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2008 Macroeconomic Update

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Australia's macroeconomic outlook – 2008 and beyond

A presentation by Professor Ian Harper
Melbourne Business School

Forecasts by ACCESS ECONOMICS
June 2008

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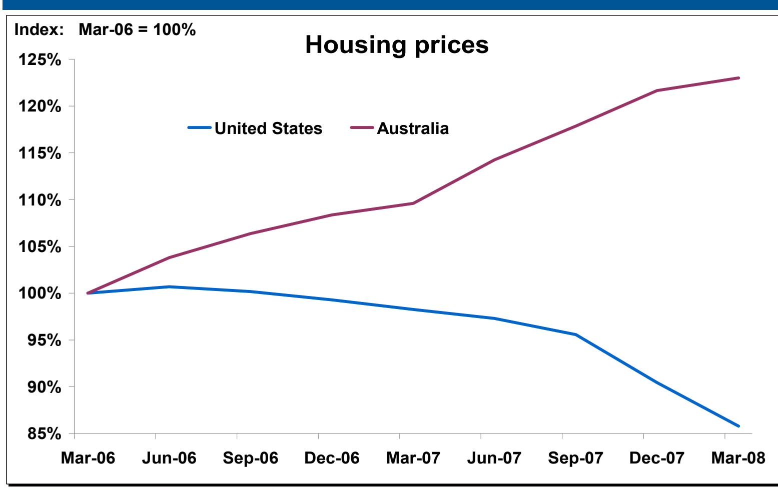
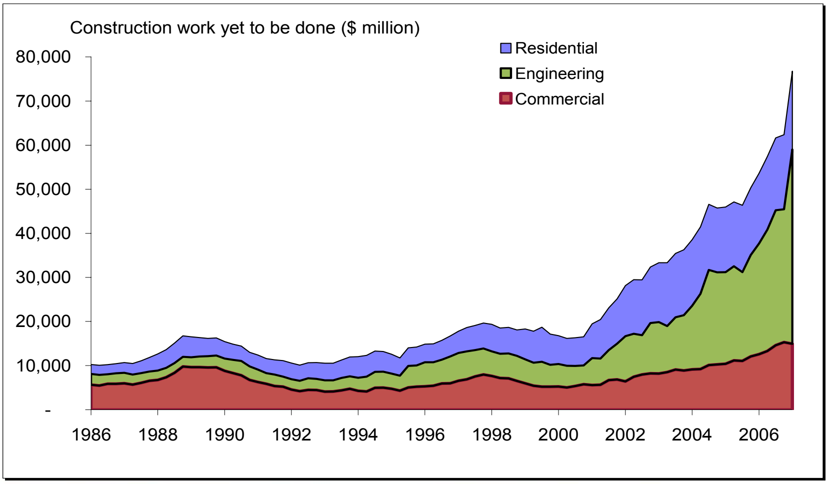
Will we follow the USA?

- The big question is whether Australia will follow the US economy into a 'growth recession'
- Both Federal Treasury and the RBA forecast a slowdown in Australia's economy this year
- But at least two factors differentiate us from the USA
  - house prices
  - exposure to the Chinese economy

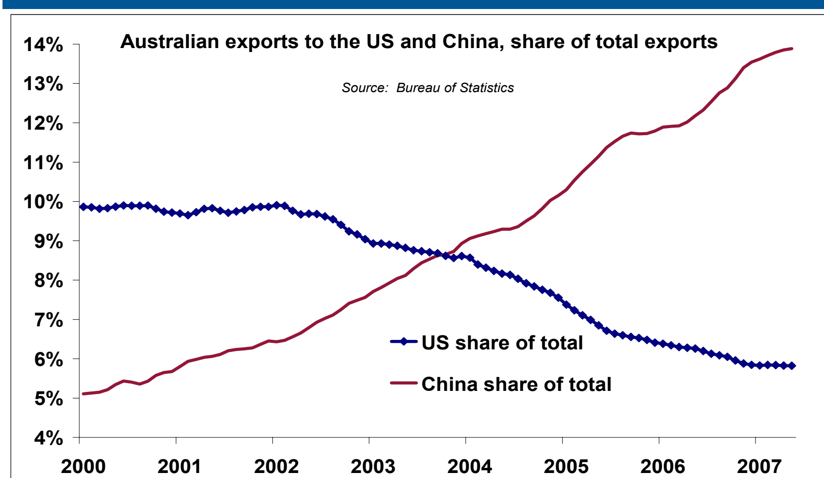
House prices are still rising here



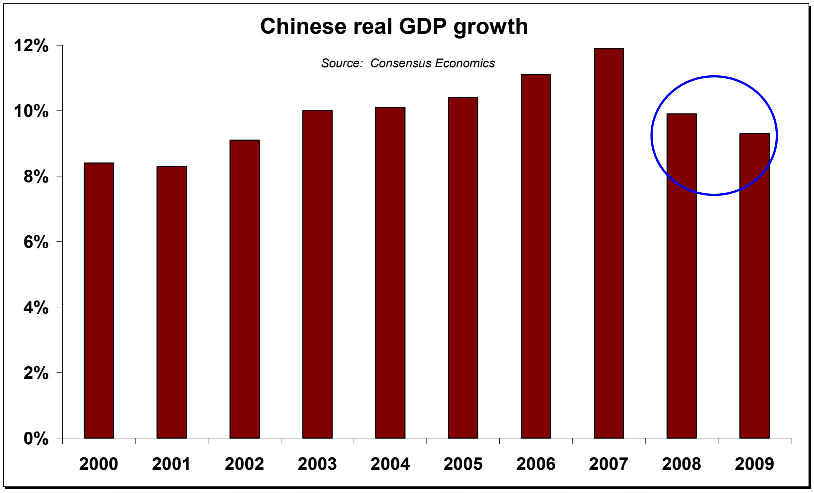
and there's plenty in our pipeline



China makes up for a slower US



and China is still growing strongly

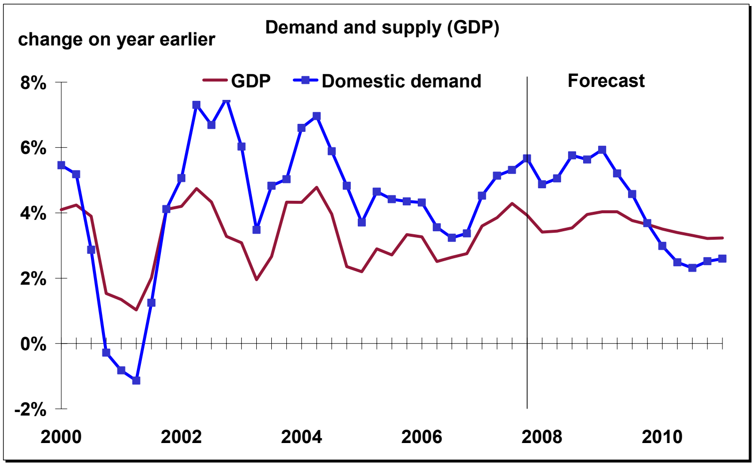


So is the world at large

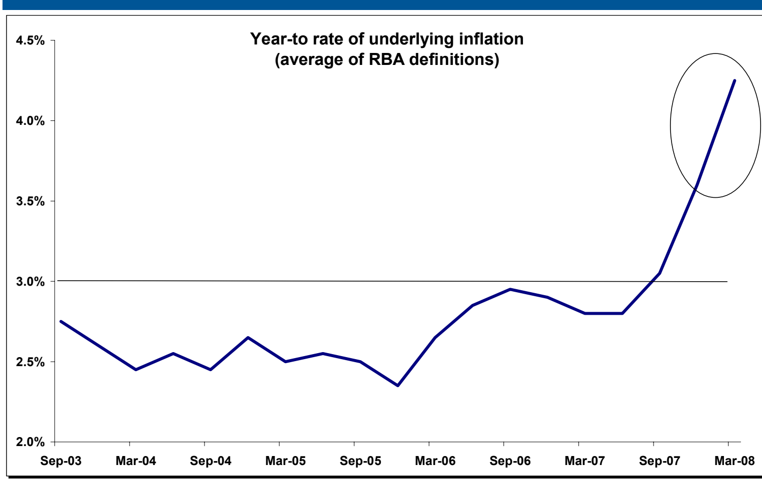
Industrial production growth (change on previous year)

Region				Consensus forecasts	
	2005	2006	2007	2008	2009
United States	3.3%	2.2%	1.7%	0.7%	2.2%
Japan	1.5%	4.5%	2.9%	1.1%	2.4%
Eurozone	1.4%	4.0%	3.4%	2.0%	1.9%
China	16.4%	16.6%	18.5%	15.9%	14.7%
World	4.5%	5.7%	5.5%	4.1%	4.6%

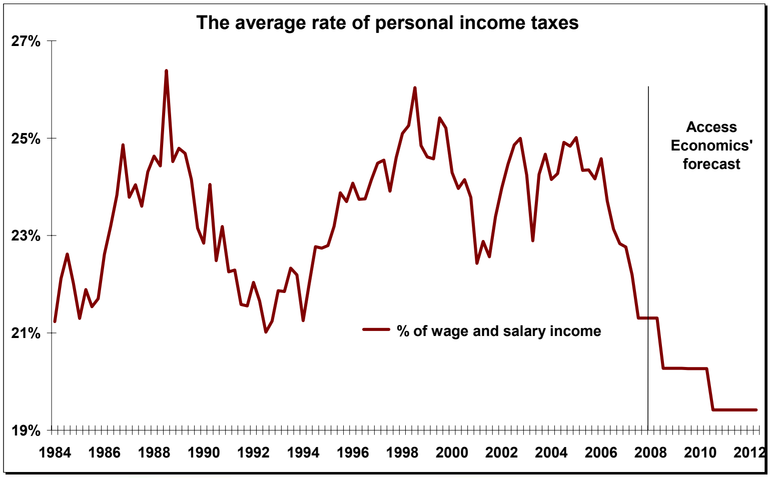
Recession is not the problem



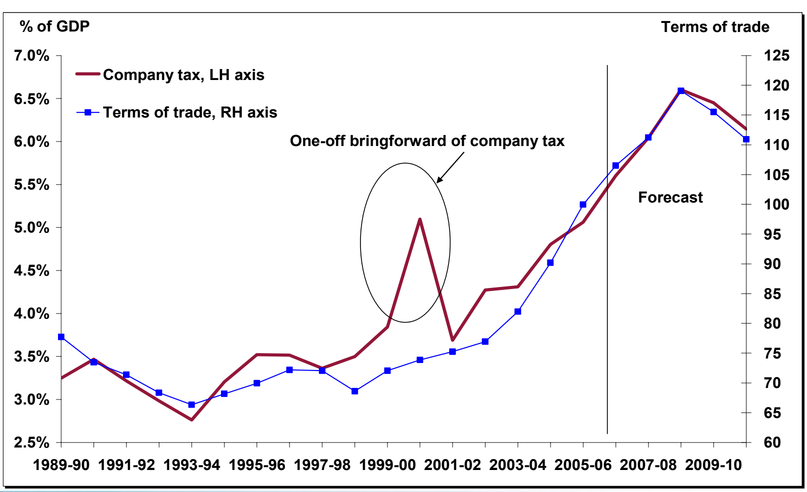
It's inflation that's the problem!



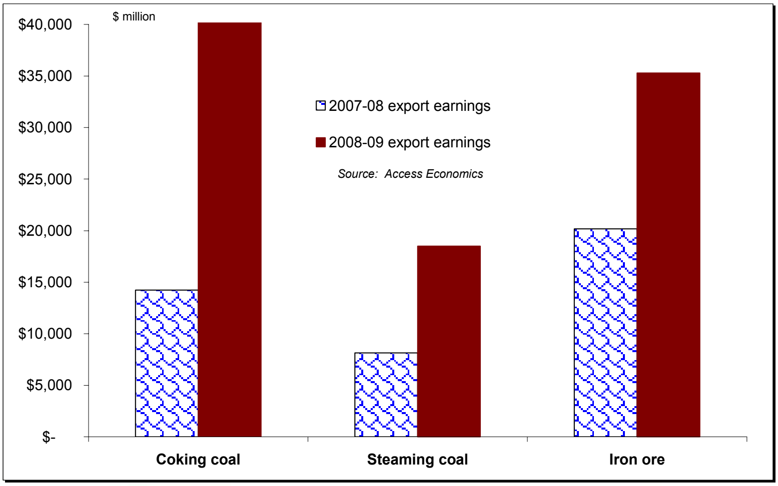
And it's fueled by tax cuts …



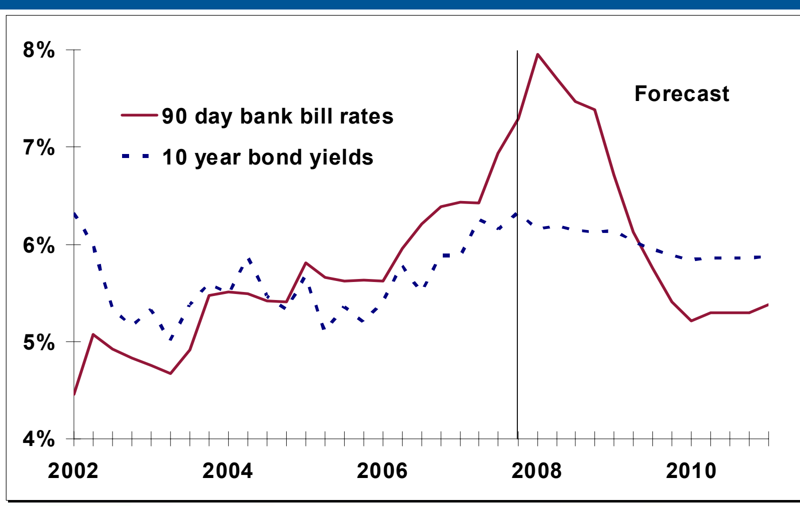
… and rising commodity prices



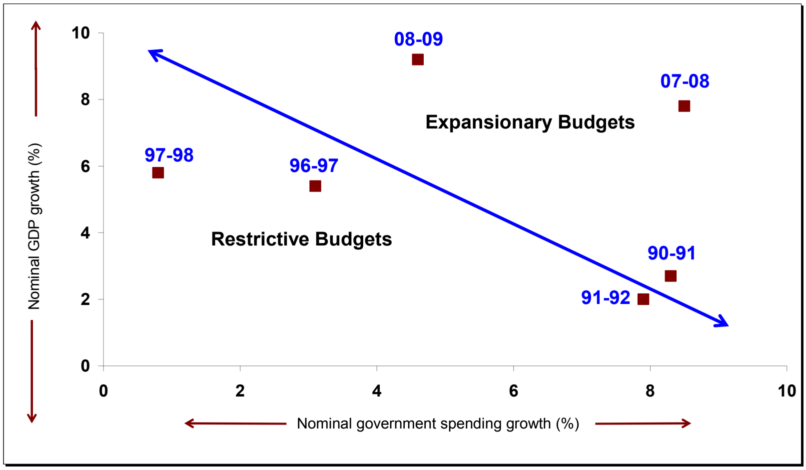
... which drive export earnings



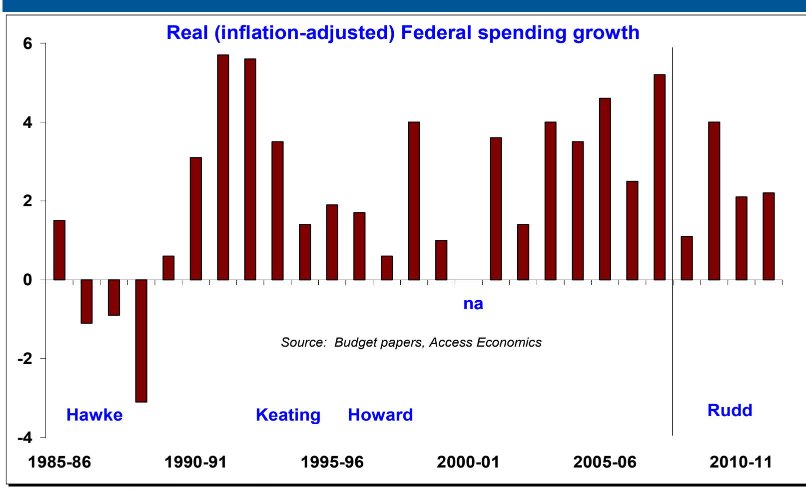
… and keep interest rates up



Did the Budget help or hinder?



Spending will soon bounce back



No recession but inflation will persist

Access Economics	2008-09	2009-10	2010-11
GDP growth	3.5%	3.6%	3.2%
Headline CPI inflation	3.8%	2.5%	2.4%
Underlying CPI inflation	3.6%	2.5%	2.4%
90 day bill rate	7.3%	6.0%	5.5%
10 year bond yield	6.2%	5.9%	5.9%
Unemployment rate	4.3%	4.4%	4.4%
$US/$A	0.92	0.80	0.74
Treasury			
GDP growth	2.75%	3.0%	3.0%
Headline CPI inflation	3.25%	2.5%	2.5%
$US/$A	0.93	0.93	0.93
Difference			
GDP growth	0.75%	0.6%	0.2%
Headline CPI inflation	0.55%	0.0%	-0.1%
$US/$A	-0.01	-0.13	-0.19

De-coupling, Emerging Markets and the Australian Economy.

Mark Crosby

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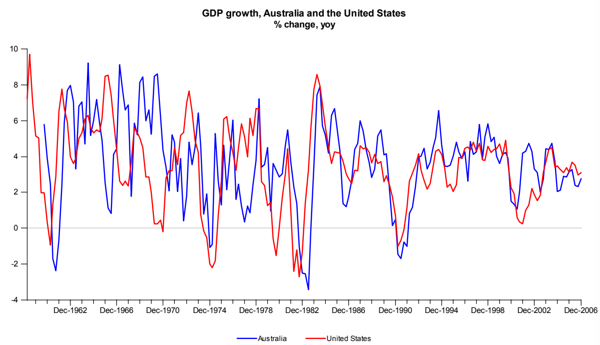
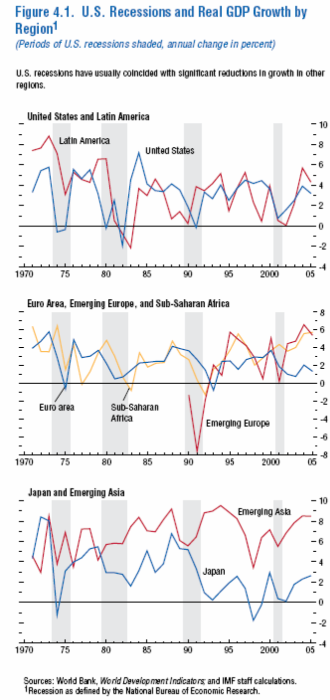
Outline

- Historical relationship between US and other countries business cycles.
- What's different today?
- Emerging market risks
  - Russia, Brazil, South Africa.
  - China and India
- Reform fatigue?
- Concluding comments

US and other business cycles

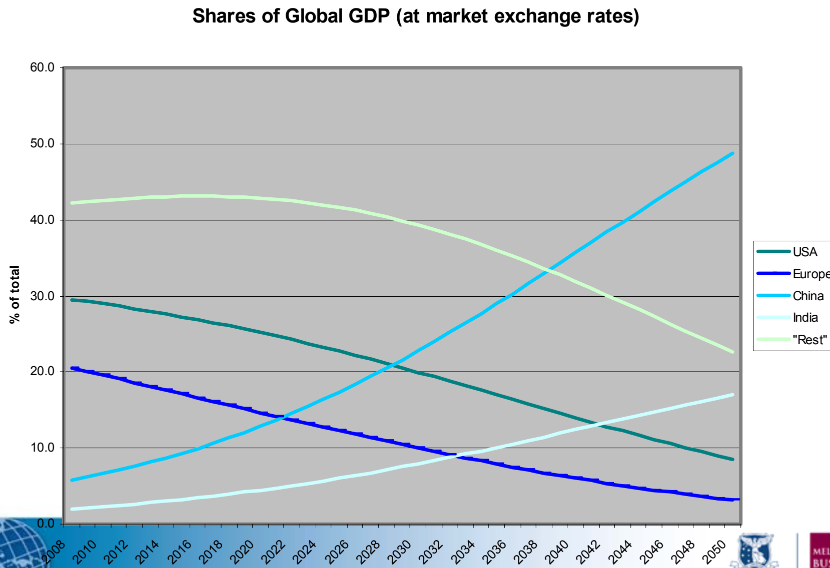




Historical connection with the US

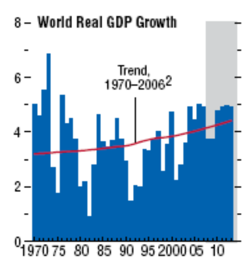
- Timing of recessions has been similar, though the US has been prone to recessions.
- Disinflation timing similar to the US.
- US a large trading partner, large share of global GDP
  - US + Euro area = 52% of global GDP at market exchange rates, 36% at PPP exchange rates for 2000-05.
  - This ratios have been fairly stable since the 1970s, but set to decline steadily going forward…

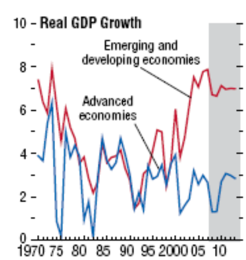
The decline of the US and Europe



What's different today

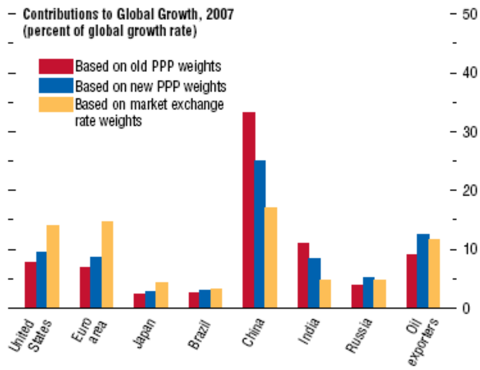
- Size of emerging market economies, and their rapid recent growth.
- Emerging markets are (roughly) 50% of global GDP, and growing very quickly.





What's different today

› Major contributions to growth globally from China and India.

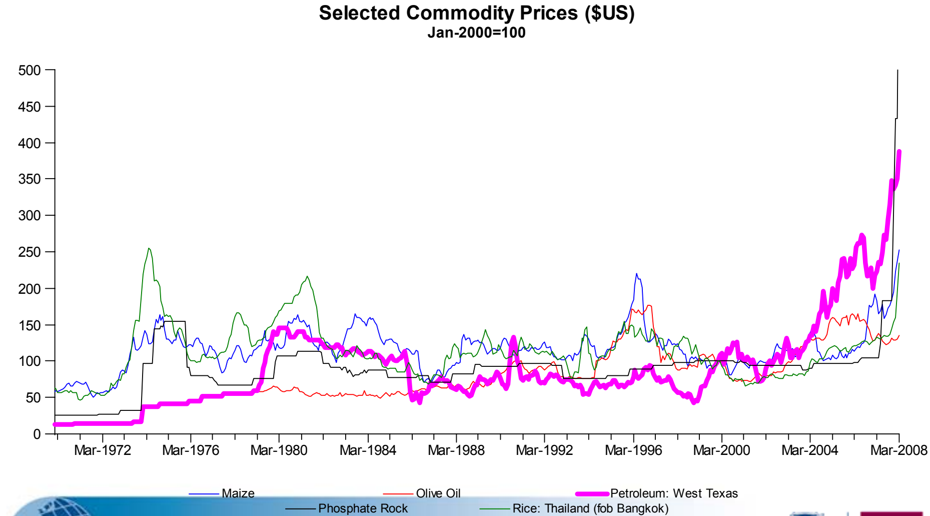


Source: IMF staff calculations.
[1]Based on October 2007 *World Economic Outlook* estimates except where noted.

Risks

› Factors that might derail emerging economies growth include
  – High oil prices?
  – High inflation?
  – Slowdown in global trade?
  – Reform fatigue?

Oil is one piece of the commodity price story



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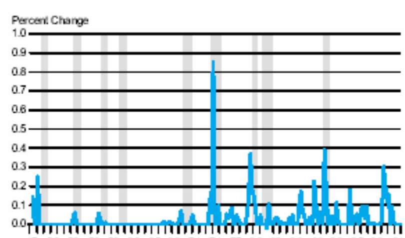
Traditionally high oil = recession

- Hamilton, writing in 1983, found that 5 out of 6 US recessions between 1947 and 1975 are preceded by large oil price increases
- updating to today, eight out of nine recessions in the US have been preceded by large oil prices increases.

FIGURE 1

Oil-Price Increases and Recessions



The net oil-price increase is calculated as the quarterly change in the logarithm of the price of oil. If the quarterly change is negative, the entry is set to zero.

Source: Philadelphia Fed Business Review 2002

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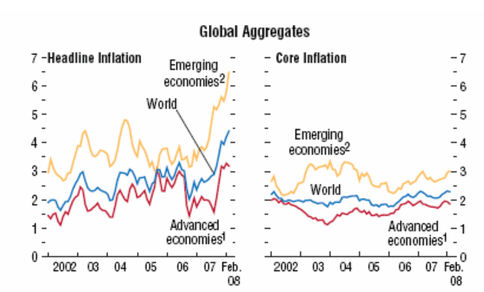
Today is different

- Several differences between current oil price rises and those that preceded previous recessions.
  - oil prices have been rising largely due to increasing demand for oil.
  - Real oil prices have still not (quite) reached historic highs, and oil/energy is less important as an input in most economies.

High inflation



- Inflation, driven by food and energy price rises is becoming a challenge in many emerging (and other) economies.
- Inflation will decline as food and energy prices stabilise, and is not a threat to growth.

Slowdown in global trade?

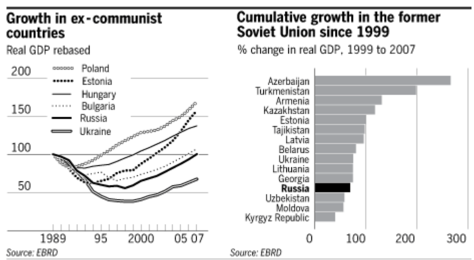
- Trade has been a very strong driver of emerging market growth.
- Possibility that this trade growth will slow…
  - Obama supported the US farm bill, McCain opposed the Bill.
  - Little sign that multilateral trade deals will make further progress.

Reform fatigue

- What has driven China's growth, and many other strongly performing emerging market economies has been a commitment to market reforms.
- Evidence is that the appetite for further reforms might be weak.

Russia

- Russia has performed far less well than Putin would have us believe, largely because of a lack of reform (a good example of dutch disease) …



China

- Growth has been underpinned by reforms since 1979.
- Response to oil, food price rises, suggests that the appetite for further reforms may not be as strong as in the past.

Summary

- Despite the risks I am optimistic about continuing emerging market growth, particularly in China and India.
- US and Europe are last century's story.

and for Australia

- this is the real story…