Weekly Economic and Financial Market Snapshot

12 August 2009

	Indicative Rates & Prices [(a)]			
	Year Ago	**Last Week**	**This Week**	**Today**
Interest Rates (% pa)				
cash	7.25	3.00	3.00	3.00
bank bills				
30-day	7.34	3.12	3.17	3.15
90-day	7.33	3.19	3.31	3.30
180-day	7.32	3.39	3.60	3.60
Swaps				
1-year	7.00	3.78	4.02	4.00
3-year	6.78	5.18	5.27	5.17
5-year	6.80	5.78	5.82	5.71
10-year	6.74	6.11	6.134	6.06
Exchange Rates units of FX per $A				
$US	0.8864	0.8348	0.8360	0.8232
yen	97.2	79.4	80.3	78.6
euro	0.5879	0.5847	0.5867	0.5823
TWI [(b)]	68.8	65.9	66.2	65.4
Commodities				
gold ($/ounce)				
$US	854.75	951.22	950.73	945.88
$A	953.07	1,139.37	1,137.24	1,149.03
oil ($/barrel)				
$US	116.25	68.55	70.98	69.45
$A	131.02	82.42	84.53	83.19
base-metals [(c)]				
$US	165.5	123.0	137.4	136.4
$A	142.4	118.3	126.3	126.5
Equities				
All Ords	5,043	4,260	4,325	4,346
Dow	11,649	9,201	9,297	9,241

Notes: *(a)* Indicative wholesale prices/yields. With the exception of cash and all data in the "today' column, all observations are weekly averages ending Wednesday. Cash is snapshot on the Wednesday of the relevant week.

(b) Trade-weighted index value of AUD, based at May 1970 = 100.

(c) Composite index based on London Metal Exchange (LME) prices of aluminium, nickel, copper, zinc and lead; weighted by each metal's relative importance in the RBA's index of commodity prices. Base of index is 3 January 2005 = 100

Within less than a day of the RBA unveiling an admittedly qualified upbeat assessment of the outlook for the local economy, more evidence that the rate of contraction in the US one is slowing came to light when July's slide in non-farm payroll employment in the world's largest economy came in at its lowest since August last year. Nevertheless, the net 247,000 jobs shed in July brought the cumulative loss to a staggering 6.7 million people, while the peak to trough decline of 4.8 per cent and counting is now deeper than the next biggest post-second world war downturn of 4.4 per cent in the late 1950s.

The slowing in the rate of job losses in the US in July was enough to bring the unemployment rate down a touch, from 9.5 per cent to 9.4 per cent, but only because the participation rate fell.

In contrast to the depth of the slide in US employment, the official trend estimate of Australia's total employment has fallen by just 0.3 per cent since it peaked in November last year, although full-time employment has dropped by a cumulative 1.1 per cent since its high point 8 months earlier.

The modest contraction in Australia's employment relative to the US is hardly surprising given the severity of the bigger economy's recession. It also seemingly reflects reluctance by employers in Australia to lose workers and then have to find suitable labour again when the economy recovers.

But the modest rise in the unemployment rate so far and flat, rather than falling total employment collectively are masking a steepish contraction in full-time employment and total hours worked economy-wide. Nevertheless, to the extent that the headline (ie seasonally adjusted) jobless rate is a key factor in consumer confidence, aggressive and co-ordinated monetary and fiscal stimulus clearly have provided a circuit-breaker that prevented pessimism feeding on itself in the darkest days and weeks following the collapse of Lehman Brothers in the middle of September last year.

Not that the cost of the fiscal stimulus is trivial, however, and it will be reflected in higher medium to longer-term interest rates than would otherwise be the case as the supply of government bonds increases to finance burgeoning budget deficits.

The extent of the rise in government bond yields to date is modest, while risk premia and yields on US corporate bonds are now falling steadily as the pace of the return of global risk appetite gathers momentum. They remain above their immediate pre-Lehman levels, but have nevertheless fallen by around 650 basis points and 550 basis points respectively since peaking in late January this year.

But just as it is legitimate to question the durability of the global economy's 'recovery' when the impact of fiscal stimulus fades, the decline in debt market risk premia are in part due to government support measures that cannot stay in place indefinitely. Moreover, global inflation is still public enemy number one of investors in longer-dated bonds, so as and when it reaccelerates - which it surely will when the recovery gathers significant momentum, bond yields could, and most probably will rise sharply.

The RBA’s assessment of the local economy late last week would have been no less optimistic if it had been made with the knowledge of the latest readings on both business and consumer sentiment, both of which continued their renaissance this week. So businesses do not seem overly concerned at the prospect of higher bond yields, while the contraction in full-time employment is not bad enough to hit consumer sentiment, in part because the headline (ie seasonally adjusted) unemployment rate, for all its faults, is the key labour market indicator that drives consumer confidence.

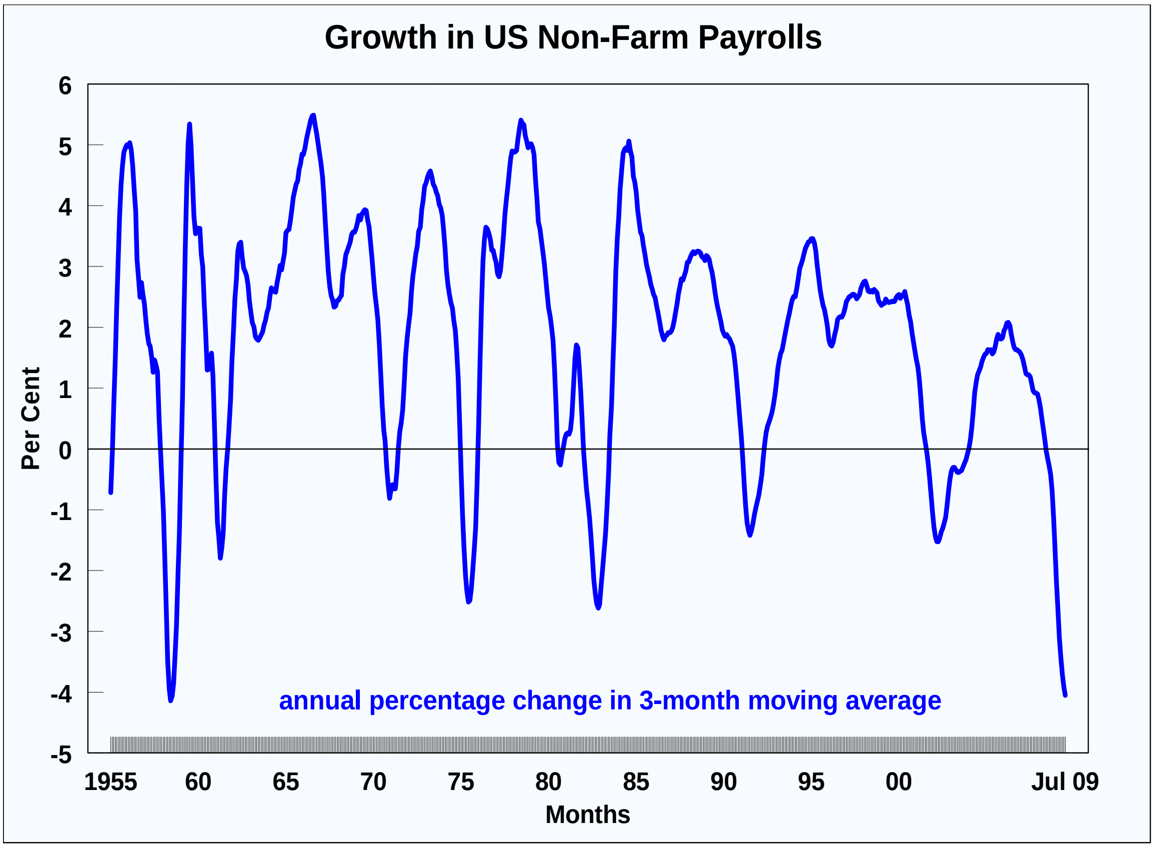
Apart from masking 11 successive months of contraction in trend full-time employment growth, both the unemployment rate and total employment growth also hide a steady contraction in total economy-wide hours worked as part-time creation and substitution from full-time employment continue to dominate labour market trends. Moreover, two successive quarters of modest growth in the wage cost index have dragged annual growth back from a peak of 4.3 per cent late last year, to 3.8 per cent in the year to June. Accordingly, when total aggregate household income growth is tallied in the national accounts, it is sure to show a significant slowing due to the combined impact of less hours worked in total across the population and slower growth in wage rates.

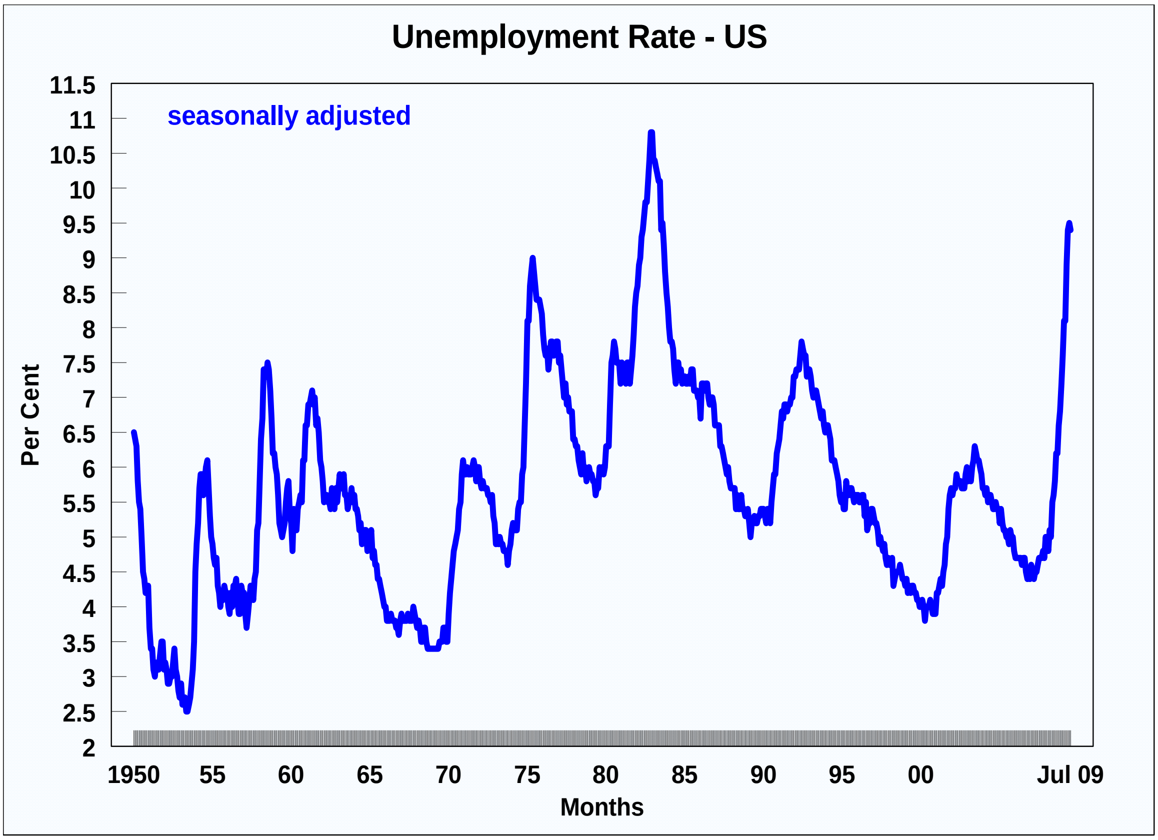
None of which is inconsistent with the RBA’s forecast that underlying inflation will continue to retreat from its current rate of 3¾ per cent, all the way back to the bottom of its 2-3 per cent medium-term target rate by the end of next year. If it does, the extent of the rise in bond yields should be manageable, although upside risk to the RBA’s inflation outlook is greater than downside potential, while supply considerations as new bonds are issued to finance Canberra’s deficit can only add to upward pressure on term interest rates in the medium-term.

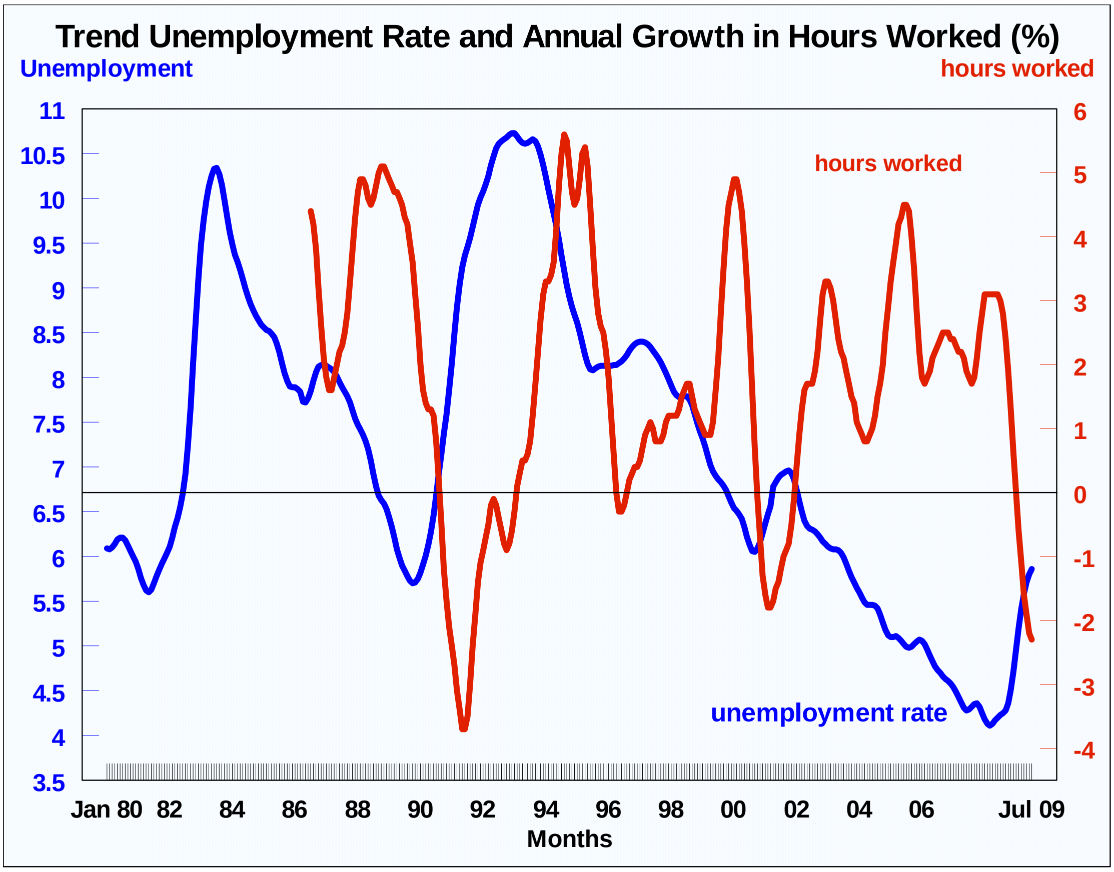
The benign wage cost index reading and the pull-back in Asian equity prices, led by the 4.7 per cent drop in the Shanghai A index - arrested the surge in local interest rates on Wednesday. Implied yields on 90-day bank bill and bond futures contracts fell by between 7 and 20 basis points, although the bill futures market that is the most sensitive to expectations of moves by the RBA is still well and truly prepared for the first of several increase in the cash rate, starting either later this year or in early 2010.

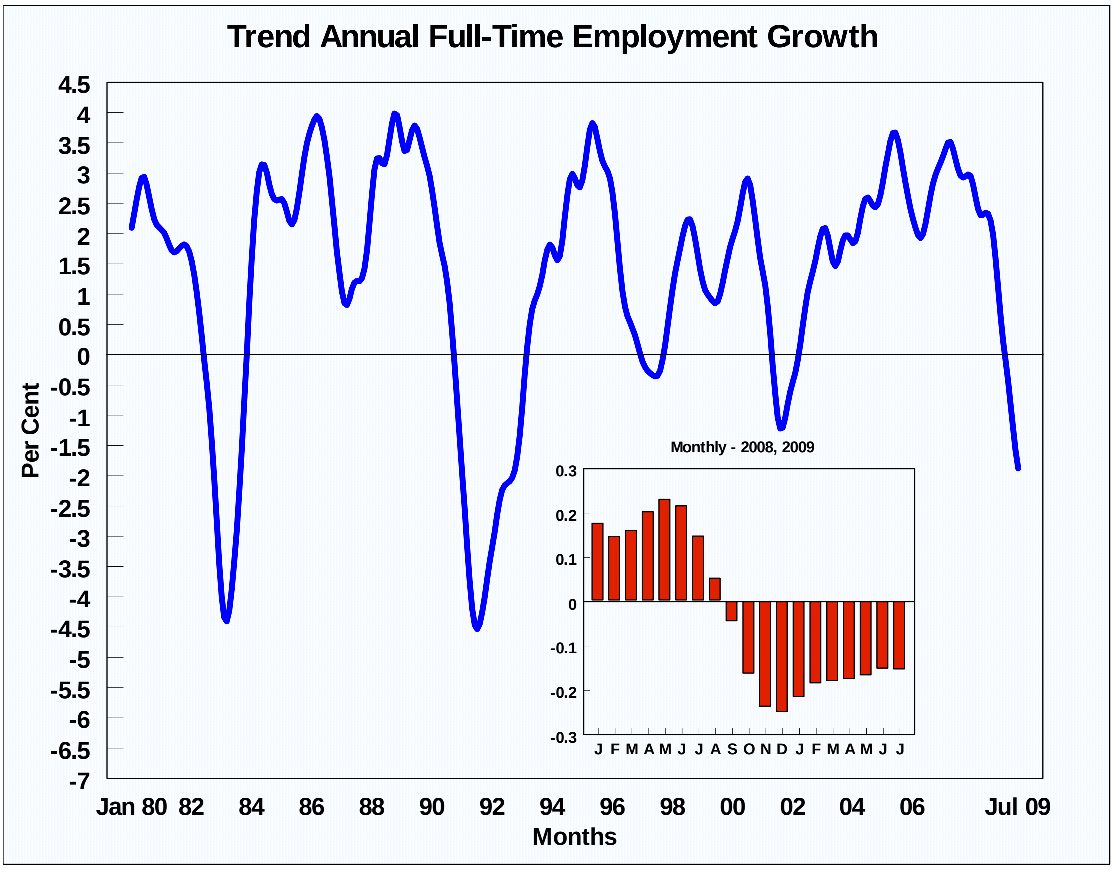
And the Australian dollar also retreated, not only on less aggressive prospective widening of short-term interest rate differentials, but also as the flip-side of the at least temporary reversal of the recent slide in Japan’s yen. The Japanese currency waxes and wanes with global risk appetite - when it rises, the yen falls as funds are borrowed at ultra cheap rates and then invested at juicier returns elsewhere, but only after the investor sells yen in exchange for the destination economy’s currency.

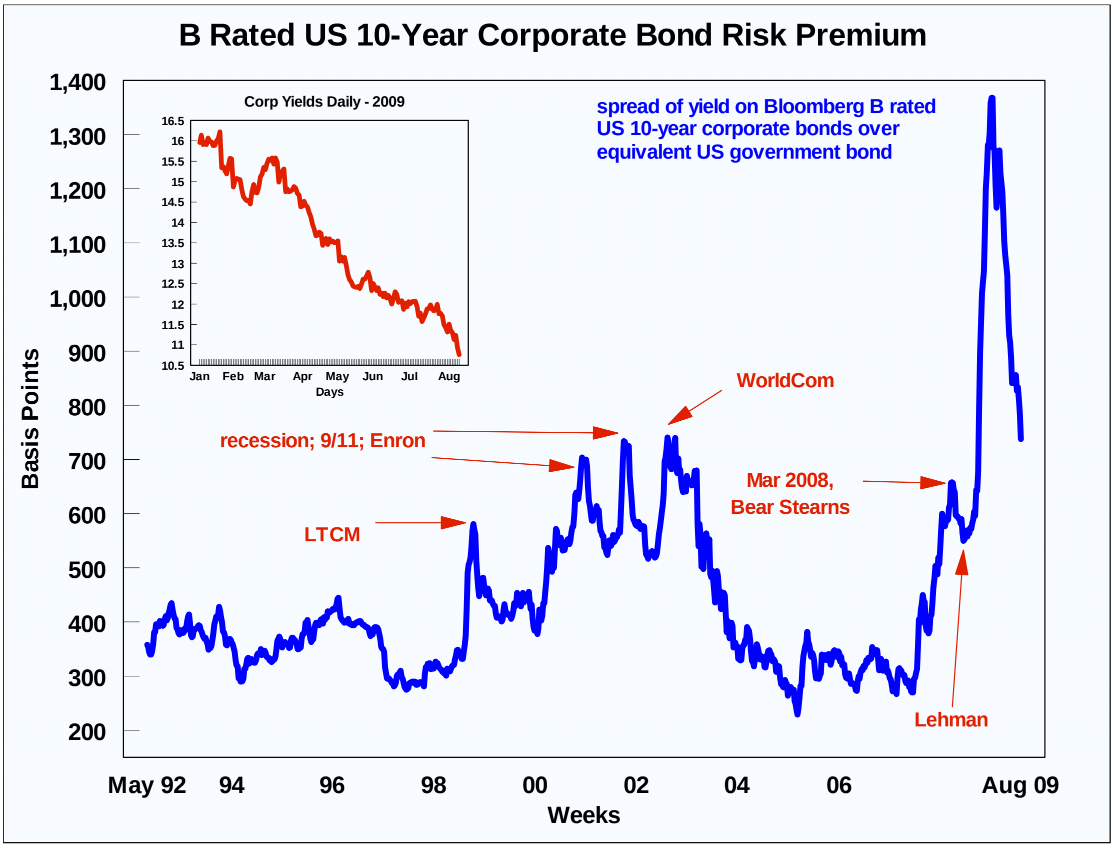
Conversely, a decline in global risk appetite (or an increase in aversion for risk) - and over the years, foreign currency risk is about as big as they come - triggers sales of the currencies where funds borrowed in Japan are parked. And throughout the era of ultra low global short-term interest rates, Australian and New Zealand rates were among the most attractive in the advanced world, so the two antipodean dollars benefited most when the yen carry trade was at its peak, but also fall more heavily whenever the yen carry trade unwinds.


Growth in US Non-Farm Payrolls
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
Per Cent
annual percentage change in 3-month moving average
1955
60
65
70
75
80
85
90
95
00
Jul 09
Months

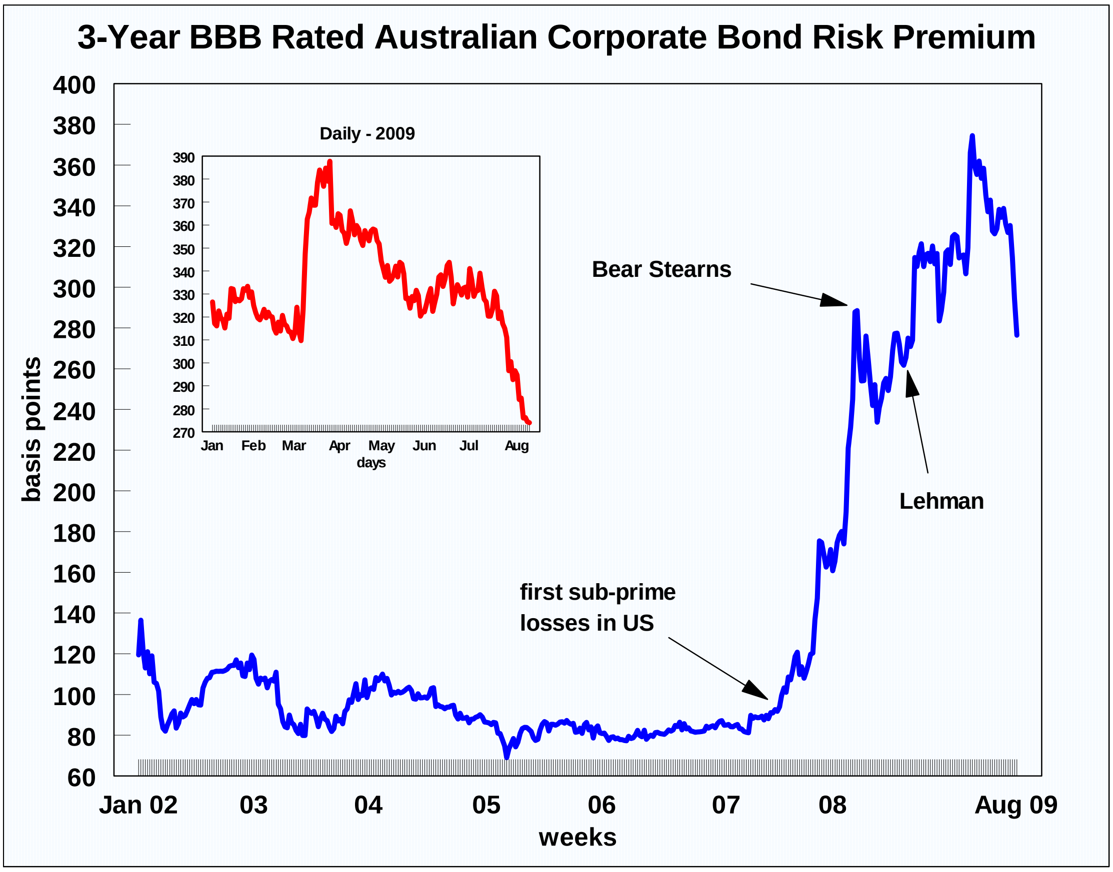

Unemployment Rate - US
11.5
11
10.5
10
9.5
9
8.5
8
7.5
7
6.5
6
5.5
5
4.5
4
3.5
3
2.5
2
Per Cent
seasonally adjusted
1950
55
60
65
70
75
80
85
90
95
00
Jul 09
Months


Trend Unemployment Rate and Annual Growth in Hours Worked (%)
Unemployment
hours worked
11
10.5
10
9.5
9
8.5
8
7.5
7
6.5
6
5.5
5
4.5
4
3.5
6
5
4
3
2
1
0
-1
-2
-3
-4
hours worked
unemployment rate
Jan 80 82 84 86 88 90 92 94 96 98 00 02 04 06 Jul 09
Months

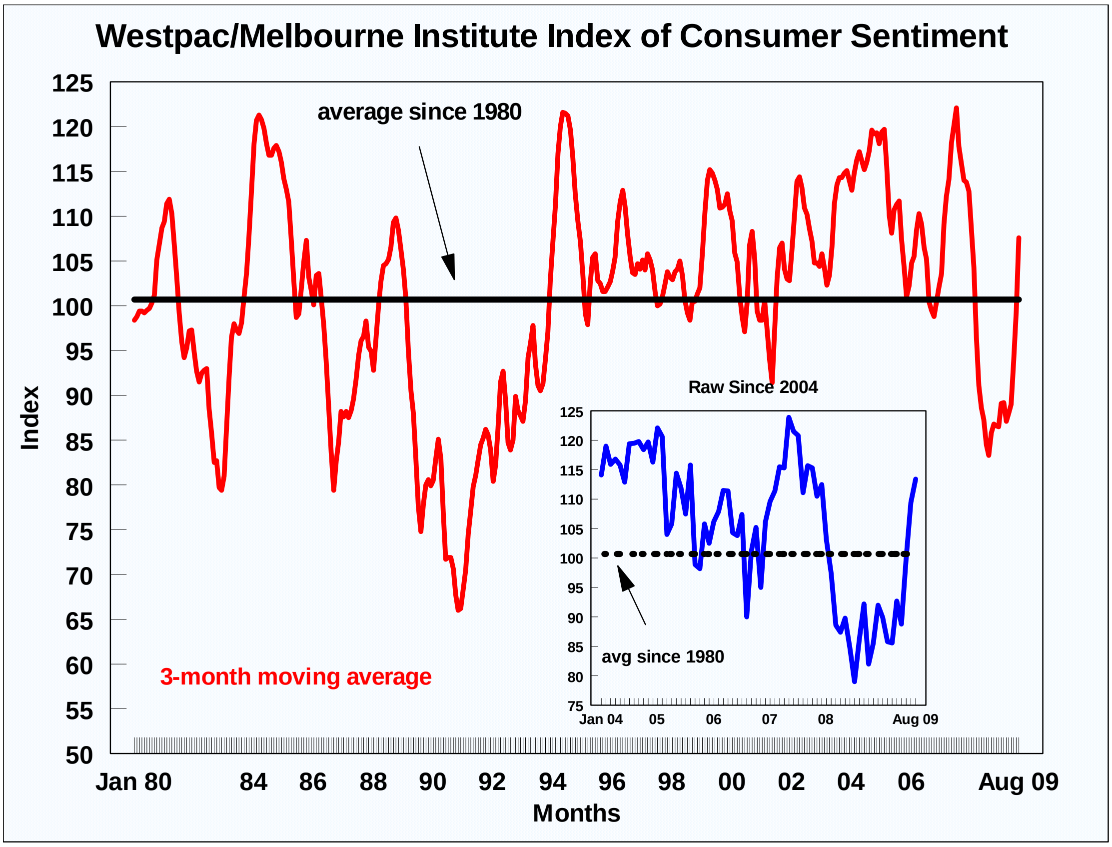

Trend Annual Full-Time Employment Growth
Per Cent
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
-3.5
-4
-4.5
-5
-5.5
-6
-6.5
-7
Monthly - 2008, 2009
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
J F M A M J J A S O N D J F M A M J J
Jan 80 82 84 86 88 90 92 94 96 98 00 02 04 06 Jul 09
Months



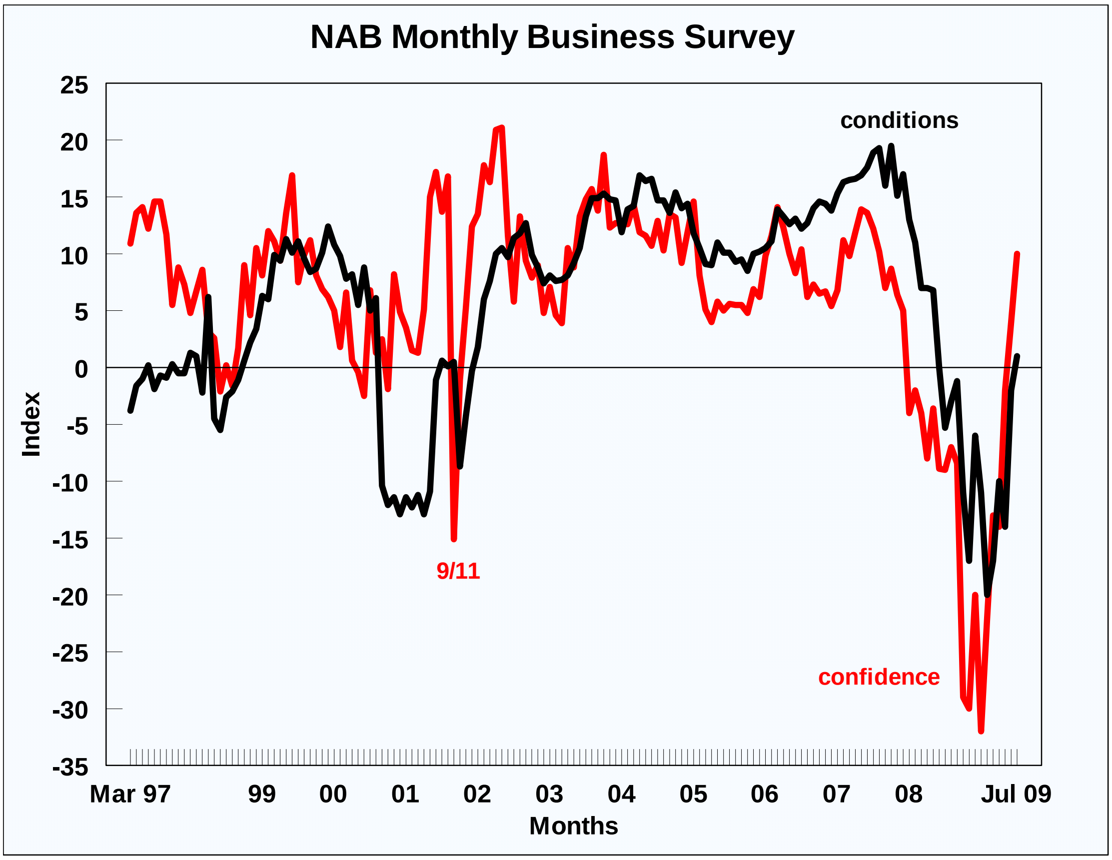
B Rated US 10-Year Corporate Bond Risk Premium
Basis Points
1,400
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
May 92
94
96
98
00
02
04
06
Aug 09
Weeks
Corp Yields Daily - 2009
16.5
16
15.5
15
14.5
14
13.5
13
12.5
12
11.5
11
10.5
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Days
spread of yield on Bloomberg B rated US 10-year corporate bonds over equivalent US government bond
WorldCom
recession; 9/11; Enron
Mar 2008, Bear Stearns
LTCM
Lehman



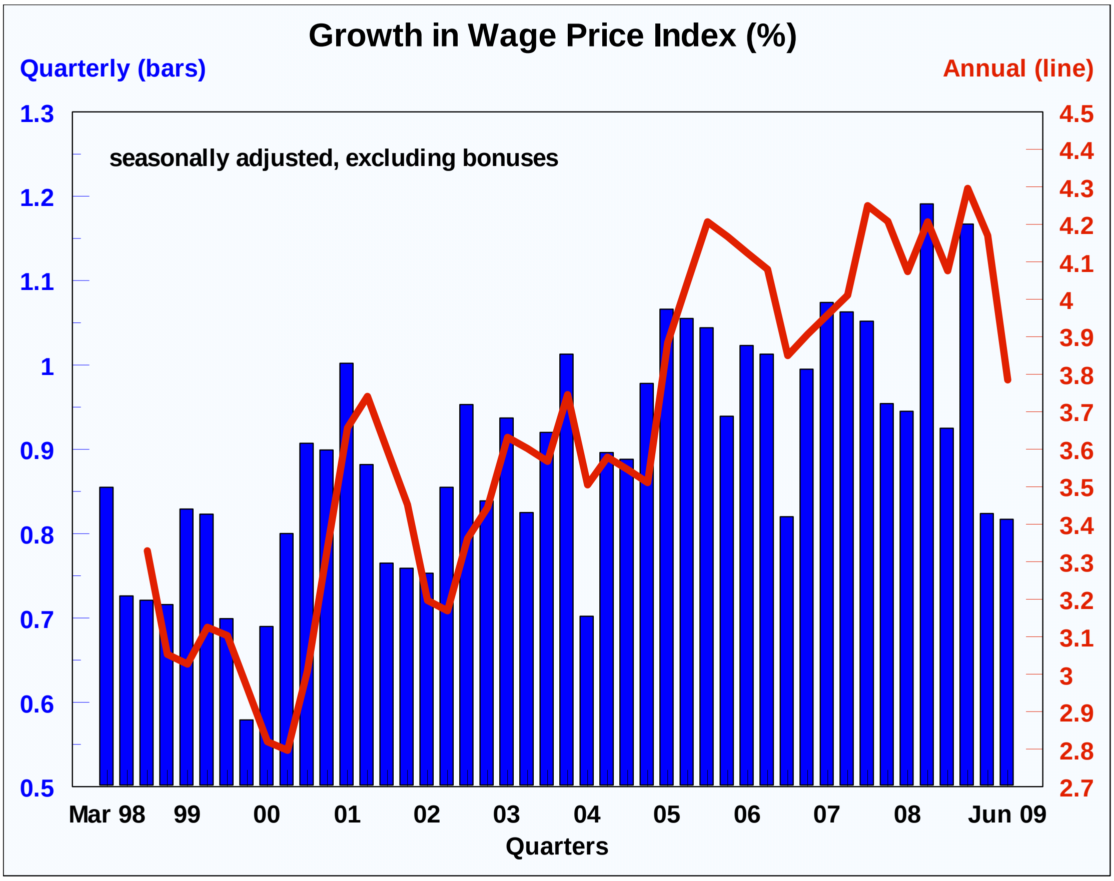
3-Year BBB Rated Australian Corporate Bond Risk Premium
basis points
400
380
360
340
320
300
280
260
240
220
200
180
160
140
120
100
80
60
Jan 02
03
04
05
06
07
08
Aug 09
weeks
Daily - 2009
390
380
370
360
350
340
330
320
310
300
290
280
270
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
days
Bear Stearns
Lehman
first sub-prime losses in US

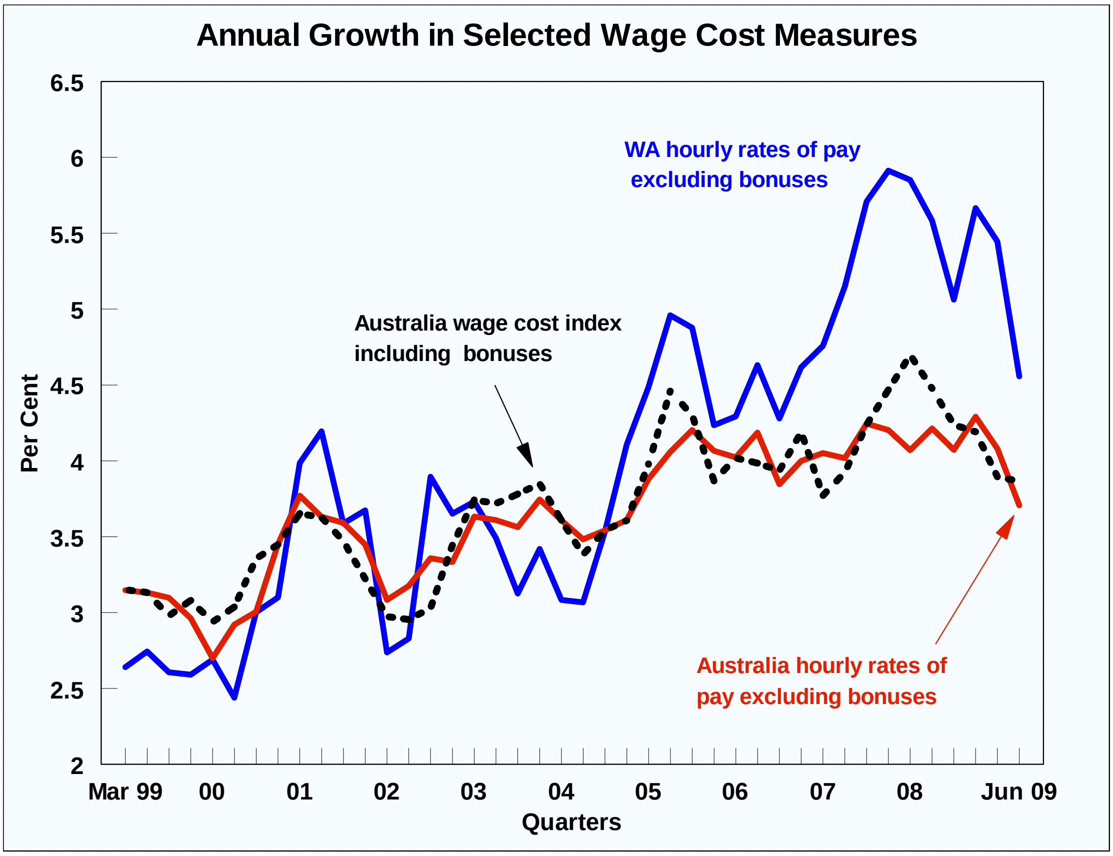


Westpac/Melbourne Institute Index of Consumer Sentiment
average since 1980
3-month moving average
Raw Since 2004
avg since 1980
Index
Months
Jan 80
84
86
88
90
92
94
96
98
00
02
04
06
Aug 09
Jan 04
05
06
07
08
Aug 09

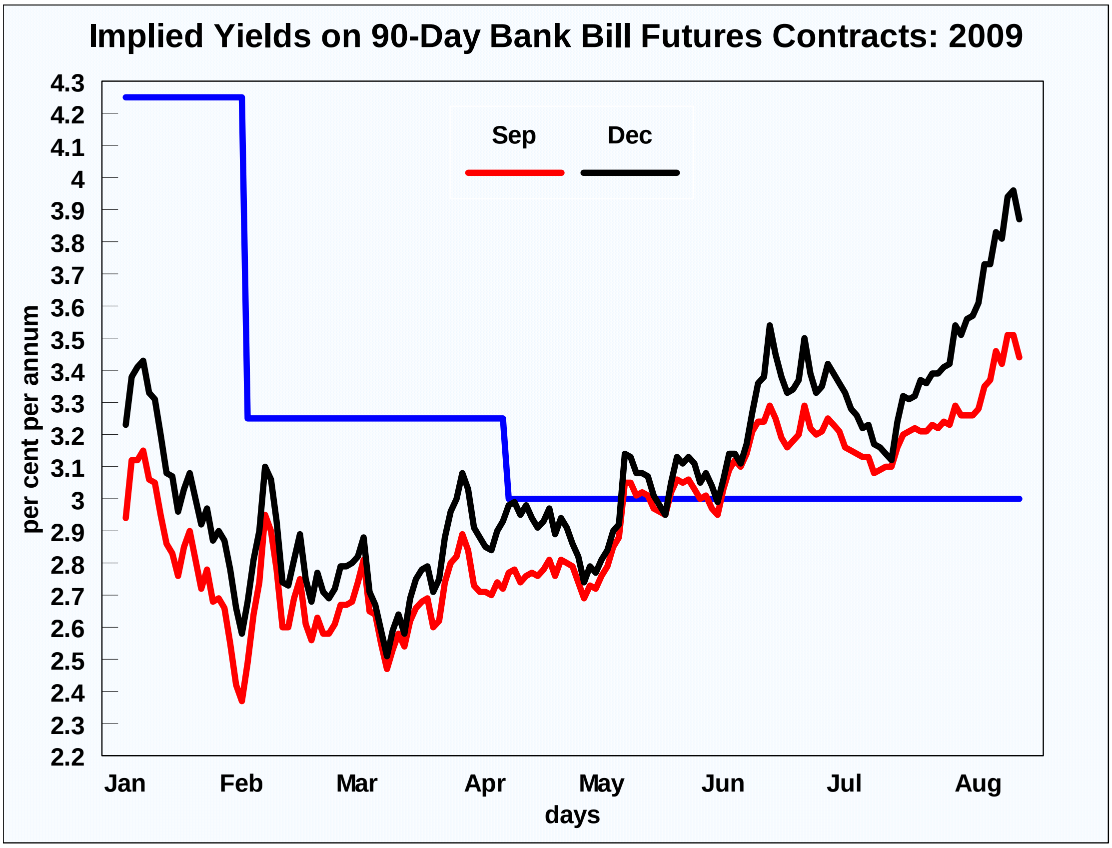


NAB Monthly Business Survey
conditions
confidence
9/11
Index
Months
Mar 97
99
00
01
02
03
04
05
06
07
08
Jul 09

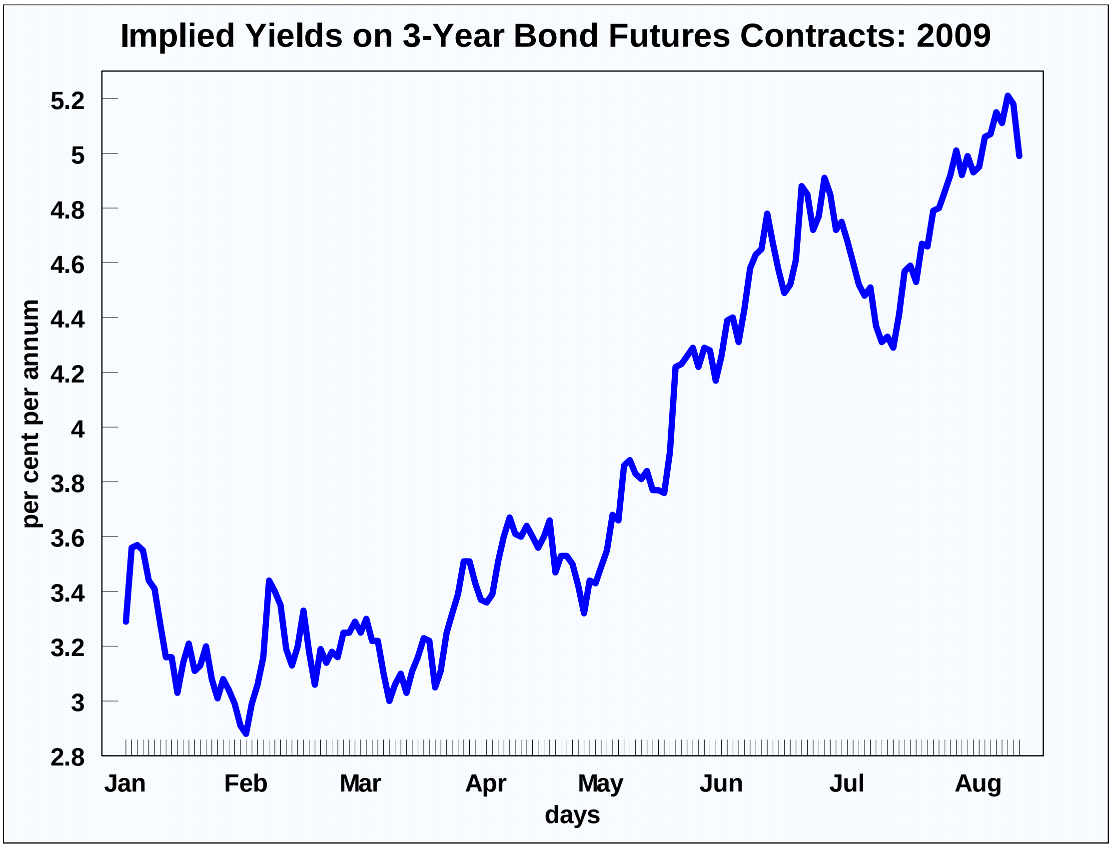

Growth in Wage Price Index (%)
Quarterly (bars)
Annual (line)
seasonally adjusted, excluding bonuses
1.3
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
3.2
3.1
3
2.9
2.8
2.7
Mar 98
99
00
01
02
03
04
05
06
07
08
Jun 09
Quarters

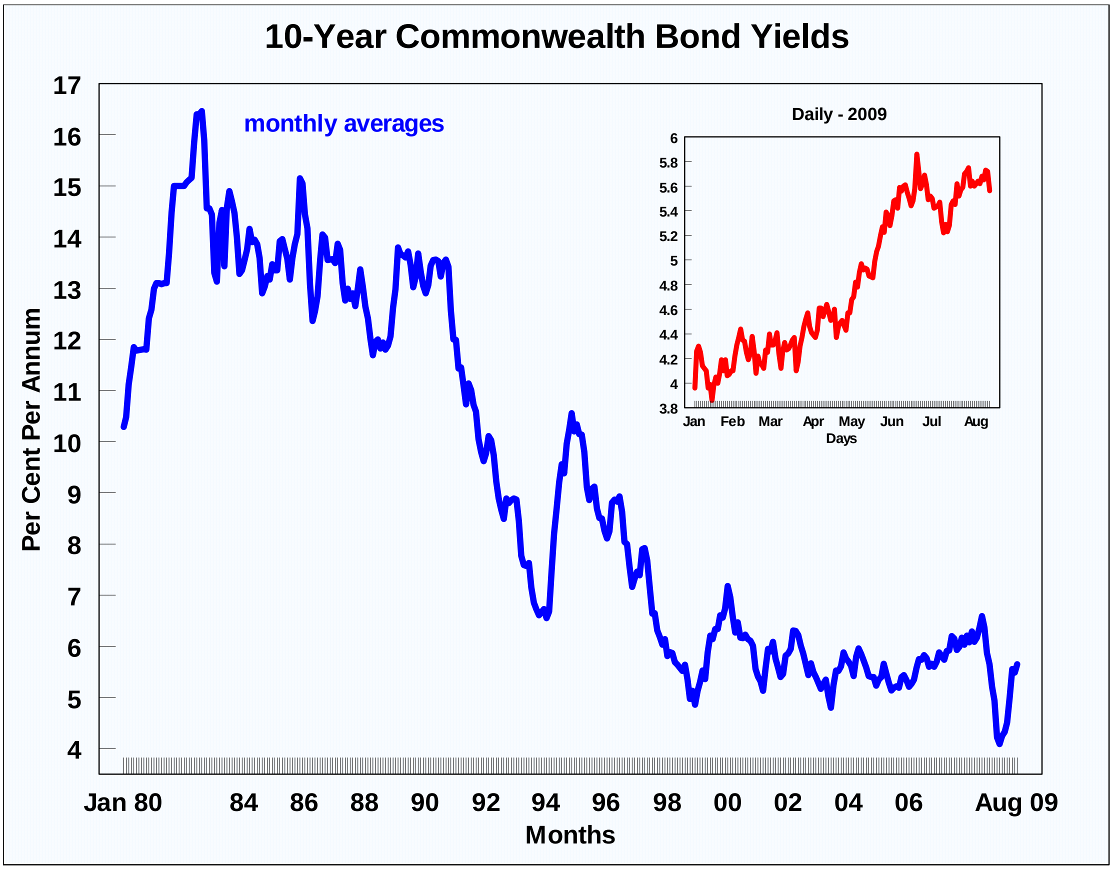

Annual Growth in Selected Wage Cost Measures
6.5
6
5.5
5
4.5
4
3.5
3
2.5
2
Per Cent
WA hourly rates of pay excluding bonuses
Australia wage cost index including bonuses
Australia hourly rates of pay excluding bonuses
Mar 99
00
01
02
03
04
05
06
07
08
Jun 09
Quarters

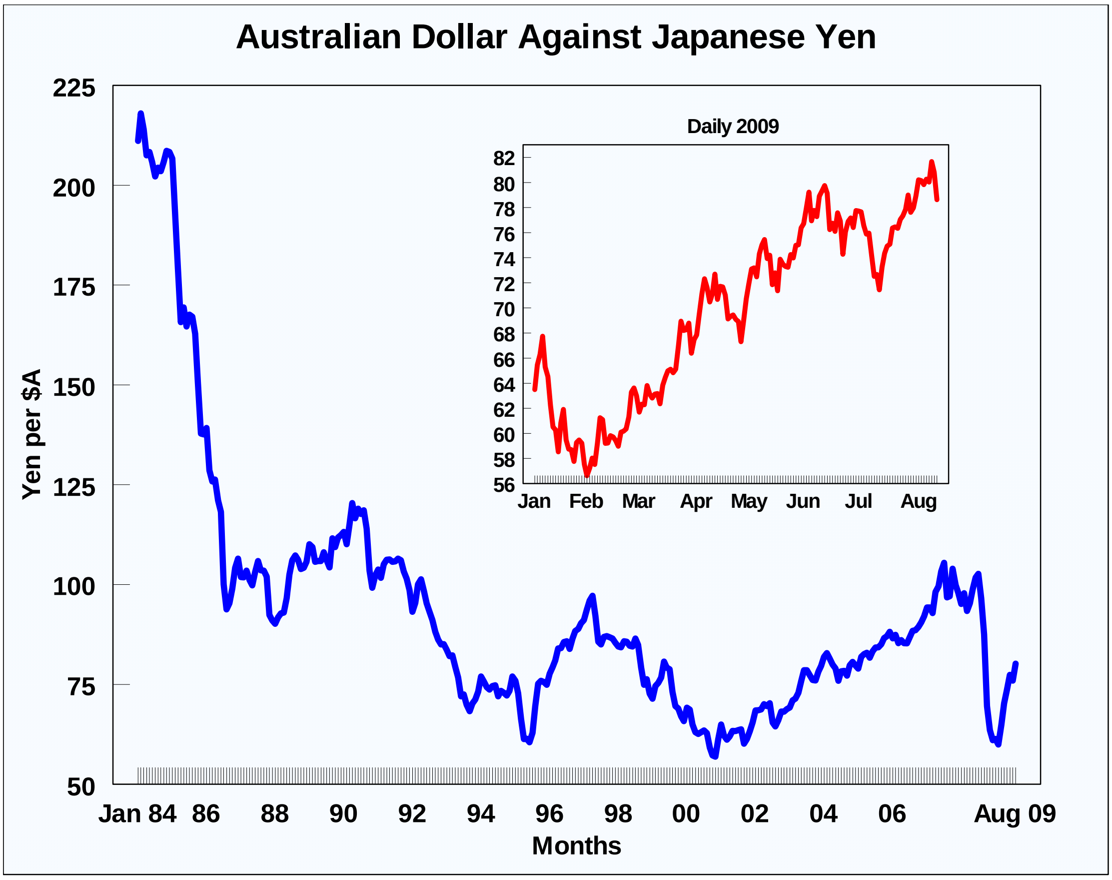
Shanghai - A Share Price Index
5-day moving average
Raw - 2009
Index Points
6,500
6,000
5,500
5,000
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
3,700
3,600
3,500
3,400
3,300
3,200
3,100
3,000
2,900
2,800
2,700
2,600
2,500
2,400
2,300
2,200
2,100
2,000
1,900
Jan Feb Mar Apr May Jun Jul Aug
Days
Jan 00 01 02 03 04 05 06 07 08 Aug 09
Days



Implied Yields on 90-Day Bank Bill Futures Contracts: 2009
Sep
Dec
per cent per annum
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
3.2
3.1
3
2.9
2.8
2.7
2.6
2.5
2.4
2.3
2.2
Jan Feb Mar Apr May Jun Jul Aug
days


Implied Yields on 3-Year Bond Futures Contracts: 2009
per cent per annum
5.2
5
4.8
4.6
4.4
4.2
4
3.8
3.6
3.4
3.2
3
2.8
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
days


10-Year Commonwealth Bond Yields
monthly averages
Per Cent Per Annum
17
16
15
14
13
12
11
10
9
8
7
6
5
4
Jan 80
84
86
88
90
92
94
96
98
00
02
04
06
Aug 09
Months
Daily - 2009
6
5.8
5.6
5.4
5.2
5
4.8
4.6
4.4
4.2
4
3.8
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Days



US labour market data is sourced from the US Bureau of Labor Statistics; Australia's from ABS catalogue 6202.0; wages growth from ABS catalogue 6345.0; Australian dollar from the RBA; all other data sourced from Bloomberg.

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