

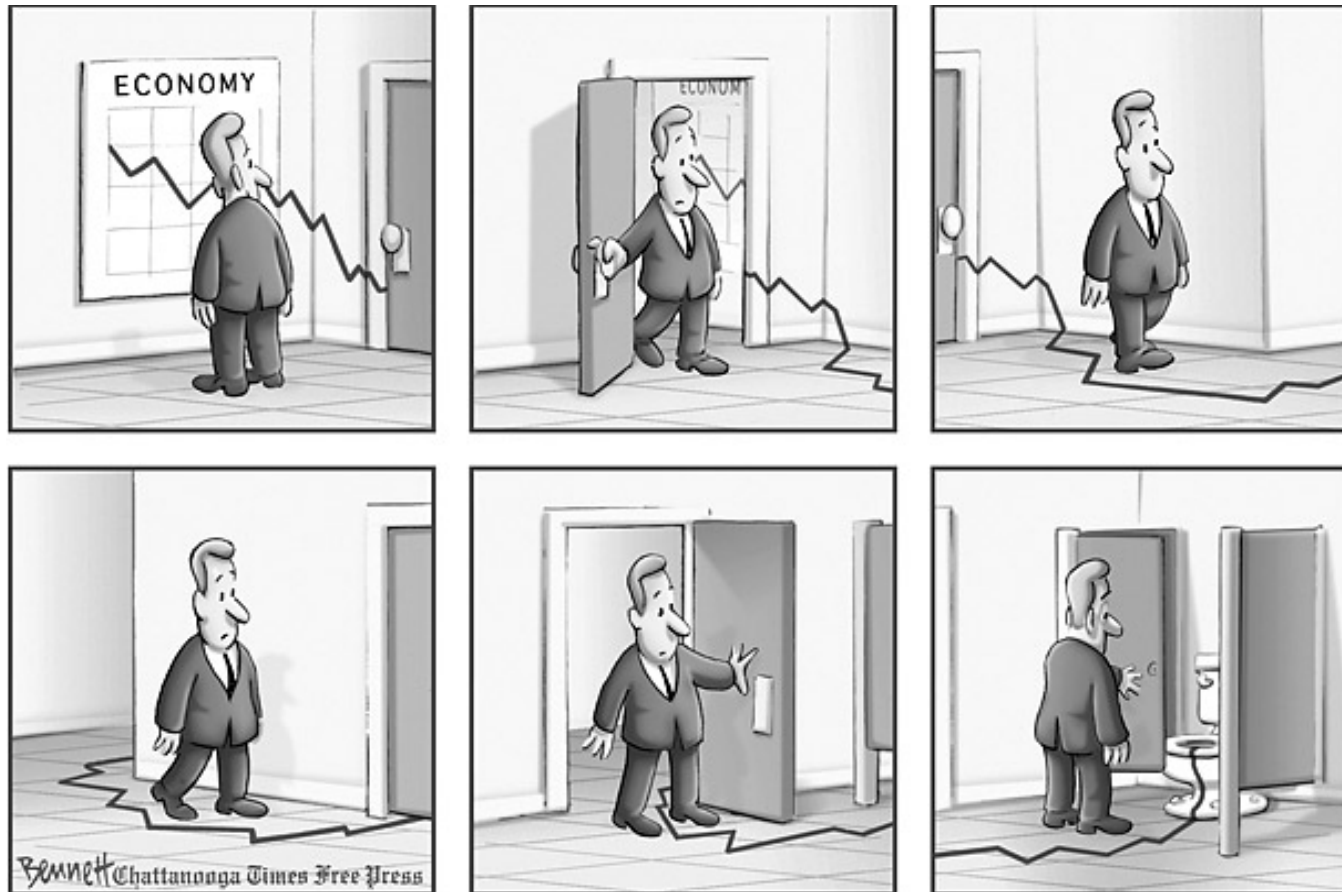
Open partnerships
Open possibilities

2009: a very difficult year for the global and Australian economies

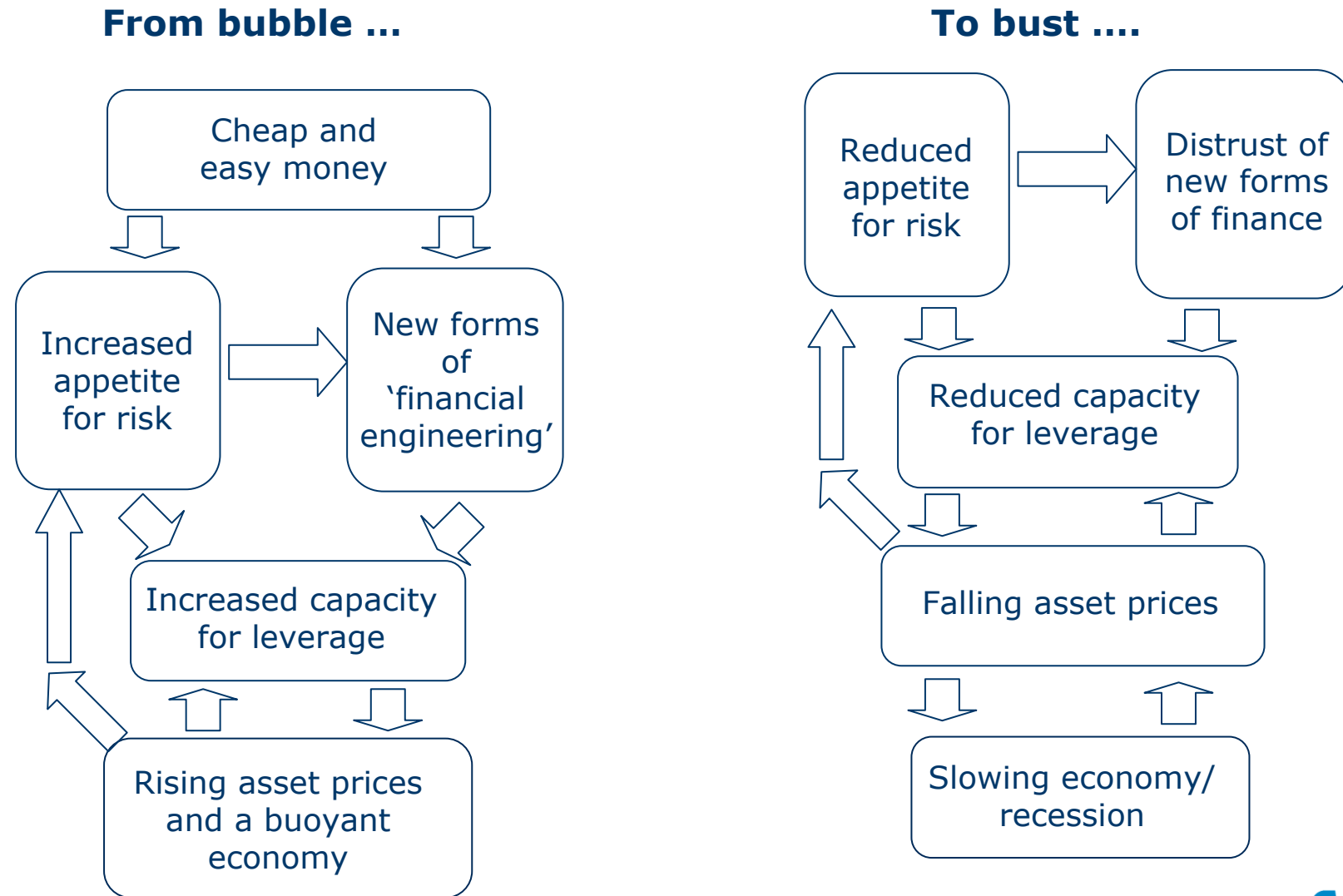
Presentation to ANZ-CCIWA
'Football & Economics' breakfast
Perth Convention Exhibition Centre
11th February 2009

Saul Eslake
Chief Economist, ANZ

A summary of the economic outlook as a growing number of people now see it



The current global financial crisis stems from the bursting of a 'credit market bubble'



Markets have not breached their mid-November lows despite persistently awful economic data

Share markets



US share market volatility

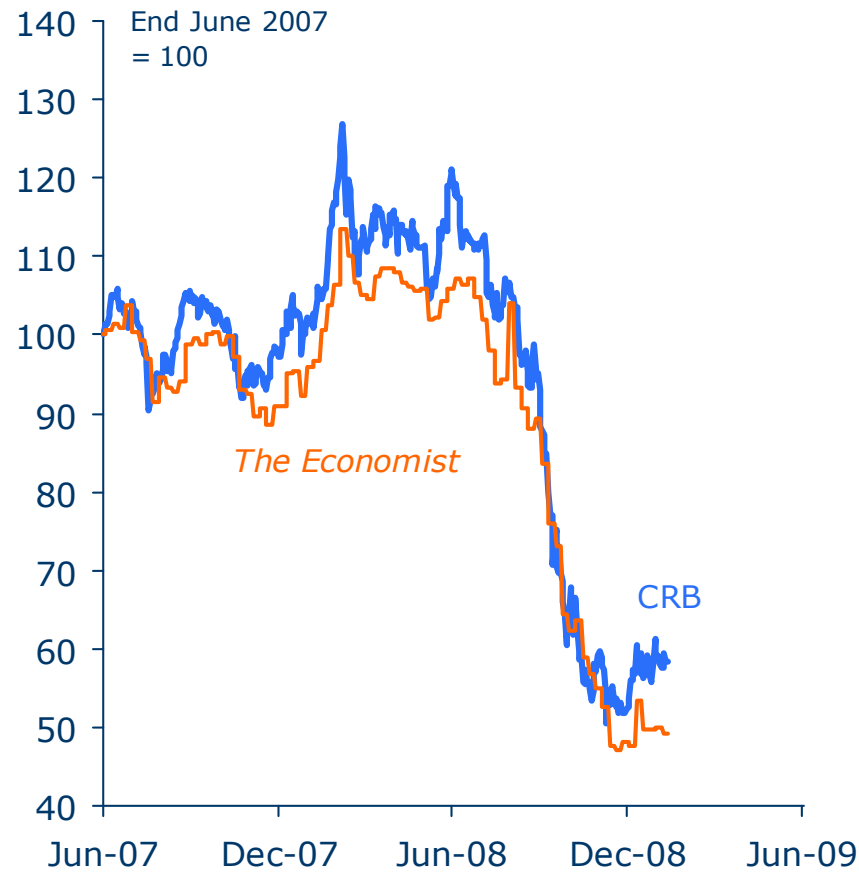


Source: Thomson Financial Datastream.



Commodity markets have been noticeably resilient to the stream of bad news regarding industrial activity and trade

Industrial commodity prices



Freight costs ('Baltic Dry' index)

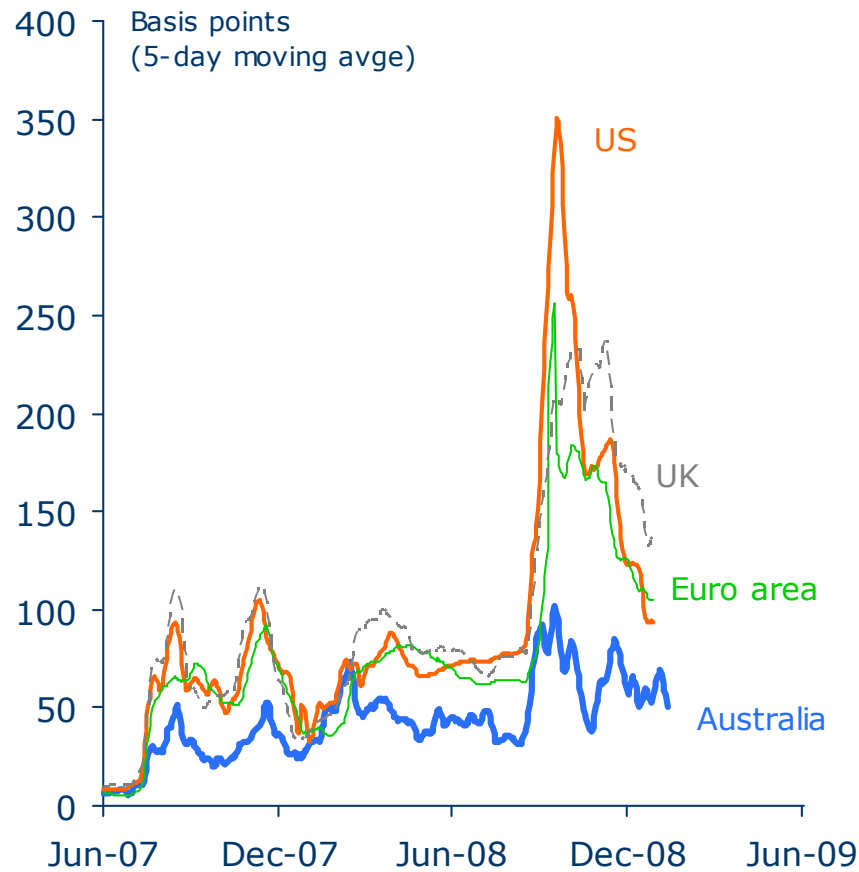


Source: Thomson Financial Datastream.

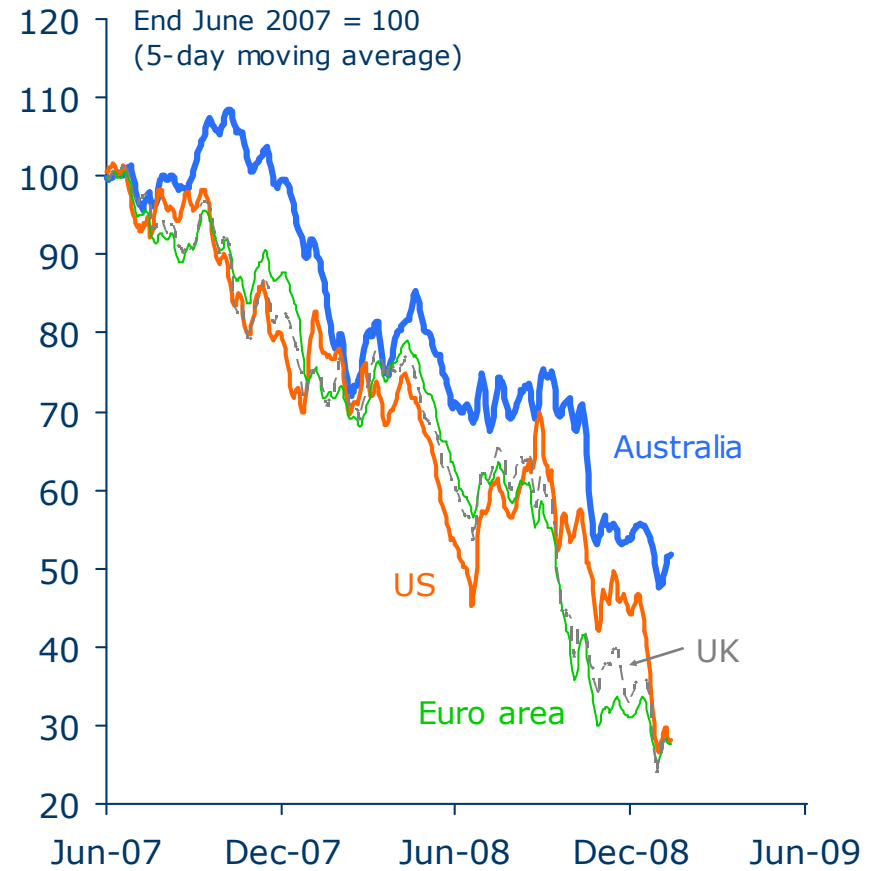


Governments & central banks have done enough to resolve concerns about bank liquidity, but not about bank solvency

3-month Libor-OIS spreads



Bank share prices



Sources: Bloomberg; Thomson Financial Datastream.



Banks may need as much as another US\$1 trillion of capital – and most of it may have to come from governments

Losses & write-downs announced since mid-2007

Country of origin	Total (US\$ bn)
United States	427.0
United Kingdom	118.0
Continental Europe	158.9
Canada	10.8
Japan	13.7
Other	14.1
Total banks	812.0
Other institutions*	260.3
Total	1,260.3

Capital raised since mid-2007

Country of origin	Total (US\$ bn)
United States	411.1
United Kingdom	93.4
Continental Europe	218.7
Canada	15.8
Japan	14.1
Other	30.8
Total	793.3
Other institutions*	128.6
Total	921.9
of which, from governments	380.0

IMF says this total will ultimately reach US\$2,200bn

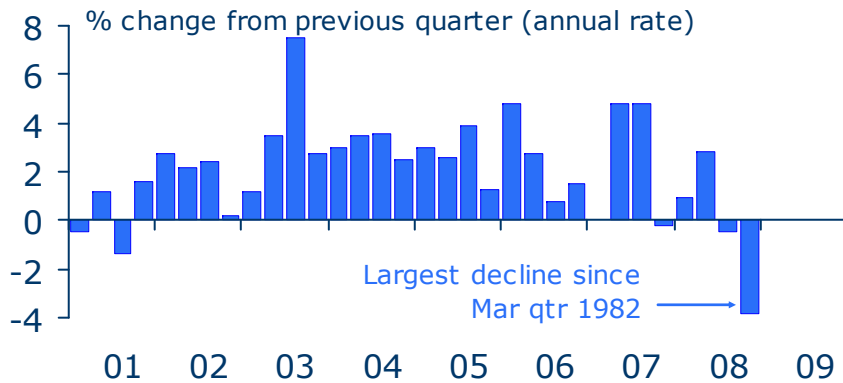
Banks may need another US\$800-\$1,000mn more in capital

* 'Other institutions' include insurance companies and the US GSEs.
Sources: Bloomberg; IMF; ANZ Economics & Markets Research.

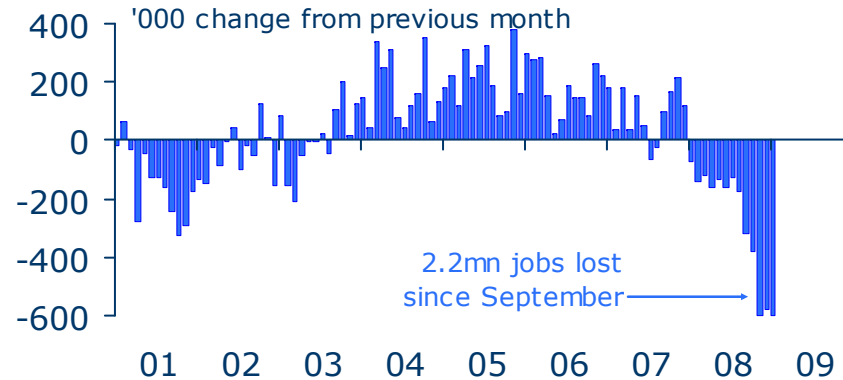
The US economy turned down sharply in the second half of last year – and the deterioration is continuing into 2009

US economic activity and labour market

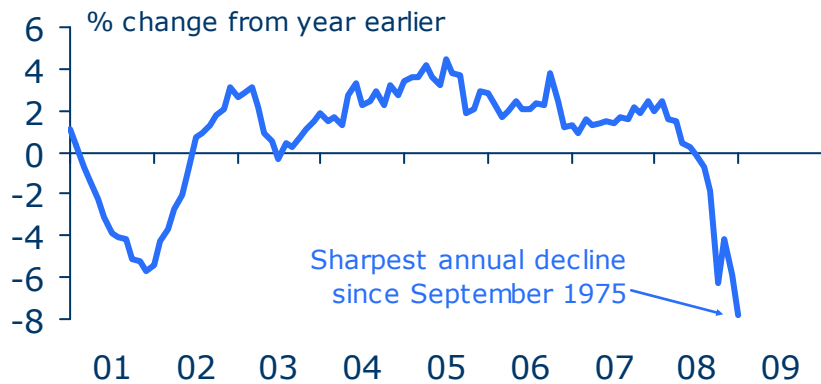
Real GDP



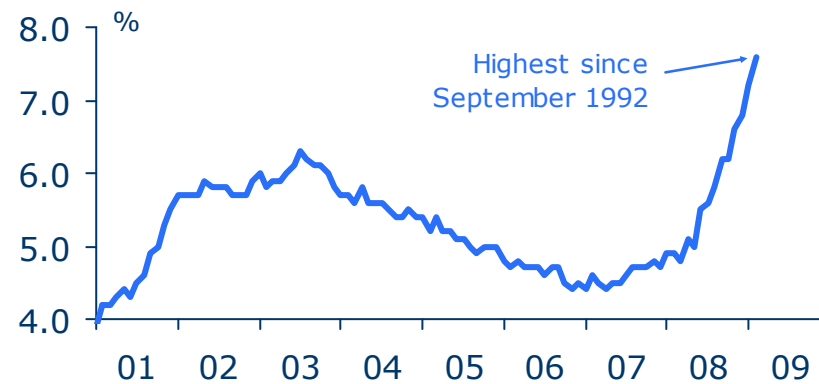
Employment



Industrial production



Unemployment rate



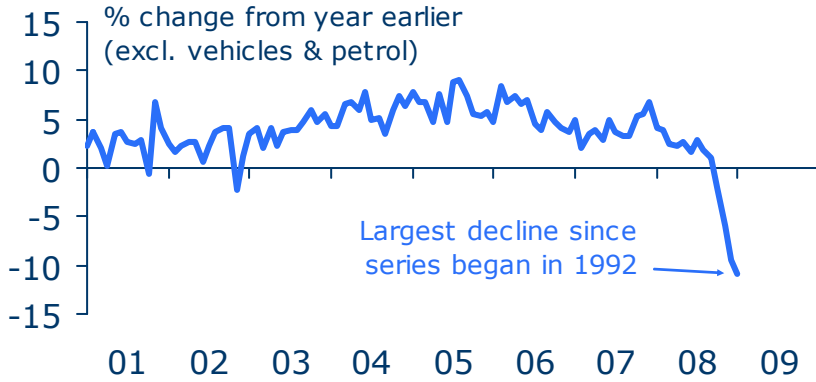
Sources: US Bureau of Economic Analysis; Federal Reserve; Bureau of Labor Statistics.



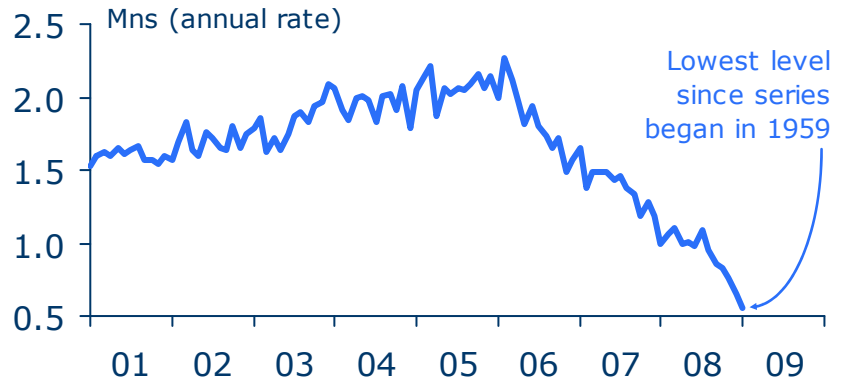
American consumers have been cutting back spending sharply – and businesses have started to cut back too

US consumer and business spending

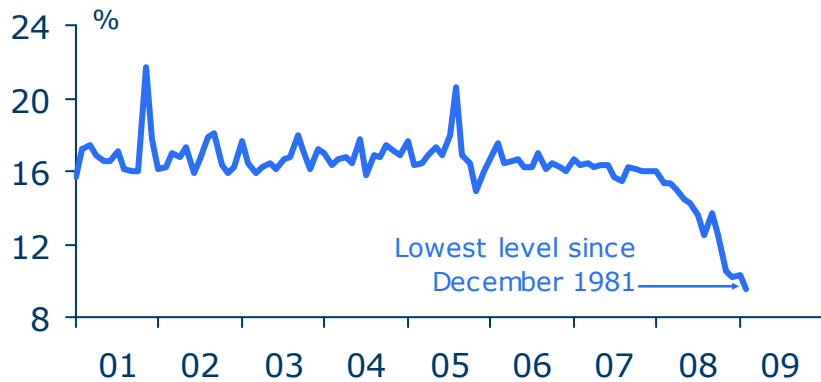
Real retail sales



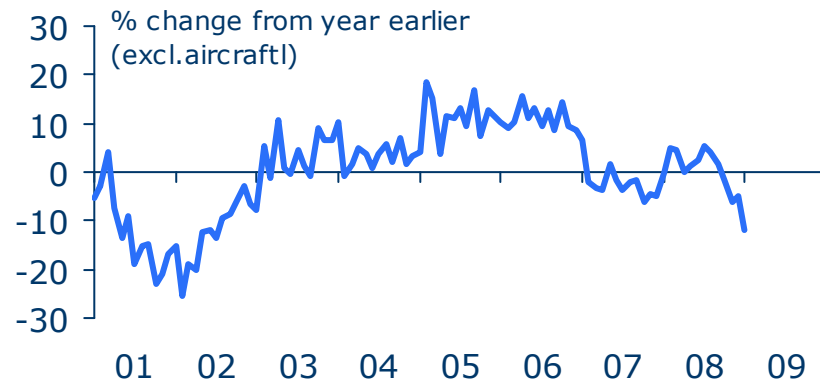
Housing starts



Motor vehicle sales



Non-defence capital goods orders



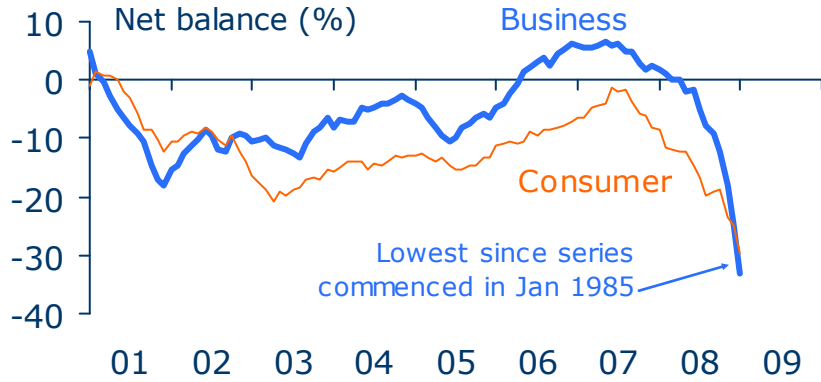
Source: US Commerce Department.



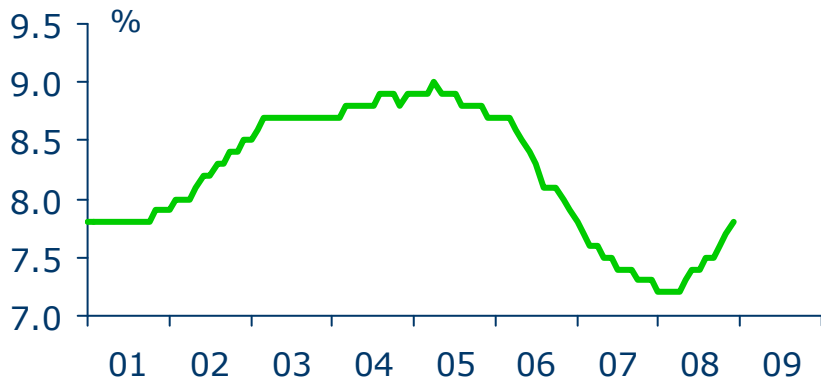
The downturn in the euro area and the UK is shaping up as almost as severe as that in the United States

Euro area

Business & consumer confidence

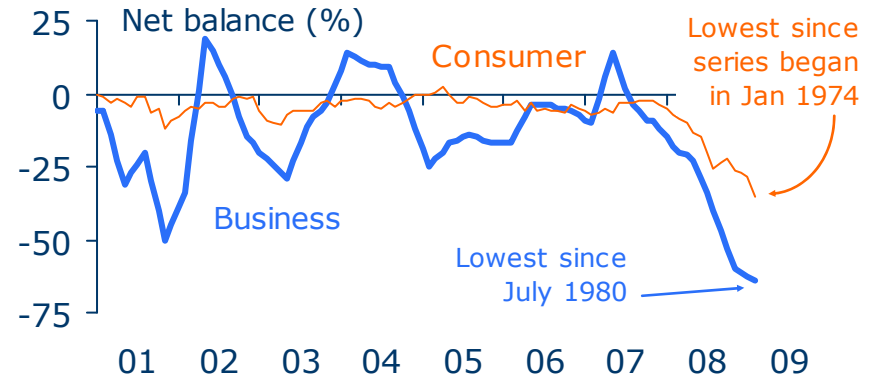


Unemployment

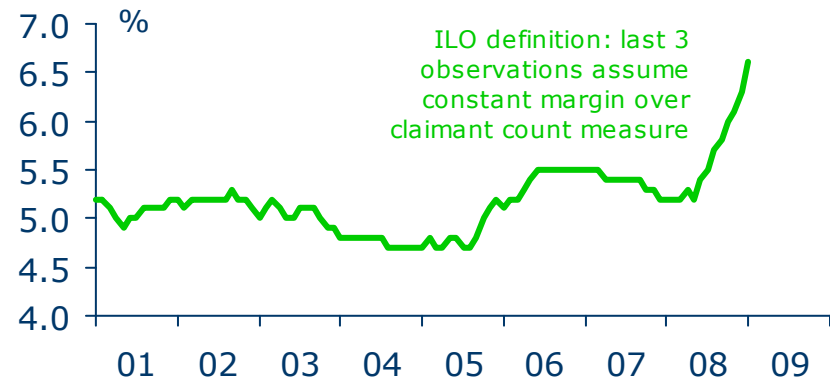


United Kingdom

Business & consumer confidence



Unemployment



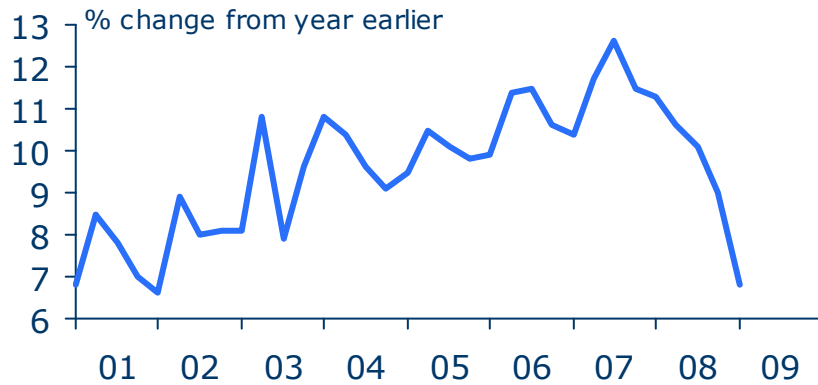
Sources: European Commission; Eurostat; Confederation of British Industry; UK Office of National Statistics; Datastream.



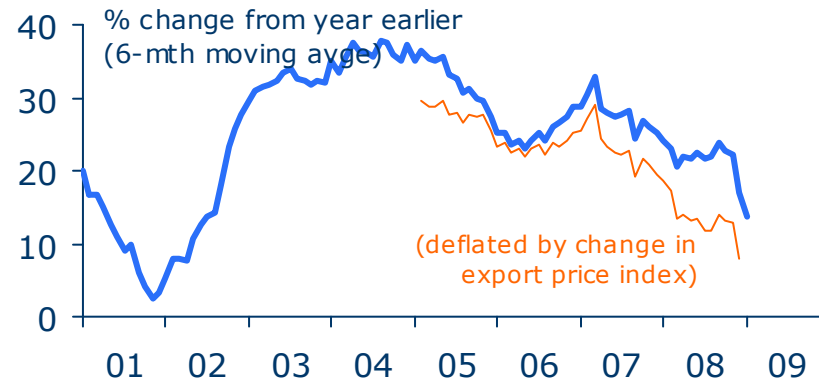
China slowed markedly late last year, only partly because of weaker exports, more because of a self-induced property collapse 11

Chinese economic indicators

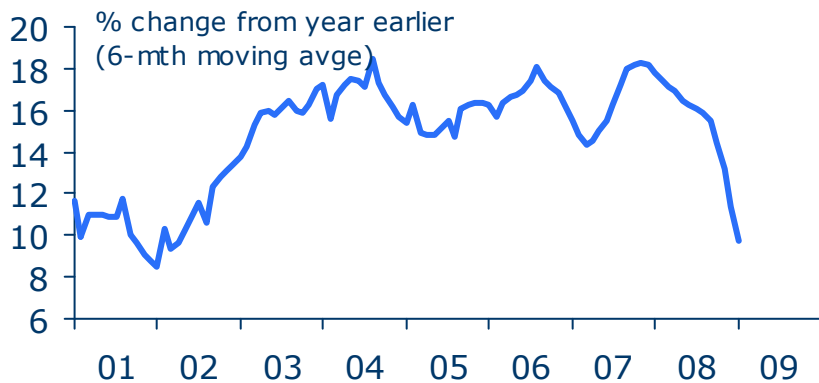
Real GDP growth



Exports



Industrial production



Real estate climate index



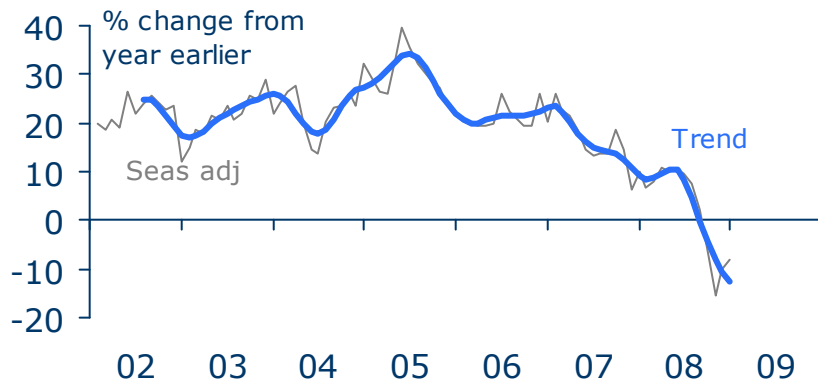
Source: China National Statistics Bureau; ANZ.



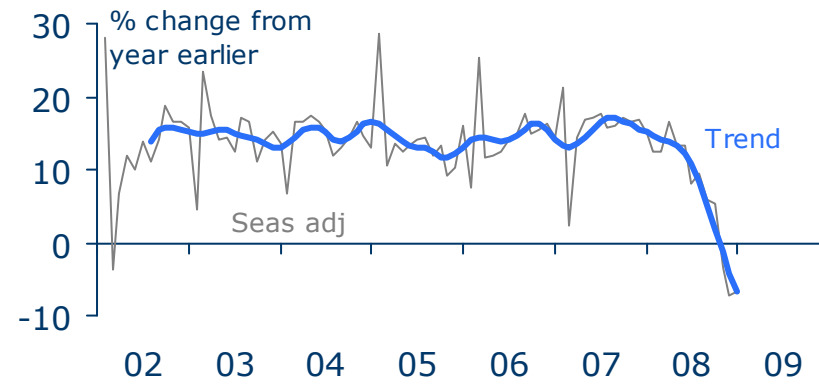
Industry data highlights the abrupt downturn in the commodity-intensive sectors of the Chinese economy ¹²

Chinese industry indicators

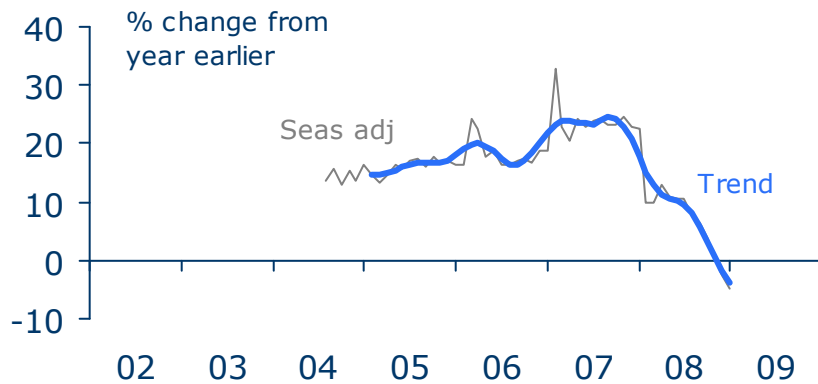
Crude steel production



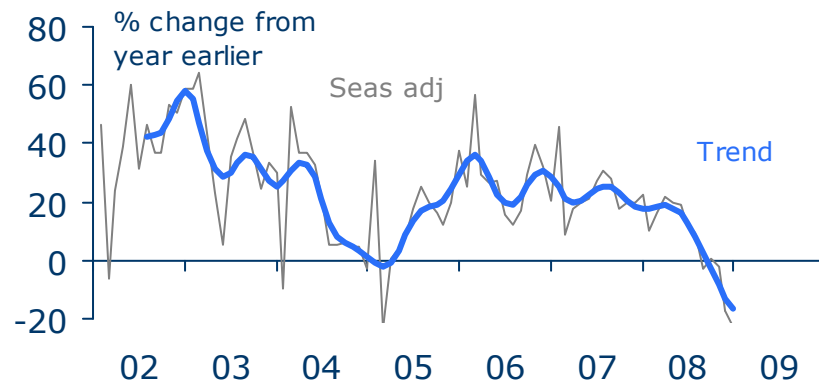
Electricity production



Non-ferrous metal production



Motor vehicle production



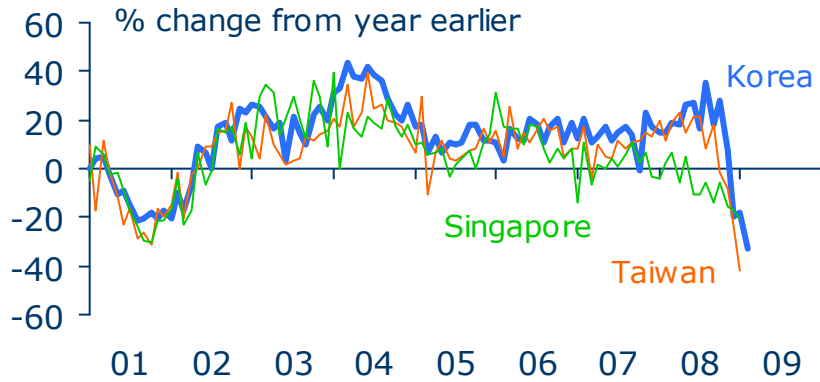
Sources: China Steel Industry Association; China Non-Ferrous Metal Industry Association; China National Statistics Office; China Association of Automobile Manufacturers; CEIC. Seasonal adjustment by DX; trend series derived by ANZ using ABS formula.



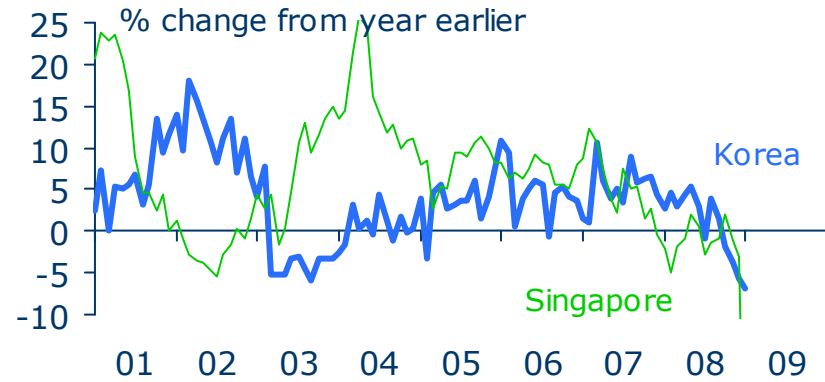
Export-intensive smaller East Asian economies have been dragged into the global slowdown

Smaller East Asian economies

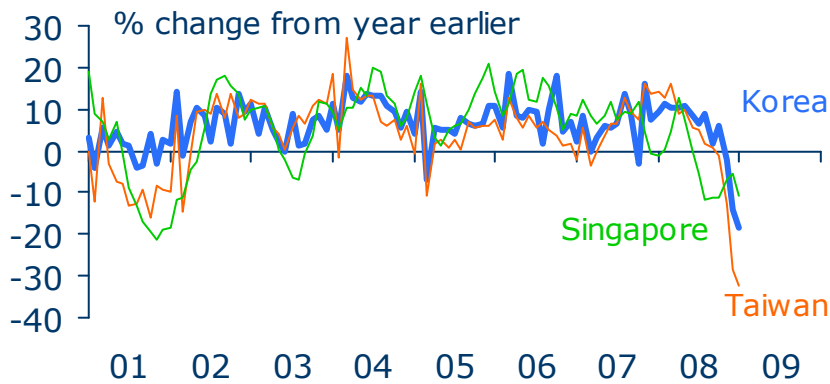
Exports



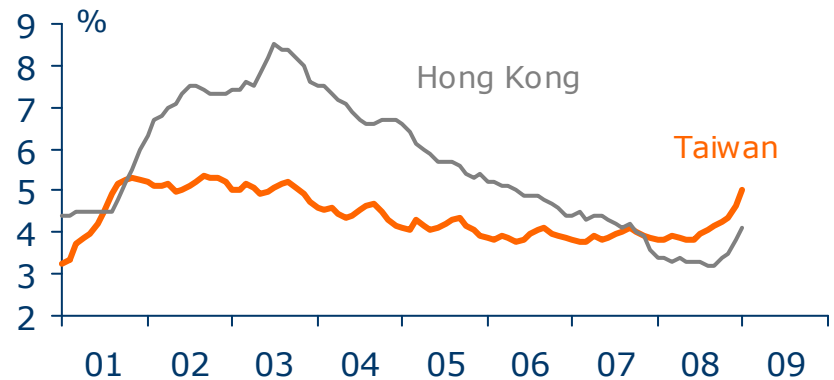
Retail sales



Industrial production



Unemployment

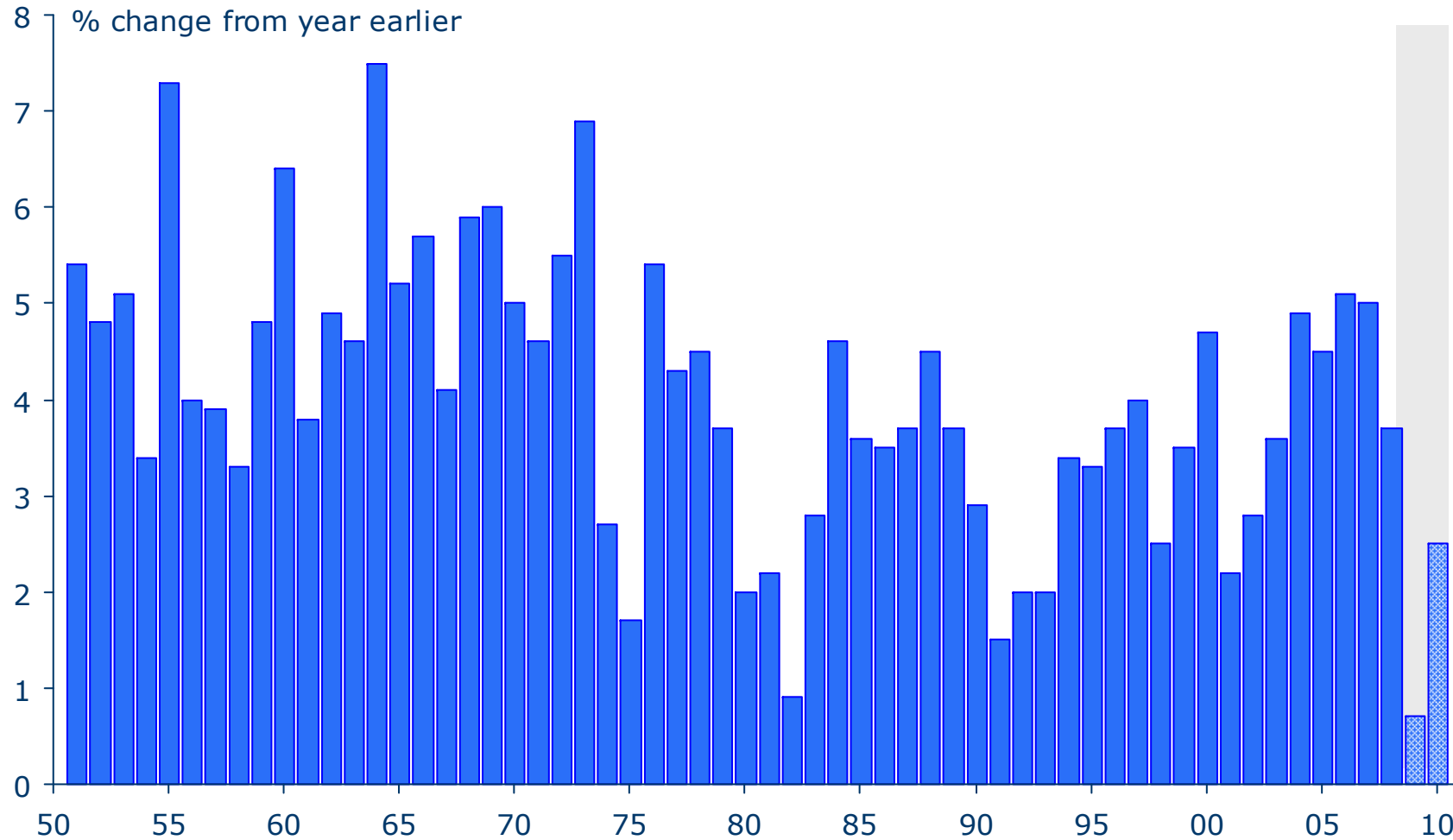


Sources: CEIC; Datastream; ANZ.



Global economic growth will be weaker in 2009 than in any year since the end of World War II ¹⁴

Global economic growth 1950-2010



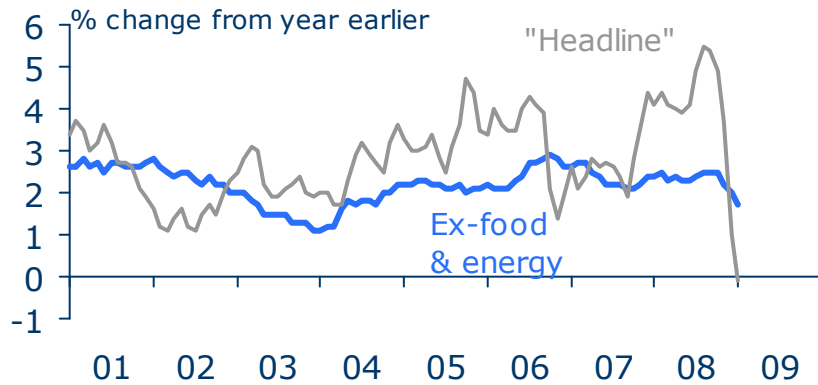
Sources: The Conference Board Total Economy Database (1950-70); IMF (1971-2008); ANZ (2009-10).



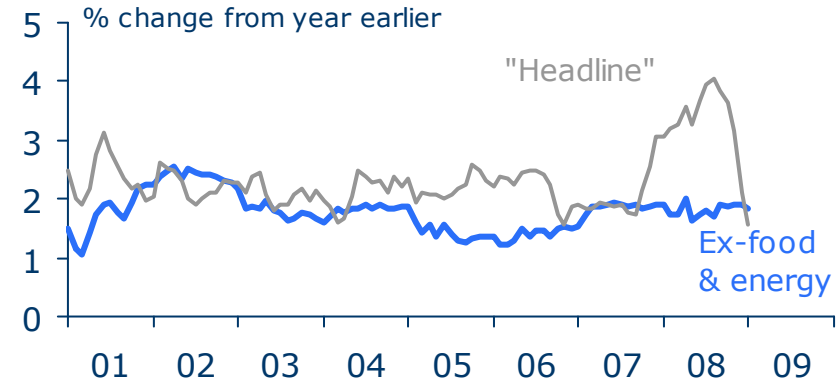
'Headline' inflation has fallen sharply in advanced economies, and core inflation is easing too – deflation is a risk for some

Consumer prices – major industrialized economies

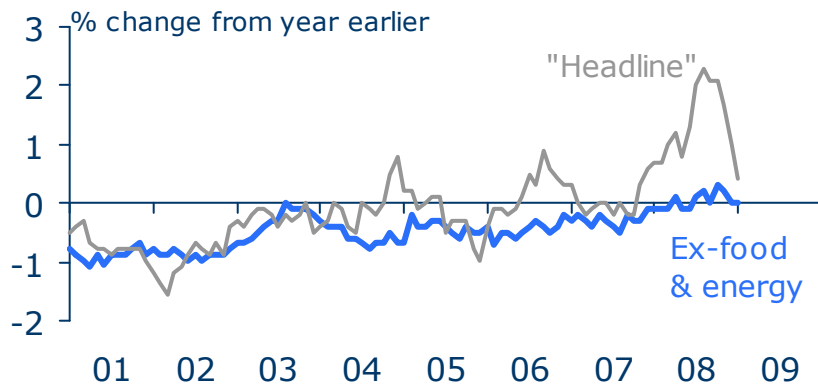
United States



Euro area



Japan



United Kingdom

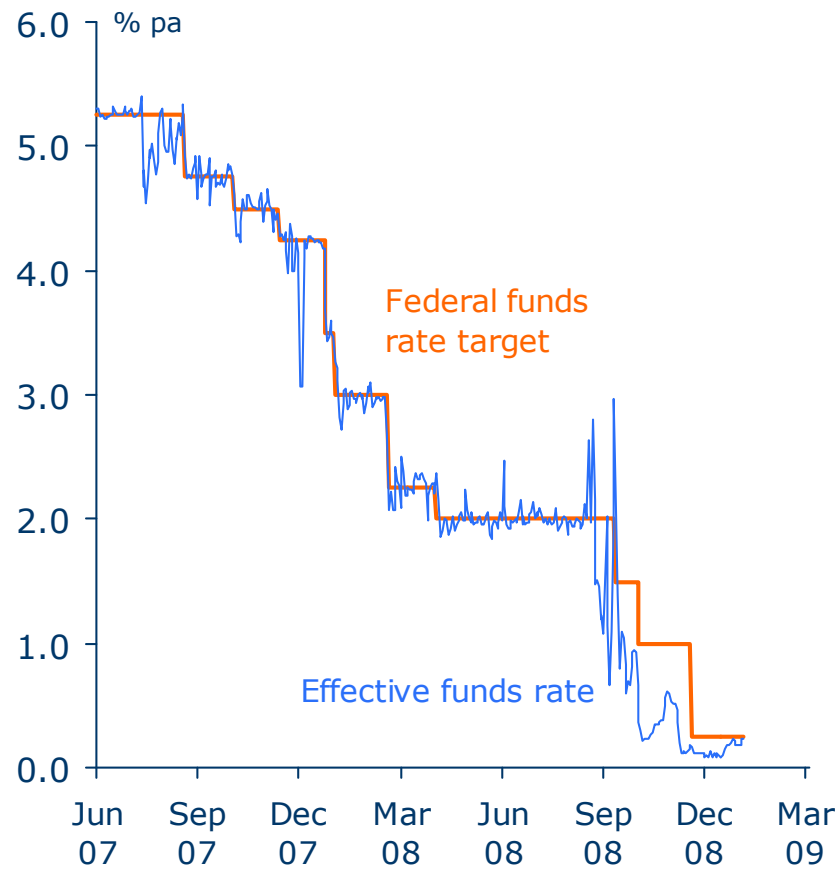


Sources: US Bureau of Labor Statistics; Eurostat; UK Office of National Statistics; CEIC.

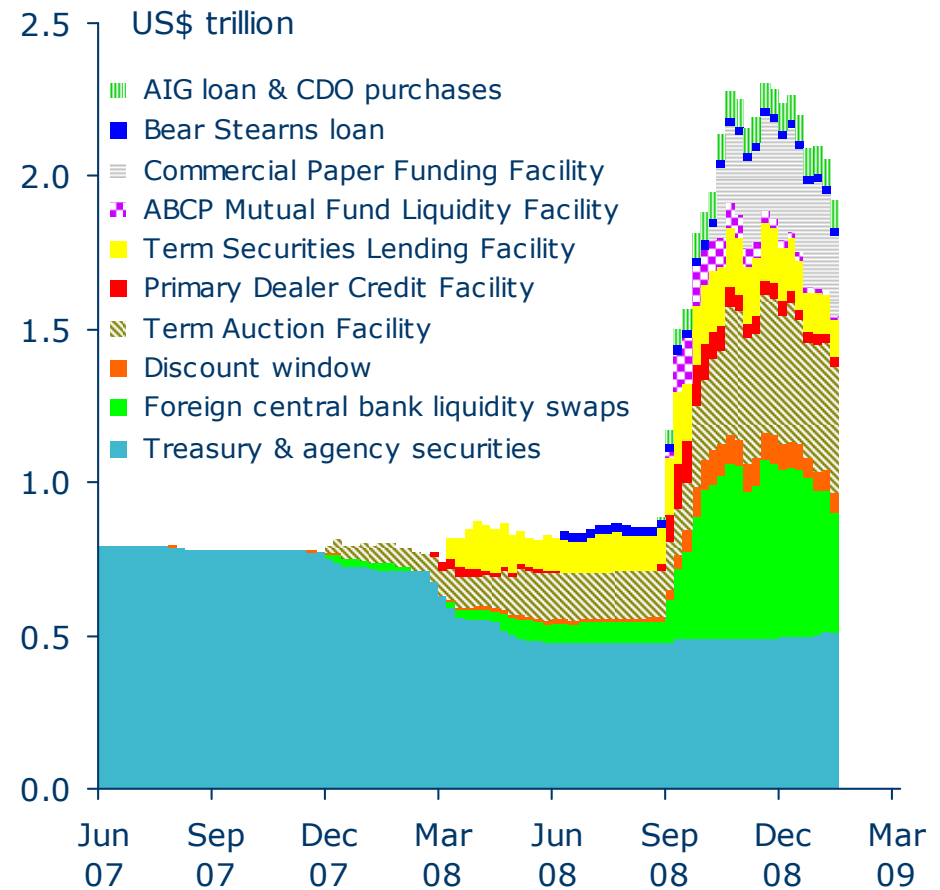


With its cash rate effectively at zero the Fed has resorted to a form of 'quantitative easing'

Target and effective Fed funds rate



Assets on the Federal Reserve's balance sheet

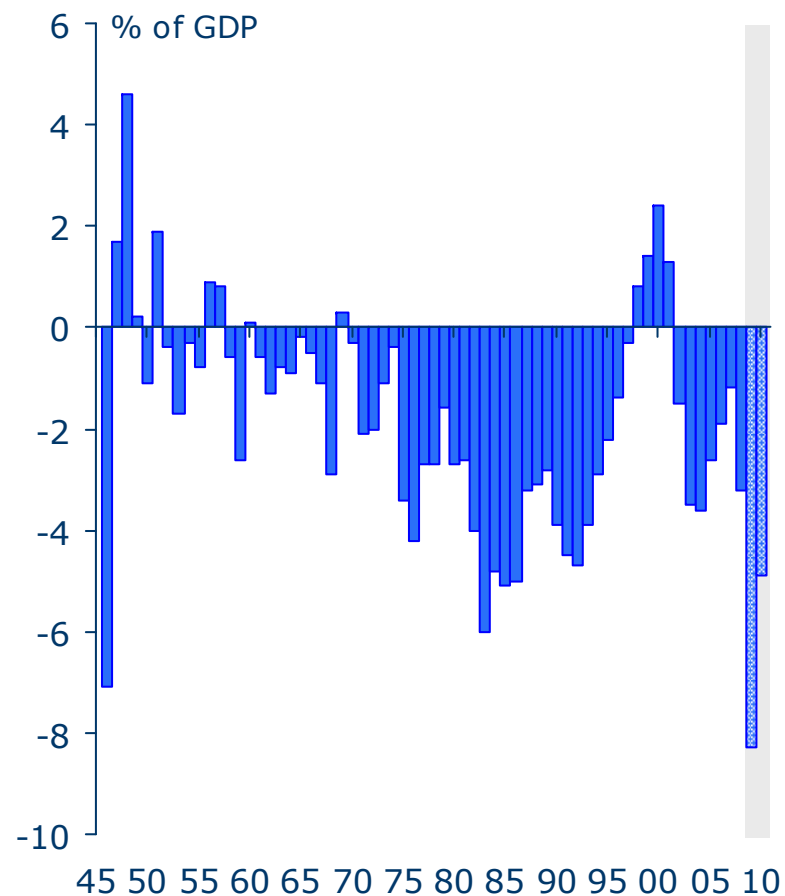


Source: US Federal Reserve Board H.4.1 Statistical Release, *Factors Affecting Reserve Balances*; Datastream.

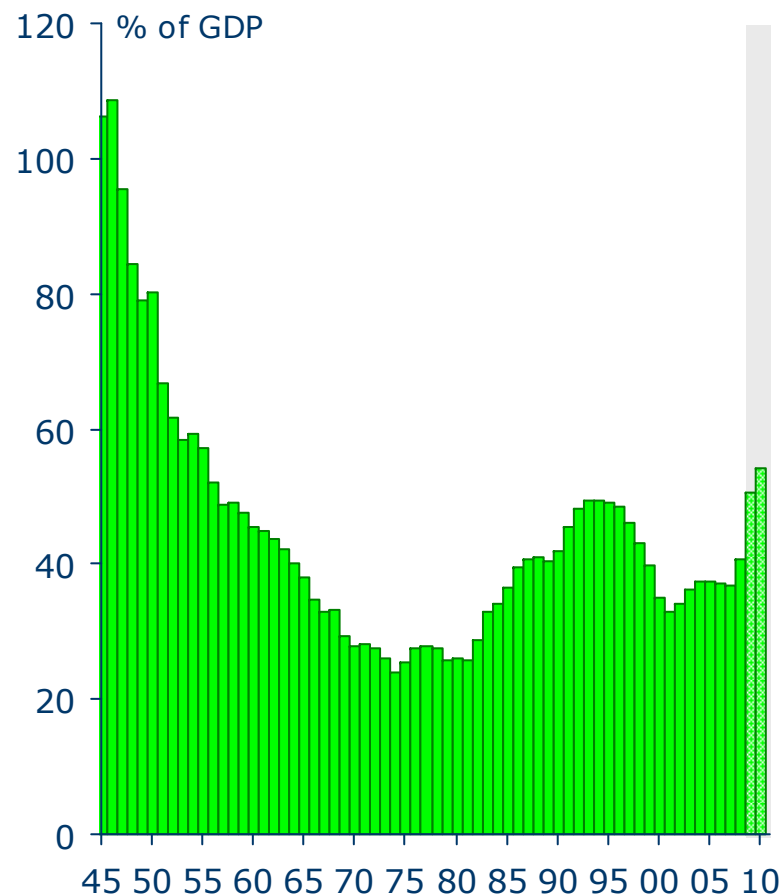


Fiscal policy has to shoulder a greater burden, pushing government debt up sharply but not to unprecedented levels

US Federal budget balance



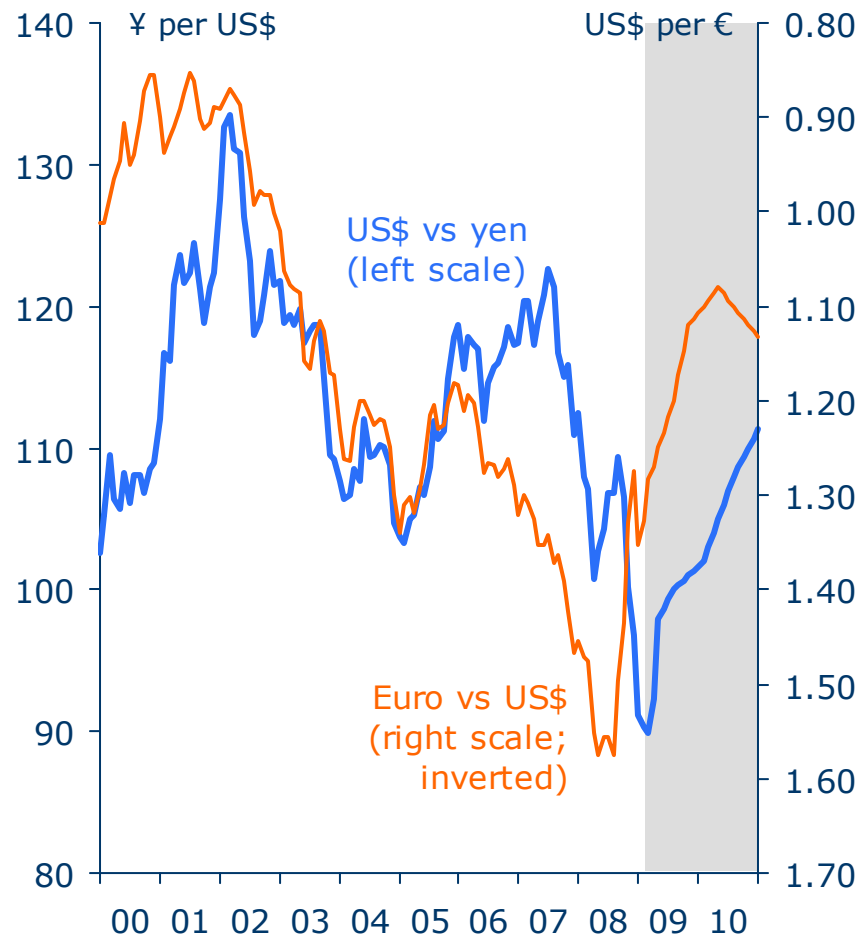
US Federal Government debt



Note: Figures for Federal Government debt exclude debt held by other Federal agencies such as the Social Security Trust Fund. *Source:* Congressional Budget Office, January 2009.

Lots of people are bearish on the US\$ - but what currency should go up against it?

US\$ vs Euro and yen



Sources: Datastream; ANZ.

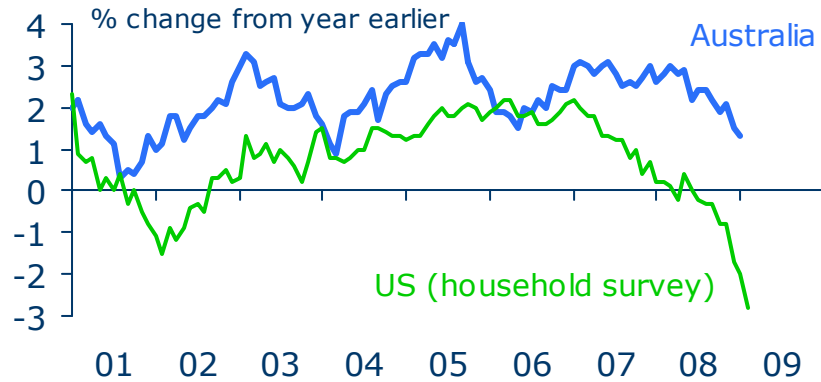
- Viewed in isolation, it's easy to get bearish about the US\$ (large budget and external deficits, deep recession, zero interest rates, etc)
- But exchange rates are relative prices – so for the US\$ to go down, some other currency has to go up
- Japan has a large external surplus, and the euro area has a much smaller external deficit than the US – but in almost every other respect, Japan's and the euro area's fundamentals are worse than the US' – and the US is doing more than either to address its economic woes
- Given that the US\$ has already fallen a lot against both the ¥ and € over past five years, it's not clear that it will fall a lot further – indeed it is perhaps more likely to rise against them
- A good case can be made for the US\$ to fall against the yuan – but the Chinese aren't going to let that happen



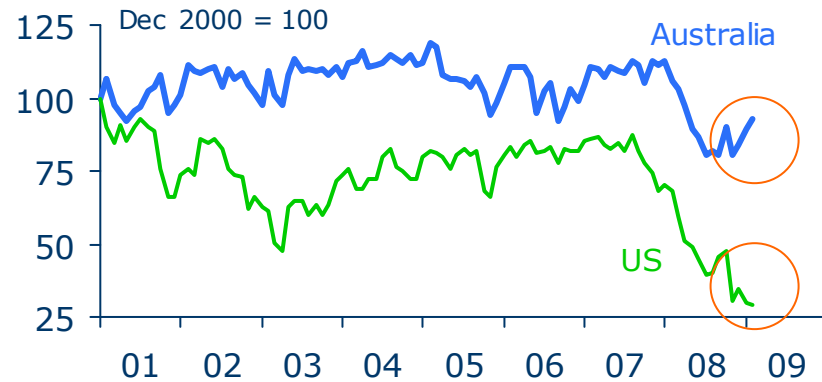
Australia's economy has thus far held up considerably better than America's ...

Australian and US labour market and household spending

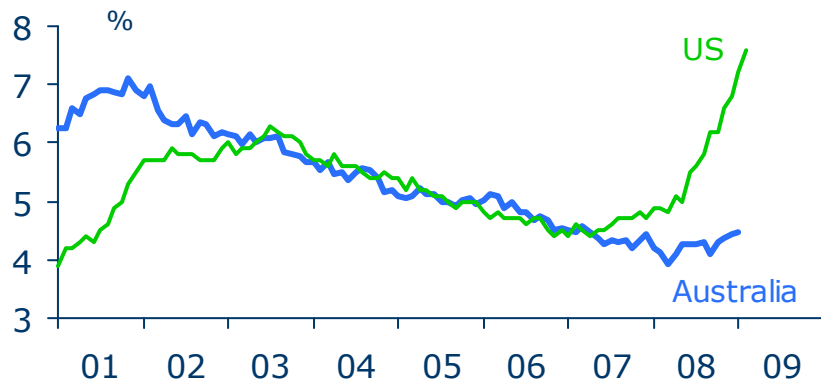
Employment



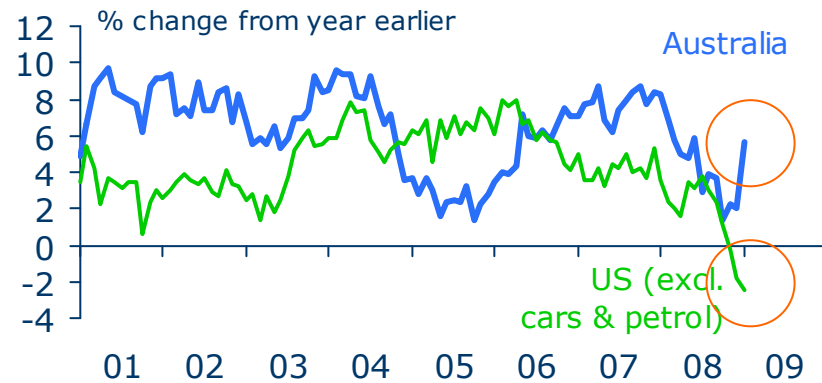
Consumer confidence



Unemployment rate



Retail sales



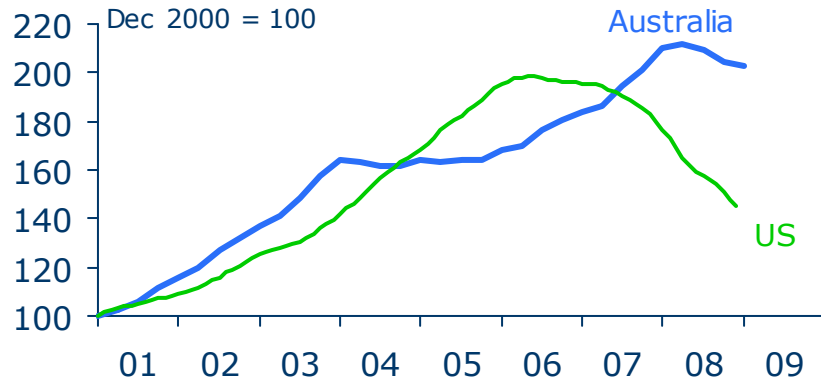
Sources: ABS; US Bureau of Labor Statistics; The Conference Board; Roy Morgan Research; US Commerce Department; ANZ.



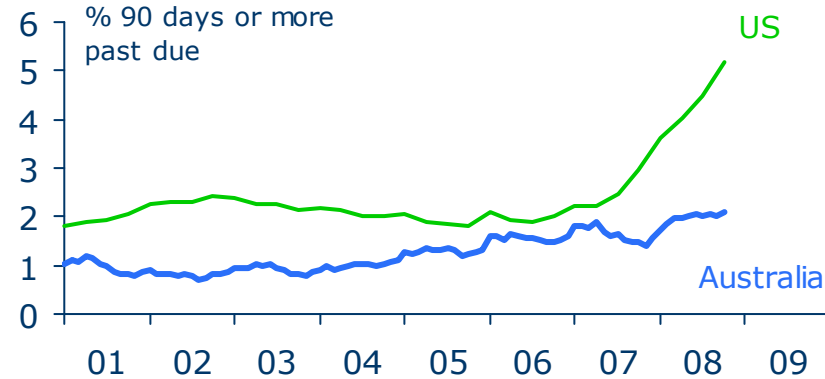
.. partly because Australia's housing market and banking system have remained stronger than America's

Australian and US housing markets and household finances

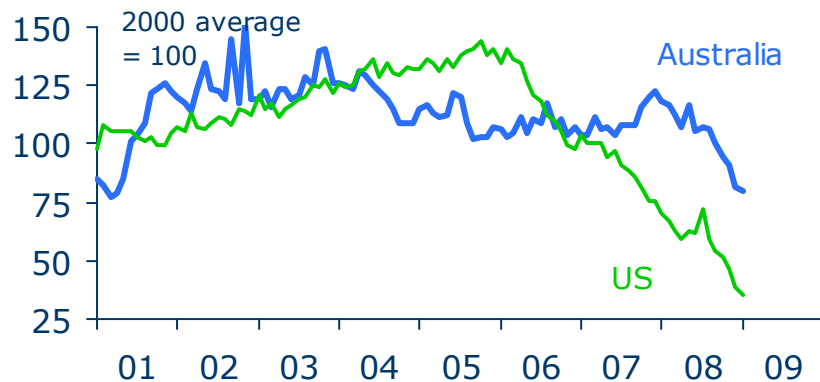
House prices



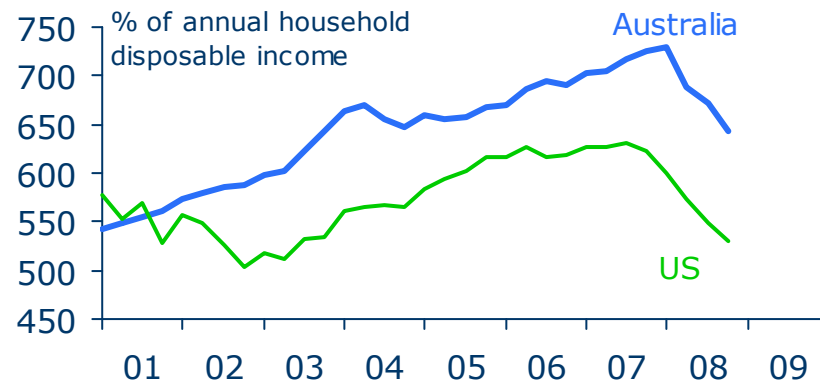
Mortgage delinquency rates



Housing approvals



Household net worth

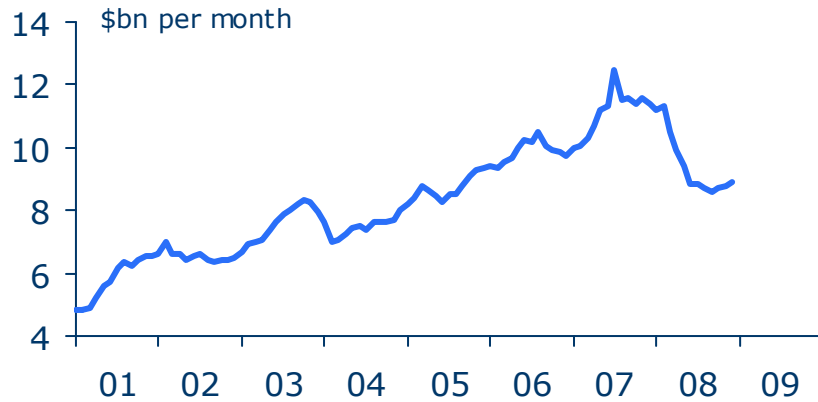


Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: ABS; S&P; US Federal Reserve; Mortgage Bankers' Association of America; US Commerce Department; ANZ.



Rising demand from first home buyers vs falling demand from (and lending to) investors will tend to put a floor under prices

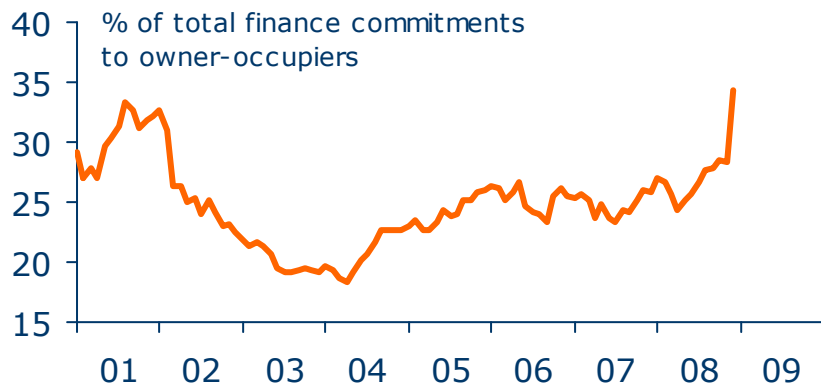
Housing finance commitments to owner-occupiers



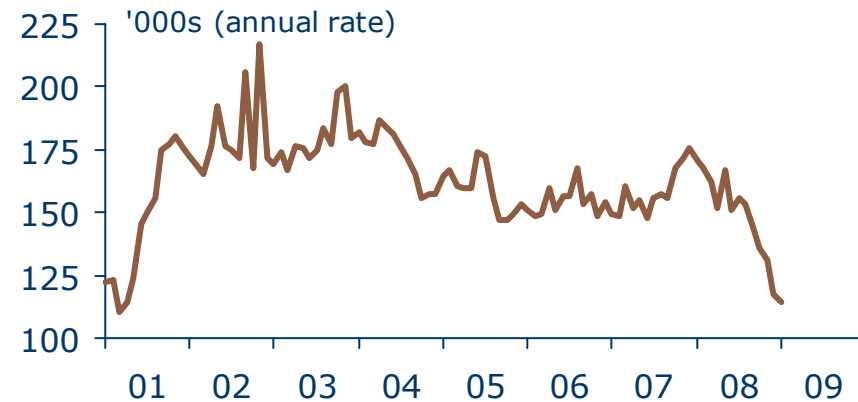
Housing finance commitments to investors



First-time buyers as a pc of total commitments to owner-occupiers



Residential building approvals by local governments

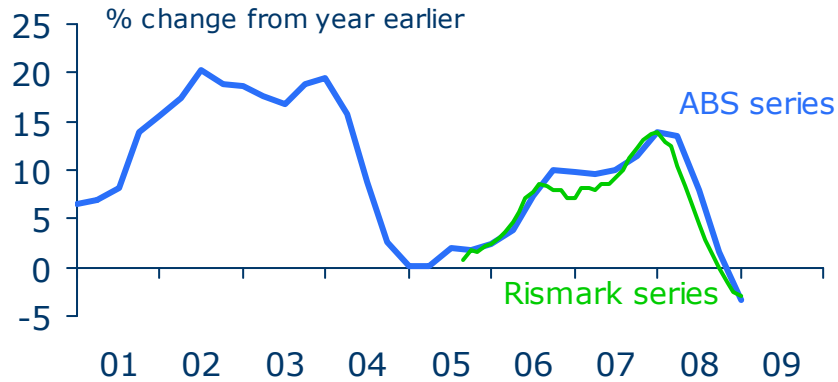


Sources: ABS; ANZ.

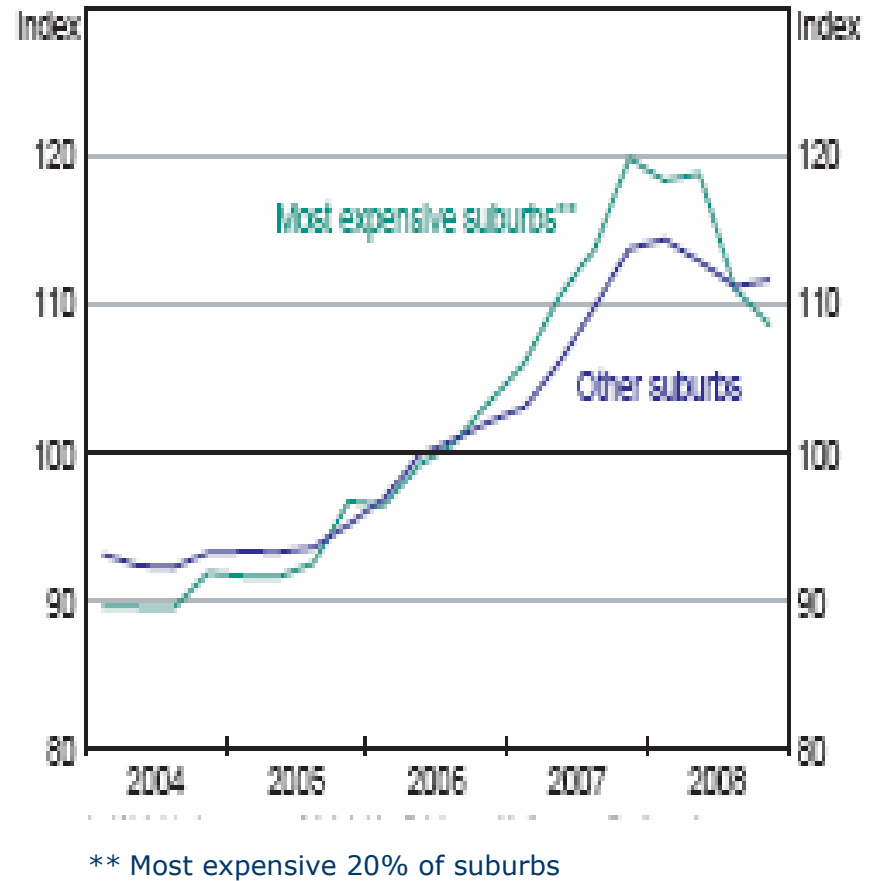


Relatively small house price declines reflect absence of 'forced' sellers; large declines concentrated in ritzier suburbs 22

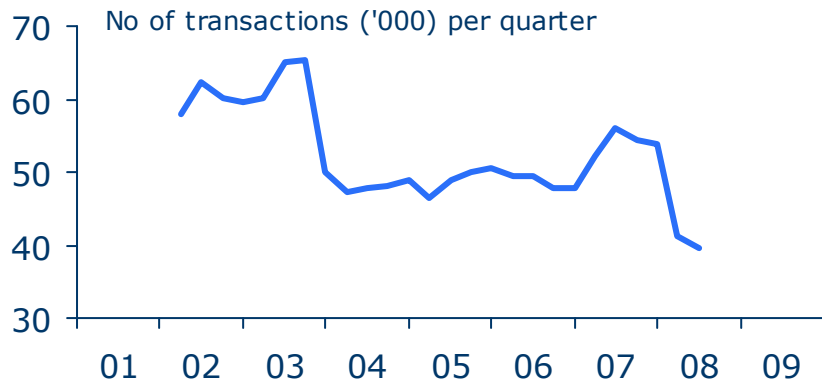
Australian capital city house prices



House prices in 'expensive' vs other suburbs



Turnover of established dwellings

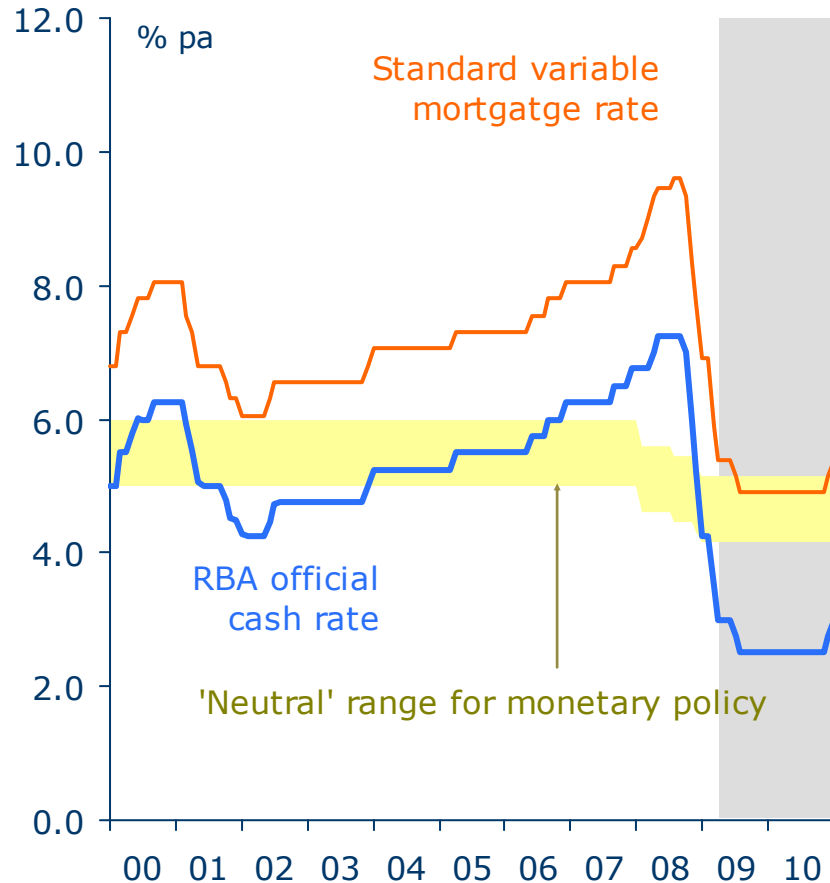


Sources: ABS; APM; ANZ. Chart on right taken from RBA Statement on Monetary Policy (February 2009)

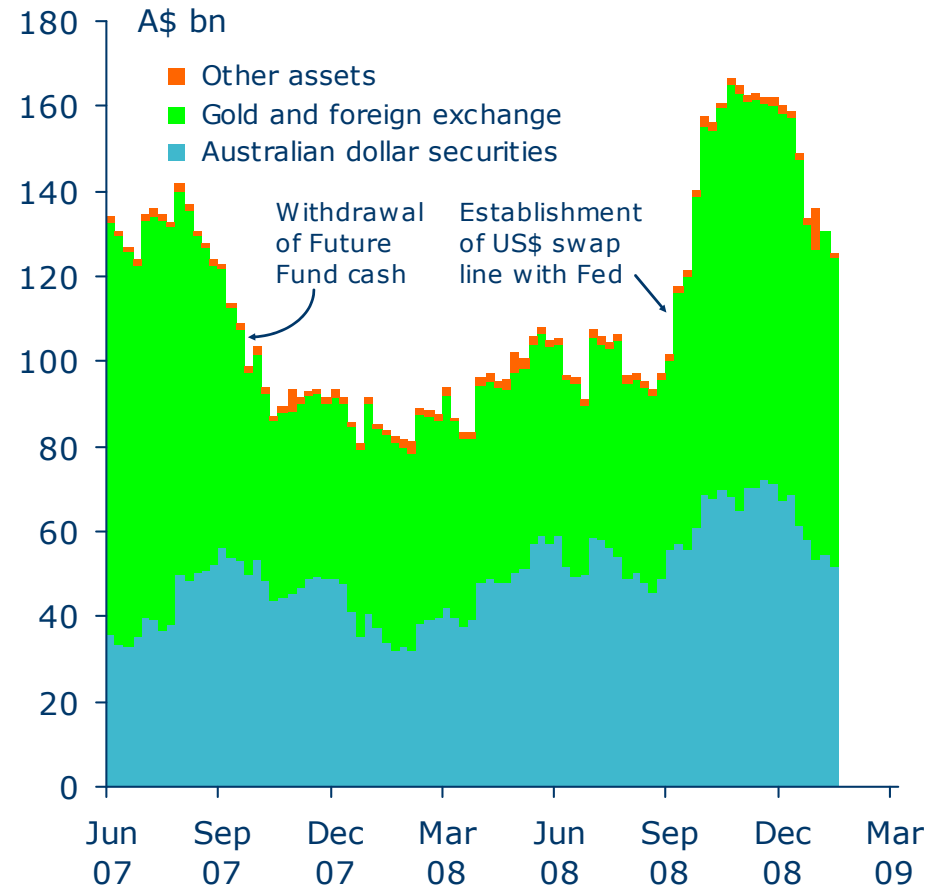


Although the RBA hasn't needed to be as 'creative' as the Fed, ²³ it has taken the cash rate to a 45-year low

Reserve Bank cash rate



Assets on the Reserve Bank's balance sheet

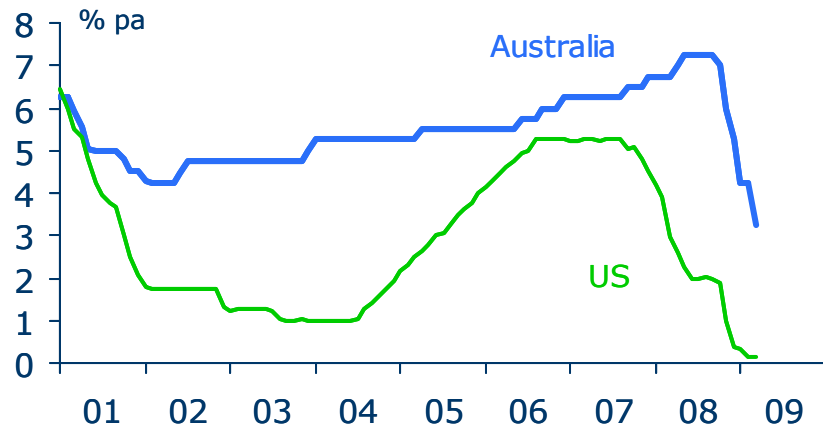


Source: RBA; ANZ.

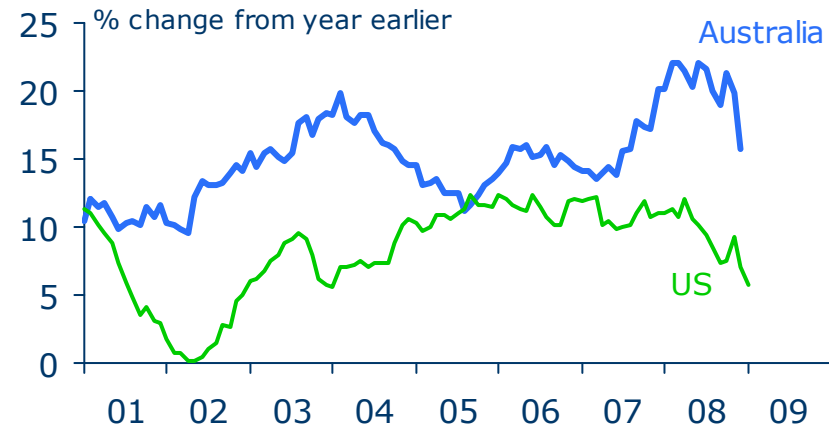


Monetary policy is 'working' more effectively in Australia than in the US, in part because the banking system is in better shape ²⁴

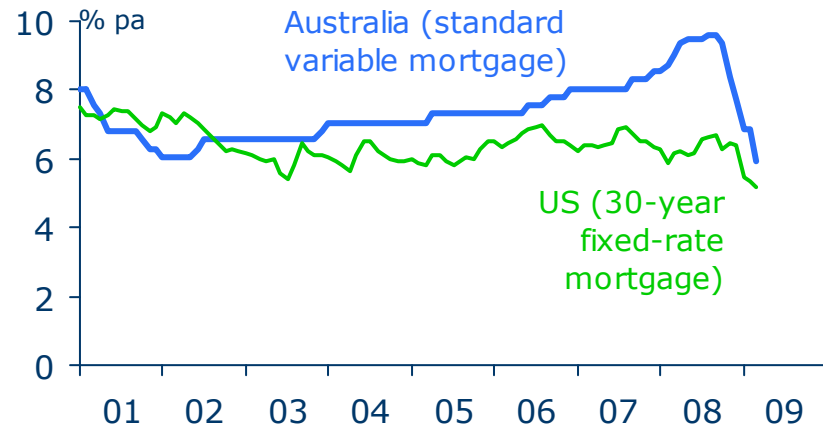
Official interest rates



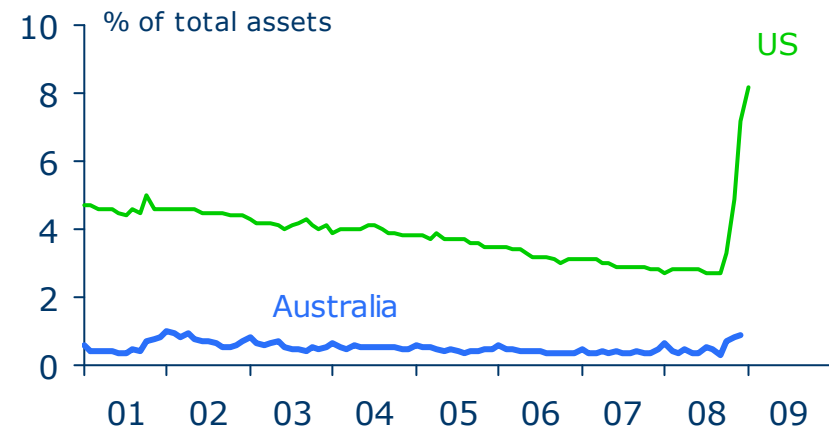
Bank lending



Most common mortgage rates



Bank cash holdings

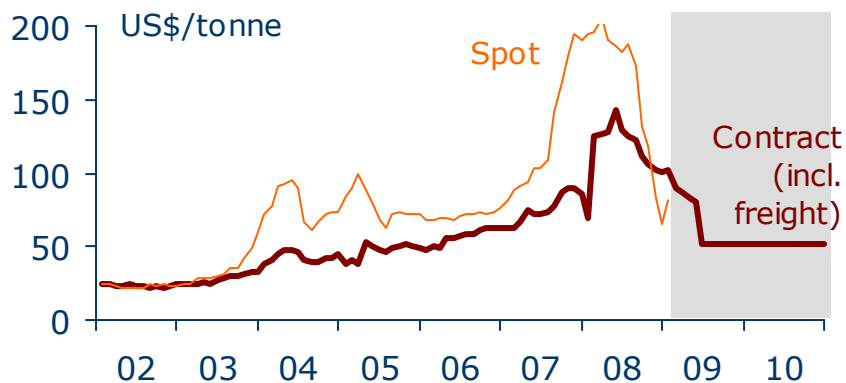


Note: 'Cash' includes deposits with the central bank. US banks are subject to required to hold cash reserves against their transactions account balances and thus typically hold a higher proportion of their assets in cash than Australian banks which are no longer subject to such requirements. Sources: RBA; US Federal Reserve; Datastream.



Base metal prices have already fallen sharply, and iron ore prices will follow in April, although gold and LNG should hold up

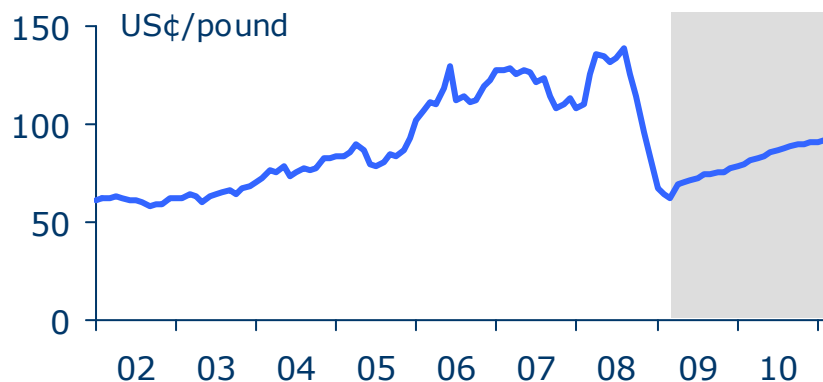
Iron ore



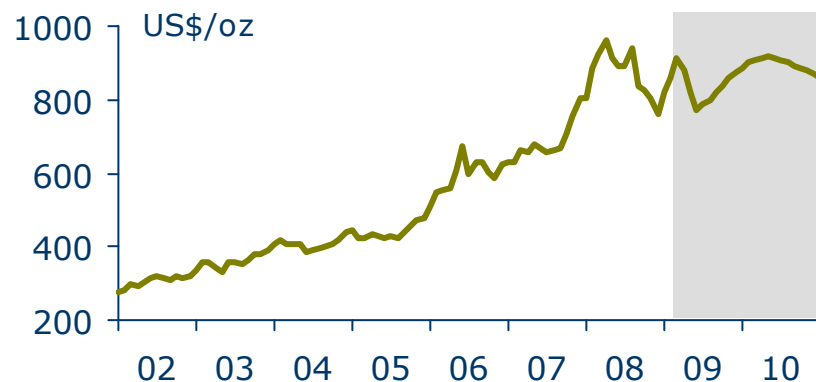
LNG



Aluminium



Gold

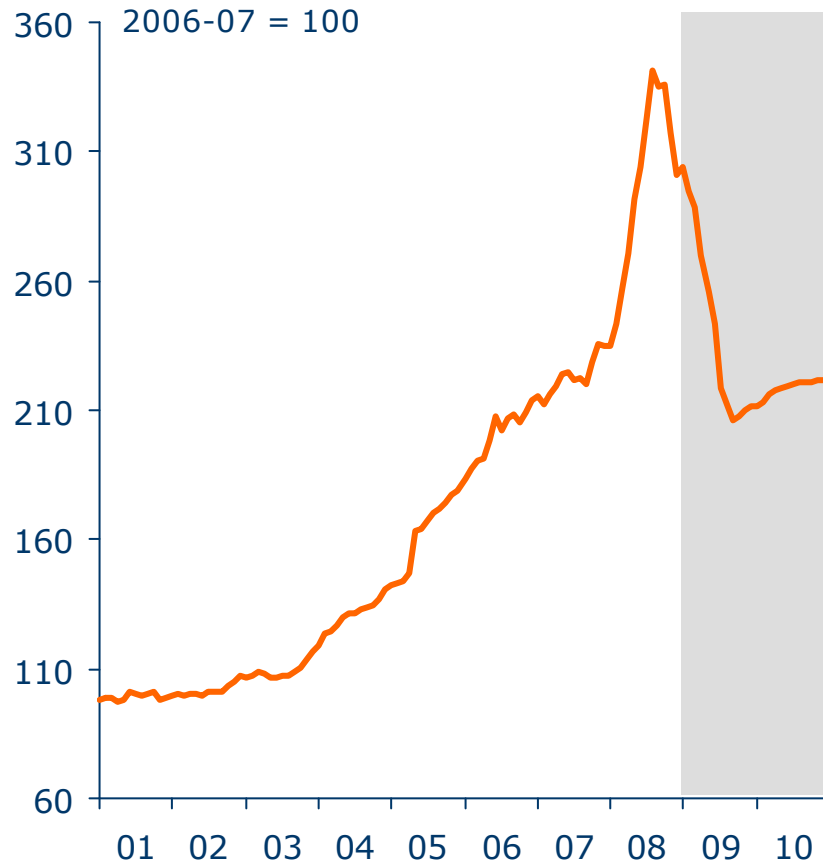


Sources: Datastream; ANZ.

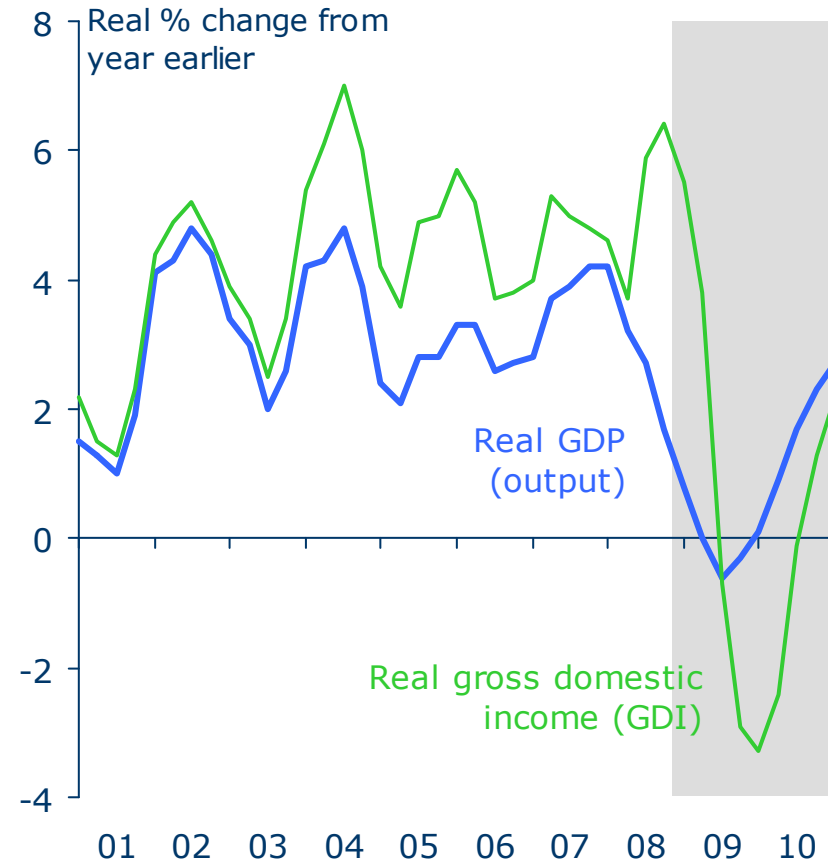


The sharp fall in commodity prices will detract substantially from Australian national income in 2009 ²⁶

Australian export commodity prices



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

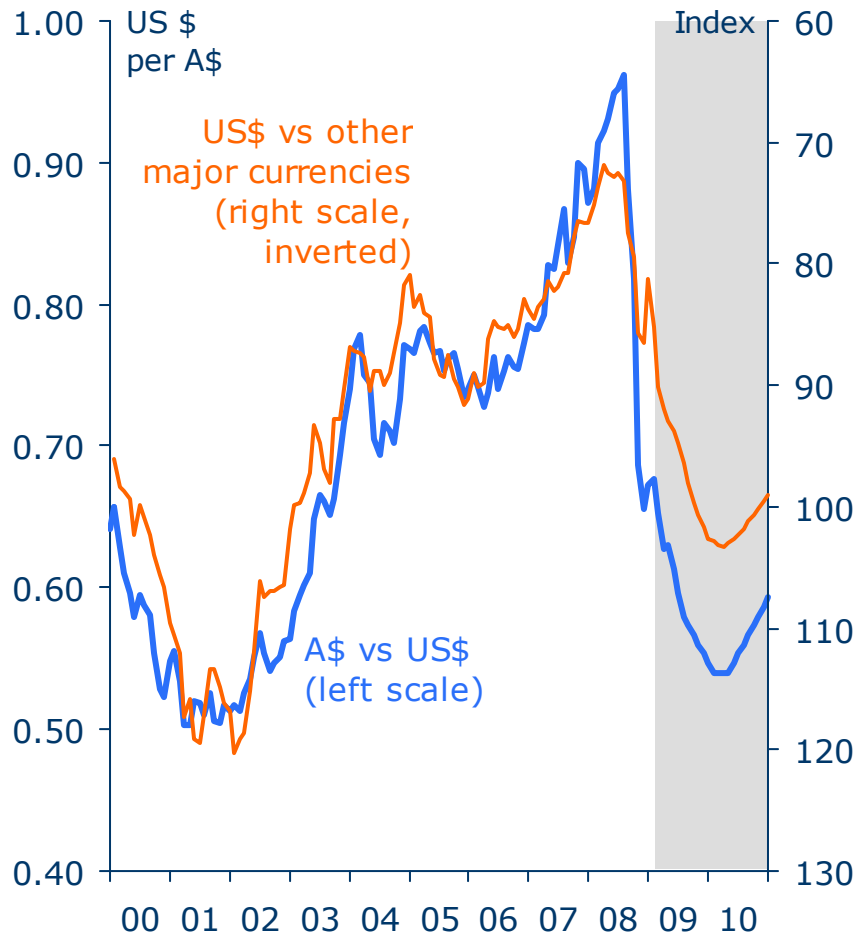


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

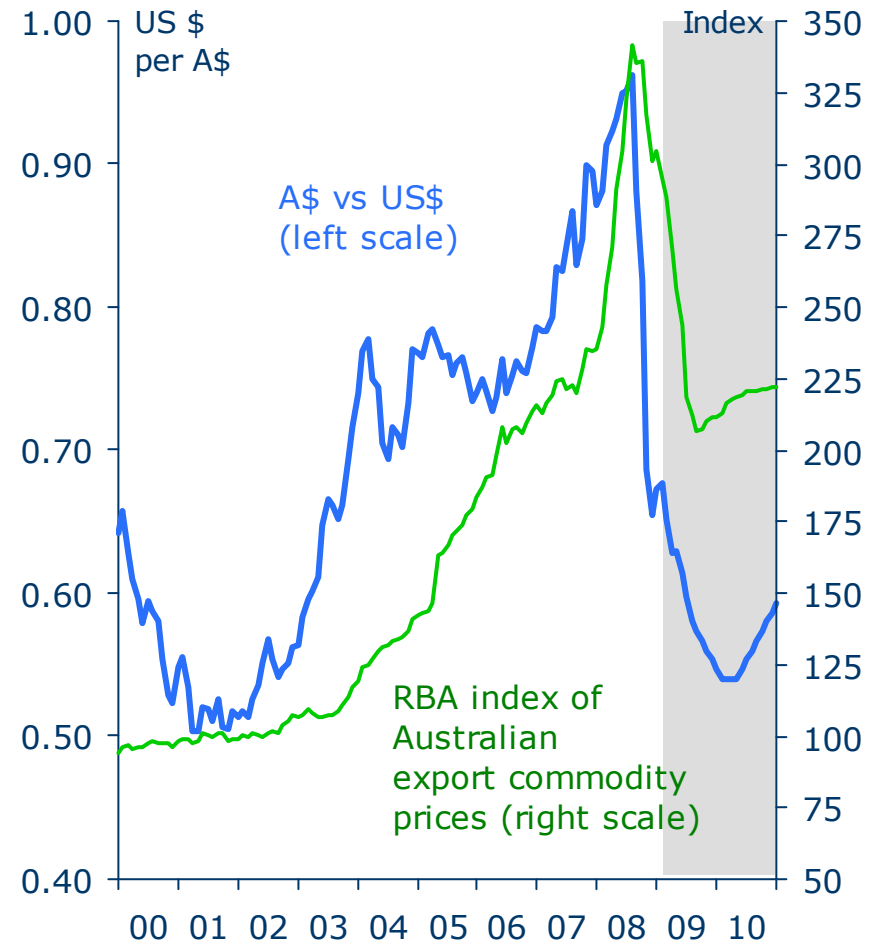


The A\$ will fall further against a resilient US\$ - though this will help cushion the economy and resist deflation ²⁷

A\$ vs US\$



A\$ & commodity prices

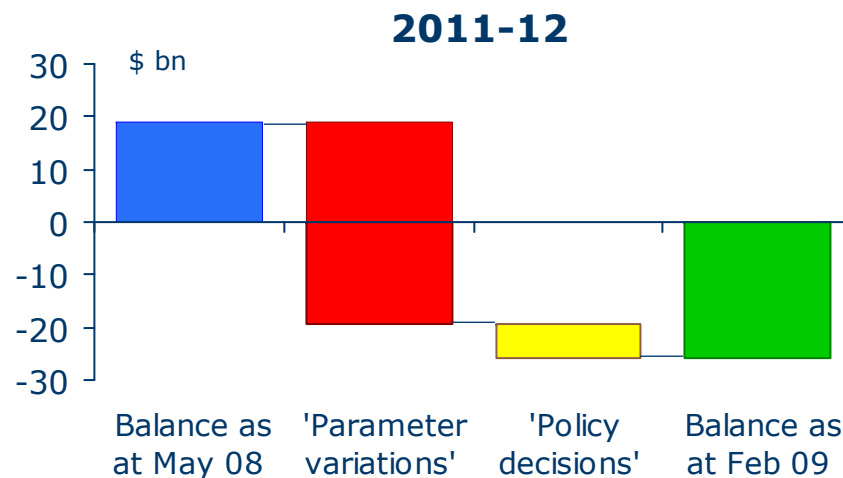
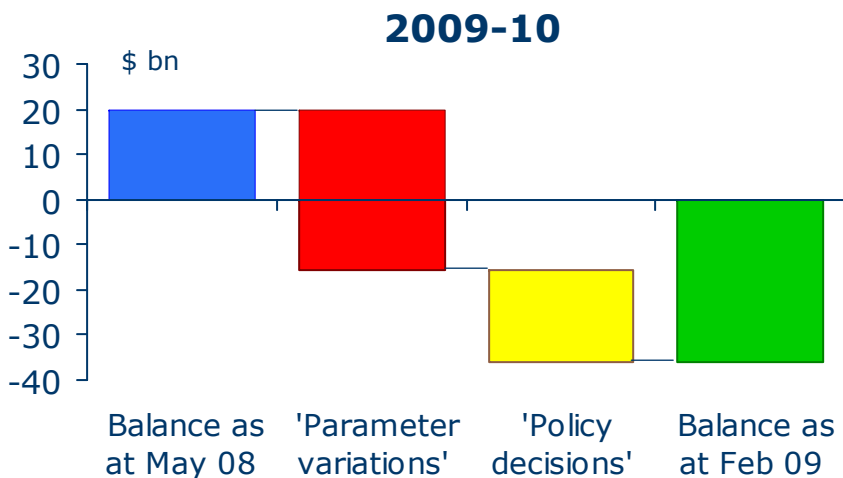
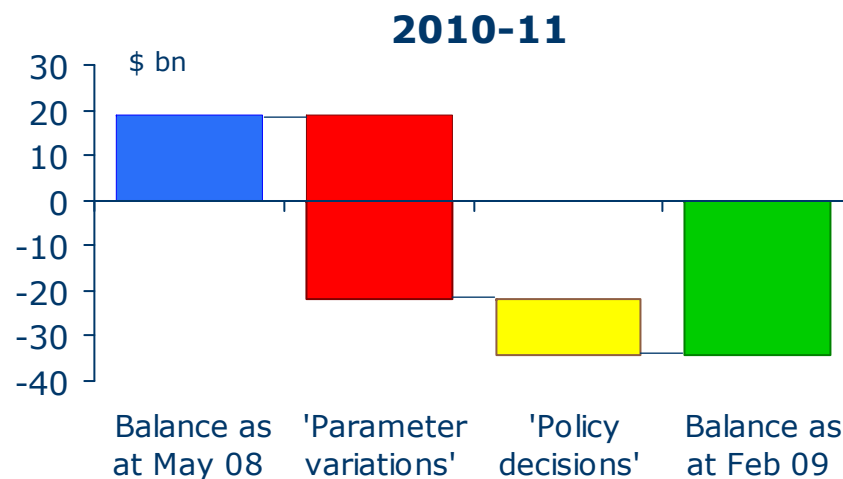
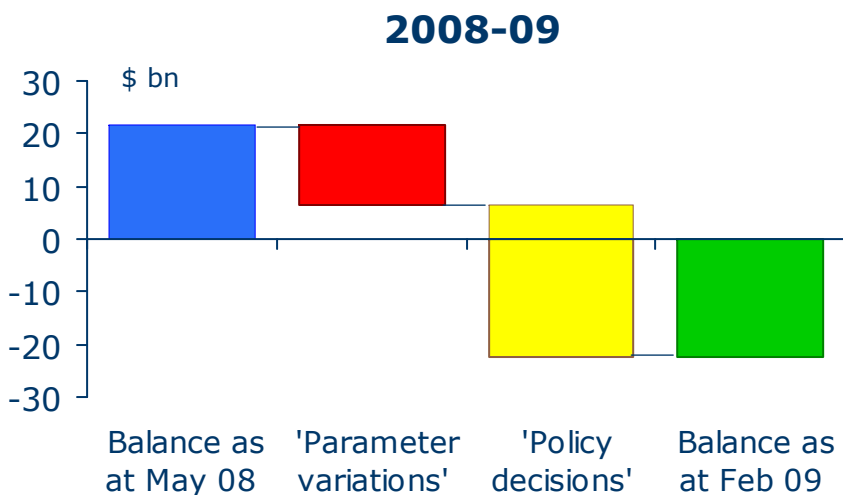


Sources: Datastream; US Federal Reserve; RBA; ANZ.



The Federal budget has swung sharply into deficit – though only just under half of this reflects deliberate policy decisions

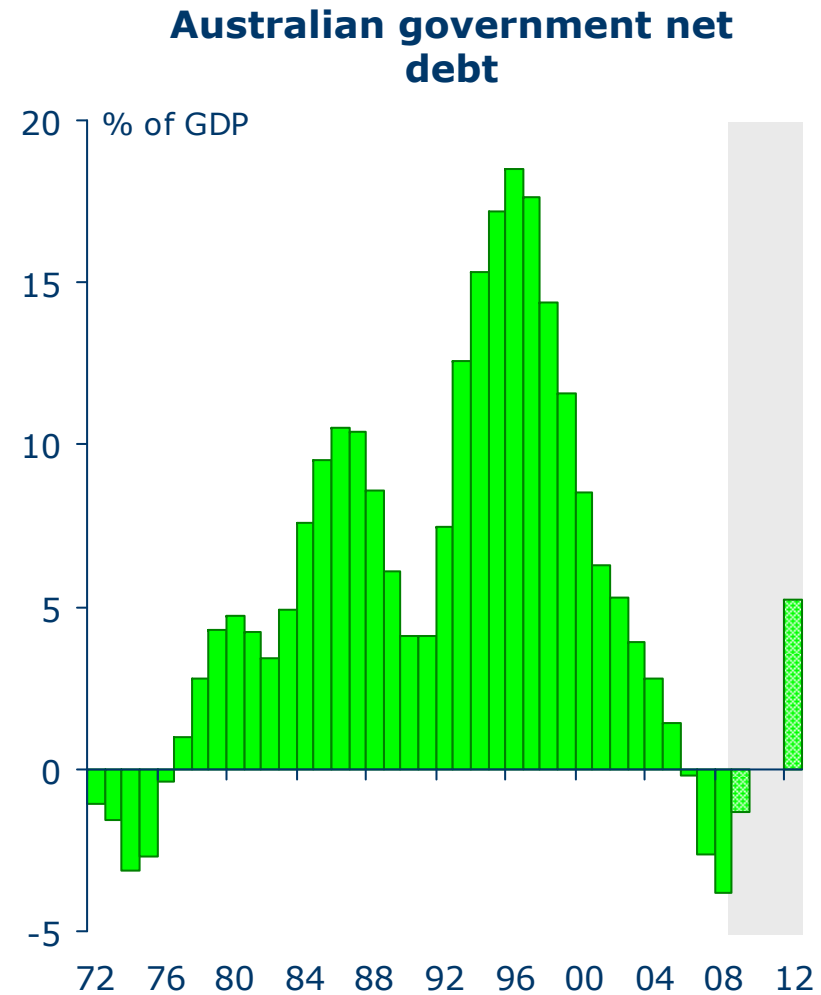
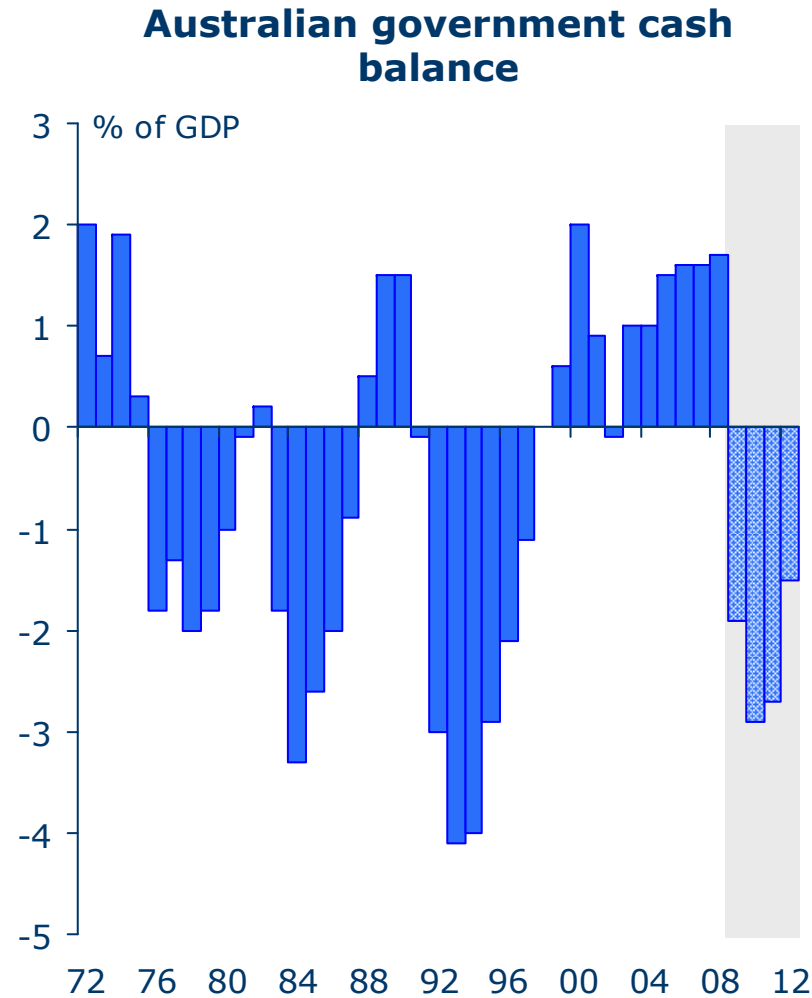
Sources of changes in estimates of the Budget cash balance



Note: 'Parameter variations' are changes in the cash balance due to changes in economic and other forecasts or assumptions. Source: *Mid-Year Economic & Fiscal Outlook* (November 2008); *Updated Economic & Fiscal Outlook* (February 2009); ANZ.



The budget deficits and resulting government net debt are by no means unprecedented ²⁹

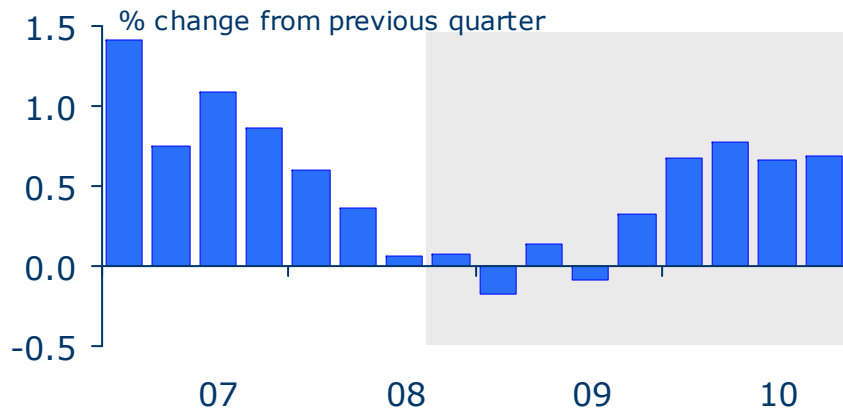


Sources: *Mid-Year Economic & Fiscal Outlook* (November 2008); *Updated Economic & Fiscal Outlook* (February 2009); ANZ.

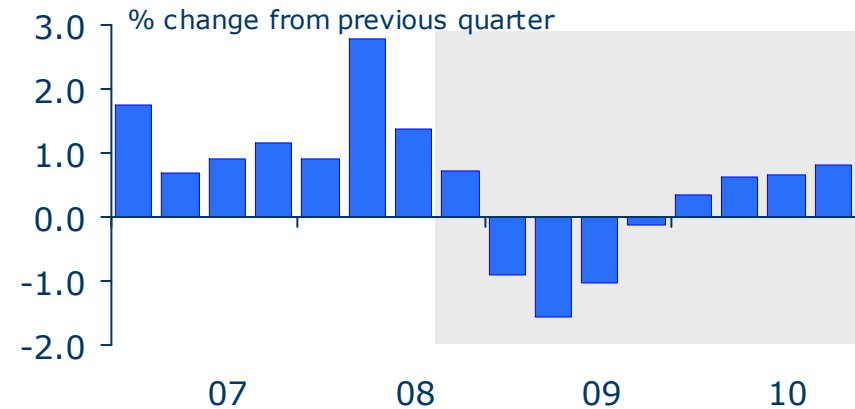


Australia might avoid consecutive quarters of negative real GDP growth, but it will have a recession by other definitions ³⁰

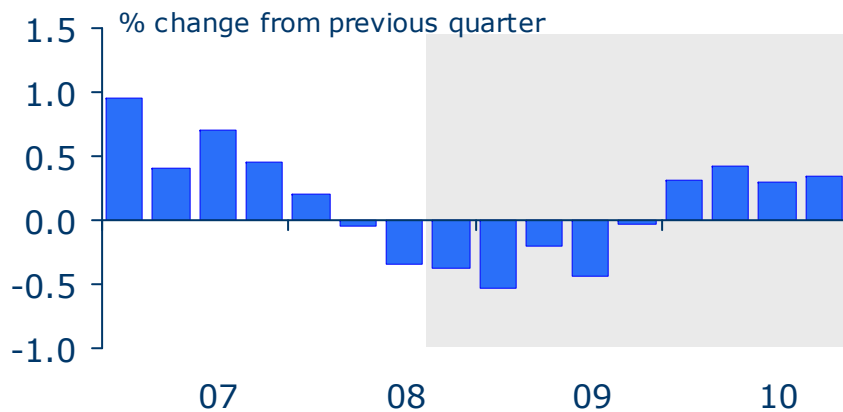
Real gross domestic product (GDP)



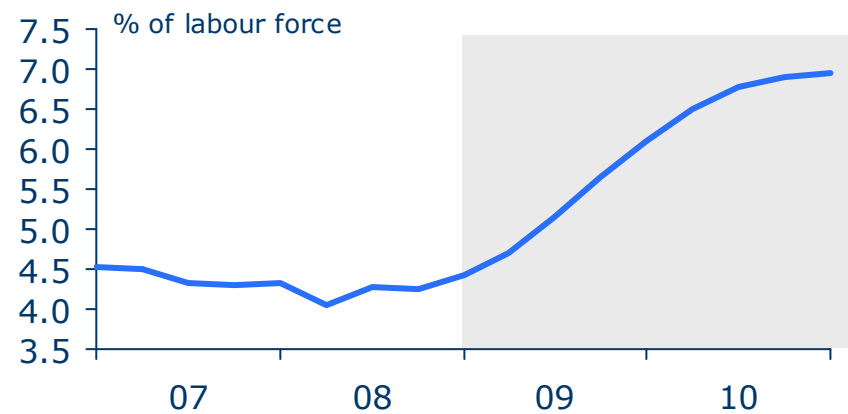
Real gross domestic income (GDI)



Real per capita GDP



Unemployment rate

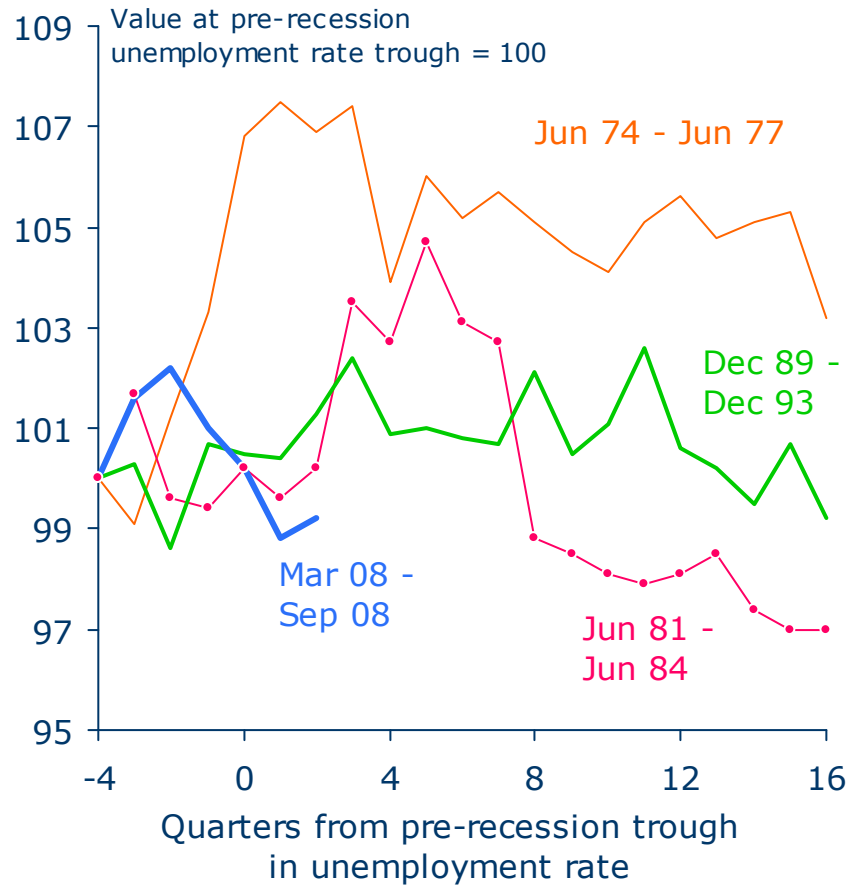


Note: Real gross domestic income is real GDP adjusted for changes in the terms of trade (export relative to import prices). Shaded areas denote ANZ estimates or forecasts. Sources: ABS; ANZ.

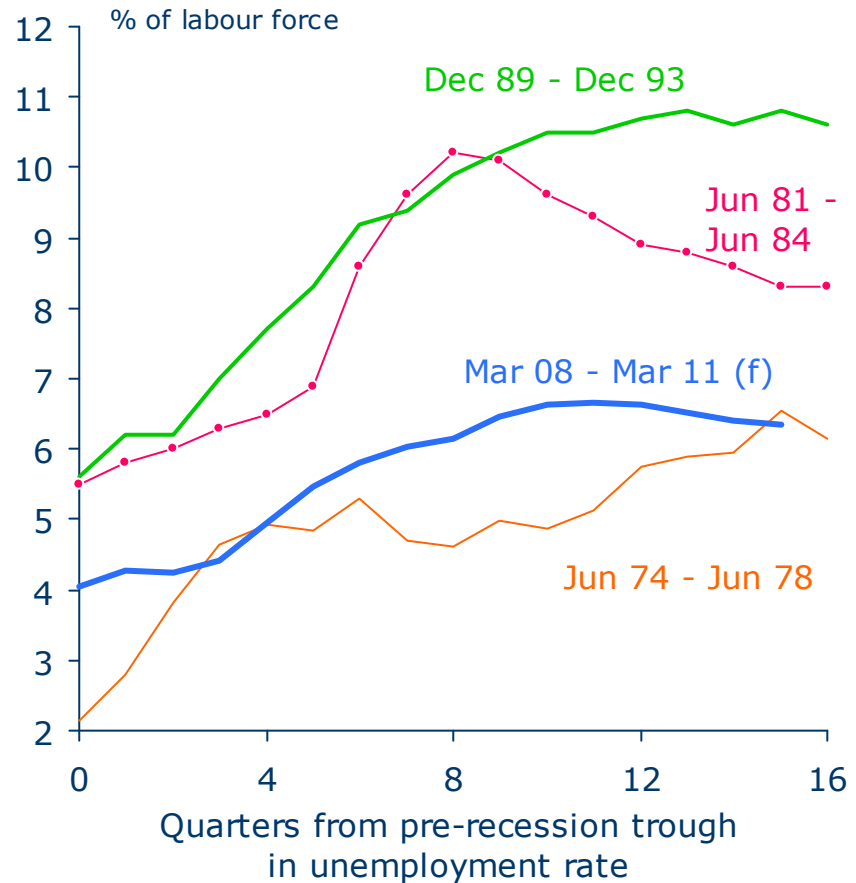


Employees haven't priced themselves out of jobs in the way that they did prior to each of the last three recessions

Real unit labour costs before and during recessions



Unemployment rate during recessions

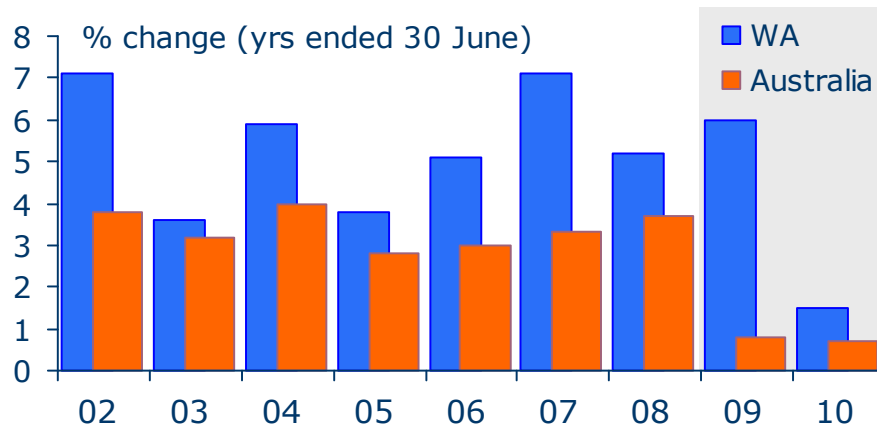


Note: real unit labour costs are employee compensation plus other 'on-costs' per unit of output produced, deflated by an index of output prices. Sources: ABS; ANZ.

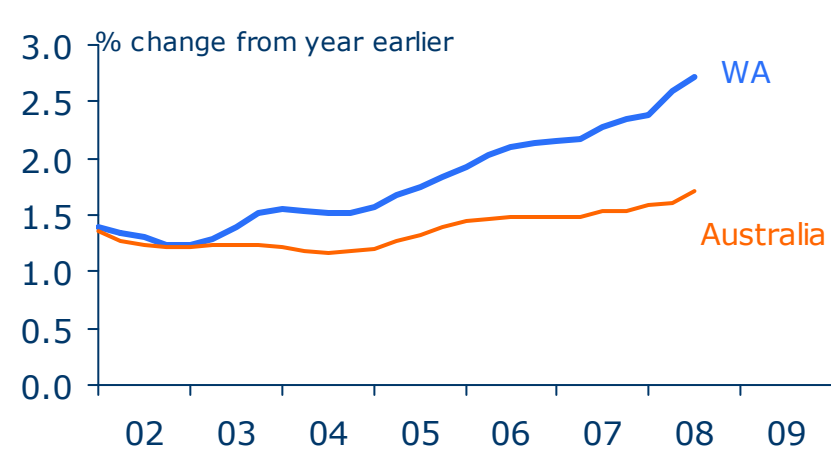


The end (for now) of the commodities boom will bring the WA economy back close to the 'national pack'

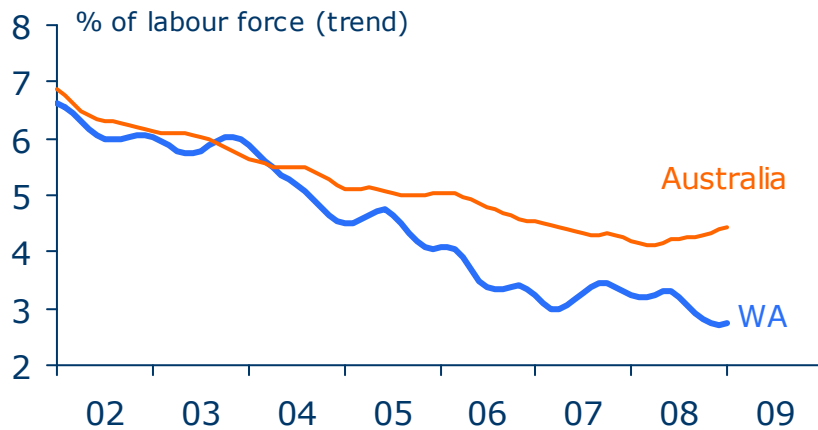
Economic growth



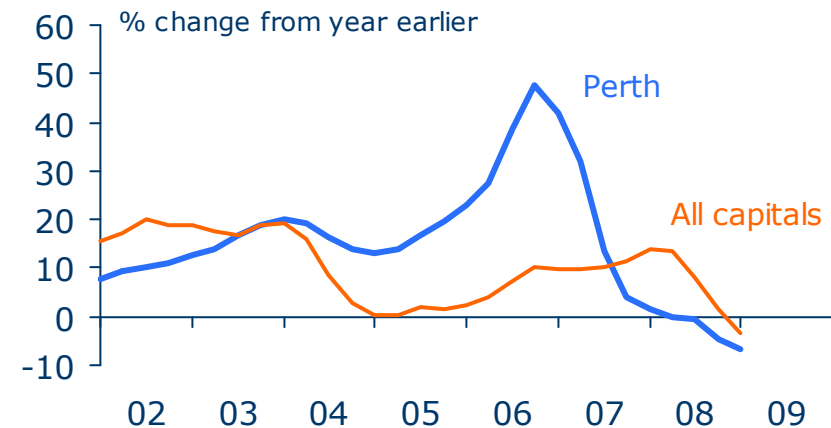
Population growth



Unemployment



House prices



Sources: ABS; WA Treasury; ANZ.



Major recessions always have consequences which persist for years if not decades after the recession has long passed

Lasting consequences of previous recessions

- 1974-75 recession
 - marked the end of the post-war era of strong growth & low unemployment
 - ushered in a period of persistently high inflation lasting 17 years
- 1982-83 recession
 - opened the way to the wide-ranging deregulation, search for market-based solutions to problems
 - followed by rapid growth in corporate leverage & external borrowing
- 1990-91 recession
 - ushered in an extended period of low inflation and low interest rates
 - which facilitated rapid growth in household leverage and in financial services
 - sustained increases in asset prices
 - interest rates the main instrument of economic policy – ‘power shift’ from Treasury to RBA

What will be the lasting effects of the 2009 recession?

- Re-regulation of the financial sector
 - part of a world-wide reaction to the financial excesses largely responsible for the current crisis and slump
- Slower growth in credit
 - reflecting impact of re-regulation on lending capacity of banks, tighter control of derivatives etc
 - and diminished demand for debt on the part of households
- Higher household saving rates
- Much more subdued growth in asset prices
 - the result of slower credit growth and more subdued economic growth
- More use of fiscal policy and less of monetary policy
 - a ‘power shift’ back from Sydney to Canberra

Forecast summary

	Economic forecasts				
	2007	2008	2009	2010	
World GDP growth (%)	4.7	3½	¾	2½	
Australian real GDP growth (%)	4.0	2¼	0	2	
Australian real GDI growth (%)	4.9	5½	-¾	¼	
Unemployment rate (year end, %)	4.3	4.5	6	7	
Inflation (year end, %)	3.0	3.8	3½	2½	
Housing starts ('000)	154	146	125	155	
Current account balance (\$bn)	-68.2	-52	-70	-85	
	Financial market forecasts				
	Dec 08	Jun 09	Dec 09	Jun 10	Dec 10
RBA cash rate (% pa)	4.25	2.75	2.50	2.50	3.00
10-year bond yield (% pa)	4.00	4.15	4.25	4.75	5.00
A\$-US\$	0.65	0.59	0.55	0.55	0.59
A\$-¥	63	59	56	59	66
A\$-€	0.52	0.49	0.50	0.51	0.52
A\$-NZ\$	1.13	1.27	1.24	1.20	1.19
Oil price (US\$/barrel)	41	40	50	58	62