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Australia’s foreign debt: a quick guide

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This quick guide looks at the level of Australia’s foreign debt, the interest liability on foreign debt and how these have changed over time. It also looks at foreign debt as a component of net foreign investment, the other component being equity investment. Finally, given that Australia’s gross foreign debt is now bigger than its annual gross domestic product (GDP), the quick guide also considers whether our foreign debt level is too high.

What is foreign debt?

Foreign debt is the amount borrowed from non-residents by residents of Australia. It includes securities such as bonds, as well as loans, advances, deposits, debentures and overdrafts.

Foreign debt is a subset of the financial obligations that make up Australia’s foreign investment position. It is distinguished from other forms of foreign investment capital inflow such as equity investment (foreign ownership) by the obligation to pay interest and/or repay capital.

Foreign debt is not to be confused with national debt, which is the total government debt. National debt comprises government borrowings from overseas residents and government borrowings from Australian residents and thus excludes overseas borrowings by the private sector.

A distinction is made between gross and net foreign debt. Gross foreign debt is the total amount of borrowing from non-residents. Net foreign debt is equal to gross foreign debt minus the sum of lending by residents of Australia to non-residents and official reserve assets held by the Reserve Bank.

Level of foreign debt

Table 1 below shows that in June 2014 the size of Australia’s gross foreign debt was $1 693 billion. Foreign debt rose rapidly from June 1984, after remaining fairly low and stable during the late 1970s and early 1980’s. Much of the increase in foreign debt since the mid–1980s can be traced to the private sector and is attributed to financial deregulation, globalisation and the significant increase in mining production financed by foreign savings. In the 30 years from June 1984 to June 2014, the dollar value of Australia’s gross foreign debt increased at an annual average rate of 12.3 per cent.

While concern might be expressed about the size of Australia’s gross foreign debt, Australia also lent money overseas. That is why the more meaningful figure is net foreign debt. After deducting Australia’s reserve assets and lending abroad, the level of net foreign debt in June 2014 was $865 billion. From June 1984 to June 2014, the dollar value of Australia’s net foreign debt increased at an annual average rate of 11.6 per cent. This is less than the corresponding figure for gross foreign debt, indicating that over the past 30 years Australian lending abroad has increased at a faster rate than Australian borrowing abroad.

As a proportion of GDP, the size of Australia’s net foreign debt has increased considerably more than threefold from 15.2 per cent in June 1984 to 54.6 per cent in June 2014. While expressing net foreign debt as a percentage of annual GDP shows its significance relative to the size of the overall economy, and reflects to a degree the

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economy's capacity to repay the debt, it does not mean that this proportion of GDP must be applied to the repayment of debt. GDP is a flow of goods and services during a period, while foreign debt is a level at a point in time which will involve interest and repayments of principal over many periods into the future. (See section following for discussion of interest on net foreign debt.)

Table 1: Foreign debt and interest on foreign debt

	Gross foreign debt		Net foreign debt		Interest on net foreign debt	
	$m	% of GDP	$m	% of GDP	$m	% of exports
1983-84	51,731	24.2	32,492	15.2	3,412	11.8
1984-85	76,735	32.6	54,138	23.0	4,890	13.6
1985-86	104,363	40.0	80,098	30.7	6,166	15.8
1986-87	125,574	43.8	90,310	31.5	7,313	16.5
1987-88	140,996	43.3	98,665	30.3	8,051	15.5
1988-89	163,592	44.3	114,598	31.0	9,803	17.6
1989-90	186,471	46.1	130,999	32.4	12,861	21.0
1990-91	200,119	48.2	142,849	34.4	12,556	18.9
1991-92	220,674	52.2	161,651	38.2	11,196	15.9
1992-93	241,200	54.3	175,799	39.6	9,663	12.4
1993-94	249,634	53.5	169,420	36.3	8,992	10.7
1994-95	271,955	54.8	188,427	38.0	9,795	11.1
1995-96	279,915	52.9	190,999	36.1	10,778	10.8
1996-97	307,858	55.3	205,313	36.9	11,140	10.5
1997-98	352,743	59.9	223,125	37.9	10,829	9.4
1998-99	366,760	59.1	225,327	36.3	10,802	9.5
1999-00	425,070	64.3	266,734	40.3	13,747	10.7
2000-01	506,419	71.8	295,880	41.9	15,096	9.7
2001-02	545,761	72.4	316,712	42.0	14,090	9.0
2002-03	597,316	74.5	348,471	43.5	12,014	7.9
2003-04	675,114	78.3	378,991	44.0	12,775	8.7
2004-05	743,190	80.5	421,888	45.7	16,874	10.1
2005-06	881,557	88.3	489,461	49.0	18,822	9.6
2006-07	1,030,271	94.7	535,964	49.3	25,884	12.0
2007-08	1,121,060	95.1	599,314	50.8	28,659	12.3
2008-09	1,204,683	95.7	620,034	49.3	29,959	10.6
2009-10	1,295,078	99.9	675,246	52.1	26,560	10.5
2010-11	1,303,837	92.7	671,174	47.7	26,501	8.9
2011-12	1,434,224	96.5	746,170	50.2	25,220	8.0
2012-13	1,560,665	102.4	796,595	52.3	20,274	6.7
2013-14	1,692,501	106.7	865,462	54.6	23,307	7.0

Source: Australian Bureau of Statistics (ABS), Balance of payments and international investment position, cat. no. 5302.0, ABS, Canberra, June 2014.

Interest liability on net foreign debt

In 2013–14 a total of $23 billion was paid in net interest overseas. The net interest paid adds directly to the current account deficit.

As with foreign debt, it is useful to obtain a measure of the relative size of interest on foreign debt. The method most commonly used is to express net interest payments as a percentage of export earnings (goods and services credits), or the debt service ratio. This emphasises the international liquidity aspects of interest payments since exports provide a source of foreign exchange income that can be applied to interest payments. The debt service ratio enables more meaningful comparisons over time since both interest and exports are affected by inflation.

As shown in Table 1, Australia's debt service ratio increased through the latter half of the 1980s to peak at 21.0 per cent in 1989–90. It later fell to 7.9 per cent in 2002-03 before rising again to 12.3 per cent in 2007–08. It subsequently fell once more and in 2013–14 Australia's debt service ratio was 7.0 per cent. In other words, in 2013–14 the equivalent of 7.0 per cent of the value of goods and services exported was required to pay the interest liability on Australia's net foreign debt.

Net foreign debt by institutional sector

Debt liabilities can be held by either the public or private sector. The public sector comprises Commonwealth, state and local governments, as well as the Reserve Bank and other public sector corporations. The private sector comprises private financial and non-financial corporations.

The public and private sector components of net foreign debt show markedly different trends over the past couple of decades. Net foreign debt of the public sector fell from $70 billion in June 1996 to a low of -$16 billion in June 2007 (when the Australian public sector became a net lender to the rest of the world). This is largely attributed to declining federal budget deficits and the emergence of budget surpluses over this period. The Global Financial Crisis of 2008–09 saw a return to budget deficits and an increase in public sector foreign debt. By June 2014 the net foreign debt of the public sector had risen to $226 billion. Net foreign debt of the private sector on the other hand, rose steadily from $121 billion in June 1996 to $582 billion in June 2009, falling briefly before rising again to $639 billion in June 2014. (See Table 2.)

Significantly, the largest portion of net foreign debt has always been held by the private sector. The private sector accounted for almost three-quarters of Australia's net foreign debt in June 2014. At the beginning of this century it was close to 100 per cent. Private sector foreign debt is considered preferable to public sector foreign debt as the private sector borrows only if the returns from investment are expected to be greater than the interest payable. Such investment improves the efficiency and competitiveness of firms.

Table 2: Net foreign debt by sector

	Public sector		Private sector	
	$m	% of total	$m	% of total
1993-94	59,724	35.3	109,696	64.7
1994-95	69,939	37.1	118,488	62.9
1995-96	70,226	36.8	120,773	63.2
1996-97	65,268	31.8	140,046	68.2
1997-98	45,417	20.4	177,708	79.6
1998-99	34,597	15.4	190,730	84.6
1999-00	18,678	7.0	248,056	93.0
2000-01	5,915	2.0	289,966	98.0
2001-02	11,477	3.6	305,235	96.4
2002-03	8,466	2.4	340,005	97.6
2003-04	5,331	1.4	373,660	98.6
2004-05	10,834	2.6	411,054	97.4
2005-06	5,993	1.2	483,468	98.8
2006-07	-15,619	..	551,583	..
2007-08	32,610	5.4	566,704	94.6
2008-09	37,755	6.1	582,280	93.9
2009-10	112,136	16.6	563,110	83.4
2010-11	146,128	21.8	525,047	78.2
2011-12	216,303	29.0	529,867	71.0
2012-13	204,508	25.7	592,087	74.3
2013-14	226,204	26.1	639,258	73.9

Source: Australian Bureau of Statistics, Balance of payments and international investment position, cat. no. 5302.0, Canberra, June 2014.

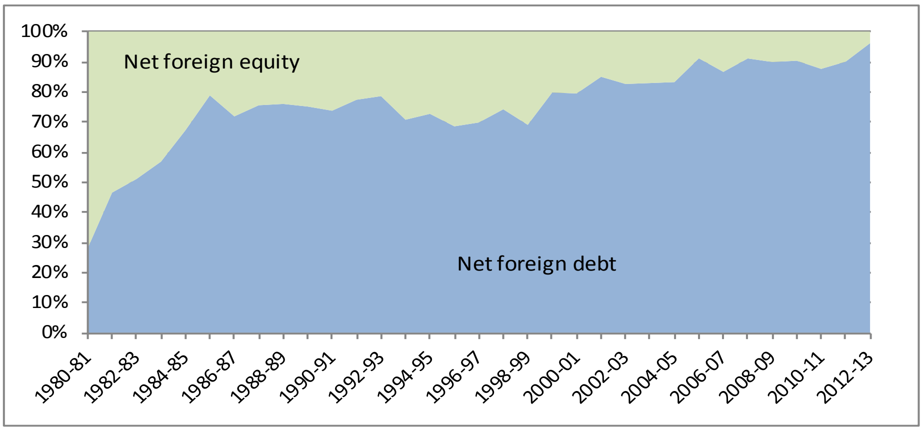
To the extent that only public sector debt has to be paid back with tax revenue, it is useful to see what change has occurred in the level of per capita real (i.e. after adjustment for inflation) net foreign debt of the public sector. After falling to a low of -$899 in June 2007, per capita real net foreign debt of the public sector rose steeply and in June 2014 it was $9 521, which is the highest it has been for at least the last 20 years.

Net foreign investment—debt and equities

Borrowing is only one kind of capital inflow, the other main one being investment in ownership of Australian assets including shares, property and the retained earnings of foreign owned companies. Capital transfers (debt forgiveness involving the cancellation of liabilities by mutual agreement between creditor and debtor, and migrant transfers) is another category of capital inflow, but is relatively small.

Chart 1 shows that in the early 1980s well over half of Australia's net foreign investment was in the form of equities. From 1983, however, that situation reversed with debt accounting for 51 per cent of net foreign investment in that year and climbing to well over 70 per cent in the latter half of the 1980s and for most of the 1990s. By the beginning of the 2000s it had climbed to above 80 per cent, and by 2013 it accounted for 96 per cent of net foreign investment.

Chart 1: Net foreign investment – debt and equity – percentage share



Source: Australian Bureau of Statistics, Balance of payments and international investment position, cat. no. 5302.0, Canberra, June 2014.

Is Australia's foreign debt too large?

While the size of Australia's foreign debt is large, especially when compared with the Commonwealth's net debt figure (expected to be $192 billion in 2013–14), it is not often talked about. One reason for this is that it hardly represents anything new. Australia has always been a net recipient of overseas funds because investment opportunities in Australia have always exceeded what can be funded from the domestic savings of its population. This has led to capital inflow that has built up capital, income and wages, but has also increased our net foreign liabilities, most of which are foreign debt rather than foreign equity.

The size of Australia's foreign debt would be a cause for concern if it was mainly caused by increased consumption rather than increased investment, raising concerns that Australia was living beyond its means. However, Australia's national saving and national investment levels are both above their long-term average, suggesting Australia is well able to cover the servicing of its debt.

Finally, while Australia has a gross foreign debt that is almost the size of its annual GDP, the more meaningful figure is net foreign debt which is just over half as big, and of this about a quarter is held by the public sector. Since only the portion of foreign debt held by the public sector is liable for repayment by the taxpayer, only this portion has budgetary implications.