

State of the
Region Summit®



Big Economic Trends

Besa Deda

(St. George Bank)

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Outlook on the Economy, Interest Rates & Aussie Dollar

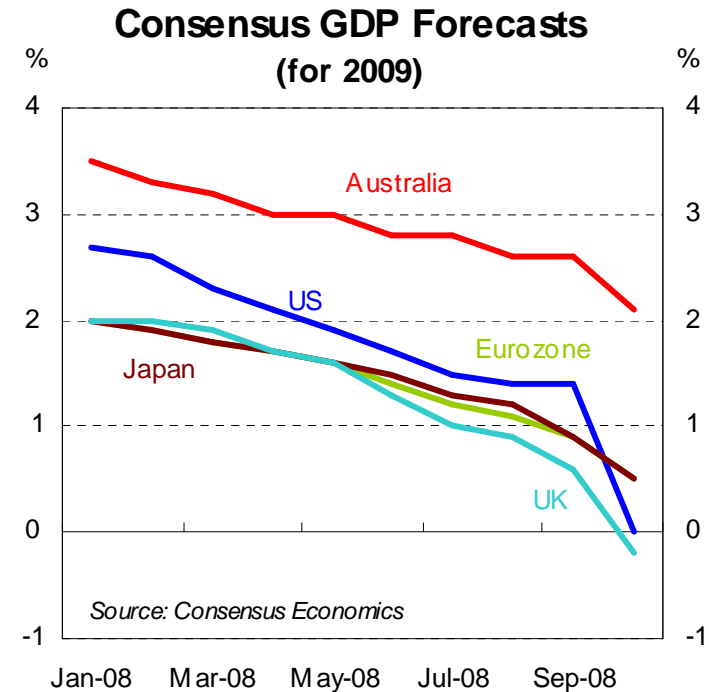
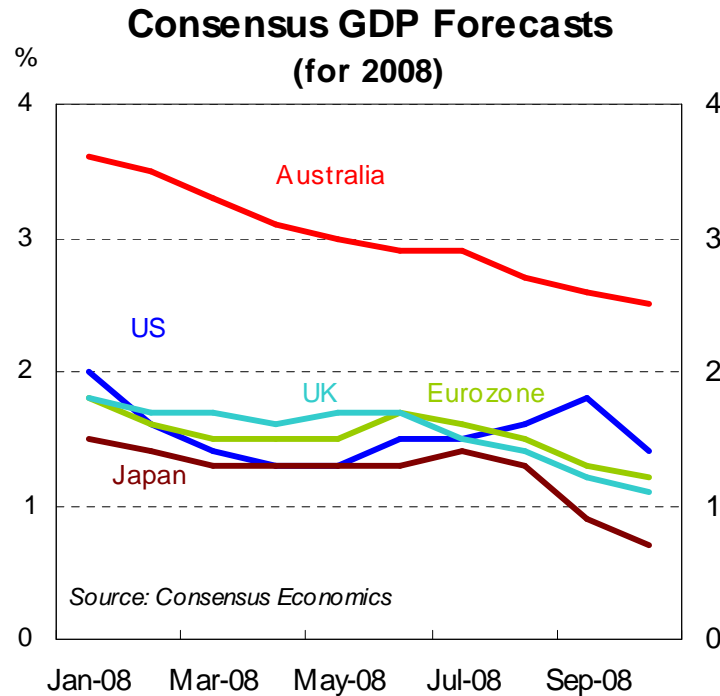


Besa Deda
Chief Economist
6 November, 2008

Road Map

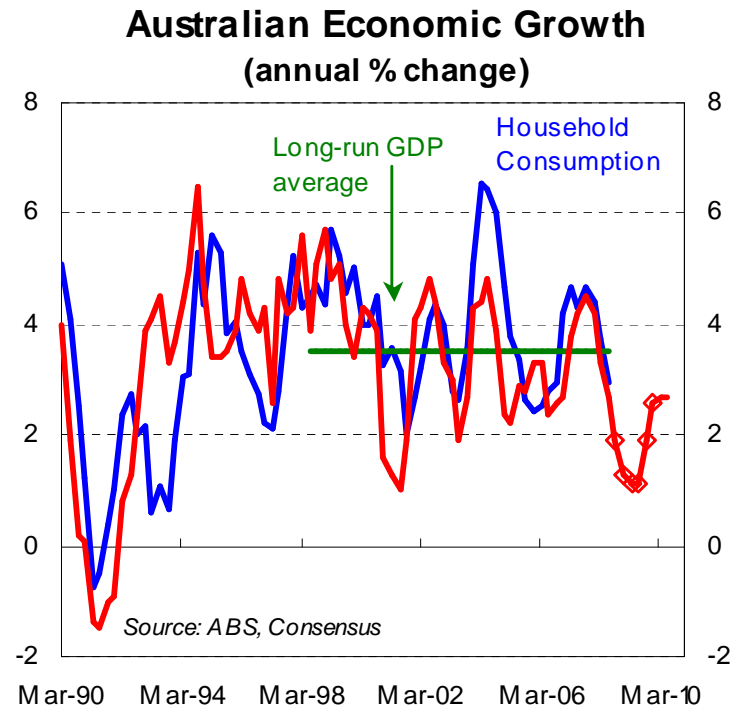
- **Domestic economic conditions**
- **External economic conditions**
- **Credit crisis**
- **Inflation**
- **Interest rate outlook**
- **Aussie dollar outlook**

Australia - Stronger for Longer



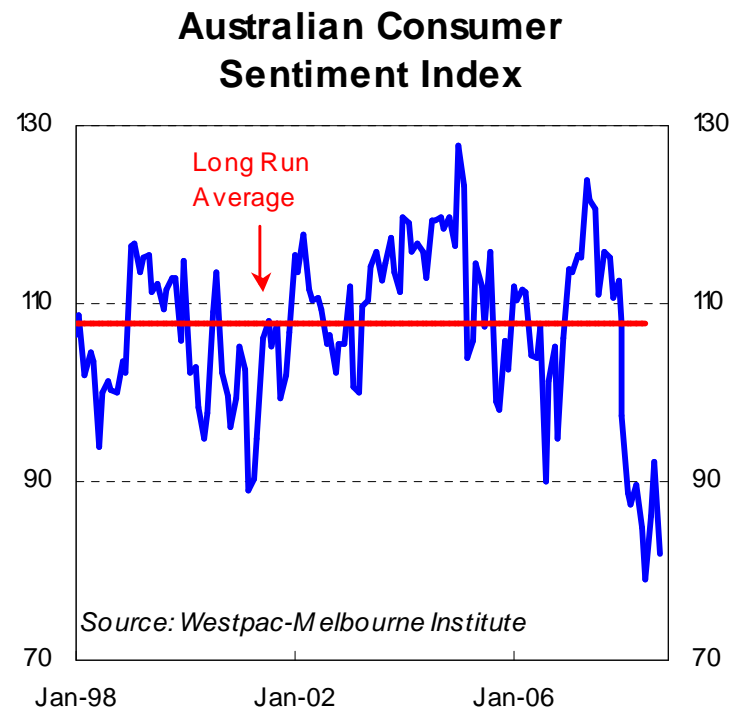
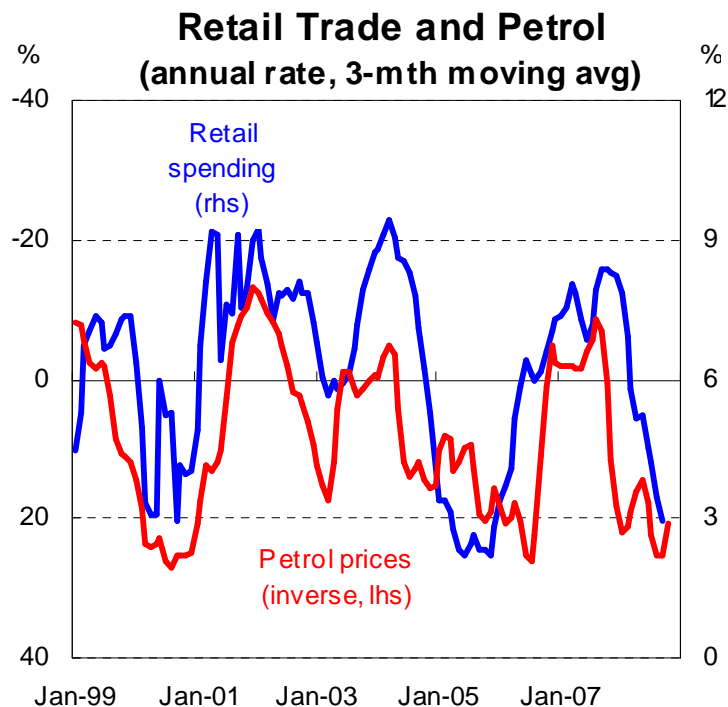
- **Growth prospects remain more favourable in Australia than in other major economies around the world.**

The Domestic Economy – Shifting Down a Gear



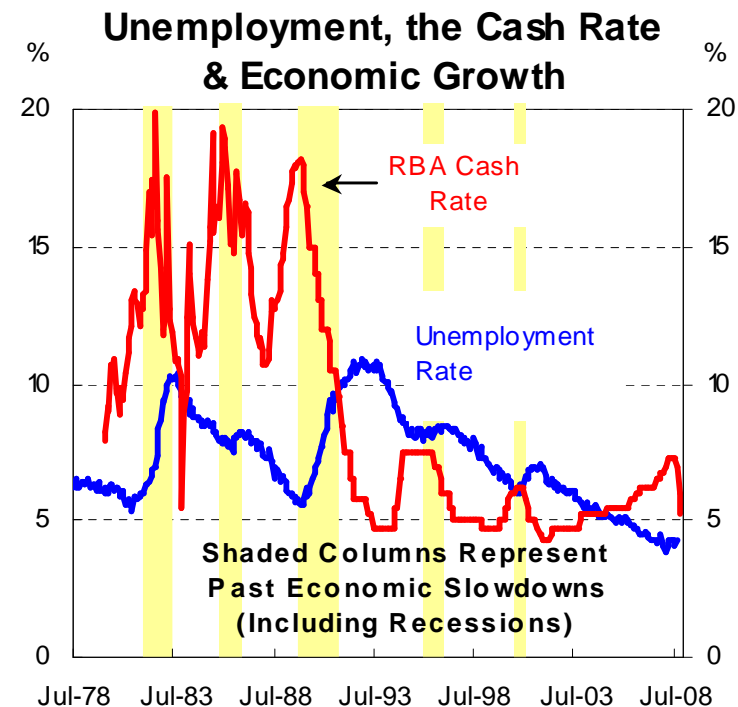
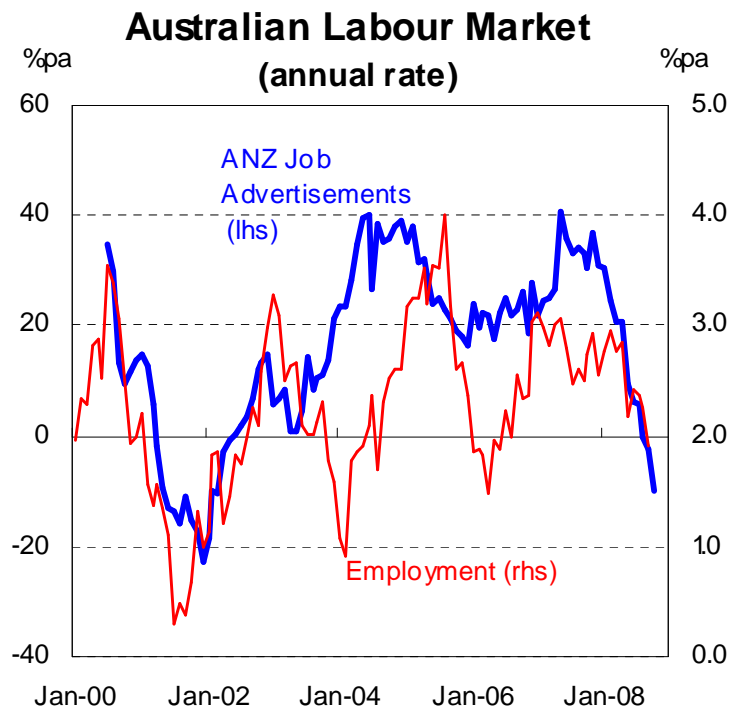
- **We expect the economy to slow further for the rest of this year, next year and part of 2010.**
- **There are increasing risks of a harder landing.**
- **Global growth is one of the biggest risk factors to Australia's outlook.**

Cautious Consumers



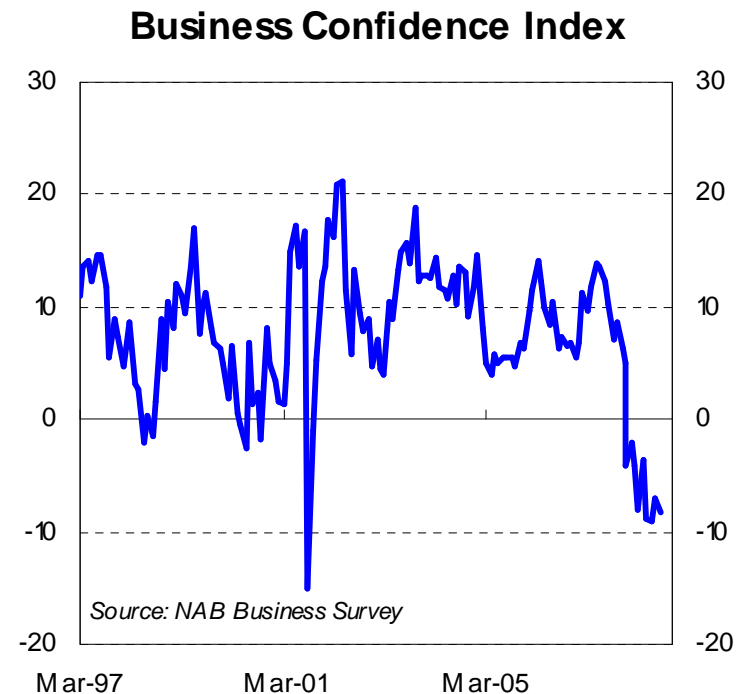
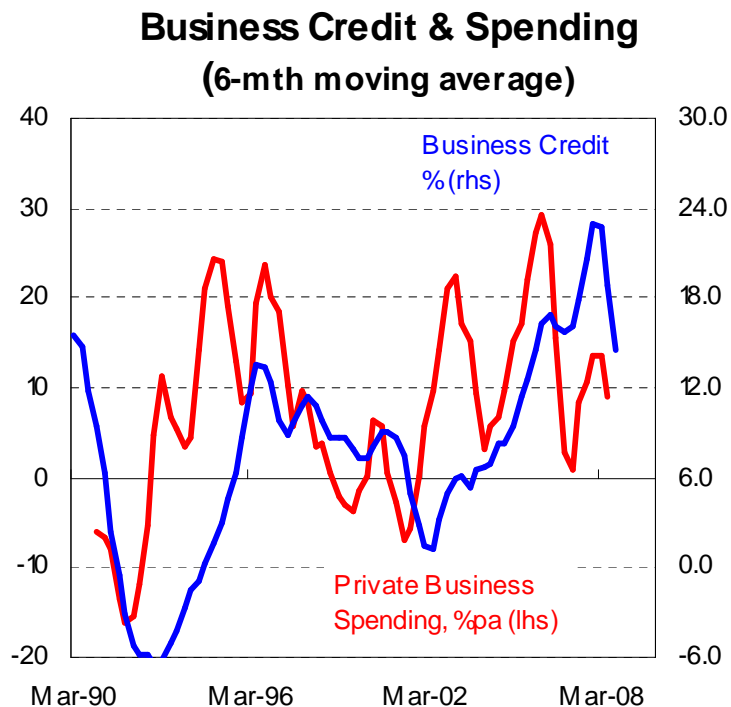
- Retail spending has slowed, as consumers' purse strings have tightened.
- Consumers remain cautious amid the uncertain economic outlook and ongoing credit crisis. Petrol prices have dropped in recent weeks, but remain elevated.
- Consumer confidence is near 16-year lows.

Smoke and Mirrors



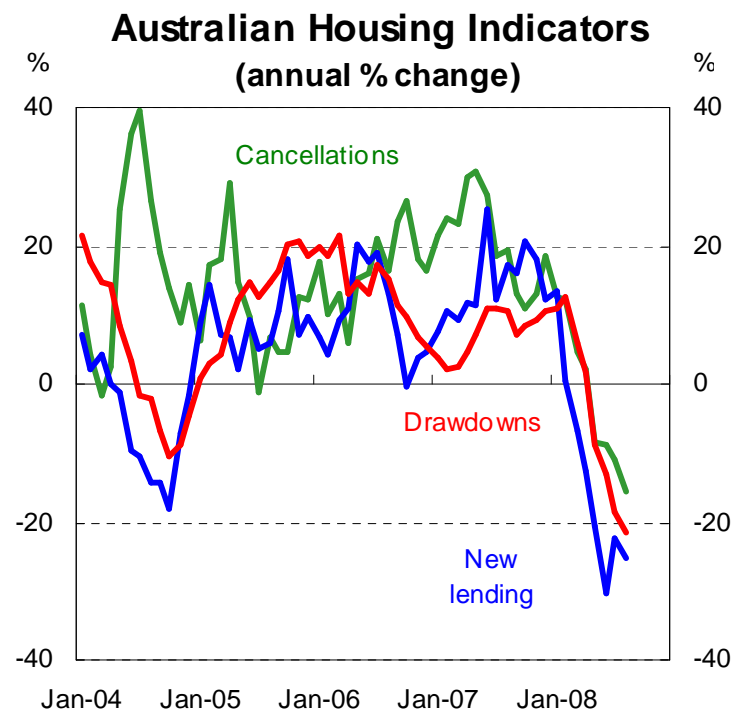
- The national unemployment rate is not far from historical lows.
- Declines in forward indicators of jobs have not yet flowed through to the official employment figures.
- We expect a pick-up in the unemployment rate over the coming year.

Business – Jewel in the Crown Needs a Polish



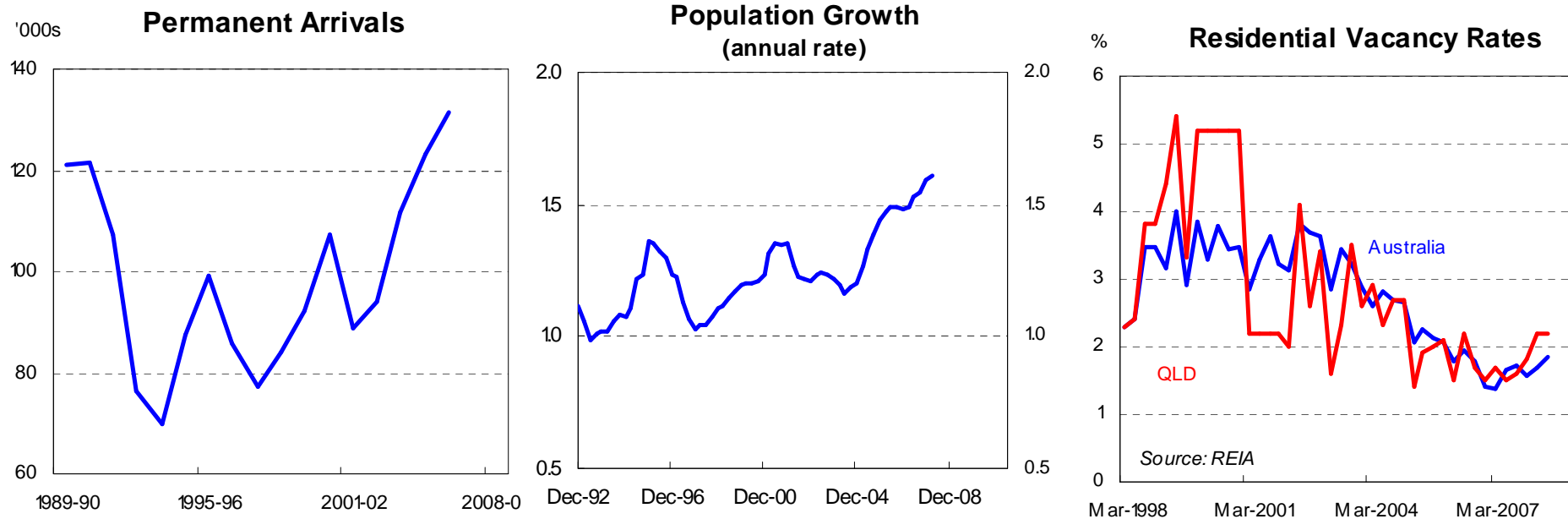
- **Expect a pull back of business investment plans due to the deterioration in credit markets.**
- **Work in the pipeline means business investment will slow but not collapse.**

The Housing Battle



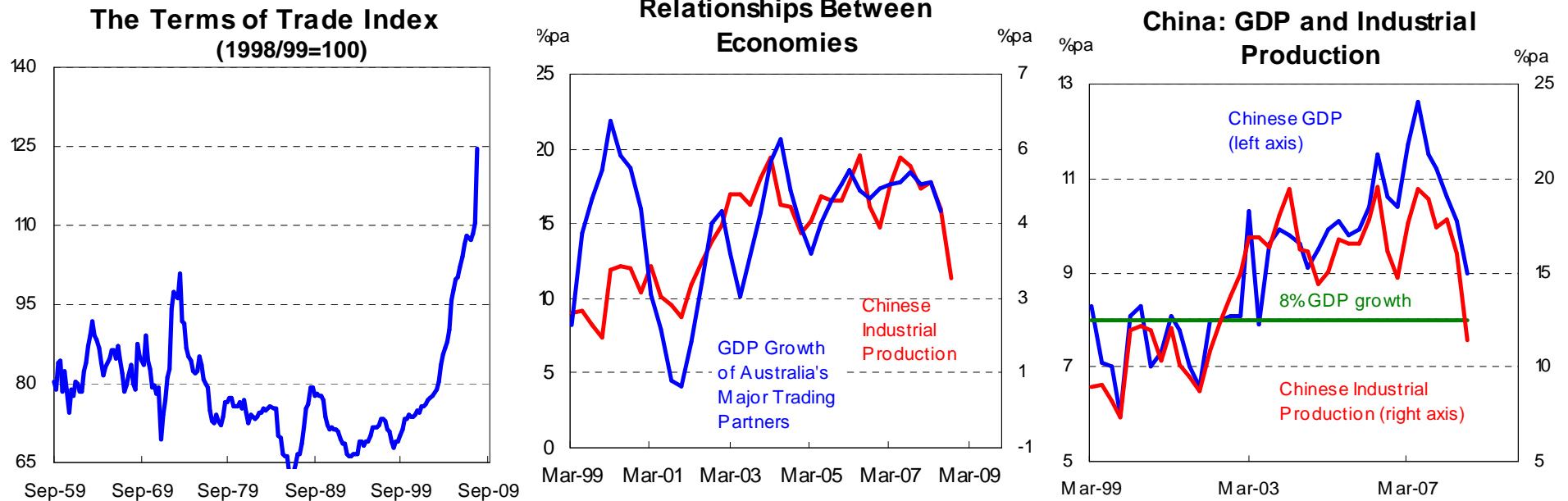
- **The global credit-crisis backdrop and uncertain backdrop are dampening housing demand.**
- **Interest rates were also biting, but interest-rate relief has come.**
- **Housing lending has fallen considerably.**
- **Firm population growth, high immigration, rising rents and low vacancy rates are creating pent-up demand.**
- **At some point in the future, the pent-up demand will be released. We suspect it will be in the medium term not short term.**

Demography is Destiny



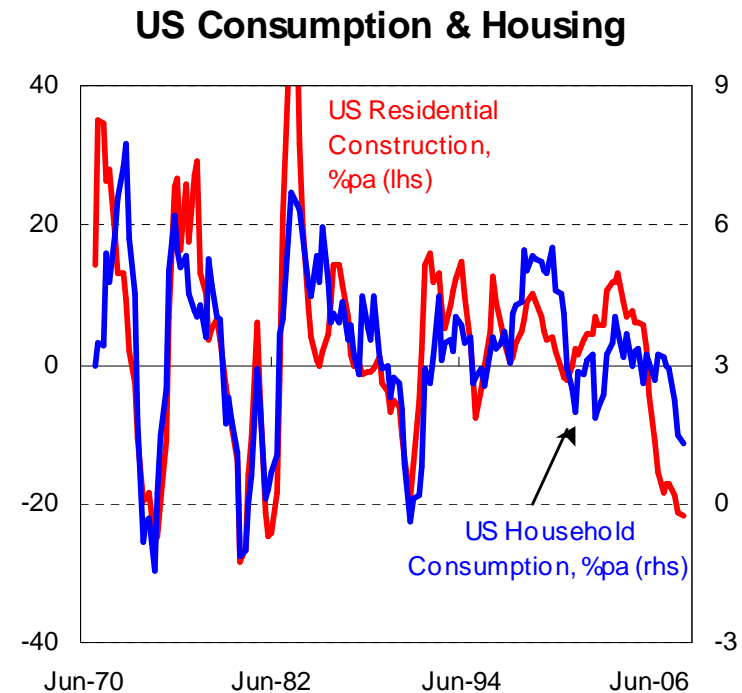
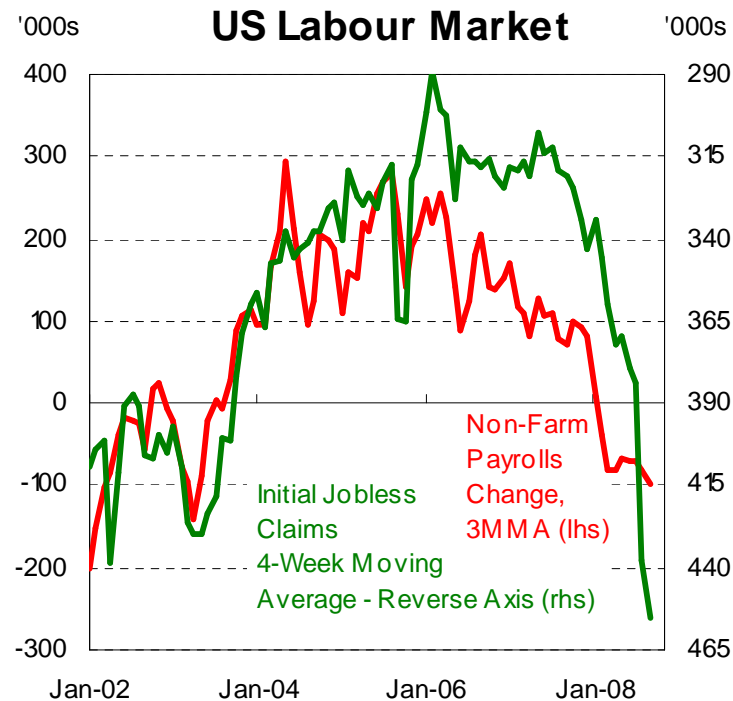
- High immigration and population growth are helping underlying demand. Residential construction is running below underlying demand estimates.
- A stabilisation of equities are likely needed to help release this pent up demand over the medium term.

The Importance of Being China



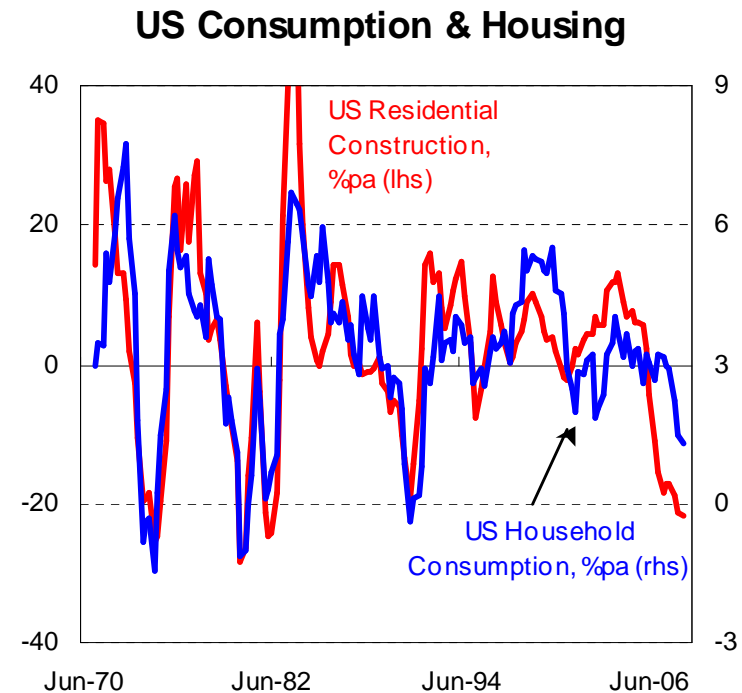
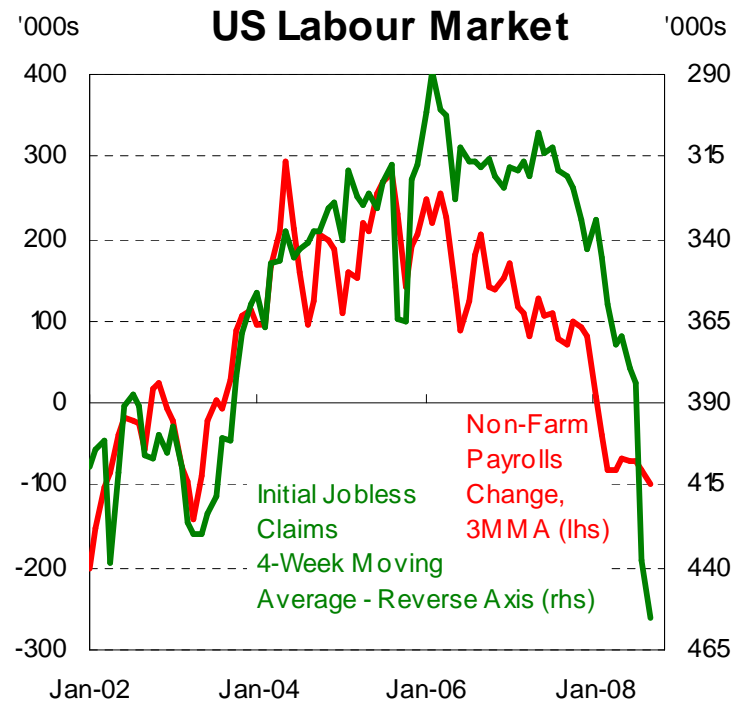
- **A rising terms of trade has provided a substantial income boost to the Australian economy. This income growth was underpinned by growth in China.**
- **China is one of the key risks to the Australian economic outlook.**
- **China's economy is slowing; GDP in Q3 was the weakest in 5 years. Industrial production suggests more slowing is likely with a real risk of sub 8%pa growth.**

US Economy – Any Light Has Faded



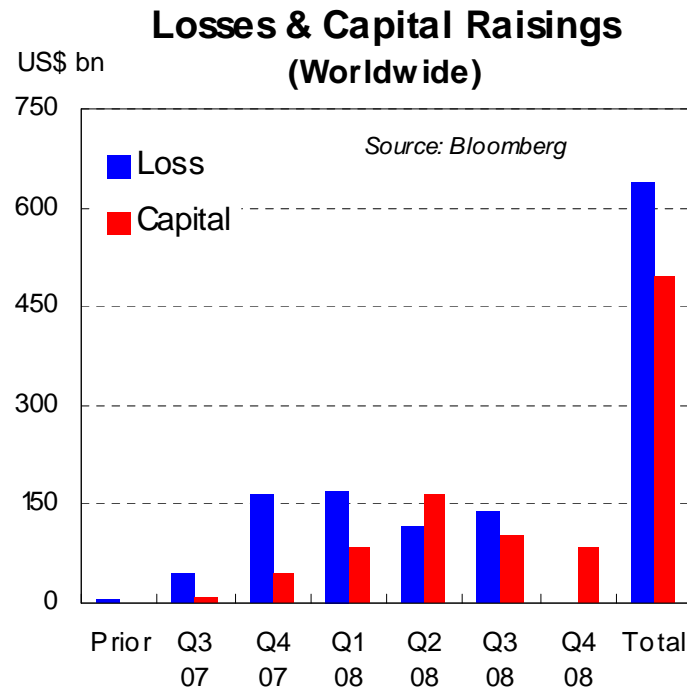
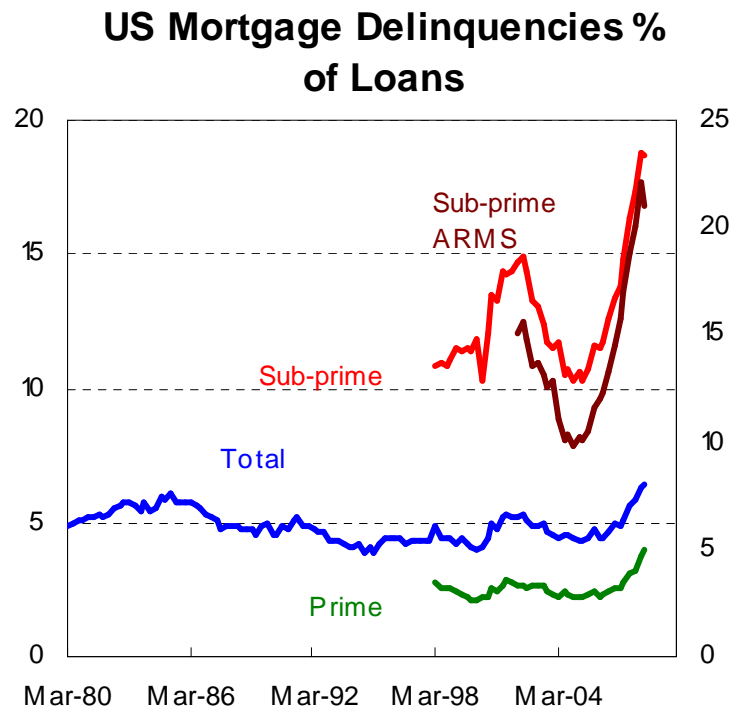
- **Downside risks to the US economic outlook are rising.**
- **Job losses are due to accelerate.**
- **Stimulus from US tax rebates has faded.**

US Economy – Any Light Has Faded



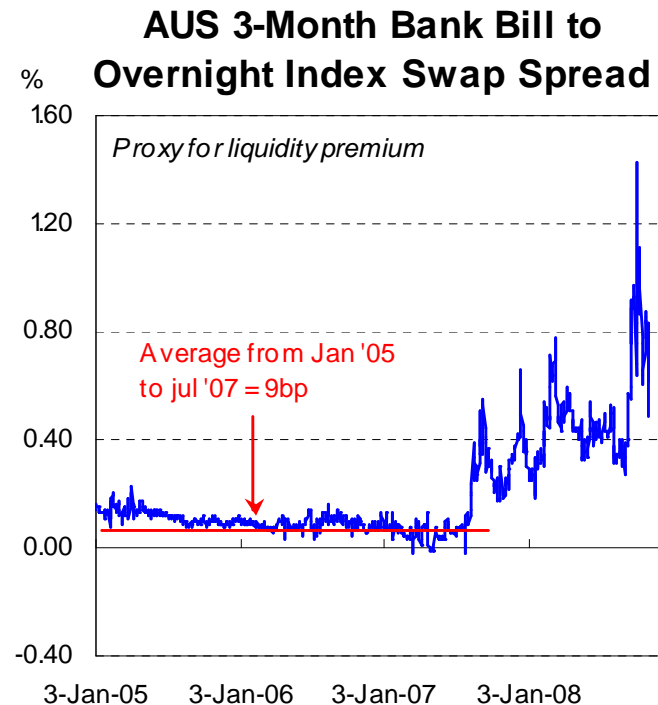
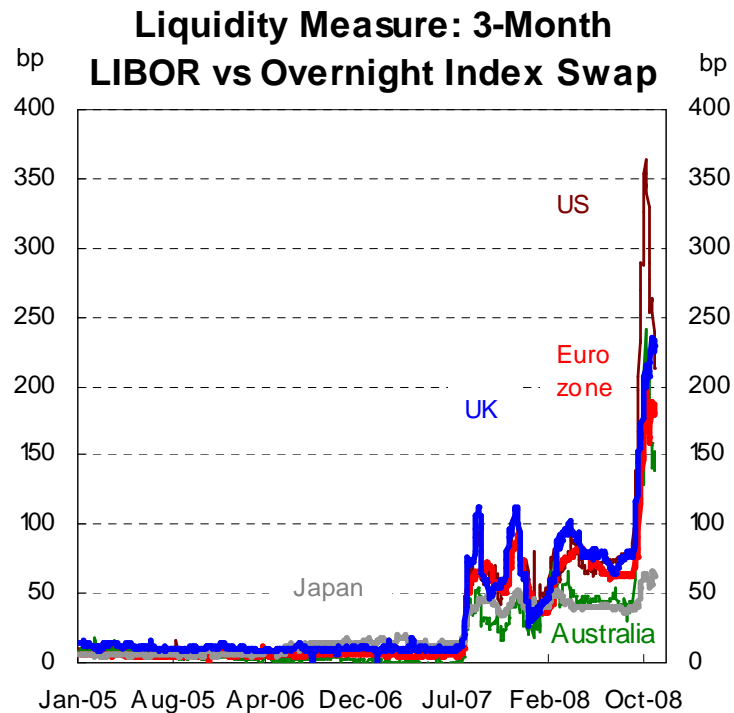
- **Downside risks to the US economic outlook are rising.**
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Credit Crunch – The Second Leg



- **Around US\$640 billion has been written down by banks globally.**
- **The IMF earlier this year estimated that write-downs will total close to US\$1 trillion before the crisis ends.**

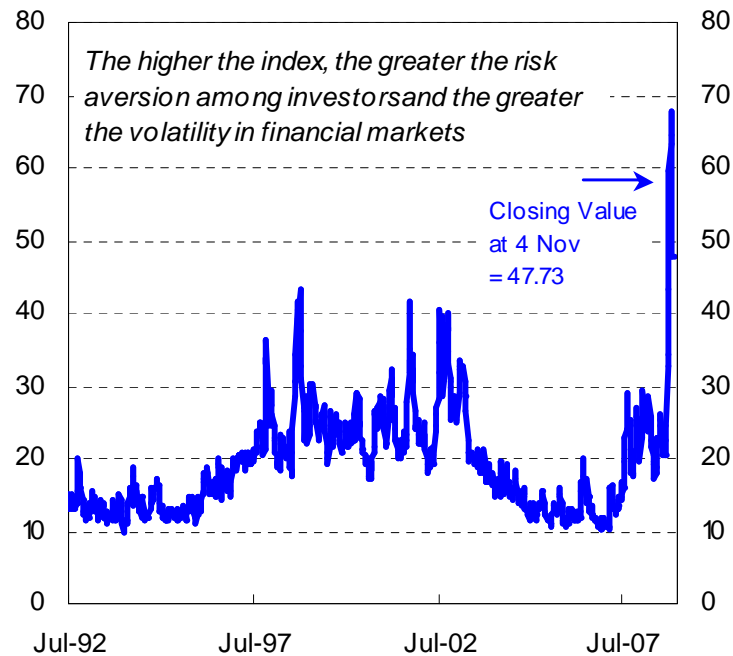
Liquidity – Still Skating on Thin Ice



- Tentative modest encouraging signs of an improvement in funding pressures.
- But sentiment remains fragile and volatility is high.

The Only Certainty is Uncertainty

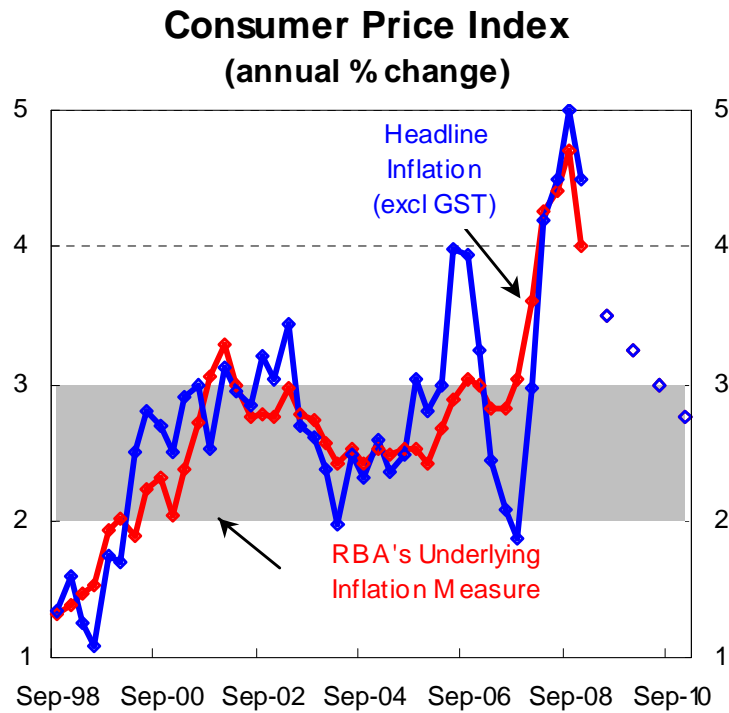
VIX Volatility Index



- Volatility in financial markets remains high (but off the peaks).
- It's reflected in wide trading ranges for most asset prices.

Date	VIX Index	S&P 500 share index 1-month later
28-Oct-1997	48.6	12% higher
11-Sep-1998	48.1	3% higher
8-Oct-1998	49.5	22% higher
21-Sep-2001	49.3	13% higher
24-Jul-2002	48.5	17% higher
29-Sep-2008 +	>48	?

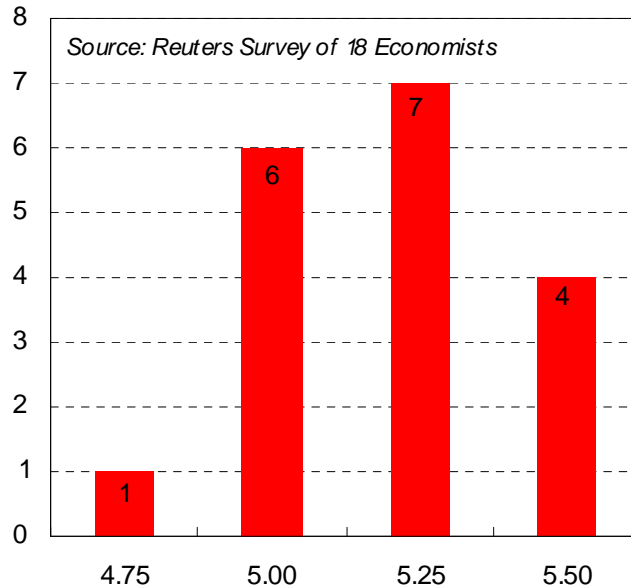
Inflation Break Out?



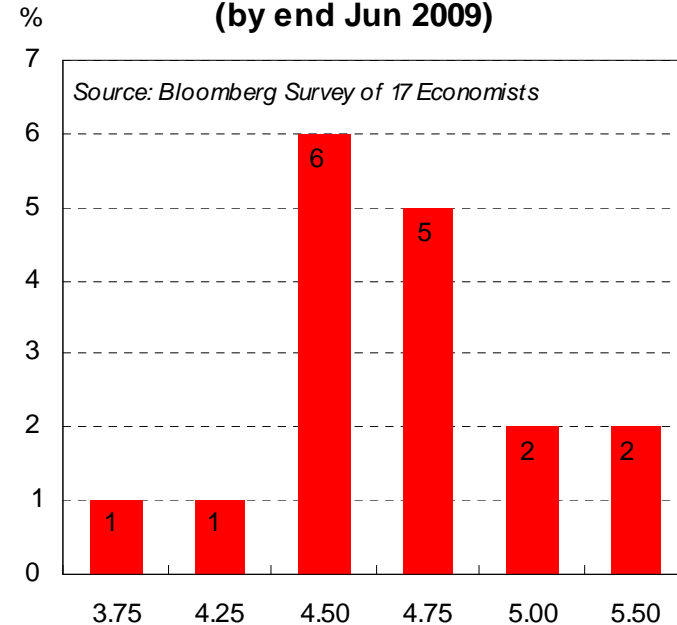
- Underlying inflation rose to 4.70%pa in Q3 2008, from 4.4% in Q2 2008.
- High capacity utilisation, high oil prices & a tight labour market flowed through to higher prices.
- RBA expects inflation to decline over the medium term, but stay high in short term.
- The RBA's inflation target is a 'medium term' framework.

Interest Rate – Radar Screen

Cash Rate Expectations
(by end Dec 2008)

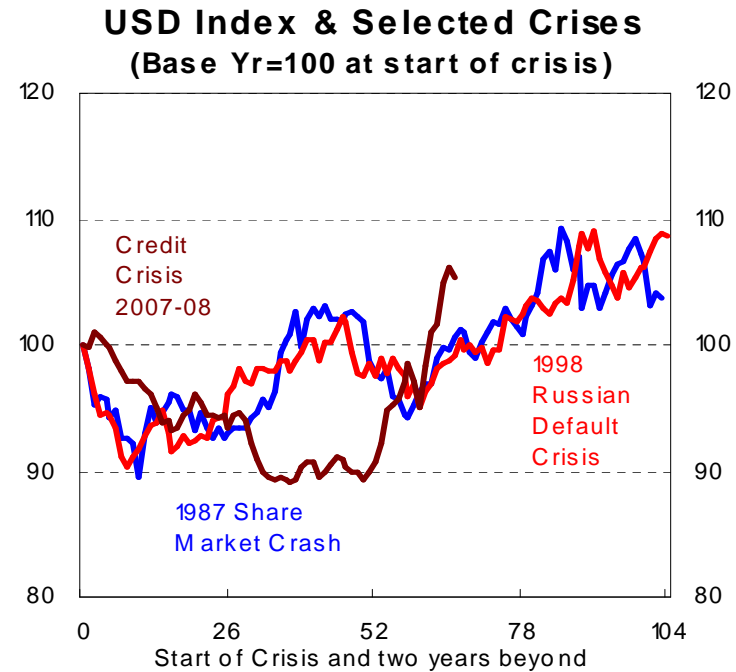
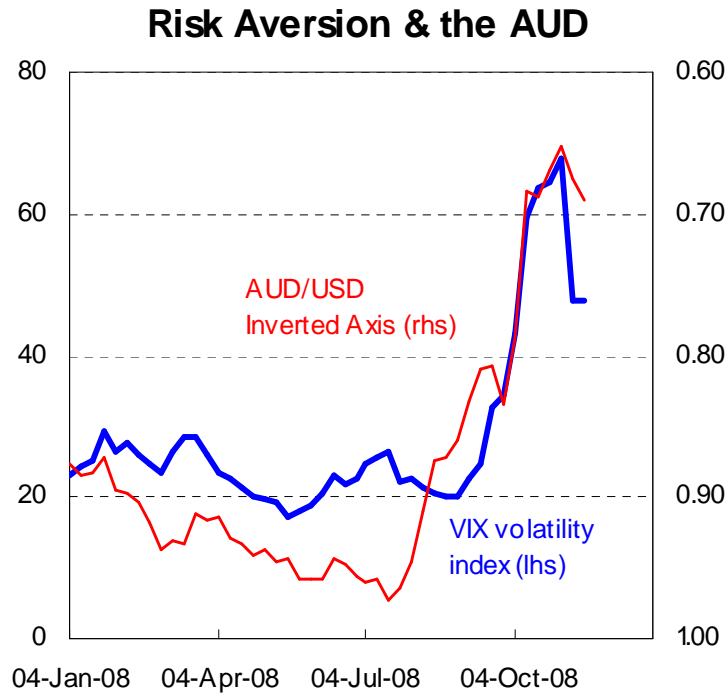


Cash Rate Expectations
(by end Jun 2009)



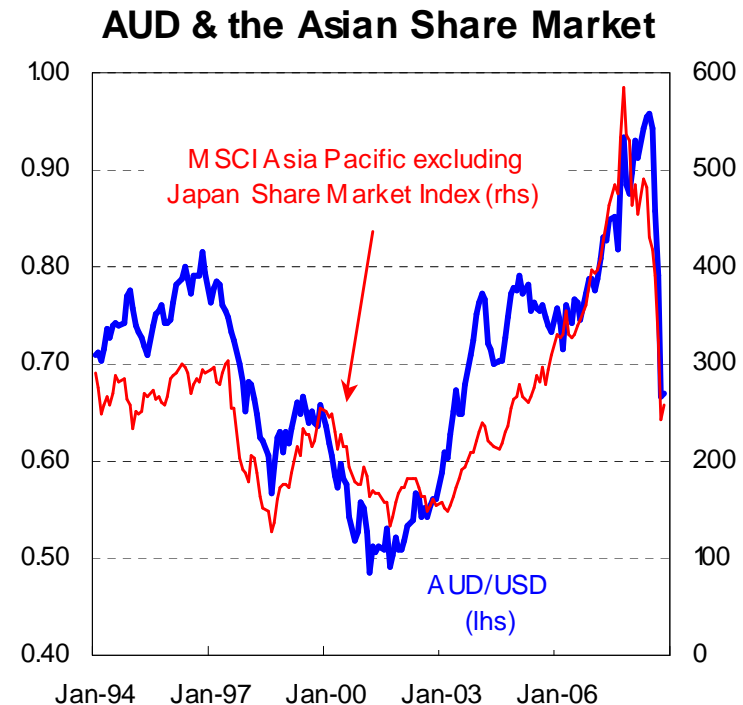
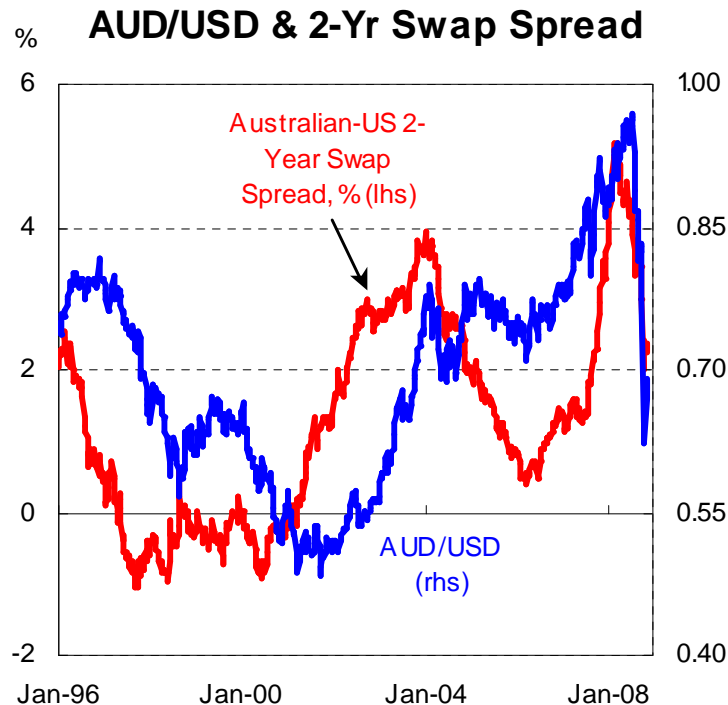
- **More rate cuts are on the way from the RBA.**
- **St George expect the cash rate to end the year at 4.75% and reach a low point of around 4.25% next year.**
- **Credit-market developments will be important in determining the low point for the cash rate.**

AUD's Headwinds



- **AUD faces headwinds from heightened risk aversion, the wide current account deficit and slower world economic growth.**

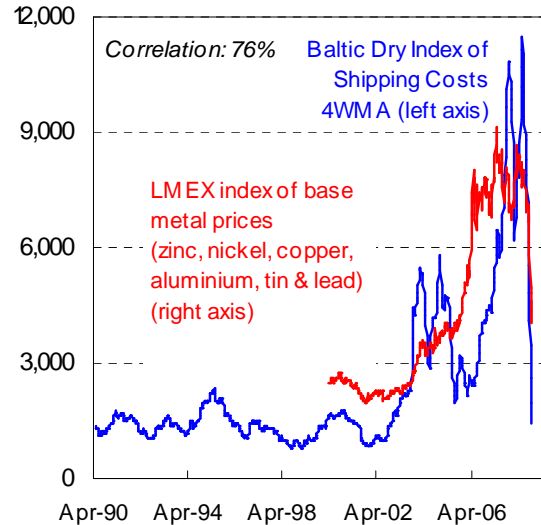
AUD – Fundamentals or Fear?



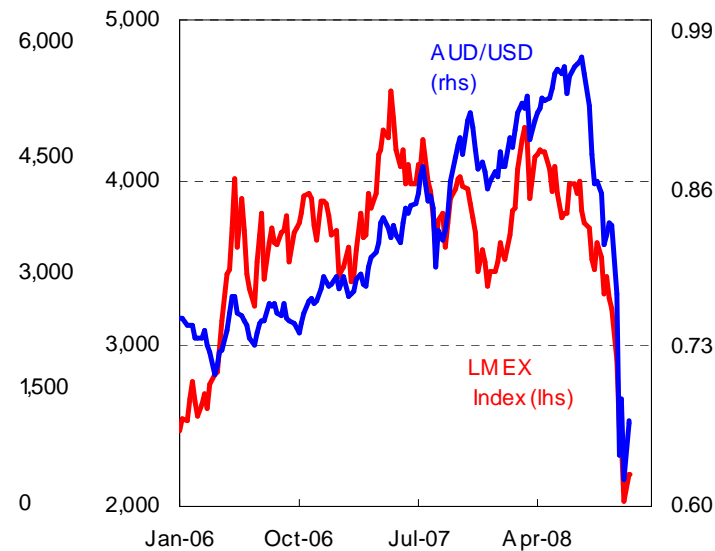
- **Fundamental drivers still playing a role. But fear is also holding sway.**
- **AUD's fortunes tightly tied to Asia with around 60% of Australia's trade done with Asia.**

Commodities – Who Let the Air Out?

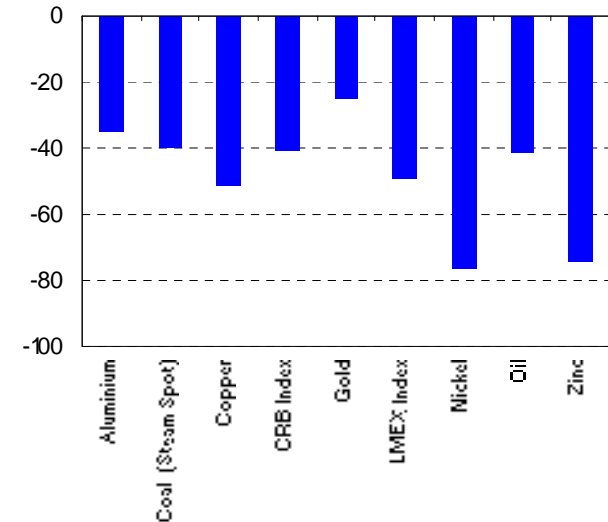
Baltic Dry Shipping Index & Base Metal Prices



AUD/USD and LME X Index



Selected Commodity Prices (% Change From Peak)



- **Commodities are well off their peaks on heightened worries about the global growth outlook.**
- **The Baltic Dry shipping index suggests base metal prices may fall further yet.**

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