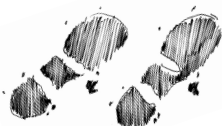
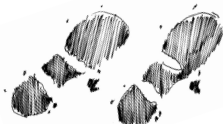


Regional Economic Report

Winter 2004

- The southeastern mainland has had a very dry start to the year and remains hampered by drought conditions.
- Those areas with adequate rainfall are facing a more optimistic year with solid farm commodity prices.
- The resource sector is riding the boom of high commodity prices created by a strong global recovery and surging demand from China.
- Westpac is forecasting the RBA to raise interest rates near the end of 2004 while the dollar is to trade in a US 68¢ to US 72¢ range.



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Westpac Economics

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Executive summary

Regional Australia is facing a significant divergence in economic activity. Southern NSW, northern Victoria and the far eastern part of South Australia are still facing significant long-term rainfall deficiencies and a large part of NSW and Victoria remain drought declared. However, there are parts of regional Australia that are facing a brighter outlook. Those towns dependent on resources are riding a commodities boom based on a solid global recovery that is being boosted by rising demand from China. This is exemplified by employment in mining rising to levels that we have not seen since the late 1980s. In addition, those regions that have received adequate rainfall are also getting the benefit of robust farm commodity prices and a retreat by the Australian dollar. Coastal towns in regional Australia are also benefiting from the very modest nature of the current correction to the Australian housing market.

We are, however, expecting 2004 to be the peak for world growth and commodity prices. Robust domestic demand, stabilising housing lending and a recovery in exports also point to higher interest rates here. However, as the US has further to go raising interest rates compared to Australia, and the Australian current account deficit remains stubbornly close to cyclical highs, the Australian dollar is forecast to weaken in 2005.

A robust domestic economy, a recovery in global exports and an extra fiscal stimulus all point to higher Australian interest rates. The focus for interest rates remains inflation concerns, the housing market and the pace of credit growth. New housing lending continues to run well in excess of the Reserve Bank's 'target'. In addition, the payments to the household sector and the tax cuts announced in the May budget are likely to push consumer spending growth back above trend. As such, we retain our view that the RBA will increase interest rates by 0.25% in December.

The international economy continues to strengthen in 2004 but higher interest rates in the US, and the recent introduction of controls to slow growth in China, will see global growth ease but remain robust in 2005. Recent economic data from the US has softened but nevertheless, the US has embarked on the long journey to higher interest rates. European domestic demand stagnation means that interest rates there will remain on hold while recent data from Japan is providing a very robust update on that economy. A great relief for Asia, and Australian resource exports, was the May Chinese data, which provided the first installment of the awaited "soft landing".

We have revised our Australian dollar forecast from the Autumn Regional Report and now expect it to stay within US 68¢ to 72¢ range for the remainder of 2004. Over the last month, the dollar traded in the lower half of the range and the first 0.25% rate rise by the US Federal Reserve had no discernible impact. However, as the market has begun to discount the expected pace of interest rate rises in the US, the US dollar has again weakened and the Australian dollar has risen. It is this shifting in US interest rate expectations that is going to keep the Australian dollar range bound. The factors behind Westpac's forecast weakening in the Australian dollar in 2005 are the forecast fall in commodity prices as world growth slows and the continuation of a cyclical high for the current account deficit.

Dry conditions in the southeast but booming resources

Dry conditions prevail in the south-east of Australia.

Following a promising start to the year, weather conditions deteriorated in autumn in the south and southeast of Australia. The autumn rains failed across large areas of southeast and southern Australia and parts of southwest WA and to top this off, above average maximum temperature so far this year magnified the impact of the poor rainfall. Above average June rainfall eased some short-term deficiencies but longer run deficiencies continue in southern NSW, northern Victoria across to eastern SA.

The lack of rain is frustrating given the current strength in commodity prices.

The lack of rain is very frustrating, especially given the current strength in commodity prices. The retreat of the Australian dollar from the February peak has also been added plus for our exporters. The seasonal outlook for the remainder of 2004 remains positive with the southern oscillation index turning positive again but potential yields are nevertheless still constrained by the lack of an early break to the season.

Resources are, however, booming.

As a result, there is a divergence in the outlook for the two main regional industries. Australia's resource sector is booming on a banquet of global economic recovery and rising demand from China. By comparison, farm production is being held back by continued dry conditions.

Commodities prices are being lifted by strong global demand.

Prices for major mineral and energy commodities are forecast peak in 2004 as higher demand based on the global recovery also peaks. The positive momentum to date has resulted in an expansion in mine activity with total mine employment rising to levels not seen since late 1989. Given the rise in productivity achieved since then, this is a significant milestone for the industry. As the growth in global demand slows in 2005, and supply increase in response to higher prices in 2004, prices for most commodities are expected to fall.

Farm employment remains at drought lows.

Farm employment is still struggling to recovery from the drought. Almost 100 thousand farm jobs were shed during the drought and while there were promising signs in 2003 that farmers were again hiring, the June ABS labour force survey suggests farmers may be again shedding jobs. If rainfall does not come soon to the dry regions soon, this situation is unlikely to change before 2005. These jobs losses remain a significant drag on the regional economy.

Consumer sentiment remains robust.

There is also another clear split in the regional economy between the coastal towns and the inland towns. The earlier group, which has been growing more rapidly due to tourism and/or "sea change" lifestyles, may be the reason behind the rise in regional consumer sentiment since the March quarter. As a result, the Westpac-Melbourne Institute Regional Consumer Sentiment remains around the decade high suggesting the consumer sector will remain a positive for the regional economy.

Signs the housing market may be stabilising.

In the Autumn Regional Report, we highlighted early signs of the heat being released from the housing market. While anecdotes of falling house prices continue to grab headlines, this "collapse" has not appeared in the hard data. In fact, we have actually seen a stabilisation in the ABS housing data. All of the talk of falling house prices may have renewed the interest of potential house buyers, which had been squeezed out of the market.

The regional "is now a good time to buy a house?" index from the Consumer Sentiment survey bounced back over 100 in the June quarter suggesting more people thought it was a good time to buy a house than not. This rebound in interest in housing along with current sound economic fundamentals, suggests the current housing downturn will be a modest one compared with previous cycles.

A positive yet patchy start for regional Australia

Chart 1.

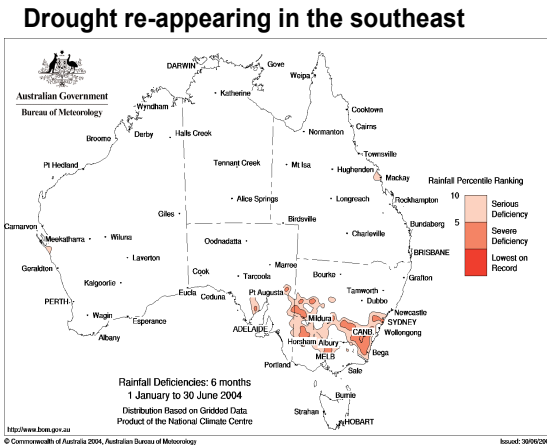


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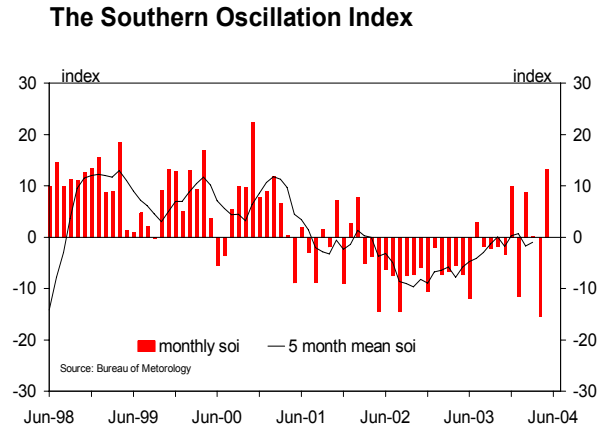


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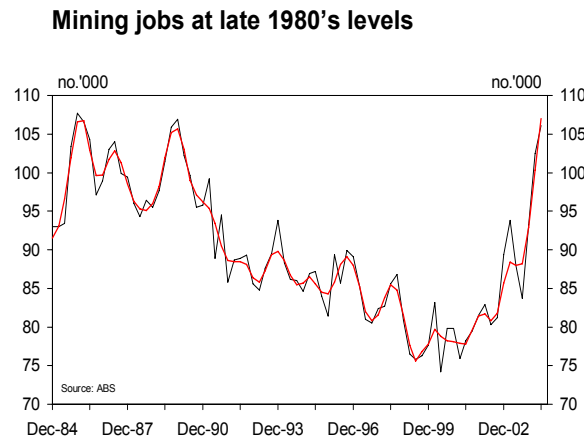


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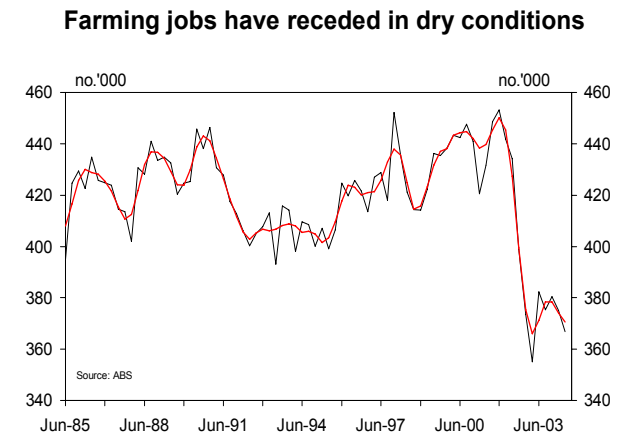


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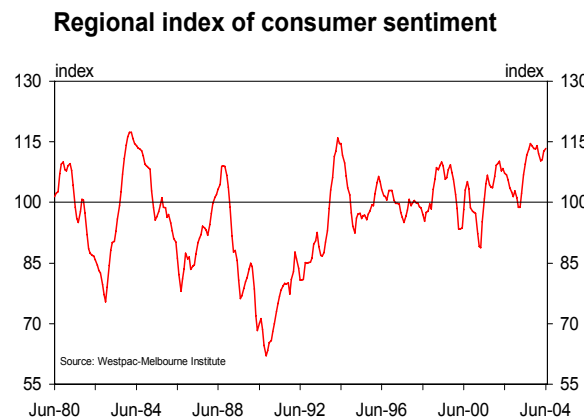


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The Australian economy and interest rates

The RBA will move in December.

We have retained our view the Reserve Bank of Australia will feel the need to nudge rates further in December by 0.25%. Following this, there is every likelihood that the markets will price in a further increase in 2005.

Housing credit remains the key.

The focus of policy remains on the housing market and the pace of credit growth. Following the two rate increases in November and December, we saw a 20% fall in new lending over the three months to January. That has subsequently been followed by a 3% "bounce" in lending to May. That has new lending running at \$12.4bn per month, well in excess of the Reserve Bank's implied target of \$9bn to \$10bn.

Lending has proved resilient.

More specifically, lending for owner-occupiers has rebounded by 7.8% from its low. For investors, overall lending is down a mild 3.6% over the same period. The recent data for investors is proving to be far more resilient than many, including ourselves, had expected.

Fundamentals remain supportive ...

The resilience in finance applications for owner-occupiers can be explained by the relatively low interest rate; a 23-year low rate of unemployment; and, the high level of consumer confidence. It does, however, appear that recent reports of poor returns for "off the plan" investments is having an effect on investor behaviour. In April, loans to investors for construction of new dwellings had fallen by 40% from their high in August last year. Loans to investors for established dwellings were down 17.5% from their high. The May update did close this gap somewhat but lending for "new" remains a laggard. As loans to investors for established dwellings represent 92% of total investment lending, it is not wise to concentrate on the "off the plan" portion of the market. Even though rental yields are near record lows, vacancy rates are back off from their highs. As such, investors in established dwellings appears to be resilient to the adverse publicity and reported losses from "off the plan" investments.

... indicating another nudge from the RBA.

At this stage, the prospects for the Reserve Bank achieving its "target" new loan rate of \$9bn to \$10bn per month appear remote. When that becomes clear, and growth in domestic demand holds around trend, we expect the Bank to see the need to act. The continuing strength of the economy is likely to "cushion" any impact of further tightenings and minimise the risk of a policy mistake from over-tightening. When this becomes apparent to the market, there is a very good chance it will move to price in two rate hikes. Markets are never happy with a solo move.

Fiscal stimulus will boost consumption.

Other factors for the economy appear to be pointing to solid growth. Due to the slowdown in residential construction and spending on renovations and additions we originally "pencilled in" a slowdown in consumer spending to a "below trend" 3½% in 2004/05. The payments to the household sector and the tax cuts announced in the May Budget are now likely to push consumer spending growth back above trend, leading to an increase in our domestic demand growth.

The construction downturn looks modest.

To date, the downturn in the residential construction cycle has been the mildest of the five documented downturns since 1980. That is not surprising given the modest interest rate cycle. We also estimate that current over-supply in residential housing is considerably below previous cycles, supporting the outlook for a moderate downturn.

The Australian economy and interest rates

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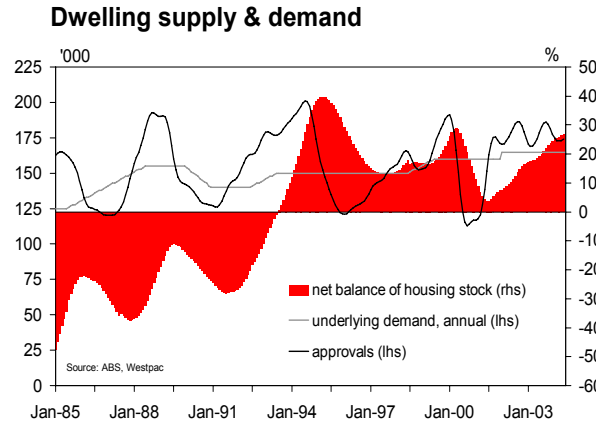


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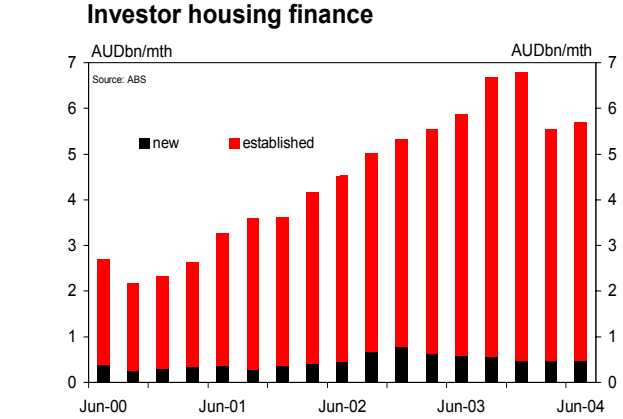


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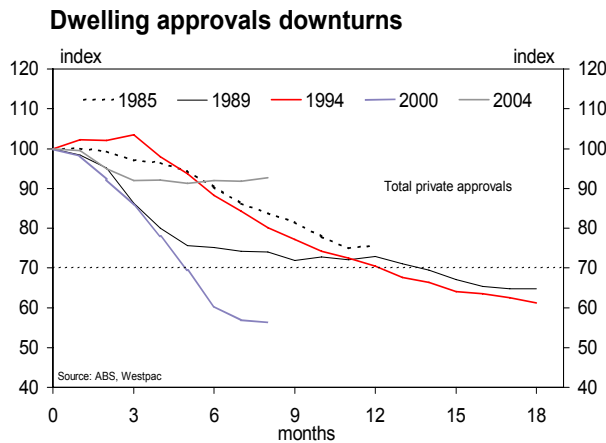


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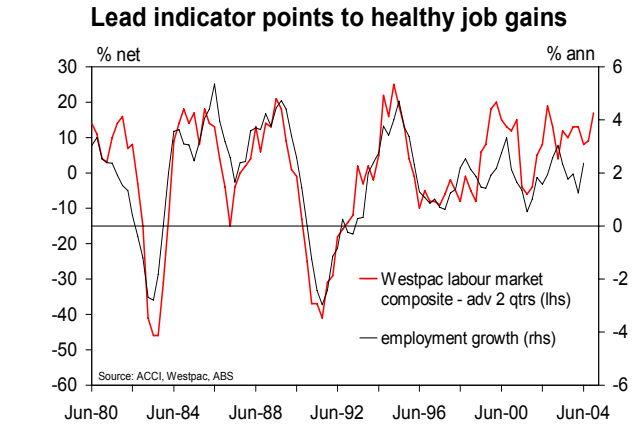


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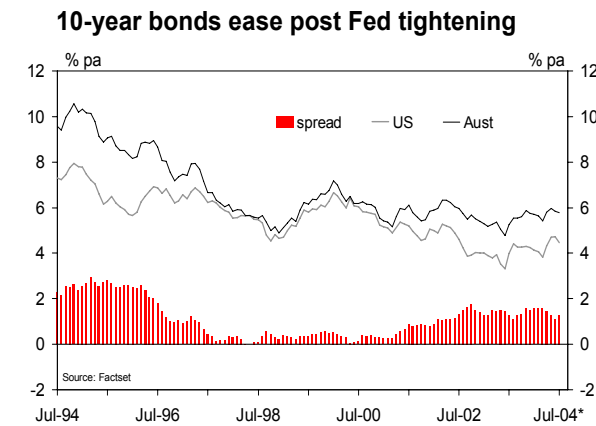
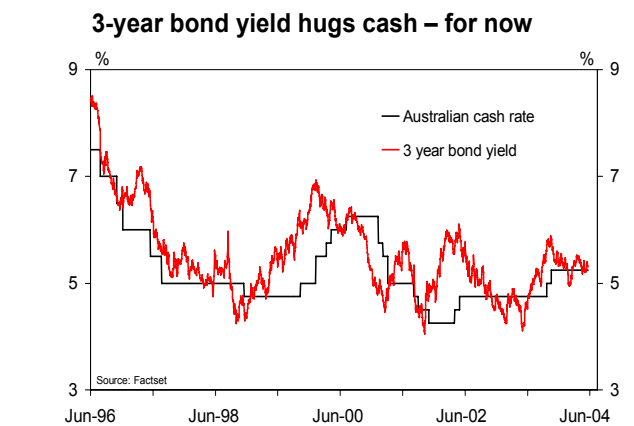


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International economy continues to strengthen

The US has started the long journey to higher interest rates.

The US Federal Reserve has begun the long journey back to a more normal level of interest rates with a June 30 hike. We expect a 2.25% Fed funds rate by year-end, against 2.0% market pricing. For end 2005, we expect 4.0%, versus our market estimate of 3.0%. Thus we remain bullish on US dollar prospects versus the European and commodity blocs – the Australian dollar, Canadian dollar, and the NZ dollar – in 2005. The lingering structural problems that weighed on the US dollar through 2003, that is the current account deficit, will be serviced via an appreciation of the Asian currency bloc.

Recent US data has softened but a solid growth environment remains.

Recent US data has been more indicative of an economy losing, rather than gaining, momentum. Most notably, the various manufacturing surveys have come off the boil and the June payroll data was disappointing. Payroll data is notoriously volatile from month to month and the latest data has not changed our view that strong labour market outcomes will be achieved going forward. Other data over the coming months may also exhibit waning momentum, in particular consumer spending. High gasoline prices and the lack of rebate cheques were factors in June. But this must be viewed within the context of a solid growth environment. We retain our 2004 US economic growth forecast of 4.5%, matching that achieved in both 1997 and 1999, to be the strongest year since 1984.

European stagnation means rates will remain on hold in 2005.

In Europe, the Central Bank has reiterated both upside and downside risks to the growth outlook in its July statement. However, only upside risks to the inflation outlook were noted. Despite this, the Bank's chief insisted that it had no "bias", which may be a sign that the Bank acknowledges it has little influence over the main factor driving inflation higher, energy prices. Recent data highlighted the relative stagnation of domestic demand, particularly in Germany. We do not expect any monetary policy action from the ECB until Q2 next year. The Bank of England retains a tightening bias, and will raise rates again in August.

The Japanese economy is turning domestic.

The June quarter Bank of Japan Tankan survey was an exceptionally robust update on the economy. Both the large manufacturers and large non-manufacturers conditions measures are now at post-bubble highs. Capital spending plans have been revised upwards aggressively across the board. Very importantly, stronger activity outcomes are eating into the excess capacity evident in the economy over most of the past decade. We remain bullish on the yen, with the current account surplus around 3% of GDP pointing unambiguously to appreciation.

China is heading for a soft landing.

In East Asia, the first installment of China's much awaited tele-movie "The Soft Landing" appeared on cue in the May data. That was a great relief for the region, for resource stocks, and the currency markets. The early stages suggest that the administration is succeeding in engineering a controlled slowdown in selected sectors. In Korea, consumption continues to disappoint. That will keep the Bank of Korea on hold despite higher inflation and rapid export growth. Elsewhere, a sweet spot for both global growth and the tech sector is undergirding activity. We maintain a constructive view on regional exchange rates moving higher against the US dollar and the euro for 2004H2 and into 2005.

International economy continues to strengthen

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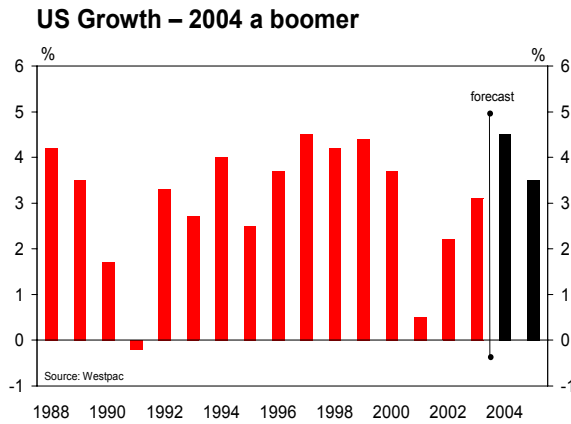


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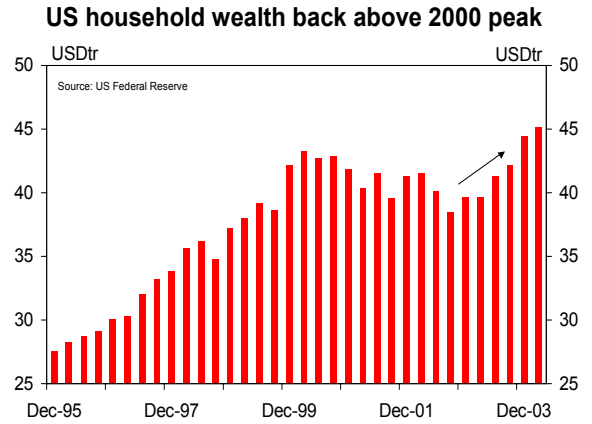


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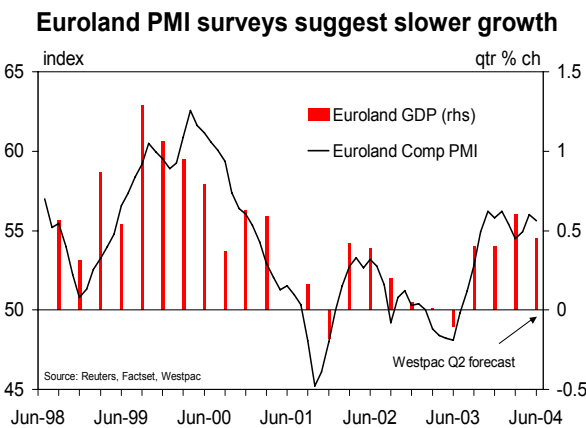


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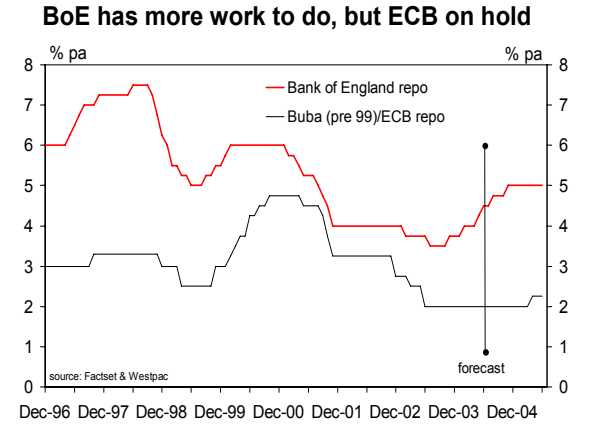


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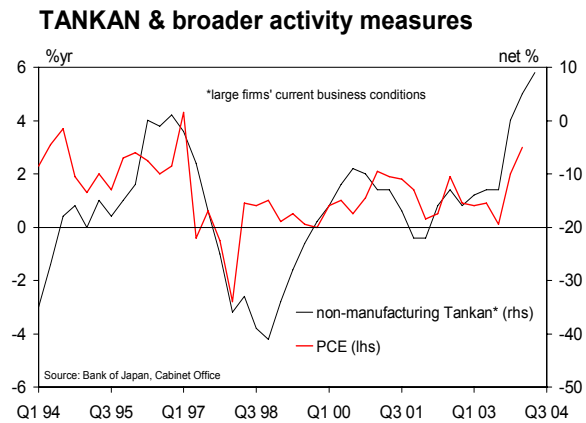
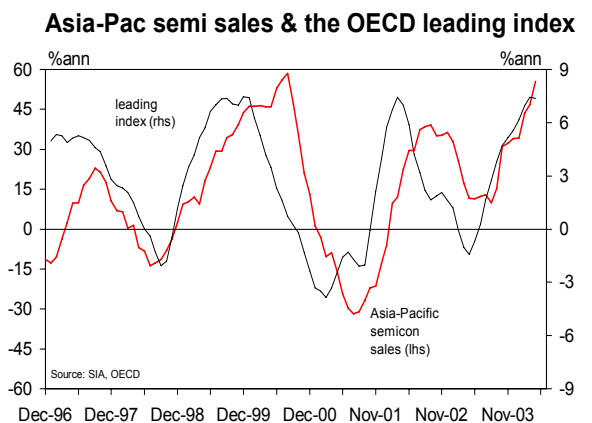


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The Australian dollar outlook

We now see the Australian dollar in a range for 2004.

Since the Autumn Regional Report, we have revised our forecast for the Australian dollar and now expect it to stay within the US 68¢ to 72¢ range for the remainder of 2004. The next big move will be for general weakness in 2005.

The first Fed hike had little impact on exchange rates ...

Over the last month the dollar has trended primarily within the weaker half of our expected range, i.e. between US 68¢ and 70¢. The 0.25% rate rise in the US and the steady policy by our own Bank were largely anticipated and had no discernible impact on the currencies. The major event over the period was the surprising weak US payrolls growth for June, which pushed the Australian dollar from 70.2¢ to 71.35¢. That was purely a US event since the Australian dollar was little changed against the yen and the euro.

... but the forward profile undoubtedly will.

The US market moved to price out one 0.25% increase in US interest rates by year's end on the weak payrolls number, with the most likely candidate being the politically sensitive September meeting. We expect this to be transitory as the momentum in the US economy recovers and markets re-price a more realistic rate increase profile.

We disagree with the market on the Fed and RBA.

It is true that the interest rate markets have priced out any rate hike by the Reserve Bank of Australia by year's end. But we still expect such a move. Indeed, once the markets recognise the need for one move they are likely to price in a second. Offsetting that will be an expected reassessment of the likely rate profile for the US Federal Reserve. We assess that markets are currently pricing in a total of around 1% in tightenings by the Fed in 2005. We expect that this will eventually move to be nearer 2%. As such, there is plenty of scope for expected interest rate differentials to favour the US dollar against the Australian dollar over the course of 2005.

Commodity prices will not re-visit their highs.

The other key factor behind Westpac's 2005 view of a weakening Australian dollar relates to the likely fall in commodity prices as world economic growth slows. The importance of commodity prices for the Australian dollar was emphasised last month. Westpac's commodity futures price index fell around 4% in the first three weeks of the month but subsequently recovered all lost ground. That profile reinforced the US dollar moves and mirrored the Australian dollar trajectory.

Australia's external accounts look stretched.

Australia's current account deficit remains the last key factor. The deficit peaked in the June quarter last year at 6.5% of GDP and has subsequently improved to 5.9%. As with previous cycles the key driver of recovery has been a surge in exports, usually associated with world recovery. In this cycle the export recovery has been weaker than in most other recoveries but, more importantly, import growth has also remained very strong. We are predicting solid 4% growth in domestic demand through 2004/05, which will limit the slowdown in imports necessary for the typical cyclical improvement in the current account deficit. Inertia in the current account deficit is likely to be an ongoing negative for the Australian dollar in 2005.

The Australian dollar outlook

Chart 1.

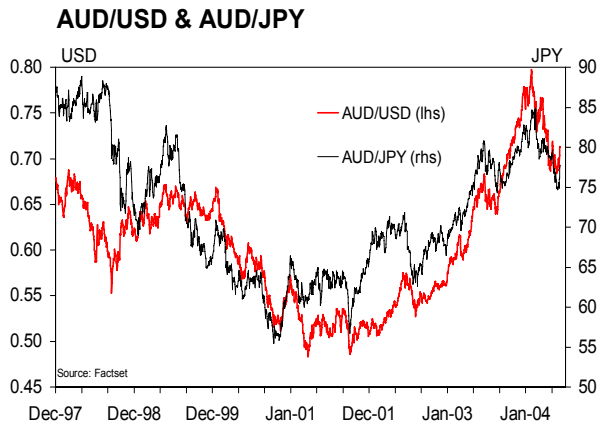


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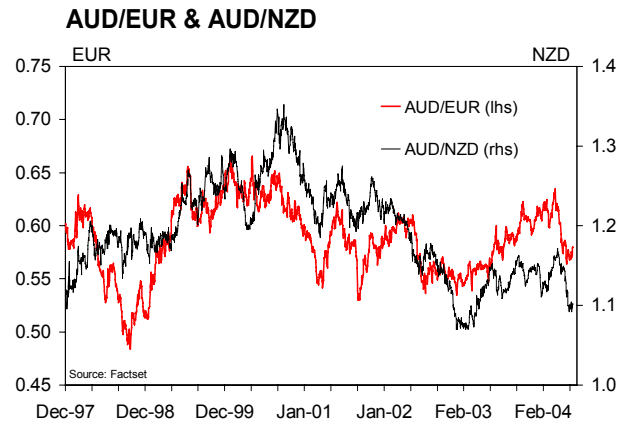


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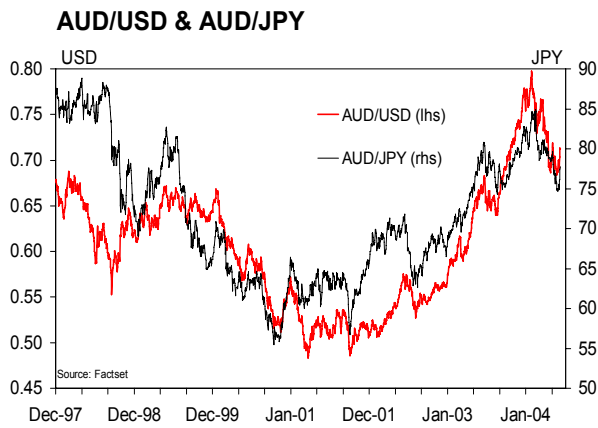


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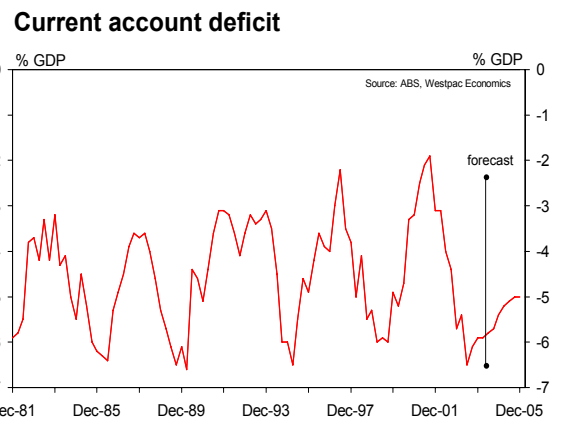


Chart 5.

Westpac Economics versus the market

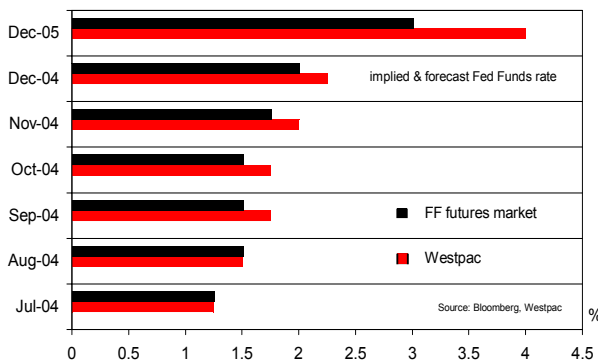
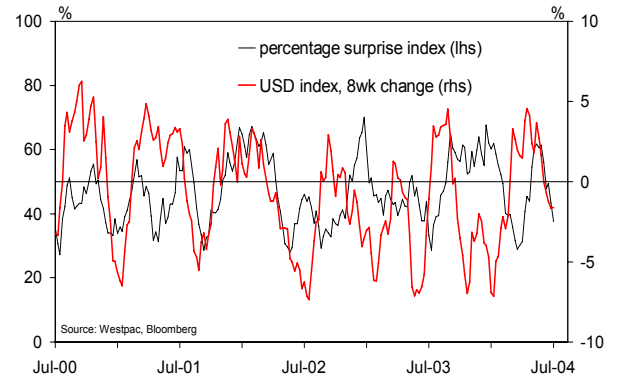


Chart 6.

Softer US data weighing on USD



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Regional industries: agribusiness

A small rise in Australian farm production but commodity prices to ease.

Global prices have peaked but a weaker dollar will help a little

ABARE is forecasting farm production to rise 1% in 2004/05 based on average seasonal conditions. Total crop production is forecast to rise 2% while a rebuilding of the flocks and herd following the drought is expected to lead to decline in the number of cattle and sheep slaughtered. Since the release of ABARE's forecasts, below average rainfall has persisted in the south and southeast of Australia and the outlook for these regions remain, at best, average.

The Australian dollar will provide only a modest offset.

As a result of lower prices and continued herd and flock rebuilding, ABARE is forecasting a fall in total farm income. With farm costs continuing to rise, the net value of farm production is forecast to fall by \$1 billion or 16% in 2004/05. A further risk for our farmers is a fall in global commodity prices. At the start of 2004, the US dollar price of Australia's farm commodities peaked at levels not seen since the early 1990s. Since then the US dollar price of our farm commodities have fallen 3½% but there has been a more than compensating offset in a 9% fall in the Australian dollar. However, Westpac is forecasting the Australian dollar to fall only a further 2½%, so the currency will offer only a small buffer to any further weakness in prices.

Wheat prices to fall on increased production.

Wheat

Global wheat prices are forecast to fall 5% through 2004/05 in response to a recovery in production, in particular from Europe, Russia, India and the Ukraine. However, dry conditions in Canada, the US and here in Australia suggest a higher than usual level of uncertainty. ABARE is forecasting this year's world wheat production to be the second highest on record at 599 million tonnes. Global wheat consumption is expected to rise by 15 million tonnes largely due to an increase in the demand for feed wheat. Wheat used for food purposes is forecast to rise by less than 1% as the downward trend in per person consumption of wheat continues as the consumption of higher protein foods and meat rises.

Poor rainfall will see a fall in Australian wheat production.

Early season rainfall in northern NSW and southern Queensland was adequate and wheat plantings in these areas are expected to have increased. At the time of the report, WA was nearing the completion of the cropping programmes while SA had a late start with heavy rainfalls over the Queens Birthday weekend. However, the southeast corner of NSW and Victoria is still awaiting decent rainfalls. Wheat production is already expected to fall 7% from the record 2004/04 harvest and the continuing dry conditions in the southeast increase the probability of a larger fall.

Increased production will place coarse grain prices under downwards pressure.

Coarse grains

World consumption of coarse grains is expected to hold in 2004/05 but an increase in world production will place downwards pressure on prices. Favourable seasonal conditions and relatively high prices are expected to lead to an increase in production from Europe, USA, China and Argentina. For Australia's main coarse grain export, barley, world prices are expected to fall by around 6% in 2004/05 in response to higher production, in particular from Europe and the Ukraine. China is Australia's principle malting barley market and growth in this market has slowed reflecting the maturing of the market and a shift to malt substitutes such as corn and rice.

The area sown to coarse grains in Australia is forecast to fall in 2004/05 as planting are reduced in the southeast. A general lack of early rainfall in this region will see some growers switch to cereals at the expense of canola and some pulses. The lack of subsoil moisture in southern and central NSW, the Mallee and the Eyre Peninsular will also reduce the potential for crops sown in these regions.

Regional industries: agribusiness

Chart 1.

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

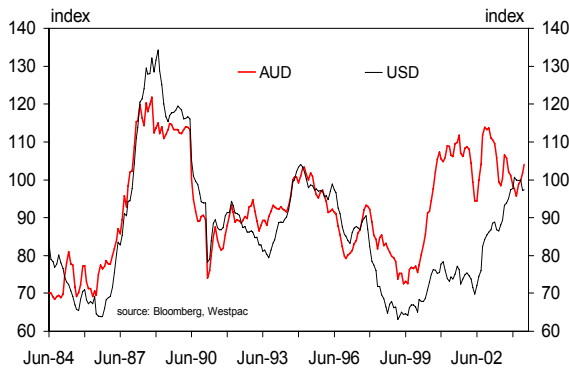


Chart 2.

Westpac NFF Farm Commodities Index

	Jun-04	Percentage change over		
		1 month	6 months	12 months
Wheat (US\$/bu)	364	-5.1	-5.1	12.6
Wool (AUD\$/kg)	873	4.0	-0.4	-13.4
Beef (AUD\$/kg)	3.40	5.7	7.9	11.7
Dairy (USD/t)	2100	5.6	13.5	26.3
Sugar (US\$/lb)	7.45	7.1	19.0	14.6
Barley (CAD/t)	150	-6.1	7.9	15.7
Cotton (US\$/lb)	54.6	-11.6	-24.0	-2.4
Canola (CAD/t)	375	-3.5	1.7	9.7
USD Index 94/95 = 100	95.6	-0.6	-2.8	7.7
AUD/USD US cents	0.694	-1.6	-6.1	4.4
AUD Index 94/95 = 100	102.4	1.1	3.5	3.1

a) Monthly averages
b) Data source is Bloomberg, USDA, EDA FAS

Chart 3.

Wheat prices boosted by low stock levels

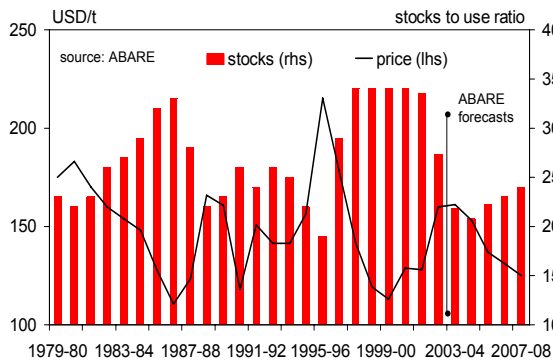


Chart 4.

China has become a net wheat importer

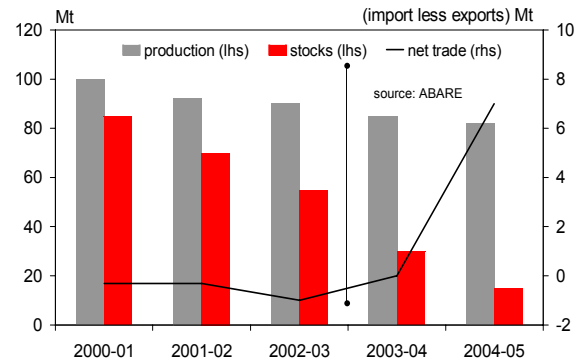


Chart 5.

Low stocks support coarse grain prices

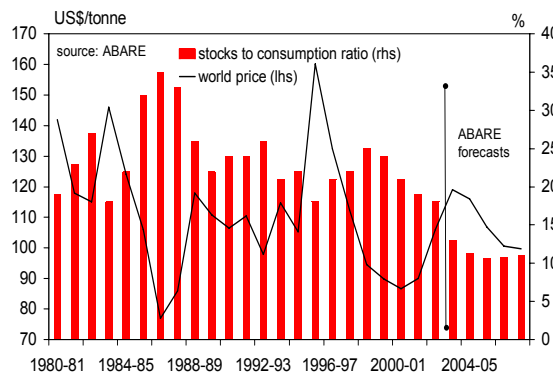
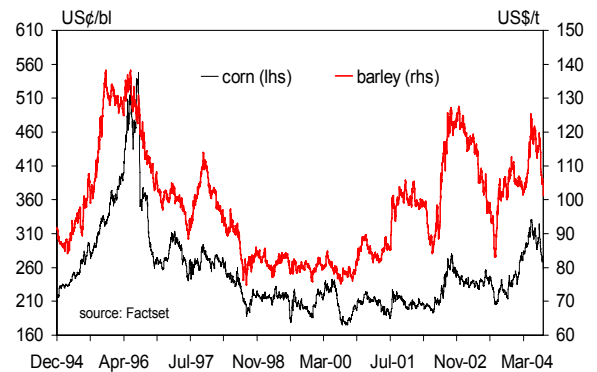


Chart 6.

World corn and barley prices



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Regional industries: agribusiness

Global plantings to increase and improved seasonal conditions for oilseeds.

Oilseeds

Due to an increase in plantings and return to average seasonal conditions in the major producing regions, world production of oil seeds is expected to rise 13% in 2004/05. With the growth in demand expected to slow, particularly from the US, Japan, China and India, the indicator soybean price is expected to fall more than 10%.

Australian production expected to fall.

Australian production is expected to fall as low soil moisture and lack of autumn rainfall has constrained planting opportunities in Victoria, SA and NSW. However, there has been an offset from increased plantings in northern NSW but even average seasonal conditions here will still see total production down around 10% on last year's crop.

Cotton prices are forecast to fall as production rises.

Cotton

Cotton prices look set to ease in 2004/05 with the world raw indicator price for cotton forecast to fall 10%. A return of average seasonal conditions and increased planting and yields in China, Indian and Pakistan are expected to be the main drivers of a significant increase in global production. China is now a major consumer of raw cotton, accounting for 25% of the world cotton trade in 2003/04 due to strong growth in demand for cotton products in both domestic and export markets. However, the resulting decline in Chinese imports due to rising domestic production should result in a 8% decline in world trade and a more than 10% rise in world stocks.

Australian cotton production makes a partial recovery from the drought.

Australian production is set to rise in 2004/05 following good rainfall in Queensland and parts of northern NSW, which has increased water levels in key storage areas. The area under cotton may rise 50% in 2004/05 but this is still down almost 20% on the average area planted in the five years prior the drought.

Dry weather conditions have been a boost for sugar prices.

Sugar

During 2003/04, dry weather conditions caused production problems in Thailand and India. This has been a recent fillip for sugar prices, taking them back up to US8 cents/lb. For 2004/05, despite the return of normal seasonal conditions in India, ongoing insect infestations and problems with cane farmer payments suggest Indian cane production should rise only modestly. Brazil will provide a partial offset with its crop expected to rise by up to 10%. And despite the recent spike in oil prices, ethanol production in Brazil is expected to rise slowly relative to sugar production. As such, the world indicator price of sugar is forecast to average around US8 cents/lb in 2004/05.

A small rise in Australian sugar production.

Conditions for the current Australian sugar harvest are a little better than last year with cane cut for crushing forecast to rise 1 million tonnes. Assuming average yields, raw sugar production should rise by around 5% in 2004/05 to around 5 million tonnes. Farmers in several key areas are facing ongoing challenges. In far north Qld there is waterlogging due to unusually heavy rainfall while the lack of sunshine is affecting the production of sucrose. In contrast, dry conditions plague Mackay cane growers.

Wool prices held down by a substitution to synthetics.

Wool and sheep

Wool prices continued to decline over the past year, despite lower wool supplies, due to lower demand as processors shift to cheaper synthetics. A positive for wool has been the depreciation of the Australian dollar since February, which has seen wool prices fall more than 10% in US dollar terms there by increasing the competitiveness of wool relative to synthetics. In addition, the recent spike in oil prices has resulted in higher synthetic prices. Nonetheless, with wool production forecast to rise by around 5% in 2004/05 the eastern market indicator is expected to fall by around 5%.

Regional industries: agribusiness

Chart 1.

World canola prices

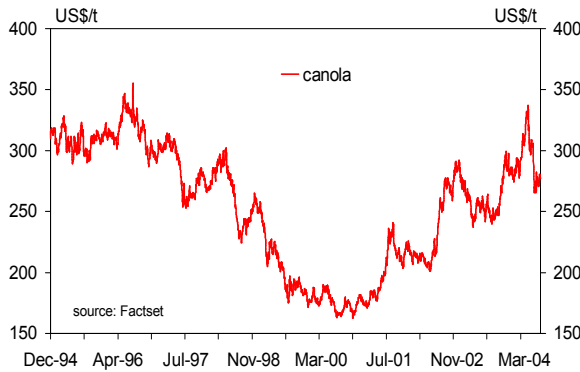


Chart 2.

Cotton prices rising as stocks dwindle

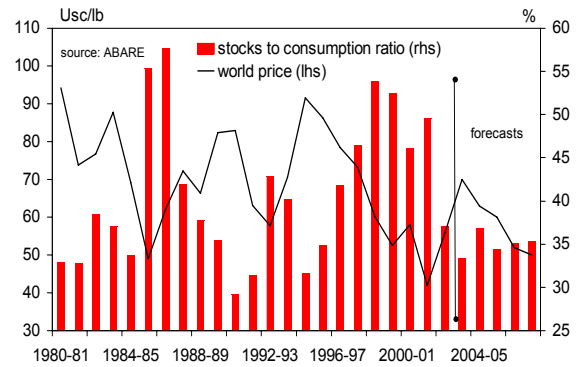


Chart 3.

Water storage in key cotton regions

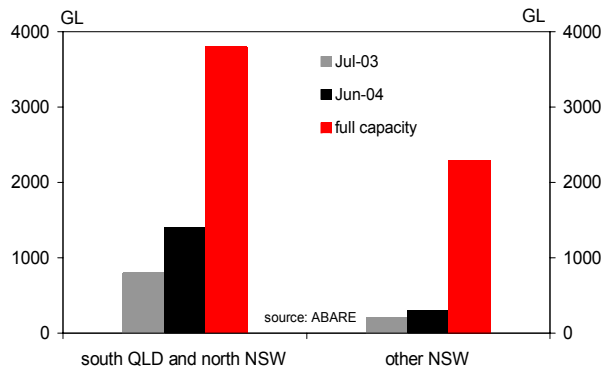


Chart 4.

Stocks continue to suppress sugar prices

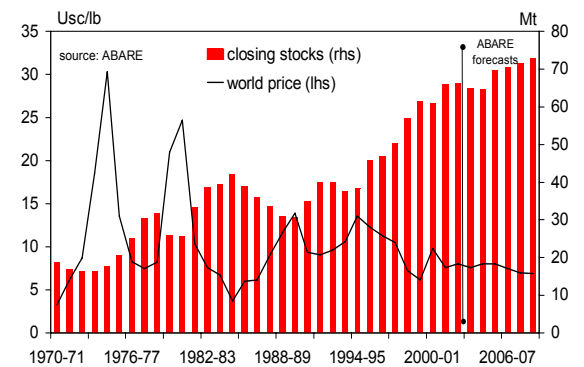


Chart 5.

Global demand will be supportive of wool

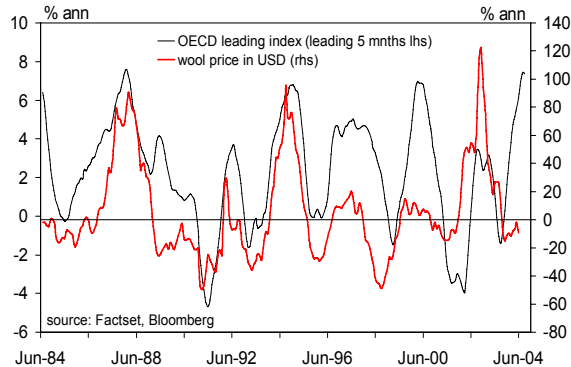
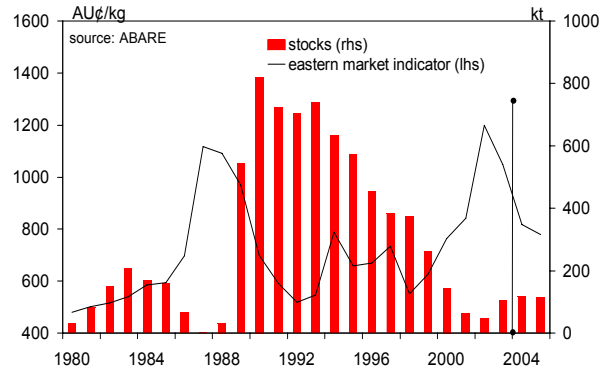


Chart 6.

Drought accelerates rundown of wool stocks



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Regional industries: agribusiness

Flock rebuilding will constrain the production of sheep meat.

Uncertainties surrounding the timing and extent of rainfall in the drought affected areas will be the key factor driving Australia's sheep meat production in the short-term. The most likely avenue for flock rebuilding is the retention of sheep from slaughter and as a result, mutton production is expected to fall by 18%. Provided seasonal conditions improve in winter and spring, lambing rates should be slightly higher in 2004/05 underpinning growth in lamb exports.

Development in the US remain vital for Australian beef prices.

Beef and veal

Developments in the US, the second largest export market for our beef, have played an important role in determining Australian prices. The impact of the embargoes following the discovery of single case of BSE may be extended following the USDA announcement of a second positive screening result for BSE in June. This resulted in an increase in demand, and rising prices, for imported beef. Robust demand is expected to continue in 2004/05 and lead to further US imports of manufacturing beef.

Herd rebuild will limit growth in Australian beef exports.

Australian exports to the US are estimated to have increased in 2003/04 but our ability to significantly increase beef exports is constrained by the drought-induced reduction in the cattle herd. Even with a return to average seasonal conditions, beef turnoff in 2004/05 will be limited as graziers rebuild their herds. In Japan and Korea, the embargoes on US beef have increased demand of Australian beef and resulted in a significant rise in exports to both countries and a rise in the number of Australian cattle placed into feedlots to meet this demand.

If the embargoes on US cattle are lifted by the end of October 2004, then increased supplies in our major export markets will translate into lower prices. A depreciation of the Australian dollar will provide some offset but if the lifting of the embargoes are realised, then Australian saleyard prices should be down slightly by the end of 2004.

Demand and dry conditions in Australasia has been supportive of dairy prices.

Dairy

Stronger global demand and dry conditions in Australia and New Zealand saw the world spot price for dairy products rise significantly in 2003/04. Cheese prices have been given a boost from strong demand, particularly from Japan and Europe, while stronger demand from Russia and the Middle East have been the main drivers of stronger butter prices. With world dairy supplies expected to grow in 2004/05, prices are expected to ease through the year. New Zealand is expected to be the main source of this increase in production due to improved seasonal conditions.

Australian milk prices will be supported by strong world prices and weaker AUD.

The farm gate price for Australian milk is estimated to have fallen 1.5% in 2003/04. For 2004/05, a combination of higher global prices and a weaker Australian dollar should see milk prices rise by more than 2% to around 27 cents per litre. Australian milk production fell during the drought only to fall a further 3% in the ten months to April 2004 as the drought continued to impact on water supplies and feed quality. An improvement in seasonal conditions and a small increase in cow numbers should result in a 2% rise in Australian milk production in 2004/05. However, continuing dry conditions in the southeast put such a forecast at risk.

Regional industries: agribusiness

Chart 1.

Beef prices and turnoff

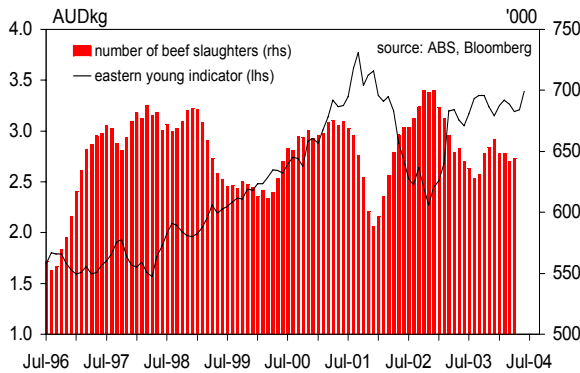


Chart 2.

Australian and US import beef prices

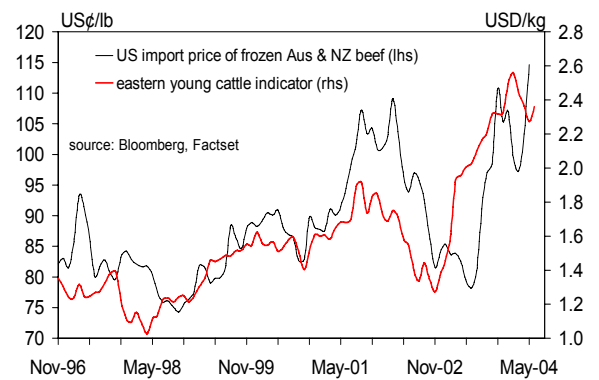


Chart 3.

US cattle prices back from the BSE slump

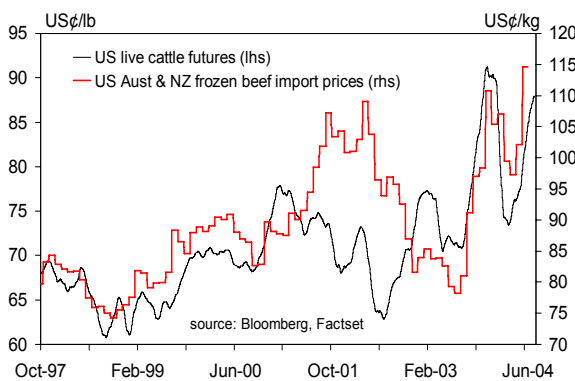


Chart 4.

Australian milk prices

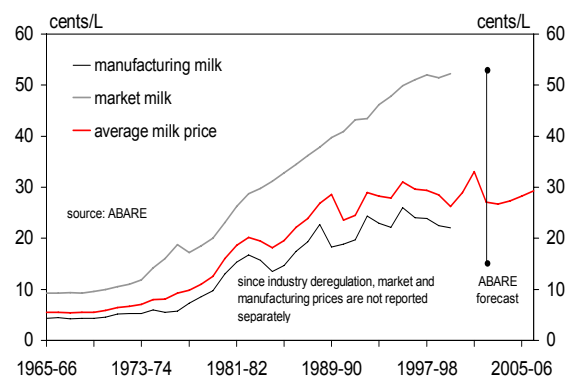


Chart 5.

Global milk prices remain a positive

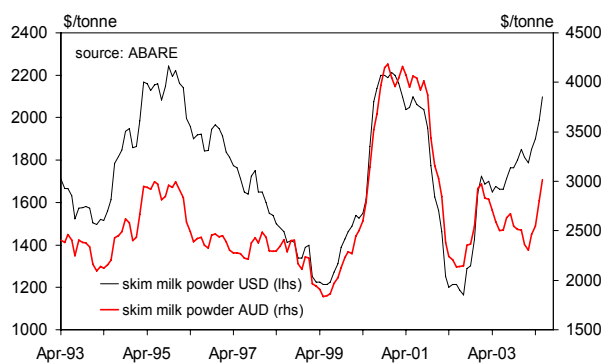
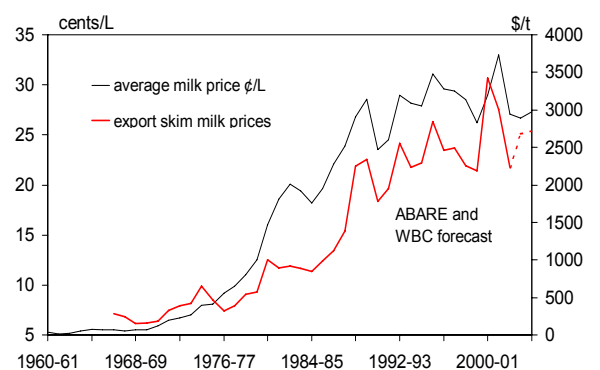


Chart 6.

Weaker AUD a small boost for milk prices



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Regional industries: energy and minerals

The peaking of global growth in 2004 will also see a peaking in commodity prices.

Energy and minerals background

Prices for all our major mineral and energy commodities are expected to remain robust, if not rise, in 2004 as demand rises with stronger global industrial activity. However, in 2005 prices are set to fall modestly as producers respond to higher prices and ramp up production and world growth slows. There will still, however, be a few out performers, such as coal and nickel, due to the limited availability of additional supply. Chinese growth will also slow and this will also help to turn down the heat on commodity prices. Export earnings from mineral and energy are forecast to rise significantly in 2004/05 as a result of increased volumes shipped, stronger world prices and a weaker Australian dollar.

Crude oil remains sensitive to supply disruptions.

Crude oil

Oil prices have seen a strong increase to above US\$40 a barrel. This price surge can be attributed to several factors including strong global demand, low OECD stocks, OPEC's production policies and geopolitical concerns in the Middle East. Following widespread concern that high oil prices would inhibit world growth, OPEC announced an increase in its production quota by 2 million barrels a day from July 1, with a possible further 0.5 million barrels a day by August. However, output is already close to the increased quota and there is very little spare capacity in most OPEC member nations. Saudi Arabia and the United Arab Emirates, where there is spare capacity, have announced they will increase output by around a million barrels a day. If this is realised, it will place some downward pressure on prices to around US\$35 a barrel in 2005. All of which, naturally, is contingent on no disruptions to Middle East oil supplies.

Coal prices have risen as demand growth has outstripped supply.

Coal

Strong global demand, especially from Asia, combined with supply constraints lead to significant increases in coal prices in 2004. China's growing consumption of coal will continue to influence the world markets by reducing Chinese coal available for export.

Thermal coal (steaming) consumption is expected to grow strongly in 2004. As world growth slows in 2005, so will energy demand. Asia remains the key growth region accounting for 70% of the growth in total trade. Japan has been a key source with the closure of some nuclear power plants and the limited availability of LNG. European demand for coal also continues to rise but in 2005 this will be constrained by a recovery in hydroelectric and nuclear electricity. Any growth in world thermal coal trade is constrained by limited spare infrastructure capacity in Australia and South Africa.

Growth in Chinese demand will eat into China's coal exports.

The demand for metallurgical (coking) coal is expected to grow more than 5% in 2004 due to higher steel production in Asia and the Russian Federation. China will continue to play a significant role as its expanding steel industry means China will no longer be an exporter of hard coking coal.

China has an insatiable appetite for steel.

Iron ore & steel

Stronger world growth in 2004 is expected to see a significant increase in global steel production. China will continue to play a significant role in global steel and iron markets as they continue to ramp up production. Notwithstanding China's continuing increase in demand associated with development, steel demand growth is forecast to slow in 2005 as the growth in industrial production is also forecast to moderate. It has been growing Chinese demand for iron ore that has underpinned the significant rise in Australian export volumes and the weaker Australian dollar will help boost iron ore export returns in 2004/05.

Regional industries: energy and minerals

Chart 1.

Australian energy & mineral exports

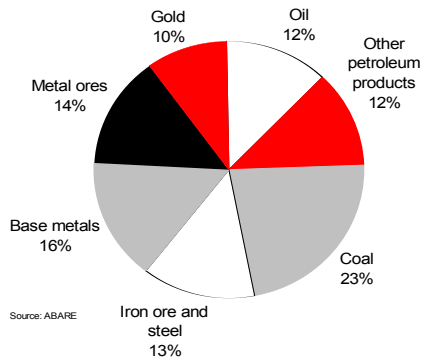


Chart 2.

World growth climbs higher for now

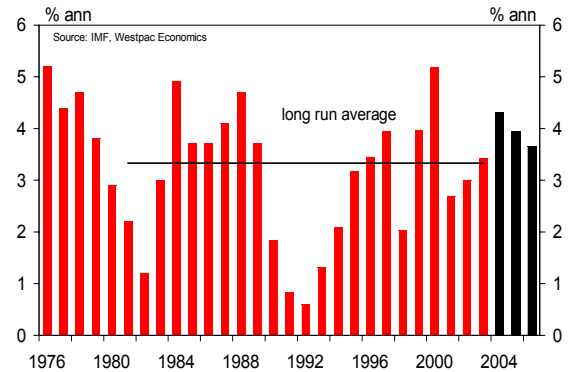


Chart 3.

The AUD & commodity prices

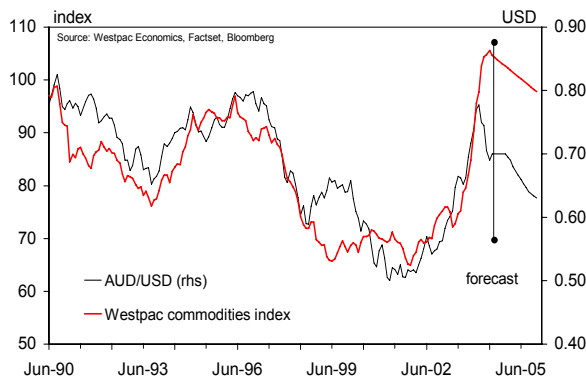


Chart 4.

Oil prices remain high

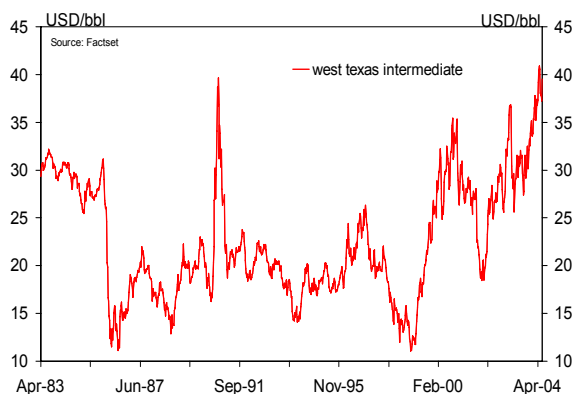


Chart 5.

Coal export prices improve in 2004

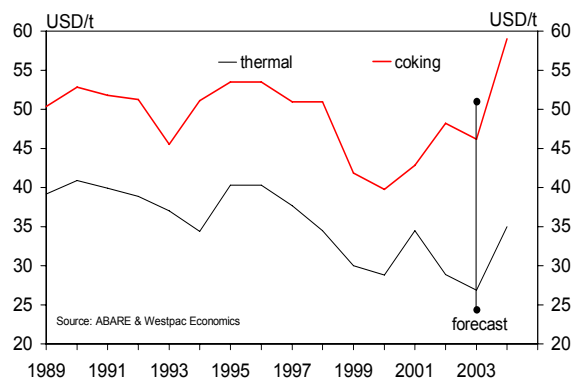
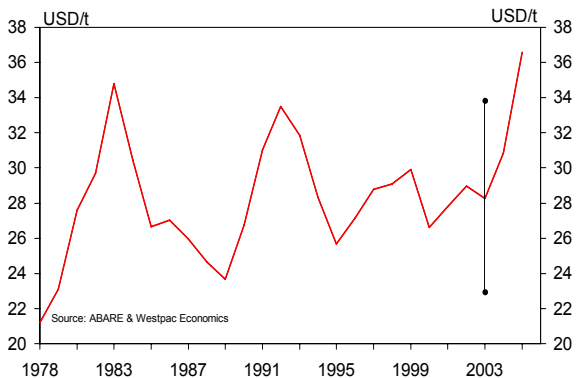


Chart 6.

Iron ore prices also strengthen in 2004



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Regional industries: base metals and tourism

Nickel prices were boosted by speculative trading in 2003.

Base metals

A strong rise in demand, only a modest rise in supplies and a decline in stocks, led to a significant rise in **nickel** prices in 2003. This was further boosted by an element of speculative buying activity and the building of a strategic stockpile in China. Speculative activity appears to have moderated following concerns about lower growth rates in China and future rises in global interest rates. However, since bottoming in May, nickel prices have again strengthened as demand remains very robust any additional supply remains limited. Supply, or the lack thereof, remains a key story in 2004 as the growth in refined nickel output is constrained by the current high rates of capacity utilisation so any increase will come from incremental production increases from existing facilities. This lack of excess capacity reflects a six year period of under investment into nickel processing due to relatively low nickel prices.

Production growth has capped the rise in Aluminium prices.

Aluminium prices rose at a more modest pace than other base metals as stronger demand was mostly offset by rising production. As a result, aluminium stocks fell only modestly and prices rose only modestly. Softer world growth, and a moderation in Chinese demand in 2004/05, will see a softening in aluminium demand and thus also prices. China has been a growing player in aluminium production but there are a number of reasons to think that the growth in Chinese production will moderate: a lack of reliable Chinese alumina supply has driven smelters onto the global spot market pushing up prices and manufacturing costs; the sharp increase in Chinese economic activity has resulted in a shortage of electricity to major aluminium producers; and, the Chinese government has placed restrictions on further investment in this industry.

Copper prices boosted by rising demand and falling stocks.

Copper prices rose rapidly in the early part of 2004 as strong global demand, falling stocks, supply disruptions and speculative buying activity. Prices have since moderated as expectations shifted to softer growth in 2005, recent measures were implemented in China to slow investment and growth, and expectations built for higher interest rates in the US. With copper demand forecast to slow in 2004/05 and mine supply to gradually increase, prices are forecast to ease slightly over the period to the end of 2005.

The weaker US dollar has been a boon for gold prices.

Gold

The significant decline in the US dollar has been a major contributing factor to the marked increase in gold prices. This relationship has, however, become less strong as despite a weak US dollar, gold prices declined between early April and mid-May as markets lifted expectations for rate rises in the US. Higher interest rates enhance the attractiveness of interest bearing securities relative to gold thus putting gold prices under downwards pressure. Increased global uncertainty, given gold's traditional role as a "safe haven", remains a positive for gold, as does the recent renewal of the 1999 central banks agreement to limit sales of reserve gold.

Australians are travelling overseas again.

Tourism

With foreign tourists determining destinations partly on relative price, the stronger Australian dollar compared with recent years has been a constraint to the number of foreign visitors to our shores. It also reduces average tourist spend and encourages Australians to travel abroad so the negative impact is compounded. So far this year, tourism arrivals are up 30% in the year to May. However, this is a base effect from such a poor 2003 with no growth so far this year and levels still well off the 2000 Olympic peak. Meanwhile, outbound tourism rebounded a solid 7% so far this year to be up more than 50% in the year to April. This means the net tourist position has deteriorated by around 40,000 visitors over the last 12 months and is unlikely to improve anytime soon with the Australian dollar forecast to hold around US70¢ to the end of 2004.

Regional industries: base metals and tourism

Chart 1.
Nickel prices sour

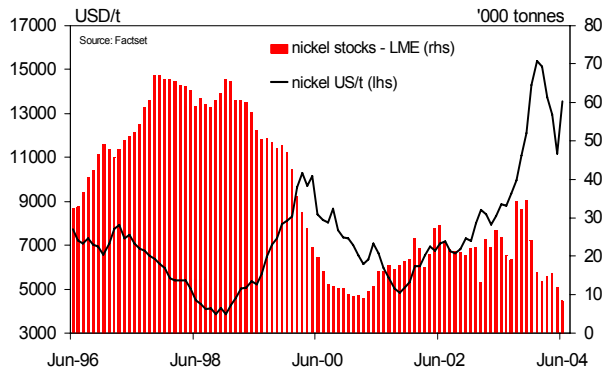


Chart 2.
Aluminium prices improve despite high stocks

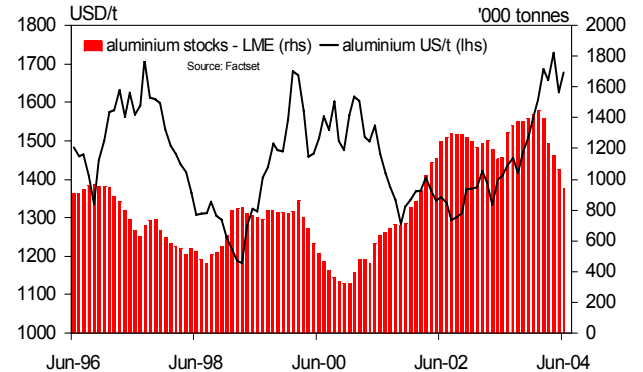


Chart 3.
Copper prices jump as stocks shrink

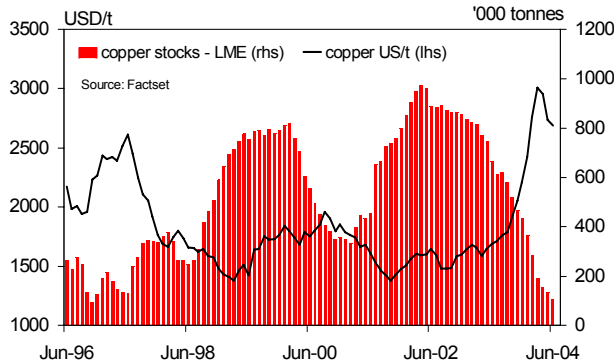


Chart 4.
Even zinc prices have started to improve

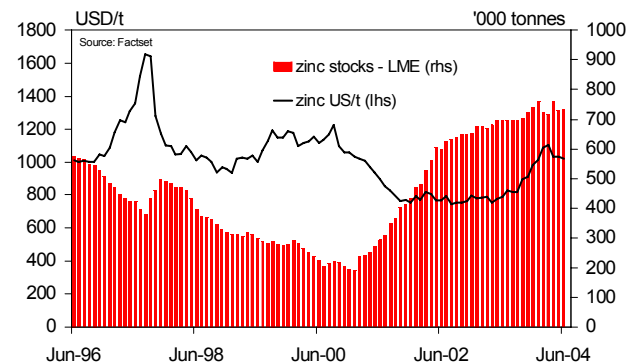


Chart 5.
Gold prices remain solid

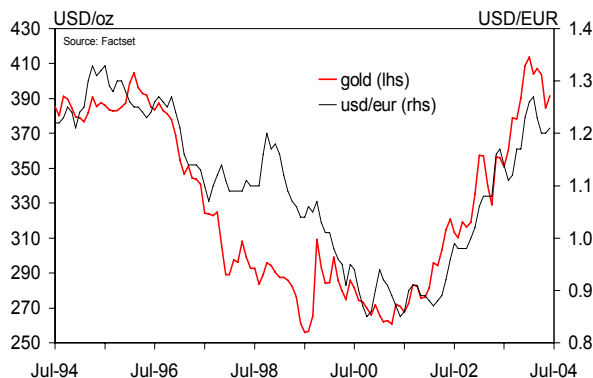
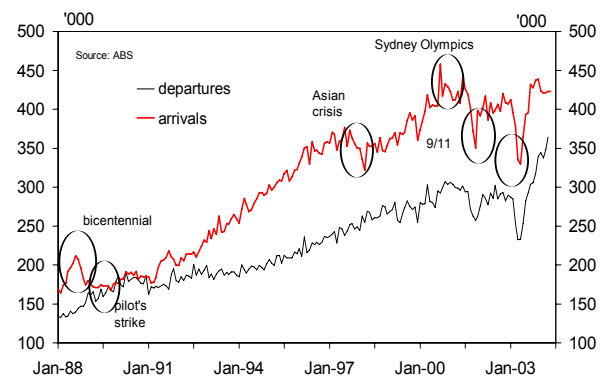


Chart 6.
International departures catching arrivals



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Regional dwelling approvals

Chart 1.

Dwelling approvals prove resilient in regions

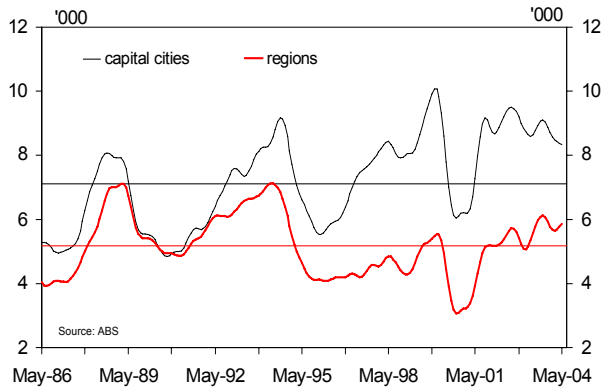


Chart 2.

Dwelling approvals gravitate towards 'trend'

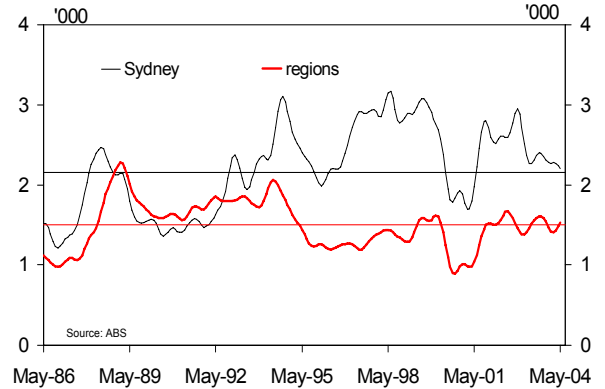


Chart 3.

Qld regional approvals off their highs

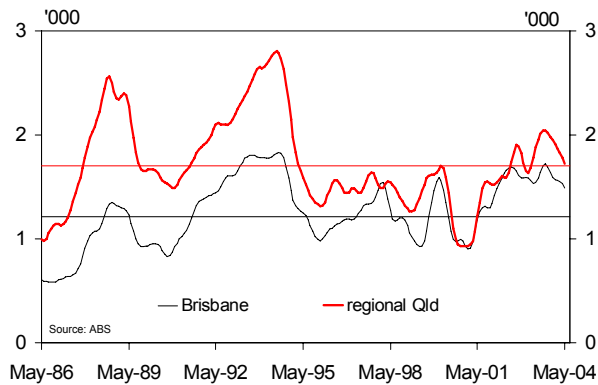


Chart 4.

Victoria still on a strong trend

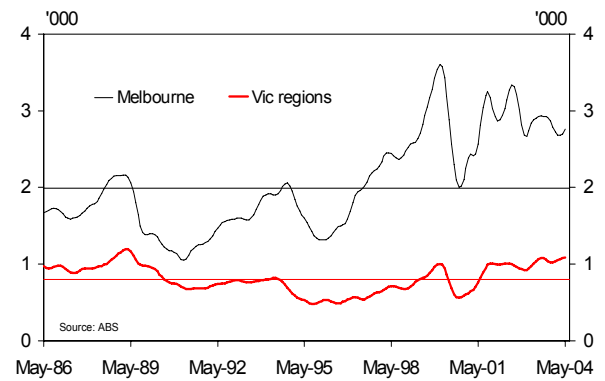


Chart 5.

WA approvals holding the highs

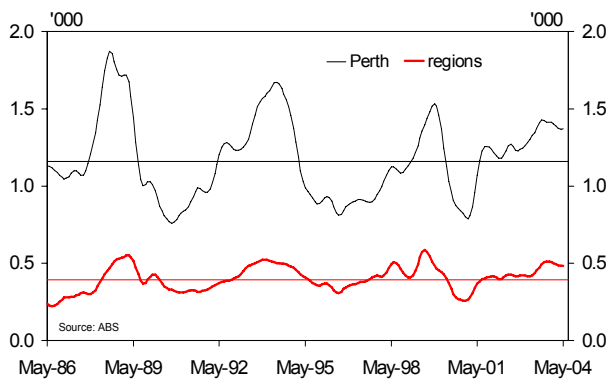
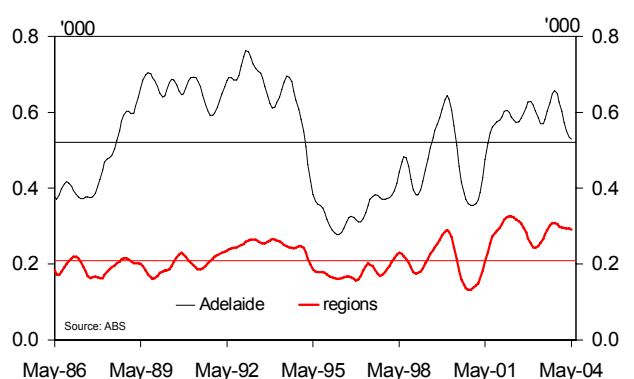


Chart 6.

Regional SA performing well



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