Chapter 6 External Economic Environment

Key Points

- » Global economic conditions are expected to remain favourable for the Australian economy, primarily reflecting strong Chinese demand for commodities.
- » Countries that are key destinations for Territory exports are expected to continue to experience robust economic growth.
- » Risks to the generally positive outlook include the possibility of inflationary pressures leading to further increases in interest rates and a greater than expected slowdown in the United States (US) economy.

Northern Territory

Demand for Territory goods both internationally and from other Australian states and territories is very important for the Territory economy. Overseas demand constitutes almost 20 per cent of Territory final demand, while interstate demand accounts for a further 10 per cent.

Many of the Territory's primary products are exported to Asia for use in the manufacture of goods that are subsequently exported worldwide. Exports to Asia are one of the key links through which global economic conditions affect the Territory economy. Major Territory exports include crude oil, liquefied natural gas (LNG), mineral ores, live cattle and tourism-related services. The major destination markets for mineral ores are the United States, China and Japan. LNG is predominantly exported to Japan. Live cattle are exported mainly to the Philippines and Indonesia. Oil is exported primarily to Singapore, China, the US and South Korea. International visitors also form an important component of Territory demand and come mainly from Europe, Japan and North America. Table 6.1 provides a summary of the economic outlook for the major Territory export destinations.

Global Economy

Strong global economic growth has continued over recent years, with world output increasing in the first half of 2006 and Consensus Economics reported global economic growth of 5.4 per cent for the year. US economic growth moderated in the second half of 2006, while China and India continue to top world economic growth rates. Japan has maintained moderate growth, while the Eurozone economic expansion gathered momentum.

The sustained world economic growth has fuelled demand for commodities, with average base metals prices increasing 60 per cent during 2006. Although oil prices have eased by about 20 per cent from the August 2006 high of about US$80 a barrel, the high price of oil during 2006 significantly contributed to global inflation. Inflationary pressure from the increase in commodity prices, along with capacity constraints, prompted many central banks to take pre-emptive action by tightening monetary policy. Most central banks, including the Reserve Bank of Australia (RBA), tightened monetary policy by increasing interest rates.

Although unrest in the Middle East, the North Korean nuclear program and other geopolitical trouble spots challenged world stability during 2006, the global economy continued to perform strongly.

Australian Economy

The increasing numbers of bilateral free trade agreements are expanding market opportunities for Australian exporters and facilitating greater investment in Australia, which has free trade agreements with New Zealand, Singapore, Thailand and the US.

In the year to December 2006, gross domestic product (GDP) increased by 2.8 per cent, which was below the 4.1 per cent growth in domestic final demand. The disparity between the two measures is largely due to Australia's trade deficit. While the increase in GDP was modest and below the 3.6 per cent 10 year average, the economy continued to operate close to full capacity and experienced labour shortages and capacity constraints. There were large disparities in gross state product (GSP) recorded in 2005-06 between the states and territories, with strong growth recorded in the Northern Territory, Queensland and Western Australia, moderate economic growth in the Australian Capital Territory and Tasmania and weak economic growth in New South Wales and South Australia.

Employment growth in 2006 averaged 2.3 per cent, resulting in a 30 year low unemployment rate of 4.5 per cent. In the November Statement on Monetary Policy, the RBA reported that skill shortages persisted in 2006 and were across multiple industries.

Stimulated by the increase in petrol prices in mid-2006 and the one-off effect of Cyclone Larry on fruit prices, inflation was 3.5 per cent per cent in 2006, above the RBA target range of 2 to 3 per cent, prompting the RBA to raise the official cash rate in May, August and November.

In the Mid-Year and Economic Fiscal Outlook, the Australian Government forecasts the fiscal balance (the difference between government revenue and government expenditure) to record an $11.8 billion surplus, continuing to underpin the strength of the currency. The Australian dollar has remained strong against the US dollar, averaging $0.755 in 2006 and contributing to the pressure experienced by Australian exporters, particularly in the manufacturing sector.

The widespread drought has resulted in significant declines in general farm production. The cropping sector has been the hardest hit, with winter crop production estimated by the Australian Bureau of Agricultural and Resource Economics (ABARE) to fall by about 60 per cent. Overall, the drought is estimated by the RBA to cut GDP by one-half of a percentage point in the 2006-07 financial year.

The commodity boom, bolstered by strong Chinese demand, continued to drive mineral and most other prices higher and has resulted in Australia's terms of trade (that is, the ratio of export prices to import prices) reaching its highest level since the wool boom of the 1950s. In 2006, the commodity price index increased by 22.7 per cent in year on year terms, moderating from the historically high growth of 32.5 per cent reported in May 2006. Commodities in the 'base metals' category, which account for 16 per cent of the total index, increased by 62 per cent in the year. The national trade balance continues to recover from the historic deficits of early 2005. Strong increases in resource export prices have supported the recovery while increases in resource export volumes were moderate. However, with a number of resource projects which will add to capacity recently completed or nearing completion, volumes are expected to strengthen. In line with the narrowing trade deficit, the current account is expected to decrease from 5.8 per cent of GDP in 2005 to 5.1 per cent in 2006.

Outlook

Global Economy

Global growth is forecast by Consensus Economics to ease slightly to 4.7 per cent in 2007. Economic growth is expected to be strong in China, India and many South East Asian countries. The US economy is expected to slow in 2007. However, with more economies continuing to contribute greater proportions to global growth, the world economy is considerably more resilient to withstand a greater than expected slowdown in the US economy.

Global inflationary pressures have lessened due to the significant decline in oil prices and the easing of commodity prices. However, inflation still poses a risk to the global economy in 2007, and wage pressure in particular remains a possibility due to labour shortages and capacity constraints. The instability in some oil-producing nations could also result in supply shortages, resulting in significant rises in oil prices.

Australia

Consensus Economics forecasts Australian GDP growth of 2.9 in 2007. The resource-rich states of Western Australia, Queensland and the Northern Territory will continue to outperform the other states, although the disparity in economic growth rates will narrow in 2007.

The direction of future interest rate changes is uncertain. Consensus Economics forecasts inflation to be 2.7 per cent in 2007, which is near the top of the RBA's target band. Employment growth is expected to remain steady, keeping the unemployment rate at 30 year lows and, with the participation rate likely to remain unchanged, Consensus Economics notes that further large wage increases remain a possibility.

ABARE forecasts mineral and energy exports to increase by 20 per cent to about $111 billion, with both value and volume increasing, and farm commodities exports are expected to decrease by 8 per cent to about $25 billion due to lower volumes, predominantly as a result of the drought.

Prospects for the rural sector affected by the drought are improving with heavy rains in many drought-affected areas in early 2007, with ABARE forecasting a return to average seasonal conditions in 2007-08.

Negotiations are proceeding with China, Malaysia, Japan, Chile and Korea for free trade agreements. The negotiations between Australia and China, which began in early 2005, have received the greatest prominence.

Table 6.1: GDP Growth (annual percentage change)

	GDP Growth (%)					
	2004	2005	2006	2007e	2008f	Comment
North East Asia						
China	10.1	10.2	10.5	9.6	9.4	The government will continue to introduce measures to boost consumption aiming to make growth less dependent on exports and investment. International pressure will increase on China to substantially revalue the currency.
Korea	4.7	4.0	5.0	4.4	4.9	An expansionary fiscal policy should mitigate the expected decline in private consumption.
Japan	2.7	1.9	2.2	2.1	2.3	Strong business investment will continue to be the main driver of growth in 2007. The large government deficit will continue to impede sustained economic growth.
Taiwan	6.1	4.0	4.3	4.0	4.6	Taiwan is actively seeking to negotiate a free trade agreement with the US.
Hong Kong	8.6	7.3	6.5	5.1	5.0	Hong Kong manufactured exports should benefit from an appreciation in the Chinese currency which will widen the gap between the yuan and the Hong Kong dollar.
South East Asia						
Philippines	6.0	5.1	5.0	5.4	na	Strong export growth and buoyant remittances from expatriates are expected to keep the current account in surplus. Inflation should ease from 6.7 per cent to 5.5 per cent in 2007.
Indonesia	5.1	5.6	5.4	5.9	5.9	Interest rates are expected to decline from 9.75 per cent, however any declines are expected to be modest in order to reduce the risk of depreciation in the currency.
Malaysia	7.2	5.2	5.9	5.4	5.7	Growth is expected to soften moderately due to strong exports, particularly electronic and electrical products and growth in private consumption and investment.
Thailand	6.3	4.5	4.6	4.8	5.0	Following the military coup in September 2006, democratic elections are planned for late 2007, restoring consumer confidence and investor sentiment.
Singapore	8.7	6.4	7.7	5.2	5.5	Private consumption and investment should be the main contributors to growth and the property market is expected to continue to recover.
North America						
United States	3.9	3.2	3.3	2.4	3.0	The downturn in the housing market did not significantly impact on consumer and stock market sentiment, easing the severity of the expected slowdown. The current account is forecast to average close to 6 per cent of GDP in 2007 and 2008, placing downward pressure on the dollar.
Canada	3.3	2.9	2.7	2.4	2.9	Growth is expected to slow in 2007 with exports to the US weakening, however the economy is still expected to operate at near capacity.
Eurozone	1.8	1.5	2.8	2.3	2.1	Business conditions are expected to be positive with unemployment continuing to decline slowly in 2007.
Russia	7.2	5.5	6.5	6.5	na	Foreign investors in the energy sector will be limited to minority stakes and existing agreements will be renegotiated. High oil prices are expected to support domestic demand.
India	7.5	8.4	8.4	7.8	na	The merchandise trade deficit is expected to widen, however surpluses on the services and transfers accounts will limit the current account deficit to less than 3 per cent.
Australia	3.7	2.8	2.5	2.9	3.2	The resource rich states of WA, Qld and the NT will continue to out perform the other states, although the disparity in economic growth rates will narrow in 2007.
New Zealand	4.4	2.1	1.7	2.1	2.8	Modest growth is expected following the soft landing and the current account deficit is expected to narrow, although remaining at an unsustainable level.

e: estimate; f: forecast
na: not available
Source: Consensus Economics Consensus Forecasts (India: financial year reported); Russia, Philippines: International Monetary Fund