

Australian Economic Outlook

A Near and Medium Term Perspective

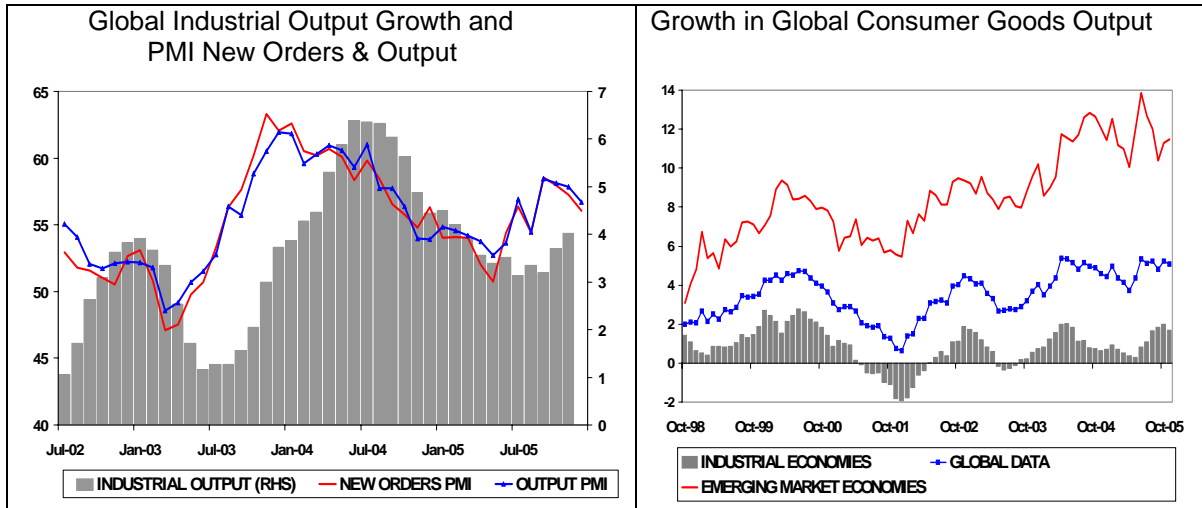
Alan Oster
Group Chief Economist
National Australia Bank Ltd

ABARE Outlook Conference
28 February 2006

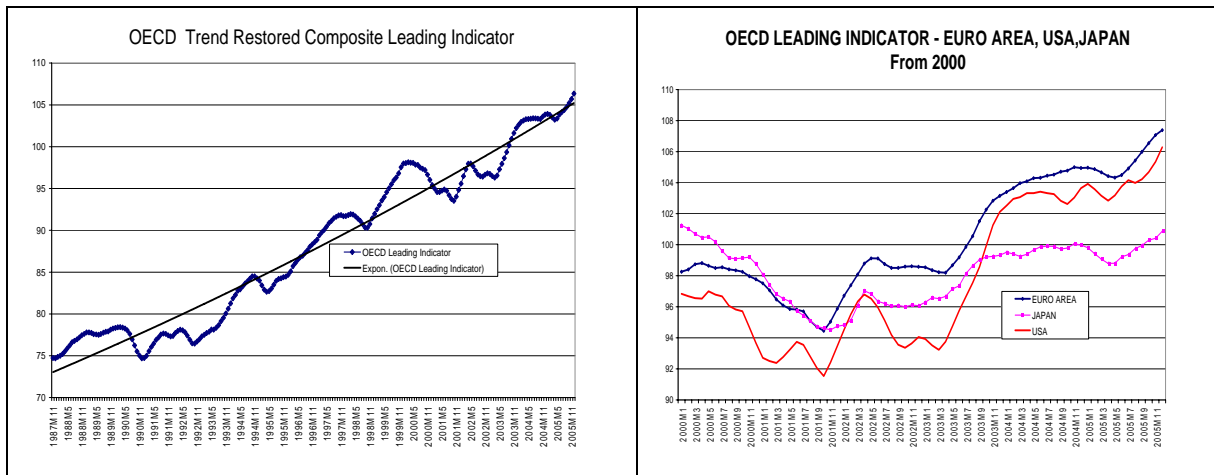
The International Context

Any assessment of Australia's short or medium term prospects is clearly very dependent on the global context. In this section I have attempted to briefly summarise our views on what might be expected globally over the next few years.

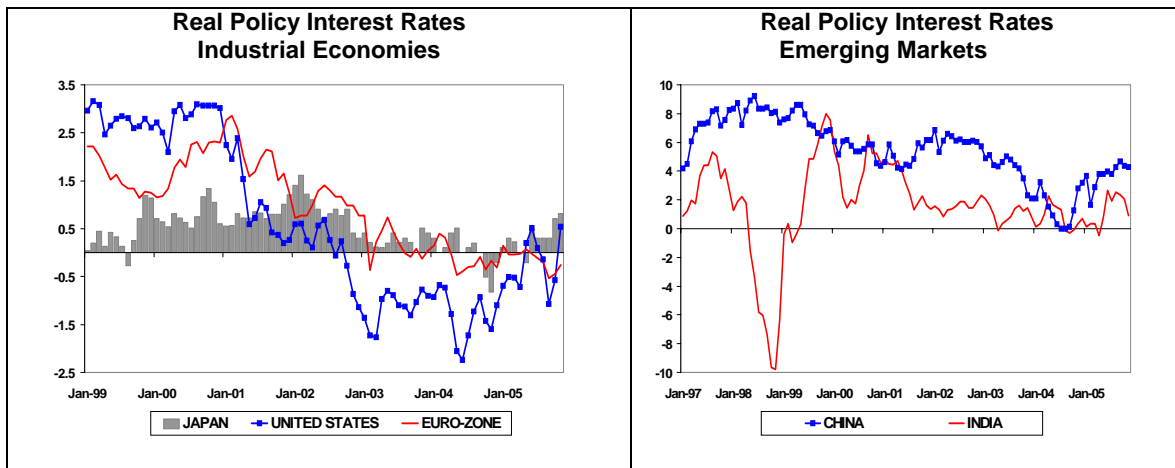
Over the last 6 months or so there is increasing evidence that after slowing from the very rapid rates of 2003/04 global industrial production has stabilised at reasonable levels and indeed appears to have started to reaccelerate. Service sector activity, on the other hand has remained at very strong rates underpinned by continuing strong growth in China and India in particular but also from robust consumer spending in the USA – very much driven by still less than neutral policy settings and the wealth effects of still strong increases in house prices.



Further evidence for an improving near term outlook can be found in the OECD's composite leading indicator series as shown below (for the OECD from the mid/late 1980s and from 2000 for the USA, Japan and Europe).



Given the reasonable growth momentum currently being experienced and the continuation of an environment of still relatively low real interest rates (see chart below), the near term policy challenge for Central Banks globally has been geared to preventing higher oil prices from feeding into core inflation and especially wage negotiations. The good news to date is that there is little evidence in the global core inflation data to suggest the recent oil price rises have flowed into wage expectations and/or outcomes. That said, Central Banks will remain cautious and pro-active. As a result we expect to see a number of countries tighten monetary policy.

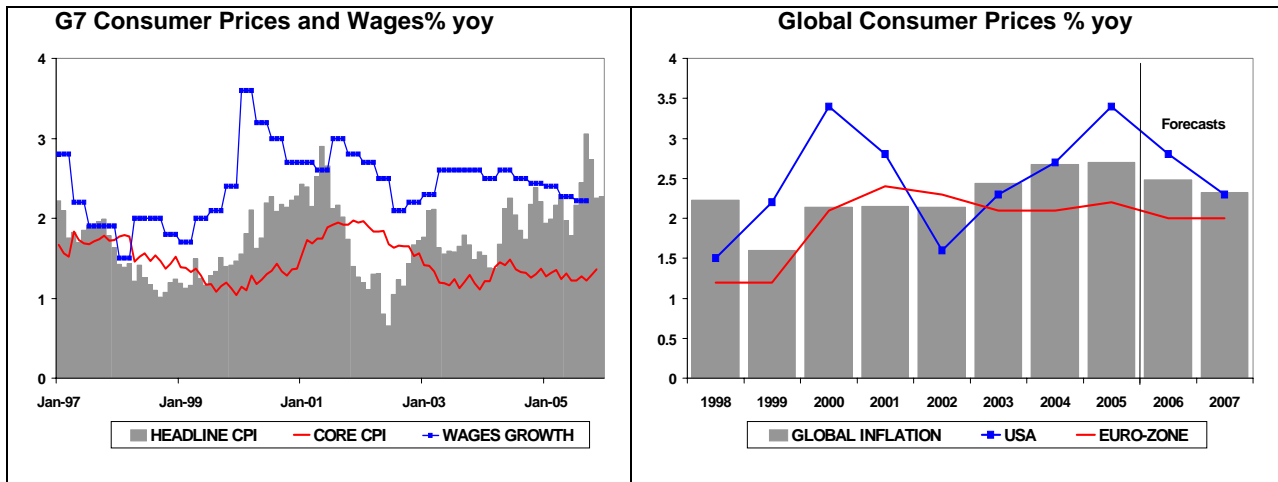


Fundamentally our global forecasts foresee a moderate slow-down from current above trend growth rates (of around 4 ½ per cent). Key themes in our forecasts by major economies relevant to Australia include:

- The outlook for the US economy is one of continuing strong growth. The Q4 GDP estimates in our view very much understated the true momentum and we see strong growth as likely in the first half of 2006 – as the GDP estimates catch up with reality and the reconstruction phase from last years hurricanes kick in. That would see GDP of around 3½ % for 2006. The US Federal Reserve emphasis on getting cash rates back to neutral and not letting the recent spike in oil prices feed into the underlying inflationary process continues. In this environment we now see the Fed Funds rate rising to 5% by May 2006 – with still further potential upside risk, depending on the data flow.
- European growth looks stronger (albeit still sluggish). The ECB believes that faster economic growth will be sustained and that inflation will stay moderate. It is, however, still worried by the risks inherent in rapid housing credit growth and rising house prices in some economies. It also fears that unions could try to boost wages in the face of income losses stemming from higher oil prices. As ECB interest rates are still below neutral and some senior officials have warned of the need to “normalise” them we see another 75 bps in monetary tightening by early 2007 (taking rates to 3%) after which Euro-zone growth slows as German tax rises and earlier rate increases take effect.
- The Japanese outlook is becoming more optimistic with increased confidence of a sustainable improvement getting underway – fed by both rising demand and improved exports. The phase of deflation and credit contraction are also nearing an end. Growth is not expected to boom but something around 2 ½ % now looks sustainable. Hence we see the Bank of Japan gradually lowering its liquidity targets and it will begin nudging interest rates up in late 2006 and into 2007.
- UK economic growth was only 1¾% in 2005 but there is growing evidence that the housing market has stabilised and that consumer spending has been modestly increasing. Inflation is around the 2% target but we expect the Bank of England to cut rates in the first half of 2006 as fiscal policy is tightened. Then we expect growth to gradually move back toward trend with a modest rise in interest rates in 2007.
- There is still little sign of much slowing in Chinese growth or industrial production - nor do we expect much slowing in the next year or so. Following recent upward revisions to GDP we now see growth staying above 9% in 2006. We also do not expect to see any significant movement in their exchange rate regime;
- New Zealand’s economy continues to press up against capacity constraints despite growth slowing in the face of relatively high interest rates and a overly strong currency. Confidence in the outlook has deteriorated recently. However with inflation likely to remain high in the near term we see little prospect of the RBNZ cutting rates soon. That process is more likely to begin in early 2007– albeit weaker than expected activity data could see the process start marginally

earlier.

- Overall global growth looks to be a very respectable 4½ per cent in 2006 and only marginally lower in 2007. While the distribution of global growth looks likely to improve going forward, much is still heavily dependent on the outlook in the US, Indian and Chinese economies. Also our expectation is that Central banks will succeed in isolating their economies from higher oil prices and hence we see some moderation in global core inflation. That in turn underpins our view that in the medium term longer term bond markets may move marginally lower globally

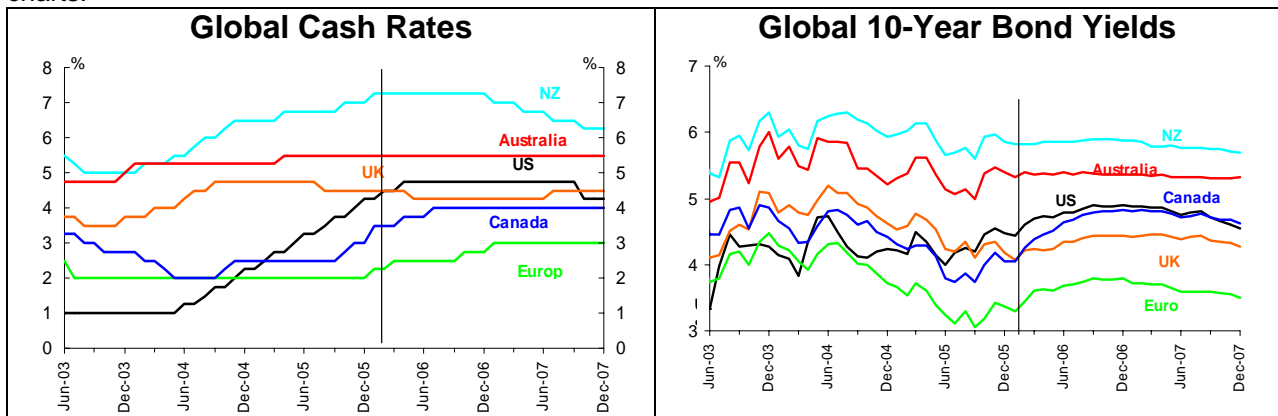


In more detail our global activity forecasts are as follows:

Global GDP Forecasts

December year annual average % change	2000	2001	2002	2003	2004	2005	2006 (f)	2007 (f)
US	3.7	0.8	1.6	2.7	4.2	3.5	3 ½	3
Japan	2.9	0.4	0.2	1.8	2.3	2.8	2½	2¼
UK	4.0	2.2	2.0	2.5	3.2	1.9	2¼	2¾
Euro-zone	4.0	1.9	1.0	0.7	1.8	1.4	2	1¾
Canada	5.2	1.8	3.1	2.0	2.8	3	3	3
Australia	3.2	2.0	4.2	3.6	3.2	2½	2¾	3¼
New Zealand	3.4	3.0	4.8	3.4	4.4	2½	1¾	1½
China	8.4	8.3	9.1	10.0	10.1	10	9¼	8¾
India	5.5	4.5	4.8	7.3	7.3	7½	6¾	6¼
World	4.9	2.5	3.0	3.8	5.0	4½	4½	4¼
Non-Japan Asia	7.9	4.5	6.6	6.6	7.8	6¼	6¾	6½
Latin America	4.0	-0.3	-1.0	2.5	5.6	4	4	3¾

Detailed forecasts for global interest rates are attached at the end of this paper, while our forecasts for official cash and 10 year bonds over a number of key countries are shown in the following charts.



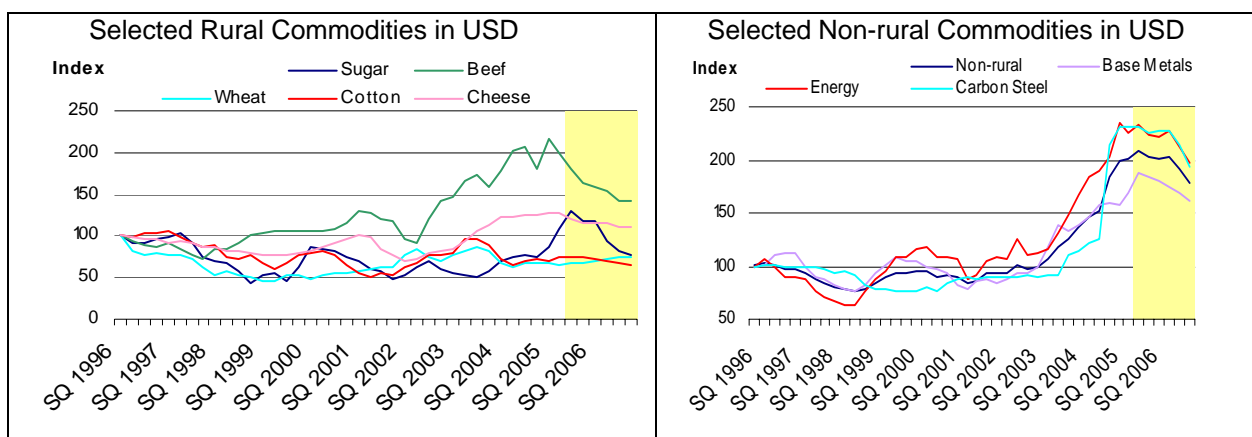
In putting together these forecasts we have made an explicit assumption that oil prices, over the next few years remain around current levels. Explicitly our forecasts are based on a price of \$US63 per barrel in 2006 and \$US57 per barrel in 2007. While our view is that these forecasts are unlikely to be sustained indefinitely (given a likely alternative supply response), to incorporate a significantly lower (or higher) assumed price would by definition also significantly alter our expectations for growth and interest rate projections:

- Our modelling of the US consumer suggests that a sustained \$US10 per barrel increase in oil would reduce real consumption spending by around ½ per cent over a 12 month period. This estimate would vary according to the US monetary authorities reaction
- In Australia (as noted below) the implied elasticity is lower but still significant – at around 0.2 per cent on real consumption spending for each 10c per litre increase in petrol prices.

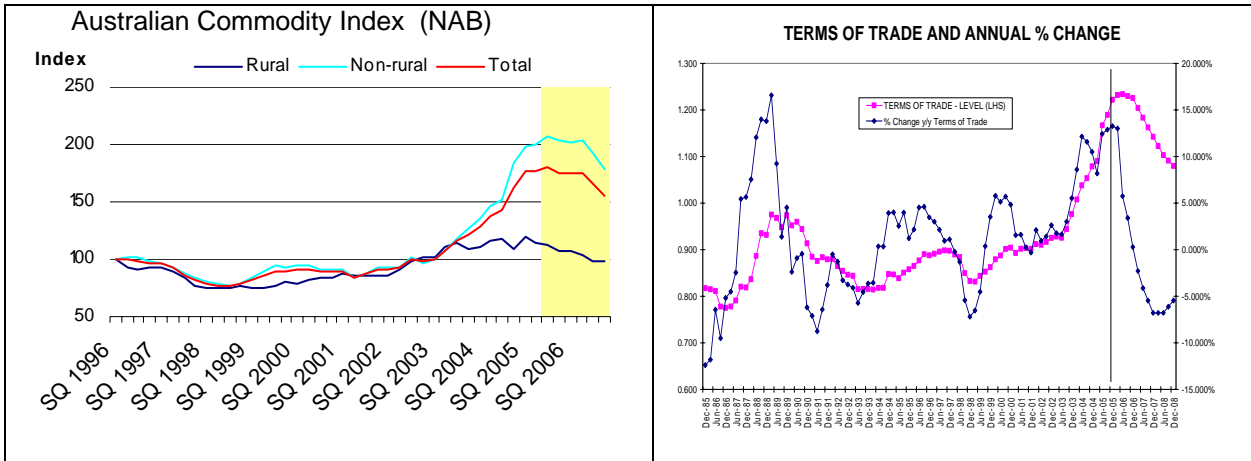
Australian Conditions and Outlook

From an Australian perspective, the global outlook is moderately encouraging. In the near term, at least, growth rates in our major trading partners are likely to remain robust – thereby underpinning a good level of demand for our exports. Importantly, we do not see much prospect of Chinese growth sharply slowing. Against that we do not see much further scope for upward movement in commodity prices. That reflects both a moderately lower overall growth path and limited potential for our customers (particularly in the non-rural area) to sustain further rapid price rises in the face of a globally subdued inflation outlook. For example, there is already growing evidence of a kick-up in loss making enterprises in China.

In general terms, we are not much different from ABARE as to our expectations for commodity prices over the next four years. Overall we expect commodity prices in US Dollar terms to fall slightly in 2006 (around 1 percent), with larger declines in rural commodities (around 10 percent) expected in 2006/07 with largely unchanged (up 1½ percent) non-rural commodities. The following chart highlights our expectations for some of the key commodities.

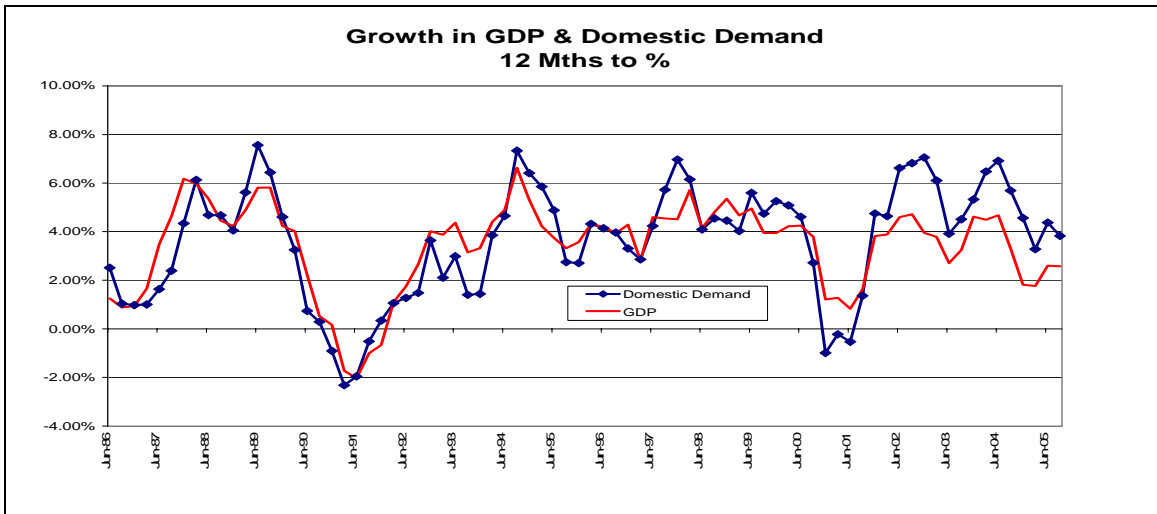


That would see a flattening out in our terms of trade in 2006 and a moderate falls in 2007 and 2008.

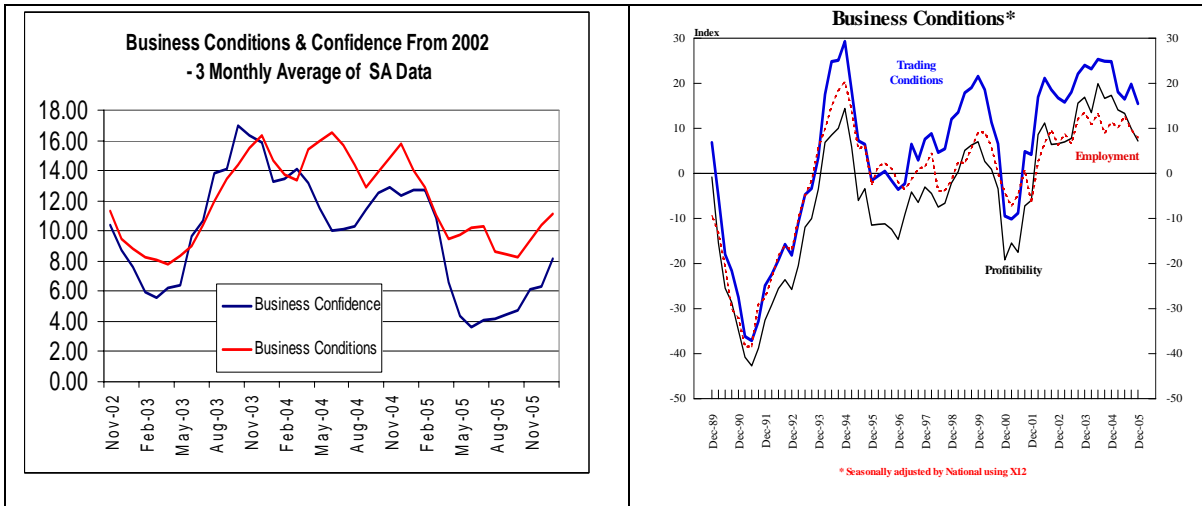


Before turning to the implications of this for export growth and the current account, we turn now to the key developments in the Australian economy and the near term prospects.

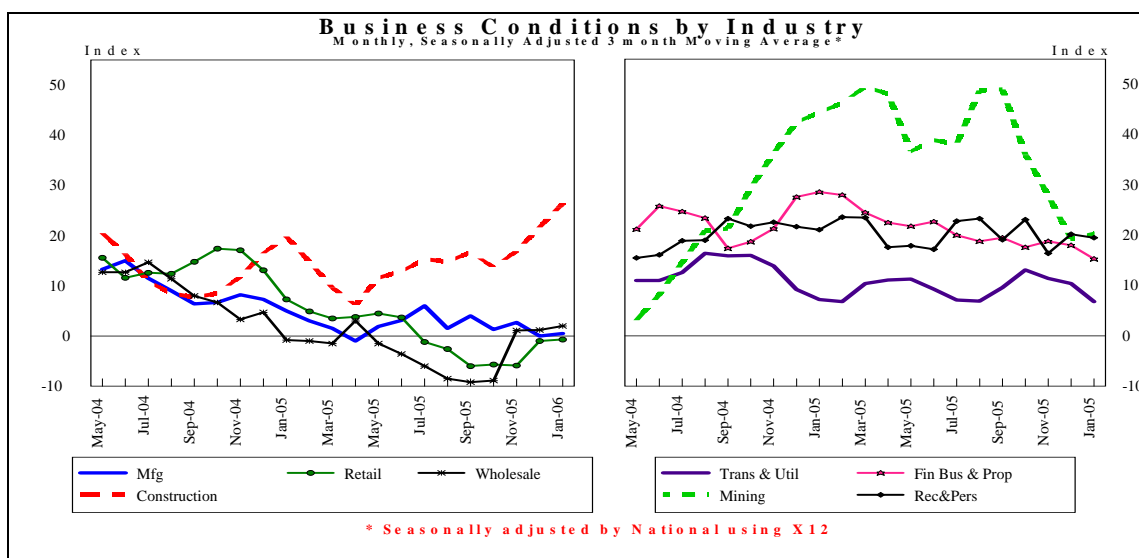
Despite the very positive income gains produced by a substantial positive terms of trade shock, the Australian economy, over the past year or so, has slowed and growth has now flattened out at around 2½ percent. The extent of the slowing has been controversial and in part has reflected the very strong growth in imports. That said domestic demand has also slowed from very rapid growth rates to be a touch below 4 percent in the year to September 2005.



Using more up to date data from our NAB Business Survey, the overall impression is that business conditions (our proxy for domestic demand) have edged down further but still remain at reasonable levels. Interestingly by mid 2005 business was concerned that activity may fall further and hence confidence fall more aggressively. Towards the end of 2005 some improvement in conditions and new orders saw confidence recover somewhat, and it could be that growth in demand is bottoming out (see chart below LHS). Having said that, the weaker levels of confidence has seen some moving back in employment intentions (see chart below RHS).



The slowing in domestic demand experienced recently has very much been driven by a weakening in consumer spending while still strong profits – particularly in mining and infrastructure – have seen very strong levels of business investment and credit demand. Hence the Australian economy is characterised at present by very different performance by industry and by geographic region. This was further highlighted by the findings of the NAB’s January 2006 Business Survey which still shows strong business conditions in mining and non-residential (infrastructure) construction, with broadly unchanged conditions in most service sectors (business services and personal & recreational services). Transport is reasonable, but clearly weakening, while weak readings continue in retail, wholesale, and manufacturing. That industry split also underpins Western Australia as the fastest growing state while NSW continues as the weakest.



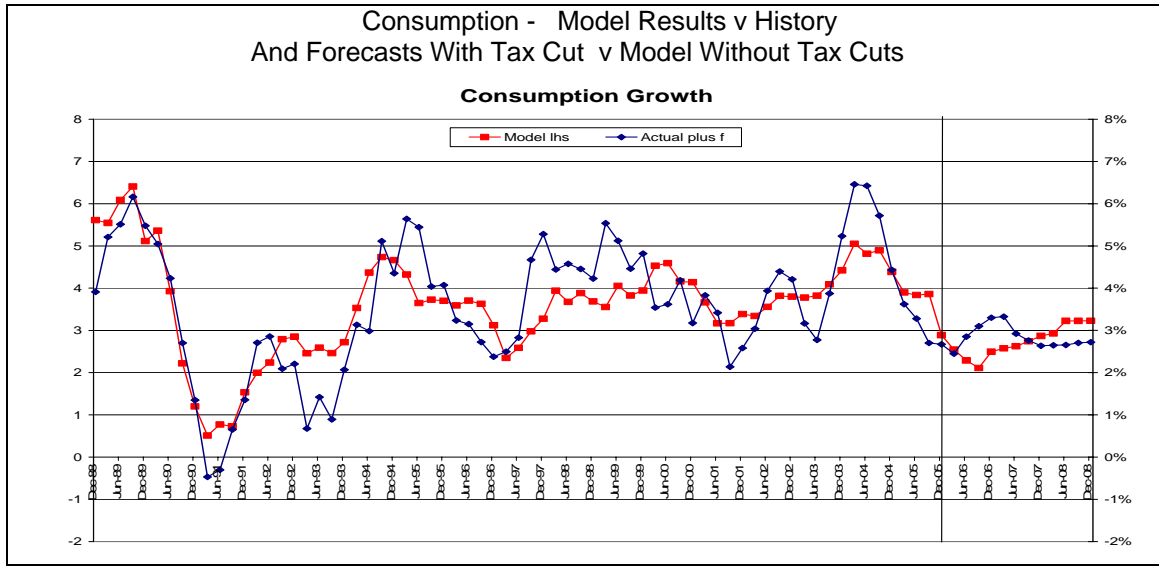
Looking forward the key driver of growth is very much expected to be the business sector with the consumer continuing to be subdued.

Our research suggests that a good deal of the recent cycle in consumer spending has been driven from the wealth effects of house prices.¹ In particular that work suggests that consumers are prepared to be cash poor during times of fast growth. With house price growth expected to be limited for some time the lagged impact of slower growth in wealth would see consumption continue to slow till mid 2006.

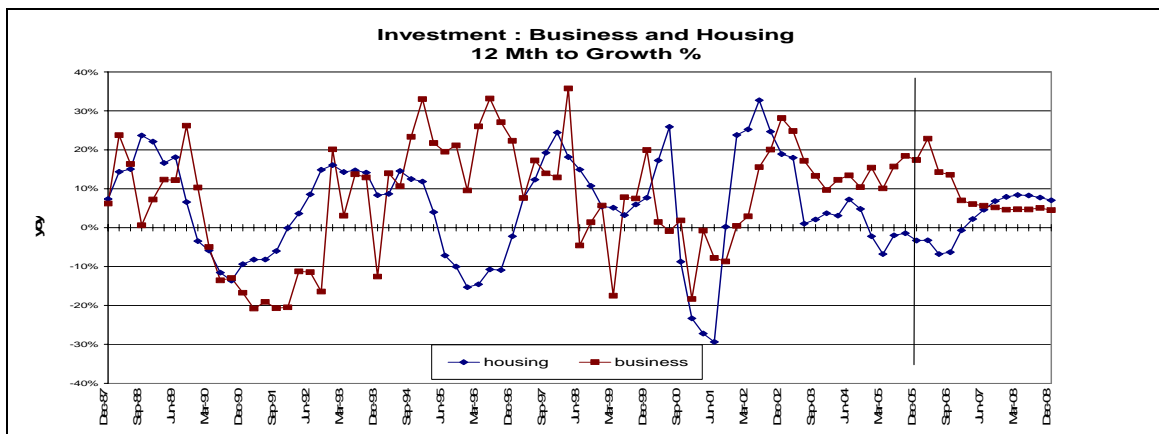
¹ For more details refer “House Prices – Drivers and Links to the Broader Economy: Rational or Irrational Exuberance”. Alan Oster, Shann Memorial Lecture 2005.

- In brief long run elasticities to consumer out of real disposable income were around 0.87, housing 0.11 and equity prices 0.01;
- Short run elasticities also included petrol at around - 0.20;
- Interest rates enter the consumption process mainly via their impact on house prices with high long run elasticity on real rates of around - 0.11 (with the other key variables being population growth and incomes).

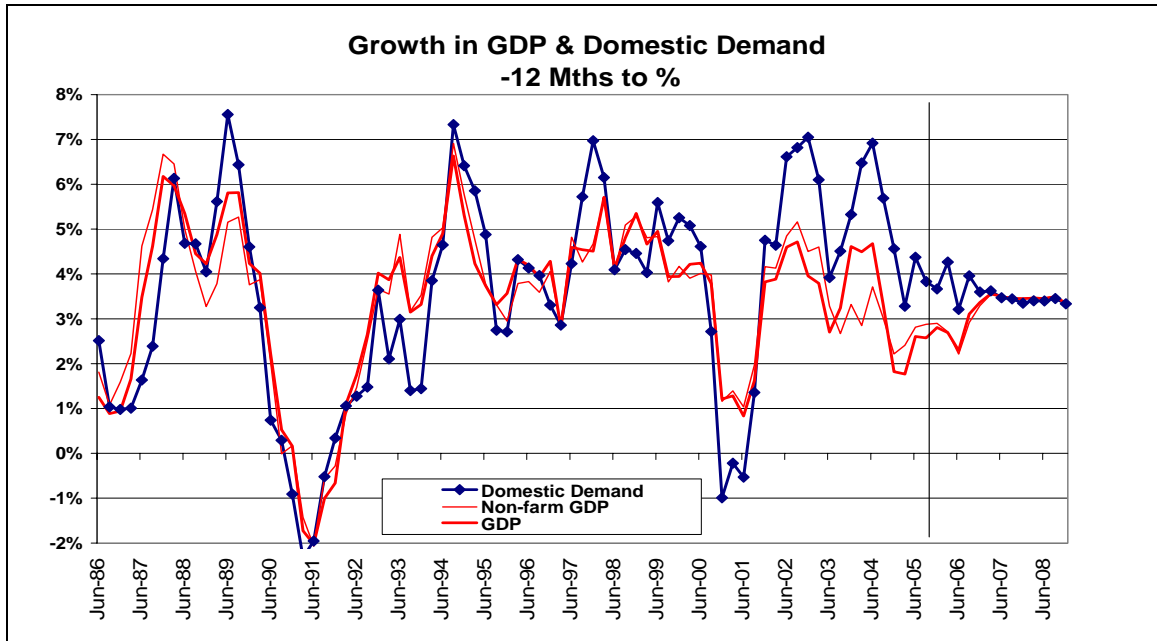
That said, given the strength in profitability from terms of trade effects, we are expecting an \$8b dollar tax cut in the upcoming budget. As can be seen from the next chart, this is expected to add around ½ percent to consumption growth in 2006/07 and underpin consumption spending at around 3 per cent in 2007.



Elsewhere in the economy, with relatively moderate overhangs in dwelling construction we are forecasting a relatively flat outcome in 2006 and a return to moderate growth. In brief, we see a very soft landing by historical standards. Against that business investment appears near the top of the cycle – currently up around 20 percent in underlying terms. While mining is clearly in boom conditions, the current momentum in business investment is not expected to be maintained. Business investment overall however could still average above 10 percent real growth over this financial year before slowing to growth rates closer to 5-7 per cent during 2007 and 2008.



With public spending expected to continue at around the 2-3 percent in the forecast period, and a relatively neutral stock cycle, this all suggests that domestic demand could still slow to around 3¼ percent in mid 2006 before moving higher to around 3½ percent over the forecast period.

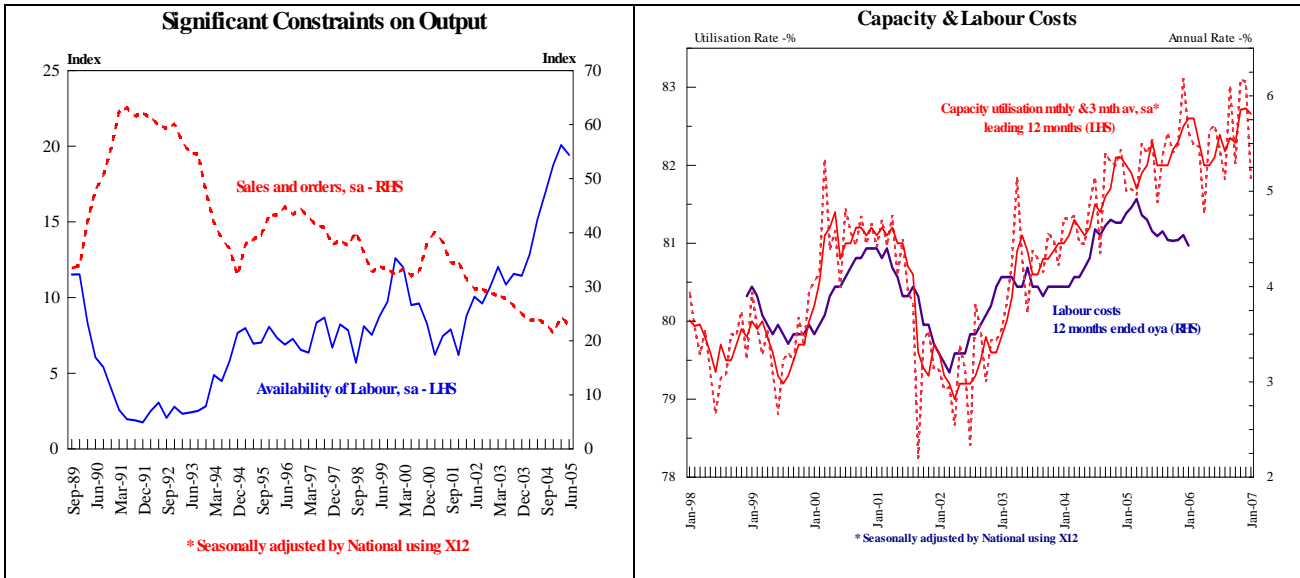


Exports are expected to begin to strengthen in the second half of 2006. At present there is little capacity to add to the pace of mineral exports and the currency (together with competitiveness issues associated with China) are hindering our manufactured exports. A lower currency and the benefits of more investment in mining will clearly help in the long run but that will probably not be apparent in the data till 2007 (when real exports are forecast to improve by 7 per cent). Imports, on the other hand, are expected to moderate somewhat in the face of more moderate domestic demand. Thus as shown in the above charts, GDP in 2006 is expected to grow by around 2½ percent – before rising to an ongoing rate of around 3½ percent in 2007.

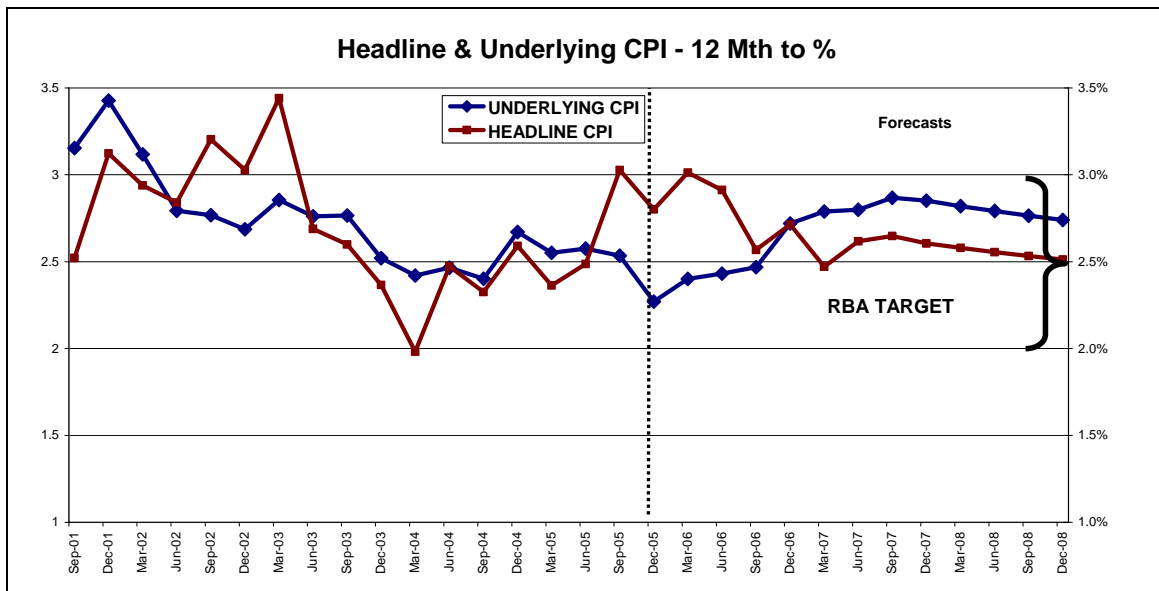
While net exports in this scenario add to GDP over the forecasting period, the current account deficit does not improve much – with flattening price effects significantly offsetting increased volumes. Thus by mid 2007, on these forecasts the current account deficit is still around 5 percent of GDP.

Further it is worth noting that while the relationship between employment and GDP has been less stable than many would expect, these sort of growth and demand outcomes would see employment growth below 2 percent and hence imply some moderate edging up in the unemployment outlook (peaking around 5¾ percent in late 2007).

With the Australian economy now into its 15th year since recession there is no doubt that we are currently operating at high levels of capacity utilisation. Further, employers still report that it is harder now than at any time since the late 1980s to obtain suitable labour (see chart below, which is based on responses from the NAB's Quarterly Business Survey). In that environment it is natural for the monetary authorities to be concerned about the potential for an acceleration of wage pressures. Indeed, in the past, higher capacity utilisation has traditionally led, with a lag, to acceleration in wage pressures. However over the past year or so that has not eventuated. As shown in the chart wage pressures appear to be stabilising at annual rates of increase of between 4 – 4½ per cent. That is a radical difference to past economic cycles where mineral booms have typically triggered wage explosions, sharp policy reactions and eventually boom bust cycles. In short, it says that labour markets are much more flexible today.



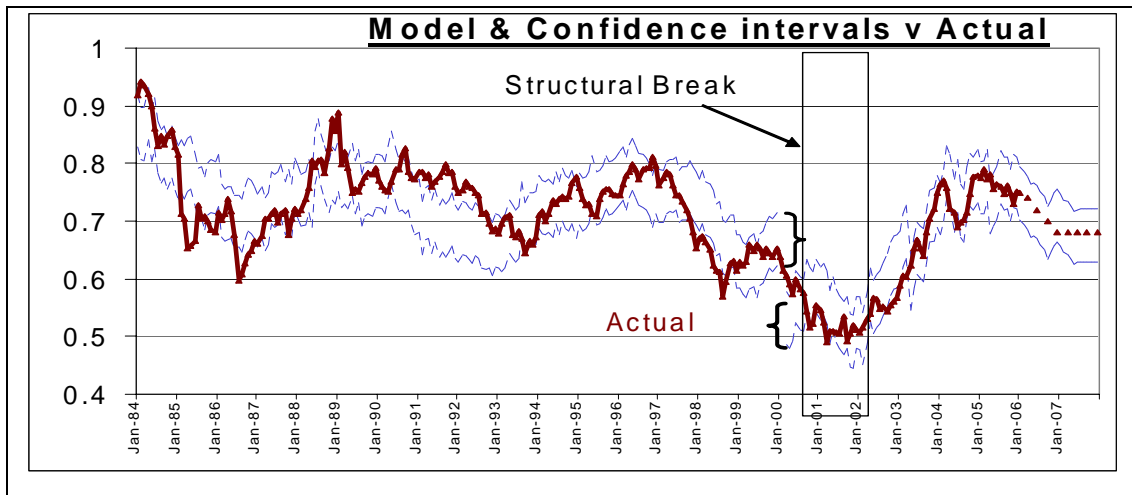
That said, the combination of skilled labour shortages, high levels of capacity and high oil prices underlie the current bias of the Reserve Bank. However, despite these concerns Australia's inflation performance has surprised on the down side. Thus while headline inflation – influenced by higher oil prices – is around 2 ¾% and is likely to stay there for some time, core inflation (trimmed mean) is currently around 2 ¼% . In part this reflects tough conditions in retailing and lower imported inflation (a combination of the currency and China). Beyond that models of underlying inflation have typically over estimated recent inflationary outcomes. Going forward we (and the Reserve Bank) now see the core rate of inflation rising to 2 ¾ % by end 2006 and then gradually easing back towards the mid point of the Reserve Bank's 2-3 target range in 2007/08. That increase in core inflation in part reflects the indirect effects of higher oil prices, lower productivity growth and our currency projections. The move gradually lower in core inflation, in turn, reflects some easing in capacity utilisation and a softer labour market from slower demand.



For interest rates this means, in our view, that the Reserve Bank will be on hold for the foreseeable future. The RBA will continue to be concerned about high oil prices and capacity constraints – especially as it impacts on future wage growth. Against that are signs that domestic demand is moderating and the level of unemployment rising moderately. Over the next year or so the Reserve Bank will undoubtedly engage in occasional bouts of jawboning, but we see little prospect of it moving in either direction for some considerable period. Thereafter, it will depend on how demand pressures and cost pressures evolve. As can be seen in the above chart, our medium term inflation

outlook is closer to the top than the bottom of the RBA's target range and, with some acceleration in growth expected in the out years, a further moderate rate increase would, on balance, be marginally more likely than a cut going into 2007/08 (albeit our formal forecasts do not incorporate any such change)

Finally, turning to the currency it should first be pointed out that economists (and other commentators) have much to be modest about in the forecasting space. However past movements suggest some relationship between the currency and: commodity prices; growth differentials; interest rate differentials and perceptions of policy sustainability (eg current account deficits) - our expectations are for a moderate decline in the Australian dollar against other major currencies. As shown in the chart below, our forecasts for a moderate easing in commodity prices and the term of trade, together with our interest rate and activity forecasts, underpin our view that the AUD will move progressively lower over the next year against the USD, bottoming out in late 2006 at around USD 68c. More detailed currency forecasts, including other cross rates, are attached to this paper.



A Few Concluding Observations on a Longer Run Perspective

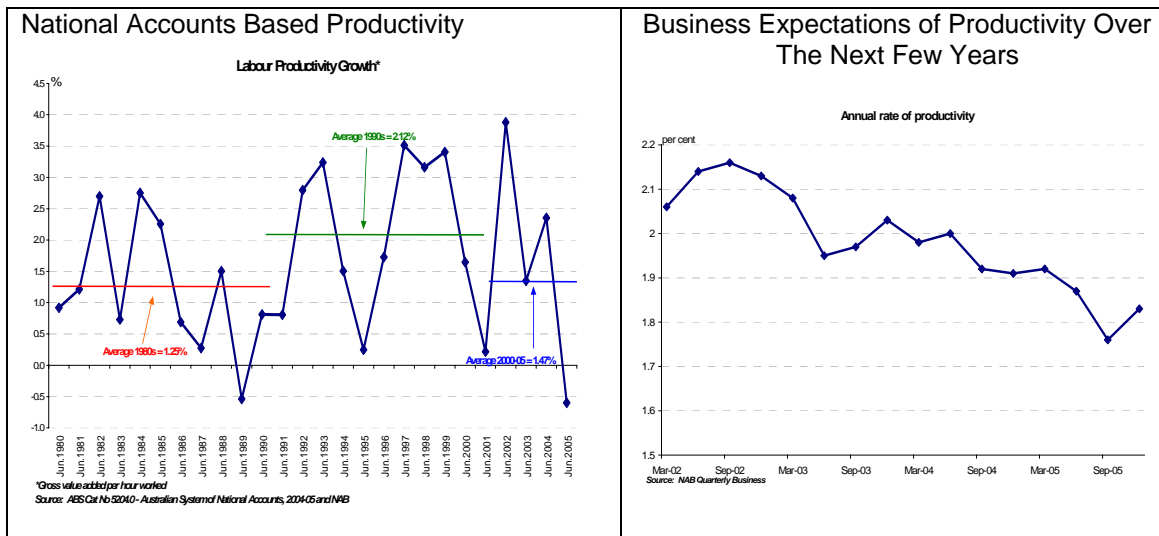
If forecasting the next full year is difficult, forecasting over a 5-10 year period is even more challenging. Most models and forecasting frameworks are deliberately built to revert to trend. Hence forecasts that see diversion from trend will typically be heavily dependent on the assumptions feed into the analysis. In the forecasting vernacular we are not good at identifying X factors – such as earthquakes, terrorism events, bird flu pandemics, wars etc. Also while scenario analysis can be useful for attempting to quantify the economic impact of certain assumptions (eg an oil price of \$US 100 or more, house-price crashes, or super commodity cycles), they are typically not what most forecasters would put into their forecasting framework as the “base” case.

Rather than look to a specific set of forecasts for say the period 2008–2015 (or beyond) a more useful framework is to identify challenges posed by gradual, but also inevitable demographic /economic trends. Here it is useful to go back to the old identity that over the long run, growth potential will fundamentally be driven by productivity, population growth and workforce rates of participation.

Much has already been written on demographics. While, in the Australian case, the big impacts are a long way into the future (20 years plus), even in the medium term slower population growth is likely to be eroding, at the edges, growth potential. Thus, for example, the Australian Bureau of Statistics latest Long term Population Projection to 2101 (ABS Cat No 3220 - published last November) suggest that population growth will slow to a range between 1.2 (the high case) to 0.70 percent (the low case) per annum in the period 2011-2021 (with the range dependent on demographic assumptions). Currently, Australia's annual population growth is around 1.4 percent.

That implies, if we are to maintain the same living standard a fundamental improvement in underlying productivity performance will be required to offset the effects of demographics even over the next 10 years or so. Alternatively, if productivity growth was maintained (at rates similar to the 1990s) that would suggest an easing in trend growth from say 3½ to 3¼ per cent.

While productivity will move cyclically, the recent trends in productivity, if anything, point to a slowing – potentially cutting potential back even further to 3 per cent. According to national accounting data, raw productivity has slowed over the last 5 years relative to that achieved in the 1990's (see chart LHS). Data from the NAB's Business Survey – which asks businesses what level of productivity they expect to achieve over the next four years – also suggests that the recent slowing in recorded productivity may contain a structural, as well as a cyclical compact (see chart RHS). In brief, we may be going backwards on productivity at a time when we need to be making improvements.



Put slightly differently, unless we improve on productivity the Reserve Bank Governor's recent warning that Australia should look to the future with growth expectations with a 2 or 3 in front of them, rather than a 4 or 5 as we have been used to, is probably correct. That is, given where we are, strong growth may only fire up inflation and hence trigger policy tightening. However it seems to me that that is an overly pessimistic outlook.

If we are to address those concerns clearly the policy agenda for future reform must first point into those areas where capacity constraints are already evident. That includes:

- education and training
- skilled migration (the population debate)
- infrastructure (and here selling one asset to invest in other assets that are more beneficial in the long run is, in my opinion, not a problem)
- increased labour market flexibility

Further it would appear fundamental that we attempt to protect and reinvigorate assets which will need to be leveraged going forward. While there are some overlaps, that also includes

- improved incentives to work (tax and welfare)
- health
- water and salination
- climate change (costs and benefits) and
- additional incentives for industry research and development (China will always win if it comes down to economies of scale).

Interestingly many of these areas involve both state and federal government interaction – placing the Council of Australian Governments right in the middle of the upcoming reform agenda.

Finally I would like to conclude on a positive note. These challenges are not impossible. Australia has come a long way down the micro economic reform agenda – as evidenced by our economic performance over the last 15 years. We are also strategically positioned next to the area of the world that will continue to have the fastest growing economies of the world. We also have strong trading relationships with those economies. That is an excellent start point. But need to better leverage our opportunities and continue to build flexibility into our economy to minimise the impact of the inevitable bumps ahead. While we have managed to avoid recession over the last 15 years, regrettably, the business cycle is not dead.

GLOBAL INTEREST RATE FORECASTS

	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
UNITED STATES												
US Fed funds	2.75	3.25	3.75	4.25	4.50	5.00	5.00	5.00	5.00	5.00	5.00	4.75
US 3mth Interbank	2.9	3.4	3.86	4.44	5.1	5.1	5.1	5.2	5.1	5.2	5.0	4.8
US 2yr Gov	3.7	3.6	4.0	4.4	4.8	4.9	4.9	4.9	4.8	4.7	4.7	4.4
US 3yr Gov	3.9	3.7	4.0	4.4	4.8	4.9	4.9	4.9	4.9	4.8	4.8	4.5
US 10yr Gov	4.5	4.0	4.2	4.5	4.7	4.8	4.9	4.9	4.9	4.8	4.7	4.6
US Yield Curve (10y-3m)	1.6	0.7	0.3	0.0	-0.4	-0.3	-0.3	-0.3	-0.3	-0.4	-0.3	-0.2
US Yield Curve (3y-3m)	1.0	0.3	0.1	-0.1	-0.3	-0.2	-0.2	-0.3	-0.3	-0.4	-0.3	-0.3
EUROZONE												
EU Refinancing Rate	2.00	2.00	2.00	2.00	2.50	2.50	2.50	2.75	3.00	3.00	3.00	3.00
EU 3mth EURIBOR	2.1	2.1	2.1	2.5	2.6	2.6	2.9	3.1	3.1	3.1	3.1	3.1
EU 3yr Gov	2.8	2.3	2.2	2.8	3.1	3.2	3.4	3.5	3.4	3.3	3.3	3.2
EU 10yr Gov	3.7	3.2	3.1	3.4	3.6	3.7	3.8	3.8	3.7	3.6	3.6	3.5
EU Cash Spread to US	-0.8	-1.3	-1.8	-2.3	-2.0	-2.5	-2.5	-2.3	-2.0	-2.0	-2.0	-1.8
EU 90-day Spread to US	-0.8	-1.2	-1.7	-2.0	-2.5	-2.5	-2.3	-2.1	-2.0	-2.1	-1.9	-1.6
EU 10 year Spread to US	-0.8	-0.6	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.2	-1.2	-1.1	-1.0
EU Yield Curve (10y-3m)	1.6	1.1	0.9	0.9	1.0	1.1	0.9	0.7	0.6	0.5	0.5	0.4
EU Yield Curve (3y-3m)	0.6	0.1	0.1	0.3	0.5	0.6	0.5	0.4	0.3	0.2	0.2	0.1
UNITED KINGDOM												
UK Base Rate	4.75	4.75	4.50	4.50	4.50	4.25	4.25	4.25	4.25	4.25	4.50	4.50
UK 3mth	4.9	4.8	4.5	4.6	4.4	4.3	4.3	4.3	4.5	4.7	4.6	4.6
UK 3yr Gov	4.8	4.1	4.0	4.2	4.1	4.2	4.4	4.4	4.5	4.5	4.4	4.4
UK 10yr Gov	4.8	4.2	4.1	4.2	4.2	4.3	4.4	4.4	4.5	4.4	4.4	4.3
UK Cash Spread to US	2.0	1.5	0.8	0.3	0.0	-0.8	-0.8	-0.8	-0.8	-0.8	-0.5	-0.3
UK 90-day Spread to US	2.0	1.5	0.7	0.1	-0.7	-0.8	-0.8	-0.8	-0.6	-0.5	-0.4	-0.1
UK 10 year Spread to US	0.3	0.0	-0.2	-0.3	-0.5	-0.4	-0.5	-0.5	-0.4	-0.4	-0.3	-0.3
UK Yield Curve (10y-3m)	-0.2	-0.6	-0.4	-0.4	-0.2	0.0	0.1	0.1	-0.1	-0.3	-0.2	-0.3
UK Yield Curve (3y-3m)	-0.2	-0.7	-0.5	-0.3	-0.3	-0.2	0.0	0.0	-0.1	-0.2	-0.2	-0.2
AUSTRALIA												
Aus Cash rate	5.25	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50
Aus 3mth bill	5.8	5.7	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Aus 3yr Gov	5.6	5.1	5.0	5.3	5.2	5.3	5.2	5.2	5.2	5.2	5.2	5.2
Aus 10yr Gov	5.6	5.1	5.0	5.4	5.4	5.4	5.4	5.4	5.3	5.3	5.3	5.3
AUS Cash Spread to US	2.5	2.3	1.8	1.3	1.0	0.5	0.5	0.5	0.5	0.5	0.5	0.8
AUS 90-day Spread to US	2.8	2.3	1.7	1.2	0.5	0.5	0.5	0.4	0.5	0.4	0.6	0.9
Aus10 year Spread to US	1.1	1.1	0.8	0.9	0.7	0.6	0.5	0.5	0.5	0.6	0.6	0.8
Aus Yield Curve (10y-3m)	-0.1	-0.5	-0.6	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Aus Yield Curve (3y-3m)	-0.2	-0.6	-0.6	-0.3	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
NEW ZEALAND												
NZ Cash rate	6.50	6.75	6.75	7.00	7.25	7.25	7.25	7.25	7.00	6.75	6.50	6.25
NZ 3mth bank bill	6.9	7.0	7.0	7.7	7.5	7.5	7.5	7.2	7.0	6.7	6.5	6.5
NZ 3yr Gov	6.3	5.9	5.6	6.1	5.9	5.9	5.9	5.9	5.8	5.7	5.7	5.7
NZ 10yr Gov	6.2	5.7	5.6	5.9	5.9	5.9	5.9	5.9	5.8	5.8	5.8	5.7
NZ Cash Spread to US	3.8	3.5	3.0	2.8	2.8	2.3	2.3	2.3	2.0	1.8	1.5	1.5
NZ 90-day Spread to US	3.9	3.7	3.2	3.2	2.4	2.3	2.3	2.0	1.8	1.5	1.4	1.7
NZ 10 year Spread to US	1.6	1.7	1.4	1.4	1.1	1.1	1.0	1.0	0.9	1.0	1.0	1.1
NZ Yield Curve (10y-3m)	-0.7	-1.3	-1.5	-1.8	-1.7	-1.6	-1.6	-1.3	-1.2	-0.9	-0.7	-0.7
NZ Yield Curve (3y-3m)	-0.6	-1.1	-1.5	-1.5	-1.6	-1.5	-1.6	-1.4	-1.2	-1.0	-0.7	-0.8
CANADA												
CA Bank rate	2.50	2.50	2.50	3.00	3.50	3.75	4.00	4.00	4.00	4.00	4.00	4.00
CA 3mth LIBOR	2.62	2.61	2.84	3.41	3.79	4.08	4.09	4.10	4.10	4.10	4.10	4.10
CA 3yr Gov	3.14	2.81	3.02	3.79	3.90	4.27	4.41	4.44	4.43	4.34	4.34	4.26
CA 10yr Gov	4.29	3.79	3.74	4.05	4.39	4.65	4.80	4.82	4.81	4.71	4.71	4.62
CA Cash Spread to US	-0.25	-0.75	-1.25	-1.25	-1.00	-1.25	-1.00	-1.00	-1.00	-1.00	-1.00	-0.75
CA 90-day Spread to US	-0.31	-0.74	-1.01	-1.03	-1.30	-1.04	-1.05	-1.07	-1.04	-1.05	-0.94	-0.65
CA 10 year Spread to US	-0.21	-0.21	-0.46	-0.42	-0.31	-0.14	-0.10	-0.07	-0.05	-0.05	-0.01	0.07
CA Yield Curve (10y-3m)	1.67	1.18	0.90	0.65	0.60	0.56	0.70	0.72	0.71	0.61	0.61	0.52
CA Yield Curve (3y-3m)	0.52	0.21	0.18	0.39	0.11	0.19	0.32	0.34	0.33	0.24	0.24	0.16
JAPAN												
JN Overnight Call rate	0.001	0.001	0.001	0.001	0.020	0.130	0.210	0.250	0.350	0.500	0.750	0.900
JN 3mth TIBOR	0.10	0.08	0.09	0.09	0.12	0.21	0.25	0.32	0.46	0.66	0.86	0.91
JN 2yr Gov	0.14	0.07	0.13	0.22	0.35	0.47	0.54	0.61	0.76	0.94	1.13	1.19
JN 10yr Gov	1.48	1.22	1.32	1.45	1.78	1.97	2.10	2.17	2.28	2.37	2.46	2.55
JN Cash Spread to US	-2.75	-3.25	-3.75	-4.25	-4.48	-4.87	-4.79	-4.75	-4.65	-4.50	-4.25	-3.85
JN 90-day Spread to US	-2.83	-3.27	-3.77	-4.35	-4.98	-4.92	-4.90	-4.85	-4.68	-4.49	-4.18	-3.84
JN 10 year Spread to US	-3.02	-2.78	-2.88	-3.02	-2.92	-2.82	-2.79	-2.73	-2.59	-2.39	-2.26	-2.00
JN Yield Curve (10y-3m)	1.38	1.14	1.23	1.36	1.66	1.76	1.85	1.85	1.82	1.71	1.60	1.64
JN Yield Curve (2y-3m)	0.04	-0.01	0.04	0.13	0.23	0.27	0.29	0.30	0.30	0.28	0.27	0.28

Global Exchange Rate Forecasts

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
AUD/USD	0.77	0.76	0.76	0.73	0.74	0.72	0.70	0.68	0.68	0.68	0.68	0.68
NZD/USD	0.71	0.70	0.69	0.68	0.67	0.63	0.60	0.58	0.58	0.58	0.58	0.58
USD/JPY	107	111	114	118	115	110	105	105	106	104	105	105
EUR/USD	1.30	1.21	1.21	1.18	1.20	1.20	1.18	1.16	1.17	1.18	1.18	1.17
GBP/USD	1.89	1.79	1.76	1.72	1.74	1.70	1.70	1.70	1.70	1.70	1.70	1.70
USD/CAD	1.21	1.23	1.17	1.16	1.15	1.15	1.18	1.22	1.25	1.25	1.25	1.25
AUD/JPY	83	84	86	86	85	79	74	71	72	71	71	71
AUD/EUR	0.60	0.63	0.63	0.62	0.62	0.60	0.59	0.59	0.58	0.58	0.58	0.58
AUD/GBP	0.41	0.43	0.43	0.43	0.43	0.42	0.41	0.40	0.40	0.40	0.40	0.40
AUD/NZD	1.09	1.09	1.10	1.07	1.10	1.14	1.17	1.17	1.17	1.17	1.17	1.17
NZD/JPY	76	77	79	80	77	69	63	61	61	60	61	61
EUR/JPY	139	134	138	140	138	132	124	122	124	123	124	123
EUR/GBP	0.69	0.68	0.68	0.69	0.69	0.71	0.69	0.68	0.69	0.69	0.69	0.69
GBP/JPY	202	198	201	203	200	187	179	179	180	177	179	179

DISCLAIMER: [While care has been taken in preparing this material,] National Australia Bank Limited (ABN 12 004 044 937) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") are accurate, reliable, complete or current. The Information has been prepared for dissemination to professional investors for information purposes only and any statements as to past performance do not represent future performance. The Information does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts.

To the extent permissible by law, the National shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such Information (including by reasons of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, the National limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. The National, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer."

UK Disclaimer: So far as the law and the FSA Rules allow, National Australia Bank Limited ("the Bank") disclaims any warranty or representation as to the accuracy or reliability of the information and statements in this document. The Bank will not be liable (whether in negligence or otherwise) for any loss or damage suffered from relying on this document. This document does not purport to contain all relevant information. Recipients should not rely on its contents but should make their own assessment and seek professional advice relevant to their circumstances. The Bank may have proprietary positions in the products described in this document. This document is for information purposes only, is not intended as an offer or solicitation nor is it the intention of the Bank to create legal relations on the basis of the information contained in it. No part of this document may be reproduced without the prior permission of the Bank. This document is intended for Investment Professionals (as such term is defined in The Financial Services and Markets Act 2000 (Financial Promotion) Order 2001) and should not be passed to any other person who would be defined as a private customer by the rules of the Financial Services Authority ("FSA") in the UK or to any person who may not have experience of such matters. Issued by National Australia Bank Limited A.C.N. 004 044 937, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 500 Bourke Street, Melbourne, Victoria. Incorporated with limited liability in the state of Victoria, Australia. Regulated by the FSA in the UK.

U.S. DISCLAIMER: This information has been prepared by National Australia Bank or one of its affiliates or subsidiaries (collectively, "NAB"). If it is distributed in the United States, such distribution is by National Australia Capital Markets, LLC (NACM) which accepts responsibility for its contents. Any U.S. person receiving this information wishes further information or desires to effect transactions in the securities described herein should call or write to NACM, 200 Park Avenue, New York, NY 10166 (or call (877) 377-5480). The information contained herein has been obtained from, and any opinions herein are based upon sources believed to be reliable and no guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose. Any opinions or estimates expressed in this information is our current opinion as of the date of this report and is subject to change without notice. The principals of NACM or NAB and/or its affiliates may have a long or short position or may transact in the securities referred to herein or hold or transact derivative instruments, including options, warrants or rights with securities, or may act as a market maker in the securities discussed herein and may sell such securities to or buy from customers on a principal basis. This material is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action. It is intended for the information of clients only and is not for publication in the press or elsewhere.