ANZ ECONOMIC OUTLOOK

June Quarter 2001

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Inside

INTERNATIONAL OUTLOOK

More downward revisions to global growth

This year's slowdown in the global economy is likely to be more pronounced than we envisaged in January. Our forecast for global growth in 2001 has been lowered from 3½% to 2¾%, while the forecast for 2002 has been cut from 4% to 3¾%.

While the forecast for 2001 remains above the traditional 'global recession' threshold of 2½%, when compared with last year's outcome of 4.8% it represents the second-sharpest deceleration in global growth from one year to the next since the end of World War II (exceeded only by the slump from 6.9% in 1973 to 2.8% in 1974).

As was the case in January, the downward revisions have been concentrated in the US and Japan, although there are consequential revisions to the outlook for other regions, most notably East Asia.

For the developed countries as a group, economic growth is expected to average just 1¾% this year – less than half last year's outcome, and the weakest since 1993. This projection reflects an expectation that growth in Western Europe, though affected to some extent by the downturns in the US and Asia, slows less markedly than either of those regions.

Across developing economies, economic growth is projected to average around 4½% in 2001, largely thanks to continued strong growth in the larger, relatively 'closed' economies of China, India, Brazil and Russia.

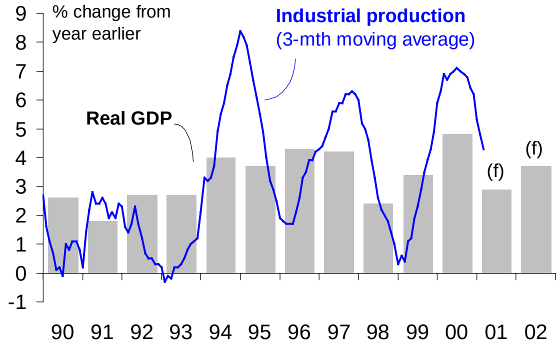
Outlook for world economic growth

% change -

	1999	2000	2001 (f)	2002 (f)
North America (a)	4.1	5.1	1½	2¾
Western Europe	2.3	3.3	2½	2¾
Japan	0.8	1.7	½	1
Australia and NZ	4.5	3.7	2	3½
China	7.2	8.0	7	7½
Other East Asia	4.8	6.4	3½	4½
South Asia	5.8	5.6	5½	6
South America	0.3	4.4	3	4
E. Europe & Russia	2.0	5.6	4	4
World (b)	**3.4**	**4.8**	**2¾**	**3¾**

(a) Includes Mexico. (b) Weighted by GDP at purchasing power parity (PPP) exchange rates.

World economic growth

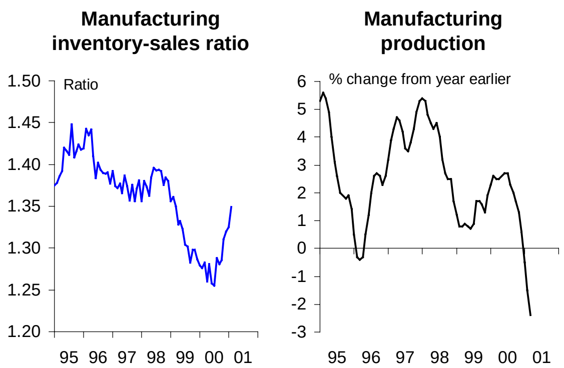


US unlikely to have a 'V'-shaped recovery

It's clear that the US economy has slowed sharply since the middle of last year. As yet, however, it can't be said that the US is in recession. So far there has not been a single quarter (let alone two or more) of negative GDP growth; and based on monthly data for January and February it's unlikely that GDP contracted in the first quarter of this year. The US has only just had its first month of falling employment. And consumer confidence seems to have stabilized after falling sharply between December and February.

The current slowdown in the US economy is being driven by a classic 'inventory cycle' concentrated in the manufacturing sector. After last year's abrupt slowing in spending on autos, the fall in housing activity in the second half, and the more recent declines in business equipment investment and exports – in turn due, to varying degrees, to higher interest rates, higher energy costs, the strong US$ and falling share prices – manufacturers have found themselves with unwanted stocks, which they have sought to clear (in time-honoured fashion) by cutting production and employment.

US manufacturing cycle



Sources: Commerce Department; Federal Reserve. Manufacturing production excludes 'high-tech' (computers, communications equipment and semiconductors.

If this 'old economy inventory cycle' were the only influence on the US economy this year, then the current period of slower growth would be both mild (since manufacturing is a smaller part of the US economy than ever before and the build-up of excess stocks has been smaller than in previous cycles) and brief. The US could look to a traditional 'V'-shaped rebound in economic growth in the second half of the year.

That does seem still to be the 'consensus' expectation of American economists, and after some doubts from late February through mid-March it would appear that financial markets are still banking on this view.

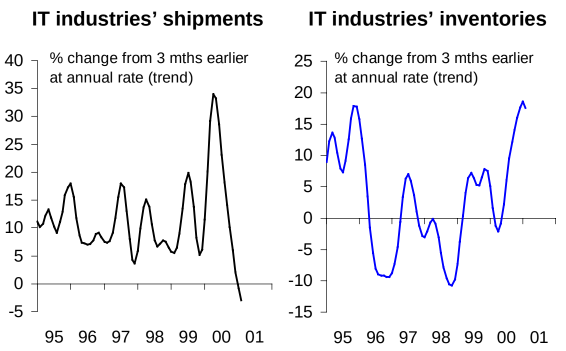
In our view, however, a 'V'-shaped recovery is actually becoming less plausible as a scenario for the US economy this year. For those who insist on an alphabetical summary of the growth profile for the US economy over the next 12-18 months, an elongated 'U' would be more apposite.

One factor which reduces the likelihood of a rapid rebound in the second half of this year is that the final stages of the inventory cycle in 'old economy' manufacturing are likely to co-incide with the onset of an inventory cycle in the technology sector.

IT spending by American businesses (including computers, software and communications equipment) surged at an annual rates of around 26% in real terms over the two years to mid-2000, fuelled by Y2K preparations and by the availability of seemingly limitless amounts of almost free equity capital for investments of this type. Such spending slowed significantly in the second half of last year. IT industries' shipments have actually been falling since September.

However, since production of IT equipment and components is still growing at double-digit rates (albeit well down from the pace in the first half of last year), unsold inventories of these products have begun to build up quite rapidly.

US IT sector inventory cycle



Source: Commerce Department. Trend estimates calculated by Economics@ANZ using ABS formulae.

As with so-called 'old economy' industries such as autos, eliminating this unwanted stock build-up will – absent a renewed spurt in demand which seems unlikely – require cutbacks in production. Anecdotal evidence suggests that these have now begun; but it is likely that the technology sector inventory cycle will still be dampening growth when the cycle in 'old economy' industries has passed its trough.

However, since the technology sector represents a fairly small proportion of the US economy (between 4 and 8% of GDP, depending on how it is defined) and since some of the downturn on demand will be absorbed by imports (especially from East Asia), the downswing in technology spending and production will not prevent at least some pick-up in overall activity in the second half of this year.

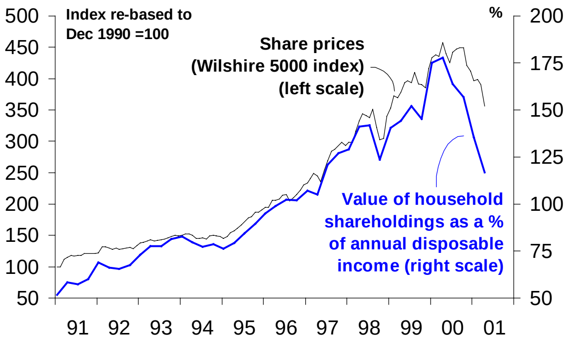
The more important constraint to a rapid rebound in the US economy is the likelihood that the sharp fall in share prices will lead to a more extended period of 'balance sheet adjustment', in which spending by both households and businesses is restrained as they seek to reduce the imbalances which were built up during second half of the past decade.

From the end of 1994 to its peak in March 2000, the US sharemarket (as measured by the Wilshire 5000 index, the broadest measure of US share prices) rose by nearly 215%. This added over $US8 trillion to the value of shares held by American households directly or through mutual funds - equivalent to a year's aggregate personal disposable income. As a result, households were able to increase their spending out of current incomes to the point where, since last July, the household saving rate has been negative for the first time since 1933.

Over the same period, the increased availability and falling price of equity capital (both through the stock market and venture capital) facilitated a significant increase in business investment. Between the end of 1994 and the end of 2000, business investment as a share of GDP rose by nearly 4½ pc points (of which computers accounted for 3 pc points) – only 1 pc point less than the increase in business investment as share of GDP in Japan over the same period a decade earlier, in circumstances where the Japanese share market exhibited many of the characteristics of the US share market in the second half of the 1990s.

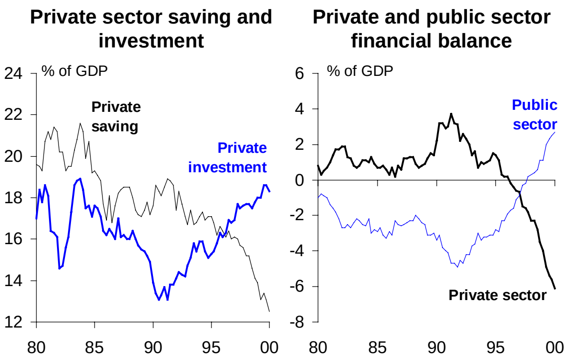
The net result of the sharp decline in household saving and the increase in business investment has been a pronounced swing in the net financial position of the US private sector, equivalent to about 6½ percentage points of GDP.

US share prices and household wealth



Note: 'Household shareholdings' are shares held directly or through mutual funds. March quarter figure is an ANZ estimate. *Sources:* Datastream; Federal Reserve Board; Commerce Department; Economics@ANZ.

US financial balances, by sector



Source: Commerce Department. 'Financial balance' is gross saving minus gross investment.

Since March last year, however, the US share market has dropped by more than 22%, reducing the wealth held by households in the form of equities by some $US3¾ trillion – or nearly half the gains racked up over the preceding five years.

It is difficult to believe that such a loss of wealth will not have some consequences for the real economy. Certainly, the US experience in pre-World War II business cycles (to which the current cycle appears to bear some resemblance), and that more recently of countries where asset price 'bubbles' have burst (such as Japan, Britain, Sweden and Australia in the late 1980s and early 1990s) suggests that the effects on economic activity can potentially be serious.

There are of course differences between the current cycle in the US and those earlier episodes. The boom in share prices wasn't paralleled by a boom in property prices, and it wasn't underwritten by a massive expansion in bank credit leaving banks saddled with massive bad debts. IT investment, which accounted for much of the increase in the share of business investment in GDP, depreciates much more quickly than office blocks or industrial equipment, so that the resulting 'excess capacity' should be worked off more quickly.

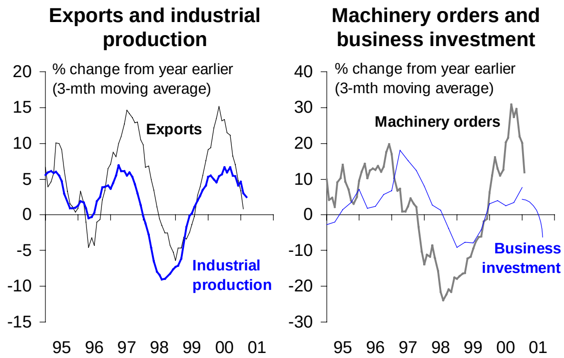
Thus, while we expect consumer spending to remain rather more subdued over the next few years as households rediscover the practice of saving out of current income, and business equipment investment to decline at least through this year, the result of these 'balance sheet adjustments' is likely to be an extended period of sub-potential growth, rather than a deep or prolonged contraction. This is the message of our forecast that the US economy will grow by an average of 1¼% this year, and 2½% in 2002, though without any quarters of negative growth (hence the 'U' as opposed to 'V'-shaped recovery).

This forecast assumes that economic policies will be appropriately accommodative for an environment such as this. We expect the Federal Reserve to continue cutting the fed funds rate, albeit perhaps not as aggressively as some in the equity markets would prefer, to 4¼% by June. But whereas the markets are discounting a 50-75 basis point increase in short-term interest rates next year, we expect that the Fed will remain 'on hold' until the first quarter of 2003.

Japanese economy turning down (again)

After posting 1.7% real growth[1] in 2000 (the best performance in three years), the first half of 2001 sees Japan's economy once again in danger of slipping back into recession. The two main drivers of the recovery from the 1998 recession are losing momentum. Exports, which grew by 12% in volume terms last year, have slowed sharply in line with the slowing global economy. This is feeding directly into weaker growth in industrial production.

Japanese growth drivers slowing



Note: (Merchandise) exports are in volume terms. Machinery orders are from private domestic customers, excluding orders for ships and from utilities. *Sources:* METI; MoF.

[1] References to 'real' growth in the Japanese context are somewhat misleading because of persistent deflation. Although *real* GDP in the December quarter of last year was 3.4% above the trough of the September quarter last year, *nominal* GDP actually declined by 0.5% over the same period. In nominal terms, the Japanese economy has shrunk by 2.4% over the past three years.

Second, 'core' machinery orders have dropped 20% since August, signalling an impending slowdown in business investment which last year rose by 4.4%. The tapering off in capital spending reflects a sharp slowing in orders for IT equipment.

Consumer spending remains constrained by falling employment and fears of future tax increases or pension cuts which are prompting households to maintain high saving rates. And as public debt approaches 120% of GDP, the scope for further increases in public spending (on top of the ¥128 trillion of fiscal packages in the past nine years) is rapidly diminishing.

A further concern relates to the stability of the banking system in the face of a continuing increase in bad debts (which have been growing faster than the banks have been writing them off) and falling share prices (which erode banks' capital positions). However, it is unlikely that a crisis along the lines of that of 1998 will recur. The banks now have much stronger capital adequacy ratios; the Bank of Japan has established lending facilities which will ensure that liquidity is maintained even under extreme conditions; and there are considerable unused public funds on hand from the 1998 rescue package.

In response to the renewed weakness in the economy the Bank of Japan has (in effect) reverted to a zero interest rate policy, undertaking to maintain sufficient excess liquidity in the banking system to keep the overnight rate at zero until core inflation 'registers a zero percent or an increase year on year'. The BoJ has signalled its willingness, if need be, to make outright purchases of government bonds in order to achieve this liquidity target.

Although for now it remains reluctant to embrace such measures, the BoJ may be willing to consider more aggressive money creation in the event that the tentative steps now being contemplated within the government to force a more rapid write-down of banks' bad loans ever amount to anything.

If the BoJ's new approach is to be effective in combating deflation, it will inevitably involve a weaker yen. The yen has already depreciated by some 7% against the US$ so far this year, and will probably fall into the ¥130-135 range later this year.

As we have noted previously, a longer-term solution to Japan's economic difficulties remains elusive. It is difficult to see how Japan's current political system can produce the authority and leadership required to promote and manage the far-reaching structural reforms which will inevitably be required.

Complacency in Europe

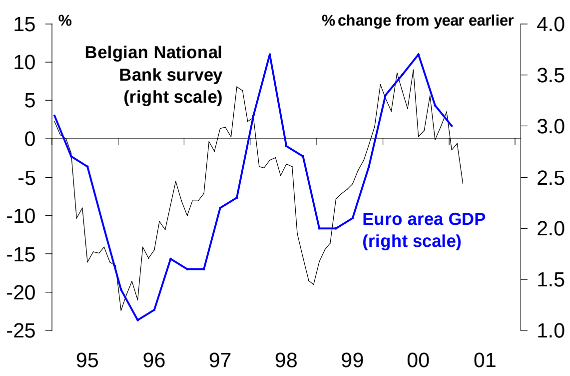
European households and businesses are less financially stretched than their American counter-parts, Europe's technology sector is smaller than that of the US, and exports to the US represent less than 4% of European GDP. Tax cuts will add the equivalent of ½% of GDP to disposable incomes this year. These considerations appear to have bred a degree of complacency on the part of the European Central Bank as to the extent to which the euro area economy will be affected by the slowdown in other parts of the world. As at mid-April, the ECB is the only major central bank yet to have cut interest rates.

Yet economic growth in the euro area has slowed. Euro area GDP grew at a 2.6% annual rate in the second half of last year, down from 3.6% in each of the two previous half-years. This largely reflects weaker growth in Germany, where GDP growth slowed from 4.0% (annualized) in the first half of 2000 to 2.0% in the second half. However the growth rate in the rest of the euro area also slowed from 3.4% to 2.9% pa over this period. Euro area unemp-loyment has remained essentially unchanged at 8.8% since last September after falling 2 pc points over the previous two years. Despite its stronger links with the US, the UK economy has been more resilient – yet the Bank of England has cut interest rates twice.

European companies are exposed to the slowdown across the Atlantic through their now considerable direct investments in the US, and through the effects of the US slowdown on confidence. The Belgian National Bank's manufacturing indicator (which is a good leading indicator of euro area GDP) is pointing to a further slowing in growth.

Although euro area inflation and money supply growth are still above the ECB's targets, we expect the ECB will cut its repo rate in April or May, and by a total of 75 basis points over the course of this year.

Europe not immune from global slowdown



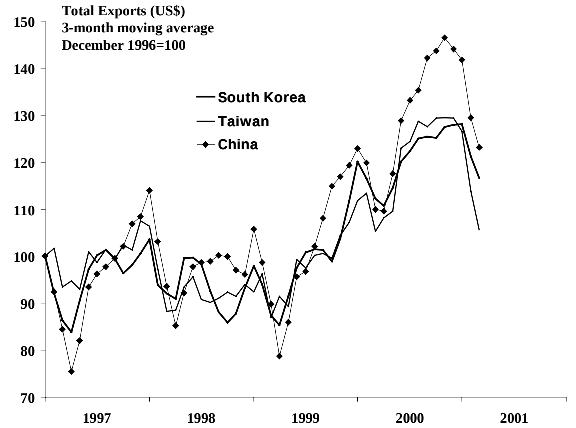
Sources: Belgian National Bank; Eurostat.

ASIAN OUTLOOK

East Asian economic outlook is deteriorating

Real GDP growth in a number of Asian countries exceeded initial expectations in 2000 with particularly strong performances by Hong Kong, Singapore, South Korea and Malaysia. But despite strong economic growth, or more likely because of it, economic reform efforts have lost momentum, especially in South-East Asia. Banking systems remain fragile and concerns persist about the slow pace of corporate sector restructuring. Political uncertainties have undermined confidence and exacerbated concerns about the economic outlook.

Weaker US demand dampens exports



Recent GDP figures confirm that growth slowed in most Asian countries in the final quarter of 2000. There has been a pronounced slowdown in the growth of exports in recent months at least partly reflecting the impact of reduced spending on IT by US companies since mid-2000. Most Asian countries are heavily dependent on exports to the US, especially of high-technology products. Exports to the US account for 7½% of the GDP of South Korea, more than 10% of the GDP of the Philippines, Thailand and Taiwan, and more than 20% of the GDP of Malaysia and Singapore. For Korea and Taiwan in particular, there is also a price, as well as a volume, dimension which reflects the importance to them of chips and related products whose prices are highly demand-sensitive.

The recent downturn in Asian exports is not confined to the electronics sector, and neither has China been immune. Although China is not expected to experience a sharp slowdown in GDP growth this year (see below), there has been a pronounced contraction in exports since mid-2000.

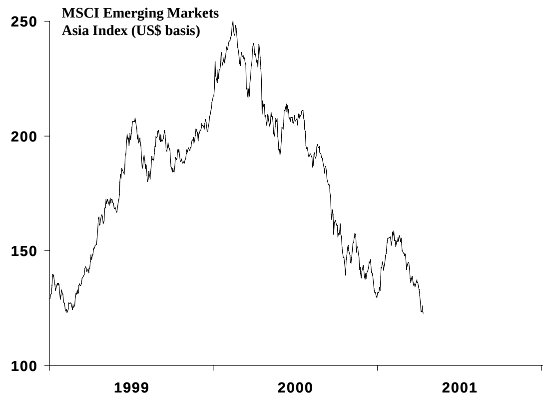
There is a significant risk that, notwithstanding recent aggressive US interest rate reductions, IT-related production in the US could remain sluggish for a prolonged period following the spectacular increases from mid-1998 to mid-2000.

There is a further adverse impact to the extent that a sharp, and/or prolonged, US downturn damages confidence in other parts of the world and thus has an additional detrimental impact on demand for Asian exports.

Recent downward revisions to Asian growth forecasts mainly reflect the effect of weaker US demand on Asian suppliers and a more gloomy assessment of US growth prospects, but the impact of other factors should not be ignored. These include high oil prices and renewed worries about the Japanese economy and banking system, as well as domestic concerns.

Banking systems in a number of countries continue to be hampered by a high level of non-performing loans so credit growth remains weak (or even negative), while poorly-performing stock markets are adversely affecting business confidence and domestic spending. In addition economic slowdown in particular countries has detrimental knock-on effects through intra-Asian trade linkages that have grown in importance and through the impact on investor sentiment towards the region as a whole.

Most Asian stock markets have fallen sharply



Source: Morgan Stanley Capital international

With the main exception of China, economic growth is expected to be significantly lower in 2001 than in 2000. East Asia (excluding China and Japan) is forecast to grow by about 3½% in 2001, down from 6.4% in 2000, on a purchasing-power parity basis.

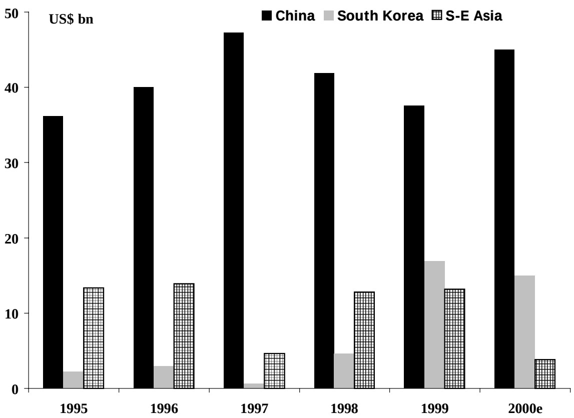
Economic growth in Asia

% change	1999	2000	2001 (f)	2002 (f)
China	7.2	8.0	7	7½
Hong Kong	3.1	10.4	3½	4
Indonesia	0.3	4.8	3	4
Malaysia	5.6	8.7	4½	5½
Philippines	3.3	3.9	3	2½
Singapore	5.4	9.9	4	5
South Korea	10.9	8.8	3¾	4¾
Taiwan	5.7	6.0	3½	4¾
Thailand	4.2	4.3	3	4½
Vietnam	4.8	6.7	5	5¾
East Asia (ex China)	**4.8**	**6.4**	**3½**	**4½**

Reform fatigue hampers economic prospects

Inadequate economic reform is damaging economic prospects in Indonesia and Thailand and there are continuing concerns about Malaysia and the Philippines. Slow reform in South-East Asia is partly responsible for a growing disparity in levels of foreign investment with such investment declining in South-East Asia at a time when it is booming in North-East Asia.

Equity Investment in Asia



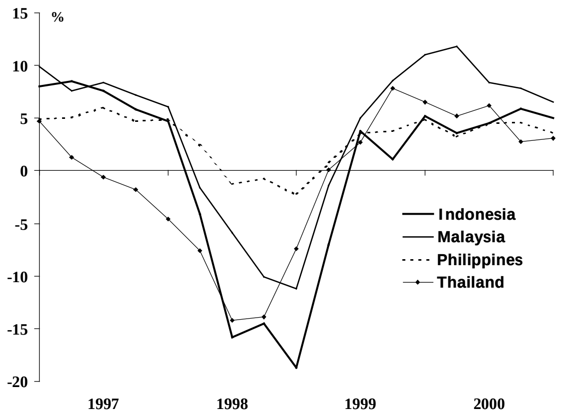
South-East Asia is Indonesia, Malaysia, Philippines & Thailand

Source: Institute of International Finance

The forthcoming entry of China to the WTO, notwithstanding continuing uncertainties about the actual timing, will create substantial new investment opportunities in China. It also reinforces the contrast between China, which is moving to open its markets in order to fulfil its economic potential, and most of South-East Asia which remains reluctant to take significant additional steps in this direction.

Unless South-East Asian countries pursue economic reform with greater vigour, their competitiveness will stagnate, foreign investors will continue to go elsewhere, and economic growth is likely to fall well below potential. But despite the need to do so, it seems unlikely that governments will push ahead with economic restructuring or reform during a period of slow economic growth

Economic growth slows in South-East Asia



Economic policies are being loosened

Some countries are using fiscal policy to try to mitigate the impact of much weaker external demand, despite sizeable fiscal deficits incurred in recent years and a growing burden of public sector debt. In addition, a number of countries have cut interest rates, already at low levels, with further reductions expected soon. In the short-term at least, the risk that interest rate reductions will fuel inflation is low given the recent sharp decline in demand.

Thailand and Malaysia opt for fiscal stimulus

The new coalition government in Thailand, led by Prime Minister Thaksin Shinawatra, is planning a fiscal stimulus package in April or May to lift economic growth which has fallen to around 3%. The previous government's economic reform program (1997-00) had reduced massive economic imbalances, but had failed to create conditions for sustainable economic growth. The Thaksin government is also pressing ahead with its electoral commitments to offer financial assistance to over 70,000 villages and provide a 3-year moratorium on debt repayments for farmers. A national asset management company to speed up the recovery of financial institutions is expected to be operational by mid-year. Low official interest rates to support economic recovery, and ample liquidity in the banking system, provided scope for commercial banks to cut their deposit and lending rates in February. But there are doubts about whether this reduction will stimulate demand for loans given considerable spare capacity in the economy and a shortage of creditworthy customers.

While weak economic conditions in Thailand provide justification for some economic stimulus, there is little prospect of the official medium-term growth target of 5-7% pa. being achieved unless the commitment to economic reform is renewed.

Economic fundamentals are much stronger in Malaysia than in Thailand, but Malaysia is particularly heavily dependent on exports of electronics and electrical products which have risen from 40% of total exports in 1992 to 61.7% in 2000. While the rapid growth of a diversified electronics sector in recent years has been impressive, Malaysia is now particularly exposed to a slowdown in international demand for such products. With the government unwilling to abandon the exchange rate peg and allow the ringgit to depreciate in order to boost export competitiveness, the authorities announced a supplementary budget in March designed to offset the sharp deceleration in external demand and raise GDP growth by 1.1 percentage points. The new measures include increased public spending of MYR3 bn (US$790 mn), a reduction in employee contributions to the Employees Provident Fund to boost consumption, and some liberalisation of regulations to encourage foreign investment.

Philippines government must restore confidence

A brief period of euphoria after the sudden presidential transition on 20 January has now been replaced by a sober mood of realism. There is no doubt that the task of implementing coherent policies and building confidence in the economy is an enormous one. After interest rates were raised by 400bp last October in a vain attempt to prop up the peso, monetary policy is now once again focussed on stimulating growth, and that hike has been more than reversed. At the same time, the new administration has revised down its budget target for 2001, but at PHP146 bn (4.1% of GDP) it is still larger than the 2000 outcome of PHP135 bn. Markets will be watching government finance figures through the year and are likely to sell the peso on any signs that the budget could be overshot.

In the first half of this year, the economy is likely to be artificially buoyed by spending ahead of the May elections. Beyond that, the economy is likely to slow, and the slowdown could be sharp. Negative factors include poor sentiment among the business community, still feeling the impact of last October's interest rate hike, and the poor outlook for exports.

The one factor that could cushion the economy in the second half is the administration's ability to win the confidence of business, investors and consumers. This could trigger a resumption of business investment spending, boost employment and reduce the risk of another peso sell-off - but it will be mid-year before a judgement can be made on how the government is doing in this regard.

Political tensions escalate in Indonesia

President Wahid's grip on power has been significantly eroded and he faces possible impeachment. Adding to the uncertain political climate is the inability of the government to control ethnic violence. On the economic front, IMF loan disbursements have been withheld since December 2000 amidst concerns over a backpedaling on reforms, issues relating to the decentralisation of power to the provinces, in particular their ability to borrow directly, and changes to the central bank law. The current impasse with the IMF could threaten an agreement with the Paris Club of official creditors to restructure some US$5.8 bn of foreign debt. The extended period of political and economic uncertainty is expected to heighten social unrest, hamper further progress on reform and weaken financial markets. The rupiah breached Rp10,000/USD in March 2001, the first time since October 1998. The stock market has also fallen quite sharply to levels not seen since mid-1999.

South Korean economy to slow significantly

Liquidity problems have intensified in South Korea, raising concerns over the true health of the corporate and financial sectors. While the government has stepped up its bid to prompt firms to restructure, workers remain strongly opposed to corporate reform. The government's task has become even more difficult against the backdrop of a sharp economic slowdown. Real GDP is projected to grow by only 3.7% in 2001 compared with 8.8% in 2000. The effects of financial and corporate sector restructuring are likely to continue to unsettle financial markets.

Strong economic growth in China

China is expected to continue to grow by 7-8% over the next 2-3 years which is positive for other East Asian countries. Nevertheless, export growth which has been the driving force of activity is slowing substantially from last year's vigorous pace. Growth of both exports and imports in January-February this year, compared to the same period last year, is only half the rate for the full year 2000. Further slowing is expected as sluggish economies mean the key US and Japanese markets are harder to penetrate.

Regardless of the impact of the external environment on China's export growth, Beijing cannot allow the pace of overall activity to falter, considering the adverse social impact of its continuing structural reform program (including the initial impact of membership in the World Trade Organisation). To maintain growth at a sufficient pace to ensure domestic stability in the face of adversities such as the Asian economic crisis, economic restructuring and now a slowing global trading environment, China has had to resort to fiscal pump-priming.

It was revealed at the recent National People's Congress that China expected a record deficit this year, as fiscal expansion aimed at supporting growth was joined by increased spending on defence, and on social welfare to soften the blow of rising unemployment. The overall deficit this year is expected to be Rmb260 bn (a 4% rise on last year) - at about 2.7% of GDP it is not yet at a dangerous level. The authorities plan to issue some Rmb150 bn of special bonds this year and next to help to fund a projected 10% rise in state investment this year, up from 9.3% last year. The bulk of this pump-priming will go toward infrastructure investment, particularly development of the western provinces, which have enjoyed very little of the benefits of China's economic development to date.

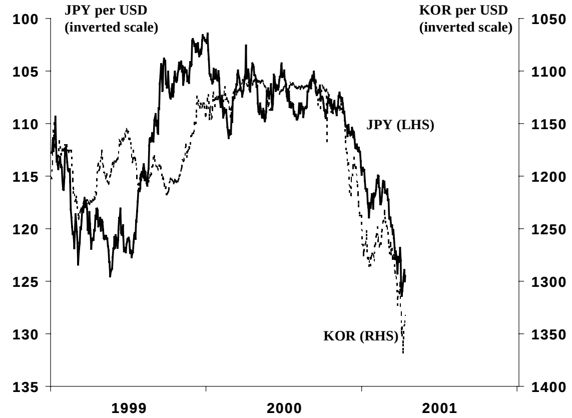
Premier Zhu Rongji is, publicly, quite relaxed about the impact of successive fiscal deficits on accumulated public debt, which last year he put at 14% of GDP. However, this does not take account of the massive non-performing loans in the state banking system, which the government would ultimately need to stand behind. Official public debt and unofficial estimates of bad loans amongst the state banks probably amount to some 35-40% of GDP, and adding unfunded pensions and unemployment benefits would take the public debt ratio to a much higher level of risk.

The government plans to lift its tax take to 20% of GDP from the current level of 14%. This notwithstanding, the quicker China can wind back the inefficient state sector and give the economy a private-sector orientation, and thus make economic growth more self-sustaining, the faster it will reduce its exposure on the fiscal front.

Weak yen could produce new tensions

The yen has fallen sharply against the US dollar since mid-2000 and the pace of depreciation has gathered momentum recently with the Bank of Japan effectively reverting to its zero interest rate policy as expectations of slow economic recovery have faded.

Weak yen is putting pressure on the Korean won



Further yen weakness is expected over coming months with a significant prospect of the yen falling to around ¥135 to the US$ in mid-year. Depreciation on that scale would have knock-on effects on other Asian currencies, particularly the South Korean won. South Korea competes with Japan in exports of cars, ships and other heavy industry, as well as in electronics, and movements of the won are closely correlated to those of the yen.

Depreciation of the yen, at a time when export prospects facing other Asian countries are deteriorating, could also produce a more general decline of other Asian currencies against the US dollar. The prospect of new currency “crises” within the region seems small, but countries with pegged exchange rates, particularly Malaysia and China to a lesser extent, will be vulnerable to a loss of export competitiveness. Pressures on countries with pegged currencies to adopt more flexible exchange rate systems are likely to intensify.

US Dollar Exchange Rates

(all rates are currency per US dollar)

Period ending	2000	10 April	June 2001f	Dec 2001f
China	8.28	8.28	8.28	8.28
Hong Kong	7.8	7.8	7.8	7.8
Indonesia	9675	10650	10500	9400
Japan	114.2	124.5	137.0	133.0
Malaysia	3.80	3.80	3.80	4.00
Philippines	50.0	50.0	50.0	47.0
Singapore	1.73	1.81	1.79	1.74
South Korea	1265	1333	1440	1400
Taiwan	33.2	32.9	33.3	33.0
Thailand	43.4	45.6	46.0	45.0
Vietnam	14493	14575	14640	14700

AUSTRALIAN OUTLOOK

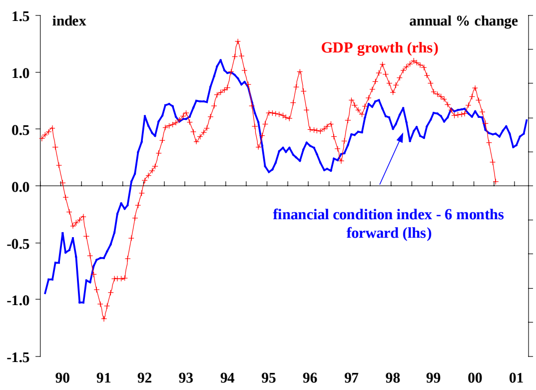
Slowdown exaggerated by GST and the Olympics

A 0.6% contraction in real GDP in the December quarter brought to an end an unprecedented 37 quarters of continuous economic growth in Australia. After averaging 4.8% over the previous three financial years, annual GDP growth fell sharply to only 2.1% over calendar 2000. The subsequent downgrading of short-term growth expectations has contributed to the deterioration in both consumer and business confidence and the decline in the $A.

However, the dramatic decline in growth in the second half of the year substantially overstates the extent of the slowdown in underlying economic activity. Much of the apparent weakening reflects an inter-temporal shift of residential building activity into the first 6 months of 2000 in order to avoid the GST. In fact, Reserve Bank estimates suggest that annual growth in GDP excluding dwelling investment and the impact of the Olympics remained relatively steady at 3¾% throughout the year.

Macroeconomic fundamentals remain healthy and the usual preconditions for recession in Australia (rising inflation, a widening current account deficit and rising interest rates) are notably absent. Fiscal policy is also likely to remain supportive in the lead-up to the federal election[2].

Financial conditions remain supportive



Source: ABS Cat. 5206.0, Economics@ANZ.

Growth in retail sales and employment in early 2001 imply a near-term technical recession is now unlikely and easier monetary policy and ongoing sharp declines in the $A have ensured financial conditions remain supportive.

Nonetheless, significant risks to growth remain. Restricted cash flows in the household and small business sectors have resulted in a marked increase in personal bankruptcies and corporate insolvencies. Moreover, weakening global growth expectations and rising inventory levels have led a sharp decline in both business and consumer sentiment. Perhaps of even more concern are the recent sharp falls in the ANZ job advertisement series, which foreshadow a further deterioration in labour market conditions, and raise questions over the sustainability of household spending growth in 2001.

However, employment, bankruptcies and insolvencies are lagging indicators of economic activity and the present weakness in these series may well be reflecting the economic downturn in the second half of 2000.

After detracting from growth last year, domestic cyclical factors will become supportive in 2001 and global growth is forecast to recover in the second half of the year. Hence, despite residual risks, we believe that the worst of the slowdown is behind us. While growth in the first half of the year will be tempered by an inventory adjustment and subdued confidence, activity should regain momentum through the course of 2001-02. The rebound in growth will be buoyed by a renewed upturn in dwelling investment (boosted by lower mortgage rates and the extension to the first homebuyer's scheme) and coincident recoveries in non-residential building activity and mining investment. Hence, we remain cautiously optimistic about the economic outlook and after slowing to only 2% in 2000-01, GDP growth is forecast to strengthen to 3.2% in 2001-02.

Downturn concentrated in New South Wales

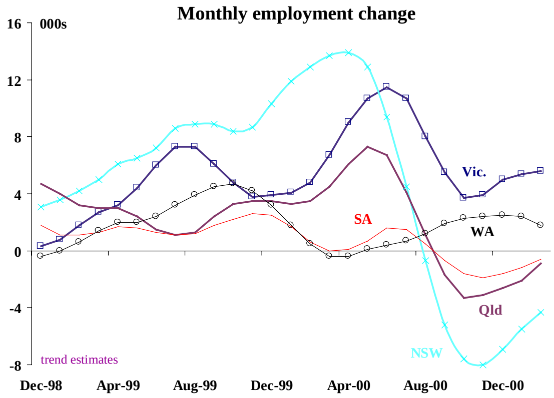
Unlike the early 1990's recession, which was heavily concentrated in Victoria, declining activity in New South Wales has led the current downturn. The downturn in NSW has been exacerbated by a post-Olympic lull in private spending, particularly building and construction investment, which fell by 40% in the second half of 2000. NSW building activity will remain subdued in 2001 as dwelling approvals in the state remain close to 14-year lows, in stark contrast to Victoria where approvals are 13% above their 15-year average level.

Employment losses have also been concentrated in NSW, again largely in the construction sector. After

[2] Despite a temporary weakening of public spending late in 2000.

peaking in August last year, by February 2001 employment in NSW had fallen by 50,000 persons compared with a national decline of only 37,000 reflecting ongoing employment gains in Victoria and Western Australia.

Employment losses centred in NSW

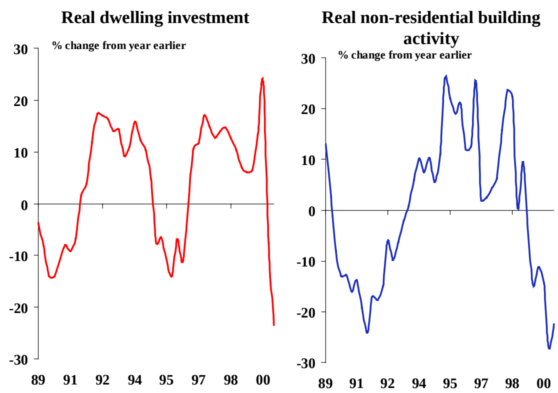


Source : ABS Cat. 6202.0

Construction drags growth lower in H2 2000

A 30% decline in construction activity in the second half of 2000, was the major culprit behind the sharp turnaround in economic growth. The counter-cyclical spike in residential building activity in the first half of 2000 was always likely to result in an equivalent post-GST contraction. Coincident steep downturns in both non-residential building and engineering construction exacerbated the downturn in the sector and had substantial negative impacts on upstream suppliers and household spending.

Construction drags growth lower



Source: ABS

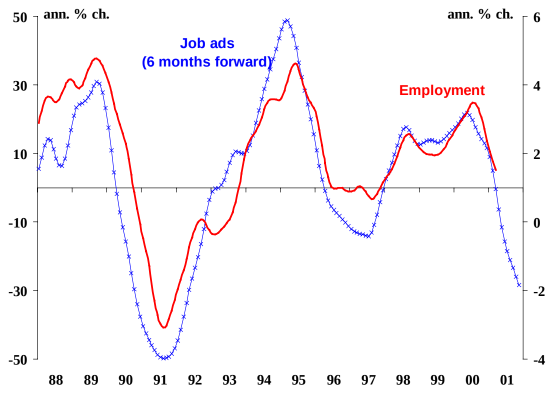
The surprisingly rapid post-GST decline in housing investment suggests the majority of the necessary adjustment was compressed into the second half of 2000. Annualised dwelling approvals in February of only 108,000 remain substantially below underlying housing demand of around 140,000 and in contrast to recent cyclical housing downturns, excess supply estimates in 2001 are relatively low[3]. As a result, the downturn, while sharp, should be relatively short-lived. Approvals data suggest that activity is close to its nadir and we expect a cyclical upturn in housing will gain momentum in mid-2001 buoyed by lower mortgage rates and the temporary impact of the $7000 extension to the first homebuyer's scheme. Non-residential building and engineering construction are also forecast to rebound in 2001 led by new office construction and renewed growth in mining investment.

Household spending remains the key to growth

Several factors, including increased debt service costs, rising petrol prices and the final Telstra instalment, weighed on household cash flows and restricted household spending in 2000. After recording growth of 5.3% in 1999, real consumption spending weakened considerably in 2000 growing by only 2.5%. A post-GST surge in motor vehicle purchases added to the downward pressure on retail spending which actually declined in real terms last year.

However, most of the factors that restrained household spending were either temporary or have turned around in 2001. Increased debt levels have raised the exposure of the household sector to changes in interest rates and the 125 basis points of monetary policy easing since January should have a rapid positive impact on cash flows and spending in 2001-02. Lower petrol prices and continued wealth gains[4] will also support spending growth this year.

ANZ job ads imply near-term weakness



Source: ABS Cat. 6202, ANZ

The greatest risk to the spending outlook is the labour market. Weakened employment growth lifted

[3] and are largely concentrated in New South Wales and Queensland

[4] in stark contrast to the US where the US Wilshire 5000 has declined by 28% since its peak in March 2000 compared to only a 2.4% fall in the all ordinaries over the same period.

the unemployment rate from 6.3% in October to 6.9% in February, and recent sharp falls in the ANZ job advertisements series foreshadow a further deterioration in labour market conditions in coming months. We expect the unemployment rate to rise to 7.5% by year's end. However, as employment losses to date have been concentrated in construction and retail trade, renewed upturns in these industries in the second half of 2001 should result in a rebound in employment growth in 2002.

Inventory adjustment will subdue growth

Weakened sales growth in the second half of 2000 resulted in a sharp build-up of manufactured, wholesale and retail stocks. By the end of 2000, the combined stocks to sales ratio for these sectors had reached levels not seen since 1991. Anecdotal evidence suggests much of this stock accumulation has been involuntary and the required inventory adjustment will clearly restrict output growth in the first half of 2001.

Inventory adjustment will restrain growth in 2001

Source: ABS Cat. 5629.0

Renewed vigour in retail sales in recent months and an expected rebound in the demand for building materials this year will support the stock drawdown. However, any weakening of sales growth would result in a more protracted adjustment.

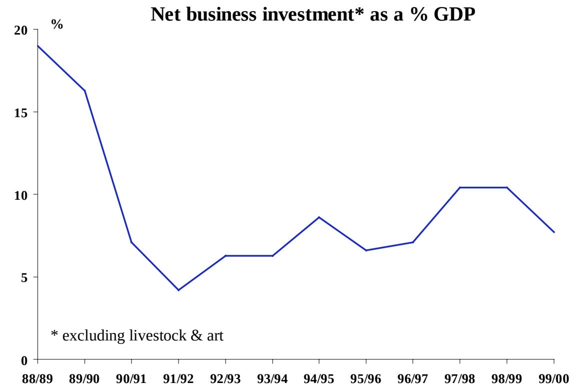
Business confidence remains subdued

Business conditions, according to a range of surveys, have continued to deteriorate in the early months of 2001. The picture painted by business surveys is of a weak economy, with further deterioration in employment in prospect and an ongoing squeeze on margins. Notwithstanding attempts by retailers to increase prices in recent months, input costs continue to rise faster than selling prices. Prices of inputs - boosted by higher oil prices and the weaker A$ - have risen 2-3 times as fast as output prices.

The decline in business sentiment and weakening business conditions late last year can be linked to a number of factors. The weak A$ had negative effects on the profit margins of domestically-oriented businesses and business profit margins were further squeezed in two respects by the new tax system. Many firms were unable to pass on the full effects of changes in indirect taxes and the 'bring forward' of business income tax as part of the move to a 'Pay as You Go' system created an additional squeeze on post-tax cash flows (which is not captured in official statistics). Some of those same factors are still affecting businesses now but current weak business conditions are also a reflection of weak demand - lower output, reduced capacity utilisation rates and slowing new orders.

In light of weakened confidence, business investment has been identified as one area of potential weakness in 2001-02. However, in stark contrast to the US where the ratio of business investment to GDP has climbed dramatically to seemingly unsustainable levels over the past decade, Australian business investment has been relatively subdued, particularly in net terms.

Business investment set to recover



Source: ABS Cat. 5204.0

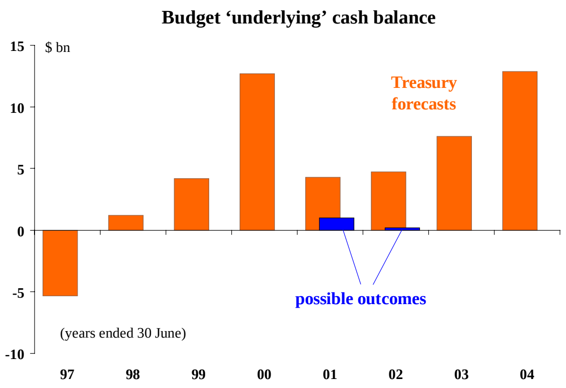
Public spending will continue to support growth

Though the government has come under pressure for significantly easing fiscal policy, the stimulus in 2000-01 has in fact been quite timely in offsetting what might otherwise have been an even steeper fall in the economy. That said, a cyclical recovery in the economy next year is already likely to be underpinned by the lagged impact of easier monetary policy and any further easing of fiscal policy could seriously undermine the Coalitions reputation for economic management.

At the Mid-year Economic and Fiscal Outlook in November, the underlying cash balance for 2000-01 was revised up to $4.3bn from $2.8bn at budget time and the surplus for 2001-02 was revised up to $4.7bn from $3.2bn.

However, instead of extra revenues from the GST boosting these expected outcomes, the budget surplus for 2000-01 appears now to have been substantially eroded. This is due to the effects of slower growth on revenues and spending, the shortfall in proceeds from the auction of 'G3' mobile phone spectrum and through conscious policy changes (in part to limit electoral damage).

Weaker growth and new policy to slash surplus



Policy announcements to date, including roads funding, the innovation statement, excise changes and the First Home Owners Scheme extension have added around $600mn to spending in 2000-01, rising to nearly $3bn in 2004-05. And further policy announcements are likely in the run up to the election. On our reckoning, the 'underlying cash surplus' is now likely to be close to zero both for 2000-01 and 2001-02. Consequently, after a surprise fall in public demand in the December quarter we expect public demand to rebound in 2001 and provide a significant positive contribution to growth.

Net exports to continue to support growth

Despite a marked slowdown in the growth prospects of our major trading partners (particularly in Asia), net exports will continue to make substantial positive contributions to growth in 2001. Export volumes have already slowed, in response to weaker global demand. However, reduced domestic demand has resulted in an even sharper sharp decline in import volumes.

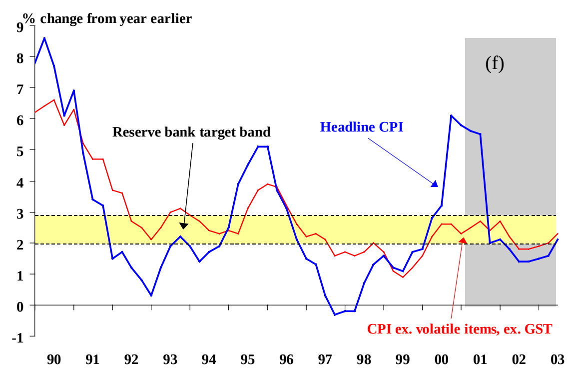
Furthermore, a solid increase in the terms of trade has led a dramatic improvement in Australia's external trade position, which in February recorded the first "non-Olympic" surplus since November 1997. Further trade surpluses are forecast in coming quarters. While a slowdown in global industrial production will weigh on some commodity prices this year, sharp gains in negotiated bulk $US commodity prices (coal and iron ore) combined with a lower $A will lift export returns considerably.

ABARE predicts commodity returns will expand by 19.4% in 2000-01 and by 3.5% in 2001-02. Consequently, we expect an ongoing dramatic improvement in the current account deficit, which is forecast to fall to only 2.4% of GDP in 2001.

Inflation remains under control

Despite escalating upstream price pressures, the CPI rose by only 0.3% in the December quarter. This surprisingly low result reflected the difficulty businesses had in passing on price rises in the face of heightened ACCC scrutiny and difficult domestic trading conditions.

Inflation in comfort zone



Sources: ABS; Economics@ANZ.

We currently estimate annual inflation (ex-volatile items, ex-GST) to be running at the lower end of the Reserve Bank's 2 to 3% target band. Anecdotal evidence and business surveys suggest that easing ACCC regulation and the continued margin pressure from the prolonged downturn in the A$, will boost prices in the March and June quarters, but that 'core' inflation should remain in the lower to middle range of the target band throughout 2001.

A number of factors will place downward pressure on prices in the medium term and we expect headline inflation to fall below the Reserve Bank's target band in the second half of this year. Growth will be running below potential, the A$ is expected to recover from record lows and petrol prices are forecast to fall. Continued pass through of savings as a result of the removal of WST and changes to a number of indirect taxes from July 2001 should also contribute to a benign inflation outlook, providing sufficient flexibility for the Reserve Bank to ease monetary policy further should it be required.

INTEREST AND EXCHANGE RATE OUTLOOK

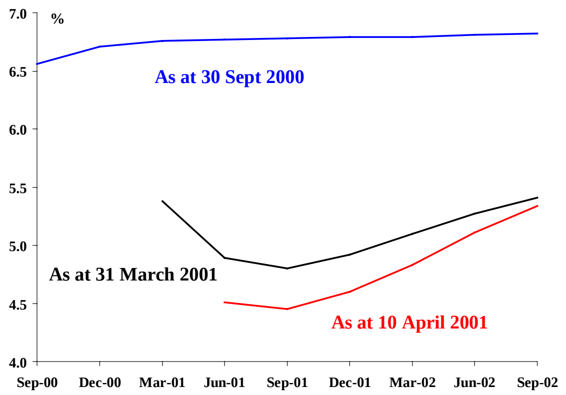
RBA shows its "pro-growth" credentials

The Reserve Bank of Australia cut the official cash rate target a further 50bps on April 4, bringing the cumulative easing over the past 3 months to 125bps. The central bank continued to hold the view that the medium term prospects for the economy are good but near term risks were serious enough to justify a further easing in monetary policy to support demand. In particular, the Bank is concerned about the risks from a weaker world economy and from the downturn in business and consumer confidence here holding back recovery.

This clearly implies that, along with most major central banks, Australian monetary policy remains in an easing cycle until we can be more certain about the international outlook. Put another way, ultimately the low in Australian rates is likely to be determined by whether or not the US economy is able to avoid recession. But at this stage, we think the Fed will be at or close to the end of their easing cycle by mid-year and that Australian cash rates too are close to a bottom. However, interest rates in both countries are likely to remain at low levels for some time.

Assuming that the US economy avoids recession, prospects are good for a recovery in Australian GDP later this year. Indeed, we welcome a reversal of some of the extreme pessimism that pervaded the market a few weeks ago in the wake of the negative Q4 GDP result. Back then bank bill futures were looking for the cash rate to bottom at around 4.25% in the second half of this year and for a period, relative US and Australian futures markets pricing implied more easing from the RBA than the Fed. Those expectations have now been scaled back.

Bank bill futures



Source: Reuters

The catalyst for the recent pessimism on Australia was the larger than expected contraction in Q4 GDP. Some incorrectly concluded that the Australian economy had "caught a cold" from the US slowdown. But in truth, Australia's slowdown owes entirely to "home-grown" or domestic factors, which themselves are largely temporary. Importantly, none of the slowdown in Australia's growth rate so far can be attributed to deteriorating economic conditions in our major trading partners.

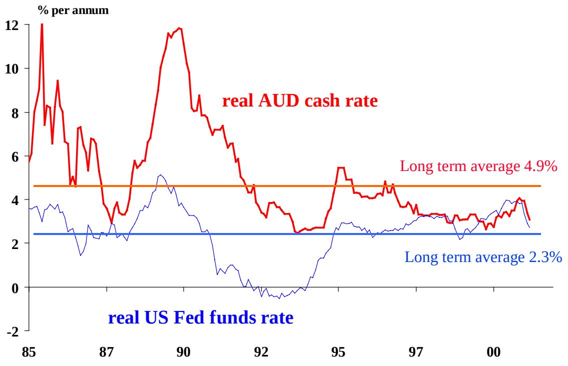
We do not believe that we will have another quarter of negative economic growth, following the 0.6% decline in the December quarter. The decline in construction activity looks to be just about over. And the policy stimulus that will come from falling interest rates, the fiscal measures that have recently been and will probably continue to be unveiled by the Government, and the weak $A, should produce some upturn in the second half of the year. However there is obviously a non-trivial risk that weaker growth in most of our major trading partners will serve to offset some of these stimulatory forces, keeping the overall rebound modest by historical standards.

We expect monetary policy to be eased a further 25bps in coming months, taking the official cash rate down to 4.75%, where it was before the Reserve Bank began raising it late in 1999. Indeed it's possible that the cash rate could go even lower than that, which would represent a new low for the modern era. The RBA is likely to hold rates steady in May in order to assess things further - in particular they may wait to see what the Fed does at its May 15 meeting and to see what further fiscal stimulus is unveiled in the Federal budget on 22nd May. This suggests the RBA may not move again until the June board meeting, at the earliest.

The RBA will, however, be keen to get policy adjustments over earlier rather than later given that the Federal election is likely to be held in the second half of the year. The central bank would prefer to be "out of the picture" when electioneering is in full swing. We still expect the election to be held in November though earlier dates are possible.

There is much less need for the RBA to lower interest rates as much as the US Fed. The cash rate in Australia is already close to its 20 year low of 4.75% and in real terms is now almost 2 percent below its 15-year average rate of 4.9%. In contrast, the Fed started lowering the Federal funds rate from a much higher starting point and it remains some way above its historical low of 3.0%. And, after adjusting for inflation, the real funds rate is still a little above its 15-year average of 2.3%.

Real short term interest rates



Note: 'Real' rates deflated by 'core' inflation in the US and 'on-going' inflation (excluding GST effects) in Australia. *Source:*Economics@ANZ

As well Australia has not experienced anywhere near the same degree of wealth creation (and subsequent destruction) from the stock market and both fiscal policy and the exchange rate continue to support growth. If cash rates were held at 4.75% for a time, this would represent a very stimulatory policy stance. The build-up in household debt levels in recent years and the subsequent rise in debt servicing as a proportion of disposable income has meant that monetary policy is now far more potent in its effect on household sector cash flow.

Is the bond rally over?

Bond markets appear to be at a turning point. Surprising resilience in some of the US economic data has seen a rise in US treasury yields and yield curve steepening as interest rate markets price for a 'V-shaped' recovery rather than recession. 10 year US T-bonds have risen nearly 30bps from their March lows and Australian 10 year bond yields have risen by even more with the spread widening to 30bps in early April.

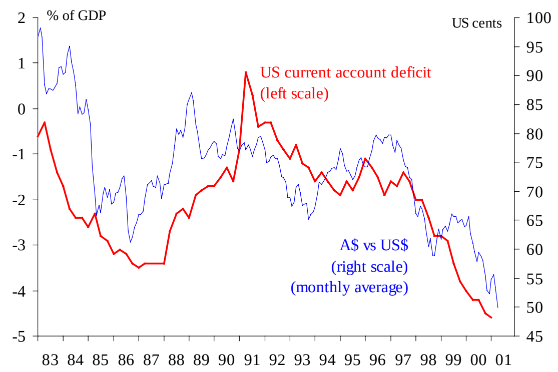
History shows that the bulk of the bond market rally usually occurs even before the easing cycle has begun. And, with the end of the Fed and RBA easing cycle in sight, we continue to believe that the bond market rally, which began at the start of 2000, is drawing to an end. Much of the bad news is now priced in and the market is becoming more sensitive to positive news or signs the worst may be over. But it's not over yet. The US (and global) slowdown is likely to be a more drawn out affair and further weak economic news and earnings disappointments should see the market rally further in coming months. In such an environment, low risk assets such as government bonds are likely to retain a positive bias for much of the year. We see US 10 year yields remaining in the range of 4.75-5.25% this year, with Australian bond yields trading around 5.0%-5.75%, with a positive spread of around 30-50 points. This is expected to reflect a growing view later this year that Australian growth is once again likely to outperform US growth and that the RBA will ease by less than the Fed.

The $A – more uncertainty ahead

The Australian dollar collapsed through $US0.50 on 13th March and has stayed largely sub-50 since with a record low at the time of writing of $US0.4775 on April 3. The Aussie's latest decline is partly a reflection of the continuing strength in the US dollar but since the $A has been among the worst performing currencies this year (recently posting a record low on the TWI of 46.8) it's a clear sign that Australian-specific factors are also at play.

Last year, US dollar strength could be explained by the strong inflows of foreign direct investment from overseas (that is, foreign companies, especially European companies, taking over US companies or increasing their investments in their existing US subsidiaries) and by international investor enthusiasm for US shares and corporate bonds. The sheer size of the United States current account deficit (more than $US400 bn in 2000) means the US absorbed more than 80% of the world's supply of surplus capital. This made it harder for other countries which also have deficits to finance (including Australia and New Zealand, and the "euro area") so placing downward pressure on their exchange rates to make their assets cheaper for foreign investors.

The US current account deficit and the $A



Sources: US Department of Commerce; Datastream; Economics@ANZ

Such was the "pull" of the US that equity capital inflows to Australia almost completely dried up, even though the fundamental factors that had traditionally influenced the $A were relatively positive. As a result, Australia was forced to rely almost completely on overseas borrowings by banks to finance its current account deficit. And because banks typically "hedge" their overseas borrowings –

in contrast to equity investors who typically don't hedge - this form of financing doesn't create any net demand for Australian dollars to offset the net selling of $A which results from all the transactions that make up the current account deficit.

Late last year it seemed as though things might finally be looking up for the Australian dollar. Not only were Australia's economic fundamentals good but storm clouds were gathering over the US economy. However, the continued strength in the $US this year, in the face of the sharp slide in US share prices, suggests foreign investors still feel their prospects will be better if they stay in US dollars rather than in any other currency. Those who have sold US shares are still keeping their funds in the US - buying US bonds instead - rather than transferring them to other markets. And the flow of direct investment by companies into the US though it's probably eased off a bit, still seems to be fairly strong.

The currency market has also concluded that anything which is bad for the US must be bad for most other countries as well - and in particular for Asia, given Asia's heavy dependence on exports of high-tech products to the US. The renewed fears over the Japanese economy and banking system haven't helped sentiment towards Asia either. As we saw during the Asian crisis in 1997-98, when the currency markets turn bearish on Asia, they also turn bearish on the liquid Australian dollar. During the Asia crisis, the $A was also dragged down by a falling yen. The same thing may be happening now. On top of these "global" factors there has been a clear deterioration in several Australian specific factors, which have provided further reason to sell the $A down.

The earlier confidence that all was well with the Australian economy has been shattered as Australia's economic weakness has come in advance of anything that could be attributed to developments in the US or Japan. And following the Reserve Bank's 125bps of rate cuts this year - which weren't even expected by the markets prior to early January - there is now no longer any positive interest rate carry on Australian money market investments.

Political uncertainty has added to the adverse impact of disappointing economic news. The recent State elections in WA and Queensland have been portrayed in the domestic and international media as heralding the re-birth of Pauline Hanson and One Nation - whose policy positions are anathema to international investors, particularly in Asia. Opinion polls suggest that it is highly unlikely that the Howard Government will be returned to office for a third term. And while the markets have no particular fear of a Labor Government, they are concerned about what the present Government might do between now and the next election in an attempt to minimise the prospect of losing office.

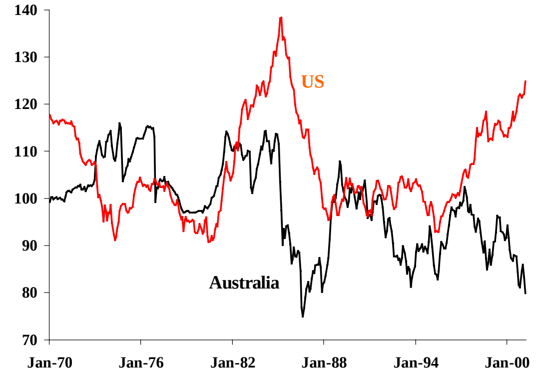
Markets understand that budget surpluses will inevitably be eroded during periods of economic weakness. After all, the Bush Administration is citing the possibility of recession as a reason to cut US taxes. However Australia's fiscal position isn't as strong as the US – in fact the combination of these 'automatic' effects (eroding revenue and boosting outlays) and (actual & prospective) pork-barrelling may have eliminated the Budget surplus for 2000-01. And the markets see clear signs of panic decisions. None of this inspires confidence in the currency.

One specific element of this general political uncertainty is particularly relevant to the currency. This is the looming decision which the Treasurer has to make on Shell's $10bn bid for Woodside, the operator of the North West Shelf Gas project. Shell's bid does raise genuine issues of the national interest, which any Australian government is obliged to consider. However, while the Government does have specific limits on foreign ownership in banking, media, airlines and residential property, no 'rules' exist in relation to the resource sector and, in the past, Australian governments have approved far more controversial deals.

The Government is under considerable political pressure, including from its own backbench to block the bid and the Prime Minister has indicated a degree of sympathy with this position. A decision to block the Shell bid, or to impose conditions on approval of it which Shell would find unacceptable, could raise doubts about Australia's credentials as a destination for foreign investment, at a time when Australia's inability to attract sufficient volumes of such investment has been a key reason for the A$'s weakness. The markets may well see it as (further) evidence that the Government was willing to sacrifice its principles in order to appease angry voters.

This combination of clear signs of economic weakness (in advance of anything that could be attributed to developments in the US or Japan) and political uncertainty is not shared by other countries whose currencies were adversely affected by US dollar strength last year, such as the euro area, Britain or New Zealand. Thus the $A has been independently weak, falling not just against the $US but against these other currencies as well.

Real effective exchange rates



Source: J.P. Morgan

Outlook for the Australian dollar

Models based on traditional "fundamentals", which have worked well in the past, suggest the $A is "undervalued" by more than US12 cents. But these models have performed so poorly over the past 12-18 months that such conclusions can no longer be trusted. In fact market perceptions of what the most important 'drivers' of the Australian dollar are have fundamentally changed. In the latest Consensus Economics survey for March 2001, respondents were asked to rank the importance of various factors in determining the $A exchange rate. Commodity prices, which ranked highest in the 1999 and 2000 surveys, failed to score in the latest survey. Instead, expected economic growth differentials have emerged as the key factor influencing the currency.

The $A is literally in uncharted waters so forecasting it is even more hazardous than usual. Near term, the risks remain skewed to the down-side and technical analysis suggests the Australian dollar could move as low as $US0.45. This would represent a further 9% fall from current levels, the $A having already fallen 16% from its January high of 0.57.

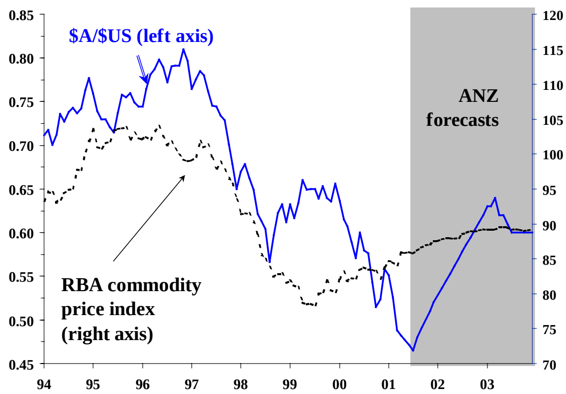
A decision by the Government to block the Shell bid for Woodside, if it comes to that, is an obvious near term trigger for another sharp move lower but there could be a number of others, such as a disappointing May Budget or further bad economic news.

To a large extent, the key determinants of the Australian dollar this year are likely to be when the 'bubble' in the US dollar finally bursts and on a resolution of political uncertainty. With the election not expected until November, the $A is likely to remain weak for much of this year, spending more time below $US.0.50 than above it.

The best prospects for a significant rebound in the Australian dollar lie with global markets realising at some point that the 'V-shaped' recovery has not eventuated and instead, the US economy is in for a protracted period of low growth. With European growth likely to outperform the US in the next few years, this should provide the rationale for a recovery in the Euro against the US dollar and other similarly undervalued currencies such as $A, $NZ, etc. This is unlikely until much later in the year and may well see a gradual marking down of the US dollar over much of 2002. Of course it is possible that something triggers a more precipitous decline in the US dollar at some point but, as always, it is difficult to know until after the fact exactly what that might be.

We expect the Euro to recover against the US dollar from around the 3rd quarter of this year, rising to 0.98 by year-end and trading a little above 1.0 for much of 2002. But unless there is a major loss of confidence in the US economy, the US dollar's correction against the euro is likely to be relatively modest. In part this would reflect continued M&A flows as well as a continued outflow of equity capital into the US dollar as the deregulation of European pension funds allows portfolio managers to sharply increase the proportion of $US assets in their portfolios.

$A forecasts



Source: Reuters, RBA, Economics@ANZ

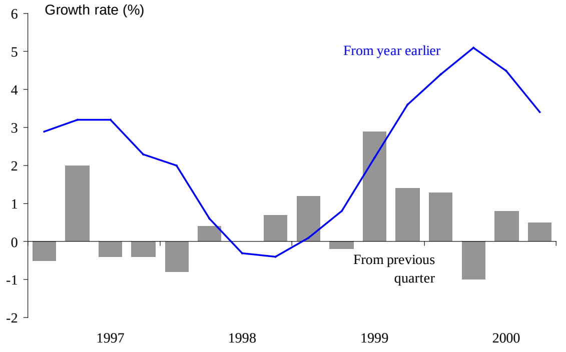
We anticipate a rebound in the $A to around 0.52 by year-end, eventually getting back above 0.60 by the end of 2002. As with the Euro, several 'structural' factors are likely to limit the extent to which the Australian dollar can rally against the US dollar. These include an overhang of exporter hedging positions and a rise in net capital outflows as Australia's funds under management continue to grow at a rapid pace and the proportion of those funds invested offshore rises. This suggests a long term range for the Australian dollar is more likely to be $US0.50-60 rather than $US0.60-70.

NEW ZEALAND OUTLOOK

Slowing global economy hits confidence

Amid a barrage of weak economic news from most trading partners in the new year, a range of economic statistics have suggested that the New Zealand economy is holding up comparatively well. Data released in April, however, suggests that the weaker global prospects have started to undermine business confidence which had earlier made a spectacular rebound.

The NZ economy grew only modestly in 2000
Real GDP



Source: Statistics NZ

Coming on top of the 0.8% rise in the September quarter, GDP recorded another solid but unspectacular gain of 0.5% in the December quarter. Growth over late 2000 was driven by a strong net export contribution coming largely from the primary sector and tourism and to a lesser extent from manufactured exports. Yet, as had been the case for most of 2000, domestic demand remained patchy in the December quarter, with weak retail spending and a sharp fall in residential construction partly offsetting the external sector strength.

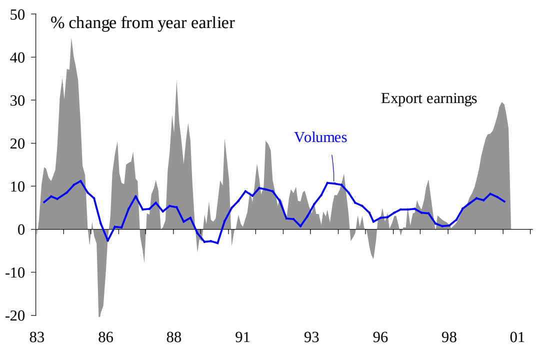
Indicators received early in the new year suggested that momentum may have returned to the domestic economy. Business confidence rebounded dramatically with the NZIER's December quarter Survey of Business Opinion (QSBO) recording the sharpest rise in business confidence in any three month period in the 30 year history of the series. Throughout 2000, weak confidence restrained business investment activity as firms deferred decisions in the face of uncertainty surrounding government policy changes and the outlook for the economy. Perhaps as a reflection of the benefits of strong export growth starting to flow through, business appeared to have cast off this pessimism.

Firms in all sectors reported better trading conditions and were upbeat about prospects thereafter. Alas the March quarter survey, released in April, shows that some of this newfound optimism has evaporated again, no doubt due to the softness in global activity and a steady string of bad news from trading partners' economies. The fall in confidence was particularly evident among manufacturers with some domestic sectors such as construction and retailing faring better.

Retail sales over the past 12 months, as a whole, have been relatively subdued, with a range of factors including last year's tax hikes for higher income earners and higher petrol prices eating into disposable incomes. However, February sales data were a little stronger and a number of partial indicators of spending have been more favourable in recent months. Surveyed consumer confidence showed a lift in the March quarter, supported by powerful gains in employment over the past six months. While we had been a little sceptical about earlier employment data, consistent gains in employment across alternative surveys since the September quarter of last year are compelling. They point to an increase in employment of more than 35,000 jobs over the past year, concentrated in the second half of 2000. This sharp rise in employment led to a further fall in the unemployment rate to a 12 year low of 5.6% in the December 2000 quarter. The implied boost to household incomes from strong employment gains should help to underpin retail sales over the months ahead. Job ad trends in the new year suggest some further job growth may be ahead though this may not last if business confidence continues to ease.

Export earnings have been very strong

Export growth remains impressive
NZ export performance



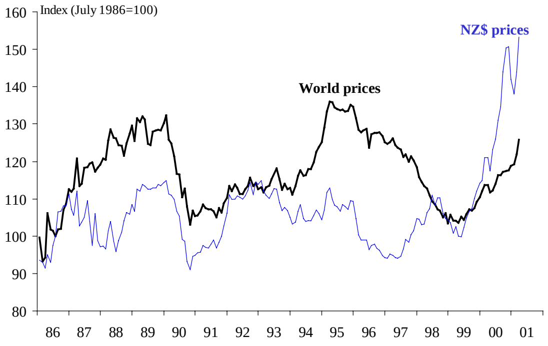
Source: Statistics NZ

While weaker business confidence poses a risk to growth over the year ahead, the export sector appears to remain in relatively good shape at present. Commodity prices in world markets continued to edge up in March and returns were at their highest ever level in NZ$ terms. Export earnings have been growing at an annual rate in excess of 20% in recent months and while growth is tapering off, it is not doing so abruptly.

Moreover, NZ exporters have continued to accrue significant gains in earnings from most major markets including the US, Europe, Asia, Australia and even Japan.

Export prices have been at record levels

ANZ export commodity price index



Source: NZEconomics@ANZ.

Prices for some products have eased on the back of slower global industrial production. However, prices for many food items, including meat and dairy products, have continued to post gains (in some cases due to factors connected with the recent BSE scare and the outbreak of foot and mouth disease in Britain). History shows that the correlation between world economic activity and New Zealand's commodity prices has been quite loose in practice with plenty of episodes in which prices have 'bucked the trend' and continued to hold despite slower global growth.

While history suggests that slower trading partner growth will have an impact on export demand, the negative effects have to be balanced against the stimulatory impact of a low NZ$ and other positive "supply" factors working to the advantage of many individual export industries – particularly for food. Looking back, New Zealand has previously managed to grow its export base in the midst of a global recession. The export expansion during 1991-1994 occurred despite a recession in many trading partners' economies. On that occasion, a falling NZ$ appears to have been the major catalyst for the export growth. It's worth pointing out that the fall in New Zealand's real exchange rate over the past two years has been much sharper than occurred over that period.

Aside from merchandise exports, the tourism industry has continued its stellar performance. This has no doubt been assisted by relatively strong world growth over the past couple of years underpinning the incomes of potential visitors and the competitiveness gains provided by NZ$ weakness – combined with the profile raising influence of events such as the America's Cup and (peripherally) the Sydney Olympics. Encouragingly, not only have visitor numbers increased markedly from their post- Asian crisis lows, but also the amount that individual tourists are spending has increased by an average of 15% over the past year. While growth is expected to slow the presently low NZ$ should enable tourism to make a positive contribution to the economy over the year ahead.

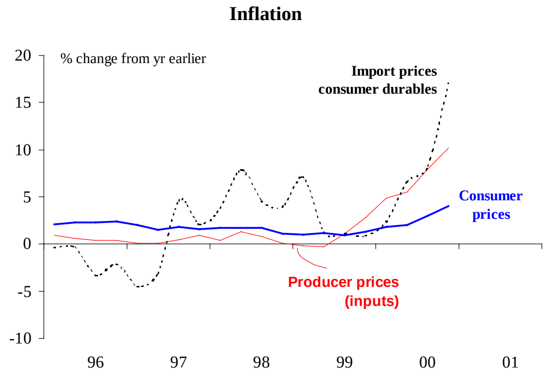
In summary, while the NZ economy appears to be in relatively good shape at present to withstand a slowdown in global growth, there are signs that business confidence may be faltering given the softer international climate. Even if external trade continues to contribute positively to economic growth, a fall confidence is a risk to economic performance overall.

Inflation heads higher

Meanwhile, question marks still remain over the medium term inflation outlook. After steadily rising through 2000, annual CPI inflation spiked to 4.0% in December – technically breaching the Reserve Bank's 0-3% target band (although given that this is expected to be a relatively short-lived breach, the Minister of Finance has indicated that he is comfortable with this). The direct impact of NZ$ weakness and high oil prices have driven much of the increase in inflation over the past year. Yet the most recent CPI data suggests that price increases have become more widespread, with some unexpectedly strong price pressures evident in the services sector.

Indeed "core" inflation has picked up to about 2½% from around 1¼% a year ago and rising activity at a time when the economy's spare capacity is relatively limited potentially jeopardises the medium term inflation outlook. More recent indicators have further reinforced this concern. Food prices have risen almost 6% over the past 12 months. While both the RBNZ and the market (rightfully) looks through short term wobbles in the Food Price Index, there have been some worrying signs in recent months of a trend pick-up in inflation within the generally more stable grocery and service-related categories. Experience shows that in times of robust activity, higher rates of inflation in the services sector are unlikely to abate rapidly – and can thus contribute a core of ongoing inflation pressure.

The RBNZ will remain uneasy about inflation



Sources: Statistics NZ.

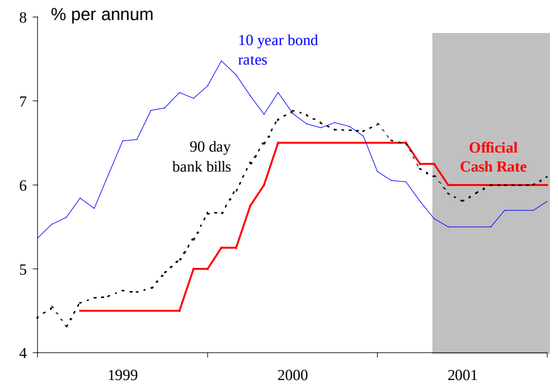
Wage inflation has remained relatively well contained to date, with private sector ordinary time average hourly earnings (the RBNZ's preferred measure of wage inflation) rising just 0.4% between August and November and by 2.6% over the year to November. But as suggested by the sharp fall in the unemployment rate over the past year, the labour market has tightened considerably and there are widespread reports of skill shortages. These shortages have been exacerbated by high rates of migration, which have seen New Zealand lose large numbers of professionals and tradespeople over the past few years.

Our analysis, based on the experience of the mid 1990s, shows that it takes upwards of 18 months for a tightening labour market to become reflected in higher wage movements. The potential impact of high headline CPI inflation on wage demands and the arguably more "union friendly" industrial relations environment created by the passage of the Employment Relations Act, suggests that the impact of a tighter labour market cannot be ignored. Risks to wage inflation over the year ahead are clearly on the upside.

Assisted by the introduction of income-related rents for state housing tenants in late 2000 (which is expected to shave around 0.6% off March quarter CPI), annual CPI inflation is expected to fall back within the RBNZ's 0-3% target band by late 2001. Yet this outlook is by no means assured – recent business surveys still show large balances of firms expecting to raise prices in the near future (though the proportions are falling). This is not surprising given the significant cost pressures, which remain in the pipeline following a year of NZ$ weakness and high oil prices – pressures which saw annual producer input price inflation accelerate to a 13 year high of 10.8% in late 2000.

RBNZ will cut rates a little further

Wholesale interest rates



Sources: Reuters; NZEconomics@ANZ

RBNZ cuts rates, but not as much as others

In spite of these pressures, the RBNZ cut the Official Cash Rate (OCR) by 25 points at the March Monetary Policy Statement. It appears that further weakness in the Australian economy and ongoing plunges in global equity markets in the week leading up to the MPS prompted a last minute rate cut decision. Moreover, the Bank has adopted a more optimistic view regarding the inflation outlook. The RBNZ expects the recent spike in inflation (which saw CPI inflation hit 4% in the year to December) to abate more rapidly than at the time of the December MPS, with inflation expected to be back down to 1.5% by March 2002. We believe the RBNZ's inflation story takes insufficient account of weak productivity growth, a tight labour market and the pipeline inflation pressures associated with high import prices.

For the moment though, it appears likely that world economic developments will dominate the RBNZ's decision-making. We are unlikely to have seen the last of the negative global economic news and the associated risks for the NZ export outlook suggest the OCR is likely to be cut further by perhaps another 25-50 points over the months ahead. But with the economy to date holding up better than those of trading partners lingering concerns about the inflation outlook mean it is unlikely that the OCR will be cut by the same magnitude as official rates in other countries such as the US and Australia.

NORTH-SOUTH KOREA RELATIONS

Breakthrough in North-South Relations

South Korean president, Kim Dae-jung's "sunshine" policy of engagement with North Korea, pursued since 1998, has helped to foster bilateral ties. The thawing of relations was reinforced by the unprecedented summit between North and South in June 2000 aimed at reconciliation. The subsequent temporary reunion of some families who had had virtually no contact since the Korean War and the North's increased need to end its isolation, have enhanced the prospect of a reunification of the two Koreas, similar to that of West-East Germany.

South Korea has indicated that it will provide more aid for infrastructure improvements, food, fertiliser, and other forms of assistance. In the South Korean budget for 2001, the amount allocated for economic projects involving North Korea was set at KRW500 bn (approx. US$400 mn). This includes funds for construction work to reconnect a railway and road between the South and North as well as food aid. Both sides have agreed to sign pacts on the treatment of investment guarantees and avoidance of double taxation to lift investments.

The major powers have welcomed the dialogue between the two Koreas although the Bush administration seems more sceptical about the process than the Clinton one. The US eased economic sanctions against the North in June 2000, paving the way for financial, trade and investment transactions. North Korea's efforts at engagement have been increased with the establishment of diplomatic relations with several countries (eg. Australia, UK, Canada, Spain, Germany). Normalisation talks between North Korea and Japan were suspended in October 2000 but could resume later this year. Japan has, however, promised aid in the form of 500,000 tons of rice. Ties with Russia, a patron of North Korea until the collapse of the Soviet Union in 1991, have improved. Relations with China, which were strained after China established diplomatic ties with South Korea in 1992, have also improved. Nevertheless, the international community remains cautious given that similar hopes of better inter-Korean relations in previous periods (1971-73, 1984-85, 1990-92) had been undermined. Moreover, concerns remain over North Korea's missile development program.

Greater co-operation bodes well for both

The process towards greater co-operation provides advantages for both the North and South. For North Korea, food shortages caused by floods and drought over the past decade, energy shortages, and a deteriorating industrial base, have underscored the urgency for financial and technical assistance to help rehabilitate its economy.

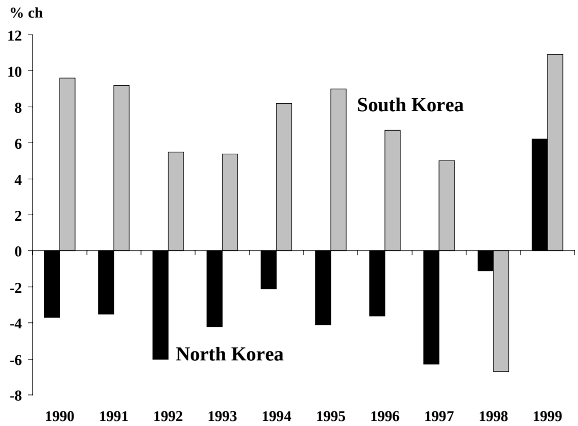
North Korea's industrial structure

1999	Real % ch	% sh. Of nom. GDP
Real GDP	6.2	
Agriculture, forestry & fishing	9.2	31.4
Mining & Manufacturing	9.9	25.6
Construction	24.3	6.1
Electricity, gas & water	6.8	4.5
Services	-1.9	32.4

Sources: Bank of Korea (South), JPMorgan

After a decade of negative growth, real GDP grew by an estimated 6.2% in 1999, reflecting a rise in food production and international economic assistance in the form of food, fuel and pharmaceuticals which helped the country to adopt new cultivation methods and lift industrial output. Real GDP was, however, only 75% of the level achieved in 1989 and nominal national income per capita was US$714, about one-twelfth that of the South and, matching the level the South achieved in 1976. Serious energy and food shortages continue to undermine economic development.

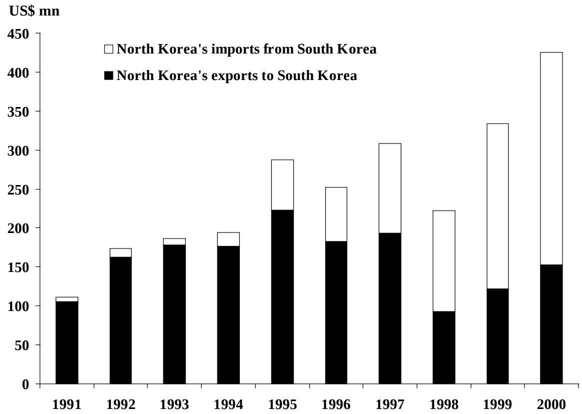
Economic Performance in the 1990s



Sources: Bank of Korea (South), Ministry of Unification

Total trade between North and South Korea has grown substantially, although there has not been a steady increase. A further improvement is, however, anticipated in the wake of the breakthrough in relations. Total inter-Korean trade was estimated at US$425 mn in 2000.

Total trade between North and South



Source : Ministry of Unification

For the South, further progress in diplomacy could lead to a potentially large reduction in military spending reflecting a diminished threat of political instability on the peninsula. Nevertheless, this is unlikely to be a near-term prospect given that the two Koreas are still technically in conflict as the 1950-53 Korean War ended with an armistice rather than a permanent peace treaty. The defence budget for 2001 is KRW15.4 tn (approx. 15% of the total budget). Personnel expenses account for around 42% of the defence budget.

Selected South Korean investments in the North

Samsung	Computer software development venture. Colour TV production on consignment. Plans to promote development of an industrial park for home electronics.
Hyundai	Operating tours to Mt. Kumgang. Plans to develop an industrial park.
Daewoo	Producing jackets, shirts, bags on consignment.
LG	Producing TVs on consignment. Plans to look for infrastructure projects.

Sources: Nikkei Weekly (June 2000), AWSJ articles

On the economic front, inadequate infrastructure in the North provides vast opportunities for construction companies. A report by Samsung Economic Research Institute indicated that about KRW10 tn (US$8.9 bn) would be needed to build road and rail links, industrial complexes and ports, as well as power generation and communication facilities, providing the basic infrastructure to expedite inter-Korean business. The cultural and language similarities, relatively low-cost labour (average wages in the North are about one-tenth that of the South), rich natural resources and proximity to the large markets of China and Russia are likely to prompt manufacturing companies to consider the North as an alternative production site. Some South Korean firms have already established joint ventures in the North and are seeking to develop industrial parks to accommodate production on a larger scale. For instance, an agreement was reached in August 2000 between Hyundai and North Korea to build an industrial complex in Kaesong to house businesses in hi-tech (eg. electronics) and labour-intensive (eg. footwear, clothing) fields. Foreign investors are likely to help finance this project.

While there are ample manufacturing investment opportunities in the North, the risks/obstacles to doing business require investors to adopt a long-term perspective. Although labour costs may be inexpensive, freight costs are likely to be high given the underdeveloped road/rail network and port facilities. In addition, legal arrangements to protect investments and avoid double taxation, as well as dispute resolution mechanisms, need to be put in place and effectively implemented to alleviate investor concerns. An agreement encompassing these issues has been signed but has not been ratified by either parliament, as yet.

Apart from the risks, the current weak financial health of South Korean conglomerates makes it difficult for the corporate sector to invest heavily in the North Korean market and withstand likely losses, which could last a few years. For instance, since embarking on the tourism development project in Mt Kumgang in November 1998, Hyundai, which signed an agreement promising US$942 mn in fees through March 2005, has spent over US$600 mn including: monthly fees of US$12 mn for the right to run the tours, infrastructure support and operation of the cruise ships. However, it has earned only just over US$200 mn from the business as tourist arrivals to the region have not reached expected levels. With the difficulty in obtaining financial assistance from other Hyundai affiliates, given their weak financial positions (the key backers of the tourism project being Hyundai Engineering & Construction and Hyundai Merchant Marine Co), Hyundai Asan Corp, the group's North Korean business arm, has sought to reduce monthly fee payments by half, with the difference to be paid at a later date. The North Korean authorities have, however, refused this request thus far. Hyundai Asan Corp. has approached its creditors for a KRW50 bn emergency loan, underscoring the serious liquidity situation. However, this project is seen as a symbol of inter-Korean business and both governments could be expected to be reluctant to see the project fail.

Reunification: a longer-term consideration

The path to one-Korea is fraught with challenges. First, the economic disparity between the two countries would mean hefty expenditure on the part of the South. North Korea's population relative to the South's (about half that of the South), is much larger than was East Germany's relative to West Germany's (about a quarter of that of the West). The gap between per capita living standards in the two halves of the Korean peninsula is more than six times larger than was the corresponding difference between East and West Germany at the time of their reunification. Moreover, the potential pressure on South Korea's fiscal and external balances is made more onerous by the heavy financial costs South Korea has had to bear to revive its own economy and deal with ongoing financial and corporate sector problems. Reunification costs have been estimated to range between US$1-3 tn to bring the North Korean economy to the level of the South within a decade.

North and South Korea : a comparison

1999	**North**	**South**
Land Area (sq.km)	122.8	99.4
Population (mn)	22.1	46.9
GNP (US$ bn)	15.8	402.1
GNP per capita (US$)	714	8,581
Energy industry		
Coal production (1000 tons)	21,000	4,200
Actual power generation quantity (bn kWh)	18.6	239.3
Oil imports (1000 tons)	320	118,160
Agriculture		
Grain (1000 tons)	4,222	6,000
Industry		
Automobiles (1000 vehicles)	7.3	2,843
Steel (1000 tons)	1,243	41,042
Synthetic fibre (1000 tons)	27	2,585
Infrastructure		
Rail (km)	5,214	6,683
Road (km)	23,479	87,534
Port capacity (mn tons)	35	417.6

Source: Bank of Korea (South)

Second, policies or measures which are perceived to threaten North Korea's sovereignty are likely to be unacceptable. North Korea has favoured central planning and it remains to be seen whether or when it will adopt market rules. There are signs that President Kim Jong-il is interested in the Chinese reform model of economic liberalisation accompanied by tight political controls.

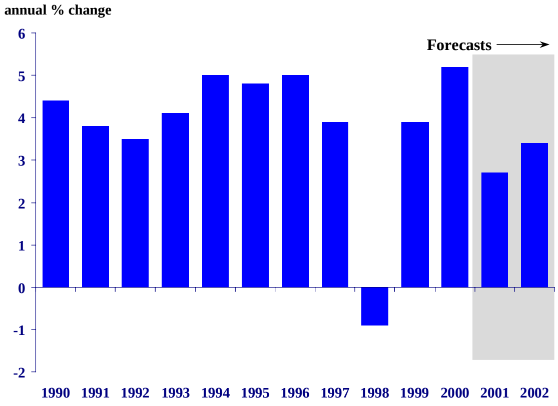
Third, international attitudes to North Korea will also influence inter-Korean ties, notably, the complexion of US-North Korean relations under the new Bush administration. Its current "review" of policy towards the North is seen as a precursor for the adoption of a more demanding stance than that of the Clinton Administration. Meanwhile, frustrated by delays in the construction of two light-water reactors undertaken by a US-led consortium to replace existing nuclear reactors in accordance with a 1994 agreement with the US, and in reaction to the US policy review, North Korea has flagged that it may scrap a moratorium on long-range missile tests and revive its nuclear program, which is suspected of supporting weapons development. Ultimately, any significant improvement in North Korea's progress in relations with the international community will depend on its willingness to improve transparency and demonstrate adherence to agreements relating to nuclear and missile issues.

Fourth, President Kim Dae-jung's term ends in February 2003 and he is unable to seek another term (presidential elections are due in December 2002). As it stands, Mr Lee Hoi-chang, leader of the main opposition Grand National Party, appears to be the favourite for President with President Kim's party, the Millennium Democratic Party, unlikely to find a candidate who commands the same presence as the President. While the opposition political parties in the South are not likely to backtrack on the policy of engagement, any lack of reciprocity on the part of the North would be weighted more heavily by them. Consequently, a less conciliatory approach could be adopted, which would be likely to slow the pace of progress toward reunification.

The above points demonstrate only a few of the challenges full integration presents. To avoid a costly reunification, South Korea is likely to encourage the North to adopt market reforms, which in turn would draw more investments and help to improve its economic prospects and narrow the income disparity between the two Koreas. Expanding economic relations against the backdrop of reduced military tensions, but with the preservation of two different political systems, is likely to best suit both governments over the medium term. Reunification is therefore only likely as a longer-term consideration.

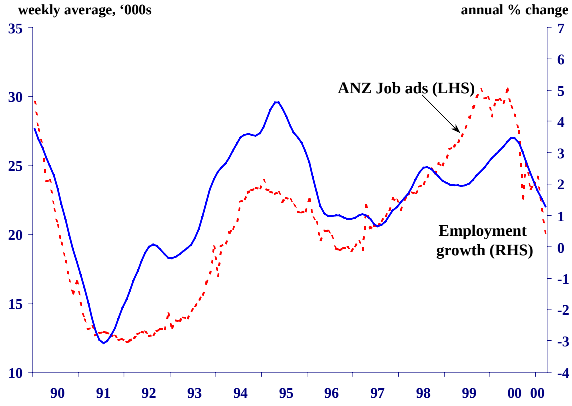
ECONOMIC CHARTBOOK

Major trading partners growth



Source: ANZ forecasts

The labour market

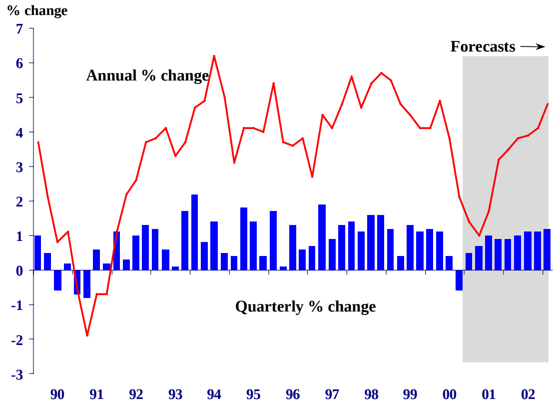


Source: ABS Cat. No. 6202.0 and ANZ

Growth in Australia's major trading partners (MTP) is expected to slow sharply from 5.2% in 1999-00 to 2.7% in 2000-01. While most forecasters anticipate a "V-shaped" recovery in the US, a more protracted downturn appears increasingly likely. The outlook for Japan is even more perilous with the renewed prospect of slipping back into recession. Non-Japan Asia has also been downgraded given slowing domestic demand, political uncertainties and reduced export growth following the sharp slowdown in global semi-conductor sales and related products. MTP growth is expected to recover to 3.4% in 2002.

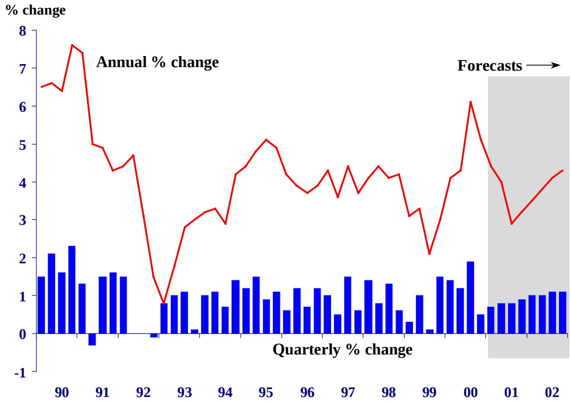
ANZ's job ads series fell by 7.9% in month of March, following a decline of 10% in February. This is the largest two-month fall since the August-September interval of 1982 and the largest year-on-year decline (32.8%) since August 1991. The decline in employment foreshadowed by the job ads series has begun to materialise with a 36,500 loss in employment in the six months to February. As a consequence, the unemployment rate has edged up from a low of 6.3% in October to 6.9% in February. Given the recent declines in job ads, the unemployment rate is expected to approach 7.5% by mid-year.

Australian economic growth



Source: ABS Cat. No. 5206.0 and ANZ forecasts

Average wage growth

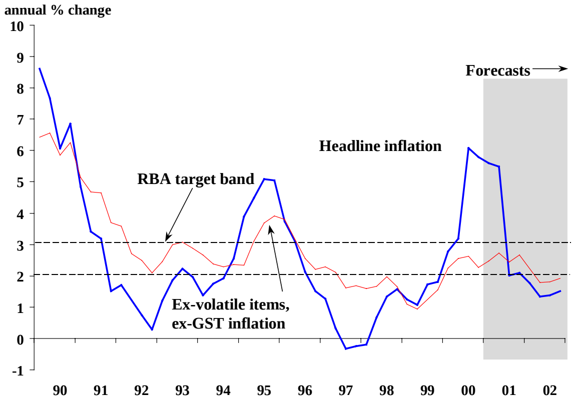


Source: ABS Cat. No. 6302.0 and ANZ forecasts

Economic growth in the December quarter fell 0.6%, taking the annual rate to 2.1%. This decline can be largely attributed to the distortionary impact of the GST, in general, and on the construction industry in particular. The lagged impact of higher interest rates, a post-Olympic lull in expenditures, and surging imported input costs were also contributing factors. While the housing industry is expected to recover by mid-year and public spending is expected to remain strong, weak business investment intentions, an unwinding of stocks, and slowing global growth will restrict growth to 2% in 2000-01.

AWOTE increased 0.5% in the December quarter, however, full-time earnings declined by 0.3% in the quarter, implying a sharp drop in overtime. This is the first time that a decline in overtime earnings has more than offset the rise in AWOTE since mid-1992. Although wage earners appear in an excellent bargaining position given the high profit share of national income, the profit cycle turned dramatically in the December quarter. This should strengthen employers' resolve to resist wage increases, while rising unemployment should see job security override wage demands. AWOTE is forecast to average growth of 4.1% in 2001.

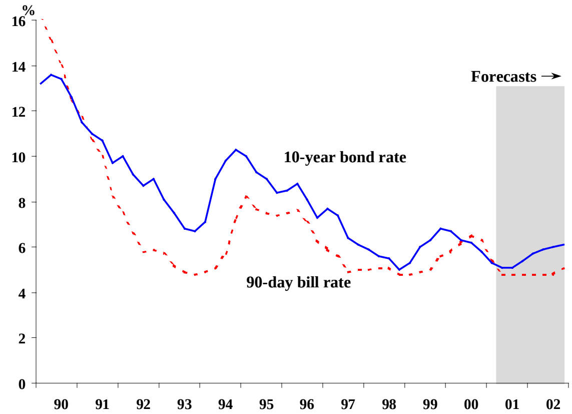
Consumer price index



Source: ABS Cat. No. 6401.0 and ANZ forecasts

The prospect of continued falls in petrol prices over the remainder of 2001, combined with weak domestic demand, prompted the RBA when cutting rates in March to declare "the risks of inflation exceeding the target in the foreseeable future are low". However, further falls in the currency have exacerbated the rise in imported input prices. The risk is that firms that were willing to endure a temporary rise in costs are now faced with the need to protect margins by passing on price rises, although these will be partly mitigated by cost reductions from the GST. Inflation is forecast to average 3.3% over 2001.

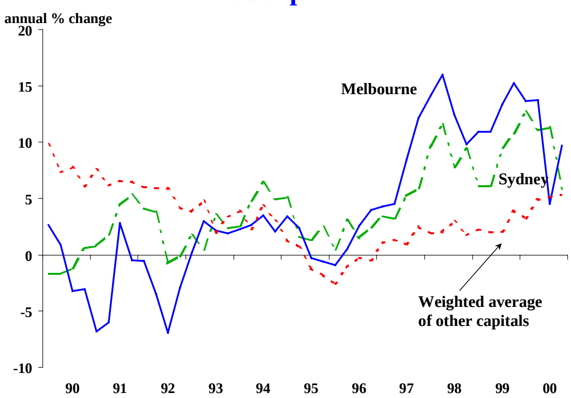
Interest rates



Source: Reuters and ANZ forecasts

The RBA's concern over the upside risks to inflation during 2000 has given way to concern over downside risks to growth. The RBA has cut its official cash rate in three successive months by 125 basis points since the beginning of February. A relatively sanguine domestic inflation outlook and easing global interest rates provided the RBA with the scope to cut interest rates. The pressure for an additional 25 basis points cut in the cash rate by the September quarter is expected to come from rising unemployment, declining corporate profits and a deterioration of Australia's export prospects.

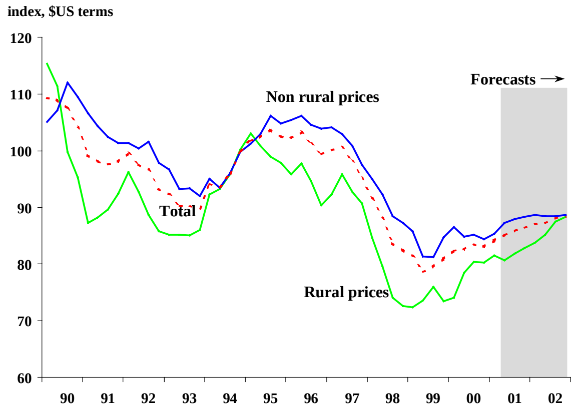
House prices



Source: ABS Cat. No. 6416.0

Established house prices rose by 2.4% in the December quarter, assisted by a sharp rebound in Melbourne house prices. In the year to December, house prices have risen 6.6%. House prices gains may well have been higher given the first home-buyer's scheme continues to place a downward bias on prices. House prices have been buoyed by sharply lower interest rates, and at the margin, by the boost to household income from the ANTS compensation package. However, declining rental yields, slowing domestic activity and high house prices to income ratios for the Sydney and Melbourne markets suggest house price rises should begin to moderate.

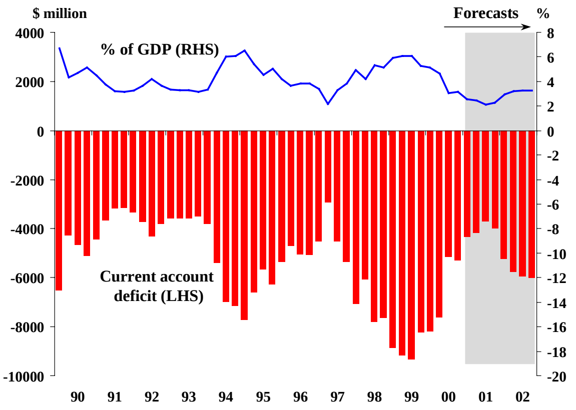
Commodity prices



Source: Reserve Bank Bulletin and ANZ forecasts

Slowing global demand will adversely affect prices received for commodities sold on the spot market during 2001, however, large negotiated price rises for contract bulk commodities (iron-ore, coal, alumina) will ensure a spike in the RBA commodity price index from the beginning of the Japanese financial year in April. In US$ terms commodity prices have risen 2.1% in the year to March, assisted by a 10% rise in rural commodity prices. The weakness in the currency has amplified these price gains in A$ terms to a 21.5% rise through the year to March. Modest price gains are expected in US$ terms in 2000-01 and 2001-02 with commodity prices forecast to rise 3.2% in both years.

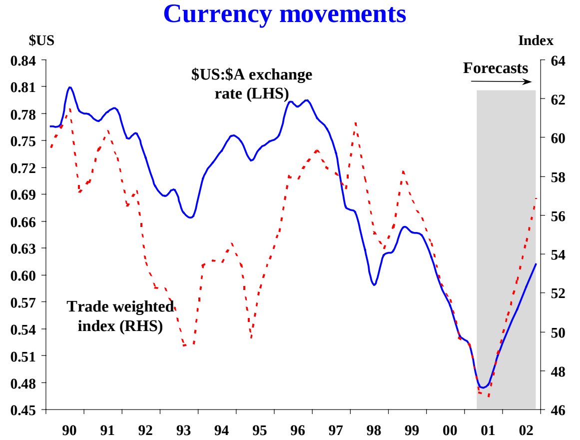
Current account



Source: ABS Cat. No. 5206.0 and ANZ forecasts

Australia's trade balance moved into surplus in February, the first "non-Olympic" surplus since November 1997. A super-competitive currency, in conjunction with the GST exemption for exports, has enabled Australian exporters to gain a greater share of global demand, despite the fact that global demand is slowing. Weak domestic demand and surging import prices restricted import volumes in H2 2000; a trend expected to continue in H1 2001. The current account deficit is expected to improve from the 4% of GDP averaged in 2000 to average 2.3% of GDP in 2001.

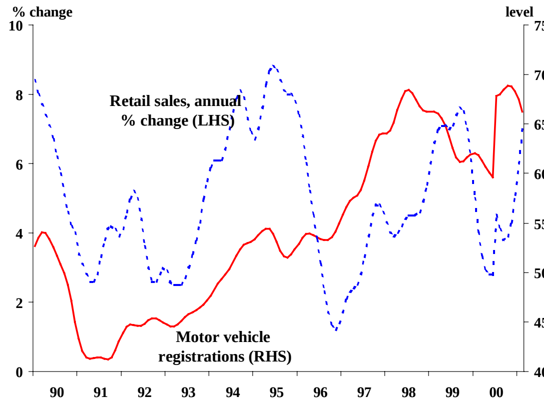
Currency movements



Source: Reuters and ANZ forecasts

The A$ has continued to strike new lows below US50¢, largely in response to continued strength in the US$, which has in turn occurred despite on-going falls in US share prices. Although an eventual correction in the US$ is expected the timing is difficult to 'pick', and may require acceptance by investors that the US will not have a 'V' shaped recovery. The A$'s more recent weakness is also partly attributable to the unexpected shortfall in Australian economic growth relative to expectations, falls in commodity prices, heightened political uncertainty and the move towards populist policies. These developments may keep the A$ in a range around or below US50¢ for much of this year.

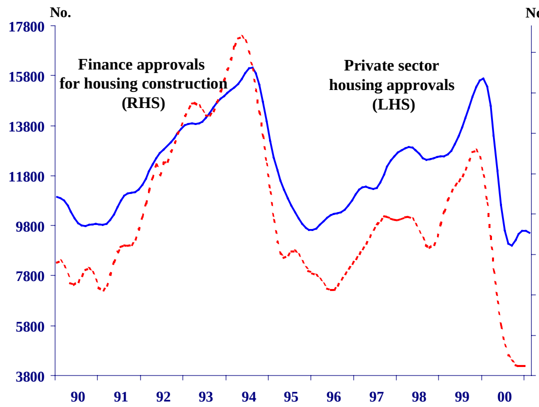
Retail sales and motor vehicle registrations



Source: ABS Cat. No. 9301.0 and 8501.0

Real retail sales declined by 1.2% in H2 2000. Further real declines appear unlikely given nominal retail sales have rebounded by 2.4% in the first two months of 2001, supported by declining interest rates and the boost to household incomes from the GST compensation package. Retail sales are also likely to be supported by a shift of expenditure from motor vehicle purchases. Motor vehicle registrations have declined by 1.7% in the year to February following falls of 11.1% and 6.8% in the months of January and February. Given historically high numbers of registrations further declines appear likely in H1 2001.

Housing sector approvals and finance



Source: ABS Cat. No. 8731.0 & 5609.0

New dwelling approvals have fallen by 44% in the year to February, the largest fall and the lowest level of approvals in the series' 16 year history. Clearly the distortions surrounding the introduction of the GST compounded the normal cyclical peak evident in housing approvals, and consequently have amplified the downturn. Continued falls in approvals for units and conversions have been the major contributor to a decline in approvals since the beginning of 2001, particularly in the NSW. Nevertheless, in trend terms house approvals have risen in each of the five months to February suggesting the recovery in housing construction will materialise by mid-2001.

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FORECAST TABLE

	Quarterly % change						Annual % change				
	Sep-2000	Dec-2000	Mar-2001	Jun-2001	Sep-2001	Dec-2001	1998/99	1999/00	2000/01	2001/02	2002/03
	← actual		forecast →				← actual		forecast →		
GDP	0.4	-0.6	0.5	0.7	1.1	1.2	5.3	4.4	2.1	3.4	4.2
- Final demand	-0.6	-1.2	0.6	1.0	0.8	1.1	5.3	5.1	0.4	3.2	4.7
- Stocks	0.1	0.8	-0.9	-0.1	0.2	0.2	0.8	-0.2	-0.3	0.1	0.1
- Net exports	0.6	0.2	0.7	0.2	0.2	-0.1	-0.7	-0.9	1.5	0.5	-1.0
CPI	3.7	0.3	0.7	0.8	0.4	0.4	1.3	2.4	5.8	2.0	1.7
Wages (ordinary time earnings)	1.9	0.5	0.7	0.8	0.8	0.9	0.3	0.6	0.8	0.5	0.7
Employment	1.0	-0.4	0.2	0.1	0.3	0.4	2.1	1.2	2.1	1.9	1.6
Unemployment rate (%)	6.4	6.5	6.7	7.1	7.1	7.4	6.7	7.0	6.8	6.6	6.8
Current account deficit ($b)	-5.2	-5.3	-4.3	-3.9	-3.8	-4.4	-33.5	-33.4	-18.7	-18.9	-24.9
- % GDP	-3.1	-3.2	-2.6	-2.3	-2.2	-2.5	-5.6	-5.3	-2.8	-2.7	-3.3
90 day bank bills (%p.a.)	6.5	6.3	5.4	4.8	4.8	4.8	4.9	5.7	5.8	4.8	5.1
10 year bond rate (%p.a.)	6.2	5.8	5.3	5.1	5.1	5.4	5.5	6.5	5.6	5.5	6.2
US$/A$	0.57	0.53	0.52	0.48	0.48	0.51	0.62	0.62	0.52	0.52	0.61
Trade weighted index	51.6	49.7	49.3	46.8	46.5	48.8	55.6	54.8	49.3	49.6	56.3
World GDP **							2.5	3.4	4.8	2.9	3.7
Trading partners' GDP **							-0.9	3.9	5.2	2.7	3.4
(**calendar years)							(1998)	(1999)	(2000)	(2001)	(2002)