

Open partnerships
Open possibilities

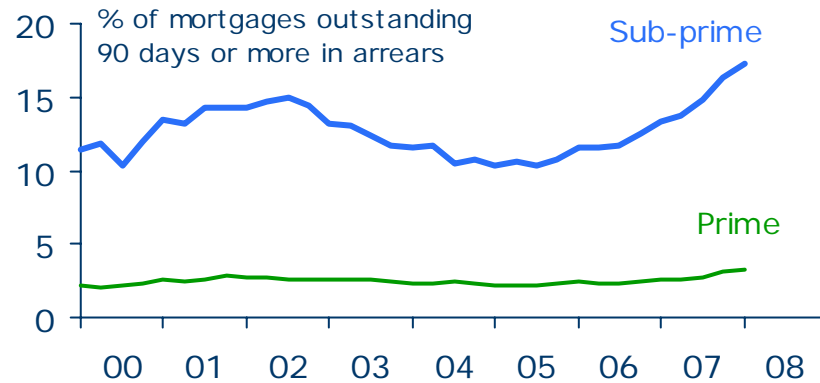
What's going on in the world economy, and what does it mean for Australia's resources sector?

The WA Mining Club
Hyatt Regency Hotel, Perth
20th May 2008

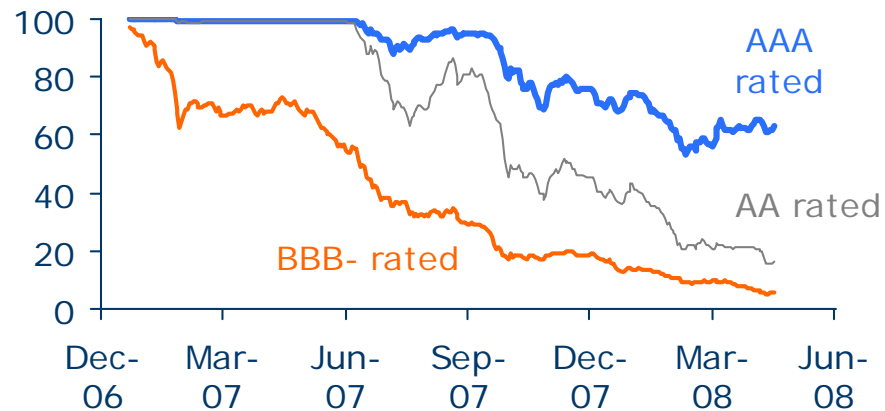
Saul Eslake
Chief Economist

The 2008-09 Budget has been brought down against the background of a serious financial crisis

US mortgage delinquencies



ABX index of prices of US mortgage-backed securities



Losses announced by major banks since mid-2007

Bank	Total (US\$ bn)
Citigroup	41.0
UBS	38.0
Merrill Lynch	31.7
Bank of America	14.9
Morgan Stanley	12.6
HSBC	12.4
JP Morgan Chase	9.7
IKB Deutsche	9.0
Washington Mutual	8.3
Deutsche Bank	7.5
Wachovia	7.3
Credit Agricole	6.5
Credit Suisse	6.3
Mizuho	5.5
Canadian Imperial (CIBC)	4.2
Societe General	3.9
TOTAL (incl. others not shown above)	290

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



The IMF has estimated that total losses could eventually reach almost US\$1 trn, nearly half of which would be by banks

Potential ultimate losses on unsecuritized loans

Type of loan	US\$bn	
	Out-standing	Estimated losses
Sub-prime	300	45
'Alt-A'	600	30
Prime	3 800	40
Commercial real estate	2 400	30
Consumer loans	1 400	20
Corporate loans	3 700	50
Leveraged loans	170	10
Total	12 370	225
of which, banks		100-130

Potential ultimate mark-to-market losses on securities

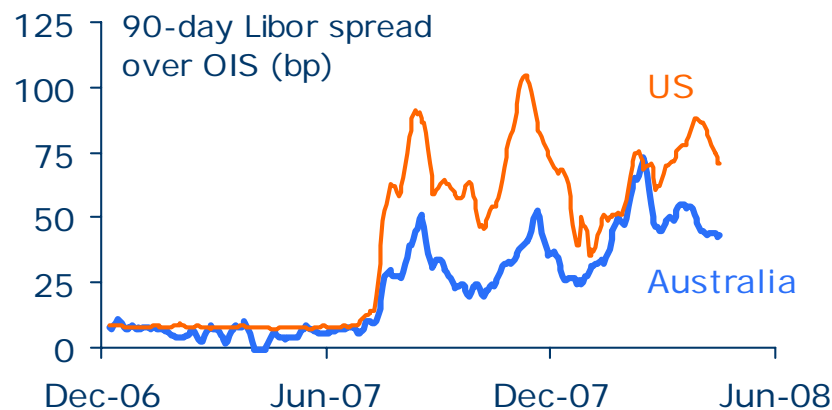
Type of security	US\$bn	
	Out-standing	Estimated losses
ABS	1 100	210
CDOs	400	240
Prime MBS	3 800	0
Commercial MBS	940	210
Consumer ABS	650	0
High-grade corporate	3 000	0
High-yield corporate	600	30
CLOs	350	30
Total	10 840	720
of which, banks		340-380

Notes: 'Alt-A' means 'low-doc' or 'no-doc' mortgage loans. ABS = asset-backed securities; CDOs = collateralized debt Obligations; MBS = mortgage-backed securities; CLOs = collateralized loan obligations.

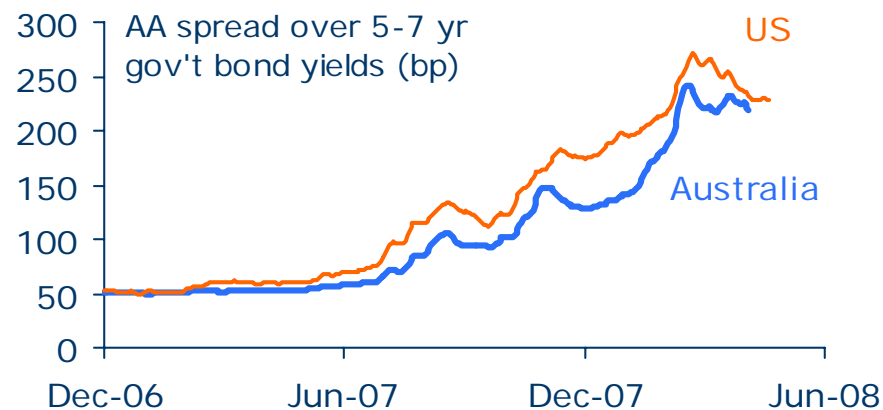
Source: IMF *Global Financial Stability Report* April 2008, p. 12

Financial market stresses have eased in recent weeks but it's far too early to say that the crisis is over

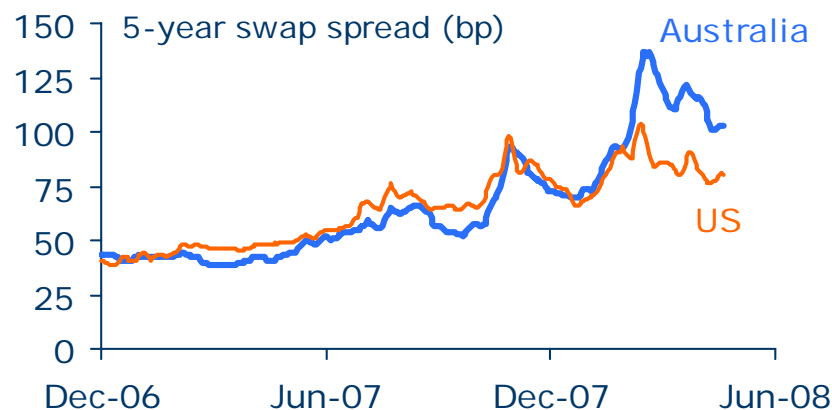
Banks' short-term funding costs



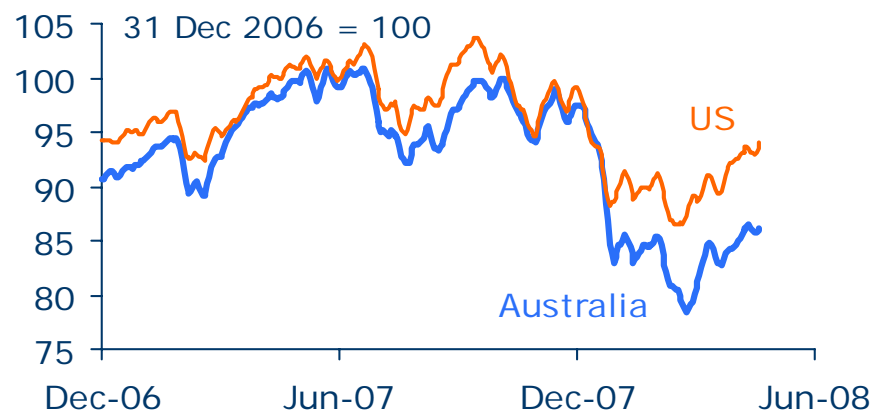
Corporate bond yield spreads



Banks' long-term funding costs



Share prices

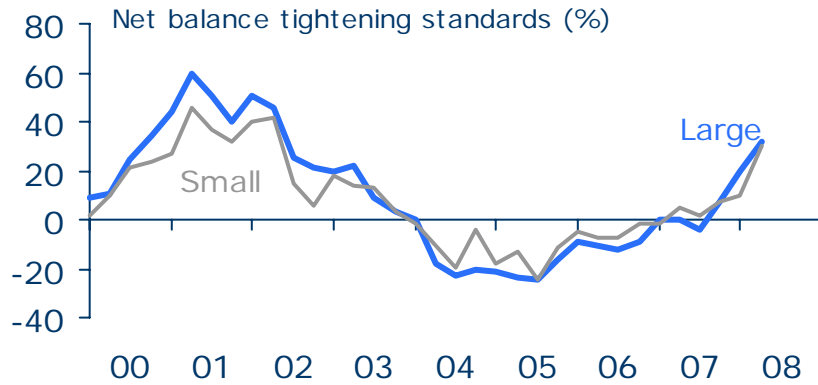


Note: all data shown as 5-day moving averages. Sources: Bloomberg; Datastream.

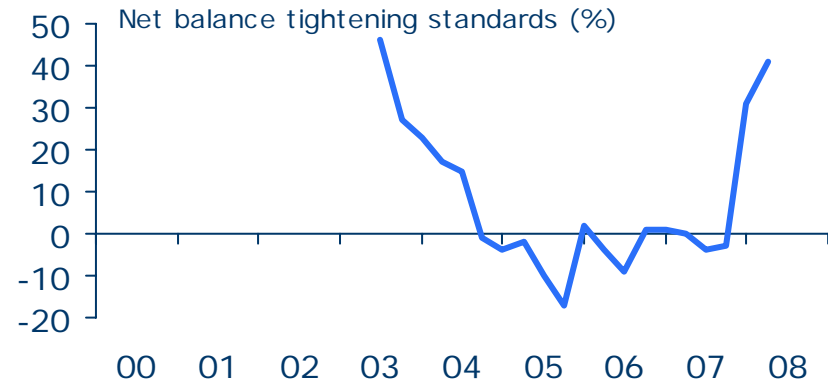


Banks in the US and the euro area are tightening credit standards

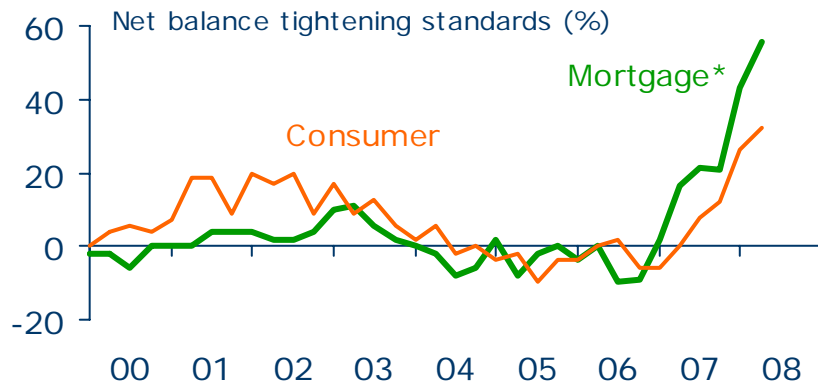
US banks
Commercial & industrial loans



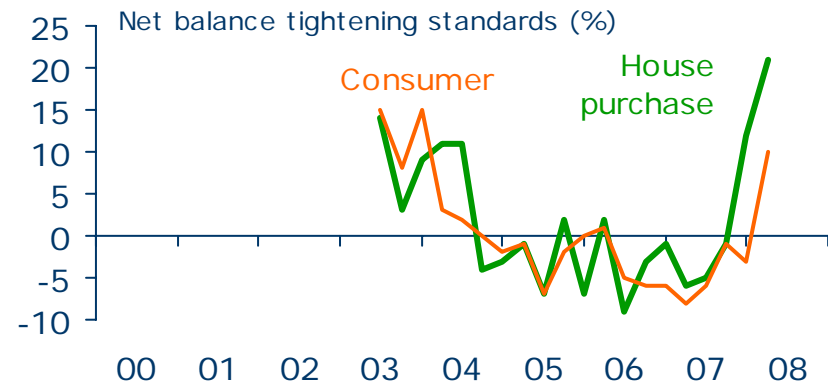
Euro area banks
Loans to enterprises



Mortgage and consumer loans



Mortgage and consumer loans



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

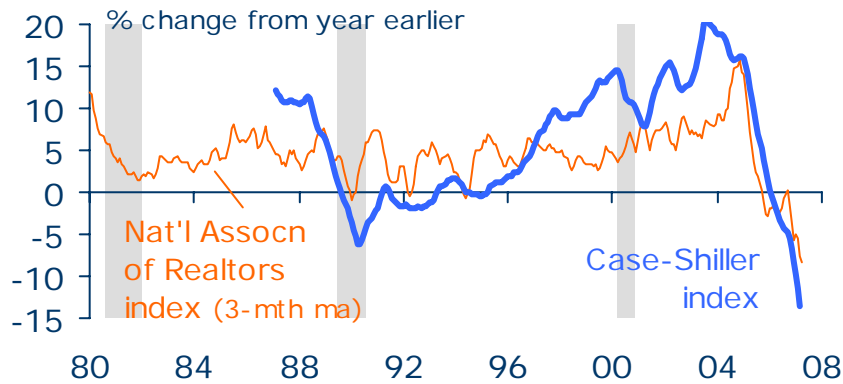
Sources: US Federal Reserve and European Central Bank surveys of loan officers.



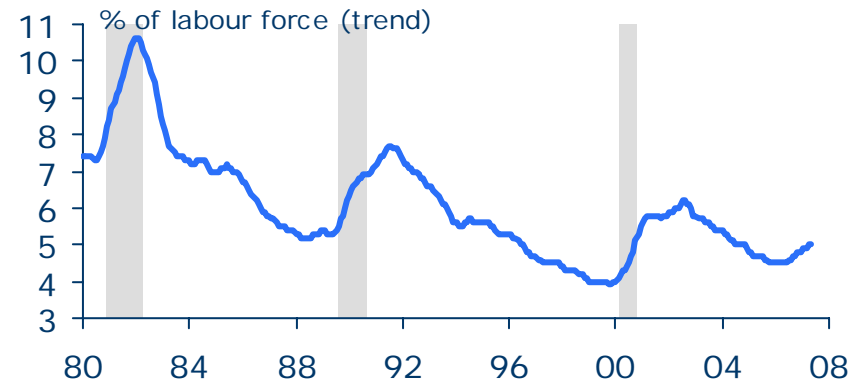
There's no sign yet that the US housing market has bottomed, or that unemployment has stopped rising

US housing, unemployment and consumer confidence

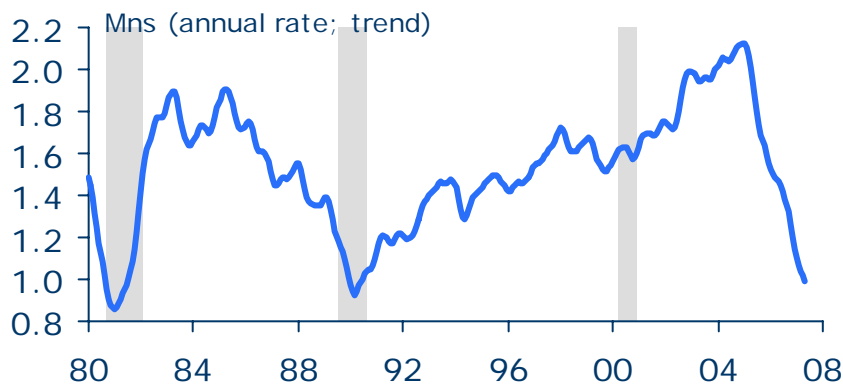
House prices



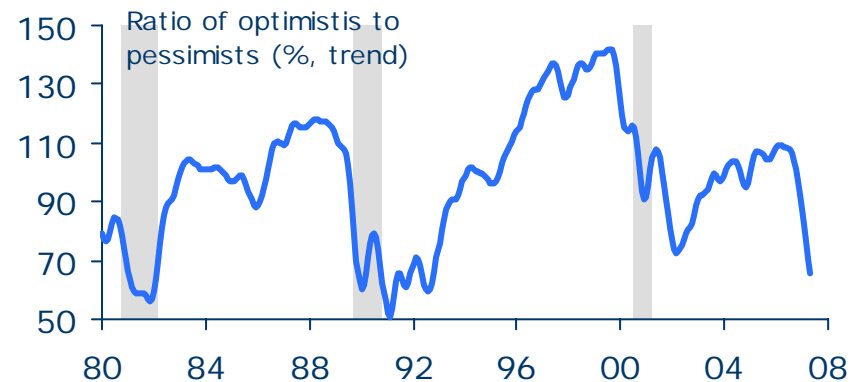
Unemployment



Housing starts



Consumer confidence



Note: Shaded areas denote recessions as defined by the National Bureau of Economic Research.

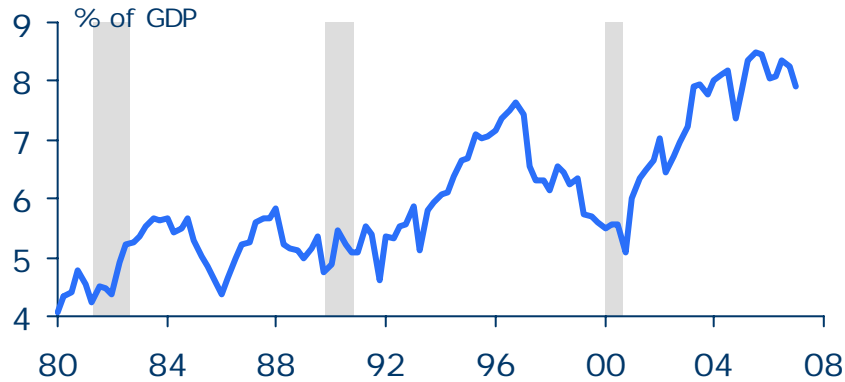
Sources: The Conference Board; Federal Reserve Banks of Chicago and Philadelphia; trend estimates derived by ANZ using Australian Bureau of Statistics formulae.



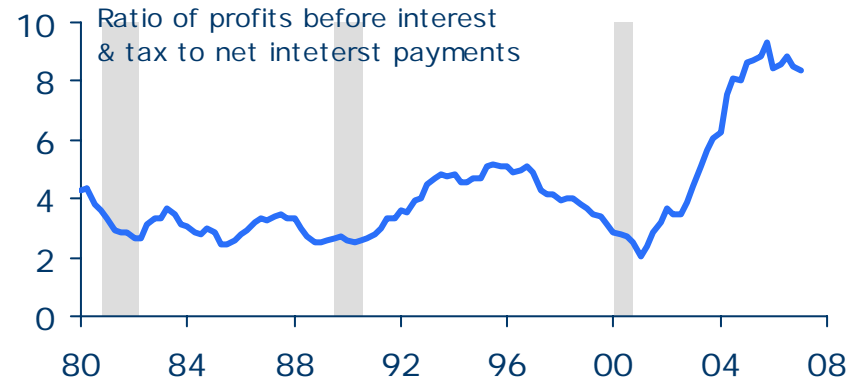
The US non-financial corporate sector isn't under the sort of pressures that typically precipitate recessions

US non-financial corporate sector

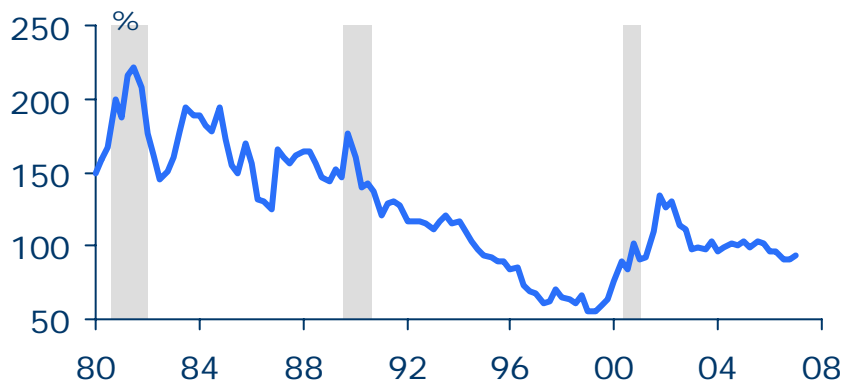
Corporate profits



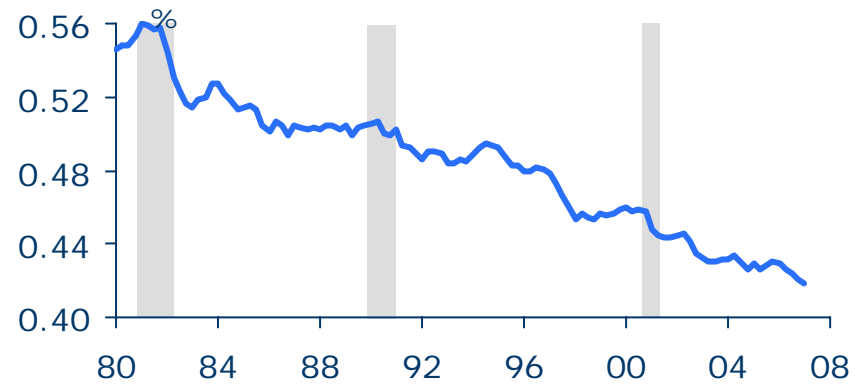
Interest cover



Corporate debt-equity ratio



Non-farm stocks-to-sales ratio



Note: Shaded areas denote recessions as defined by the National Bureau of Economic Research.

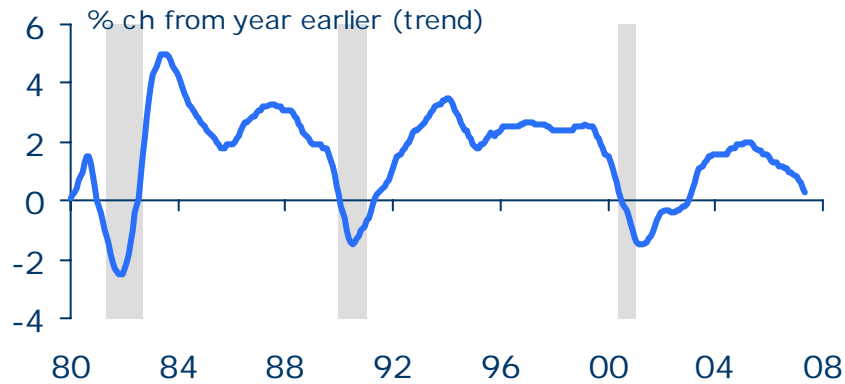
Sources: Commerce Department; Federal Reserve Board; ANZ.



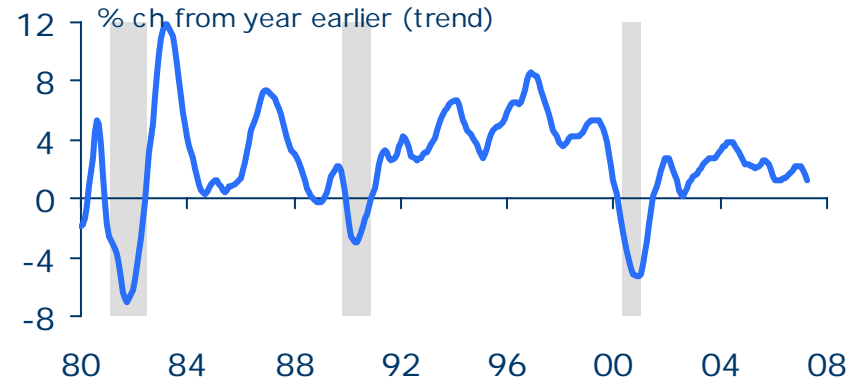
US businesses aren't slashing employment, production, capital expenditures, and stocks as they typically do in a recession

US employment, durable goods orders, production and inventories

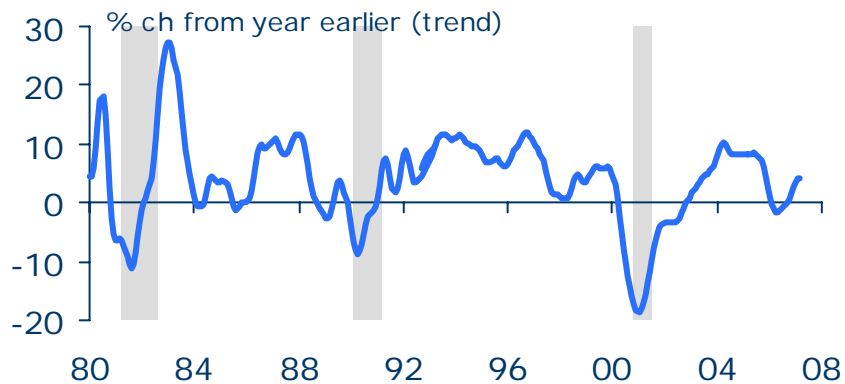
Non-farm payroll employment



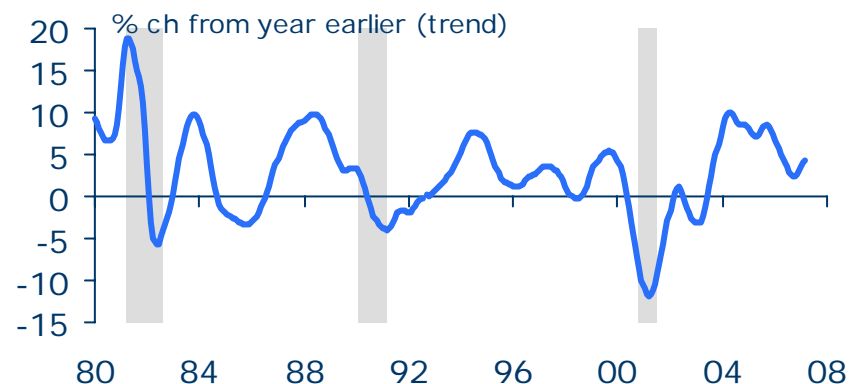
Industrial production



Orders for non-defence capital goods



Manufacturers' inventories



Note: Shaded areas denote recessions as defined by the National Bureau of Economic Research.

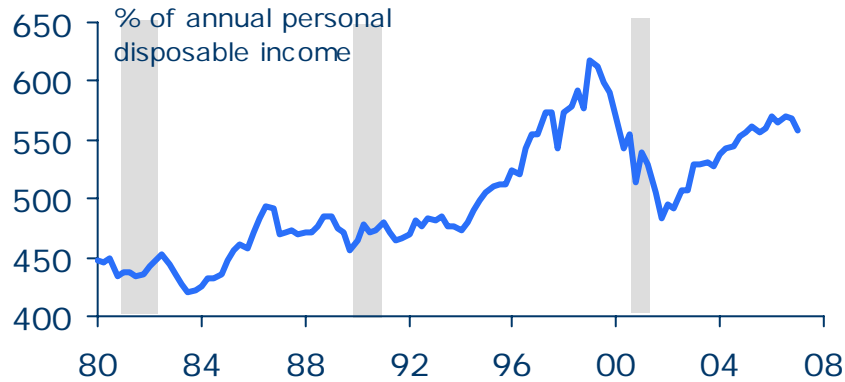
Sources: Bureau of Labor Statistics; Commerce Department; Federal Reserve Board; trend estimates derived by ANZ using Australian Bureau of Statistics formulae.



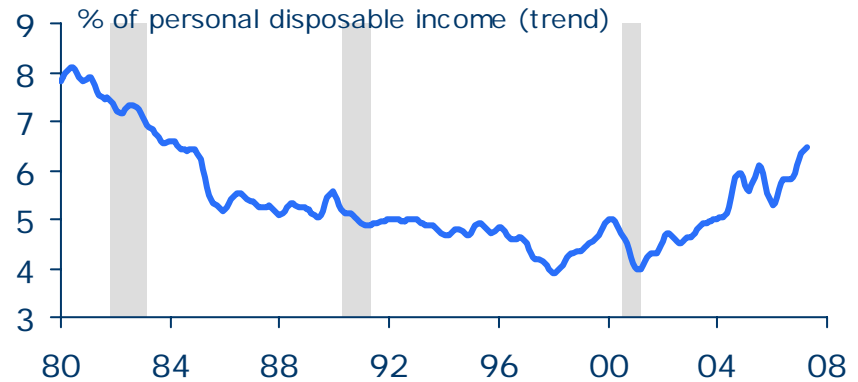
However US household finances are under considerably greater financial pressure than ever before

US household sector finances

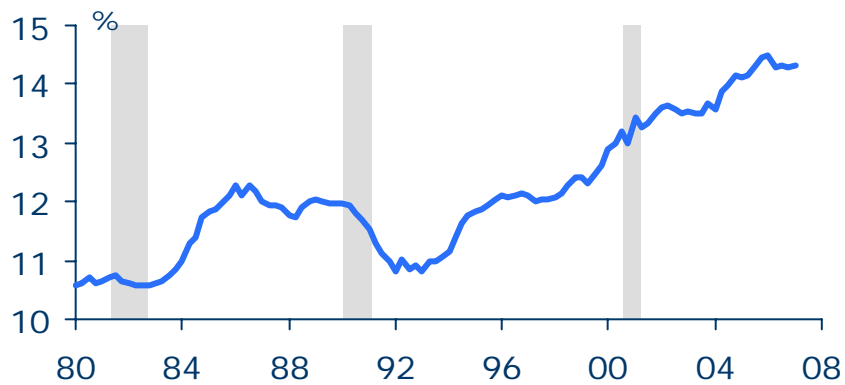
Household net worth



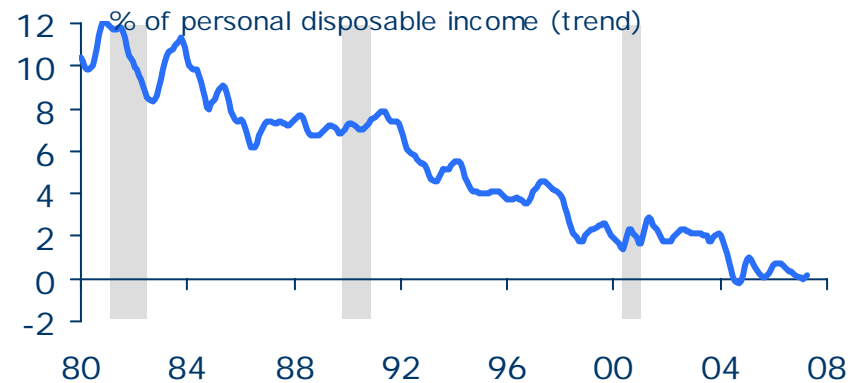
Household spending on energy



Household debt service ratio



Personal saving rate



Note: Shaded areas denote recessions as defined by the National Bureau of Economic Research.

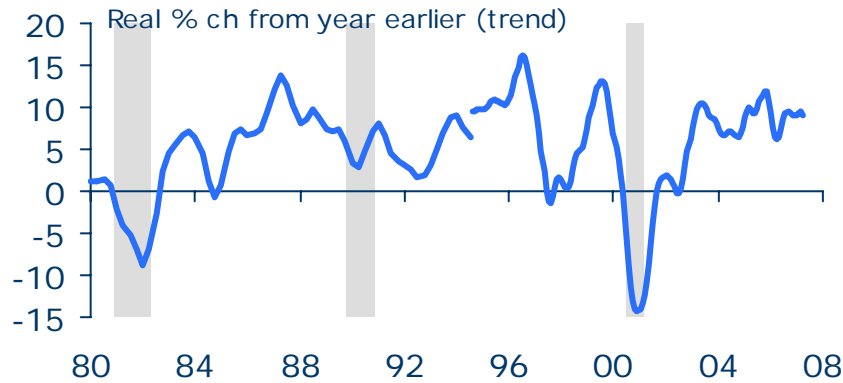
Sources: Commerce Department; Federal Reserve Board; ANZ.



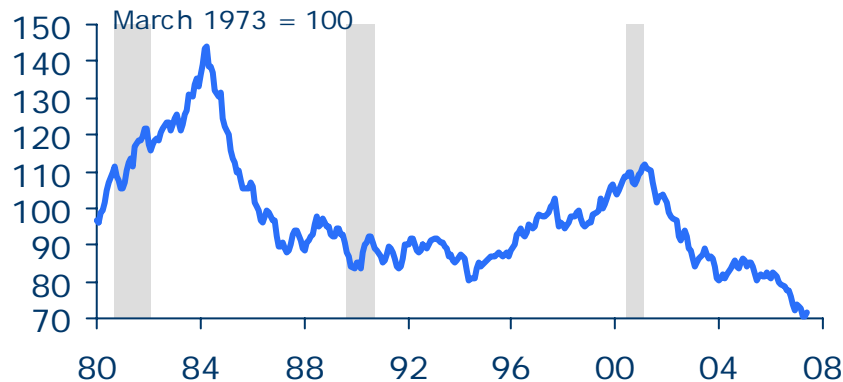
Rising exports, aided by a weaker US\$, have more than offset the impact on GDP growth of falling housing construction

US dollar, exports and housing

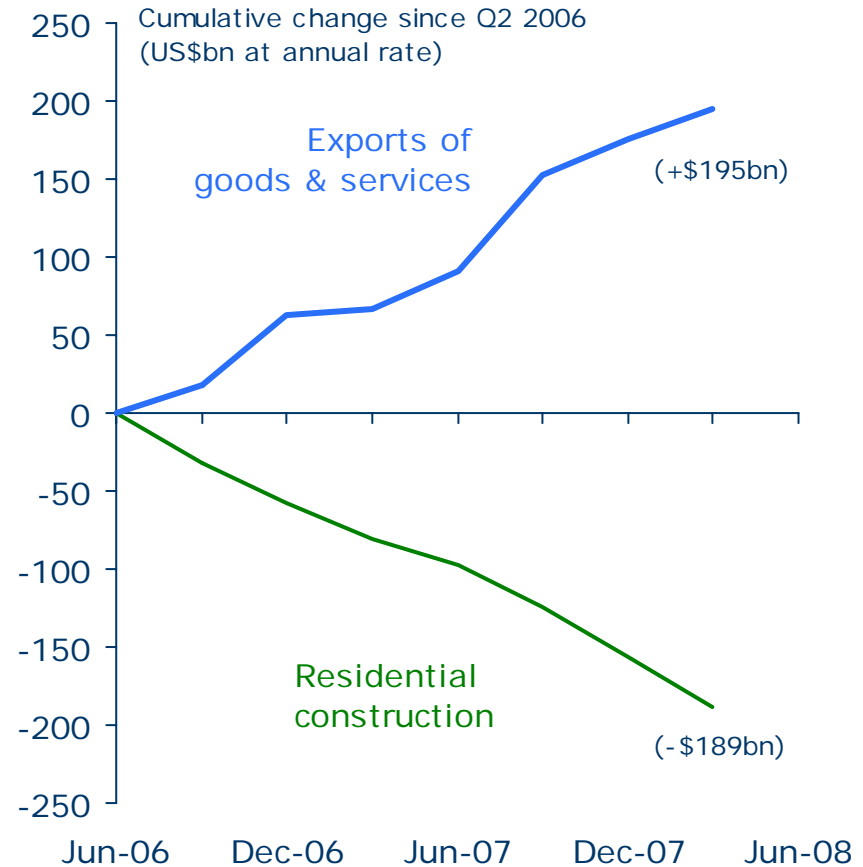
Exports of goods and services



Trade-weighted value of US\$



Exports and housing



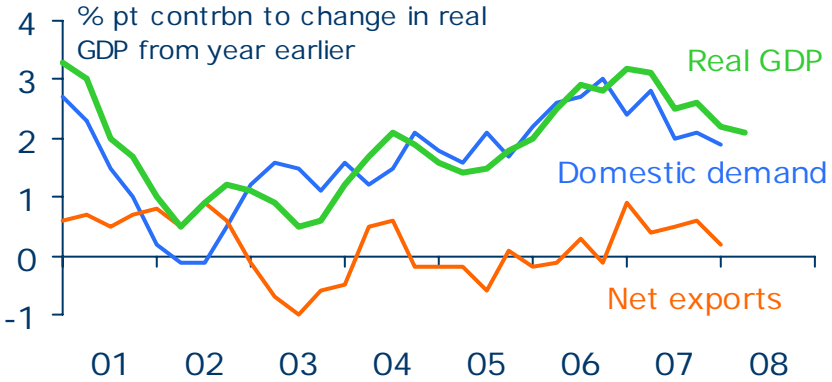
Sources: Thomson Financial; US Bureau of Economic Analysis; ANZ.



European and Japanese economies will be adversely affected by stronger currencies and (in Europe) tighter financial conditions ¹¹

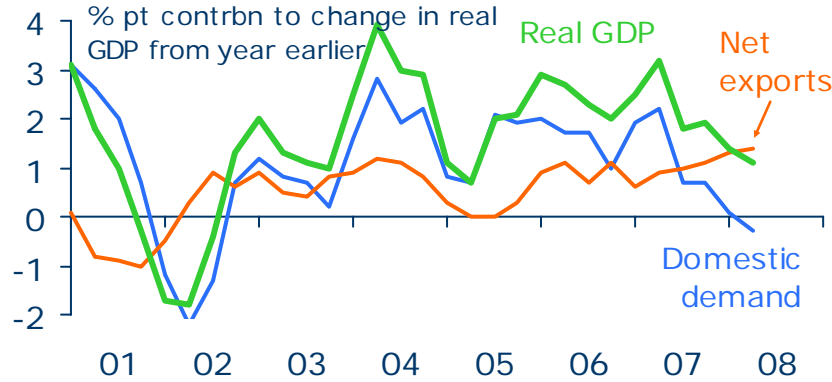
Euro area

Composition of real GDP growth

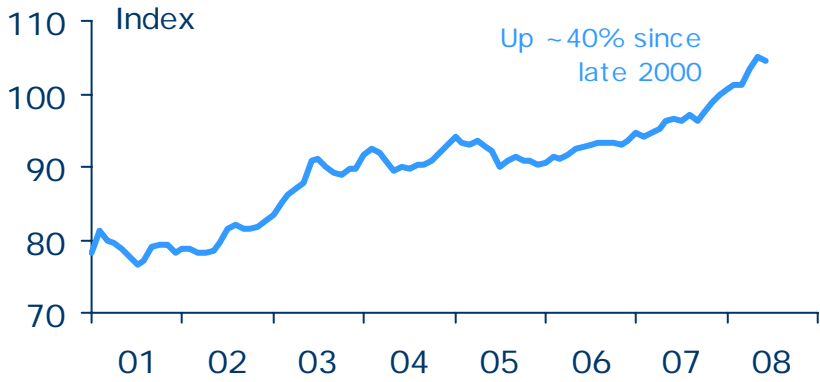


Japan

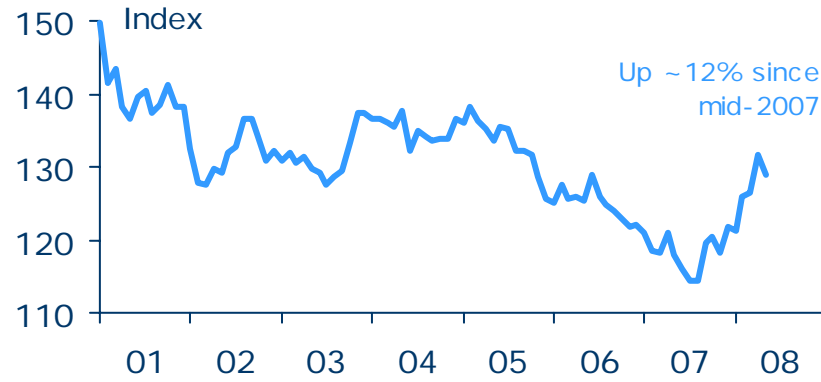
Composition of real GDP growth



Trade-weighted value of euro



Trade-weighted value of yen

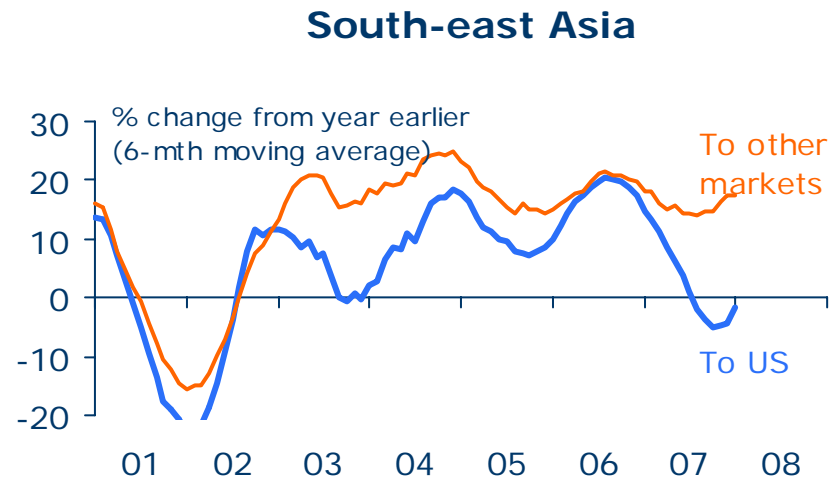
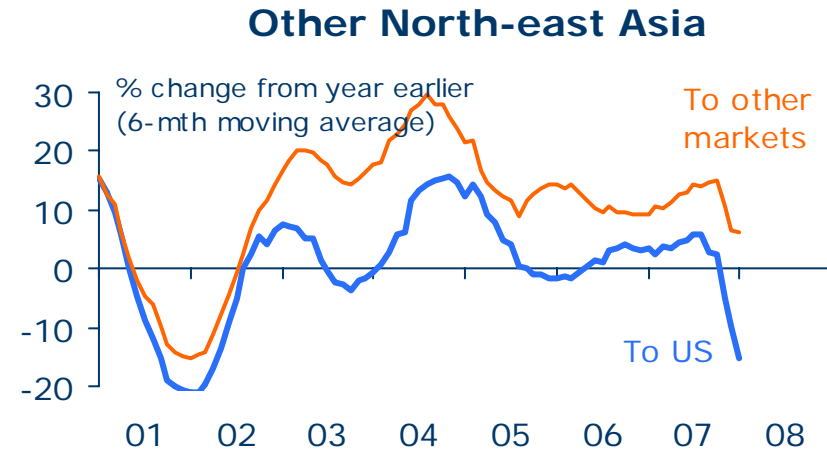
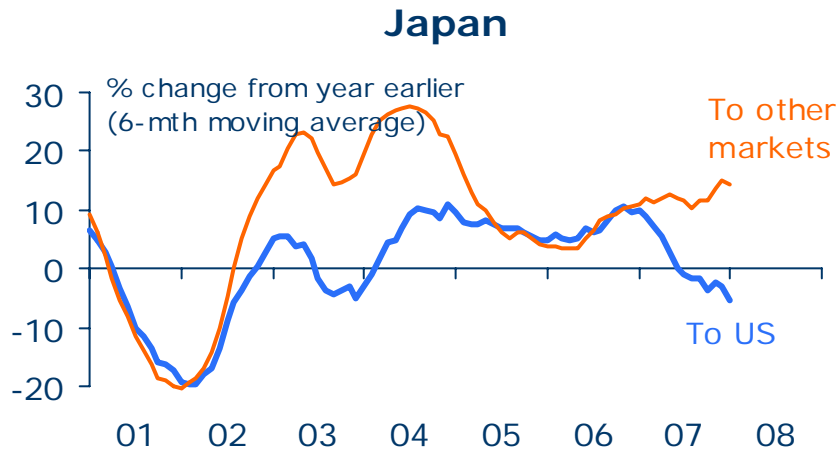


Sources: EuroStat; ECB; Japan Economic & Social Research Institute; Bank of Japan.



Developing country exports will be affected by the downturn in the US, though in a different pattern from 2001

Asian exports to US and other markets

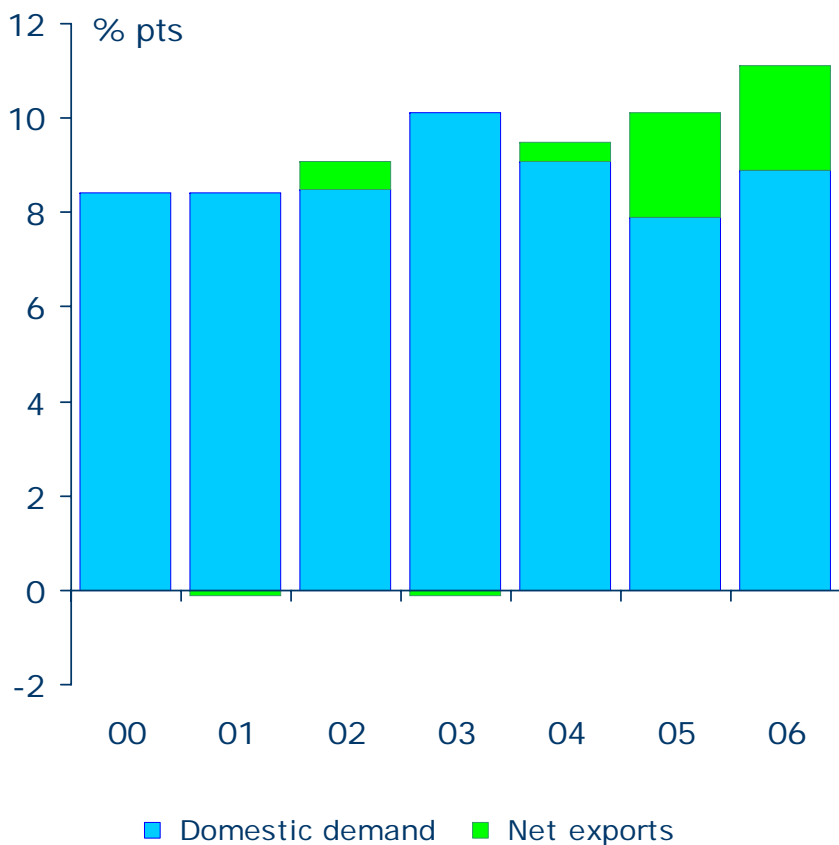


Sources: IMF Direction of Trade Statistics.

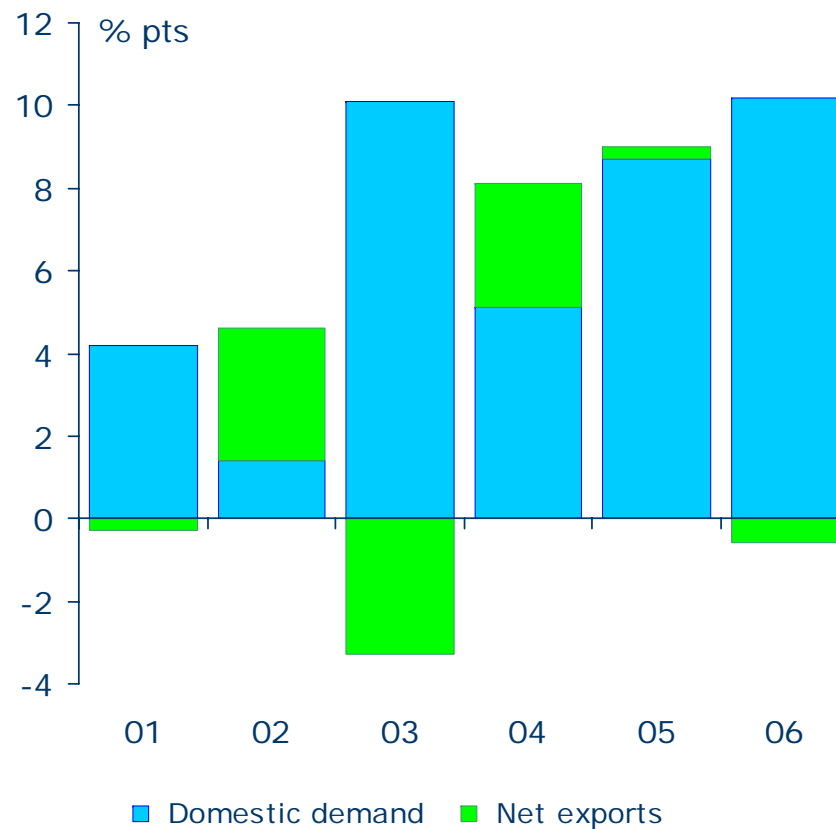


Growth in the big developing economies is not, in any case, largely dependent on exports

Contributions to China's real GDP growth



Contributions to India's real GDP growth

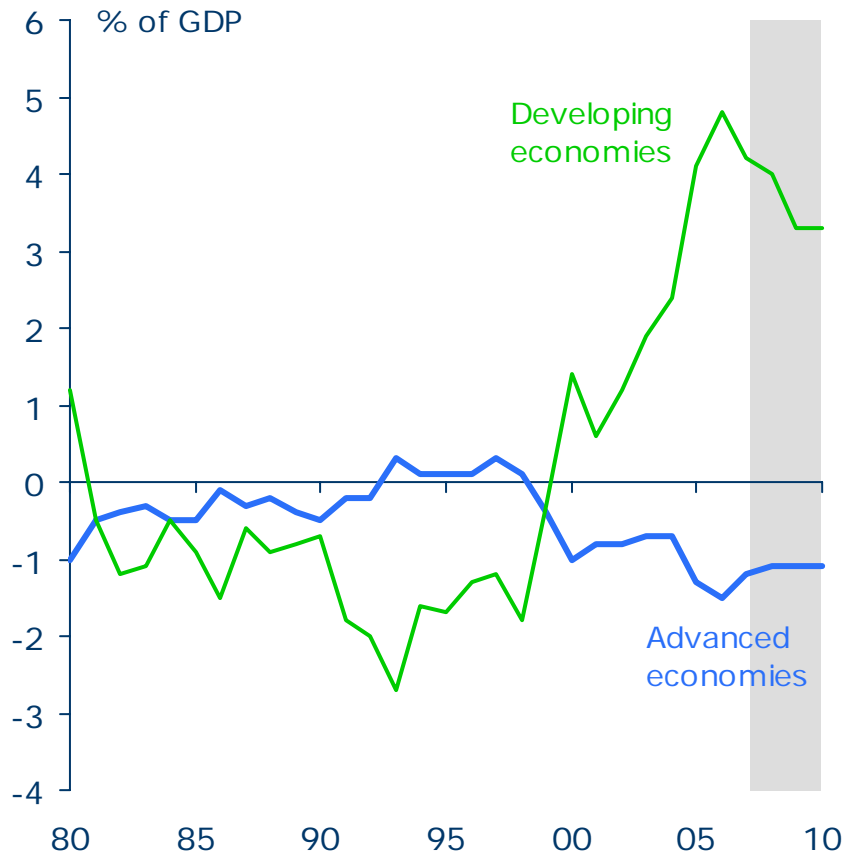


Source: China National Bureau of Statistics, CEIC.

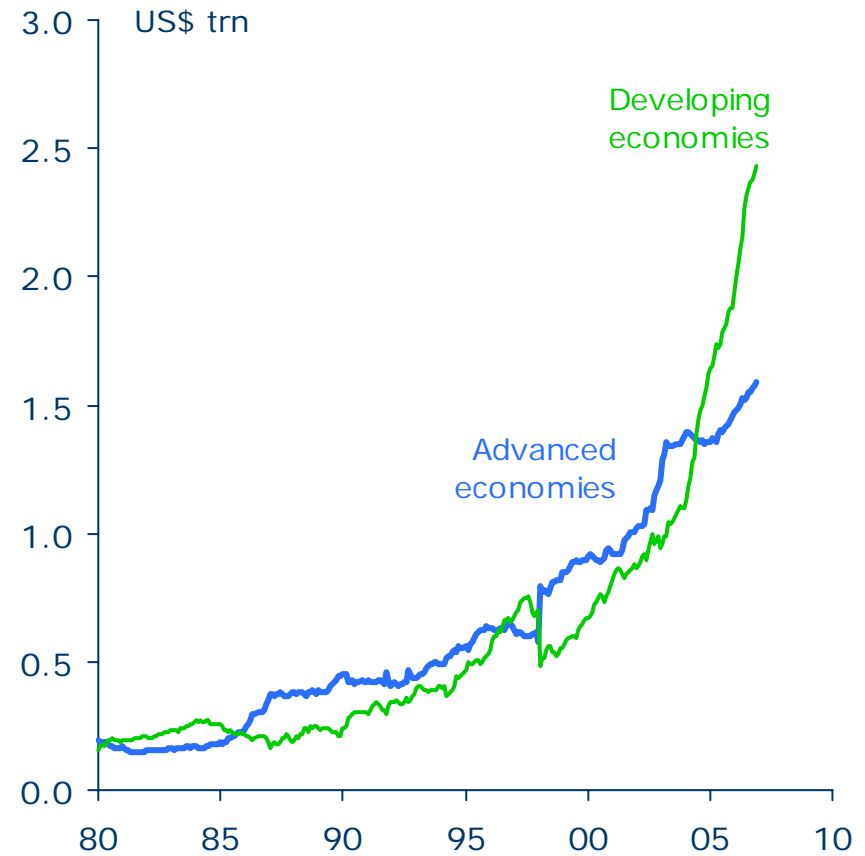


Developing countries are much better placed to withstand global financial upheavals than in the latter part of the 20th century ¹⁴

Current account balances



Foreign exchange reserves

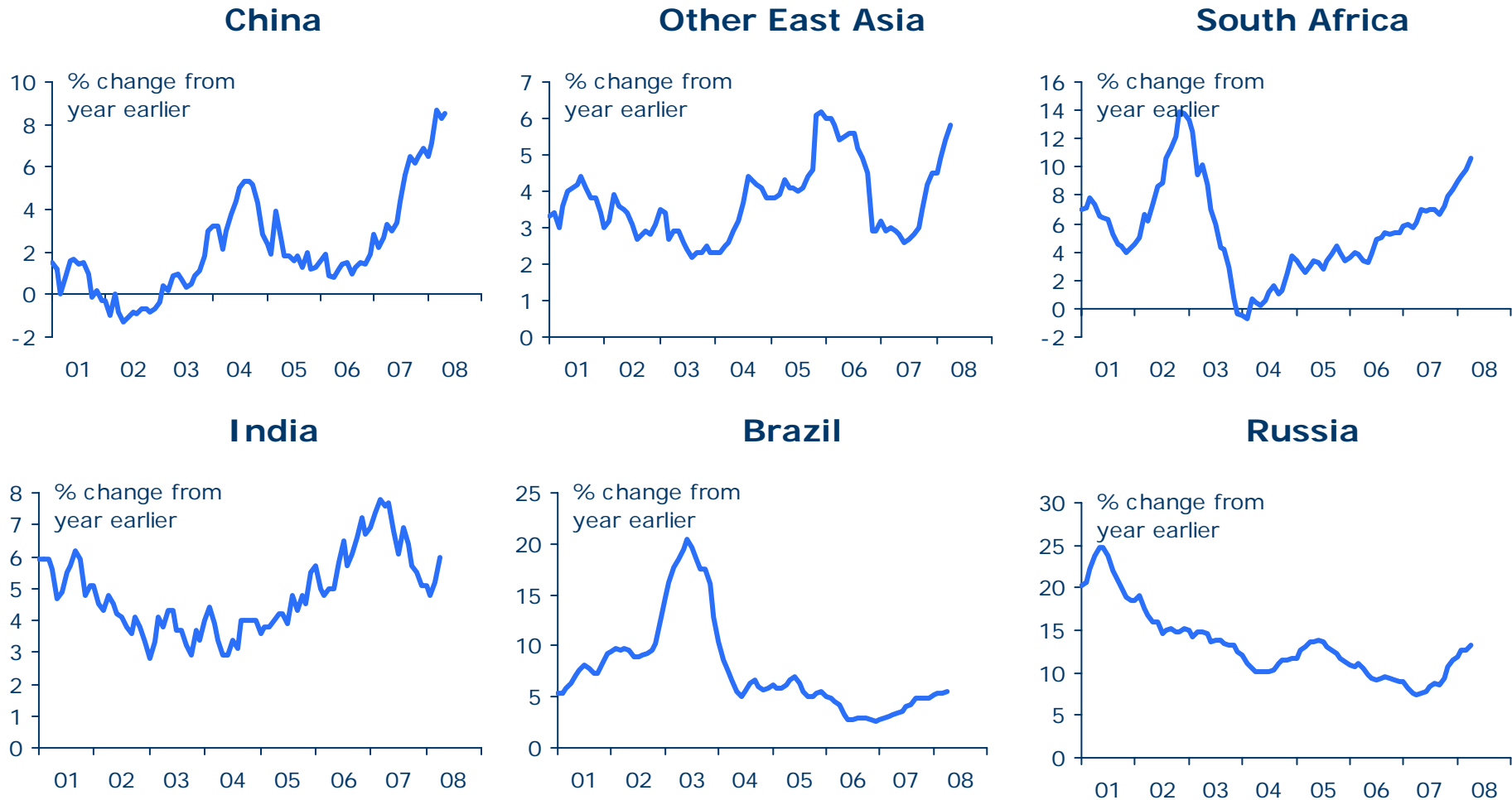


Sources: IMF; ANZ.



Most developing countries are more worried about rising inflation than slowing growth

Major developing economies – consumer prices

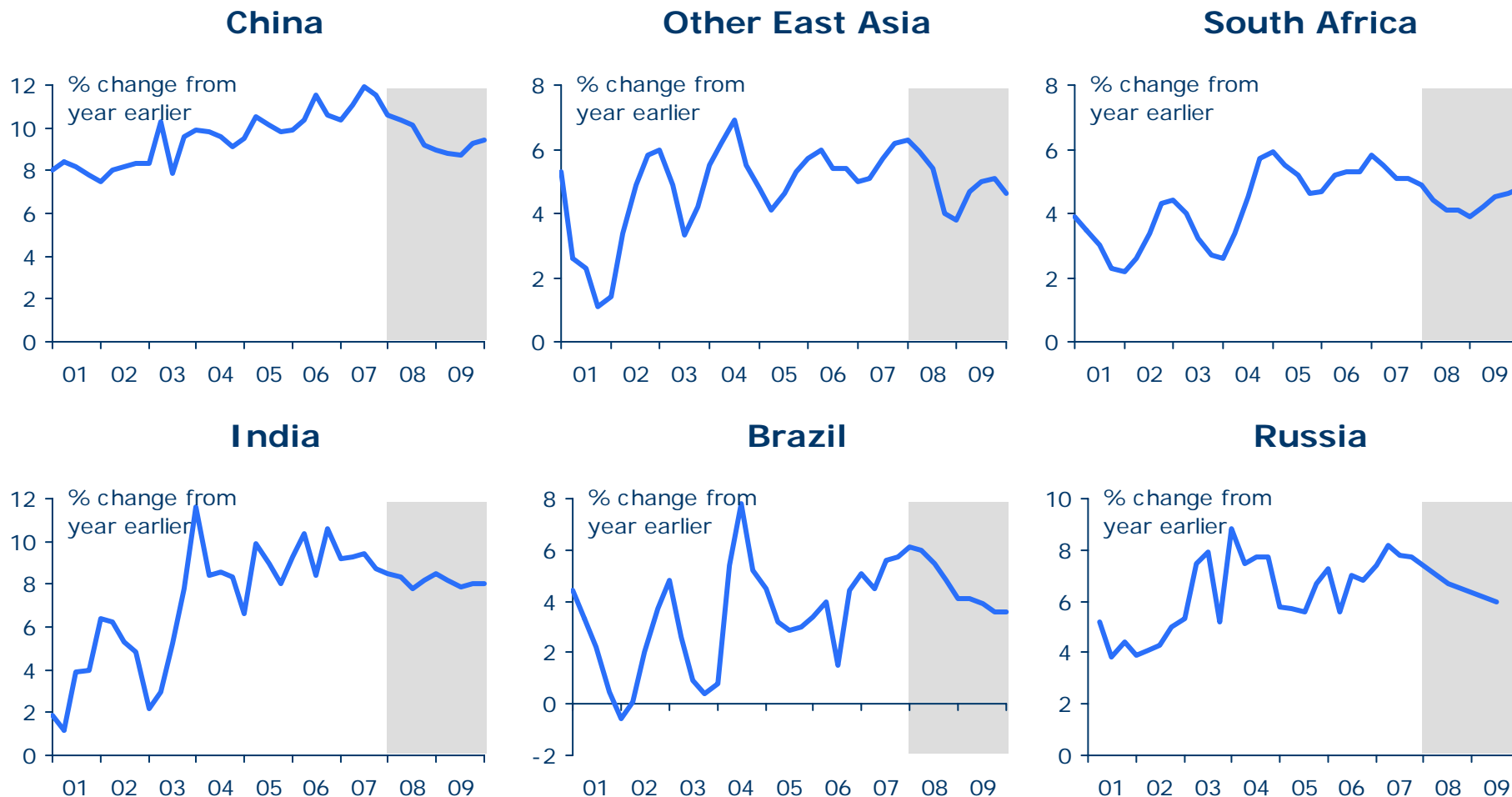


Sources: national statistical agencies; ANZ.



Major developing countries should continue to experience relatively strong growth, albeit a little slower than in 2006-07

Major developing economies – real GDP growth

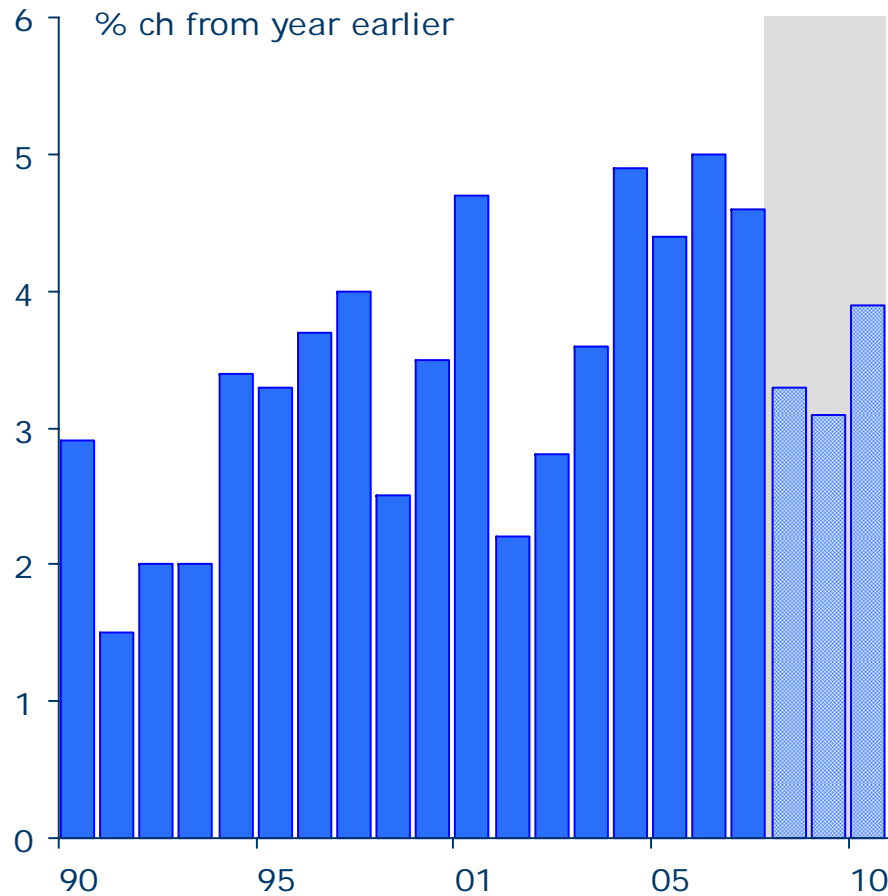


Sources: national statistical agencies; ANZ.

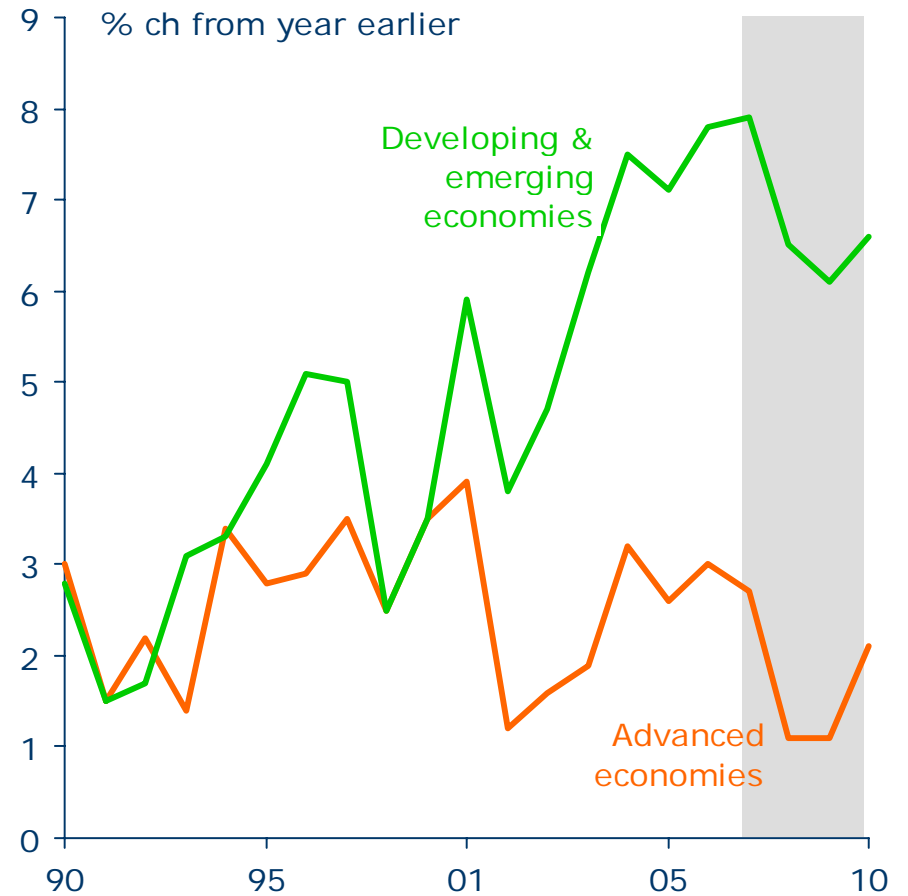


Advanced economies' growth will slow sharply this year, but developing countries' growth should stay fairly strong

World GDP growth



World GDP growth

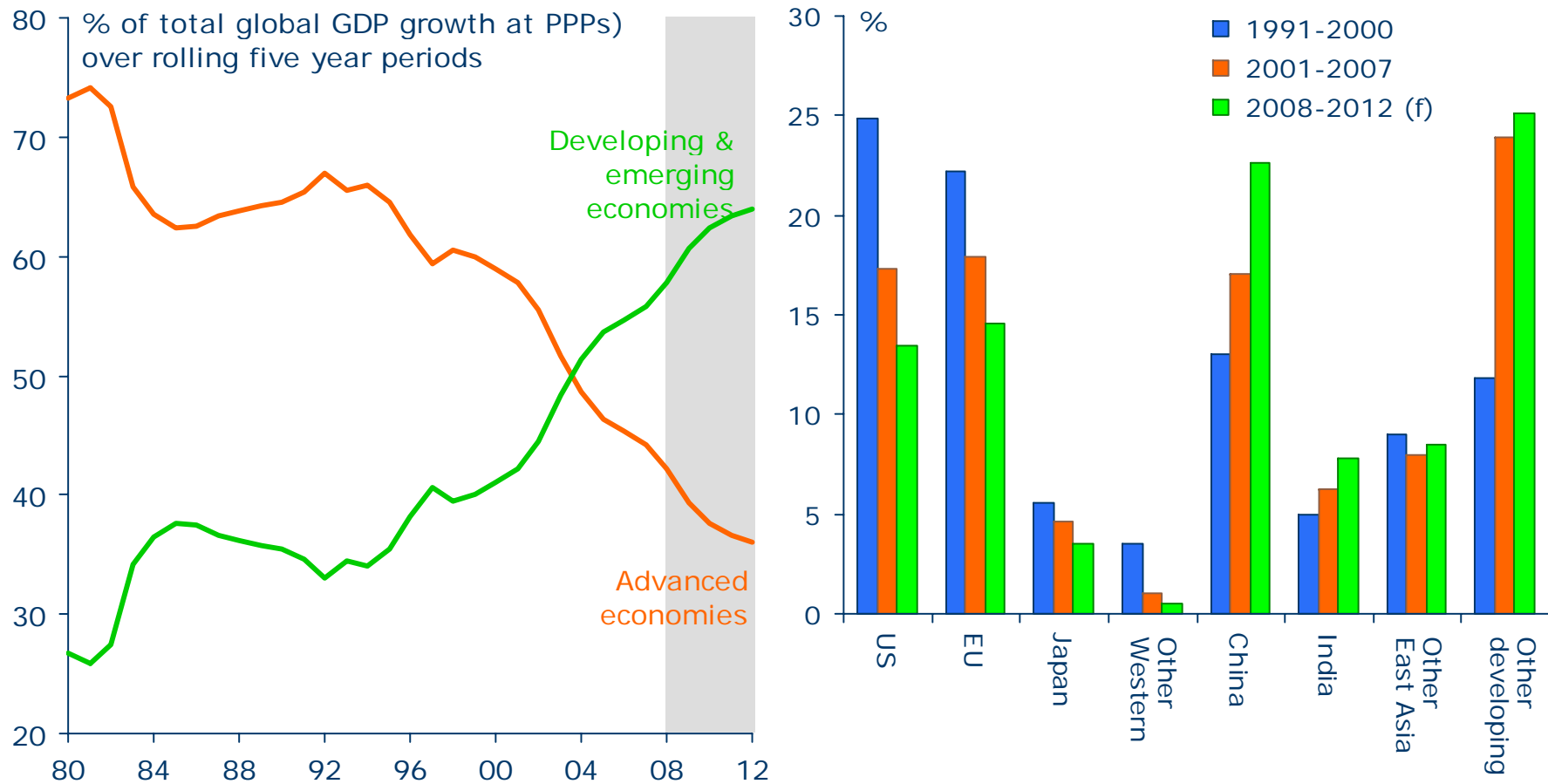


Note: Country and regional GDPs combined using purchasing power parity (PPP) weights
 Sources: IMF; ANZ estimates.



Developing countries will contribute two-thirds of total growth in the world economy over the next five years ¹⁸

Shares of world GDP growth

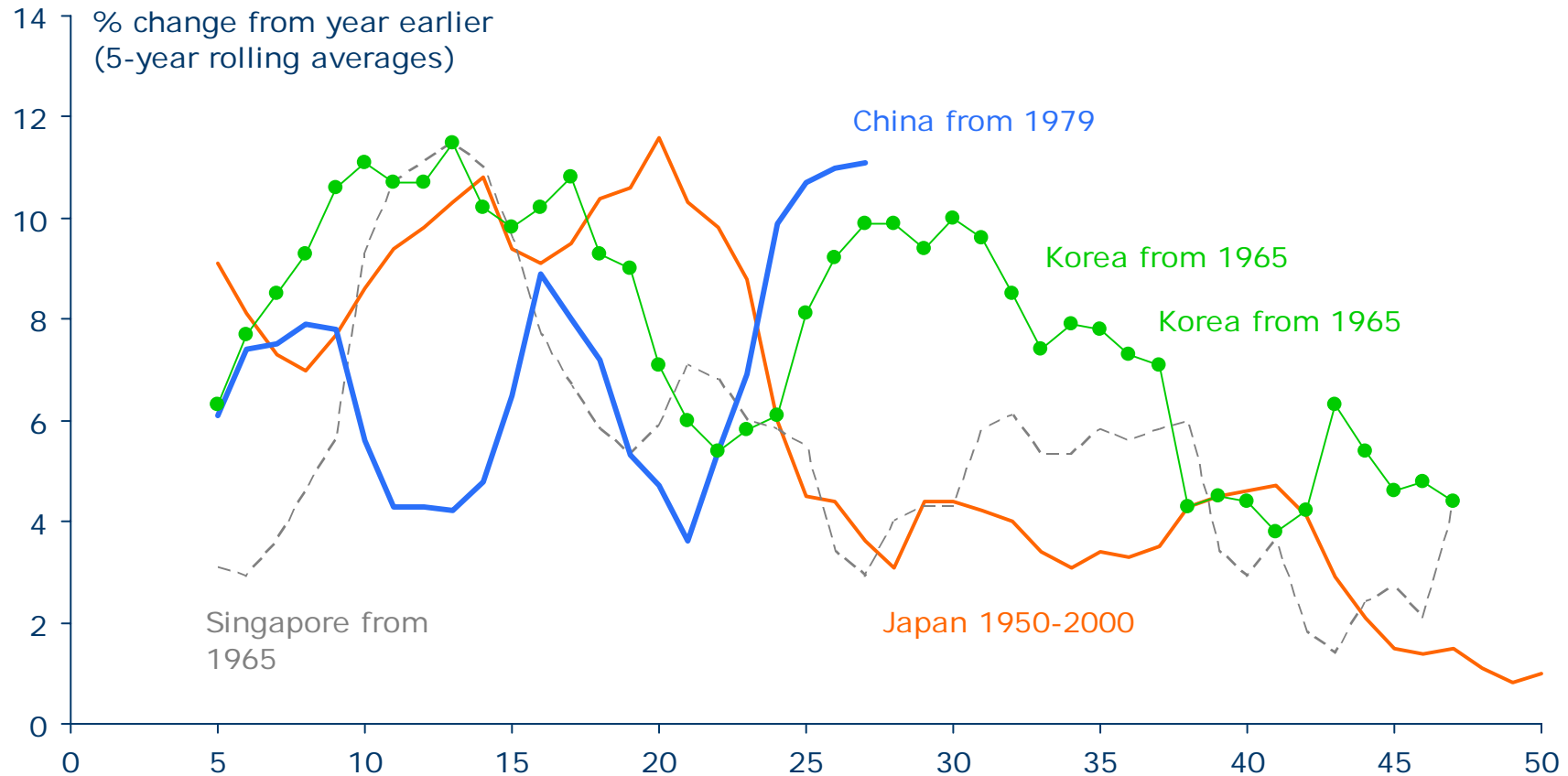


Note: Korea, Taiwan, Hong Kong & Singapore classified as 'developing' economies for these charts.
 Sources: IMF World Economic Outlook database April 2008; ANZ calculations.



China isn't doing anything that other Asian economies haven't done before (except that it's on a much bigger scale)

Long-term growth in selected Asian economies

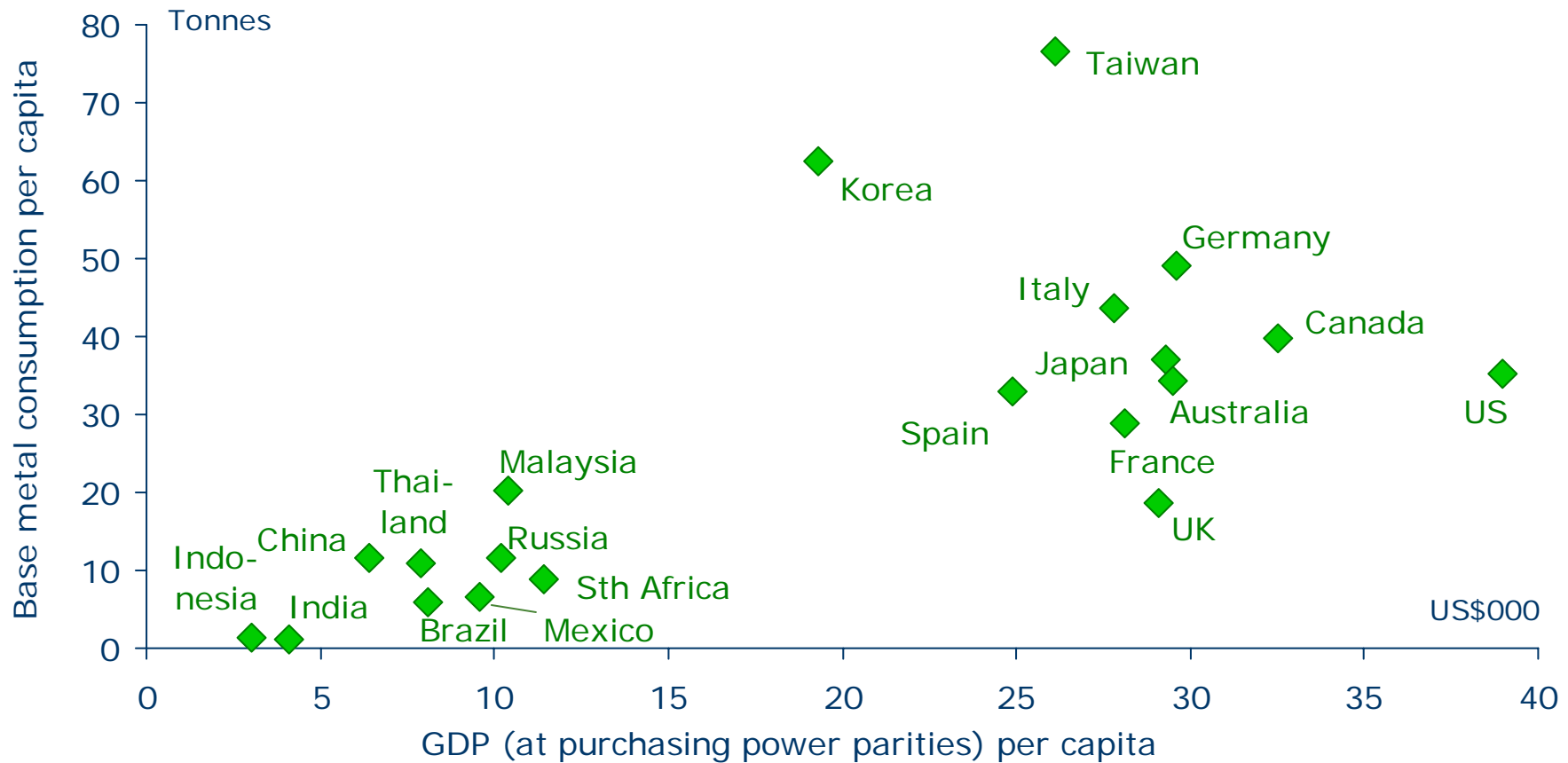


Sources: The Conference Board *Total Economy Database* January 2008; ANZ.



The 'metal intensity' of developing country growth is likely to rise sharply

Base metal consumption and GDP per capita, 2004

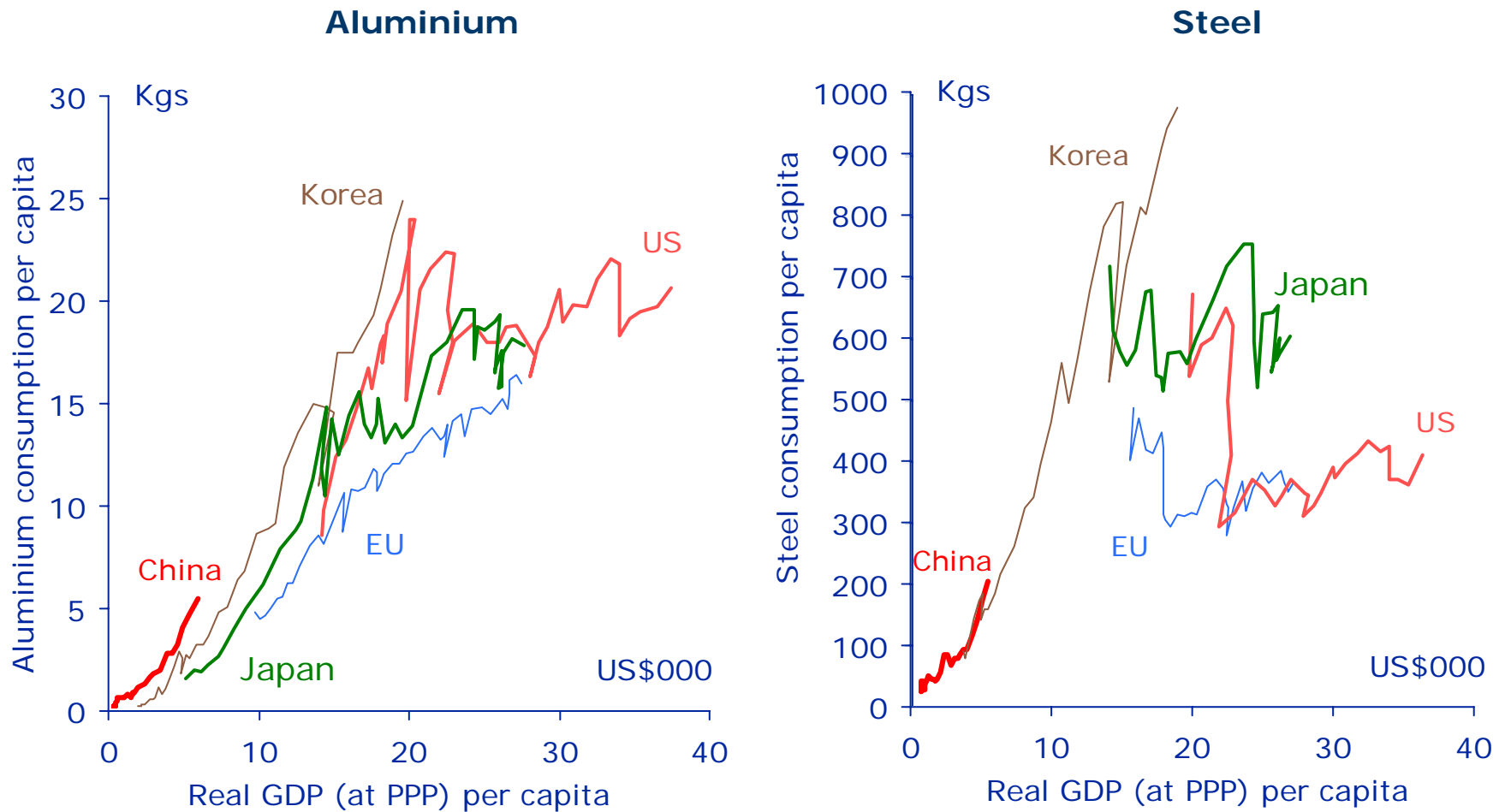


Sources: IMF World Economic Outlook September 2006; Economics@ANZ.



Metal demand from China (and other emerging markets) is likely²¹ to continue to grow rapidly

Metal consumption and GDP per capita, 1965-2005

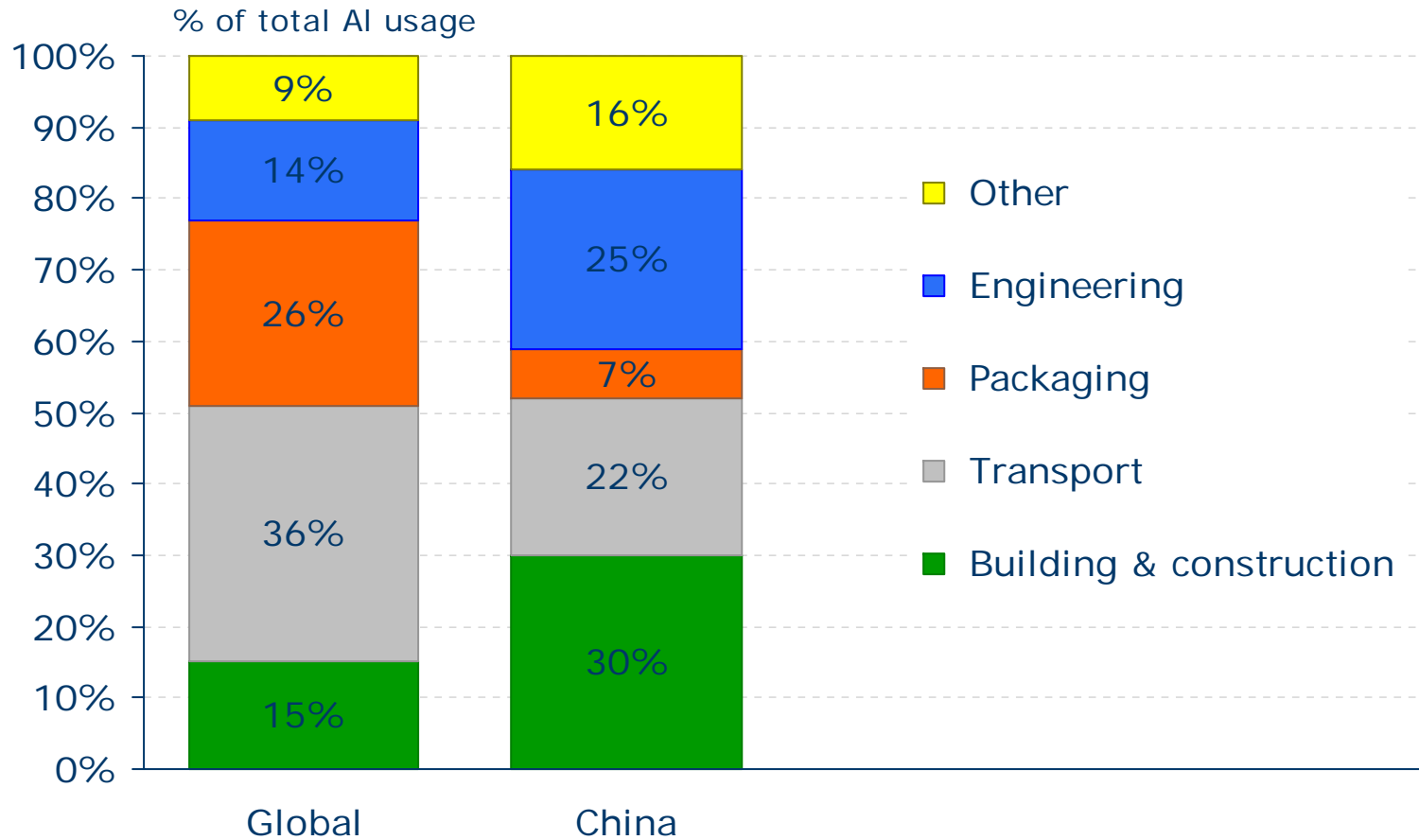


Sources: IMF World Economic Outlook September 2006; (Figure 5.7); Economics@ANZ.



Chinese demand for aluminium for transport and packaging is likely to grow very rapidly in coming years

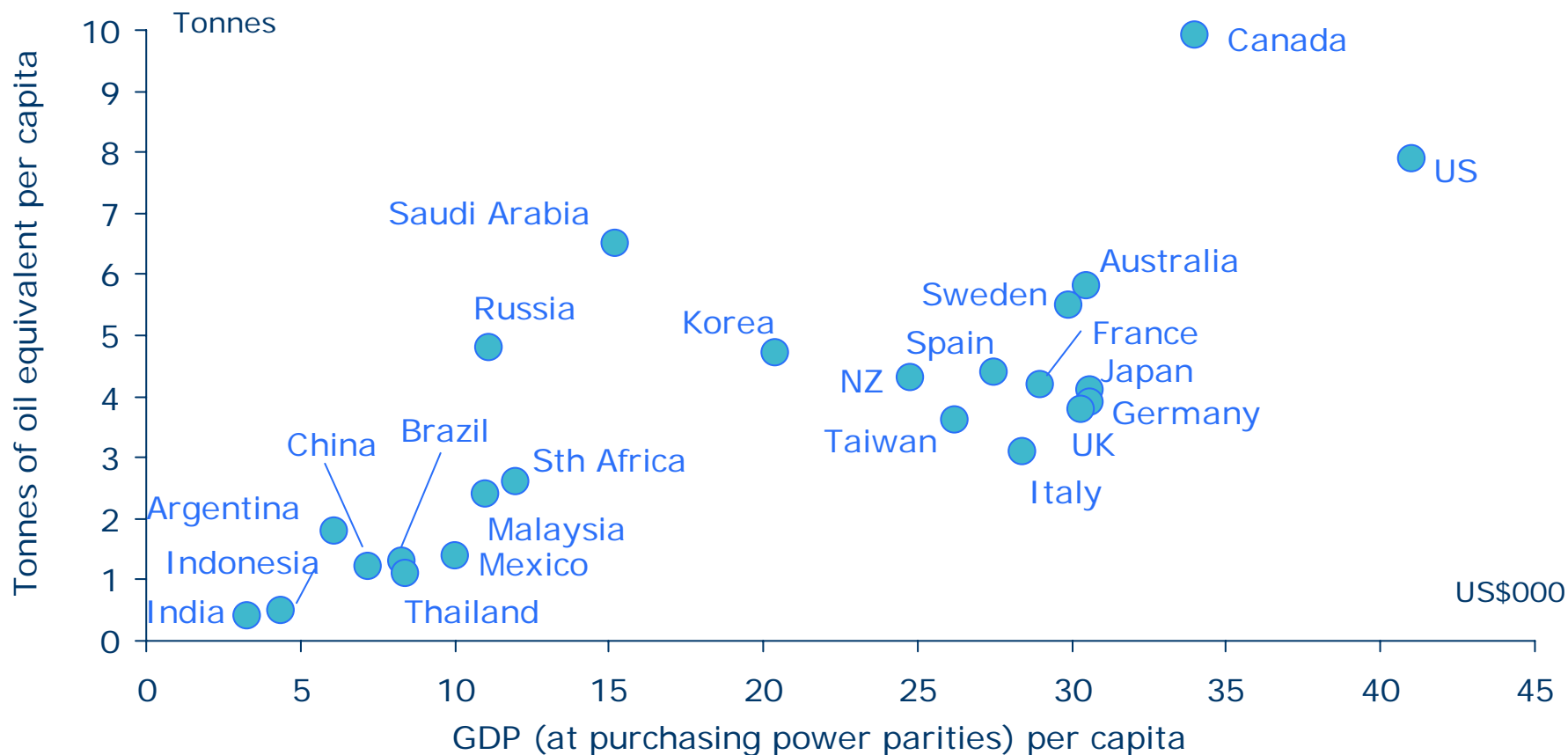
World and Chinese aluminium usage



Sources: WMBS; Australian Mineral Economics.

Developing country energy consumption will rise faster than incomes for the next few decades

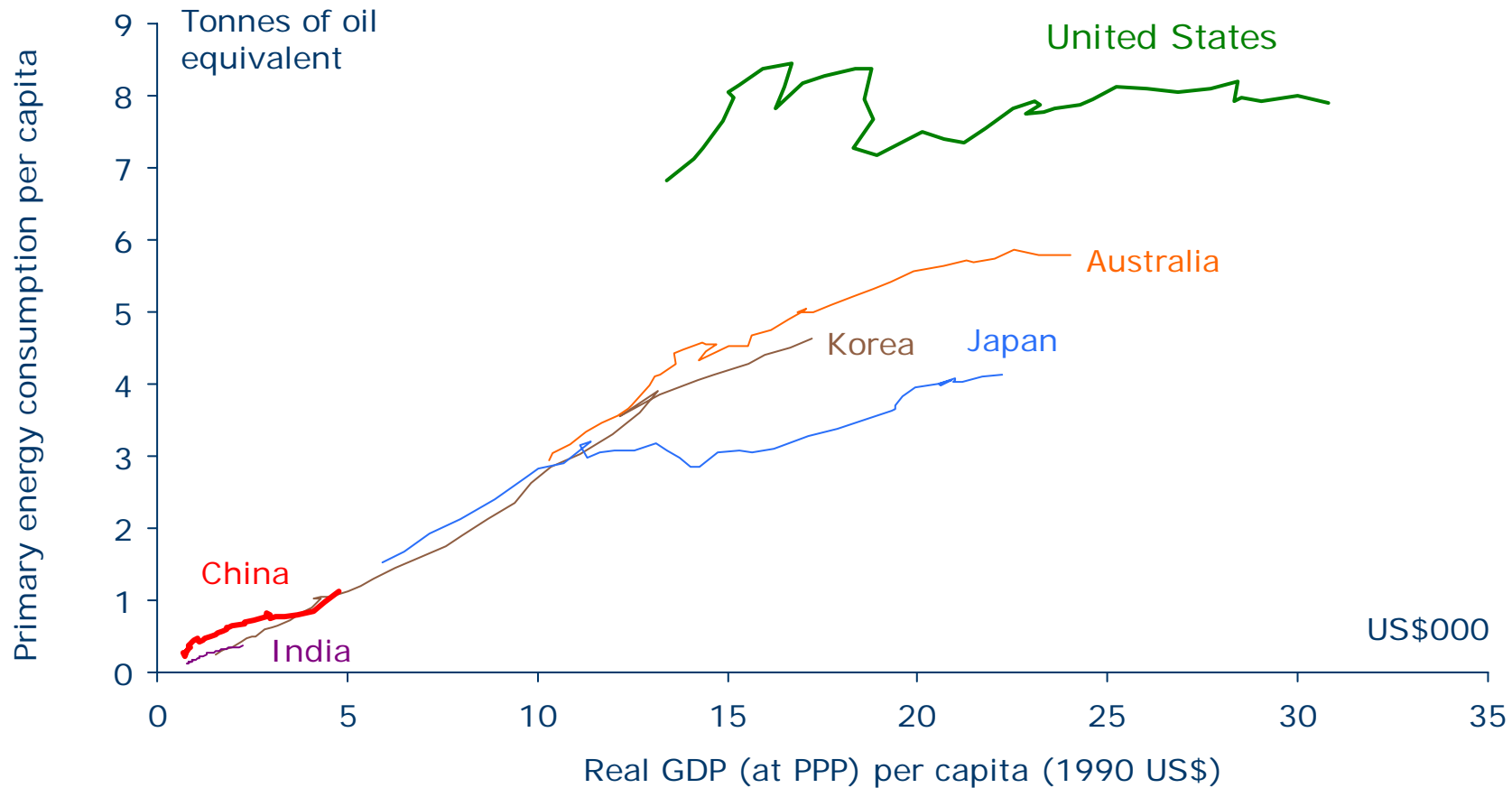
Primary energy consumption and GDP per capita, 2005



Sources: BP Statistical Review of World Energy 2005; IMF World Economic Outlook September 2006; Economics@ANZ.

Primary energy consumption in China, India etc will rise substantially

Primary energy consumption and GDP per capita, 1965-2005

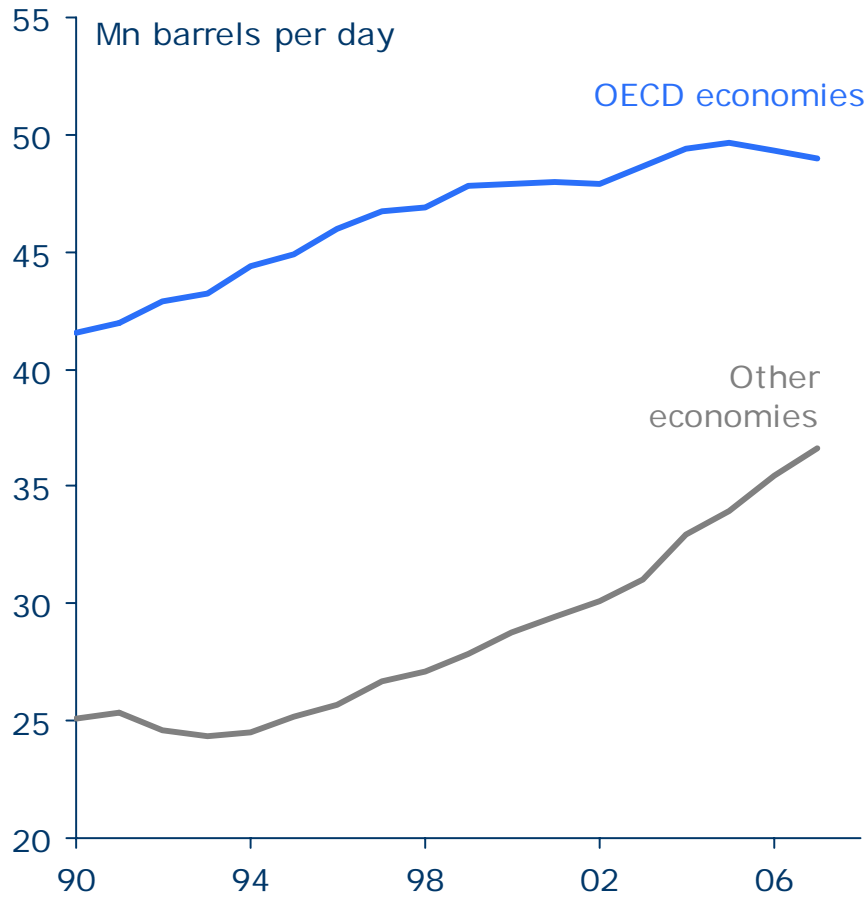


Sources: Groningen Growth and Development Centre *Total Economy Database*; BP *Statistical Review of World Energy* (2006); Economics@ANZ.

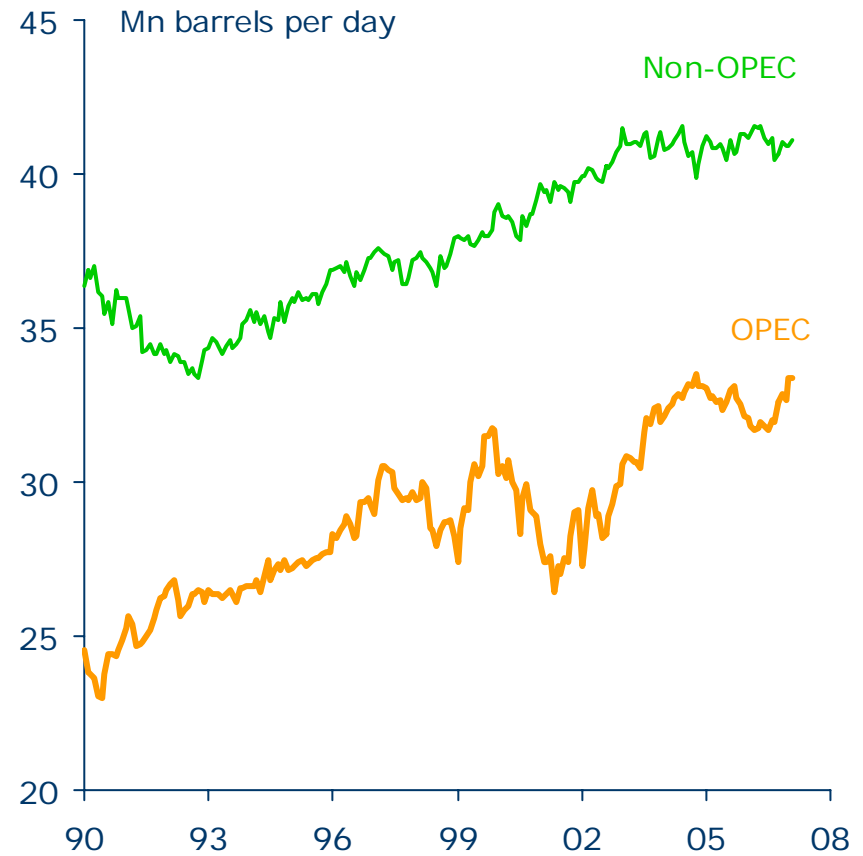


Persistently rising oil prices partly reflecting rapid growth in developing country demand, and flatlining in non-OPEC output

Oil consumption



Oil production



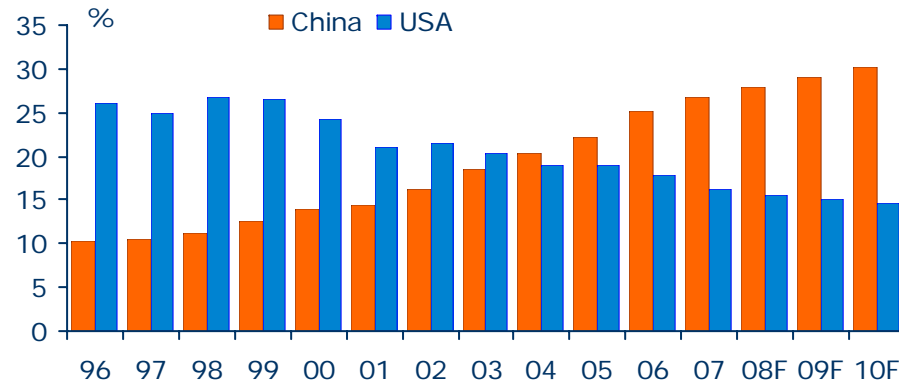
Sources: US Department of Energy; ANZ.



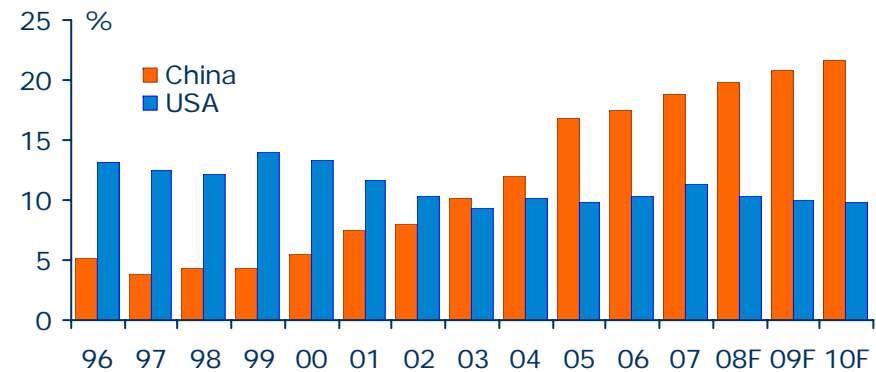
Chinese demand now dominates all commodities with the conspicuous exception of oil

Shares of total consumption – China and US

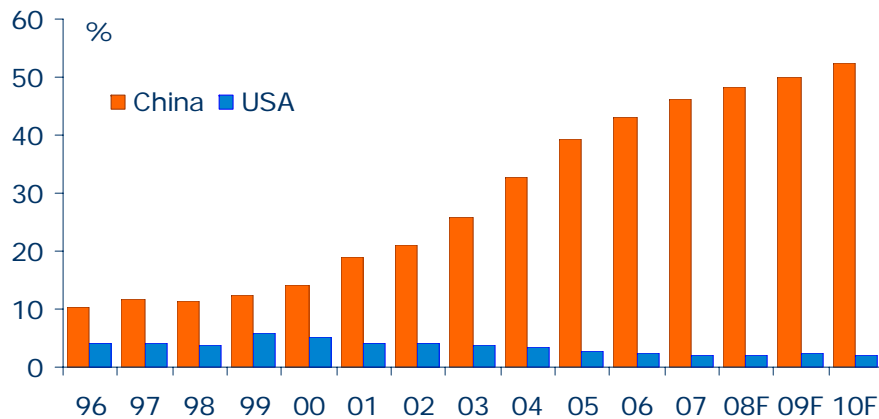
Aluminium



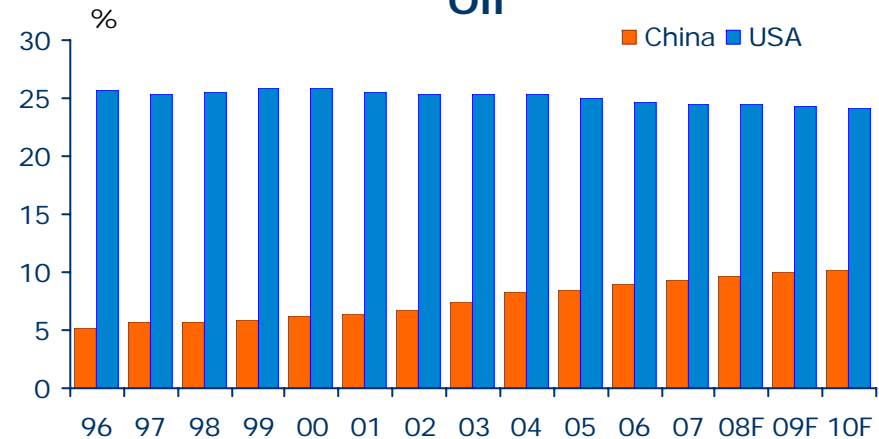
Nickel



Iron ore



Oil

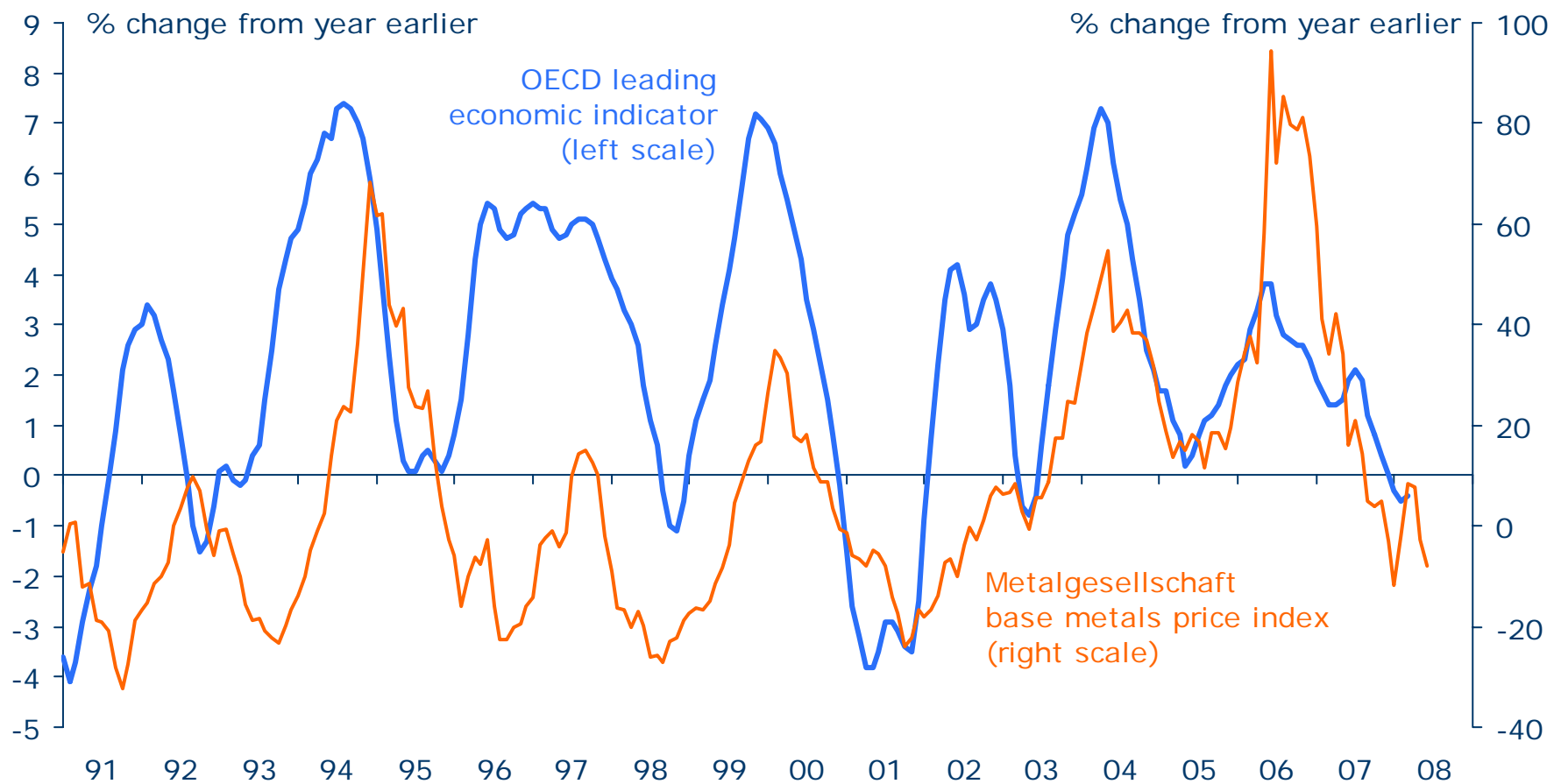


Source: WBMS, AME, EIA, ANZ forecasts



Slowing economic growth in OECD economies points to an easing in base metal prices ...

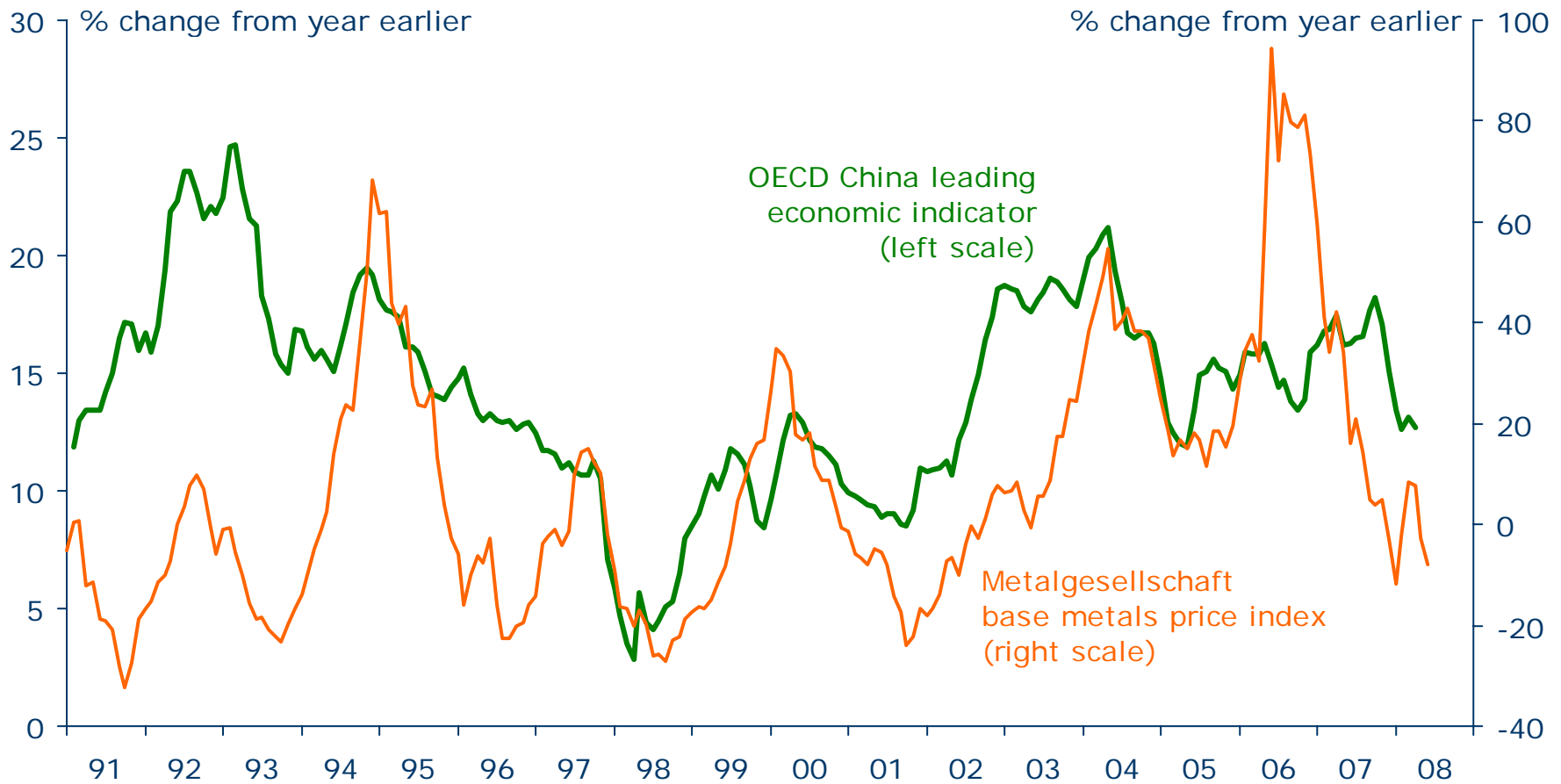
The OECD business cycle and base metal prices



Sources: Datastream; OECD.

... as does some moderation in the pace of Chinese economic growth

The Chinese business cycle and base metal prices

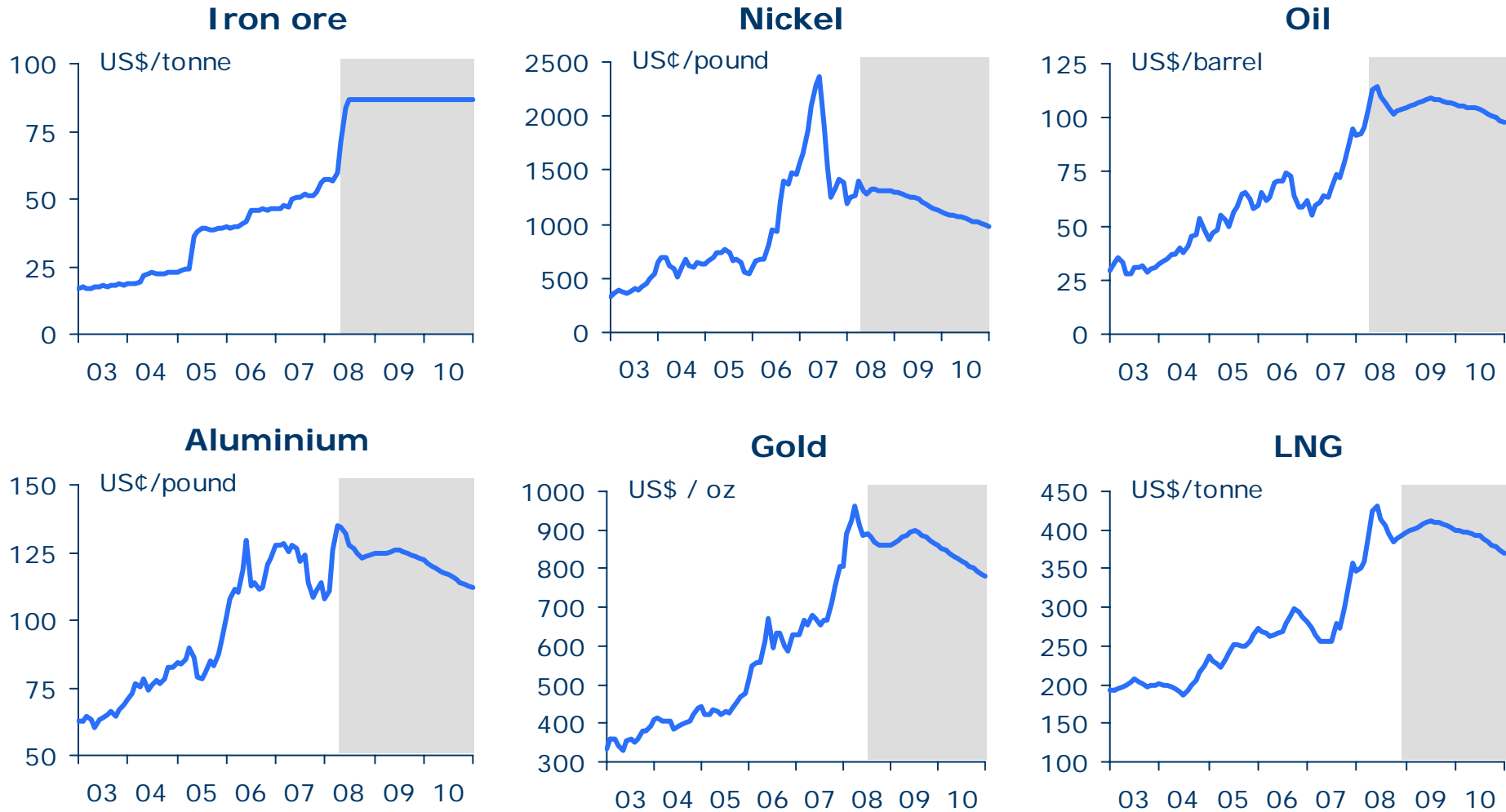


Sources: Datastream; OECD.



Resources commodity prices are unlikely to rise much further but will remain elevated by historical standards

Base and precious metal prices

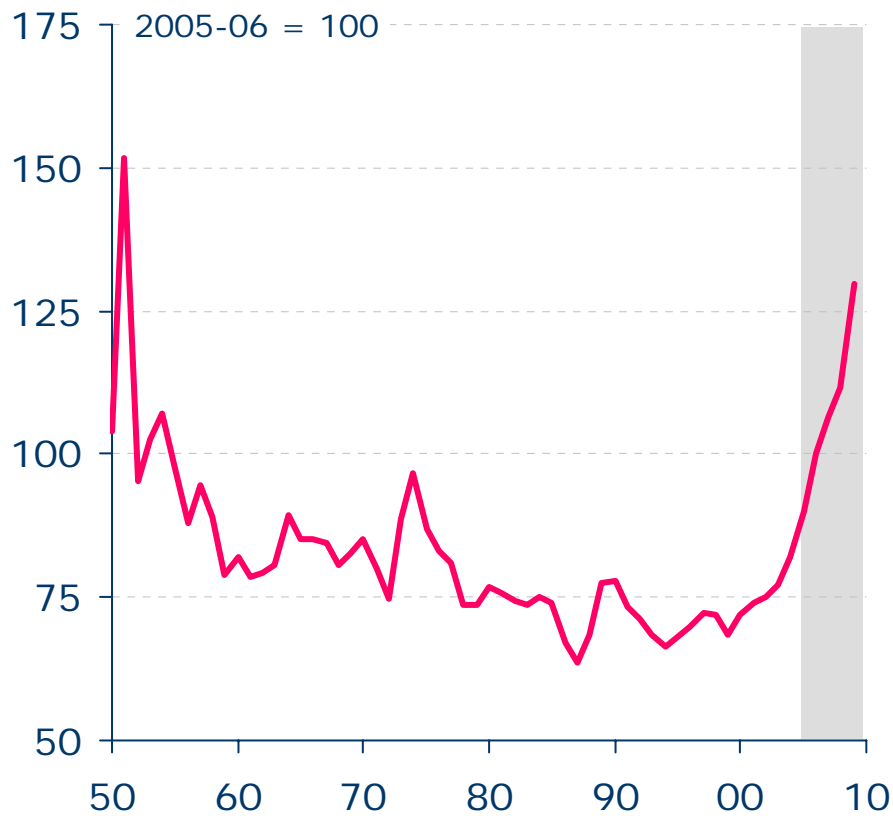


Sources: Thomson Financial; ANZ.

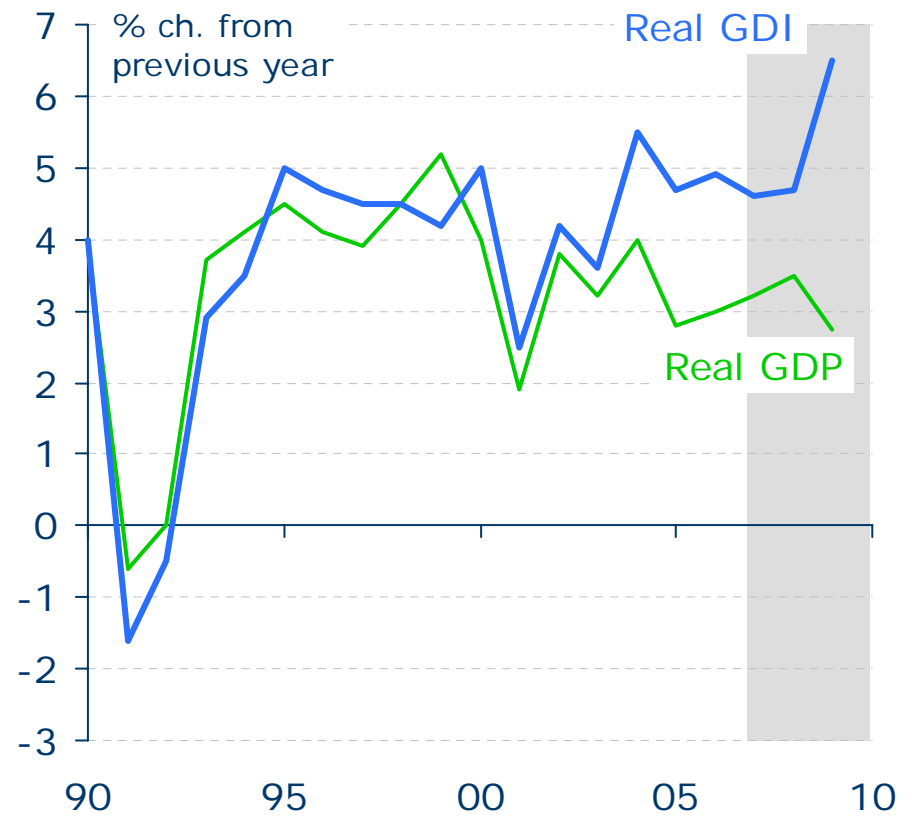


Australia's national income will gain a further huge boost in 2008-09 from higher coal and iron ore prices

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



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

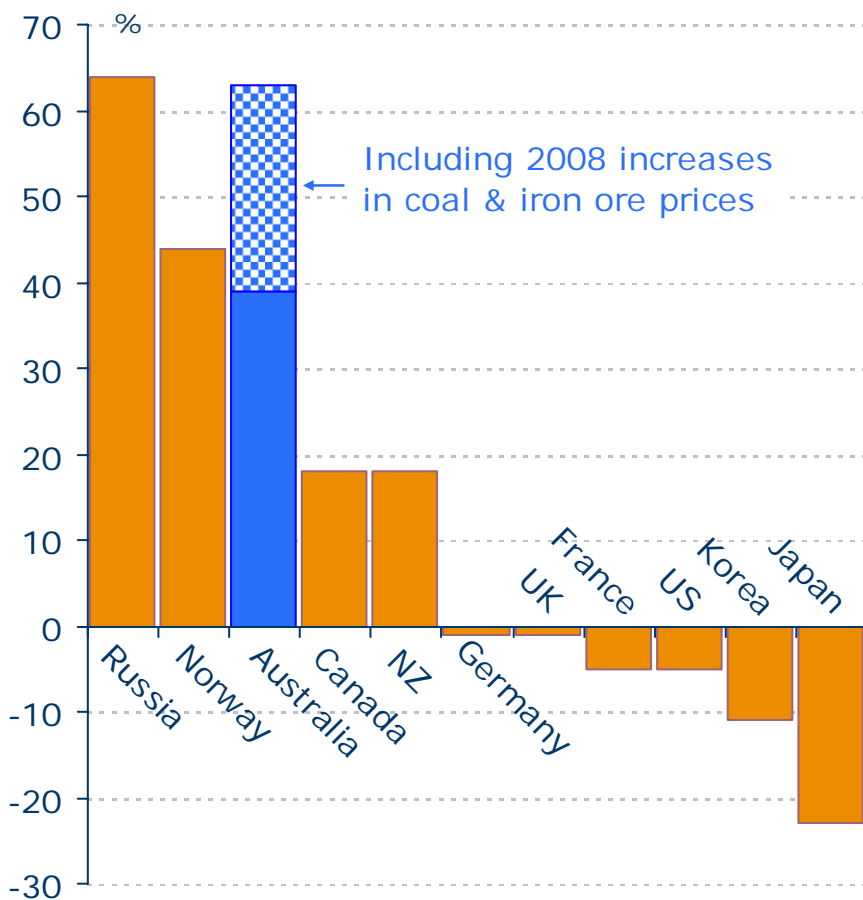


Sources: ABS; Budget Paper No. 1, Statement 3.

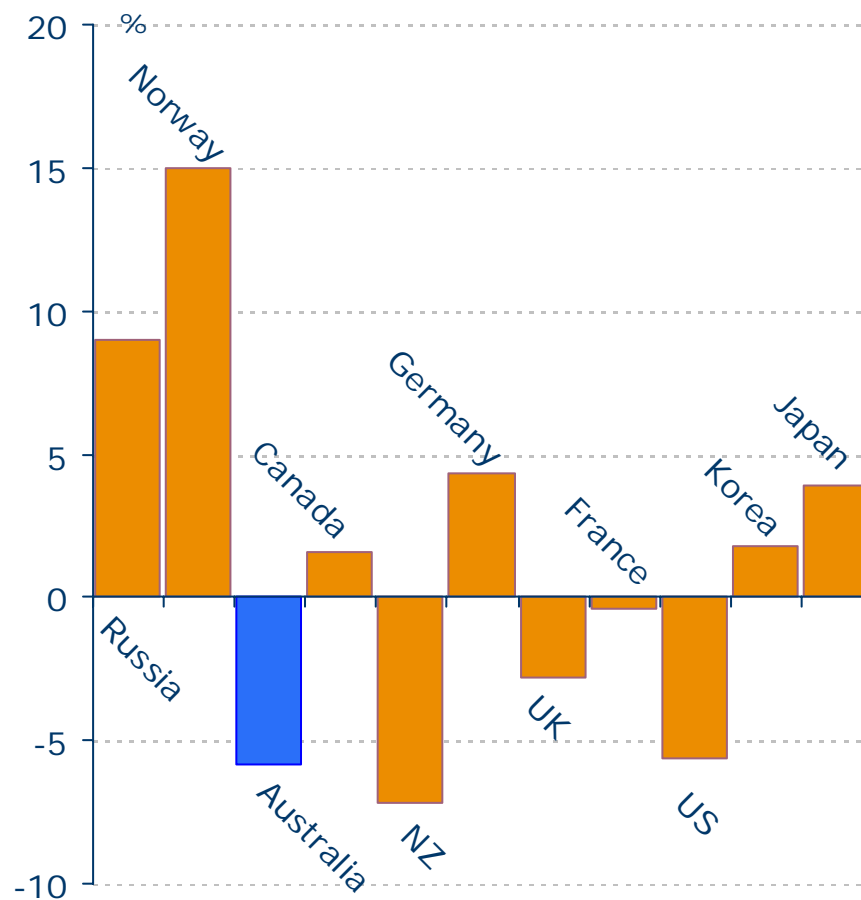


Australia's has gained more than most economies from rising commodity prices – yet still runs a very large external deficit

**Terms of trade changes,
Mar qtr 2003 – Dec qtr 2007**



**Current account balances
% of GDP, 2003-07**

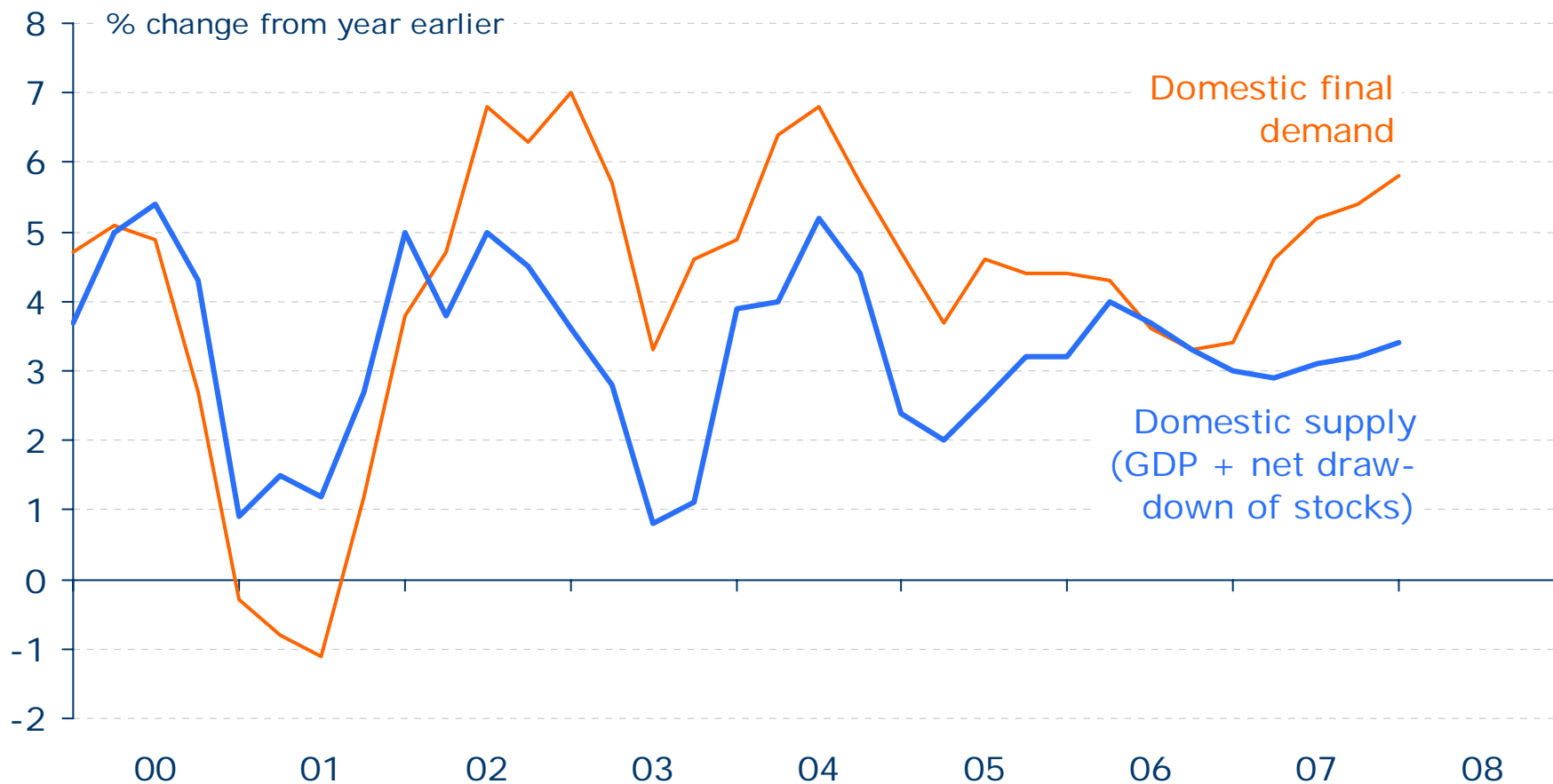


Sources: RBA Statement on Monetary Policy May 2008; IMF, World Economic Outlook database, April 2008.



Most of this extra income has been spent, adding to demand pressure in an increasingly capacity-constrained economy

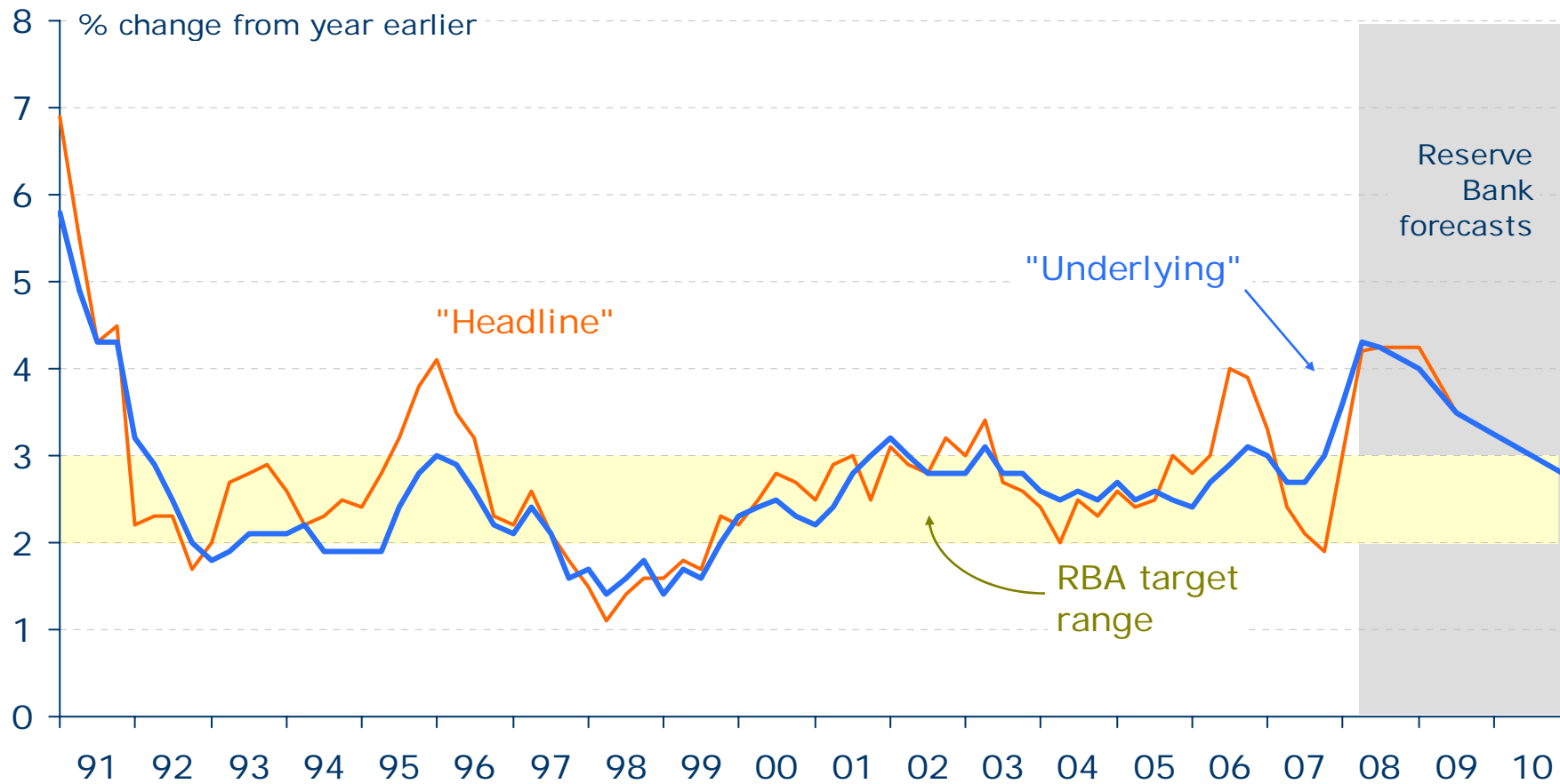
Domestic demand vs 'supply'



Sources: ABS; ANZ.

Australia's 'underlying' inflation rate is now at its highest level since inflation-targeting began

Consumer prices

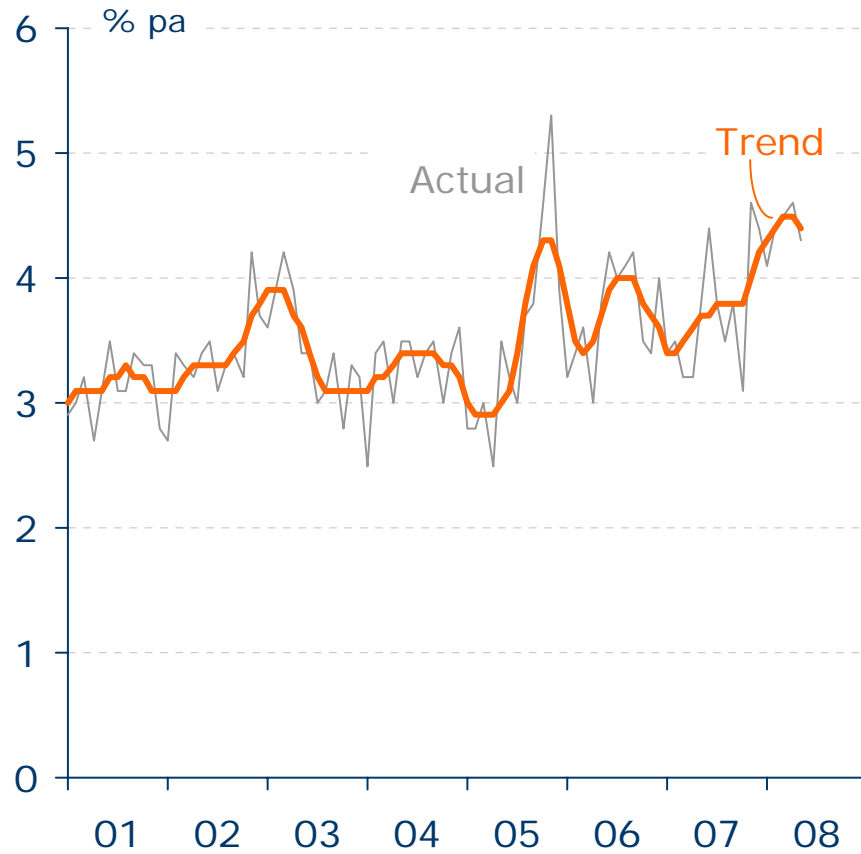


Note: excludes impact of introduction of GST and major health policy changes.
Sources: ABS; RBA.

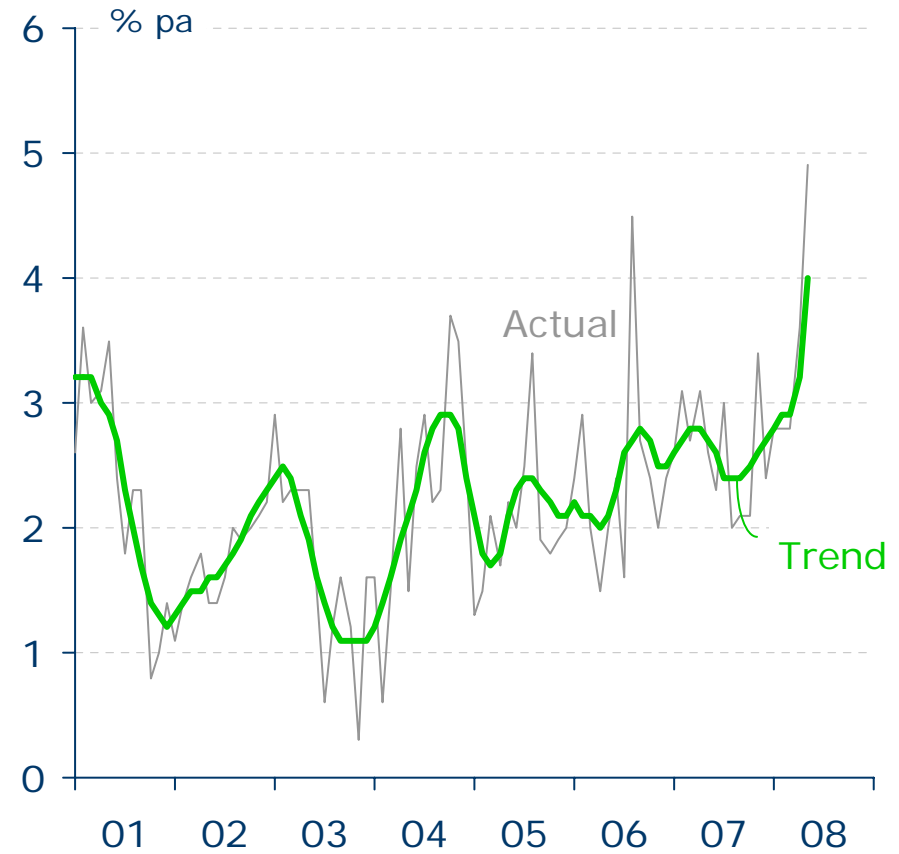


The Reserve Bank is particularly concerned at the uptrend in inflation expectations

Household inflation expectations



Business selling price expectations

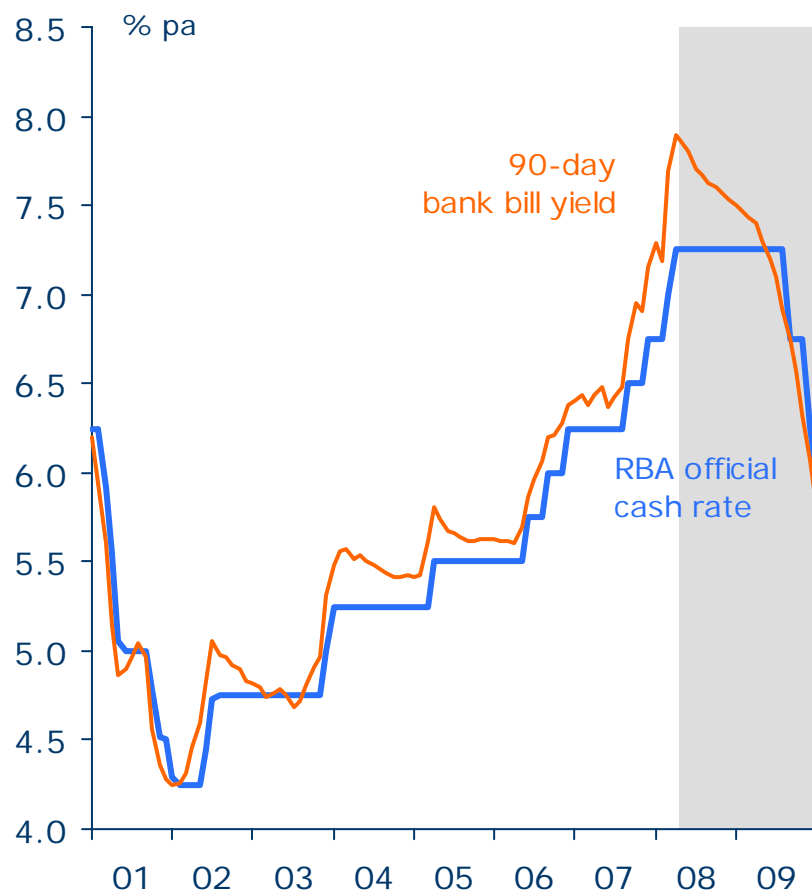


Sources: Westpac-Melbourne Institute; nab.



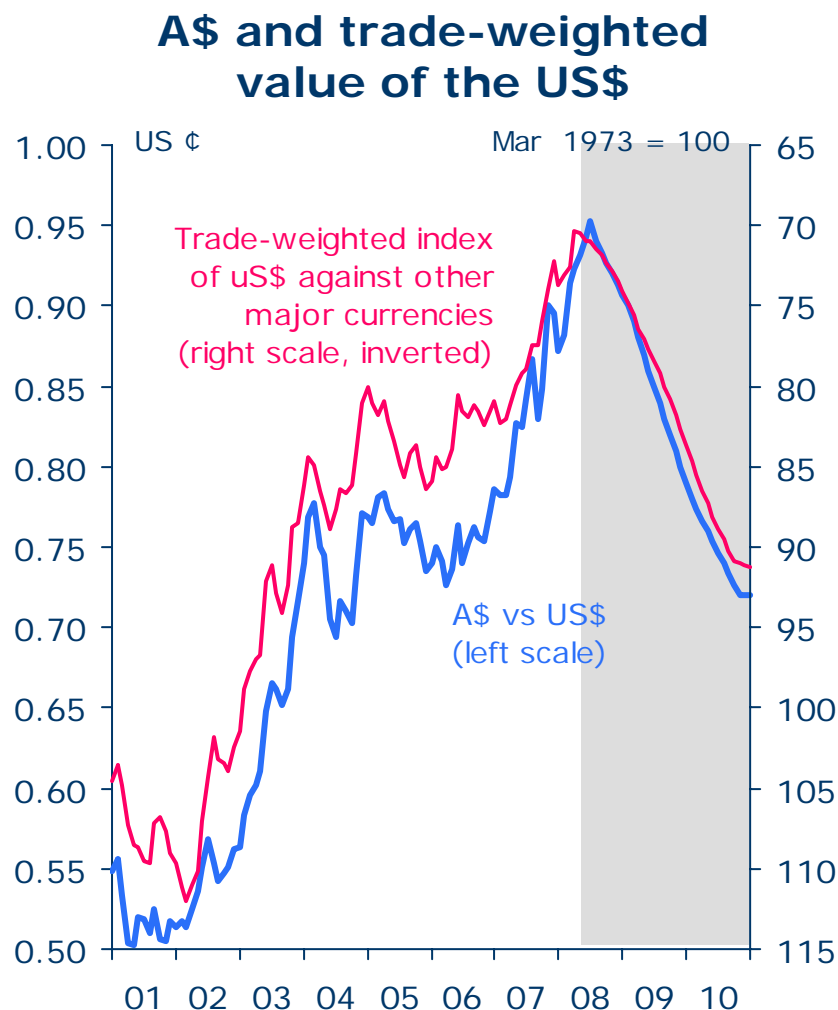
Provided the economy continues to slow, and wages remain controlled, the RBA won't have to lift official interest rates again

Short-term interest rates



- Since inflation began breaking out of the RBA's target range in mid-2007, the RBA has stepped up the pace of monetary tightening, raising official rates by 100 basis points in nine months
- Rates actually paid by borrowers have risen by an additional 40-50 basis points as banks have passed on some of their increased wholesale funding costs
- 'Soft' and, increasingly, 'hard' data is beginning to suggest that this tightening of financial conditions is working to slow growth in domestic spending as required to bring inflation from 4% back to 2-3%
- The RBA will thus keep official rates 'on hold' – provided that domestic spending doesn't re-accelerate, and that wages growth remains 'well behaved'
- Last week's Budget didn't do anything to alter that outlook
- Rates won't start falling until mid-2009

Some of the A\$'s strength reflects US\$ weakness, and that is likely to change over the next 18 months

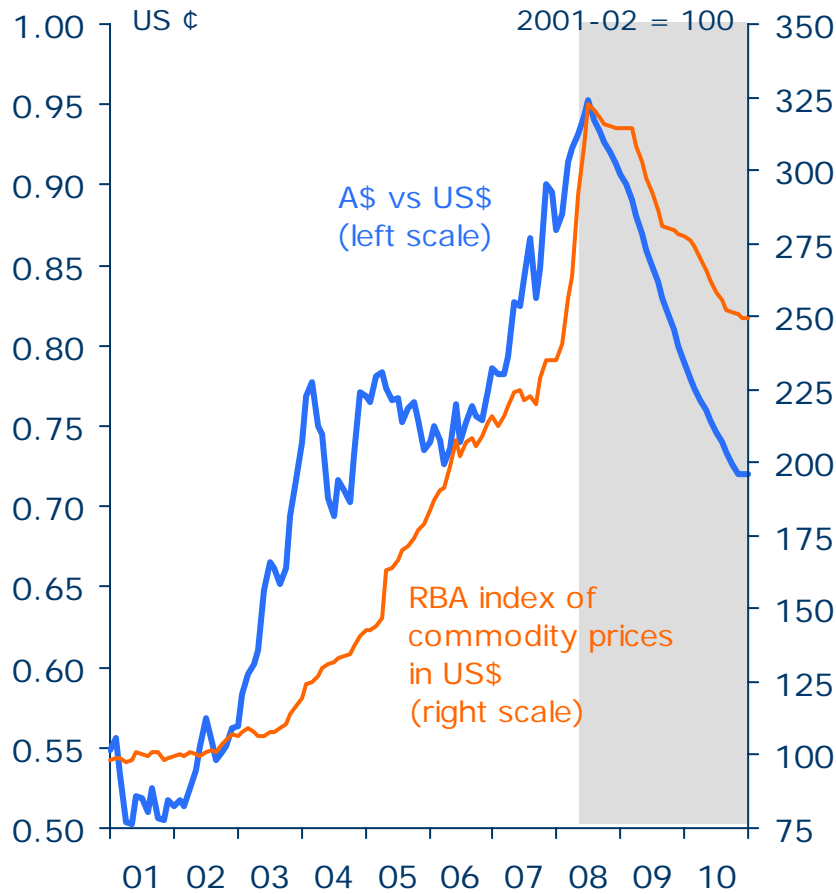


Sources: Datastream; US Federal Reserve; ANZ.

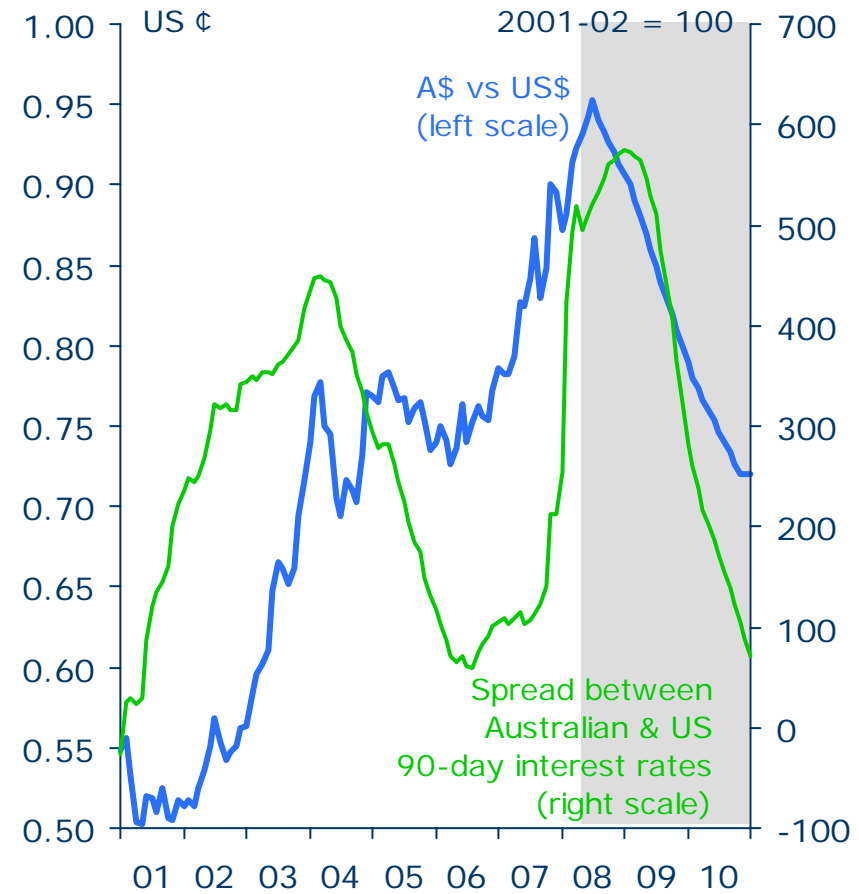
- The US dollar likely passed a major cyclical low in April – when negative sentiment about the credit crunch and the outlook for the US economy was at its most extreme
- Since then fears of a deep US recession have receded somewhat, and market confidence in the Fed's ability to balance downside risks to growth vs upside risks to inflation has improved
- The US current account deficit is on a slowly improving path
- Meanwhile market attention is shifting to the downside risks for European growth, and the prospects for eventual cuts in euro area interest rates
- Prospects for the US\$ against other major currencies are improved by the growing likelihood that developing countries will allow greater appreciation of their currencies as an anti-inflation policy

Support for the A\$ from commodity prices and interest rate differentials will erode next year

A\$ and commodity prices



A\$ and interest rate spreads



Sources: Datastream; Reserve Bank of Australia; ANZ.

