Outlook for the World Economy

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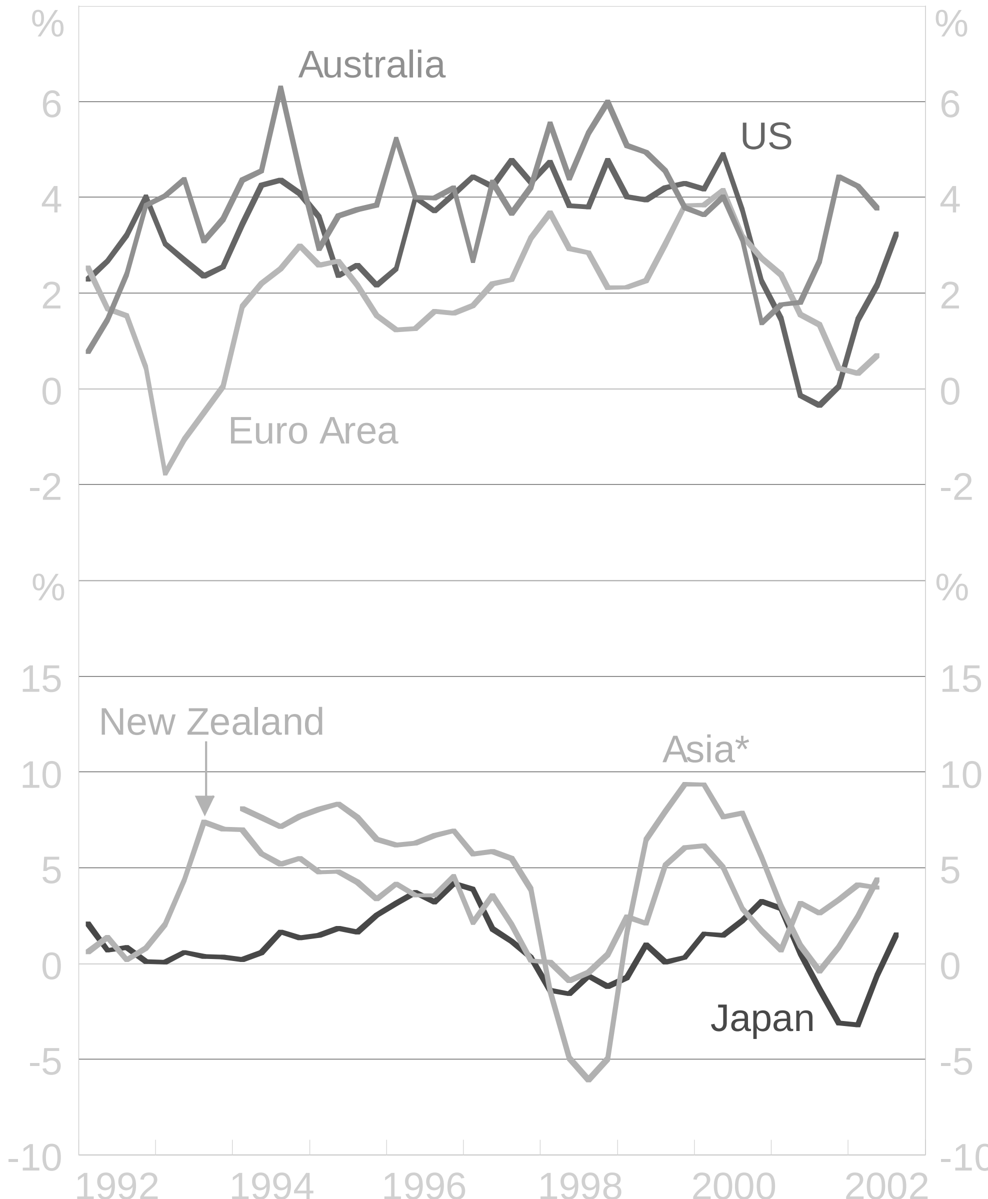
Overview

- Where is the World Economy Now?
  - United States
  - Europe
  - Japan
  - Non Japan Asia
- Where is the World Economy Heading?
  - Key Issues
  - Nature of recent shocks
- Conclusions

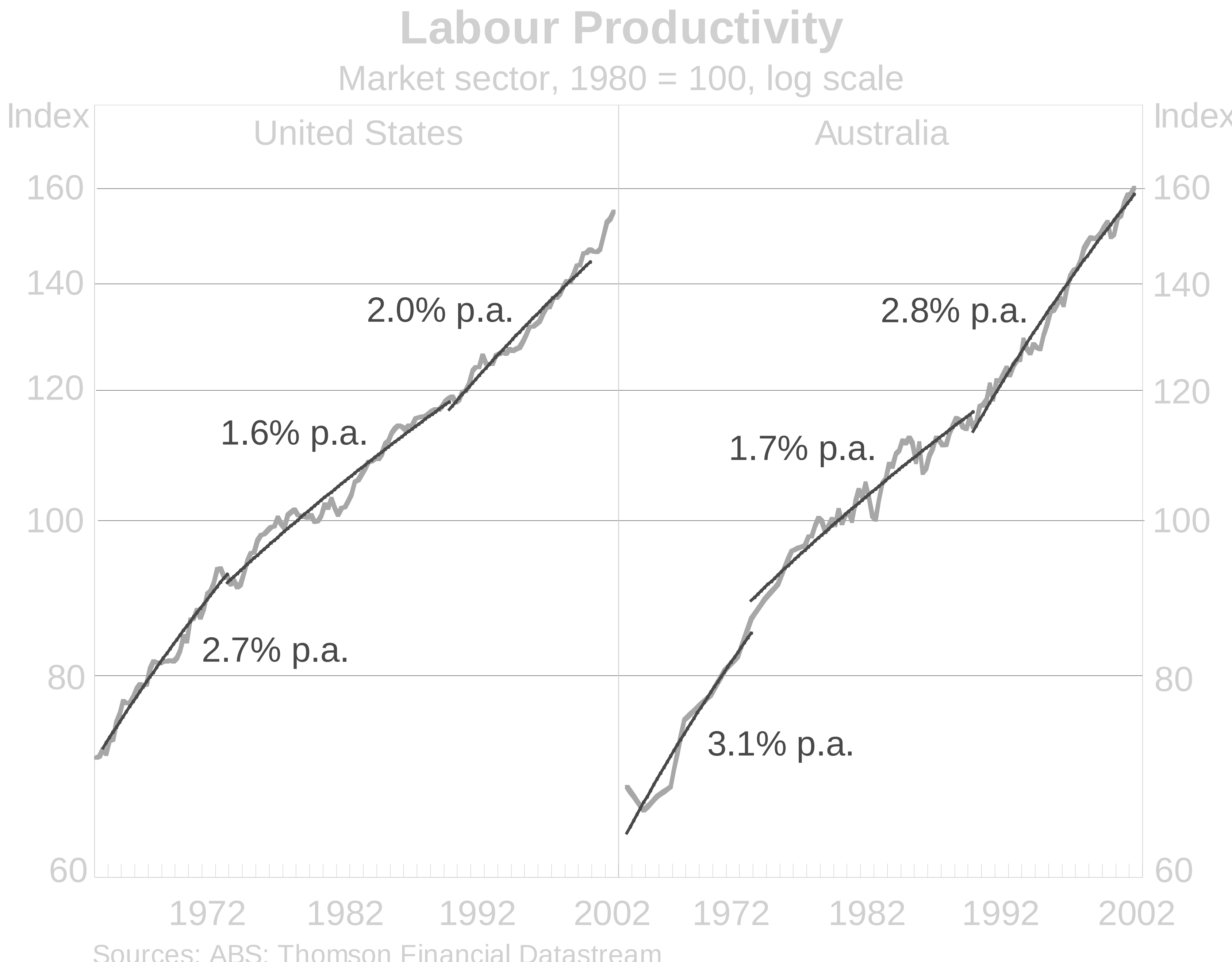
Real GDP

Year-ended percentage change



* Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand

* Seasonally adjusted by the RBA.
Source: CEIC

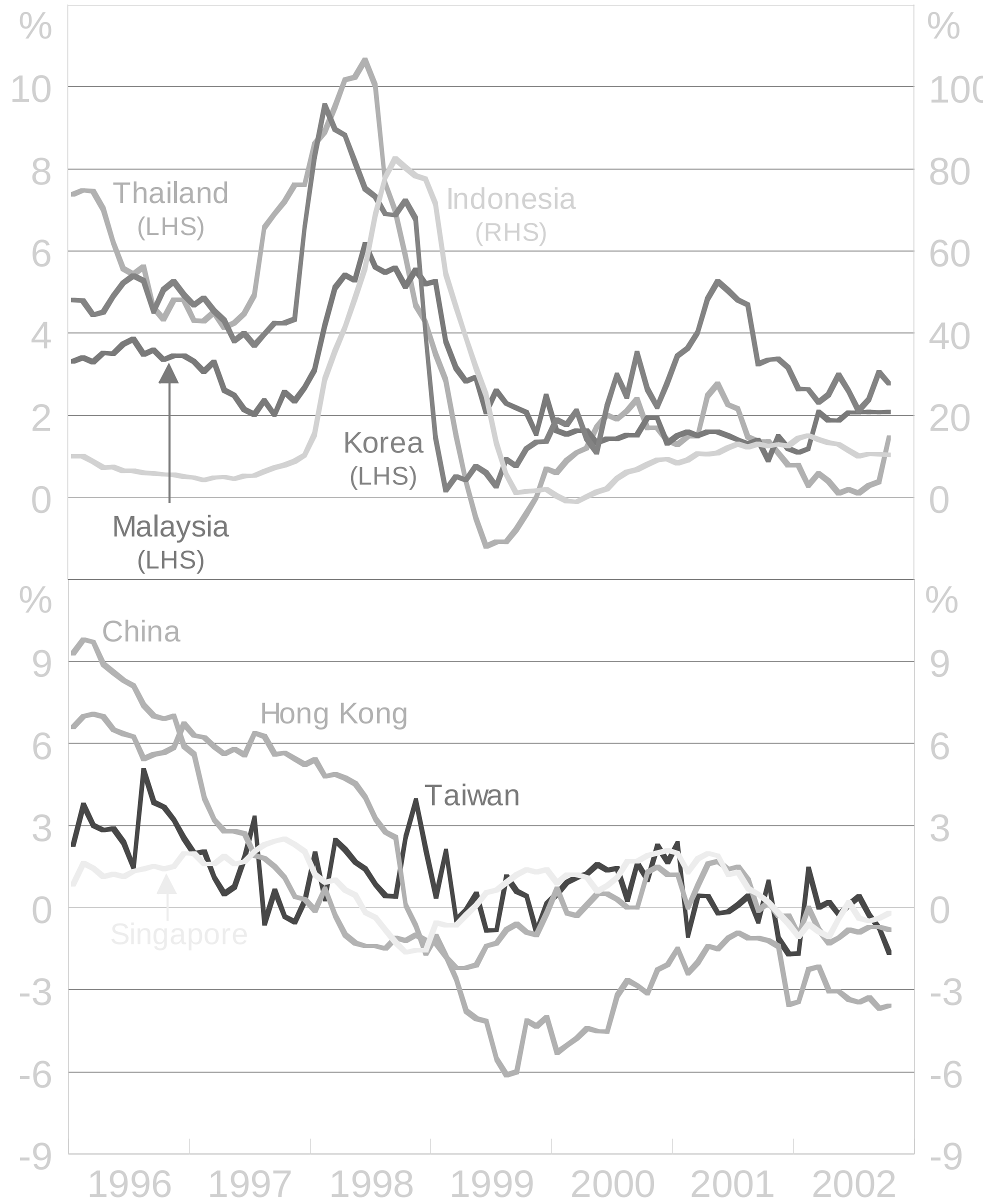


Labour Productivity
Market sector, 1980 = 100, log scale
Index
United States
Australia
Index
160
140
120
100
80
60
2.0% p.a.
1.6% p.a.
2.7% p.a.
2.8% p.a.
1.7% p.a.
3.1% p.a.
1972
1982
1992
2002
1972
1982
1992
2002
Sources: ABS; Thomson Financial Datastream


Consumer Prices
Year-ended percentage change
United States
Core
Headline
Euro area
Japan
%
4
2
0
-2
1992
1994
1996
1998
2000
2002
Source: Thomson Financial Datastream

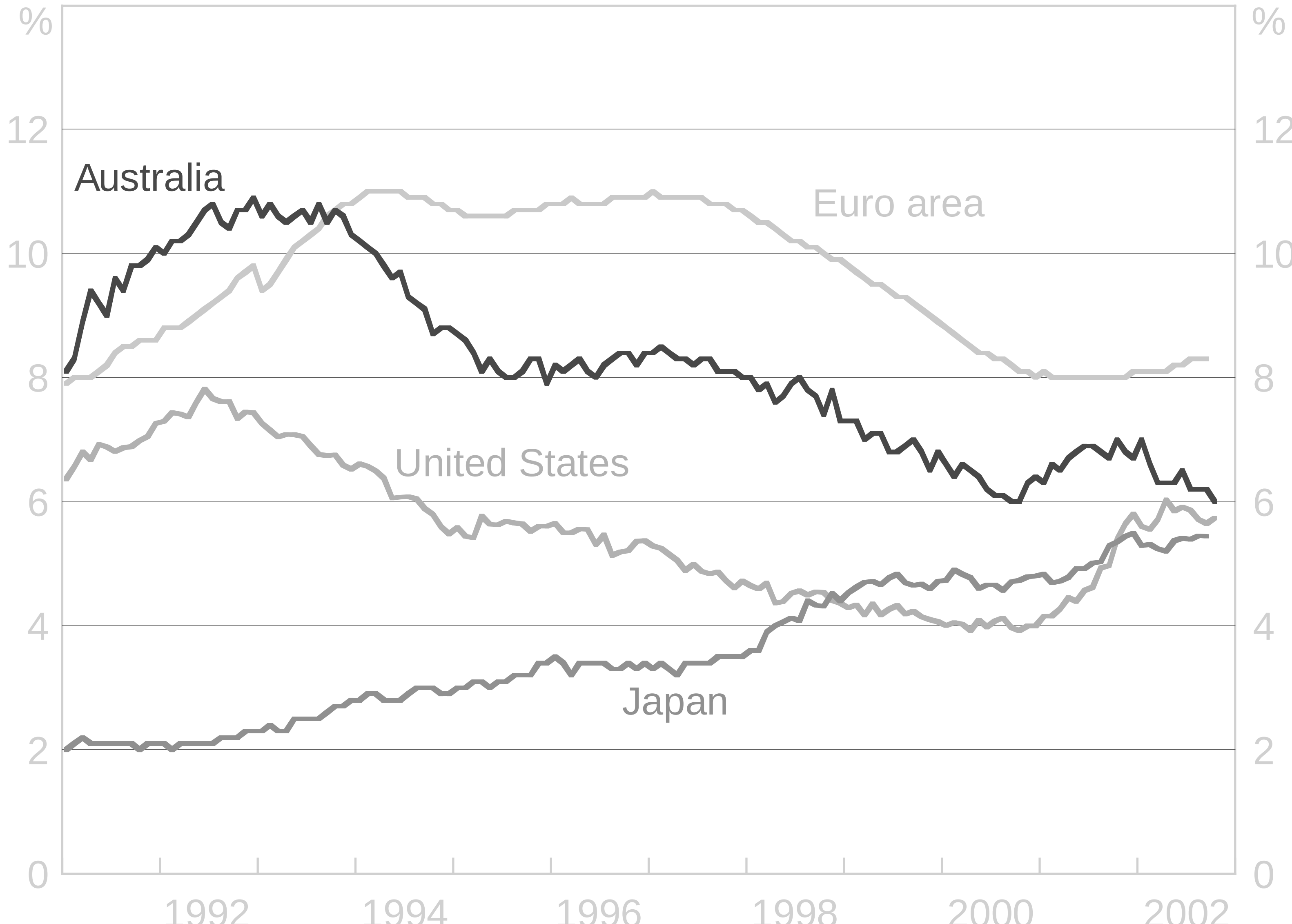
Asia – Consumer Prices

Year-ended percentage change



Source: CEIC

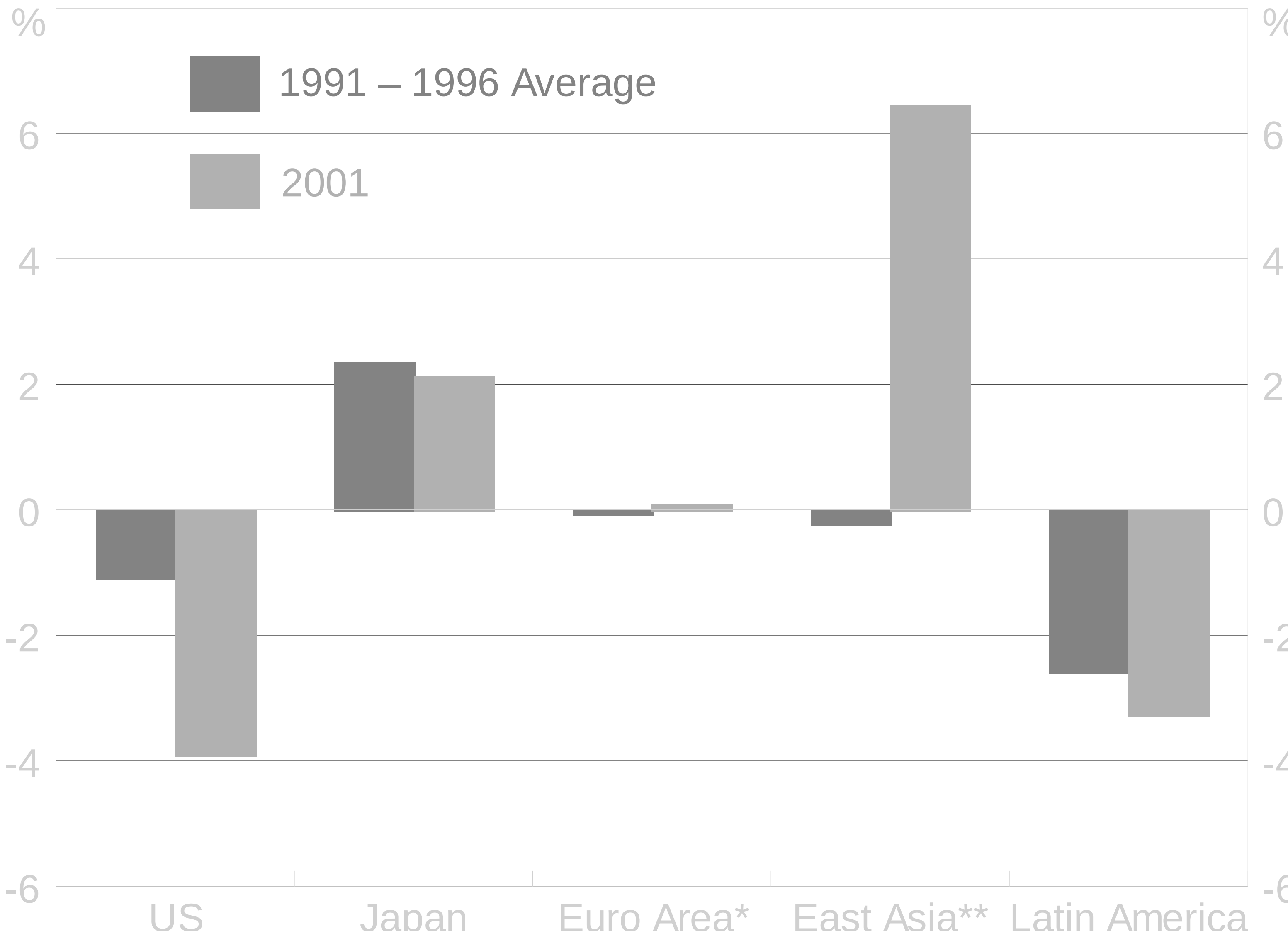
Unemployment Rate



Sources: ABS; Thomson Financial Datastream

Current Account Balance

Per cent of GDP



*   Excluding Belguim, Greece, Ireland and Luxembourg

** Excluding China, Hong Kong and Japan

Source: Thomson Financial Datastream

Where is the World Economy Heading?

Focus on scenarios rather than forecasts

Key Issues

- Comparing this business cycle with previous cycles is probably not very helpful in understanding the outlook

- The adjustment over the next few years depends on what has caused the downturn as well as likely new shocks and policy responses

Key Issues

- Nature of Shocks
- Existing Policy Regimes
- Underlying drivers of growth
- Inflation outlook

Key Issues

- Shocks
  - Rise in equity risk premia in US/Europe/Japan
  - Fall in expected US productivity growth
  - Reassessment of recent US productivity performance
- Policy Responses
  - US fiscal/monetary expansion
  - Europe fiscal/monetary tightening
  - Japan muddling along

Scenarios

- Based on

www.EconomicScenarios.com

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Key Issues

- United States
  - Adjusting to excess investment
    - Bursting of High tech bubble
    - Revision of risk
    - Downward reassessment of future productivity growth
    - Implies weak investment and slower growth for several years

Key Issues

- United States
  - flexible fiscal and monetary response
    - Policy mix implies
      - Little change in $US then continued depreciation, stronger growth, CA deficit
  - Productivity growth has remained strong during this downturn

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Key Issues

- Europe
  - Reassessment of risk
    - Slowdown in growth
  - Growth and Stability Pact
    - Fiscal tightening
  - ECB establishing “in”credibility
    - Tight monetary policy
  - Structural rigidities

Key Issues

- Japan
  - Coordination failure between monetary and fiscal authorities
  - large Yen depreciation needed to kick-start the economy and enable structural reforms
  - Will this happen?
    - Might already be

Key Issues

- Non Japan Asia
  - Strong growth particularly in China and Korea
  - Underlying continued strong productivity growth (falling prices in China)
  - Flexible fiscal policy
  - Undervalued exchange rates
    - Substantial accumulation of reserves

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Issues

- US productivity growth remains strong
  - Strong policy response but investment overhang
  - Falling $US over time
- Will Japan stimulate the economy?
- Will Europe change fiscal/ monetary mix?
- War with Iraq?

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Conclusion

- Global recovery likely to continue
- But would be more likely if regime change in Europe and Japan could occur sooner rather than later
- Strong case for policy coordination across US/Europe/Japan and Asia
  - Coordinated temporary fiscal and monetary expansion (with yen depreciation, Rest of Asia appreciation)
  - Structural reforms
  - Doha Trade Round

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Sources:

- www.notwrong.com
- www.economicscenarios.com

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