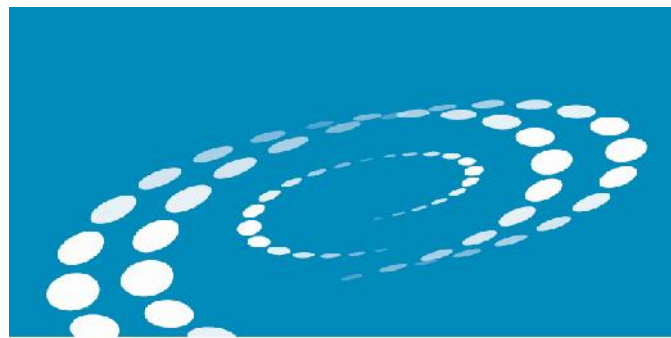


The CONUS Quarterly

March 2011



CONUS

Business Consultancy Services



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What's the impact likely to be?

Editor's Note

2011 has certainly started with some challenges for our local and State economy. In this issue we take a look at what the economic impacts of the floods and cyclone are likely to be.

In June last year we analysed the situation with regard to the tourism sector and we believe it is now time to revisit that theme.

If there are specific topics you would like to see covered in future issues of *The Conus Quarterly* please let us know.

We hope that you, your family and your business are now well on the road to recovery after Cyclone Yasi. As always, if Conus Business Consultancy Services can help you with information or research on any of your other business needs, please do not hesitate to contact us.

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4th Quarter Australian GDP

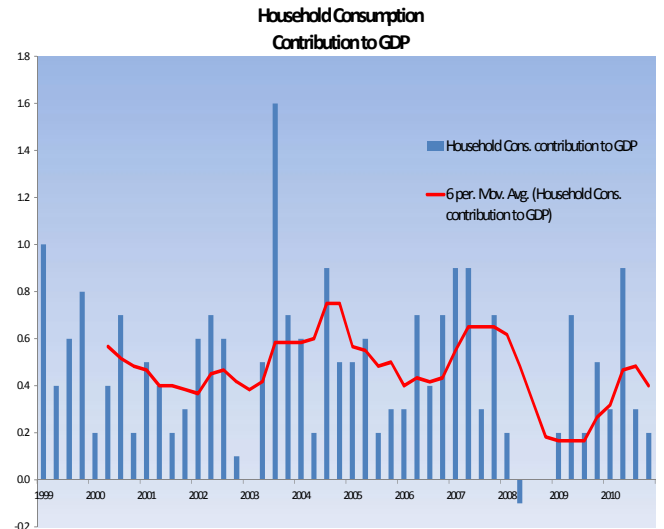
The Australian economy continued to grow in the final quarter of 2010. Despite some earlier (weather related) concerns for a weak, or even negative plot, GDP was up 0.7% from the previous quarter and up 2.7% over the year.

The rather weak third quarter growth, which had been originally estimated at +0.2%, was revised down to just +0.1%.

The main contributors to growth in the quarter were inventories (which added 0.8% to GDP growth), and private capital formation in machinery and equipment (+0,3%). As expected net exports had zero effect.

Household consumers remain cautious (adding just 0.2% to growth) and it is this reticence to spend which is helping to mitigate against some of the pressure being imposed on the economy by the resources boom. When we see the consumer starting to spend, rather than save, we can then expect to see the Reserve Bank eyeing the Cash Rate carefully with a view to further hikes.

As the chart opposite shows, Household Consumption has not fully recovered from its GFC-induced decline. Pre-GFC consumers would routinely add between 0.4% and 0.8% to quarterly GDP growth. Since the GFC that figure has fallen significantly. It is this decline, combined with a strong A\$ keeping import prices low, that has allowed the Reserve Bank to hold off on any interest rate hikes since their 25bps hike in November.



Source: Australian Bureau of Statistics

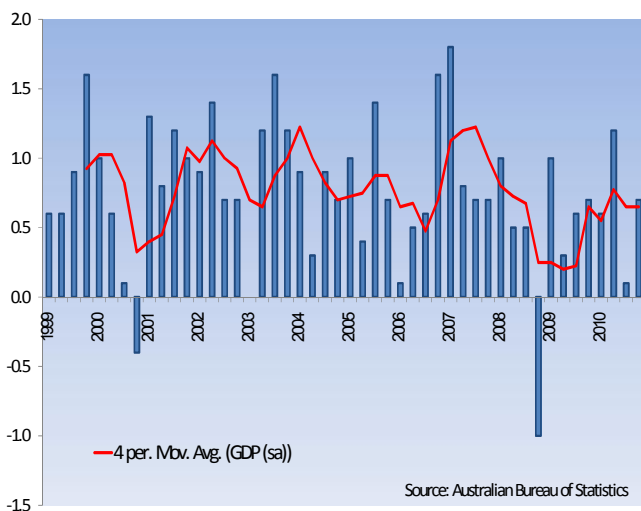
wasn't until the impact of the financial crisis was felt in 2008 that the savings rate really started to increase. Part of this significant spike will have been due to the government's cash hand-out fiscal stimulus package but, even after the effect of that had faded, the savings rate has settled at a level not seen in over 20 years (see graph below).

However, as incomes continue to climb (up 8.7% in the year to December 2010) and the unemployment rate moves below 5%, we can expect to see consumers becoming happier to spend rather than save or pay down existing debt.

With global economies starting to show signs of life again (in particular in the US) the A\$ is unlikely to continue to appreciate at the same scale as recently.

Price risk appears to be all on the upside and we would therefore expect to see the Reserve Bank continuing its tightening policy as we move through 2011. The markets are pricing a rate hike by mid-year at only a 22% chance; we believe the risk is greater than that.

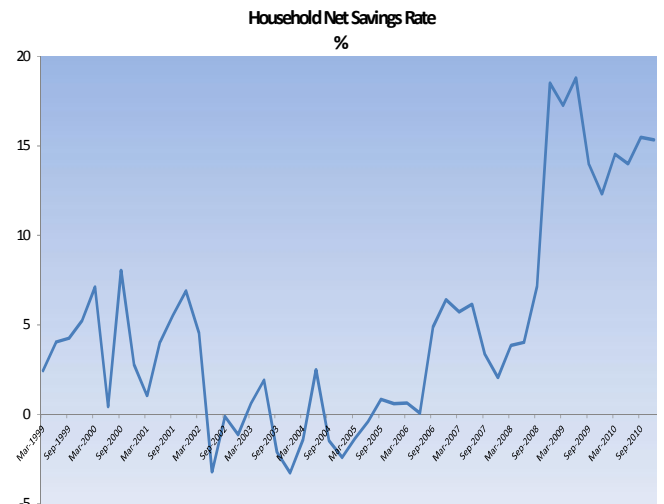
GDP Q/Q



Source: Australian Bureau of Statistics

Of course the flip-side to this wariness of the consumer is the increase in the net savings rate of households. Before the shock of the GFC Australian households were saving at rates that were barely positive (and in many instances were negative). This had followed a decades long decline from savings rates of around 15% in the 1980's.

Although savings rates had started to increase by 2006 it



Source: Australian Bureau of Statistics

Tourism Trends

It has been almost a year since our last detailed look at the tourism sector (see *The Conus Quarterly June 2010*), so we decided it was time to revisit the subject and see what has happened.

Back in June last year it was clear that the strength of the A\$ was a significant contributing factor to the struggle in the sector. Since then the A\$ has continued to appreciate against almost all currencies and now stands at US\$1.01 and £0.62 (US\$0.85 and £0.56 in June 2010).

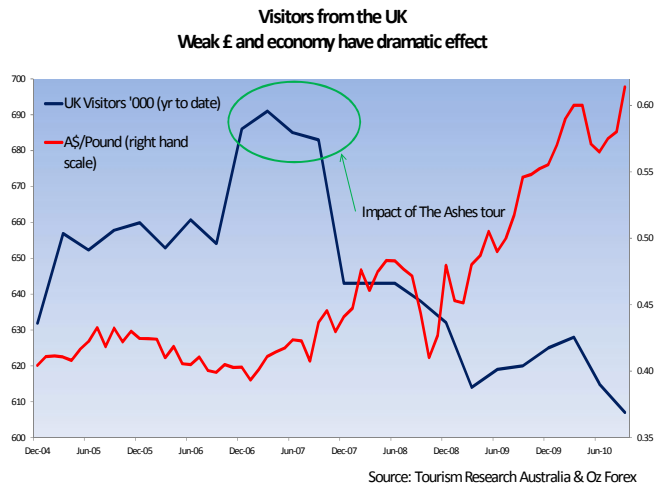
The graph below shows how short term (less than 12 months) departures from the country have continued to climb sharply to now stand at over 7 million for the year to December 2010. It also demonstrates that arrivals too are increasing (albeit at a much slower rate) having increased some 5 or 6% in the past year. {Figures vary depending on whether you use the ABS monthly short term arrivals data or Tourism Research Australia's quarterly International Visitors Survey}

Ten years ago there were almost 1.5 million more arrivals each year into Australia than departures from it. Today that position has almost completely reversed and there are now over 1.1 million more departures than arrivals.

Domestic travel, having fallen sharply from early 2008, has recovered only a small number of those losses and still stands significantly below levels of a decade ago.

The strength of the A\$ continues to play a large hand in these figures. The graph opposite is clear witness to the decline in numbers of visitors from the UK as the £ has weakened over the last four years. Not only has the £ weakened against the A\$ but the austerity package put in place by the British government has shaken confidence and spending power for many British consumers. This is an important fact for the Australia tourism industry since the UK market is still the second largest provider of Total In-bound Economic Value (A\$2.9 billion in year to Sept. 2010). The scale of the decline in the UK market is clear when we consider that as recently as the middle of 2006 visitors from

the UK accounted for 13.1% of all international visitors to Australia. Today that figure stands at just 11.2%. The impact of the latest Ashes tour is yet to show up in the data so we can expect to see a short term boost to annual numbers from the December 2010 quarter onwards.



Back in June last year we commented on the fact that visitor numbers from the Euro-zone countries had held up well due to only limited A\$ appreciation against the Euro. Since then, of course, turmoil in Europe has seen the Euro depreciate some 13.7% from A\$1.60 at the end of 2009 to A\$1.38 currently. It is surprising therefore that the number of visitors from the Euro-zone has barely changed. They remain just over 3% of total foreign visitors.

The story for Tropical North Queensland continues to look bleak. From a high in June 2006 when almost 870,000 international visitors came to the region we have seen numbers slide. In the 12 months to Sept. 2010 there were only 672,000 international visitors (although that is an improvement from the Dec. 2009 figure of just 650,000). Domestic visitors to the region have also fallen slightly. Having been stable at 1.5 to 1.6 million per year for some time, the latest figures indicate just less than 1.4 million.

As we pointed out in June, perhaps the most worrying aspect for TNQ is the decline in its share of those international visitors to Australia. Since the heady days of 1999 when over 18% of all visitors from abroad made it up to TNQ things have been on a steady slide. The latest available figures (Sept. 2010) confirm the decline that started in 2006. Currently only 12.5% of international visitors come to TNQ. This reduction in market share equates to a net loss of some 300,000 international visitors per year to the region.

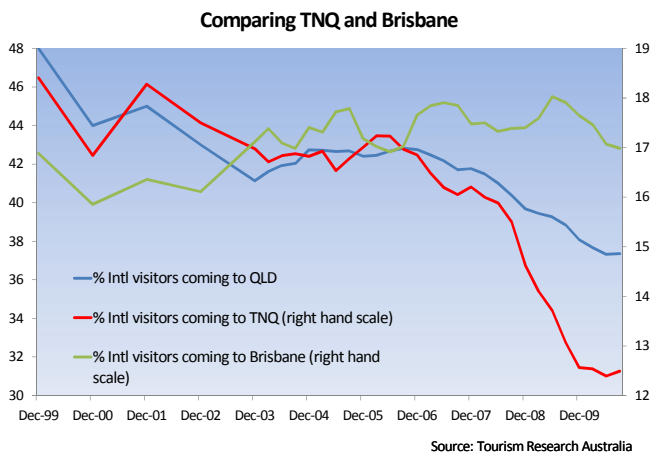
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Travel Trends



Tourism Trends cont.

The graph below demonstrates the fact that TNQ has suffered much worse than, for example, Brisbane. The State capital has maintained a share of international visitors at between 17% and 18% for some years. The decline in Queensland's total share of international visitors is almost fully due to the decline in TNQ. Had TNQ's share stayed around 18% then Queensland's share would currently be around its long term trend of 43%.



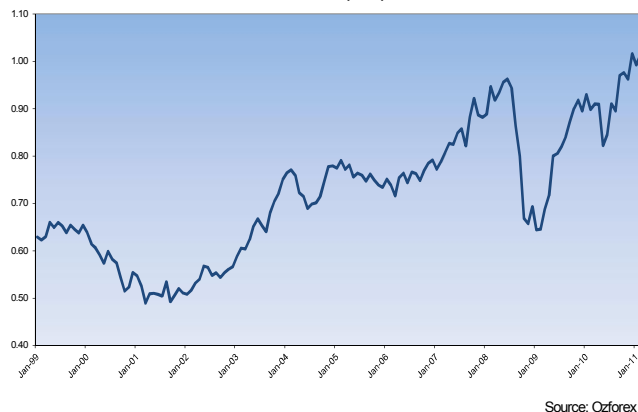
The fact that Brisbane, and indeed the rest of the State as a whole, has managed to maintain its market share is evidence that TNQ is facing problems other than simply the strong A\$ or the slowdown in the global economy following the GFC (which has, with a few exceptions, largely ended with most economies having returned to growth). Brisbane, Queensland and the nation as a whole have all had to face the same strong A\$ and the same weaker spending power of some international visitors. Yet it is TNQ that has suffered disproportionately.

Clearly the fallout from the floods in SE Queensland and the cyclones in the North can only be negative for tourism in the State. Anecdotal evidence from earlier in the year was that many visitors planning to come to the Far North were concerned about their plans in the face of the floods; despite the fact that the floods had no effect this far North. Likewise, we can be sure that concerns about the effects of the cyclones are likely to be felt far from the actual areas effected.

The strength of the A\$ is a reality that the tourism industry will have to come to terms with. With the US economy now returning to growth and the cycle for interest rates in Australia probably now *closer* to the high point (although there is certainly scope for some further rises), we are not expecting the US\$/A\$ rates to appreciate a great deal further. Indeed a return to levels closer to US\$0.90 would be more in line with our expectations.

Likewise, a return to some normality in Europe after the sovereign debt concerns may mean that the Euro is unlikely to depreciate much further against the A\$.

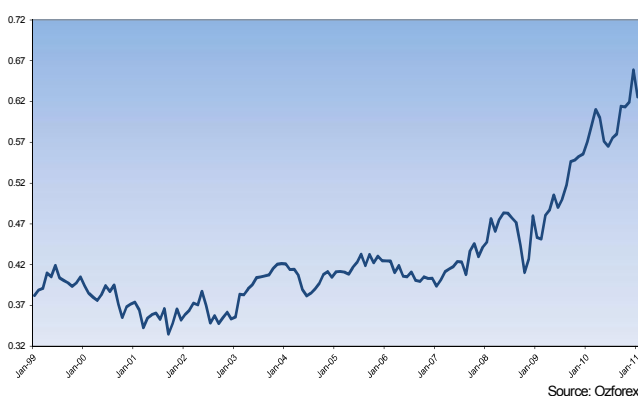
US\$/A\$



Euro/A\$



£/A\$



The challenge facing the tourism industry in TNQ is to recognise the reasons for the relative decline witnessed in the region. Exchange rates fluctuations and global economic downturns are not within their power to control. The fact that the region has lost 300,000 international visitors a year (that is 44% of existing international visitors) relative to the rest of the nation needs to be acknowledged and the reasons for that decline pinpointed and addressed.

Only then can we expect to see the declining trend in these numbers being reversed.

Effects of the Floods and Cyclone

2011 has got off to a dramatic start for Queensland with significant flooding events in the South East and Tropical Cyclone Yasi in the Far North. Both these events are likely to have economic effects not only in the immediate region, but State-wide and nationally.

Whilst confirmed costs of the reconstruction efforts required for both these events are as yet uncertain, the most recent Queensland State Government estimates are that the SEQ floods will cost somewhere in the region of \$5bn with Cyclone Yasi reconstruction adding a further \$800m. These figures are only for the rebuilding and repair of publically owned assets such as roads, rail and council infrastructure. The insurance industry is looking at payouts of between \$2bn - \$3bn for the rebuilding and restocking of private homes.

The Natural Disaster Recovery and Relief Arrangements (NDRRA) will cover 75% of these public costs (i.e. approx. \$4.35bn), leaving the State to find the remaining \$1.45bn. These funds appear likely to come from the long-term lease of the Abbot Point Coal Terminal just north of Bowen.

Whilst Tropical Cyclone Yasi has obviously been the most significant event for our region, the floods in SEQ are actually far more significant from a State and national perspective. The scale of the repair bill noted above demonstrates that fact.

However, Cyclone Yasi will have major impacts on all three of the main industries in our region. The banana industry has perhaps been impacted most directly with the loss of a major portion of the region's crop. The storm is estimated to have wiped out up to 85% of the nation's \$400 million banana output. The industry had already been weakened by an extended period of very low prices for bananas which saw many growers forced to sell their product at or below the cost of production. The National Farmers Federation are estimating that it will take between 12 and 18 months to return production to pre-Yasi levels.

The sugar industry in the region has also been hit hard by the storm with Canegrowers estimating losses at approximately \$500 million. Like bananas, the sugar industry had already been struggling after an extremely wet harvesting season had seen production hit with much of the crop left in the paddock. The effects on the industry are likely to be felt for years.

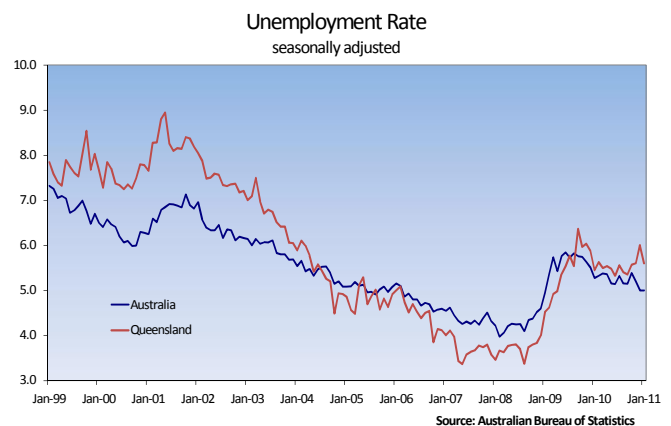
Tourism too will take another hit from both the flood and cyclone events. Even before Cyclone Yasi struck, tourism experts were estimating the impact of the SEQ floods to be

some \$300 million for the 2010/11 fiscal year. Tropical North Queensland has been suffering a tourism downturn for some years (see Tourism Trends on page 4) and the impacts on tourism in the region are likely to be felt for some time to come.

The economic impact of the SEQ floods have been felt most in the mining and agricultural sectors. Queensland accounts for some 20% of national GDP and, of that, 12% comes from the mining industry (20% in WA). Loss of mining production is estimated to knock 0.2-0.3% from GDP, although half of this will be offset by higher prices for coking coal.

Queensland produces almost 30% of the nation's fruit and vegetables and the floods will certainly have had a short term impact on production. Whilst there exists some concern as to the inflationary impact of increases in fruit and vegetable prices, the Reserve Bank are unlikely to place much weight on what will be only short term price increases.

The RBA will be far more concerned about the impact that rising labour costs might have on core inflation. As the reconstruction efforts in both SEQ and the Far North get into full swing we are likely to see an increase in associated labour costs. However, the fact that unemployment in Queensland, and particularly FNQ, is above the national



level would suggest that inflationary wage pressures here may be less than some believe.

Whilst estimates of the scale of the impact on the economy have varied, there seems to be consensus that growth is likely to take a hit of somewhere between 0.2% and 0.5%; with the bulk of this decline to be felt in the first quarter of 2011. Looking forward, the effects of the massive reconstruction effort are estimated to add up to 1.2% to growth over the next two years.

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