

Economic & Financial Outlook- A Global Collision Course? AIG, Brisbane



Jeff Oughton
Head of Australian & Industry Economics
Group Economics
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Presentation Outline

- **World Outlook** (10 minutes)
- **Australian Economic & Financial Prospects** (15 minutes)
 - In Aggregate
 - By Sector
 - By State
- **Opportunities, Risks & Watch** (5 minutes)
- **Q & A**



GLOBAL ECONOMY



Global Base Case

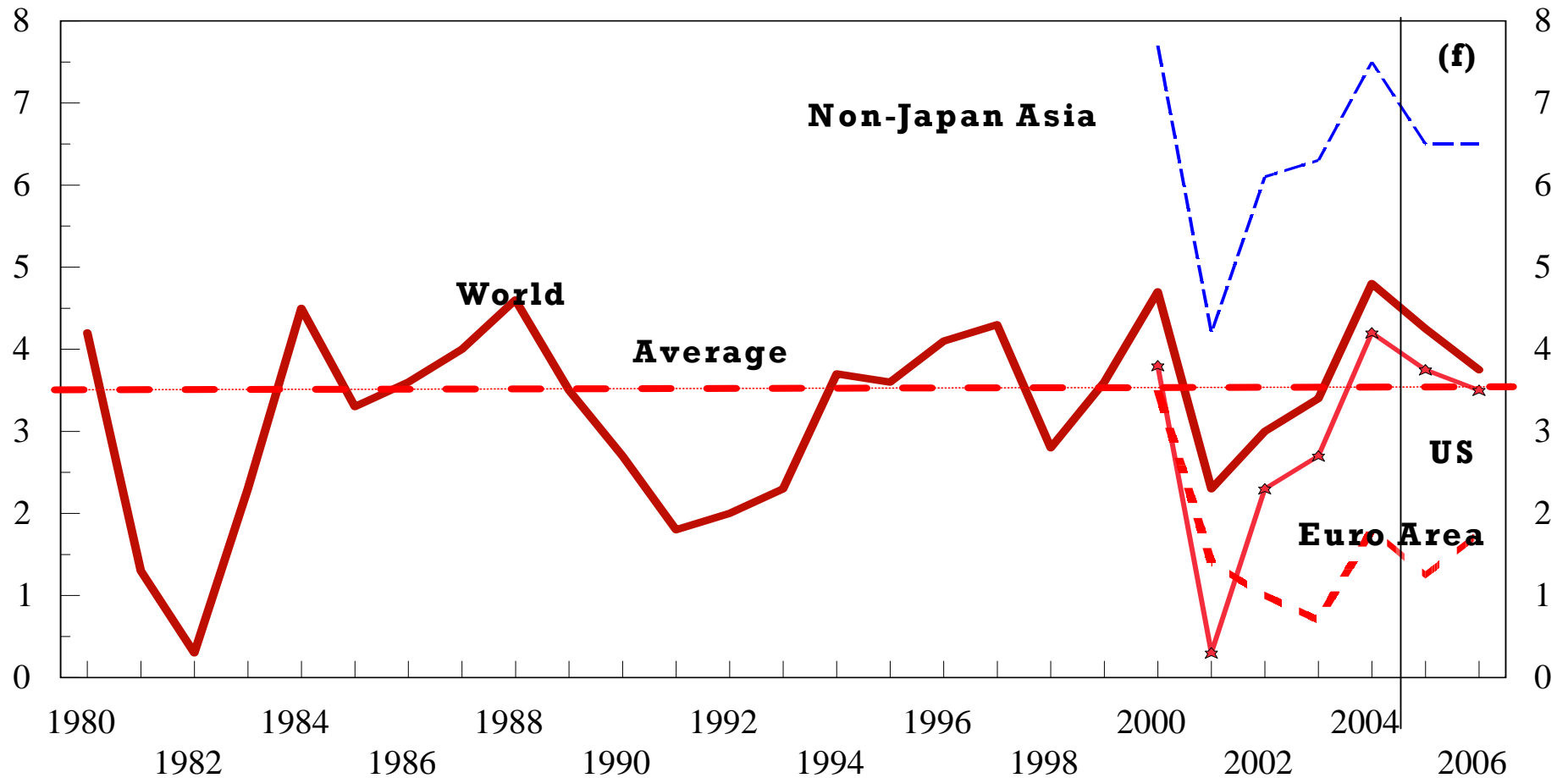
US sustains recovery....Euro stabilizes....Go China & Asia

Slower But Still Relatively Strong Global Growth in 2005 & 2006

World GDP Growth

annual % change

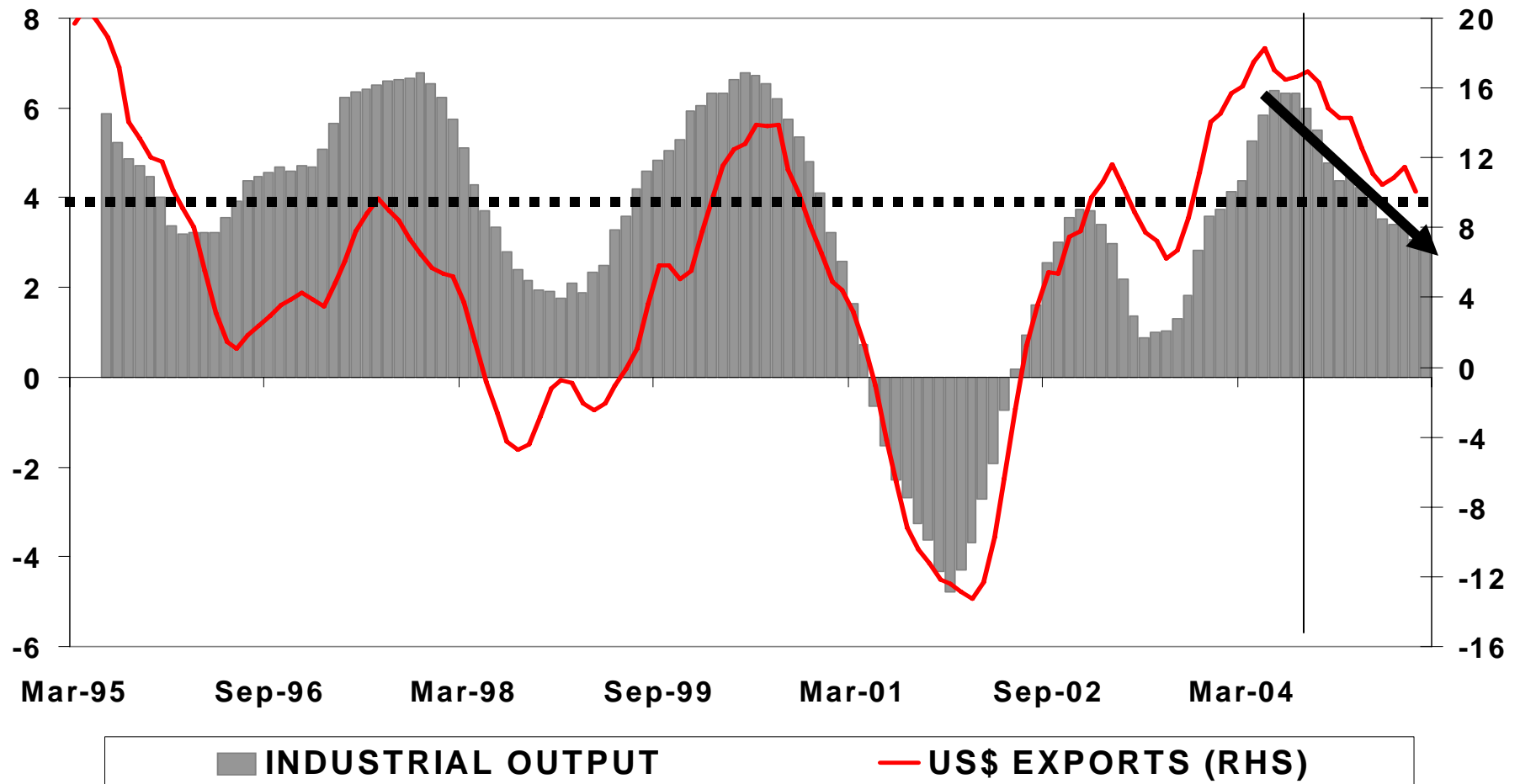
annual % change



Global industrial output & trade

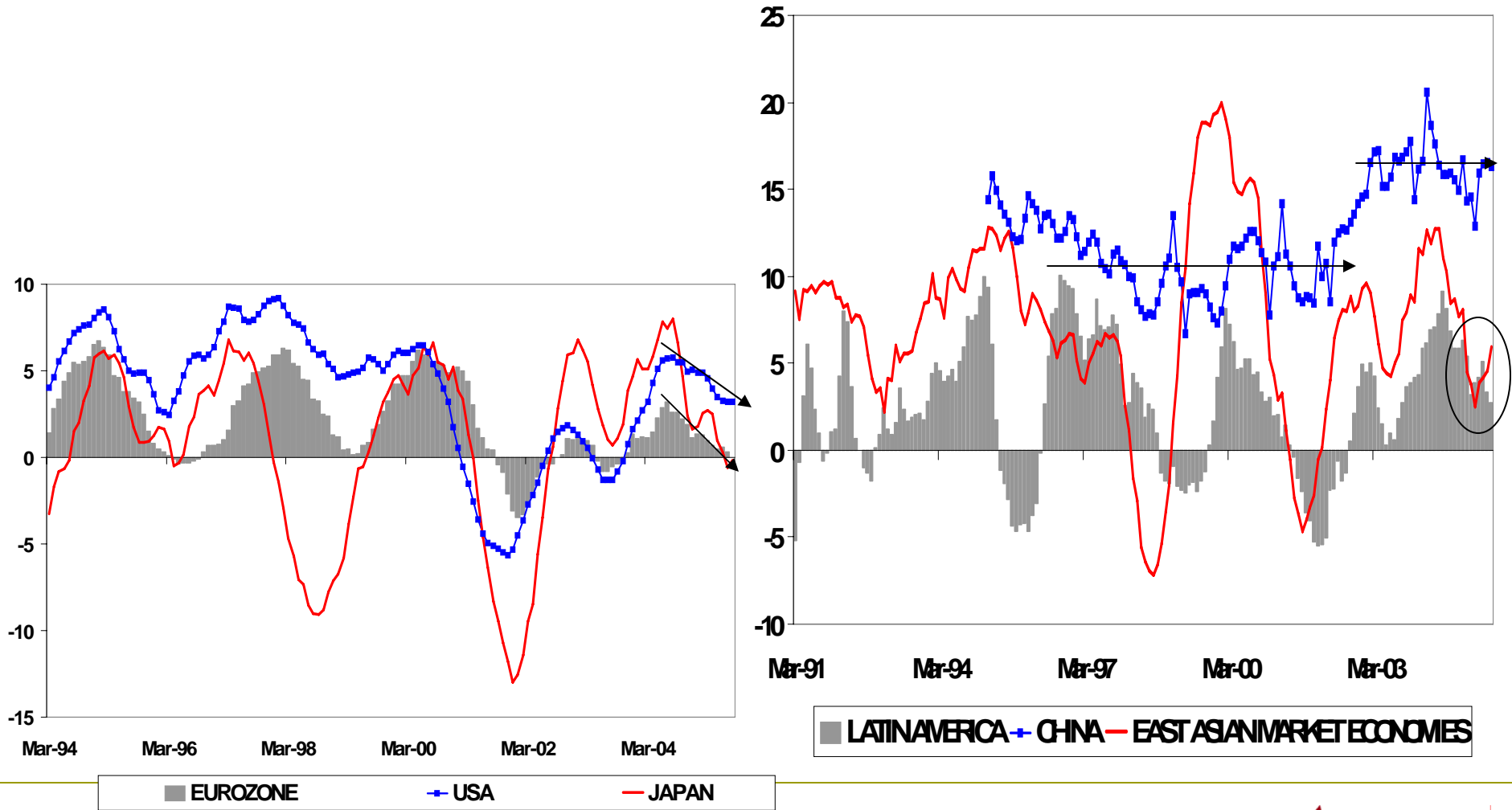
SlowingTighter policy in US & China....Higher Oil Prices
But Stabilising at Reasonable Pace

Industrial Output & Exports



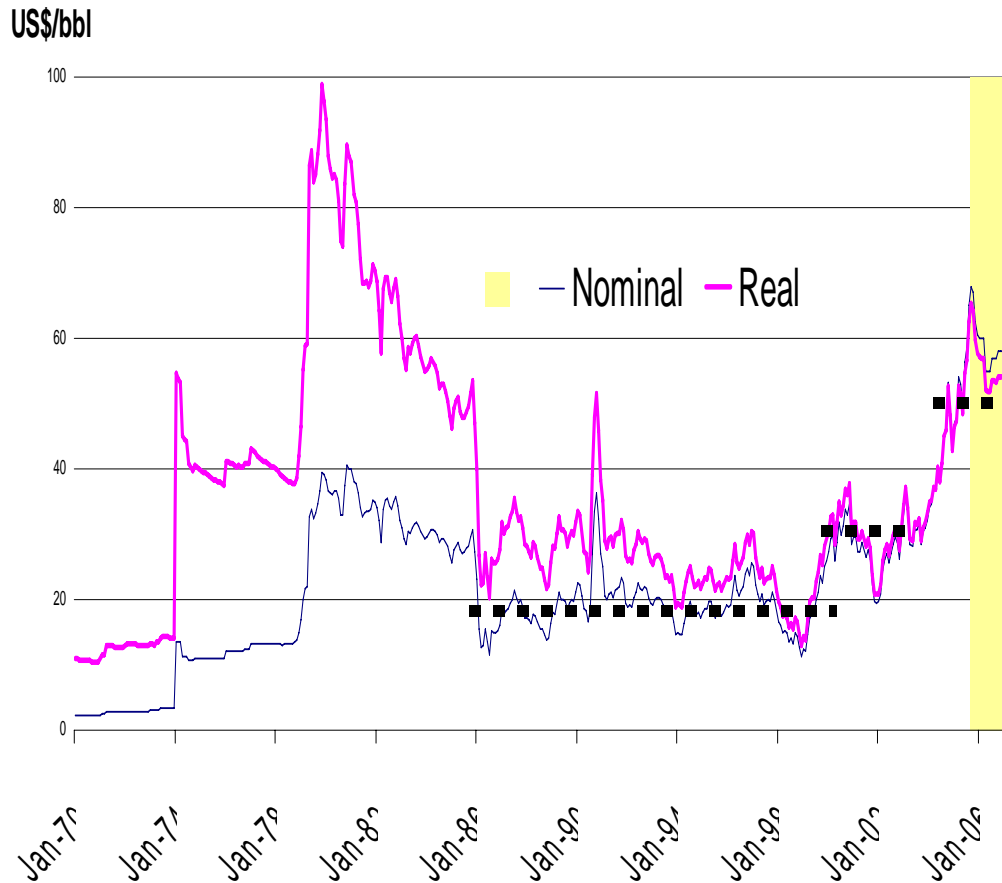
Industrial Output – Mixed Across Regions Largely Driven by China & US...East Asia

Industrial Output % yoy



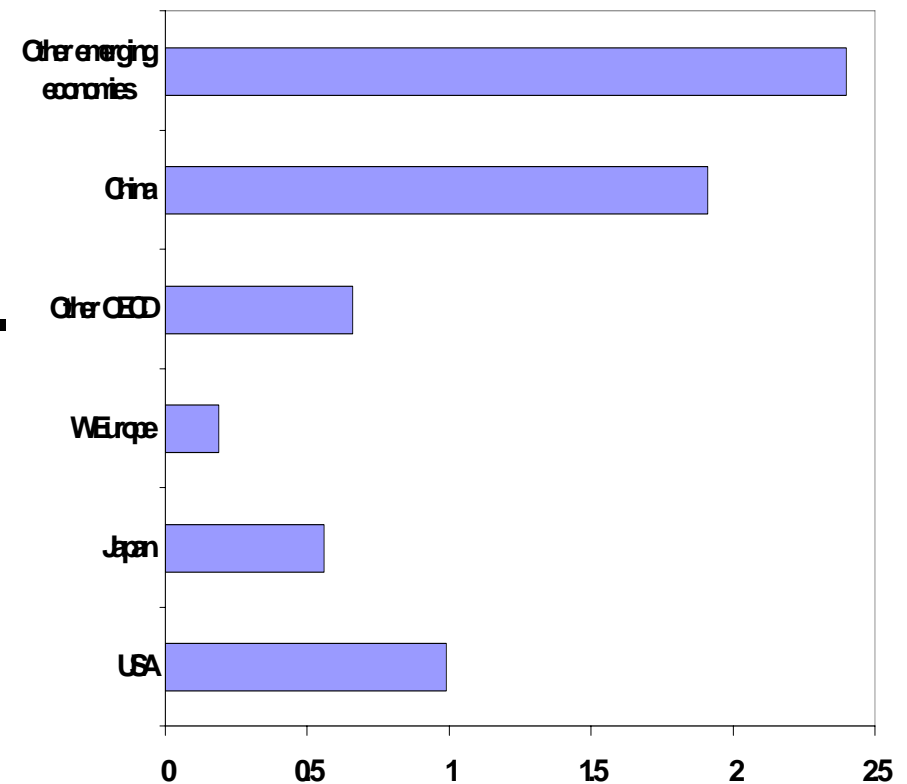
OilSustained higher prices price, but Smaller shock, matters less, better policy....

Real & nominal oil prices



Change in oil demand

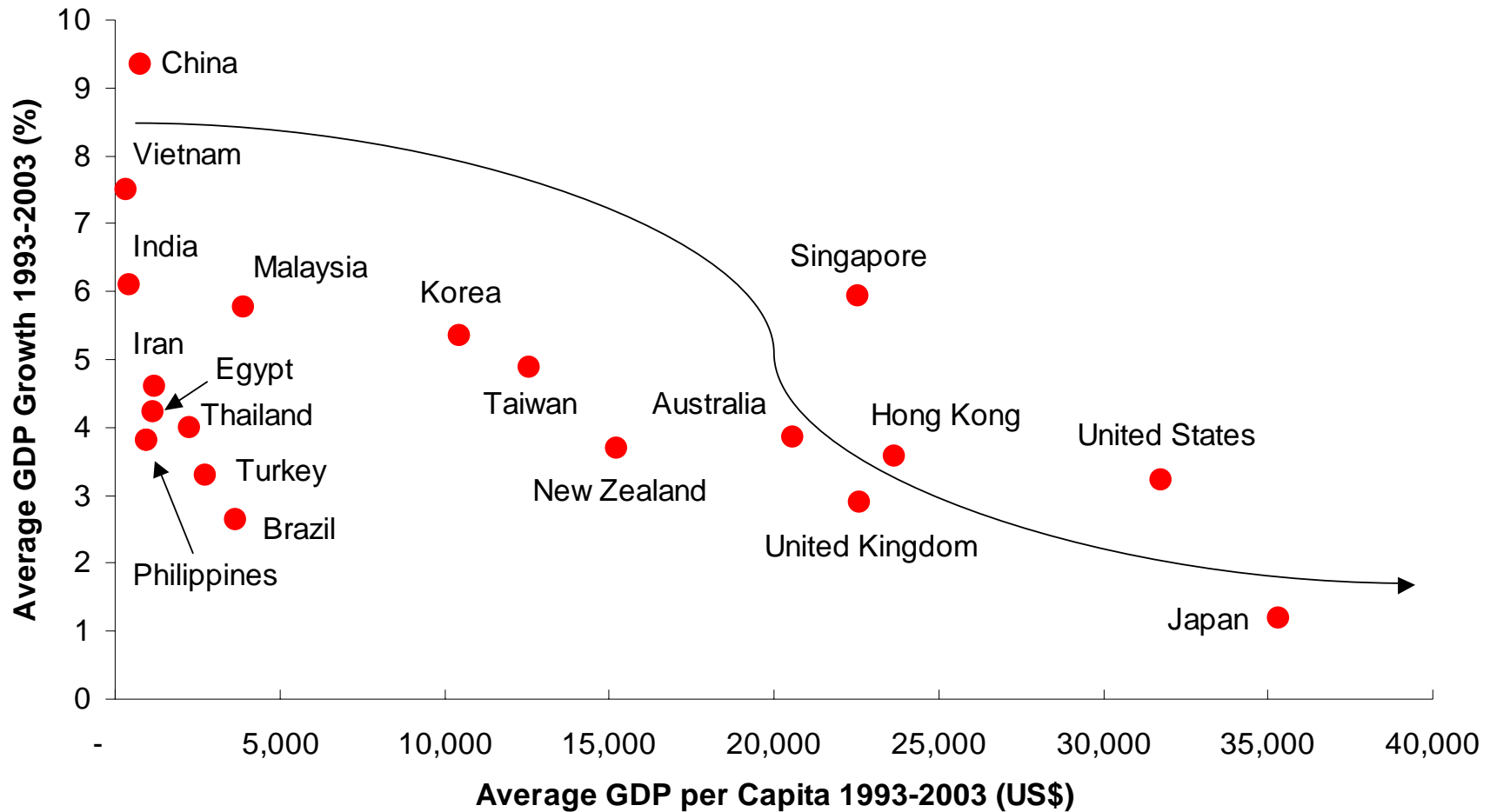
2001-Mar 2005 m bl



Up US30/bbl subtracts 1-1½% of world GDP

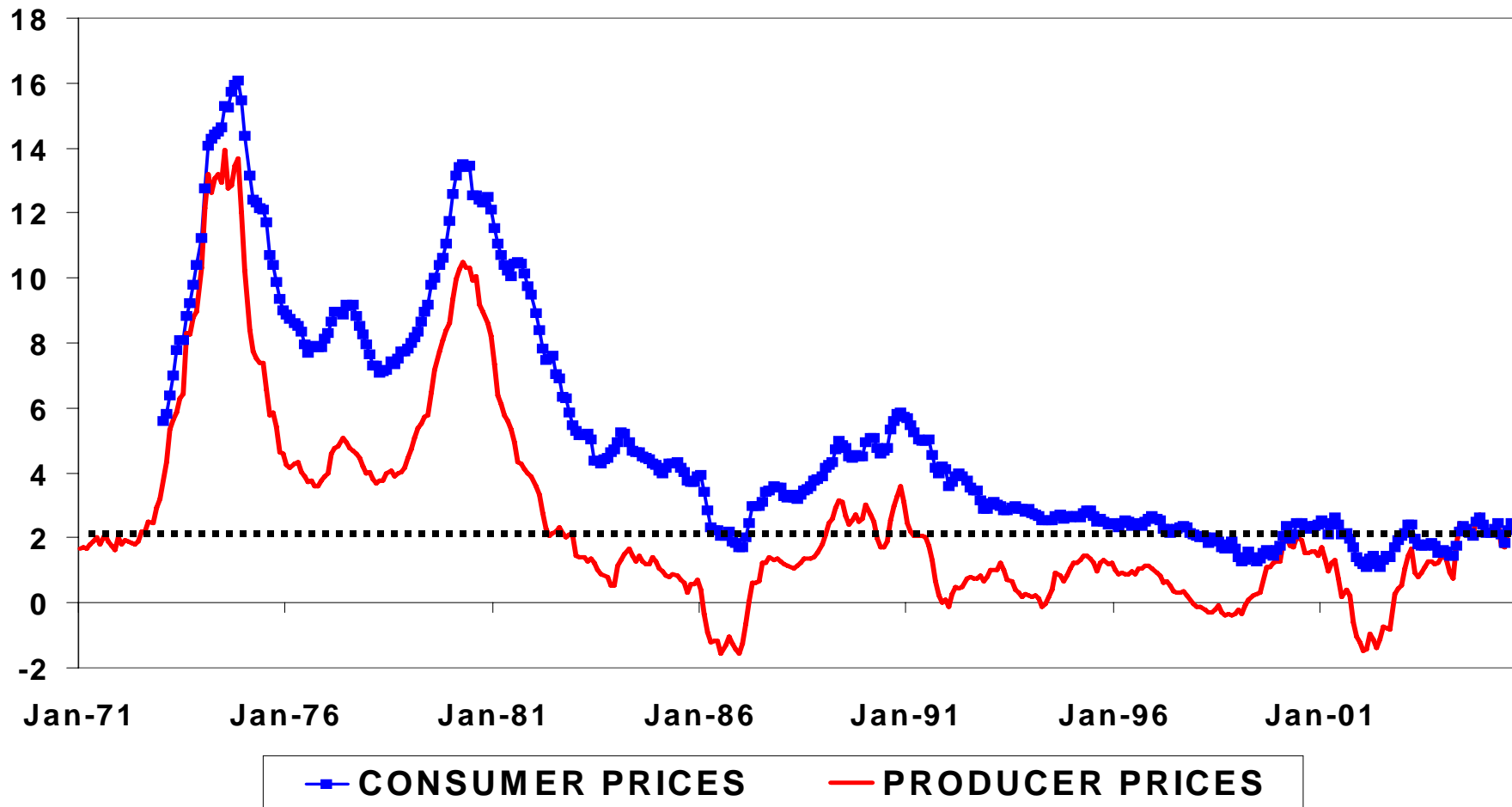
Long-term Growth Prospects
Selected MTPs & Other Smaller Countries.....Go China, etc
Lots of potential.....

Income & Real GDP Growth: Averages 1993-2003

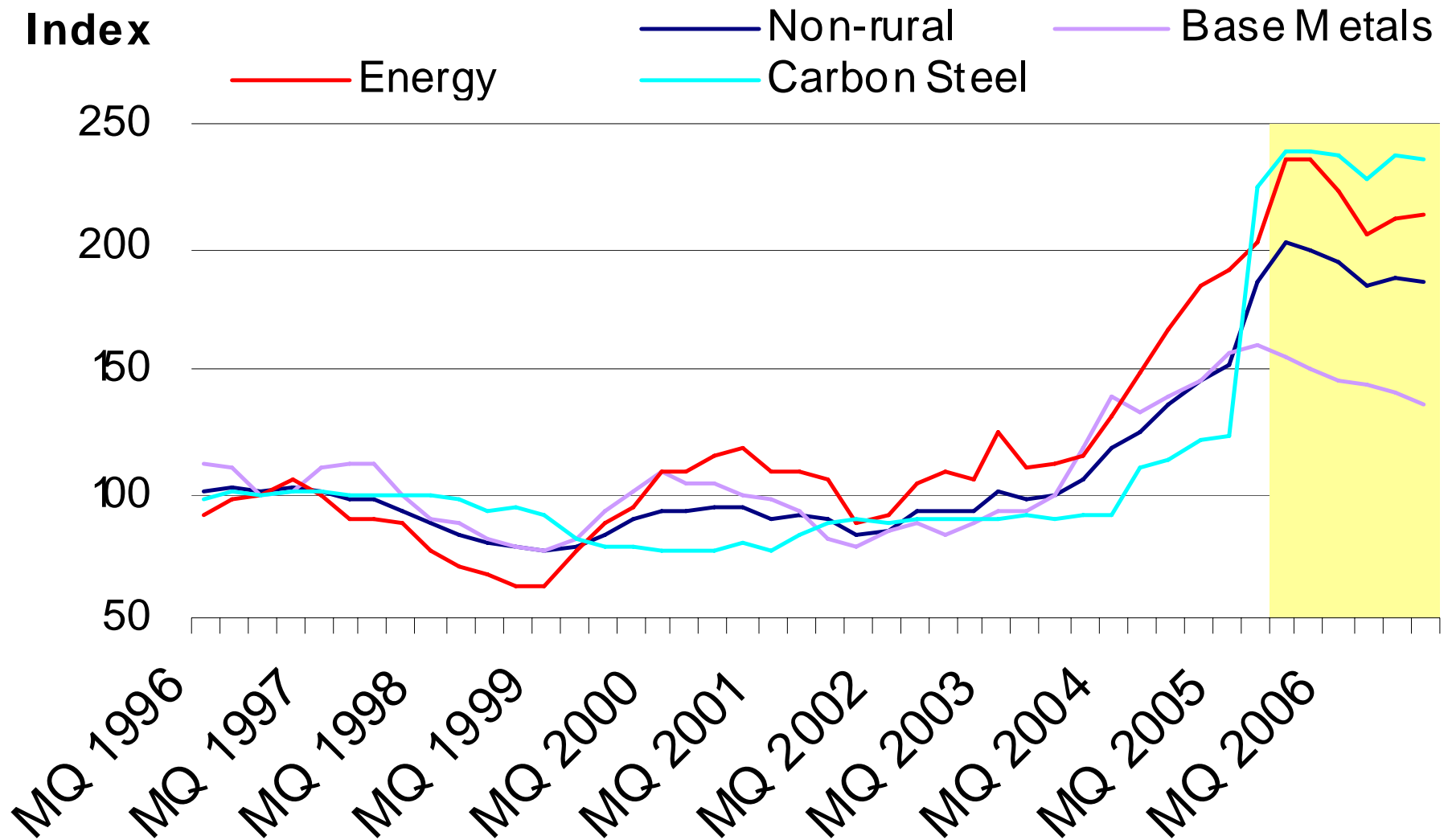


Inflation picking up a little bit – mainly energy
Industry margins being squeezed,
Little sign of “second round” effects on wages.....

Global - % oya



Strong World....Lagging Supply & Low stocks.... High (Non-rural) Commodity Prices (& Overvalued \$A)



Global Outlook

Activity to Slow, But Still Reasonable

December year annual average % change	2003	2004	2005 (f)	2006 (f)
US	27	42	3½	3½
Japan	1.4	27	2½	2¼
UK	25	32	1½	2¼
Eurozone	0.7	1.7	1¼	1½
Canada	20	28	2¾	3
Australia	36	27	2½	3
New Zealand	34	44	2½	2½
China	9.3	9.5	9¼	8½
India	7.3	7.3	7½	6½
World	36	48	4¼	4
Non-Japan Asia	6.3	7.5	6½	6½
Latin America	24	5.7	5	3¾

National's Global Base Case ...

Sustained But Slower Global Growth
US Growth on Track – Post Hurricanes
China & India Likely to Remain Strong – “Catch up not Blow up”
Rest of Developing Asia & Japan a Bit Better
Europe Stabilising

Commodity Prices Peak & Fall Modestly
Oil Prices Peak too
Consumer Prices Up A Bit But Contained
“Neutral” Monetary Policy
Higher Bond Rates

Global Macro Risks & Opportunities

- **Geo politics** - Both political, oil & trade tensions overhang the outlook.
- **Unbalanced global growth** – Much still depends on the US & Asia esp. China. Continental Europe continues to lag.
- **Chinese Reforms** – “3 Represents” managed with political/social/economic stability
- **Anglo-Saxon household leverage** – Increased household gearing, low savings and “expensive” housing leaves some consumers vulnerable to higher interest rates & sustained loss of jobs.
- **Financial instability** – As interest rates rise to more “normal” levels, some asset valuations may become volatile & lead to instability amongst investors and institutions.
- **Oil prices** - Sustained high prices would prove a headwind to the global recovery under way.
- **Bird flue** – Likely to be contained, albeit watch for human pandemic.



AUSTRALIA



Australian Economic Outlook

Growth Sustained But Slower
Different Mix -
Household Moderation & Exports Pick Up
Inflation Temporarily Higher – Due to Oil, But Contained

Cash Rates Around Neutral,
USD Stabilises & \$A Retraces From Recent Highs
Equities Perform & House Price Rises Cool, Not Crash

Risks Now More Balanced

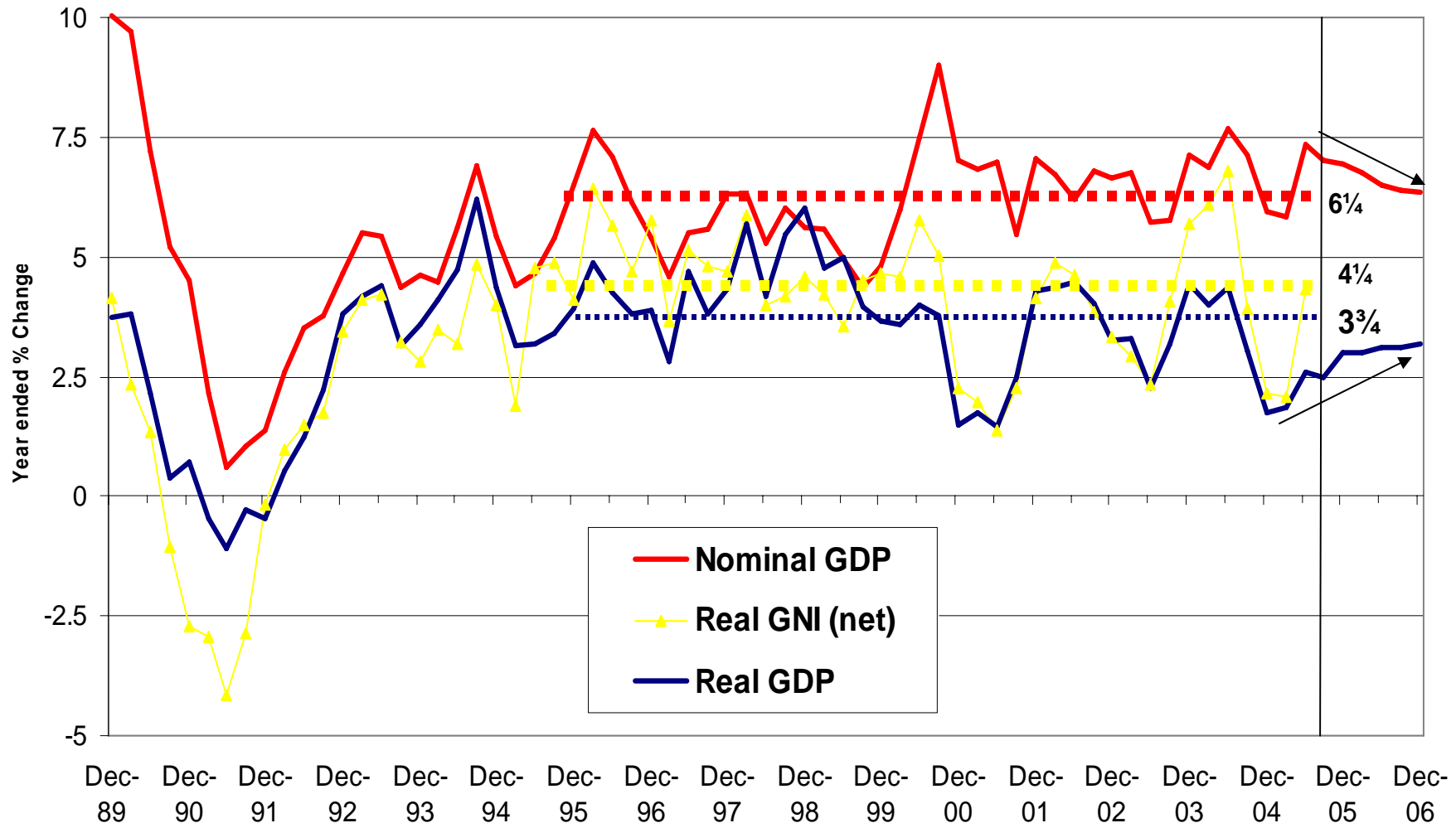
Key Risks

Residential Property Markets,
Tight Labour Markets
World & Exports (\$A, Values & Prices)

Australian Economic Miracle...Sustained Income Expansion

Real GDP – A Bit Slower...Real GNI – AverageNominal GDP Still Strong

Australian Incomes

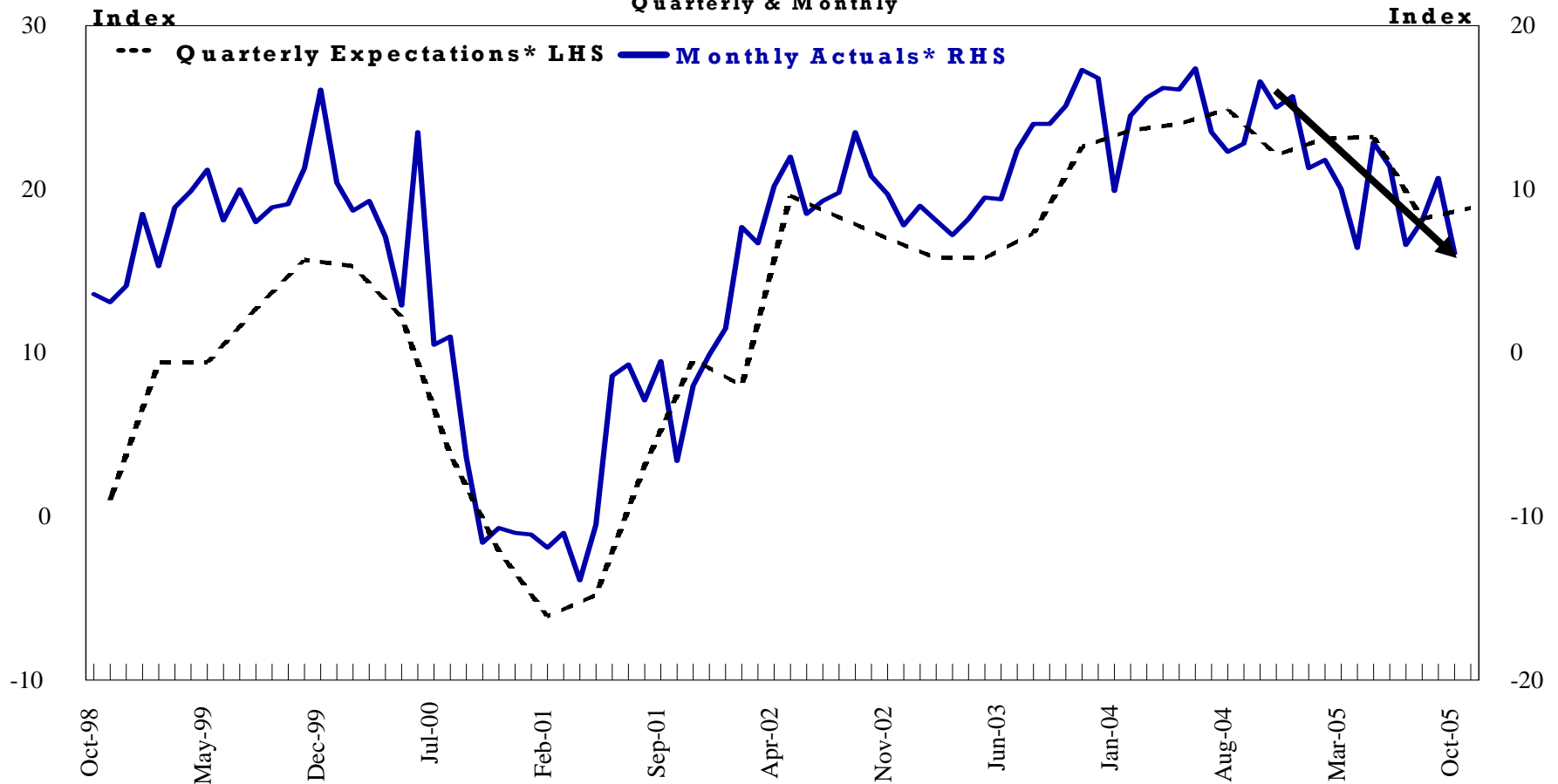


1 % of GDP is about \$8.6 bn

Australia

Activity/Spending is slowing too....Confidence below average too

Business Conditions Quarterly & Monthly



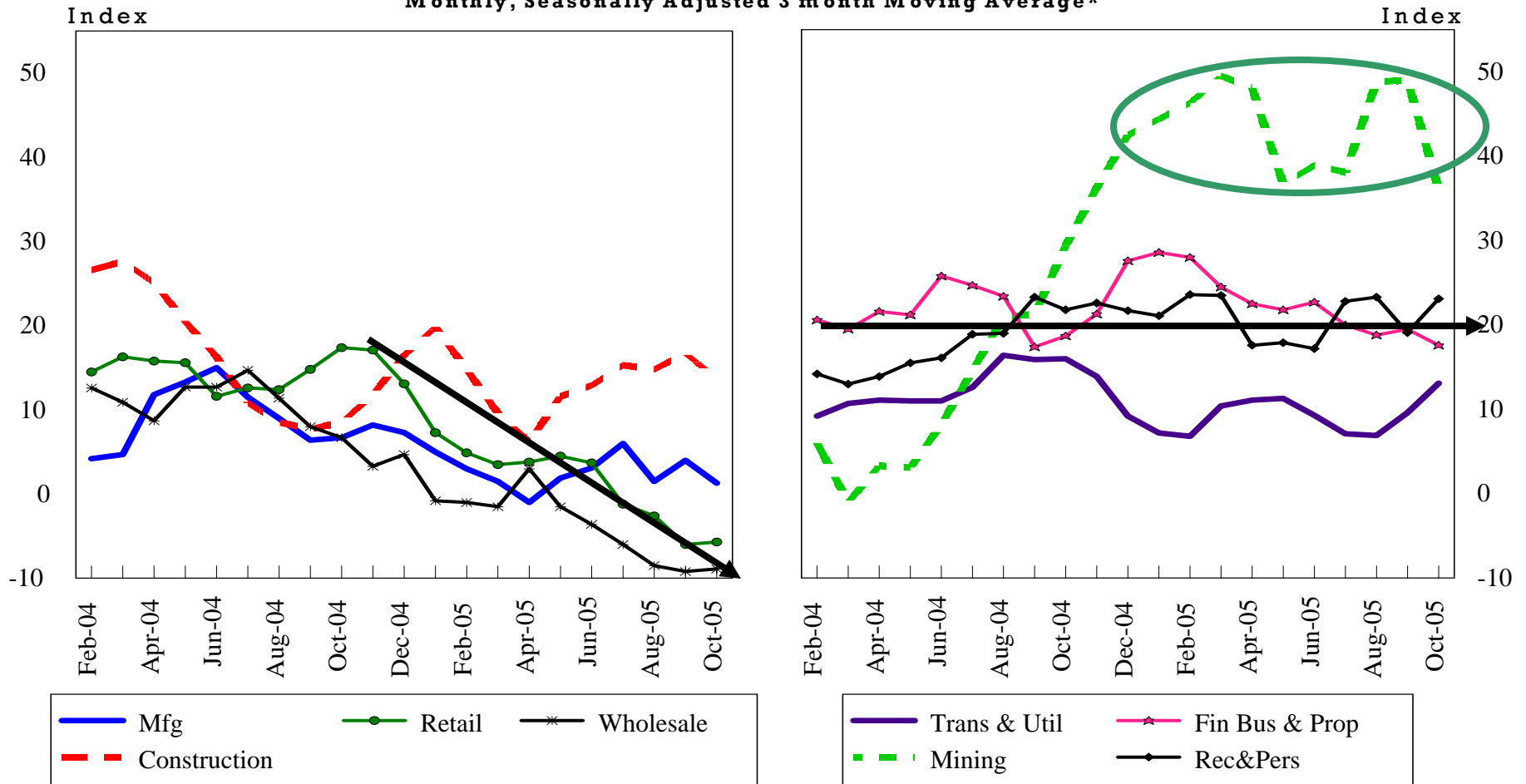
* Seasonally adjusted by National using X12

National's forecast is for slowdown to continue...

Business Conditions Somewhat Mixed Mining Booming, Household Slowdown, Services Reasonable

Business Conditions by Industry

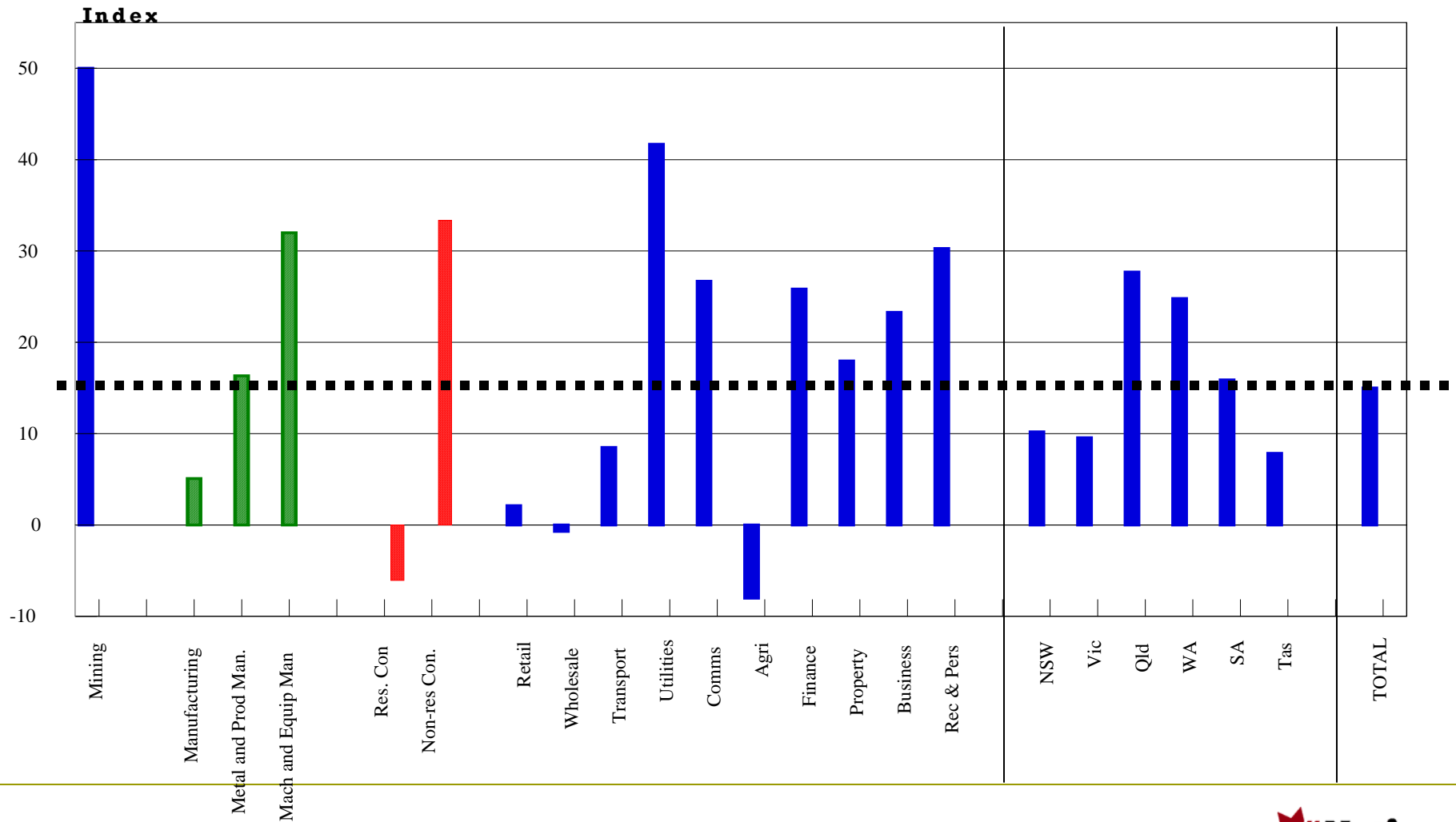
Monthly, Seasonally Adjusted 3 month Moving Average*



* Seasonally adjusted by National using X12

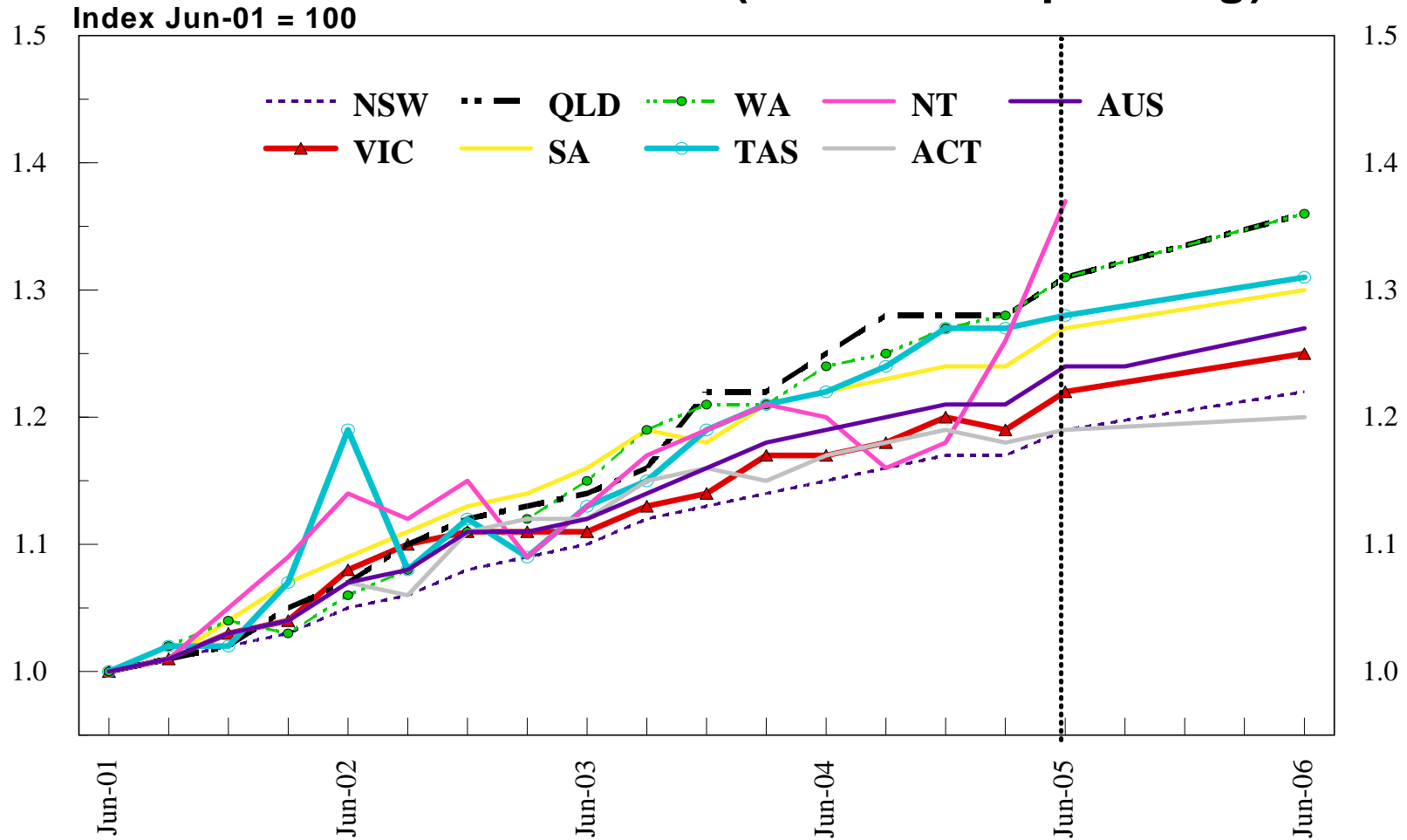
By state & industry...Sep quarter Smaller States Doing Better....NSW & Vic. Under Performing

Business Conditions By Industry and State, Sep Quarter



Smaller states outperform the larger States

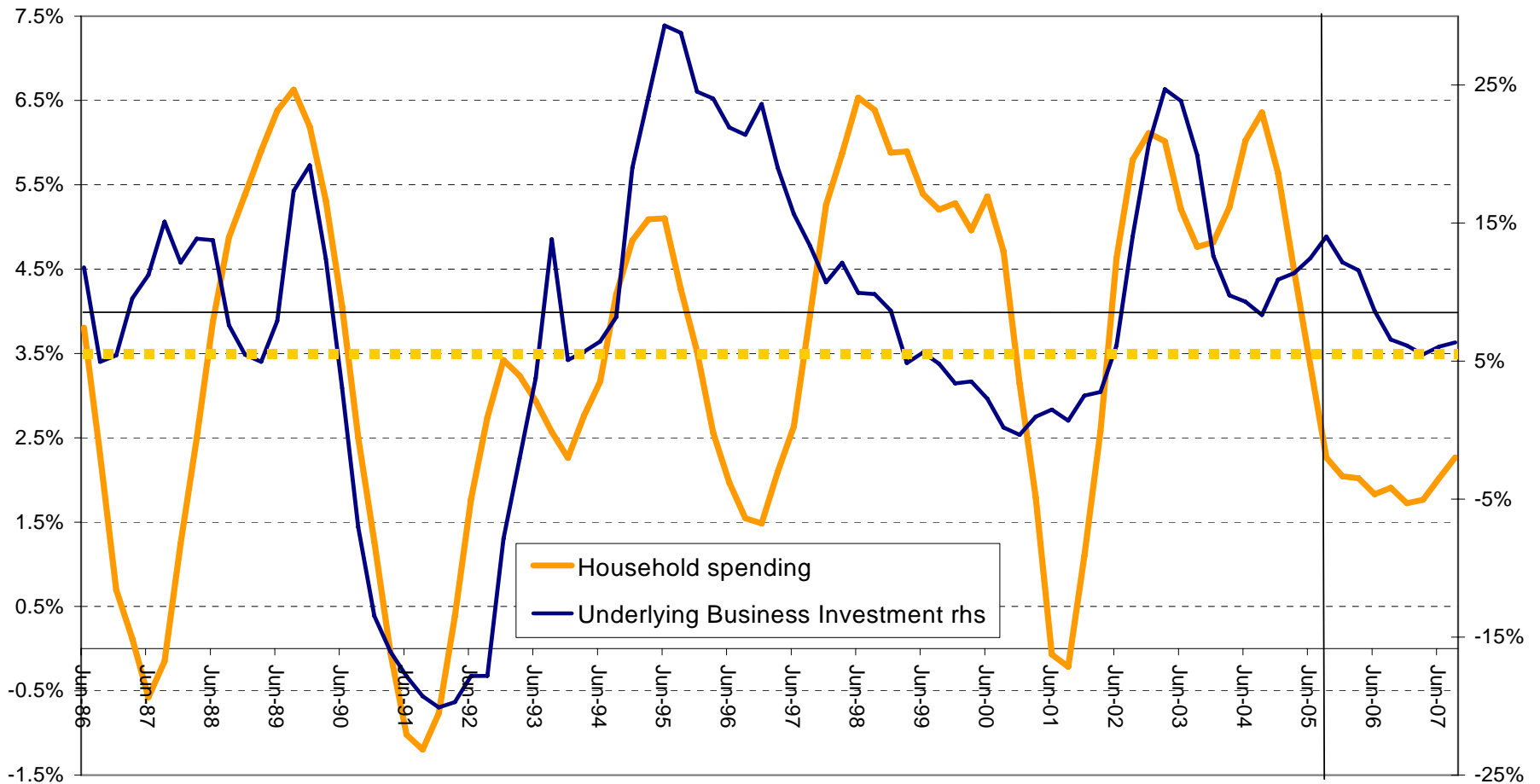
Real Final Demand (Domestic Spending)



Domestic Slowdown

Household Spending....Diminishing Wealth Effects, Higher Oil, Slower Job Gains

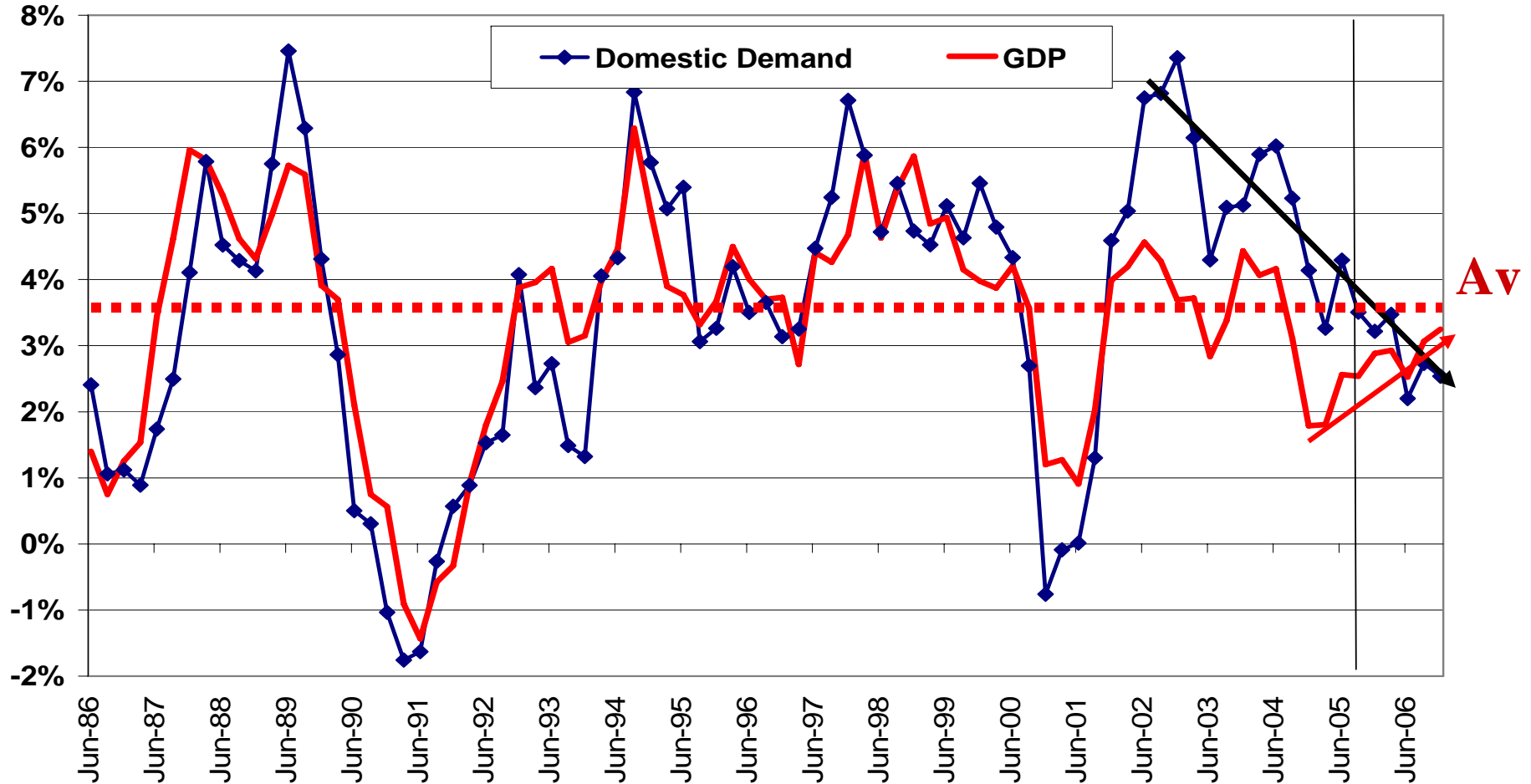
Key Drivers of GDP - Household Spending & Business Investment



Australian Economic Growth Outlook

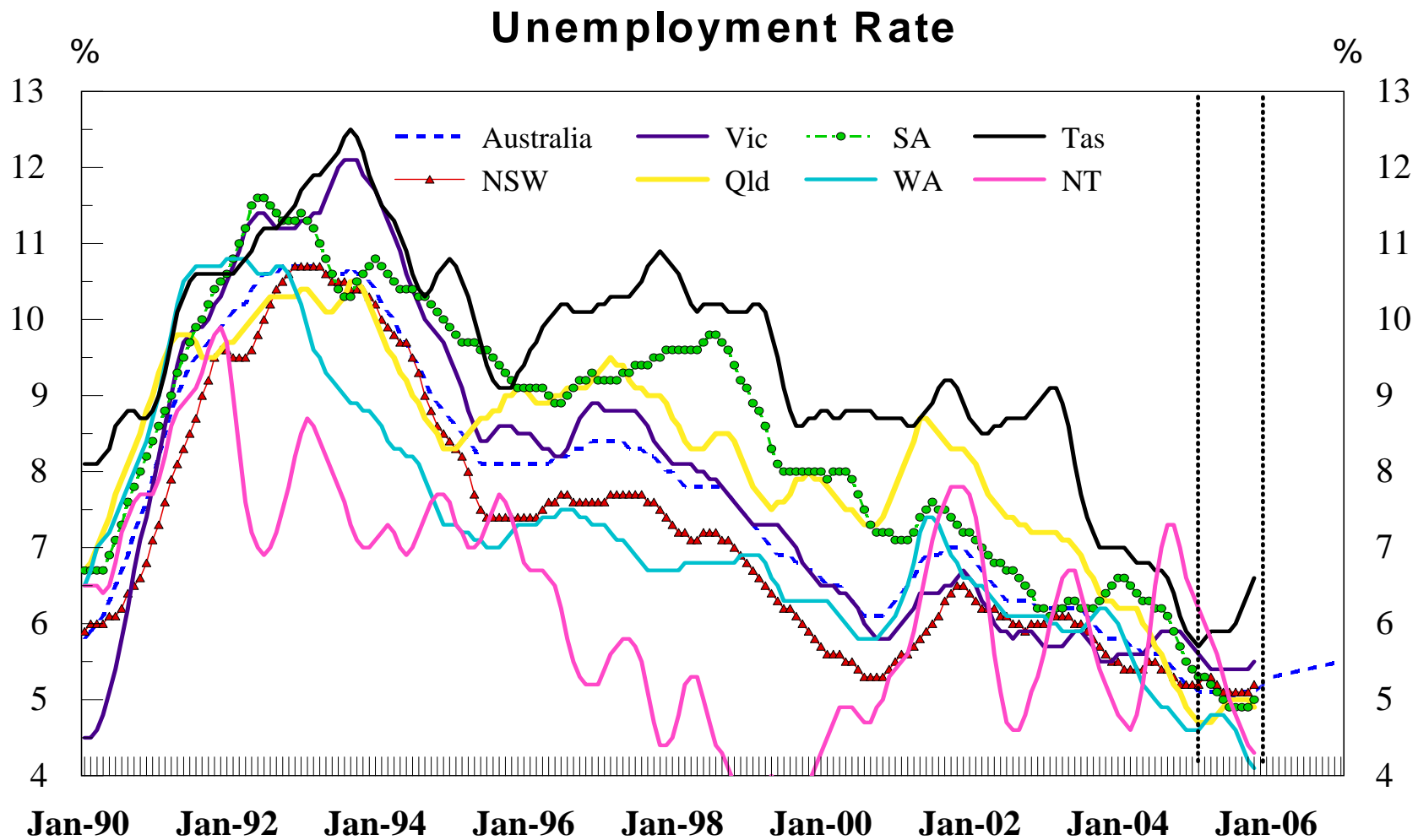
Activity Sustained, As Domestic Spending Moderates, Exports Pick up

Growth in GDP & Domestic Demand - 12 Mths to %

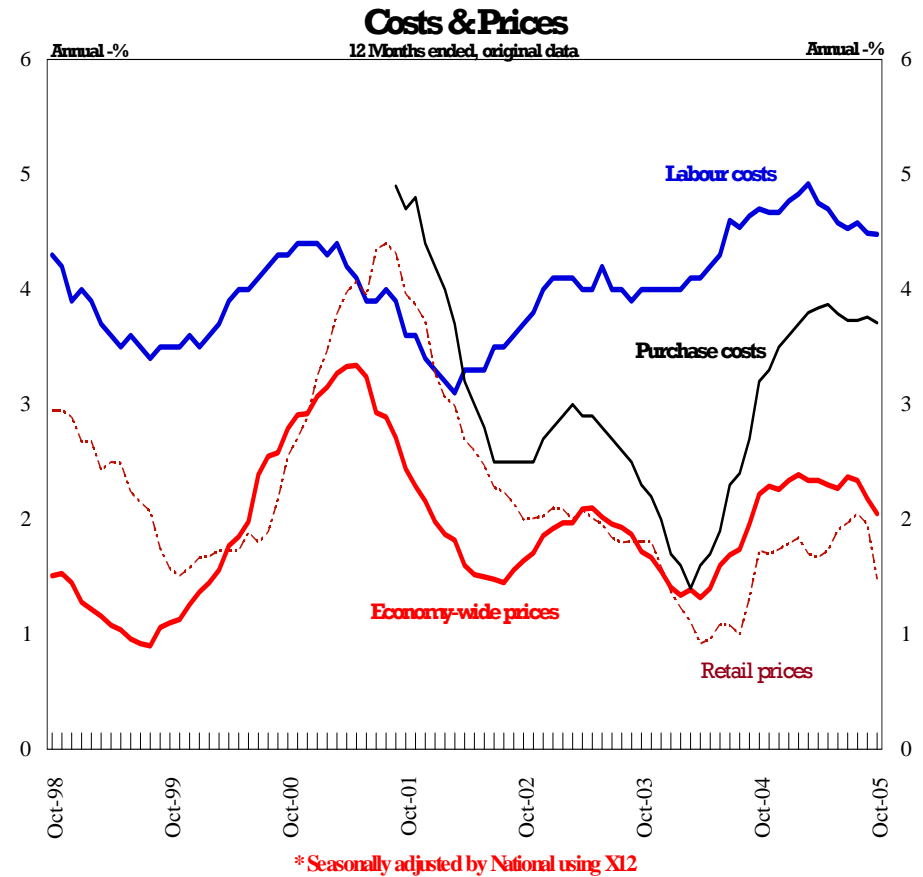
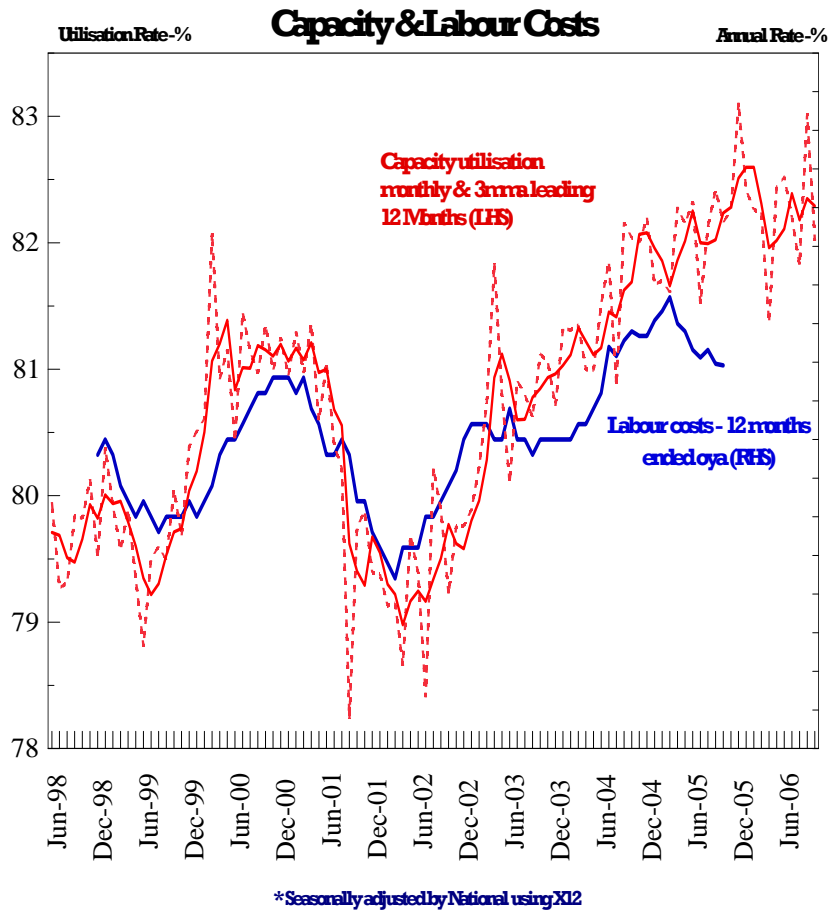


Unemployment Rates....

“Happy” Households....But Cooling Down, Except WA



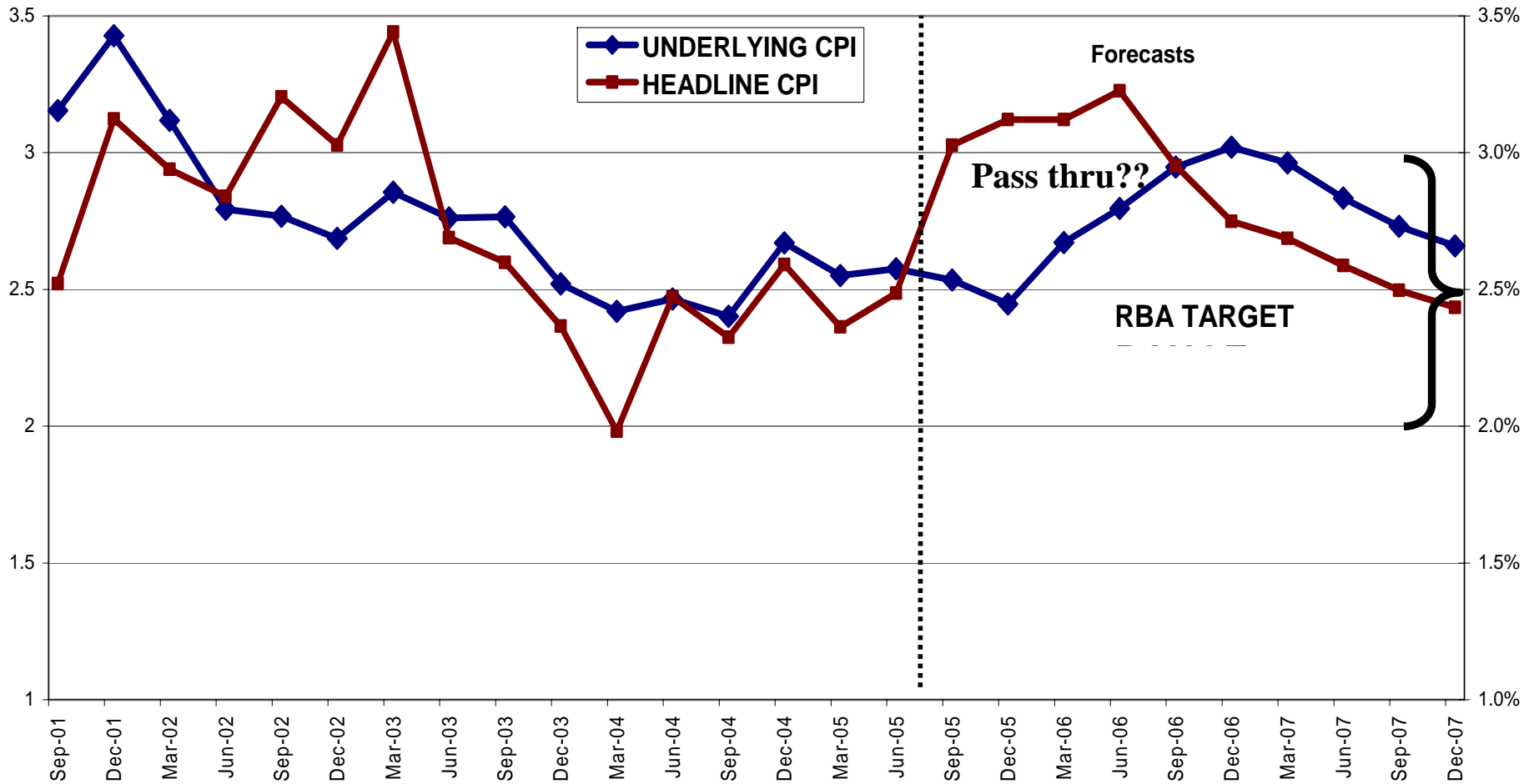
Wage pressures softening, but still high capacity utilisation & indirect effects of oil prices driving up purchase costs



Slides summarise RBA's inflation concerns.....rising cost pressures
 But demand to slow further & margins squeezed in National's view

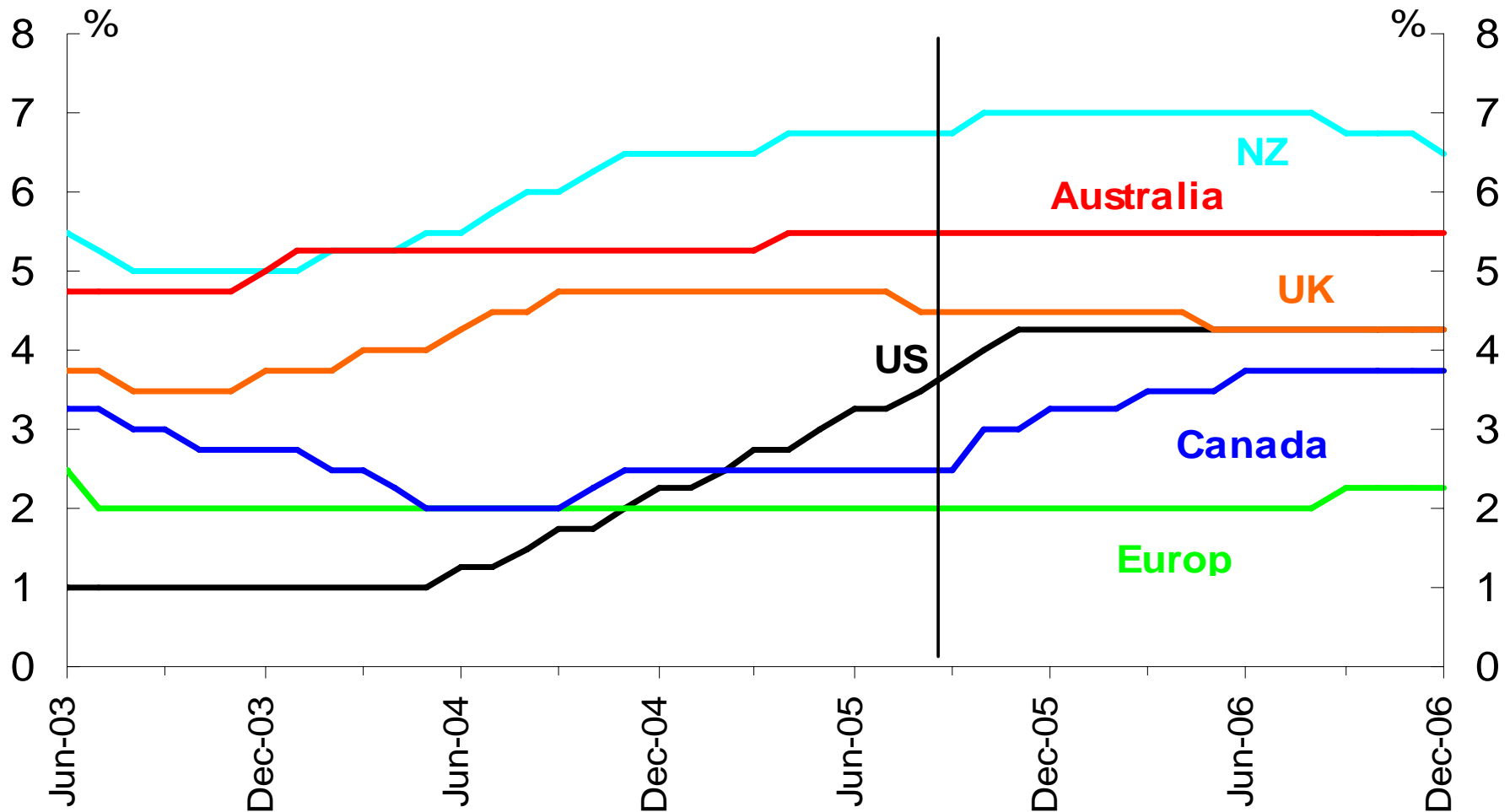
Underlying Inflation Contained Risks Balanced ...Higher Oil Prices V Easing Capacity Constraints

Headline & Underlying CPI - 12 Mth to %

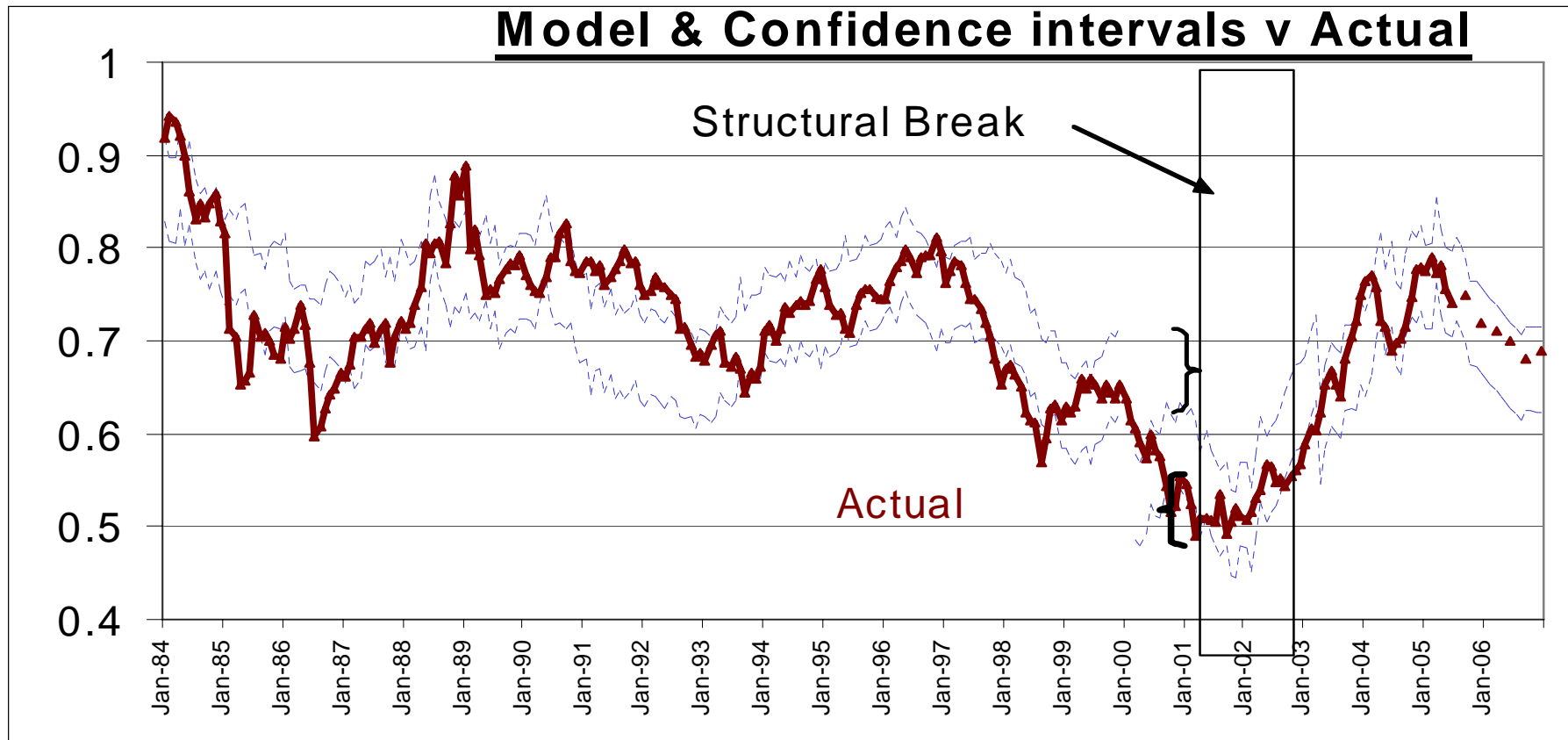


RBA on hold Cash rates unchanged in Australia, As US Fed Remains Measured

Global Cash Rates



\$A Models used to do well.
But unable to cope in 2000-2002 (very much a \$US story).....
Now working reasonably well – or at least as per pre 2000.....



- Models Driven by - commodity prices (global growth)
- growth differentials (UN and I differentials)
 - sustainability (policy/CAD & capital flows)

National's Macroeconomic Base Case for Australia...

Australia

Growth Slower But Spending Sustained
Unemployment Rises A Bit
Inflation A Bit Higher But Contained
Change in Mix of Growth/Business Activity
Moderation in Household Spending
Exports Recover As Global Growth Sustained

Cash Rates Around Neutral,
USD Stabilises & \$A Retraces From Recent Highs
Equities Perform & House Price Rises Cool, Not Crash

Good Times Most Likely to be Sustained.....!!!!

'Top' Economic Drivers & Watch Issues

- **Unbalanced World** – heavily dependent on US as Euro & Japan slowly reforms
- **Developing World** – rapid industrialization/integration(esp. China & Eastern Europe)
- **Oil /Energy** – sustained high oil prices despite slower global growth
- **Geopolitics** – terrorism disrupts oil supply, economic activity & financial stability
- **Anglo Saxon Property** – exposure to higher interest & unemployment rates
- **Trade Reforms** – Doha round & Euro CAP reforms & bi-lateral deals
- **Chinese Reforms** – “3 Represents” managed with political/social/economic stability
- **Australian Reforms** – winners & losers from next round of industrial relations, competition, health, education etc reforms



A Quick Look at Construction

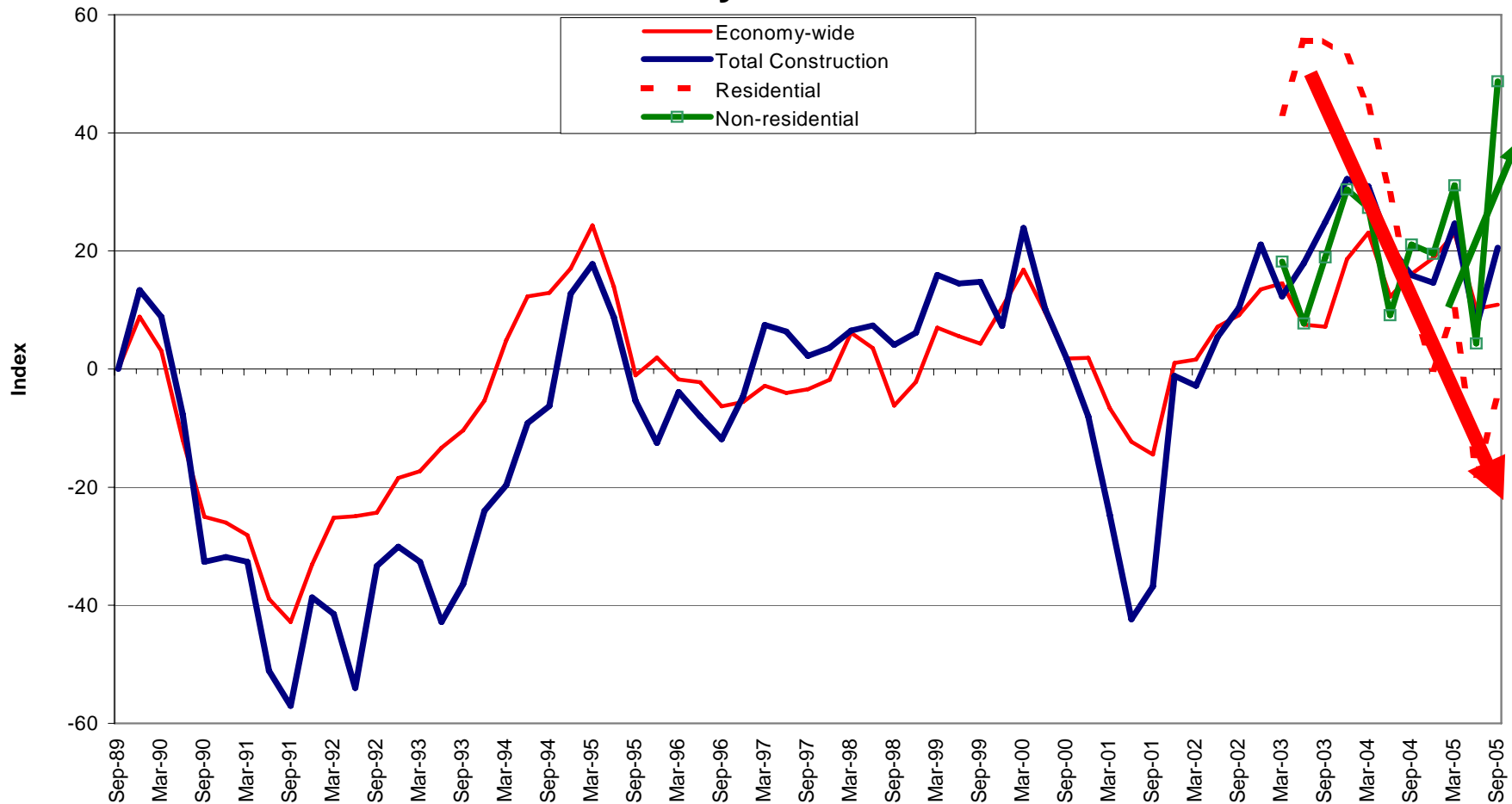


National's Business Survey

Residential ...strongest to poorestnear the bottom....

Non-residential....one of the strongest....foreseeable future

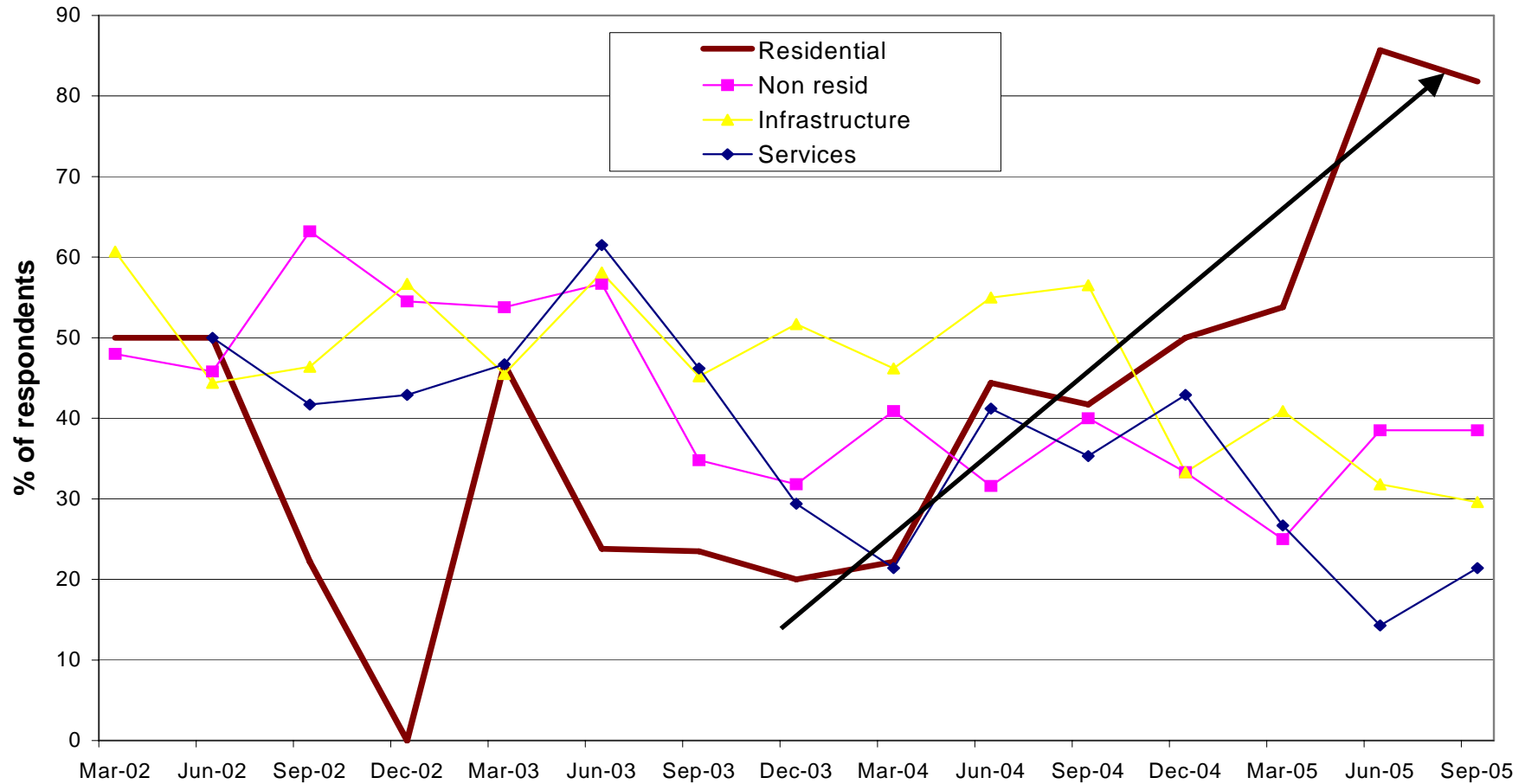
Business Conditions by Construction Subsectors



National's Business Survey

Residential Profit Outlook...Demand, demand...

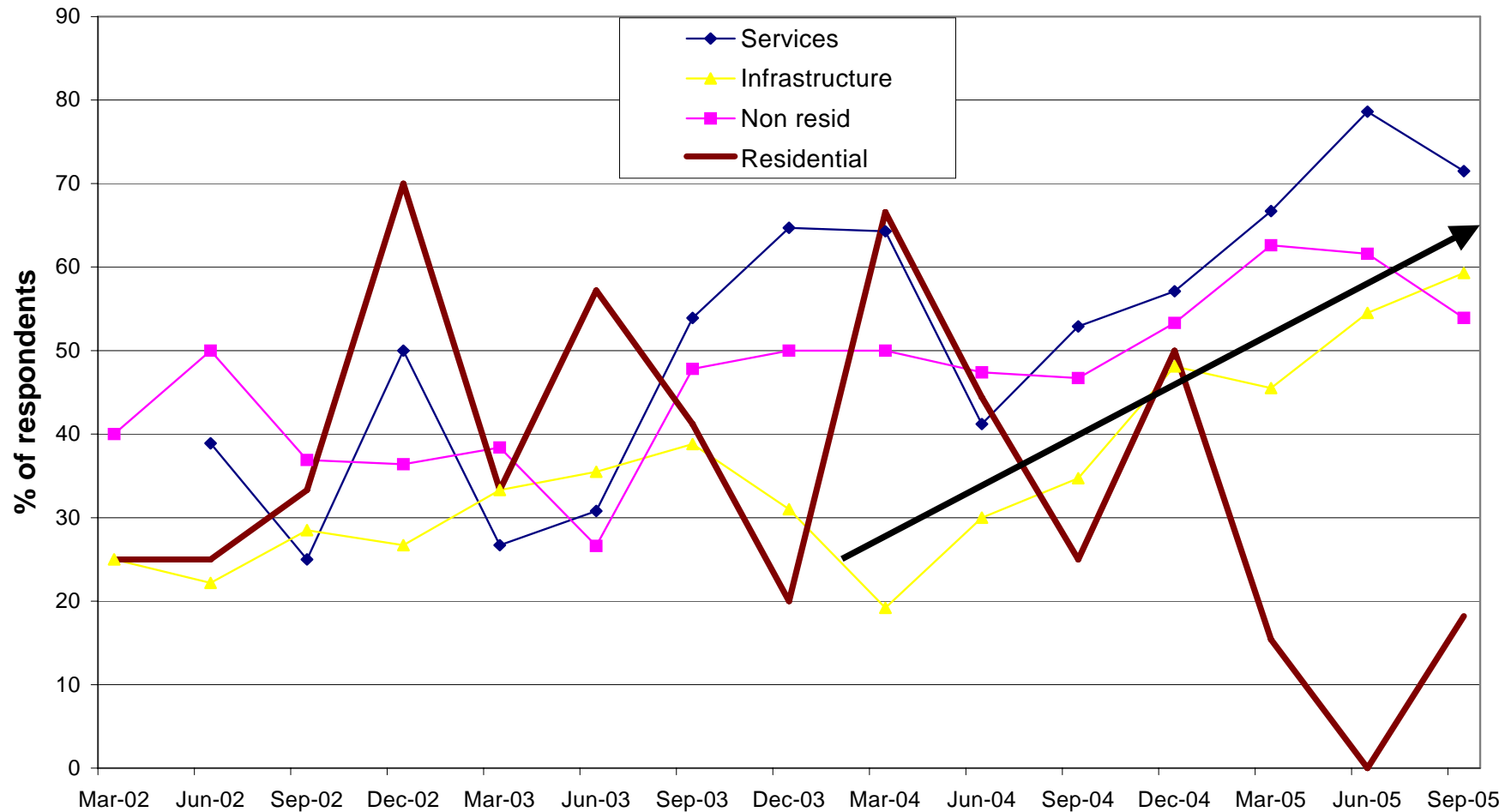
DEMAND - Sales & Orders



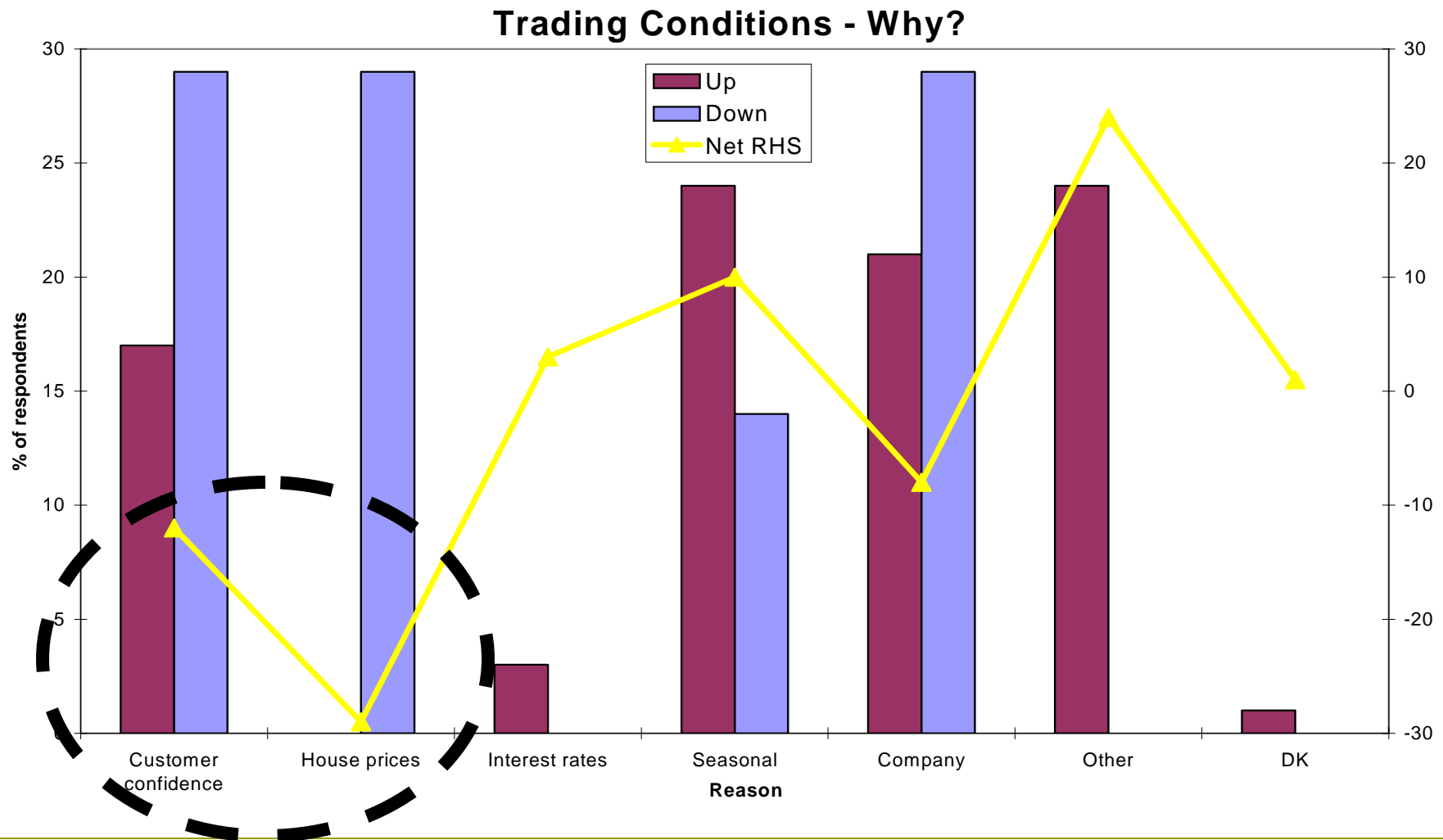
National's Business Survey

Non-Residential Outlook...Labour market

LABOUR - Cost & Availability

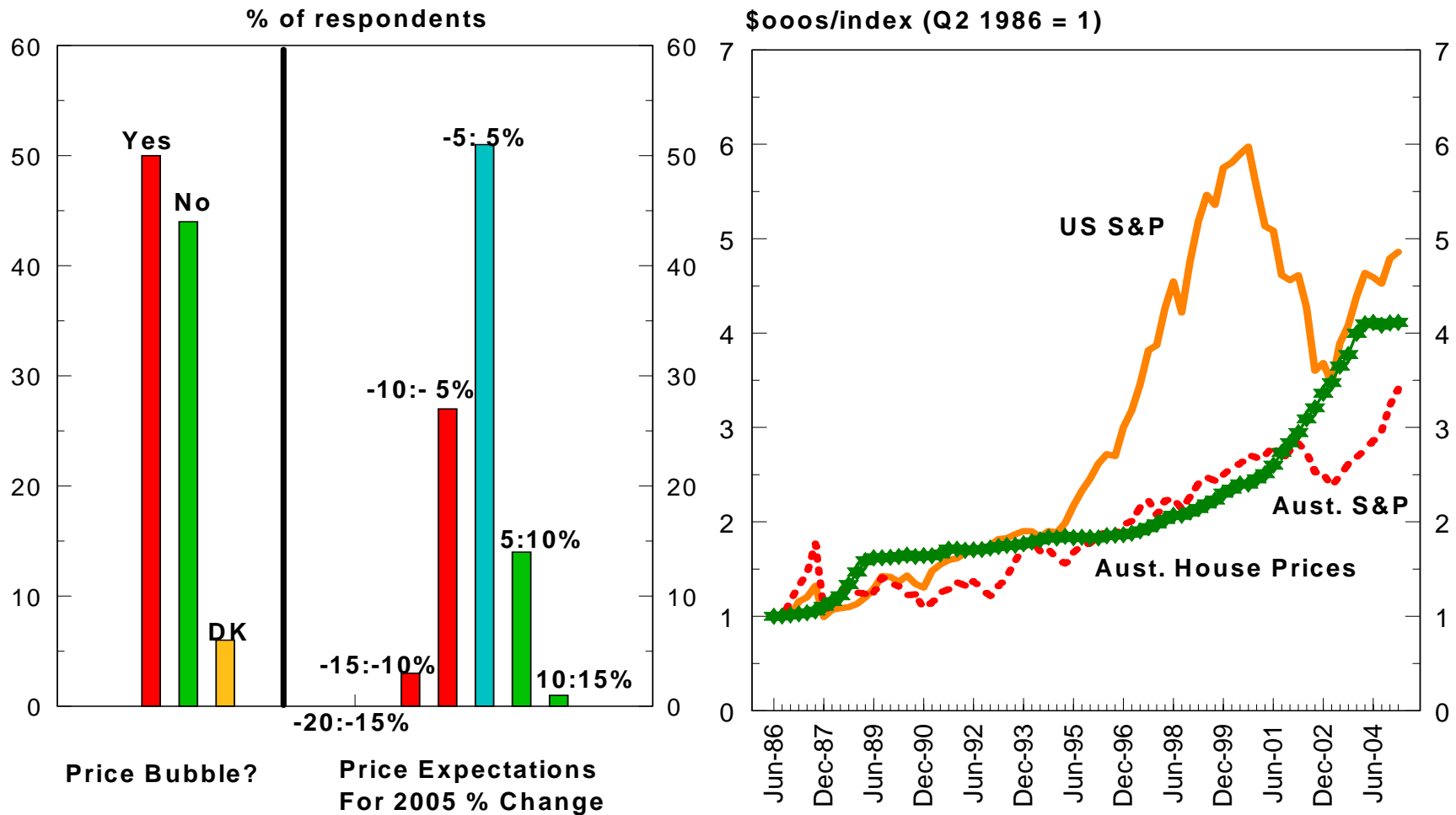


Trading conditions/salesup & down & why? Confidence & prices.....company specific



Anglo Saxon Bubbles..... No...For Crash Need Trigger(s)
 Driven by Increased HBA.....Plenty of Collateral & Under Geared Customers

Australian House Prices

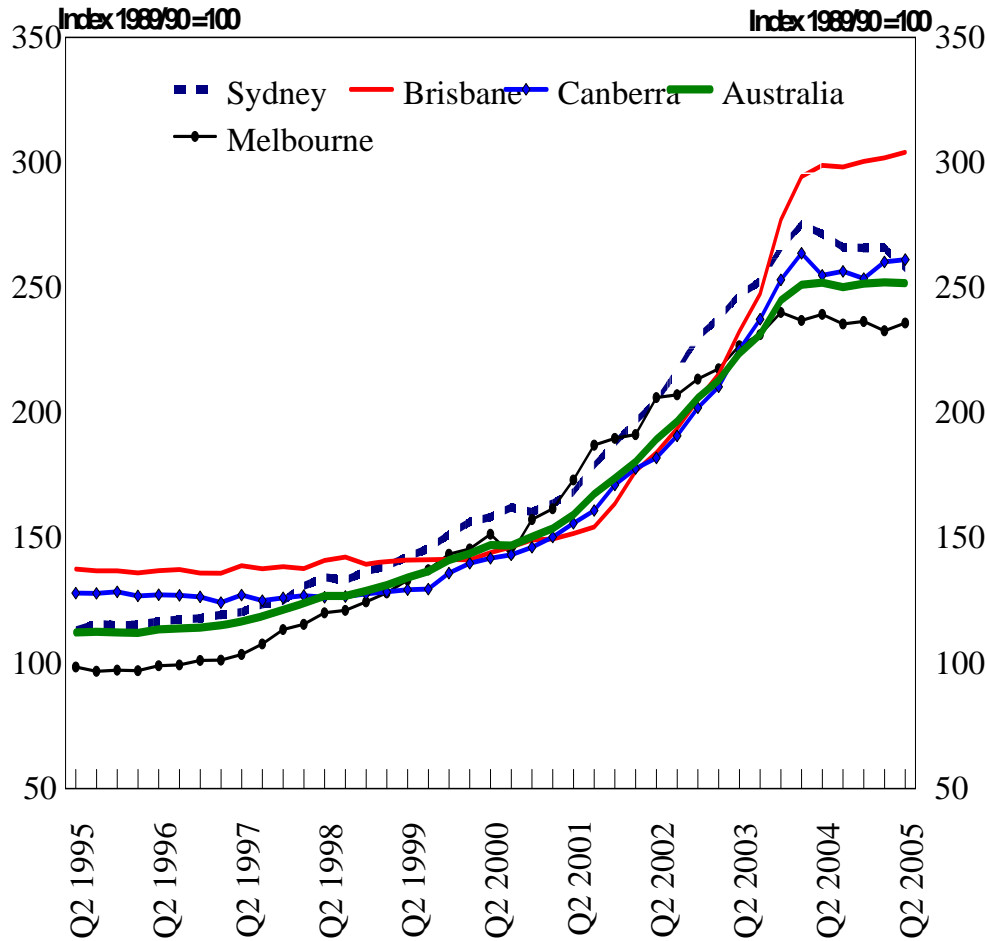


Housing market across capitals...

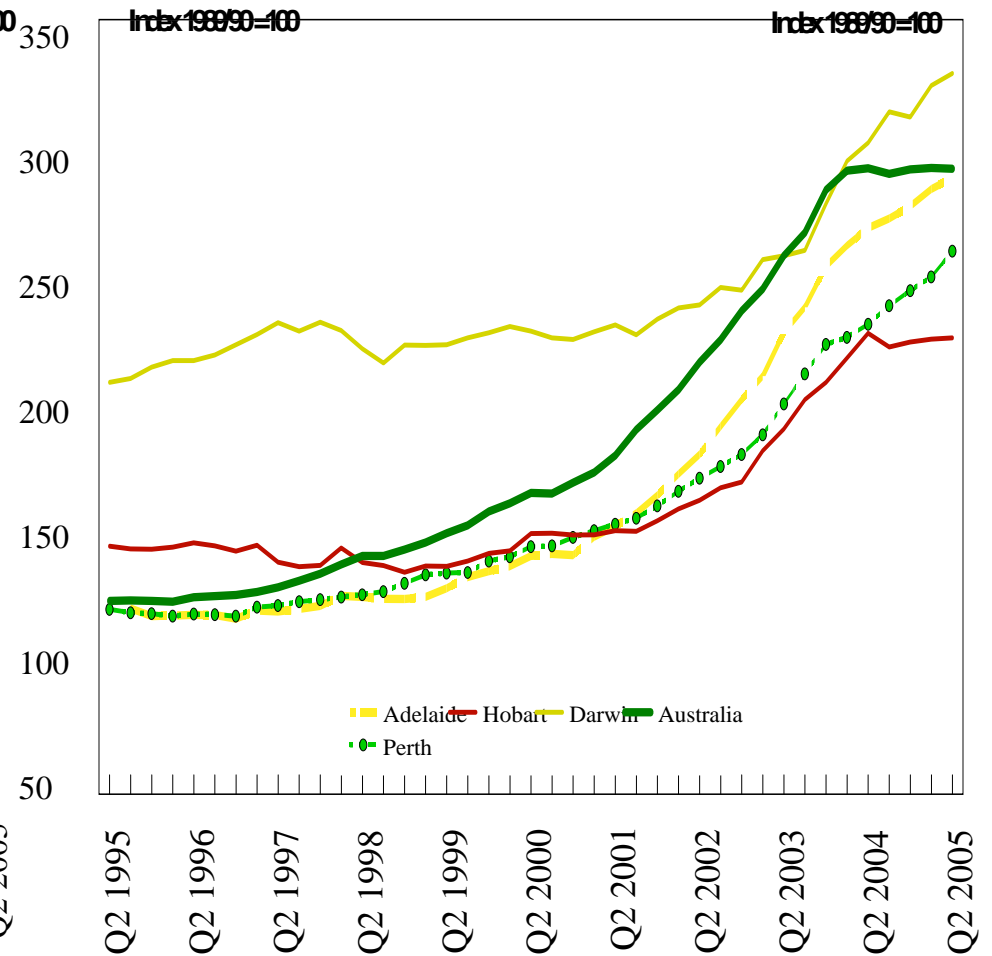
Big States Cooling

Smaller States later in "cycle".....Tassie still going

House Prices- ABS



House Prices- ABS

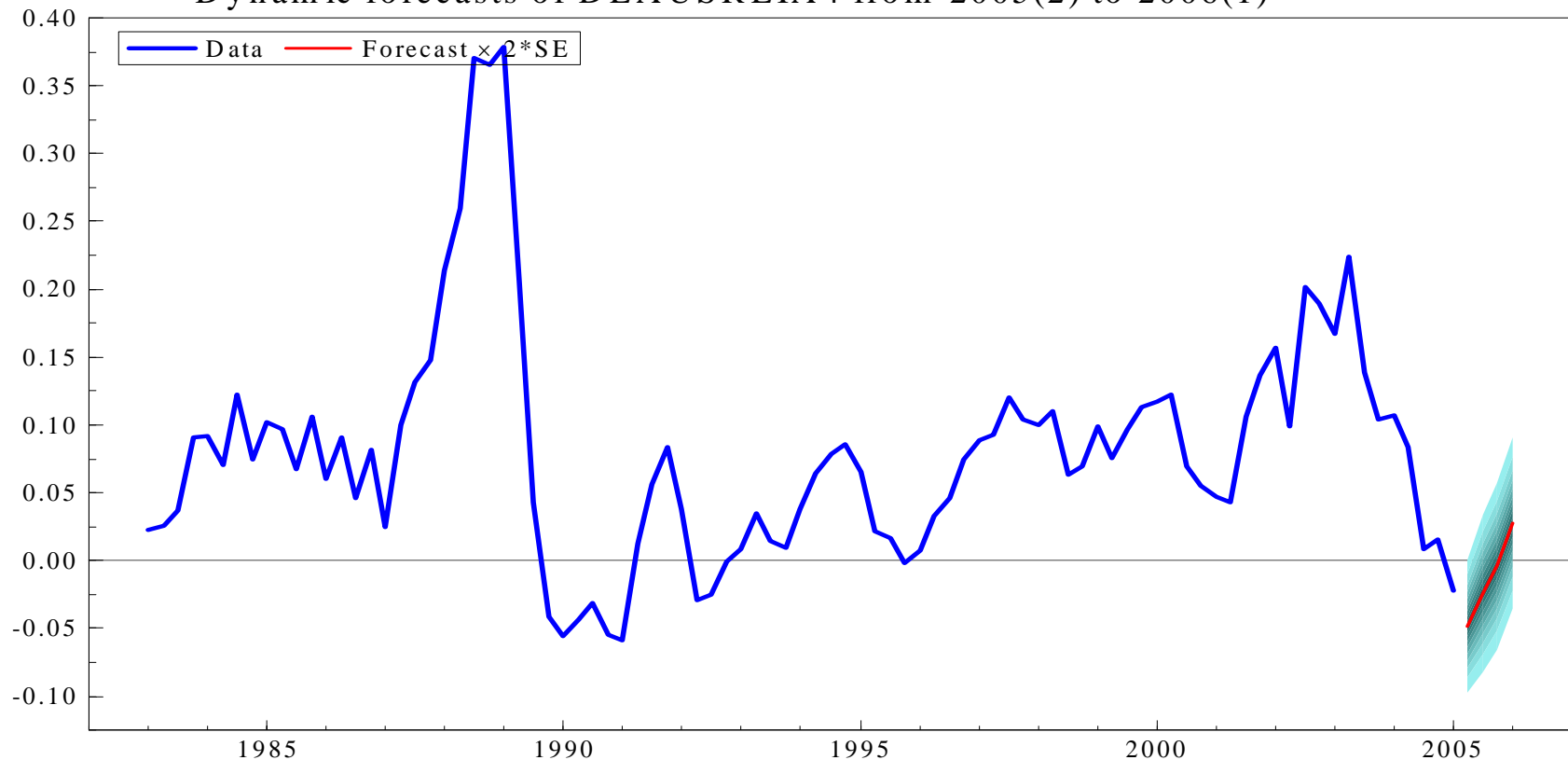


Housing Price Model....

Longer run driven by population, incomes and real rates.

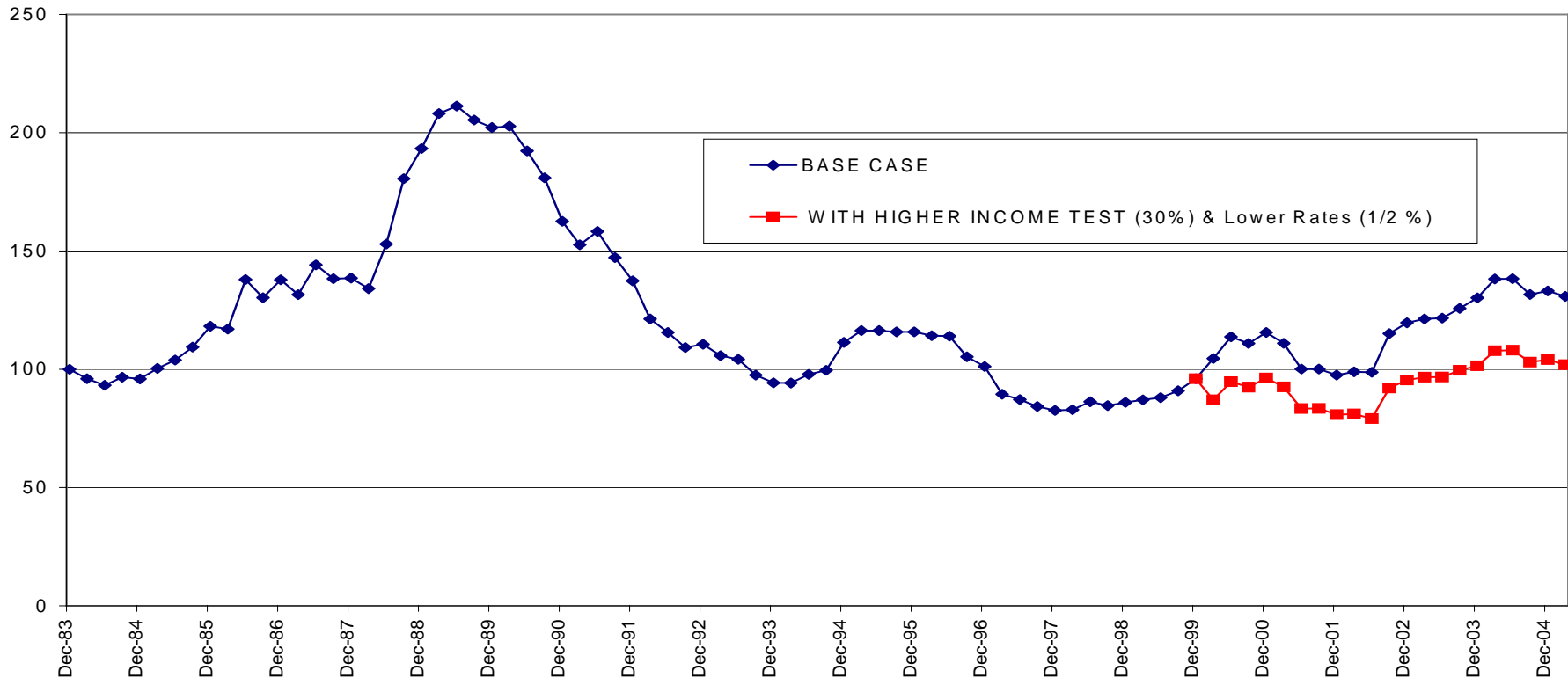
Short run driven by : incomes, construction cycle, unemployment and to a lesser extent share prices. And how far from equilibrium ..(1½ yrs)

Dynamic forecasts of DLAUSREIA4 from 2005(2) to 2006(1)



HBAAnother approach household borrowing ability

Australian House Prices to Maximum Lending Criteria
- Higher Income Test from 2000 & 1/2 % Lower Rates From 2003 -

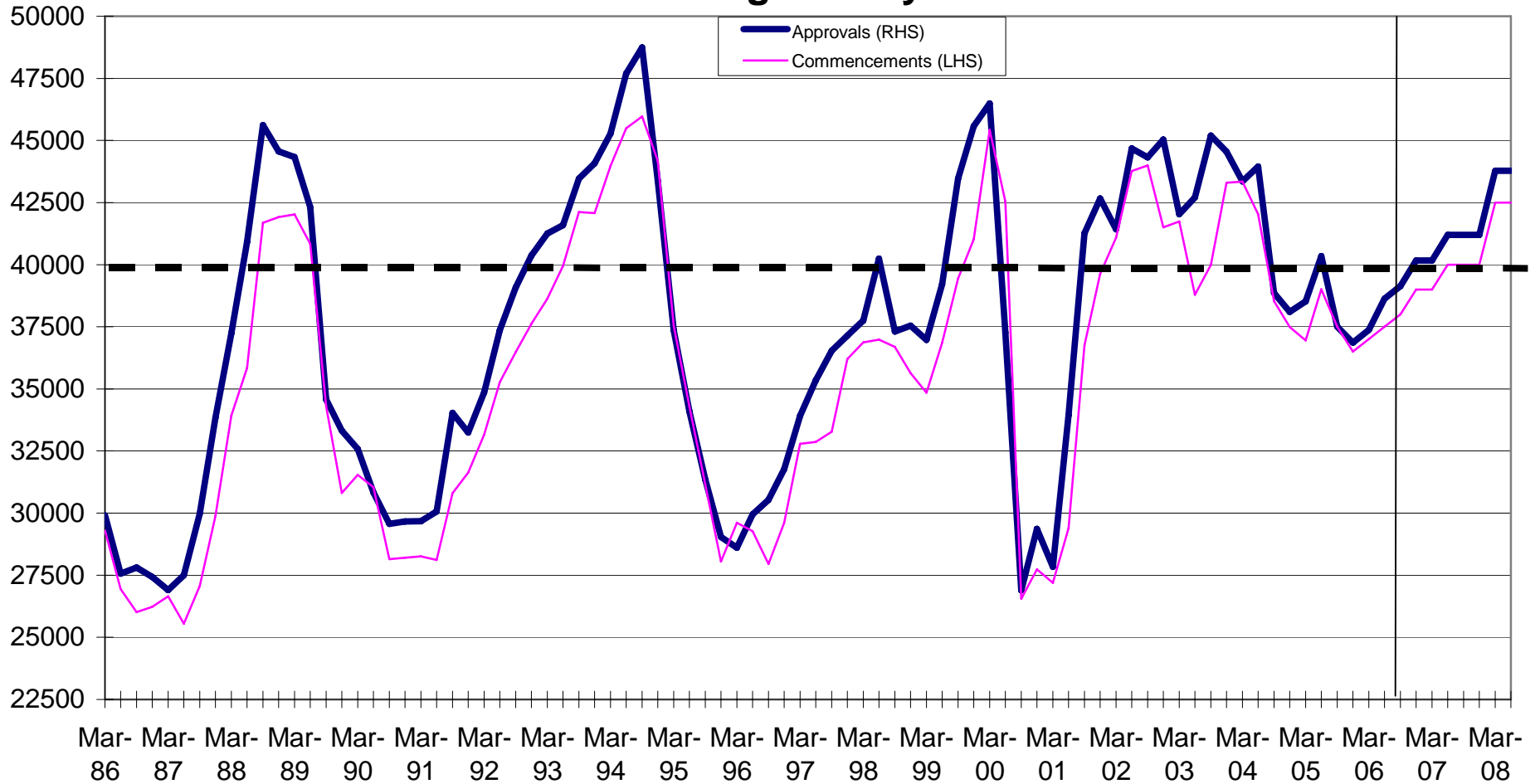


**For average home loan, higher income test & lower rates....
House prices fit well with fundamentals...no macro trigger..no crash**

Residential Activity Cycle

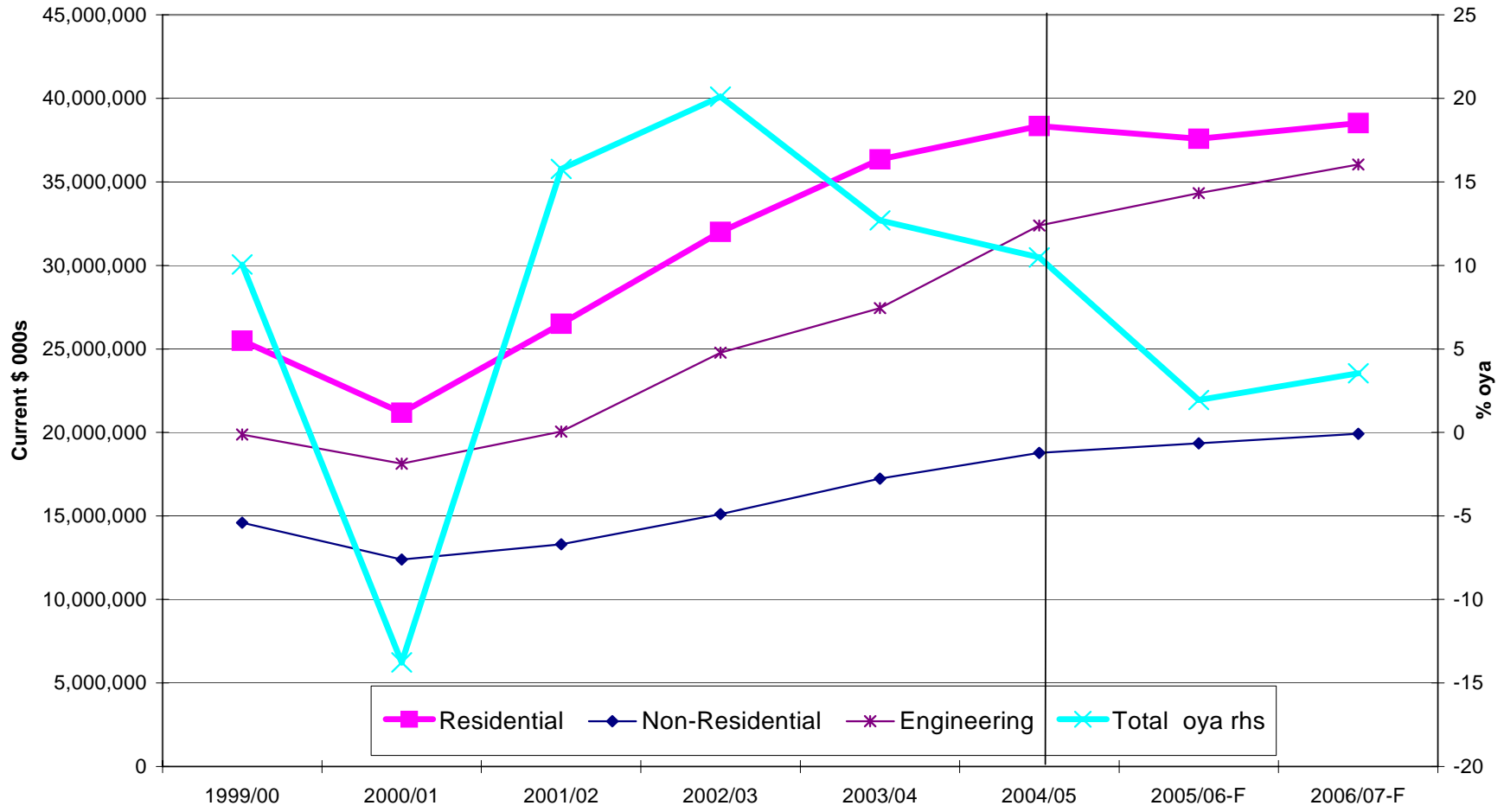
Limited excess supply....led by owner-occupier..... waiting for return of patient investor

Private Dwelling Activity - Number



Total Activity....By sector Mix Management...by type & state.....& Costs

Building Construction: Work Done, \$'s & Growth



Important Notices

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