

The Global Context for the South Australian Economy

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Good morning. Thanks for inviting me to address your group on the issue of the global context for the South Australian economy.

Over the past several years whenever I have addressed your group before, I'm sure my remarks were upbeat – talking about the opportunities for South Australia arising out of new trade agreements in the Asia-Pacific and globally.

The East Asian area has seen some of the most important economic growth over the past several decades and through its links with the region, Australia has shared in that growth.

For the country as a whole, these numbers demonstrate how deeply integrated we've become with the main economies of the region.

With 19 percent of all of our exports going to Japan, 15 percent to China and 21 percent of our overall trade linked to the ten ASEAN economies, it is easy to understand why Australia has negotiated or is negotiating trade agreements with all of these partners.

And the impact of the trade agreements will be to link us even more closely with the region.

The new agreement with ASEAN – called AANZFTA – has recently been signed and should enter into force later this year.

Negotiations are continuing with Japan and China on bilateral free trade agreements with those countries.

South Australian international trade benefits from these arrangements, but the profile of the State's exports is different from the country overall.

A relatively greater percentage of the State's exports go to markets in North America and Europe, even if about half of our trade is still with East Asia.

It is also the case that a relatively large share of the State's exports are to niche markets where special relationships have been developed over the years.

Many of these markets are high-value markets some of which are less sensitive to the current global downturn than others.

What about the global financial crisis and its impact on the global context for our State's economy?

There's good news and bad news. First, the bad news. Globally, things are really really bad and possibly getting worse before they get better.

The good news is that we are much better off than nearly all of our trading partners.

The world has not seen anything this bad for eighty years. Just look at these statistics from the new WTO report.

Global trade is expected to decline by 9 percent in 2009.

As the economists say, the fall-off in trade is synchronized. We are all in this together. US imports are down by 51 percent and Chinese exports fell by 26 percent.

For the first time since the 1930's, we can expect to see a drop in real global output.

Now, courtesy of some clippings from the Australian Financial Review over the past few weeks, I am going to treat you to an international trade horror movie.

This map of the world is appropriately titled "World of Pain" and it shows just how bad the fall-off in GDP growth has been around the world.

At positive growth of 6.8 percent, China might look like a bright spot. However, when the Australian Ambassador in Beijing visited Adelaide last October he said that China faced the possibility of massive social unrest if economic growth fell below 7 percent.

So far, more than 20 million people in China have lost their jobs – mainly due to the collapse of China's exports.

This scary slide shows how bad the situation is in our main export markets.

Australia's export income from Japan soared recently to more than \$50 billion from \$32 billion a year earlier – mainly as our mining companies exploited global shortages to make super profits.

As Japan's economy goes into free fall, we can expect to see that reversed. In 2009, many expect the value of our exports to Japan to fall by more than \$20 billion.

650,000 Japanese lost their jobs in the year to December and the Japan research institute estimates unemployment will rise above seven percent in the current cycle – with two million people losing their jobs on top of the 2.7 million Japanese already out of work.

Through no fault of our own, Australians are in for a scary ride in export markets.

This slide makes it clear that the downturn is truly global in nature. If it were not for the 6.8 percent growth in China, the line at the top of this chart would be down at zero or below with all of the others.

But remember, 6.8 percent growth in China is not enough.

Air cargo traffic globally was down 23 percent in December compared to a year ago – led by a 26 percent fall in the Asia-Pacific region.

Another measure that has received a lot of attention recently is the Baltic Dry Index – a measure of the cost of shipping bulk cargo by sea, published by the Baltic Exchange in London – the leading world marketplace for brokering shipping contracts.

Movements in the index can be tracked to global demand for manufactured goods. Between June and November of 2008 the Baltic Dry Index fell by 94 percent.

The cost of shipping a container of goods from Shanghai to North America – if you exclude charges for freight and handling – is close to zero.

This slide is so dramatic that it needs little explanation from me.

China's industrial production has fallen off a very steep cliff. You can see why 20 million Chinese have lost their jobs.

Clearly a decline this steep cannot be sustained.

Malaysian GDP growth has also fallen off a cliff. One of the reasons for steep declines of this magnitude related to the increasing presence of global supply chains in total trade.

Malaysia and its ASEAN neighbours, together with China, are integral links in some of the most important electronics industry global supply chains.

The supply chains mean that trade contraction or expansion is no longer simply a question of changes in trade flows between a producing country and a consuming country.

Goods cross frontiers many times during the production process and components in the final product are counted every time they cross a frontier. This explains why some ASEAN countries show a participation in trade as a percentage of GDP in excess of 100 percent of GDP.

It also explains why the fall-off in trade now is so steep.

Even Singapore is not immune. The country has swung from a position of running consistent trade surpluses to a situation where it now has a large trade deficit.

The flow-on effects on the local economy are so negative that nearly 100,000 foreign workers have left Singapore in the past two months after losing their jobs in manufacturing and shipping.

With the huge fall in international trade, Singapore – one of the world's most significant entrepôts – has become a giant parking lot for freighters with nothing to carry. The Port Manager was reported to have said that he was running out of room to park the boats.

This slide shows what has happened to steel output around the world. In Europe, North and South America, production of steel is about half of what it was a year ago.

The situation is not much better elsewhere. China is slightly positive, but it is obvious that even there, the growth in steel output is far below the general – and already weak – growth in the economy.

This means more bad news for Australia. The drop in steel production means a big drop in demand for some of our most important minerals.

Not only volumes but also prices are going to suffer. Two weeks ago, the first coking coal benchmark settlement was agreed between Korea's POSCO and major Australian pulverized coal injection producer, MacArthur Coal. The price agreed to was \$90 a tonne – down 63 percent from last year's price of \$240 a tonne.

The ANZ Bank's head commodity strategist was reported in the paper as saying that the expected 40 percent drop in iron ore prices could wipe as much as \$9 billion from Australian export earnings – and that is if volumes remained stable – which is unlikely.

The global slowdown means more than a fall-off in our exports and a deterioration of the terms of trade.

The fall-off in demand at home and overseas means that domestic production cannot be sustained at previous levels and people are losing their jobs.

The resource boom isn't booming for the more than 5,000 employees of BHP Billiton and Rio Tinto that have lost their jobs.

All the estimates I have seen recently predict a seven percent unemployment rate for Australia by the end of the year – meaning it is going to get worse before it gets better.

The Australian Bureau of Agricultural and Resource Economics (ABARE) said earlier this month that earnings from total commodity exports are not predicted to reach 2008 levels until 2013 or 2014.

ABARE also said that prices for commodities are expected to pick up again in 2012 – with earnings rising to almost \$30 billion by 2013 – but that amount is still well below 2008's record levels.

The good news is that when things do get better, Australia is in good shape to take early advantage of the opportunities.

The financial system is sound. The exchange rate is likely to be favourable and new and significant trade agreements with ASEAN and probably also with China, Japan and Korea will all open new opportunities for our exporters.

The next couple of years are likely to be tough for South Australia just as they will be for the rest of the country. But we should be trying to read the tea leaves and develop a strategy for the future.

My own suggestions for a strategy that would enhance the State's ability to share in world growth when we emerge from the recession are:

Join in the green revolution and aim to be a leader in the new green technologies that will profit by climate change based demand both here and in overseas markets.

Globalisation has shown us that it has its downsides as well as upsides. When the markets in East Asia to which we are so tied dive as they have, we cannot avoid the negative effects.

But East Asia will eventually come out of the slump and we want to be strategically well-positioned to build on the relationships that have generally served us so well in the past.

Finally, it's a dynamic world and South Australia needs to ensure that it plays a proactive role in the trade and investment environment, both in Australia and overseas.

Thank you for your attention.