

Recent trends in trade between Australia and the European Union

With its most recent expansion to encompass 27 countries, the European Union (EU) is now home to around half a billion people. The EU accounts for over a third of the world's total trade.

In 2006, Australia's total two-way trade with the EU was valued at \$75.0 billion. The EU, as a whole, was our largest two-way trading partner in 2006, our second-largest market for exports (behind Japan) and our largest source of imports.

The EU has a stable and predictable regulatory framework and, with its economy growing at a steady pace, the EU market represents a sizeable opportunity for Australian exporters. Australia's robust economic conditions also provide a business environment conducive to expanded trade and investment with the EU.

Recent trends

Exports of goods and services

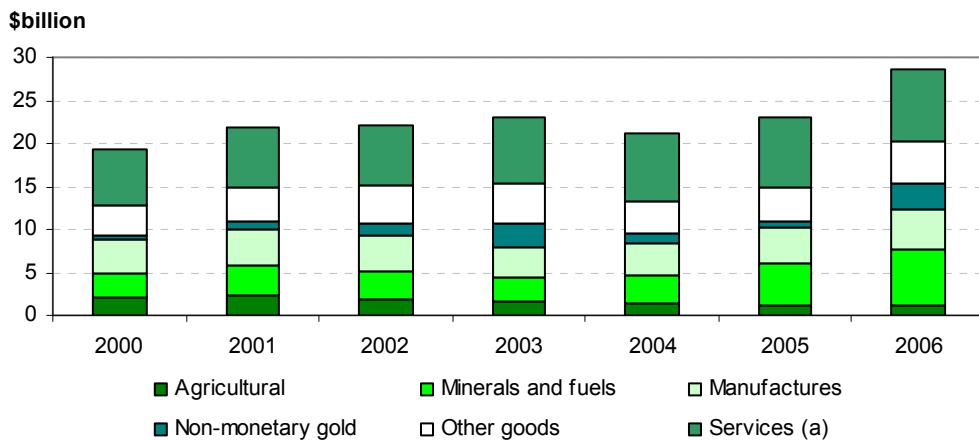
Total goods and services exports to the EU increased by 25 per cent to \$28.6 billion in 2006 (**Figure 1**). Merchandise exports to the EU were worth \$20.3 billion in 2006, an increase of 36 per cent on 2005 merchandise exports. A key driver of this result was the 370 per cent increase in our exports of non-monetary gold to the UK. Excluding non-monetary gold, our total merchandise exports rose by 21 per cent to \$17.4 billion in 2006.

- Minerals and fuel exports (not including gold) rose by 35 per cent to \$6.4 billion in 2006, reflecting the strength of commodity prices.

Coal exports (our top-ranking export to the EU) were up 8 per cent to \$3.7 billion, other ores increased by 157 per cent to \$1.0 billion and nickel ores more than doubled to \$895 million.

- Manufactures exports increased by 8.7 per cent to \$4.7 billion, with elaborately transformed manufactures up 3 per cent to \$3.6 billion and simply transformed manufactures up 37 per cent to \$1.0 billion reflecting strong growth in leather goods and inorganic chemicals.
- Rural exports increased by 8 per cent to \$1.3 billion in 2006.

Figure 1: Australia's exports to the EU



(a) Includes EU15 only until 2004.

Source: ABS trade data on DFAT STARS database and ABS catalogue no 5368.0.

- Services exports to the EU grew by 4 per cent in 2006 to reach \$8.3 billion. Solid increases were recorded in our exports of business-related travel services and computer and information services.

Direction of trade

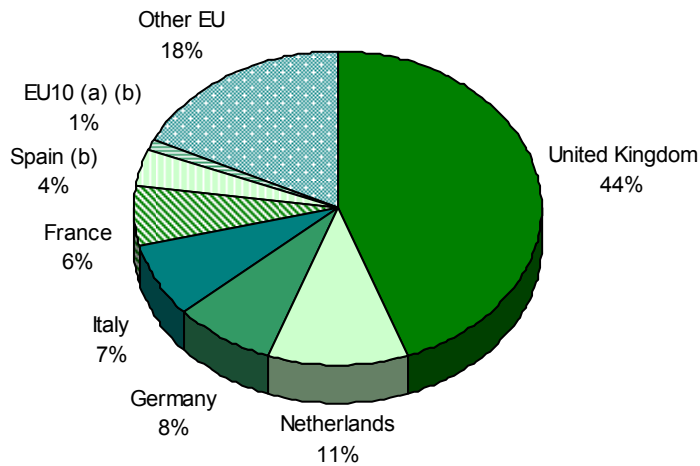
The UK is the largest destination for our exports to the EU accounting for 44 per cent of our total exports to the EU in 2006, with gold being a significant component (**Figure 2**). Over the last five years, Australia’s exports to the Netherlands and Spain have shown robust growth. The newer EU member countries—the EU10—are growing as

export markets, though from a lower base—in 2006 total Australian merchandise exports to these countries rose by around 40 per cent to \$270 million.

Drivers of export performance

Our major exports to the EU have grown strongly over the last five years, with the exception of wool (**Figure 3**). Prices of commodity exports such as coal, iron ore, nickel ores, and other ores have been markedly higher in the last three years, reflecting the strong world demand for resources. Wine and medicines have continued to expand their markets in Europe.

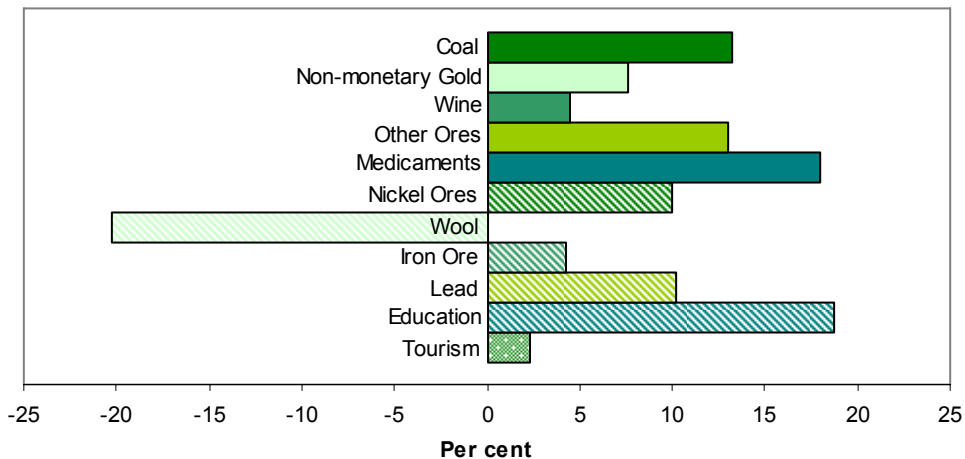
**Figure 2: Direction of trade 2006
(Per cent of Australia’s total exports to the EU)**



(a) EU10 includes Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia.
(b) Merchandise trade only.

Source: ABS trade data on DFAT STARS database and ABS regional services data.

**Figure 3: Five-year average growth of major exports
2001 to 2006**



Note: Education and Tourism data are for EU15 only until 2004.

Source: ABS trade data on DFAT STARS database and ABS regional services data.

Coal exports

Currently, the EU is Australia's second-largest market (after Japan) for coal exports. In 2006, exports of coal to the EU grew by 8 per cent to \$3.7 billion. Notwithstanding commitments by European countries to source a greater share of their energy supplies from renewable sources such as wind, solar and biofuels, it is expected that there will continue to be strong demand for Australian coal in Europe.

The EU's Strategic Energy Review, released in January 2007, concluded that 70 per cent of Europe's energy sources will be imported by 2030. The German Government recently reached agreement with the German coal-producing states and the key trade unions about ending coal mining in Germany by 2018, primarily because of the economic inefficiency of the industry. As a result, coal imports are likely to figure in the energy mix for the EU for many years to come.

Gold exports

A significant component of our total exports to the EU comes from our exports of non-monetary gold to the UK (the UK being a key world gold trading centre). Australia exported \$2.9 billion worth of gold to the UK in 2006, an increase of 370 per cent on 2005's \$620 million (**Figure 4**).

The increase in gold exports partly reflects an increased price of gold. However, a feature of world gold markets in recent years has been the growing number of 'exchange traded funds' allowing investors to invest in gold without having to physically hold it. The AGR Matthey Gold Refinery in Western Australia offers such services in addition to its refinery function. As a result, gold can be sold by producers to overseas buyers, whose gold holding accounts are credited but the

physical gold (on which claims are held) continues to be held at the refinery. This 'location swap' means that there is no need for producers to physically transport gold overseas when trade in gold takes place. AGR Matthey now has offices in five of Australia's state capitals, as well as Auckland, Hong Kong and China in response to the global nature of the gold trade.

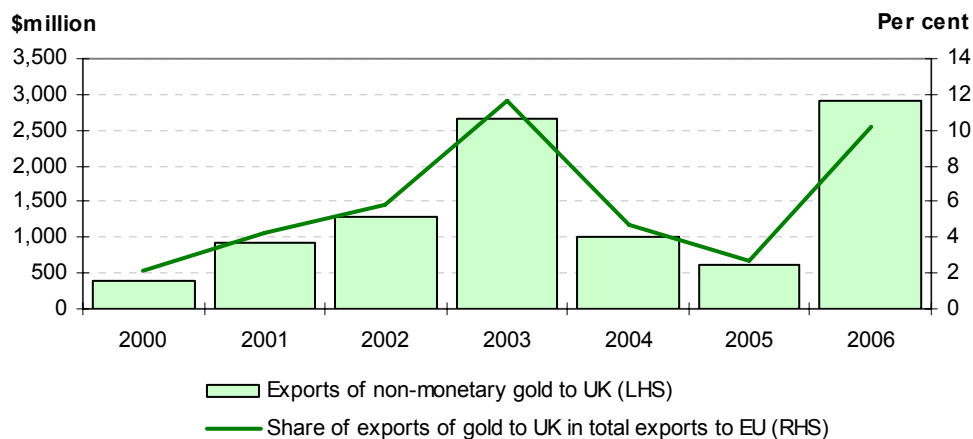
Wine exports

Exports of wine to the EU have shown average yearly growth of 4.5 per cent since the start of the decade. In 2006, Australia exported \$1.3 billion worth of wine to Europeans. The UK is our dominant export market receiving 72 per cent of our total wine exports to the EU.

Australian wine exporters are also actively and effectively increasing their presence in the continental Europe wine market. For example:

- Australia's wine exports to Denmark reached \$53 million in 2006 and have grown by around 21 per cent each year since 2001. More than 225 Australian brands are sold in Denmark.
- Wine exports to Sweden have grown by 16 per cent per year over the last five years to be worth \$45 million in 2006. There are more than 100 Australian wines available through Sweden's state-owned, monopoly alcohol retailer.
- Eastern Europe is emerging as an export market. Over the past five years, wine exports to Poland have grown by an average rate of 46 per cent per year to \$2.3 million in 2006, while wine exports to the Czech Republic have grown by an average rate of 47.8 per cent to \$1.1 million.

Figure 4: Australia's gold exports to the UK (A\$ million and per cent of total exports to the EU)



Source: ABS trade data on DFAT STARS database.

The 1994 European Commission-Australia Wine Agreement has been a valuable tool in facilitating Australian access to the European wine market. A Revised Wine Agreement was initialled in Canberra on 5 June 2007 by the chief Australian and EU negotiators. It will provide further benefits to the Australian wine industry, including recognition by the EU of Australia's wine making practices, a streamlined process to approve new practices, as well as simplifying labelling provisions. The Revised Wine Agreement is expected to come into effect in 2008.

Wool exports

Australia's wool exports to the EU were worth \$1.2 billion in 2001. In 2006, they had fallen to \$453 million. Structural changes in the European wool industry over the last five years have resulted in lower demand for Australian wool. This is due mainly to some European wool processors shifting their operations to lower wage countries. However, the European textile industry (especially in Italy) has improved its competitiveness following industry consolidation, which should support Australian wool exports in coming years. In particular, Italy's leading textile companies will remain key players for high quality merino wool.

Education

Australia's education-related services exports to the EU(15) displayed trend growth of 19 per cent per year between 2000 and 2004 to reach \$517 million. In the two years since EU expansion, education exports have risen further to be worth \$635 million in 2005 and \$694 million in 2006.

In 2006, almost 26,700 students from the EU were enrolled in Australia—around 7 per cent of total foreign student enrolments. The UK, Germany, France, Spain and the Netherlands have been the source of especially strong trend growth in enrolments and commencements over the past five years. Austrade recently signed an international education agreement with Sweden to support growth in this market.

Recreational travel services exports

The EU as a whole is the source of the most overseas visitors to Australia, with 1.3 million Europeans visiting in 2006. Recreational travel services exports have grown at a steady rate of 2.3 per cent per year since 2001 to be worth \$3.9 billion in 2006.

The UK was Australia's biggest tourism market for 2006, with 734,200 visitors contributing \$2.3 billion to the Australian economy. Our fastest growing tourist markets in the EU are France, Ireland and Italy.

Innovative products – niches for Australian exports to Europe

Australia produces a range of niche products that are well-suited to the discerning and sophisticated tastes of the European market. A good example of an Australian company in a niche market is the export of bottled water from Tasmania (**Box 1**).

Box 1 – Tasmanian rainwater marketed in Europe

A Tasmanian entrepreneur, Duncan McFie, has recently secured a deal to export a second shipment of 13,000 bottles of his rainwater drink, King Island Cloud Juice, to Spain. Mr McFie has taken advantage of the uniquely pure rainwater which falls on King Island after evaporating from the pristine environment of the southern ocean. Mr McFie thinks that Western European markets offer unique opportunities to businesses looking for growth opportunities. "Western Europe offers large, mature markets, a shared business culture and business leaders with a strong affinity with Australians", Mr McFie said. His product is stocked in France, Germany, Portugal and Italy, as well as in Spain.

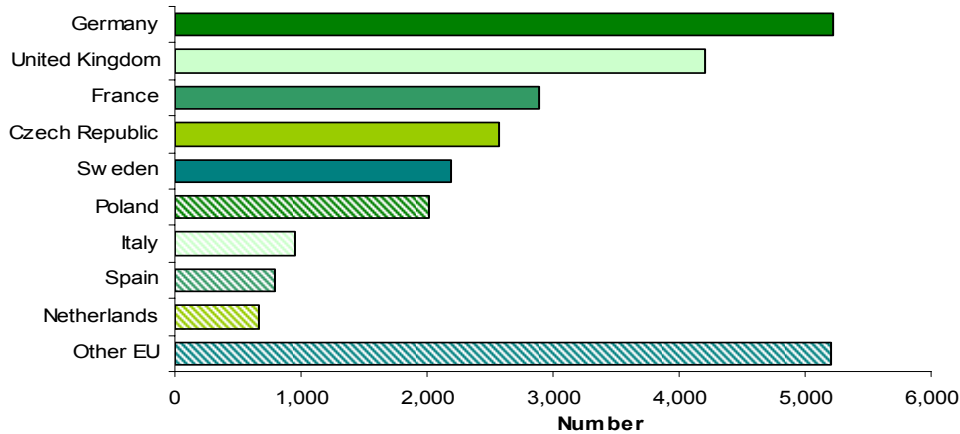
Australia's reputation as a producer of high quality, "clean and green" agriculture and seafood products presents great opportunities for Australian exporters in European markets where consumers are prepared to pay a premium for quality. Particular niches also exist in exports of off-season fruits, genetically modified organism-free products and organic foods. Australian cosmetics company, Aesop, has recently opened a boutique in Paris, following a trend in the successful establishment within Europe of Australian cosmetics based on natural products.

Australian companies have also found niches in Europe based on innovative products, including in areas such as industrial biotechnology and precision medical and laboratory equipment. In addition, our services exports have been growing strongly and can be expected to continue to expand, including in the construction and waste management sectors. A good example here is the success enjoyed by Lend Lease Corp (**Box 2**).

Imports of goods and services

Australia's imports of goods and services from the EU in 2006 totalled \$46.4 billion, up 2.1 per cent from 2005. Imports were dominated by manufacturing goods, with medicines (our largest import) down 0.9 per cent to \$4.1 billion. Imports of motor vehicles were down 7 per cent to

Figure 5: European student enrolments in Australia 2006



Source: Australian Education International.

Box 2 – Bovis Lend Lease UK Defence Contract and Waste Treatment Contract

In January 2007 Australian construction firm, Lend Lease Corp, won an \$835 million five year contract to build 3,800 apartments for the British military. The project is the second phase of a project aimed at improving housing for UK military personnel. The contract was won by Lend Lease subsidiary, Bovis Lend Lease, which also has responsibility for the first phase, worth \$1.15 billion and which involves building accommodation for 7,000 bed spaces. The mainstay of the contract will be for design and construction work by Bovis Lend Lease.

Bovis Lend Lease has also, in partnership with Global Renewables, the Manchester-based subsidiary of Australian engineering and development group GRD Limited, signed one of the largest and most significant Waste Private Finance Initiative contracts ever awarded in the UK. The 25 year contract, awarded by Lancashire County Council and Blackpool Council, is worth more than \$5 billion over the full term and will make Lancashire the UK's "greenest" county for treatment of household waste.

\$2.8 billion while imports of telecommunications equipment rose by 45 per cent to \$1.2 billion. Australia's services imports from the EU rose 6 per cent to \$10.0 billion in 2006.

A good deal of our imports from the EU comes in the form of capital and intermediate goods, which serve to boost our productive capacity and competitiveness. Over the last five years, imports of capital goods have increased by 7 per cent per

year while imports of intermediate goods have grown by 4 per cent per year on average.

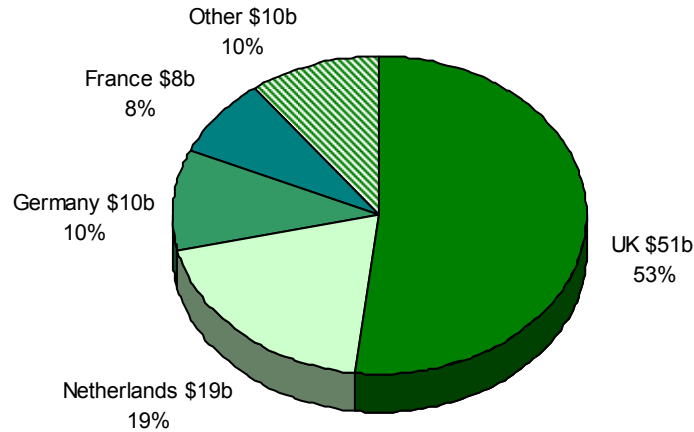
Investment

The EU (as a single entity) is Australia's biggest foreign investor. At the end of 2005, EU's direct investment in Australia was almost \$100 billion—about \$29 billion more than the United States, our second-largest foreign investor. **Figure 6** shows the EU countries that are the most significant investors in Australia as at 31 December 2005.

UK companies dominate EU direct investment in Australia at about 53 per cent. The UK is the second-largest source of direct investment in Australia behind the United States. At 31 December 2005, the level of the UK's direct investment in Australia was about \$51 billion. British firms have traditionally held significant investments in Australia, setting up operations in the resources and energy sector (for example, Shell and Rio Tinto-Zinc), telecommunications (Vodafone and British Telecommunications) and food and beverages (Cadbury and Unilever).

Germany has approximately 330 subsidiary companies and 470 branch offices in Australia working in a diverse range of areas such as banking and finance (Deutsche Bank), automobiles (DaimlerChrysler, BMW, Bosch, Hella and VDO), telecommunications (Siemens) and chemicals (Boehringer, Schering). There are now around 300 companies in Australia with French equity, employing around 70,000 people. French investment has centred on the financial services (AXA), resources (Vivendi) and agribusiness (Perno-Ricard) sectors. Major Dutch businesses in Australia include Royal Dutch Shell, Philips, ABN-AMRO, Rabobank and ING.

**Figure 6: EU direct investment in Australia as at 31 December 2005
(Per cent of total EU direct investment in Australia)**



Source: ABS catalogue no 5352.0.

The EU is also the second-largest destination for Australia's direct investment abroad (behind the United States). As at 31 December 2005, Australia had invested about \$59 billion in the EU region. Our largest direct investments were in the UK, the Netherlands and Germany.

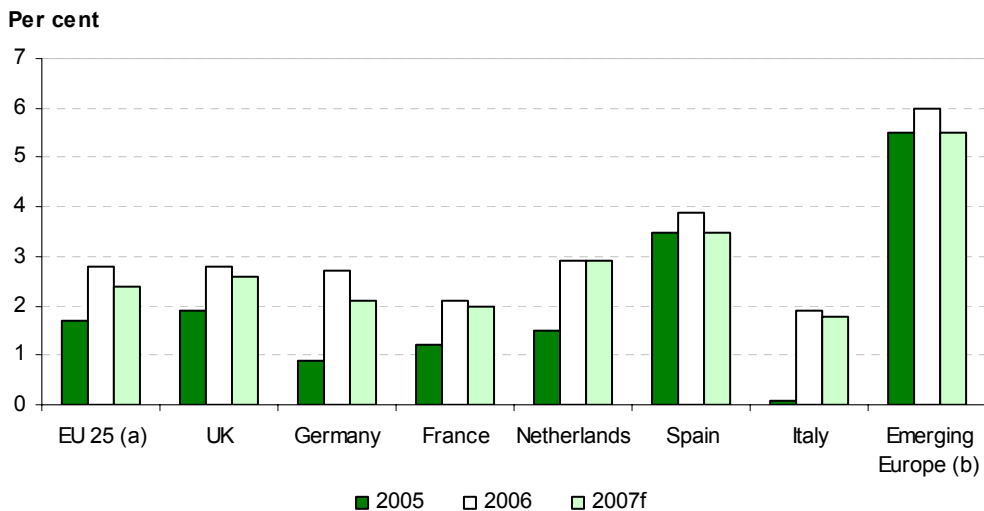
Economic outlook

EU growth is estimated to have picked up to 2.8 per cent in 2006 following subdued economic growth in the earlier part of the decade. The European Commission expects growth to moderate in 2007 to 2.4 per cent reflecting

reduced US growth and tighter fiscal policy in Germany.

In the UK, GDP growth of 2.6 per cent is forecast for 2007, reflecting continued growth in services industries. The economies of Germany and Italy picked up in 2006 and growth is expected to continue in 2007, albeit at a slower pace. The French economy is expected to continue to grow at a moderate pace in 2007 reflecting steady growth in domestic demand. Solid economic growth is expected in Spain and the Netherlands. Growth in Emerging Europe is robust.

Figure 7: GDP growth in major EU economies



(a) European Commission, *Economic Forecasts, Autumn 2006*.

(b) IMF, *World Economic Outlook, April 2007*.

f = forecast.

Source: Consensus Economics, *Consensus Forecasts, April 2007*.

Trade outlook

With the recent entry of Bulgaria and Romania, the EU has a total population of almost half a billion people and an economy worth \$19 trillion, around 19 times the size of Australia's GDP. The average per capita GDP is in the vicinity of \$41,000 (compared with around \$49,000 in Australia). As a single entity, the EU is Australia's largest two-way trading partner and our largest foreign investor.

Our trade relationship with the EU is underpinned by each side's solid economic fundamentals—growing economies give rise to more opportunities for exporters. This offers not only prospects for expanded trade, but also investment opportunities from companies on both sides.

Energy has been an important part of the bilateral trade relationship, with Australia supplying around 10 per cent¹ of EU's coal consumption in 2004 and 12 per cent² of its uranium requirements in 2006. With its abundant resources of coal and uranium, Australia is well placed to be a reliable and efficient supplier of energy to Europe for many years to come.

But our exports to Europe are much more than resources. Europe is now a major market for Australian wine and for medicines. Australian wines are growing in numbers and prominence within continental Europe. The EU services market, particularly in the education and tourism sectors, is a major market for Australian service providers. Product niches are being found in the food and beverage industries to cater to European tastebuds. The May 2007 DHL Export Barometer reports that 65 per cent of Australian exporters expect an increase in orders to Europe over the next 12 months.

With the recent economic expansion of the EU bloc to include some fast growing economies, Australian businesses are poised to benefit as the new members adopt the enhanced trade and investment regulatory framework of the EU. Trade with the EU is set to expand further under the stable and predictable business environment offered by the EU.

¹ Derived from data sourced from the Energy Information Administration, DFAT STARS database and Australian Bureau of Agricultural and Resources Economics.

² Australian Bureau of Agricultural and Resources Economics and Australian Uranium Association.

*Author: Peter Bartlett
Trade and Economic Analysis Branch
peter.bartlett@dfat.gov.au*

*This article benefited from comments and suggestions made by Tony Urbanski,
Director, International Economic and Finance Section.*