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A two speed economy
- analysis of the Dutch disease

Snapshot

For a country with a population about 25 per cent less than Australia's, the Netherlands sure features a lot in our language! We talk about Dutch courage, going Dutch, double Dutch and Dutch elm disease.

And in recent times "Dutch disease" has become the vogue term for economies that run at two speeds, where one part is going gangbusters while the other goes into reverse.

So how did the Dutch get the "blame" for this latest phenomenon? In the 1970s when the Netherlands was enjoying the natural gas boom, the Dutch currency at the time, the guilder, skyrocketed. This had a negative impact on Dutch exports, previously a strength of the economy.

Many economists say that is exactly what Australia is experiencing with the resources sector enjoying strong growth while manufacturing takes a back seat.

And the reason for the poor performance of manufacturing is the strong Australian dollar caused by the resources boom. With foreign funds flowing into Australia to pay for such commodities as iron ore and coal, our currency is pushed higher. It may be great news for resource companies but it's not for the manufacturers and farmers who export, since their products become less competitive in global markets, causing a drop off in demand. On the domestic front, cheaper imports continue to erode the shrinking market share of domestic Australian manufacturers who attempt to compete. Economists have a term for all this: "de-industrialisation".

Those companies with offshore operations are also hurt by the strong currency as the money they earn overseas translates to far fewer Aussie dollars when it's brought back here.

The positive signs

But it's not all doom and gloom. Firstly, for the manufacturers reliant on imported components, a higher dollar translates to cheaper production costs. And strong demand for our resources certainly isn't harming our national

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economy. There's no denying the demand from China, India and Japan for our raw materials was a key reason for our escaping the global financial crisis. Plus, businesses that service the communities in the booming mining towns are also enjoying the ride.

Of course there can be a danger in too heavy a reliance on one sector of the economy.

In a way it's akin to the classic investment mantra of not putting all your eggs in one basket. If our economy were to become solely focused on resources then we might find ourselves with no "Plan B" should the demand for resources start to unravel.

Preventative health measures

So, do we have a Plan B in place?

Tim Harcourt, chief economist at the Australian Trade Commission, says the answer to the two-speed economy lies in the three "i's" — innovation, investment, and international competitiveness.

"By focusing on innovation, investment and international competitiveness and taking advantage of the new opportunities offered by the free trade agreements, the rest of Australia will share in the gains from trade as well," says Harcourt.

He cites how "second speed" Australian states have already taken up the gauntlet — Victoria has been innovating with emphasis on multimedia, biotechnology and other life sciences; South Australia through education.

Indeed international education has become such a growth industry that the sector was worth an impressive $18.6 billion to the Australian economy in 2009, according to figures released by the federal agency Australian Education International. That's up 22.9 per cent on the 2008 calendar year.

It puts education among the top export income earners in Australia. Latest figures from the ABS show metal ores and minerals earned $53.36 billion in the 2009–10 and coal $36.46 billion, so $18.6 billion is not to be sneezed at.

While there are still plenty of opportunities for all states to leverage off the resources boom, Western Australia and Queensland are clearly finding life less of a struggle.

The July business confidence statistics from the NAB reflect the two-speed economy, showing monthly business confidence halved in July from four to two points.

"While confidence in mining did kick up (by 25 points) to better align with very strong mining activity and profitability data, substantial falls in confidence in manufacturing, construction and retail more than offset the mining impact," says the report.

But perhaps we shouldn't read too much into these figures.

As the Australia Chamber of Commerce and Industry says in its report *The Future for Australia's Manufacturing Sector: A Blueprint for Success,* the Australian manufacturing sector may be facing a difficult trading environment, but it does not mean de-industrialisation is having a negative effect on Australia's welfare.

"Australia does not necessarily require a large manufacturing sector relative to GDP to produce high incomes per capita," it argues.

While resources remain so strong, Australia will remain a two-speed economy. However, it is unlikely the Dutch disease is terminal. Indeed you might say what doesn't kill us makes us stronger!

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More4Life® Financial Services
225/20 Dale Street
Brookvale NSW 2100

T +61 2 9939 0702
F +61 2 9939 0706

james@mlfs.com.au
www.mlfs.com.au