How much can Australia’s economy withstand?

Michael Menhart
Munich Re’s Chief Economist
Major natural catastrophes are a burden even to successful national economies like Australia’s. The Australian government spends over half a billion Australian dollars annually on post-disaster relief and recovery, but only A$ 50m on pre-disaster prevention and mitigation. Is Australia adequately prepared for potential risks of change?

The development of the Australian economy is a remarkable success story. It has seen inflation-adjusted, average growth of over 3% every year for the last 20 years. Though it did not emerge totally unscathed, Australia even weathered the global financial crisis without slipping into recession.

The country benefits from its wealth of natural assets and resources, particularly in the sectors of mining, tourism and farming. Iron ore and coal make up over one third of its total export volume. In fact, Australia is one of the world’s largest coal producers and exporters. However, these economic strengths are also what make the country so vulnerable when natural catastrophes occur. The situation is further compounded by a rising concentration of values in Queensland and Western Australia, and growing urbanisation in the coastal regions.

Australia hit hard by 2010/2011 floods

In late 2010 and early 2011, the Queensland floods, one of the costliest natural catastrophes ever to hit Australia, led to direct losses of A$ 6.8bn. While this is equivalent to just 1% of Australia’s economic output, the overall economic effect of a natural catastrophe is not just the sum of direct damage to buildings, roads and mines. Indirect, secondary effects must also be taken into account, such as production losses in flooded mines or a reduction in coal exports. Roughly 25% of mines had to temporarily suspend operations altogether, another 60% suffered severe restrictions. The mining sector was hit hardest, with immediate production losses of A$ 6bn. Australian farming sustained crop losses of A$ 2bn while revenue losses in tourism came to A$ 400m.

Major natural catastrophes take a lasting economic toll

The immediate effects of natural catastrophes on a country’s economic activities can easily be observed and measured, but what lasting impacts do natural catastrophes have? It is often assumed that natural catastrophes (notwithstanding the tragic human consequences) can have a positive effect on an economy because reconstruction acts as an economic stimulus.

Empirical studies show, however, that the indirect, positive effects on overall prosperity do not make up for the indirect losses natural disasters cause. For example, “severe, devastating, major” natural catastrophes with over 100 fatalities and over US$ 250m (A$ 300m) in direct, inflation-adjusted losses were found to lead to a statistically significant reduction in real GDP of nearly 4% after five years, compared to real GDP growth without the catastrophe.

The financial burden of natural catastrophes is not immediately evident in economic growth rates, for instance because the costs of recovery work in the wake of a disaster are subsequently posted as income. Nevertheless, the long-term repercussions should not be underestimated. This applies in particular to government finances. As data from the International Monetary Fund indicate, Australia’s general government debt, at 34% of GDP, is still relatively low by international standards.

“Climate change is a risk to the success story of the Australian economy”

Michael Menhart, Munich Re’s Chief Economist
The Australian government currently spends an estimated A$ 560m annually on post-disaster relief and recovery, but only A$ 50m on pre-disaster prevention and mitigation. Public investments in cost-efficient resilience and disaster reduction measures could reduce natural catastrophe costs by more than 50% by 2050, as estimated by the Australian Business Roundtable for Disaster Resilience & Safer Communities in June 2013.

Australia must arm itself against changing parameters

Should climate change greatly increase the frequency and/or intensity of events, the prevention and recovery costs will pose an immense economic challenge. In Australia and New Zealand, the increase in greenhouse gas concentrations over the last 50 years has already led to a significant rise in average temperatures. They are expected to rise further in this century. The consequences could be more frequent hot extremes and extreme rainfall, associated with the flood risk in many locations.

Precisely because of the country’s impressive economic success story, Australia must arm itself against the changing parameters. Research shows that countries with higher insurance penetration suffer less from the economic impact of natural catastrophes. Insurance has an essential role to play in mitigating these adverse effects.

mmenhart@munichre.com