

Will the economy deliver for Bendigo small business in 2004/05?



Presentation to AIM/ANZ Breakfast

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**Bendigo
July 21, 2004**

Economics@ 

Despite official data suggesting economic weakness in the early months of 2004



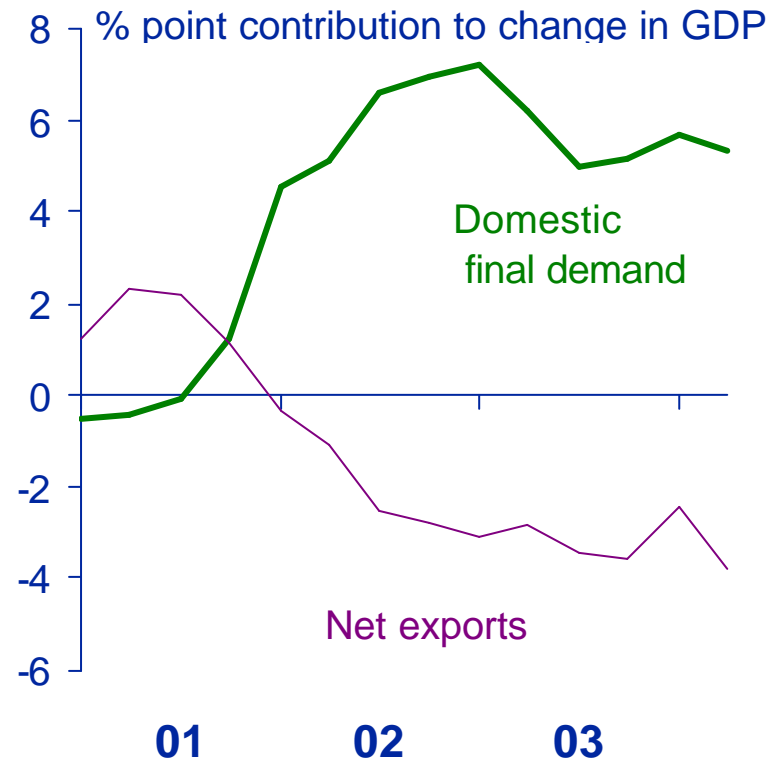
Source: National Accounts ABS Cat.no. 5601.0

The domestic economy continues to power ahead

Australian economic growth

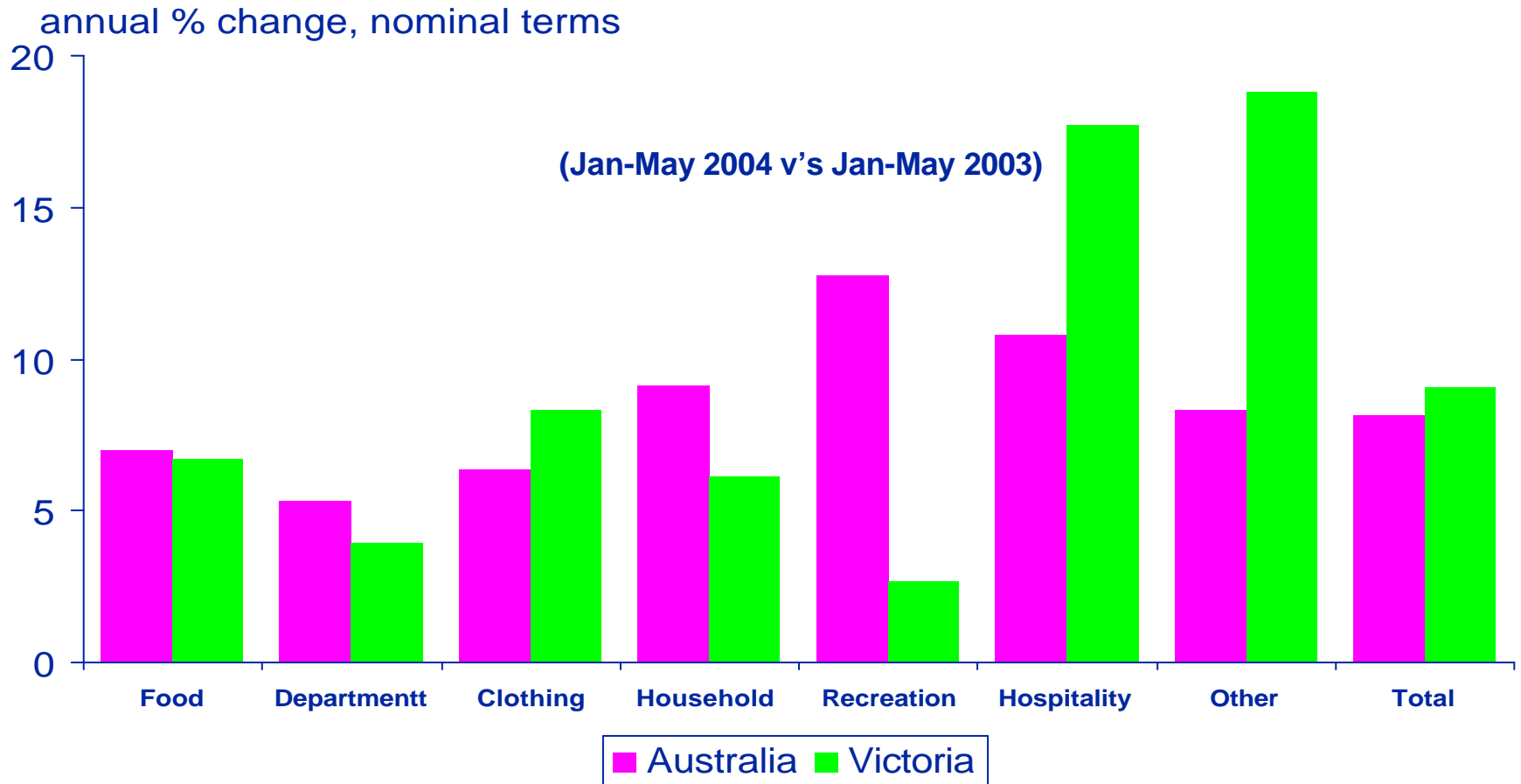


Sources of GDP growth



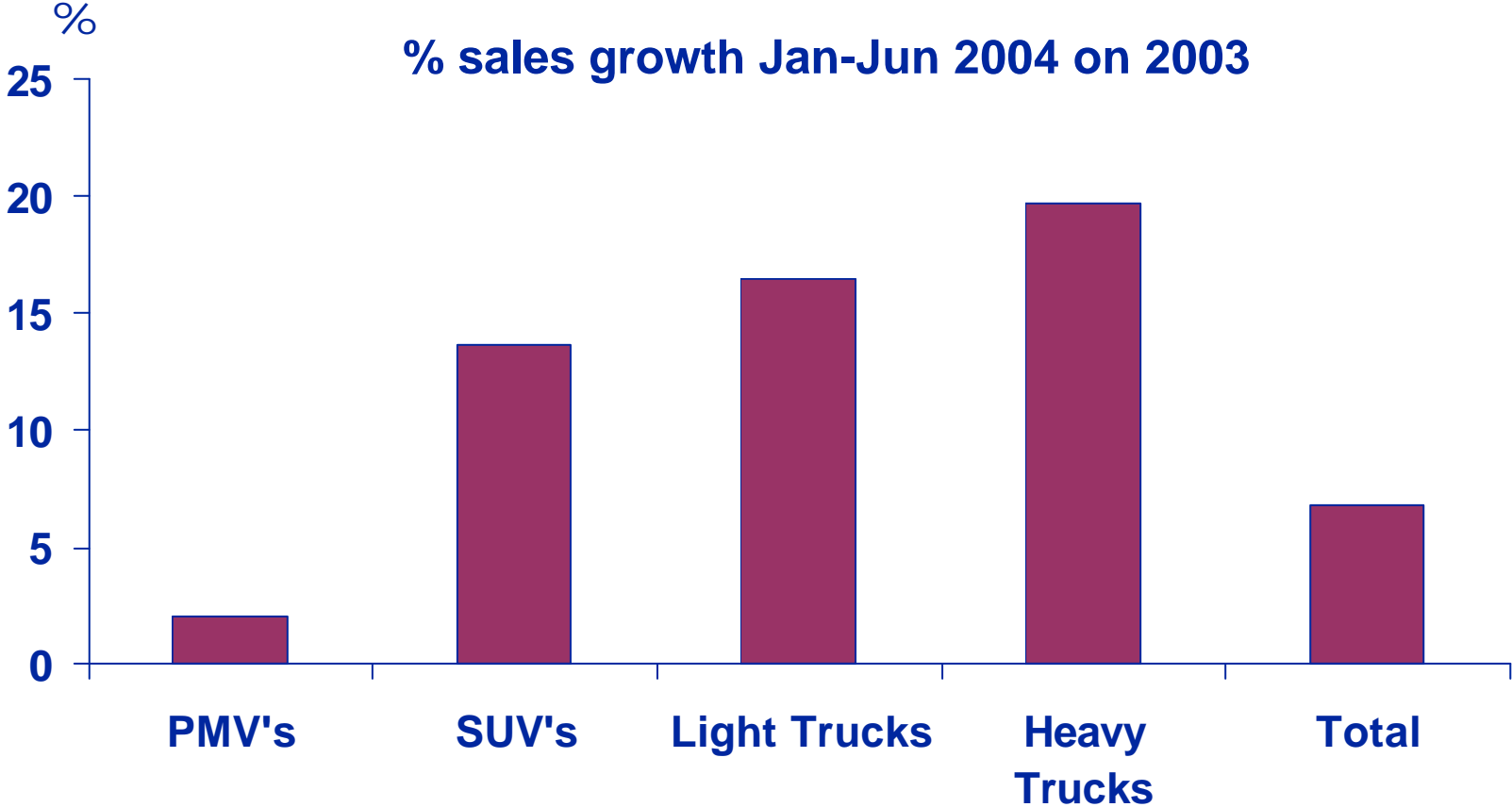
Source: National Accounts ABS Cat.no. 5601.0

Retail trade continues to grow at scintillating rates boosted in June by one off family payments



Source: Retail Trade ABS Cat. No. 8501.0

New motor vehicle sales have powered to record highs

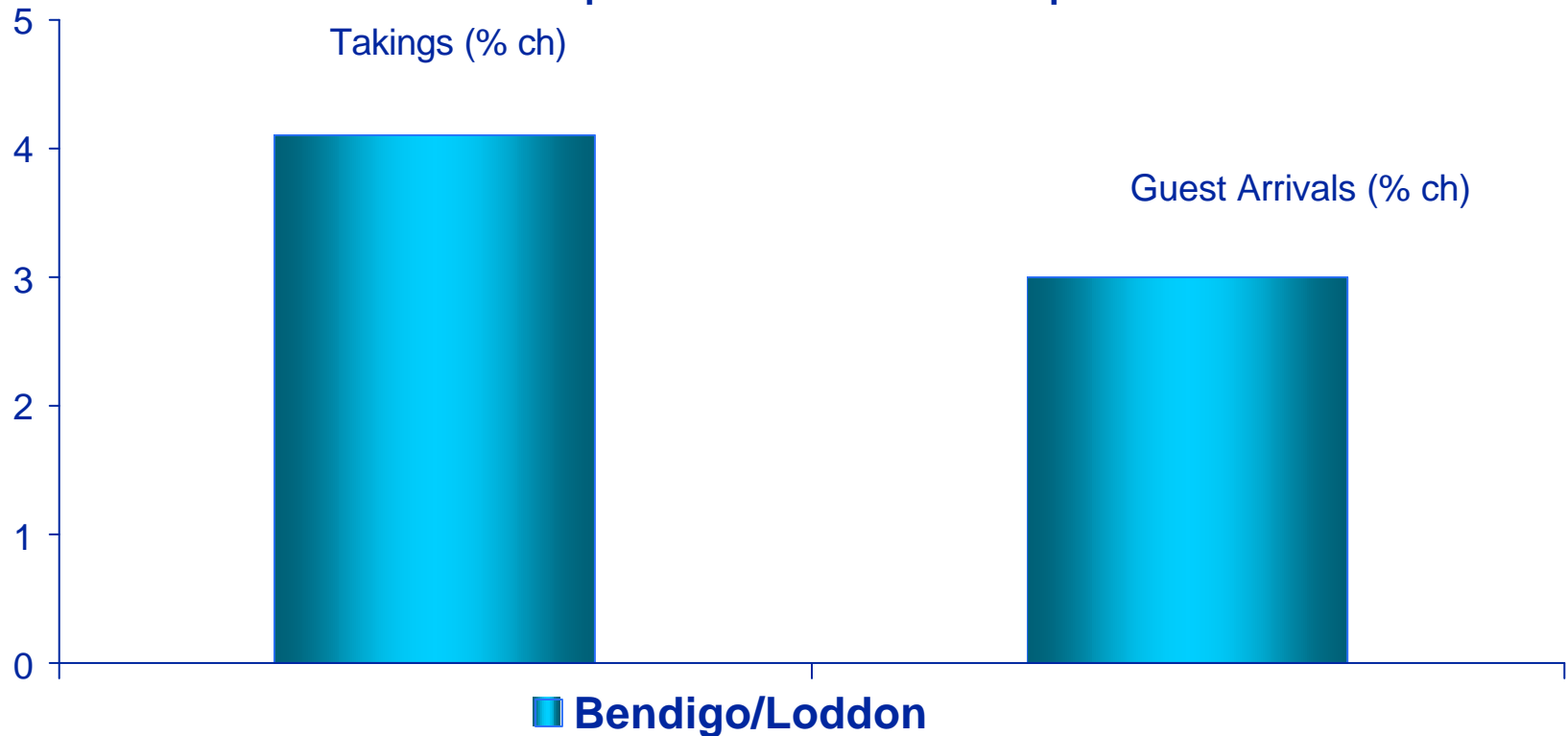


Source: Vfacts & Sales of New Motor Vehicles ABS Cat. No. 9314.0

Domestic tourism numbers are rising with favourable benefits on tourism accommodation

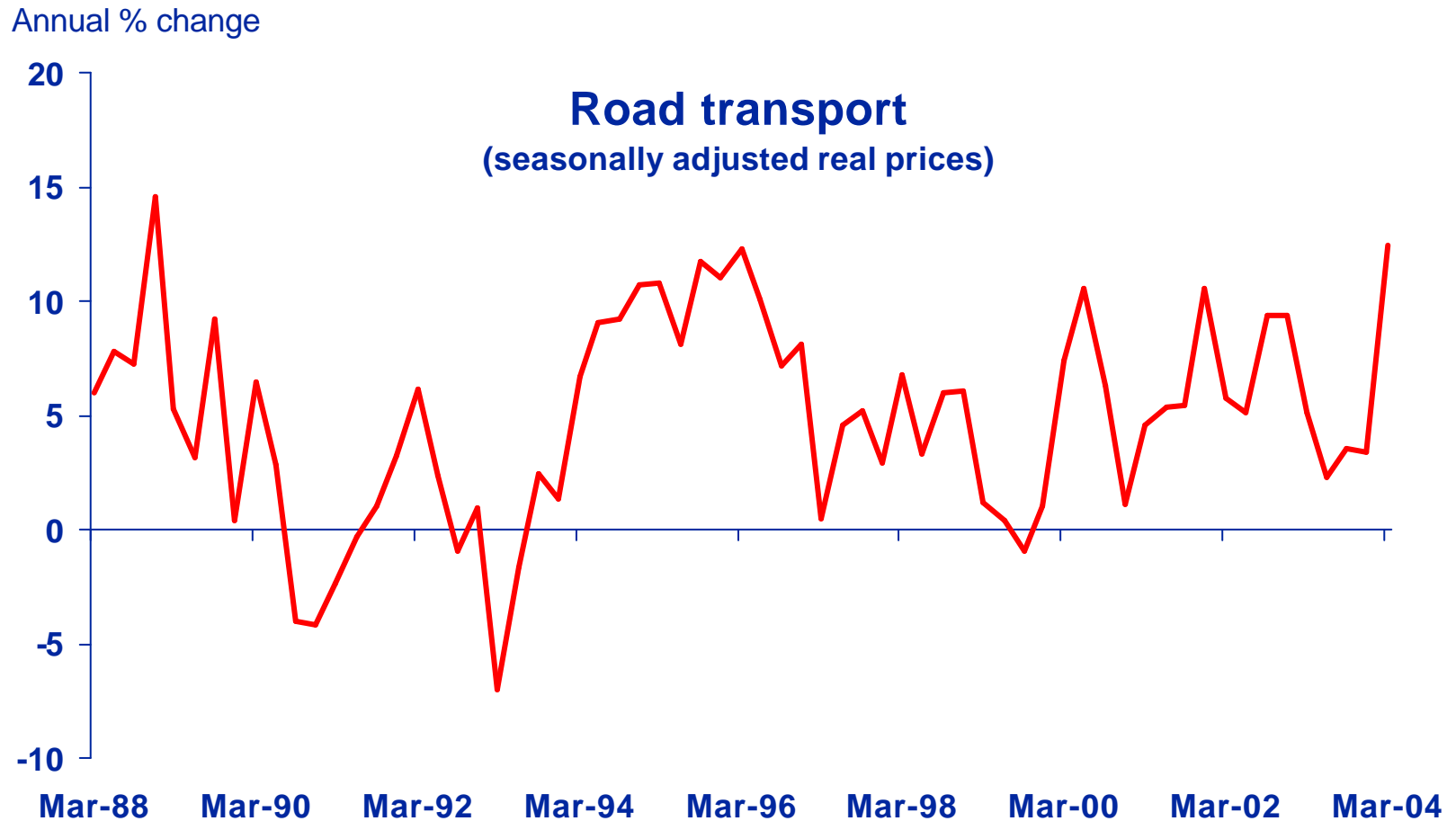
Bendigo Loddon accommodation (hotels/motels/serviced apts)

December quarter 2003 vs December quarter 2002



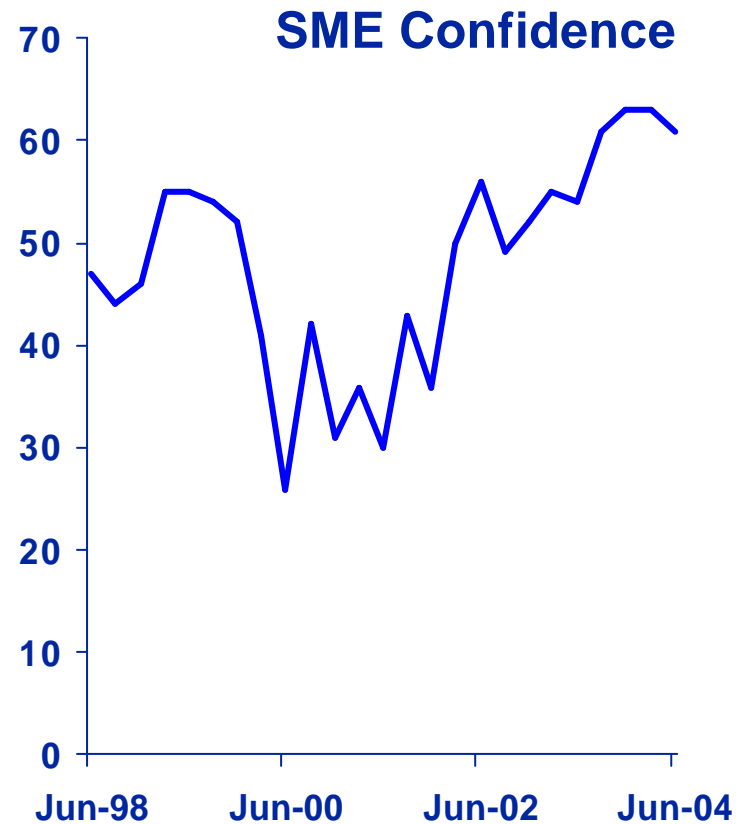
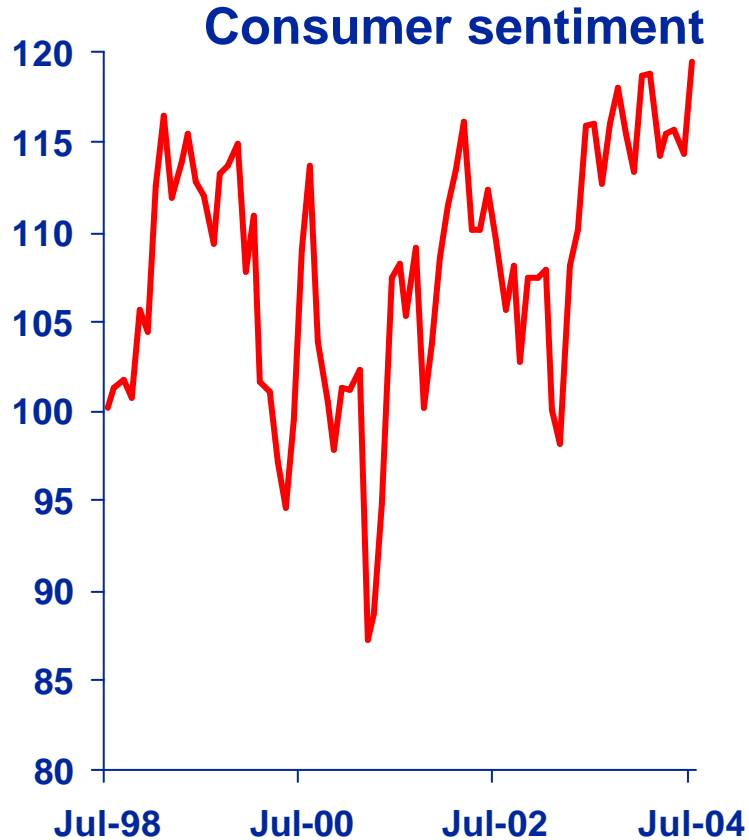
Source: ABS

Reflecting economic buoyancy, road transport activity is strong with latest figures showing annualised growth of 12.5% - the fastest in 15 years



Source: National Accounts ABS Cat. No. 5206.0

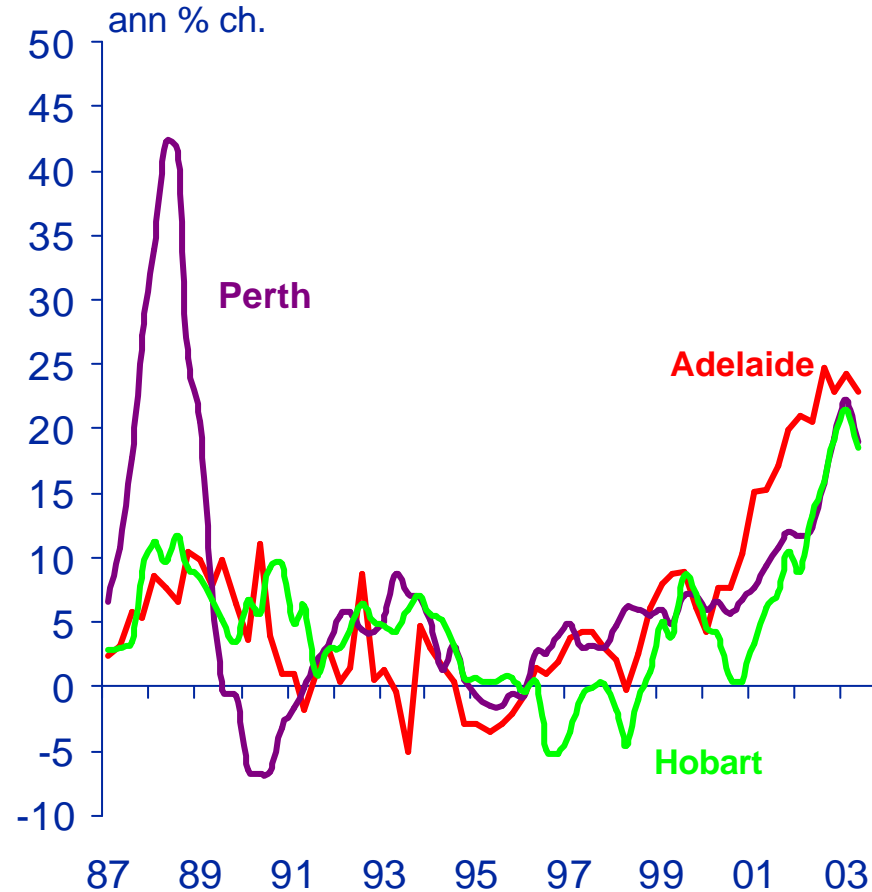
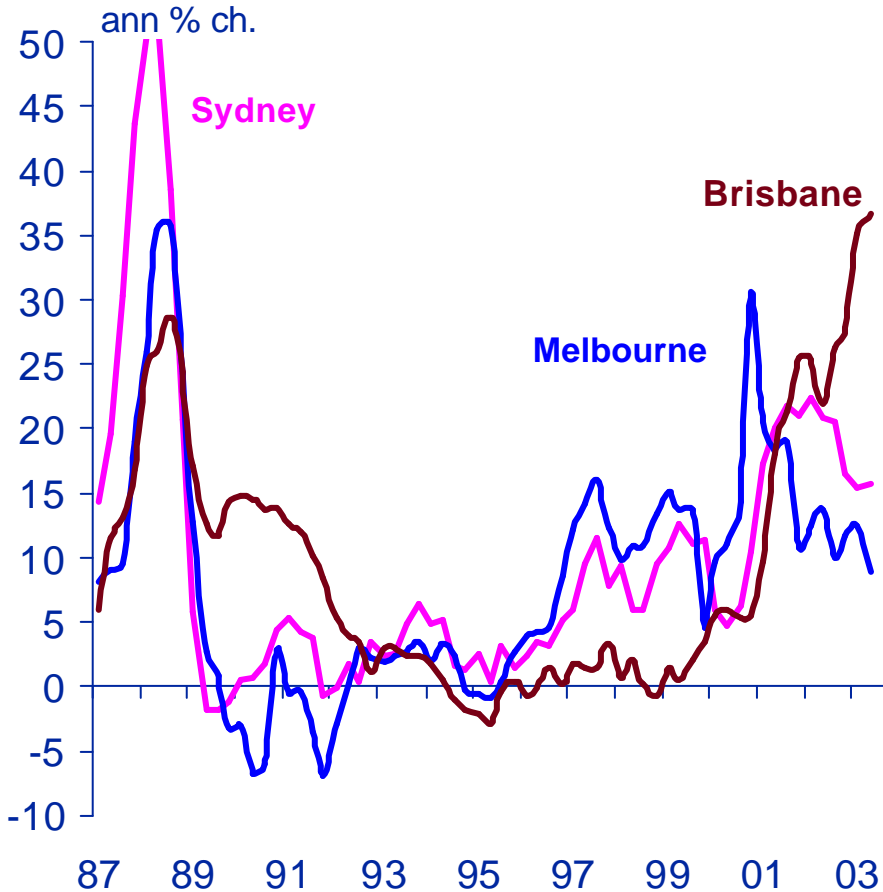
Consumer confidence has risen to the highest level in a decade and business remains extremely bullish



Source: Sensis and
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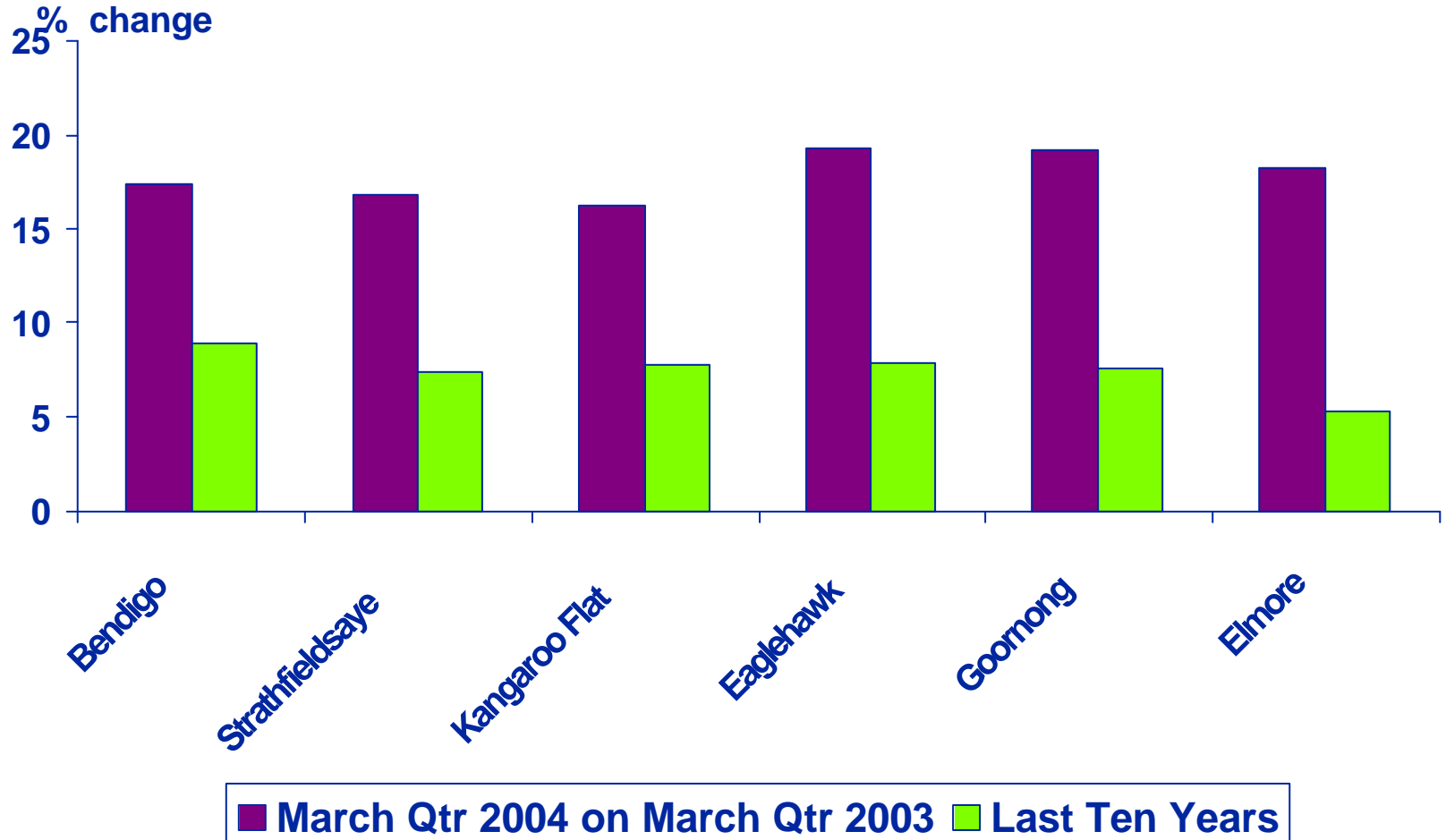
Consumer confidence has been underpinned by rapid house price growth in capital cities

ABS house price growth



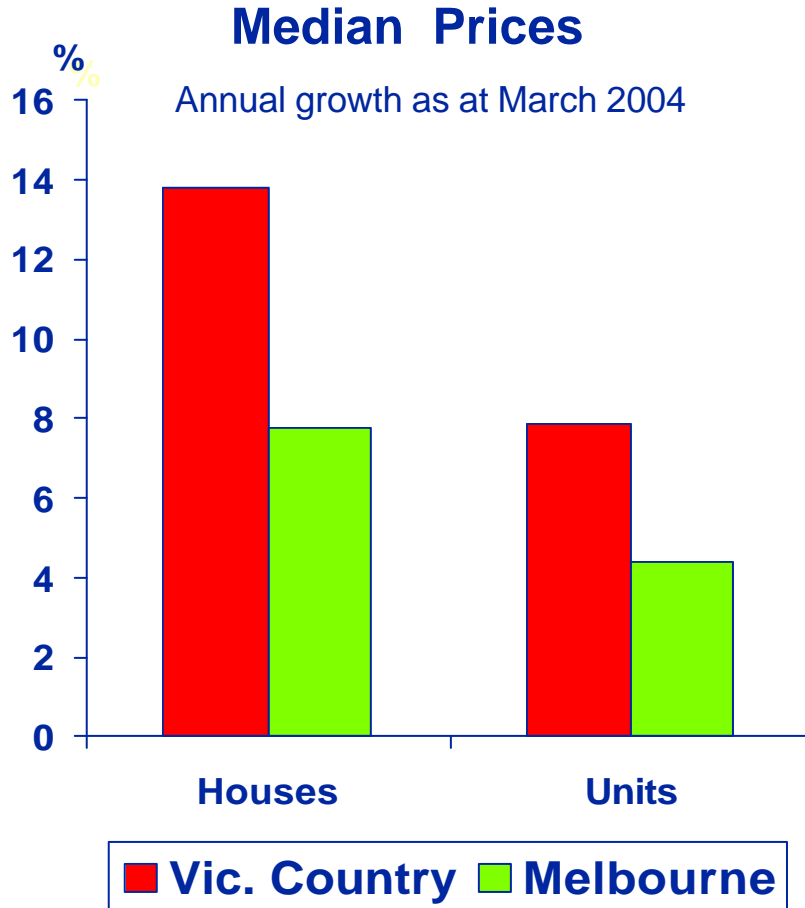
And throughout regional cities, towns, coastal resorts and even rural hamlets

Median House Price Growth



Source: Residex Pty. Ltd.

Property price growth has been faster in country Victoria than in Melbourne



Source: Residex Pty. Ltd.

- Underpinned by improved employment prospects in agriculture due to farm consolidation and growth in more intensive areas of agriculture.
- Movement of lower income groups out of metropolitan areas due to affordability.
- Growth of tourism.
- Lifestyle considerations.
- Investors seeking the better yields available in country towns than capital cities.
- Improved communications and upgrading of transport links to capital cities.

Other data gave evidence of a robust economy.

- Non residential construction continues to run hot with plenty of uncompleted work in the pipeline.
- The labour market remains strong and the unemployment rate remains at levels last seen 14 years ago.
- Business is experiencing good conditions with strong cash flows through business and profit share at close to record highs.
- Cost pressures remain reasonably subdued - a surprise given the boom conditions the economy experienced in the latter part of 2003.
- Advertising expenditure has been very strong.
- There has been a notable increase in information technology expenditure.

In short

- **Macro economic conditions were super strong in the latter half of 2003 - as good as it gets for Australian business.**
- **Conditions were not as good in the early months of 2004 but nonetheless remained strong.**
- **Overall 2003/2004 will have been a great year for domestically based Australian business.**

So after the buoyancy of last financial year, is the economy heading for a hangover in 2004/05?

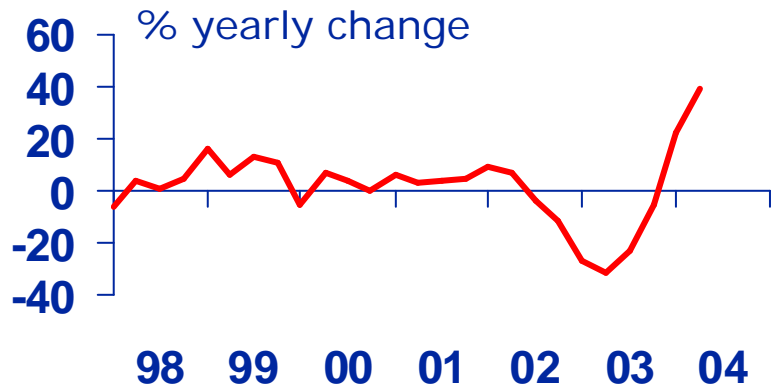


Australian economic growth will be assisted by a buoyant world economy

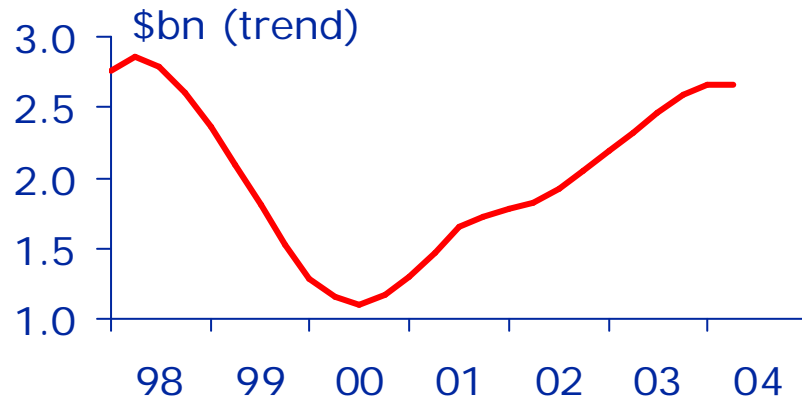
- **The world economy is enjoying its strongest growth in four years.**
- **US economic growth has bounced back strongly assisted by massive policy stimulus with the Fed funds rate at 1.25%, tax cuts and increased government expenditure.**
- **As a consequence, the US economy is forecast to grow about 4.5% in 2004 – the best outcome since 1997.**
- **Japan's sustainable upturn has been the big global growth surprise with growth of 2.7% in 2003 and on track to lift to 4.5% in 2004 with business conditions the best in six years.**
- **The Chinese economy is red hot with growth at around 10% and despite a cooling due to capacity constraints is expected to continue to grow strongly.**
- **Nearly all East Asian economies will record stronger growth this year.**
- **The U.K. economy is strong and while the picture in the rest of Europe is more subdued things are looking better after two dismal years.**

Exports are set for a sharp rebound as 2004 proceeds

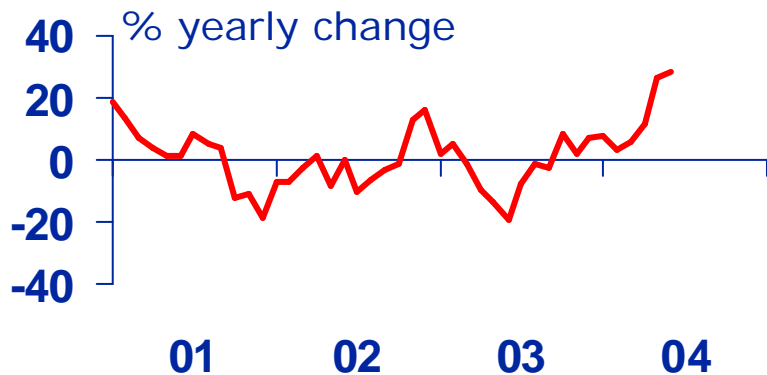
Farm production



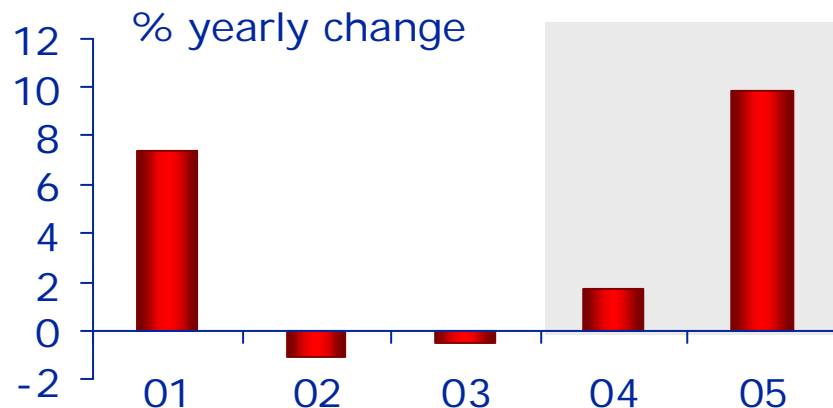
Mining investment



Overseas tourist arrivals



Export growth



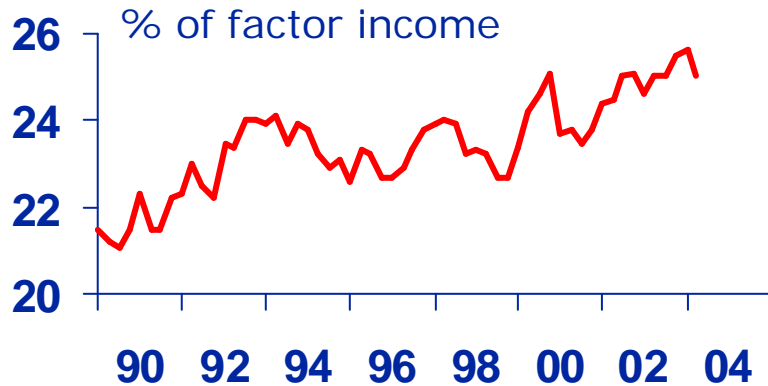
Source: ABS, Economics@ANZ

Rural Victoria is looking strong

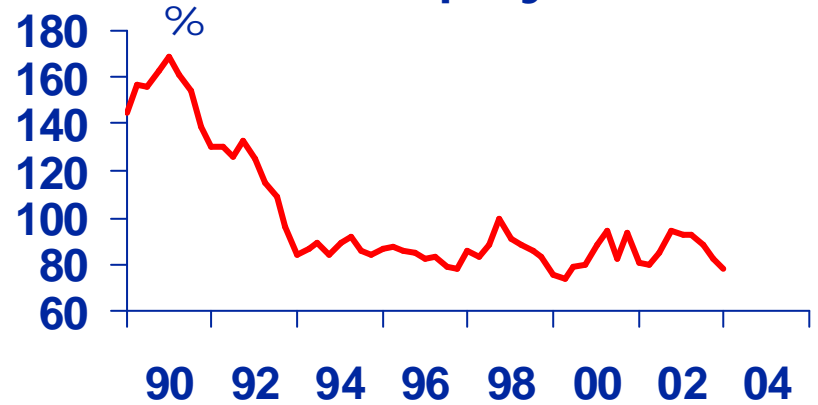
- Dairy opening season prices are stronger, water allocations are up on last year and feed costs will be lower.
- Non irrigated pasture growth is strong across the State suggesting bountiful feed, hay and silage this season.
- The winter crop harvest is looking good and world prices are holding well.
- Lamb prices are at record highs.
- Beef prices are strong underpinned by the continuing ban in North Asia of US beef imports while store cattle are fetching sensational prices as strong re-stocker demand continues.
- Wool prices have fallen from their unsustainable peak but the recent rise in oil prices is correcting the distortion that developed between wool and synthetic prices.

The macroeconomic environment for business remains favourable

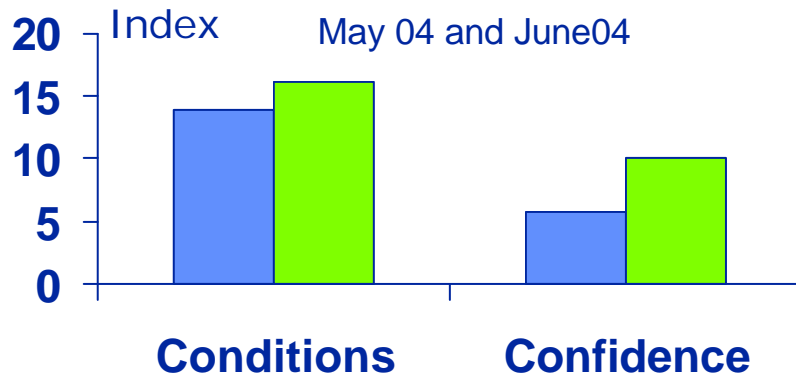
Profit share



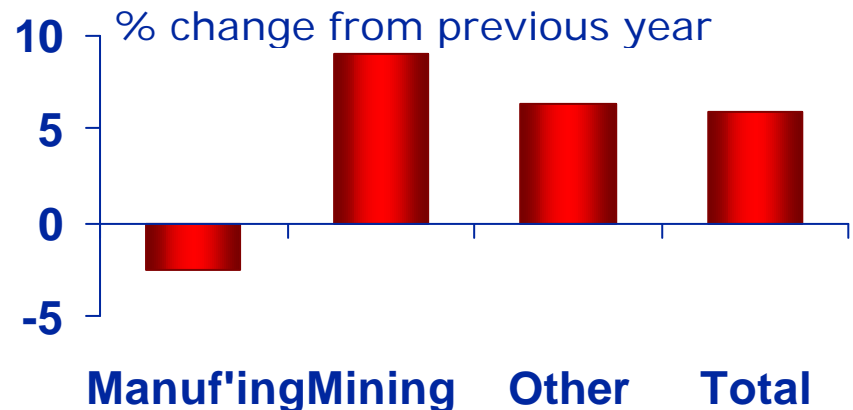
Debt to equity ratio



Business confidence



2004-05 investment plans



Source: Sensis, NAB, ABS *adjusted for five year realisation ratios, nominal

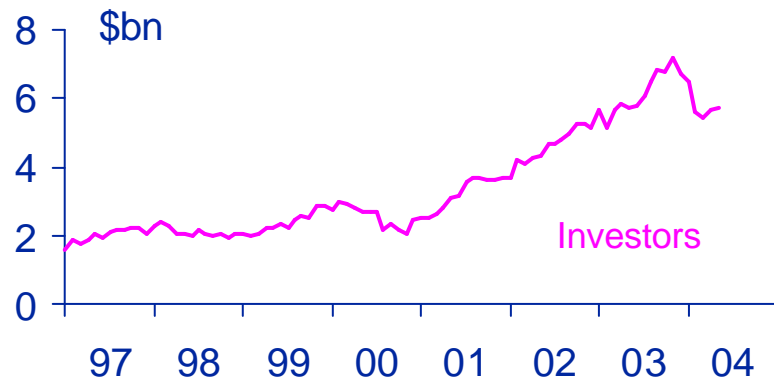
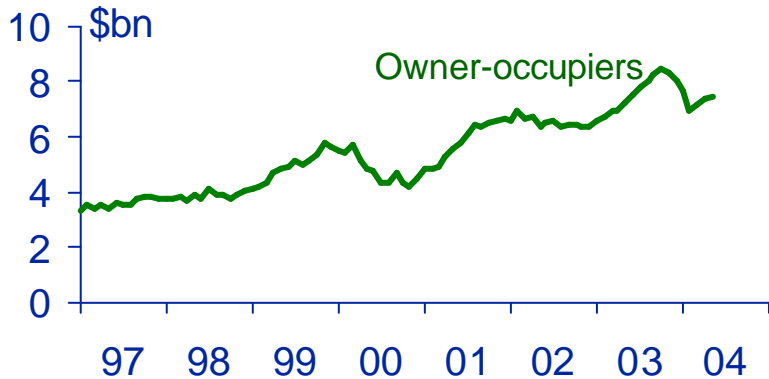
Consumer spending will be assisted by income tax cuts to flow to higher income earners and increased family benefits from July 1

	Net change in revenue (\$bn)				
	04-05	05-06	06-07	07-08	Total
Income tax cuts	1.93	3.80	4.25	4.75	14.73
Families	3.4	4.3	4.7	4.8	17.2

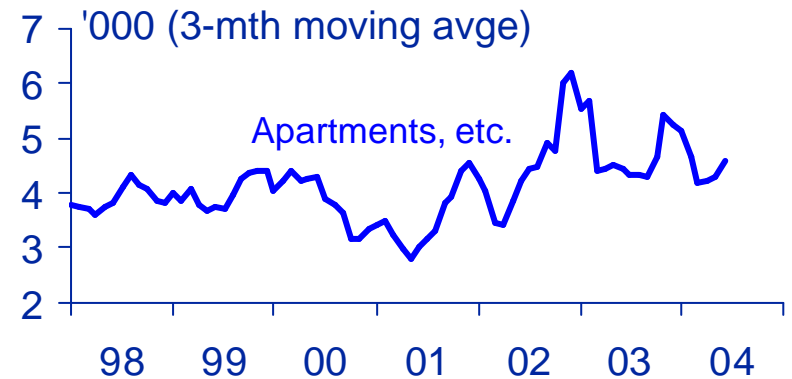
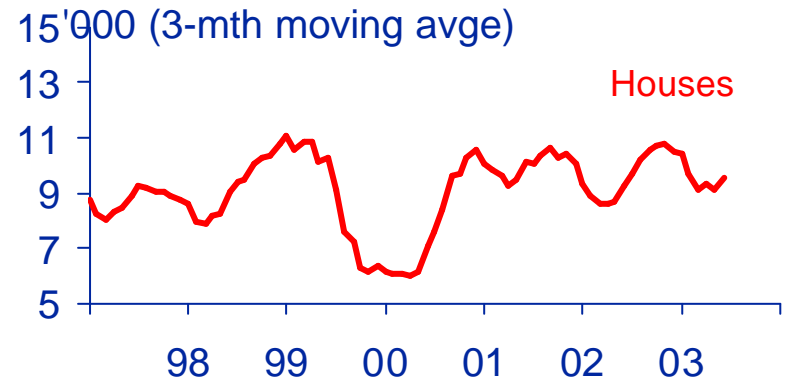
Note: figures in this table are in accrual, not cash, terms

The housing sector refuses to die despite a mature cycle

Housing finance commitments



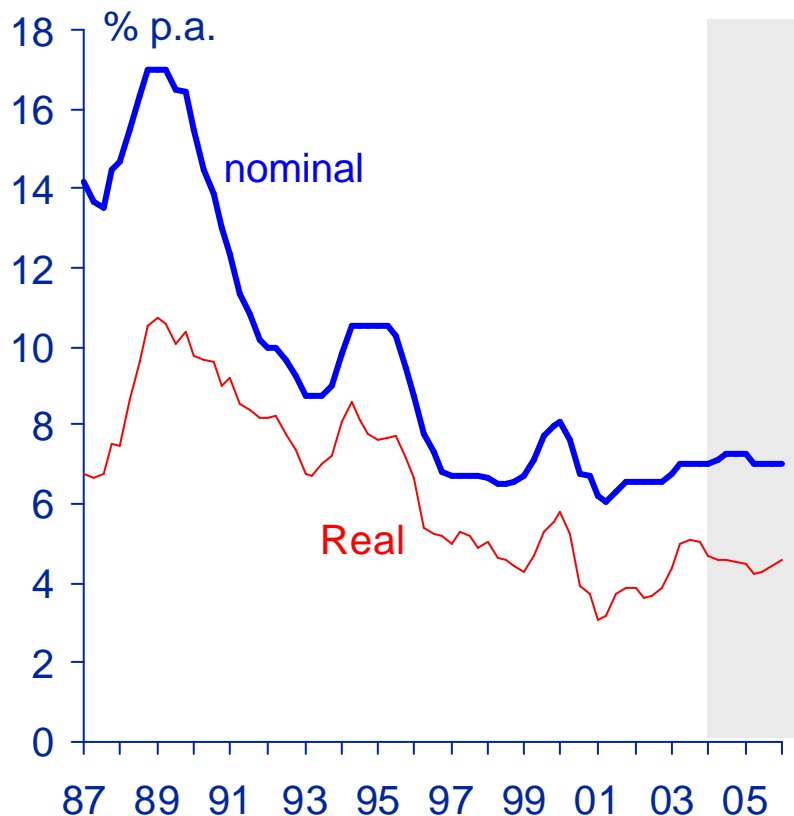
Residential building approvals



Note: Finance commitments are for the construction or purchase of all dwellings. Approvals are for private sector only. Source: ABS.

And the two main 'triggers' that have caused past 'busts' in the housing market are benign

Mortgage rates



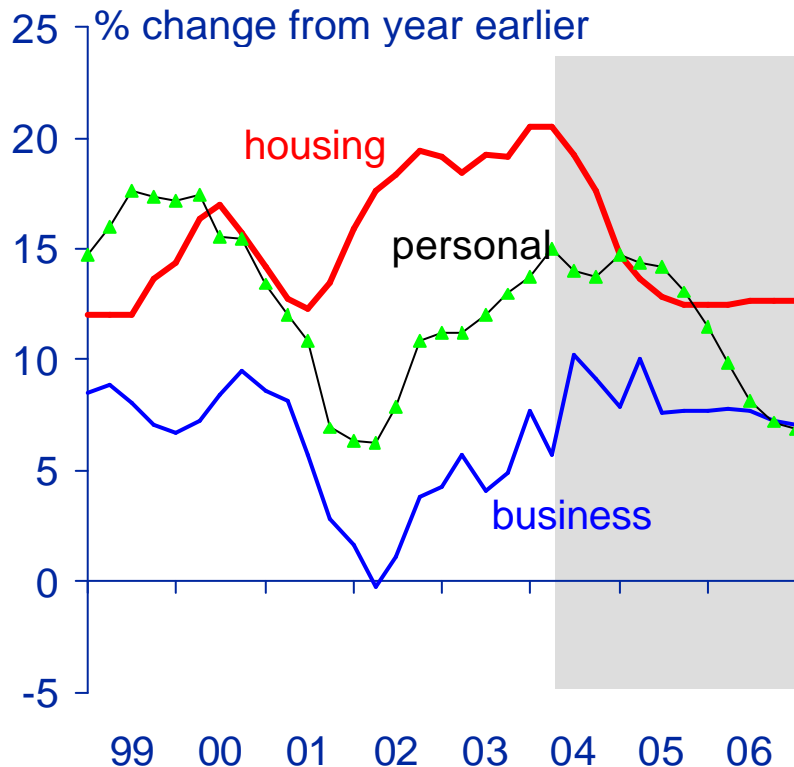
Unemployment rate



Sources: ABS; Economics@ANZ

Despite strong credit growth the RBA says it will not kill the golden goose

Credit growth

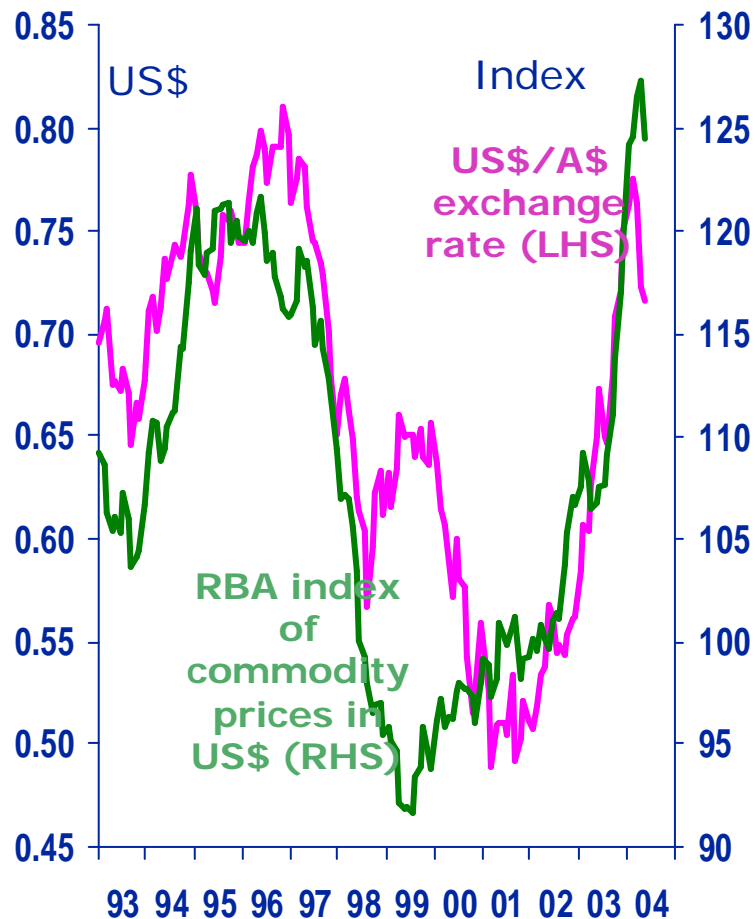


Sources: RBA, Economics@ANZ.

- The Reserve Bank for sometime has viewed present interest rates as mildly stimulatory- out of sync with a booming economy.
- Credit growth remains strong led by housing credit growing at 20% p.a. and personal lending at 14%.
- Although the RBA remains concerned about the pace of credit growth reduced commitments will ensure a slowing over the rest of the year.
- The RBA also believes that the excesses of the property price boom have passed.
- Hence recent statements have sent a clear message that interest rates are on hold.
- However in our view an interest rate increase is more likely than not.

Has the A\$ peaked/bottomed?

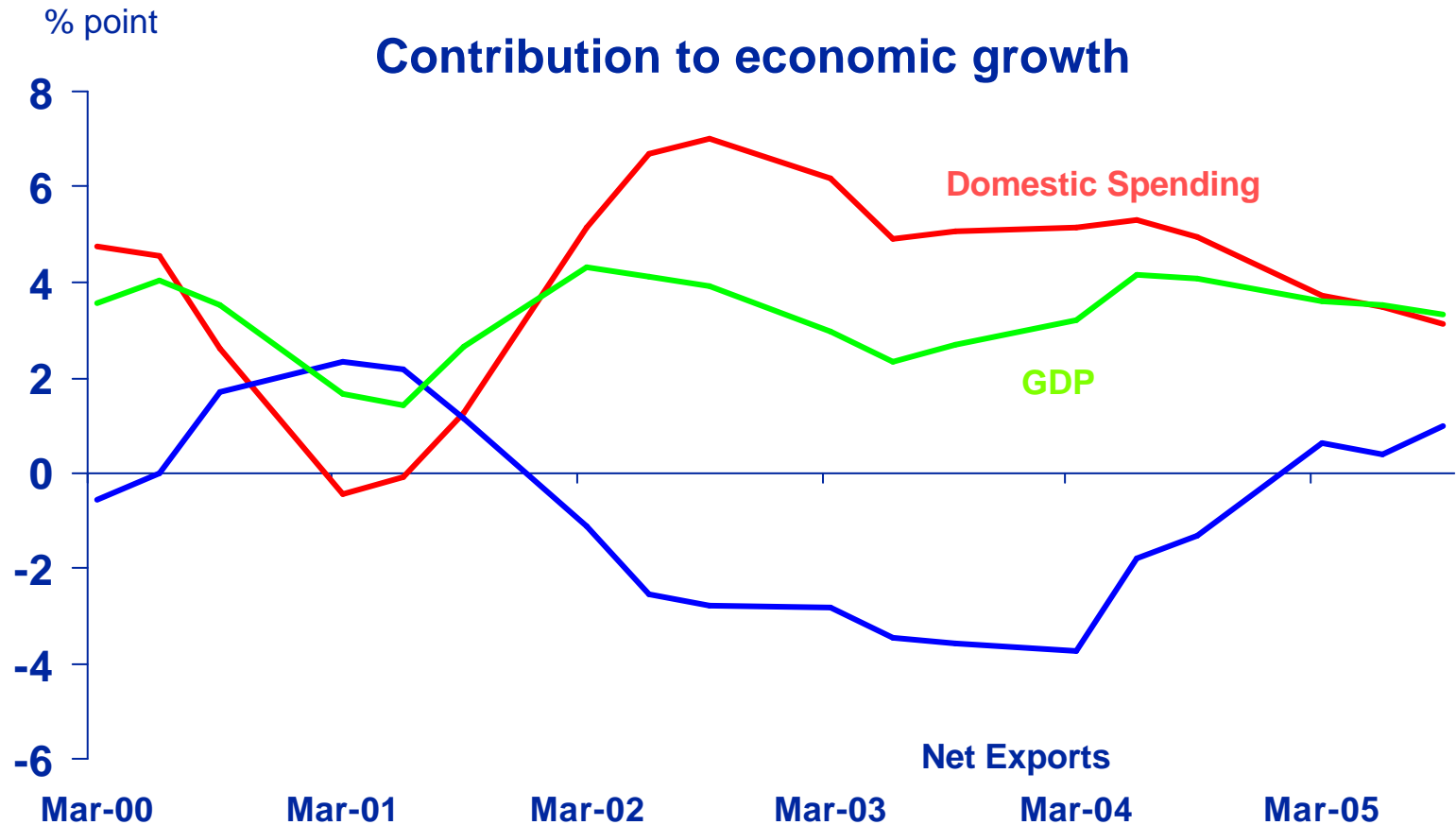
Australian dollar



Sources: Datastream, Economics@ANZ

- Most of the rise in the A\$ since early 2002 was due to the decline in the US\$ but the sharp run up to US 80c was aided by the Australian dollar story i.e.
 - strong economic performance
 - sharp acceleration in commodity prices
 - and wide interest rate differentials with overseas.
- So why did the currency tank in April?
 - a belief that the interest rate differential would narrow
 - concern about China and the implications for commodity prices.
- However we believe that the markets have overshot and our modelling suggests that fair value is US74c.
- Hence the currency may rally again to beyond this value before weakening in 2005 back to 65c by end 2005.

Economic growth should rebound in the second half of 2004 but the drivers of growth will change



Sources: ABS; Economics@ANZ

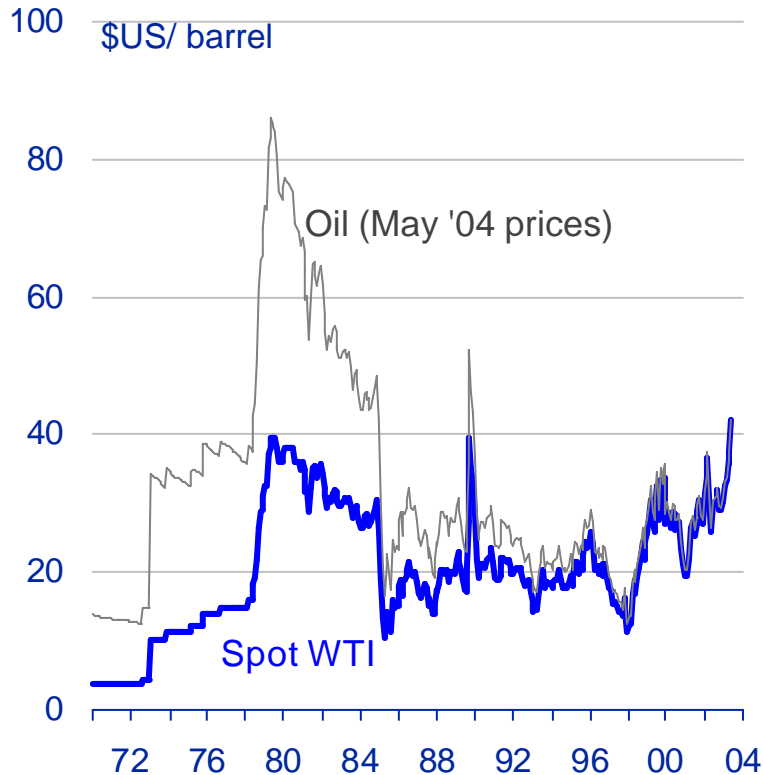
Four key economic issues impacting on business in the Bendigo region

Will high oil prices sink the world recovery?



While oil prices pose a risk they need to be kept in perspective

WTI crude oil price



Sources: Datastream; Economics@ANZ

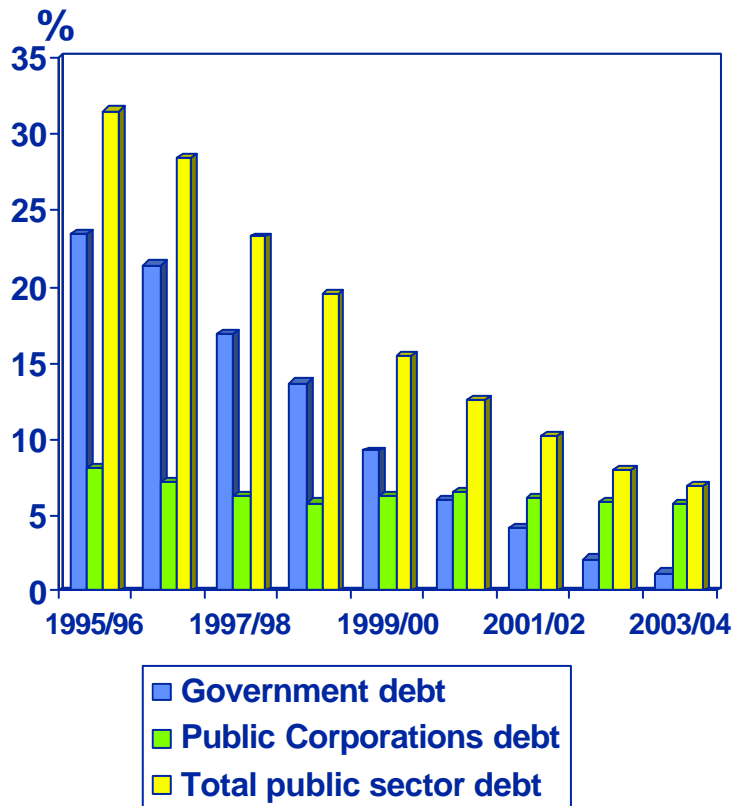
- The high oil price is as much a story of a booming world economy as of potential supply problems.
- Since 1980, oil in today's prices have averaged US \$24/ barrel compared to the present price of around US\$40.
- While oil at record (nominal) terms unsettles investors, in real terms the oil price is lower than at the time of the last oil crisis.
- And efficiency gains and the development of alternative sources means the world has become less dependent on oil.
- However the market is especially sensitive to bad supply-side news.
- Any further sustainable price increases have the ability to stifle world economic growth.

Can more be done for Regional Australia?



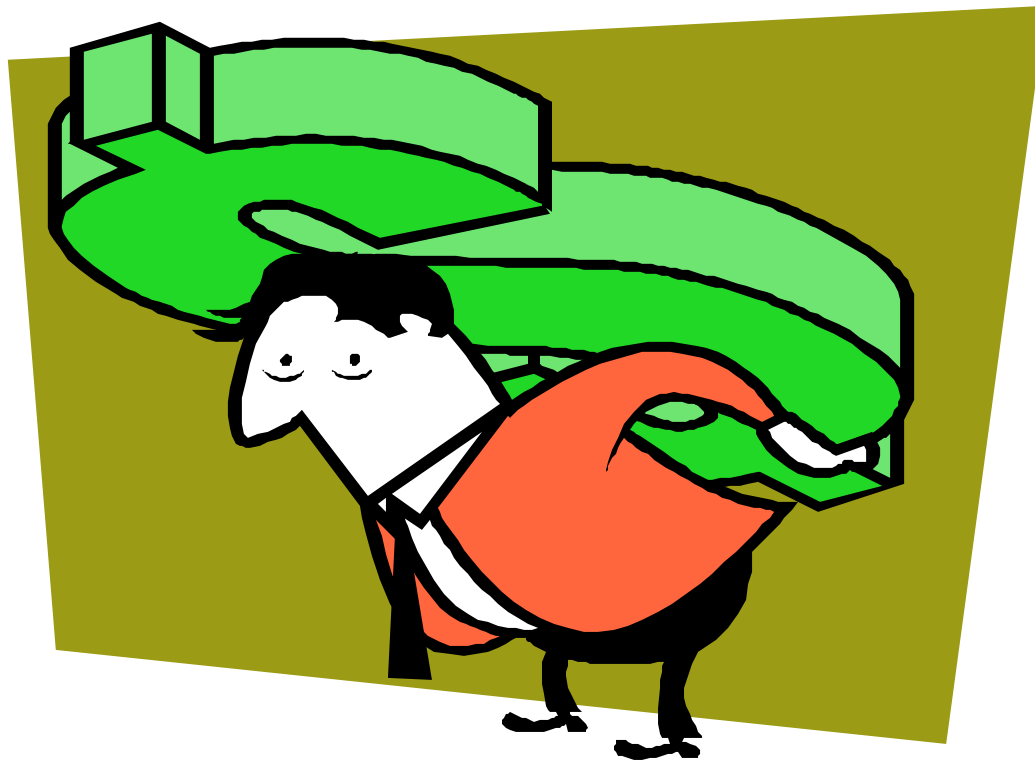
Absolutely with infrastructure the key

Government debt as a % of GDP



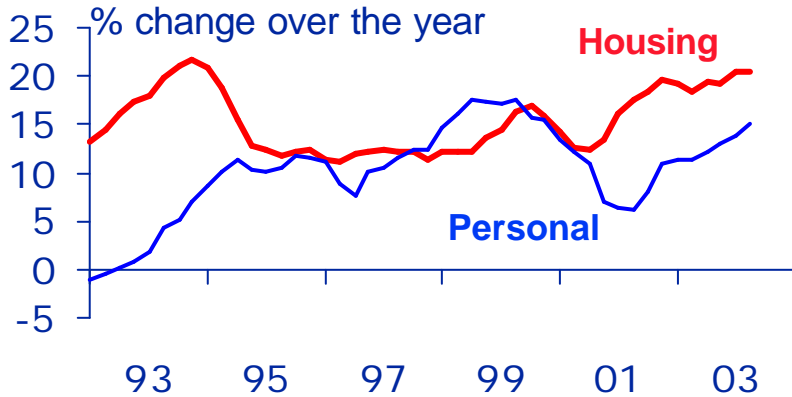
- Infrastructure provision rather than grants and subsidies are the key to creating a dynamic regional Victoria.
- Access to a rapid internet service is essential to promoting business in regional Australia.
- Good transport links are important— hence the recent announcement of funds to continue the upgrading of the Calder highway is welcomed.
- As is commitments from both Federal and State governments for rail upgrades.
- But more can be done

Will debt sink the household sector?

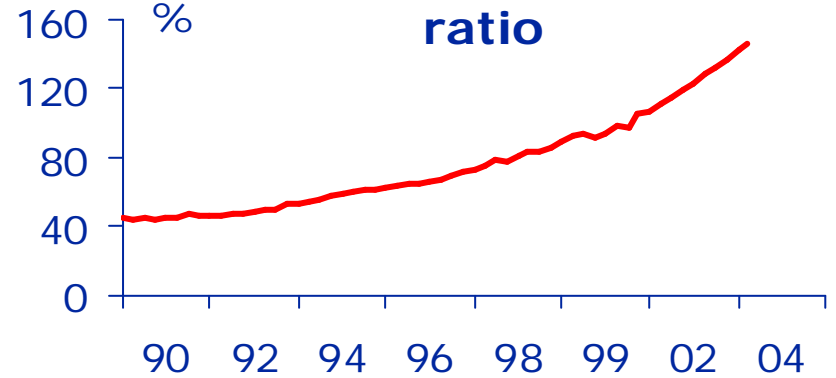


Household debt accumulation has been high

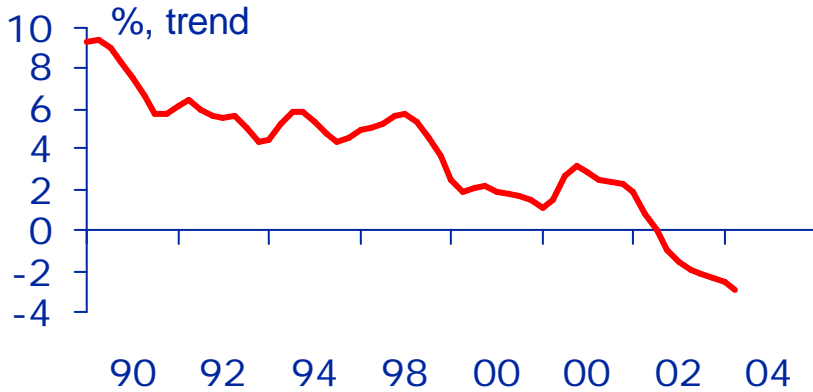
Household borrowing



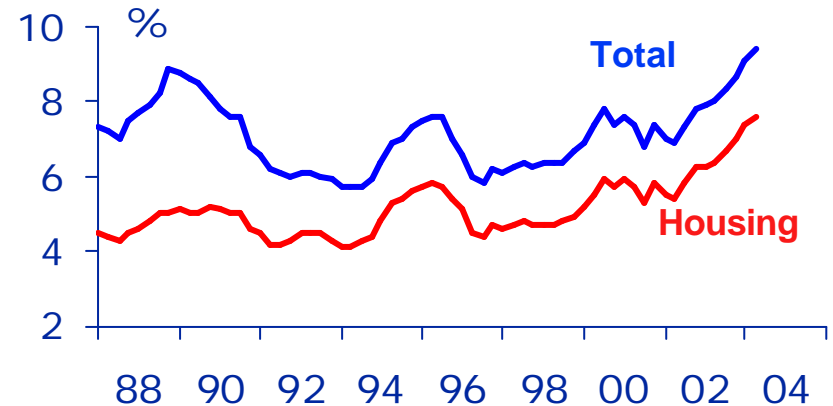
Household debt to income ratio



Household saving ratio



Interest payments to income



Source: ABS, ANZ, RBA

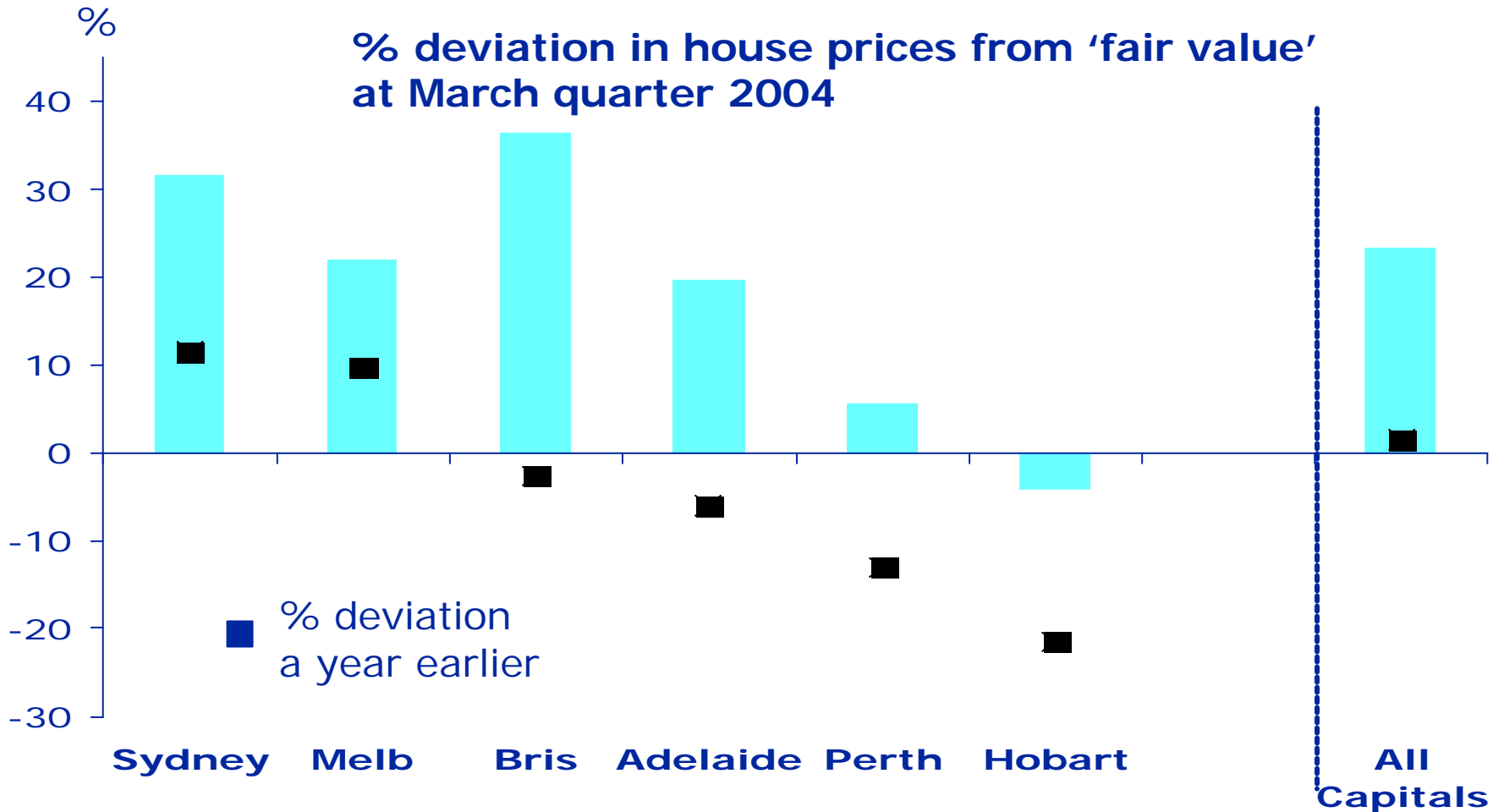
And further

- And after years of building equity in their homes Australians are indulging in a new game – net equity withdrawal – with latest data suggesting that it is now close to 10% of household incomes.
- Hence Australian households have placed themselves in the position where they are more vulnerable to economic shocks.
- Have Australian households lost their marbles?
- Debt accumulation has been driven by key structural changes
 - declines in inflation and interest rates since the early 1990s
 - financial innovation and competition among lenders
 - a widely held belief that property is the place to be
 - generational and superannuation concerns.
- These developments have been a key driver of the strong surge in property prices and the subsequent rise in wealth has in turn allowed household spending to grow at a much faster rate than disposable income.
- So house prices become an important economic determinant.

Will established house prices crash?



Affordability constraints are beginning to pressure house prices and hence household wealth

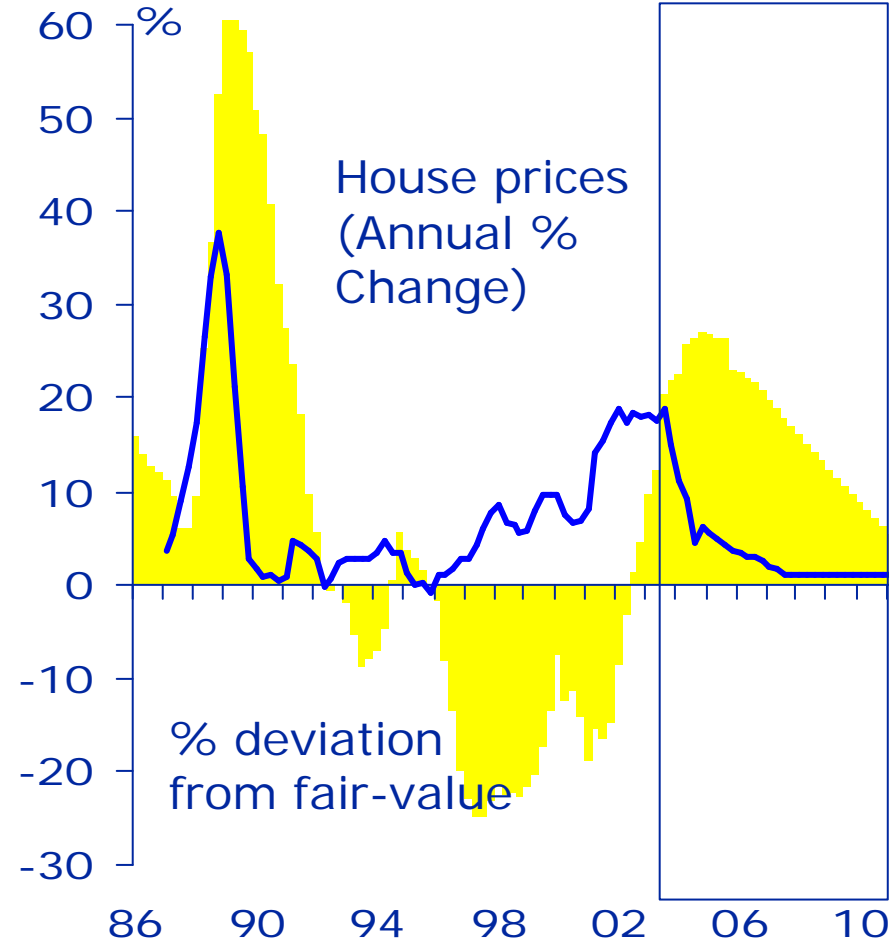


Sources: ABS; Economics@ANZ.

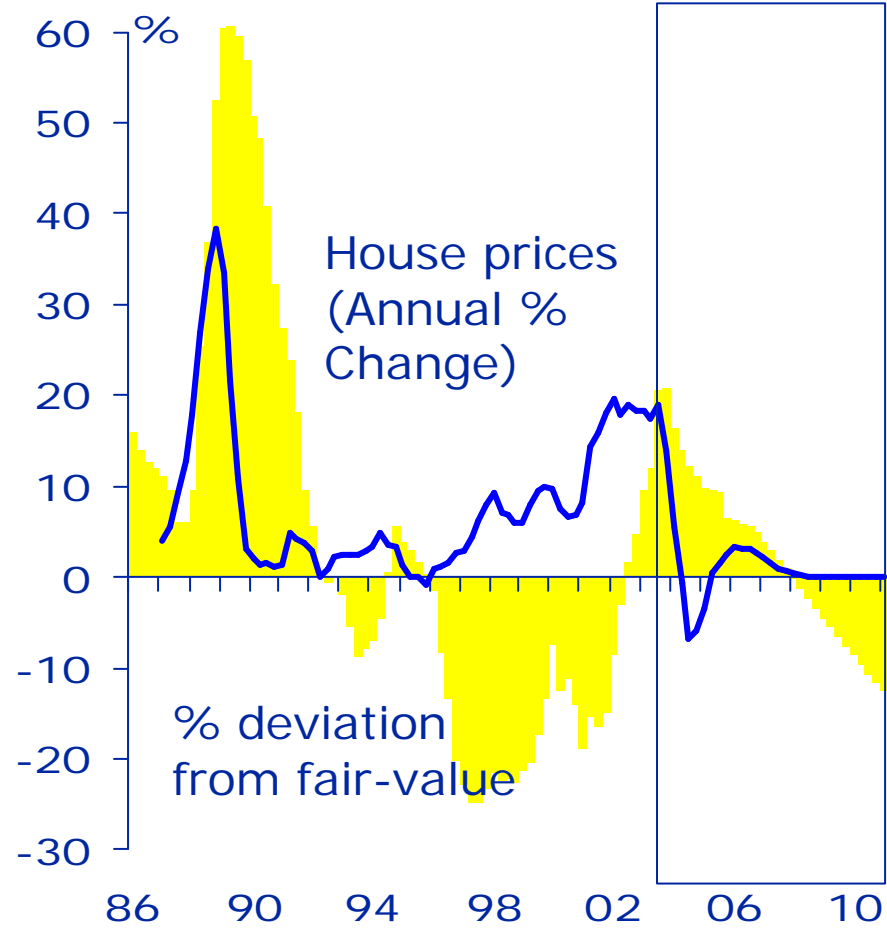
Note: "Affordability" calculated for buyer on average income with 20% deposit for given level of mortgage interest rate.

But in our house prices will be tempered by the favourable macro-economic environment

'Soft-landing' (a)



'Front-load' adjustment (b)



(a) Assumes adjustment to over-valuation occurs over a comparable period to previous episode (7 years)

(b) Assumes adjustment occurs more quickly, sentiment turns against housing, causing undervaluation by end of decade

Conclusions

- The Australian economy has performed strongly in recent times, underpinned by a booming household sector.
- Economic conditions remain strong in the short-term with household expenditure gaining some support from the budget initiatives while growth will be supported by a recovery in exports.
- Domestic economic conditions will likely moderate from later this year
 - households can't keep borrowing to fund consumption and the housing cycle is turning down.
 - a housing bust is unlikely, although price falls are possible.
- Australian interest rates are on hold for now.
- Australian economic growth is expected to be similar to this year largely due to a recovery in the external sector.
- The Australian dollar will hold its recent recovery on the back of short term \$US weakness but by 2005 will be headed down.

Would you like a “soft copy” of this presentation?

Do you have any other questions?

Send an e-mail to:

bourked2@anz.com