

GROUP MARKET OUTLOOK

AUGUST 2007

LEIGHTON HOLDINGS LIMITED ABN 57 004 482 982

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LEIGHTON

Group Market Outlook

August 2007

Overview

The **Leighton Group Market Outlook** provides an overview of the Leighton Group's key markets and activities in **Australia**, with an economic overview of key countries in **Asia** and the **Gulf** region.

In Australia, the markets of focus are:

Infrastructure

- including road, rail, water, electricity and telecommunications;

Resources

- including construction of new mines, heavy industrial facilities and contract mining activities;

Property

- including commercial, social and residential property construction and development; and

Services

- including operation and maintenance activities and waste management.

This publication is made available to key stakeholders and internal staff on a half yearly basis (February and August). Leighton Holdings would like to acknowledge the use of actual and forecast data from key economic research houses in the preparation of this publication. This document may not be distributed, or information quoted or copied, without prior written consent from Leighton Holdings' General Manager, Investor and Corporate Affairs.



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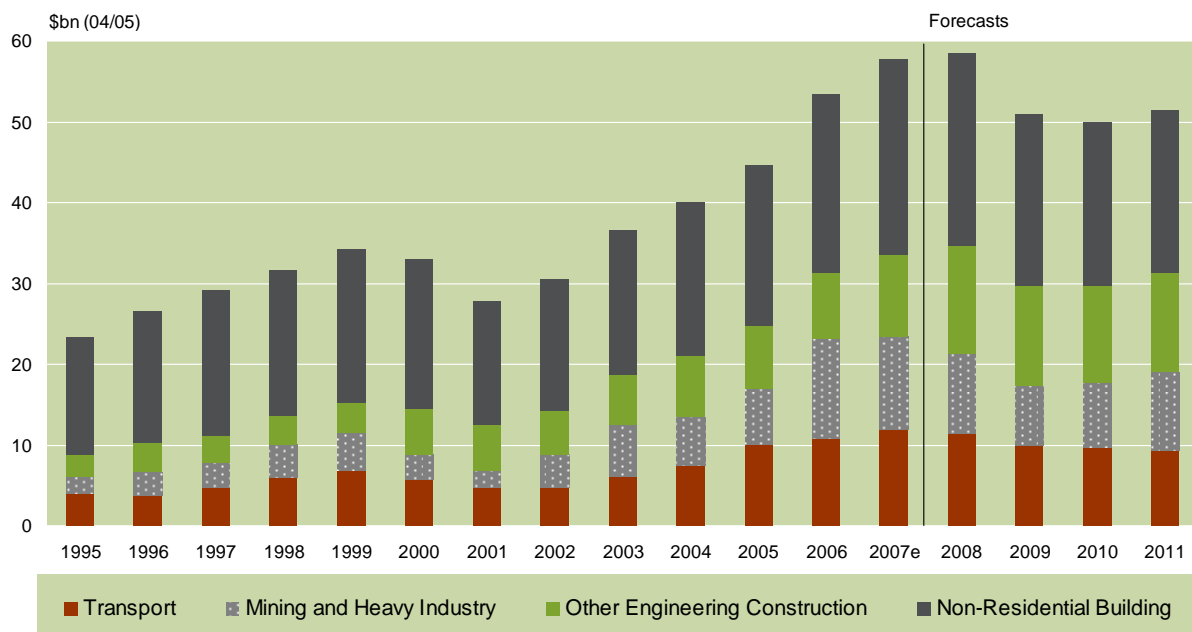
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Snapshot and Forecasts

- The Australian economy continues to reap rewards from the global commodities boom and is looking for GDP growth close to 4% through to 2008/09.
- The rates of growth in mining, construction and business investment are moderating from previous record levels, however there are strong signals that these sectors will remain the key driving forces of the economy for at least the next two years.
- With a Federal election this year and budget surpluses from most State Governments, fiscal spending is projected to remain extremely high and concentrated in transport and utilities.
- Western Australia and Queensland are expected to continue growing strongly primarily as a result of the resources stimulus, with NSW and Victoria predicted to pick up pace with an improving residential market and public investment.
- Wages growth and inflation have been remarkably modest, however underlying pressures are strong and are expected to remain so during the outlook period, with on-going capacity constraints.
- Skills shortages appear to be the key issue for businesses going forward – unemployment is expected to remain very low, although the participation rate is picking up. As a result, demand for office space will continue to be exceptionally tight through to the end of 2008.
- Interest rates rose by 25 basis points in August and one more rise is tipped for 2007/08, partly to contain the inflationary pressures arising from wages, transport costs and food prices.
- The Australian dollar has been very strong in 2007 reaching \$US0.88c. It is expected to remain above \$US0.80c over the next 12 months supported by strong commodity prices.

Figure 1: Levels of construction work done in Australia remaining high



Source: Bis Shrapnel, March and June 2007, Total Value of Work Done by the Private Sector (04/05 dollars), year ending June.

Table 1: Australian economic forecasts

Economy		04/05	05/06	06/07	07/08 f	08/09 f
Economic growth (GDP)	average %	2.7	2.9	3.1	3.8	3.9
Inflation – underlying (CPI)	average %	2.4	3.0	2.7	2.6	2.7
Interest rates (cash at June)	yr end %	5.50	5.75	6.25	6.75	6.50
Exchange rate \$US per \$A	yr end	0.76	0.74	0.84	0.81	0.75
Unemployment rate	yr end %	5.3	4.8	4.3	4.7	4.6
Wage Cost Index	average	4.0	4.1	4.1	4.2	4.1
Construction Value of Work Done¹		04/05	05/06	06/07 e	07/08 f	08/09 f
Engineering infrastructure (private)	\$ 000s	24.9	31.3	33.5	34.6	29.7
	% growth	18%	26%	7%	3%	-14%
Non-residential building	\$ 000s	19.8	22.1	24.3	23.8	21.3
	% growth	5%	11%	10%	-2%	-11%
Total construction	\$ 000s	44.7	53.4	57.8	58.4	51.0
	% growth	12%	19%	8%	1%	-13%

Source: Various, year ending June.

¹ Construction Value of Work Done in 2004/05 dollars.

Table 2: Economic forecasts across the World and Asia

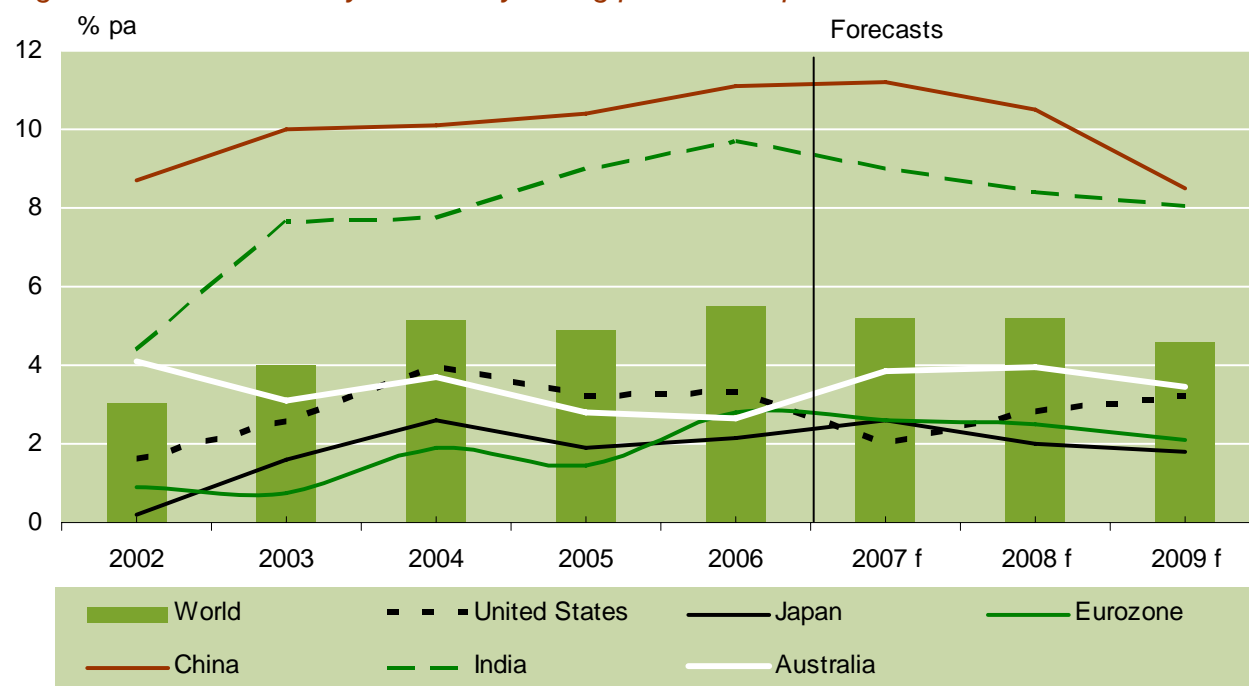
GDP Growth		2005	2006	2007 f	2008 f	2009 f
World	%	4.7	5.5	5.2	5.2	4.6
USA	%	3.3	3.3	2.0	2.8	3.2
Japan	%	1.9	2.2	2.6	2.0	1.8
China	%	10.4	11.1	11.2	10.5	8.5
India	%	9.0	9.7	9.0	8.4	8.1
Indonesia	%	5.7	5.5	6.1	6.6	6.0
Hong Kong	%	7.4	6.8	5.8	5.7	4.8
United Arab Emirates	%	8.5	9.7	8.2	7.2	5.0
Inflation		2005	2006	2007 f	2008 f	
USA	%	3.4	3.2	1.9	2.5	
Japan	%	-0.6	0.3	0.2	0.4	
China	%	1.8	2.8	3.0	2.5	
India	%	4.2	5.5	6.5	5.5	
Indonesia	%	10.5	13.1	6.3	6.0	
Hong Kong	%	1.2	2.2	2.5	2.7	
United Arab Emirates	%	7.8	10.1	6.2	4.6	

Source: Various, Year ending December.

Global Influences

- World GDP is expected to sustain its strong expansion and average growth around 5% in 2007 and 2008, however with increasing inflationary pressures.
- Whilst the slowdown in the US economy and negative credit situation pose some concern, it is industrialisation in developing countries that forms the basis for continued global expansion.
- Rapid growth in China and India is forecast to continue. China is now expected to exceed GDP growth in 2007 of 10% and India is heading for 8% growth.
- Demand from these countries is expected to keep global commodity prices reasonably high across the medium term, with positive flow-on effects for growth across the region
- Japan also appears to be on the economic rise again with positive capital expenditure and strong exports. This is good news for the region, particularly Australia where Japan is its largest trade partner after China.
- Parts of Europe are also picking up pace with Germany and the former Eastern European countries emerging confidently from economic reforms over the past decade.
- Global inflation has eased dramatically after the oil price spikes in 2005, however moderate pressures are emerging in demand-heated economies.
- These include wages pressures from tight labour markets globally and growing concern regarding asset price inflation from buoyant financial markets where there is an abundance of liquidity.
- The outlook for the Gulf region is also strong with average GDP growth of 7.5% predicted for 2008, however this may keep inflation high at around 5%.

Figure 2: Global economy is in a very strong position despite the US slowdown

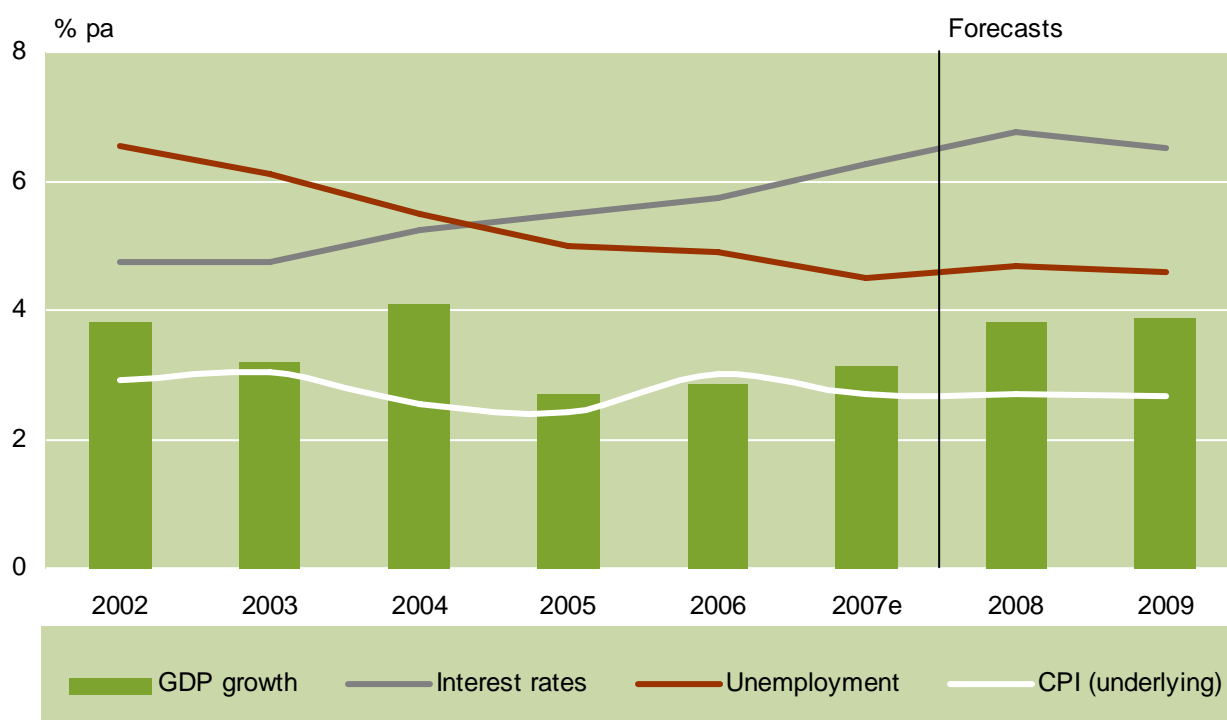


Source: Various, year ending December.

Economic Outlook for Australia

The economy is continuing on its positive upward swing, with some analysts saying it is in a 'purple patch' as it enters its 16th year of growth. GDP growth is forecast to reach close to 4% in 2007/08, largely based on an increase in commodity exports, particularly minerals. The focus has definitely turned to improving the 'supply side' of the economy – so that the country can leverage off the current enviable position of global demand exceeding supply. Skills shortages are still the biggest issue on business agendas and will continue to be a main focus as the ageing population has its effect on the workforce over the next decade.

Figure 3: Australian economy continuing to perform well



Source: Various, year ending June.

Mining and construction drivers to be joined by resurgence in consumer spending

The current 'mainstay' sectors of the economy – mining and construction, particularly transport and utilities – are expected to continue to drive the economy over the next two to three years, albeit with a moderation in the pace of growth. A change in fortunes for the residential construction sector is due in 2007/08, with housing shortages in the NSW and Victorian markets enticing investors and homeowners back into the market. Increased income flowing to households and corporates from greater employment, corporate profits and tax cuts is also expected to boost consumer confidence.

Inflation and wages growth relatively modest, despite continued underlying pressures

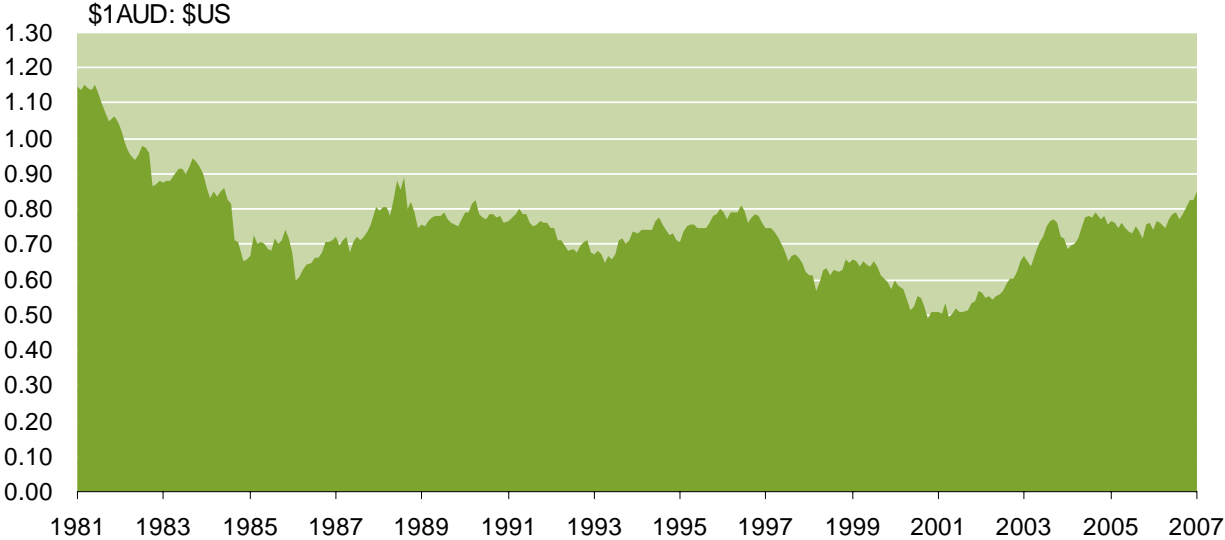
Despite capacity and wages pressures, inflation has remained within the RBA's target range to date and analysts are debating whether the peak has been reached. Although the effects from the resurgence in oil prices have been dampened by the higher exchange rate, upside pressures are still reflected in business surveys, producer prices and the level of work yet to be done. Food prices are also seeing general increases as a belated impact from the drought. Given these forces, the Reserve Bank of Australia increased interest rates to 6.50% in August and analysts are predicting one more interest rate rise could be possible over the next year.

Wages growth has been tracking higher than inflation between 4%-4.5% and this is expected to continue in the short to medium term. Overall this growth appears relatively modest in the face of adverse skills shortage conditions, although specific industries and States have experienced higher wage movements. Federal industrial relations reforms have been credited for creating a more moderate and stable wages growth environment. The unemployment rate is predicted to remain low between 4.5%-5% in 2007/08, although there has been a recent rise in the participation rate.

Exchange rate has recently surprised on the upside, lifting expectations for the future

The exchange rate has been one of the more noticeable changes in recent months, with the AUD hitting close to a 20-year record high of \$US0.88. Whilst this level is not expected to be sustained for long, it has pushed up short-to-medium-term expectations for the Australian dollar to an average of at least \$US0.80. The rise in the value of the dollar reflects the sustained high levels of commodity prices and the interest rate differential with the USA as Australian interest rates track higher.

Figure 4: Exchange rate hovering at the highest levels seen in a decade



Source: Reserve Bank of Australia, year ending June.

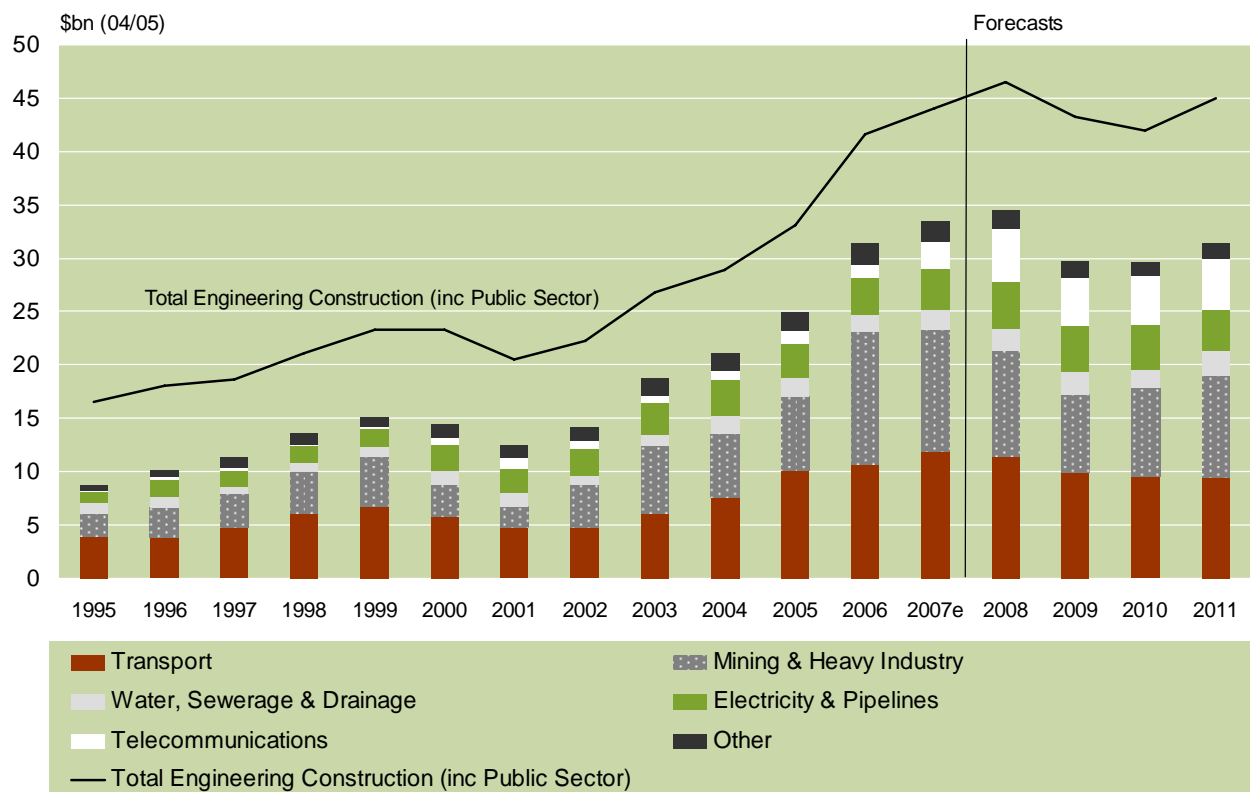
A stronger exchange rate has good and bad implications for the economy. The immediate effect has been the positive contribution to the value of Australian exports and the ‘cheaper’ nature of imports. This assists the current account deficit and boosts the terms of trade. The higher rate has also offset the recent oil price rise which would have otherwise had a greater effect on inflation and fuel prices. However, a stronger dollar stifles investment in non-resource industries – particularly manufacturing and tourism, as well as imports – increasing the cost of plant and machinery. If this is sustained over a longer period of time it erodes Australia’s global competitiveness across all industries.

Infrastructure

The level and value of activity across the engineering construction industry continues to impress. With final figures for 2006/07 yet to be released, the expectation is for almost \$34 billion worth of construction to have taken place by the private sector in engineering construction alone. This represents growth of around 10%, after an incredible 25% step-up in 2005/06. A peak is expected in 2007/08 at around \$35 billion. For the following three years, Bis Shrapnel forecast that the value of construction work by the private sector will retreat mildly to around \$30 billion. However, the industry's perception based on the level of work in hand and spate of recent government announcements indicates that any slowing is likely to occur later rather than sooner.

\$30 - \$35 billion represents extraordinarily high levels of construction. It is more than double the value of annual construction undertaken in the decade prior to 2004. A gradual slow down in the rate of construction should come as some relief to the industry, with the pressures on capacity more than evident with continued bottlenecks, project delays, cost overruns and in some cases complete deferment of projects, particularly in Western Australia.

Figure 5: Engineering construction, will there be a downturn?



Source: Bis Shrapnel, March and July 2007, Total Value of Work Done by the Private Sector (04/05 dollars), year ending June.

Heavy industry is the largest growth sector

The largest contributor to recent growth has been the heavy industry sector, driven by mining and industrial construction, amounting to around \$12 billion of construction annually. Although global market drivers such as demand from China have not abated, the sector is forecast to take a slight 'breather' with a considerable number of projects delayed due to capacity constraints and rising costs. (The drivers of this sector are discussed more fully in the Resources chapter.)

Transport industry spending over \$10 billion per annum

A close second in terms of value and growth is the transport sector – roads, rail, bridges and ports, which has doubled in value over the last five years to hit \$10 billion worth of construction annually. This sector is likely to continue with similar levels of expenditure across the medium term driven by:

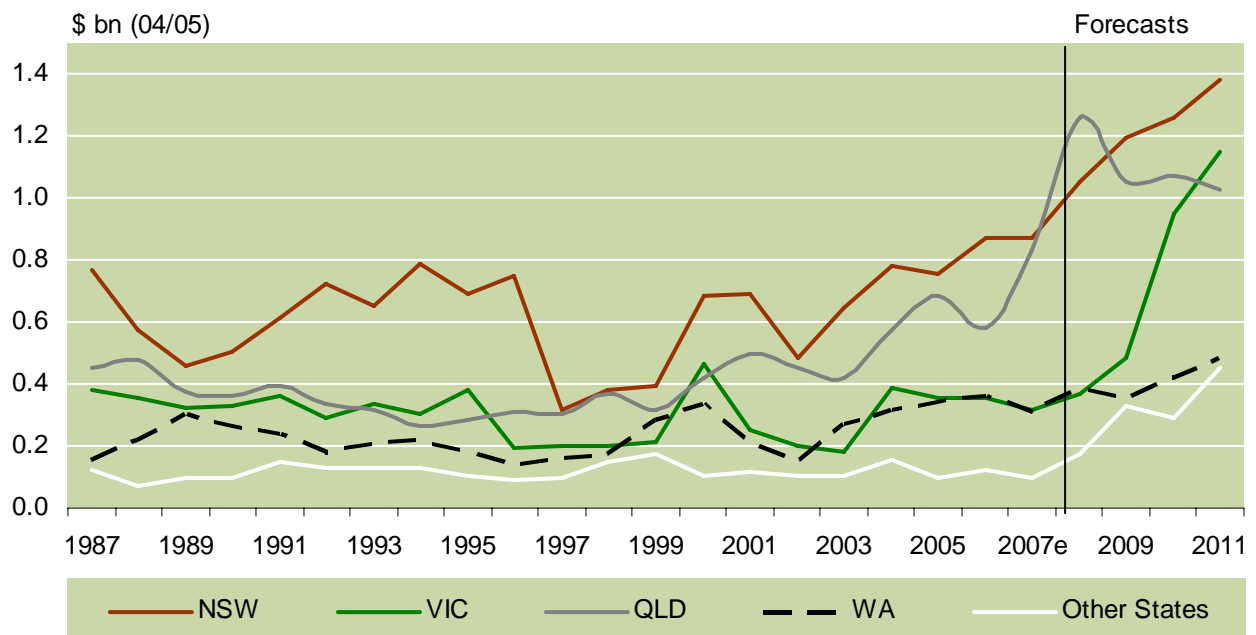
- The Federal Government \$22 billion Auslink II contributions from 2008/09, an increase of 40%;
- State Governments' focus on improving public transport and freight transport and handling; and
- Improvements required at ports and associated rail to relieve severe capacity constraints, particularly for the export of resources.

Whilst the spending emphasis within the roads sector is set to move from toll roads towards national highways, there are still a considerable number of major motorways on the drawing board in:

- Melbourne – \$2.0bn Eastern Freeway Extension;
- Sydney – \$2.0bn F3-M2 Orbital Link, \$2.0bn M4 East and \$1.9bn F6 Link; and,
- Brisbane – \$3.0bn Airport Link and \$ 2.2bn Northern Link.

Rail is also seeing serious investment with committed proposals for domestic passenger rail tracks, light rail city transport and new public and private freight lines. NSW Government has stated it wants 40% of freight in the State moved onto trains by 2012, which represents a 20% increase from the current situation. Victoria and Western Australia have also announced similar plans with the aim of moving 30% of port-related freight to rail by 2010.

Figure 6: Water sector in crisis mode, major project commitments occurring



Source: Bis Shrapnel, July 2007, Total Value of Work Done (04/05 dollars), year ending June.

Essential services including water, sewerage, electricity and telecommunications are receiving significant attention and are expected to continue growing in value over the next five years. The water sector is moving closer to crisis point around the country with desalination plant commitments recently made by almost every State, including a second plant for Western Australia, a \$3 billion plant for Melbourne and Sydney finally committing to its \$1 billion plant. Queensland is also not waiting for its \$1.2 billion plant to be completed and is progressing with commitments on two new dams at Traverston Crossing and Wyalong. South Australia will also require future water solutions,

particularly with the strong influx of resources investment. Whilst BHP Billiton will invest in its own desalination plant for its Olympic Dam site, the SA Government still needs to increase the capacity of its current dam or possibly use desalination for additional domestic supplies.

Power supply only as good as the underlying network

In electricity, the transmission and distribution network owners have secured reasonably large capital and maintenance funding and are in the midst of significant improvements and augmentation of their systems. With NSW recently hitting another peak in electricity demand, this time during winter, it provides a further catalyst for expenditure. NSW has also put privatisation of its retail arms on the agenda, although it is unlikely to happen in the next three years. Debate is also circling around new generation capacity with particularly strong calls from the NSW industry sector. Victoria and South Australia are also looking at further new capacity from the private sector, including wind farms.

Large spend on telecommunications still to come

The telecommunications industry is awaiting broadband and fibre-to-the-node announcements from the Government which could see over \$5 billion spent around the nation. Ongoing funding for telecommunications is said to be supported by the newly established \$2 billion Federal Government Telecommunications Fund which has been seeded from the privatisation of Telstra.

The Government has promised that 99% of the Australian population will have access to fast affordable broadband by 2009, with \$1 billion allocated to regional connections through the *Australia Connected* program. For capital cities and major regional centres, a fibre-to-the-node network is expected to be built. A competitive tender process is slated to commence in September with release of the terms of tender. Whilst the current Federal government is not expected to provide any public funding, they have stated they are prepared to legislate an effective monopoly to prevent overbuilding by competitors. Alternatively, the Labor Government is prepared to spend up to \$4.7 billion for its proposal, in conjunction with the private sector.

Private sector involvement growing as acceptance of PPPs increases

There is a growing acceptance of the PPP model with a national list of projects ranging from hospitals, prisons and schools through to roads and rail construction which the various Governments have stated will be offered as PPPs. However, legislation containing long-awaited changes to the tax treatment of finance arrangements for PPP projects has yet to be tabled in Federal Parliament. The reforms are intended to give greater certainty to parties involved in major infrastructure projects by making the tax rules simpler and more relevant to modern-day financing arrangements.

Federal Government and Auslink II

The biggest announcement from the Federal Government in the May Budget is the commitment of over \$22 billion to the Auslink II program from 2009/10 to 2013/14, a 40% increase over the current five year program. Auslink's mandate is to develop and maintain a national transport network, comprising road and rail links to major population and economic centres, as well as provide support to improve local roads. The next round of funding includes allocation to ports which has become a national economic issue.

Whilst the program and projects are still being finalised, the States are making their priorities known. Both Victoria and Queensland have submitted funding proposals worth over \$30 billion each. These include variations on the Inland Rail project, a high speed rail freight service between Melbourne and Brisbane, which has an expected capital cost of construction of \$3.4 billion. A scoping study has already been initiated by the Federal Government on this project.

There are certainly no shortage of projects, the hardest part will be deciding which projects take priority over the next five years. Projects that miss out on Federal funding, however, still have a very good chance of progressing, possibly with private sector funding arranged by the State, given there is such a pressing need to improve transport links.

Other Federal Government news includes:

- The increase in the Defence budget to \$22 billion. The current Defence Capability Plan outlines \$51 billion of new acquisitions over the next ten years which will raise the demand for associated services industries.
- A sharp focus on increasing the skilled migrated intake and initiatives in higher education, vocational training and schools. This is aimed at improving the quality and quantity of skilled workers across the short, medium and long term to overcome current capacity issues and the ageing population situation.
- The introduction of a carbon trading scheme by 2012 and the setting of an aspirational greenhouse gas emissions target. Final decisions will be made after the Federal Election.

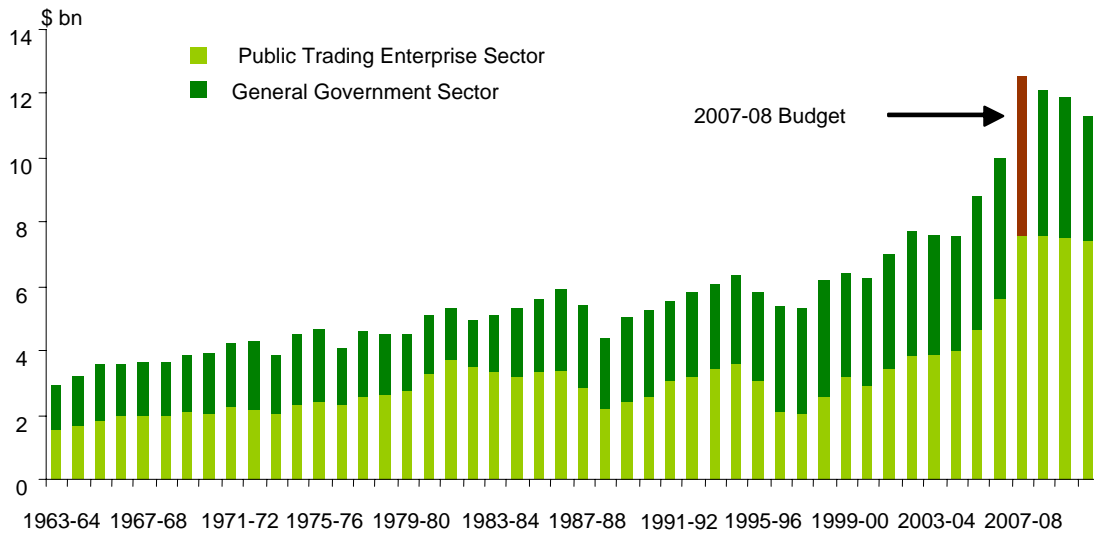
It is likely that further Federal Government initiatives in these areas, as well as additional areas such as broadband and other climate change policies will emerge in the lead-up to the election which is predicted to be held in November.

New South Wales

Recording the lowest State Product growth in 2006/07, NSW is determined not to be left behind in the coming years. It has increased its annual capital expenditure by almost 30% to \$12.5 billion for 2007/08, with plans to spend almost \$50 billion in the four years to 2011. This is part of the *NSW Ten Year State Infrastructure Strategy*, released in 2006 with forecast total capital expenditure to 2015/16 of \$110 billion, representing a major step-up and commitment going forward.

The *State Infrastructure Strategy* will be updated every two years and covers forecasts of the major capital priorities for the coming decade. It is supported by a *Metropolitan Strategy* and six individual regional strategies recently released which cover the Lower Hunter, Far North Coast, South Coast, Mid North Coast, the Illawarra and the Central Coast. Work is also underway on a *Sydney to Canberra Corridor Regional Strategy*.

Figure 7: NSW capital expenditure program showing significant increases



Source: NSW Treasury, May 2007, real 2007/08 dollars.

The current Budget will go towards the new \$1 billion desalination plant at Kurnell; the continuation of the \$1.8 billion rail clearways program and the planning of the South West and North West passenger rail extensions, where land has already been purchased. In education there will be over \$400 million of expenditure directed to schools and new TAFEs. The health portfolio has funding allocated to it for major works at the Orange, Mater, Liverpool and Royal North Shore Hospitals, where commencement processes are underway.

In road transport, the Premier has put the \$2 billion M4 East road connection firmly back on the agenda, which may be awarded as a PPP. The Government is also stepping up its push for an \$8 billion Sydney Harbour Rail Line, and will seek funding through Auslink II. This project, as well as the F3 Connection, F6 Freeway Extension and Spit Bridge Connection are listed in the Infrastructure Partnerships Australia 'Australia's Infrastructure Priorities' paper released on 1 August 2007.

Ports in NSW also require significant investment, particularly with the closure of the Sydney Harbour facility in 2012. New intermodal terminals at Enfield and Moorebank have been proposed and Port Botany will be expanded with the contract due to be awarded by the end of 2007.

Although only 10% - 15% of the State Plan is currently allocated to PPPs, the NSW Government has firmly reiterated its commitment to PPPs and private sector involvement. In May 2007, the NSW Treasury released its guideline on *Risk Allocation and Commercial Principles* which should further facilitate these types of projects going forward. The most anticipated news is whether the Government will go ahead with its privatisation agenda slated for its energy retailing arms, WSN Environmental Systems and Sydney Ferries.

Victoria

The Victorian Government had a surprise change in leadership on 30 July 2007 when Mr John Brumby, formerly the State Treasurer, stepped in as Premier on the resignation of Steve Bracks. The new Brumby Government has emphasised several priority areas including education, accelerating public transport improvements and strengthening the delivery of major projects.

This supports the Victorian Government's \$30 billion submission to Auslink II 'National Transport Links – Growing Victoria's Economy' which it recently published. The paper details 30 priority projects, with one of the larger projects proposed being the \$10 billion East-West road and Rail Tunnel for Melbourne. Also proposed is a \$2 billion tunnel under West Gate Bridge and freight links between Melbourne and Sydney and Melbourne and Brisbane.

Table 3: Priority Victorian projects submitted for Auslink II funding

Corridor	Project
Melbourne Urban	Western Ring Road Capacity Enhancement Dynon – Port-Rail Access and Port Precinct Intermodal Terminal Webb Dock Rail Access Metropolitan Intermodal Terminal Development (Altona/Laverton and Dandenong) Melbourne – Dandenong: Port Hastings Freight Link Stage 1
Melbourne – Adelaide	Western Highway Duplication – Ballarat to Stawell Western Freeway Realignment – Melton to Bacchus Marsh National Rail Dooen (Horsham) Intermodal Terminal
Mildura – Melbourne	Calder Highway Interchange – Calder Alternative Route, Ravenswood
Melbourne – Geelong – Portland – Mt Gambier – Adelaide	Geelong Ring Road – Stage 4A (Geelong Ring Road to Anglesea Road) Stage 4B (Anglesea Road – Princes Highway West) and Stage 4C (Surf Coast) Geelong Intermodal Terminal Princes Highway West Duplication – Waurin Ponds to Colac
Melbourne – Sydney	National Rail Improvement Program: North South Rail Line – Melb. to Wodonga Wodonga and Somerton Intermodal Terminals
Melbourne – Brisbane	Goulburn Valley Highway – Shepparton Bypass, Nagambie Bypass and Strathmerton Deviation Shepparton Intermodal Terminal
Sydney – Adelaide	Sturt Highway – Mildura Truck Bypass
Sale – Melbourne	Princes Highway East Duplication – Traralgon to Sale

Source: Victoria Department of Infrastructure, July 2007.

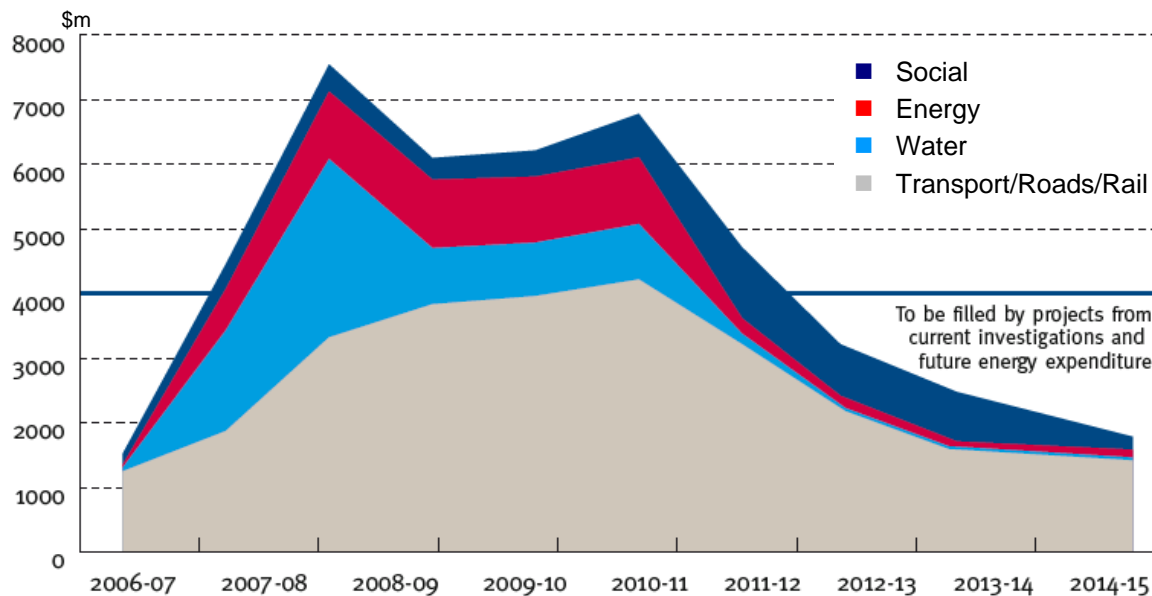
The biggest recent commitment by the Victorian Government is the desalination plant proposed for Wonthaggi. With an estimated cost of over \$3 billion, it will be the largest plant in Australia. The announcement from the Government has been made in light of low rainfall and a continuation of the drought, with Melbourne at Level 4 water restrictions. Partial funding will come from the expected budget surpluses to 2011 – an average of \$400 million per annum. The Government is also heavily focused on improving education, health and public housing. Key infrastructure project proposals include the \$450m Royal Children's Hospital redevelopment; construction of an additional 800 public housing units and a modernisation program for State schools.

Queensland

Queensland is benefiting enormously from the resources boom, and the State is capitalising on the higher levels of interstate migration created by the employment opportunities. It launched its largest-ever capital expenditure program in 2007, which will provide funding for infrastructure investment in regional Queensland; the continuation of the South East Queensland Infrastructure Plan (SEQIP) and the Transapex Road Scheme for Brisbane. Projects and costs for the SEQIP program were

recently updated, and now amount to over \$80 billion investment to 2026. This includes over \$50 billion for transport investment and further investigations, including funding for the Port of Brisbane and the Transapex scheme for the greater Brisbane area. Full details of each project are outlined in the *South East Queensland Infrastructure Plan and Program 2007 to 2026*, released in May 2007 and *Projects Queensland 2007*, due to be launched in August. This year also saw the launch of the *South East Queensland Regional Freight Network Strategy 2007 to 2012*.

Figure 8: South East Queensland Infrastructure Plan activity over 2007–2015



Source: Queensland Government, May 2007.

In addition, the State Government has recently submitted a \$30 billion funding submission to Auslink II which includes a \$2.5 billion rail link from Caboolture to Maroochydore. The Goodna Bypass has already secured Auslink funding with plans to be operational by 2012. The Government is also undertaking a business case for the Eastern Busway and the feasibility of a second range crossing which will bypass Toowoomba.

This will continue the incredible momentum in roads construction with two major projects currently well underway – Rivercity North-South Tunnel and the Gateway Bridge, and the Airport Link and Hale St Bridge projects are due for award soon. The remaining major road project under the Transapex Scheme will be the Northern Link toll road.

The Government has also stated it remains committed to working in conjunction with the private sector. It is currently delivering, or plans to deliver, major projects as PPPs such as the Airport Link, Toowoomba Bypass, the Gold Coast Rapid Transit project, regional hospitals and State schools. It is also currently seeking Expressions of Interest from the private sector to develop, own and operate an ultra high-speed broadband network in the Brisbane Local Government Area.

In addressing the water situation with Brisbane and surrounding areas at level 5 restrictions, an additional \$1 billion has been allocated to new water sources; the Traverston Crossing Dam and Wyaralong Dam. This is on top of the Western Corridor Recycling Project and \$1.2bn Tugun desalination plant which is well into construction. Together these projects will create a water grid capable of moving water from the Sunshine Coast through Brisbane to the Gold Coast, and will put Queensland amongst the world leaders in terms of water sustainability and recycling.

The Beattie Government has also admitted that the current structure of Queensland Rail is under investigation with reform options including a partial sell off. A main goal will be to improve the efficiency of the freight network which is currently a serious bottleneck to the mining industry. A report on the infrastructure backlogs at the State's ports is due out in August.

Western Australia

Western Australia is climbing up the ranks in terms of spending per capita, with the 2007/08 Budget outlining over \$21 billion worth of infrastructure expenditure over the next four years across electricity, new water assets, road and health-related assets – including a \$1 billion hospital. This will be funded by the huge capital surpluses generated from resources income. The capital works program will be a staggered timetable, with the commencement of two major infrastructure projects – the Northbridge Link Rail project and the Stadium, postponed by the Government due to cost escalation and the inability to secure staff and resources in the current environment.

Table 4: Top infrastructure priorities proposed for South Australia and Western Australia

Western Australia	South Australia
Fiona Stanley Hospital	Royal Adelaide Hospital Redevelopment
Multi User Sporting Arena	City Tram Loop
Northbridge Link	Northern Expressway
Fremantle Inner Harbour Dredging	Melbourne – Adelaide Crossing Loop Extensions
Oakajee Port Development	National Energy Market – new interconnectors and base load
Fremantle Outer Harbour Port Development	Adelaide Desalination Plant
Goldfields Water Project	Adelaide Water Recycling Projects

Source: Infrastructure Partnerships Australia, August 2007.

South Australia

In South Australia, the \$7 billion BHP Billiton Olympic Dam development, and the award of the \$8 billion Defence contracts for ship building will be major catalysts for the State's economic growth and investment.

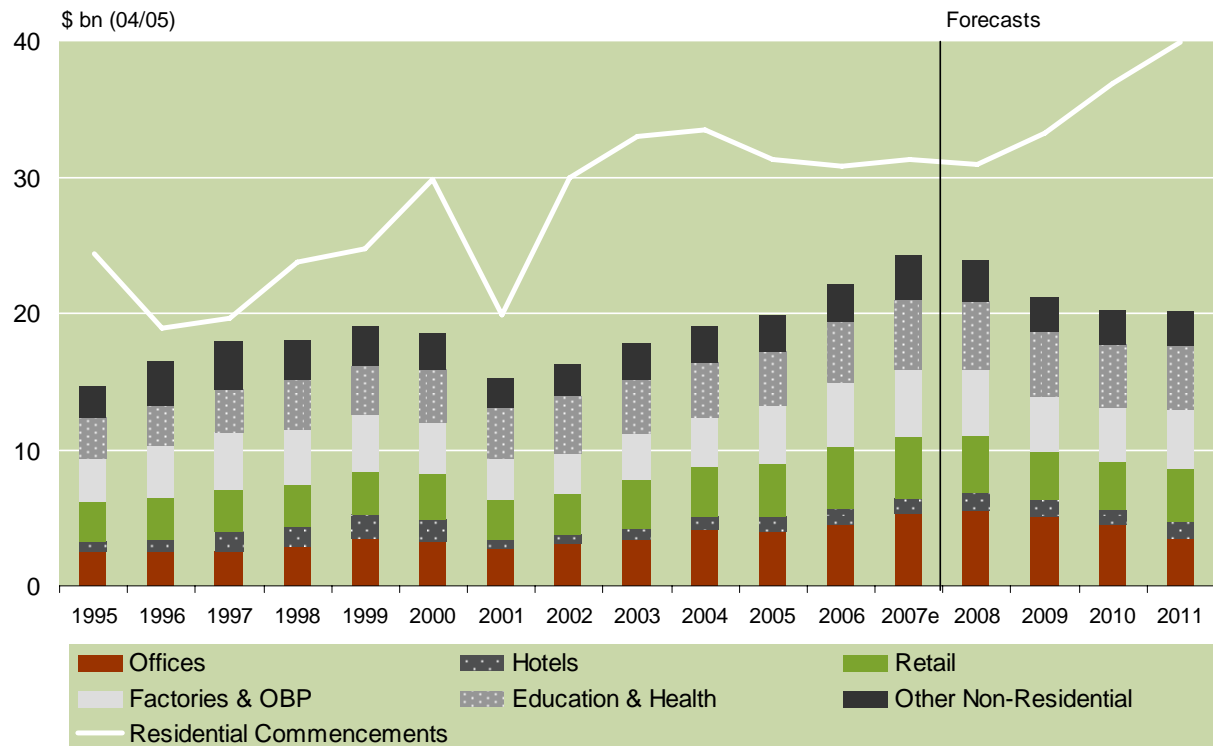
South Australia now has a number of prominent mining projects underway, including Oxiana's Prominent Hill, Santos Cooper Basin development and OneSteel's Project Magnet. These have created a robust market for mining, construction and supporting services including accommodation and business services, as well as raised the focus on the need for greater freight and transport linkages. The outlook for South Australian minerals development is extremely promising and resources investment is being encouraged by the State Government as it provides a long-term stimulus to the economy.

The South Australian Government is also heavily focused on providing social infrastructure for the future and has recently sought interest for a \$500 million PPP project for the construction of four new prison facilities. A \$130 million PPP to deliver new school infrastructure has also just been awarded and the redevelopment of the Royal Adelaide Hospital is also in planning. Details of these and other projects can be found in South Australia's *Strategic Infrastructure Plan* released in 2005/06, covering a ten year period.

Property

After almost six years of upswing, the non-residential sector is tipped to deliver its strongest result in 2006/07 with over \$23 billion worth of work done. The pace is forecast to begin dropping in 2007/08, leading to a gradual decline in the value of work done over the medium term. The residential sector is moving in the opposite direction, however, as housing investment comes back in favour in NSW and Victoria. Overall, the building industry is expected to maintain similar levels of work through to 2009 and approach \$70 billion in total work done.

Figure 9: Non-residential and residential sectors moving in opposite directions



Source: Bis Shrapnel, June 2007, Value of Work Done (04/05 dollars), year ending June.

The strength in the non-residential market has been seen across almost every sector and despite the peak passing through, strong underlying drivers are still evident:

- Vacancy rates are at all time lows on the back of employment growth and the commercial sector is expected to continue its stellar run through until at least the end of 2008;
- The industrial market is also likely to expand steadily with a number of new transport routes in planning. This should continue to open up opportunities for improvements to logistics and supply channels;
- A lift in consumer spending is evident which should maintain the demand for retail, tourism and entertainment facilities; and
- The social sectors of health, education and corrective facilities are benefiting from State Government's budget surpluses and the focus on providing services for future generations.

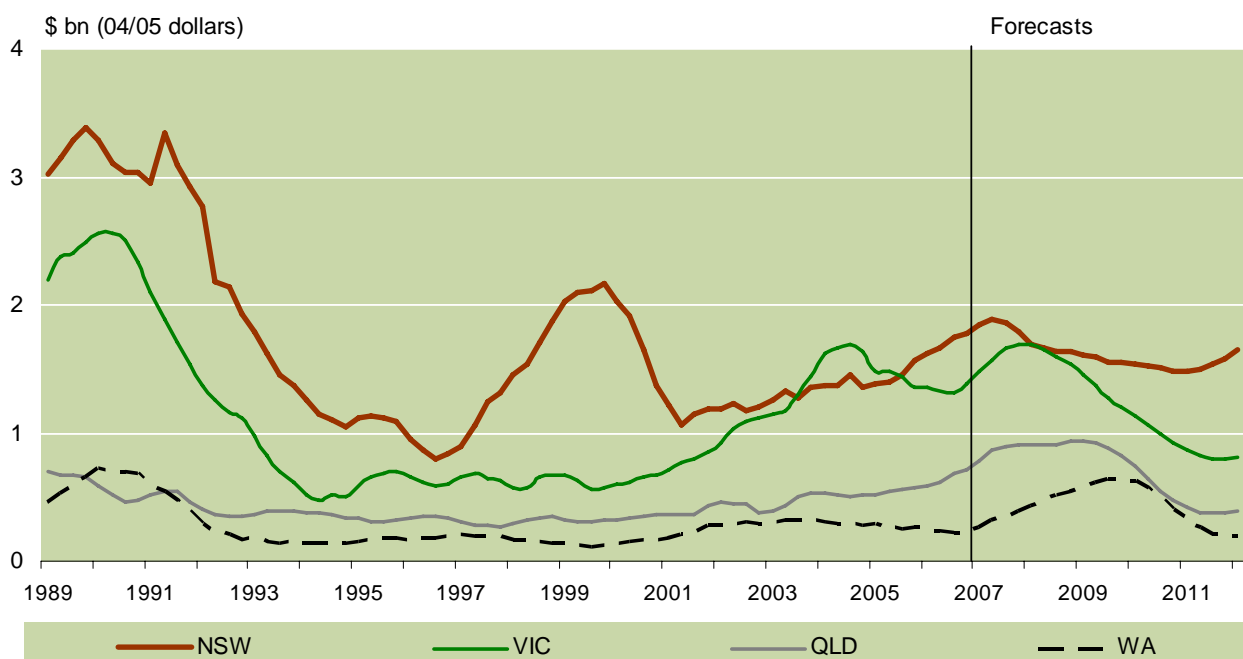
The industry as a whole is particularly susceptible to economic growth and financial costs. This outlook is premised on a continuation of reasonable growth conditions and only modest increases in interest rates. A gradual decline from 2008 assumes some emerging oversupply, particularly in offices.

Offices

The value of work done in the office market is forecast to peak in 2007/08 at \$5.5 billion. The sector has been enjoying a long and fruitful investment period which is benefiting strongly from economic and employment growth, particular in white collar workers. It has also been spurred on by buoyant company profits creating the incentive to consolidate and relocate staff to new, larger premises.

Whilst corporate conditions are likely to remain robust over the next two years, there is some caution emerging with capacity constraints and high prices for land and construction costs beginning to impact on investment decisions. These reasons were cited by Westpac, who recently signed an extension to its lease in Melbourne rather than relocate its offices into one building as it did in Sydney.

Figure 10: Office market approaching peaks of current cycle in most States



Source: Bis Shrapnel, June 2007, Value of Work Done (04/05 dollars), year ending June.

Vacancy rates are still at crucial lows however, with the most dramatic situations in Brisbane and Perth. Very strong returns are still expected nationally over the next 12-18 months until supply comes on board and the shortages are alleviated. It is reported that Commonwealth Bank is still on the lookout for new space in Melbourne and designers and developers are planning a number of new large scale office towers around Australia, including BHP Billiton's new Perth quarters and another five buildings for Sydney over the next few years. Although Western Australia and Queensland are smaller markets, further opportunities still exist given the pace of economic growth is still very rapid.

Positive trends in commercial space which should continue to support the sector across the medium term include:

- Consolidation of large corporations into one building to achieve synergies and retain staff;
- Development of the 'office park' concept and move to outer-suburb or fringe locations for cost advantages; and
- Demand for sustainable and 'worker friendly' buildings with 3 star buildings no longer sufficient. This is also lifting demand for refurbished buildings.

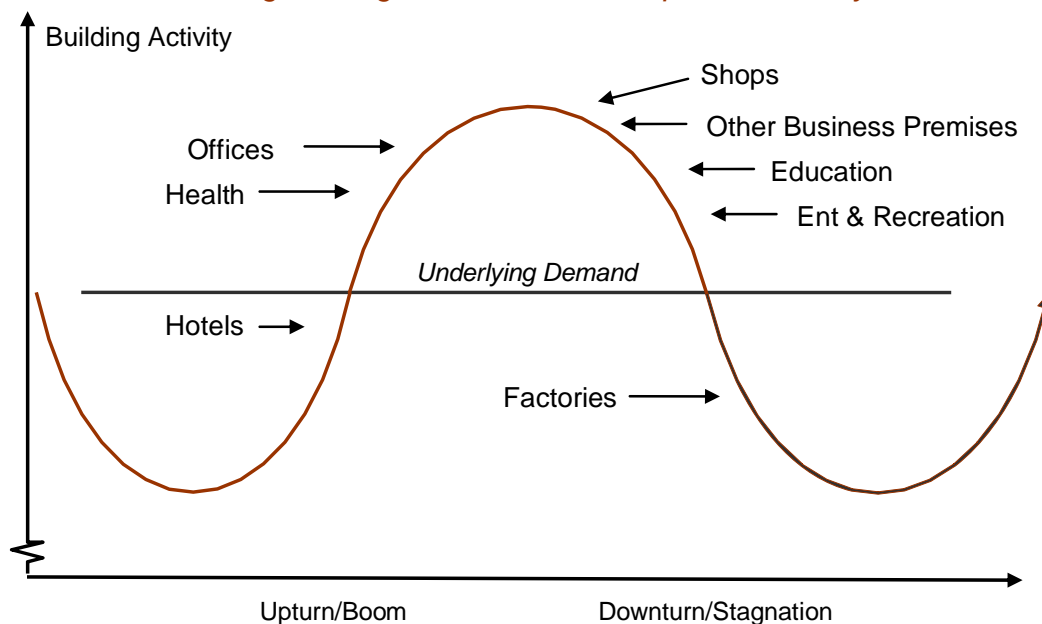
Light industrial buildings

In the past, the industrial property sector has been highly responsive to conditions in the manufacturing sector, however an increasing trend toward industrial parks and a focus on logistics has been an alternative driver and the sector has flourished. With manufacturing not expected to pick up in the near term due to the strong rise in the Australian dollar, the continued expansion of the sector is dependent on new transport routes, including road and freight links as well as ports. It also relies on robust economic conditions to stimulate consumer spending and encourage businesses to expand their operations – build new warehouses, factories and distribution centres. Predictions are that consumer spending will remain strong with wages growth and tax cuts propping up income.

Retail and bulky goods

The retail sector bucked the trend over the previous few years and continued with expansion plans, despite softer consumer spending. The investment seems to have paid off and it is well set to enjoy the good times coming in household demand. This means, however, we are unlikely to see any significant change in construction across the retail sector, perhaps even a decline. Forecasts are pointing to annual average commencements over the next five-year period 2008-2012 on par with that in the five year period to 2007. This will be partly driven by residential land developments and new suburbs which require new retail complexes.

Figure 11: Non-dwelling building sectors at different points of the cycle as at June 2007



Source: Bis Shrapnel, June 2007.

Hotels and recreation

Construction of new hotels has been falling since 2004/05, when commencements hit its highest level in over 15 years at \$1.5 billion. The situation has been partly driven by the reasonably high Australian dollar which has deterred overseas visitors as well as encouraged Australians to venture offshore.

A recovery is expected to emerge in 2007 as occupancy levels have begun to rise. Tourism is being encouraged by solid global growth and an increasing wealth factor across Australia. Queensland is expected to benefit strongly as its economy continues to prosper and attract inter-state and

overseas visits. Tourism operators have identified a gap in the luxury hotel market which hopefully should contribute to an increase in opportunities across the medium term.

In Melbourne, a shortage of accommodation surrounding its airport has been identified which should provide medium-term opportunities. The State is also continuing to invest in its entertainment sector. Construction of the Convention Centre is underway and plans are in place for a new Olympic Park stadium. Perth will also build a new Indoor Sports Stadium at an expected cost of \$180 million, however, plans have been deferred in the short term with the current capacity constraints in the State.

Social building

The skills shortages across the nation has lifted the focus on education and training facilities, and the ageing population has increased investment in hospitals, medical and aged care facilities. Since statistics collection began in 2001, aged care now accounts for around 50% of construction activity in the health sector.

Social building sectors are also emerging with solid PPP opportunities. These are viewed as low-risk investment vehicles for property trusts and fund managers. With the level of investment funds available through superannuation still on a significant upward path, this is likely to support demand in the social building sector across the long term.

There are a fair number of health and education projects, largely sponsored by State Governments, still to proceed which should see activity remain robust. However, after very high levels of activity over the past two years there appears to be limited growth upside.

Table 5: Social building projects yet to be constructed

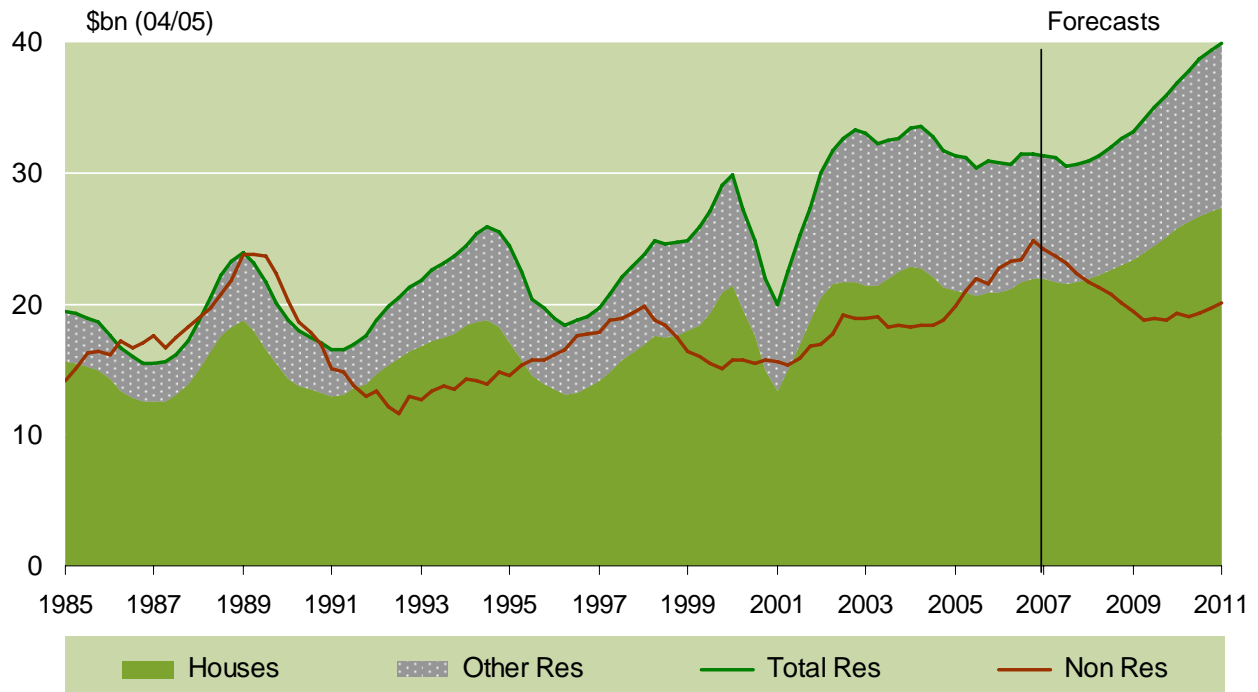
Project Name	State	Value
Fiona Stanley Hospital	WA	\$1.0bn
Gold Coast University Hospital	Qld	\$1.2bn
Sunshine Coast Hospital	Qld	\$940m
Royal North Shore Hospital redevelopment	NSW	\$700m
Queensland Children's Hospital	Qld	\$700m
New Prisons PPP	SA	\$500m
Royal Children's Hospital redevelopment, Melb.	Vic	\$450m
Liverpool Hospital redevelopment, Sydney	NSW	\$180m

Source: Various.

Residential property

The residential property market is said to be approaching the low-point of its current activity cycle, driven primarily by NSW and Victoria. Despite magnificent upswings in Western Australia and Queensland to date, it has not been enough to offset the declines in the country's two most populated States. NSW is only just climbing back from the trough created after its housing boom in the late 1990s which led to persistently low investor returns and declining home affordability.

Figure 12: Residential commencements trending upwards in the future



Source: Bis Shrapnel, June 2007, Value of Commencements, (04/05 dollars), year ending June.

From 2008, the residential market is expected to expand solidly, based on the expectation that demand will continue in Queensland, and New South Wales and Victoria will swing into action. A severe shortage of land and housing is already evident in Queensland and New South Wales and overcoming this is expected to take residential construction to its highest level yet at \$40 billion, almost double the current value of non-residential construction at the moment. The changing demographics of Australia towards smaller households and the increasing population through migration is expected to contribute to an expansion in the size of the sector across both housing and apartments.

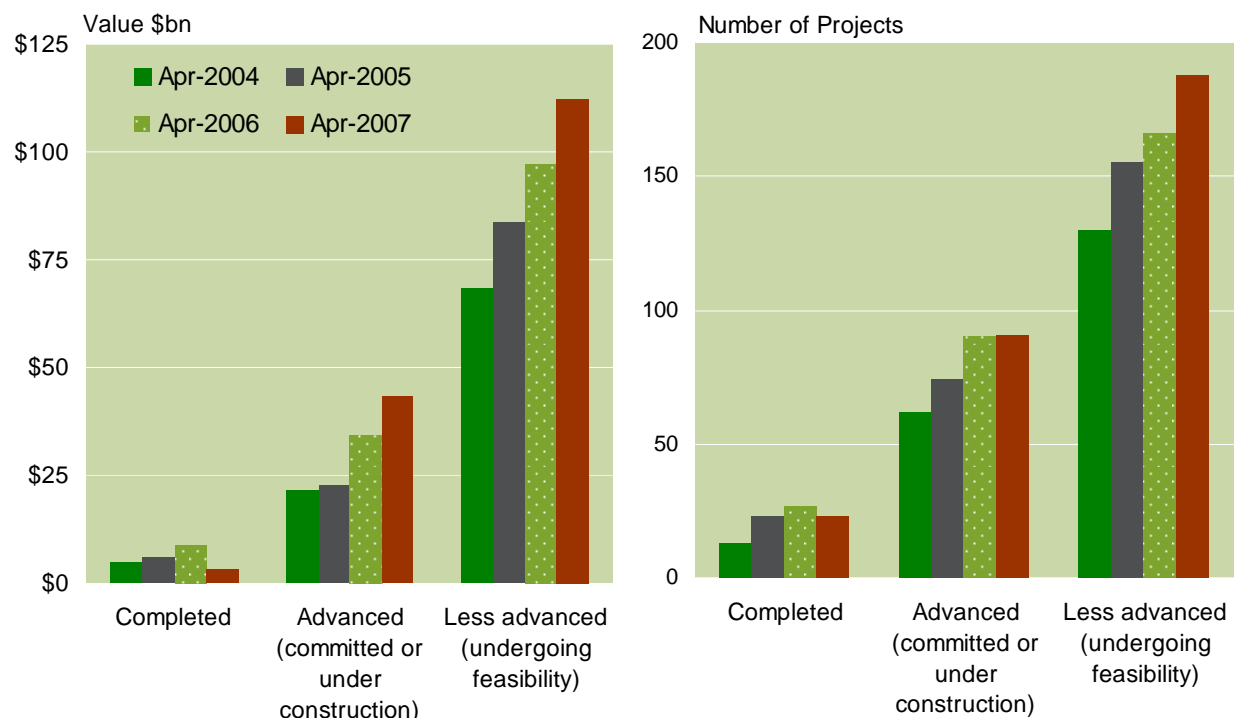
Resources

The strength in the mining sector in Australia has been driven by the incredible demand for raw materials globally. Demand is forecast to remain at these high levels into the foreseeable future, particularly for coal and iron ore. This is well supported by the recent update of China's GDP growth which reflects continued strength, after growing at its fastest rate in 12 years. On the back of this, it has now overtaken Japan as Australia's largest export market.

The strong global forecast is despite the introduction of export taxes in China and India to stem growth and consumption of raw materials. In China an export tariff of 5%-10% has been placed on its steel products and India has introduced a tax on iron ore exports from 1 June. These levels are anticipated to have limited impact in the short to medium term however.

In Australia, ABARE's list of major development projects has \$112 billion worth of projects waiting in the wings, dwarfing the value and number of mining projects completed or presently under construction. Exploration expenditure, particularly on brownfield sites is also at its highest level in real terms since the 1980s at an estimated \$4 billion, indicating that even more investment may be on the horizon. In the short term, ABS surveys of industry intentions show that new capital expenditure could rise by a further 30% in the coming year.

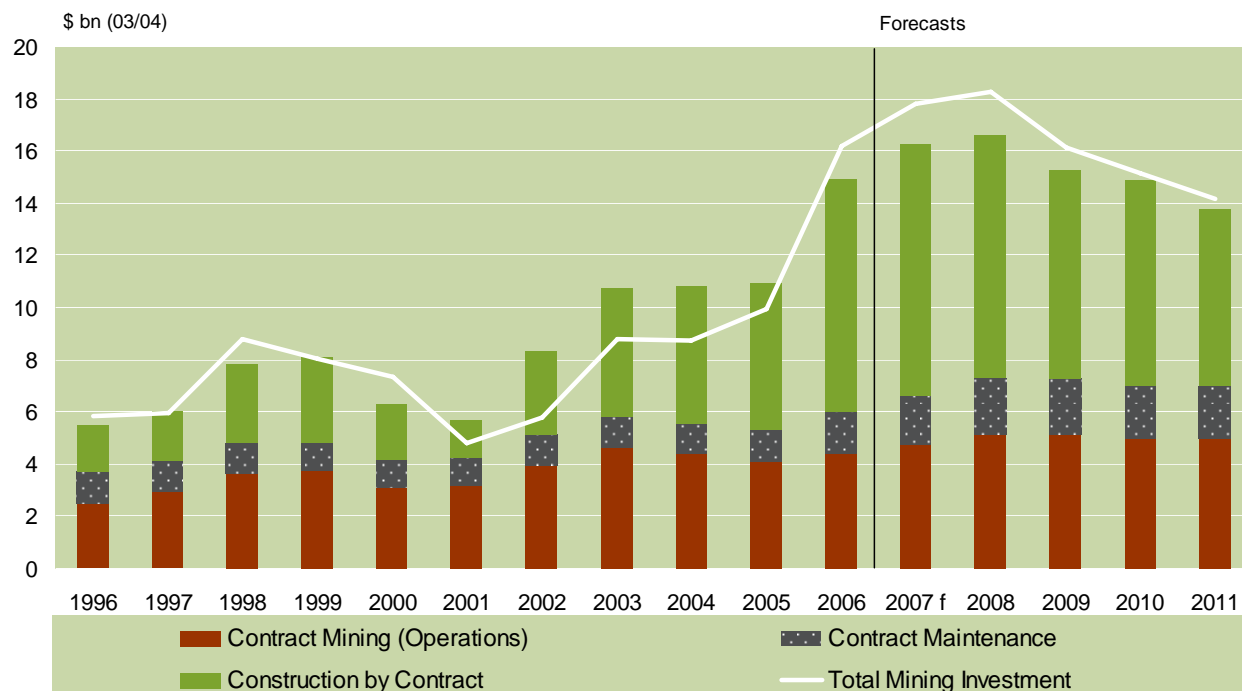
Figure 13: Value and number of mining projects on the planning horizon still growing



Source: ABARE, April 2007, year ending June.

For all facets of the mining industry, this represents good news as further investment in plant and equipment and capital projects are likely to continue to reap rewards across the medium term. Specifically for contract mining and maintenance, the workload is not expected to drop off anytime over the next five years, averaging around \$5 billion per annum.

Figure 14: Base contract mining work very strong over the next five years



Source: Bis Shrapnel, December 2006.

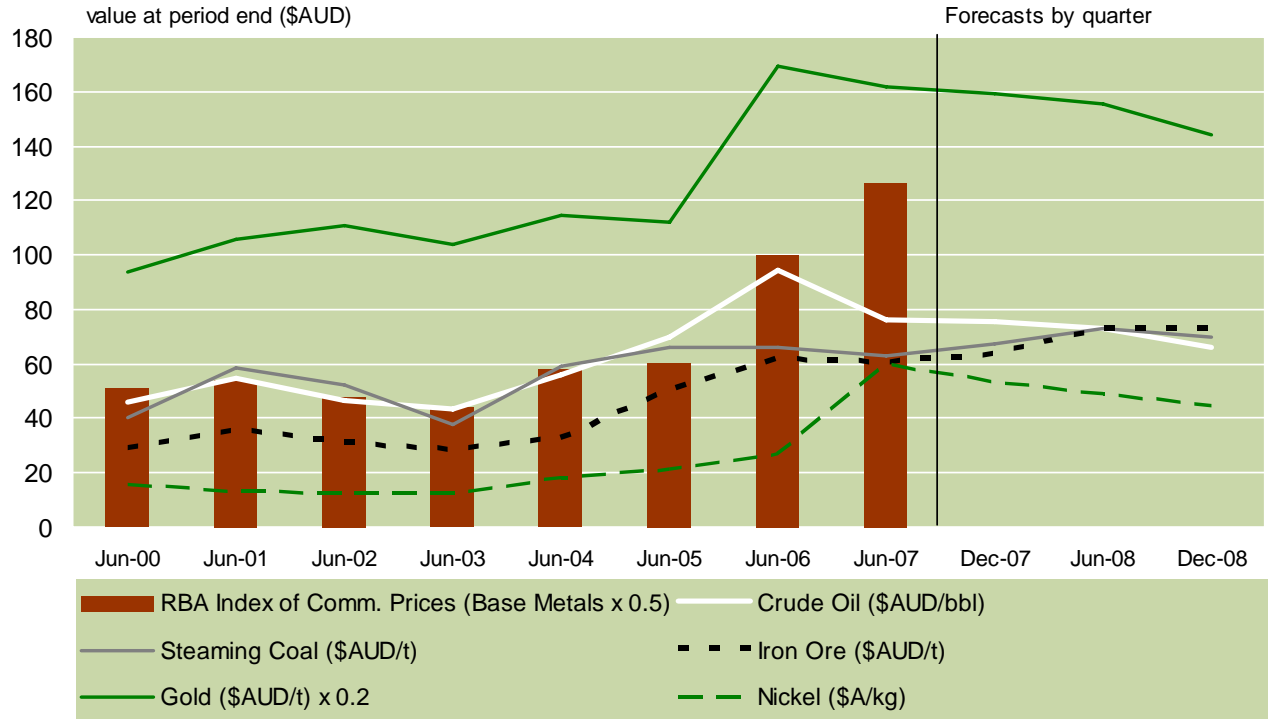
The picture is not all rosy however, as it means continued competition for resources, and constant pressure on costs, labour and capital. The effects on 2006/07 results for major mining companies such as Rio Tinto indicate that the cost situation is at the forefront of issues. More than ever businesses need to have robust business planning, risk management and staff development in place so that they can capitalise at every stage of this unique 'boom' which is emerging to be longer than most forecasters predicted.

Commodity prices

Most commodity prices have held up very strongly over the past year after some volatility early in 2007. Upward pressure on prices remains very strong due to recent supply disruptions globally – a result of isolated unforeseen events such as cyclones, storms, strikes and geopolitical tensions, all in the face of continued strength in demand. This has had an effect on oil, iron ore, thermal coal, nickel and copper spot prices this year to date. In Australia particularly, capacity constraints at ports and rail terminals are still having a serious effect on exports and will not be resolved in the short term.

Despite the continued pressures, forecasters are predicting the peak in price rises is near. The exception is iron ore with predictions of a 10% to 20% price rise next year. Over the next two to three years significant increases in supply in many minerals are due to come on stream globally which should eventually lead to a weakening in prices, although levels considerably above historical averages are expected to be maintained.

Figure 15: Commodity prices are expected to remain high

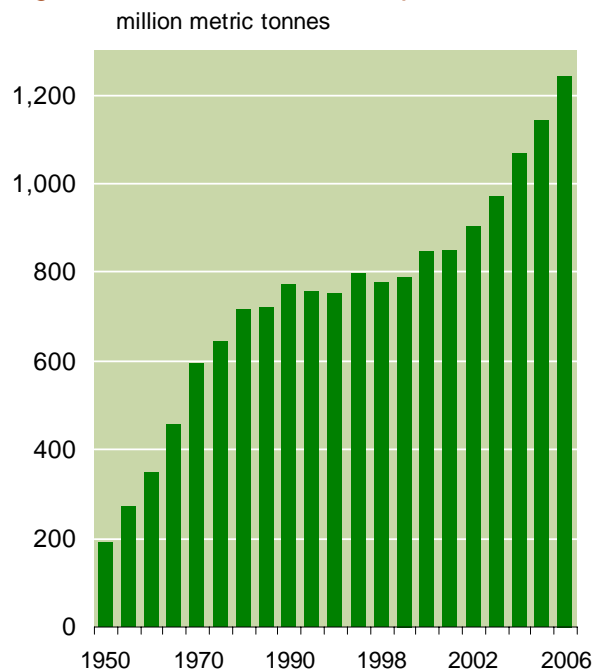


Source: Bis Shrapnel, June 2007.

Iron ore

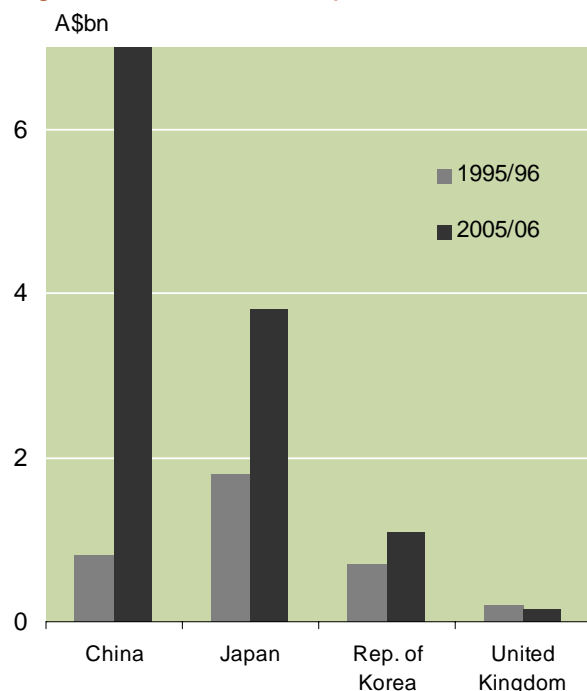
The 9.5% rise in the contract price for 2007/08 has not been enough to dampen demand and steel production has continued to rise globally. China now accounts for more than one-third of the world's steel production, and is by far the largest export market for Australia, although India's steel production is also notably on the rise as it industrialises. Both countries have introduced domestic measures to curb production.

Figure 16: World crude steel production



Source: International Iron and Steel Institute, June 2007.

Figure 17: Australian exports of iron ore



Source: ABARE, June 2007.

Recently, exports from Australia have been further hampered by severe weather conditions and acute capacity constraints. Coupled with global shortages in equipment and labour, including recent strikes in Canada, input prices are expected to remain high in the near term and are very likely to have a flow-on effect on world-wide supply levels. With these supply constraints and China's recent growth acceleration, analysts are tipping that iron ore prices could rise for a fifth consecutive year in 2008/09 by a further 10%-20%.

Globally, there are significant developments in iron ore mines, with iron ore production forecast to rise almost 15% over 2007 and 2008 collectively across Australia, Brazil and China. In Australia, projects slated for commissioning are BHP Billiton's Rapid Growth 3 Project, the Fortescue Metals Mine and Rio Tinto's development of Hope Downs. BHP Billiton has recently approved Rapid Growth project 4 at a cost of \$2.3bn, and a considerable number of large projects are still in planning stage across the industry.

Table 6: Iron ore projects undergoing feasibility in Australia

Project Name	State	Estimated capital value
Australasian Resources Balmoral South Magnetite Project	WA	\$2.8bn
Mineralogy Cape Preston State 1 and Stage 2	WA	\$2.6bn
Murchison Metal Jack Hills Stage 2 Mine	WA	\$1.8bn
Yilgarn Oakajee Port and Rail Project	WA	\$2.0bn
Atlas Iron Pardoo Magnetite Project	WA	\$1.0bn
Gindalbie Metals Karara Magnetite Mine	WA	\$1.0bn
Rio Tinto Hope Downs Stage 2	WA	?

Source: ABARE, June 2007.

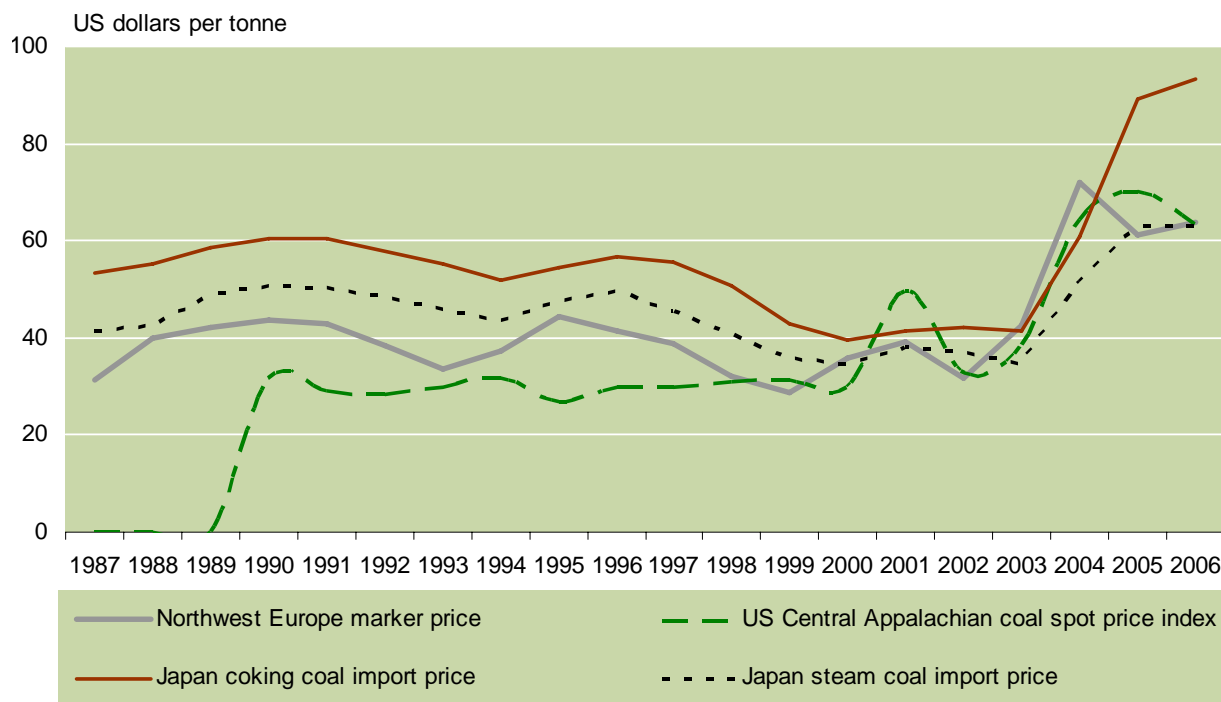
In China, production is also on the rise as it increases mining of its own lower grade iron ore – which although costly, the higher global prices makes this feasible. Brazil, through CVRD, is also hoping to increase its exports by approximately 20% over the next two years to 310 million tonnes, which would overtake Australia as the largest exporter by volume in the world.

Coal

Coal-fired electricity generation in Asia and the US continues to grow rapidly, primarily as it remains the most cost effective source of energy. With a few key supply disruptions this year, including a week long shut down in the Hunter Valley in Australia, thermal coal spot prices have increased in recent months and the Japanese contract price for 2007/08 saw a 5% increase to \$US55.50/tonne. Further upward pressure will also come from the fact that China has moved from being a net thermal coal exporter to net importer in order to cope with its own demand.

Indonesia has been able to quickly mobilise its product for exporting at relatively low cost as a significant proportion of coal transport is via barge rather than rail. With a 25% ramp up in 2006, it is now the world's largest exporter of coal with a forecast 178 million tonnes, followed by Australia which exports around 110 million tonnes.

Figure 18: Coal prices at highest levels in well over 20 years



Source: BP, 2007.

The significant event to watch over the next 6-12 months will be policy changes in China. With the world's largest thermal coal output at 2.2 billion tonnes, over eight times that of Australia, it has traditionally been a net exporter of coal to Asia. However, with higher domestic prices due to strong electricity demand, as well as new coal taxes, Chinese coal exporters are benefiting from domestic sales and exports are due to fall over 40%.

India is due to increase its imports by over 25% in the two years to 2008. Despite it being the third largest producer of hard coal, the majority of its coal is of a lower quality which requires blending with higher grades. These additional imports from both India and China are expected to be sourced from Vietnam and Indonesia due to the freight advantage in these countries.

Coking coal prices likely to rebound again

Metallurgical, or hard coking coal, is one of the highest coal grades and is a key input to steel. Australia produces some of the best quality coal in the world and is one of the closest markets of supply to Asia, after Indonesia. Despite these natural benefits however, 2007/08 contract prices negotiated with Japan saw a decline of 16% in anticipation of increased production from over 19 new mines in Australia. This has not come on board as quickly as expected however with the infrastructure congestion in Australia and higher world demand squeezing supply. As a result, higher prices were negotiated with Europe and South America and there will definitely be pressure on 2008/09 prices with Australia's infrastructure problems unlikely to be resolved in the short term.

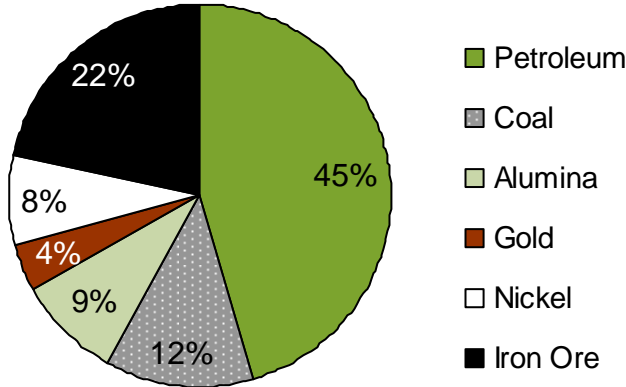
Oil and gas

Oil prices have experienced considerable volatility recently, with geopolitical tensions in the Middle East the catalyst for further price rises at the end of March. As at the end of July they were still hovering around \$US75 a barrel. With non-OPEC reserves at their lowest level since 2002 and declines in OPEC spare production capacity, pressure on the demand-supply balance remains.

ABARE is forecasting global oil production to rise by less than 2% over the next five years. This is despite seven large petroleum projects due to come on stream in Australia by the end of 2008, with a total value of \$4 billion. These include Woodside's 5th LNG Train, Vincent and Angel gas fields and Otway in Victoria. With this backdrop in mind, including world growth revised upwards to close to 5% and supply disruptions in Nigeria, the outlook for oil prices remains high and volatile.

In terms of projects in the pipeline in Australia, ABARE has projects listed to the value of \$50 billion in petroleum, almost half the total value of mining projects across Australia. This includes a further seven noteworthy projects undergoing feasibility studies which would collectively add around 50 million tonnes of annual LNG production capacity in the medium to long term. These include Woodside's Pluto gas discovery, Chevron's Gorgon development and Shell's Monash Energy Project.

Figure 19: Value of mining projects in planning

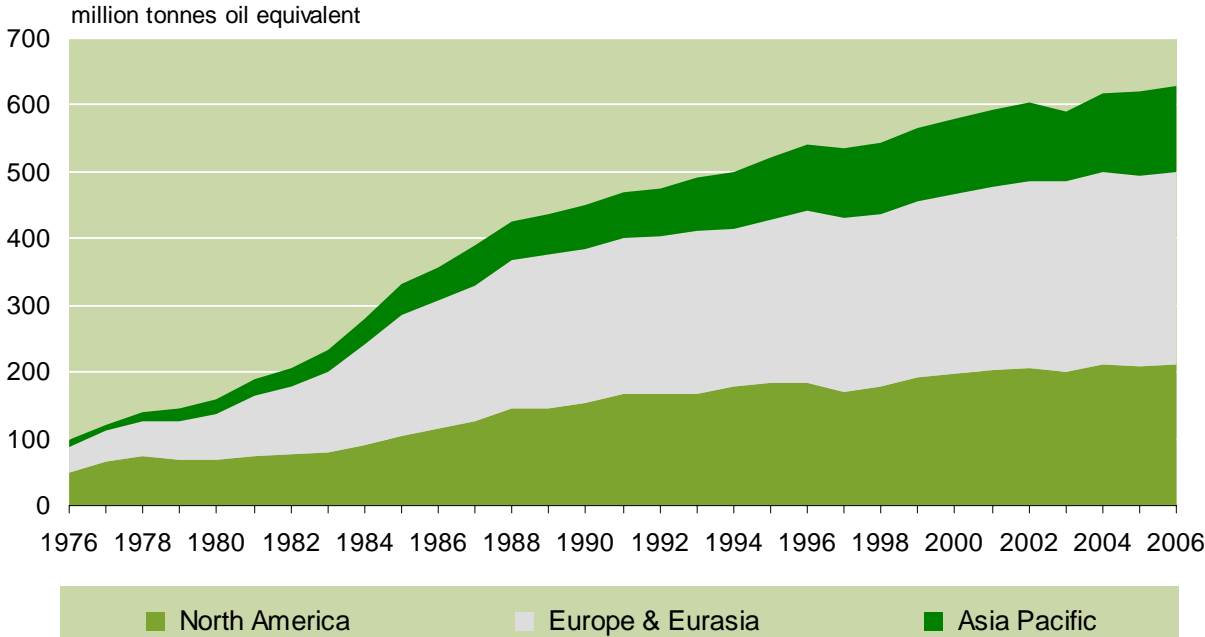


Source: ABARE, April 2007, Advanced/Less Advanced Projects.

Uranium

Uranium achieved a record 180% price increase in the year to June 2007, with even higher prices being achieved in the newly established uranium futures market. With the global spotlight on climate change and Australia sitting on vast reserves, this has prompted the listing of many junior miners on the Australian Stock Exchange. Although there has been little change in the regulatory approach to uranium mining in Australia to date, the debate has moved into political focus particularly with the upcoming Federal election.

Figure 20: Nuclear energy consumption increasing globally



Source: BP, 2007.

Gold

Currently demand for gold is being driven by jewellery demand, with an increasing 'wealth' factor throughout China, India and the Middle East. Prices almost made \$US700 an ounce in early May however have since fallen back to around \$US650 an ounce. The higher prices are prompting some Central Banks to part-sell their reserves and diversify away from traditional gold assets into more high yielding assets, however this is unlikely to have a significant effect on prices.

Gold will always remain a low risk investment and a secure hedge against inflation, which are valued qualities in today's economic environment. With expected higher world growth, demand for gold and hence prices are likely to remain high over the next 18 months. In Australia, production is forecast to increase as a number of existing operations increases and new mines commence production. Globally however, the production of gold is likely to remain relatively flat particularly as gold mines have a reasonable long gestation period with low exploration success rates. This is also evident in Australia where the search for gold is becoming more expensive as it moves underground. In 1997 it was reported that 60% of gold output came from open-pit mines, now in 2007 it is reported only 19% comes from open pit mines.

Other metals and minerals

In Australia, the value of **nickel** exports rose by 160% in 2006/07 and a further 10% increase is expected in 2007/08. The planned shutdown at the Murrin Murrin mine during 2007/08 is expected to be offset by the commissioning of BHP's Ravensthorpe project and the Avebury mine in Tasmania.

Nickel prices have had an extraordinary run this year to date. When stocks reached an historical low of only 2.5 weeks, consumption prices increased by over 172% in the year to May 2007. In June however, the London Metals Exchange relaxed its lending rules and the price has since dropped by over 30% to around \$US40,000/mt. With stocks only expected to build slowly over the rest of the year, the price remains vulnerable to capacity constraints and supply disruptions. The precarious demand-supply balance has also had an impact on the stainless steel industry with manufacturers seeking alternative inputs, however in many industries there are few or no substitutes possible and it is expected that 60% of nickels demand will continue to be from stainless steel.

Zinc and **lead**, other key inputs to stainless steel, have also seen sharp price rises in 2007 reaching record highs. Whilst demand is likely to remain very strong due to industrialisation across Asia, the long-awaited supply response is expected to appear over the next three years. This will place downward pressure on prices, however the fall is not expected to be very protracted as the additional supply is expected to be taken up by growth in world demand. The extent of speculative action across the market however poses a risk and introduces greater volatility.

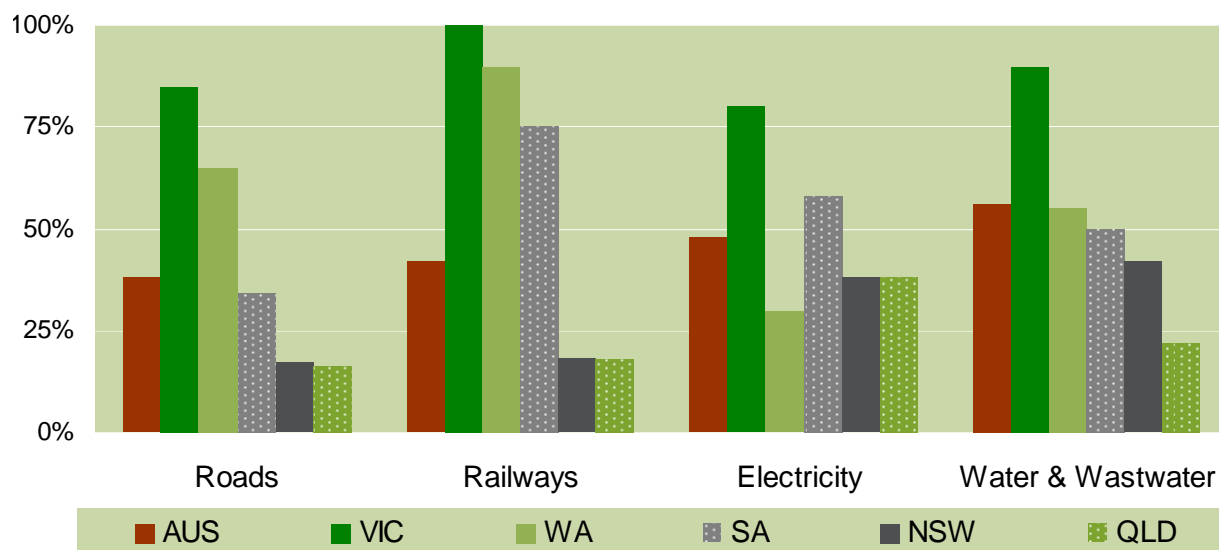
The future strength in **aluminium** demand has also been brought to light by Rio Tinto's \$44 billion purchase of Alcan. This is a definite signal of confidence in the alumina and aluminium market with Rio Tinto believing that China will move to being a net importer of the product, despite its own large levels of production.

Services

Operations and maintenance

The size of the services market across transport, utilities, mining and the property sector is approaching \$30 billion per annum. The increasing number and value of operations and maintenance contracts is being driven by new investment in infrastructure and buildings around Australia. Other key drivers include the significant amount of stock approaching the end of its economic life, and the increasing trend by State-Owned Enterprises (SOEs) towards outsourcing, alliancing and privatisation.

Figure 21: Percentage of operations and maintenance outsourced by State and sector



Source: Bis Shrapnel, March 2006.

On average, just over half of all operations and maintenance work is contracted out to the private sector, however this varies considerably between States and the industry. In general, this figure is moving upwards as State Governments struggle to cope with demand and industry-wide capacity constraints, and are turning to the private sector to achieve faster and more efficient delivery of services. These are particularly promising developments for the services industry and the private sector as it indicates a permanent step-up in the annual level and value of work to be undertaken across Australia.

Privatisation on the agenda

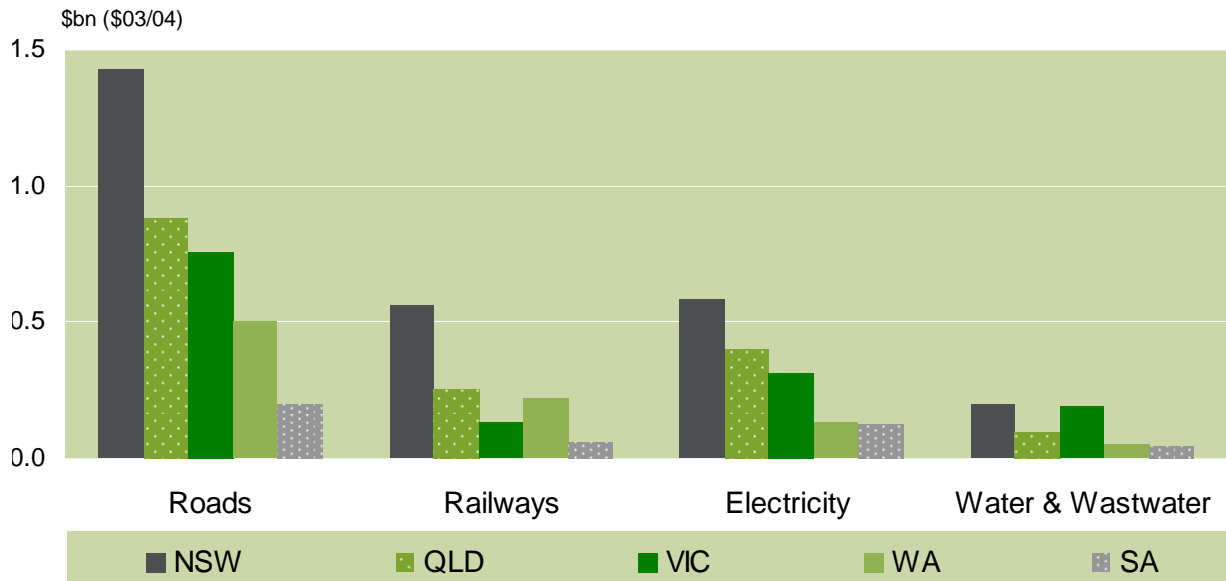
Recent examples of increased private sector involvement include five year 'project bundling' contracts by the Water Corporation in Western Australia to deliver water and wastewater pipelines and conduct major treatment plant upgrades throughout the State. The WA Economic Regulator has also raised the possibility of privatisation, and is currently undertaking an inquiry on introducing further competition in the sector, including third party access where service providers could compete to treat wastewater for either disposal or recycling (decentralised procurement achieved via third party access).

NSW also has large scale possibilities in regards to privatisation, with the NSW Premier recently raising the possibility in regards to rail maintenance yards as well as Sydney Ferries. A report is expected to be released by the end of August regarding the privatisation of the state's retail

electricity assets, which include EnergyAustralia, regional Country Energy and Integral Energy. These assets could fetch between \$3 billion and \$4 billion. The recommendations could pave the way for privatisation of the rest of the state's electricity assets which are worth at least \$35 billion.

The Beattie Government in Queensland will also be investigating reforms to Queensland Rail, including a partial-sell off. A main goal will be to improve the efficiency of the freight network which is currently a serious bottleneck to the mining industry. Discussions are currently underway regarding the options for the business.

Figure 22: 2004/05 operations and maintenance expenditure by State



Source: Bis Shrapnel, 03/04 dollars, March 2006.

Telecommunications a growth market

With the number and types of networks expanding with technological advances, one can foresee considerable ongoing telecommunications services demand. Currently, there are three significant investment phases underway or in planning which should see average annual construction and maintenance expenditure maintained close to peak levels over the next three years. These are the 3G network rollouts, the \$1 billion regional broadband initiative (“Australia Connected”) by the Federal Government, and the much anticipated fibre-to-the-node network which is estimated to cost around \$4 billion. Ongoing funding will be supported by the newly established \$2 billion Federal Government Telecommunications Fund seeded from the privatisation of Telstra.

Waste disposal¹

The amount of waste generated tends to increase with the level of economic activity and Ibisworld predicts growth of 3%-4% over the next five years. The sector is predicted to benefit from the increased focus on environmental concerns due to the creation of niche markets for recycling and improved disposal technologies. It is a fairly competitive industry in Australia with a number of smaller players, particularly in the industrial waste sector. However, there has been considerable consolidation over the last two to three years, with further rationalisation likely, given there are

¹ The waste disposal sector is an environmental service and is not regarded as operations and maintenance by Bis Shrapnel.

significant advantages stemming from economies of scale. This has attracted foreign investment into the Australian market with Veolia and SITA estimated to account for about 40% of domestic waste demand.

Further opportunities on the horizon include the increasing trend of councils towards outsourcing, increased regulations on disposal of commercial waste requiring more specialist operations, and the move by NSW towards privatisation and sale of its WSN Environmental Systems. They are the major provider of solid and industrial waste management services in the Sydney Metropolitan area as well as provider of kerbside collection services to many Councils.

Offshore Markets

Developing countries in Asia are expected to continue to drive the world economy, with growth across the region proving to be stronger than forecasts made earlier this year. China achieved a record 12% growth in its quarterly result to March 2007 and both India and Vietnam are aiming for more than 8% GDP growth this calendar year. This has had an effect on prices however with Indonesia, India and Vietnam still looking at over 6% inflation for 2007. Interest rates are also still at reasonably high levels, after taking the oil price spike in 2005 into account.

Figure 23: GDP forecasts for Asia

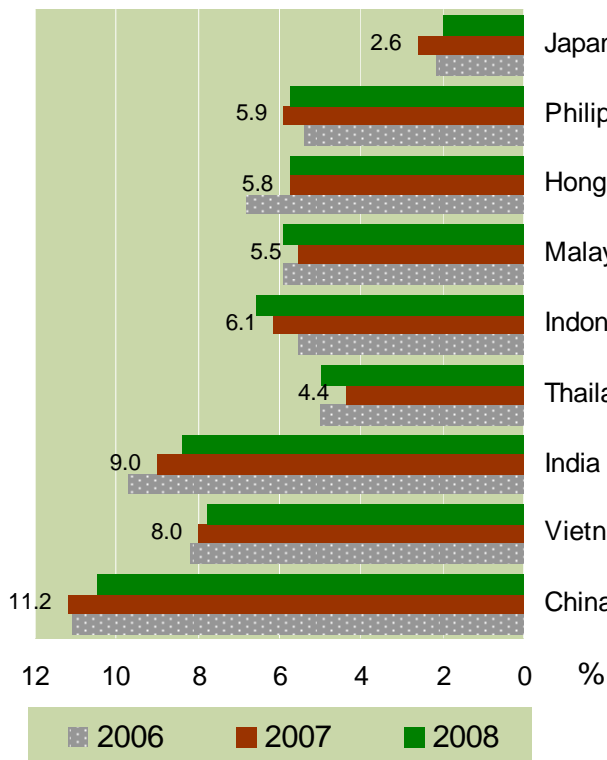
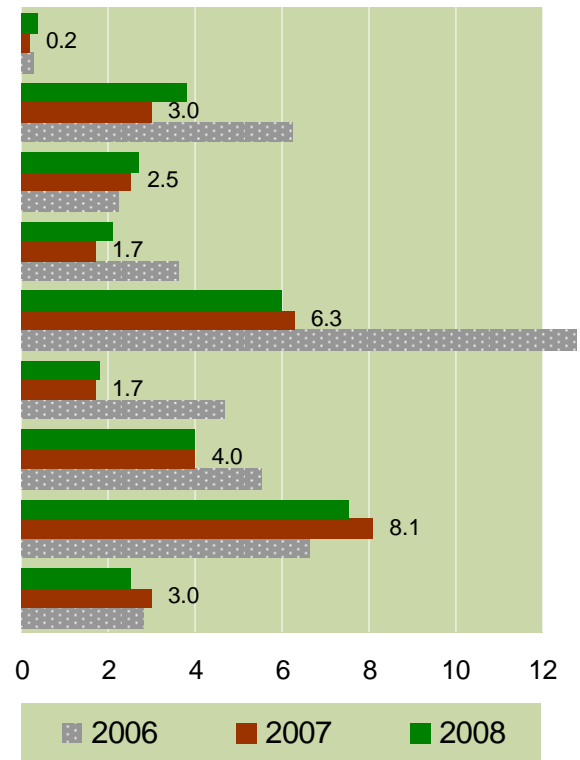


Figure 24: Inflation forecasts for Asia



Source: Various, year ending December.

The key theme is the continuation of the China 'bull run' which is lifting the general output of the region. Increased inter-regional trade has also been greatly assisted by new Free Trade Agreements and improved levels of activity in Japan. Although still at moderate levels, it is one of the region's main trading partners which should help sustain manufacturing exports in nearby countries such as Malaysia and Hong Kong, which are being affected by the drop-off in demand from the USA.

Region has further potential – it is only just returning to 'pre-Asian crisis' growth levels

The other theme this year has been how well Asia has positioned itself after the Asian Financial Crisis which occurred exactly ten years ago in July. The pace of economic activity across key nations – Indonesia, Korea, Philippines and Thailand is still less than the average achieved in the years leading up to the crisis, even with the current stimulus from China and India. It is only in this past year that GDP per capita has returned to pre-crisis levels in Indonesia and Thailand, with Malaysia only reaching this point in 2005. This indicates that the region is still suffering the 'hangover' effects ten years on, although it also indicates there is still considerable growth potential.

Since 1997, considerable reforms to exchange rates, the capital markets, and reserve levels are well and truly in place and positive results are evident. Reasonably strong economic growth across the region is encouraging many Asian countries to implement substantial infrastructure plans, including Thailand, India, Indonesia, Malaysia and the Philippines. Whilst progress in some parts has been slow due to the level of regulatory and political reform required, most governments remain committed to reform with success vital to achieving their long-term economic development goals. India, Indonesia and the Philippines also have burgeoning mining investments planned to enable them to capitalise on the growth in global mining, and the potential for private sector involvement across the medium to long term is considerable.

Figure 25: Interest rate forecasts for Asia

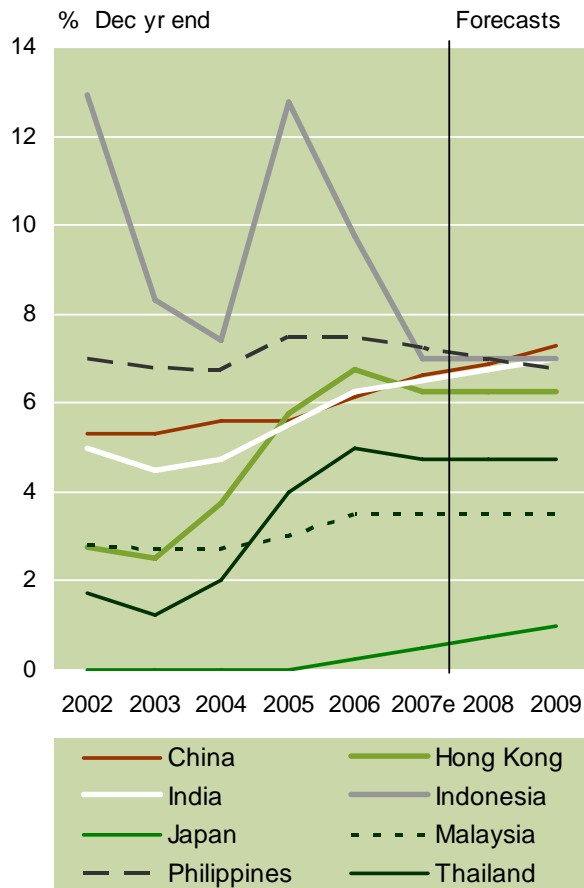
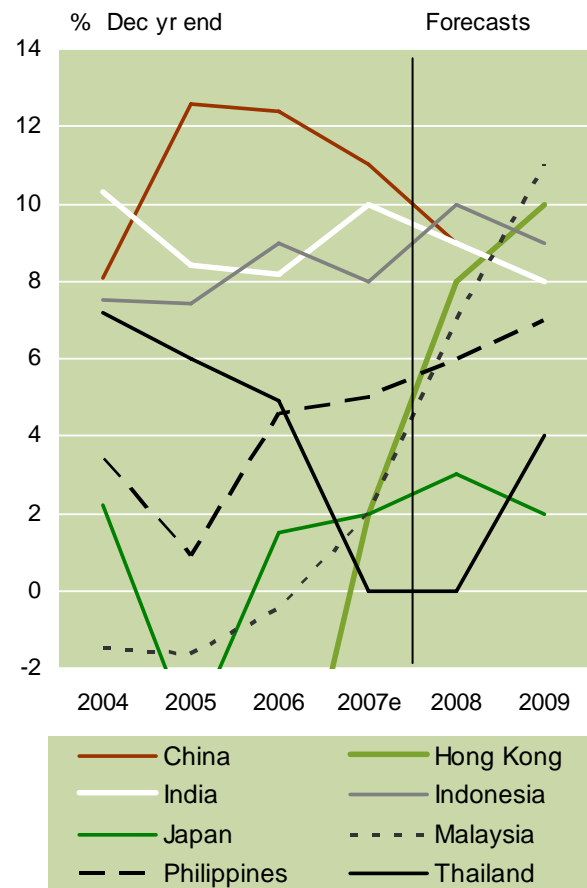


Figure 26: Construction % of GDP in Asia



Source: IMA Asia, June 2007, year ending December.

China

The story for China is for a fifth consecutive year of growth above 10%, with latest figures proving to be even stronger than previously forecast. This is in spite of the Government's introduction of various policy measures to moderate growth and prevent overheating. Whilst inflation forecasts are surprisingly on the low side at less than 3%, pressures are evident, particularly in food prices. The financial and assets sector will also be watched carefully with the strong surge in the equity markets posing stability risk.

High GDP growth rates in China are not a new phenomenon – its average annual growth rate was over 8% in the decade to 2005. What is different is the pronounced influence the growth is having on the region and the world economy. The effect primarily stems from the change in Chinese government policies which are aimed at a more market-based economy and encourage foreign

involvement. With growth and capital expenditure occurring at such a rapid rate across many sectors, the government is keen to involve the private sector in order to achieve efficiency. Whilst there is still a long way to go in many sectors, changes are visible and there are significant opportunities for foreign companies to assist China in its transition, particularly in the mining and power sectors.

Some examples of recent sector and financial market reforms include:

- The floating of state-owned enterprises on domestic stock exchanges
- The floating of the Yuan in 2006;
- Relaxation of foreign ownership laws; and
- Introduction of a unified corporate tax regime for foreign investors and domestic firms, planned for January 2008.

Further positive changes are likely to come after the 17th Chinese Communist Congress which will be held in November this year.

Indonesia

The Government is aiming for GDP growth close to 7%. This is expected to be mainly driven by construction, which is set to steadily rise as a percentage of GDP right through until 2015. There have also been recent key changes made to boost spending, including a focus by the National government on fiscal reform and directing public spending to provincial governments. Progress is yet to be seen however, as the country has had grand infrastructure plans on its agenda for some time but has had little success in implementation to date. In terms of inflation and interest rates, there have been considerable declines since the broad fuel subsidy reforms introduced after the substantial oil price rises in 2005, although there are now broader economic pressures on the upside.

Indonesia has considerable reserves of LNG, coal, nickel, zinc and gold and hence is prospering from the strong global commodities market. It increased its nickel production by over 130% in 2006 and thermal coal exports over 25%. It is now the world's largest exporter of thermal coal, exporting in volume terms more than 90% of Australia's total thermal coal production. Forecasts out to 2012 indicate a continuation of this trend, with increasing exports to India. This is despite ongoing concerns regarding weak and declining exploration investment and difficult licence and operating conditions. Gradual progress in reforming the mining sector is evident, with a new mining law to be passed in 2007 aimed at eliminating the differences in the treatment of foreign and domestic investors.

Domestic coal and gas consumption is also set to rise with plans to accelerate its coal-fired and gas power generation capacity towards the end of the decade. The intention is to replace oil fired power plants and utilise local coal and LNG supplies to meet the forecast electricity demand.

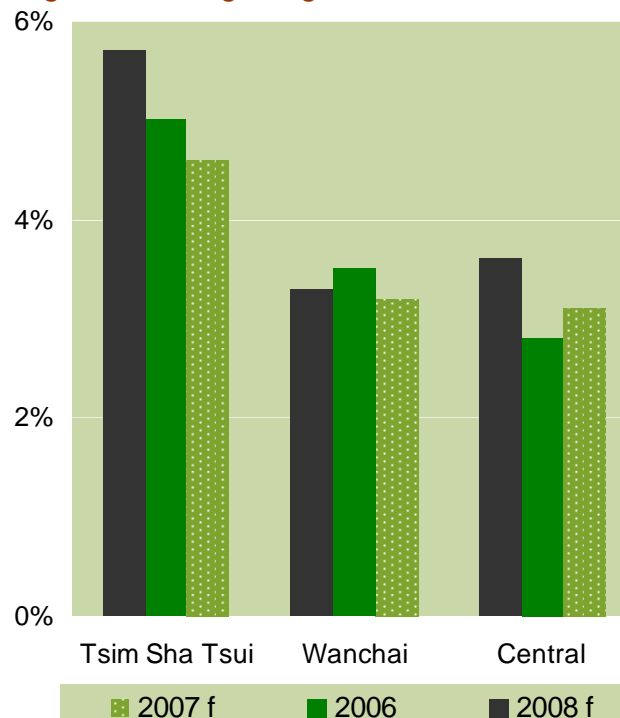
In other minerals, there is a major zinc project planned for Indonesia and there are a number of smaller scale copper projects expected to commence production during the outlook period.

Hong Kong

Hong Kong's economy has shown considerable strength with expected growth rates of close to 6% and continuing budget surpluses over the next three years.

Going forward, underlying indicators are reasonably strong with private consumption forecast to return to 'trend' levels of around 6% through to 2010, well up from the average of 2% experienced over the last five years. Healthy levels of employment are also pushing up demand for buildings and commercial services. Office vacancy rates are approaching all time lows with little new supply having been built in the last few years.

Figure 27: Hong Kong office vacancies



Source: Colliers International, July 2007, year ending December.

In infrastructure, there is a significant backlog of both private and public projects, largely caused by Government delays. However, a number of major projects have recently been re-accelerated and are due to start construction this financial year. This includes the Tamar development project, water mains replacement and the East Asian Games sports facilities, which are together expected to create around 23,000 jobs across the construction industry.

Further major projects in planning include the Central-Wan Chai Bypass and Wan Chai Development Phase II, Central Kowloon Route and Kai Tak Development, with an expected total cost of \$AUD7 billion. Two large infrastructure projects also on the drawing board are for Container Terminal 10 and a bridge from Hong Kong to Zhuhai to cut transport costs to the mainland.

Overall, investment and construction is forecast to see a 20% increase in spending over the next three years to 2009. This is based on the Government's pledge to spend an average \$AUD4 billion on infrastructure projects over each of the next few years.

India

The Indian Government's 11th Plan targets 'Faster and More Inclusive Growth' of 10% per annum over the next three years. This is after GDP growth of 9% was achieved in both 2005 and 2006. However, the strength in demand has been reflected in inflation which averaged above 5% in 2006/07 and is likely to remain there in the short term.

The economy is being driven by a fundamental transformation from a rural-based cycle to one driven by industrial services. Capital spending is approaching 30% of GDP, and there is a young, innovative population with an increasing middle class fuelling demand for goods and services.

The Government has recognised that the key to continued growth is providing infrastructure and resources – such as transport networks and reliable essential services. India already has one of the largest road networks in the world, however national highways comprise only about 2% of the total road length although they carry about 40% of the total traffic. The National Highways Development Project of over 25,000km has been underway for some time with some 10,000km of construction remaining for award.

In rail, the 2007/08 Budget plans for an additional 30% spending. The Budget also highlighted that supporting GDP growth of 10% will require dedicated freight corridors. A 2,700km long railway line project is on the drawing board called the Eastern and Western Corridors with a Special Purpose Vehicle already formed to implement the project.

Opportunities for the private sector are available in most sectors, including mining, where 26 coal blocks with reserves of over 8.5 billion tonnes have been allotted for development by government companies and approved end users. Power requirements are also being facilitated through private developers via merchant power plants as well as private participation in transmission projects.

Other significant and emerging needs include airline travel, hotel accommodation, tourism facilities and retail infrastructure. An example of recent innovation and private sector participation is the establishment of hotels adjoining government railway stations for the benefit of railway passengers and tourists.

The constraints to growth, apart from the lack of infrastructure, are already noticeable – these include human resources and staff retention issues, increasing salaries, and regional variations with widening income gaps. These are not believed to be insurmountable however as there is a young, educated population and mobile workforce.

Other Asian countries

Philippines

With offshore worker remittances flowing in amounting to approximately 10% of GDP, the Philippines is entering what appears to be a sustainable upturn. Growth is being led by construction and fuelled by income and consumer spending. With an improving fiscal position, the Government has foreshadowed a doubling of the annual budget for infrastructure which would amount to up to \$US5bn until 2010. Overall, fixed investment is expected to rise to 25% of GDP.

Private investment is also expected to recover steadily with the current President, who is halfway through her six year term, making some headway with reforms and taxes. A new mining law has been passed which should see a considerable increase in exploration investment and mining production, with some small-scale copper projects already in progress.

Vietnam

Over the next few years, GDP growth is expected to average a very high 8%, with some analysts predicting investment growth may replicate China and approach 40% of GDP, driven by export manufacturing. This forms part of its strict reform path to open up its economy after joining the World Trade Organisation late last year. Overall, the reform process is anticipated to take six to eight years.

With its regions undergoing urbanisation simultaneously, the immediate risks include cost inflation, staffing issues, power shortages and property price hikes. Capacity constraints and a tight labour market are already evident with inflation of around 7% expected to persist until 2009. Controlling this poses the greatest risk to achieving the growth goals.

Thailand

With a current unstable political environment still reeling from the past corrupt government, the interim government established after Thaksin is intending to revert to a more 'controlled' economy. This is expected to do little to promote growth in the economy and involves cutting back the scope of mega-projects and curbing foreign involvement.

As a result, business investment and consumer spending has slumped, and no growth in construction is expected during 2007, particularly in real estate and property. Inflation is expected to remain contained, however the labour market is still tight. Signs of positive change will be watched for carefully over the next year as the country has considerable potential if it can achieve political stability. It also has considerable infrastructure needs, with a number of mega-projects waiting in the wings.

Malaysia

Malaysia is performing well and is approaching GDP growth of 6% driven by consumer spending, services expansion and infrastructure expenditure. Although government spending has been outpacing private spending ever since the Asian Financial Crisis, it is still not regarded as sufficient, and a major lift through the 9th Malaysian Five Year Plan is expected to boost construction levels significantly.

Inflation is expected to remain low at around 2% and interest rates are forecast to be steady at 3.5% through until 2008. Consumer demand has been strong, and is expected to remain so with major public sector pay rises ranging from 7%-45% for police and the military. This is estimated to add at least 0.5% to GDP. The positive response from the pay rises has fuelled rumours that the election may be called in early 2008 although it is not due until March 2009.

Macau

Expectations are for a continuation of healthy construction growth over the next five years with further expansion plans for casinos, entertainment complexes and supporting infrastructure. The aim is to provide an entertainment, resort and conference hub similar to Las Vegas which will support the influx of Chinese visitors and encourage longer stays in the region.

Gulf Co-Operative Council

The growth in the Gulf Co-Operative Council (GCC)² region continues unabated, averaging 7.5% in 2006. The profits being generated from the petrochemical resources are astounding, moving Qatar and the United Arab Emirates (UAE) up the table in terms of world GDP per capita.

Table 7: 2007 forecasts for key Gulf Co-Operative Council (GCC) States

%	UAE	Saudi Arabia	Qatar	Oman	Bahrain	Kuwait
GDP growth (real annual)	8.2	4.8	8.0	6.0	6.9	3.5
Current Acct Bal. % of GDP*	21	33	49	19	21	52
Inflation (annual)	6.2	2.8	10.0	3.8	3.0	2.8

Source: International Monetary Fund.

* 2006 actual figures.

So where are all the funds going? Besides further significant investment in petrochemicals, the GCC states have embarked on ambitious expansionary fiscal policies to develop their non-oil based industries which will ensure long term prosperity. Currently, spending plans for 2006-2010 total over \$AUD700 billion which is spread out across transport and infrastructure, tourism, business, property and education developments.

As with any sound investment strategy, the GCC States have also been diversifying their risk by investing in other countries to generate income from global capital and equity markets. They are also encouraging foreign inflows to the region, with political and economic reforms underway in order to create an attractive place to invest by locals and foreigners alike. The UAE has been leading the pace since 2002 when it opened up land ownership to foreigners, and created the beginning of the real estate boom. This was followed by Qatar in 2004, then Bahrain, Abu Dhabi and Oman. Further stimulus to the industry has also come from the low interest rates generated in part by the exchange rate peg to the US dollar. Other measures in place include privatisation of state-run facilities, establishment of free trade zones and free trade agreements as well as measures to increase the strength of the capital and financial markets.

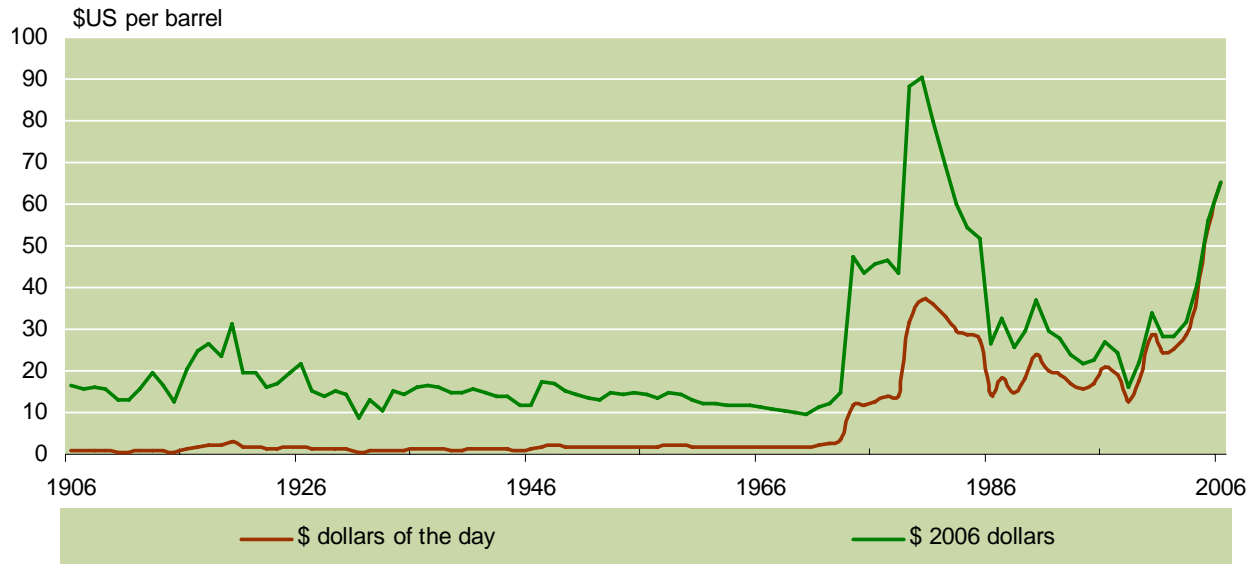
The momentum across the GCC is being further driven by its growth in population, which has seen a tripling in the last 15 years, one of the highest rates of the world. It also has one of the youngest populations in the world with less than 5% of its population aged over 60. This compares to rates of 15%-25% in Australia, Japan, the USA and the UK. There is also extremely good mobility of labour where it is estimated that working expatriates make up almost 50% of the GCC population.

As a consequence however, there are emerging conflicts amongst multinational workers and local conditions, stemming from the overheated market and are hampering productivity. The labour market requires further reform if it is to sustain the continued rates of growth in the construction industry. The other downside from the ongoing 'boom' is that costs and inflation are rising strongly, averaging close to 5% across the GCC in 2006, with 7.5% in the UAE alone.

² The GCC includes the States of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

In terms of further short-term risks, given the sensitivities of world markets, if oil prices suffer any sort of fall it may deflate the current 'zest' for investment. Over the medium to long term however, trends for world petrochemical demand and supply indicate that it will continue to be a balancing act and that prices should remain relatively high in light of historical figures.

Figure 28: Current oil prices trending higher than historical averages



Source: BP, 2007.

New Zealand

The New Zealand economy is shifting gear with an overheated property market. Ongoing wages pressure are also contributing to rising inflation. The cash rate was recently raised to 8.25%, pushing the variable housing rate to over 10%. With the majority of home loans sitting on fixed interest rates however, the desired slowdown in the market is expected to be gradual. Capacity constraints are holding back the economy with the labour market still extremely tight at 3.8%.

The current Government is hanging on to its accumulated budget surpluses stating that any additional fiscal spending will provide further unwanted inflationary stimulus. How long they will maintain this stance however, remains to be seen in light of the election due in 2009. It will also not stop infrastructure plans for the Rugby World Cup in 2011, which will see investment in new sports facilities and public transport – particularly in improving road congestion in Auckland.

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