

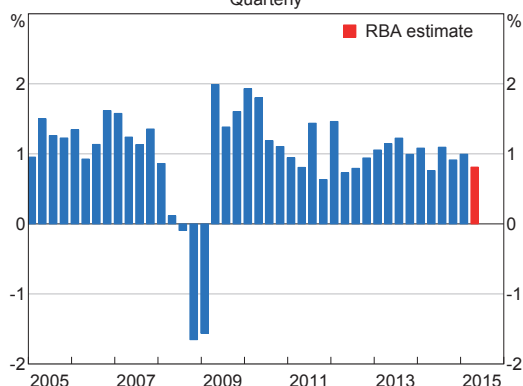
1. International Economic Developments

Economic growth in Australia's major trading partners (MTPs) remained around its long-run average in the first half of 2015 (Graph 1.1). Advanced economies have, in general, continued to recover, while growth in emerging economies has tended to ease over recent quarters. In China, economic activity, particularly in resource-intensive sectors, continued to moderate in the first half of this year and, in response, various policy settings have been adjusted to provide more support to growth. The Japanese economy has recovered since late last year, while growth in economies in the rest of the Asia-Pacific region has slowed to a little below its decade-average pace. The euro area economy has continued to recover gradually, while economic growth in the United States returned to the pace recorded at the end of 2014 following some weakness in the March quarter.

Growth in global trade looks to have eased over the first half of 2015, as has growth of global industrial production. Weakness in Chinese demand, in particular, contributed to a further decline in commodity prices in recent months.

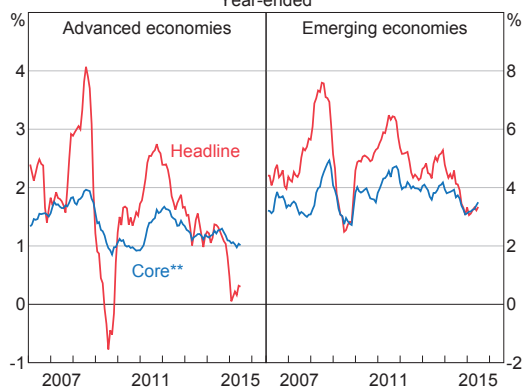
Following their sharp decline over the second half of 2014, oil prices are at a relatively low level. This is likely to continue to support growth in most of Australia's MTPs given that they are net energy importers. Much of the downward pressure on global headline inflation from lower oil prices has now passed, although it is still evident in year-ended inflation rates (Graph 1.2). Core inflation in advanced economies has remained relatively stable in year-ended terms and remains below the targets set by central banks in most economies.

Graph 1.1
Australia's Trading Partner Growth*



* Aggregated using total export shares
Sources: ABS; CEIC Data; RBA; Thomson Reuters

Graph 1.2
Global Inflation*



* PPP-weighted; sum of emerging and advanced economies accounts for around 80 per cent of global GDP

** Excluding food and fuel

Sources: CEIC Data; IMF; RBA; Thomson Reuters

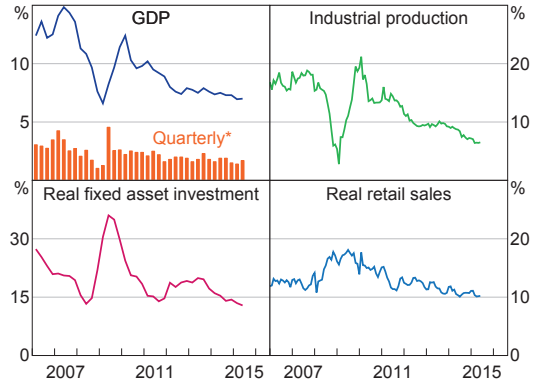
Asia-Pacific

In China, GDP growth increased in the June quarter, while year-ended growth remained at 7 per cent (Graph 1.3). However, there has been continued weakness in the industrial sector, slowing residential construction activity and lower growth of infrastructure investment. Consumption growth also looks to have been a bit weaker in the first half of 2015; growth rates for surveyed urban household consumption and real retail sales have eased, while automobile sales have declined. More accommodative monetary policy, including reductions of benchmark interest rates and reserve requirement ratios, together with the announcement of further approvals for infrastructure investment, should provide some support to growth in coming quarters.

Growth of industrial production has fallen further over the past six months, especially for construction-related products. Conditions in the steel industry have been subdued and are likely to remain so in the near term (Graph 1.4). Production of crude steel has been below earlier trends and domestic steel consumption appears to have moderated. Reflecting weak demand and subdued prices, domestic iron ore production has trended lower, and imports of iron ore, including those from Australia, have also declined over recent months.

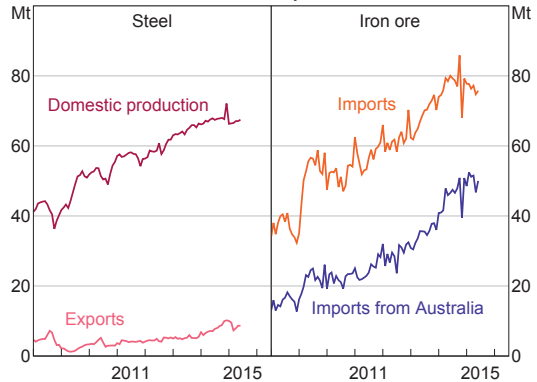
While infrastructure spending has slowed, it is growing faster than the other components of fixed asset investment. The authorities have announced several large-scale rail projects and have released a list of proposed infrastructure projects for funding via public-private partnerships. Most infrastructure investment is conducted and financed by local governments. In recent months, the Chinese Government has begun to implement a debt restructuring plan for local governments to lower their interest burden and control the overall stock of debt. The plan, which allows debt of local government financing vehicles to be exchanged for local government bonds at a significantly lower yield, has resulted in a sharp increase in local

Graph 1.3
China – Activity Indicators
Year-ended growth



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

Graph 1.4
China – Steel and Iron Ore
Monthly

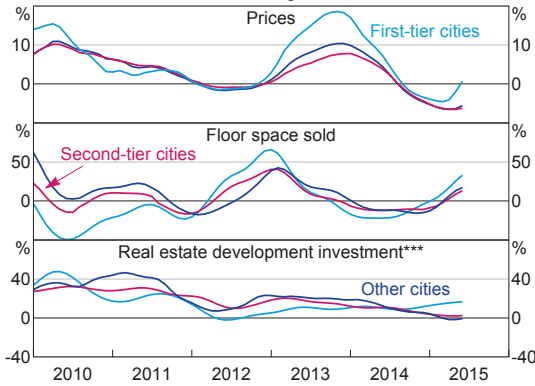


Sources: CEIC Data; RBA

government bond issuance. In June, the Chinese authorities announced that the value of debt that can be restructured under the plan had been doubled to ensure that local governments continue to have access to funding for infrastructure projects, particularly in an environment of falling land sales. The authorities have also urged banks to continue to lend to existing infrastructure projects.

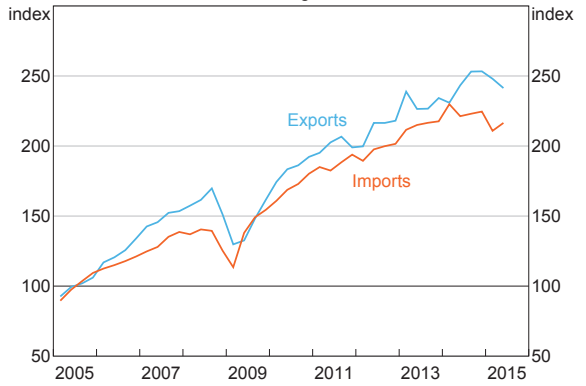
Conditions in the Chinese residential property market have improved somewhat since the start of the year (Graph 1.5). On average, Chinese housing prices have been rising in recent months, although the increases have been concentrated in the larger

Graph 1.5
China – Residential Property Market*
 Year-ended growth**



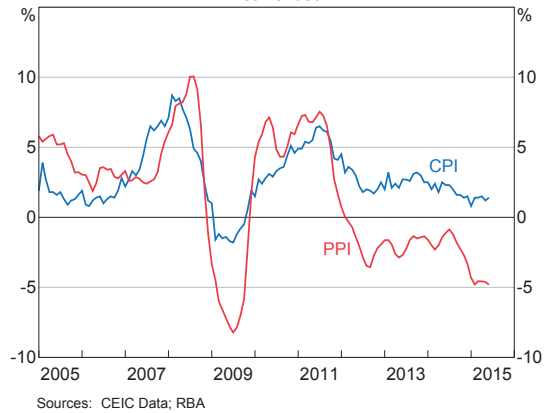
* The share of investment and floor space sold for first-tier cities is less than 10 per cent; second-tier cities' share is less than 30 per cent
 ** The trend series for floor space sold and investment is used to calculate growth
 *** Investment by developers and other construction companies in the development of residential property; includes land purchases
 Sources: CEIC Data; RBA

Graph 1.6
China – Merchandise Trade Volumes*
 2005 average = 100



* Seasonally adjusted by RBA
 Sources: CEIC Data; RBA

Graph 1.7
China – Inflation
 Year-ended



Sources: CEIC Data; RBA

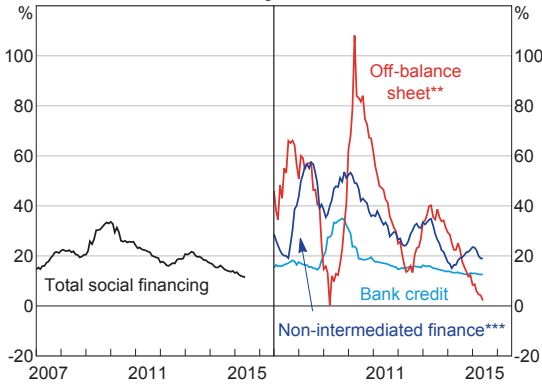
cities and conditions in smaller cities remain weak. In response to the decline in property prices since mid 2014 and more accommodative policy settings, the volume of floor space sold has expanded strongly over the past few months and inventory-to-sales ratios have eased in many cities. However, stronger growth of sales is yet to translate into a noticeable pick-up in residential construction. While real estate investment growth has strengthened in the first-tier cities, they accounted for only around 8 per cent of total residential real estate investment in 2014.

Imports have been weak in value and volume terms, which is in line with the moderation in growth of domestic investment and consumption (Graph 1.6). Exports, particularly to east Asia and the European Union, have edged lower since late last year. This is consistent with the broader decline in trade in the Asia-Pacific region.

Inflationary pressures in China remain subdued; CPI inflation has been well below the authorities' target of 3 per cent in 2015 (Graph 1.7). Producer prices have continued to decline, which in part is due to lower commodity prices.

Growth of total social financing (TSF) has moderated further, largely owing to a slowing in off-balance sheet financing activity (Graph 1.8). This slowing reflects weaker growth in demand for funding, the tightening of regulations on non-bank and off-balance sheet funding last year, and greater awareness among financial institutions of credit risks associated with more subdued economic growth. In contrast, growth of non-intermediated financing activity remained firm, partly supported by an increase in equity financing associated with the earlier boom in Chinese share prices. Despite the pick-up in new equity and secondary issuance,

Graph 1.8
China – Total Social Financing*
 Year-ended growth in stock



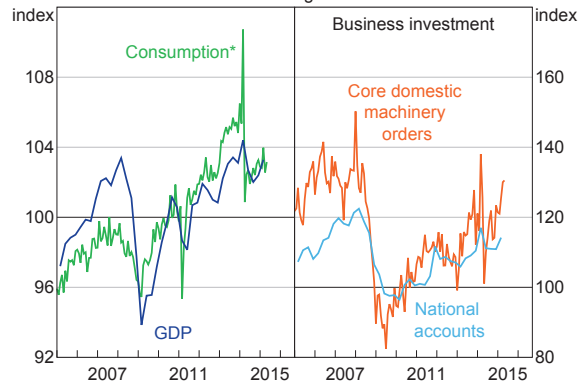
* RBA estimates
 ** Entrusted loans, trust loans and undiscounted bank acceptance bill issuance
 *** Corporate bond and equity issuance
 Sources: CEIC Data; People's Bank of China; RBA

equity finance remains small as a share of TSF (see the 'International and Foreign Exchange Markets' chapter and 'Box A: The Recent Decline in Chinese Equity Prices' for a discussion of developments in Chinese equity markets).

In Japan, economic activity has grown since late last year after having contracted following the consumption tax increase in the June quarter 2014 (Graph 1.9). Growth of business investment has increased this year, while growth of consumption has been more modest. Available data suggest that export volumes declined in the June quarter, having grown steadily since the middle of last year.

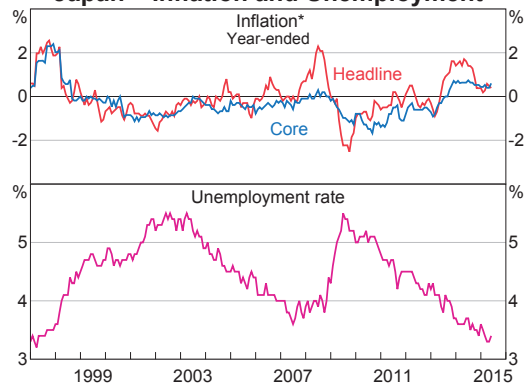
The Japanese labour market remains tight. The unemployment rate has declined further this year and is around its lowest level in almost two decades (Graph 1.10). Meanwhile, the ratio of job-offers-to-applicants has reached its highest level over the same period. These conditions have placed upward pressure on base wages, which are rising at a faster rate than they were a year ago. Although these developments point to some increase in domestic inflationary pressures, year-ended inflation remains lower than a year ago reflecting the fall in oil prices and the fading effects of the earlier depreciation of the yen. In recent months, both core and headline

Graph 1.9
Japan – Economic Indicators
 2010 average = 100



* The Cabinet Office's monthly measure of real private consumption
 Sources: CEIC Data; Thomson Reuters

Graph 1.10
Japan – Inflation and Unemployment



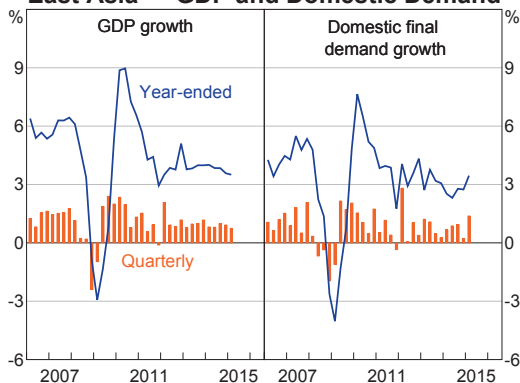
* Excluding the effects of the consumption tax increase in April 2014
 Sources: Bank of Japan; RBA; Thomson Reuters

inflation have stabilised but remain well below the inflation target of the Bank of Japan (BoJ). The BoJ has indicated that it expects to achieve its 2 per cent inflation target around the middle of 2016, which is a little later than it had previously expected.

In the rest of east Asia, growth has declined to be slightly below average in the first half of 2015. Early in the year, much of the slowing reflected weaker growth in exports within the region, while domestic demand growth remained robust (Graph 1.11). More recently, there have been indications that the growth of domestic demand has declined a little. Although the slowing in activity has been broad-based

Graph 1.11

East Asia* – GDP and Domestic Demand



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

across the region, some country-specific factors, such as public health concerns in Korea, have also contributed.

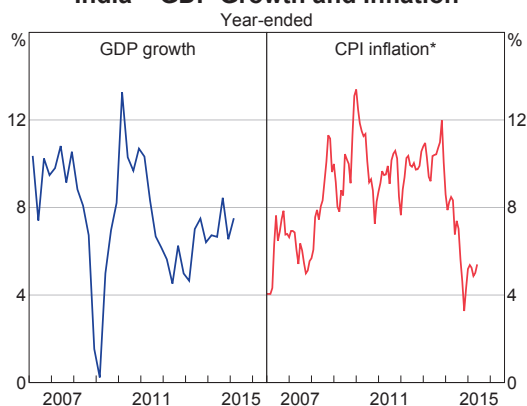
Headline inflation is low across most of the region due to the decline in global oil prices. Core inflation has been more stable than headline inflation, but is also at a low level. Several central banks in the region have eased monetary policy this year in response to the moderation in growth and subdued inflationary pressures.

GDP growth in India has been around 7 per cent over the past year, which is stronger than the growth rates recorded in 2012 and 2013 (Graph 1.12). Over the past year, growth of industrial production appears to have strengthened, while the agricultural sector has continued to contract. A range of other indicators, including project approvals, point to a further increase in the growth of investment in coming quarters. Meanwhile, consumer price inflation remains below the target set by the Reserve Bank of India (RBI) of 6 per cent for January 2016. The RBI eased policy in early June and referred to weakness in domestic consumption growth, weaker corporate sales and falling capacity utilisation.

In New Zealand, economic growth has moderated this year as rebuilding activity following the Canterbury earthquakes appears to have peaked and commodity prices have fallen sharply. The

Graph 1.12

India – GDP Growth and Inflation

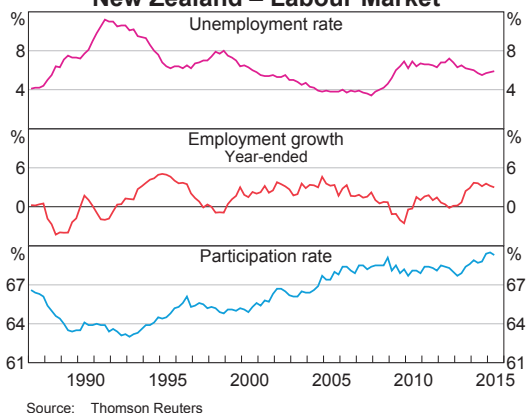


* Reserve Bank of India estimates prior to January 2012
Sources: CEIC Data; RBA; Reserve Bank of India

economy had expanded at an above-average pace over 2014, which was supported by the rebuilding activity, record-high net immigration and continued strength in the housing market. Employment growth has also been strong, while the participation rate and net migration have increased (Graph 1.13). Aided by the expansion in the supply of labour, wage and price pressures have remained subdued, and the Reserve Bank of New Zealand eased monetary policy in June and July.

Graph 1.13

New Zealand – Labour Market



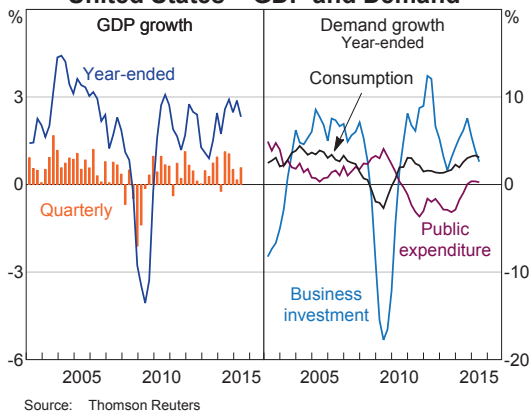
Source: Thomson Reuters

United States

The US economy grew at a moderate pace in the June quarter following temporary weakness

recorded early in the year (Graph 1.14). Household consumption continues to underpin growth in activity, although survey measures indicate that around half the boost to real incomes from lower oil prices has been saved rather than spent. In contrast, growth rates for industrial activity and investment have declined since last year; weaker activity in the energy sector accounts for much of this, although the appreciation of the US dollar since the middle of last year may also be having some effect.

Graph 1.14
United States – GDP and Demand

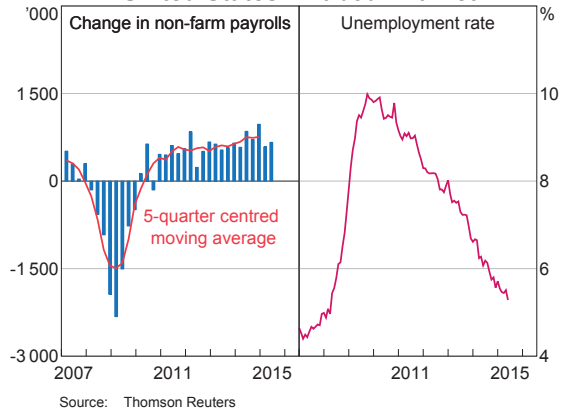


The ongoing expansion in economic activity has contributed to a further improvement in labour market conditions. The pace of employment growth rose in the June quarter following a moderation earlier in the year, and the unemployment rate has declined further (Graph 1.15). Other indicators of labour market slack have recovered more slowly.

Tightening conditions in the labour market appear to have led to some upward pressure on wage inflation. The employment cost index, a broad measure of wage growth, grew only slightly in the June quarter, after growth of wages had picked up over the previous year (Graph 1.16). Meanwhile, core inflation has remained relatively stable at around 1¼ per cent, and headline inflation has stabilised at a low level, reflecting the decline in oil prices and the appreciation of the US dollar. The Federal Open Market Committee reiterated that it is likely to begin

Graph 1.15

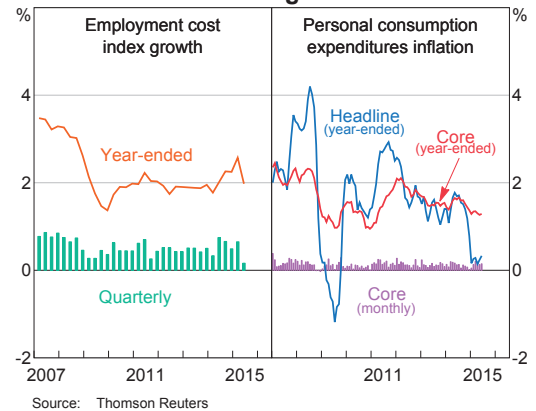
United States – Labour Market



Source: Thomson Reuters

Graph 1.16

United States – Wages and Inflation



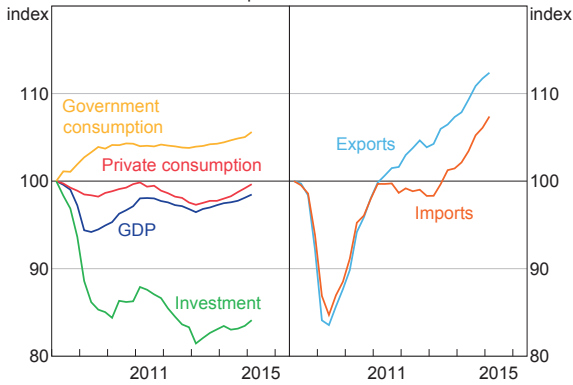
Source: Thomson Reuters

the process of raising interest rates before the end of the year.

Europe

In the euro area, economic activity continues to recover gradually. Over the past year, there has been a pick-up in the growth of consumption and investment. Private consumption has almost recovered to its pre-crisis level (Graph 1.17). Investment has increased of late, but it is not far above its low point of two years ago and is well below its pre-crisis peak. The depreciation of the euro since mid 2014 has supported the gradual increase in the rate of growth of exports; imports have grown with domestic demand.

Graph 1.17
Euro Area – GDP
March quarter 2008 = 100



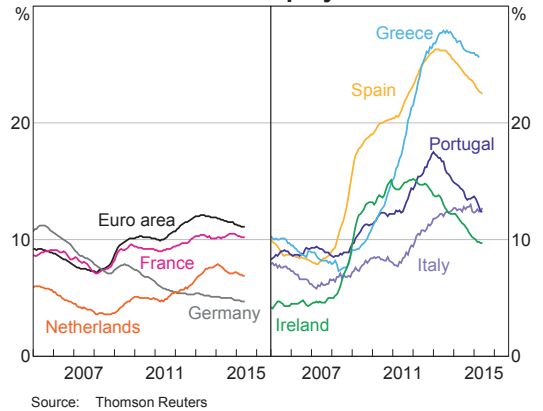
Source: Thomson Reuters

There has been little sign to date that developments in Greece have had a significant effect on economic conditions or confidence elsewhere in the euro area. Indeed, measures of consumer and business confidence are at above-average levels, and credit growth has picked up this year. However, in Greece itself, recent developments have no doubt led to a sharp contraction in economic activity, which in early 2015 was already more than 25 per cent below its level prior to the global financial crisis.

The euro area unemployment rate has continued to decline to be around a percentage point below its peak in mid 2013 (Graph 1.18). Much of the decline has been driven by falls in unemployment in Spain, Portugal and Ireland, where output growth has been above trend recently; in Greece, the decline in the unemployment rate can in part be explained by outward migration. However, unemployment rates generally remain very high, although the unemployment rate is relatively low in Germany.

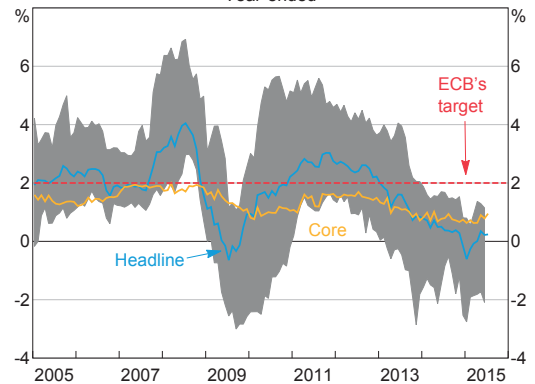
Inflation has increased since earlier in the year, although it remains well below the target of the European Central Bank (Graph 1.19). Longer-term inflation expectations have also increased but remain historically low.

Graph 1.18
Euro Area – Unemployment Rates



Source: Thomson Reuters

Graph 1.19
Euro Area – Consumer Price Inflation*
Year-ended



* Harmonised Index of Consumer Prices (HICP); shaded area represents range of individual euro area economies

Sources: RBA; Thomson Reuters

Commodity Prices

The RBA Index of Commodity Prices (ICP) has declined further in recent months. The decrease since the previous *Statement* was driven by declines in the prices of coal and base metals (Table 1.1; Graph 1.20). In SDR terms, commodity prices are around 20 per cent lower than a year earlier. The decline in bulk commodity prices contributed to a fall in the terms of trade of 3 per cent in the March quarter and of 11 per cent over the year to March.

There has been considerable volatility in the spot price of iron ore in recent months (Graph 1.21).

Table 1.1: Commodity Price Growth^(a)
SDR, 3-month-average prices, per cent

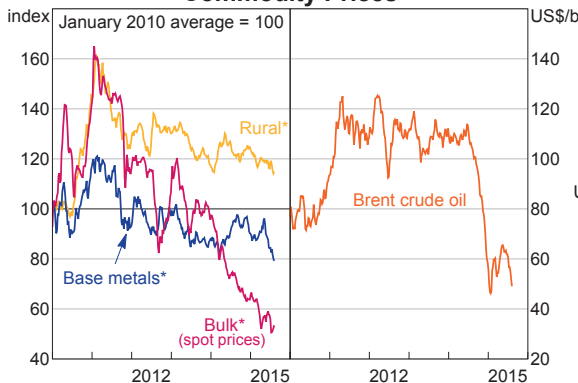
	Since previous Statement	Over the past year
Bulk commodities	-6	-26
– Iron ore	0	-34
– Coking coal	-18	-17
– Thermal coal	-5	-9
Rural	-1	-6
Base metals	-5	-6
Gold	-3	-1
Brent oil ^(b)	3	-45
RBA ICP	-5	-19
– using spot prices for bulk commodities	-5	-20

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

(b) In US dollars

Sources: Bloomberg; IHS; RBA

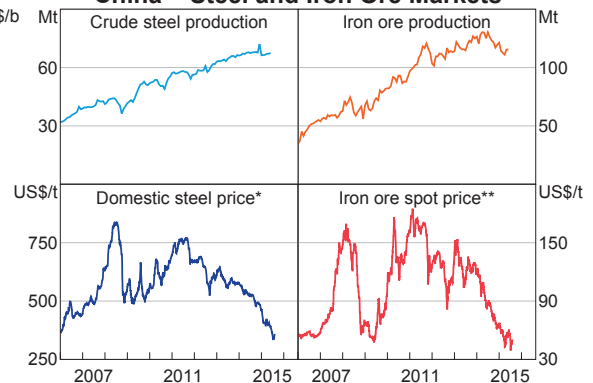
Graph 1.20
Commodity Prices



* RBA Index of Commodity Prices sub-indices

Sources: Bloomberg; RBA

Graph 1.21
China – Steel and Iron Ore Markets



* Average of hot rolled steel sheet and steel rebar prices

** Free on board basis

Sources: Bloomberg; CEIC Data; RBA

Optimism about further policy stimulus from Chinese authorities and a reduction in Chinese iron ore production led to a noticeable increase in the spot price of iron ore early in the June quarter. Concerns about the strength of the Chinese economy and, consequently, the demand for steel and iron ore have re-emerged, while global production of iron ore is expected to expand further over the next year or so. This contributed to a sharp fall in the spot price of iron ore to its lowest level in around 10 years in early July. The price has since picked up somewhat. Given

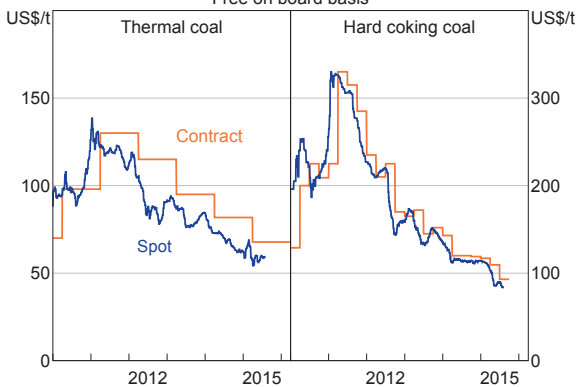
reductions in production costs over recent years, together with the depreciation of the Australian dollar, most Australian production appears to have remained profitable at current prices, although some smaller, higher-cost Australian producers remain under pressure.

Both the spot and contract prices of coking coal have fallen sharply in recent months, reflecting subdued growth in Chinese demand for steel. The spot price of thermal coal remains around 10 per

cent below the levels prevailing in the second half of 2014 (Graph 1.22). At current prices, a substantial share of global coal production is estimated to be unprofitable. Liaison suggests that some Australian producers have been considering whether to maintain production in light of lower profitability, although the recent depreciation of the Australian dollar has offset some of the weakness in US dollar prices.

**Graph 1.22
Coal Prices**

Free on board basis



Sources: Department of Industry and Science; IHS; RBA

The Brent crude oil price has fallen since the previous *Statement*, to be around 50 per cent below its average level of recent years (see Graph 1.20). Oil prices had risen early in the June quarter on the news of an easing of production and a decline in inventories, although prices have declined more recently in response to OPEC's decision to maintain its production quota, expectations that Iran will gradually increase its oil exports later this year, and concerns about Chinese economic growth. The decline in oil prices since mid 2014 is gradually being reflected in regional LNG prices, as LNG contracts are linked to the price of oil with a lag.

Base metal prices have, on average, fallen to their lowest level since 2009, which is consistent with the easing in the growth of global industrial production. The prices of nickel and aluminium have fallen particularly sharply since the previous *Statement*. ↘

