

Open partnerships
Open possibilities

Turbulent times for the global and Australian economies

Presentation to the CEO Forum

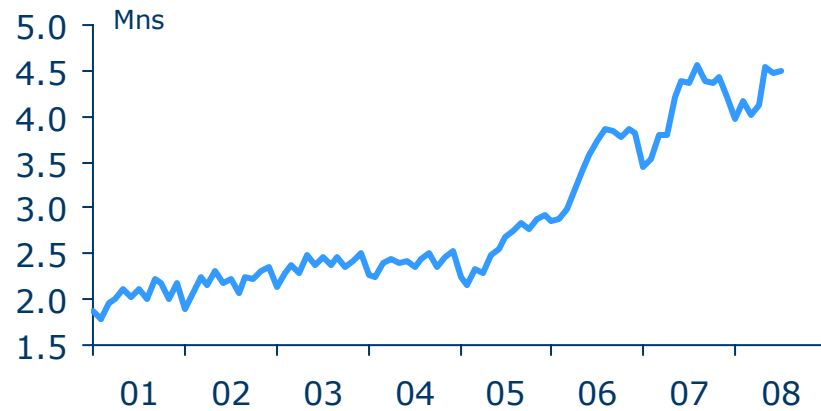
Westin Hotel, Melbourne
14th August 2008

Saul Eslake
Chief Economist

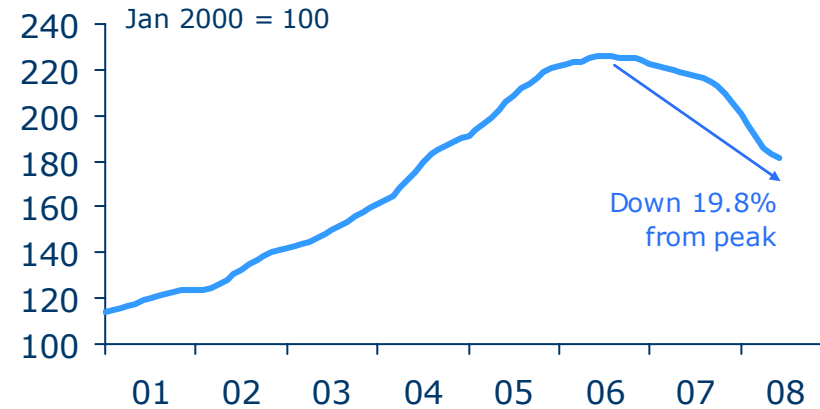
There is as yet no sign of that the US housing market has reached a trough

US housing market indicators

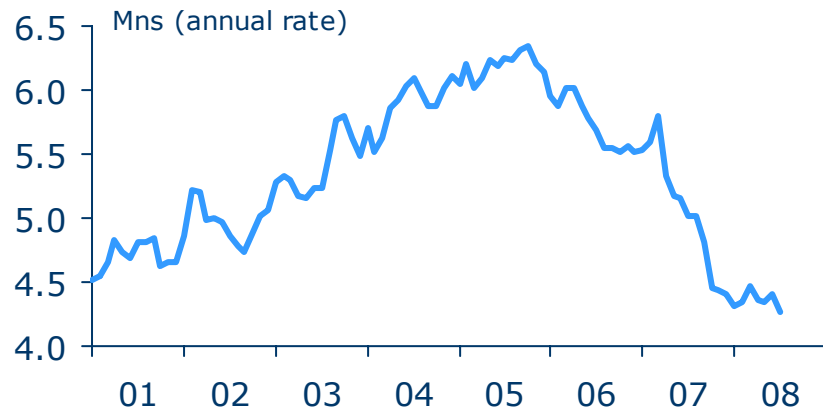
Existing houses for sale



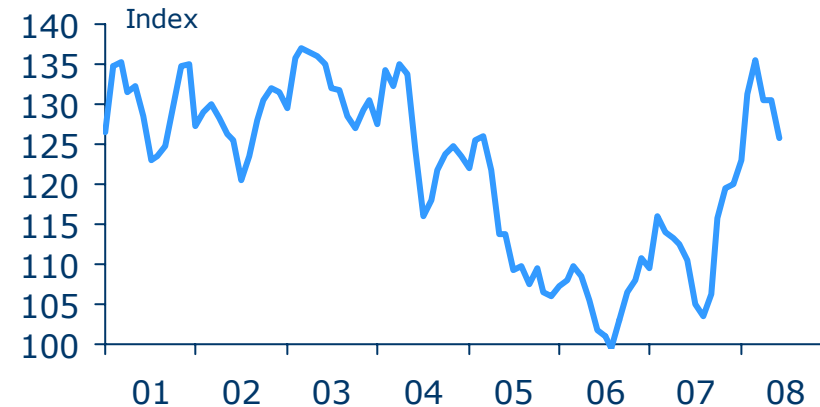
Existing home prices



Existing home sales



Housing affordability

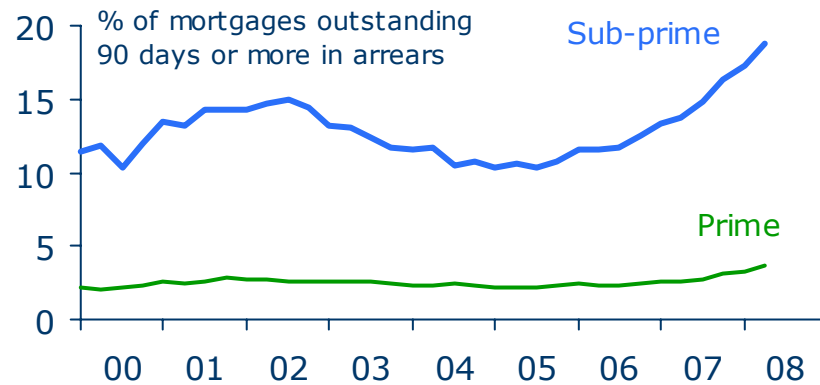


Sources: US National Association of Realtors; Commerce Department; S&P (the Case-Shiller index).

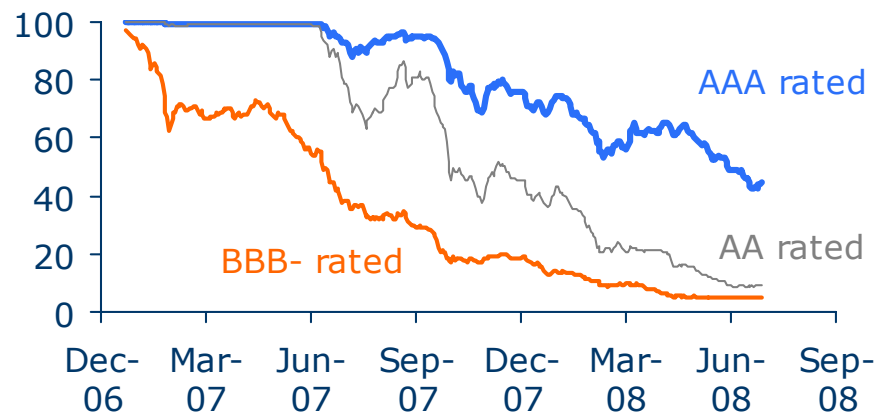


The US mortgage market meltdown has prompted a tidal wave of losses and write-downs by banks around the world

US mortgage delinquencies



ABX index of prices of US mortgage-backed securities



Losses announced by major banks since mid-2007

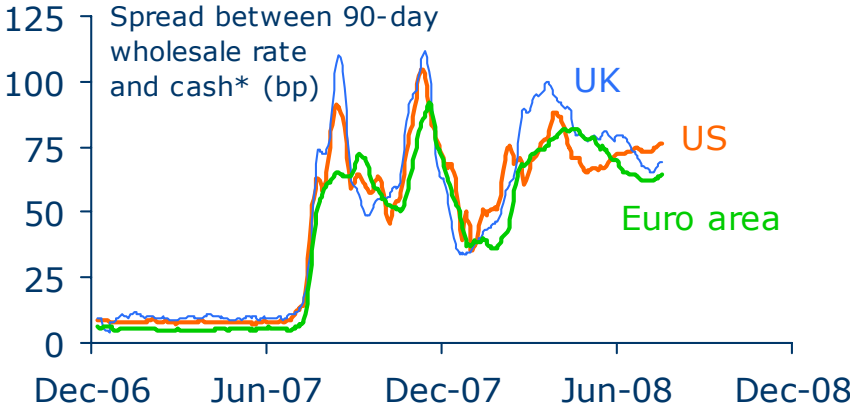
Bank	Total (US\$ bn)
Citigroup	55.1
Merrill Lynch	51.8
UBS	44.2
HSBC	27.4
Wachovia	22.5
Bank of America	21.2
IKB Deutsche	15.3
Royal Bank of Scotland	14.9
Washington Mutual	14.8
Morgan Stanley	14.4
JP Morgan Chase	12.8
Deutsche Bank	10.8
Credit Suisse	10.5
Wells Fargo	10.0
Lehman Brothers	8.2
Credit Agricole	8.1
HBoS	7.1
Societe Generale	6.8
Total (incl. others not shown above)	501.1

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

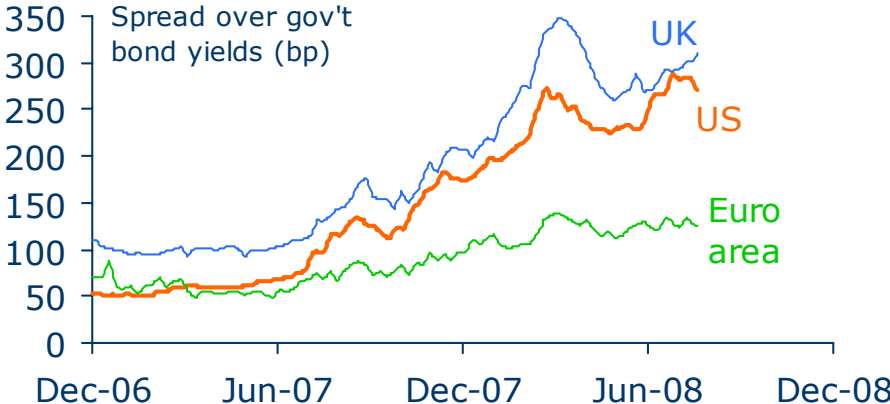


Financial market stress has continued and affected the money, swap, bond and share markets

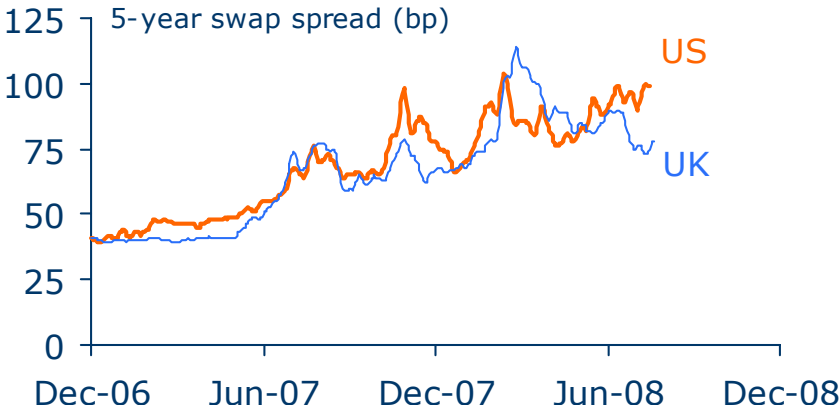
Banks' short-term funding costs



Corporate bond yield spreads



Banks' long-term funding costs



Share prices

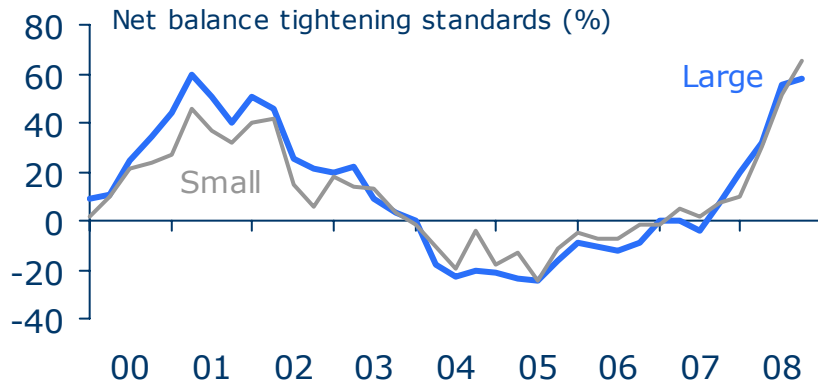


Note: all data shown as 5-day moving averages. Sources: Bloomberg; Datastream.

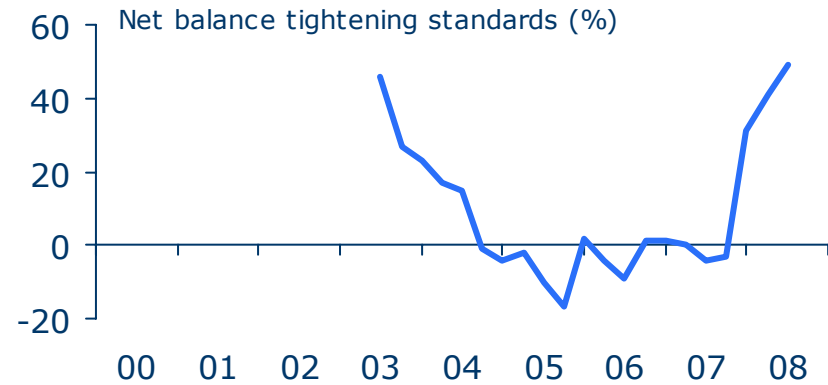


Banks in the US and the euro area are tightening credit standards

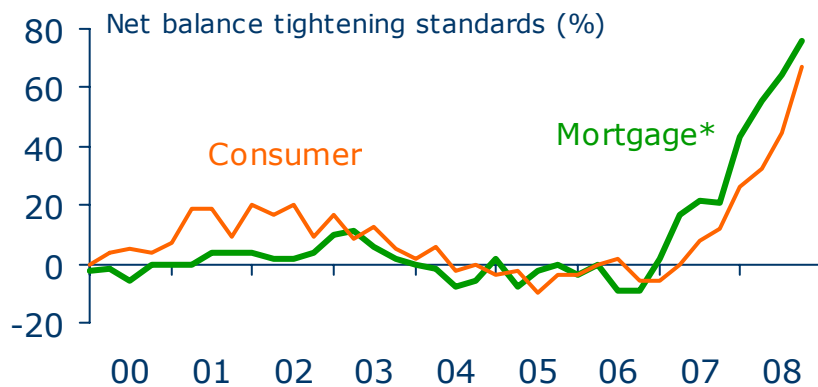
US banks
Commercial & industrial loans



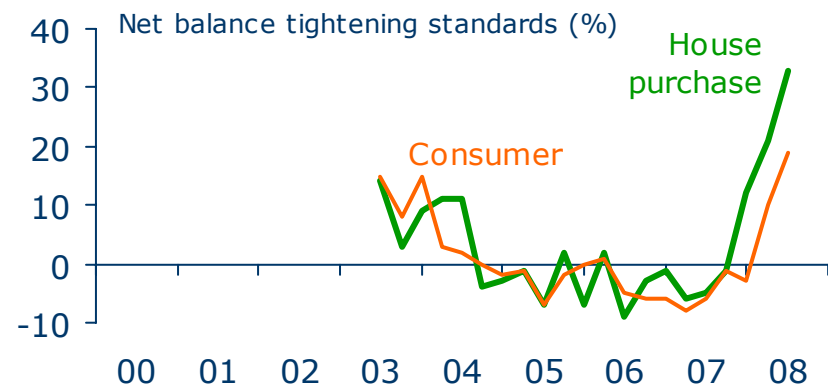
Euro area banks
Loans to enterprises



Mortgage and consumer loans



Mortgage and consumer loans



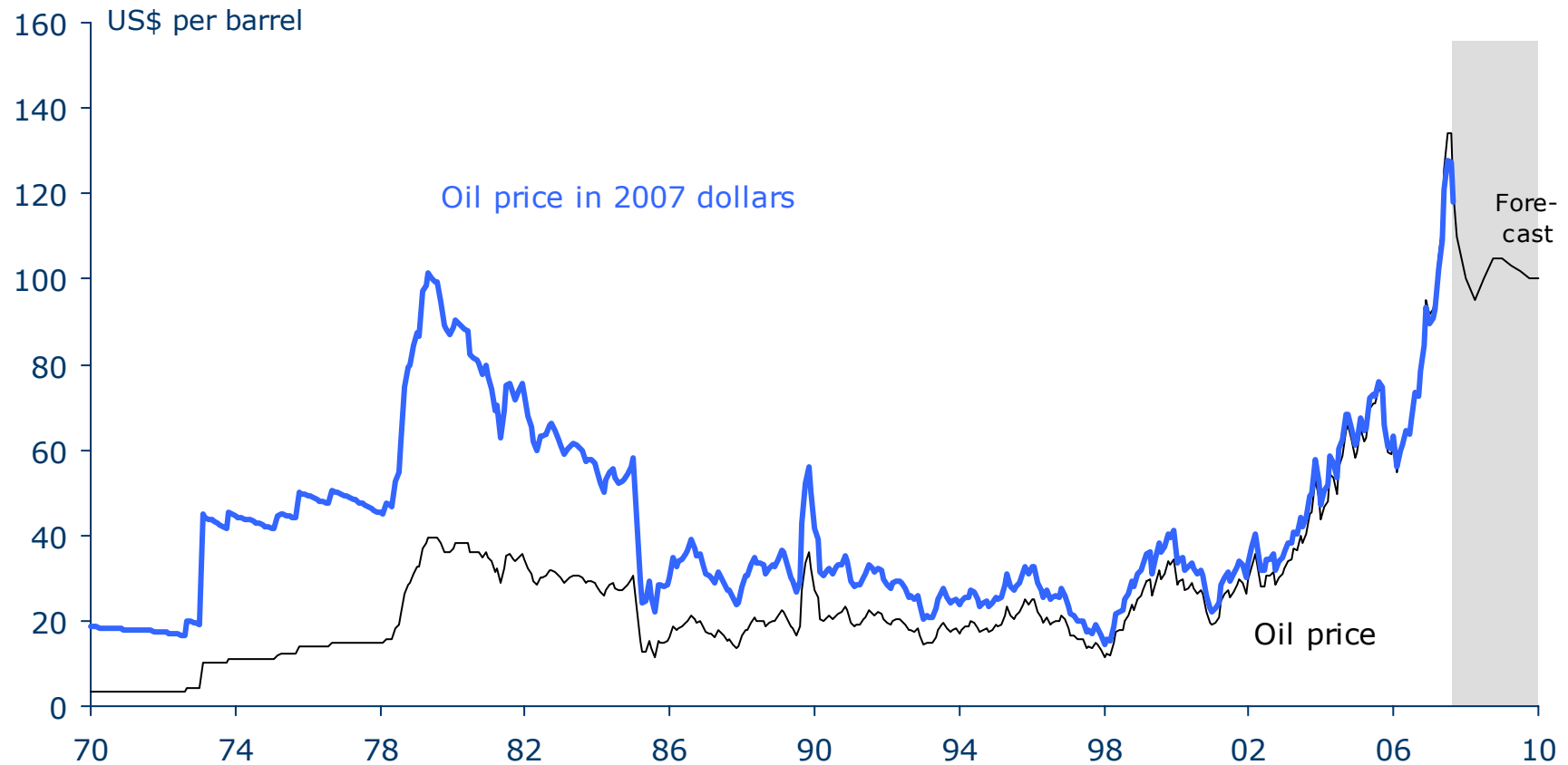
* Weighted average of prime & sub-prime after June 2007

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



Oil prices appear to have peaked for now but are still well above their previous high in inflation-adjusted terms ⁶

Oil prices

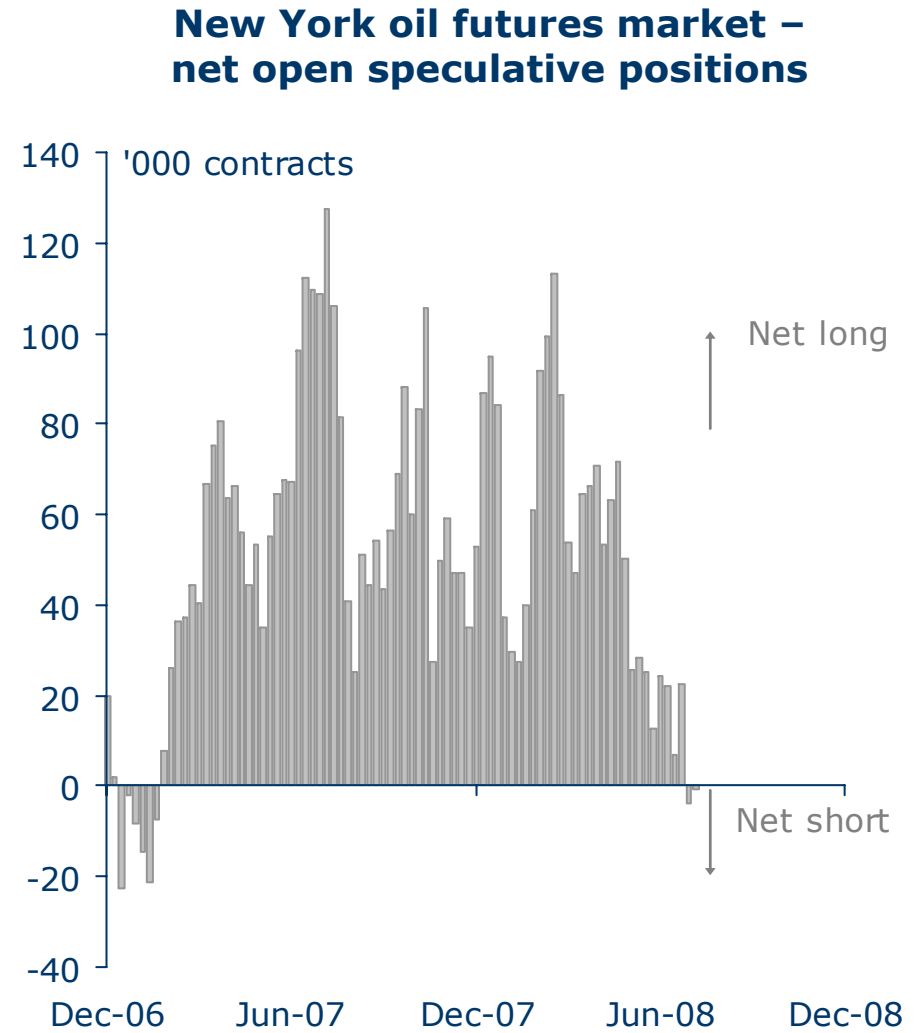
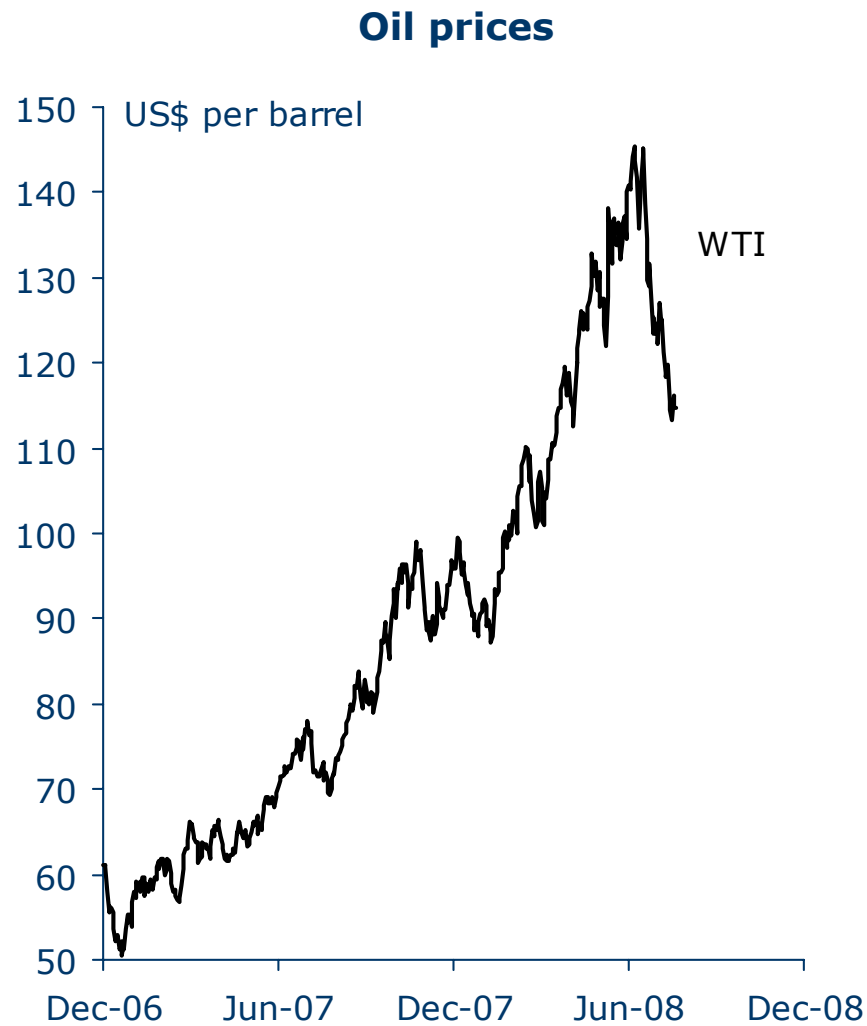


Note: Oil price is West Texas Intermediate.

Source: Thomson Financial Datastream; US Bureau of Labor Statistics; ANZ.



Oil prices have begun falling as speculative positions have been cut - and reflecting softening demand too ⁷



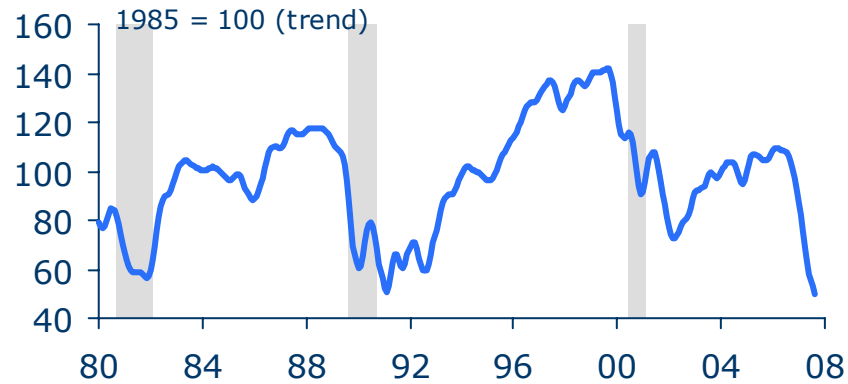
Sources: Datastream; Bloomberg.



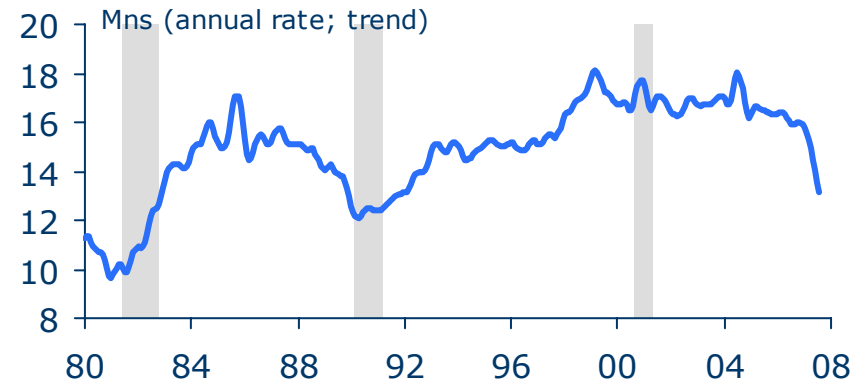
Many indicators suggest that the US economy is heading for, or already in, recession

Selected US indicators

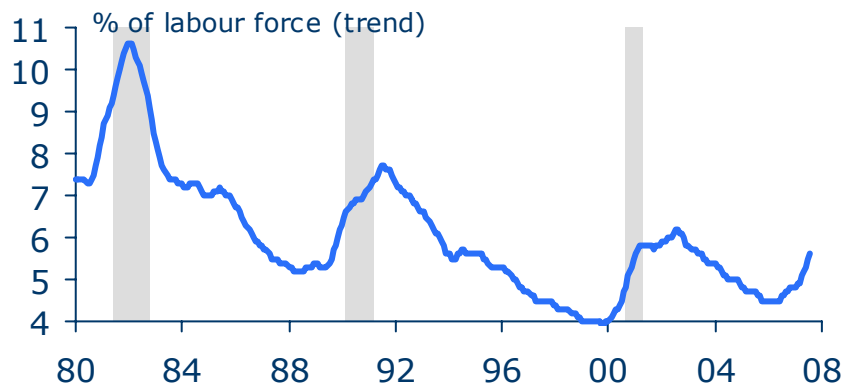
Consumer confidence



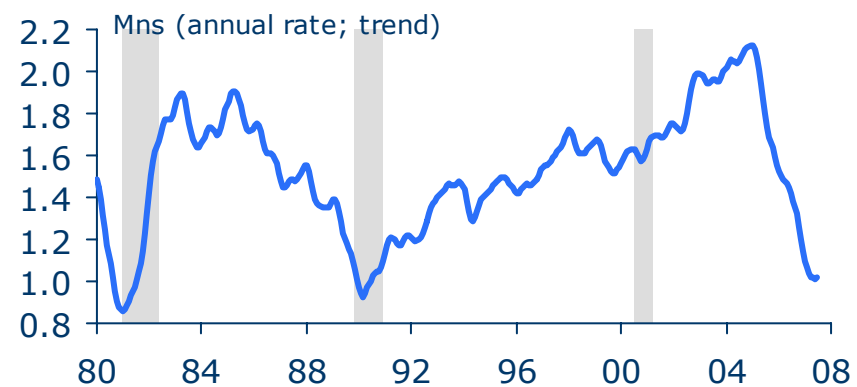
Motor vehicle sales



Unemployment



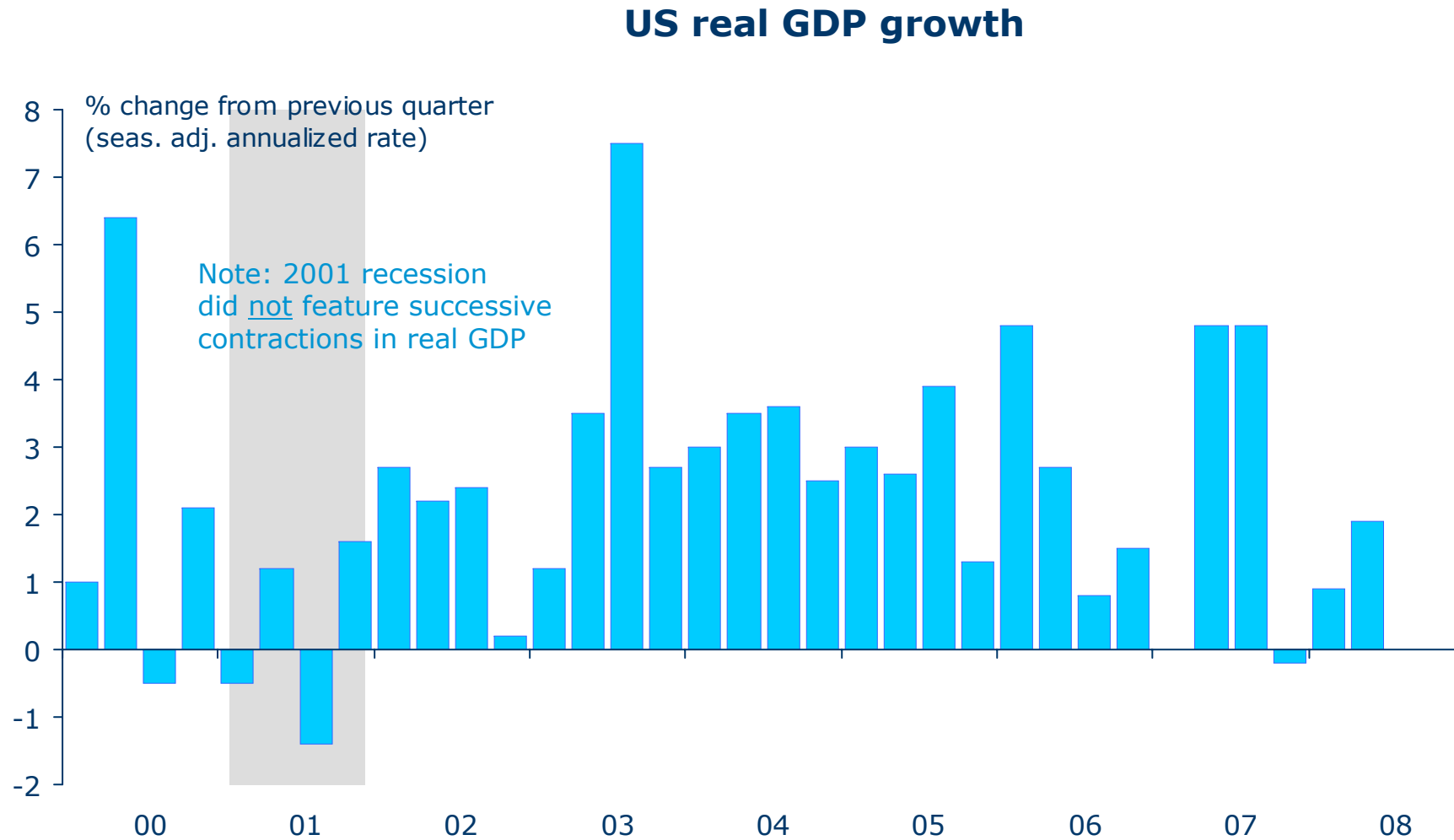
Housing starts



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



The US hasn't experienced consecutive quarters of negative GDP growth (yet) ⁹



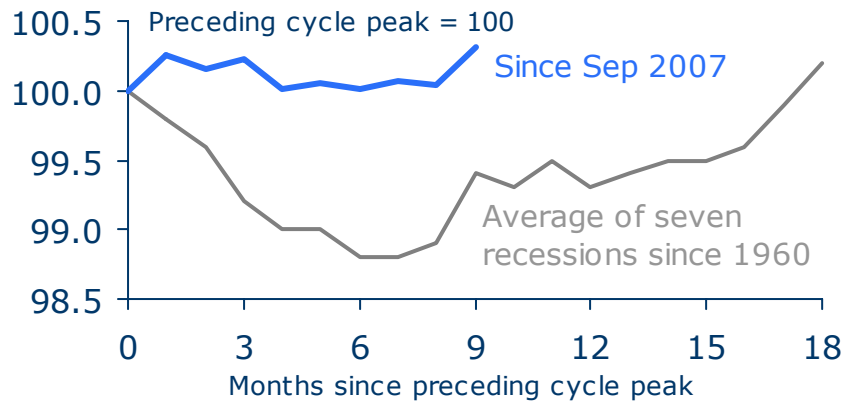
Source: US Bureau of Economic Analysis. Shaded area denotes 2001 recession as designated by National Bureau of Economic Research.



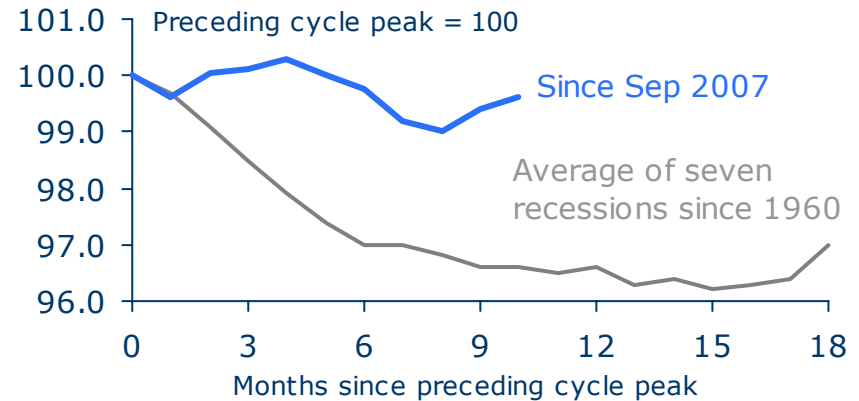
The four key indicators used to delineate recession in the US have not yet turned down sharply as in previous recessions

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

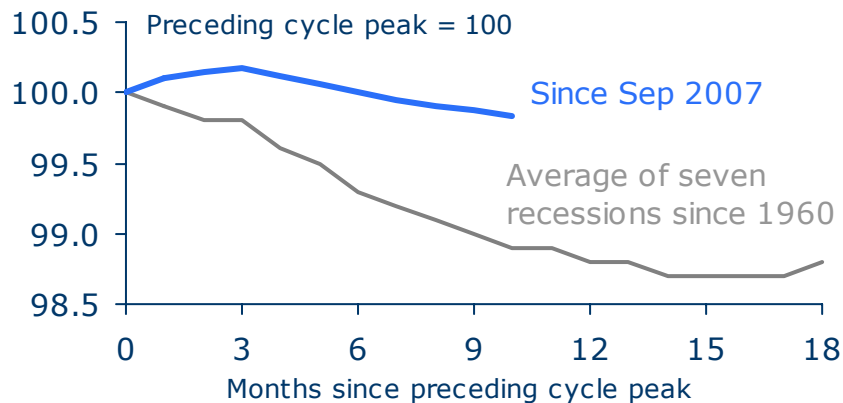
Real personal income less transfers



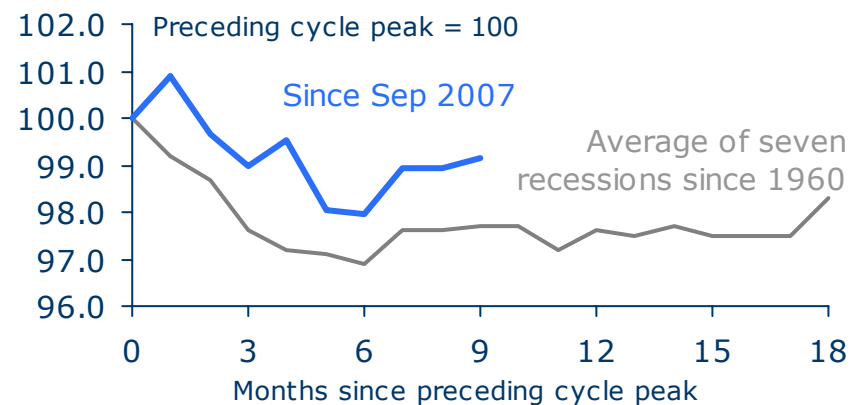
Industrial production



Employment



Real business sales



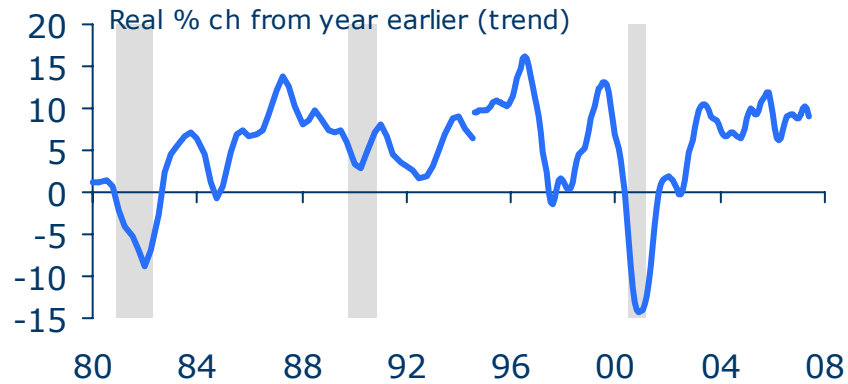
Sources: US Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve Board; Commerce Department; ANZ Economics & Markets Research.



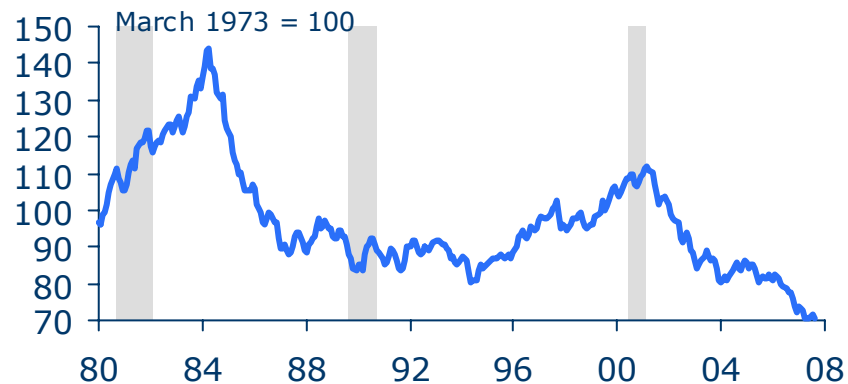
Rising exports, aided by a weaker US\$, have more than offset the impact on GDP growth of falling housing construction

US dollar, exports and housing

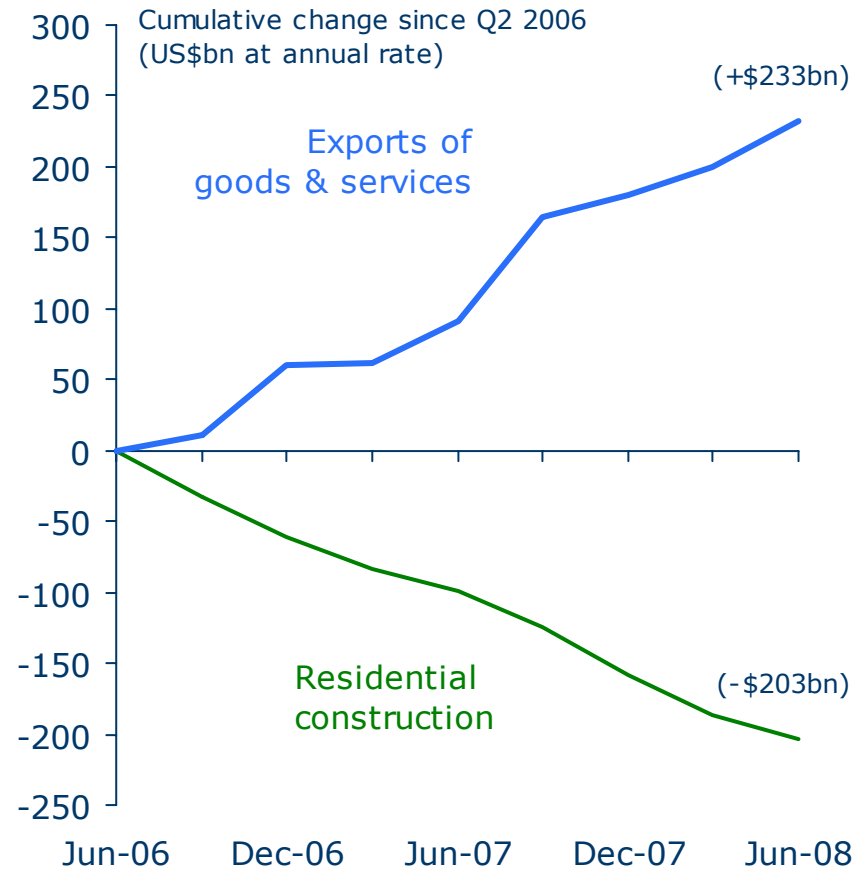
Exports of goods and services



Trade-weighted value of US\$



Exports and housing

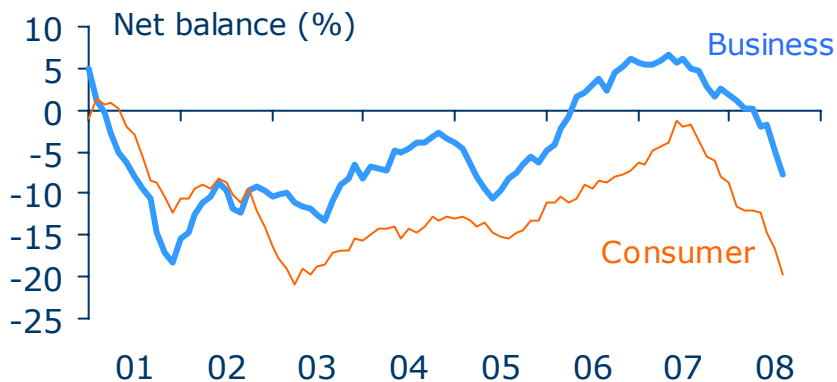


Sources: Thomson Financial; US Bureau of Economic Analysis; ANZ.

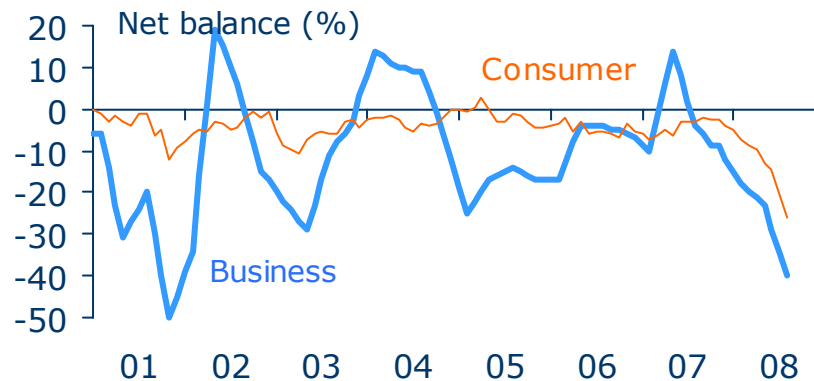


European and Japanese economies are also showing signs of a marked slowdown

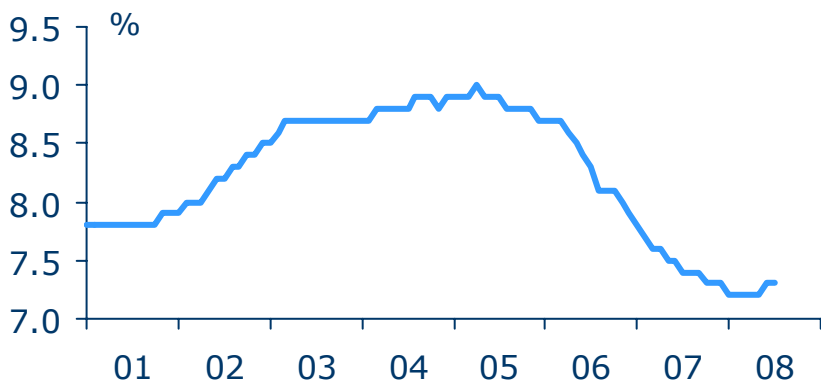
Euro area Business & consumer confidence



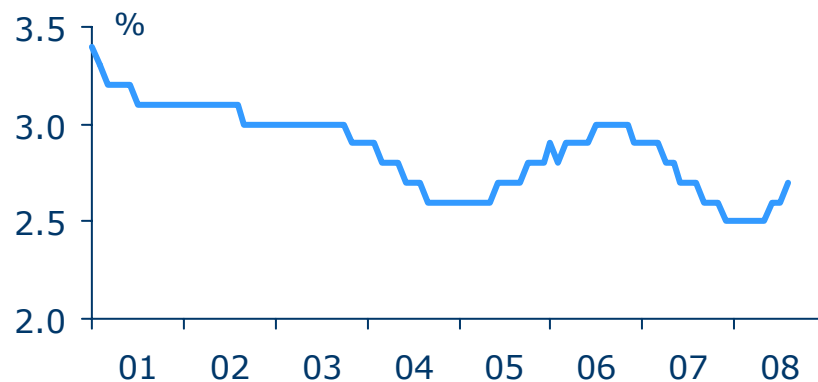
UK Business & consumer confidence



Unemployment



Unemployment



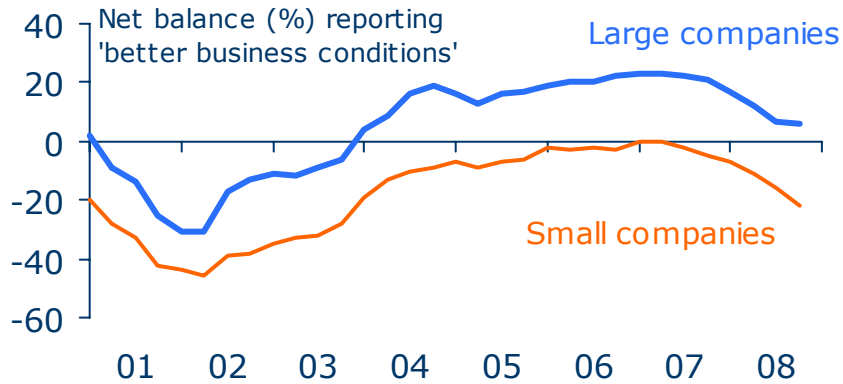
Sources: European Commission; Eurostat; Confederation of British Industry; UK Office of National Statistics (note UK unemployment measure based on claimant count).



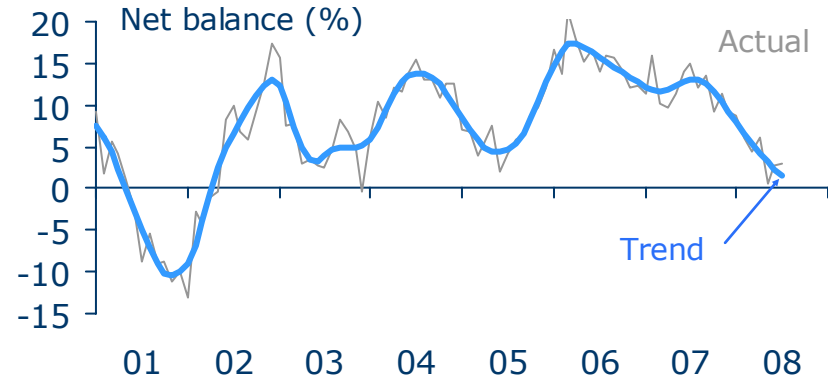
Japan's economy has slowed sharply even though its banks have very little exposure to the global credit crisis

Japan

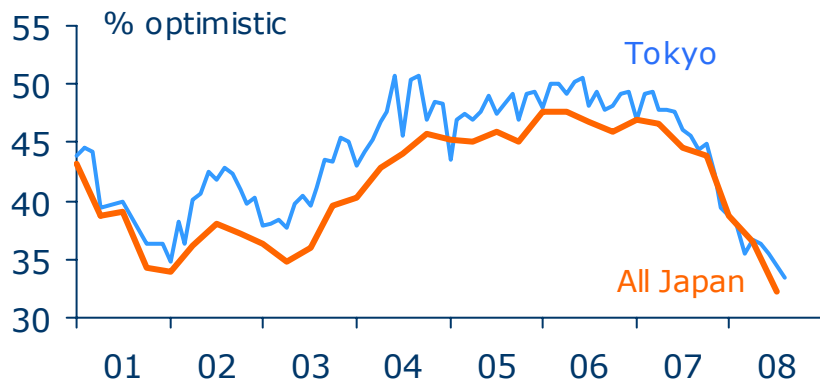
Business confidence



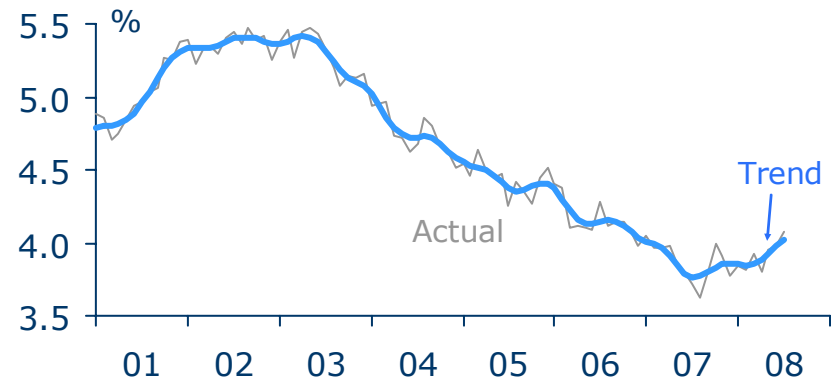
Exports



Consumer confidence



Unemployment



Sources: European Commission; Eurostat; Bank of Japan; Japan Economic & Social Research Institute; Japan Home Ministry.



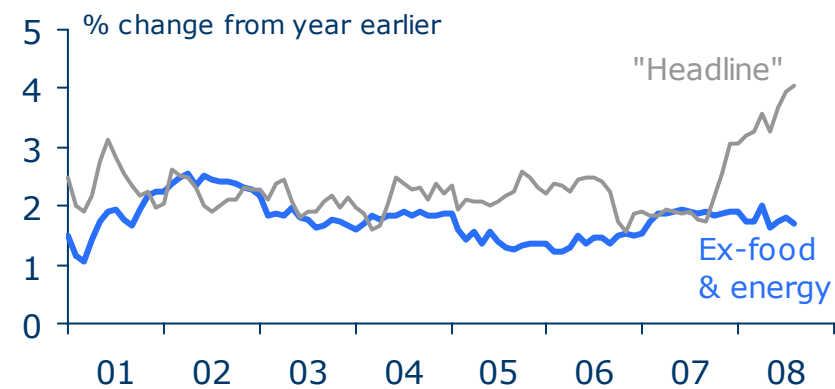
Although higher oil and food prices are pushing up headline inflation, 'core' inflation remains little changed in G7 countries

Consumer prices

United States



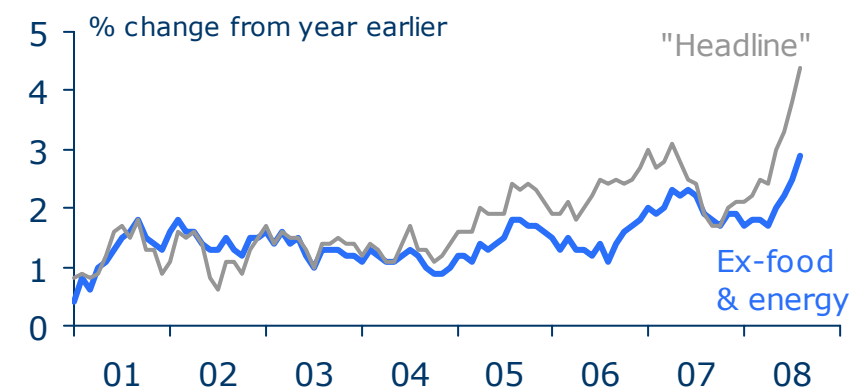
Euro area



Japan



United Kingdom



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

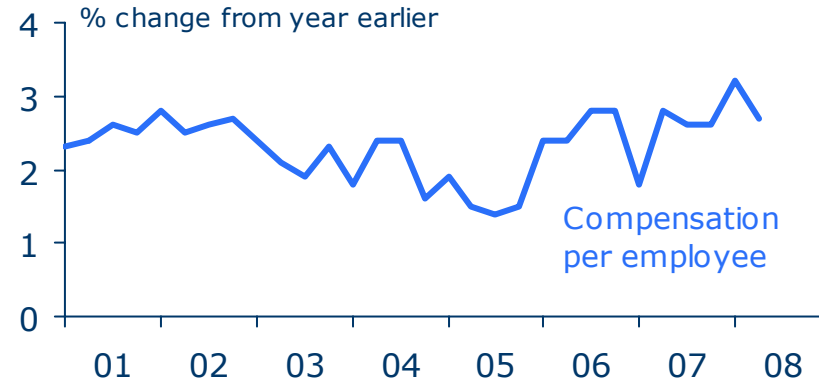
Moreover wages growth has remained moderate in developed countries, making it less likely that inflation will keep rising

Measures of wages growth

United States



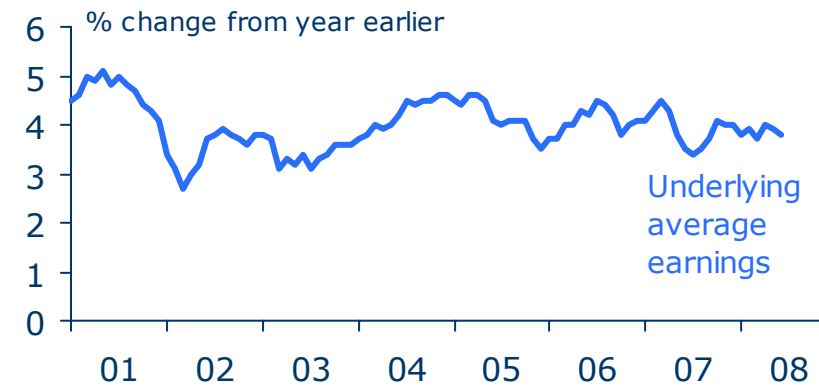
Euro area



Japan



United Kingdom



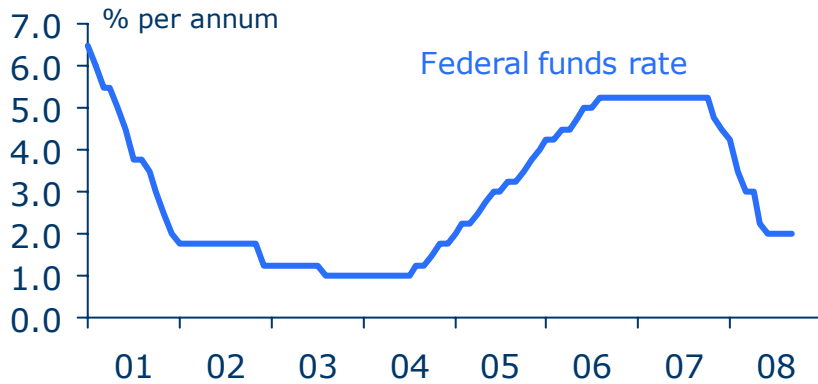
Sources: US Bureau of Labor Statistics; Japan Labour Ministry; Eurostat; UK Office of National Statistics.



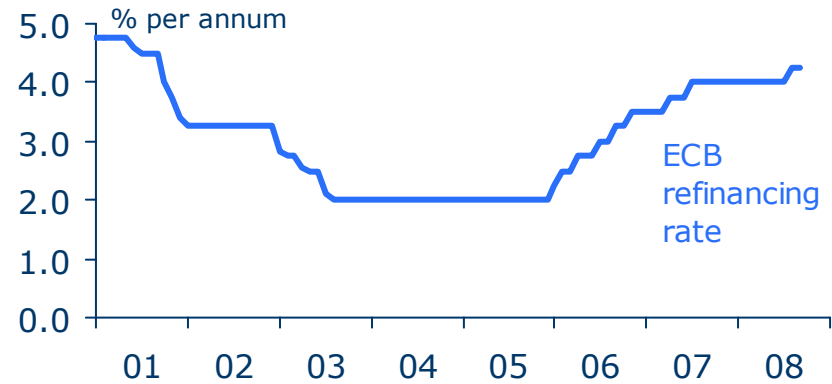
Inflation concerns have prevented European and Japanese central banks from cutting rates (indeed the ECB has raised them) 16

Monetary policy interest rates

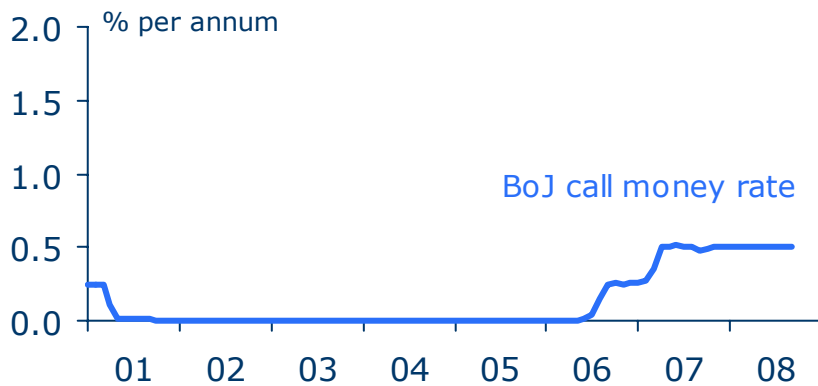
United States



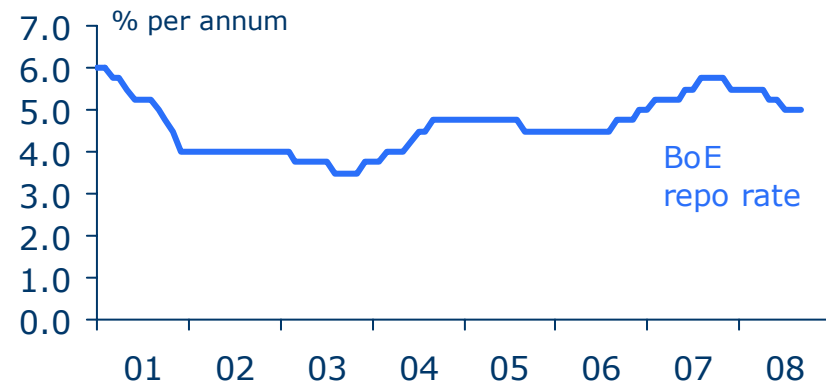
Euro area



Japan



United Kingdom



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



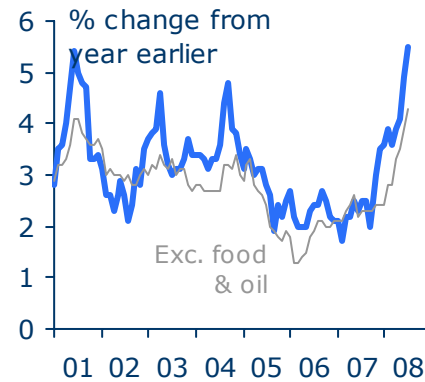
Inflation is rising sharply across Asia – partly though far from entirely driven by higher food prices

Asian economies – consumer prices

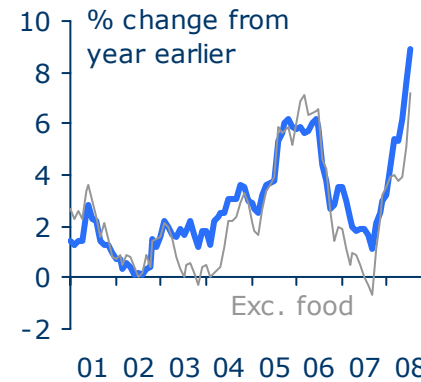
China



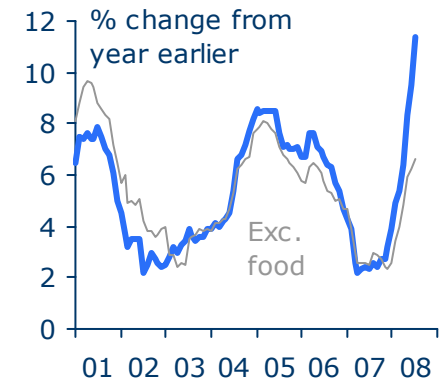
Korea



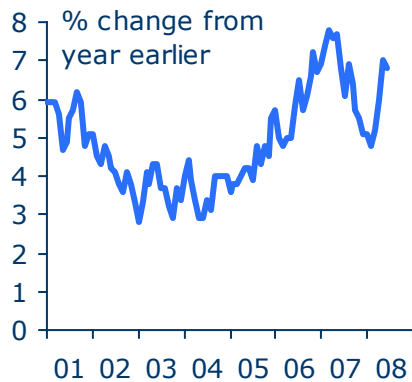
Thailand



Philippines



India



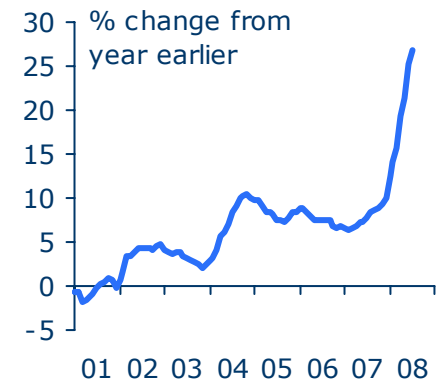
Indonesia



Malaysia



Vietnam

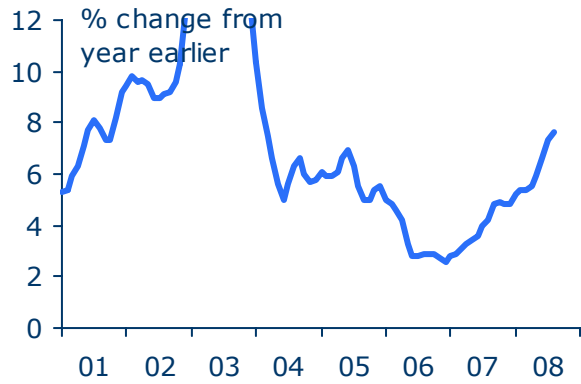


Sources: national statistical agencies; ANZ.

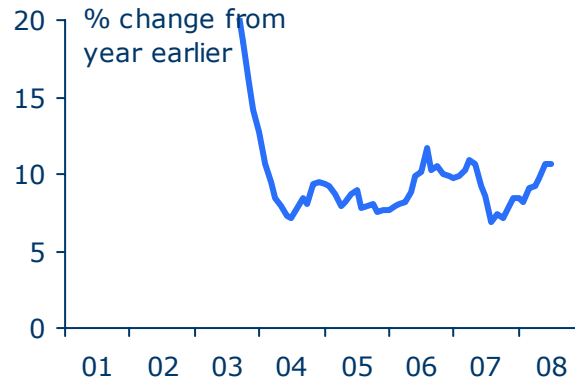
Inflation is also rising across other parts of the developing or emerging world

Selected other developing economies – consumer prices

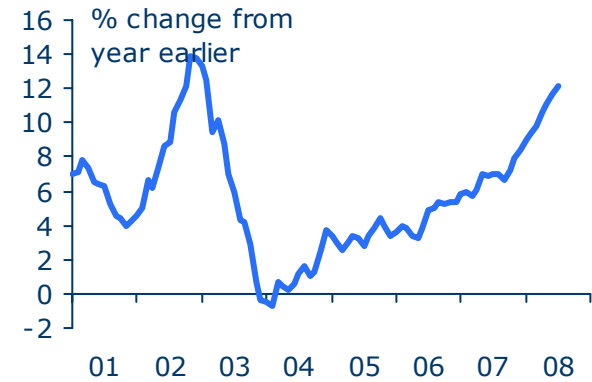
Brazil



Turkey



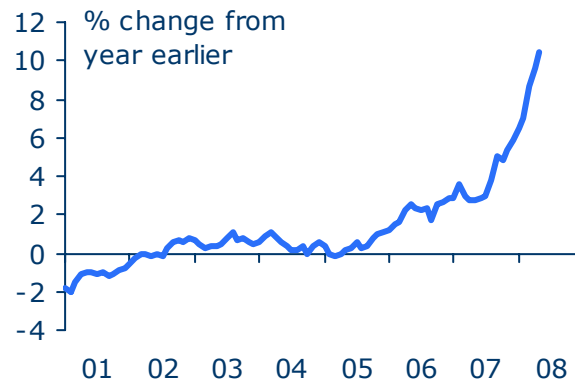
South Africa



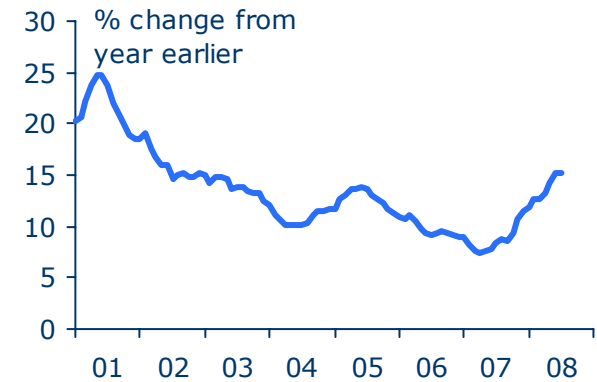
Chile



Saudi Arabia



Russia



Sources: national statistical agencies; ANZ.



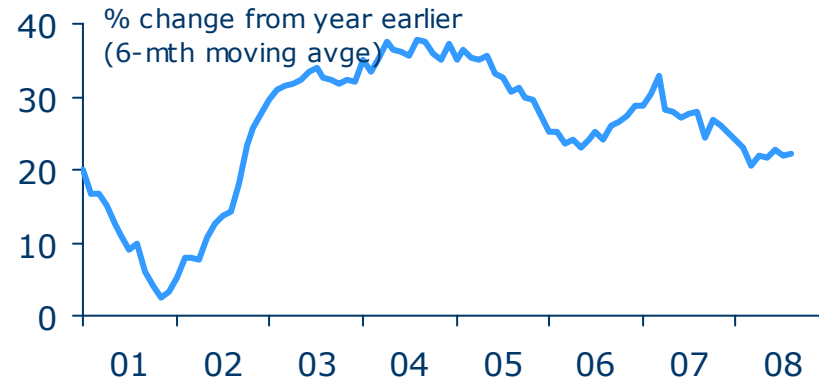
Even China's economy is showing signs of slowing – albeit from a much more rapid pace than anywhere else in the world ¹⁹

Chinese economic indicators

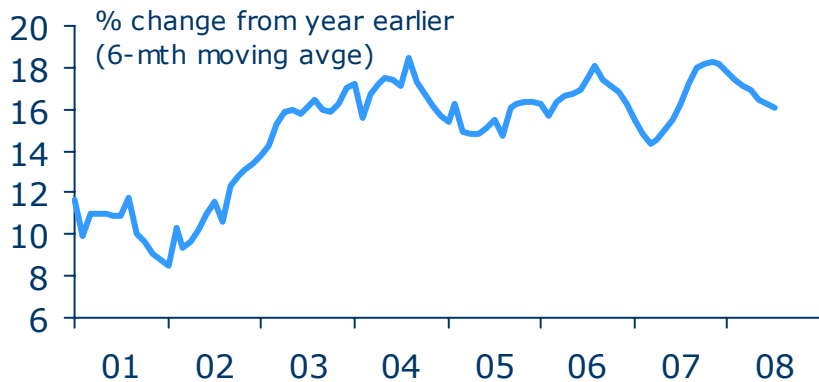
Real GDP growth



Exports



Industrial production



Bank lending

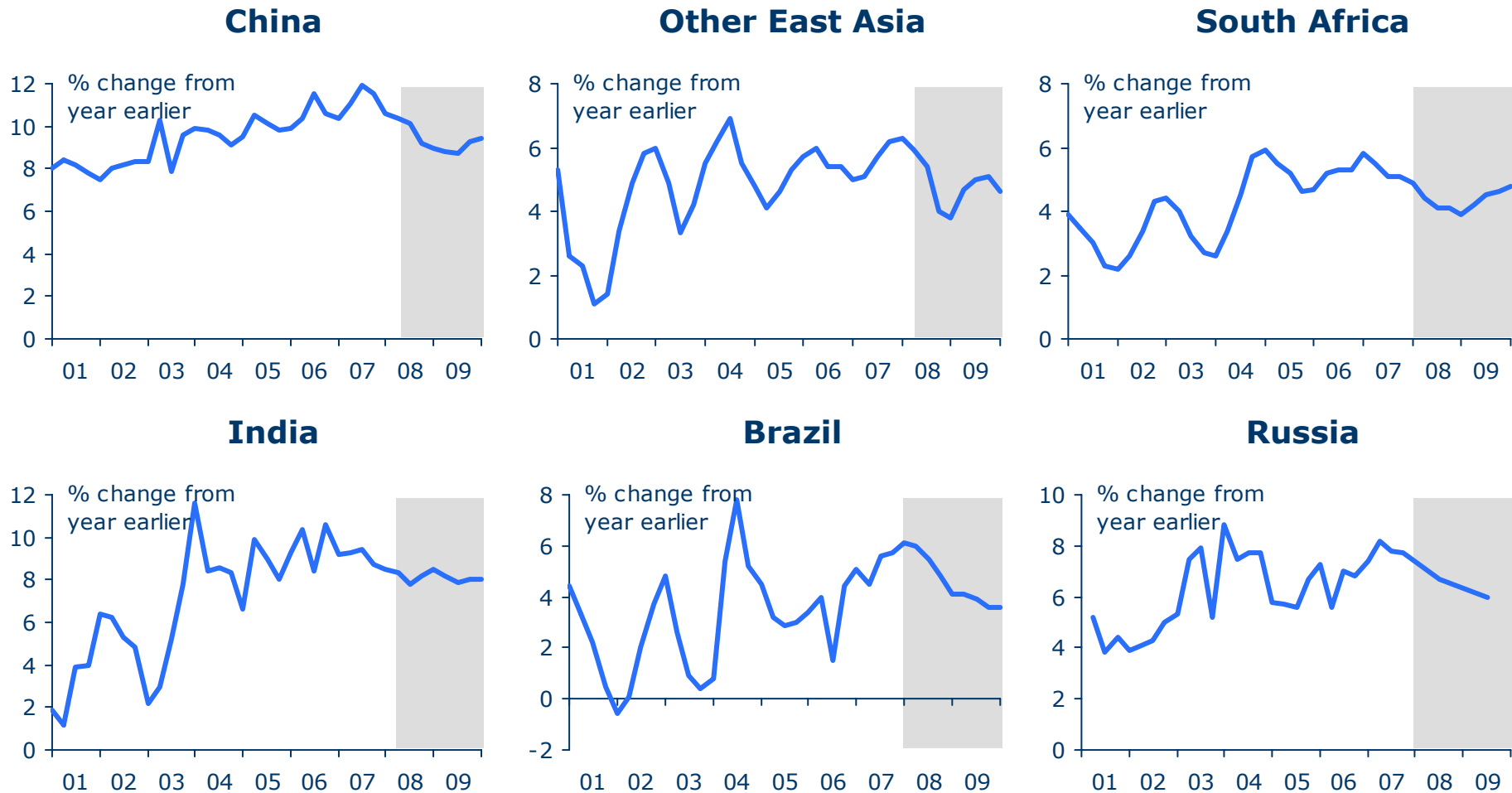


Source: China National Statistics Bureau.



Growth is also slowing in the developing world, although growth rates there will still be strong by historical standards ²⁰

Major developing economies – real GDP growth

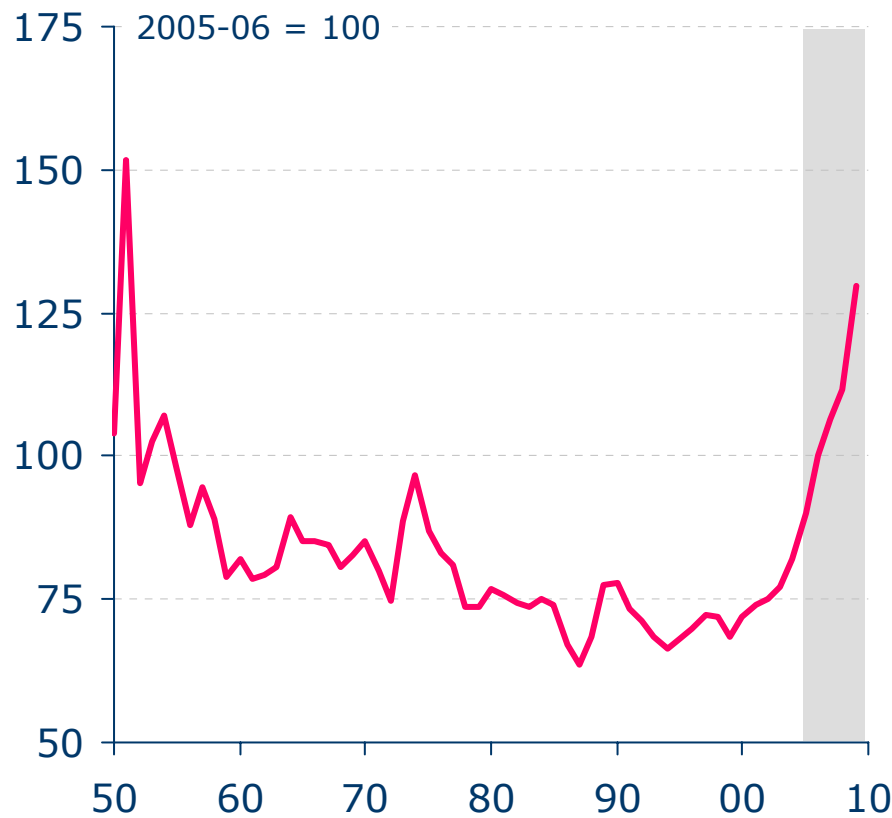


Sources: national statistical agencies; ANZ.

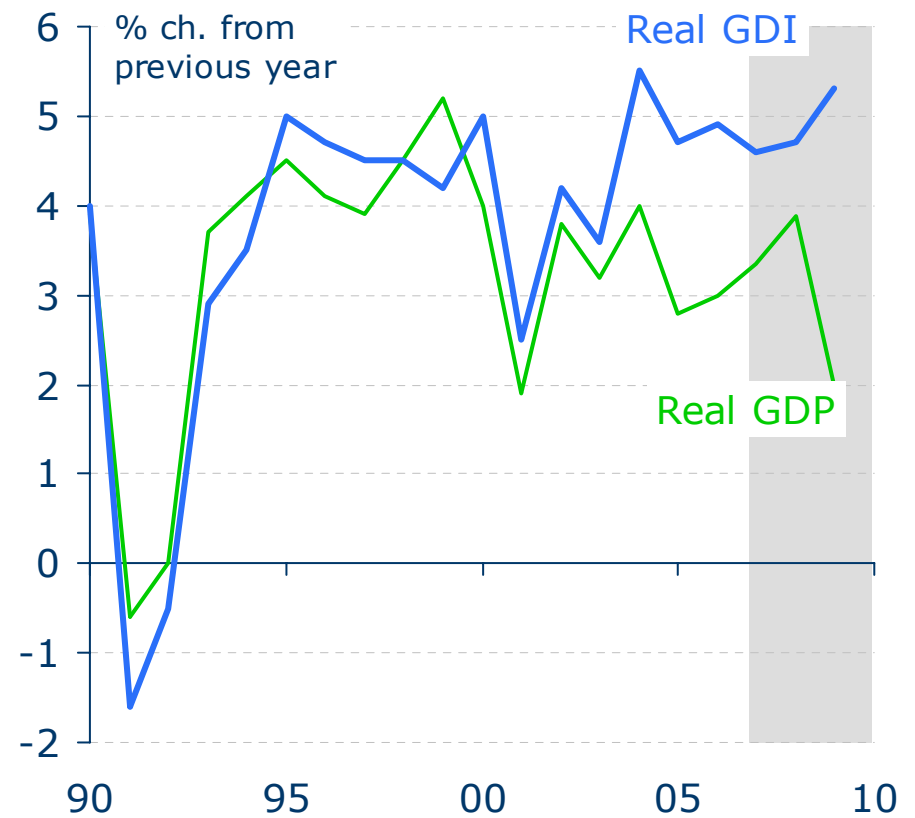


Australia's national income is continuing to get a huge boost from rising commodity prices

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



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

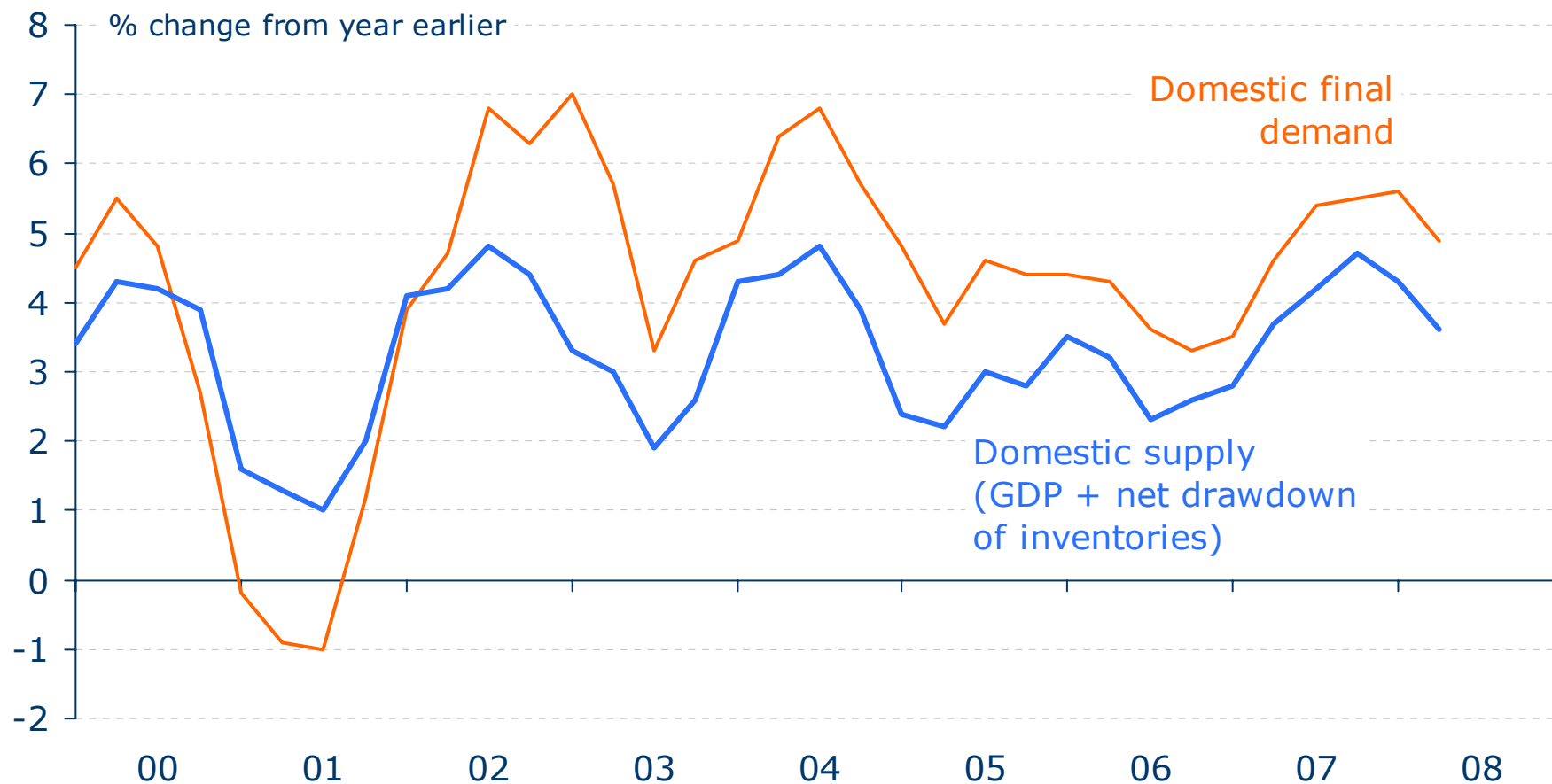


Sources: ABS; Budget Paper No. 1, Statement 3; ANZ Economics & Markets Research.



Up until very recently most of the income generated by the commodities boom has been spent

Domestic demand vs 'supply'

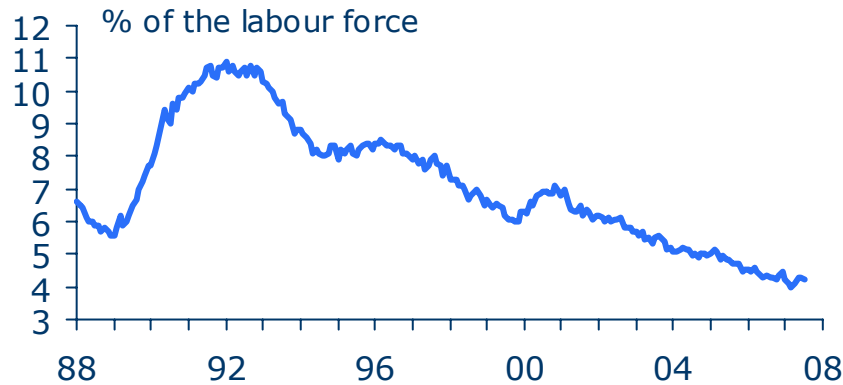


Sources: ABS; ANZ.

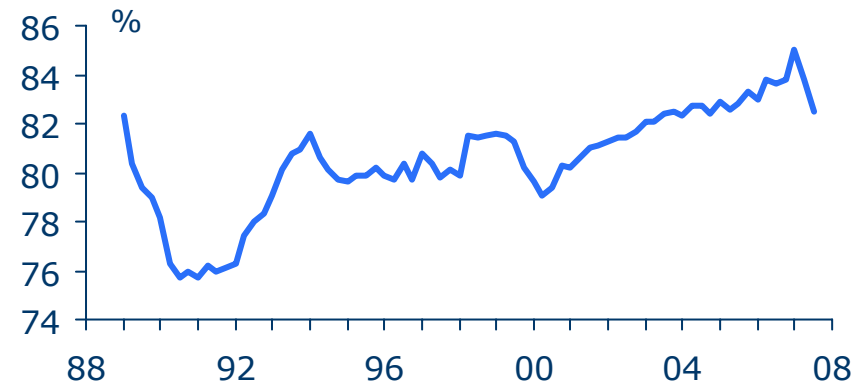
After nearly 17 years of continuous economic growth, Australia's economy has run into serious capacity constraints ²³

Indicators of 'spare capacity' in the Australian economy

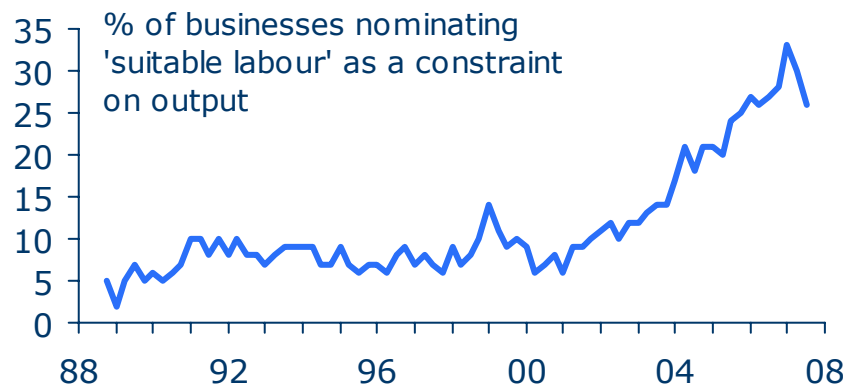
Unemployment rate



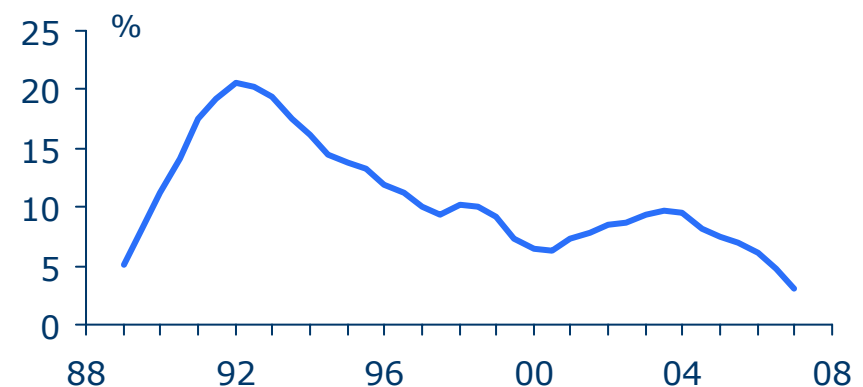
Capacity utilization rate



Businesses reporting labour shortages



Office vacancy rates

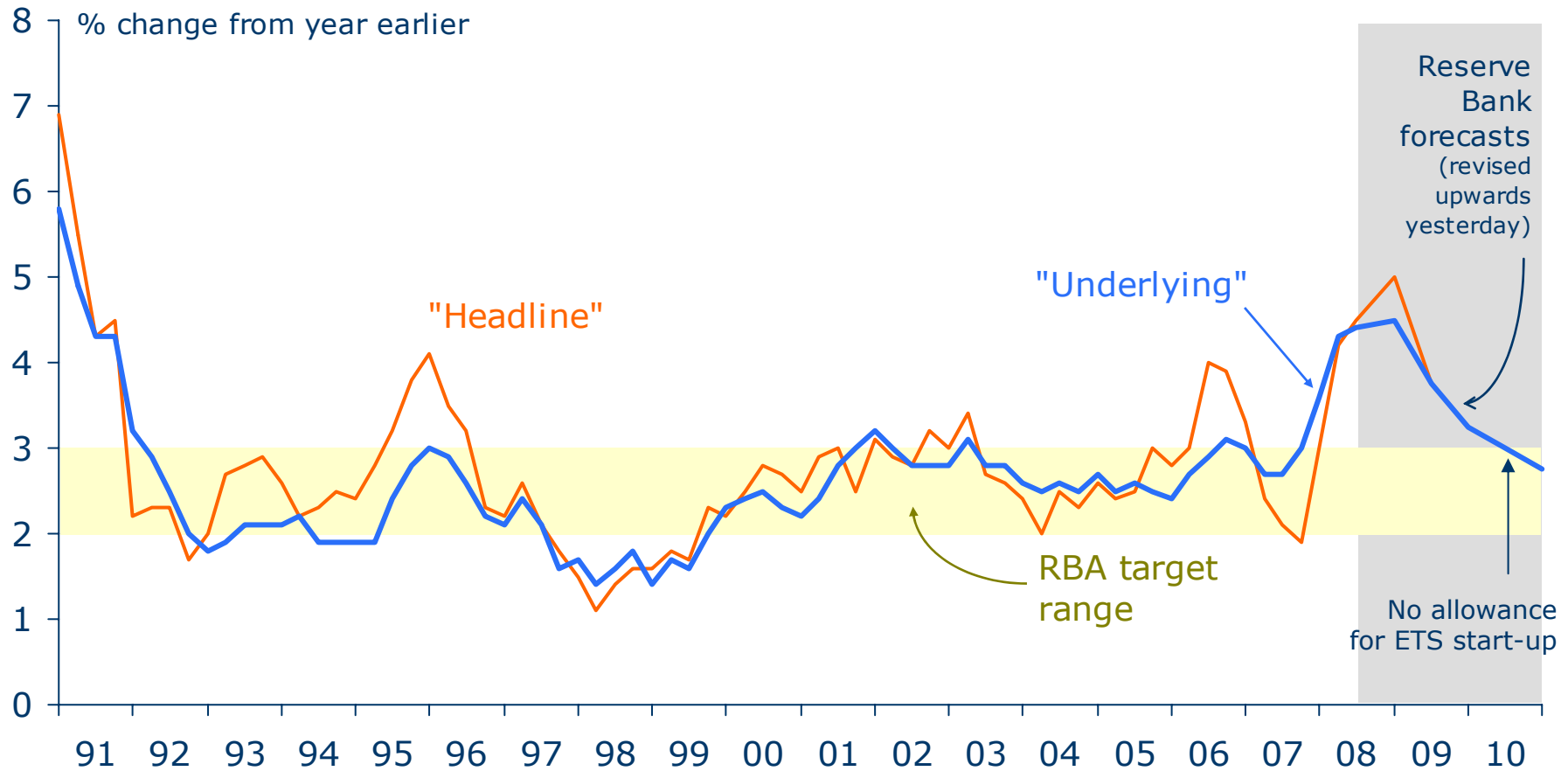


Sources: Australian Bureau of Statistics; nabCapital; Property Council of Australia.



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

Consumer prices

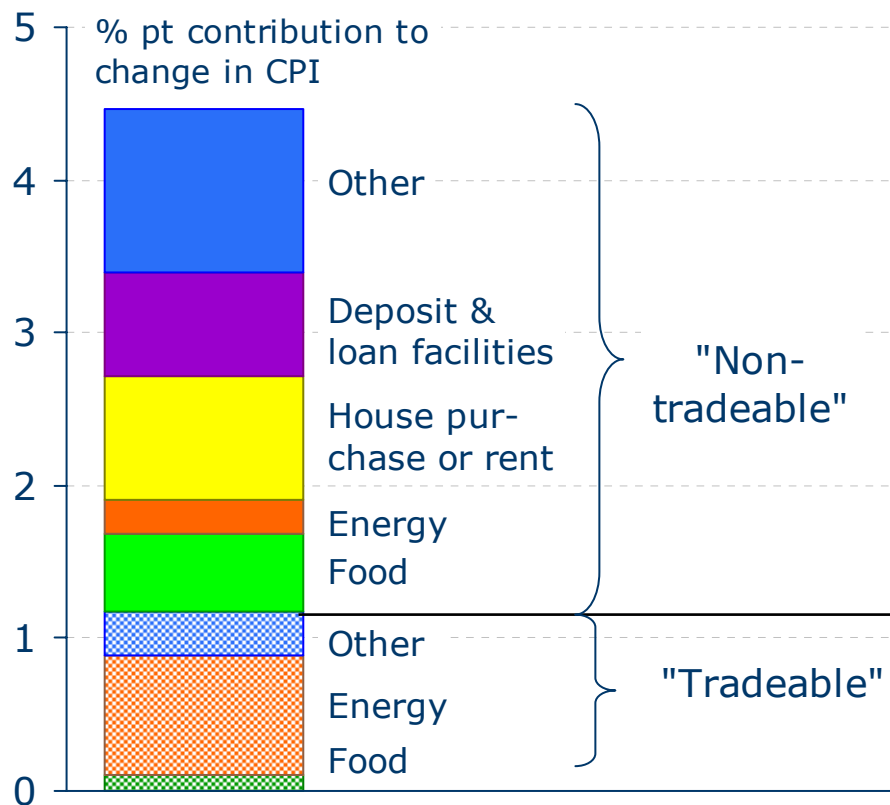


Note: excludes impact of introduction of GST and major health policy changes and proposed commencement of emissions trading scheme in mid-2010. Sources: ABS; RBA.

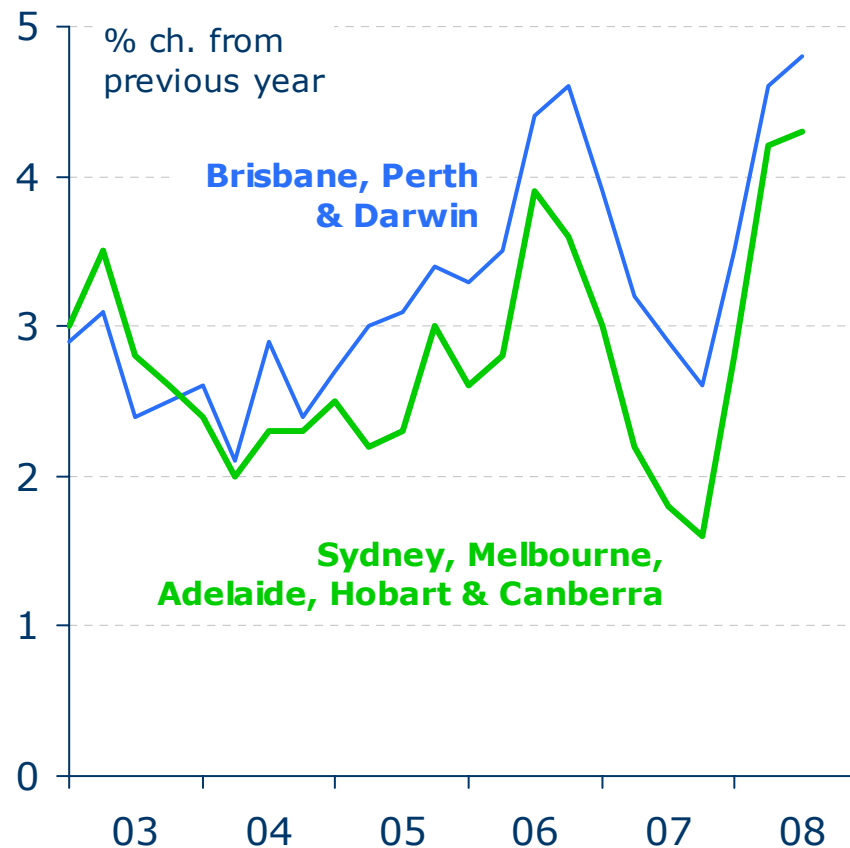


The rise in inflation has been broadly-based, and not solely due to global forces or in resource-rich States

Contributions to 'headline' inflation, year to June quarter 2008



'Headline' inflation, resource boom cities vs others

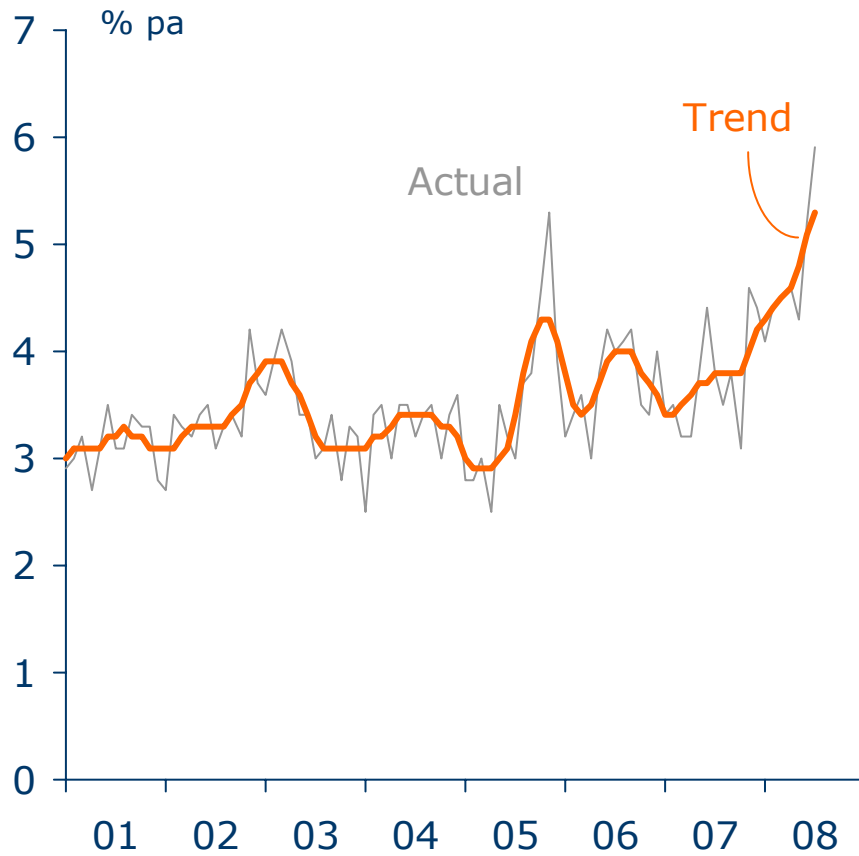


Sources: ABS; ANZ.

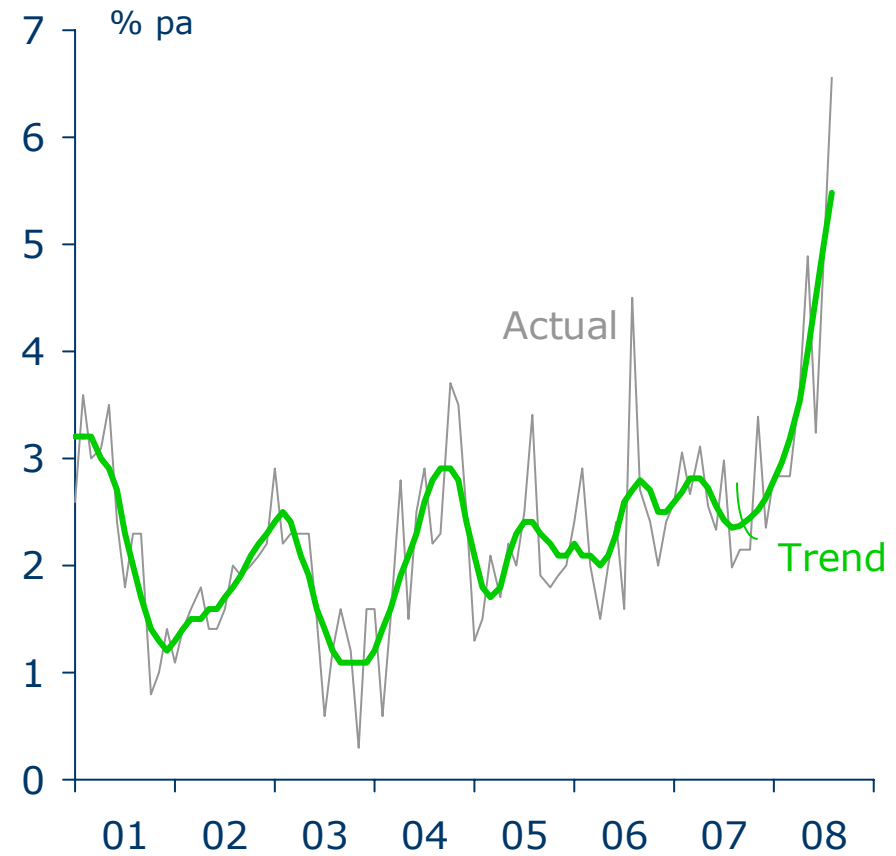


Inflation expectations remain elevated, although falling petrol prices and slowing growth should help to cool them down

Household inflation expectations



Business selling price expectations

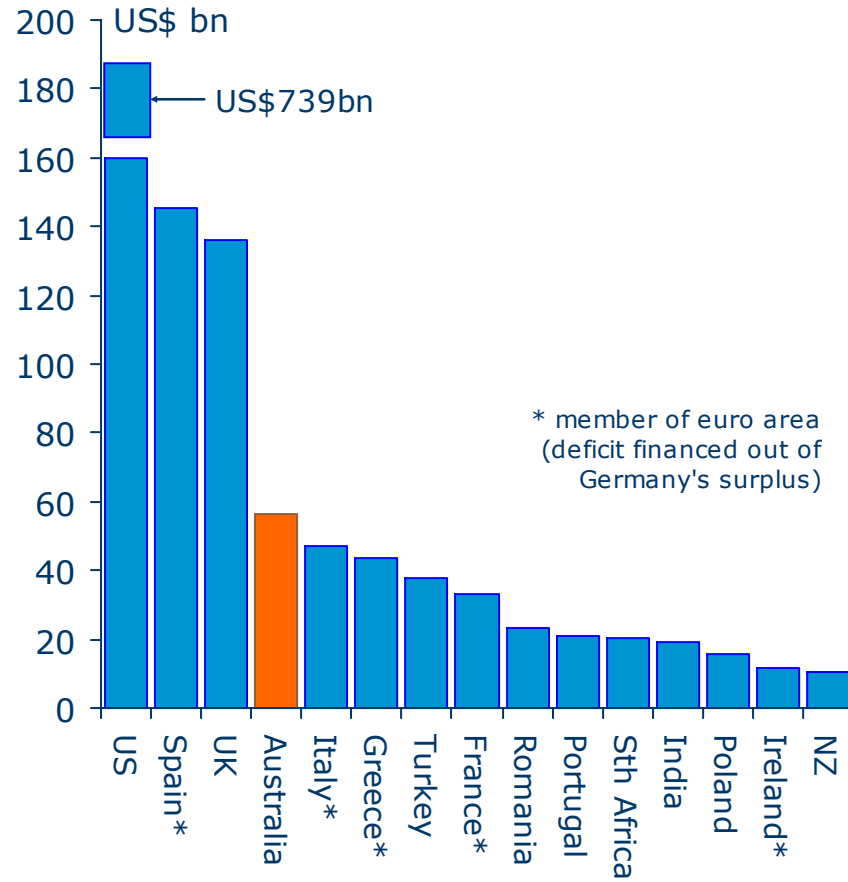


Sources: Westpac-Melbourne Institute; nab.

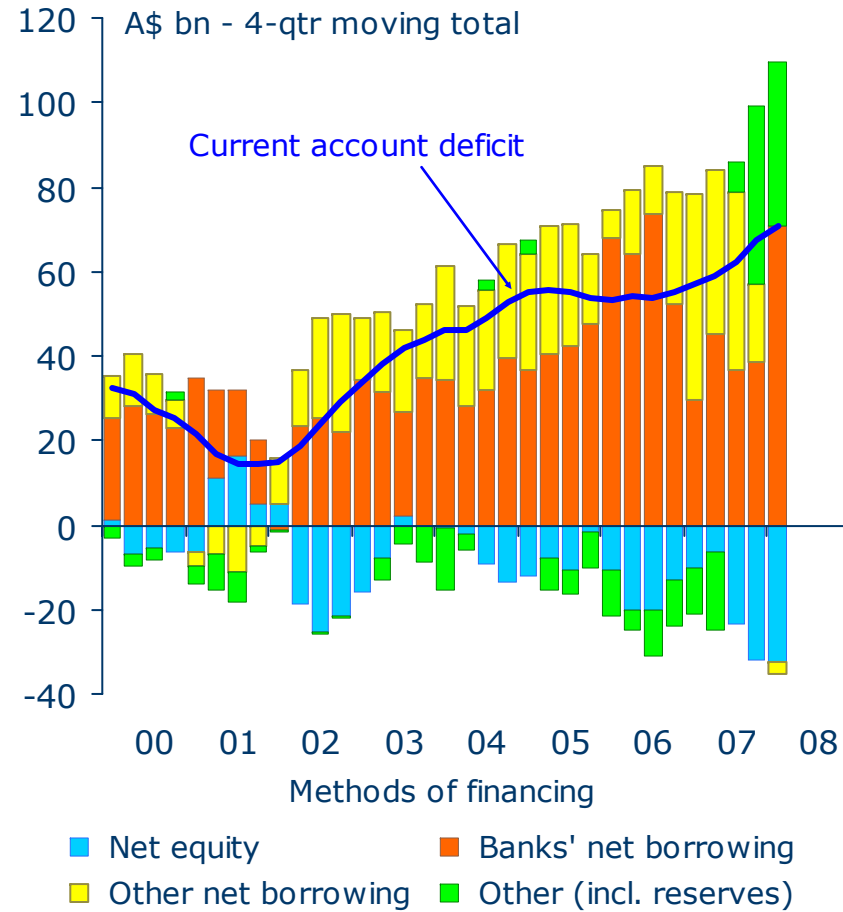


Australia is exposed to the global credit crunch because of our large external deficit and the way we finance it

Current account deficits 2007



Financing Australia's current account deficit

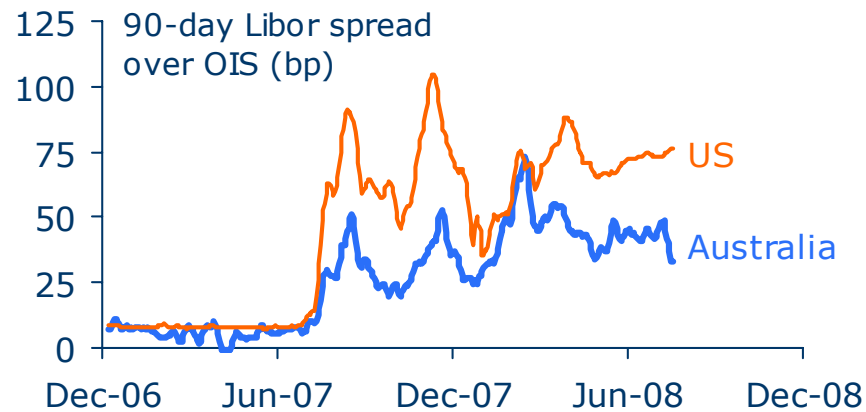


Sources: IMF; Australian Bureau of Statistics; ANZ.

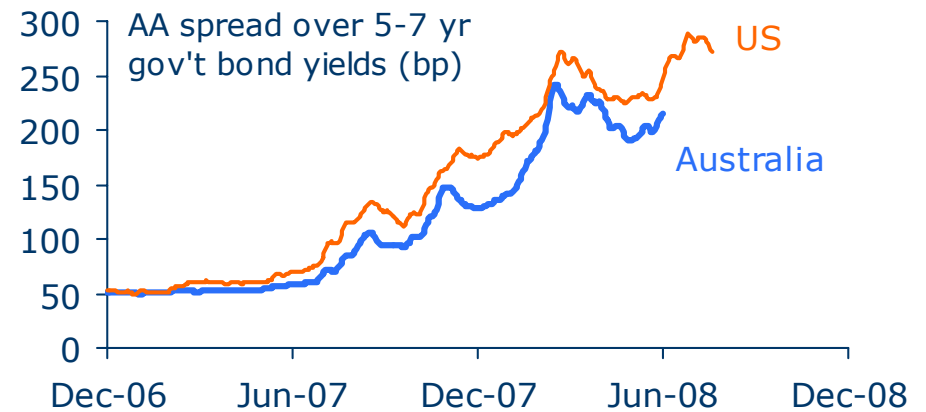


Australian financial markets have come under the same pressures as their overseas counterparts

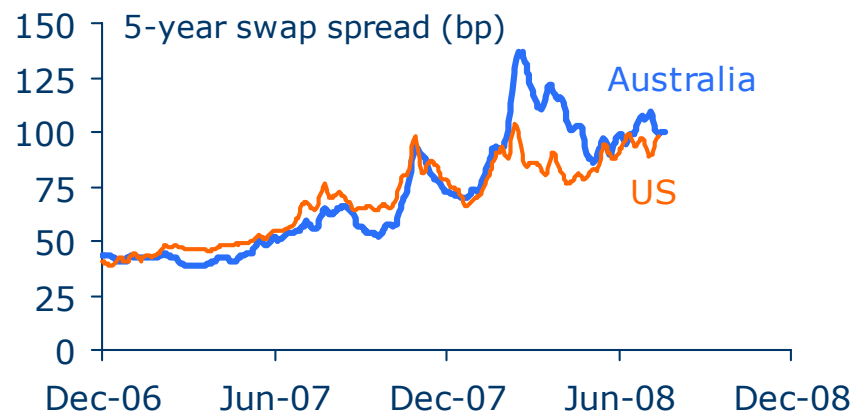
Banks' short-term funding costs



Corporate bond yield spreads



Banks' long-term funding costs



Share prices

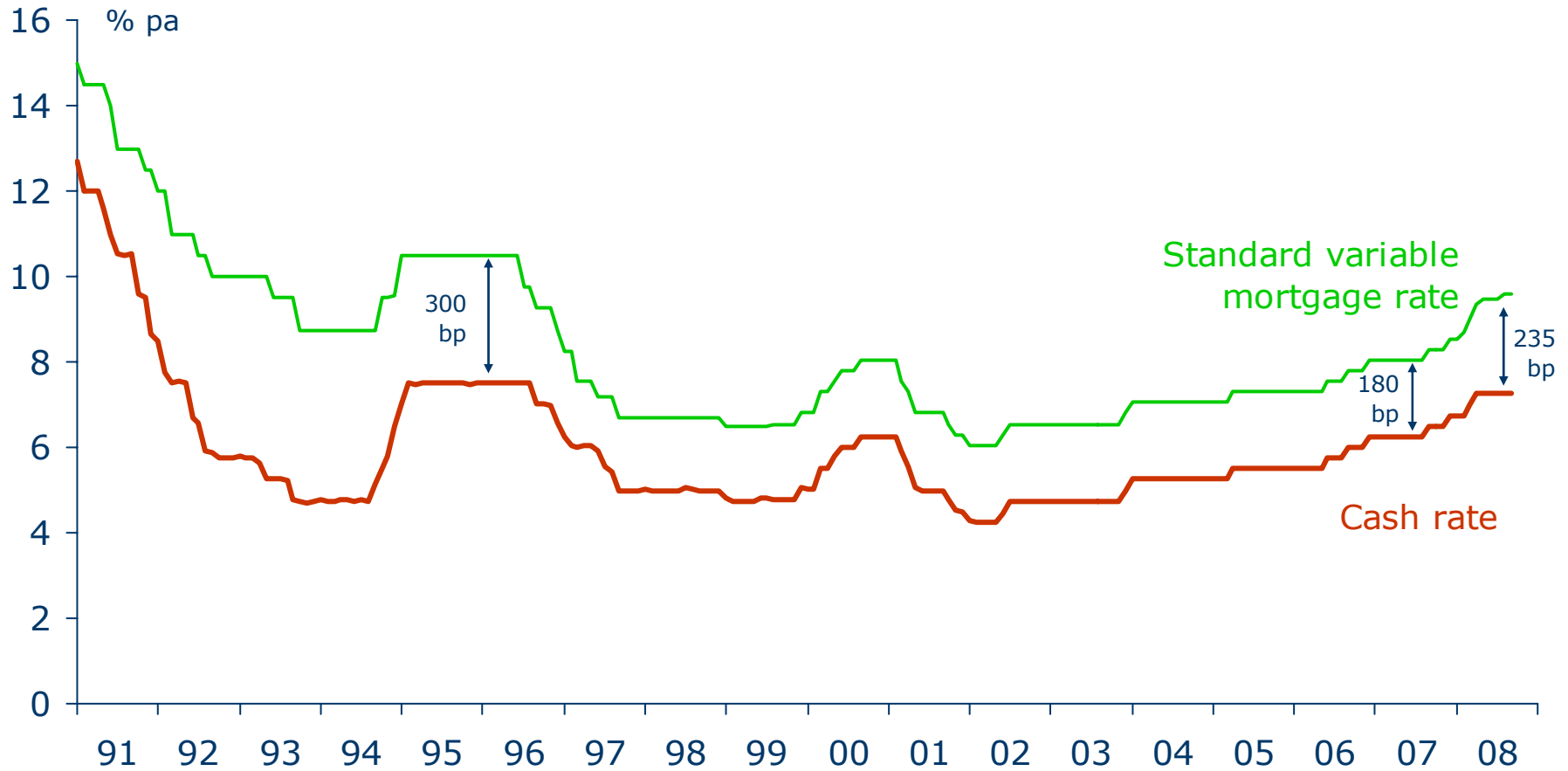


Note: all data shown as 5-day moving averages. Sources: Bloomberg; Datastream.



As a result, banks have raised lending rates by more than the increases in the Reserve Bank's official cash rate

Australian interest rates



Source: RBA.



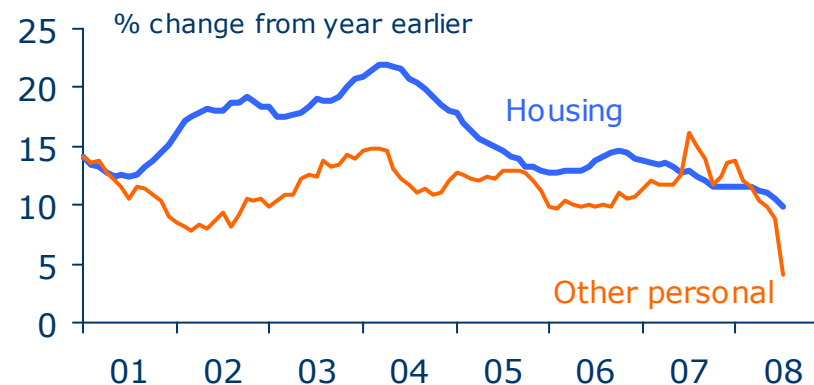
The 'credit crunch' plus the effect of higher interest rates on credit demand has led to a sharp slowdown in credit growth

Credit provided to the Australian private sector

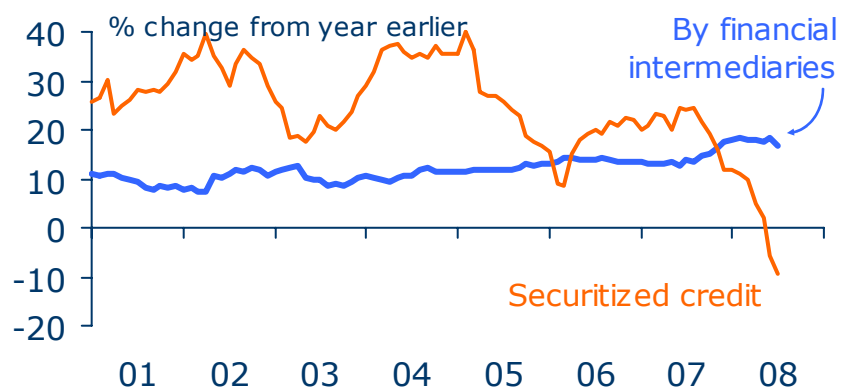
Total credit



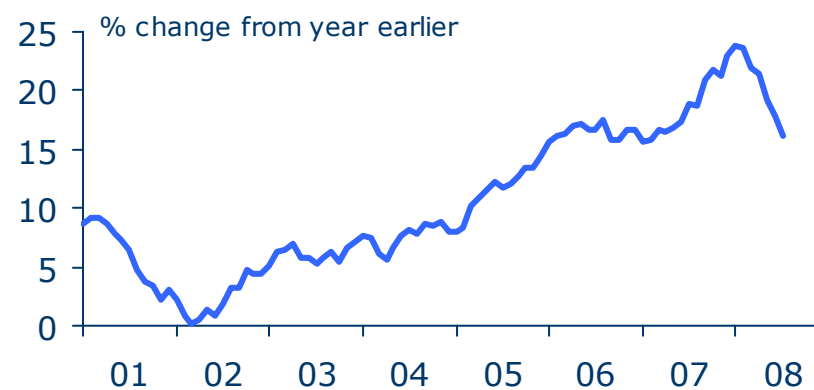
Credit to households



Credit by source



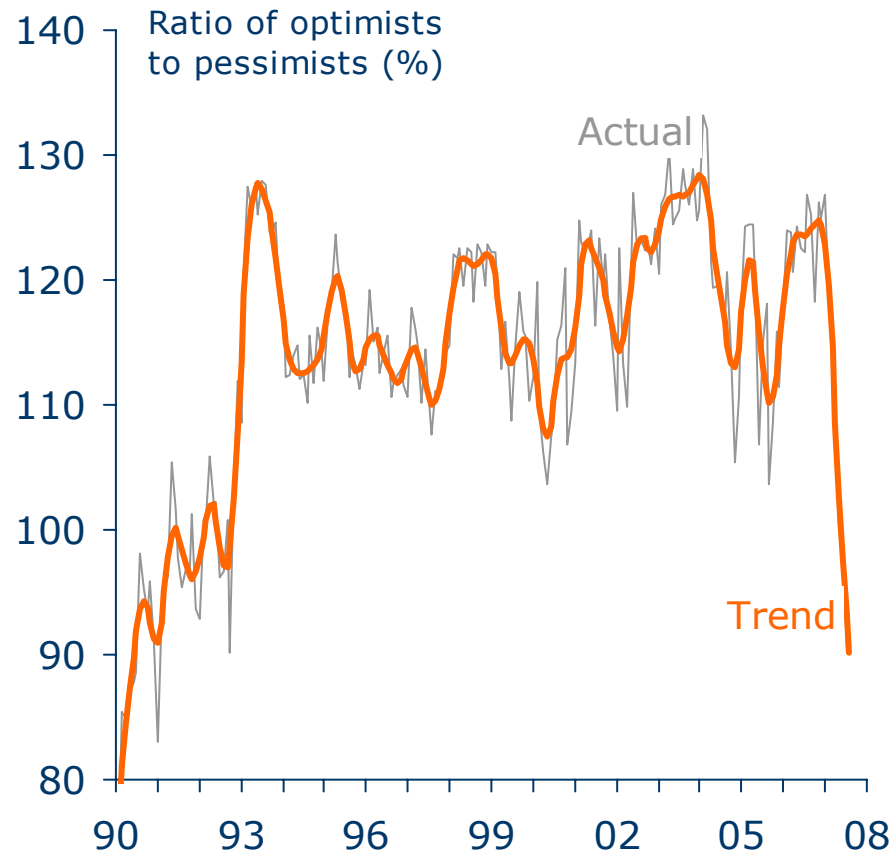
Credit to business



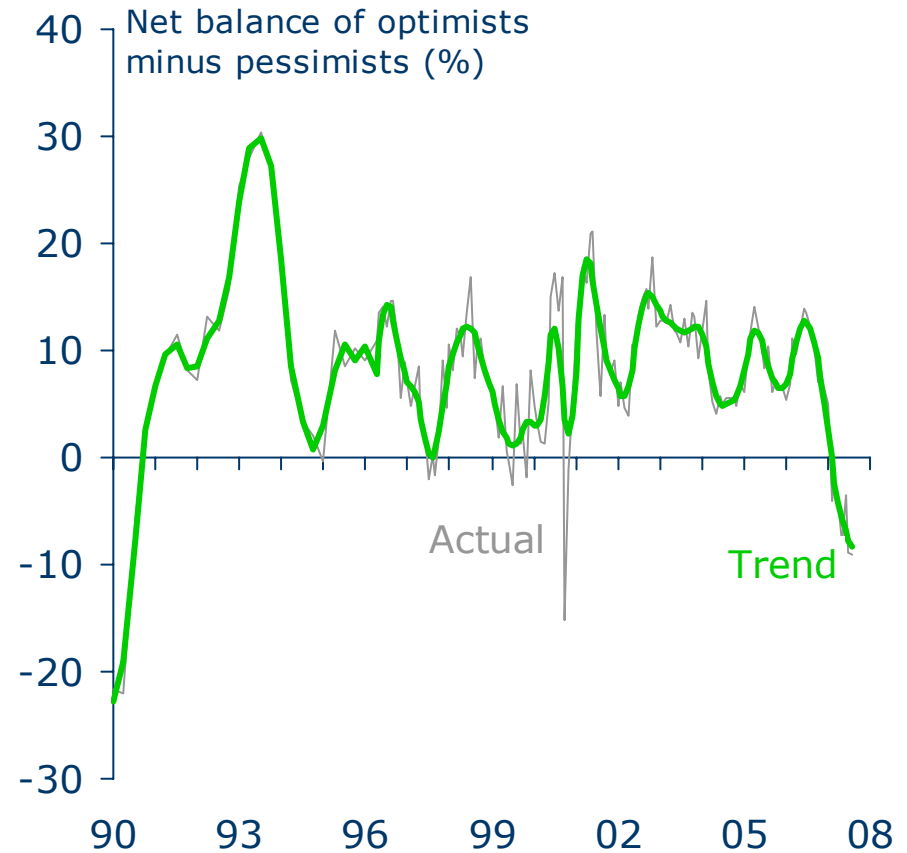
Source: Reserve Bank of Australia.

Tighter financial conditions and global uncertainty have contributed to sharp falls in confidence

Consumer confidence



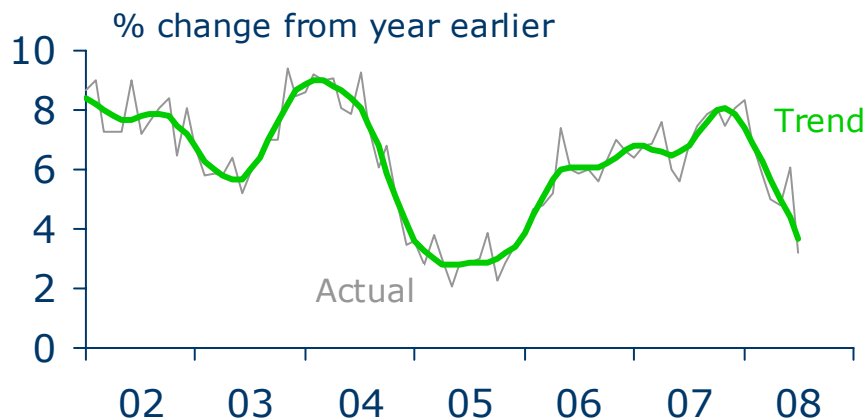
Business confidence



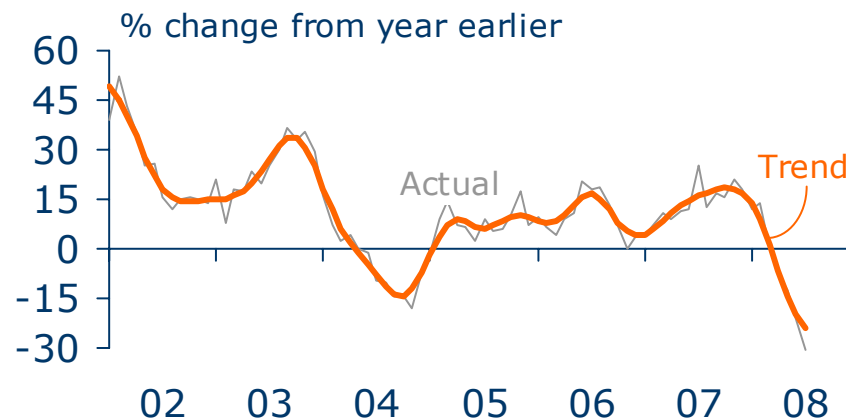
Sources: Roy Morgan Research; nab; ANZ

'Hard' data is also increasingly suggesting that the economy is slowing – more quickly, perhaps, than expected

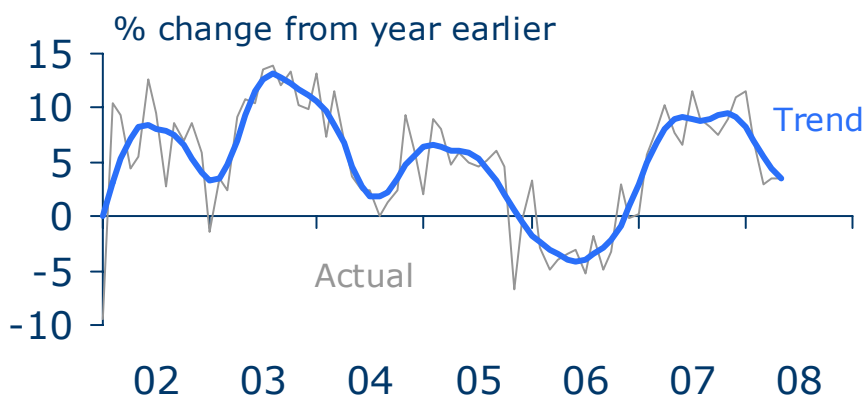
Retail sales



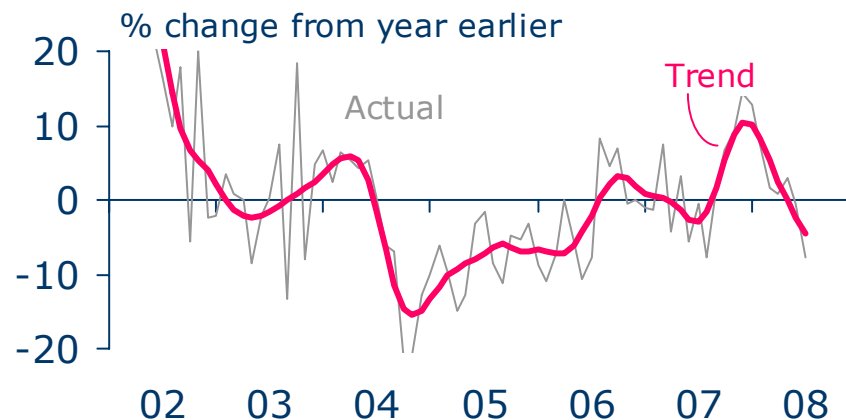
Housing finance commitments



Motor vehicle sales



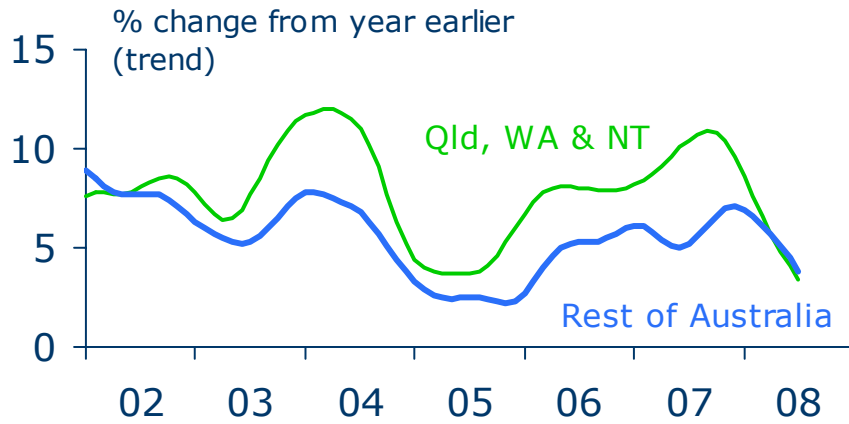
Residential building approvals



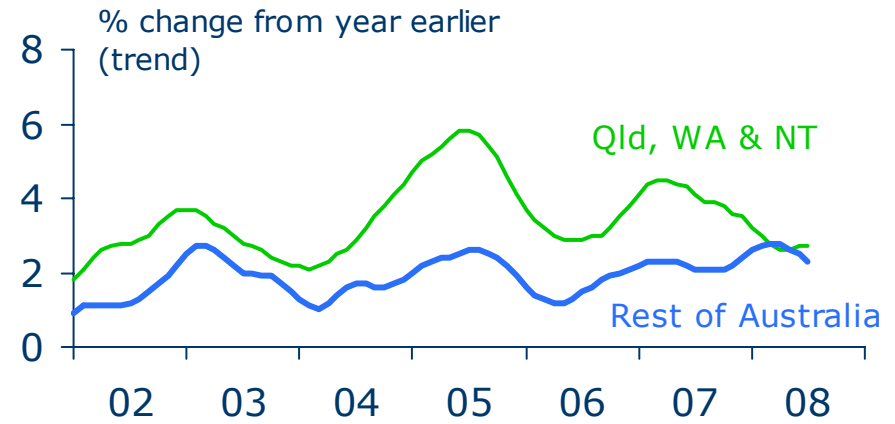
Sources: ABS; ANZ Economics & Markets Research.

The 'resource boom States' appear to be slowing more markedly than the rest of Australia

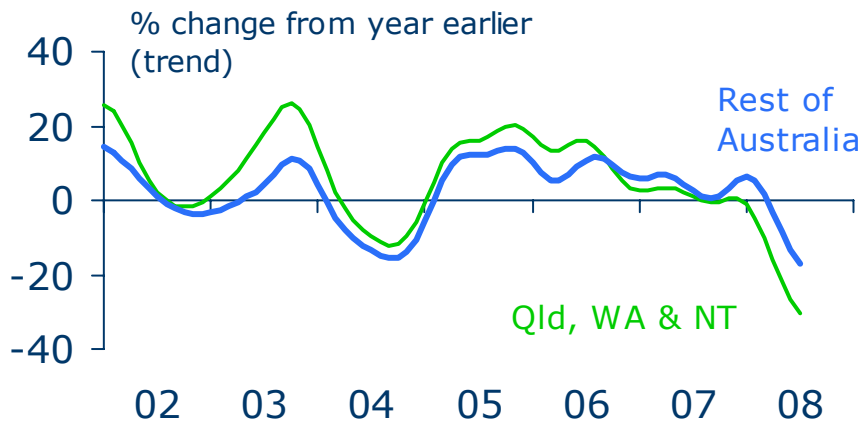
Retail sales



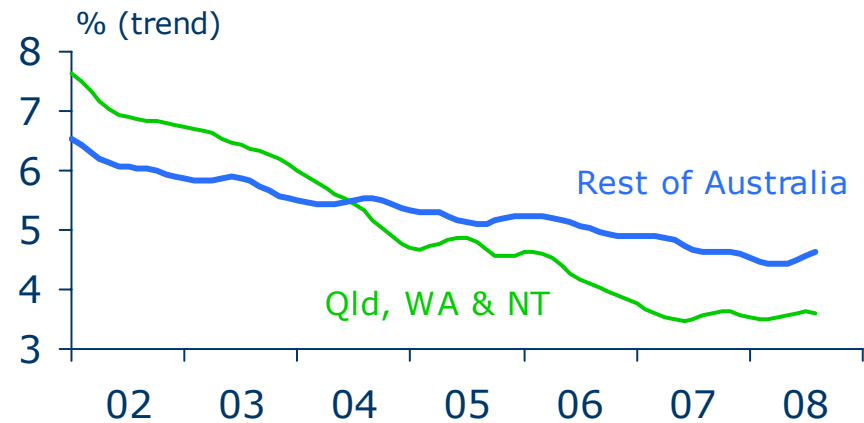
Employment



Housing finance commitments



Unemployment rate

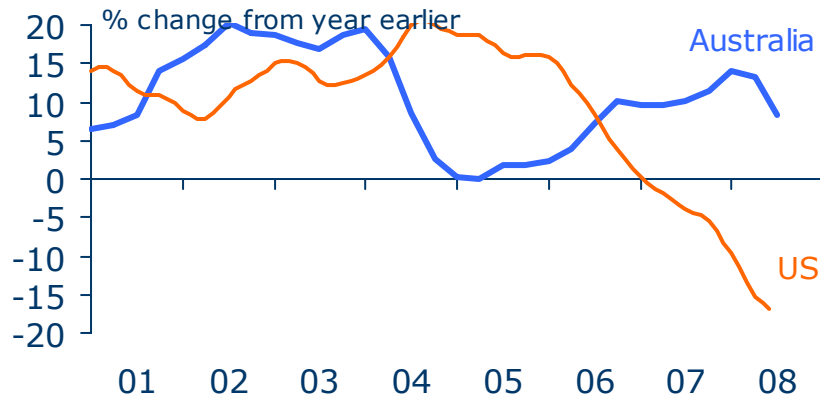


Sources: ABS; ANZ Economics & Markets Research.

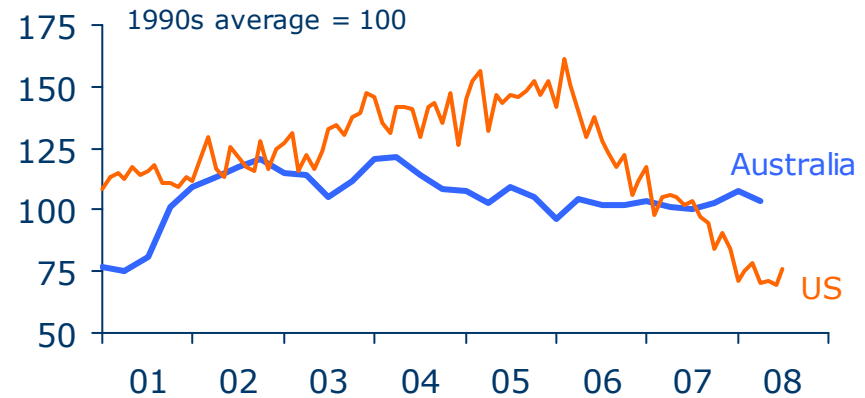


Australia's housing market has clearly softened but is unlikely to become as dire as America's

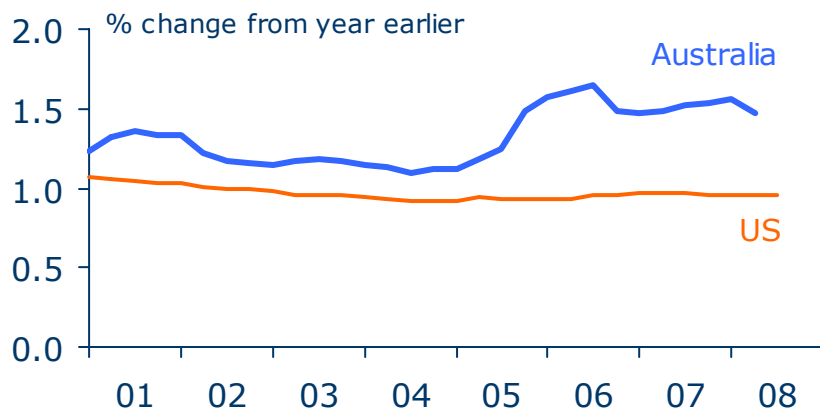
House prices



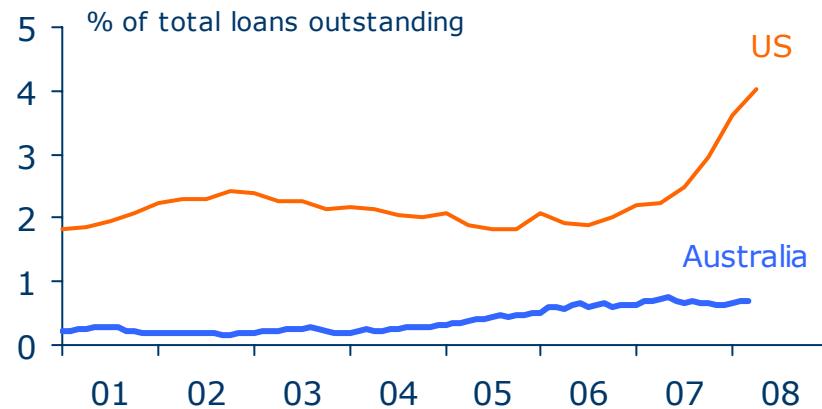
Housing commencements



Population growth



Mortgage delinquency rates*

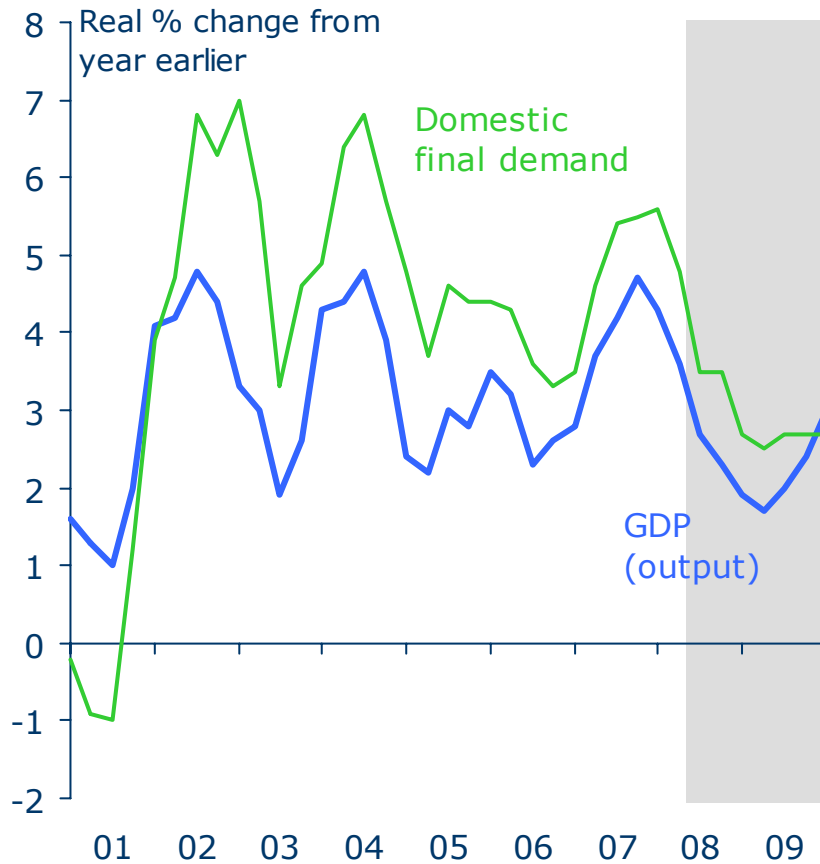


* 90 days or more past due. For Australia, securitized mortgages only. Sources: ABS; US Commerce Department; S&P; Mortgage Bankers' Association of America.

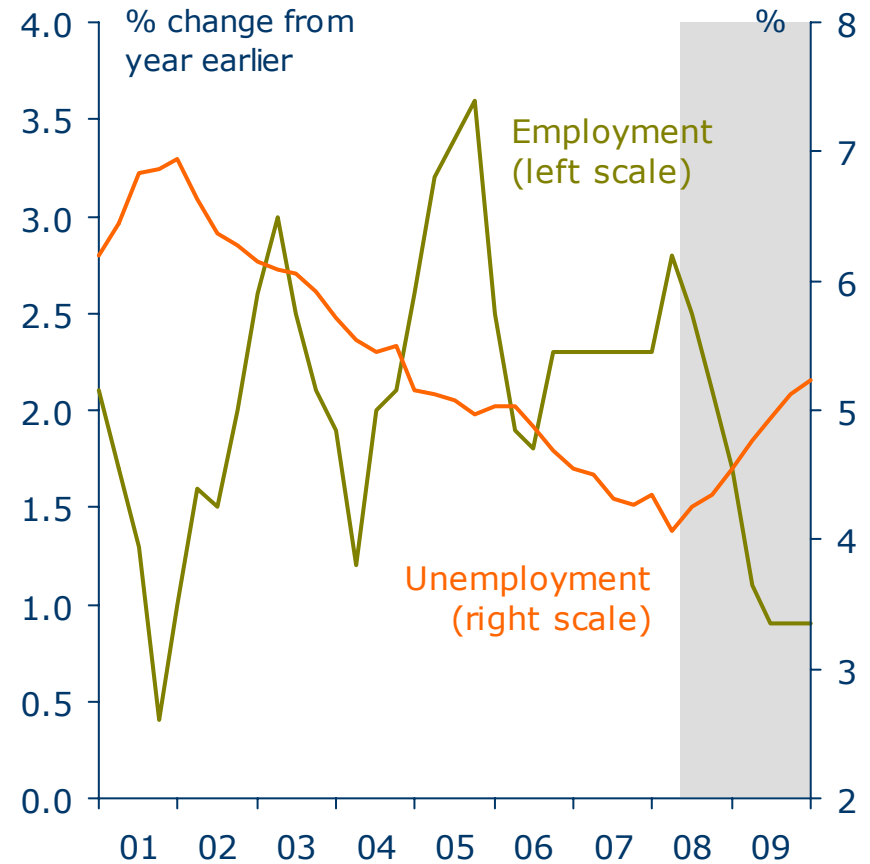


Economic growth will be much slower in 2008-09 than in recent years, and the unemployment rate will increase 35

Spending and output



Employment and unemployment

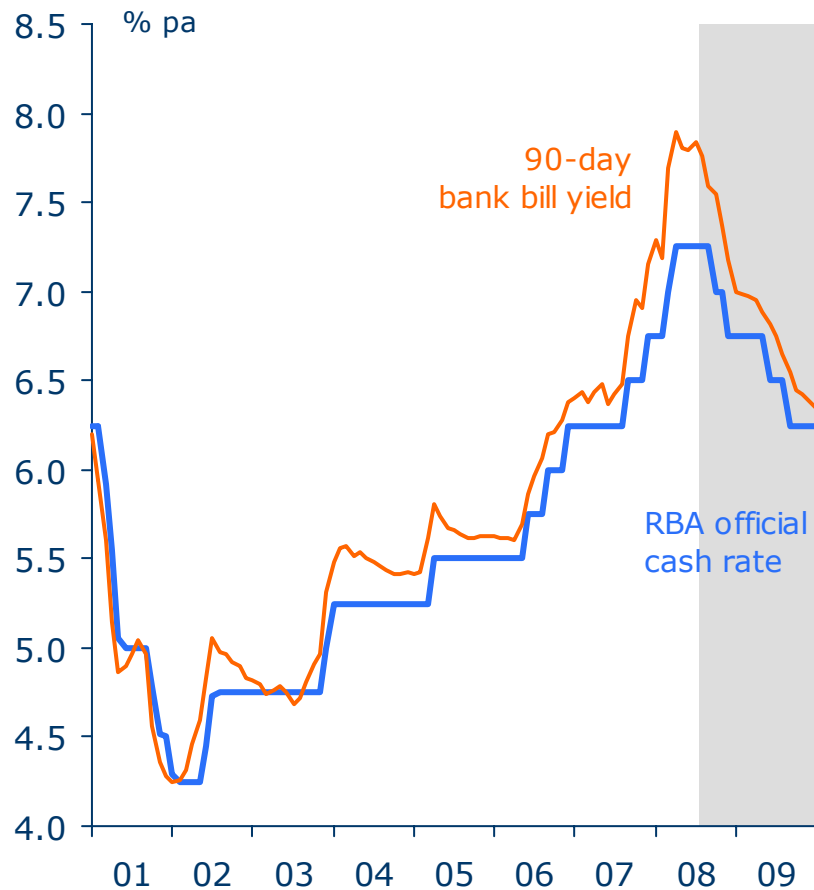


Sources: Australian Bureau of Statistics; ANZ.



The Reserve Bank has signalled that it will be cutting rates soon – probably beginning next month 36

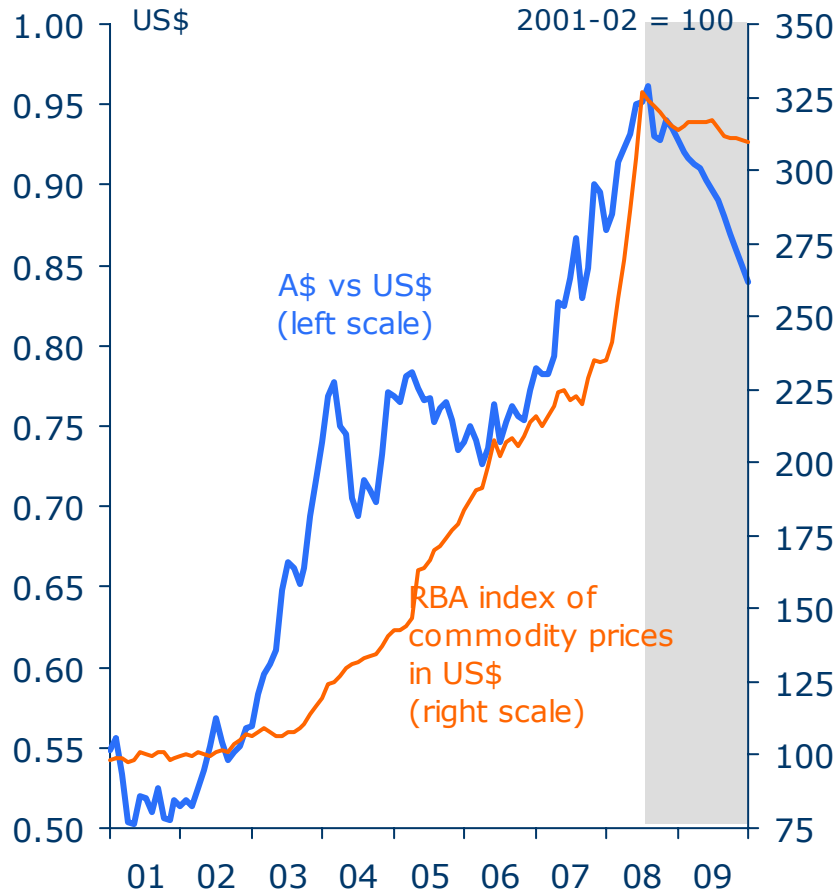
Short-term interest rates



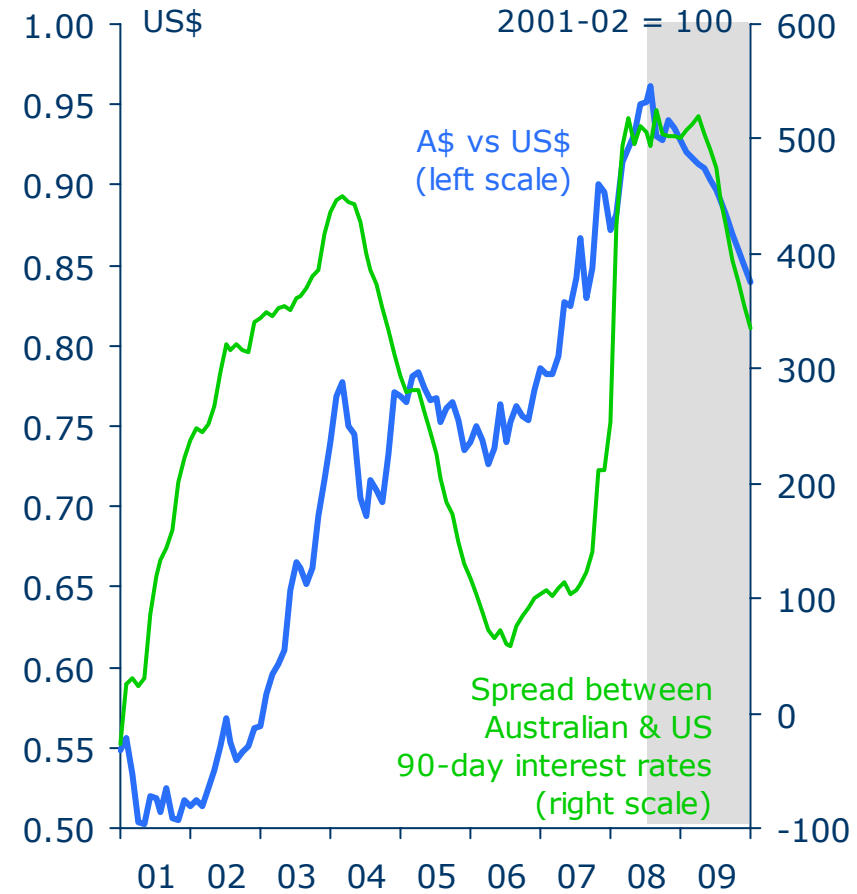
- Yesterday's RBA Board meeting left the cash rate unchanged at 7¼%, but signalled that 'scope to move towards a less restrictive stance of monetary policy in the period ahead is increasing'
- That probably means that they will cut the cash rate at next month's meeting
- This earlier-than-expected rate cut likely stems from two considerations –
 - the further increase in banks' lending rates in July (when the RBA thought no further lift in official rates was needed)
 - the marked slowing in the economy over the past couple of months (perhaps more than they wanted)
- There will likely be a second rate reduction before year-end (if only to ensure that lending rates do actually fall)
- Depending on the extent to which inflation begins to decline, rates will fall further during 2009

The prospect of lower interest rates and signs that commodity prices have peaked imply that the A\$ is now heading lower

A\$ and commodity prices



A\$ and interest rate spreads

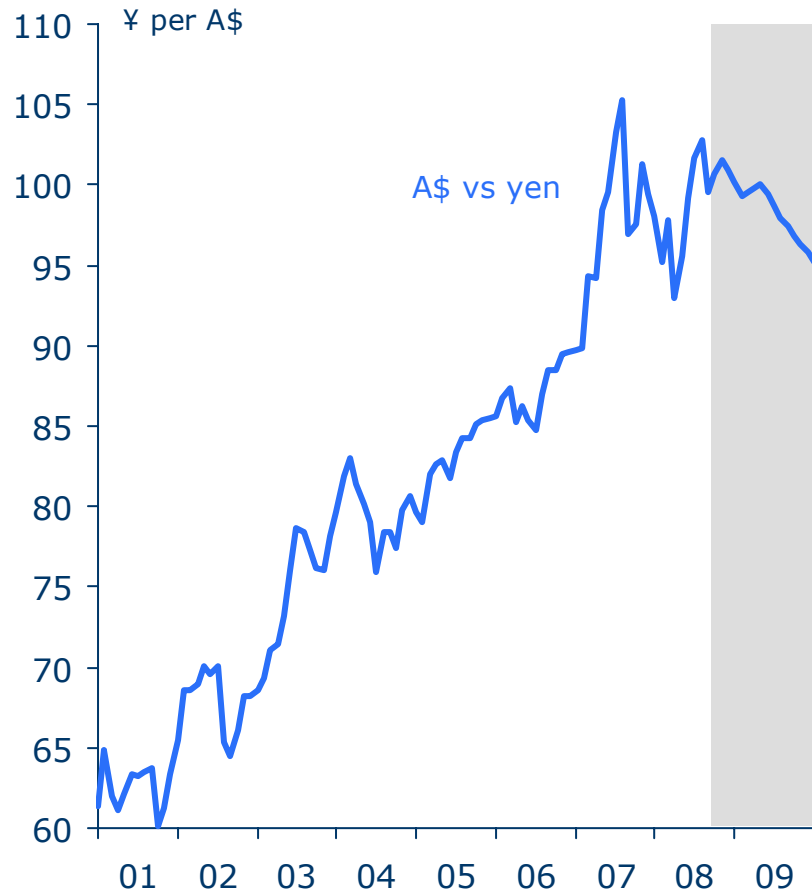


Sources: Datastream; Reserve Bank of Australia; ANZ.

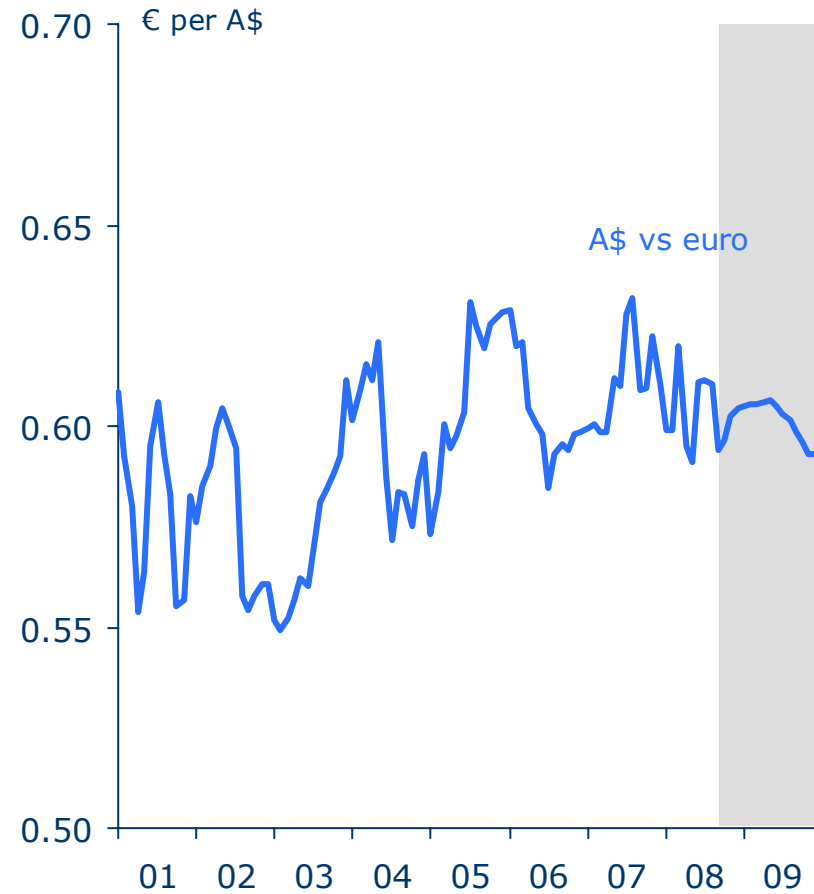


A\$ is also likely to weaken against the Japanese yen, and to a lesser extent against the euro

A\$ vs Japanese yen



A\$ vs euro



Sources: Datastream; ANZ.



Summary

- The global credit crunch is continuing
 - and won't end until the US housing market bottoms out, which seems unlikely any time soon
- The world economy is slowing
 - the US hasn't experienced recession yet, but probably will during the next 12 months
 - some other advanced economies will also fall into recession
 - in the developing world, by contrast, inflation is a bigger risk than recession
- Australia's economy is also slowing noticeably
 - rapid developing-country growth benefits Australia via its impact on commodity prices
 - but Australia is also exposed to the global credit crunch via our large current account deficit and the way in which it is financed
 - the effect of that exposure has been magnified by the upward trend in Australian interest rates (and oil prices) over the past 12 months
- The next movement in Australian interest rates will be down
 - with the first rate cut now likely to come as early as next month
- The A\$ has probably peaked against the US\$
 - the US\$ may take another leg downwards against major currencies later this year as a US recession becomes more evident
 - but with Australian interest rates and commodity prices having peaked the A\$ is now on a downward trend

Australian forecast summary

	Economic forecasts				
	2006-07	2007-08	2008-09	2009-10	
Real GDP growth (%) – Australia	3.3	4	2	3¼	
Employment growth (%)	2.6	1.4	1	1	
Unemployment rate (year end, %)	4.3	4.3	5	5¼	
Inflation (year end, %)	2.1	4.5	3¼	3	
Housing starts ('000)	154	138	154	175	
Current account balance (\$bn)	-59.7	-70	-45	-75	
Household saving rate (%)	0.2	1¼	3¾	6½	
	Financial market forecasts				
	Jun 08	Dec 08	Jun 09	Dec 09	Jun 10
RBA cash rate (% pa)	7.25	6.75	6.50	6.25	5.75
90-day bill yield (% pa)	7.84	7.00	6.75	6.35	5.90
A\$-US\$	0.96	0.93	0.89	0.84	0.79
A\$-¥	101	100	98	95	92
A\$-€	0.61	0.61	0.60	0.59	0.59
Gold price (US\$ / oz)	930	760	750	790	750
Oil price (US\$ / barrel)	127	100	100	105	102