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**Authors:**

- Sally Auld**  
Co-Head of Australian Economics and Interest Rates Research
- Amy Auster**  
Head of Foreign Exchange and International Economics Research
- Philip Borkin**  
Economist, New Zealand
- Katie Dean**  
Senior Economist
- Paul Gruenwald**  
Head of Economics, Asia
- Tony Morriss**  
Senior Currency Strategist
- Tony Pearson**  
Deputy Chief Economist
- Mark Pervan**  
Head of Commodities Research
- Amber Rabinov**  
Economist
- Jasmine Robinson**  
Senior Economist
- Mark Rodrigues**  
Senior Economist
- Ivy Tan**  
Economist, Asia

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GDP growth (%)	2007	2008(f)	2009(f)	2010(f)
Australia	4.3	2.8	2.4	3.3
New Zealand	3.0	0.6	1.2	2.1
United States	2.2	0.7	0.8	2.2
Euro zone	2.7	1.9	1.5	2.2
Japan	2.0	1.1	0.9	2.0
China	11.6	9.7	9.0	9.9
Other East Asia (excl. Japan & China)	5.9	4.5	4.8	5.3
World (PPP)	4.8	3.6	3.5	4.4

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## Overview

Tony Pearson

### Economic challenges ahead

The global economic environment remains challenging. Growth is slowing, inflation is rising, asset prices are falling in key markets, prices of key resources particularly oil continue to increase, and the acceptance of the need to tackle climate change is becoming more widespread. The “easy prosperity” of the middle of this decade has clearly now passed.

### Global growth is slowing... but keep it in perspective

Through the middle of this decade the world enjoyed the strongest economic activity in a generation. The years 2004 through 2007 were the four strongest consecutive years of growth for over 30 years, with an average global growth rate of 4.7%. The key feature of this period was the accelerating growth of the emerging economies including China, India, Latin America and Eastern Europe. Over these four years emerging economies grew by a staggering average annual rate of 7.5%, triple the developed country annual growth rate of only 2.5%.

In 2008 growth has slowed. The downturn has been led by the US and the UK, but the emerging world is now also showing signs of slowing. In 2008 we estimate global growth will slow by around 1¼% to around 3½% and remain at that slower pace through 2009.

This slowing needs to be kept in perspective. Growth of 3½% is still stronger than in 2001, 2002 and 2003. Also, the anticipated slowdown in growth this year is much less marked than the very sharp deceleration in 2001, when global growth more than halved to only 2.1%.

### Inflation could prove more of a problem

Consumer price inflation is rising worldwide. It has been accelerating since 2004, and in 2008 we forecast global inflation will reach an annual average rate of 4.9%, the highest since the late 1990s. The rise in inflationary pressures has been broad-based. In Western Europe it will reach 3% in 2008, the highest since 1993; in Japan it will rise to 1.3%, the highest since 1997; in Australia it will reach 4.2%, the highest since 1995 (excluding the introduction of the GST); and in New Zealand it will reach 3.7%, the highest since 2002. The US is one developed economy where inflation may already have peaked, although it will remain elevated in 2008 at around 2.9%.

Headline inflation has also accelerated in emerging Asia. In 2008 we forecast inflation will average 6.8% in China, 7% in India, 9.8% in Indonesia, 6.2% in Thailand and an alarming 22% in Vietnam. Recent cuts to fuel subsidies in Malaysia, Indonesia, India, and China may exacerbate these pressures.

The combination of slowing global growth and rising inflation is posing something of a dilemma for central banks. Some have opted to stick to their inflation-fighting mantle and increase policy rates. Australia has been well ahead of the game in this, increasing the official cash rate over the past six years to the highest in 12 years. New Zealand interest rates have been at decade highs for a year. The European Central Bank has been increasing its policy rate since late 2005 and its rates are now at their highest in seven years. Some emerging Asian central banks including China, India and Indonesia have also opted to lean on emerging inflationary pressures.

Other central banks have shown greater concern about slowing economic growth, although even in these countries, aggressive policy easing looks to have almost run its course. The US might have one more easing to come, but then we forecast it will begin to lift rates again from mid-2009. The UK is unlikely to cut rates again this year.

We forecast global inflation to ease somewhat in 2009 to around 3.5% as a result of the slowing in economic momentum, but this forecast assumes no further increases in commodity prices (particularly oil) and also assumes that higher inflation does not become embedded in inflationary expectations. Central banks will continue to have a treacherous path to tread in their battle against inflation.

### Even while asset values fall

One of the paradoxes is that asset values in key markets have fallen sharply even while consumer price inflation has accelerated. Global equity markets had their sharpest falls in decades in 2007-08. The US and UK key markets were down 15% in the year, Australia fell 17%, Germany was down 20%, France 27%, Japan 26% and China 28% down.

House price inflation is also slowing in some countries. US house prices fell by 16% over the year to April (Case Schiller Index); and UK house prices were down by 6% over the year to May (Halifax Index).

In contrast, median house prices in Australia have continued to rise, with an increase in the national median house price of 13% over the year to March. Some supranational institutions have warned of imminent house price deflation in Australia. While we believe this is overly pessimistic, we agree that Australian house price inflation cannot continue at its recent pace and will be slowed by higher domestic interest rates and tighter availability of finance. We forecast an average national increase in house prices of only 2% to 3% over the next year.

### The third oil shock

The era of cheap oil now appears to be over, with the world in the midst of the third “oil shock”. Global oil prices have more than doubled over the year to

June 2008, in early July touching over US\$145/bbl, an all time high. Who can now remember that oil was less than US\$20/bbl in late 2001? Fuel prices in Australia have closely followed global trends, with retail petrol prices recently reaching a peak of A\$1.70 a litre in some state capitals.

Oil prices have risen sharply before, particularly during the first two oil shocks in the 1970s, but the drivers this time are different. The 1970s shocks were due to deliberate withholding of supply by OPEC producers. This time it is strong demand driving the price skyward and supply is seemingly struggling to keep up. Whilst the world still has plenty of oil – estimates suggest proven reserves will last another forty years at current rates of consumption, and that excludes “unproven” reserves in the form of Canadian tar sands, shale oil deposits etc – there is now growing concern at the ability of production to increase to meet rising demand, particularly from emerging economies. There is a view that at some point in the not too distant future, the world will reach “peak oil”, the point at which rising production from new (more difficult and expensive) sources is unable to offset declining production from old (cheap and easily accessible) fields.

Our forecasts suggest the world oil price is unlikely to fall below US\$115/bbl over the next two years and will remain above US\$100/bbl for the foreseeable future. We will have to learn to live with expensive oil.

### Abating climate change will not be costless

There is now broad (though by no means universal) acceptance that the earth is warming and that the major contributor is human activity that releases greenhouse gases, in particular stored carbon (carbon dioxide) from burning fossil fuels such as oil, natural gas and coal. There is also a broad acceptance that climate change will have significant pecuniary and non-pecuniary costs for humans, and that it makes financial sense to enact measures to slow down (or ideally halt and even reverse) global warming. Australia has come late to the global consensus on climate change. What seems to be only beginning to dawn on industries and households is that the cost of abating climate change will not be trivial. The primary mechanism for reducing our release of carbon will be to increase the price of doing so.

The Garnaut Climate Change Review’s Draft Report, released on 4 July, recommends for Australia:

- A cap and trade carbon emissions trading scheme from 2010
- Companies will bid for permits to pollute from government
- Widest possible coverage including energy, industry, transport and fuel but not initially agriculture or forestry

- 50% of proceeds from the auction of permits to be used to compensate low income households
- 20% used to invest in renewable energy projects
- 30% used to compensate “trade exposed” companies
- Reduced total emissions over time.

The government will now need to decide on many issues including the structure of the Emissions Trading Scheme, an indicative initial price of carbon, which industries will initially be subject to the regime (or more accurately, which politically sensitive industries will be initially exempt from the scheme), and compensation measures for target groups. A draft package of legislation will be prepared by year end.

The economic costs of this action cannot yet be quantified. But given that Australia has a very carbon intensive economy (due largely to our reliance on coal fired power generation, large scale livestock grazing and the requirements of long distance transport) the scheme will need to induce major changes in economic activities. Higher prices for energy, fuel and food will inevitably increase inflation and reduce growth. For many businesses there are some very significant challenges ahead. But we need to remember Garnaut’s warning that the costs of inaction are unacceptable for Australia and may indeed be higher than the cost of action.

### Still the lucky country

All of the above might suggest that the prognosis for Australia is gloomy. Nothing could be further from the truth. The paradox is that, while the globe remains gripped in a severe financial crisis, while global growth is slowing, and while there are significant economic challenges ahead, Australia continues to deal with the problems of success. This is illustrated most starkly in what is happening to commodity prices. Australia’s three most important commodity exports will this year record further stellar increases in prices. Contract iron ore prices will rise 85%; steaming coal prices will more than double; and coking coal prices will more than triple. This will deliver in excess of \$50bn in additional export revenue in 2008-09. And of course the Federal Government will take its 30% share of the additional profits, to the tune of more than \$15bn.

Having said that, Australia’s economic growth rate will slow quite sharply in 2008-09. But this will not be the accidental result of global influences. Rather, it will be a slowdown deliberately engineered by the Reserve Bank in order to cool inflationary pressures. The idea is not to end Australia’s prosperity, but rather to restore the low inflation environment that will underpin continued economic expansion. Despite the considerable challenges ahead, it is still a great time to be Australian.

## International Outlook

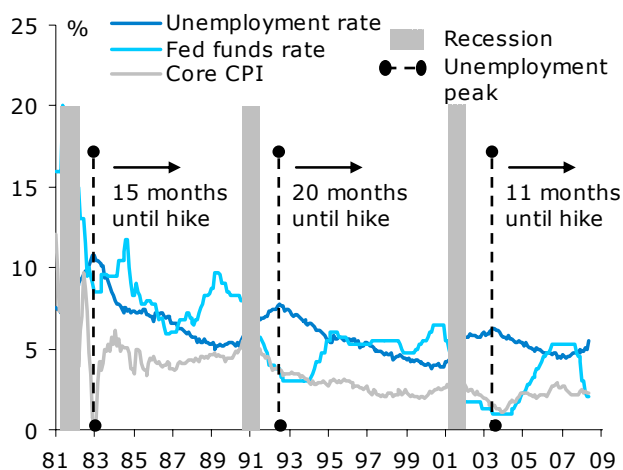
Amy Auster, Tony Morriss, Jasmine Robinson and Amber Rabinov

### Growth versus inflation

The US sub-prime-initiated credit crunch that began nearly 12 months ago continues to cause ripples of bad news, but the real waves are now being generated by an increasingly uncertain outlook for global growth and inflation.

In our view, the expectation for significantly higher interest rates in the G7 economies, spurred by recent central bank hawkish rhetoric and rising commodity prices, is overdone. The deepening crisis surrounding the US dollar suggests that there is now little scope for the Fed to hike rates. Fed Funds Futures now see just a 9% chance of a 25bps hike at the next Fed meeting, down from 57% a month ago. We believe the latest rate hike by the European Central Bank (ECB) to be a one-off. The Bank of England (BoE) and Bank of Japan (BoJ) are both expected to remain on hold.

#### Fed focus 1

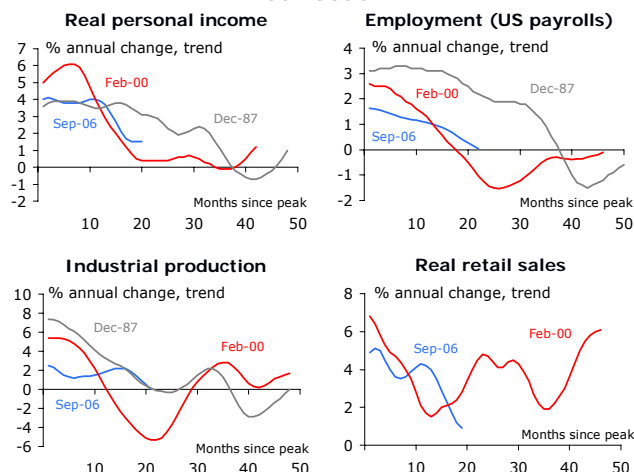


Sources: Bloomberg, Datastream, ANZ.

Our Fed view is that it still has one rate cut to go in the fourth quarter, as the steady drum of poor data will continue to unfold and cause woes in the financial markets, particularly for equities. Regardless, the market has come around to our view – for now – that the Fed will not be in a position to raise rates in 2008. The above chart speaks to why this is the case; inflation typically peaks during a recession, then falls by 1.5-2ppts on average two years after a recession begins.

The data look soft from where we sit. The chart below presents the four leading indicators that the US National Bureau of Economic Research uses to determine whether the economy is expanding or contracting, and compares recent trends since September 2006 with peak-to-trough periods of previous recessions. We look to be well on track for a serious slowdown in the US. Consumers are looking far more glum than in the 2000 recession – no doubt thanks in part to higher energy prices.

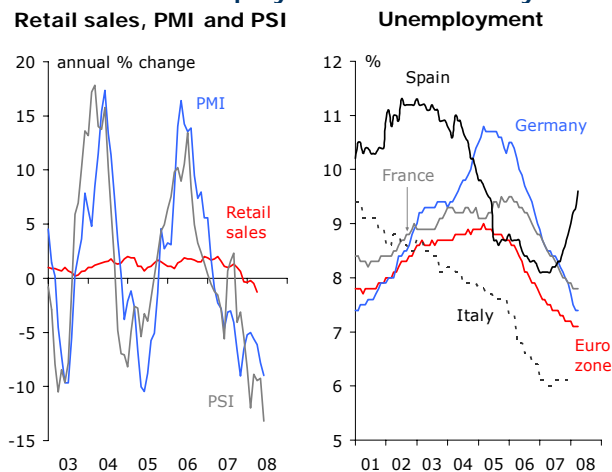
#### Fed focus 2



Sources: Bloomberg, Datastream, ANZ.

The only G7 central bank to raise rates in recent months is the ECB in July. Although labour market conditions are tight and inflation is persistent in the Euro zone, we do not anticipate a series of rate rises as the regional economy is set to slow. Moreover, the ECB is in a more difficult position to set policy as growth rates in the Euro zone are diverging. The overall Euro area indicators remain far stronger than in the US, mainly because the German economy has performed fairly well to date. Italy, Spain and France are not doing nearly as well, with Italy approaching negative growth and industrial production sliding quickly outside of Germany.

#### Euro zone unemployment still relatively low



Sources: Bloomberg, ANZ.

Even while the growth outlook has worsened across most of Europe, the rate of unemployment remains at cyclical lows – and this is the biggest problem for the ECB. Unlike in the US, where unemployment has risen to a rate last seen in mid-2004, the unemployment rate is still at its trough in Germany, France and even Italy. With the jobs market holding up well in Europe, the ECB will remain concerned about the possibility of higher commodity prices passing through into core inflation, particularly via second-round effects from wage demands. The ECB will not be able to ease monetary policy while labour markets are strong, despite the fact that leading

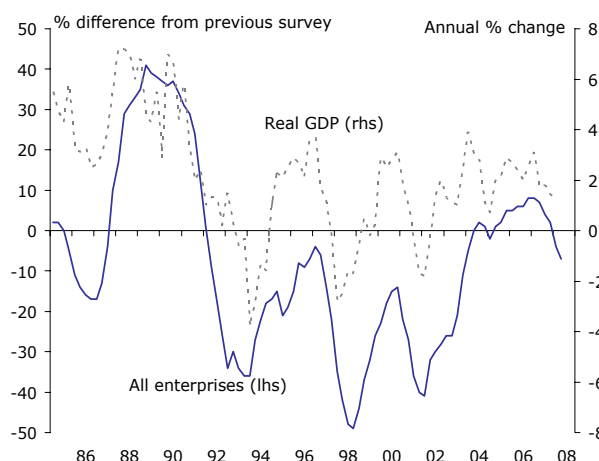
indicators such as consumer confidence, retail sales and the purchasing managers' index are looking decidedly ill. In fact, if inflation continues to print above expectations over the coming months, then the ECB may be compelled to increase rates another notch, although this is not our central forecast.

In the case of the UK, the BoE letter to the UK Chancellor hit the nail on the head: further rate rises will cause undue damage to an economy already facing a housing market collapse, a consumption squeeze from high oil and food prices, tight credit conditions and falling external demand.

Although UK consumers have remained resilient, with retail sales volumes 8.1% higher over the year to May (the strongest growth in six years), such spending is not sustainable. The household savings ratio dipped to just 1.1% in the March quarter from 3% in the December quarter 2007. Moreover, the unemployment rate has ticked back up to 5.3%. Activity data tell a much more grim story: the PMI and PSI both suggest that the economy is contracting, with both indices at their lowest levels since late 2001. Combined with inflation forecast to head up to 4% over coming months, the UK outlook for the remainder of 2008 is bleak.

Downside risks to growth and higher inflation have also hit Japan, which after years of deflation, has seen consumer prices rise to their highest level since 1994. However, Bank of Japan rhetoric points to concern over the expected slowdown in external demand and high materials prices and their impact on the domestic economy, suggesting that interest rates are unlikely to rise this year.

#### Japan's Tankan survey deteriorates



Sources: Bloomberg, Datastream, ANZ.

The worsening terms of trade, combined with a strong yen eroding export competitiveness and high commodity prices lifting the value of imports, have dampened Japanese consumer and business sentiment as real incomes decline. The BoJ's Tankan survey of business sentiment, while better than market expectations, recorded the third successive deterioration in business conditions in the June quarter as rising input costs and softer demand pared back earnings forecasts. Looking at historical

trends in the chart above, these relatively sharp drops in business expectations raise the risk that the economy could be heading for a recession. Corporate earnings are expected to decline for the first time since 2001 and the flow-through to households in terms of wages and labour market conditions will continue to keep domestic demand weak.

#### Is it time to go long dollar?

Recent weeks have seen growing pressure to stabilise the US dollar, particularly as weakness in the US currency has contributed to soaring commodity prices and inflation expectations. Not only has China been calling for a stable dollar but the Middle East economies, which mostly peg their currencies against the greenback, have faced growing pressure to break those pegs to address intense inflationary pressures. Coordinated intervention cannot be ruled out but a sustained upward move in the US dollar would require an improved economic outlook and higher interest rates. Our short-term view is that the US dollar will remain under pressure for a while yet as the economy remains soft and the Fed will have little scope to consider higher rates. The outlook by year-end and into 2009, however, is for the US dollar to develop some momentum, as an economic recovery gains ground, lifting scope for increases in US interest rates by the second half of 2009.

The ECB rate hike in July was largely priced in, but the interpretation of ECB President Trichet's comments as a shift to a neutral stance has seen a sell-off in the Euro in recent days to help stabilise the US\$. The medium-term view is for the euro to weaken against the US\$ as further evidence of a downturn in economic growth and a moderation in inflation becomes apparent. The yen is likely to continue to track in a narrow range (as it has over recent months) but wider interest rate differentials in favour of the US dollar towards the latter part of 2009 should see renewed yen weakness.

#### US dollar softens



Sources: Bloomberg, ANZ.

## Emerging Asia

*Paul Gruenwald and Ivy Tan*

Inflation has moved front and centre as the main challenge facing emerging Asia. A number of central banks have raised policy rates, moved to tighten monetary conditions and/or have communicated a hawkish stance in the near term.

To some degree, ongoing price pressures reflect that growth momentum in the region (as well as in emerging markets outside of Asia) remains surprisingly robust despite a slowing US economy, growing signs of weaknesses in Europe, and a large degree of financial market contagion, particularly in the equity markets. Inflationary pressure in emerging Asia also reflects, to varying degrees, exchange rate policy, as those economies with currencies tightly linked to the US dollar effectively import loose US monetary conditions, which are currently inappropriate for emerging Asia given the region's growth momentum.

### Inflation on the Rise

Inflation across all metrics rose sharply in emerging Asia in the second quarter of 2008. As of May, year-on-year inflation averaged (unweighted) 7.8%. This was 2% higher than in December 2007. In many cases, inflation reached its highest levels since the early to mid-1990s, rising to double digits in India, Indonesia, the Philippines and Vietnam.

In response to the rise in inflation, a number of central banks have responded by raising policy rates. Korea, Indonesia, Philippines and Taiwan have all raised official rates in recent months. Meanwhile, the authorities in China, India, Singapore and Vietnam have also taken various measures to tighten monetary conditions. Monetary authorities have begun to intervene to limit exchange rate depreciation as part of this strategy.

Central bank interest rates

%	Q4 2007	Q1 2008	Q2 2008
India	6.00	6.00	6.00
Indonesia	8.00	8.00	8.50
Malaysia	3.49	3.49	3.50
Philippines	5.25	5.00	5.25
Singapore	2.38	1.31	1.19
South Korea	5.00	5.00	NA
Taiwan	3.38	3.50	3.63
Thailand	3.19	3.23	3.25

Source: Bloomberg.

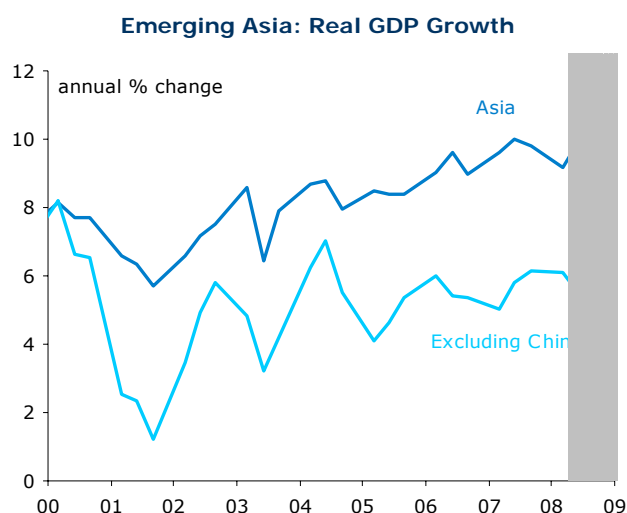
Vietnam currently provides the most dramatic case of inflation, with the CPI rising by 26% through June. Following years of loose monetary policy and above-potential growth, imports surged and pressures emerged on the balance of payments. This led to a "crisis of confidence" in mid-2008 as equities declined sharply and depositors began to shift out of the dong. The authorities responded by raising interest rates, slowing investment by State Owned Enterprises, widening the trading band for the dong, and using reserves to defend the currency. Local markets have stabilized somewhat as of writing, but the situation remains fragile.

The presence of fuel subsidies in a number of lower-income emerging Asian economies implies that inflation pressures are being underestimated or, in cases where abrupt changes in administered prices take place, distorted. Owing to (quasi-) fiscal pressures resulting from not fully passing through increases in international oil prices to domestic consumers, China, India, Malaysia, Thailand and Indonesia have recently announced large increases in retail fuel prices, in some cases causing social tensions. An important side effect of these policies is that global demand for petroleum fuel is not being allowed to adjust to higher oil prices.

Owing to base effects, particularly with regard to food (which carries the highest weight in most emerging Asian consumer price indices), headline inflation is likely to moderate. This assumes that the second-round effects — namely, wage increases — remain contained. While this has so far been the case, it is unclear whether emerging Asian workers (or policymakers) will countenance the substantial decline in real wages from high inflation.

### De-linking: real vs financial split

Activity across emerging Asia has continued to surprise on the upside, suggesting some degree of de-linking from developments elsewhere, at least in the real economy.

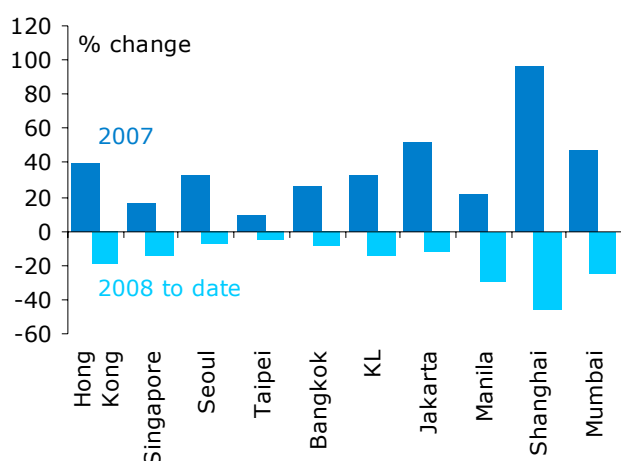


Source: Bloomberg, ANZ.

GDP growth in the first quarter was virtually unchanged from the final quarter of 2007, despite a slowdown in the US and Europe. China and India continued to lead the region, although growth in the rest of emerging Asia held up well. Export growth remains reasonably robust despite slower shipments to the US, with the slack being taken up by China and other emerging markets. Indicators of domestic demand — industrial production and retail sales — have moderated, but suggest continued strength.

In contrast to real variables, contagion from the rest of the world to emerging Asia has been quite high for financial variables. In particular, equity markets in the region have followed down their counterparts in the advanced countries. While there is a large variation in percentage declines across economies in emerging Asia, year-to-date declines are well into double digits with the largest being the Mumbai, Shanghai and Ho Chi Minh indices, which fell by about 40, 40 and 50% respectively through early July. That being said, in most cases the declines have not been sufficient to offset the gains run up in 2007 (see chart below).

Emerging Asia sharemarket performance



Source: Bloomberg.

Currencies have been a mixed bag in the recent quarter. Measured against the US dollar, only the Chinese renminbi and the Indonesian rupiah have continued to strengthen. Meanwhile the Thai baht and Philippines peso have been the only currencies to weaken, although the latter has firmed lately. The remaining currencies have traded sideways in recent months. Given the inflation pressures noted above, we would expect monetary authorities in the region to more actively intervene to keep currencies from depreciating (on a multilateral basis) in order to not loosen monetary conditions. Indeed a number of country authorities have explicitly stated that their focus has shifted from promoting growth to combating inflation.

## Can Growth Hold Up?

We think it unlikely that emerging Asia will escape unscathed from the global growth slowdown currently underway. That being said, the region is better placed than during the 2001 tech bubble burst (and certainly better placed than at the time of the Asian currency crisis) to weather the storm. Fundamentals are stronger, economies are more flexible, and policymaking has generally improved.

We project growth in emerging Asia to decline by about 1½ percentage points to 7.9% in 2008 (a much smaller decline than in the tech bust). Excluding China, growth falls by about 1 percentage point to 4.8%. Reflecting our call of continued weakness into 2009, growth in emerging Asia will remain soft, declining by a further ½ percentage point before retuning to trend in the following years (see table of international growth forecasts below).

Looking at the components of growth, this forecast reflects a lower contribution to growth from net exports, and relatively robust domestic demand, which has been a large contributor to recent growth in China, India and the ASEAN countries. The wealth channel in emerging Asia also appears to be less important than in advanced countries, suggesting a smaller effect from the recent drop in equity prices.

A key unknown for emerging Asia going forward is the trajectory of US and European growth. A sharper than expected slowdown in foreign demand is likely to have non-linear effects on Asia, meaning a sharper downturn as second round or confidence effects kick in. An accompanying sharp decline in commodity prices would also negatively effect growth in most of Asia (although it would be positive for the inflation outlook as growth would slow substantially) given the recently large contribution to Asian exports from commodity-producing regions.

## Commodities Outlook

Mark Pervan

### A re-think on momentum

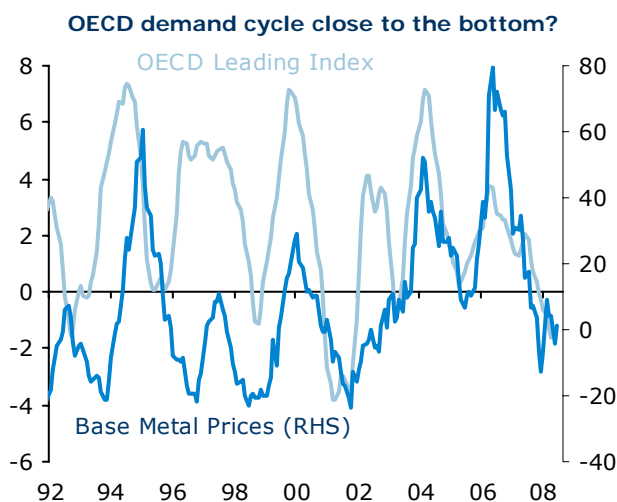
Commodity markets have yet again surprised on the upside this quarter, with positive price momentum attracting increased investment buying from disillusioned (spooked) debt, equity and property market investors. The currency market has had less of an impact, with a firming US\$ being lately ignored, particularly in the booming energy markets. The rapidly rising oil price has, and continues to hold, centre stage. Although attracting basket buying in most commodities, it may prove to be the catalyst for lower prices in coming months.

The recent pick-up in price volatility suggests that sentiment may be shifting – and that the one-way positive momentum story could be running out of legs. We think that the surging oil price is now at a level where the market is re-visiting and downgrading global growth assumptions. A mild recovery in the US\$ (our forecast) will also halt the popular currency hedging strategies supporting oil and gold, while the *prospect* of a lull in Chinese demand post the Olympic games may convince others to profit-take.

### Not overly bearish though

However, we're not overly bearish on prices. There's still enough uncertainty in other markets to keep an each-way bet on commodities. The US\$ is not a certain recovery-call, and rising geo-political tensions are likely to remain a key factor in the oil market.

The market will also continue to grapple with the de-coupling theory of slowing developed demand versus ongoing strong emerging demand. Interestingly, the closely watched OECD lead index looks close to bottoming on a year-on-year basis, suggesting OECD physical demand conditions may be close to bottoming in the next six to nine months.

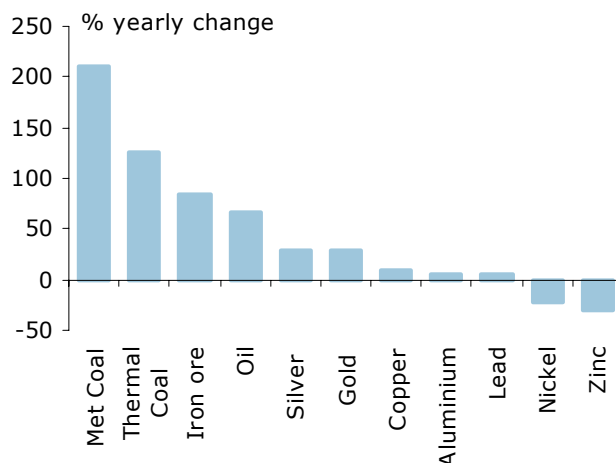


Source: Bloomberg.

The litmus test could come after the Beijing Olympics, with expectations rising that China will pull back on commodity demand, after investing heavily in infrastructure and emergency stockpiling of commodities (particularly energy) ahead of the event. In fact, the slowdown may occur earlier, with reports the government will force the closure of heavy industry within a two hundred kilometre radius (of Beijing) two to three weeks ahead of the games in an effort to clean up air quality. Although we think the Beijing Olympics is marginal to the overall China commodity story, reports of slowing demand could weigh on market sentiment.

As a result, we think commodity prices will be mixed in the coming months, with easing base metal, oil and gold prices offsetting resilient bulk iron ore and coal markets. Oil, copper and aluminium looked fully (over) priced, while secondary base metals – nickel, lead and zinc – looked oversold. The coal and iron ore markets are concluding another year of very strong contract price outcomes – and will likely continue to be positively underpinned by strong emerging-market energy and infrastructure demand and constrained supply issues.

### ANZ commodity price forecasts, 2007-2008



Source: ANZ.

### Base metals should be mixed

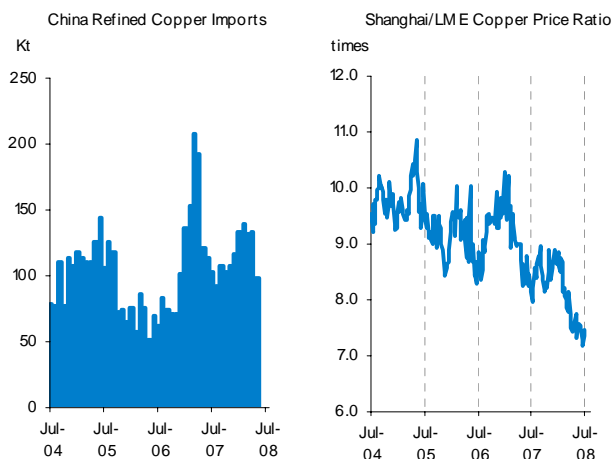
We think base metal prices will be choppy to weaker in the second half of 2008, as softer demand conditions and a larger supply response usher in selling. High oil prices and the global credit crunch have pared back what was already softer metal demand expectations. The supply situation is mixed, but rising London Metal Exchange (LME) aluminium, nickel, lead and zinc inventories have become more apparent. The widening premiums of LME to Shanghai metal prices also suggests that Chinese metal imports will continue to ease, while exports could rise, particularly for aluminium.

Copper and aluminium look most vulnerable to a price correction following strong gains in the first half of 2008. Declining China copper imports and the widening differential between LME and Shanghai prices suggests the weaker import trend will

continue. Limiting the downside is tight LME and Shanghai supply. Treatment charges are also very low, suggesting a meaningful supply response is still somewhat off. Aluminium looks finely balanced with the market having already priced-in meaningful high cost supply closures from high oil prices. If Chinese smelting capacity growth continues on its recent strong path, prices look set to fall 10-20% in the near term.

Nickel, lead and zinc may stage mild relief rallies from oversold positions. The nickel market has been hit by a protracted drop in stainless steel demand, which we feel may have been accentuated by the temporary closure of downstream metal fabricating businesses in China, in reaction to new labour laws. Reports of surging sulphuric acid prices may also slow supply from high-cost nickel laterite operations, improving the price outlook. Lead would receive a boost from lower oil prices taking the pressure of a struggling car and car battery market (70% of lead's end-use). Zinc should firm on reports that Chinese smelters have agreed to cut production by 10% to lift local prices.

#### China remains the key



Source: Bloomberg.

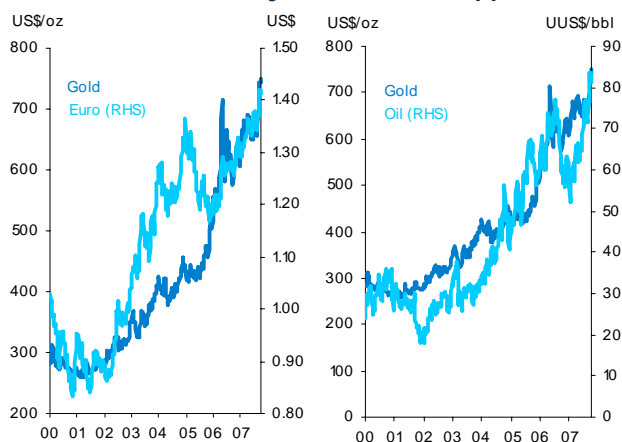
#### Oil should ease

Oil will continue to be a tough call, with rising geopolitical tension and buoyant emerging demand offsetting slowing developed country (OECD) demand. Price volatility has increased, creating greater sensitivity to news developments. With most news reports being negative lately (Nigeria or Iran), prices in the short-term could move higher. However, a more predictable deteriorating demand backdrop, together with a mildly recovering US\$, suggests prices should ease in the second half of 2008. Increased demand from developing countries and uncertainty over OPEC production will keep a high floor on prices (over US\$120/bbl) for some time to come.

#### Gold to track oil

Gold should drift lower through 2008 in line with an easing oil price and a firmer US\$. Sentiment has improved lately though, on increased nervousness in equity markets and a sticky high oil price. In fact, gold's correlation to oil prices has strengthened significantly in the past month, suggesting prices will fall once oil prices start to decline. The US\$ still holds a major influence on sentiment, and a mild recovery in the second half of 2008 (more from euro and yen weakness than US\$ strength) should dampen gold's currency hedge appeal. An uncertain equity outlook, particularly with the credit crisis still filtering through, should still support safe-haven buying and limit the downside in gold prices.

#### Gold's currency and inflation appeal



Source: Bloomberg.

#### Bulks to remain strong

The bulk markets of iron ore and coal are likely to remain strong. China will continue to consume huge amounts of imported iron ore, while coal markets remain on their knees from massive supply disruptions in Australia and China earlier in the year. The massive scale of the operations will also continue to cause rail and port infrastructure bottleneck constraints, limiting the supply response to still-booming Asian steel and energy markets.

Thermal coal looks the best placed, with reports that China will reduce coal export quotas further in the second half because of booming demand. The rising trend of converting high CV (calorific value) thermal coal into higher priced semi-soft coking coal will also further tighten Australian thermal coal exports. South Africa is likely to start cannibalising its own coal exports to replenish a very lowly stocked domestic market. Iron ore is a bit of an each-way bet, with rising Pilbara iron ore exports (Fortescue) offset by falling Chinese iron ore grades (and production). The drawdown of high iron ore port stocks in China may be the catalyst for slightly cooler sentiment conditions short term.

## Australian Outlook

Sally Auld and Katie Dean

### Inflation remains top priority

There is little doubt that the Australian economy is slowing. Higher interest rates, record oil prices, an equity-market in bear territory and the strongest currency in 25 years are all hurting. Retail sales are weakening, building approvals are dropping, business confidence is bruised and labour demand is easing. Together, these factors will probably cause non-farm GDP growth to ease to around 2¾% in the year to the June quarter 2008, a significant turnaround from the peak in growth of 5.0% achieved in the June quarter 2007.

Yet, despite a slowdown in spending, Australian inflationary pressures continue to rise. Having surged to a 16-year high of 4.2% in the year to the March quarter, inflation now looks set to accelerate further to above 4½% before year-end. Our models suggest that even with current 'tight' policy settings, inflation will not return to anywhere near the RBA's 2-3% target band until at least 2010.

Having kept official interest rates on hold at 7.25% since March, the RBA has signalled its comfort with the current slowdown in domestic spending. However, for inflation's sake, this slowdown must have further to run. Indeed, the RBA themselves have implied that non-farm GDP growth must drop further — to around 1¾% — before it can be sure that price pressures will ease as required.

The dilemma is that while domestic demand is slowing, income tax cuts and commodity price windfalls mean that the risk of a reacceleration in growth, particularly if petrol prices and financial markets stabilise, is significant. Given the inflation backdrop, the RBA will have little tolerance for signs of a rebound in spending. The important question for the outlook therefore is not *whether* a further slowdown in the economy will occur, but *how*.

### Inflation is not just about oil and food

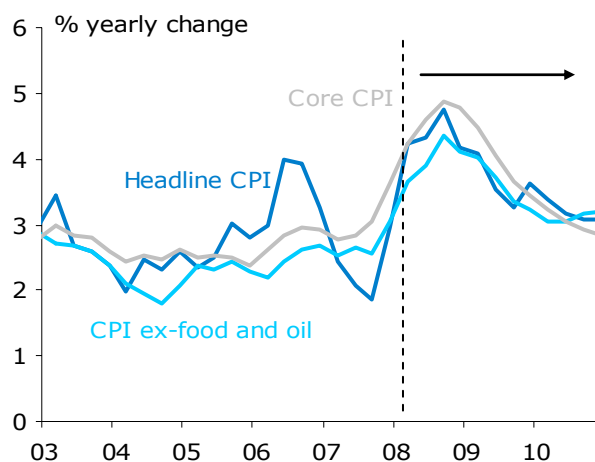
Before we consider the challenges facing economic activity, let's first reiterate why fighting inflation must be the RBA's priority number one. Rising inflation is not just a problem for Australia. As outlined in the early part of this publication, higher energy and food costs are pushing up prices across most parts of the world, from booming China to the beleaguered US. This has led some to argue that Australia's rising inflation rate is being driven by global forces. As such, the argument follows, raising local interest rates is not the right policy tool to cool these price pressures.

There are two problems with this theory, both of which present major challenges for the RBA. The first is that Australia, as a major exporter of resource and agricultural commodities, is a net beneficiary of higher commodity prices. Higher

commodity prices, to a point, are thus still more likely to be inflationary, not disinflationary, for the Australian economy. It is no coincidence that other major commodity producers, including Indonesia, Russia, South Africa, Norway, Chile, Brazil and India have all raised policy rates in recent months.

The second and more important problem is that even if we exclude soaring food and energy prices, inflation in Australia is still likely to *accelerate* from 3.6% towards 4½% in the coming quarters. Prices for 'non-tradeable' goods and services are now rising by 5% p.a., the fastest pace since the introduction of the GST. With further significant price rises expected across a wide range of domestic sectors, including rents, utilities, property rates, childcare and education, this non-imported, 'non-tradeables' inflation is set to accelerate further, to at least 5½%. Unfortunately, as the RBA has been at pains to outline, the least disruptive counter to a broad-based inflation problem is slower spending.

### Australian inflation is not just imported



Source: ABS and ANZ.

### Households to bear the burden

The challenge for the policy-makers is to slow the Australian economy whilst also facilitating a transition in the main drivers of growth. Continued strong investment is crucial if Australia's capacity constraints — a major source of domestic inflationary pressure — are to be resolved. Meanwhile, a pick up in export growth now, finally, looks almost assured, as extra capacity kicks in across the mining sector and improved seasonal conditions bless the rural sector. Indeed, Australia now looks set to sustain a trade surplus over much of the next six months.

It is thus households that will bear the biggest brunt of the slowdown in the Australian economy. Households now face powerful forces, in both directions. On the one hand, higher interest rates and sharp price rises for non-discretionary goods are constraining discretionary spending. Moreover, falling equity prices and easing house price growth caused the value of household wealth to decline in the March quarter, the first fall since December 1994. But, providing some buffer to these challenges, the unemployment rate remains near

30-year lows and recent income tax cuts are softening the blow from rising costs.

Household income growth, and primarily the labour market, remains *the* fundamental driver of household spending. Given ongoing capacity constraints, we believe labour hoarding, not shedding, is more likely as the economy slows. While household disposable income growth will slow from last year's outstanding 10% rate, favourable labour market conditions and income tax cuts should help to soften some of the pain from recent interest rate rises. It is instructive to note that in both 2006 and 2007 income tax cuts more than offset higher interest rates to prompt a rebound in consumer spending in the second half of each year. There is clearly a risk that such behaviour will be repeated this year. If we do see such a pick-up in household spending, we expect the RBA would have little choice but to raise interest rates further.

The major factor that is likely to prevent the need for further RBA policy action is higher petrol prices. While petrol makes up just 0.3% of total household spending, prices are reaching a critical point. Our analysis suggests income tax cuts are not sufficient to offset the impact to household budgets from current record prices around \$1.60c a litre. If these prices are sustained or continue rising, the economy will slow further below trend, providing a strong case for rates to stay indefinitely on hold.

### Interest rate outlook – growth or inflation?

The past quarter was a volatile one for Australian term interest rates, with the 3-year government bond yield trading a 100bp range. Even the 10-year government bond yield traded a 75bp range in the three months to 30 June. But against the backdrop of considerable uncertainty about both the global and domestic economic outlook, this sort of volatility is not really surprising.

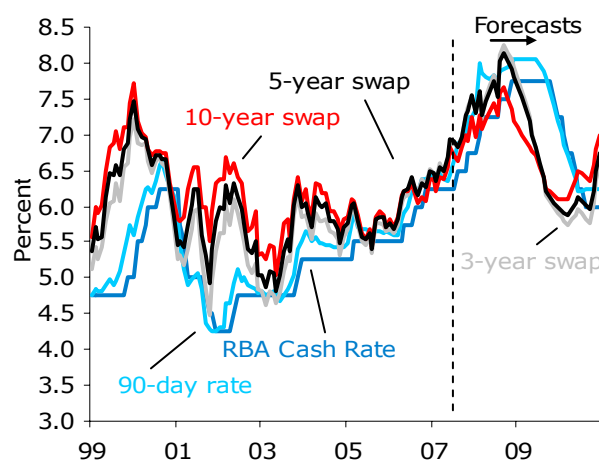
As we note above, there are a very diverse set of risks facing the domestic economy at present. On the one hand, inflation concerns seem to be omnipresent. But there are also risks to growth in both directions. For term interest rates, each of these risks has very different implications. For those who believe that downside risks to growth are the relevant set of risks facing the Australian economy, then it is probably clear that interest rates are close to or already beyond their peak for the cycle.

But if both growth and inflation surprise on the upside over the next 6 to 12 months in Australia, then there is a good chance that term interest rates – particularly in the 1-year to 3-year part of the curve – have further to rise this cycle.

While the outlook for the economy (and by definition, interest rates) is very uncertain at present, we still think that term yields could have further to rise for the cycle. Until markets are more confident that inflation will return to the target band in an appropriate time frame, nominal bond yields

should struggle to fall too much. Indeed, we doubt whether term yields will return to the lows seen in mid-June anytime soon.

### Term rates are still more likely to rise than fall



Source: Bloomberg and ANZ.

But if the RBA is true to its inflation targeting mandate, this should shore up inflation expectations and allow the bond market to rally as we move into 2009. Ultimately, we expect term yields to respond to the prospect of lower growth and better inflation outcomes in Australia. But we remain very mindful of the fact that near term risks are probably skewed towards higher term yields over the next 3 months.

Higher term yields and strong export returns are expected to support further gains in the A\$. The US\$/A\$ now looks poised to break parity and should also make good gains on most crosses, including the euro and the NZ dollar by year-end. A faster than expected slowdown in the local economy, or a sudden disruption to the global commodity boom, remain the key risk events for the Australian dollar.

### Equities – what went up did come down!

It was really a tale of two halves for the Australian share market in the June quarter. For the first 6 weeks of the quarter, the equity market made solid gains, rising around 11%. But sentiment changed rapidly in mid-May, and shares slipped dramatically to finish over 4% down for the quarter. Energy stocks were the best performers in the quarter, while financial and consumer discretionary stocks weighed on overall performance.

Looking ahead, we expect that volatility will remain a common theme for global equity markets. Australia should be no different. And we expect that the divergence in performance across sectors should be maintained for some time yet. The RBA Governor made this clear in a speech last month: *“Practically speaking, domestic consumption, together with housing demand, and some areas of business investment not linked to the resource sector, is being asked to make some room, for some period of time, for the rise in other forms of investment that will sustain higher incomes and living standards in the future.”*

## New Zealand Outlook

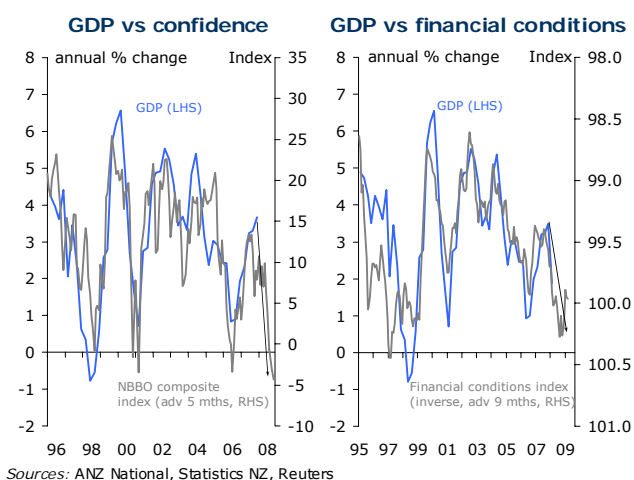
Philip Borkin

### The NZ economy is heading backwards...

After a decade of largely uninterrupted growth, the NZ economy finally looks to be entering a period of rebalancing and consolidation. Economic activity contracted by 0.3% over the first three months of 2008, taking year-on-year growth to 1.9%. Indicators for the June quarter look no better, and in fact suggest activity could possibly be weaker than in the March quarter.

What started as a correction in the housing market has now broadened to other sectors. Sales of 'big-ticket' items such as motor vehicles, appliances, and furniture is heading backwards, employment is falling, business and consumer confidence have tumbled — with the latter at the lowest levels since the 1991 recession — and financial conditions remain very tight.

Drought-like conditions experienced last spring and summer have led to falls in agricultural production and are expected to continue to weigh on production over the remainder of the year as livestock numbers take time to rebuild. Low lake levels are also seeing more reliance on thermal electricity generation rather than hydro generation — providing less value-added to GDP. The resulting spike in wholesale electricity prices has seen some large industrial users shut production temporarily.



Sources: ANZ National, Statistics NZ, Reuters

Positive support factors are still present. Commodity prices remain elevated, personal tax cuts are being rolled out from October this year, there remain large pending infrastructure projects and the unemployment rate is still near historical lows (although it does appear to be turning). However, these factors are being dwarfed by other headwinds facing the economy. Domestic petrol prices are at record high levels and have increased 23% this year alone. Food prices have also risen strongly and mortgage rates remain elevated. NZ\$48bn in fixed-rate mortgages is due to roll off their fixed interest rate contracts within the next 12 months, facing rate increases of up to 100bps.

At the same time, property values are falling, with prices 2% below their November 2007 peak (although a lack of sales of lower-valued properties means prices have probably fallen further) and equity markets have tumbled.

We have pencilled in another contraction in GDP for the June quarter and given the altered credit environment, it is likely that the second half of 2008 will also be very subdued.

### ...against a backdrop of simultaneous credit and inflation shocks

The NZ economy is facing three simultaneous shocks: a housing shock, the worst global credit conditions in 50 years, and a commodity (inflation) shock. This is at a time when the economy is already vulnerable with a high current account deficit, weak household savings, high indebtedness and poor productivity growth, which in themselves were pointing to an adjustment phase. Capacity constraints and domestic inflationary pressures meant the RBNZ was already trying to engineer a slowdown. In the past, the tipping point for NZ's business cycle has been triggered by offshore events, and it looks no different once again.

Credit resided at the heart of the elongated expansive phase over the past few years, through both its relative price and ease of access. The current account deficit (which peaked at 9% of GDP) was easy to fund and the housing market performed strongly. It drove wealth, spending, profits, jobs, asset prices, wealth, spending and so on. With the global credit cycle turning in mid-2007, the danger is that we see a reciprocal situation where falling asset values see spending contract, profits fall, jobs reduced, lending standards tighten and weaker asset prices — and the inward spiral is set in motion. Both spirals are heavily behavioural. What looked initially to be a liquidity adjustment, now appears to be entering the next leg, namely traditional credit risk in relation to a weakening economy. This is clearly evident in the local finance company sector where, although reinvestment rates have fallen, difficulties associated with a declining property market as assets are unloaded are now surfacing.

### Households are most exposed, pointing to a period of de-leveraging and consolidation...

Households enter this slowdown most exposed. While the unemployment rate is low, the combination of falling property values, high indebtedness, poor savings and increased cost of living pressures are major headwinds and point to a period of de-leveraging and consolidation ahead. Arguably this is a healthy development. But to do this, households typically only have one lever to pull and that is reduced spending. For this reason, household consolidation tends to be a long and drawn out affair.

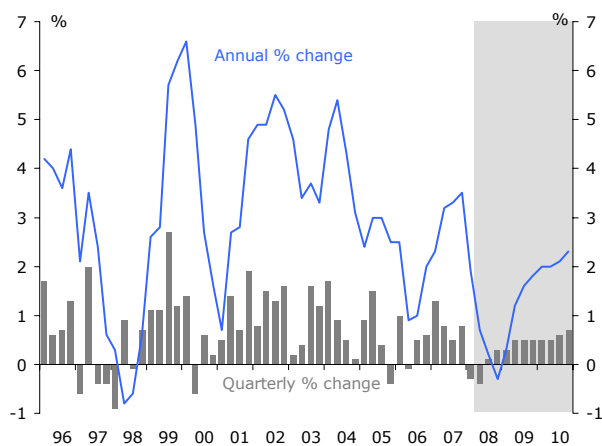
### ...underpinning a weak growth outlook

Economic activity will remain subdued into 2009 as spending, notably for residential investment and consumption, remain weak.

The corporate sector will not be immune, particularly those closely aligned to housing or domestic sectors of the economy. Although balance sheets remain solid, margins are being squeezed and profitability expectations have fallen sharply. Employment intentions are also falling and are expected to result in further softness in the labour market. The unemployment rate is expected to increase towards 5% by the end of 2009. Although the NZ\$ is eventually expected to fall (it has already on a TWI basis), it is likely to be some time before the benefits begin to be felt by the export sector. Some of the benefits are likely to be offset by weaker growth from NZ's trading partners.

As the rebalancing process broadens and financial conditions ease – via a lower currency and interest rates – momentum will strengthen. A stronger focus on productivity over the coming year across the corporate sector will be a precursor to the next upswing. But in the meantime it is a case of the economy lacking a real economic engine. We are forecasting GDP growth of just 0.6% for calendar year 2008 and 1.2% for 2009, recovering to a still sub-trend rate of 2.1% for 2010.

#### Economic growth forecast



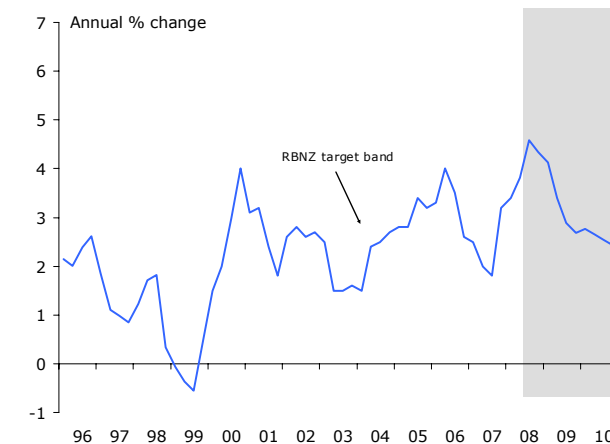
Sources: ANZ National, Statistics NZ

### But inflation pressures remain strong

Although the economy is slowing sharply, inflation pressures remain. Headline inflation is projected to increase from the current rate of 3.4%, to over 4½% before the end of the year as the global commodity price boom spills over into higher domestic fuel and food prices. Elevated inflation expectations and increasing pricing intentions portend further upside risk. However, the nature of the recent price increases (core staples) also act as a deflationary influence on the economy as discretionary income is siphoned into other areas. This, in conjunction with a weak economy and a downturn in the labour market, results in a more favourable medium-term inflation outlook. We

forecast the CPI to return to within the target band by the second half of 2009.

#### Headline CPI forecast



Sources: ANZ National, Statistics NZ

### Key financial market views

Although the near-term inflation outlook has deteriorated, a significantly weaker domestic economy has provided the RBNZ with confidence that medium inflation pressures will subside. The RBNZ formally moved to an easing bias at the June *Monetary Policy Statement* and explicitly stated that "we are now likely to be in a position to lower the OCR later this year." This is contingent on the economy continuing to slow and price increases not feeding into inflation and wage expectations.

We expect the RBNZ to begin cutting interest rates from September this year. However, given significantly weaker growth, tumbling consumer confidence, a higher cost of international credit to fund NZ's savings shortfall, and ironically a NZ\$ that is holding up against the US\$, we cannot rule out the possibility of the RBNZ cutting rates as soon as their next meeting in July. The June quarter CPI data and high oil prices may well be sticking points to an early rate cut. Given the high inflation starting point, we are drawn to the concept of a few stabilisation rate cuts in order to offset the tightening in financial conditions coming from other areas, and notably an altered global credit environment. We would not be surprised if the easing was stop-start in nature, as a game of chicken unfolds between the currency and interest rates. The Reserve Bank wants a lower currency but can ill afford to let it fall too far too quickly for fear of increasing inflation – hence "playing chicken".

The NZ\$ continues to look vulnerable given the deteriorating economic environment and softer tone from the RBNZ. For now, US\$ weakness is ensuring that the NZ\$ remains entrenched in a broad range. Nevertheless, we expect the NZ\$ to move lower once yield support is withdrawn by the RBNZ and a weakening growth performance relative to the US comes to light. The NZ\$ is expected to fall to below 0.65 cents against the US\$ by the end of 2009 and below 0.73 cents against the A\$.

## Feature Article: Australia's investment boom

Mark Rodrigues

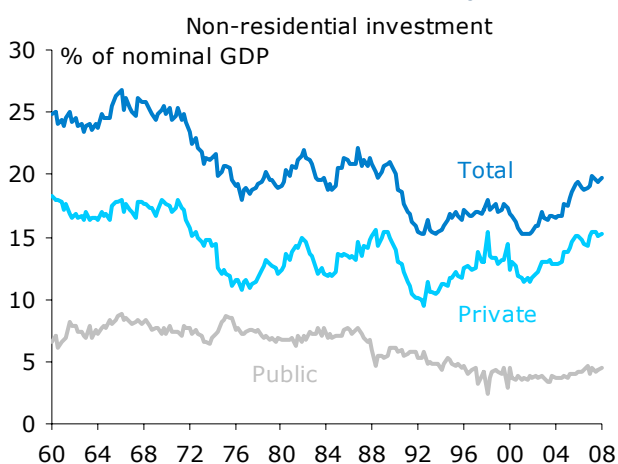
Australia is in the midst of its biggest investment boom since at least the 1980s, and potentially since the heady days of the 50's and 60's. Tighter financial conditions and capacity constraints — particularly in the labour market — pose a risk to investment intentions being realised in the short term. But in the longer term, macroeconomic indicators suggest the boom may continue for some years yet.

### In the midst of an investment boom...

In recent years, Australia's business community and governments have been scrambling to upgrade and expand the nation's capital stock after a decade of under-investment through the 1990s. Over the past six years, total non-residential investment has grown at an average rate of almost 12% p.a. in nominal terms, more than double the pace of the decade prior. The turnaround has been most stark in the public sector, where investment growth has accelerated to average 11.9% in the past six years, up from a paltry 2.2% p.a. in the decade prior. Not to be outdone, private sector business investment has grown at an average annual pace of 12.2% over the past six years, up from 7.3% p.a. in the previous decade.

As a result of the very strong investment growth in recent years, the non-residential investment share of GDP has lifted from an historical low of 15.2% in the middle of 2001 to 19.7% by the March quarter 2008.

### Non-residential investment has been increasing as a share of the economy



Source: ABS.

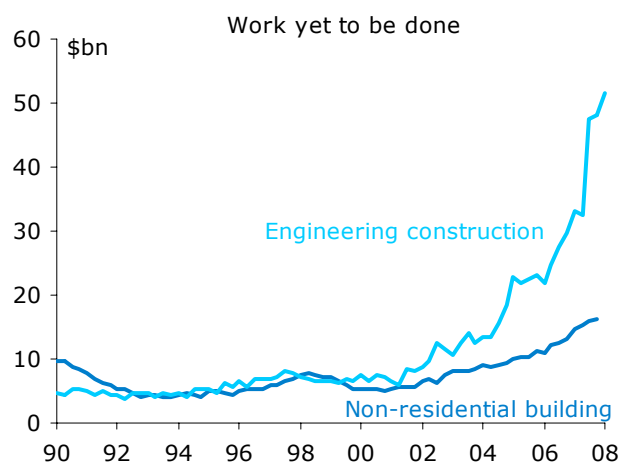
### ...with no end in sight

Typically, after six years of double-digit growth in investment expenditure we would be bracing for a sharp correction. Yet there seems little prospect of that on the horizon. Quite the contrary: the latest survey of private sector capital expenditure saw

investment intentions actually revised up in the March quarter 2008, and now points to a 24% lift in capital expenditure in 2008-09, following an expected 12% in 2007-08.

While these are just expectations and not locked in by any means, the pipeline of work yet to be done suggests that such estimates are not too far off the mark. For example, total engineering construction work yet to be done stood at a whopping \$51.6bn at the end of the March quarter, up over 56% on a year earlier. Meanwhile, the value of non-residential building work yet to be done surged over 22% to be \$16.2bn by the end of 2007.

### The investment pipeline is strong



Source: ABS.

The public sector is also planning on ramping up investment expenditure in the years ahead. The most recent round of state government budgets saw massive increases in capital spending intentions across most jurisdictions. The four largest states announced capital works programs totalling \$42.5bn in 2008-09, with Queensland accounting for \$17bn of this and New South Wales a further \$13.9bn. The numbers get even bigger when you consider spending plans over the full four-year budget estimates period, with New South Wales looking at \$57.6bn worth of capital investment, Western Australia \$26.1bn, Victoria \$17.2bn and South Australia \$10.3bn. And that doesn't even include Queensland, for which we don't have details of capital expenditure investment plans beyond 2008-09, but which is likely to spend at least as much as much as New South Wales over the four-year period from 2008-09.

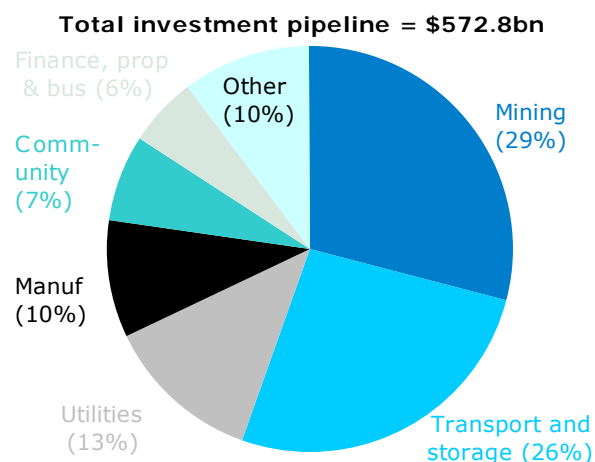
This massive increase in state government infrastructure spending comes at the same time that the Commonwealth Government is also focussing on upgrading the nation's infrastructure. The 2008-09 Budget provided for three new nation-building funds: the *Building Australia Fund* to fund transport and communications infrastructure; the *Education Investment Fund* for capital investment in both higher and vocational education, and; the *Health and Hospitals Fund* for capital investment in health facilities. Together, these funds will provide over

\$40bn for future capital investment and infrastructure. This is in addition to the \$22.3 billion slated for new land transport infrastructure from 2009-10 to 2013-14 under AusLink 2.

Overall, Access Economics estimates that the investment pipeline is worth some \$572.8bn as at the March quarter 2008, up almost 20% on a year earlier. This reflects \$159.8bn worth of projects currently under construction, \$51.8bn committed, and a further \$371.2bn listed as either 'under consideration' or 'possible'.

Of this massive pipeline of investment, some \$167.3bn (or 29%) is in the mining industry, while a further \$149.2bn (or 26%) is in transport and storage. Also of note is \$71.9bn of potential investment in electricity, gas and water, reflecting the current focus on water-related infrastructure, renewable and 'clean' energy generation.

#### The investment pipeline is dominated by mining, transport and water-related projects



Source: Access Economics.

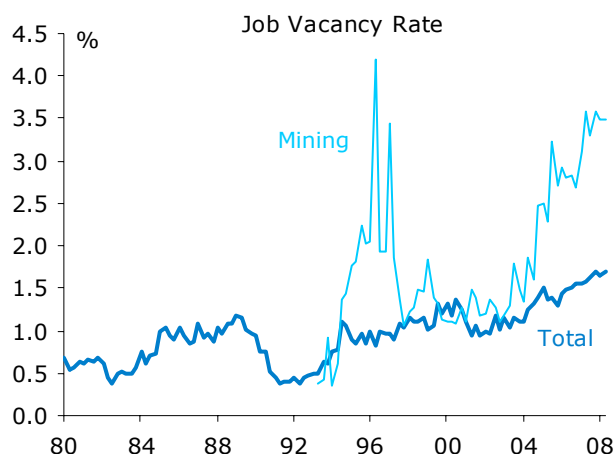
By state, not surprisingly, Western Australia and Queensland is where most of the action is, with 29.1% and 22.6%, respectively, of the total potential investment pipeline. The largest states of New South Wales and Victoria account for a further 30% of the investment pipeline, with the remainder shared amongst the smaller states and territories.

#### Some roadblocks in the short term...

There are, however, some clouds on the horizon. First, rising interest rates and falling share prices have raised the cost of both debt and equity finance. At the same time, the meltdown in global credit markets has closed previously cheap and abundant non-intermediated funding options for most non-financial corporate borrowers. The credit crisis has also hit state government borrowers who, despite investment grade credit ratings, have similarly experienced significant increases in the cost of debt. Those states utilising PPP funding models have encountered the additional difficulty of finding willing and viable private sector partners in the current environment.

Second, capacity constraints, particularly in the labour market, continue to impede the delivery of major infrastructure projects on time and on budget. A strategic review of Western Australia's capital works program last year found that the expected timeframes for a number of projects were not realistic in the current tight labour market, resulting in some projects being delayed by 6 to 12 months, and others being shelved indefinitely. And conditions aren't easing on this front: the unemployment rate dipped back down to near 30-year lows of 4.2% in June. Meanwhile, the number of job vacancies currently stand at a record 1.7% of total desired employment (actual employment plus vacancies), confirming record levels of excess demand for labour. Not surprisingly, the shortage is most acute in the mining industry. In the current environment, it seems likely that labour will be hoarded rather than let go, suggesting that the labour market will remain historically tight even as economic growth slows.

#### Job vacancies are at an historic high as a share of total desired employment



Source: ABS and ANZ.

#### ... but the current boom is well grounded in fundamental need

Fundamentally, the expected longevity of the investment boom seems well founded. Despite all of the investment that has occurred over the past six years, the average age of non-dwelling construction capital stock remained near record highs at the end of 2006-07, at 20 years. Similarly, while the average age of the nation's machinery and equipment has fallen slightly in recent years, it remains relatively high at 8.5 years. This is the result of chronic under-investment through the 1990s and early 2000s, when nominal investment grew at only 3% p.a. On this measure at least, we need not be concerned about the efficiency of investment — and therefore the potential for a sharp reversal in activity — for some time yet.

Instead, it seems likely then that the boom will roll on, moderated only by short-term cyclical risks and the capacity of the labour market to absorb the activity.

## International Economic Growth Forecasts

	2006	2007	2008(f)	2009(f)	2010(f)
US	2.9	2.2	0.7	0.8	2.2
Japan	2.4	2.1	1.1	0.9	2.0
Germany	2.9	2.5	2.1	1.3	2.4
France	2.4	2.1	1.8	1.4	1.9
Italy	1.9	1.4	0.3	0.8	1.5
UK	2.9	3.1	1.5	1.2	2.4
Canada	2.8	2.7	0.7	2.0	3.1
<b>G7</b>	<b>2.7</b>	<b>2.2</b>	<b>1.0</b>	<b>1.0</b>	<b>2.2</b>
Spain	3.9	3.8	2.0	1.4	2.2
<b>Euro zone</b>	<b>2.6</b>	<b>2.7</b>	<b>1.8</b>	<b>1.4</b>	<b>2.2</b>
Australia	2.8	4.3	2.8	2.4	3.3
New Zealand	2.3	3.1	0.6	1.2	2.1
<b>Developed countries</b>	<b>2.8</b>	<b>2.5</b>	<b>1.2</b>	<b>1.2</b>	<b>2.3</b>
China	11.6	11.9	9.7	9.0	9.9
Korea	5.1	5.0	3.7	2.8	3.2
Taiwan	4.9	5.7	2.3	4.6	5.4
Indonesia	5.5	6.3	5.9	6.2	6.6
Thailand	5.1	4.8	5.4	6.0	4.9
Hong Kong	7.0	6.3	4.8	4.1	5.5
Malaysia	5.8	6.3	5.6	5.0	6.0
Singapore	8.2	7.7	4.0	5.0	6.5
Philippines	5.4	7.3	5.2	5.4	5.8
Vietnam	8.2	8.5	6.0	7.0	7.8
<b>East Asia excl. Japan &amp; China</b>	<b>5.6</b>	<b>5.9</b>	<b>4.5</b>	<b>4.8</b>	<b>5.3</b>
<b>East Asia excl. Japan</b>	<b>9.2</b>	<b>9.5</b>	<b>7.7</b>	<b>7.4</b>	<b>8.2</b>
Fiji	3.4	-4.4	1.0	1.5	2.3
Papua New Guinea	2.6	6.2	6.6	7.0	6.0
India	9.7	9.0	8.0	8.0	8.5
<b>South Asia</b>	<b>9.2</b>	<b>8.5</b>	<b>7.4</b>	<b>7.5</b>	<b>7.9</b>
<b>Eastern Europe</b>	<b>6.9</b>	<b>7.2</b>	<b>5.9</b>	<b>5.5</b>	<b>5.5</b>
<b>Latin America</b>	<b>5.4</b>	<b>5.6</b>	<b>4.3</b>	<b>3.6</b>	<b>4.4</b>
<b>Emerging countries</b>	<b>7.9</b>	<b>8.0</b>	<b>6.5</b>	<b>6.3</b>	<b>6.9</b>
<b>World (PPP)</b>	<b>4.9</b>	<b>4.8</b>	<b>3.6</b>	<b>3.5</b>	<b>4.4</b>

## Australian and New Zealand Economic Forecasts

	Annual (period average)% ch.				Quarter% ch.			
	2007	2008(f)	2009(f)	2010(f)	Mar-08	Jun-08(f)	Sep-08(f)	Dec-08(f)
<b>Australia</b>								
GDP	4.3	2.8	2.4	3.3	0.6	0.4	0.7	0.4
Household consumption	4.6	3.3	1.9	2.6	0.7	0.3	0.6	0.4
Dwelling investment	3.1	-2.5	2.0	13.2	0.0	-2.1	-1.5	-0.3
Business investment	12.0	6.4	4.2	2.8	1.5	1.6	2.2	1.8
Public demand	2.7	4.7	2.2	2.6	1.5	0.6	0.5	0.5
<i>Domestic final demand</i>	5.2	3.6	2.3	3.2	0.9	0.4	0.7	0.6
Net Exports (cont. to growth)	-1.7	-1.7	0.1	-0.1	0.0	-0.1	0.0	0.0
Inflation: Headline CPI	2.3	4.4	3.4	3.2	1.3	1.3	1.1	0.4
Core CPI*	3.1	4.6	3.9	3.0	1.2	1.3	1.2	1.0
Wages	4.1	4.4	4.4	3.7	0.9	1.2	1.2	1.2
Employment	2.8	2.4	1.4	1.4	0.8	0.4	0.4	0.4
Unemployment rate (%)	4.4	4.2	4.6	4.6	4.1	4.1	4.2	4.4
Current account balance (A\$ bn)	-66.4	-63.1	-54.4	-70.0	-19.5	-16.6	-15.0	-12.0
(% of GDP)	-6.1	-5.4	-4.4	-5.4	-6.9	-5.7	-5.0	-4.0
<b>New Zealand</b>								
GDP	3.1	0.6	1.2	2.1	-0.3	-0.4	0.1	0.3
Inflation: Headline CPI	3.2	4.3	2.7	2.4	0.7	1.4	1.2	0.9
Wages	4.3	4.7	4.2	4.1	1.5	1.1	1.0	1.1
Employment	1.8	-0.6	0.3	1.1	-1.3	0.2	-0.2	0.0
Unemployment rate (%)	3.4	4.2	4.8	5.0	3.6	3.8	4.0	4.2
Current account balance (NZ\$ bn)	-13.8	-13.8	-13.4	-14.2	-3.4	-3.6	-3.2	-3.3
(% of GDP)	-7.9	-7.5	-7.1	-7.2	-7.8	-7.5	-7.5	-7.5

\*Average of RBA weighted median and trimmed mean statistical measures.

## Financial Market Forecasts

	Annual (period end)				Quarter (period end)			
	2007	2008(e)	2009(f)	2010(f)	Mar-08	Jun-08(f)	Sep-08(f)	Dec-08(f)
<b>Interest rates (% p.a.)</b>								
<i>Australia</i>								
90 day bank bills	7.24	8.05	7.20	6.25	7.86	7.84	7.90	8.05
10 year bond rate	6.33	6.15	5.35	6.45	6.05	6.45	6.65	6.15
<i>United States</i>								
3 month LIBOR	4.70	2.00	3.00	5.00	2.69	2.78	2.50	2.00
10 year bond rate	4.02	3.40	3.75	5.65	3.41	3.97	3.85	3.40
<i>Euro area</i>								
3 month LIBOR	4.68	4.50	4.15	3.75	4.73	4.95	4.75	4.50
<i>New Zealand</i>								
90 day bank bills	8.88	7.68	6.20	6.20	8.88	8.64	8.23	7.68
<b>Exchange rates</b>								
A\$/US\$	0.88	1.04	0.87	0.80	0.91	0.96	1.01	1.04
NZ\$/US\$	0.77	0.75	0.63	0.62	0.79	0.76	0.77	0.75
A\$/¥	97.77	108.16	95.70	91.20	91.03	95.56	107.27	108.16
A\$/€	0.60	0.67	0.62	0.63	0.58	0.61	0.64	0.67
A\$/£	0.44	0.54	0.48	0.46	0.46	0.48	0.52	0.54
A\$/NZ\$	1.14	1.39	1.38	1.29	1.16	1.26	1.31	1.39
US\$/¥	111.7	104.0	110.0	114.0	99.7	99.7	106.2	104.00
€/US\$	1.46	1.55	1.40	1.27	1.58	1.58	1.58	1.55
A\$TWI	68.70	79.26	68.27	63.28	68.90	68.90	73.40	79.26

## Contacts

### ANZ Economics & Markets Research

**Saul Eslake**  
Chief Economist  
+61 3 9273 6251

[Saul.Eslake@anz.com](mailto:Saul.Eslake@anz.com)

**Fiona Allen**  
Business Manager  
+61 3 9273 6224

[Fiona.Allen@anz.com](mailto:Fiona.Allen@anz.com)

**Tony Pearson**  
Deputy Chief Economist and  
Head of Industry and Strategic  
Research  
+61 3 9273 5083

[Tony.Pearson@anz.com](mailto:Tony.Pearson@anz.com)

**Mark Rodrigues**  
Senior Economist,  
Industry and Strategic Research  
+61 3 9273 6286

[Mark.Rodrigues@anz.com](mailto:Mark.Rodrigues@anz.com)

**Julie Toth**  
Senior Economist,  
Industry and Strategic  
Research  
+61 3 9273 6252

[Julie.Toth@anz.com](mailto:Julie.Toth@anz.com)

**Warren Hogan**  
Co-Head of Australian Economics  
and Interest Rates Research

+61 2 9227 1562

[Warren.Hogan@anz.com](mailto:Warren.Hogan@anz.com)

**Sally Auld**  
Co-Head of Australian Economics  
and Interest Rates Research

+61 2 9227 1809

[Sally.Auld@anz.com](mailto:Sally.Auld@anz.com)

**Katie Dean**  
Senior Economist,  
Australian Economics and  
Interest Rates Research  
+61 3 9273 1381

[Katie.Dean@anz.com](mailto:Katie.Dean@anz.com)

**Riki Polygenis**  
Economist,  
Australian Economics and  
Interest Rates Research  
+61 3 9273 4060

[Riki.Polygenis@anz.com](mailto:Riki.Polygenis@anz.com)

**Dr. Alex Joiner**  
Economist,  
Australian Economics and  
Interest Rates Research  
+61 3 9273 6123

[Alex.Joiner@anz.com](mailto:Alex.Joiner@anz.com)

**David Croy**  
Strategist,  
Australian Economics and  
Interest Rates Research  
(London)  
+44 20 7378 2070

[David.Croy@anz.com](mailto:David.Croy@anz.com)

**Patricia Gacis**  
Strategist,  
Australian Economics and  
Interest Rates Research

+61 2 9227 1272

[Patricia.Gacis@anz.com](mailto:Patricia.Gacis@anz.com)

**Jason Hill**  
Credit Analyst

[Jason.Hill@anz.com](mailto:Jason.Hill@anz.com)

**Amy Auster**  
Head of Foreign Exchange and  
International Economics  
Research

+61 3 9273 5417

[Amy.Auster@anz.com](mailto:Amy.Auster@anz.com)

**Tony Morriss**  
Senior Currency Strategist,  
Foreign Exchange and  
International Economics  
Research

+61 2 9226 6757

[Tony.Morriss@anz.com](mailto:Tony.Morriss@anz.com)

**Jasmine Robinson**  
Senior Economist,  
Foreign Exchange and  
International Economics  
Research  
+61 3 9273 6289

[Jasmine.Robinson@anz.com](mailto:Jasmine.Robinson@anz.com)

**Amber Rabinov**  
Economist,  
Foreign Exchange and  
International Economics and  
Commodities Research  
+61 3 9273 4853

[Amber.Rabinov@anz.com](mailto:Amber.Rabinov@anz.com)

**Mark Pervan**  
Head of Commodities Research

+61 3 9273 3716

[Mark.Pervan@anz.com](mailto:Mark.Pervan@anz.com)

**Amber Rabinov**  
Economist,  
Foreign Exchange and  
International Economics and  
Commodities Research  
+61 3 9273 4853

[Amber.Rabinov@anz.com](mailto:Amber.Rabinov@anz.com)

**Paul Braddick**  
Head of Property and Financial  
System Research

+61 3 9273 5987

[Paul.Braddick@anz.com](mailto:Paul.Braddick@anz.com)

**Ange Montalti**  
Senior Economist,  
Property and Financial System  
Research  
+61 3 9273 6288

[Ange.Montalti@anz.com](mailto:Ange.Montalti@anz.com)

**Dr. Alex Joiner**  
Economist,  
Property and Financial System  
Research  
+61 3 9273 6123

[Alex.Joiner@anz.com](mailto:Alex.Joiner@anz.com)

**Stephanie Wayne**  
Research Analyst,  
Property and Financial  
System Research  
+61 3 9273 4075

[Stephanie.Wayne@anz.com](mailto:Stephanie.Wayne@anz.com)

**Paul Gruenwald**  
Head of Economics, Asia  
+65 6419 7902

[Paul.Gruenwald@anz.com](mailto:Paul.Gruenwald@anz.com)

**Ivy Tan**  
Associate Director, Credit  
Research, Markets Asia  
+65 6419 7914

[Ivy.Tan@anz.com](mailto:Ivy.Tan@anz.com)

### Research & Information Services

**Mary Yaxley**  
Head of Research & Information  
Services

+61 3 9273 6265

[Mary.Yaxley@anz.com](mailto:Mary.Yaxley@anz.com)

**Marilla Rough**  
Senior Information Officer, R&IS

+61 3 9273 6263

[Marilla.Rough@anz.com](mailto:Marilla.Rough@anz.com)

**Manesha Jayasuriya**  
Information Officer, R&IS

+61 3 9273 4121

[Manesha.Jayasuriya@anz.com](mailto:Manesha.Jayasuriya@anz.com)

### ANZ New Zealand Research

**Cameron Bagrie**  
Chief Economist  
+64 4 802 2212  
[Cameron.Bagrie@anz.com](mailto:Cameron.Bagrie@anz.com)

**Khoon Goh**  
Senior Economist  
+64 4 802 2357  
[Khoon.Goh@anznational.co.nz](mailto:Khoon.Goh@anznational.co.nz)

**Philip Borkin**  
Economist  
+64 4 802 2199  
[Philip.Borkin@anznational.co.nz](mailto:Philip.Borkin@anznational.co.nz)

**Steve Edwards**  
Economist  
+64 4 802 2217  
[steve.edwards@anznational.co.nz](mailto:steve.edwards@anznational.co.nz)

**Kevin Wilson**  
Rural Economist  
+64 4 802 2361  
[Kevin.Wilson@nbz.co.nz](mailto:Kevin.Wilson@nbz.co.nz)

**Important Notice**

Australia and New Zealand Banking Group Limited is represented in:

**AUSTRALIA** by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

14th Floor 100 Queen Street, Melbourne, Victoria, 3000, Australia

Telephone +61 3 9273 6224 Fax +61 3 9273 5711

**UNITED KINGDOM** by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121 Fax +44 20 7378 2378

**UNITED STATES OF AMERICA** by:

ANZ Securities, Inc. (Member of NASD and SIPC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

**NEW ZEALAND** by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

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