Special Bulletin

A Japanese Perspective on the International Energy Landscape (259) February 17, 2016

Challenges for Australia Facing Resources Recession

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

I had an opportunity to visit Perth in Australia from February 14 through 17. The main purpose of the visit was to attend the fifth Asian conference of the International Association for Energy Economics (IAEE). I discussed various topics with participants in the conference, including Australian energy industry stakeholders as well as energy experts, government officials and businesspersons. The discussions strongly impressed me with resource-rich Australia that has been greatly affected by the present resources recession.

Australia's nominal gross domestic product in 2014 stood at $1.44 trillion, the 12th largest in the world. Per capita GDP was $61,066, ranked fifth. Its GDP continued to expand for 23 years until 2015, since 1992. The mining and energy resources industry has a great presence in Australia, although its major industries also include financial, agricultural, tourism and services sectors. Australia is one of the world's largest coking coal and iron ore exporters. It is also a major steam coal and liquefied natural gas exporter. The country is very rich with coal, natural gas, uranium, iron ore and other resources. As the resources boom continued since the early 2000s, resources and energy exports played a key role in expanding the Australian economy. From 2008 to 2014, its exports grew at an annual rate of about 7%. Particularly, mineral resource exports scored a sharp annual increase of 16%. In 2014, mineral resources and energy accounted for 61% of Australia's total exports. During the period, China grew as an export destination for Australia, replacing Japan as Australia's largest trading partner.

However, the resources boom came to an end on growing supply as well as the world economy's slowdown including the Chinese economy's deceleration following its massive energy consumption. Particularly, crude oil price plunges and LNG price falls since the second half of 2014 have dramatically changed the environment surrounding Australia's resources and energy industry. Australian GDP growth decelerated from 2.7% in 2014 to 2.4% in 2015, according to an estimate by the International Monetary Fund. As for 2016, the Department of Finance, the Reserve Bank of Australia and other Australian organizations have tended to revise GDP growth downward. While the resources sector is plagued with price plunges and a global demand slowdown, the brisk services sector is reportedly supporting overall economic growth. Therefore, business confidence differs from state to state in Australia, depending on industry mixes. Including Western Australia which I visited, Australian states where the resources and energy industry has a great weight have thus indicated great shocks from the resources recession.

The general resources recession affects various resources markets commonly and differently. A common problem for these markets is slowing demand in the Chinese market. China's demand slowdown has greatly affected the whole of Australia's resource exports. Regarding coal and some other resources, particularly, Australia had benefited from export growth depending on China's demand expansion. As a result, the Chinese market's structural supply excess has dealt Australia a double blow consisting of the slack export demand and the price drop. Furthermore, Chinese demand is unlikely to recover in the immediate future. Even in the medium and long term future, recovery in coal demand is uncertain due to environmental measures. In this sense, the current resources recession facing Australia is the most structurally difficult problem.

In the LNG market as well, China's slowing demand has accelerated a sense of glut. In the high oil price period that lasted until the first half of 2014, many LNG supply project investment decisions came on the assumption of robust Asian LNG demand including expanding Chinese demand. As crude oil prices plunged from the second half of 2014, have remained weak and are expected to stay slack, Asian LNG prices linked to crude oil prices have slackened, affecting the profitability of LNG projects. At the same time, natural gas demand levelled off in 2015 in China that had been expected to drive Asian gas demand growth. Demand has also slowed in other Asian countries, adding fuel to a sense of excessive LNG supply. The demand slowdown coincides with production launch for LNG projects subjected to investment decisions during the high-price period, accelerating a sense of excessive supply.

Future LNG supply growth will come mainly from prosperous U.S. LNG export plans and a large number of Australian LNG projects. Depending on production launch for Gorgon and other LNG projects under construction, Australia could rival or replace Qatar as the largest LNG exporter in the world, competing with the United States and Qatar for the position of the world's largest LNG exporter. Although oil and LNG prices are unlikely to remain at the current low levels over a long time, the market environment is likely to stay severe for the Australian LNG industry under an LNG glut expected to remain until around 2020. More frequently, Middle Eastern countries and Russia may attract attention as countries to be affected seriously by crude oil and other commodity market weakness. As resource prices slacken generally, however, impacts of the resources recession on resource-rich Australia will not be small.

Through the discussions in Perth, I felt that conference participants had great interest in the future course of the Chinese market that is a problem for Australia's resources recession. At a time when downside risks still remain, many energy industry stakeholders pay attention to a medium to long-term outlook for the Chinese economy as well as a short-term outlook. I felt that if China fails to recover its massive energy consumption quickly, they would have great interest in India and the Association of Southeast Asian Nations. Regarding Asian demand expansion, conference participants also indicated interests in uranium, a key export item for Australia, as well as LNG, coal and iron ore. They were interested in how many massive nuclear power plant construction projects in Asia would be implemented, how these projects would influence the uranium market and how business chances would be for Australia.

On low crude oil prices as a symbol of resource market weakness, conference participants frequently discussed short-term and medium to long-term outlooks. Interestingly, the "Lower Price Scenario" in the "Asia/World Energy Outlook 2015" by the Institute of Energy Economics, Japan, attracted much attention from them. Amid excessive resources supply, how to secure markets and sales channels and how to respond to conditions and needs for export destinations or buyers are important for Australia. I felt that Australia was growingly recognizing the significance of flexible responses to demand-side needs. As a matter of course, most energy market participants recognize that current market conditions will not last permanently and that the resource market weakness will induce demand expansion and supply investment shortages and bring about major cyclical changes again over a medium to long term. The repetition of excessive cyclical price drops and hikes may eventually create problems both for the supply and demand sides. Although Australia is now plagued with a resources recession, we may have to consider that a cyclical change could reverse the situation to the disadvantage of the demand side again.

Contact: report@tky.ieej.or.jp
The back issues are available at the following URL
http://eneken.ieej.or.jp/en/special_bulletin.html