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Australia is enjoying an unprecedented period of prosperity, and the good news is there is no end in sight. Not all regions have shared equally in the good times. The resource-rich states and territories have recorded the strongest growth in economic activity, population, employment, and house prices. The south-eastern states and territories have lagged. These differences will narrow in 2007-08 as the slowest growing states lift their performance. *Page 2*

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**Tony Pearson**  
Head of Australian Economics

**Australia's near-term economic outlook is favourable**

**Regional disparities will persist, but narrow, in 2007-08**

**Growth across the mainland states will in part be driven by government infrastructure investment**

## The big picture

Australia is enjoying an unprecedented period of prosperity. It has completed 16 years of continuous expansion, the longest period of unbroken growth since Federation. Over the past half decade an important driver of growth has been the once-in-a-generation commodity boom, with record prices adding to national income, and with the associated business investment boom adding to economic activity and employment.

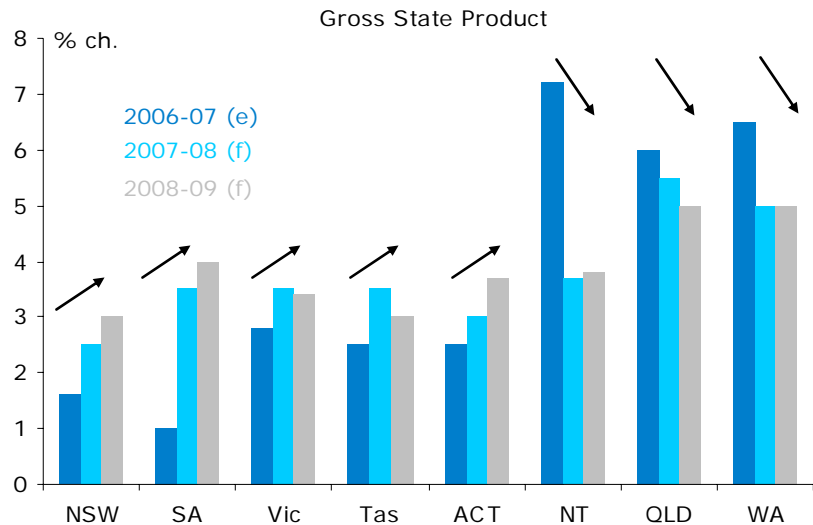
The Australian economy is expected to continue to perform very strongly over the next year. There will be some increase in rural production, although not as much as seemed likely earlier in the season. Business investment will remain solid, buoyed by continued strong overseas demand for resources. Households will continue to spend freely as incomes are boosted by continued growth in employment, solid wage outcomes, and further personal income tax cuts. One uncertainty is the effect on global and Australian growth of the recent period of financial market volatility. One legacy is likely to be higher borrowing costs reflecting a global re-pricing of risk. This may have some impacts on business investment and household spending at the margin but nothing that would alter the generally favourable outlook for Australia's economic performance.

Not all regions have shared equally in the good times. The resource-rich states and territories have recorded the strongest growth in economic activity, population, employment, and house prices. The south-eastern states and territories have lagged. These differences will narrow in 2007-08. Growth in Western Australia, the Northern Territory and Queensland will ease as the impetus from the commodities boom peaks. Some other states will gain a greater boost from resources, particularly South Australia. In contrast, difficulties will remain in the eastern states, with rural conditions remaining problematic in central and western New South Wales, and more generally for irrigators in the Murray-Darling Basin. The housing construction sector, particularly in New South Wales, will remain constrained by rising interest rates. And manufacturers will continue to struggle with a high A\$.

All state governments will attempt to drive growth to varying degrees through increased infrastructure spending. This will add to economic activity directly in the present and will underpin growth in the future by easing some of the infrastructure constraints and lifting the speed limits to economic expansion.

On balance it seems likely that even the slowest growing states will lift their performance in 2007-08, although the performance gap to the resource rich states will not be completely closed.

### Resource-rich states dominate, but regional disparities will narrow



Sources: Australian Bureau of Statistics and Economics@ANZ

## New South Wales: still room for improvement

*Tony Pearson, Head of Australian Economics*

New South Wales has been the economic laggard of the major states in recent years. In 2005-06 gross state product increased by only around 1½%, about half the rate of Victoria, and the slowest of all the states and territories. In 2006-07 the Government expects growth to be little changed at 1.5%, again about half the pace of Victoria, and a growth rate expected to be underperformed only by South Australia.

### Some signs of improvement

That relatively sobering outlook probably undersells the clear signs of improvement in key areas. The June quarter National Accounts showed a pleasing lift in domestic demand, with a trend rise of 1.3%, the strongest quarterly increase since the December quarter 2003.

Business investment has been a weak link in the state's performance. This now appears to be turning around. Seasonally adjusted estimates suggest private business investment rose by a very strong 9% in the June quarter, the strongest increase for two years. This more positive view is supported by private non-residential building approvals, which have risen steadily since April 2006 in monthly average terms to a record \$509mn in July 2007. And the value of non-residential and engineering construction (both public and private) rose by 14% over the year to March 2007. Having said that, the pipeline of unfinished work remains short, with work yet to be done of \$7.1bn in the March quarter only a bit over four months work at the current pace of \$4.7bn a quarter. Nevertheless, the overall story on business investment does appear to be improving.

A further optimistic sign is that household spending remains robust. Household consumption rose by a solid 1% in trend terms in the June quarter. And trend retail sales are running at around 0.6% per month, much stronger than in Victoria.

The improving economic performance has reflected in a strengthening labour market, with the unemployment rate falling to 4.7%, the lowest in 30 years. However, employment growth remains soft at an annual trend rate of around 1.8%, below the national average of 2.6%.

### The 'r' word

Having said that, there remain a couple of areas where the economic story is disappointing. Perhaps the most critical from a growth perspective is dwelling investment, which has been declining in trend terms for the three years since June 2004. Prospects for a speedy turnaround do not look good. Dwelling commencements in the June quarter 2007 were 7,188, the lowest number for at least 23 years. And local council dwelling construction approvals in July 2007 were 46% lower than the cyclic peak in November 2002, and again were the lowest for at least 23 years. The volume of

alterations and additions has also declined, although this sub sector remains well above the cyclic lows.

Our blunt assessment is that the dwelling construction industry in NSW is in recession. This is partly due to national factors – higher interest rates generally suppress dwelling construction, and it is no coincidence that construction has also been subdued in some other states.

But there is a qualitative difference. In no other state has the recent decline been as marked as it is in New South Wales. And all other states and territories looked to have stabilised or to be improving; New South Wales is the only one where dwelling commencements and approvals are still clearly falling. So it seems state-specific factors are at work. It is not a lack of demographic pressure; very low vacancy rates and rising rents point to a very tight housing market. Rather, industry representatives suggest that state government taxes and charges add so much to the cost of a new dwelling that new stock cannot be delivered to market at an affordable price. This is an area of ongoing discussion between developers and the government. In the meantime, any recovery in dwelling construction in the short term is likely to be hampered by the further increases in the cost of housing finance, including those resulting from central bank policy actions (the August rate rise) and those resulting from the market induced tightening in credit conditions.

Conditions in the rural sector also remain problematic. The winter planting season began with great promise with good soaking rains and heavy plantings. But the lack of follow up rains now means that some crops have failed. ABARE estimates that winter crop production in New South Wales will rise by only 2.82Mt in 2007-08 to 5.88Mt from the 2006-07 figure of 3.06Mt, which was a 12-year low. This compares to the recent peak production of 11.29Mt in 2005-06. Irrigated crops also remain critically short of water. Rural incomes will be supported to some extent by record high prices for some rural commodities, particularly grains, but this is scant comfort if there is no crop to sell. New South Wales has also been hardest hit by equine influenza. This has very significantly depressed incomes in the horse racing and breeding industries, and had a negative impact on gambling revenues, and in turn the state government revenue derived from these activities.

### The exodus continues

Population growth also remains something of an enigma. New South Wales has lower percentage and absolute population growth than Victoria. The prime difference is interstate migration. New South Wales loses 26,000 people a year to other states and territories while in net terms Victoria loses almost no one. Why do people leave New South Wales but not Victoria? The difference can't be in retirees

heading for the sun – both states have broadly similar population age demographics. It most probably has to do with younger folk seeking jobs and/or cheaper housing. Melbourne housing remains less expensive than Sydney (Sydney remains the most expensive city with median prices for existing houses still one third higher than in Melbourne) and Victoria has enjoyed much stronger employment growth over the past four years (an annual trend rate of growth of 2.3% versus 1.5%).

The low rate of house construction and growing shortage of supply has had one benefit, and that is that it has helped to arrest the decline in house prices. Since end 2003 Sydney house prices had shown the weakest performance of any of the capital cities, falling by 10% from the peak in December quarter 2003 to the trough in the March quarter 2006. Subsequently prices have begun to rise, by 3.4% over the year to June 2007. These average figures hide considerable variation across the city, with anecdotal information suggesting prices in the south west remain weak.

### Growth accelerating, but still relatively soft

The state government forecasts growth in gross state product to accelerate by 1ppt to 2.5% in 2007-08. That looks about right to us. The bad news is it would leave New South Wales as the slowest growing of all the states and territories. And there are downside risks, with the rural sector still fragile, and a recovery in dwelling construction likely to be delayed by yet higher interest rates stemming from official actions and market adjustments.

The state's budgetary position is looking significantly stronger than it did in last year's Budget and the mid-year review. This reflects increased revenues from one off commercial property transactions

(\$751mn higher) and very strong investment income returns (\$835mn higher). The latest budget estimates now show a net operating *surplus* of \$444mn in 2006-07 (rather than the deficit of \$497mn forecast in the December mid-year review) and a continued surplus of \$376mn in 2007-08.

The Government has also lifted its capital works program, with \$12.5bn provided for capital works in 2007-08 and nearly \$50bn over the next four years. As a share of the state's economy, this takes capital spending to its highest in over a decade. This should add to growth directly and lift the speed limits to growth through expanding the supply side of the economy.

The increased infrastructure spending has come at the cost of an elevated level of debt. By the end of the forward estimates period (30 June 2011), NSW public sector net debt is estimated to reach \$39.3bn (9.3% of GSP). This represents a turnaround from the very low debt levels of the past few years to a more moderate position. Ratings agency S&P has confirmed that the increased debt will not threaten the State's AAA credit rating.

In terms of infrastructure, one of the future challenges for the government will be how best to provide for the generation and distribution of electricity. The Owen Inquiry into Electricity Supply in NSW, released in September 2007, recommends that the government divest itself of all state ownership in both retail and generation. Retaining these assets could require expenditure of between \$12bn and \$15bn over the next 10 to 15 years. Divesting the assets would mean that total state net debt would be up to \$26bn lower in 2020.

### Economic data – New South Wales

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	1.0	-0.8	-0.3	1.4	1.5	0.7
Private building approvals	-8.0	6.1	-12.1	1.4	0.5	n.a.
Employment	0.1	0.2	0.7	0.1	-0.1	0.2
Unemployment rate, %	4.9	5.0	4.9	4.7	4.7	4.7
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	1.2	0.4	0.7	1.8	1.3	0.2
Private investment	-3.2	-1.5	-4.3	2.0	3.2	7.1
Public demand	0.7	0.9	2.6	0.2	-2.1	0.5
State final demand	0.2	0.1	0.2	1.5	1.0	1.6
Population, ann. % ch.	0.3	0.1	0.3	0.3	0.3	n.a.
Median house price – Sydney, \$'000s	487.9	497.4	497.9	500.0	500.5	512.1
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	1.5	0.8	1.4	1.6	2.5	3.0
Employment	1.2	1.4	1.7	1.8	2.0	2.0
Consumer prices – Sydney	2.2	2.5	3.0	2.7	2.7	2.7

Sources: Australian Bureau of Statistics and Economics@ANZ

## Victoria: 'The place to be'

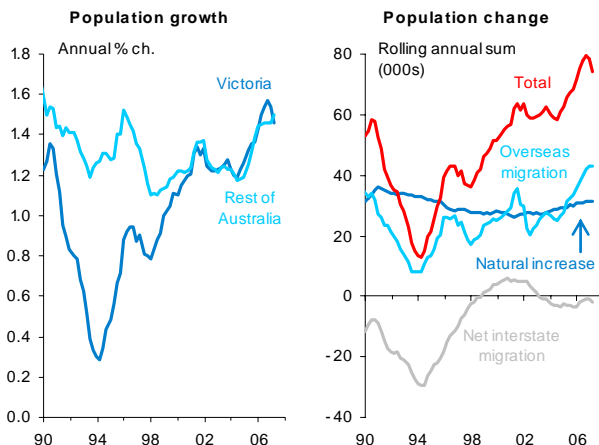
*Riki Polygenis, Senior Economist, Australia (Acting)*

Victoria continues to be the standout performer of the non-resource states. Economic growth in the three years to 2005-06 was 3.4% per annum, greater than the national average. And while it is expected to have slowed to 2.8% in 2006-07, Victoria is still expected to have outperformed the other non-resource states.

### Victorians stay put

Victoria's relatively buoyant economic performance can in large part be explained by demographic drivers, with the state experiencing a population surge in recent years. Annual population growth in Victoria is currently running at 1.5%, compared with rates of 1.0% or lower in the other south-eastern states. This has mostly been driven by higher international migration, but also reflects the fact that net interstate migration is negligible. It seems that most Victorians actually agree with the state government's slogan that Victoria is 'the place to be'.

### Overseas migration drives population growth



Source: Australian Bureau of Statistics

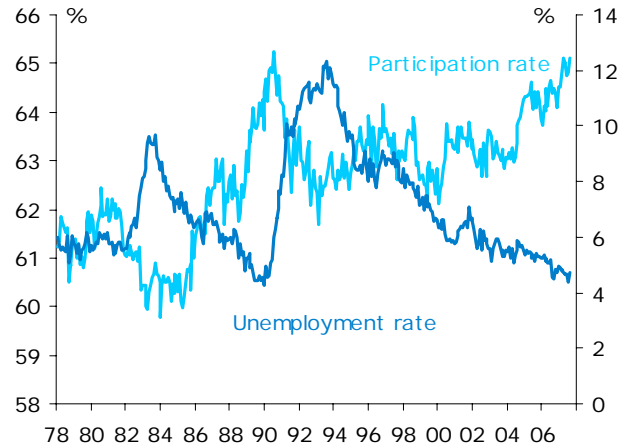
Strong population growth is having wide-ranging implications for the Victorian economy. Firstly, strong population growth has meant that Victoria's labour supply has expanded to meet the growing demand for labour. This is reflected in a marked pickup in employment growth to 2.7% in 2006-07. As for the national economy, Victoria's pool of labour has also been boosted by an increase in labour force participation, particularly amongst older workers.

However, growth in employment has still outstripped the increase in labour supply and Victoria's unemployment rate fell to 4.8% in 2006-07, the lowest rate since 1989-90. Victoria also boasts the lowest unemployment rate of the non-resource states.

A faster rate of population growth, all other things unchanged, also leads to greater spending on goods and services. Indeed, growth in household consumption in Victoria has already accelerated to

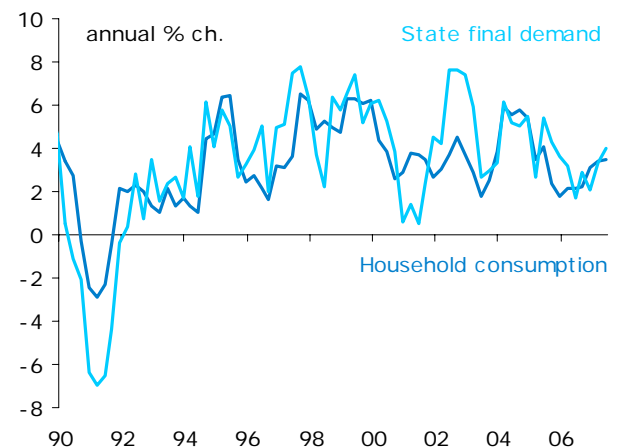
an annual rate of 3.5% over the year to June 2007, from a low of 1.8% in the December quarter 2005. With household consumption making up almost 60% of Victoria's state final demand, this has also helped drive a pickup in the pace of economic activity in the state, with annual growth in state final demand accelerating to 4.0% in the June quarter.

### Victoria's labour market tightens further



Looking forward, we expect household consumption to continue to expand firmly. Tax cuts, together with strong population and employment growth, will continue to support household incomes. In addition, retail sales data for July and August show little impact on spending stemming from the August interest rate rise and turbulence on financial markets.

### Household consumption drives up state final demand



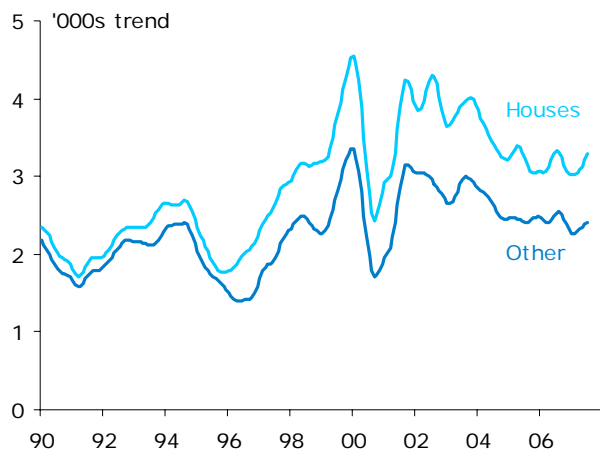
Source: Australian Bureau of Statistics

### Housing market tightens but rising interest rates weigh on new construction

Population growth has also resulted in increased demand for housing in the state. Melbourne's rental market has tightened considerably, with the rental vacancy rate decreasing to just 1.5% in the June quarter and rental growth picking up to 4.1%. House prices have also reaccelerated, increasing by 11.5% over the year to June.

The recent improvement in house price and rental growth is unlikely to prompt a significant turnaround in dwelling construction in the short term. Dwelling construction approvals are at low levels and the prospect of further rate rises is likely to further dampen sentiment.

#### Dwelling approvals track sideways



Source: Australian Bureau of Statistics

Capital expenditure by both the government and business sector is also likely to boost growth going

forward and add to Victoria's productive capacity. The state government plans a massive \$13bn in infrastructure spending in the next four years. In addition, business investment should remain at a high level, with continued growth in non-residential building offsetting some slowdown in engineering construction.

In aggregate therefore, there are good reasons to be optimistic about the outlook for the Victorian economy and we expect economic growth to pick up to 3½% in 2007-08.

But there are challenges ahead. The high A\$ will continue to exert competitive pressure on Victoria's export sector, particularly in traditional industries such as manufacturing and agriculture. In addition, Victoria's farmers remain subject to the vicissitudes of the weather. Forecasts of Victoria's winter crop in 2007-08 were recently revised down by 1.15mt to 5.15mt. Irrigators in the Murray-Darling Basin are also being affected by significantly reduced water allocations, with consequences for production of dairy and fruit and vegetables.

#### Economic data – Victoria

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	0.7	-0.6	-0.7	1.6	0.1	0.9
Private building approvals	-13.2	2.2	0.0	2.4	16.3	n.a.
Employment	0.1	0.7	0.0	-0.2	0.5	0.2
Unemployment rate, %	4.9	4.7	4.7	4.6	4.4	4.7
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	0.9	0.7	0.3	1.1	1.2	0.8
Private investment	-2.4	0.5	3.6	-3.7	3.9	3.0
Public demand	-2.3	1.8	2.2	2.3	-4.1	2.1
State final demand	-0.5	0.9	1.4	0.2	0.7	1.5
Population, ann. % ch.	0.5	0.3	0.4	0.3	0.4	n.a.
Median house price – Melbourne, \$'000s	335.1	344.9	351.1	359.9	366.2	384.4
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	5.2	2.4	2.7	2.8	3.5	3.4
Employment	1.7	3.1	1.7	2.7	2.7	2.0
Consumer prices – Melbourne	2.3	2.0	3.1	2.6	2.9	2.8

Sources: Australian Bureau of Statistics and Economics@ANZ

## Queensland: the sun still shines

Tony Pearson, Head of Australian Economics

Queensland remains resolutely in the group of fast growing resource-rich states. State final demand grew by a very robust trend 2.4% in each of the March and June quarters. This reflected strong household consumption, solid business investment (using seasonally adjusted data), positive investment in dwellings, and strong public sector investment. Somewhat surprisingly, the external sector remains a source of weakness, with imports of goods still expanding more quickly than goods exports, but at least goods exports are growing again after a period of decline in early to mid 2006.

### Everyone wants to live in Queensland

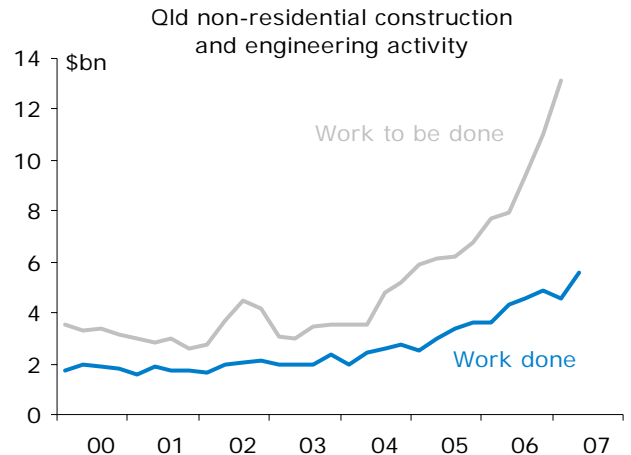
Queensland has regained its mantle as the state with the fastest growing population, moving back above Western Australia. Growth over the year to March 2007 was 2.3% taking the population to 4.2mn. Population growth is driven broadly equally by natural increase, international immigration, and interstate immigration. Queensland remains the state of choice for migrants from other states and territories, attracting a net 26,700 per year, by far the highest interstate immigration (the next highest is Western Australia with 4,100 per year).

This strong economic and population growth continues to power house prices. Brisbane established house prices rose by 15.7% over the year to June 2007, the strongest gain of all the state and territory capitals. Nevertheless, Brisbane housing remains relatively affordable; still less expensive than Sydney, Perth, Darwin and Melbourne.

The forward indicators for dwelling investment remain positive. Both the number of dwellings commenced and local council approvals to build new dwellings have risen solidly since the end of 2005 in response to rising demand and increasing house prices. Also, the proportion of dwelling investment contributed by alterations and additions has been rising over time, and now stands at around 45% of total dwelling investment. A continuation of this trend is expected to further support dwelling investment.

Non residential building work, including construction and engineering, also continues to rise strongly. The value of work done has been rising at an annual rate in excess of 20% per annum since mid 2004. And it appears this high pace of activity will continue for some time yet; in the March quarter 2007 the value of work yet to be done was a record \$13.2bn, representing a pipeline of more than seven months work at the current record pace of activity.

### There remains a significant amount of non-residential building in the pipeline



Source: Australian Bureau of Statistics

Mining is an important part of the Queensland economy, contributing 8% of state factor income, although it is not as dominant as in Western Australia, where it contributes 21%. Coal is by far the most important Queensland commodity in terms of both production and exports. ABARE estimates global metallurgical coal consumption will rise by 10% in 2007 and by 6% in 2008. In response ABARE estimates Australian exports will lift by 5% in 2007-08 reflecting additional mine output in Queensland. However, the impact of these higher volumes on incomes are likely to be largely offset by lower US\$ contract prices and a strengthening A\$. The outlook for thermal coal is a little more promising, with higher volumes and higher prices expected to deliver increased revenues. One potential constraint is that exports from Queensland have been hampered by infrastructure bottlenecks, but these are expected to ease in 2008 as upgrades and extra capacity comes on line.

Queensland's labour market continues to tighten in response to the continued strong demand for labour. Employment grew by 3.6% over the year to August, with the unemployment rate falling by 0.9ppts to 3.5%, the third lowest rate behind the Australian Capital Territory and Western Australia.

Queensland has fared better than some other states in terms of the recovery from the drought. Average to above average rainfall across most of the cropping region in August, and in some areas in early September, has helped to underwrite the winter crop. Production is forecast by ABARE to increase by 36% in 2007-08 to around 1.14mn tonnes. Prospects for the cotton crop are not so good. Water shortages suggest that plantings of irrigated cotton will be very low. ABARE estimates that Australian cotton production in 2007-08 (across all states) will fall by 62% to 104,000 tonnes, the smallest Australian harvest since 1982-83. The most important rural export by value for Queensland is beef. Production and exports are expected to ease in

2007-08 as graziers rebuild herds, but this is expected to be compensated by higher prices.

### Australia's economic powerhouse

Queensland's economic growth is expected to ease in 2007-08 to around 5.5%, but this would still make it the fastest growing of all the states and territories. The slowing will be driven by an easing in private business investment, although it will remain high in absolute terms, largely offset by a lift in rural production and in export volumes. Household spending will remain robust, driven by the strongest population growth in the country, strong employment gains, solid wage outcomes, and continued wealth gains from rising house prices. Dwelling construction should remain positive, driven by continued demographic pressures, although this may be tempered by higher interest rates.

Queensland's fiscal position remains very sound. The 2006-07 operating surplus is projected to be much higher than forecast at the time of the last budget or at the mid-year update – try a surplus of

\$2.393 billion versus the mid-year estimate of only \$226 million. This reflects massively higher revenues, due to increased tax receipts and higher investment returns. The 2007-08 budget operating surplus is projected at a much more modest \$268 million. The budget is expected to retain an operating surplus above \$200 million in the out years.

Queensland Treasury figures suggest state taxes per capita will remain low relative to other states, with Queenslanders paying on average \$257 less per person per year than the average for the other states and territories.

The government is ramping up investment in infrastructure, with an increase of 15.6% to \$14.0bn in 2007-08. There will be increased funding among other things for transport, water and to address climate change. To fund this, state borrowings will increase sharply in 2007-08 and again in 2008-09, but the Queensland balance sheet position will remain very sound and there is nothing to suggest the AAA credit rating will be compromised.

### Economic data – Queensland

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	2.4	0.1	0.5	2.5	1.5	0.5
Private building approvals	-1.7	7.0	-10.2	11.1	-7.5	n.a.
Employment	0.4	0.3	-0.1	0.1	-0.2	0.4
Unemployment rate, %	4.0	3.4	3.4	3.5	3.6	3.5
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	1.5	0.6	0.4	0.7	1.8	0.7
Private investment	6.9	-1.1	3.7	1.3	9.5	2.5
Public demand	6.3	0.2	6.2	0.3	-1.7	10.0
State final demand	3.8	0.1	2.4	0.7	3.0	3.1
Population, ann. % ch.	0.6	0.5	0.5	0.5	0.7	n.a.
Median house price – Brisbane, \$'000s	319.4	326.2	331.5	340.0	354.4	377.4
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	5.3	4.8	4.9	6.0	5.5	5.0
Employment	3.3	5.2	3.5	4.6	4.0	2.5
Consumer prices – Brisbane	2.9	2.6	3.1	3.3	3.2	3.0

Sources: Australian Bureau of Statistics and Economics@ANZ

## Western Australia: when you're hot you're hot

Tony Pearson, Head of Australian Economics

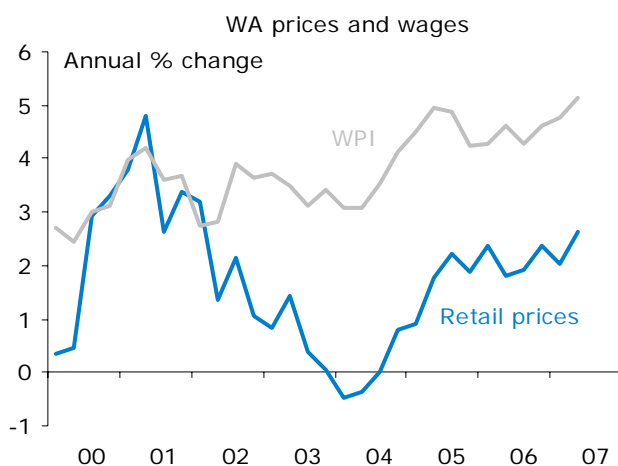
Western Australia recorded the highest growth in gross state product of all the states in 2005-06 – and second only to the Northern Territory – and is on track to record a similarly impressive performance in 2006-07. In the June quarter the state recorded an astonishingly robust rise in trend domestic demand of 3.8%. This was driven by solid household consumption and very strong investment in dwellings. Seasonally adjusted data suggest private business investment and public sector investment were both strong in the June quarter.

Strong economic growth and plentiful employment continues to attract people to the state, and Western Australia has the second highest population growth rate of any state or territory, with the population increasing over the year to the March quarter 2007 by 2.2%. The biggest source of population increase remains overseas immigration, which accounts for just over half of inflows, although there has also been a lift in natural increase (births less deaths) which accounts for 38%. Migration into Western Australia from other states remains relatively less important as a source of population growth, although inflows have steadily accelerated over the past four years.

This strong population growth may now be overwhelming the pace of jobs creation. The annual growth in employment has accelerated through 2007 to a very robust annual rate of 3.9% in August 2007, and yet the unemployment rate has edged up from a low of 3% in early 2007 to 3.4% in trend terms in August 2007. That said, this is still below the national average of 4.3%.

Strong economic activity is pushing up wage and price pressures in the state. Wages growth is now running at an annual rate of 5.2%, the highest in the nation, and well above the Australia-wide average of 4%. Retail prices rose by 2.6% over the year to the June quarter, the highest rate of increase since March quarter 2002.

### Wage and price inflation has accelerated



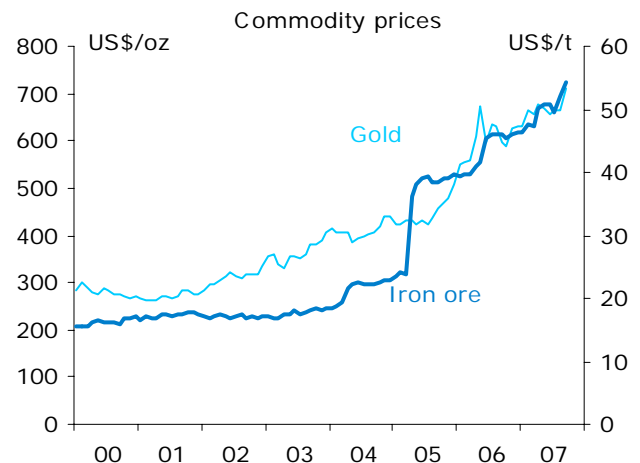
Source: Australian Bureau of Statistics

The high rates of economic and population growth have spurred demand for housing. Perth has enjoyed the highest rate of house price appreciation in recent years, with existing house prices nearly doubling since end 2003. However, there are signs the market is now topping out, with the quarterly rate of increase easing steadily since mid 2006 and with prices actually falling by around 1% in the June quarter 2007. Investment in dwellings seems likely to remain robust. There was some easing in dwelling construction approvals in the back half of 2006 and into 2007, but the decline was from a high base and recent data show some steadying. Continued strong demand from high population growth should continue to underpin this sector of the economy.

### The 'gold rush' continues

Forward indicators suggest prospects for the mining sector remain very robust. Iron ore is the biggest single export from Western Australia. Prices have been progressively increasing over the 2000s, with prices trebling over the seven years to the 2007-08 contract year. Latest indications are that a further increase of around 20% for the 2008-09 contract year is achievable. Gold is the second most important export from Western Australia; gold prices have also firmed in recent months to around US\$730/oz at time of writing, the highest in over a year, if still somewhat shy of the recent peak of US\$785.60 in early November 2006. It seems as if "manna from heaven" will continue to rain on Western Australia for some time yet.

### Commodity prices continue the push north

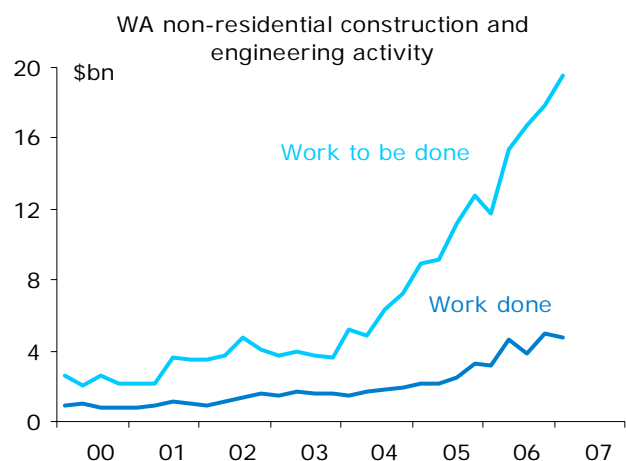


Source: Bloomberg

The resources boom continues to drive strong business investment. Over the year to the March quarter, the value of non-residential construction and engineering rose by 52%. Heavy industry constituted the bulk of this, although there were also solid increases in infrastructure such as bridges, railways and harbours, and electricity generation and distribution. And work yet to be done continues to rise to new records. In the March quarter the value of work yet to be done reached \$19.5bn, an increase of 66% from a year earlier. This represents

over a years worth of work in the pipeline at the current record pace of work done.

### Record levels work in the pipeline suggests non-residential building will be strong for some time



Source: Australian Bureau of Statistics

Prospects are also brighter for the rural sector. Improved seasonal conditions particularly in the southern grain growing areas are expected to underpin a 15% lift in winter crop production to 870mn tonnes. While this is a pleasing improvement, it is still only a little over half the peak production in 2003-04.

The resources boom also continues to deliver windfall gains to the Western Australian government. In 2007-08 mining royalties are forecast at \$2.6bn or 15% of total general government revenue. There would also be an indirect flow on to revenue in the form of increased payroll taxes and stamp duties from increased employment, and increased dwelling construction and sales activity, and higher land taxes from rising property values. These gains have allowed the government to lower taxes (particularly for first home owners) and to fund capital works worth \$5.8bn in 2007-08 and \$21.6bn over four years. And the government has still been able to preserve a sizeable operating surplus of \$1.85bn in 2006-07 and \$1.45bn in 2007-08.

We expect growth in gross state product to ease slightly to 5.0% in 2007-08 from 6% in 2006-07, which would leave Western Australia as the nation's second strongest economy. Business investment is expected to slow (although it will remain high in absolute terms), investment in dwellings is expected to steady, and household consumption will cool under the influence of higher interest rates and less spectacular wealth gains from house prices. Countering this slowing in domestic demand will be a lift in net exports as expanded infrastructure capacity comes on line.

### Economic data –Western Australia

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	1.7	-0.4	-0.1	0.9	0.2	0.7
Private building approvals	12.1	2.9	-1.2	10.7	-21.1	n.a.
Employment	0.4	-0.7	1.1	0.5	0.8	0.3
Unemployment rate, %	2.8	2.8	3.2	3.8	3.2	3.1
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	0.9	1.5	1.4	1.7	1.7	0.8
Private investment	4.4	10.0	-10.0	11.6	9.4	7.6
Public demand	0.1	2.8	-0.8	0.0	1.1	1.1
State final demand	1.8	4.5	-2.9	4.5	4.2	3.2
Population, ann. % ch.	0.7	0.4	0.5	0.5	0.7	n.a.
Median house price – Perth, \$'000s	346.9	397.0	441.0	456.0	461.9	457.6
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	7.6	4.7	4.9	6.5	5.0	5.0
Employment	1.3	4.2	4.9	2.5	2.5	2.0
Consumer prices – Perth	2.1	3.2	4.3	3.9	3.2	3.0

Sources: Australian Bureau of Statistics and Economics@ANZ

## South Australia: On the mend

Mark Rodrigues, Senior Economist, Australia

South Australia is likely to post the slowest rate of economic growth of the states and territories in 2006-07, but there are signs its economy is on the mend.

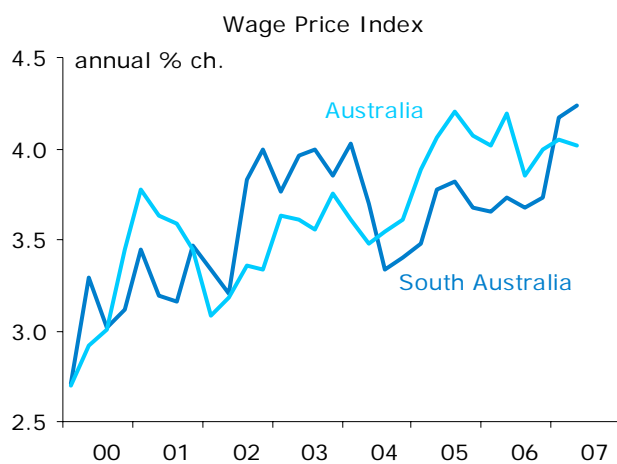
State final demand expanded by 0.4% in the June quarter 2007 to be 3.4% higher over the year. This represents a marked acceleration in momentum from a year earlier, when growth in final demand was a paltry 0.4%.

### Confidence is a wonderful thing...

The pick up in the state's economic fortunes has been relatively broad based. Consumer demand has shown signs of renewed vigour, with household consumption up 0.6% in the June quarter following growth of 1.3% in March.

Confidence amongst households has been bolstered by strong growth in incomes, reflecting improved labour market conditions. Employment increased by 1.7% over the year to August, pushing the unemployment rate down to 4.7%, not far shy of generational lows of 4.6%. Wages have begun to respond to the tightening labour market, increasing 4.2% over the year to the June quarter 2007, above the national average rate of 4% and up ½ a ppt in the past year.

### South Australian wages have accelerated sharply over the past year

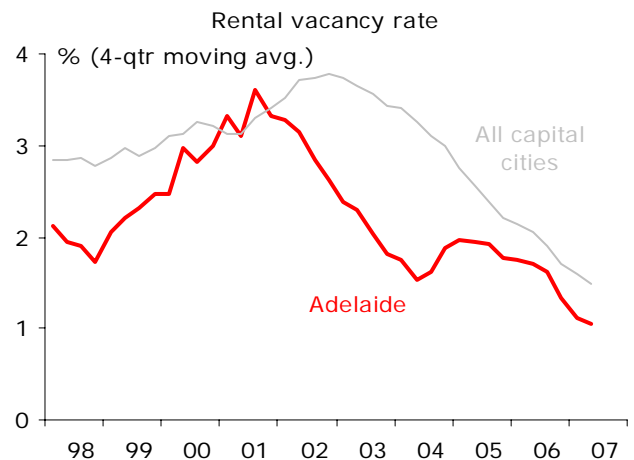


Source: Australian Bureau of Statistics

The renewed confidence of South Australians is also reflected in the state's housing sector. Dwelling investment has increased 13.9% over the past year, well above the national increase of 3.7% over this period, and bettered only by Western Australia's booming industry. While increased investment in the state's dwelling stock has eased the shortage of housing that had emerged from the late 1990s somewhat, Adelaide's housing market remains historically tight. Residential vacancy rates in the capital city are currently a little above 1%, slightly up from the recent low of 0.5% at the end of 2006, but still around the lowest of Australia's capital cities. Meanwhile, established house prices have

surged 11.7% over the past year, only slightly behind that recorded in Brisbane and Perth.

### Adelaide's housing market remains historically tight

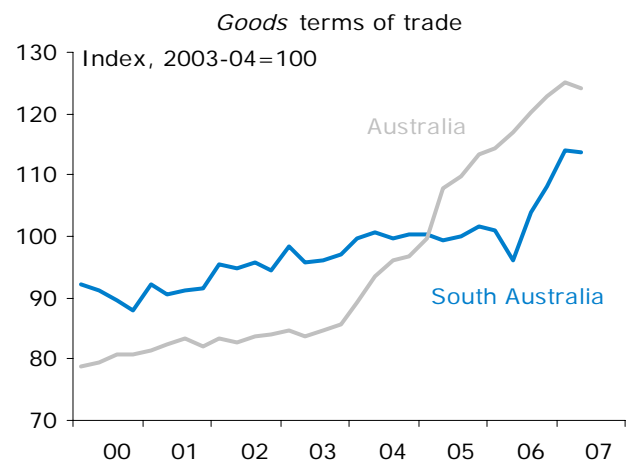


Sources: Real Estate Institute of Australia and Economics@ANZ

### The commodity boom spreads to South Australia

The improvement in consumer confidence is closely correlated with the fortunes of the state's business community, as it finally begins to share in the spoils of the commodities boom. South Australia's *goods* terms of trade increased a remarkable 18.4% over the year to the June quarter 2007, around three times the national increase. This follows a period between 2004 and the middle of 2006 when the state's terms of trade was essentially flat while the surge in resource commodity prices saw the national goods terms of trade rise 36%. The surge in the terms of trade has boosted incomes, underpinning employment, wages and investment in the state in much the same manner as in Western Australia and Queensland in recent years.

### South Australia is beginning to share in the spoils of the commodity boom

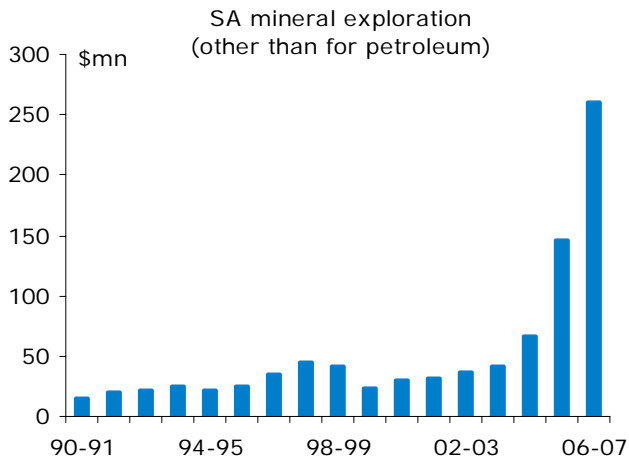


Source: Australian Bureau of Statistics and Economics@ANZ

## If you build it, they will come...

The combination of strong global demand, high commodity prices and, now, rising incomes, has spurred a new wave of investment in South Australia, led by the resources industry. Private sector capital expenditure intentions point to a 16.5% increase in capital expenditure in the state in 2007-08, while mineral exploration expenditure (other than for petroleum) was around 80% higher in 2006-07.

### Exploration investment in South Australia has skyrocketed!



Source: Australian Bureau of Statistics

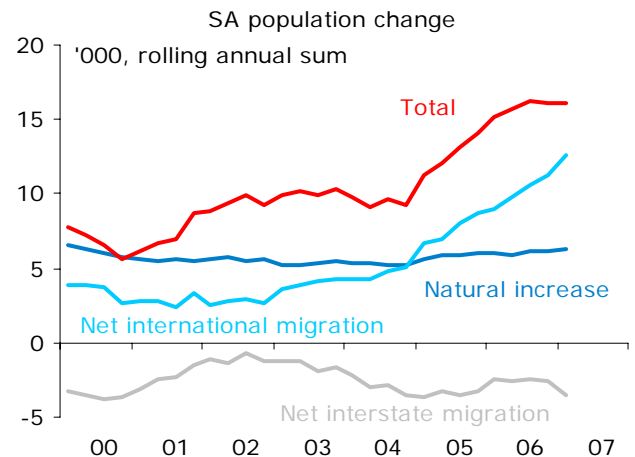
## Good times and challenges ahead

One need look no further than the current excitement surrounding the resource potential of BHP Billiton's Olympic Dam copper/uranium mine to understand that South Australia's economic prospects are hitched to the global commodity cycle. With commodity prices likely to remain high, there is every reason to believe that the recent upturn in the South Australian economy will be sustained. We expect GSP to grow by a very healthy 3.5% in 2007-08.

That said, the state's outlook is not without its fair share of risks and challenges. Near term, prospects for South Australia's farmers have deteriorated markedly, with ABARE downgrading its forecasts for winter crop production in the state by 1.5Mt to just 5.4Mt. And even this downgraded outlook is looking optimistic as each day passes without significant rainfall in the state's agricultural areas. For irrigators in the Murray-Darling Basin, the drought may have permanent consequences as ongoing low water allocations jeopardises the health of permanent plantings.

Longer term, relatively low rates of population growth continue to pose a challenge for economic development in South Australia. While population growth has picked up marginally over the past year, thanks largely to higher rates of international migration, the state continues to haemorrhage its citizens to other states and territories.

### South Australia continues to lose its citizens to other states and territories



Source: Australian Bureau of Statistics

## Economic data –South Australia

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	0.9	-0.9	0.4	1.7	0.1	0.8
Private building approvals	-29.2	2.3	2.8	0.0	-1.2	n.a.
Employment	-1.3	0.8	0.7	-0.1	-0.4	1.5
Unemployment rate, %	5.1	5.2	4.7	4.8	4.9	4.7
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	0.5	1.1	0.7	-0.2	1.3	0.6
Private investment	0.1	-0.9	3.5	-0.7	5.1	-0.3
Public demand	-0.2	1.0	3.6	1.0	-3.0	0.7
State final demand	0.3	0.7	1.9	0.0	1.1	0.4
Population, ann. % ch.	0.4	0.2	0.3	0.2	0.4	n.a.
Median house price – Adelaide, \$'000s	281.5	285.5	287.2	295.0	301.5	318.8
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	3.8	1.2	2.2	1.0	3.5	4.0
Employment	1.9	1.4	2.0	1.7	2.0	1.3
Consumer prices – Adelaide	3.0	2.3	3.2	2.6	2.4	2.5

Sources: Australian Bureau of Statistics and Economics@ANZ

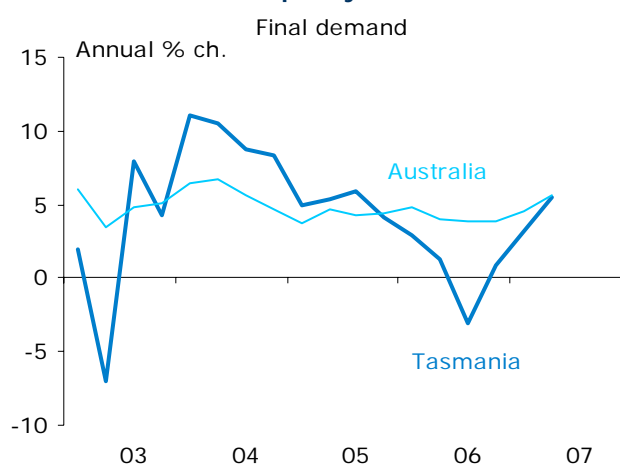
## Tasmania: A strong rebound

Mark Rodrigues, Senior Economist, Australia

Tasmania's economy is forecast to grow by 3.5% in 2007-08, a noticeable pick up from the 2.5% expected in 2006-07.

Recent data suggest that the economy has already turned the corner on last year's slowdown. State final demand increased by 2.0% in the June quarter to be 5.6% higher over the year. While state level data are notoriously volatile, particularly for the smaller states, it nonetheless says something about the strength of the recovery that annual growth in final demand is now bettered only by the boom states of Western Australia and Queensland.

### Tasmanian demand has accelerated sharply over the past year



Source: Australian Bureau of Statistics

### The consumer is king

The resurgence in the local economy has been led by the consumer. Household consumption increased by a remarkable 8.3% over the year to the June quarter 2007, up from 1.6% a year earlier.

Consumer confidence has been buoyed by improved labour market conditions recently. Annual growth in employment has accelerated from a paltry 0.2% at the start of this year to 1.4% currently. As a result, the unemployment rate has fallen further, to be just 5% in August. Against the backdrop of a tightening labour market, wages growth has accelerated to be currently running at an annual pace of 4½%, the highest outside of the resource boom states of Western Australia and Queensland.

New residential construction in Tasmania remains tepid, with total dwelling investment up just 4.8% on year-ago levels and still 9% below levels achieved at the peak of the housing boom in early 2004. As a result, there is now a significant shortage of housing stock in the state, evidenced in low rental vacancy rates of a little above 2% and ongoing strong growth in established house prices in Hobart of around 10% per annum.

Business investment, which had fallen markedly last year, has also begun to recover. The latest data show that investment has increased strongly in the last three quarters to be back around the same level as a year ago. Going forward, state government hopes of a renewed investment surge are being pinned on a few major projects including Gunns Ltd's recently approved pulp mill, the Alinta power station at Bell Bay and the Musselroe Bay eco-tourism project.

As with the other smaller states and territories, achieving and maintaining higher levels of population growth remains the key medium-term challenge for economic development in Tasmania, particularly in light of the ageing workforce. The most recent data confirm that Tasmania is once again losing people to the mainland. This has seen Tasmania's population growth rate halve, from a recent peak of 1.2% in 2004 to 0.6% currently.

### Economic data –Tasmania

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	0.9	1.2	1.4	1.6	0.1	1.3
Private building approvals	7.5	-7.4	-5.0	-3.1	-11.0	n.a.
Employment	0.2	0.2	0.2	0.2	0.2	0.2
Unemployment rate, %	5.2	5.1	5.0	5.0	5.0	5.0
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	0.7	1.8	3.5	2.6	1.2	0.7
Private investment	-5.1	-7.2	-9.2	1.6	5.3	4.4
Public demand	-0.9	0.1	-10.3	10.4	-0.2	3.6
State final demand	-0.8	-0.3	-2.2	4.3	1.4	2.0
Population, ann. % ch.	0.2	0.1	0.1	0.2	0.2	n.a.
Median house price – Hobart, \$'000s	257.4	265.5	270.8	275.3	284.7	291.3
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	3.3	4.1	3.1	2.5	3.5	3.0
Employment	4.3	2.8	3.2	0.8	2.3	1.3
Consumer prices – Hobart	2.5	3.2	3.2	2.5	2.6	2.4

Sources: Australian Bureau of Statistics and Economics@ANZ

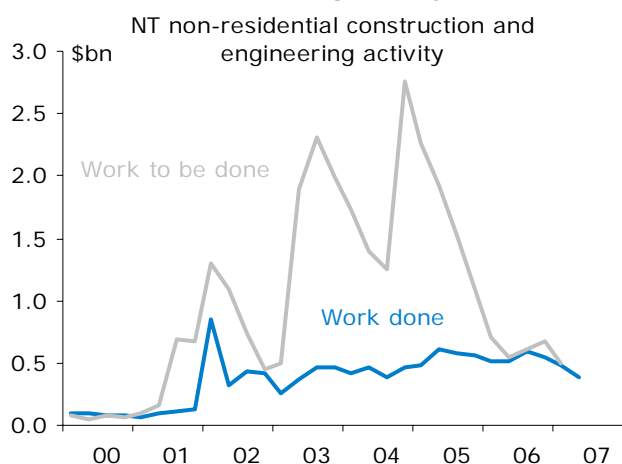
## Northern Territory: Growth slowdown ahead

Tony Pearson, Head of Australian Economics

The Northern Territory economy is estimated to have grown by 7.2% in 2006-07, the strongest of any of the states and territories. There are signs, though, that this recent strong growth momentum might now be easing. Trend final demand has fallen for the past three quarters, reflecting declining dwelling investment, softer public demand and, looking at seasonally adjusted data, weakening business investment (although this series is highly volatile and needs to be interpreted with caution).

This story of activity easing from its highs is supported by data on non-residential construction and engineering, which show the value of work done in the March quarter was the weakest in nearly three years. There has also been a sharp decline in the pipeline of work, with the value of non-residential construction and engineering work yet to be done declining steadily from end 2004. There is now only four months work in the pipeline at the recent slower pace of work done.

### Non-residential building activity has slowed



Source: Australian Bureau of Statistics

The stimulus from the external sector also seems to have waned in recent quarters, with softer exports and stronger imports.

Despite declining dwelling investment, approvals have remained steady since mid 2005, suggesting this sector is not in cyclic decline. This is likely to be because population growth remains very robust, with growth over the year to March 2007 of 2.0%, third fastest behind Western Australia and Queensland. It is interesting that net interstate migration has again turned negative – that is, people are leaving the Northern Territory for other parts of Australia, and this has led to a slight slowing in overall population growth in recent quarters. Natural increase and international immigration remain steady.

The signals from the labour market are mixed. Employment growth remains robust with an annual rate around 5%, although the trend unemployment rate has increased from a recent low of 2.6% in late 2006 to 4.6% in August 2007. This would seem to reflect an increase in the supply of labour rather than any waning in demand.

We forecast that economic growth will halve in 2007-08 to just 3.7%. This is still a robust pace of growth, but would be the slowest in four years.

The Northern Territory budget shows a steadily improving position, with a small operating surplus of \$29mn forecast for 2007-08 and remaining in surplus in the out years. There has also been a steady reduction in the ratio of net debt to revenue, from 67% in 2002 to 44% in 2007, with it expected to remain at this lower level in the out years. Territory revenue is heavily skewed to Canberra, with 65% of revenue from the GST, 15% from Commonwealth Government grants, and only 20% from own source revenue. The largest component of own source revenue is payroll tax (20%). Mining royalties contribute 10% of own source revenue.

### Economic data –Northern Territory

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	1.0	0.3	0.6	1.7	0.3	0.2
Private building approvals (trend)	3.0	2.0	1.9	-0.9	-1.0	n.a.
Employment (trend)	0.3	0.5	0.7	0.9	1.0	0.9
Unemployment rate, % (trend)	3.9	4.3	4.5	4.6	4.6	4.6
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	1.5	0.4	1.0	-0.1	1.7	0.9
Private investment	1.0	-4.2	10.0	-19.7	9.1	-6.9
Public demand	1.2	-0.2	4.3	3.6	-1.9	-1.3
State final demand	1.3	-1.1	4.4	-4.4	2.2	-1.8
Population, ann. % ch.	0.6	0.5	0.6	0.3	0.6	n.a.
Median house price – Darwin, \$'000s	335.7	357.6	362.4	380.0	389.5	384.0
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	0.2	6.0	7.5	7.2	3.7	3.8
Employment	-2.9	-1.2	2.9	5.5	2.3	2.3
Consumer prices – Darwin	1.4	2.2	3.4	4.4	3.1	3.1

Sources: Australian Bureau of Statistics and Economics@ANZ

## Australian Capital Territory: Solid but not spectacular

Riki Polygenis, Senior Economist, Australia (Acting)

While the ACT has very little in the way of natural resources, it has benefited indirectly from the commodities boom through the positive impact on federal government revenue which facilitated increased public sector employment and spending. In 2005-06, the ACT economy expanded by 3.4%, well above the national average of 2.9%.

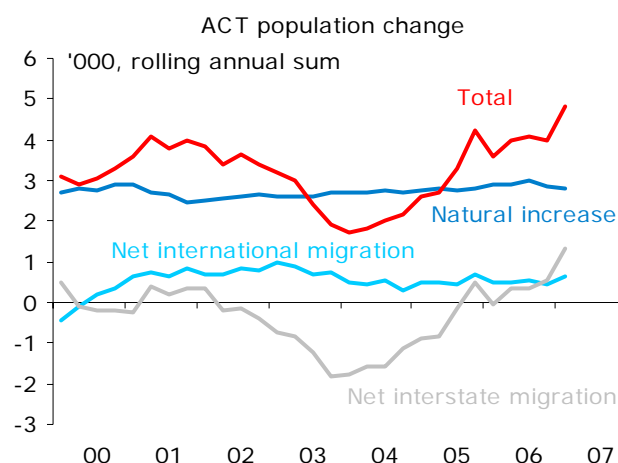
However, the ACT economy appears to have slowed in the first half of 2007. Annual growth in final demand has eased from a peak of 8% in June 2006 to 3.5% in June 2007, largely driven by slower growth in household consumption. This in turn is likely to have been a reflection of slower employment growth, which has ground to a halt in thus far in 2007. Private business investment has also slowed from the phenomenal growth rates seen in 2005-06 associated with the development of new office buildings to accommodate the larger number of public servants working in the ACT.

Despite the recent slowdown in both activity and employment, the outlook for the ACT looks bright. Population growth has picked up substantially, rising to 1.5% in the year to March 2007 or the same as the national average. The pickup in population growth has been driven by a surge in net interstate migration which has once again turned positive following a long period in which the ACT was losing people to other states. Faster population growth is expected to enable a reacceleration in employment growth and support growth in household incomes and consumption.

More people also require more houses, and faster population growth is putting further pressure on an already stretched housing market. Our estimates suggest that underlying demand for housing is already running well ahead of supply, generating higher prices and rents. House prices increased by

9.0% over the year to June, and rental vacancy rates have fallen to just 1.6% in 2006-07 as a whole. This has prompted a pickup in rental growth, which increased to 5.4% over the year to June. Tighter market conditions are yet to prompt a significant turnaround in dwelling construction which increased by just 0.9% in trend terms over the year to June. However, a rebound does not appear far off, with the number of dwelling approvals in the ACT more than doubling since January.

### Higher interstate migration drives population growth



Source: Australian Bureau of Statistics

A further reason to be optimistic about the ACT's prospects relates to the solid outlook for commonwealth government revenue. In May, the federal government estimated that revenue would expand rapidly by 4.8% in 2007-08 and 5.6% in 2008-09. If anything, these figures are now looking overly conservative, particularly in light of upward revisions to forecasts for bulk commodity prices. This bodes well for future growth in public sector employment and government spending.

### Economic data –Australian Capital Territory

Monthly data (% change)	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail sales	1.8	-0.8	0.4	0.7	-1.8	2.2
Private building approvals (trend)	13.5	15.9	16.2	16.0	10.9	n.a.
Employment (trend)	0.0	0.0	0.0	0.0	0.0	0.1
Unemployment rate, % (trend)	3.0	3.0	3.0	2.9	2.8	2.8
Quarterly data (% change)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
Household consumption	1.4	1.3	0.3	0.9	1.6	0.0
Private investment	-2.7	19.0	-3.4	3.1	-0.8	-5.2
Public demand	-1.8	3.6	0.9	1.6	-1.1	4.4
State final demand	-0.8	4.3	0.2	1.5	-0.2	1.9
Population, ann. % ch.	0.3	0.3	0.3	0.4	0.5	n.a.
Median house price – Canberra, \$'000s	392.1	403.4	414.7	421.5	427.2	439.6
Annual data (% change)	03-04	04-05	05-06	06-07 (e)	07-08 (f)	08-09 (f)
Gross state product	0.4	2.0	3.4	2.5	3.0	3.7
Employment	0.1	2.1	1.2	3.8	2.0	1.5
Consumer prices – Canberra	2.6	2.3	3.6	2.9	2.7	2.6

Sources: Australian Bureau of Statistics and Economics@ANZ

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