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Before and after: How the commodity boom changed Australia's resource sector

Mark Cully
Office of the Chief Economist

Contributed presentation at the 61st AARES Annual Conference,
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Australian Government
Department of Industry, Innovation and Science

Office of the Chief Economist

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Mark Cully

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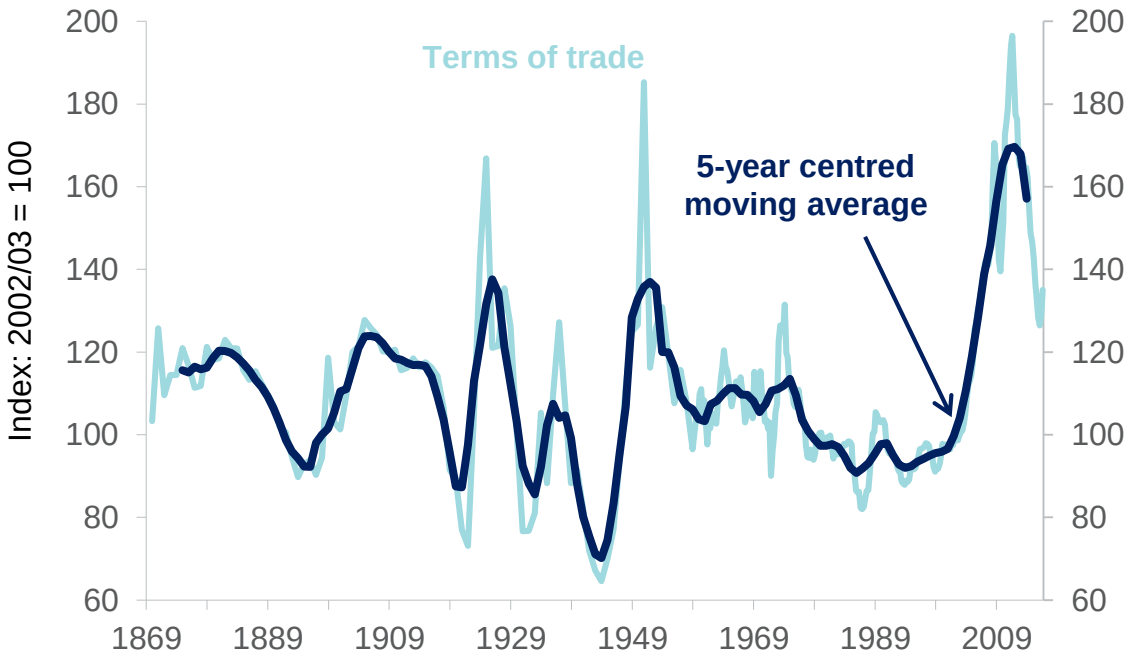
10 February 2017

Reviewing the macroeconomic story

We have lived through the biggest terms of trade boom in Australia's history

- The latest boom lasted much longer than previous booms, and may yet settle at a higher than average level.
- The removal of trade barriers and currency restrictions allowed the surge in the terms of trade to flow more easily through the economy, with net trade shifting sharply, due to growth in capital imports and then higher commodity exports.



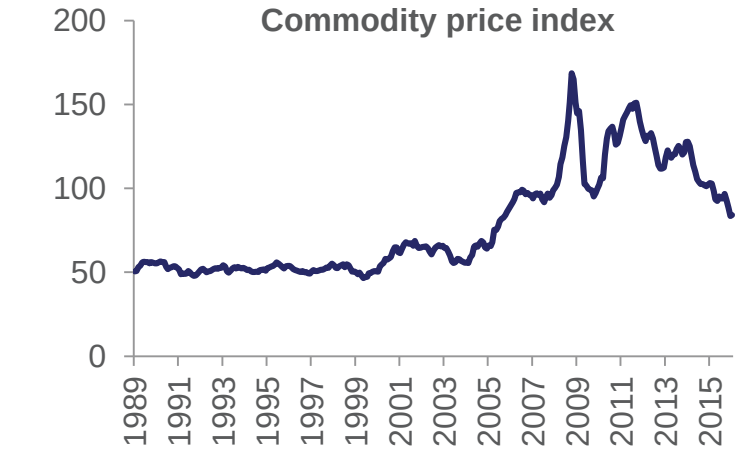
Source: Gruen 2017, speech to CEDA forum

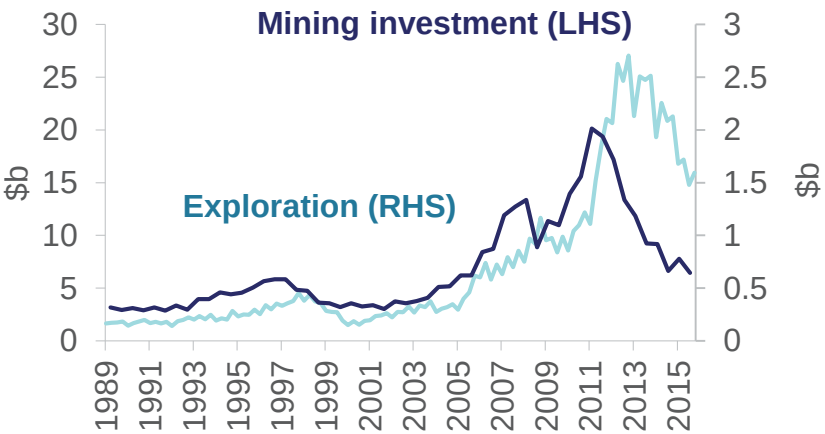
A three-pronged boom

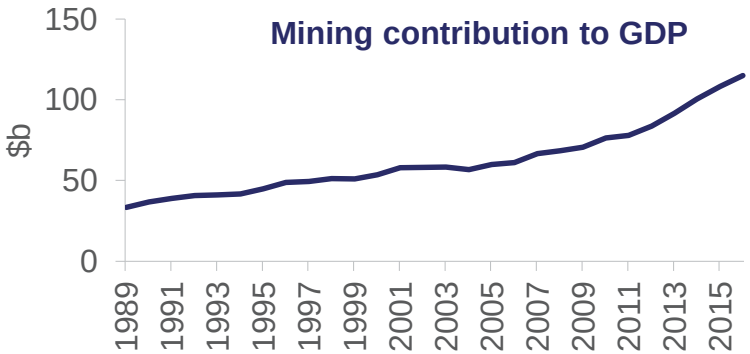
- Australia has faced several commodity booms over its history. These booms have been driven by industrialisation of overseas economies, supply disruptions, and wars.

- The latest boom began around 2003, when growing Chinese demand ended decades of relative commodity price stability. It fed through into three sequential responses:

  - prices
  - exploration and investment
  - output.

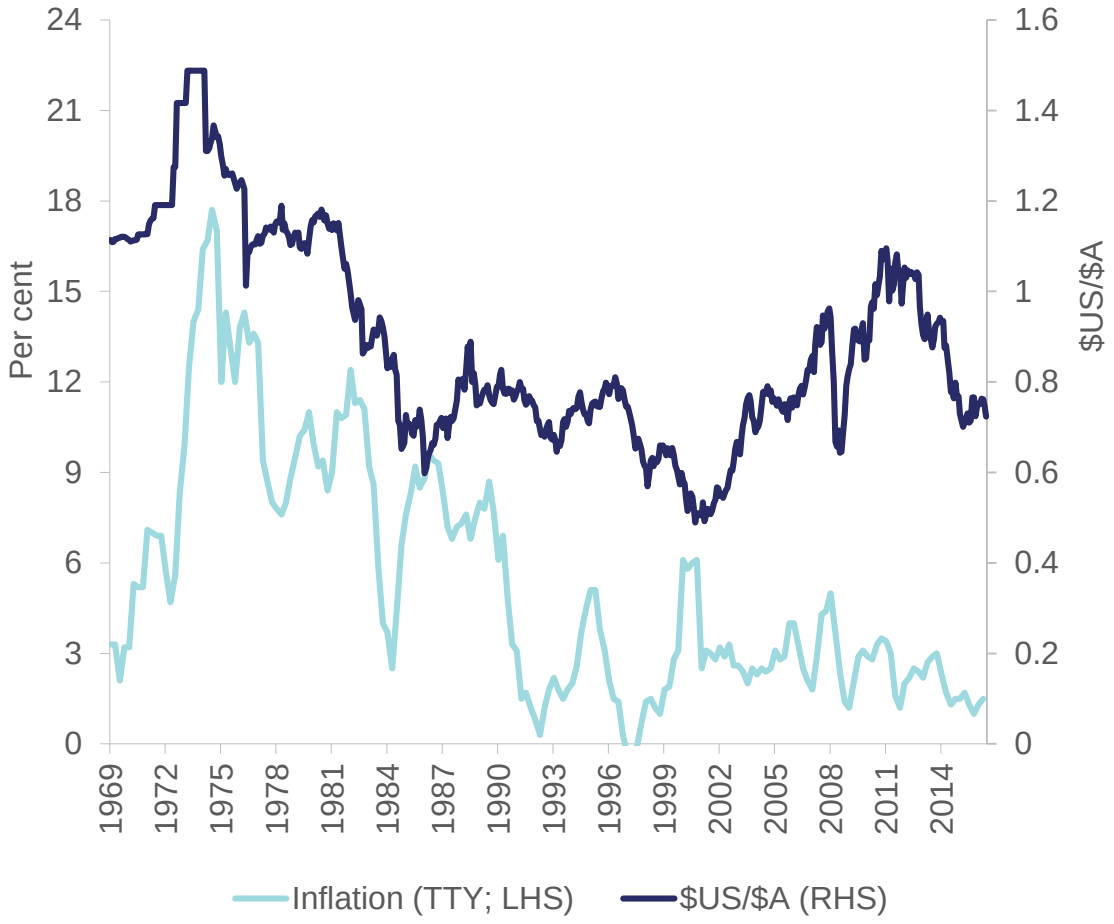






Source: ABS Cat. No. 8412.0, table 1, 5625.0, table 1, RBA statistical database

The most recent boom did not spur inflation

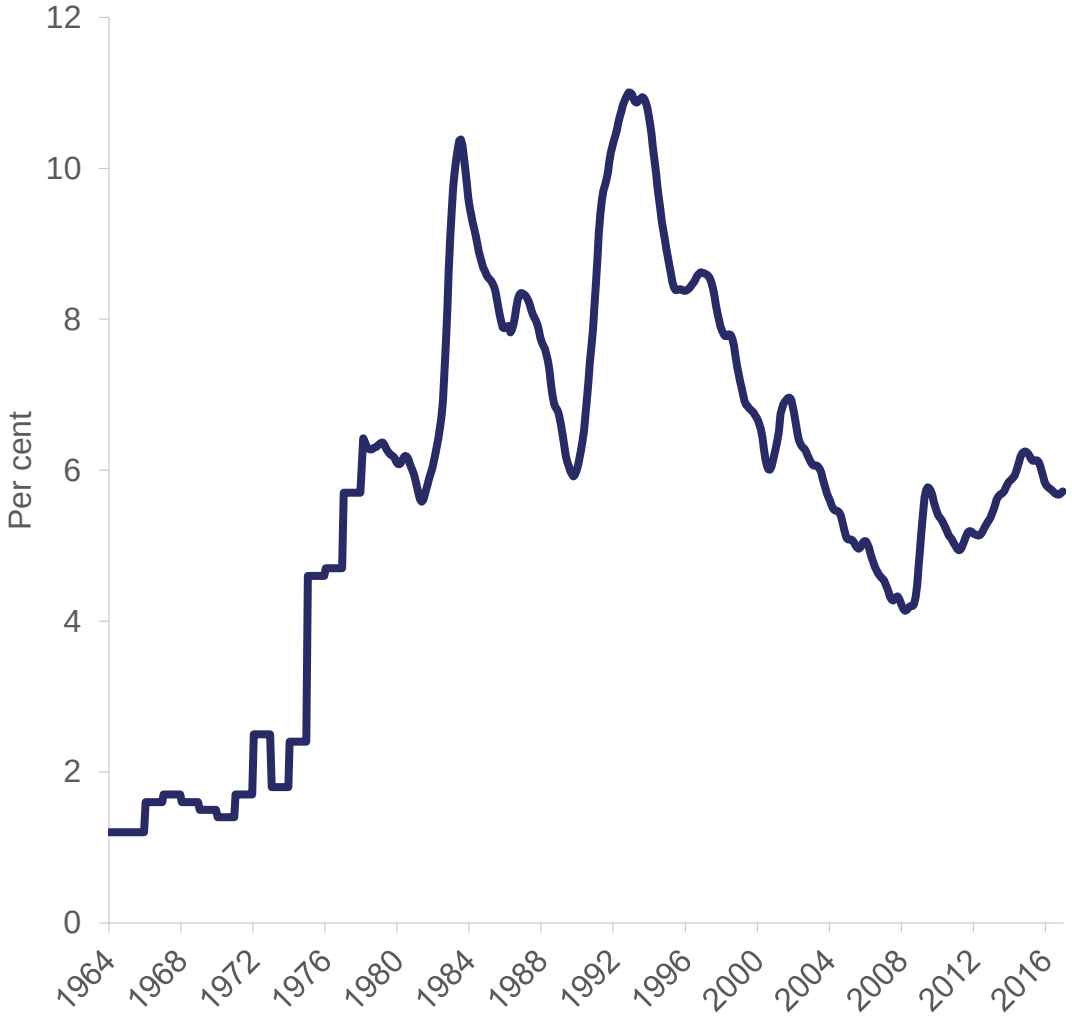


Source: RBA Statistical database table F11, ABS Cat. No. 6401.0, table 1

Despite its record scale, the latest commodity boom had less effect on inflation than prior booms.

This is partly down to the removal of a rigid wage fixing system. It also reflected the floating of the exchange rate, which created an alternative means to absorb price pressure.

Nor, in the wake of the boom, unemployment



Source: ABS Cat. No. 6202.0, table 1

Previous booms led to wage rises above 20%, resulting in high unemployment.

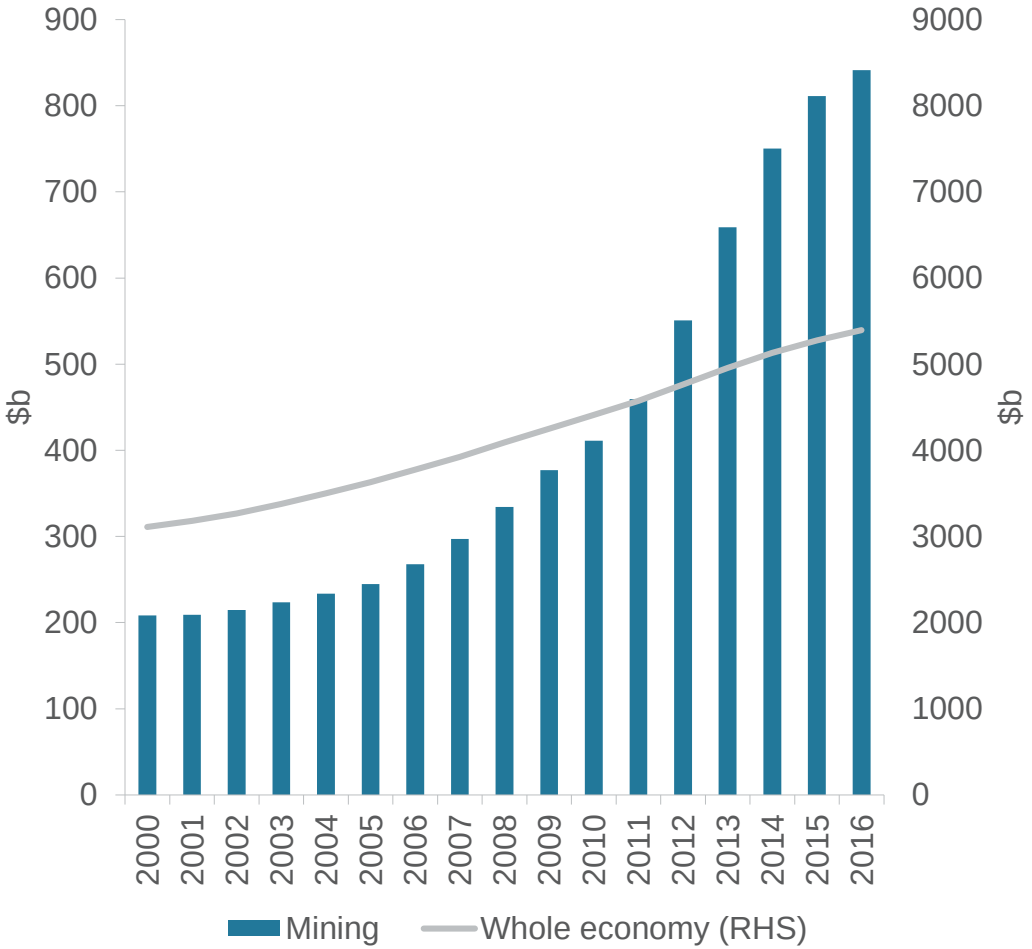
Greater labour market flexibility largely offset this issue, with the result that job losses post-boom were small enough to be offset by job growth elsewhere in the economy.

Reviewing the sectoral story

Enduring boom: a threefold increase in capital stock

The latest boom has exceeded all records on capital investment.

- Resource capital stock summed to $841 billion in 2015-16, from a total of $5,396 billion across the whole economy.
- A stronger platform for the extraction and exportation of commodities has been built, which will last for decades.



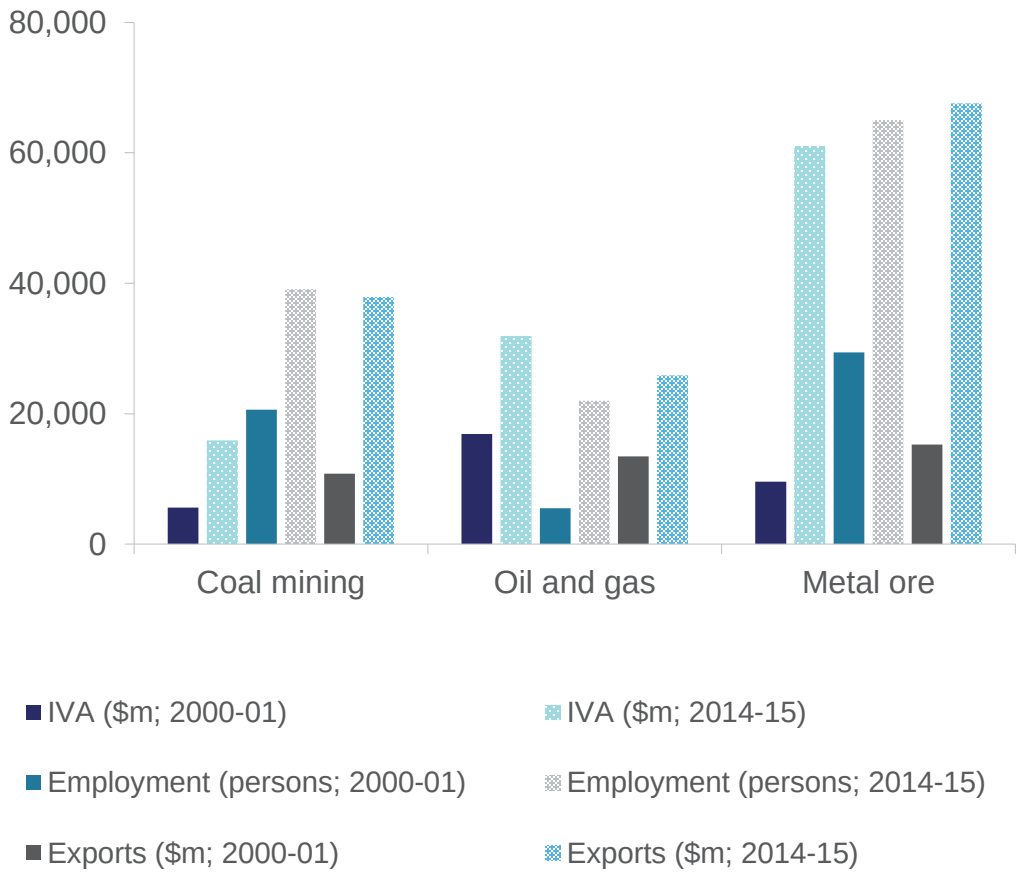
Source: ABS Cat. No. 5204.0, table 63

Enduring boom: end of boom and bust cycle

The usual “boom-to-bust” cycle hasn’t emerged — the sector locked in many gains:

- Growth in iron ore has far outstripped processed metals (aluminium, copper & gold). The use of hematite iron ore has reduced the need for processing. Economies of scale will help iron ore producers to withstand price falls.

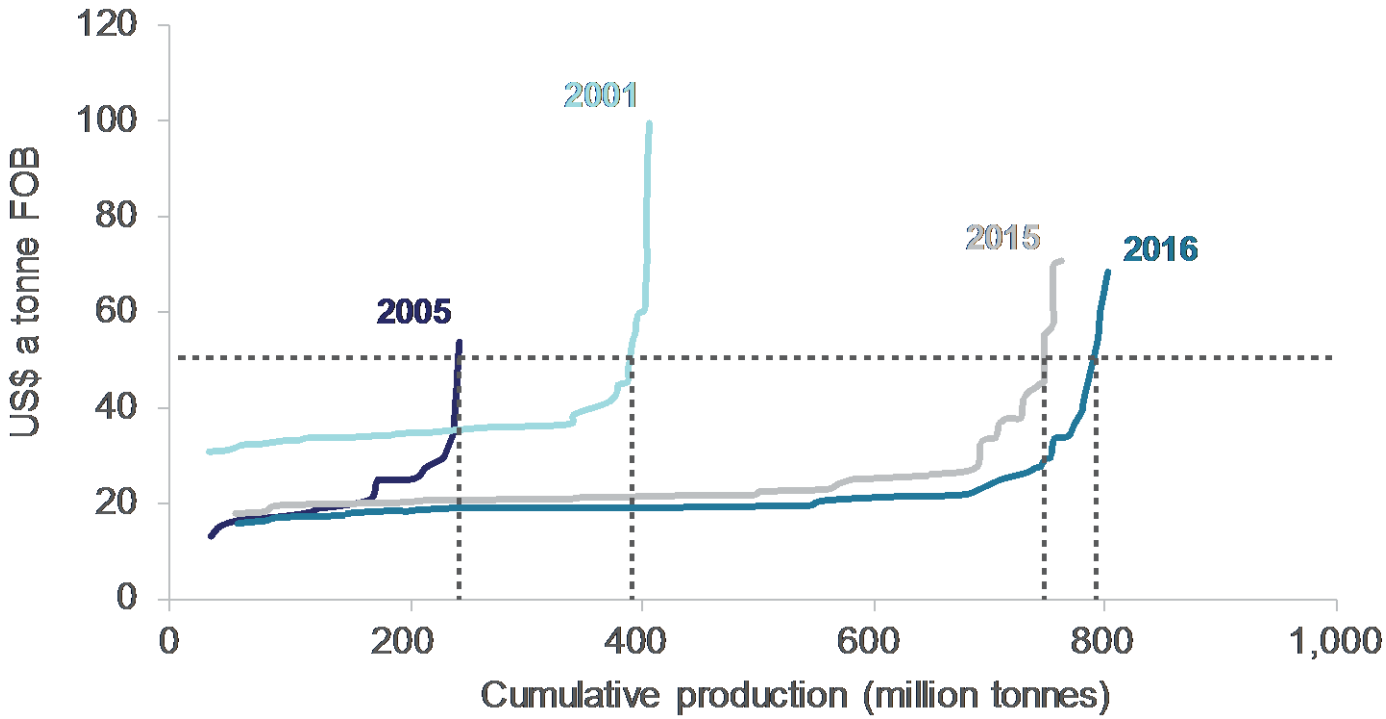
- Australia now brings far more natural gas to the world market. Strong demand has created the conditions for large and long-term growth in extraction capacity.



Source: ABS Cat. No. 8415.0 chapter 1.1, Cat. No. 6291.0.55.003, table 6

The supply curve has pushed out massively

- From 2005 to 2016, the amount of iron ore that Australia could produce at US$50/tonne has more than tripled.
- Australian miners have led the world in introducing new technologies such as driverless trucks, which has helped to bring down costs.



Source: AME

Export earnings have tripled – and growing

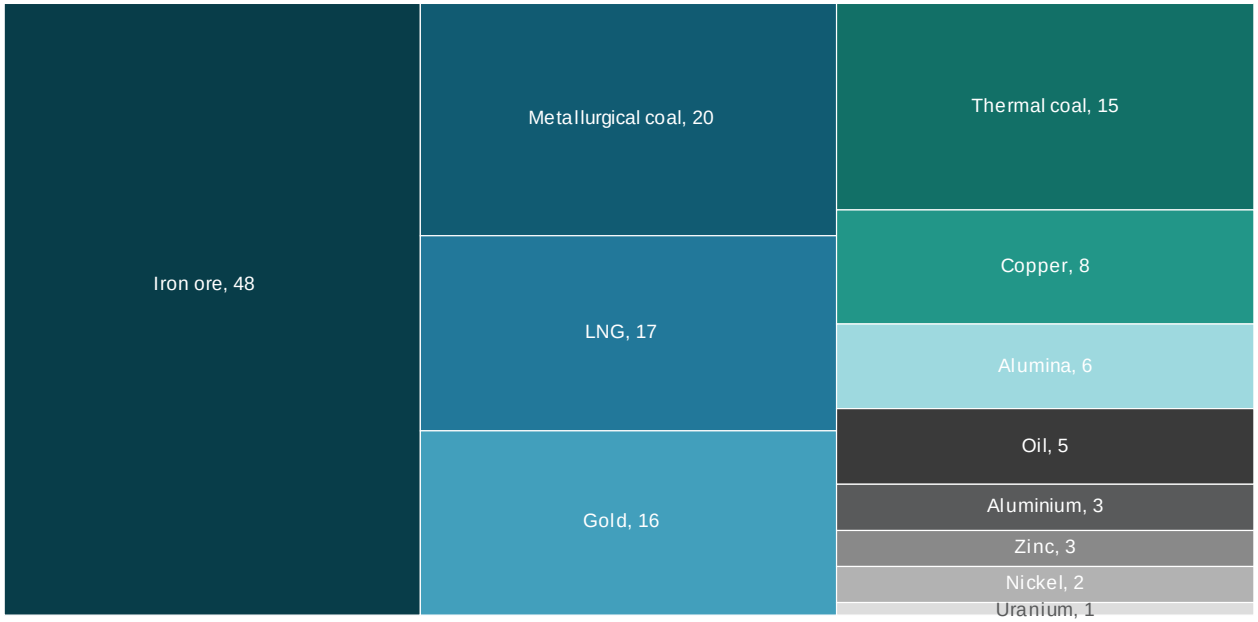
- Resource export values rose from $58 billion in 2000–01 to $157 billion in 2015–16.
- Iron ore, LNG and coal became far more significant within the broader export profile.

2000–2001

$58b

2015–2016

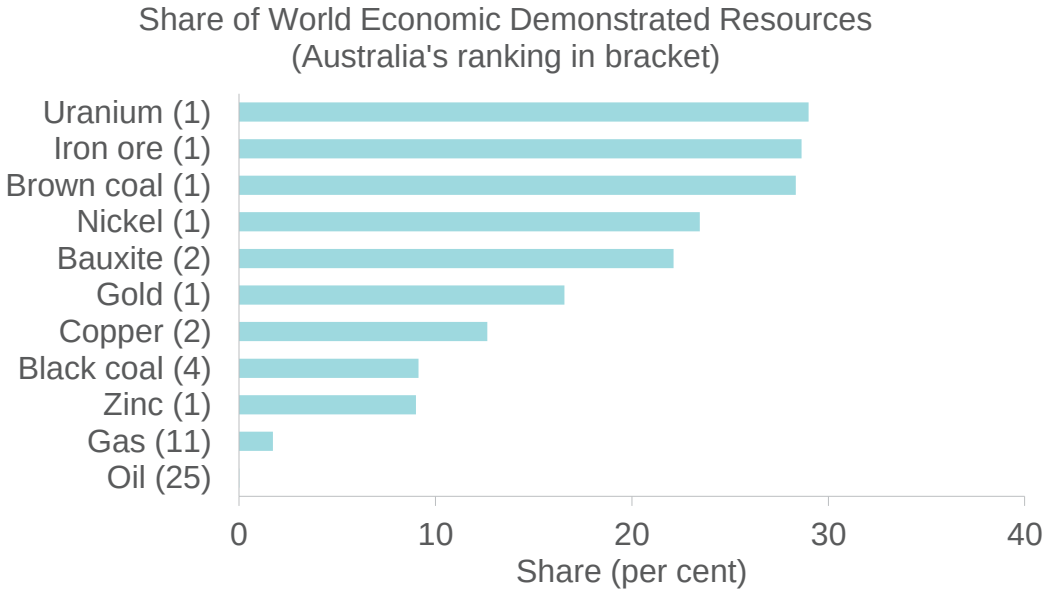
$157b

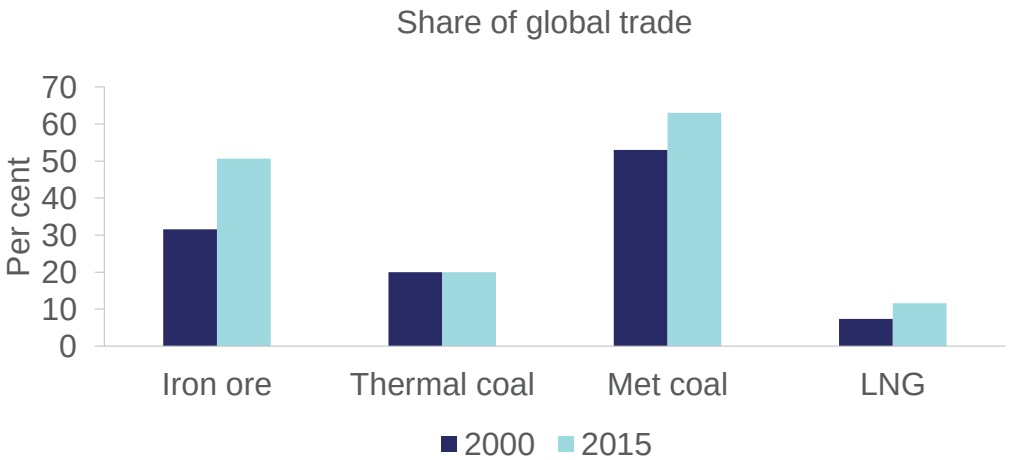


In rising markets, Australia is a world leader

Australia is now number one in a number of resources.

- This natural advantage should underpin a long period of strong exports and fundamental change to the resource sector in Australia.
- Australia has also strongly improved its share of global trade for key commodities including coal, iron, and LNG. Australia was better able to capitalise on opportunities than other countries.





Source: GeoScience Australia and Office of the Chief Economist

Conclusions

1. The latest boom had certain features in common with its predecessors:

- Commodity prices spiked and business investment responded
- Net trade deteriorated initially, and then rebounded.

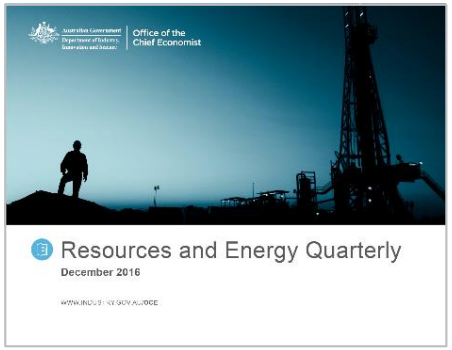
2. But certain points of difference:

- The size and scale was greater than ever before
- There were deeper structural and long-term effects with massive increases in capacity and a long-term realignment towards iron ore and gas extraction
- Inflation and wage breakouts were avoided.

3. Economic reforms helped to offset potential downsides:

- Exchange rates and flexible labour markets did much to absorb the price shock and reduce disruption
- Australia has emerged as a world leader in many commodities.

Further information



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