

## Taking stock

10 September 2009

### Authors:

**Warren Hogan**  
Acting Chief Economist & Head of  
Australian Economics and Interest  
Rate Research  
+61 2 9227 1562  
Warren.Hogan@anz.com

**Tony Morriss**  
Senior Rates Strategist  
61 2 9226 6757  
Tony.Morriss@anz.com

**Julie Toth**  
Senior Economist  
+61 3 9273 6252  
Julie.Toth@anz.com

**Riki Polygenis**  
Economist  
+61 3 9273 4060  
Riki.Polygenis@anz.com

**Dr. Alex Joiner**  
Economist  
+61 3 9273 6123  
Alex.Joiner@anz.com

**Amber Rabinov**  
Economist  
+61 3 9273 4853  
Amber.Rabinov@anz.com

**Daniel Bae**  
Analyst  
+61 2 9227 1272  
Daniel.Bae@anz.com

### Our Vision:

For Economics & Markets Research to be the most respected, sought-after and commercially valued source of economics and markets research and information on Australia, New Zealand, the Pacific and Asia.

### Macroeconomic update: Fading stimulus

- While measures of confidence remain high, disappointing retail sales and employment data this week highlight the clouds still hanging over consumer spending and GDP growth in H2.

### Interest rate markets: Weaker data prompts a reassessment of the policy outlook

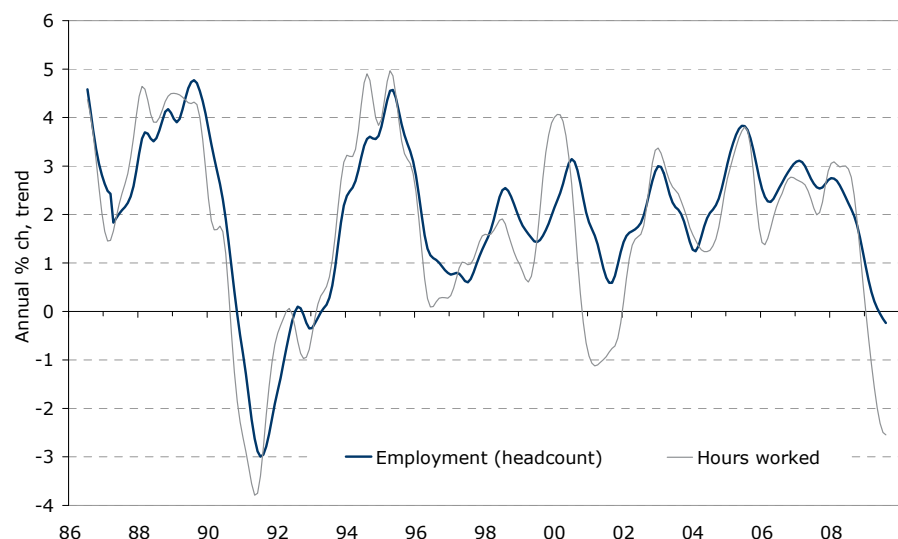
- There is scope for short-dated swap yields to head lower in the near-term as market expectations for RBA rate hikes are pushed back following some weaker than expected data releases.
- There is still a strong case for some normalisation of rates at some point. So, this represents another opportunity to lock in longer-term hedging.

### FX: Real money, not speculators, bid AUD up

- The AUD/USD broke out of its recent 0.81-0.85 range this week to touch a one-year peak of 0.8668 as real money and model buying drove risk currencies higher across the board.
- Our trading desk has seen significant flows from central banks buying AUD/USD over the past few days, perhaps in a sign that central banks, particularly those based in Asia, are diversifying their reserve base away from USDs.
- Over the longer-term, we could see the structural value of the AUD/USD rise on any gradual move by global central banks to diversify their reserves away from USDs and towards AUD/USD (and even into commodities).

### Chart of the week: Hours worked continue to fall

Figure 1: Employment versus aggregate hours worked



Source: ABS.

**Riki Polygenis**  
 Economist  
 +61 3 9273 4060  
 Riki.Polygenis@anz.com

## Macro update: Fading stimulus

- While measures of confidence remain high, disappointing retail sales and employment data this week highlight the clouds still hanging over consumer spending and GDP growth in the second half of the year.

Last week's GDP data highlighted the significant out-performance of the Australian economy in the first half of the year. Weaker than expected retail sales data this week however confirmed suspicions that some of this strength, particularly in consumer spending, represented a bring-forward of demand related to significant monetary and fiscal policy stimulus. Retail sales fell by 1.0% in nominal terms in July following a 0.8% decline in June after rising by a cumulative 4.5% between March and May.

The question now is whether this is a temporary pull-back and consumer spending will rebound later in the year, or whether the latest retail data marks the beginning of a period of weaker consumer spending and GDP growth (with household consumption representing 55% of GDP). The good news is that the jump in the household savings rate in Q2 should provide support to household balance sheets and the capacity to spend in coming months. On the flipside however, household incomes are likely to be weak. Just how weak will ultimately depend on employment and hours worked and we received mixed information regarding this in recent days.

In an encouraging sign, the ANZ Job Advertisements series improved for the first month since April 2008. This suggests that labour demand may be starting to improve, or at the very least stabilise after falling to recessionary levels. However the NAB employment index deteriorated in July to -11 after improving to -5 in June although the improvement in business confidence and profitability could be taken as a positive sign. The official labour market data also disappointed, with employment declining 27.1K in August. While this data has admittedly been choppy – the fall in August followed a 33.6K bounce in July – employment is still declining in trend terms. In addition, hours worked continued to decline at an annual rate of -2.5%, as the rotation away from full-time towards part-time employment continued.

At this stage, we are optimistic that consumer spending will not fall outright in the second half of the year despite lower income growth. Consumer confidence is at a two-year high, even if the relationship with spending has not been particularly strong in recent months, and households have managed to rebuild some savings. However, this will not be enough to prompt tighter monetary policy in itself, with the recovery elsewhere in the economy expected to be relatively narrowly based and the RBA keenly aware of premature hiking "choking off" demand. The RBA will need to see a sustained improvement in retail sales and employment data to be confident that the recovery in the first half of the year continues to gain traction (see Interest Rate update on page 3).

### Data wrap

- The **ANZ Job Advertisements Series** rose by 4.1% in August, the first monthly increase since April 2008.
- **Business confidence** surged 8 points to +18 and **business conditions** improved 3 points to +4, driven by higher profitability and trading conditions, although forward orders and employment expectations both declined.
- **Consumer confidence** surged by 5.2% in August to be 34.4% higher in the past four months.
- **Retail sales** declined by 1.0% in July following a 0.8% decline in June (revised up from a 1.4% decline).
- The *number* of **housing finance approvals** for owner occupiers declined 2.0% in July. The *value* of approvals decreased 2.3% with owner occupier (-1.7%) and investor (-4.0%) approvals both down.
- **Consumer inflation expectations** were unchanged at 3.5% in September.
- **Labour force** data showed that employment fell by 27.1K in August following a 33.6K increase in July. Despite lower employment, a fall in the participation rate to 65.1% saw the unemployment rate hold at 5.8%.

**Tony Morriss**  
 Senior Rates Strategist,  
 Australian Economics and  
 Interest Rates Research  
 61 2 9226 6757  
 Tony.Morriss@anz.com

## Interest rate markets: Weaker data prompts a reassessment of the policy outlook

- There is scope for short-dated swap yields to head lower in the near-term as market expectations for RBA rate hikes are pushed back following some weaker than expected data releases.
- There is still a strong case for some normalisation of rates at some point. So, this represents another opportunity to lock in longer-term hedging.

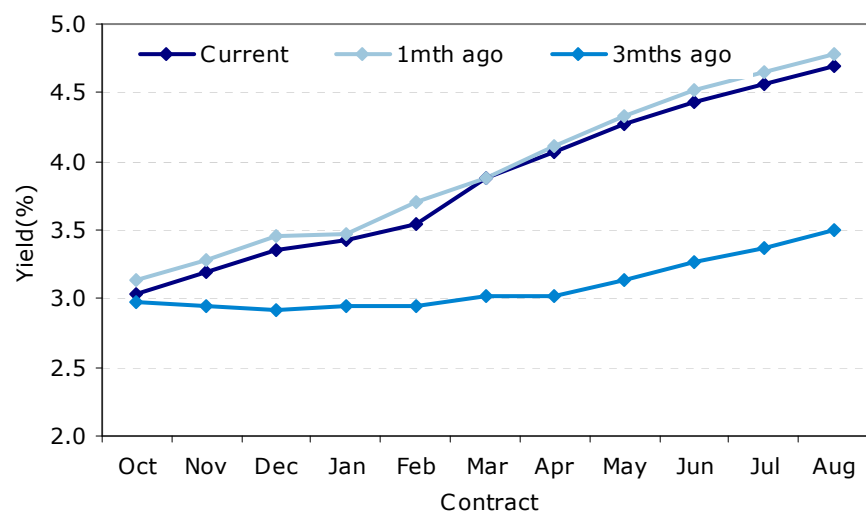
The recent run of weaker than expected data appears to have hinted at the first real signs that the impact of the fiscal boost is starting to wane and that the outlook for household income will continue to be challenging. This is significant for rate markets because it increases the risks of moving too early to unwind policy accommodation. The RBA now appears to have a real obstacle to build a convincing case to move on policy early as retail activity and the labour force look vulnerable again.

In addition, the atmospherics surrounding the G20 Finance Ministers meeting held last weekend also lend support to the view that any move to unwind extraordinary policy settings will be gradual and tentative. Policy-makers in that forum stressed it would be premature to consider exit strategies in light of the uncertain economic outlook.

There has been a noticeable change in the tone of government rhetoric since the meeting. Finance Minister Tanner moved on Monday to downplay recent strong domestic data: GDP growth of 0.6% in Q2 (+1.1% non-farm) was still "pretty modest" and the country faces a period of "ordinary growth." It was also his view that the RBA was "not indicating it will raise rates soon."

Markets are now moving to reflect this reassessment of the outlook. Below is a chart of market expectations of the likely path of cash rates. While the move lower for implied yields looks to be minor when compared to the re-pricing of the market in recent months, there still looks to be scope for markets to unwind expectations further should the run of data remain weak.

**Figure 2: Monthly Inter Bank Futures implied yield**



Source: ANZ & Bloomberg

October now looks to be out of the frame as a "live" meeting at which the RBA might start to remove policy accommodation. And we would need to see a rebound in retail activity, better labour market outcomes and a strong CPI report to increase the chances of a November rate hike especially as the currency is now taking more of the strain.

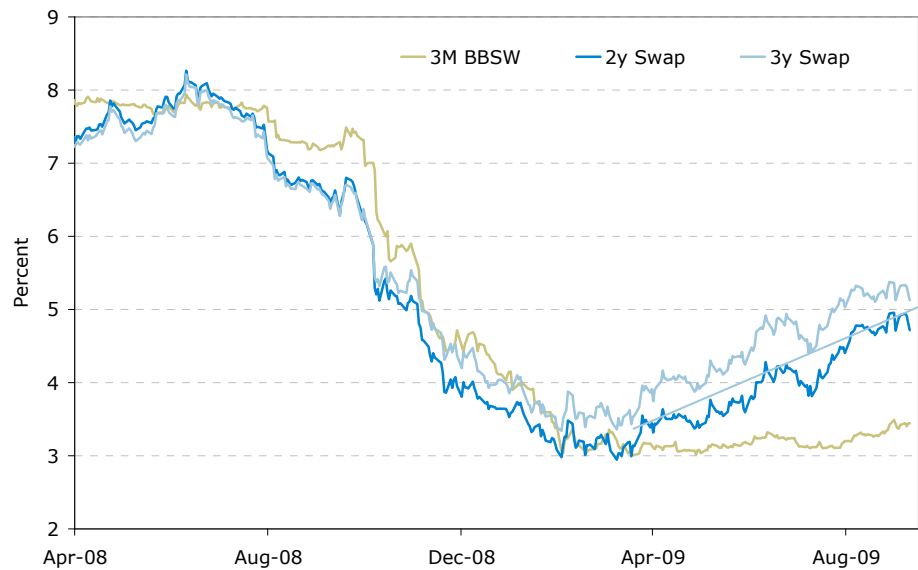
The yield curve has steepened sharply in recent days. After collapsing from a high around 140bps at the start of June to 30bps at the end of last month, the

3/10-year government bond spread is already back above 60bps and looks likely to steepen further in the near-term to reflect the shift back in risks towards expecting a gradual removal of policy accommodation over a longer period of time.

### Limited scope for swap yields to head sharply lower in the near-term

These developments have also arrested the recent rise in swap yields seen since March. Shorter-dated swaps have obviously been anchored by low cash rates and have not returned to anything like more normal levels. So this looks like another opportunity for borrowers to lock in hedge rates before policy does eventually head back towards more normal levels. While recent data might have put back the unwinding of rate cuts it must be remembered that current levels still represent "emergency" settings.

**Figure 3: Two-year and three-year swaps**



Source: ANZ & Bloomberg

We look at some key target levels for 2 and 3-year swaps below.

**Two-year swap:** Recent lows in yield from August that lie around 4.60% are back within range. There might be scope for a more extended move lower to levels that previously capped the rise in rates over June around 4.35%, but this looks unlikely without a more comprehensive reassessment of the outlook for policy. The key area to watch on the upside is around the 5.03-09% level as a break would signal a more extended move higher towards 5.65% and possibly higher.

**Three-year swap:** The market has already moved towards a key pivotal area from 5.00-5.10%. This is the base of the trading range over August, it was the area that capped the market over June and is also the uptrend dating from February lows – see trend line on the chart above. A break here would target a move down towards 4.60-4.70%. Similar to the profile for 2-years above we would need to see a more extensive reassessment of the policy outlook to reach this level. The recent high around 5.50% should cap trading in the near-term. A break above this level would see rates set to rise above 5.80%.

**Amber Rabinov**  
 Economist, Foreign Exchange  
 and International Economics  
 Research  
 +61 3 9273 4853  
 Amber.Rabinov@anz.com

## FX: Real money, not speculators, bid AUD up

### AUD/USD Key levels: 0.8380 – 0.8770

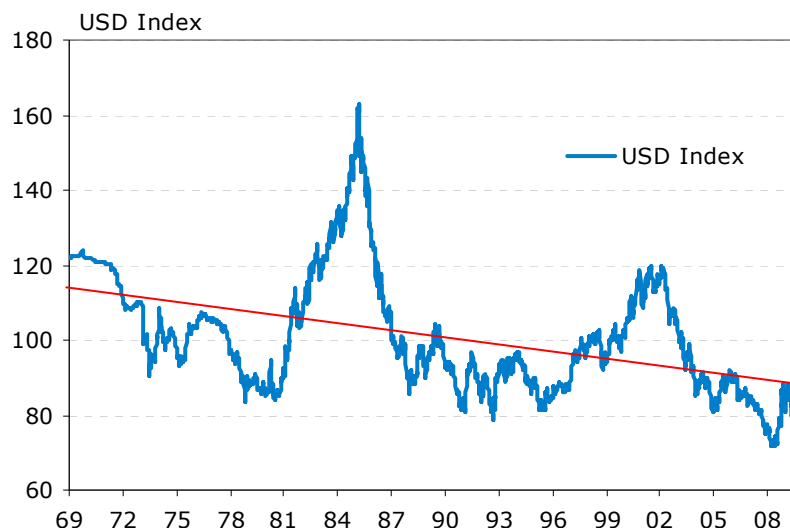
The AUD/USD broke out of its recent 0.81-0.85 range this week to touch a one-year peak of 0.8668 as real money and model buying drove risk currencies higher across the board. With domestic economic results disappointing markets (see our *Macroeconomic update* on page 2 for more details), look to some near-term consolidation in AUD/USD at current higher levels. Minutes from the RBA's September Board meeting will be the local economic highlight over the coming week, while a raft of data due out in the US should also provide good direction. Weaker results could trigger a temporary turnaround in risk appetite to support a USD recovery and provide an opportunity for AUD/USD buyers to take advantage of a fall to 0.8460, then towards 0.8380. However, AUD/USD sellers should beware of a potential continuation of recent buying trends that could see AUD/USD reach 0.8700 relatively quickly before moving towards 0.8770.

### Asian reserve diversification key to AUD/USD's strength?

What a week it has been. Risk currencies, including the AUD/USD, have soared to new 2009 highs as the USD weakened against the majors. But economic atmospherics for the AUD, exemplified by this week's disappointing Australian retail sales and employment data, have not justified the significant moves higher that we have witnessed. Instead, our trading desk has seen significant flows from central banks buying AUD/USD over the past few days, perhaps in a sign that central banks, particularly those based in Asia, are diversifying their reserve base away from USDs.

In the medium-term, we do not see such solid AUD buying by central banks as a threat to the USD's place as the world's reserve currency of choice (around 65% of allocated currency reserves are in USDs). But over the longer-term, we could see the structural value of the AUD/USD rise on a gradual move by global central banks to diversify their reserves away from USDs. One reason for the strong demand for AUDs in particular as part of this process is likely due to the fact that in the absence of open and deep capital markets for most emerging currencies (particularly China), the AUD offers a liquid and sound (ie. free-floating) proxy for exposure to these markets, and hence poses an attractive non-USD reserve alternative.

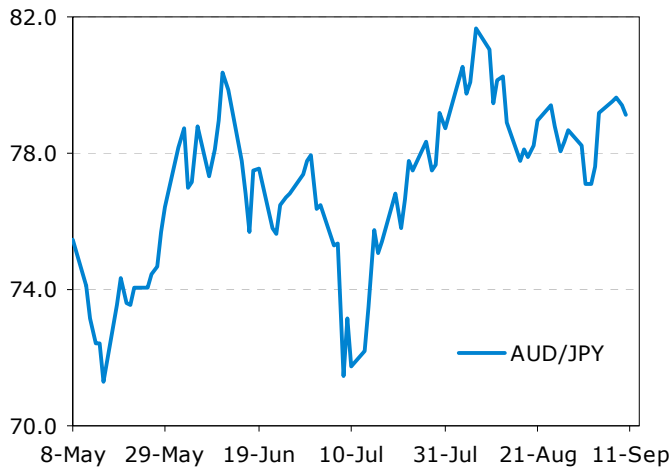
**Figure 4: Will reserve diversification see the USD continue to decline?**



Source: ANZ, Bloomberg

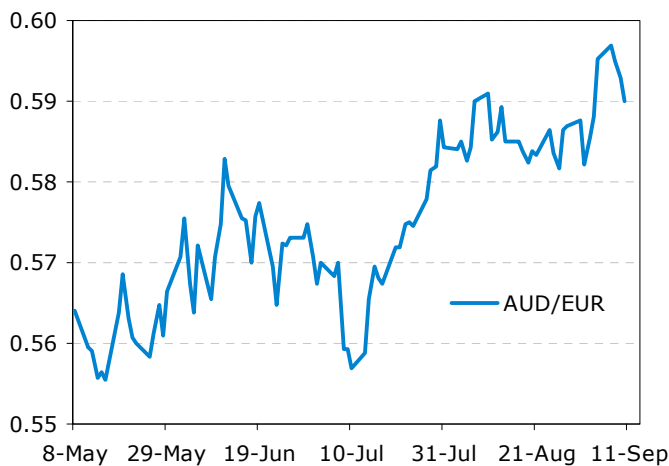
Moreover, over the coming decade the possibility is that more central banks will diversify out of currencies and into commodities. The AUD is a beneficiary of this scenario, as increased reserve holdings of commodities adds further upward pressure to these prices, in turn giving the AUD support as a commodity currency. This suggests the equilibrium for the AUD/USD could continue to drift higher for now.

## AUD cross view



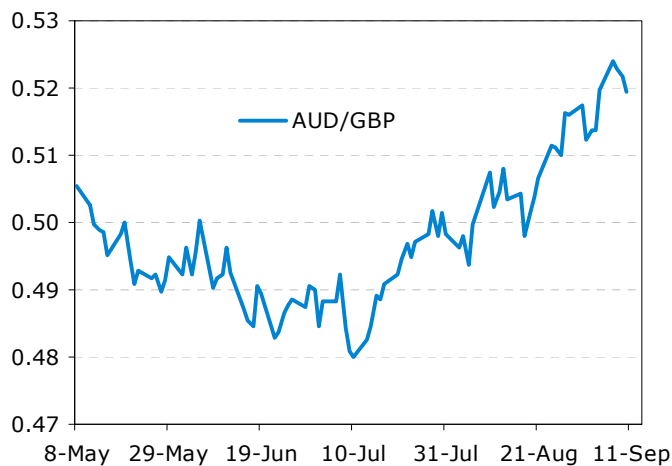
### AUD/JPY Key levels: 76.50 – 81.50

- AUD has outperformed JPY over the past week, seeing AUD/JPY rally comfortably back above 79. The 100-day moving average, currently at AUD/JPY76.46, continues to provide good downside support. On the upside, 81.50 remains the key topside target that the cross has failed to hold above since last year's Lehman Bros collapse.
- Any impact on the cross from the patchy Japanese data flow next week is likely to be limited. While an improvement in consumer confidence is expected, the sluggish economic outlook is likely to see the Bank of Japan leave policy unchanged at its September meeting.



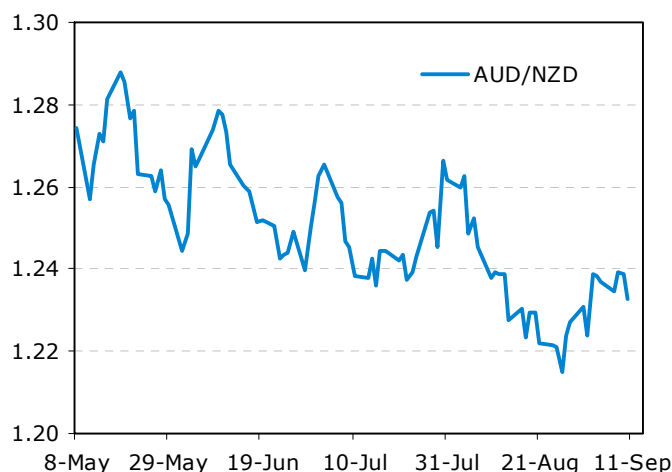
### AUD/EUR Key levels: 0.5810 – 0.5980

- Strong upward momentum saw AUD/EUR reach a 2009 high above 0.5980 this week, breaking through solid resistance around 0.5910, as real money buying drove AUD higher. Solid demand has since bid EUR/USD towards 1.46, with EUR clawing back half of this week's losses versus AUD and AUD/EUR back around 0.59. Look to the cross remaining well supported above 0.5810 this week as firm interest keeps AUD elevated.
- Some direction for the cross may be generated from Euro zone releases of the September ZEW economic sentiment survey, and industrial production and trade data for July.



### AUD/GBP Key levels: 0.5080 – 0.5325

- AUD/GBP has risen over 40% since October last year, with around a third of this rally taking place since July. Upward momentum remains solid as the cross begins to eye off its 1996 high of 53.25. This should also limit dips to around 0.5080.
- The longer-term outlook for the UK economy is clouded, with an end to the temporary reduction VAT due in January and higher income taxes set to be implemented in the new fiscal year (from early April 2010). These measures will be a strong headwind for the broader economy, and with the interest differential between Australia and the UK set to widen, this should lend support to AUD/GBP.



### AUD/NZD Key levels: 1.2200 - 1.2460

- The recovery in AUD/NZD stumbled this week as the cross failed to sustain moves above 1.24 as NZD/USD rallied above 0.70 (albeit briefly) for the first time in over a year on strong buying demand.
- NZ retail sales and manufacturing activity data will be the key economic focus next week. But like for the AUD, the NZD is likely to continue to be pushed around by overnight flows and global risk dynamics rather than by any developments in the underlying fundamental drivers. As such, look to trade in AUD/NZD to remain largely contained within a 1.2200-1.2460 range.

## ANZ economic and financial market forecasts

Australian economic indicators	2008	2009f	2010f	2011f
<b>Economic activity (annual % change)</b>				
Private final demand	4.4	-0.4	1.2	3.7
Household consumption	2.6	1.4	1.5	3.0
Dwelling investment	2.8	-7.6	5.3	5.9
Business investment	13.9	-3.8	-1.6	5.6
Public demand	6.2	2.6	6.9	4.2
Domestic final demand	4.8	0.3	2.5	3.9
Inventories (contribution to GDP)	-0.7	-0.3	0.6	0.0
Gross National Expenditure (GNE)	4.1	0.0	3.1	3.9
Exports	3.8	1.0	1.1	4.5
Imports	11.3	-9.6	6.9	9.5
Net Exports (contribution to GDP)	-1.8	2.6	-1.3	-1.3
<b>Gross Domestic Product (GDP)</b>	<b>2.4</b>	<b>0.8</b>	<b>1.6</b>	<b>3.2</b>
<b>Prices and wages (annual % change)</b>				
Inflation: Headline CPI	4.4	1.8	2.5	2.0
Underlying*	4.4	3.7	2.4	2.1
Wages	4.2	3.6	2.9	3.3
<b>Labour market</b>				
Employment (annual % change)	2.2	0.0	-0.3	1.8
Unemployment rate (%)	4.3	5.9	7.2	7.1
<b>External sector</b>				
Current account balance: A\$ bn	-54.5	-48.5	-56.5	-63.0
% of GDP	-4.6	-4.0	-4.5	-4.7

\*Average of RBA weighted median and trimmed mean statistical measures.

Australian interest rates	Current	Dec 09f	Mar 10f	Jun 10f	Sep 10f	Dec 10f
RBA cash rate	3.00	3.00	3.25	3.50	3.75	4.00
90 day bill	3.45	3.45	3.55	3.80	4.30	4.30
3 year bond	4.66	5.00	5.15	5.10	5.20	5.25
10 year bond	5.41	5.60	5.65	5.60	5.80	5.85
3s10s yield curve	0.74	0.60	0.50	0.50	0.60	0.60
3 year swap	5.16	5.30	5.45	5.40	5.67	5.72
10 year swap	6.01	5.95	5.95	5.90	6.35	6.40
<b>International interest rates</b>						
RBNZ cash rate	2.50	2.50	2.50	2.50	3.00	4.00
NZ 90 day bill	2.77	2.80	2.80	2.80	3.63	4.47
US Fed funds note	0.25	0.25	0.25	0.25	0.50	0.75
US 2 year note	0.93	1.00	1.25	1.50	2.00	2.25
US 10 year note	3.48	4.00	4.15	4.30	4.50	4.45
Japan call rate	0.10	0.10	0.10	0.10	0.25	0.25
ECB refinance rate	1.00	1.00	1.00	1.00	1.00	1.25
UK repo rate	0.50	0.50	0.50	0.50	0.50	1.00

For additional information on interest rates please refer to ANZ's *Interest Rate Strategy Weekly*.

Foreign exchange rates	Current	Dec 09f	Mar 10f	Jun 10f	Sep 10f	Dec 10f
<b>Australian exchange rates</b>						
A\$/US\$	0.8601	0.80	0.80	0.83	0.84	0.86
NZ\$/US\$	0.6976	0.64	0.59	0.59	0.60	0.62
A\$/¥	79.12	80.00	84.00	89.64	92.40	96.32
A\$/€	0.5899	0.58	0.58	0.59	0.60	0.61
A\$/£	0.5195	0.50	0.49	0.51	0.50	0.51
A\$/NZ\$	1.2327	1.25	1.36	1.41	1.40	1.39
A\$/CA\$	0.9275	0.86	0.84	0.87	0.88	0.88
A\$/CHF	0.8939	0.91	0.91	0.94	0.95	0.96
A\$/CNY	5.872	5.46	5.46	5.67	5.73	5.85
A\$ Trade weighted index	67.40	63.84	64.48	66.92	67.39	68.60
<b>International cross rates</b>						
US\$/¥	92.00	100.0	105.0	108.0	110.0	112.0
€/US\$	1.4579	1.38	1.38	1.40	1.40	1.42
€/¥	134.12	138	145	151	154	159
£/US\$	1.6557	1.60	1.62	1.64	1.67	1.70
€/£	0.8799	0.86	0.85	0.85	0.84	0.84
US\$/CA\$	1.0785	1.07	1.05	1.05	1.05	1.02
US\$/CHF	1.0396	1.14	1.14	1.13	1.13	1.12
US\$ index	76.93	80.8	81.1	80.5	80.5	79.6
<b>Asia exchange rates</b>						
US\$/CNY	6.828	6.83	6.83	6.83	6.82	6.80
US\$/HKD	7.751	7.75	7.75	7.76	7.77	7.80
US\$/IDR	9930	9750	9500	9625	9250	9000
US\$/INR	48.34	48.00	47.00	47.50	47.00	47.00
US\$/KRW	1225	1125	1175	1150	1100	1050
US\$/MYR	3.49	3.50	3.48	3.45	3.40	3.40
US\$/PHP	48.32	48.00	48.00	47.00	47.00	46.00
US\$/SGD	1.42	1.46	1.45	1.44	1.44	1.43
US\$/THB	34.01	34.00	34.00	34.00	33.50	33.50
US\$/TWD	32.68	32.50	32.00	31.50	31.00	30.30
US\$/VND	17832	18500	18500	18500	18500	19300
<b>Pacific exchange rates</b>						
PGK/US\$	0.373	0.374	0.392	0.381	0.395	0.386
FJD/US\$	0.509	0.472	0.469	0.476	0.480	0.486

**Important Notice**

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

100 Queen Street, Melbourne, Victoria, 3000, Australia

Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of FINRA [[www.finra.org](http://www.finra.org)] and SEC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

This document ("document") is distributed to you in Australia and the United Kingdom by Australia and New Zealand Banking Group Limited ABN 11 005 357 522 ("ANZ") and in New Zealand by ANZ National Bank Limited ("ANZ NZ"). ANZ holds an Australian Financial Services licence no. 234527 and is authorised in the UK and regulated by the Financial Services Authority ("FSA").

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZ S") (an affiliated company of ANZ), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any securities referred to herein should contact ANZ S, not its affiliates.

This document is being distributed in the United Kingdom by ANZ solely for the information of its eligible counterparties and professional clients (as defined by the FSA). It is not intended for and must not be distributed to any person who would come within the FSA definition of "retail clients". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZ, ANZ NZ, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZ, ANZ NZ, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will directly or indirectly relate to specific recommendations or views expressed about any securities or issuers in this document. ANZ, ANZ NZ, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.

Where the recipient of this publication conducts a business, the provisions of the Consumer Guarantees Act 1993 (NZ) shall not apply.