Australia has avoided a recession since 1990 thanks to its nature as an advanced open economy with sound financial institutions. The U.S. can learn from the Australian experience, specifically from the funding composition of Australian banks. Other characteristics of its economy are unique to smaller open economies such as the depreciation of its currency during downturns, increasing output (specifically exports). Another unique aspect of Australia is its special trading relationship with China and other parts of Asia, keeping an export-focused economy afloat in adverse economic conditions. If the U.S. desires to learn from Australia it may look at a well-capitalized financial sector that avoids excessive leverage. Other aspects are more country specific and are attributable to chance like large trading partners that keep demand up even during the crisis.

Australia’s economy since 1990 has four distinct features. First, the country maintains a special relationship with China and Japan, fueling constant export growth. Goods exports with China and Japan have grown from the 1990’s and together consist about half of the country’s exports. Graph 4 highlights the time series since 2000. Note that Australia’s exports have also risen as fraction of GDP since 1990 with a few exceptions (Graph 3). Australia’s close connection with China, which unleashed a torrent of fiscal and monetary stimulus during the financial crisis, helped keep Australia’s economy afloat. “Thank goodness the Chinese believed Keynesian story,” remarked a senior Australian Treasury official.¹

Second, Australia’s exchange rate depreciates during economic downturns, cushioning the blow of downturns. Cordella and Gupta (2014) label the Australian dollar as pro-cyclical, it appreciates in good times and depreciates in bad ones. In general, developing counties tend to have pro-cyclical currencies, but limit the excessive float of their currencies with capital controls. Australia, New Zealand, Finland, and Iceland form a group of advanced exporting countries with pro-cyclical currencies (Cordella and Gupta 2014). Australia has no capital controls and its currency depreciated in the 2008 crisis (Gauton, Gaudry, Wilcox 2012). Possible explanations for this phenomenon include: first, the “flight to quality” where capital flowed to the U.S., Japan, and Switzerland during the crisis, appreciating their currencies compared to the $AUD, second, the unwinding of carry trades contributed to a depreciation.² Kohler (2010) notes that the unwinding of yen-based carry trades led to sharper depreciations of the $AUD.³ He finds that the currencies with higher interest rates before 2008 crisis experienced sharper depreciations

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¹ David Gruen—Deputy Secretary, Economic (Australian Treasury)—quoted in Barret (2011)
² In the midst of the crisis capital flowed to places like the US, the center of the crisis, Japan and Switzerland, appreciating the value of their currencies.
³ Interestingly, Japan was Australia’s largest destination for its exports in 2008.
during the crisis. Notably, the Australian dollar quickly appreciated in the year following the crisis. See Graph 4.

**A small depreciation in Australia’s currency may have acted as an automatic stabilizer during the global financial crisis.** According to DSGE models of the Australian economy, a permanent 10% depreciation is estimated to increase the level of GDP by about 1% (Kohler, Manalo, Perera). Further, a temporary 10% depreciation of the $AUD increases GDP $\frac{1}{4}$-$\frac{1}{2}$ percent over the next one to two years. This second claim is probably a better approximation of what occurred in 2008 and provides evidence for the Australian dollar acting as an automatic stabilizer.

**Third, Australia’s banks engage in less risky behavior** compared to other major economies. At no point did Australian banks receive public funds during the crisis. In fact, Australian banks relied less on securitization and derivative exposure, although there was a large share of short-term funding before the crisis (see Graph 5). Although we dismissed this fact in our initial conversation, this fact bears some weight because of the stark difference between the funding composition of banks in the U.S. and those in Australia (i.e. less derivative exposure and securitization, and higher capital ratios). See Graph 6.

**Fourth, the former Australian Treasury chief of staff to Wayne Swan claims that the timely nature of both fiscal and monetary policy allowed the Australian economy to get out in front of the crisis.** Reaction to worsening economic indicators lagged in the U.S. compared to Australia. NBER dates the American Recession to December 2007. The Recovery Act passed in February 2009 (about 14 months after the recession began) and positive growth began in June 2009. Granted, temporary tax cuts, TARP, and some bank consolidation had already taken place before the Recovery act. Nevertheless, Australia is a little different: It experienced negative growth in December 2008, legislation passed in February 2009, and took effect in June of that year (Barret 2011). Australia’s timely response should be noted.

Looking forward, as Australia basks in 28 years of economic growth, household debt is increasing and home prices are diverging from fundamental value. Credit expansion combined with overvalued home prices is not a good sign. House pricing growth is growing faster than their consumer price index.

**In conclusion,** Australia last experienced a recession in 1990, making it a country worth observing. Australia’s position as an advanced export-focused country with close ties with Asia has helped it weather financial storms. Its healthy fiscal position and financial sector also help.

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4 A statistical note: Australia barely avoided the statistical definition of a recession in the 4th quarter of 2008. If the blow in that quarter had been spread out along the other quarters, the economy would have experienced two quarters of negative growth.
Still questions regarding Australia and countries that have not experienced a recession remain. Do countries that experience recessions fare better in the long run? Channeling the work of Joseph Schumpeter, are recessions the price to pay for sustained economic growth? Can the US learn from the Australian experience? Why did similar countries experience a recession?

Graph 1. Australian GDP Growth. Source: Reserve Bank of Australia (RBA).

Graph 4. Destination of Goods Exports in percentages. Data from Australian Department of Foreign Affairs and Trade.

Graph 3. Share of Exports as a fraction of GDP. Source: screenshot from World Bank.
Graph 4. Real and Nominal Exchange Rates. Source: RBA.

**Australian Dollar Trade-weighted Index**

*May 1970 = 100 for nominal; real indexed to equate post-float averages; latest observations for real TWI are estimates*

Sources: ABS; RBA; Refinitiv; WM/Reuters

Graph 5. Funding Composition of Australian Banks. Source: RBA

**Funding Composition of Banks in Australia**

*Adjusted for movements in foreign exchange rates; tenor of debt is estimated on a residual maturity basis*

**Includes deposits and intragroup funding from non-residents*

Sources: APRA; Bloomberg; RBA; Refinitiv; Standard & Poor’s
Note: Tier 1 consists of funding like ordinary shares and retained earnings. Tier 2 consists of more senior funding, like subordinated debt for example (Gorajek and Turner, 2010).

Graph 6. Capital Ratios of the largest Australian Banks compared to other banks. Source: screenshot from an independent PwC report commissioned by Australian Bankers Association. I highlighted the 4 main Australian Banks and a few U.S. banks.
References


