

# **Global Economic and Currency Outlook**

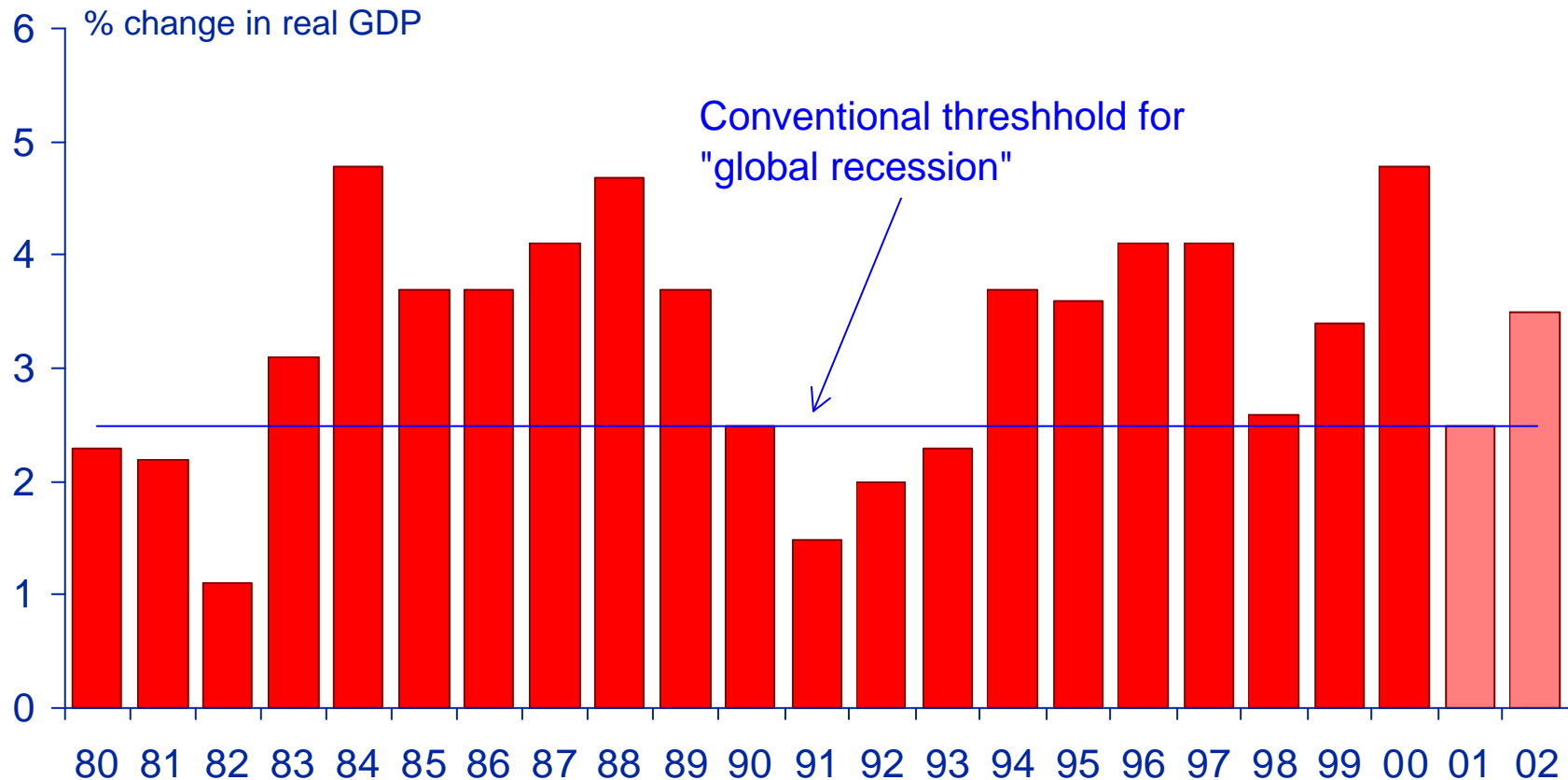
**Presentation to the Second  
Australian Wine Marketing Conference**

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Chief Economist  
ANZ Bank**

**Convention Centre  
Adelaide  
16 July 2001**

# The world economy is slowing sharply this year, but will recover gradually through 2002

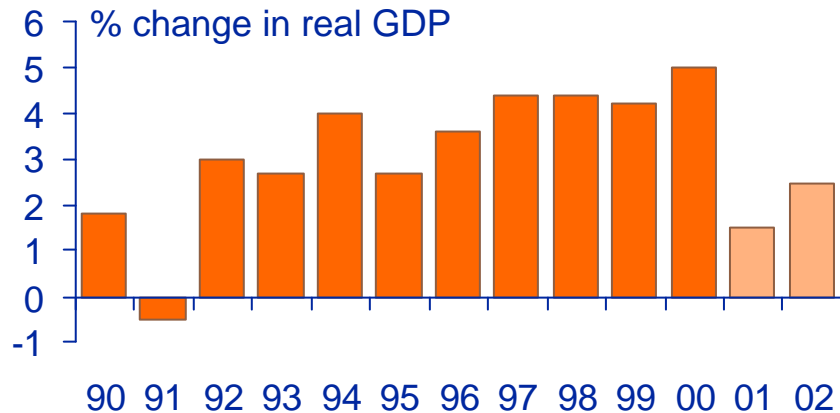
## World economic growth



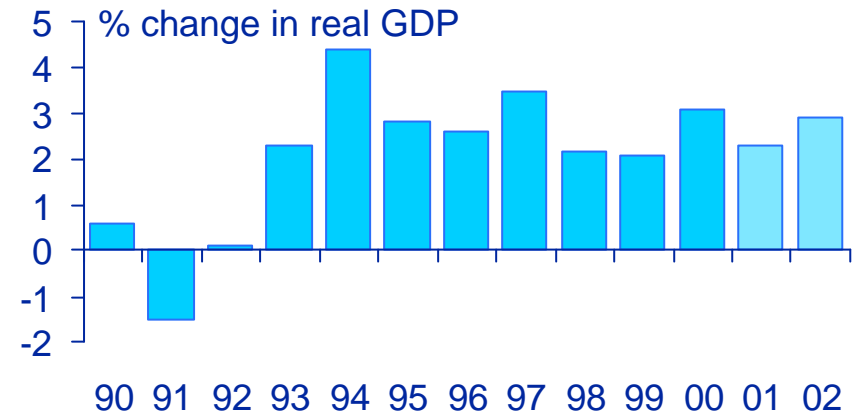
Sources: IMF; Economics@ANZ forecasts.

# All of Australia's major wine markets will see slower overall economic growth this year

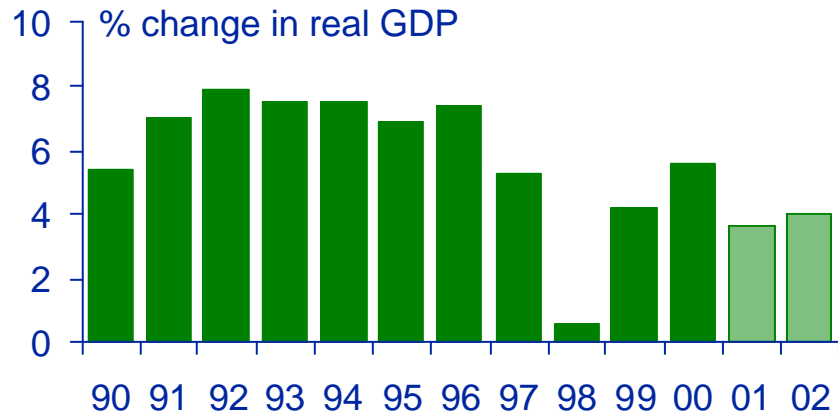
## United States



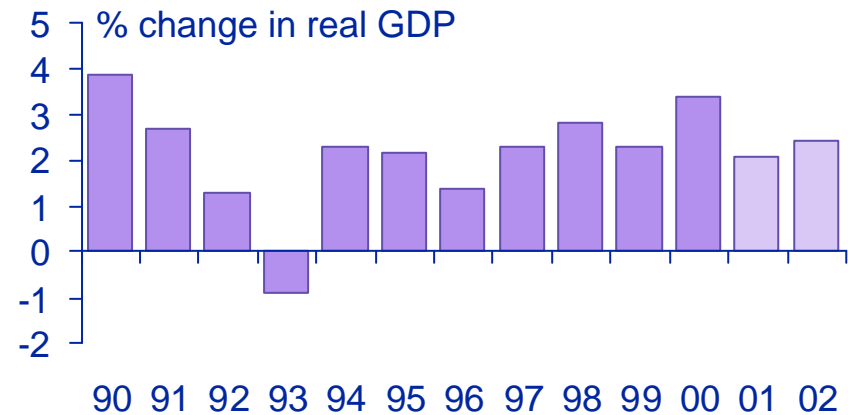
## United Kingdom



## East Asia



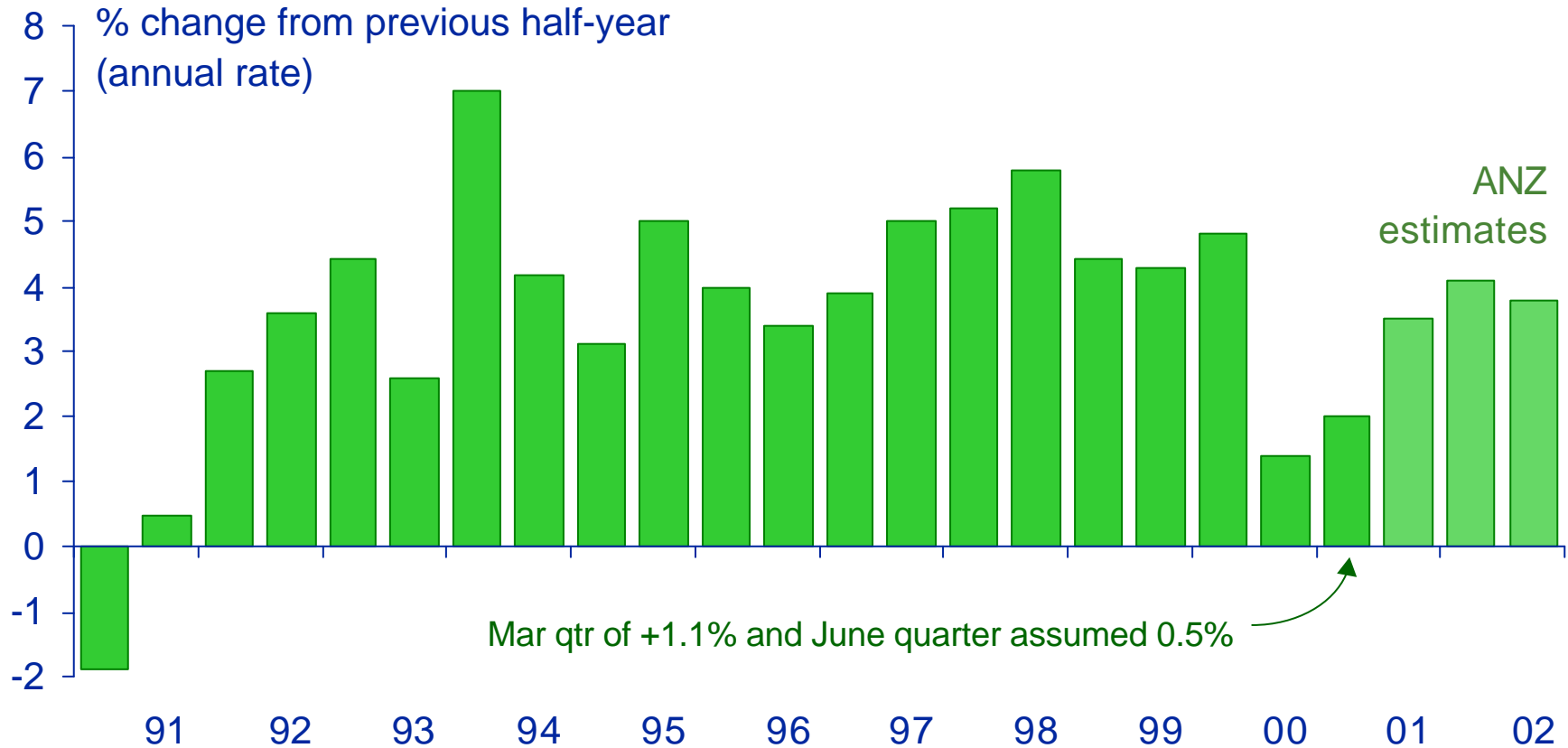
## Euro area



Sources: National and other statistical agencies; Economics@ANZ.

# The Australian economy slowed sharply last year but should pick up over the next 18 months

## Australian real gross domestic product (GDP)



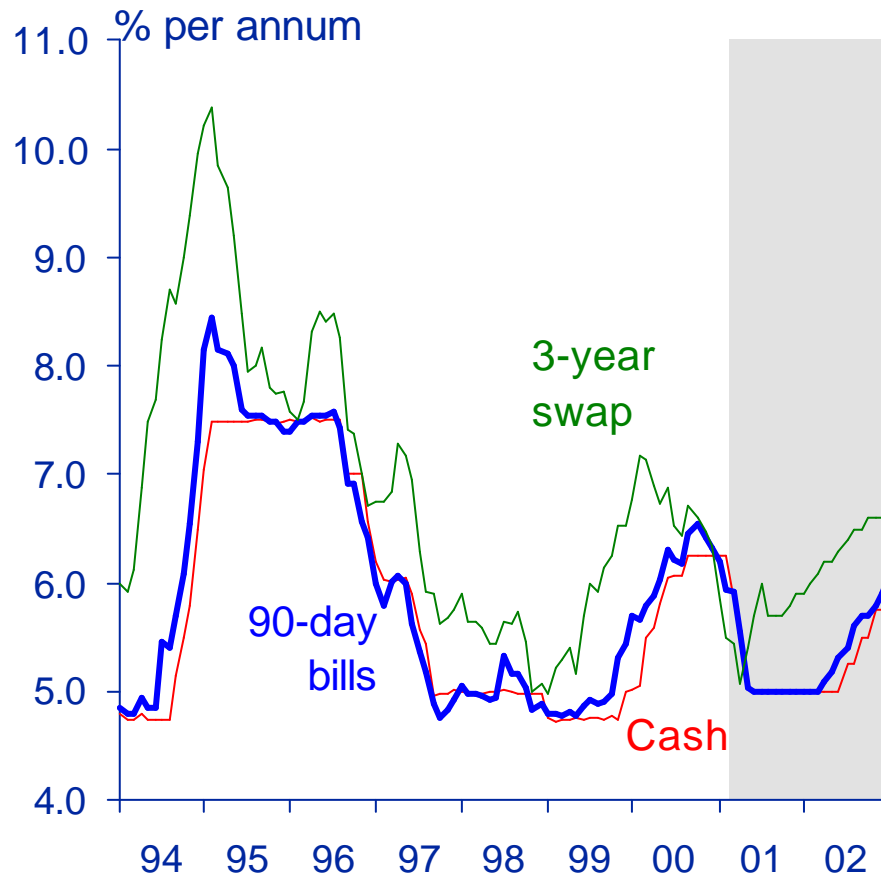
Source: ABS; Economics@ANZ.

# Why will the Australian economy pick up while the rest of the world is slowing down?

- **Because the factors causing the slowdown in our major trading partners are not present in Australia**
  - no technology sector (short-term benefit, long-term problem)
  - no decline in share or property prices
  - no major economic imbalances to be corrected
- **Because the weak A\$ will moderate the impact on Australia of slower growth in our trading partners**
  - similarly to the Asian crisis but in contrast to earlier global slowdowns when the A\$ was over-valued
- **Because the factors which slowed the Australian economy over the past twelve months are now fading**
  - in particular, the transitional effects of the new tax system
- **And because domestic policy settings are stimulative**
  - interest rates have fallen to within  $\frac{1}{4}$  pc point of 30-year lows
  - fiscal (budgetary) policy is highly expansionary

# Australian interest rates have probably bottomed, and are likely to be rising again next year

## Australian interest rates

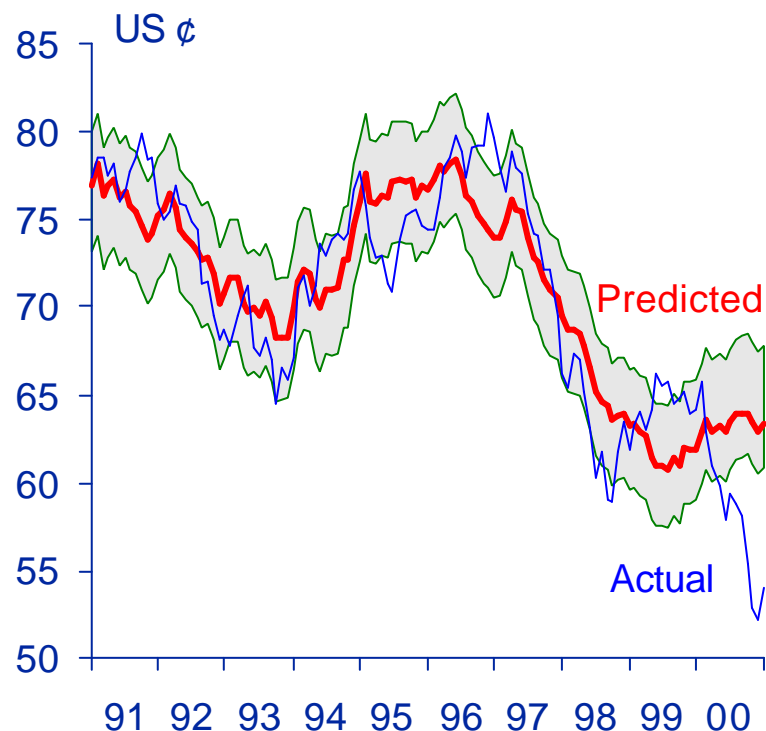


- The Federal Reserve will probably cut US rates again
- But the Reserve Bank hasn't 'followed' the last three US rate cuts, and it probably won't follow the next one
- Only if the world outlook deteriorates a lot further will the Reserve Bank cut Australian rates again
- The markets are now pricing a 1¼ pc pt rise in interest rates, beginning late this year
- They're wrong - rates will rise next year, but less and later

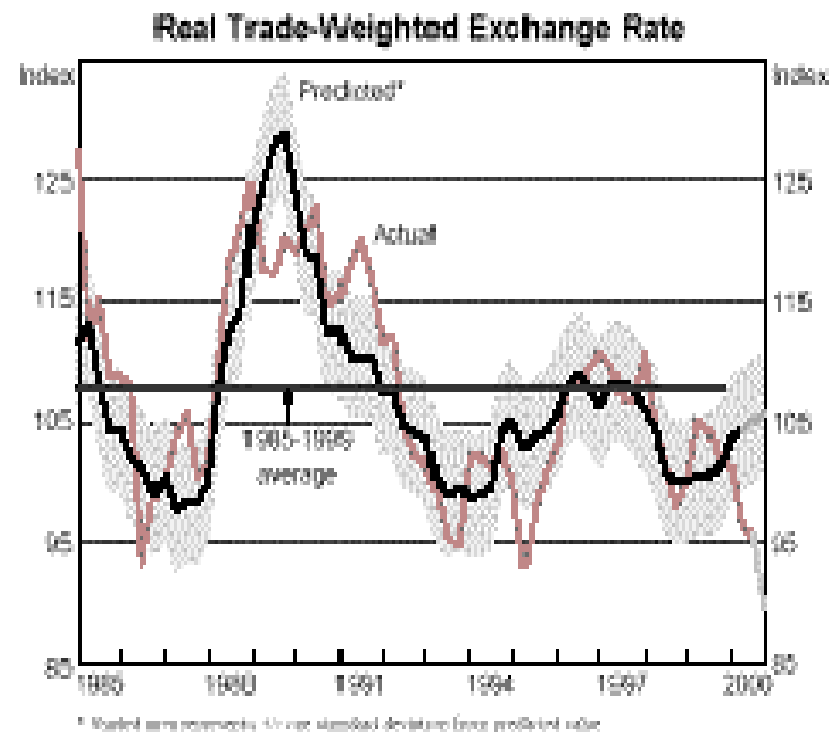
Sources: Reserve Bank; Datastream; Reuters; Economics@ANZ.

# All currency forecasters have found it very difficult to get the A\$ 'right' since 1999

## ANZ's model



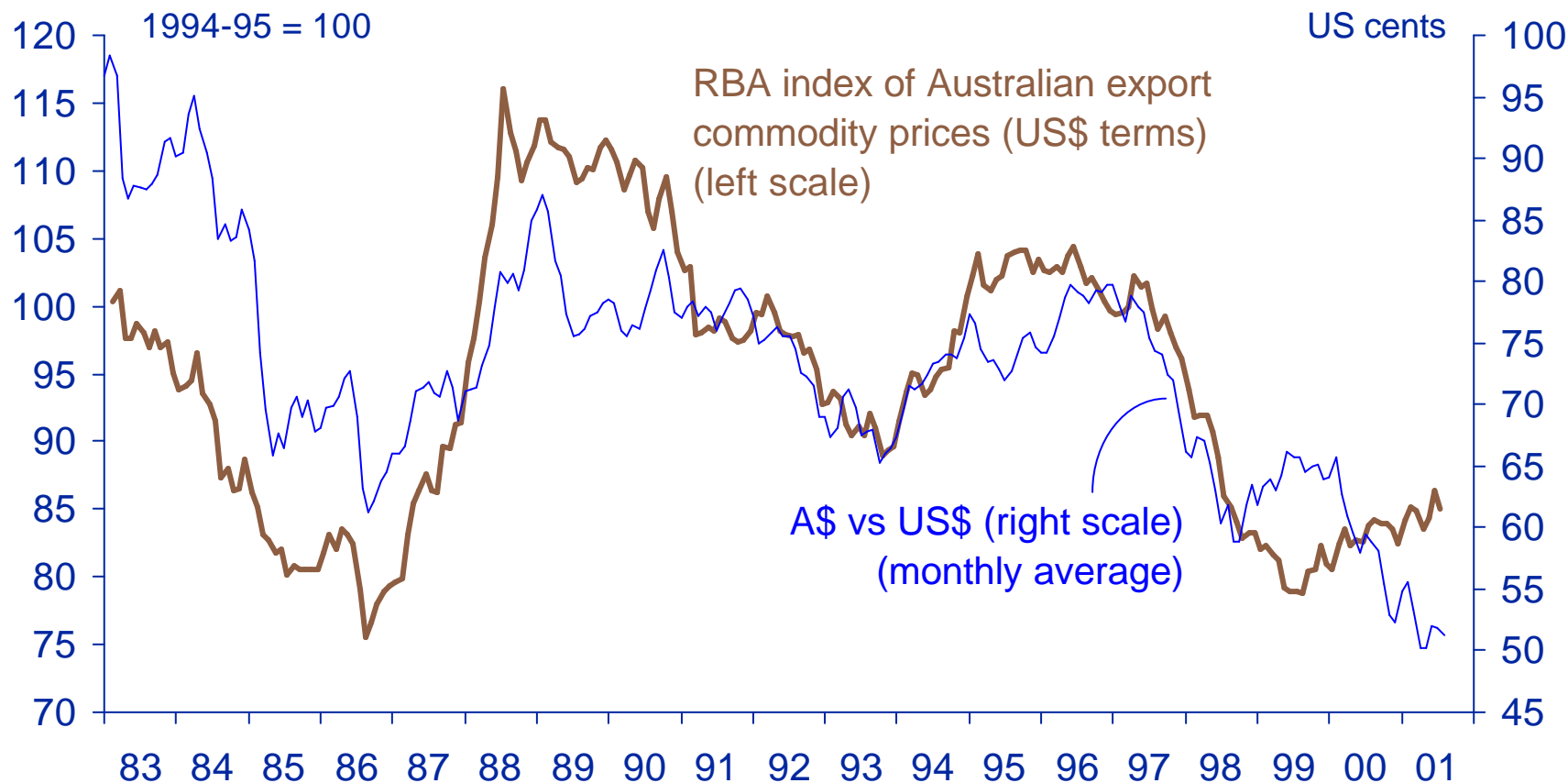
## The RBA's model



Sources: Economics@ANZ; IJ Macfarlane, *Recent Influences on the Exchange Rate*, Talk to CEDA Annual General Meeting, Melbourne, 9 November 2000.

# The long-standing link between commodity prices and the A\$ has broken down

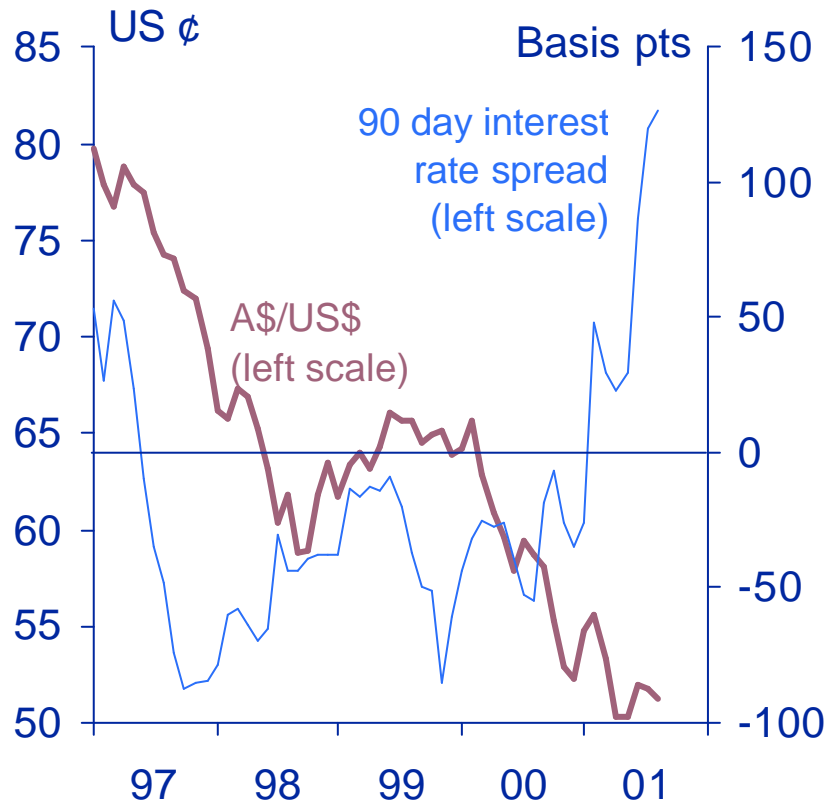
## Commodity prices and the A\$



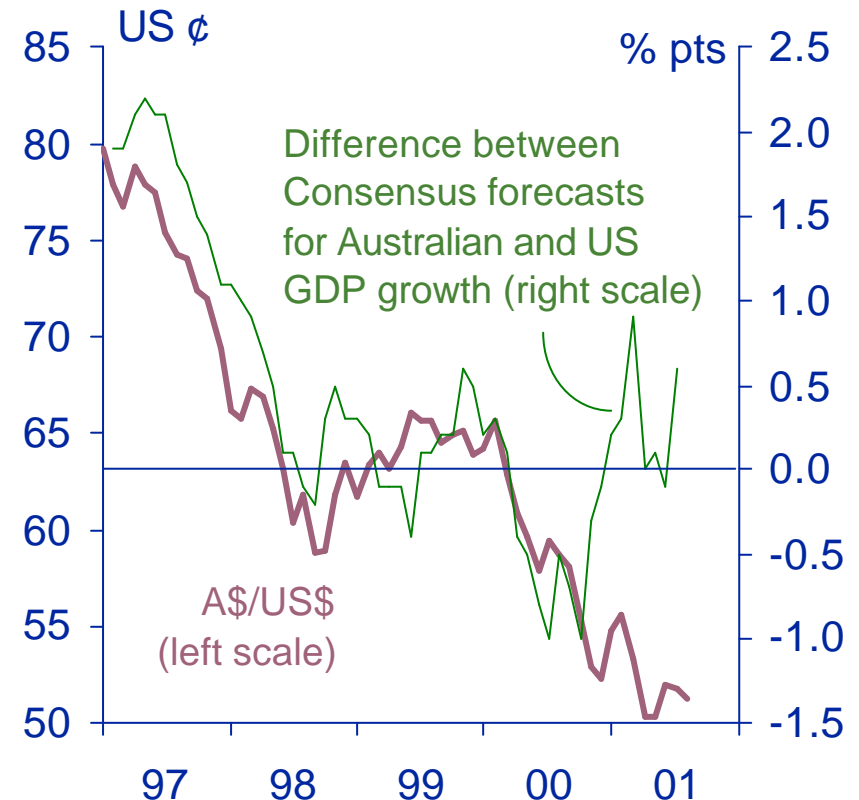
Sources: Reserve Bank of Australia; Datastream.

# Neither interest rate nor growth rate differentials provide much explanation for A\$ movements

## A\$ vs US\$ and 90-day interest rate differentials



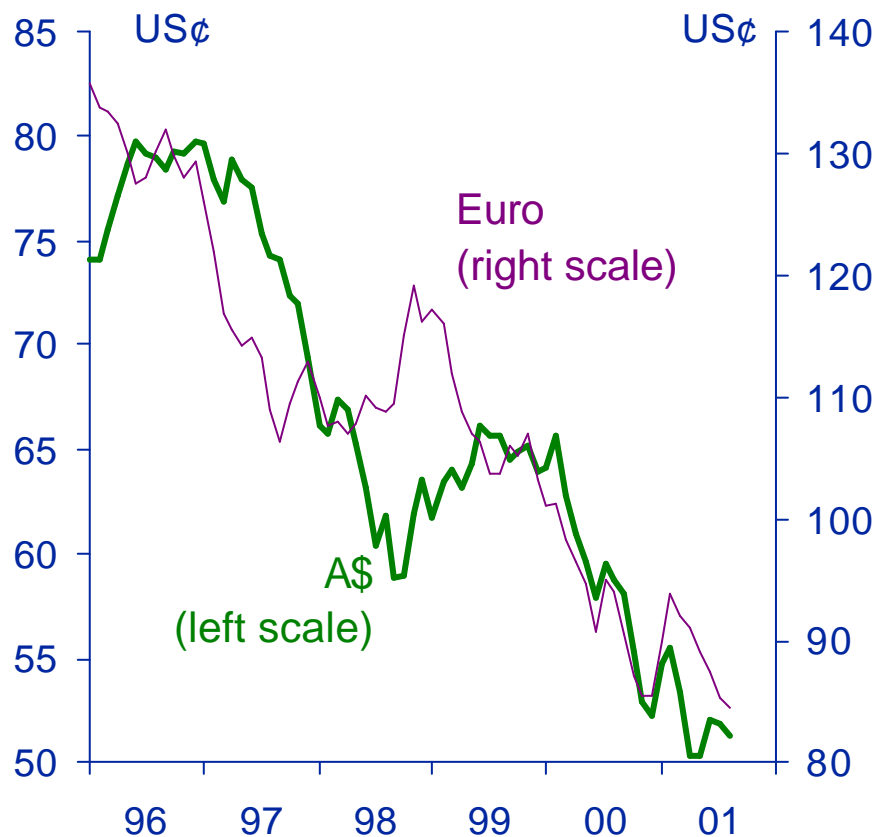
## A\$ vs US\$ and expected growth rate differentials



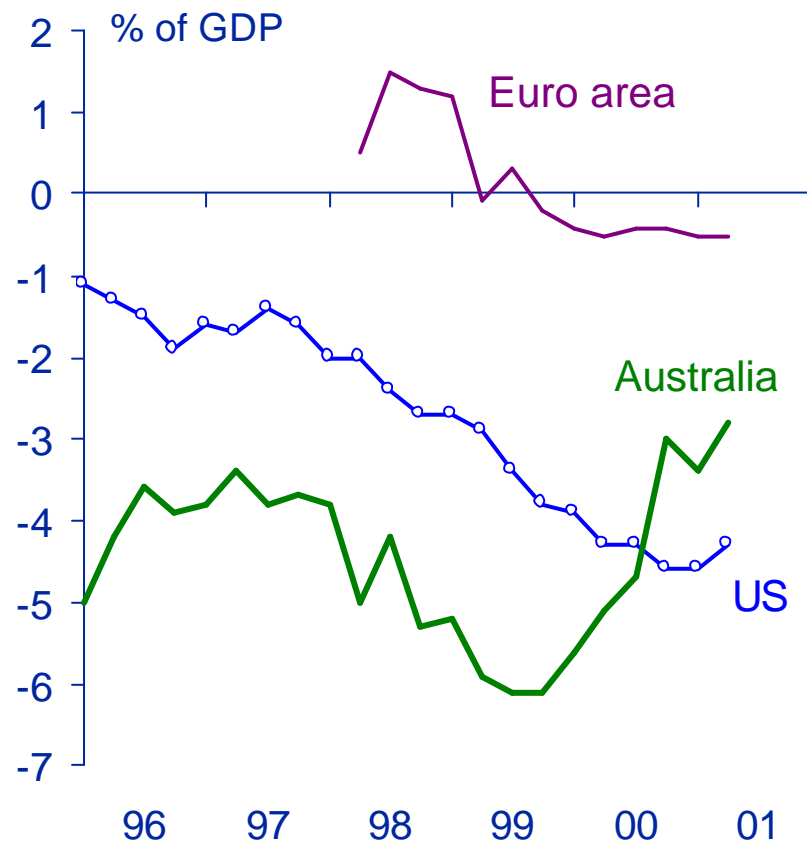
*Note:* Consensus forecasts are for current year up to September each year and for following year thereafter.  
*Sources:* Consensus Economics Inc., Datastream, Economics@ANZ.

# A\$ and Euro have been weak against the US\$ even though the US has a much bigger deficit

## A\$ and euro vs US\$



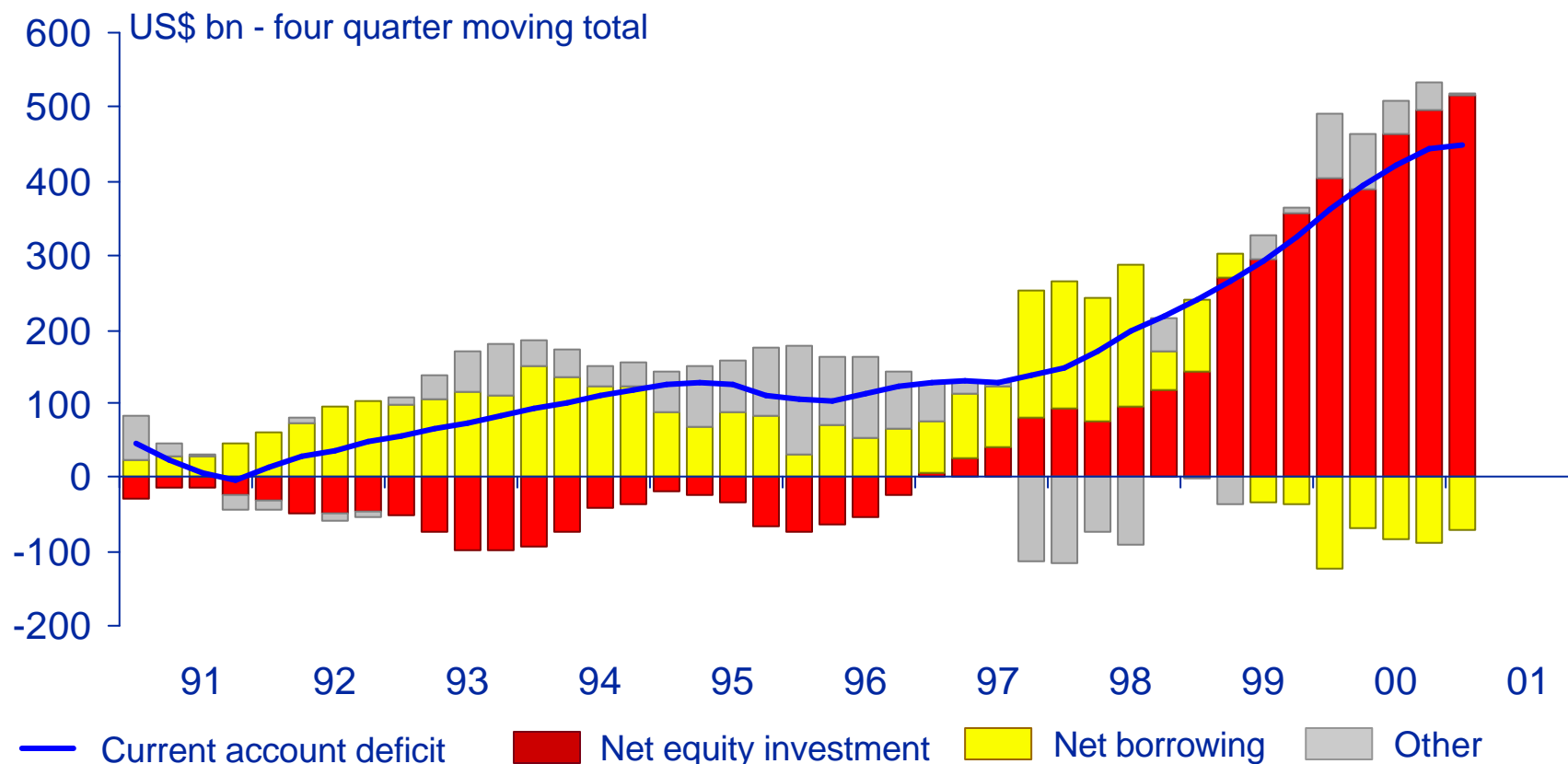
## Current account balances



Sources: Datastream; Eurostat; US Commerce Department; ABS.

# The US\$ has been strong because the US deficit has been financed by equity capital inflows

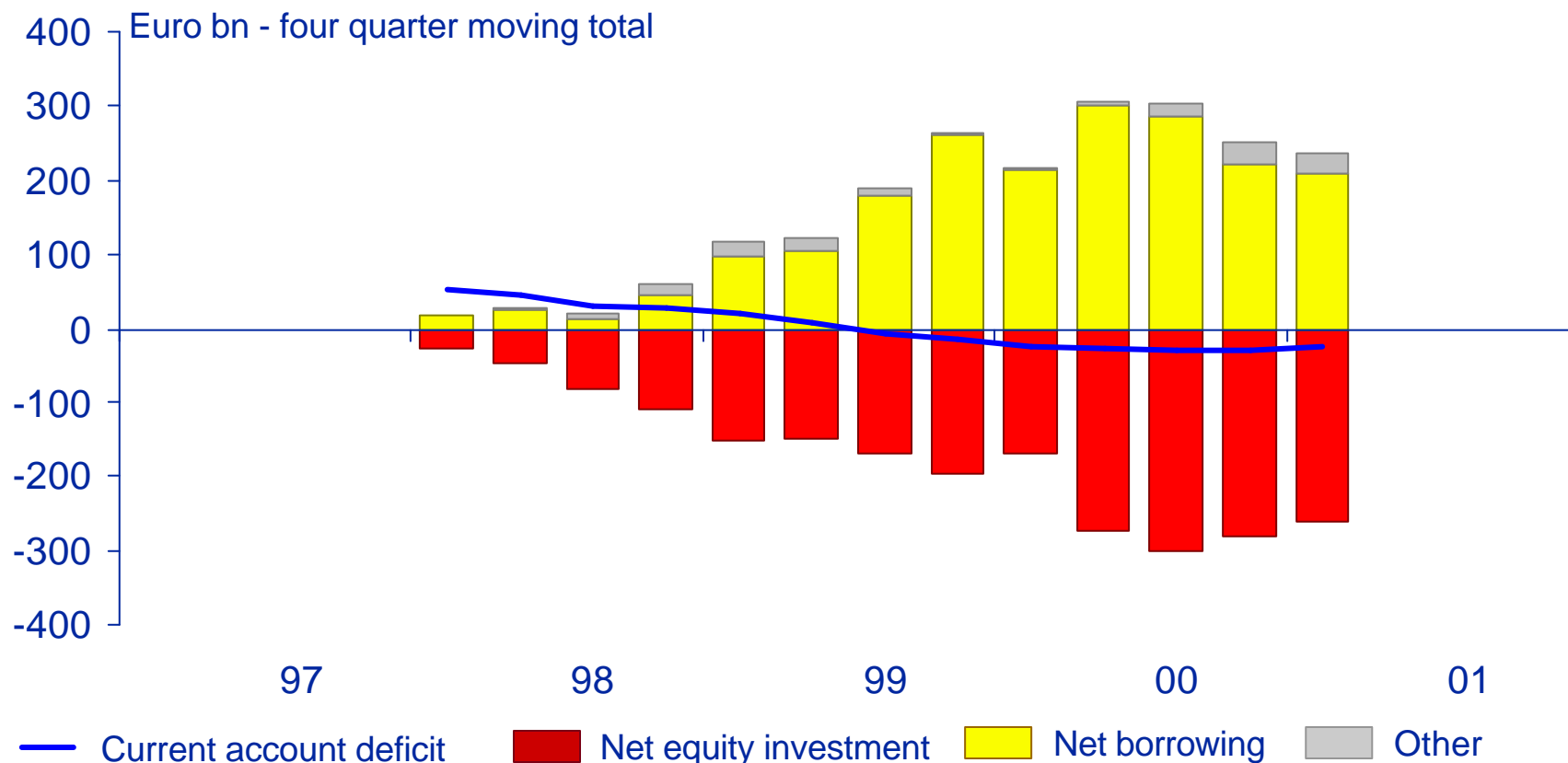
## US current account deficit and its financing in the 1990s



*Note:* 'Net equity' comprises net foreign direct investment plus net foreign purchases of non-US government securities (ie includes corporate bonds). 'Other' includes changes in US and foreign official holdings and balancing item. *Source:* US Commerce Department; Economics@ANZ

# Conversely, equity capital outflows have weighed heavily on the euro

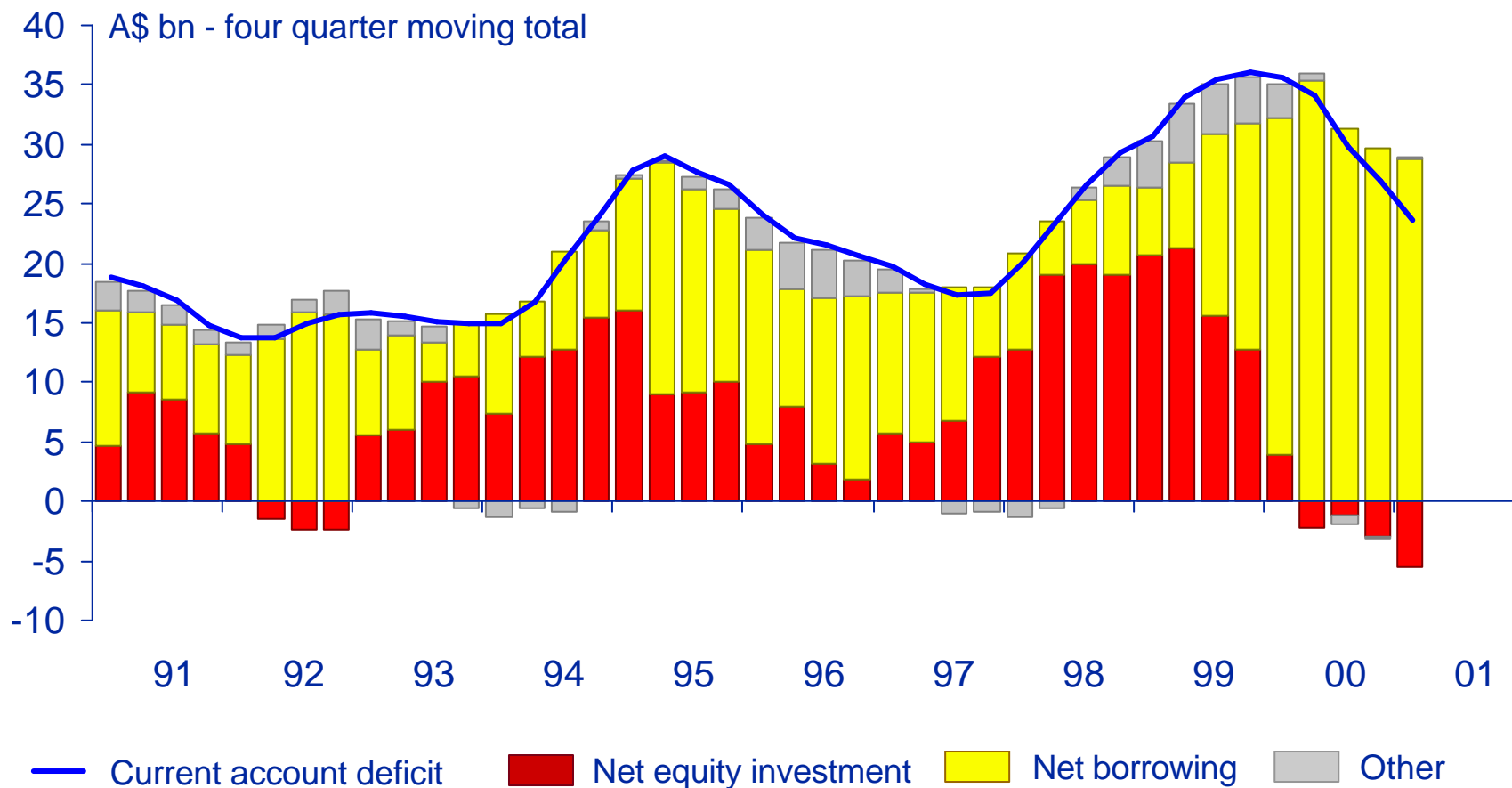
## Euro area current account and its financing



*Note:* 'Net equity' comprises net foreign direct investment plus net portfolio equity investment.  
*Source:* Eurostat; Economics@ANZ.

# The weakness in the A\$ reflects the fact that Australia has become an equity capital exporter

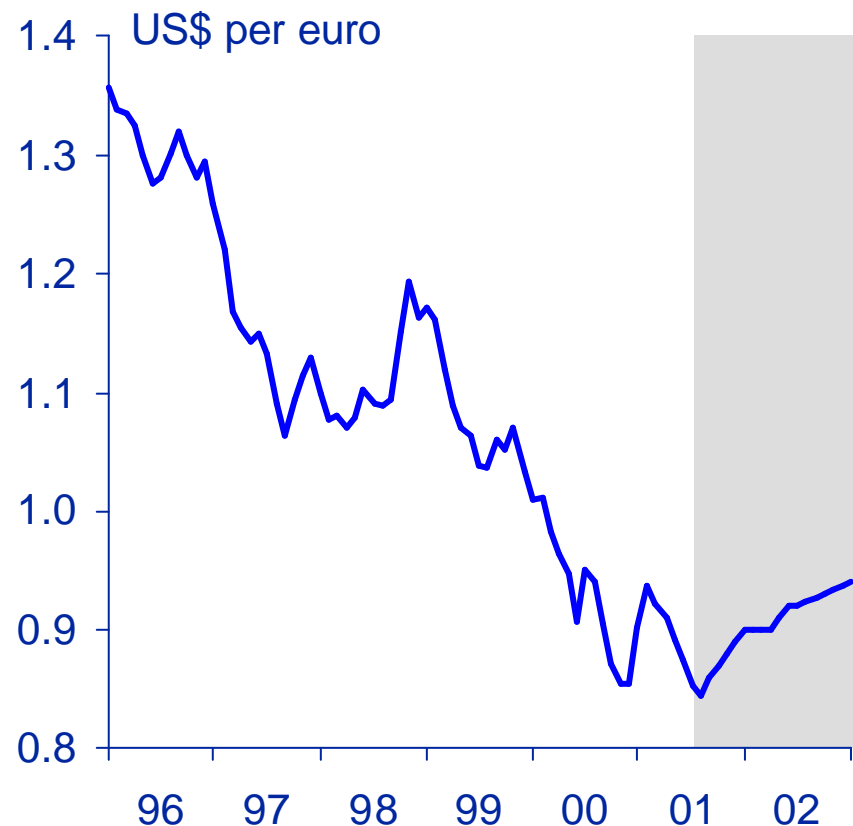
## Australian current account deficit and its financing



Source: ABS; Economics@ANZ

# If and when the US\$ 'bubble' bursts, the euro will recover some of its lost ground

## Euro vs US\$

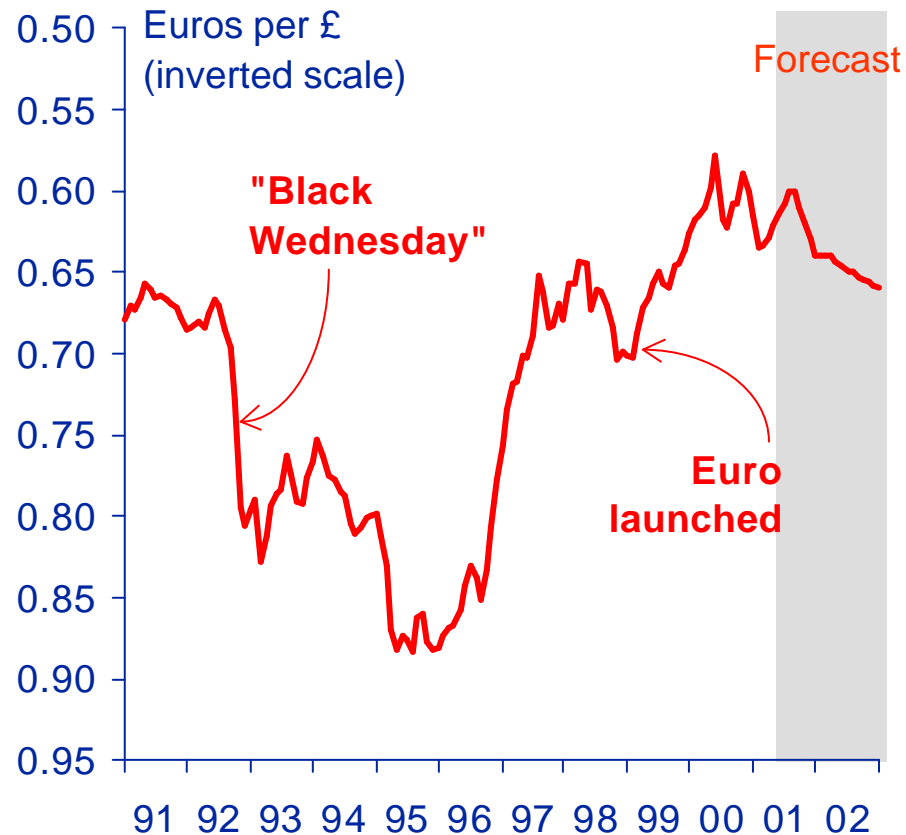


Sources: Datastream; Economics@ANZ.

- The US\$ is strong and the euro is weak largely because of the huge volume of equity capital flows across the Atlantic
- If and when these abate, the euro will reverse some of the past two years' decline against the US\$
- In the meantime, the euro will become a 'real' currency on 1 January 2002, as euros replace deutschmarks, French francs, liras, pesetas etc.
- Transaction costs for exporters to the euro area will be reduced
- Pricing structures will be much more transparent across the euro area

# Britain is unlikely to join the euro any time soon - and certainly not at the current exchange rate

## £ vs euro

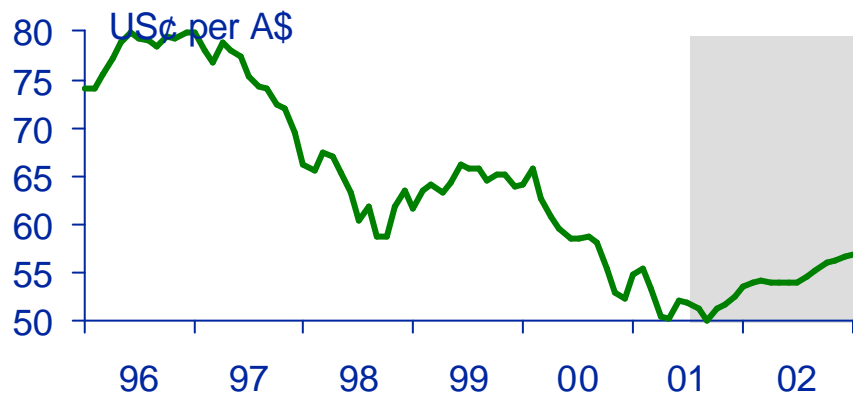


- Treasury will report by mid-2003 on whether the government's "5 tests" for euro membership have been satisfied
- The government will probably need to make an 'in principle' decision before then if it is to call a referendum during its current term
- At the moment, a referendum on euro membership would be decisively defeated
- The pound would need to fall by at least 10% before euro entry in order to be sustainable - managing this transition will be a major challenge

Sources: Datastream; Economics@ANZ.

# The A\$ should recover some ground vs the US\$ and £ but remain well below long-run averages

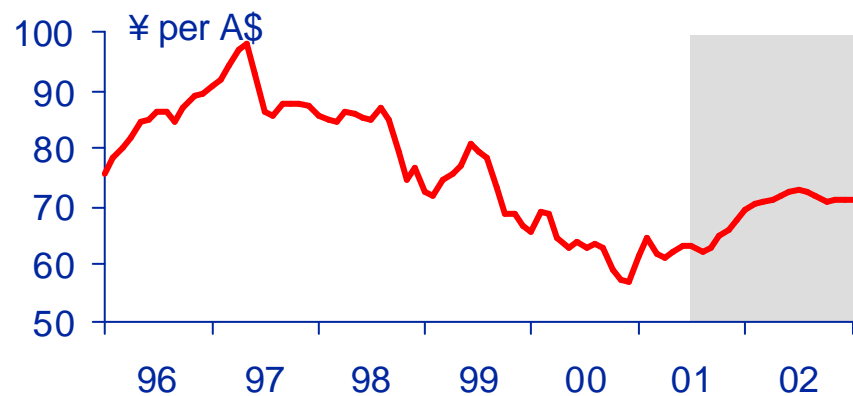
## A\$ vs US\$



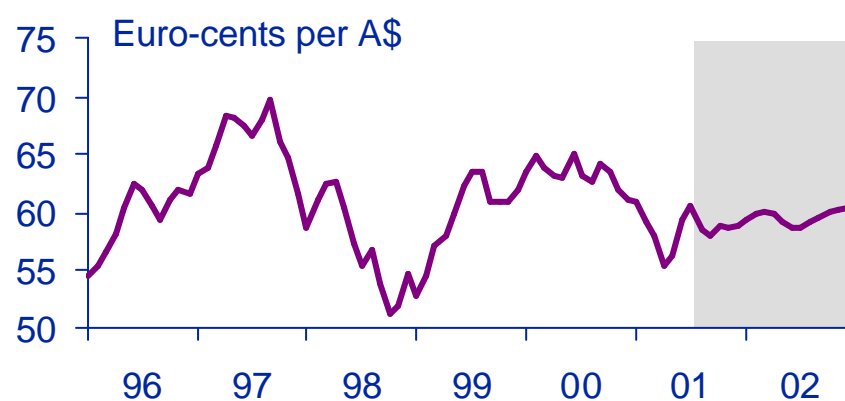
## A\$ vs £



## A\$ vs yen



## A\$ vs euro



Sources: Datastream; Economics@ANZ.

# Is a weak Australian dollar a 'good thing' ?

- Farmers, miners and other exporters - and Australian firms competing against imports - would say 'yes'
- Without doubt a weak A\$ is a very helpful 'cushion' against the current downturn in the economies of our major trading partners
  - as it was in the Asian crisis
  - but in contrast to our experience during other global downturns (1974-75, 1982-83, 1989-90)
- But is it a 'good thing' in other respects?
  - technology and knowledge become more expensive
  - it's more expensive for Australian businesses to establish themselves in foreign markets, undertake marketing campaigns etc.
  - Australian businesses are more vulnerable to foreign take-overs (conversely it's harder for Australian firms to take over foreign ones)
  - the 'gap' between the earnings and wealth of people who are 'internationally mobile' and those who aren't widens - ie, inequalities in income and wealth distribution are made worse
- Even for the Australian wine industry, therefore, an undervalued A\$ is a mixed blessing