

# Regional Economic Report

Autumn 2005

- The Federal Budget focused on tax cut and welfare reform.
- World growth will slow as interest rates rise in the US.
- The RBA will not raise rates again in 2005 and the Australian dollar is set to fall below US70¢ in 2006.
- The resource sector will power through 2005 but commodity prices will ease in 2006 as global demand moderates and supply responds to high prices.
- Farm commodity prices remain hostage to global seasonal conditions. Very dry conditions continue on the east coast suggesting Australian farm production will struggle to achieve an average result in 2005/06.



## Contents

---

Executive summary	3
The 2005/06 Federal Budget	4
US growth to slow and weigh on the global economy	6
The Australian dollar and interest rate outlook	8
Regional industries – resources	10
Regional industries – agribusiness	14
Regional economic indicators	22

The Westpac regional economic report  
is a quarterly publication produced by  
Westpac Economics

**Editor:**

Justin Smirk, Senior Economist

Email: [economics@westpac.com.au](mailto:economics@westpac.com.au)

**This report was finalised on May 17, 2005.**

---

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141. Information current as at date above. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs. Westpac's financial services guide can be obtained by calling 132 032, visiting [www.westpac.com.au](http://www.westpac.com.au) or visiting any Westpac Branch. The information may contain material provided directly by third parties, and while such material is published with permission, Westpac accepts no responsibility for the accuracy or completeness of any such material. Except where contrary to law, Westpac intends by this notice to exclude liability for the information. The information is subject to change without notice and Westpac is under no obligation to update the information or correct any inaccuracy which may become apparent at a later date. Westpac Banking Corporation is regulated for the conduct of investment business in the United Kingdom by the Financial Services Authority. If you wish to be removed from our e-mail, fax or mailing list please send an e-mail to [economics@westpac.com.au](mailto:economics@westpac.com.au) or fax us on +61 2 9284 9336 or write to Westpac Economics at Level 5, 255 Elizabeth Street, Sydney NSW 2000. Please state your full name, telephone/fax number and company details on all correspondence. © 2004 Westpac Banking Corporation. Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

## Executive summary

---

The start of May saw drought breaking rains over much of the agricultural region of Western Australia, northern NSW and southern Queensland. However, many regions are still holding their breath for the long awaited rainfall. We are all hoping that 2005 does not herald the return, or in some areas the continuation, of drought. But the medium-term outlook released by the Bureau of Meteorology is not encouraging and the lack of summer rainfall means sub-soil moisture levels are so low that widespread above average rainfall is required if we are to achieve even an average year. But there is good news out there. Most of Victoria has received reasonable, if not average, rainfall and global dairy prices continued to be supported by solid demand. Sugar prices have also made some gains this year and beef prices continue to remain well above long run averages. The resource sector also continues to go from strength to strength and is set to continue to do well into 2006.

Autumn brings the annual Federal Government Budget. This year, there were many things to applaud with a strong economy boosting revenues by \$10.5 billion. The government allocated \$5.8 billion of this to new initiatives split roughly 60/40 between tax cuts and increased expenditure. The government also introduced an ambitious revamp of the welfare system to encourage the long-term unemployed and those on disability or supporting mother's pensions to return to the work force. For farming, it was disappointing there were no new initiatives for land care and water reform, as these issues are critical for the long-term viability of the industry.

In this report, we take a look at the US economy and find that high debt levels are a growing burden on US households. Thus, while the US economy can remain robust, interest rates will continue to rise and consumers will respond by raising their savings dampening economic growth going forward. Chinese growth leverages of the US economy via exports, and thus a slowdown in the US will have ramifications for China and the overall global commodity markets.

The Reserve Bank of Australia hit the headlines early in 2005 warning that rates were set to rise. The Bank then raised rates by a quarter of a percent in March. However, this was a once off move and the RBA has since moved the risk for inflation, and thus interest rates, from the upside to balanced. In addition, with high household debt and higher interest rates, households will have a higher propensity to save, rather than spend, and therefore we do not see the budget as a risk for interest rates.

It is our view that interest rates will continue to rise in the US but remain on hold here. Also, we see world growth slowing. With rising resources production, commodity prices are set to fall. It should therefore be easy to see why we are calling the Australian dollar to fall to US72 cents by the end of 2006 and under US70 cents in 2006.

The one exception in the medium term outlook is the bulk commodities, coal and iron ore. These commodities are predominately sold under fixed priced contracts, which are set twelve months in advance. The coking coal contract prices rose 120 per cent this year to US\$125 per tonne.

Over the last year, beef, dairy and sugar prices have risen as these commodities benefited from robust global demand and supply constraints. However, rural commodity prices remain at the mercy of global weather conditions and an improvement in conditions has seen upward revisions to crop forecasts and falling prices for grains, pulses and oil seeds. Wool prices have been at the mercy of the stronger Australian dollar. A falling currency in 2005/06 should be an offset to softer global demand.

Beef prices eased back through March and April due to increased cattle sales and seasonally soft demand out of Japan and Korea. An increase in Australian production, assuming it rains, and the return of Canadian and US products to the Pacific Rim markets will see beef prices ease in 2005/06. Australian dairy farmers have also benefited from strong global demand conditions and rising prices. A weaker Australian dollar should also provide some offset to the downside risk to global prices from softer world demand. However, Australian dairy farmers' still face significant challenges in an increasing competitive export market.

Overall, we see a positive outlook for regional Australia but one that is very dependent on rain coming soon. This is our second regional economic report for 2005 and we hope you find our latest thinking on the prospects for regional Australia interesting as well as useful.

---

## The 2005/06 Federal Budget

---

Surplus is well up on the mid year estimate ...

... with the company tax take going through the roof.

A welcomed initiative on welfare reform.

The welfare package is timely given the strong need for reform in Australia.

No policy on infrastructure, an opportunity missed.

Tax cuts were the focus this time ...

... but there were no direct initiatives to address infrastructure issues.

The policy objectives this time were macro rather than an industry focus.

The underlying cash surplus is forecast to be \$8.9 billion in 2005/06, all but unchanged from a likely \$9.2 billion in 2004/05. The 2005/06 cash surplus forecast has almost doubled from the \$4.5 billion expected in the December Mid-Year Economic & Fiscal Outlook.

Indeed the starting position for 2005/06 compared with the government's mid-year update was upgraded by \$9.7 billion – with revenue \$10.5 billion higher but expenses little changed. Revenues have been inflated by the commodity boom, as well as upgrades to receipts from individuals (lower than expected unemployment rate) and small business. This improved position was used to fund \$5.8 billion of new initiatives – initiatives split roughly 60/40 between reduced revenues and increased expenditures.

The key initiatives in this Budget are personal income tax cuts and the beginning of an ambitious revamp of the welfare system to encourage long-term unemployed, recipients of the sole parents payment and new applicants for the disability support pension to enter the workforce. The need to address these issues is fairly clear. Over the last 20 years the number of disability support pensioners has trebled and there are now more people receiving the disability support pension than receive unemployment benefits.

For sole parents, the arguments are also strong. Australia has the third highest incidence of joblessness in families with children under 15 in the OECD. The Department of Family and Community Services argues that such a high rate of joblessness among single parent families has partly reflected the passive nature of Australia's income support system.

Prior to this Budget, the government required sole parents with a youngest child aged thirteen or more to do up to 150 hours of work related activity every six months. In most other countries in the OECD the minimum ages range from three years to eight years. The steps announced in the Budget with appropriate allowance for child care places, training schemes, lower tax rates, reduced taper rates and tougher guidelines all represent a start to undoing years of neglect in providing disadvantaged Australians with the incentives, skills and support to re-enter the workforce.

Personal tax cuts in Budget 2005 were far more substantial than expected, costing \$3.1 billion in 2005/06 and \$21.7 billion over four years. The top marginal tax rate will cut in at \$125,000 from 1 July 2006 compared with the \$70,000 cut in point now. The superannuation surcharge has also been abolished, costing \$2.5 billion over four years.

Conspicuously absent from the Budget has been a clear strategy to provide funds for the upgrading of Australia's infrastructure. A large proportion of the Government's windfall surpluses have come from high company tax takes associated with the surge in commodity prices, particularly the bulks (coal and iron ore). A normal supply response to these high prices and the expected slowdown in global demand is likely to see these prices fall substantially in future years. These Budget gains will not be permanent. Assumptions with respect to the longevity of these gains appear to be overly optimistic. As such, this may have been a missed opportunity to increase infrastructure investment.

The budget contained few new initiatives specific to agriculture. Some of the initiatives that will impact on regional Australia includes confirmation of a \$20 million provision to offset the cost of electronically tagging infected livestock, and \$9.8 million per year funding for Biosecurity Australia, but farmer did miss out on the requested removal of the three to 5 per cent tariff on farm inputs and \$250 million over four years to help farmers carry out environmental work. Skill shortages are an increasing problem in rural Australia and the government initiative to introduce scholarships for apprentices in skill shortage areas may go some way to help alleviate this problem.

# The 2005/06 Federal Budget

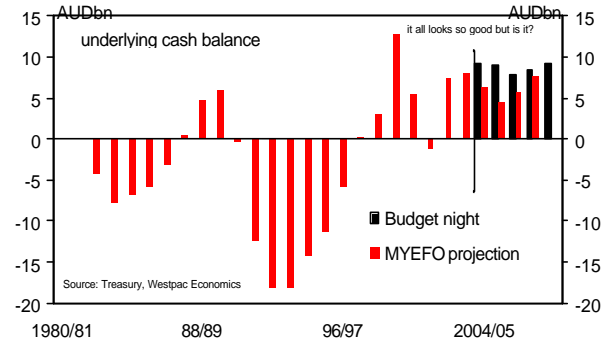
**Chart 1.**  
Summary of the main Budget numbers

AUDbn	2004/05	2005/06	2006/07	2007/08
Underlying cash balance	9.2	8.9	7.9	8.5
% of GDP	1.1	1.0	0.8	0.8
Headline cash balance	7.9	7.9	18.2	18.6

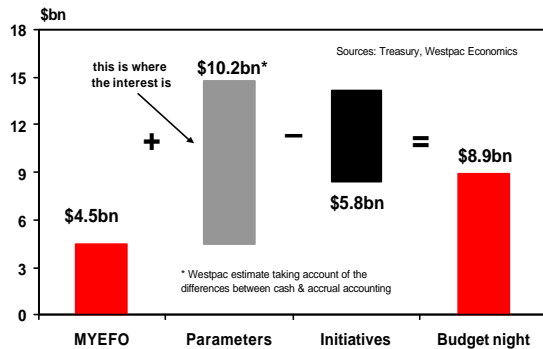
**Impact of budget measures on MYEFO AUDbn**

Revenue measures (net)	0.0	-3.5	-6.7	-7.7
Expenditure measures (net)	0.9	2.0	3.0	3.2
Net measures	-1.0	-5.8	-9.9	-10.9
MYEFO Forecast changes	3.1	9.7	12.4	12.4
Net change	2.1	3.9	2.5	1.4

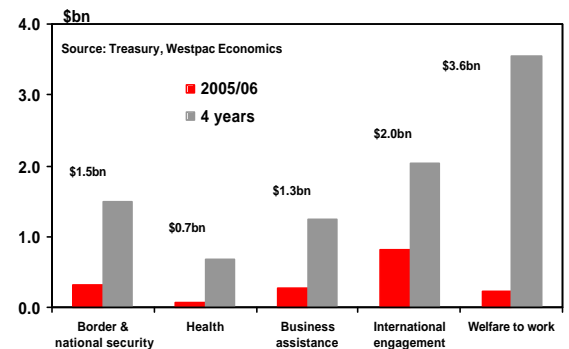
**Chart 2.**  
A run of budget surpluses



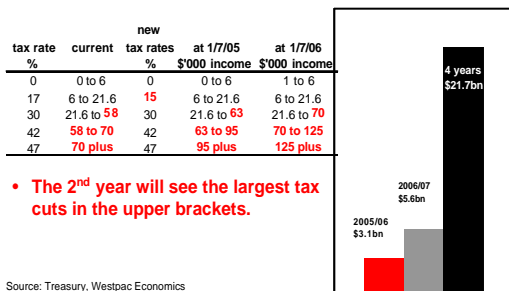
**Chart 3.**  
Decomposing the 2005/06 surplus



**Chart 4.**  
New spending initiatives in the Budget



**Chart 5.**  
Tax cuts – the aim is to lift participation



**Chart 6.**  
Economic forecasts 2005/06

% change	Government	Westpac
GDP	3	2%
Domestic demand	3½	3.0
Housing	-2	-7½
Exports	7	7
GNE	3¼	3
Unemployment rate	5	5½
Current account A\$bn	-48	-56

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## US growth to slow and weigh on world economy

---

World growth will ease back in 2005 and 2006...

Global growth hit a sweet spot in 2004, reflecting very expansionary fiscal and monetary policy settings. However, we will not see a repeat performance in 2005, as stimulatory policy settings, are progressively removed. World growth is expected to ease back a notch from the five per cent pace set in 2004, albeit only moderately, to a still above trend pace of four per cent in 2005. This trend is expected to continue into 2006 with growth forecast to come in a little under four per cent.

... led by the US ...

Developments in the US economy are critical to outcomes of the global economy. In the US, loose monetary policy settings have been progressively wound back over the past year, with the Feds Fund rate rising from 1 percent in mid 2004 to 3 percent where it currently stands. However, rates are still well below what we would consider normal and hence expect the US Federal Reserve to stay the course and continue to raise interest rates.

... as higher interest rates bite.

Higher interest rates in the US will work to slow growth through several channels. US households are more highly leveraged, particularly compared with previous tightening cycles. Just like here in Australia, low interest rates encouraged households to borrow at a very rapid pace. Home loans were up over thirteen per cent in 2004 on the back of a similar rise in 2003 and accounted for more than three-quarters of the increase in household debt through this period. This has created strong demand for dwellings and seen house prices run up rapidly, which has provided a considerably wealth boost to US households. In turn, households have drawn down on this wealth and consumption has run ahead of income growth. However, as a proportion of disposable income, household debt is now 115 percent. Servicing costs have risen to over 13 percent of disposable income and will trend higher as interest rates rise further. This will not only dampen spending power but higher interest rates will also deflate the housing market as affordability and refinancing incentives move in the wrong direction.

A slower US will reverberate around the rest of the world.

A consumer-driven slowdown in the US will reverberate throughout the rest of the global economy. In recent years, China has accounted for an increasing share of US imports, particularly in the areas of consumer and electronic goods, which represent close to half of total US imports. Hence slowing demand in the US will see import growth slow and weigh on activity in China. However, this is likely to be a 2006 story rather than 2005. Indeed the latest round of activity data for the Chinese economy was substantially firmer than expected. March quarter GDP growth came in at 9.5 per cent, equivalent to the pace of the prior quarter, and equal to the calendar year outcome for 2004. Most forecasters, including ourselves, had anticipated a modest deceleration, following government moves to tighten credit and slow investment in mid 2004.

China to slow modestly ...

... while Japan slows below trend.

For Japan, 2004 was the best year for the economy in some time. The key driver of growth was exports, aided by strong growth among Japan's key trading partners such as the US and increasingly China. This saw employment growth improve sharply through the year, which will benefit consumer spending. This, along with continued solid contributions from net exports and capital expenditure, should see Japanese growth come in just below trend for 2005 and again in 2006.

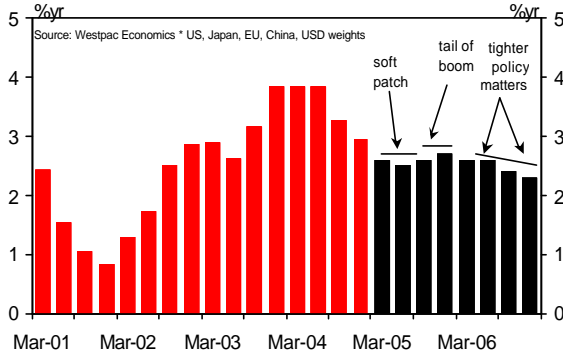
Outlook for Euro area remains subdued.

For the Euro area, economic growth has consistently registered below potential. Moreover, with business sentiment trending down and unemployment rising, this situation is unlikely to improve in the near term. Despite this, the European Central Bank continues to talk tough in terms of interest rates. However, with inflation trending down due to excess capacity, we see interest rates remaining on hold for the rest of 2005.

# US growth to slow and weigh on world economy

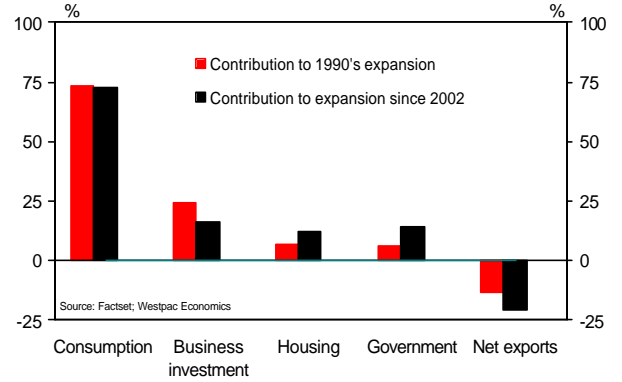
**Chart 1.**

**World growth**



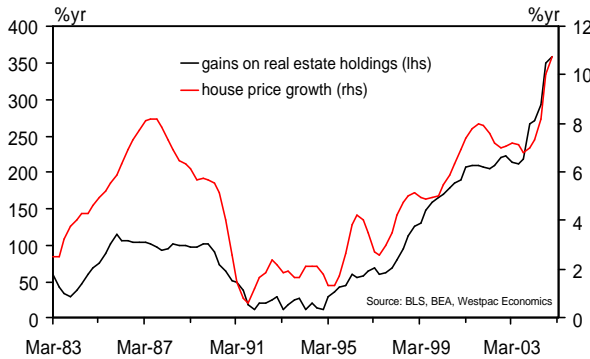
**Chart 2.**

**US consumer – key driver of growth ...**



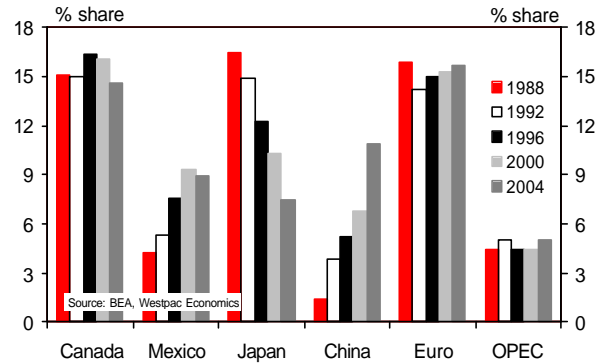
**Chart 3.**

**... as households tap into wealth gains.**



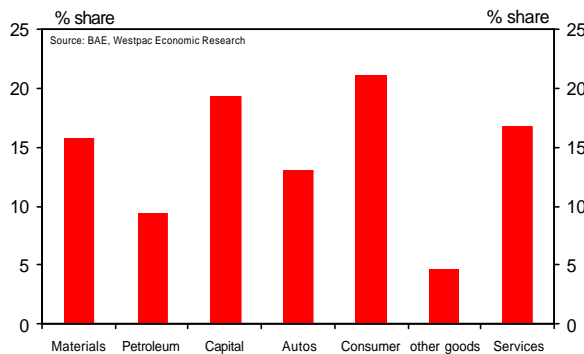
**Chart 4.**

**Source of US imports**



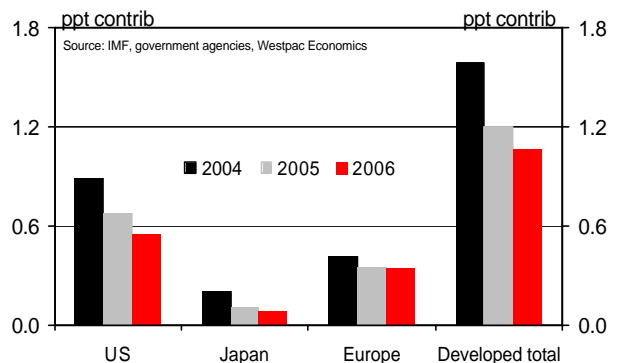
**Chart 5.**

**Composition of US imports**



**Chart 6.**

**Contributions to global growth**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## The Australian dollar & interest rates outlook

---

We have stuck to our framework and still see the dollar lower in 2005.

Our framework for forecasting the Australian dollar is extremely transparent. Over the medium term, it will be the direction of commodity prices, relative interest rate movements and the position of the external accounts that drives our view on the currency. For some time, this method has indicated to us that the dollar looks set for a fall in the second half of this year, our forecast is US72 cents by end 2005. The fundamentals do not improve in 2006 either. In fact, the unfavourable trend accelerates.

Commodities are a key component of the Australian dollar outlook.

Commodities are a key component of the forecast and the current significant increase in coal and iron contract prices will be feeding into the system over the next six months. For this reason we have to acknowledge upside risks in the short term. However, the recent correction in base metal prices gives us confidence to stick with our medium term view that a moderation in demand growth and a significant increase in supply will generate a trend depreciation in commodity prices and the Australian dollar.

Commodities supply will respond to high prices.

There are early sign that the supply of commodities is responding to high prices. Our index of global mining employment has shown an influx of labour to the sector after a decade of structural decline. Inventory levels remain low across the majority of metals, but the rate of depletion has slowed despite no real respite in terms of demand. Futures markets have also begun pricing in a decline from current elevated price levels. And the anecdotal evidence continues to mount that the global industry is making assertive moves to increase output volumes by opening new capacity, re-opening old capacity and using existing sites more extensively. In addition to these factors, we have the weak external account position, and the market under-estimating the potential for US dollar consolidation. The latest labour market figures out of the US highlight that the Federal Reserve will stay the course, and will not pull up short of 4 percent.

Official interest rates rising in the US, on hold here but ...

We have been arguing for some time, that the March rate hike by the Reserve Bank of Australian would be the last for this year. And our reading of the May Statement on Monetary Policy indicates that the Bank has significantly weakened its inflation, and thus interest rate, outlook. Indeed, our assessment is that the Bank is as close to a neutral bias as you can get without it actually saying so.

... the RBA Statement leaves the door open for rate hikes ...

The Statement is no a guarantee the Bank will not raise rates in 2005. Our call has been that the data will show evidence of slowing domestic demand and receding inflation pressures. However, the unemployment remains at a generational low and the risk associated with this still remain. However, if price pressures do not emerge soon, softer demand raises the potential a rise in the unemployment rate and an easing in domestic inflationary pressures.

... while tempering the inflation outlook.

The overall discussion of inflation and domestic demand in the Statement was more balanced than it has been for some time. The Bank maintained its forecast that underlying inflation will increase gradually to 3 per cent by the end of 2006. However, it no longer chooses to highlights upside risks. "The risks around this (inflation) outlook now appear more evenly balanced, rather than upside as indicated in previous Statements". This is about as close as you can get to a neutral bias, that is a no rate change bias, without actually saying so.

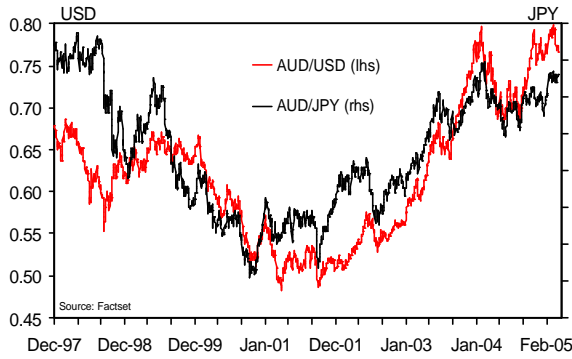
The absence of housing in the Statement was a surprise.

In a major surprise, the Bank chose not to mention housing in the key introduction to the Statement. In February, the Bank noted that housing activity and lending may have stabilised and be in the process of recovery. There is no similar observation in this Statement. The comments on credit growth are fairly neutral, noting that credit growth had been steady in recent months.

# The Australian dollar & interest rates outlook

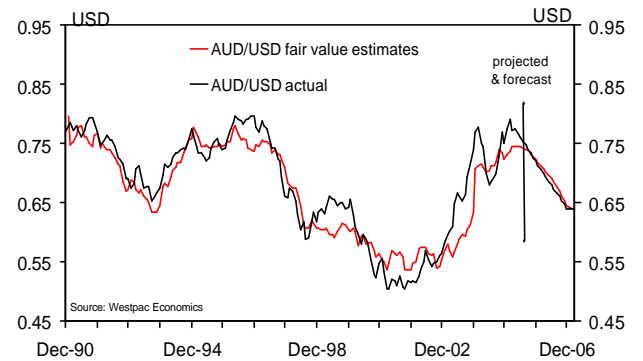
**Chart 1.**

**AUD/USD & AUD/JPY**



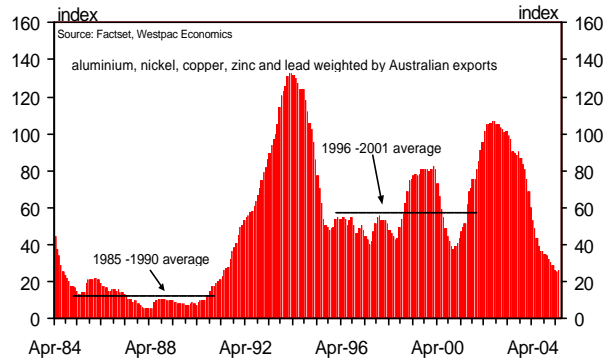
**Chart 2.**

**Actual, fitted & forecast Australian dollar**



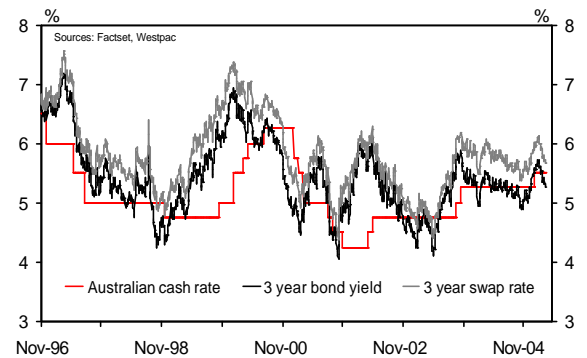
**Chart 3.**

**Metals stocks find base despite strong demand**



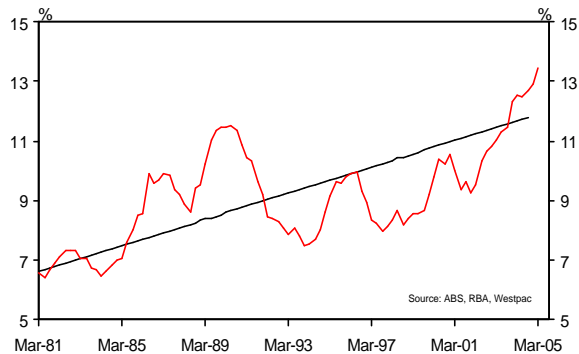
**Chart 4.**

**Markets overly optimistic on rates outlook**



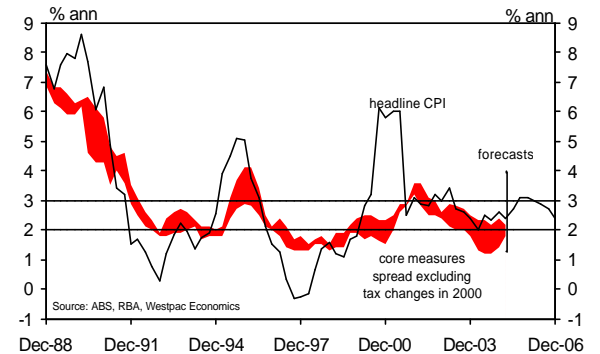
**Chart 5.**

**Household debt servicing ratio – above trend**



**Chart 6.**

**Australian inflation measures**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## Regional industries – bulk resources

---

A moderation in global demand is a key forecast parameter.

You would have noticed by now that one of our core forecasts is that global growth will slow, now just through 2005 but also into 2006. As such, global demand for commodities is forecast to decline in 2005 and into 2006 in line with an expectation for weaker global industrial activity. As such, the price for most minerals and energy products are expected to decline as world stocks rise. Thus we expect the value of Australian mineral and energy exports to peak in 2005 and any growth from this point onwards would be driven by volumes. The recent moderation in bulk shipping costs as measured by the Baltic dry index, could be an early sign of this.

Asian demand has driven prices higher but supply is responding.

### **Thermal coal**

Strong growth in Asian coal fired electricity generation, and constrained supply, have driven thermal coal prices higher through 2003 and 2004. However, prices eased in the second half of 2004 because of lower seasonal demand and higher than expected exports from China. Nevertheless, prices remain significantly higher than in 2003. The Japanese contracts prices negotiated in January 2005 saw price rises of 20 per cent to US\$53.80 per tonne. Slower global growth and its impact on both electricity demand and thermal coal related construction activity (such as cement manufacturing and some minerals processing) combined with incremental increases in supply are expected to place downward pressure on prices. Beyond 2005, expanded thermal coal export capacity in Australia, South Africa and Indonesia will accentuate this pressure on prices.

Continued robust demand will underpin robust growth in steel production.

### **Steel and steel making raw materials**

In the outlook to 2010, strong growth in demand in China, India and Brazil will underpin robust growth in global steel production. As blast furnaces will account for most of the growth, the outlook for iron ore and metallurgical coal remains positive. Non-Japan Asia is expected to account for most of the increase in iron ore and metallurgical (coking) coal demand. Developments in China will continue to have significant impact on the market. Despite China having significant reserves of both iron ore and coking coal, Chinese production has not kept pace with demand so imports of raw materials have soared. Australia's relative proximity to Asian markets should allow it to capture an increasing share of global trade in coking coal and iron ore.

Coking coal prices more than doubled in 2004/05.

### **Metallurgical/coking coal**

The benchmark price for Japanese coking coal contracts rose 120 per cent to \$125 per tonne for hard coal while semi-soft coal prices rose 96 per cent to \$85 per tonne earlier this year. However, in the medium term coal prices are expected to decline as global supply increases - primarily from Australia - and along with efficiency improvements and an increased used of pulverised coal injection, which replaces more expensive coking coal. This will more than outweigh any support from growth in blast furnace steel production. In addition, the slowdown in global activity at a time of rising steel production should also result in a fall in global steel prices.

Iron ore prices are supporting significant development in new iron ore capacity.

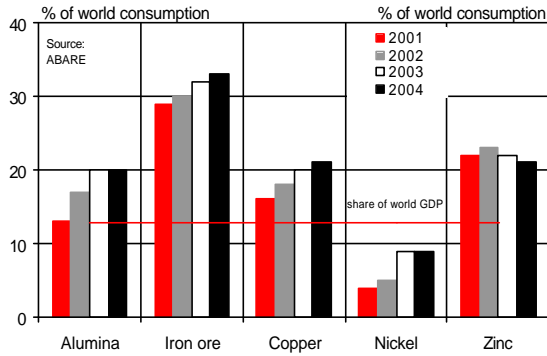
### **Iron ore**

The recent negotiations for iron ore contract prices saw Australian producers achieve a 71 per cent lift in its iron ore contract price. The strength of demand and the increase in prices over the last two years, plus the prospect of further substantial increases in demand, has supported the development of significant new iron ore capacity, particularly in Brazil and Australia. The increase in iron ore capacity is expected to be sufficient to lead to falling iron ore prices in 2006. Nevertheless, Chinese demand will ensure that iron ore prices remain higher than they have been for some time.

## Regional industries – resources

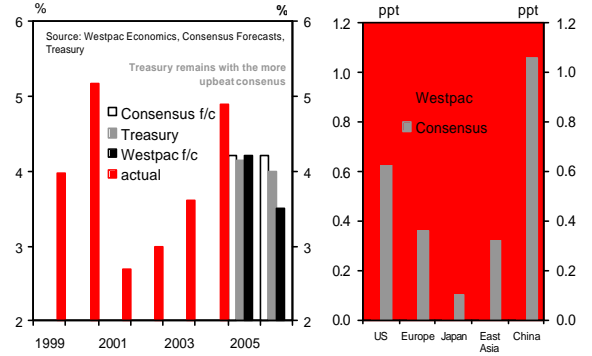
**Chart 1.**

**China's share of global commodity demand**



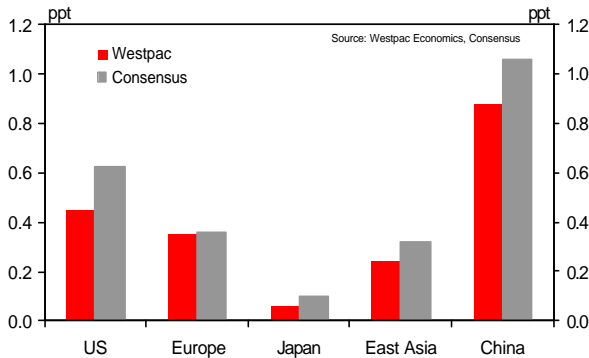
**Chart 2.**

**World growth forecasts**



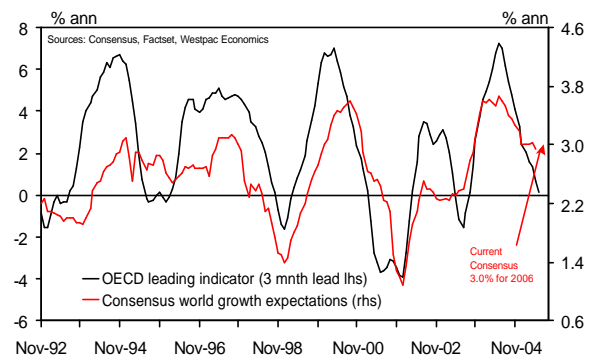
**Chart 3.**

**Contributions to growth in 2006**



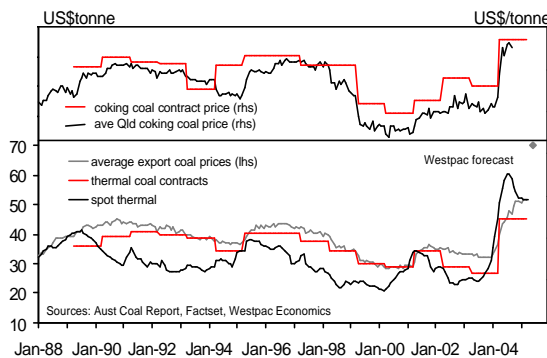
**Chart 4.**

**Consensus forecast tend to follow the data**



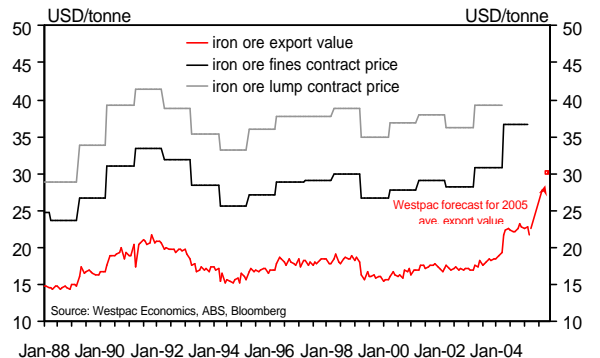
**Chart 5.**

**Coal prices set to rise significantly in 2005**



**Chart 6.**

**Iron ore export values are also rising in 2005**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## Regional industries – base metal resources

---

Global slowdown will hit but supply constraints will keep prices firm in the short run.

The expansion capacity will underpin significant growth in Australian alumina exports.

Copper prices will moderate and falling prices helps to smooth industrial unrest.

The long lead time for nickel means prices can remain elevated for some time.

We continue to hold the view oil prices will moderate in 2005/06 as demand slows.

An appreciation in the US dollar would be a negative for gold prices.

### Base metals overview

A slowdown in demand, and increase supply, are the biggest factors in the outlook for base metals. Copper is facing slower consumption growth in both China and the US while production is forecast to grow strongly. Zinc prices are expected to remain firm in 2005 as stocks continue to fall but prices will decline in 2006 as supply firms. Nickel will be a clear outperformer due to the long lead time for new refining capacity and limited scrap stainless steel in the key expanding steel market of China, India and Brazil.

### Aluminium

Strong consumption growth and a significant fall in stocks saw aluminium prices rise more than 20 per cent in 2004. However, aluminium prices fell more than 8 per cent at the start of January due to the uncertainty about future Chinese demand. Aluminium prices are forecast to ease in 2005 in line with slower global economic growth and rising world production. Committed and proposed expansions in Australia's alumina capacity will underpin significant growth in alumina exports to 2010.

### Copper

Copper prices were boosted in 2004 due to strong global growth, production shortfalls, industrial unrest, rapidly falling stocks and strong speculative buying. Prices peaked at US\$3,040 per tonne in April but have since eased as stocks have started to stabilise. For the remainder of 2005, production is expected to rise as many of the factors that limited production in 2004 fade. The resulting moderation in prices should also help smooth the settlement of outstanding labour agreements that affected around one third of the world copper capacity in 2004.

### Nickel

Early in 2005, world nickel prices continued their recent upward trend reaching a peak of around US\$17,500 per tonne in May. This increase in price reflected continued robust growth in stainless steel production and limited additional nickel supply. There is a significant time requirement for the construction of new nickel refining capacity and this will constrain new supply becoming available any time before 2008. In addition, the regions that have had the strongest growth in steel demand, namely China, India and Brazil, have limited supply of scrap stainless steel and as such, will have a high demand for nickel. Therefore, nickel remains the commodity with a significant upside price risk from any positive global growth surprise.

### Crude oil

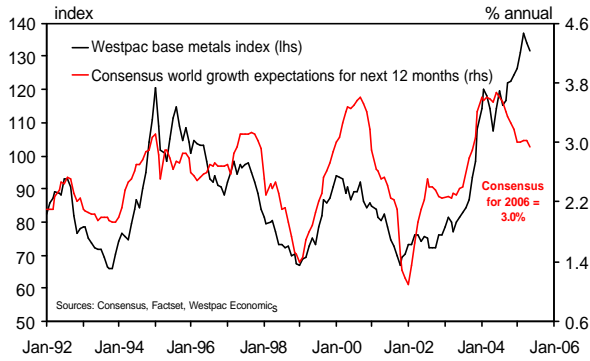
Oil price are forecast to remain at robust levels for at least the short-term, supported by rising demand from China, India and Brazil and a continuing sizable risk premium. However, as we have argued from some time, rising US crude oil inventories suggests the underlying supply and demand conditions, while there are tighter than they have been for some time, are being distorted by official accumulation of crude oil stocks. The market has come to accept this view and prices recently fell below US\$50 per barrel. Slower world growth and rising production will weigh on oil prices in the medium term.

### Gold

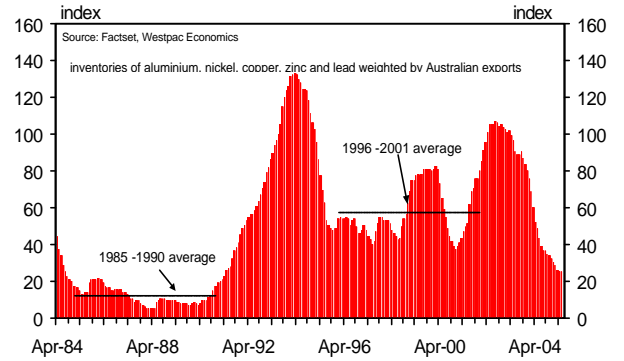
Our forecast for an appreciation of the US dollar is a key factor here. Over 2004 the US dollar fell 8 per cent against the euro and 5 per cent against the yen. During this period, the US dollar price of gold rose 5 per cent. Along with the appreciating US dollar, gold mine production is expected to rise and with the global slowdown, gold jewellery consumption is expected to fall.

# Regional industries – base metal resources

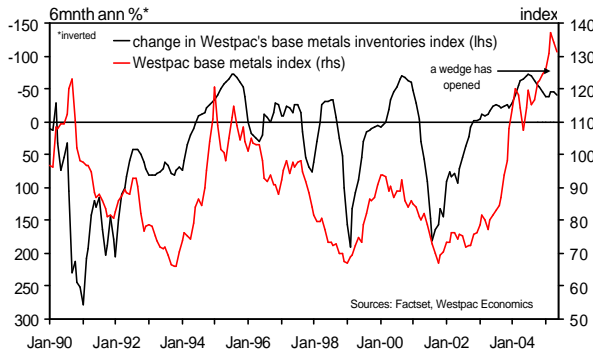
**Chart 1.**  
**Base metals should correct as growth slows**



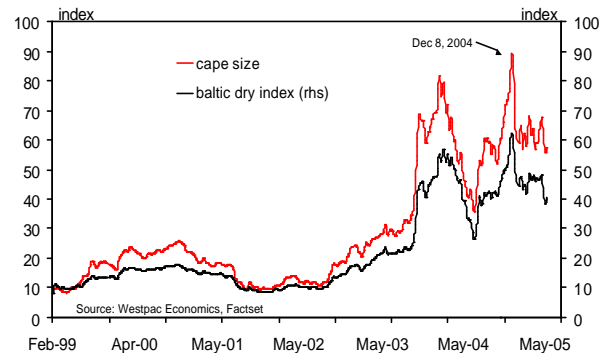
**Chart 2.**  
**Westpac base metals inventories index**



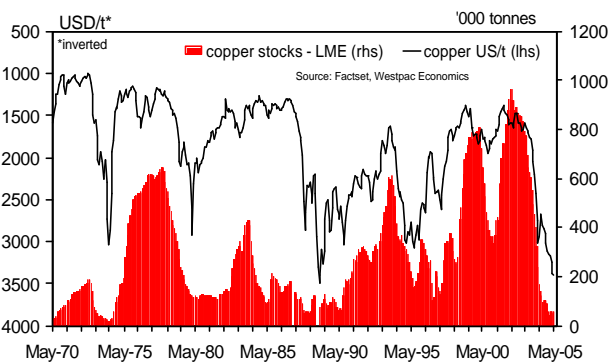
**Chart 3.**  
**Base metal inventories and prices**



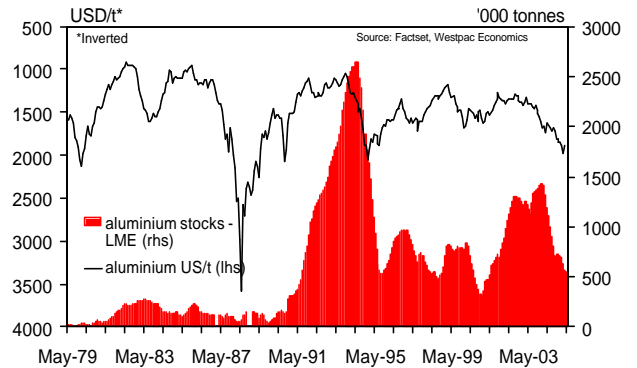
**Chart 4.**  
**Freight costs still elevated but well off the high**



**Chart 5.**  
**Copper stocks have found a base**



**Chart 6.**  
**Aluminium stocks and prices stabilising**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## Regional industries - agribusiness

---

Welcome rain has fallen in WA, northern NSW and southern Queensland.

A strong Australian dollar has been offset by rising commodities prices.

Wheat prices have come under pressure and northern hemisphere crop improves.

Coarse grains are benefiting from rising livestock production.

### Farm outlook

April rainfall was below to very much below long-run averages over much of the country. Australia-wide, the average rainfall for the first four months of the year was the second lowest on record. May brought significant falls in Western Australia and parts of northern NSW and southern Queensland. However, large areas in southern and eastern Australia continue to experience deficiencies and are yet to see a full recovery from the drought conditions of 2002-03. In its most recent outlook, the Bureau of Meteorology is favouring a wetter season in southeast Queensland and northern NSW. For the rest of the country, the probability of achieving average rainfall in the coming three months is close to 50 per cent, giving little comfort to those watching the skies. As such, it is unlikely farm output will achieve an average year in 2005.

The Australian dollar has risen over the last twelve months, but so too did the global prices of beef, skim milk powder, cheese and sugar. These commodities have benefited from robust global demand and a reduction in supply. However, rural commodities remain at the mercy of global weather conditions and wheat prices have moderated due to record crops of soybeans and coarse grains. ABARE is forecasting the net value of farm production to fall twelve per cent to \$5.1 billion in 2005/06, mostly due to weaker commodity prices. This year also brings the risk commodity prices will be hit by slower growth in global demand. However, agribusiness incomes should be supported by the Australian dollar, which Westpac is forecasting to be around US72 cents by the end 2005.

### Wheat

Wheat prices are up almost eight per cent over the last six months but this is still not enough to overcome the price collapse in the second half of 2004 with prices down 18 per cent in the year. And the outlook is not that positive. The International Grains Council recently increased its forecast for the 2004/05 wheat crop and with consumption expected to match this year's production, carryover stocks from last year's record crop will keep downside pressure on prices. It will be a volatile ride this year as production estimates are revised. If we get average seasonal conditions, Australian production will rise around eleven per cent to 22.5 million tonnes. However, continuing dry conditions will make this forecast look increasingly optimistic and the risks must lie for another below average crop.

### Coarse grains

World coarse grain production is forecast to rise ten per cent in 2004/05, exceeding one billion tonnes for the first time, lead by a record US corn crop with support from rising production from the EU, other parts of Europe and parts of the former Soviet Union. With world coarse grain consumption forecast to rise just two per cent, there will be a solid boost to world stocks, the first rise in global coarse grain stocks in six years. For the more medium term, coarse grain consumption should benefit from rising incomes in developing nations and the resulting increase in higher protein foods such as meat. Higher demand for livestock will increase the demand for feed grain. In addition, rising oil prices have seen the production of grain-based ethanol, which in the US is based on corn, increase substantially in recent years.

ABARE is forecasting Australian coarse grain production to rise ten per cent in 2005/06. Of course, just like the wheat forecasts, this is predicated on a return to average or normal seasonal conditions. At this stage, it is looking increasing like a below average season and thus a smaller than forecast crop.

# Regional industries - agribusiness

**Chart 1.**

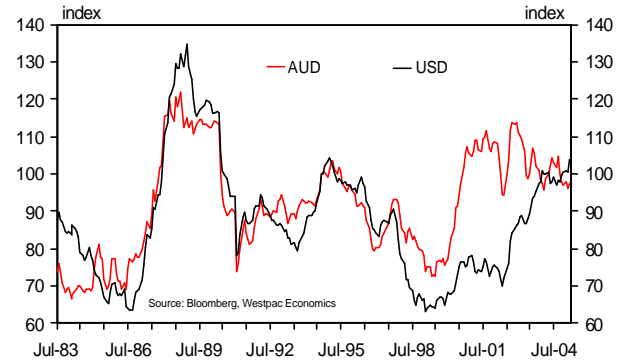
**Westpac Farm Commodities Index**

	Index number	Percentage change over		
	Mar-05	1 month	6 months	12 months
Beef (AUD\$/kg)	3.67	-2.4	-1.9	13.7
Wheat (US\$/bu)	343	1.4	8.0	-18.0
Wool (AUDc/kg)	811	4.5	-0.1	-2.9
Skim milk powder (US\$/t)	2175	0.0	2.9	17.6
Sugar (US\$/lb)	8.78	-4.1	-1.1	34.6
Cotton (US\$/lb)	54.6	9.4	12.0	-14.5
Barley (CAD/t)	117	3.9	-4.4	-27.0
Canola (CAD/t)	288	4.1	-6.9	-32.8
<b>USD Index 94/95 = 100</b>	<b>103.7</b>	<b>3.3</b>	<b>5.6</b>	<b>3.8</b>
<b>AUD/USD US cents</b>	<b>0.79</b>	<b>1.7</b>	<b>13.4</b>	<b>5.2</b>
<b>AUD Index 94/95 = 100</b>	<b>97.5</b>	<b>1.5</b>	<b>-6.8</b>	<b>-1.3</b>

a) The index uses daily mid prices to calculate monthly averages  
b) Data source is Bloomberg, USDA FAS, Westpac Economics

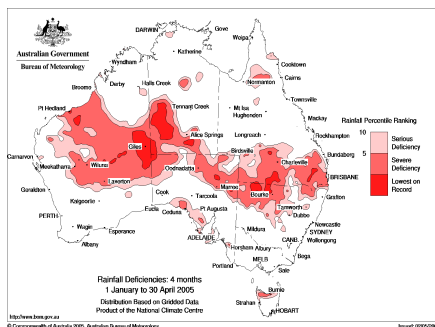
**Chart 2.**

**Westpac NFF Farm Commodities Index**  
In AUD and SDR 1994/95 = 100 monthly averages



**Chart 3.**

**Rainfall deficiencies across Australia**



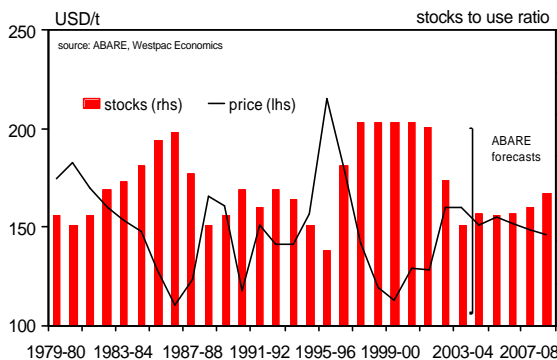
**Chart 4.**

**The outlook for rainfall is far from promising**



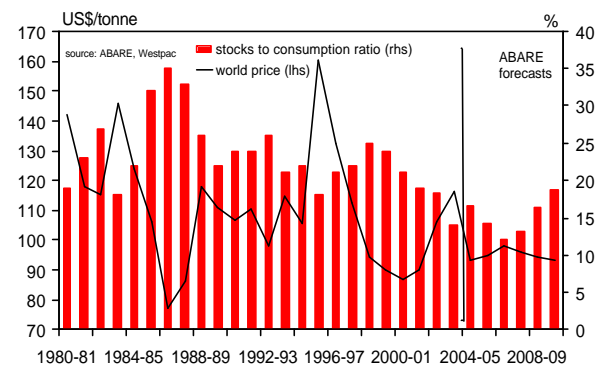
**Chart 5.**

**Rise in wheat stocks has hit prices**



**Chart 6.**

**Stocks build is a drag on corn prices**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## Regional industries - agribusiness

---

Average seasonal conditions would see a fall in global oil seed production this year.

### Canola

Based on the assumption of average seasonal conditions, world oil seed production should fall around eleven per cent in 2005/06. Asian soybean rust was found in the US crop in 2004 and the cost of controlling this disease is likely to reduce soybean planting in the US. Also ABARE is forecasting the production of canola and cottonseed to fall in 2005/06. However, demand for oilseeds and oilseed meal is expected to decline with the forecast decline in pig production – oilseed meal is used extensively in pig industries. An offset will be the demand for vegetable oil which is likely to remain around 105 million tonnes in 2005/06 as rising incomes in India and China, and a shift in consumer preferences, offset any weakness from the overall slowdown in world economic growth.

Sugar prices are up 40% but Brazilian production forms a price ceiling.

### Sugar

Global prices have risen more than forty per cent in the last year, coming off record lows as production problems in India and Thailand limited exports from these countries. The short-term outlook remains positive with ABARE expecting world consumption to exceed production and thus prices to average higher in 2004/05. However for 2005/06, Brazil will continue to expand production and with production increases from other major producing nations, total production will grow faster than consumption and prices should fall back below US8¢ per pound. Prices at these levels will continue to test the Australian sugar industry's ability to change and improve competitiveness.

ABARE is forecasting sugar cane production to rise around two per cent this year to 37.5 million tonnes. Reflecting higher sugar content in the cane this year, total sugar production is forecast to rise three per cent. With Queensland sugar pool prices forecast to rise more than twenty per cent to \$285 a tonne, this will improve returns to cane growers and stimulate an increase in inputs such as fertiliser. If there is an average season in 2005/06, then this increase in inputs could lift total sugar production by around 1½ per cent.

Cotton consumption may exceed production this year supporting prices.

### Cotton

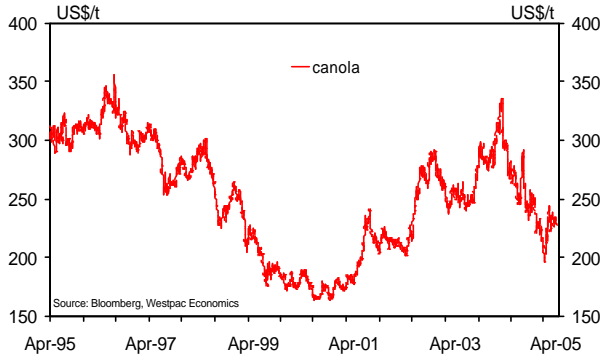
There has been some positive news for Australian cotton farmers with the World Trade Organisation upholding an earlier ruling on US cotton subsidies, which means the US will need to move to dismantle these trade distorting practices. As the US is currently the second largest producer of cotton, this may also lead to higher world cotton prices in the long-term. For 2005/06, with world consumption of cotton expected to exceed production, stocks should fall and prices rise. ABARE is forecasting the Cotlook A index to average around US60¢ per pound in 2005/06. A fall in production is seen as a response to the significantly lower cotton prices in the lead up to the planting of the northern hemisphere cotton crop, resulting in smaller crop areas in China, India and Pakistan.

Improvements in the availability of water prior to the planting of the 2004/05 crop lead to a sixty per cent increase in the area planted. Average rainfall over parts of northern NSW and southern Queensland over the past three to six months has increased water storage levels in key cotton growing areas. If these seasonal conditions continue, this could lead to a further increase in cotton plantings this year.

## Regional industries - agribusiness

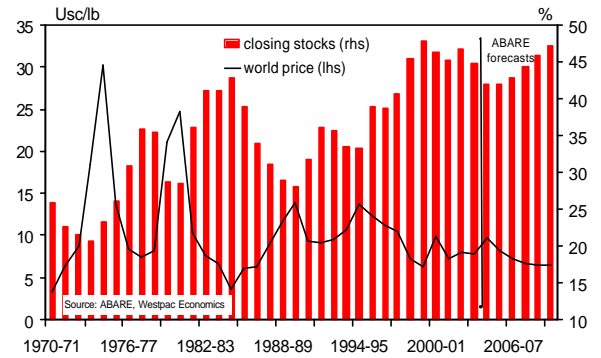
**Chart 1.**

**World canola prices remain under pressure**



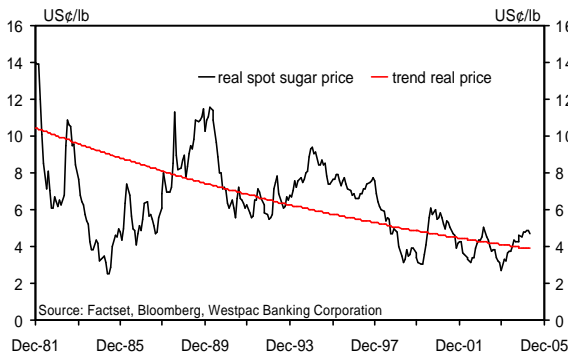
**Chart 2.**

**Sugar prices boosted supply shortfall**



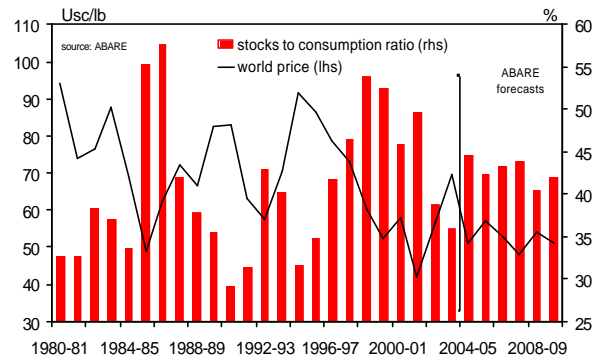
**Chart 3.**

**Real sugar prices have edged above trend**



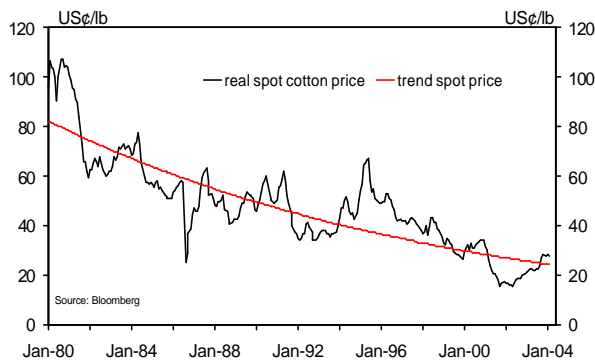
**Chart 4.**

**Cotton under pressure from production**



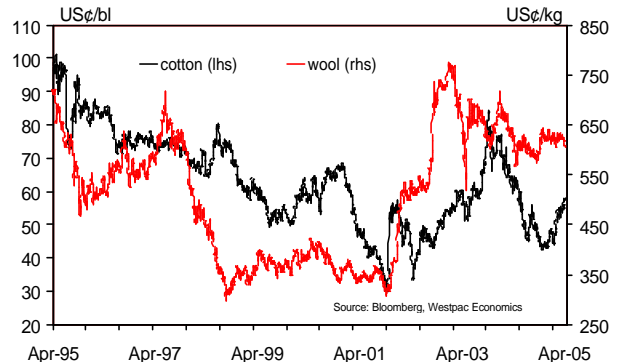
**Chart 5.**

**Real prices around long-term trend**



**Chart 6.**

**Cotton prices a drag on the fibre market**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

## Regional industries - agribusiness

---

The slowdown in global demand will be offset by a weaker Australian dollar.

Beef exports will face increased competition in the key Pacific Rim markets.

The dry condition on the east coast poses the biggest risk to the sheep meat industry.

Pig producers continue to face stiff competition from Canada and the US.

### Wool

Wool prices have started to strengthen since the low point in February in response to the more competitive Australian dollar. Continued strong global growth, led by demand from China, and sustained higher oil prices increasing the relative cost of synthetics to wool, have also been positive factors for wool prices. ABARE is forecasting wool prices to average lower in 2005/06 reflecting higher wool supplies and weaker world demand. Westpac's own research has shown that the US dollar value of wool is affected by changes in economic activity. In particular, the poor performance of the Italian, German and Japanese economies is unlikely to support an increase in wool demand from these countries. However, if Westpac is correct and the AUD is around US72¢ by the end of 2005, then this will be supportive of domestic wool prices.

### Beef

Beef prices eased back through March and April with an almost twenty per cent jump in export volumes and seasonally slow demand from Japan and Korea. On the supply side, an increase in cattle through saleyards, combined with mixed quality due to poor seasonal conditions, contributed to the easing of prices for Australian producers. However, prices still remain at historically high levels. Looking forward, a forecast increase in Australian beef production, and an increase in cattle supplies in the Pacific Rim markets are likely to result in lower saleyard prices for cattle in 2005/06. Beef prices will remain under pressure over the medium term as the United States and Canada re-enters the Pacific Rim markets and South American beef producing nations increasingly compete in these markets as well.

### Lamb and meat sheep

Sheep meat prices made solid gains through 2004 and ABARE is forecasting lamb prices to average around 355 cents per kilogram in 2004/05. Prices have been supported by strong export demand, particularly from the US which is the largest export market for Australian lamb. Prices had also been supported by restocking demand. However, the extended dry conditions over a large part of the south eastern mainland has recently seen prices fall to 310 cents per kilogram as growers unload stock they are no longer able to support. The risk here is that the ABARE price forecast is achieved, if not exceeded, but due to dry conditions reducing supply rather than strong demand.

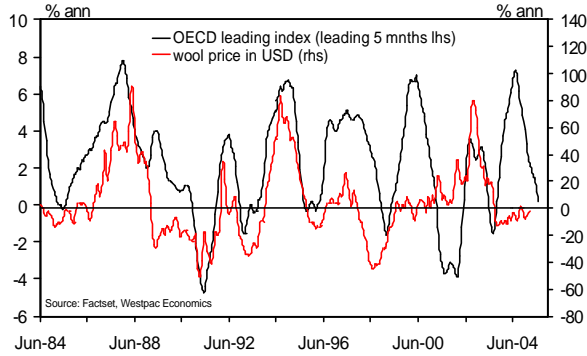
### Pigs

Pig prices have fluctuated significantly in recent years as the local market has been increasingly exposed to the global market through both imports and exports. In 2003/04 an increase in imports, particularly from Canada and Denmark, and a rise in Australian production saw saleyard prices fall around four per cent. However, prices rose in the second half of 2004 as domestic production moderated and imports declined. ABARE is forecasting that in the medium term, an increase in global meat production will result in lower global, and thus Australian, prices. For Australian producers, while a lower Australian dollar may provide some offset they will still face stiff competition from Canadian and US producers, who appear to have significant cost advantages.

# Regional industries - agribusiness

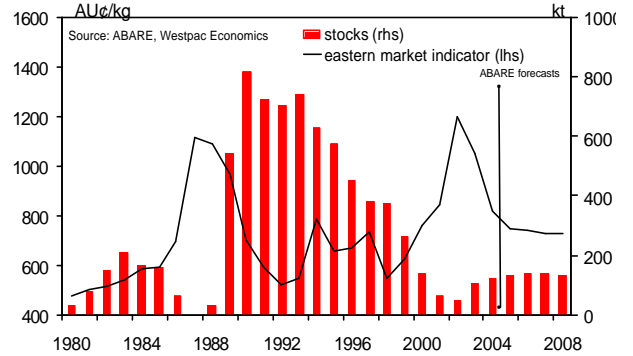
**Chart 1.**

**Wool prices are tied to global demand**



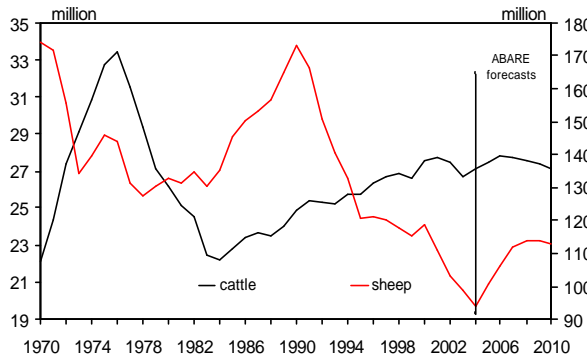
**Chart 2.**

**Softer demand so small rise in wool stocks**



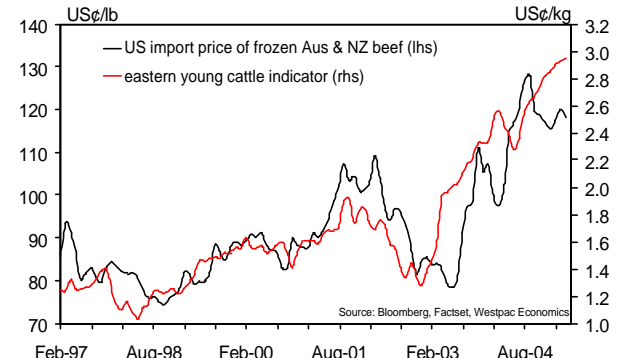
**Chart 3.**

**The herds & flocks being rebuilt**



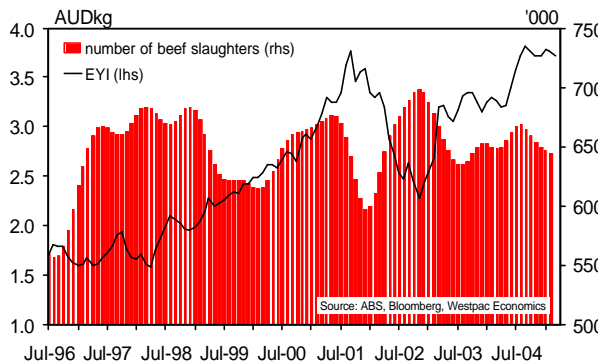
**Chart 4.**

**Australian beef prices with a head of steam**



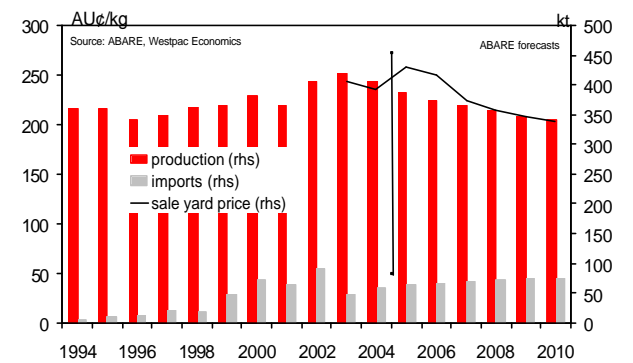
**Chart 5.**

**Beef prices and cattle slaughtering**



**Chart 6.**

**Pork imports to continue to grow**



## Regional industries - agribusiness

---

Global dairy prices are expected to remain around current levels ...

... but Australian farmers are still facing a very competitive global market.

The global wine market is becoming increasingly competitive.

Growth in fisheries production to come from aquaculture.

Tourism will get a boost from a weaker Australian dollar.

### Dairy

Dairy prices rose solidly through 2004 as dry conditions in Australia and New Zealand hit cow numbers, and thus production, resulting in a significant reduction in global stocks. An added boost came from rising demand, in particular steady growth in global cheese consumption, mainly in response to economic growth in Latin America, the westernisation of Asian diets and the spread of fast food (particularly pizza) throughout the world. World cheese supplies are expected to remain constrained, at least for the short-term, before rising at an increasing rate as milk production growth accelerates towards 2009/10.

Australian dairy farmers are nevertheless facing significant challenges in the increasingly competitive export markets. We have to agree with ABARE's assessment that in the longer term, the number of dairy farms will continue to decline as the higher cost operators leave the industry. However, with dairy farms getting larger and more productive, the number of cows and total milk production will still grow over the medium term.

### Wine grapes

The Australian wine grape industry harvested a record 1.9 million tonne crop in 2003/04, more than thirty per cent larger than the drought affected 2003/04 crop and almost twenty per cent larger than the previous record in 2001/02. With exports now accounting for more than forty per cent of Australian wine production, global events play a key role in the outlook for the industry. The global market for wine grew nearly two per cent in 2004 with particularly strong growth in European demand for Californian and Australian wines. 2004 also saw strong growth in the demand for premium wines, particularly from the 'new world' wine makers, as robust incomes growth and changing lifestyles saw an increase in wine consumption. In contrast, demand for low quality table wine continues to fall as aggregate wine consumption falls in France, Spain and Italy. In the medium term, global demand for premium wine is expected to continue to increase as consumption per person grows. However, supply has also grown strongly as 'new world' wine producers expand production. Global wine production is estimated to have risen ten per cent in 2004 with production again exceeding consumption by around seven billion litres. Therefore a combination of lower export values and above average yields should result in further reductions in both red and white wine grape prices in 2004/05 and into 2005/06.

### Fisheries

Aquaculture will be the main source of world growth in fish production as worldwide catches of wild fish are expected to remain fairly static over the medium term. Australia produced \$2.2 billion of edible seafood products in 2003-04, of which around a third came from aquaculture. Australian edible seafood exports were valued at \$1.3 billion in 2003/04 with an offset from imports valued at \$905 million. If Westpac is correct and there is a moderation in growth in the major export markets, seafood prices are likely to face downwards pressure in 2005/06.

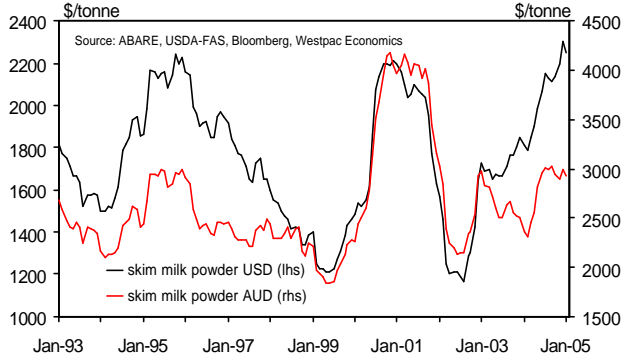
### Tourism

Australian tourism continues to rebound from the lows induced the SARS outbreak in 2003. Short-term arrivals hit a new record of 470,700 in March. However, it remains a very competitive industry with the strong Australian dollar encouraging Australians to holiday overseas. Short-term international departures also hit a new record of 387,400 in March. Remembering that four out of five tourism dollars comes from the domestic market the forecast depreciation of the Australian dollar will help here.

# Regional industries - agribusiness

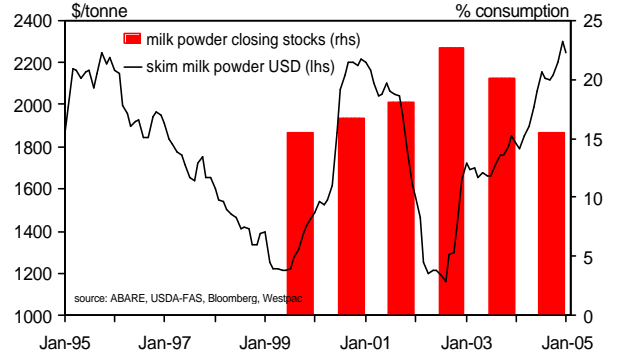
**Chart 1.**

**Dollar is crimping domestic milk prices**



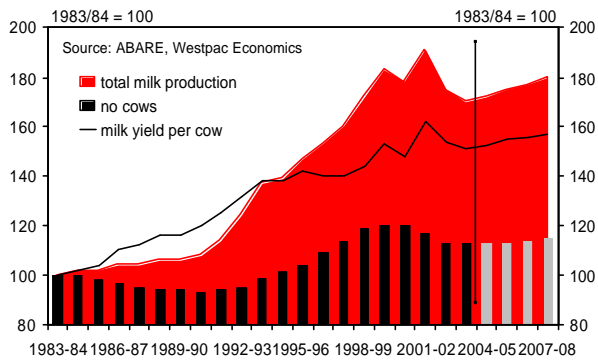
**Chart 2.**

**Strong demand, falling stocks, rising prices**



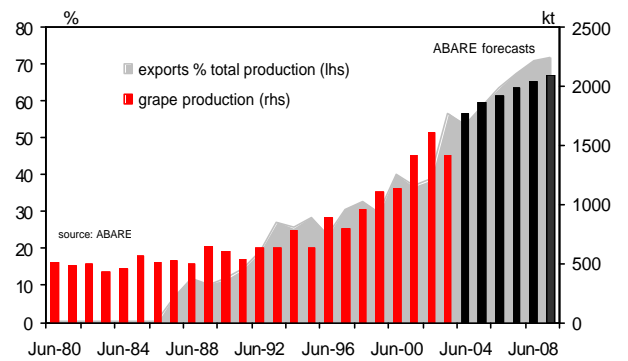
**Chart 3.**

**Productivity behind milk production**



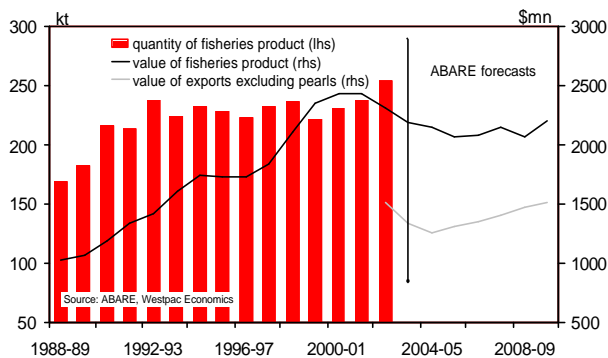
**Chart 4.**

**Exports are vital for the wine industry**



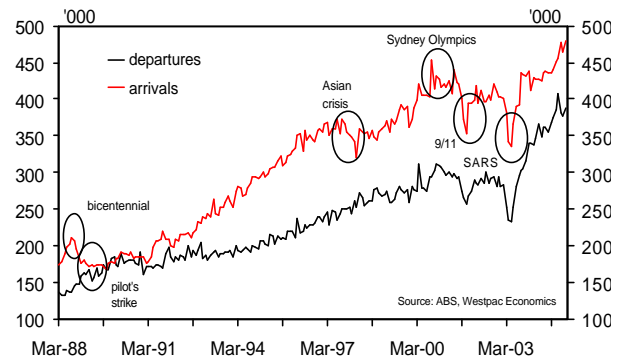
**Chart 5.**

**Total fisheries output has stabilised**



**Chart 6.**

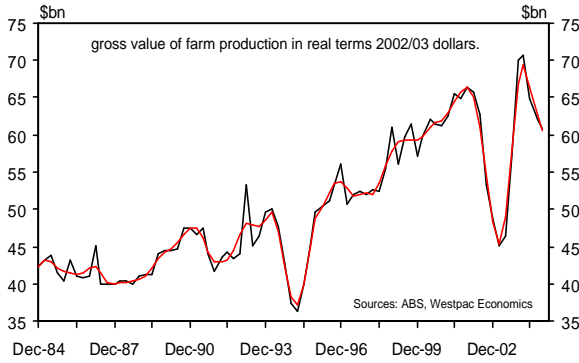
**Outbound tourist rebound with strong A\$**



# Regional economic indicators

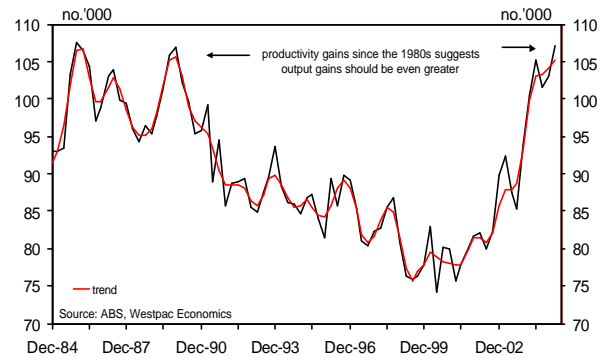
**Chart 1.**

**The extended dry is all ready biting**



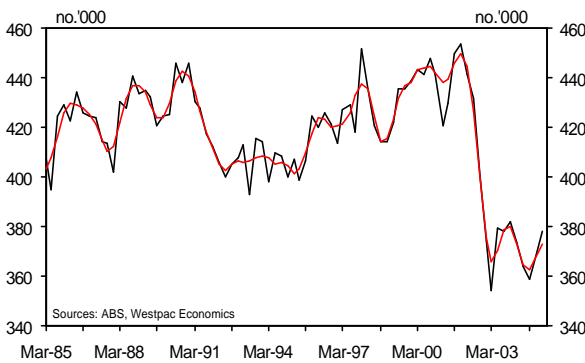
**Chart 2.**

**Mining jobs are hitting new highs in 2005**



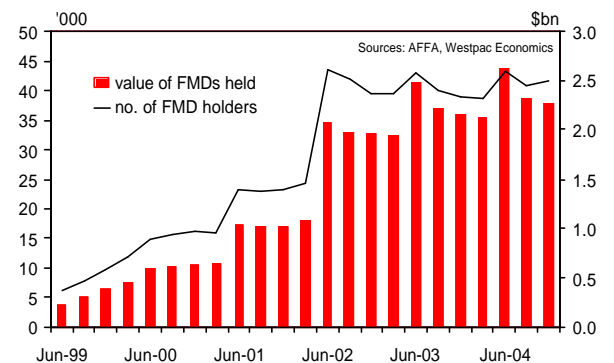
**Chart 3.**

**Farming has not regained drought job losses**



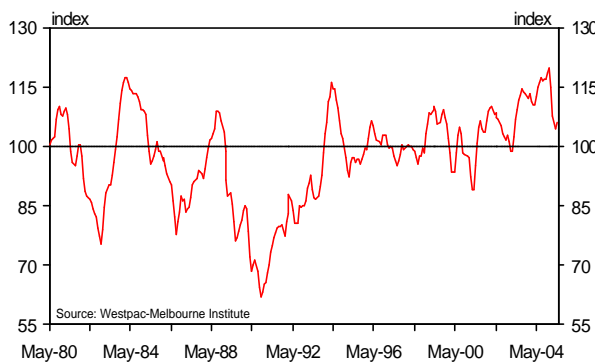
**Chart 4.**

**Farms retain a healthy level of liquidity**



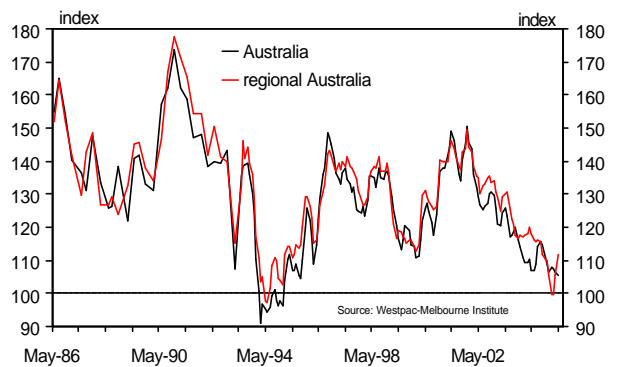
**Chart 4.**

**Regional index of consumer sentiment**



**Chart 5.**

**Unemployment expectations**



## Corporate directory

---

### Westpac economics

#### Sydney

Level 5, 255 Elizabeth Street  
Sydney NSW 2000  
Telephone (61-2) 9284 8372  
Facsimile (61-2) 9284 9363

#### Bill Evans

Global Head of Economics

#### Andrew Hanlan

Senior Economist

#### Huw McKay

Senior International Economist

#### Justin Smirk

Senior Economist

#### Anthony Thompson

Senior Economist

#### Jonathan Cavenagh

Economist

### Westpac regional banking

#### Melbourne

Level 12, 360 Collins Street  
Melbourne VIC 3000  
Telephone (61-3) 9608 5792  
Facsimile (61-3) 9608 3824

#### Jamie Ritchie

National Manager Regional Banking

#### John Cashmore

Regional Executive  
Northern Victoria  
Telephone (61-3) 5820 2553

#### Colin Clark

Regional Executive  
Southern Victoria  
Telephone (61-8) 9565 8465

#### Barry Ruddy

Regional Executive  
Inland NSW  
Telephone (61-2) 6393 4501

#### Steve Hannan

Regional Executive  
Northern NSW  
Telephone (61-2) 6584 2856

#### Peter Willshire

Regional Executive  
Northern Australia (NT & Nth QLD)  
Telephone (61-7) 4722 8279

#### Rod Kelly

Regional Executive  
Central & Southern QLD  
Telephone (61-7) 4688 6063

#### Jay Watson

Regional Executive  
Western Australia Regional  
Telephone (61-8) 9426 2525

---