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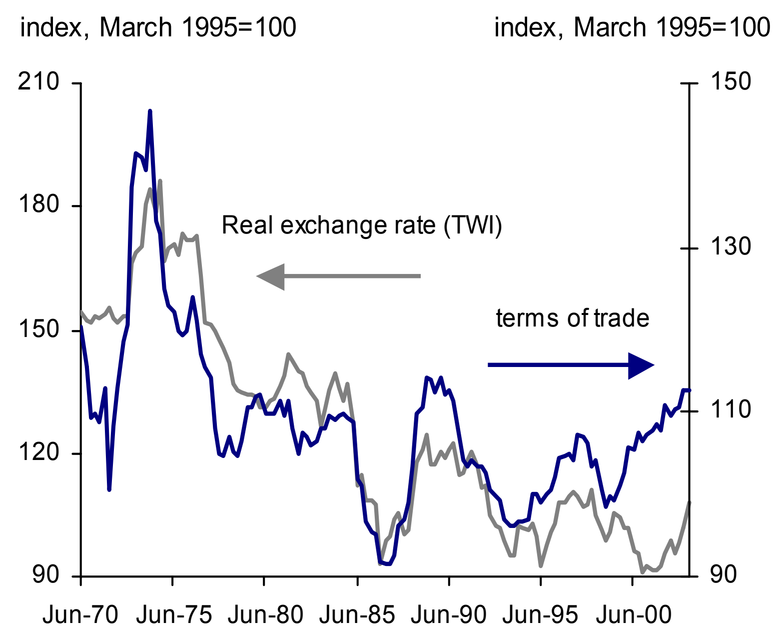
AUSTRALIA'S TERMS OF TRADE TURNAROUND

- There has been a fairly close relationship between Australia's terms of trade (the ratio of export prices to import prices) and the real exchange rate. This has especially been the case since the float of the dollar - twenty years ago this month.*

- For much of the second half of the twentieth century Australia's terms of trade were on a declining trend and the real exchange rate followed. This trend decline appears to have bottomed in the mid-1980s, and for much of the past decade Australia's terms of trade have tended to improve. So if past relationships continue to hold, this should signal a period of real exchange rate appreciation.

- Is the turnaround likely to be durable? There are good reasons for thinking that it might be. The rise of East Asia in general and China in particular as a new manufacturing and trading power has placed the price of manufactured goods – which make up a large proportion of Australian imports – under sustained downward pressure. At the same time, Asian industrialisation is boosting demand for resources, which should support the price of several key Australian exports.

Terms of trade turnaround should drive real appreciation



Source: RBA

*Why does the Australian Dollar move so closely with the terms of trade? David Gruen, Tro Kartian. RBA discussion paper 9601. May 1996.

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