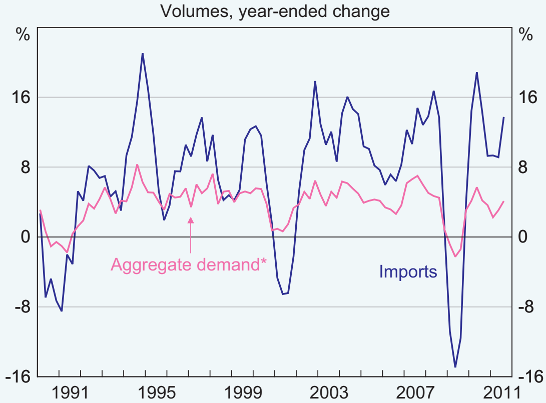
Box C
Imports and Investment

Import volumes have grown very strongly over recent years (Graph C1). While this partly reflects a recovery in demand following the global financial crisis, an unusually large proportion of the recent increase in demand has been met with higher imports, rather than domestically produced goods, with this trend particularly pronounced for investment goods. Accordingly, the average import intensity of demand has risen sharply in real terms. At the same time, the value of imports as a proportion of nominal GDP has actually declined, because import prices have fallen sharply over recent years (Graph C2). Indeed, overall import prices in Australian dollar terms are now lower than they were more than 20 years ago (Graph C3).

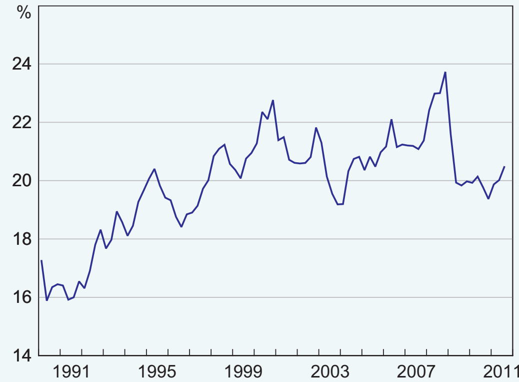
There are a number of factors driving these trends. First, Australia's trade openness has been trending higher for several decades, in line with the rise in world trade as a share of global GDP. This trend reflects lower trade barriers, falls in transport costs, and the growth of low-cost manufacturing in

Graph C1
Imports and Aggregate Demand
Volumes, year-ended change



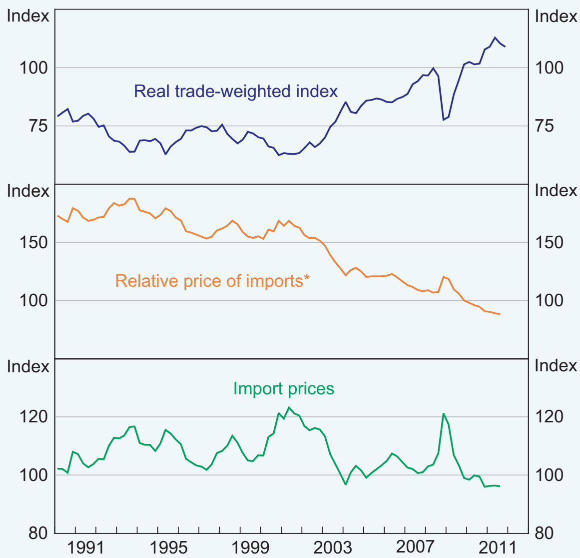
* Gross national expenditure plus exports
Sources: ABS; RBA

Graph C2
Import Intensity
Imports as a per cent of nominal GDP



Source: ABS

Graph C3
Import Prices and the Exchange Rate
2009/10 = 100



* Imports implicit price deflator divided by GDP implicit price deflator
Sources: ABS; RBA

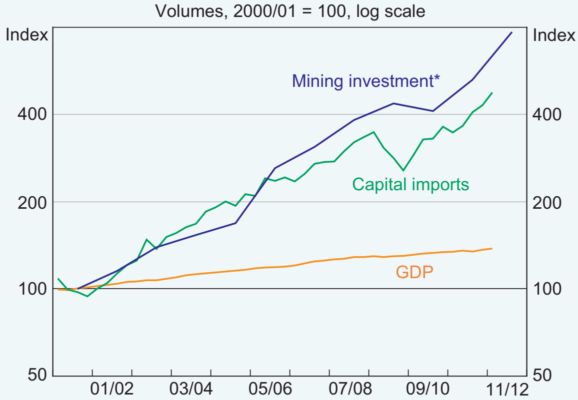
emerging economies. As a result, import volumes have tended to grow more quickly than aggregate demand for an extended period (Graph C1). While this long-run trend has continued, it has recently been amplified by several other factors. The most obvious of these is the sharp appreciation of the exchange rate over recent years, which has lowered the Australian dollar price of imports (Graph C3). In particular, firms and households switch towards imports as they become cheaper relative to similar goods and services produced domestically, while the increase in real purchasing power as a result of lower import prices boosts domestic demand more generally.

Another key driver of the recent strength in import demand is the current boom in mining investment. Mining investment is significantly more import intensive than other forms of spending, and has therefore contributed to a sharp rise in imports (particularly of capital goods) as it has surged as a share of GDP (Graph C4). Liquefied natural gas (LNG) projects, which have accounted for a very large share of recent project commencements, are particularly import intensive.

Graph C4

Mining Investment and Capital Imports

Volumes, 2000/01 = 100, log scale



* Annual; RBA estimate for 2011/12

Sources: ABS; RBA

The import intensity of current mining investment projects is also higher than in earlier years. One aspect of this is a global tendency for greater use of off-site 'modular' construction processes as opposed to the traditional on-site 'stick-build' processes. Developers of LNG and magnetite iron ore projects are increasingly modularising their processing plants, making it easier for them to be built offshore and then installed in Australia. In addition, a range of inputs to mining projects that have historically been sourced locally are now often being imported. This includes, for example, rail wagons and track, chemicals, container housing for construction workers, and engineering services. This change in large part reflects the same factors boosting import penetration in the economy more generally – namely, the trend rise in import intensity and the more recent significant decline in the relative price of foreign goods and services as a result of the appreciation of the exchange rate. In addition, the sheer scale of current mining investment projects has meant that local industry does not always have the capacity to service the large contracts being tendered by project managers. Further, the infancy of the LNG industry in Australia has meant that local firms are sometimes at a competitive disadvantage, due to a perception that they lack the same experience as foreign suppliers.

With the ongoing boom in mining investment – particularly in import-intensive LNG projects – and the high level of the Australian dollar, strong growth in demand for imports looks set to persist for the next few years. While the high exchange rate will involve difficult adjustment for some domestic import-competing industries, other industries are benefiting from lower-cost imported capital and intermediate goods, which should help boost productivity over time. More generally, the increased use of foreign sources of supply is an important mechanism for reducing pressures on overall capacity and inflation in Australia when demand is growing rapidly.