Australia And The Resource Curse

If you find yourself pining for the bad old days of the financial crisis, you might want to cozy up next to the fire with one of those 25-ounce cans of Foster's Lager, a schmear of Vegamite and some old *Dire Straits* albums and contemplate the relative performance of Australia of late.

Australia's resource bounty has been a blessing and a curse, mostly a blessing for the past two decades when large chunks of it were dug out of the ground and shipped to Asian markets in general and to Chinese markets in particular. While this was not the entirety of the Australian economy, it certainly was an engine of growth for the country and for major mining firms such as BHP Billiton (BHP) and for U.S. mining equipment suppliers such as Caterpillar (CAT) and Joy Global (JOY).

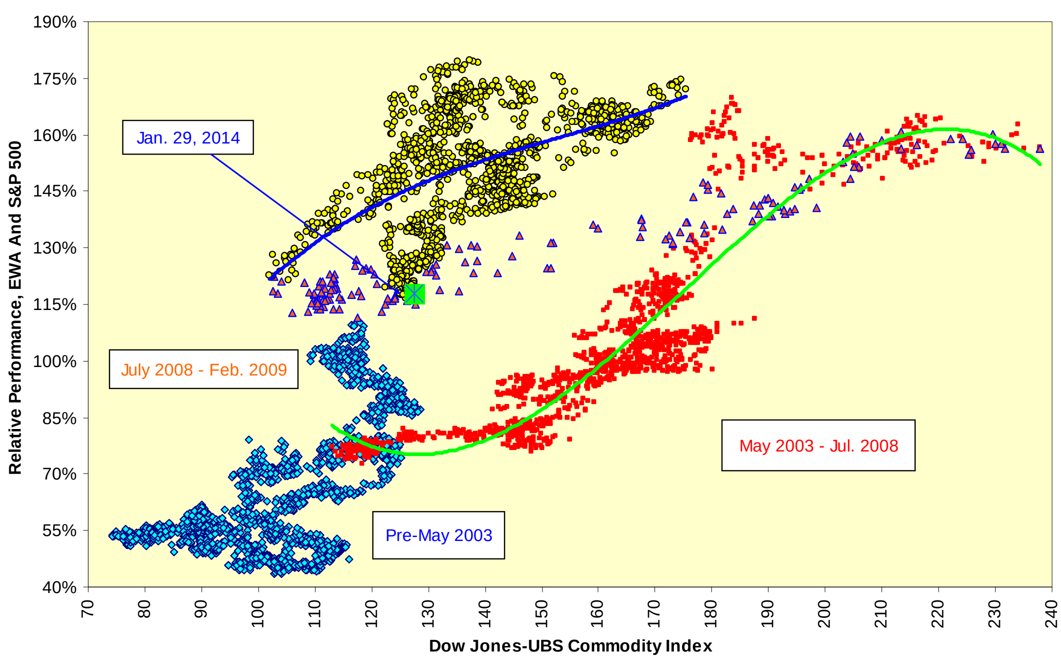
This trade was so large it played tricks on some favorite economic indicators such as the Baltic Dry Freight index. This index' surge attracted new vessel construction and, as I noted in [March 2011](), led to a disconnection between the index and global equity returns. Even so, we cannot ignore the 64.6% decline in the Baltic Capesize index, the one representing large ore carriers, since the end of September 2013. We can quibble about Chinese economic data but should take market-derived prices with as being reasonably representative.

Relative Performance

Let's map the relative performance of USD-denominated iShares MSCI Australia index ETF (EWA) to that of the S&P 500 (SPY) as a function of the Dow Jones-UBS commodity index and divide it into four periods. The first, marked in turquoise extends to the Federal Reserve's first declaration of war on deflation in May 2003. The second, marked in red, occurred during the commodity boom extending to July 2008. The third, marked in blue-orange, is the financial crisis extending through February 2009, and the fourth is the QE-era onwards.

Australia's current relative performance has declined to the bottom of the current range and indeed is indistinguishable from the July 2008 – February 2009 range. I might add similar results are obtained by mapping relative performance against the Australian dollar. Unless Asian demand turns around unexpectedly and starts pulling physical commodity prices higher, a difficult trick given the vast expansion of mine capacity over the past decade, Australia will find what so many resource-dependent economies have found throughout history and that is being dependent on the import demand of others is like relying on the kindness of strangers.

Australia's Relative Performance Declining Relative To Commodity Prices



Addendum: Sector Comparison
The breadth of Australian underperformance extends across all sectors. If we map the total returns of each of the S&P economic sectors for the U.S. and Australian markets, the latter displayed in both USD and AUD terms, since May 2013, we see the U.S. outperforming in all ten sectors. Indeed, the only sector of the Australian market with positive returns in USD terms has been health care. The worst performers in USD terms have been consumer staples and utilities.