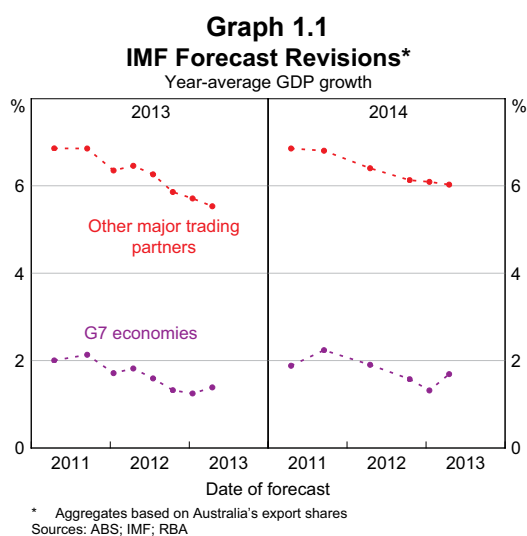


1. International Economic Developments

Global economic indicators have been somewhat mixed in early 2013, and suggest that growth in the March quarter was not as strong as it was in the December quarter. Growth in the Chinese economy slowed a little in the early part of this year, but indications are that growth will continue to be supported by strong investment in infrastructure and real estate. The outlook for growth in the Japanese economy has improved following policy initiatives there. Elsewhere in east Asia, conditions have eased a little. The US economy grew at a moderate pace, while the euro area remains in recession.

On balance, growth of the global economy in 2013 is expected to be slightly below its average pace, and to strengthen a little in 2014 (Graph 1.1). Activity in the advanced economies continues to be restrained by ongoing balance sheet repair and fiscal consolidation but is expected to pick up gradually through 2014. Growth in developing economies is also expected to be stronger in 2014 and is forecast to remain considerably higher than in the advanced economies. Australia trades more with developing economies, which are currently experiencing better economic conditions. As a result, growth in Australia's major trading partners is expected to be around its average pace and continue to exceed that for the world as a whole.

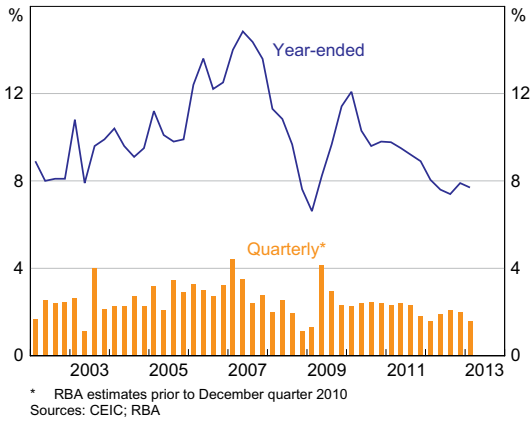
Overall, inflation is well contained in all the major regions and commodity prices generally declined in recent months. In most economies, monetary conditions remain very accommodative. This is especially so in the major advanced economies, including Japan where significant further monetary expansion was announced in April.



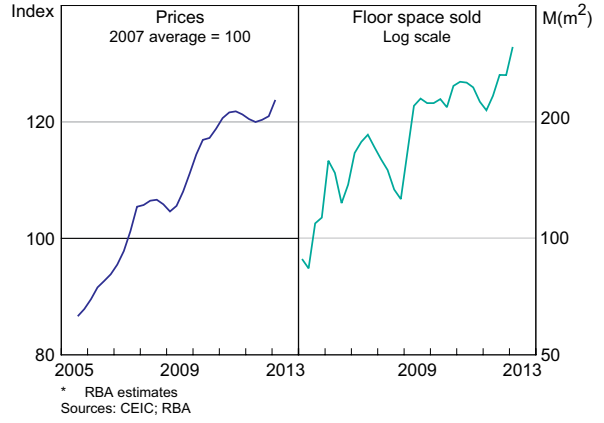
Asia

Growth in the Chinese economy slowed a little in the first quarter of 2013 to 1.6 per cent, with output 7.7 per cent higher over the year (Graph 1.2). Although it is below the rapid pace of growth achieved through much of the late 2000s, this is a more sustainable pace of growth for China. The easing in the quarter primarily reflects softer consumption growth, in part owing to government efforts to rein in some forms of public expenditure, while growth in household income was also a little lower. At the same time, investment growth remains stable overall – with strong growth in infrastructure – and may pick up following strength in financing activity in recent quarters (Graph 1.3).

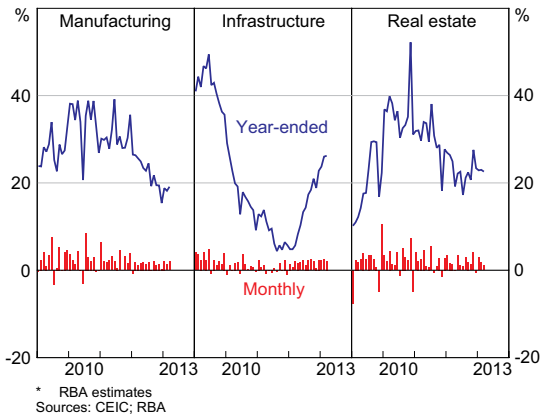
Graph 1.2
China – GDP Growth



Graph 1.4
China – Residential Property Market*



Graph 1.3
China – Growth in Nominal Investment*

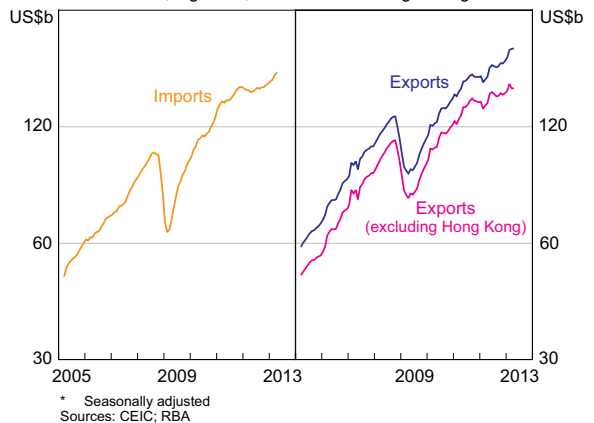


Growth in industrial production slowed over the year, but has stabilised in recent months. Growth in investment in the manufacturing sector has also been stable following a steady decline since the end of 2011.

Exports are reported to have grown strongly over the first few months of 2013 (Graph 1.5). However, exports to some economies have been much stronger than implied by the corresponding data on imports from China. This is most significant for Hong Kong which is a large destination for Chinese exports. Import values grew strongly in the month of March after a period of relatively subdued growth; the value of resource imports stabilised in March after contracting earlier in the year.

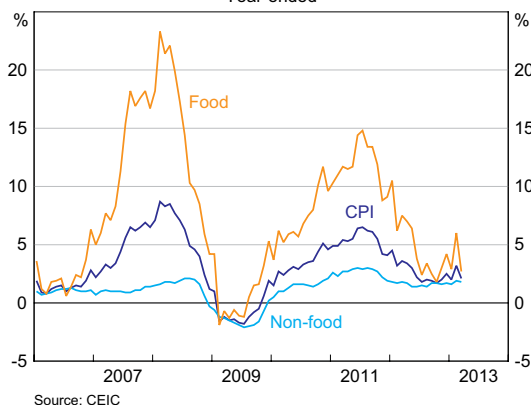
Demand for residential property has continued to strengthen in recent months, which is likely to support investment in the real estate sector. Sales of property have increased, and in the March quarter property prices increased by 3.1 per cent, the largest quarterly increase since 2009 (Graph 1.4). Indeed, in response to ongoing concerns about housing affordability, authorities announced a tightening of restrictions on the purchase of property and introduced a number of other measures, including increases in capital gains taxes. Reports suggest that this has temporarily boosted sales activity, as some buyers have pulled forward purchases to avoid the implementation of the tighter restrictions.

Graph 1.5
China – Merchandise Trade*
Values, log scale, three-month moving average



Inflationary pressures in China remain contained, with recent consumer and producer price data suggesting some easing (Graph 1.6). The earlier pick-up in food price inflation has reversed recently, owing in part to weaker demand for meat following concerns about diseased pigs. Also, vegetable prices declined, reversing the earlier spike associated with especially bad weather in January. Producer prices declined in the first quarter, after previous signs of stabilisation. The People's Bank of China has not adjusted reserve requirements or benchmark interest rates since the previous *Statement*.

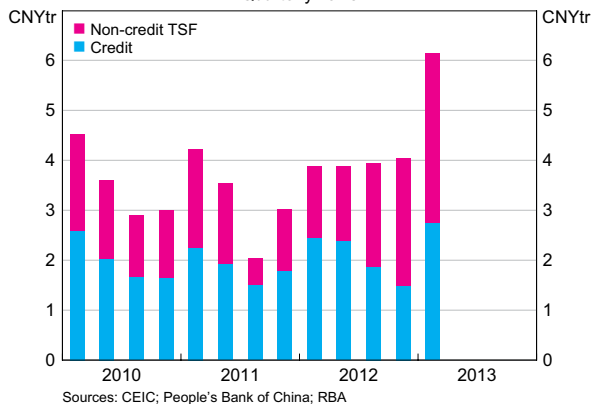
Graph 1.6
China – Consumer Price Inflation
Year-ended



In the March quarter, bank credit recorded strong growth, consistent with its usual seasonal pattern, while non-credit total social financing grew at an even faster pace (Graph 1.7). The strength in non-credit total social financing has been broadly based across components, with particularly substantial corporate bond issuance since late last year. At the end of March, in response to concerns about the quality of credit, authorities announced measures to increase the transparency of wealth management products and placed restrictions on where these funds can be invested.

In Japan, indicators of sentiment and economic activity picked up in early 2013, following the announcements of fiscal expansion and changes to monetary policy (see the 'International and Foreign

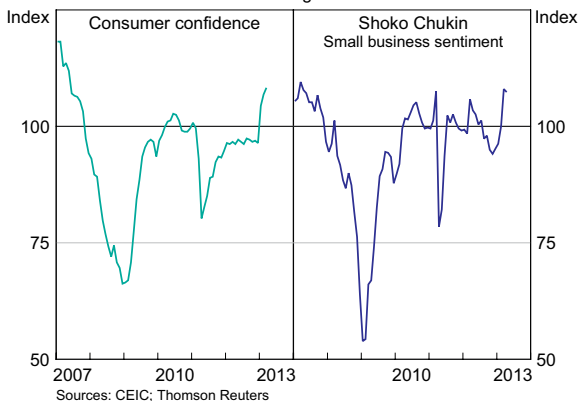
Graph 1.7
China – Total Social Financing
Quarterly flows



Exchange Markets' chapter for more detail). Equity prices and business and consumer sentiment have been rising since late 2012, and the sentiment indicators are now at their highest levels since 2007 (Graph 1.8). Indicators of household expenditure also increased in early 2013. The additional fiscal stimulus will increase transfer payments from April 2013 and includes an expansion in public works.

Survey data for March and April indicate a sharp rise in new orders from both domestic and foreign customers (Graph 1.9). The substantial depreciation of the yen in recent months is expected to provide some support to Japanese exports in the period ahead. However, because a large share of

Graph 1.8
Japan – Consumer and Business Surveys
2010 average = 100



Graph 1.9
Japan – Manufacturing PMI



manufactured exports in Asia is tied to supply chains across multiple countries, this may take some time to take effect. With the export share of GDP in Japan relatively low, at around 15 per cent, an increase in export demand is likely to have a relatively moderate effect on aggregate demand overall.

In the rest of east Asia, economic activity appears to have grown at a slightly below-average pace in the March quarter, with falling industrial production and weak external demand. Conditions continue to vary between the higher- and lower-income economies in the region. Consumer confidence, growth of retail spending and production of machinery and equipment have been stronger in the lower-income economies (Graph 1.10). Exports slowed in the March quarter, following strong growth in the December quarter 2012. In Korea, growth in economic activity in 2012 was relatively low but it picked up a little in the December quarter and by a lot more in the March quarter. In April, the Korean Government announced fiscal stimulus measures aimed at job creation.

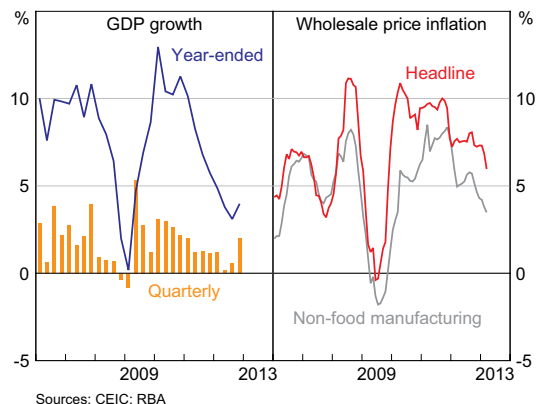
Inflationary pressures in east Asia remained contained, although food prices are exerting some upward pressure in lower-income economies. In Japan, prices continued to decline, but indicators of inflation expectations have risen significantly following the announcement of further monetary stimulus.

Graph 1.10
East Asia – Activity Indicators



In India, GDP growth rebounded in the December quarter, with a pick-up in both consumption and investment (Graph 1.11). Growth was stronger in spite of cuts in government spending implemented to meet fiscal targets. Industrial production has also picked up in recent months, driven by manufacturing. Headline wholesale price inflation and non-food manufacturing inflation both fell noticeably over the past three months. In response to this, the Reserve Bank of India cut interest rates at both its March and May meetings.

Graph 1.11
India – Economic Indicators

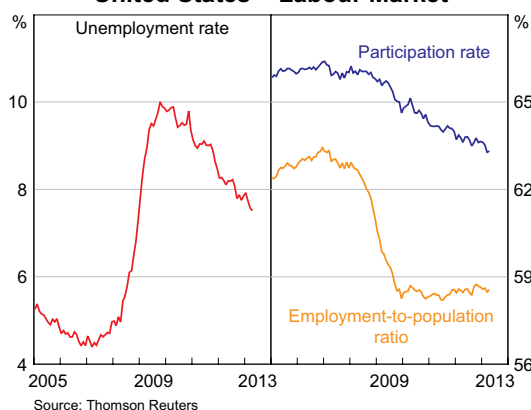


United States

Economic conditions in the United States have generally continued to improve in recent months. GDP expanded at a moderate pace in the March quarter, following little growth in the December quarter, with growth in private demand offsetting falls in public demand. Inflationary pressures have continued to ease over the past few months, with both headline and core measures of inflation remaining well below 2 per cent in year-ended terms.

Labour market conditions have continued to improve in recent months, with employment growing at a moderate pace and the unemployment rate declining further (Graph 1.12). Nevertheless, both the participation rate and the ratio of employment to population remain around their lowest levels in the past two decades, in part reflecting an increase in the number of discouraged workers as well as the effect of the ageing of the population.

Graph 1.12
United States – Labour Market



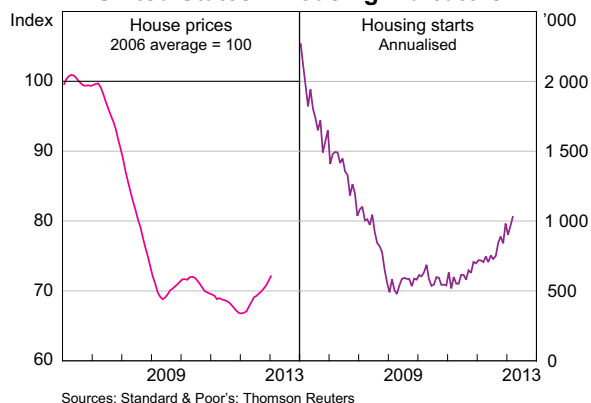
Monetary policy remains highly accommodative and this is having an effect on financing activity, with lending standards for low-risk borrowers being eased somewhat and non-mortgage credit growing.

In March, automatic federal government spending cuts (the so called 'sequester') came into force. These will weigh on both public demand and household consumption as spending on government programs

is reduced and public sector wage payments decline. A range of forecasters have estimated that these spending cuts will subtract around half a percentage point from GDP growth in 2013. While household consumption growth was resilient to the increases in the payroll tax rate in the March quarter, the effect of the sequester on household incomes is yet to be seen.

Conditions in the housing market have improved further in 2013, with house prices and housing starts continuing to rise (Graph 1.13). While the increase in housing starts has contributed to a pick-up in residential investment over the past six months, it remains low as a share of GDP. The rise in housing activity has led to an increase in employment in the construction industry. The stock of distressed and foreclosed homes has continued to decline from high levels, while the increase in house prices, along with higher equity valuations, has seen household wealth continue to rise, which is expected to support consumption spending.

Graph 1.13
United States – Housing Indicators



Europe

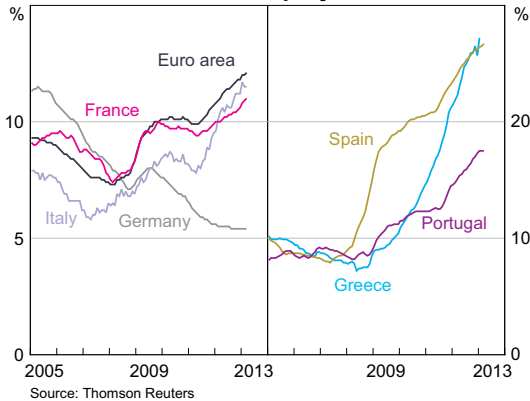
Economic conditions remain weak in the euro area. Industrial production was little changed in the first two months of the year, after contracting sharply in the December quarter, while exports remain flat. Household consumption appears to have stabilised, following significant falls in late 2012, with

retail sales increasing slightly in the March quarter. Nevertheless, indicators of sentiment remain well below average, suggesting that consumer spending is likely to remain weak.

The crisis economies are still contracting as fiscal consolidation, high unemployment and tight funding conditions continue to weigh on domestic demand. Labour market conditions deteriorated further across the euro area with unemployment rates increasing, with the exception of Germany where the unemployment rate has been steady (Graph 1.14).

Inflation has declined further over recent months, to well below 2 per cent. Inflation pressures are expected to remain subdued, in line with the weakness in domestic demand.

Graph 1.14
Euro Area – Unemployment Rates



Commodity Prices

Commodity prices have generally fallen since the February *Statement*. The RBA Index of Commodity Prices, based on spot prices for the bulk commodities, has decreased by around 10 per cent in SDR terms. Most major components have fallen (Graph 1.15, Table 1.1).

The spot price for iron ore in US dollar terms has fallen by 17 per cent since the previous *Statement*. Price declines had been anticipated given the unexpectedly large rise around the turn of the year (Graph 1.16). The spot price remains above the levels seen for most of the second half of 2012; iron ore

Graph 1.15
Commodity Prices
Weekly

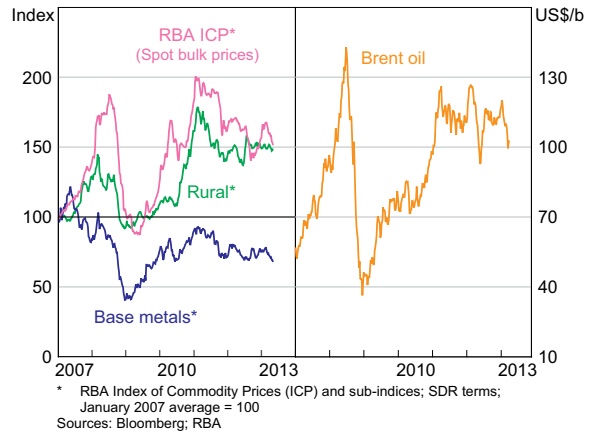


Table 1.1: Commodity Prices Growth^(a)
SDR, per cent

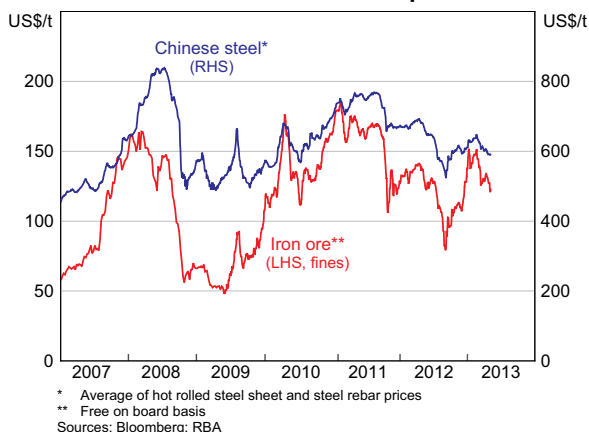
| | Change since previous <i>Statement</i> | Change over the past year |
|--|--|---------------------------|
| Bulk commodities | -13 | -13 |
| - Iron ore | -15 | -7 |
| - Coking coal | -7 | -27 |
| - Thermal coal | -7 | -10 |
| Rural | -3 | 5 |
| - Beef | -1 | 0 |
| - Cotton | 8 | 3 |
| - Wheat | -2 | 29 |
| - Wool | -14 | -16 |
| Base metals | -10 | -7 |
| - Aluminium | -9 | -6 |
| - Copper | -10 | -10 |
| - Lead | -15 | -1 |
| - Nickel | -16 | -11 |
| - Zinc | -13 | -5 |
| Gold | -10 | -6 |
| Brent oil ^(b) | -11 | -7 |
| RBA ICP | -1 | -6 |
| - using spot prices for bulk commodities | -10 | -9 |

(a) RBA Index of Commodity Prices (ICP) components; prices of bulk commodities are based on spot price movements

(b) In US dollars

Sources: Bloomberg; RBA

Graph 1.16
Chinese Steel and Iron Ore Spot Prices



inventories at Chinese ports are at low levels relative to steel production and growth in Chinese steel production in early 2013 is likely to have provided some support for iron ore prices. While the spot price for hard coking coal declined by 9 per cent in US dollar terms since the February *Statement*, the June quarter benchmark contract price was settled at 4 per cent above the March quarter contract price (Graph 1.17).

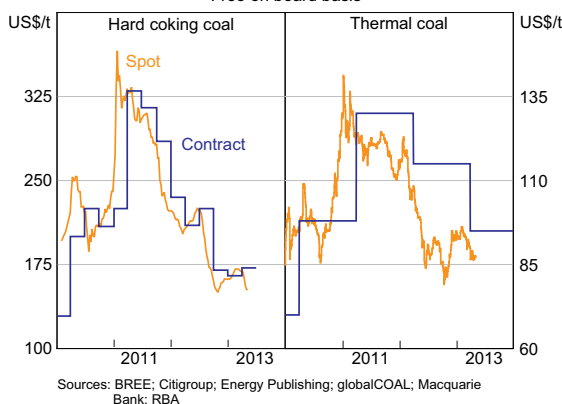
The declines in most other major commodity prices coincided with the release of some weaker-than-expected data on economic activity in China, the United States and Europe. Base metal prices have

fallen by 10 per cent since the February *Statement*, while the prices of precious metals have fallen sharply over recent months from very high levels, with the spot price of gold back to the levels of early 2011.

Energy prices are lower than three months ago, with declines in both crude oil prices and global spot prices for thermal coal, which is used in electricity generation. The spot price for Newcastle thermal coal declined by 9 per cent in US dollar terms over the past three months; the 2013 Japanese Fiscal Year contract price for Newcastle thermal coal is 17 per cent lower than the 2012 contract. The falls in thermal coal prices since early 2012 reflect a number of factors, such as subdued demand from importing countries and low natural gas prices in the United States, which has reduced demand for thermal coal.¹ Despite some recovery in US natural gas prices since mid 2012, thermal coal prices have increased only modestly, suggesting that demand for thermal coal remains soft.

There have been divergent trends in rural prices since the February *Statement*. Grain prices are little changed, but are substantially lower than the elevated levels in the second half of last year, cotton prices have increased, while wool prices have declined. ❖

Graph 1.17
Coal Prices
Free on board basis



¹ See RBA (2013), 'Box A: Thermal Coal Prices', *Statement on Monetary Policy*, February, pp 13–15.