The World Economy in 2000

Outlook for Australia

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Abstract

This paper examines the outlook for the Australian economy over the course of the year 2000 and into the first decade of the next millennium. The legacy of Asia's economic crisis of the late 1990s is considered along with the reasons for this crisis. How Australia is set to perform over the coming year is considered as is its major trading partners in Asia. Longer-term economic and social trends are considered and potential scenarios offered. The social transformation of Australia's changing demographic profile is discussed with implications for the property sector.

Outlook for the next Millennium

As Australia enters the next millennium some consideration may be given to the economic and social environment likely to face the country over the next few years. Predicting the future is at best problematic, but some lessons can be drawn from recent history that serve as pointers for the future. Chief among these is the economic upheaval experienced by many of Australia's trading partners in Asia during the 1990s. The causes of this crisis and how these countries have managed it provide useful insights into the environment Australia will experience in the first few years of this century.

Also of importance is the social composition of Australia, its demographic profile and what this means for our economic and business environment. The aging of the Australian population combined with the maturing of generations born in the 1970s and 1980s will serve to change the nature of work and lifestyles. These forces are likely to have a strong impact on the property sector over the coming decades.

Asia's Economic Crisis – The Causes

The 'economic crisis' that plunged many of Asia's economies into turmoil during the past two years was the result of four interconnected factors:

Factor 1. Overheated economies

Throughout the 1980's and 1990's many of Asia's economies had experienced one of the longest economic boom periods since the second world war. Countries such as Taiwan, Thailand, Malaysia, Indonesia, Korea, Singapore and Hong Kong rapidly expanded their economies with massive levels of foreign investment. These newly industrialised countries (NICs) or **"Tiger Economies"** appeared unstoppable. However, by 1997 these economies were reaching the limits of their growth with labour shortages and rising inflation (Rodrik, 1999).

Factor 2. Over Investment in all industry sectors

An aspect of this economic boom was a massive level of investment in all industry sectors of many of these countries. While many investors sought to direct their funds to long-term 'stable' industries, much was deployed in speculation. Asian stock markets traded in high risk, high return stocks while too much money was tied up in high rise CBD office towers and other property. Over investment also took place in such areas as semi-conductors, motor vehicles and steel. World markets became oversupplied, prices fell and cash flows were crippled.

Factor 3 - Imprudent Lending by Banks

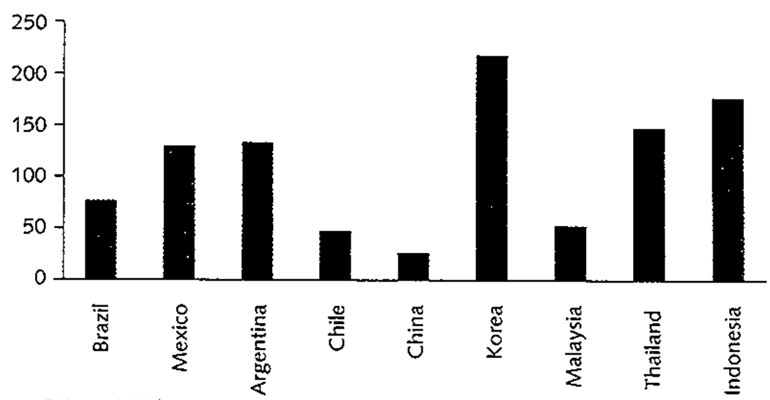
Many of the banks in these countries borrowed money offshore at low prices and lent it back into their domestic market for a premium. This was assisted by Government policy that artificially 'pegged' the local currencies to the US Dollar. Lending practices of many banks in Asia were 'imprudent' with evidence of lax credit controls and cronyism.

Compared with many of the world's developing economies many of those in Asia - particularly Korea, Thailand and Indonesia were carrying too much debt. Much of this was in the form of short-term foreign currency loans that were 'unhedged' against currency risk due to the perception that things were held stable by the 'pegging' of local currencies against the US Dollar.

Many companies in these Asian economies exceeded their borrowings. For example, Korea's *'Chaebols'* carried debt to equity ratios of around 400 per cent prior to the collapse. Asia's banks had an average of 20 per cent of their loan portfolios recorded as non-performing – this figure was as high as 60 per cent in Indonesia.

Such lending practice was due to cronyism, poor banking controls and the belief that the boom would last. Many of Asia's banks were simply unable to cope with the massive influx of foreign speculative capital. Once the currency pegs were removed and company financial weaknesses exposed these banks faced serious financial loss. Figure 1 illustrates this situation.

Figure 1: Imprudent Lending - Short-term debt as a percentage of gross reserves June 1997



Source: BIS IMF (1998)

Factor 4 – Competition from China

Into this volatile cocktail emerged China, newly open to the world economy, and capable of competing directly against these "Asian Tigers" with low priced products or commodities. By 1997 investors were becoming cautious. Faced by rising costs of capital, Government's removed their 'currency pegs' leading to the collapse of the system. Figure 2 illustrates this through the example of China and Malaysia competing for share of the manufactured exports market.

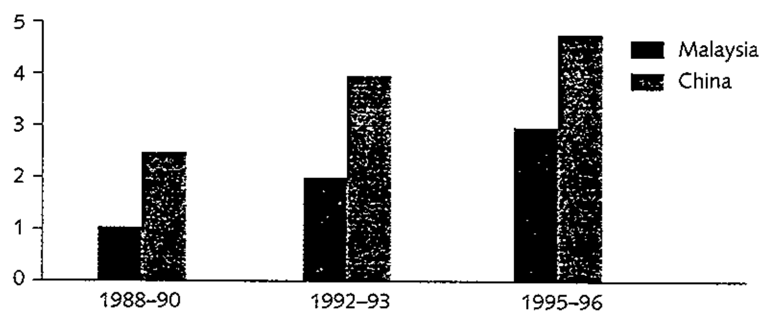
Today there are signs of recovery but it is patchy and painful (Woodall, 1998). The lack of adequate bankruptcy laws in many Asian countries makes it difficult for poorly run 'insolvent' firms with no viable assets to write off their debts. Nepotism and a lack of will by governments to close down 'bad' businesses, is squeezing out viable firms seeking to lead the recovery (Chowdhury and Paul, 1997).

While some Asian governments appear willing to force restructuring on their economies, many others refuse to accept the need for substantial change. Such denial will only prolong the recovery (Higgott, 1998).

Outlook for Key North Asian Economies

A look at the forecasts for Australia's key **North Asian** trading partners over the course of the year 2000 suggests the following trends (Ernst & Young, 1999; Sowinski, 1999):

Figure 2: Competition from China - Share of world exports in top 10 manufactured products



Source: Bhattachary, Ghosh & Jansen (1998)

Japan

As in 1996 the fiscal stimulus engineered by the Japanese government is expected to trigger a more durable economic upturn with forecast growth of 2.3 per cent. Although the pace of reform remains low so too will interest rates and the value of the yen.

Korea

IMF led reforms of the Chaebols is expected to continue with a writing-off of bad debts, restructuring and refinancing. While painful, these changes should attract foreign investment leading to a subdued export led recovery. This will be dampened somewhat by excess capacity particularly in manufactures such as cars and electronics.

China

While still competitive the Chinese economy will face increasing pressures from both within and without for reform. Foreign investment may slow leading to rising unemployment and social unrest. Government subsidy of export industries may conflict with the countries desire to gain entry to the WTO.

Taiwan

Less effected than most Asian economies, Taiwan is predicted to experience 6 per cent growth rates in GDP over the course of next year. Exports will remain strong as will domestic demand. Diplomatic tensions with China can be expected to affect investment.

Hong Kong

Although this Special Administrative Region will remain a base for many Western Corporate Headquarters seeking only modest growth is expected. Forecasts suggest 3.8 per cent is possible with an easing of bank credit restrictions on the back of stabilisation in the property sector.

Outlook for Key ASEAN Economies

A look at the forecasts for Australia's key **ASEAN trading partners** over the course of the year 2000 suggests the following trends (Ernst & Young, 1999):

Malaysia

In 2000 Malaysia is expected to experience positive growth rates in most industry sectors with forecast real GDP growth up 4.7 per cent. Exports are likely to recover but financial problems may remain due to Government restrictions on foreign investment. Uncertainty over the succession of Prime Minister Mahathir Mohammed may weaken investment.

Singapore

Supported by stable government and sound legal structures Singapore is expected to recover well next year. Exports should strengthen and a turn-around in the construction sector is likely.

Thailand

A weak recovery is possible with positive GDP growth at 3.6 per cent forecast by some while others expect a downturn. Exports and private consumption may strengthen but foreign investment is likely to remain stagnant due to incomplete restructuring and continued over supply.

Philippines

Largely unaffected by the 1997/98 crash the Philippines is expected to see growth rates of up to 5 per cent with stronger investment and exports. The introduction of new tariffs is possible in some sectors.

Vietnam

A real GDP growth rate of 5.2 per cent is predicted in Vietnam with enhanced exports and foreign investment. However, the political structure remains a major impediment to sustained growth. Doing business in Vietnam will continue to be difficult.

Indonesia

Ongoing political instability and social unrest will delay recovery. Small export and GDP rises may occur along with modest foreign investment. The aftermath of the East Timor conflict is likely to dampen economic activity between Australia and Indonesia for some time. However, this may change rapidly if the new administration in Jakarta is willing to mend diplomatic fences with Canberra.

From "Poor White Trash" to "Strong Man of Asia"

In the mid-1980s Paul Keating, then Federal Treasurer, remarked that Australia risked becoming a "Banana Republic" in the face of a serious deterioration in its balance of trade figures, a falling dollar, rising interest rates and heavy public sector debt. Singapore's Prime Minister Lee Kwan Yew, perhaps to shock Australian's into action commented that we risked becoming the "Poor White Trash" of Asia if our economy continued to slide.

Over the past two decades the Australian economy has been comprehensively restructured and reformed. The economy has diversified from commodities to manufactures and services. Reduced tariffs and increased labour productivity has assisted Australia to become substantially more competitive (OECD, 1998).

During the past two years the All Ordinaries Index increased by

30 per cent breaking the 3,000-point in May last year. Consumer confidence has remained high despite the economic troubles in Asia with exports shifting smoothly from Asia to Europe - where they rose by 40 per cent - and the United States - where they rose by 30 per cent - over the past year (Lorrimer, 1999).

Although unemployment remains around 7.2 per cent this is lower than it has been in three decades. Both inflation and interest rates continue to be low, industrial production is up by 3 per cent over the past year and the outlook is for a 3.3 per cent rise in GDP over the year 2000.

Australia's economic performance is illustrated in Figure 3 showing real GDP growth over the period from 1994 to 2000. It can be seen that while the ASEAN states outperformed Australia in the mid-1990s with annual growth rates of over 8 per cent, the past two years since 1997 has seen a sharp reversal of fortunes (Ernst & Young, 1999). This is particularly the case in our nearest neighbour Indonesia where the economic collapse has undone almost twenty years of economic development. In 1998 the Indonesian economy experienced a decline in real GDP of around 17 per cent.

The outlook for ASEAN and many other Asian economies in the next year is brighter. With the long term forecast for average annual GDP growth in ASEAN over the next decade predicted to top 5 per cent. By comparison Australia's GDP growth over the same ten-year period is expected to be a more sedate 3.6 per cent (Ernst & Young, 1999).

Of interest is the comparison between Australia and the OECD. As shown in Figure 3 the Australian economy has performed well against the OECD average over the past decade. Further, it is expected to continue to nudge ahead of the OECD that is predicted to have a ten-year average annual GDP growth rate of around 3 per cent.

Australia's economic performance against ASEAN and the OECD can also be examined in terms of consumer price inflation. As shown in Figure 4 the OECD has experienced a relatively stable inflation rate over the past six years. By comparison the ASEAN economies have had something of a 'roller coaster' ride with substantial inflation spikes on the back of their currency collapse in the period from 1997 to 1999.

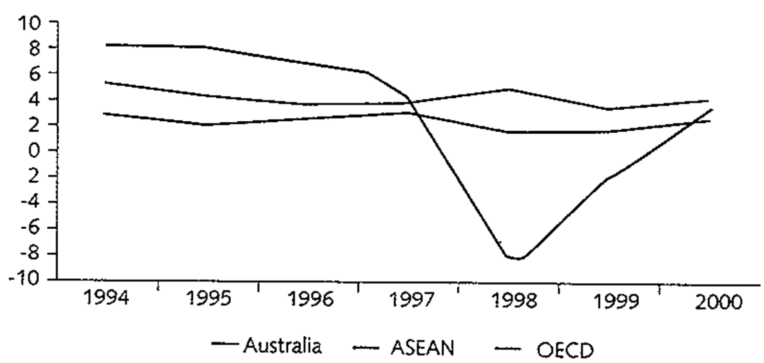
Although the situation in ASEAN is expected to improve over the course of next year the outlook for Australia is less optimistic. The level of inflation is expected to rise above 2 per cent with a worsening of the current account deficit.

The Sydney Olympics is expected to boost both private and public sector spending in tourism and retailing. Some capacity constraints may emerge in industry causing additional pressure on the current account as imports rise. More importantly for the property sector is the prediction that interest rates will rise in the year 2000.

Diversification of Exports

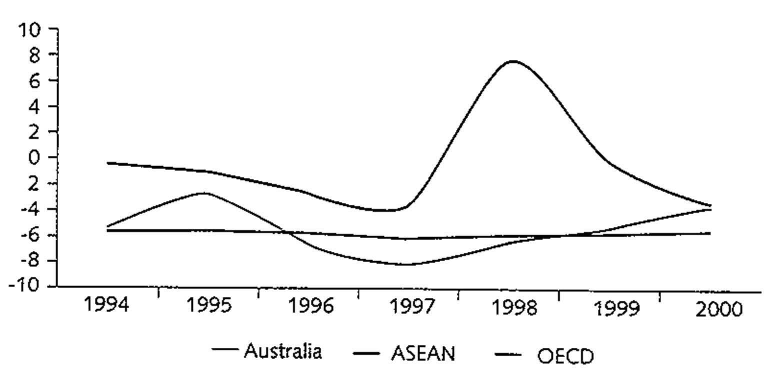
The Australian economy has responded to the economic down turn in Asia by diversifying its export markets to the United Kingdom, the European Union and the United States. Export growth to the UK over the period 1996-1998 rose sharply with

Figure 3: Australia vs. ASEAN and the OECD - Real GDP Growth 1994–2000 annual % change



Source: Ernst & Young

Figure 4: Australia vs. ASEAN and the OECD - Consumer Price Inflation 1994–2000 annual % change



Source: Ernst & Young

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total export values rising from $2.8 billion to $4.7 billion. Overall exports to the European Union rose from $8.4 billion in 1996 to $12.3 billion in 1998. During the same period exports to the North America – specifically the United States and Canada – grew from $6.3 billion to $9.8 billion (DFAT, 1999).

By contrast exports to North Asia saw only most growth over the period 1996-1998 with a fall from $35.4 billion to $35.1 billion from 1997 to 1998. Exports to ASEAN experienced even more significant declines from $11.6 billion down to $10.1 billion over the same three year period (DFAT, 1999).

Despite this, the Asian region continues to be Australia's most important export market taking around 51 per cent of the country's exports. Imports - particularly from Asia - continued to rise as Korean or Japanese manufactured products became cheaper. This has been particularly noticeable in the motor vehicle industry.

Outlook for the Australian Economy

World economic growth is forecast to rise by 2.5 per cent over the year 2000. This will be led by improvements in the European Union and East Asia and supported by economic recovery in Latin America and Eastern Europe. The United States is expected to perform well but uncertainty over the Japanese economy could dampen expectations (IMF/Treasury, 1999).

Federal Treasury (1999) expectations are for a GDP growth of around 3 per cent over the 1999-2000 financial year. Australia's economy is expected to rise in concert with the improved conditions throughout the world. The introduction of the GST is expected to have a limited impact on the Australian economy in the first half of 2000 but Treasury is anticipating a largely positive impact.

Household consumption is expected to grow by up to 3.75 per cent over the period FY 1999-2000 underpinned by falling unemployment levels, real wages growth, low interest rates and enhanced consumer confidence. The impacts of the AMP and Telstra 2 share floats are also considered to impact positively on national consumption along with taxation reform measures (Federal Treasury, 1999).

Investment by business and the resources sector over the course of 2000-2001 is expected to be subdued as the 'Y2K bug' and Sydney Olympics pass into memory. The substantial pre-GST spending – particularly in housing and construction may also contribute to this (Access Economics, 1999).

Over the course of 2000 inflation is expected to remain low with gradual declines in construction. Consumer spending is expected to remain buoyant with the prospects of a 'feast to famine' for retailers as households seek to 'beat the GST' in the first six months only to reduce activity in the latter half of the year (Access Economics, 1999). The impact of the post-Olympic games environment on construction can be measured by the fall in property projects in NSW from around $10 billion during 1999 to a mere $5.7 billion scheduled for 2000.

Preparing for the 21st Century

If we look towards the next century and consider the recent past we can predict a number of **general trends** likely to challenge us over the first few decades from 2000 onwards:

Demographic explosion

Population levels will continue to grow in Asia and Africa while shrinking in the developed world. This will increase the pressure for economic refugees to seek asylum in Australia. Our vulnerable and open coastline may become a battleground.

Communications and the Rise of E-Commerce

The world will shrink as more people connect to the Internet and trade 'online'. Total world E-Commerce is predicted to grow to over $425 billion with users rising from 28 million in 1998 to 128 million by 2002. Radio took 40 years to develop a mass audience of 50 million, Television took 15 years, and cable TV 10 years to achieve the same reach. By contrast the Internet has achieved this in only 5 years. A division may soon emerge however between the 'information rich' and 'information poor' defining those with access to the Internet and those without. This will be particularly critical in education.

World Agriculture and the Biotechnology Revolution

The demand for clean food will rise strongly over the next century as will the need for security of food supply. Biotechnology offers a new potential for Australia. Already this has been recognised by the Federal Government who specifically targeted this area for R&D support.

Robotics, Automation and the New Environmentalism

Robotics and automation should continue to replace the labour force in manufacturing while environmental issues are likely to emerge again as a key political and economic consideration. Of particular concern is likely to be food quality in a world where genetic engineering is rapidly becoming necessary to maintain food security. Debates over greenhouse gas emissions will also re-emerge as devel-

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oping countries – such as China and India - seek to avoid negative impacts on their industrialization, while the developed nations attempt to sustain their competitiveness.

Social Forecasts for the Australian Population

Life expectancy will continue to extend over the next century. For men life expectancy is now predicted at 76 years while for women it is around 81 years. In Australia the number of "Baby Boomers" (aged 40-55) is lower than that for "Generation X" (aged 25-39). Generation X is characterised by a lower commitment to marriage and lower fertility levels. In somewhat equal proportions are "Generation Y" (aged 10-24).

The age profile of the Australian population is likely to have an impact on the property market with the 'Baby Boomer' segment seeking to leverage the equity in their family homes for investment purposes. The property industry may find the competition for this money substantially more fierce if share prices perform well in relation to real estate capital gains.

Alternative residential property opportunities may also emerge as the older age groups - the 'empty nesters' - seek to downsize their homes in favour of more apartments and inner city residential housing. Younger age groups - particularly the wealthier "Generation X" - who may have no commitments to either marriage or kids, could reject the conventional family house in the suburbs for alternative living. If the "Baby Boomer" segment is unable to sell its housing to the 'Generation X' segment some residential property values may decline. This is particularly likely in the outer suburban areas.

The "Baby Boomers" have previously shown a preference for detached housing with substantial floor space and large gardens. As this group ages its preferences are likely to shift toward smaller 'inner city' dwellings. However, concern has been raised over the ability of the 'Baby Boomers' to fund their lifestyles in retirement. Many have little superannuation and are seeking to leverage the equity in their residential property to build wealth over the next 5 to 10 years. Personal household debt levels are rising dramatically – around 15 per cent per annum over the past 4 years – and some 'downsizing' of property may be inevitable in the next decade (O'Connor, 1998).

Finally, as Australia's suburbs sprawl ever further from the CBD the proportion of people seeking to work from home is likely to grow. Enhanced access to the Internet technology will accelerate this process. Lifestyle employment is likely to be particularly popular among the "Generation X" and emerging "Generation Y" groups. Highly computer literate, these demographics are defined by their capacity to seek non-traditional forms of employment based on services and capable of being operated from homes. House design over the course of the next decade may need to include home-based employment.

Where do we go From Here?

To conclude let me address how the future might look - first on a global level - and then in terms of the Property Industry Australia. **On a global level three potential scenarios might emerge** (Hammond, 1999):

1. **A Market World scenario** in which the globalisation of the world economy continues to grow led by free market economics. National industries may disappear in the face of global competition.

2. **A Fortress World scenario** in which poverty and political instability serve to raise trade barriers and polarise the world into the "haves" and "have-nots". Wealthy enclaves will attempt to coexist alongside poverty traps. The potential for political and social upheaval will be high.

3. **A Transformed World scenario** in which the spread of E-commerce and spirit of free trade can both open markets and empower the individual. Greater access to information and willingness by developed nations to assist less developed ones may create enhanced opportunities for all.

It is to hope that the transformed world model is the one that we enjoy, although elements of the other two are likely to be found in our future. Within the Australian property industry the outlook for the coming years is one of challenges and opportunities. The value of property projects across Australia has risen some 14.3 per cent from last quarter 1998 to last quarter 1999 (Access Economics, 1999). Sydney's Olympics construction boom has been reflected in a similar 'mini-boom' in Queensland. Some dampening may be experienced over the course of 2000.

Over the longer term the property industry will face greater deregulation and increasing competition. In real estate there is likely to be convergence between conventional property sales & management and investment advice. This is already taking place but seems likely to accelerate with greater demands being placed upon those in the industry to be better trained and educated. Property will be viewed more as another class of asset to compete for investors dollars along with shares and commodities. Those within the industry will need to be multi-skilled and capable of dealing with a more sophisticated consumer in an increasingly deregulated market place. ■

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Biography

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