

The travelling economist: The Top End

Economic research paper

1 July 2011

- Darwin is a great example of the ‘two speed’ Australian economy.
- Current and prospective resource projects in the Darwin area promise a significant upswing in capital spending, exports and employment opportunities that should bring with them increased prosperity.
- This will also be supported by the growing presence of Australia’s defence forces in the area.
- These positives are being offset, at least partly, however, by softness in the tourism industry, the suspension of live cattle exports and the very expensive nature of the Darwin housing market.
- Overall the Northern Territory (NT) economy looks set to be one of the fastest growing in Australia as a key ‘resource’ based economy, with the opportunities outweighing the many challenges.
- This Travelling Economist would also highly recommend a visit to the Top End, with a focus on the culture of the indigenous community and world-class environmental regions.

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Darwin overview

This Travelling Economist was recently fortunate enough to visit Darwin and Australia’s ‘Top End’. Darwin is a great example of the ‘two speed’ national economy, with some parts of the local economy going through some tough times (e.g. tourism), while other parts are gearing up for a significant increase in activity that will likely bring with it much greater wealth and prosperity (e.g. resources related capital spending and the defence forces).

As such, it is useful to look at the economy around the Darwin area as a possible guide to how other parts of the ‘two speed’ national economy may develop. In this report we will look at the current state of the economy and its outlook and what challenges and opportunities lie ahead for this important, if sometimes forgotten, part of Australia.

The economy

The global financial crisis was not kind to the NT economy, with GSP growth of just 1.3% per year in 2009-10, after annual growth of around 4.5-5.0% in the previous few years. Growth is set to recover to around 2.2% per year in 2010-2011, but then accelerate to 3.2% per year in 2011-2012.¹ Further out, however, as detailed below, the opportunity looks to exist for the NT to return to annual economic growth rates well above the national average as one of Australia’s ‘resources states’.

Opportunities

Resources: One of the biggest sources of opportunity for growth in the NT is the resources sector, driven by significant capital spending and export receipts, and the employment opportunities, population growth and consumer demand that comes with this.

¹ As detailed in 2011/12 NT Budget

Economic growth in the year ahead is expected to be driven by increased exports of such resources as oil, uranium and manganese from both existing mines and the commencement of new production (mainly from the Kitan and Montara oilfields in the Timor Sea).

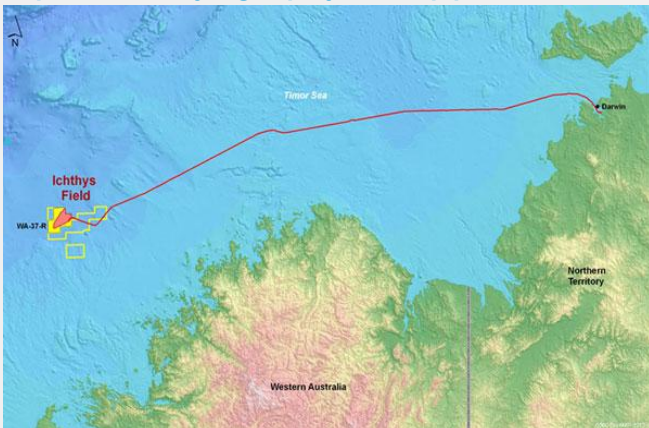
Longer-term, one of the potential sources of significant economic growth and development is the Ichthys gas field to be developed by the Inpex group (76%) and the Total group (24%). As shown in the map below, the gas field is off the north-west coast of WA, but with the gas to be piped 885km to a LNG processing plant in Darwin harbour. After processing, the LNG will then be exported out of Darwin to customers, largely in Japan and Taiwan, for use in electricity generation.

The Ichthys gas project is currently in the FEED stage (front-end engineering design), with a final decision on the project expected to take place in Q4 2011. Recently, 24 June, Inpex announced that it had secured buyers to cover all of the anticipated 8.4 million tonnes of annual production.

Just this week, 28 June 2011, the Australian government granted environmental approval for the Ichthys project, a major step forward towards the final decision to proceed.

The project is expected to cost around \$A25 billion and create around 2,000 jobs in its construction phase and between 300-700 permanent jobs once exports commence. The project also comes with significant conditions with relation to the indigenous population and traditional land-owners, as well as protection of the land and marine environment.

Map of the Ichthy's gas project and pipeline



Source: Inpex Corp.

As an aside, while in Darwin this travelling economist met a man who was a professional diver. One of his current roles was to dive in Darwin harbour (avoiding the crocodiles) to locate unexploded bombs and weapons left over from WWII. These bombs and ammunitions will

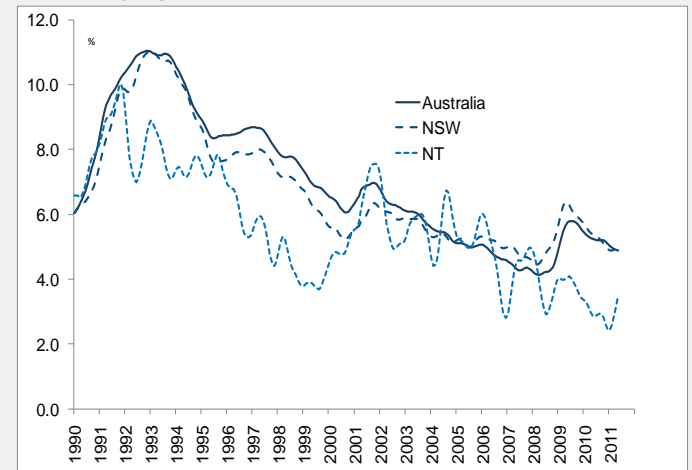
need to be removed (by the Navy) prior to the laying of the pipeline for the Ichthys project on the floor of Darwin harbour.

Strong employment: The unemployment rate in NT in May 2011 was 3.5%, well below the national average of 4.9%.

As can be seen in the chart below, the NT unemployment rate is traditionally well-below the national average. This partly reflects the small nature of the population in this part of the country and the fact that those who move to Darwin, either from elsewhere in Australia or offshore, do so with a specific job to go to, rather than on the off-chance of finding employment.

The strength of the resources sector, both currently and in the future, could be expected to ensure that the unemployment rate in the NT remains among the lowest in the county.

NT unemployment rate vs national rate



Source: ABS

Population: One of the key supports over many years for the NT economy was its strong population growth, obviously closely related to the strength of the employment market. (note, the total population of the NT is just short of 230k, around 1% of Australia's 22.5m people).

Through 2007-2008 and 2009-2010, the NT's population grew at an annual rate of around 2.5% per year, well above the national average, as people came to the NT to satisfy the demand for jobs (i.e. as noted above, people usually only move to Darwin with a specific job to go to). In 2010-2011 and 2011-2012, however, the NT's population growth rate looks set to slow to just 1% per year, perhaps reflecting the softness in the employment market over recent months.

Another important factor in population growth has been, however, movements of the defence forces, with a Battalion (7th Battalion, the Royal Australian Regiment) moving from Darwin to Adelaide in early 2011. This move involved 1,200 soldiers and a total of 2,000 people including spouses and children.

In the future, however, the NT's population growth rate is set to accelerate again, and likely will be close to 2% per year higher from 2012-2013 onwards. This will reflect both increased job creation from major resource projects, as well as an increase in defence force numbers in the Darwin region in the years ahead (see below for further details).

Defence forces: When this travelling economist was in Darwin one of the local newspapers carried the headline 'Super Warships for Darwin'. The story was about the expectation that the current review into Australia's defence force structure will conclude that a significant portion of Australia's defence force capabilities needs to be moved from the 'south' to the 'north'.

The reason for having more defence force assets in the north, especially in Darwin, include: the ability to protect the significant offshore and onshore resource assets now being constructed; closer proximity to regional powers (i.e. Indonesia, Singapore and China) for training and military exercises; closer proximity to respond to natural disasters and humanitarian needs in the region; and quicker response times to illegal entry into Australian waters, i.e. fishing vessels and asylum seekers.

It is expected, therefore, that naval and air-force assets will be moved to Darwin in the years ahead, likely adding significantly to Darwin's population and economic growth potential.

Indigenous issues: One of the most positive aspects to the NT economy is the indigenous population. When visiting the many art galleries in Darwin and on trips out to the culturally and environmentally significant lands (i.e. Kakadu) the obvious pride and commitment to their culture of the local aboriginal people is a great thing to observe and be part of.

Challenges

Tourism: The tourism market in Darwin looks to be divided into three clear groups; the backpackers, more affluent Australians and more affluent international visitors.

Overall inbound tourism declined post the GFC, but is now back to around the levels seen pre-GFC. The pace of growth remains very moderate. Casual observation indicates that the backpacker market remains quite

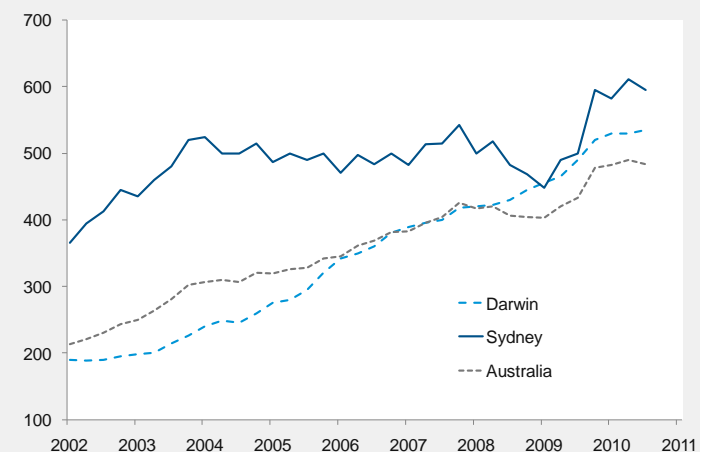
strong, but the 'average spend' of this group is well below that of the other groups. On this front the number of more affluent visitors from both Australia and offshore looks to be very soft, with the high AUD clearly having an impact on tourism numbers (i.e. it is cheaper for Australian's to holiday offshore and expensive for international visitors to come).

Perhaps a tourism strategy more focused on attracting the growing middle-classes from the near-by Asia nations would be a worthwhile development.

Housing market: This travelling economist was very surprised to see the price of housing and rents in Darwin. As shown in the chart below, the average house price in Darwin as at Q3 10 (based on ABS data) was \$A535k, well above the national average of \$A483k and not much below Sydney prices of \$A595k on average. Given the small size of the Darwin population (around 125k), this is rather an incredible statistic. In addition the cost of rents in Darwin is also very high, again approaching Sydney prices (i.e. I was told at least \$A800 a week for a waterside apartment).

The NT government is trying to alleviate this problem through increased residential construction, especially in the Palmerston East area just outside Darwin. Given, however, the strong employment and population growth rates expected in the years ahead it would be reasonable to assume that the cost of housing, both the purchase and rent, will remain a significant challenge for the local population and government.

Darwin, Sydney and Australia house prices



Source: ABS

Live cattle exports: The suspension of live cattle exports out of Australia to Indonesia is having a significant impact on many people in the NT region. The live cattle export industry is estimated to generate income of around \$A700m a year, of which some 47% (\$A320m) is from exports to Indonesia – so the decision to suspend these exports for up to 6 months is having a

significant impact on the industry in Darwin and the wider NT economy.

Apart from the direct impact on income and jobs, there is the obvious flow-on effect of what to do with the cattle that were destined for offshore markets and the general impact the government's decision has had on confidence in the industry.

The government has announced an \$A30m 'live exports assistance package' for the industry and an 'income recovery subsidy' for individuals affected, but it does seem that this issue will be a source of concern for the local economy for some months to come.

Indigenous issues: As noted above, one of the main sources of positive outcomes in the NT is the indigenous population and their culture. However, walking around the streets of Darwin it is also possible to observe the opposite end of the socio-economic spectrum, with a

number of local aboriginal people clearly suffering the effects of unemployment, cultural alienation and alcohol dependency.

It was explained to this travelling economist that with the Federal government's 'intervention' policies making many of the regional communities in the NT 'dry', that some of the worst elements of these communities that were significantly affected by alcohol abuse had made their way into Darwin, concentrating the number of people in this poor state within the Darwin area.

This will clearly remain a challenge for the Australian and NT government's and the local community. This is an issue that should be the focus of all Australians.

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