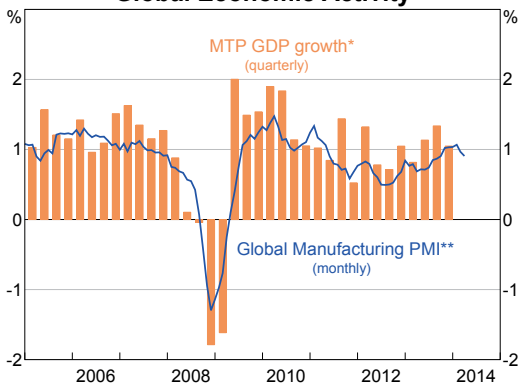


# 1. International Economic Developments

Growth of Australia’s major trading partners (MTPs) was close to its long-run average in 2013 (see ‘Box A: Growth of Australia’s Major Trading Partners’). The Global Manufacturing PMI and other timely indicators are consistent with growth remaining close to average in early 2014 (Graph 1.1). In China, growth in the first quarter was a little slower than it had been, although growth this year is still expected to be consistent with the government’s target. The US economy is showing signs of moderate growth and activity in the euro area is picking up gradually. Japan’s recovery has progressed, but demand is expected to weaken following the increase in the consumption tax in April. Other east Asian economies have continued to grow at around their decade-average pace.

**Graph 1.1**  
**Global Economic Activity**



\* Aggregated using Australia’s export shares

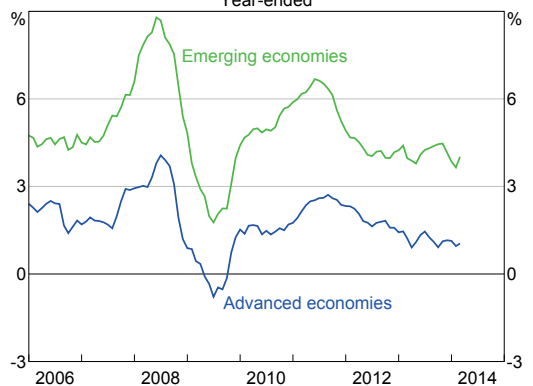
\*\* Level of PMI rescaled to match MTP GDP growth

Sources: ABS; CEIC Data; Markit Economics; RBA; Thomson Reuters

Global inflation remains low, particularly in the advanced economies and notwithstanding the recent increase in Japan (Graph 1.2). Inflation in

advanced economies has remained low over the past two years, suggesting that there is considerable spare capacity in these economies despite the recent increase in growth. In emerging economies, inflation developments are more mixed but, overall, price pressures remain contained.

**Graph 1.2**  
**Global Inflation\***  
Year-ended



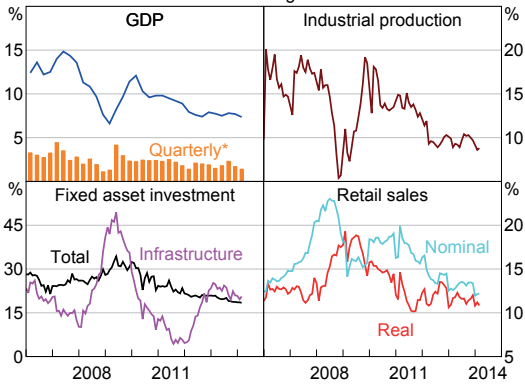
\* PPP-weighted; accounts for over 80 per cent of world GDP

Sources: CEIC Data; IMF; RBA; Thomson Reuters

## Asia-Pacific

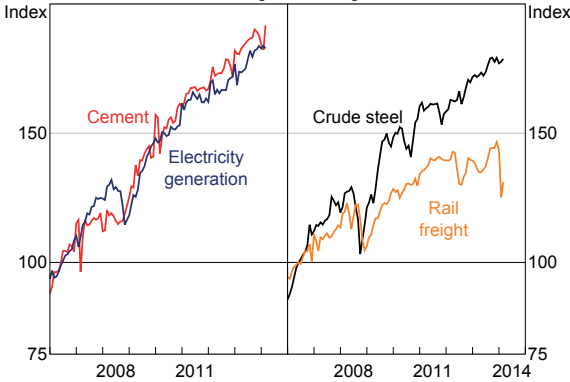
In China, economic growth moderated a little in early 2014, although this was similar to the pattern of weaker growth at the beginning of the previous two years. GDP grew by 1.4 per cent in the March quarter, to be 7.4 per cent higher over the year (Graph 1.3). A range of indicators suggest that the moderation in industrial activity that was evident in late 2013 continued into early 2014. Growth of crude steel production and electricity generation have slowed and rail freight volumes have fallen (Graph 1.4), although since February a number of indicators

**Graph 1.3  
China – Activity Indicators**  
Year-ended growth



\* RBA estimates prior to the December quarter 2010  
Sources: CEIC Data; RBA

**Graph 1.4  
China – Industrial Products**  
2006 average = 100, log scale



Sources: CEIC Data; RBA

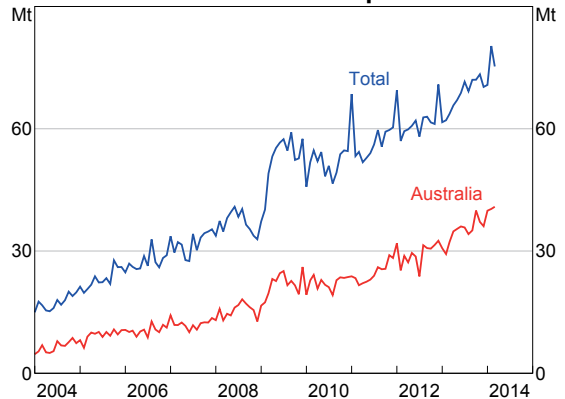
have shown tentative signs of improvement. Growth of real fixed asset investment picked up in the March quarter, but has moderated a little over the past year, owing largely to slower growth of infrastructure investment. Real household consumption growth looks to have remained strong, although growth of household disposable income showed signs of slowing in the March quarter.

In March, the Chinese Government announced growth targets for 2014 for a range of economic variables. These were largely unchanged from last year, with the target for GDP growth remaining at 7.5 per cent. The government's target of 2.1 per cent of GDP for the fiscal deficit was also little changed.

More recently, the government has flagged tax concessions for small businesses and made a public commitment to expand the construction of social housing and extend rail networks in central and western regions. The authorities also took measures to boost rural credit, including cuts to required reserve ratios for county-level rural banks and rural cooperative banks. These measures represent an extension of existing policies, and their impact is likely to be relatively minor, but they will provide some support for economic activity and confidence in the period ahead. Ongoing investment in social housing and the rail sector is consistent with the continuing process of urbanisation; the Chinese authorities have pledged to facilitate a rise in the national urbanisation rate from 54 per cent currently to 60 per cent by 2020.

Chinese exports declined in the March quarter, to be 3.8 per cent lower over the year. In the quarter, declines were recorded across most destinations. The weakness in measured exports at least in part reflects efforts by the authorities in late 2013 to reduce false trade invoicing, with the Chinese data on exports to Hong Kong moving into line with Hong Kong's imports data in recent months. Chinese imports softened recently, consistent with some moderation in indicators of domestic activity, although iron ore imports remain high, after rapid growth through last year (Graph 1.5).

**Graph 1.5  
China – Iron Ore Imports\***

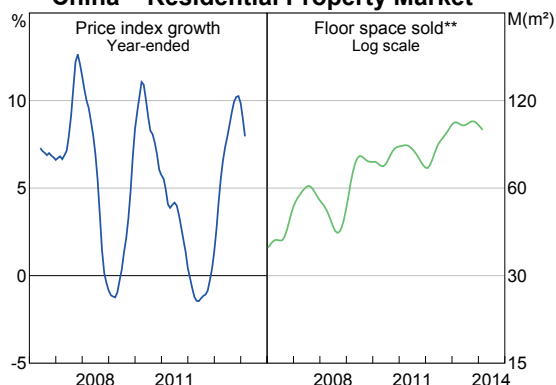


\* Seasonally adjusted by RBA  
Sources: CEIC Data; RBA

Growth of total social financing has continued to ease, reflecting a more modest expansion of non-bank financing. In line with the usual seasonal pattern, the flow of financing rebounded in March following weakness in February (reflecting the Chinese New Year holiday period). Adjusting for seasonality, the pace of growth has been slowing since the first half of 2013, reflecting the authorities' efforts to place the growth of banks' off-balance sheet business and the financing activities of non-bank financial institutions on a more sustainable footing.

Conditions in the property market in China continue to moderate, following the tightening of controls on property transactions and borrowing over 2013. Residential property price inflation has eased further in recent months, reflecting a broad-based moderation in property price inflation across Chinese cities (Graph 1.6). Recent data suggest slight declines in property prices in some smaller cities and are consistent with reports of an increase in discounts offered for new property purchases. The volume of property sales has eased in recent months, but remains at a high level.

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

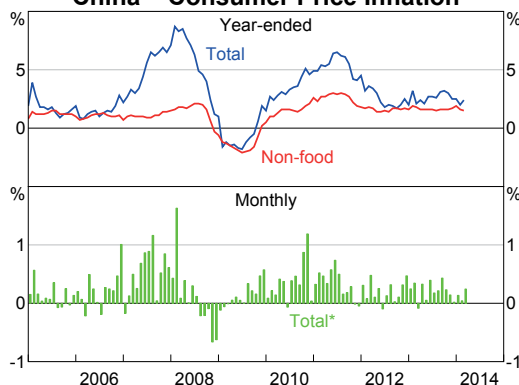


\* RBA estimates  
\*\* Trend  
Sources: CEIC Data; RBA

Inflationary pressures in China remain contained. At 2.4 per cent, year-ended CPI inflation in March was well below the government's 3.5 per cent target (Graph 1.7). Food price inflation has edged higher in recent months, but non-food price inflation

remains low, and there is little evidence of upstream price pressures, with producer prices continuing to decline.

**Graph 1.7**  
**China – Consumer Price Inflation**

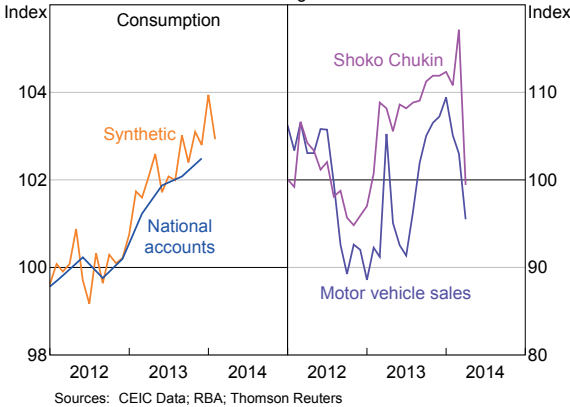


\* Seasonally adjusted by RBA  
Sources: CEIC Data; RBA

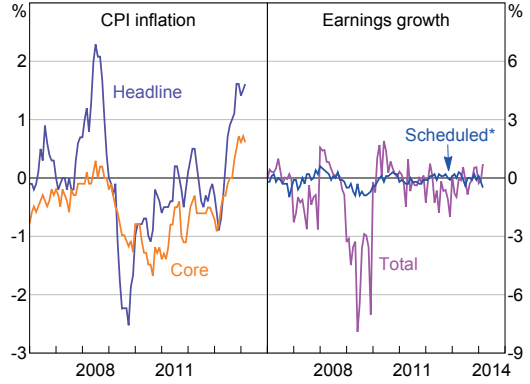
In Japan, year-average GDP growth in 2013, at 1.5 per cent, was well above its decade average, supported by strong domestic demand on the back of more stimulatory fiscal and monetary policies since late 2012. Growth appears to have continued at a strong pace in the March quarter 2014, as spending and production were brought forward ahead of the increase in the consumption tax rate implemented on 1 April (Graph 1.8; see also RBA (2014), 'Box A: Japan's Consumption Tax Increase', *Statement on Monetary Policy*, February, pp 12–13). Data available for April suggest that, as expected, economic conditions have softened following the consumption tax rise, with motor vehicle sales, consumer sentiment and the Shoko Chukin survey of small business sentiment all falling sharply.

Export volumes declined slightly in the March quarter, but are little changed since mid 2013, suggesting that any boost to external demand from the depreciation of the yen has been smaller than might have been expected. In part this may reflect the fact that many Japanese exports are intermediate inputs into regionally integrated supply chains, and demand for intermediate inputs tends to be more responsive to economic conditions in trading partner countries than changes in exchange rates.

**Graph 1.8**  
**Japan – Economic Indicators**  
2012 average = 100



**Graph 1.9**  
**Japan – Prices and Average Earnings**  
Year-ended change



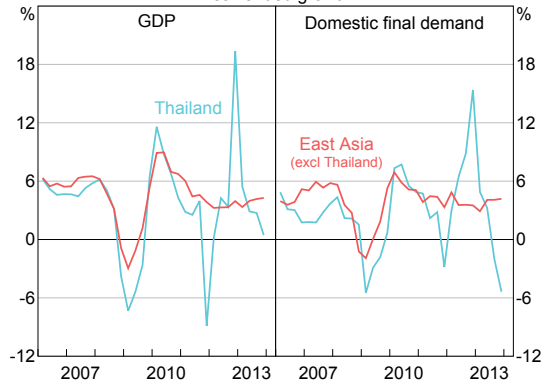
\* For full-time workers  
Sources: CEIC Data; RBA; Thomson Reuters

Both headline and core CPI inflation rose sharply over much of 2013, as the depreciation of the yen fed through to higher prices of imported goods, particularly to energy prices (Graph 1.9). More recently, inflation appears to have stabilised as the effects of the depreciation have faded. The consumption tax increase in April will increase consumer price inflation significantly, but temporarily; the CPI for Tokyo, which is released earlier than the economy-wide measure, increased in April by nearly 2 per cent, which was in line with the expected effect of the consumption tax increase. To date, domestic consumer prices have not increased noticeably although they are no longer declining, as they had in previous years. Similarly, nominal wages are little changed over the past year, although in the recently concluded spring wage negotiations large Japanese companies have announced small increases in base wages for the first time since the onset of the global financial crisis.

In the rest of east Asia, most economies appear to have grown at around their decade-average pace over the past six months (Graph 1.10). Thailand is a notable exception to this, with economic growth remaining weak amid ongoing political turmoil.

Across the region, growth of domestic demand over 2013 was supported by generally accommodative

**Graph 1.10**  
**East Asia\* – GDP and Domestic Demand**  
Year-ended growth



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

fiscal and monetary policies, credit growth and strong labour markets. Consumption growth was broad based across economies, while investment growth was strong in the higher-income economies but fairly subdued in the middle-income economies after an earlier period of strong growth.

In late 2013 and early 2014, there have been tentative signs of a pick-up in external demand (Graph 1.11). Industrial production data and the PMIs are consistent with continued steady growth of output over recent months.

**Graph 1.11**  
**East Asia – Production and Exports**  
2006 average = 100



\* Excludes China, Hong Kong, Indonesia and Japan

\*\* Excludes China and Japan; domestic exports for Hong Kong and Singapore (non-oil); non-oil and gas exports for Indonesia

Sources: CEIC Data; IMF; RBA; United Nations

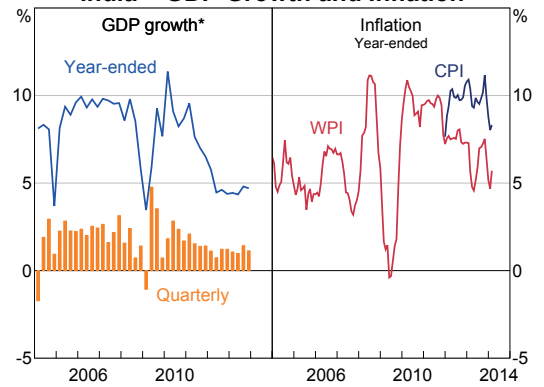
Inflationary pressures have been subdued in the region, although year-ended inflation rates remain elevated in some economies, partly owing to reductions in energy subsidies in 2013. Moreover, the exchange rates of a number of economies in the region have depreciated since mid 2013 when markets started anticipating the unwinding of the Federal Reserve’s asset purchases, adding to inflationary pressures in these economies. Exchange rates have stabilised somewhat more recently.

In India, economic growth has been relatively subdued at slightly below 5 per cent for the past two years (Graph 1.12). Over the second half of 2013, growth of consumption and investment eased. However, exports have grown faster than imports, partly reflecting the earlier depreciation of the rupee and gold import restrictions. Growth of agricultural production also increased following a good harvest, while recent indicators suggest that services sector activity has improved. The good harvest has contributed to a moderation of food price inflation, with consumer price inflation falling from a peak of 11.2 per cent to 8.3 per cent in March. Following on from a period of monetary policy tightening beginning in the second half of 2013, in March the Reserve Bank of India committed to reducing consumer price inflation to 8 per cent by the start of 2015, and to 6 per cent by the start of 2016.

Economic growth in New Zealand picked up over the second half of 2013, led by strong growth of both domestic demand and exports. The labour market has strengthened considerably in recent quarters, with employment growth and the participation rate rising and the unemployment rate edging down (Graph 1.13).

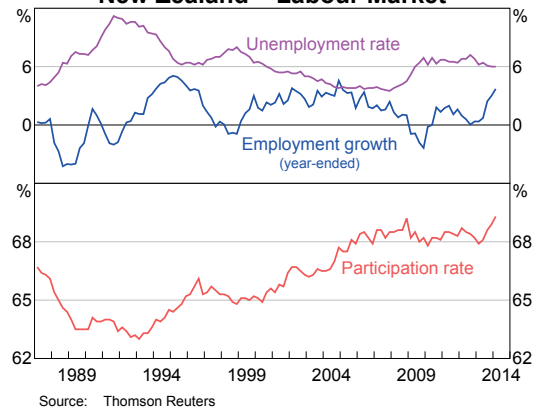
Housing prices have continued to rise rapidly, especially in Auckland and Christchurch. However, in early 2014 there have been signs of a decline in turnover. This follows the Reserve Bank of New Zealand’s implementation of restrictions on mortgage lending to borrowers with high loan-to-valuation ratios, and increases in mortgage rates associated with the recent tightening of monetary policy.

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



\* Measured at factor cost  
Sources: CEIC Data; RBA

**Graph 1.13**  
**New Zealand – Labour Market**

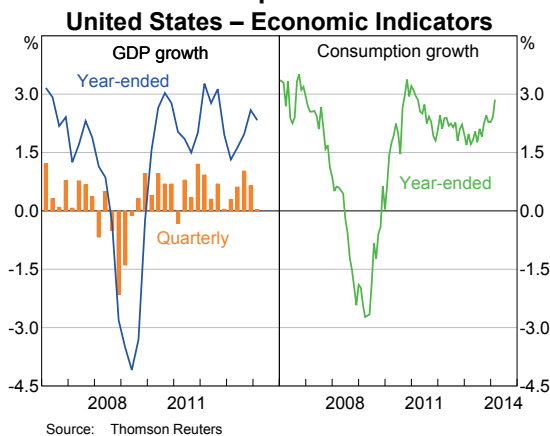


Source: Thomson Reuters

## United States

In the United States, very stimulatory monetary policy continues to support the economic recovery. Real GDP recorded negligible growth in the March quarter, although this in part reflected unusually severe weather conditions that weighed on activity early in the year (Graph 1.14). More timely indicators, including retail sales, motor vehicle sales and manufacturing production, suggest that economic activity picked up as the weather improved.

Graph 1.14

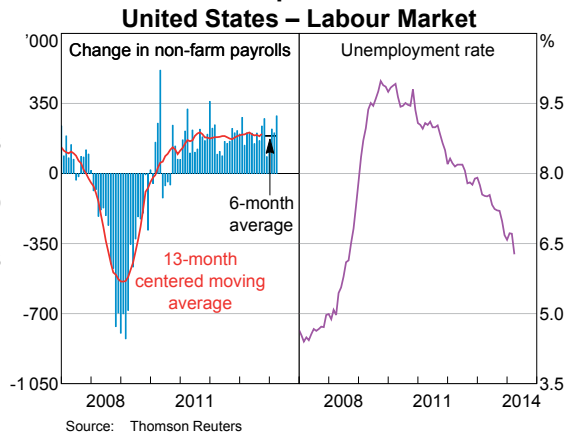


The pace of recovery in the housing market looks to have moderated a little from the rapid rates seen over 2012 and the first half of 2013. Residential construction activity declined in early 2014, at least in part because of the unusually severe weather in some parts of the country. While prices for established houses have continued to increase at an annualised rate of around 10 per cent, sales volumes have fallen considerably since the middle of last year. This reflects both a limited stock of houses for sale and some softening in demand, in part reflecting higher mortgage interest rates.

Labour market conditions improved further in early 2014. Non-farm payrolls increased strongly in April, and over the past six months they increased at around the average pace of the previous two

years. The unemployment rate has declined further (Graph 1.15). The participation rate has been steady in recent months, remaining around its lowest level since the late 1970s. Low labour force participation, coupled with high rates of both longer-duration unemployment and part-time workers who would prefer full-time employment, all suggest that there is still considerable spare capacity in the labour market. The Federal Open Market Committee took this into account when it revised its forward interest rate guidance, to include a range of measures of labour market conditions, inflation pressures and inflation expectations, and financial conditions (see the 'International and Foreign Exchange Markets' chapter).

Graph 1.15

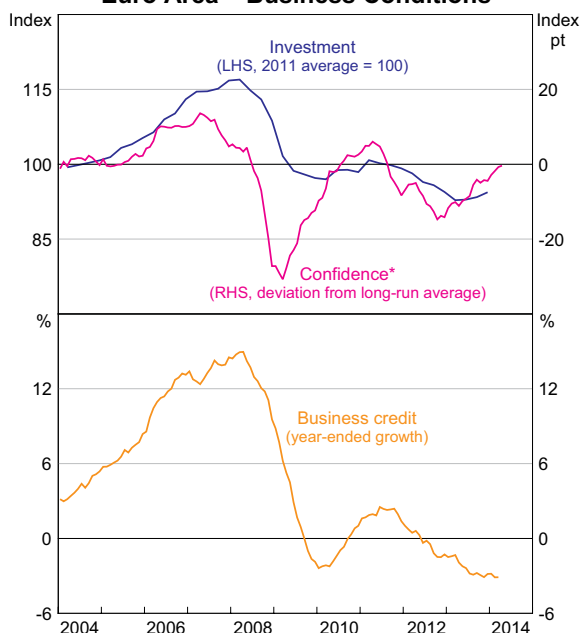


## Europe

The gradual recovery of economic activity in the euro area continued in the December quarter, with GDP expanding modestly for the third consecutive quarter and growth over the year positive for the first time since 2011. Growth in the quarter was driven by investment and exports, with private consumption increasing only slightly. The recent pick-up in export growth follows an improvement in competitiveness in some of the more fragile economies in the region, which has occurred as a result of weak growth (or even declines) in prices and wages.

The recovery appears to have continued into the March quarter. Retail sales grew strongly in the quarter, and consumer confidence continued to improve. Various indicators suggest that investment has continued to grow, albeit very modestly. Surveys suggest that business confidence has improved over recent months and is now close to its long-run average, although business credit has continued to decline reflecting weakness in both demand and supply (Graph 1.16).

**Graph 1.16**  
Euro Area – Business Conditions

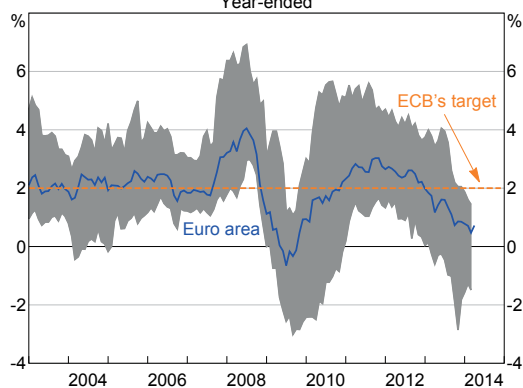


\* Aggregated from industry-level confidence indicators  
Sources: European Central Bank; Thomson Reuters

The unemployment rate in the euro area has stabilised but it remains high, and spare capacity in the economy more generally has led to a decline in core inflation over 2013; the higher exchange rate is also likely to have contributed. Falling fuel prices and slowing food price inflation have contributed to a more noticeable decline in headline inflation. Low inflation is broad based, with all euro area economies experiencing inflation below the European Central Bank's (ECB) target, which is for inflation to be below but close to 2 per cent (Graph 1.17). Indeed, consumer prices in a few of the more fragile

economies have declined. The ECB has stated on a number of occasions that it will do whatever it deems necessary to address the risk of deflation in the euro area as a whole.

**Graph 1.17**  
Euro Area – Consumer Price Inflation\*  
Year-ended

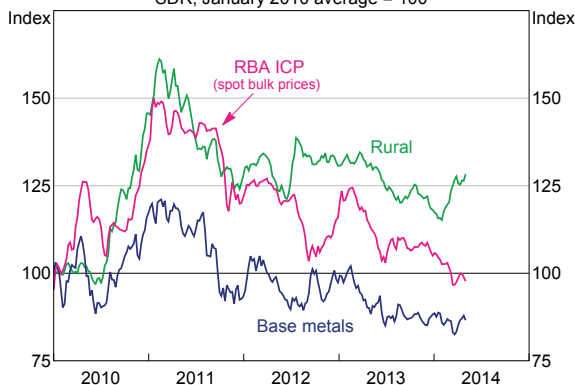


\* Shaded area represents range of individual economies  
Source: Thomson Reuters

## Commodity Prices

Commodity prices have declined over the past few months, with particularly large falls in the prices of iron ore and coal associated with a weakening in Chinese steel demand. Base metals prices have also declined, while prices of rural commodities and gold have increased (Graph 1.18; Table 1.1).

**Graph 1.18**  
Commodity Prices\*  
SDR, January 2010 average = 100



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

**Table 1.1: Commodity Prices Growth<sup>(a)</sup>**  
SDR, 3-month-average prices, per cent

|  | Since previous Statement | Over the past year |
|--|--------------------------|--------------------|
| Bulk commodities                         | -14                      | -24                |
| – Iron ore                               | -14                      | -23                |
| – Coking coal                            | -14                      | -30                |
| – Thermal coal                           | -11                      | -19                |
| Rural                                    | 5                        | -6                 |
| Base metals                              | -1                       | -9                 |
| Gold                                     | 5                        | -17                |
| Brent oil <sup>(b)</sup>                 | -1                       | 0                  |
| RBA ICP                                  | -3                       | -12                |
| – Using spot prices for bulk commodities | -6                       | -16                |

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

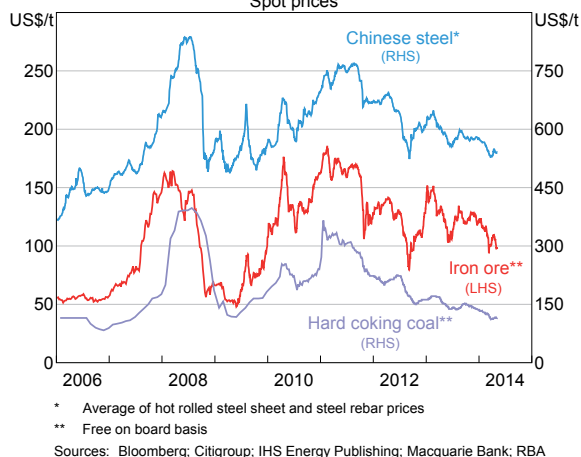
(b) In US dollars

Sources: Bloomberg; IHS Energy Publishing; RBA

Following a gradual decline in January and February, the spot price for iron ore fell sharply in early March and remains more than 20 per cent lower than a year ago (Graph 1.19). The recent decline appears to reflect weaker demand for Chinese steel, a tightening in credit conditions in the Chinese steel industry and, reportedly, increased scrutiny by Chinese authorities over the use of iron ore as collateral for loans. Significant expansions to the supply of iron ore, particularly from Australia, have also weighed on prices over the year.

Consistent with weaker demand for steel, the spot price for premium hard coking coal has also declined in recent months. The June quarter contract price for premium hard coking coal is US\$120 per tonne, which is 16 per cent lower than it was in the March quarter. Global spot prices for thermal coal remain

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



at low levels, with the spot price for Newcastle thermal coal now around 10 per cent below the 2014 Japanese Fiscal Year contract price of about US\$82 per tonne. It appears that some higher-cost Australian coal mines are unprofitable at current spot prices, although take-or-pay contracts with port and rail operators (where miners pay a fixed cost for access to port and rail facilities regardless of whether they use them or not) may mean that ceasing production would incur higher losses than continuing to produce.

Rural prices have, on average, increased over the past three months. This partly reflects higher wheat prices, as drier-than-normal conditions have affected the outlook for wheat production in the United States. The prices of base metals are, on average, slightly lower over the past three months, although the price of nickel has risen steadily over this period, following Indonesia's ban on mineral ore exports in January. ↘