

The Australian economy in 2006

Presentation to
CEDA Economic and Political Outlook

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ANZ Bank

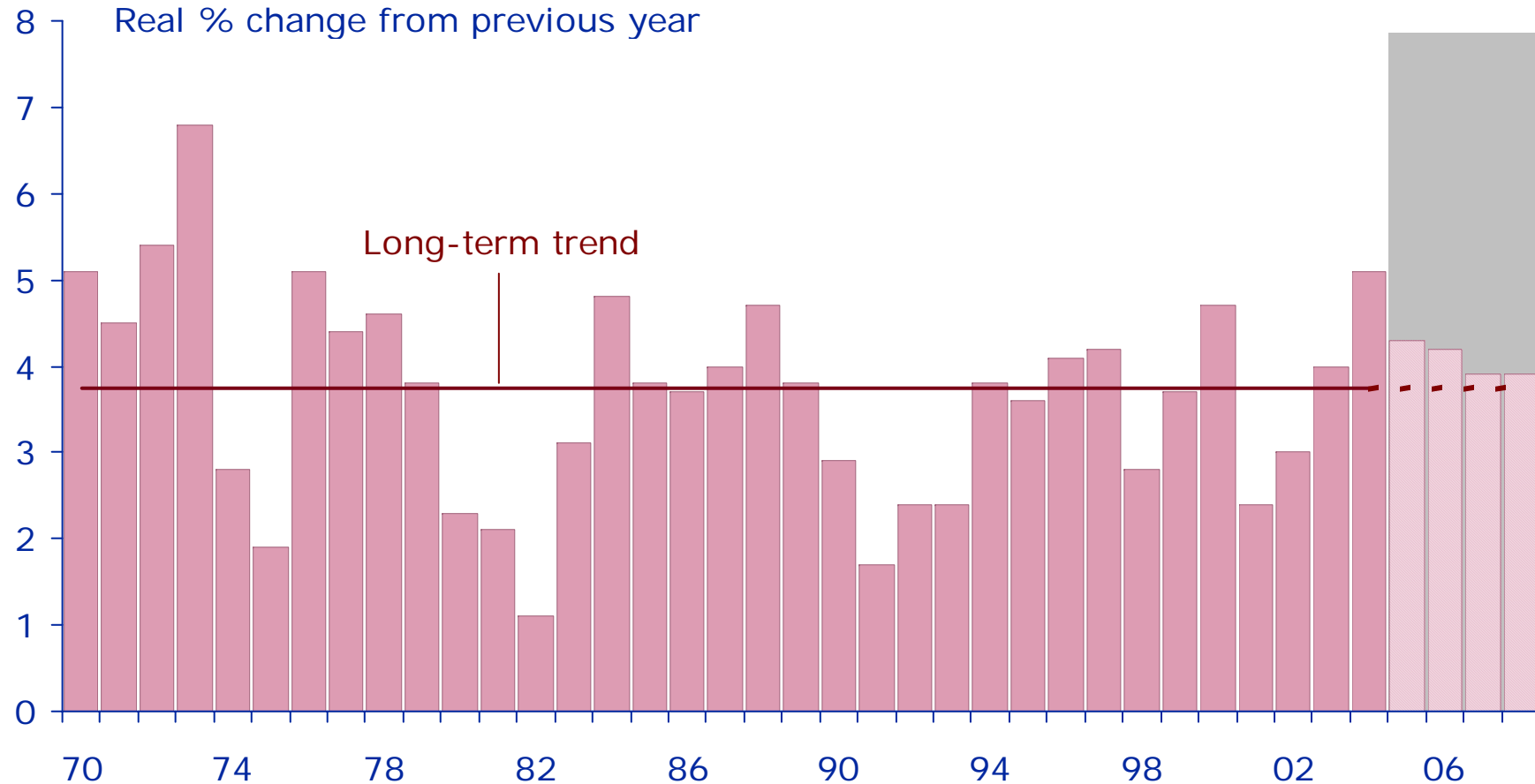
Zinc@ Fed Square
Melbourne
17th February 2006

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The world economy is doing remarkably well

Global economic growth

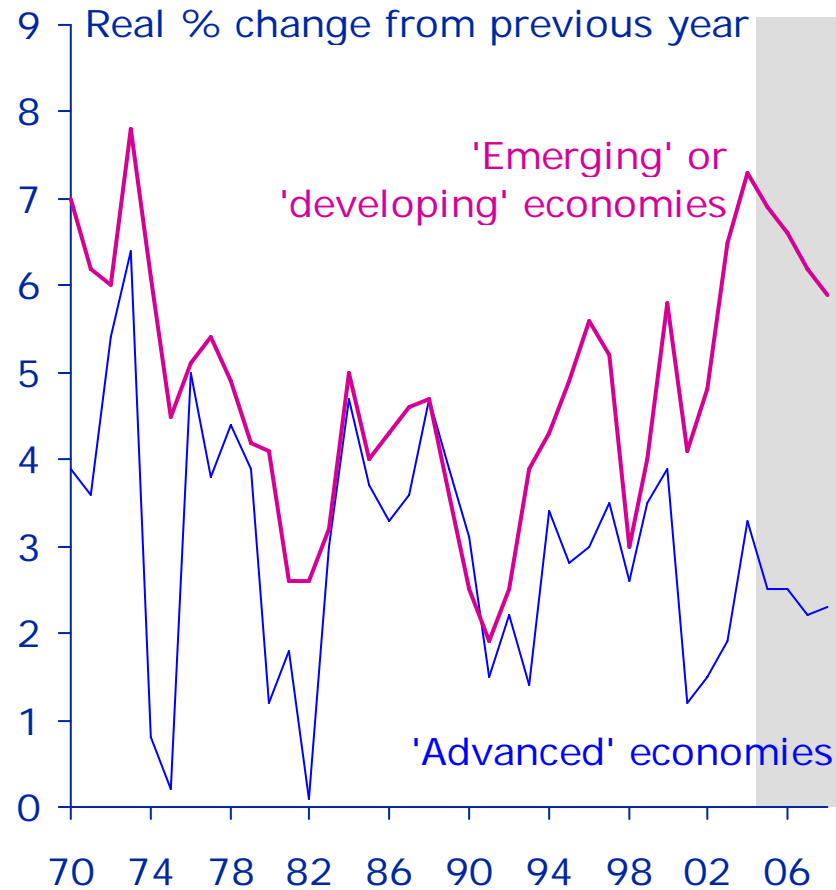


Note: GDP is measured in US\$ at purchasing power parities.

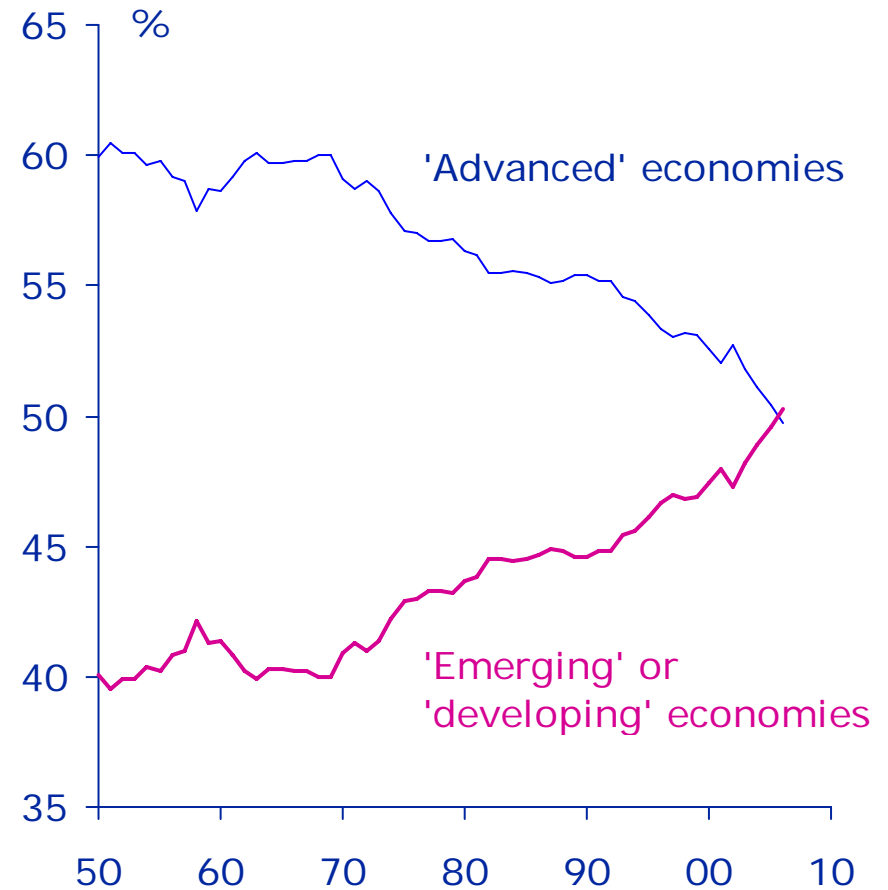
Source: IMF; Economics@ANZ.

Global growth is being increasingly driven by developing economies

Real GDP growth



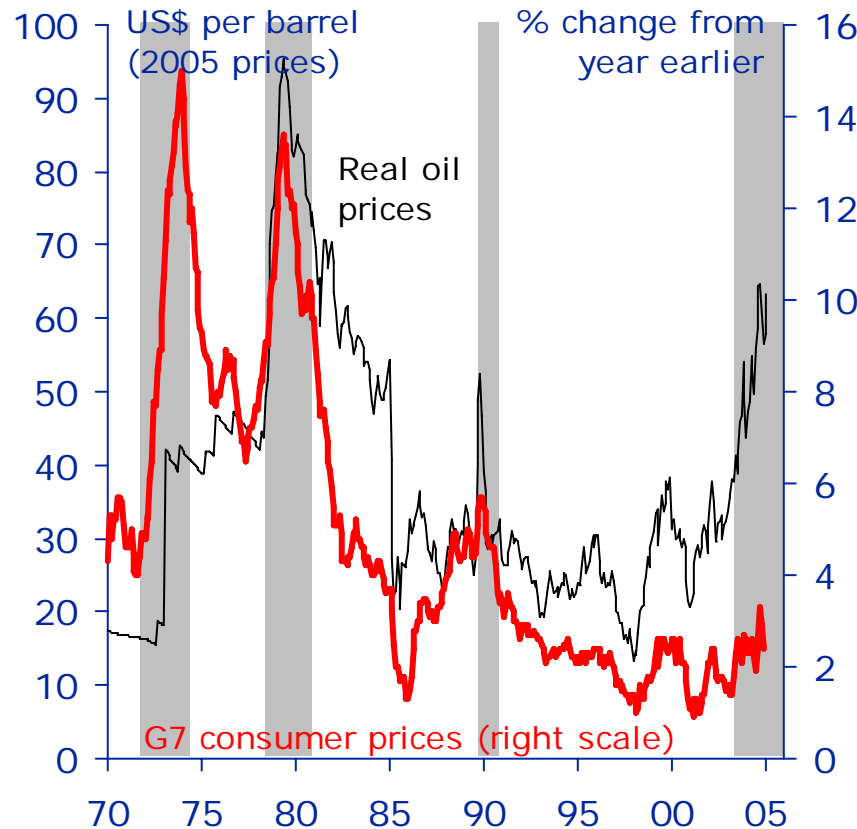
Shares of world GDP



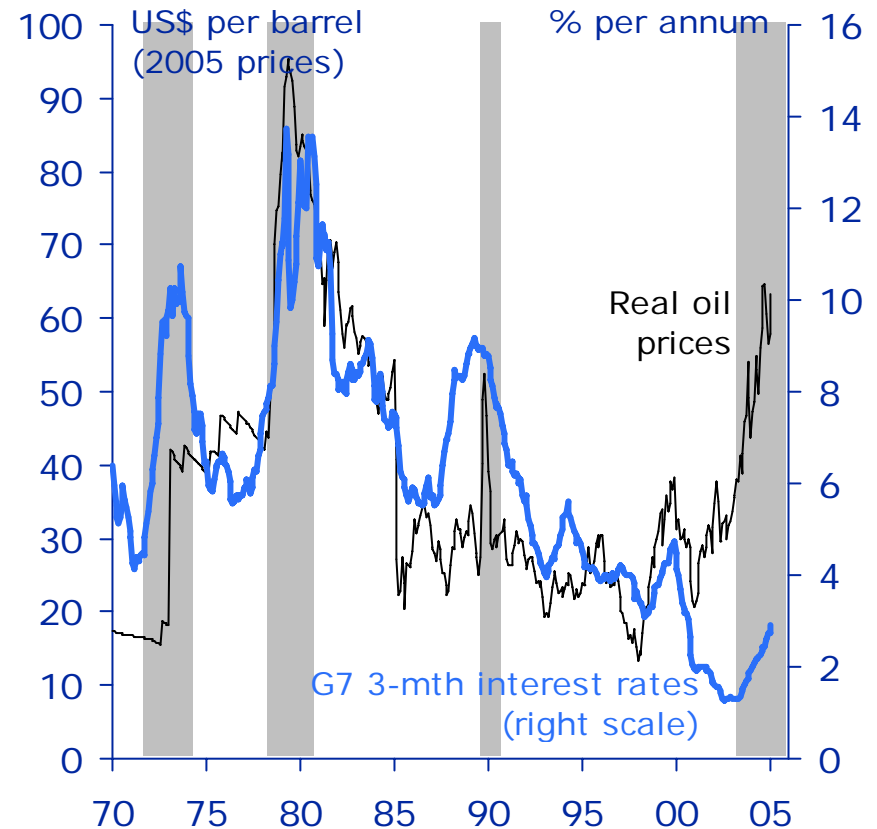
Sources: IMF, *World Economic Outlook*; Angus Maddison, *The World Economy: Historical Statistics*; Economics@ANZ.

Higher oil prices aren't (thus far) leading to higher inflation and interest rates

Oil prices and inflation



Oil prices and interest rates

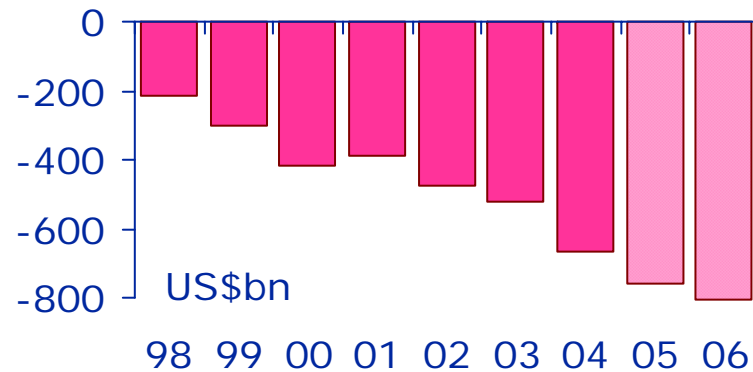


Note: Shaded areas denote "oil price shocks"
Sources: Datastream; OECD; Economics@ANZ.

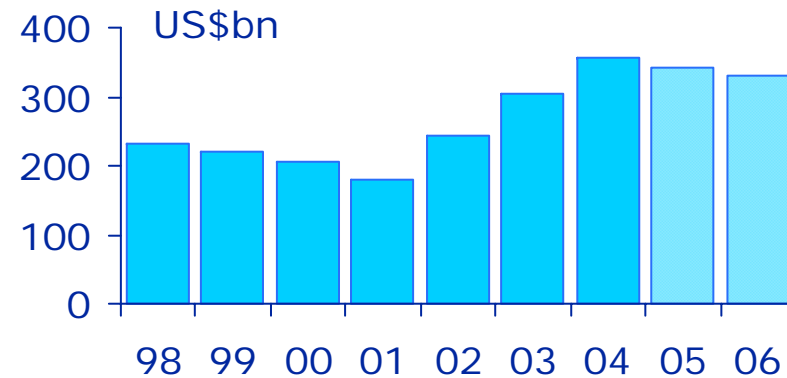
Higher oil prices are leading to some potentially significant shifts in current account balances

Current account balances

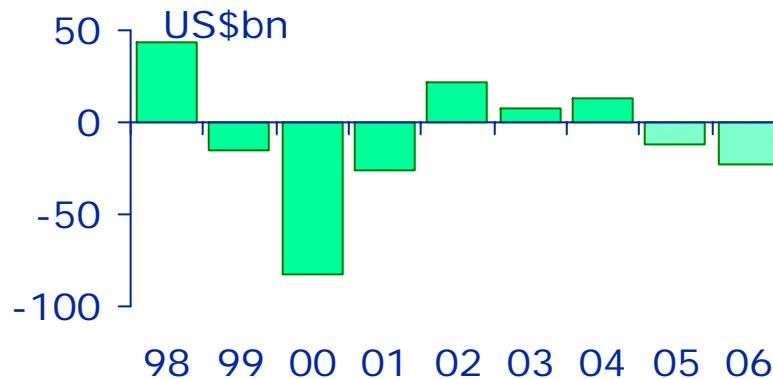
United States



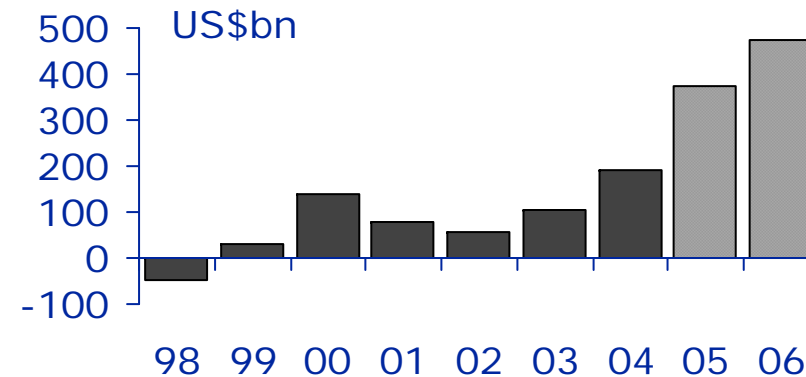
East Asia (incl Japan)



European Union



Selected oil producers

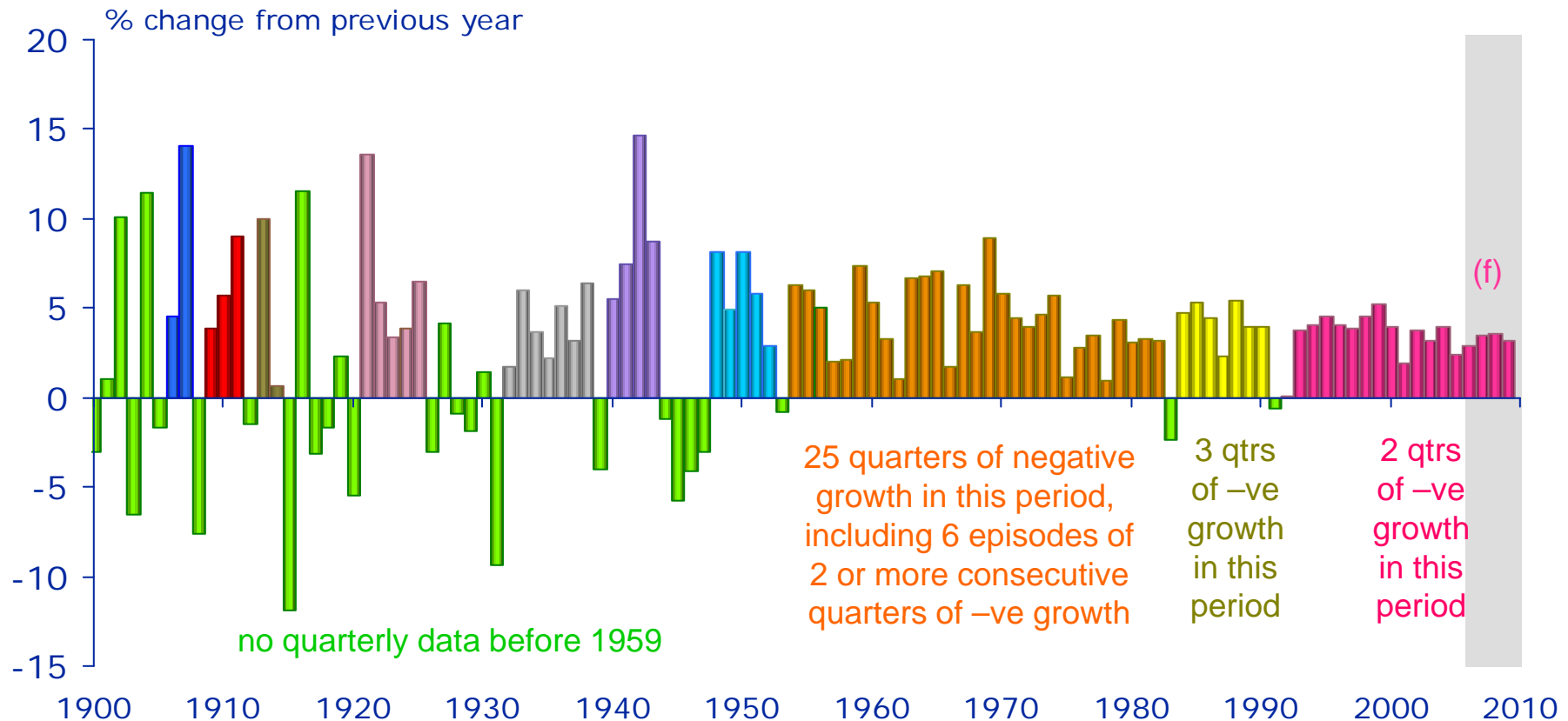


'Selected oil producers' are those in the Middle East, Africa, Russia, Kazakhstan, Azerbaijan, Venezuela and Ecuador.

Source: IMF, *World Economic Outlook* September 2005.

After Australia's longest run of uninterrupted economic growth since Federation ...

Australian real GDP growth, 1901 - 2009

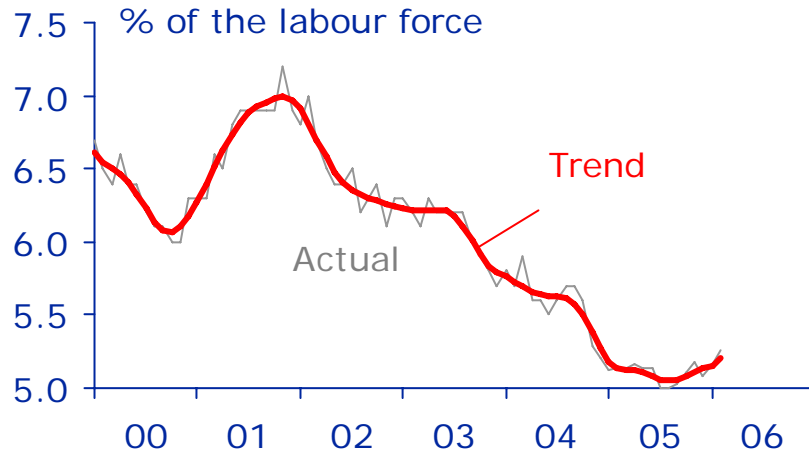


Note: data are for financial years ended 30 June.

Sources: Angus Maddison, *Monitoring the World Economy 1820-1992*; Reserve Bank; ABS; Economics@ANZ.

... the economy is now operating at close to full employment of labour and capital

Unemployment rate



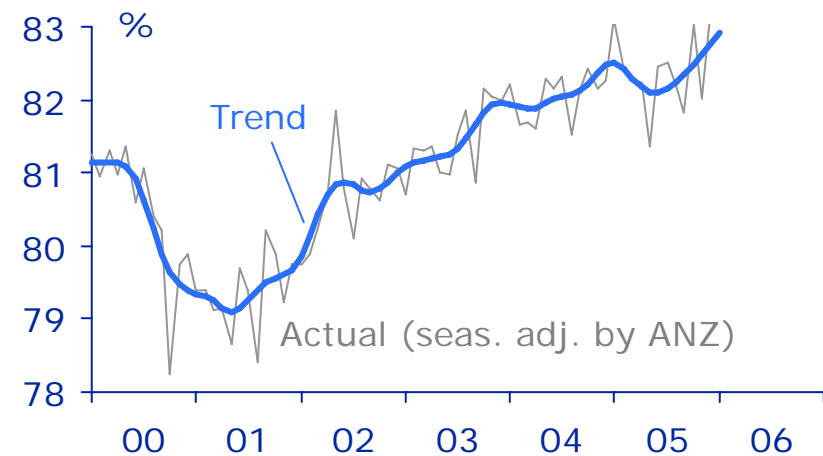
CBD office vacancy rates



Labour shortages



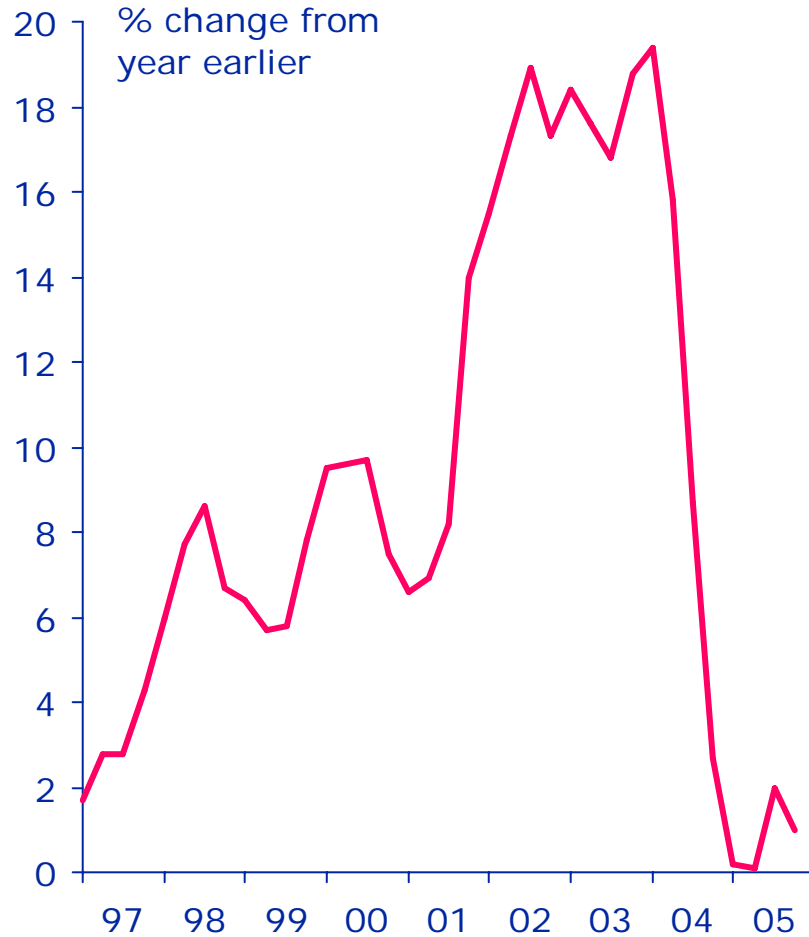
Capacity utilization



Sources: ABS; National Australia Bank; Property Council of Australia.

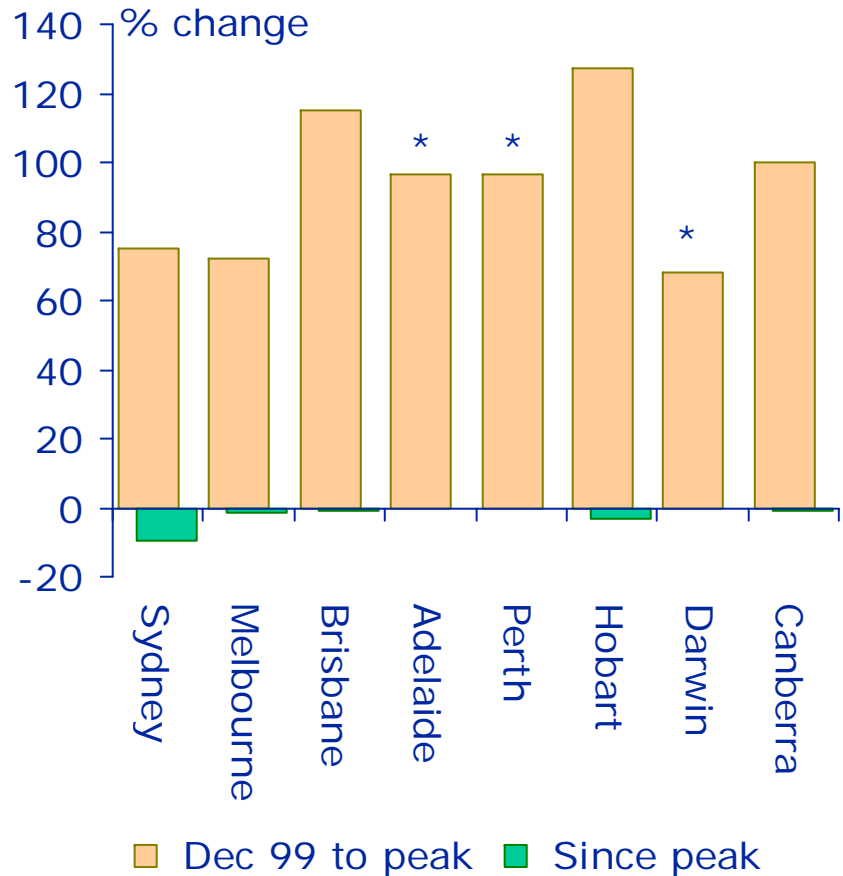
The housing boom is over in most of Australia's capital cities

Capital city house prices



Sources: ABS; Economics@ANZ.

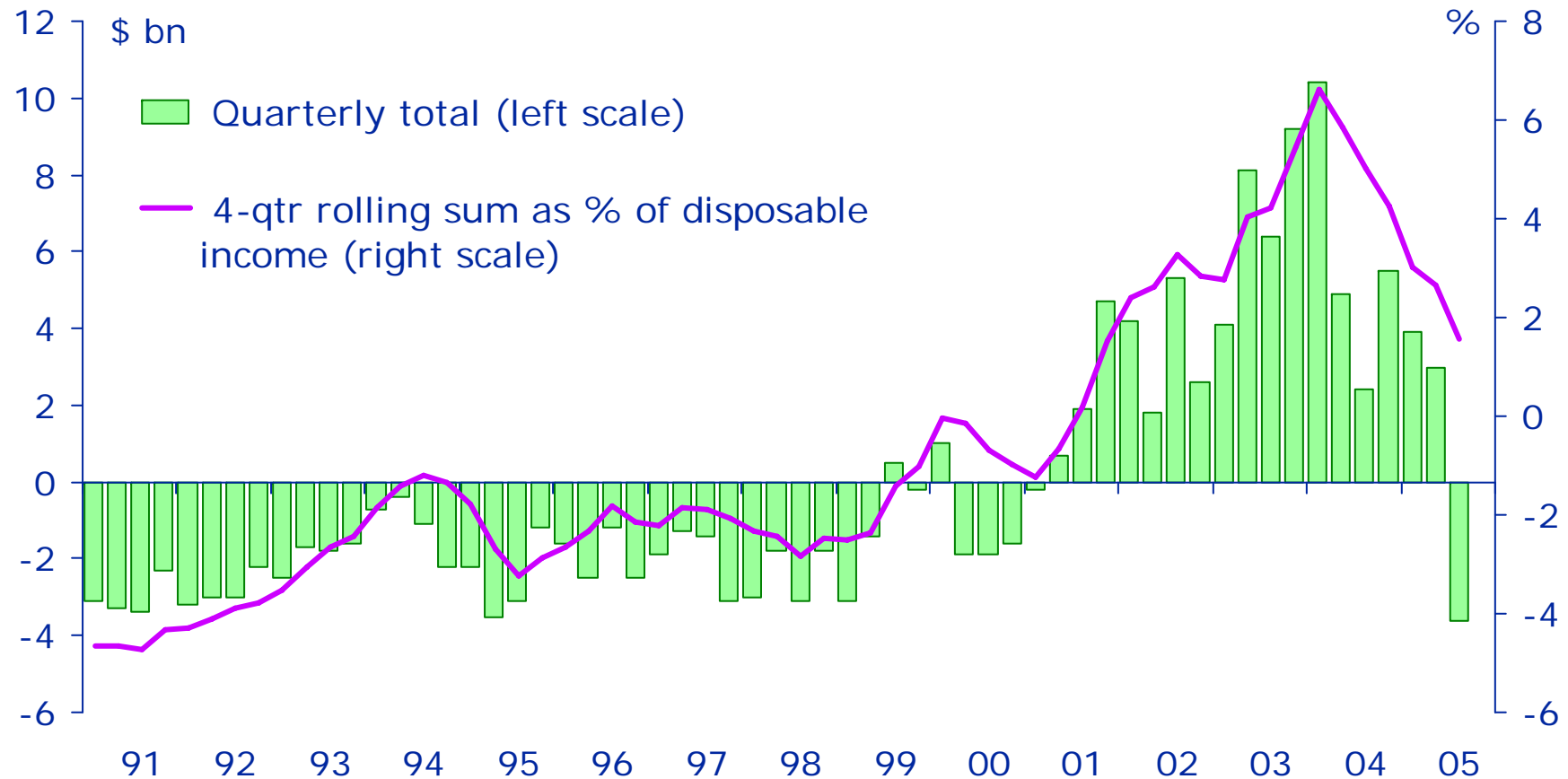
Movements to and since peak



* Not yet peaked (as of Sep 2005)

Australian households have stopped borrowing against actual or expected rises in house prices

Mortgage equity withdrawal

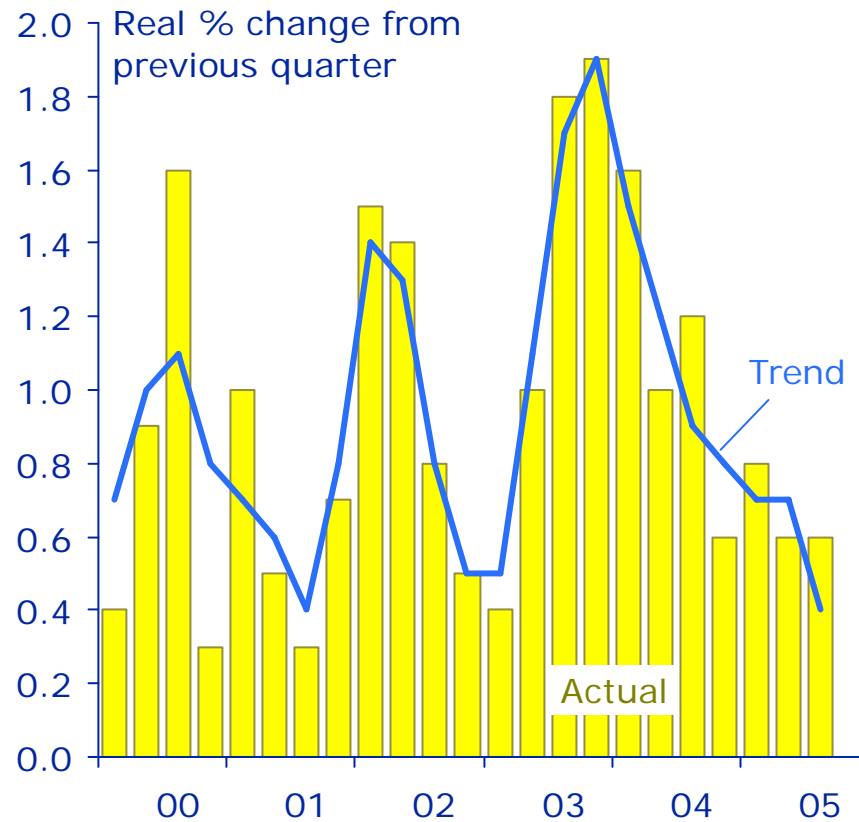


Note: 'mortgage equity withdrawal' measures borrowings for (or secured against) housing net of repayments and purchases of housing.
Sources: ABS; RBA; Economics@ANZ.

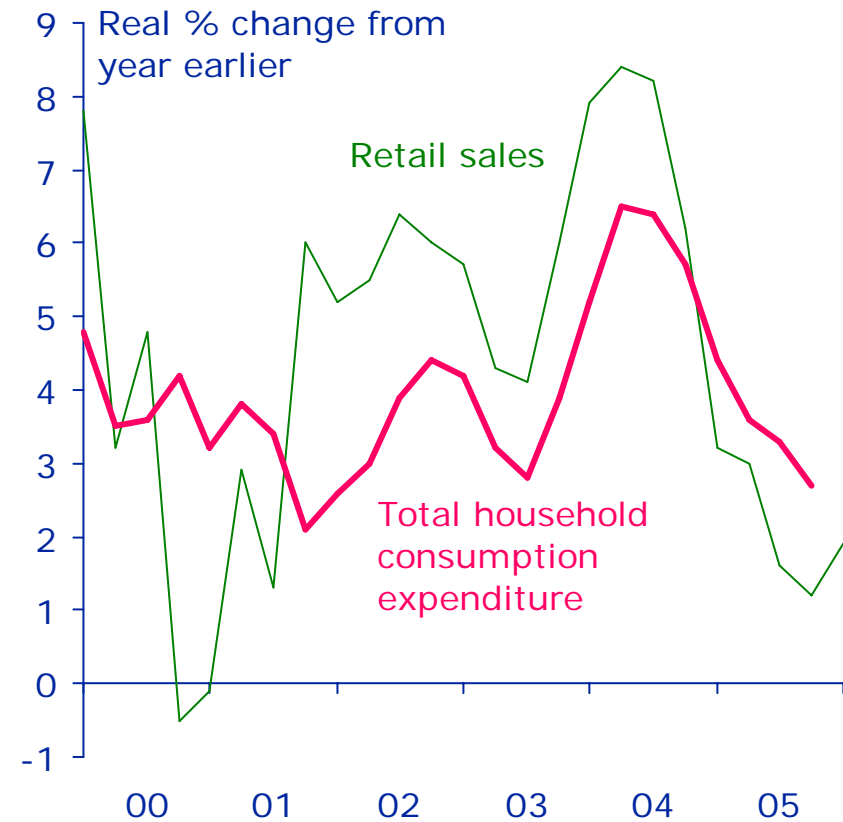
Consumer spending – which has been the main driver of growth in recent years – is now slowing

Growth in consumer spending

Quarterly



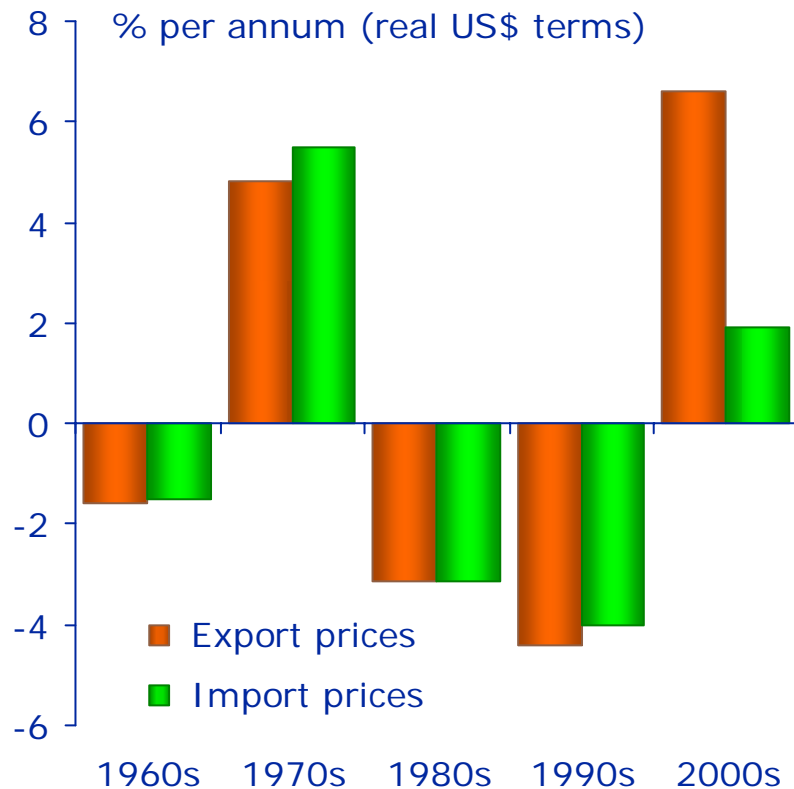
Annual



Source: ABS.

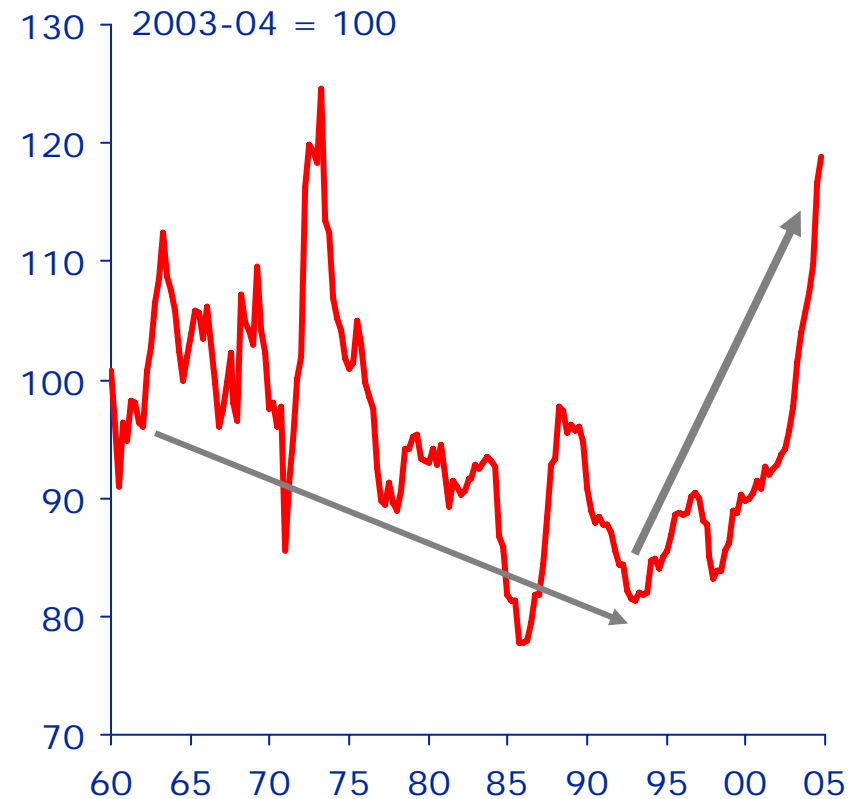
China's global impact on *relative* prices is hugely beneficial for Australia

Long-term price changes for Australian exports and imports



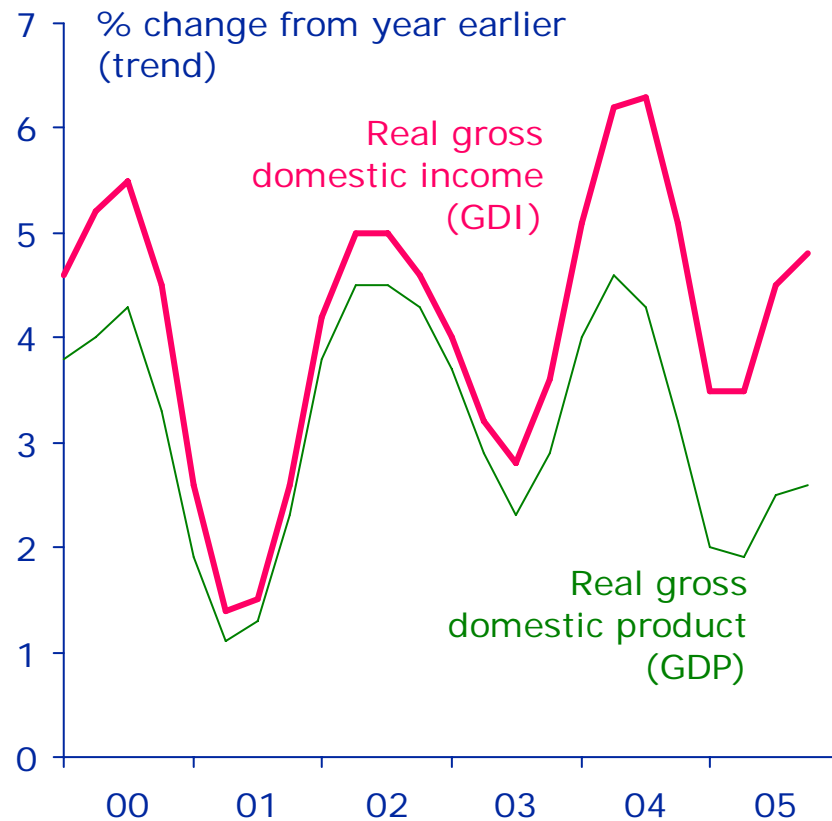
Sources: Australian Bureau of Statistics; US Bureau of Economic Analysis; Economics@ANZ.

Ratio of Australian export prices to import prices

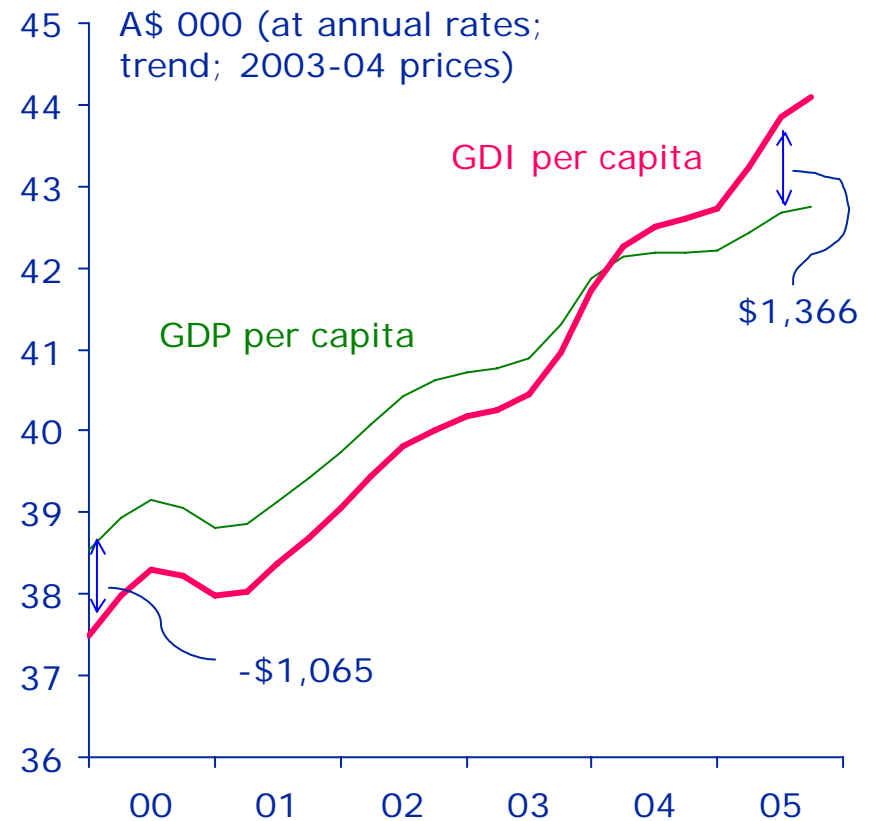


'Terms of trade' gains since 1999 have been worth \$2,430pa to each Australian, on average

Real gross domestic product and income



Real gross domestic product and income per capita



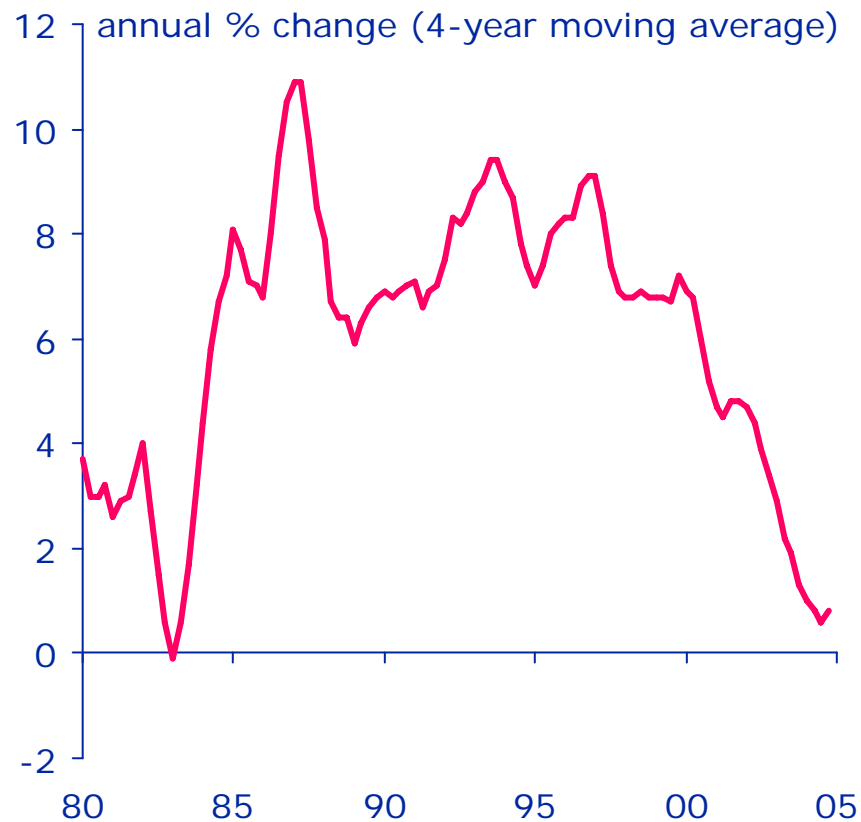
Note: Gross domestic income (GDI) is GDP adjusted for changes in the terms of trade (ratio of export to import prices).

Sources: ABS; Economics@ANZ.

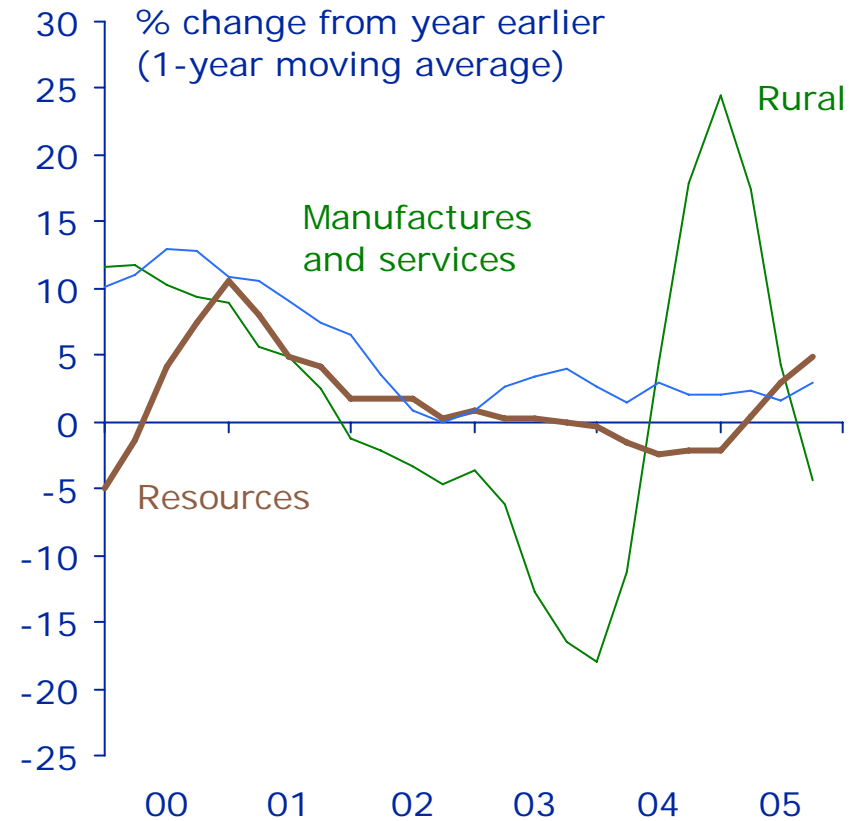
However growth in the volume of exports during this period has been very poor ...

Volume of Australian exports

Total



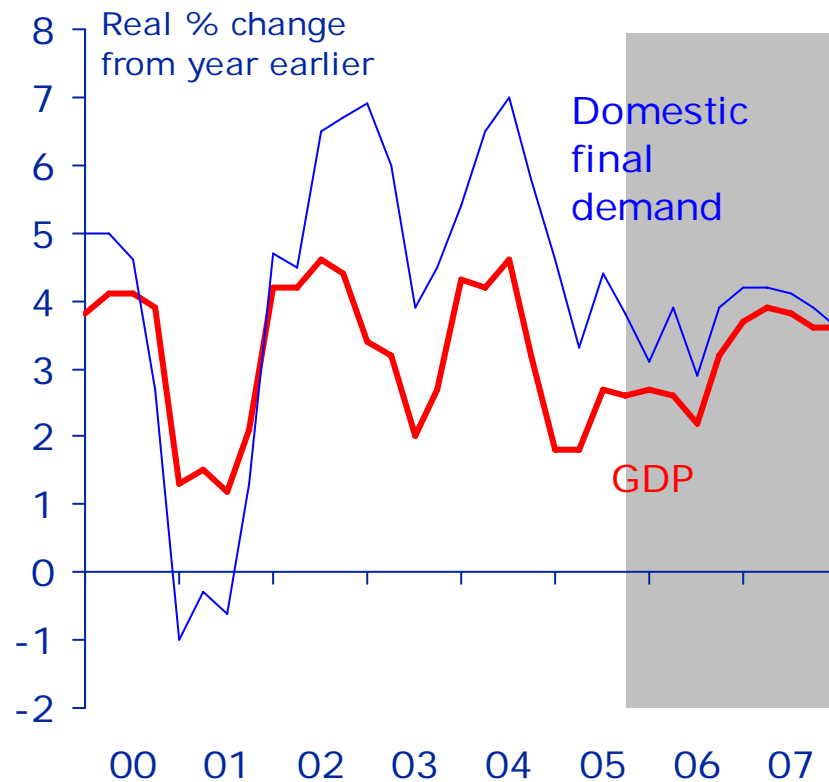
By major category



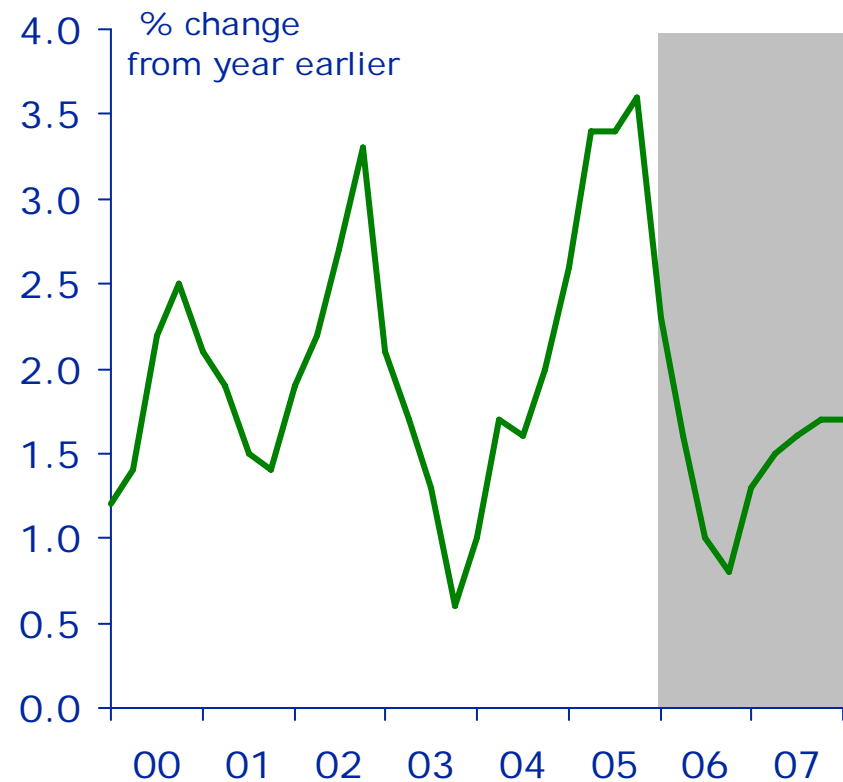
Sources: ABS; Economics@ANZ.

After a sluggish first half, the economy will pick up in the second half of 2006 and into 2007 ...

Real domestic spending and output



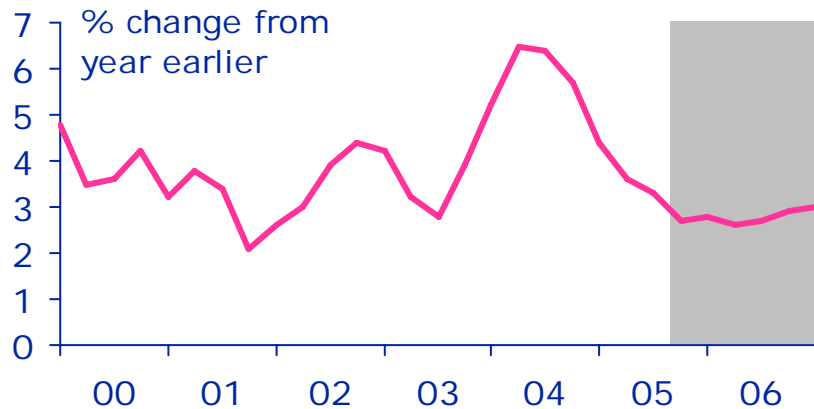
Employment



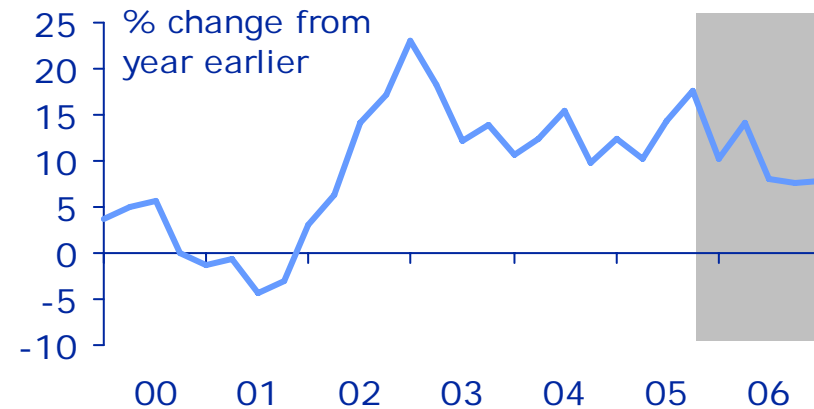
Source: Australian Bureau of Statistics;
Economics@ANZ forecasts (shaded areas).

... but the 'mix' of Australian economic growth will be different from the first half of this decade

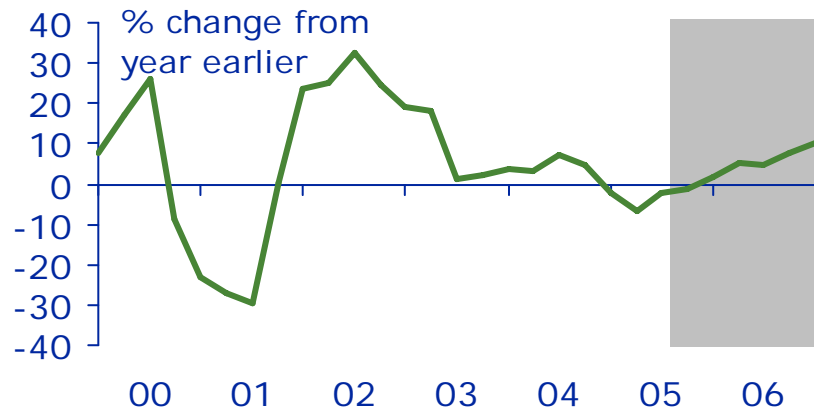
Consumer spending



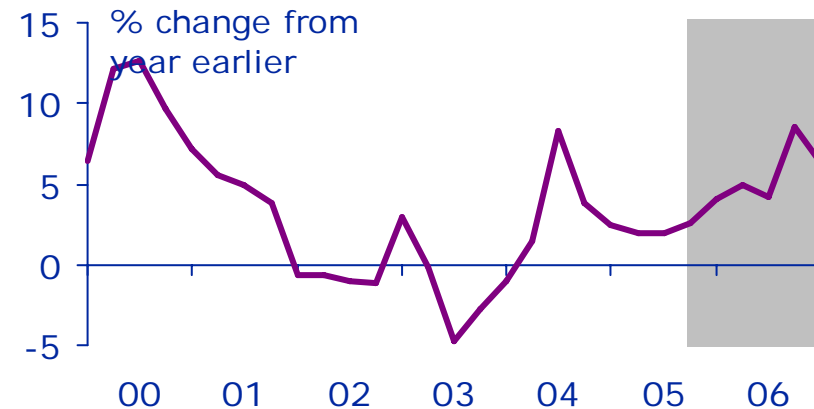
Business investment



Dwelling investment



Exports



Note: shaded areas denote forecasts.
Sources: ABS; Economics@ANZ

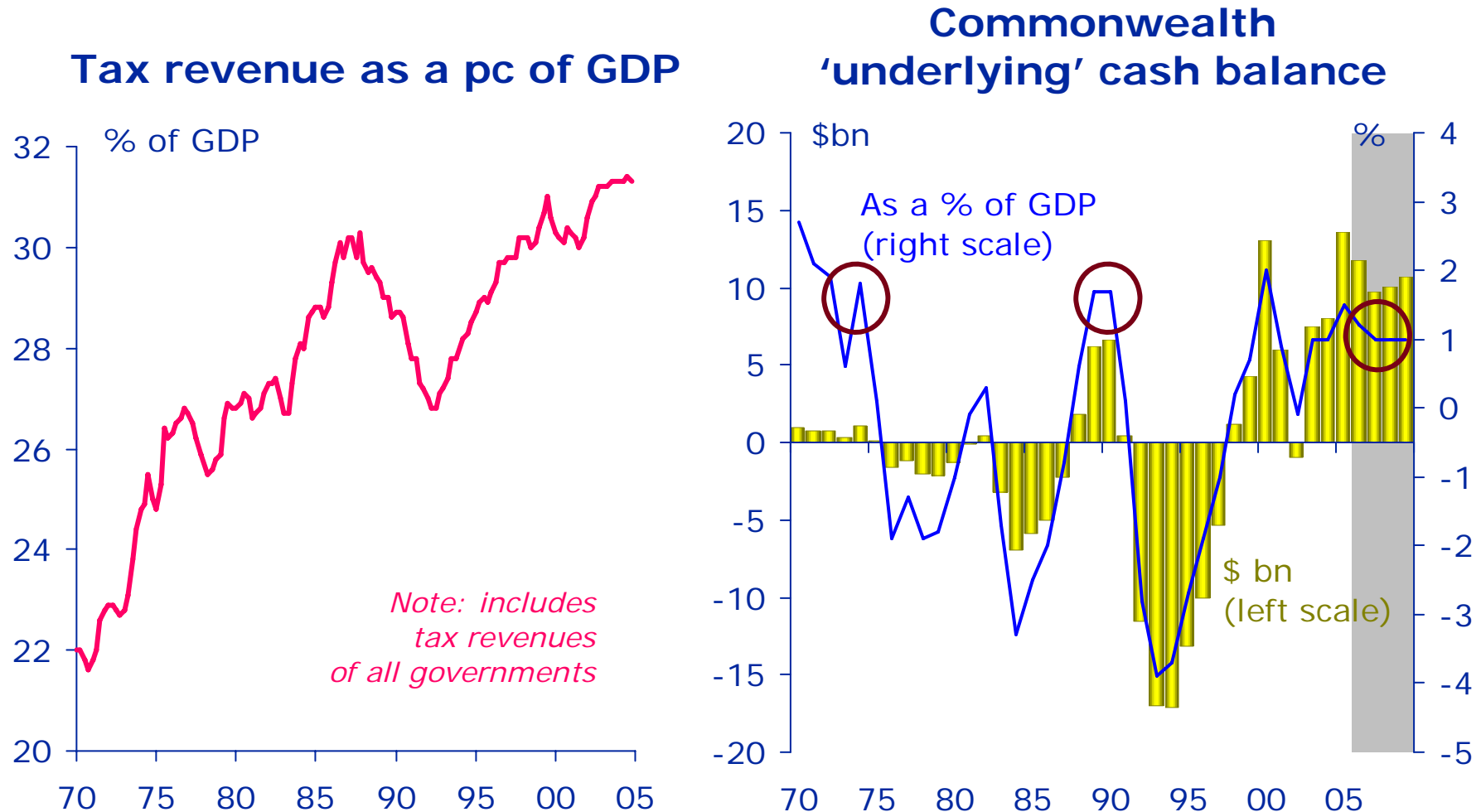
The economy is near the point in the cycle where the seeds of previous recessions have been sown

In some important respects the Australian economy is at a similar stage to where it was in 1960, 1973, 1981 and 1989 – just before each of the past 4 recessions

Three policy mistakes have traditionally been made at this stage of the business cycle -

- **Allowing wages to grow faster than justified by productivity in a tight labour market**
 - much less of a risk now that centralized wage fixation is (almost) dead
- **Failing to allow the Reserve Bank to raise interest rates before inflation has begun to accelerate**
 - not a serious risk now that the RBA is 'independent'
- **'Giving away too much' of the revenue dividend in spending increases and tax cuts**
 - still a significant risk (as demonstrated in recent years)

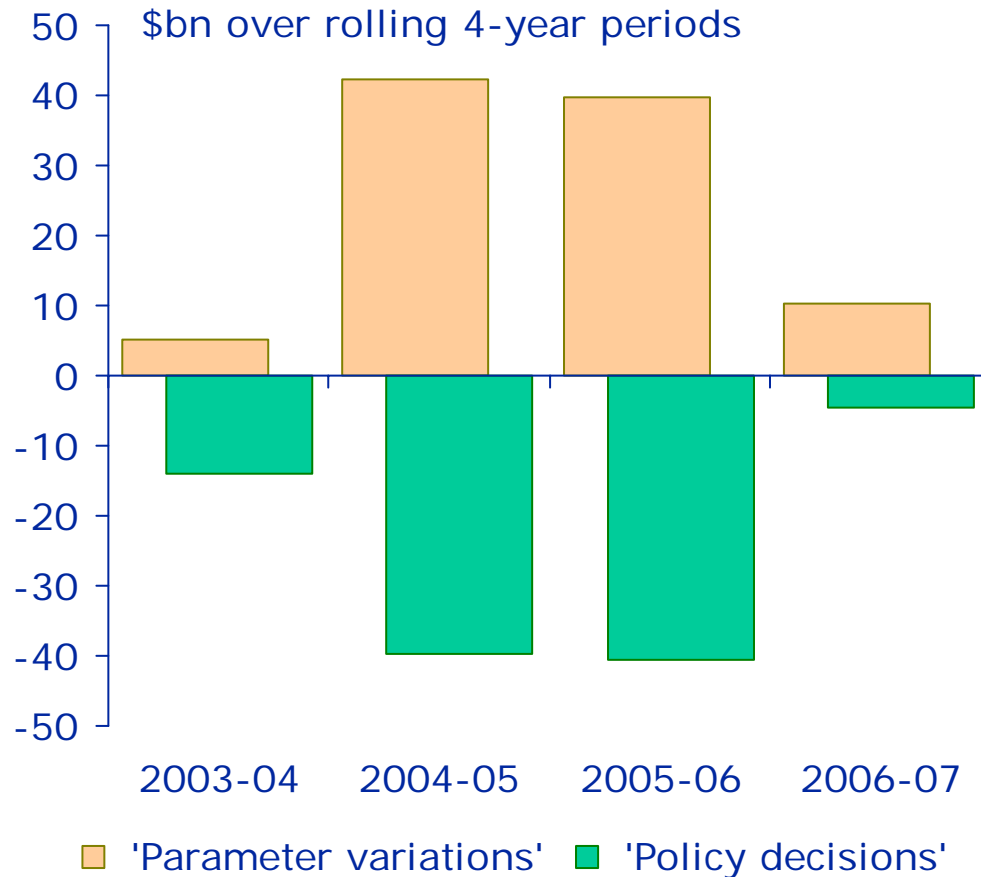
Tax revenue is at a record high ... but the budget surplus is not



Sources: ABS; Commonwealth Government Budget Papers; Economics@ANZ.

The government has 'given away' all of the windfall it has reaped from the recent boom

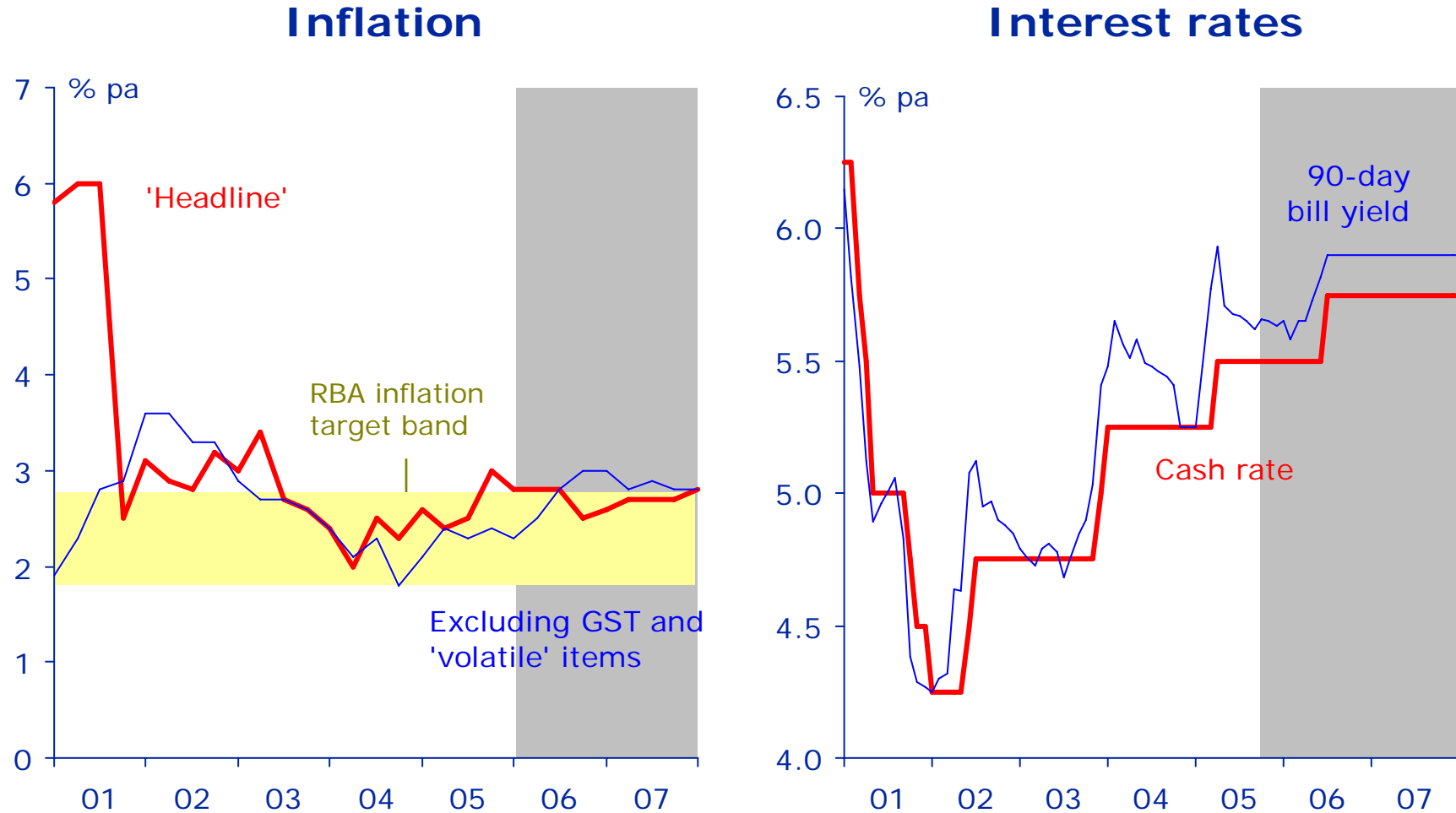
Policy decisions and 'parameter variations' in the last 3½ Budgets



- Over the last 3½ budget cycles (ie including the first half of the 2006-07 budget cycle), 'parameter variations' (mainly upward revisions to revenue estimates) have improved the underlying budget position by a total of \$97.5bn over six years ...
- ... while 'policy decisions' (new spending and tax cuts) have taken \$98.8bn off what would otherwise have been the budget surplus over that period

Sources: Commonwealth Budget and Mid-Year Economic & Fiscal Outlook papers; Economics@ANZ.

With core inflation likely to keep rising the RBA will probably raise the cash rate again this year



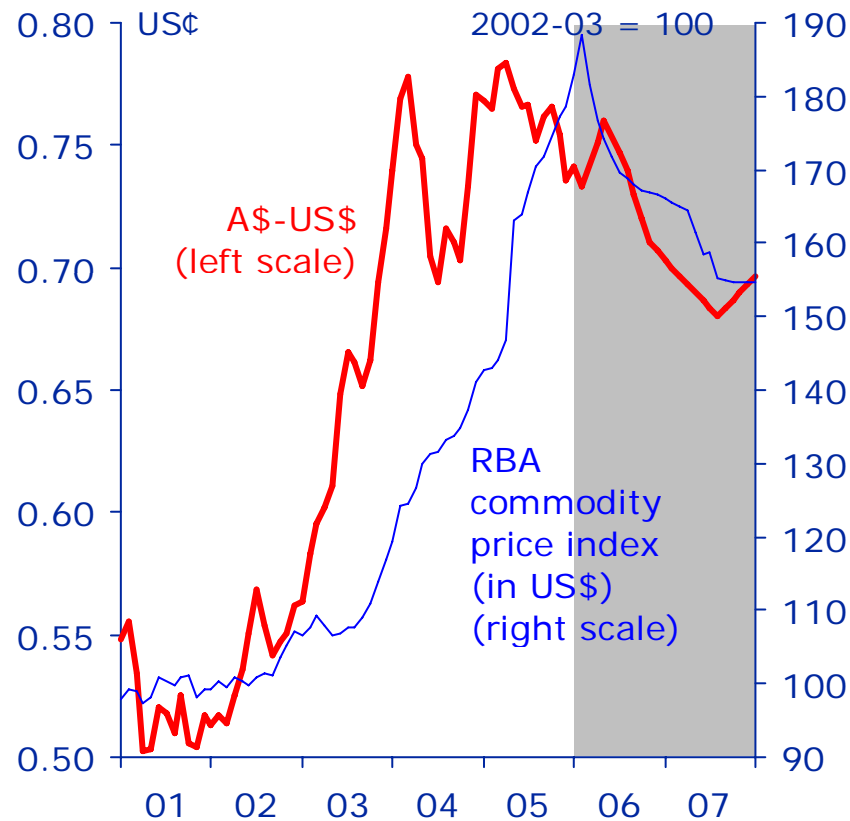
Shaded areas denote forecasts.

Sources: ABS; RBA; Economics@ANZ.

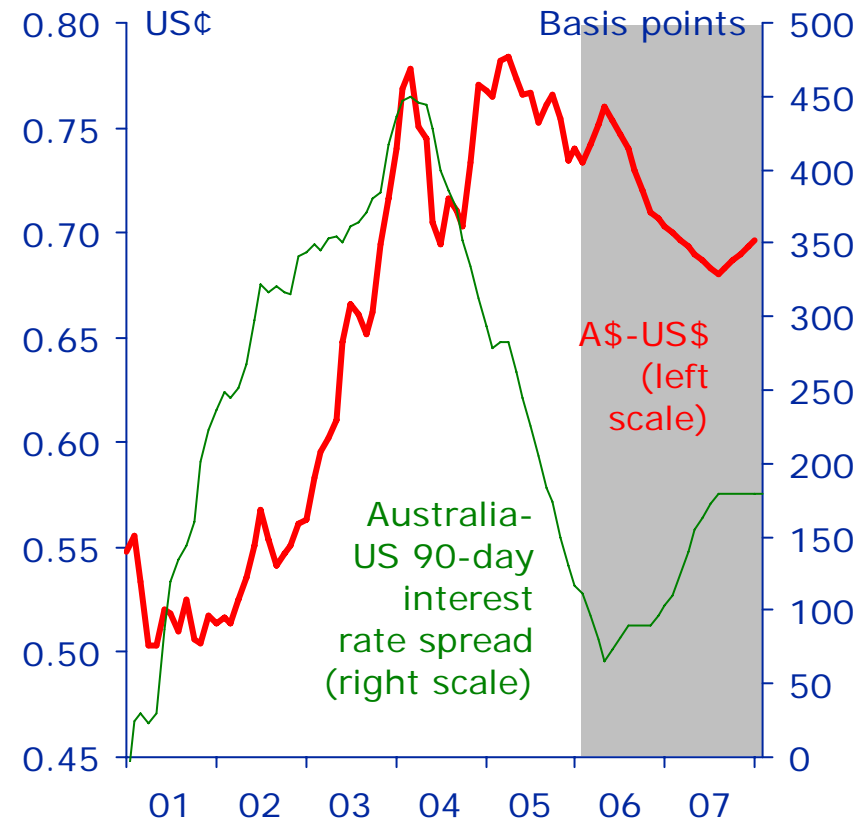
Easing commodity prices and narrower interest rate spread will see the A\$ decline through 2006

Economic influences on the value of the A\$

Commodity prices



Interest rate spreads



Shaded areas denote forecasts.

Sources: Datastream; Reserve Bank of Australia.

Summary

- Growth in the world economy is increasingly being driven by the developing economies, not the industrialized ones
 - emerging economies can continue to grow at rapid rates for a number of years yet
 - emerging economies are largely responsible for the combination of high commodity prices, low inflation and low long-term rates
- The biggest risk to the global economy stems from the shift in surpluses from Asia to oil producers
 - oil producers may be less likely to re-cycle their surpluses back to the US as willingly as Asian countries have done
- The drivers of growth in the Australian economy are changing
 - away from debt-funded household spending
 - towards capital investment and exports
- The Australian economy is likely to continue to operate at close to 'full capacity'
 - which means the risks to inflation are tilted to the upside
 - and so are the risks to interest rates
- The A\$ is likely to decline some more during 2006
 - as commodity prices come off their peaks

Summary of the economic outlook for Australia

	2004	2005	2006	2007
Real GDP growth (%)	3.5	2½	3	3½
Employment growth (%)	2.1	3.2	1¼	1½
Unemployment rate (%) ^(a)	5.2	5.2	5¼	5¼
CPI inflation (%) ^(b)	2.6	2.8	2¾	2¾
Current account deficit (\$bn)	55	56	60	66
Current account deficit (% GDP)	6.3	6	6	6¼
RBA cash rate (%) ^(a)	5.25	5.50	5.75	5.75
90-day bill rate (%) ^(a)	5.43	5.63	5.90	5.90
Standard variable mortgage rate	7.07	7.32	7.57	7.57
A\$ - US\$ ^(a)	0.77	0.74	0.70	0.70

(a) December (b) Year to December quarter; all other forecasts are year-average