|  |  |
| --- | --- |
| **THE CURRENT ACCOUNT** | |
| Goods | Physical items which are demanded by consumers, for example wheat, meat, wool, cars, computer software |
| Services | Activities carried out by people rather than the production of physical goods, for example personal services, distribution services, social services, producer services and utility/construction services |
| Primary income | Income that Australian residents earn from, less that they pay to, the rest of the world from working and from financial investments – payments of interest, profits, dividends and wages – largest cause of the CAD |
| Secondary income | A minor element of the current account which includes pensions and provisions of foreign (either in cash or of non-capital nature) |
| **THE CAPITAL ACCOUNT** | |
| Capital transfers | Transactions where one party has transferred ownership of something to another party without receiving anything in specific in return, for example, debt forgiveness, transfer of assets between residents and non-residents |
| Acquisition/disposal of non-produced, non-financial assets | Sale and purchase of non-produced, non-financial assets such as copyrights, patents, franchises and trademarks |
| **THE FINANCIAL ACCOUNT** | |
| Direct investment | Reflects a long-term interest, implies a significant degree of influence, generally involves 10% or more ownership – financial transactions related long-term capital investment in a business |
| Portfolio investment | Covers investment in equity and debt securities, common with life assurance companies and pension funds, less than 10% ownership |
| Financial derivative | Purchase or sale of financial derivatives where the transactions involve the exchange of risk between parties, rather than funds |
| Reserve assets | Purchases or sale of reserve assets held by the Reserve Bank – controlled by the bank to meet policy objectives such as intervention in the foreign exchange market and assist the Australian government in meeting its commitments to the IMF |
| Other investment | Transactions that do not fit into one of the other categories – these include derivatives, trade credits, loans, currency and deposits |

|  |  |
| --- | --- |
| Trade surplus | Occurs if the total value of goods and services exports (credits) exceeds the total value of goods and services imports (debits) |
| Trade deficit | Occurs when the total value of imports exceeds the total value of exports |
| Credit | If the dollars come into Australia, it is a credit – exports and foreign investment inflows are recorded as credits |
| Debit | If the dollars go out of Australia, it is a debit – imports and net income outflows are recorded as debits |
| Why does Australia usually run a deficit? | We run a deficit as a nation as we have a small population and a small savings base, we also have more capital-intensive industries such as agriculture and mining, so we rely on foreign investment to supplement our savings base. This means that when the money for foreign investment comes in it is a credit in the financial account. We thus end up with a very large surplus in the capital and financial account. We need to service that foreign investment in the form of paying interest, wages, dividends and profits and we pay that out through the primary income account of the current account which causes the deficit. The interest component is the largest servicing cost. There are some credits in the primary income account, but they are much smaller in comparison. |

**Savings-investment gap**

* CAB = S – I
* The current account balance is equal to the difference between a country’s saving and investment. A current account surplus (or financial account deficit) will occur when total savings (S) > total investment (I). A current account deficit (financial account surplus) will occur when I > S
* OECD = Organisation for Economic Organisation and Development

**The significance of the current account deficit**

* Over the past 30 years Australia’s current account balance has averaged -4.3% of GDP (meaning the KAFA surplus has averaged +4.3% of GDP)
* In 2019-20, Australia recorded a current account surplus
* A fast-growing economy is likely to experience a current account deficit since its investment will exceed its savings – this is what occurs when the Australian economy is in the expansion phase of the business cycle
* There are a number of events that could decrease Australia’s current account balance
* A fall in the terms of trade – export prices fall relative to import prices, export receipts fall and import payments will increase
* Decline in international competitiveness – productivity levels decline/real wages rise more than productivity – country’s exports will be less competitive in overseas markets
* Higher rate of economic growth – this leads to increased national income and increase in consumption and investment spending – increases demand for imports, decreases balance on trade
* Increase in foreign investment – rate of return on investment is higher in Australia than the rest of the world – large capital inflow into Australia – increases primary income deficit due to outflow of investment income
* Decline in national savings – savings decrease then the CAB will decrease
* Increase in investment – if investment increases by either the private or public sector, CAB will decrease