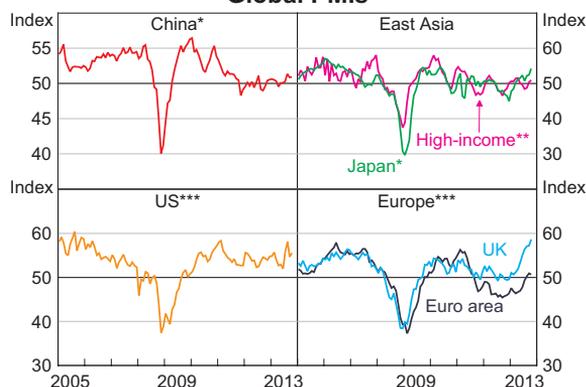


1. International Economic Developments

Growth in Australia's major trading partners in the September quarter looks to have been close to its average of the past decade (Graph 1.1). Economic conditions in China have picked up over the course of the year, with recent indicators suggesting that growth for 2013 will be around the authorities' target of 7½ per cent. In Japan, economic activity has strengthened noticeably since late last year, while in the rest of east Asia growth has been around its decade average. The US economy appears to have continued to grow at a moderate pace. There are signs that economic conditions in Europe have improved a little.

**Graph 1.1
Global PMIs**

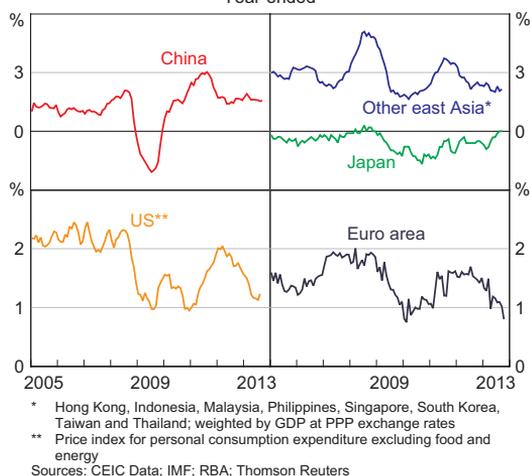


* Manufacturing PMI; China series seasonally adjusted by the RBA
 ** Manufacturing PMI; Hong Kong, Singapore, South Korea and Taiwan; weighted by GDP at market exchange rates; whole economy PMI used for Hong Kong
 *** Composite PMI; ISM prior to 2008 for US
 Sources: CEIC Data; Markit Economics; RBA; Thomson Reuters

Core measures of inflation have continued to ease in most advanced economies over the past few months, except in Japan where consumer prices are unchanged over the year after a long

period of deflation (Graph 1.2). Inflation in the euro area and the United States is now quite low, consistent with substantial excess capacity in these economies following an extended period of below-trend growth. Monetary policy remains highly accommodative in most advanced economies, but it has been tightened recently in a number of developing economies (see the 'International and Foreign Exchange Markets' chapter).

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

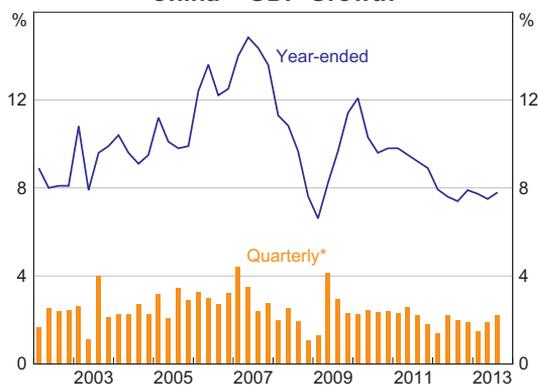


* Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand; weighted by GDP at PPP exchange rates
 ** Price index for personal consumption expenditure excluding food and energy
 Sources: CEIC Data; IMF; RBA; Thomson Reuters

Asia-Pacific

In China, GDP growth has picked up a little through 2013; GDP expanded by 2.2 per cent in the September quarter, to be 7.8 per cent higher over the year (Graph 1.3). While external demand remains subdued, domestic conditions have been comparatively strong. This is evident in the relatively

Graph 1.3
China – GDP Growth



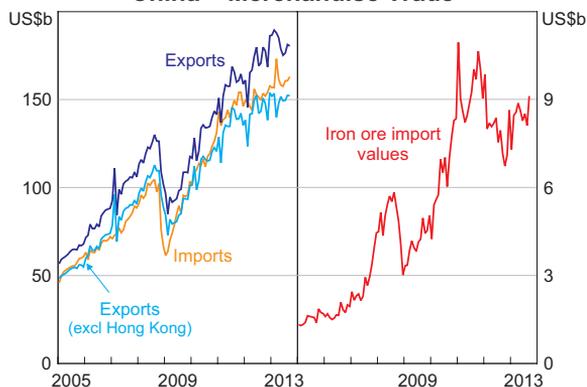
* RBA estimates prior to December quarter 2010
Sources: CEIC Data; RBA

high growth rates of investment in manufacturing and infrastructure, as well as strong retail sales. The growth of production has increased moderately across a broad range of industries, including for crude steel and steel products.

Export values contracted slightly in the September quarter (Graph 1.4). However, excluding exports to Hong Kong (which overstated the rise and subsequent decline in exports earlier in the year), exports increased modestly in the quarter. Exports to East Asia were subdued, as demand from higher-income economies in the region slowed. The strengthening in domestic demand in China coincided with a rise in imports in the September quarter, with the volume of iron ore and crude oil imports increasing noticeably.

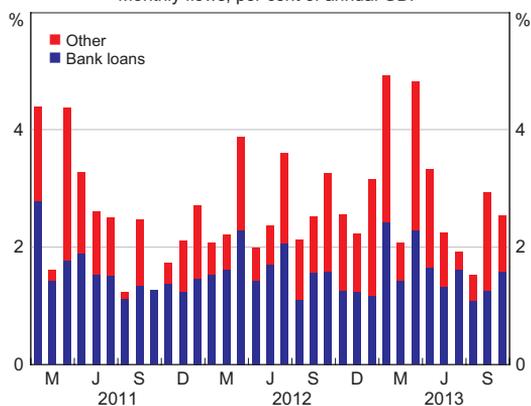
The Chinese authorities had previously signalled their intention to place financing on a more sustainable footing. However, after slowing in the three months to July, the flow of total social financing picked back up in August and September (Graph 1.5). The increase was particularly pronounced in financing activity outside of bank loans, which had been something of a concern for the authorities earlier in the year. Bank loans to non-financial corporations also increased in the quarter. The growth of bank loans to households remains brisk at 24 per cent over the year.

Graph 1.4
China – Merchandise Trade*



* Seasonally adjusted
Sources: CEIC Data; RBA

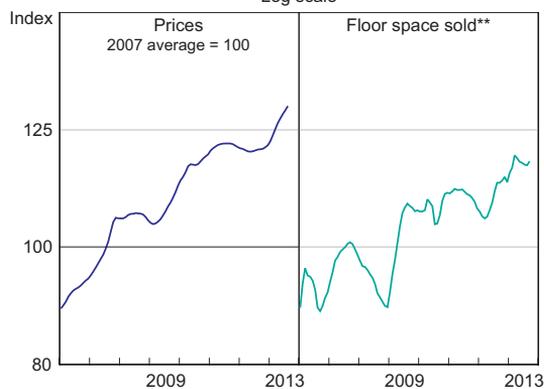
Graph 1.5
China – Total Social Financing
Monthly flows, per cent of annual GDP



Sources: CEIC Data; RBA

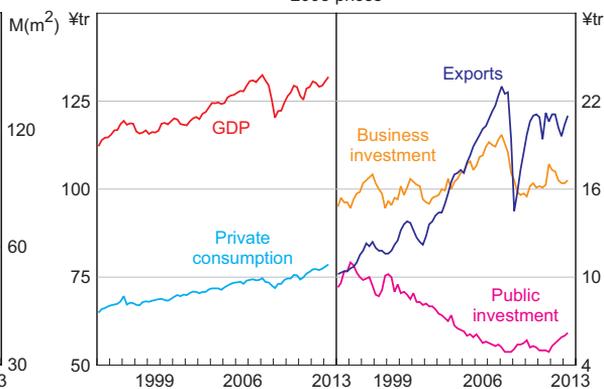
Real estate investment growth has moderated a little since the beginning of the year, particularly in the non-residential sector. Growth of residential real estate investment also eased somewhat in the September quarter, possibly owing to a running down of inventories by developers. In some cities where house price inflation has eased, local governments have pared back restrictions on the purchase of residential property. The volume of residential property sold remains high and property prices rose by 2.5 per cent in the September quarter, to be 9.3 per cent higher over the year (Graph 1.6).

Graph 1.6
China – Residential Property Market*
Log scale



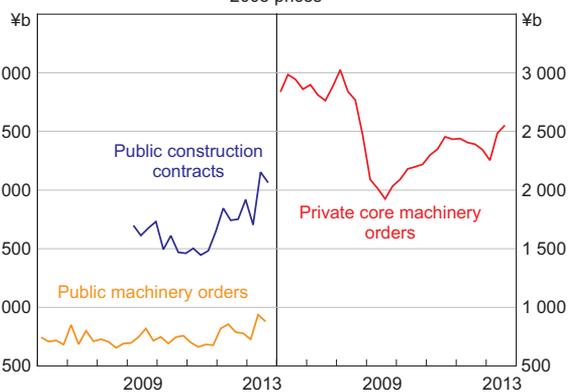
* RBA estimates
** Three-month moving average
Sources: CEIC Data; RBA

Graph 1.7
Japan – GDP and Components
2005 prices



Source: Thomson Reuters

Graph 1.8
Japan – Investment Indicators
2005 prices



Sources: CEIC Data; RBA

Consumer price inflation picked up a little in the September quarter, owing to a strong rise in food prices, but it remains well below the peak of 2011. Vegetable prices rose sharply in September following adverse weather conditions in key agricultural areas. Non-food consumer price inflation has remained at a low level.

Japanese economic activity picked up over the first half of 2013, following the announcement and implementation of more expansionary fiscal and monetary policies, which has contributed to the depreciation of the yen since late last year. Stronger growth has been driven by consumption, exports and public investment while business investment picked up in the June quarter after falling over the previous year (Graph 1.7).

The pace of growth in the September quarter appears to have slowed somewhat from the stronger pace in the first half of the year, with a range of indicators suggesting that growth of household consumption and export volumes has slowed. Even so, growth still appears to be around the average of the past decade, and forward-looking indicators of both public and private investment suggest that growth in investment will be strong in the near term (Graph 1.8).

The Japanese Government confirmed that it will increase the consumption tax from 5 per cent to

8 per cent in April next year. The increase will be accompanied by a temporary fiscal stimulus to mitigate the adverse effects of the higher tax on activity. Inflation has increased further in recent months, driven by rising energy prices resulting primarily from the depreciation of the yen. Inflation expectations derived from bond prices and consumer surveys have also risen since late 2012.

In the rest of east Asia, economic activity over recent months appears to have continued to expand at a similar pace to the average of the past decade. Domestic final demand grew strongly in the June quarter, led by rising investment, while exports also contributed to growth. Services production,

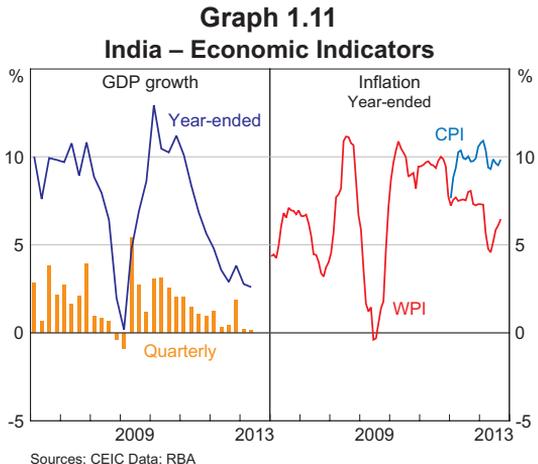
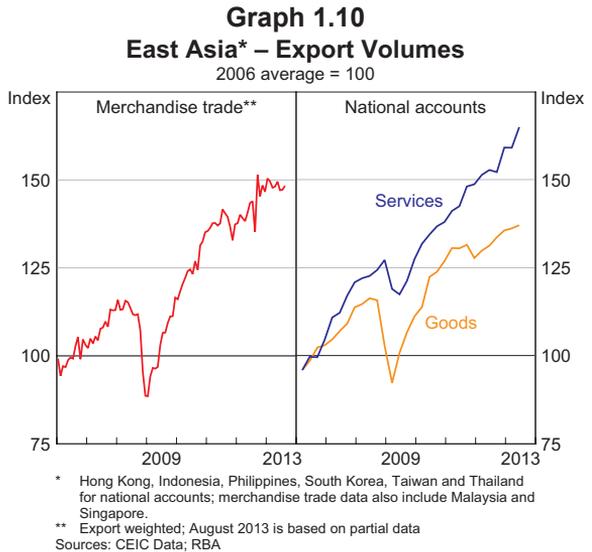
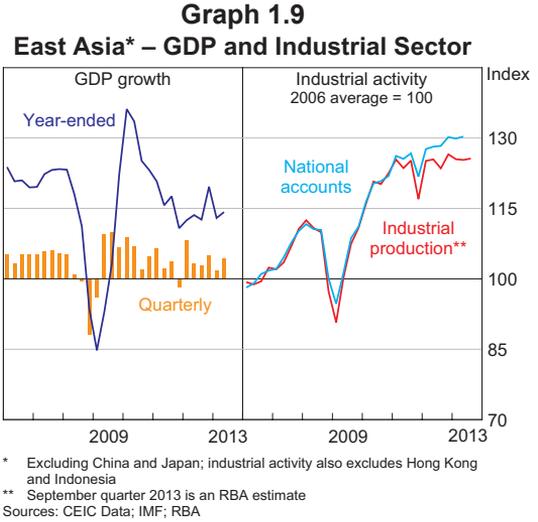
which accounts for just over half of output across these economies, has been growing strongly over the past couple of years. According to the national accounts, industrial activity has continued to grow, and by more than is indicated by monthly industrial production data, which in some countries in the region give smaller weight to faster-growing industries (Graph 1.9).

Growth in retail sales has continued at a moderate pace, and consumer confidence remains at a relatively high level in most economies in the region. In Indonesia there was a fall in consumer confidence following the depreciation of the rupiah and outflows of capital in August (see the 'International and Foreign Exchange Markets' chapter). Recent sharp rises in fuel prices and Bank Indonesia's 150 basis point tightening of its policy rate since June are also likely to have weighed on confidence.

For the region as a whole, merchandise trade data have shown little growth in export volumes over the past year. In contrast, exports have been growing according to the national accounts. This disparity in part reflects the fact that exports of services, which have been growing strongly, are only included in the national accounts measure of exports. However, most recently the national accounts have also recorded stronger growth for goods exports than have the merchandise trade data (Graph 1.10).

Inflation generally remains low throughout the region. However, in Indonesia, inflation has been elevated, and reductions in fuel subsidies caused a spike in inflation in July. Malaysian fuel subsidies were also reduced recently, although to a lesser extent than in Indonesia and so the resulting increase in prices was smaller. In the Philippines, Korea and Thailand, inflation is below or near the lower end of their central banks' target ranges for inflation.

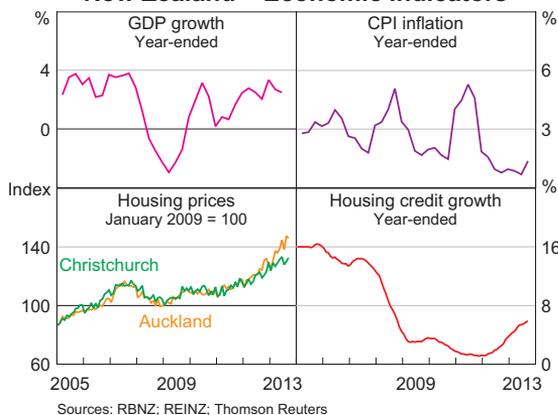
In India, GDP growth remained weak in the June quarter, with investment and household consumption subdued (Graph 1.11). There was some recovery in public demand in the June quarter after the Indian Government cut expenditure in the March quarter to meet its budget deficit target. Industrial



production has remained weak, although exports grew in the quarter. Agricultural production has picked up, aided by above-average monsoon rainfall. Meanwhile, wholesale price inflation (WPI) increased in recent months as a result of higher food prices, while consumer price inflation has remained elevated. Inflationary pressures have been exacerbated by the depreciation of the rupee (see the 'International and Foreign Exchange Markets' chapter).

In New Zealand, GDP growth slowed in the June quarter owing to a contraction in exports following earlier drought conditions. Domestic demand continued to grow strongly and employment has picked up noticeably of late. Inflation has been low, partly reflecting the appreciation of the New Zealand dollar. House prices have grown rapidly in Auckland and Christchurch over the past year or so and credit growth has picked up (Graph 1.12). In response, the Reserve Bank of New Zealand has restricted new residential mortgage lending at loan-to-valuation ratios of over 80 per cent to no more than 10 per cent of the dollar value of each bank's new housing lending flows.¹

Graph 1.12
New Zealand – Economic Indicators



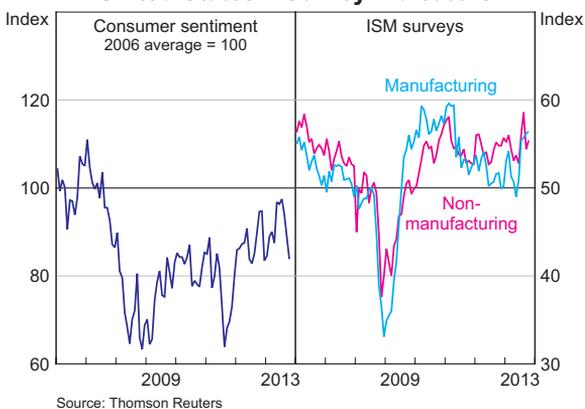
United States

Economic activity in the United States continued to expand at a moderate pace through the middle of 2013. Private demand drove growth in the June

quarter while fiscal consolidation continued to weigh on demand.

The recent partial shutdown of the US federal government and the protracted negotiation of an increase to the debt ceiling are likely to have detracted a little from growth in the December quarter, although it is too early to gauge the precise extent of the effect. In addition, several data releases, including the national accounts for the September quarter, have been delayed as a result of the shutdown. Some effects of the uncertainty surrounding the fiscal negotiations were evident in financial markets (see the 'International and Foreign Exchange Markets' chapter), and consumer sentiment declined in October (Graph 1.13).

Graph 1.13
United States – Survey Indicators



Conditions in the housing market remain stronger than in recent years; however, some indicators have softened recently. Mortgage applications have declined in response to higher mortgage rates, while pending home sales and housing starts are a little lower than they were earlier in the year (Graph 1.14). Nevertheless, house prices have continued to rise through to September, and residential construction activity expanded further in recent months.

The labour market has continued to recover over recent months. However, the pace of improvement has slowed a little compared with earlier in the year. The unemployment rate declined further, to

¹ See RBA (2013), 'The Global Financial Environment', *Financial Stability Review*, September, pp 5–14.

7.2 per cent, but so too has the participation rate (Graph 1.15). While the decline in the participation rate, in part, owes to some workers becoming discouraged about their job prospects and leaving the labour force, it is also the result of the ageing of the population. People aged 55 or above have lower participation rates as they are nearing or entering retirement, and their share in the population has increased in recent years. These demographic changes appear to have accounted for much of the decline in the participation rate over recent years.

Inflation has continued to decline over the past few months with both core and headline measures of inflation (based on personal consumption

expenditure) at just over 1 per cent over the past year, well below the Federal Open Market Committee's goal of 2 per cent.

Europe

Economic conditions have improved a little in the euro area, with GDP increasing in the June quarter following six quarters of contraction. Outside of Germany and France, there was little growth, although the rate of decline in the crisis economies eased slightly. Both domestic demand and exports contributed to growth in the quarter.

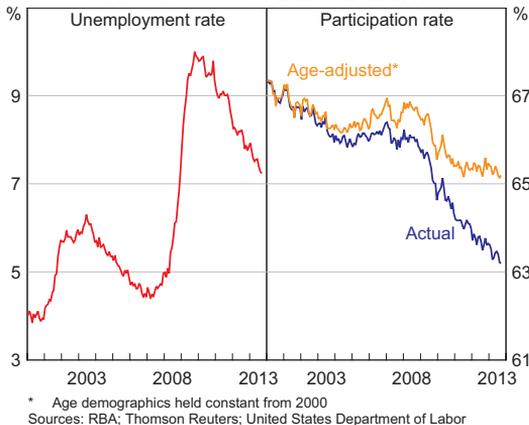
More recently, industrial production and exports have softened somewhat, although retail sales and survey data of sentiment have strengthened. Measures of both consumer and industrial sentiment are now back to around their long-run average levels (Graph 1.16). Similarly, PMIs have improved noticeably since June. Nevertheless, unemployment rates remain high in most euro area economies with the exception of Germany (Graph 1.17).

In the United Kingdom, the labour market has improved slightly alongside a moderate recovery in GDP growth supported by stimulatory monetary policy. More timely indicators have been positive, with the PMIs and house prices increasing strongly over recent months.

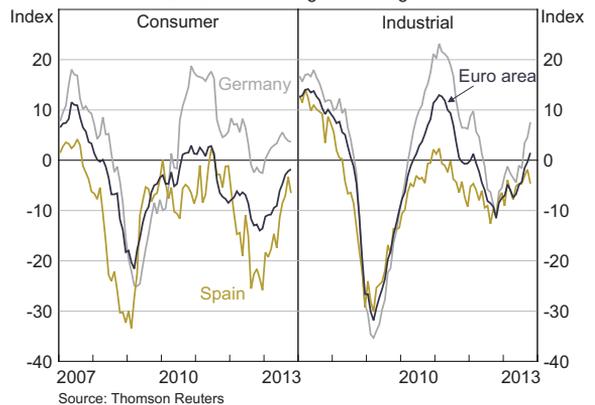
Graph 1.14
United States – Housing Indicators



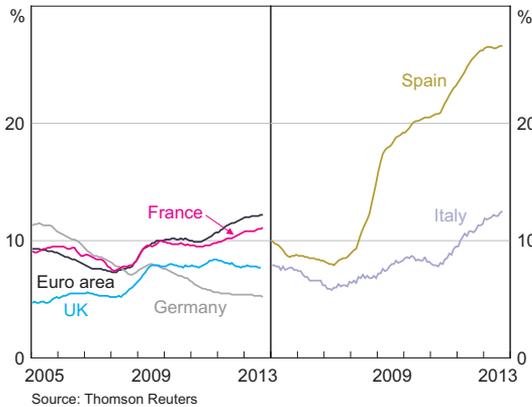
Graph 1.15
United States – Labour Market



Graph 1.16
Euro Area – Sentiment
Deviation from long-run average



Graph 1.17
Europe – Unemployment Rates



Commodity Prices

Commodity prices have been little changed on average in recent months (Graph 1.18, Table 1.1). The spot price for iron ore has risen, coinciding with an increase in Chinese crude steel production, while the spot price for coking coal has also edged higher (Graph 1.19). The December quarter benchmark contract price for premium hard coking coal was settled at US\$152 per tonne, slightly higher than the September quarter contract price. Base metal prices have been little changed since the August *Statement*.

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

	Since previous Statement	Over the past year
Bulk commodities	4	10
– Iron ore	7	25
– Coking coal	2	–11
– Thermal coal	–4	–8
Rural	–2	–8
– Beef	1	–4
– Cotton	–4	8
– Wheat	–1	–11
– Wool	3	0
Base metals	0	–7
– Aluminium	–1	–8
– Copper	1	–9
– Lead	1	2
– Nickel	–2	–16
– Zinc	1	–1
Gold	–1	–21
Brent oil ^(b)	5	–2
RBA ICP	–1	–4
– using spot prices for bulk commodities	1	0

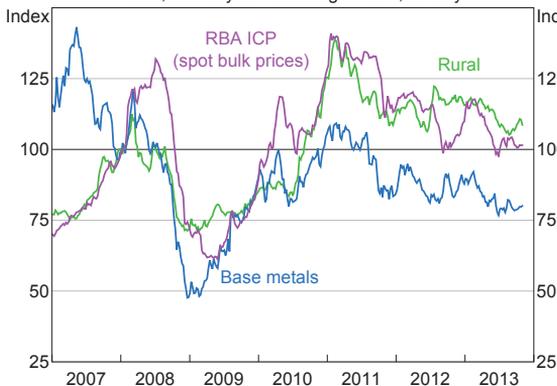
(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodities prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS Energy Publishing; RBA

Graph 1.18
Commodity Prices*

SDR, January 2008 average = 100, weekly



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

Source: RBA

Graph 1.19
Steel, Iron Ore and Coking Coal Prices

Spot prices



* Average of hot rolled steel sheet and steel rebar prices

** Free on board basis

Sources: Bloomberg; Citigroup; IHS Energy Publishing; Macquarie Bank; RBA

Developments in energy prices have been mixed (Graph 1.20). Over the past year, global thermal coal prices have declined significantly, weighed down by seaborne supply from Australia, Indonesia and the United States, but to date there has been little scaling back in global supply. Thermal coal prices have picked up noticeably in recent weeks. Crude oil prices, on the other hand, have increased on average since the August *Statement*.

Overall, rural prices have been little changed in recent months. Expectations of a strong increase in global grain and oilseeds production have weighed on the prices of canola and corn in particular, while wool prices increased slightly. Most rural prices remain elevated relative to history. ❖

