

The Terms of Trade

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Definition

- The terms of trade is a relative measurement of the movements of export prices and import prices
- $XPI/MPI*100$

Factors affecting the Terms of Trade

- Export Index (Volatile)
 - Commodity Price Index
 - Australia is primarily a commodity exporter and thus the terms of trade has a positive relationship with the commodity price index
 - Price taker in the global resource market
 - Vale Dam Collapse increased iron ore prices
 - World Economic Growth
 - Chinese Economic Growth
- Import Index (Stable)
 - Decrease in import prices over time as Asian countries begin to produce more efficiently

Effect of movement in the TOT

- Changes in the TOT will affect
 - Economic Growth
 - Output
 - National Income
 - Employment
 - Net exports
 - The CAD
- Ceteris paribus, a favourable movement in the terms of trade will have an expansionary effect on the economy

Recent movements in the Terms of Trade

- As a result of the end of the mining boom and a fall in global commodity prices the terms of trade fell from 2011-2016
- Recently however an increase in global commodity prices has seen a resurgence in the terms of trade
- This was due partly to global supply shortages caused by the Vale Dam collapse
- Australia recently recorded a record high trade surplus as a result