

Recent flooding, which has largely affected the eastern states of Australia since late December, looks destined to puncture the short-term growth prospects of the economy.

To capture the impact of the floods on the economy, we use recently released data from the Australian Bureau of Resource Economics and Sciences (ABARES), the Queensland Government, Commonwealth Government and the Insurance Council of Australia to quantify effects arising from:

- the loss of coal, agricultural manufacturing and services production
- the disruption to economic activity resulting from the floods
- the reconstruction of residential and commercial property
- the reconstruction of damaged and destroyed public infrastructure, including the impact of government spending cuts and the flood levy
- the effect of higher food prices, including the impact on banana prices from Tropical Cyclone Yasi.

Table 1 summarises our estimates of the losses arising from the recent floods. Incorporating these shocks, along with government funding arrangements, into our model of the national economy results in a sharp reduction in real gross domestic product (GDP) growth in the current quarter. As shown in Table 2, real GDP growth is now expected to fall by 0.6 per cent in the first quarter of 2011 when the impact of the floods is incorporated: a fall of around 1½ percentage points. This will make 2011Q1 the first quarter of negative GDP growth since 2008Q4, which was at the height of the global financial crisis, and only the second quarter of negative growth since 2000Q4, when the dotcom bubble burst.

Half of the decline in first quarter growth is due to the disruption to economic activity in Brisbane, while a loss of coal production contributes around a third of the fall in growth. Lost agricultural production, combined with falls in activity in other industries outside Brisbane, lowers 2011Q1 growth by a further 0.3 percentage points.

Higher food prices contribute a further small reduction in 2011Q1 growth. This impact includes the effects of TC Yasi, which fortunately did not wreak the damage on property and infrastructure that was initially feared. The main economic impact appears to be an increase in the price of bananas, as 75 per cent of the crop was destroyed. In contrast to the aftermath of TC Larry in 2006, however, the Queensland State government has allowed bananas that have fallen to the ground to be sold, resulting in a price increase of just \$3 per kilo. This would temporarily add around 0.1 percentage points to 2011Q1 CPI.

Table 1. Initial impact of the recent floods

	Losses	
	\$ billion	% of annual national GDP
Brisbane/Ipswich		
Production losses		
1 week loss of production	2.17	0.16
Property losses		
Damage to residential property	0.64	0.05
Damage to commercial property	0.10	0.01
Infrastructure damage	1.00	0.07
Total property losses in Brisbane/Ipswich	1.74	0.13
Total Brisbane	3.91	0.29
Other regions		
Production losses		
Manufacturing and services	0.76	0.06
Coal production	2.50	0.19
Sorghum	0.03	0.00
Cotton	0.15	0.01
Fruit & vegetables	0.23	0.02
Winter crop losses	0.20	0.01
Total agriculture	0.60	0.04
Total production losses in other regions	3.86	0.29
Property losses		
Damage to residential property	0.56	0.04
Damage to commercial property	0.09	0.01
Infrastructure damage	3.92	0.29
Total property losses in other regions	4.57	0.34
Total other regions	8.43	0.63
Overall total	12.34	0.92

Sources: QIC, Queensland Government, ABARES, Insurance Council of Australia

As the loss in production is only temporary, GDP will largely recover to its baseline level in the second quarter of 2011, resulting in an offsetting increase in GDP growth of 1.5 percentage points compared to base in the second quarter of the year.

Nonetheless, output lost in the first quarter is sufficient to substantially lower the average annual growth rate in 2011 by 0.4 percentage points, from a baseline level of 3.1 per cent to a revised rate of 2.7 per cent. As the level of GDP recovers, the average annual 2012 growth rate rises. Compared to our baseline rate of 3.6 per cent, GDP growth is 0.5 percentage points higher in 2012 at 4.1 per cent.

While many commentators have emphasised the impact of reconstructing property and infrastructure, our results find little evidence that reconstruction will have a significant impact on GDP growth rates over coming years. This reflects two

factors: (i) the fully funded nature of the reconstruction of public sector infrastructure and (ii) the low level of expenditure on reconstruction relative to GDP. We have assumed that reconstruction expenditure will be around \$6.3 billion, approximately 0.5 per cent of GDP. Spread over three to four years, this amounts to only 0.1 per cent of GDP per annum. With the federal government reducing expenditure and raising taxes to pay for the restitution of public sector infrastructure, the net effect on national GDP from reconstruction is approximately zero.

Disruption to agricultural production is expected to lead to a temporary spike in food prices, pushing inflation up to around 3.5 per cent in mid 2011. As agricultural production recovers to pre-flood levels, food prices are expected to ease with inflation returning to the Reserve Bank of Australia's (RBA) target band of 2.0 per cent to 3.0 per cent in 2012. The RBA has indicated that it will look through temporary effects of the floods; therefore, the higher food prices will not affect monetary policy.

Table 2. Impact on Australian GDP of recent floods

	Real GDP growth (%) Base	Impact from flood shocks on Australian real GDP growth (ppts)							Real GDP growth (%) New forecast
		Production shocks				Net property & public infrastructure rebuild	Higher food prices	Total	
		Manufacturing & services Brisbane	Other	Coal	Agriculture				
Quarterly									
2010q4	0.8	0.0	0.0	-0.1	0.0	0.0	0.0	-0.1	0.7
2011q1	0.9	-0.7	-0.2	-0.4	-0.1	0.0	-0.1	-1.4	-0.6
2011q2	0.8	0.7	0.2	0.5	0.1	0.1	0.0	1.5	2.4
2011q3	0.6	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.5
Annual avg									
2010	2.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.7
2011	3.1	-0.2	-0.1	-0.1	0.0	0.1	-0.1	-0.4	2.7
2012	3.6	0.2	0.1	0.1	0.0	-0.1	0.1	0.4	4.1
2013	3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3

Source: QIC

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