



**Global & Australian Overview
&**

**– the challenges of a multi speed economy
and mining's role in the process**

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Key messages: The Global Outlook

Global outlook slowing to trend but very varied by region

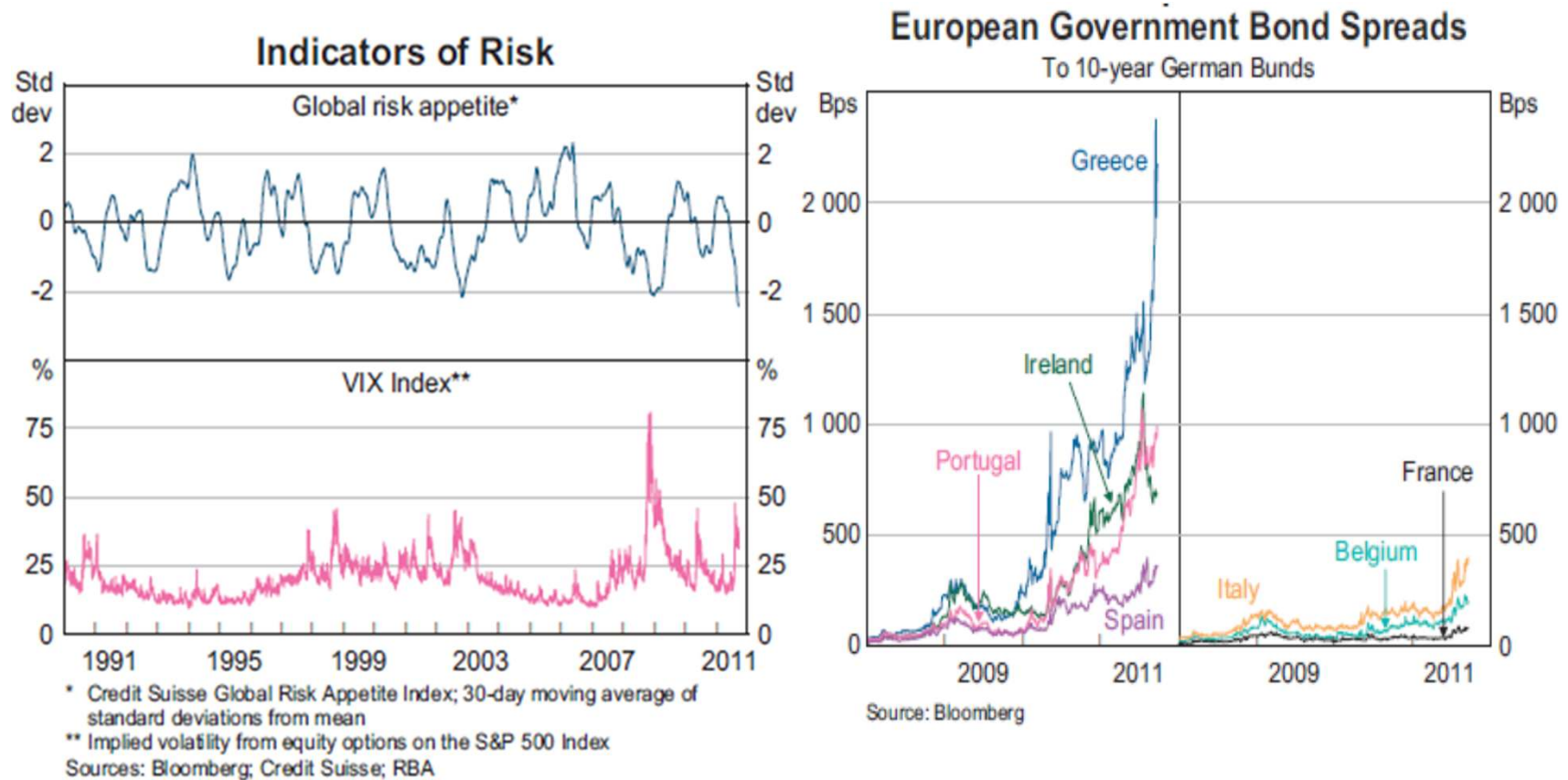
Developed world in very slow growth phase with lots of risks

- US not growing fast enough & big headwinds - “politics poor” re policy. Unemployment to rise.
- European core OK but slowing and periphery very high risk (broke)
- UK economy struggling – fiscal consolidation and high unemployment massive headwinds
- Globally consumer and business “afraid” and “cautious”

Emerging economies fuelling growth

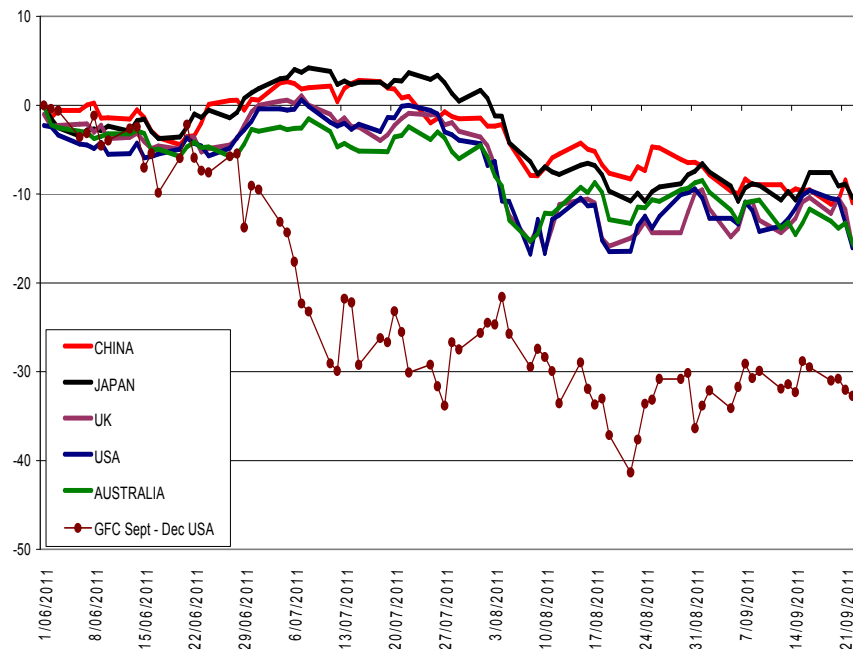
- Ongoing China strength - with Chinese more concerned about inflation.
- Non Japan Asia strong on back of China. but slowing.
- While US and European debt issues could cause massive disruption if things go badly the key will be how will China be affected and what would be their response (why not another package)

Clearly markets now very much focused on risk of global recession and especially European default.

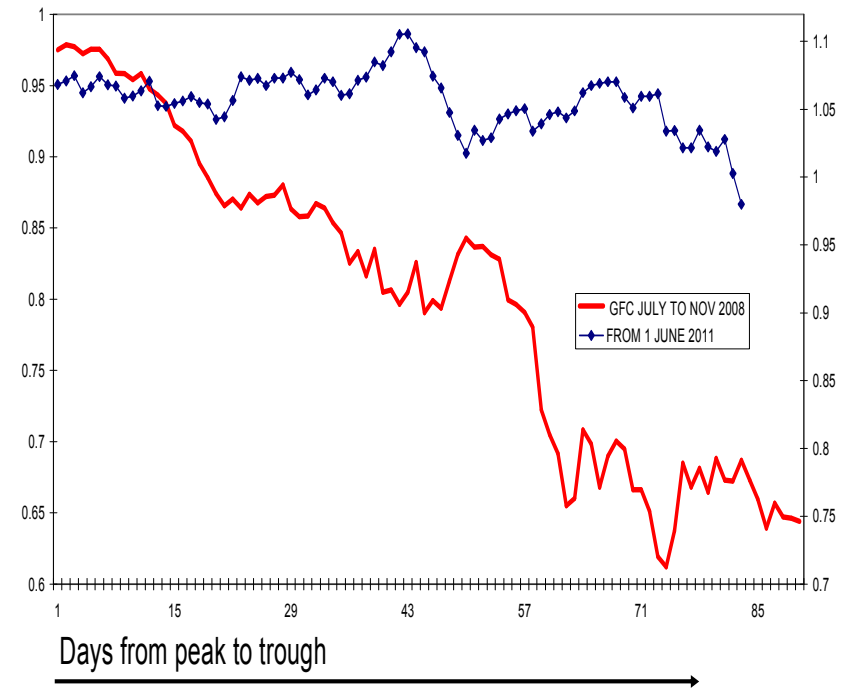


Clearly equity markets volatile and are generally around 15% compared to June. But during height of GFC (Sept to Nov 2008) they fell 30-35%. So far AUD volatility not like GFC.....

Change in Equity Markets since 1 June 2011

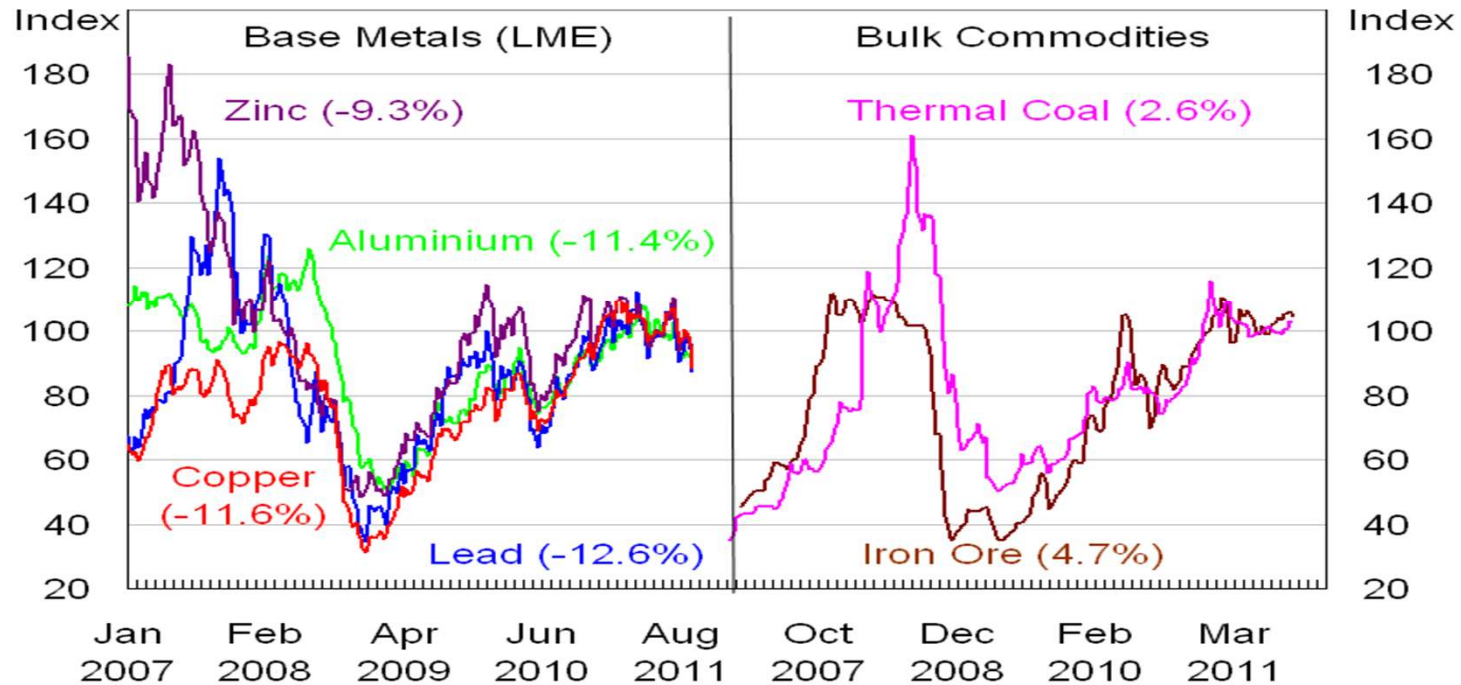


AUD V USD - LAST 3 months v GFC



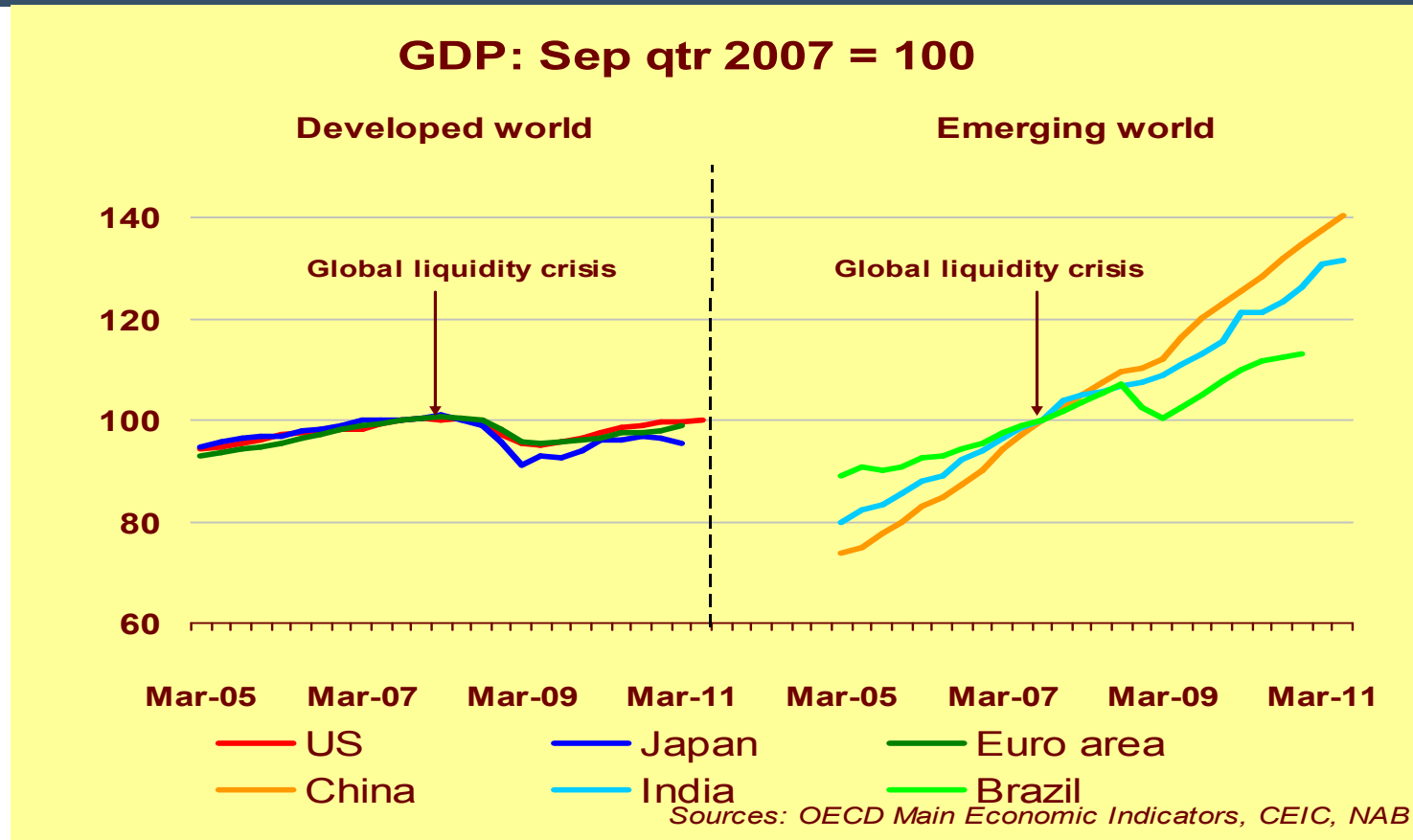
That is because commodity prices not reacting as if a global crunch is underway or likely....

Commodity Prices*
June 2011 = 100, Weekly

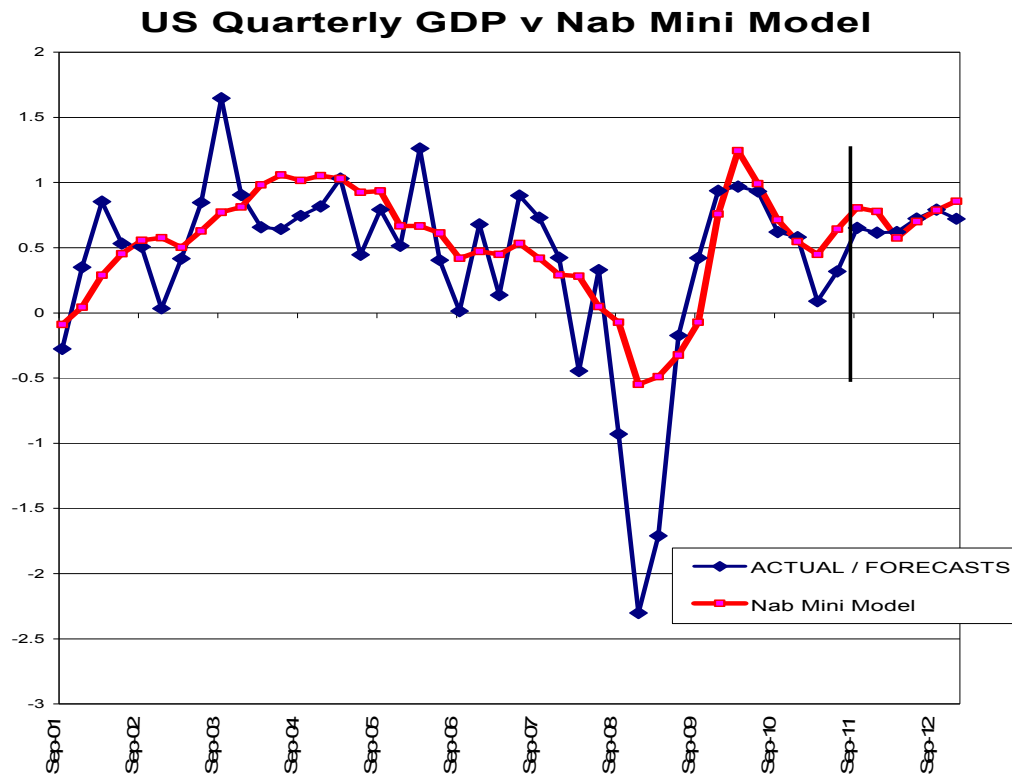


* Values in brackets represent percentage decline from June average.

Globally there is a multi speed economy problem.
 Big 3 developed economies at best only just back to pre GFC levels.
 Developing world very much stronger. But attracting much less attention !!!



**In the USA growth has slowed significantly – and surprisingly
But models point to continuing growth
The problem is the rate of the growth...**



■ Historical revisions mean that annual growth will only be around 1.6% in 2011 and 2.4% in 2012

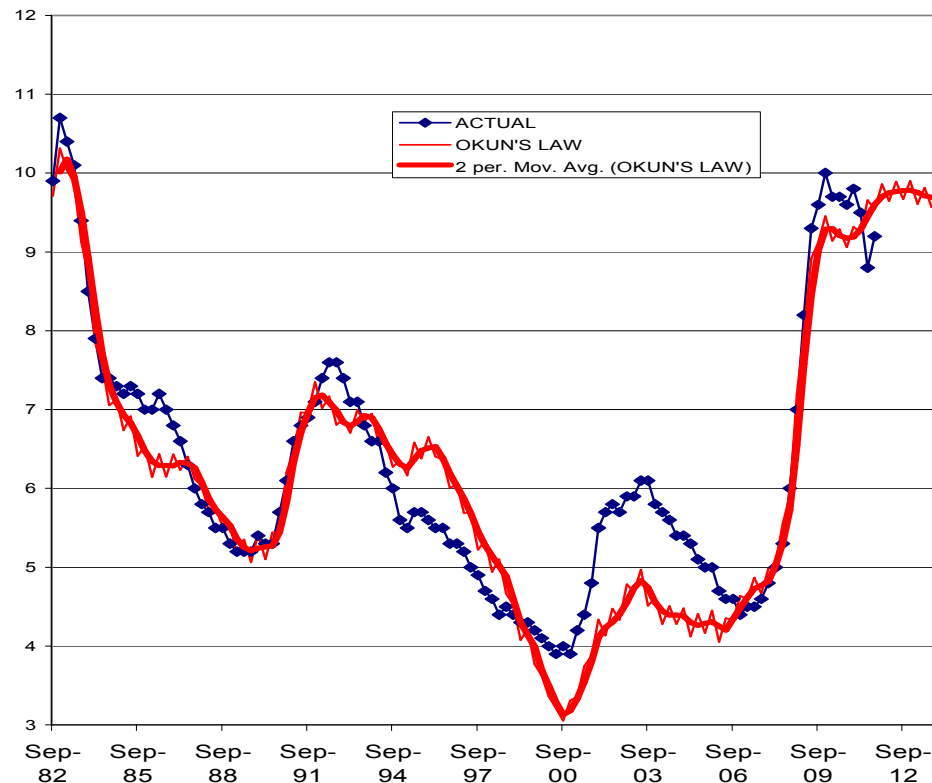
■ Fiscal retrenchment a medium term headwind. Not an immediate problem

■ Real problem is what it implies for unemployment

Problem is growth not fast enough to fundamentally lower unemployment. Indeed suggests near term upside risks

- **Growth of below 2% does not stabilise unemployment.**
- **As shown by OKUNs law unemployment likely to stay around 9½% for the next year or even longer**
- **This clearly raises concerns re the jobless recovery and confidence / political issues**

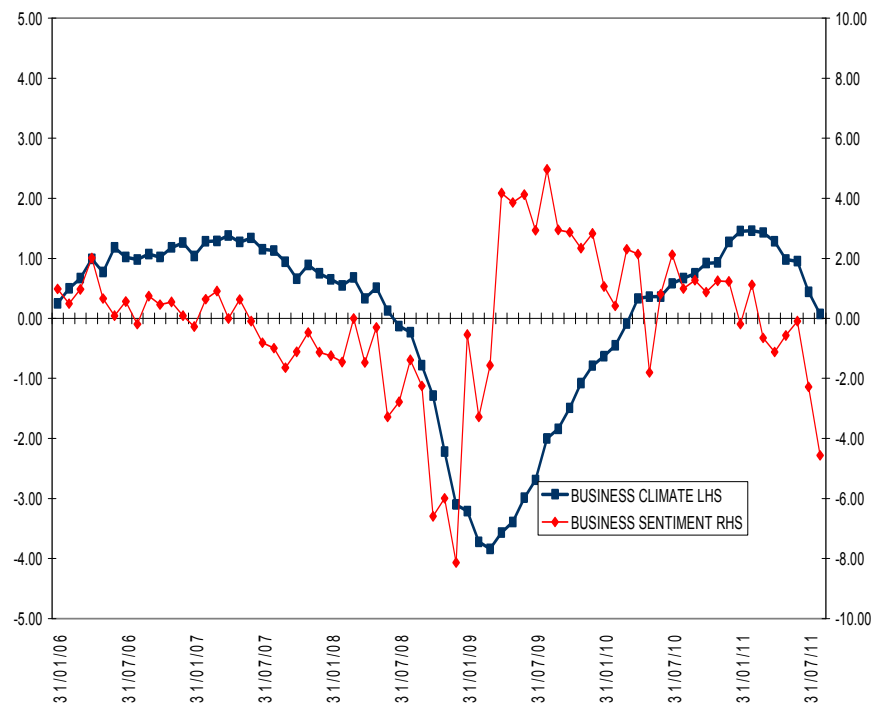
OKUN'S LAW FOR USA UNEMPLOYMENT



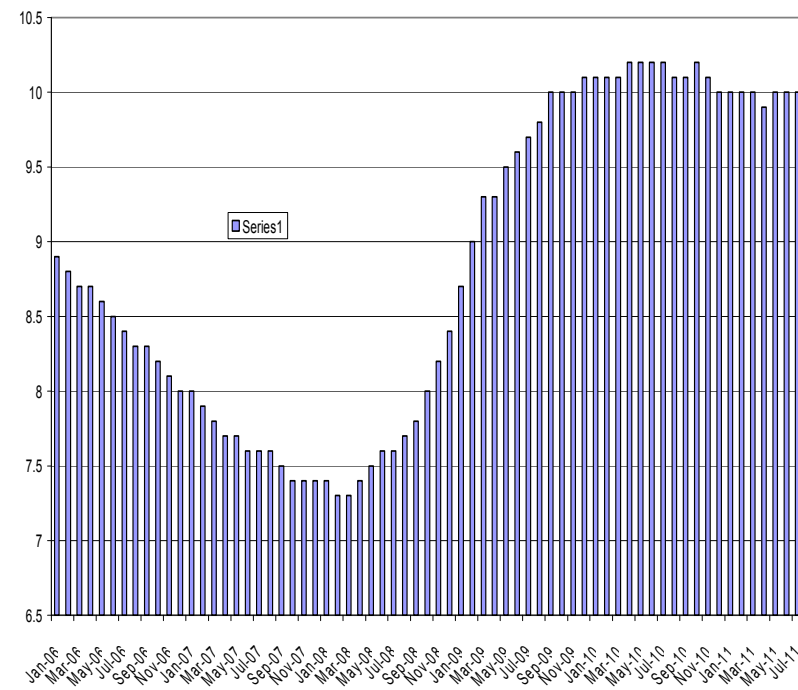
EURO data has softened noticeably. Even in the core activity was very low in mid 2011 (Germany 0.1% in Q2 and Europe 0.2%).

Confidence sharply lower since June. Unemployment very high.

EURO BUSINESS CLIMATE AND SENTIMENT INDICES



EUROPEAN UNEMPLOYMENT %



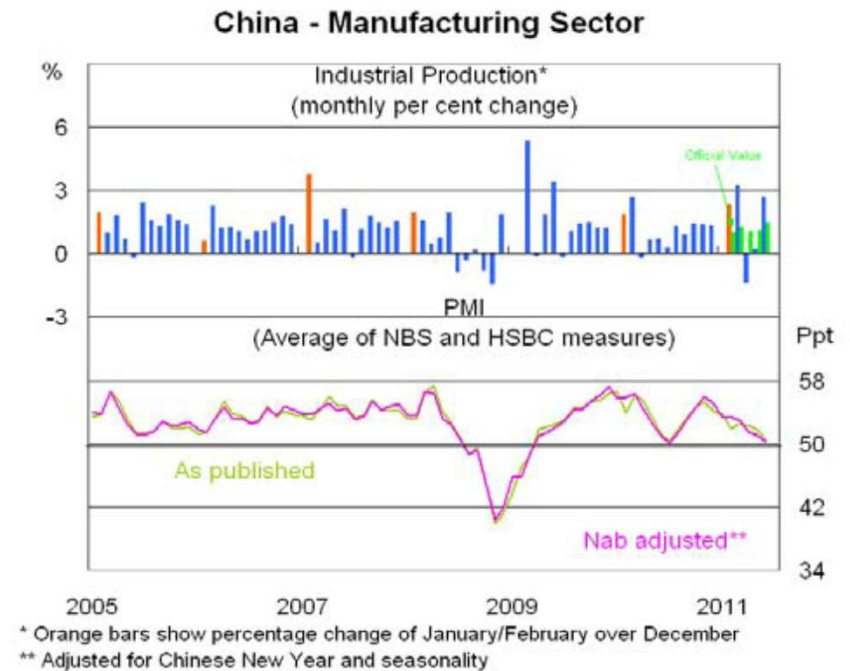
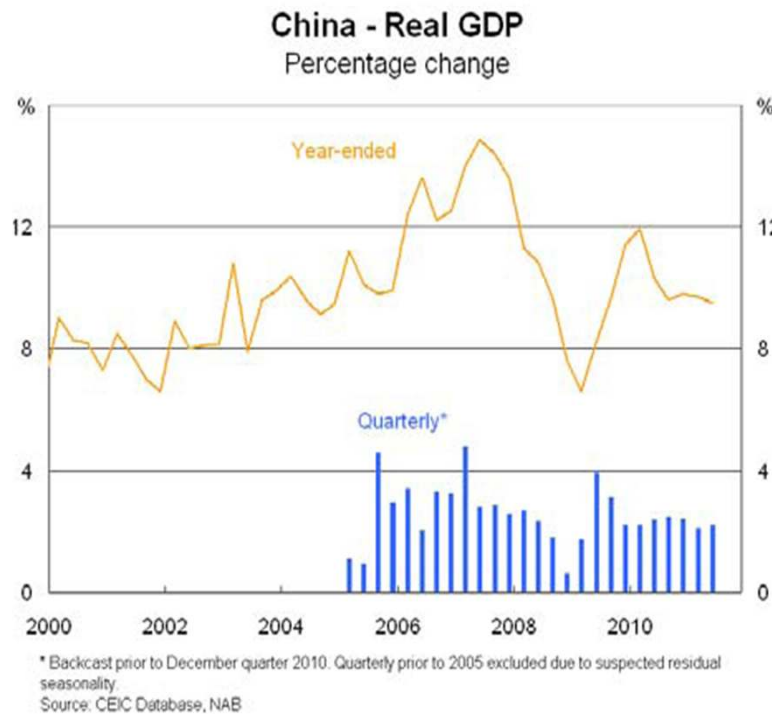
Periphery Europe: sustainable?

Markets pricing in an event risk

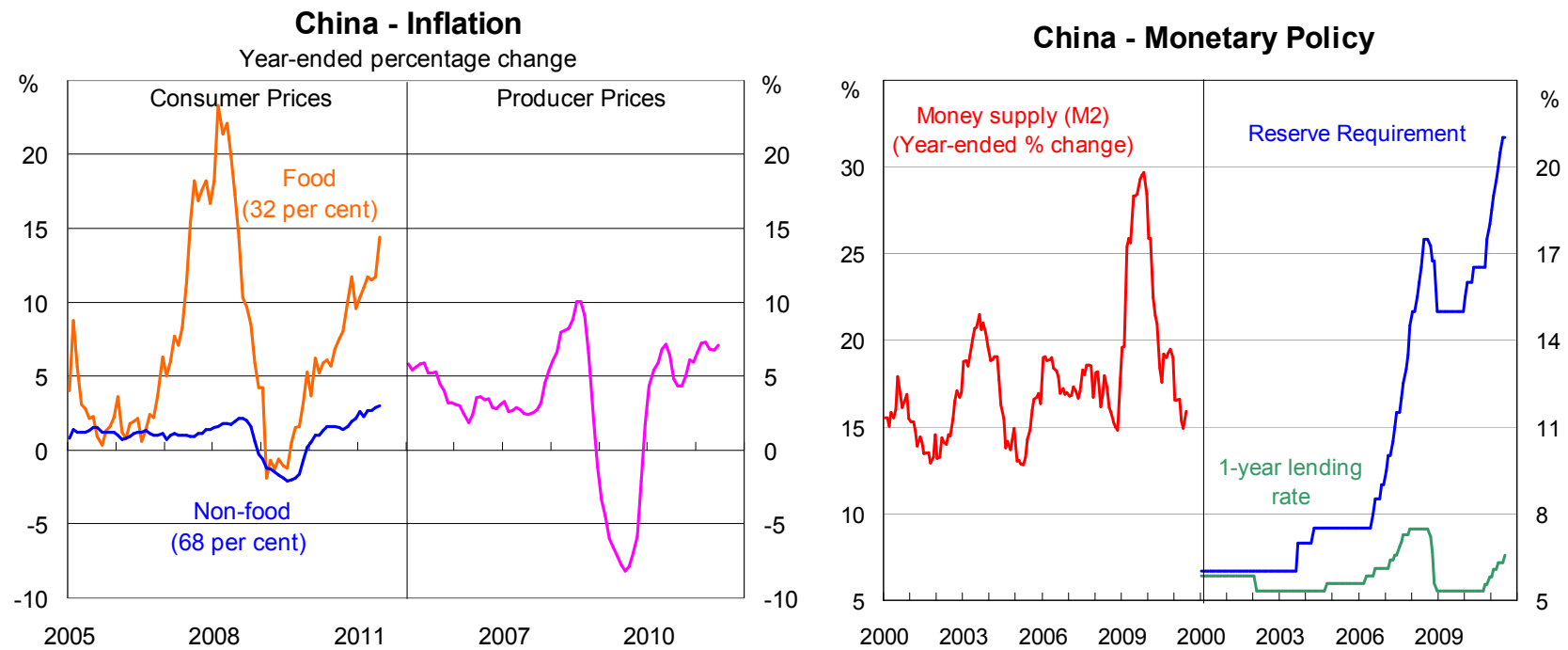
Public appetite for austerity being tested in Europe

- Unemployment in periphery very high (Spain 20%) & large house price falls
- Focus on risk of effective default by Greece, Portugal, Ireland
- Major issues
 - Expect rescheduling in next 12 months or sooner- **if you are broke.....**
 - Medium-term growth prospects patchy & subdued
 - Implications of European default for Australia
 - Potential short-term exchange rate instability against \$US and Euro
 - Otherwise not large given our connection with China
 - Main risk is GFC-style contagion through financial markets – *in particular if Greece (and or others – especially Italy) defaults what will be impact on European banks capital positions*

Latest Chinese data show ongoing strength of GDP – up 9.5% in year to Q2 and around 2.2% in the quarter. That said tightening policy and Japanese disruption has see slowing in manufacturing and retail sales during Q2.



Chinese authorities attention now on making sure inflation doesn't get away. PPI still high and CPI now up 6.2% - albeit heavily food driven. Policy has mainly been via increased reserve requirements

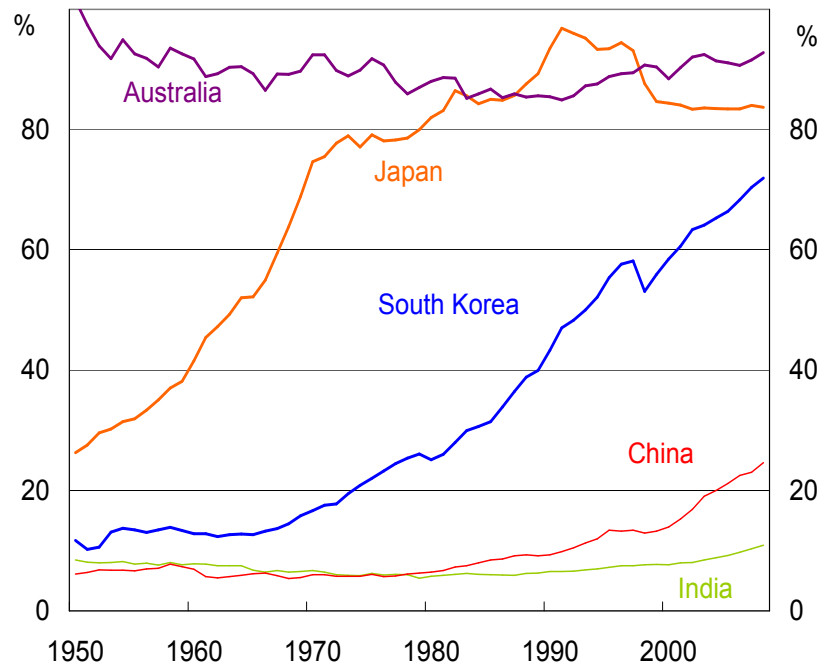


Global economic forecasts

	2010	2011(f)	2012(f)	2013(f)
United States	3.0	1.6	2.4	3.3
Japan	4.0	-0.6	3.3	1.9
Euro-zone	1.7	1.7	1.0	1.5
Asia ex. Japan & China	7.8	4.8	4.3	4.0
China	10.4	9.0	8.3	8.0
India	9.0	7.5	6.9	6.0
World	5.1	3.8	3.7	3.6
Australia's MTPs	6.2	4.3	4.6	4.3

**China matters because it is the swing player in commodity markets.
And will be very important given the stage of development it is at.
Already China accounts for 50% of global steel.**

Relative Economic Development
GDP per capita relative to advanced economies, equivalent prices



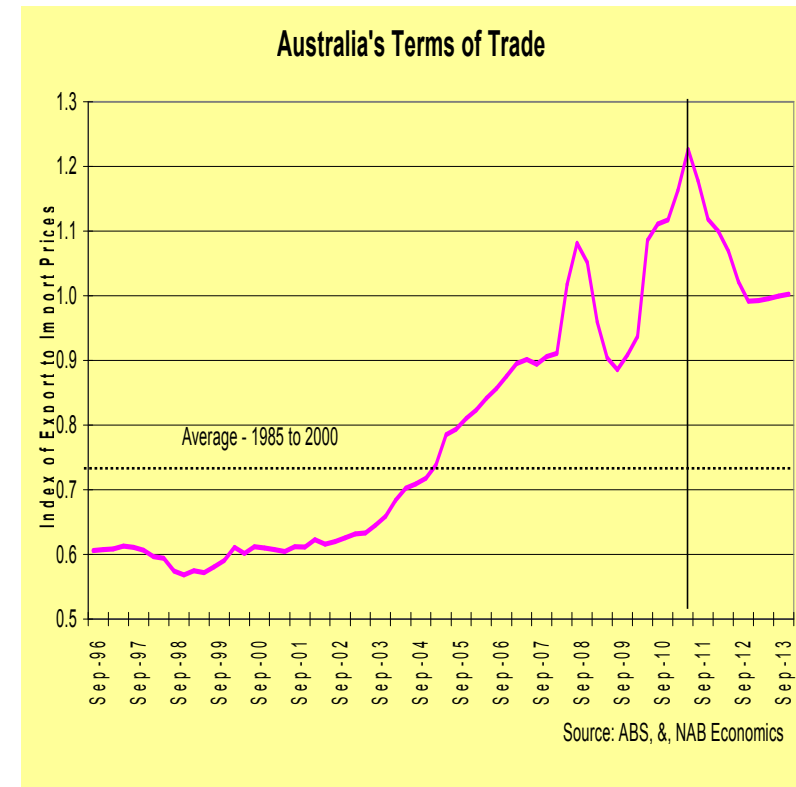
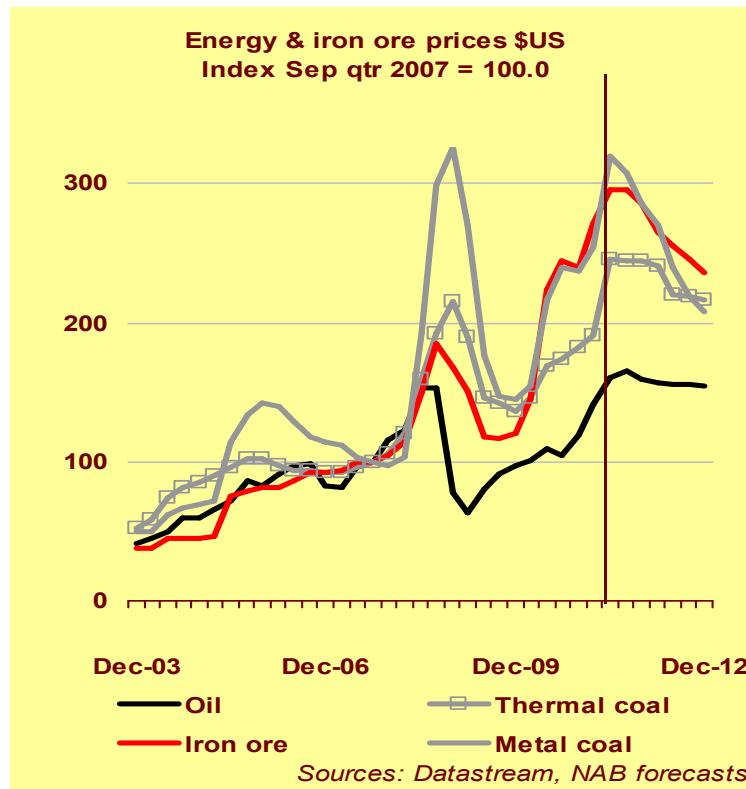
Source: Maddison database

China – Share of World Steel Production



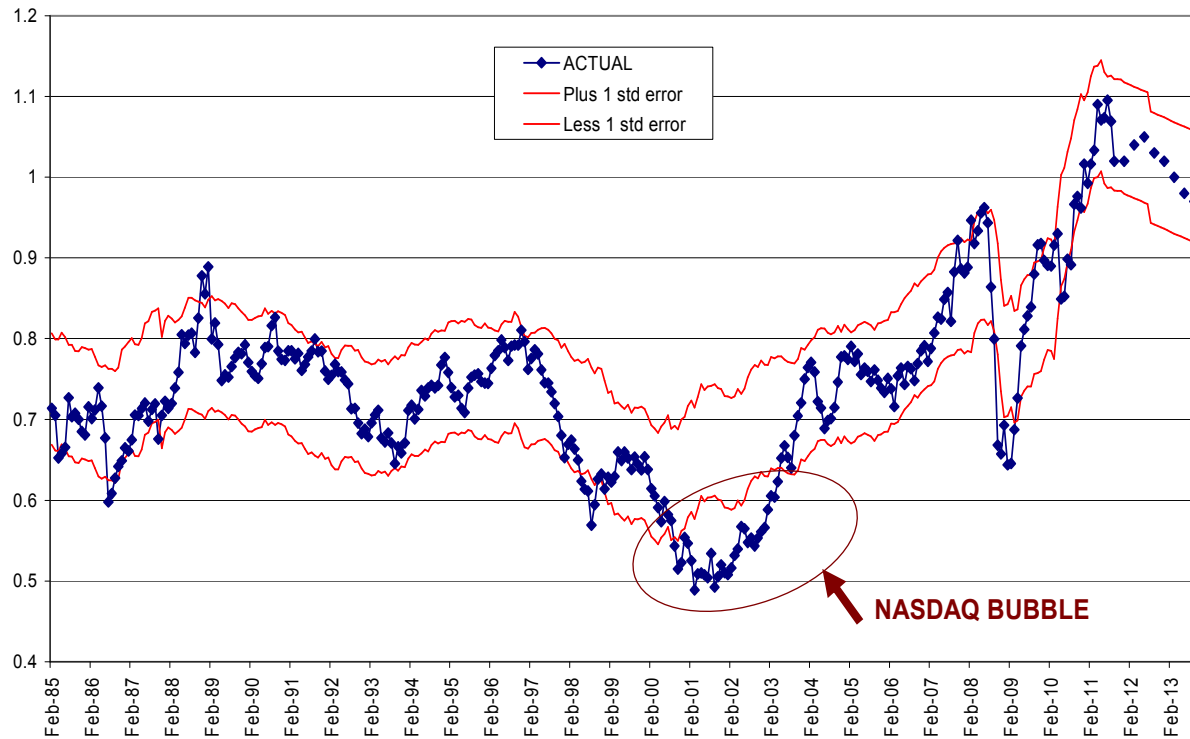
Sources: World Steel Association; RBA

While Australian economy will benefit from fast major trading sector growth, more important is the income effects of **very high commodity prices** and once in a 100 year terms of trade boost.



AUD a proxy for global (& especially Chinese) growth. Our model says AUD good value USD 1.05c (+/- 5c). We see AUD around 1.02 by late 2011 (fear reigns) then back to 1.05 by mid 2012. Long run around 95c (late 2013)

Model AUD and Forecasts v Actuals



Model driven by:

- **Commodities;**
- **USD / EURO – as a measure of USD weakness**
- **Long & short run rates;**
- **Relative unemployment;**
- **Relative Equity Mkts**

Key messages: The Australian Outlook. Australia is slowing below trend with multi speed economy becoming more pronounced as restructuring occurs. Longer run outlook: Accelerating growth but significant rebalancing challenges

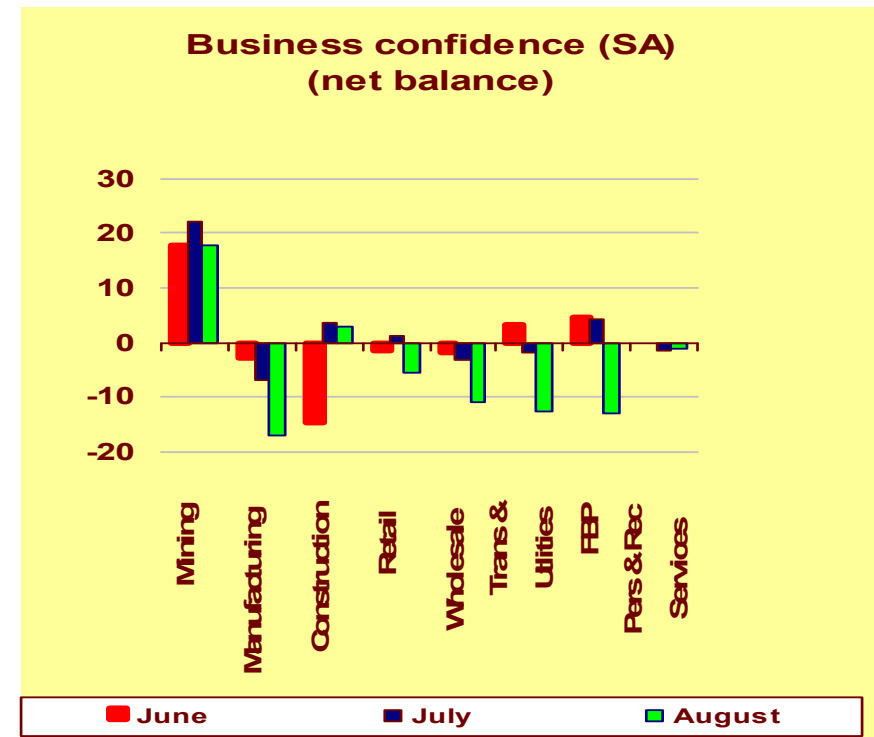
- **Natural disasters had bigger impact than expected (especially coal) - transferring 2% of GDP**
- **Consumers are extremely cautious. Pressure on retail and discretionary spending. High dollar (here to stay) which is hurting manufacturing, tourism and construction.**
- **The surprise has been that the weak are getting weaker. RESTRUCTURING.**
- **But miners, professional services, health and personal services strong. Not just mining.**
- **Terms of trade, Qld rebuild, and mining investment plans unprecedented**
- **Overall, accelerating (but mixed) growth, sluggish credit demand but higher inflation. Rates on hold for a long period but bias up (mid next year).**

**Business confidence eroded during the middle of 2011. And has been hit in last months financial market instability. Not surprising – and could have been worse. What happens next important (to be determined by outcomes).
By industry – manufacturing bleak, and market turmoil hurt services (esp. Finance)**

Business confidence (s.a. net balance)



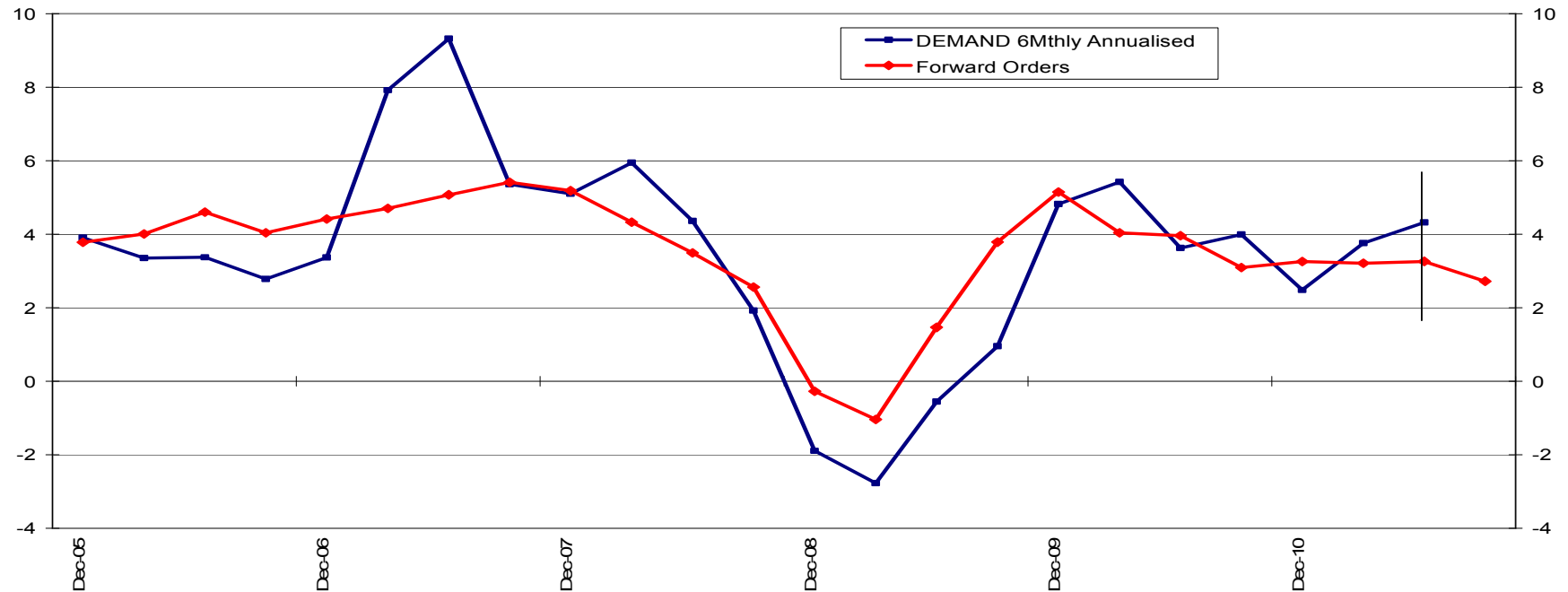
By Industry



**Survey indicative of demand continuing to soften
 August still weakening a touch – suggesting demand around 2 ½% at an
 annualised rate in Q3 2011.**

DEMAND

**Forward Orders (Change & Level) As an Indicator of Domestic Demand
 - 6 Mthly Annualised % in Demand**



Business conditions under pressure

QLD floods were as bad for business as GFC

Recovery now under way

- **Transport disrupted:**

 - 4700 km of railways:
4400 km restored

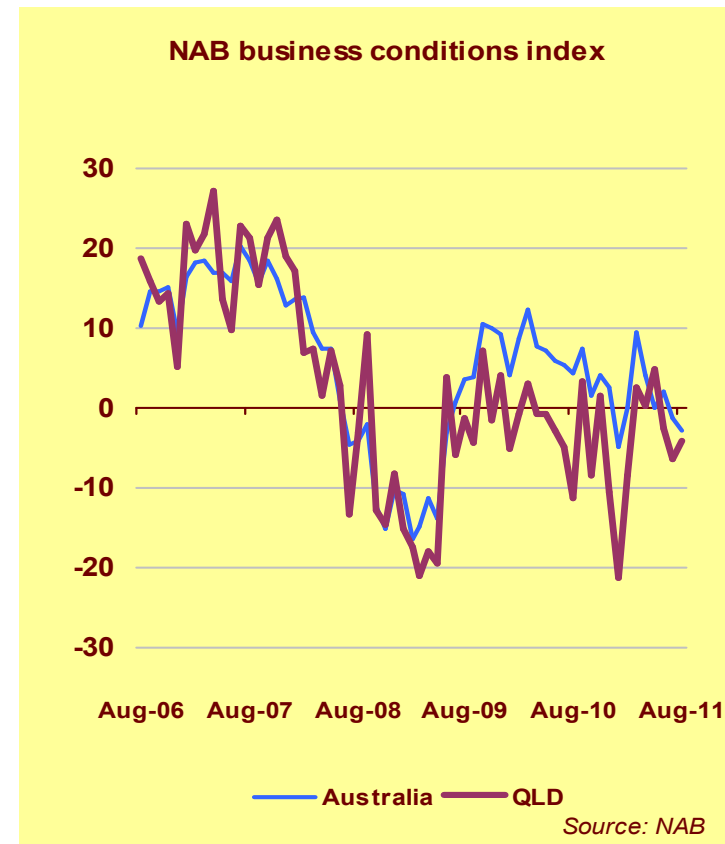
 - 9100 km of state roads:
8500 km restored

 - 45,500 km local roads:
36,900 km restored

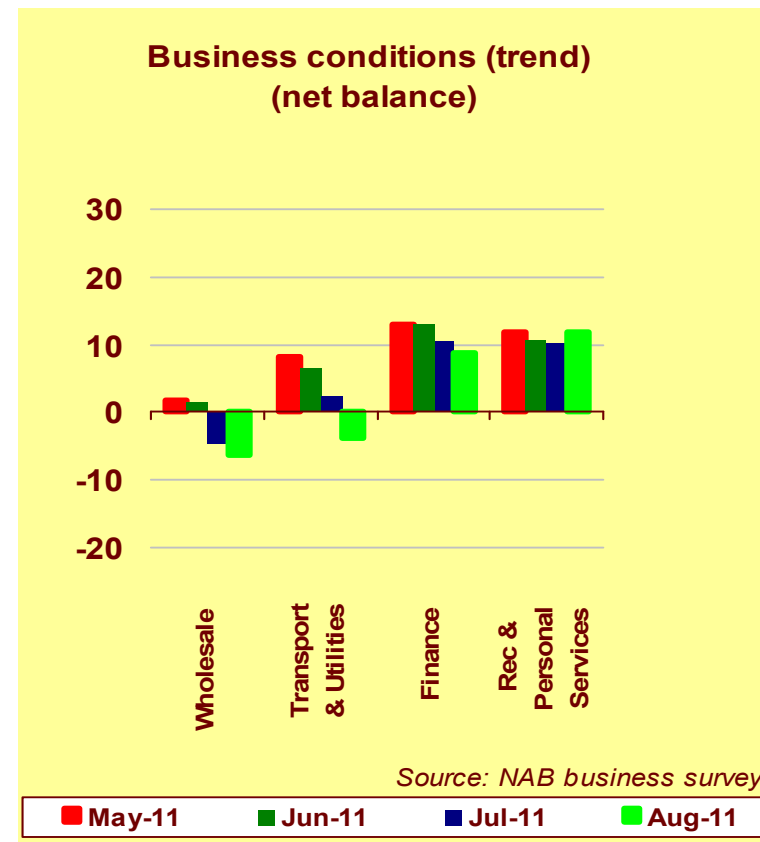
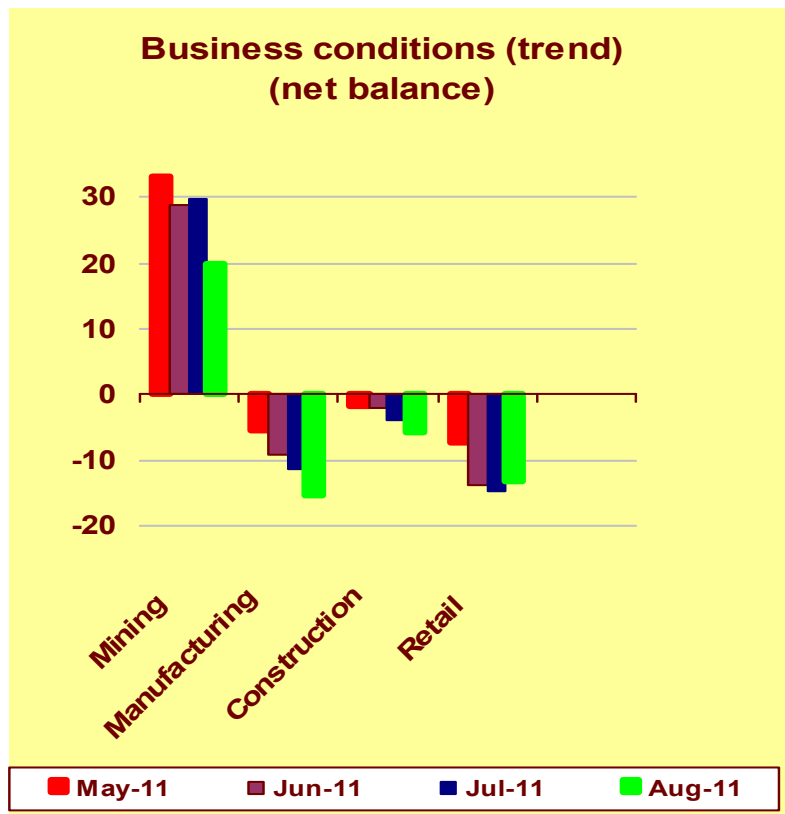
- **Sugar cane, cotton, grain & bananas badly affected**

- **Coal exports reduced**

 - 11 ports closed (all restored)



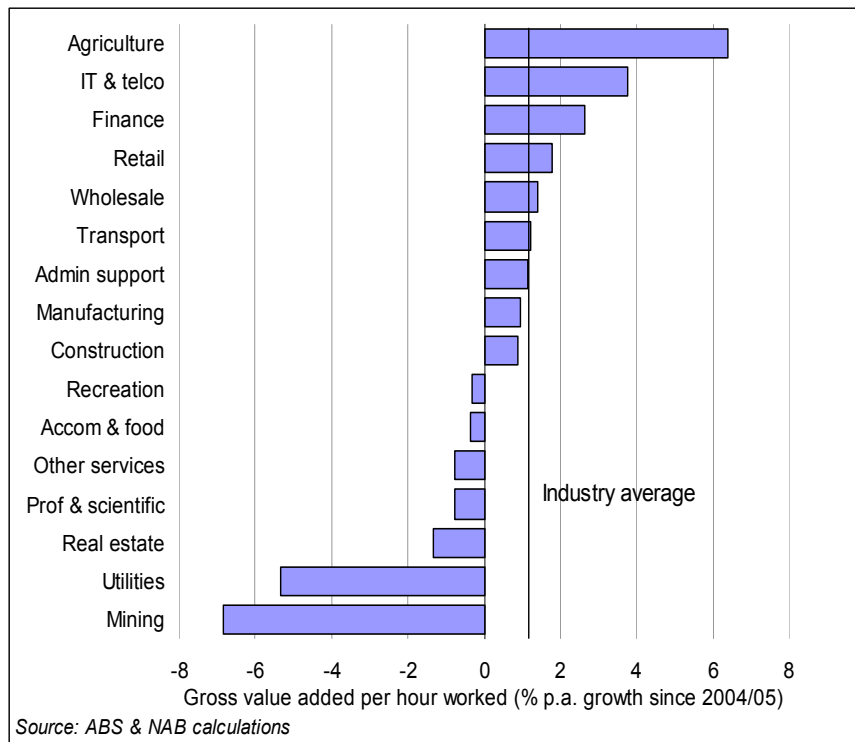
The multi speed economy very apparent. Mining still very strong. Utilities, (large) transport, finance and personal recreational services all reasonable. But manufacturing deteriorating rapidly while retail remains at very poor levels. Construction and wholesaling weakening.



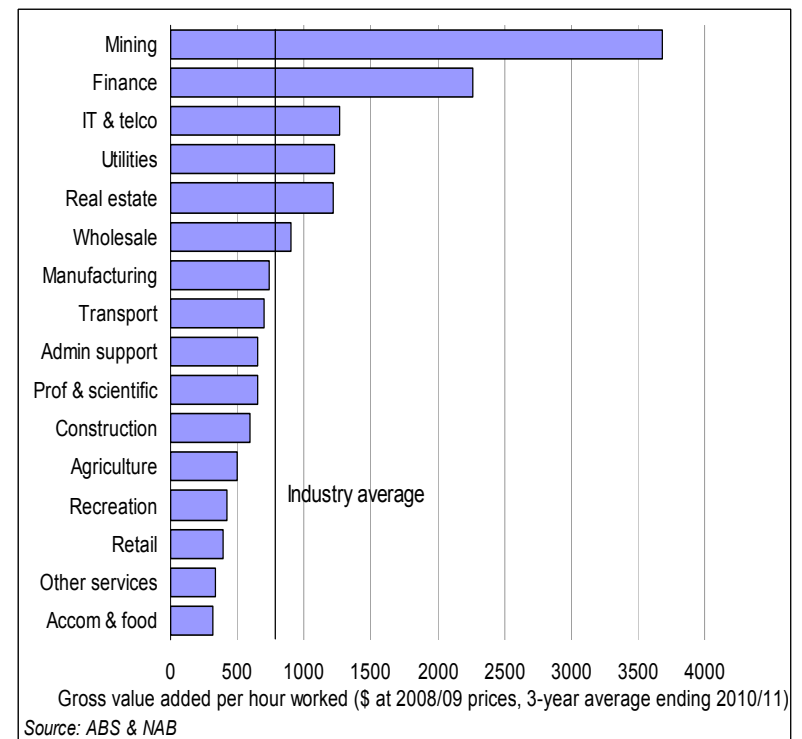
Mining is important in explaining slower productivity in Australia

That largely reflects lags Mining in fact is the highest productivity sector in level terms

Mining growth in productivity slow



But level of productivity highest



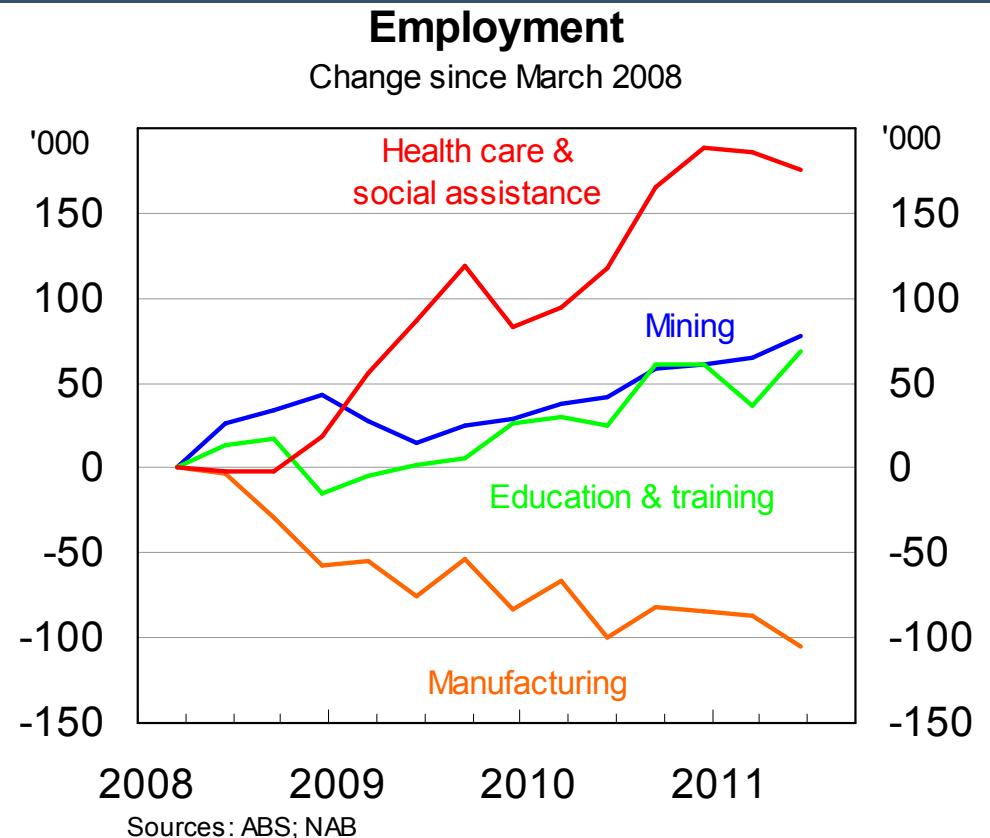
Australia is undergoing significant adjustment

Mining productivity growth is all about lags

The focus more broadly is adopting to the new challenges

■ **Faster growth in mining investment & utilities has subtracted around 0.9% from growth in productivity. Or around half the recorded slowing.**

■ **Previously business has hoarded labour – also contributing to slower productivity That now accelerating in poorer performing industries**

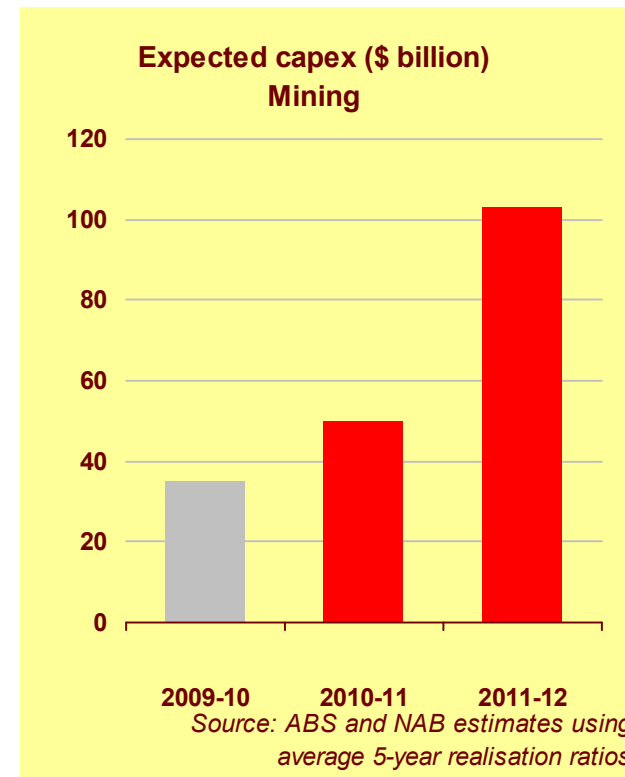
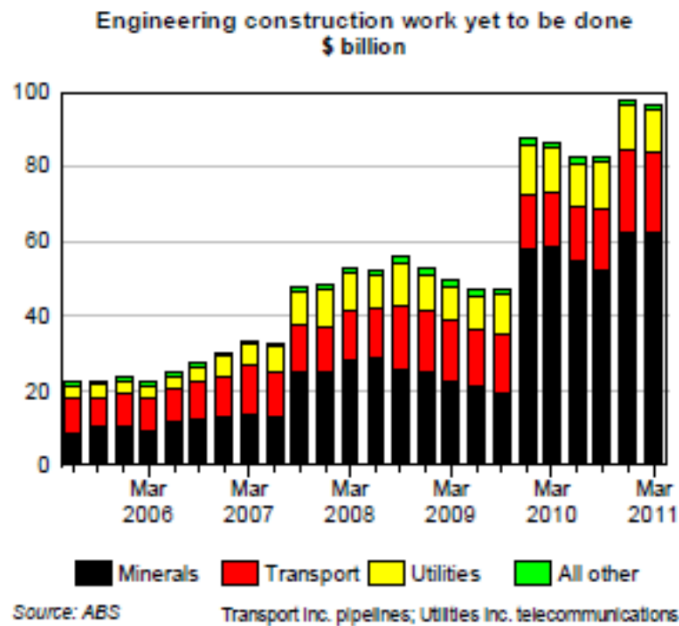


Structural v Cyclical productivity

- Focus should be on structural productivity – not cyclical
- That includes facilitating the movement of resources to higher productivity sectors and out of lower productivity sectors
 - improving labour mobility,
 - re- skilling and higher human capital
- Resources rent tax part of the story – or funding the adjustment. Miners are not facing the restraints that other sectors are

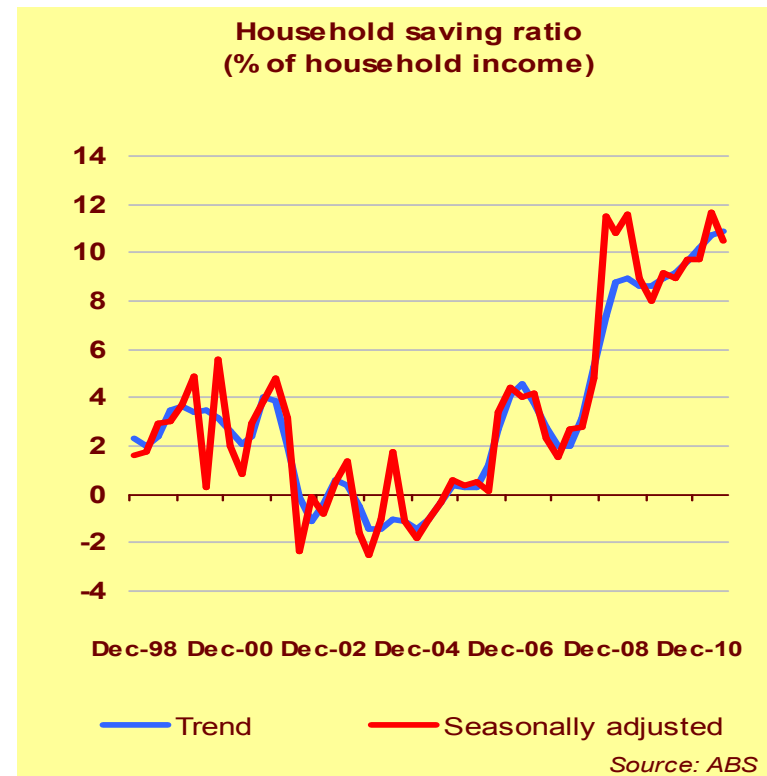


**Against that construction work yet to be done is very large.
While the pipeline for future investment is massive.**



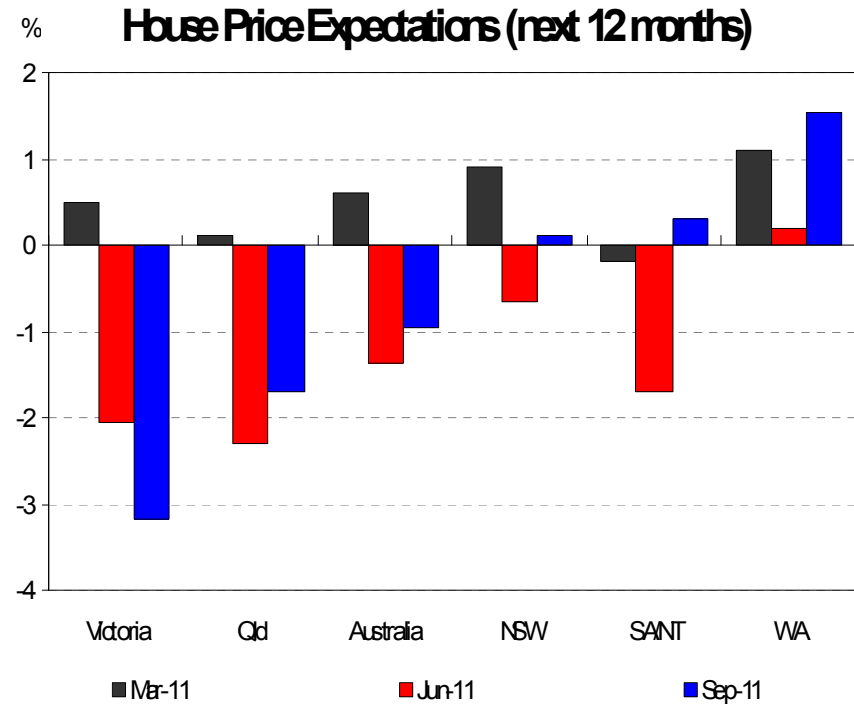
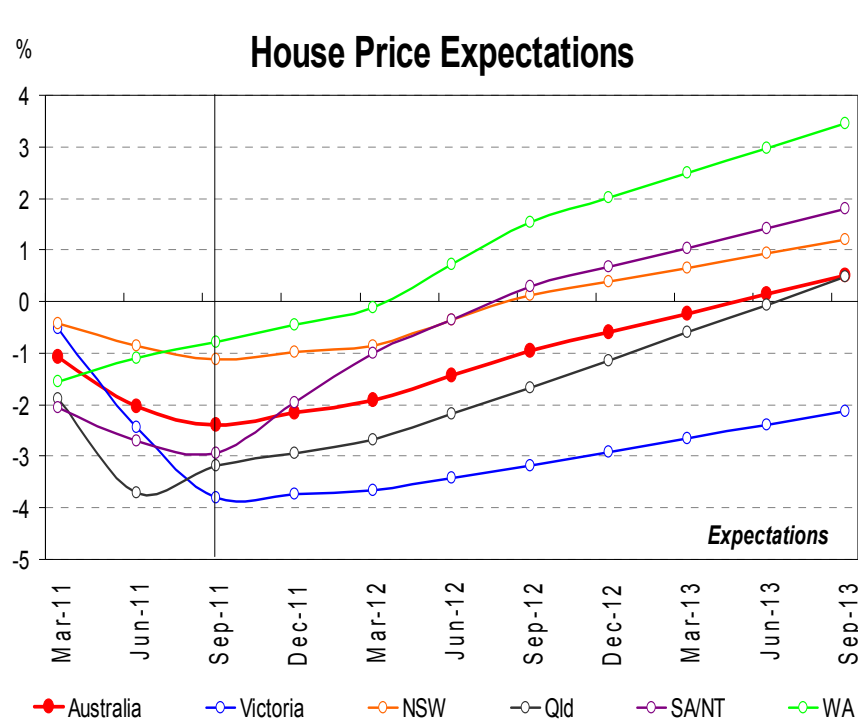
On consumers: Consumers are more still extremely cautious. Don't expect caution to ease much going forward

- Consumers are still wary and de-leveraging. Saving ratio has moved up significantly
 - And while internet growing its not the main driver
- Survey suggests that retail overall is experiencing extremely weak conditions
- But they are happy to spend on personal services

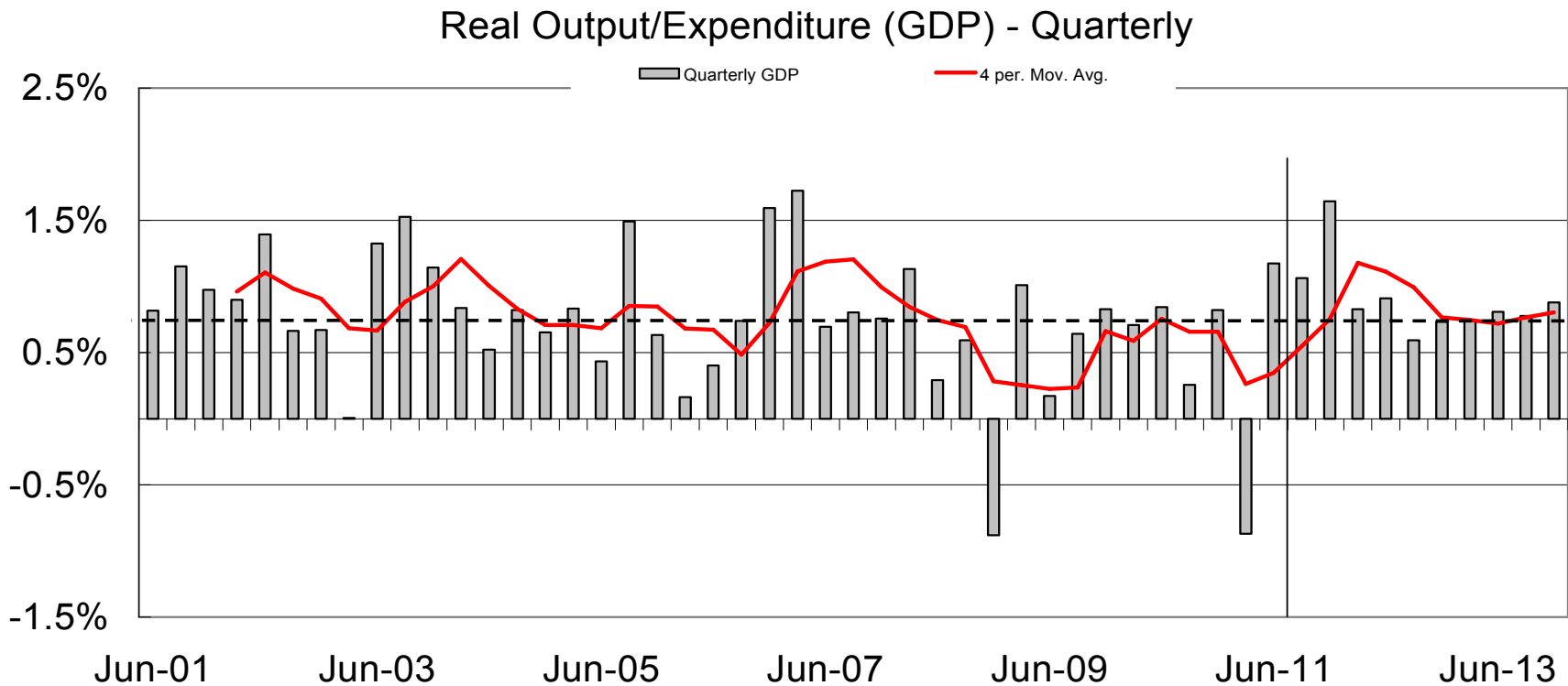


Another factor holding back consumers is relatively flat to falling housing markets. Expectations of professionals are for further falling prices. Victoria has fallen sharply with poor outlook. WA the strongest.

Results of NAB Residential Survey Sept Qtr



For 2011 we see growth of around 1.9%. Ex mining H2 will be a struggle. Miners are starting up production albeit not yet exported. But by late 2011 coal exports, lagged effects of high commodity prices, mining investment and Qld rebuild will be powerful drivers. While carbon a negative, GDP of 4% in 2012.



On carbon tax: in near term net negative to GDP and boost to inflation. But overall impact likely to be moderate

- **On inflation – accept 0.7% increase in 2012/13**
- **On growth - around 0.3% off GDP in 2012/13**
 - Reflects lower consumption from falling real wages
 - And lower business investment reflecting uncertainty and increased cost of capital
- **Not enough to change unemployment much but will be net negative to near term jobs growth**
- **Also dangers re cost of living increases feeding into wage pressures The rise likely to be most apparent by mid 2012. RBA will be watching**
- **Longer run suspect more negative than current modelling – wages are not fully flexible**

Core CPI history has just changed which will importantly affect RBA near term bias

- Previously RBA has been worried about their core measures of inflation rising strongly
- ABS has introduced a new version of CPI which will show a much lower core CPI
 - Rather than having core inflation at or above 3% (their target) for the next 3 years
 - The new version will have core inflation around 2 ½% out to at least early 2013. Then moves up as carbon impacts
- This must change RBA bias – to flat with a bias to cut in near term
- But we still think in the long run a further rise will be necessary to deal with higher inflation in 2013

On short term interest rates dynamics...

- Following the damage caused by floods etc RBA has been surprised by the softness in local domestic orientated sector.
- Global uncertainties have also mounted – Europe sovereign debt, US slowing and concerns re debt ceiling in the USA and subsequent downgrade. This further slows local activity via wealth and confidence effects.
- **RBA really now waiting to see what happens.** If the world crunches or unemployment rises substantially they will cut. **Markets still too negative – they are pricing an event risk (over 100 points in cuts).**
- We still think RBA in for a long period of inaction. We believe the economy and the labour market will strengthen. **By end 2012 they will still need to increase rates to cope with 2013 inflation**
- However the **short term bias** now must be that they are worried about the world , confident on stronger growth but with a bias to cut if labour market or activity weakens further
- Trigger points include
 - unemployment above 5.5% (currently 5.2%)
 - or a fall in our business conditions below -10 (currently -3)

Australian economic forecasts

	2011-12	2012-13	2011	2012	2013
GDP	3.6	3.3	1.9	4.1	3.0
Employment**	1.8	1.8	0.6	2.4	1.7
Unemployment rate*	4.8	4.9	5.2	4.8	5.0
Average earnings	4.6	4.8	4.0	5.0	4.6
CPI (Ex carbon underlying)**	2.6	3.1	3.2	2.7	3.1
RBA cash rate*	4.75	4.75	4.75	5.0	5.0
\$US/\$A*	1.05	0.98	1.02	1.02	0.96

* Level at the end of the period

** Year to the end of period %