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OVERVIEW OF AUSTRLIAN ECONOMY

- At the time of the Economic Statement and PEFO, GDP was expected to grow at around trend in 2010-11 and above trend in 2011-12. Fiscal and monetary stimulus was being withdrawn, and there were early signs that private sector activity was picking up.
- Over the weekend I attended the G20 finance ministers meeting in Seoul. Again, the main message from that meeting is that while we are seeing a global economic recovery, it is still uncertain and uneven.
  - While the developing world continues to grow strongly, there are increasing concerns about the strength of the recovery in advanced economies as unemployment remains very high in the US and Europe and their capacity for further policy stimulus is limited.
- In contrast, economic conditions in Australia continue to indicate strength despite the expected net negative impacts from the high exchange rate:
  - In the June quarter of 2010, GDP grew by 1.2 per cent. The strength of this quarterly result provides further evidence that a broad-based self-sustaining private sector recovery is gathering momentum as fiscal and monetary stimulus are withdrawn.
  - The unemployment rate remained steady at 5.1 per cent in September. Employment grew well above trend, while the participation rate reached its highest point since May 2009.
  - Consumer spending is also continuing to increase, driven by strong employment and incomes growth, as well as high levels of consumer confidence.
  - The ABS survey of capital investment intentions suggests that 2010-11 will be a strong year for business investment, with private capex expected to be around $120 billion.
  - Inflationary pressures are expected to continue to build in the future, given expected ongoing strength in the economy.
  - December quarter 2010 contract prices for Australia's key commodity exports of iron ore and metallurgical coal have settled below September quarter contract prices and rising supply is expected to place further downward pressure on prices in the period ahead. However, prices still remain near historical highs – which will lead to strong business investment and corporate incomes going forward.
- The Australian dollar has appreciated on a trade-weighted basis and by more against the US dollar. This recent appreciation of the Australian dollar appears to be driven by stronger demand for commodities boosting our terms of trade; our comparatively strong economic growth; the interest rate differential between Australia and other advanced economies; the strength of our government balance sheet; and the weakness in the US dollar.
- The appreciation of the dollar is likely to dampen growth somewhat, reflecting a decline in the competitiveness of exporting and import-competing industries such as tourism, education and parts of the manufacturing sector. Australian dollar profits for commodity exports will also take a hit. Weaker foreign demand for our exports may result in weaker business investment in the exporting industries, with a negative impact upon employment and wages.