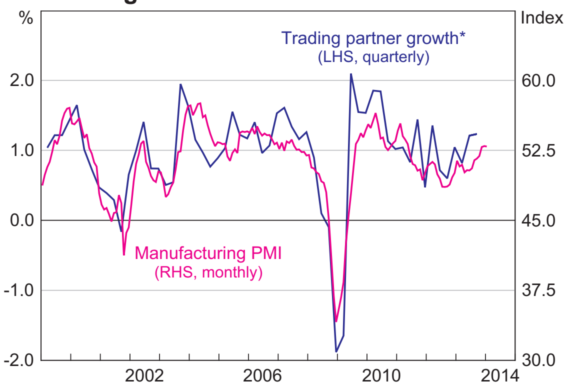
# 1. International Economic Developments

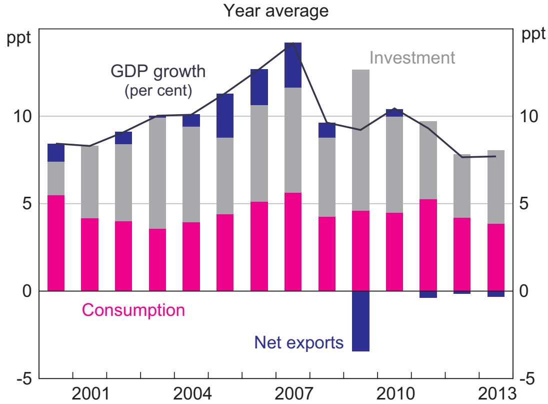
Growth in Australia's major trading partners in the September quarter remained close to its average of the past decade. Global PMIs and the available GDP data are consistent with these conditions continuing into the December quarter (Graph 1.1). Conditions have improved in the advanced economies and have been little changed in China, while Australia's other trading partners in Asia have generally been growing at around their decade-average pace.




* Aggregated using total export weights
Sources: CEIC Data; IMF; Markit Economics; RBA; Thomson Reuters

## Asia-Pacific

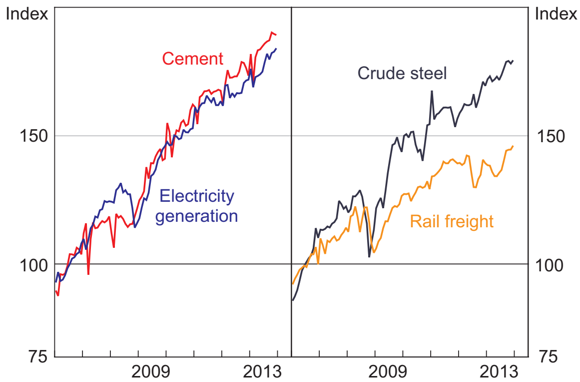
In China, economic growth has now been relatively stable for a year and a half, following an earlier slowing in the pace of growth. In the December quarter, GDP increased by 1.8 per cent, to be 7.7 per cent higher in 2013 (Graph 1.2). Real household consumption has grown strongly, consistent with the growth of household disposable income, and growth of fixed asset investment has been stable despite some decline in the rate of growth of infrastructure investment. A range of indicators suggest that industrial activity moderated a little towards the end of 2013 (Graph 1.3). Growth in electricity generation and rail freight volumes slowed in November and December, while modest growth in the output of construction-related products, such as crude steel and cement, partly offset stronger outcomes for other manufactured items.




Source: CEIC Data

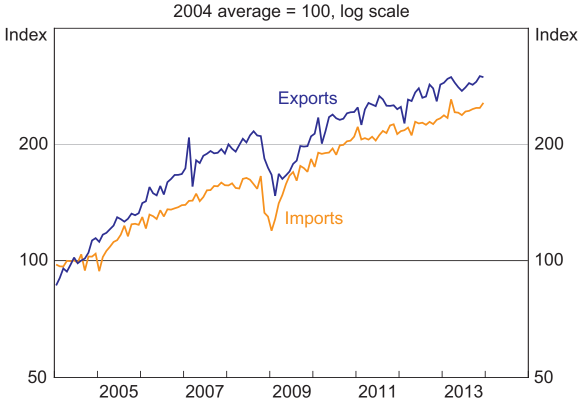
Exports rose strongly in the December quarter, with the pick-up broad based across destinations (Graph 1.4). This is consistent with the stronger growth in advanced economies. In recent months, exports to Hong Kong have continued to grow more rapidly than implied by Hong Kong's imports data. In December, Chinese authorities tightened controls on trade documents to counteract false invoicing of exports being used to circumvent controls on capital flows. Both non-resource imports and resource imports (including coal and iron ore) grew at a moderate pace in the December quarter.

## Graph 1.3
### China – Selected Activity Indicators
2006 average = 100, log scale




Sources: CEIC Data; RBA

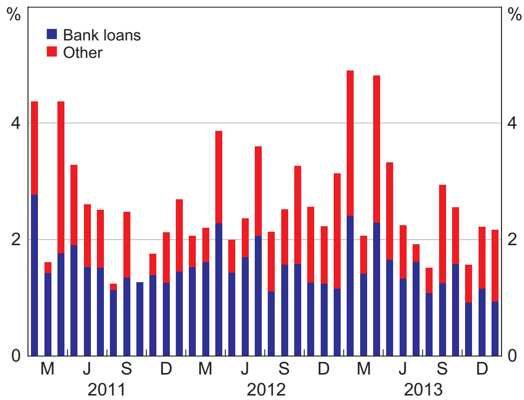
## Graph 1.4
### China – Merchandise Trade Volumes*
2004 average = 100, log scale




* Seasonally adjusted by the RBA
Sources: CEIC Data; RBA

Liquidity conditions in Chinese money markets tightened markedly on a number of occasions in recent months, following a period of relative calm since the earlier tightening in June (see the 'International and Foreign Exchange Markets' chapter). Total social financing flows have moderated from the rapid pace seen in early 2013, consistent with authorities' efforts to reduce the scale of bank and non-bank financing (Graph 1.5). However, financing activity is still being substantially driven by non-bank sources, which has been a particular concern of the authorities over the past year. Somewhat related to this, there have been concerns about local governments' liabilities and their ability to service

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

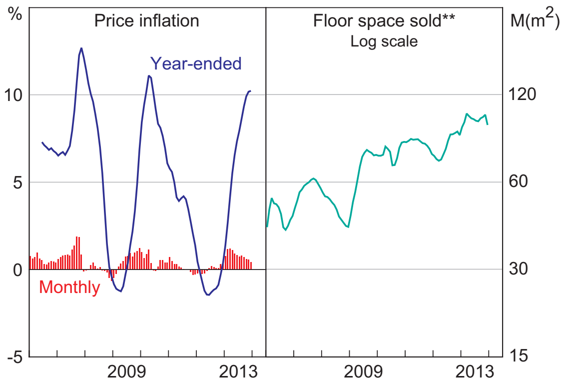



Sources: CEIC Data; RBA

them. In response, an audit of government debt was conducted, which estimated that local government borrowing had increased to around 33 per cent of GDP as at mid 2013, higher than reported by the previous audit at the end of 2010. The composition of local government debt had changed noticeably and, as with non-government debt, was increasingly being sourced from outside of bond markets and the formal banking sector. Reflecting concerns about the risks involved in the type of financing used by local governments, reforms announced late last year would eventually enable more local governments to issue debt directly rather than needing to obtain funding via less transparent means.

The property market appears to be responding to the tightening of controls on property transactions and borrowing imposed through 2013. In particular, price growth has slowed a little in recent months (Graph 1.6). In the large eastern cities, the authorities have introduced city-specific controls and increased the supply of land available for development; these policies are expected to remain in place through 2014. Consistent with the slowing in property price inflation, property sales fell in the December quarter. Real estate investment grew at a strong pace in the quarter, reflecting strong growth in non-residential building and more moderate growth in residential building investment.

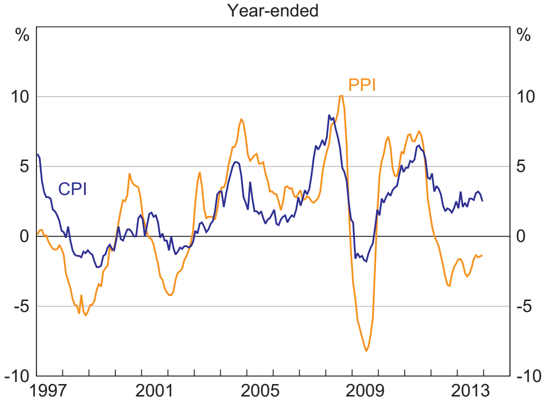
## Graph 1.6
### China – Residential Property Market*




* RBA estimates
** Three-month moving average
Sources: CEIC Data; RBA

Inflationary pressures in the Chinese economy remain contained (Graph 1.7). Year-average inflation for 2013, at 2.6 per cent, was well below the authorities' target of 3.5 per cent. Non-food price inflation remained subdued, and there was little evidence of upstream price pressures, with producer prices continuing to decline. Food price inflation has stopped rising, consistent with improved supply conditions after weather-related disruptions to vegetable crops earlier last year.

## Graph 1.7
### China – Inflation
Year-ended

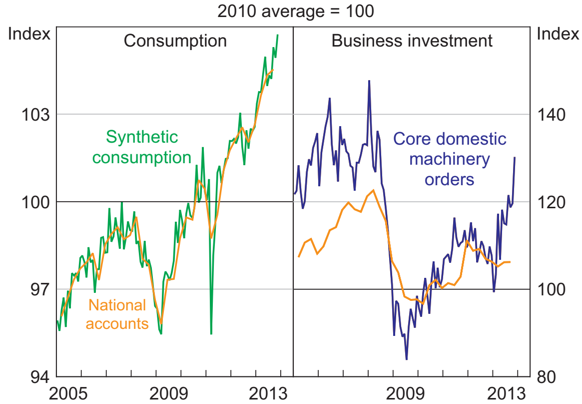



Source: CEIC Data

In Japan, the implementation of more expansionary monetary and fiscal policies, as well as the associated depreciation of the yen, saw economic growth pick up to be well above the average of the past decade. Private consumption, residential investment, public demand and exports grew strongly over the first three quarters of 2013.

A range of indicators suggest that the above-average pace of growth was sustained in the December quarter, with PMIs and exports rising further and industrial production growing strongly. Timely indicators suggest that consumption also continued to grow in the quarter and investment picked up (Graph 1.8). Consumption is likely to have been supported, at least in part, by consumers bringing forward some spending ahead of the scheduled increase in the consumption tax in April (see 'Box A: Japan's Consumption Tax Increase').

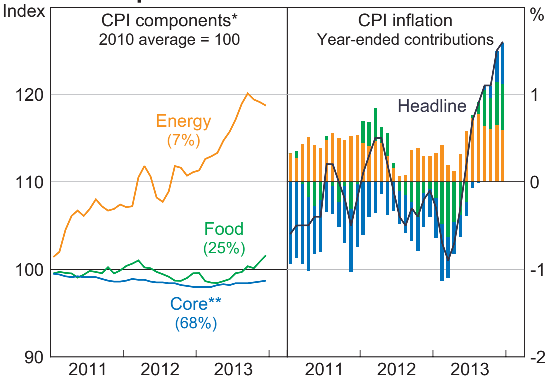
## Graph 1.8
### Japan – Consumption and Investment
2010 average = 100




Sources: CEIC Data; RBA; Thomson Reuters

Consumer price inflation picked up markedly over 2013 and is now close to the Bank of Japan's 2 per cent inflation target (Graph 1.9). The pick-up in inflation has largely flowed from increases in import prices, particularly for energy, stemming from the depreciation of the yen. More recently, energy prices appear to have stabilised. While inflation expectations have increased somewhat, to date there does not appear to have been a significant increase in wages. The increase in core inflation (which excludes food and fuel) appears to mostly reflect the effect of rising prices for imports and rising administered prices.

**Graph 1.9**
**Japan – Consumer Price Index**

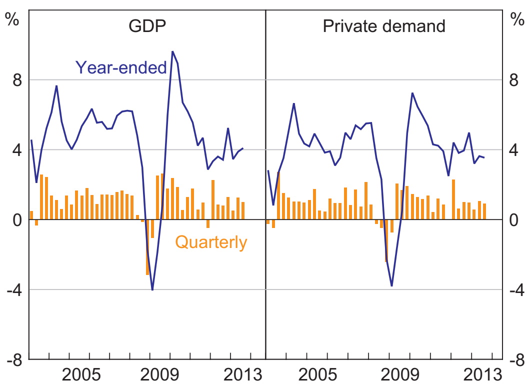



* Share of total CPI in 2010 indicated in parentheses
** Excludes energy and food (less alcoholic beverages)
Sources: CEIC Data; RBA; Thomson Reuters

In the rest of east Asia, growth in the September quarter was close to its average of the past decade (Graph 1.10). Recent growth has been broad based across private consumption, investment and exports.

The available data suggest that growth continued at around its average pace in the December quarter. PMIs and industrial production picked up in the quarter while retail sales data suggest moderate growth of consumption across the region. Growth of export volumes in the December quarter was above the pace seen in recent quarters.

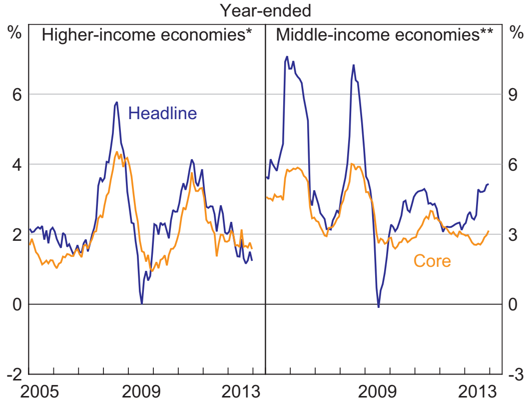
**Graph 1.10**
**East Asia* – GDP and Demand Growth**




* Excluding China and Japan
Sources: CEIC Data; IMF; RBA

Meanwhile, inflation has been subdued in most economies in the region, although it has increased in some of the middle-income economies (Graph 1.11). In Malaysia, monthly headline inflation has remained elevated following reductions in fuel subsidies in September. The Malaysian Government allowed the national power distributor to increase electricity prices from January. In Thailand, inflation has been moderate alongside below-average growth in 2013, and recent political unrest may further weaken growth in 2014.

**Graph 1.11**
**East Asia – Consumer Price Inflation**
Year-ended

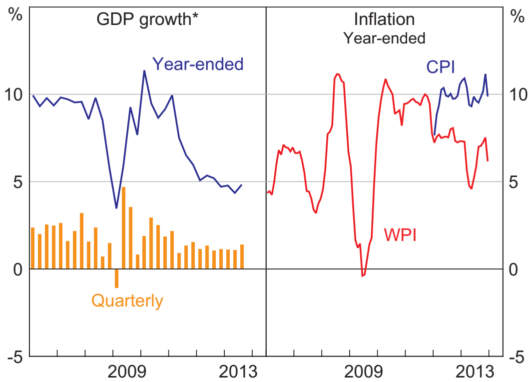



* Hong Kong, Singapore, South Korea and Taiwan
** Indonesia, Malaysia, Philippines and Thailand
Sources: CEIC Data; IMF; RBA; Thomson Reuters

Depreciations of a number of currencies in the region since the middle of 2013 have also put some upward pressure on import prices, which is expected to flow through to consumer prices.

In India, recent data on activity show tentative signs of improved conditions, with GDP at factor cost growing by 4.8 per cent over the year to September 2013 (Graph 1.12). While consumption and investment rose in the quarter, both continued to grow at relatively modest rates. Net exports made a significant contribution to growth, partly reflecting the effect of depreciation of the rupee earlier in the year. Growth was also supported by agricultural output following good monsoon rainfall, although the large harvest in October and November will mostly be reflected in the December quarter output

## Graph 1.12
## India – GDP Growth and Inflation




* Measured at factor cost
Sources: CEIC Data; RBA

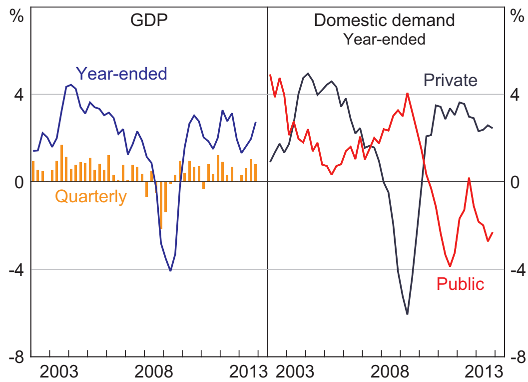
data. Inflation in India has shown some signs of moderating, aided by an easing of food prices following the improved harvest. The Reserve Bank of India recently published a review of its monetary policy framework, which recommended the eventual adoption of a target range for consumer price inflation centred on 4 per cent.

In New Zealand, the pace of economic growth picked up in the September quarter, to be 3.5 per cent higher over the year. Growth was driven by strong domestic demand, especially for residential investment. Housing prices increased by around 9 per cent over 2013, with the fastest pace recorded in Auckland. Consumer price inflation remains moderate; headline inflation is around 1½ per cent in year-ended terms.

## United States

The pace of economic growth in the United States increased a little over the second half of 2013, with the economy expanding at an annualised rate of 3½ per cent (Graph 1.13). The recovery continues to be driven by private demand, with a noticeable increase in consumption, while declining public demand continues to weigh on growth. The recent political agreement to avoid further automatic federal government spending cuts in 2014 and 2015 implies that public demand will contract a little less than might otherwise have been the case.

## Graph 1.13
## United States – Economic Growth



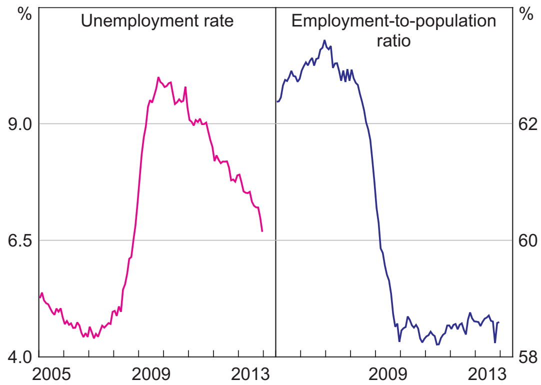

Source: Thomson Reuters

More timely indicators are consistent with moderate growth of the US economy in recent months. Consumer sentiment has picked up in recent months and is now almost back to the levels seen just prior to the government shutdown in October last year. The manufacturing PMI and ISM index declined in January, although some of this weakness is likely to reflect adverse weather conditions. Capital goods orders ticked down in December, following strong growth in the preceding month.

Housing market conditions remain generally favourable. Housing prices have continued to rise at an annualised rate of around 10 per cent, builder confidence remains high and forward-looking indicators of residential building have picked up after a weak patch in the September quarter. Sales of new and existing homes have been below their recent peaks.

Conditions in the labour market have continued to improve over recent months. Even though non-farm payrolls employment increased only modestly in December, this followed a considerable increase in November. Over the two months, monthly payrolls growth was close to the average in the preceding six months. The unemployment rate declined by 0.9 percentage points over the second half of 2013, bringing it close to the Federal Open Market Committee's stated threshold of 6½ per cent for considering raising the federal funds rate (see the 'International and Foreign Exchange Markets' chapter; Graph 1.14). Nevertheless, the ratio of employment to

**Graph 1.14**
**United States – Labour Market**




Source: Thomson Reuters

population has remained around its lowest level in 30 years as the participation rate has declined. This is in large part because of the ageing of the population, but it is also likely to reflect some discouraged workers leaving the labour force.

Both core and headline measures of inflation are around 1 per cent in year-ended terms. In both December and January, the US Federal Reserve reduced its monthly asset purchases by US$10 billion to US$65 billion.

## Europe

The gradual recovery of economic activity in the euro area continued in the September quarter, with GDP expanding modestly. Consumption and investment rose for the second consecutive quarter and imports continued to grow strongly. Germany again recorded comparatively strong growth, although GDP also increased in a number of other countries, including the Netherlands and Spain.

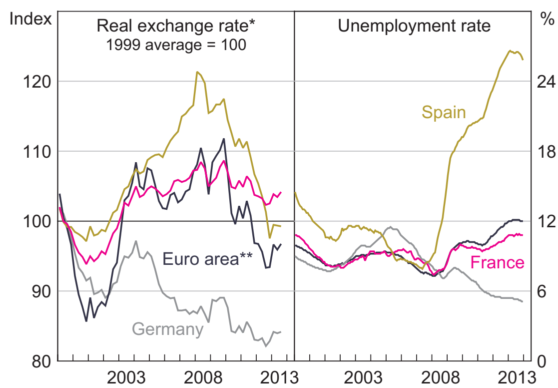
Activity also looks to have increased in the December quarter. Industrial production picked up noticeably in November, to be above the levels of the September quarter. More generally, the PMIs have been well above their levels of early 2013, and measures of both consumer and industrial confidence continued to improve to be slightly above long-run average levels.

These better economic conditions follow a period of gradually improving competitiveness in some crisis economies, reflecting a decline in unit labour costs relative to their major trading partners (Graph 1.15). Notably, Portugal and Spain saw strong growth of exports over 2013.

The unemployment rate appears to have stabilised over the second half of 2013, although it remains very high in many euro area economies. At the same time, credit growth has been particularly weak. Inflation remains very low in the euro area, with both headline and core inflation less than 1 per cent in year-ended terms, well below the European Central Bank's target of 2 per cent.

In the United Kingdom, the pace of economic growth picked up in 2013, with the economy expanding by 2.8 per cent over the year to the December quarter. Inflation has eased and has returned to the Bank of England's target of 2 per cent.

**Graph 1.15**
**Euro Area – Economic Indicators**



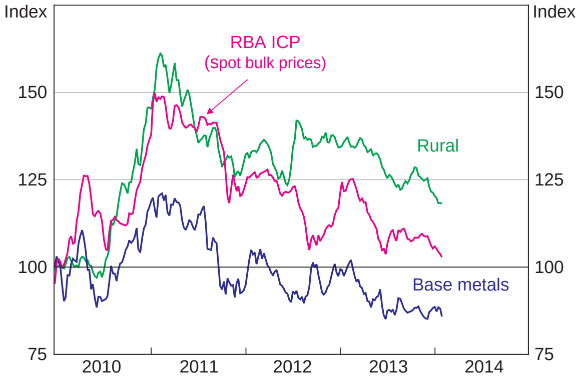

* Trade-weighted; deflated by unit labour costs
** Excluding intra-regional trade
Sources: European Central Bank; Thomson Reuters

## Commodity Prices

Commodity prices have declined in the past few months (Graph 1.16; Table 1.1). The spot price for iron ore is a little lower, on average, since the November *Statement*. This reflects a decline in the iron ore price over the past month as growth in Chinese steel production has moderated. The spot price for hard coking coal continues to ease, which is likely

## Graph 1.16
## Commodity Prices*

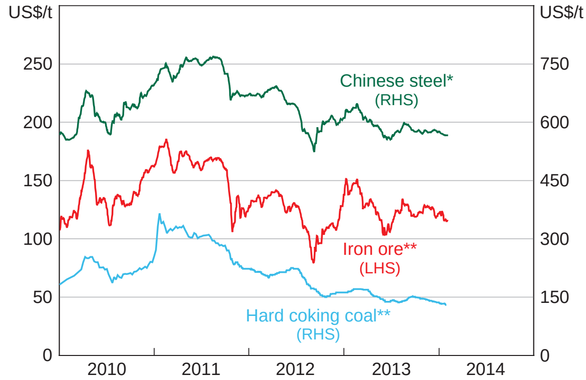
SDR, January 2010 average = 100, weekly




* RBA Index of Commodity Prices (ICP) sub-indices
Source: RBA

## Graph 1.17
## 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; IHS Energy Publishing; Macquarie Bank; RBA

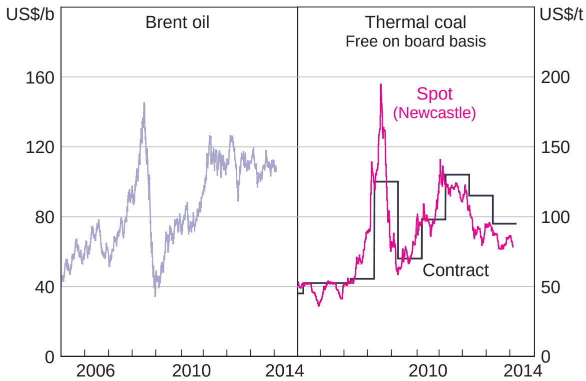
## Table 1.1: Commodity Prices Growth[(a)]

SDR, 3-month-average prices, per cent

| | Since previous *Statement* | Over the past year |
|---|---|---|
| Bulk commodities | –2 | –7 |
| – Iron ore | –2 | –4 |
| – Coking coal | –7 | –15 |
| – Thermal coal | 4 | –9 |
| Rural | –3 | –11 |
| Base metals | –2 | –11 |
| Gold | –8 | –27 |
| Brent oil[(b)] | –2 | –2 |
| RBA ICP | –1 | –6 |
| – using spot prices for bulk commodities | –2 | –9 |

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodities prices are spot prices
(b) In US dollars
Sources: Bloomberg; IHS Energy Publishing; RBA

## Graph 1.18
## Energy Prices




Sources: Bloomberg; BREE; RBA; Thomson Reuters

to reflect increasing supply on the seaborne market (Graph 1.17). Base metal prices have edged a little lower since the November *Statement*. Gold prices declined over 2013, in anticipation of the US Federal Reserve's scaling back its asset purchase program.

Developments in energy prices have been mixed over the past few months (Graph 1.18). Crude oil prices have been little changed since the November *Statement*, while global spot prices for thermal coal have strengthened after declining over much of 2013. However, spot prices for thermal coal remain at low levels and considerably below the Japanese Financial Year contract price.

Prices of rural commodities overall have declined a little in recent months, despite some variation across individual commodities. Wheat prices have declined in conjunction with upward revisions to estimates of global crop production, but prices remain elevated relative to inflation-adjusted averages of recent decades.