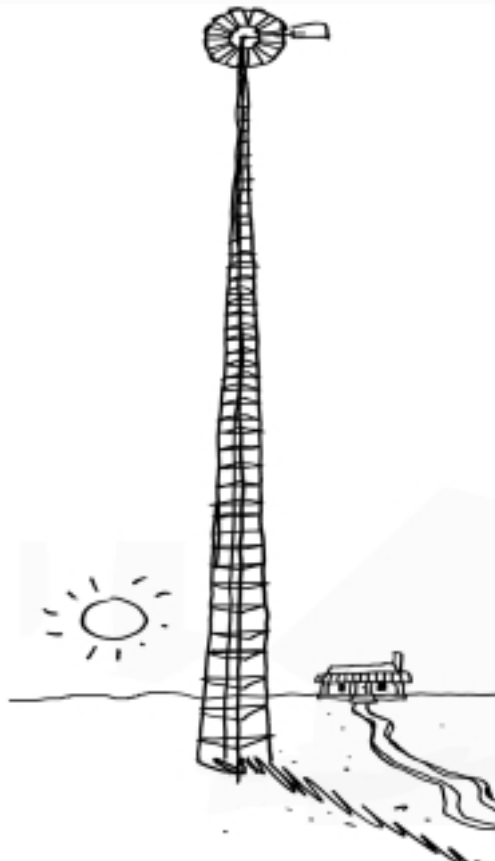


Regional Economic Report

Summer 2005

- The “Sunshine States” are currently the powerhouse for economic growth.
- The resource boom to continue through 2005.
- Rainfall has come to most of the agricultural region but commodity prices have peaked.
- Interest rates to rise, the Australian dollar to fall in 2005.



Contents

Executive summary	3
Regional Australia economic outlook	4
The Australian economy and interest rates	6
Regional consumption, the “Sunshine States” power on	8
The international economy, a modest deceleration	10
The Australian dollar outlook	12
Regional industries – resources	14
Regional industries – agribusiness	18
Westpac-Melbourne Institute regional 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

This report was finalised on February 3, 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 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 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 "Sunshine States", Queensland and Western Australia, continue to power on with these two states alone accounting for almost half of the growth in consumption in 2004. While growth will have to, eventually, succumb to gravity solid population growth and the kick to incomes provided by a booming resource sector will see these states again outperform the national average in 2005.

The main economic events that we think will unfold in 2005; is a further rate rise from the RBA; and, the Australian dollar falling back under US70 cents. Upstream price pressures and a recovery in the housing market will see the RBA lift rates in the June quarter. The Australian dollar, while benefiting from a short-run boost from commodity prices will, eventually, succumb to the pressure of a ballooning current account deficit.

Our analysis of the farm sector finds it in an overall healthy state. Solid rainfall in December has removed the rainfall deficiencies recorded in most of eastern Australia though the outlook for northern Queensland is for below average rainfall. Farm finances are in a healthy state and solid tractor sales point to a coming lift in productivity. However, farm employment remains at drought lows suggesting many of the jobs lost during the drought may not reappear any time soon. Clearly, farmers are learning to do more with less labour but it may not be a totally discretionary decision; the booming resource sector would be dragging skilled labour away from the farming sector.

The resource sector is booming as surging Chinese demand drives up commodity prices, which is providing a significant windfall for regional Australia, particularly for resource rich WA. Mining employment has returned to 1980s levels with rising profits being poured back into resources investment. Slower global growth and rising production means commodity prices will ease in 2005. However, as global stocks are at very low levels, prices will remain at somewhat elevated levels. Coal and iron ore are the stand out exception with rising Chinese demand for steel driving up the price of both these commodities.

Tourism has bounced back from the Sars lows and it has even weathered the hit of a strong Australian dollar. Westpac is forecasting the dollar to fall through 2005 and this will boost foreign tourist spend in Australia and divert a significant number of Australians away from overseas holidays to domestic locations.

For individual regional industries:

Coal and iron ore prices are being supported by strong demand, particularly from China. The current negotiations for contract sales to Japan are looking at prices rising from between 40 per cent and 100 per cent.

Aluminium prices have not risen by as much as other base metals and a significant increase in production will weigh heavily on prices in 2005.

Copper prices reached a 14-year high in 2004 as strong demand and supply disruptions ate into stocks. Rising production and moderating demand will see prices fall in 2005.

Nickel prices rose more than 40 per cent as China is finding an insatiable appetite for stainless steel. With stocks at very low levels, prices will remain at elevated levels for some time to come.

A global record harvest is weighing on just about all grain prices. **Wheat** prices are down almost 20 per cent with no relief in sight. **Canola** prices have fallen 40 per cent and are still heading south.

Record crops are also weighing on **cotton** prices as well and this is also acting as a drag on **wool** prices even though higher oil prices are boosting synthetic fibre prices.

Regional Australia economic outlook

The "Sunshine States" outperform the rest ...

The clear standout for Regional Australia is the continuing out performance of the "Sunshine States" Western Australian and Queensland. These two states alone contributed almost half of the rise consumption in 2003/04. From the analysis reported in this edition of the Westpac Regional Economic Report, we believe this can be explained by strong population growth, a continuation of the later stages the housing up cycle and, particularly for WA, a solid bounce back from the drought and a booming resource sector.

... but they will, eventually, have to submit to gravity.

We do believe than the growth in the "sunshine states" will eventually submit to gravity but there are a number of reasons to expect another out-performance of the national average this year. Firstly, house prices are only just peaking in these states and thus will provide solid bedrock for further consumption growth. Also, these states have enjoyed strong employment growth and given the support of the resource sector, particularly for WA, should continue to do so again in 2005.

2004 was as good as it gets for rural commodity prices.

For the farm sector, we have to say for most farm commodities prices 2004 was about as good as it gets. While Westpac's forecast for a weaker Australian dollar will be supportive, record global grain crops are weighing heavily on prices. Fibre prices are being weighed down by record cotton crops and an outlook for slower global growth. Livestock has been a standout performer with beef prices getting a boost from the closure of the Japanese market to US beef. Global dairy prices continued to grind higher in 2004 as demand remain robust and supplies from key exporting nations remain constrained. However, a lift in supply and a moderation in demand will see both beef and dairy product prices ease on the world market in 2005. So in 2005 average farm commodity prices will come under downward pressure.

Farm jobs remain at drought lows but ...

A continuing disappointing aspect of the recovery from the drought is the lack of recovery in farm jobs. Employed in agriculture remains at drought lows and the longer this remains the case, the more it appears that a structural change has occurred and farmers are leaning to do more with less labour. This in turn will continue to weigh on the long-term viability of smaller regional communities dependent on farm employment.

... farm liquidity and solid farm investment suggest a healthy industry.

This does not, however, mean that farming is in an unhealthy state. As noted in the last report, farm investment has strengthened with tractor sales returning to levels not seen since the late 1980s. In addition, the total value of Farm Management Deposits rose to \$2.6 billion at June 2004 (the most recent data available) just exceeding the last peak of \$2.5 billion in June 2003. On top of the investment numbers, this rise in liquidity suggests most farmers are in a healthy financial position.

Resources are booming and will remain solid in 2005.

A further positive for regional Australia is the current resource sector boom, which is expected to continue through most of 2005. While we do think that base metal prices have peaked, above trend global growth and low stocks means that prices can remain at sound levels. In addition, coal and iron ore prices are expected to rise significantly from the first quarter of this year as the annual contract negotiations are completed.

Positive signs for a recovery by tourism.

A recovery in the tourism sector also remains a positive for a significant part of regional Australia. While international arrivals have recovered from the Sars low, they are still well under the highs hit post the Sydney Olympics and the trend has flattened out. In addition, with the recent recovery in the Australian dollar the cost of offshore holidays has fallen resulting in a rise in Australian international departures. But Westpac is forecasting the dollar to fall under US70 cents by the end of the year and this will both boost international arrivals and crimp international departures.

Regional Australia economic outlook

Chart 1.

Consumption per capita by region

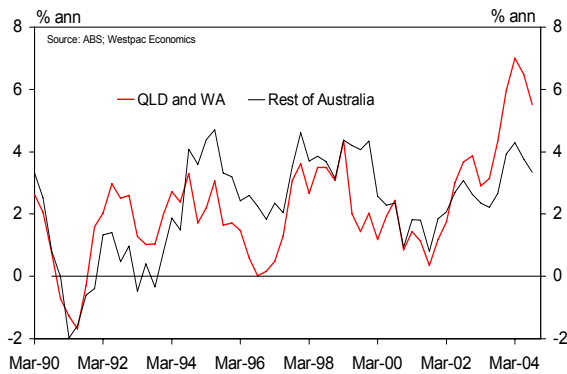


Chart 2.

Farm production bounces back from drought

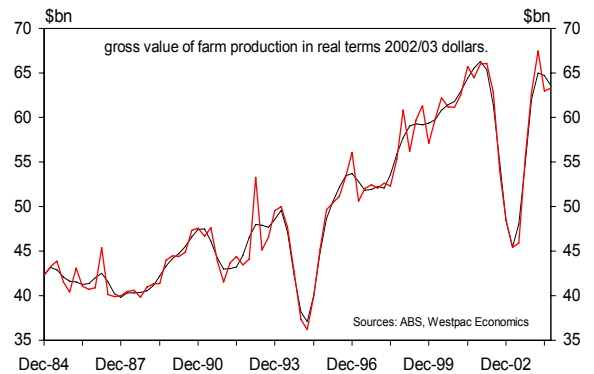


Chart 3.

Farming jobs still at drought lows

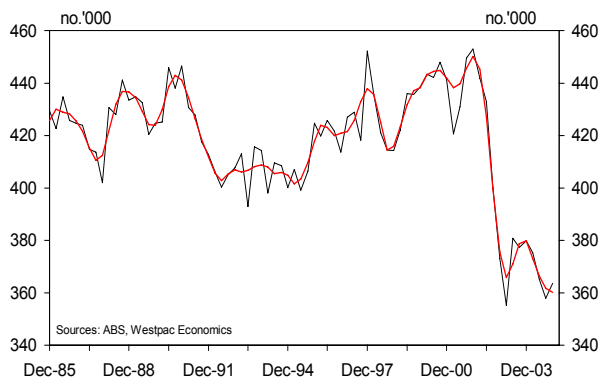


Chart 4.

Farms have a healthy level of liquidity

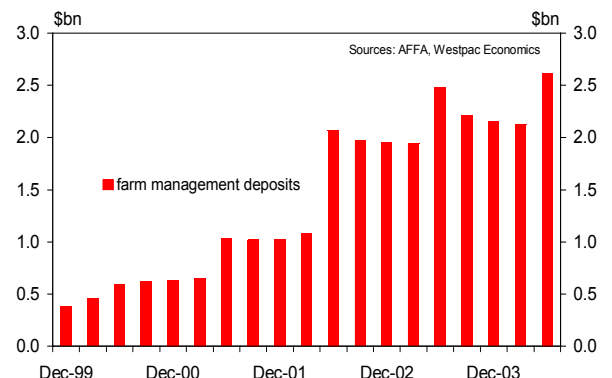


Chart 5.

Mining jobs back to 1980's level

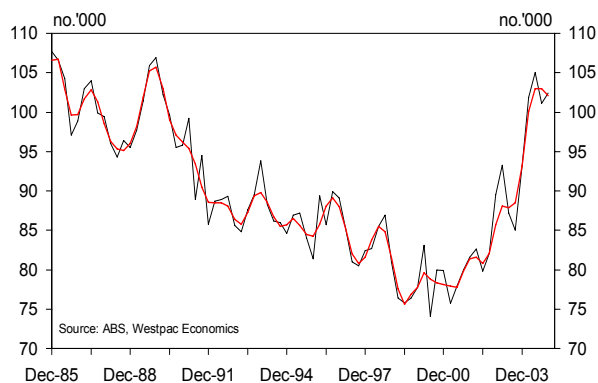
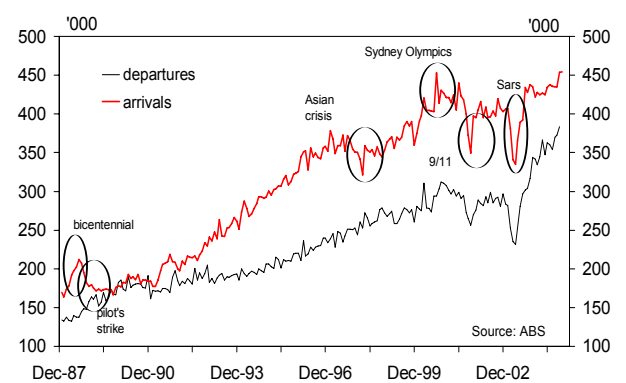


Chart 6.

International departures taking off for now



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 economy and interest rates

Rates hikes are just a matter of time.

Since the last Regional Economic Report (prepared on October 13) we have "pushed back" our forecast for a rate hike to the June quarter. We do want to stress that our view on the economic developments and outlook continues to point to the RBA needing to further raise rates. The key will be the Bank seeing some evidence of a less favourable outlook for inflation and that a tight labour market is leading to an acceleration in wages.

Housing finance approvals are stronger than expected.

There are very strong signs the Australian economy is continuing to outperform expectations. The Reserve Bank's preferred measure of housing finance approvals surged in November lifting the year on year fall from 20 per cent to October to 10 per cent to November. It was the fifth straight month of rising new loans to owner-occupiers. Total new lending is now up 5.2 per cent. Our take is that the Reserve Bank will still believe that lending to investors for housing is on a downward trend. This "mindset" is likely to keep the RBA "satisfied" with developments in the housing market even with rising new loans for owner occupation. However, if we are wrong and the November data is a genuine signal that sentiment toward housing has turned, then the RBA would not hesitate to move again given the state of the labour market.

Approvals for apartments are still falling while housing approvals are stabilising.

There is, however, a dichotomy between finance for investors and owner-occupiers. This is further drawn out in recent trends for building approvals. In the last four months, approvals for houses appear to have stabilised after falling 14 per cent from the September 2003 peak. On the other hand, approvals for units have fallen by almost 30 per cent over the last four months after having already fallen by 24 percent from September 2003.

The fear of a significant negative wealth effect from housing is fading.

From a growth perspective the most encouraging aspect of the trend in lending to owner occupiers that has developed in the last six months is that the "fear" of a major negative wealth effect, due to falling house prices, could eventually derail consumer spending seems to be progressively less justified, as lending and approvals stabilise.

The fall in total building approvals does, however, ensure housing will be a drag on economic growth for most of 2005. We have seen the first evidence of this in the September quarter of 2004 when housing investment fell by more than 1%.

Unemployment has fallen to a 30 year low ...

Strong employment growth has seen the unemployment rate hit a generational low. If this level of unemployment is maintained over the next three to four months then this will see a significant increase of wage pressures, and possibly rising inflation expectations, and thus greater pressure on the RBA to lift rates. Business surveys and other leading indicators point to strong employment growth in 2005. This could eventually see the unemployment rate falling below 5 percent, which would significantly challenge Australia's economic policy makers.

... but consumption and growth has nonetheless gone through a soft patch.

Contrasting the growth positives we have weak GDP growth of just 0.3 per cent in the September quarter, although private final demand grew by a "trend" 0.8 per cent mainly due to strong consumer spending. Retail sales grew just 0.1 per cent in November, following a surprising 1 percent fall in October. These observations have clearly been affected by the 17 per cent rise in petrol prices in the year to November but note a 6 per cent fall in December.

Looking for a more solid second half of 2005.

For 2005, we expect the "housing uncertainty/petrol" drag on consumers to gradually lift through the first half of 2005; building approvals will bottom out in the first quarter; the dollar will move back towards US70 cents; and, export growth to accelerate mainly due to a strong supply response in resources.

The Australian economy and interest rates

Chart 1.

Housing finance, value

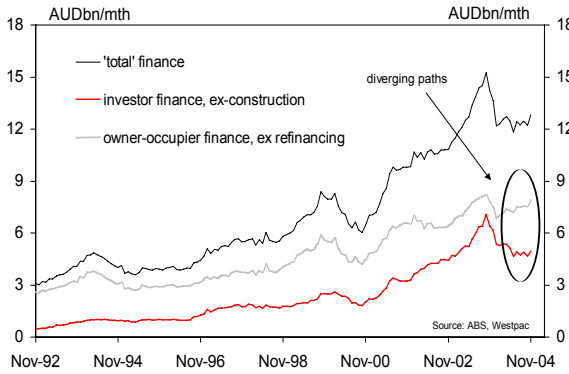


Chart 2.

Spending will slow relative to income in 2005

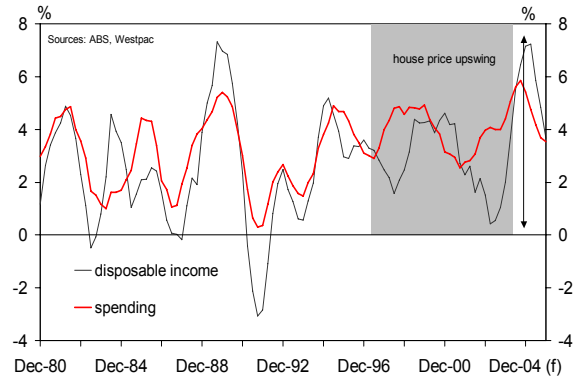


Chart 3.

Demand moderates as housing cools

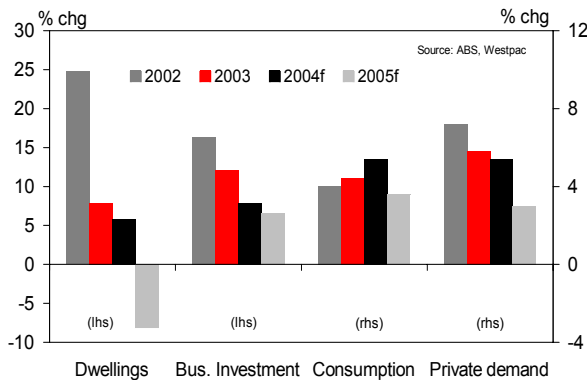


Chart 4.

Upstream prices point to an acceleration

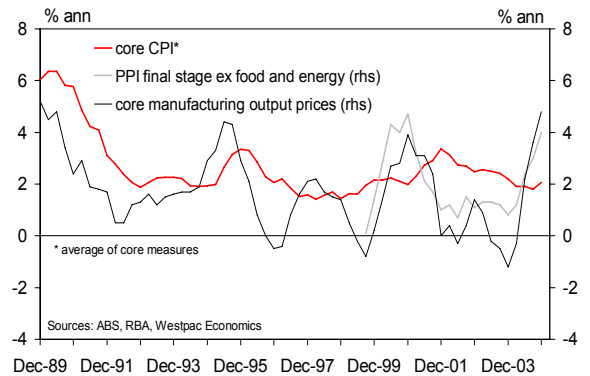


Chart 5.

Labour is getting harder to find

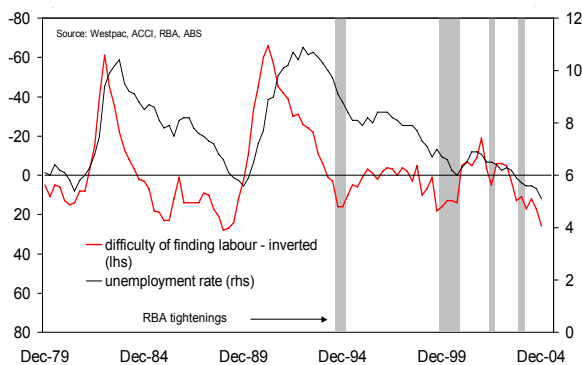
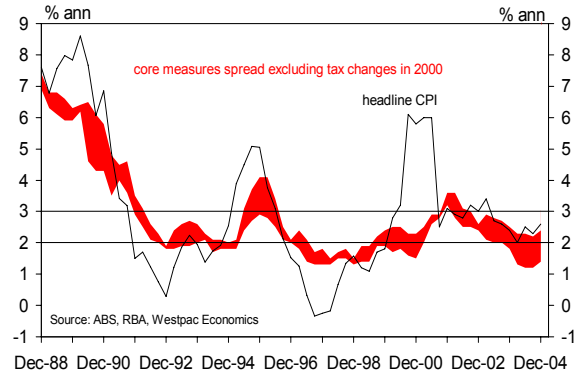


Chart 6.

Inflation troughed in 2004, now moving higher



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 consumption – the Sunshine States power on

Qld and WA have powered on ...

The September quarter of last year marked the fourth consecutive reading of 5 per cent plus year-ended consumption growth. That is a feat not achieved since the late 1980s. Much of the recent strength in aggregate consumption has reflected exceptionally strong growth in Queensland (Qld) and Western Australia (WA). In 2003/04, these two states contributed just under half the 5.6 per cent rise in aggregate consumption. That compares to a 0.9 percentage point contribution to aggregate growth of 4.1 per cent in 1999/00.

... part of the story reflects population growth.

What explains this strong performance? A partial explanation is population growth. Qld and WA combined have enjoyed considerably faster population growth than the rest of the country. However, once we adjust for population growth and look at consumption growth per capita, the out-performance of these two regions remains. Therefore other factors must have been at play.

Housing wealth effects ...

Much has been made of the strong rise in house prices from the mid 1990s, and the boost to household consumption via the wealth effect. However, when we look at house price data by capital city, the timing of this wealth effect has not been uniform. In Brisbane, where house prices were flat throughout the mid 1990s before rising very strongly from 2000 onwards. Year-ended house price growth in Brisbane peaked at 37% in the March quarter of 2004. The amplitude of the Perth/WA house price up-cycle has been smaller than Brisbane, but the timing has been roughly coincident. Both cycles go going after Melbourne and Sydney, and both are enjoying extended “shelf-lives”.

... and commodity prices have also been important.

Non-rural commodity prices have risen by 26 per cent in AUD terms this year. The RBA notes that that the strength in commodity prices over the past year has provided a significant stimulus to incomes and spending. This comment is particularly pertinent to WA, where the state economy is under-pinned by non-rural commodity exports. WA consumption growth has a fairly coincident relationship with swings in non-rural commodity prices.

When wealth effects slow in QLD & WA ...

WA has also benefited from volume growth on the rural side. Following the recovery from the drought, national agricultural income rose by \$3bn in 2003/04. WA accounted for just under half (\$1.3bn) of this increase, on the back of a record wheat crop. In other states, the recovery in agricultural incomes was more modest, reflecting less favourable rains in the eastern states and a greater exposure to the beef and irrigation related industries which are yet to fully recovery from the drought.

... jobs will provide an offset.

Qld and WA have accounted for a disproportionate share of national consumption growth in recent times. History indicates that consumption growth in these two states will submit to gravity, as happened in the mid 1990s. Yet we think it likely that Qld and WA will continue to contribute a healthy share of national consumption growth in coming quarters.

Housing and commodities still have legs.

This view is predicated on several factors. Firstly, on the back of strong consumption growth, since around the middle of 2004, Queensland and WA have enjoyed strong employment outcomes compared with the rest of the country. Further, house prices have peaked only recently in both states, and this follows an extended period of strong growth, particularly in the case of Qld. Also, commodity prices should remain at a relatively elevated level and provide continuing support to incomes in WA. Recent anecdotes have supported the view that the annual bulk commodity supply contracts for coal and iron ore will see sharp rises. That will offset any moderation in base metals spot prices. WA’s iron ore and energy assets will serve it well in this environment.

Regional consumption – the Sunshine States power on

Chart 1.

QLD and WA are currently the key drivers.

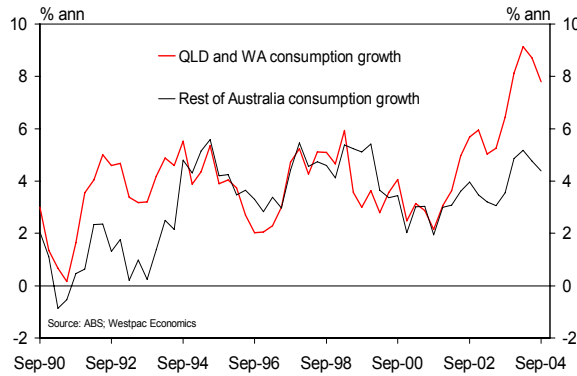


Chart 2.

Consumption per capita by region

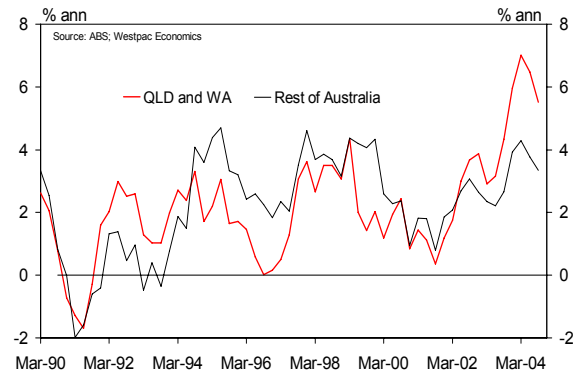


Chart 3.

Brisbane house prices strong since 2000

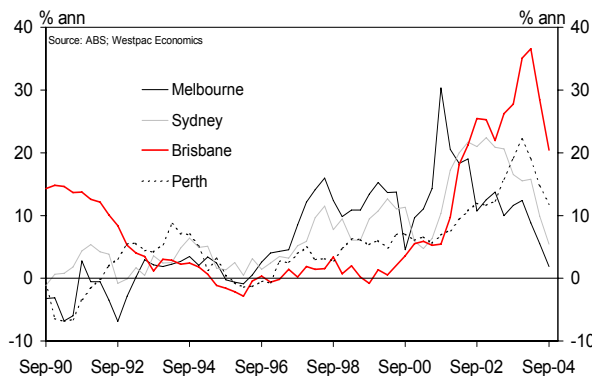


Chart 4.

Commodity prices have supported WA ...

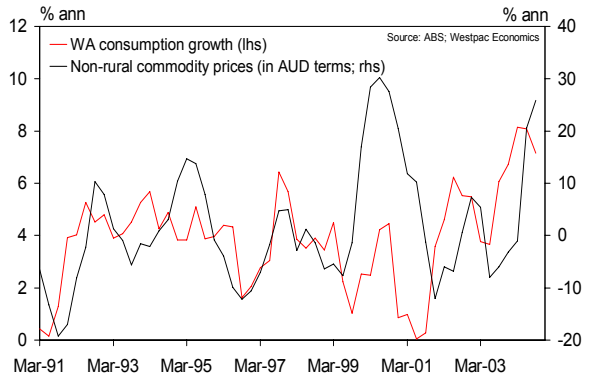


Chart 5.

... & so has recovery from the drought

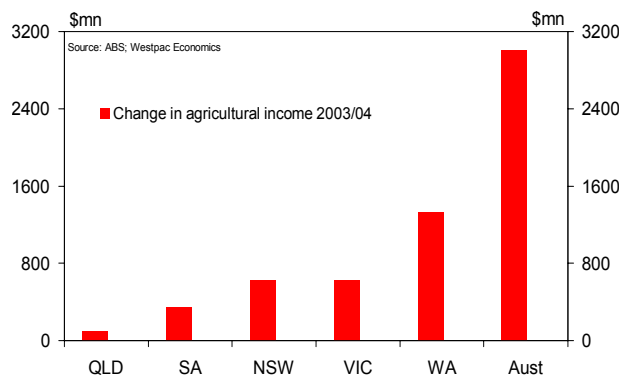
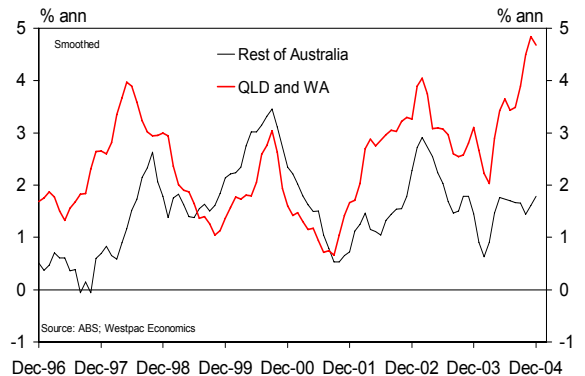


Chart 6.

Employment growth by region



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 international economy: a modest deceleration

World growth remains in good health ...	The global economy continued to expand at a healthy above trend pace in the December quarter of last year. There was however a tangible slowdown in the second half of 2004 from the rapid pace of expansion evident over the end of 2003 and first half of 2004. This slowdown was most evident in the developed economies.
... but a tangible slowdown ...	Our view is that a moderation in growth was to be expected in the second half of 2004, with the slowing trend to become clearer in 2005. That trend will be visible in both developed economies and emerging markets. Yet we maintain our view that global economic growth looks set to maintain an above trend pace next year. In purchasing power parity terms, we expect an expansion of around 4 percent in 2005, down from a spectacular rate in excess of 4½ per cent in 2004.
... is occurring in late 2004.	In order to assess aggregate momentum at a higher frequency, we have assembled proxy quarterly series of global GDP and industrial production. We reproduce these series in charts one and two. The reduced momentum towards the end of 2004 versus the first half of the year and end 2003 is immediately evident in the first picture. That reflects a moderation in the strength of the Japanese and European data flow, and lower reported activity growth in the US and China.
The US will slow closer to trend.	In the US, the data flow suggests the economy remains in solid shape. Survey data for the business and household sectors continues to be positive. We see consumer and business spending remaining resilient through 2005. This implies that the Fed will stay the course and continue to raise interest rates in 2005. The Fed's Funds rate is expected to be 4.00 percent by year's end. In contrast, the data flow from the Europe has been weaker, with conditions in the manufacturing and service sectors deteriorating towards the end of 2004. Moreover, with no evidence of a pick-up in domestic demand across Europe, this rules out an ECB monetary tightening in the foreseeable future.
IP is forecast to out-perform GDP next year ...	Reflecting these developments forecasters' expectations, as reported to Consensus Economics, see a sequential slowdown in the year-ended rate of growth in the global economy through 2005. Unsurprisingly, forecasters express a similar preference for the forward profile of global industrial production. Yet global industrial production growth is expected to be more resilient than global growth.
... which is a China effect.	Why might this be so? The answer is that the increased importance of emerging markets, particularly China, has skewed the composition of global output towards manufacturing over services. Services account for around four-fifths of the US economy, but they only represent a third of Chinese output. Given that China (and other high growth manufacturing focussed emerging markets) grow much faster than the developed world, there is an upward bias in industrial production relative to overall economic growth.
Emerging markets will toe the line.	The increased importance of China and other emerging markets to global growth figuring cannot be ignored. However, the majority of these economies are still very much leveraged to the global growth cycle. Therefore they essentially fall into line with the trajectory of the developed economies. Chart six shows Consensus expectations for 2004 and 2005 growth in selected non-east Asian emerging markets. Outside of India and South Africa, where special circumstances apply, the overall story of moderating but still healthy growth is clearly evident.

The international economy: a modest deceleration

Chart 1.

World IP proxy - quarterly

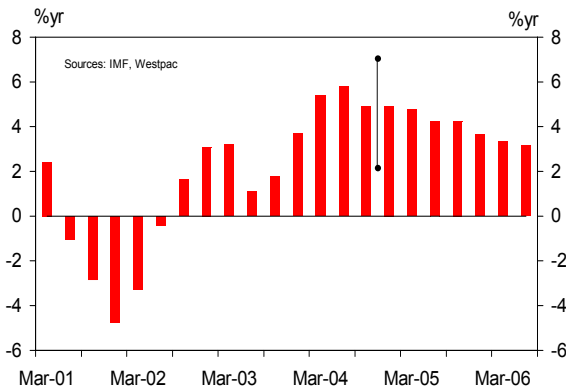


Chart 2.

World GDP proxy - quarterly

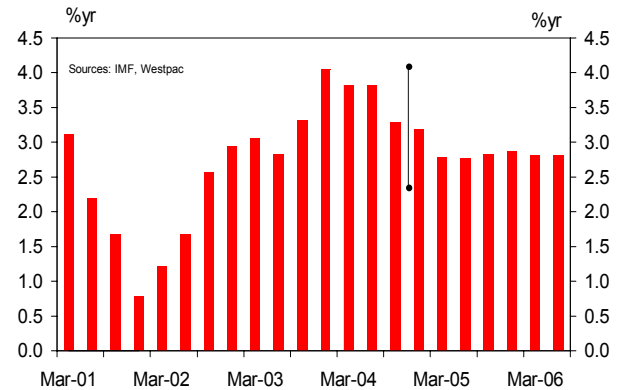


Chart 3.

Leading indicators of global growth

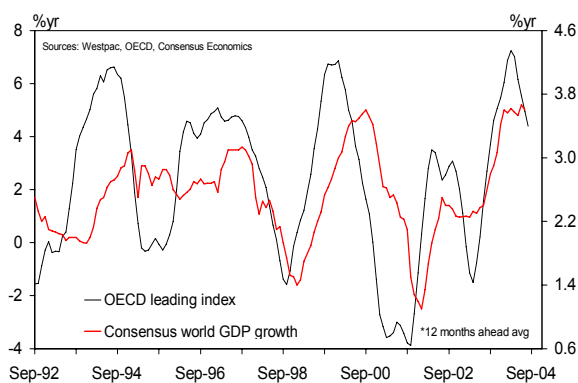


Chart 4.

US economy remains in good shape

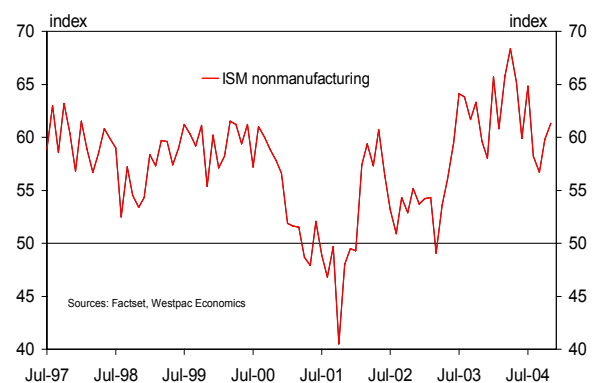


Chart 5.

Consensus expectations* for Asian growth

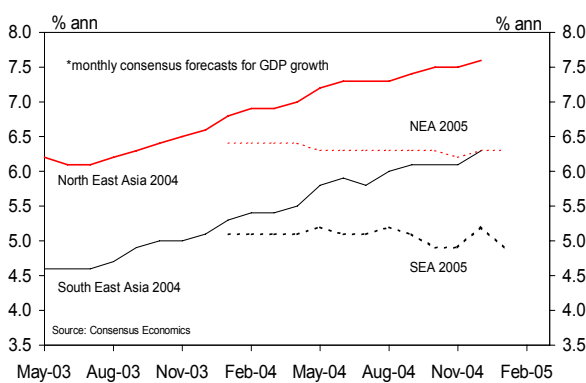
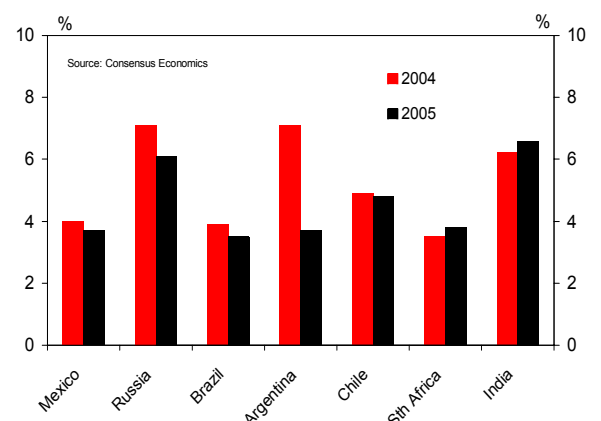


Chart 6.

Emerging markets to slow 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.

The Australian dollar outlook

Short-term upside risk but the Australian dollar should weaken by year's end.

We continue to hold to the core view that the Australian dollar will depreciate substantially against the US dollar this year. We have to admit, the renewed strength in the Aussie dollar near the end of 2004 did catch us by surprise and we have had to slightly raise the forecast the profile. Also the stellar projections for coal and iron ore contract price rises will place short-run upside pressures on the dollar. We do, however, still expect the Australian dollar to fall to around US68¢ by the end of 2005. Why?

Our reasons can be divided into factors we see leading to a weaker Australian dollar and those that we think will lead to a stronger US dollar.

Commodity prices should ease as global demand growth slows but ...

For weaker Australian dollar, part of the arguments hinges around China and its demand for resources. Whilst we expect that China will be successful in negotiating a soft landing, the economy will need to slow much more quickly than has been the case to date. This slowdown will be drawn out over the next couple of years and we don't think that commodity markets have factored this into current prices. On the supply side, base metal production is now responding to the record high prices. Our measure of global base metal inventories shows that stocks are starting to stabilise.

... the rise in coal and iron ore contract prices in 2005 are a short-term upside risk.

Westpac's analysis reveals commodity prices as a key driver of the Australian dollar. As such, a fall in base metals prices will impact directly on the dollar. Bulk commodities, such as coal and iron ore, are more lumpy so we expect to see large increase in coal and iron ore prices in the first half of 2005. However, as demand slows we expect to see falls in the spot prices and thus downward pressure on the contract prices for 2006. Hence, this implies downward pressure on the dollar in the second half of 2005.

The blowout in the Australian current account deficit is a significant negative.

The other negative for the dollar remains our own current account deficit. The unexpected blowout to 6½ per cent of GDP in the September quarter was driven by a three per cent fall in exports. A strong dollar is also a drag on services and manufacturing export growth and we cannot be confident that in a near-term supply driven recovery in resource exports is in place. Bottlenecks at ports and the mining rail system are unlikely to be solved immediately, thus too is a near term bounce in exports is also unlikely.

The US dollar will not remain on the path to "destruction".

There are a number of US specific issues that give us confidence that the US dollar is unlikely to stay on the path to "destruction". The first is that the growth outlook for both Europe and Japan is not encouraging, and so too the outlook for returns in those economies is not promising.

The US current account has peaked and will start to correct.

We assess that about half of the recent deterioration in the US current account was due to the sharp rise in the oil price. Our 2005 US growth forecast of 3½ per cent is consistent with a modest improvement in the current account deficit. That should be enough to assuage pessimists who expect a continuous deterioration in the US trade position.

The fiscal deficit will correct as US growth continues at a solid pace.

Strong growth in 2004 and solid growth in 2005 will herald a turning point in the US fiscal deficit via positive automatic stabilisers, such as increased tax revenue. A turnaround in the structural deficit is perhaps more problematic, as discretionary policy could wreak havoc.

Interest rates to rise faster in the US.

We also think that interest rates in the US are set to rise more than in Europe where we are looking for rates to remain on hold with a possible easing bias against market expectations of a possible rate hike. This further squeeze on the interest rate differential between Europe and the US will place further upwards pressure on the US dollar.

The Australian dollar outlook

Chart 1.

Base metals should correct as growth slows

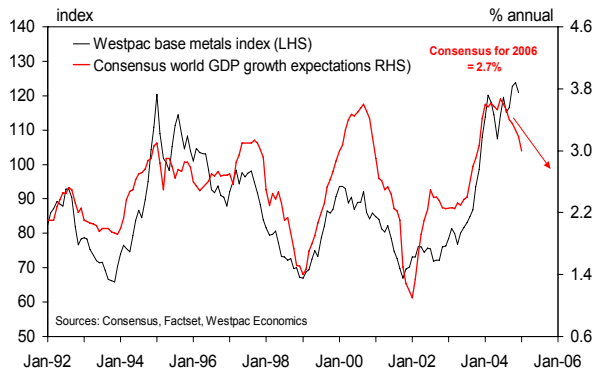


Chart 2.

Westpac base metals inventories index

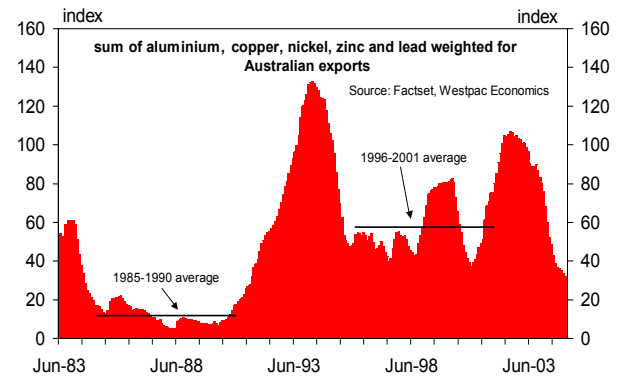


Chart 3.

Westpac's Australian dollar model(s)

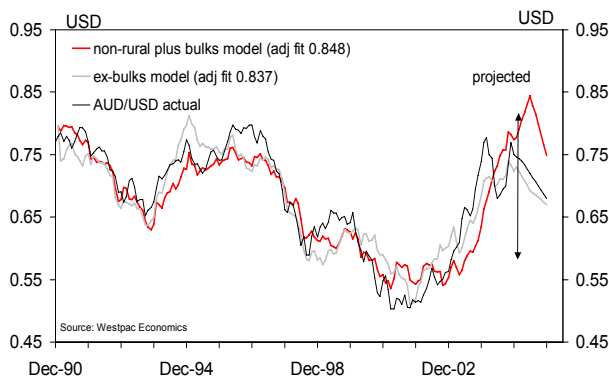


Chart 4.

Central bank watch: market v's Westpac

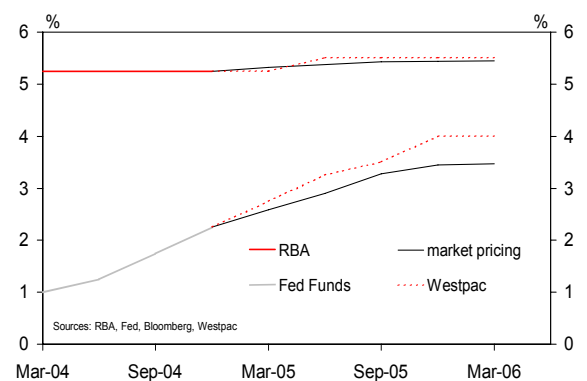


Chart 5.

Current account correction – the drivers.

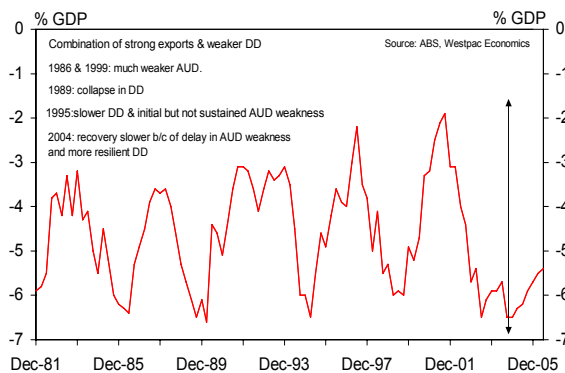
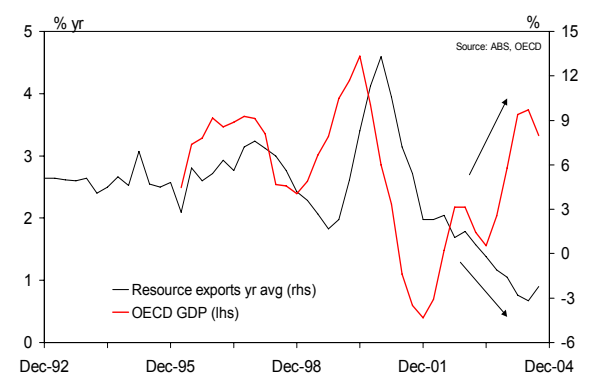


Chart 6.

OECD GDP & Australian resource exports



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 – resources

Chinese growth has been a boon for commodity prices.

Chinese demand has continued to surprise on the upside and this has been a significant boost to commodity prices. But demand is set to slow. The most recent Consensus Economics survey has economists downgrading global growth from a 4 per cent pace in 2004 to a 3 per cent pace for 2005. The peaking of the G7 leading index last June is also consistent with such an outcome.

Softer demand and rising production will see prices fall in 2005 ...

There are other indicators that are also highlighting a slowdown in demand. International shipping rates, as captured by the Baltic Dry Index (BDI), peaked back in December and has since fallen around 30 per cent. Early in 2004, as the world worried about a collapse in Chinese demand, the fall in freight rates was short-lived and correctly highlighted a second leg of commodity price inflation. Since December, the BDI has exhibited a clear down trend suggesting a moderation in shipping and thus an overall slowdown in global demand.

... but only marginally as demand will remain robust.

China remains a significant positive for commodity prices as it is increasingly punching above its weight in terms of commodity consumption. So given that China, and other manufacturing focused developing economies, are growing much faster than the developed world, global industrial production and thus resource commodities demand should exceed global growth expectations.

Higher prices means higher profits which has been recycled back into investment.

Higher commodity prices are, of course, being reflected in stronger profits which in turn has seen rising mining employment (as discussed earlier) and a deepening of mining and resource investment. Following a number of years of underinvestment, the infrastructure that supports the resource sector is creaking at the seams trying to match current demand. On top of the resulting port delays, shortages in equipment and skilled labour is also pushing up costs and delaying the implementation of many projects.

Chinese demand for steel is driving coal prices higher ...

Coal

Grabbing the headlines has been projections of hard coking coal contracts rising as high as US\$120 per tonne in 2005, more than double the 2004 average. But it should be noted that this price is for the premium product and there are lower grade products that will bring the average down. As Chart 5 highlights Queensland hard coking coal export prices tend to be less than the average contract price.

Thermal (steaming) coal makes up about two fifths of our coal exports. Thermal coal prices received a significant boost in 2004 due to rising oil prices and the closure of a number Japanese nuclear power plants boosting Japanese imports of thermal coal. Since then, prices have eased as supply increased and demand eased back a touch. Nevertheless, the combination of higher thermal and coking coal contract prices should see average coal exports prices rise more than 40 per cent this year.

... and iron ore prices will follow.

Iron Ore

The main story for iron ore is rising Chinese demand for steel. China was the world's largest importer of steel in 2003 but surging Chinese production has seen Chinese steel imports fall and exports rise. But this increase in steel production has meant that Chinese imports of iron ore rose 53 million tonnes in 2004. As a result, steel prices have risen significantly and Japanese steel producers have been making solid profits. With steel prices remaining at an elevated level, it is not surprising that some of the more optimistic estimates point to iron ore export contracts to Japan rising up to 100 per cent or more this year.

Regional industries – resources

Chart 1.

Leading index suggest that prices are turning

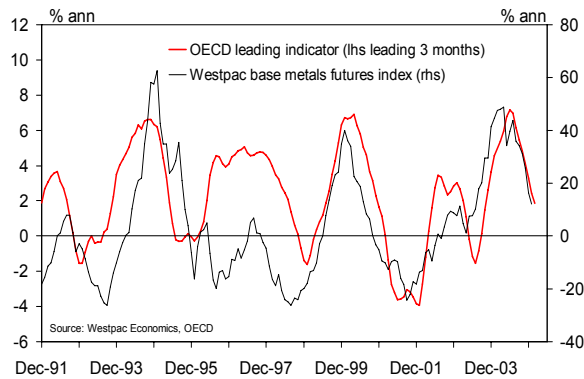


Chart 2.

Freight costs continue to moderate

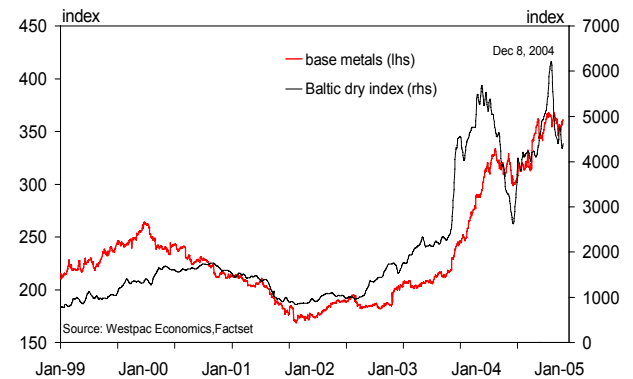


Chart 3.

China's share of global commodity demand

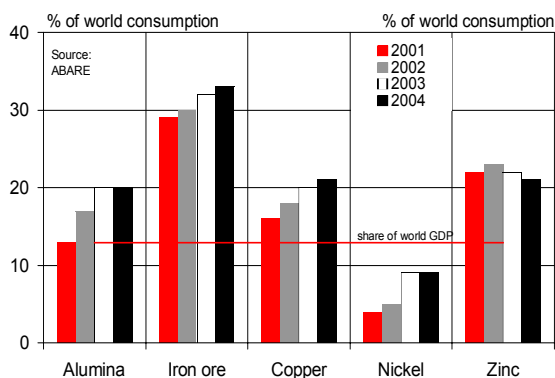


Chart 4.

Commodity prices support mining profits

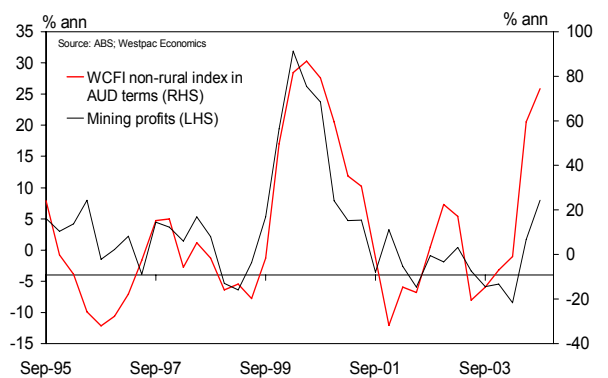


Chart 5.

Coal prices to rise significantly

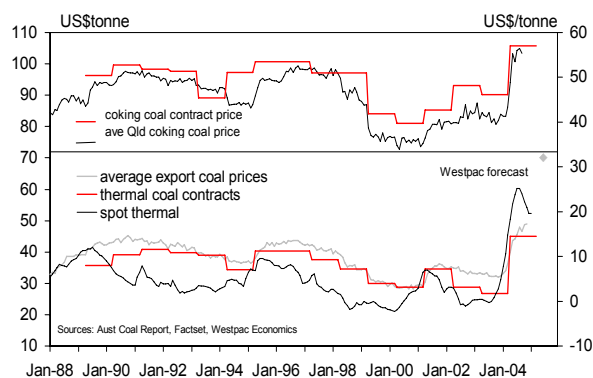
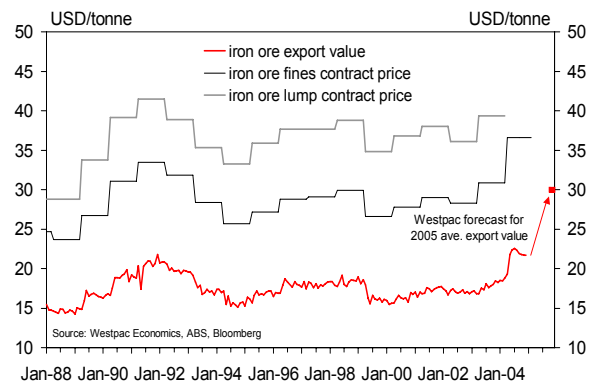


Chart 6.

Iron ore export values average less than contract



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 - resources

Slower Chinese growth to weigh on base metal prices in 2005 ...

... as will the increase in supply due to the rising investment in mining.

Low stocks will, however, remain supportive.

Supply and demand conditions more balanced for aluminium.

Copper prices boosted in 2004 by very low stock levels and supply disruptions.

Nickel has had a stellar performance as the demand for stainless steel accelerates.

Rising stocks pointing to a moderation in oil prices.

Base metals overview

The price for most base metals is expected to fall in 2005 as global growth slows. With China having accounted for a dominant proportion of growth in global demand, slower Chinese growth will be a major contributor to lower demand for base metals. Of course, if Chinese growth again surprises on the upside, this will lend further support for base metal prices even in the face of the expected headwind a lift in production.

The price of base metals has not just spurred on Australian investment in resource projects, it is also a global phenomena. Firms are not just rejuvenating old brownfield projects but also investing in new greenfield projects. In addition, firms are restarting production at closed mines or increasing production from currently operating mines. Notable is Phelps Dodge restarting a number of mothballed copper mines and Alco reopening idle capacity in some of its North American aluminium smelters. As such, production for base metals is expected to increase in 2005.

Stocks of base metals fell sharply in 2004 as large deficits developed in most base metal markets. With the increase in production, and a slowing in consumption growth in 2005, inventories of base metals are expected to rise. They will, however, remain at relatively low levels and thus remain supportive of prices.

Aluminium

World aluminium prices were relatively stable to mid 2004 before robust demand from both the US and China reduced stocks and pushed prices higher. However, the fall in stocks was not as great as for other base metals and in 2005 continued growth in aluminium production is expected to result in an increase in stocks placing downwards pressure on prices.

Copper

Copper prices rose strongly from the third quarter of 2004 to peak a 14-year high around mid October. Very low stocks and actual and/or threatened strike activity provided ongoing support. As the fears of a Chinese hard landing faded, speculative buying of copper also exploded as the market positioned itself for even higher prices. In 2005, an increase in production and a moderation in demand will result in a small increase in copper stocks. However, even though stocks may still be relatively low at the end of 2005, the unwinding of speculative copper positions will see prices fall by more than 10 per cent.

Nickel

Nickel prices rose more than 40 per cent in 2004 as stocks fell to record lows. Strong growth in industrial production and rising consumer incomes boosted Chinese stainless steel consumption and thus global demand for nickel. In 2005, nickel prices are likely to remain at elevated levels as continued robust demand is set against a backdrop of short-term supply constraints. As such, stocks will remain at very low levels.

Crude oil

Crude oil prices rose to US\$50 a barrel in December as forecasts of a colder than usual winter and threats to oil supplies loomed large. As neither of these proved to be as drastic as first thought, US oil stocks are back to the level they were before the Mexican Gulf hurricanes disrupted supply and the US government dipped into its strategic reserves. The build up on stocks gives us confidence prices will head back to US\$40.

Regional industries - resources

Chart 1.

Copper stocks have found a base

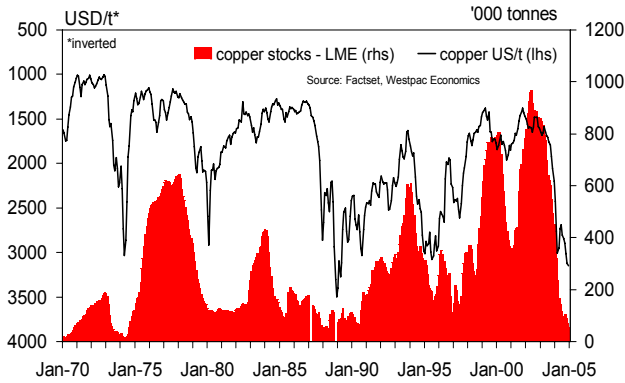


Chart 2.

Aluminium prices lift as stocks fall

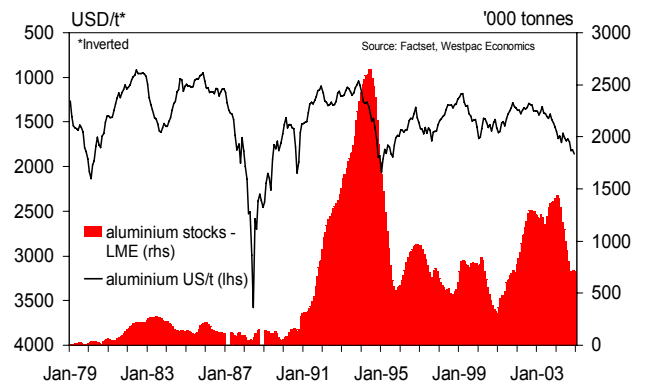


Chart 3.

Nickel prices jumped with fall in stocks

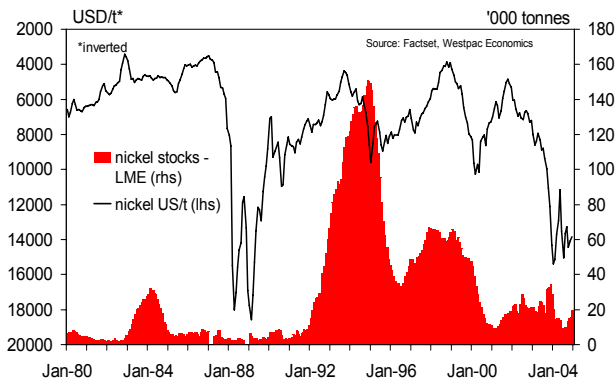


Chart 4.

Even zinc stocks have drifted down

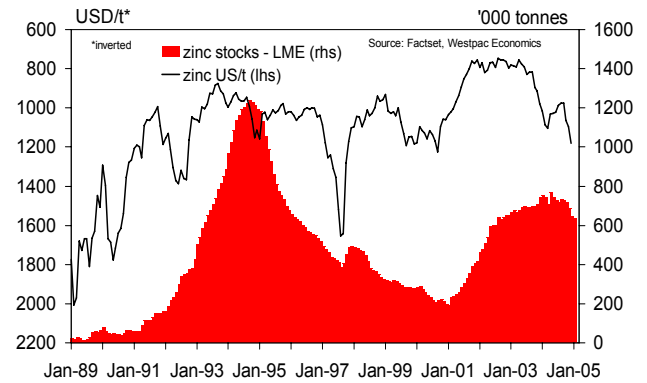


Chart 5.

Lead stocks stabilising after a large fall

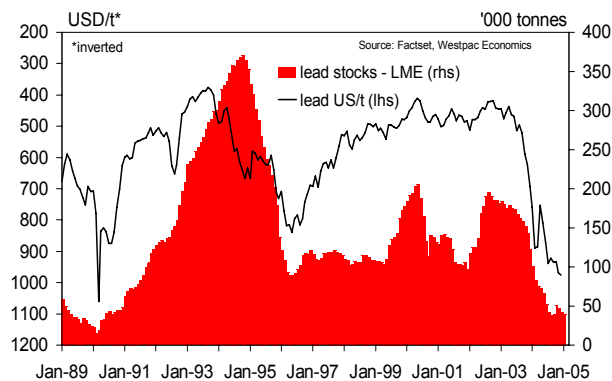
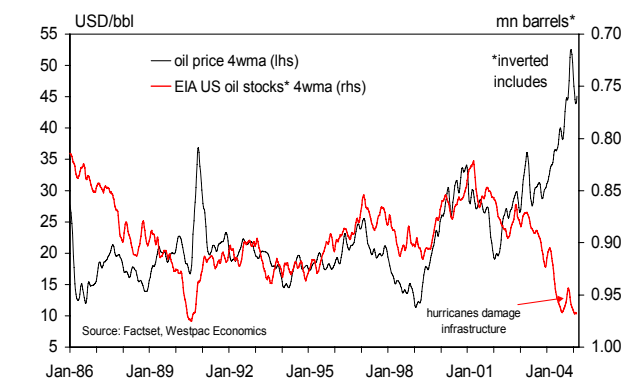


Chart 6.

US oil stocks recover hurricane losses



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

Rainfall deficiencies have all but disappeared.

Farm outlook

Very much above average rainfall in southern and eastern Australia removed most of the rainfall deficiencies recorded since January 2004. Nevertheless, a smaller winter crop and softer grain prices suggests the net value of farm production may fall more than 20 per cent in 2004/05. Global production will suppress grain prices through 2005 but beef, sugar and dairy should benefit from solid demand and restricted supply. Westpac's forecast for a weaker Australian dollar is also supportive of farm incomes. So far, most of the country is expecting at least an average start to the season except for Northern Queensland where the odds have shifted towards a dryer than average summer/autumn.

Global drought boosted wheat prices in 2002/03 and 2003/04.

Wheat

The global wheat market has been at the mercy of wild gyrations in supply due to drought in a number of major exporting countries. In 2002/03, Australian, Canada and the US suffered from severe droughts and wheat prices rose by more than 25 per cent. In 2003/04, when these countries were rebounding from drought, Europe experienced a severe drought and production fell. As such, global wheat prices remained elevated at around US\$160 a tonne in 2003/04.

A record crop in 2004/05 is a heavy weight for wheat prices.

The current global harvest is on track for a new record of more than 620 million tonnes as production from Europe and Russia rebounds from last year's cold winter and hot dry spring-summer conditions. Crop prospects in Argentina have also improved. Such a large increase in production has placed considerable downward pressure on world prices. With dryer than normal condition across much of the Australian wheat belt, the wheat harvest is expected to fall by around 20 per cent on last year's record.

Brazilian soybean production has more than offset rising demand.

Canola

World oilseed prices have fallen as a forecast record soybean crop exceeds expectations. Brazilian soybean production has grown rapidly since the early 1990s, with the area sown to soybeans more than doubling in the past fifteen years. With improvements in farming techniques, infrastructure and transport, Brazilian soybean production will continue to increase.

Australia's canola crop hit by frost, insects and hot dry weather.

China is one of the world largest producers of soybeans; but it is also one of the largest consumers and importers. Chinese consumption is forecast to rise by 10 per cent in 2004/05 resulting in a 30 per cent rise in imports. Nevertheless, with soybean and canola production forecast to reach a record level in 2004/05 prices will remain under downward pressure. Hit hard by frost, insects and hot dry weather, Australia's canola production is forecast to fall around 25 per cent in 2004/05.

A record cotton crop has led to a collapse in cotton prices.

Cotton

Positive global growing conditions are also lifting cotton production, which has been leading to lower cotton prices in 2004/05. World cotton production is forecast to rise 25 per cent to 24.3 million tonnes, a new record and 20 per cent more the previous record in 2001/02. As such, while demand is expected to rise to a new record, closing stocks will still increase by more than 30 per cent. Such a significant lift in stocks is why cotton prices are forecast to fall by 25 per cent. Cotton prices bottomed in December at just under US43¢ a pound, following a sharp fall of close to 20 per cent from the late 2004 peak, and have since broadly drifted sideways.

Cotton production is expected to lift significantly in Australia, despite the markedly lower prices, due to improved water availability. Planted area is forecast to increase by 57 per cent while cotton lint production is forecast to rise 57 per cent.

Regional industries - agribusiness

Chart 1.

Westpac Farm Commodities Index
In AUD and USD 1994/95 = 100 monthly averages

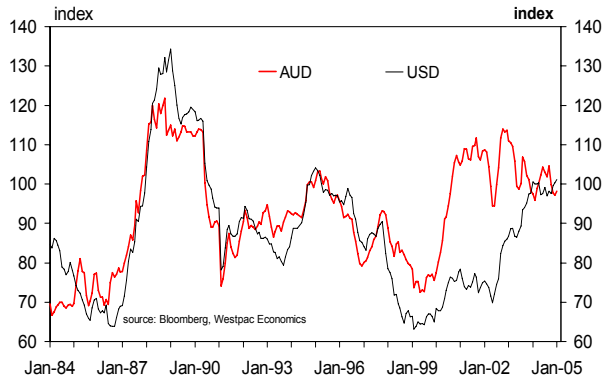


Chart 2.

Westpac Farm Commodities Index

	Index number	Percentage change over		
		Jan-05	1 month	6 months
Beef (AUD\$/kg)	3.83	2.1	6.2	13.0
Wheat (US\$/bu)	303	-3.6	-4.9	-21.1
Wool (AUDc/kg)	806	-1.2	-5.1	-8.3
Skim milk powder (US\$/t)	2250	-2.2	4.7	24.1
Sugar (US\$/lb)	9.15	1.4	7.7	53.8
Cotton (US\$/lb)	47.9	10.0	4.4	-33.4
Barley (CAD/t)	111	-4.4	-12.0	-19.2
Canola (CAD/t)	261	-7.6	-21.5	-30.2
USD Index 94/95 = 100	101.2	0.9	2.1	0.6
AUD/USD US cents	0.77	0.0	6.9	0.0
AUD Index 94/95 = 100	98.1	0.9	-4.8	0.6

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

Chart 3.

Strong demand, falling stocks, rising prices

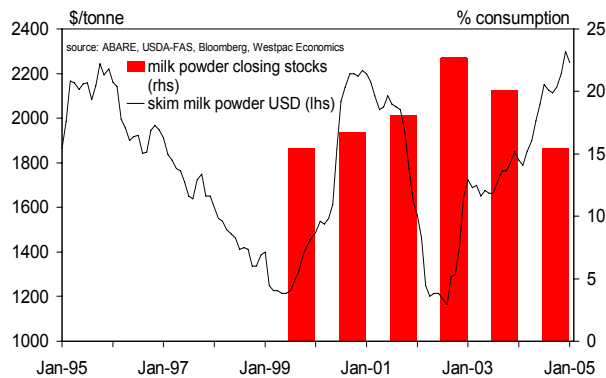


Chart 4.

Dollar is crimping domestic milk prices

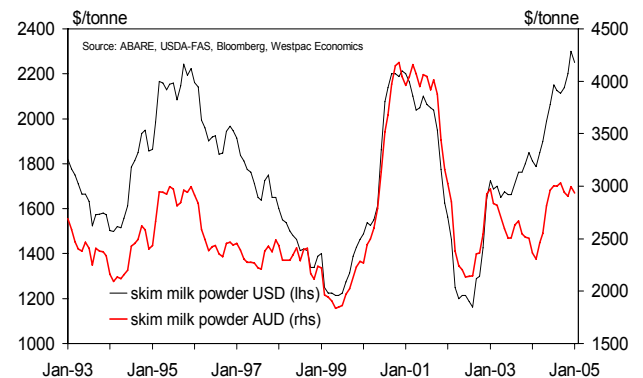


Chart 5.

Rise in wheat stocks has hit prices

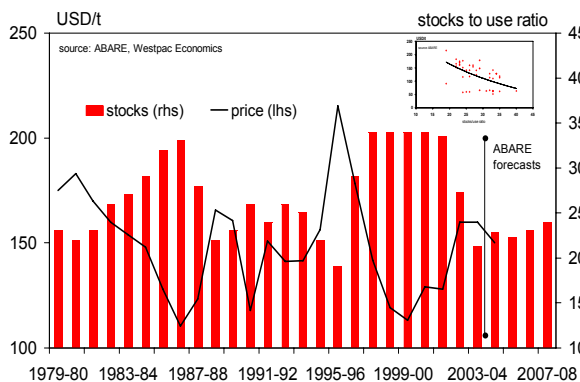
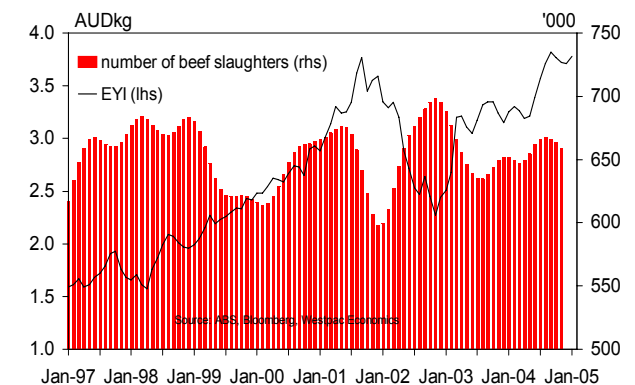


Chart 6.

Beef prices and turnover



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

Wool prices being held back by strong Australian dollar and cheap cotton prices.

Wool

In the second half of 2004, when the Australian dollar appreciated more than 10 per cent, wool prices fell 6 per cent. As a result, the underlying US dollar price actual rose around 4 per cent over the same period suggesting wool has become more expensive in Australia's major export markets, especially China where the currency is pegged to the US dollar. However, the currency impact in Europe has been less where the Australian dollar has appreciated less than 1 per cent against the euro. Whilst synthetic fibre prices have also risen in line with oil, declining cotton prices weighed on the entire fibre market.

Oil prices and Indian demand are supporting sugar prices.

Sugar

Strong world consumption is expected to exceed production in 2004/05, eating into the global sugar stockpile and helping support higher prices. While Brazil is looking at another record crop, both India and Thailand have been affected by adverse seasonal conditions and India has also had insect infestations. India is a key factor in the outlook, not just in terms of production but also demand. Indian sugar consumption is forecast to continue to rise and as such, India will either have to eat into stocks, which the government claims to have, or turn to imports. In 2003/04, production shortages in India relieved some of the downward pressure on prices. China is likely to increase imports in 2004/05 as domestic sugar consumption continues to grow. The recent increase in crude oil prices has also made ethanol more attractive as a substitute for traditional petroleum based fuels. If current higher global oil prices are sustained, this would lend support to world sugar prices.

Beef exports are set for another stellar year.

Beef

Australian beef exports are looking for another stellar year in 2005 following on from a strong performance in 2004. Australia has benefited from the closure of the Japanese market to US beef following the discovery of a case of BSE in December 2003. Japan and the US have agreed on a framework for a resumption of trade but there are still a number of issues to be resolved so only a relatively small volume of US beef will be exported to Japan in the first half of the year. In response to favourable export prices, the number of Australian cattle on feed has risen 24 per cent in the year to September with around half destined for the Japanese market. Higher export prices and strong domestic demand should provide some support for saleyard prices in 2004/05 and Westpac's forecast for a weaker Australian dollar would be a further boost.

Supply constraints will be supporting of global dairy prices.

Dairy

Global prices for dairy products rose strongly in 2003/04 and continued to grind higher in the second half of 2004. As growth in demand from the major importing countries is expected to remain healthy, and supplies from key exporting countries remain constrained, international dairy prices are expected to remain firm in the short to medium term. Supply is unlikely to lift significantly until European milk production lifts from its seasonal trough. Demand will remain elevated due to strong import growth by Russia, the Middle East (both benefiting from high oil prices) and North Africa. With a domestic market more in balance, and lower export subsidies, export prices out of Europe have firmed. However, global prices should be capped at current levels as buyer resistance is appearing and product substitution is a growing risk. Australian milk production fell 2½ per cent in 2003/04 due to below average seasonal conditions and reduced cow numbers. Seasonal conditions did improve towards the end of spring, and with more water being made available to irrigators in most districts, pasture conditions improved. So with cheap grain prices also helping to lift yields, a modest increase in cow numbers should ensure total milk production rises in 2004/05.

Regional industries - agribusiness

Chart 1.

Falling US prices have not hit Aust. prices

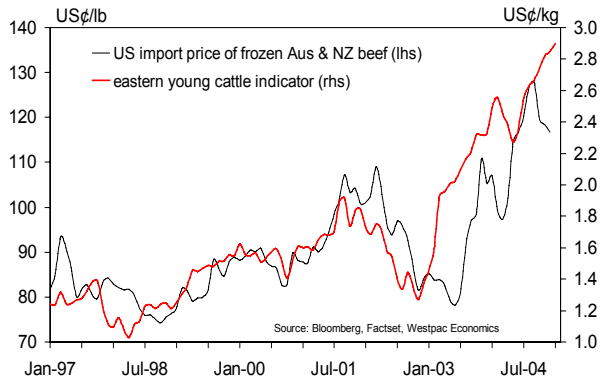


Chart 2.

The A\$ has depressed wool prices

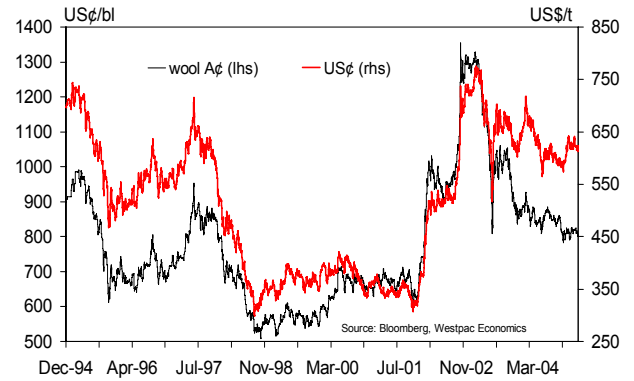


Chart 3.

Softer demand, small rise in stocks

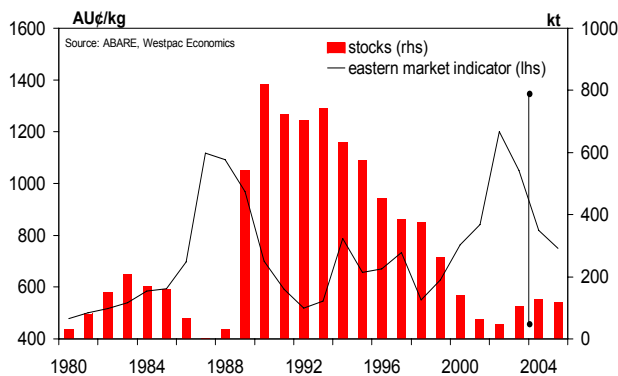


Chart 4.

Cotton prices a drag on the fibre market

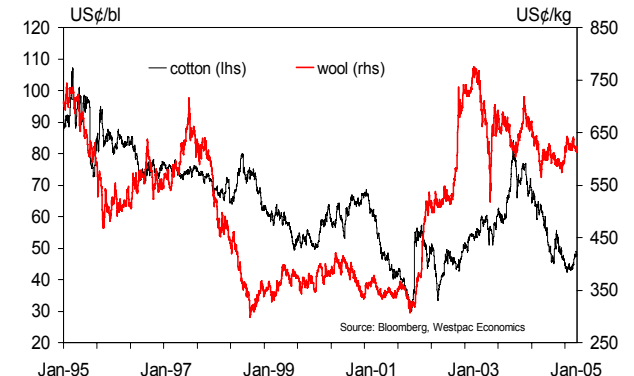


Chart 5.

Cotton under pressure from production

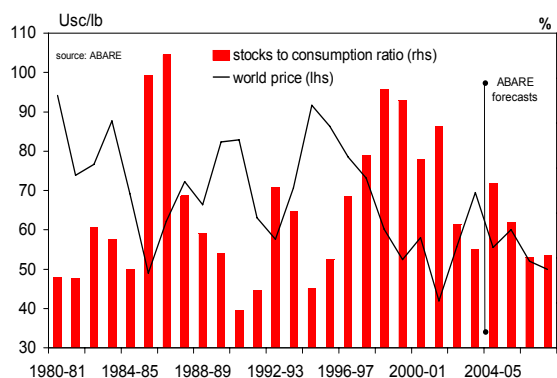
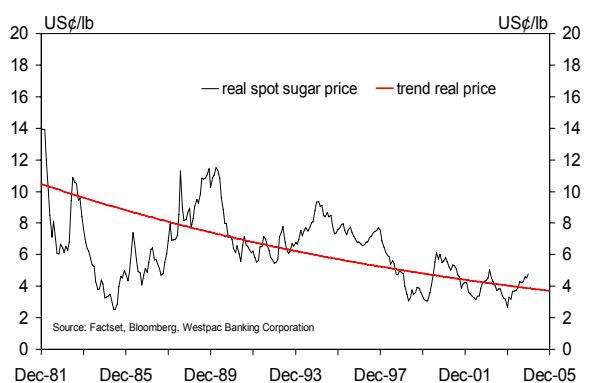


Chart 6.

Real sugar prices above long-run trend



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.

Westpac – Melbourne Institute Regional Indicators

Chart 1.
Regional index of consumer sentiment

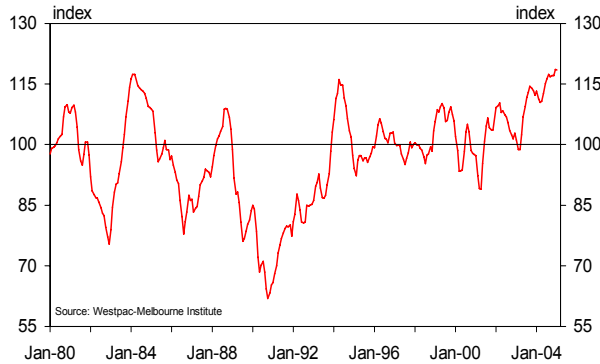


Chart 2.
Unemployment expectations

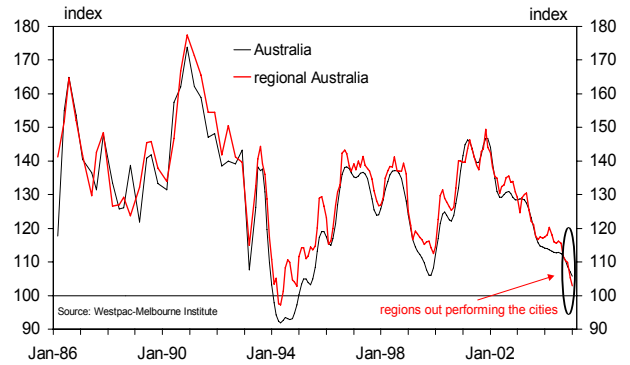


Chart 3.
Regional – is it a good time to buy a house?

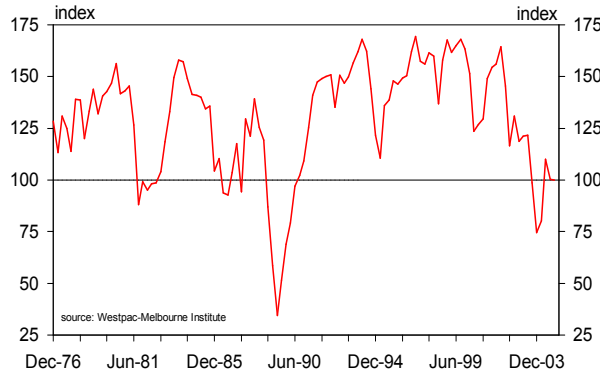


Chart 4.
Regional – wisest place for savings

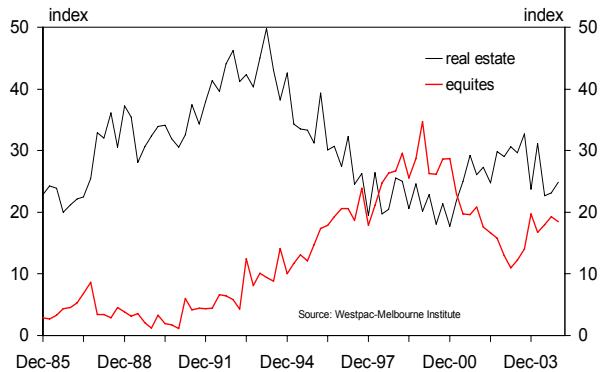


Chart 5.
NSW Index of Consumer Sentiment

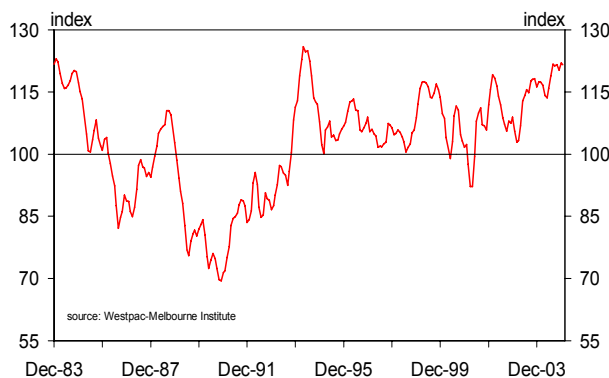
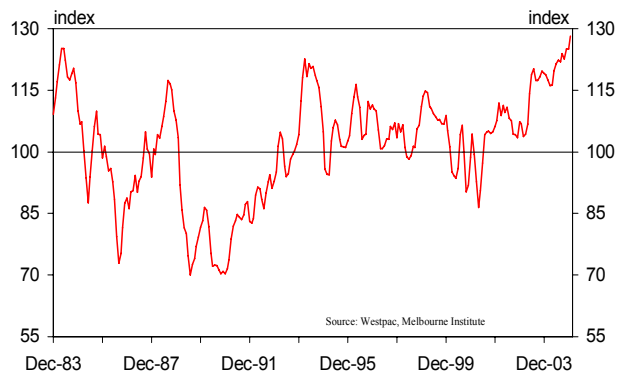


Chart 6.
WA Index of Consumer Sentiment



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.

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

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
