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**Highlights of this issue**

China has rapidly transformed from a closed, centrally planned economy to a market-focused nation and is now the world’s sixth largest economy. This issue of the *Queensland Economic Review* contains the first of a series of articles on China.

The initial article discusses China’s economic reform between 1949 and the mid 1990s, from the country’s transition to socialism through to its Open Door Policy and transition to a market economy. Subsequent articles will look at the more recent history of reform and the current opportunities and challenges facing the Chinese economy, as well as the implications for Queensland and Australia.

The usual detailed updates on the Queensland, national and international economies are also included in this issue. The Queensland economy continues to perform solidly, characterised by strong domestic demand more than offsetting a weak trade sector. Gross state product grew by 3.9% in 2003-04 compared with the previous year. Household consumption continues to be the main driver of growth.
The Queensland Economic Review is also now available through the Queensland Treasury Internet site:

www.treasury.qld.gov.au

For further economic, financial and statistical information relating to Queensland, visit the Office of Economic and Statistical Research internet sites:

OESR: www.oesr.qld.gov.au
Statistics Queensland: www.statistics.qld.gov.au
Economics Queensland: www.economics.qld.gov.au
Qstats: www.qstats.qld.gov.au

Notes for Contributors

The Queensland Economic Review (QER) invites articles from organisations and individuals on a broad range of topics suitable for inclusion in future issues of the publication. Three or four issues are published each year and 16 pages are set aside in each issue for articles. Some of the articles are prepared by officers of Queensland Treasury.

To get an idea of the types of articles that are published, please peruse previous issues. Please note aspects such as length and style of articles. Each article is usually two, three or four pages in length. Allow about 750 words per QER page, without headings or illustrations. Articles should be written in a style that is understandable to a diverse range of readers, and should include tables/charts/diagrams and one or two levels of headings.

Completed articles or ideas for articles can be emailed to oesr@treasury.qld.gov.au. Text should preferably be in Word. All tables, charts and diagrams should be in Excel, Illustrator, etc. as appropriate rather than imported into the Word document. Some editing of articles may occur. A typeset copy will be sent to authors for approval before printing.
Summary

International economy
Despite the adverse impact of higher oil prices, the global economic outlook remains positive, with the US, Asia and Japan all forecast to record strong growth over 2004.

National economy
Economic growth in Australia remained solid in June quarter 2004, with GDP growth of 0.6% in the quarter and 3.6% in year-average terms in 2003-04.

Exchange rates
The value of the $A was slightly higher against the $US over the three months to early October and has remained broadly around $US70¢ during this time.

Monetary policy
The RBA has left the cash rate unchanged at 5.25% during 2004, but has suggested that strong domestic demand is not necessarily consistent with a policy stance that is still ‘mildly accommodative’.

Bond and bill yields
Despite recent comments by the RBA, 90-day bank bill yields fell slightly over the past three months, to be 5.4% in early October, implying financial markets have priced in very little chance of an interest rate rise in the next three months.

Queensland economy
Queensland economic growth in June quarter 2004 continued to be characterised by very strong growth in domestic demand more than offsetting the weak performance of the trade sector.

Employment
Jobs growth in Queensland strengthened in the June quarter, with the State accounting for more than 40% (19,300 jobs) of all jobs created nationally in the June quarter.

Unemployment
Strong employment growth in Queensland reduced the trend unemployment rate to 5.9% in June quarter 2004, the lowest rate in 22 years.

Job vacancies
Employer hiring intentions continue to be positive, with growth in job ads strengthening to 6.2% in the June quarter and increasing by 22.7% over the year.

Employment by industry
Jobs growth in Queensland was again driven by the services sector, although this was partially offset by employment declining in the agriculture industry.

State economic growth
A weak trade sector resulted in the Queensland economy recording overall economic growth of 0.2% in trend terms in June quarter 2004. Domestic activity, however, grew at a faster pace, with gross state expenditure rising by 1.2% over the quarter.

Consumption
Household consumption expenditure in Queensland remains the main driver of domestic activity, with annual growth in consumer spending (11.2%) remaining at near-record rates in the June quarter.

Housing investment
Although already at historically high levels, housing investment rose by a further 2.1% in the June quarter, underpinned by strong population growth.

Business investment
Business investment in Queensland again recorded strong growth in the June quarter, driven by rises in both machinery and equipment investment and non-dwelling construction.

Business conditions
Queensland business conditions were healthy in June quarter 2004, with most surveys suggesting business conditions should at least remain steady, if not improve, in the September quarter.

Agricultural and mining trends
The outlook for the State’s mining industry remains positive, with further growth expected in key export markets, such as coal, while strong gains are also expected in Queensland’s summer crop production.

Overseas merchandise exports
Strong rises in the value of rural and mineral exports saw the nominal value of overseas merchandise exports in Queensland rise 17.1% over the year to the June quarter.

Commodity prices
International prices for Queensland’s major commodity exports rose by 11.7% in $A terms in the June quarter, partly driven by a depreciation in the $A exchange rate over this period.

Tourism
Short-term visitor arrivals to Australia rose 4.1% over the year to June quarter 2004, reflecting a stronger world economy and the passing of the major impact from previous terrorist events and disease outbreaks.

Inflation
The Brisbane consumer price index rose 0.6% in the June quarter, with housing costs and oil prices the principal drivers of inflation.

Wages
Wages continued to increase in Queensland in the June quarter, with the Wage Cost Index rising by 3.7% and Average Weekly Ordinary Time Earnings increasing by 5.6% over the year.

Population
The resident population in Queensland grew by a further 0.5% in March quarter 2004, representing an increase of 19,100 persons over this period.
International and national economies

International economy

Despite a slight softening in conditions in the June quarter, the outlook for the international economy remains positive, with the world’s largest economies forecast to record solid growth over 2004 and into 2005.

High oil prices have coincided with some softening in current conditions, due to their impact on production costs, consumer incomes and sustainable growth. The oil price rose from $US37 per barrel at the end of June to $US49 per barrel by mid August and has recently risen above $US50. However, with some of the factors causing high oil prices being temporary, Consensus Economics expect the oil price to fall over the coming year, providing an improved global outlook in this respect.

The US recovery appears to have passed through a ‘soft patch’ in the June quarter. After recording GDP growth of around 1% in each of the previous two quarters, growth eased to 0.7% in the June quarter. Consumer spending remained subdued, partly due to higher energy prices. However, capital spending recorded a solid increase. The Federal Reserve has also raised short-term interest rates in each of its last three meetings, suggesting it believes economic fundamentals still point to a sustained recovery.

The outlook for Japan in 2004 remains positive, despite the adverse impact of higher oil prices on current levels of retail and other consumer spending. Non-Japan East Asia continues to outperform other areas of the global economy, with China recording annual growth of 9.7% over the first half of 2004. Consumer demand and exports continue to grow strongly in China. Yet, in sectors where authorities have been concerned with overheating, such as fixed asset investment, evidence of any desired slowdown has been mixed. However, market analysts await September quarter economic data before entertaining the possibility of a ‘hard landing’ for China.

The outlook for the euro zone remains subdued relative to other regions. Low consumer confidence and persistently high unemployment have constrained any sustained increase in consumption in economies such as Germany and France. In the absence of a demand-led recovery, the European Central Bank, like the Bank of Japan, is expected to keep interest rates on hold over the short term.

National economy

National economic growth eased in June quarter 2004, with gross domestic product (GDP) rising 0.6% in trend terms, following 0.9% growth in the March quarter. In year-average terms, GDP rose 3.6% in 2003-04, slightly below the 3¾% estimated in the Commonwealth Budget.

As in recent quarters, domestic economic activity continued to drive overall growth in the June quarter. Household consumption rose 1.3% (trend) over the quarter, after peaking at 1.6% growth in the December quarter. High growth in consumption in recent quarters has been driven by wealth effects related to house price rises, low interest rates and very strong labour market conditions. Growth in dwelling investment (up 1.9%) eased slightly in the June quarter, but the overall level of dwelling investment remained at record levels. Growth in business investment (up 1.5%) also continued to ease, due to a moderation in growth in non-dwelling construction investment.

Weakness continued in the trade sector in the June quarter, partly offsetting solid domestic demand. Exports recorded solid growth of 1.6%, reflecting a further improvement in global industrial production as well as the ongoing recovery in domestic agricultural production. However, import volumes rose a further 3.6%, following very high growth in previous quarters. As a result, net exports detracted 0.6% point from overall growth in the June quarter, following a similar detraction in the previous two quarters.

Despite economic growth easing, labour market conditions continued to strengthen in the June quarter. Employment recorded solid growth of 0.5%, driven by 0.6% growth in full-time employment. Jobs
growth continued to outpace labour force growth, producing a further fall in the national unemployment rate to 5.6% in the June quarter.

**Exchange rates**

The value of the $A was slightly higher against the $US over the three months to early October 2004, but remained broadly around $US70c during this time. After peaking in mid February at just under US80c, the $A traded steadily downwards to reach US69c in mid June, before stabilising in the past three months. A rise in commodity prices in late September was associated with a rise in the $US/$A exchange rate, to be currently around $US72c.

The $A has also recently gained ground against the Japanese yen, as the Japanese currency responded negatively to news of higher oil prices, which have recently reached new all-time highs. However, the $A has remained fairly steady against other currencies such as the euro, and slightly stronger against the UK pound. As a result, the Australian trade weighted index (TWI), which measures a basket of currencies of Australia’s trading partners, was slightly stronger over the three months to October, and remains closely in line with the $US/$A exchange rate.

The outlook for the $A over coming quarters will rely heavily on developments in the US. Recent government and trade deficits have markedly increased the US current account deficit, prompting fears that the $US may have to fall further in coming quarters. Government spending commitments during the US federal election may exacerbate these concerns and encourage the $A to appreciate against the $US.

**Monetary policy**

In its most recent Statement on Monetary Policy, the Reserve Bank of Australia (RBA) noted that it would be ‘surprising’ if interest rates did not increase further in the current economic cycle. The RBA has left interest rates unchanged at 5.25% over 2004, but has recently suggested that the strong level of domestic demand in the economy as well as an improving international outlook is not necessarily consistent with a policy stance that is still ‘mildly accommodative’ (i.e. interest rates remain relatively low).

Apart from the improving international economy, the RBA has recently noted that underlying inflation ‘can soon be expected to start increasing’. On the other hand, the RBA has been encouraged by signs of slowing house prices, but notes that housing finance will ‘need to adjust further’. Despite these relatively direct statements from the RBA and expectations of interest rate increases from some analysts, financial markets are currently pricing in very little chance of an increase in official interest rates in the next three months.

**Bond and bill yields**

Australian long-term bond yields have declined steadily over the three months to early October 2004, with the Commonwealth 10-year bond yield falling by almost 0.5% point to around 5.5%. Australian bond yields closely follow bond market developments in the US, where Federal Treasury yields also fell over the three months, dipping below 4% briefly in late September.

Recent economic figures in the US have been below market expectations, and have pointed to a ‘soft patch’ in US economic growth during the June quarter. As a result, investors have sought to shift their money into ‘safe’ investments such as bonds, placing downward pressure on yields. In addition, recent Australian data on employment and retail trade have disappointed local financial markets, causing Australian Commonwealth bond yields to fall further than corresponding yields in the US over the three months to early October.

In contrast to longer-term bonds, yields on 90-day bank bills are largely determined by expectations of future movements in the official cash rate, which is set by the RBA. Despite recent RBA statements that suggest that interest rate rises may occur later this year, 90-day bank bill yields have remained subdued. Bank bill yields actually fell slightly over the past three months, to be around 5.4% in early October, compared with the official cash rate, currently 5.25%.

**Domestic interest rates**

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<td>5.0</td>
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</tbody>
</table>

1-Oct-03 1-Jan-04 1-Apr-04 1-Jul-04 1-Oct-04

Source: Datastream
State economic performance

Queensland economy

Overview

Queensland’s domestic sector continues to grow strongly, driven by solid growth in consumer spending, and dwelling and business investment. However, a combination of external and internal factors continues to constrain the performance of the trade sector in Queensland to a greater extent than in the rest of Australia.

The June quarter 2004 Queensland State Accounts show that growth in private consumption, housing activity and business investment in Queensland continues to outpace that in the rest of Australia. Strong interstate and overseas migration, as well as low interest rates, have provided ongoing support for the State’s housing sector. This has in turn underpinned household-related spending which, coupled with positive labour market conditions and high levels of consumer confidence, caused annual growth in consumer spending to reach near-record rates in the March and June quarters.

Net exports continue to detract more from growth in Queensland than in the rest of Australia. Stronger growth in consumer spending has resulted in relatively faster import growth in the State. Furthermore, the appreciation in the Australian dollar over the year preceding the June quarter, along with the more delayed impact of the drought in Queensland, has also adversely affected the performance of the State’s export sector.

However, with the domestic economy growing strongly, Queensland continued to generate significant gains in employment during the June quarter. Queensland accounted for more than 40% of all jobs created nationally in the quarter, reducing the State’s unemployment rate to its lowest in 22 years.

Employment growth continued to strengthen slightly in June quarter 2004, with employment increasing by 1.0% in trend terms, following growth of 0.8% in the previous quarter. Queensland continued to record stronger employment growth than the rest of Australia, where employment growth eased by 0.3% point to 0.4% in the June quarter.

Queensland accounted for just over 40% of all jobs created nationally in the quarter, reducing the State’s unemployment rate to its lowest in 22 years.

Unemployment

Consistent quarterly jobs growth in Queensland since June quarter 2001 has helped the State achieve its lowest unemployment rate in 22 years in June quarter 2004.

The State’s trend unemployment rate has fallen 2.8% points from a recent high of 8.7% in June quarter 2001 to 5.9% in June quarter 2004. In comparison, the rate for the rest of Australia fell 0.9% point to 5.5% over the same period. As a result, the unemployment rate differential between Queensland and the rest of Australia has narrowed substantially, from 2.3% points in June quarter 2001 to only 0.4% point in June quarter 2004.

After remaining at 6.2% in March quarter 2004, the State’s unemployment rate fell 0.3% point to 5.9% in the June quarter, as employment growth (1.0%) exceeded labour force growth (0.8%) during the quarter.

Queensland’s labour force growth (0.8%) in the June quarter was driven by robust civilian population growth of 0.6% (the twelfth consecutive quarter of growth at or above 0.6%), as well as a 0.1% point increase in the trend participation rate to 64.9%.
In comparison, the labour force in the rest of Australia grew by 0.3% in the June quarter. This was driven by civilian population growth of 0.3%, with the participation rate in the rest of Australia remaining unchanged at 63.3% in the quarter.

**Job vacancies**

Job vacancy data for June quarter 2004 show that employer hiring intentions in Queensland remain positive. Quarterly trend growth in the ANZ Job Advertisement Series for Queensland strengthened to 6.2% in the June quarter (up from 4.0% in the March quarter), while in annual terms, job advertisements rose 22.7%. Nationally, job advertisements rose 1.3% in the June quarter and 7.3% over the year.

Growth in the DEWR Skilled Vacancy Index for Queensland was flat (0.0%) in the June quarter, following a small decline of 0.8% in the previous quarter. Nationally, the index rose 1.9% in the June quarter, following a decline of 0.8% in the March quarter. The strength in demand for skilled labour in Queensland was highlighted by annual growth of 28.3% in the index in the June quarter (Australia, up 10.2%).

This strength in overall job advertisement growth in Queensland suggests that employment growth in the State should remain solid in the coming quarter.

**Employment by industry**

Employment growth in Queensland over the year to June quarter 2004 (in original terms) continued to be driven by the services sector (up 60,500 persons). Growth in this sector was partially offset by an overall decline in employment in the primary and secondary sectors, which fell by 4,400 persons.

However, the entire decline in these sectors was attributable to the agriculture, forestry and fishing industry (down 10,500 persons), in which the ongoing impact of the drought continues to keep employment below normal levels. Of the other industries in these sectors, mining employment rose by 3,600 persons while the manufacturing industry created 2,500 new jobs over the year to the June quarter.

Strong building activity and consumer spending over the period was reflected in solid jobs growth in the construction, retail trade, and property and business services industries (up 16,200, 7,500 and 6,300 jobs respectively). Other industries to record strong jobs growth were transport and storage (up 11,000) and health and community services (up 7,900).

**State economic growth**

The latest Queensland State Accounts show that economic growth in Queensland moderated slightly in June quarter 2004. Queensland recorded growth in real trend gross state product (GSP) of 0.2% in the June quarter, easing from growth of 0.4% in the March quarter. This compares with 0.7% growth in the rest of Australia in the June quarter. In annual terms, Queensland recorded economic growth of 2.8% over the year to the June quarter (rest of Australia, 3.9%).

The slower overall growth in Queensland is partly due to a number of factors that have had a greater impact on the State’s trade sector relative to that in the rest of Australia. In contrast, gross state expenditure, a measure of domestic demand, grew at an annual rate of 9.7% in Queensland in the June quarter, compared with only 5.3% in the rest of Australia.

In year-average terms, Queensland recorded GSP growth of 3.9% in 2003-04, exceeding economic growth in the rest of Australia (3.6%) for the eighth consecutive year.
Household consumption expenditure continued to be the main driver of domestic demand in Queensland in June quarter 2004. Consumption rose a further 1.8% in the June quarter, to be 11.2% higher over the year. Queensland’s annual growth was more than double that recorded in the rest of Australia, where consumption rose by 5.0% over the year. Consumption growth in the State continues to be driven by high population growth, positive employment conditions and low interest rates.

Despite being at historically high levels, dwelling investment in Queensland continued to rise in the June quarter, increasing a further 2.1% in the quarter and rising 19.8% in annual terms. In the rest of Australia, dwelling investment increased at a more moderate pace, rising 1.8% in the quarter and 7.2% over the year.

Business investment made a solid contribution to overall growth in Queensland in the June quarter, rising by 3.3% and contributing 0.4% point to growth in gross state expenditure. In annual terms, growth in business investment slowed over the first half of 2003-04, but accelerated over the second half of the year.

Strong consumption and business investment growth continued to fuel import growth in the State in the June quarter, although the pace of growth moderated from that of recent quarters. Imports rose 2.3% in the June quarter, while total exports from Queensland (overseas and interstate) declined by 0.2%. As a result, the trade sector continued to detract from overall growth, with net exports subtracting 1.1% points from overall GSP growth in the June quarter.

Consumption

Household consumption expenditure in Queensland remained robust in June quarter 2004, growing 1.8% in trend terms. This represents a slight easing from the 2.4% growth recorded in the March quarter. The rest of Australia continued to experience solid consumption growth in the June quarter (1.2%), the fifth consecutive quarter of growth between 1.1% and 1.3%. Queensland recorded growth in consumer spending of 11.2% over the year to the June quarter, maintaining annual growth at near-record rates. In contrast, annual growth in the rest of Australia was 5.0% for the second successive quarter.

Retail turnover (which accounts for more than 40% of total household consumption expenditure) strengthened in nominal terms in the June quarter to 1.9%, up from 1.4% in the March quarter. However, Queensland’s real retail trade growth continued to moderate in the June quarter, easing to 1.7%, compared with 2.4% growth in the March quarter and down from a recent peak of 4.0% in September quarter 2003.

These contrasting movements in real and nominal retail trade growth in the June quarter highlight the fact that nominal retail trade growth reflects a combination of price effects and changes in the volume of retail trade. In particular, the upward pressure on retail prices in the June quarter may largely reflect the weakening in the $A, which depreciated almost 10% during the June quarter, making imported consumer goods more expensive.
**Housing investment**

Although already at historically high levels, housing investment continued to rise in June quarter 2004. Total dwelling investment rose a further 2.1% in real trend terms, although the pace of growth has moderated from a recent peak of 6.4% in December quarter 2003. Dwelling investment in the rest of Australia rose by 1.8% in the June quarter.

Over the past year, dwelling construction in Queensland has proceeded at a much stronger pace than nationally. Housing investment in Queensland rose 19.8% over the year to the June quarter, more than double the growth recorded in the rest of Australia (7.2%). Queensland’s higher growth is attributable to a number of factors. The State is at an earlier stage in the property cycle than the other major states, with Queensland experiencing by far the strongest growth in property prices of any state over the year to the June quarter. Further, the population in Queensland is currently growing at around twice the rate in the rest of Australia, driving sustained demand for new dwellings in the State.

Despite the very strong growth achieved over the past year, forward indicators suggest that dwelling investment in Queensland will remain strong in the near future. After declining through the first five months of 2004, the number of building approvals rose in each of the three months from June to August. The number of housing finance approvals for the construction of new dwellings for the three months ending July 2004 was 2.9% higher than the previous three month period. In addition, a build-up of approved but not yet completed building work should also help to sustain the pace of dwelling investment over the coming quarters.

**Business investment**

Business investment in Queensland again recorded strong growth in June quarter 2004, increasing 3.3% in trend terms, following 3.8% growth in the previous quarter. In annual terms, growth in business investment has accelerated over the past two quarters, rising 4.4% in the March quarter and 10.0% in the June quarter. In comparison, business investment in the rest of Australia grew at a more moderate pace, rising 1.1% in the June quarter and 6.7% over the year.

**Business investment, Queensland**

($m, quarterly, CVM, trend)

Source: Office of the Government Statistician, Queensland State Accounts

Investment in other buildings and structures rose steadily through 2003-04, increasing a further 3.0% in the June quarter. Non-dwelling construction in the June quarter was boosted by several significant projects currently underway in the electricity generation and coal mining industries. The much improved outlook for world economic growth and its consequent impact on the demand for Queensland’s energy and mineral products has continued to benefit non-dwelling business investment.

Investment in machinery and equipment rose at a more modest pace in the June quarter, increasing 0.6%, following similar growth in the previous quarter. The appreciation of the $A during the first half of 2003-04 assisted businesses in the purchase of imported capital items, while strong growth in domestic activity in Queensland has also underpinned investment in machinery and equipment.

The outlook for business investment over coming quarters remains positive. The focus of business investment is expected to continue to shift from domestic to export-oriented industries, reflecting a slowing in Australia’s economic activity and an anticipated strengthening in international demand for the State’s mineral and processed metals products.

**Business conditions**

According to the latest surveys, business conditions in Queensland were healthy in June quarter 2004. Conditions should at least remain steady, if not improve, in the September quarter.
Following a substantial moderation in the March quarter, the National Australia Bank Quarterly Business Survey reported that the business conditions index for Queensland rose slightly in the June quarter (up 3% points to 25%), due to continuing positive domestic economic conditions and improving global demand. Of the three components that comprise the index, trading performance remained the most positive (29%), despite a slight decline (-1% point) in this index. The indices measuring profitability (up 6% points to 21%) and employment (up 3% points to 25%) both improved in the June quarter, while all three indices for Queensland remained well above those reported nationally.

The August 2004 Sensis Business Index survey shows that, over the three months to July, the indices measuring employment, sales, profitability and prices received in Queensland all outperformed those nationally. The slight decline in business confidence over this period (down 3% points to 70%) only partially reversed the strong gain of 9% points experienced over the previous three months. Furthermore, the Sensis survey reports that Queensland businesses expect that conditions will improve in the coming three month period.

The Commerce Queensland Pulse Business Index reported a healthy improvement in overall business conditions in June quarter 2004. The index rose 4.1 points to 62.6 in the quarter, its highest level since September quarter 2002, and is forecast to remain at a similar level in the September quarter.

### Agricultural and mining trends

According to the Australian Bureau of Agricultural and Resource Economics (ABARE), Queensland’s winter crop production is forecast to fall by around 30% in 2004-05, to under one million tonnes. Production of wheat and barley is expected to fall by 29% and 28% respectively. Drier than normal seasonal conditions experienced during June and July, including less than average rainfall in central Queensland and the eastern Downs, is thought to have contributed to the fall. Despite generally favourable conditions for planting winter crops in the western Downs/Maranoa region, good follow-up rain is required to facilitate plant growth and development.

The outlook for Queensland’s summer crop production is more favourable. The area planted to sorghum, the State’s largest summer crop, is expected to rise in 2004-05, with production estimated to increase by 4% to 1.4 million tonnes. Poor winter crop plantings in central Queensland and eastern Downs may also help boost sorghum crop plantings in the summer months. The area planted to cotton, the second largest summer crop, is expected to rise by 64% to over 156,000 hectares, mainly due to an increase in the volume of water in main dam storages and on-farm water storages. Accordingly, cotton lint and seed production is expected to rise by 67% and 52% respectively in the 2004-05 season.

Production trends for Queensland’s key agricultural exports have been mixed. Queensland sugar cane production resulting from the 2003 harvest fell by 3% from the previous year to an estimated 34.1 million tonnes, according to the Queensland Department of Primary Industries and Fisheries. The Central cane growing region experienced a 16% fall in production as a result of poor seasonal conditions in the area.

The continued ban on Canadian and US beef imports to Japan (following the discovery of BSE or mad cow disease in the United States in late 2003) has resulted in strong rises in the demand for Australian beef. Producers have delayed herd rebuilding, following drought conditions in recent years, to benefit from higher beef prices.

Queensland’s mining sector continues to strengthen. According to the Queensland Department of Natural Resources and Mines, coal production rose by 4.2% in 2003-04 to 160.1 million tonnes. Coal exports also reached record levels, increasing by 4.5% to 135.0 million tonnes. Dalrymple Bay, Gladstone and Hay Point ports all recorded increases in coal throughput in 2003-04 compared with the previous year.

Strong demand for minerals has also been supported by increased exploration expenditure. The Australian Bureau of Statistics reports that expenditure on mineral exploration in Queensland (excluding petroleum) rose by 9.5% in 2003-04 to $125.2 million, with about half spent on coal exploration. Queensland accounted for 16.0% of mineral exploration expenditure in Australia in 2003-04.

Overall, the outlook for Queensland’s mining industry remains positive with further growth expected in key export markets.

### Overseas merchandise exports

In annual terms, the nominal value of Queensland’s overseas merchandise exports rose by 17.1% in June quarter 2004. This is the first annual increase since March 2002. The improvement in export performance was driven by strong rises in the value of rural and mineral exports.

The value of rural exports from Queensland rose strongly, by 31.9%, in June quarter 2004 compared with a year earlier. A 26.8% rise in the value of meat
exports (which accounted for 57.2% of rural exports in the quarter) drove the overall rise in the value of rural exports. Beef prices rose during the quarter, resulting from increased demand from Japan for Australian meat. This is a result of restrictions placed on beef exports from Canada and the United States following an outbreak of BSE in late 2003, which has curtailed global market supply. Improvements in seasonal conditions in 2003-04 have also led to strong annual increases in the nominal value of cereals and textile fibre exports in the June quarter (up 148.8% and 52.2% respectively).

**Overseas merchandise exports, Queensland**

*(nominal)*

| Source: ABS, unpublished foreign trade data |

<table>
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<th>June quarter</th>
<th>Rural (a)</th>
<th>Change</th>
<th>Crude minerals</th>
<th>Manufactures</th>
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<td>2004 $m</td>
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<td>Processed minerals and metals</td>
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<td>17.4</td>
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</tr>
<tr>
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<td>270.8</td>
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</tr>
<tr>
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<td>1,453.6</td>
<td>31.9</td>
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<td>1,775.6</td>
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<td>512.3</td>
<td>20.2</td>
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<td>2,287.9</td>
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<td>Total crude minerals</td>
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<td>1,032.5</td>
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<td>590.5</td>
<td>8.5</td>
<td>90.8</td>
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<td>Processed minerals and metals</td>
<td>56.2</td>
<td>60.6</td>
<td>7.8</td>
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<tr>
<td>Non-ferrous</td>
<td>544.4</td>
<td>590.5</td>
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<td>182.7</td>
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<td>56.2</td>
<td>60.6</td>
<td>7.8</td>
<td>651.1</td>
</tr>
<tr>
<td>Total</td>
<td>600.6</td>
<td>651.1</td>
<td>8.4</td>
<td>Transport equipment</td>
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<td>182.7</td>
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<td>73.4</td>
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<tr>
<td>Transport equipment</td>
<td>55.6</td>
<td>50.8</td>
<td>-8.8</td>
<td>80.5</td>
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<tr>
<td>Miscellaneous manufactures</td>
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<td>3.8</td>
<td>12.2</td>
<td>442.4</td>
</tr>
<tr>
<td>Other manufactures – other</td>
<td>453.4</td>
<td>442.4</td>
<td>-2.4</td>
<td>1,032.5</td>
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<tr>
<td>Total</td>
<td>1,054.0</td>
<td>1,093.5</td>
<td>3.7</td>
<td>Total manufactures</td>
</tr>
<tr>
<td>Confidential and special (a)</td>
<td>876.1</td>
<td>1,032.5</td>
<td>17.8</td>
<td>1,032.5</td>
</tr>
<tr>
<td>Total</td>
<td>5,012.4</td>
<td>5,867.5</td>
<td>17.1</td>
<td>Total manufactures</td>
</tr>
</tbody>
</table>

(a) Most of the value of sugar exports, an important revenue earner for Queensland, is included in the confidential and special category.

Further, the value of ‘confidential and special’ exports, of which a large proportion is sugar, rose by 17.8% in June quarter 2004 compared with the same quarter a year earlier.

The nominal value of coal, other crude minerals, and processed mineral and metal exports also rose in the June quarter. The nominal value of coal exports rose by 14.3% in the quarter compared with a year earlier, while the value of other crude mineral exports and non-ferrous metal exports rose by 20.2% and 8.5% respectively. Rises in the value of mineral exports were driven in part by the depreciation of the $A against the $US over the period.

Overall, the nominal value of ‘other manufactures’ exports, including chemicals, leather and rubber products, machinery and transport equipment, fell by 2.4% over the year to the June quarter, largely reflecting a decrease in the value of chemical exports (down 10.0%).

The nominal value of Queensland’s overseas merchandise exports to most of the State’s major export destinations rose over the year to June quarter 2004. Exports to North East Asia (excluding Japan), South East Asia and Japan rose over the year (up 40.1%, 30.7% and 24.4% respectively). A 31.1% annual increase in the value of coal exports to Asia in the quarter drove the rise. Exports to New Zealand and the United States also increased, by 23.3% and 11.3% respectively. Meanwhile, the nominal value of exports to the European Union and the United Kingdom fell marginally over this period.

**Commodity prices**

The weighted index of international prices for Queensland’s major commodity exports rose in both $A and SDR terms, by 11.7% and 4.2% respectively, in June quarter 2004. A 7.3% depreciation in the $US/$A exchange rate over the quarter partially drove the rise in the index.

**Queensland Commodity Price Index**

*(Index base 2001-02 = 100, quarterly)*

| Source: Queensland Treasury |

<table>
<thead>
<tr>
<th>All commodities ($A)</th>
<th>All commodities (SDR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>120</td>
<td>100</td>
</tr>
<tr>
<td>100</td>
<td>80</td>
</tr>
</tbody>
</table>

Note: The components of the Queensland Commodity Price Index have recently been re-weighted to reflect their current shares of total Queensland exports. Accordingly, the index is not directly comparable with those published in previous editions of the Queensland Economic Review.

The agricultural index rose by 5.1% in $A terms in the June quarter. A rise in the index was supported by an increase in the price of beef exports to the United States and Japan, up 32.2% and 7.2% respectively, over the quarter. In SDR terms, however, the index fell by 1.9%, driven by a deterioration in the $A over the period.
In S$A and SDR terms, the minerals index rose strongly, by 15.6% and 7.8% respectively, in the June quarter. The rise in the index was mainly driven by a rise in the price of coal exports. Continued demand from Asia for construction materials helped to boost world prices of nickel, aluminium and lead (up 6.0%, 4.6% and 2.6% respectively) over the quarter.

**Tourism**

Short-term visitor arrivals to Australia rose 0.8% in trend terms in June quarter 2004 to be 4.1% higher over the year. The increase reflects a strengthening in the world economy and the passing of the major impacts from previous terrorist events and disease outbreaks. While it is likely that the terrorist bombing in Jakarta on 9 September will have some impact on visitor arrivals to Australia, it is too early to quantify the possible impact at this stage.

**Inflation**

Consumer price inflation, measured by the change in the Consumer Price Index (CPI), stood at 0.6% in Brisbane in June quarter 2004, giving an annual rate of 3.2%.

Domestic pressures have driven Queensland inflation, with the housing cycle resulting in housing costs contributing 50% of the rise in the Brisbane CPI over the year to the June quarter. The impact of higher crude oil prices on fuel costs as well as higher health and alcohol and tobacco costs also contributed to the increase in Queensland prices in 2003-04. Despite a recent depreciation of the S$A, its steady appreciation over much of 2003-04 caused the price of overseas holidays as well as imported goods such as electronic equipment to fall over the year.

Nationally, headline consumer prices rose by 0.5% in the June quarter, to be 2.5% higher than a year earlier and in the middle of the Reserve Bank’s 2-3% inflation target band. However, the annual inflation rate was higher in the June quarter (from 2.0% in the March quarter), representing the first time the annual inflation rate has risen since March quarter 2003.

Recent currency movements have caused a disparity between the prices of traded and non-traded goods and services in the national economy. The prices of internationally traded goods and services rose only 0.5% over the year to June quarter 2004, while non-traded goods and services rose 4.1% over the year.

The recent depreciation of the S$A has sparked fears that inflation in internationally-traded goods and services may increase from recent lows and therefore cause an upward movement in the overall inflation rate. As a result, the Reserve Bank has recently revised its inflation forecasts upward.

**Wages**

The two key labour cost measures produced by the ABS show that wages in Queensland and nationally continued to increase at a sustainable rate in June quarter 2004.

The preferred measure of growth in wages and salaries is the Wage Cost Index (WCI), as it removes the increase in wages due to productivity improvements, giving a clearer indication of the rise in actual wage
costs. According to the WCI, the total hourly rate (excluding bonuses) in Queensland increased 0.4% in the June quarter, to be 3.7% higher over the year. Nationally, the WCI rose 0.5% in the quarter, to be 3.5% higher over the year.

Trend average weekly ordinary time earnings (AWOTE) for adults employed full-time grew 0.8% in Queensland in the June quarter. Following increases of 1.0% or above in each of the five previous quarters, annual growth in AWOTE remained relatively high, at 5.6% over the year. Nationally, AWOTE rose 0.7% in the June quarter, while annual growth eased to 3.8%, down from a recent peak of 5.9% in September quarter 2003.

**Wages growth (WCI)**
(annual % change, quarterly, original)

Queensland’s strong wages growth over the past year partly reflects tightening labour market conditions, with the trend unemployment rate in June quarter 2004 at its lowest rate since September quarter 1981, and ongoing improvements in productivity, as evidenced by annual growth in the WCI in Queensland remaining below growth in AWOTE.

**Population**

Population growth in Queensland eased 0.1% point to 0.5% in March quarter 2004, with the State’s estimated resident population increasing by 19,100 persons to 3,863,600. Similarly, annual population growth eased slightly, down 0.1% point to 2.2% or 82,300 persons over the year to the March quarter. Queensland has now recorded annual population growth of 2% or above for 11 consecutive quarters, although the rate of growth has eased in each quarter since a recent peak of 2.5% in March quarter 2003.

In the rest of Australia, population growth remained steady in March quarter 2004, up 0.3% or 44,800 persons over the quarter and up 1.0% or 152,500 persons over the year. As a result, the national estimated resident population passed 20 million persons in the quarter, to be 20,062,000 persons at the end of March.
China: Economic reform to the mid 1990s

The International Monetary Fund recently estimated that China has the world’s sixth largest economy. It has rapidly evolved from a closed, centrally planned economy to a market-focused nation that is quickly integrating into the world economy. This rapid assimilation into world markets has had a major impact on the international economic landscape.

To understand China’s remarkable economic transformation and the likely implications for the Queensland and Australian economies, the Queensland Economic Review is publishing a series of three articles on China. This initial article outlines the history of China’s economic reform until the mid 1990s, from the China of Chairman Mao Zedong to that of Deng Xiaoping, and the process of liberalising and assimilating the Chinese economy into international markets. The more recent history and the current opportunities and challenges facing the Chinese economy, as well as the implications for Queensland and Australia, will be covered in subsequent articles.

Chinese economic reform and Chairman Mao Zedong

The catalyst for China’s early economic reform was the Communist Revolution, when the Chinese Communist Party (CCP) came to power. This led to the formal establishment of the People’s Republic of China in 1949, with Beijing as its national capital. Mao Zedong became the chairman of the new republic, a position he dominated until his death in 1976. The period of Mao Zedong’s leadership was characterised by wide-sweeping economic and social changes, driven largely by his individual political ideology.

The transition to socialism, 1949 to 1957

The CCP aimed to transform China into a socialist economy based on state ownership and bureaucratic economic coordination through central planning. In 1953, the Chinese Government began its officially designated ‘transition to socialism’ era by implementing its first five year plan (1953-1957).

This period was characterised by efforts to achieve industrialisation, collectivisation of agriculture, and political centralisation. Among China’s most pressing needs in the early 1950s were food for its large and growing population, and capital for investment, largely the purchase of technology, machinery and equipment, and military hardware.

To satisfy the first of these needs, the Government began to collectivise agriculture by redistributing land ownership and establishing agricultural producers’ cooperatives. In addition, the Government nationalised banking, industry and trade, while private enterprise in mainland China was virtually abolished. With the State holding economic control, policies were introduced to decentralise economic decision making in the Chinese economy by giving greater economic power to local governments. This decentralisation took the form of two distinct waves of policy reforms: the first from 1958 to 1962; and the second from 1966 to Mao Zedong’s death in 1976.

The Great Leap Forward, 1958 to 1962

With the first five year plan completed, sweeping government reforms were introduced in 1958, coined by Mao Zedong as ‘The Great Leap Forward’. These reforms were aimed at accomplishing the economic and technical development of the country at a rapid pace. The Great Leap Forward initiative was a policy of extensive administrative decentralisation, with the target of a high economic growth rate to overtake the United Kingdom and catch up with the United States in terms of economic wealth. This was to be achieved by rapidly raising industrial and agricultural production and decentralising the control of many of China’s industries.

This process centred on a new socioeconomic and political system, involving grouping the population into autonomous regions, known as people’s communes. By 1958, about 750,000 agricultural producers’ cooperatives had been amalgamated into approximately 23,500 communes, each averaging 5,000 households, or 22,000 people. Each commune was planned as a self-supporting community for agriculture, small-scale local industry, schooling, marketing, administration, and local security. The individual commune was placed in control of all the means of production and was to operate as the sole accounting unit. Each commune was responsible for remittance of fiscal revenue to the local government and for sharing agricultural and other products as a community.

Although these reforms began with enthusiastic support, they quickly encountered difficulties. Normal market mechanisms were disrupted, agricultural production declined, and corruption within communes developed. Between 1960 and 1962, China experienced the greatest famine in human history, estimated to have caused up to 30 million deaths.

This humanitarian and economic tragedy forced the government to reverse much of the 1958 commune policy in terms of autonomy. However, the communes...
remained as regional production sectors, which were allocated specific production quotas under the centrally planned system. Another result of the reversal of the Great Leap Forward reform was the recentralisation of many industries, including airlines, coal mining, petroleum production, the defence industry, railways and the major shipping harbours.

In April 1959, Mao Zedong, who bore the chief responsibility for the Great Leap Forward, stepped down as chairman of the People’s Republic. The National People’s Congress elected Liu Shaoqi as Mao Zedong’s successor. In the early 1960s, State President Liu Shaoqi and his protégé, Party General Secretary Deng Xiaoping, took over direction of the CCP and adopted economic policies at odds with Mao Zedong’s vision.

To recentralise economic control, the CCP established six regional bureaus responsible for agricultural production. On the industrial front, emphasis was now placed on realistic and efficient planning, with more control of production decisions given to managers and coordinators.

However, this change in policy direction was not to last. Through 1964 and 1965, Mao Zedong gradually but systematically regained control of the party.

The Cultural Revolution, 1966 to 1976

After consolidating his political leadership in the late 1960s, Mao Zedong’s second attempt at reform in 1970 saw a huge merging of government ministries, including the State Planning Commission, Economic Commission, Price Commission, Statistical Bureau, Labour Ministry and Material Ministry, to form a new State Planning Committee.

This was followed in the same year by the second wave of decentralisation, with a focus on regional steel production to support a modern and powerful Chinese army. Again, decentralisation was focused on grouping regional centres into communes.

Mao Zedong’s death in September 1976 removed the driving force behind China’s economic ideology since the Communist Revolution and prompted a search for a new leader of the CCP. The new, pragmatic leader was Deng Xiaoping – one of the consistent leaders of the opposing faction of the CCP prior to the Cultural Revolution. Deng Xiaoping emphasised the importance of economic development and adopted economic reform policies aimed at expanding rural income and incentives, encouraging experiments in enterprise autonomy, reducing central planning, and attracting foreign direct investment into China. This process was described as the ‘Open Door Policy’ initiative of 1978 and marked the beginning of China’s historical transition to a market economy.

The Open Door Policy and the transition to a market economy

Deng Xiaoping’s 1978 Open Door Policy was an important period in the history of China’s economic reform and resulted in great changes to the Chinese economy, focusing on integration with the world economy.

Reforms were introduced to allow market forces of supply and demand to determine prices, and to remove the barriers between the local economy and the outside world. The Open Door Policy inspired wide-sweeping, market-based reforms that reached almost all sectors of the economy. Some of the key sectors of reform are outlined below.

(a) Agriculture and industry

China’s agricultural growth in the socialist period prior to the 1978 reforms was sluggish. However, as part of the Open Door Policy, China began a series of fundamental reforms in the rural sector.6

As one of the primary initiatives for reform, the Chinese Government implemented ‘dual-track’ goods, which carried two prices – a planned price as before, and a market price that was not regulated by the Government. This approach to market liberalisation was used in both the industrial and agricultural sectors (i.e. steel, coal and grain) and allowed the continuation of the centrally planned method of allocating grain (under the Chinese Government’s self-sufficiency policy), as well as the simultaneous instigation of a free market track. This dual-track approach aimed to protect the status quo under the pre-existing plan, while also stimulating and encouraging greater efficiency and production for exchange in the free market.7

The use of the market track expanded rapidly, rising from 5.6% of all transactions in 1978 to 69% in 1990, and the success of the agricultural reform strategy was apparent as early as 1984. Per capita rural incomes increased by about 50% in the first six years of the dual-track system and output rose by 25%. Chinese annual economic growth peaked at 15.2% in 1984. This was partially the result of the strong productivity-driven increase in output within the agricultural sector of 12.9% (see Table 1).

production. Four SEZs were established in Shenzhen, for business firms to locate there for export-based and to establish SEZs with a variety of incentives to encourage foreign investment and technology transfers. However, in 1979, a joint-venture law was enacted to and to carry out exporting and importing of goods. Only state-owned foreign trade corporations were allowed to have contact with foreign businesses restricting. Only state-owned foreign trade corporations were allowed to have contact with foreign businesses and to carry out exporting and importing of goods. However, in 1979, a joint-venture law was enacted to encourage foreign investment and technology transfers and to establish SEZs with a variety of incentives for business firms to locate there for export-based production. Four SEZs were established in Shenzhen, Zuhai and Shantou in Guangdong province and Xiamen in Fujian province. Later, in 1981, Hainan Island was designated as the fifth SEZ. In 1984, 14 cities along China’s Pacific coastline from Liaoning province in the north to Guangxi province in the south were declared Economic and Technical Development Zones, and were opened to foreign direct investment and technology (see Figure 1).

The inflow of foreign direct investment enabled market-focused production of essential commodities such as steel, coal and aluminium, and led to a peak in investment-driven growth in the secondary (14.5%) and tertiary sectors (19.4%) of the economy in 1984 (see Table 1).

In 1985, the existing SEZs were enlarged to cover a greater portion of China’s coastal areas and to focus on important commercial rivers, with both the Yangtze and Pearl River delta regions opened to foreign trade and investment. Furthermore, in line with the shift in ideology towards supporting markets, the Chinese Government worked towards stimulating foreign direct investment and technological development in these areas through specific policy initiatives to make the SEZs more attractive to foreign investors. Such policies included relaxing taxes and tariffs to companies within the zones and providing greater banking transparency.

The Open Door Policy exposed China to international linkages it had not experienced for over 30 years. Initially, much of China’s foreign linkages were with near neighbours, such as Hong Kong, Thailand, Japan and Taiwan, and were concentrated in the newly established SEZs in coastal China. To further encourage foreign trade, local authorities and enterprises were allowed to set up their own trading corporations. Large private firms were also allowed to engage in foreign trade directly. Whereas previously the Chinese Government had maintained tight control over foreign exchange, foreign trade corporations and exporting firms were allowed to retain up to 25% of their foreign exchange earnings, with further retention rights given to key export industries.

As a result of the implementation of SEZs, China experienced a rapid boom in foreign direct investment in the early 1990s. Foreign direct investment climbed from US$4.4 billion in 1991 to US$11 billion in 1992, and to US$28 billion in 1993, as China became the second most popular destination for foreign direct investment behind the United States.

### Table 1: Annual growth rate of GDP and components, China (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Primary industry(a)</th>
<th>Secondary industry(b)</th>
<th>Tertiary industry(c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>11.7</td>
<td>4.1</td>
<td>15.0</td>
<td>13.7</td>
</tr>
<tr>
<td>1980</td>
<td>7.8</td>
<td>-1.4</td>
<td>13.6</td>
<td>5.9</td>
</tr>
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<td>1982</td>
<td>9.0</td>
<td>11.5</td>
<td>5.5</td>
<td>13.0</td>
</tr>
<tr>
<td>1984</td>
<td>15.2</td>
<td>12.9</td>
<td>14.5</td>
<td>19.4</td>
</tr>
<tr>
<td>1986</td>
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<td>1988</td>
<td>11.3</td>
<td>2.5</td>
<td>14.5</td>
<td>13.2</td>
</tr>
<tr>
<td>1990</td>
<td>3.8</td>
<td>7.3</td>
<td>1.2</td>
<td>2.3</td>
</tr>
<tr>
<td>1992</td>
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<td>1994</td>
<td>12.6</td>
<td>4.0</td>
<td>18.9</td>
<td>9.6</td>
</tr>
</tbody>
</table>

(a) Agriculture. (b) Construction and manufacturing industries, as well as the provision of electricity and water services. (c) Predominantly services, excluding those included in secondary industry.


Strong growth continued through the early 1980s, with the application of the dual-track approach to both agriculture and steel paving the way towards markets by promoting efficiency and competition.

(b) Foreign direct investment and international linkages

An important goal of the Open Door Policy was to expand the level of investment in key sectors of the economy by attracting foreign direct investment as well as increasing economic wealth through international trade.

As a first step toward achieving this goal, China opened up a handful of selected regional areas, named Special Economic Zones (SEZs), to foreign investment and trade. The opening of these regions allowed an inflow of international capital into China, enabling a much greater level of investment in the economy, as well as foreign technology and expertise, prompting a surge in productivity.

The particular zones were selected as a result of their geographical advantage (i.e. on the coastline, close to Hong Kong and Taiwan) and their pre-existing infrastructure (which could support market industries), which made them readily accessible to foreign investors looking to establish production facilities.

Before 1979, foreign direct investment was severely restricted. Only state-owned foreign trade corporations were allowed to have contact with foreign businesses and to carry out exporting and importing of goods. However, in 1979, a joint-venture law was enacted to encourage foreign investment and technology transfers and to establish SEZs with a variety of incentives for business firms to locate there for export-based production. Four SEZs were established in Shenzhen, Xiamen in Fujian province. Later, in 1981, Hainan Island was designated as the fifth SEZ. In 1984, 14 cities along China’s Pacific coastline from Liaoning province in the north to Guangxi province in the south were declared Economic and Technical Development Zones, and were opened to foreign direct investment and technology (see Figure 1).

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The Open Door Policy exposed China to international linkages it had not experienced for over 30 years. Initially, much of China’s foreign linkages were with near neighbours, such as Hong Kong, Thailand, Japan and Taiwan, and were concentrated in the newly established SEZs in coastal China. To further encourage foreign trade, local authorities and enterprises were allowed to set up their own trading corporations. Large private firms were also allowed to engage in foreign trade directly. Whereas previously the Chinese Government had maintained tight control over foreign exchange, foreign trade corporations and exporting firms were allowed to retain up to 25% of their foreign exchange earnings, with further retention rights given to key export industries.

As a result of the implementation of SEZs, China experienced a rapid boom in foreign direct investment in the early 1990s. Foreign direct investment climbed from US$4.4 billion in 1991 to US$11 billion in 1992, and to US$28 billion in 1993, as China became the second most popular destination for foreign direct investment behind the United States.

(c) Exchange rate and convertibility of the Chinese yuan

Throughout the central planning period from the mid 1950s to the late 1970s, exchange rate policy in China was subordinate to trade policy, which aimed merely to balance imports against exports. Changes in the exchange rate could not affect directly the overall balance of trade because the volumes of imports and exports were fixed by a centrally determined trade plan. The exchange rate’s primary role was an accounting device linking foreign trade and the domestic economy. Economically, it was relevant only for non-trade transactions, such as foreign tourism and one-way income transfers.

Exchange rate reform began in the 1980s and was a process of improving or removing administrative restrictions over exchange rate decisions. The Chinese Government adopted a ‘crawling peg system’ to its currency, the yuan, meaning that the exchange rate was fixed, but was regularly revalued when the Chinese Government considered it to be overvalued. As Table 2 shows, the yuan was devalued nearly 200 times between 1981 and 1985.

Table 2: Historical nominal devaluations of the yuan

<table>
<thead>
<tr>
<th>Date</th>
<th>Devaluation (%)</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crawling peg exchange rate,</td>
<td>1981</td>
<td>13.6</td>
</tr>
<tr>
<td>incrementally adjusted</td>
<td>1982</td>
<td>9.7</td>
</tr>
<tr>
<td></td>
<td>1984</td>
<td>28.6</td>
</tr>
<tr>
<td></td>
<td>1985</td>
<td>14.3</td>
</tr>
<tr>
<td>Pegged exchange rate, infrequently adjusted</td>
<td>5 July 1986</td>
<td>15.6</td>
</tr>
<tr>
<td></td>
<td>16 Dec 1989</td>
<td>27.0</td>
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<tr>
<td></td>
<td>17 Nov 1990</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>1 Jan 1994</td>
<td>50.0</td>
</tr>
</tbody>
</table>


The experiment with the crawling peg ended in 1986. The official rate was then pegged, with occasional but large devaluations. Large and sudden fluctuations in the value of a country’s currency have serious implications for the revenues and costs of importers and exporters, and can cause economic and financial instability. Indeed, the fluctuations in the early 1980s had destabilised the Chinese economy, but the adoption of a pegged exchange rate in the late 1980s failed to bring stability to the currency. As a result, the Government formally announced the adoption of a floating exchange rate regime in April 1991.

A floating exchange rate adjusts to reflect the supply and demand of the currency, theoretically making the exchange rate more reflective of its actual value. However, the Chinese Government retained control of the level of the exchange rate by maintaining control over foreign exchange transactions and import and export licences.

As a result, the official exchange rate was gradually overwhelmed by a secondary ‘swap’ exchange rate market that had been developing during the late 1980s, and was not subject to such strict government controls. This market expanded rapidly, and by 1993, almost 80% of China’s foreign exchange transactions were conducted through this market. The swap market experiment proved to be a useful transition mechanism for China’s foreign exchange liberalisation. By enabling a considerable proportion of foreign exchange to be allocated through interactions between market demand and supply, it slowly wound down the system of exchange controls.

Despite the relative success of the swap market, the existence of multiple exchange rates led to unpredictable discrimination and profit-seeking activity. In order to minimise the disruption of the exchange rate on the economy, and to establish a stable exchange rate regime, China pegged the yuan at 8.3 yuan to the US dollar in 1994. Currency transactions were only allowed to occur in a tight band around this peg, a level that China has maintained to the present day.

After experimenting with a wide range of exchange rate regimes, many of which resulted in substantial currency devaluations, the Chinese Government appears to have settled on a rate fixed to the US dollar, providing a stable and predictable level for foreign transactions and facilitating international trade.

(d) Monetary system

Before 1978, the Chinese Government maintained control of the banking and finance sector, including central fiscal and monetary policy, as well as the setting of prices, wages, interest rates and exchange rates, with the stated objective of providing cheap resources for implementing production plans. The People’s Bank of China (PBC) was organised as a ‘mono-bank’, combining certain functions of a central bank and a commercial bank.13 The PBC was not a ‘bank’ in the commercial sense of profit seeking, loan payment, assets liquidity and bank solvency. Instead, it was an accounting subsidiary of the Finance Ministry, with the main function of assisting with the state production plans and ensuring they were fulfilled. The result was an inefficient allocation of the country’s investments.

As reform commenced in the real economy and the economic ideology of the Chinese Government began to evolve, the monetary system came under pressure to change.

In 1983, the State Council granted the PBC the authority of a central bank (including the administration of monetary policy) and transferred commercial operations to four specialised banks: the Agricultural Bank of China, for the rural sector; the Industrial and Commercial Bank of China, for the industrial sector; the People’s Construction Bank of China, for long-term investment; and the Bank of China, for foreign exchange business. Although each sector of the Chinese economy was initially serviced by only one bank, the banks were allowed to compete in each other’s previously monopolised sectors in 1984. This structural change has led to greater competition for deposits and loans, creating lower costs for businesses and individuals.

The reform period also allowed enterprises to make their own production and investment decisions, which had a number of consequences for the functions of monetary policy and the banking system.14

In the early 1980s, enterprises began to supplement planned wage and salary payments with bonus payments. In combination with the initiation of the dual-track price system on certain products in the early 1980s, the central authorities lost most of their control over prices. The increase in income, spending and goods prices threatened to increase inflation rapidly, highlighting the need for effective monetary policy. As a result, the Chinese Government introduced

a number of monetary policy tools, including a centrally determined interest rate for retaining indirect control over the economy’s debt and borrowing. By altering the interest rate, the PBC could change the cost of funds available to banks, and as a result, alter the amount of borrowing in the economy. However, the PBC adjusted official interest rates infrequently, making only 18 changes between 1978 and 1999.\textsuperscript{15}

In addition to interest rates, China implemented a fractional reserve system, which required banks to keep a certain fraction of their deposits with the PBC. Fractional reserve methods of controlling money supply are commonly used in developing economies as a method for ensuring stability of the banking system. By altering the required fraction, the PBC was able to indirectly control the amount of money that banks were lending to individuals and corporations. In this respect, the PBC was capable of indirectly adjusting the amount of lending conducted by the banking sector.

However, in addition to indirect money supply controls of interest rates and fractional reserves, the PBC also retained a credit quota allocation policy tool. This involved the PBC setting lending quotas for each regional and sectoral bank and specifying where funds should be directed.

After the early reforms, the central government was left with a significant revenue shortfall, as decentralisation had allowed private companies and individuals to retain a much higher proportion of their revenue. Meanwhile, many state-owned enterprises (SOEs) became loss-makers (and even technically bankrupt) because of strong competition from non-state and foreign counterparts, a sharp decline in budgetary grants, and the loss of state-protected markets. However, banks rapidly accumulated deposits resulting from robust economic growth in the non-state sectors, increased individual incomes, high savings incentives, and a lack of financial alternatives. The credit allocation policy allowed the Chinese Government to direct banks to provide loans to the SOEs, easing some of their financial difficulties.

Unfortunately, the banking system had to accommodate sizeable loans to largely unprofitable SOEs, increasing the fragility of China’s banking system and making further financial reform risky. This, together with the complex combination of monetary policy tools, reduced the transparency of the Government’s policy stance and complicated investment and savings decisions in the Chinese economy. Monetary policy and the burden of the SOEs continue to provide challenges for the Chinese economy to the present day.

(e) Labour market

The Open Door Policy of 1978 exposed the Chinese economy to a range of new international practices and foreign expertise. This resulted in an improvement in efficiency and productivity, and shifts in labour allocation throughout the 1980s, as labour market reform slowly caught up to the rest of the economy. However, much rigidity remained within the labour market until well into the 1990s.

As in the goods sectors, China’s labour market reform started with a dual-track market liberalisation approach. The Chinese Government believed that the success of the dual-track process in the agriculture and industry sectors could be transferred to the labour market. Indeed, this proved to be the case. Although around 70% of China’s 400 million employed persons in 1978 were farmers,\textsuperscript{16} Table 3 shows the impact of the dual-track approach to non-agricultural employment. The number of non-agricultural private sector employees increased by 319% between 1978 and 1994, while the number of employees in the public sector increased by only 51%.\textsuperscript{17} As a result, the private sector’s share of non-agricultural employment rose rapidly from 40% in 1978 to 65% in 1994.

Table 3: The dual tracks in non-agricultural employment, China (million persons)

<table>
<thead>
<tr>
<th>Year</th>
<th>Public</th>
<th>Private</th>
<th>Private employment as a proportion of total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>74.5</td>
<td>48.9</td>
<td>40</td>
</tr>
<tr>
<td>1983</td>
<td>87.7</td>
<td>62.1</td>
<td>41</td>
</tr>
<tr>
<td>1985</td>
<td>89.9</td>
<td>108.0</td>
<td>55</td>
</tr>
<tr>
<td>1988</td>
<td>99.8</td>
<td>138.3</td>
<td>58</td>
</tr>
<tr>
<td>1989</td>
<td>101.1</td>
<td>136.5</td>
<td>57</td>
</tr>
<tr>
<td>1990</td>
<td>103.5</td>
<td>152.5</td>
<td>60</td>
</tr>
<tr>
<td>1991</td>
<td>106.6</td>
<td>159.5</td>
<td>60</td>
</tr>
<tr>
<td>1992</td>
<td>108.9</td>
<td>172.3</td>
<td>61</td>
</tr>
<tr>
<td>1993</td>
<td>109.2</td>
<td>195.9</td>
<td>64</td>
</tr>
<tr>
<td>1994</td>
<td>112.1</td>
<td>204.9</td>
<td>65</td>
</tr>
</tbody>
</table>

Labour market reform had a relatively fast and substantial impact on the Chinese economy, evident in the fall in the urban unemployment rate between 1978 and 1984 (see Figure 2).

Figure 2: Urban unemployment rate, China (%)
In addition, the implementation of the market track in agriculture encouraged individual farmers and growers to increase production and maximise income. The resulting boom in agricultural production soaked up much of the unemployed rural labour, complementing the falls in unemployment recorded in the urban areas.

The results of the dual-track labour reform were evident by the mid 1980s, with the market track allowing wages to follow more of a market trend of supply and demand. From the beginning of reform in 1978 to 1993, wages rose by more than 700% (see Figure 3).

Figure 3: Total wage index, China (1978 = 100)

![Figure 3: Total wage index, China (1978 = 100)](source: EconData)

**Conclusion**

The history of economic reform in China has been eventful and diverse, with the rapid and wide-sweeping changes of the Mao Zedong era – particularly the Great Leap Forward and the Cultural Revolution – being replaced by a market-based focus for the Chinese economy. Deng Xiaoping's Open Door Policy has been instrumental in guiding China’s transition to a market economy, and has proved to be, in general, a huge success for the Chinese economy. The policy has effectively introduced China into the world arena, while maintaining the basic stability of the Chinese economy.

However, the story of China’s reform does not end there. In the last decade, China has continued with reform in the face of negative external shocks such as the Asian financial crisis and SARS. Many economic reform challenges remain, including state-owned enterprises, exchange rate reform and meeting the requirements of membership of the World Trade Organisation. These topics, as well as the implications of China’s reform for Queensland and Australia, will be covered in future articles in the *Queensland Economic Review*.

**References**


### Major economic indicators by state

<table>
<thead>
<tr>
<th>Indicator</th>
<th>ABS cat. no.</th>
<th>Data period</th>
<th>Growth</th>
<th>Qld as % of Aust</th>
<th>Qld</th>
<th>NSW</th>
<th>Vic</th>
<th>Growth rate</th>
<th>SA</th>
<th>WA</th>
<th>Tas</th>
<th>Aust</th>
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</thead>
<tbody>
<tr>
<td><strong>Gross state product (a) (cvm)</strong></td>
<td>5206.0</td>
<td>Jun-04(q)</td>
<td>Annual</td>
<td>18.2</td>
<td>11.2</td>
<td>4.4</td>
<td>5.5</td>
<td>4.9</td>
<td>7.2</td>
<td>7.3</td>
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<td>Household final consumption expenditure</td>
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<td>Private gross fixed capital formation</td>
<td>5206.0</td>
<td>Jun-04(q)</td>
<td>Annual</td>
<td>20.1</td>
<td>12.0</td>
<td>7.9</td>
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<td>0.5</td>
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<td>Public final demand</td>
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<td>State/national final demand</td>
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<td><strong>Gross state product/gross domestic product</strong></td>
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<td>Quarterly</td>
<td>na</td>
<td>0.2</td>
<td>na</td>
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<td>na</td>
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<td>Retail trade</td>
<td>8501.0</td>
<td>Jun-04(q)</td>
<td>Quarterly</td>
<td>21.5</td>
<td>4.6</td>
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<td>-0.9</td>
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<td>Jun-04(q)</td>
<td>Quarterly</td>
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<td>4.6</td>
<td>-0.5</td>
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<td>Dwelling approvals (no.)</td>
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<td>-3.4</td>
<td>-1.4</td>
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<td>15.2</td>
<td>-15.1</td>
<td>3.2</td>
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<td>17.0</td>
<td>-18.9</td>
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<td>New equipment (v)</td>
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<td>0.8</td>
<td>-2.7</td>
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<td>Population</td>
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<td>Mar-04(q)</td>
<td>Annual</td>
<td>19.3</td>
<td>2.2</td>
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<td>Qtr level</td>
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<td>0.1</td>
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<td>Quarterly</td>
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<td>1.9</td>
<td>0.1</td>
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<td>2.4</td>
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<td>DEWR (b) Skilled Vacancy Survey</td>
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<td><strong>Wages and prices</strong></td>
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<td>Average weekly ordinary time earnings (l)</td>
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<td>Jun-04(q)</td>
<td>$ level</td>
<td>93.5</td>
<td>890.4</td>
<td>995.8</td>
<td>953.7</td>
<td>873.3</td>
<td>956.5</td>
<td>845.5</td>
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<tr>
<td>Consumer Price Index (o)</td>
<td>6401.0</td>
<td>Jun-04(q)</td>
<td>Quarterly</td>
<td>93.5</td>
<td>3.2</td>
<td>2.3</td>
<td>2.1</td>
<td>3.0</td>
<td>2.6</td>
<td>2.5</td>
<td>2.5</td>
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</table>
| **Note:** All data are in trend terms unless otherwise indicated. Annual growth rate is the percentage change between the latest quarter and the same quarter a year earlier. Quarterly growth rates represent growth on the previous quarter. (d) The Queensland State Accounts are the source of all Queensland data, except state final demand. Remaining data, i.e. for other states, Australia, and state final demand for Queensland, are sourced from ABS 5206.0. (b) Commonwealth Department of Employment and Workplace Relations.  
cvm - chain volume measure  
l - level or rate, i.e. not rate of change  
o - original  
q - quarterly data  
v - value  
na - not available
Economic indicator charts

Retail trade
(quarterly % change, CVM, trend)
Source: ABS 8731.0

Residential building approvals
(quarterly % change, trend)
Source: ABS 8731.0

Queensland commodity price indices
($A, index base 2001-02 = 100, quarterly)
Source: Queensland Treasury

Red meat production and wool receivals
(annual % change, quarterly, trend, Queensland)
Source: ABS 7215.0

New motor vehicle sales
(quarterly % change, trend)
Source: ABS 9314.0

Private non-residential construction indicators
(annual % change, quarterly, Queensland)
Source: ABS 8731.0, 8752.3 and 8762.0

Coal production
(kt, quarterly)
Source: ABARE, Quarterly Mineral Statistics

Overseas merchandise exports
(annual % change, 12 month rolling sum, Queensland)
Source: ABS 5422.0
Commodity price charts

Note: All charts show quarterly average data.

Sugar prices
(US cents/pound, quarterly)
Source: New York Commodities Exchange

Wheat prices
($US/t, quarterly)
Source: Australian Wheat Board

Export coal prices*
($A/t, weighted export price, quarterly, Queensland)
* Recent movements in coal prices may not be accurately reflected, due to lags in receiving coal price data.
Source: Department of Natural Resources and Mines; and Queensland Treasury

Beef prices
(Index base 2001-02 = 100, $US, quarterly)
Source: Livestock and Meat Authority - Weighted Export Price Index

Wool prices
($A/kg, quarterly)
Source: Australian Wool Corporation - Wool Market Indicator

Gold prices
($US/ounce, quarterly)
Source: New York Mercantile Exchange

Aluminium and copper prices
($US/t, quarterly)
Source: London Metals Exchange

Nickel and lead prices
($US/t, quarterly)
Source: London Metals Exchange

Note: All charts show quarterly average data.
Glossary

ABARE
Australian Bureau of Agricultural and Resource Economics

ABS
Australian Bureau of Statistics

annual change, monthly
percentage change between one month and the same month a year earlier

annual change, quarterly
percentage change between one quarter and the same quarter a year earlier

AWE
average weekly total earnings for all employees. Includes overtime earnings and part-time workers’ earnings, in addition to full-time workers’ ordinary time earnings.

AWOTE
average weekly ordinary time earnings for full-time adults. Includes award wages and over award (or ‘drift’) payments.

chain volume measures (cvm)
conversion of prices (by means of an index) in order to abstract from the effects of inflation. Designed to reflect changes in quantity, rather than price, they are often referred to as ‘real’ terms. Chain volume measures are compiled by linking together (compounding) movements in volumes, calculated using the average prices of the previous financial year, and applying the compounded movements to the current price estimates of the reference year.

CPI
Consumer Price Index

current prices
the total value in today’s dollars. Movements reflect both quantity and price changes. Often referred to as ‘nominal’ terms.

DEWR
Department of Employment and Workplace Relations (formerly DEWRSB, DEETYA, DEET)

EMU
European Monetary Union – launched on 1 January 1999. Comprises Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

EU
European Union – comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

GDP
Gross Domestic Product – the total value of final output produced in the nation in a given period of time

GNE
Gross National Expenditure – the total value of final household and general government consumption spending, gross private and public investment and change in inventories by the nation in a given period of time

GSE
Gross State Expenditure – the total value of household final consumption spending, gross private investment and government spending in a given period of time

GSP
Gross State Product – the total value of final output produced in the State in a given period of time

IMF
International Monetary Fund

leading indicators
statistics or data which provide an early indication of a likely change in the pattern of economic activity

moving average
average value of a series of data calculated over a set period such that, as new data become available, the earliest dated observation is removed from the calculation of the average and the most recent observation added in its place

natural increase
the excess of births over deaths

net exports
exports minus imports. For Queensland, includes interstate as well as overseas trade.

net interstate migration
the excess of interstate migrant arrivals over departures

net overseas migration
the excess of overseas migrant arrivals over departures

OECD
Organisation for Economic Cooperation and Development

original data
raw or unadjusted survey based data

seasonally adjusted data (sa)
original data are adjusted to remove the effect of identifiable movements due to regular seasonal factors, e.g. Christmas, Easter, etc.

SDR
Special Drawing Rights. Calculated by the International Monetary Fund, based on a weighted average of five key world currencies – the $US, German mark, French franc, Japanese yen and Pound sterling.

State Final Demand
the total value of final household and general government consumption spending, and gross private and public investment, in a given period of time

tourism
interstate (overseas) tourism exports refers to interstate (overseas) residents holidaying in Queensland. Imports are Queensland residents holidaying interstate (overseas).

trend data
seasonally adjusted statistical data are smoothed to reduce the impact of irregular factors and allow analysis of the underlying behaviour of the series over time

TWI
Trade Weighted Index

year average growth
percentage change between the average over one year and the average over the previous year

yield curve
plots market yields against the term to maturity for a range of securities. If the yield on longer-term securities is higher (lower) than short-term securities the yield curve is said to be positively (negatively) sloped
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The Office of Economic and Statistical Research (OESR), a portfolio office of Queensland Treasury, is the principal agency for independent economic, social and demographic information, advice and research for the Queensland Government.

The main office is located in Brisbane, with regional offices in Townsville, Rockhampton and Cairns.

Core business
OESR provides the following services:

- Economic and statistical research – the office advances research agendas in economic, social and demographic issues in partnership with Government agencies and the academic community
- Economic and statistical modelling – OESR conducts a range of economic, social and demographic modelling to improve Government decision making
- Statistical services – the office designs, collects, analyses and disseminates a wide range of accurate and timely information to aid high quality planning, decision making, resource allocation and policy development
- Statistical coordination and information management – the office performs various coordination and information management functions across Government.

Products and services
Examples of the products and services produced by the office are:

- Economic and statistical information, econometric and social modelling
- Major surveys on social issues such as crime victimisation, consumer issues, the environment, government services, and community issues and attitudes
- Publications and reports on a range of economic and statistical issues important to the growth and development of the State and its regions
- The Queensland State Accounts and state and regional input-output tables.

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