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THE CAIRNS ECONOMY THE COMING BOUNCE BACK

A DIFFERENT CITY

Cairns is a highly successful growth city.

However, to share in that success, it is important to recognize that the city's sources and patterns of growth can be quite different to those of metropolitan centres and regional cities in southern Australia. It is important to understand in some depth the structures, driving forces and factors that influence Cairns' short and long term growth.

A LONG-TERM GROWTH TRAJECTORY

The economy of Cairns has shown strong growth over a long period of time.

In every decade since the 1950's, population growth has averaged in the range of 2 - 4% per annum. Long term average has been about 3% per annum. This pattern has continued this decade with average residential population growth 2000 to 2008 again 3% per annum (see **Table #1**). Apart from residential population, visitor population has been growing and census count population (ie. total on-the-ground including visitors) has risen 1976 to 2006 from 48,753 to 143,436 at an average rate of 3.7% per annum – a rate well above other Australian cities with the exception of the fringe metropolitan cities of Sunshine Coast and the Gold Coast (see **Table #2**).

SUSCEPTIBILITY TO EXAGGERATED SHORT-TERM SLOW DOWNS

However, the city's success leads to a susceptibility to periodic exaggerated slow downs and the annual pattern has not been smooth.

Periods of very strong growth lead to very high construction rates that can push growth even higher. This can result in the city being susceptible when negative shocks come along and the construction rate falls back strongly with downward multiplier effects.

While Cairns has a history of very strong growth and exaggerated slow downs, it also has a history of strong bounce backs.

SOME PREVIOUS SLOW DOWNS & BOUNCE BACKS

In the three years, 1986, 1987 and 1988, visitor nights in hotels and motels in the Cairns region doubled. a massive building boom took place, and population grew by 20% over the five years 1985 to 1990.

In 1989 (at a time when the building rate was overshooting), the pilots' dispute followed by the 1990/91 recession hit the city hard with population growth dropping from 5.1% in 1988/89 to 1.2% in 1990/91. However, the rate quickly rose again and four years later in 1994/95, the population growth rate was back to the very high level of 4.9%.

The Asian Crisis in 1998 also slowed Cairns' growth and events like 9/11, the Iraq War and Sars prolonged the slow down falling to 0.5% in 2001.

But in 2002, it jumped back up to 2% and then rose to record 3.6%, 4.0%, 3.5%, and 4.1% in the four years 2004/05 to 2007/08.

THE PRELUDE TO THE GLOBAL FINANCIAL CRISIS

Thus, in the financial year before the global crisis hit, Cairns was recording a residential population growth rate of 4.1% and the sprawling underdeveloped region that Cairns services recorded a population growth rate of 3% - the fastest in Queensland (ahead of both the Gold and Sunshine Coasts), and second only to the Margaret River region in Western Australia.

Building approvals were running up at levels of over \$1bn and on a par with the State of Tasmania.

However, before the global financial crisis hit in July/August 2008, the city received a series of shocks coming out of the excesses of the preceding high growth periods. Two of the region's major developers had overstretched themselves financially, were in trouble and having to pull back on development plans. Under the influence of a sky high Australian dollar, Japanese tourism was being affected and Qantas/Jetstar made a precipitous decision in June 2008 to drastically cut flights between Cairns and Japan.

Visitor numbers from Japan were running at about 200,000 per annum. The new flight capacity to come into effect later in the year would carry, at the best, 130,000 a year.

However, Cairns' tourism is spread over a range of markets, domestic and overseas, and the nett effect of the cuts promised to reduce tourism income by only about 3 – 4% and of gross regional product only about 1 - 1½%. However, the decision affected confidence and expectations markedly. Building approvals started to fall, but with a great deal of hangover work still to be completed, the city's economy continued to run along at a high level until the end of 2008.

THE IMPACT OF THE GLOBAL FINANCIAL CRISIS

Progressively during 2009, the economy of Cairns was hard hit. Building approvals plummeted from their previously very high levels, especially for flats and for non-government general construction.

Apart from Japanese tourism, other markets were damaged by the crisis including China, but also the long distance travel markets UK/Europe and North America. The situation was made worse by the Reserve Bank giving indications they intended to raise interest rates back up again at a time when Australian rates were already higher than overseas. The value of the Australian dollar shot back up again making the local tourist industry less competitive.

By end 2009, indications from industry surveys and airport statistics were that overall visitor numbers were down by about 8% and income probably by over 10%.

While the region received its share of government household and first home buyer stimulus money, a further blow occurred in mid-2009. When the federal government's major infrastructure spending was announced, it included very little for the Cairns region.

In the second half of 2009, local businesses were complaining about bank lending attitudes to proposed developments in the region as contributing to the problems.

Against this background, unemployment rose sharply during 2009.

Cairns as a desired place to live usually had more people arriving than jobs and has traditionally run a relatively high unemployment rate along side a high job creation rate. It went into the crisis with an unemployment rate of 5%. This rate shot up over the year to peak in the 11 – 13% range by about September, recording the highest levels in Australia.

THE UNDERLYING SITUATION NOT THAT BAD

However, it needs to be appreciated that the underlying situation in the regional economy was not that bad and much of the reaction to the global financial crisis has been panicky and exaggerated.

One of the problems was an exaggeration of the dependence of Cairns' economy on tourism.

Cairns' primary economic role is that of being a regional servicing capital – a transport, distribution, manufacturing, administration and services hub for the Far North Queensland region. Although tourism is important in the economy, the region is also the largest agricultural region in northern Australia with a gross value of production about the same size as Tasmania.

The region has significant forestry and fishing sectors. Its strategic position gives it a role as Australia's north east naval and air surveillance base.

The city has an important servicing role, especially for mining activity, across the north and into Papua New Guinea and Papua Indonesia with air links into 16 different mining related centres. It is the major maritime activity centre in northern Australia. Cairns airport is Australia's major north eastern gateway with a major aviation industry servicing capacity.

In fact, the combined total of 'other' activities earning income from outside the region has been exceeding tourism by a ratio of about 60 to 40.

While the global financial crisis resulted in a short-term check to mining activity, the other sectors earning outside income have held up. In fact, in the agricultural sector, record sugar prices are currently pumping something like \$200m a year extra into the regional economy.

Overall, the medium and longer term forward prospects for the Cairns regional economy remain excellent. A strong bounce back can be expected over the next few years.

THE TOURISM REBOUND

There are a number of indications that tourism will rebound progressively as 2010 progresses. There have been some fundamental changes that can be expected to impact favourably on the sector.

In the first place, during 2009, Cairns airport management passed to private ownership from being controlled by the State Government with increasing political interference resulting in disastrous results in recent years.

The benefits of the change are already becoming evident as negotiation of new airline arrangements take place.

In the second place, the shock of the loss of the Japanese flights led to major new *Tourism Repositioning* research funded by the Commonwealth Government. This has helped provide new impetus and direction to the sector's marketing activity. The shock has also seen the sector price itself more competitively in the market place.

Finally, the Australian Government has changed its air services regulatory regime. The new rules will allow international carriers coming in from overseas to pick up in Cairns to carry on to third countries. Thus, for instance, Air New Zealand would be able to come into Cairns and pick up passengers for Asian destinations. Emirates could fly into Cairns and carry between Cairns and Fiji. In addition, overseas airlines that fly into regional cities like Cairns will receive more favourable consideration of rights to fly into metropolitan airports.

Against this background, Auckland airport have indicated they will take a 25% share in Cairns airport, extending the already existing ownership and management links between Cairns airport and the Gold Coast airport.

These foregoing factors have already been coming into play to help transform the prospect for air services into Cairns.

Additional domestic services announced include:

- Extra daily flights from Sydney and Melbourne and capacity expansion from Brisbane - a total of over 3,000 seats a week.
- Step up of flights from Adelaide from 4 per week to daily flights and from Perth from 3 per week to daily flights - an increase of about 1,200 seats a week.

Total annual extra seats is about 230,000 per annum.

Additional international flights announced include:

- Japan - Jet Star daily flights from Osaka - extra seats about 1,200 a week.
- Guam (links from Japan) – Continental Micronesia to step up from 2 to 4 per week with additional 3 per week seasonal mid-March to mid-April - extra seats about 300 a week plus 465 a week seasonal.
- New Zealand - Pacific Blue 2 new services per week from Auckland - about 300 seats a week.

Total additional international seats is just short of 100,000 a year.

We thus have an expansion of capacity that at a 70% load factor would accommodate about 160,000 additional domestic visitors and about 70,000 additional international visitors. This would provide for an expansion of total domestic visitors by over 10% and international visitors by close to 10%.

The *Tourism Repositioning* research carried out early in 2009 particularly indicated how comfortable Japanese visitors were in visiting Cairns and the level of disappointment both among visitors and in the Japanese travel industry at the reduction of air services. There is a widespread expectation that a strong re-expansion of Japanese visitor numbers will take place when the new services commence.

Of potential importance also, recent tourism statistics from Japan have been indicating that the long decline in Japanese outbound travel may be ending. The four months to November 2009 show a positive trend compared with the same months in the previous year. Examination of figures by destination indicates that major beneficiaries were relatively close tropical destinations of Guam and Hawaii. This augers well for Cairns (whose figures were not separately recorded) which is also a tropical holiday destination the same distance from Japan as Hawaii, but with the advantage of being almost in the same time zone.

The additional Pacific Blue flights to New Zealand will provide competition to the existing Air New Zealand flights.

Cairns' penetration of the New Zealand market has been surprisingly low in the past. However, strong linkages seem likely to build up, in part, because of potential new air linkages via Cairns to Papua New Guinea, Pacific and Asian centres.

The daily domestic services from Perth and Adelaide are also likely to be more than just about domestic tourism to Cairns. In both cases, the services potentially provide a route for travel between those areas and Japan.

However, Cairns airport also is a hub point for fly-in services to the major mining developments across north eastern Australia, Papua New Guinea and Papua Indonesia. Mining in South Australia is expanding strongly and Perth is now the major centre for mining companies and support services in Australia. The major LNG and other projects currently underway in Papua New Guinea (see below) are likely to generate substantial traffic from Perth via Cairns.

EXPANDING EARNINGS FROM AGRICULTURE

Cairns services an underdeveloped frontier region 1½ times the area of Victoria and as large as the British Isles. The region accounts for 27% of the nation's water runoff. Its Mitchell River basin alone has a water run off equivalent to the whole Murray Darling system. Agriculture in the region has been expanding in real terms at an average of about 2% per annum. It is the major fisheries and forestry region in northern Australia.

The region's large underutilized water resources are of increasing interest for meeting national demand for agricultural products against a background of concerns about the impact of climate change on traditional producing areas in southern Australia. The region is well positioned to benefit from expanding world demand, especially from nearby Asian markets, for foodstuffs, and of potentially increasing importance, biofuels, bioplastics and other bio based industrial products.

High world sugar prices are currently bringing an additional \$200m per annum into the regional economy.

MINING RESURGENCE

Cairns is in an excellent position to supply workforce and other services as mining expands in its own region, but also because of its air links, throughout the wider north Australia, Papua New Guinea and Papua Indonesia area.

Within the region, Kagara are gearing up to commence gold mining operations at Chillagoe, Rio Tinto recently put on 60 extra staff at Weipa and a new bauxite export operation is due to commence north of Weipa.

Plans for new phosphate mines in north west Queensland/adjacent Northern Territory area are underway along with a major expansion of coal mining in central Queensland. To Cairns' immediate north, a go ahead was given late in 2009 to the Esso Highlands \$15billion LNG project near Port Moresby. A second similar size project by Interoil is being planned.

Two major companies operating in Papua New Guinea have bases in Cairns (Interoil has a staff of 60). The major Australian buying base for Freeport Indonesia is located in Cairns with air services to the mine and shipping operating from Cairns on a ten-day cycle carrying over \$300m of cargo a year. Two other mining companies with operations in Papua New Guinea are currently looking at locating substantial staff in Cairns with one looking at relocating their shipping and supply services to come out of Cairns.

CITY SERVICES GROWTH

As observed earlier, Cairns city's primary economic role is that of a regional servicing capital. Population in Cairns and the region it directly services is now the largest in northern Australia and rapidly approaching 300,000.

Over the past 20 years, the city has passed in size seven (7) other Australian regional cities. Apart from leading the north in population, the Cairns region now leads the north by a long way in business numbers, in retailing, in employment, in finance and business services and in manufacturing locations.

The city's growth has been private enterprise led with government provided services often slow to catch up. It is however, benefiting at present from a catch up taking place in government funded services.

James Cook University are aiming to lift their student numbers from 3,000 to 5,000 over the next 5 years. They are in the process of establishing their new Dental School at the Cairns Campus. An international research centre called the "Cairns Institute" is being set up to become a centre of excellence for social science studies in the world's tropics. A research facility at Cairns Campus funded by the Gates Foundation has become a world leader in efforts to beat dengue fever.

A \$400m upgrading of Cairns Base Hospital is underway. A \$400m upgrading of the Lotus Glen Correctional Centre is underway and new government offices are under construction in the CBD.

AVIATION & MARINE SERVICES HUB

Cairns is the major air transport hub in north east Australia with direct links across Australia and into six Asia/Pacific cities. It is home of a major aviation servicing sector that is expanding its services into a growing Asia/Pacific market.

Cairns dominates the north in terms of marine activity. Locally based shipping includes Australia's largest tourism fleet, a large fishing fleet and a range of trading and work vessels. It is the home of Australia's north eastern operational naval base with a workforce of about 900. Cairns' slipways and marine services sector is of national significance with markets reaching into the Pacific. Government funding has been made available to build a new maritime training college. Funding has also become available to upgrade the city's cruise ship terminal to enhance the city's growing role as a cruising port.

GOVERNMENT RESPONSE

It has taken the government a substantial period of time to get a number of its stimulus programmes underway.

Although the region missed out in the government's major infrastructure spending package announced earlier in 2009, the rapid escalation of unemployment has led to a strong reaction from the government in the second half of 2009 to target the region for special additional spending.

However much of the impact is yet to be felt.

Only half of the first round of the government schools' upgrading programme is underway and a further second round will be decided in March. Only a few of 300 'social' houses to be built in the region have been commenced. The bulk of the \$1.16bn Remote Indigenous Housing programme will be spent in the region but is yet to get underway. There was little in the first round of the "Jobs Fund" for the region. Given the high unemployment rate that developed, it is expected that something like \$10m in second round funding will be announced shortly.

It can thus be expected that full impacts will not start being felt until the middle and second half of 2010.

THE NEXT TWELVE MONTHS

Of critical importance, the data available indicates that the region held its population during 2009 and rising unemployment levels were associated with a population that was continuing to grow. The unemployment did not result in losses of population.

There is now evidence emerging that the region's level of unemployment has peaked and is starting to recede.

Numbers receiving unemployment benefits (Newstart and Youth Allowances) peaked in July and has fallen back in August to November but with a small seasonal upswing in December. The ABS unemployment series are based on a sample survey and the extent of month by month changes can be inaccurate. However, the series is indicating that the seasonally adjusted unemployment rate probably peaked about September, and that the employed workforce is moving back up again.

It is normal that a seasonal lull occurs during the wet season period, January to March. It is our expectation that from about April on, an upswing will be evident:

- As the additional airline capacity starts coming on stream.
- As the various government programmes start to reach full delivery.
- As financial confidence continues to return.

Overall, we expect that Cairns' current construction downturn with major impacts on employment levels, is likely to be short lived and the city and region can be expected to return to its strong long-term growth trajectory over the next few years.

THE NORTHERN BEACHES AREA

Cairns as a city lies on a relatively narrow coastal plain backed by high rainforest clad mountains. The city has long expanded beyond its central area, northward along the beaches area and southward down the valley towards Gordonvale.

In recent years, the expansion to the north and the south has been about equal. While in the coming decades, there will be more room for the city to expand southwards, the Northern Beaches area properties are generally at a premium because of the ambience of the beaches and proximity to the city.

The beach locations are also highly desired as tourism locations. The location of the still relatively underdeveloped and expanding university campus in the area, along with growth of sub regional shopping and service centres, is likely to underpin growing employment opportunities in the area.

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THE COMING BOUNCE BACK**

Table #1: Actual Average Annual Growth Rates of Estimated Residential Population Cairns' Urban Area by Decades

1950 – 1960	3.2% per annum
1960 – 1970	2.0% per annum
1970 – 1980	4.0% per annum
1980 – 1990	3.6% per annum
1990 - 2000	2.9% per annum
8 years 2000 - 2008	3.0% per annum

Source: Cummings Economics from ABS data.

Table #2: Census Count Population Growth, Australian Cities, 1976 to 2006

	1976 Census	2006 Census	Av Annual Growth
<u>Metropolitan</u>			
Brisbane	985,900	1,782,976	2.0% pa
Perth	820,100	1,444,500	1.9% pa
Sydney	3,094,800	4,148,574	1.0% pa
Melbourne	2,672,000	3,592,765	1.0% pa
Adelaide	912,100	1,102,843	0.6% pa
<u>Sub Metropolitan</u>			
Sunshine Coast	62,664	293,904	5.3% pa
Gold Coast	125,600	518,198	4.8% pa
Canberra	221,800	327,595	1.3% pa
Newcastle	370,500	489,602	0.9% pa
Hobart	162,700	198,946	0.7% pa
Wollongong	218,900	261,865	0.6% pa
Geelong	135,600	159,294	0.5% pa
<u>Regional</u>			
Cairns	48,353	143,436	3.7% pa
Darwin	46,655	117,332	3.1% pa
Mackay	39,500	72,687	2.1% pa
Toowoomba	66,436	114,325	1.8% pa
Townsville	88,753	148,414	1.7% pa
Albury Wodonga	63,409	96,095	1.4% pa
Bendigo	55,152	81,160	1.3% pa
Rockhampton	51,669	69,964	1.0% pa
Ballarat	68,450	84,654	0.7% pa
Launceston	81,636	99,103	0.6% pa
Orange Bathurst	55,933	66,196	0.6% pa

Source: Cummings Economics from ABS data.