

## Weekly Economic and Financial Market Snapshot

16 September 2009

	Indicative Rates & Prices <sup>(a)</sup>			
	Year Ago	Last Week	This Week	Today
<b>Interest Rates</b>				
(% pa)				
<b>cash</b>	7.00	3.00	3.00	3.00
<b>bank bills</b>				
30-day	7.22	3.18	3.18	3.19
90-day	7.23	3.42	3.40	3.40
180-day	7.15	3.767	3.65	3.65
<b>Swaps</b>				
1-year	6.68	4.23	4.04	4.05
3-year	6.43	5.29	5.11	5.12
5-year	6.44	5.75	5.61	5.61
10-year	6.34	6.04	5.93	5.90
<b>Exchange Rates</b>				
units of FX per \$A				
\$US	0.8032	0.8489	0.8621	0.8662
yen	85.3	78.7	78.6	78.8
euro	0.5666	0.5918	0.5902	0.5901
TWI <sup>(b)</sup>	63.8	66.8	67.2	67.4
<b>Commodities</b>				
<b>gold</b> (\$/ounce)				
\$US	764.25	993.47	1,002.21	1,016.79
\$A	946.64	1,170.30	1,162.45	1,173.85
<b>oil</b> (\$/barrel)				
\$US	98.24	68.78	70.47	70.93
\$A	125.10	81.76	81.85	82.28
<b>base-metals</b> <sup>(c)</sup>				
\$US	153.6	134.3	132.5	130.0
\$A	146.8	121.6	118.1	116.1
<b>Equities</b>				
All Ords	4,855	4,478	4,581	4,653
Dow	11,220	9,391	9,618	9,683

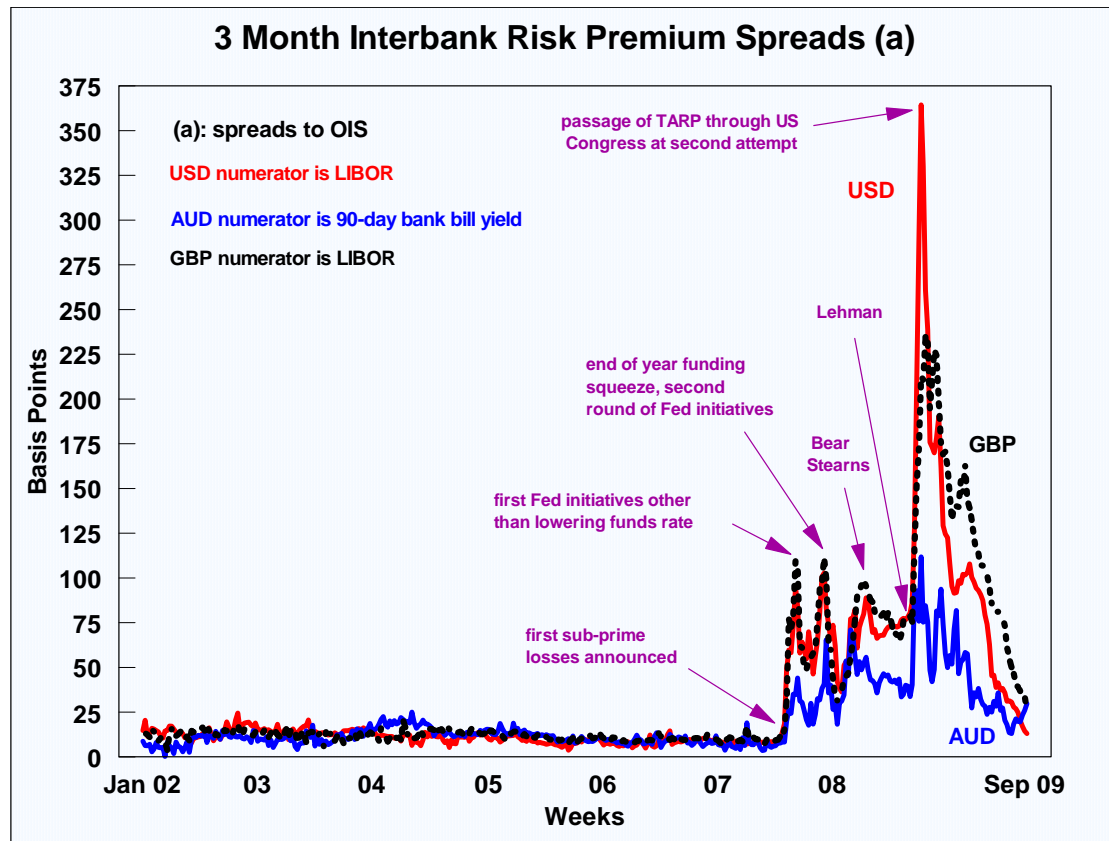
Notes: (a) Indicative wholesale prices/yields. With the exception of cash and all data in the "today" column, all observations are weekly averages ending Wednesday. Cash is snapshot on the Wednesday of the relevant week.

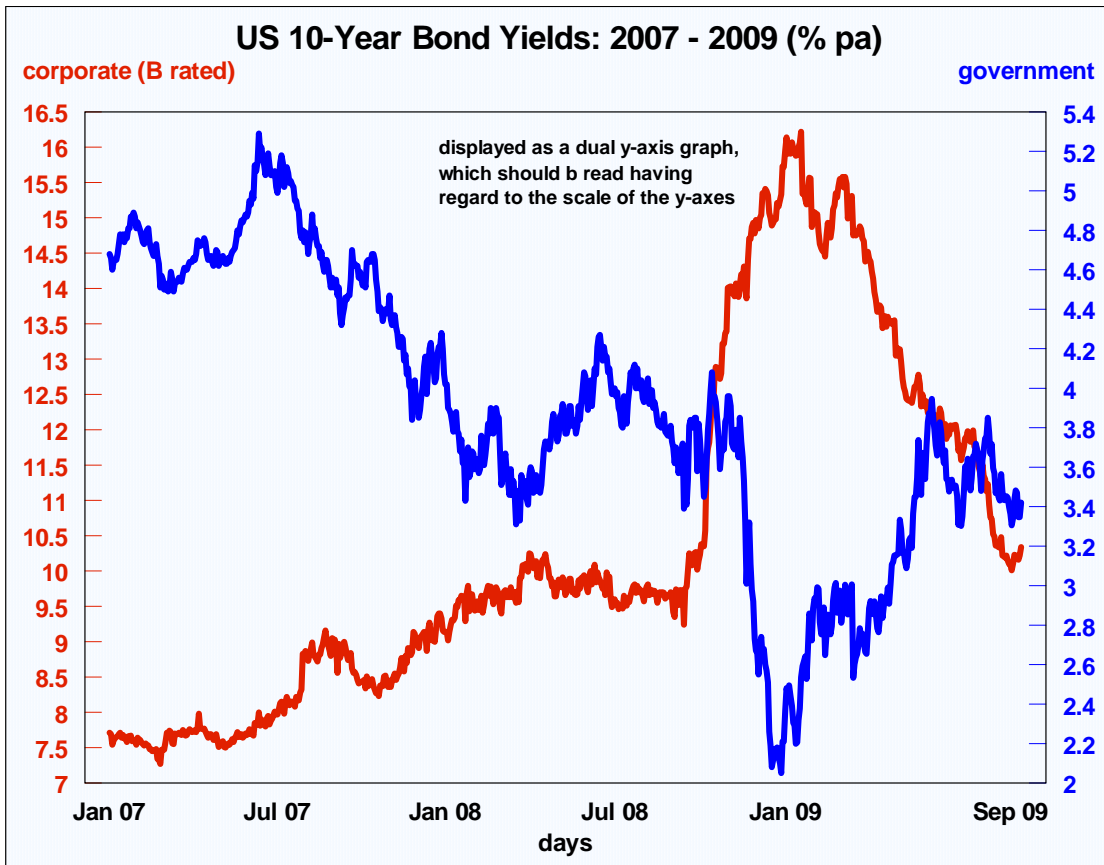
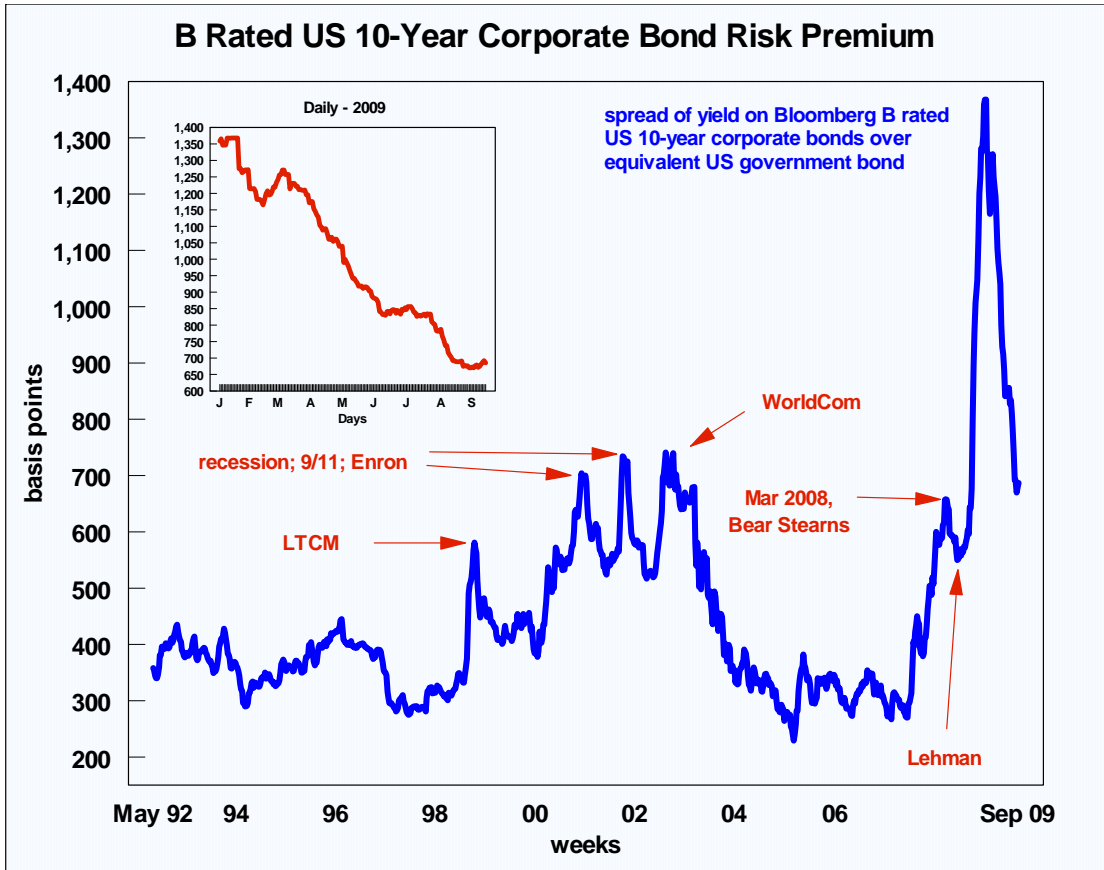
(b) Trade-weighted index value of AUD, based at May 1970 = 100.

(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

Although the credit crunch started life as the sub-prime mortgage crisis in late July 2007, it was not until the collapse of the once venerable New York investment bank Lehman Brothers in the middle of September last year that the crisis jumped species to become what is now widely known as the global financial crisis (GFC). One year on, the benchmark USD 3 month London Interbank Offer Rate (LIBOR) over 3 month overnight indexed swap (OIS) spread is not only back to where it was immediately BL - before Lehman - but it is almost back to where it was in the few years leading up to the fist sub-prime losses.

Similarly, a range of benchmark US corporate bond risk premia are getting close to being back to where they were BL, because absolute yields on the corporate bonds have retreated at the same time as yields on the risk-free government paper side of the equation have risen from their extreme risk-aversion lows of around 2% pa late last year.

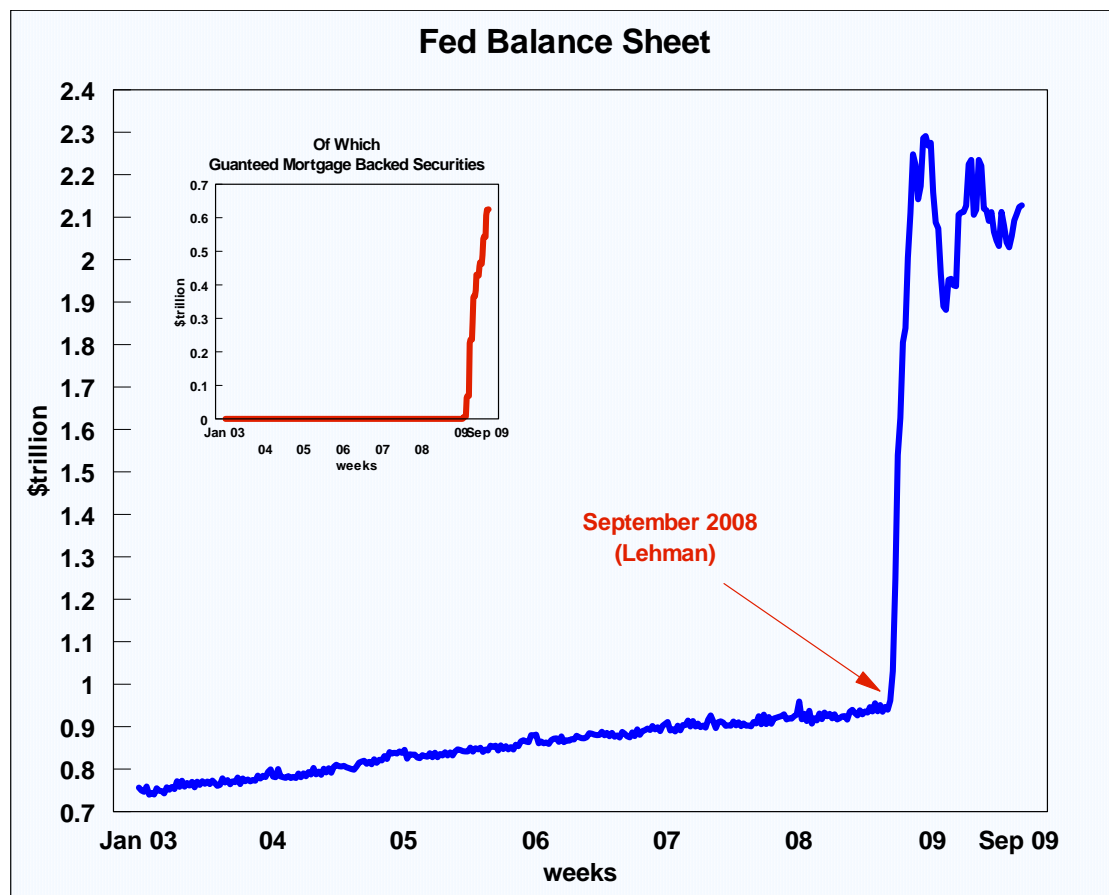




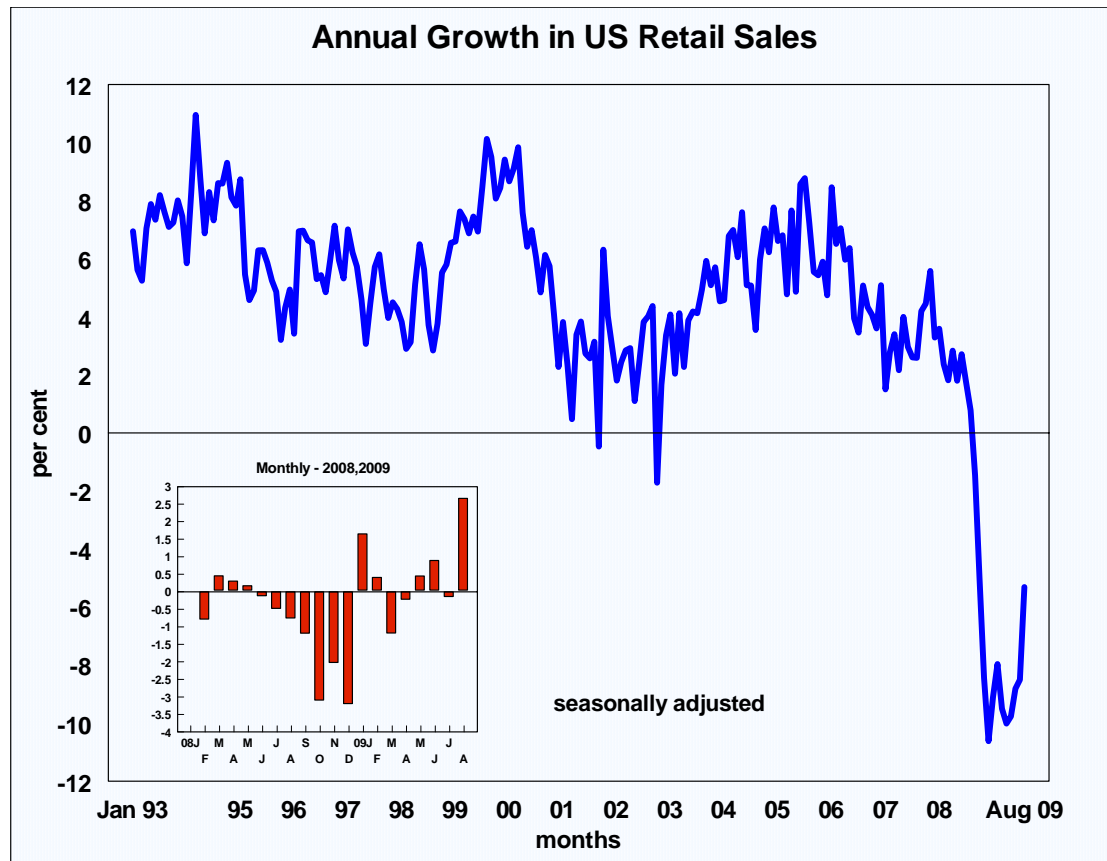
But both short and longer-dated debt market risk premia are to some extent - and a still significant extent at that - held down by government support measures that will have to be removed eventually. More generally, the apparent recovery in the global economy owes its origins to the massive fiscal stimulus implemented in parallel with monetary stimulus - both lower official cash rates and the raft of unconventional measures that the Fed in particular, but by no means in isolation, has deployed to get credit markets functioning again after they had all but collapsed in the dark few weeks following Lehman's demise.

Throw in the as yet untested troubled asset relief programme's (TARP) scheme to purge American banks of the toxic assets that started the whole thing in the first place, and the array of support mechanisms becomes even more mind boggling, and so too do the potential pitfalls as they are progressively unwound as and when the global economy is strong enough in its own right to grow at a solid clip without the aid of much greater than normal government assistance.

Theoretically, one of the Fed's support measures - the purchase of up to \$300 billion of Uncle Sam's bonds to limit upside risk to their yields - will end next month, but the \$283 billion worth purchased so far is less than half the \$625 billion of mortgage backed securities guaranteed collectively by Fannie Mae, Freddie Mac and the less well know Ginnie Mae that also now adorn a Fed balance sheet that grew rapidly from around \$950 billion just BL, to more than \$2 trillion by the end of the following month last year. It has grown little since then, but neither has it been wound back, and neither is it likely to be in the near-term.



Whereas the 'you call that a recession' in the US in 2001 was mainly caused by the savage contraction in business investment in the wake of the vaporisation of the NASDAQ in early 2000, the genuine and deep recession of 2008/2009 was/is very much driven by the precipitous contraction in private consumption, which is by no means unrelated to the equally precipitous fall in house prices across the length and breadth of the US. But further evidence of a thawing in frozen consumption in the world's largest economy was published on Tuesday night, when retail sales grew strongly, although as with all other portents of 'recovery', whether or not it is followed up with further gains remains to be seen.



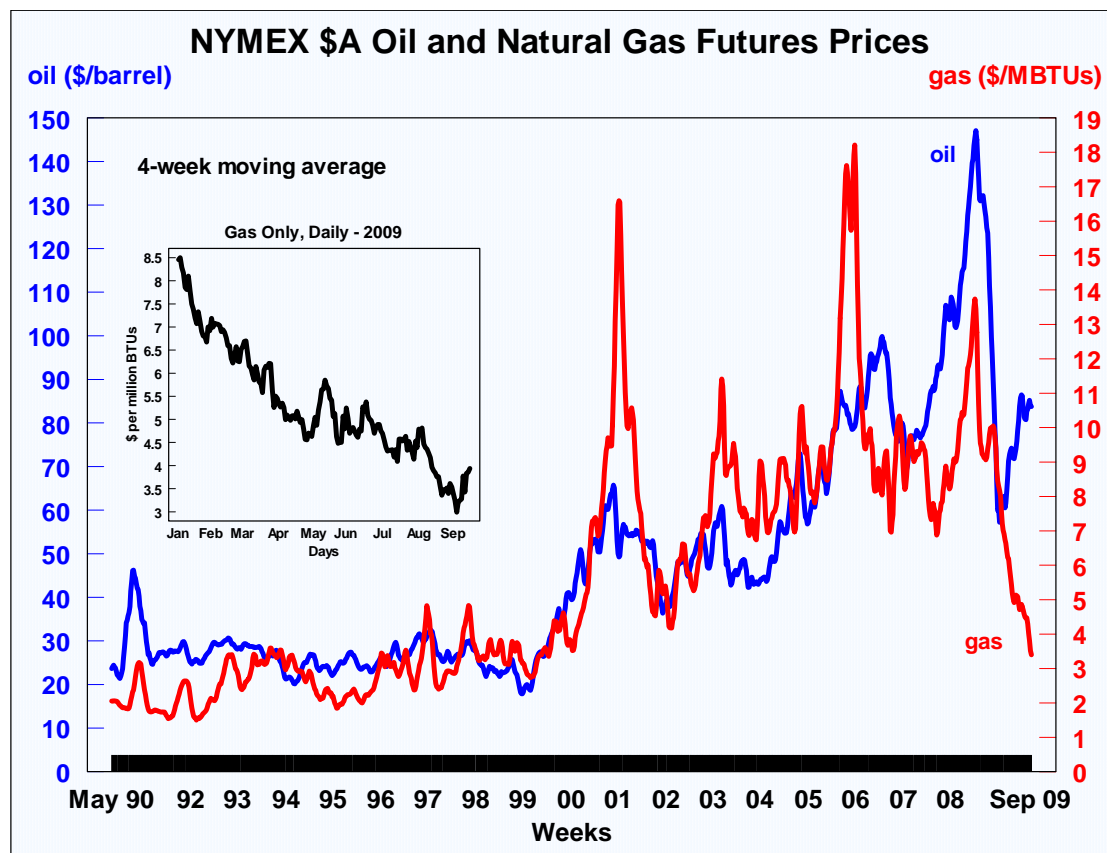
If the marking of the anniversary of Lehman's collapse and the associated debate on the prospective regulatory framework that hopefully will lessen the risk of something similar happening again is the major focus in global financial markets this week, then the formal approval of the mega Gorgon LNG project in Australia is much more than just a footnote. If nothing else, it will do no harm to both consumer and business sentiment, although both will seemingly have to grapple with a higher cash rate by February next year, if not sooner, although the RBA for one is well aware of what could go wrong with the unwinding of government support measures around the world.

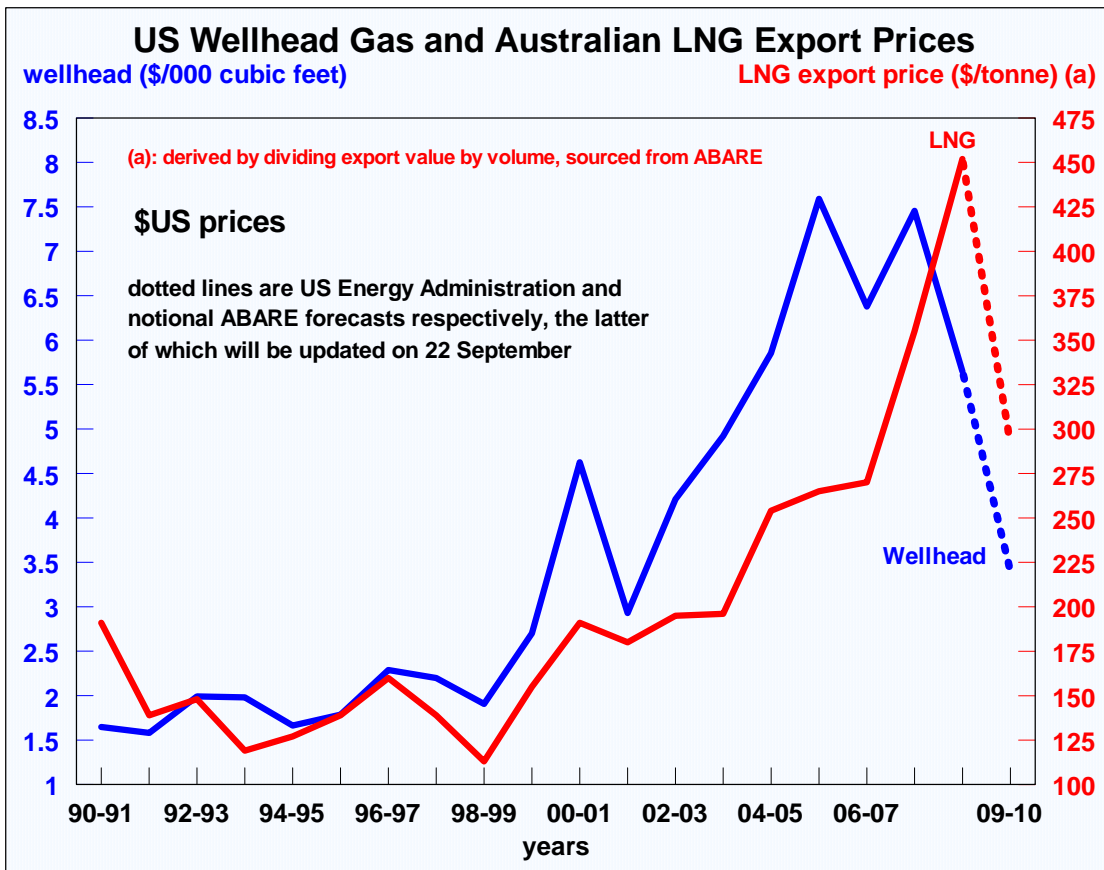
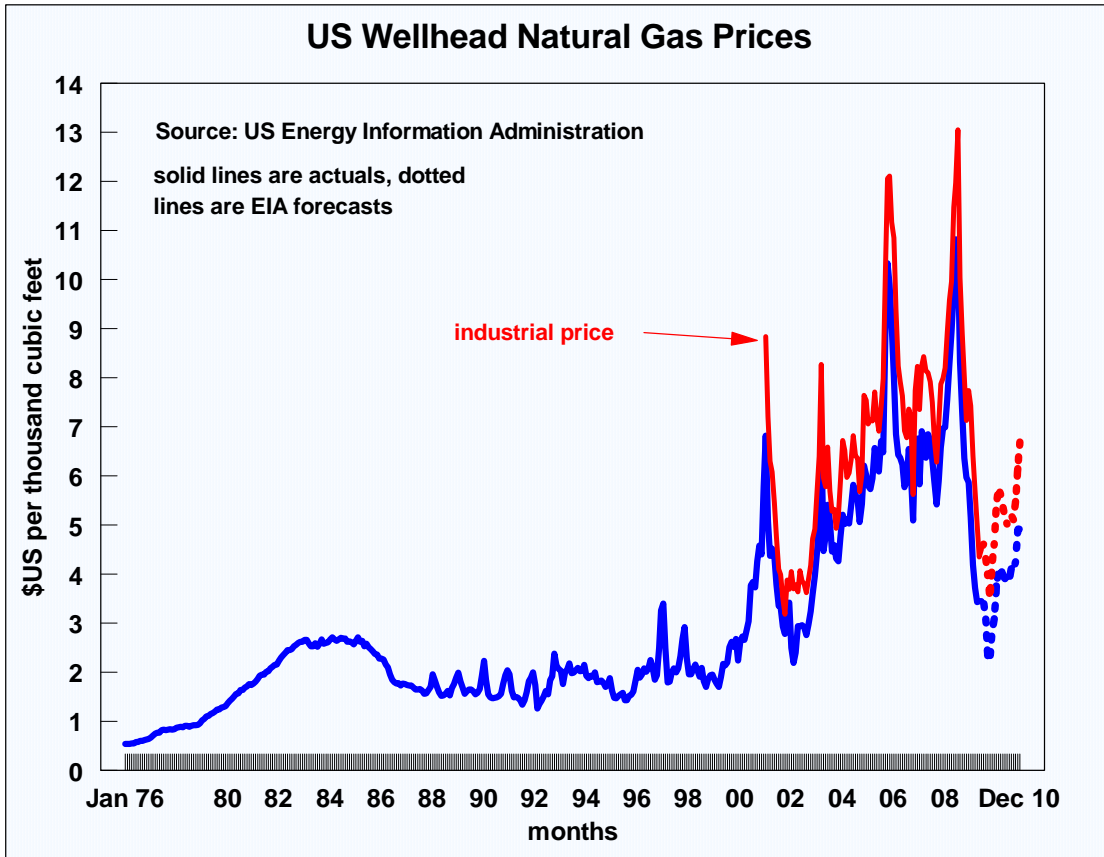
The ascent of the Australian dollar is doing some of the RBA's work for it, although the extent of its rise is nowhere enough in its own right to anything more than delay the first move by the RBA by up to a few months, but more likely just one or two.

Not only does the muscular Australian dollar make it more likely that underlying inflation will ease back sooner rather than later to within the RBA's 2-3 per cent medium-term inflation target, but it is accentuating the latest wobble in some commodity prices, but the slide in natural gas prices in particular.

As with iron ore, the majority of Australia's LNG export prices are based on long-term contracts, so it is not necessarily possible to get a day to day or even week to week handle on trends in the price of what may one day rival coal and iron ore as Australia's chief exports - at least if the WA Premier's contention that Gorgon will enhance, rather than hinder other prospective projects' chances of securing long-term agreements with prospective customers is on the money.

The profile of New York Mercantile Exchange (NYMEX) gas futures contracts undoubtedly reflects factors peculiar to the US gas market, so does not necessarily reflect trends in the global market for the current darling of the Australian economy, but the downside divergence of it from the oil price is unprecedented in the history of the contract back to 1990. Moreover, coincidentally or not (but surely not), US wellhead gas prices are more than just a rough guide to Australian export LNG prices. The US Energy Administration is forecasting a rebound in wellhead prices from October, but unless the recovery is more robust than forecast, the financial year average price will still be around 40 per cent lower than it was in 2008-09, which in turn was 24 per cent down on the previous year ending 30 June 2008.

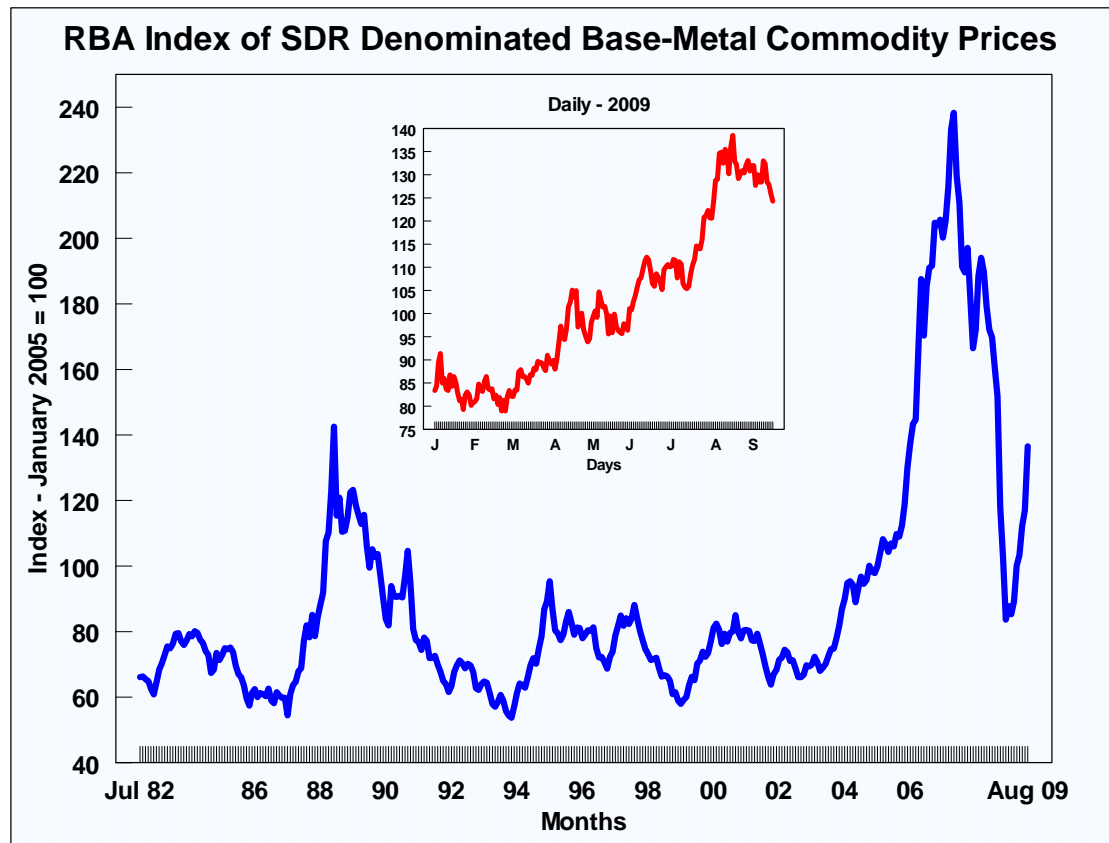


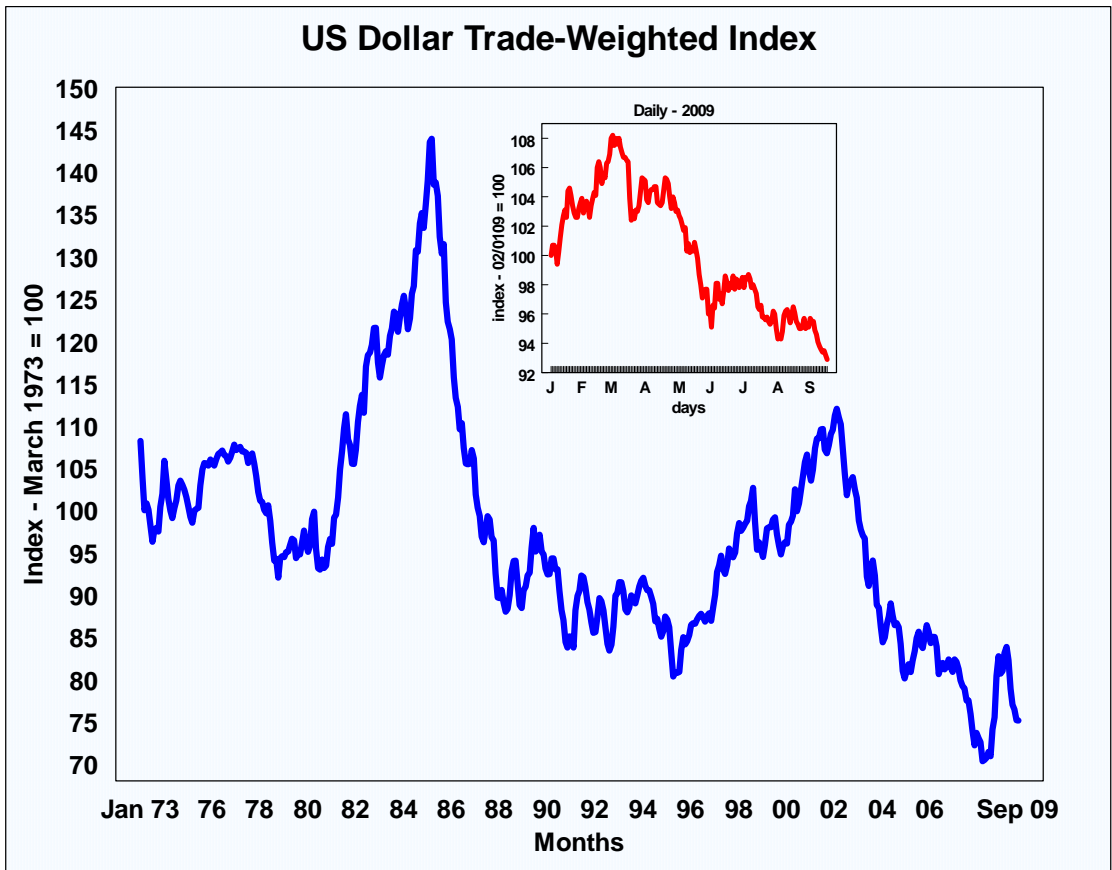


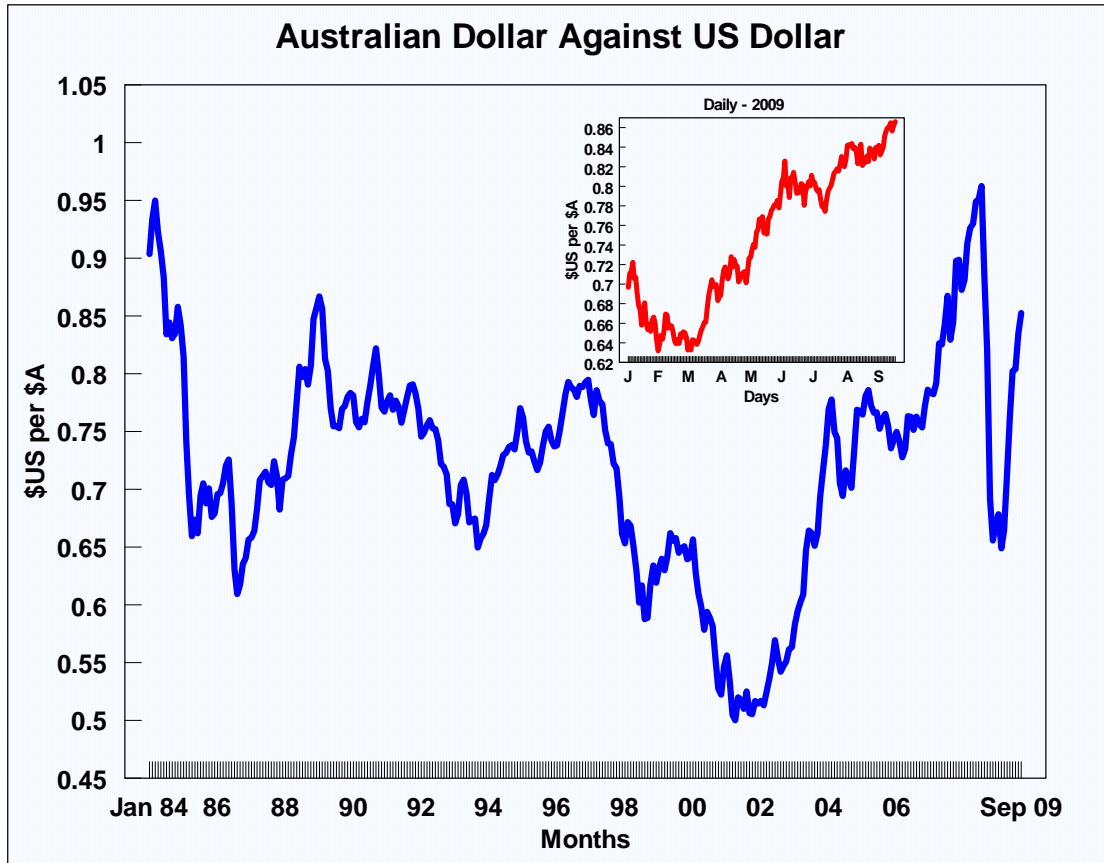
The appreciation of the Australian dollar is more than just the flip side of the continuing slide in the US dollar, but the latter is once again distorting commodity prices trends, as it so often does when it is trending anyway other than sideways.

Distortion of commodity prices by re-alignment of the US dollar to some extent can be neutralised by analysing prices in multi-currency IMF special drawing right (SDR) terms. Some of the shine clearly is wearing off base metal prices, although they are still well above the extreme risk-aversion lows they fell to late last year.

The latest easing in commodity prices, including in Australian dollar spot iron ore prices, is not enough to sway the RBA from its intention to start to remove emergency monetary stimulus in the next few months, if not sooner, but to the extent that it reflects a scaling back of some of the more optimistic assessments of the outlook for the global economy, including in particular China's capacity to lead it out of recession, it strengthens the case to wait until early next year.







Fed balance sheet and US dollar trade-weighted index are sourced from the Fed; Australian dollar from the RBA; all other data sourced from Bloomberg.

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