

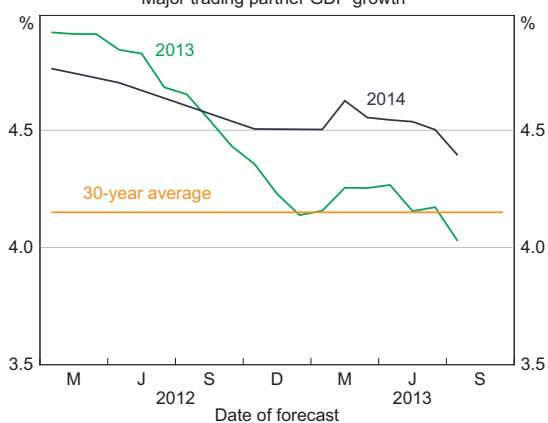
1. International Economic Developments

Growth in Australia's major trading partners around the middle of 2013 appears to be close to its average of the past decade. The rate of growth of the Chinese economy has been stable for some months now, at a bit below the authorities' target, and more recent indications are that growth is now likely to remain close to this target over the remainder of this year. The US economy has continued to grow at a moderate pace. Economic conditions in Japan have strengthened in recent months, while output growth in the rest of east Asia has been a little weaker than its recent average. The euro area remains in recession.

Many forecasters have revised down their outlook for global growth and that for Australia's trading partners (Graph 1.1). Previously it seemed likely that the pick-up in growth in the second half of the year would be stronger. Growth in Australia's trading partners is expected to be a little below average in 2013, in part reflecting weaker growth early in the year. Growth is then expected to pick up to a bit above average in 2014. The outlook for global growth is weaker than this, reflecting the greater weight of the slower growing advanced economies in that measure.

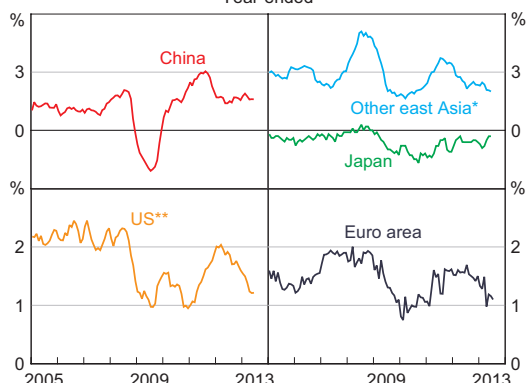
Inflation has eased in most economies over the past year and remains well contained in the advanced economies and east Asia (Graph 1.2). The recent absence of price pressures is consistent with substantial excess capacity, although this has been present for some time, especially in the advanced economies. In response, monetary policy has remained highly accommodative in much of the world.

Graph 1.1
Consensus Forecasts
Major trading partner GDP growth*



* Weighted using Australia's export shares
Sources: ABS; Consensus Economics; RBA

Graph 1.2
Global Core Inflation
Year-ended

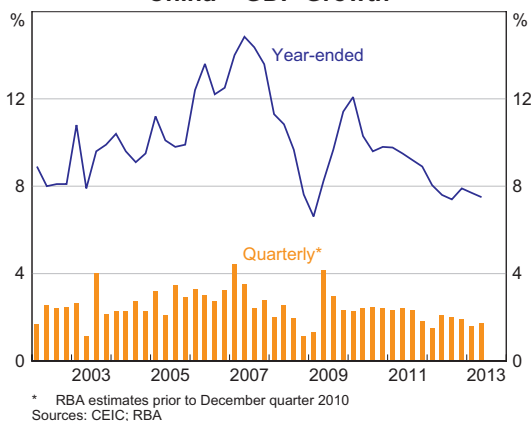


* Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan and Thailand; weighted by GDP at PPP exchange rates
** Price index for personal consumption expenditures
Sources: CEIC; IMF; RBA; Thomson Reuters

Asia-Pacific

In China, GDP grew at a slower rate over the first half of 2013 than in much of 2012. GDP expanded by 1.7 per cent in the June quarter, to be 7.5 per cent higher over the year (Graph 1.3). A range of other indicators have been consistent with growth in 2013 being relatively stable. Subdued external demand weighed on growth in the quarter, while a number of indicators suggest that domestic demand remains strong, in large part reflecting still high rates of growth in investment, including infrastructure and real estate. There is evidence that consumption growth has recovered somewhat after temporary factors weighed on consumption earlier in the year. In particular, retail sales growth has increased a little in recent months. Meanwhile, industrial production continues to grow at a steady pace, although there has been a slowing in the growth of production in light industry, consistent with weaker external demand for manufactures.

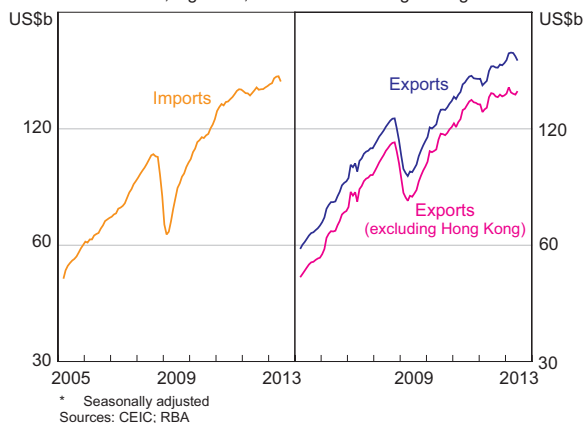
Graph 1.3
China – GDP Growth



Exports are reported to have contracted in the June quarter, though much of this is owing to a sharp decline in exports to Hong Kong (Graph 1.4). This decline unwound much of the exceptional growth recorded earlier in the year, when exports to Hong Kong grew very rapidly and much faster than implied by Hong Kong imports data. The contraction followed measures taken by Chinese authorities in response to indications that Chinese export

invoices had been inflated, reportedly to circumvent restrictions on capital inflows. Import values, which have also been volatile, are little changed from the start of the year. However, while the volume of coal imports contracted, the volume of imports of iron ore grew at around its average pace for much of the first half of this year.

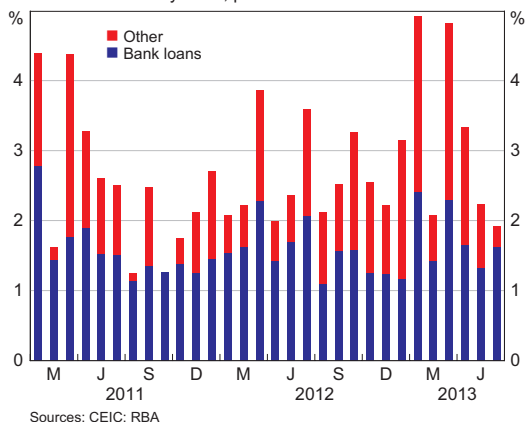
Graph 1.4
China – Merchandise Trade*
Values, log scale, three-month moving average



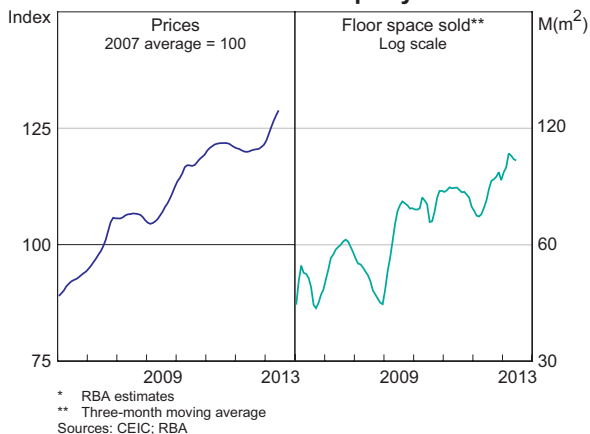
Chinese financial markets have been volatile in recent months, with liquidity conditions in Chinese money markets tightening considerably in June (see the 'International and Foreign Exchange Markets' chapter). This tightening appears to have had some effect on financing in June, with financing from sources other than bank loans contributing less to the flow of total social financing, which declined to be a little below 2 per cent as a share of annual GDP (Graph 1.5). This slowdown in financing activity is consistent with the authorities' aim of placing Chinese financing activity on a more sustainable footing. This would imply that financing for investment purposes will become harder to obtain, and may weigh somewhat on economic activity for a time.

Within bank loans, there has been a substantial pick-up in the growth of loans to households over the past year. This has been in line with strong demand for residential property. Property sales have increased and property prices have risen by 2.9 per cent in the June quarter, to be 7.3 per cent higher over the year (Graph 1.6). While this is the

Graph 1.5
China – Total Social Financing
Monthly flows, per cent of annual GDP



Graph 1.6
China – Residential Property Market*

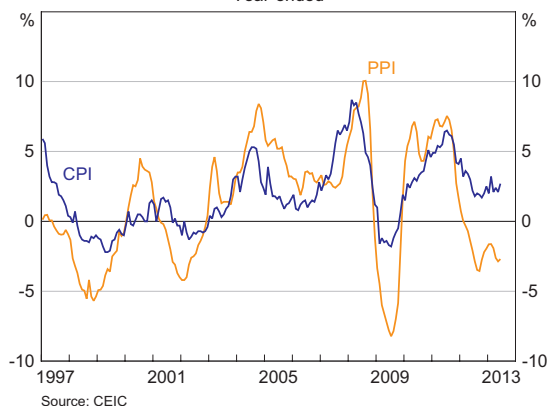


fastest annual growth in property prices for almost three years, property prices have grown more slowly than nominal GDP. Despite a slight moderation in property price growth in some cities of late, the restrictions on the purchase of property and other measures announced earlier in the year have not yet had a noticeable effect; indeed, it is not clear that these measures are being enforced outside of a few of the larger eastern cities.

Inflationary pressures in China remain contained (Graph 1.7). While food prices rose strongly in June, non-food inflation remained stable at a low level. Pork prices have begun to recover following several months of depressed prices owing to consumer

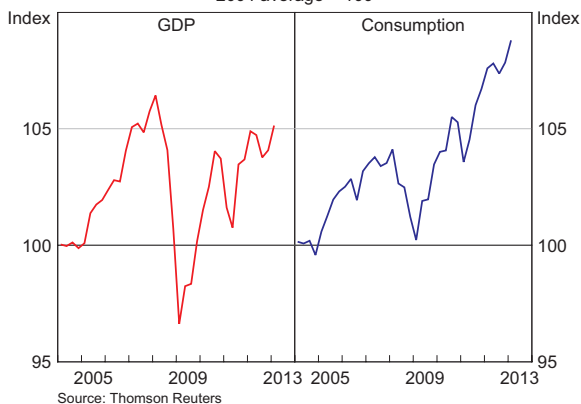
concerns about diseased pigs. Producer prices, which tend to be more cyclical than consumer prices, continued to decline, reflecting ongoing global weakness in commodity prices and pockets of overcapacity in Chinese industries.

Graph 1.7
China – Inflation
Year-ended



The Japanese economy grew quite rapidly in the March quarter, owing to strong consumption and exports growth (Graph 1.8). This pick-up in growth followed the announcement of expansionary fiscal and monetary policies, and the sustained depreciation of the yen since late last year.

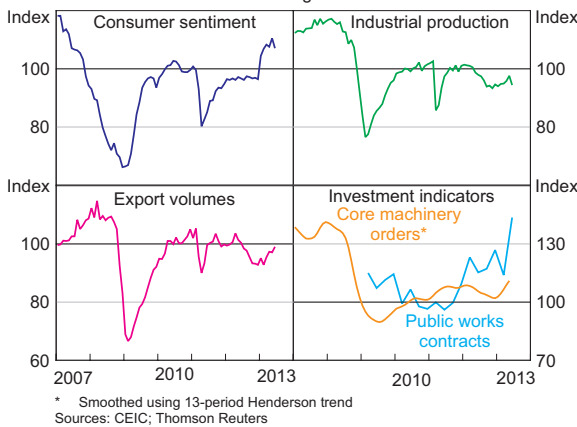
Graph 1.8
Japan – GDP and Consumption
2004 average = 100



A range of indicators suggest that strong growth continued into the June quarter, notwithstanding a sharp fall in industrial production in the month

of June (Graph 1.9). Indicators of household consumption have generally increased and consumer sentiment remained higher than it has been in the past six years, despite a small decline in June. Export volumes also increased. Industrial production rose in April and May and, while it fell sharply in the month of June, this is widely expected to be only temporary. The fiscal expansion announced in April is also expected to make a substantial contribution to growth in the June quarter, with the value of public construction contracts already rising sharply. Higher core machinery orders suggest that private investment is recovering, albeit from a low level.

Graph 1.9
Japan – Economic Indicators
 2010 average = 100



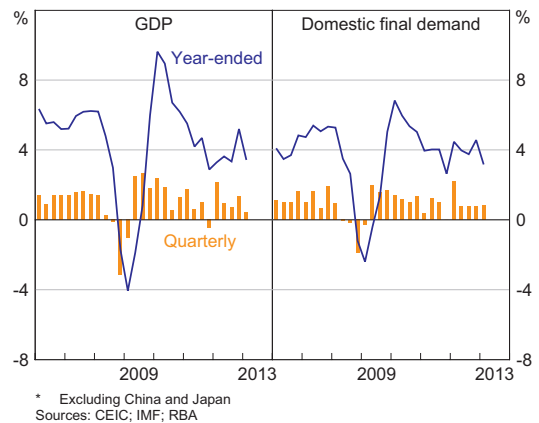
The consumer price index increased slightly over the three months to June. This mainly reflects a rise in import prices following the depreciation of the yen, with domestic prices little changed. Nevertheless, inflation expectations have risen noticeably since the end of 2012, in part owing to the combined effect of the depreciation and scheduled increases in the consumption tax in 2014 and 2015.

The Japanese Government unveiled a package of structural reforms in June, with the aim of lifting nominal annual GDP growth to around 3 per cent over the next decade. Although few specific details are available at this stage, proposed reforms include tax incentives to boost corporate capital expenditure, deregulation of the electricity sector, measures to

increase female participation in the labour market and a commitment to boost trade.

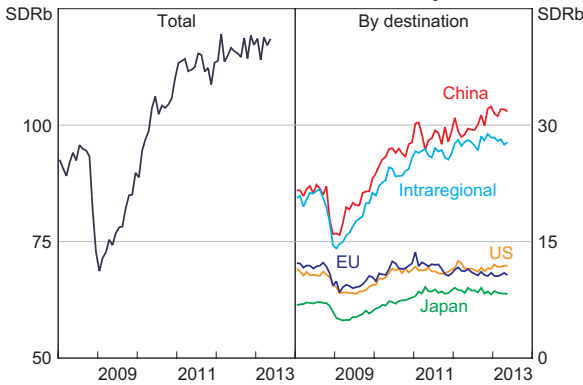
In the rest of east Asia, economic activity in the June quarter appears to have expanded at a pace above that in the March quarter. Private consumption has strengthened somewhat, with consumer confidence rising and retail sales expanding at around the pace of the past year. Indeed, quarterly growth in domestic final demand over the past year has been stable at an annualised rate of around 3 per cent, notwithstanding somewhat subdued investment growth in recent quarters (Graph 1.10). Domestic demand has been supported by accommodative monetary policy and a degree of fiscal stimulus. In Korea, an expansionary supplementary budget is supporting domestic demand this year; in Thailand and Indonesia significant infrastructure spending is planned, although the timing of the various projects is still unclear. In addition, minimum wage rises in a number of economies in the region are expected to support consumption.

Graph 1.10
East Asia* – GDP and Demand Growth



In contrast, the pace of overall export growth has declined over recent quarters (Graph 1.11). The value of intraregional trade has declined a little, largely owing to falling exports from Indonesia to high-income Asian economies. In part, this is likely to reflect lower prices of energy exports from Indonesia, although volumes of these exports have also moderated. Flat external demand has

Graph 1.11
East Asia* – Merchandise Exports



* Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand; domestic non-oil exports for Singapore
Sources: CEIC; IMF; RBA

been accompanied by a softening in production indicators; industrial production fell slightly in the June quarter and the manufacturing PMIs declined in recent months. Inflation is well contained in most economies in the region, although Indonesian inflation has been elevated since March this year, in part owing to the recent reduction in government fuel subsidies.

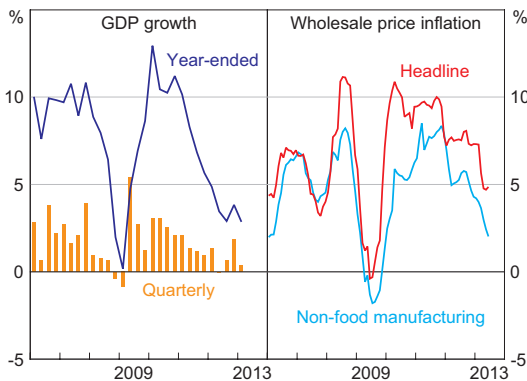
In India, GDP growth slowed markedly in the March quarter, following strong growth in the December quarter (Graph 1.12). Weaker investment growth and moderating household expenditure contributed to the slowing, with some of the weakness in investment due to cutbacks in government expenditure. Industrial production declined over the June quarter,

driven by the manufacturing sector. However, with this year's monsoon rainfall well above last year's poor season, agricultural production is expected to increase in the second half of this year.

Headline wholesale price inflation picked up slightly in June as food prices rose sharply. This followed significant declines in the inflation rate since the start of the year. The Reserve Bank of India (RBI) focuses on non-food manufacturing price inflation as a measure of core inflation, which has continued to moderate. However, the recent depreciation of the Indian rupee is likely to contribute to upward pressure on prices in coming quarters and the RBI has suggested that the volatility of the rupee has reduced the scope for further monetary easing.

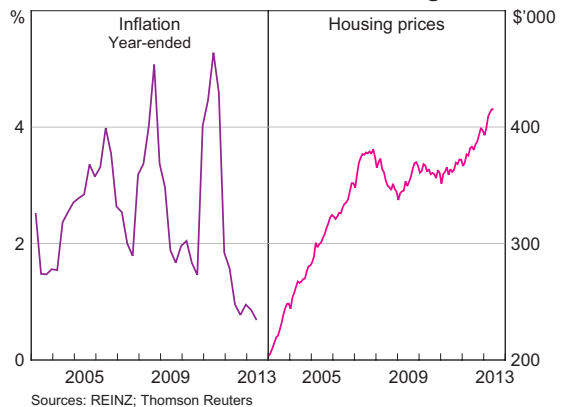
In New Zealand, economic activity has increased at an above-average pace, with demand being supported by repairs and rebuilding in Canterbury following the earthquakes of 2010 and 2011. The terms of trade are at historically high levels largely owing to strong demand for commodity exports, with the recent rise primarily driven by increases in dairy export prices. Nevertheless, consumer price inflation has been very low over the past year, reflecting the high New Zealand dollar and strong domestic and international competition. Meanwhile, dwelling prices and housing credit have increased rapidly, in part reflecting stimulatory monetary policy settings (Graph 1.13).

Graph 1.12
India – Economic Indicators



Sources: CEIC; RBA

Graph 1.13
New Zealand – Inflation and Housing Prices

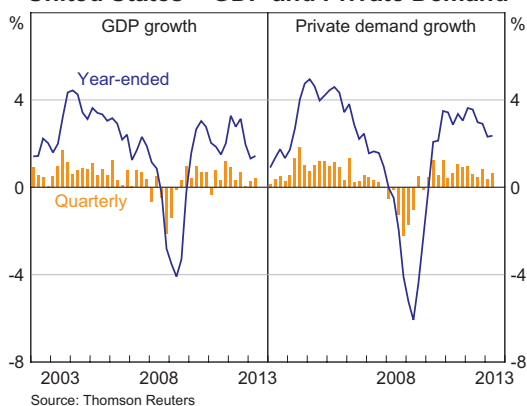


United States

Economic activity in the United States has continued to expand at a moderate pace. Despite lower government spending and higher taxes, growth of private sector demand has held up over the first half of the year (Graph 1.14). Moderate consumption growth has been supported by the steadily improving labour market and a noticeable pick-up in house prices.

Graph 1.14

United States – GDP and Private Demand



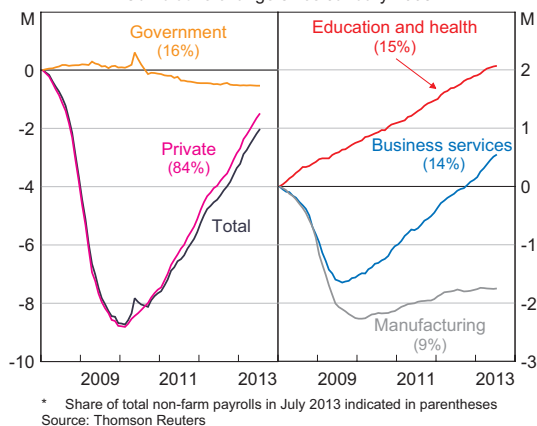
Conditions in the housing market have improved across a broad range of measures. In addition to house prices rising by about 14 per cent since early 2012, housing starts and construction activity have picked up. Sales have increased strongly, and both the average time taken to sell a property and the proportion of distressed sales have fallen significantly. The share of mortgages with negative equity has been declining as property valuations rise and debt is repaid. However, the recent rise in 30-year mortgage rates following the Federal Open Market Committee (FOMC) communications (see the 'International and Foreign Exchange Markets' chapter) may slow the improvement in the housing sector somewhat.

Labour market conditions continued to improve over the three months to July, with the pace of payrolls employment growth similar to that of the

preceding year. Nevertheless, the unemployment rate has declined only gradually over 2013 to date. At 7.4 per cent, the unemployment rate is still well above the threshold of 6½ per cent at which the FOMC has indicated that it would consider raising the Federal Funds rate. The participation rate has stabilised in recent months, but remains substantially below its pre-recession level. Service industries in the private sector have been leading the recovery in employment, while government payrolls have been contracting (Graph 1.15).

Graph 1.15

United States – Non-farm Payrolls* Cumulative change since January 2008



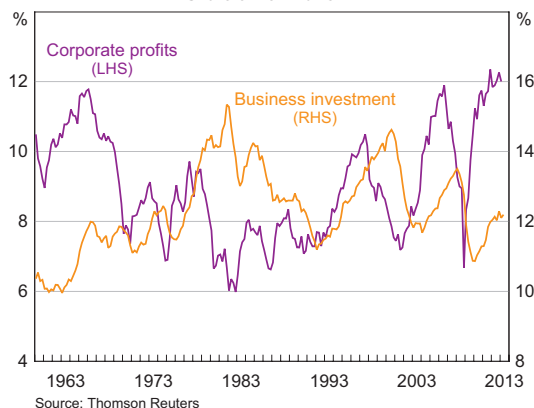
The manufacturing sector has been fairly subdued, with industrial production broadly flat in the June quarter. However, manufacturing employment has increased over the past 3½ years, in contrast to the trend decline in employment in this sector over several decades.

Business investment has been relatively weak in 2013 to date, although strong profitability and the corporate sector's high cash reserves suggest that funds are available to accommodate a pick-up in investment (Graph 1.16).

Monetary policy remains highly accommodative and lending standards have eased further over the three months to July, although total bank credit growth has slowed a little in recent months.

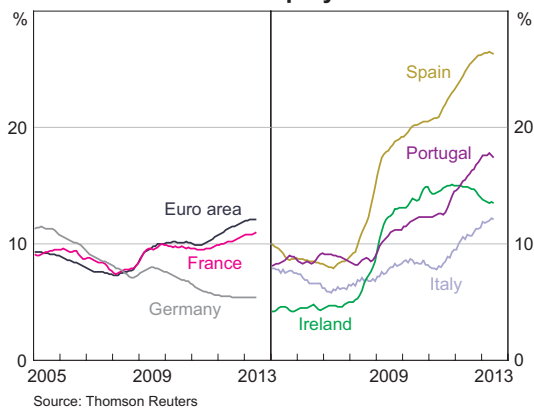
Graph 1.16

United States – Business Investment and Profits
Share of nominal GDP



Graph 1.17

Euro Area – Unemployment Rates



Europe

Economic conditions remain weak in the euro area and inflation pressures continue to be subdued, consistent with the weakness in demand. GDP is expected to have declined in the June quarter, having contracted over the previous one and a half years. Although PMIs improved in recent months, they remain below their average levels. Exports, which had made a positive contribution to growth over much of 2012, slowed over the first half of 2013.

The German economy has shown some signs of resilience and it appears that its output has stabilised over the first half of 2013, but there have been few signs of stabilisation in other countries in the euro area. This difference is apparent in the labour market, with the unemployment rate low in Germany but high in most economies, particularly the crisis economies (Graph 1.17).

Commodity Prices

The RBA Index of Commodity Prices, based on spot prices for bulk commodities, has declined since the May *Statement*. Over the past three months, commodity prices have been, on average, around 10 per cent lower in SDR terms than in the preceding three months (Graph 1.18, Table 1.1). While iron ore and steel prices increased a little recently, coking coal prices remain subdued (Graph 1.19). The September quarter benchmark contract price for premium hard coking coal was settled at US\$145 per tonne, almost US\$30 lower than the June quarter contract price.

Graph 1.18
Commodity Prices*

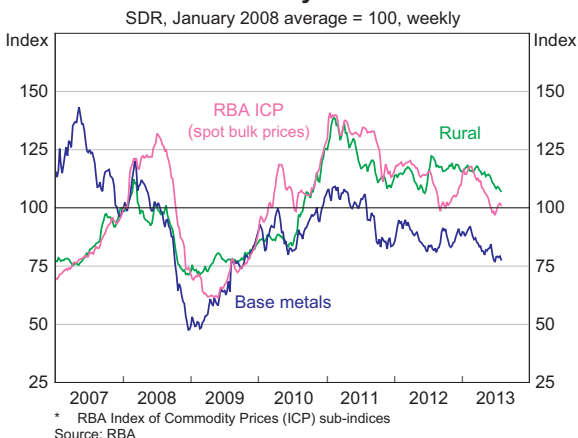


Table 1.1: Commodity Prices Growth^(a)
SDR, 3-month-average prices, per cent

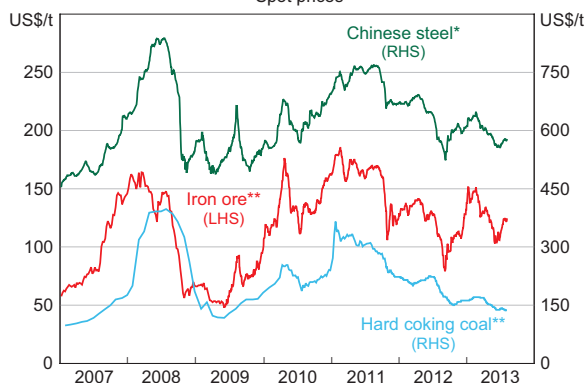
	Since previous Statement	Over the past year
Bulk commodities	-14	-15
- Iron ore	-14	-6
- Coking coal	-14	-34
- Thermal coal	-9	-9
Rural	-5	-2
- Beef	-8	-4
- Cotton	0	11
- Wheat	0	3
- Wool	-12	-11
Base metals	-6	-4
- Aluminium	-6	-5
- Copper	-6	-6
- Lead	-3	10
- Nickel	-13	-13
- Zinc	-5	-1
Gold	-14	-16
Brent oil ^(b)	-3	2
RBA ICP	-6	-10
- using spot prices for bulk commodities	-10	-11

(a) Prices from the RBA Index of Commodity Prices (ICP);
bulk commodities prices are spot prices

(b) In US dollars

Sources: Bloomberg; Energy Publishing; RBA

Graph 1.19
Steel, Iron Ore and Coking Coal Prices
Spot prices



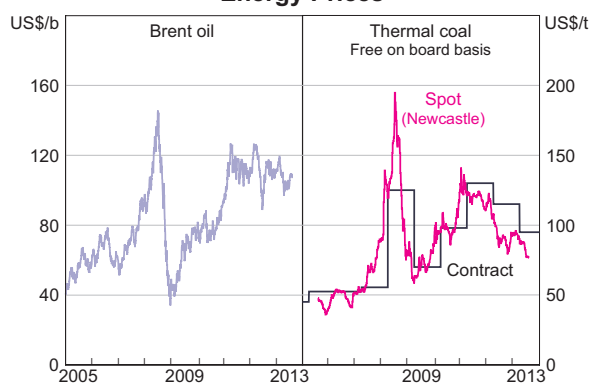
* Average of hot rolled steel sheet and steel rebar prices

** Free on board basis

Sources: Bloomberg; Citigroup; Energy Publishing; Macquarie Bank; RBA

Energy prices declined over recent months. Spot prices for thermal coal declined further since the *May Statement*, weighed down by elevated levels of exports from the United States into the Pacific market (Graph 1.20). Over the past year, global thermal coal prices have declined significantly, but to date global production has been scaled back only a little. Average crude oil prices over the past three months have also been lower than at the *May Statement*.

Graph 1.20
Energy Prices



Sources: Bloomberg; BREE; RBA; Thomson Reuters

Base metal prices declined on average by 6 per cent since the *May Statement*, accompanied by falling prices of precious metals, such as gold. Market commentary suggests that concerns regarding a possible withdrawal of monetary stimulus by the Federal Reserve and weaker-than-expected growth prospects for China have been affecting these markets.

Prices of rural commodities eased over the past three months. Wheat prices are unchanged, but they remain high by historical standards; beef and wool prices are also lower. ↘