

AUSTRALIA – ASIA TRADE INFRASTRUCTURE PLAYS CATCH UP

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One simple and practical indicator of the trade surge between Australia and Asia is the fact that important Australian port infrastructure assets are now groaning under the weight of demand.

Some ports struggling

When facilities such as the Dalrymple Bay coal loading complex were first completed, Australians took great pride in their engineering competence, modernity, efficiency and ability to supply the Asian market. The assets are all still relatively modern and efficient but the only problem is that they are just too small – not only are they groaning under the demand, they are failing to meet full expectations.

Other assets, such as coal loading facilities at the Port of Newcastle in NSW, share much the same predicament. Australians are proud that Newcastle is the highest volume coal exporter in the world and the second highest tonnage port in Australia. The only problem, again, is the fact that whatever the pride might be, the port loading facilities are just not sufficient to meet Asia's demand.

Various data can be gathered to show the extent of the growth in trade but the fact that these ports can no longer cope is a proof that the trade has grown at a faster rate than contemplated by the planners – both at company level and at government level.

Uneven trade growth pattern

Analysis of the overall export situation for Australia to Asia shows that the growth is uneven. Some commodities are responsible for the surge in exports and the strain being felt at certain ports. Others are patchy.

Let's itemise the patchy areas first. Due to Australia's long running drought the overall pattern of rural exports to the whole world has declined significantly and remains in the doldrums. Statistics published by the Australia's department of foreign affairs and trade for the December quarter 2004, show that the value of rural goods exported in the period fell by a massive 10% to \$6.3 billion. The volume of rural goods exported during the same period fell by 7%.

To add insult to injury, there was also a fall-off in prices for rural commodities of around 3% showing that not only was supply in a poor state but that demand was not all that healthy either. These figures reflect a fall in certain dry bulk commodities such as wheat and other grains and also include products such as wool, cotton, meat exports and vegetable oils.

Another poor performer has been the services export sector. The December quarter figures show that this sector has diminished by 0.2% to \$8.5 billion and were 3% lower than in the December quarter just one year earlier.

So it is not necessarily true to say that growth of Australia – Asia trade is occurring evenly in all sectors.

Strong lift in general trade

Despite these lacklustre sectors, however, the overall volume of trade in lifting strongly and Asian destinations figure prominently in the growth surge. Overall exports for the December quarter were 12% above the level for the corresponding period in the previous year. In the category of non rural exports the sector of Minerals and Fuels rose by 5% in the December quarter alone.

Sectors of growth

Within the growing market areas, Asia generally and China specifically, represents the bulk of the underlying trade and the prime motivator for the increases in volumes. Examination of the attached side box reveals that not only are world trade figures increasing from Australia, but also the proportion going to Asia has increased significantly over the five year period under review.

The most telling feature about the climb in the Asia-bound proportion is the fact that markets for coal and iron ore were already mature markets bedded down into the pattern of international trade over decades. And so the growth percentages have been achieved from a large base rather than from a small and immature new market.

The LNG market could not be described as mature at this stage as it is still in the ramp up phase. But, here too, the value of exports has nearly doubled in the past five year period and this market will grow substantially as new fields come on line and the specialised ships built to move the LNG. The Asia-bound component of this is by far the greatest proportion with Japan, Korea and China contracting for the lion's share of production. .

Freight as a factor

Australia is well placed with regard to its main competitors to deliver iron ore and other minerals to the China market. With regard to iron ore, the main competitor for large volumes of iron ore is Brazil but, due to Australia's relative proximity to China a significant freight saving is available for the Australian ore. Shipping utilisation on the shorter route is much higher and there is no requirement for the Australian ore to pass though the Panama Canal or around Cape Horn.

Translated into dollar terms the latest long term agreed price for Australia ore for delivery to China is around \$USD57 per tonne delivered including cost, insurance and freight (CIF). The same cost for Brazilian supplied ore is around \$USD75 per tonne. India, another iron ore competitor for Australia, is currently selling iron ore on the China spot market at around \$USD84 per tonne CIF.

The Australian advantages in freight are therefore significant and represent a total annual saving of around \$USD2.0 billion for all Asian customers when compared with the theoretical cost of sourcing all the iron ore from elsewhere.

China underpins growth

Underpinning the entire situation seems the inordinate expansion of the Chinese economy and the enormous demands this is creating for energy and metals production. When the comment is made that China is underpinning everything, the important thing to realise is that the China economy is not growing at the expense of other economies in Asia, it is growing in association with the other Asian economies. China's growing wealth is based on trade and trade implies that both parties must benefit.

China's enormous demand for Australian commodities is driven by its prodigious growth rate – currently expected to grow at between 7% - 9% per annum. This compares with an average of only 3% per annum for the OECD average.

This growth fuels lifting demand in China for iron ore and coal and total demand has reached record levels. Monthly steel production can be used as an indicator of coal and iron ore demand. This has grown from 12 million tonnes per month in January 2001, to more than double by the end of 2004 – to 25 million tonnes per month. Steel production in other major steel producing nations was steady but none of the Asian steel producing nations declined in production. Thus, the extra Chinese steel production means new exports from iron ore and coal mines – many of them in Australia.

Chinese demand is also driven by gigantic national objectives such as the nation's drive to become the world's largest ship builder by 2015. In addition to an already existing mega yard at Shanghai, another is being built nearby to become the largest yard in the world – 15% greater than the world's largest existing yard in Korea. With a production capacity of 8 million DWT per annum, this yard represents a large quantity of Australian iron ore and coal coming out of the ground.

China's gross iron ore imports from 43.9 million tonnes in 1996, to 148 million tonnes in 2003 and 208 million tonnes in 2004. Australia supplied nearly 40% (80,052,260 tonnes) of the total China import for 2004. China iron ore import is forecast to lift to 251 million tonnes in 2005. China already consumes around 20% of the global production of aluminium, alumina, copper and crude steel, close to 30% of iron ore and around 25% of zinc.

Other Asian economies create strong demand

Added to the China expansion factor is the fact that, while some of the other economies in Asia are not expanding as rapidly as China's, they are still massive economies with massive demand for Australian economies. While it is easy to become fascinated by the growth of the China figures, this needs to be put in context with the fact that it is the trade with the whole region which is burgeoning.

Japan is still the world's second largest national economy behind the United States and demand in economies like Japan and Korea are still being sustained at a high level. Despite the attention and hype that is going towards the China industrial expansion, let us not forget the fact that Japan and Korea together accounted for a massive 68% of the world's new ship building orders for 2004.

To illustrate the broad nature of the Asian demand it is worth considering that, despite all the fuss about the growth of the China market, the combined purchasing demand from Japan and Korea is still substantially greater than that of China. In 2004 Japan and Korea, accounted for 131.5 million tonnes of coking and thermal coal from Australia. In the same year, China accounted for 6.5 million tonnes. In 2004 Japan and Korea accounted for 107.1 million tonnes of Australian iron ore while China accounted for 80.0 million tonnes.

Supply chain challenges

The scale of the supply chain problems referred to earlier can most clearly be seen in the case of Dalrymple Bay in Queensland. The coal loading facility helps clear export coal from the central Queensland area.

When first built the facility had a capacity of 60 million tonnes per annum (mta) and a state government regulator appointed to control the fees charged by the loader to the coal exporters. At the centre of the bottle at the moment is the fact that the operator refuses to invest in new capacity because it says that the current fee levels charged to coal producers is not sufficient to allow the investment. The operator has plans to extend capacity to 90 mta but these are completely stalled pending resolution of the dispute..

Meanwhile a fleet of up to 50 coal ships awaits in a queue outside the port for their turn to load. Demurrage costs involved with this queue are enormous – estimated by Queensland coal industry spokesperson, Ken Talbot, at \$500 million for the next twelve months alone. The mining industry has called for urgent investment of \$3.2 billion in upgraded port facilities and railways to handle the expected increase.

Producers expect that production from central Queensland, alone, will rise from its current total level of 135 mta to as much as 215 mta in just five years – by 2010. With these type of predictions – based on a realistic understanding of the growth of the China market – it is time for Australian companies, state governments and regulators to really shift their minds into higher gear if the growth of the Australia- Asia trade is to be sustained.

There is now a long-term demand for Australia's coal and that prices are likely to remain at their current high levels. An earlier Asian coal boom was experienced by Australian exporters in the early 1980's when all the demand was coming from Japan. The difference with the situation now is that the strong demand still exists in Japan and the other more mature markets such as Korea. The Asian demand is much more broadly based than in other commodity export booms. Strong demand is coming from all major markets.

Similar infrastructure problems exist at Newcastle where the port has a nominal approved capacity of 102 mta but, through supply chain problems of its own last year, achieved only around 86 mta during 2004. The state government is moving to address the shortfall in capacity with the Premier recently announcing tenders for a third coal loader to be built in the port. The estimated cost of this project is around \$500 million but the big snag is that work is not expected to commence until 2008 and completion is not expected until 2011.

The same problem of lead time exists at Dalrymple Bay. Even if construction were to commence right now there could be a two year lead time and what would be preferable would be if the two year construction time was coming to completion now.

Need to align interests

Perhaps the supply chain problems are best solved at those coal and iron ore ports where there is a clear alignment of interest between the coal and iron ore producers and the port operators. One case of this is the BHP Billiton owned and operated facility at Hay Point. There is no queue at Hay point and no demurrage problems either. BHP Billiton as the coal owner and the port operator is expanding capacity without having to wait the approval of a regulator about loading costs.

The Rio Tinto iron ore loading facilities at Port Hedland are another case where the clear alignment of interests between the miner and the port operator makes for better reaction decisions to the growing Asian demand.

Conclusion

With the massive upsurge in wealth creation underway in Asia – most notably in China – the growth of Australia-Asia trade is on the increase. The Australian side to this trade partnership must, however, take firm measures to make sure that the infrastructure bottlenecks are cleared with a little more urgency than seems to be the case at the moment. The time has come for Australians to get as serious about national development as are our main Asian trade partners.

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FIVE YEAR GROWTH IN ASIA PROPORTION OF TRADE

In the five year period from 1999 to 2004, the proportion of Asia-bound trade lifted across several significant commodities.

Commodity	Year	Total volume Volume Million tonnes	Asia Volume. Millon tonnes	Percentage to Asia
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Thermal coal	1999	78,694,468	69,732,009	88.6%
	2004	106,874,468	98,345,846	92.0%
Coking coal	1999	91,956,735	55,729,916	60%
	2004	116,835,710	79,608,557	68%
Iron ore	1999	139,277,768	121,426,116	87%
	2004	210,270,357	198,417,251	94%
Alumina (public record)	1999	393,260	231,194	58%
	2004	314,513	215,044	68%

Note about alumina: Gross exports for 2004 were 13,654,890 million tonnes
But a staggering 13,340,377 were confidential sales in which no country of
Destination was recorded.

LNG by value

Total LNG sales in 1999 were \$AUD1,458,116,282 (\$1.4bn). By 2004 annual sales lifted to \$AUD2,594,198,598 (\$2.6bn). The increases in LNG sales were almost exclusively within Asia.

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