

COMMONWEALTH OF AUSTRALIA

JULY 2007

CREDIT GUARANTEE COUNTRY PROFILE:

IES 02/ ATTACHMENT N

<u>Country Rating</u>	<u>S/T Business Cycle Indicator</u>	<u>S/T Political Indicator</u>	<u>Debt Recovery</u>
1A	→	→	Either the legal route or a debt collection agent may be used for recoveries.

Credit Guarantee Experience

We are open for cover without restriction in this market where we have a large exposure and favourable experience.

Political Highlights

- ❑ Queen Elizabeth II is the head of state and is represented by a governor-general Michael Jeffery who was sworn in, in August 2003. John Howard is the prime minister.
- ❑ The next election is likely to take place at the end of this year and Mr. Howard is expected to draw on all his considerable political skill to stay for a fifth term. The 2007/08 budget includes infrastructure initiatives and tax and spending sweeteners designed to pacify a disgruntled electorate.

Economic Trends

- ❑ Australia has a population of 20m that is estimated to grow at a rate of 0.8% in 2007.
- ❑ This enviable Western-style capitalist economy has undergone significant structural and macroeconomic reforms over the last two decades, including the floating of the exchange rate in the early 1980s, that are aimed at reducing or removing distortions to competition in order to improve the functioning and flexibility of markets. Industry reform has focused on opening previously regulated sectors to competition and stimulating farm innovation for the medium-to-long term benefit of producers and consumers. Over 95% of Australia's farms are family owned and operated.
- ❑ Environmentalist Tim Flannery predicted that Perth in Western Australia could become the world's first ghost metropolis as its population will be forced to abandon the city due to lack of water. Australians are one of the world's greatest energy users and people in Perth consume more water than any other Australian city. Mining activity is boosting the population in Perth which is soon expected to reach two million. Climatologists say that global warming has affected this city the most in the world.
- ❑ Australia's prime minister announced at the end of April that irrigation supply to the Murray-Darling basin (eastern Australia's main water source) will be cut off if the drought-afflicted region does not receive heavy rainfall over the next two months. Seeing as this is Australia's most important agricultural area, which makes up two-thirds of farm output by value, the decision to cut water supplies will exacerbate the already weak sector, escalate food-price inflation and hurt exports. The region accounts for 85% of Australia's irrigated land. A sharp decline in agricultural output, which contributes 3.6% to GDP, would inevitably slow the growth of the economy.
- ❑ The devastating floods that hit the coastal city of Newcastle in June 2007 has resulted in five thousand people evacuating their homes with power losses in over fifty thousand homes in the region. The Insurance Council of Australia has put the damages of the storms at A\$200m. Mining giant BHP Billiton has called 'force majeure' at its Mt Arthur coal mine in New South Wales, which limits its contractual liability to deliver coal, after sever storms battered the Newcastle/Hunter Valley region. Force majeure is a contract which aims to free parties from liability when an extraordinary event or circumstances beyond the control of the parties, such as a flood occurs. The storms are the latest issue to hinder the east coast coal miners, who are struggling to meet demand due to infrastructure constraints at a number of port facilities, including the Port of Newcastle where up to sixty ships are anchored waiting to load coal.
- ❑ Despite the likelihood of further fiscal expansion, the Reserve Bank of Australia appeared more relaxed in March on inflation prospects and stated additional interest rate increases were unlikely. The RBA believed inflation will fall sharply in the coming quarters. Inflation is expected to average 2.7% this year from 3.5% in 2006 and will gradually reach 2.2% by 2011. Australia's employment increased four times as much as expected in May, worsening a labour shortage that may force the central bank to now change its stance and raise interest rates to ward off inflation.
- ❑ Although the drought will continue to have a negative effect on economic growth in 2007, GDP is still expected to expand by 3.3% in 2007, 3.1% in 2008, 2.7% in 2009, 2.8% in 2010 and 2011. Growth until 2008 will be boosted by export expansion, growth in domestic demand and improved rural conditions. Australia is now in its sixteenth year of economic expansion during which time it has grown 3.6% on average per annum, well above the OECD average of 2.5%. Its GDP understates the economic benefits of the commodities boom. Its improved terms of trade has resulted in gross domestic income growing by an average 4.5% over the past four years. This however has not prevented it from running a huge current account deficit of 6% of GDP in the fourth quarter of 2006. The economy grew 1.6% in the three months ended 31st March 2007 driven by consumer spending and business investment as mining companies expanded to meet the surging Asian demand.
- ❑ During the financial year 2005-06, agriculture added over A\$25bn to the economy and accounted for around 15% of Australia's total exports. On average, Australia accounted for almost 15% of world wheat exports, with Western Australian growers being the key producers of the crop. Western Australia is also a significant producer of wool, meat and livestock. Australia's Farm Management Deposit Scheme encourages primary producers to put aside money during favourable conditions to cover the inevitable poor years that will occur. Australia recently increased the maximum deposit limit from A\$300,000 to A\$400,000 and lifted the non-primary production income threshold. This should further help farmers to prepare for and manage future shocks and downturns. There is currently A\$2.3bn invested in the scheme.
- ❑ With the impending elections approaching, John Howard has changed course abruptly and announced that Australia will adopt a cap-and-trade system for greenhouse gases by 2012. He however stated that the level of the cap would not be set until after the elections –

and competitive threats to Australian firms from less carbon-constrained places such as China will be one factor considered when setting it.

- ❑ Hundreds of people who work beyond retirement age in return for a pension bonus worth up to A\$32,000 are dying before they reap the benefit. The work-till-you drop policy has saved the Federal Government tens of millions of dollars in pension payments but left it severely embarrassed. The spouses of elderly workers have been prevented from claiming the pension bonus owed to their deceased partner. Approximately 63,000 Australians are estimated to be taking part in the pension bonus scheme. Workers must have reached retirement age but work 960 hours per year to qualify.
- ❑ The capital cost of the Train 5 expansion of the Woodside-managed North-West Shelf gas project has incurred inflating cost pressures of as much as A\$2.6bn. The project was estimated to cost A\$2bn in June 2005 and a new review of the cost is expected at the end of the month. Credit Suisse is confident that the project remained economically viable due to increased liquefied natural gas prices on the back of current strong demand in Asia. The construction of the Shelf project's fifth gas processing train will lift its annual capacity to 16.3m tonnes of LNG. Commissioning of Train 5 is due to start in mid-2008 and the first LNG shipment is expected in the fourth quarter of 2008.
- ❑ Rio Tinto has renewed its focus on North America and Europe to stem a potential decline of its 23% share of the world's seaborne iron ore trade. The company has recently bolstered its efforts by promoting a potential \$6bn iron ore project in West Africa and forming a dedicated Atlantic marketing team. Rio's exports to the Atlantic markets were 12% of its total production last year. It spent over \$50m studying the \$6bn Simandou project in Guinea as part of its plan to increase its share of the Atlantic iron ore market, which is dominated by Brazil's CVRD. Simandou, which could produce 70m tonnes of high-grade hematite annually, has become an increasingly prominent feature of Rio's iron ore presentations. Rio indicated that it could approve the Simandou project in 2010 and start production in 2013. Rio is examining an expansion at Corumba that would allow it to produce 15m tonnes annually, up from 1.75m last year. The bulk of Rio's output comes from the Pilbara region of West Australia and is shipped to China, Japan, South Korea and other Asian nations.
- ❑ A trade liberalisation survey was conducted to assess the benefits to merchandise trade. It forecast that global trade liberalisation would boost Australia's agricultural exports by \$9bn in 2020. World agricultural trade is estimated to expand by more than \$286bn in 2020. Much of Australia's agricultural exports occur in the dairy, beef, sugar and wheat industries. Australian dairy product exports are estimated to increase in value by 39% and beef exports by 34% in 2020.

Trade Developments

- ❑ Main trading commodities: coal, gold, meat, wool, alumina, iron ore, wheat, machinery and transport equipment, computers and office machines, telecommunication equipment, crude oil and petroleum.
- ❑ Major trading partners: Japan, China, South Korea, US, New Zealand, India, Singapore and Germany.
- ❑ Government's ambitious trade policy is geared towards increasing economic activity, creating jobs and getting a fair deal for Australia in the international marketplace. Belgium is an important destination for Australian coal, copper, steel and metal ores. Other major export items from Australia to Belgium include alcoholic beverages, pearls and gems, wool and confidential items (diamonds).
- ❑ The prime ministers of Japan and Australia have signed a security pact to enhance military co-operation between the two nations. Australia says that the pact may lead to intelligence sharing and to Japanese troops taking part in military exercises on Australian soil. The Economist says that the new security deal carries long term risks for Australia. Although China reacted calmly to the declaration, it may still complain about it and possibly use it as a basis to form other disputes. Other Asian countries are not expected to welcome increased Japanese military presence in the region. The deal is expected to strengthen Australia's ties with the US.
- ❑ Government has recently announced the commencement of a FTA with Japan. Japan is a key market for Australian farmers. In 2005-06, agriculture, fisheries and forestry exports to Japan were valued at A\$6bn.
- ❑ SA's exports to Australia fell from R9.7bn in 2005 to R9bn in 2006. Exports for March 2007 totaled R789m and R1.9bn in the year to March 2007. It is currently SA's 14th largest export destination. Imports from Australia grew from R7bn in 2005 to R9.5bn in 2006 and amounted to R2.3bn in the year to March 2007. Australia is SA's 15th largest import source.