1997-98 In Review: A Resilient Australian Economy

This article discusses the major developments in the Australian economy during 1997-98 and compares actual outcomes with the forecasts from the 1997-98 Budget and the *1997-98 Mid-Year Economic and Fiscal Outlook.*

A major development during 1997-98 was the growing economic and financial crises in some of Australia's Asian trading partners. The financial disturbances in Asia began in the second half of 1997 and the adverse effects on economic activity in the region became more evident in the first half of 1998. Australia's largest trading partner, Japan, which had been experiencing sluggish growth for some time, slumped into recession in 1997-98 with output falling in the December quarter 1997 and in the March and June quarters 1998.

There was much speculation as to the likely impact the slowdown in Asia would have on the Australian economy, given the large proportion of Australia's exports going to Asia. However, notwithstanding the sharp slowdown in Asia, Australia experienced strong economic growth in 1997-98 with GDP(A) increasing by 4.0 per cent. Robust growth in domestic demand was underpinned by subdued inflation, low nominal interest rates, modest wages growth and high levels of corporate profits. The effect of weaker demand for some categories of exports was cushioned to some extent by the depreciation of the Australian dollar over the year and the opportunity this provided for exports to be diverted to the still strongly growing North American and European economies.

The events over the course of 1997-98 provide an opportunity to reassess how the economy responds to international developments. A key lesson is that it is always important to keep in perspective the impact on the Australian economy of developments in specific export markets, given that the share of Australia's exports directed to individual overseas markets is not fixed. It is also evident that developments in financial markets will have an important bearing on how the economy responds. More generally, the ability of the Australian economy to adjust to the reduced export demand and lower commodity prices brought on by the Asian crisis illustrates the benefits of an economy made more responsive, flexible and resilient through microeconomic and regulatory reforms and a sound macroeconomic policy framework.

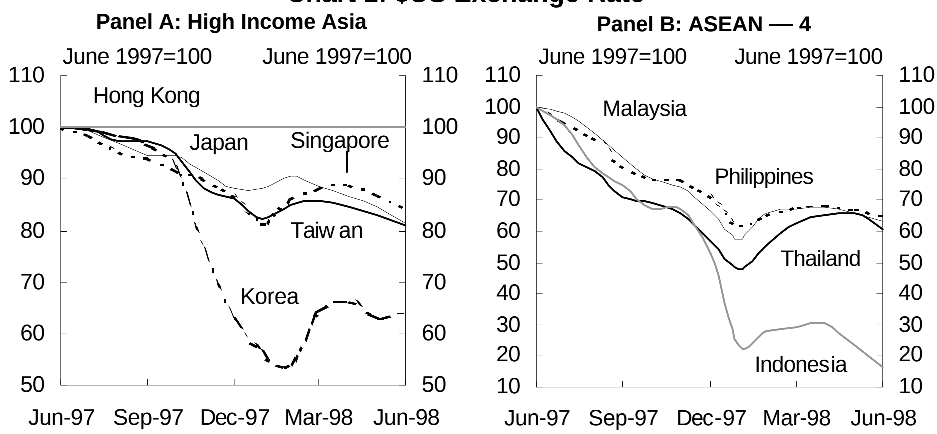
INTERNATIONAL ECONOMY

Underpinning the 1997-98 Budget was an expectation of a continued favourable international economic environment. However, the outcome was significantly weaker than anticipated, with both private sector and official estimates being scaled down as the year progressed. The extent to which this expectation of continued strength was unfulfilled is more evident if allowance is made for the relative importance of Australia's trading relationships with individual countries — overall GDP in Australia's Major Trading Partners (MTP)[1] rose by 1.3 per cent in 1997-98, in contrast to the Budget assumption of 4½ per cent.

This weakness was most apparent in the Asian economies, reflecting large contractions in output in the aftermath of the financial instability which resulted from a reappraisal by international investors of economic fundamentals. Of particular concern were structural deficiencies in the corporate and financial sectors, reflecting high debt-equity ratios and rapidly increasing levels of non-performing loans. A lack of transparency and inadequate standards of governance further exacerbated the situation. In some economies, inappropriate macroeconomic policies were an additional influence. Confidence in the region quickly evaporated as these concerns became more apparent, resulting in a sudden reversal of the earlier high levels of capital inflow.

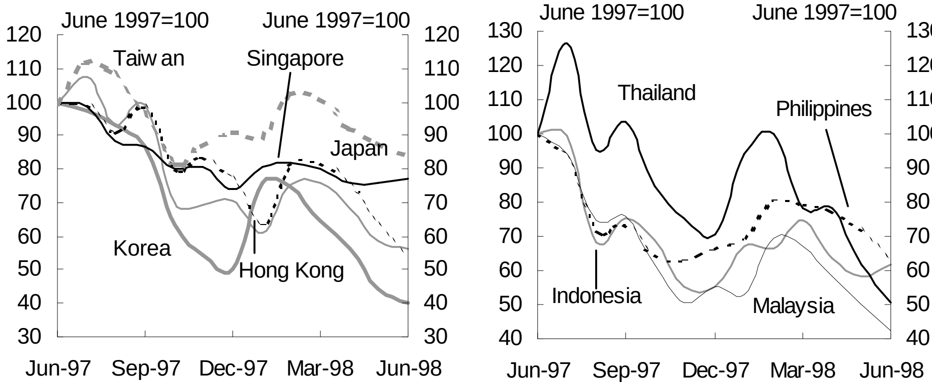
This reversal of capital flows resulted in pronounced declines in regional currencies and equity markets. By the end of 1997, there had been very large depreciations in the currencies of Thailand, Malaysia, Indonesia, the Philippines and Korea, and weakness was also apparent more generally throughout the region (Chart 1). There was more stability of exchange rates in general over the latter half of the financial year, and some significant strengthening occurred in relation to the currencies of Korea and Thailand. Nevertheless, with the exception of Hong Kong, currencies in mid-1998 remained well below year-earlier levels. Capital also flowed out of regional stock markets, with large falls in equity prices apparent in all countries (Chart 2).

Chart 1: $US Exchange Rate



1 Australia's MTP in descending order of export shares were Japan, South Korea, the United States, New Zealand, Singapore, Taiwan, China, Hong Kong, the United Kingdom, Indonesia, Malaysia, Thailand, Canada, Italy, Germany, the Philippines and France.

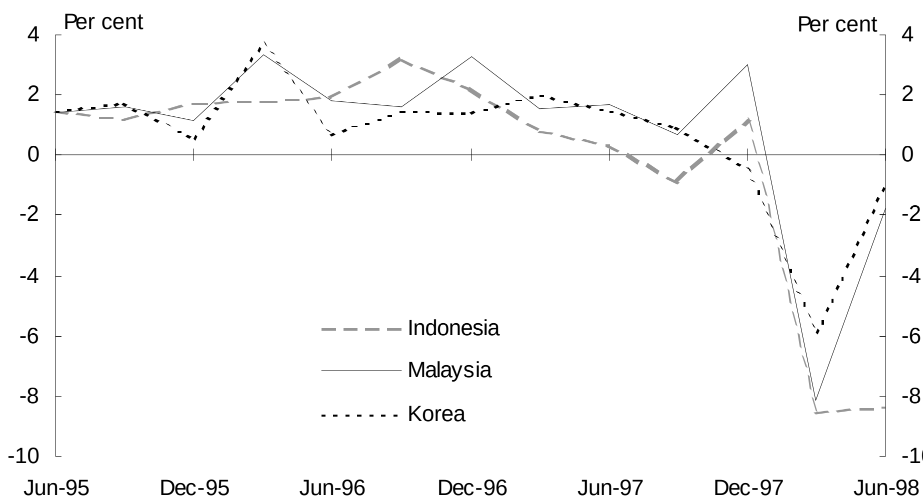
Chart 2: Stock Market Indexes, High Income Asia



Source: CEIC

The impacts on activity were more delayed, but large declines in GDP occurred in the first half of 1998 in Indonesia, Malaysia and Korea (Chart 3), and industrial production similarly fell sharply in Thailand. The higher interest rates and tighter fiscal policies required to stabilise currencies impacted together with falling property values and equity prices, constrained credit availability, social dislocation, and falling confidence to cause large contractions in domestic demand. Moreover, export growth was not stimulated to a degree which the large currency-induced improvements in competitiveness might have suggested, due to dislocations in production, a lack of available trade credit financing and general weakness in intraregional demand.

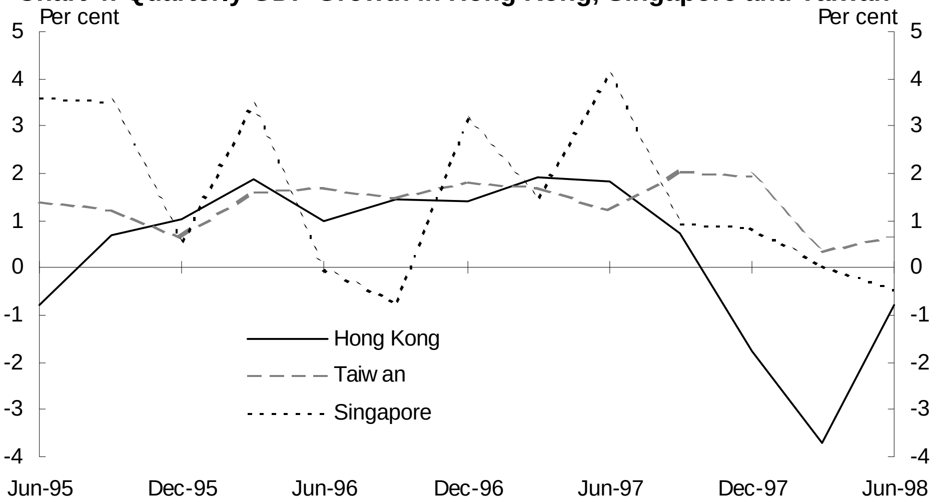
Chart 3: Quarterly GDP Growth in Korea, Malaysia and Indonesia(a)



(a) Seasonally adjusted by Treasury.
Source: CEIC

Output was also significantly affected in Hong Kong and Singapore (Chart 4), despite corporate and financial sector fundamentals in both being sounder than in those economies initially affected. In Hong Kong, significantly higher interest rates — to maintain the currency link with the US dollar — contributed to large falls in property prices, investment and general confidence. In addition, weak regional demand had a large effect on the economy's large external sector. Singapore's high integration in the region (both in terms of trade/capital flows and general confidence), its initial adoption of high interest rates to slow the fall in its currency against the US dollar, and large falls in asset values combined to constrain activity in the first half of 1998.

Chart 4: Quarterly GDP Growth in Hong Kong, Singapore and Taiwan(a)



(a) Seasonally adjusted by Treasury.
Source: CEIC

Less affected, however, were China and Taiwan. Sound macroeconomic fundamentals, as well as relatively low corporate debt rates and a sound financial sector, allowed Taiwan to maintain solid growth rates, albeit at lower levels than in previous years (Chart 2). The external sector began to weaken as exports to its regional neighbours declined. China's economic growth remained robust and a continuing trade surplus along with limited external exposure enabled the authorities to maintain a stable exchange rate. Domestic demand slowed but remained strong relative to most other East Asian economies. External demand weakened as a result of falling exports to East Asia, but this was partially offset by strong growth in exports to the US and Europe. In response to the slowing economy and unfavourable external environment the Chinese Government has increased infrastructure spending in an attempt to stimulate domestic demand.

The prospects of an early return to growth for the crisis-affected economies of the region were largely dissolved by the concurrent economic deterioration experienced by the single largest consumer of the region's exports, Japan. While the Asian currency crisis was a factor, the making of Japan's decline was, for the most part, domestic in nature. After exhibiting signs of a return to strong growth through 1996 and into 1997, the Japanese Government launched an ambitious program of fiscal consolidation in mid 1997. Growth in domestic demand quickly slumped as the stimulus from earlier government spending was removed, and the underlying weakness in consumer and business spending and sentiment was exposed.

The continuing failure to address structural weaknesses, particularly those in the banking sector, enabled a further erosion in the asset base of lending institutions, including a substantial increase in non-performing loans, to continue largely unchecked, leading in late 1997 to the collapse of several major financial institutions. Banks' attempts to restore health to their balance sheets, following the introduction of the first steps to deregulate the banking sector (the so-called 'Big Bang' reforms), have seen over the last year a significant decrease in new lending and a reduction in the balance of loans outstanding, leading in turn to rising corporate bankruptcies, unemployment and a substantial loss of consumer and business confidence.

In reflection of these factors, overall economic activity declined in real terms in each of the last three quarters (to the June quarter 1998), making the current recession the worst in 50 years.

While the Asian economies have been much weaker than anticipated at the time of the 1997-98 Budget, this weakness was in part offset by stronger growth in the non-Asian OECD economies. North America experienced significantly stronger growth in 1997-98 than assumed at the time of the 1997-98 Budget, and European growth strengthened as expected.

The US economy grew strongly over the past year, and in the June quarter of 1998 activity was 3.6 per cent above the year-earlier level, driven by robust domestic demand, which more than offset weakness in net exports. Strong private consumption and investment growth has been the underlying strength behind domestic activity.

The deterioration in the economic performance of the Asian region was an important constraint on US economic growth. US exports fell over the past year as a result of the deterioration in external demand, in particular from Asia, and the strength of the US dollar. Imports, on the other hand, grew strongly as a result of strong domestic demand and lower import prices. While the effects of the Asian crisis restrained economic growth in the US, there have been a number of offsets that have provided support. The 'flight to quality' of capital from the Asian region and other emerging markets delivered lower interest rates, helping to support business investment and consumption. Import prices have been suppressed, which has assisted in keeping inflation low in the US, despite the continued strength of economic activity.

The strong economic growth generated robust employment growth, and unemployment fell to around 4½ per cent. Despite a tight labour market, inflation remained subdued. The US benefited from a number of factors that have helped mitigate the effects of wage growth and restrain price inflation: exchange rate appreciation; lower commodity prices; low health cost inflation; and cyclically high productivity growth. These offsets to inflation provided the opportunity for the US economy to grow at levels normally considered to be unsustainable.

The European economic expansion occurred broadly along the lines expected. Although initially export-led, the recovery broadened into the domestic economy with growth in private consumption and business investment. Accommodative monetary conditions and strong consumer confidence and business sentiment have contributed to a strengthening labour market. Net exports held up better than expected in the face of the deterioration in troubled Asia, as exports were redirected towards the strong US market.

EXPECTED IMPACT OF INTERNATIONAL DEVELOPMENTS ON THE AUSTRALIAN ECONOMY

As discussed above, a major development in 1997-98 was the significant weakening in the economic performance of some of Australia's Asian trading partners. A major focus of the discussion in the *1997-98 Mid-Year Economic and Fiscal Outlook* was the likely impact of these developments on domestic economic activity. While it was acknowledged that there was considerable uncertainty about the timing and magnitude of the impact on Australia of substantially weaker growth in the Asian economies, a decline in Australia's export volume growth and lower export prices were expected. The depreciation of the exchange rate was, however, expected to partly offset these effects and encourage the diversification of exports to other strongly growing markets such as North America and Europe.

Manufactures and services exports were expected to be most affected by the Asian crisis for several reasons. The demand for these items tends to be quite sensitive to changes in income growth in destination markets. Further, manufactures and services tend to be heterogeneous in nature with world markets relatively fragmented, so that diversion of exports from one market to another may be difficult in the short term. On the other hand, demand for commodities is generally less sensitive to income changes in particular markets and the homogenous nature of commodities makes diversion to other markets easier. Hence, there was expected to be less impact on the volume of commodity exports, although some decline in commodity prices on world markets was anticipated, given weaker overall world economic growth. Some impact on business and consumer confidence in Australia was also expected to be felt, with repercussions for consumption and investment spending and employment decisions.

Notwithstanding these expected influences on the domestic economy, the assessment at the time of the *Mid-Year Economic and Fiscal Outlook* was that domestic demand had strengthened, being supported in particular by easier monetary conditions (reflecting declines in interest rates since the Budget and the depreciation in the exchange rate). Overall, the assessment was that the economy would continue to grow strongly in 1997-98, with stronger domestic demand offsetting the effects of the substantially weaker outlook for the Asian economies.

1997-98 OUTCOME COMPARED WITH THE FORECASTS

The preliminary estimate contained in the June Quarter 1998 National Accounts of GDP growth of 4.0 per cent in 1997-98 is slightly higher than the May 1997 Budget and December 1997 *Mid-Year Economic and Fiscal Outlook* forecasts of 3¾ per cent growth. The composition of growth was, however, broadly in line with the *Mid-Year Economic and Fiscal Outlook* forecasts, with a strong contribution from domestic demand offsetting a sizeable net export detraction from growth. Table 1 compares the outcome for 1997-98 with the forecasts.

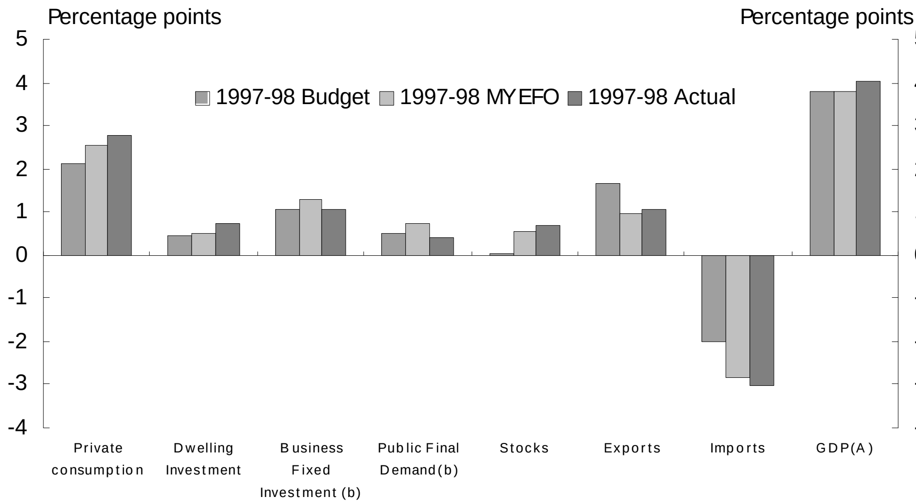
The slightly higher outcome for GDP growth compared with the *Mid-Year Economic and Fiscal Outlook* forecast reflected stronger consumption, dwelling and business investment spending more than offsetting lower than expected growth in public demand (Chart 5). The outcome for net exports was in line with the *Mid-Year Economic and Fiscal Outlook* forecast but significantly weaker than forecast in the 1997-98 Budget.

Table 1: 1997-98 Budget and Mid-Year Economic and Fiscal Outlook (MYEFO) Forecasts and Outcomes

	1997-98 Year Average Budget Forecast	1997-98 Year Average MYEFO Forecast	1997-98 Year Average Outcomes
Demand and Output			
Private consumption	3 1/2	4 1/4	4.6
Private investment			
Dwellings	11	12	14.7
Total business investment	8	10	11.2
Private final demand	4 3/4	5 3/4	6.5
Public final demand	2 1/4	3 1/2	0.0
Total final demand	4 1/4	5 1/4	5.2
Increase in stocks (a)			
Private non-farm	0	1/4	0.2
Farm and public authority	0	1/4	0.5
Gross national expenditure	4 1/4	6	5.9
Exports of goods and services	7	4	4.3
Imports of goods and services	9	12	12.7
Net exports (a)	- 1/4	-2	-2.0
Gross domestic product (Average measure)	3 3/4	3 3/4	4.0
Non-farm product	4	4	4.3
Farm product	-2	-5	-2.5
Other Selected Economic Measures			
Prices and wages			
Consumer Price Index (b)	1 3/4	1	0.7
Treasury 'Underlying' measure (b)	2	1 3/4	1.6
Average earnings (National Accounts basis)	4	4 1/4	4.5
Gross non-farm product deflator	2	1 1/2	1.6
Labour market			
Employment (Labour Force Survey basis)	2	1 1/4	1.3
Unemployment rate (per cent) (c)	8	8	8.1
Participation rate (per cent) (c)	63 3/4	63 1/4	63.3
Current account balance ($billion)	-21	-23	-23.9

(a) Percentage point contribution to growth.
(b) Through the year to June quarter. 12th series basis.
(c) Estimate for the June quarter.
Source: ABS

Chart 5: Contributions to GDP(A) Growth[(a)]



(a) Year average growth.
(b) Abstracting from the sale of the Dampier to Bunbury pipeline from the Western Australian government to the private sector in 1997-98.
Source: ABS Cat. No. 5206.0

THE DOMESTIC ECONOMY

While much of the economic commentary over the past year focussed on the likely impact of developments in Asia on Australia's export prospects, the main influence on the performance of the Australian economy in 1997-98 was the very strong growth in domestic demand.

As discussed in the *Summer 1998 Economic Roundup*, the current approach to macroeconomic policy and the impact of microeconomic reform have strengthened the stabilisation mechanisms in the Australian economy, making it more resilient to economic disturbances such as the economic and financial crisis in Asia. Sound macroeconomic policies, which have maintained low inflation and restored an underlying Budget surplus have been crucial in maintaining foreign investor confidence. Product and financial markets are now more flexible when faced with external shocks, with reforms increasing the speed with which markets can respond to economic disturbances. In product markets, the removal of non-tariff trade barriers and the reduction of tariffs have increased competition in the economy, providing an incentive for firms to respond more rapidly to changes in business conditions. Many commodities are now more freely traded on world markets, which has assisted firms to re-direct their exports to other markets. The deregulation and increasing sophistication of financial markets has also expanded the ability of Australian exporters to gain access to credit on flexible and competitive terms, and to access an ever increasing range of derivative financial products. In addition, the floating of the Australian dollar has allowed the exchange rate to decline and cushion the

Australian economy from a significant downturn in some of its major export markets.

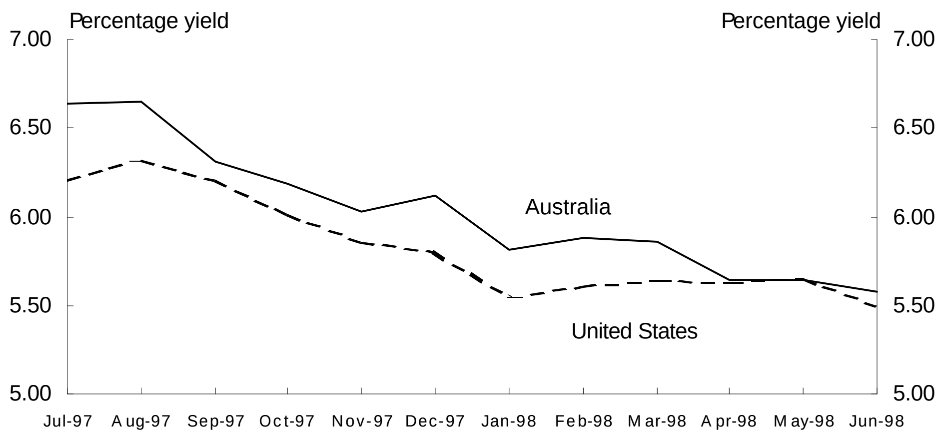
Fiscal policy produced a turnaround from a $4.9 billion underlying deficit in 1996-97 to an underlying surplus of $1.2 billion in 1997-98, representing a significant contribution to improved national saving. This meant that the Government did not contribute directly to the increase in the current account deficit and, coupled with the proceeds of asset sales, contributed to a reduction in Commonwealth general government net debt (from 18.3 per cent of GDP in 1996-97 to 14.8 per cent of GDP in 1997-98).

In line with the **monetary policy** objective of an underlying inflation rate of 2-3 per cent, on average, over the course of the cycle, official interest rates were reduced twice after the May 1997 Budget, by 50 basis points in May and July 1997 reflecting the favourable inflation outlook. As a result the official cash rate remained at 5 per cent for most of 1997-98.

Yields on Australian long-term bonds fell sharply during 1997-98, due to the 'flight-to-quality' flow of funds out of Asia, lower expectations for world growth and inflation, and an expectation of lower government bond supply in future years. The yield on Australian 10-year Treasury bonds fell from around 6.6 per cent in July 1997 to around 5.6 per cent in June 1998. Within that period, the yield fell to a low of 5.3 per cent, which at that time was the lowest rate since the late 1960s.

The differential between Australian and US long-term bonds also fell significantly over the course of 1997-98 (Chart 6). In that time the differential between Australian and US 10-year Treasury bond yields ranged between +50 and –20 basis points. In 1997-98 the differential averaged around +20 basis points, while in 1996-97 the average was near 110 basis points.

Chart 6: 10 year bond yields for Australia and the United States(a)



(a) Monthly averages of daily cob rates.
Source: Reserve Bank of Australia

Domestic demand rose by 5.2 per cent in year average terms in 1997-98. Despite the increasing contribution of exports to the overall economy, the Australian economy still predominately produces for the domestic market.

In 1997-98, the production of non-tradables[2] in Australia (which are largely produced for the domestic market) accounted for around three-quarters of GDP and around 80 per cent of total employment. The production of non-tradables was the main contributor to GDP(P) growth over the year, contributing around 3.0 percentage points to growth in GDP(P) of 3.6 per cent through the year to the June quarter 1998.

The stronger than forecast growth in **private consumption** in 1997-98 primarily reflected stronger than expected growth in spending on services and motor vehicles. The very strong growth in spending on motor vehicles in 1997-98 was influenced by the significant decline in motor vehicle prices over the course of the year, an outcome of the intense competition in the world and domestic motor vehicle markets. Measures of consumer confidence generally remained high over most of the year, despite developments in Asia, with consumer spending also supported by solid growth in employment, two falls in official interest rates in mid-1997 and rising household wealth (a result of increasing housing and stock prices). The increase in consumer spending was considerably stronger than growth in household income, leading to a decline in the household saving ratio.

The reductions in official interest rates in mid-1997 and ongoing competition in the housing finance market supported high levels of housing affordability. This underpinned stronger investment in **dwellings** than forecast at Budget and in the *Mid-Year Economic and Fiscal Outlook.*

Low interest rates and low levels of inflation, together with solid capacity utilisation and high levels of corporate profits, saw **private business investment** grow strongly in 1997-98, the year average increase being broadly in line with that forecast in the Budget and in the *Mid-Year Economic and Fiscal Outlook.*

Measured business confidence fell sharply in the latter part of 1997 in response to the Asian crisis (and the media reporting of the events in Asia and other emerging economies). This may have contributed to the slowdown in growth in private business investment in the latter part of 1997-98. In the six months to December 1997, underlying business investment (which abstracts from second hand asset sales) rose by 9.3 per cent while in the six months to June 1998 it fell by 0.5 per cent.

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2 Includes Electricity, gas and water, Construction, Wholesale trade, Retail trade, Accommodation, cafes and restaurants, Transport and storage, Communication services, Finance and insurance, Property and business services, Government administration and defence, Education, Health and community services, Cultural and recreational services, and Personal and other services.

Other contributors to GDP growth in 1997-98 were public spending and stocks. While **public final demand** was considerably weaker than forecast at Budget and *Mid-Year Economic and Fiscal Outlook*, remaining flat compared with forecasts for growth of 1½ per cent and 2½ per cent respectively, these differences can be attributed almost entirely to revisions to data for 1996-97.

Stocks contributed slightly to GDP growth in 1997-98, in line with the Budget and *Mid-Year Economic and Fiscal Outlook* forecasts. While there was some build-up in non-farm stocks in the second half of 1997-98, this appears to have been a response to lower than desired stock levels over the previous year. The modest build-up in non-farm stocks over the year was more than offset by continued strong sales growth, with the result that the stocks-to-sales ratio continued to fall over 1997-98, reaching historically low levels.

Underlying inflation remained subdued in 1997-98, rising by 1.6 per cent over the year to the June quarter 1998, consistent with the *Mid-Year Economic and Fiscal Outlook* forecast and slightly lower than the Budget forecast. This low outcome reflected both the lagged effect of the appreciation of the exchange rate in early 1997, as well as strong competitive pressures (both domestically and abroad) which limited the pass-through to retail prices of higher import prices from the subsequent depreciation of the exchange rate. In addition, motor vehicle prices have been discounted heavily over the past two years, the result of a very competitive domestic and international motor vehicle market.

Headline inflation remained flat in 1997-98, significantly lower than the Budget forecast of 1¾ per cent and the *Mid-Year Economic and Fiscal Outlook* forecast of 1 per cent. This partly reflected the fall in some components of the CPI following the Budget, such as interest charges and health insurance premiums, but also falls in petrol prices which occurred in the first half of 1998.

Low inflation and low inflationary expectations contributed to the moderate wage outcomes in 1997-98. **Wages**[3] grew by 4.5 per cent, slightly higher than the Budget forecast and consistent with the *Mid-Year Economic and Fiscal Outlook* forecast. The shift to an enterprise focus for wage determination also meant that higher wages growth for some sectors during 1997-98, such as the construction industry, did not spread into more generalised wage rises.

Strong growth in domestic demand, together with modest real wages growth, underpinned solid **employment** growth in 1997-98. Employment rose by 2 per cent through the year to the June quarter 1998, only slightly lower than the 2¼ per cent forecast at both Budget and *Mid-Year Economic and Fiscal Outlook*. The **unemployment rate** declined over 1997-98, from 8.7 per cent in the June quarter 1997 to 8.1 per cent in the June quarter 1998, in line with both the Budget and the *Mid-Year Economic and Fiscal Outlook* forecast.

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3 The National Accounts measure of average earnings.

THE EXCHANGE RATE AND TRADE PERFORMANCE

A crucial factor cushioning the Australian economy from the effects of the unfolding financial and economic crisis in Asia was the depreciation of the Australian dollar. There was, however, a significant divergence in the movements of the Australian dollar with respect to other currencies over the course of 1997-98 (Table 2). The Australian dollar depreciated significantly against the US dollar and European currencies, and appreciated against Australia's major Asian trading partners.

Table 2: Selected exchange rates[(a)]

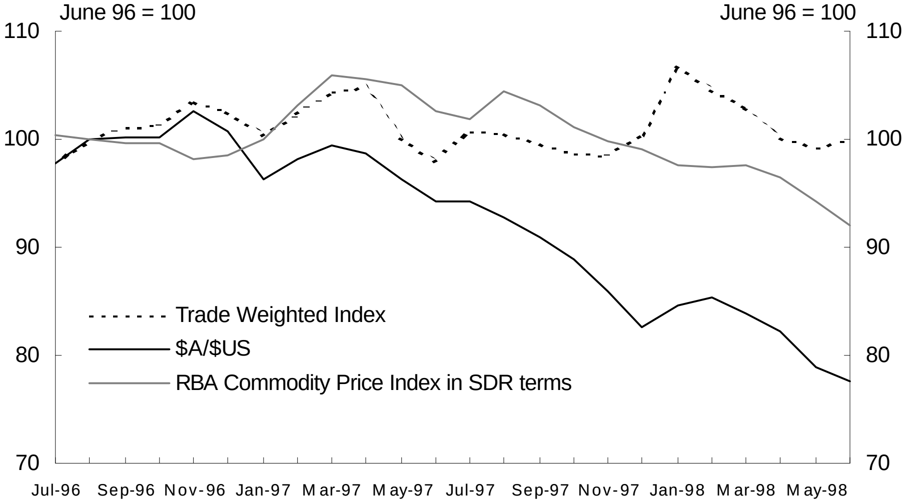
	Jun-97	Jun-98	% change
$A/$US	0.7542	0.6031	-20.0
TWI (b)	57.29	56.55	-1.3
TWI (non-Japan Asia) (c)	56.67	68.14	20.2
TWI (EU and Japan) (d)	60.25	54.08	-10.2

(a) Monthly averages of daily cob rates.
(b) Nominal TWI deflated by the terms of trade.
(c) Non Japan Asia is defined as South Korea, China, Taiwan, Singapore, Indonesia, Malaysia, Hong Kong, Thailand, PNG, India and the Philippines.
(d) EU is defined as Britain, Germany, Italy, France, Sweden, Belgium, Netherlands and Switzerland.
Source: Reserve Bank of Australia

A particular effect of the depreciation of the Australian dollar over 1997-98 in cushioning the Australian economy was that commodity prices in Australian dollar terms increased (Chart 7). Commodity prices in US dollar terms[4] declined by around 14 per cent over the year to June 1998, but in Australian dollar terms commodity prices rose by 7½ per cent over this period. In the past, various measures of the exchange rate have tended to move in the same direction as commodity prices, other factors unchanged, although usually by a smaller percentage.

One factor in addition to lower world commodity prices that may have influenced the exchange rate was the weaker outlook for Australian non-commodity exports. Earlier slowdowns in world growth which resulted in falls in commodity prices had been generated by slower growth in the major OECD economies, while the Asian economies had continued to grow. With slower growth in Asia, the demand for Australia's manufactured and service exports suffered. The volume of services and elaborately transformed manufactures (ETMs) exports grew by around 3 per cent and 6 per cent respectively in 1997-98, less than half the rate experienced over the past decade.

Chart 7: Commodity prices and exchange rates



Source: Reserve Bank of Australia

As a result of the rise in commodity prices in Australian dollar terms, the domestic currency income of commodity exporters as a whole rose during 1997-98. There were, however, considerable differences in the magnitude of the price changes faced by commodity producers. For example, non-rural commodity prices rose nearly 10 per cent in Australian dollar terms while rural commodity prices rose by only 2½ per cent, with some key commodities such as wool declining in Australian dollar terms.

Thus, despite sharp economic downturns among many of Australia's Asian trading partners and much lower commodity prices on world markets, the **value of exports** of goods and services continued to grow, recording a solid 8.2 per cent growth in 1997-98. This is only marginally lower than the average annual growth rate of 8.5 per cent over the previous five years.

As expected, however, the severe crisis in Asia resulted in slower growth in **export volumes** in 1997-98. Export volumes grew by 4.4 per cent in 1997-98, well below the average annual growth rate of 8.2 per cent over the previous five years. Bulk commodities were least affected in volume terms by low Asian demand due to greater scope for diversion, although they were affected by supply limitations. Lower availability, particularly of cereals, largely drove the decline in the volume of rural exports in 1997-98. The volume of non-rural commodities, on the other hand, increased at a rate similar to their five year historical average, even after allowing for the boost to exports from Reserve Bank gold sales in 1996-97. However, growth in ETM exports was adversely affected, recording single digit export volume growth for the first time since

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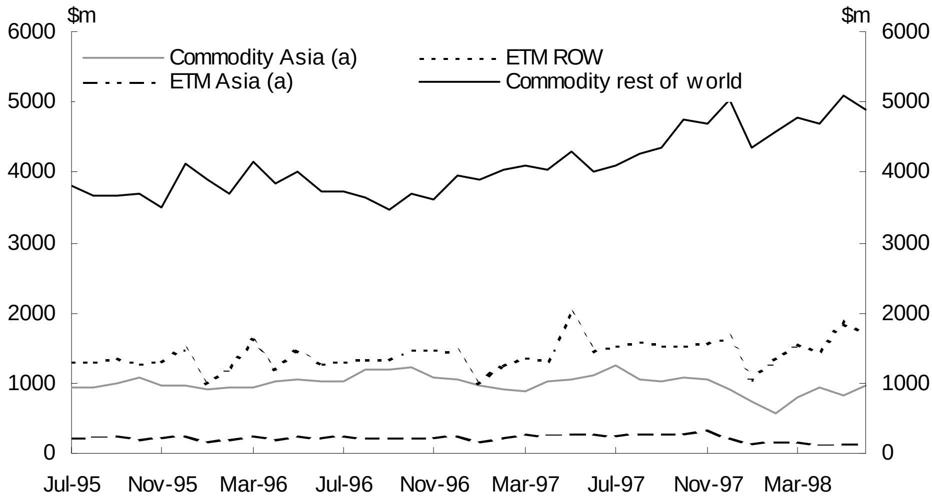
4 Commodity prices referred to in this article are as measured by the RBA commodity price index.

1988-89. Service exports also recorded significantly lower growth than in previous years, although this was almost entirely due to lower visitor arrivals affecting both travel and passenger services receipts. Other services grew strongly, especially communications and computer and information services.

A significant feature of Australia's export performance in response to the Asian crisis was the ability to divert sales to more strongly growing markets. Exports to Korea, the Philippines, Indonesia, Malaysia and Thailand declined by around 12 per cent over 1997-98, while exports to the rest of the world increased by 17 per cent.

As outlined in Chart 8, the growth in commodity exports and simply manufactured exports (SMEs) to the rest of the world has supported Australia's total export growth. Exports of commodities and SMEs to the rest of the world grew by nearly 20 per cent over 1997-98, compared with a fall of 11.7 per cent to Korea, the Philippines, Indonesia, Malaysia and Thailand. As expected, exports of ETMs fell sharply in 1997-98 to these countries and grew solidly to the rest of the world.

Chart 8: Comparison of commodity and ETM exports



(a) Includes the Asian countries affected by economic difficulties in 1997-98 which were Korea, Thailand, Indonesia, Malaysia, and the Philippines.
Source: Unpublished ABS data

Australia's exports to Japan also held up during 1997-98, although the rate of growth in these exports slowed markedly over the course of the year. Commodity exports to Japan grew strongly in 1997-98, particularly exports of coal and coke, metalliferrous ores and non-ferrous metals, with large falls in exports of sugar and cereals.

Overall, **net exports** detracted more from growth in 1997-98 than forecast at Budget, although the outcome was consistent with the *Mid-Year Economic and Fiscal Outlook* forecast. Growth in exports slowed as expected, with strong growth in non-rural and ‘other exports’ offsetting weaker rural, manufactures and services exports. Imports of both consumption and capital goods rose strongly, consistent with strong growth in private consumption and business investment over 1997-98. Imports of non-monetary gold were also a major contributor to import growth, reflecting the increased flow of gold scrap from Asia in the wake of the financial instability in the region. This imported gold was later re-exported so that the net impact on Australia’s balance of trade in 1997-98 was minimal.

The **current account deficit** in 1997-98 was $23.9 billion or 4.4 per cent of GDP, in line with the *Mid-Year Economic and Fiscal Outlook* forecast and only slightly higher than the Budget forecast of $21 billion.

CONCLUSION

The Australian economy continued to grow strongly in 1997-98, despite the impact of the Asian economic and financial crisis. The resilience of the economy in 1997-98 to such a severe shock reflected the strong domestic fundamentals and the increased flexibility of the economy. Domestic demand remained strong, supported by historically low short and long term interest rates, while the downward adjustment of the Australian dollar over the course of the year provided a substantial cushion for Australia’s export industries. The lower dollar meant that commodity prices were relatively stable in Australian dollar terms, while also facilitating a diversion of Australia’s exports to more buoyant markets.