

Chapter 6 External Economic Environment

Key Points

- The significance of the mining and tourism industries makes the Territory economy particularly reliant on exports and susceptible to developments in key export markets.
- Demand for Territory-produced goods and services comes from the rest of the world and from other Australian states and territories.
- The global economic recovery continued to gain momentum in 2003, led by the United States and China (see Charts 6.1 and 6.2).
- Global growth has been supported by expansionary monetary and fiscal policy settings in many of the world's major economies.
- Despite weaker exports, the Australian economy has maintained a solid pace in recent years due to strong domestic demand and weak Australian dollar.
- Solid growth, nationally and internationally, in coming years is expected to boost demand for Territory exports, including tourism-related exports.

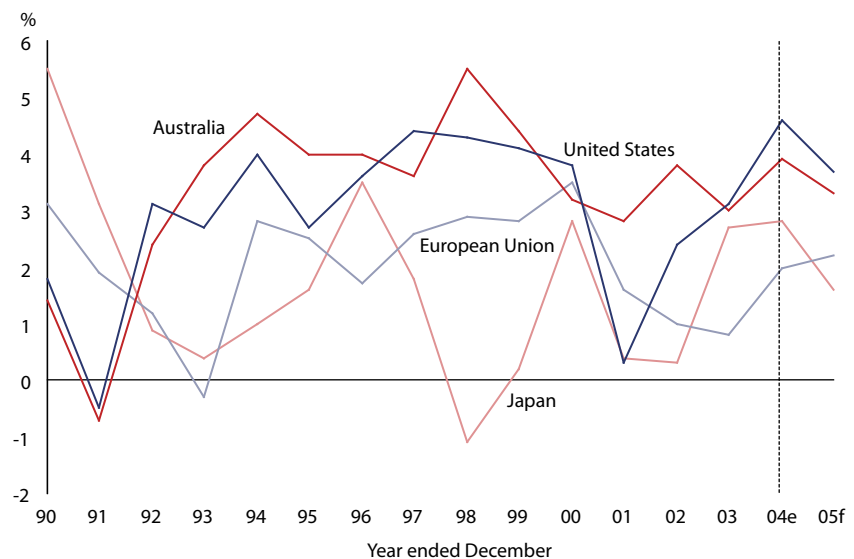
Overseas and Australian markets

Overseas export demand constitutes more than 20 per cent of Territory final demand, while demand from other Australian states and territories is more than 12 per cent. External demand is therefore particularly significant for the Territory economy and it is useful to examine likely changes in external demand, both in aggregate and in the markets of major individual trading partners.

As discussed in chapter 7 (International Trade), much of the Territory's exports consist of mineral ores, oil, live cattle and tourism-related services exports. The major destination markets for mineral ores are the US, China and Japan. Live cattle are exported mainly to the Philippines and Indonesia. Oil is primarily exported to Singapore, the US and Korea for refining. International visitors come primarily from Western Europe, North America and Japan.

The trade links between the Territory and the US are critical for the Territory's export demand. Many of the Territory's primary products are used in manufacturing production in Asia, for subsequent export to the US and other nations. It is through these demand linkages that economic conditions in the major growth centres of the world can affect the Territory economy.

Chart 6.1: Real GDP Growth - Japan, Europe, US, Australia (annual percentage change)

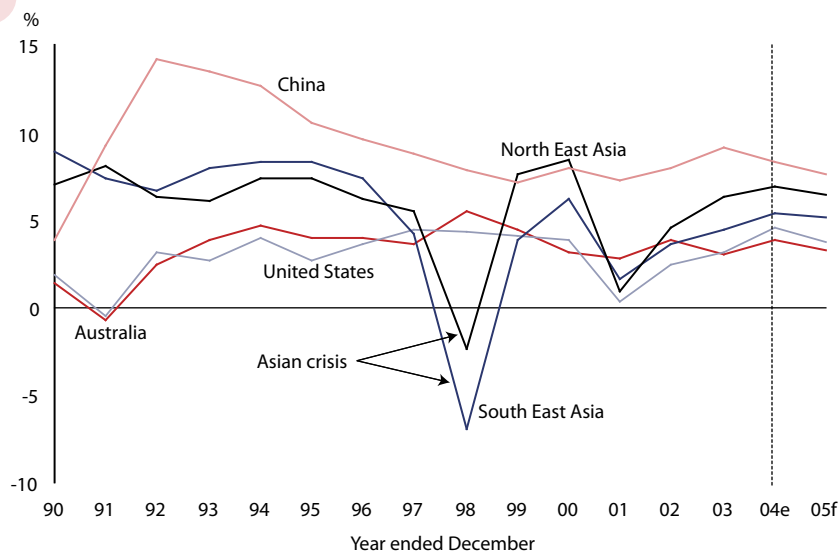


European Union: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

Chart 6.2: Real GDP Growth - China, Asia, US, Australia (annual percentage change)



Weighted averages have been used to calculate South East Asia (Indonesia, Malaysia, the Philippines, Singapore and Thailand) and North East Asia (China, Hong Kong, South Korea and Taiwan).

e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

Global Economy

Global economic growth, notably in Europe, was weak in 2003 as the war in Iraq, the Severe Acute Respiratory Syndrome (SARS) outbreak and a struggling US economy affected growth. Nonetheless, growth did start to improve in many of the world's major economies in the second half of 2003. Consensus Economics forecasts world economic growth to strengthen from 2.6 per cent in 2003 to 3.7 per cent in 2004. Business investment is expected to recover strongly in 2004 and, with consumption, will continue to be stimulated by expansionary policies of many central banks and governments around the world. The US recovery and continued strength in the Chinese economy is expected to provide a major impetus for global economic growth and trade in 2004 and 2005.

Australian Economy

The Australian economy, also a major destination for Territory goods and services, looks set to experience continued growth, as exports increase due to the breaking of the drought and recovering world economy. Any depreciation of the Australian dollar will also help boost export growth. Further out, domestic demand is expected to slow as the effect of the two interest rate increases in late 2003 gradually take effect.

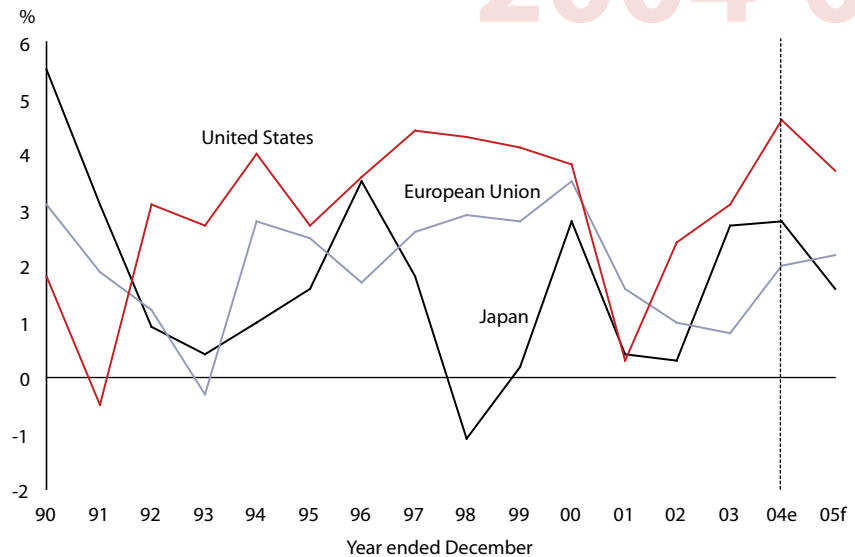
Table 6.1: Australian and Overseas Real GDP Growth Forecasts (percentage change, calendar year)

	1998	1999	2000	2001	2002	2003	2004e	2005f
United States	4.3	4.1	3.8	0.3	2.4	3.1	4.6	3.7
Japan	-1.1	0.2	2.8	0.4	0.3	2.7	2.8	1.6
European Union	2.9	2.8	3.5	1.6	1.0	0.8	2.0	2.2
Australia	5.5	4.4	3.2	2.8	3.8	3.0	3.9	3.3
China	7.8	7.1	8.0	7.3	8.0	9.1	8.3	7.6
Hong Kong	-5.3	3.0	10.4	0.2	1.5	3.1	5.5	4.5
Indonesia	-13.1	0.8	4.8	3.3	3.5	4.1	4.6	4.7
Malaysia	-7.4	6.1	8.3	0.5	3.5	5.2	6.0	5.7
New Zealand	-0.2	3.9	3.8	2.5	3.0	3.5	3.1	2.4
Philippines	-0.6	3.4	4.4	3.2	4.0	4.5	4.2	4.3
Singapore	-0.1	6.9	10.3	-2.0	3.6	1.1	5.3	4.5
South Korea	-6.7	10.9	9.3	3.0	6.3	2.8	5.3	5.4
Taiwan	4.6	5.4	5.9	-1.9	3.3	3.2	5.2	4.5
Thailand	-10.5	4.4	4.6	1.8	3.5	6.7	7.0	6.2

e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

Chart 6.3: Real GDP Growth - US, European Union, Japan (annual percentage change)



e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

United States

Positive Outlook

Following growth of 3.1 per cent in 2003, Consensus Economics expects US GDP growth to strengthen to 4.6 per cent in 2004 before falling to 3.7 per cent in 2005. The strengthening in the US economy has been across private consumption and investment and supported by increased exports and strong growth in public expenditure.

After a decade of growth following the 1991 recession, the US economy softened, slowing markedly in 2001 as investment slumped following several years of over investment, particularly in technology-related production, and as excesses in equity markets were unwound. Countries dependent on US markets for their exports, particularly Asia, subsequently faced reduced demand.

Stimulated by lower interest rates and tax cuts, household spending played a major role in carrying the US economy throughout 2003, particularly in relation to durable goods, while residential investment remained buoyant. Increased spending on defence-related activities has helped boost demand, but despite the strength the recovery displayed throughout 2003, it is only just starting to feed through to employment gains.

Interest rates in the US, at 1.0 per cent, are at 45-year lows, and combined with expansionary fiscal settings have been a major stimulus to economic activity. Nonetheless, the US economy has been weak for several years and is only now starting to show signs of sustained growth, reflected in employment and consumption growth.

As the recovery gathers pace, there will be greater pressure to implement fiscal spending cuts and to tighten monetary policy to reduce the budget and trade deficits.

Japan

Easing Growth

Following growth of 2.7 per cent in 2003, Consensus Economics predicts Japanese GDP growth of 2.8 per cent in 2004, before easing to 1.6 per cent in 2005. Growth in 2003 was stimulated by strong consumption growth (at least by Japanese standards) and increased business investment, output and exports.

Business investment increased strongly in 2003, as corporate restructuring supported increased profits and confidence. Following growth of 9.1 per cent in 2003, business investment is forecast to grow by 9.3 per cent and 5.1 per cent in 2004 and 2005 respectively, as increased export demand boosts confidence and improves corporate balance sheets.

Increased demand for Japanese goods, particularly information technology and communication products, should see exports grow solidly in 2004, buoyed by an expected upturn in demand from Japan's major trading partners, especially the US. Ongoing corporate reform remains crucial to Japan's long term recovery, as weakness in the non-manufacturing sector continues to dampen growth.

Western Europe

Consensus Economics expects Western Europe's output growth to strengthen to 2.0 per cent in 2004, following weak growth of 0.8 per cent in 2003. Growth in 2005 is forecast at 2.2 per cent. Private consumption and business investment are forecast to remain weak but increased external demand will boost exports in the short term. Export growth has been affected by the strong Euro since 2002, although as the global recovery gains momentum through 2004, exports are expected to start to recover.

Germany

German economic growth remains weak, with GDP growth in 2004 expected to be just 1.7 per cent, up from -0.1 per cent in 2002. Growth in 2005 is forecast at 1.8 per cent, with export growth the main driver, although supported by stronger consumption associated with a series of legislated tax cuts in 2005.

Construction investment continues to act as a drag on growth, but business investment is strengthening following three years of decline. Private consumption is forecast to remain weak in the short term, as high unemployment constrains income growth and consumer confidence. German economic growth continues to be affected by social security and labour market rigidities.

United Kingdom

Growth in the United Kingdom (UK) is forecast to strengthen to 3.1 per cent in 2004, following growth of 2.3 per cent in 2003. Growth is then forecast to moderate to 2.6 per cent in 2005. Growth in recent years has benefited from low unemployment and expansionary monetary and fiscal policies impacting on private and public consumption.

The UK economy has been less affected by the global downturn than most other European economies and buoyant consumer and business sentiment has supported spending. The outlook for 2005 is for unemployment and inflation to remain low and positive, but consumption and export growth moderating.

France

Economic growth in France is expected to remain weak over the next few years, with Consensus Economics estimating GDP growth of 1.7 per cent in 2004 and 2.1 per cent in 2005. GDP growth in 2003 was only 0.2 per cent, the weakest rate of growth since 1993. Weak domestic demand and the impact of a stronger Euro on exports have affected employment and economic growth.

Exports are expected to pick up with stronger global growth and should stimulate investment and GDP growth in 2005.

Chart 6.4: Real GDP Growth - Germany, UK, France and Italy



e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

Italy

As in Germany, the Italian economy has been very weak, recording growth of only 0.4 per cent in both 2002 and 2003. Consensus Economics forecasts growth to strengthen to 1.4 per cent in 2004 and 2.0 per cent in 2005. As with many of the European economies, growth is expected to benefit from stronger global demand and the impact on exports flowing through to domestic activity. However, with more than half of Italy's exports going to countries outside the European Union, the export sector suffers more markedly than other Euro area countries from any currency appreciation. Relatively high inflation is expected to moderate given recent productivity growth and moderate wage increases.

East Asia

Many countries in the East Asian region depend heavily on demand from the US, Japan and, increasingly, China. Japan is unlikely to provide significant stimulus in the short term, but the recovery in the US and ongoing strength in China will improve the growth prospects of many East Asian economies.

China

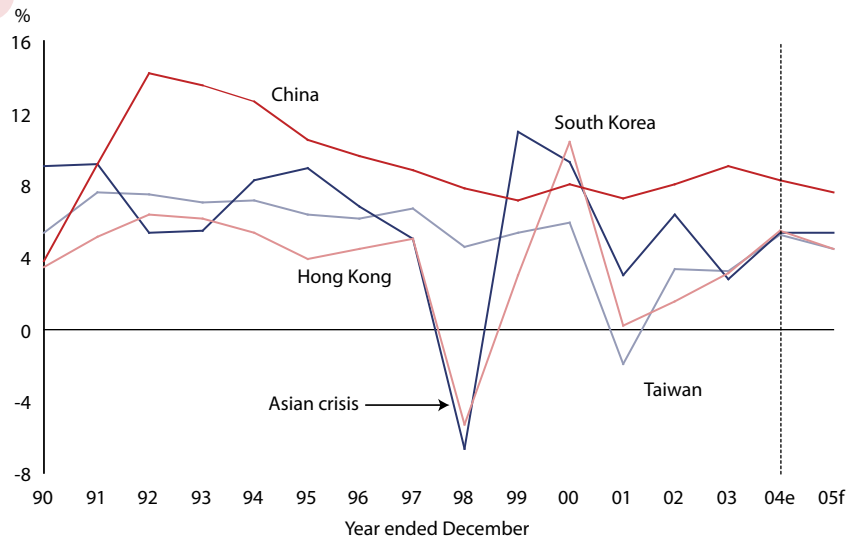
Chinese economic growth has been consistently strong over the past decade and in 2003 is estimated at 9.1 per cent despite the war in Iraq and the impact of SARS. Consensus Economics expects economic growth of 8.3 per cent and 7.6 per cent in 2004 and 2005 respectively.

Economic growth has been associated with strong investment and export growth flowing through to solid consumption and other domestic demand. Domestic demand is expected to pick up in 2004, supported by rising incomes and increased consumer credit. Strong domestic demand is flowing through to increased inflationary pressures, and suggests that the economy may be overheating.

Progress on structural reforms, notably in the banking and state-owned enterprise sectors, will be an important determinant of macroeconomic stability in China over the next few years.

2004-05

Chart 6.5: Real GDP Growth - China, Hong Kong, Taiwan and South Korea



e: estimate; f: forecast.

Source: Consensus Economics, IMF, OECD

Hong Kong

Consensus Economics predicts Hong Kong's economic growth will be 5.5 per cent in 2004 and 4.5 per cent in 2005. Economic prospects have benefited from closer economic integration with China, the decline of SARS, a strengthening world economy and increased investment spending.

Private consumption and investment are set to recover strongly in 2004 and 2005, following several years of very weak growth. Tourism-related activity will continue to strengthen following the SARS outbreak in 2003. Recent deflationary pressures are expected to ease as domestic demand strengthens.

Taiwan

Consensus Economics predicts Taiwanese economic growth of 5.2 per cent in 2004 and 4.5 per cent in 2005. This follows growth of 3.2 per cent in 2003. Taiwan's economy continues to depend heavily on information technology (IT) exports and in recent years economic growth has been affected by weak global demand for these products. However, in 2003, electronics exports returned to levels not seen since the IT boom of the late 1990s. Taiwan's main export markets for its high-tech goods (China, Hong Kong and the US) are forecast to enjoy strong growth in 2004, with the outlook for Japan, Taiwan's third largest export market, also improving. Taiwan's economy is vulnerable to its over reliance on the export sector, particularly for electronic goods.

South Korea

Consensus Economics expects South Korean GDP growth of 5.3 per cent in 2004 and 5.4 per cent in 2005 as domestic demand and exports strengthen.

Exports will continue to add considerable impetus to growth in 2004, largely due to increased demand from China. Exports growth should boost capital spending and employment growth and stimulate domestic consumption. Downside risks to the forecast include geopolitical uncertainties such as the North Korean nuclear crisis, continued debt and credit concerns, and instability associated with the impeachment of the President in early 2004.

South East Asia

Economic recovery across South East Asia is expected to result in broad-based growth of nearly 5.5 per cent in 2004 associated with increased domestic spending and external demand for the region's exports. Financial reforms and initiatives are expected to boost investment in coming years as nations in the region respond to attract foreign investment which is increasingly going to China and India.

Singapore

Economic activity in Singapore is expected to gather considerable pace in 2004 as export growth is stimulated by strengthening global demand and commencement of the Singapore-US Free Trade Agreement. Consensus Economics predicts growth of 5.3 per cent and 4.5 per cent in 2004 and 2005 respectively. In contrast to the strong performance of exports in 2003, domestic demand continued to fall along with consumer confidence. Private consumption weakened and unemployment reached its highest level in 17 years, exacerbated by the effects of SARS.

Singapore relies heavily on its manufacturing sector (predominantly electronics) and faces intense competition from China and India. Despite this, strengthening global demand is expected to result in increased exports in 2004, as Singapore's highly open economy benefits from the increase in external demand.

Indonesia

Consensus Economics predicts Indonesian GDP growth of 4.6 per cent in 2004, up slightly from 4.1 per cent in 2003. Further out, growth of 4.7 per cent is forecast for 2005. Consumption and export growth were the drivers of growth in 2003 as business investment remained weak, affected by labour market and institutional problems.

Growth in 2005 is expected to come from increased business investment and continuing solid consumption growth. Inflation, which has been high in recent years, is expected to moderate in 2004 and 2005.

Malaysia

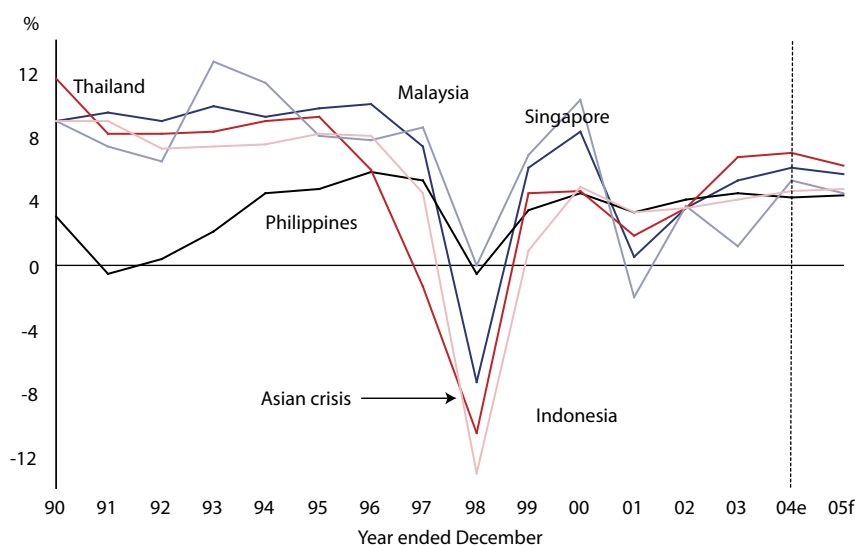
Consensus Economics predicts Malaysian GDP growth of 6.0 per cent for 2004, following from 5.2 per cent in 2003. The economy has started to move away from its dependence on a narrow range of export items (namely electronic and electrical goods) and efforts to broaden its economic base appear to be working.

The global recovery will drive economic growth in 2004, with strong demand for electrical and electronic products. Low interest rates will continue to stimulate private consumption and investment, as will tax cuts and expansionary fiscal policies. Although Malaysia has undertaken significant reforms in the financial sector, GDP is yet to return to pre-crisis levels.

Philippines

Consensus Economics expects GDP growth of 4.2 per cent in the Philippines in 2004, improving to 4.3 per cent in 2005. Despite relatively strong growth of 4.5 per cent in 2003 (associated with increased agricultural output and overseas remittances), economic momentum is likely to ease back marginally in 2004.

Chart 6.6: Real GDP Growth - Indonesia, Malaysia, the Philippines and Thailand



e: estimate; f: forecast.
Source: Consensus Economics, IMF, OECD

The economic outlook is clouded by considerable political uncertainty ahead of elections in 2004. Private consumption is forecast to grow at much the same level as last year due to the ongoing effect of remittances from migrant workers overseas, with low interest rates forecast to stimulate private investment growth. Although the International Monetary Fund has credited Philippine officials for having undertaken important reforms since the Asian crisis, it has also indicated that significant reforms are still required across areas including tax administration and the banking system, as well as greater transparency in government, in order for the Philippines to remain globally competitive.

Thailand

The Thai economy is the second largest in South East Asia and one of the fastest growing, with GDP growth of 6.7 per cent in 2003. GDP growth in 2004 is estimated at 7.0 per cent before easing back to 6.2 per cent in 2005.

Growth in 2003 was driven largely by private consumption and investment and expansionary fiscal policies. Strengthening global economic growth is expected to boost exports and domestic spending in 2004, before the strengthening baht impacts on competitiveness and leads to an easing in economic growth in 2005.

Australia

The Australian economy performed strongly in 2003, despite a number of setbacks associated with a weak world economy, the effect of SARS and security concerns on tourism, and the drought. Export growth was also affected by the appreciation of the Australian dollar. Strong consumption growth and the continuing recovery in business investment were the drivers of growth in 2003, supported by historically low interest rate levels. Inflationary pressures, as in recent years, were contained and are expected to remain so in the short term.

Although the export sector has struggled in recent years, the outlook is to improve in 2004. International visitors are starting to return, output from the farming sector is set to recover and a number of large resource projects are about to start production. As export demand strengthens (although the stronger Australian dollar will affect competitiveness), domestic activity is expected to moderate as interest rate rises impact on demand.

In the medium term, the outlook appears more balanced between the external and domestic sectors of the economy. The recovering global economy will lead to export and jobs growth, while the domestic economy continues to moderate following recent interest rate increases affecting dwelling investment and household consumption.