Monthly Economic Outlook

September 2009

Monday, 21st September 2009

- The Reserve Bank (RBA) held interest rates steady this month for the fifth month in a row. Rhetoric from the central bank has continued to be progressively more upbeat, indicating that we are getting closer to an interest rate hike cycle in Australia.
- The RBA has held back from taking on an explicit tightening bias, despite its more optimistic outlook. It has indicated that there are still some uncertainties clouding the outlook. In particular, the RBA has highlighted the risk that domestic spending could be weaker in the second half of this year in those areas of the economy where spending was pulled forward to the first half of this year. Such uncertainties indicate to us that the RBA could delay raising rates until next year. This would be when it is more confident about the strength of the current recovery. Much will depend on the incoming economic dataflow. If the data consistently paints a picture of an economy that is firming, then a rate hike before the end of this year can't be ruled out.
- In overseas developments, the data from most major economies suggests that major economies are bottoming or recovering. The Asian economies have continued to improve and have been standout performers in the global landscape.
- The Australian dollar has continued to be underpinned by favourable growth prospects in Australia, attractive Australian interest rates, improving risk appetites and the improving outlook for the global economy. On September 17, the AUD reached a 13-month high of USD0.8775.
- Our special feature article this month is titled "Hot Property". St.George Bank commissioned RP Data, a leading property analysis firm, to research the suburbs across Australia that are likely to provide the best value and prospects over the medium to long term. This month's "Hot Property" article identifies 24 locations nationally that are likely to give the strongest value and prospects to homebuyers.

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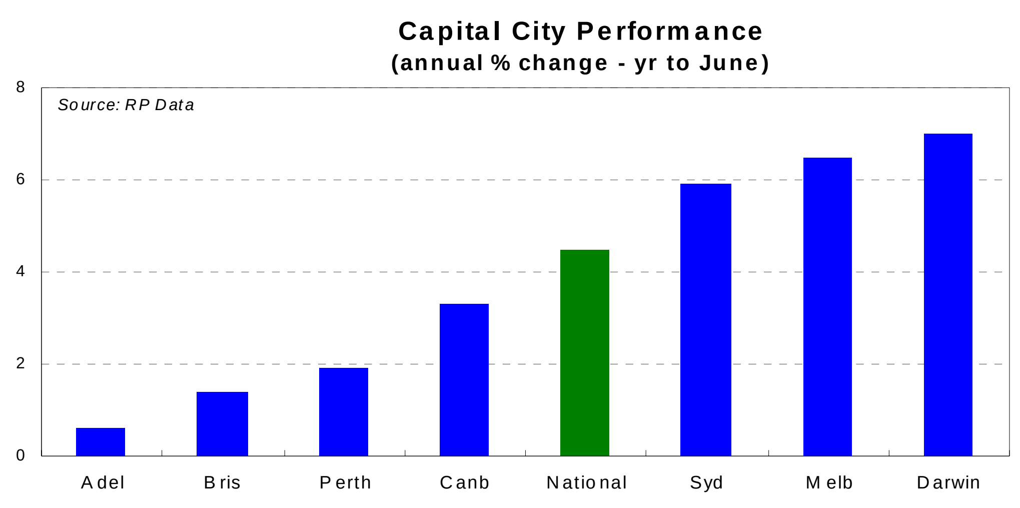
SPECIAL FEATURE ARTICLE – HOT PROPERTY

House price pressures have already emerged in the residential housing market. Low interest rates, the boost to the first-home-buyers' grant, improved housing affordability combined with favourable demographic factors like strong population growth have been the recipe for the price growth. Indeed, housing prices are recovering this year after witnessing a modest downturn of only 3.9% in the wake of the global credit crisis.



Against this backdrop, St.George Bank commissioned RP Data, a leading property analysis firm, to research the suburbs across the country that are likely to provide the best value and prospects over the medium to long term. This research published in the St.George / RP Data National Hotspots Property report has identified 24 locations nationally that are likely to give the strongest value and prospects to homebuyers.

The hotspots chosen on a region-by-region basis are:

Sydney	Brisbane	Melbourne	Hobart
Granville	Keperra	Chadstone	North Hobart
Rockdale	Margate	Ashburton	
Lidcombe	Cannon Hill	Brunswick	**Canberra**
Riverwood	Fairfield	Flemington	Dickson
Waterloo	Kedron	Fawkner	
Perth	**Adelaide**	**Darwin**	**Regional Australia**
Bassendean	Thebarton	Rapid Creak	Gulliver
Thornlie	Glanville		Redan

Within these 24 hotspot suburbs, there were 5 stand-out suburbs identified in Australia. These were Granville (in Sydney), Chadstone (in Melbourne), Keperra (in Brisbane), Bassendean (in Perth) and Thebarton (in Adelaide).

These suburbs were identified as hotspots based on four key factors.

Firstly, the attributes of the location were considered. Location is a critical factor when purchasing property. A well-located property should grow in value. Many of the hotspot suburbs identified are within 10 kilometres of a capital city or only a few kilometres away from another major centre.

Secondly, the value of housing was considered. The price was the most important determinant here. Homebuyers should look to buy in areas within their budget and those that provide a quality / value proposition. Many of the hotspot suburbs were discounted or showed weaker capital growth compared with nearby suburbs.

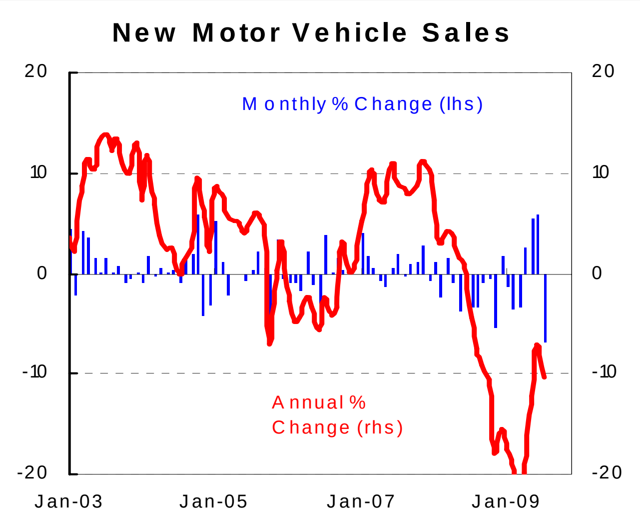
Many of the hotspot suburbs showed common threads. A common thread is that many of the hotspot suburbs have been typically overlooked in favour of traditional blue-ribbon suburbs, despite a range of positive factors that underpin the overlooked suburbs. For example, some of the suburbs identified are currently light-industrial areas close to a major CBD that are expected to eventually transform into residential areas with good access to amenities.

In summary, the National Hotspots property research highlights that savvy homebuyers and investors should consider looking outside the square when buying or investing in property.

To obtain full details of the National Hotspots suburbs, please visit the St.George Bank website at http://www.stgeorge.com.au/loans/home-loans/faqs/RP-Data-Report.asp.

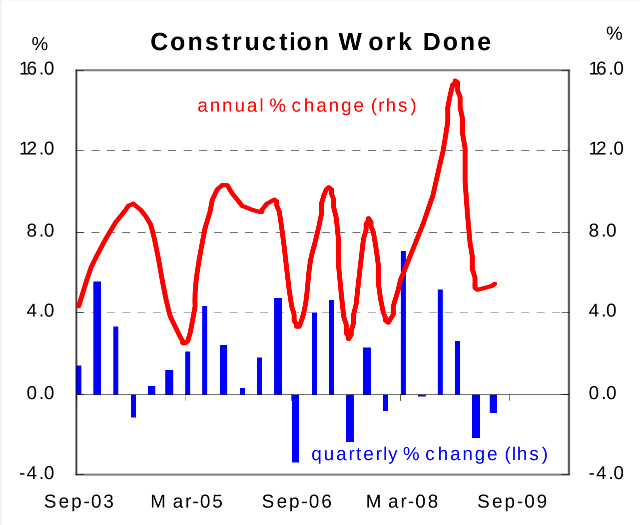
Australian Economic Data

New Motor Vehicle Sales



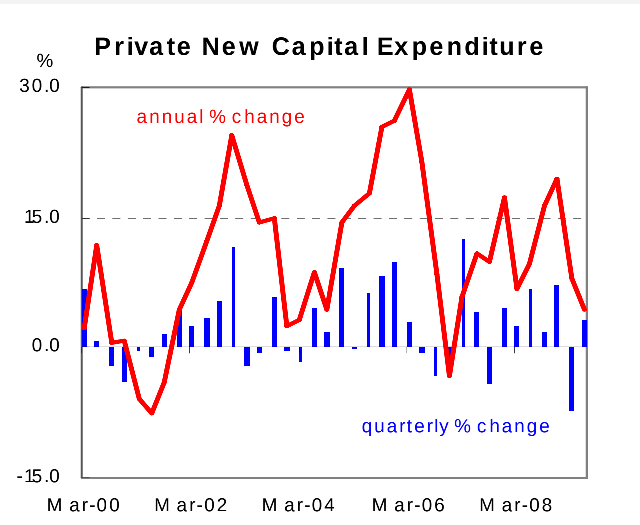
New vehicle sales fell 6.9% in July according to the ABS, after gaining sharply for three consecutive months. SUVs helped lead the decline. But this was offset by a 0.3% gain in passenger vehicles. The annual rate of contraction for overall vehicle sales has dropped to 10.4% from 7.1% in June. July's fall may be due to an unwinding of some pull forward in spending to beat the end of the 2008-09 tax year (even though the small business investment allowance remains in place until the end of this year).

Construction Work Done



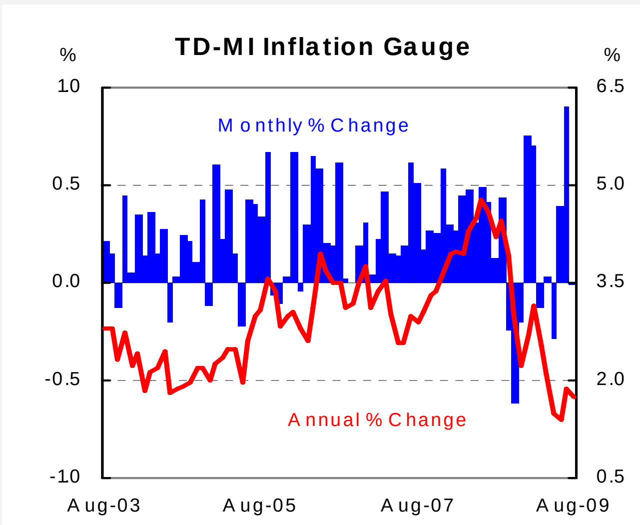
Construction work done edged 0.1% lower in the June quarter after a 2.2% drop in the March quarter. The annual pace of growth held steady at 5.4%. The outcome was better than expected (consensus was for –3.0% q/q). Residential and non-residential construction was weak in the quarter. These sectors fell by 2.6% (-7.6% y/y) and 9.5% (-9.8% y/y), respectively. But infrastructure-work done rebounded 8.2%, helping to cushion the fall in overall construction work done.

New Private Capital Spending



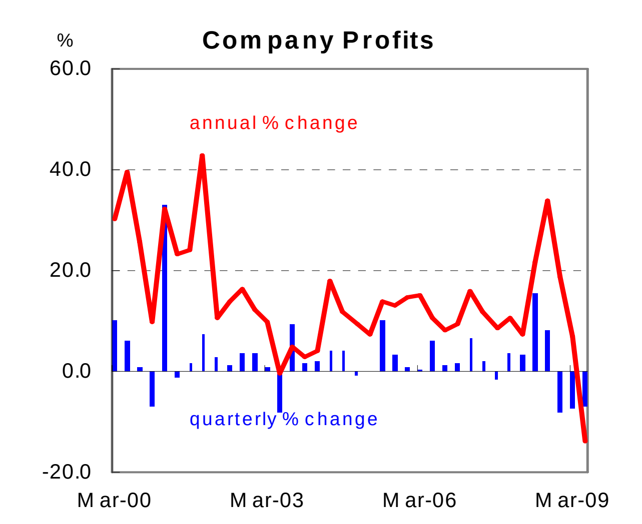
Private new capital expenditure (CAPEX) was unexpectedly strong in the June quarter, rising by 3.3%. There were, however, signs that this unexpected strength was partly due to the pull-forward of spending to qualify for tax concessions for the year ended June 30. However, investment plans for the year ahead have also been revised up with improving confidence over the outlook for the economy encouraging business to lift spending.

TD-MI Inflation Gauge



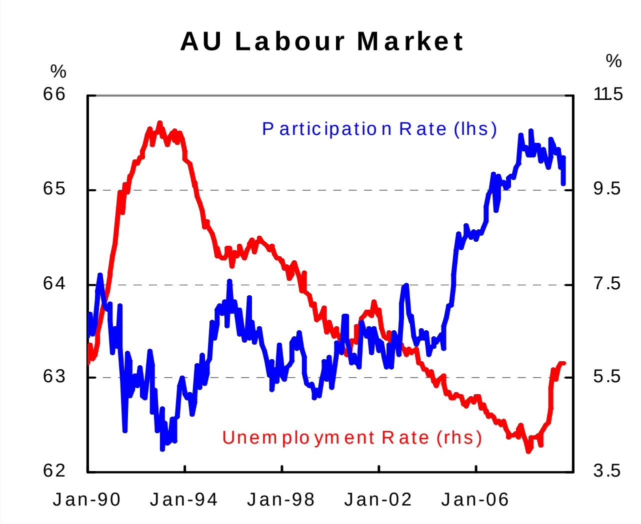
The TD-MI measure of inflation was flat in August, after a 0.9% spike in July. It caused the annual rate of inflation to fall from 1.9% to 1.7%. It remains below the 2-3% per annum band at which the RBA aims to keep inflation within over the medium term. Slower economic growth has been a dampener on price pressures. The largest price declines in the month were for prices of holidays, travel, accommodation & financial services.

Company Profits & Inventories



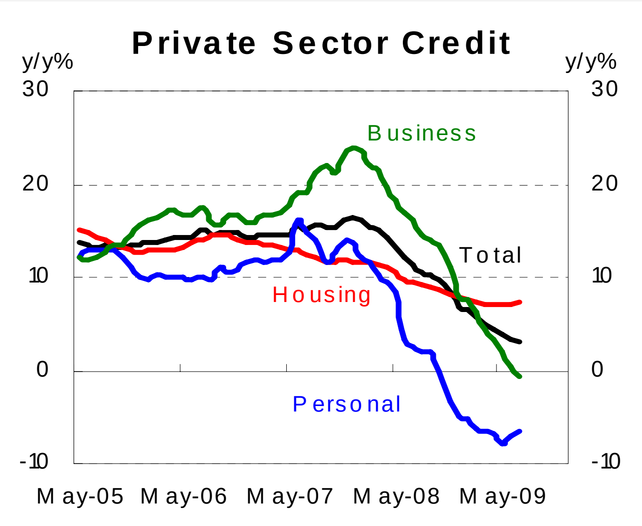
Company gross operating profits fell by 7.8% in the June quarter, the largest fall in six years. Compared to the same time a year ago, profits decline by a record 14.8% (i.e. largest decline since the series begun in Q3 1994). The outcome indicates that the Australian economy has taken a hit in terms of national income. The drop off in profits was deepest in the mining industry; mining profits fell by a record 24.7% in the June quarter. The rolling off of the record contract prices for iron ore and coal depressed incomes but other commodity prices are also lower. Business inventories fell by 3.4% in the June quarter. It was the third consecutive fall in inventories.

Employment



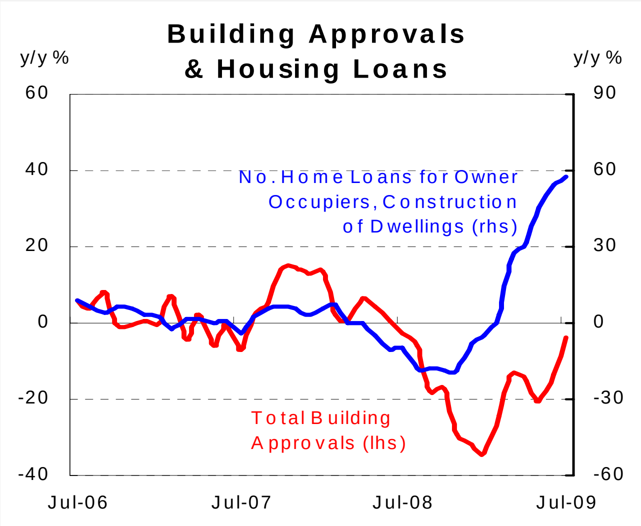
Employment fell by 27.1k in August, partly reversing the jobs growth of 33.6k in July. The unemployment rate held steady at 5.8% for the fourth straight month but that was due to a drop in the participation rate. A breakdown of the data suggests that employers are continuing to respond to soft economic conditions where needed and wherever possible by reducing the hours that staff work. While full-time jobs are down 2.8% over the year, part-time jobs are 6.0% higher. The drop in full-time jobs in August, however, was quite large at 30.8k taking the total number of jobs lost over the last four months to nearly 110k.

Private Sector Credit



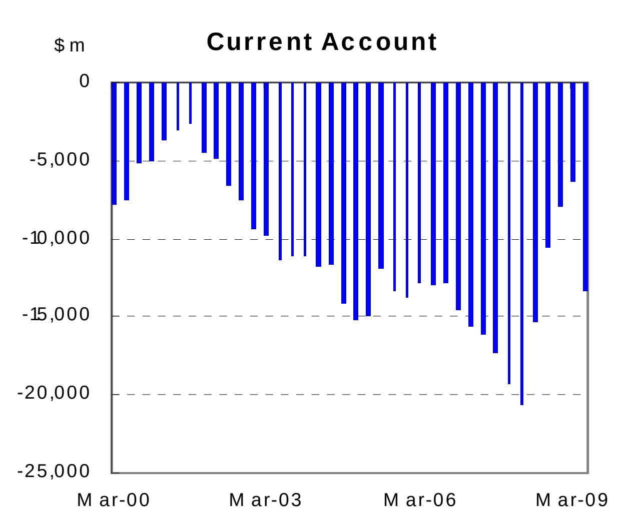
Credit to the private sector grew by 0.2% in July. This rate of growth is anaemic in nature but it is the strongest monthly growth rate recorded in six months. Annual growth of credit to the private sector continued to deteriorate; annual growth slowed to a 16-year low of 3.0%. Credit to the business sector remains weak but housing credit is on a recovery path. 'Other' personal credit (which includes margin loans, personal loans and credit cards) is also showing some tentative signs of recovery.

Building Approvals



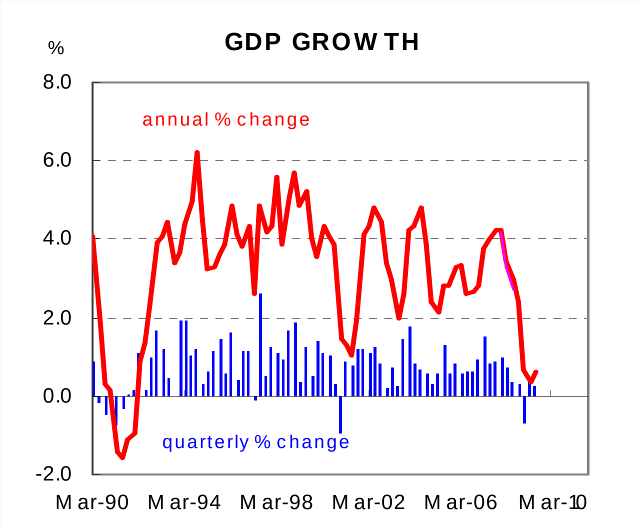
Building approvals jumped 7.7% in July to hit a 13-month high. In the past two months, approvals are up 18.3% - the strongest back-to-back gain in eight years. Low mortgage rates and the boost to the first-home owner's grant are continuing to spur a recovery in building approvals. The improving trend in building approvals is following, with a lag, the recovery in lending. A recovery in residential construction will also follow (starting with detached housing), but probably not until later this year.

Current Account Balance



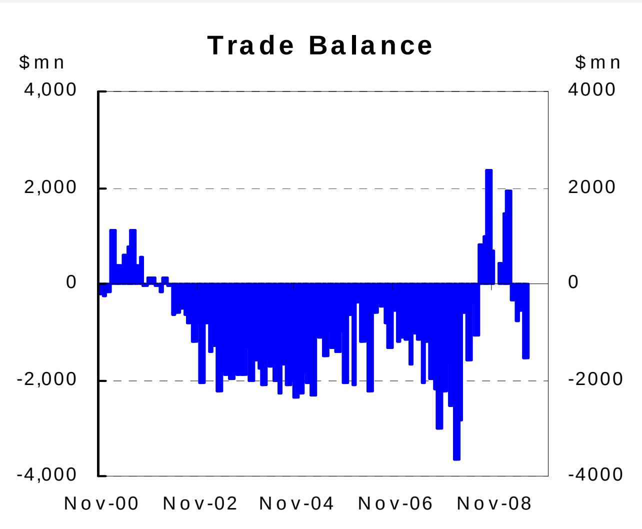
The current account deficit widened by $7.0bn to $13.3bn in Q2. It is the worst outcome in a year and was driven by a marked widening in both the trade and income deficits. The trade balance widened by $5.9bn to a deficit of $1.7bn. It is the first trade deficit since the June quarter of 2008. The trade account was struck by the double whammy of sharply lower commodity prices and a much stronger Australian dollar during the quarter (negative for exports). Exports, in nominal terms, dropped a record 14.9% in Q2. The terms of trade retreated further; it fell by 7.4% in the June quarter and fell by 11.6% on a year ago. The annual percentage drop is the largest in over 23 years.

Gross Domestic Product



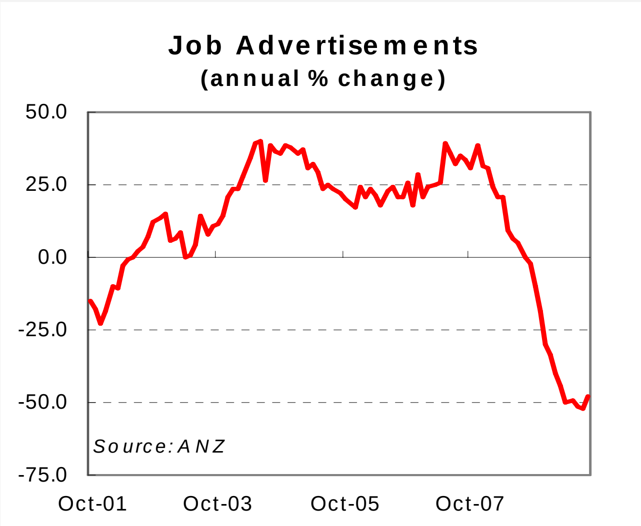
The Australian economy grew by 0.6% in the June quarter, beating consensus expectations for growth of 0.3%. It follows an increase of 0.4% in the March quarter and takes the annual growth rate to 0.6%. Economic growth is still well below potential but it's clear that Australia is skirting the worst of the global downturn and is continuing to surprise investors and analysts with its resilience. But stimulus measures may have caused spending in some areas to be brought forward into the first half of this year, so there is some risk that the pace of spending will slow or pull back from the current rate.

International Trade Balance



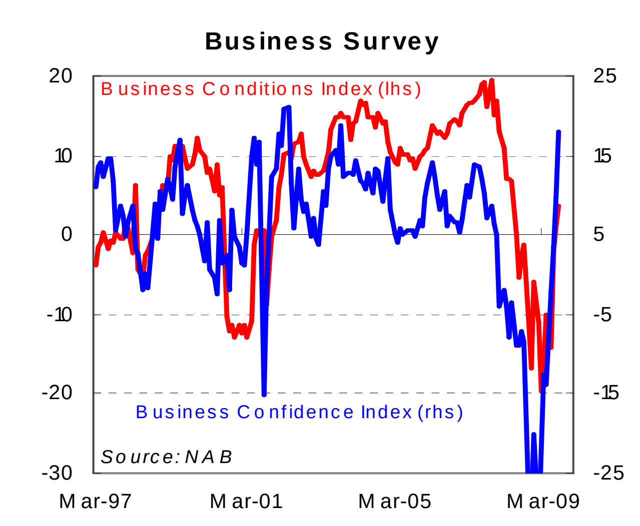
The Australian trade deficit was much higher than consensus in July, rising $1.0bn to $1.6bn. It is the widest trade gap since May 2008. The consensus was for a deficit of $880mn. There were some swings in the volatile components that exaggerated the monthly deterioration but there were also a number of underlying trends. The latter included ongoing resilience in non-rural exports, a continuing downtrend in capital goods imports (excluding aircraft) and strengthening in consumption-goods imports.

Job Advertisements



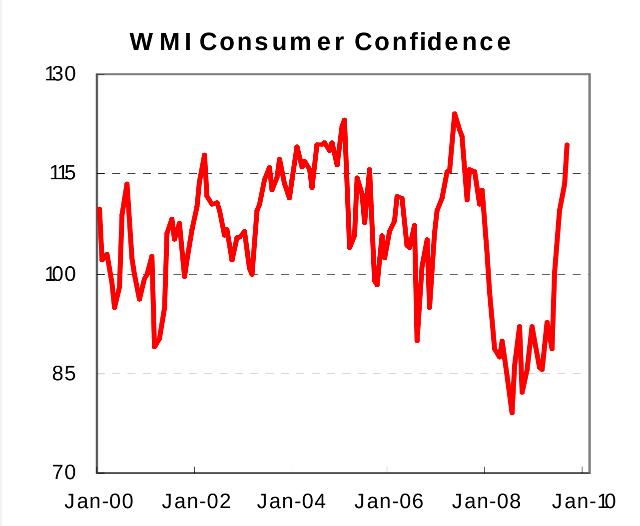
ANZ job advertisements rose by 4.1% in August after a fall of 1.7% in July. It is the first increase since April 2008. It reflected a 5.5% month-on-month gain in newspaper job ads (-43.1% y/y) and a 4.0% increase in internet job ads (-48.4% y/y). The total trend in overall job advertisements is still a deteriorating one but the pace of deterioration from month-to-month is easing. Indeed, the deterioration in employment in recent months has not been as bad as initially anticipated.

Monthly Business Survey



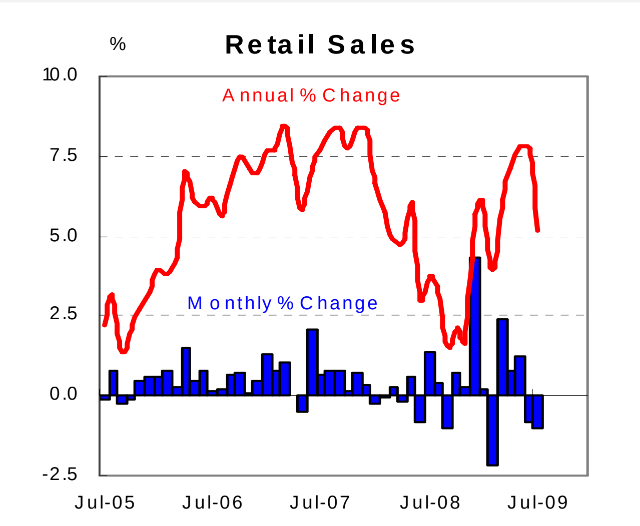
The NAB business survey for August revealed a rebound in business conditions and an improvement in business confidence. The business conditions index rebounded from a low of –20 points in February to +4 points in August. Meanwhile, the business confidence index climbed to +18 points, which is the highest level since 2003. The improvement in both these indices suggests that business spending may continue to trend higher.

Consumer Confidence



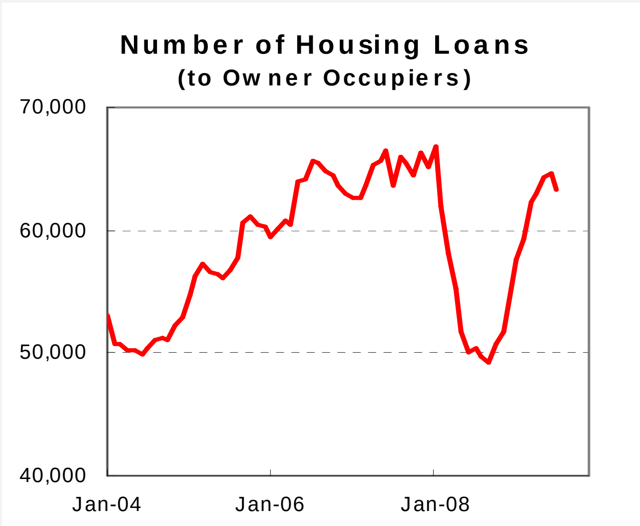
Consumer confidence to the highest level in more than two years in September with domestic economic conditions continuing to be better than expected. The index rose 5.2% to 119.3 points, which is the highest reading since July 2007. In terms of the components of this index, expectations for economic conditions over the next 12 months jumped 9.8% and assessments of family finances versus last year gained 8.3%.

Retail Sales



The value of retail sales retreated by 1.0% in July, taking the decline in retail spending over the two months to July to 1.9%. It is the largest back-to-back decline in five months and erases a large part of the 2.4% expansion that occurred in retail spending earlier this year. The pullback likely reflects the drying out of the government cash handouts and speculation in the press and markets of forthcoming RBA rate hikes. Some of the boost from lower petrol prices also appears to be waning. However, a number of positive factors underpinning retailing remain. These include tax cuts, improving share markets and a more positive outlook about the future from consumers.

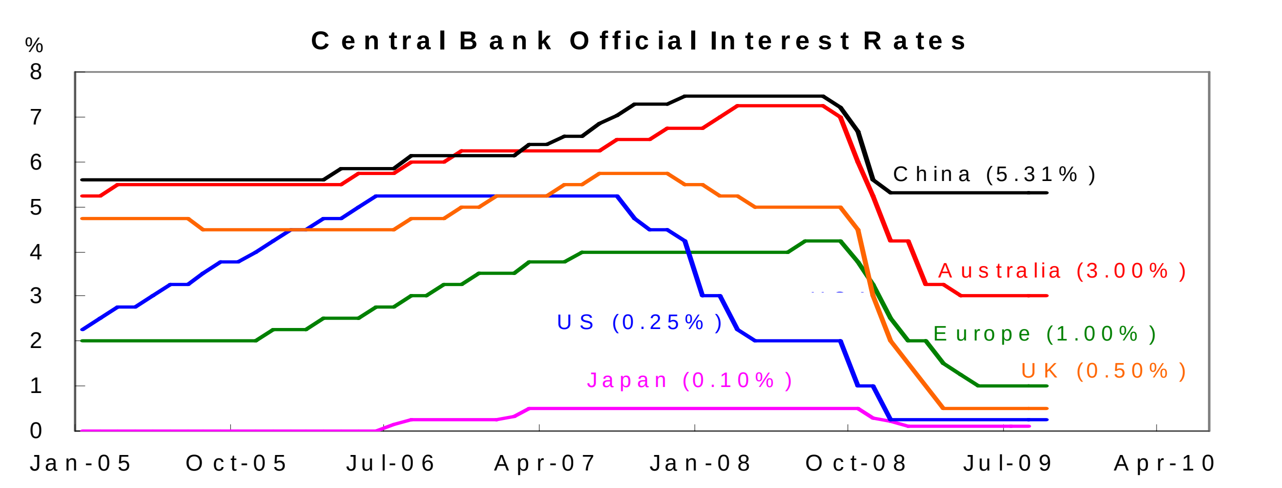
Housing Finance



The number of housing finance loans to owner-occupiers fell by 2.0% in July. But it is the first fall in ten months and from a year ago housing finance is still up a hefty 25.7%. Falls were recorded across all categories in July; the construction of new dwellings fell by 0.7%, the purchase of new dwellings fell by 0.5% and the purchase of established dwellings fell 2.3%. Despite these monthly declines, the annual rates of growth remain very strong in all these categories. It suggests residential construction will soon join the recovery, although some lingering difficulties in financing may delay the start of residential construction cycle until next year.

Interest Rate Markets

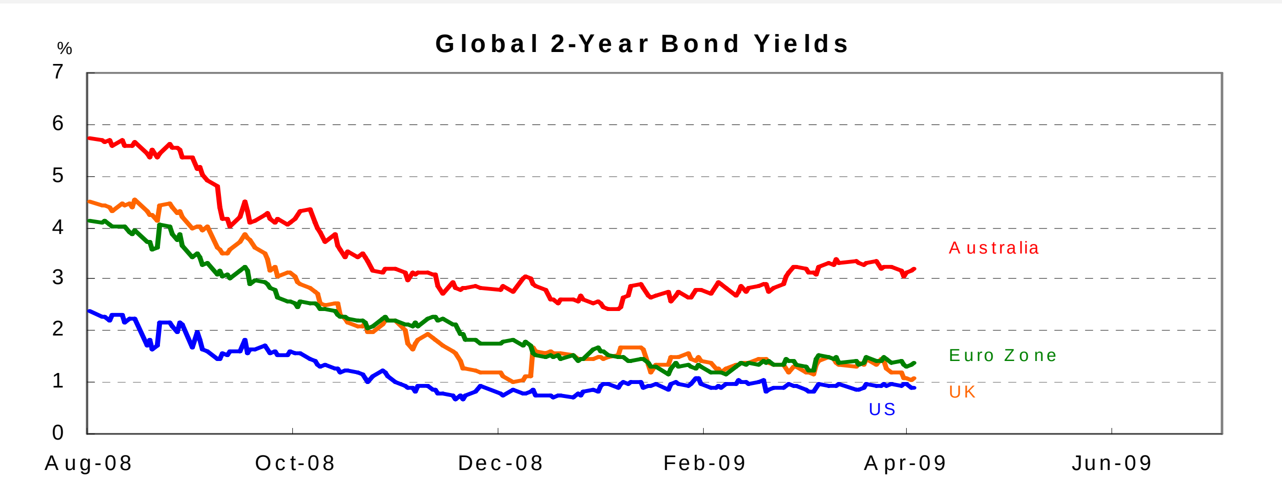
Central Bank Outlook



The RBA kept its cash rate steady at 3.00% this month, for the fifth month in a row. RBA rhetoric continues to reveal a progressively more upbeat central bank. It clearly indicates that the next move in the cash rate will be up. The RBA has noted that the global economy continues to improve. The Asian region has been the standout performer but there are signs that most other major economies are approaching a turning point. The RBA has so far refrained from taking on an explicit tightening bias, warning that there is still some uncertainty surrounding the outlook in Australia and offshore. It highlighted that there is the question of whether or not recent improvements in economies were largely due to stimulus measures or if the basis for such growth were more fundamental. Meanwhile, there is also a risk of weaker spending activity in the second half of this year in Australia due to spending in some areas pulled forward into the first half. Our core view is that the RBA will start raising rates early next year, but we would not fully rule out a rate hike in November or December. The upcoming data flow will be critical to the timing of the first rate move.

Looking outside of Australia, improving global growth prospects mean that additional rate cuts or unconventional policy easing moves are likely not needed in most major economies. The Reserve Bank of New Zealand (RBNZ), however, has not ruled out more rate cuts. The RBNZ said that it only expects a "patchy" recovery in the NZ economy. Accordingly, it states that monetary policy should continue to provide "substantial" support for some time and as a result it expects to continue to "keep the OCR at or below the current level through until the latter part of 2010".

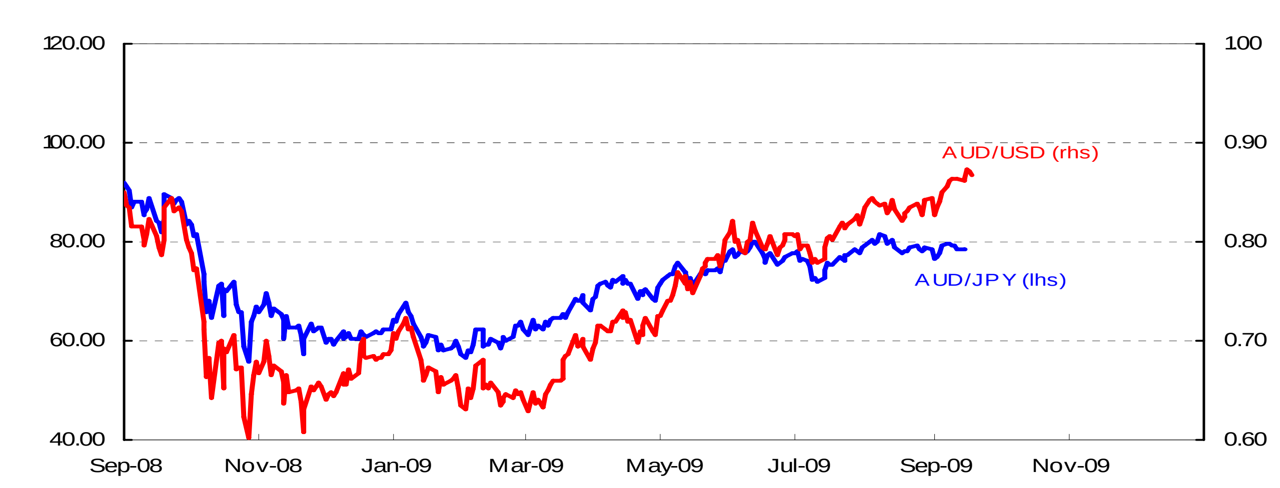
Bond Yields



US 2-year bond yields fell 3bp over the month (to September 18) amid a growing view that the Federal Reserve would keep rates low for longer. Two-year yields also dropped as government sales of bonds drew stronger-than-expected demand. Yields in the UK and Euro Zone followed this trend, falling by 16bp and 3bp, respectively. In Australia, a larger 21bp fall in 2-year yields was observed as the market pared back the probability of near-term RBA rate hikes; the probability of a 25bp rate as soon as November fell from a peak of 160% on August 31 to 73% at the time of writing.

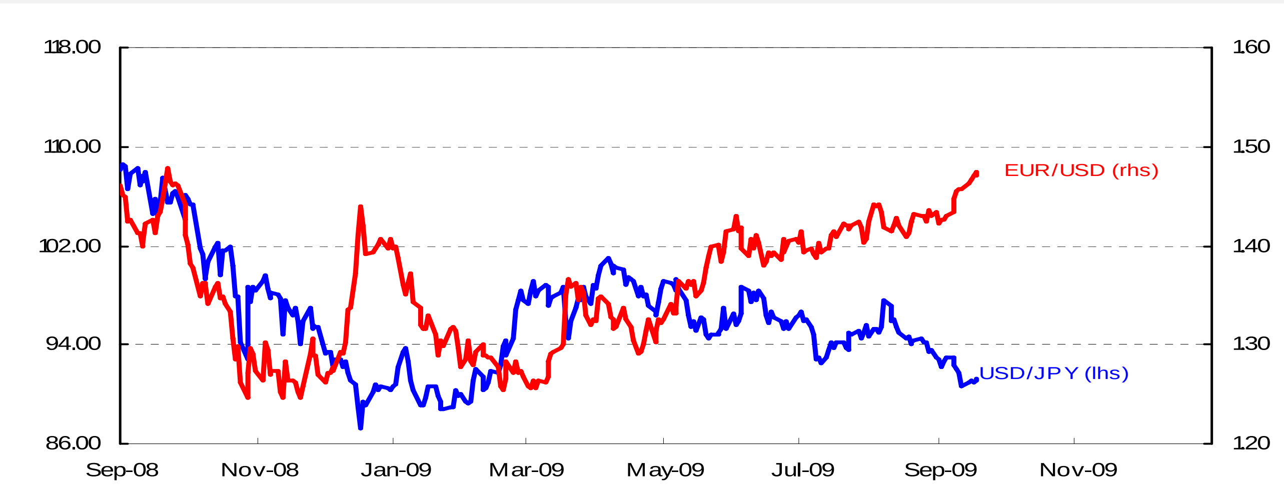
Currency Markets

Australian Dollar



The Australian dollar appreciated by 4 US cents over the last month and recorded a 13-month high of USD0.8775 on September 17. An ongoing improvement in risk appetites has provided key momentum to the Aussie. This improvement has occurred as the flow of economic data continued to suggest a more upbeat picture for the world economy than what was the case a few months back. The improvement has been most pronounced in the Asian economies, which is a positive for the Asian-dominated export market in Australia. Recent information also suggests global economic activity is improving. Indeed, the IMF recently revised up its forecasts for world growth. The AUD's performance is closely tied to global growth prospects and so these developments are giving key support to the currency. Australia's favourable economic-growth prospects and interest-rate differentials are also underpinning demand for the AUD. While the AUD remains well supported, it is likely to continue to exhibit considerable volatility.

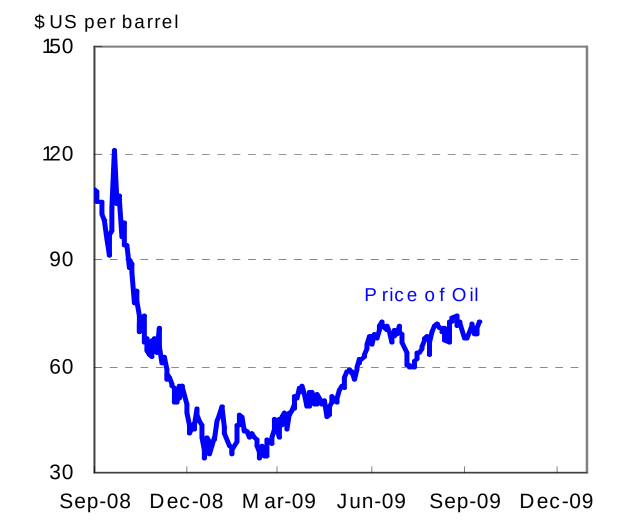
Global Currencies



The US dollar weakened further over the past month as risk appetites trended higher and investors unwound safe-haven flows into the greenback. Based on the USD G6-Weighted Index, the greenback has sold off by about 3.2% (over the month to September 18). The USD has been particularly weak against the JPY, falling by 3.1% over the last month. It also lost ground against the EUR and CHF, falling by 4.1% and 4.3%, respectively. However, the USD rose against the GBP during the last month by 1.6%. The US economic recovery is fragile and the big government deficit remains a big concern, but many other major economies are facing similar issues. The key driver weighing on the US dollar over the past month was the ongoing revival of risk appetites among investors. This revival is encouraging flows away from the USD. Market expectations about how soon the US Federal Reserve will start raising rates next year have also been pared back marginally over the last month. There is a risk that the outcome of the approaching Federal Reserve meeting on September 22-23 causes a correction in the USD; the Fed is unlikely to change rates but its accompanying commentary could see markets lift their optimism over the US economic outlook.

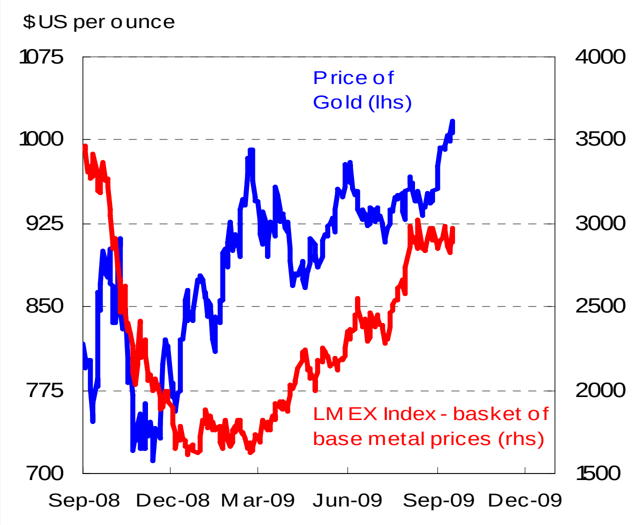
Commodity Markets

Oil



Oil rose a further $US2.23 (or +3.2%) over the past month (to September 18). A weaker US dollar and improved economic optimism over the global economic outlook has underpinned oil prices. Further, in mid September the Organisation of Petroleum Exporting Countries (OPEC) revised upwards its global oil demand forecasts for 2009 and 2010 on evidence the global economy is close to resuming growth. The US International Energy Agency (IEA) also upgraded its oil consumption forecasts.

Gold & Base Metals



The weaker USD and longer-term inflation fears amid better global growth prospects have been spurring gold higher. Gold has risen by 7.4% over the last month and struck an 18-month high of near US$1,024/oz on September 17. But on September 18, IMF member countries formally endorsed a plan for strictly limited sales of 403.3 tonnes of gold from its stockpile.

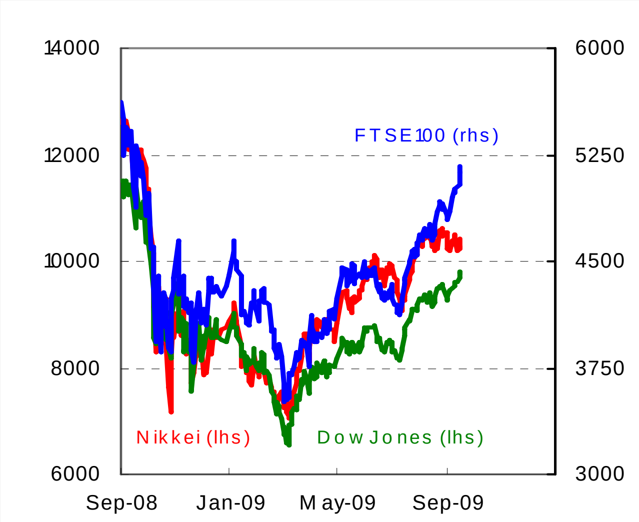
Base metals moved 0.3% higher over the month (using the LMEX index) with strong gains in lead and zinc.

Share Markets

Australia

The ASX200 is up 7.1% over the past month. All key sectors excluding the telco sector (-9.7%) recorded gains. The best performers were consumer discretionary stocks (+10.7%), financials (+10.1%), industrials (+10.0%), (+10.7%) and energy stocks (+9.6%).

International Markets



Global equity markets continued to surge over the month. The UK FTSE (+10.4%) and the German DAX (+8.6%) were among the strongest performers. The US Dow Jones Index (+6.5%) also posted a solid gain while Japanese Nikkei (+0.8%) lagged behind.

Recent Australian Economic Data

Red – Indicates the result was **weaker** than consensus expectations
Blue – Indicates the result was **stronger** than consensus expectations
Black – Indicates the result was in line with consensus expectations
All data is for month-on-month unless otherwise specified. The source for consensus forecasts is Bloomberg.

September 2009 WMI Inflation Expectations +3.5% Previous +3.5% 10/9 WMI Consumer Confidence +5.2%, Previous +3.7% 9/9 **August 2009** Employment –27.1k, Consensus –15.0k 10/9 NAB Business Confidence +18 points, Previous 10 8/9 ANZ Job Ads +4.1%, Consensus –1.7% 7/9 TD-MI Inflation 0.0%, Previous +0.9% 31/8 WMI Inflation Expectations, 3.5% Previous +3.2% 13/8 WMI Consumer Confidence +3.7%, Previous +9.3% 12/8 New Motor Vehicle Sales Aug +0.3% Previous –6.9% 21/9 **July 2009** Housing Finance –2.0%, Consensus –1.5% 9/9 Retail Sales Value –1.0%, Consensus +0.5% 9/9 Trade Balance –$1.6bn, Consensus –$0.9bn 3/9 Building Approvals +7.7%, Consensus +3.3% 1/9 Private-Sector Credit +0.2%, Consensus +0.1% 31/8 New Motor Vehicle Sales –6.9%, Previous +5.8% 24/8 Employment +32.2k, Consensus –20k 6/8 ANZ Job Ads –1.7%, Previous –6.7% 3/8 TD-MI Inflation +0.9%, Previous +0.4% 31/7 DEWR Skilled Vacancies +6.0%, Previous –2.0% 22/7 WMI Inflation Expectations +3.2% y/y, Previous +2.8% 9/7 WMI Consumer Confidence +9.3%, Previous 12.7% 8/7	**June 2009** GDP +0.6% q/q, Consensus +0.2% q/q 2/9 Current Account –$13.3bn q/q, Consensus –$10.7bn 1/9 Inventories –3.4% q/q, Consensus –1.1% q/q 31/8 Company Profits –7.8% q/q, Consensus –4.5% q/q 31/8 CAPEX 3.3% q/q, Consensus –5.0% q/q 27/8 Construction Work Done –0.1% q/q, Consensus –3% 26/8 Wage Cost Index +0.8% q/q, Consensus +0.8% q/q 12/8 Housing Finance +1.1%, Consensus +1.8% 10/08 Trade Balance -$441mn, Consensus -$800mn 5/8 Retail Sales Value –1.4%, Consensus +0.6% 4/7 Retail Sales Volumes +2.0% q/q, Consensus +1.3% q/q 4/7 Private-Sector Credit +0.1%, Consensus +0.1% 31/7 Building Approvals +9.3%, Consensus +6.0% 30/7 Headline CPI +0.5% q/q, Consensus +0.5% q/q 22/7 Core CPI +0.8% q/q, Consensus +0.8% q/q 22/7 New Motor Vehicle Sales +5.7%, Previous +5.4% 21/7 PPI –0.8% q/q, Consensus –0.1% q/q 20/7 Export Prices –20.6% q/q, Consensus –16.0% q/q 17/7 Import Prices –6.4% q/q, Consensus –6.0% q/q 17/7 NAB Business Confidence +4 points, Previous –2 pts 14/7 Employment Change –21.4k, Consensus –25k 9/7 ANZ Job Ads –6.7%, Previous –0.2% 6/7 TD-MI Inflation 0.4%, Previous –0.3% 6/7 WMI Consumer Confidence +12.7%, Previous –4.3% 10/6

Upcoming Data and Events – Australia & US

Australian Data / Events Underlined

September 22 US Richmond Mfg Index, September US House Price Index, July September 23 <u>AU Skilled Vacancies, September</u> US FOMC Meeting & Rate Decision US Fed Chairman Bernanke Address September 24 <u>AU RBA Financial Stability Review</u> US Existing Home Sales, August US Initial Jobless Claims, Sept 19	September 25 US Durable Goods Orders, August US UoM Consumer Confid., September US New Home Sales, August September 28 US Chicago Fed Nat Activity Ind, August US Dallas Fed Mfg Index, September September 29 <u>AU RBA's Head Econ. Analysis Speaks</u> US S&P/CaseShiller House Prices, July US Consumer Confidence, September	September 30 <u>AU Private Sector Credit, August</u> <u>AU Retail Sales, August</u> <u>AU Building Approvals, August</u> US ADP Employment, September US GDP (f), June Quarter US Chicago PMI, September October 1 US Personal Income & Spend'g, August US ISM Manufacturing, September US Pending Home Sales, August

Forecasts

	2008		2009				2010	
End Period:	Q3	Q4	Q1	Q2	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)
RBA Cash, %	7.00	4.25	3.25	3.00	3.00	3.00	3.25	4.00
3 Year Bond, %	5.09	3.90	3.40	4.56	4.85	5.00	5.15	5.45
10 Year Bond, %	5.40	3.99	4.42	5.52	5.60	5.70	5.80	5.90
AUD/USD	0.7924	0.7073	0.6913	0.8064	0.8600	0.8700	0.8800	0.8900
USD/JPY	106.11	90.60	98.96	96.36	97.00	99.00	101.00	103.00
EUR/USD	1.4092	1.3978	1.3250	1.4033	1.4300	1.4250	1.4100	1.4100
GBP/USD	1.7805	1.4626	1.4323	1.6458	1.7000	1.7200	1.7400	1.7600
USD/CHF	1.0644	1.0669	1.1394	1.0859	1.1000	1.1100	1.1200	1.1300
USD/CAD	1.1221	1.2165	1.2602	1.1623	1.0900	1.0800	1.0700	1.0600
NZD/USD	0.6698	0.5835	0.5595	0.6457	0.6750	0.6800	0.6900	0.7000
USD/CNY	6.8460	6.8225	6.8339	6.8305	6.8250	6.8100	6.8000	6.7900
USD/SGD	1.4354	1.4303	1.5529	1.4474	1.4500	1.4600	1.4650	1.4700
AUD/EUR	0.5623	0.5055	0.5217	0.5746	0.6014	0.6105	0.6241	0.6312
AUD/JPY	84.08	64.03	68.41	77.70	83.42	86.13	88.88	91.67
AUD/GBP	0.4451	0.4835	0.4827	0.4990	0.5059	0.5058	0.5057	0.5057
AUD/CHF	0.8892	0.7549	0.7877	0.8757	0.9460	0.9657	0.9856	1.0057
AUD/CAD	0.8435	0.8604	0.8712	0.9373	0.9374	0.9396	0.9416	0.9434
AUD/NZD	1.1830	1.2109	1.2356	1.2787	1.2741	1.2794	1.2754	1.2714
AUD/CNY	5.4248	4.8256	4.7243	5.5081	5.8695	5.9247	5.9840	6.0431
AUD/SGD	1.1374	1.0117	1.0528	1.1672	1.2470	1.2702	1.2892	1.3083

Source:
Bloomberg for historical data

Notes:
i) Cash rate forecasts and 3-year bond rate forecasts are effective 6 August 2009
ii) 10-year bond rate forecasts are effective 18 September 2009
iii) Exchange rate forecasts are effective 3 August 2009
iv) AUD cross exchange rates have been rounded

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