplier

- If spending increases by \$10bn and GDP rises by \$25bn then the multiplier = _____
- The formula for the multiplier (k) is
 $k = 1/(1 - mpc)$ or _____
if the $mpc = 0.5$; $mps =$ _____ then $k =$ _____
if the $mpc = 0.67$; $mps =$ _____ then $k =$ _____
if the $mpc = 0.8$; $mps =$ _____ then $k =$ _____
if $k = 4$ then $mpc =$ _____ $mps =$ _____



30

The AE Model



What is the equilibrium level of real GDP? _____
 If GDP = \$800m, inventories would _____
 What is the mpc ? _____
 What is the multiplier? _____
 If $Y_p = \$1600$ million, then govt should increase G by _____

31

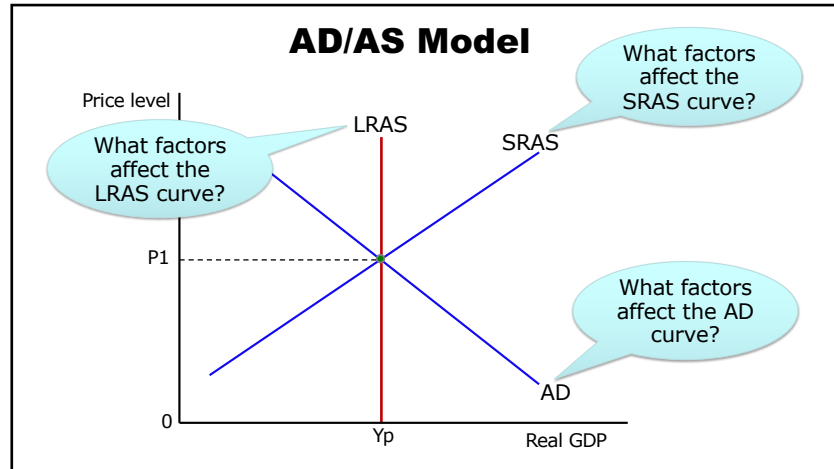
AE Model

How would each of the following affect the AE function?

- The Chinese economy expands
- The RBA increases the cash rate
- House prices rise
- Iron ore prices fall
- The budget deficit increases

AE line	Why?

32



33

AD/AS Model & the Business Cycle

What is the effect of a **negative AD shock**?

- The AD curve shifts to the _____
- Real GDP _____, unemployment _____ and the price level _____
- Fiscal/Monetary policy? _____

What is the effect of a **negative SRAS shock**?

- The AS curve shifts to the _____
- Real GDP _____, unemployment _____ and the price level _____
- Fiscal/Monetary policy? _____

34

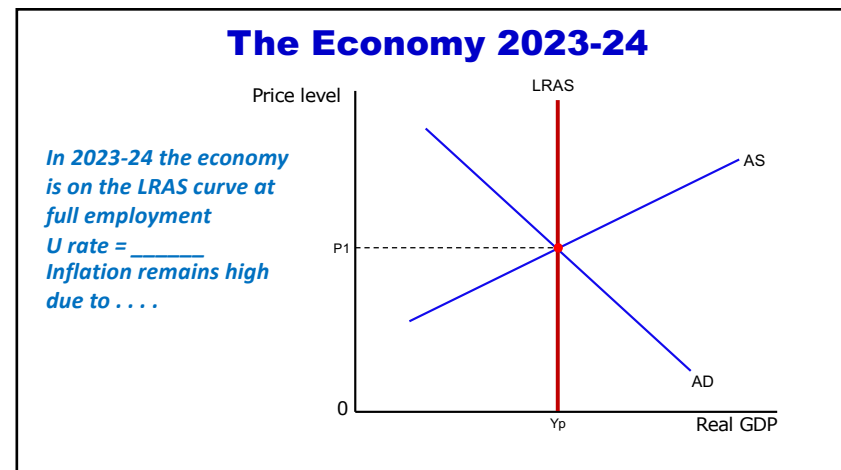
Review

How would each of the following affect the AD/AS model?

- I. Share prices fall
- II. Oil prices increase
- III. China's economy contracts
- IV. Productivity increases
- V. Govt spending on infrastructure increases

AD/AS Model

35



36

What is fiscal policy?

- **Fiscal Policy:** changes in government taxes (T) and spending (G) that are intended to achieve economic policy objectives:
 - i. Full employment
 - ii. Price stability
 - iii. _____
 - iv. _____
- Fiscal policy is reflected in the government's budget
 - A budget deficit ($G > T$) will have _____ effect
 - A budget surplus ($T > G$) will have _____ effect
- Fiscal policy consists of
 1. **Discretionary policy – purposeful changes to G & T**
 2. **Automatic stabilisers – changes to G & T due to _____**

37

Automatic Stabilisers

- Automatic fiscal stabilisers have an important effect on the budget balance
- When the economy contracts the budget balance will fall & automatically shift to a _____
- Why? Because G will ____ & T will ____
- When the economy expands, the budget balance will rise & automatically shift to a _____
- Why? Because G will ____ & T will ____

38

Fiscal Policy & the Multiplier

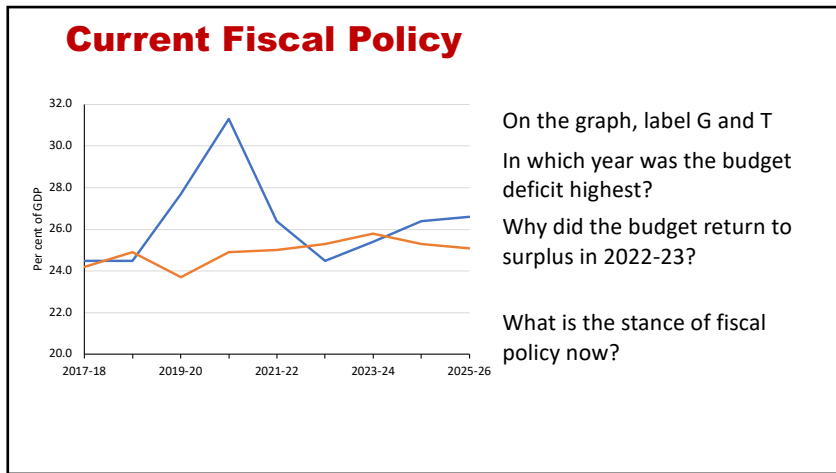
- What has a stronger multiplier effect – an equivalent change in G or T?
- If the $mpc = 0.75$, then $k =$ _____ .
 - An increase in G of \$10bn will increase GDP by _____
 - A decrease in T of \$10bn will increase C by _____ and then increase GDP by _____
- What would happen to GDP if the government increased G by \$10bn & increased taxes by \$10bn?

39

Fiscal Policy

- A change in G and/or a change in T will shift the AD curve
- Can fiscal policy affect the AS curves? _____
- An increase in government investment (infrastructure) will increase the _____ & shift the AS curves to the _____
- How does the government finance a budget deficit?
- By _____
- How? _____
- A budget deficit will _____ government debt which will result in higher interest payments
- Is this a problem?

40




41

What is monetary policy?

- The Reserve Bank Board sets the **cash rate** so as to achieve its economic objectives:
 - The stability of the currency of Australia*
- what does this mean?
 - The maintenance of **full employment** in Australia*
- achieving an unemployment rate of around _____
 - The economic prosperity and welfare of the people of Australia.*
- What is conventional monetary policy?

42

Monetary Policy



The Reserve Bank will **increase** the cash rate. . .

- When the economy **expands too quickly**
 - **Inflation** _____
 - **Unemployment** _____ to or below the natural rate
 - _____ shocks to AD
- The current cash rate is _____
- The current stance of monetary policy is _____
- Aim?** _____

43

The Transmission Mechanism

How do interest rates affect the AD curve?

- Saving & Investment** – higher interest rates increase the **cost of borrowing**, decreasing the incentive to _____ & increasing the incentive to _____
- Cash flow** – a rise in interest rates increases **debt repayments** which decreases the cash flow of households & firms & **decreases** _____
- Asset prices** – a rise in interest rates decreases the price of shares & property, decreasing _____
- Exchange rate** – a rise in interest rates will _____ **the \$AUD** which will _____ net exports

44

Unconventional Monetary Policy

- This involves the Reserve Bank using tools **other** than the cash rate to influence economic activity
- Why? The cash rate is close to _____ and is no longer effective
- Main type - **Quantitative easing**
 - the Reserve Bank purchases _____ from the public to increase **liquidity** & decrease _____ interest rates.



45

Fiscal & Monetary Policy

- Which policy is best to use to stabilise the business cycle? _____
- Which policy works best in a contraction? _____
- Which policy works best in a boom? _____
- Which policy is the most direct? _____
- Which policy is the most flexible? _____
- Which policy has the shortest effect lag? _____
- Which policy has the shortest decision lag? _____
- Which policy suffers from political bias? _____



46

Know the Key Verbs

Verb	Explanation	Marks
State/Define	Give the precise meaning of a concept including an example	1
Describe/Outline	State the main characteristics or features of a concept or topic	
Explain	State the meaning & provide reasons for cause & effect; make the relationship between concepts clear	

47

Success in the Exam

- **What is the simplest way to increase my result?**
 - **Define**/describe – precise meaning & key characteristics
 - **Examples** – provide one or two to illustrate meaning



48

Additional Notes

