

ANNEXURE F

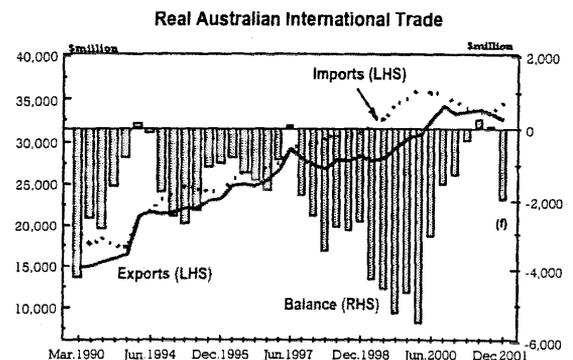
Australian Markets Outlook – Will Exports Contribute to Growth in 2002?

- The trade sector will be crucial to Australia's overall growth performance this year.
- Net exports held up well through the first phase of the global slowdown but are now beginning to deteriorate.
- Prospects in the second half of the year depend crucially on the timing and strength of the recovery in our major trading partners.
- While global growth will be moderately stronger this year, led by the US, continued weakness in Japan will constrain the rebound in growth of our major trading partners.
- Overall, prospective developments in dwelling investment, business investment and net exports suggest Australia could well be struggling to maintain its current pace of growth into the second half of the year.

Over the past two weeks we have explored future trends in dwelling investment and private business investment, and concluded there is likely to be a "hole" in growth in the second half of this calendar year. This raises the issue of what other sector of the economy might expand to make up the difference and help maintain overall growth at a respectable clip. One possibility is the trade sector.

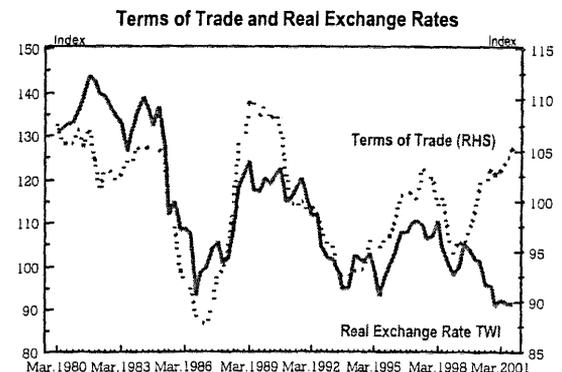
Trade accounts begin to deteriorate

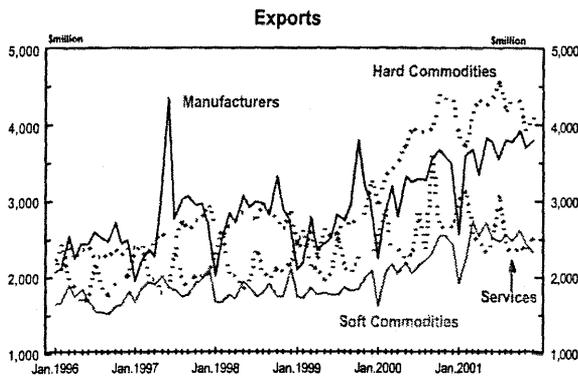
Global growth decelerated sharply through 2001. Against this trend, Australian growth accelerated from its December quarter 2000 low. This environment is usually one in which Australia's trade balance would deteriorate as a result of weaker exports and strengthening imports. The surprise was that Australia's trade position actually improved in the first half of the year, with some softness in export volumes being more than compensated by even weaker imports. This made a handy contribution to overall growth. The position began to deteriorate in the second half of 2001 as import growth picked up in response to strengthening domestic demand, with a particularly sharp contraction in net exports in the December quarter. We estimate this contraction subtracted a full 1% from growth in the quarter.



Although the trade position is now turning for the worse, the overall performance over the past year has been superior to the outcomes during the Asian downturn of 1997/1998.

It is instructive to ponder for a moment why the trade position performed so well in the face of the most severe global downturn in 20 years. The magic behind it was the supercompetitive Australian dollar. The real TWI value of the Australian dollar has historically closely tracked the terms of trade. But this relationship has broken down over the past couple of years, with the AUD falling to historical lows even while the terms of trade rose to levels which were quite high in historical terms. The low AUD has caused pain for importers and overseas travellers – but has underpinned economic growth by boosting export volumes and moderating imports.





Looking at the product mix of exports shows that the core weakness from late 2000 has been in services. This would include travel services, and it is interesting that the peak in this class of exports coincided with the September 2000 Olympic Games. One can question whether the claimed flow on benefits to travel exports have in fact been delivered. Also, more recently, there is no surprise that a discretionary item such as travel would be wound back in response to a sharp downturn in global growth. Australia's traditional exports of soft (rural based) and hard (mining) commodities have also been impacted, although to a lesser extent than services, and later in the cycle. The success story has been manufacturing exports, which includes machinery, transport equipment, other manufactures and sundry items. These exports seem to have been relatively unaffected by the global slowdown. This is probably because they are less directly related to industrial production and more related to domestic demand conditions in foreign countries, which have held up better than production in most of Australia's trading partners.

Exports should accelerate this year

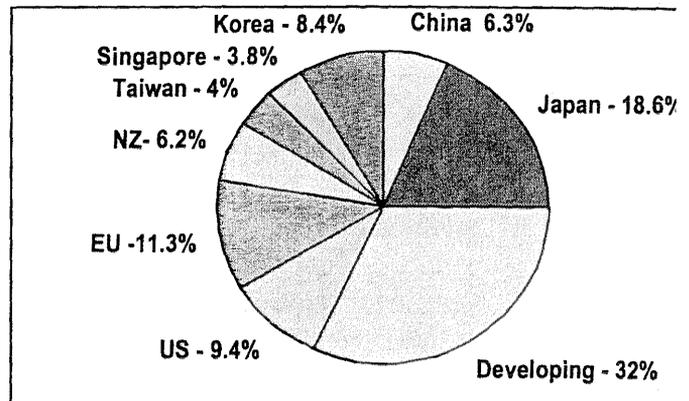
Imports are currently growing more quickly than exports and we expect they will continue on an upward trend now that domestic demand is off its lows. This means that increased exports will be the key to an improvement in the trade balance. This in turn will depend on the timing and strength of the recovery in global growth, particularly of Australia's major export recipients.

We expect a modest upturn in global growth in 2002, led by a reasonably robust recovery in the US. Our forecast US growth rate may not look that strong, but it is year average, and implies a year end growth rate of close to 4%. Unfortunately the recovery in the growth of our major trading partners will not be as marked, as it will be

weighed down by continued economic contraction in Japan. Japan still accounts for 19% of merchandise export values and 17% of the value of services exports. We forecast MTP growth to accelerate very slightly to a still anaemic 1.5%pa in 2002. This acceleration will be just adequate to generate sufficient growth in exports to outpace imports. This will see net exports make a small – something less than 0.5% – contribution to growth in the second half of 2002.

In making this assessment we assume a soft appreciation of the AUD to USD0.57, but any stronger appreciation than this would place further pressure on the net export sector.

Graph: Merchandise Exports By Country – Dec 2001



Graph: Services Exports By Country – Dec 2001

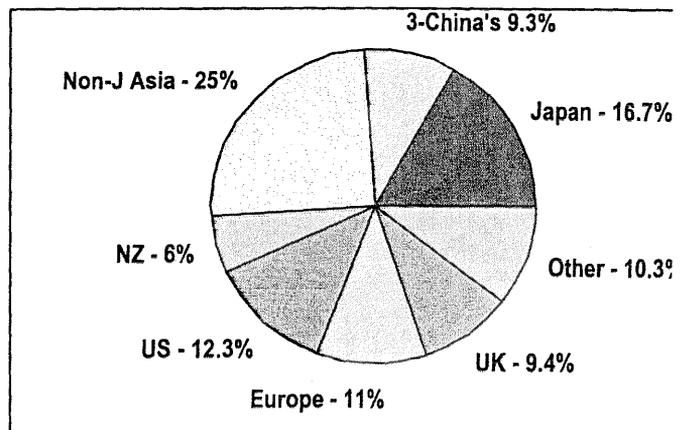


Table: World Growth GDP Forecasts

Annual Average	1999	2000	2001 (f)	2002 (f)
United States	4.1	4.1	¾	1½
Germany	1.7	3.2	0.6	1.0
United Kingdom	2.1	3.0	2.4	1¾
Japan	0.7	2.2	-0.6	-1.1
Non-Japan Asia	6.5	7.5	3¾	4½
Australia	4.8	3.1	2¾	3¾
New Zealand	4.0	3.8	2¾	2¾
OECD	3.1	3.7	½	1¼
World	3.8	4.7	1¼	2.0
Australia Major Trading Partners	2.70	3.60	1.10	1.50

Conclusion

The picture painted in reviewing likely developments in dwelling investment, business investment and net exports is one where Australia could well be struggling to maintain its current pace of growth into the second half of the year. Perhaps we are too pessimistic – perhaps major trading partner growth will bounce back more quickly than we expect, and business investment will surge on the back of it – but it is too early to bet the ranch on such an optimistic outcome. As long as it remains a hope but not a certainty the RBA will be reluctant to raise rates.

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