ANZ Economic Outlook

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World economic forecasts

GDP growth (%)	2007	2008(f)	2009(f)	2010(f)
Australia	**4.2**	**2.3**	**1.8**	**1.9**
New Zealand	**3.2**	**0.7**	**0.5**	**2.5**
United States	2.0	1.5	0.7	1.7
Euro zone	2.6	1.1	0.6	1.7
Japan	2.0	0.6	0.7	1.6
China	11.6	9.7	8.0	8.9
Other East Asia (excl. Japan & China)	5.9	5.1	4.8	5.6
World (PPP)	**4.8**	**3.6**	**2.9**	**3.8**

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Overview

Tony Pearson, Deputy Chief Economist

An extraordinary public sector response to an unprecedented global crisis

In April 2008 the IMF described the global financial crisis as it then was as the "largest financial shock since the Great Depression". The good news is that the situation has evolved since then. The bad news is it has gotten a whole lot worse.

There is now no doubt the world is in the midst of a systemic financial crisis which in duration and magnitude we have not seen in our lifetimes. This crisis began in the US, but has now spread to engulf most of the developed world. Banks and other key financial institutions have failed in the USA, Europe and the UK. Prices across key asset classes are falling, including shares, commodities, and, in some countries, prices of houses and commercial property. The financial system in many countries is no longer functioning properly, in the sense that it is not facilitating the flow of funds from those with surpluses to those who wish to borrow. In much of the developed world there is now a true "credit crunch" in that some normally credit-worthy borrowers are unable to obtain financing at any price.

Regulators and governments have been exerting tremendous effort to stabilise the situation. There have been five sets of responses.

The first has been aimed at ensuring adequate liquidity in the banking and financial system. That has involved central banks in many countries pumping very large amounts of liquidity into interbank settlement systems. It has also involved the progressive extension of direct access to central bank credit to a wider range of institutions to include those outside the regulated banking sector. And it has entailed central banks accepting a wider range of securities in exchange for liquidity, including securities not directly backed by governments or banks such as AAA rated mortgage backed securities and commercial paper. The desire to maintain adequate liquidity has been within what might be considered the normal ambit of central bank operations, although the scale and creativity of the avenues through which liquidity has been provided have been of a precedent-setting scale.

The second step has been the public sector purchase from the private sector of the illiquid assets clogging balance sheets, with the government assuming some of the risks which are crippling financial flows. The money put on the table has been of a truly staggering size. The extreme example is in the US with the US$700bn "Troubled Asset Relief Program", which was in fact US$850bn after adding a range of tax incentives for other industries. Now US$850 is A$1.2 trillion at an exchange rate of US$0.70. And that is slightly more than Australia's annual GDP!

The third response has been the imposition of new controls on stock market trading in an effort to contain price falls. This reflected a belief that the extreme price declines experienced by some companies were the result of speculative short selling by hedge funds and that such declines did not reflect the underlying business fundamentals of the companies. A variety of bans on short selling were imposed in the USA, UK, Canada, France, Germany, Switzerland, Portugal, Ireland, and Australia, with Australia's among the most restrictive. These bans were for relatively short terms — for example, Australia's were for 30 days from 29 September — although at time of writing there was uncertainty about whether some more permanent restrictions on short selling and perceived market manipulation might ensue.

Another remedial action has been good old fashioned pump priming through central bank interest rate cuts. Until recently central banks had been (mostly) keeping their liquidity injection/stabilisation efforts separate from their macro economic management interest rate policy decisions. But the failure of other measures to stabilise the financial uncertainty, further increases in market funding costs, and the mounting evidence of damage to real economic activity, has now led to significant interest rate reductions in key countries. In a coordinated move, on 8 October the US Federal Reserve, European Central Bank, Bank of England, Bank of Canada, Sweden's Riksbank and the Swiss National Bank cut their policy rates. The People's Bank of China also eased for the second time in the month, followed by rate cuts in South Korea, Taiwan, and Hong Kong. And these moves were pre-dated by the Reserve Bank of Australia's 0.25% cut in early September and the surprise 1% cut in the cash rate in early October. These actions are intended to reduce bank funding costs, and to achieve a reduction in the cost of finance to end household and business borrowers so as to encourage demand for credit and to limit the downside risks to economic activity.

The final and most recent response in the US, Europe and the UK has entailed the nationalisation or part nationalisation of key institutions to bolster shattered balance sheets and to maintain them as going concerns. There has also been in many countries the extension of government guarantees to deposits with banks and other financial institutions. The idea behind the latter step is to restore confidence in lending to banks — the risk is effectively to the government, not to the bank — and to forestall concerned depositors from redeeming funds deposited with banks.

Australia will slow, but no recession

Amidst this chaos it needs to be stressed that the problems from which this crisis stemmed have

nothing to do with Australia. Australian banks have little direct exposure to the financial losses which have crippled many overseas institutions. Our banks remain tightly regulated, well capitalised, profitable, and are able to access required sources of funding from both onshore and offshore markets. Banks remain able and willing to lend to creditworthy borrowers. The four major banks in Australia are rated AA, among the highest rating of any banks globally. Only 20 other banks in the world have a rating equal to or higher than the four major Australian banks (S & P Global Bank Ratings).

Nevertheless, Australia is part of a global financial system, and so has not been able to completely escape some of the impacts of global events. Our asset markets have been significantly buffeted, with share prices (ASX 200) down around 42% from the early November peak as at close of business on Friday 10 October. Commercial and residential property markets now look to have stalled. Prices of many commodities relevant to Australia are heading lower, including base metals and coal and iron ore. The terms of trade boost to the Australian economy will begin to unwind in 2009. And market interest rates have risen sharply relative to the risk-free rates as lenders have sought to compensate for increased uncertainty.

The authorities in Australia have worked hard to offset these negative influences in a manner similar to their counterparts overseas. A point of difference is that there has been no nationalisation and no failures of deposit taking institutions. Of key importance, the government has assumed private sector risks, with the government guaranteeing all bank, building society and credit union deposits for three years; and also guaranteeing (for a fee) the wholesale (non-deposit) funding of financial institutions. It has also permitted the Australian Office of Financial Management (AOFM) to purchase $8bn of Residential Mortgage Backed Securities to assist funding of smaller financial participants in the home lending market. And most recently the Commonwealth Government has announced a $10.4bn stimulus package, with handouts directed to those most in need and with a high propensity to spend, and with an increase in the first home owners grants so as to boost demand at the lower end of the housing market.

We do not believe Australia is heading for recession although the road ahead looks rocky and the outlook is more uncertain than usual. One reason for some optimism is that the authorities have considerable further ammunition at their disposal to counter a downturn. The Reserve Bank has already cut the cash rate by 125 bp, but at a level of 6%, policy remains on the tight side of neutral, and we expect further significant rate reductions through late 2008 and into 2009. The Commonwealth Government is also in a very comfortable fiscal position, with no net debt (it also had a large budget surplus for this year estimated at the time of the May Budget at $22bn, although this is now likely to be close to zero after allowing for the economic slowdown and the fiscal stimulus announced to date). This provides plenty of scope for additional spending or tax cuts should economic stimulus be required. And this could be augmented through dipping into the various special investment funds which have been established through years of surpluses, with spending from the infrastructure fund already being slated to be brought forward.

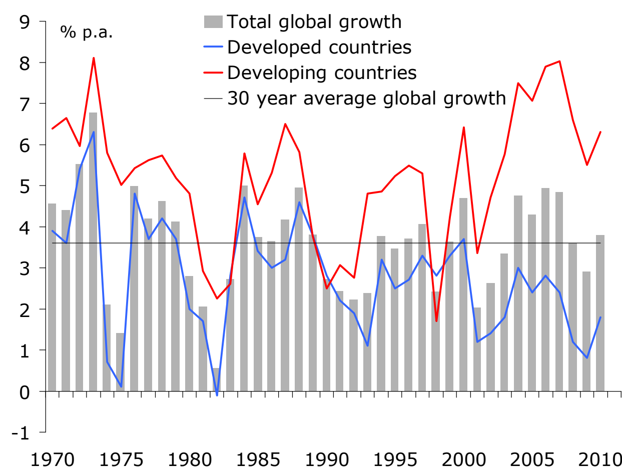
Global growth will be the slowest since 2002

The news for the rest of the developed world is not so good. The US, Europe and the UK are now in recession, even if the official data do not yet show it. And economic activity will slow further in 2009.

Asia remains to some extent insulated from the financial fallout, with healthy banks and limited direct exposure to troubled US assets. Financial markets have nevertheless suffered from contagion, with equity markets severely impacted this year, and with a widening of private sector risk premiums. Economic growth is slowing, with north east Asia and the money centres taking a relatively larger hit. But as elsewhere, central bankers have moved to loosen their monetary policy stance. Central banks in China, Taiwan and Hong Kong have cut rates, while liquidity has been injected by various means in a number of countries across the region. Indonesia has gone against the trend, raising rates again in early October, reflecting still high inflation and strong growth momentum.

Overall global growth is expected to slow further in 2009 to around 3%, the slowest growth since 2002. But the economic outlook has become more uncertain, with the depth and duration of the downturn very dependent on the success of public sector actions across the globe in restoring the more normal operation of what is now a deeply fractured financial system.

Global growth will slow to well below trend



Sources: Datastream, ANZ

International Outlook

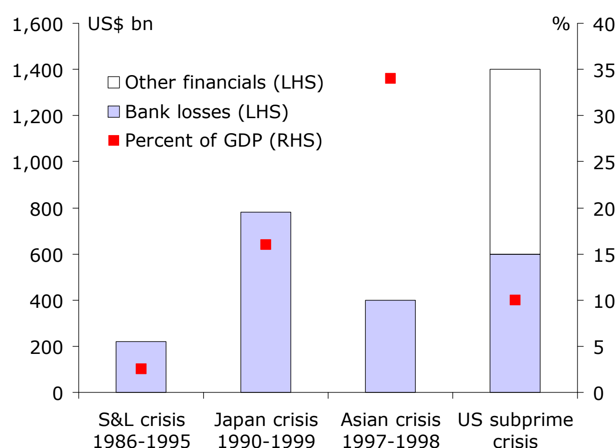
Amy Auster, Jasmine Robinson, Amber Rabinov

The crisis becomes systemic…

The past quarter has witnessed an earthquake in the financial system of the developed world that will change our economic and financial landscape for years to come. The magnitude of the quake and the damage is has caused is perhaps unprecedented in modern economic history.

The most immediate change has been the entry of government authorities into the private payments and financial system. We have seen more than 10 major private financial institutions fail, and another three institutions become nationalised by the US government – the first nationalisations of financial companies ever in the history of the United States – as well as a further 14 major global banks receive equity capital injections from the public sector.[1] Announced write-downs and losses have reached more than US$640 bn; the IMF estimates that losses could total US$1.4 trillion.

Financial institutions losses exceed US$640 bn



Source: IMF Global Financial Stability Report, Oct 2008

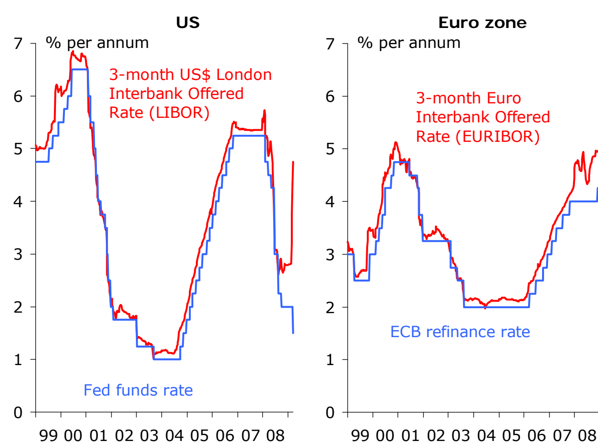
The IMF's figures, summarised in the above chart, are comforting in the sense that total losses as a share of US GDP are expected to be lower than in the Japan crisis of the early 1990s, and in emerging Asia in the late 1990s. What is different about this crisis is the way that the losses are spread through all financial institutions, not just banks. Over the past few months, the spread of losses combined with numerous bank failures has led to a significant rise in counter-party risk, in which banks are not willing to lend to each other and instead tend to hoard cash out of fear that even inter-bank loans will not be repaid. Central bank action to flush in liquidity has not improved banks' willingness to deal with each other, and the flow of payments and credit through the financial system is frozen.

[1] For further information and analysis on government and central bank intervention, please see "Global Wrap – October 2008" on www.anz.com.

There is no starker picture of the deep freeze in funding markets than the chart below, which plots three-month US dollar LIBOR, or the inter-bank borrowing rate, against the Federal funds rate, or the Fed's target rate for cash. The cost of one bank borrowing cash from another bank for 90 days reached 4.82% on 10 October, more than 3¼ percentage points above the Fed funds rate. This spread is unprecedented, even including the dislocations that accompanied the S&L crisis in the early 1990s.

Interbank rates have spiked

Cash and money market rates



Sources: Bloomberg, ANZ

Though the early stages of this credit crisis were confined mainly to the US, the past six weeks have seen trouble establish a beachhead on European shores. Major European financial institutions have required emergency aid, including the second-largest property lender in Germany, Hypo Real Estate Holdings. Hypo ran into trouble not because of the quality of its property loans, but because one of its financing units relies on the now-closed money markets to finance public infrastructure loans.

The case of Hypo demonstrates the problems of the "known unknown" in this environment. The known is that the freeze in funding markets will negatively impact borrowers, and the economy as a whole. The unknown is how long the freeze will continue, and how bad the damage will be. A decline in inter-bank funding costs is essential to restore order to the markets and stabilise growth expectations. Though the US-European bank packages have helped, this problem has no quick fix. The solutions are money – which will have to increasingly come from government borrowing – and time.

… ensuring the onset of a global recession

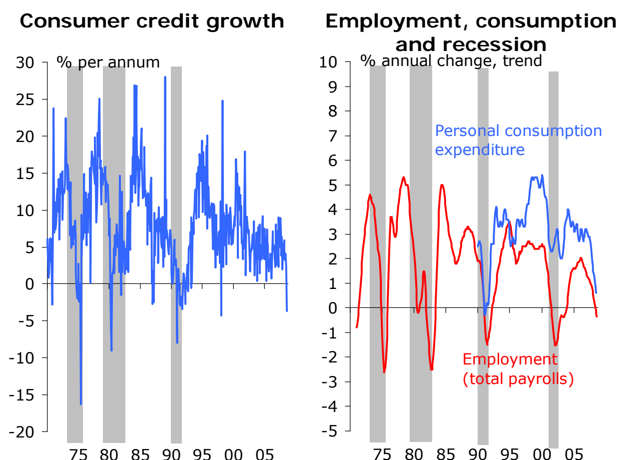
The expectation that financial institutions throughout Europe and the US will remain under pressure for some months has caused us to slash our global growth forecasts. Starting in the US, we know that credit to households and business has been turned off and that investment and consumption will decline. In an ominous sign, Fed data show consumer credit contracted by 3.7% on an annual basis in August (seasonally adjusted).

With the exception of a single month blip in 1998, this is the first time personal credit has contracted since the early 1990s.

We also know the US economy is already in a fragile state. As can be seen in the chart below, the labour market has been contracting on a month-to-month basis for nine months – the most reliable signal that the economy is close to or in recession territory. Retail sales are weak, and personal consumption expenditure, adjusted for inflation, looks to have been flat in the third quarter. The bout of extreme financial market distress that unfolded at the end of the third quarter and cut off credit to the economy looks certain to tip the US into deeper recession.

Given the data flow and worsening credit crunch, we have downgraded our forecasts for US economic growth such that we now expect the US economy to expand by only 1.5% this year and 0.7% next year. Our forecast includes three quarters of negative GDP growth, and the first full-year contraction in domestic demand since 1994. Inflation is expected to head to well below 2%, and the Fed funds rate to trough at 1.25% early in 2009.

US looks to be in recession



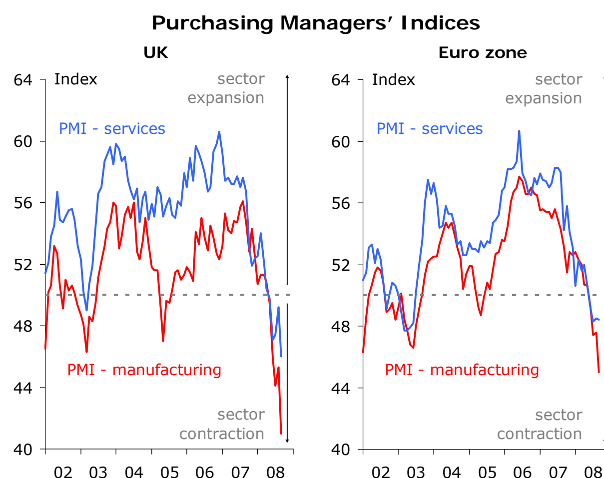
Sources: Datastream, ANZ

Perhaps more importantly in relation to our global outlook, we have slashed our growth forecasts for Europe as a result of events there over the past six weeks. We had anticipated that European growth would soften but not contract in the Euro area's largest economies; we are now forecasting a recession for the Euro area as well as for the UK.

After contracting 0.2% in Q2, the economic climate in the Euro zone has since worsened, and overall economic confidence is at an all-time low. Retail sales are falling in annual terms across the Euro zone, as is industrial production (even in the German powerhouse), and the strong Euro has slowed export growth. In the UK, the financial crisis has tightened its grip. Unemployment has begun to rise, exacerbating the pain already felt by households due to plunging house and equity prices.

We have also downgraded our growth forecast for Japan, although our forecasts had already been below consensus. Domestic consumption is slowing rapidly, and all forward indicators of confidence and business activity are worsening.

Industry is contracting in the Euro zone & UK



Sources: Bloomberg, ANZ

As a result of these downgrades, we now anticipate that economic activity in the G7 economies will expand at a slow rate of 1.1% this year and fall to only 0.6% growth next year. Over a two-year period, this is a far worse outcome for the G7 than during 2001-2002, and is about on par with the recession of 1982. A growth rate of 0.7% next year for all "developed" economies represents the slowest single-year rate of expansion since 1982.

The emerging economies are also expected to slow in the coming year, as a result of multiple factors. First, the G7 slowdown will cause export growth to fall, and reduce the contribution of net exports to growth. Second, falling oil prices will dent the investment prospects for oil-exporting economies, most of which are in the developing world. Third, household wealth in the large emerging markets of Russia, Brazil, India and China has taken a huge hit from plunging stock markets, and this will most likely affect domestic consumption. More analysis on East and South Asia can be found in the following pages; suffice to say here that real GDP growth in East Asia ex-Japan is forecast to fall away by nearly 3 percentage points – a big slowdown – from a peak growth rate of during this expansion of 9.5% in 2007. South Asia is also expected to slow from 8.8% growth in 2007 to 6.6% next year.

Although our forecasts do not show global growth turning negative on an annual basis, we do view our forecasts as indicating a global recession, as the depth of a slowdown indicates a contraction in business activity at this stage of the cycle. Similarly, we estimate that growth among Australia's major trade partners, on a weighted average basis, will contract in the first and second quarters of 2009, and fall from an annual growth rate of 6.8% in the last quarter of 2007 to 3.3% in the first half of next year. Buckle up – we're in for a rough ride.

Asian Outlook

Paul Gruenwald, Tamara Henderson, and Ivy Tan

Emerging Asia won't escape unscathed

The question was never whether emerging Asia would be affected by the global credit crisis that began in the U.S. in mid-2007; it was always by how much. With stress in the global financial system intensifying over recent weeks, the associated asset market nosedive, and the increasingly apparent knock-on effects on real activity, emerging Asia now seems set to take a bigger hit to growth than previously expected. That being said, we do not see a repeat of the Asian crisis, or even a downturn on a par with the tech bubble burst in 2001-02. But cracks have definitely started to appear in the more exposed economies in the region.

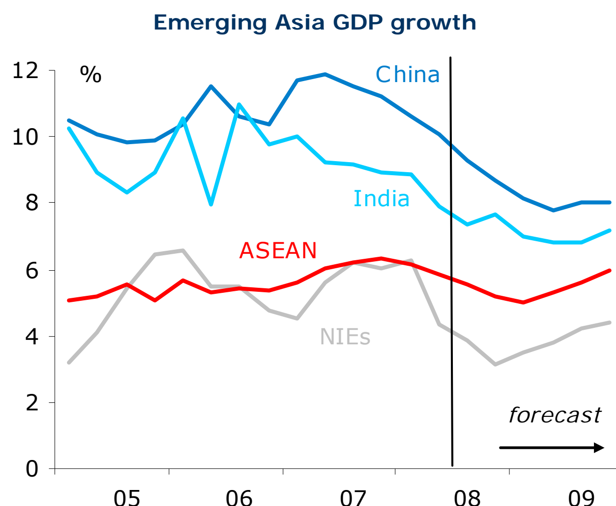
In contrast with our report in the previous Outlook, the focus in emerging Asia has shifted noticeably from inflation to growth. Indeed, inflation as a concern has largely—though not totally—disappeared from the radar screen as evidence mounts that (i) price pressures have peaked (with little sign of feared second-round effects); (ii) growth is slowing, in some cases sharply, across the region; and (iii) there are now prospects for a deeper- and longer-than-expected slowdown in the U.S. and Europe.

The Asian growth split, contagion, and policy responses

Unlike the Asian financial crisis or the tech bust, the latest shock to the global economy has come from outside the region. As a result, the effects on emerging Asia are necessarily indirect. Our model for analysing how growth plays out in the region focuses on the reliance of growth on domestic demand versus net exports, and the current account position. We also take into consideration the importance of the financial sector in the economy as well as political considerations.

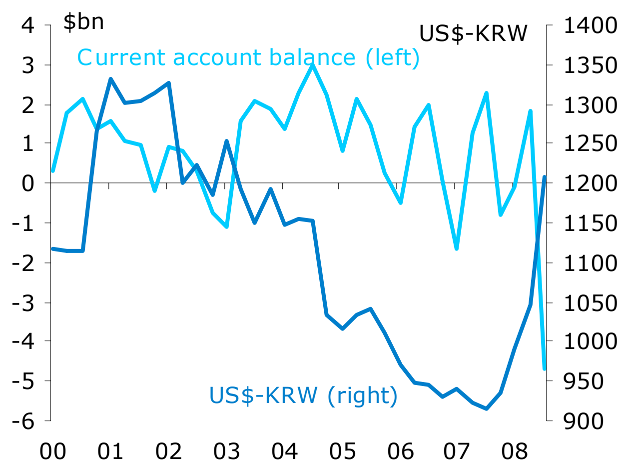
As noted elsewhere, the outcome of our analysis is an "Asian growth split," where Northeast Asia and the money centres (together known as the Newly Industrialised Economies or the NIEs) take a relatively large hit to growth while Southeast Asia, with its strong domestic demand, does better. This has already begun to play out with Singapore in a technical recession (with back-to-back contractions in Q2 and Q3 GDP) negative Q2 GDP growth in Hong Kong with Q3 growth looking rather soft, and weak confidence in South Korea and weak exports in Taiwan. The pace of activity also appears to be slowing in China, including from ongoing efforts by the authorities that pre-date the current crisis, although the rate of growth there remains high. Growth in India has moderated as well while momentum in the ASEAN group (Malaysia, Indonesia, Philippines, and Thailand) is largely intact.

Emerging Asia GDP growth



Sources: Bloomberg, CEIC, ANZ

South Korea: KRW vs the current account balance



Source: Bloomberg

The financial market impact on Asia from developments elsewhere has been much less nuanced and contagion has been high. Through mid-October, equity markets across the region have been hard hit by the recent sell-off, and are down by as much as 60% year to date in local currency terms, with the NIEs doing somewhat better than the ASEAN group. About one-third of this has taken place over the past few weeks following a brief post-Lehman bounce.

Asia ex-Japan currencies have generally wilted against the US dollar. In particular, currency markets have been punishing the Asian economies with current account deficits—South Korea and India. The countries with relatively small current account surpluses have also been under-performers within the region—the Philippines and Thailand. In the credit markets, CDS spreads have widened considerably across sovereigns and sectors.

As noted, inflation has faded quickly as a concern facing emerging Asia. In a number of countries, mainly in Northeast Asia, inflation has clearly peaked. Although headline CPI growth in a number

of other countries remains elevated, inflation momentum (measured as the annualised growth of the previous quarter's price increase) has fallen away sharply suggesting that most of the price pressures are well behind us. Producer price inflation has come down less quickly across the region, but the recent drop in commodity prices indicates that this measure of inflation is set to decline as well.

Taking into account these developments, central bankers have moved to loosen their monetary policy stance, and liquidity has been injected by various means in a number of countries across the region. Central banks in China, Taiwan, and South Korea have reversed course and cut rates. Singapore, which adjusts monetary conditions via its exchange rate, similarly loosened policy by adopting a zero percent appreciation path in its S$NEER policy band. The largest easing in the region so far has been by the Hong Kong Monetary Authority, which not only tracks adjustments in the Fed funds target (because of its currency peg), but also changed the gap between its base rate and the Fed funds target to 50 bps from 150 bps. This easing trend has been bucked in Indonesia, which raised rates again in early October, where inflation remains high and growth momentum remains strong.

One important aspect of the Asian resilience story so far is the strength of the region's banks. Unlike their counterparts in the U.S. and Europe, Asian banks have generally healthy balance sheets and limited exposure to toxic assets. Of note, the reported inter-bank exposures of Asian banks to Lehman Brothers was only about 1% of the global total, with one-third of these claims held by Japanese institutions. The exposure to sub-prime credits on the part of Asian banks was also quite modest and loan-to-value ratios remain low in most economies, with South Korea being a notable exception.

Slower growth and turbulent markets ahead, but no regional crisis

Looking ahead, GDP growth across emerging Asia will fall from current levels as the pace of activity in the global economy declines. The main effect will be through the trade channel and the economies most reliant on net exports for growth will take the biggest hit. In addition, those economies reliant on foreign savings (i.e., those running a current account deficit) to finance investment will see relatively sharp declines as well.

We see growth for the NIEs as a group declining by 2½ ppt from early 2008 to a trough of 3½% (year on year) in the second half of 2009. We forecast a similar decline for Chinese growth, which will fall to 8% (with policymakers there using their ample scope for countercyclical action if required), and India, which should fall to 7%. The ASEAN countries, in contrast, should be more resilient to the global slowdown given their buoyant domestic demand and growth should moderate from 6% to around 5%.

We expect foreign exchange markets to start to target the currencies with the largest export exposures and the more developed financial sectors—notably Taiwan and Singapore. Swift policy reversals by China's PBoC and Taiwan's CBC also suggest that the persistent downtrend in US$-CNY and US$-TWD is over for now. Spreads should remain elevated in the period ahead, with a gradual restoration of counterparty confidence beginning only after the worst of the crisis has past.

Despite their strength to date, the region's banks will not be unaffected as the global economy slows further. In the current climate of "no confidence" globally, we expect weaknesses to appear in terms of profitability, asset quality and capital strength, although we see the probability of any systemic bank failure to be very low. That being said, the failures and consolidation of the US and European banks will cause job losses in those economies where these entities have significant operations.

Related to this, we expect that the relatively healthy balance sheets across much of emerging Asia combined with high savings rates will allow for the continued accumulation of assets of the world's deficit economies. While the ongoing credit crisis and its effects on asset markets has resulted in a staggering loss of global wealth, it has also seen the transfer of wealth (and ownership) from weak balance sheets to strong ones.

We see the risks to our forecast to be on the downside. While the durability of domestic demand in some economies may surprise, a much more likely scenario is that the global slowdown will be sharper and longer than expected. A deeper and more protracted global slowdown is likely to have more severe (and perhaps non-linear) effects, on emerging Asia. However, even if these downside risks were to materialize, the likelihood of a repeat of 1997-98 is remote given the lower external risks including much higher reserve levels, better policy frameworks, more resilient economies and structural reforms put in place over the past ten years.

Australian Outlook

Warren Hogan and Katie Dean

A new and dangerous phase…

The Australian economy now faces the most challenging environment since the recession of the early 1990s and possibly the depression of the 1930s. This new and dangerous phase in global financial markets has caused two of the biggest drivers of Australia's prosperity in recent times – the credit and commodity cycles – to turn sharply. Since mid-September, resource commodity prices have fallen by more than 35% and heightened counter-party risk and a shortage of liquidity has caused wholesale funding costs to soar. Our local sharemarket has followed global markets to fall sharply with the ASX 200 losing 37% — or about $900bn — since its 2007 peak. The A$, which traditionally acts as a bellweather for the global economy, has collapsed.

…prompts extraordinary policy response…

These unprecedented events have prompted extraordinary local policy responses, across the monetary, fiscal and regulatory sphere. The RBA has slashed 125bp from the overnight cash rate since September. This included cutting rates by 100bp at its October Board meeting, the biggest rate cut at a single meeting since the recession of 1992. The RBA has also broadened the scope of its open market operations to try and improve interbank liquidity conditions and aid the functioning of local money markets. Unfortunately to date, these measures have had little impact on interbank funding costs with the spread between 3-month BBSW-OIS (a measure of one source of bank funding) remaining near 100bps, just near record wides and ten times higher than pre-crisis levels.

The mounting seriousness of the crisis has also prompted the Australian government to act. In mid-October (following the 'Black Friday' on equity markets) the government moved to guarantee all deposits in Australian banks and Authorised Deposit Institutions (ADIs) and has also guaranteed (for a fee) wholesale funding for these institutions. It is important to note that the Government's guarantee does not reflect any problems in the local banking sector. Indeed, Australian banks remain in a healthy financial position; well capitalised with relatively low loan default rates[2]. Rather, with other international governments guaranteeing bank deposits and funding, there would be a significant risk of a loss of deposits and funding from overseas if Australia did not follow. With Australian banks relying on offshore wholesale investors for around 60% of funding requirements, a loss of this funding source would have been catastrophic for the sector and economy.

The government has also just announced a fiscal stimulus package worth $10.4bn (worth around 0.9ppt of annual GDP). This package includes $8.7bn of direct payments to pensioners and families, to be paid in full in December 2008. If all of these payments are spent, our estimates suggest this package could add as much as 3ppt to Q4 GDP growth — an extraordinary boost. In our view such a large impact to growth is unlikely; the real economy will adjust to this financial sector crisis through deleveraging, which for households means increasing their saving rates. Nevertheless, this fiscal package will provide a short-term buffer to what otherwise was shaping up to be a very soft end to 2008 for economic growth. With the Budget still expected to stay in surplus, the fiscal package also highlights that Australia has far more capacity than most other countries to use economic policy if needed to help sustain growth.

…the risks are for a deeper slowdown…

This is not to say that the Australian economy won't slow further from here and the risks of a deeper and more sustained downturn have been completely averted. While the fiscal stimulus may now prevent Q4 GDP growth from turning negative, it is only a one-off boost. The outlook for 2009 remains clouded as the transmission to local activity from this financial shock and global recession has barely started.

The Australian economy was already slowing sharply heading into the current crisis; retail sales have been well below trend, housing finance approvals have hit 13-year lows and the unemployment rate is rising. Our forecasts now see GDP growth slowing to around 1¾% in 2009 and staying soft at around 2% in 2010. This outlook is based on the successful reengineering of growth, via monetary and fiscal stimulus, back to the consumer and away from exports and business investment, which will be hit hardest by weak global growth and higher credit costs. This is our core view, but significant challenges still lie ahead:

The end of the commodity boom. It is now clear that commodity prices, and thus Australia's terms of trade, have peaked. Spot prices for coal and iron ore, which had been trading above contract prices, have fallen more than 40% in recent months. At this stage, we are factoring in 20% falls in US$ iron ore and thermal coal contract prices and a 30% fall in US$ coking coal contract prices over 2008-09. With the weaker A$ offsetting some of the impact of this price fall on earnings, this is likely to see the terms of trade fall by around 15%. This could knock up to 2ppt off national income and will also likely dampen, but not halt, production growth, investment and employment across the sector. However, there is still considerable scope for a sharper, or more damaging correction. The Baltic Dry Index – an index of global shipping costs and a leading indicator for global commodity demand and our terms of trade — is now 85% below its peak. With the resources sector accounting for around 25% of national profits and investment in 2007-08, such a fall in Australian commodity export prices

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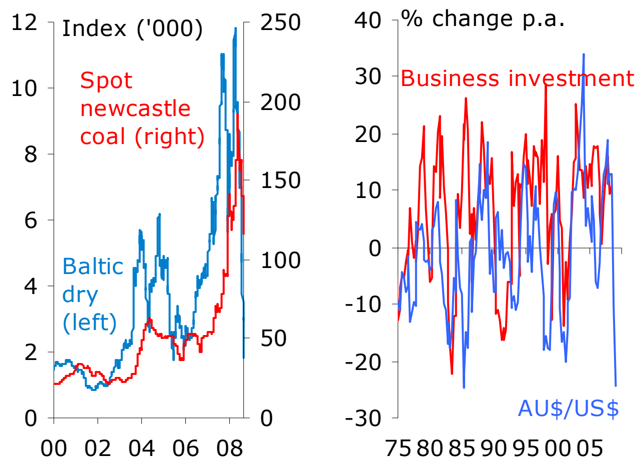
[2] The RBA (Sep-08) notes in Australia 90+ day housing loans arrears was 0.41% at June-08. In Jun-08 30+ arrears are 6.4% in US and 2.9% in UK.

would have catastrophic effects not just across resources but across the broader economy.

The drivers of Australian growth have turned sharply



Source: ABS and ANZ

A fall in business investment. Prior to the deepening of the global crisis, booming investment in resources and infrastructure was expected to drive Australian growth in 2008-09. Surveyed business intentions had pointed to investment growth in excess of 15%. This now looks unlikely. In Australia, downturns in business investment typically occur in periods of global recession, falling local share prices or a below-average A$. Australia now faces all three of these challenges, as well as tighter credit availability and higher credit costs. Investment in Australia cannot be expanded if it cannot be cost-effectively funded or if expected demand is no longer there. If we apply historically low realisation ratios, the CAPEX business survey suggests flat investment by the non-mining sector next year. We have factored this into our forecasts but still see an outright fall in investment as the key risk to the Australian economy in 2008-09.

A sharp rise in unemployment. Indicators of labour demand are falling sharply. ANZ newspaper job ads are down 25% YoY, which is consistent with the unemployment rate rising to around 5¾% by end-2009. With economic growth to stay soft at 2% in 2009, the usual metrics would suggest that a further rise in the unemployment rate towards 6½% looks in prospect. To be sure, there are arguments to suggest the local labour market will prove less sensitive to the economic cycle; persistent skills shortages will likely see some labour hoarding and strong corporate balance sheets, relative to the 1990s recession, mean local firms should be less pressed to shed labour as sales slow. Nevertheless, in this uncertain environment we remain concerned that firms may be forced into greater than expected labour shedding. This would lead to increased household debt defaults and would not only put considerable downward pressure on house prices but, by prompting a deeper deleveraging amongst households, would also sharply increase the chance of a recession.

A collapse in house prices. We do not expect a US style housing market collapse in Australia. This is mainly because sharply rising house prices in Australia have occurred in *response* to a housing shortage, unlike in the US where sharply rising house prices occurred *despite* housing oversupply. With lower interest rates boosting housing affordability, we now expect national house price growth to remain flat (or record small falls) over the next few months before pushing higher over the next few years. The performance of the labour market is the major risk to this assumption. In Australia, the most powerful driver of mortgage defaults and subsequent falls in house prices is a rise in the unemployment rate. On our estimates, a rise in the unemployment rate towards 8% would be sufficient to trigger a fall of up to 10% in national house prices. This is well outside our core forecasts. But, as events unfolding in the US and Europe now highlight, such an event would be calamitous for households and the economy.

…the RBA to take rates below 5% in 2009

We expect the RBA to continue easing monetary policy over the year ahead as the slowing in the domestic economy and the global credit crunch dampen inflation risks and bring downside growth risks to the fore. The RBA has already aggressively cut rates to 6.0% in response to the deterioration in global and local growth prospects and the impact on Australian money and debt markets from the tightening of financial conditions in global markets. With inflation risks falling we believe the RBA will be quick to move interest rates back to a neutral setting, defined in Australia as short-term rates of around 5.5%. This suggests that at least another 50bp of rate reductions will be forthcoming by the end of the year. If money market pressures fail to subside in the wake of government extending guarantees to the banking system, the RBA may have to cut by more than this as market interest rates may not fall by as much as the RBA cash rate.

Beyond the immediate need to get interest rates back to neutral, the RBA is likely to have to reduce rates further, to a level typically described as stimulatory. Although we still expect the Australian economy to avoid recession, an important reason is the use of policy to provide a stimulus to the economy that counters the deflationary effects of a global downturn. As such we expect the cash rate to decline to around 4.5% in the middle of 2009.

Interest rate markets have fully priced a rapid easing of monetary policy into the forward curve. Government bond yields have declined substantially (the 3-yr bond fell as low as 4.25% at one stage in mid October) and futures markets are fully priced for another 150 to 200bp of rate cuts by March of 2009. It will be difficult for further substantial declines in term yields unless the RBA is more aggressive in it's easing than we expect. We expect term yields to remain low but are unlikely to fall much over the next six months. We expect Australian dollar swap rates of tenor from 3-yr to 10-yr to trade around 5% to 6% for the next six months.

New Zealand Outlook

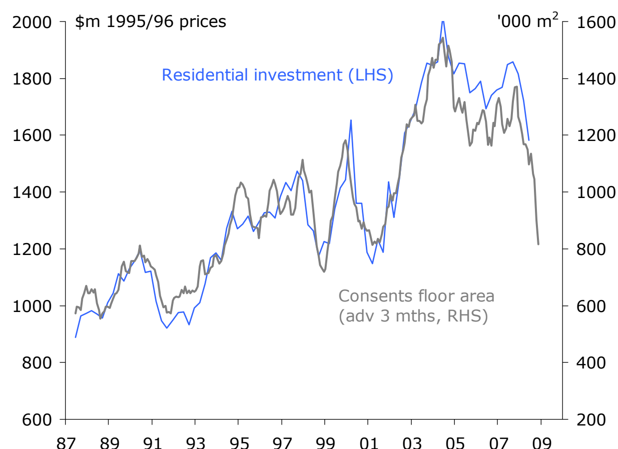
Philip Borkin

The NZ economy contracts, sustained rebound is still some way off

Growth within the economy is non-existent. Economic activity contracted by 0.2% in the June quarter, following a 0.3% contraction over the first three months of the year. Year-on-year growth has now slowed to just 1.0%. We are also expecting a further negative read for September quarter GDP growth and the potential is for it to be worse than H1 2008.

However, some signs of stabilisation are beginning to surface. Certainly, the construction sector is expected to remain weak, and household consumption will stay subdued as the unemployment rate rises and house prices continue to fall. Some forward-looking gauges have now either started to stabilise or are showing signs of a pick-up. Business and consumer confidence have recovered from precipitous lows. While they remain at low levels and look to be a response to expectations of lower interest rates, any improvement is of course encouraging. Yet, this rebound in sentiment is likely temporary. These surveys do not fully take into account the latest bout of financial market turbulence, and as such are likely to overstate the level of optimism within the economy.

Construction sector at forefront of slowdown



Sources: ANZ National, Statistics NZ

Hence, we are not buying into the “reflation” theme. The composition of June quarter GDP growth, with stock levels high across the country, suggests further weakness to come and we are still not at the trough. Mortgage rates may have fallen, as have petrol prices, and these will provide some near-term relief to households. But we are mindful that we are yet to see the full impact of the global credit crisis flow through. The global backdrop continues to deteriorate, and despite the best efforts of policymakers, financial markets remain turbulent. With credit markets in gridlock, the focus could soon turn to countries with large current account deficits. NZ’s deficit rose to 8.4% in the June quarter despite the biggest terms of trade boom in thirty years. This is a significant structural headwind running against those espousing the strong rebound thesis.

The global credit backdrop is the key risk

As a country heavily reliant on offshore capital to fund a savings shortfall, the current global backdrop leaves the economy vulnerable. At the heart of the upswing over the last few years was a strong financial accelerator that manifested in insatiable risk appetites, strong growth and booming asset prices over the preceding eight years. It was a global phenomenon. We are now seeing the reverse as the turn in the credit cycle and subsequent repricing of risk acts as a decelerator. The risk is that this decelerator becomes an inward spiral that is difficult to break. Policymakers have attempted to stabilise sentiment, but there remains no silver bullet. There is still cash available offshore, but the cost and the confidence to put it to work have materially changed. Funding costs for NZ (and Australian) banks have risen significantly and this represents a defacto tightening in financial conditions for NZ borrowers. It will mitigate the impact of falls in the Official Cash Rate.

Real economies are now being impacted and it is no longer a US story. Growth across developed nations is slowing, with recessions in a number of countries now a real risk. Emerging markets are also beginning to slow as export growth weakens. For NZ, there are two key areas we are watching very closely:

First, the dairy sector. The recent announcement of a 2008-09 forecast dairy payout of $6.60 per kilogram of milk solids is a good news story and should be recognised as such. Yet this is a downward revision on an earlier estimate. Dairy prices are now falling. Skim-milk powder prices are 46% off their late-2007 peak and whole-milk powder some 40% off. Slowing demand and the escalating tainted milk situation in China suggest further headwinds ahead, although we also need to appreciate that overall dairy commodity prices are still up strongly on where they resided two years ago. But this is only part of the story. Dairy farm costs rose by 11% in the year to June (the biggest rate of increase since the mid-1980s) and are putting pressure on the bottom line. We have also already seen much exuberance capitalised into stock and land values and this suggests the payout will need to be maintained at a high level to get a viable economic return. The risks are for payouts to be lower going forward.

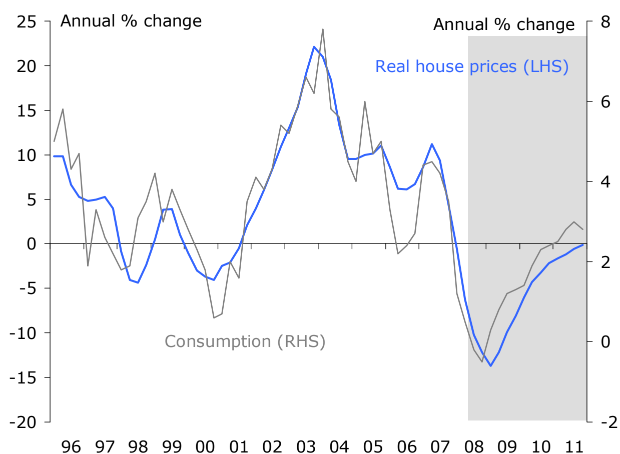
Second, tourism inflows. Tourism is a luxury good with an income elasticity of around two. Hence, small changes in global growth can have a big impact. It is also very pro-cyclical in relation to the global growth cycle and influenced by the wealth effect. Falling wealth is currently a big drag and likely to be for some time given declining equity

markets and house prices in most developed nations. When you are worth less, you travel less. Finally, tourism is a logical by-product and beneficiary of globalisation, and oil prices (whether that be via freight rates or jet fuel costs for airfares) is a major spanner in that process at present. It's not widely recognised but the tourism sector is NZ's largest foreign exchange earner.

It is this backdrop that sees us shift to an expectation of an "L" shaped cycle for the economy — but still with downside risk

We have long held the view that the NZ economy will go through a protracted period of subdued growth as imbalances are purged. However, we now see risks that this period of slow growth lingers for much longer. While the story is still one of household consolidation and de-leveraging as high indebtedness, falling house prices, rising unemployment and cost of living pressures see precautionary savings rebuilt, the global backdrop now adds another layer of downside risk. Previous economic slowdowns have shown the economy choppy and wobbly at the trough with no clear trend and we expect this cycle to be no different. But ultimately, the economy is embarking on a current account adjustment process and these typically tend to take place via two angles. Firstly, a significant domestic slowdown that chokes off import demand and second, a weaker currency that stimulates the export sector. The former has yet to really take hold, but we suspect it is only a matter of time. A sharp turn in the labour market represents the next leg of vulnerability for households.

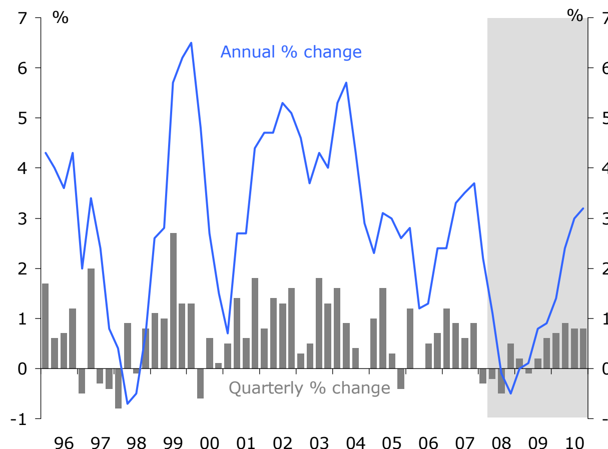
Private consumption and real house prices



Sources: ANZ National, Statistics NZ, QVNZ

Economic activity will remain subdued well into 2009 as the spending side of the economy, notably residential investment and consumption, remain weak. GDP growth is forecast at 0.7 percent for calendar year 2008, and just 0.5 percent for 2009. Exports will eventually lead the economic recovery, and a lower NZ$ is the first step in the rebalancing process, but this is a 2010 story. The big caveat is of course the global economy. The potential is for recent global events to lead to another leg of domestic weakness as the business sector gets caught in the rip, both from offshore and from less domestic demand.

New Zealand economic growth forecast (GDP)



Sources: ANZ National, Statistics NZ

Key financial market views

For the RBNZ, the focus has quickly moved from one of a weakening domestic economy to that of financial stability. While inflation pressures are still a concern, the RBNZ stated at their September *Monetary Policy Statement* when they cut the Official Cash Rate by 50bps that *"at this time, we believe it is appropriate to lend more weight to the downside risks associated with the deteriorating global outlook, increased credit pressures, and domestic housing market correction."* Since this statement, the international credit backdrop has deteriorated further with the contagion spreading into Europe and the UK. International money markets remain in a state of grid-lock despite the best efforts of policymakers and equities are under considerable pressure. Financial market confidence is almost non-existent.

We now expect the RBNZ to cut rates by a further 100bps at their next meeting in October and follow it up with a 50bp cut in December. It is all about front-loading the easing cycle. The surprise cut of similar magnitude by the RBA is a huge barometer and a clear signal that if an aggressive stabilisation move is warranted, there is little reason to wait. Further rate cuts over 2009 are then expected and see the cash rate reach 4.75 percent by July 2009.

The NZ$ continues to look vulnerable given the deteriorating economic environment, easing profile from the RBNZ, increased risk aversion and uncertain global backdrop. We see the NZ$ bottoming out at around US$0.55 and staying there for some time. We would not be surprised to see a bounce higher in the near-term if policymakers restore some order to financial markets. But the big picture, and where the risks reside are clear. A lower NZ$ remains a key prerequisite for the rebalancing the economy is undertaking.

Commodities Outlook

Mark Pervan and Doug Whitehead

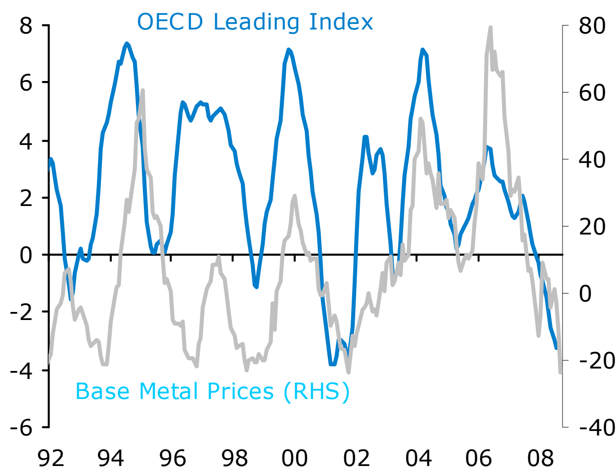
Safe-haven status disappears

Commodity markets have lost their safe-haven status against a falling US$ and a faltering US economy, with prices crumbling in the past quarter. Investors have discounted the US-China de-coupling theory and linked commodity markets back with the wider slowing global economy. After an impressive 20% second quarter rally led by oil, the key CRB index collapsed 39% in the third quarter - the largest quarterly decline on record - bringing to an end, with an almighty thud, the stellar commodity price rally of the past six years. Energy and metal prices experienced the biggest falls, with precious metals and agricultural/soft prices faring relatively better (or less worse).

There were a number of catalysts triggering the sell-off, but the first appeared to be basket-selling from the sharp turn downwards in oil prices from mid July as the market switched from positive one-off supply issues to negative on-going demand issues (mainly US led). The shutdown of heavy industry over the Beijing Olympic period clouded the China growth story through August, while the credit crunch bombshell that detonated through the US banking system in September convinced enough that global growth industries were next in the firing line.

Ironically, the global growth story was already a negative headline in the second quarter, with the key OECD leading indicator pointing sharply down year-on-year and Baltic freight rates correcting, albeit off a high base. However, market participants chose to ignore these demand warnings for a more appealing rallying oil price and a sinking US$. As mentioned, that turned around in July as oil prices corrected. This took pressure off the US trade deficit and importantly, the sick looking US$ — creating a more convincing reason to sell — and they did.

OECD demand cycle still plummeting

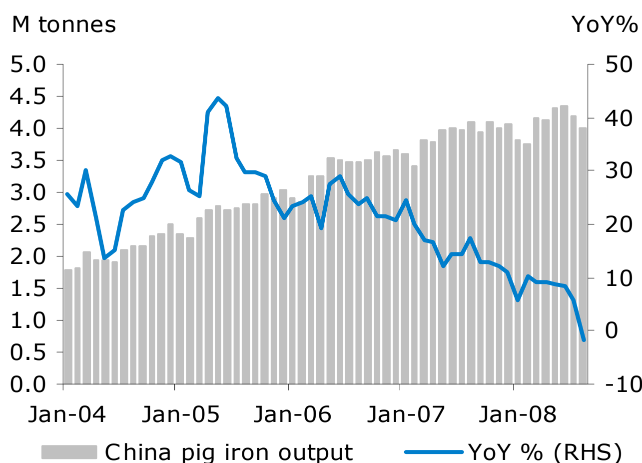


Source: Bloomberg

These factors are all still in play, but accentuated from levels in the third quarter. Accordingly, the mood has swung sharply negative, with the market now fully aware and focusing on the negative risks to global growth.

The coming quarter could throw up further (downward) pressure, with signs Chinese demand is cooling. Additional focus will be given to the monthly China trade and production data to see whether the recent softness in activity can be put down to the shutdown initiatives around the Beijing Olympics – we think it's not. Seasonally, the commodity market also goes into a slow patch, with busy northern hemisphere summer building activity coming to an end. Overlaying this is a recovering US$, which adds another (big) incentive to sell.

China Steel output growth grinding lower



Source: Bloomberg

In fact, we don't see many buy catalysts in the near-term. The US$ could possibly turn back downwards, if we see another nasty US-based credit crunch surprise. At best, this would create a relief rally, with the realisation, that further turmoil in financial markets will eventually play-out (negatively) in the wider economy. China could, as it's done in the past, surprise on the upside. However, the recent steel output cut pledges, the slowing residential and automobile market, and the obvious pressures surrounding export markets, suggests China would need to pull something large, wide and positive out of left-field to please the current bearish looking market.

It won't be an even playing ground either, with the commodities close to the marginal cost of supply and the safe-haven precious metals market likely to perform better (or less worse in the current environment). The sting in the tail may come from sharp downgrades in contract bulk iron ore and coal prices, which so far have missed the significant corrections inflicted on base metals, energy and the agriculture/softs markets. The annual bulk price negotiations get started in mid November, and with rising concerns about end-user demand, the risks remain to the downside.

No upside for base metals

Although base metals have corrected heavily over the past six months, sentiment is unlikely to improve under the deteriorating demand conditions. Supply remains tight for copper, lead and zinc, while for nickel and aluminium it looks more ample. We think copper has the biggest downside risk, with prices still 20% above the marginal cost of supply. Aluminium may also disappoint, with fast falling energy prices taking pressure off high cost smelting capacity. More responsive high cost lead and zinc supply closures flags a better relative price performance for those metals. And nickel still remains hamstrung by slack demand from high nickel-grade stainless steel demand.

Oil too leveraged to the US

Oil has been whacked and rightly so – as heightened speculative buying activity surrounding limited (longer term) spare capacity quickly gave way to deteriorating (short term) demand conditions. And this will remain the trend for the time being, with oil's Achilles heel being its high exposure to sharply slowing US demand. Recovering US refining capacity (from hurricane activity in August) will also weigh (down) on prices. We expect a tighter production response from OPEC, but the impact will be muted, with the market more focused on demand rather than supply issues.

Heightened risk plays in gold's favour

Gold will continue to perform better than other commodities because of its safe-haven characteristic – which in the current environment becomes a drawcard. Despite this, gold's other key drivers – the US$ and oil prices – are likely to play against better gold prices. Accordingly, we expect prices to be choppy to mildly weaker over the coming months – potentially stronger in the very near term as the credit crunch financial fallout plays further out. Heightened volatility is also curbing end-user demand, which may hurt, with gold entering the strongest demand period of the year – the Indian wedding season.

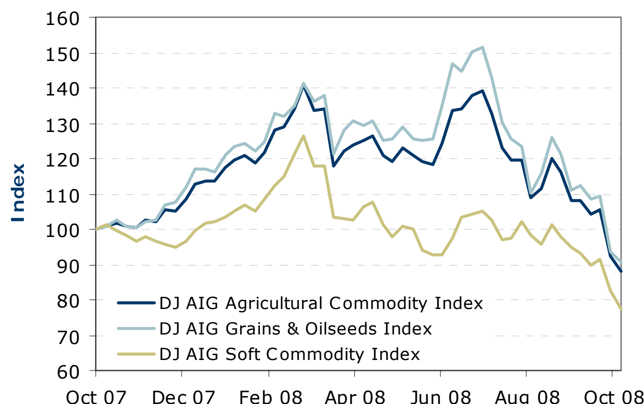
Bulks vulnerable to downgrades

The contract iron ore and coal markets now look vulnerable to their first price falls in three years (six years for iron ore) as plunging Baltic freight rates and spot prices swings pricing leverage back to the consumers. Stockpiles of both coal and iron ore in China have risen substantially in the past couple of months at a time when demand appears to be waning. Falling oil prices will continue to weigh on alternative energy sources such as thermal coal prices. Reports of substantial steel output cuts in China and Europe will reduce the demand for key steel input materials — coking coal and iron ore — over the medium term.

Agricultural Commodities

Agricultural commodities have suffered heavy price declines over the past three months. The same rampant speculative activity, which drove the creation of agricultural commodities as a new asset class and saw prices reach record highs in the first half of 2008 has now departed. This combined with a significant supply-side response to the overwhelmingly tight market experienced in 2007/08 has exacerbated the recent downward momentum in prices. Despite the strong supply response, many agricultural markets still remain at historically tight levels, which would generally be supportive for commodity prices. However, considering the heightened level of negative sentiment engulfing commodity markets, we see little chance of price upside until the outlook becomes more assured.

DJ AIG Agricultural Commodity Index and Sub Indices plummeting



Source: Bloomberg

Grain prices to remain on the defensive

With record wheat production and replenished export surpluses, competition in global wheat markets will strengthen in 2008/09, resulting in a continuation of the bearish outlook for world wheat prices. Additionally, the substitutional nature of wheat and feed grains will see more wheat enter the animal feed ration at the expense of coarse grains, which will work to keep global grain markets on the defensive. Conversely, oilseed prices are expected to be supported over the longer-term by the potential for lower US and Brazilian production and the ongoing strength of export demand from emerging markets, particularly China.

Feature Article: Where to from here for equities?

Mark Rodrigues

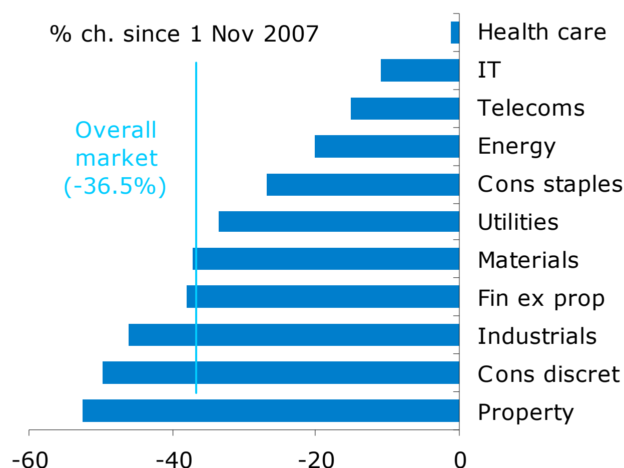
The shake-out in equity markets is causing much consternation amongst weary investors. In this article we examine recent movements, the factors behind them and what it might take for conditions to stabilise. As highlighted in the articles above, the fundamentals of the Australian economy remain significantly better than in other industrialised nations, leaving the local equity market well placed to rebound when risk aversion eventually recedes.

Equities sell-off intensifies

The rout in the Australian share market has intensified in recent weeks, extending losses since the peak in November 2007. After blipping back above the 5000 point mark on 22 September, the benchmark S&P/ASX 200 index fell over 21% in three weeks to 3961, its lowest level since May 2005. The market has clawed back some losses in recent days following significant government interventions around the globe, but remains 36.5% below its November 2007 peak.[3]

No sector has escaped unscathed, although some have been punished more than others. Highly geared industries (listed property, down 52% since the peak in the overall market in November 2007), industries sensitive to global and consumer demand (consumer discretionary and industrials, down 50% and 46% respectively), those reliant on wholesale credit markets (financials, down 38%), and businesses exposed to the commodity price cycle (materials, down 37%) have been hardest hit.

All industries have been hit, some more than others



Source: Bloomberg

In contrast, industries such as health care, energy and consumer staples — which are generally considered to be defensive plays in bear markets because they are less sensitive to the cycle — have been marked down less than the overall market.

The current bear market is shaping up as one of the worst Australia has experienced over the past three decades. Over this period there have been six distinct bear markets (not including the current episode), which have lasted an average 11 months from peak to trough and yielded a decline of 28% in the benchmark index. The current downturn is now into its twelfth month and has produced a downturn of 36.5% to date, broadly on par with the April '81 downturn and not far behind in terms of severity to the '87 crash, where stocks fell 47% in the space of just five months.

The silver lining to this cloud is that **the bigger the downturn, the bigger the rebound** when the recovery does eventuate. On average, the sharemarket has risen by 27% in the twelve months following a trough, and as much as 44% following the crash in 1981.

Performance of the ASX All Ordinaries Index during and after bear markets

Start of downturn	Duration (months)	Market performance during downturn	12 month performance from end of downturn
Apr 81	15	-38%	+44%
Sep 87	5	-47%	+22%
Sep 89	16	-32%	+34%
Feb 94	12	-18%	+21%
Apr 98	7	-11%	+11%
Mar 02	12	-20%	+27%
Average	**11**	**-28%**	**+27%**
Nov 07 - present	*11*	*-36.5%*	*?*

Source: Bloomberg, ANZ

The incredible events of recent weeks have not been restricted to Australia. All major equity indexes around the globe have been similarly punished. In the US, the S&P 500 fell 17% between 22 September and 14 October, in Japan the Nikkei 225 fell 22%, and in the UK, the FTSE 100 slumped 19%.

Can you smell the fear?

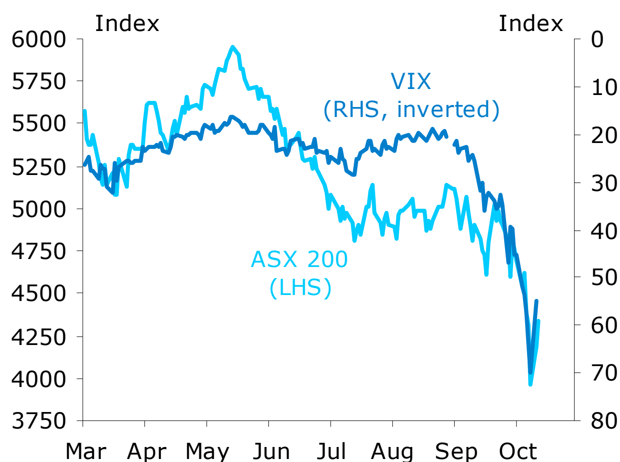
While there are many explanations for the meltdown in global equity markets, **in the end**, **it all boils down one simple emotion**: **fear**. And there's been plenty to be fearful of. Consider this: since September we've witnessed the failure of Lehman Brothers, the forced sales of Merrill Lynch, Wachovia and Washington Mutual, and the government sponsored bailouts of insurer American International Group, Dutch Bank Fortis, UK lender Bradford & Bingley and German commercial property lender Hypo Real Estate.

[3] All data as of 14 October 2008.

The run of financial institution failures around the globe has seen strains on remaining institutions intensify even further, as depositors withdraw funds and banks become even more wary of lending to each other. This in turn risks spurring yet more failures as well as increasing the severity and depth of the global economic downturn already in train.

The clearest expression of the sense of fear gripping market pricing at present is given by the VIX index — a measure of implied volatility of S&P 500 index options commonly used as a measure of market risk aversion — which has just eased from its highest levels on record, but remains more than double the levels that prevailed just a month ago.

Equity markets running scared



Source: Bloomberg

Policy response has been significant

The policy response has been significant. Central banks and governments have taken a number of steps (see the Overview on p2 for further detail) involving large amounts of public money to rebuild the function of, and confidence in, the global financial system. Initially these actions were taken unilaterally but recently there has been greater global cooperation.

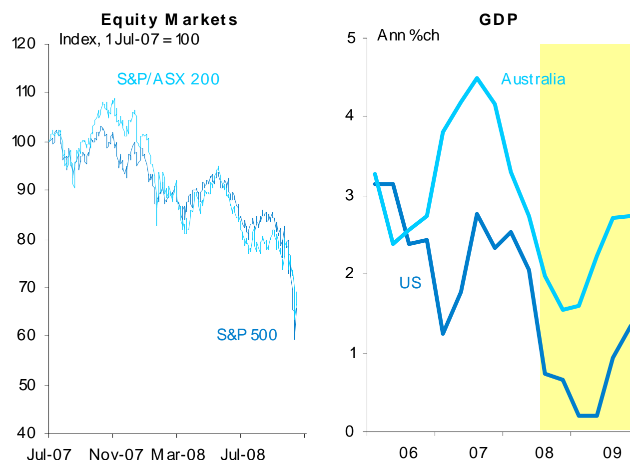
There have been coordinated interest rate cuts by central banks in the US, UK, Europe and Asia, with the Australian central bank also cutting deeply. More significantly, recent meetings of the G-7 and G-20 nations endorsed the IMF's prescription that resolution of the crisis will require concrete actions to address the interrelated problems of insufficient capital, falling and uncertain asset valuations, and dysfunctional funding markets.

As we go to print, announcements are being made by individual national governments – including the purchase of equity stakes in banks and the provision of further capital injections and government guarantees – as part of a coordinated and consistent global response. For its part, the Australian Government has announced that it will: guarantee all banking deposits for three years; guarantee (for a fee) the wholesale (non-deposit) funding of financial institutions, and; will buy another $4bn of residential mortgage-backed securities. While there remains some way to go before the proper functioning of credit markets is restored, **the positive reaction of financial markets in recent days suggest that these measures are a major step in the right direction**.

Australia well placed

Stepping back from the daily gyrations in financial markets, it is worth noting that while the Australian share market has been punished as much as the US market – the S&P/ASX 200 has fallen 31% since 1 July 2007, just before the crisis erupted, compared with a 34% decline in the US S&P 500 – **the fundamentals of the Australian economy remain infinitely better than the US**, and indeed, any other industrialised economy for that matter.

Australian equity markets have been discounted as heavily as the US despite better fundamentals



Sources: Bloomberg, ABS, US BEA

The local banking sector is profitable and well capitalised, has maintained prudent practices in relation to residential loans, and has not been exposed to sub-prime mortgages and related securities as overseas banks have.

The economy is also entering the current period of turmoil from a position of strength. While economic growth is slowing it should remain well supported. In particular, the corporate sector is healthy and investment intentions remain strong. And while the labour market has softened, it is still tight and there is no indication that the business community is about to shed labour *en masse*. Meanwhile, residential construction is likely to be bolstered by strong pent-up demand and interest rate cuts.

A third major point of distinction with other industrialised economies is that Australian policy makers have significantly more scope to prime the economy if conditions deteriorate unacceptable, a point underscored by the 100bp interest rate cut by the RBA and the federal government's $10.4bn fiscal stimulus package. It seems clear, then, that **the Australian sharemarket is well positioned to recover strongly** when risk aversion finally recedes.

International Economic Growth Forecasts

GDP	2007	2008(f)	2009(f)	2010(f)	2011(f)
US	2.0	1.5	0.7	1.7	3.2
Japan	2.0	0.6	0.7	1.6	1.5
Germany	2.6	1.5	0.4	1.6	1.2
France	2.1	0.8	0.5	1.7	2.8
Italy	1.4	-0.1	0.3	1.1	1.1
UK	3.1	0.9	0.2	1.7	2.4
Canada	2.7	0.5	1.0	2.1	3.8
G7	**2.2**	**1.1**	**0.6**	**1.7**	**2.6**
Spain	3.7	1.2	0.4	1.4	2.6
Euro zone	**2.6**	**1.1**	**0.6**	**1.7**	**2.0**
Australia	4.2	2.3	1.8	1.9	2.5
New Zealand	3.2	0.7	0.5	2.5	3.6
Developed countries	**2.4**	**1.2**	**0.7**	**1.7**	**2.6**
China	11.6	9.7	8.0	8.9	10.0
Korea	4.9	4.7	4.0	4.4	5.0
Taiwan	5.7	4.1	3.8	5.0	4.6
Indonesia	6.3	6.2	5.8	6.5	6.4
Thailand	4.7	5.3	5.3	5.5	5.6
Hong Kong	6.3	4.4	4.0	5.0	4.7
Malaysia	6.3	6.1	5.4	6.0	6.0
Singapore	7.7	3.8	4.5	6.0	5.6
Philippines	7.2	4.5	4.9	5.5	5.1
Vietnam	8.5	6.4	6.6	7.5	7.0
East Asia excl. Japan & China	**5.9**	**5.1**	**4.8**	**5.6**	**5.6**
East Asia excl. Japan	**9.3**	**7.9**	**6.8**	**7.6**	**8.4**
India	9.3	8.1	7.0	7.8	8.0
South Asia	**8.8**	**7.4**	**6.6**	**7.4**	**7.6**
Eastern Europe	**7.2**	**6.3**	**4.8**	**5.2**	**5.5**
Latin America	**5.6**	**4.1**	**2.7**	**3.3**	**4.2**
Emerging countries	**8.0**	**6.6**	**5.5**	**6.3**	**7.0**
World (PPP)	**4.8**	**3.6**	**2.9**	**3.8**	**4.6**

Australian and New Zealand Economic Forecasts

	Annual (period average)% ch.				Quarter% ch.			
	2007	2008(f)	2009(f)	2010(f)	Sep-08(f)	Dec-08(f)	Mar-09(f)	June-09(f)
Australia								
GDP	4.2	2.3	1.8	1.9	0.1	0.3	0.4	0.8
Household consumption	4.5	2.5	1.7	2.3	0.4	0.3	0.5	0.5
Dwelling investment	3.1	-0.1	-0.3	12.7	-1.7	-2.1	-0.6	1.1
Business investment	13.0	8.1	-0.3	2.5	-1.4	0.3	-0.7	-0.7
Public demand	2.9	5.7	2.9	2.1	0.7	0.7	0.6	0.7
Domestic final demand	5.3	3.7	1.4	2.9	0.0	0.2	0.2	0.4
Net Exports (cont. to growth)	-1.8	-1.3	1.0	-0.9	0.0	-0.2	0.0	0.1
Inflation: Headline CPI	2.3	4.5	3.4	2.6	1.0	0.6	1.0	0.6
Core	3.1	4.3	3.3	2.7	0.9	0.9	0.8	0.8
Wages (Wage Price Index)	4.1	4.3	3.7	3.5	1.1	1.0	0.9	0.8
Employment	2.8	2.3	0.2	0.7	0.3	0.1	-0.1	0.0
Unemployment rate (%)	4.4	4.3	5.4	6.2	4.2	4.5	5.0	5.3
Current account balance (A$ bn)	-67.2	-57.3	-68.0	-71.5	-11.5	-13.2	-14.0	-17.5
(% of GDP)	-6.2	-4.9	-5.6	-5.7	-3.9	-4.4	-4.7	-5.8
New Zealand								
GDP	3.2	0.7	0.5	2.5	-0.5	0.5	0.2	-0.1
Inflation: Headline CPI	3.2	4.5	3.4	2.7	1.3	0.8	0.9	0.9
Wages	4.3	4.9	3.9	3.4	0.9	1.0	1.2	0.5
Employment	1.8	-0.1	-0.3	0.7	-0.6	-0.3	-0.2	0.1
Unemployment rate (%)	3.4	4.7	5.7	6.2	4.2	4.7	5.0	5.2
Current account balance (NZ$ bn)	-14.3	-16.6	-13.7	-14.4	-4.4	-4.0	-3.6	-3.4
(% of GDP)	-8.2	-9.2	-7.4	-7.4	-8.7	-9.2	-9.2	-8.4

Financial Market Forecasts

	Annual (period end)				Quarter (period end)			
	2007	2008(e)	2009(f)	2010(f)	Sep-08	Dec-08(f)	Mar-09(f)	Jun-09(f)
Interest rates (% p.a.)								
Australia								
90 day bank bills	7.24	5.60	4.80	4.70	7.32	5.60	5.35	4.80
10 year bond rate	6.33	4.90	5.05	5.40	5.40	4.90	4.70	4.85
United States								
3 month LIBOR	4.70	2.50	1.75	3.30	4.05	2.50	2.00	1.80
10 year bond rate	4.02	3.40	3.75	4.20	3.82	3.40	3.25	3.45
Euro area								
3 month LIBOR	4.68	4.50	3.75	3.90	5.28	4.50	4.25	4.00
New Zealand								
1.2090 day bank bills	8.90	6.53	5.05	5.00	7.97	6.53	5.83	5.33
Exchange rates								
A$/US$	0.88	0.77	0.68	0.67	0.79	0.77	0.68	0.67
NZ$/US$	0.77	0.62	0.56	0.56	0.67	0.62	0.64	0.61
A$/¥	97.79	78.54	76.16	76.38	84.16	78.54	76.16	76.38
A$/€	0.60	0.56	0.54	0.57	0.50	0.56	0.54	0.57
A$/£	0.44	0.44	0.41	0.40	0.45	0.44	0.41	0.40
A$/NZ$	1.13	1.24	1.21	1.19	1.21	1.24	1.17	1.20
US$/¥	111.8	102.0	112.0	114.0	106.2	102.00	112.00	114.00
€/US$	1.46	1.38	1.26	1.18	1.58	1.38	1.26	1.18
A$TWI	68.70	62.29	56.71	55.66	73.40	62.29	56.71	55.66

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