

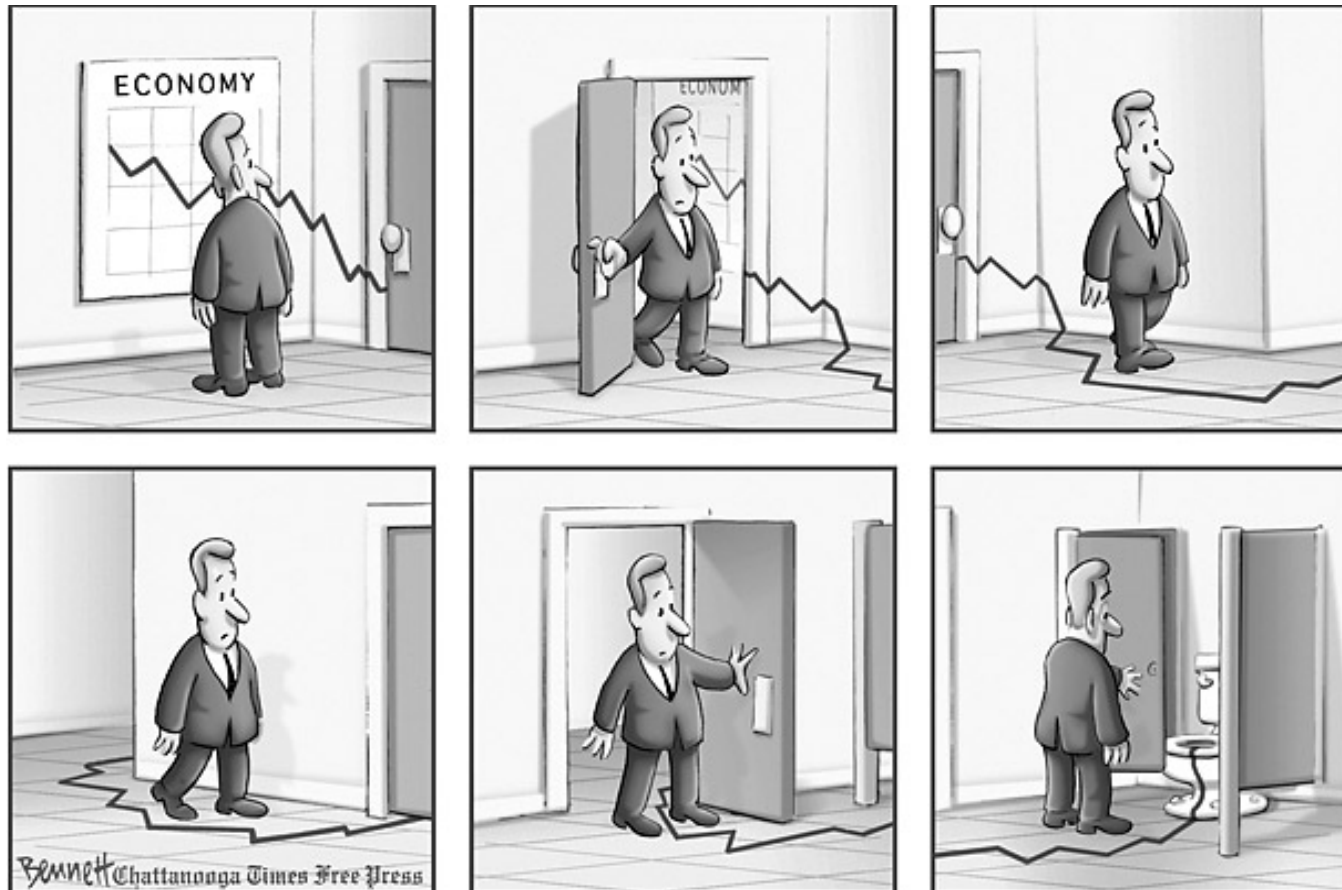
Open partnerships
Open possibilities

Economic Outlook for 2009

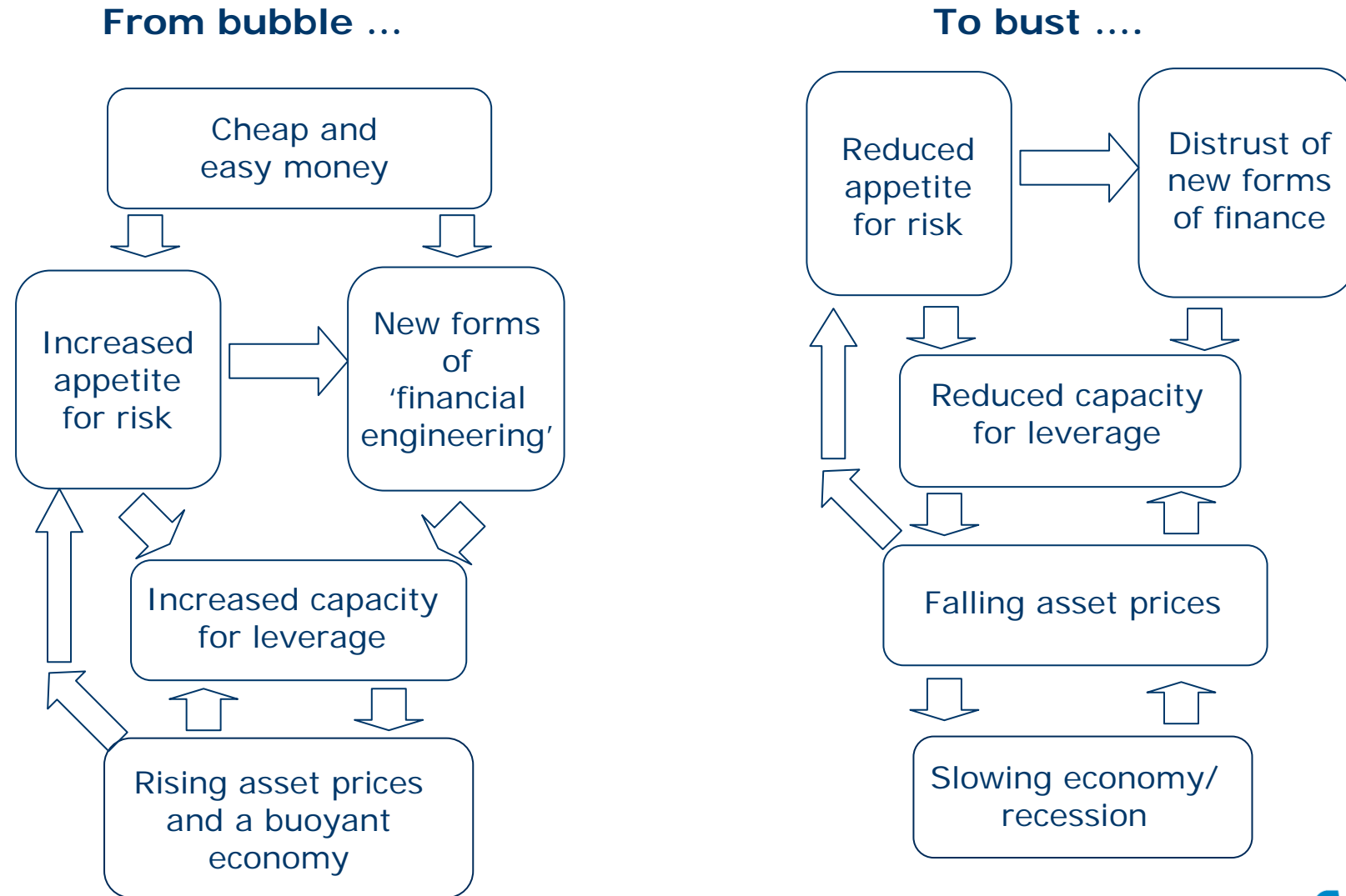
Presentation to CEDA Economic & Political Outlook
Hyatt Regency, Adelaide
16th February 2009

Saul Eslake
Chief Economist, ANZ

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

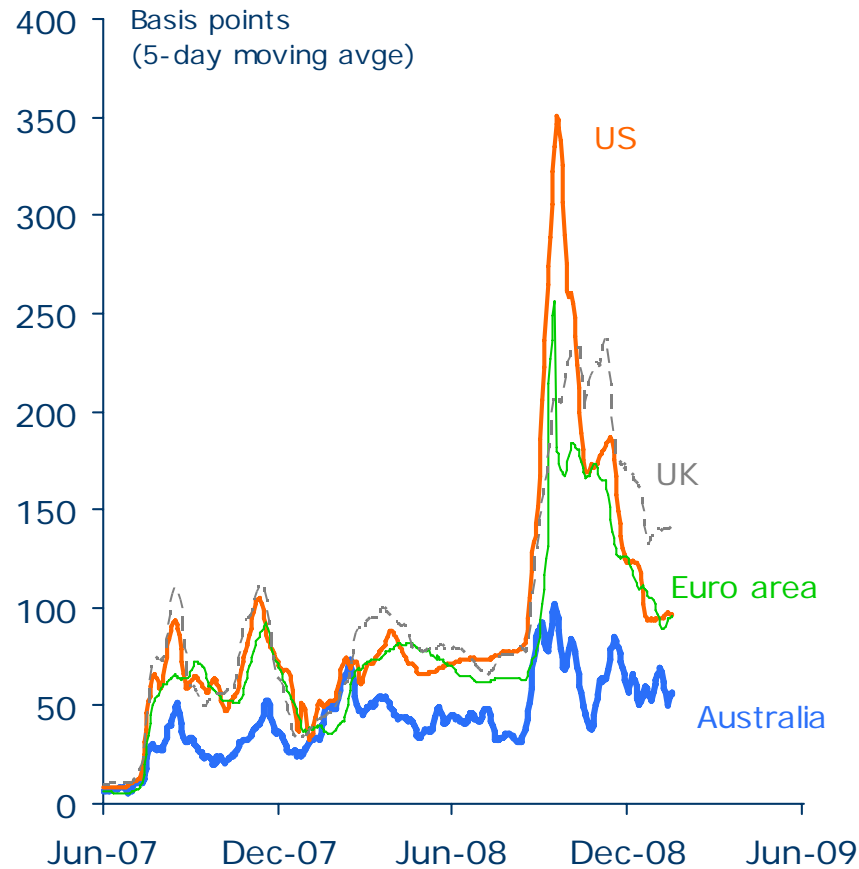


The current global financial crisis stems from the bursting of a 'credit market bubble'

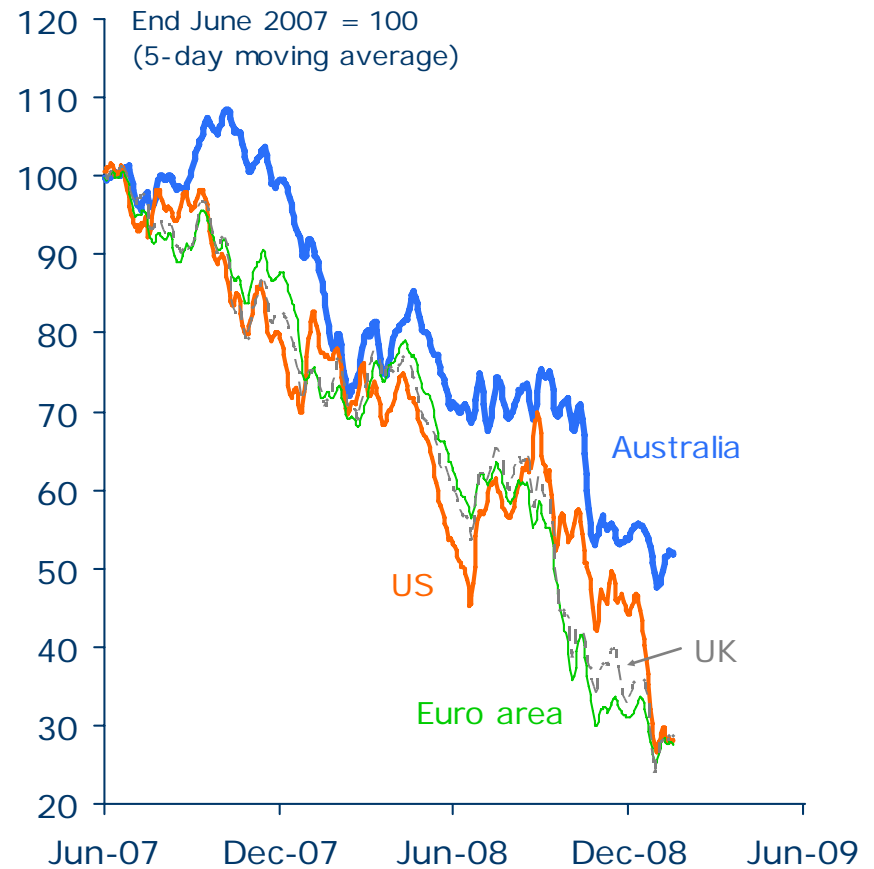


Governments & central banks have done enough to resolve concerns about bank liquidity, but not about bank solvency

Spreads between 3-month bank wholesale funding cost and official cash rates*



Bank share prices



* Strictly speaking, the spread between the 3-month Libor (or in Australia bank bill swap rate) and the 3-month overnight index swap (OIS) rate which measures market expectations of future changes in the official cash rate. 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*	258.7
Total	1,038.5

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

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

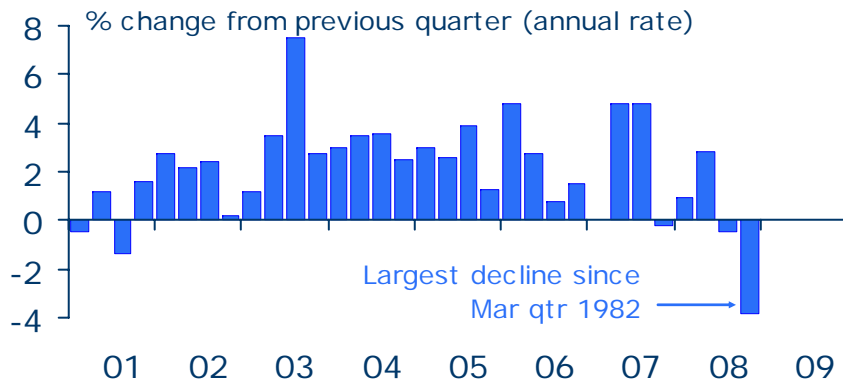
Banks may need another
US\$800-\$1,000bn more
in capital

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

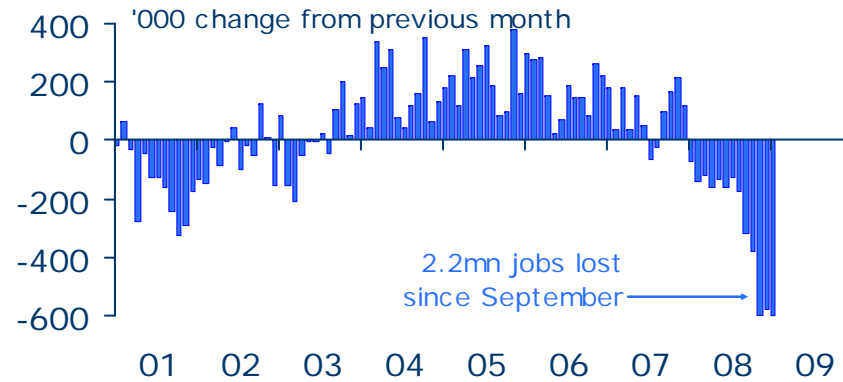
The US economy turned down sharply in the second half of last year – and the deterioration is continuing into 2009

US economic activity and labour market

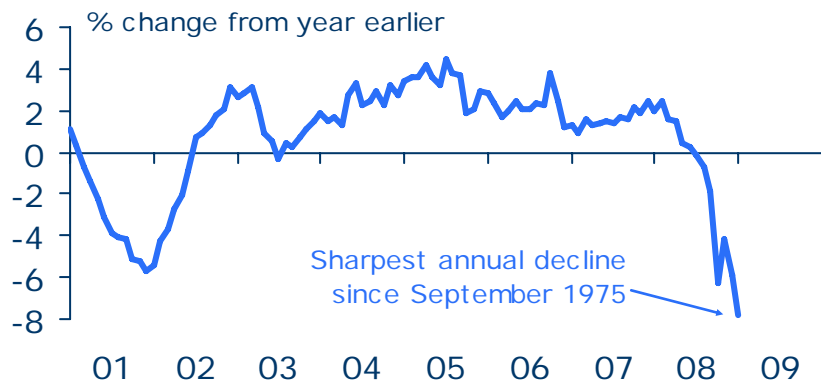
Real GDP



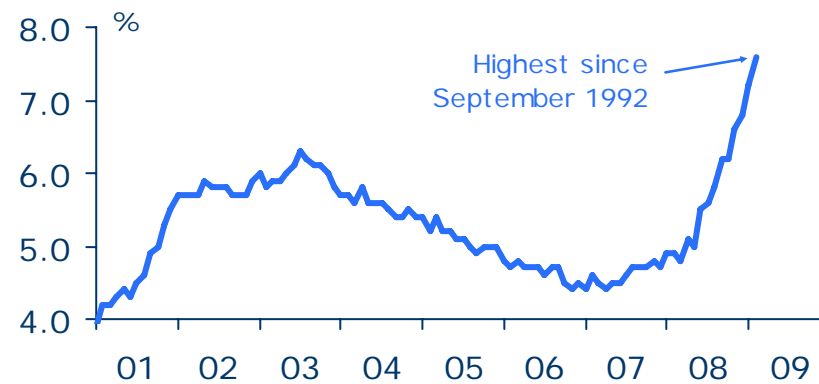
Employment



Industrial production



Unemployment rate



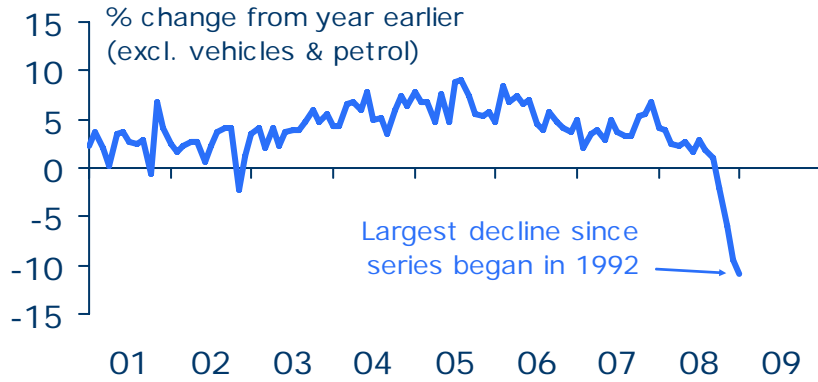
Sources: US Bureau of Economic Analysis; Federal Reserve; Bureau of Labor Statistics.



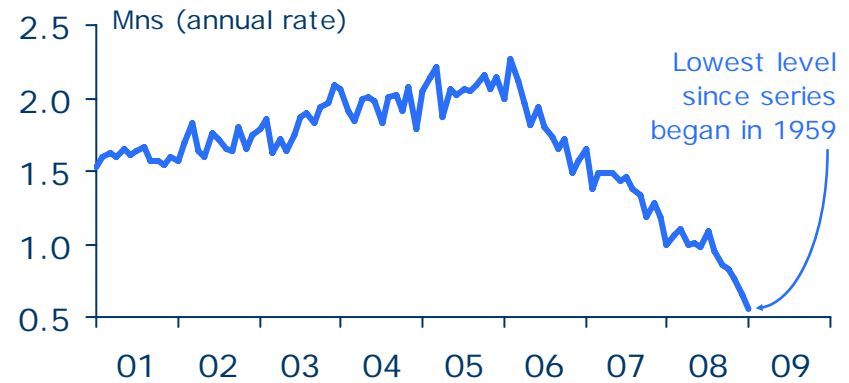
American consumers have been cutting back spending sharply – and businesses have started to cut back too

US consumer and business spending

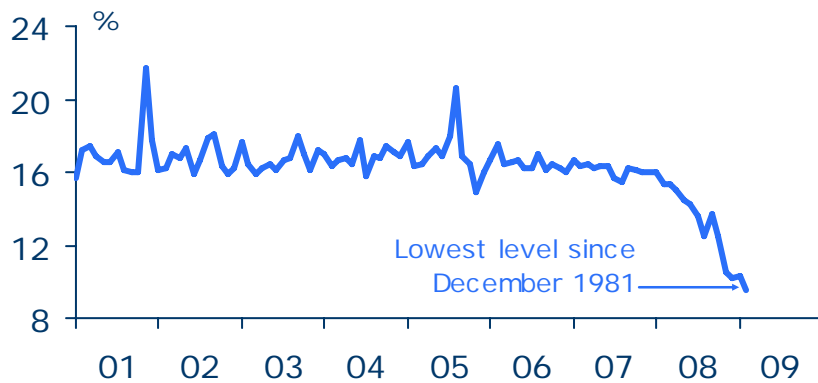
Real retail sales



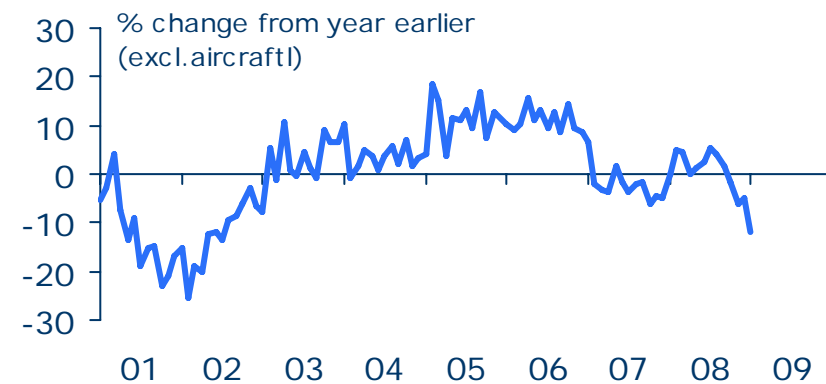
Housing starts



Motor vehicle sales



Non-defence capital goods orders



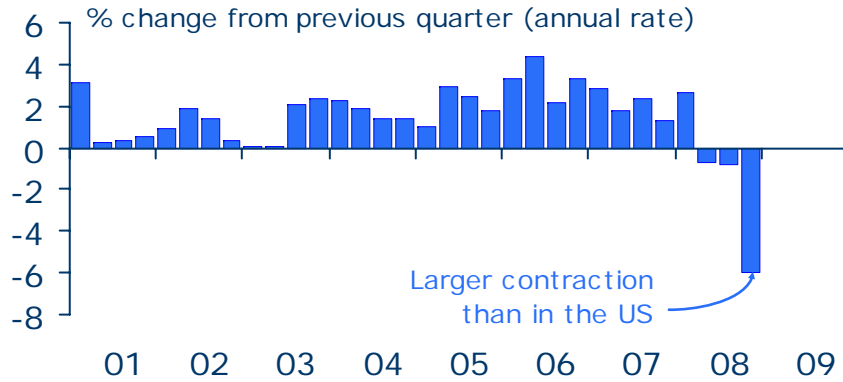
Source: US Commerce Department.



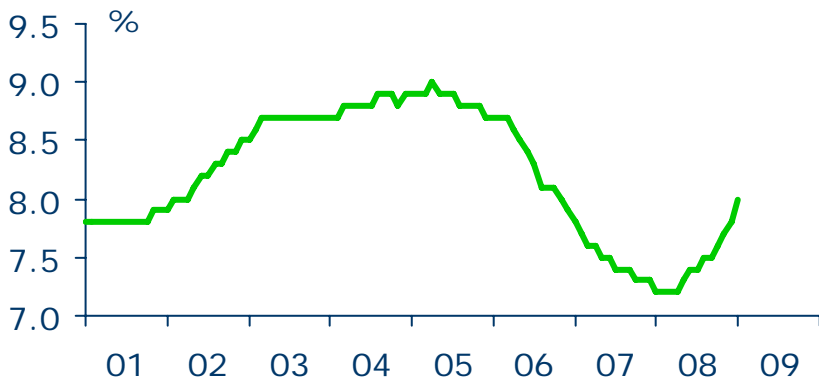
The downturns in the euro area and the UK have been more severe than that in the United States

Euro area

Real GDP

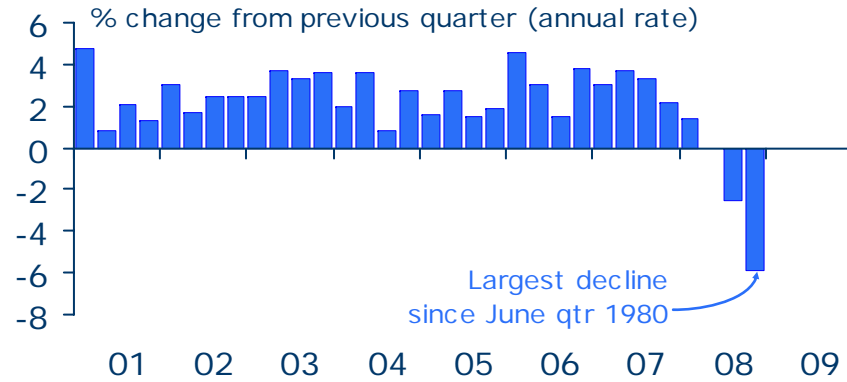


Unemployment

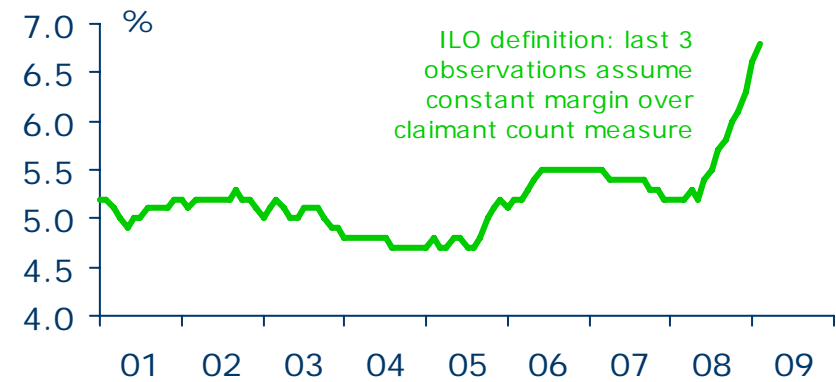


United Kingdom

Real GDP



Unemployment



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



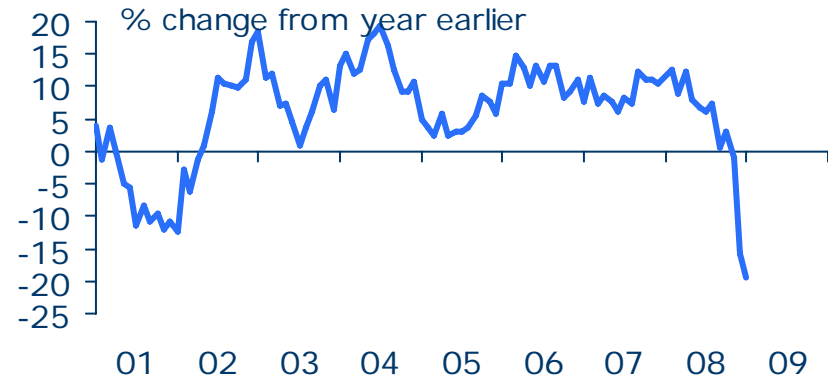
Japan's economy experienced a dramatic downturn at the end of 2008

Japan

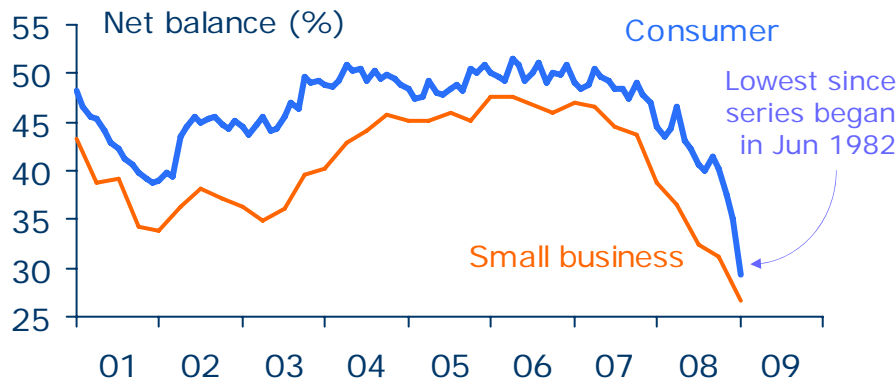
Industrial production



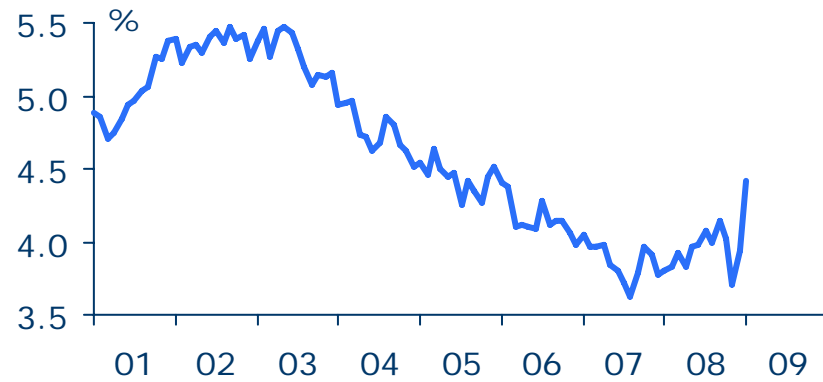
Export volumes



Consumer confidence



Unemployment



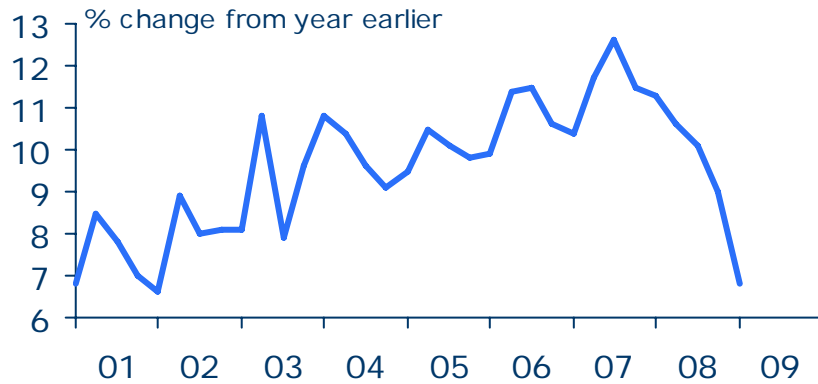
Sources: Japan Economic & Social Research Institute; Ministry of Economy, Trade and Industry; Japan Home Ministry.



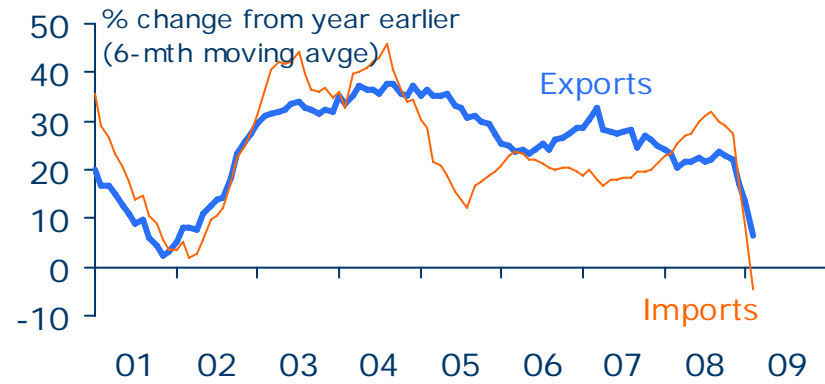
China slowed markedly late last year, partly because of weaker exports, also as a result of the collapse of China's own bubble` ¹⁰

Chinese economic indicators

Real GDP growth



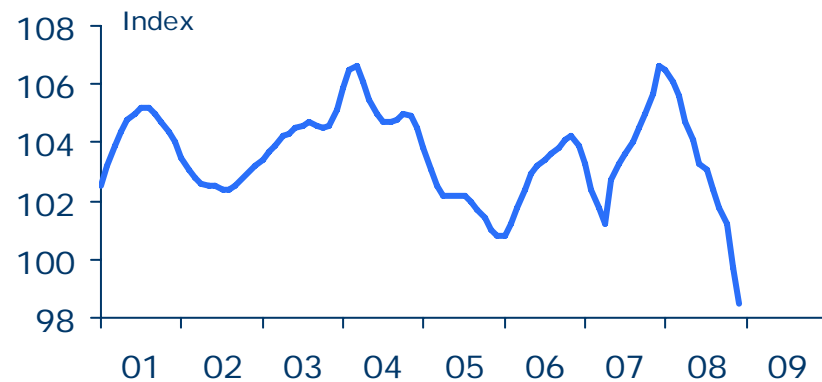
Exports



Industrial production



Real estate climate index

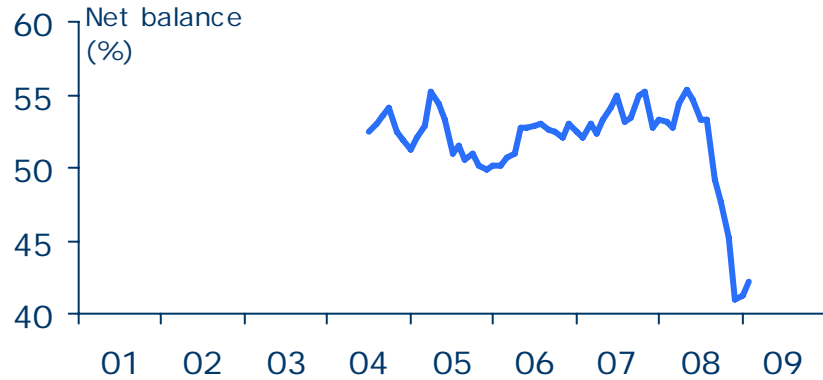


Source: China National Statistics Bureau; ANZ.

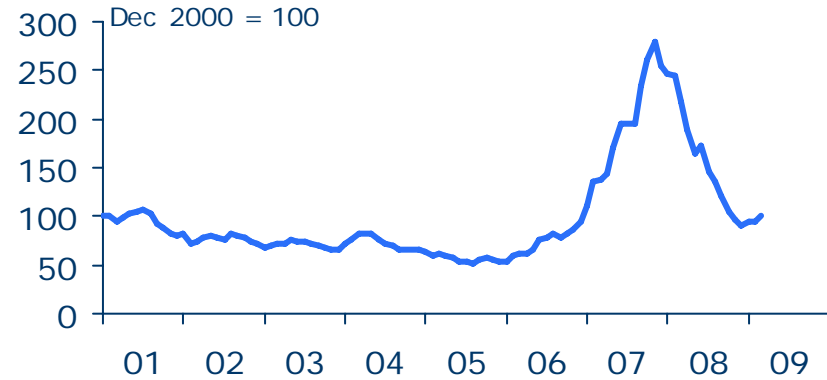


There are some 'straws in the wind' tentatively suggesting that China's strenuous efforts to revive growth may be taking hold ¹¹

Purchasing managers' index



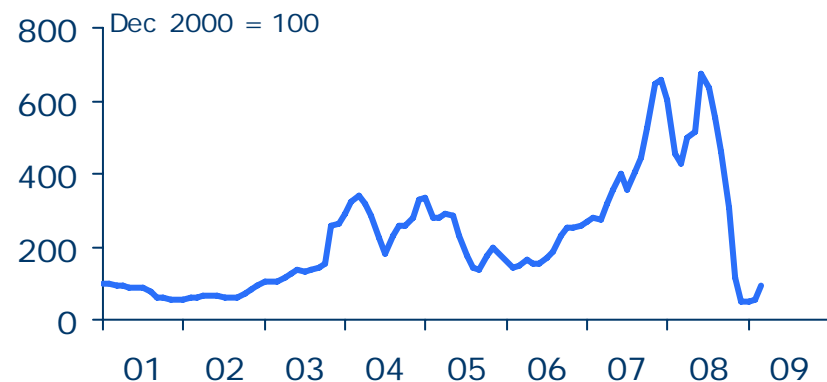
Shanghai composite index



Bank lending



Shipping freight costs



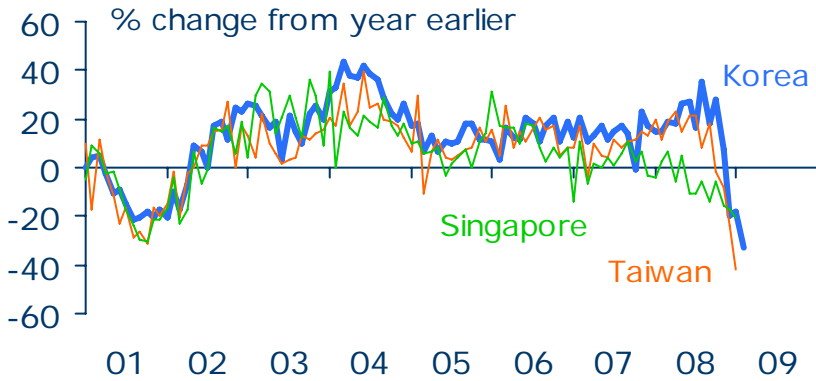
Source: CLSA; People's Bank of China; Datastream



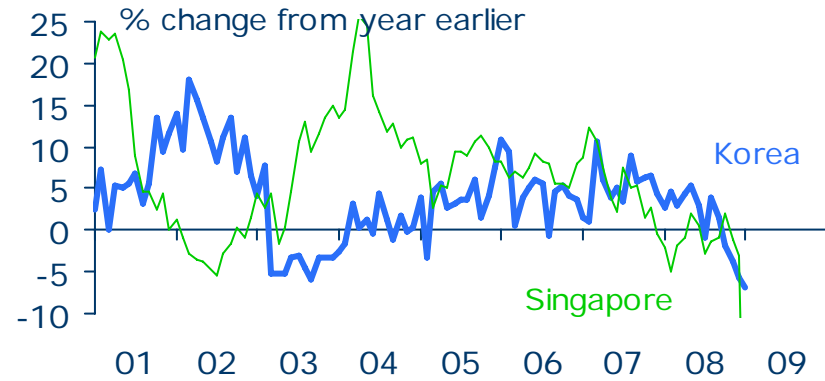
Export-intensive smaller East Asian economies have been dragged into the global slowdown

Smaller East Asian economies

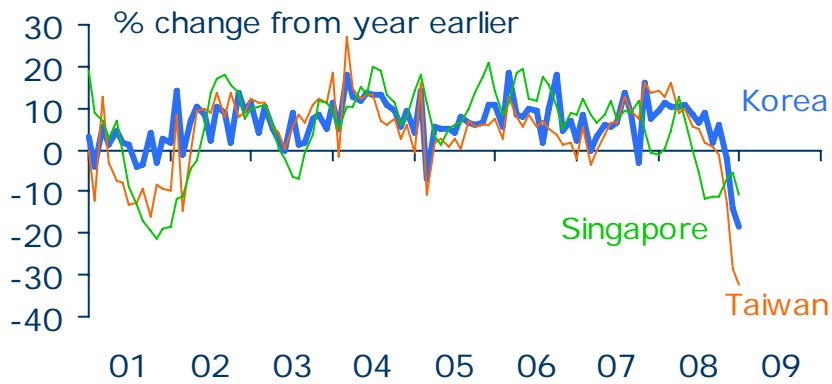
Exports



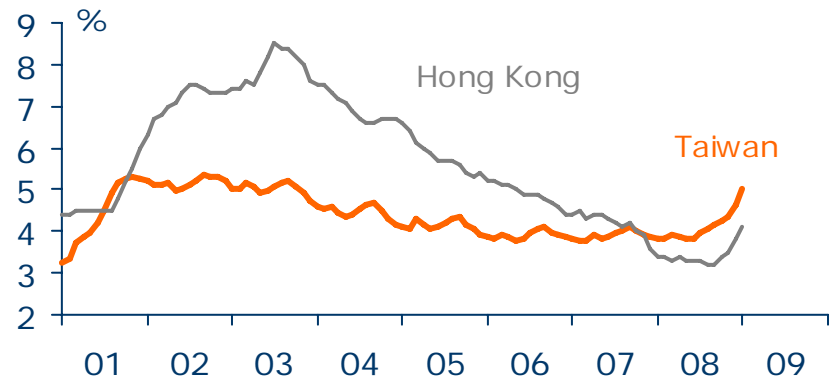
Retail sales



Industrial production



Unemployment

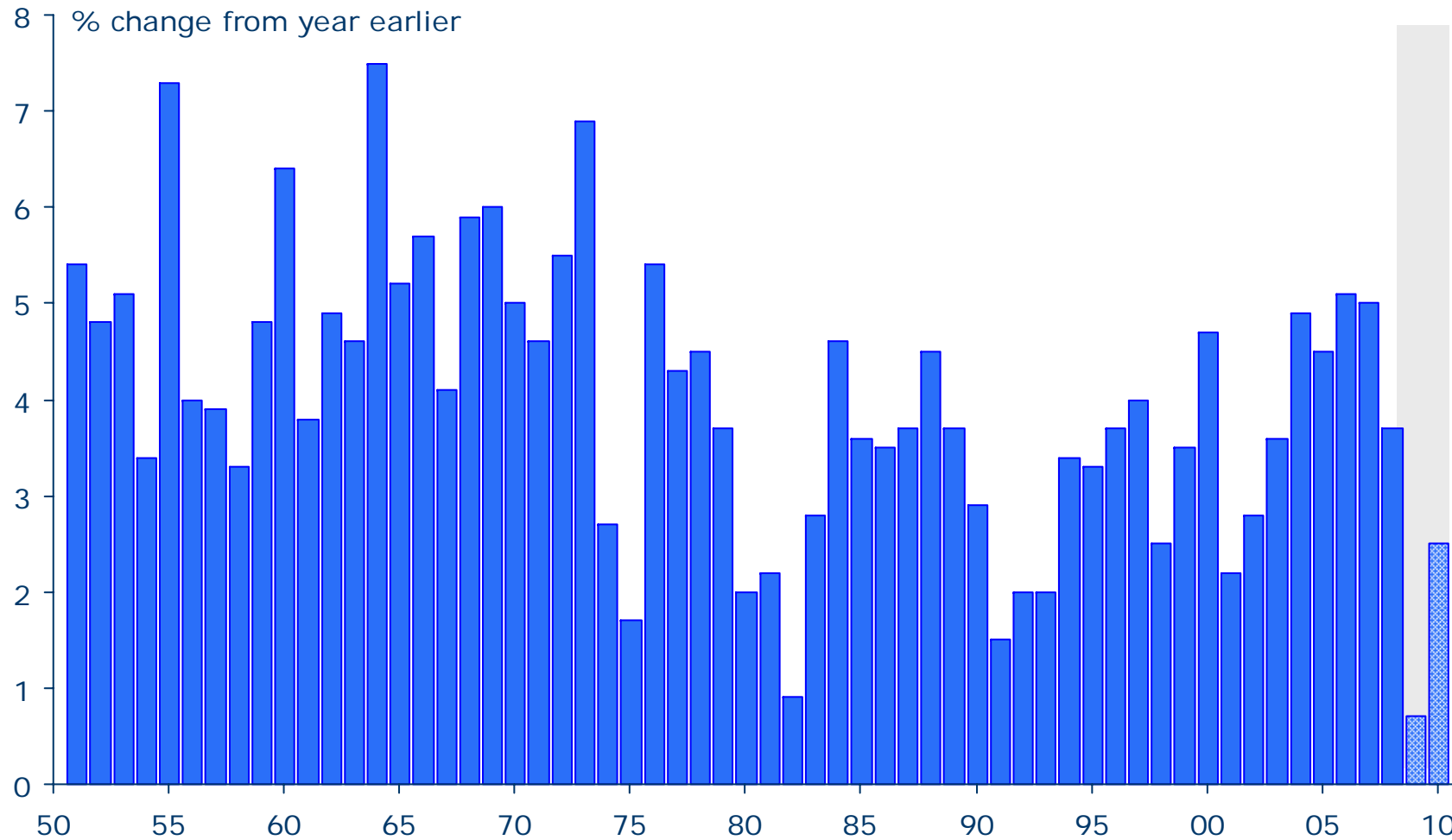


Sources: CEIC; Datastream; ANZ.



Global economic growth will be weaker in 2009 than in any year since the end of World War II ¹³

Global economic growth 1950-2010



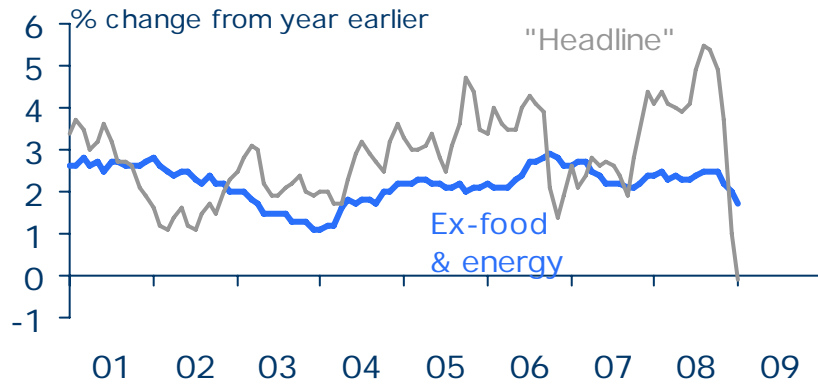
Sources: The Conference Board Total Economy Database (1950-70); IMF (1971-2008); ANZ (2009-10).



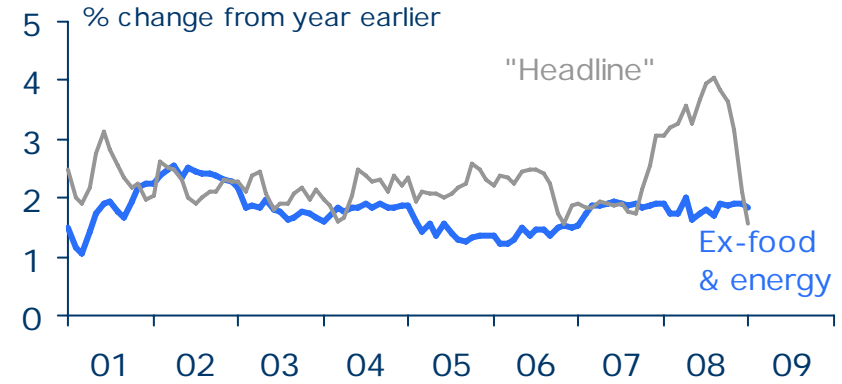
'Headline' inflation has fallen sharply in advanced economies, and core inflation is easing too – deflation is a risk for some

Consumer prices – major industrialized economies

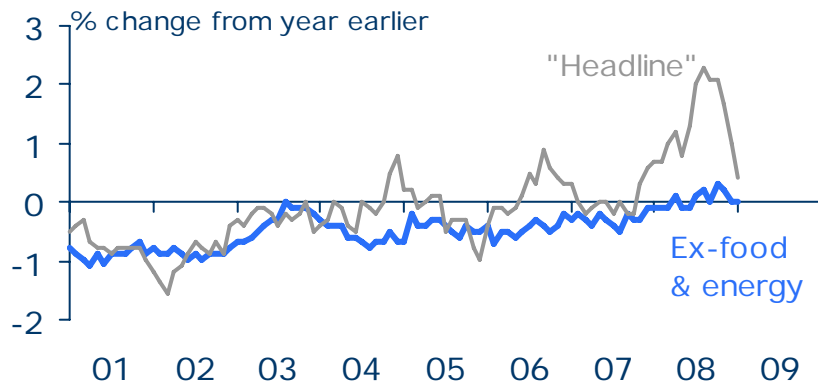
United States



Euro area



Japan



United Kingdom

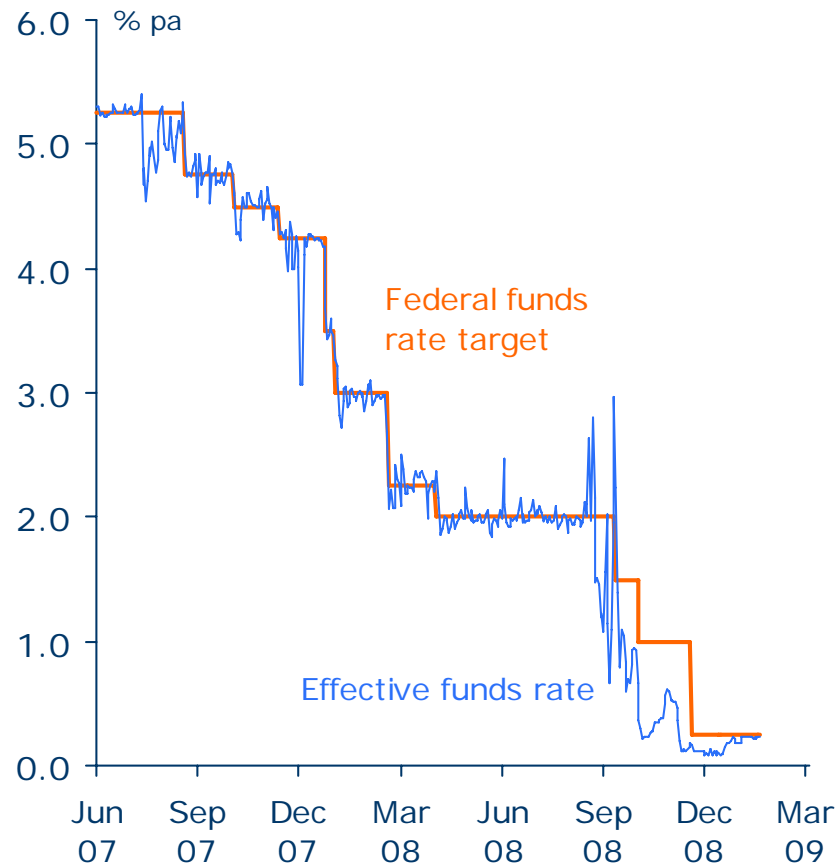


Sources: US Bureau of Labor Statistics; Eurostat; UK Office of National Statistics; CEIC.

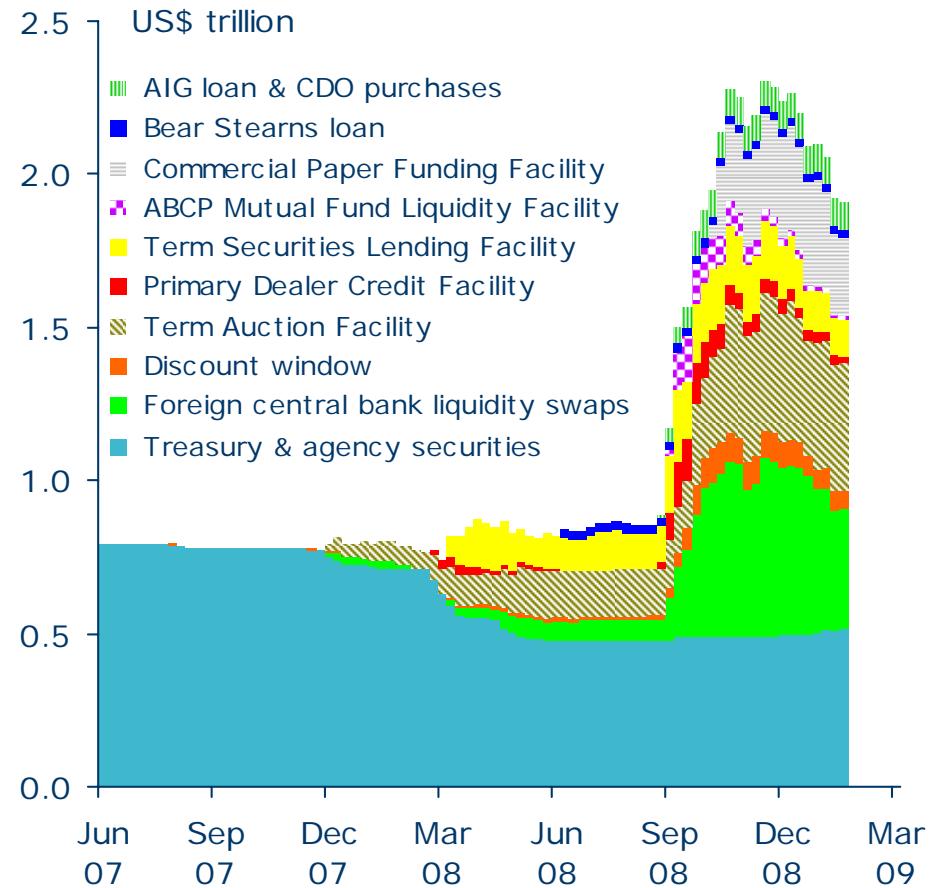


With its cash rate effectively at zero the Fed has resorted to a form of 'quantitative easing'

Target and effective Fed funds rate



Assets on the Federal Reserve's balance sheet

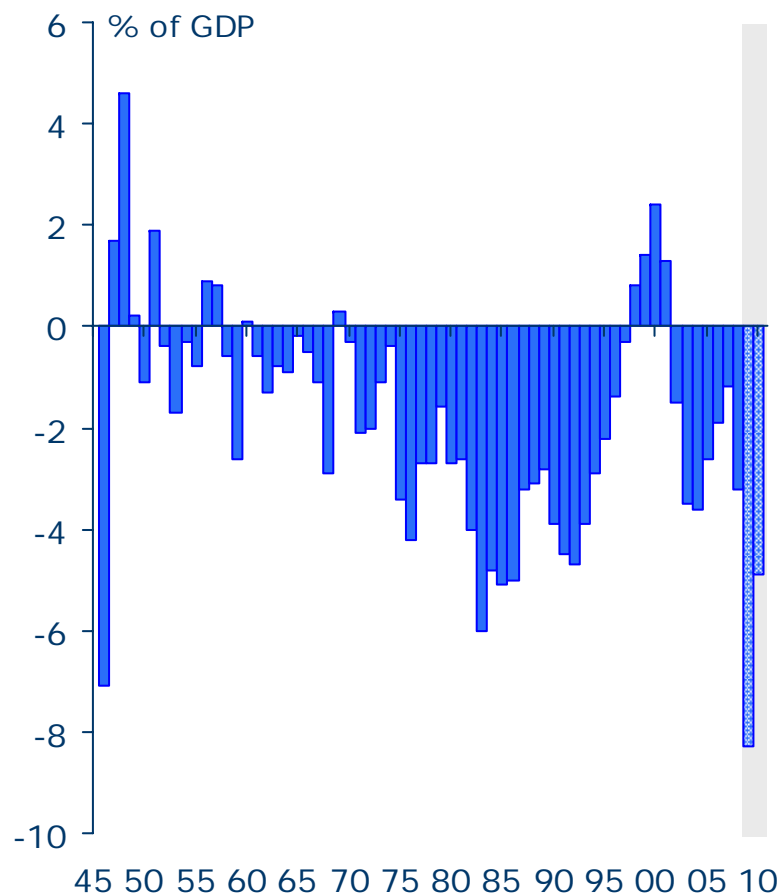


Source: US Federal Reserve Board H.4.1 Statistical Release, *Factors Affecting Reserve Balances*; Datastream.

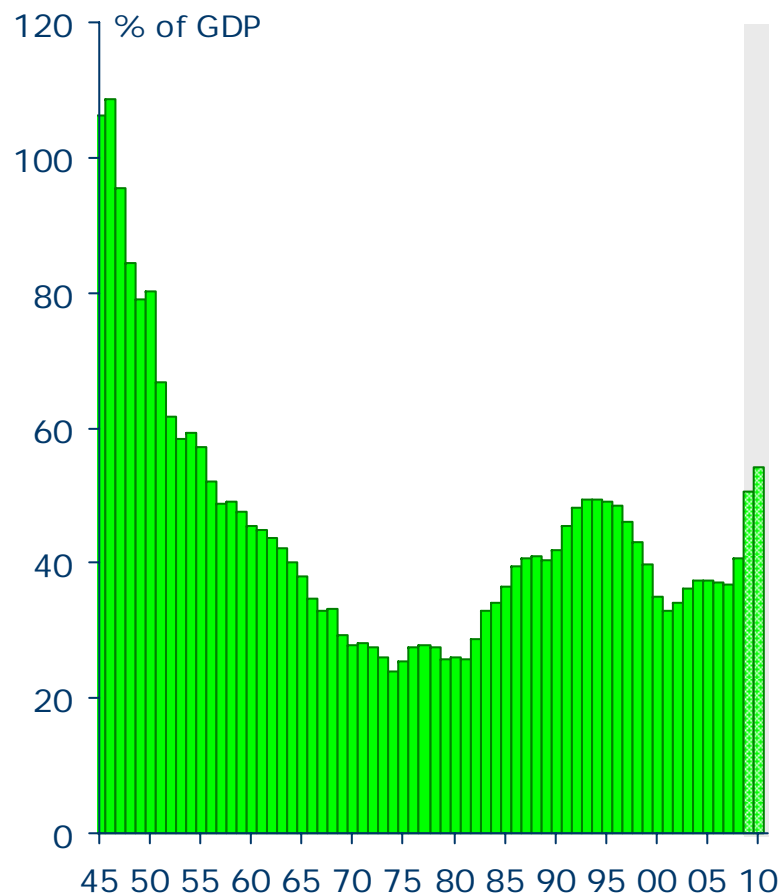


Fiscal policy has to shoulder a greater burden, pushing government debt up sharply but not to unprecedented levels

US Federal budget balance



US Federal Government debt



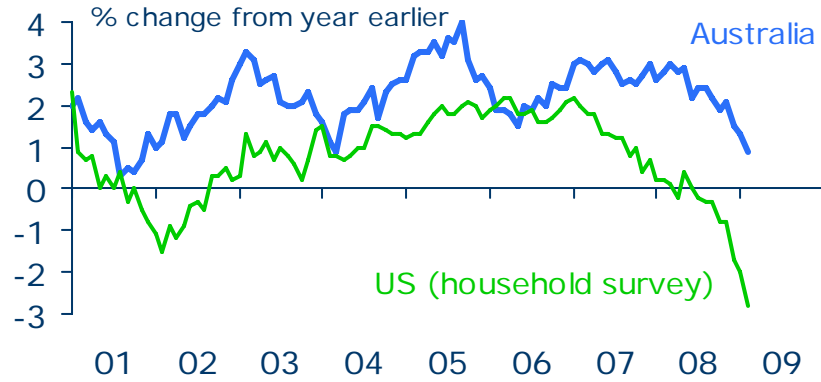
Note: Figures for Federal Government debt exclude debt held by other Federal agencies such as the Social Security Trust Fund. *Source:* Congressional Budget Office, January 2009.



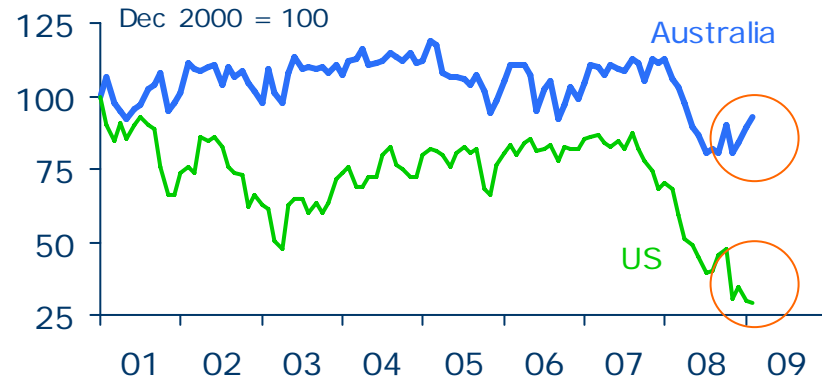
Australia's economy has thus far held up considerably better than America's ...

Australian and US labour market and household spending

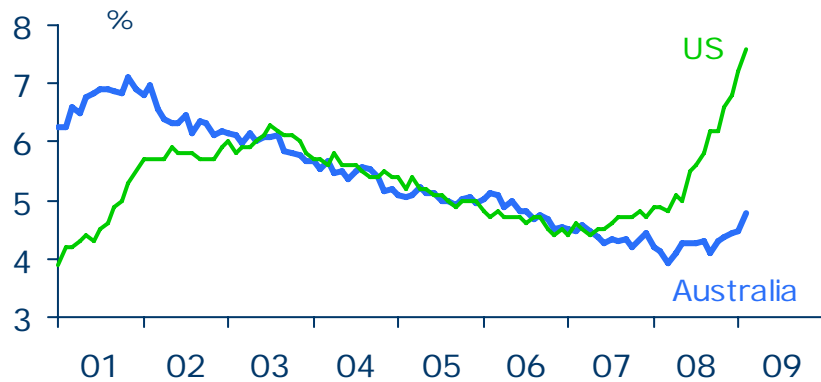
Employment



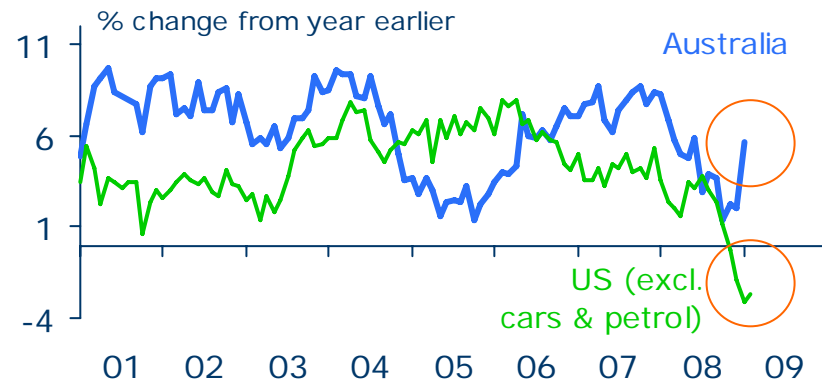
Consumer confidence



Unemployment rate



Retail sales



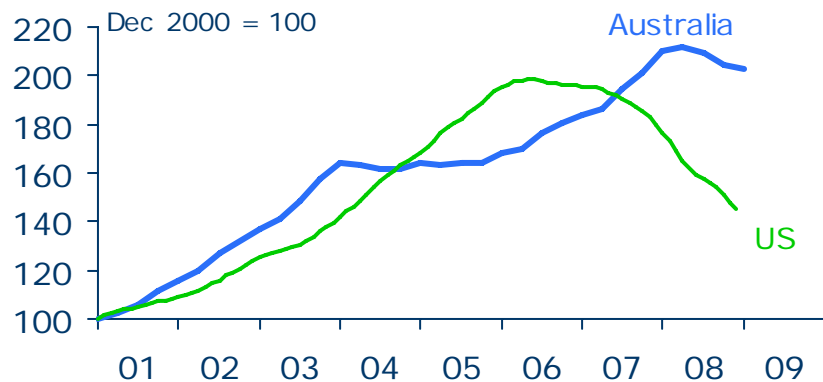
Sources: ABS; US Bureau of Labor Statistics; The Conference Board; Roy Morgan Research; US Commerce Department; ANZ.



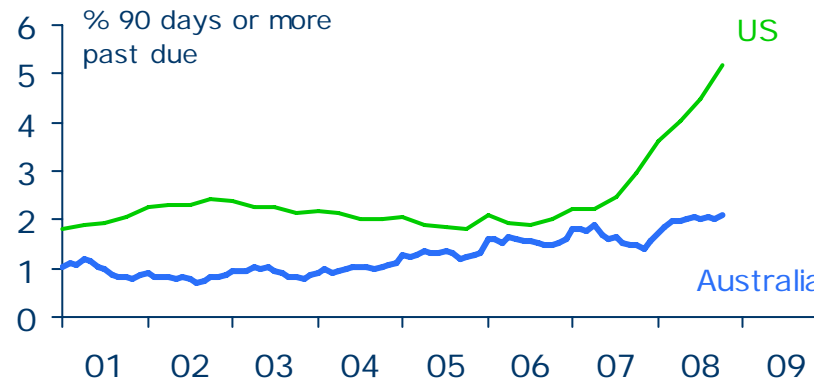
.. partly because Australia's housing market and banking system have remained stronger than America's

Australian and US housing markets and household finances

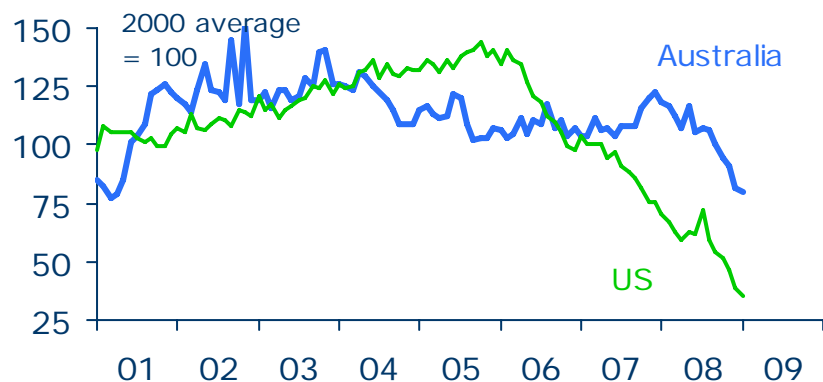
House prices



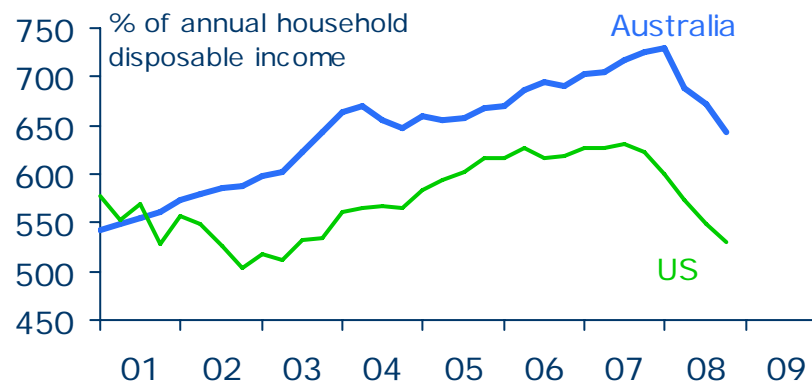
Mortgage delinquency rates



Housing approvals



Household net worth

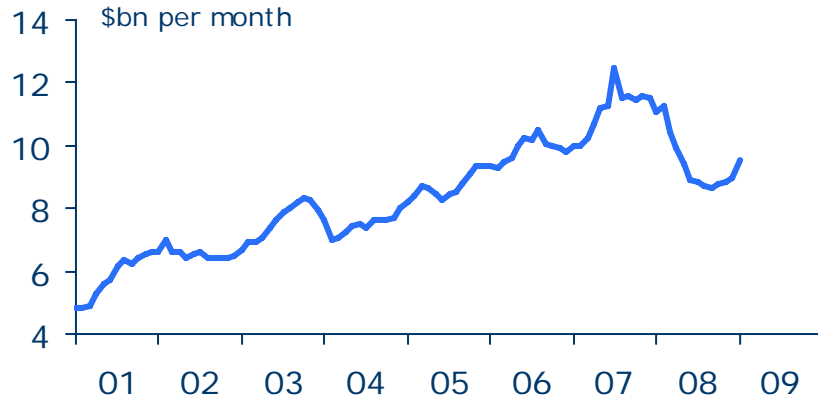


Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: ABS; S&P; US Federal Reserve; Mortgage Bankers' Association of America; US Commerce Department; ANZ.



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

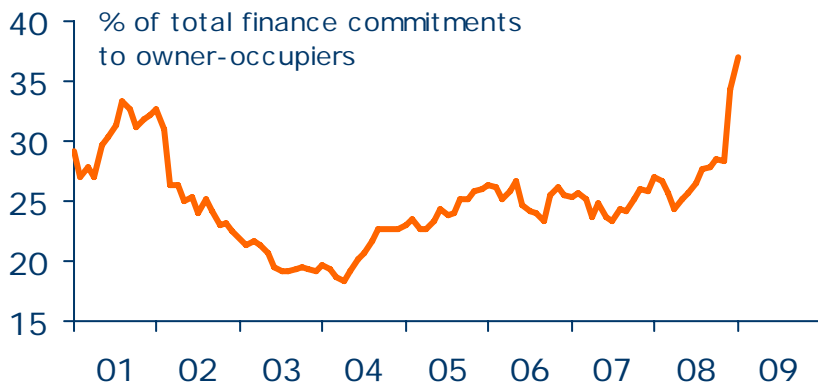
Housing finance commitments to owner-occupiers



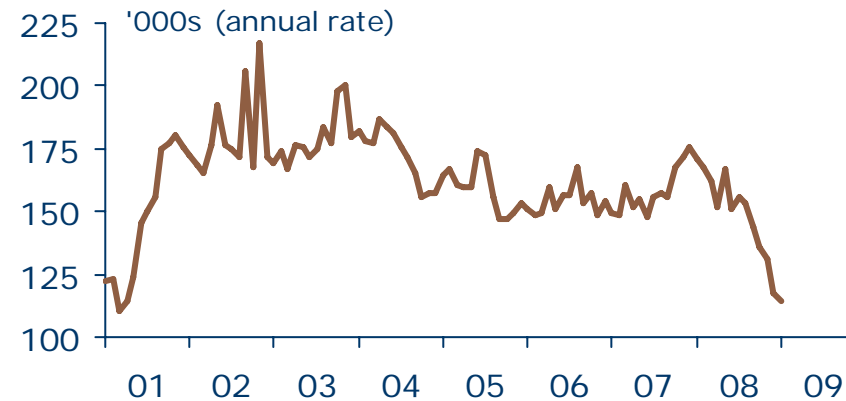
Housing finance commitments to investors



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



Residential building approvals by local governments

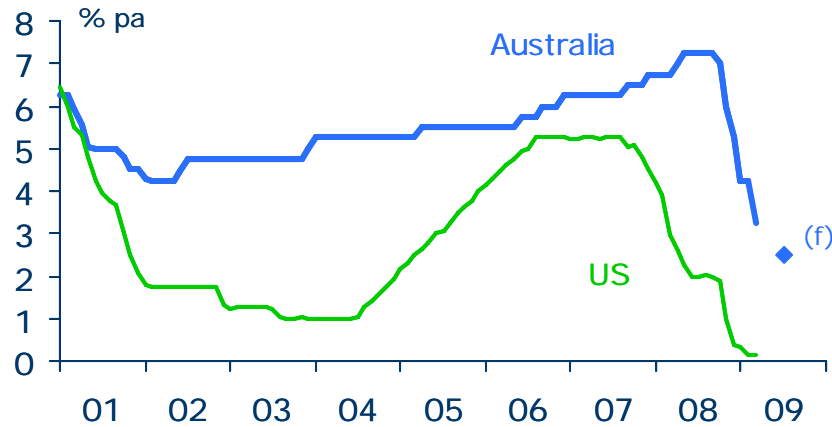


Sources: ABS; ANZ.

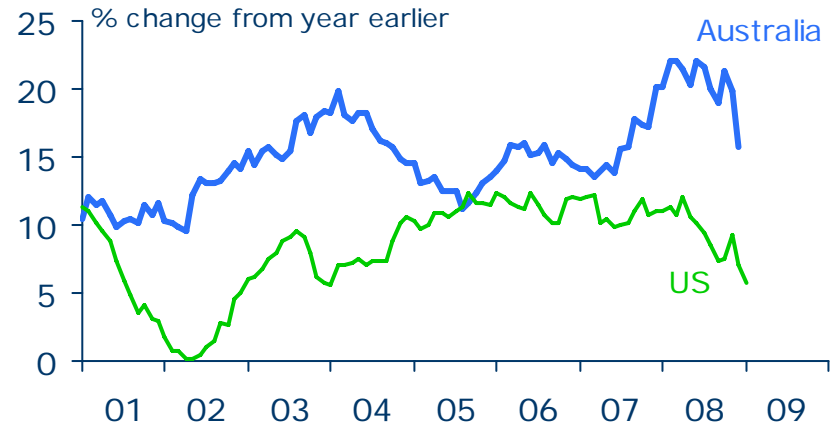


Monetary policy is 'working' more effectively in Australia than in the US, in part because the banking system is in better shape ²⁰

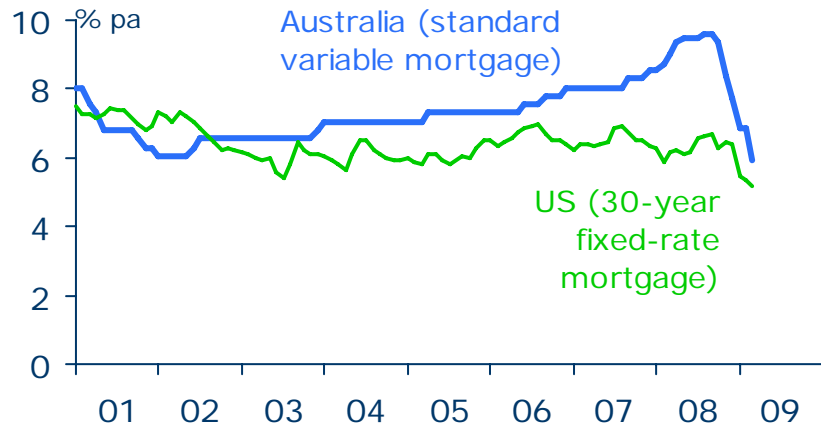
Official interest rates



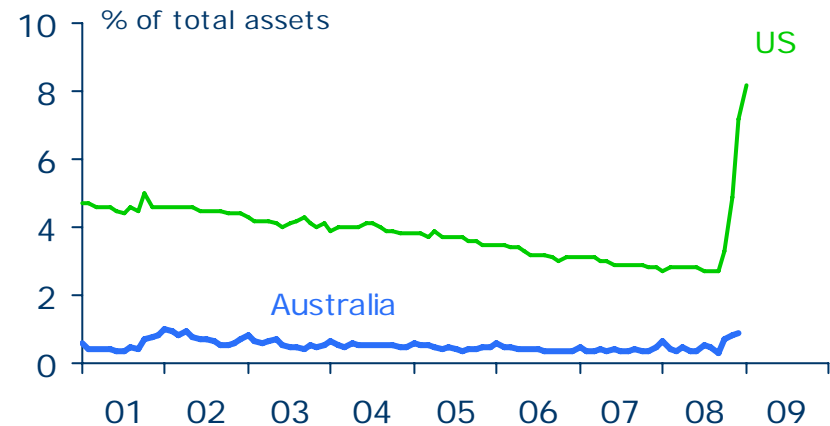
Bank lending



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.



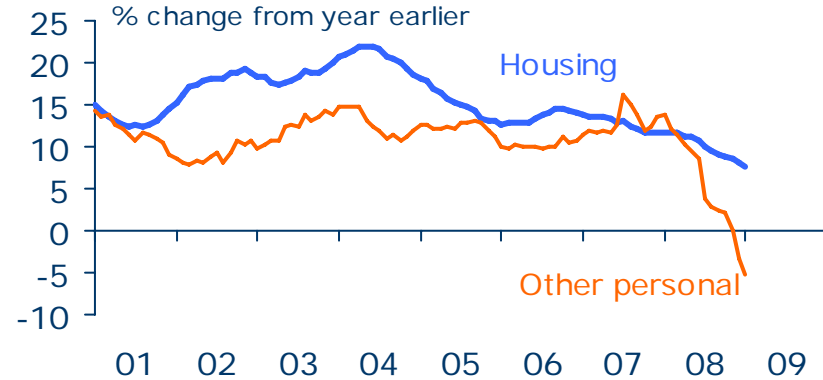
Nonetheless both the demand for and supply of credit to Australian households and businesses is slowing

Credit provided to the Australian private sector

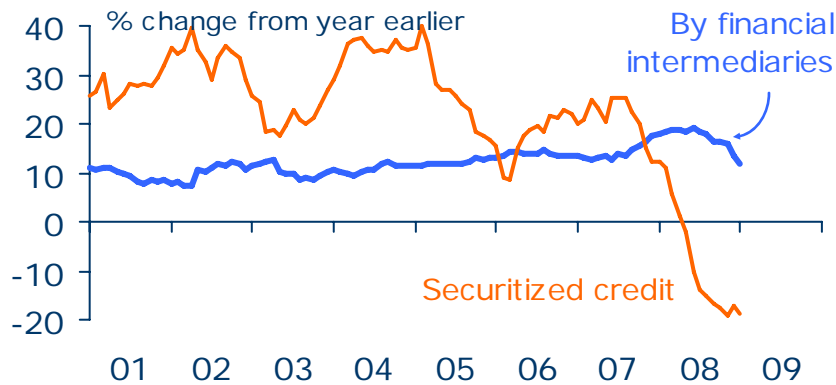
Total credit



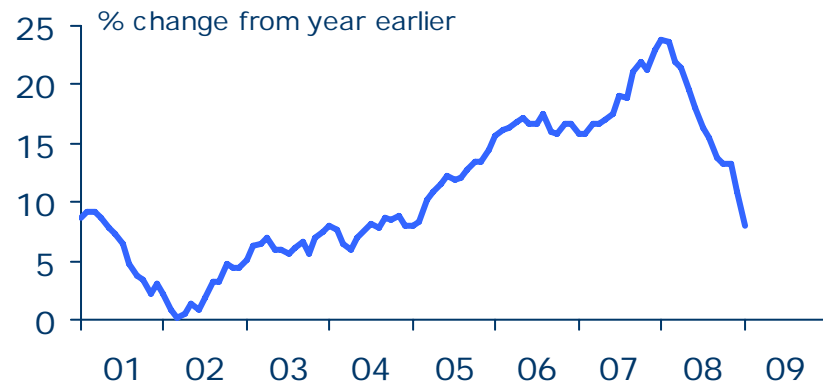
Credit to households



Credit by source



Credit to business

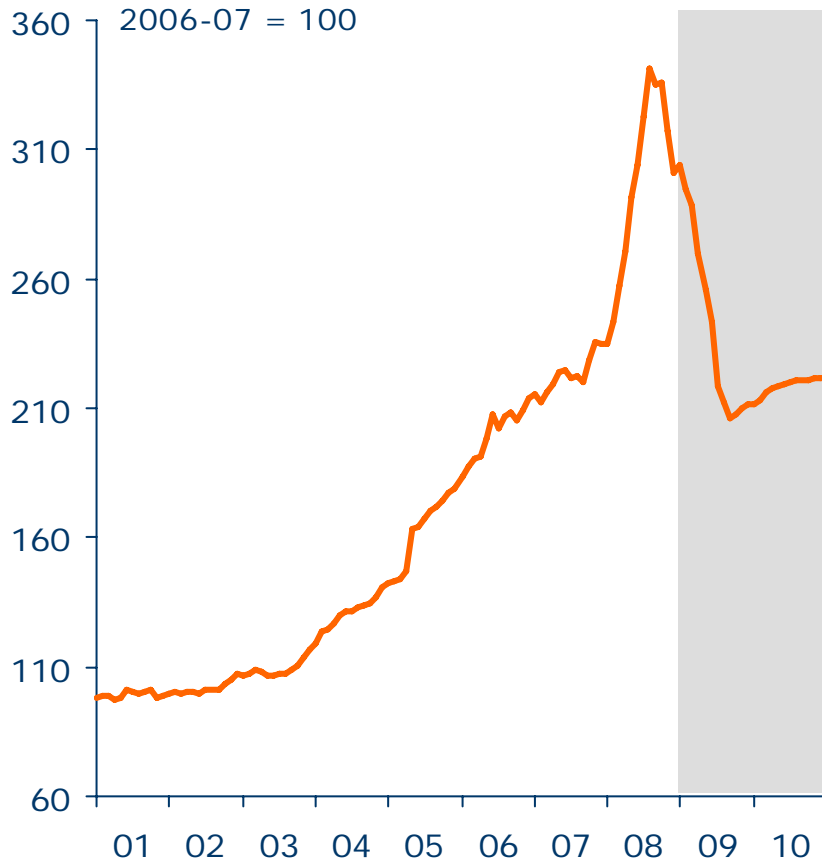


Source: Reserve Bank of Australia.

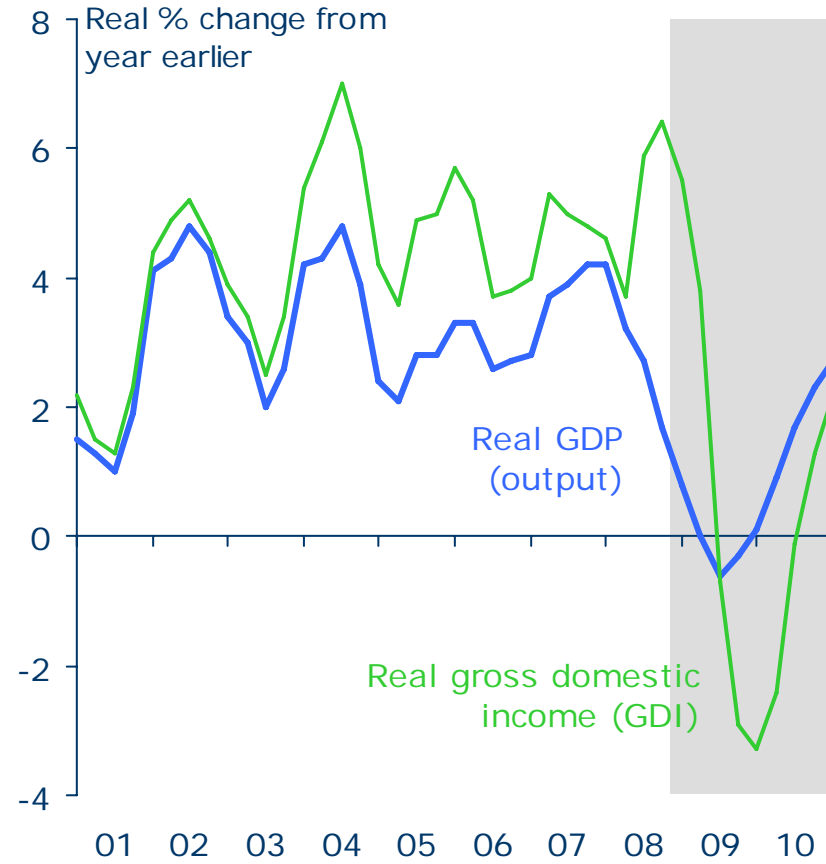


The sharp fall in commodity prices will detract substantially from Australian national income in 2009 ²²

Australian export commodity prices



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

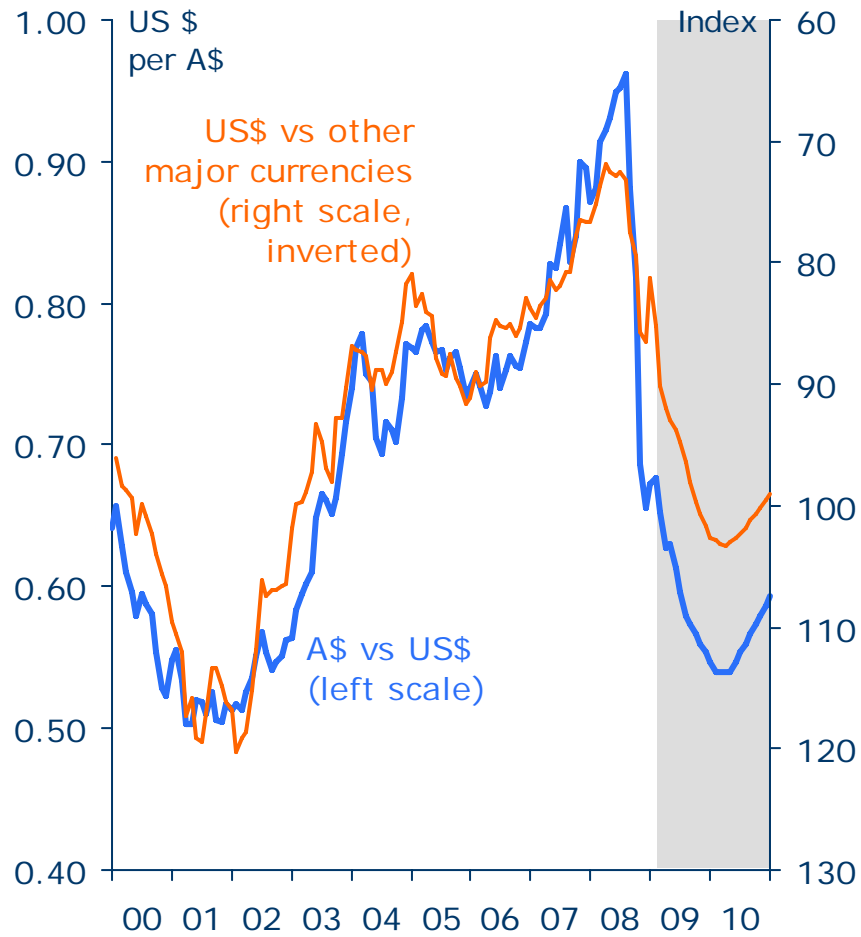


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

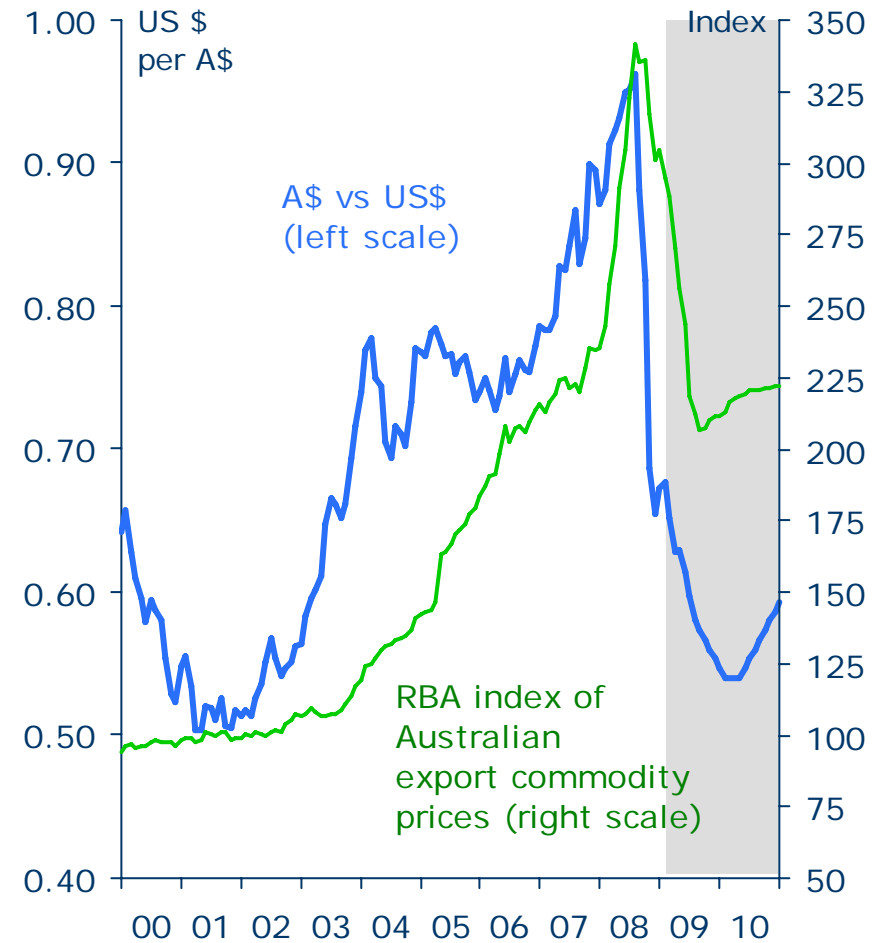


The A\$ will fall further against a resilient US\$ - though this will help cushion the economy and resist deflation ²³

A\$ vs US\$



A\$ & commodity prices

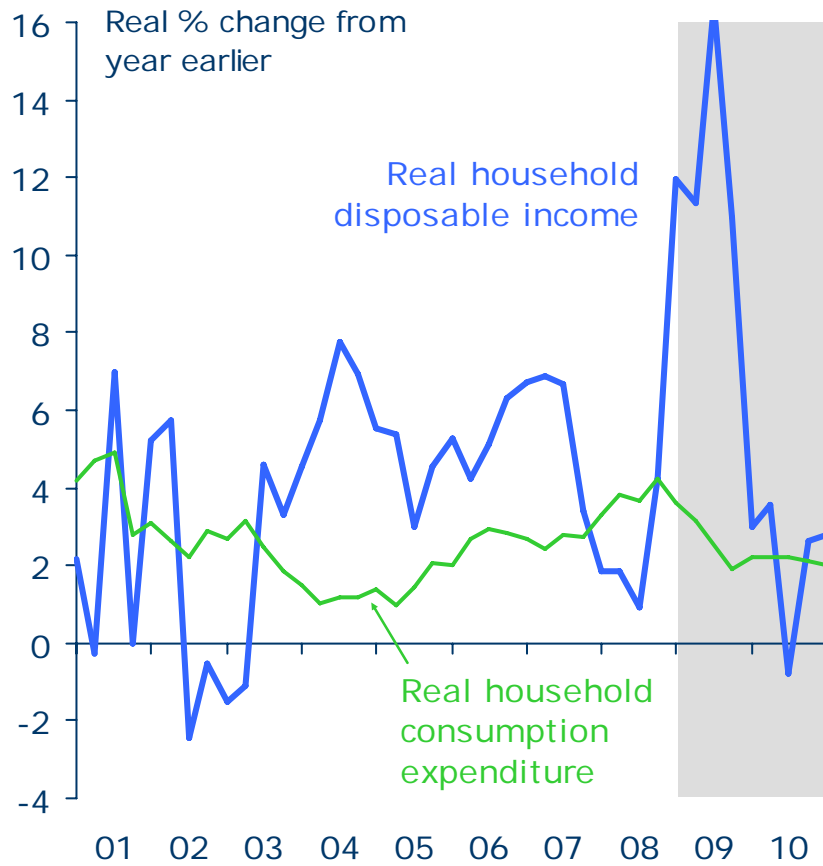


Sources: Datastream; US Federal Reserve; RBA; ANZ.

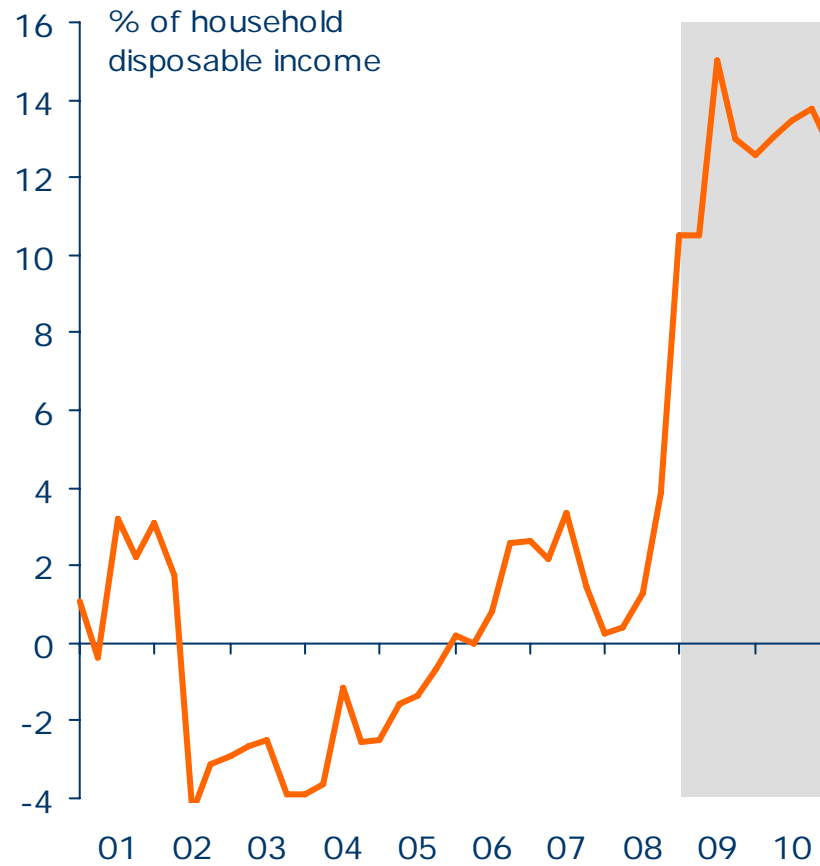


Cash handouts, interest rate cuts, and lower petrol prices will boost household incomes substantially – but a lot of it will be saved 24

Household disposable income and spending



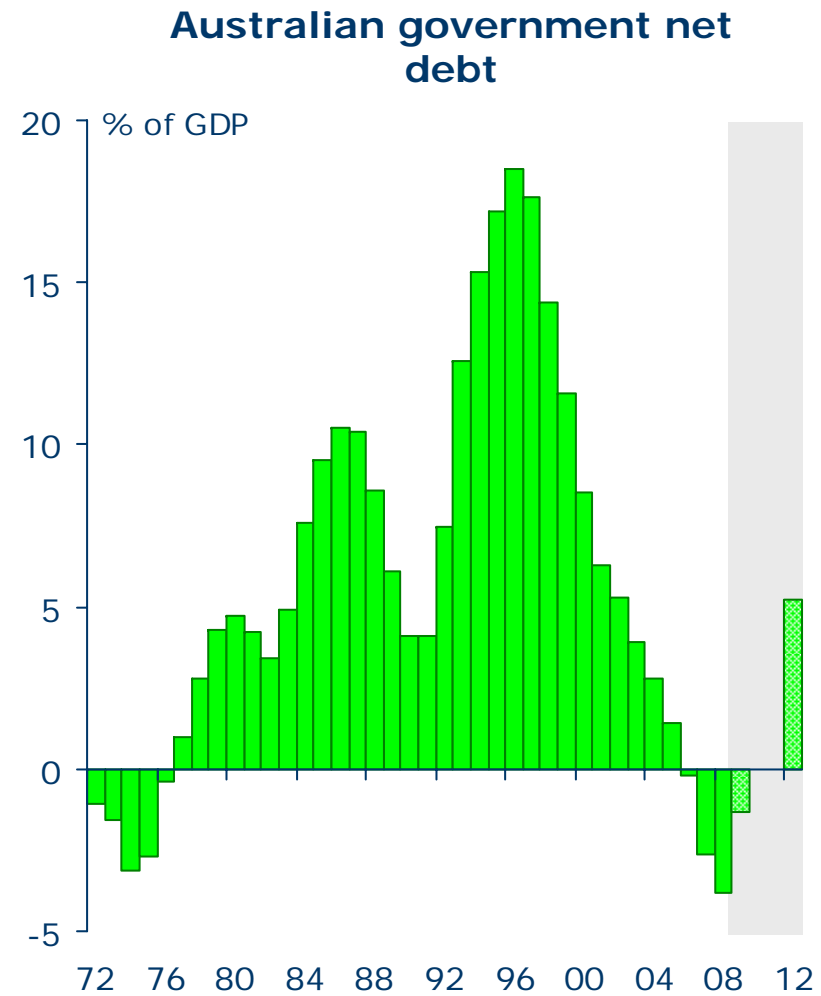
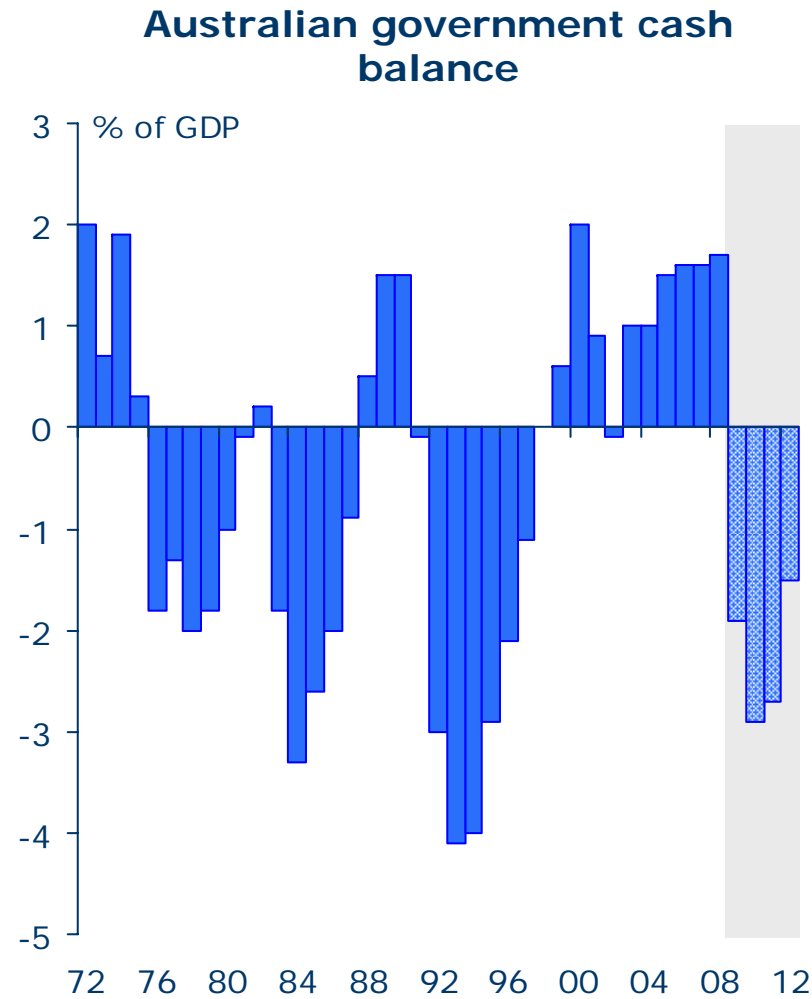
Household saving rate



Sources: ABS; ANZ.



The budget deficits and resulting government net debt are by no means unprecedented ²⁵

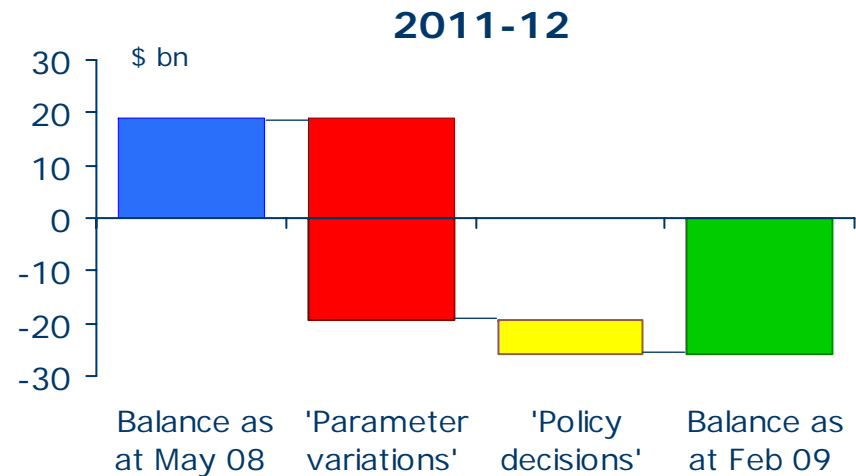
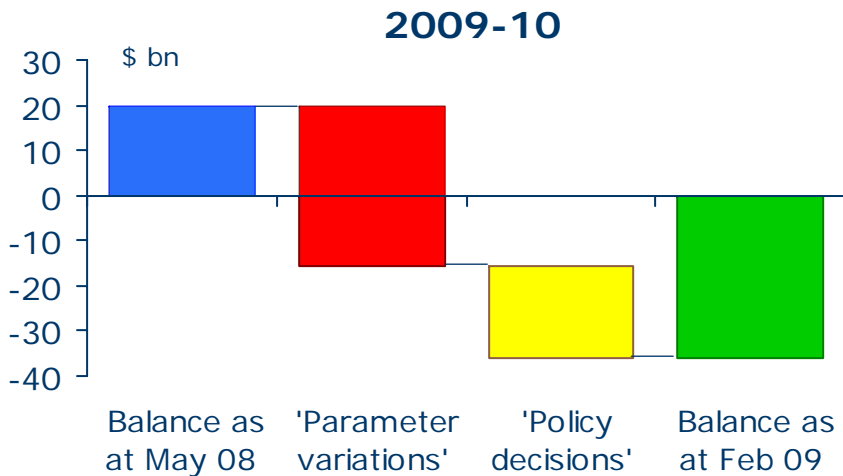
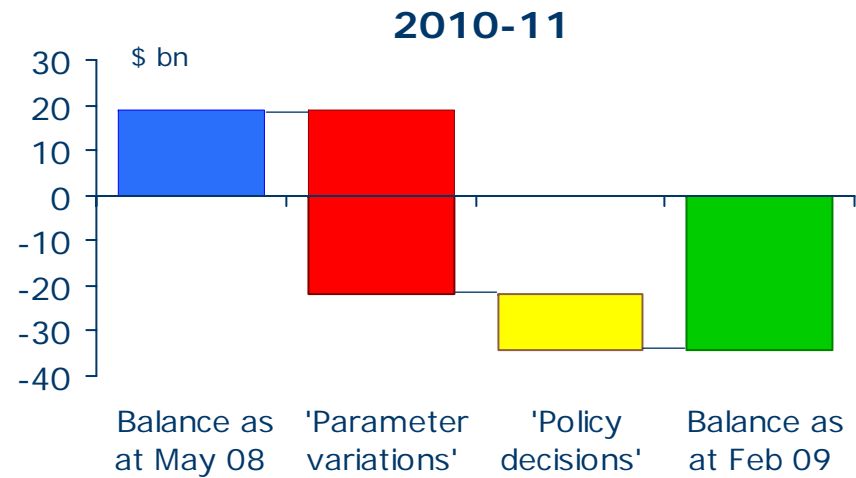
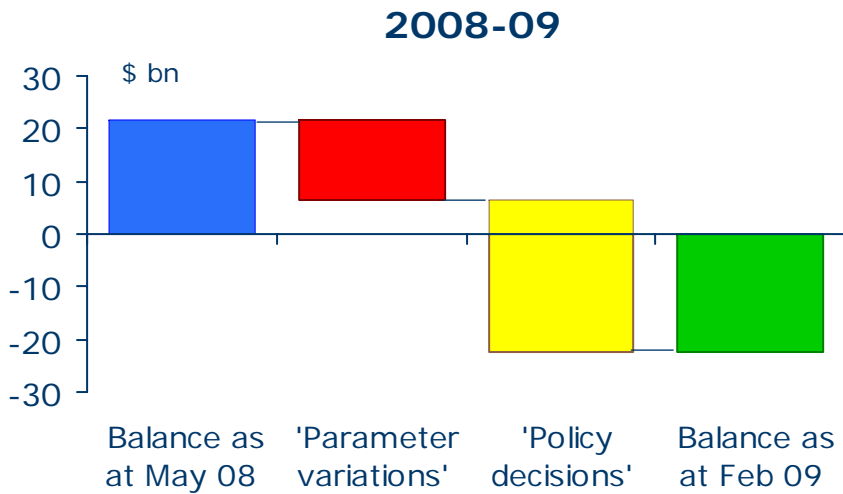


Sources: *Mid-Year Economic & Fiscal Outlook* (November 2008); *Updated Economic & Fiscal Outlook* (February 2009); ANZ.



The sharp swing in the Budget owes more to the collapse in revenues than to deliberate fiscal stimulus measures

Sources of changes in estimates of the Budget cash balance

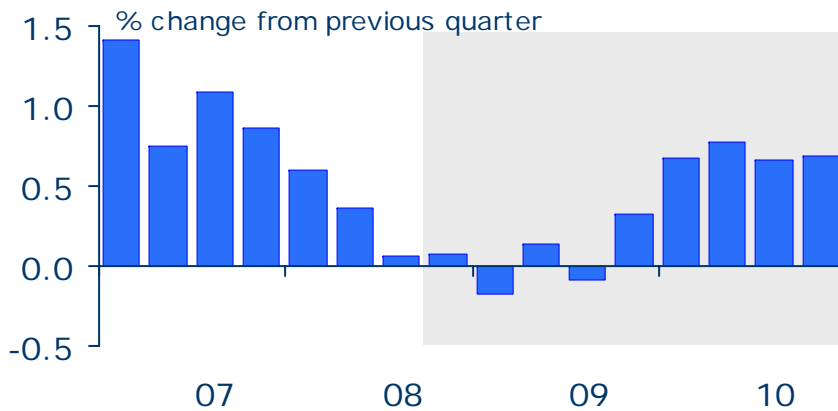


Note: 'Parameter variations' are changes in the cash balance due to changes in economic and other forecasts or assumptions. *Source:* *Mid-Year Economic & Fiscal Outlook* (November 2008); *Updated Economic & Fiscal Outlook* (February 2009); ANZ.

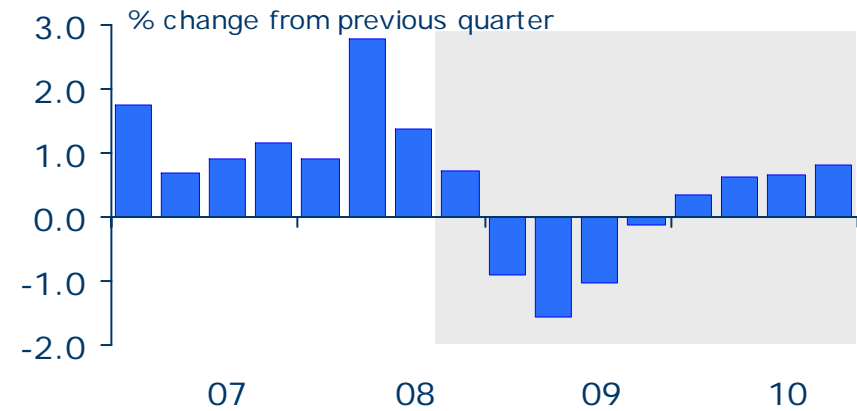


Australia might avoid consecutive quarters of negative real GDP growth, but it will have a recession by other definitions ²⁷

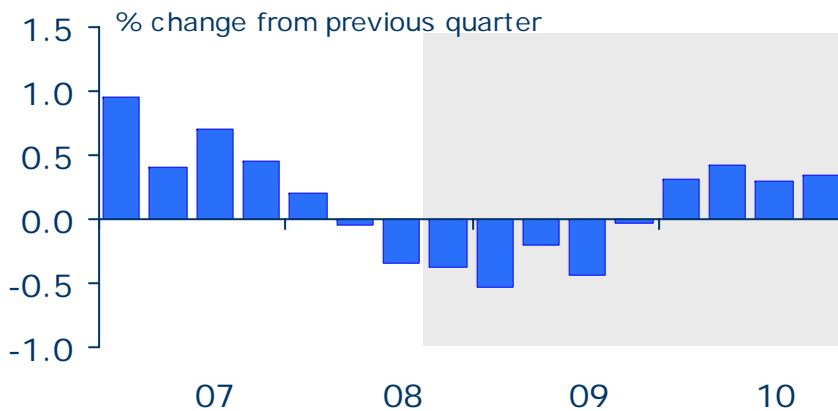
Real gross domestic product (GDP)



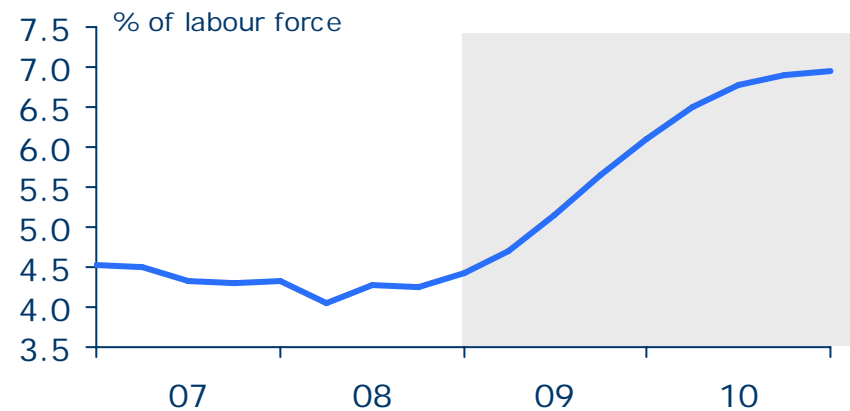
Real gross domestic income (GDI)



Real per capita GDP



Unemployment rate

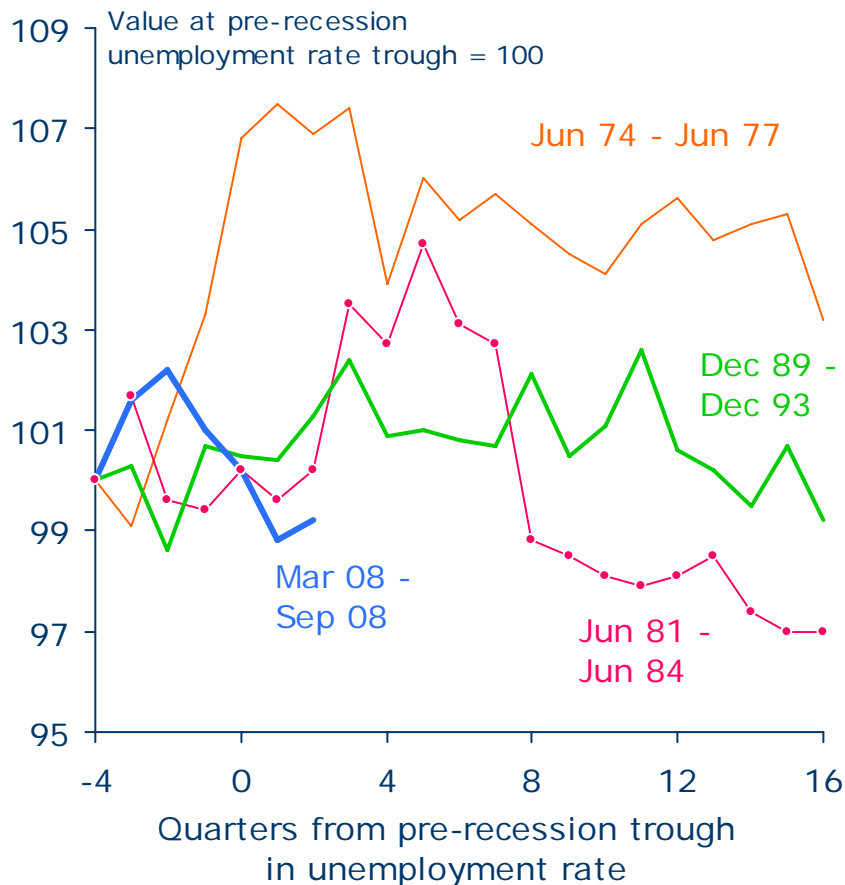


Note: Real gross domestic income is real GDP adjusted for changes in the terms of trade (export relative to import prices). Shaded areas denote ANZ estimates or forecasts. *Sources:* ABS; ANZ.

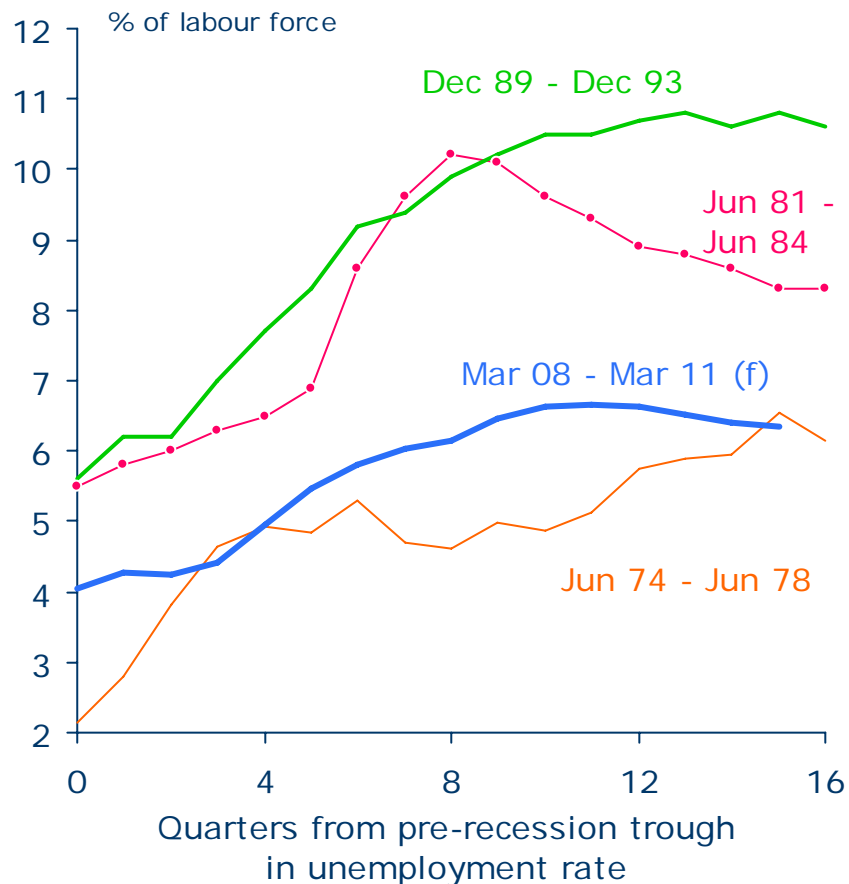


Employees haven't priced themselves out of jobs in the way that they did prior to each of the last three recessions

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.



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