

The Ghost of Christmas Yet to Come



RESERVE BANK OF AUSTRALIA

Andrew Hauser*

Deputy Governor

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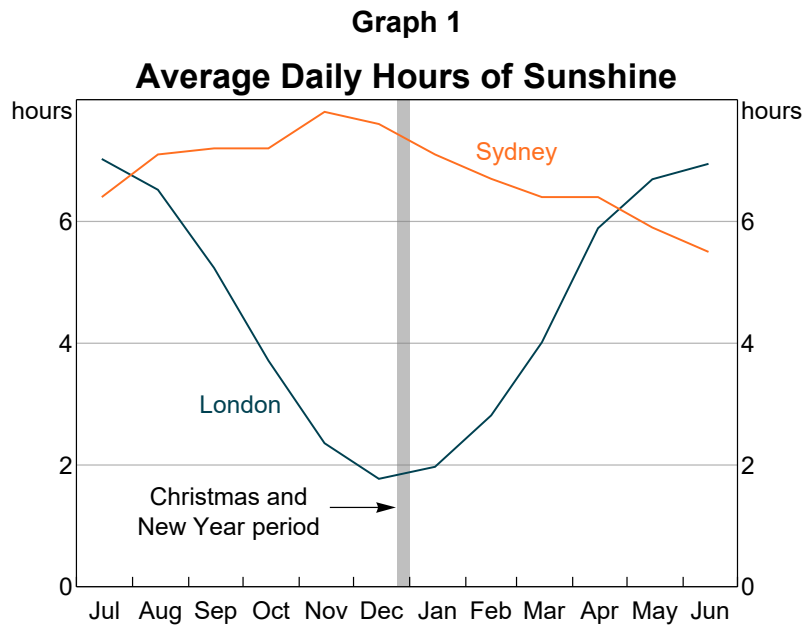


Introduction

It is a pleasure to be here. My theme tonight is trade – so it is fitting that we are meeting on George Street, which is said to lie on an ancient trading route between farmed grasslands to the south and the fresh fish and water here in the harbour.¹ In that context, I would like to acknowledge the Gadigal people of the Eora Nation as the traditional owners and custodians of this land and pay my respects to Elders, past and present.

This is my first festive season in the Southern Hemisphere – and while there have been many reminders this year of why being asked to move from the UK to Australia was such a privilege, few perhaps beat the prospect of seeing in the New Year in temperatures of 25–30° C while my former colleagues at the Bank of England scrape frost off windscreens and thaw frozen pipes. The contrast in terms of sunshine is starker still: indeed, London seems barely to get light at all at this time of year (Graph 1).

It was this cold, dark British version of the festive season – not the sun-drenched Australian alternative – that Charles Dickens described in *A Christmas Carol*. In one of the most dramatic scenes, the Ghost of Christmas Yet to Come shows the miserly Ebenezer Scrooge a nightmarish vision of his own future, in which he dies alone and unloved, without friends or family, his possessions stolen and sold for scrap.



Some commentators fear a similar fate for the world economy in 2025 if the United States triggers a tit-for-tat trade war with China and other countries. In that hypothetical scenario, the worry goes, economic activity would fall and prices would rise across the world – including here in Australia – as global supply chains are disrupted, leading to weakened competition, productivity and innovation.

Nothing can be definitively ruled out: Australia is intimately linked to the world economic and financial system at every level. And history shows that when trade, labour and money flow freely in the global economy, we thrive – but when countries turn inwards, we suffer.

But, just as Scrooge did not in the end meet his seemingly inevitable fate, the macroeconomic implications for Australia from future global trade policies may be less obvious than they first appear:

- First, we so far know little about the scale, scope and timing of those policies.
- Second, the scale of any depressing effect on Australian economic activity is uncertain. We are not a major exporter to the United States – so the direct impact of any tariffs on such trade would be limited. We have strong comparative advantages in raw materials and services that other countries need, both to power traditional industries and the industries of the future. We have a track record of nimbly reshaping our trading relationships, through a combination of market forces and proactive policy. And our flexible inflation target and exchange rate can help to absorb the impact of global shocks.
- Third, the implications for Australian inflation, and hence for monetary policy, could be positive or negative, depending on how tariffs affect the balance between supply and demand.

I want to use the rest of my remarks this evening to elaborate on these points. In doing so, I am explicitly *not* going to cover the many other potential risks and opportunities in the world economy in the year ahead.

Australia and the world

While researching this speech it became clear that to understand the importance of trade for Australia you could do worse than look at the history of the very address we are meeting at tonight: 199 George Street, Sydney.

The first substantial structure on this site – the George Street jail – was funded, ironically enough, by tariffs on spirits, wine and beer. In the mid-1800s, this area was part of ‘Little Canton’ – where the Chinese community lived, worked and traded at the wharfs. And from the early 20th century, the Greek Andronicus Brothers sold imported coffee and chocolate here, first to walk-in customers and later, when the construction of the Sydney Harbour Bridge poleaxed that business, also to the wholesale trade. In 1982, as part of the economy’s long swing towards services, the building we sit in today opened as the Regent Hotel, described by some as Sydney’s first modern luxury hotel. A year later, a glittering ceremony led by then Prime Minister Bob Hawke, launched the Business Council of Australia – its purpose not, in the words of its first President, Sir Arvi Parbo, to ‘whinge to the government about narrow interests’ but to develop ‘long-term views in the broad national interest’. And shortly before Christmas 1983, the government floated the exchange rate and liberalised Australia’s capital account – ushering in an era of wider economic reform that set the country on the road to prosperity.²

If those are the Ghosts of Christmas Past, fast forward to Christmas Present and the effects of that era of reform are clear (Table 1). Our two-way trade equates to nearly 50 per cent of GDP – somewhat below other small open economies like South Korea or Sweden, but much higher than the United States; and we are a world leader in some markets, including iron ore. We attract some of the best-educated workers from overseas. Our institutional and business environment ranks in the top echelon, according to the IMD World Competitiveness Yearbook. And, while our banks tend to be relatively domestically focused, our superfunds increasingly invest in overseas assets; half our (Australian dollar denominated) Commonwealth government debt is held by foreigners; and key financial variables can move closely with global developments.

Table 1: Some Indicators of Australian Openness

Macroeconomic / macrofinancial	Exports + imports as a share of GDP ^(a)	46%
	Share of global iron ore trade	56%
	Proportion of superfunds’ assets held offshore	48%
	Banks’ foreign assets as a share of total assets	23%
	Foreign ownership of Australian Commonwealth government debt	47%
Correlation with international financial variables ^(b)	Australia/US policy rate expectations	0.9
	ASX and S&P500	0.8
	Variation in Australian dollar explained by global factors	0.8
	Three-year Australia/US government bond yields	0.9
Global ranking	Attracting highly educated workers	1st
	Destination for international university students ^(c)	3rd
	World competitiveness ranking	13th
	Net migration rate	15th
	Turnover in domestic currency vs US dollar	6th
	Total exports (US dollars)	21st

(a) Measure includes goods and services.

(b) Based on correlations of month-end changes for the three years to end-2024.

(c) Among English-speaking countries, 2018.

Sources: ABS; BIS; CIA World Factbook; Department of Industry, Science and Resources; IMD World Competitiveness Yearbook; NAB Biennial FX Hedging Survey; OECD; RBA; Statista; TIME Association.

Threats and opportunities for Australia in the New Trading Order

So what does the future hold?

Let's start with a positive. The direct impact of any US tariffs on Australia is likely to be limited. And that's because our exports to the United States are relatively modest. Indeed, unlike many trading nations, we run a substantial trade *deficit* with the United States (Table 2) – one of the largest in the world.

Table 2: Australian goods trade with the United States and China (2022)

	Rank in Australian ...		Australian exports to country as share of ... (per cent)		Australian imports from country as share of ... (per cent)		Australian trade balance (US \$bn)
	Exports	Imports	Australian exports	Country imports	Australian imports	Country exports	
US	5	2	5	0.4	10	1.5	-16
China	1	1	29	6	28	2	42

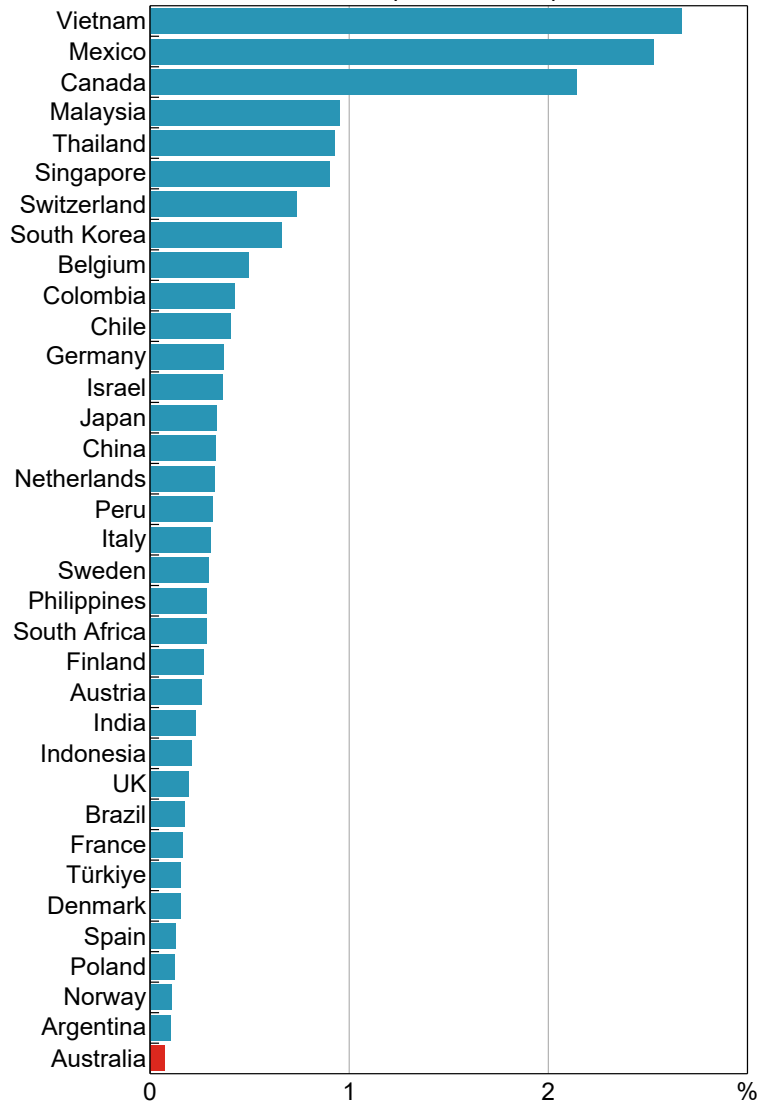
Sources: Observatory of Economic Complexity; UN Comtrade.

It is too soon to say what the scale and scope of any such tariffs might be. We have a free trade agreement with the United States and successfully negotiated exemptions in 2018.³ But even if blanket tariffs are imposed, the value of our exports that are directly exposed, as a share of GDP, is among the smallest of any developed country (Graph 2).⁴

Graph 2

Direct Exposure to US Tariffs*

For an additional 10 per cent tariff, per cent of GDP



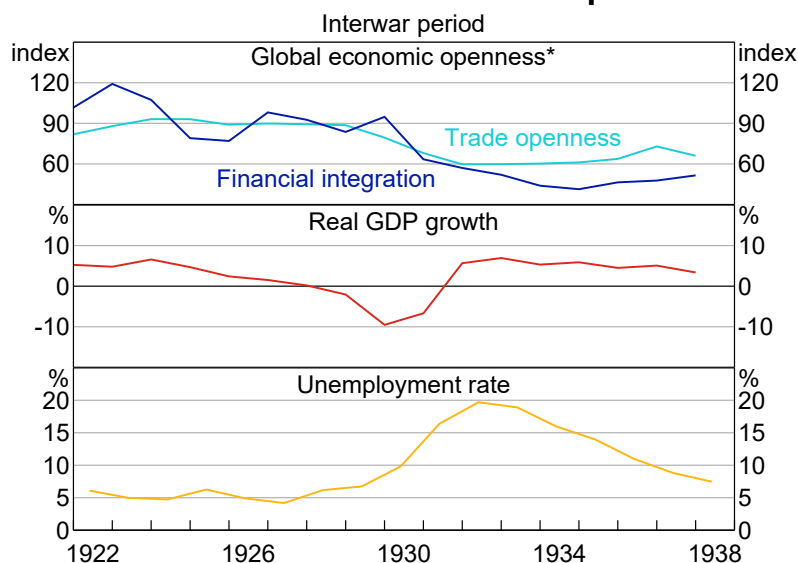
* Calculated as 10 per cent of the value of 2022 exports to the US divided by GDP; calculated in US dollars; does not account for trade redirection, tax incidence or price changes.

Sources: Deutsche Bank Research; RBA; UN Comtrade; World Bank.

So far so good? Well, not really, because that's only the start of the story. US tariffs would depress demand in the United States and other affected countries, and may provoke retaliatory tariffs against the United States. The most extreme end-game of such a scenario – an all-out global trade war – would depress world activity and trade everywhere.

When seeking a historical analogy for such an outcome, people often reach for the Great Depression of the 1930s. The Depression did not begin with a trade war – but the tariffs imposed by the US *Smoot Hawley Tariff Act*, and retaliation from other countries, made it much deeper and longer lasting. Global activity fell by 15 per cent and global trade by two-thirds – and that hit Australia hard, causing real GDP here to fall by around 10 per cent and the unemployment rate to rise to 20 per cent, leaving gaping economic and political scars (Graph 3).⁵

Graph 3 Australian Growth and Global Openness*



* 1900 = 100. Trade openness is measured by exports to GDP, financial integration is measured by average absolute current account to GDP ratios. Data for 18 advanced economies.

Sources: Butlin (1977); Butlin (1986); Butlin (1988); Jorda Schularick & Taylor (2017); Maddison Project Database (2023).

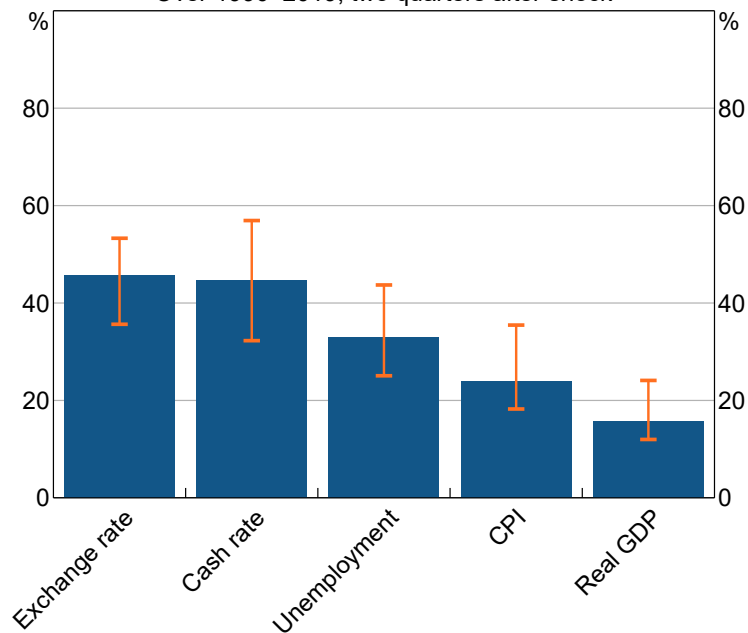
But the Depression is a poor analogy for the possible outlook we face today for several reasons.

Perhaps the most important is the fundamental difference in macroeconomic policy frameworks. The contraction in activity in the 1930s was substantially amplified by the primacy given to maintaining fixed exchange rates, in the belief that this was the best way to ensure price stability. Adherence to fixed exchange rate pegs delayed the devaluation that countries like Australia needed against the US dollar to re-establish external balance.⁶ And it required restrictive monetary conditions, further depressing domestic demand.

Today's policy framework is much less likely to amplify the effects of a global downturn. The exchange rate floats freely, and monetary policy is focused on inflation and full employment – providing a powerful 'first line of defence' against global developments.⁷ Indeed, as a [new RBA Research Discussion Paper](#) published today by Patrick Hendy and Benjamin Beckers, global shocks explain only a fifth of the variability in domestic prices and activity over the past quarter of a century – and that's because changes in the exchange rate and the cash rate absorbed the lion's share of those shocks (Graph 4).

Graph 4 Variation Explained by Global Shocks*

Over 1990–2019, two quarters after shock



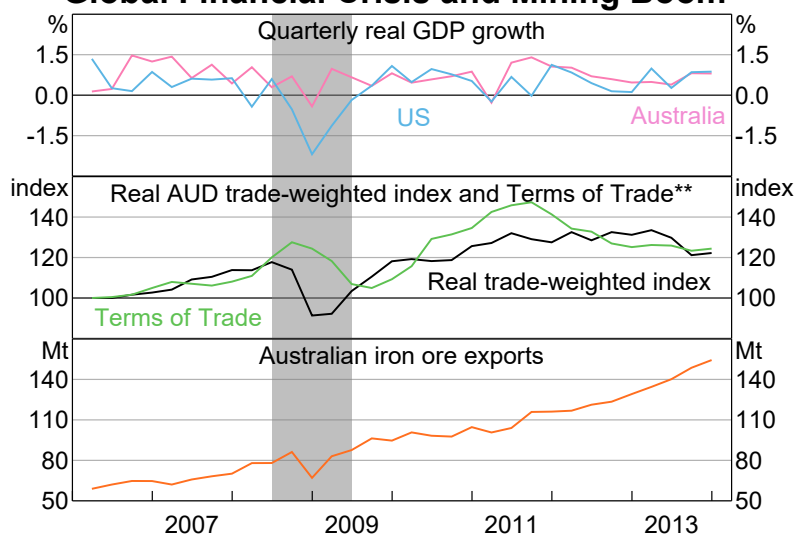
* 68 per cent error bands shown; results are forecast error variance explained cumulatively by global factors in a factor-augmented vector autoregression model two quarters after incidence of shock.

Source: Hendy and Beckers (2024).

A familiar illustration of that point comes from the Global Financial Crisis (GFC) and the parallel ‘mining boom’ (Graph 5).

Following the onset of the GFC, the flexible exchange rate regime allowed the RBA to cut interest rates rapidly – and that, together with substantial fiscal stimulus and a stable domestic banking system, helped to underpin domestic demand. Australian activity was also supported by strong growth in China, which began with its ascension to the World Trade Organisation in 2003 and was given further momentum by its CNY4 trillion stimulus package in late 2008. The huge increase in Chinese infrastructure and real estate construction led to a boom in steel production, which in turn gave a huge boost to demand for Australian commodities, most notably iron ore. The mining boom that followed transformed the Australian economy, lifting the terms of trade, drawing in massive investment flows and solidifying China as Australia’s key trading partner. The shock-absorbers were again in action during this period: in particular, the progressive appreciation of the Australian dollar helped the economy to adjust to the increase in national income and demand without threatening the inflation target.

Graph 5
Global Financial Crisis and Mining Boom*



* Shading corresponds to the four quarters of consecutive negative real GDP growth in the US from September quarter of 2008 to June quarter of 2009.

** March 2006 = 100.

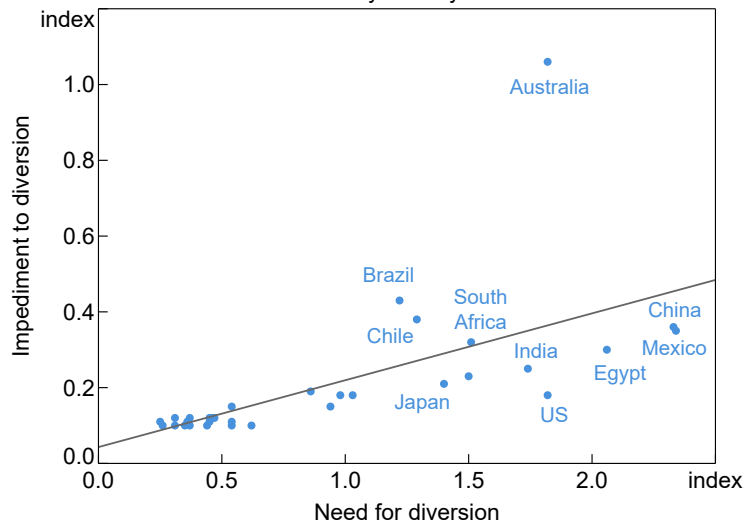
Sources: ABS; LSEG; OECD; RBA.

So our limited direct exposure to US tariffs, and our flexible policy framework, should provide some insulation. But that's obviously not the end of the story – because higher tariffs in the United States (and potentially elsewhere) will also have an indirect effect on Australian demand by depressing activity right across global supply chains, many of which involve Australian firms.

There's some good news on this front too: Australia's participation in global value chains – meaning trade in goods that cross borders two or more times between origination and final consumption – is lower than in many countries. Our global value chain-related activity accounted for only 11 per cent of total output in 2022, compared with an average of 26 per cent among other high- and middle-income countries, according to Asian Development Bank data.⁸

But within this average, our exposure is unusually concentrated. To see that point vividly, consider Graph 6, produced by the Bank for International Settlements.⁹ For each country, the x-axis measures the extent to which countries trade with countries with different geopolitical outlooks (proxied by the differences in their voting patterns at the United Nations): the potential 'need for diversion'. The y-axis measures the extent to which countries would struggle to find alternative markets for their exports in geopolitically more aligned countries, given the current structure of trade flows: the 'impediment to diversion'. Australia is by some distance the biggest outlier on this chart – in part reflecting the fact that over 80 per cent of Australia's iron ore exports are directed to China, and China accounts for three-quarters of global iron ore imports.

Graph 6
Exports at Risk*
 By country



* Higher numbers indicate greater risk; the 'need for diversion index' is the trade-weighted average of the geopolitical distance between each country and its trading partners; the 'impediment to diversion index' is the trade-weighted average across sectors of a measure of sectoral concentration adjusted for geopolitical distance; line of best fit shown in grey.

Sources: Qiu, Xia and Yetman (2024); RBA.

On the face of it, this seems to suggest that Australia could find itself more seriously affected by a global trade war than some of the average exposure data suggest, if China is subject to disproportionately punitive tariffs and/or the trend towards countries trading less with those they are most geopolitically distant from accelerates. But here too we should be careful not to jump to conclusions:

- First, whether Australian producers actually *need* to find other markets is yet to be seen, and will depend, among other things, on: the specific details of any tariffs the United States imposes on China; the response of Chinese exporters; the extent of any additional Chinese stimulus and the degree to which that influences Australian exports; and any exchange rate adjustments. It is dangerous to put too much weight on past experience, but during the US–China trade war of 2018–2020, the dominant influence on Australia–China trade was not bilateral US–China tariffs but the Chinese authorities' policy stimulus, which saw Australia's share of trade conducted with China rise. While there were important indirect adverse effects from tariffs on Australia during this period, they paled in comparison with those felt by other countries.¹⁰
- Second, if Australian producers *do* find themselves needing to divert some of their output to other markets, they may find more opportunities than Graph 6 suggests. And that is because the data underpinning the chart assume the current set of prices, exchange rates, geographical production capacities and trade policies. In practice, however, at least some of these would adjust. When China imposed restrictions on Australian exports in 2020, for example, exporters of barley, beef and coal found alternative buyers for at least part of their output elsewhere in Asia and the Middle East within 6–12 months, through a combination of market mechanisms and targeted government support.¹¹ There are limits to this analogy of course: Australian goods exports to China fell by only 2 per cent between 2019 and 2020; so a larger or more sustained reduction could be harder to manage. Certainly, no other country has sufficient steel-making capacity today to take anything like the whole of China's annual US\$134 billion iron ore purchases. But a reduction of this scale is extremely unlikely, and Australia's relatively low production costs means we are not the marginal supplier. Demand may also be supported through relocation of more Chinese production to Asia, Europe or even the United States itself – as Japanese car manufacturers did in the 1980s.

- Third, over the longer term, persistently higher tariffs on some countries or products would be likely to incentivise Australian producers to adjust the shape of their production more radically – diversifying the range of products, employing more efficient, lower cost technologies, and moving investment and output towards lower tariff sectors. Such adjustments are costly and time consuming. But Australia has plentiful supplies of valuable minerals, traditional and renewable energy sources, and high-quality human capital. And we have done it before: the country has undergone at least three tectonic shifts in its export markets since Federation – from the UK/Commonwealth trade bloc, then to Asia outside China, and most recently to China.

Bringing it together: So what for monetary policy?

So what could this all mean for Australian activity and inflation, and hence monetary policy?

Turning first to activity, Table 3 summarises some of the considerations I've covered this evening. At one extreme, if tariffs were imposed clearly and predictably in countries to which we export little (directly or indirectly) – and this were coupled with appropriate adjustment in the real exchange rate, material policy stimulus in affected countries, nimble re-routing of exports to affected countries, minimal financial market and capital flow contagion – the impact on Australian activity could be very modest. One could even envisage scenarios in which tariffs could *increase* activity for a time if they led to, or accompanied, substantial overseas policy stimulus – as happened in 2018–2020.

Table 3: Components of impact on Australian activity

Smaller impact on activity	Larger impact on activity
Unilateral or limited-coverage / wide-exception tariffs in small export markets	Limited-exception tariffs covering more countries, including key export markets
Clarity on tariff policy allows planning	Widespread uncertainty on tariff policy impairs planning
Larger real exchange rate depreciation	Smaller real exchange rate depreciation (or appreciation)
Larger overseas policy stimulus	Smaller overseas policy stimulus (or tightening)
More trade re-routing	Less trade re-routing
Minimal financial market contagion through risky asset prices and capital flows	Material financial market contagion through risky asset prices and capital flows

Of course, that may not be the most likely outcome this time around. Relax one or more of those assumptions – a more comprehensive set of tariffs, less overseas stimulus, or a slower, more costly rerouting of trade flows, for example – and Australian activity is likely to take a hit. But the point I've tried to make today is that the far right of this table is a *very* extreme scenario: the system contains a mix of automatic and discretionary shock absorbers that lean against it. Consistent with that, one of the most comprehensive external assessments so far completed, which contains some of those shock absorbers, estimates that global tariffs would subtract only 0–0.2 percentage points from Australian GDP over the subsequent two years, depending on the scale of tariffs implemented and the degree of retaliation.¹²

What about inflation? In countries imposing tariffs, the aggregate price level will typically rise – increasing measured inflation, at least for a period – as the (intended) higher price of imports works through the system.¹³ That direct price level effect will not apply in countries that don't impose tariffs (which I assume for the purposes of this discussion includes Australia). But over time, tariffs – particularly if they are widespread – will impair the supply side of the world economy, disrupting global supply chains and reducing competition. And that effect, coupled with the potential for stronger overseas stimulus and greater pass-through of any exchange rate depreciation, will tend to push up on prices here too – the scenario shown in the right-hand column of Table 4.

Working against this upward pressure will be the downward effects of the weaker demand that I discussed above, and the potential diversion of cheaper foreign goods to Australian markets that previously would have been sold in higher tariff countries.

Table 4: Components of impact on Australian inflation

Lower inflation	Higher inflation
Materially lower demand	Dominant global stimulus
Supply diversion – Australia benefits from cheaper goods avoiding high-tariff regions	Supply impairment – disrupted global supply chains, weaker global competition
Limited exchange rate depreciation	Sharp exchange rate depreciation

So the impact on Australian inflation is ambiguous, in large part because it depends on a far wider set of considerations than the imposition of US tariffs alone. Given this uncertainty, it is important that we don't prejudge the implications of tariffs for policy but monitor developments closely and stand ready to respond appropriately as the facts emerge. And that is what we at the RBA will do, factoring that assessment into our overall policy judgements in the months ahead.

Conclusion

Let me conclude.

If Scrooge's grim premonition of his own death is one of the bleakest moments in *A Christmas Carol*, one of the most joyous occurs earlier in the book, when the Ghost of Christmas Past takes him to see how his old boss, Mr Fezziwig, celebrates Christmas Eve. It is an exuberant extravaganza, replete with food, wine, presents, singing, dancing and general high spirits. This, Dickens intimates, is a vision of what Scrooge could have been.

No-one could claim that Mr Fezziwig's ball is an apt metaphor for the global trading system, or Australia's part in it, in 2025. But neither is the graveyard. The chances of being propelled into another global Depression are low. Our direct exposure to US tariffs is likely to be small. We have strong comparative advantages in raw materials and services that other countries need, both to power traditional industries and the industries of the future. We have a track record of nimbly reshaping our trading relationships, through a combination of market forces and proactive trade policy and negotiation. And our flexible exchange rate and independent monetary policy can serve as powerful shock-absorbers. Australian inflation could move in either direction.

So it would be unwise to prejudge what may happen in practice. As with every element of monetary policy setting, we will be alert to developments and ready to respond – in either direction, with force if needed, to deliver our mandate of low and stable inflation with sustained full employment.

I wish you all a very happy festive season, and look forward to our discussion this evening.

Endnotes

* I am particularly grateful to Patrick Hendy and Jess Young for their excellent help in preparing this speech and to Susan Black, Michele Bullock, Natasha Cassidy, Stephen Cupper, Jacqui Dwyer, Samuel Evangelinos, Ian Harper, Sarah Hunter, David Jacobs, Bradley Jones, Christopher Kent, Jeremy Lawson, Vanessa Li, Michael Plumb, Tom Rosewall, Penny Smith, Katie Sun, Michelle Wright and Dora Xia for comments and contributions.

1 Although this claim is widely made, the evidence base is quite sparse – perhaps because, as Macphail and Owen (2018) note in *Australasian Historical Archaeology*: 'Between 26 January and March 1788, Sydney Cove was subject to "clearing of the Land, cutting, grubbing and burning down trees [and] Enclosing Farms and Gardens" (Worgan 1978:8). Not surprisingly this had an immediate and profound effect on the natural environment and the local Aboriginal culture, as well as destroying many of the native plants and plant communities growing around Sydney Cove and along the Tank Stream Valley. As such, 'few details of the pre-settlement natural environment were recorded at the time (GML 2017:18–30; Karskens 2009)'.

- 2 See Berger-Thomson L, J Breusch and L Lilley (2018), 'Australia's Experience With Economic Reform', Treasury Working Paper, October. I had hoped to include a George Street Christmas reference to the introduction of Australia's inflation targeting regime too, but timing and location are against me: see Cornish S (2018), 'The Evolution of Inflation Targeting in Australia', Australian National University and Reserve Bank of Australia.
- 3 Norman J (2018), 'Donald Trump, Malcolm Turnbull Hit on Deal to Exclude Australia from New US Tariffs', *ABC News*, 10 March.
- 4 I am grateful to George Saravelos and Michael Puempel (Deutsche Bank) for the original idea for this chart.
- 5 Data come from Gruen D and Colin Clark (2009), 'What Have We Learnt? The Great Depression in Australia from the Perspective of Today', 19th Annual Colin Clark Memorial Lecture, Brisbane, 11 November; Office of the Historian (undated), 'Milestones in the History of U.S. Foreign Relations – Protectionism in the Interwar Period', US Department of State. Further discussion of Australia and the Great Depression can be found at: Kent CJ (2011), 'Two Depressions, One Banking Collapse: Lessons from Australia', *Journal of Financial Stability*, 7(3), pp 126–137; McLean IW (2012), *Why Australia Prospered: The Shifting Sources of Economic Growth*, Princeton University Press; Schedvin CB (1970), *Australia and the Great Depression*, Sydney University Press; Beaumont J (2022), *Australia's Great Depression*, Allen & Unwin.
- 6 Australia's currency had been repegged to gold in 1925, and the private banks, as well as the Commonwealth Bank – the predecessor to the RBA – were initially unwilling to sponsor a devaluation, viewing the peg as indispensable to 'sound finance'. But as the Depression progressed, many countries – including Australia in 1931 – were forced to leave the gold standard, and Australia repegged against the pound sterling. The timing with which countries departed the gold standard and accepted a currency devaluation was strongly associated with when they each began their slow economic recovery.
- 7 Because most of Australia's debt is denominated in local currency or heavily hedged, depreciation is also less likely to trigger financial instability. For more on the topics covered in this section, see Stevens G (2013), 'The Australian Dollar: Thirty Years of Floating', Speech to the Australian Business Economists' Annual Dinner, Sydney, 21 November; Smith P (2023), 'The Extraordinary Decline in Australia's Net Foreign Liabilities', Speech to the CFA Societies 2023 Australian Investment Conference, Sydney, 18 October; Bullock M (2023), 'Monetary Policy in Australia: Complementarities and Trade-offs', Speech to the 2023 Commonwealth Bank Global Markets Conference, Sydney, 24 October.
- 8 World Bank WITS GVC Output Table, available at <<https://wits.worldbank.org/gvc/gvc-output-table.html>>, calculated from Asian Development Bank input-output tables.
- 9 Qiu H, D Xia and J Yetman (2024), 'Deconstructing Global Trade: The Role of Geopolitical Alignment', *BIS Quarterly Review*, September.
- 10 See Table 4 in Wu *et al* (2021), 'Evaluating the Cumulative Impact of the US-China Trade War Along Global Value Chains', 15 March.
- 11 See for instance: Zhou W and J Laureceson (2022) 'Demystifying Australia-China Trade Tensions', *Journal of World Trade*, 56(1), pp 51–86; Edmonstone G (2024), 'China's Trade Restrictions on Australian Exports', United States Studies Centre, 2 April; (2024), AXSMarine, 'How Australia Adjusted its Coal Exports to China's Import Ban', 20 September.
- 12 McKibbin WJ, M Hogan and M Noland (2024), 'The International Economic Implications of a Second Trump Presidency', PII Working Paper No 24-20, September; for broader analyses, see also Blanchard O (2024), 'How Will Trumponomics Work Out?', PII, 13 November; Baldwin R (2024), 'Trump Tariffs, Season 2: 10% and 60% Tariffs are Not the Same', 15 November.
- 13 Of course, the scale and persistence of any rise in inflation in tariff-imposing countries will depend on many other factors, including: the extent to which firms exporting to the country seek to maintain sales by compressing their price margins; the extent to which exchange rate appreciation chokes off the rise in the price level; and the response of other domestic policy – most notably domestic monetary policy.