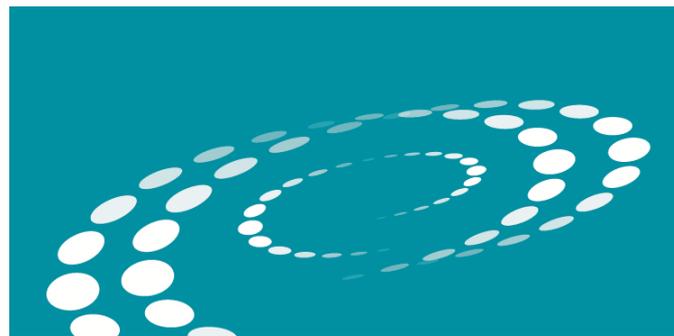


The CONUS Quarterly

Vol. IV - Issue 1 - Mar. 2012



CONUS

Business Consultancy Services



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Editor’s Note

Despite almost universal expectation of a further rate cut by the RBA in February, the Cash Rate remains unchanged since our last issue in December. Readers of this publication and our Economics Blog will be well aware that the RBA standing pat in February (and again in March) was not unexpected by us.

In this issue we have returned to a recurrent theme, and one that is of special interest in our region; tourism. For many years we have been making the argument that there are structural problems inherent in the tourism industry in FNQ and it now appears that there is growing support within “official” channels for that stance. You can read the story on page 4.

The past three months have been very busy ones for Conus and we are delighted to have successfully completed projects for both the Cassowary Coast and Tablelands Regional Councils. We have a number of other community based projects in hand at present and are proud to be offering our local communities what we believe are first class, value for money services.

In a few weeks applications for our CONUS 2012 Grants will close and we are pleased that we have already received a large number of exciting and worthy applications. Results of applications will be available in April.

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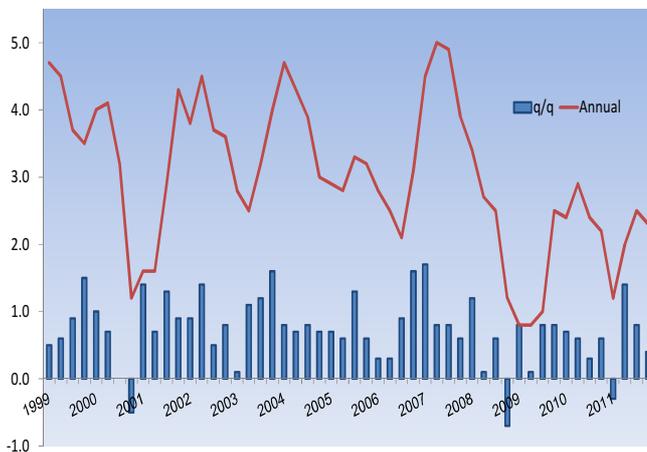
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4th Quarter Australian GDP

The fourth quarter 2011 GDP data came in at a level slightly below most expectations and confirms that, although the economy continues to grow, growth is below trend. The data for Q4 shows GDP up a seasonally adjusted 0.4% and the Q3 data revised downwards to a 0.8% increase (had been +1.0%). This combines for an annual increase through 2011 of 2.3%.

Although this result will disappoint many the fact remains that growth has been forecast to be somewhat below trend through 2011/12 and that is now precisely what we are seeing. The RBA have made it abundantly clear that their growth targets are sub-trend and that, unless there is a significant uptick in unemployment (data to be released tomorrow), they are comfortable with rates where they are. This GDP data will not have materially altered the RBA's rates view.

GDP



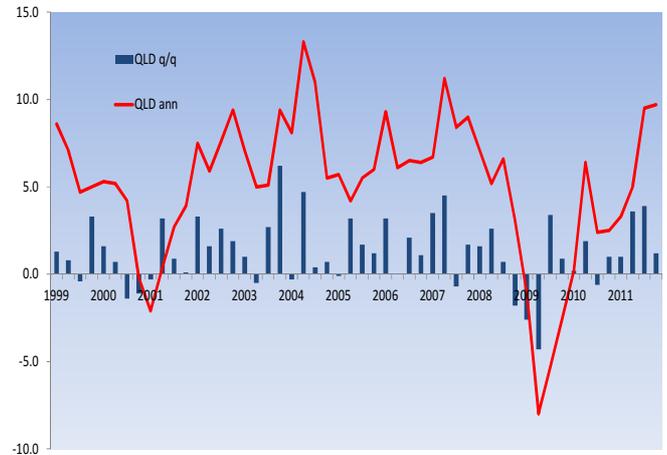
Source: Australian Bureau of Statistics

Looking at the composition of the data also throws up few surprises. Consumer spending remains sluggish; household consumption grew just 0.5% in the quarter and 3.5% over the year. These lower numbers are not a shock given the rather inflated levels seen in both Q2 and Q3. This is clearly well below trend levels and confirms the reluctance of the consumer to spend (and borrow) but rather deleverage personal balance sheets. However, the savings ratio declined again in Q4 and now stands at 9.0%, down from its peaks around 11.5% at the beginning of the year.

Q3's dramatic surge in private fixed capital formation has been somewhat reversed this quarter with the sector deducting 0.3ppt from GDP, predominantly via a decline in private dwellings.

For the first time since the first quarter of 2009 net exports have contributed positively to GDP. Exports were up 2.2% for the quarter and up 0.8% for the year. Imports rose just 0.7% in the quarter but were still up 12.8% from a year ago. The net position was a contribution of 0.2ppt to GDP in Q4. For the first time since Q3 2009 the terms of trade (the ratio of prices of exports to imports) fell. The terms of trade fell 4.7%

QLD Final State Demand



Source: Australian Bureau of Statistics

after a 3.2% increase the previous quarter.

The highly volatile inventories component also added 0.3ppt having been a significant drag (minus 0.9ppt) on growth in Q3.

But it is not just inventories that can be volatile. The State Final Demand data paints a very varied picture across the nation. The "mining states" of Queensland and W. Australia both posted solid annual gains in 2011 of 9.7% and 11.0% respectively. But even here there was volatility with WA showing a 2.4% decline in Q4 while QLD rose 1.2%.

Variations amongst the other states and territories was also evident. While NSW, Victoria and ACT all posted annual gains close to 2% (actually 1.6% for Victoria, 2.0% for NSW and 2.6% for ACT) South Australia and Tasmania both recorded declines over the year (SA -0.6% and TAS -0.7%). After a very strong Q4 the Northern territory managed to record an annual increase of 6.1%.

In Queensland the major drivers remain private fixed capital formation (+4.9%) although this is a significant slowdown from the growth rates of 12.0% and 13.3% in Q3 and Q2. Household consumption remains sluggish rising just 0.3% after a 1.7% increase in Q3. This was the lowest result since Q2 2010.

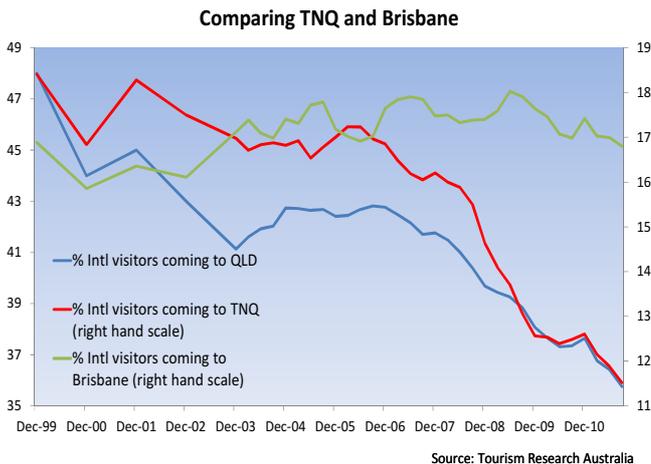
Within the public sector there were two major reversals in Q4. Final government consumption went from a 2.6% decline in Q3 to a 1.2% increase this quarter while public fixed capital formation swung from a 5.7% increase in Q3 to a 6.4% decline in Q4.

So the extended period of sub-3% growth continues (the last time annual growth was above 3% was Q1 2008). There may be those who will argue that this should force the RBA to ease policy further and yet we believe that despite growth somewhat lower than trend the Bank is content. It may simply be that in this era of fiscal restraint we need to revise downwards what "trend" growth should be.

Tourism Trends

Regular readers will be aware that the subject of tourism has been covered at regular intervals for some years now. They will also be aware that since our original foray into the topic in our June 2010 issue we have been highlighting the fact that tourism in TNQ has been suffering significantly since well before the GFC or the emergence of the strong A\$.

In our original June 2010 article we noted that since the end of 1999 the percentage of international visitors to Australia who made their way to TNQ had fallen from 18.5% to just 12.5%. By the time we revisited the theme in March 2011 that percentage appeared to have stabilized at 12.5%. However, recent figures show a further dramatic decline since then and it currently stands at just 11.5%. While these may not sound like large changes it is perhaps worth noting that for the year to September 2011 there were a total of 626,000 international visitors to TNQ. Had the region's share of the international market remained at its 1999 levels (i.e. 18.5%) that figure would have been just over 1,000,000; that's 60% more international visitors than the region actually attracted.



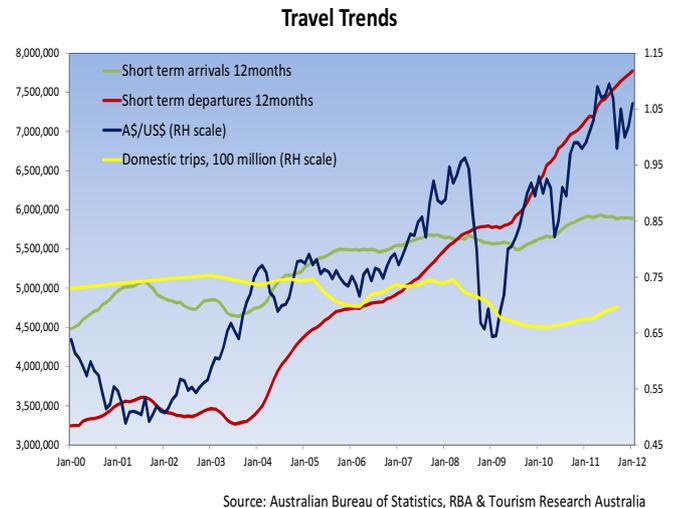
During the period from the end of 1999 to September 2011 the total annual number of international visitors to Australia has increased by 1.3 million; to Sydney the increase is 285,000; to Melbourne it is 620,000 and to Brisbane it is 214,000. International visitors to TNQ have fallen by 136,000! It is worth noting from the chart above that the decline in market share for Queensland as a whole is almost completely due to the decline in market share for TNQ.

Clearly something is going on here that cannot simply be attributed to a strong A\$ or the GFC. Ever since we broached this subject we have been suggesting that the problem may in fact lie with the product that has been offered by tourism in TNQ. This has been an unpopular stance to take and one that has been met, by many in the tourism industry, with a myriad of other "excuses". Inadequacy of State and Federal marketing spending has been a common complaint. All too often operators have

preferred to focus on looking outside their own industry and product mix rather than addressing issues much closer to home. As we said in June 2011, "the challenge facing the tourism industry in TNQ is to recognize the reasons for the relative decline witnessed in the region".

As the Australian economy has grown and matured over the past decades there has been a significant shift in the tourism mix within the country. Wealthier Aussies are now choosing to spend their A\$ abroad rather than holiday at home and the number of departures has rocketed. Figures released by the ABS yesterday showed another record gap between the number of visitors arriving and residents departing for the year to January. In the past 12 months almost 1.9 million more residents have departed than visitors arrived. That is a massive turnaround since August 2001 when almost 1.5 million more visitors arrived than residents departed.

Throughout this 10 year period the number of domestic trips taken has remained broadly flat and the percentage share of those trips taken in TNQ has also remained largely unchanged (at about 2%). However, as IBISWorld point out in their January 2012 report "Tourism in Australia", there is a shift to short-term (overnight and weekend) domestic holidays that only some operators have taken advantage of. IBISWorld note that Victoria and Tasmania

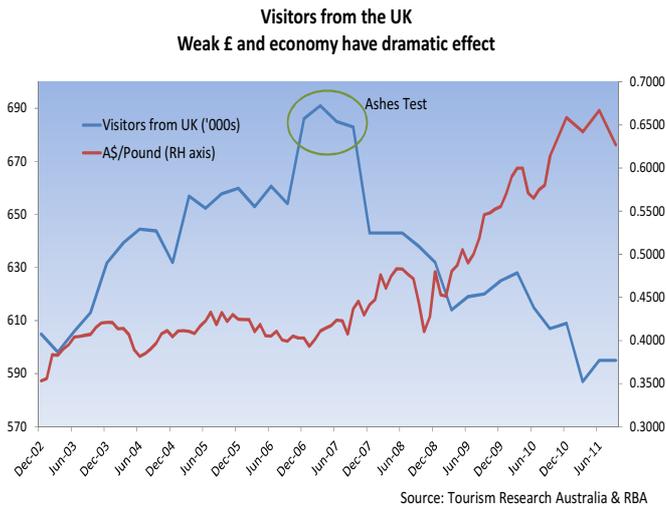


have bucked the trend in domestic tourism by refocusing on short term stays, in particular tied to eco-tourism and food. However, they also highlight that "the majority of industry operators have been very slow to adapt to changing preferences of consumers. This is especially the case for the Queensland and NSW industries with the focus of services and marketing remaining unchanged since the 1980s."

Continued on page 5...

Tourism Trends...cont.

What has also changed is the make-up of the international visitors themselves. At the end of 2003 visitors from the UK made up 14.3% of all international tourists; since that time the percentage has fallen to less than 11%. As the chart below clearly demonstrates, the impact of the strong A\$/weak £ and the weak UK economy have been dramatic on the number of visitors from the UK. Since the end of 2003 the annual number of UK visitors has **fallen** by 36,800 while the total of international visitors has **risen** by 971,000.



Since the end of 2003 the number of visitors from China has exploded and increased from 4% to just over 9%. Indeed for the year to September 2011 (the latest data available), Chinese visitors became, for the first time, Australia's most valuable foreign tourism market.

Although we have been discussing this issue of Australian, and in particular TNQ, tourism for some time there has been little notice taken by the mainstream press. It would appear that may now be changing. In recent months we have read a number of articles and tourism bodies seem to be finally acknowledging the problem.

An article by Cameron Stewart in *The Weekend Australian* on February 18th, whilst not specifically discussing TNQ, raised many of the issues that we have been writing about for some time.

In that article, entitled "Industry gone on holiday", Stewart notes the dramatic shift in tourism demographics and the decline in previously major markets such as the UK and Japan. While acknowledging the impact the strong A\$ has had on the industry and the trend for Australians to holiday abroad he says "*this trend is likely to be permanent rather than merely exchange-rate driven*". The article goes on to quote Tourism Australia's managing director Andrew McEvoy as saying that the shift is "*more structural than cyclical*".

Even Federal Tourism Minister Martin Ferguson accepts

that Australia needs to "*improve the quality of product it offers to overseas visitors*" and that simply throwing more money at marketing is "*pointless*" unless the industry has the productive capacity to deliver.

Ann Sherry, CEO of Carnival Australia, sounds a similar note when she says "*we all need to be robust enough to weather the storms and the dollar. You need to get on with it and get the right products to the right customers at the right time.*"

The article concludes with a sentiment that we feel is particularly relevant for tourism in TNQ ; "*..the industry needs to accept that Australia is a high-cost destination, stop whingeing about the dollar and lift standards so that it can attract the well-heeled tourists from the Asian tigers.*" Putting it another way is RBA Deputy Governor Philip Lowe in a speech to the Australian Industry Group today in Sydney when he notes that "*industries affected by the high exchange rate will need to find ways of moving up the valued-added chain.*"

Whilst tourism operators throughout Australia have struggled, and continue to struggle, with the strong currency, bureaucratic red-tape, high labour costs and the like, it is clear that tourism in TNQ has not kept up with others in the industry (both domestically and internationally). With the structural changes that have been forced on the industry unlikely to change anytime soon the industry in the region needs to face up to these challenges if it is to remain relevant in coming years.

What the RBA Governor's Statement Means

Yesterday's RBA Board decision to leave the Cash Rate unchanged at 4.25% was accompanied by a statement from Glenn Stevens, RBA Governor. It is perhaps interesting to look in details at some of the comments made to gain a better insight into the current thinking of the RBA.

"Recent information is consistent with the expectation that the world economy will grow at a below-trend pace this year, but does not suggest that a deep downturn is occurring. Several European countries will record very weak outcomes, but the US economy is continuing a moderate expansion. Growth in China has moderated as was intended, but on most indicators remains quite robust overall."

While accepting that world growth generally will be at a weak pace the Bank highlights that the US recovery is in place and that China remains robust. Despite yesterday's downward revision to China's growth forecast for 2012 (from 8% to 7.5%) the outlook remains very positive for our most important trading partner. This should support growth in Australia.

"The acute financial pressures on banks in Europe have been alleviated considerably by the actions of policymakers, though there is more to do to put European banks and sovereigns onto a sound footing for the longer term and Europe will remain a potential source of shocks for some time yet. Financial market sentiment has continued to improve in recent weeks and capital markets are again supplying funding to corporations and well-rated banks, albeit at costs that are higher, relative to benchmark rates, than in mid 2011."

The quantitative easing from many Central Banks has eased funding pressures. While banks are able to raise funds the Bank notes that bank's funding costs have increased. They will not have been surprised by the small increase in lending rates push through by the banks recently. Indeed comments from the minutes of the February meeting make it clear that the Bank had fully expected the banks to hang on to 10 or 15bps of the December rate cut and only pass through 10 or 15bps in lower lending rates.

"Most information on the Australian economy continues to suggest growth close to trend overall, with differences between sectors and considerable structural change. Labour market conditions softened during 2011 and the unemployment rate increased slightly in mid year, though it has been steady over recent months. CPI inflation has declined as expected and will fall further over the next quarter or two."

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In underlying terms, inflation is around 2 1/2 percent."

The Aussie economy is growing a little below trend and the RBA recognizes the reality of the "2 speed economy". However, the RBA need to consider the economy as a whole when setting monetary policy; it is simply impossible for them to put into effect a lower interest rate for those weaker sectors while having a higher one for the booming components of the economy. As RBA Deputy Governor Philip Lowe noted in a speech to the Australian Industry Group today in Sydney *"The task for monetary policy is to ensure stability in the overall economy so that difficult decisions at the firm and industry level are not further complicated by macroeconomic instability."* Despite some softening in the labour market towards the end of 2011, unemployment remains low. This data will be updated on Thursday when the ABS release the latest jobs data. Inflation remains in the centre of the Bank's target range. This suggests the crux of why the Bank left rates unchanged. **With inflation sitting comfortably within range and growth only slightly below trend the Bank are happy with a neutral stance.**

"With growth expected to be close to trend and inflation close to target, the Board judged that the setting of monetary policy remained appropriate for the moment. Should demand conditions weaken materially, the inflation outlook would provide scope for easier monetary policy. The Board will continue to monitor information on economic and financial conditions and adjust the cash rate as necessary to foster sustainable growth and low inflation."

Unless there is a marked deterioration in demand conditions (or a major crisis precipitated by Europe) the Bank appear content to remain with rates where they are. Although the market, and many commentators, continue to anticipate further rate cuts throughout this year we remain sceptical. It seems entirely possible to us that we may already be at the bottom of the current interest rate cycle and that the next move in rates could be up; although we would certainly not expect this to be the case until 2013.