

Growth: there's plenty more where that came from



Kevin Rudd may feel slightly cheated because John Howard has had the best part of Australia's interconnected dotcom and terms of trade booms. But even if the terms of trade are about to peak and China's growth takes a temporary dip in the next couple of years, whoever wins the federal election will have a valuable consolation prize.

As Access Economic's latest *Investment Monitor* shows, Australia's investment boom will be a source of growth for years to come. The quarterly monitor, which includes projects worth \$5 million or more, shows that the value of "definite" (approved or under construction) projects has increased by a massive \$28 billion over the past year. In addition "a staggering" \$357 billion worth of projects are currently at the planning stage. That's \$40 billion more than a year ago.

New potential mining projects recorded in the latest quarter include the massive \$7 billion Santos LNG facility and the Arrow Energy-Alcan \$1 billion gas-to-liquids project, both at Gladstone in Queensland.

Australasian Resources has also begun a feasibility study on its \$2.8 billion Balmoral South magnetite project in Western Australia, and Santos is undertaking an engineering design study for the proposed Reindeer gas field project in the Carnarvon Basin. New oil and gas developments also have been announced in Victoria's Gippsland Basin. The resource sector is also driving a substantial share of investment in economic infrastructure including coal terminals at Gladstone and Dalrymple Bay

and new power generation to meet the energy demands of the new resource projects.

"Mining has a ton of work underway and a seemingly endless list of new projects scheduled for the near future," Access says. "The future for Australia's oil and gas sector has never looked brighter, with strong global demand (and a relatively favoured greenhouse footprint for gas) encouraging a rush of investment."

"Future gas development in Western Australia could dwarf current works, thanks in large part to Gorgon."

The Gorgon project on Western Australia's Barrow Island is owned by Chevron, Exxon-Mobil and Shell and is expected to cost at least \$15 billion and produce 10 million tonnes of liquefied natural gas a year by 2011.

Gorgon, the \$11 billion Pluto LNG project on the Burrup Peninsula, and Gunn's \$1.7 billion pulp mill in Tasmania, all recently received environmental approval from the federal government.

Access makes the point that once they and a handful of other very large projects get the go-ahead from their owners, their construction will help sustain investment spending at very high levels even if there is a deterioration in the general investment climate.

That spending will support aggregate demand in the immediate future, but the impact on the economy will continue much further into the future. Once major resource projects are in place, they add to Australia's exports and national income regardless of what happens to China and the terms

of trade.

While the "fixed" cost (mainly interest) of the resource projects is huge, the "marginal" cost of production (the cost of producing an additional unit of LNG or pulp) is usually relatively small.

For that reason, it is worth

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keeping the plant in production even if prices fall to the point that the project becomes unprofitable. The owner is financially ahead so long as the price received is enough to cover the marginal cost of production and make a contribution to the fixed costs, which have to be paid even if nothing is produced.

There was a similar situation in the 1980s when a global recession undermined the early profitability of projects conceived in the resources boom of the late 1970s. The Hawke government, elected at the end of the recession in 1983, found it had inherited a massive seam of productive capacity, thanks to the billions of the dollars that had been sunk into resources sector projects.

A further plus for the new government will be the contribution of these projects to increasing the total supply of goods and reducing inflation pressures. This was referred to by the treasury in its Mid Year Economic and Fiscal Outlook statement: "Wage and inflation pressures are forecast to ease in

2008-09. This reflects an easing in demand pressures and increasing supply flowing from strong and sustained business investment. Moreover, stronger productivity growth is expected to put downward pressure on unit labour costs.”

The dramatic increase in investment spending over the past three years has been dominated by the mining sector. But spending on mining investment contributes to the supply of goods more generally via imports. That is, we convert minerals into cars and clothes and other goods in the global

market place. An important part of that story involves the appreciation of the Australian dollar which makes imports cheaper and more profitable for importers.

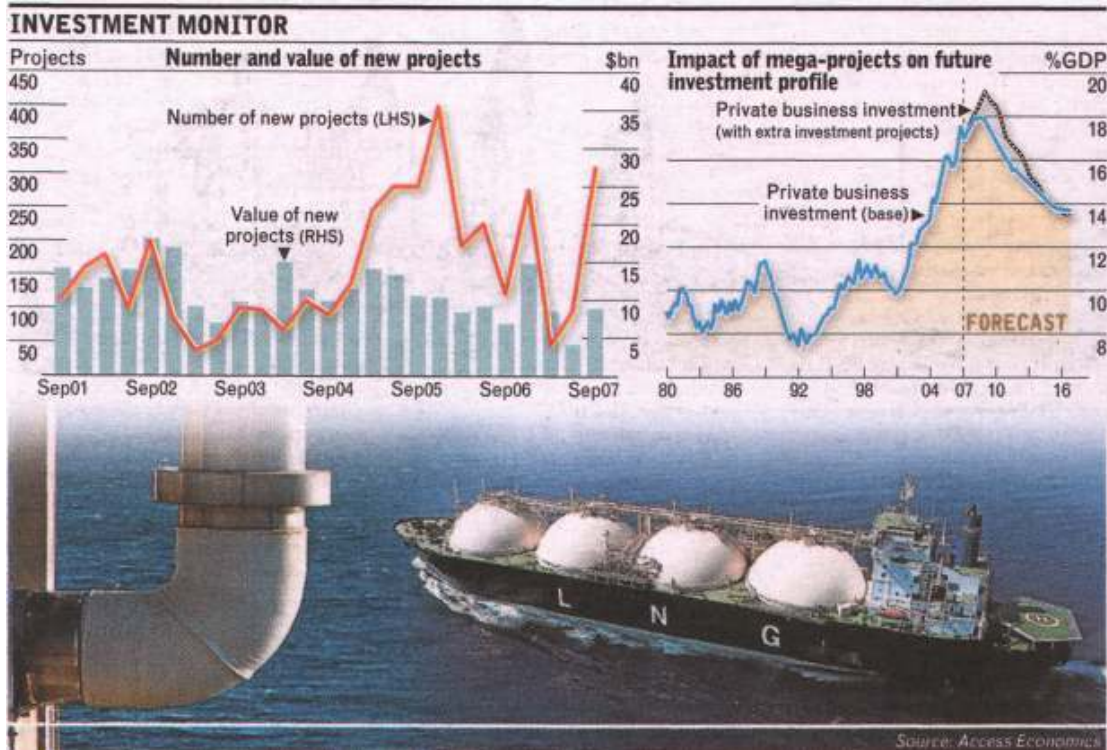
Of course there is a limit to the extent that people can import services. Producers of services and goods that are not internationally traded (the so-called non-traded sector) get the benefit of the boom in the resources sector and disposable incomes more generally without any competition from imports.

The non-traded sector is always a major beneficiary of a

resources boom. It is also the primary source of inflation pressure.

There has been an increase in investment in the services sector with healthy demand for commercial building including an improving climate for retail investment. Strong investment in the transport sector, including roads, will also add to productivity.

But price pressures building up in the non-traded sector would have been the major factor behind Wednesday's interest rate rise.



Investment spending will support aggregate demand in the immediate future, but the impact on the economy will continue for much longer.