

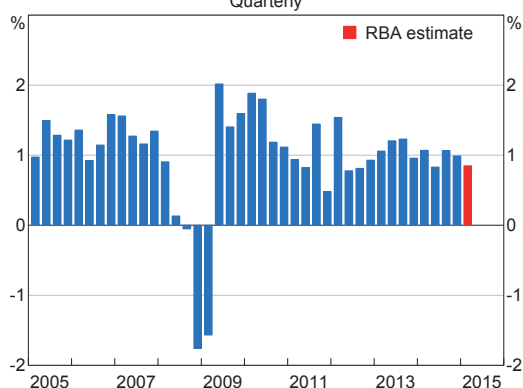
1. International Economic Developments

Overall, it appears that the growth of Australia's major trading partners (MTPs) eased a little in the first few months of 2015, but remained close to its long-run average (Graph 1.1). In China, growth of resource-intensive sectors of the economy, such as property and manufacturing, continued to slow in the early part of this year. The Japanese economy has recovered modestly from the weak growth recorded last year following the increase in the consumption tax. In aggregate, other economies in the Asia-Pacific region have continued to grow at their decade-average pace. The euro area economy continues to recover gradually, while the US economy has been growing at an above-trend pace, notwithstanding a moderation in the pace of growth in the March quarter.

Growth of global industrial production has eased over the past year, in part as a result of slower growth in China. This has contributed to a further decline in commodity prices since the beginning of 2015, although much of the decline in commodity prices over recent years appears to have reflected the increase in the global supply of commodities.

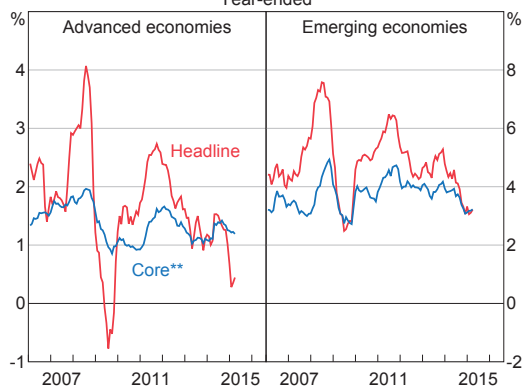
Oil prices remain at a low level relative to recent years. This will continue to support growth in most of Australia's major trading partners (given that they are net energy importers) and put downward pressure on global inflation (Graph 1.2). Core inflation in the advanced economies has not changed significantly in year-ended terms, and remains below central banks' targets in most economies. Monetary policies remain very accommodative.

Graph 1.1
Australia's Trading Partner Growth*
Quarterly



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

Graph 1.2
Global Inflation*
Year-ended



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

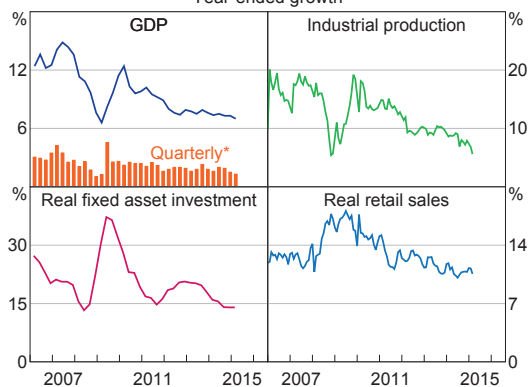
** Excluding food and fuel

Sources: CEIC Data; IMF; RBA; Thomson Reuters

Asia-Pacific

In China, economic growth moderated further in the March quarter, with the slowing apparent across a range of domestic activity indicators (Graph 1.3). Conditions remain subdued in the property and manufacturing sectors. GDP growth eased further in the quarter, driven by weaker growth in domestic expenditure, which was reflected in a sharp fall in imports. In March, the Chinese Government announced a GDP growth target for 2015 of around 7 per cent, down from around 7½ per cent in 2014. The target of creating 10 million new urban jobs for the year was unchanged in 2015. Slightly more accommodative fiscal policy is expected to make a modest contribution to growth this year, and more recently the authorities have acted to ease monetary policy.

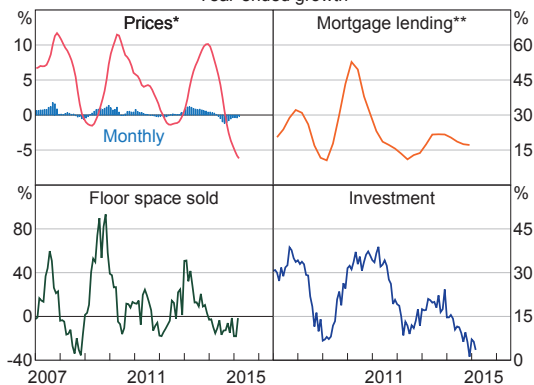
Graph 1.3
China – Activity Indicators
Year-ended growth



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

Conditions in the property market remain weak, as prices and sales volumes have continued to fall and growth of investment has slowed (Graph 1.4). The authorities have announced further measures to support the property market including: a lower minimum down payment for second mortgages of 40 per cent; lower down payment requirements for home buyers participating in housing fund contribution schemes; and more generous capital gains tax concessions. The authorities are also

Graph 1.4
China – Residential Property Market Indicators
Year-ended growth

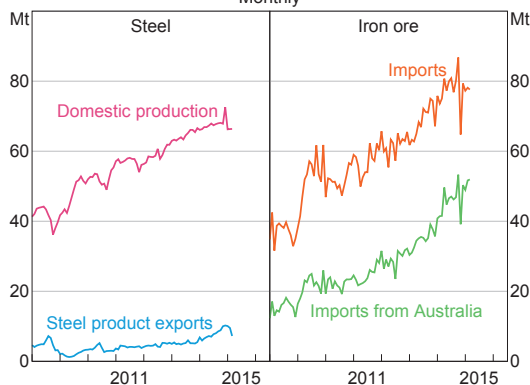


* Newly constructed property in 69 large and medium-sized cities
** Total real estate loans minus development loans
Sources: CEIC Data; RBA; WIND Information

attempting to address the overhang of housing investment through plans for local governments to purchase existing stock from developers to use for social housing.

Conditions in the industrial sector have softened, especially for construction-related products, but growth in the production of a range of other manufactured items has also slowed. Weakness in sectors that use steel as an input has led to a slight fall in domestic steel consumption since mid 2014. Production of steel has eased a little and steel exports have declined after growing rapidly in 2014 (Graph 1.5). Iron ore imports have been relatively

Graph 1.5
China – Iron Ore and Steel
Monthly



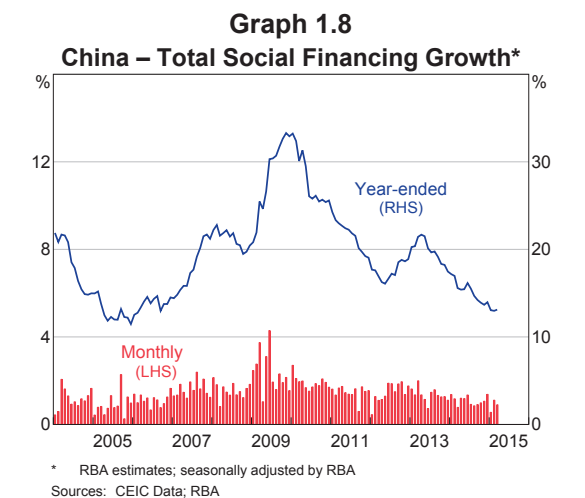
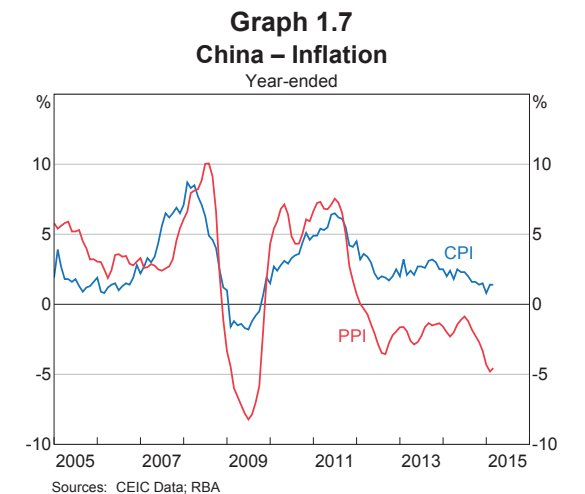
Sources: CEIC Data; RBA

flat overall, although imports from Australia have continued to increase, and Chinese domestic iron ore production has fallen in recent months. In early April, in an effort to support struggling domestic producers, the Chinese Government reduced the proportion of resource tax collected from iron ore mines operating in China from 80 to 40 per cent, which on some estimates implies tax relief of between US\$1 and US\$4 per tonne.

Growth of real fixed asset investment has moderated and remains relatively low in year-ended terms. While real estate and manufacturing investment growth have both weakened in recent months, growth of infrastructure investment has been resilient, consistent with the pick-up in approvals for infrastructure projects announced by the authorities in the second half of 2014. Consumption indicators have weakened slightly with growth of real retail sales and automobile sales both easing. Export volumes have fallen in recent months after a sharp run-up last year (Graph 1.6). Imports have declined sharply in both value and volume terms.

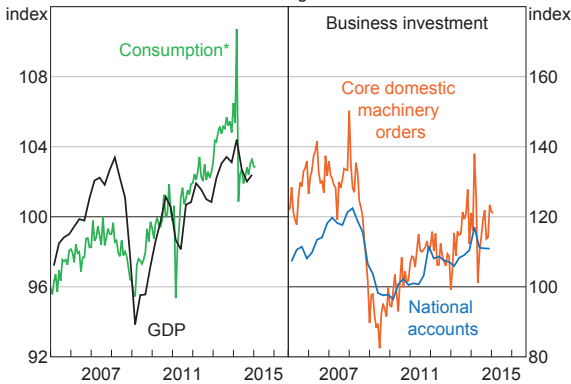
Inflationary pressures remain subdued (Graph 1.7). In March, CPI inflation was 1.4 per cent in year-ended terms, which is well below the CPI inflation target for 2015 of 3 per cent. Producer prices have continued to decline, consistent with excess capacity in manufacturing and falling global commodity prices.

Growth of total social financing has continued to ease, driven by a broad-based slowing in off-balance sheet financing consistent with policy efforts to reduce its share in overall financing activity (Graph 1.8). Growth of bank credit remains stable. Growth of the money supply (M2) is currently a little above the government’s new target for 2015 of 12 per cent; the authorities recently indicated that this target may be exceeded if further stimulus is required to support economic activity. Monetary policy has been more accommodative in recent months: the People’s Bank of China cut benchmark interest rates in February, lowered reserve requirement ratios in April and has injected liquidity through a range of lending facilities (see the ‘International and Foreign Exchange Markets’ chapter).



In Japan, growth in economic activity resumed in the December quarter, following significant declines in output in the previous two quarters. Growth appears to have continued at a modest pace in the March quarter, although business indicators and measures of consumer spending have been mixed (Graph 1.9). While business investment remained subdued in the second half of 2014, indicators for the March quarter, such as core machinery orders, have been a little more positive. Export volumes have picked up since late last year.

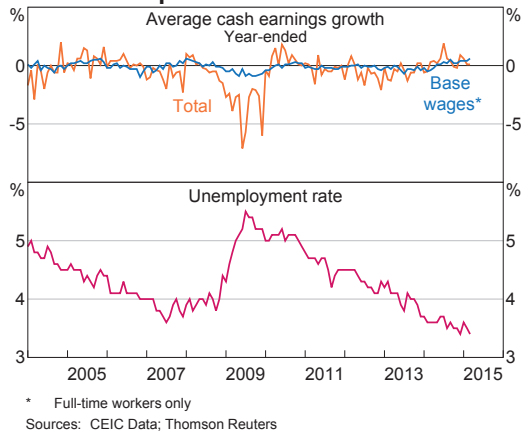
Graph 1.9
Japan – Economic Indicators
2010 average = 100



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

The Japanese labour market remains tight. The unemployment rate is around its lowest level in almost two decades and the ratio of job offers to applicants has reached its highest level over the same period (Graph 1.10). Increasingly, there is evidence that labour market conditions are placing upward pressure on nominal wages, which had been stagnant for some time. Wage growth has been picking up of late and the recent annual spring wage negotiations have resulted in several large companies increasing base wages by more than they did a year ago. Despite the recent pick-up, wage growth remains below the Bank of Japan's (BoJ's) inflation target. Although these developments point to some increase in domestic inflationary pressures, inflation has drifted lower of late reflecting the fall in oil prices and the fading effects of the earlier depreciation of

Graph 1.10
Japan – Labour Market

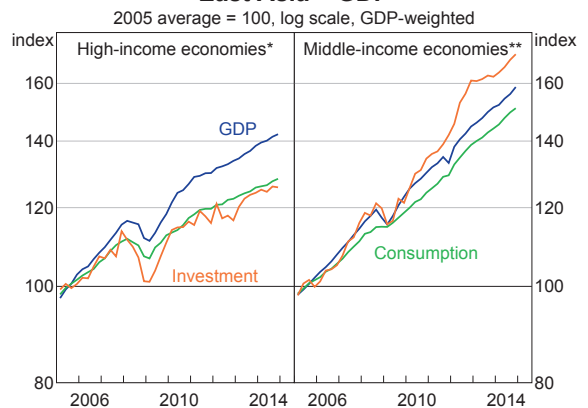


* Full-time workers only
Sources: CEIC Data; Thomson Reuters

the yen. Core inflation has been relatively steady at around ½ per cent, well below the BoJ's target of 2 per cent, while financial market-based measures of longer-term inflation expectations have declined to just below 1 per cent.

In the rest of east Asia, growth returned to an around-average pace in the second half of 2014, following a period of slower growth. Growth picked up in the middle-income Asian economies in the December quarter, but slowed a little in the high-income Asian economies (Graph 1.11). It appears that moderate growth has continued in the March quarter for the high-income economies.

Graph 1.11
East Asia – GDP



* Hong Kong, Singapore, South Korea and Taiwan
** Indonesia, Malaysia, Philippines and Thailand
Sources: CEIC Data; RBA

Growth in the middle-income Asian economies has been driven by strong growth in investment, including in infrastructure, and consumption. In contrast, international trade has been more important for growth in the high-income economies, and domestic demand in these economies has grown at a more moderate pace. Growth in intraregional trade has slowed in recent years, though a pick-up in demand from the United States over the past year has provided an offsetting support to exports in the east Asian region.

Falling global oil prices have led to a moderation in headline inflation across most of the region. Core inflation has been little changed and remains low. Declining inflationary pressures have contributed to decisions by several central banks in the region to ease monetary policy in recent months.

In India, year-ended GDP growth was revised higher to between 6 and 8 per cent over the past few years (Graph 1.12). The share of manufacturing in output has been revised significantly higher, from one-quarter to one-third of GDP, and growth of both manufacturing and services production were revised upwards. This may, in part, reflect better coverage of faster-growing enterprises in the national accounts. GDP growth eased in the December quarter, reflecting subdued agricultural and industrial output. Some partial indicators, such

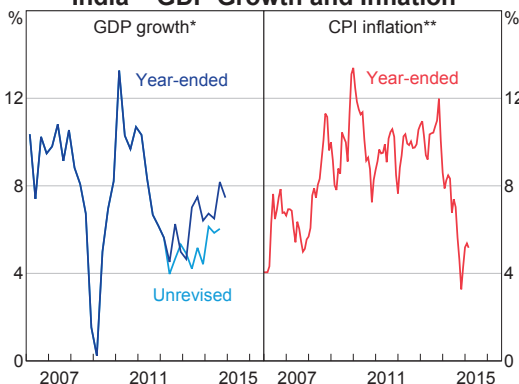
as industrial production and investment approvals, have improved in recent months.

A newly announced monetary policy framework formally established a target for consumer price inflation as the Reserve Bank of India's (RBI's) key objective. Consumer price inflation remains below the RBI's January 2016 target of 6 per cent. In March, the RBI cut its policy rate by 25 basis points for the second time this year, citing weak demand conditions, contained inflation and a positive appraisal of the government's fiscal strategy. The recently released government budget for 2015/16 projects a slight easing in the pace of fiscal consolidation over the next several years. As a share of GDP, public capital expenditure, particularly on infrastructure, is forecast to rise significantly, while public expenditure overall is projected to fall, partly due to a reduction in fuel subsidies.

New Zealand's economy grew at an above-average pace over 2014, as rebuilding following the 2010 and 2011 Canterbury earthquakes, record-high net immigration and continued strength in the housing market have supported activity. The labour market has continued to strengthen, with increases in the participation rate and net migration contributing to strong growth in the supply of labour. Despite the decline in the unemployment rate over recent years, wage and price pressures have remained subdued.

Graph 1.12

India – GDP Growth and Inflation



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

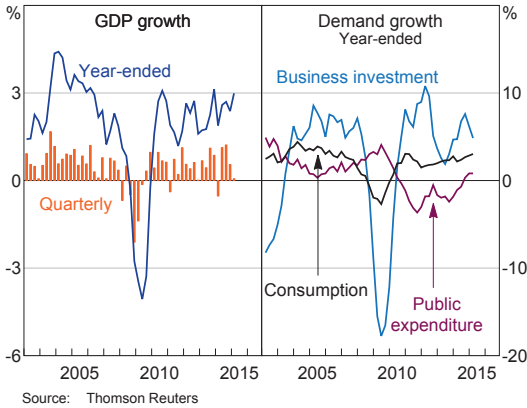
United States

Growth in the US economy moderated in the March quarter, largely reflecting the impact of temporary factors (Graph 1.13). Industrial action across many ports temporarily disrupted the operation of supply chains and adverse weather conditions affected activity in some regions. Despite these factors, conditions remain favourable for both consumers and businesses, supported by low fuel prices and very stimulatory monetary policy.

The expansion in economic activity over the past year has supported strong growth of non-farm payrolls employment and led to further declines in the unemployment rate (Graph 1.14). Other

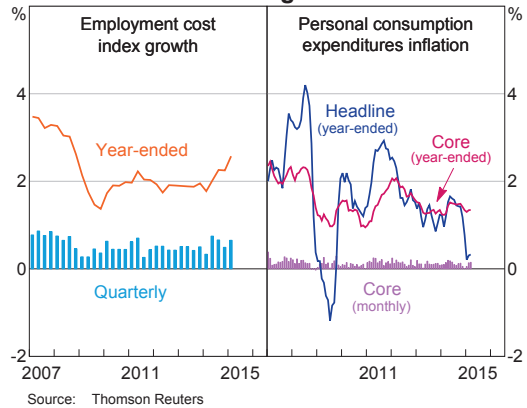
Graph 1.13

United States – GDP and Demand



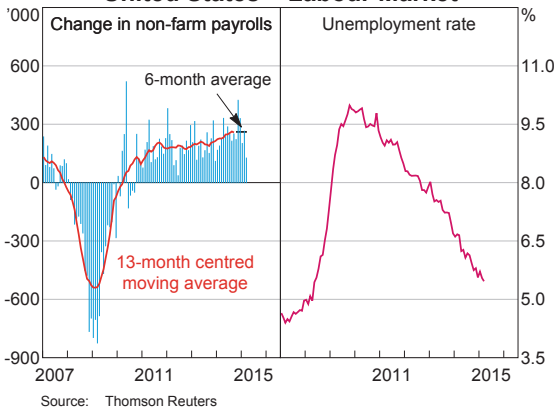
Graph 1.15

United States – Wages and Inflation



Graph 1.14

United States – Labour Market



indicators of slack in the labour market have recovered more slowly than the unemployment rate. Nevertheless, wage growth, as measured by the employment cost index, has picked up over the past four quarters to be slightly below its long-run average in year-ended terms (Graph 1.15). Falling energy prices have contributed to lower headline inflation, while core inflation has remained relatively stable at around 1¼ per cent. The Federal Open Market Committee has indicated that it is likely to begin the process of normalising interest rates in the second half of this year.

Europe

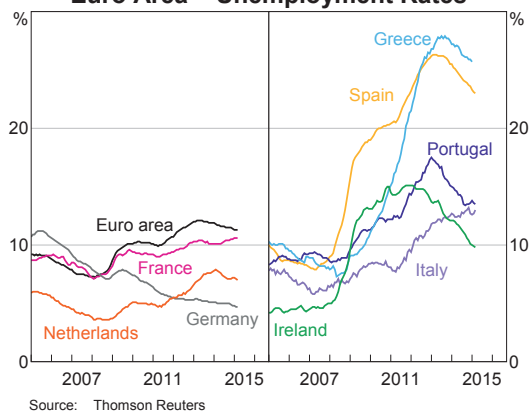
In the euro area, economic activity continues to recover gradually. In the December quarter, GDP expanded for the seventh consecutive quarter. Growth in the quarter was driven by consumption and investment, although the level of investment activity is only a little above its low point of two years ago. Exports also picked up following the depreciation of the euro since mid 2014.

The gradual recovery appears to have continued into the March quarter. Retail sales grew strongly in the quarter, and consumer confidence remained high. The PMIs and measures of business confidence have improved. Meanwhile, credit conditions and loan demand also continue to improve. Growth in household and business credit has lifted a little in recent months, property prices have risen and construction activity is above the lows of early 2013.

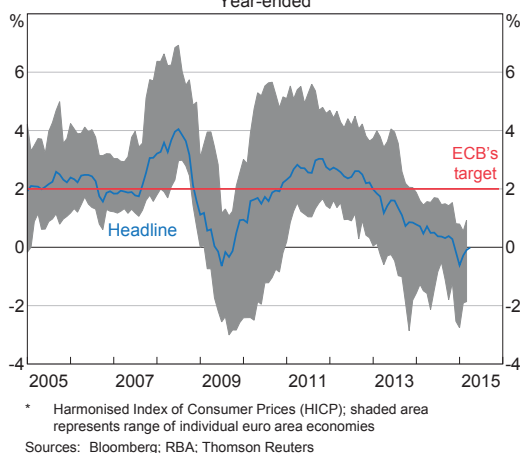
The region's unemployment rate has continued to decline, to be almost 1 percentage point below its peak in mid 2013 (Graph 1.16). Larger declines in unemployment have occurred in Ireland, Portugal and Spain where GDP growth has been above trend over recent quarters.

Consumer prices have increased a little in recent months, but remain lower than a year ago, partly reflecting the fall in oil prices (Graph 1.17). While measures of core inflation have been relatively stable

Graph 1.16
Euro Area – Unemployment Rates



Graph 1.17
Euro Area – Inflation*
Year-ended

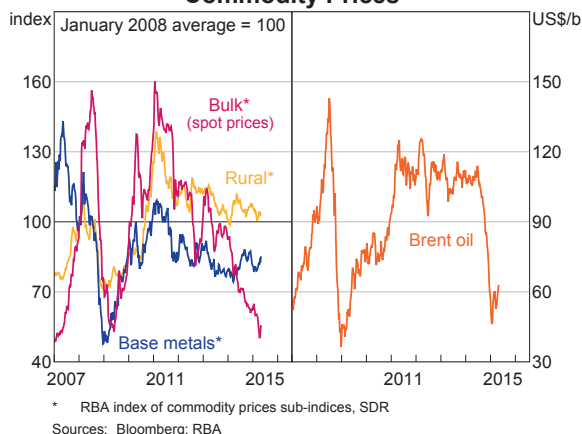


in recent months, they remain well below the target of the European Central Bank. Longer-term inflation expectations have stabilised over recent months but remain historically low.

Commodity Prices

Since the February *Statement*, the RBA index of commodity prices (ICP) has declined significantly, although it has rebounded to some extent over the past month, driven by developments in prices of iron ore and oil (Graph 1.18; Table 1.1). Overall, commodity prices are 7 per cent lower in SDR terms than at the time of the previous *Statement* and

Graph 1.18
Commodity Prices



21 per cent lower than a year ago. The terms of trade declined by 11 per cent over 2014 and are expected to have declined further over the first part of this year, judging by recent levels of commodity prices.

The spot price of iron ore has declined since the previous *Statement*, despite some pick-up in recent weeks (Graph 1.19). While additions to global supply put downward pressure on prices over 2014, price declines since then have also reflected weaker growth in Chinese demand for steel, which in turn reflects weak conditions in the property and manufacturing sectors. Iron ore producers, both in Australia and elsewhere, appear to have been able

Graph 1.19
Chinese Steel and Iron Ore Spot Prices



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

	Since previous Statement	Over the past year
Bulk commodities	-10	-31
– Iron ore	-15	-45
– Coking coal	-4	-2
– Thermal coal	-4	-11
Rural	-3	-4
Base metals	-1	6
Gold	2	1
Brent oil ^(b)	-5	-46
RBA ICP	-5	-20
– using spot prices for bulk commodities	-7	-21

(a) Prices from the RBA index of commodity prices (ICP); bulk commodities prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS; RBA

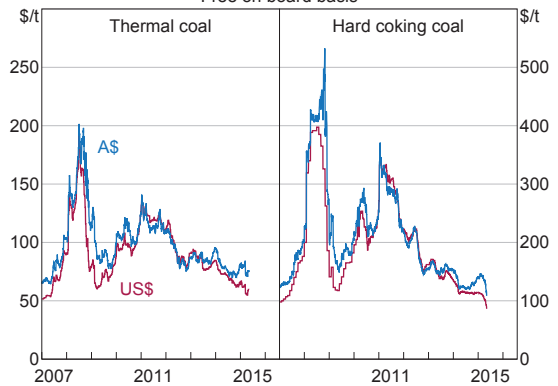
to lower production costs in response to declining prices, aided in part by lower oil prices (which are a key input into extraction and transport). There has been only a limited response of the global supply of iron ore to the decline in prices so far. There are signs that some higher-cost producers in Australia are responding to the lower prices by curtailing production. At current prices, however, most Australian production appears to be profitable. So far, the response from higher-cost producers elsewhere, including in China, has been less than expected given that many are estimated to be unprofitable.

Despite rebounding somewhat from its recent low in January, the Brent oil price remains around 40 per cent below its average level of recent years, largely reflecting the substantial increase in global supply. The recent volatility in oil prices has reflected the combined impact of news about the strength in unconventional oil production, the build-up of crude oil stocks, the decline in oil rig numbers in the United States and tensions in the Middle East. The sharp fall in oil prices since mid 2014 is being reflected in regional liquefied natural gas prices, albeit with some delay (see 'Box A: The Effect of Oil Price Movements on the Terms of Trade').

Spot prices of hard coking coal have declined in recent months and thermal coal prices remain relatively low despite picking up more recently (Graph 1.20). Both spot and contract prices for coking coal have fallen, reflecting subdued growth in Chinese demand for steel. At current prices, a substantial share of global coal production is estimated to be unprofitable. Liaison and recent company announcements indicate that some producers in Australia are considering whether to maintain production in light of lower profitability

Graph 1.20
Coal Spot Prices

Free on board basis



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

and some companies have announced either delays to projects in the investment pipeline or a reduction in coal production. Accordingly, the growth of Australian coal production is expected to moderate over coming years. Over the past year, the depreciation of the Australian dollar has offset some of the weakness in bulk commodity prices for Australian producers, although the Australian dollar has been a little higher over the past three months. Base metal prices have declined slightly on average in recent months, but remain higher than a year ago. ↘