Economics & Markets Research

ANZ Australian Markets Weekly

Labour market sours but consumers feeling sweet

09 July2009

Inside:

Authors:

Warren Hogan
Head of Australian Economics and Interest Rates Research
+61 2 9227 1562
Warren.Hogan@anz.com

Tony Morriss
Senior Rates Strategist
+61 2 92266757
Tony.Morriss@anz.com

Katie Dean
Senior Economist
+61 3 9273 1381
Katie.Dean@anz.com

Julie Toth
Senior Economist, Industry
+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
Daniel.Bae@anz.com
+61 2 9227 1272

Our Vision:

For ANZ 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: Is consumer confidence signalling a quick rebound?

- Consumer confidence rebounded strongly in May and June, and is now well above its long-term average.
- The direct drivers of this confidence boost are unclear, but fiscal stimulus and lower rates seem to be working to reassure and support consumers.
- History and forward indicators still point to a deteriorating labour market from here, with jobs set to decline and unemployment to rise further.

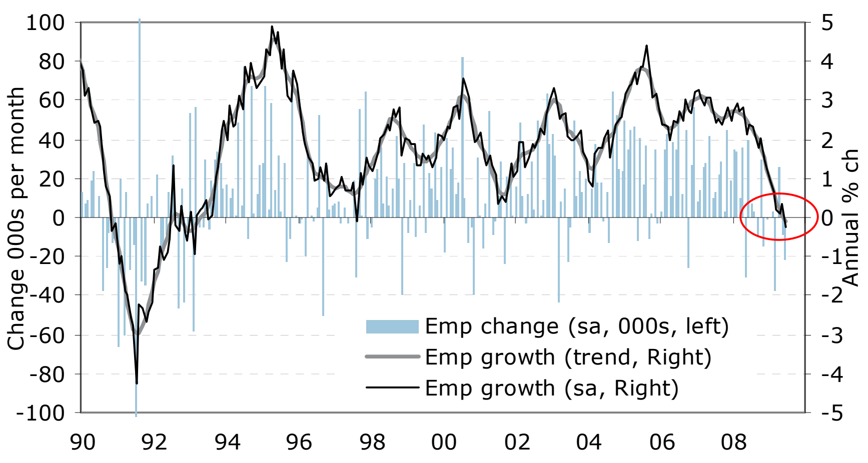
Interest rate markets: Yields move into correction mode

- Market rates have started to correct after the recent sell-off, as concerns mount regarding the sustainability of global growth's path to recovery.
- Swap rates are unlikely to return to previous lows. We look at some near-term target levels for swap rates.
- Concerns over global growth, weaker commodity markets and a rise in risk aversion have helped to push yields lower. But increased supply and policy-stimulus means we are unlikely to see a return to previous lows.

FX: Moving to a bearish trading channel

- Technical indicators for the AUD are turning rapidly bearish.
- This week we have seen a sharp retracement in risk trades. The AUD has suffered accordingly and is lower on all the major crosses. The catalyst for these moves is market nerves ahead of the US Q2 reporting season.
- Weaker commodity prices have also added to the AUD's woes.

Chart of the week: annual jobs growth turns negative in June, for the first time since 1993



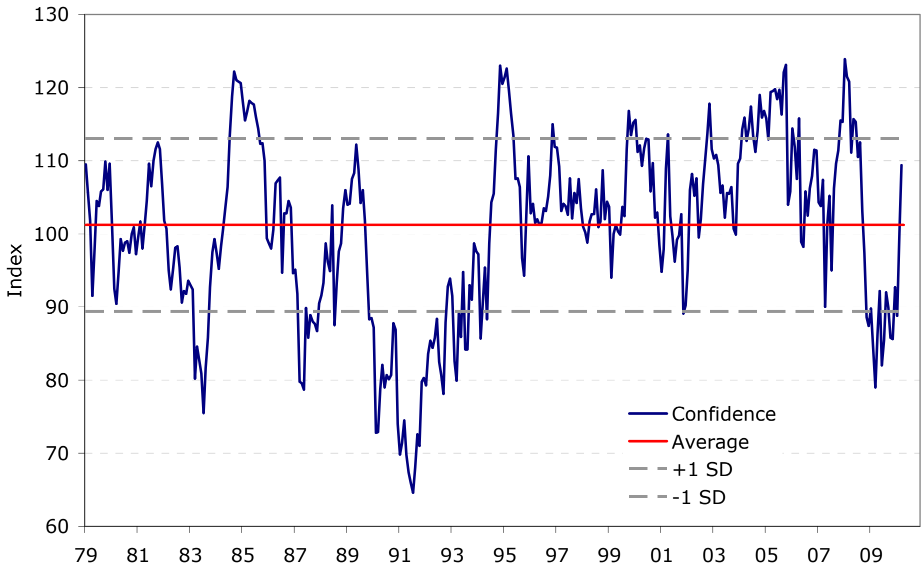
Warren Hogan
Head of Australian Economics
and Interest Rate Research
+61 2 9227 1562
Warren.Hogan@anz.com

Macroeconomic update: Is consumer confidence signalling a quick rebound?

The Westpac Melbourne Institute measure of consumer confidence showed a phenomenal jump in July, rising 9.3% to 109.4, the highest reading since December 2007. This is the second consecutive large increase, after a 12.7% rise in June. The index reached a cyclical low last July of 79, in the wake of rising interest rates, and has since steadily increased, despite the global financial crisis. Since May, the index has surged 23.2%, the strongest two month gain on record (see figure 1 below).

The long-run average of the index is 101.2 with a standard deviation of 11.8. This means the great majority of consumer confidence results over the past three decades have been between an index reading of 89 and 112. With the sentiment index rising from 88.8 in May to 109.4 in July, we can conclude that consumer perceptions of the economic and financial situation have gone from bearish (below average) to bullish (above average) in the space of two months.

Figure 1: MI Consumer Confidence Index, long-term trends



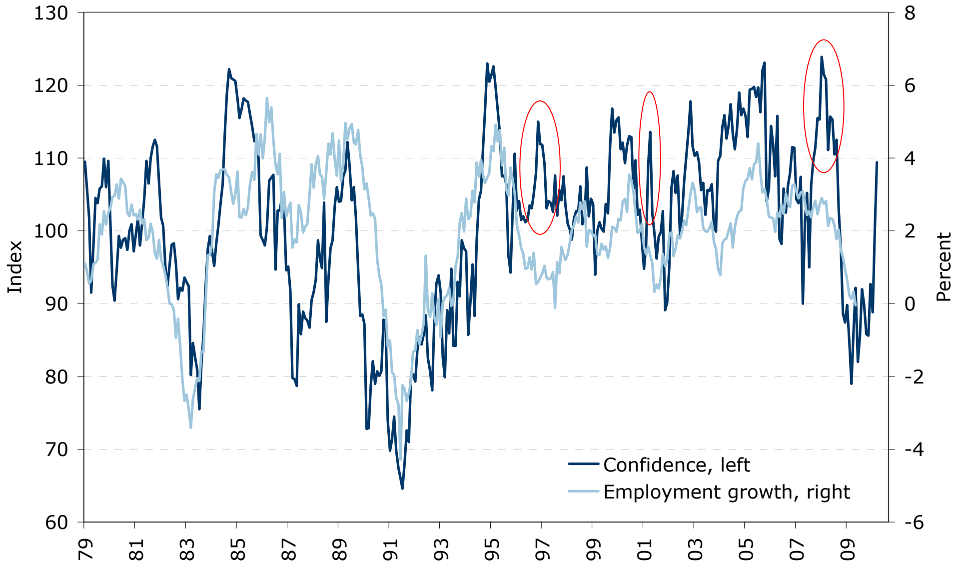
What is intriguing this month is the driver of the rise in confidence. Typically, movements in interest rates, petrol prices, equity markets and the unemployment rate will explain most of the movement in confidence in any given period. But in the past two months, none of these factors has moved much. Interest rates and equities have been flat, while petrol prices and unemployment are a little higher than they were two months ago.

In early June, the ABS reported that the economy grew by 0.5% in Q1, thus averting a technical recession. This appears to have had a profound effect on the national psyche. It may well be a case that consumers feel they are getting the benefits of a recession in the form of fiscal stimulus, lower rates and persistent sales at the shops, without any of the nasty consequences, most importantly, the widespread job losses usually associated with recession.

There is no doubt that retail sales are benefiting from rising consumer confidence, but a look at the relationship between confidence and employment suggests that consumer optimism may lead to a stronger labour market over the year ahead. Figure 2 shows that consumer confidence has a broad cyclical leading relationship with total employment growth. In this chart, the confidence series leads employment by around 9 months. The correlation coefficient is relatively high at 58% (for the whole period) and rises to 62% since 1998.

While the rise in confidence is encouraging, there have been a number of episodes when confidence has shot ahead of the underlying economy only to be disappointed. These are circled in figure 2 below.

Figure 2: MI Consumer Confidence Index and employment growth



The outlook for the labour market is critical to the broader economic outlook and so far the labour market has held up much better than most forecasters had expected. The June employment numbers do little to reduce the uncertainty. Employment fell by 21k in June and is now lower than a year ago for the first time since 1997, or ignoring that one month of decline, since the last recession in 1993. However, the experience of past recessions and most leading indicators tell us that the employment situation should be much worse.

Businesses are clearly hoarding labour for longer in this downturn in anticipation of a recovery in the broader economy. A reasonably healthy corporate balance sheet allows this flexibility. And the recent rise in consumer confidence is encouraging for businesses, particularly in the retail sector. But with hours worked and indicators of new labour demand already at recessionary levels, we doubt that labour hoarding can continue without a sustained improvement in underlying demand. With direct fiscal stimulus likely to fade over the months ahead, the risk of a broader downturn in the labour market remains.

Data wrap

- **TD Securities monthly inflation gauge** indicated monthly inflation of 0.39 in June and an annual inflation rate of just 1.38%, well below the RBA target.
- **ANZ job advertisements** fell by 6.7% in June, taking the annual fall to 51.4%. Newspaper ads grew by 0.9% but internet ads fell by 7.2%.
- The **AiG performance of construction index** fell 4.3 ppts to 42.6, still under the 50 points cut-off separating contraction from expansion, but well above its all-time low of 29.5 in February (data series back to 2005 only).
- The **RBA held the cash rate steady**, at 3.00%, with the door left open for further easing through the rest of 2009.
- The **WBC-MI consumer confidence index** increased by 9.3% in July, to a firmly positive 109.7, the highest reading since Dec 2007. Expectations for the economy in 1 year's time rose 12% while expectations for the economy in 5 years' time improved by 35.8% to the highest in this series (since 1974).
- Monthly **housing finance commitments** grew by 2.3% by value and 2.2% in number in May. The proportion of loan approvals going to first home buyers grew to 29.5%, a record high in this data series (back to 1991). The proportion of new mortgages on fixed rates grew to 6.5% (from 2.5%).
- **Employment** declined by 21,000 (-0.2%) in June, with all of the fall coming from fulltime employment and predominantly from Queensland and WA.
- **Unemployment** increased 0.1 ppt to 5.8%, its highest since Oct 2003.
- The **participation rate** fell by 0.1 ppt to 65.3%.

Interest rate markets: Yields move into correction mode

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

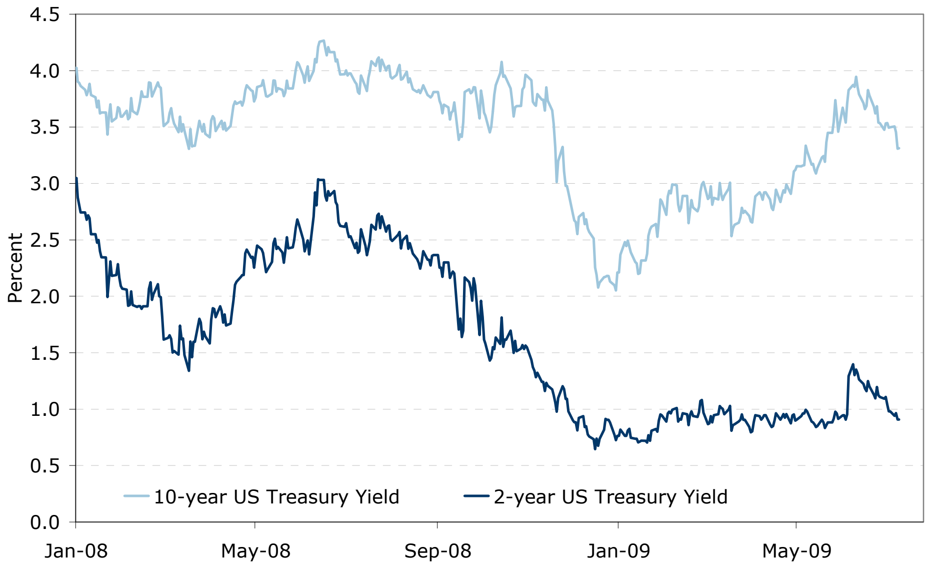
- **Market rates** have started to correct after the recent sell-off, as concerns mount regarding the sustainability of global growth's path to recovery.
- **Swap rates** are unlikely to return to previous lows. We look at some near-term target levels for swap rates.
- Concerns over global growth, weaker commodity markets and a rise in risk aversion have helped to push **yields** lower. But increased supply and policy-stimulus means we are unlikely to see a return to previous lows.

Market yields have turned decisively lower in recent days despite the resumption of AOFM bond tenders for the start of the new fiscal year and a heavy supply schedule in the US this week. US 2-year Treasury yields are down 52 bps from recent highs while 10-year yields are down 69 bps. We have largely matched these moves, despite seeing some strong data in recent days, particularly the surge in consumer sentiment and broader strength in housing finance.

And today's Labour Force data suggested mild weakness in the labour market.

The recent correction in yields can be seen in figure 3 below. Two-year yields are back below 1.0% after breaking a 6-month range early in June. The return to more normal levels for 10-year yields has been more apparent. But this momentum has clearly faded on the failure to break back above the 4.0% level.

Figure 3: US Treasury Bond yields



Source: ANZ & Bloomberg

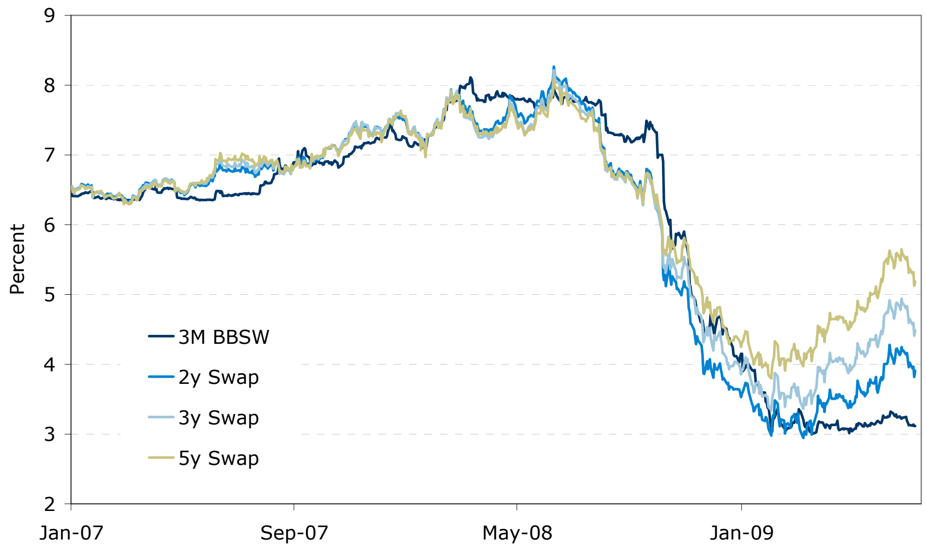
Rising risk aversion as stocks markets lose momentum going into the US Q2 reporting season, a 17% fall in oil prices over the past month, continued weakness in key data such as the US labour market and ongoing concerns over global growth have helped to cap the recent rise in yields. Currency moves back into JPY and USD from higher-yielding commodity-linked currencies such as the AUD would appear to confirm a shift into a more risk-averse environment.

This is setting the tone for the local market and helps to explain why bond supply is being easily absorbed in this environment. The AOFM resumed bond tenders for the new fiscal year this week with an issue of $700m of 2013 bonds yesterday that was well received and saw strong underlying demand. We will get a further $700m of 2011 bonds tomorrow. And in the US, $73bn of longer-dated Treasuries were also easily absorbed this week.

If risk-aversion remains an enduring theme across markets in coming weeks then yields have scope to rally further.

But there is still a big maturity schedule of benchmark ACGB and Semi-government bonds before the end of October as we have highlighted previously in this weekly. And the data also argue for a steady stance from the RBA for the foreseeable future that will help to anchor short-term rates without providing the momentum for yields to return to previous lows that were driven by intense risk-aversion, weaker data outcomes and expectations of further rate cuts.

Figure 4: Swap rates to June 2009



Source: ANZ

Three-month inter-bank rates have stabilised based on the more stable outlook for RBA rates as can be seen in the chart above. Speculation of rate hikes clearly looks to be premature in this environment.

So if rates are on hold for now and the scope and rationale for further aggressive policy action is limited, the next question is how far can this correction run in terms of setting target levels to lock-in borrowing? Even with the recent rise in yields, rates are still well below historic averages.

In terms of the near-term market outlook for 2-year swaps 3.65-3.80% looks to be a significant area where yields might find it hard to break. And a move back above 4.0% would be a signal that the recent momentum for lower rates had been eroded.

Similarly for 3-year swaps the area from 4.20-4.40% appears to represent a significant band that yields would find difficult to break. On the topside a break above 4.70% could be an early signal that momentum was building for a move above recent highs around 5.0%.

And for 5-year swaps the equivalent key band of resistance on the downside lies in the 4.75-5.0% area. The level to watch on the upside lies around 5.45%.

A move below the levels highlighted above cannot be ruled out, but we would need to see an unexpected degree of economic weakness in the months ahead to drive yields lower while there is unlikely to be a reduction in the scale of government issuance to cover existing fiscal programs.

Katie Dean
Senior Economist
+61 3 9273 1381
Katie.Dean@anz.com

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

FX: Moving to a bearish trading channel

Recommendation

As per last week, clients should look to top up hedging to take advantage of lower options volatility, which is now at risk of spiking higher in whippy FX markets. Technical indicators for the AUD are turning rapidly bearish. AUD sellers should look to take advantage of any moves above AUD/USD 0.7850. AUD buyers should find dips below AUD/USD 0.7750 attractive. AUD/JPY buyers could struggle to meet targets above 72.50.

Reversal from this week's lows to be capped

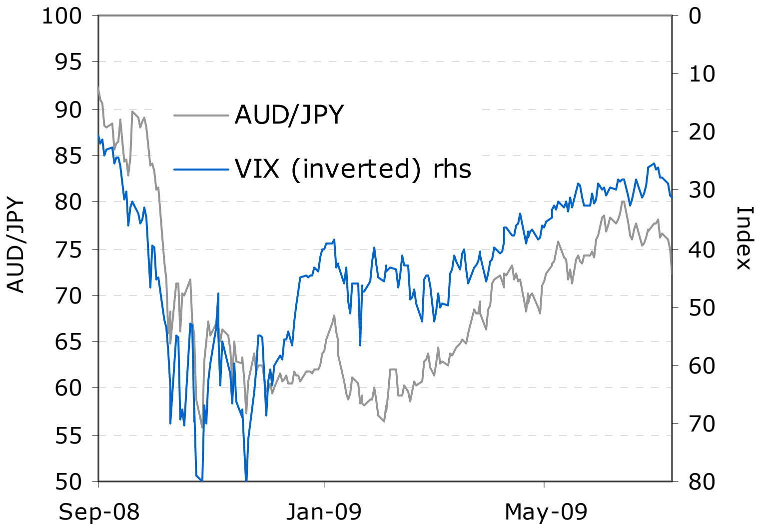
This week we have seen a sharp retracement in risk trades. The AUD has suffered accordingly and is lower on all the major crosses. AUD/USD has lost around 2% but the biggest mover has been the AUD/JPY which has fallen more than 5% as a recent build up in carry-trades has been unwound. Indeed, the JPY has been the major beneficiary from this rise in risk aversion, outperforming the USD with the DXY (the broad USD currency index) drifting higher but failing to make a strong break above its recent range.

The catalyst for these moves is market nerves ahead of the US Q2 reporting season. Focus is shifting from signs of a turnaround in the balance sheets of the financial sector to the level of distress that is now being felt across the 'real economy'. So long as the global economy remains in recession, profits across all sectors will remain under pressure. This has sent equities lower and the VIX volatility index has spiked 25% in the last week (albeit back to a level that is only slightly above June's average).

Adding to the AUD's woes has been weaker commodity prices and overnight news that a Chinese buyer had cancelled an Australian coal export delivery. This was seen as negative for Australian export prospects. However, we think the event more likely reflects price arbitrage (i.e. Chinese buyers taking advantage of lower prices in other markets) rather than outright falls in Chinese coal demand). Hence, while we expect the AUD/USD to maintain a heavy tone, we are cautious that this cross may actually be susceptible to some reversal in coming sessions as some of this "bad China news" is priced out.

Having peaked at USD0.8263 in late May, recent moves, particularly last night's close below the 50-day moving average of 0.7852, are close to confirming the AUD/USD is now entering a bearish channel. With markets skittish, a build up in net longs in AUD/USD amongst IMM speculators (back to nearly 1-year highs) leaves AUD vulnerable to a further turn in sentiment. Prospects for the AUD/USD to sustain a move back above 0.80 over Q3 are rapidly diminishing.

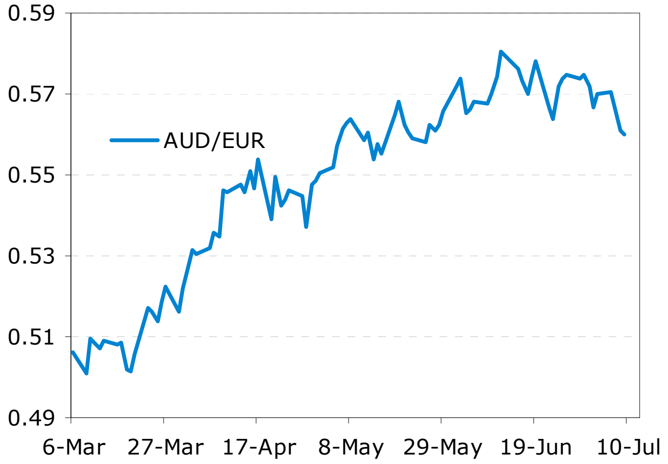
Figure 5: AUD/JPY has fallen sharply as risk trades are pared back

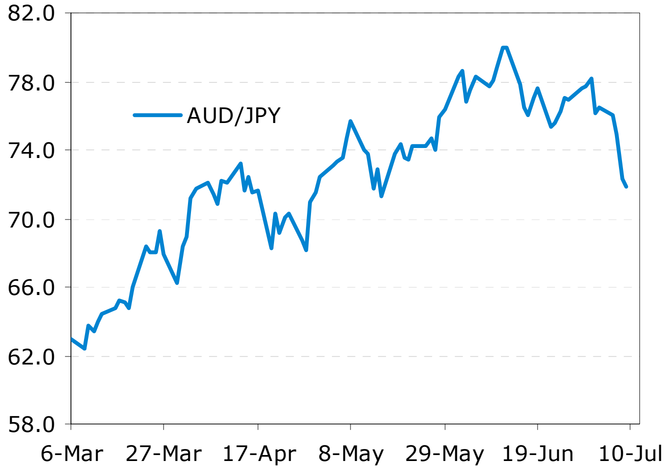


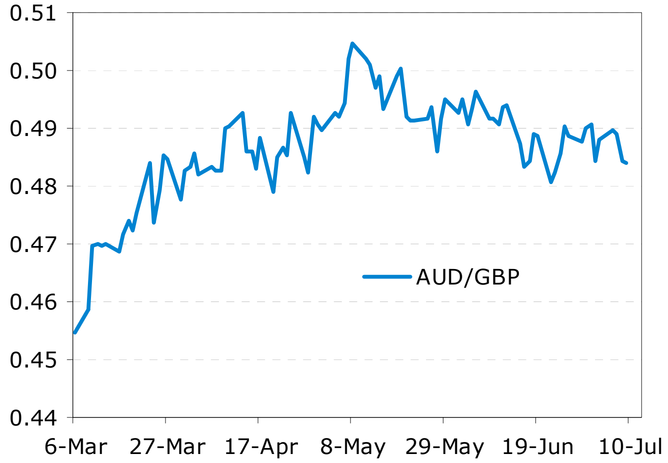
Source: ANZ, Bloomberg

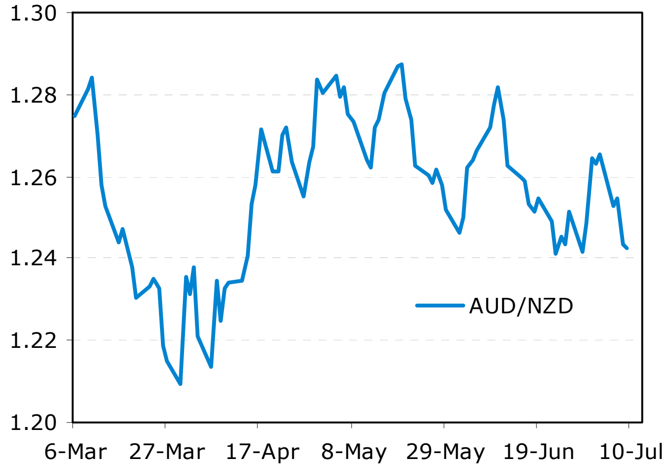
AUD/USD Key levels: 0.7710 – 0.7860. A break of 0.7710 opens the way for a fall back to 0.7550. On the upside, 0.7860 must hold for AUD/USD to reverse its recent bearish trading channel.

AUD cross view









AUD / EUR Key levels: 0.5580 – 0.5750

- AUD/EUR fell to the bottom of its tight range this week. In a bearish signal, AUD/EUR has had two consecutive closes below its 50-day moving average of 0.5660. Support was tested and has so far held above 0.5580.
- We remain cautious of a further fall in AUD/EUR. A close below 0.5600 could confirm the move into a lower range. With local data flows quiet, the minutes from the FOMC's last meeting, due Wednesday, is one major risk for AUD/EUR next week, with the EUR likely to outperform should the Fed have discussed any need to expand quantitative easing.

AUD / JPY Key levels: 71.00 – 75.50

- AUD/JPY more than reversed last week's gains to fall heavily towards a two-month low this week. Support is holding at 71 for now, but sentiment is bearish with the AUD/JPY closing well below its 50-day moving average of 75.66 in recent days.
- The US reporting season, and its impact on equity markets, remains the biggest risk for further AUD/JPY depreciation. Ranges could be wide with 70.90 the next key downside support level. The BoJ rate decision (on Wednesday) is unlikely to have any meaningful impact on the AUD/JPY, with no major policy announcements anticipated.

AUD / GBP Key levels: 0.4810 – 0.4920

- With AUD and GBP both underperforming this week, this cross has kept to a tight range. Attempts to break resistance at the 50-day moving average of 0.4915 were not sustained with this level continuing to provide solid resistance. On the downside, the key 2009 50% retracement level of 0.4810 should continue to provide initial downside support.
- There is little on the data calendar likely to drive the AUD/GBP out of recent ranges with UK CPI and unemployment unlikely to have a big impact on the GBP. Further rises in risk aversion is likely to only slightly benefit GBP relative to AUD.

AUD / NZD Key levels: 1.2350 - 1.2660

- AUD/NZD had a whippy week. Moves above 1.2660 proved unsustainable. The sharp overnight fall in the AUD has seen this cross now fall below the key support level of 1.2490.
- We expect the global backdrop, in particular risk appetite amidst the US reporting season, will dominate direction for this cross. With speculative longs favouring AUD over NZD recently, the risk is that an unwind could see AUD/NZD fall further to test support at 1.2350.
- Locally, the main risk event for AUD/NZD is Monday's NZ retail sales release.

ANZ economic and financial market forecasts

Australian economic indicators	2008	2009f	2010f	2011f
Economic activity (annual % change)				
Private final demand	4.1	-2.0	-1.3	3.2
Household consumption	2.2	1.0	1.2	2.9
Dwelling investment	2.5	-6.8	8.4	10.3
Business investment	13.8	-9.8	-14.2	1.0
Public demand	5.3	2.0	6.6	4.1
Domestic final demand	4.4	-1.1	0.5	3.4
Inventories (contribution to GDP)	-0.6	-0.2	0.3	0.1
Gross National Expenditure (GNE)	3.8	-1.3	0.8	3.5
Exports	3.9	-1.9	-3.5	4.2
Imports	10.3	-11.7	1.1	7.7
Net Exports (contribution to GDP)	-1.5	2.5	-1.0	-0.9
Gross Domestic Product (GDP)	**2.3**	**0.0**	**0.5**	**3.0**
Prices and wages (annual % change)				
Inflation: Headline CPI	4.4	1.8	2.4	1.7
Underlying*	4.5	3.7	2.4	2.1
Wages	4.3	3.6	2.9	3.2
Labour market				
Employment (annual % change)	2.2	-0.3	-0.7	2.0
Unemployment rate (%)	4.3	6.1	7.8	7.6
External sector				
Current account balance: A$ bn	-51.0	-42.6	-65.5	-73.0
% of GDP	-4.3	-3.6	-5.4	-5.6

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

Australian interest rates	Current	Sep 09f	Dec 09f	Mar 10f	Jun 10f	Sep 10f
RBA cash rate	3.00	3.00	2.50	2.50	2.50	2.50
90 day bill	3.11	2.90	2.75	2.75	2.80	3.00
3 year bond	4.15	4.05	4.05	4.15	4.20	4.60
10 year bond	5.20	5.35	5.25	5.25	5.20	5.45
3s10s yield curve	1.06	1.30	1.20	1.10	1.00	0.85
3 year swap	4.46	4.35	4.35	4.45	4.50	5.07
10 year swap	5.63	5.75	5.60	5.55	5.50	6.00
International interest rates						
RBNZ cash rate	2.50	2.50	2.50	2.50	2.50	2.50
NZ 90 day bill	2.80	2.80	2.80	2.80	2.80	2.80
US Fed funds note	0.25	0.25	0.25	0.25	0.25	0.50
US 2 year note	0.93	1.10	1.00	1.25	1.50	2.00
US 10 year note	3.32	4.25	4.00	4.15	4.30	4.50
Japan call rate	0.10	0.10	0.10	0.10	0.10	0.25
ECB refinance rate	1.00	0.75	0.75	0.75	0.75	1.00
UK repo rate	0.50	0.50	0.50	0.50	0.50	0.50

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

Foreign exchange rates	Current	Sep 09f	Dec 09f	Mar 10f	Jun 10f	Sep 10f
Australia and NZ exchange rates						
A$/US$	0.78	0.76	0.73	0.74	0.76	0.78
NZ$/US$	0.63	0.58	0.55	0.54	0.54	0.55
A$/¥	72.57	74.48	73.00	77.70	82.08	85.80
A$/€	0.56	0.56	0.56	0.57	0.58	0.59
A$/£	0.48	0.48	0.46	0.46	0.48	0.48
A$/NZ$	1.24	1.31	1.33	1.37	1.41	1.42
A$/CA$	0.91	0.87	0.88	0.87	0.87	0.90
A$/CHF	0.85	0.85	0.83	0.84	0.85	0.87
A$/CNY	5.33	5.19	4.99	5.05	5.19	5.32
A$ Trade weighted index	62.50	62.36	59.98	61.22	63.25	64.28
International cross rates						
US$/¥	93.1	98.0	100.0	105.0	108.0	110.0
€/US$	1.39	1.35	1.30	1.30	1.31	1.32
€/¥	130	132	130	137	141	145.20
£/US$	1.61	1.59	1.58	1.60	1.60	1.62
€/£	0.86	0.85	0.82	0.81	0.82	0.81
US$/CA$	1.16	1.15	1.20	1.18	1.15	1.15
US$/CHF	1.09	1.12	1.14	1.14	1.12	1.12
US$ index	80.6	82.5	85.0	85.2	84.9	84.61
Asia exchange rates						
US$/CNY	6.83	6.83	6.83	6.83	6.83	6.82
US$/HKD	7.75	7.75	7.75	7.75	7.76	7.77
US$/IDR	10205	10250	9750	9500	10000	9500
US$/INR	49.01	48.50	48.00	47.00	47.50	47.00
US$/KRW	1279	1225	1125	1175	1225	1100
US$/MYR	3.57	3.60	3.55	3.50	3.50	3.45
US$/PHP	48.19	49.00	48.00	48.00	47.00	47.00
US$/SGD	1.46	1.52	1.51	1.50	1.50	1.49
US$/THB	34.09	36.00	35.50	35.00	35.00	34.50
US$/TWD	33.00	32.50	32.00	31.50	31.00	30.30
US$/VND	17803	18500	18500	18500	18500	18500
Pacific exchange rates						
PGK/US$	0.382	0.320	0.350	0.350	0.360	0.360
FJD/US$	0.476	0.418	0.406	0.400	0.403	0.407

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 NASD and SIPC)

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 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 for the information of its market counterparties and intermediate customers only. It is not intended for and must not be distributed to private customers. In the UK, ANZ is regulated by the FSA. 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.