

Chapter 3 External Economic Environment

Key Points

- The Northern Territory is heavily reliant on trade and is susceptible to developments in the economies of its major trading partners and in the world economy generally.
- The International Monetary Fund forecasts the world economy to be in recession in 2009.
- Consensus Economics forecasts Australia will be in recession in 2009, with rising unemployment and falling demand for Australian products.
- Long-term trading contracts for major commodity exports and high levels of government investment are expected to partially cushion the Northern Territory against the impact of the global financial crisis.

Background

This chapter considers the interaction of the Territory economy with other economies, both in Australia and abroad, and the effect on the Territory of developments in these external economies.

The reliance on a small number of commodities and trading partners to sustain export and import growth makes the Territory susceptible to changes in global demand and exchange rates, and fluctuations in world commodity and financial markets.

For more information on Territory exports and imports, see Chapter 8: International Trade.

Global Economy

The global financial crisis (GFC) and other factors that have had global repercussions include large falls in asset prices, record high commodity prices, extreme volatility in equity markets and plunging consumer and business confidence.

BIS Shrapnel observes that a noticeable result of the crisis is the increase in bad debts, heightened by large equity losses, primarily a result of falling asset prices, placing strain on financial markets and increasing the difficulty in obtaining credit. This is placing considerable pressure on businesses and governments around the world when difficulty in refinancing debt, financing expansionary business opportunities and servicing government spending deficits has resulted in a slowdown in global economic activity.

Major Trading Partners

The demand for Territory exports is spread throughout Australia and the world but is dominated by a handful of commodities, with demand primarily from Japan and China. Although the Territory imports a wide variety of products from many countries and from other Australian jurisdictions, Singapore is the main source of Territory imports.

Consensus Economics and the International Monetary Fund (IMF) observe that a major contraction in global consumer demand is expected to aggravate worsening economic conditions in most countries, and restrict the demand for exports generally, particularly those used in producing other goods or services. Although demand for Territory goods has slowed in 2009, exports

are expected to remain at high levels, supported by long-term supply contracts with major Territory trading partners.

Table 3.1, at the end of the chapter, summarises the economic outlook for each of the Territory's major trading partners.

Japan Japan is the second largest economy in the world. It is the largest importer of Territory products, accounting for over 30 per cent of Territory exports in 2007-08. Japan is currently in a major and protracted economic recession. However, as Japanese demand for Territory exports is predominantly liquefied natural gas (LNG), traded under long-term supply contracts and used for energy production, it is expected that exports to Japan will remain at relatively high levels, despite worsening economic activity in Japan.

China China is the second largest destination for Territory exports, predominantly manganese, and accounted for almost 30 per cent of Territory exports in 2007-08. The IMF estimates China's economy will grow by 6.7 per cent in 2009, its lowest level in over ten years. However, Consensus Economics proposes that a strong increase in bank lending in early 2009, combined with a large government stimulus package, will help to support higher economic growth and offset the fall in China's exports resulting from decreased global demand.

While China's demand for imports fell significantly in 2009, demand for Territory products has remained high, supported by sustained demand for manganese, largely the result of favourable trading conditions and long-term supply contracts.

United States of America The United States (US) is the third largest destination for Territory exports and accounted for about 8 per cent of Territory exports in 2007-08, significantly smaller than the respective shares of Territory exports to Japan and China.

In 2008-09 the US faces a third year of recession in housing, large cuts in employment and productivity flowing from the financial devastation in the car manufacturers and financial industries, with significantly weaker consumer demand. A slowdown in US demand for Territory exports appears to have been offset by a favourable exchange rate.

Singapore Singapore is an important trading partner to the Territory, being the source of 28 per cent of imports to the Territory in 2007-08. Consensus Economics expects Singapore's economy to contract by 4.7 per cent in 2008-09 as industrial production has fallen strongly and exports to the United States and China are expected to fall by over 50 per cent. As a result, inflation is moderating and resulting in lower cost inputs to petroleum refined products, the Territory's chief imported good. However, the demand for petroleum products in the Territory is expected to remain high and is more likely to be affected by changes in crude oil prices than the domestic situation in Singapore.

The Effect of the Global Financial Crisis on the Australian and Northern Territory Economies

Commonwealth Treasury anticipates that no country will be immune from the effects of the GFC. The fall in commodity prices and demand for Australian exports, the loss of equity and restrictions on accessing credit are the major concerns for Australia and the Territory.

In an attempt to restore consumer and business confidence and to stimulate demand, the Reserve Bank of Australia has cut interest rates by 4.25 percentage points since September 2008. However, a decline in the gross domestic product result in the December quarter 2008 and rising unemployment continue to fuel concerns about the short-term economic prospects for Australia and for Australian exporters.

Financial Sector

In 2008, all major Australian banks declared exposure to the bad debts resulting from the GFC. The realisation of global credit constraints has placed major restrictions on lending, forcing many firms to postpone or cancel new and existing projects and in some cases, to be placed under administration.

On 12 October 2008, the Commonwealth announced it would guarantee all money on deposits and wholesale funding of Authorised Deposit-taking Institutions (ADIs) regulated by the Australian Prudential Regulation Authority (APRA). The intent of this scheme was to restore confidence and promote stability in Australia's financial system and to assist ADIs to access funds, providing for a significant injection of equity into the banking system. In addition, on 25 March 2009, the Commonwealth announced it would also guarantee state and territory borrowings, with a view to facilitating access to funding for ongoing government infrastructure programs.

Significant losses faced by financial institutions have resulted from falls in equity markets. Commonwealth Treasury reports that global equity markets are exhibiting considerable volatility as a result of weak economic conditions and have lost about US\$32 trillion in value since peaking in October 2007. Superannuation funds in Australia also face large losses resulting from the steep decline in the value of Australian equities. These losses have reduced the borrowing capacity for many businesses and individuals and limited future consumption and investment spending.

Unemployment

Credit constraints and falling commodity prices have led to job losses throughout Australia, particularly in the mining sector, and have resulted in the deferral or closure of large mining, engineering and construction projects in the Territory.

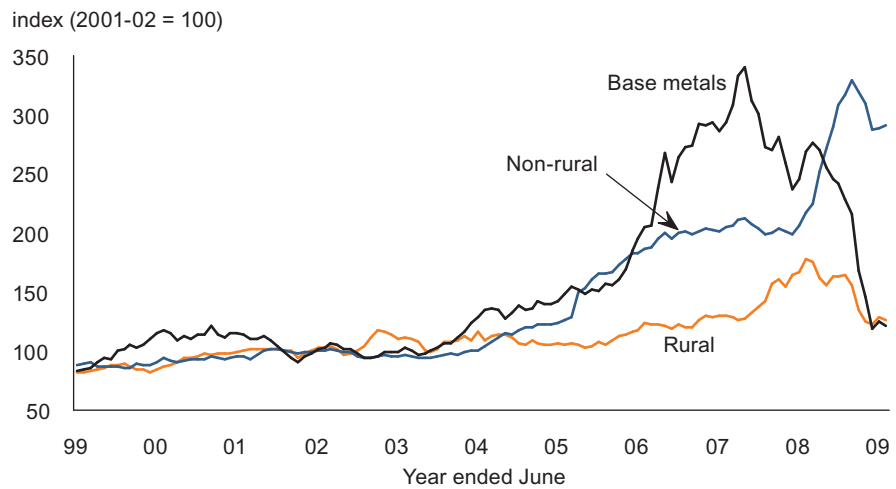
Also, in response to worsening economic prospects, other sectors in the Territory and throughout Australia have also shed workers, notably the finance and banking sector as well the retail, tourism and manufacturing sectors. However, this is less pronounced in the Territory.

Exports

The constraints on the availability of credit and the impact of the GFC on the Territory's major trading partners have resulted in a fall in the value of, and demand for, exports since October 2008, resulting in a weaker contribution to economic growth and lower incomes for exporting companies and companies supporting exporters.

Although demand for commodities in developing economies such as China saw global commodity prices soar in the two years to 2007, a slowdown in global investment and falling business confidence as a result of the GFC has quelled this demand. As a result, commodity prices have fallen sharply since 2007, losing much of the gains made in previous years (Chart 3.1). However, despite falling global demand and volatile commodity prices, long-term supply contracts and lower commodity prices generally, combined with a weaker Australian dollar, have sustained export volumes.

Chart 3.1: Reserve Bank of Australia Commodity Price Index



Source: Reserve Bank of Australia

Another key issue affecting growth in export markets is restricted access to credit, which is likely to deter or delay resources development projects in the Territory, and limit future growth in exports.

Outlook

Global Economy

The outlook for the global economy in 2009 is for continued deterioration, with almost all the major advanced economies forecast to be in recession, including the United States of America, the United Kingdom, much of the Eurozone and Japan. Significant slowdowns are expected in emerging economies, most importantly in China and India, although both are expected to avoid recession.

It is expected that no country will be immune from the global financial crisis, with the majority of economic forecasters cutting growth projections across the globe. The IMF has made significant downward revisions to its global growth forecasts, projecting a 1 per cent contraction of world economic growth in 2009. A modest recovery is expected in 2010, when the world economy is expected to expand by 2 per cent. The IMF anticipates the collective result of various stimulus packages, initiatives designed to increase credit availability and concerted policy actions to stabilise financial conditions throughout the world will contribute to the recovery.

Australia

The IMF forecasts Australia to be in recession in 2009.

The economic environment in Australia is expected to be largely affected by events in China and Japan, Australia's two biggest export partners, and the success of the United States' \$3 trillion stimulus package. With economic growth forecasts cut dramatically for China, and with Japan expected to remain in a deep recession, Australian exports can be expected to fall as a

result of decreased demand for Australian products as major trading partner economies slow. A fall in Australian exports is expected to lead to additional job losses and lower business profits and government revenue collections.

Worsening economic conditions and weak business and consumer confidence are also expected to see slowing domestic demand for goods and services and business investment, as businesses and households increase their precautionary savings and anticipate further job losses. On the flip-side, increased confidence in the financial sector and a pick up in production anticipated as a result of the respective United States and Commonwealth stimulus packages, combined with the likelihood of additional interest rate cuts by the Reserve Bank of Australia in 2009, may provide additional stimulus to the economy and help curb falling asset and house prices.

The Commonwealth Treasury expects that lower demand and business profits will cause the Australian unemployment rate to reach 7 per cent in 2010. Higher unemployment and increased uncertainty about future employment prospects will create downward pressure on goods, prices and wages as people will restrict their spending.

Lower exchange rates are expected to provide some relief in Australia from the negative economic conditions. Exports will be more attractive, although growth in imports may suffer. Higher import prices as a result of a lower exchange rate are expected to also have some flow-on effects to domestic prices, as some imports are used as intermediate goods in the production of final goods in Australia.

The recovery phase of economic activity in Australia will depend on the success of a number of combined factors throughout the world. These include the appropriateness and success of various stimulus packages, comprehensive stabilising policies and fiscal support, an improvement in credit conditions, a bottoming of the US housing market, and the softening effect of lower commodity prices.

Table 3.1: GDP Growth (annual percentage change)

	GDP Growth (%)					Comment
	2006	2007	2008	2009e	2010f	
North East Asia						
China	11.6	13.0	9.0	7.0	8.3	Government has announced massive stimulus measures and interest rate cuts to target a minimum growth rate of 8 per cent to prevent social unrest. Although 20 million migrant workers have lost jobs and manufacturing and exports have declined due to weak foreign demand, some recent indicators reflect tentative signs the economy may be starting to stabilise.
South Korea	5.1	5.0	2.5	-3.0	3.5	Economy is falling at a faster than expected pace. Exports and imports down as well as consumer spending. Bank of Korea expected to reduce interest rates further.
Japan	2.1	2.4	-0.7	-5.8	0.7	Decreases in private consumption, domestic demand and business investment, as well as a decline in exports.
Taiwan	4.8	5.7	0.1	-4.9	2.9	Extremely open economy leaving it highly exposed to global conditions. Currently in recession, record falls in exports, imports and industrial production and record high unemployment. Government has released a US\$9.5B job creation plan.
Hong Kong	7.0	6.4	2.5	-3.4	2.4	Recession expected to worsen as economy contracted in first half of 2009. Deteriorating labour market conditions, reduction in imports and exports and consumer confidence. Stimulative measures of increased government expenditure on infrastructure, job growth and education.
South East Asia						
Philippines	5.4	7.2	4.6	1.9	3.6	Experiencing softening external and private domestic demand, prices have been declining resulting in less inflationary pressures.
Indonesia	5.5	6.3	6.1	3.4	4.7	As monetary policy is eased around the world, Bank Indonesia is able to cut interest rates without putting pressure on Indonesian rupiah. Prices have fallen as have imports and exports. A stimulus plan comprising of tax cuts, infrastructure investment and subsidies boosting economic growth, domestic demand and employment. Moderating inflation and reduced fuel and transport tariffs.
Malaysia	5.8	6.3	4.6	-0.7	3.6	Economy edging closer to recession, possibly a further stimulus package. Prices and official interest rates have declined.
Thailand	5.2	4.9	2.6	-1.6	3.2	Manufacturing output expanded for 2008 as a whole, but slowed compared to 2007 due to reduction in exports. Imports have also reduced narrowing the trade surplus. Private investment has slowed while consumer prices have fallen, easing inflationary pressures and prompting further reductions in interest rates. Long-term infrastructure projects expecting to support economic growth.
Singapore	8.4	7.8	1.1	-4.7	3.2	Current recession expected to intensify. Slump in industrial production and export demand. Support package brought forward by government to provide relief and save jobs and companies. Consumer prices are easing and inflation moderating.
North America						
United States	2.8	2.0	1.1	-2.8	1.7	The US housing market is in its third year of recession, its automotive industry has nearly collapsed and its financial industry is in turmoil. Unemployment has increased and consumer demand is down. The government has introduced a US\$3T stimulus package to help stabilise the financial sector and save 3-4 million jobs over the next two years.
Canada	3.1	2.7	0.5	-1.8	2.3	Concern of falling into protracted recession, Bank of Canada may cut target rates again. Consumer prices have fallen, contraction in manufacturing and industrial production and unemployment rate increased. Government introduced stimulus package targeting infrastructure projects, liquidity injections to the banking sector and tax credits.
European Zone						
Russia ¹	6.5	8.1	6.2	-0.7	1.3	The value of the Russian rouble has declined due to a reduction in the price of oil. Government has introduced a stimulus package to help financial crisis.
India ²	9.5	9.7	6.4	5.2	7.8	Slowing inflation, interest rate cuts expected in coming year, domestic activity has weakened, exports have fallen while imports have risen.
Australia	2.8	4	2.1	-0.3	1.7	Inflation moderated significantly, interest rates reduced, unemployment up. Government stimulus package to boost growth including long-term infrastructure spending.
New Zealand	2.0	3.1	0.0	-1.7	2.0	Inflation reduced, consumer prices eased, reduction in cash rate, wage growth slowed due to reduced hiring intentions by firms, unemployment increased, diminished consumer spending and lower fuel prices.

e: estimate f: forecast

Source: Consensus Economics Consensus Forecasts February 2009

¹ Russia: International Monetary Fund ² India: fiscal year reported is April to March