

Economic Watch

Emerging Markets

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Economic Analysis

Emerging Economies

Chief Economist
Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk
852 2582 3281

Asia

Chief Economist
Stephen Schwartz
stephen.schwartz@bbva.com.hk
852 2582 3218

Cross-Country Emerging Markets Analysis

Mario Nigrinis Ospina
mario.nigrinis@bbva.com
+852 2582 3193

Booming commodity exports in Australia: Any lesson for Latin America?

The rise of China's economy in the last decade has created a boom in commodity prices. This has brought a windfall of revenues and a boost to economic growth for commodity exporters. At the same, however, exchange rates in commodity abundant economies have appreciated, diverting production away from other sectors. In Latin America, some economists have flagged the risk that commodity-abundant economies may end up suffering from a "Dutch disease" problem by which prices and exchange rates would appreciate excessively which only the commodity sector can afford. For this reason and others, policy makers always advise against treating the commodity boom as a permanent shock to the terms of trade but, rather, a temporary one.

At the same time, on the other side of the world Australia has been facing the same tailwinds from its commodity abundance but does not look so worried about a Dutch disease problem. This watch briefly discusses the more hands-off approach of the Australian authorities as opposed to a more hands-on one in most South American countries. In the specific case of Brazil, an array of measures have been taken to avoid an excessive appreciation of the currency, including capital controls, foreign exchange intervention, leading to a massive accumulation of reserves, as well as getting into trade disputes.

- **Australia has become a more intense commodity exporter than Latin America**

Both areas being endowed with a large amount of natural resources explains their export concentration. However, and contrary to the conventional wisdom, Latin America was able to diversify its export structure through the end of the nineties whereas Australia has generally maintained its commodity-intensive export structure. During the last few years, both Latin America and Australia have increased their concentration of exports in commodities on the back of China's economic boom but Australia has done so more intensively than Latin America (See Chart 1 below).

Other than just looking at export concentration, we move towards a measure of export dependence by computing an exports dependency index to China. Such an index is based on the relative importance of commodity exports compared to total exports, the value of exports directed to China, and the global size of China's demand for commodities.¹ The results show that for the case of iron ore, Australian exports are more dependent on China than other exports of the same commodity, including Brazil (see Chart 2 below).

- **Australia takes a mostly hands-off approach to the commodity boom**

In Australia, high commodity prices have resulted in an unprecedented resource boom, enabling the country to become one of the world's largest exporters of coal and iron ore. Strong economic links to Asia in particular, have propelled growth through demand for commodity exports, and have served as a crucial buffer against the slowdown in advanced economies. China is Australia's largest export market, accounting for 25% of the total, up from around 5% a decade ago; Japan, Korea, and India are also significant markets which, together with China, now account for about 60% of total exports.

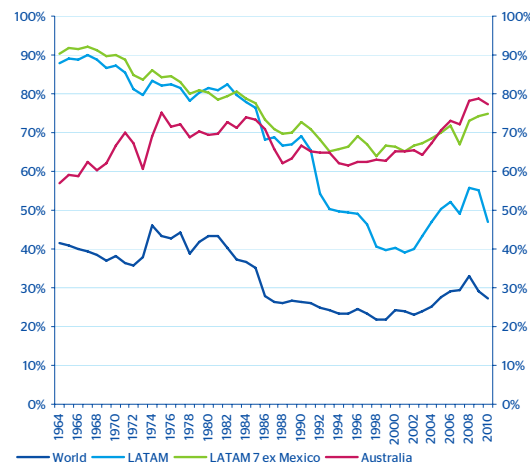
¹ For more details on the calculation of the index, please refer to BBVA forthcoming working paper "Evaluating Latin America's commodity dependency on China" by Alicia García-Herrero, Matt Ferchen and Mario Nigrinis (forthcoming as BBVA Working Paper, 2012)

Lurking below the surface, however, there are a number of challenges and risks, similar to those facing Latin American economies, and perhaps even larger. Chief among them are symptoms of the “Dutch Disease”, in which mining and currency appreciation (see Charts 3 and 4 below) are crowding out manufacturing and other traditional activities. In fact, Australia has let its nominal exchange appreciate against its trading partners much more than other Latin American countries, including Brazil. The situation is not as obvious for the real effective exchange as inflation in Brazil has remained stubbornly high, especially when compared with Australia.

Behind the exchange rate developments, there is probably a different view about the nature of the terms of trade shock. In fact, the Australian authorities tend to consider the positive shock on commodity prices as a structural one due to the projected strong demand from emerging markets. Latin American economies - still mindful of the terrible experience of the 1980s - view it more as a temporary shock. Against that background, Australian authorities avoid supporting ailing industries to facilitate the movement of production towards mining and associated activities while this is not necessarily the case in Brazil.

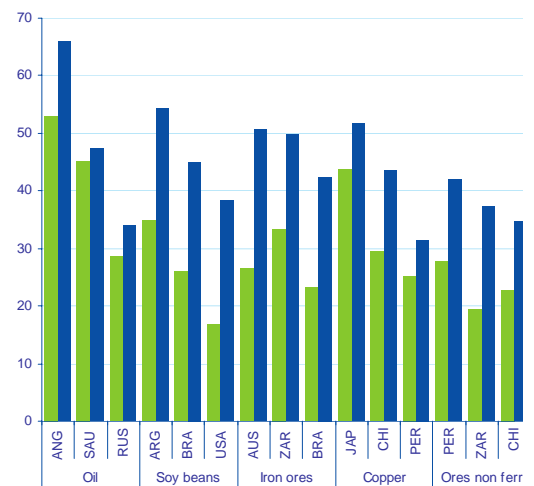
The Australian authorities’ “free market” approach is not without risks, as it entails a growing reliance on the resource sector and continued demand from China. A collapse in commodity prices and/or a hard landing in China (which, in any event, we regard as unlikely) could result in strong downward pressures on Australia’s growth trajectory. In such an event, the authorities believe that currency flexibility and room for fiscal and monetary policy stimulus would provide important buffers. Aware of such a risk scenario, the Australian authorities are trying to accumulate enough buffers from the fiscal side. In fact, they have announced budget surpluses in the next years to come, supported by a recently enacted tax on mining profits. Exchange rate flexibility and active monetary policy should also be instrumental. For more information about this issue check our latest [Australia Economic Watch](#).

Chart 1
Commodity exports share of total exports (percentage)



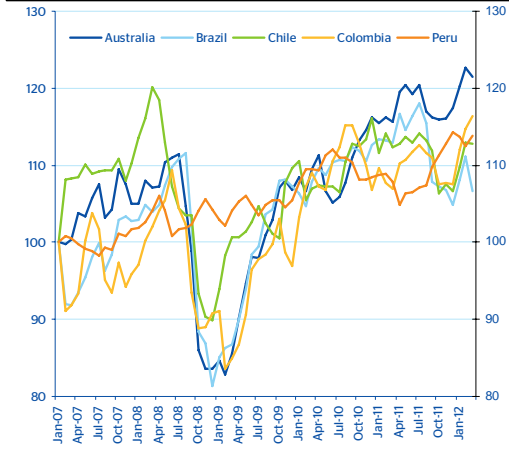
Source: BBVA Research and UN Comtrade

Chart 2
Exports dependency to China (Index, 0 no dependency - 100 absolute dependency)



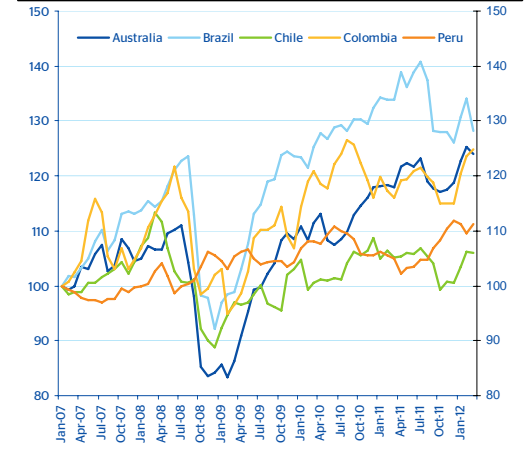
Source: BBVA Research and UN Comtrade

Chart 3
Nominal Equilibrium Exchange Rate
(Index, Jan 2007 = 100)



Source: BBVA Research and BIS

Chart 4
Real Equilibrium Exchange Rate
(Index, Jan 2007 = 100)



Source: BBVA Research and BIS

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