

Open partnerships  
Open possibilities

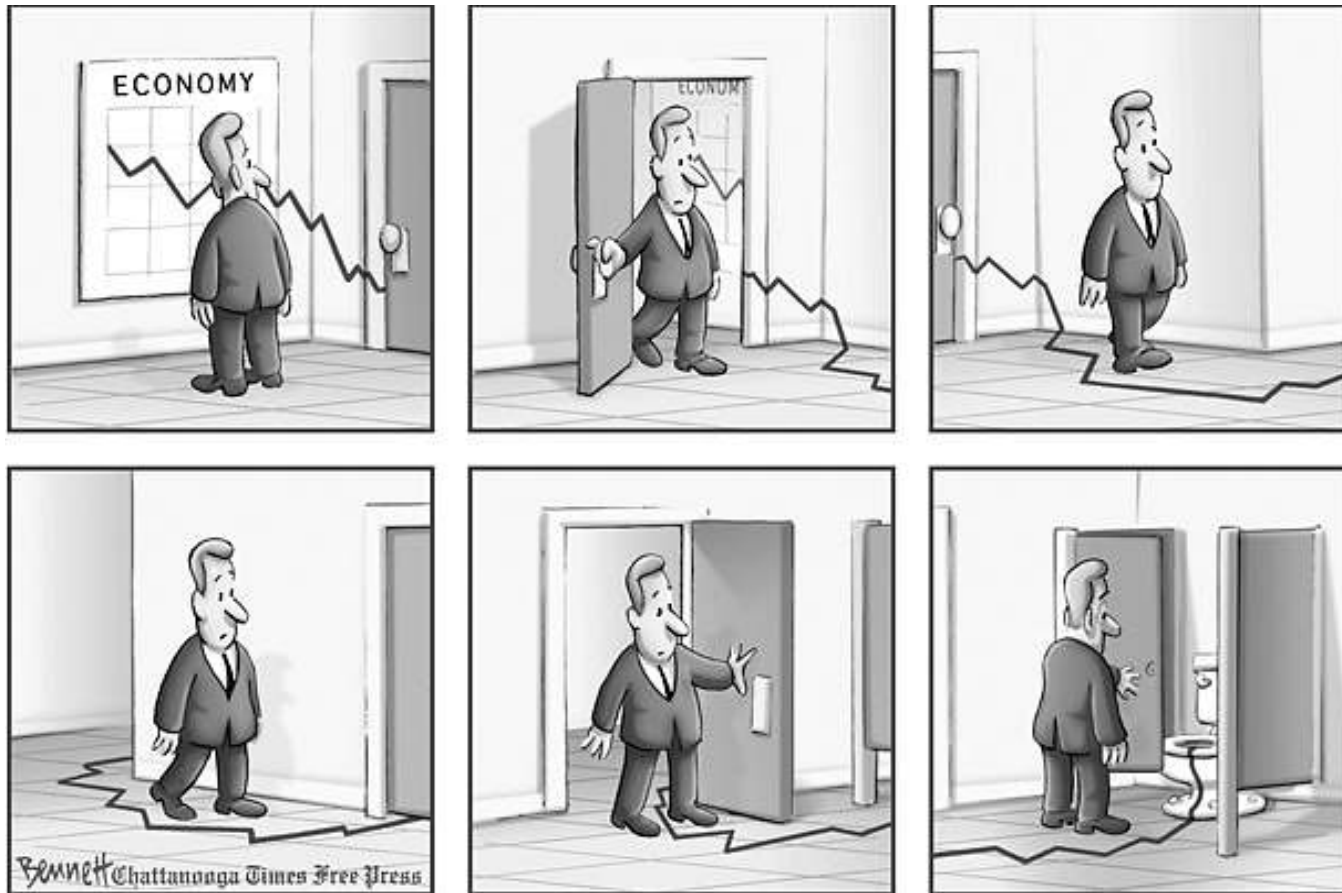
# Economic Outlook for 2009

Presentation to the Brisbane Mining Club  
19<sup>th</sup> February 2009

Saul Eslake  
Chief Economist, ANZ

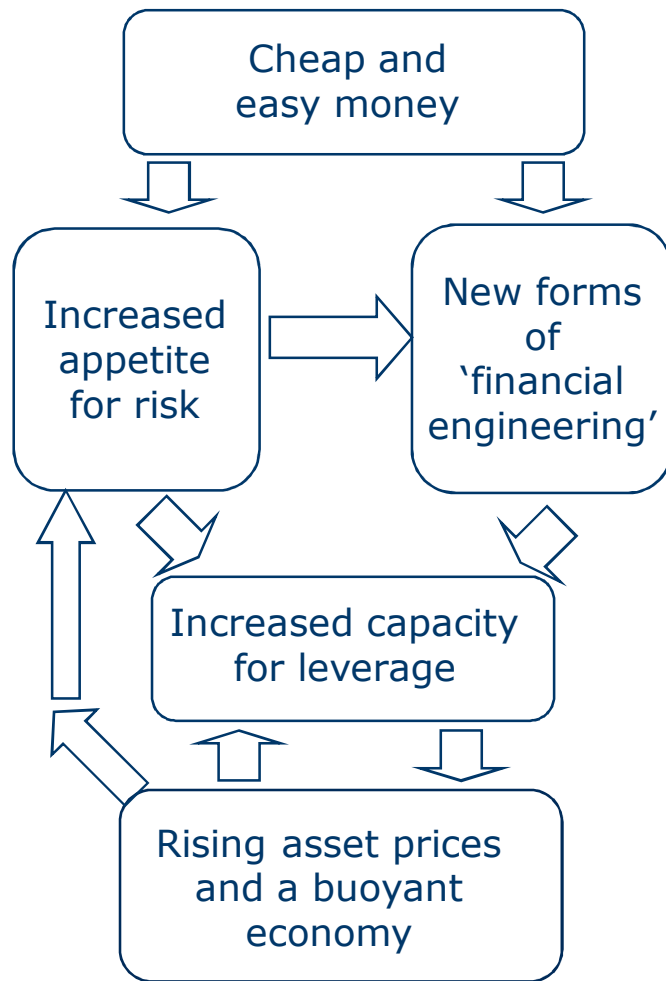
# A summary of the economic outlook as a growing number of people now see it

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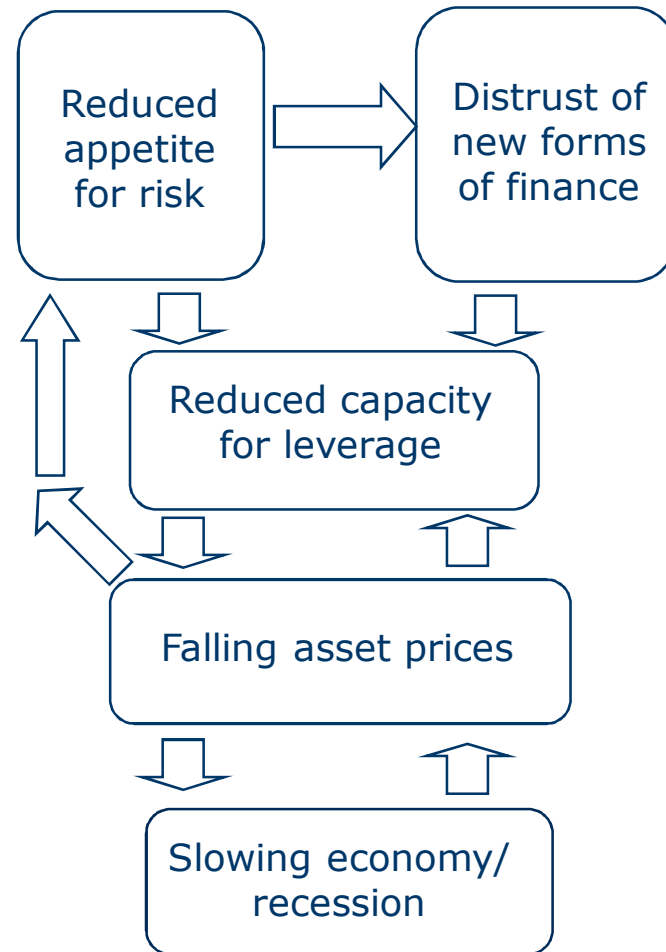


# The current global financial crisis stems from the bursting of a 'credit market bubble'

## From bubble ...

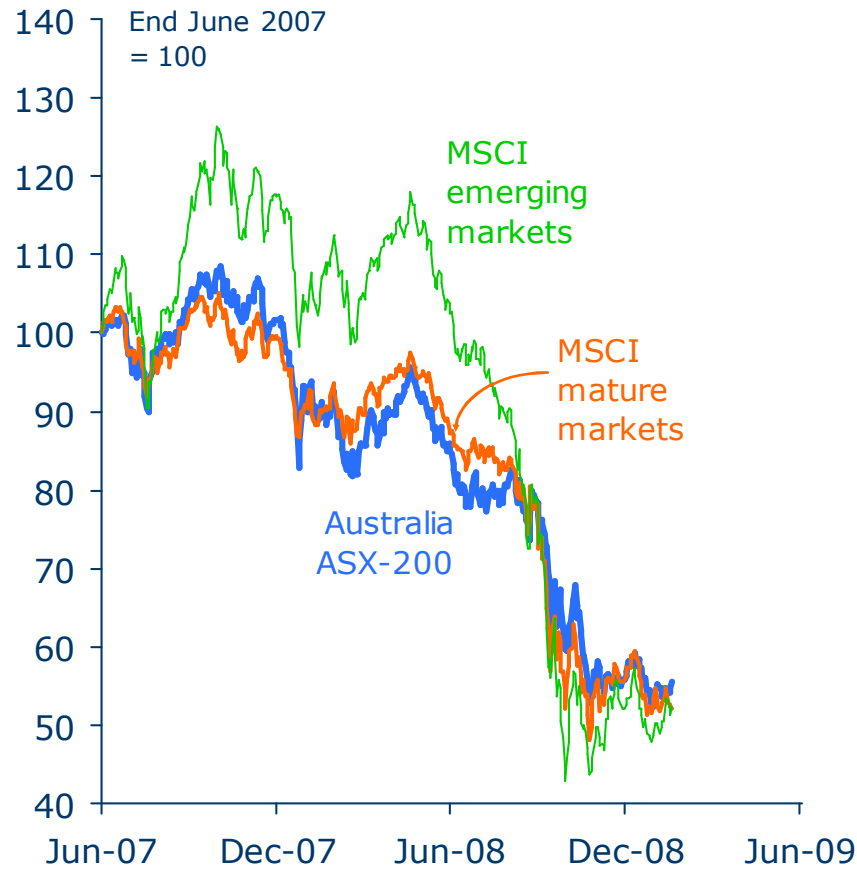


## To bust ....



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

### Share markets



### US share market volatility



Source: 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
<b>Total banks</b>	<b>812.0</b>
Other institutions*	258.7
<b>Total</b>	<b>1,038.5</b>

### 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
<b>Total</b>	<b>793.3</b>
Other institutions*	128.6
<b>Total</b>	<b>921.9</b>
of which, from governments	380.0

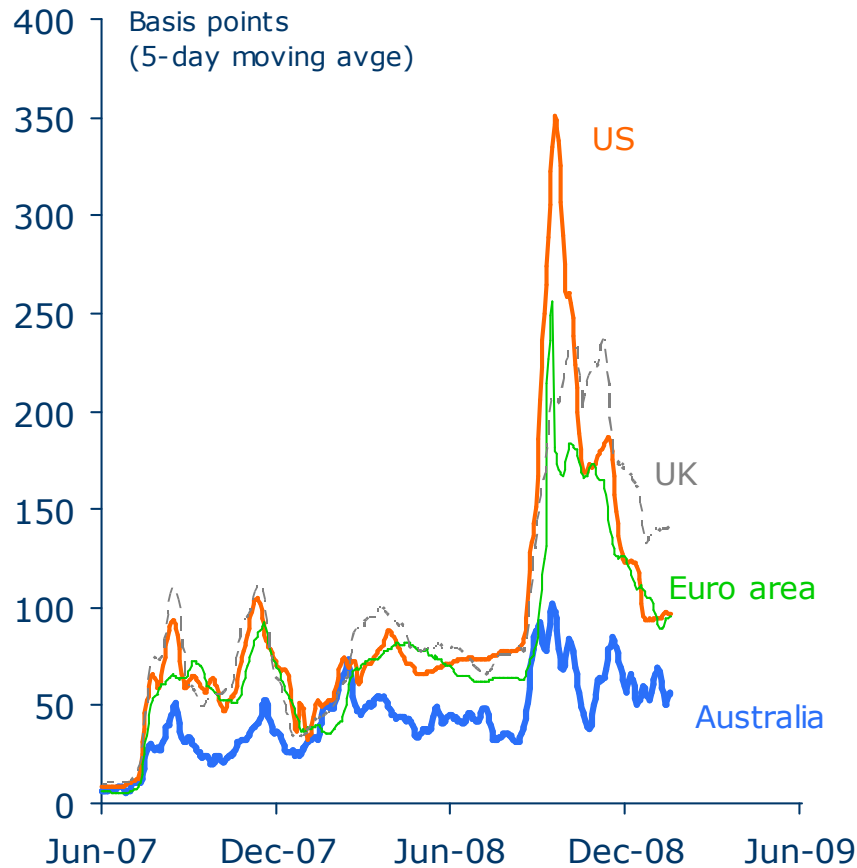
IMF says this total will ultimately reach US\$2,200bn

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

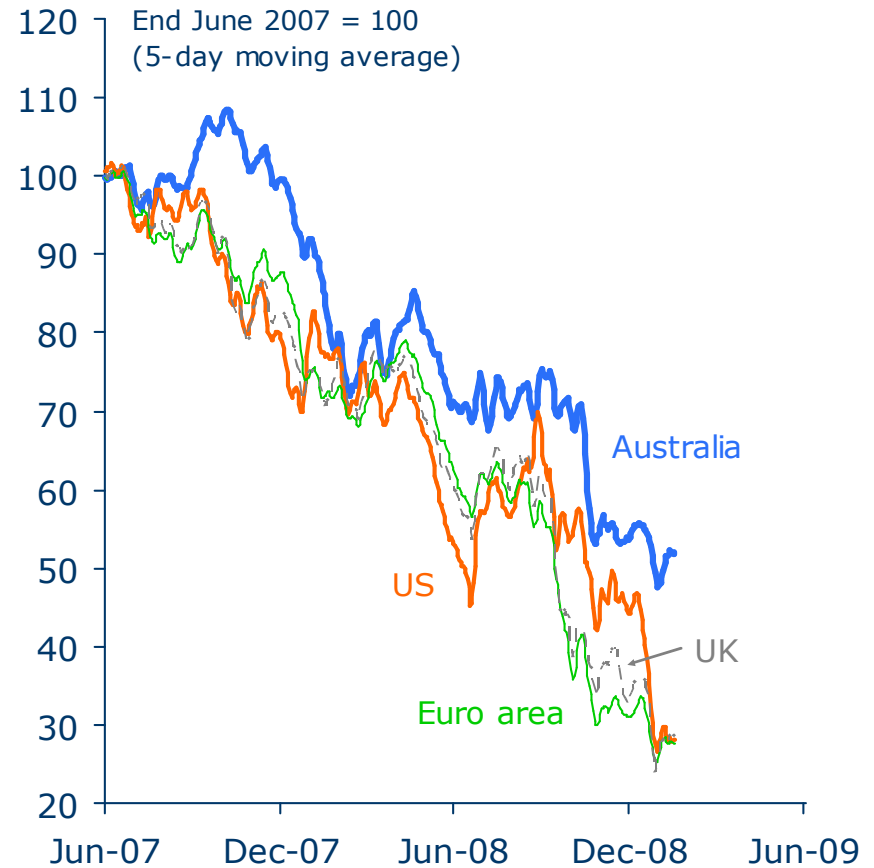
\* 'Other institutions' include insurance companies and the US GSEs.  
Sources: Bloomberg; IMF; ANZ Economics & Markets Research.

# 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



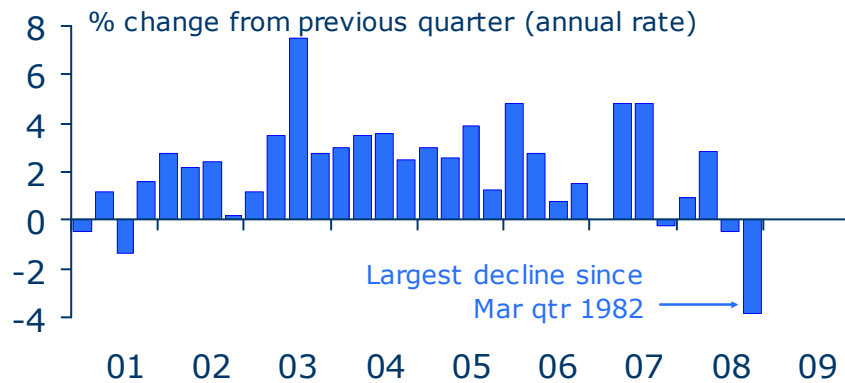
\* Strictly speaking, the spread between the 3-month Libor (or in Australia bank bill swap rate) and the 3-month overnight index swap (OIS) rate which measures market expectations of future changes in the official cash rate.  
Sources: Bloomberg; Thomson Financial Datastream.



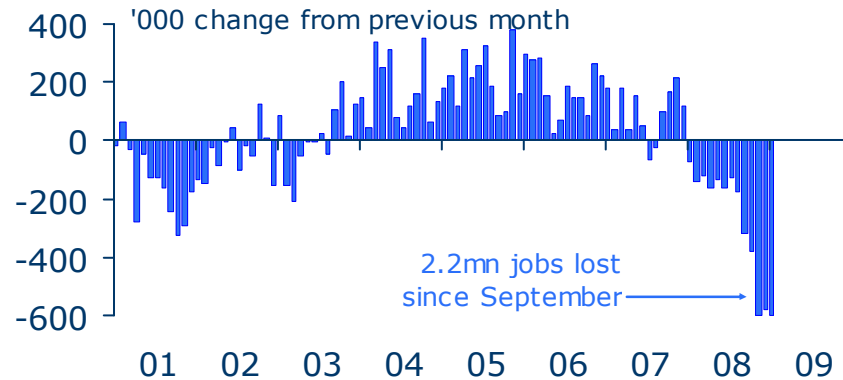
The US economy turned down sharply in the second half of last year – and the deterioration is continuing into 2009 <sup>7</sup>

## US economic activity and labour market

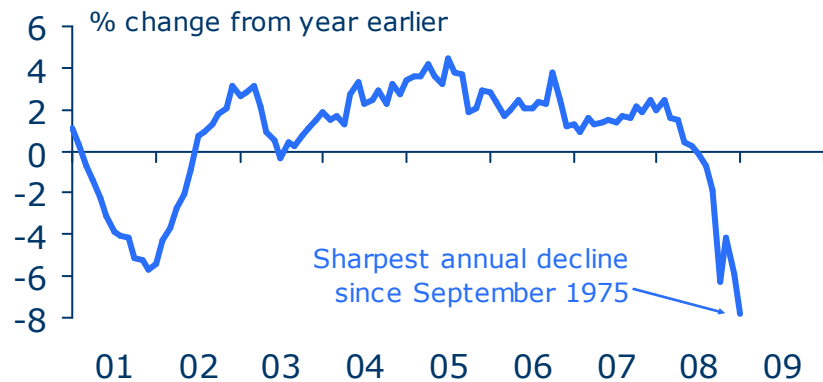
### Real GDP



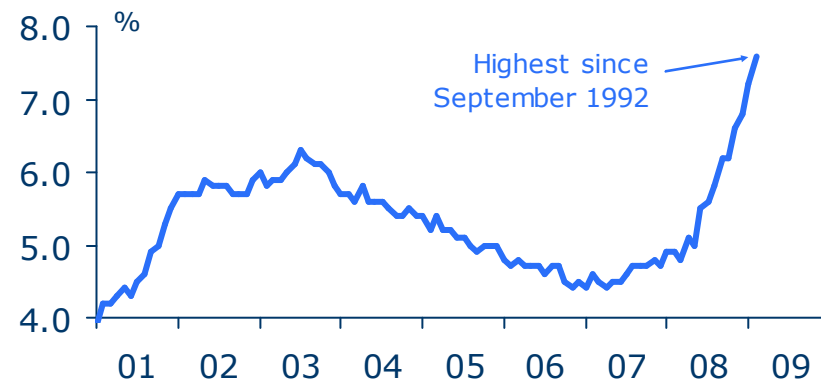
### Employment



### Industrial production



### Unemployment rate



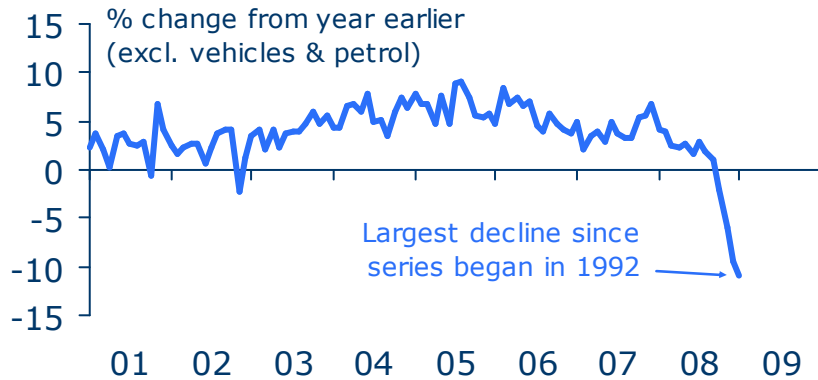
Sources: US Bureau of Economic Analysis; Federal Reserve; Bureau of Labor Statistics.



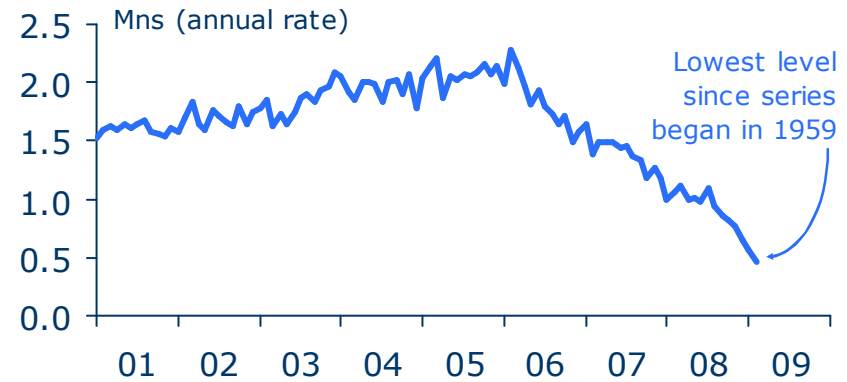
American consumers have been cutting back spending sharply  
– and businesses have started to cut back too

### US consumer and business activity

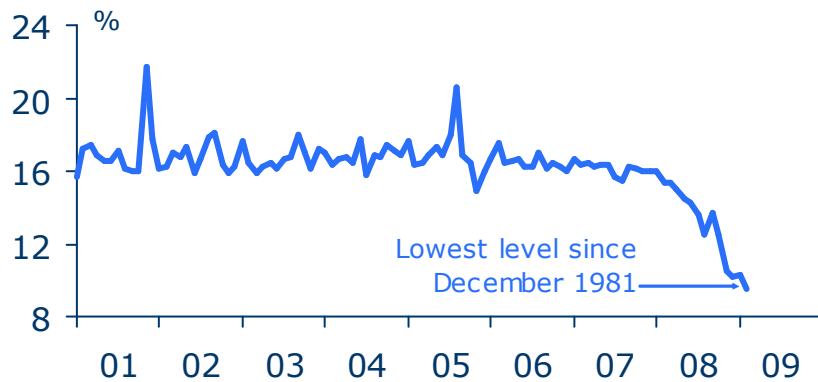
#### Real retail sales



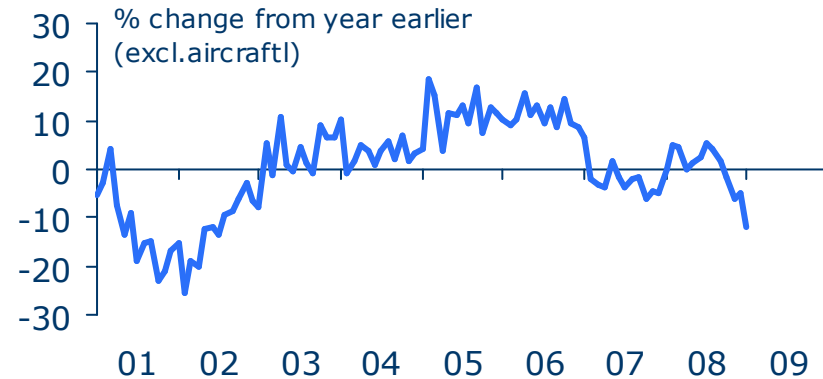
#### Housing starts



#### Motor vehicle sales



#### Non-defence capital goods orders



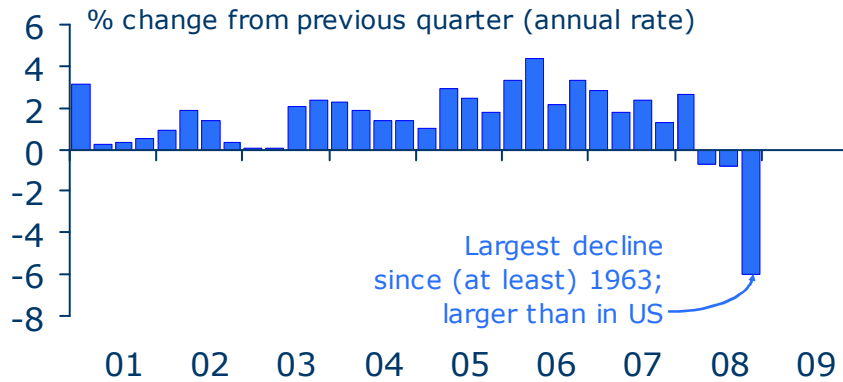
Source: US Commerce Department.



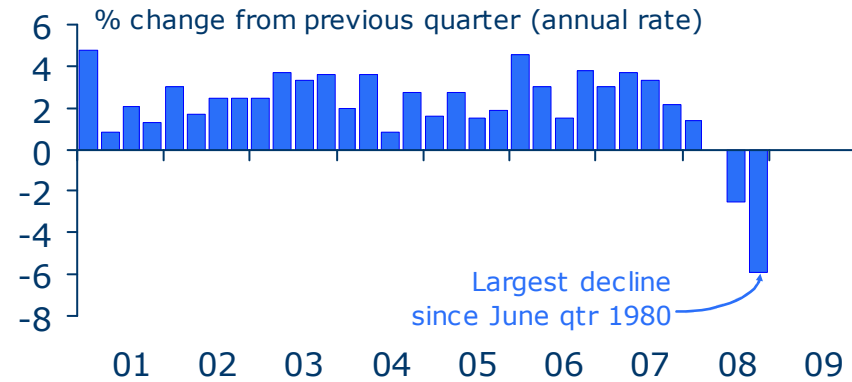


# The downturns in the euro area and the UK have been more severe than that in the United States

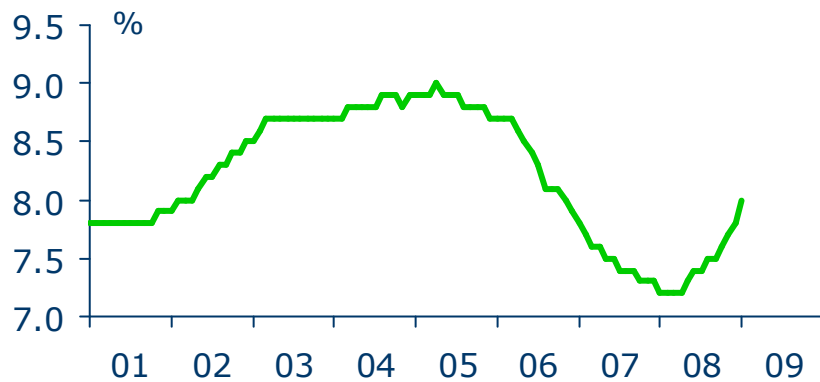
**Euro area**  
**Real GDP**



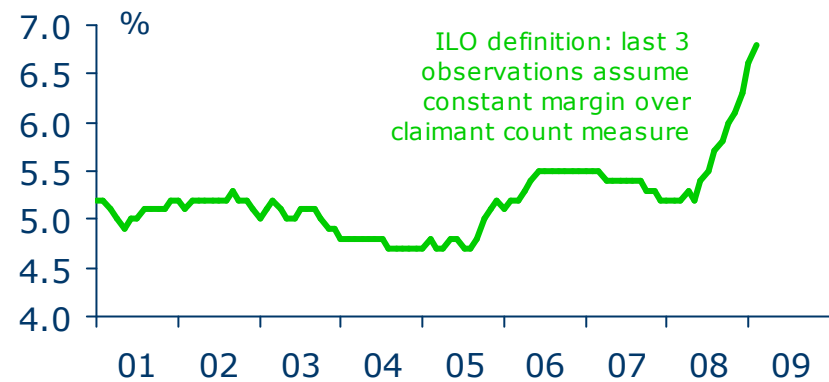
**United Kingdom**  
**Real GDP**



**Unemployment**



**Unemployment**



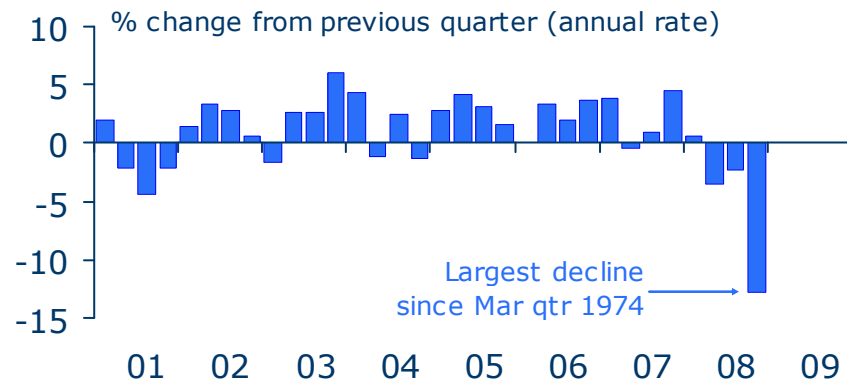
Sources: European Commission; Eurostat; Confederation of British Industry; UK Office of National Statistics; Datastream.



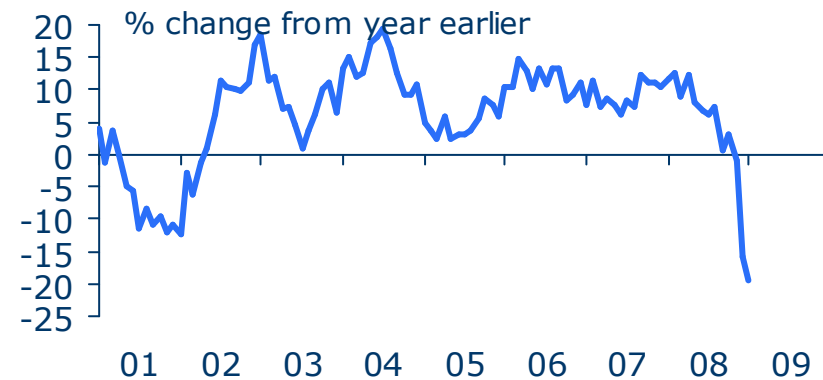
# Japan's economy experienced a dramatic downturn at the end of 2008

## Japan

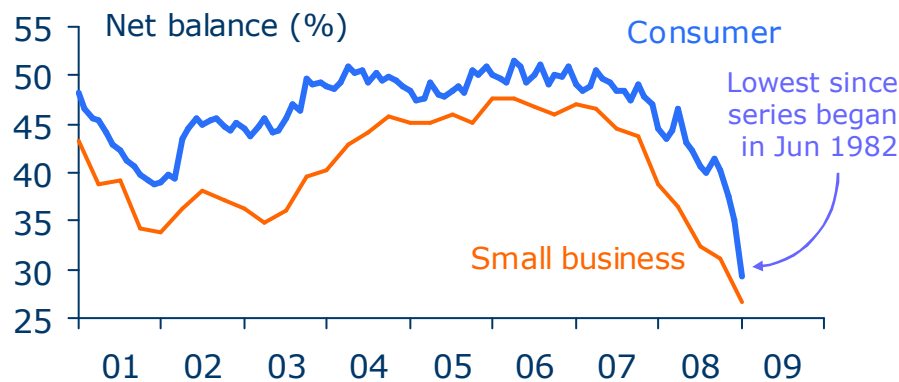
### Real GDP



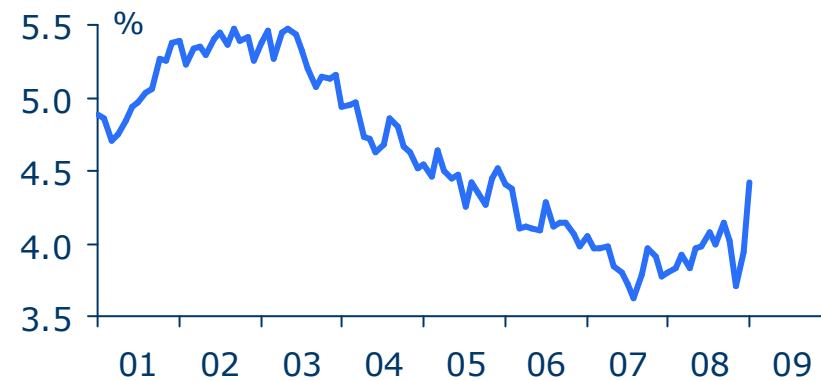
### Export volumes



### Consumer confidence



### Unemployment



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



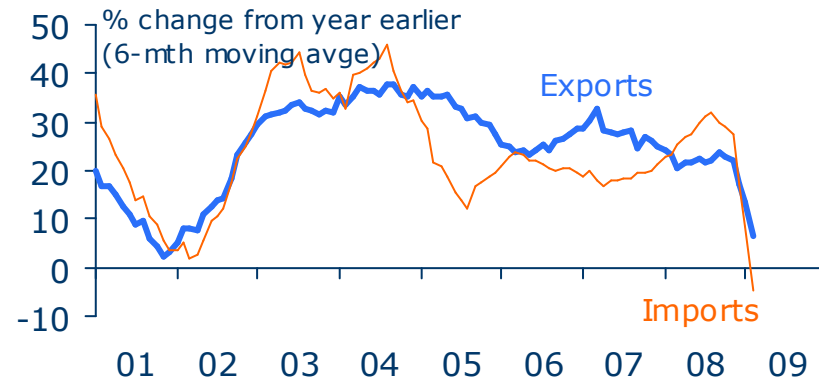
China slowed markedly late last year, partly because of weaker exports, also as a result of the collapse of China's own bubble` 11

### Chinese economic indicators

#### Real GDP growth



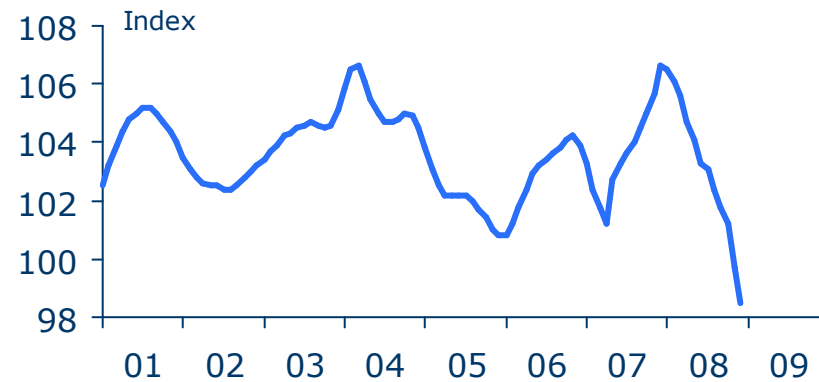
#### Exports



#### Industrial production



#### Real estate climate index



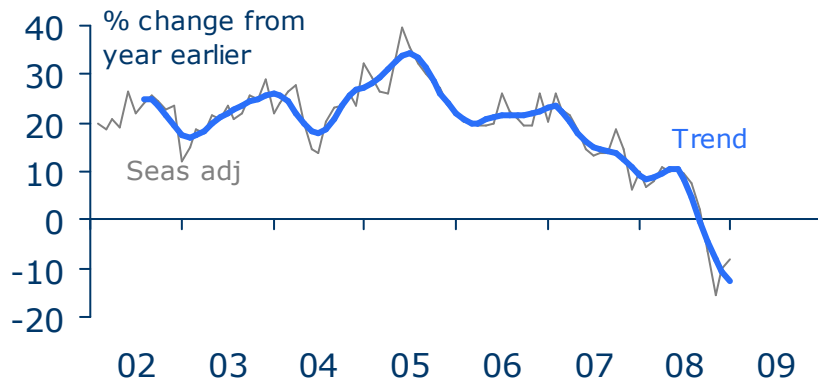
Source: China National Statistics Bureau; ANZ.



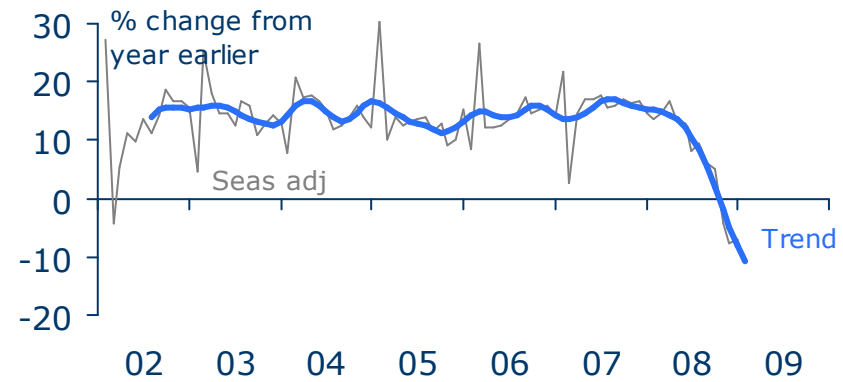
# Industry data highlights the abrupt downturn in the commodity-intensive sectors of the Chinese economy <sup>12</sup>

## Chinese industry indicators

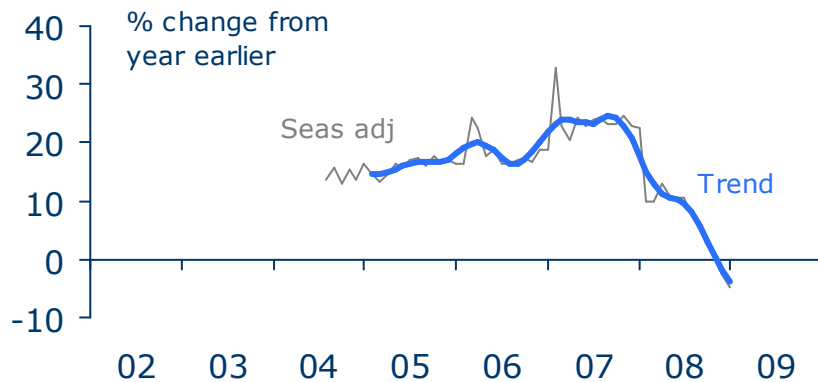
### Crude steel production



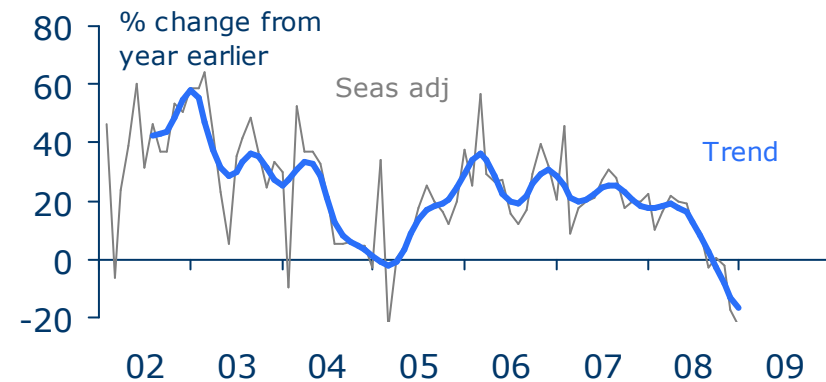
### Electricity production



### Non-ferrous metal production



### Motor vehicle production



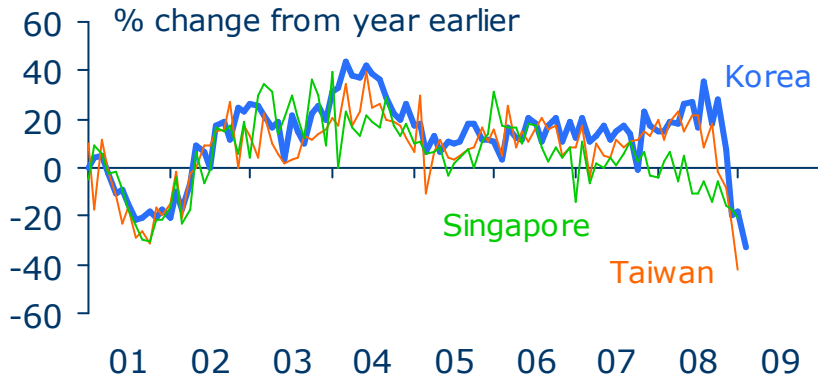
Sources: China Steel Industry Association; China Non-Ferrous Metal Industry Association; China National Statistics Office; China Association of Automobile Manufacturers; CEIC. Seasonal adjustment by DX; trend series derived by ANZ using ABS formula.



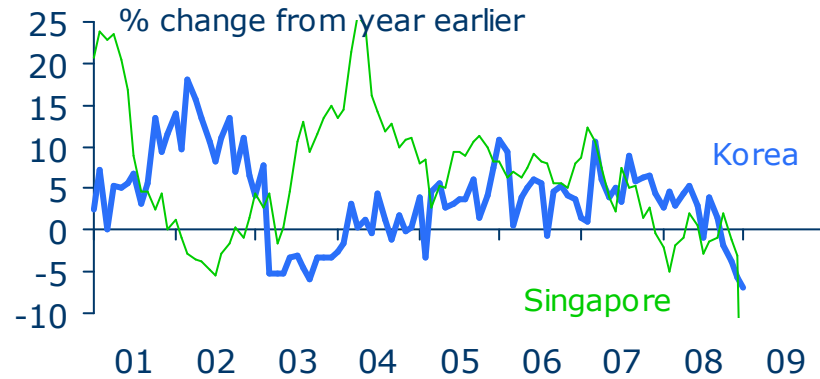
# Export-intensive smaller East Asian economies have been dragged into the global slowdown

## Smaller East Asian economies

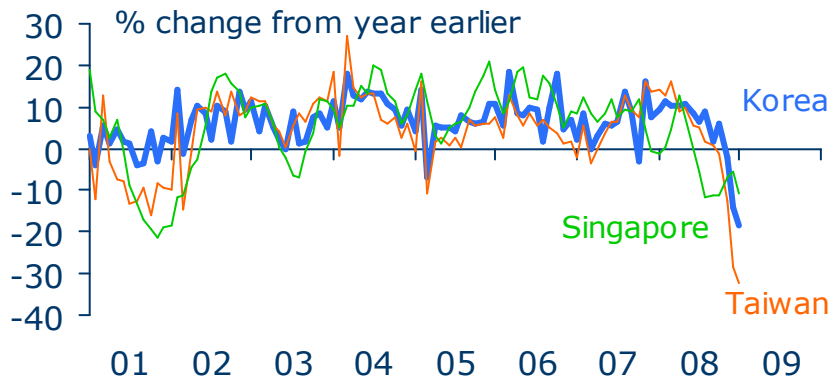
### Exports



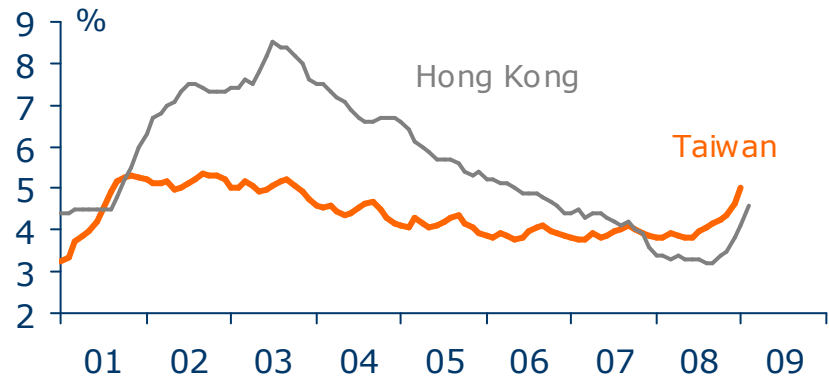
### Retail sales



### Industrial production



### Unemployment

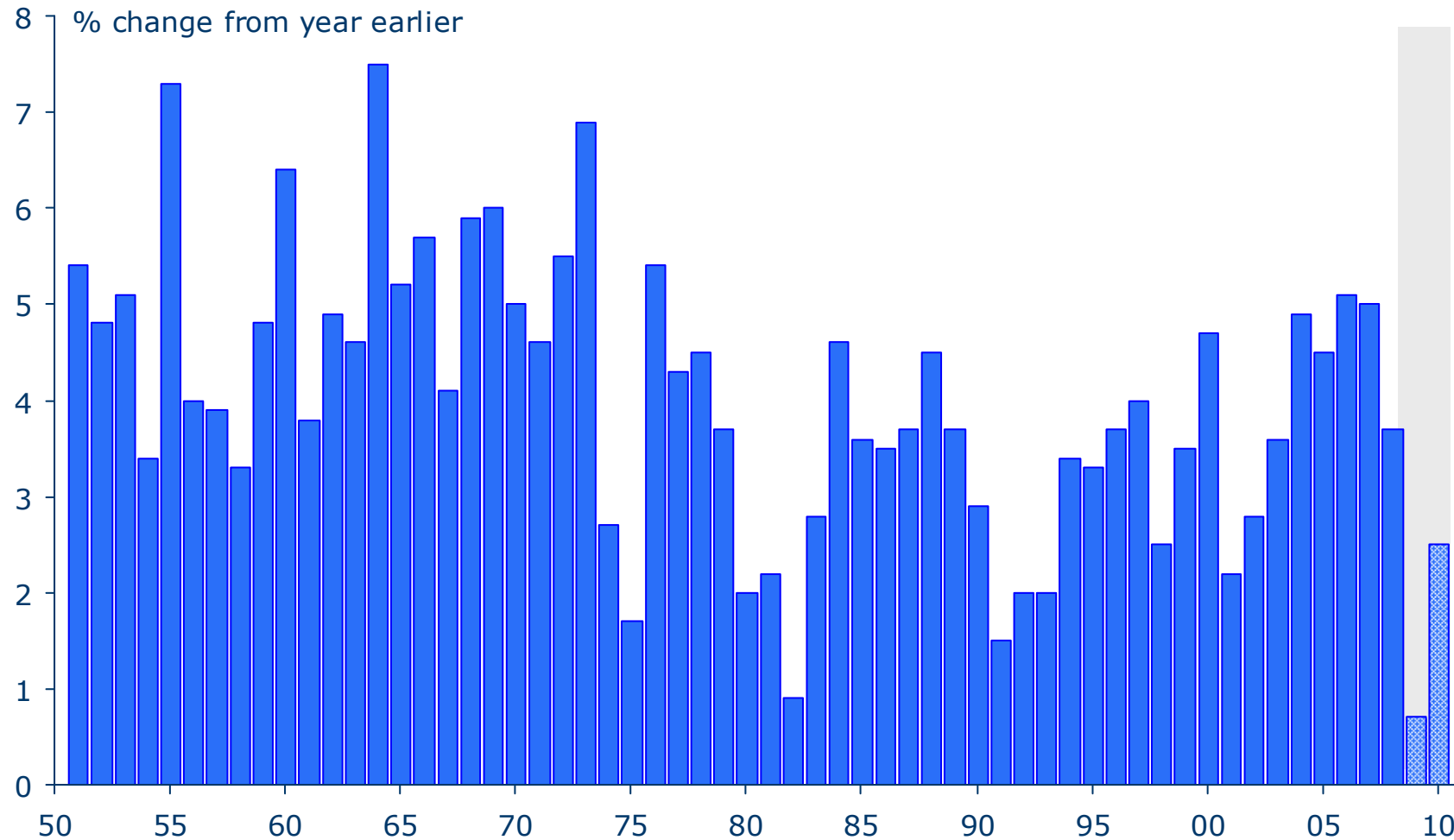


Sources: CEIC; Datastream; ANZ.



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

### Global economic growth 1950-2010



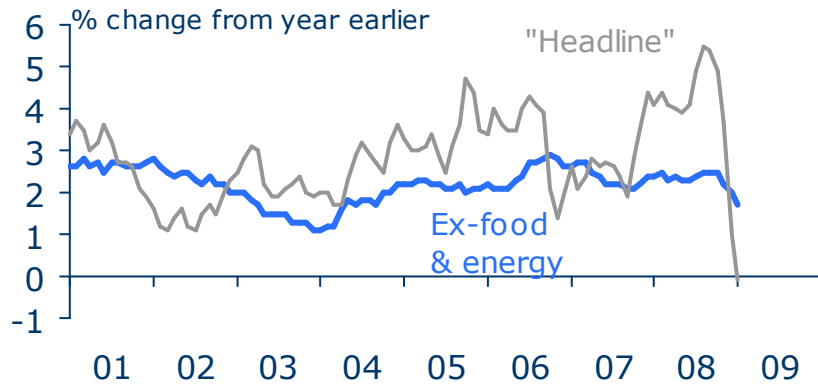
Sources: The Conference Board Total Economy Database (1950-70); IMF (1971-2008); ANZ (2009-10).



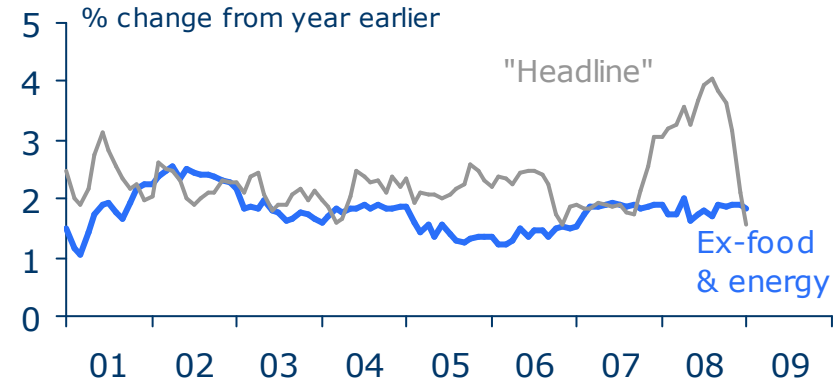
'Headline' inflation has fallen sharply in advanced economies, and core inflation is easing too – deflation is a risk for some

### Consumer prices – major industrialized economies

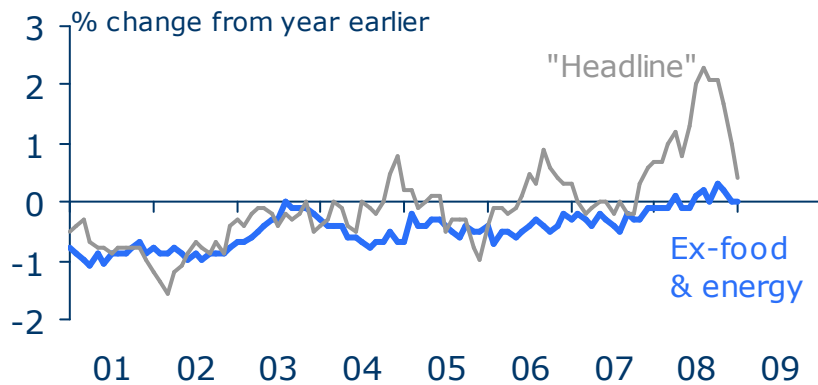
#### United States



#### Euro area



#### Japan



#### United Kingdom

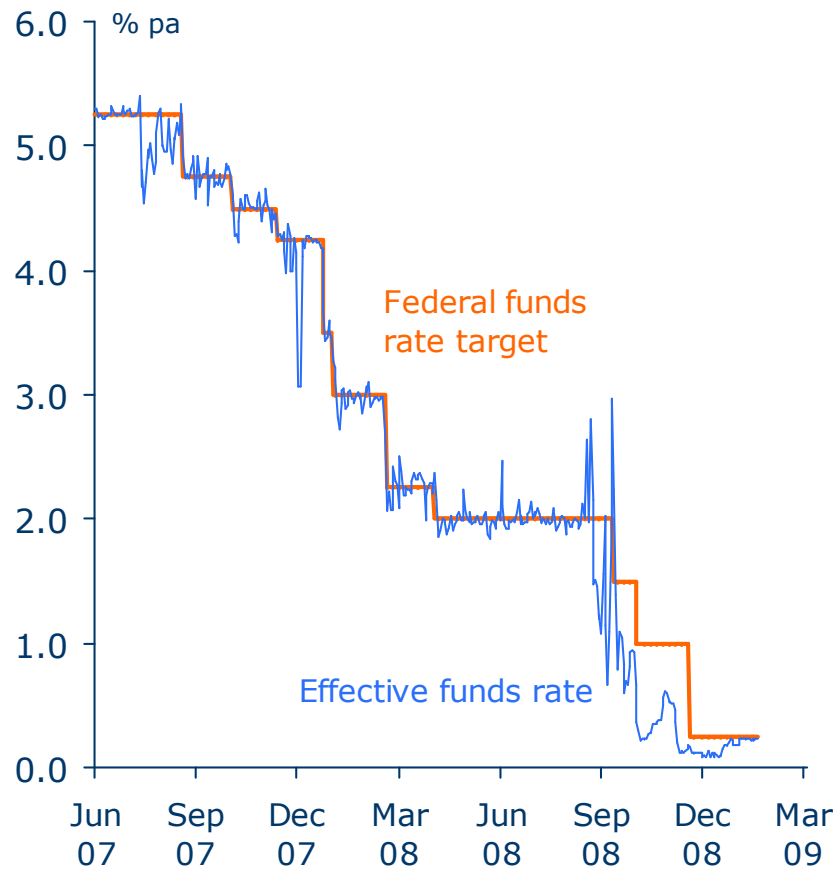


Sources: US Bureau of Labor Statistics; Eurostat; UK Office of National Statistics; CEIC.

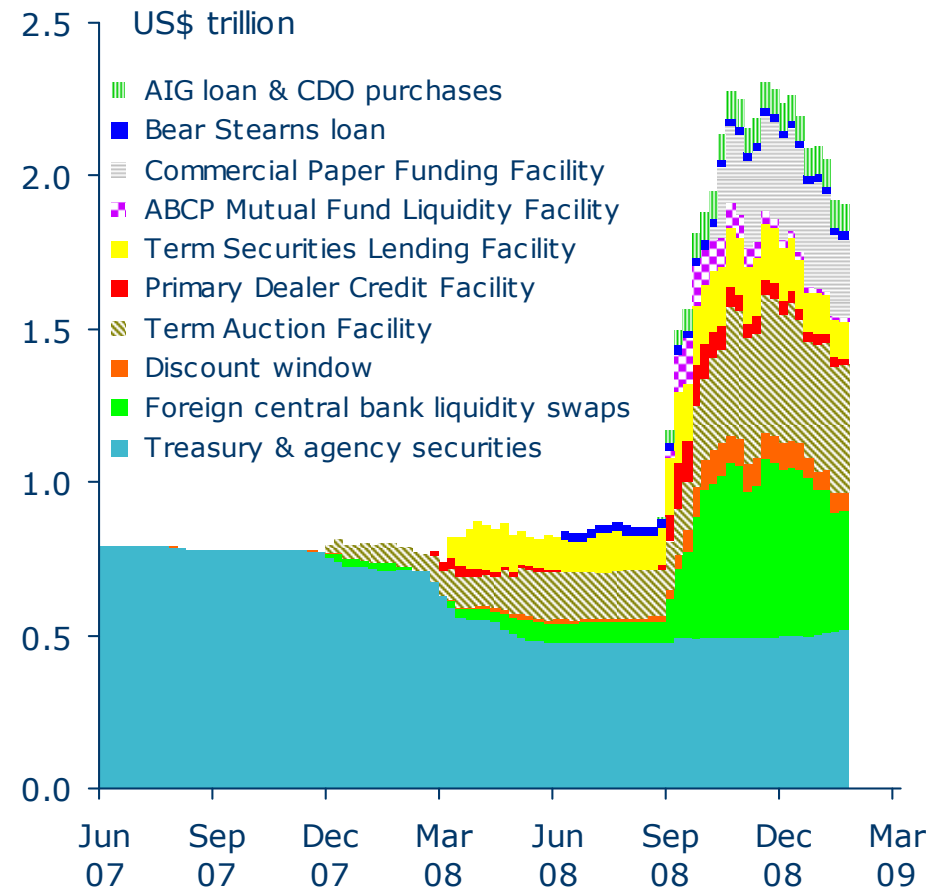


With its cash rate effectively at zero the Fed has resorted to a form of 'quantitative easing'

**Target and effective Fed funds rate**



**Assets on the Federal Reserve's balance sheet**



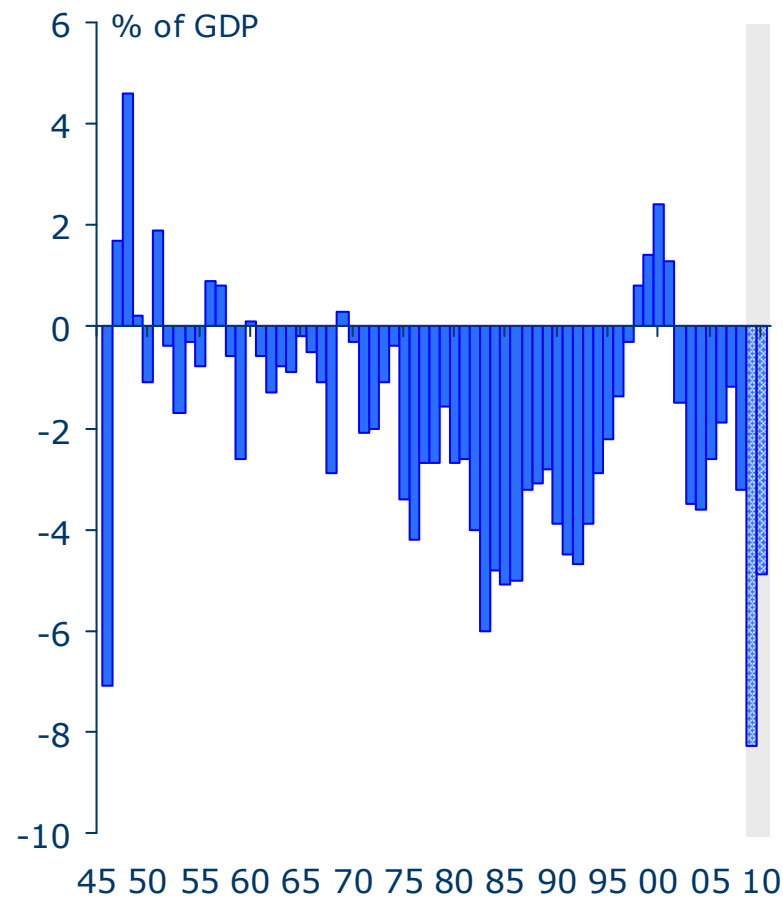
Source: US Federal Reserve Board H.4.1 Statistical Release, *Factors Affecting Reserve Balances*; Datastream.



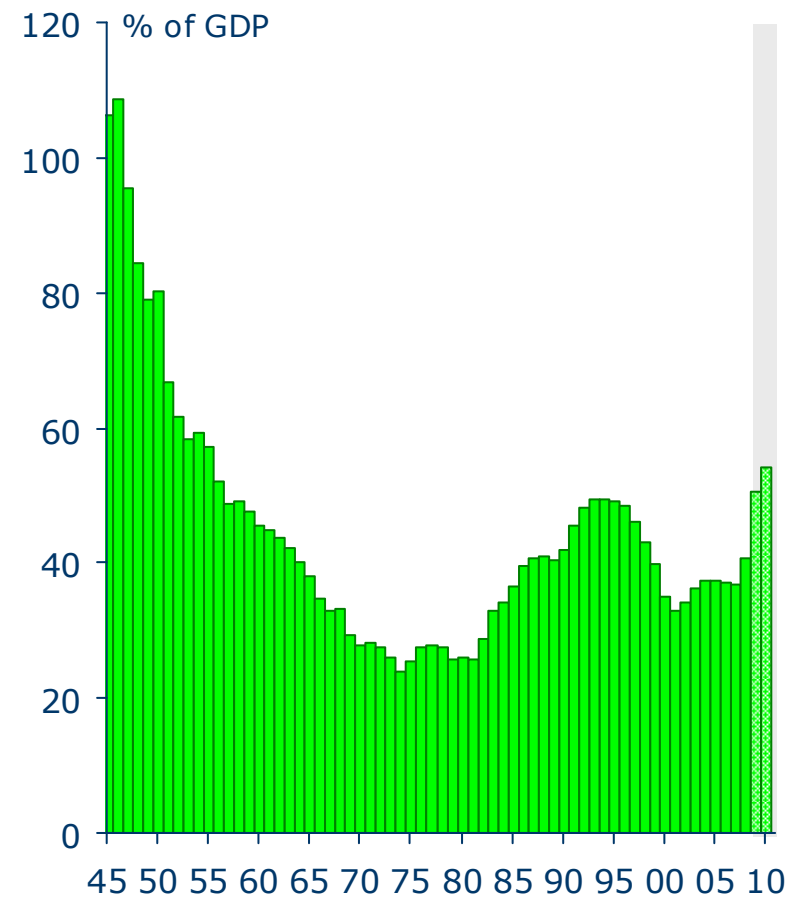


Fiscal policy has to shoulder a greater burden, pushing government debt up sharply but not to unprecedented levels

**US Federal budget balance**



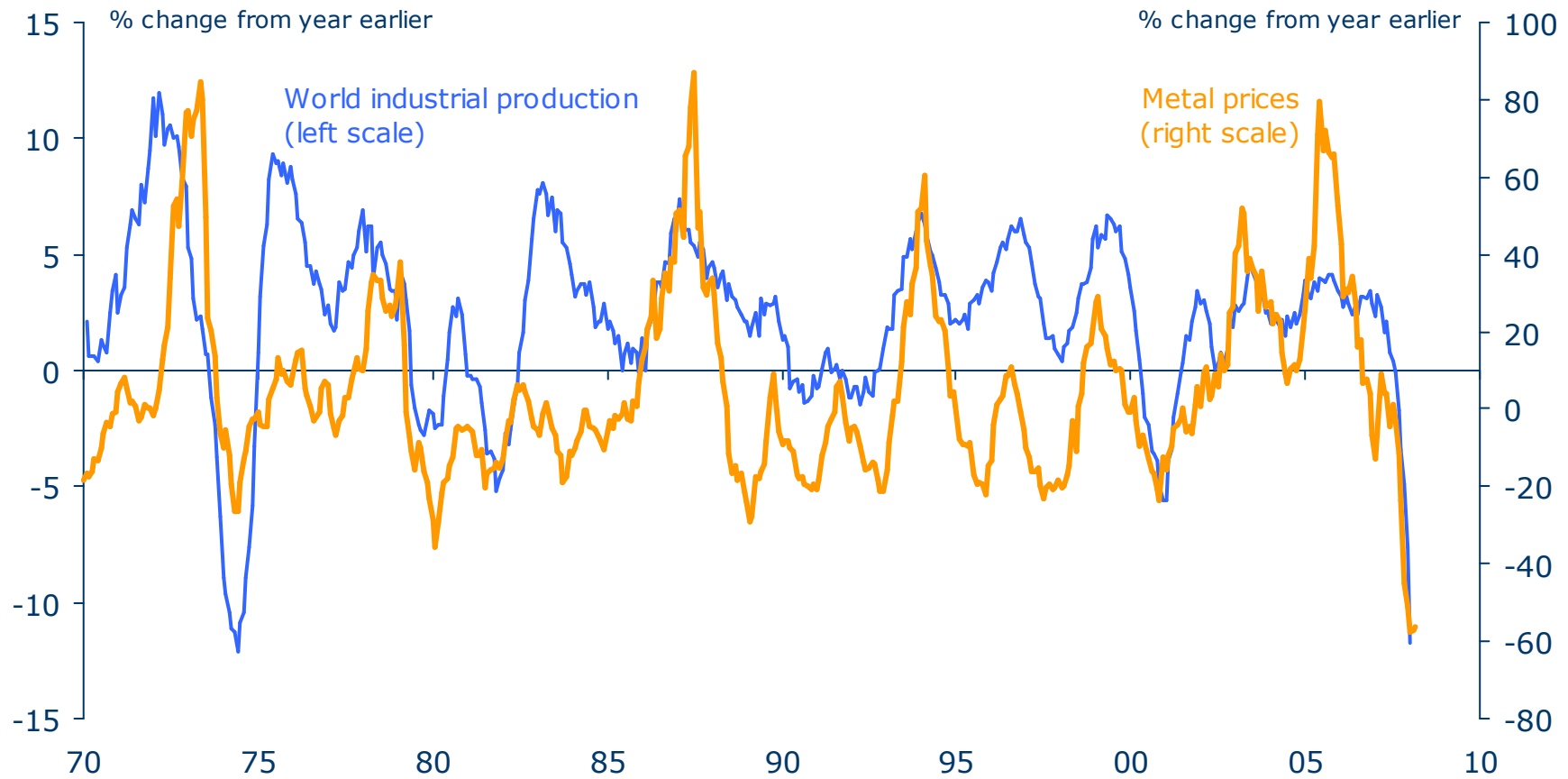
**US Federal Government debt**



*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.



### World industrial production and metal prices



Note: 'World' is OECD prior to 1980; includes other East & South Asian and Latin American economies from 1981 onwards, and Russia & Eastern Europe from 1991 onwards.

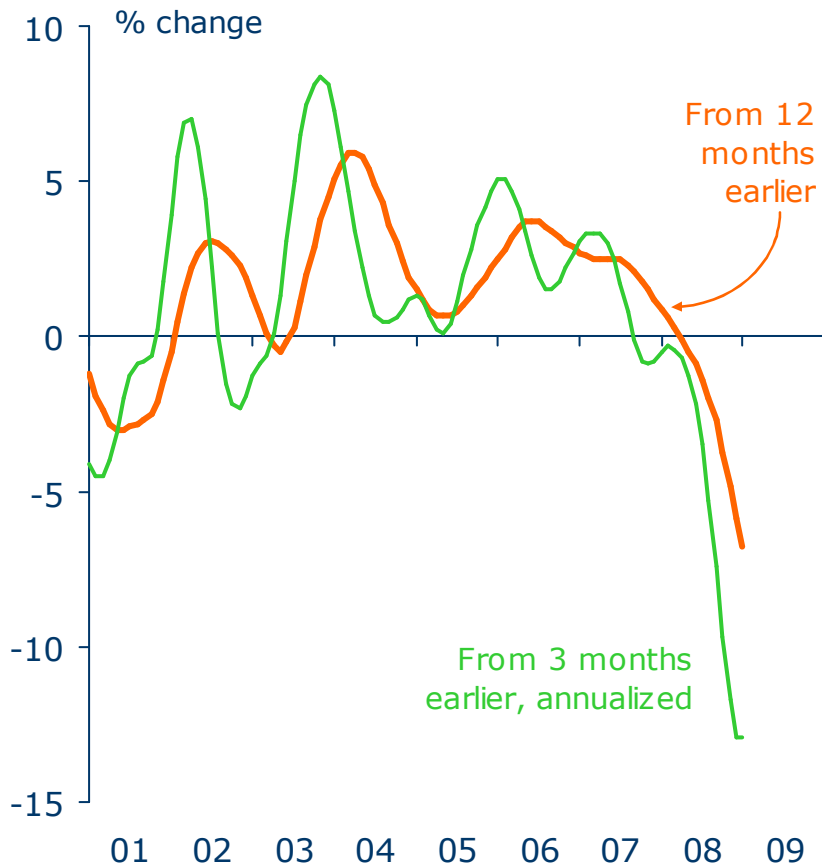
Sources: OECD; national statistical agencies; Datastream; Bloomberg; ANZ.



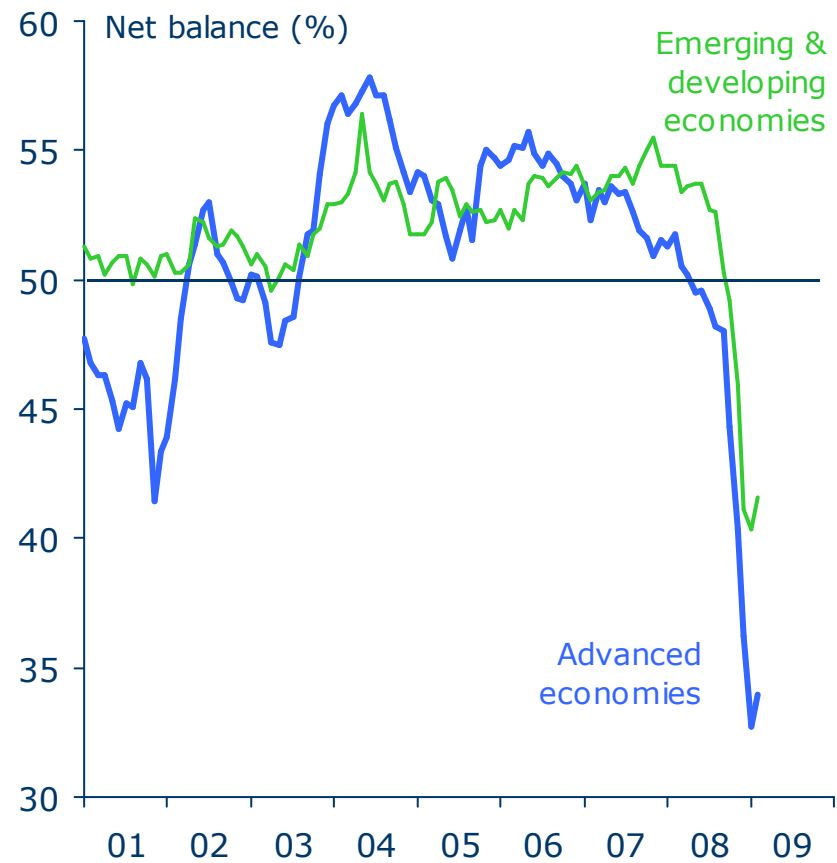
Leading indicators do not yet convey any suggestion that world industrial production is close to bottoming

### Leading indicators of global industrial production

OECD leading indicator



Purchasing managers' indices

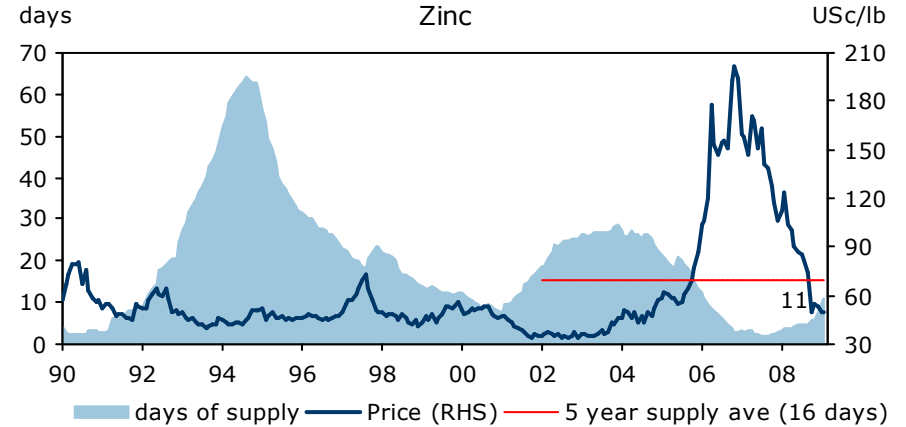
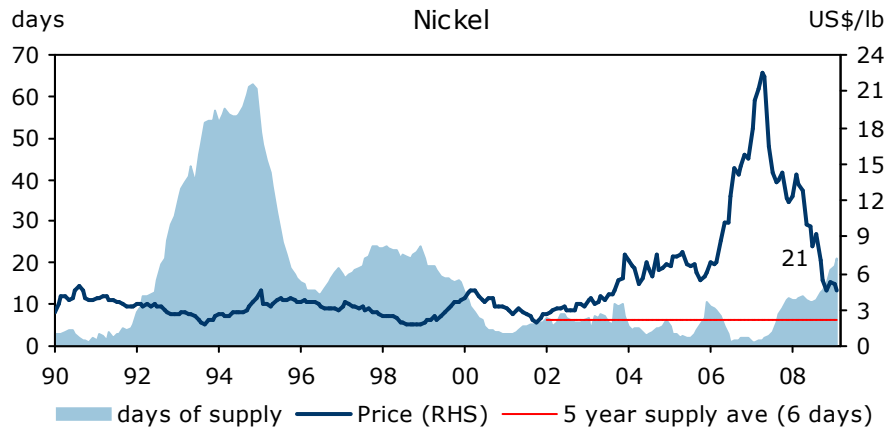
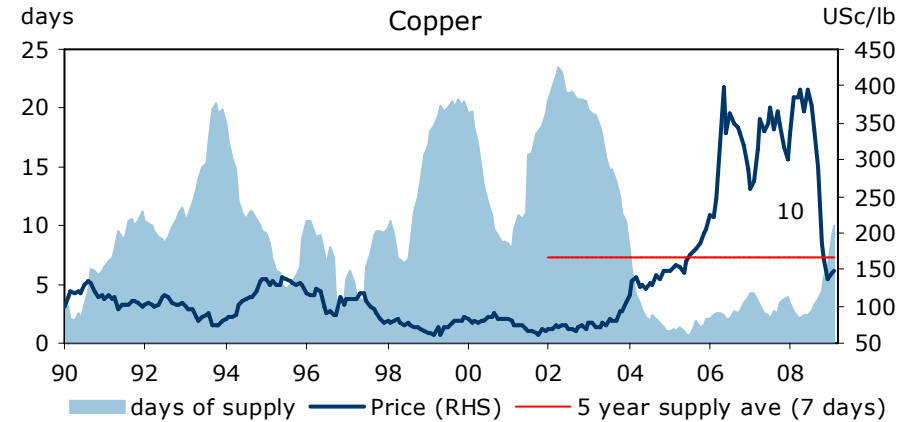
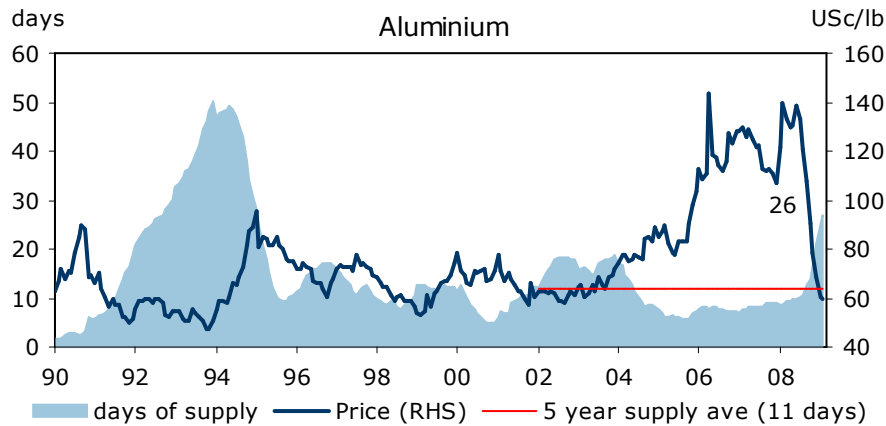


Sources: OECD; national purchasing managers' associations and supply management institutes; Markit Economics; IMF; Datastream.



# Supply of most base metals is now above five year averages highlighting the weak demand environment

## Metal inventories and prices

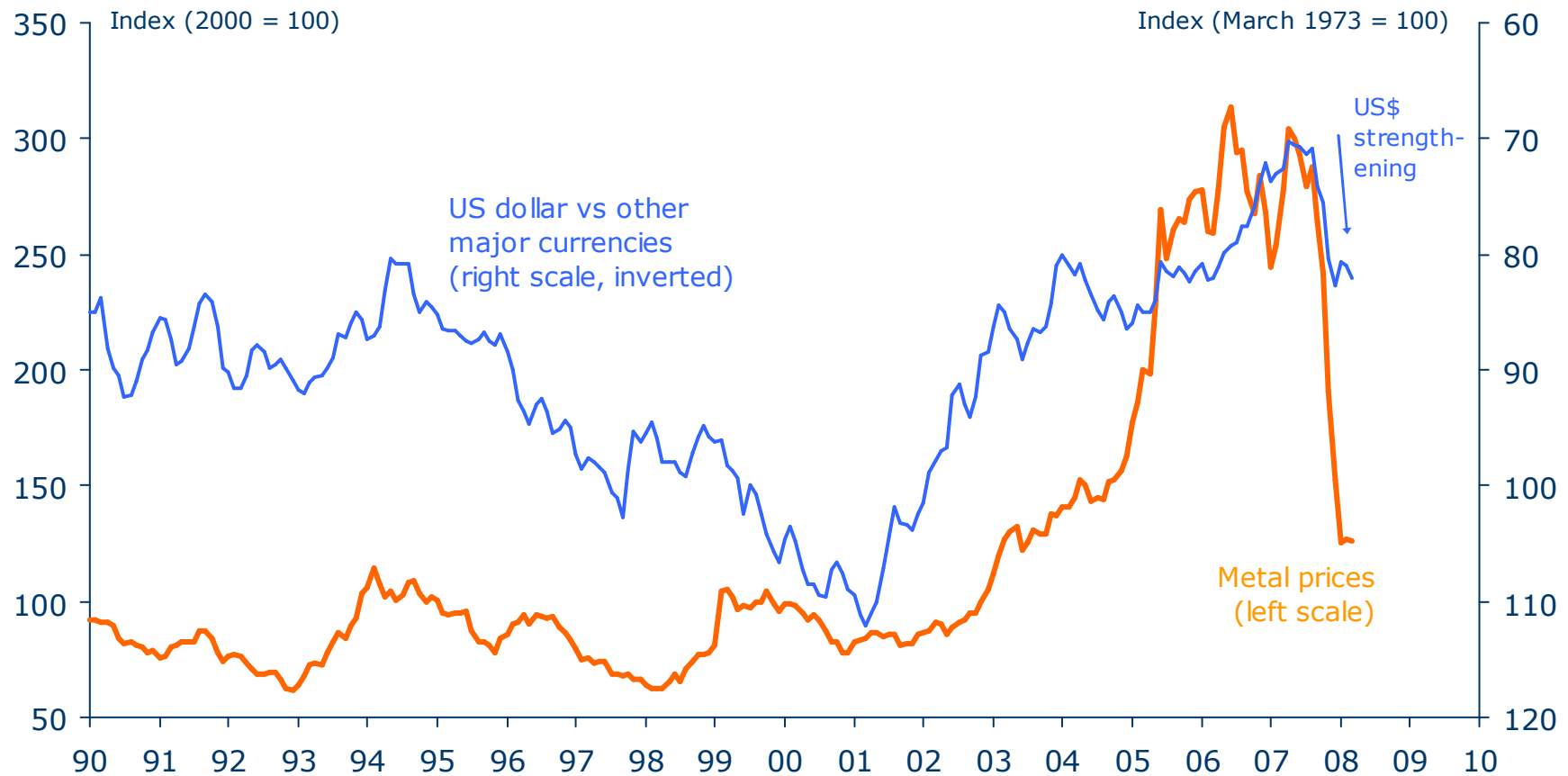


Source: Bloomberg; ANZ Commodities Research.



# The (in many ways surprising) strength of the US dollar isn't helping metal prices either

## Metal prices and the US dollar

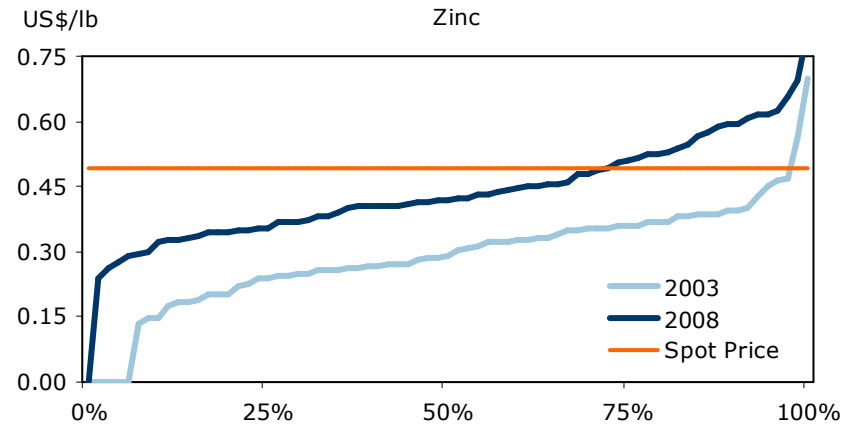
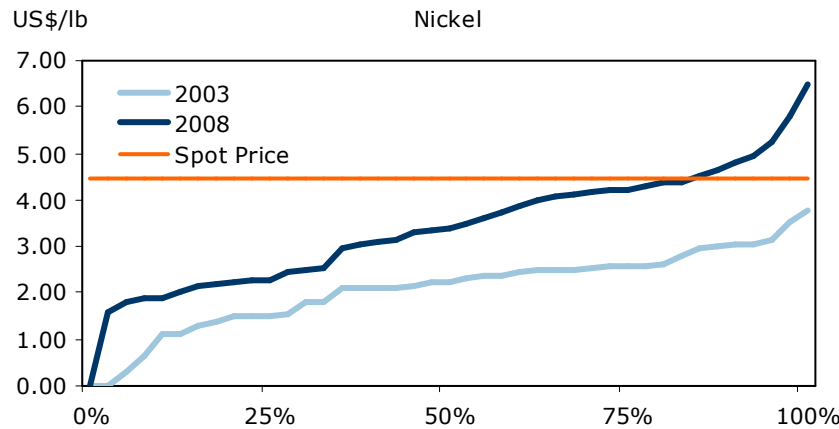
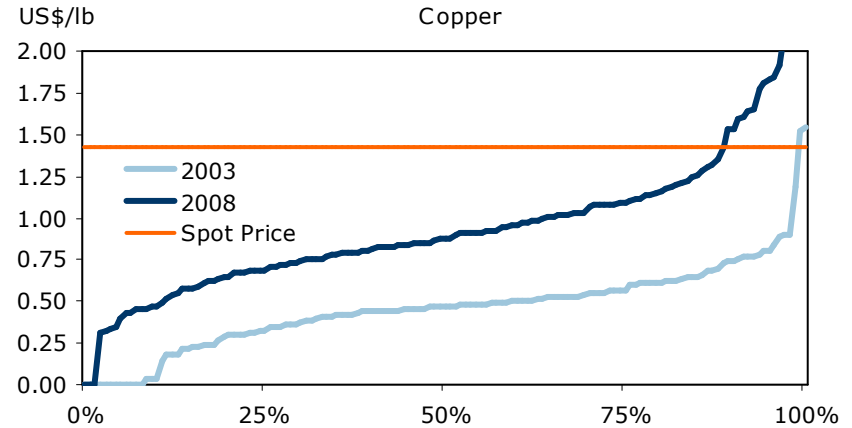
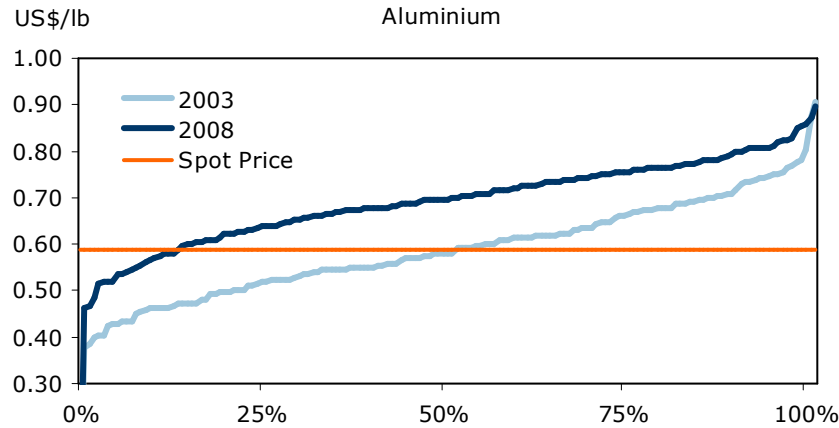


Sources: The Economist; US Federal Reserve; Datastream.



Metal prices have now fallen through the top end of the cost curve suggesting limited downside risk from current levels

### Metal cash production costs and prices



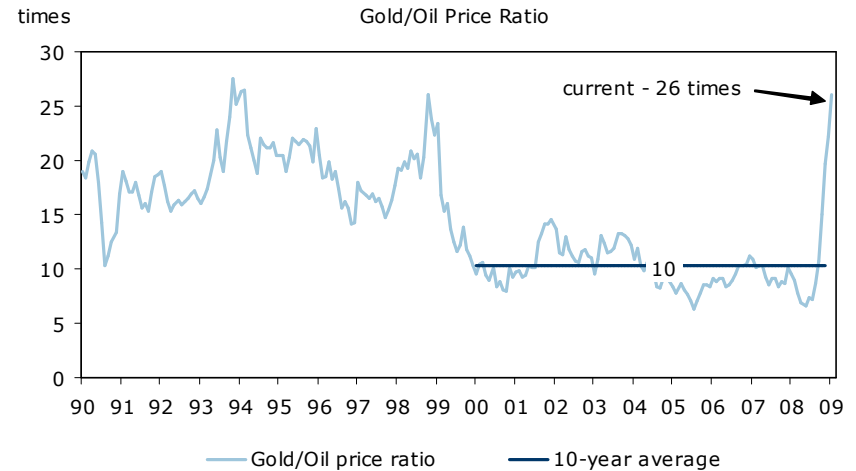
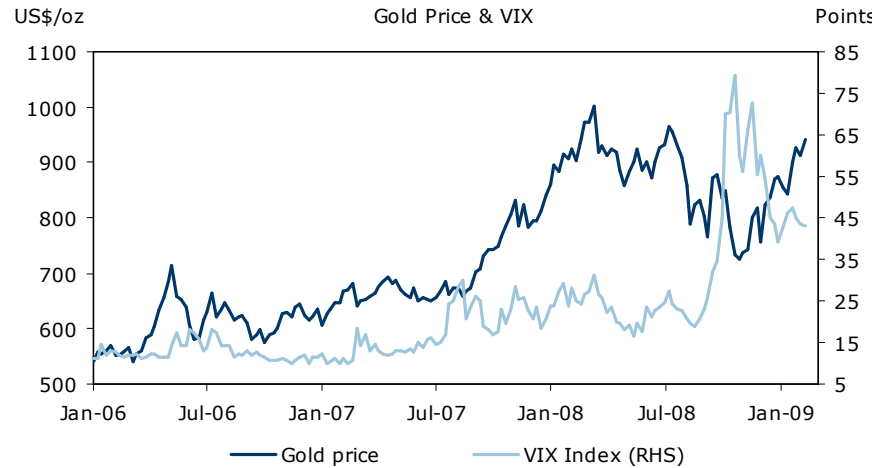
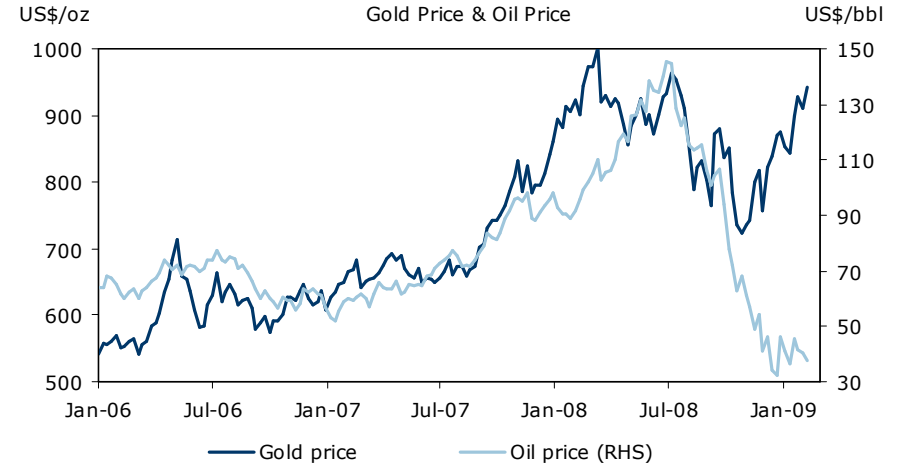
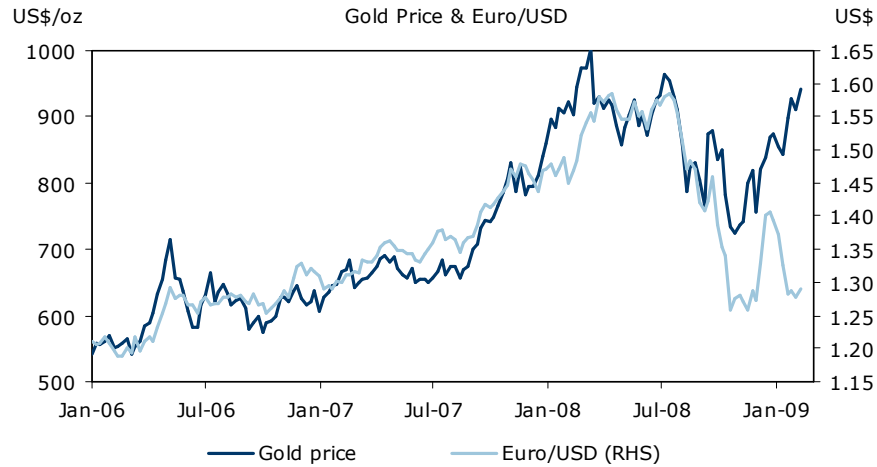
Cumulative proportion of producers ranked by production costs

Source: Bloomberg; ANZ Commodities Research.



# Gold has become a 'play' on the US\$, economic weakness (oil) and investor risk aversion (VIX)

## Gold vs the US\$, oil and sharemarket volatility (VIX)



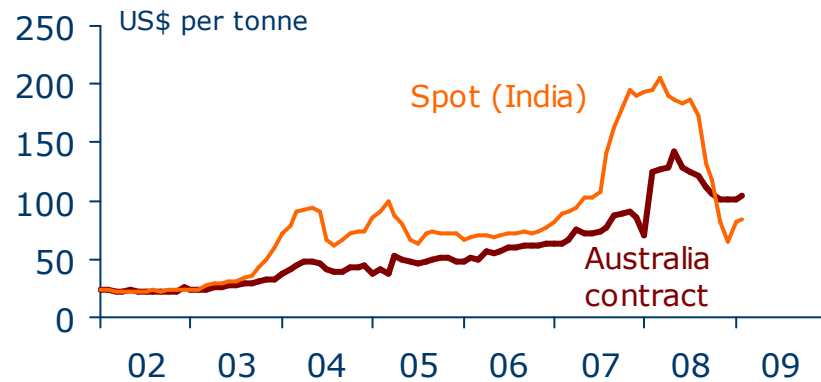
Source: Bloomberg; ANZ Commodities Research.



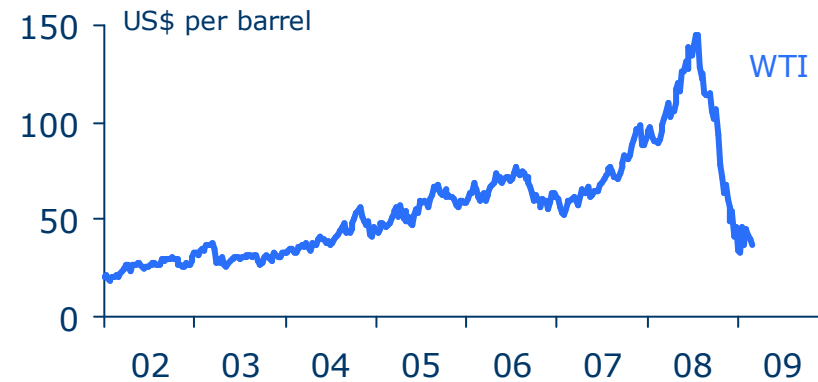
Some tentative signs that bulk and energy commodity prices may be stabilizing, but too soon to be sure

## Bulk commodities, oil and shipping freight rates

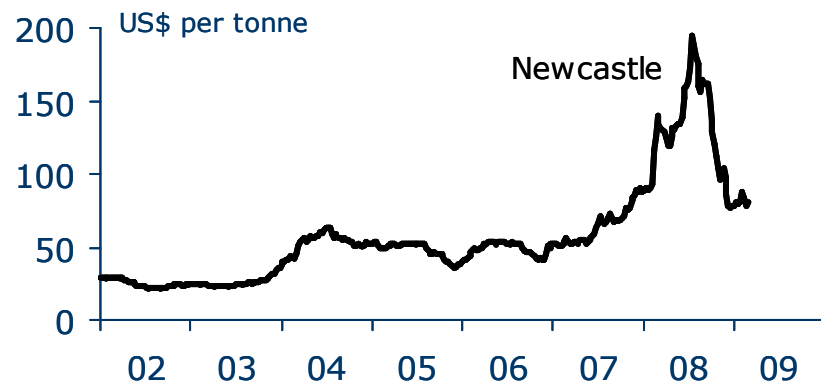
### Iron ore



### Oil prices



### Thermal coal



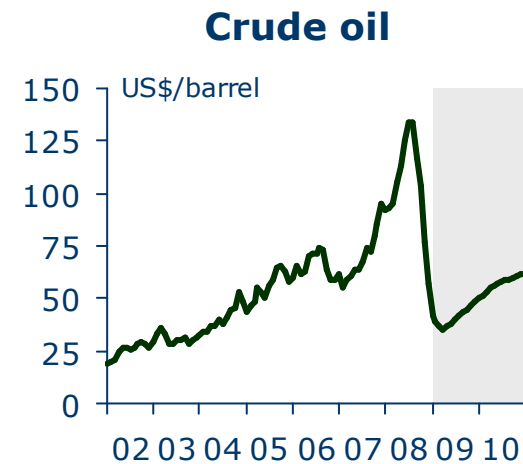
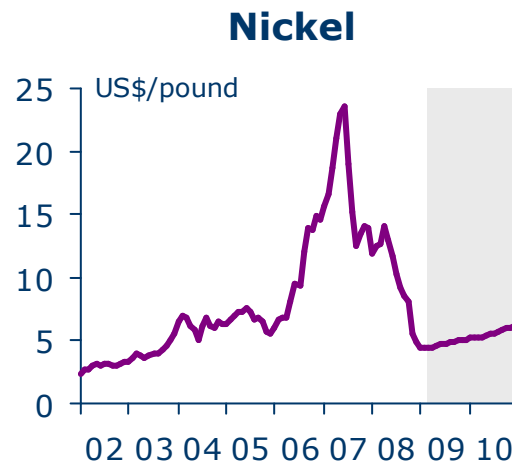
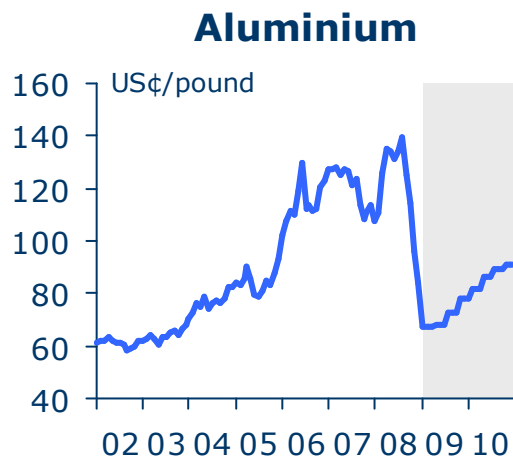
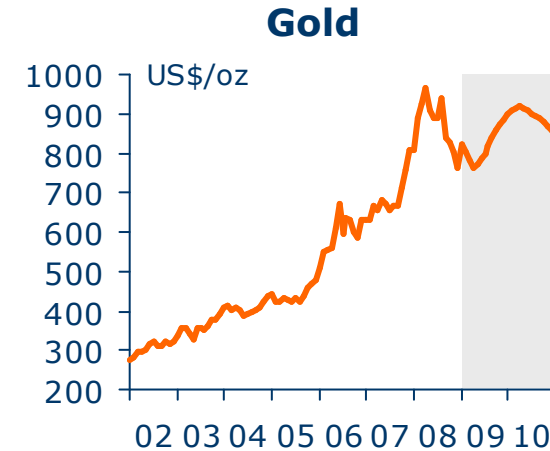
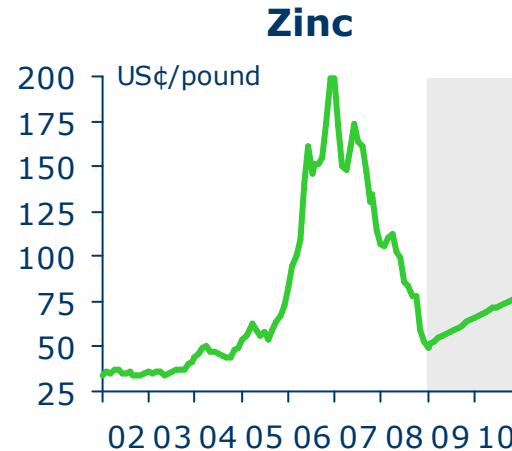
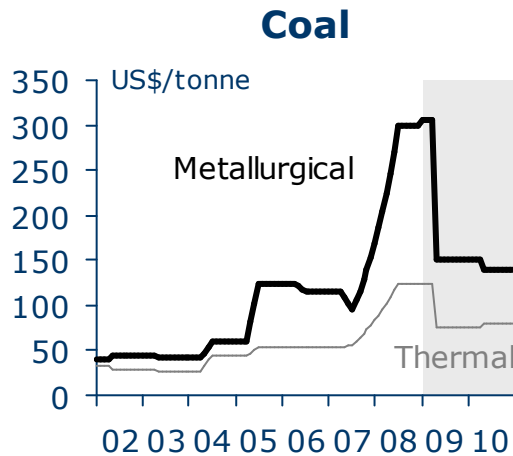
### Baltic freight



Sources: Bloomberg; Datastream.



# Bulk commodity contract prices will fall 35-50%, but base metal prices are close to bottoming <sup>25</sup>

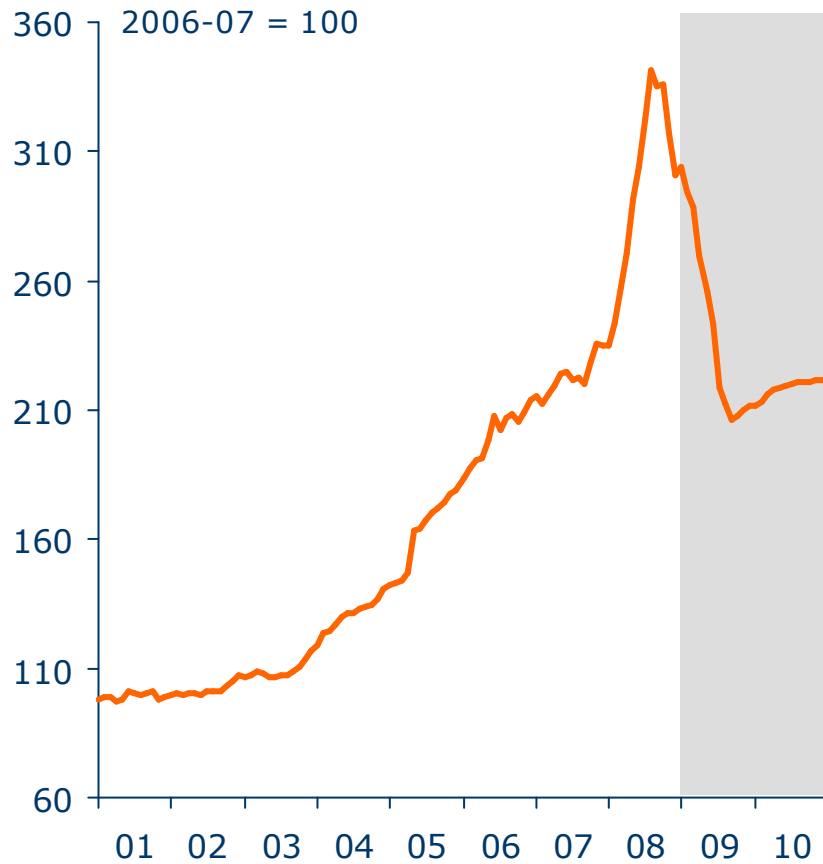


Sources: Datastream; ANZ Commodities Research.

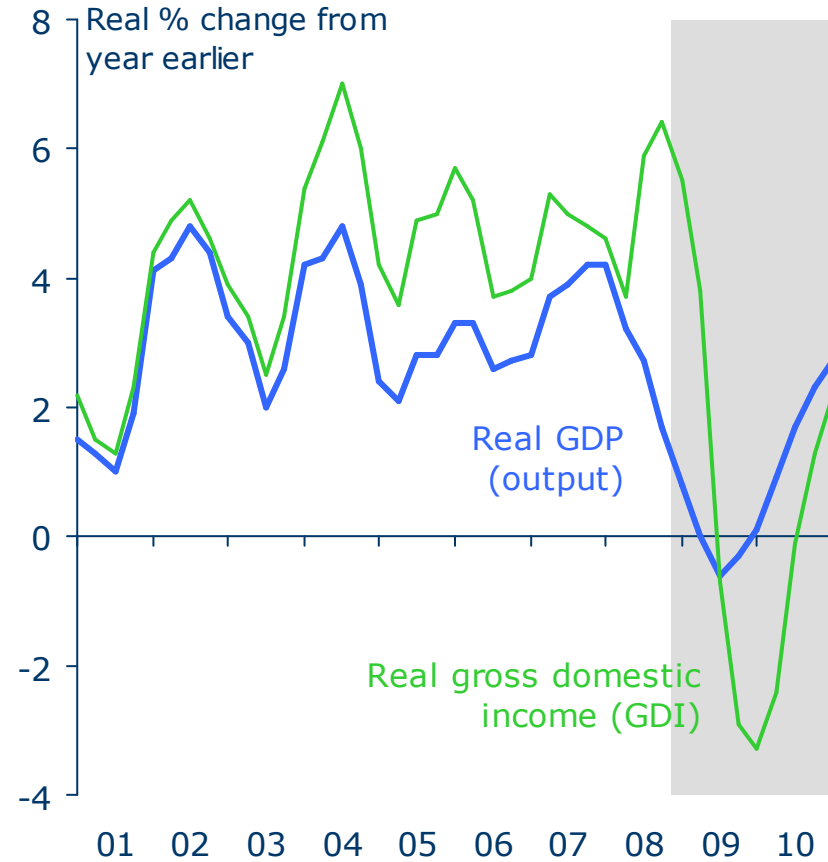


# The sharp fall in commodity prices will detract substantially from Australian national income in 2009 <sup>26</sup>

### Australian export commodity prices



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

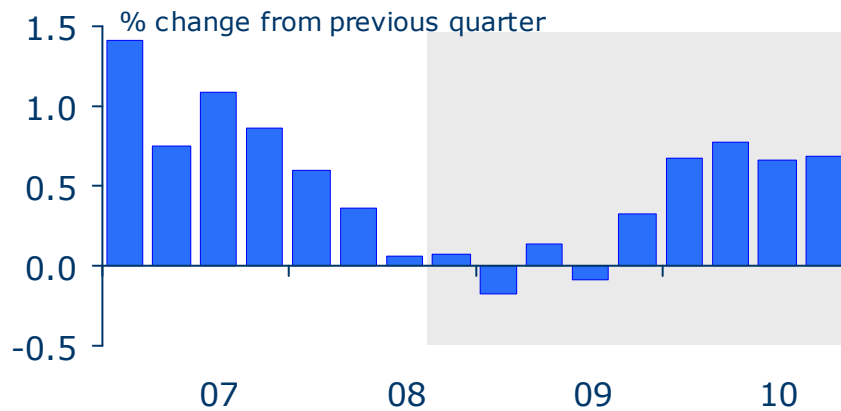


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

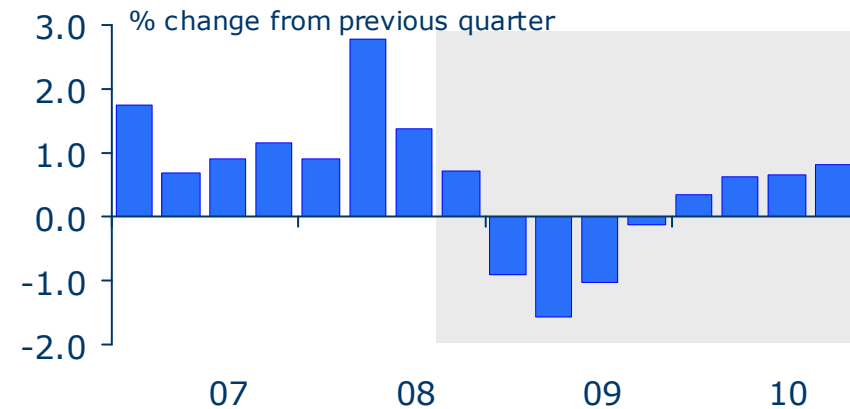


# Australia might avoid consecutive quarters of negative real GDP growth, but it will have a recession by other definitions <sup>27</sup>

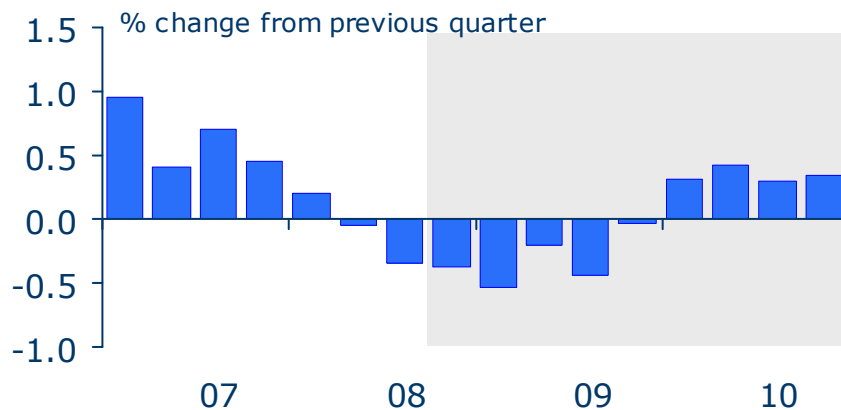
### Real gross domestic product (GDP)



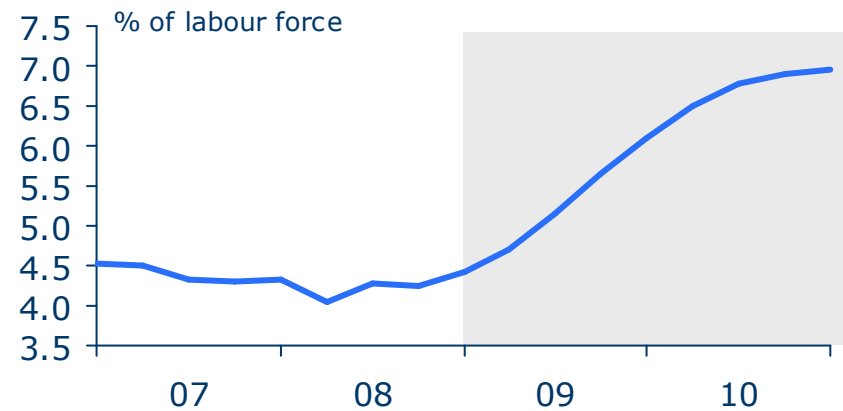
### Real gross domestic income (GDI)



### Real per capita GDP



### Unemployment rate



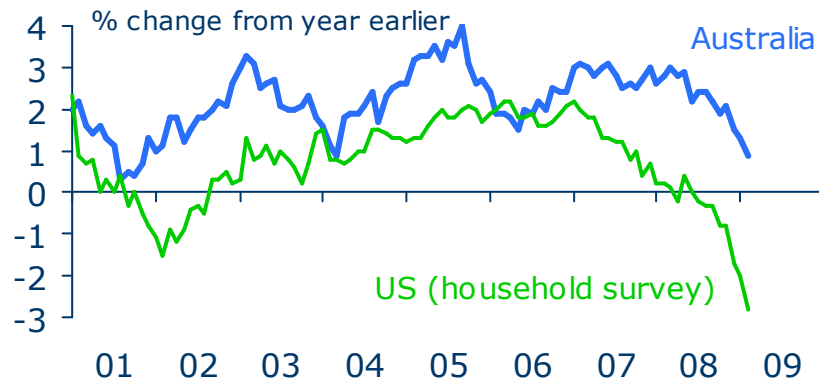
Note: Real gross domestic income is real GDP adjusted for changes in the terms of trade (export relative to import prices). Shaded areas denote ANZ estimates or forecasts. Sources: ABS; ANZ.



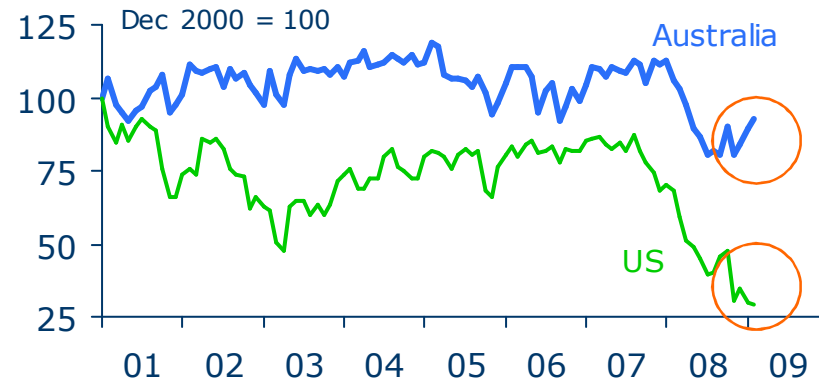
Australia's economy has thus far held up considerably better than America's ...

### Australian and US labour market and household spending

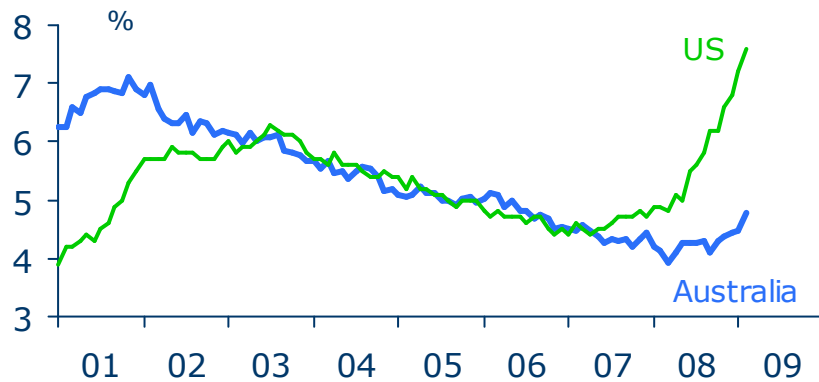
#### Employment



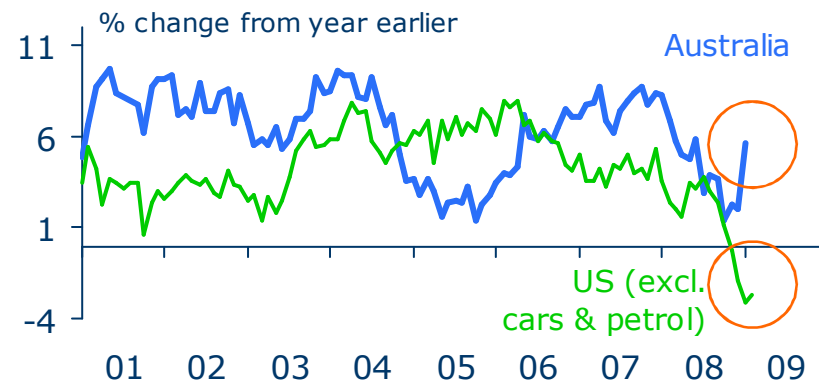
#### Consumer confidence



#### Unemployment rate



#### Retail sales



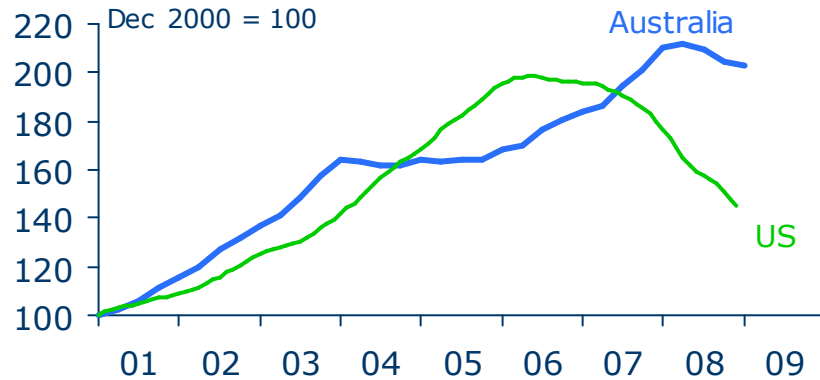
Sources: ABS; US Bureau of Labor Statistics; The Conference Board; Roy Morgan Research; US Commerce Department; ANZ.



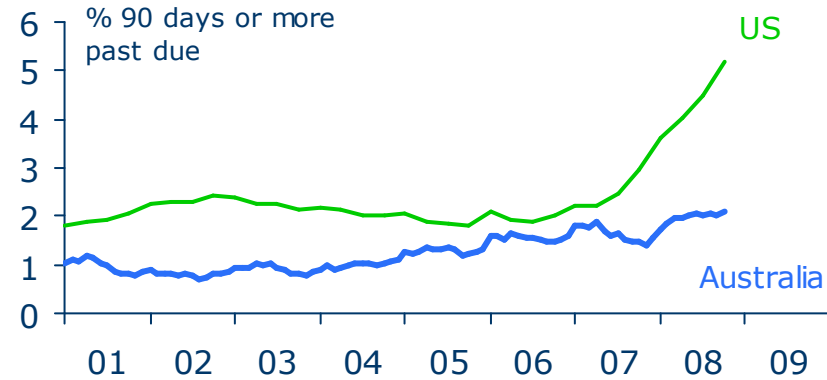
.. partly because Australia's housing market and banking system have remained stronger than America's

## Australian and US housing markets and household finances

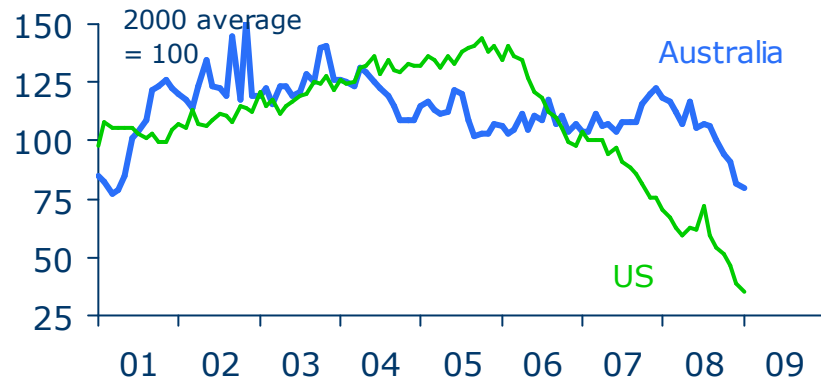
### House prices



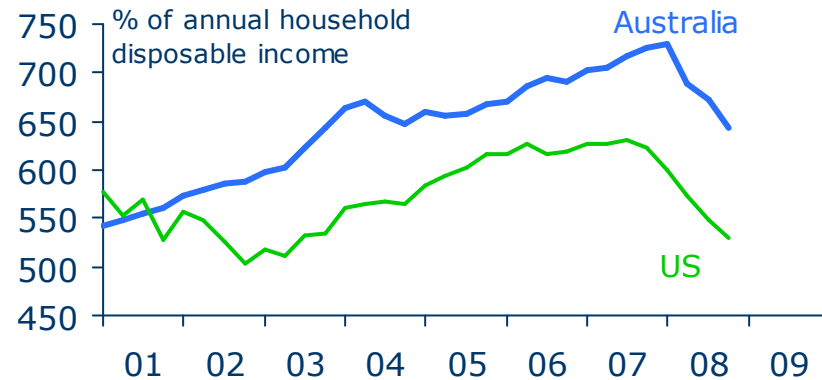
### Mortgage delinquency rates



### Housing approvals



### Household net worth

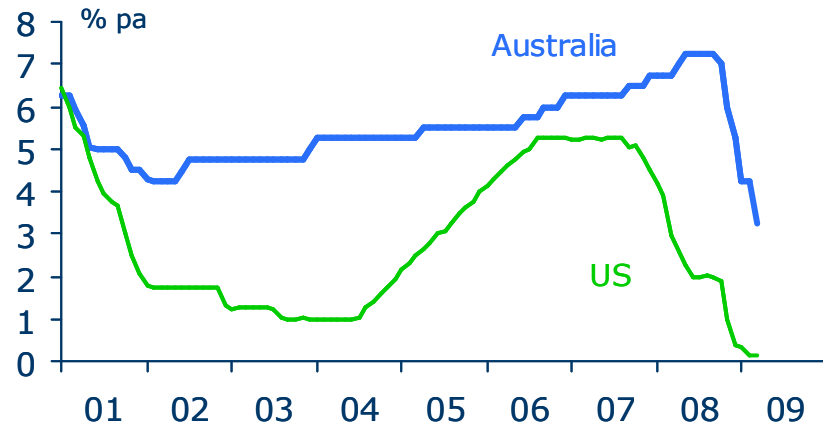


Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: ABS; S&P; US Federal Reserve; Mortgage Bankers' Association of America; US Commerce Department; ANZ.

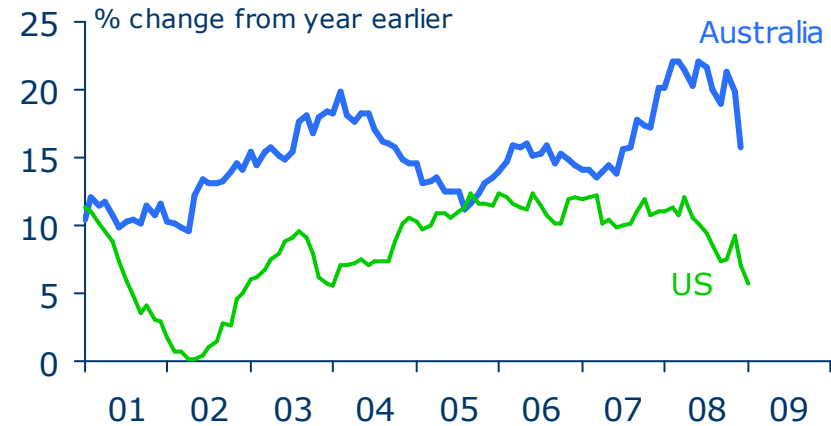


# Monetary policy is 'working' more effectively in Australia than in the US, in part because the banking system is in better shape <sup>30</sup>

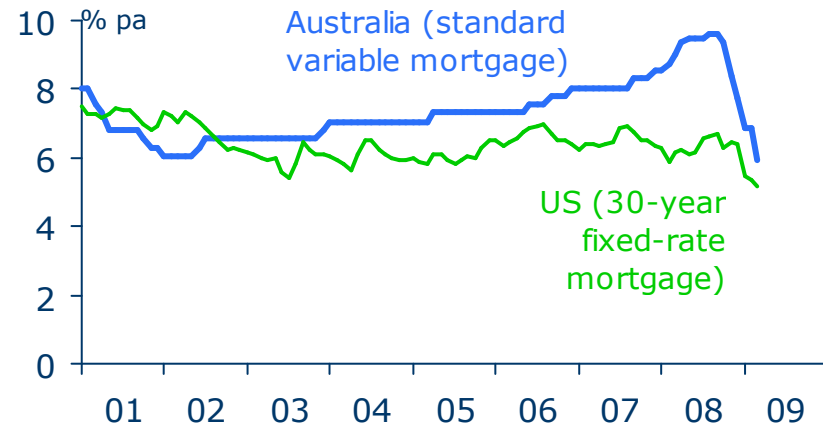
### Official interest rates



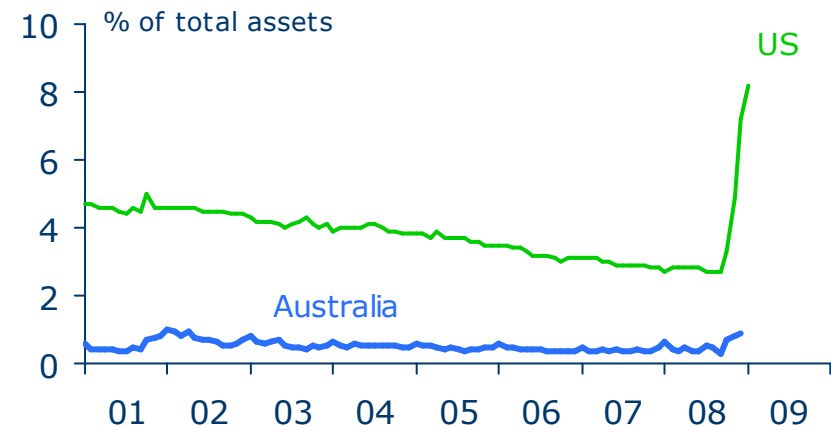
### Bank lending



### Most common mortgage rates



### Bank cash holdings



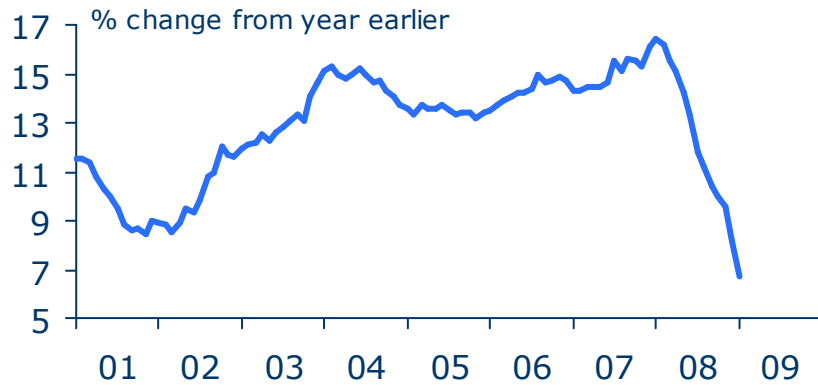
Note: 'Cash' includes deposits with the central bank. US banks are subject to required to hold cash reserves against their transactions account balances and thus typically hold a higher proportion of their assets in cash than Australian banks which are no longer subject to such requirements. Sources: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



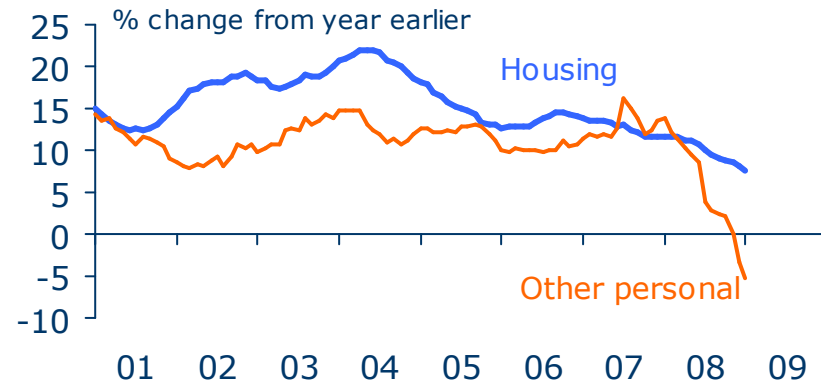
# Nonetheless both the demand for and supply of credit to Australian households and businesses is slowing

## Credit provided to the Australian private sector

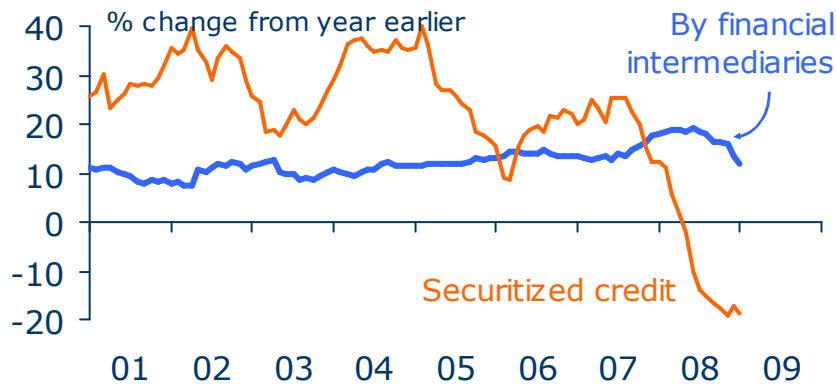
### Total credit



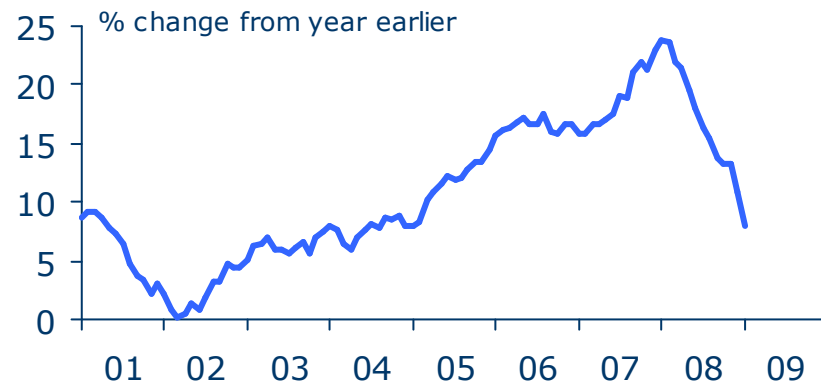
### Credit to households



### Credit by source



### Credit to business



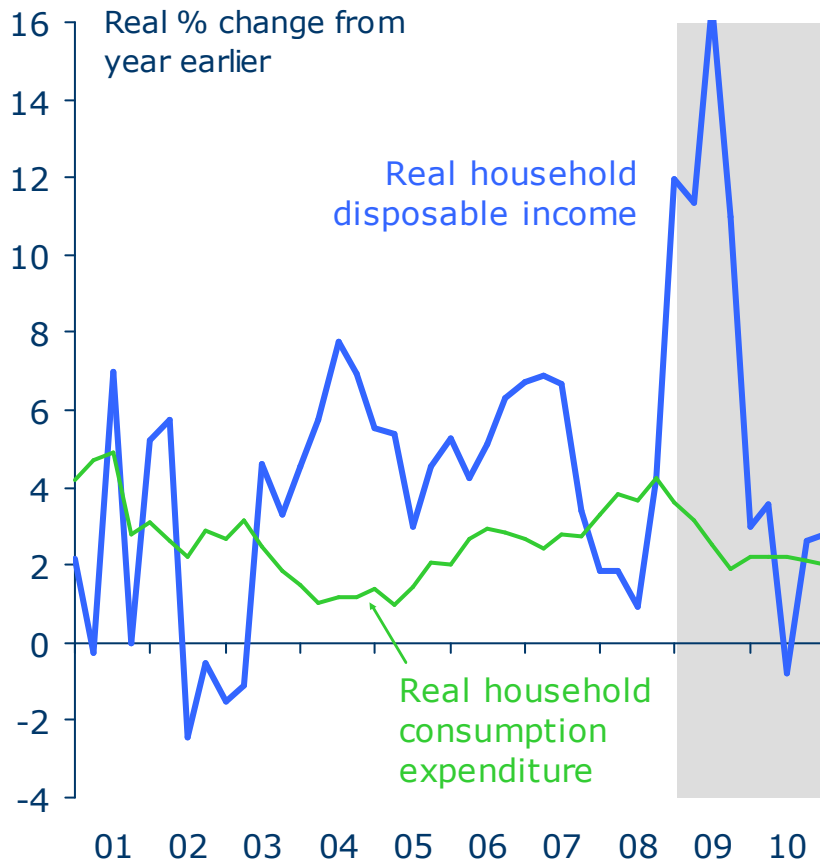
Source: Reserve Bank of Australia.



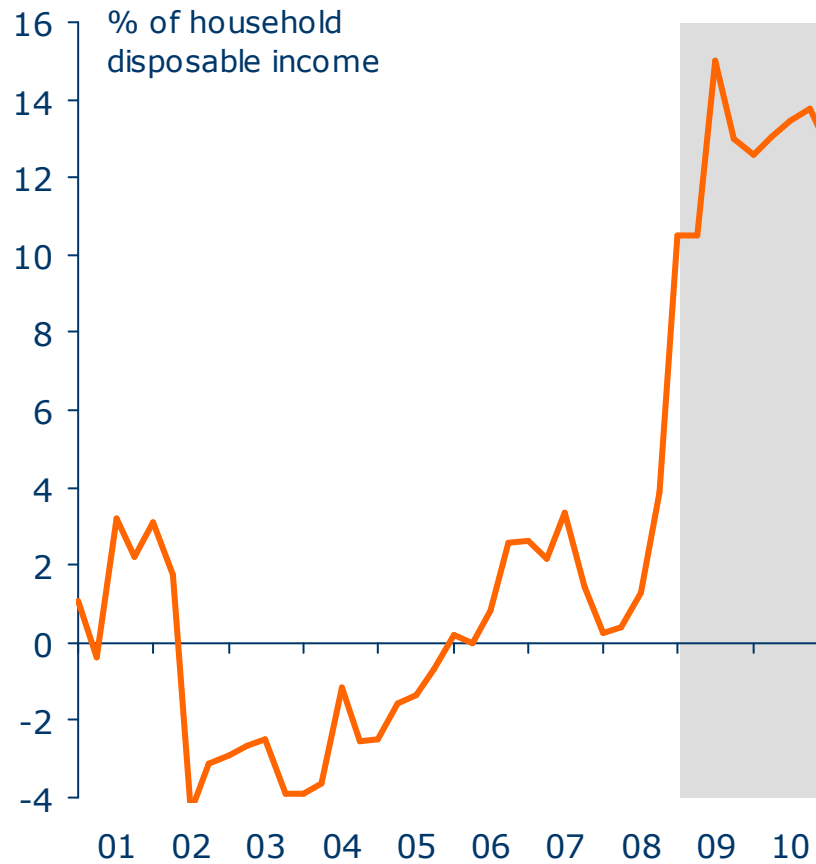
Cash handouts, interest rate cuts, and lower petrol prices will boost household incomes substantially – but a lot of it will be saved 32

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### Household disposable income and spending



### Household saving rate



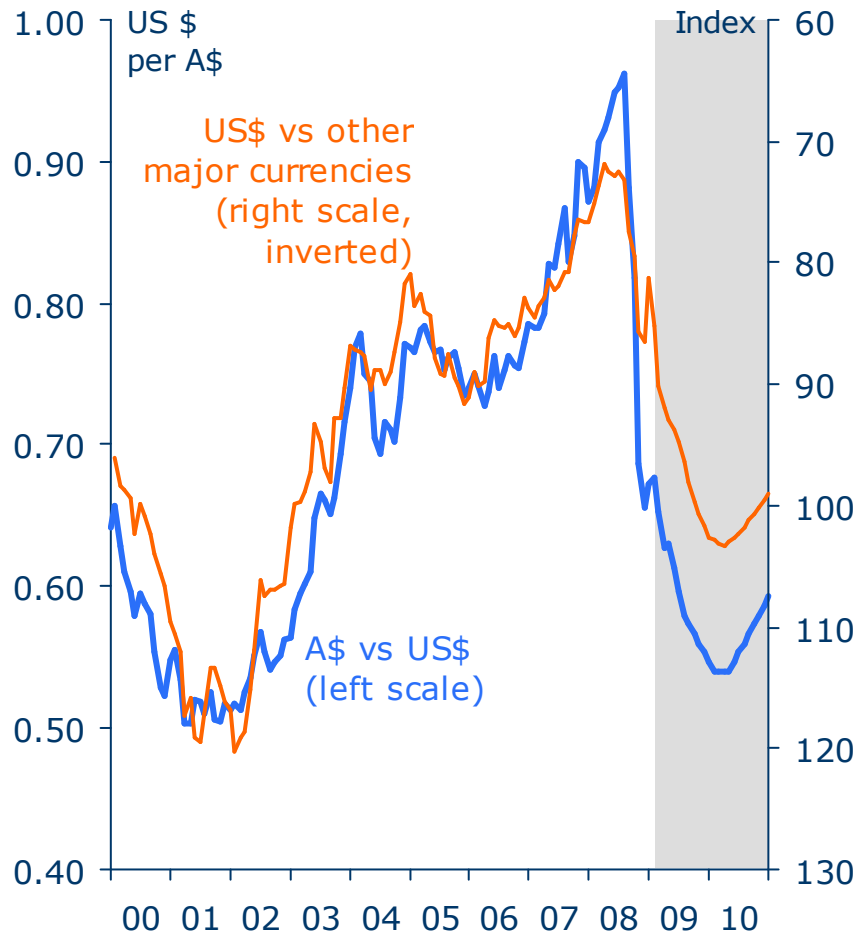
Sources: ABS; ANZ.



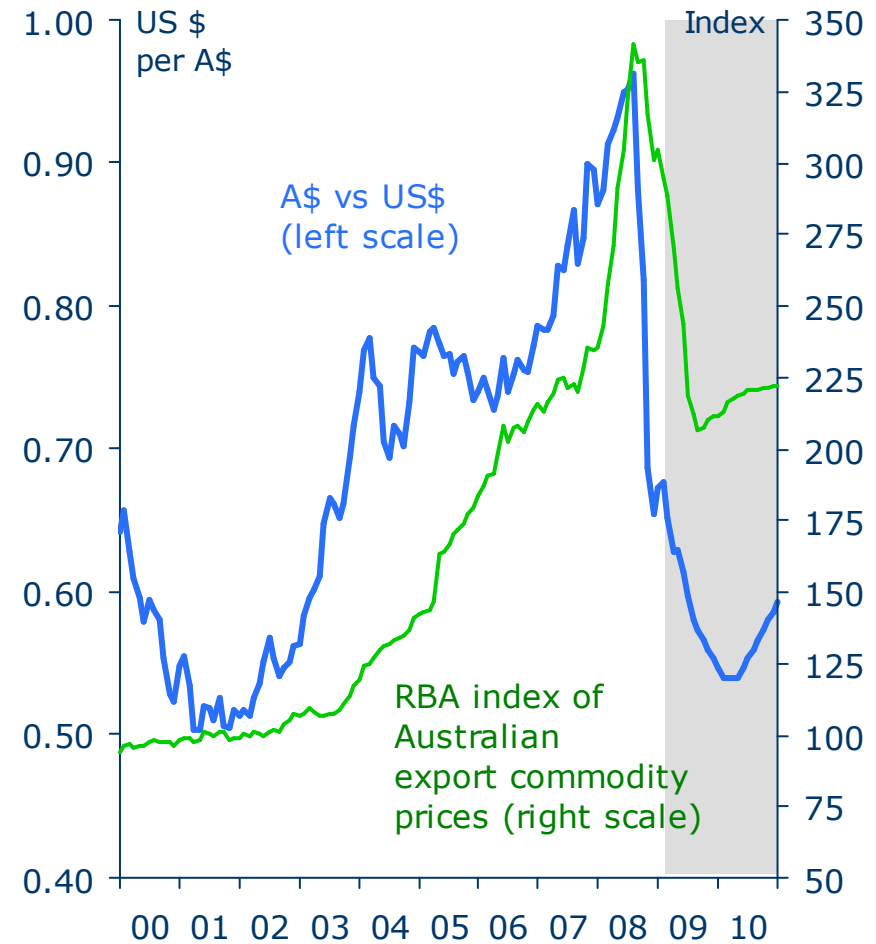


# The A\$ will fall further against a resilient US\$ - though this will help cushion the economy and resist deflation 33

### A\$ vs US\$



### A\$ & commodity prices



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



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

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## 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