

Box B

The Mining Sector and the External Accounts

The mining boom is having a significant effect on Australia's external accounts. Export receipts have been boosted by the sharp increase in commodity prices and higher resource export volumes. At the same time, strong growth in mining investment has provided considerable impetus to imports. The appreciation of the real exchange rate associated with the mining boom has increased demand for imports in the economy more generally, while weighing on non-commodity exports. Overall, the trade surplus has increased to its highest level as a share of GDP since the early 1970s.

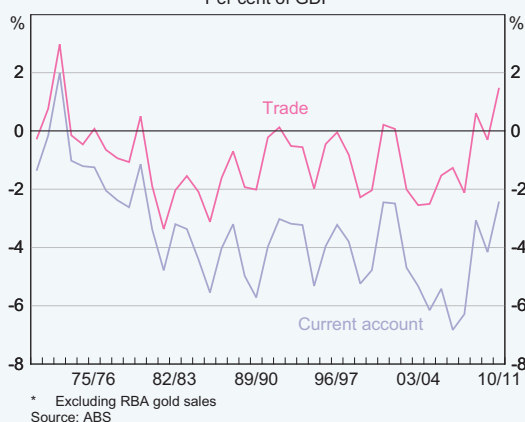
The surge in mining profits has also increased income accruing to overseas residents in the form of dividends and retained earnings, reflecting the high share of foreign ownership in the mining sector. Notwithstanding the increase in income accruing to foreigners, the current account deficit (CAD) has narrowed significantly. From a saving-investment perspective, this recent narrowing has reflected national saving rising more quickly than national investment.

Inflows of foreign investment to Australia's mining sector remain relatively high, helping to fund the large expansion in mining capacity currently underway. Looking forward, the strong upswing in mining investment may lead to some widening in Australia's CAD over coming years. The resulting increases in mining production capacity will, however, eventually lead to significantly higher export volumes, led by liquefied natural gas (LNG), iron ore and coal exports.

Trade Account

Australia's resource export earnings have increased by almost 90 per cent in Australian dollar terms over the past five years to \$47 billion in the June quarter 2011. This has been largely due to a 60 per cent rise in commodity prices in Australian dollar terms over this period (110 per cent in SDR terms), driven by Australia's largest commodity exports, iron ore and coal. Resource export volumes have also increased by almost 20 per cent due to expansions in mining capacity, notwithstanding the recent disruptions to coal exports following the Queensland floods. The strong growth in resource export earnings has resulted in a marked turnaround in the trade balance, from an average deficit of 1½ per cent of GDP over the first half of the 2000s to a surplus of the same magnitude, which is close to a 40-year high (Graph B1).

Graph B1
Trade and Current Account Balances*
Per cent of GDP

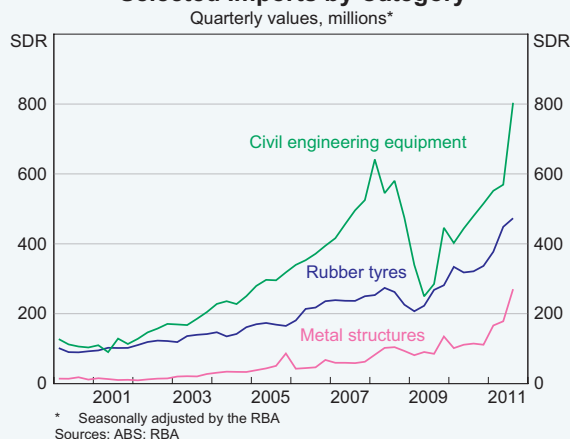


Looking ahead, growth in Australia's resource export earnings is likely to slow somewhat. While export volumes should increase significantly as a large pipeline of mining investment comes online, this is expected to be partly offset by an easing in commodity prices as global mining capacity expands.

Mining investment has been growing strongly over the past five years and is expected to increase to a record high of around 7 per cent of GDP over the next few years, with the construction phase of a large stock of mining projects expected to ramp up or commence over the coming year. A large share of the inputs used for these projects is imported rather than sourced domestically, due to the type and scale of the mining projects; for example, the \$146 billion of LNG projects currently underway or committed will be relying extensively on imported large modularised components.¹ The surge in mining investment to date has been accompanied by a sharp increase in the volume of capital equipment imports, which has risen by almost 75 per cent over the past five years. While it is difficult to specifically identify capital imports that are used in mining investment projects, there has been rapid growth in several import categories that are likely to reflect capital spending by the mining sector. For example, imports of civil engineering equipment, like bulldozers and excavators, have increased very sharply over recent years, as have imports of rubber tyres and metal structures (Graph B2). The expansion in mining production, in addition to mining investment, is also likely to be contributing to stronger imports growth, as

the sector tends to rely on imported intermediate inputs, such as fuel and machinery parts.

Graph B2
Selected Imports by Category



Financial Account

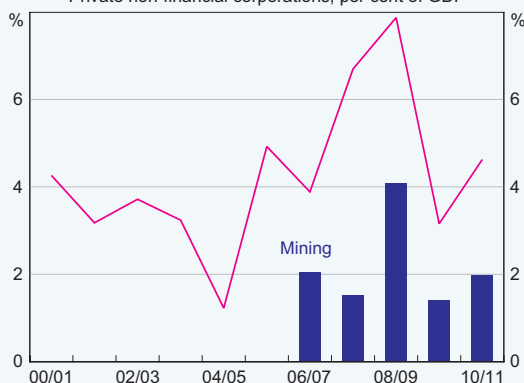
To fund investment, mining companies can either use retained earnings from their local operations (internal funding), funding from offshore parent companies, or external funding (sourced either domestically or offshore, either intermediated or from the capital markets). Data for domestically listed mining companies suggest that over the past decade the share of internal funding has been higher than in other industries, as profits have been boosted by high commodity prices.

However, the foreign ownership share of the mining industry is also significantly higher than for other industries. Most estimates suggest that effective foreign ownership of current mining operations in Australia is around four-fifths, although this varies significantly by commodity and by individual mine. Accordingly, in the balance of payments much of the investment in this sector is treated as being financed from abroad. This includes retained earnings that

¹ The mining boom is resulting in a large increase in imports of high-value capital goods, such as modularised LNG processing equipment. In the National Accounts and Balance of Payments, imports are recorded when ownership changes, which for high-value items often occurs over a number of quarters before the goods arrive in Australia (often approximated by progress payments made during the manufacture of the goods). As some imports of high-value capital goods will likely be identified only when the goods actually land in Australia, imports (and mining investment) may be underestimated in real time and subject to upward revision.

accrue to foreign direct investors.² In recent years, mining has accounted for a large share of the foreign investment inflows into Australia (Graph B3). Importantly, a number of committed LNG projects are wholly foreign-owned, which means much of the investment over the next few years will be funded entirely by offshore parent companies. This should see an increase in measured foreign direct investment flows into Australia.

Graph B3
Gross Foreign Investment Inflows*
 Private non-financial corporations, per cent of GDP



* Excludes flows relating to the reincorporation of News Corporation in 2004/05. Mining data available from September quarter 2006
 Sources: ABS; RBA

Net Income

Australia's net income balance is the net sum of income flows associated with the stock of Australia's debt and equity assets and liabilities. Australia has a persistent net income deficit due to the large stock of net foreign liabilities and because foreigners are estimated to consistently earn higher yields on their investments in Australia than Australian residents receive on their investments abroad. The mining sector mainly affects the net income deficit via the share of mining profits that accrue to foreign investors (through dividend payments and/or reinvested earnings on direct investment). While such data are not available by industry, total reinvested earnings on foreign direct investment have steadily increased as a share of GDP, in line with strong mining profits in recent years. Given the outlook for the mining sector, this trend is expected to continue. ✖

² Direct investors are defined as foreign shareholders with at least a 10 per cent equity stake in the Australian company; all other foreign shareholders are defined as portfolio investors. In line with international practice, retained earnings that accrue to direct investors appear as a notional income flow out of Australia, along with an offsetting financial inflow item for the notional reinvestment of these earnings. In reality, these reinvested earnings remain on business balance sheets in Australia for internal funding purposes.