

15 April 2009

Economic Quarterly

Overview



There have been a number of significant events over the last few months which mark this point in time as historically auspicious in Australia and globally. One such example is the consensus reached amongst member nations at the G20 summit in London at the beginning of April. Member nations agreed to seed several hundred US\$B into the IMF and have also pledged to collectively spend US\$5T before year end 2010. The sheer size of this commitment is difficult to grasp and for the average person its time to start wondering just where all this money comes from and how it all gets paid back. If nothing else it is apparent future generations are going to have to finance the ongoing borrowing for many years.

The second major event is uniquely Australian. This is the announcement on 7 April by the Federal Government that it will build a \$43B National Broadband Network (NBN). This is a defining moment in Australian history as the Rudd Government has identified the communications network in the country as a "public good" - meaning that the Government's social ambitions (such as fast broadband to the masses) cannot be met purely by private interests. To achieve its aim, it will mean either a re-regulation of Telstra with compulsory (or voluntary) acquisition of some, or all of its existing network. This feeling of *de ja vu* could easily be described as "back to the future" wherein we have telecommunications networks once owned by the Government, then floated in the bullmarket of the 1990's and now taken back and funded by Government.

Other recent economic milestones worthy of note are :-

- The RBA has conceded that Australia will not escape a recession in 2009 and there will be an ongoing sharp rise in unemployment.
- The OECD has precipitously downgraded its forecast for the developed world's GDP to a drop of 4.3% in calendar 2009 and negative 0.1% in 2010.
- The World Bank has forecast the global economy is expected to shrink by 1.7% in 2009, its first contraction since World War II.
- The OECD has also warned that the number of jobless workers in the G7 (Britain, Canada, France, Germany, Italy, Japan and the US), was expected to double from its mid-2007 level to top 36M in late 2010 and,
- Predictions of job losses in the US suggest the 10% unemployment mark could be breached in 2010.

Despite all the doom and gloom, stocks markets have re-bounded strongly in recent weeks, with bears arguing an artificial dawn about the worst being over. The ASX200 for instance is up 13% since 10 March 2009. If nothing else we appear to be in the twilight between a share market recovery but a bottoming real economy with earnings downgrades, falling dividends and rising unemployment. Most economists see some recovery in stock markets this year partly based on evidence of a nadir in the real world economy. Nonetheless, there seems to be very little statistical evidence to support the bottom argument and it could be more about hope than substance. That said, it seems unlikely markets will dip back to previous lows (in Australia this is below the 3200 mark) Equally there's very little reason to support the "animal spirits" (Keynes) that have pushed the markets rapidly north in recent weeks.

Australia

Unemployment
7.5%++
GDP -0.5-1%

The unemployment rate in Australia is now expected to breach 7% and there are sobering predictions of 8-9% in early 2010. This is a lag indicator as businesses react slowly to worsening conditions and implement the easy cost cutting measures early (cutting travel, entertainment; overtime, etc) with the harder human resource cuts later. That said, the Rudd Government hopes its current (although transient) Fiscal package, combined with RBA largesse (another 25bps reduction in the cash rate on 7 April) will make for a soft landing. Regardless, the impact across the States will be fractured due to the different business profiles (manufacturing – SA and VIC); resources (Queensland and WA) and finance (principally NSW). Notwithstanding, Australia still remains fiscally healthy with a possible Federal deficit in FY10 of \$45B (only 4.5% of GDP, c/f US at 12-14% and Italy with public debt at over 100%!).

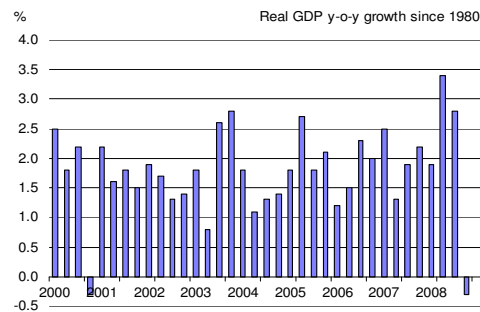
It is easy to be blasé and suggest that Government's have singularly and collectively done enough to stabilize financial markets and put confidence back in real markets. That may be the case but the only thing that matters at this juncture is *the belief* that it is the case thus restoring badly missing confidence, both at business and at individual level. Unwinding the credit markets will do little if demand for credit remains tepid (and even slipping).

There appears to be positive reaction following the outcome of the G20 meeting and a general consensus that John Maynard Keynes is still living amongst us. Nonetheless, there is a potentially painful gap between the excitement observed at the G20 meeting by our world leaders and real and tangible outcomes that redress the current economic malaise.

Rest of World

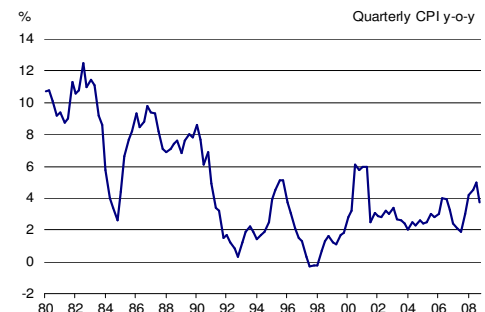
Big picture indicators

GDP



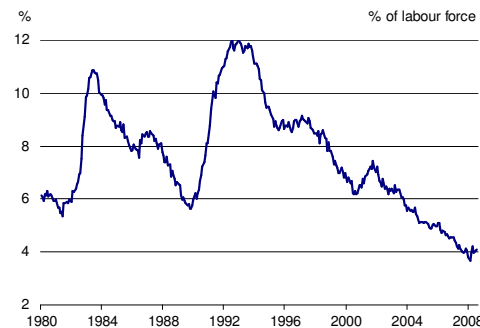
Source: RBA

CPI



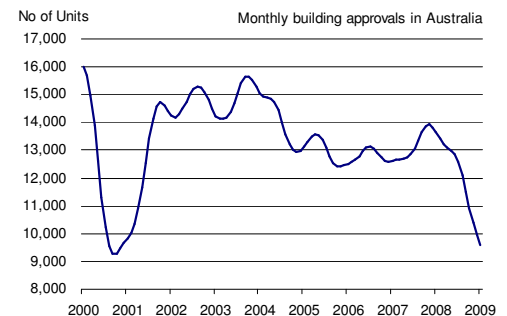
Source: ABS

Australian monthly unemployment rate



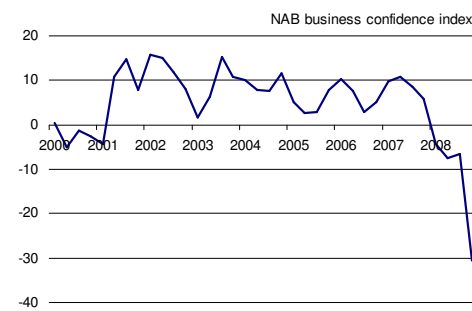
Source: ABS

Monthly building approvals in Australia



Source: ABS

Business sentiment index



Source: NAB

Stock market



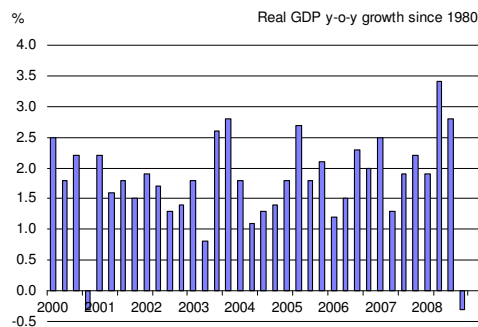
Source: IRESS

KEYPOINTS

- GDP declining and inflation falling is about where we would hope to be in the cycle and allows the RBA increasing flexibility to use monetary policy to further stimulate credit markets.
- The slowing economy is lagged by unemployment which is starting to accelerate upwards and has led to predictions in Australia of 9% unemployed in 2010. This is harsh, although a key unknown is the potential further weakness in commodity markets and implications for resources based employment.
- Business confidence remains very weak, although while not shown above, the Westpac Bank-Melbourne Institute index of consumer sentiment, released on 8 April, showed an 8.3% jump in April from March. The jump could be accredited to lower interest rates, pending (or previous) fiscal initiatives and the improvement in the local performance of the bourse.

Economic Activity

Real GDP



Source: RBA

Monthly building approvals



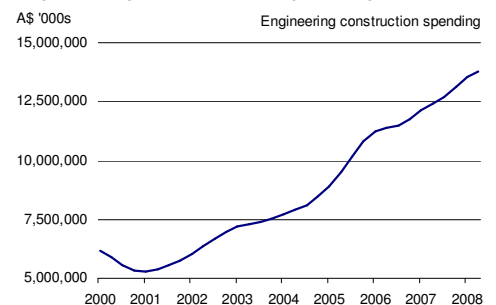
Source: ABS

Monthly car sales



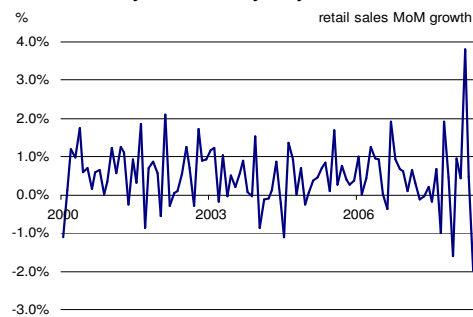
Source: ABS

Engineering construction spending



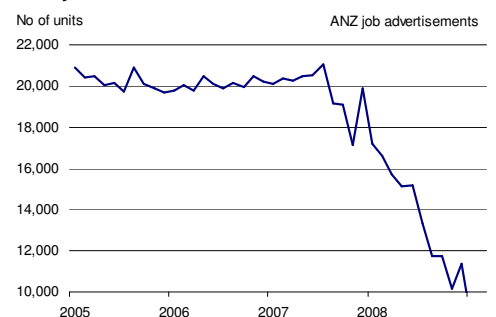
Source: ABS

Real monthly seasonally adjusted retail sales



Source: ABS

ANZ job ads



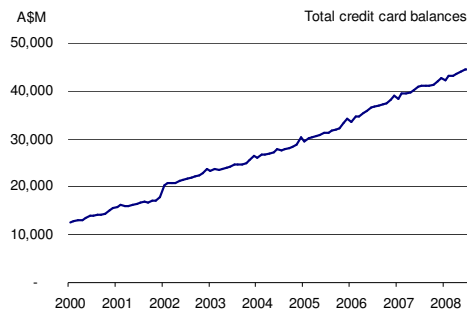
Source: ANZ

KEYPOINTS

- There is a ground swell of opinion that Australia will be in a technical recession in calendar 2009. This is purely academic as the statistical evidence already confirms the level of overall economic activity is weak; Federal and State finances are under serious pressure and job losses are mounting;
- The other charts confirm the daily reality that times are tough and may get tougher, although housing finance figures released on 8 April suggest some nascent signs of recovery in the housing market. Amongst all the economic indicators, this is the most significant and one could contend that this momentum will continue to build in coming months.

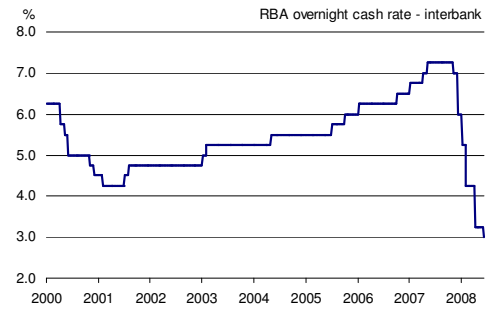
Finance

Total credit card balances



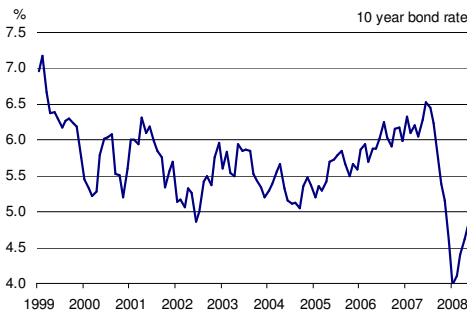
Source: RBA

RBA overnight cash rate



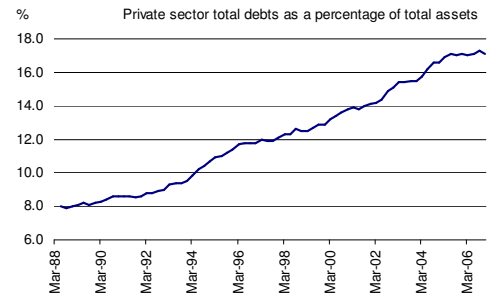
Source: RBA

10 year bond



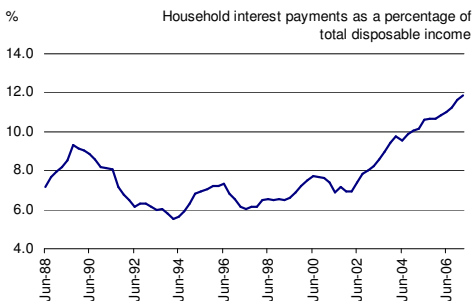
Source: RBA

Private sector total debts



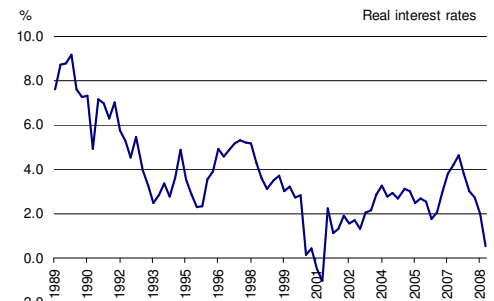
Source: RBA

Household interest payments as a %



Source: RBA

Real interest rates



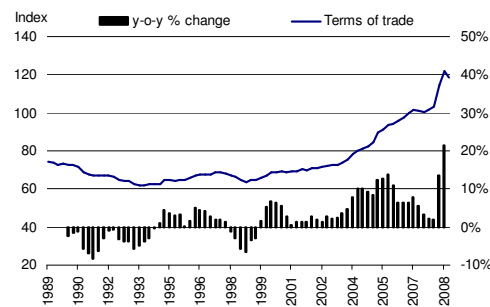
Source: RBA; KPM.

KEYPOINTS

- Real interest rates are falling and that is expansionary. It puts some perspective on the 7 April cut in the cash rate by just 25bps and the almost even split amongst economists in the lead up to this announcement on how the Central Bank will call it, given recent economic data. The Bank would have also noted the strong bounce in the stock market and been cognisant that something finally appears to be moving in the right direction.
- Economists also anticipate a sharp tick down in forthcoming statistics in relation to household interest payments as a percent of disposable income, given the improving household affordability situation (falling/stagnating house prices and substantial declines in interest rates and thus funding costs).

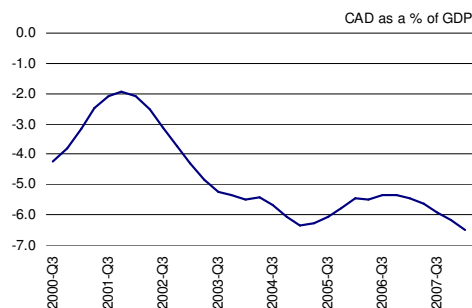
External

Terms of trade



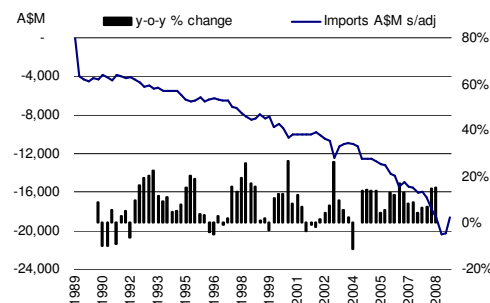
Source: ABS, RBA, KPM

CAD as a % of GDP



Source ABS, RBA, KPM

Imports



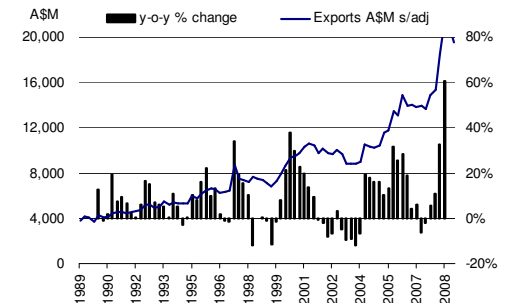
Source: ABS, RBA, KPM

A\$/US\$



Source: RBA

Exports



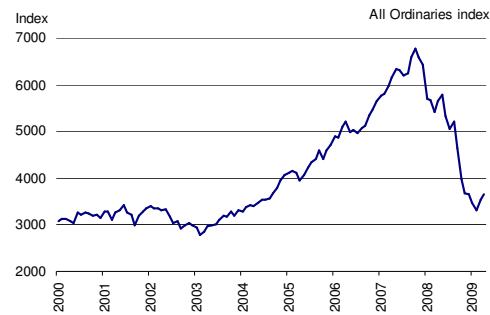
Source: ABS, RBA, KPM

KEYPOINTS

- One of the most significant indicators of both internal and external financial health is the value of the A\$ to the US\$. Exchange rate forecasting consensus at one point indicated a move to A\$0.50 against the US\$, following previous (and recent) calls for it to hit parity. However, it is a complex potpourri and a function of our domestic exchange rates; Federal budget deficits/surpluses and, more importantly, commodity prices. No-one can be expected to get it right all the time and most get it wrong most of the time. Take the report just released by the University of California which showed that of 284 "experts" on economic and political phenomenon, 82,361 predictions were "wrong two-thirds of the time". Extraordinary that we continue to value the forecasting.

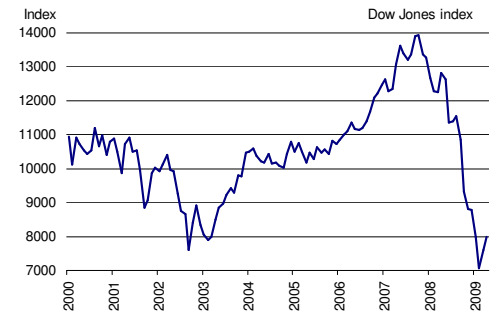
Markets

ASX



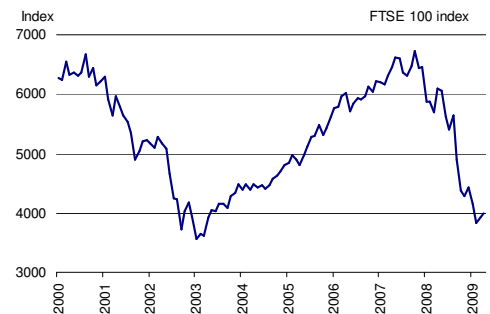
Source: IRESS

DOW



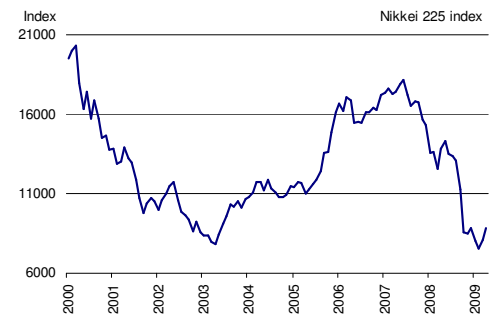
Source: IRESS

FTSE



Source: IRESS

Nikkei



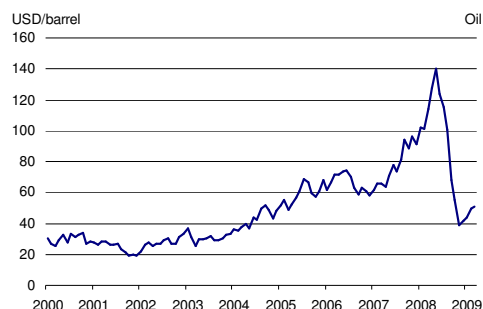
Source: IRESS

KEYPOINTS

- There is a nice bounce in these numbers and the pattern is consistent across the globe. This doesn't mean the worst is over or even that the momentum can be sustained. In fact following the lines back to 2000 we can see many false starts/false dawns which the brokers call the "dead cat bounce". Nevertheless, with the possibility that all bad news is now factored in the market it is unlikely markets will retrace to previous lows and these lines will not be breached again. This seems to be an increasingly consensual view.

Commodities

Oil



Source: LME

Aluminium



Source: LME

Copper



Source: LME

Gold



Source: LME

Nickel



Source: LME

KEYPOINTS

- This is a distressing picture. If it gets worse, Queensland and WA will become a lot more stressed and the A\$/US\$ would logically slip further. The offsetting benefit of a lower A\$/US\$ exchange rate offers trading irony in that it makes A\$ exports cheaper and can even be the quid pro quo to balance out a loss in both volumes and prices for the miners. "Curiouser and curiouser" said Alice.

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