

## Weekly Economic and Financial Market Snapshot

2 September 2009

	Indicative Rates & Prices <sup>(a)</sup>			
	Year Ago	Last Week	This Week	Today
<b>Interest Rates</b>				
(% pa)				
<b>cash</b>	7.20	3.00	3.00	3.00
<b>bank bills</b>				
30-day	7.21	3.15	3.18	3.19
90-day	7.21	3.30	3.46	3.44
180-day	7.20	3.59	3.66	3.73
<b>Swaps</b>				
1-year	6.87	4.03	4.19	4.19
3-year	6.67	5.21	5.28	5.25
5-year	6.68	5.75	5.76	5.73
10-year	6.54	6.03	5.97	5.98
<b>Exchange Rates</b>				
units of FX per \$A				
\$US	0.8513	0.8335	0.8362	0.8231
yen	92.6	78.6	78.0	77.3
euro	0.5817	0.5836	0.5850	0.5849
TWI <sup>(b)</sup>	67.1	65.9	66.1	65.8
<b>Commodities</b>				
<b>gold</b> (\$/ounce)				
\$US	823.80	948.47	949.78	954.90
\$A	966.20	1,137.97	1,135.85	1,147.58
<b>oil</b> (\$/barrel)				
\$US	114.73	72.72	70.93	68.05
\$A	135.66	87.51	84.74	80.82
<b>base-metals</b> <sup>(c)</sup>				
\$US	164.5	134.3	135.0	133.3
\$A	148.4	123.7	124.5	123.7
<b>Equities</b>				
All Ords	5,187	4,403	4,477	4,437
Dow	11,570	9,437	9,495	9,311

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.

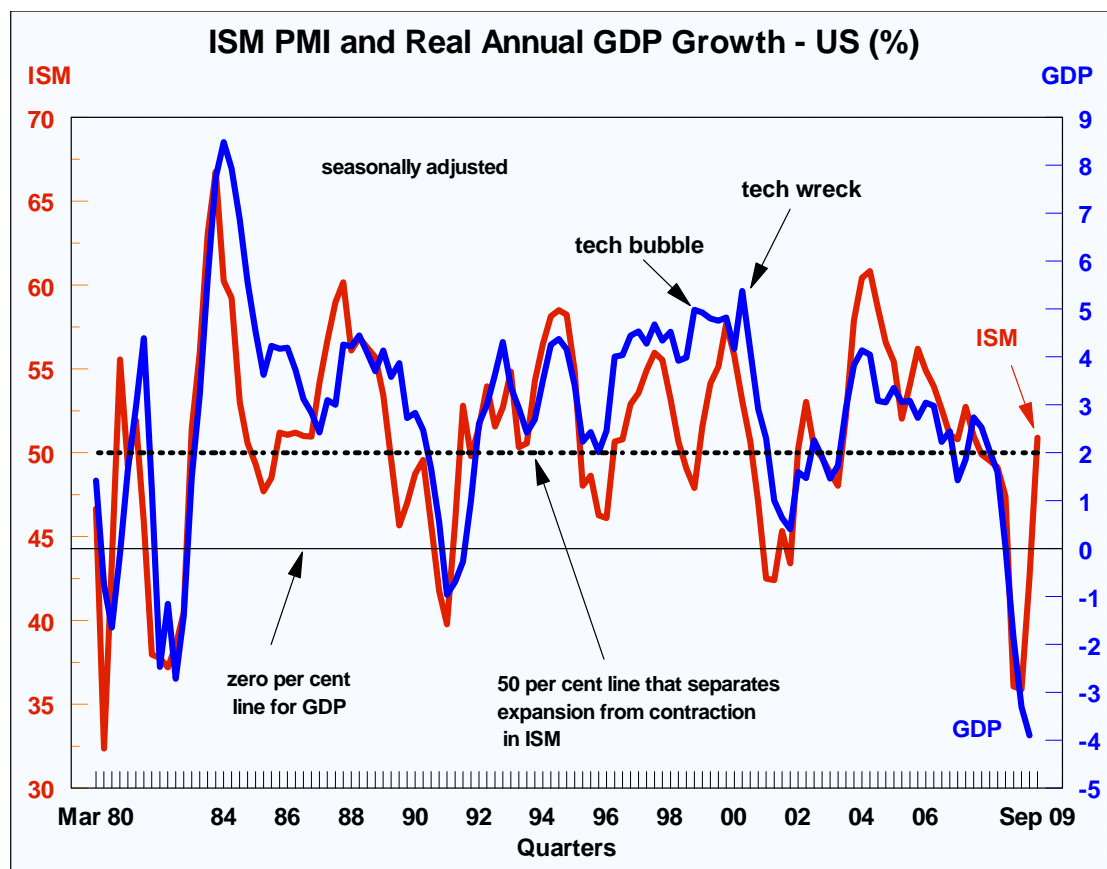
(b) Trade-weighted index value of AUD, based at May 1970 = 100.

(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

News that the American manufacturing industry had expanded in August for the first time in 19 months was not enough to prevent Wall Street getting the staggers on Tuesday night, as renewed nervousness about the health of the financial sector at least temporarily knocked the wind out of the sails of confidence that the global recession is all but over.

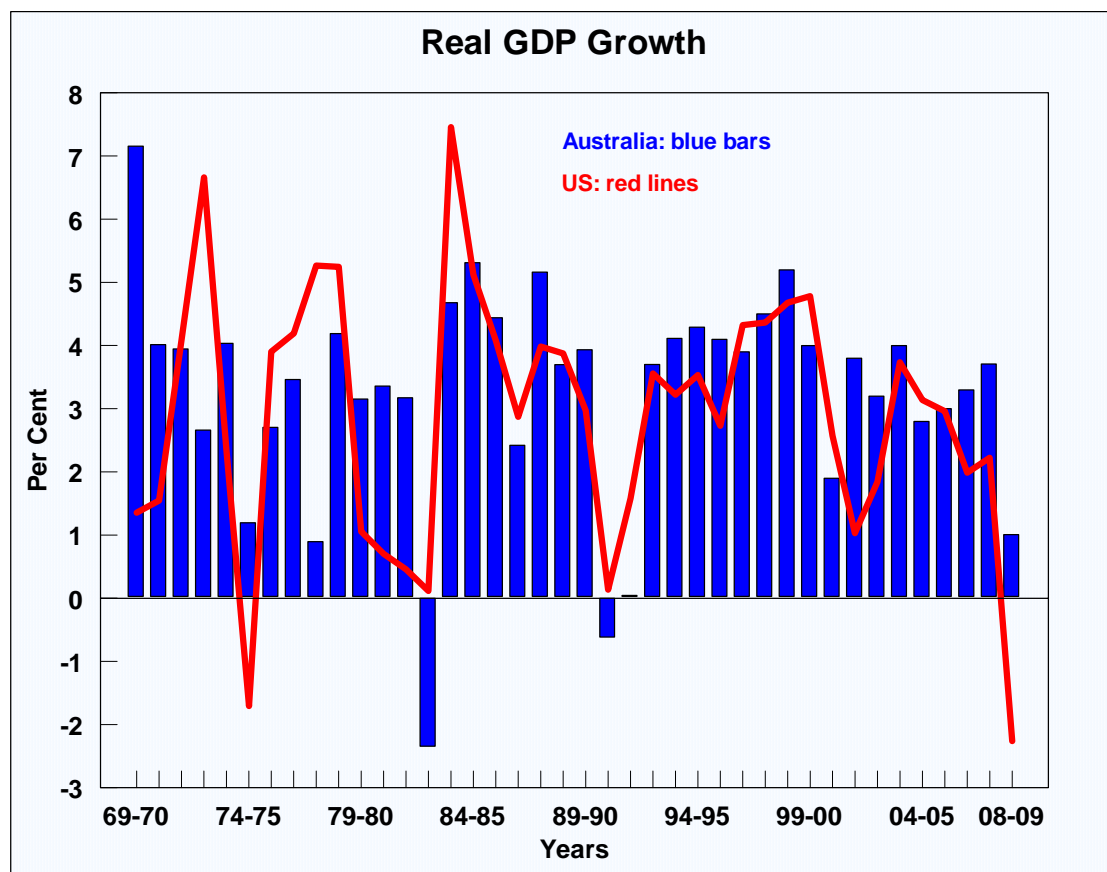
The benchmark Institute of Supply Management's (ISM) purchasing managers index (PMI), which has a pre-eminent record at picking turning points (both up and down) in the US economic cycle, had already risen sharply from the 28-year low of just 32.9 per cent that it had plumbed in December last year, but in August it surged through the 50 per cent mark that separates expansion from contraction in the 'old' US economy.

Historical interrogation of the relationship between the PMI and GDP by the ISM indicates that a reading of greater than 41.2 per cent, "over a period of time", means that GDP is probably growing. April of this year was the last of seven months on the trot that the PMI was below that level. Given that depth and nature of the recession in the US is like no other since the PMI started life in 1948, it is far from inconceivable that the latter will diverge from GDP for a while, so definitive conclusions cannot necessarily be drawn just yet - certainly equity markets did nothing of the sort on Tuesday night. But the long-time partners also diverged during the tech boom of the late 1990s, when the booming 'new' economy seemingly left the staid old one behind. But when the NADAQ vaporised in early 2000, GDP quickly fell back in line with the PMI when it was decided that the new economy wasn't bullet-proof after all.



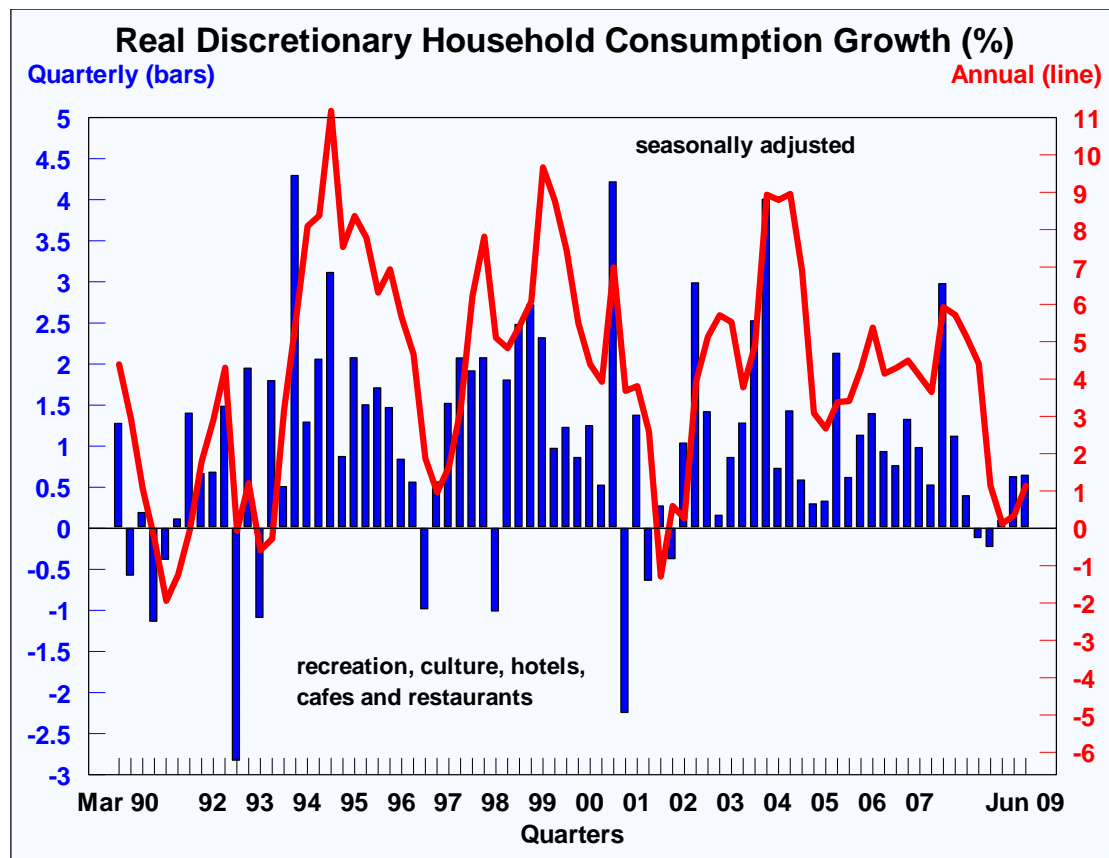
Possible reasons for a prolonged trial separation between the PMI and GDP in the US are endless, although the most likely sources are a new financial crisis - or maybe a re-run of the old one - and/or withdrawal symptoms when the fiscal stimulus propping up the world's largest economy is unwound. As if any more reasons were needed for it to pose a legitimate source of a potentially significant pull-back in equity markets that in recent weeks had probably gotten a bit too far ahead of the global economy's capacity to generate the earnings needed to underpin such a rapid rise in prices.

If the PMI and GDP have been America's favourite happy couple through the ages, the Australian economy has been a close family friend at least since the early 1970s, although the recession in the middle of that decade was deeper in the US than locally, while Australia's recession the early 1980s was much deeper than its US counterpart. The recovery in the US from the recession of the early 1990s was more vigorous, but the most striking feature this time is that the US has contracted by a chunky total of 3.9 per cent since its recession started around the middle of last year, while the Australian economy contracted in a single quarter only (December last year) and then by just 0.7 per cent.

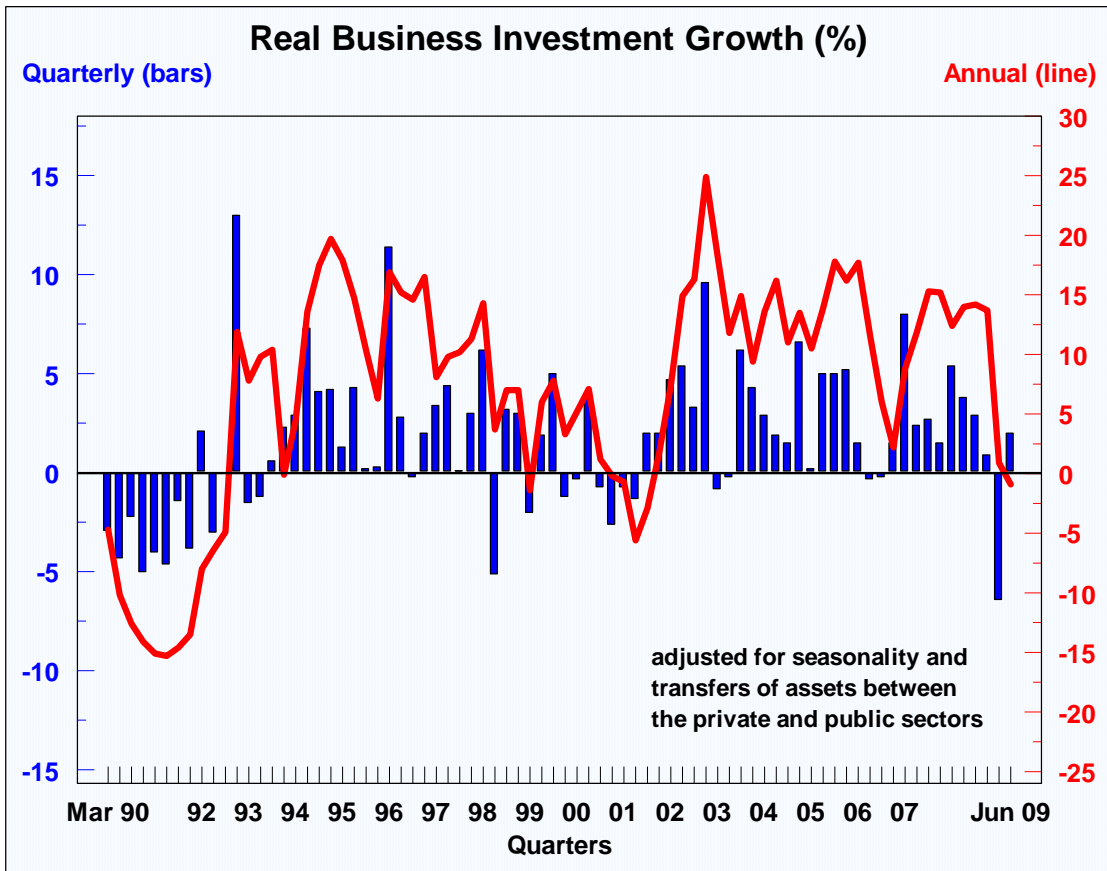
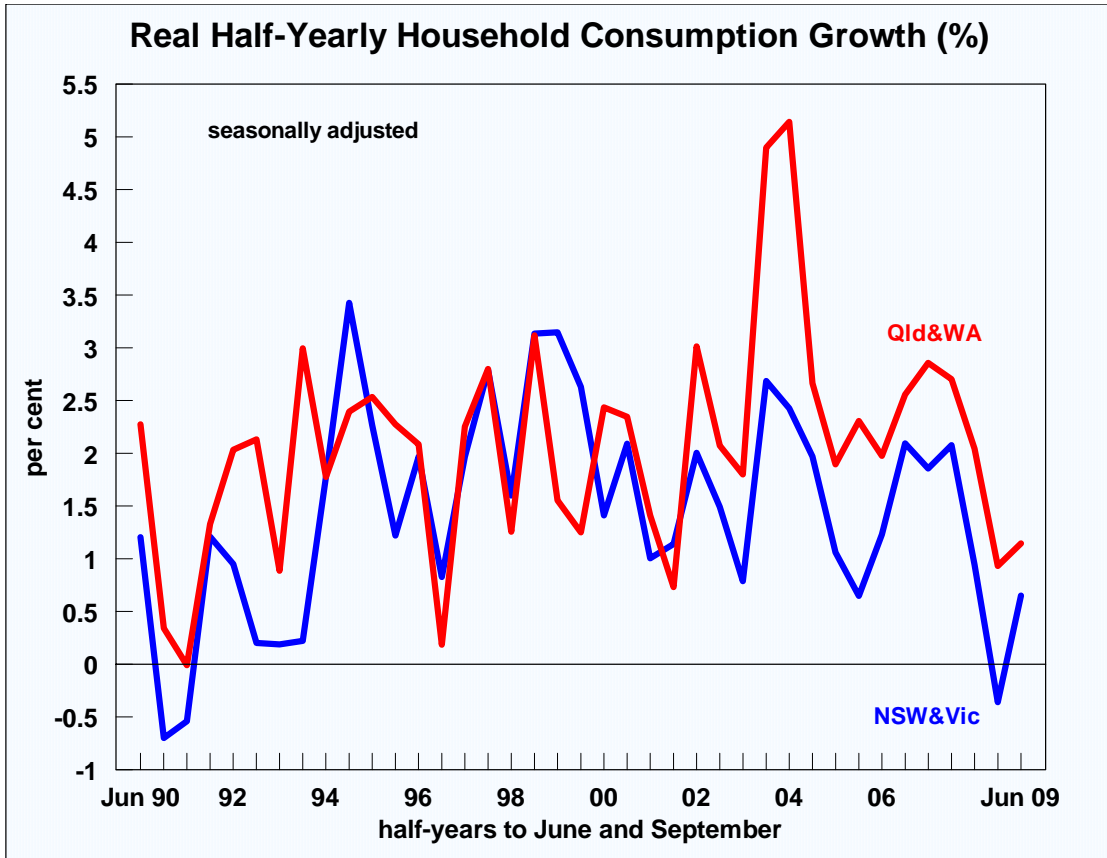


That's not to say that Australia won't necessarily contract in one or more of the next few quarters, or even that the June quarter was the trough in the US economy, but rather that if the worst is over for both economies, the impact of the credit crunch was much less pronounced in Australia than where it all started. Given that sub-prime mortgages were only ever at most 1 per cent of housing loan balances in Australia compared to a peak of 15 per cent in the US, a relatively modest adverse economic impact down under is hardly surprising. But Japan also had negligible exposure to sub-prime mortgages, yet of all the major advanced economies, its recession was the deepest, at a massive 8.3 per cent peak to trough - assuming it has troughed, that is.

Australia's June quarter national accounts provide clear evidence that fiscal stimulus hit at least one of its chief targets early this year, as discretionary household consumption rebounded in each of the March and June quarters after contracting in both the September and December quarters of last year. Moreover, the gulf in the rates of growth in the broader measure of total household consumption in the two most populous states relative to the two mining states of WA and Queensland has narrowed markedly, although it also reflects the exceptionally high base from which the booming states have retreated since commodity prices topped out.

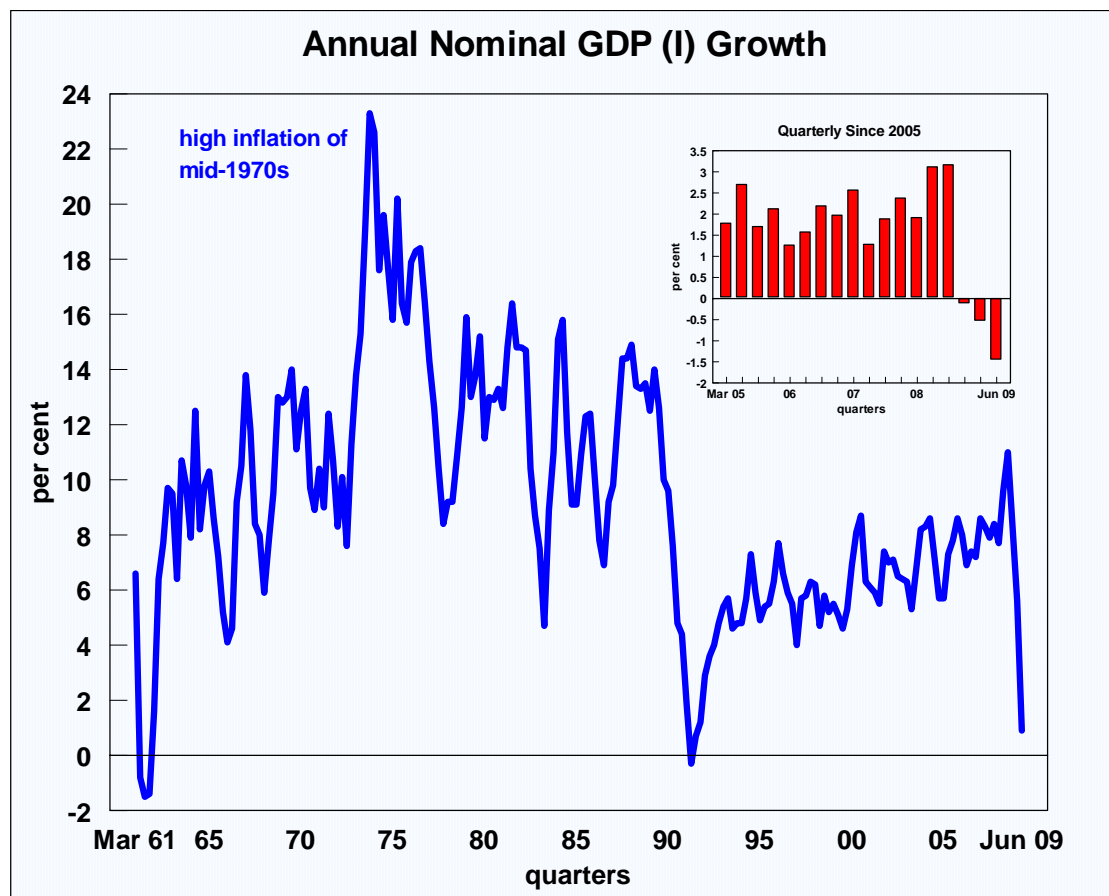


Business investment rebounded in the June quarter after falling sharply in the March quarter. It is too early to conclude that investment has troughed, but the media statement issued by the RBA on Tuesday announcing an unchanged cash rate attributed the “resilience” of business investment, alongside exports and consumer spending as the reasons why ... “Economic conditions in Australia have been stronger than expected”. That’s past tense, but looking forward ...“it now appears that investment may not be as weak over the year ahead as earlier expected”.

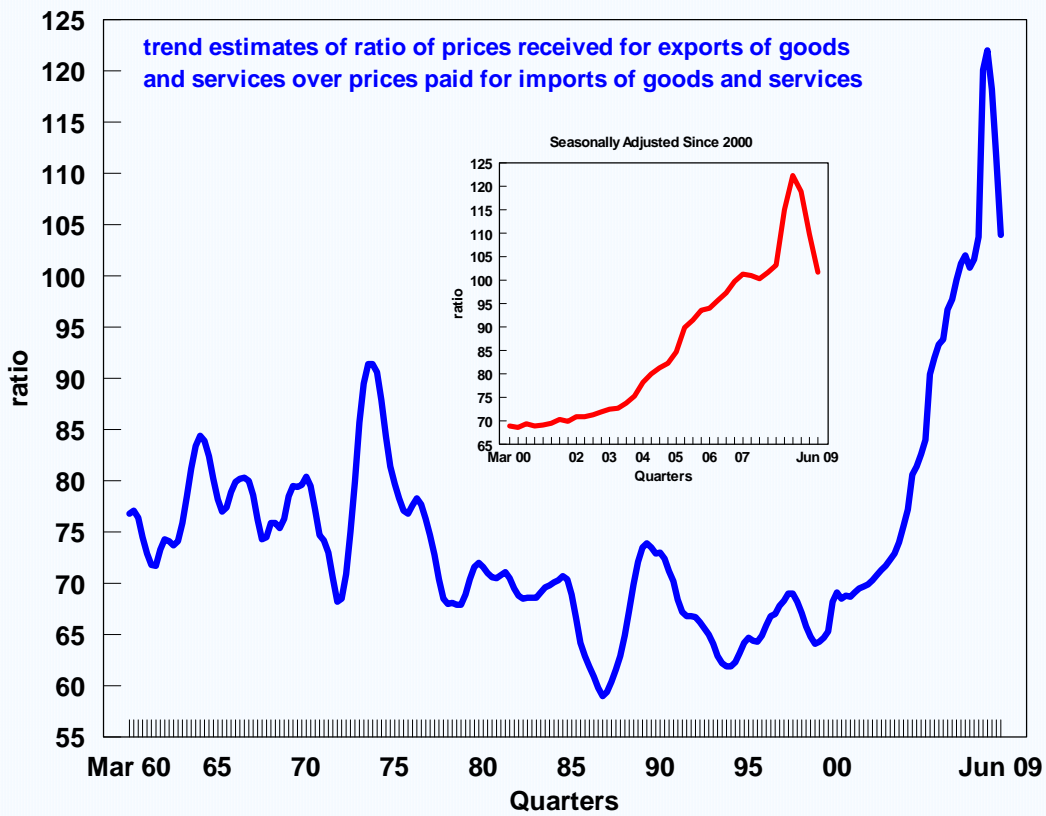


So the national accounts remove, at least on the surface, another of the hurdles in the way of an early withdrawal of emergency monetary stimulus. But the case is not necessarily complete, because within the GDP figures, the reliance on fiscal stimulus to sustain the expenditure side of the national accounts in the face of falling aggregate income is starkly apparent from the contraction in the nominal income measure of economic growth [GDP(I)] in each of the last three quarters. Moreover, the terms of trade are falling just as rapidly as they rose during their last hurrah in the last couple of years of the commodity price boom. Accordingly, unless growth in aggregate national income recovers quickly - say by an increase in aggregate hours worked and/or a rebound in business gross operating surplus - there is likely to be a soft patch in economic growth between the end of front-loaded fiscal stimulus (ie cash handouts) and the ramping up of the infrastructure components of Canberra's largesse, leaving the impending cyclical upswing in the residential dwelling cycle to shoulder a heavy burden.

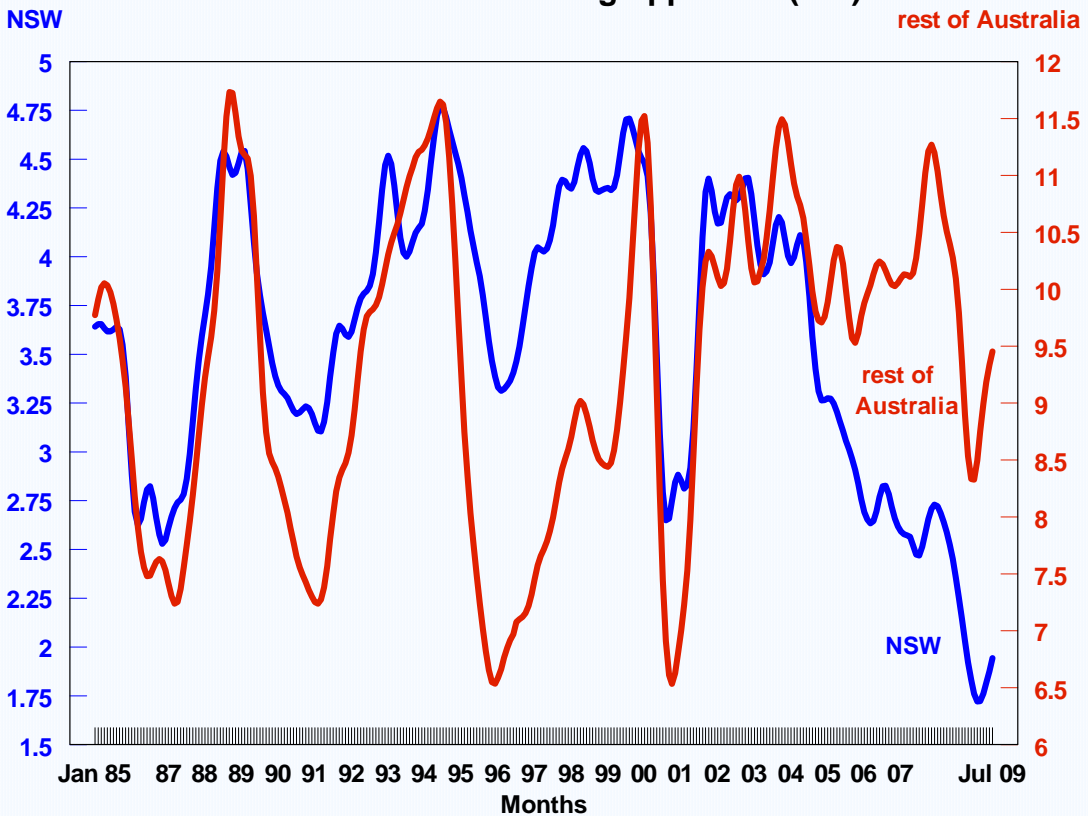
To that end, building approvals are now catching up with the earlier rebound in new housing finance approvals for the construction of new dwellings, even in the seemingly perennially laggard NSW. But even that owes much of its impetus to the first home owners boost (FHOB) component of the fiscal stimulus that is to be phased down at the end of this month and then extinguished at the end of the year. And the remainder to the aggressive easing of monetary policy by the RBA between October last year and February this year, although demographic trends are doing no harm either.



### Terms of Trade



### Trend Residential Building Approvals (000)

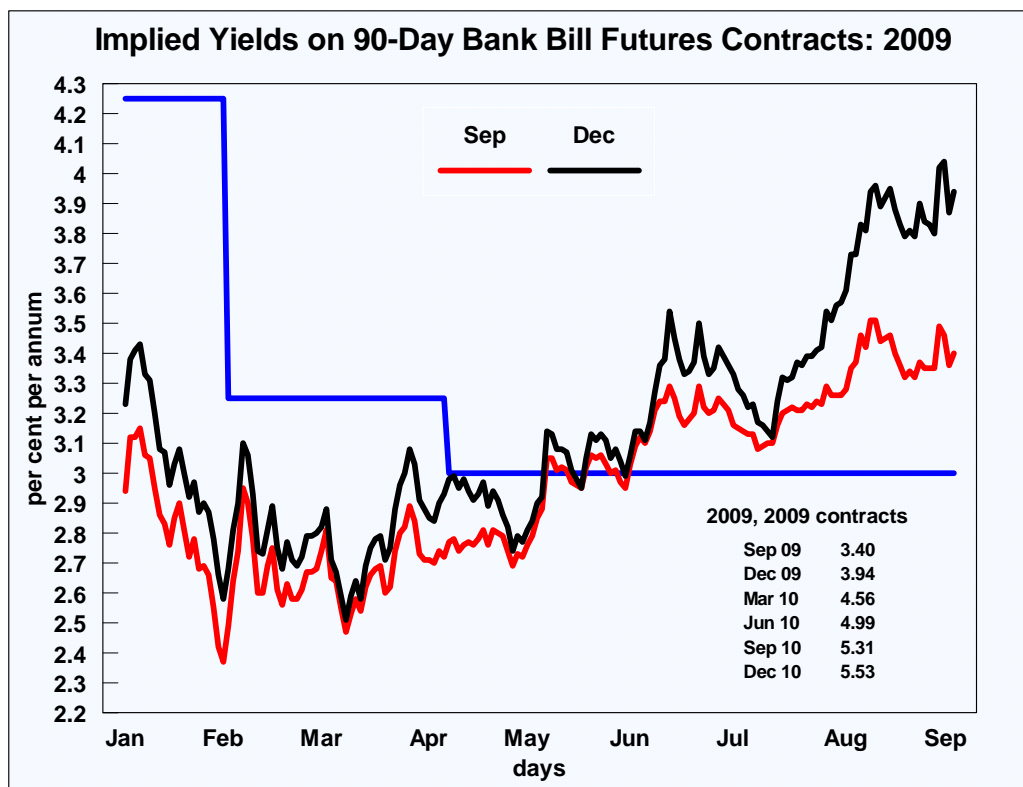


The local bank bill futures market had rallied strongly on Tuesday when the RBA held the cash rate steady and issued a statement that was perhaps not as hawkish as it might have been if the RBA had already flicked off the safety catch on the monetary policy trigger. But the market gave back some of the previous day's gains on Wednesday in response to the headline real GDP growth figure of 0.6 per cent in the June quarter and the same clip in the year to June.

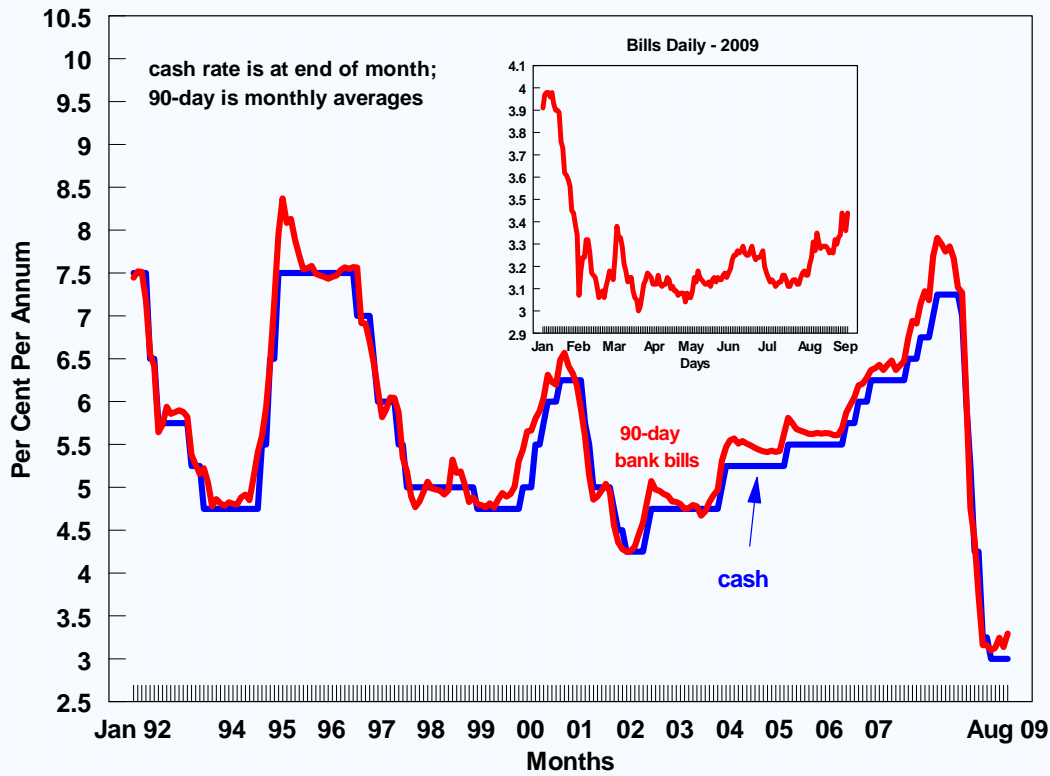
With the exception of its kiwi cousin, the Australian dollar lost ground across the board on Tuesday night when risk aversion reared its head again in New York on Tuesday night, although against the US dollar at least, the 1 cent drop across the day was nothing out of the ordinary by any means. Certainly not enough to extinguish the inflation and export suppressing consequences of the recovery in the local currency since the extreme risk aversion of late last year gave way to the tentative return of risk appetite; firstly in base metals early this year, then eventually in equities around the middle of March when the then new administration in Washington put some meat on the bones of the TARP component of the broader Financial Stability Plan.

But unveiling details of how US banks are to be purged of the toxic assets that lay waste to their balances sheets is one thing, actually getting the plan up and running and then eventually selling the assets back into whatever the market for them looks like in future years is another.

The RBA also cited ... “the effects of economic weakness on the balance sheets of financial institutions” as ... “one of the main remaining risks to the global expansion”, so as impressive as is Australia’s relative insulation from the global financial crisis and its associated recession, it is by no means assured that protection is ongoing if the financial crisis part of the equation is not over.

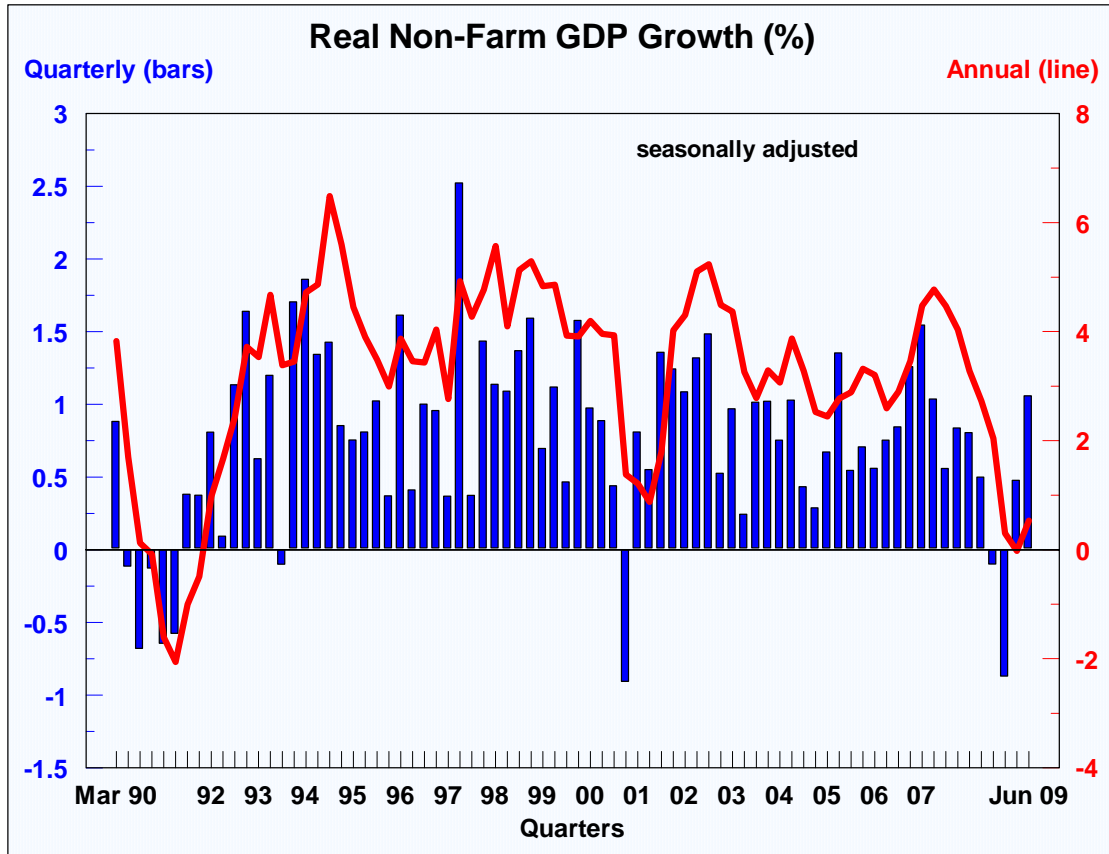


### Short-Term Interest Rates



### \$A against yen and All Ordinaries Index: 2008, 2009





Australian GDP growth and its components are sourced from ABS catalogue 5206.0; residential building approvals from ABS catalogue 8731.0; Australian dollar from the RBA; US GDP growth the US Bureau of economic Analysis; ISM directly from the ISM; all other data sourced from Bloomberg.

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