

Open partnerships
Open possibilities

Economics, interest rates and currencies chart pack

Presentation to ANZ Senior Management

9th December 2008

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Summary of economic forecasts

	2007	2008f	2009f	2010f
	World economy			
Oil prices (US\$ per barrel)	72	101	43	55
US GDP growth (%)	2.0	1½	-¾	1
Euro area GDP growth (%)	2.5	1	-¼	¾
Japan GDP growth (%)	2.1	¼	-½	1
China GDP growth (%)	11.6	9½	8	9
World GDP growth (%)	4.7	3½	1¾	2¾
	Australian economy			
Real GDP growth (%)	4.3	2¼	½	2
Unemployment rate (year-end, %)	4.3	4½	6	6½
'Underlying' inflation (year-end, %)	3.6	4¼	3½	2¾
Current account deficit (% of GDP)	-6.3	-4¼	-5½	-6½
Credit growth (calendar year-end %)	16.3	7	6	6½
	New Zealand economy			
Real GDP growth (%)	3.2	½	-1	2¼
Unemployment rate (year-end, %)	3.4	4¾	6	6½
'Underlying' inflation (year-end, %)	3.2	3½	2½	2½
Current account deficit (% of GDP)	-7.9	-7¼	-6	-6½
Credit growth (%)	14.0	10	2	3

Summary of financial market forecasts

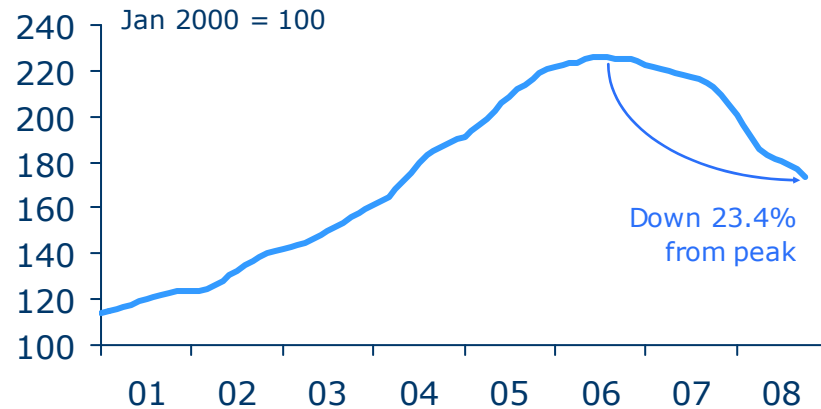
	Dec 08	Jun 09	Dec 09	Jun 10	Jun 10
	International markets				
US Fed funds rate (% pa)	1.00	0.50	0.50	1.00	2.25
US 10-year T-note yield (% pa)	2.50	2.15	2.85	3.60	4.10
ECB refi rate (% pa)	2.50	1.75	1.75	2.25	2.75
€ - US\$	1.27	1.16	1.08	1.09	1.13
US\$ - ¥	96	99	102	107	111
£ - US\$	1.54	1.49	1.41	1.43	1.55
Yuan - US\$	6.84	6.85	6.84	6.77	6.64
	Australian markets				
RBA cash rate (% pa)	4.25	3.50	3.50	3.50	4.25
90-day bill yield (% pa)	4.50	3.75	3.75	3.75	4.70
10-year bond yield (% pa)	4.30	4.25	4.70	4.90	5.30
A\$-US\$	0.65	0.60	0.55	0.55	0.60
	New Zealand markets				
RBNZ cash rate (% pa)	5.00	3.50	3.50	5.00	6.00
10-year bond yield (% pa)	5.50	4.95	5.63	5.90	6.15
NZ\$-US\$	0.54	0.47	0.44	0.46	0.50
AS-NZ\$	1.22	1.23	1.23	1.22	1.20

The global credit crunch is continuing despite concerted efforts to recapitalize banking systems and stabilize money markets ⁴

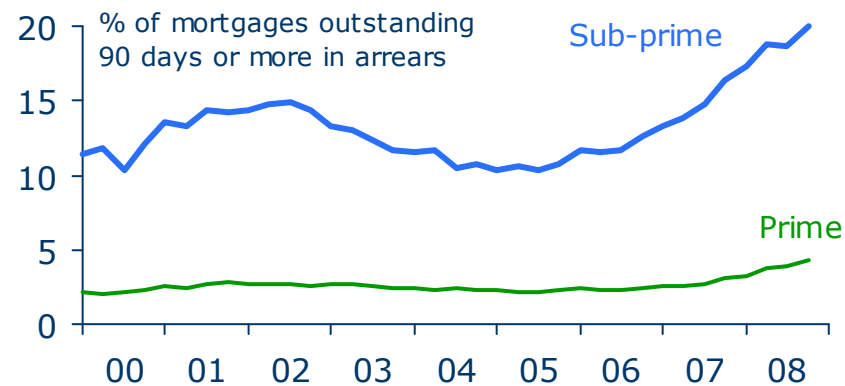
- **The global financial crisis which began with the sub-prime mortgage market meltdown in July 2007 took a much more ominous turn following the US Treasury's decision to allow Lehman Brothers to fail in mid-September, the subsequent decisions to take AIG, Fannie Mae and Freddie Mac into 'conservatorship' and the failure of Washington Mutual. These events triggered an almost complete shut-down of the credit and money markets and an 'investor' run on the global banking system, and raised the spectre of a retail depositor run on the banking systems of some countries.**
- **In mid-October, governments and central banks of most Western economies and many emerging economies undertook to guarantee their banking systems' wholesale borrowings and retail deposits, and (where necessary) to inject substantial amounts of equity capital into banks.**
- **Bank asset write-downs and credit losses since the beginning of 2007 now total US\$711bn (\$230bn more than three months ago), while losses at other financial institutions are approaching \$260bn. The IMF has revised upward its estimate of the eventual total losses on all loans and securities (including losses on commercial real estate, consumer finance and - corporate loans and securities) to US\$1,405bn (from \$950bn in August), of which banks' losses could eventually reach US\$950-\$1,110bn (from \$450-510bn in August).**
- **Banks have thus far raised US\$762bn in fresh capital, of which governments have provided US \$345bn. Banks have also announced job losses in excess of 175,000 worldwide**
- **Central banks have dramatically expanded their balance sheets (in the Fed's case, from just over US\$900bn to over US\$2.1trn; for the ECB, from €1.2trn to €1.9trn; for the RBA, from A\$90bn to A\$160bn) in order to provide liquidity to their respective banking systems and securities markets, as well as aggressively slashing official interest rates.**
- **These measures have largely succeeded in narrowing spreads between official cash rates and wholesale borrowing costs (although these may drift wider again ahead of year-end balance dates), and in the US at least in reviving the CP market. US banks have so far issued US\$44bn of FDIC-guaranteed bonds but will need to refinance \$360bn of maturing debt next year. However other securities markets have remained moribund with spreads continuing to widen in many cases.**

US house and MBS prices are continuing to decline, but bank losses are now matched by capital raisings

US existing home prices



US mortgage delinquencies



Losses & write-downs announced since mid-2007

Country of origin	Total (US\$ bn)
US banks	414.6
European banks	258.4
Canadian banks	10.2
Asian and other banks	27.8
Total banks	711.0
Other institutions*	257.9

Capital raised by banks since mid-2007

Country of origin	Total (US\$ bn)
US	397.2
European	300.7
Canadian	19.3
Asian and other	44.9
Total	762.1
of which, from governments	344.8

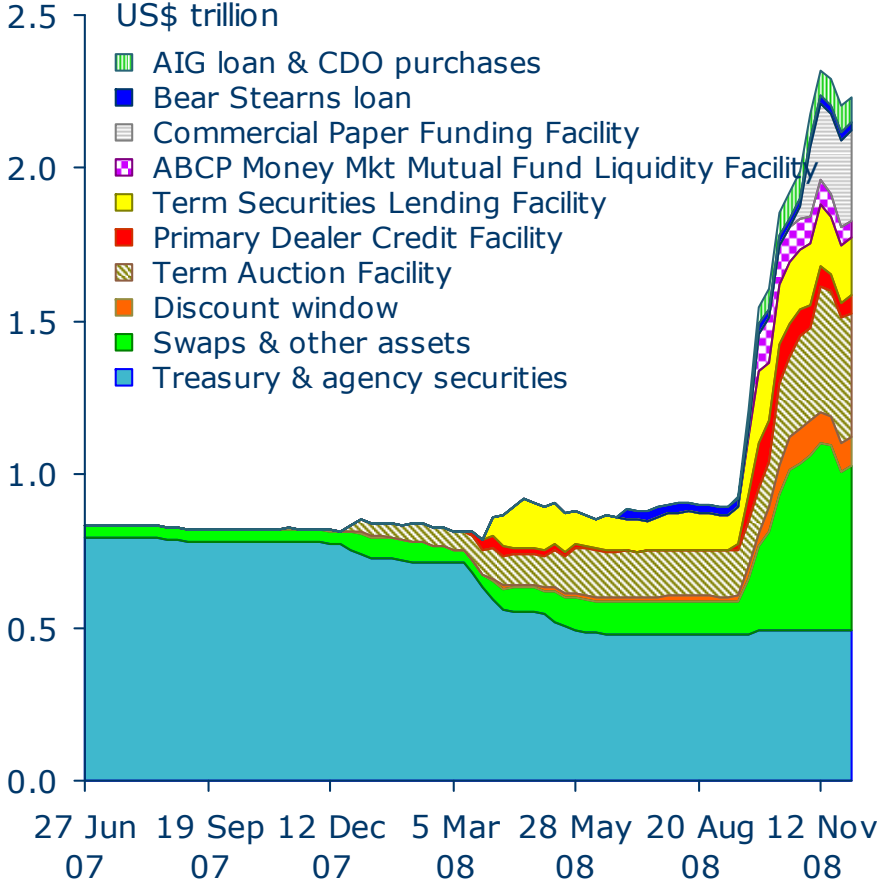
* 'Other institutions' include insurance companies and the US GSEs.

Sources: S&P; US Mortgage Bankers' Association; Bloomberg; ANZ Economics & Markets Research.

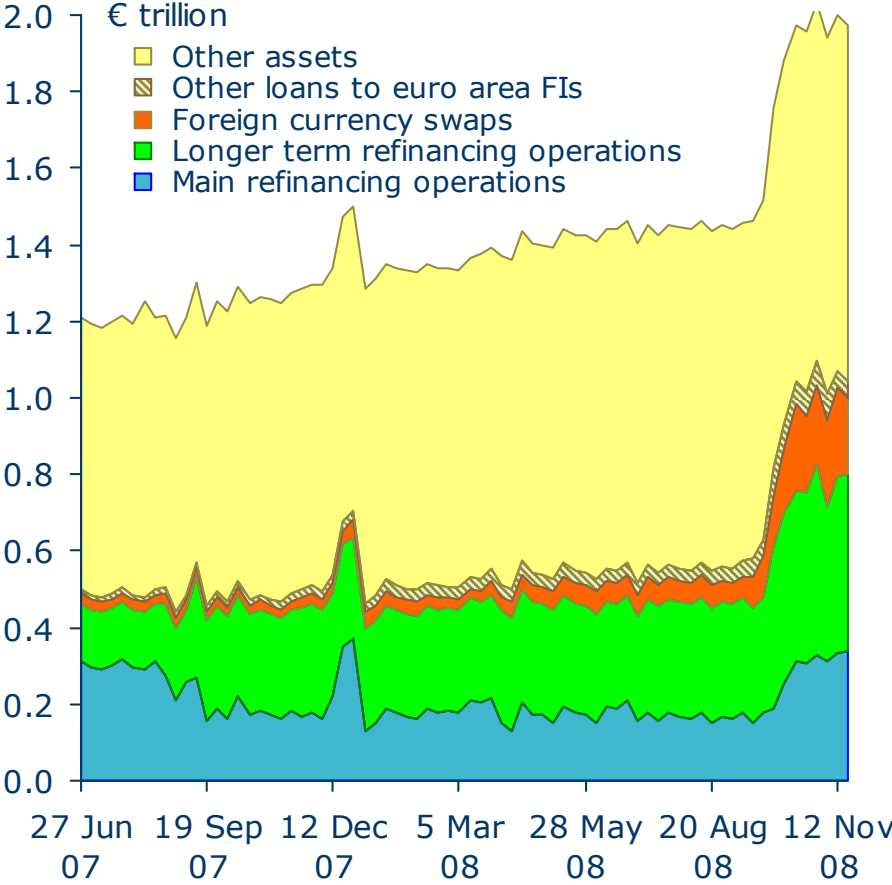


Central bank balance sheets have ballooned as they seek to keep their banking systems and money markets functioning

Assets of the Federal Reserve Board System Open Market Account



Assets of the European Central Bank



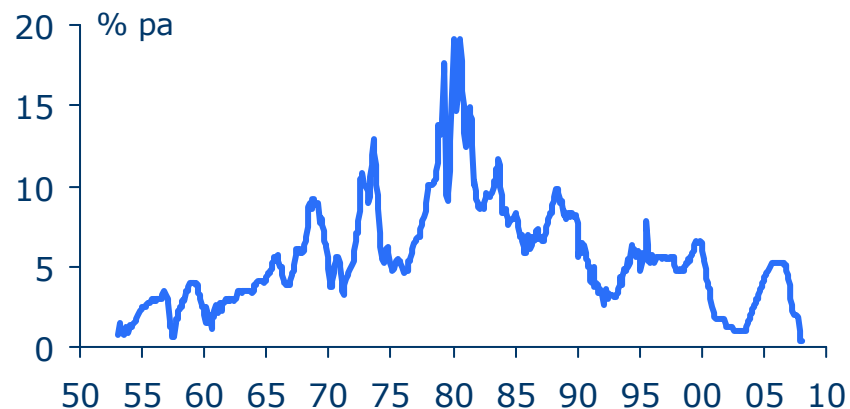
Sources: US Federal Reserve Board H.4.1 Statistical Release, *Factors Affecting Reserve Balances*; European Central Bank *Consolidated Financial Statements of the Eurosystem*.



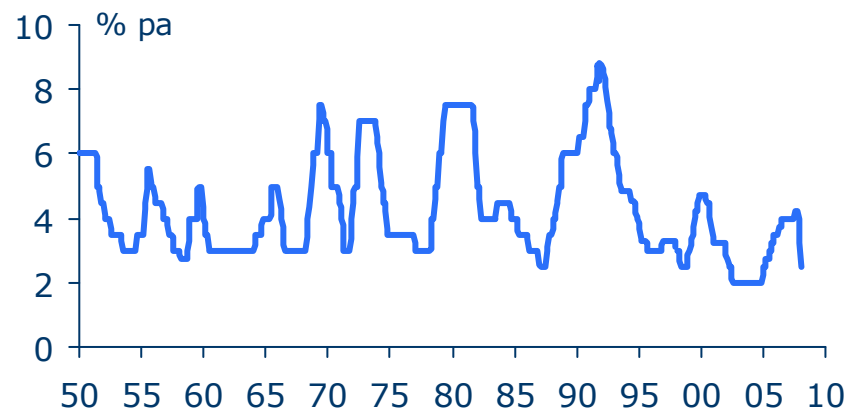
Policy interest rates have been (or will soon be) reduced to multi-decade lows

Monetary policy interest rates

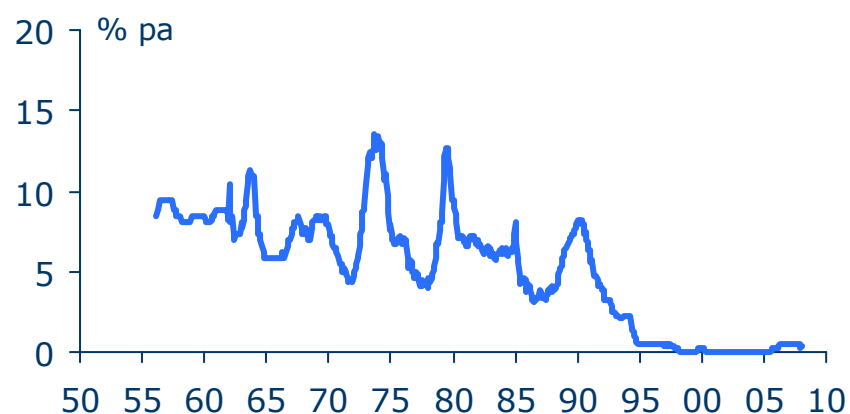
US Fed funds rate



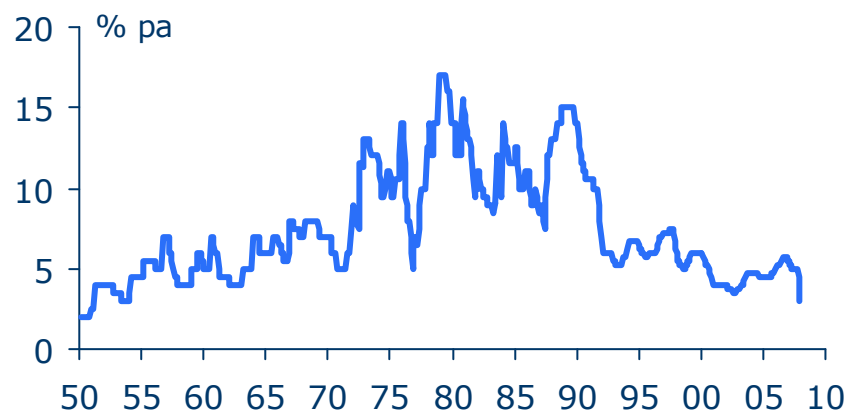
Euro area refi rate*



Japan call money rate



UK base rate



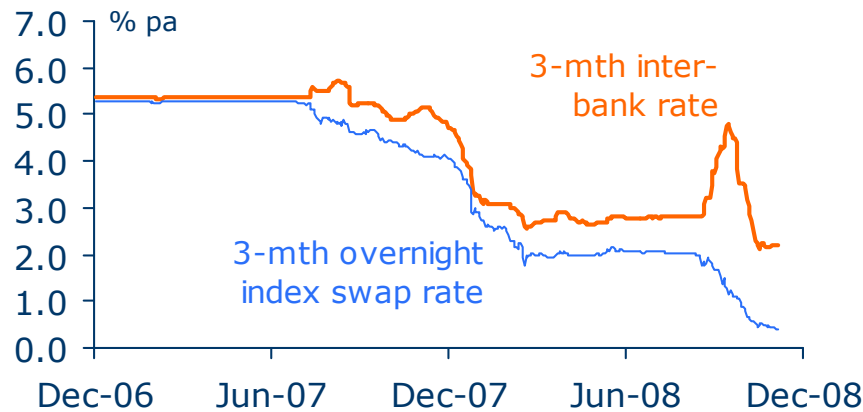
Note: For euro area, Bundesbank discount rate from December 1950 until September 1992, Bundesbank repo rate from October 1992 until December 1998. Source: Thomson Financial Datastream.



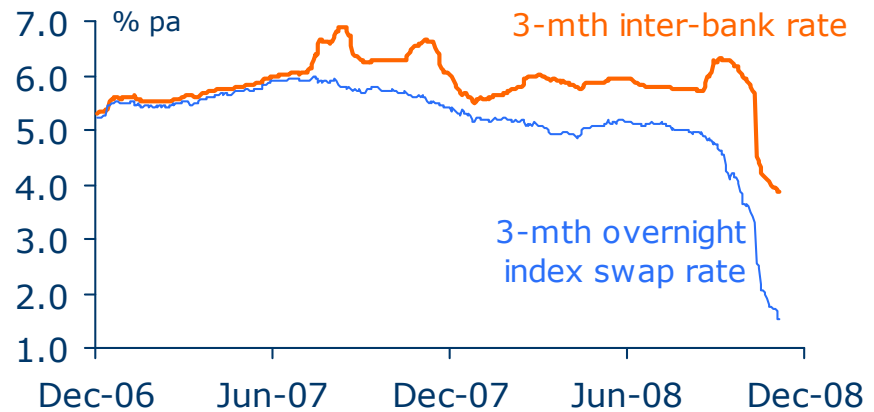
Measures announced by governments since mid-October are slowly working to ease financial market stress

3-month inter-bank borrowing rates and official cash rates

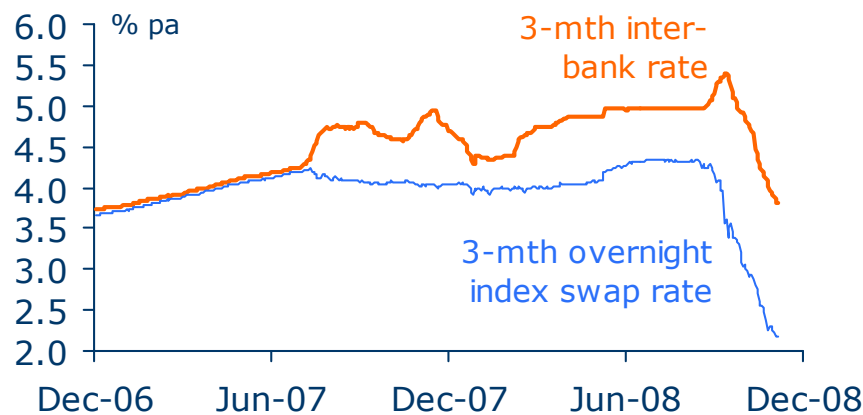
United States



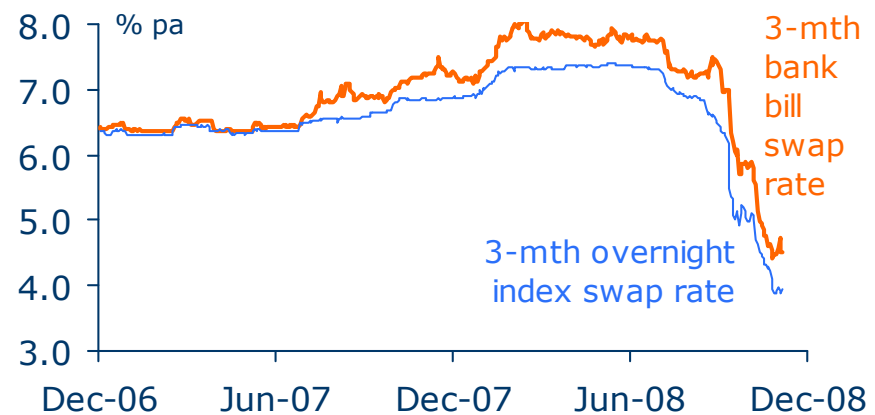
United Kingdom



Euro area



Australia



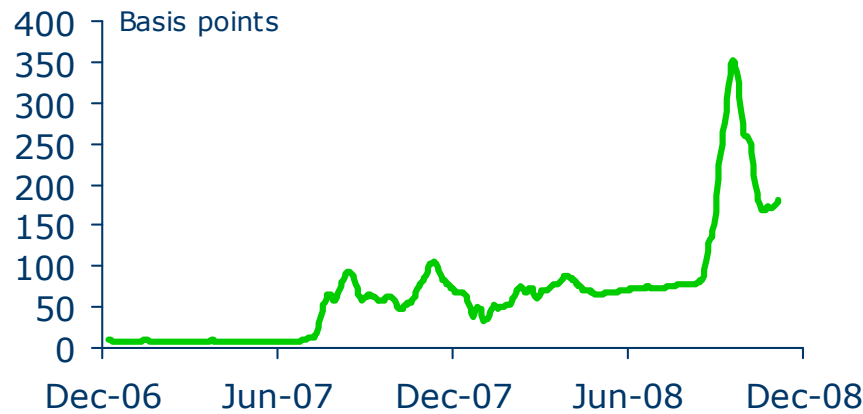
Note: The 3-mth overnight index swap (OIS) rate shows market expectations of the average official cash rate over the following three months. Source: Bloomberg.



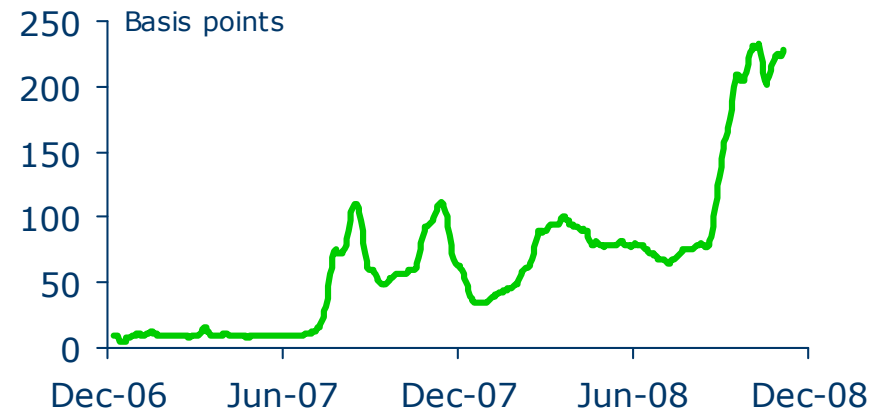
Except in the UK, spreads between market expectations of official cash rates and wholesale funding costs have narrowed

Spreads between 3-mth wholesale funding and OIS rates

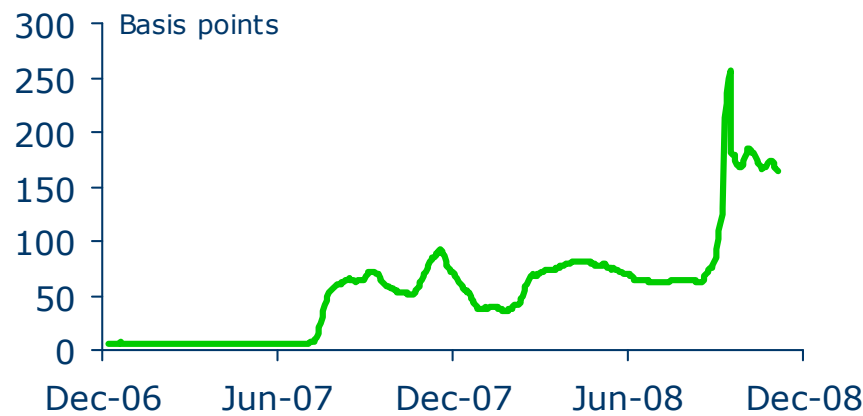
United States



United Kingdom



Euro area



Australia



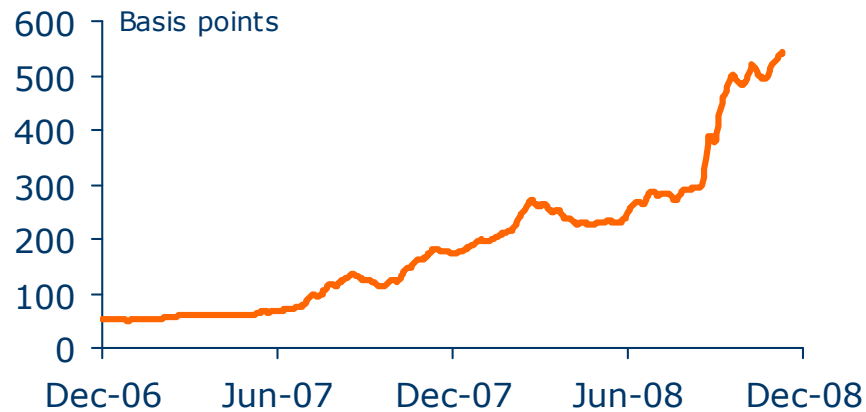
Note: The 3-mth overnight index swap (OIS) rate shows market expectations of the average official cash rate over the following three months. Source: Bloomberg.



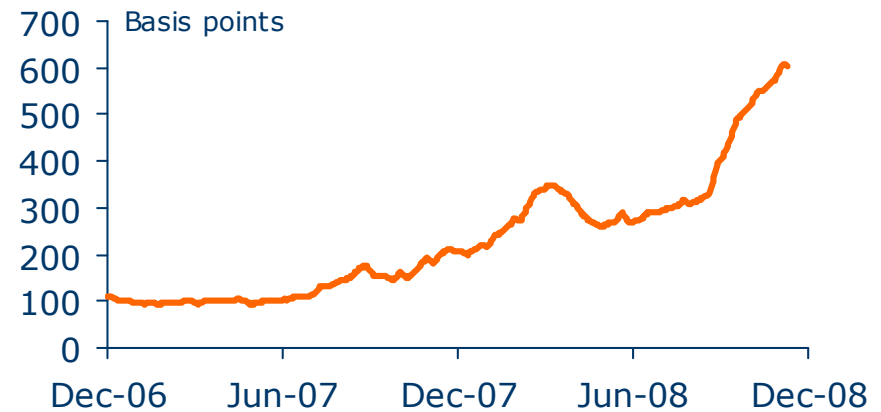
However spreads between corporate and government bond yields have remained wide

AA 5-7 year corporate bond yield spread over governments

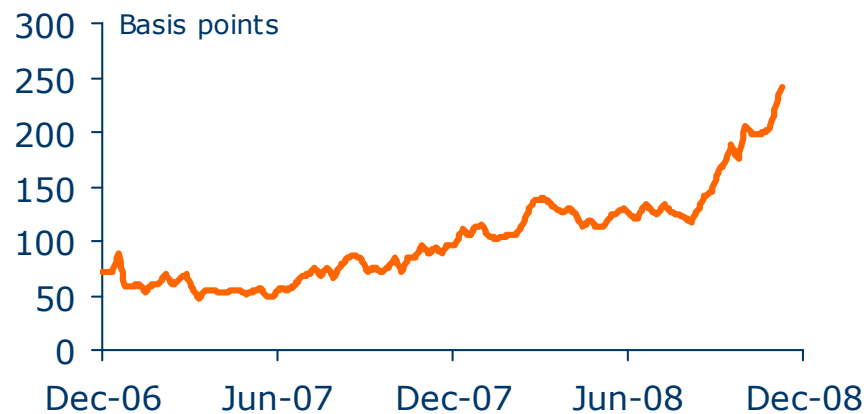
United States



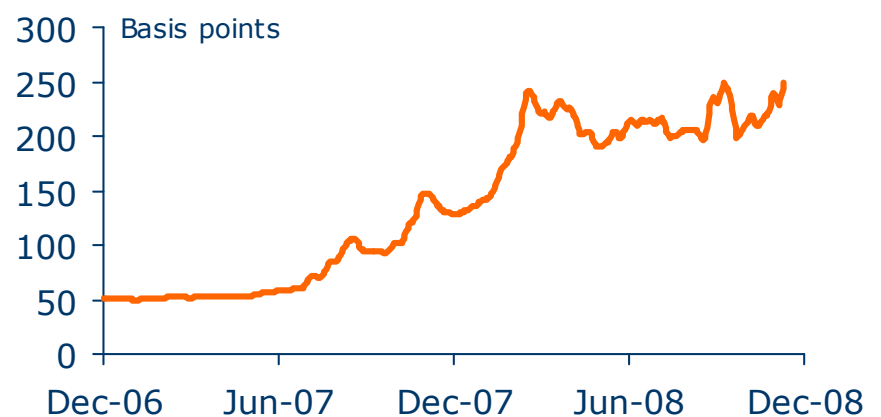
United Kingdom



Euro area



Australia

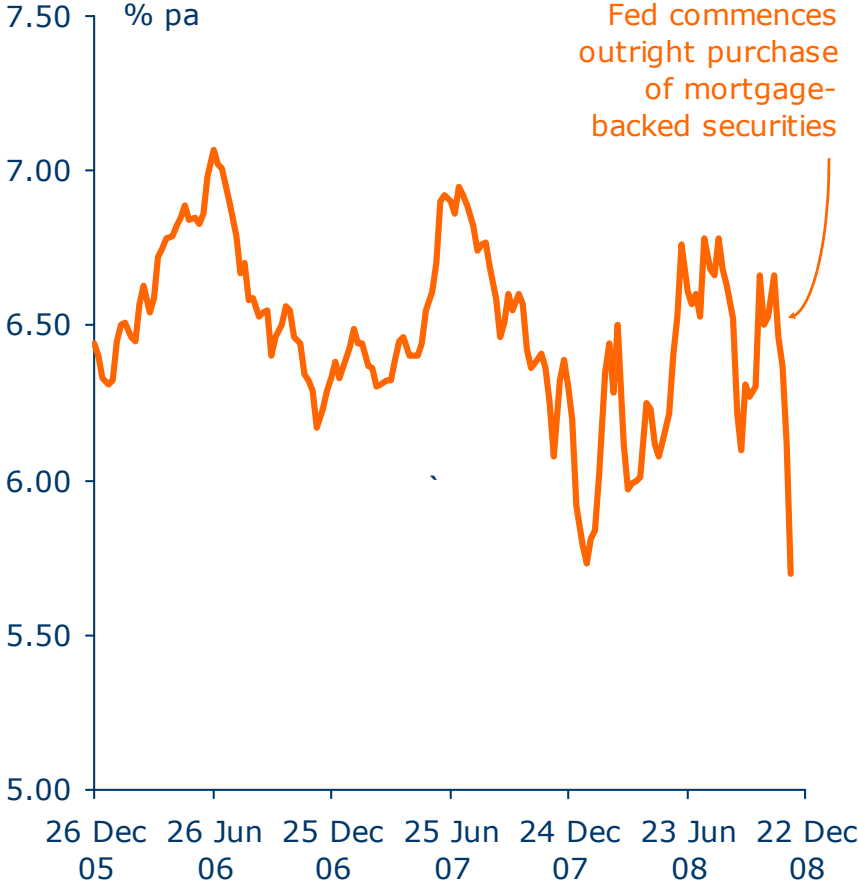


Sources: Thomson Financial Datastream; Reserve Bank of Australia.

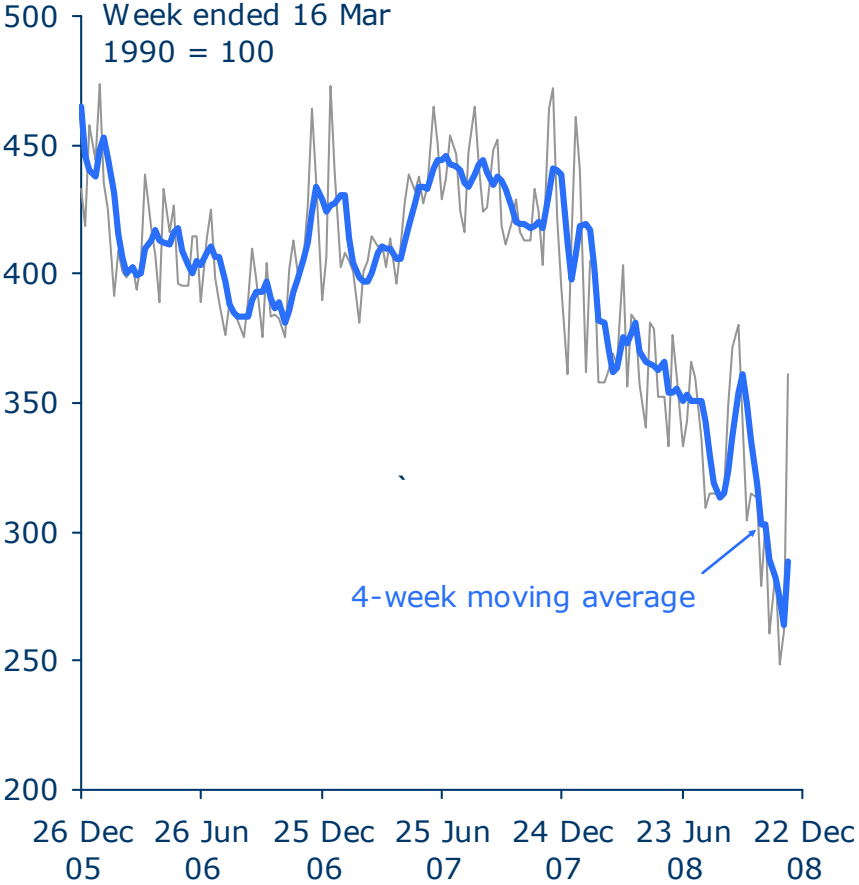


Since the Fed began buying MBS outright, mortgage rates have fallen and applications for mortgages have risen

30-year fixed mortgage rate



Applications for mortgages for home purchase



Source: Thomson Financial Datastream; Mortgage Bankers' Association of America.

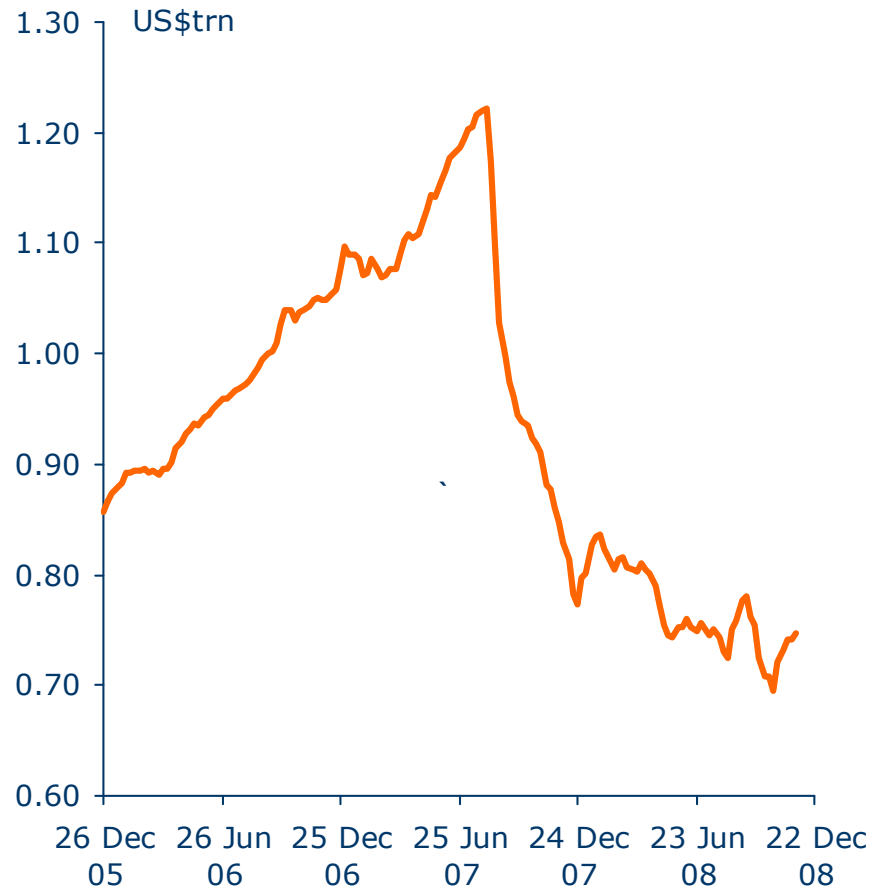


The Fed's decision to start buying CP outright has prompted a modest revival in CP issuance

Financial commercial paper outstanding



Asset-backed commercial paper outstanding



Source: Federal Reserve.

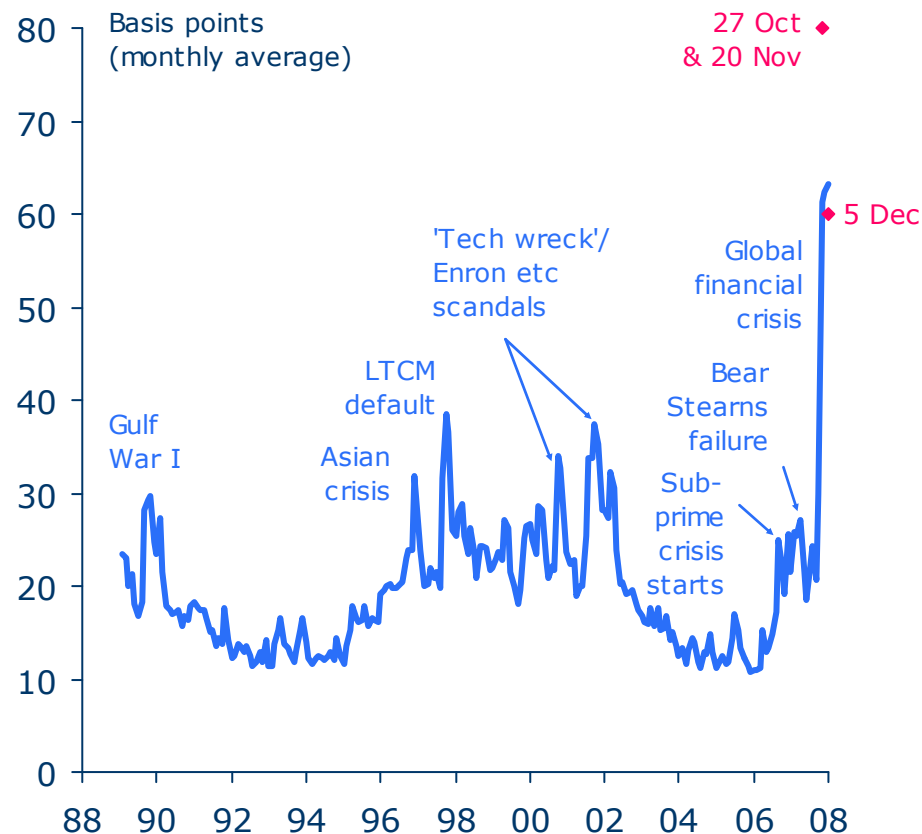


Indicators of 'fear' in financial markets have retreated a bit from October's all-time peaks but remain elevated

'TED' spread between 3-month inter-bank US\$ rates and 3-month US Treasury bill yields



'VIX' index of implied volatility of the US S&P 500 share index

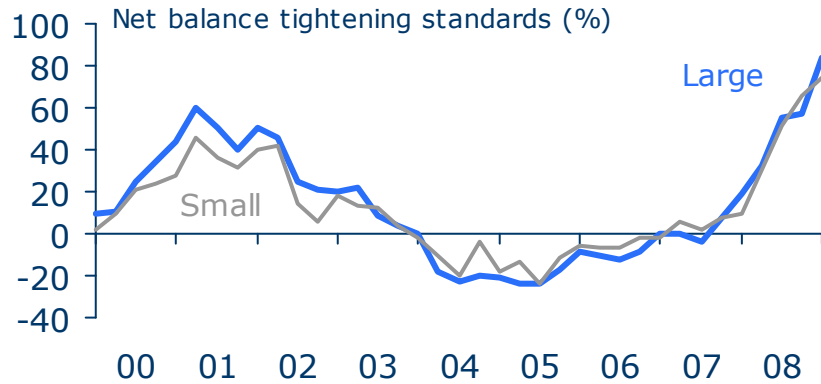


Sources: US Federal Reserve; Datastream; ANZ.

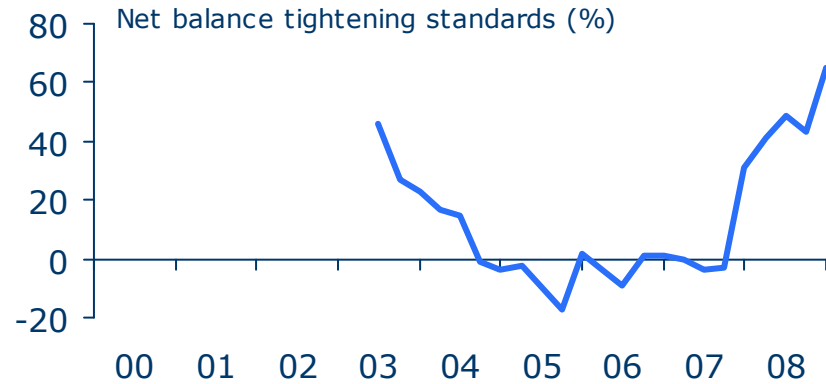


Banks in the US and the euro area are continuing to tighten credit standards

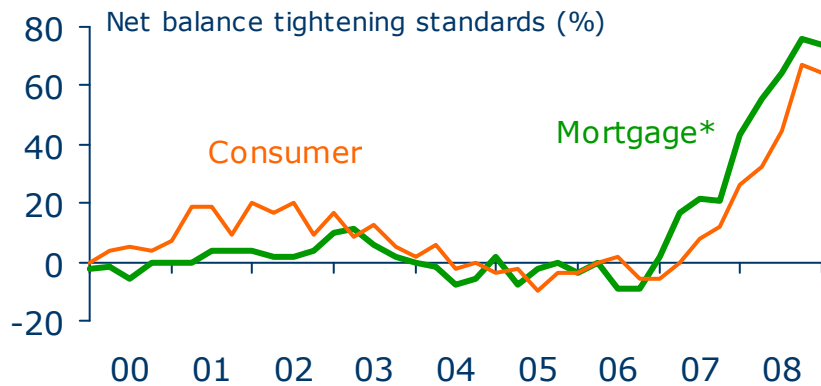
US banks
Commercial & industrial loans



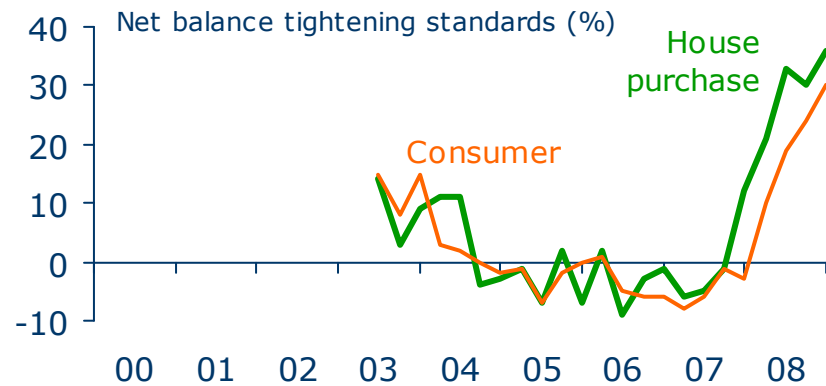
Euro area banks
Loans to enterprises



Mortgage and consumer loans



Mortgage and consumer loans



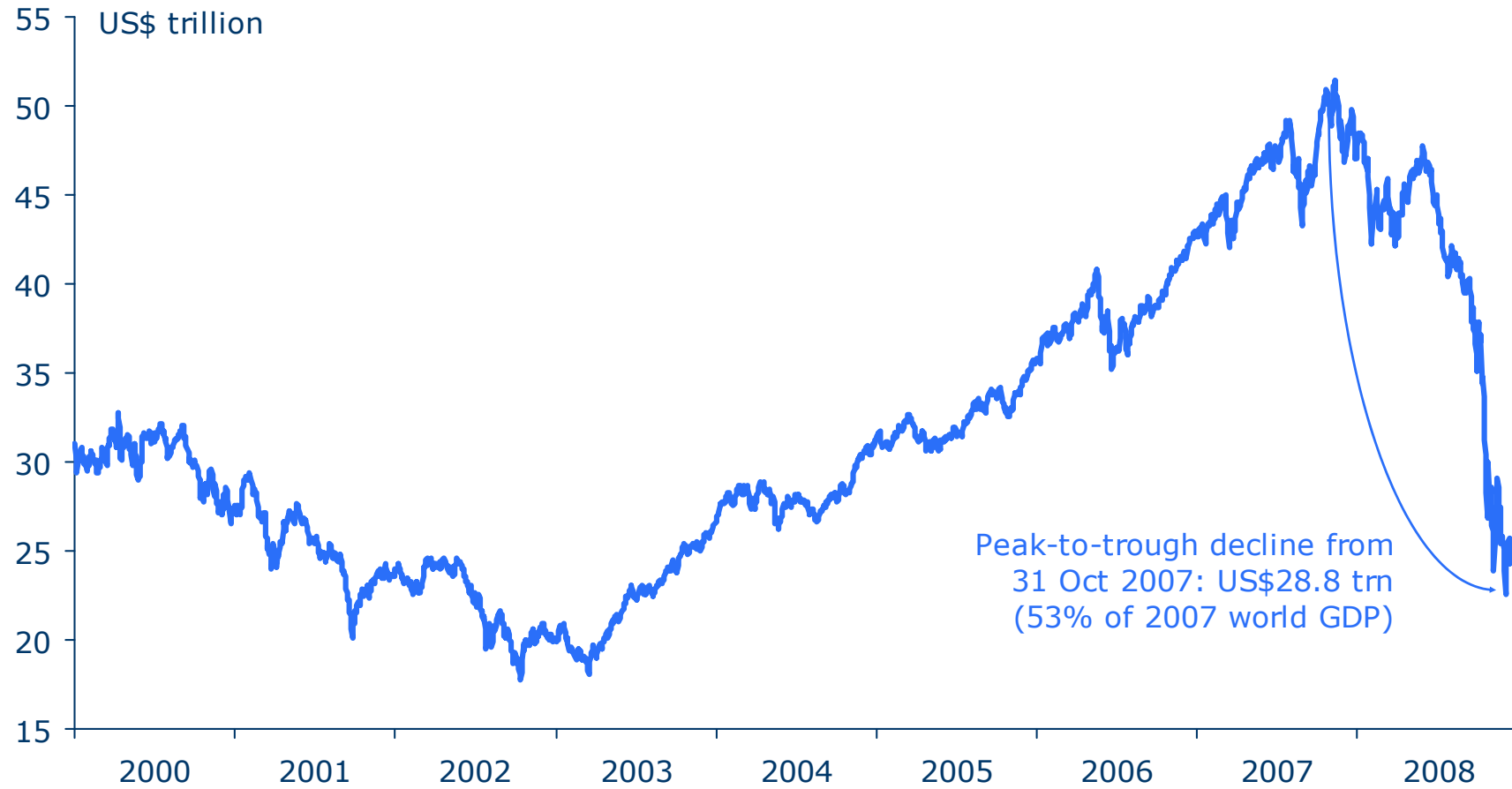
* Weighted average of prime & sub-prime after June 2007

Sources: US Federal Reserve and European Central Bank surveys of loan officers.



Share market investors around the world have lost almost US\$30 trillion since the end of October 2007

Capitalization of world equity markets



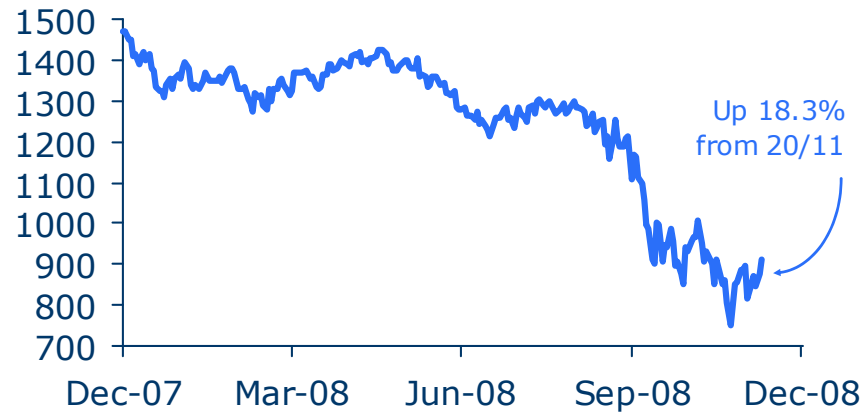
Source: Datastream.



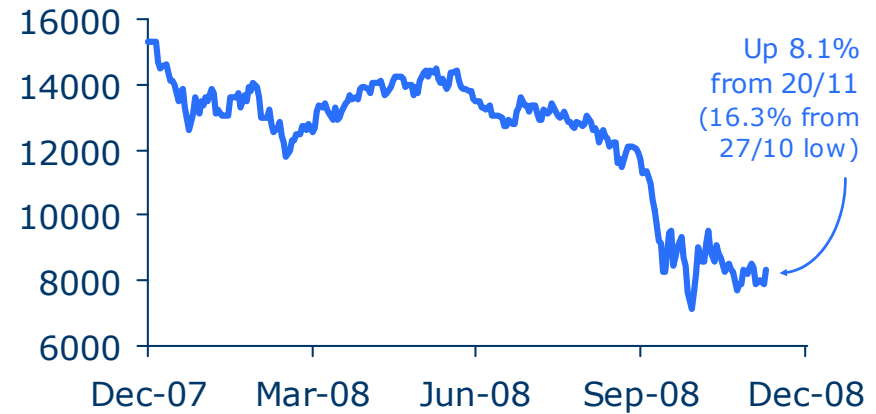
Stockmarkets have rallied since 20 November despite uniformly bad economic data, on hopes of major stimulus

Stock markets

United States S&P 500



Japan Nikkei



United Kingdom FTSE 100



Australia All Ords



Source: Thomson Financial Datastream.



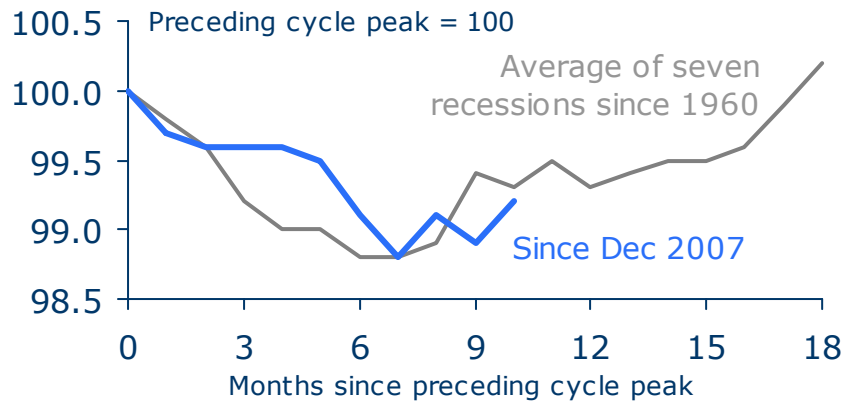
The global credit crunch is continuing despite concerted efforts to recapitalize banking systems and stabilize money markets¹⁷

- **Growth in the world economy has slowed abruptly during the current half, with all of the major industrialized economies experiencing negative, or only barely positive, growth and many of the more important developing economies also exhibiting pronounced slowdowns.**
- **The US National Bureau of Economic Research has concluded that the US economy entered recession in December 2007 – even though the US has yet to experience consecutive quarters of negative growth (which is a sufficient but not necessary condition for a US recession). The current recession is already longer than the post-war average (10 months) and will almost certainly end up being longer than the two previous longest post-war recessions, those of 1973-75 and 1981-82 (both of which lasted 16 months). It also seems likely to entail a greater contraction in real GDP than the 2.3% average for post-war recessions.**
- **Other countries do not have counterparts to the NBER, and tend to use the ‘consecutive quarters of negative real GDP growth’ rule-of-thumb to designate recessions. By that standard, Japan, the Euro zone, the UK, Hong Kong and Singapore entered recession in the second quarter of 2008.**
- **China’s annual real GDP growth rate slowed to 9% in the September quarter, the slowest since the 2003 SARS outbreak, and (based on monthly data) has almost certainly slowed to less than 8% in the current quarter. China’s slowdown owes more to an abrupt downturn in its property and construction sectors than to weakening exports, although the latter will become more apparent in 2009. India’s growth rate slowed to 7.6% in the September quarter, also the slowest since 2003, as a result of slowing household spending and a deteriorating trade account.**
- **The abrupt slowdown in global economic growth and the accompanying sharp fall in commodity prices has halted the sharp rise in inflation which dominated the thinking of most central banks (apart from the Fed) until about two months ago. In some countries – especially those whose currencies have appreciated (including the US, Japan and China), deflation is a real possibility in 2009.**
- **Although monetary policy is now being eased rapidly around the world, lower interest rates combined with ‘quantitative easing’ will by themselves do little to ease the downturn in activity or revive growth. Major fiscal policy actions are likely to be required and in a number of cases (including the US after next month’s transition) appear to be forthcoming.**

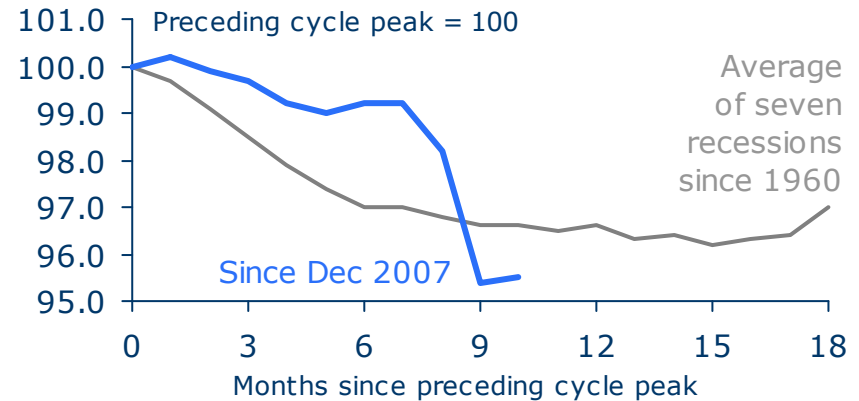
The US National Bureau of Economic Research has formally declared that a recession began in December 2007 ...

NBER's key recession gauges since Dec 2007 cf. previous recessions

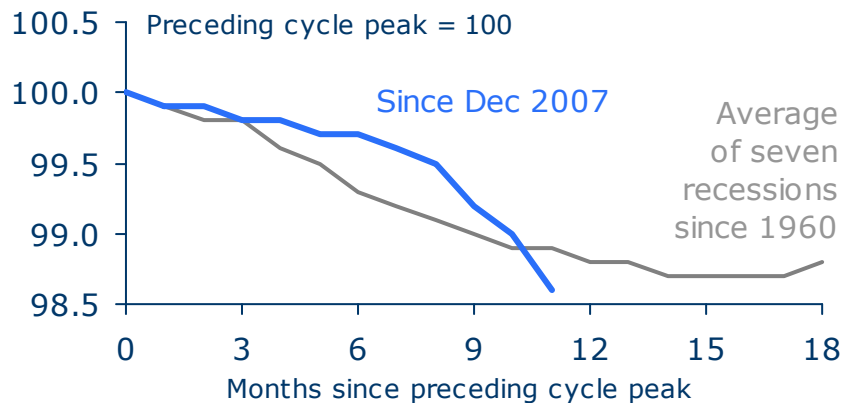
Real personal income less transfers



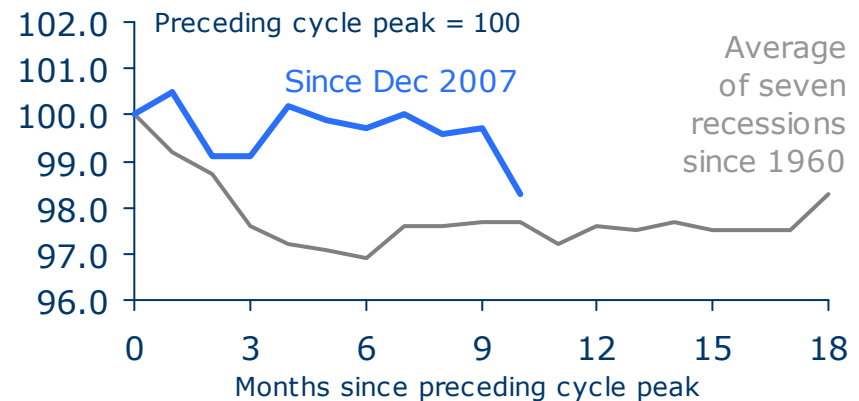
Industrial production



Employment



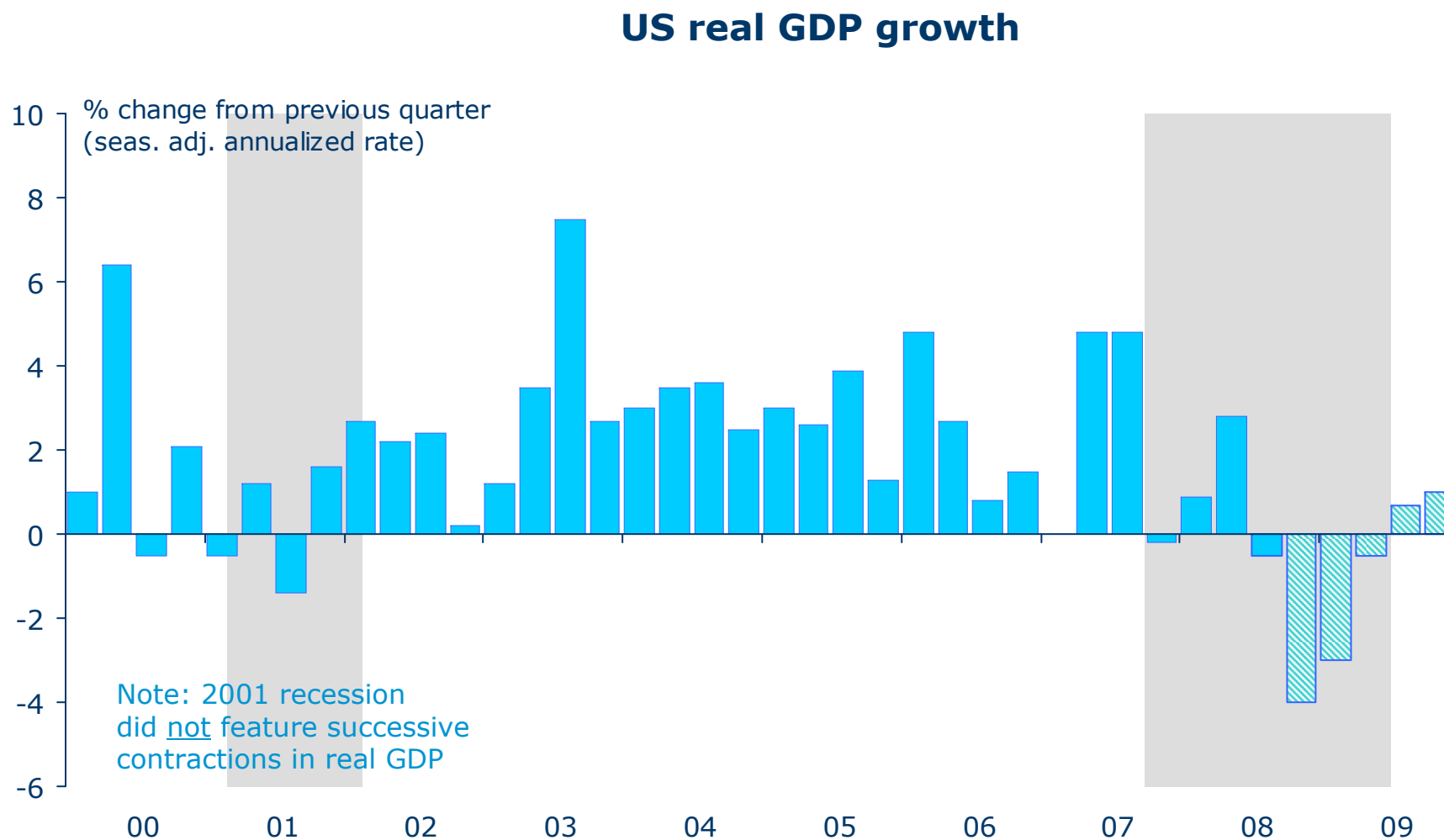
Real business sales



Sources: US Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Board; Commerce Department; ANZ Economics & Markets Research.



... even though the US has yet to experience consecutive quarters of negative real GDP growth



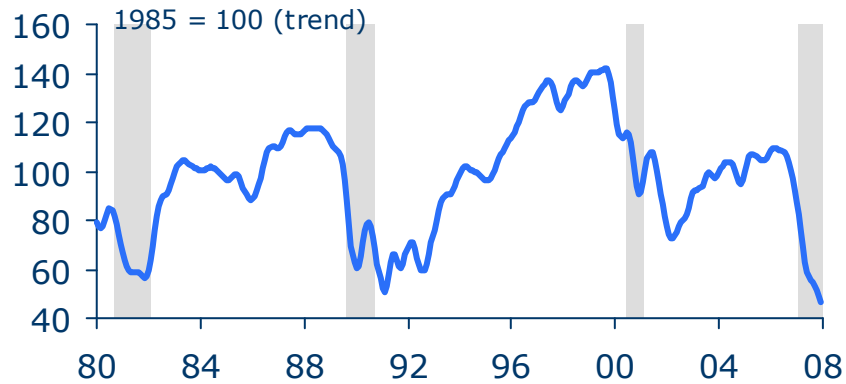
Note: Shaded area denotes recessions as designated by National Bureau of Economic Research.
Source: US Bureau of Economic Analysis; ANZ.



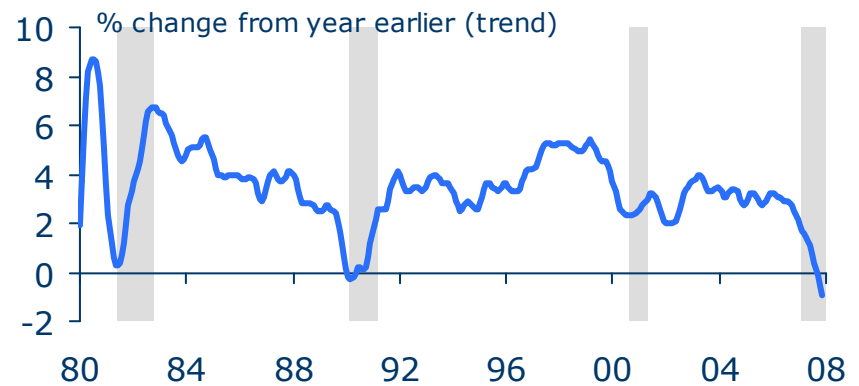
The recession is being driven (in the first instance) by household responses to deteriorating net worth ²⁰

US household indicators

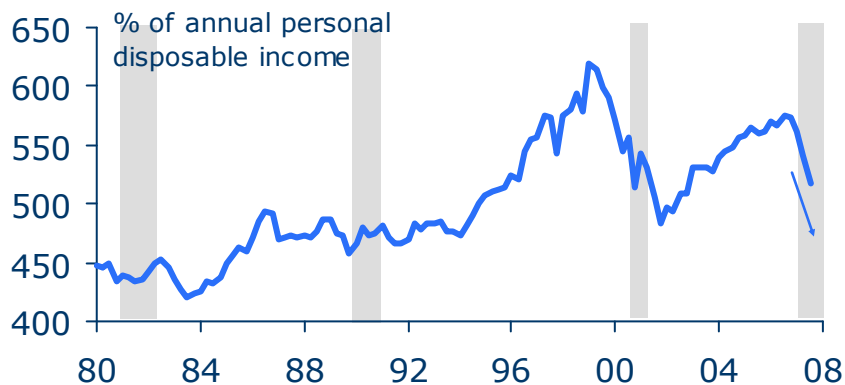
Consumer confidence



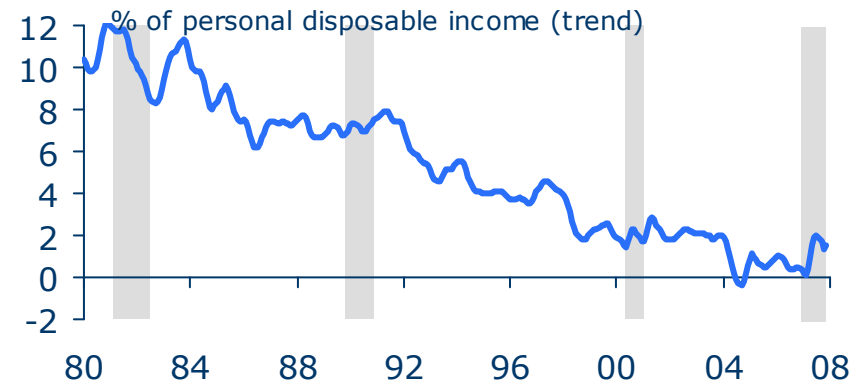
Real personal consumption expenditure



Household net worth



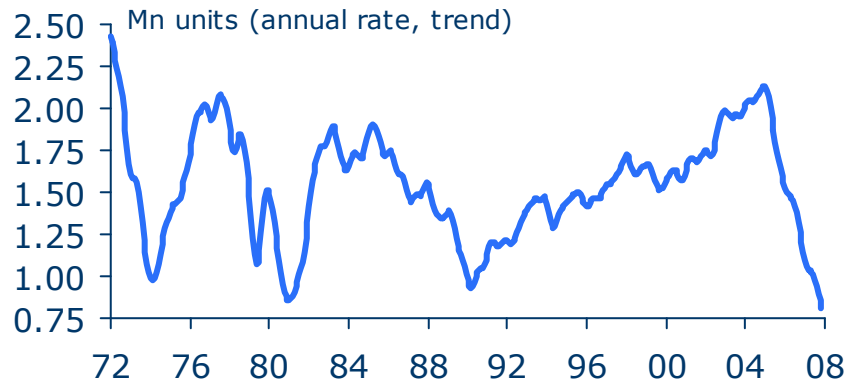
Real personal saving



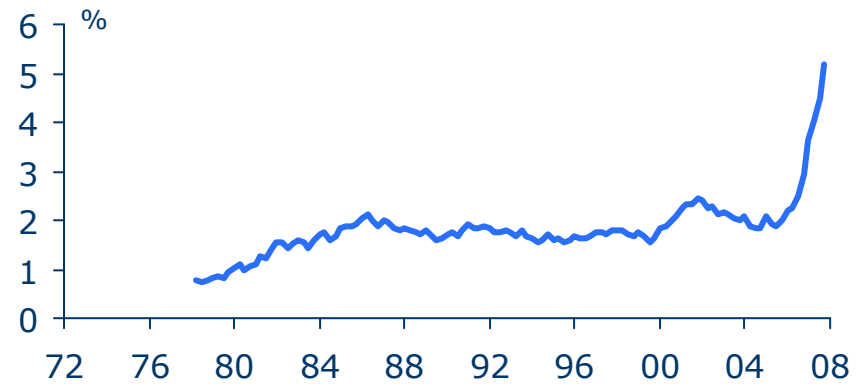
Note: shaded periods denote recessions as designated by National Bureau of Economic Research.
Sources: The Conference Board; Bureau of Labor Statistics; Census Bureau.

US housing market indicators

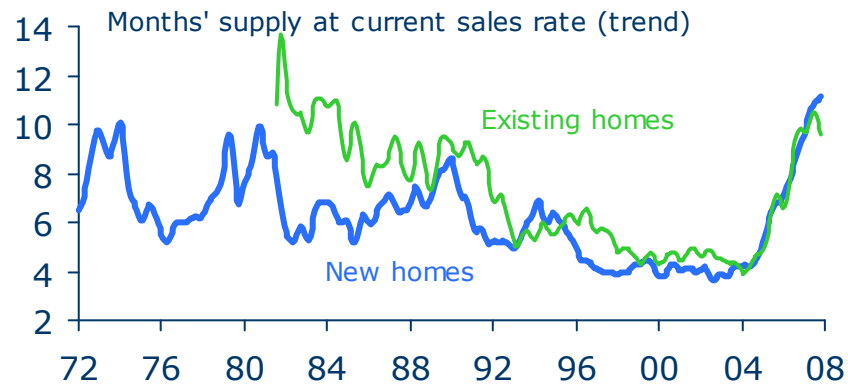
Housing starts



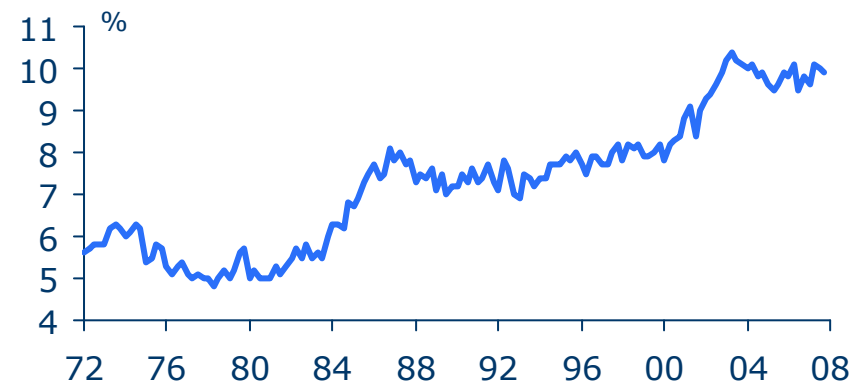
'Seriously delinquent' mortgages



Inventory of unsold homes



Rental vacancy rate



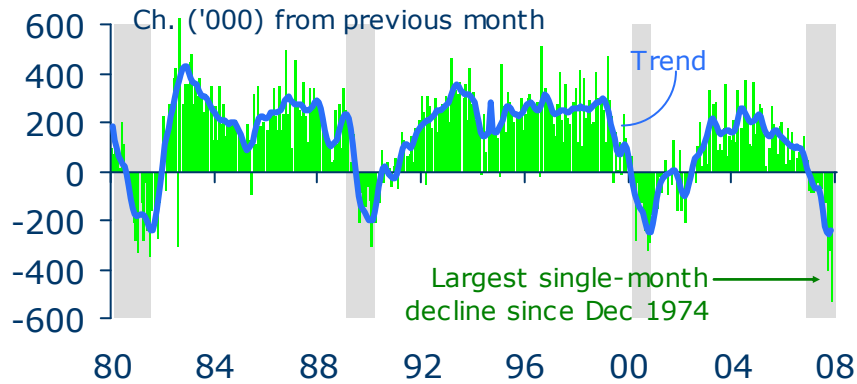
Sources: US Commerce Department; National Association of Realtors; National Association of Home Builders; Mortgage Bankers' Association of America.



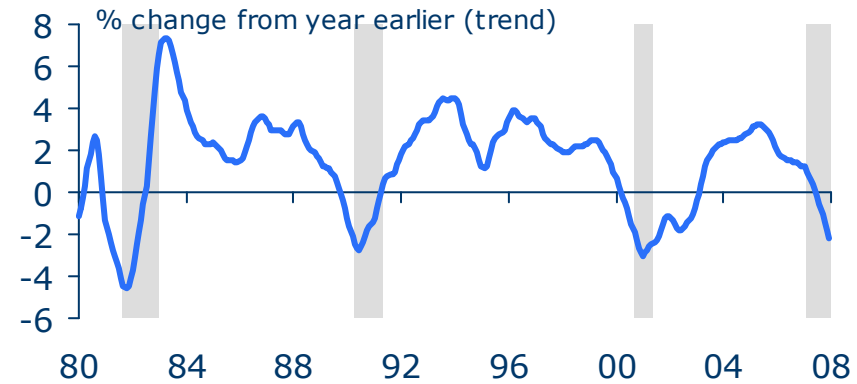
Household spending will come under further pressure from a rapidly deteriorating labour market

US labour market indicators

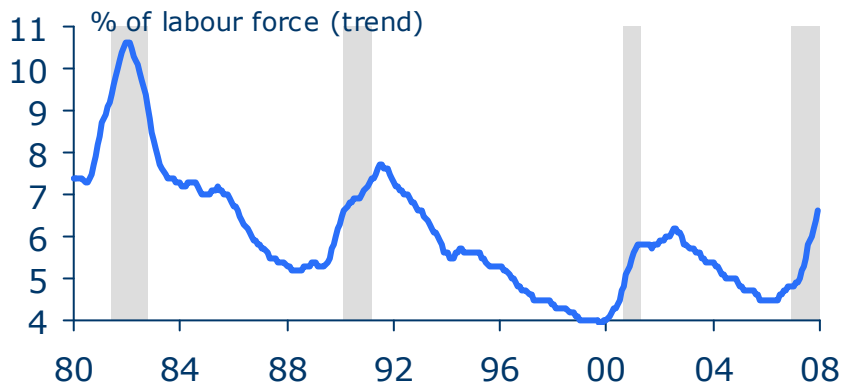
Payroll employment



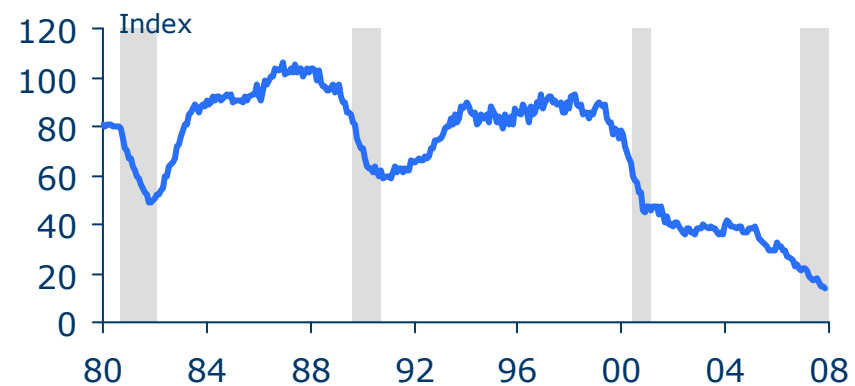
Hours worked



Unemployment



'Help wanted' advertising



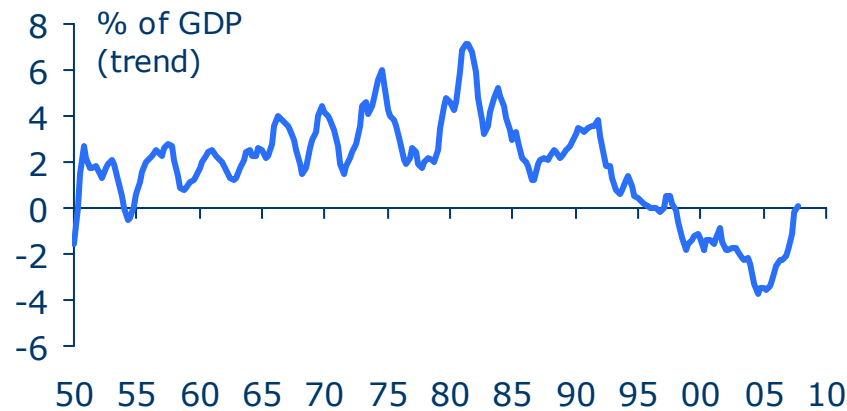
Note: shaded periods denote recessions as designated by National Bureau of Economic Research.
Sources: US Bureau of Labor Statistics; The Conference Board.



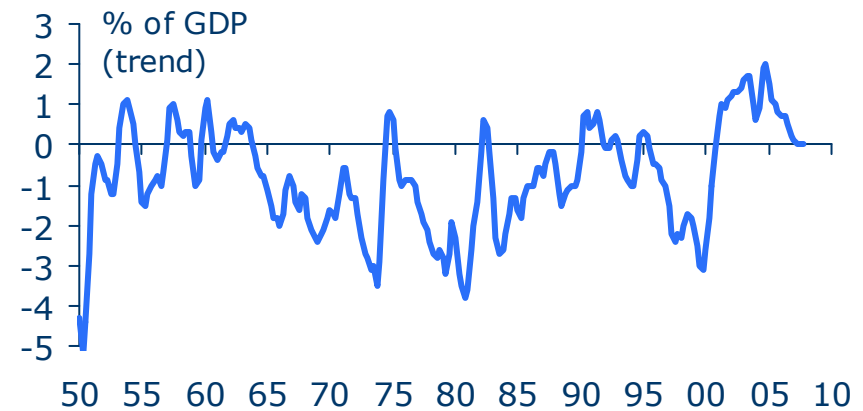
The US household sector will cut spending in order to return to its long-term position as a net lender

US private sector net lending and liabilities

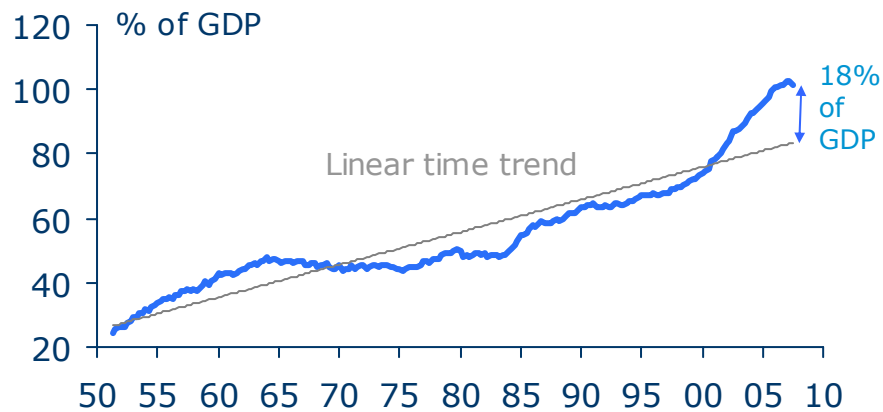
Household net lending



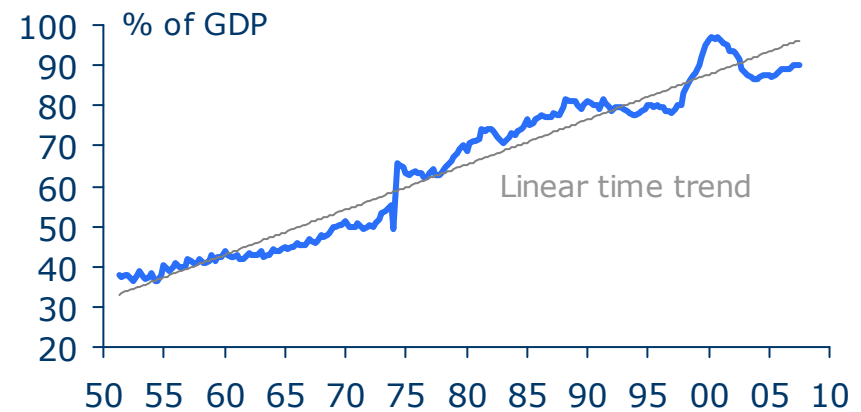
Non-financial corporate net lending



Household liabilities



Non-financial corporate liabilities



Note: 'Net lending' is gross saving minus gross investment.

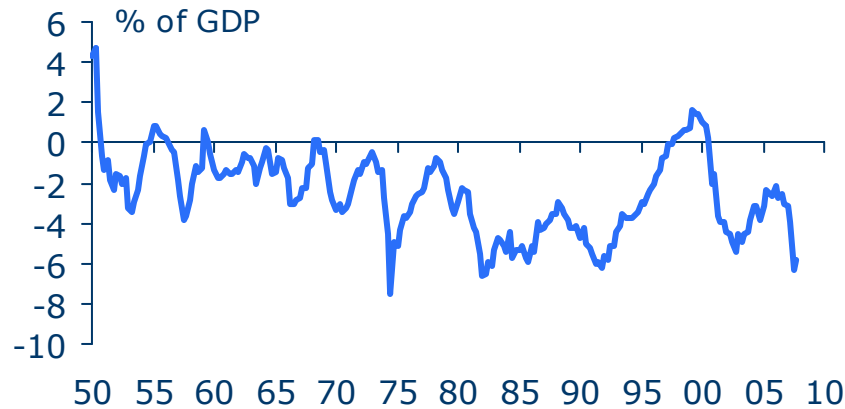
Sources: Federal Reserve Flow of Funds (Z1) statements; Bureau of Economic Analysis; ANZ.



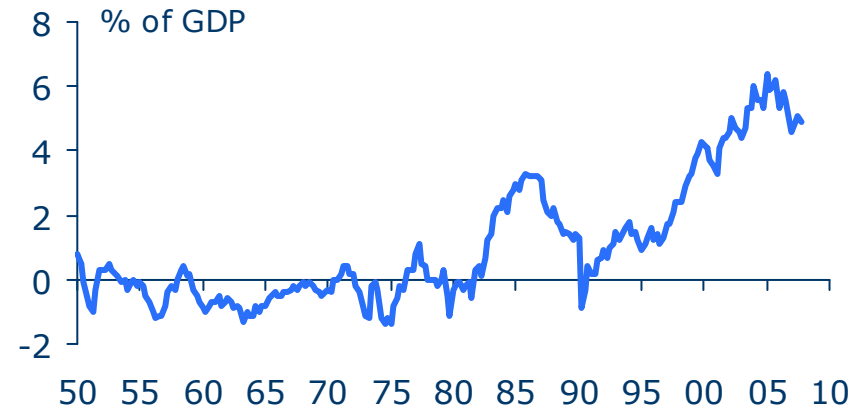
The US public sector should (and can) increase its net borrowing substantially to cushion the impact of household de-leveraging ²⁴

US government and foreign net lending and liabilities

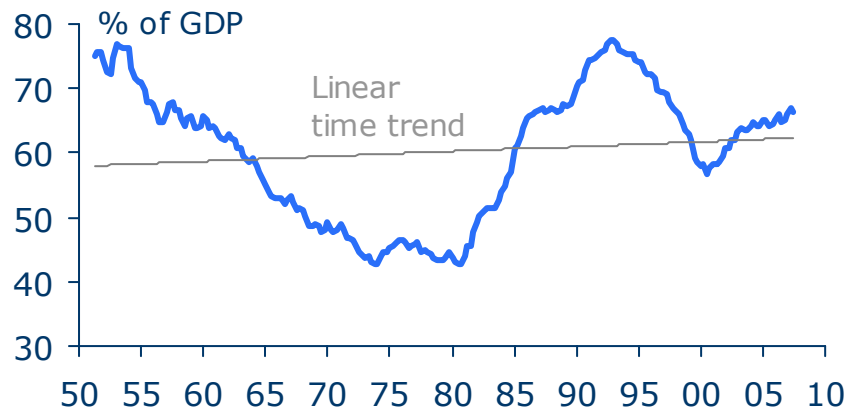
Government net lending



Foreign net lending



Government liabilities



Note: 'Net lending' is gross saving minus gross investment.

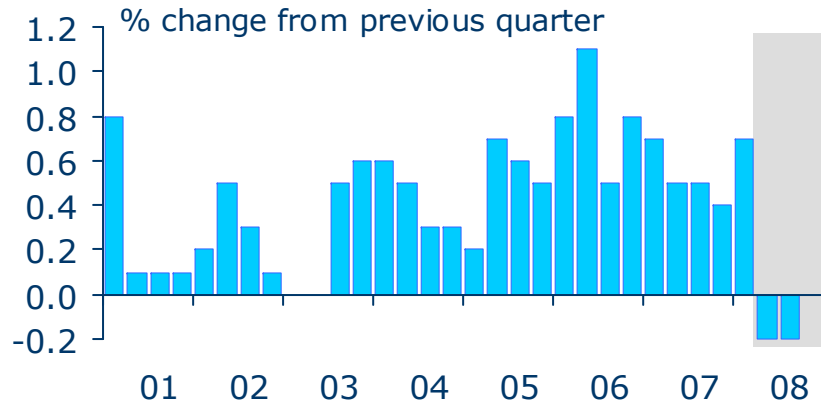
Sources: Federal Reserve *Flow of Funds* (Z1) statements; Bureau of Economic Analysis; ANZ.



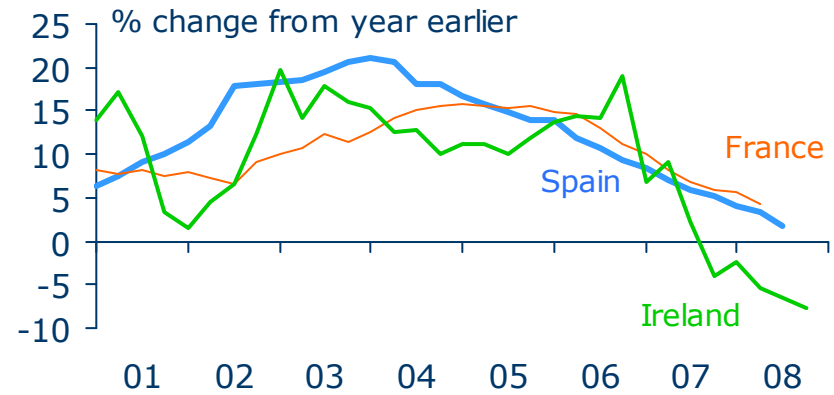
The euro area has also entered recession, although it may not be as severe as in the UK

Euro area economic indicators

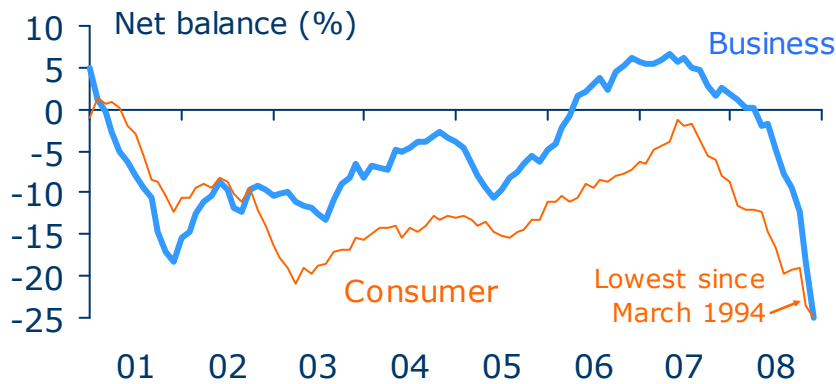
Real GDP



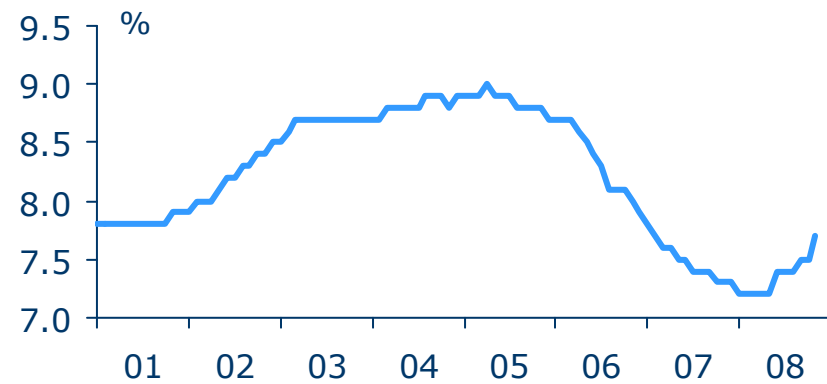
House prices



Business & consumer confidence



Unemployment

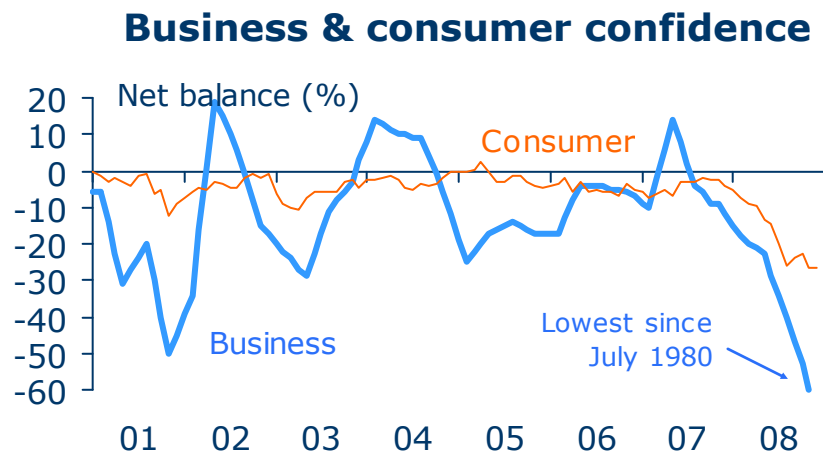
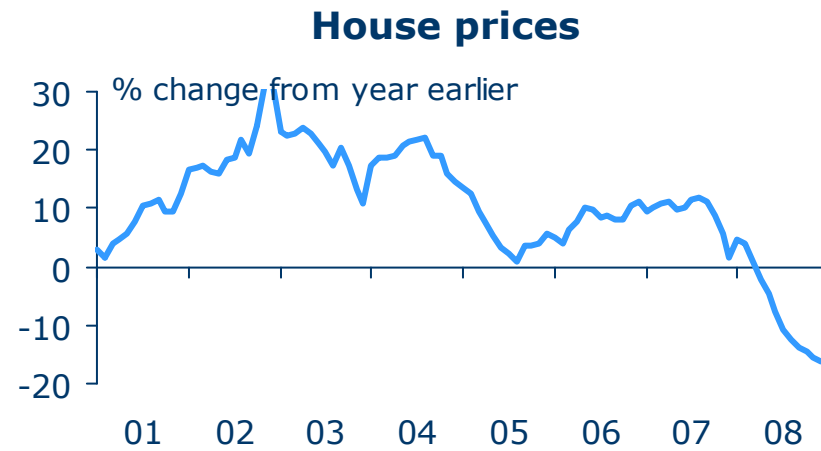
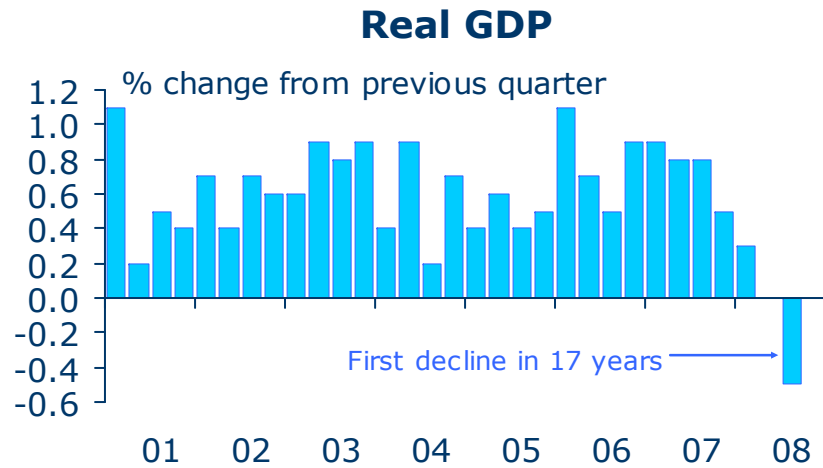


Sources: European Commission; Eurostat; Datastream.



With a relatively large financial sector and house prices falling almost as much as the US, the UK will have a sharp recession

UK economic indicators



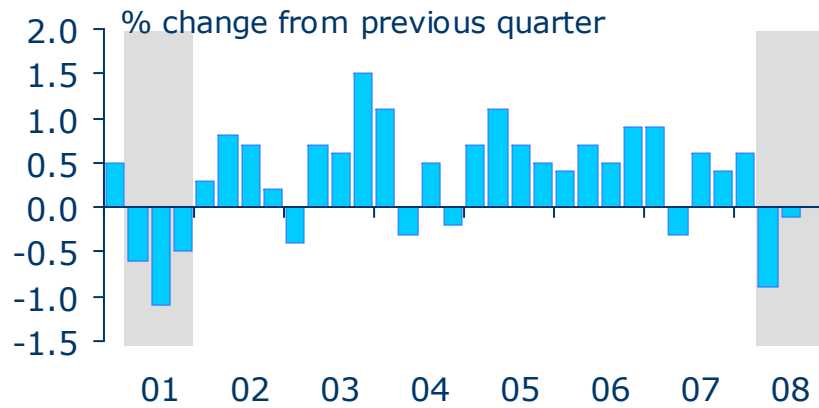
Sources: UK Office of National Statistics; Confederation of British Industry; Eurostat; HBoS.



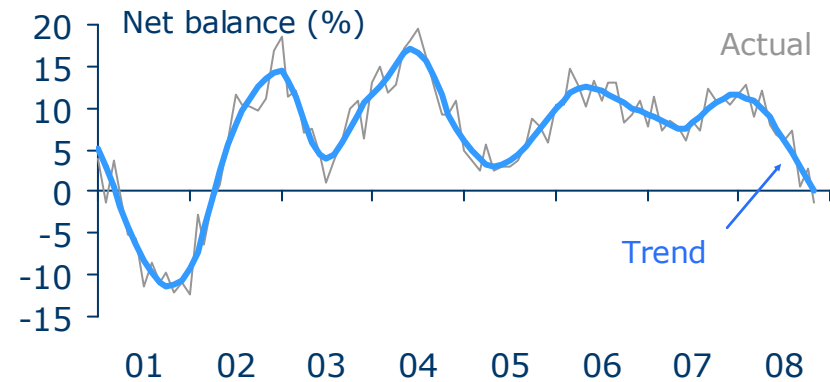
Japan's economy has entered recession even though its banks have very little exposure to the global credit crisis

Japan

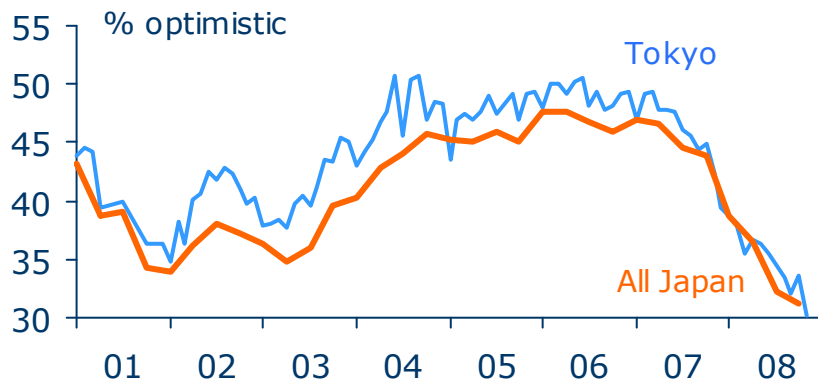
Real GDP



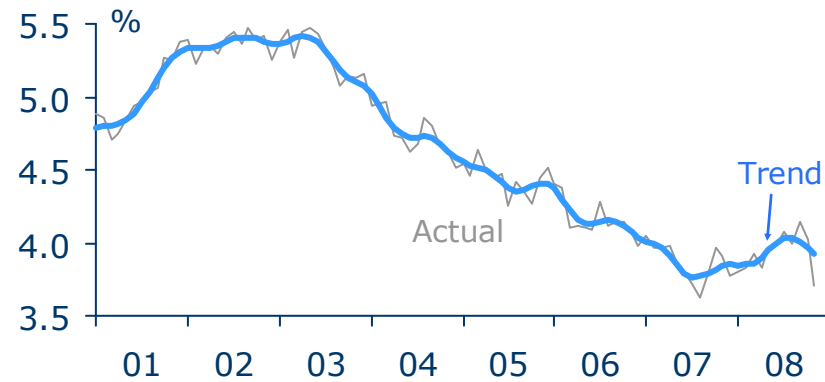
Export volumes



Consumer confidence



Unemployment



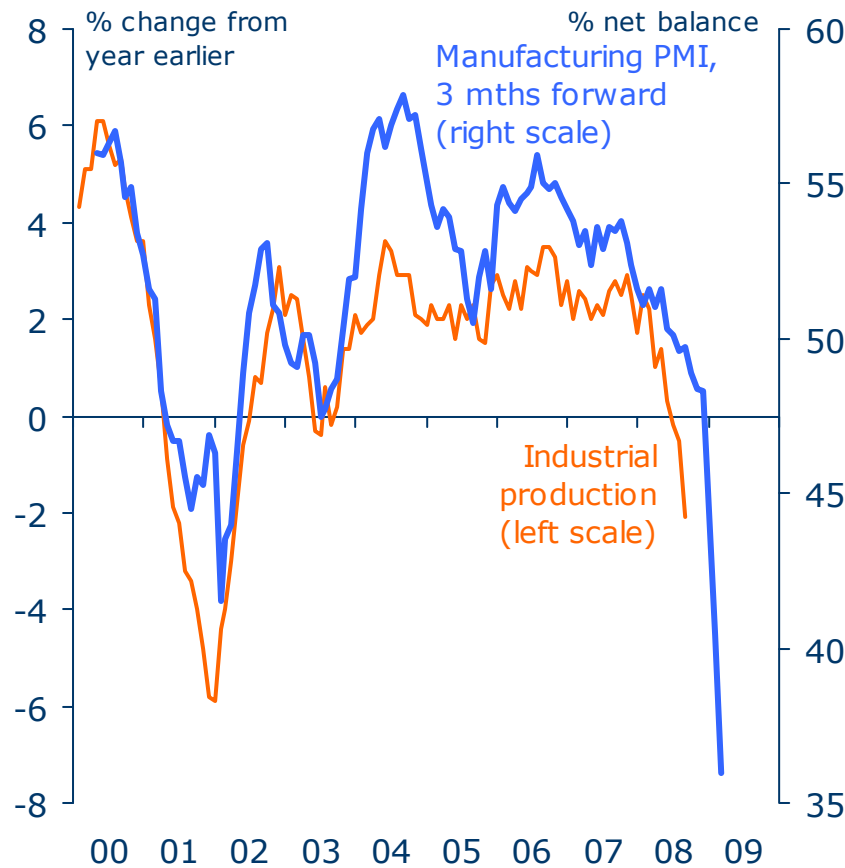
Sources: Japan Economic & Social Research Institute; Ministry of Economy, Trade and Industry; Japan Home Ministry.



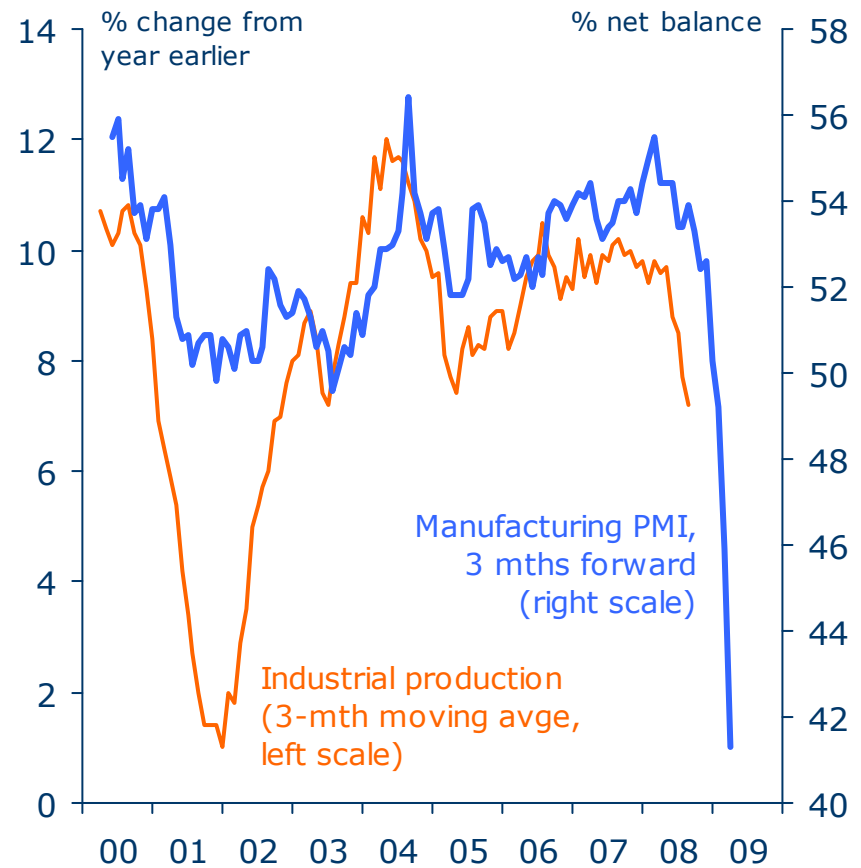
Industrial production is declining in Western countries and also set to slow sharply in developing and emerging economies

Manufacturing purchasing indices (PMIs) and industrial production

Advanced economies



Developing economies



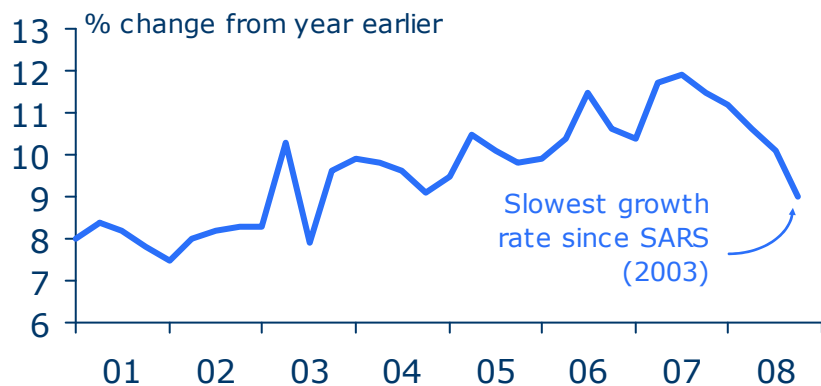
Sources: IMF World Economic Outlook October 2008 database; updated by ANZ Economics & Markets Research.



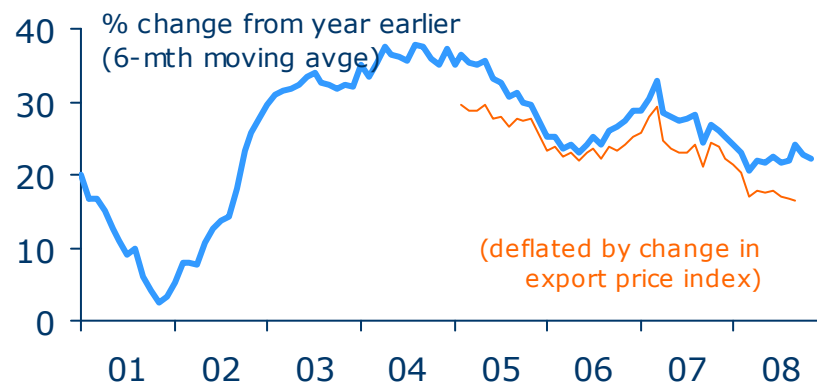
China's economy is slowing, reflecting slower export growth and an internal property slump ²⁹

Chinese economic indicators

Real GDP growth



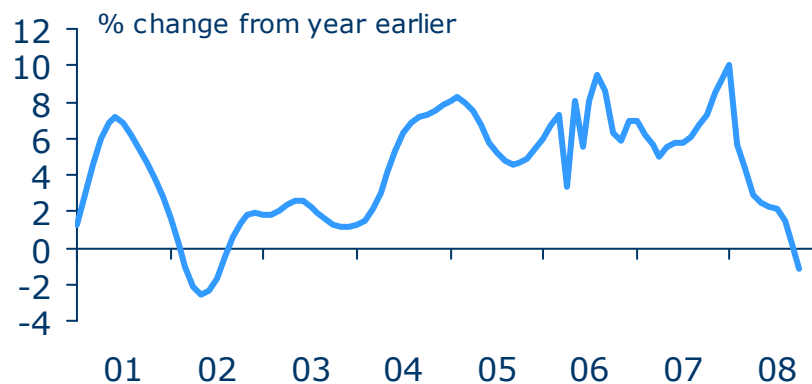
Exports



Industrial production



Real estate prices



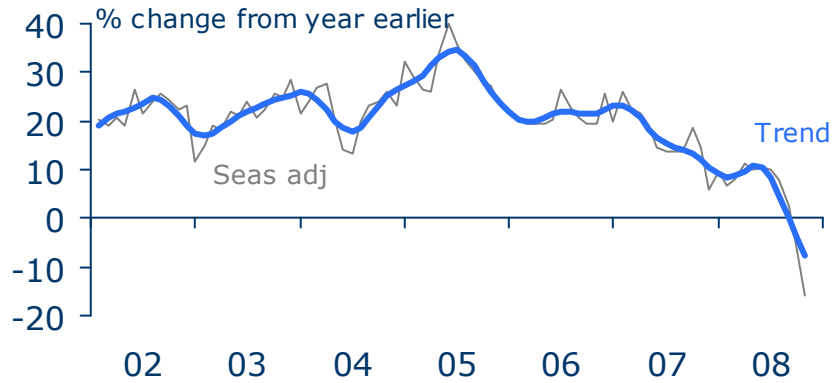
Source: China National Statistics Bureau; ANZ.



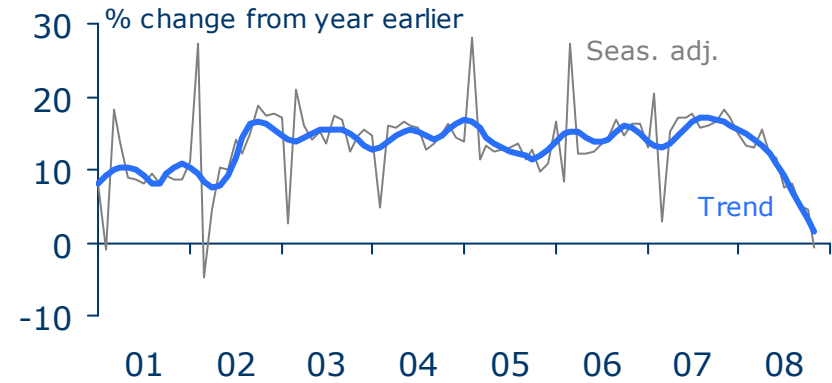
Industry indicators provide a starker indication of the slowdown in China's economy ³⁰

Chinese industry indicators

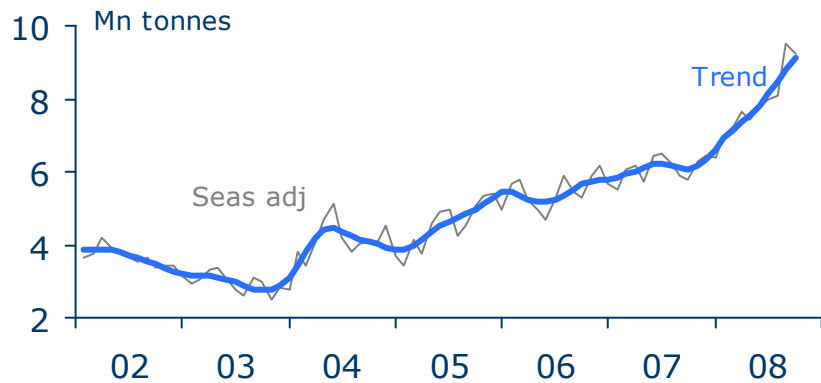
Crude steel production



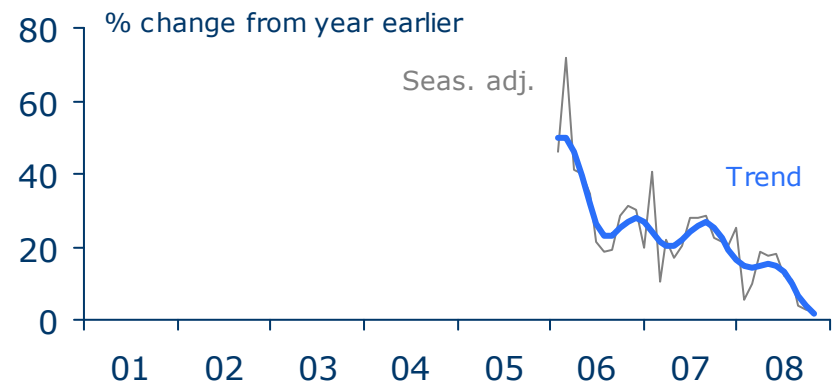
Electricity generation



Steel product inventories



Motor vehicle production



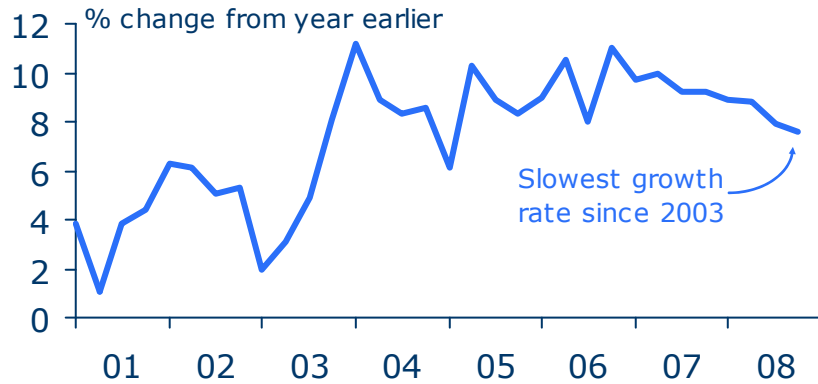
Sources: China Steel Industry Association; China National Statistics Bureau; China Association of Automobile Manufacturers; CEIC. Seasonal adjustment and trend series by ANZ using DX.



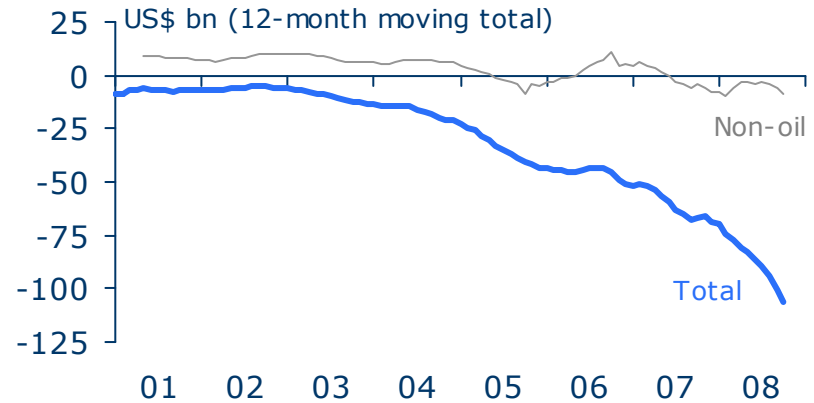
India's economy has also slowed, largely reflecting weaker household spending and a deteriorating trade performance

Indian economic indicators

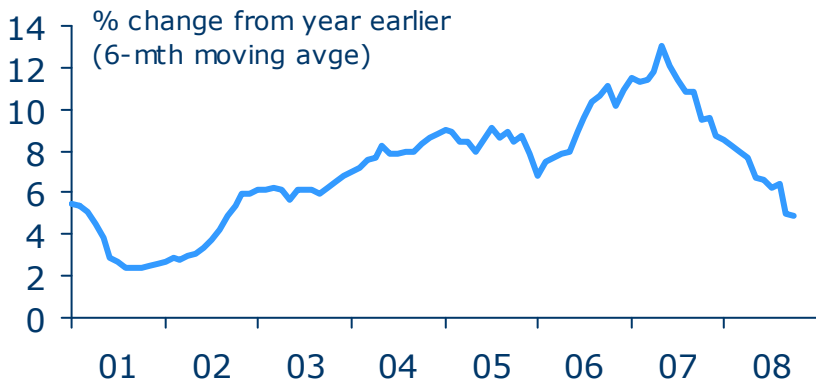
Real GDP growth



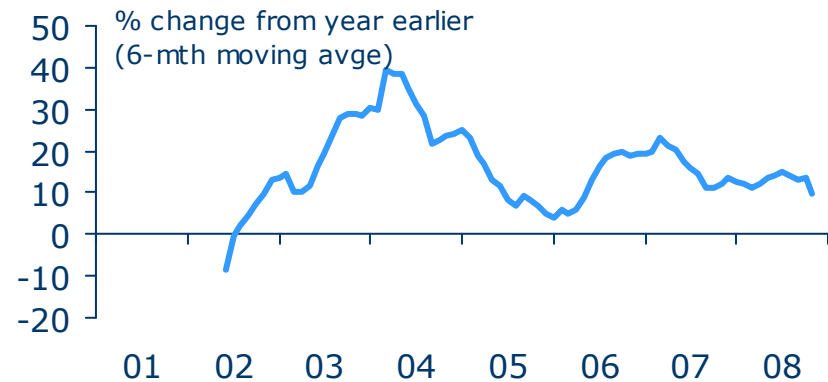
Merchandise trade



Industrial production



Motor vehicle sales

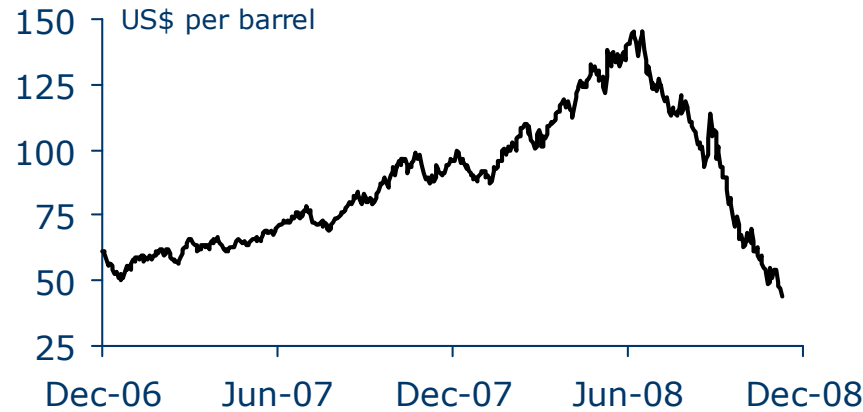


Source: Central Statistical Organization (CSO) of India; Society of Indian Automobile Manufacturers; RBI; CEIC; ANZ Economics & Markets Research.



Commodity prices have fallen reflecting declining demand, the unwinding of speculative trades and a stronger US dollar

Oil



Gold



Base metals



Wheat

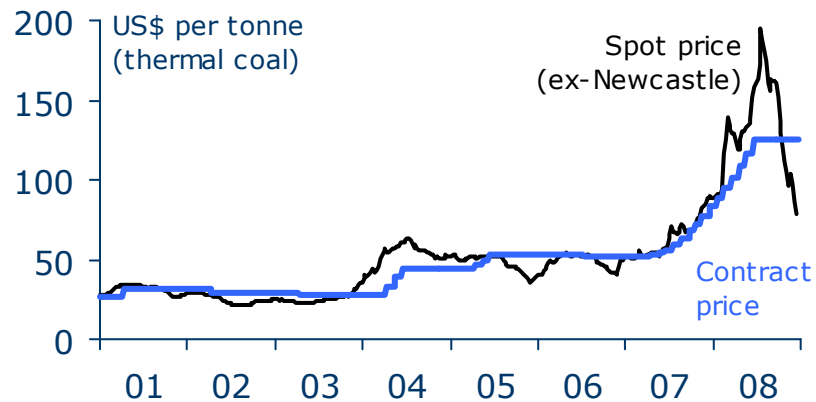


Sources: Bloomberg; Datastream.

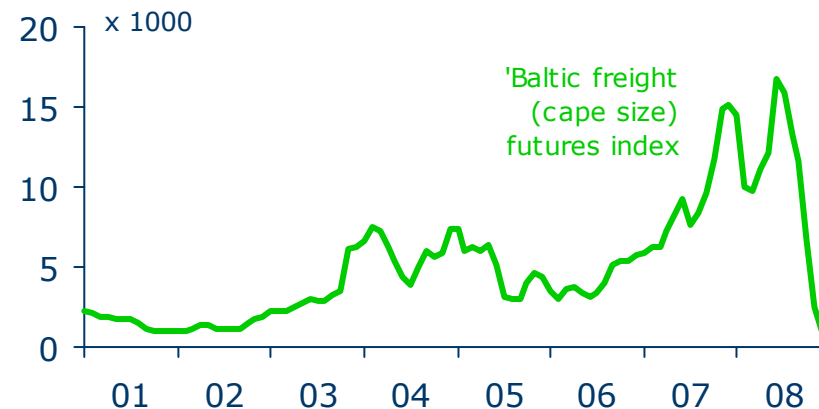


Spot prices for Australia's two largest commodity exports have fallen sharply in recent weeks and are likely to decline further

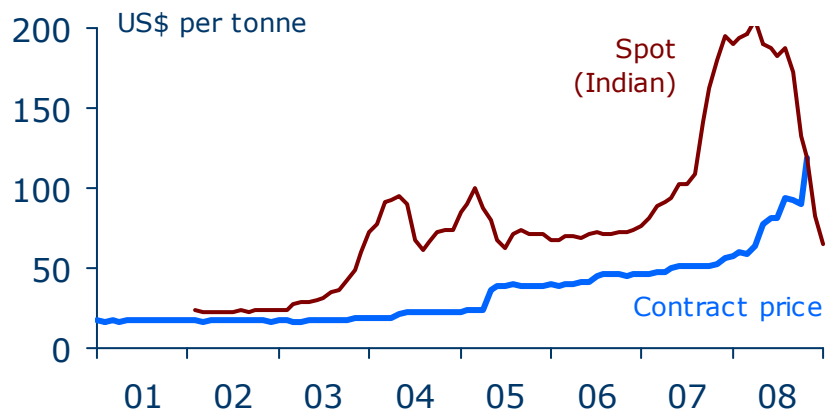
Coal prices



Bulk commodity shipping costs



Iron ore prices

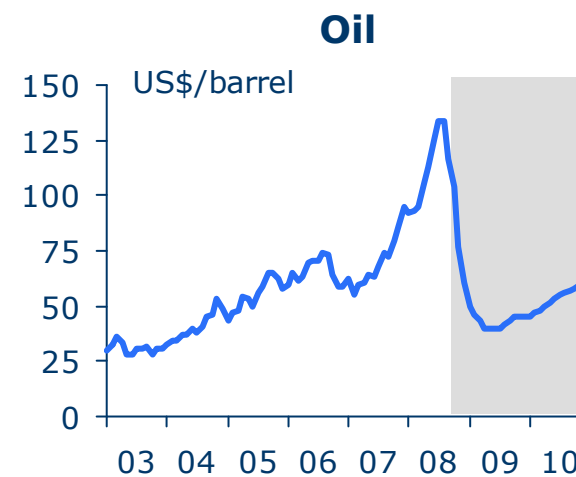
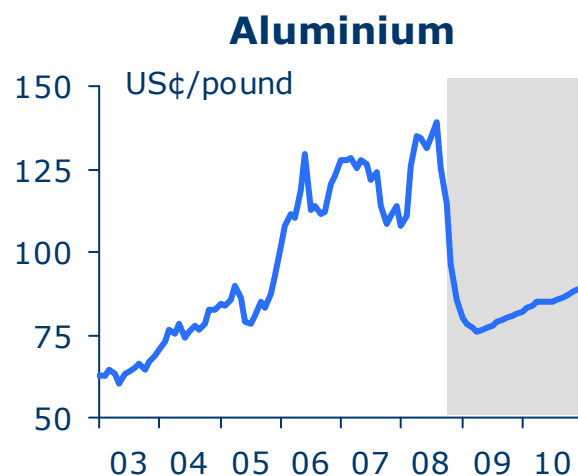
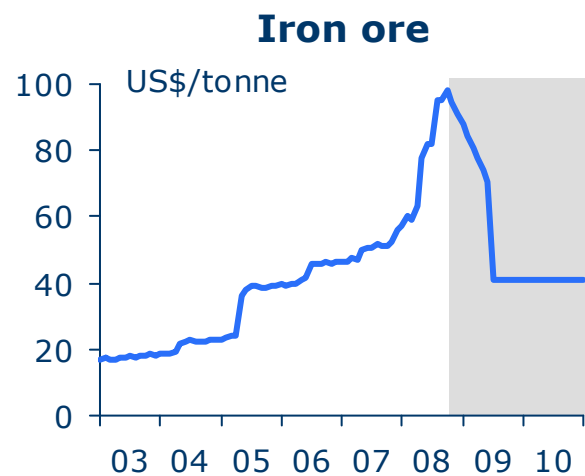
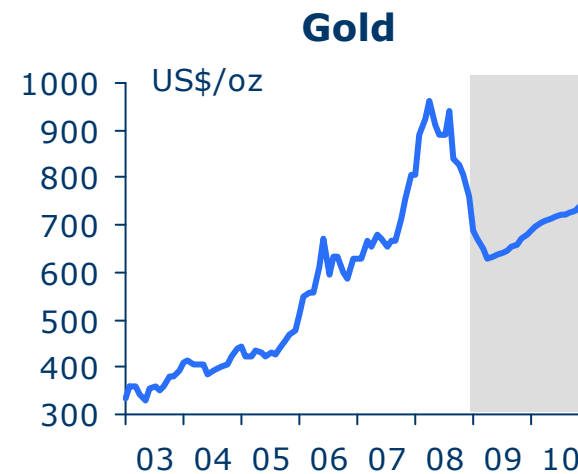
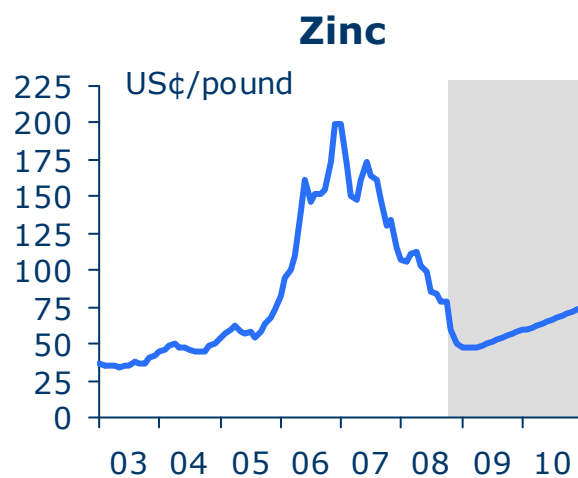
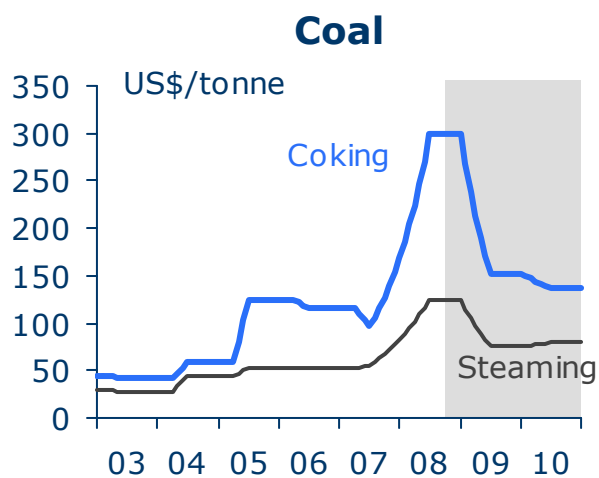


Sources: Datastream; Bloomberg; ANZ Economics & Markets Research.



Commodity prices will fall further over the next 6-12 months though should remain strong by historical standards

Resource commodity prices



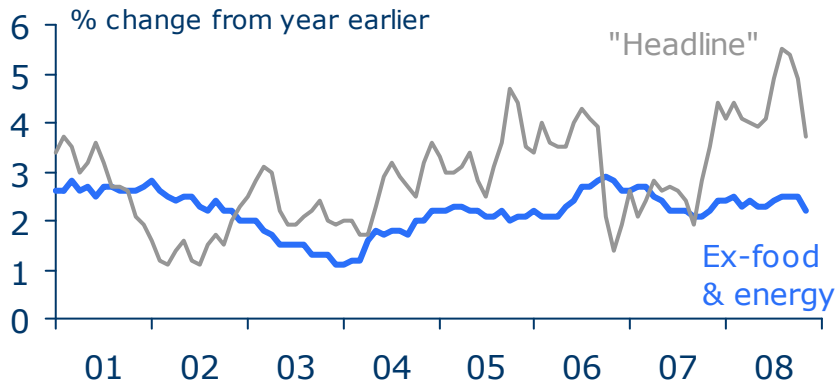
Sources: Thomson Financial; ANZ.



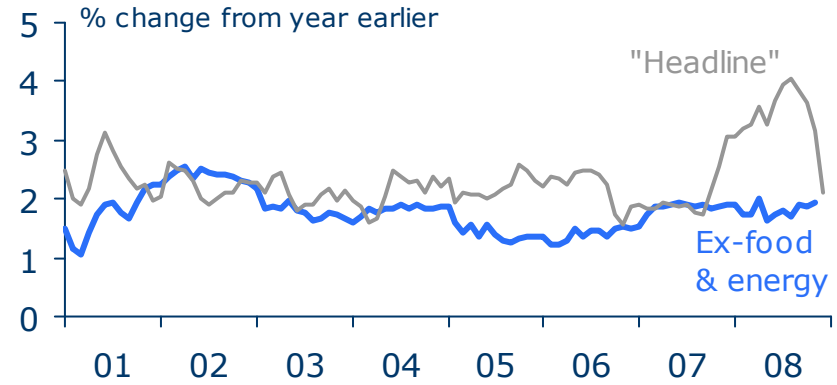
Headline inflation in the G7 economies has begun to come down rapidly, and 'core' inflation is also likely to fall significantly ³⁵

Consumer prices

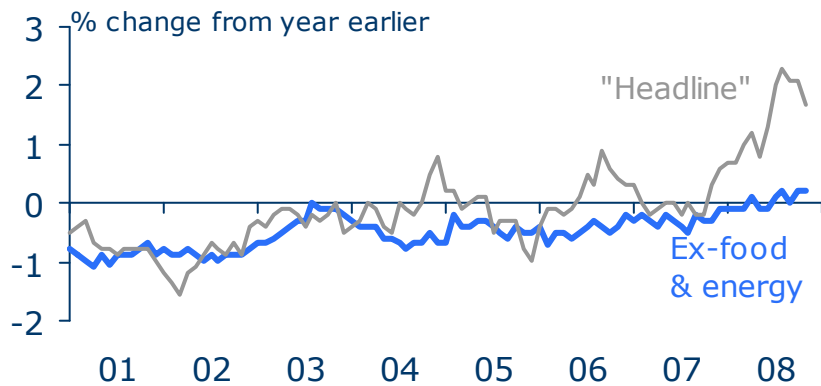
United States



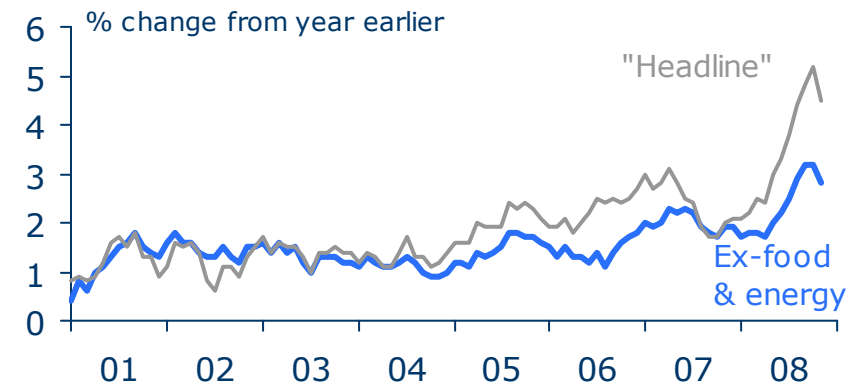
Euro area



Japan



United Kingdom



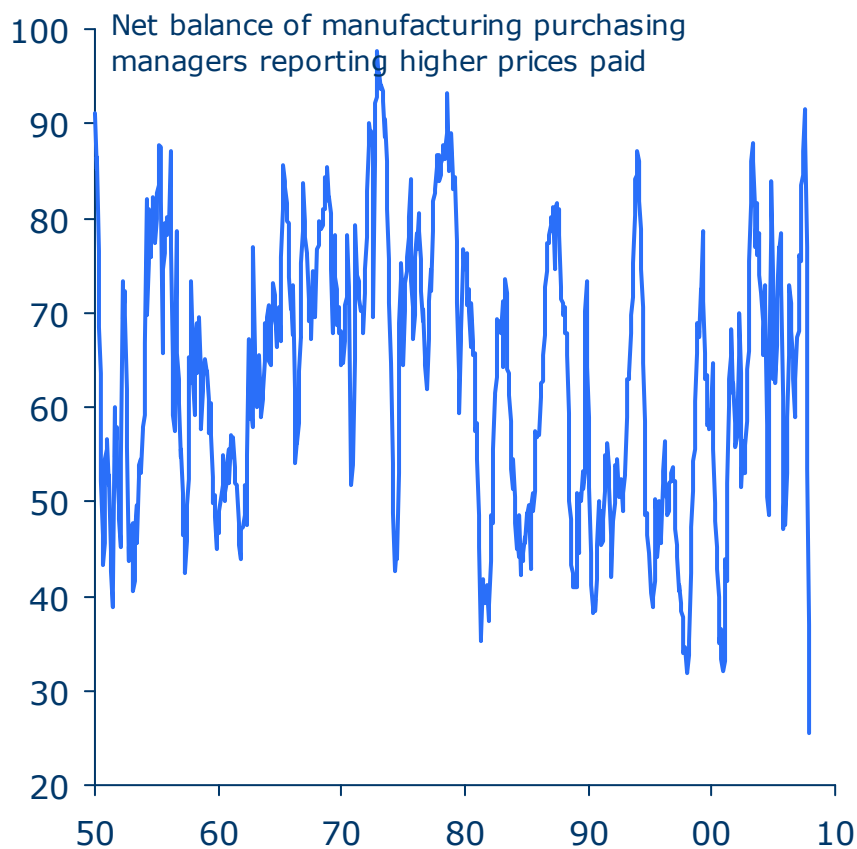
Sources: US Bureau of Labor Statistics; Eurostat; OECD.



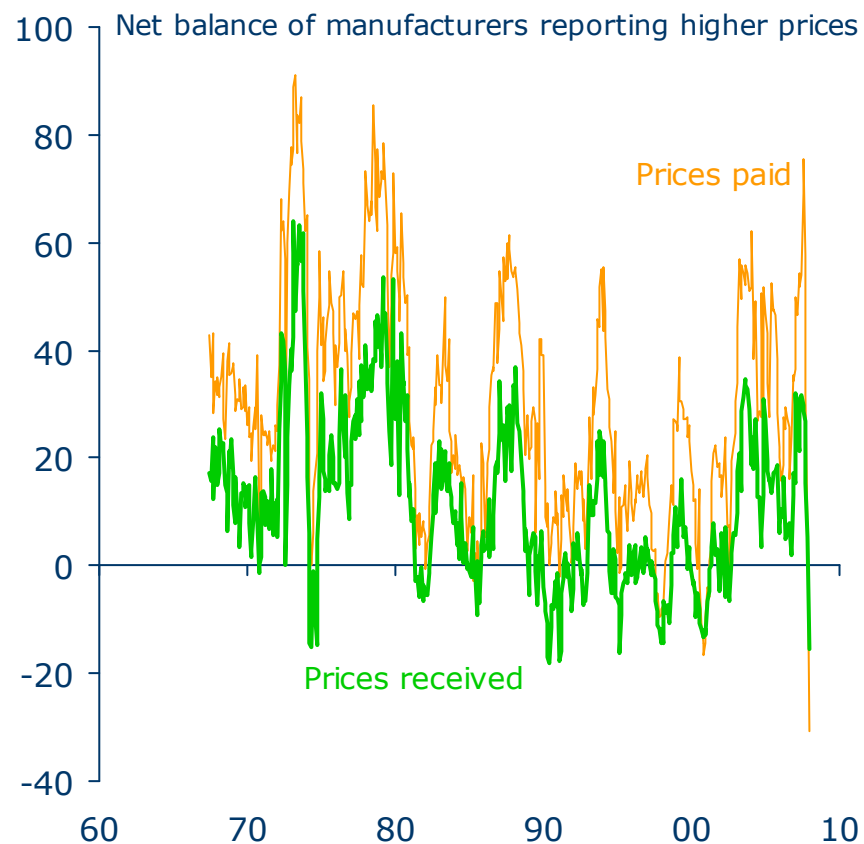
Indeed, a period of deflation is not out of the question in the United States

Survey-based measures of 'upstream' US price pressures

Purchasing managers' survey prices paid



Philadelphia Fed survey prices paid and received



Note: The ISM survey is calculated as 50 + half the net balance of respondents reporting 'higher' or 'lower' while the Philadelphia Fed is calculated as the difference between those reporting 'higher' or 'lower'.
Sources: US Institute of Supply Management; Federal Reserve Bank of Philadelphia.



Inflation has also peaked in much of the developing world (with one or two exceptions such as India)

Major developing economies – consumer prices

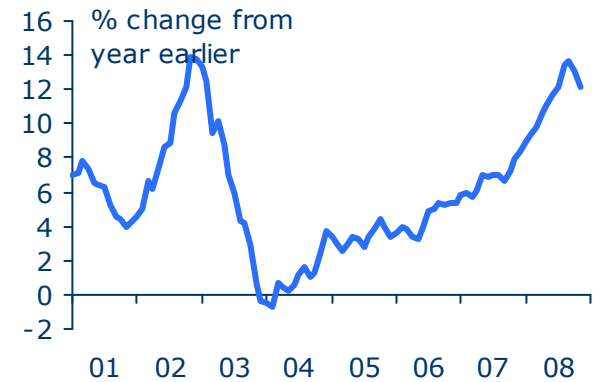
China



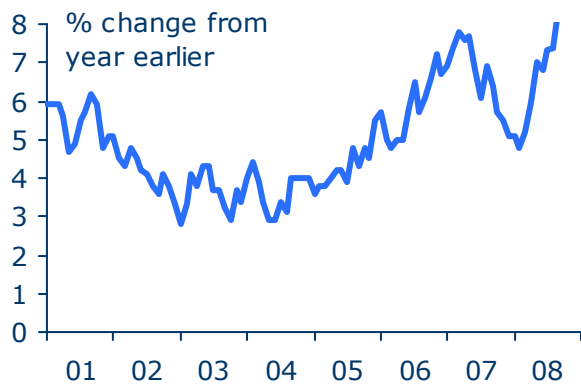
Other East Asia



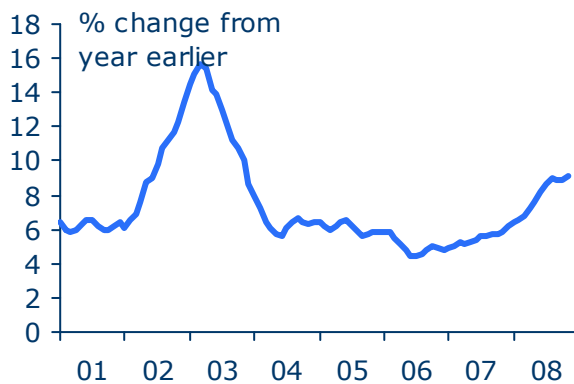
South Africa



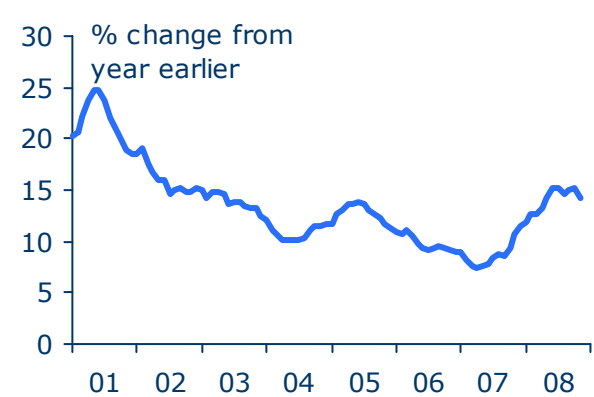
India



Latin America



Russia

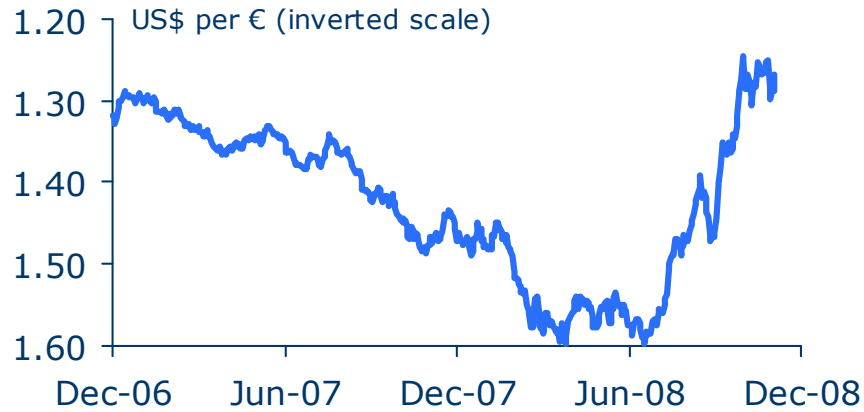


Sources: national statistical agencies; ANZ.

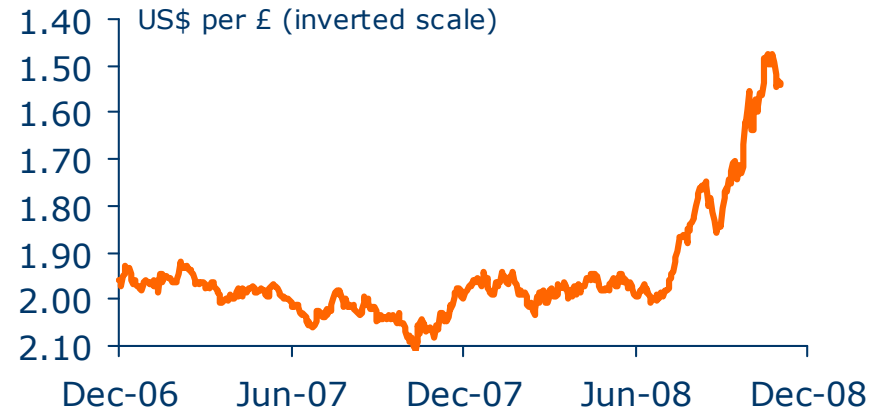


The US\$ and ¥ have risen since July, reflecting the hoarding of US\$ and unwinding of leveraged positions and 'carry trades' 38

US dollar vs euro



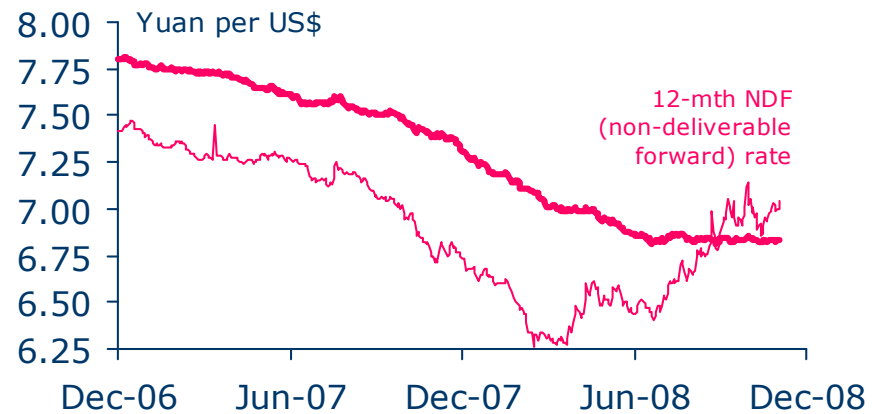
US dollar vs British pound



US dollar vs yen



US dollar vs yuan



Source: Datastream.

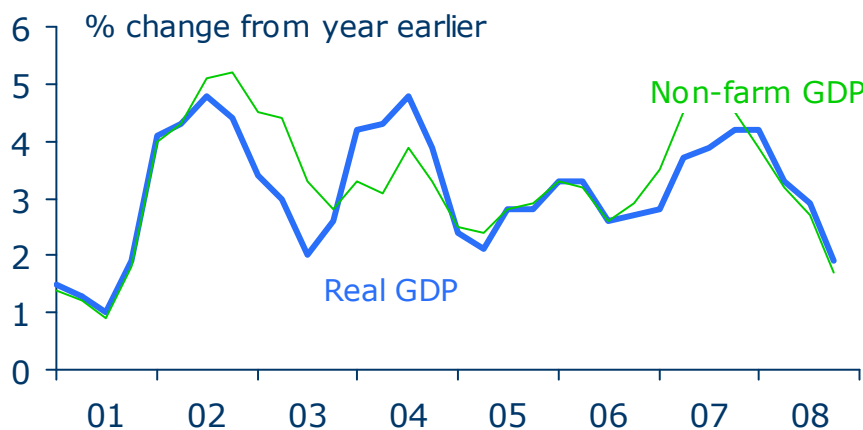


Australia's economy had slowed significantly before the global downturn began in earnest

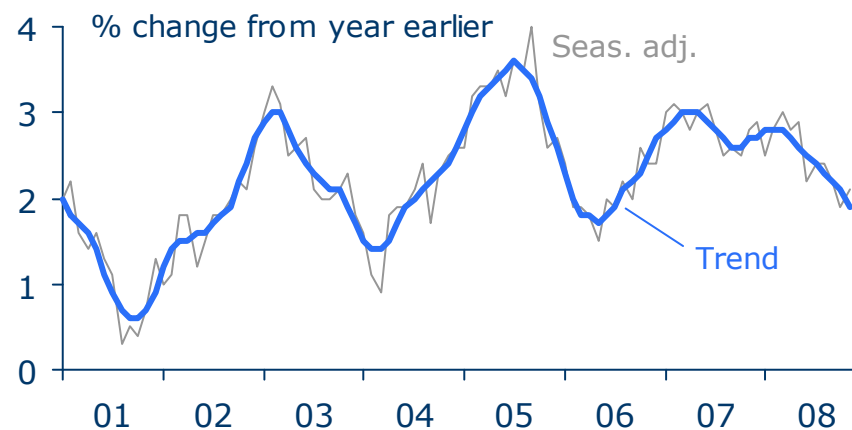
- The most recently released national accounts show that Australia's economy had already slowed significantly before the latest stage of the global financial crisis and ensuing economic downturn, reflecting the impact of the tightening of monetary policy up to March this year and rising fuel prices. Real GDP grew by just 0.1% in the September quarter (and non-farm GDP actually contracted by 0.3%) – although real gross domestic income (GDI, which captures the impact of changes in relative export and import prices) rose by 1.4% (for annual growth of 6.4%), supporting continued growth in domestic demand (4% from a year earlier).
- The sharp turnaround in commodity prices will detract significantly from Australian national income growth, especially once bulk commodity (iron ore and coal) export prices fall sharply in the June quarter of next year. Real GDI may fall by 2% in 2009, even though real GDP growth is expected to remain marginally positive (at ½% on average).
- Australian house prices have softened, but have not fallen (and are not expected to fall) at anything like the rates experienced in the US or UK. Nonetheless, Australian households appear to be seeking to lift their saving and consumer spending is therefore likely to remain weak well into next year. The most recent surveys of business investment intentions (taken in October and November) were surprisingly robust, although capital spending plans are likely to be scaled back during 2009.
- Australia may well avoid recession, if defined as consecutive quarters of negative real GDP growth, if only because of the timing and magnitude of fiscal policy measures. However Australia is likely to experience recession defined as a rise in the unemployment rate of at least 1½ pc pts in 12 months or less during 2009, even though the relatively strong position of the corporate sector suggests that there is less need for mass retrenchments than during previous downturns.
- Despite the sharp fall in the A\$, inflation is likely to fall back into the RBA's 2-3% target range more quickly than previously foreseen (note that the RBA has a contrary view).
- The RBA has responded decisively to the dramatic shifts in economic prospects, reversing in three months the tightening of monetary policy implemented over the preceding six years. The cash rate is likely to fall further, to 3½% or lower, over the first half of 2009.
- The A\$ will likely depreciate further (to ~ US55¢) during 2009 as commodity prices fall further and the interest rate premium on A\$ assets erodes.

The Australian economy had been slowing since late 2007, although income growth remained strong and unemployment low

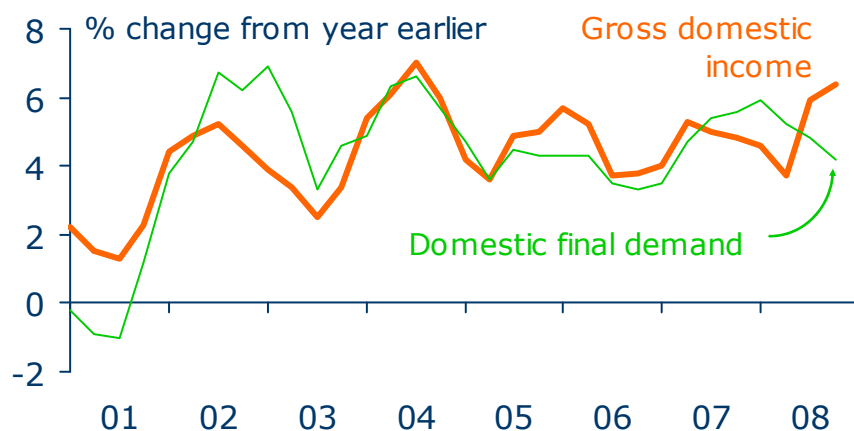
Real GDP growth



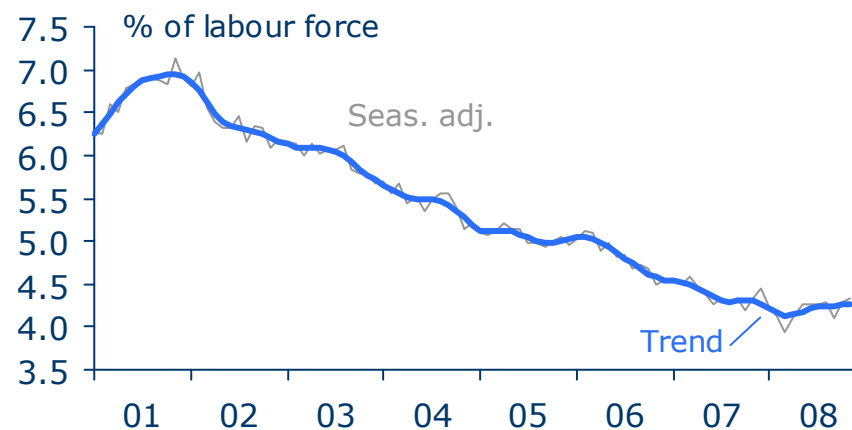
Employment



Real income and expenditure



Unemployment rate

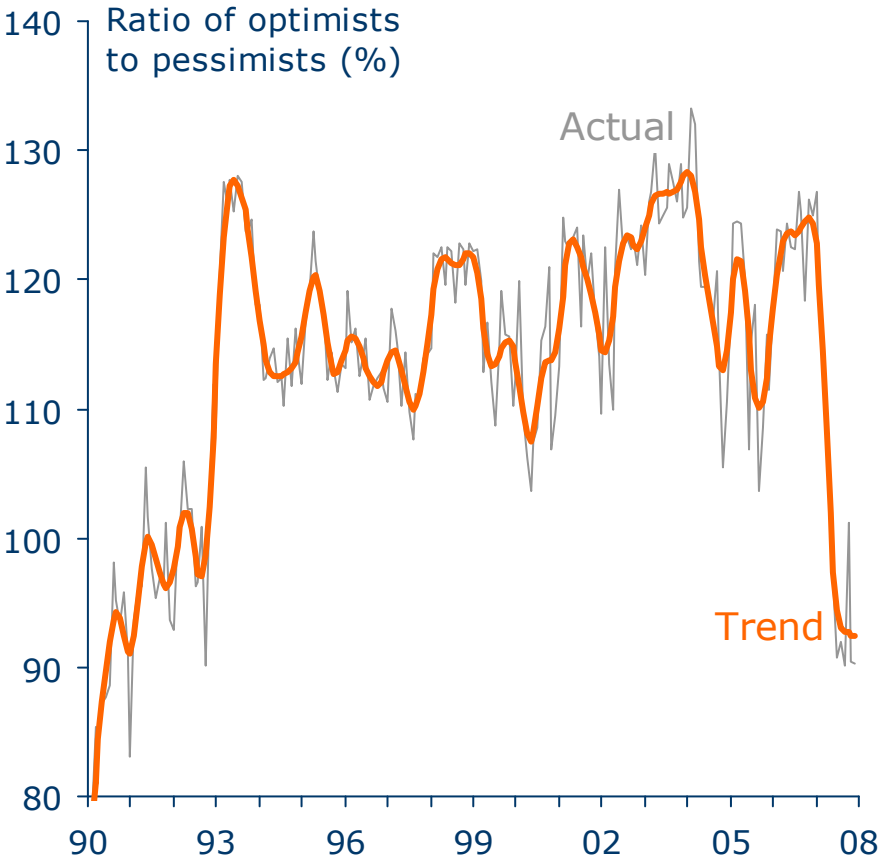


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

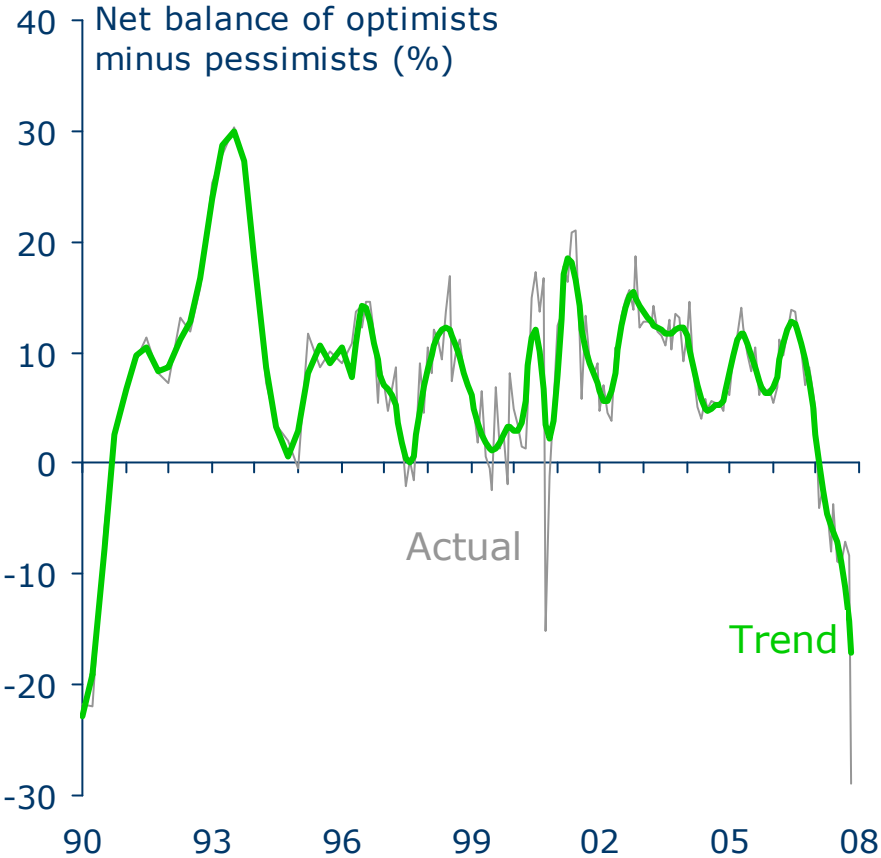


Consumer and business confidence have fallen sharply this year although both now seem to be stabilizing (for now, anyway) ⁴¹

Consumer confidence



Business confidence

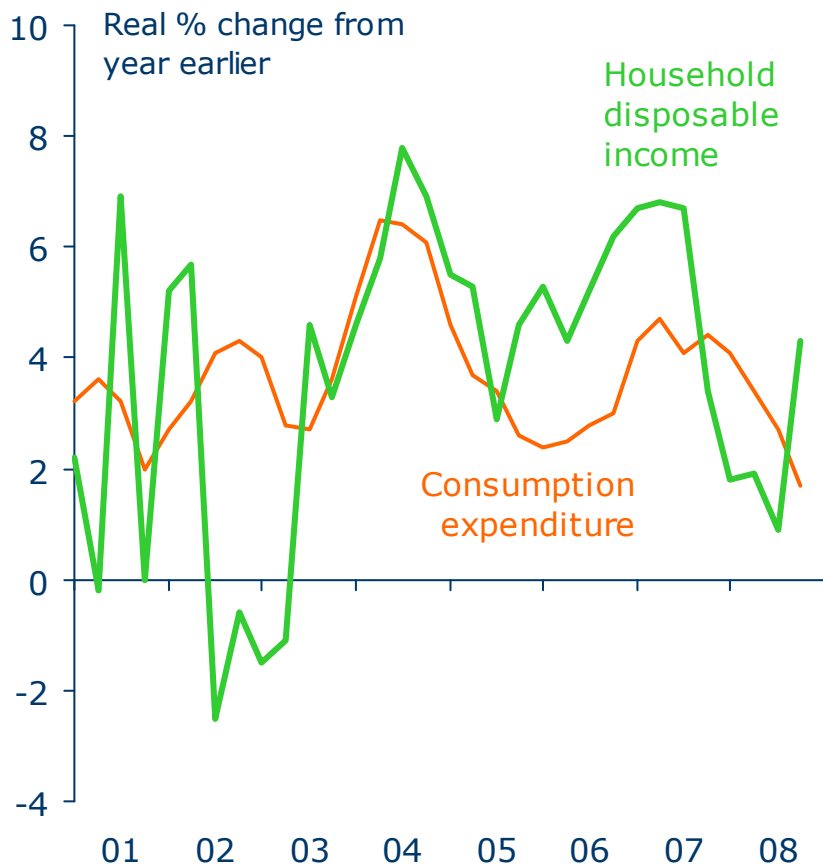


Sources: Roy Morgan Research; National Australia Bank; ANZ

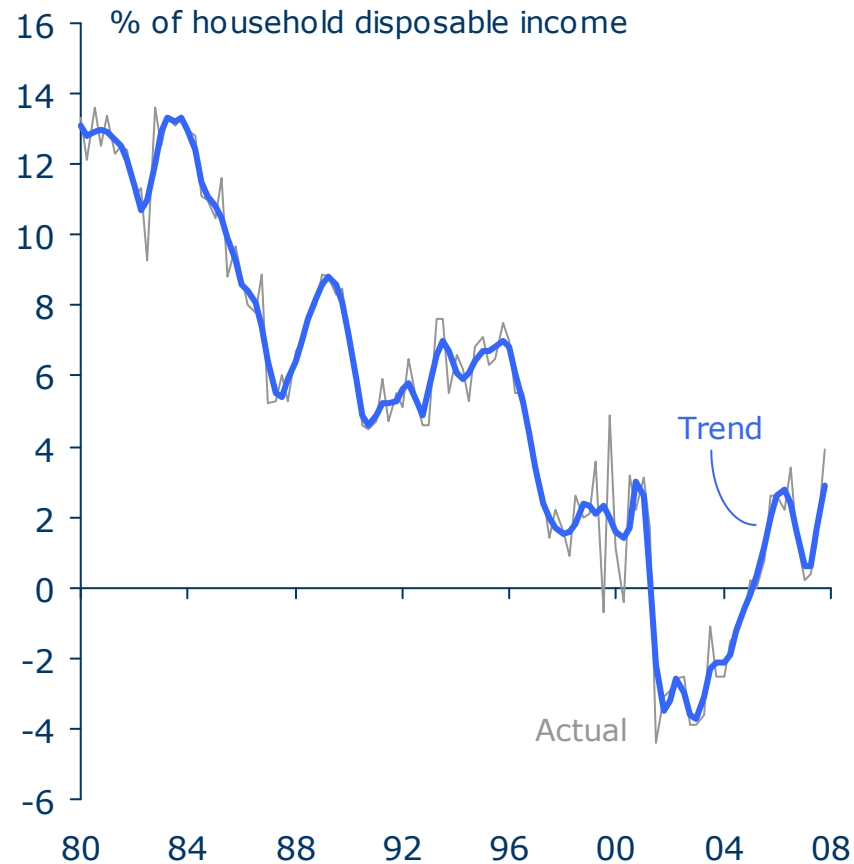


Households are responding to declining wealth by lifting saving – to its highest level (as a proportion of income) in a decade

Household income and spending



Household saving

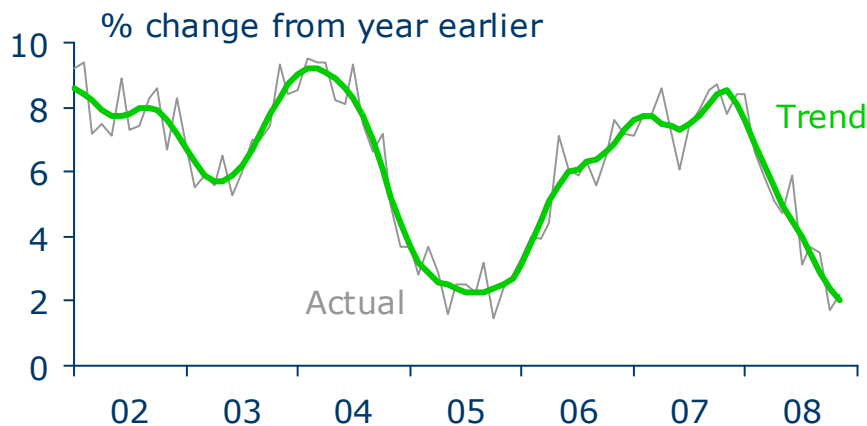


Sources: Australian Bureau of Statistics; ANZ.

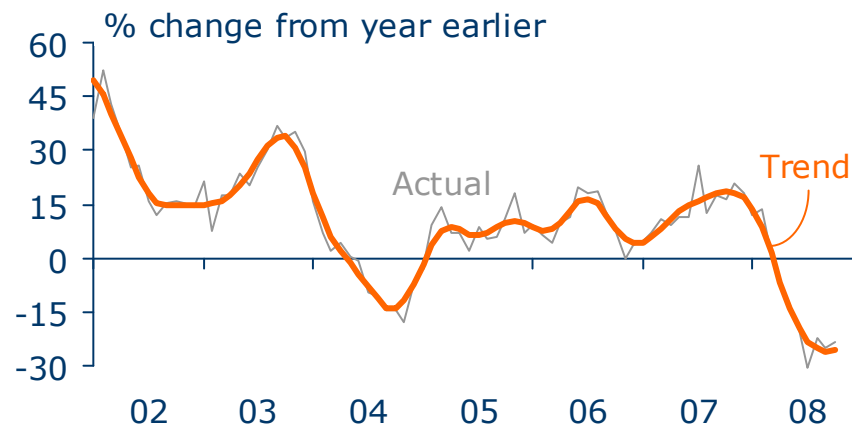


Household spending and borrowing, and housing activity, have both slowed sharply over the past six months

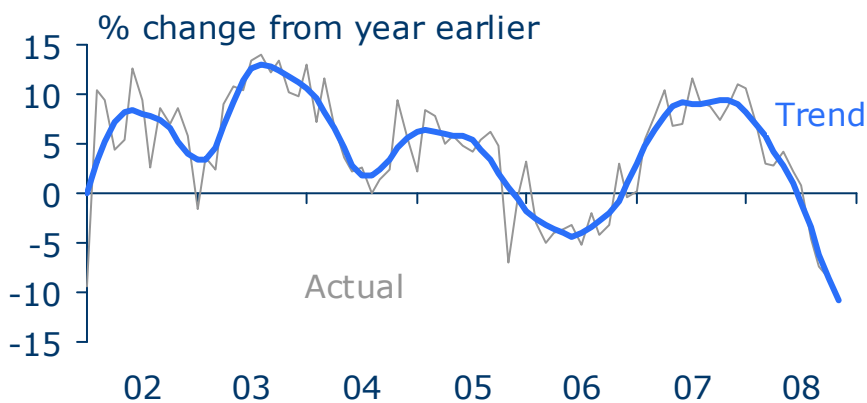
Retail sales



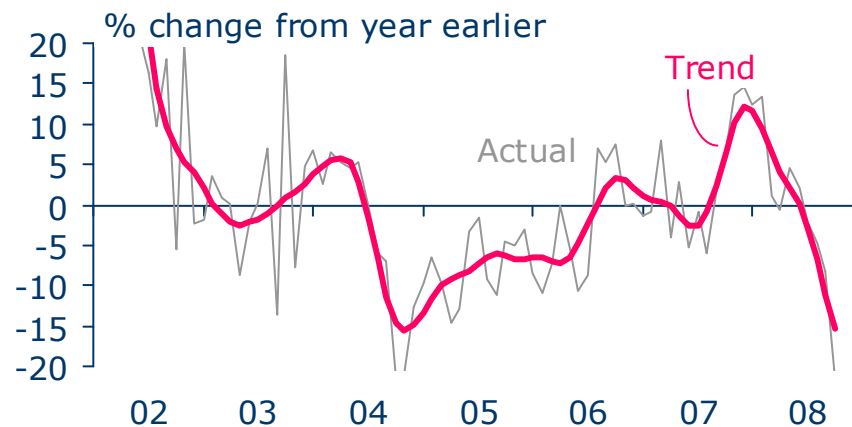
Housing finance commitments



Motor vehicle sales



Residential building approvals

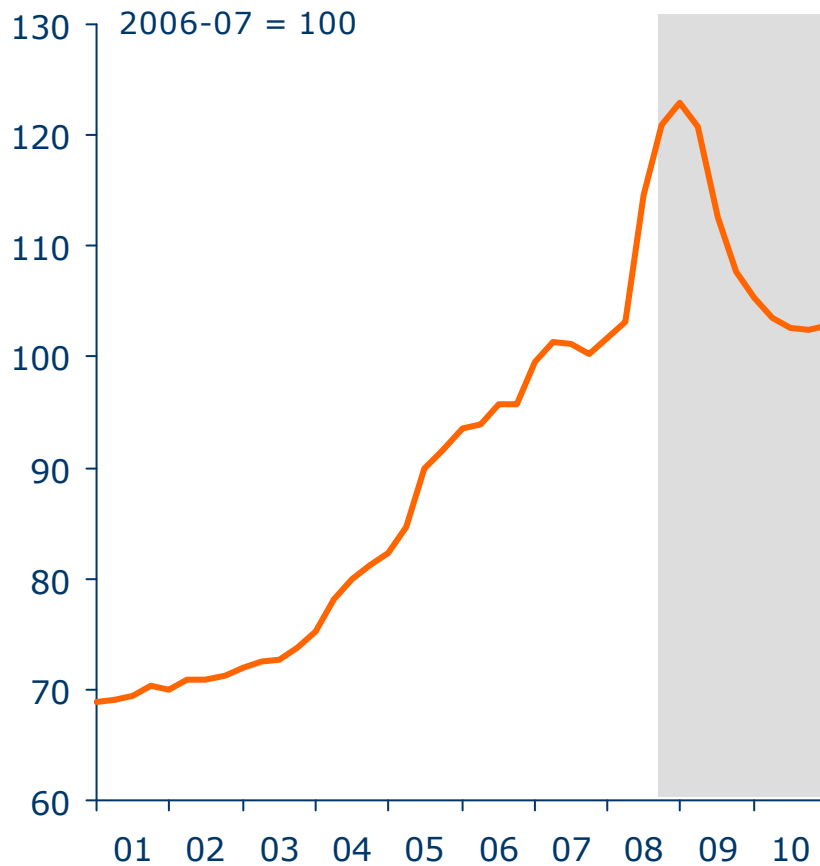


Sources: ABS; ANZ Economics & Markets Research.

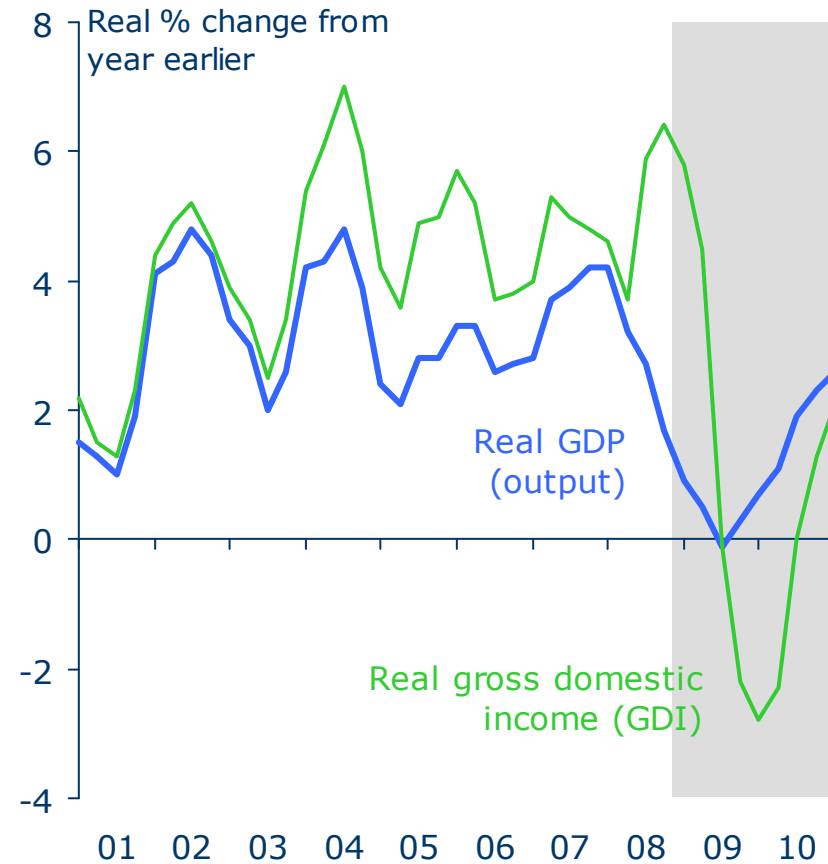


The sharp fall in commodity prices will detract substantially from Australian national income in 2009 ⁴⁴

Australia's terms of trade (ratio of export to import prices)



Real gross domestic income (GDI) and product (GDP)

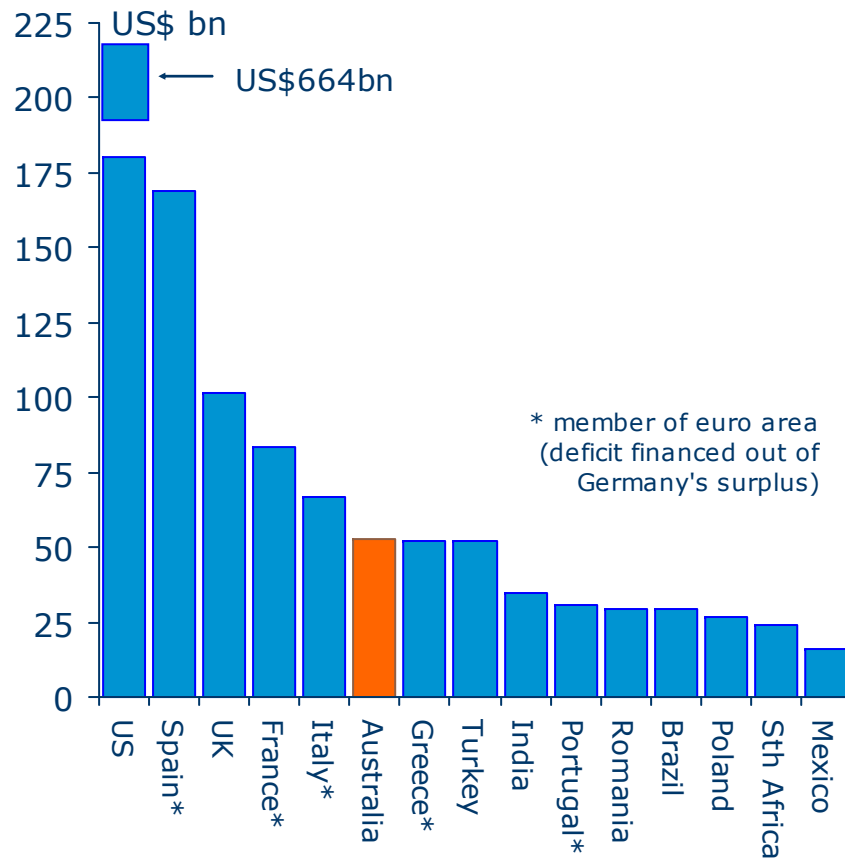


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

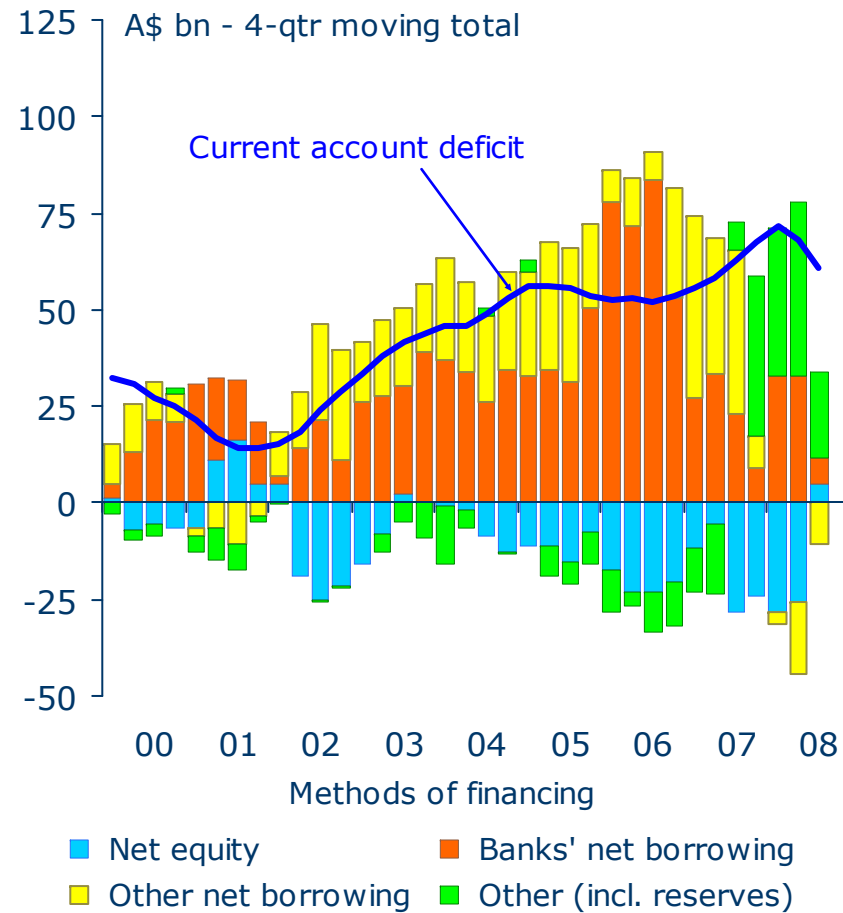


Australia is also exposed to the global credit crunch because of the large external deficit and the way it has been financed

Current account deficits 2008



Financing Australia's current account deficit

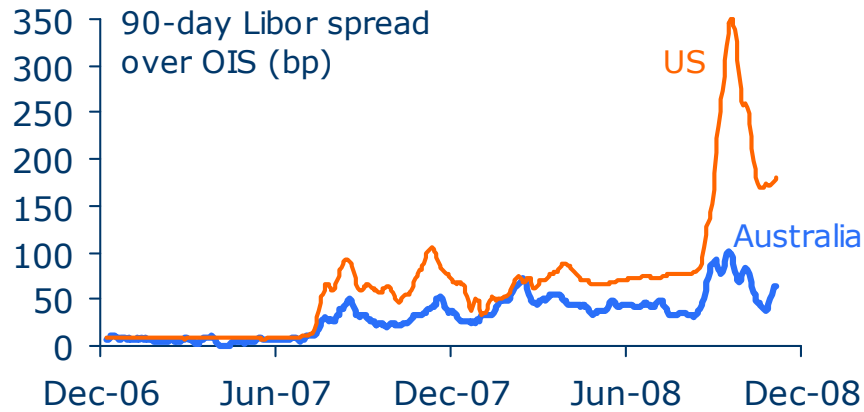


Sources: IMF World Economic Outlook (October 2008); ABS; ANZ. Note that apparently large movements in 'other (incl. reserves) in 2007-08 largely reflect the withdrawal of cash deposits at the RBA by the Future Fund; the RBA had invested these largely in US Treasuries, and they were reported as part of the RBA's official reserve assets.

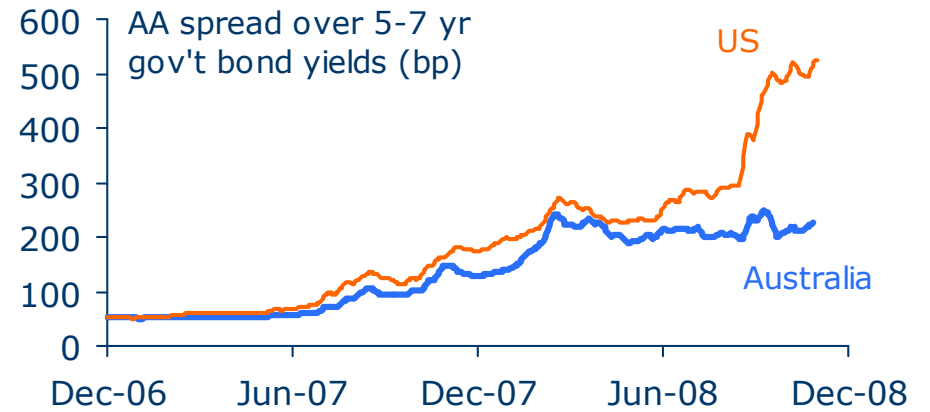


Hence Australian banks and securities markets have come under similar pressure to banks and markets overseas

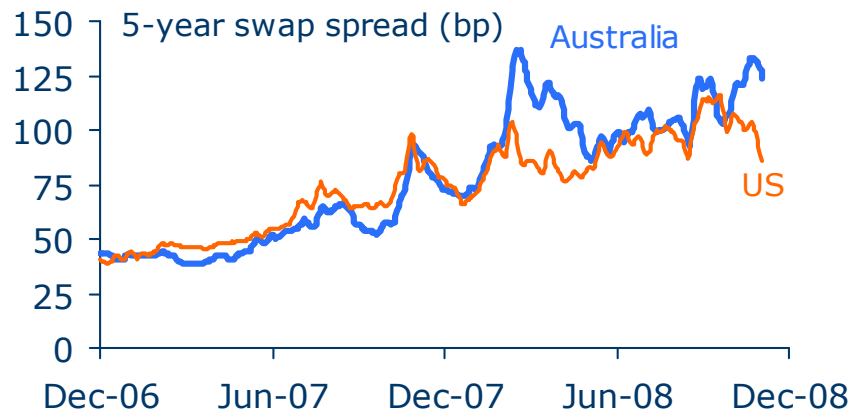
Banks' short-term funding costs



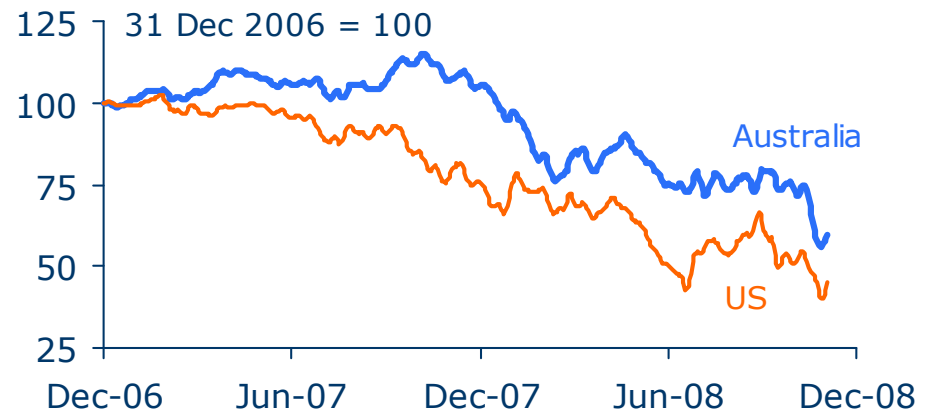
Corporate bond yield spreads



Banks' long-term funding costs



Bank share prices

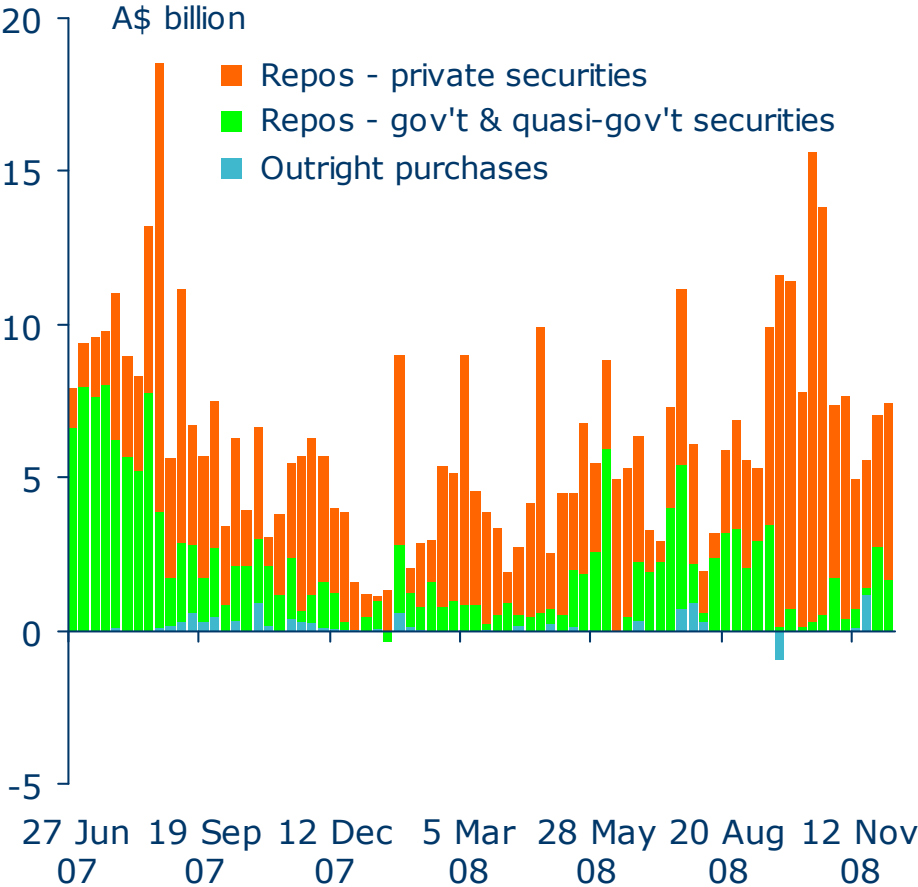


Note: all data shown as 5-day moving averages. Sources: Bloomberg; Datastream.

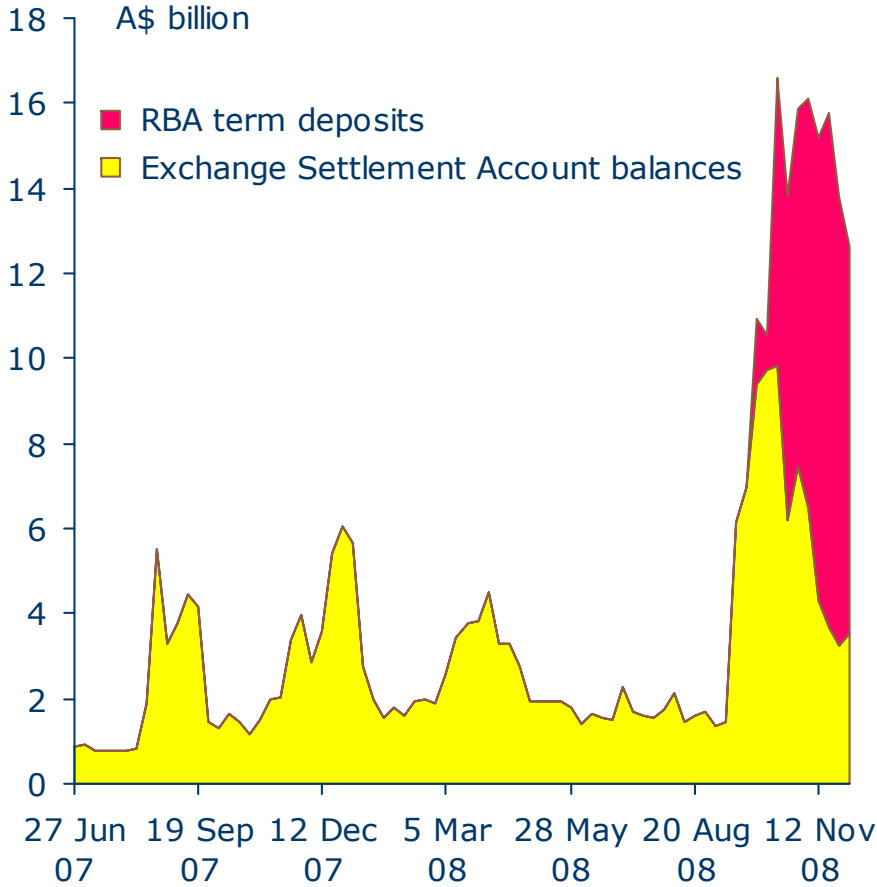


Like other central banks, the Reserve Bank of Australia has been expanding its balance sheet to support liquidity

RBA open market operations



Commercial bank deposits with the RBA



Source: RBA Statistical Bulletin and Weekly Statement of Liabilities and Assets.



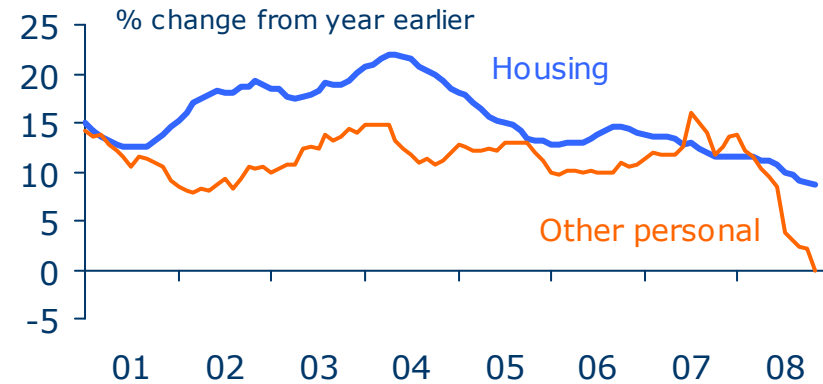
The 'credit crunch' plus the effect of higher interest rates on credit demand has led to a sharp slowdown in credit growth

Credit provided to the Australian private sector

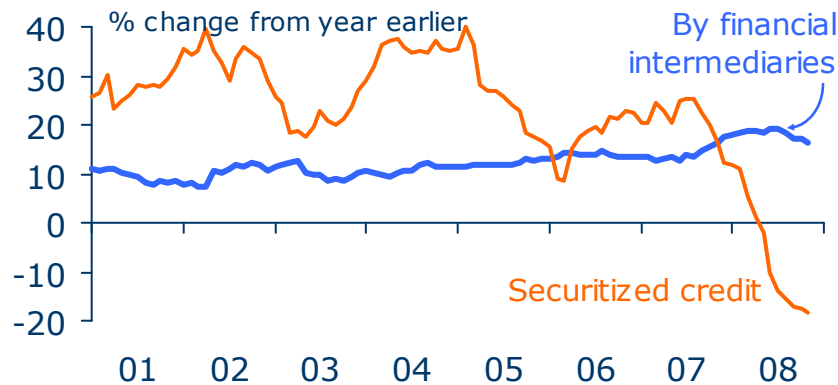
Total credit



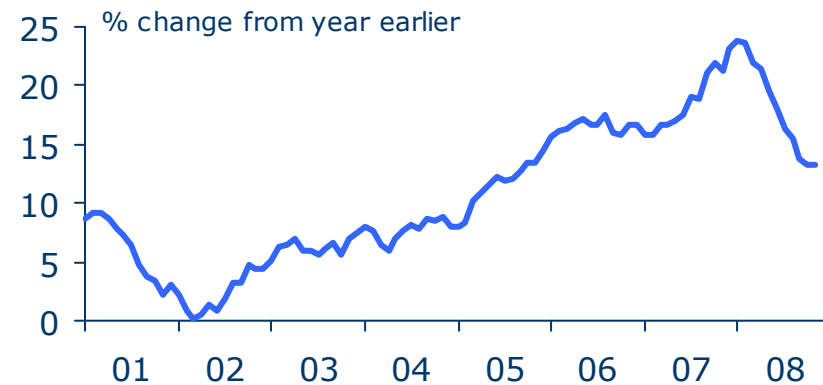
Credit to households



Credit by source



Credit to business



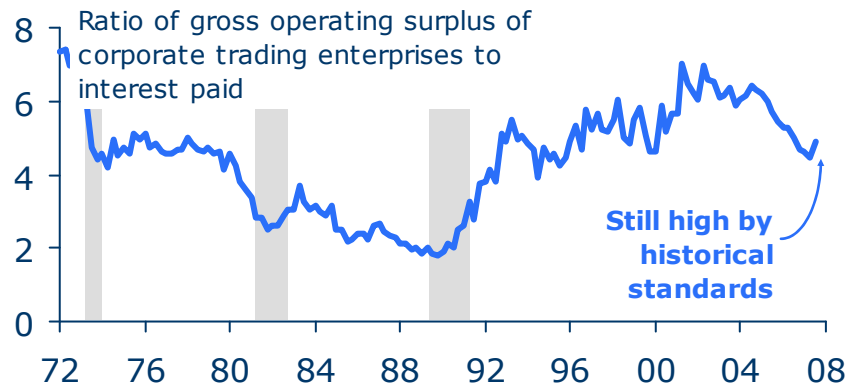
Source: Reserve Bank of Australia.



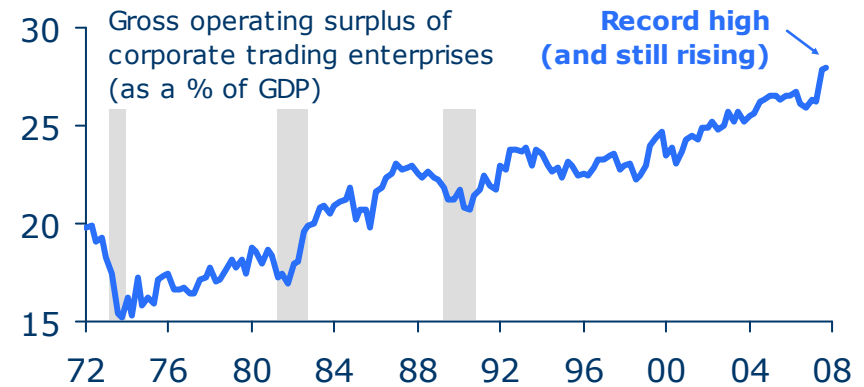
The corporate sector is (in general) in a strong financial position and doesn't need to cut labour costs aggressively ⁴⁹

Australian non-financial corporate sector finances

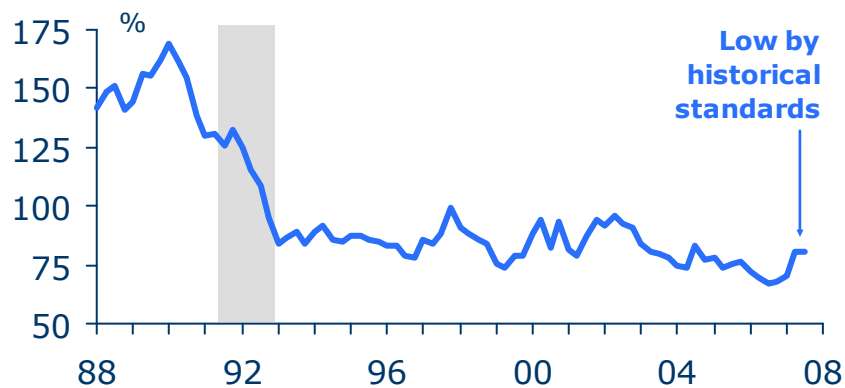
Interest cover ratio



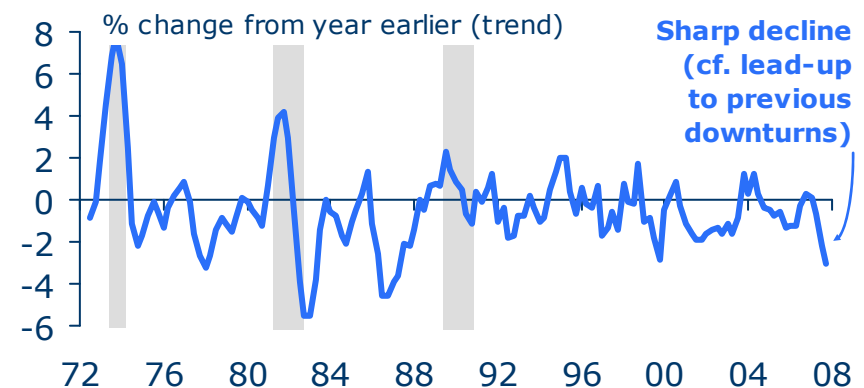
'Profit share' of national income



Debt-equity ratio



Real unit labour costs



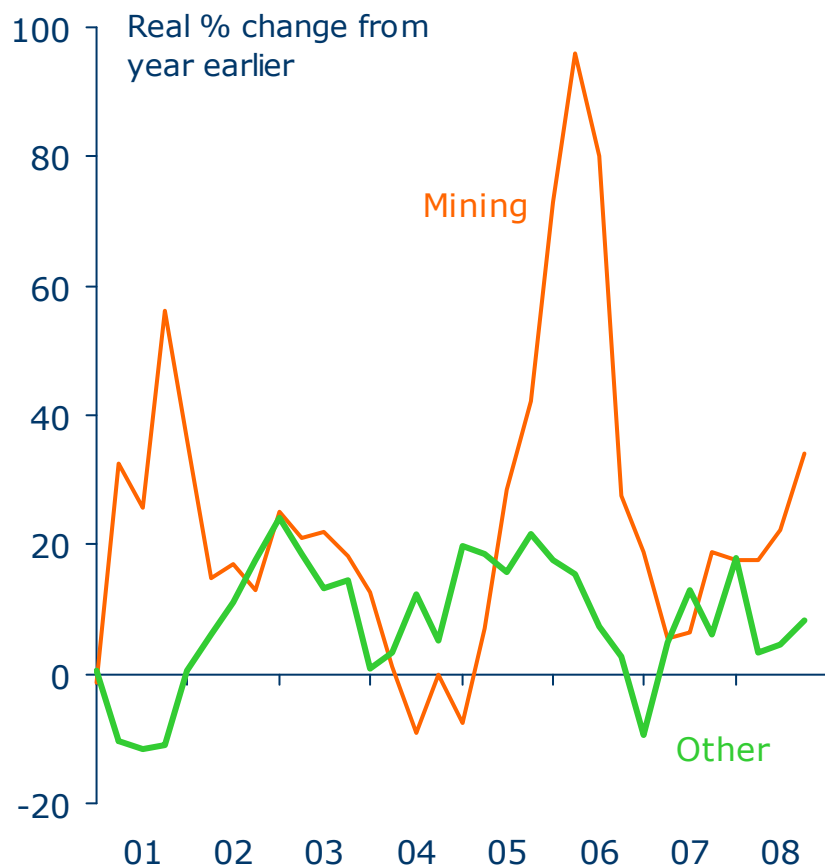
Note: Shaded areas denoted recessions.

Sources: Australian Bureau of Statistics; Reserve Bank of Australia; ANZ.



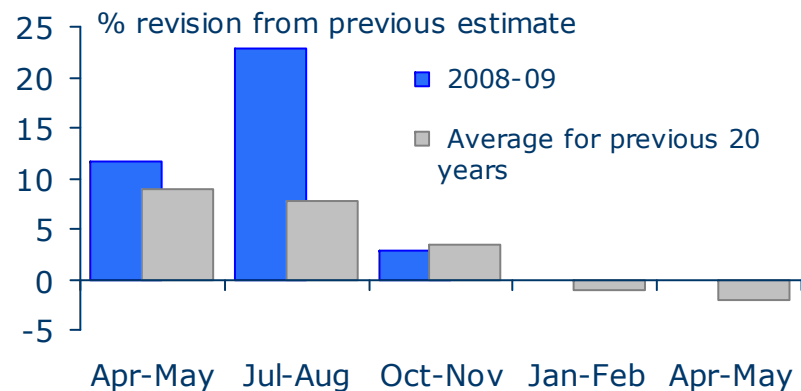
Business capital expenditure expectations have remained remarkably strong, even into October-November

Business new fixed capital expenditure

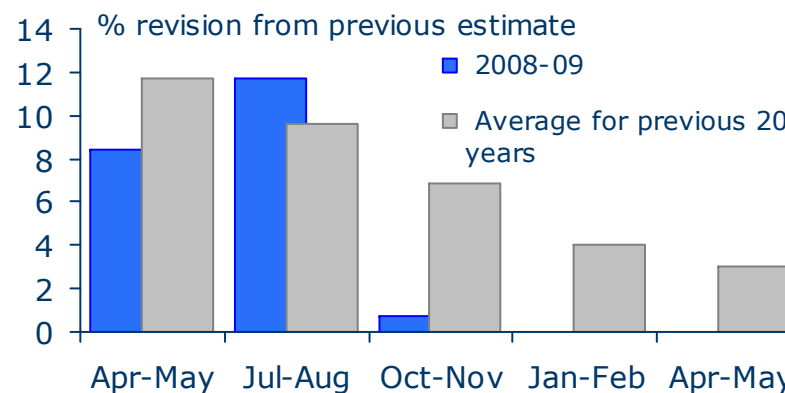


Capital expenditure expectations

Mining



Other



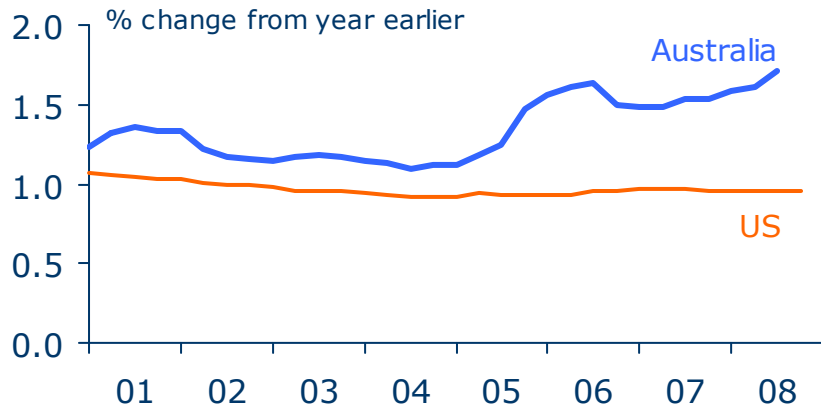
Note: The ABS survey of business capital expenditure expectations taken after the end of each quarter produces six sets of expectations for each financial year. The charts on the right show the extent to which these estimates have been revised in successive surveys, in 2008-09 and on average over the past 20 years.

Sources: ABS; ANZ.

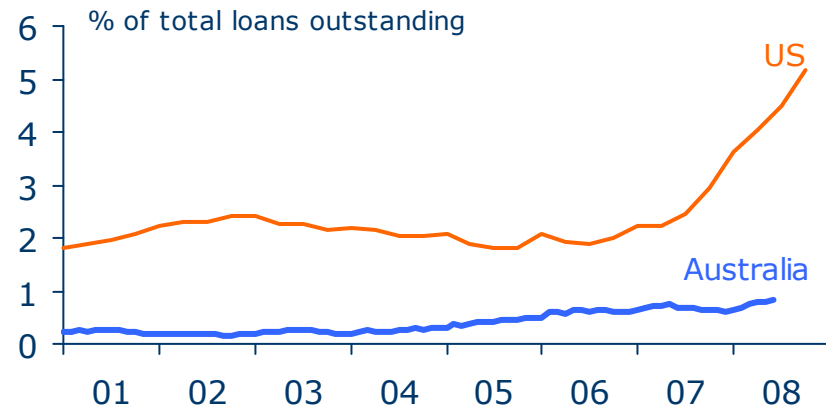


Australia's housing market has clearly softened but it won't become as dire as America's unless unemployment rises sharply

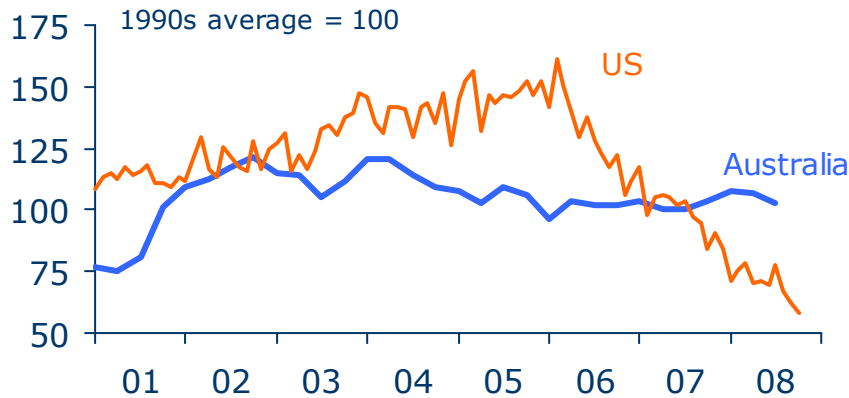
Population growth



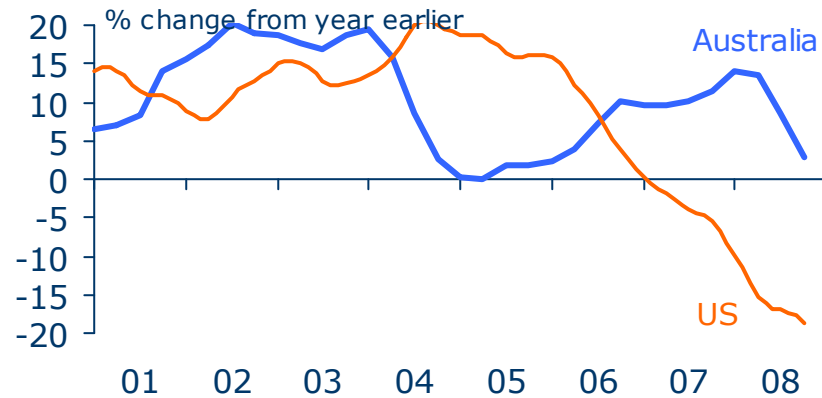
Mortgage delinquency rates*



Housing commencements



House prices



* 90 days or more past due. For Australia, securitized mortgages only (including on-balance sheet mortgages would result in a lower figure). Sources: ABS; US Commerce Department; S&P; Mortgage Bankers' Association of America.



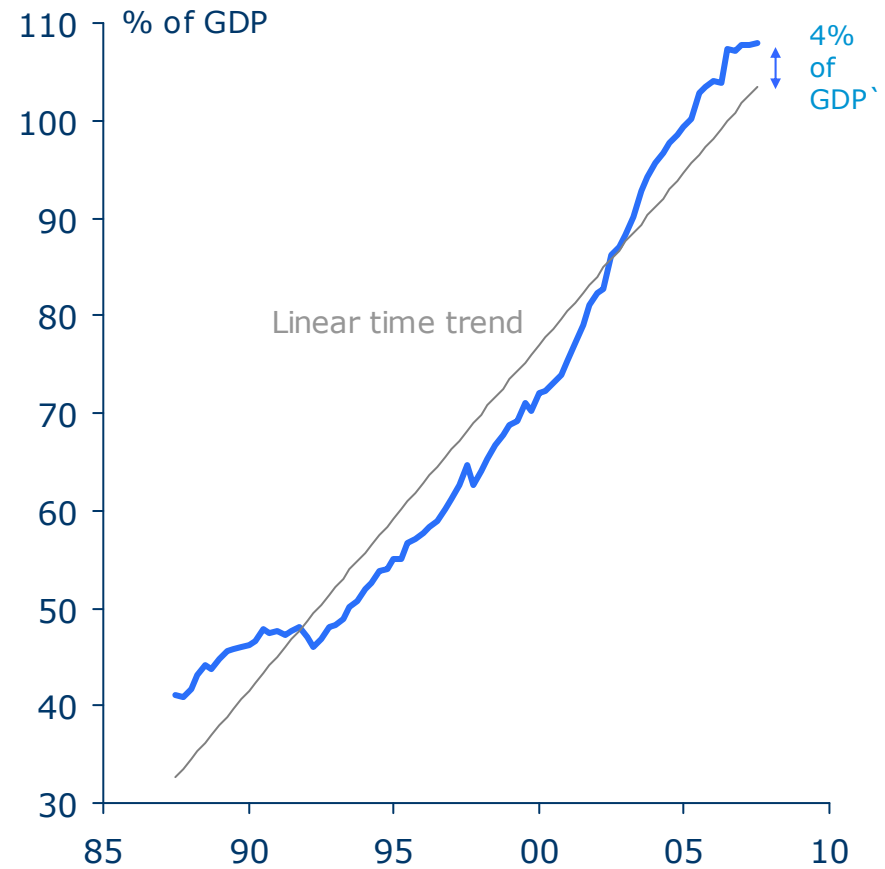
Australia's household sector (like the US's) will probably revert to its traditional position as a net lender

Australian household net lending and liabilities

Household net lending



Household liabilities

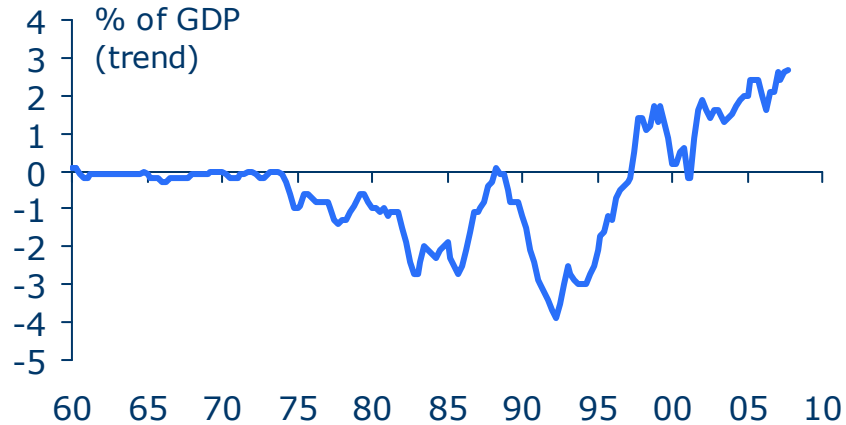


Note: 'Net lending' is gross saving minus gross investment. Sources: ABS; ANZ Economics & Markets Research.

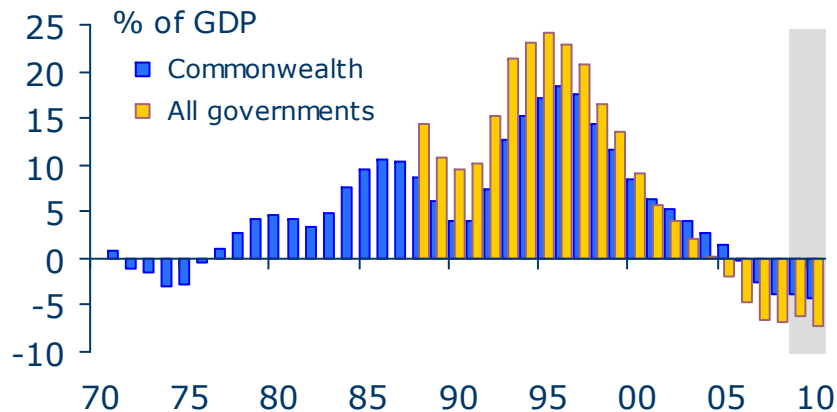


There is considerable scope for government borrowing to moderate the impact of household sector de-leveraging

General government net lending



General government net debt

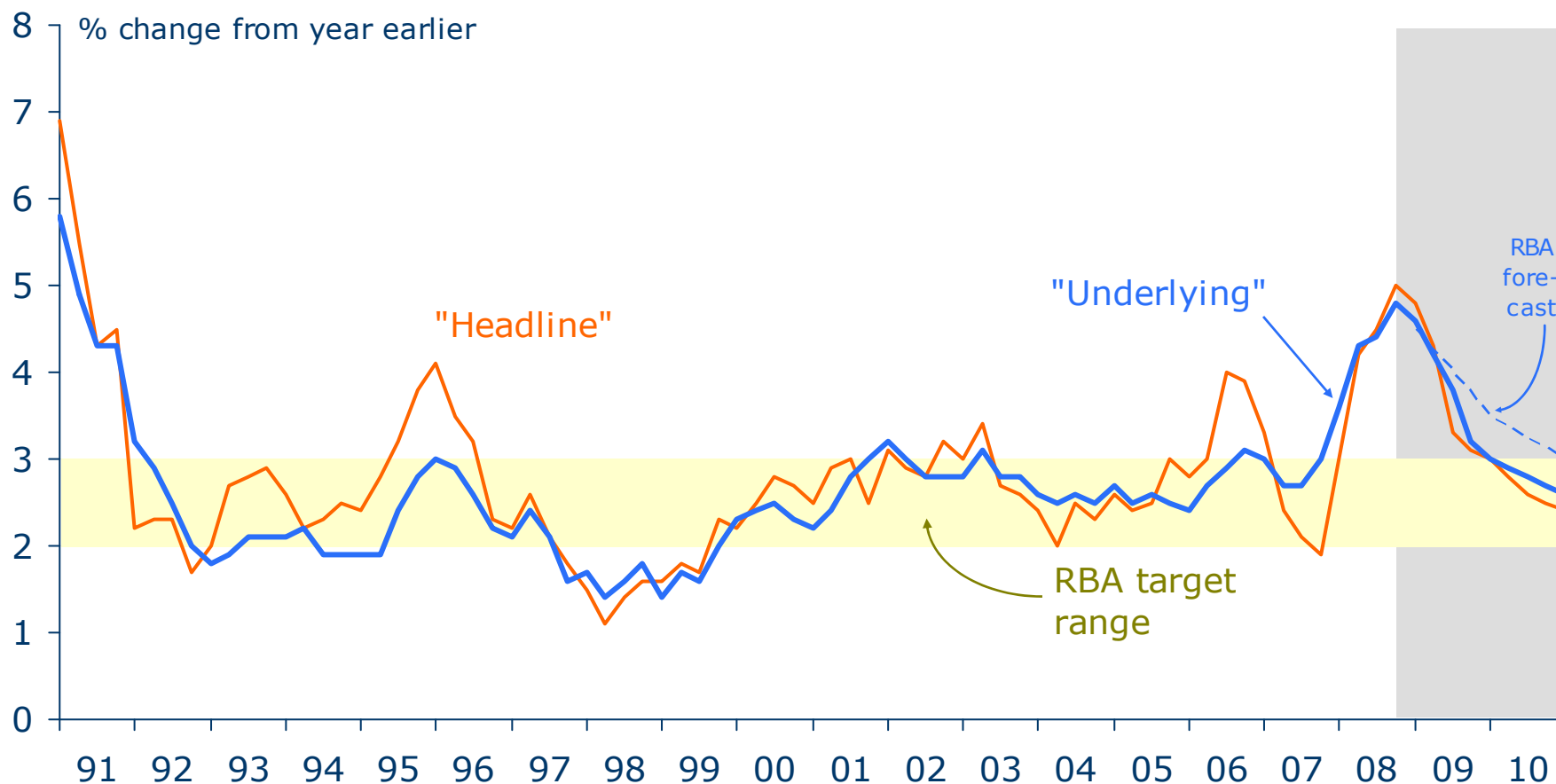


Sources: ABS; Commonwealth Government, *2008-09 Budget Paper No. 3* (Table C.7) and *Mid-Year Economic and Fiscal Outlook 2008-09* (Table D.4).

- Australia's general government sector has been running surpluses, on average, since 1998 (apart from a brief interlude in 2001-02), allowing the elimination of its net debt and the accumulation of net financial assets equivalent to ~7% of GDP at the end of the 2007-08 fiscal year
- The recent mid-year review of the Commonwealth Budget lowered the projected surplus for 2008-09 from 1.8% of GDP to 0.4%, and for subsequent years from 1.3-1.5% of GDP to 0.2-0.5%, reflecting the A\$10.4bn 'Economic Security Strategy' announced in October and downward revisions to revenues
- State & Territory Governments are revising up estimates of their deficits for 2008-09 and beyond
- Further fiscal measures are both likely and warranted, notwithstanding that the result is likely to be budget deficits of the order of 1-2% of GDP; Australia has more scope than most Western countries for expansionary fiscal policy

Inflation will likely fall more quickly than the RBA expects, despite the fall in the A\$

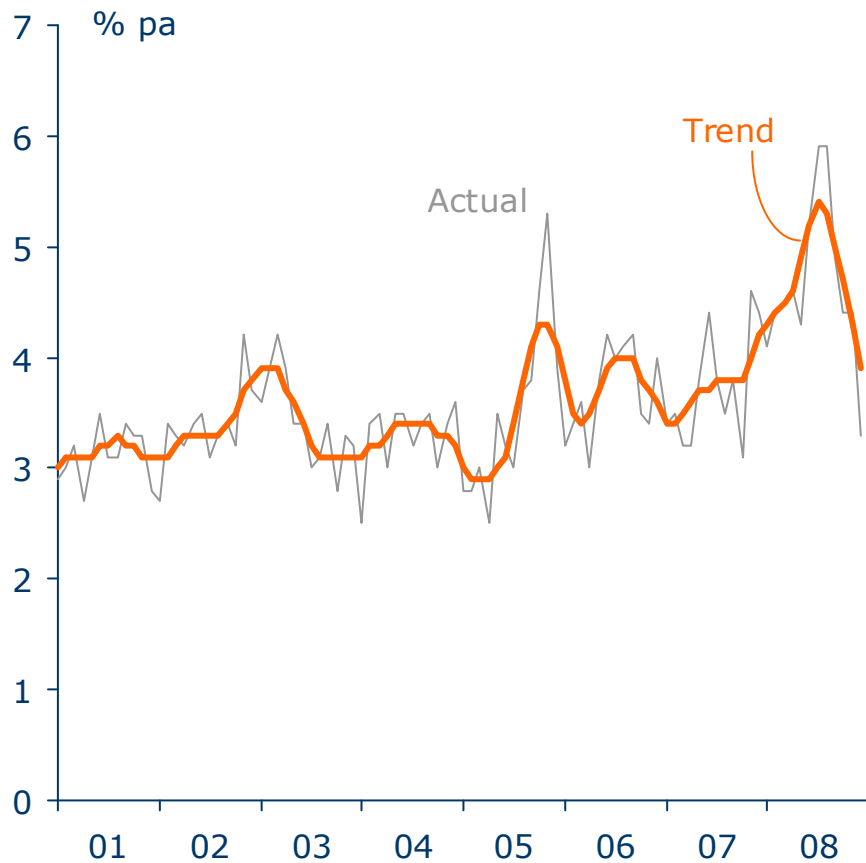
Consumer prices



Note: excludes impact of introduction of GST and major health policy changes and proposed commencement of emissions trading scheme in mid-2010. Sources: ABS; RBA Statement on Monetary Policy (November 2008); ANZ Economics & Markets Research.

Inflation expectations peaked during the September quarter and are now falling (sharply in the case of consumers) ⁵⁵

Household inflation expectations



Business selling price expectations

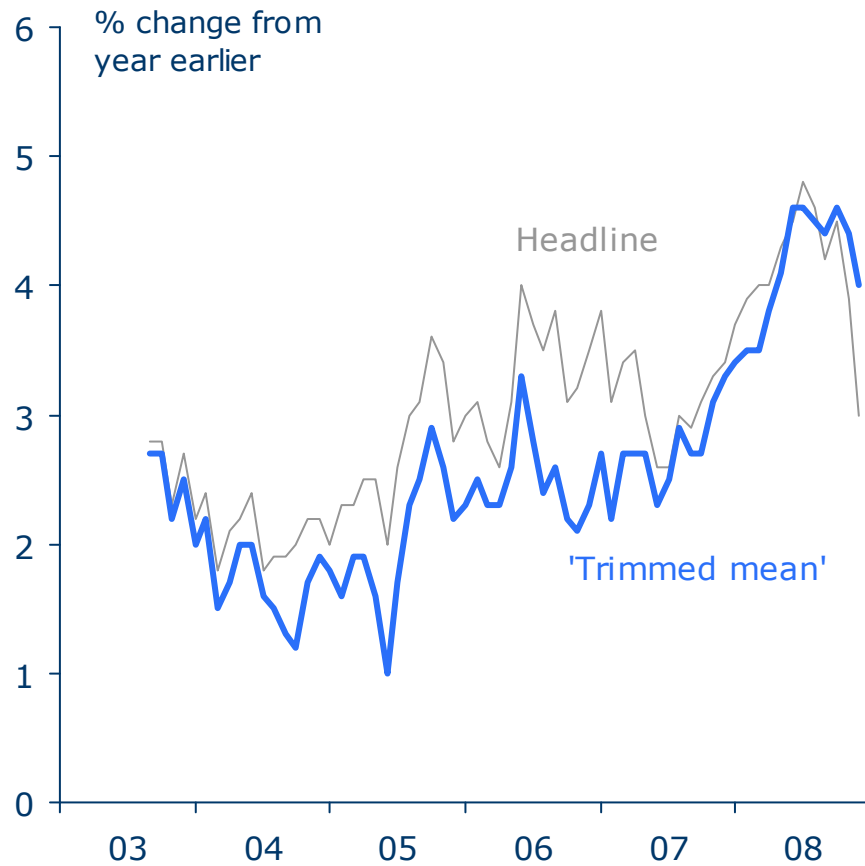


Sources: Westpac-Melbourne Institute; National Australia Bank; ANZ.

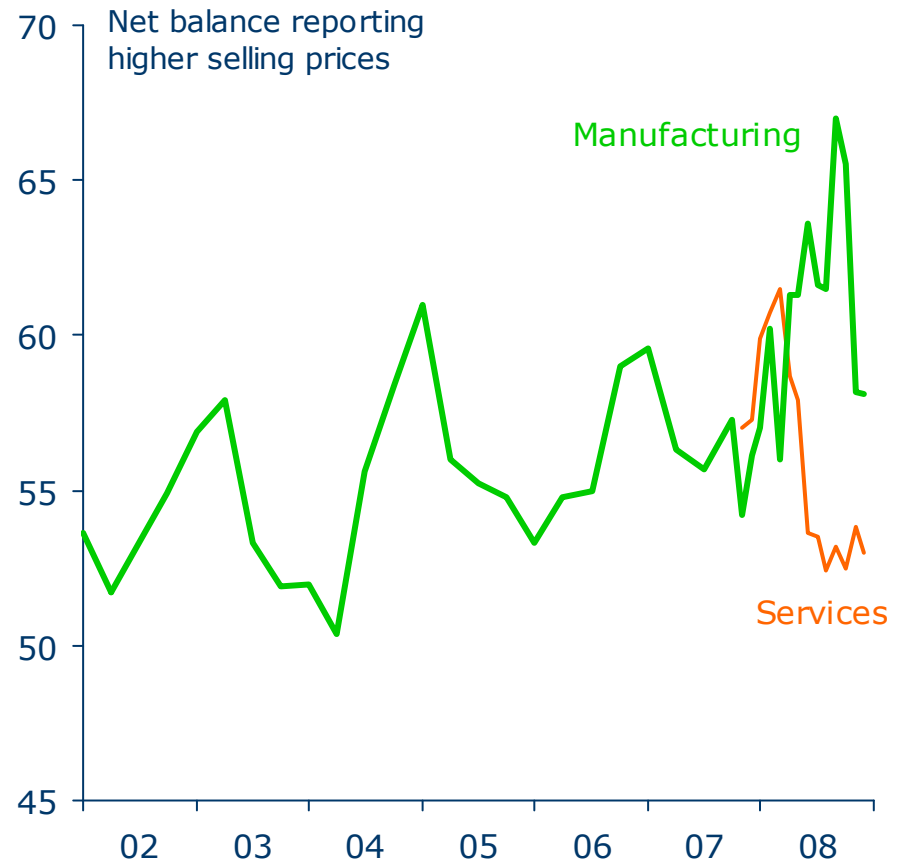


Other monthly data also points to inflation having peaked and now declining

Monthly inflation gauge



Purchasing managers' survey selling prices

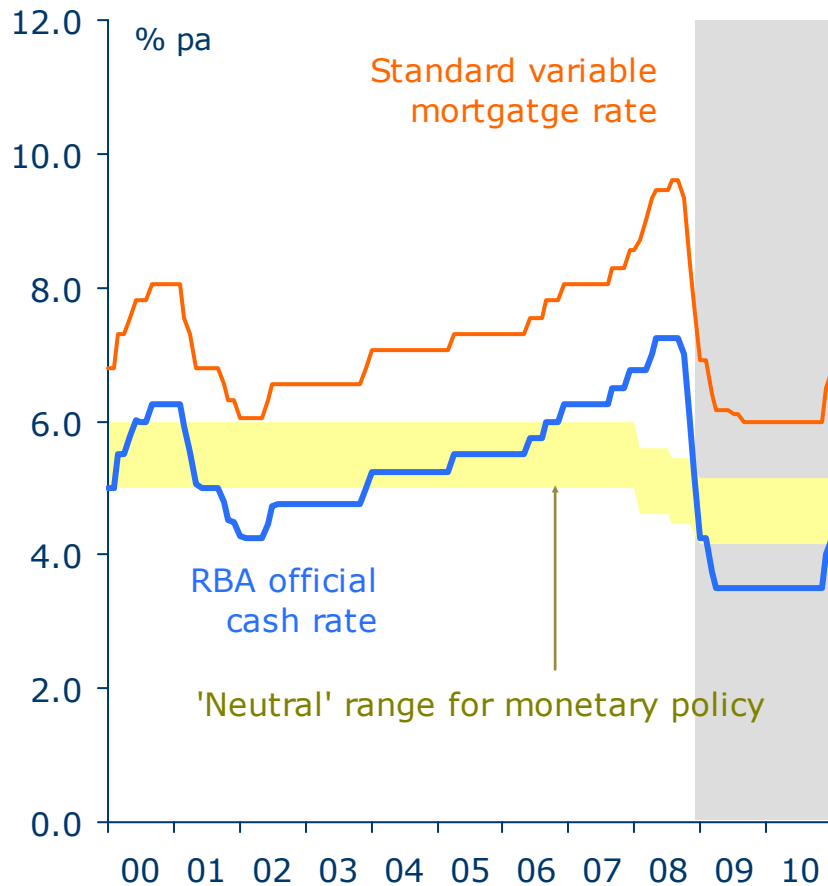


Sources: TD Securities Australia; Australian Industry Group



The RBA's cash rate is likely to be lowered further, to 3½% (or even less) during the first half of 2009 ...

Short-term interest rates



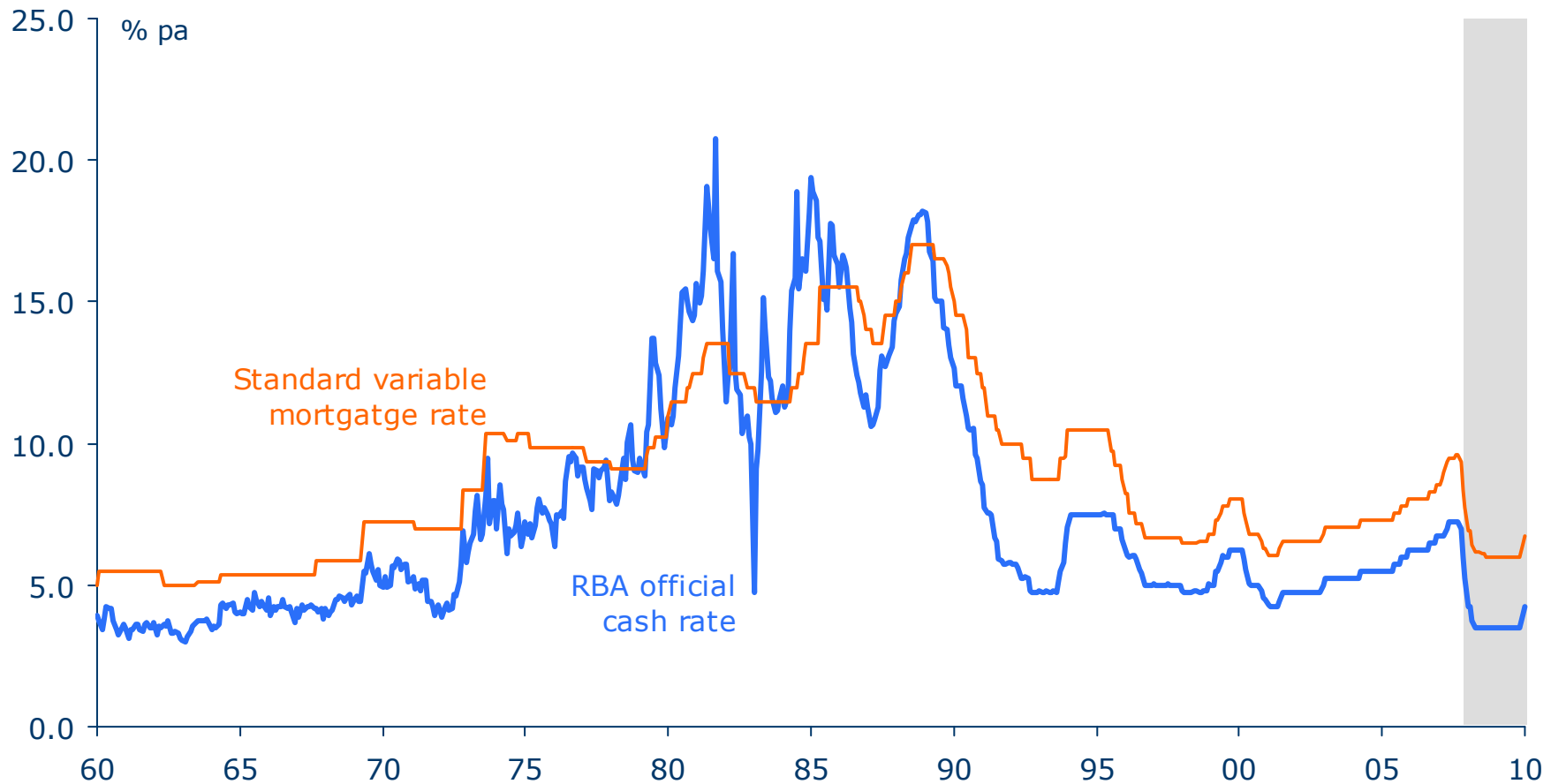
Sources: RBA; ANZ Economics & Markets Research.

- The RBA has cut its cash rate by 3 pc points over the past three months – entirely reversing the increase¹/₄s over the previous 6¹/₄ years
- Over the past two decades, the RBA has come to regard a cash rate in the range 5-6% as consistent with 'neutral' policy settings, ie neither stimulating or restraining economic activity
- This view has been premised on a stable margin between the cash rate and the rate which borrowers actually pay
- However with the spread between the cash rate and the standard variable mortgage rate having widened by ~80bp this year (and that between the cash rate and business lending rates by even more), the range consistent with 'neutral' must have moved down to somewhere around 4¹/₄-5¹/₄%
- Moreover, the economic outlook surely warrants monetary policy settings significantly on the 'easy' side of 'neutral'



... implying that official interest rates will be at their lowest since the late 1950s, and mortgage rates since the early 1970s ⁵⁸

Short-term interest rates

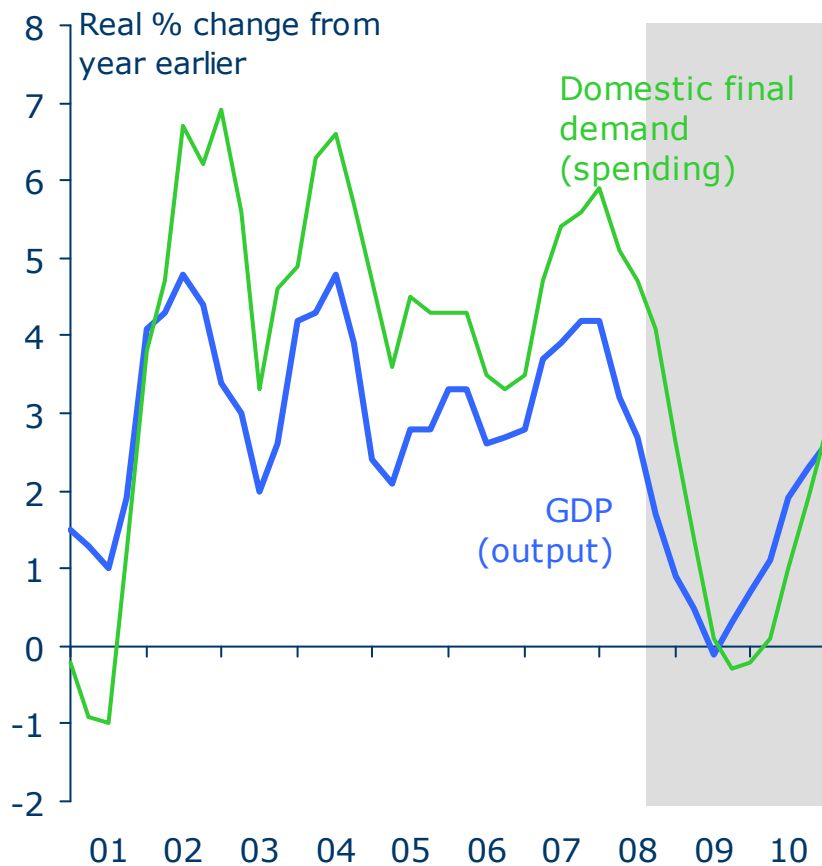


Note: 'neutral' range for monetary policy defined as a cash rate of between 5 and 6%, adjusted since January 2008 for the widening in the spread between the cash rate and the standard variable mortgage rate.
Sources: RBA; ANZ.

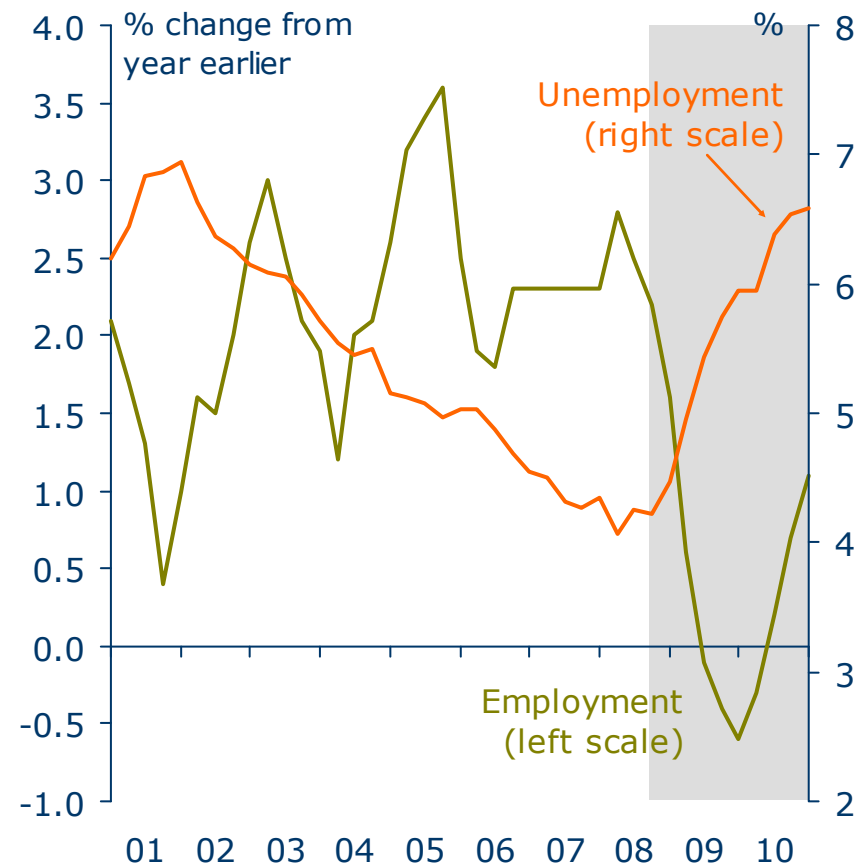


The economy will slow sharply (although it may not contract outright) and unemployment will rise by around 2½ pc points

Spending and output



Employment and unemployment

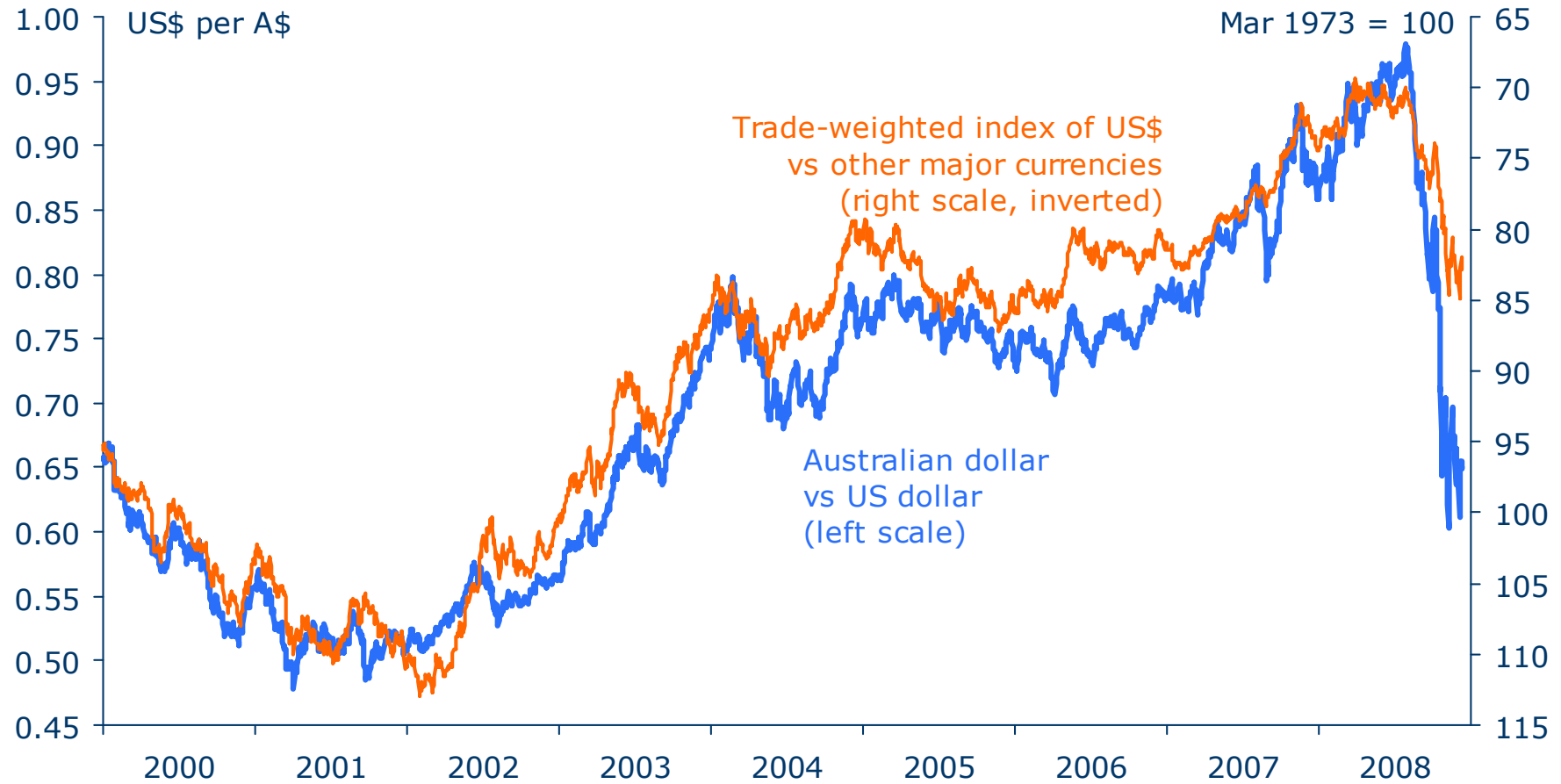


Sources: Australian Bureau of Statistics; ANZ.



The recent sharp drop in the A\$ is partly a reflection of the rebound in the US\$...

A\$ vs US\$ and US\$ vs other major currencies

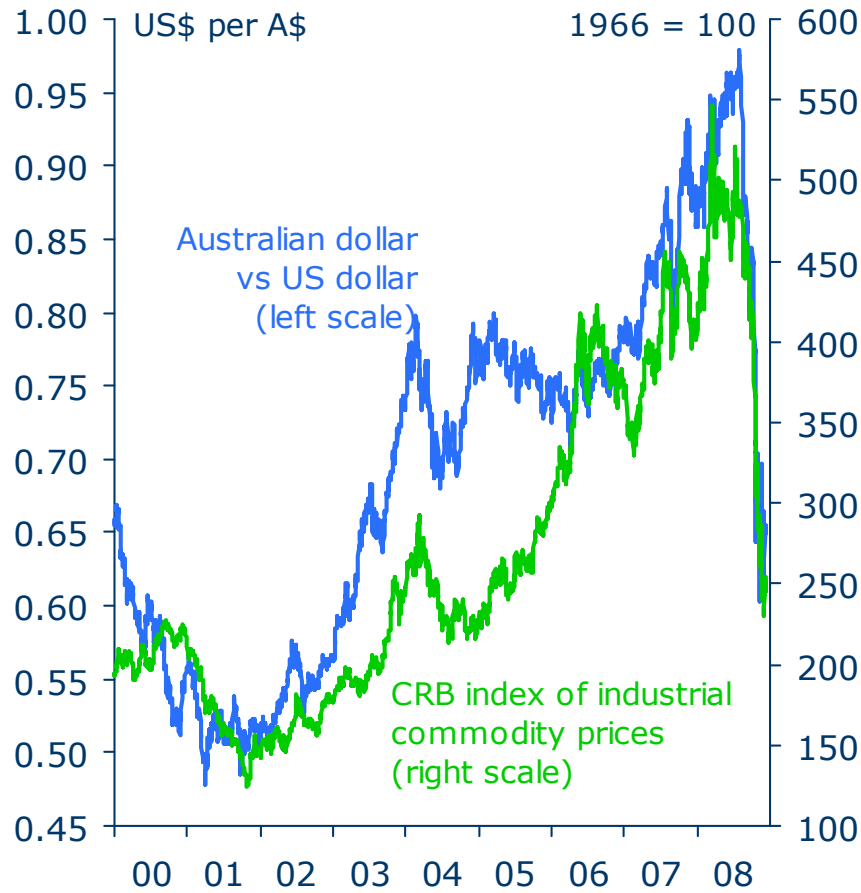


Source: US Federal Reserve Board; Datastream.

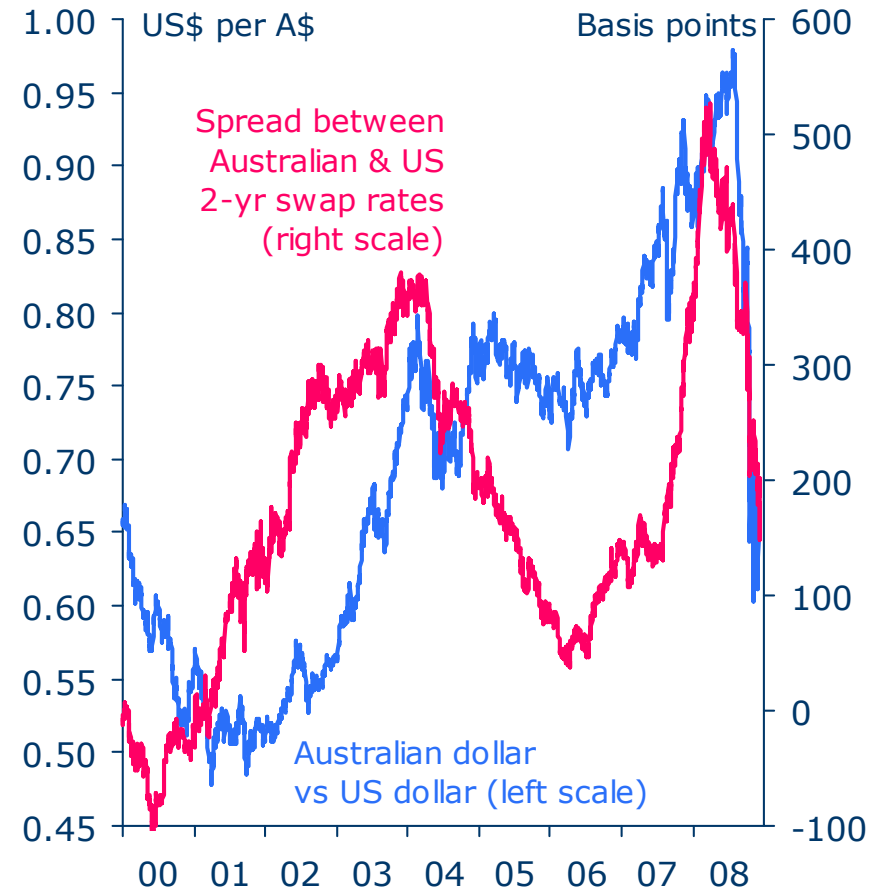


The A\$'s decline also reflects plummeting commodity prices and the narrowing Australian-US interest rate spread

A\$ vs US\$ and commodity prices



A\$ vs US\$ and Australia-US interest rate spreads

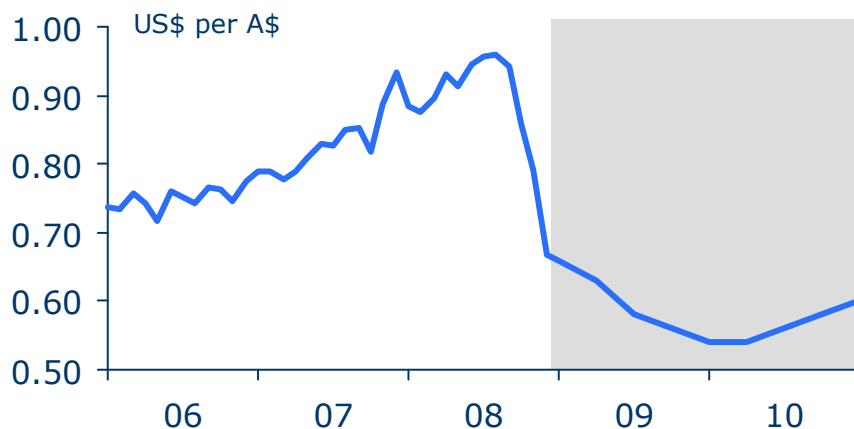


Source: US Federal Reserve Board; Datastream.

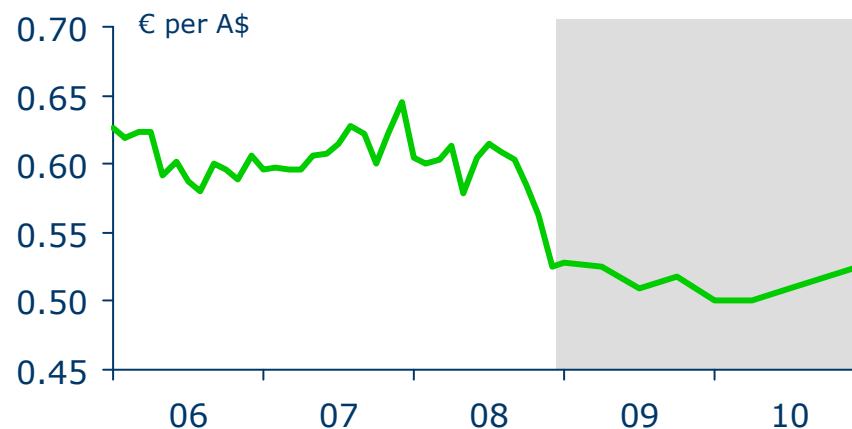


The Australian dollar is likely to remain weak against the US\$ and yen over the next two years

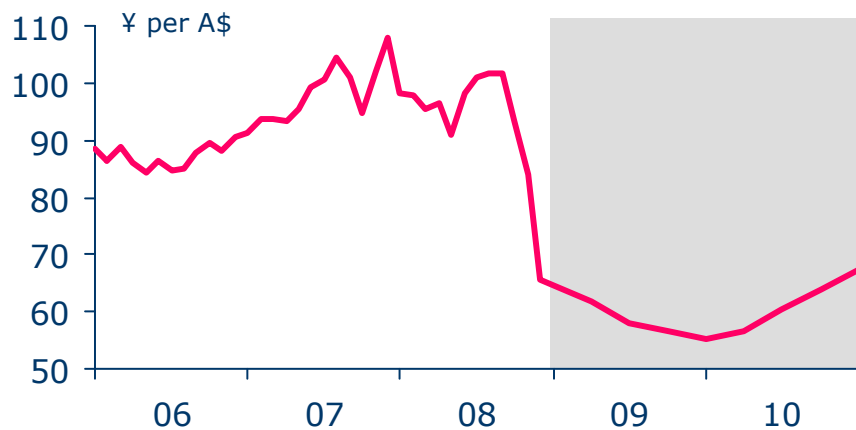
Australian dollar vs US dollar



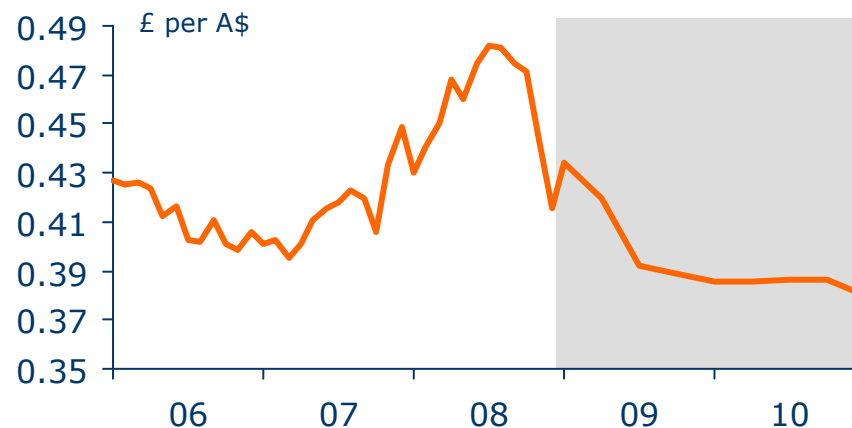
Australian dollar vs Euro



Australian dollar vs Japanese yen



Australian dollar vs British pound

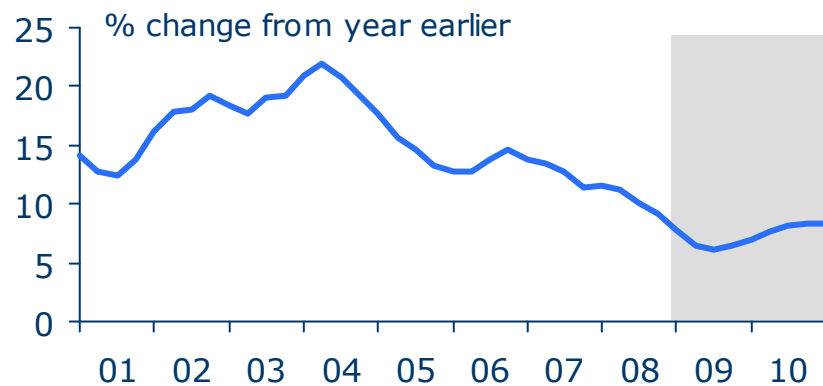


Sources: ABS; ANZ Economics & Markets Research.

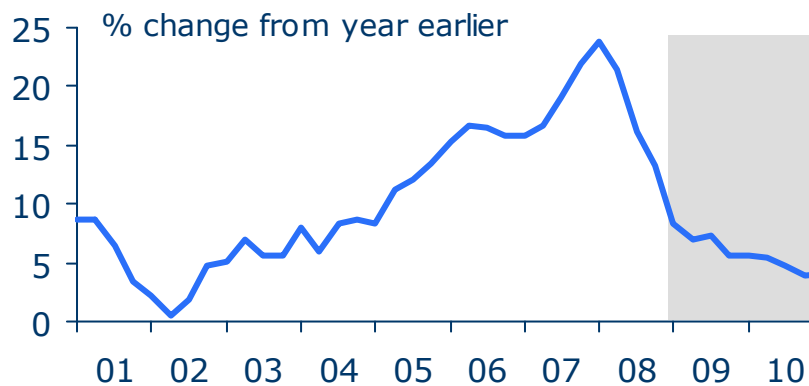
Credit growth is expected to slow over the next two years reflecting both demand and supply influences

Credit growth

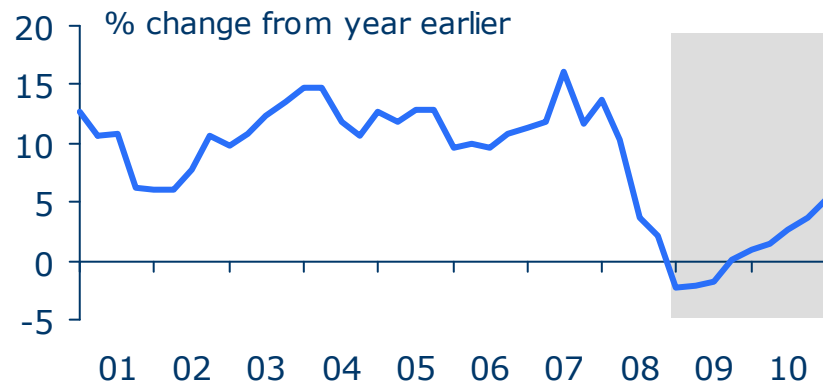
Housing



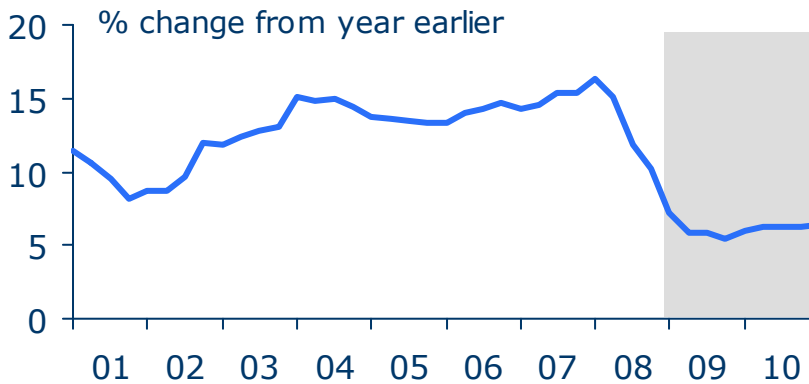
Business



Other personal



Total



Sources: RBA; ANZ.

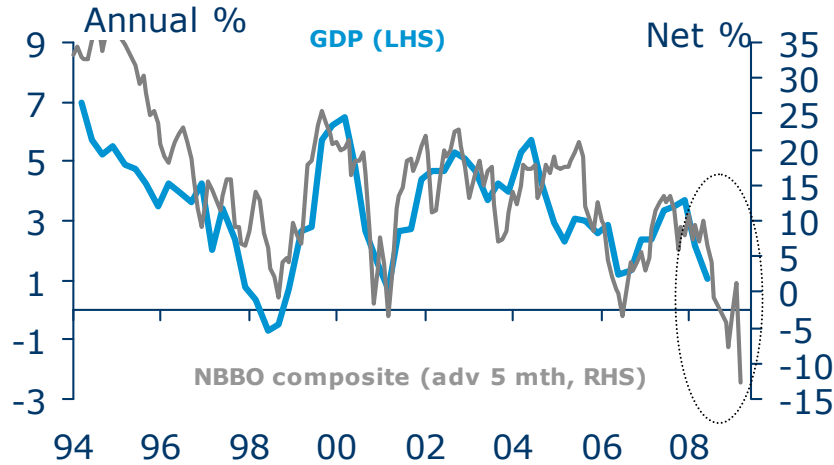


Outlook for the New Zealand economy

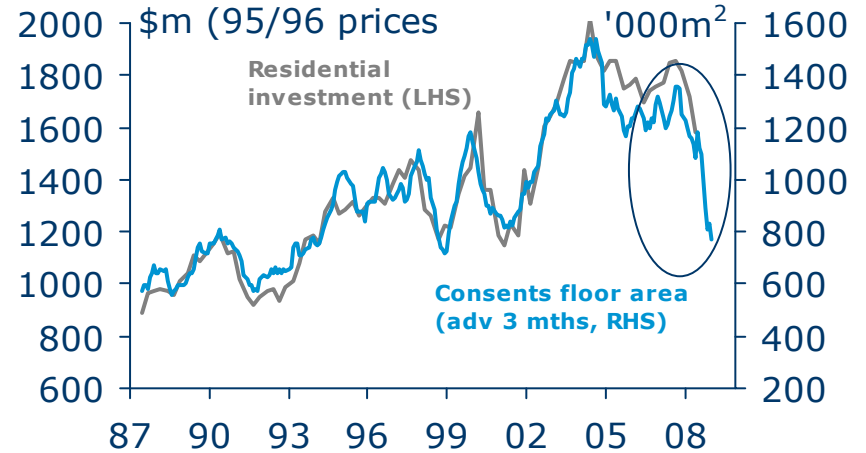
- **The New Zealand economy is in recession, having contracted by 0.3% in the March quarter and 0.2% in the June quarter, and in all likelihood by ½% in the September quarter. Our own business conditions survey and anecdotal evidence point to ongoing and significant weakness in economic activity. Further declines in real GDP are expected in the first half of 2009. The unemployment rate has risen from 3.4% to 4.2% so far this year, and is likely to reach 6% by the end of 2009. New Zealand's trade account remains in deficit (unlike Australia's), so the current account adjustment process is likely to be more severe.**
- **NZ house prices have fallen by 6% so far this year (cf. an average of about 2% in Australia) while the volume of transactions is down almost 60% from its early 2007 peak. Residential construction activity is also declining sharply, with building consents (approvals) falling to a record low in October. Underlying demand for housing (derived largely from population growth) is weaker in NZ than in Australia, while the predominance of fixed-rate mortgages means that whatever benefit might be provided by reductions in official interest rates takes longer to be felt.**
- **Despite the sharply lower NZ\$ and lingering pressures in 'non-contestable' sectors, consumer prices are likely to fall in the current and following quarters, pulling the annual 'headline' inflation rate down from 5.7% to 3.1% by the March quarter of 2009, with a further decline to 1.5% (and possibly to the bottom of the 1-3% target band) by the September quarter of next year.**
- **The RBNZ has cut its official cash rate by 325 basis points (to 5%) since July, including an unprecedented reduction of 150 basis points earlier this month. A further 50 bp cut is likely in January, with the cash ultimately falling to 4% and perhaps even lower.**
- **The newly-elected government of Prime Minister John Key is likely to deliver a significant fiscal stimulus package before Christmas.**
- **Given the poor NZ economic outlook and the likelihood of further declines in NZ commodity prices and interest rates, the NZ\$ is likely to remain on a generally downward trajectory against both the US\$ (dropping below US50¢ during the first half of 2009 with a trough of ~US44¢) and, to a rather lesser extent, against the A\$ (with the cross-rate reaching NZ\$1.23 during the first half of 2009).**

The New Zealand economy is in recession, and continues to weaken

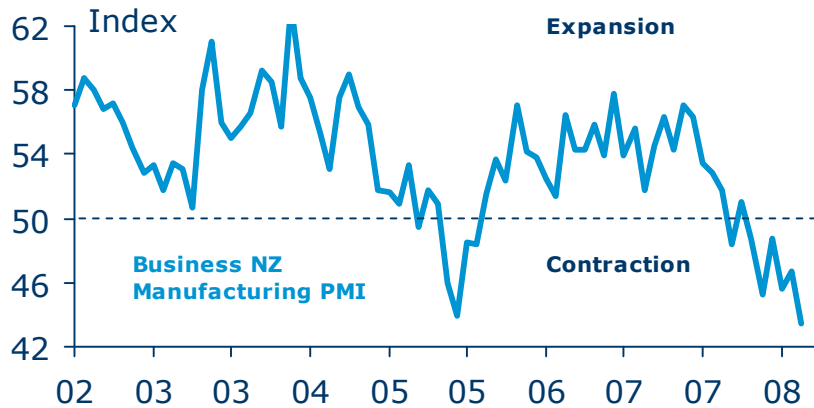
Business confidence down again



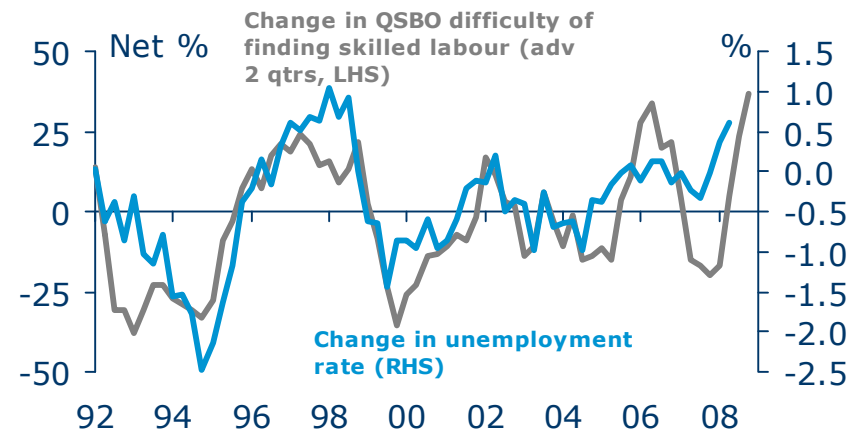
Construction sector leading the charge



Broadening beyond housing-centric sectors



The labour market is turning



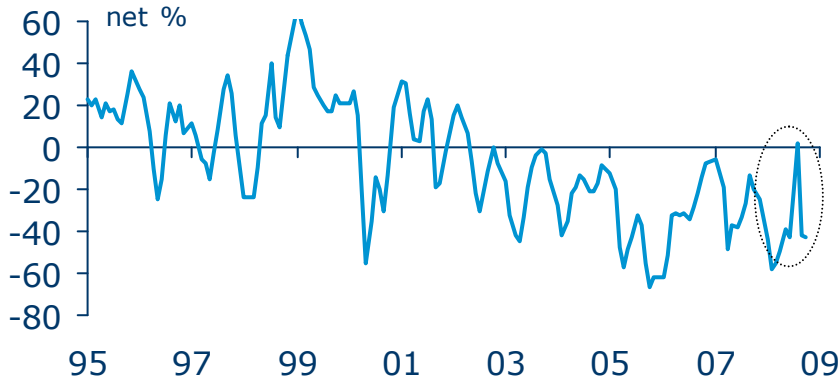
Sources: Statistics NZ, Business NZ, NZIER, ANZ National



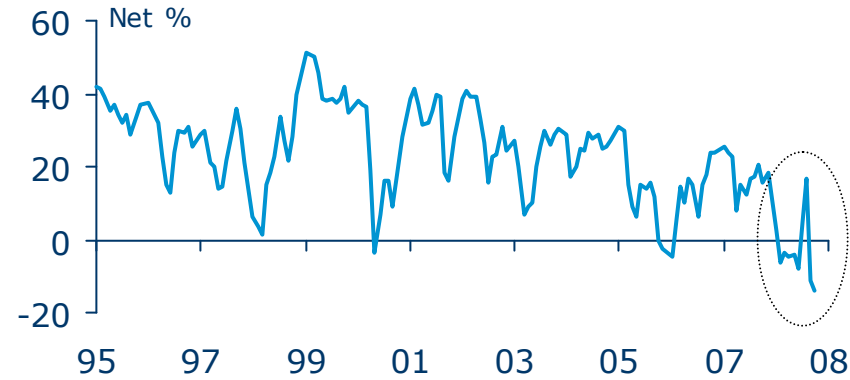
NZ business confidence is deteriorating

ANZ National Bank *Business Outlook* survey

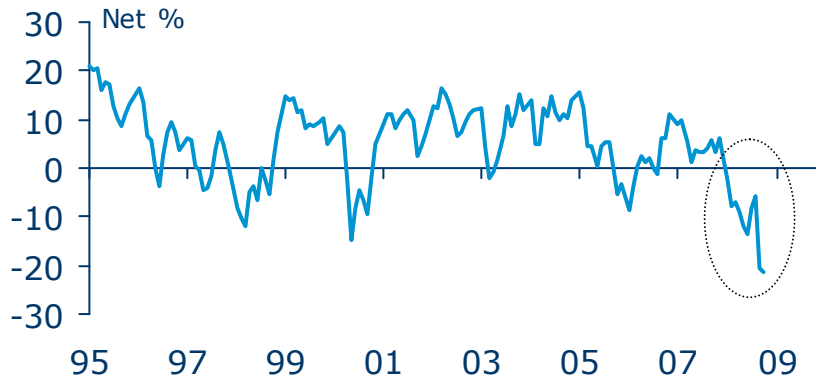
Headline confidence



Own activity



Employment



Investment

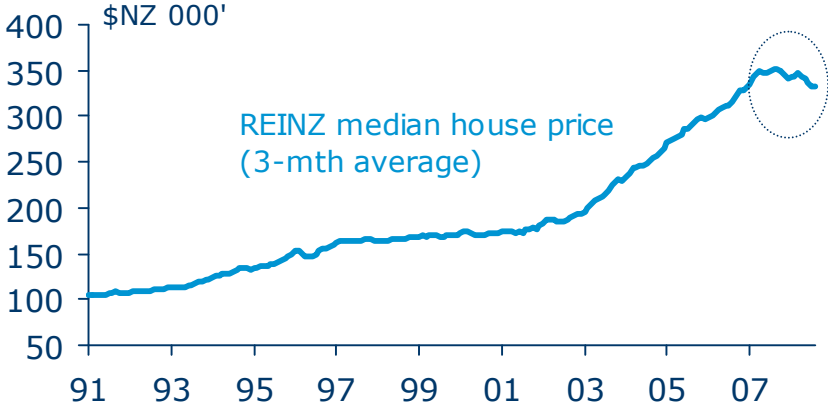


Sources: ANZ National

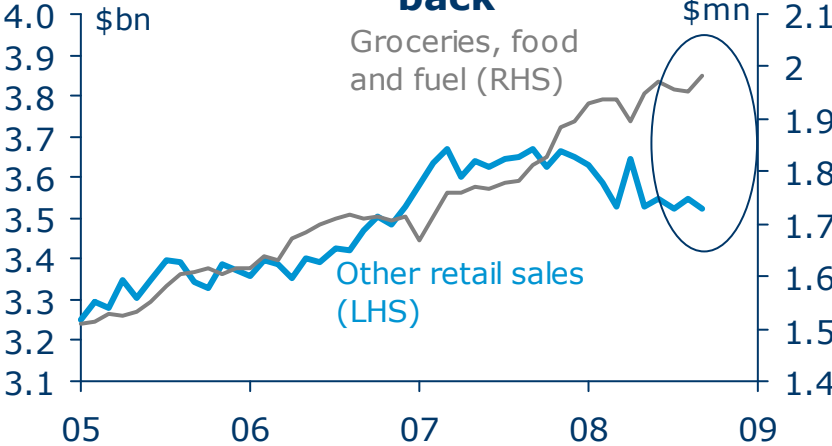


NZ households have begun a period of balance sheet consolidation

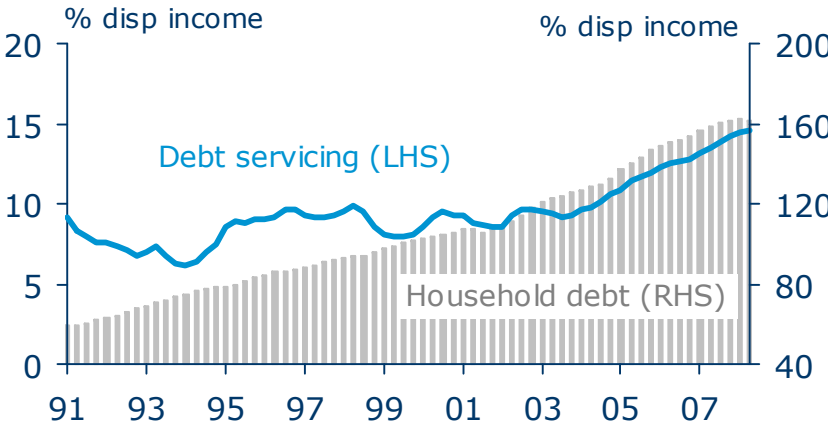
House prices retreating



Discretionary spending being pared back



Debt servicing burden is high



Household credit growth subdued

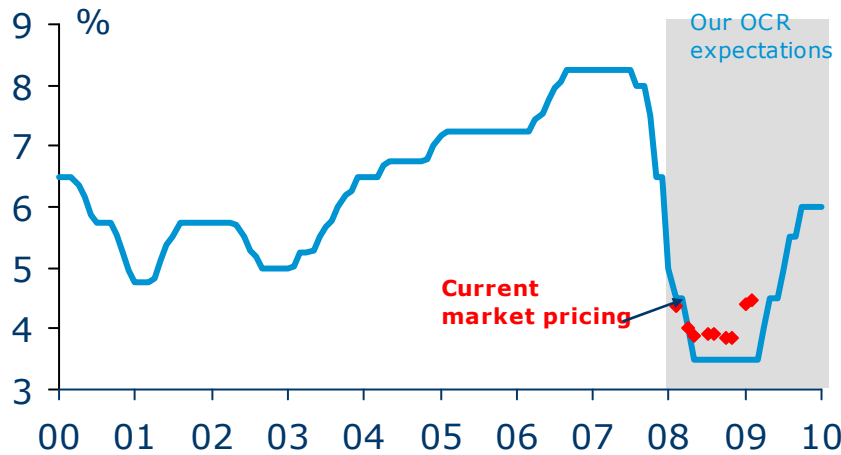


Sources: RBNZ, REINZ, Statistics NZ, ANZ National



As in other countries, monetary and fiscal policy are responding to the deteriorating economic outlook

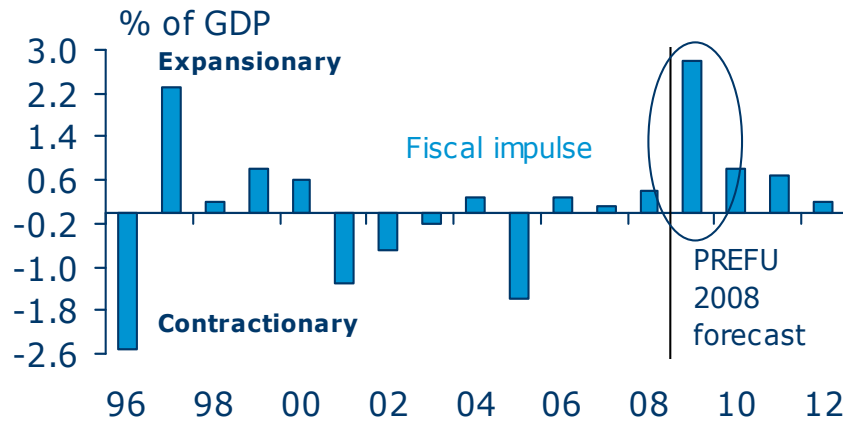
Interest rates are falling



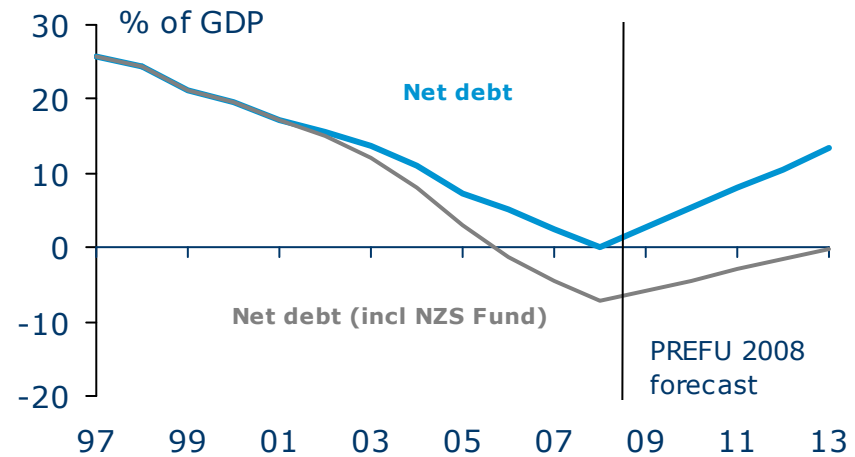
The currency is adjusting, with more to come



Fiscal policy to support



Government should use its balance sheet to do more

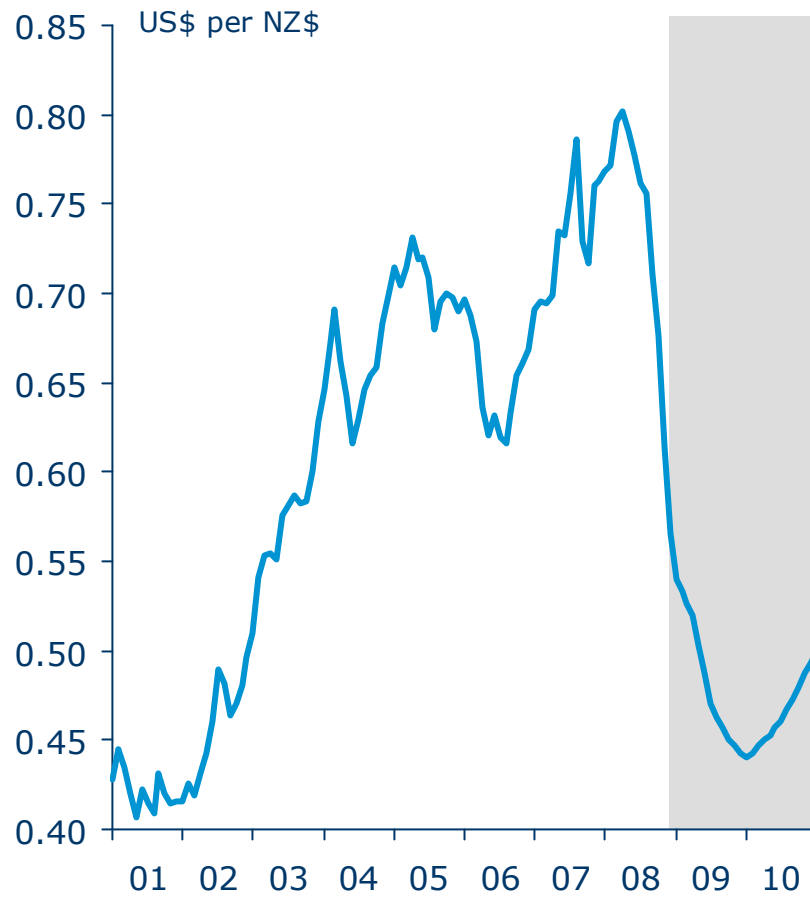


Sources: NZ Treasury, Bloomberg, ANZ National

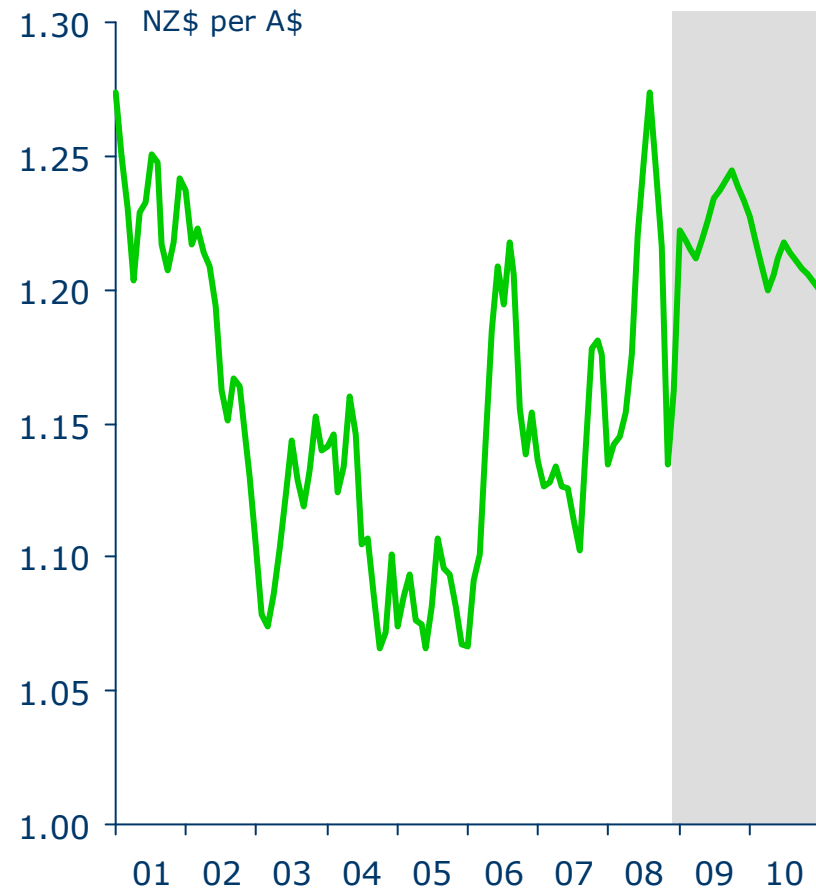


New Zealand dollar to remain under pressure

NZ dollar vs US dollar



Australian dollar vs NZ dollar

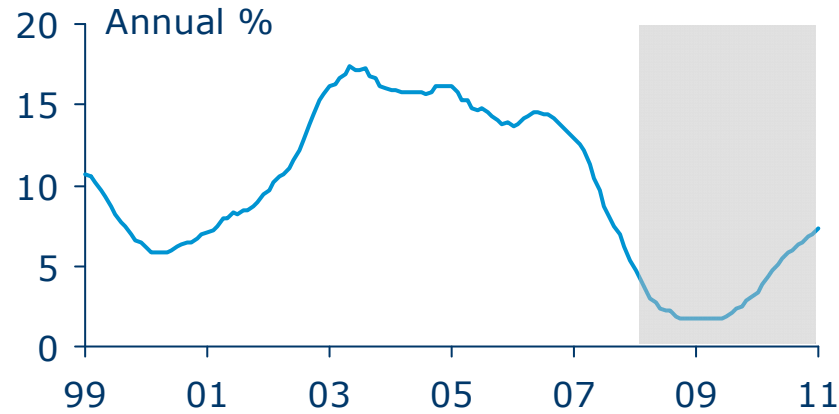


Sources: Bloomberg, ANZ National

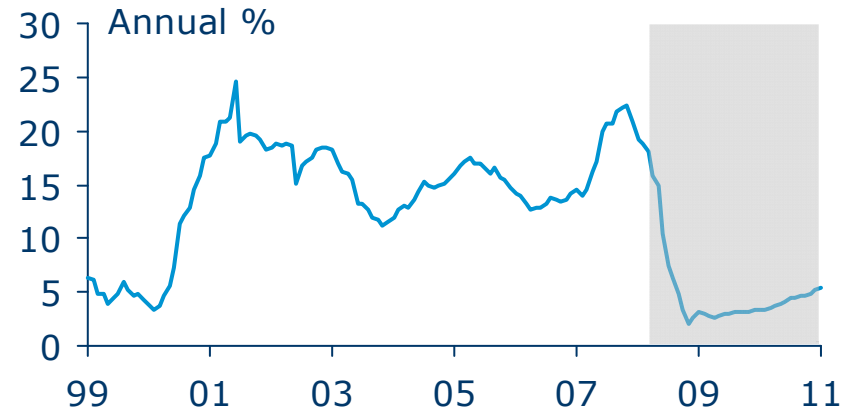


Credit growth is weak and looks likely to remain so

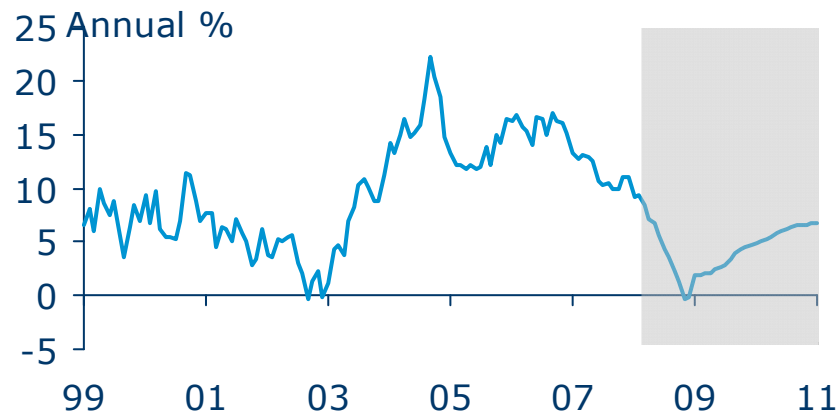
Housing credit



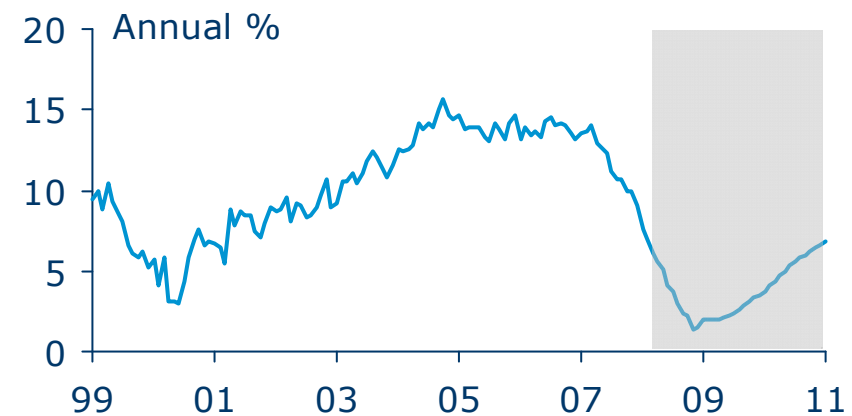
Business credit - agriculture



Business credit - other



Total credit



Sources: ANZ National; RBNZ



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