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HD **End of the boom; Australia**

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A cooling **Chinese** economy has hurt the mining sector, threatening a quarter century of uninterrupted growth and prompting protests over the prime minister's tough new budget. By Jamie Smyth

The small coal mining town of Singleton was so over-run by contractors seeking jobs during Australia 's decade-long mining boom that some had to join waiting lists for apartments. Unemployment was virtually non-existent and businesses thrived as an army of workers arrived to work in the dozen mines that ring the town.

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"It was so vibrant here it was impossible to keep good staff. Most went to highly paid jobs in the mines," says Danny Gresham, director of the Singleton Tyre and Battery Centre, a local industry supplier.

But in 2011 the world began to change for Singleton, a small town of 22,000 people in the Hunter Valley, about two hours' drive from Sydney. "There have been so many job losses people are coming in and asking us for work now," Mr Gresham says.

Thermal coal prices have halved over the past three years, forcing companies to close unprofitable mines, reduce staff and squeeze suppliers. Brazilian miner Vale said last month it would cut 500 staff as it closes two mines in the area. Glencore Xstrata is mothballing a nearby mine and Rio Tinto has warned the future is uncertain for its Mount Thorley Warkworth mine, which employs 1,300 people, as the coal sector struggles with its worst crisis since the mid-1980s.

The local troubles are emblematic of wider challenges facing the Australian economy in the wake of the biggest boom in capital investment since the gold rush of the 1850s.

For 23 consecutive years, the country was the only developed state in the world to avoid recession. Driven by **China**'s rapacious demand for coal, iron ore and liquefied natural gas, companies committed to investing A$394bn between 2003-2012, says the Australian Bureau of Resources and Energy Economics. This investment boom helped Australia to escape the worst of the global financial crisis and boosted average incomes to a level 25 per cent above those in the US. For a time the Australian dollar was more valuable than the US greenback.

But as investment from resource projects dries up and concerns about the **Chinese** economy have caused a sharp fall in the price of Australia's key exports, iron ore and coal, observers warn a correction is coming. In February unemployment briefly touched 6 per cent - the highest in a decade. The ruling Liberal-National coalition, which was elected in September, is warning that fast-rising government spending has created a " budget emergency ", which threatens Australia's hard-won prosperity.

Last month Prime Minister Tony Abbott unveiled the toughest Australian budget in almost 20 years, which proposes slashing planned spending on welfare, health and education, and raising income taxes for high earners.

"If these necessary measures don't pass the Senate, our triple A rating is at risk and if we lose our triple A credit rating we pay higher rates of interest on our debt," he said.

But Mr Abbott faces resistance this month from opposition parties, which hold the balance of power in the upper house of parliament. Many young Australians, who have no experience of tough economic times, oppose the spending cuts, which have sparked a spate of student protests.

"There is increasing polarisation in politics," says Ian McAllister, professor of politics at Australian National University. "This first budget is very important for Abbott. He has never been a popular party leader and his government has lost support quicker than any other for decades. He faces a challenge getting it passed."

Many economists dispute the government's claim that it faces a "budget emergency" given Australia's 2.75 per cent growth rate, low public debt of 12 per cent of gross domestic product and a modest budget deficit forecast at 3.1 per cent for 2014. But the slowdown in mining investment, weakness in other sectors such as manufacturing and the potential for political gridlock in the Senate point to turbulent times ahead Down Under.

"The problem arose because we spent the benefits of the resources boom as they came in, as if it was going to be with us forever," says Ross Garnaut, economics professor at Melbourne university, and author of Dog Days: Australia After the Boom .

Successive governments under former prime ministers John Howard and Kevin Rudd cut taxes during the boom years of the noughties. OECD figures show Australia reduced income tax rates from 31 per cent in 2000 to 27.4 per cent in 2013 - one of the lowest in the industrialised world. Government spending has increased over the past seven years from 24.8 per cent to 26.2 per cent of GDP, prompting the coalition to propose cuts and tax raises aimed at restoring a budget surplus by 2018-19.

Mr Garnaut argues that Australia is internationally competitive in too few sectors and the country faces lower average incomes and higher unemployment unless radical action is taken. "There is a risk of recession when Australia hits the mining investment cliff, although this is not a certainty," he says.

The resources boom has driven up wages, the price of goods and services and the value of the Australian dollar, making it difficult for exporters to sell their products overseas. General Motors' Holden subsidiary, Toyota and Ford blame this phenomenon, often called the Dutch disease, for the decisions to close all their plants and end a century of car making in the country by 2017.

Australia's National Institute for Economic and Industry Research estimates that up to 200,000 direct and indirect jobs could be lost in the states of South Australia and Victoria as a result of these closures.

"Manufacturing is imploding here in Edwardstown," says Rod Rebbeck, managing director of Multi Slide Industries, a **company** in South Australia that supplies parts to the carmaker Holden. "A few years ago we employed 160 people and now we employ 38. Further jobs will go when car-making ends. A lot of other suppliers here have already closed. It is really traumatic."

Aware of the challenges facing the economy, the Reserve Bank of Australia slashed interest rates to a record low of 2.5 per cent in August last year and has left them unchanged ever since. It is seeking to rebalance the economy, shifting away from resource-driven growth to stimulating other activities such as construction, housing, tourism and agriculture.

The bank says its policy is working, although insiders admit it is not yet clear if resurgent growth from other sectors of the economy will coincide with the sharp drop in mining investment expected later this year.

"Australia's rebalancing act is under way and monetary policy is working," says Paul Bloxham, economist with HSBC. He points to the drop in the Australian dollar from an all-time high of A$1.10 against the US dollar in September 2012 to A$0.92, which is helping boost inward- bound tourism and exports to Asia.

The number of **Chinese** tourists has more than tripled over the past decade to 747,000 in 2013. International student enrolments, which had fallen steadily from a peak in 2009, increased 2 per cent last year to 410,925 as the dollar weakened.

As **China** becomes an increasingly important destination for food and drink exports, leading commentators talk of Australia's transition from the "mining to dining boom". "**China** and Asia are shifting their growth model towards boosting domestic demand, which is not such a bad story for Australia," says Mr Bloxham.

Beef exports to China from Australia surged to 155,000 tonnes in 2013, up from 30,000 a year earlier. This represented almost half of China's total beef imports. Farmers also see opportunities in the dairy sector, particularly if Canberra can ink a free trade deal with China later this year.

Cheap credit is revitalising the housing market, with prices jumping 11 per cent nationally and 16 per cent in Sydney in the past 12 months. There were 188,000 home building approvals in the 12 months to the end of March, which is the highest level recorded since 1995.

The property boom is illustrated by the growing number of high-rise residential towers along the Sydney and Melbourne skylines. Many are being built by Asian developers including Singapore's Frasers Centrepoint, Malaysia's SP Setia and China's Fuxing Huiyu Real Estate.

Greenland Group, one of China's biggest developers, is investing A$1.5bn in Melbourne and Sydney, where it is building the city's highest residential tower and a hotel. It says the first phase of 250 apartments of its 66-floor Greenland centre sold in three hours, raising about A$275m.

"We are contributing important investment, employment and taxes into the Australian market because we feel it is a stable economic and political environment with clear market regulations," says Sherwood Luo, Greenland's managing director.

He argues the country's long history of immigration is a draw for the company. More than 50 per cent of its apartments have been purchased by overseas buyers, mostly from Asia. Every year Australia welcomes 200,000 permanent immigrants, providing a significant boost to the local housing market and wider economy.

Colm Harmon, economics professor at Sydney University, says the RBA's rebalancing strategy is showing initial signs of success with low inflation and a drop in value of the Australian dollar. But he cautions against reliance on a housing boom to fuel growth. "The economy does need to find the long run track," he says. "Manufacturing is not going to be that source, so services, agriculture, education are all areas where the government should be looking."

The coalition is pinning its hopes on growth through enhanced trade with Asia and investment in infrastructure at home. In April, it agreed free trade deals with Japan and South Korea, and is confident of finalising a bilateral deal with China later this year.

Its budget prioritises spending on motorways, ports and airports that should boost employment. There is also a commitment to create the world's biggest medical research fund, a A$20bn investment vehicle funded by an A$7 charge each time a patient consults a doctor. But this measure is one of several expected to be blocked by opposition parties in the Senate following a surge of protests.

Some observers warn the botched presentation of the budget by the coalition has damaged consumer sentiment at a sensitive time and could undermine Australian's two-decade long commitment to prudent economics. A failure by the coalition to get its budget passed in the Senate could pose an even bigger risk as it signals a period of political instability ahead.

"The danger with the negative sentiment surrounding the budget is that it is knocking consumer confidence and could dampen retail sales," says Simon Cox, head of equity capital markets at UBS. "What would be worse is if a political impasse is reached in the Senate and some budgetary measures cannot be passed. This would create uncertainty for companies and investors about the policy framework and business environment in Australia."

Iron ore

Source of heated dinner-party debates

If in the UK people obsess over house prices and the weather, in Australia there are heated dinner-party debates over iron ore and the health of the Chinese economy.

Last year exports of the reddish- brown mineral - the key ingredient for steel - from the Pilbara region in Western Australia surged to A$57bn, making it the most valuable commodity in the country.

Resources are the largest contributor to trade with China, which reached a record A$127bn last year.

A cooling Chinese economy and a surge in iron ore supply have caused prices to slump by a quarter to $92 per metric tonne since January. Goldman Sachs estimates it could fall to $80 in 2015.

"For every $1 drop in the iron ore price there is roughly a A$800m hit to national income and A$300m hit to the tax take," warns Chris Richardson at Deloitte Access Economics. "If China goes bad and the price of iron ore drops sharply, it is possible Australia could have a recession."

The drop in prices coincides with the end of a decade-long boom in mining that has boosted employment and national income, leading some observers to fear a mining bust.

Optimists say a surge in supply from Australia's big miners - BHP Billiton, Rio Tinto and Fortescue - will support the economy regardless of a dip in prices.

Robert Rennie, Westpac Bank's global head of commodity strategy, predicts production will increase from 460mt to 680mt in the next fiscal year.

"The lift in exports will add to growth, it will reduce Australia's reliance on foreign capital, it changes offshore perception of the Australian economy and it will change our status within Asia," he says, forecasting growth of 3 per cent in 2015.

Most economists agree on the vital importance of **China** to Australia's fortunes, and stress the need to insulate its economy against a downturn by diversifying and fixing its budget deficit. "**China**'s economy is becoming more of a market economy and will become more volatile in five years or so when further reforms are introduced," says Marco Annunziata, chief economist with GE.

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