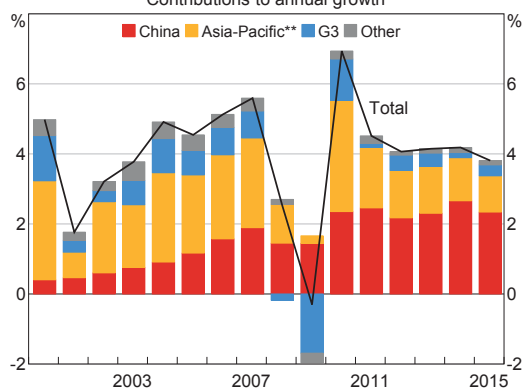


1. International Economic Developments

Over 2015, growth in the Asian region has slowed, while the recoveries in the United States and euro area economies have continued (Graph 1.1). Overall growth of Australia's major trading partners (MTPs) has been slightly below its decade average over the year to the June quarter, and is likely to have remained so in the September quarter.

Graph 1.1
Australia's Trading Partner GDP*
Contributions to annual growth



* Aggregated using Australia's export shares; RBA estimate for 2015

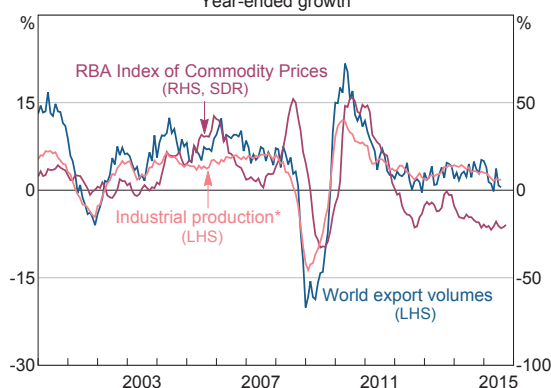
** Includes India, New Zealand and selected economies in east Asia other than China and Japan

Sources: CEIC Data; RBA; Thomson Reuters

Growth in global industrial production and trade volumes has slowed over 2015, reflecting the slowdown in the Asian region (Graph 1.2). Commodity prices have fallen substantially since 2014 in response to this softening in demand as well as ongoing increases in the supply of commodities.

Oil prices have fallen by around 60 per cent since mid 2014. Given that much of the decline in oil prices reflects strong supply, this is likely to support growth in most of Australia's MTPs, which are generally net

Graph 1.2
Global Activity and Commodity Prices
Year-ended growth



* Weighted by share of world industrial production at market exchange rates

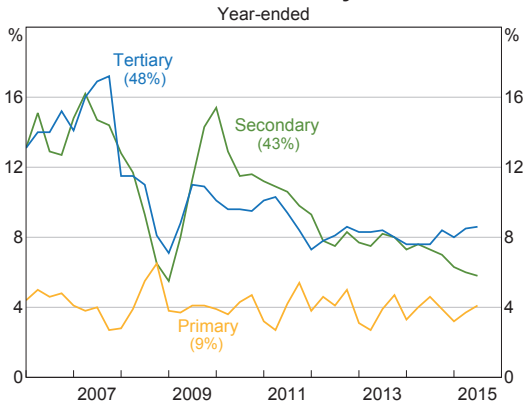
Sources: CEIC Data; CPB Netherlands Bureau for Economic Policy Analysis; RBA; Thomson Reuters

energy importers. Growth is also being supported by very accommodative monetary policies in many economies. Year-ended global headline inflation has been little changed over 2015, and remains low, reflecting the decline in oil prices to a large extent. Core inflation has been generally steady in both advanced and emerging economies, and remains below central banks' targets in most economies.

Asia-Pacific

A range of activity indicators suggest that growth in China has continued to ease over 2015, as strong growth in the tertiary (or services) sector has been outweighed by a slowdown in the secondary (or industrial) sector (Graph 1.3). The strength in the services sector appears to have been driven by financial services in recent quarters. Conditions

Graph 1.3
China – GDP Growth by Sector*

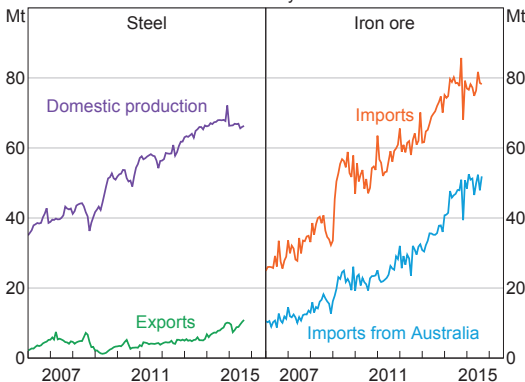


* Numbers in parentheses show 2014 shares of GDP
Sources: CEIC Data; RBA

in the industrial sector, which accounts for about 40 per cent of economic activity, have weakened noticeably over the year to date (see 'Box A: China's Industrial Sector').

Weakness in the industrial sector partly reflects subdued conditions in residential construction, which have curtailed demand for a range of construction-related manufactured items, including steel products. Domestic crude steel consumption has declined over 2015, but levels of production have stabilised in recent quarters, supported by increases in steel exports (Graph 1.4). Production of

Graph 1.4
China – Steel and Iron Ore
Monthly

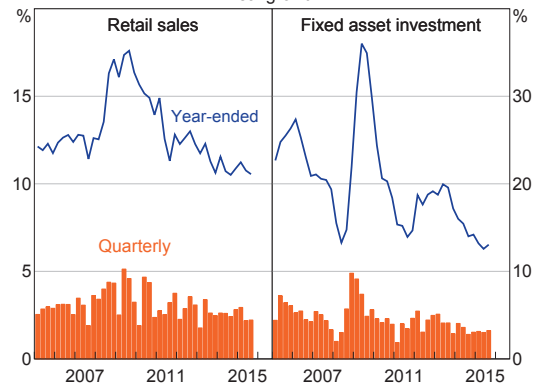


Sources: CEIC Data; RBA

iron ore in China has picked up somewhat in recent months but is still lower than it was in the first half of 2014. Imports of iron ore, including from Australia, have been broadly flat over the past year or so.

Growth in household consumption has been fairly stable in recent quarters. Real retail sales growth has been little changed in the past few months and automobile sales have retraced the decline seen over the first half of the year. Consumer spending appears to have been supported by steady growth of household income, which in turn has been aided by a rise in new jobs; the Government's 2015 target of 10 million new urban jobs was exceeded in the first three quarters of the year. Growth of fixed asset investment remains subdued by the standards of recent years (Graph 1.5). Growth in spending on infrastructure remains high, supported by a pick-up in project approvals this year, but has been offset by continued weakness in the growth of manufacturing and real estate investment (Graph 1.6).

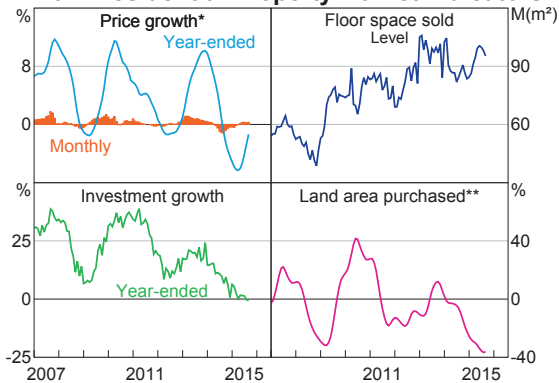
Graph 1.5
China – Activity Indicators
Real growth



Sources: CEIC Data; RBA

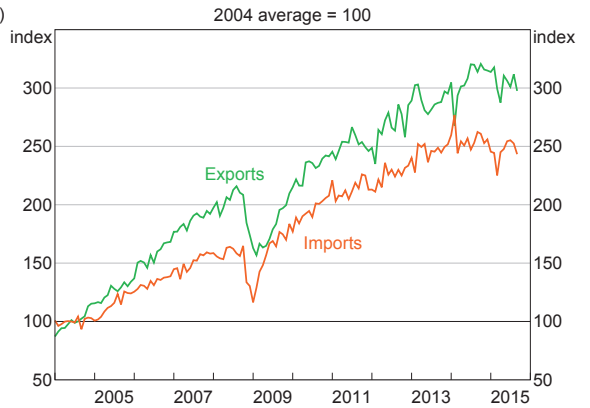
Conditions in the Chinese residential property market have been mixed. Overall, Chinese residential property prices have been rising in recent months, driven by strong increases in the larger cities, but they remain below levels observed a year ago. The volume of floor space sold has fallen a little since June but is still higher than last year. The stock of unsold housing remains substantial in many cities

Graph 1.6
China – Residential Property Market Indicators



* Newly constructed property in 69 large and medium-sized cities
 ** Year-ended growth of trend series, includes non-residential land
 Sources: CEIC Data; RBA; WIND Information

Graph 1.7
China – Merchandise Trade Volumes*



* Seasonally adjusted by the RBA
 Sources: CEIC Data; RBA

and hence real estate investment remains weak. Land area purchased by developers has trended lower over the year to date. The authorities have continued to introduce measures to support the residential property market, most recently by reducing the minimum mortgage down-payment requirement for first homes in most cities.

More generally, the Chinese authorities have continued to undertake a range of measures to support growth. These include reducing official benchmark interest rates, cutting banks' reserve requirement ratios, announcing further approvals for infrastructure investment and halving tax rates that apply to certain types of automobile purchases. It has been reported that the large 'policy' banks will issue CNY1 trillion in bonds to fund infrastructure projects between 2015 and 2017.

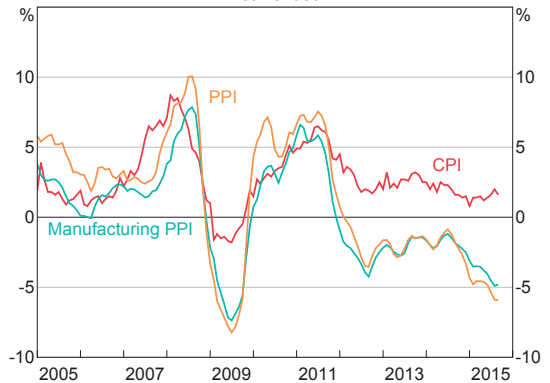
China's merchandise imports from all regions of the world remain weak, and are around their levels of two years ago in volume terms, consistent with the slowing in domestic demand (Graph 1.7). Exports to most destinations have also fallen, to be around the levels seen two years ago. Weakness in exports may, in part, reflect the effect of the sizeable real exchange rate appreciation over the past year or so.

Disinflationary pressures in China have increased. Producer prices have continued to decline, due in

part to lower commodity prices, but also reflecting the ongoing effects of spare capacity in the manufacturing sector (Graph 1.8). The implied GDP deflator fell in the September quarter, reflecting falls in prices of industrial goods. CPI inflation has risen over 2015, but remains well below the authorities' full-year target of 3 per cent.

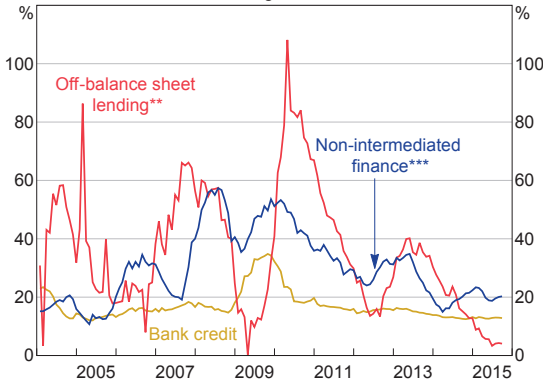
Financing conditions have improved a little in recent months. The growth of total social financing (TSF) has increased, largely reflecting a pick-up in non-intermediated finance and continued strength in bank credit (Graph 1.9). Recent data on TSF may understate the growth of economy-wide financing,

Graph 1.8
China – Inflation
 Year-ended



Sources: CEIC Data; RBA

Graph 1.9
China – Total Social Financing*
 Year-ended growth in stock



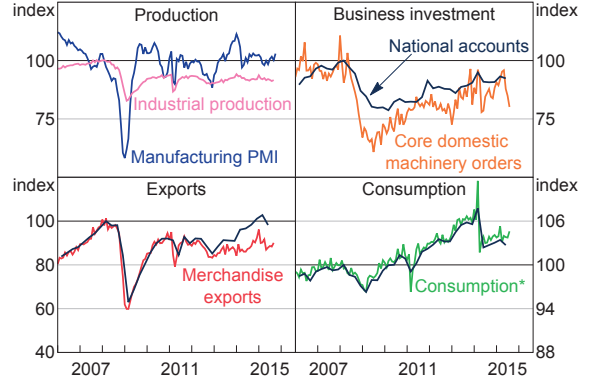
* Non-seasonally adjusted
 ** Entrusted loans, trust loans and undiscounted bank acceptance bill issuance
 *** Corporate bond and non-financial corporate equity issuance
 Sources: CEIC Data; People's Bank of China; RBA

as they exclude local government debt, which has been progressively issued since early this year to replace loan types that are included in TSF. While CNY2.5 trillion of local government debt had been issued by September, the process of restructuring is likely to take many years.

The economic recovery in Japan appears to have stalled in mid 2015. GDP declined in the June quarter, due to broad-based weakness across consumption, business investment and exports (Graph 1.10). On balance, recent indicators point to little, if any, growth in the September quarter. Exports are likely to remain weak in the near term, due to a slowdown in Japan's major trading partners in Asia, which account for nearly 60 per cent of its exports. In line with this, leading indicators of business investment have also declined in recent months. While some business surveys point to healthy investment plans, some of that may reflect offshore investment by Japanese corporations; sales by foreign subsidiaries of Japanese companies have been growing much faster than exports from Japan since 2012.

Nevertheless, labour market conditions remain tight in Japan, reflecting increased demand for labour (associated with the rise in output over the past few years) and reduced labour supply as the population

Graph 1.10
Japan – Economic Indicators
 March 2008 = 100



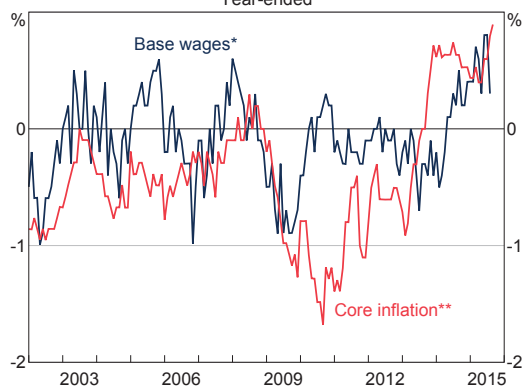
* The Cabinet Office's monthly measure of private consumption
 Sources: CEIC Data; Markit Economics; RBA; Thomson Reuters

ages. The unemployment rate has declined further this year and is low by historical standards, while the ratio of job offers to applicants has been rising steadily. These conditions have been placing upward pressure on labour compensation over the past few years, although wage growth in real terms has remained low in recent years as inflation has also picked up. This may be contributing to the slow recovery in consumption following the increase in the consumption tax in 2014.

Following a sustained period of deflation after the financial crisis, core consumer prices have been rising for two years. However, the rate of core inflation remains below the Bank of Japan's (BoJ) target of 2 per cent (Graph 1.11). Headline inflation is positive, but at a lower level, reflecting the ongoing effects of the decline in the oil price since last year. Market-implied measures of inflation expectations also remain below the BoJ's target. Nonetheless, the BoJ expects inflation to reach its target by early 2017, conditional on oil prices rising moderately from their recent levels.

In the rest of east Asia, economic activity has grown at a below-average pace this year. The key driver has been weakness in external demand, especially for the higher-income economies in the region. A sharp fall in exports from Taiwan and Singapore led to a decline in GDP in those economies in the

Graph 1.11
Japan – Wage Growth and Inflation
 Year-ended



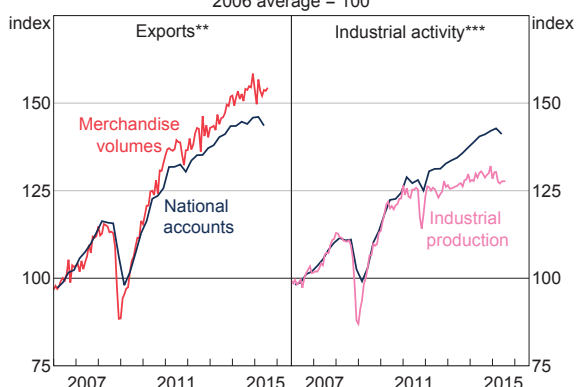
* Full-time workers only
 ** Excluding the effects of the consumption tax increase in April 2014
 Sources: Bank of Japan; CEIC Data; RBA; Thomson Reuters

June quarter. Recent indicators, and September quarter GDP data to hand for a number of east Asian economies, point to further below-average growth, including a continuation of subdued export growth (Graph 1.12).

Trade between the economies in the east Asian region has accounted for a significant part of the slowdown in trade in the region since mid 2014. This region is also exposed to slowing demand growth elsewhere, including China, which is a significant source of intermediate and final demand for the region's exports. However, trade should be assisted to some extent by recovery in the United States and euro area, which account for around one-third of the final demand for the region's exports. Real exchange rate depreciations over 2015 for many economies in the region will also help to support external demand. In value terms, the weakness in exports from the region has been even more pronounced in 2015 due to the declines in oil prices.

There are tentative signs that the external sector weakness facing the east Asian region is beginning to affect domestic activity. Growth in domestic demand slowed to a below-average rate in the June quarter. This was driven by a decline in investment growth, especially in the middle-income economies, while consumption growth was a bit

Graph 1.12
East Asia* – Exports and Industrial Activity
 2006 average = 100



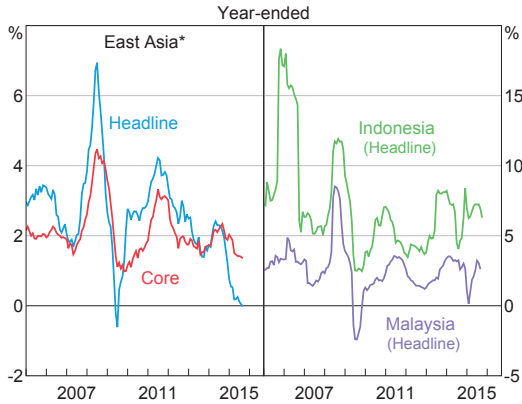
* Selected economies in east Asia excluding China and Japan
 ** Merchandise volumes are non-oil domestic exports for Singapore; non-oil and gas exports for Indonesia; excludes re-exports through Hong Kong, national accounts includes re-exports and services exports
 *** Excludes Hong Kong and Indonesia
 Sources: CEIC Data; IMF; RBA

below average. A range of indicators, such as below-average retail sales growth, lower levels of industrial production over the past year, and below-average manufacturing PMIs, point to a continuation of recent trends in consumption and investment.

Headline and core inflation in the region remain subdued in most economies, other than Malaysia and Indonesia where reductions in fuel subsidies in 2014 and, in the case of Malaysia, the introduction of a goods and services tax in April this year have put some upward pressure on inflation (Graph 1.13). In response to slowing inflation and economic activity, monetary policy has been eased this year in economies including Korea, Singapore, Taiwan and Thailand. Despite the moderation in growth and inflation, unemployment in the region remains low and stable.

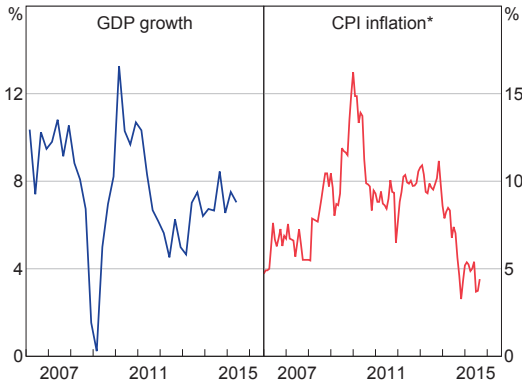
In India, growth remained strong in the June quarter, although deficient monsoon rains are likely to lead to lower agricultural output over the remainder of the year (Graph 1.14). Growth in the manufacturing sector has been relatively strong in recent months, but private investment has slowed. External demand has remained subdued, and the current account deficit widened over the June quarter.

Graph 1.13
East Asia – Inflation



* Selected economies in east Asia excluding China, Indonesia, Japan and Malaysia
Sources: CEIC Data; IMF; RBA; Thomson Reuters

Graph 1.14
India – GDP Growth and Inflation

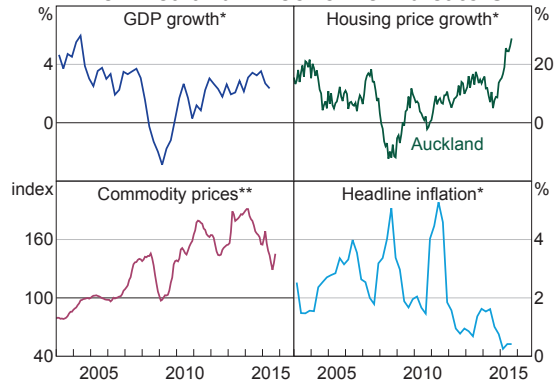


* Reserve Bank of India estimates prior to January 2012
Sources: CEIC Data; RBA; Reserve Bank of India

Consumer price inflation remains well below the Reserve Bank of India's (RBI) interim target of 6 per cent by January 2016. The RBI cut the policy rate by an additional 50 basis points in late September, following a cut in June, citing a range of factors including weaker global conditions and contained food price inflation. Together with lower oil prices and increases in government capital expenditure, this should continue to support growth of the Indian economy.

In New Zealand, GDP growth moderated over the first half of 2015, driven partly by weak external demand and a further decline in commodity prices (Graph 1.15). With inflation remaining low, the Reserve Bank of New Zealand has cut its policy rate by a cumulative 75 basis points since June. This, along with the recent rebound in dairy prices and the exchange rate depreciation over 2015, is likely to support growth and contribute to inflation in the medium term. Strong net immigration continues to underpin growth in the labour force and put upward pressure on housing prices, especially in Auckland.

Graph 1.15
New Zealand – Economic Indicators



* Year-ended
** January 2005 = 100
Sources: ANZ; RBA; RBNZ; REINZ; Thompson Reuters

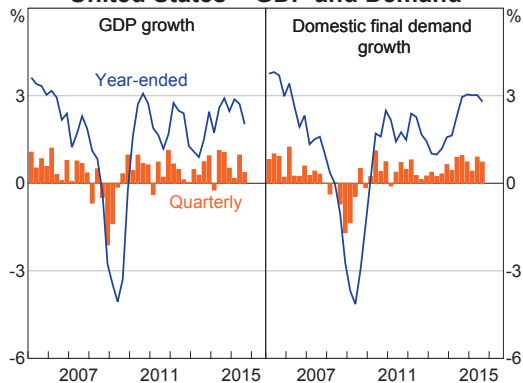
United States

The recovery in the United States economy has continued this year (Graph 1.16). Consumption growth has been strong, supported by further improvement in the labour market, the boost to real household incomes from lower fuel prices and rising household wealth. These factors, along with recent consumption activity indicators, suggest further consumption-led growth in the period ahead.

Modest growth in business investment, and the continuing recovery in residential investment, have also provided some support to growth in the US economy in 2015. At the same time, however, exports have been weak and investment in the energy sector has declined due to the sharp fall in

Graph 1.16

United States – GDP and Demand



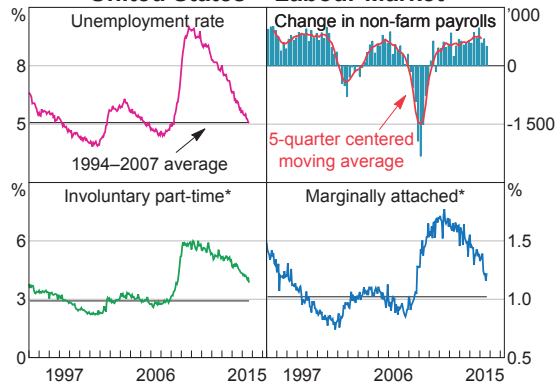
Source: Thomson Reuters

oil prices. Recent business activity indicators point to a further modest increase in business investment in the near term. Survey measures of conditions in the services and construction sectors, which account for more than two-thirds of economic output in the United States, remain above or around average levels of recent years. In contrast, conditions in the manufacturing sector, which accounts for only about 10 per cent of economic activity, have been more subdued. In particular, industrial production, core capital goods orders and survey measures of manufacturing business conditions have been mostly unchanged over recent months and remain below their late 2014 levels.

Labour market conditions have continued to improve in line with the economic recovery. While employment growth has slowed somewhat in recent months, it has been sufficient to absorb the growth of the working-age population and contribute to a further gradual decline in labour market spare capacity (Graph 1.17). Specifically, the unemployment rate and other measures of labour market underutilisation have continued to decline gradually, and are at, or are closing in on, their pre-crisis long-run averages. This has put upward pressure on labour incomes; growth in the employment cost index picked up in the September quarter to be around the post-crisis average over the year (Graph 1.18).

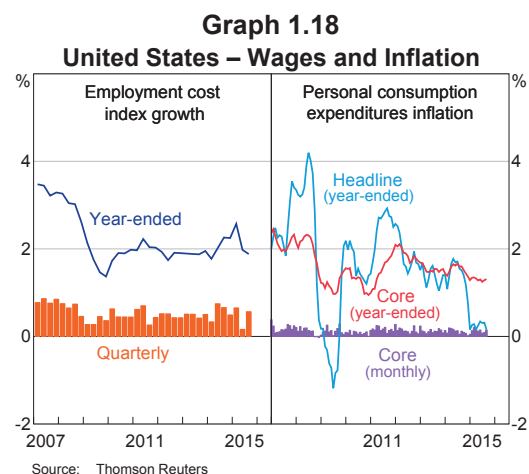
Graph 1.17

United States – Labour Market



* Per cent of labour force

Sources: RBA; Thomson Reuters



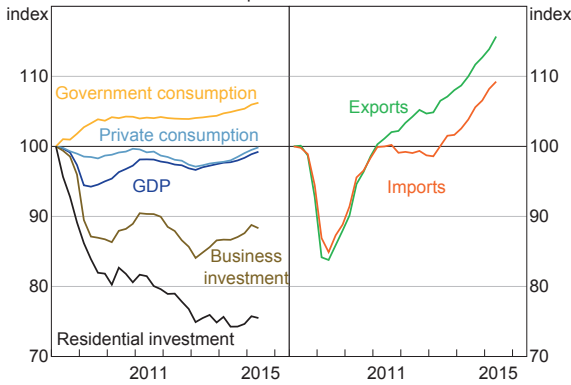
Source: Thomson Reuters

Headline inflation has remained low since late 2014, reflecting the effects of lower oil prices. Core inflation has been broadly stable this year at around 1¼ per cent in year-ended terms.

Europe

The recovery in the euro area economy has continued into the second half of 2015. GDP has been rising since the beginning of 2013, and more recently has been growing at an above-trend pace (Graph 1.19). Growth has been supported by household and government consumption; household consumption has now recovered to its pre-crisis levels. In contrast, investment remains

Graph 1.19
Euro Area – GDP
March quarter 2008 = 100



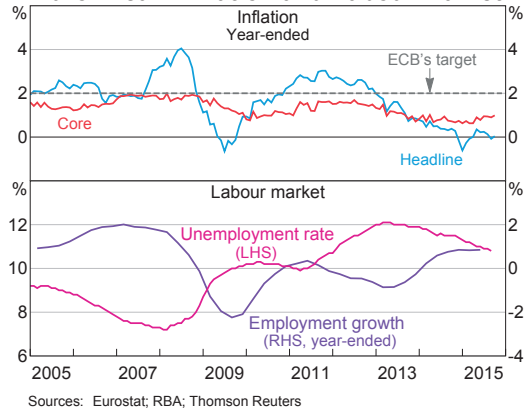
Source: Thomson Reuters

subdued, and residential construction investment has remained particularly weak. Exports have continued to grow at roughly the same pace as imports.

More timely indicators point to economic activity in the September quarter having grown at a similar rate as in recent quarters. Consumer and business confidence remain above their average levels. The euro area PMIs, in both the services and manufacturing sectors, have remained high relative to their recent history. Industrial production has been little changed in recent months, but is above its level of a year ago. Household credit has continued to grow, albeit at low rates, reflecting improved supply of and demand for credit. After declining consistently for some time, business credit is little changed over the past year.

The labour market in the euro area continues to improve gradually (Graph 1.20). Employment in the June quarter grew at its fastest pace in seven years, although the level of employment is yet to reach its pre-crisis peak. The region's unemployment rate has been declining but remains high, and is still only around 1¼ percentage points below its mid 2013 peak. The improvement in labour market conditions has been broad based across countries, but has been greatest in Ireland, Portugal and Spain, where GDP growth has been relatively strong recently.

Graph 1.20
Euro Area – Inflation and Labour Market



Sources: Eurostat; RBA; Thomson Reuters

Headline inflation remains low, reflecting the lower oil prices to a large extent. Core inflation increased over 2015 but remains well below the European Central Bank's target. Longer-term market-implied inflation expectations have declined in recent months after rising in early 2015; they remain at historically low levels.

Commodity Prices

The RBA Index of Commodity Prices (ICP) has declined further in recent months, led by lower prices of bulk commodities, oil and base metals (Table 1.1; Graph 1.21). Overall, commodity prices are now around 50 per cent below their peak in 2011 but are still around 80 per cent above levels seen in the early 2000s. The fall in commodity prices since 2011 has occurred in response to substantial increases in supply, particularly for oil and bulk commodities, as new resource projects have started production. More recently, weakness in demand, especially from Asia, has also contributed to falls in commodity prices.

The Brent crude oil price remains around 60 per cent lower than in mid 2014 (Graph 1.21). The decline in oil prices since mid 2014 continues to be reflected in weakness in liquefied natural gas (LNG) prices, particularly in the Asian region.

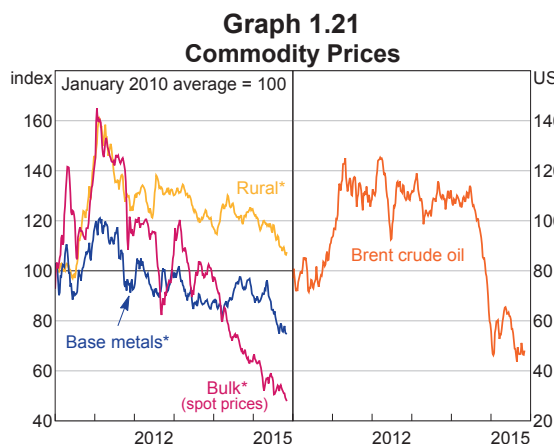
Table 1.1: Commodity Price Growth^(a)
SDR, 3-month-average prices, per cent

	Since previous Statement	Over the past year
Bulk commodities	-6	-24
– Iron ore	-6	-30
– Coking coal	-5	-22
– Thermal coal	-6	-10
Rural	-6	-10
Base metals	-11	-19
Gold	-3	-2
Brent oil ^(b)	-21	-50
RBA ICP	-6	-21
– using spot prices for bulk commodities	-6	-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



* RBA Index of Commodity Prices sub-indices, SDR

Sources: Bloomberg; RBA



* Average of hot rolled steel sheet and steel rebar prices

** Free on board basis

Sources: Bloomberg; RBA

The spot price of iron ore has declined in recent months, driven largely by concerns about the strength of the Chinese economy and the associated demand for iron ore (Graph 1.22). Notwithstanding these concerns, the volume of global low-cost iron ore production, including from Australia, is expected to increase further. In the absence of a pick-up in the growth of global demand, this will place further downward pressure on the iron ore price for some time. However, reductions in production costs

over recent years, together with the depreciation of the Australian dollar, mean that most Australian production of iron ore appears to be profitable. Nevertheless, some smaller, higher-cost producers remain under pressure and scope for further cost reductions is becoming more limited.

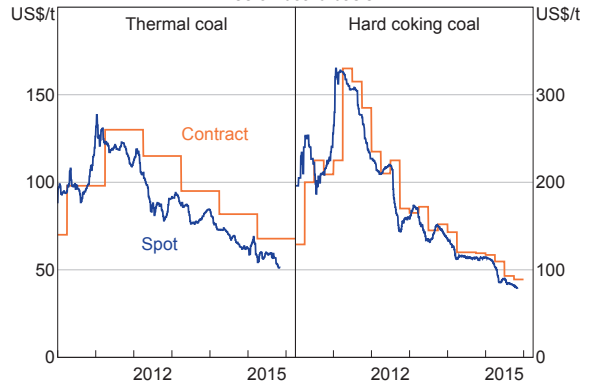
Prices of thermal and coking coal have fallen in recent months, in part reflecting weaker demand from China for steel production, particularly in the

case of coking coal (Graph 1.23). At current prices, a substantial share of global coal production, including in Australia, is estimated to be unprofitable. Recently, weak demand associated with slower growth of global industrial production has also led to declines in the prices of base metals. In response, global production of some base metals, notably zinc and aluminium, has been reduced. ↘

Graph 1.23

Coal Prices

Free on board basis



Sources: Department of Industry, Innovation and Science; IHS; RBA