

## Weekly Economic and Financial Market Snapshot

19 August 2009

	Indicative Rates & Prices <sup>(a)</sup>			
	Year Ago	Last Week	This Week	Today
<b>Interest Rates</b>				
(% pa)				
<b>cash</b>	7.25	3.00	3.00	3.00
<b>bank bills</b>				
30-day	7.32	3.17	3.16	3.15
90-day	7.30	3.31	3.28	3.28
180-day	7.29	3.60	3.59	3.57
<b>Swaps</b>				
1-year	6.94	4.02	4.01	3.95
3-year	6.69	5.27	5.17	5.08
5-year	6.71	5.82	5.72	5.65
10-year	6.63	6.134	6.07	5.99
<b>Exchange Rates</b>				
units of FX per \$A				
\$US	0.8695	0.8360	0.8299	0.8246
yen	95.6	80.3	78.9	77.8
euro	0.5888	0.5867	0.5875	0.5841
TWI <sup>(b)</sup>	68.0	66.2	65.8	65.4
<b>Commodities</b>				
<b>gold</b> (\$/ounce)				
\$US	801.60	950.73	942.04	935.47
\$A	923.29	1,137.24	1,135.08	1,134.45
<b>oil</b> (\$/barrel)				
\$US	114.44	70.98	68.83	69.19
\$A	131.46	84.53	82.97	83.95
<b>base-metals</b> <sup>(c)</sup>				
\$US	161.7	137.4	136.7	135.9
\$A	142.7	126.3	126.4	126.7
<b>Equities</b>				
All Ords	5,010	4,325	4,415	4,387
Dow	11,527	9,297	9,287	9,218

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

Try as they might - and they did, last Friday - members of the House of Representatives Standing Committee on Economics could not draw the RBA Governor into giving away anything more than he wanted to when probed on either the timing or the speed of the impending removal of emergency monetary stimulus. But the general tone of the message was that a tightening this year could not be ruled out, although there is probably no immediate urgency unless the next CPI is at odds with the RBA's expectation of a gradual deceleration in underlying inflation and/or house prices rise further at the expense of a further uptick in approvals for new dwellings.

More than one committee member was well across the masking of the contraction in total hours worked by the modest extent of the rise in the unemployment rate in recent months, but the RBA views the dispersal of the labour market's burden of adjustment to the slowing economy as a virtue rather than a portent of debt serving difficulties when the cash rate rises. Moreover, on the subject of household's capacity to service debt ... "the fall in the servicing burden we have had in the last nine months is a larger and faster fall than we have ever had before in such a period".

Committee members were no more successful in pinning the RBA chief down to a discrete level of the 'normal' cash rate, other than it was ... "a good deal north of where the cash rate is now" ... and ... "it is higher than three, and it is probably noticeably higher than three". The latter in response to a Committee member's question that ... "Historic evidence suggests somewhere in the fives?"

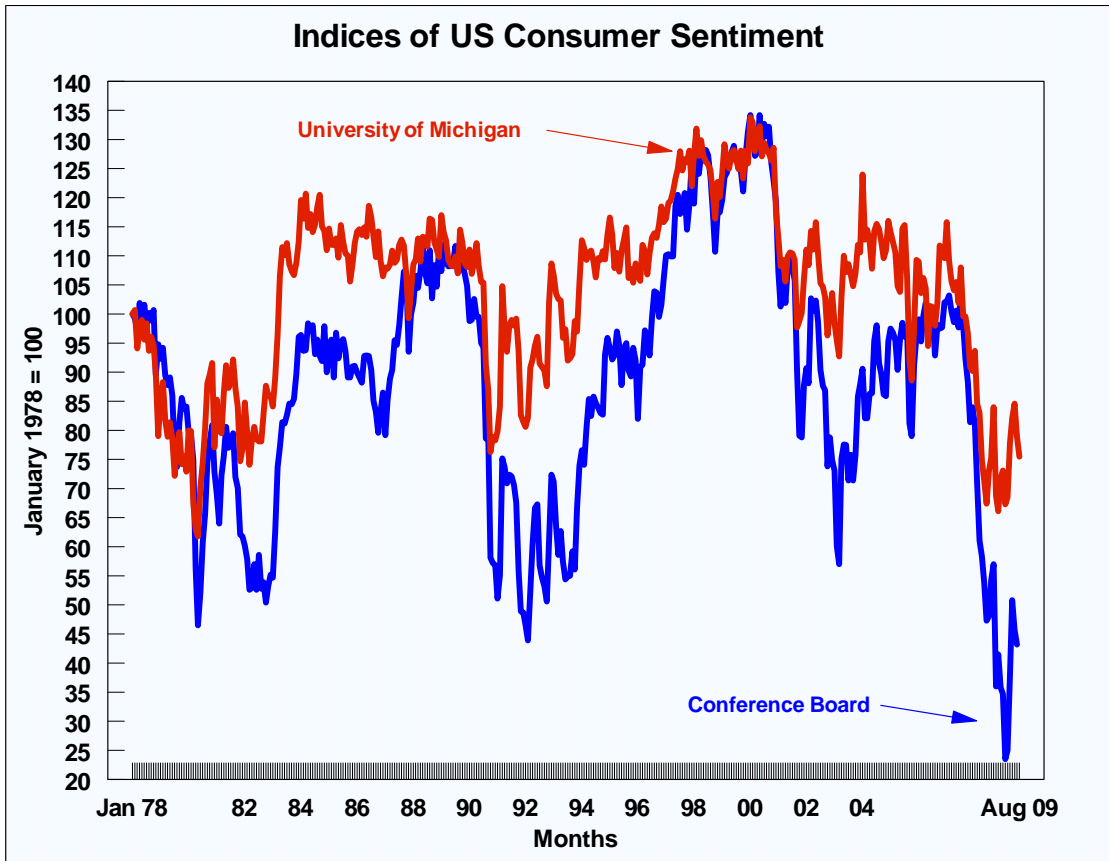
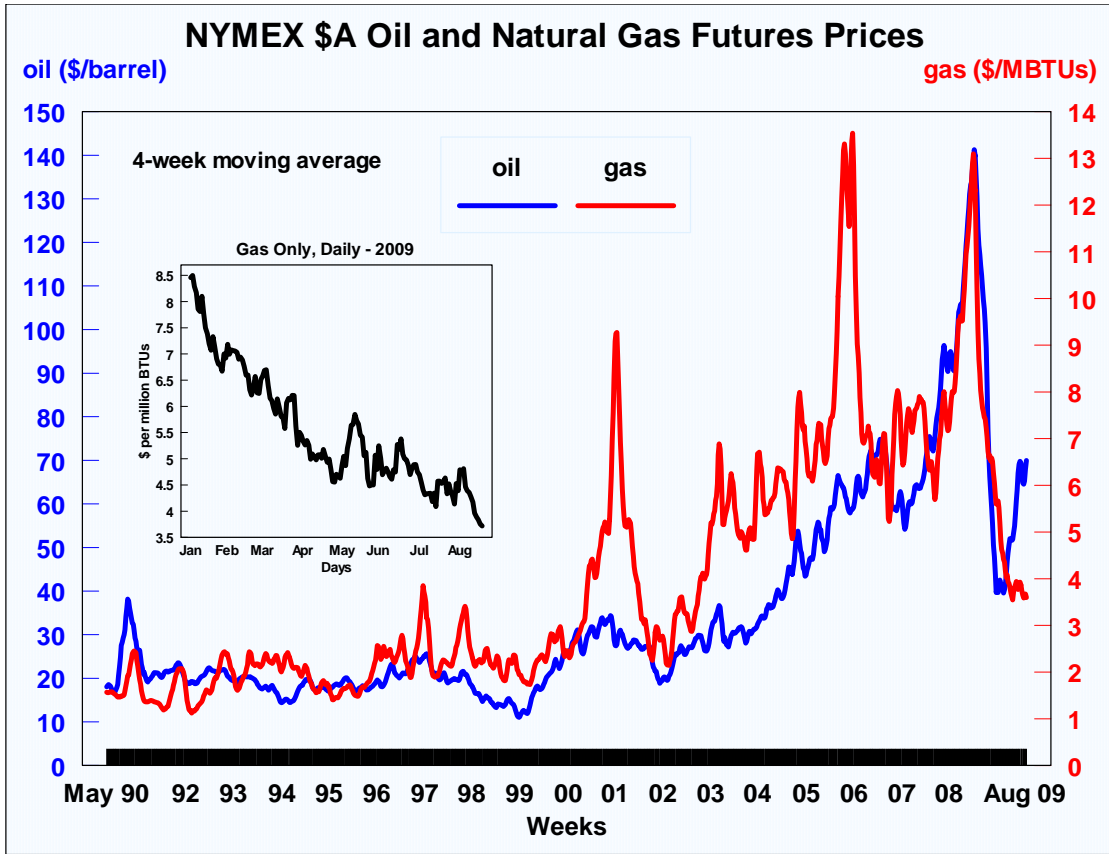
A proliferation of soft readings on the economy, including in particular one or two biggish jumps in the headline jobless rate between now and Christmas, would dent the case for an earlier and/or more aggressive tightening of monetary policy, while the Treasury Secretary (and RBA Board member) helpfully warned that a double-dip global recession cannot by any means be ruled out.

Not that either low and still falling gas prices - both in absolute terms and relative to the rejuvenated oil price - or the risk of a painfully slow global recovery were enough to scuttle the signing of much vaunted agreements to sell LNG from the prospectively massive Gorgon project to India and China within the space of a week.

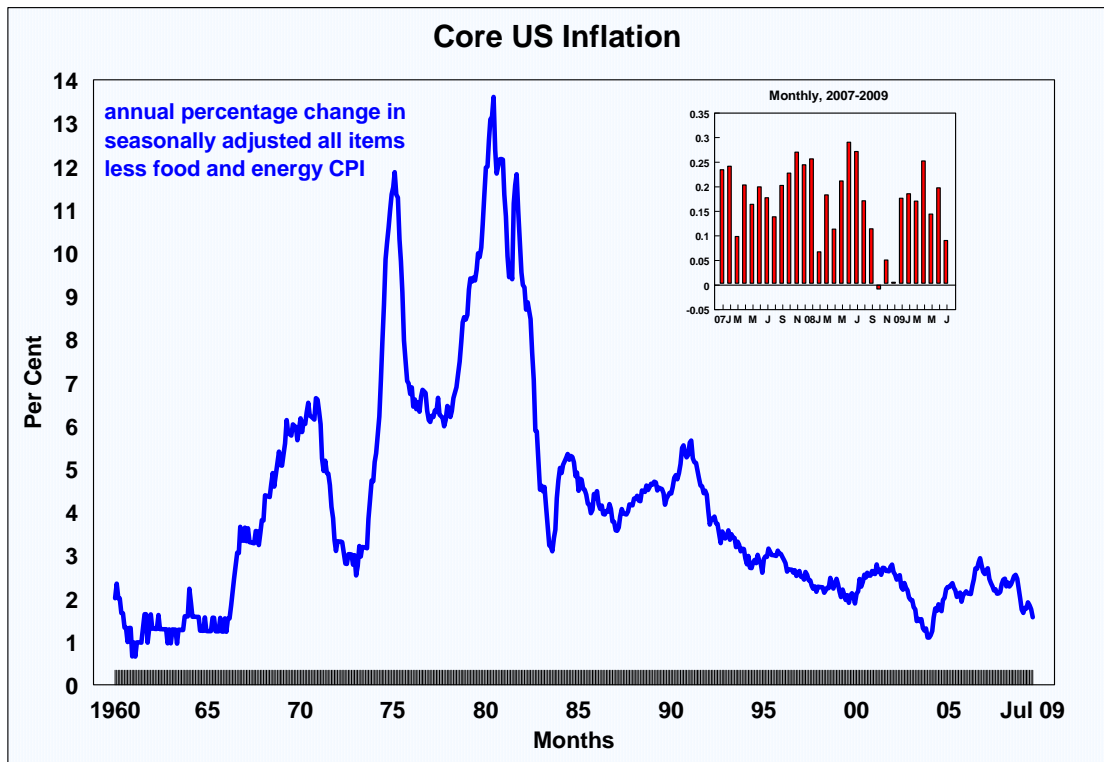
The Gorgon project still needs to obtain approval from the Federal Environment Minister and then get the go ahead from the project's three proponents - global oil and gas giants Chevron (50 per cent and operator); ExxonMobil (25 per cent) and Shell (also 25 per cent), but the Prime Minister was happy to devote considerable time to its economic impact in Parliament on the 18<sup>th</sup> of August, so he for one doesn't seem to have much doubt that it will proceed, if for no other reason than the part royalties from the project will play in winding back Canberra's budget deficit.

And if Gorgon does get the nod and commences the construction phase sooner rather later, it will hardly do anything to dent newly buoyant local consumer and business confidence, both of which are key items on the RBA's check list of factors to be taken into consideration when deciding when to start removing emergency monetary stimulus.

Rising actual and prospective confidence in the outlook for the Australian economy contrasts sharply with the US, where the rebounds in both of the benchmark measures of consumer confidence have been stopped in their tracks by the reality of just how hard the slog to durable economic recovery will be.

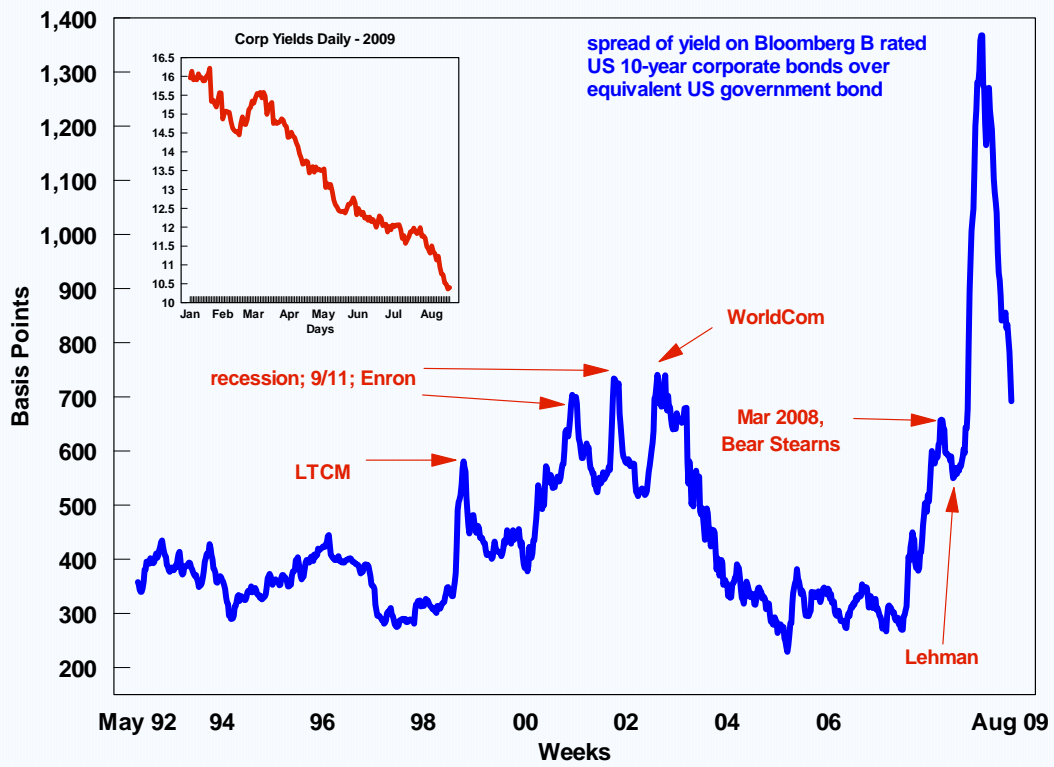


The subdued US economy continues to constrain actual consumer price inflation, the core (ie excluding food and energy) measure of which dipped to a five and a bit year low of 1.6 per cent in July, still well above the 1.1 per cent trough in hit in late 2003, when concerns about deflation drove the funds rate to the 1.0% pa level that helped fuel the great global search for yield that led, amongst other places, to the collateralised debt obligations, the implosion of which was the epicentre of the credit crunch.

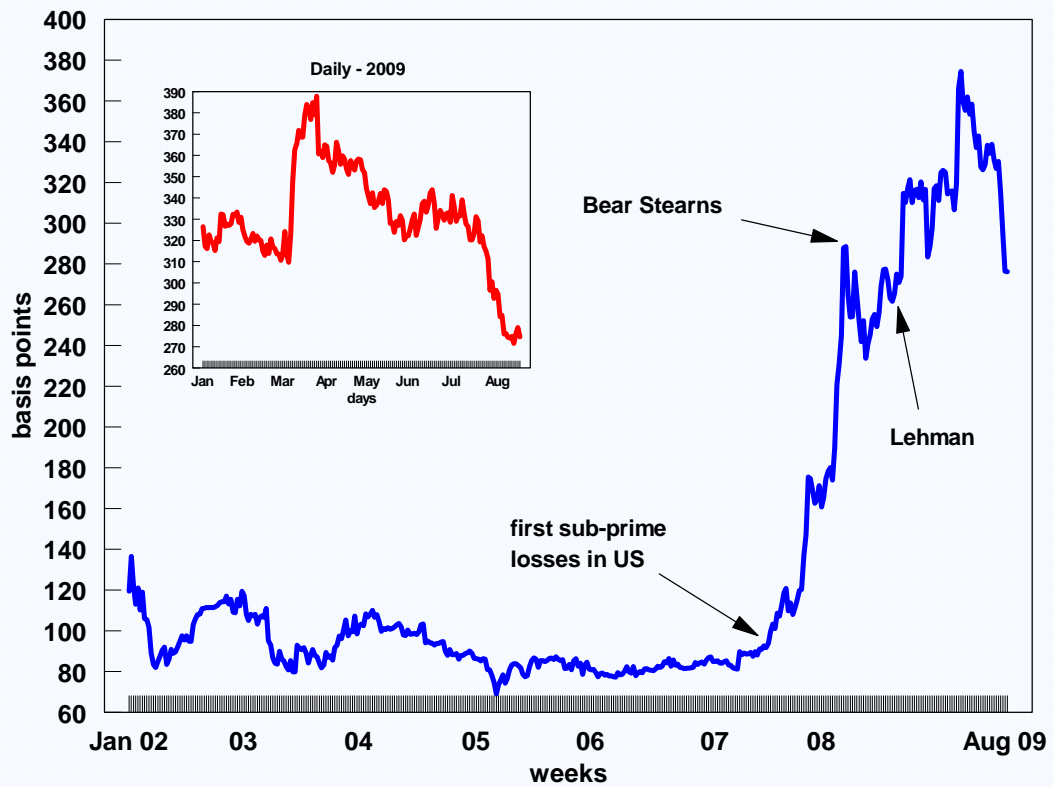


Subdued actual inflation is doing its bit, along with further recovery in investors' appetite for risk, to push corporate bond yields down further despite the opposing force on the total bond market from the ever expanding supply of government paper to finance the budget deficits racked up to limit the depth and duration of the global recession. But to some extent US government bond yields are being held down by Fed purchases of the paper issued by the Treasury to finance Washington's burgeoning deficit. The Fed will withdraw the support measures when the US economy recovers enough ground to keep corporate bond risk premia down to manageable levels, but when excess industrial capacity built up during the recession is absorbed, inflation will not be nearly as obliging. That day is not imminent, but it will arrive before the debts incurred by governments return to pre-crisis levels. In any case, fund managers will push bond prices down (ie yields up) well before it happens.

### B Rated US 10-Year Corporate Bond Risk Premium

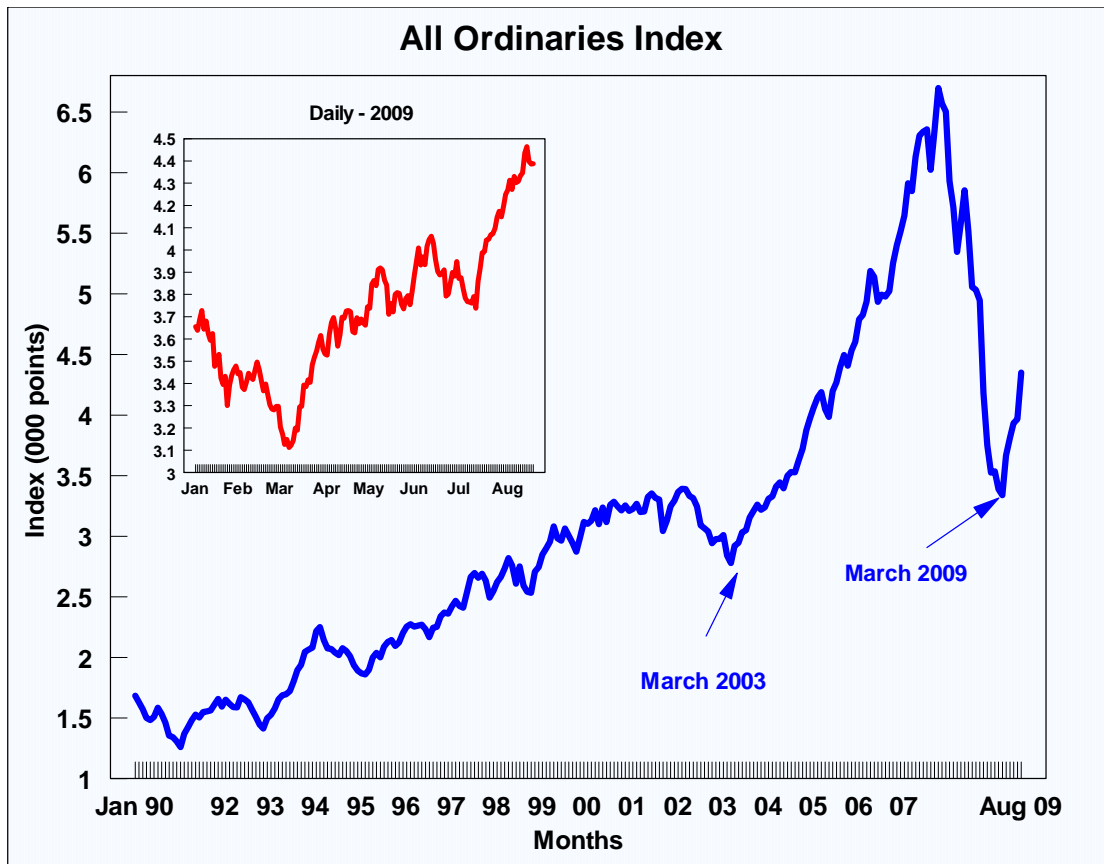


### 3-Year BBB Rated Australian Corporate Bond Risk Premium



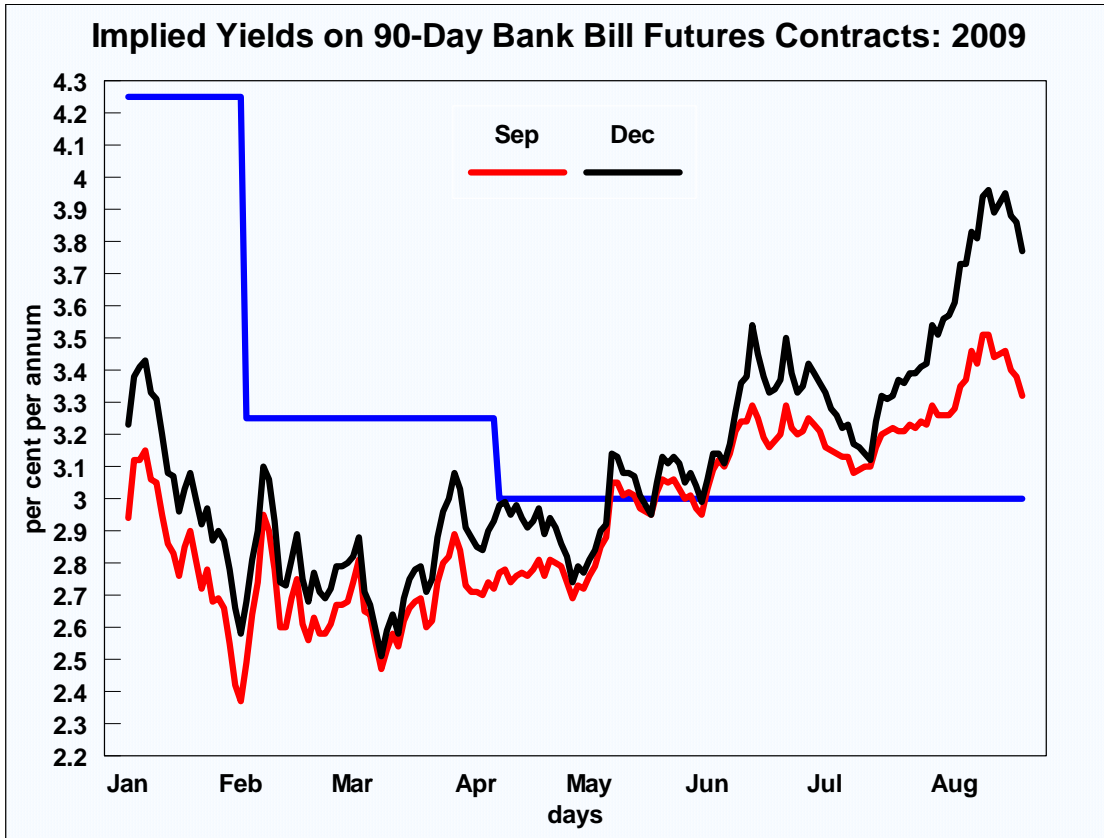
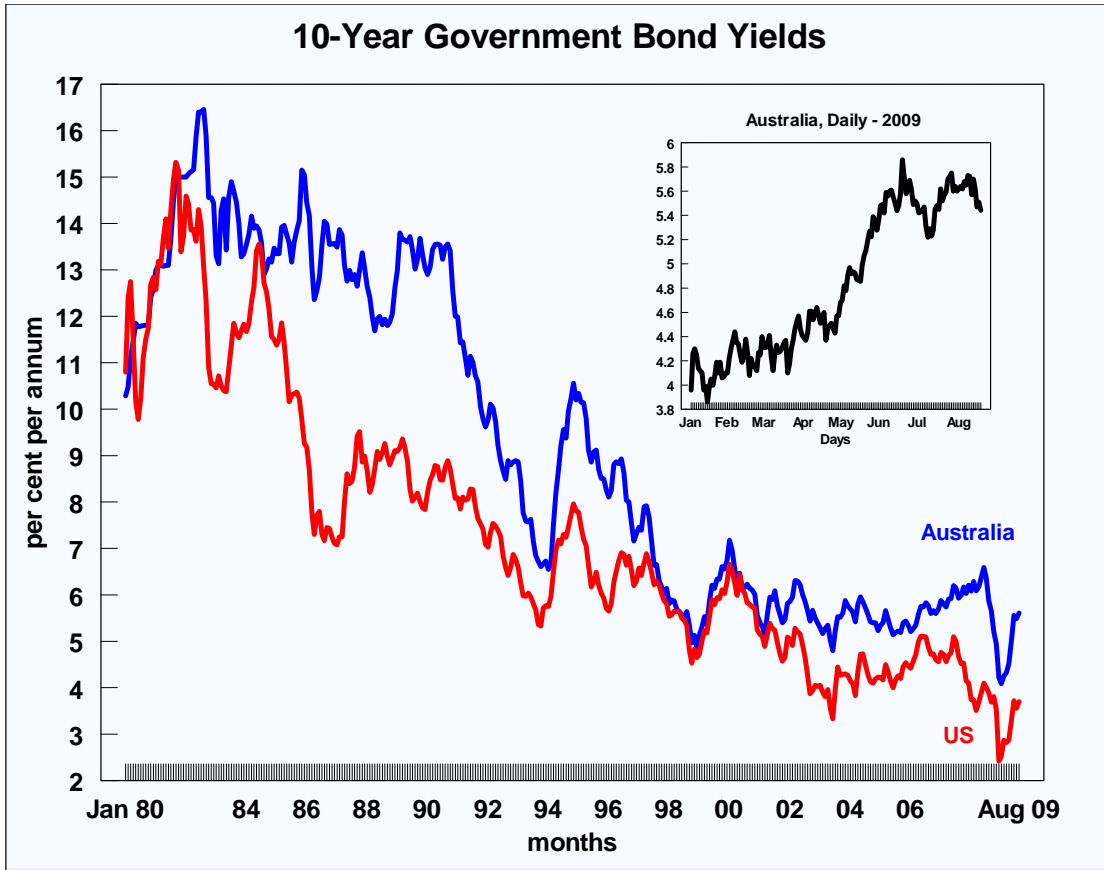
The temporary stalling in global equity markets' renaissance does not reflect nervousness about upside risk to bond yields, but rather a bit of stock taking, so to speak, about whether the run-up in recent weeks had maybe had gotten too far ahead of realistic prospects for a quick and durable recovery in the major industrial economies. More generally, while global appetite for risk is generally rising, its elevation has stopped to draw breath, as evidenced by the latest plateauing in an Australian dollar that is a proxy for risk appetite. And the stalling in risk appetite is not confined to the established industrial economies that were hardest hit by the credit crunch - since peaking on the 4<sup>th</sup> of August, Shanghai's stock market has shed a chunky 720 of the 1,839 index points it had gained since bottoming in early November last year, as even the most avid buyers of the China story at least have the odd second thought or book profits from the ride up. But it clearly hasn't dented Beijing's need for LNG.

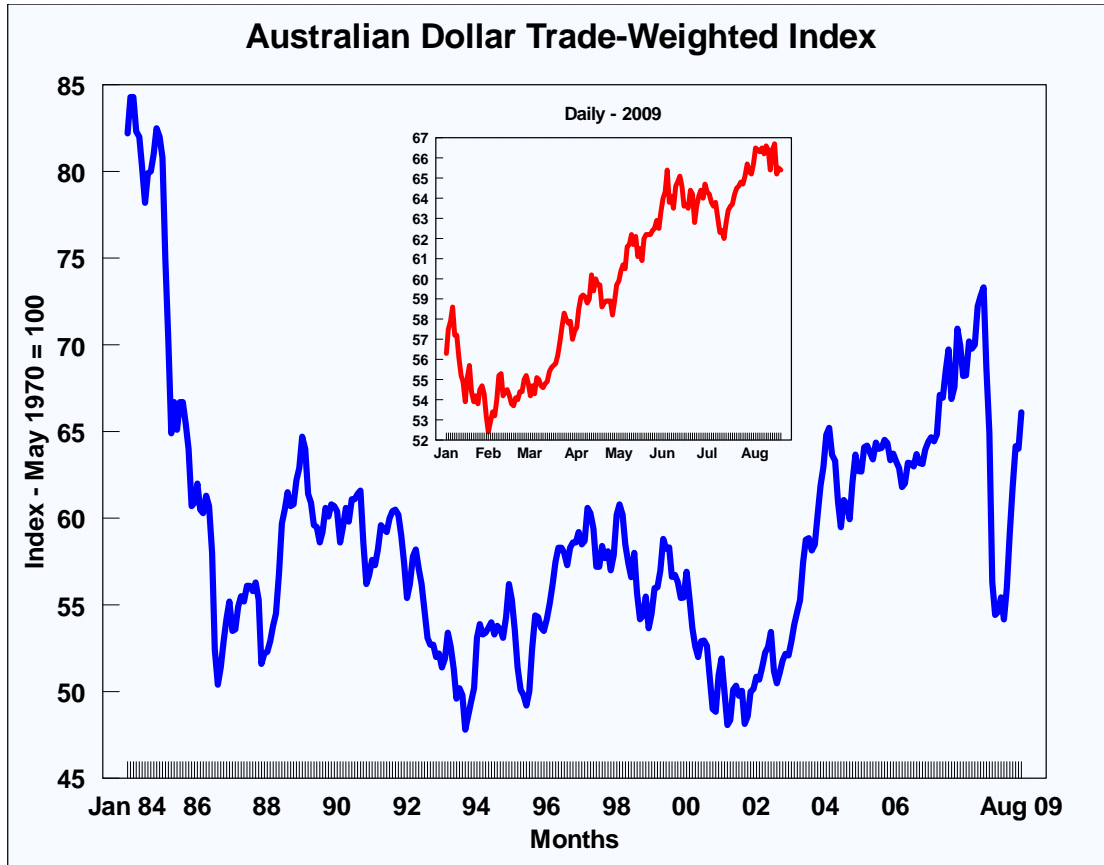




The stalling in equity prices and the slowing in the pace of the return of global risk appetite, along with the RBA Governor's reluctance either to "encourage" or "dissuade" financial market pricing in of "higher interest rates starting to towards the end of the year" have collectively pushed implied yields on 90-day bank bill futures contracts dated 2009 and 2010 down by between 18 and 36 basis points since they peaked on the 11<sup>th</sup> of August. And both physical and implied government bond yields have topped out for now in line with 'guidance' from a US bond market that always has a strong influence on the rest of the world's, including on an Australian one that is underpinned by a much stronger economy.

The recovery in household wealth as equity markets have recovered is just one more reason the RBA is laying the groundwork for the removal of emergency monetary stimulus. And so too the risk of a sharp and/or significant pull-back is one of the broader risks that all central banks must grapple with when considering the timing and speed of the reversal of ultra-low official short-term interest rates. It's just that the RBA is right at the front of the queue, because of all advanced economies, Australia has most to gain if the wobbles in China's equity market are no more than a bit of profit-taking rather than a warning of impending slackening in China's economic rebound after only a brief and shallow slowing.





Core US inflation is sourced from the US Bureau of Labor Statistics; Australian and US 10-year government bond yields from the RBA and Fed respectively; Australian dollar from the RBA; all other data sourced from Bloomberg.

Alan Langford                    +61 8 9449 6354                    [alan.langford@bankwest.com.au](mailto:alan.langford@bankwest.com.au)

Natalie Sullivan                +61 8 9449 6891                    [natalie.sullivan@bankwest.com.au](mailto:natalie.sullivan@bankwest.com.au)

The information contained in this publication is of a general nature and is not intended to be nor should it be considered as professional advice. You should not act on the basis of anything contained in this publication without first obtaining specific professional advice. To the extent permitted by law, Bank of Western Australia Ltd, its related bodies corporate, employees and contractors accepts no liability or responsibility to any persons for any loss which may be incurred or suffered as a result of acting on or refraining from acting as a result of anything contained in this publication.