



ECONOMICS & MARKETS RESEARCH

ANZ AUSTRALIAN ECONOMICS WEEKLY

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ECONOMIC UPDATE: ECONOMY AND RATES STAY ON TRACK

- The RBA increased the cash rate by 25 bps to 4.00% this week, as expected by economists and required by current estimates of economic growth.
- Headline real GDP grew 0.9% QoQ in Q4 and Q3 growth was revised up a touch, taking annual growth for the 2009 calendar year to 1.3%. This was easily the best annual growth rate among major developed economies in 2009.
- Early 'hard' data for Q1 2010 support the RBA's (and our own) view that the economy is rapidly moving back toward trend growth of around 3% in 2010.

RBA CONTINUES TIGHTENING AS ECONOMY RAPIDLY REGAINS STRENGTH

This week's decision by the RBA to withdraw stimulus after the pause last month is a further step in taking lending rates back to a more normal setting. But even with a cash rate of 4.00%, the RBA believes retail lending rates are still below average levels, leaving open further short-term lifts in the cash rate in the coming months.

The wording of the statement was very similar to February's statement (accompanying no move) in suggesting the decision was a close call. But this month, more concrete positive signals tipped the balance, including continuing gains in the labour market, "very strong" investment in the resources sector and only a moderate slowdown in new home loan approvals in recent months as the First-home Buyer Grant has tailed off and interest rates have risen. Retail trade growth for January also came in strongly (+1.2% MoM), suggesting consumer confidence is still strong enough to support spending, even after 3 rate rises. The RBA is optimistic about both the near-term and longer-term drivers of economic growth and the (seemingly modest) impact from the rise in interest rates so far. The Bank made it clear in February's statement that it wanted time to assess the impact of last year's lift in the cash rate. And as was expected, the data has continued to support (and vindicate) its tightening stance.

Now that the economy is back on track, the RBA is aiming to take rates back to neutral. And only a very weak run of activity data or an unexpected drop in inflationary pressures would be likely change its mind on this. Indeed, further cash rate rises from here are only a matter of timing. Another sharp fall in the unemployment rate (due for release next Thursday) for example, might be enough to seal the next lift in the cash rate as early as April, especially given the continuing strength of retail trade and the property market so far this year. We still expect the cash rate to reach 4.75% by year.

Q4 GDP TELLS TALE OF DOMESTIC STRENGTH BUT ONGOING EXPORT WOES

Real GDP expanded by 0.9% in Q4 2009 following a (revised up) 0.3% increase in Q3:

- The yearly rate of growth jumped to 2.7%,
- Non-farm GDP expanded by 0.8%.

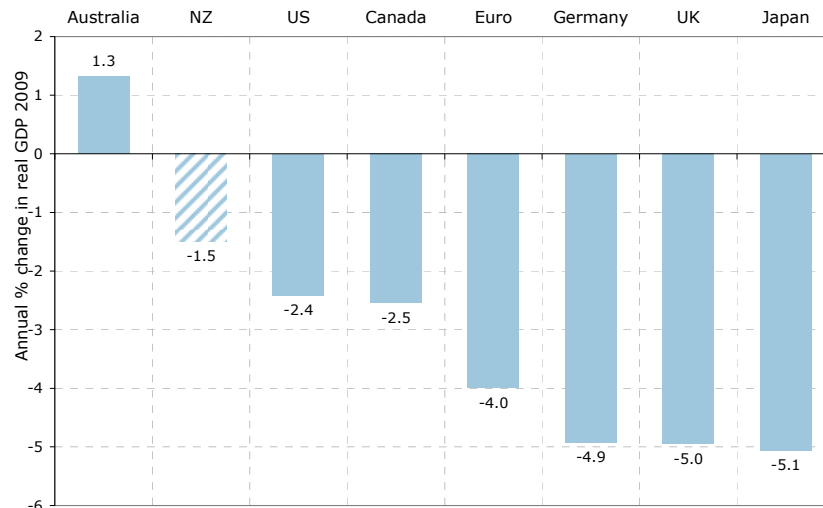
On the **expenditure** side of GDP the key drivers of growth in Q4 were:

- a 3.5% increase in private investment (GFCF), with a 10.9% jump in machinery and equipment investment driving a 4.9% rise in business investment,
- a 10.2% increase in public investment on the back of a 13.0% rise in General, State and local investment government,
- a 0.7% increase in household expenditure. Purchase of vehicles (+6.8%) and rent and other dwelling services (+0.7%) were key in this expansion,
- Weighing on growth, was net exports with a sharp rise in imports (+7.7%) outweighing relatively modest exports growth (+1.7%).

Remarkably, with 1.3% annual average growth for the 2009 calendar year, Australia's GDP growth was beaten only by Poland (1.7%) among all OECD/developed countries.

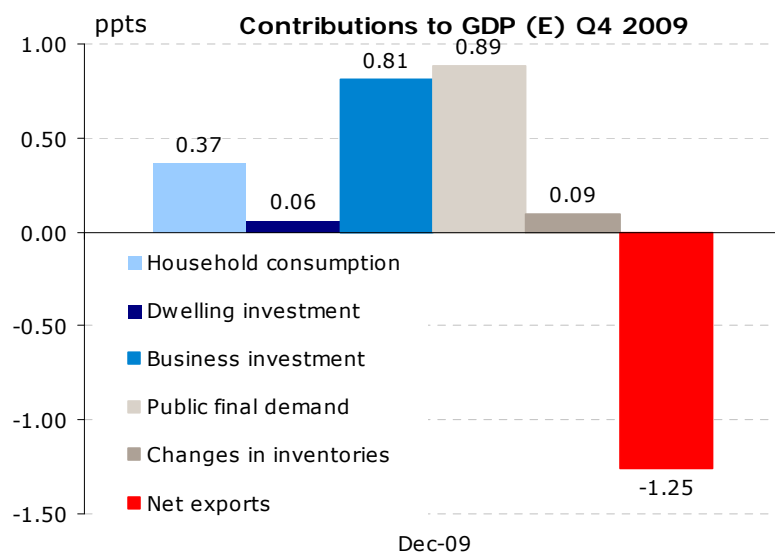
ECONOMIC UPDATE

FIGURE 1. AUSTRALIA OUTGUNNED ALL DEVELOPED PEERS IN 2009



Source: ABS, Bloomberg, ANZ forecast (New Zealand).

FIGURE 2. Q4 GROWTH DRIVEN BY CONSUMPTION AND INVESTMENT



Source: ABS.

The major contributions to expenditure growth in the Q4 were: Machinery and equipment investment (0.8 ppts), public gross fixed capital formation (0.6 ppts), household final consumption expenditure (0.4 ppts) and inventories and dwelling investment (both 0.1 ppts). Offsetting the growth was imports of goods and services (detracting 1.6 ppts).

Again this quarter we witnessed the impact of fiscal stimulus, particularly through public sector investment and accommodative monetary policy. Household consumption was solid but as interest rates rise we are likely to see this growth moderate in 2010. However, offsetting this should be business investment which continues to recover strongly, stepping in as public sector investment also fades.

The implications from these expenditure data are clear, the domestic economy is in good nick, indeed domestic demand expanded a stellar 2.0% in the quarter. As a result we are likely to see the external sector continue to weigh on overall growth as the domestic economy drives strong imports growth while export growth remains tepid as the global economy recovers. Despite, trade volumes working against the economy, a 2.9% rise in the terms of trade suggests trade prices are moving the right way. This will continue into 2010 as large bulk commodity price rises come into force mid-year.

ECONOMIC UPDATE

The **income** side of GDP rose by 0.9% in the quarter, with 4 quarter ended growth at 2.6%. In current prices, income from GDP rose 1.9%. Non-financial corporate profits rose by 4.8% in the quarter but remain down 6.2% over the past year. Financial corporations profits gained 2.1% in the quarter. Employee compensation rose by 0.4% in the quarter on the back of a strong labour market performance. Yet reflecting higher part time work average compensation per employee actually fell 0.5%. Household income growth was flat in the quarter and given the gain in consumption the HH savings ratio fell to 2.3%. Labour productivity (GDP per hr worked in the market sector) fell by 0.2% in the quarter following a 0.7% gain in Q3, again reflecting a record high proportion of part-time workers (30.2%). Real Gross Domestic Income rose by 1.5% in the quarter reflecting the gains in the terms of trade.

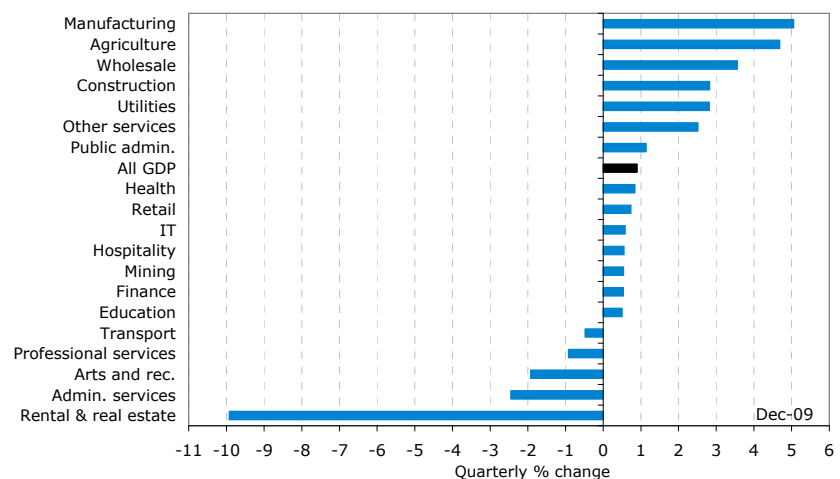
On the **production** side of GDP, agriculture, manufacturing, construction, wholesale trade, financial services and healthcare all contributed 0.1 ppts (plus 0.1 from 'ownership of dwellings') to GDP growth. This was despite their quarterly growth rates being relatively weaker than some other industries. It reflects their sheer size in the Australian economy. Financial and insurance services (currently Australia's largest industry, in value-added terms) actually grew only 0.5%QoQ, health services were up 0.8% while construction value added grew a stronger 2.8%.

Manufacturing was probably the star performer this quarter, with a very healthy rebound of 5%QoQ, its strongest quarterly growth since 1988. But after several quarters of contraction, it is still only 0.6% larger than last December. Manufacturing remains Australia's second-largest industry, in value-added terms. The best growth rates among manufacturing sectors were in the dominant machinery and equipment segment (+14.9%QoQ), the smaller wood and paper products (+10.8%), printing and recorded media (+7.3%) and a rare growth spurt from textiles clothing and footwear (+6.8%).

Among other industries, wholesale trade recorded strong quarterly growth of 3.6%, probably reflecting more activity among importers of vehicles and other business-investment-related goods. Retail trade expanded by only 0.7% however, reflecting relatively weaker consumer spending. Other sectors showing good growth in output this quarter included utilities (+2.8%QoQ and +5.9%YoY), public administration (+1.1%QoQ but only +.3%YoY) and the always volatile agriculture industry (+4.7%QoQ and +8.1%YoY).

Industries that saw some contraction in output in Q4 were all in the business and services sectors, including rental and real estate services (-9.9%, almost totally undoing the 9% growth of Q3, and 5.9% below a year earlier), professional services (-0.9%), administrative services (-2.4%) and arts and recreation (-1.9%). Mining output was also weak, at +0.5%QoQ but -0.3% YoY. Construction, hospitality, transport and administrative services also finished the year below their output levels of a year earlier.

FIGURE 3. WHERE DID OUR OUTPUT GROWTH COME FROM IN Q4?



Source: ABS.

ECONOMIC UPDATE

State final demand (which measures total consumption but not income or production in each state) in Q4 was strongest in Victoria and the ACT (both 3% QoQ), with WA and NSW both showing solid growth in demand (+2.6% and +2.4% respectively). Victorian consumption is clearly showing the signs of a boom in population and jobs growth, while the ACT is benefiting from stronger federal government activity, and WA may be already benefiting from the resurgent commodities boom. Elsewhere, SA was surprisingly weak, with only 0.6% growth in demand.

EARLY INDICATORS FOR Q1 SHOW RECOVERY IS WELL ON TRACK

The Australian economy showed considerable strength in Q3 and Q4 2009, relatively early in the recovery phase, supported by stimulatory monetary and fiscal policies. The first quarter of this year probably marks the first real test of how the economy is faring in the post-stimulus phase, and so far, it is passing with flying colours. Business sentiment and conditions surveys, the national labourforce data and retail trade data for January have been particularly encouraging, as noted by the RBA when it raised rates this week. Good growth prospects are now in train on a number fronts, including in the all-important business investment outlook.

Going forward we anticipate that business investment will be the key driver of growth as a modest tightening path for interest rates weighs on aggregate household disposable incomes and spending. Nonetheless, as we move further into 2010, we expect growth will continue to accelerate apace as we return to trend growth of 3%.

DATA WRAP: WEEK COMMENCING 1 MARCH 2010

- **AiG's PMI** increased to 53.8 points in February from 51.0 in January (readings above 50 points indicate net expansion in this survey).
- **TD Securities inflation gauge** slowed to 0.1% MOM in February from 0.8% in January, taking estimated annual inflation from 2.6% in January to 1.9% in February.
- **HIA's new home sales** grew 9.5% (MoM) in January, up from a revised -1.1% in December (revised up from -4.6%).
- **Current account balance** for Q4 came in at -17.4M, widening from 14.7M in Q3 of 2009.
- **Inventories** for Q4 increased by 0.2%, a much softer figure when compared to the +0.8% increase in Q3.
- **Corporate Operating Profits** rebounded strongly to 2.2% in Q4, from the previous quarter's release of -1.4%.
- **Building approvals** in January fell to -7.0% QoQ (47.6% YoY) from 2.2% QoQ (53.3% YoY) in December.
- **Retail trade turnover** in January were much stronger than anticipated at 1.2%, up from -0.7% in December.
- **RBA cash rate** increased by 25bps to 4.00%
- **AiG's PSI** increased to 48.3 for the month of February, up from 47.4 in January (readings above 50 points indicate net expansion in this survey).
- **GDP** in (Q4) increased by 0.9% QoQ (2.7% YoY), up from 0.3% QoQ (0.5%).
- **FCAI's total new vehicle sales** for February came in at 82,219 vehicles (raw unadjusted data), 9.8% higher than January and 17.1% higher than the same month a year ago.
- **International trade balance** for January contracted to 1176M, from 2252M in December.

FORECASTS

AUSTRALIAN ECONOMIC INDICATORS	2008	2009	2010 F	2011 F
Economic activity (annual % change)				
Private final demand	4.2	1.1	4.2	4.7
Household consumption	2.7	2.2	2.4	3.0
Dwelling investment	2.6	-4.4	16.5	7.9
Business investment	12.3	-0.7	5.9	8.8
Public demand	6.7	3.1	8.2	3.9
Domestic final demand	4.8	1.6	5.1	4.5
Inventories (contribution to GDP)	-0.4	-0.5	0.5	0.0
Gross National Expenditure (GNE)	4.5	1.0	5.6	4.5
Exports	2.6	0.5	2.4	5.4
Imports	11.4	-7.7	14.7	9.9
Net Exports (contribution to GDP)	-1.8	1.8	-2.5	-1.2
Gross Domestic Product (GDP)	2.4	1.3	3.2	3.4
Prices and wages (annual % change)				
Inflation: Headline CPI	4.4	1.8	2.4	2.8
Underlying *	4.4	3.8	2.9	2.7
Wages	4.2	3.6	2.8	3.3
Labour market #				
Employment (annual % change)	2.2	0.3	2.5	2.0
Unemployment rate (annual average %)	4.2	5.6	5.2	4.9
External sector				
Current account balance: A\$bn	-54.6	-51.7	-60.4	-57.8
% of GDP	-4.4	-4.1	-4.5	-4.0

* Average of RBA weighted median and trimmed mean statistical measure.

AUSTRALIAN INTEREST RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
RBA cash rate	4.00	4.00	4.25	4.50	4.75	4.75
90 day bill	4.20	4.17	4.75	4.85	5.00	5.00
3 year bond	4.84	4.85	5.00	5.05	5.30	5.55
10 year bond	5.46	5.44	5.50	5.45	5.60	5.75
3s10s yield curve	0.62	0.59	0.50	0.40	0.30	0.20
3 year swap	5.20	5.22	5.45	5.50	5.75	6.00
10 year swap	5.96	6.03	6.05	6.00	6.15	6.30
INTERNATIONAL INTEREST RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
RBNZ cash rate	2.50	2.50	2.75	3.25	3.75	3.75
NZ 90 day bill	2.69	2.85	3.22	3.72	4.05	4.05
US Fed funds note	0.25	0.25	0.25	0.25	0.75	1.25
US 2 year note	0.80	0.82	1.50	1.75	2.20	2.65
US 10 year note	3.60	4.56	4.30	4.25	4.40	4.45
Japan call rate	0.10	0.10	0.10	0.10	0.10	0.10
ECB refinance rate	1.00	1.00	1.00	1.00	1.50	1.75
UK repo rate	0.50	0.50	0.50	0.50	1.00	1.25

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

FORECASTS

FOREIGN EXCHANGE RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
Australian exchange rates						
A\$/US\$	0.9023	0.89	0.87	0.86	0.85	0.82
NZ\$/US\$	0.6903	0.70	0.68	0.67	0.65	0.64
A\$/¥	79.80	79.2	78.3	79.1	79.9	78.7
A\$/€	0.6592	0.65	0.65	0.65	0.65	0.64
A\$/£	0.5982	0.57	0.56	0.56	0.56	0.54
A\$/NZ\$	1.3072	1.27	1.28	1.28	1.31	1.28
A\$/C\$	0.9308	0.93	0.92	0.92	0.92	0.89
A\$/CHF	0.9643	0.95	0.95	0.95	0.97	0.95
A\$/CNY	6.1600	6.08	5.86	5.72	5.58	5.31
A\$ Trade weighted index	70.40	69.1	68.0	67.1	66.4	63.9
International cross rates						
US\$/¥	88.44	89.0	90.0	92.0	94.0	96.0
€/US\$	1.3687	1.37	1.34	1.32	1.30	1.28
€/¥	121.05	122	121	121	122	123
£/US\$	1.5084	1.55	1.54	1.54	1.53	1.53
€/£	0.9074	0.88	0.87	0.86	0.85	0.84
US\$/C\$	1.0315	1.05	1.06	1.07	1.08	1.08
US\$/CHF	1.0688	1.07	1.09	1.11	1.14	1.16
US\$ index	80.07	79.9	81.3	82.4	83.6	84.7
Asia exchange rates						
US\$/CNY	6.8266	6.83	6.74	6.65	6.56	6.47
US\$/HKD	7.7627	7.77	7.79	7.77	7.78	7.78
US\$/IDR	9270	9300	9500	9300	9000	8800
US\$/INR	45.79	45.5	46.0	45.0	44.0	43.5
US\$/KRW	1143	1150	1175	1125	1100	1050
US\$/MYR	3.3705	3.34	3.37	3.40	3.40	3.35
US\$/PHP	46.015	46.0	46.5	46.0	45.0	45.0
US\$/SGD	1.3997	1.39	1.40	1.40	1.41	1.40
US\$/THB	32.650	33.00	32.50	32.50	32.50	32.00
US\$/TWD	31.955	32.00	32.20	31.50	30.50	30.00
US\$/VND	19070	19000	19300	19300	19300	19300
Pacific exchange rates						
PGK/US\$	0.3660	0.392	0.381	0.395	0.386	0.372
FJD/US\$	0.5157	0.516	0.507	0.501	0.495	0.484

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