

MONTHLY ECONOMIC OUTLOOK

June 2009

Tuesday, 16 June 2009

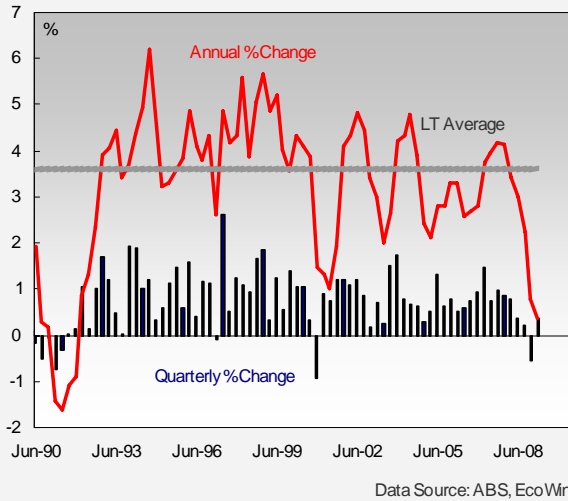
- There is a growing belief in financial markets that a world economic recovery will be underway within six to nine months. This belief remained the dominant theme over the past month and was reflected in improved financial market sentiment and greater investor appetite for risk. On the global data front, there are mixed signs that global economic activity is stabilising in some of the major economies.
- The Reserve Bank of Australia (RBA) left interest rates on hold for the second month running in June. Sentiment is still fragile and inflation is expected to ease further over the next two years. Accordingly, the RBA has left the door open for further interest rate cuts. We believe that interest rates could move down to 2.50% by the end of this year from the current level of 3%. But we also acknowledge the risk that if economic and financial conditions continue to improve, the RBA may have completed their easing cycle.
- Recent local economic data have support the RBA's decision to pause on the rates front again in June. The Aussie economy expanded in Q1, contrary to wide expectations for a second straight quarterly contraction. This means that unlike many other economies, Australia avoided registering a 'technical' recession.
- The housing sector remains a ray of light in the economy. First-home buyers continue to rush into the housing market on the back of very low interest rates and the boost to the first-home owners grant. The current environment has also been conducive for investors. House prices across most capital cities are down on a year ago, rents are still high, there's a national housing shortage and population growth is firm.
- But economic conditions are should be difficult for some time yet and the likely recovery later this year in the local economy is likely to be gradual. The boost to spending from the Government cash handouts will soon peter out; it leaves a weaker outlook for household consumption in coming months amid the expected continued uptrend in the unemployment rate. Businesses are likely to continue to peel back investment activity this year given the fragile economic climate and significantly more difficult trading and funding conditions. Meanwhile, the firmer Australian dollar is making exports less competitive.

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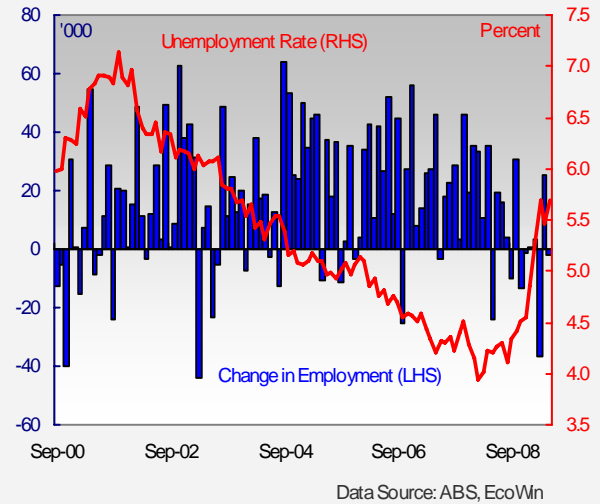
Australian Economic Data

GDP



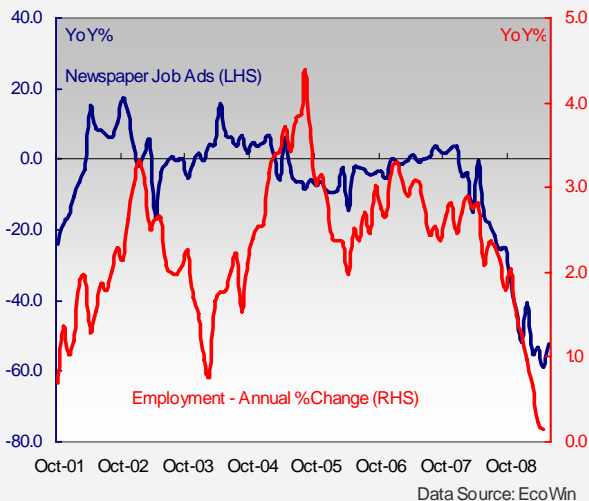
The economy expanded by 0.4% in the March quarter. The increase comes on the heels of the first GDP contraction in eight years in Q4 2008, of 0.6%. It means that Australia avoided a 'technical' recession in the March quarter (defined as two or more consecutive quarters of negative GDP growth). Growth in the March quarter reflected a strong contribution from net exports.

Employment



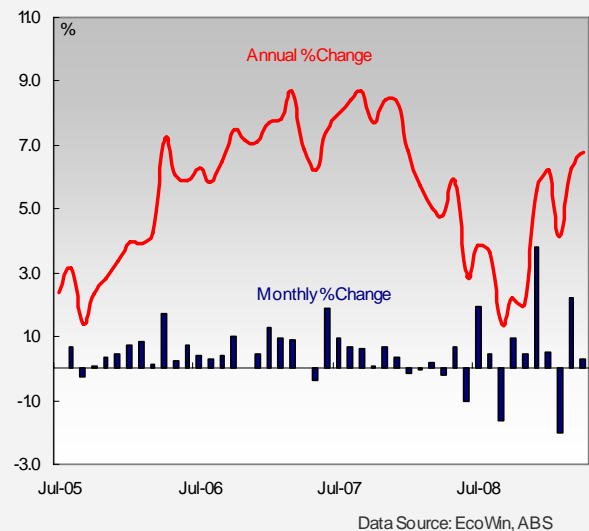
Only 1.7k jobs were lost in May, contrary to expectations for a larger fall of 30k. But full-time jobs fell sharply by 26.2k offset by a 24.5k increase in part-time jobs. The unemployment rate rose by 0.2 percentage points (ppt) to 5.7% as the participation rate edged 0.1ppt higher. It matches rate in March, which was a five-year high. Job advertisements are almost 50% lower from a year ago, pointing towards higher unemployment rates.

ANZ Job Ads



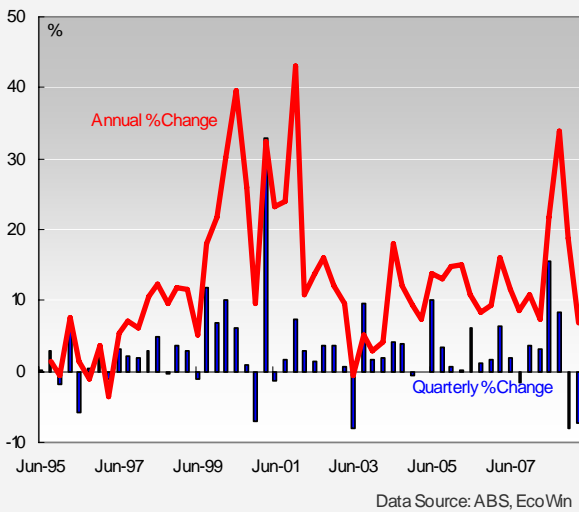
Job advertisements fell a further 0.2% in May. It marks the 13th consecutive month of falls. The drop, however, was significantly more subdued than the average falls of 5.5% seen in the prior twelve months. Moreover, the annual rate of contraction improved a touch to 49.1% from 49.9%. Both newspaper (-1.0% m/m, -52.5% y/y) and internet job ads (-0.2% m/m, -48.8% y/y) were down on the month and significantly lower on a year ago.

Retail Trade



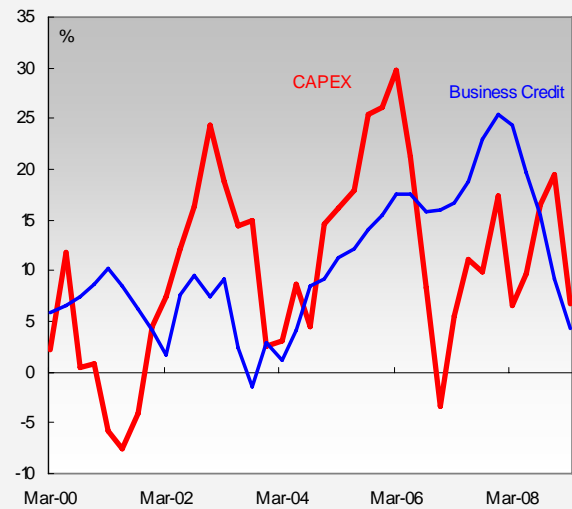
Retail sales edged 0.3% higher in April after a much stronger 2.2% jump in March. The annual rate of retail sales moved up to 6.8%, which is the strongest pace since January 2008. The data shows that the effects of the government cash handouts are still providing some support to retailing. But they appear to be dissipating and once they fully dry out, concerns about job security could once again weigh on the consumer.

Company Profits



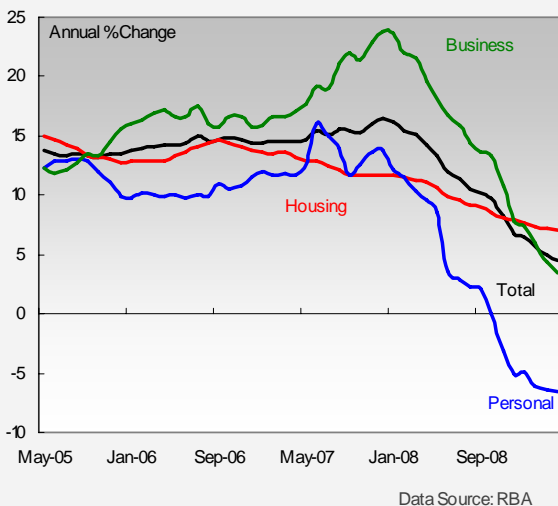
Company gross operating profits fell by 7.2% in the March quarter after an equally large 8.0% drop in the December quarter. The annual rate of growth has eased sharply, to 6.8% from the double-digit rates seen in the second half of last year. Business inventories fell 1.2% in the March quarter, marking the second consecutive quarterly fall. The weak outcomes reflect much slower economic conditions in Australia.

CAPEX



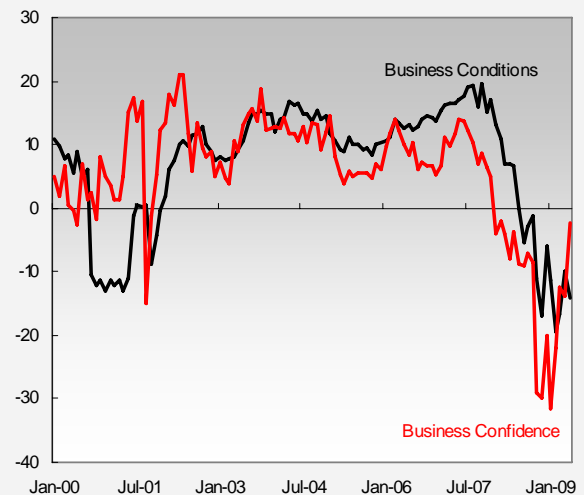
Private new capital expenditures (CAPEX) plunged 8.9% in the March quarter. It marked the first drop since the September quarter of 2007. Given large gains in prior quarters, however, CAPEX is up from a year ago, by 6.8%. Both investment for 'buildings and structures' (-4.7%) and for 'equipment, plant & machinery' (-10.8%) contributed to the large fall in the quarter. Investment intentions in the survey for both 2008-09 and 2009-10 were downgraded, indicating that business investment is set to slow further and that jobs losses are set to grow.

RBA Credit



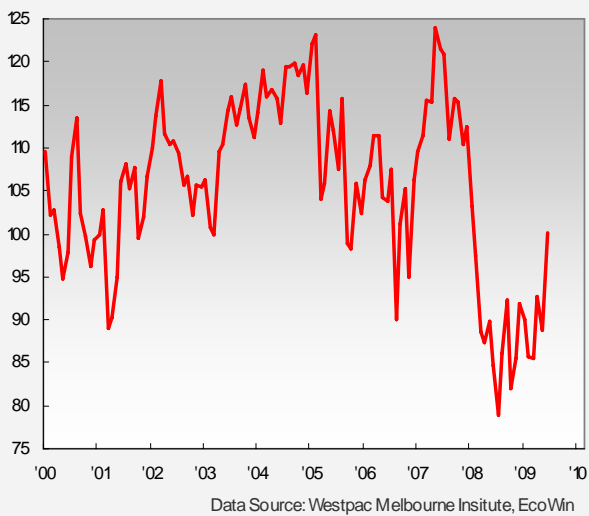
Private sector credit rose only marginally in April, by 0.1%. It follows a similar gain in March and was weaker than market expectations for a 0.3% increase. The annual rate of credit to the private sector slowed further to 4.6% from 4.9% in March and the recent high of 16.4% in December 2007. April's monthly outcome was all due to higher housing credit (+0.7%) but was offset by falls in business credit (-0.5%) and personal credit (-0.3%).

NAB Business Confidence



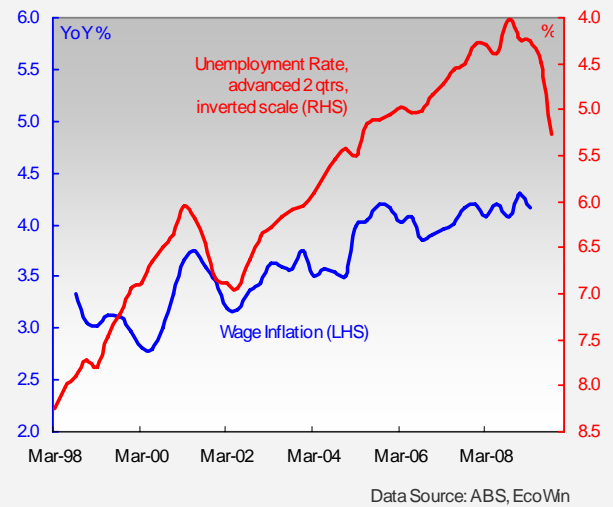
Business conditions deteriorated in May but confidence improved as the government announced further measures in the Federal Budget. The business conditions index dropped 4 points to -14 points and was dragged down by a sharp plunge in the employment component. But business confidence surged 12 points in the month to -2 points. It reflected improvements in construction, manufacturing and wholesale.

WMI Consumer Confidence



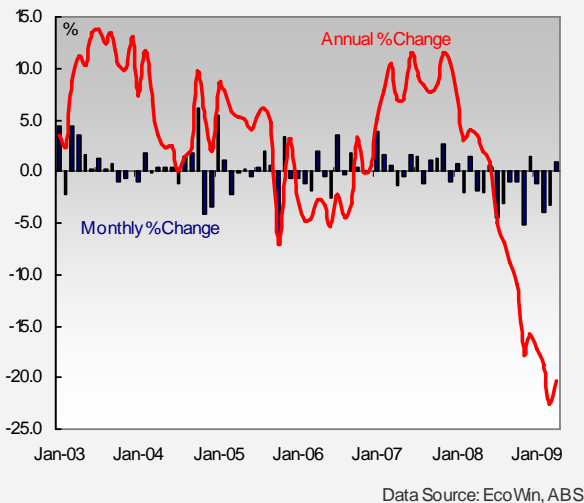
Consumer confidence jumped 12.7% in June, marking the largest monthly improvement in 22 years. It also represents the second largest increase on record since the survey began in 1974. The improvement comes amid further signs of 'green shoots' in the global economy (i.e. improvements in various economic and financial indicators) appearing in various economies across the globe.

Wage Cost Index



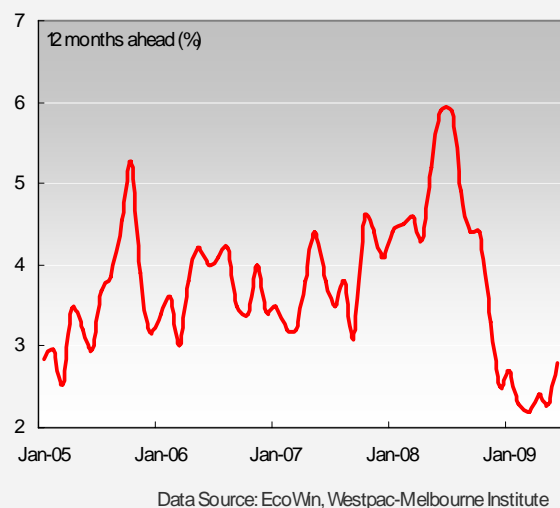
The Wage Price Index (WPI) - which measures total hourly rates of pay excluding bonuses - rose by 0.8% in the March quarter. It brought the annual wage inflation rate down to 4.2% from 4.3% previously. It remains below the RBA's 'perceived' line in the sand of 4.5%pa. The recent easing (and expected continued deterioration) in employment conditions suggests that wage inflation should continue to trend lower.

Vehicle Sales



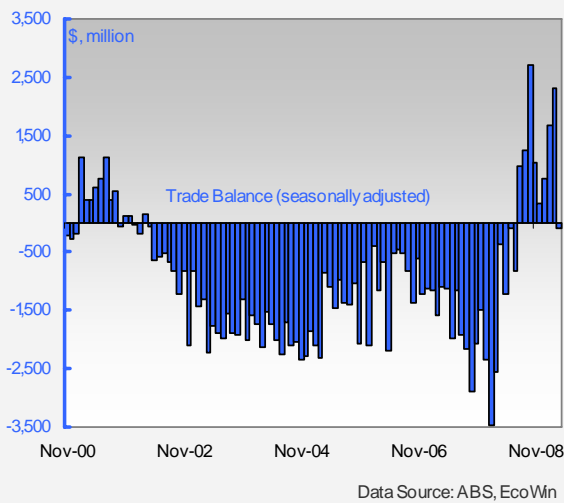
New motor vehicle sales in Australia rose 0.9% in April after falling for three consecutive months. It reflected a 3.4% gain in SUVs and a 1.8% increase in passenger vehicles in the month. The small business investment allowance and government cash handouts may have provided a boost in the month. The annual rate of new motor vehicle sales remains sharply in negative territory with sales down 20.3%. The sharp decline over the year illustrates that consumers have moved away from spending on big-ticket items amid the fragile economic climate.

Inflation Expectations



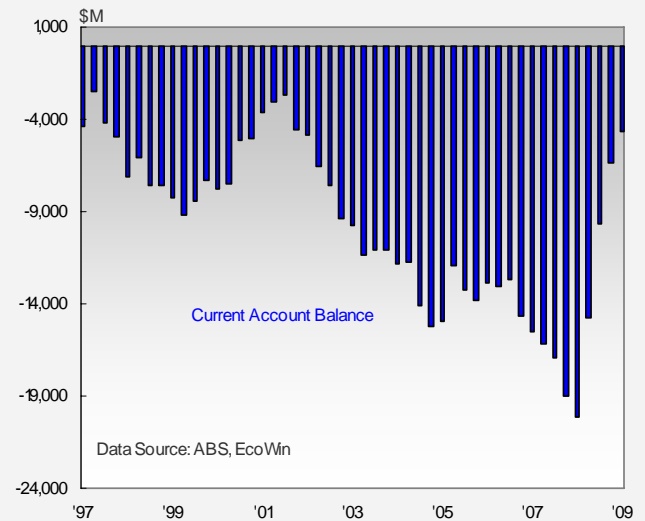
The WMI measure of consumer inflation expectations for the next 12 months picked up in June to 2.8%pa from 2.3% previously. The increase was likely on the back of higher economic optimism with consumer confidence having surged by the most in 22 years in that month. Inflation expectations are, however, still well below the recent peak of 5.9% reached in the middle of last year. This was when the economy was growing much closer to its long-term potential of 3.5%.

International Trade



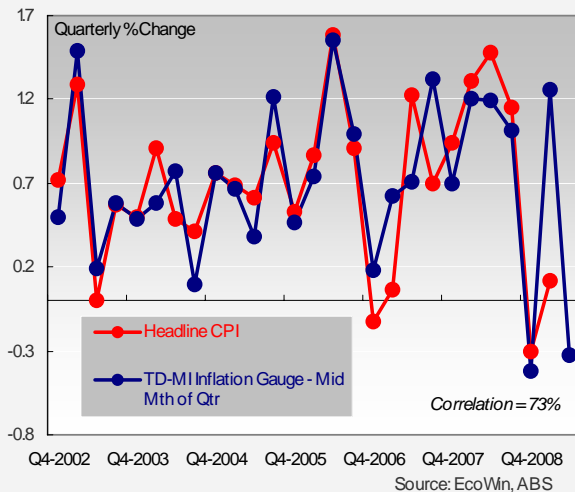
Australia's trade balance swung sharply to a deficit of \$91mn in April from a surplus of \$2.3bn in March. In the eight months prior to April, the trade balance had posted surpluses averaging around \$1.4bn per month. April's deficit was caused by an 11.3% price-led plunge in exports and as Australian goods became less competitive given the rebound in the Australian dollar. It was the largest drop in nearly twelve years. Imports were down by 1.7%.

Current Account



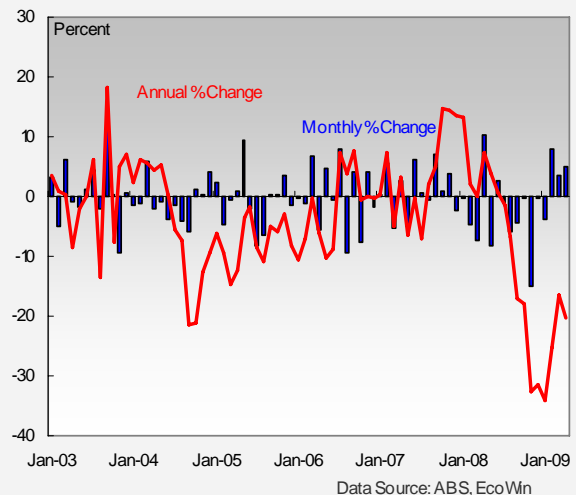
Australia's current account deficit was much better than expected in the March quarter, narrowing to \$4.6bn from \$6.4bn. A sharp improvement in the balance on goods and services account was a key contributor to the decline in the current account deficit. Improvements in the net income deficit (of 8.0%) and the international investment position (of 3.0%) also helped.

TD-MI Inflation



TD-MI's consumer price measure fell 0.3% in May after a flat reading in April. This brought the annual inflation rate down from 2.1% to a record low pace of 1.5%. Downward influences on the measure in the month were lower rents and lower costs for holiday travel and accommodation and alcoholic drinks. Rents were down 1.5% in May to be 4.5% lower since March. TD-MI's measure of underlying inflation also fell in the month, by 0.2%. The annual rate slowed to 1.9% from 2.4%.

Building Approvals

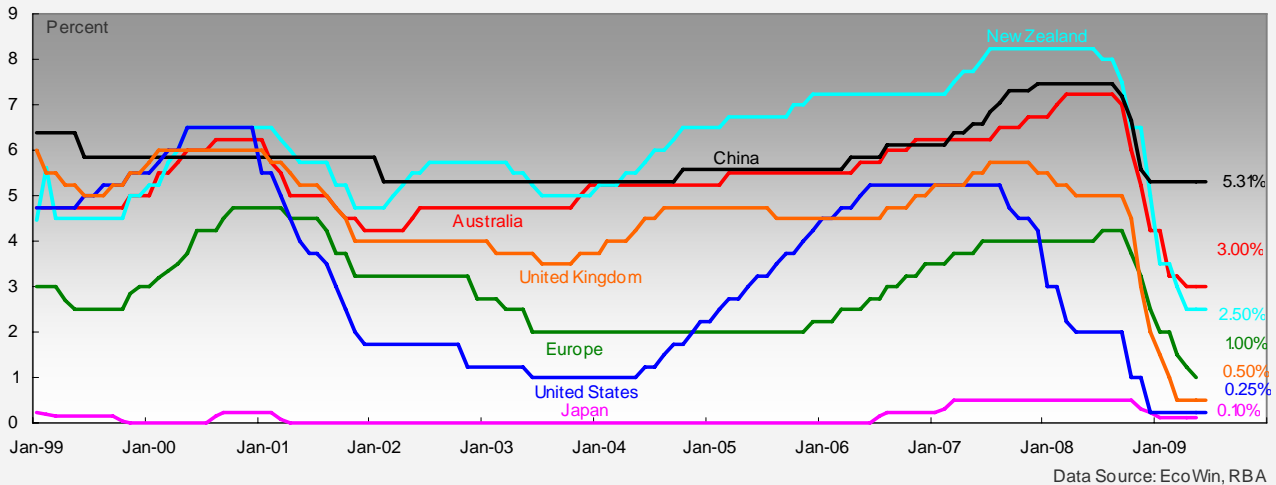


The number of dwelling units approved jumped 5.1% in April. It marks the third consecutive month of significant gains with approvals having increased 6.3% in March and 8.7% in February. From a year ago, however, approvals are still significantly lower, by 16.1%. Nonetheless, the data continues to show the flow-through effect of the recent large increases in new home loans. We expect very low interest rates and the First-Home Owners Grant (FHOG) to continue to provide support to housing construction in the near-term.

Interest Rate Markets

Central Bank Outlook

Central Bank's Official Interest Rates



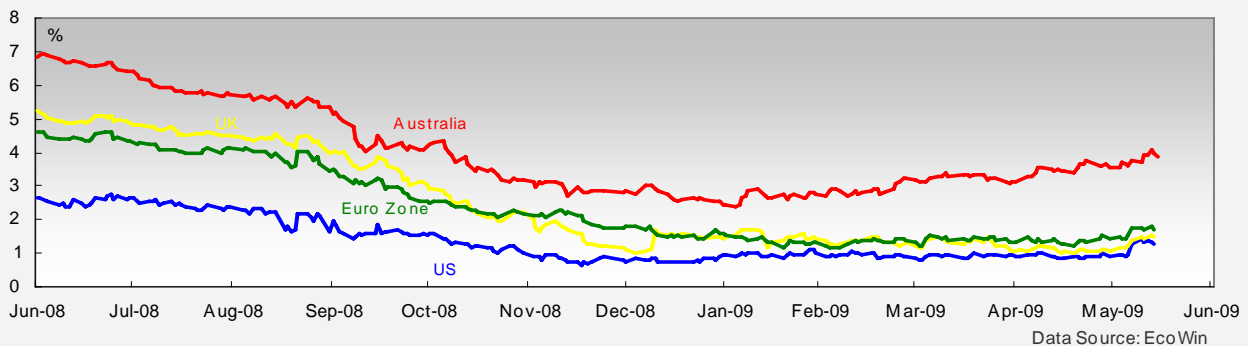
The RBA left its official interest rate unchanged at 3% this month, as was widely expected. The central bank explained that there are growing signs of a stabilisation in the global economy given the considerable macroeconomic stimulus in place. Financial market conditions have also improved. The central bank noted that the economic turnaround is most noticeable in China and some other emerging countries.

The RBA, however, also cautioned that confidence still remains fragile, balance sheets under pressure and credit is still tight. Domestically, business borrowing is falling amid tighter lending standards. Meanwhile, inflation should continue to ease in the next two years, taking its lead from the slowdown in the domestic economy. A new phrase included in this month's statement also indicates that the door is still being left open for further rate cuts. The RBA said that, "...the prospect of inflation declining over the medium term suggests that scope remains for some further easing of monetary policy, if needed". But with the full effects of the monetary and fiscal policy stimulus yet to be felt, the probability for further easing will depend on how economic and financial conditions unfold. Our central forecast is for rates to reach a low point of 2.50% by the end of the year. But we also acknowledge that if economic and financial conditions continue to improve, then there is also the possibility that interest rates could have bottomed.

Elsewhere, the major central banks left interest rates unchanged with rates in these countries already at very low levels. In the US, however, markets are pricing in some chance that the Fed could start to hike rates before the end of this year; futures markets currently attach a 38% chance to a 25bp rate hike. We, however, believe that such pricing is overdone. While a global economic recovery is likely to get underway later this year or early next year, we think the markets are pricing in too strong a recovery too soon. The weak global economy remains vulnerable.

Bond Yields

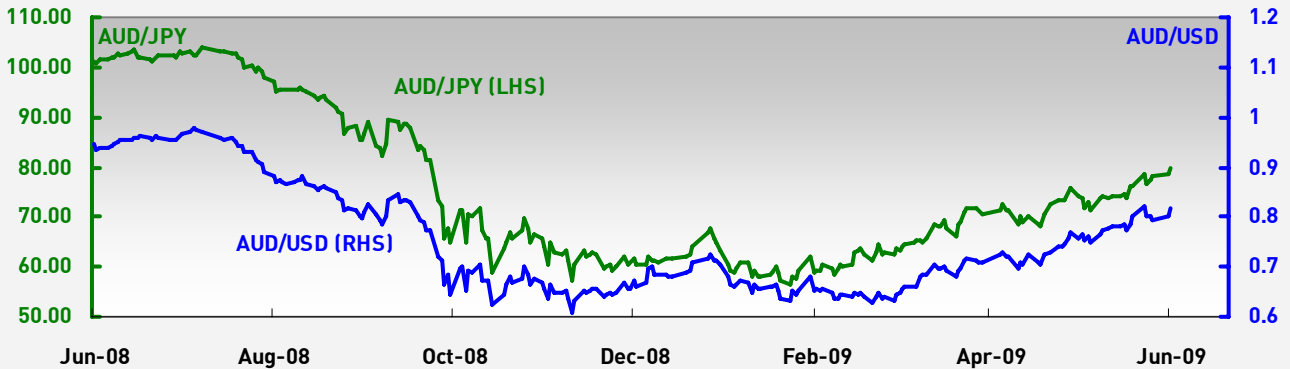
Global 2-Year Bond Yields



The rise in government bond yields has continued. This occurred on the back of growing economic optimism surrounding a recovery in global growth and greater bond supply. Since the end of April, 2-year yields rose by 31bp in the US, 33bp in the UK, 28bp in the Eurozone region and 60bp in Australia.

Currency Markets

Australian Dollar

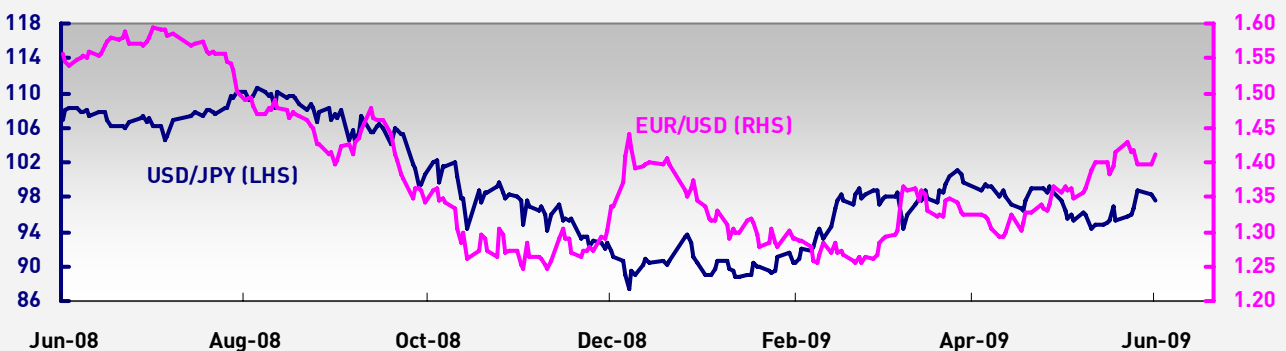


Data Source: EcoWin

The Australian dollar has risen strongly over the past month on growing optimism about the global economy's prospects. The AUD is now trading at just above USD0.7900 but had traded as high as USD0.8263 on June 3. We have highlighted before in this report that the AUD tends to be a bellwether for global growth prospects. Accordingly, investors' growing view of improved global growth prospects has pushed the AUD up substantially. Reflecting this sharp improvement in sentiment has been a surge in equity markets to be well above their lows. The ASX 200 index, for example, is around 26% higher from the recent lows reached in March 2009. The AUD is very closely correlated to movements in the equity market, which are a reflection of investor sentiment or investors' willingness to take on risk.

In the near term, however, we still see the risk of a further correction lower and expect the AUD/USD to end this quarter below 80 US cents. It is because the currency appears overvalued based on its correlation with some key fundamentals, such as the Baltic Dry Index (which tracks freight prices for dry bulk goods). But we believe the currency will resume its upward trend and end the year near US 83 cents. The AUD could benefit from an even higher level of economic optimism as we move closer to the anticipated recovery in global growth later this year.

Global Currencies

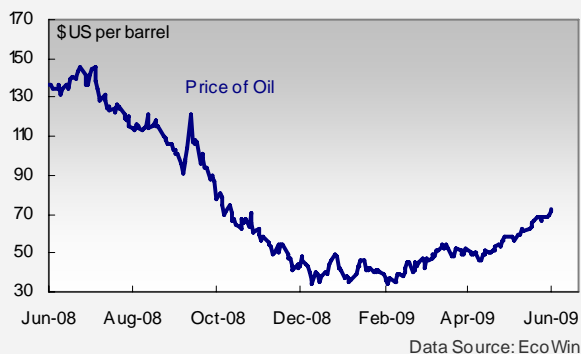


Data Source: EcoWin

The US dollar sold off further over the month. It is down 4.4% on a trade-weighted basis. Against the majors, it has depreciated 4.6% and 10.3% against the euro and sterling, respectively, but is 2.4% higher versus the Japanese Yen. The USD has depreciated as rising economic optimism caused an unwinding of safe-haven and repatriation flows into the US. The past month also saw concerns surrounding the growing twin deficits in the US and the threat this creates for the US credit outlook. These concerns were sparked after Standard & Poors (S&P) downgraded the credit outlook for the British economy, posing downside risks to the UK's AAA credit rating. S&P said that the outlook for the UK was "negative and no longer stable". In terms of the US, Moody's Investor Services has declared that it is comfortable with the AAA sovereign rating in the US, although it also said that this is not guaranteed to be the case forever. We think that the US economy will be the first major economy to come out of the global financial crisis, and this may lend some support to the USD later in the year.

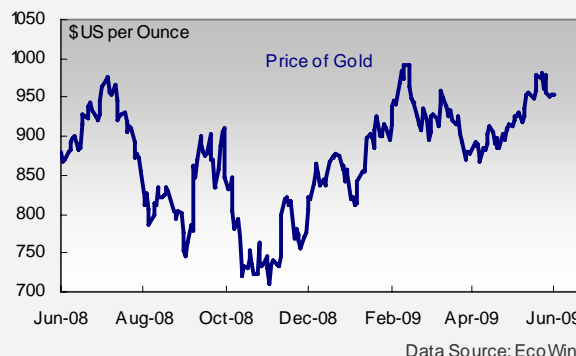
Commodity Markets

Oil



The oil price jumped a further \$US19.10 a barrel (37.4%) over the month to trade above \$US70 per barrel. It extends the uptrend that began around the middle of February 2009. Continued improvements in various economic indicators across the globe have added to expectations that global growth could resume later this year. Such hopes for a recovery have brightened the oil demand outlook, and hence, pushed up the oil price. These projections for an improvement in the global economy have also fuelled concerns surrounding longer-term inflationary pressures. As a result, there has been a revival of interest in commodities as an investor class. The weaker US dollar has also been another key factor providing support to the price of oil. From a year ago, however, oil is still down heavily (by 47.9%).

Gold & Base Metals

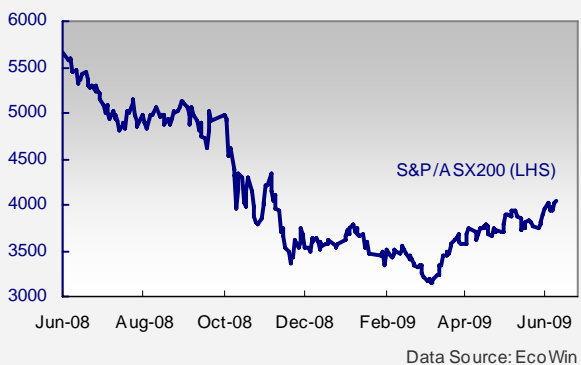


The price of gold rose US\$44.77 an ounce (or 5.0%) to \$US933 an ounce currently (+7.0% y/y). Although in dollar terms the increase in gold over the month may seem large, in percentage terms, the gain was well below what was observed in the oil price. Gains in the gold price have been capped by increased investor optimism. Gold, as a safe-haven asset, typically benefits from increased investor pessimism and vice versa.

Base metal prices were also boosted by the weaker USD and economic optimism. The LME basket of base metal prices rose by 13.6% since the end of April and is up 37.2% on a year ago. Gains were seen across the board with the best performers nickel (+26.5%), lead (+26.1%), tin (+21.6%). Copper (13.0%), zinc (+10.5%) and aluminium (7.8%) also posted firm gains.

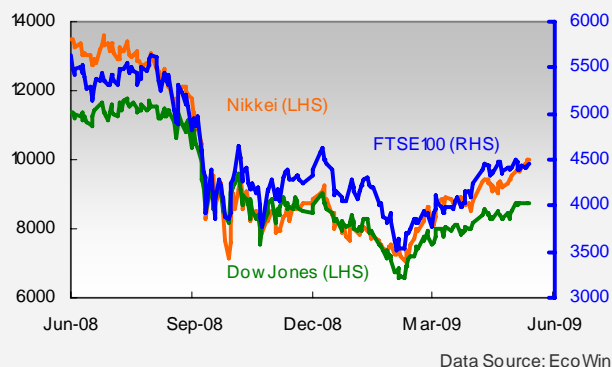
Share Markets

Australia



The S&P/ASX200 gained 4.8% over the month and is a hefty 26% higher from the lows reached in March 2009. The best performing share market sectors were materials (+13.7%), energy (+8.4%), industrials (+8.1%), followed by financials (+6.5%) and consumer discretionary stocks (+4.9%). The other major sectors fell by between 0.1% and 4.0%.

International Markets



The US Dow Jones Index surged 5.4% since the end of April and is 31.5% higher from the recent low point in March 2009. Most other equity markets also enjoyed strong rallies. The Japanese Nikkei was up 10.5%, the German DAX rose 2.5%, the Hong Kong Hang Seng jumped 15.8% and the Shanghai Composite Index surged 11.9%. The FTSE100, however, only rose 1.9%.

Recent Australian Data

Red – Indicates the result was **weaker** than consensus expectations

Blue – Indicates the result was **stronger** than consensus expectations

Black – Indicates the result was **in line** with consensus expectations

<p>June 2009 WMI Consumer Confidence +12.7%, Previous -4.3% 10/6</p> <p>May 2009 Employment -1.7k, Consensus -30k 11/6 ANZ Job Ads -0.2%, Previous -7.5% 9/6 NAB Business Confidence -14, Previous -18 9/6 TD-MI Inflation -0.3%, Previous 0.0% 1/6</p> <p>April 2009 Housing Finance +0.9%, Consensus +1.5% 10/6 Trade Balance -\$91m, Consensus +\$1.4bn 4/6 Building Approvals +5.1%, Consensus +2.0% 2/6 Retail Trade +0.3%, Consensus +0.5% 1/6 RBA Credit +0.1%, Consensus +0.3% 29/5 Vehicle Sales +0.9%, Previous -3.3% 21/5 Employment +27.3k, Consensus -25k 7/5 ANZ Job Ads -7.5% m/m, Previous -8.5% 4/5 TD-MI Inflation Gauge 0.0% m/m, Previous +0.7% 4/5</p> <p>March 2009 GDP +0.4%, Consensus +0.2% 3/6 Current Account -4.6bn, Consensus -5.5bn 2/6 Inventories -1.2%, Consensus -1.4% 1/6 Company Profits -7.2%, Consensus -4.5% 1/6 CAPEX -8.9%, Consensus -5.0% 28/5 Wage Cost Index +0.8%, Consensus +0.8% 20/5</p>	<p>Housing Finance +4.9%, Consensus +4.5% 12/5 Trade Balance \$2.5bn, Consensus \$1.9bn 6/5 Retail Sales (Volumes) +1.0% q/q, Consensus +0.8% 6/5 Retail Sales (Nominal) +2.2% m/m, Consensus +0.5% 6/5 Building Approvals +3.5%, Consensus +2.3% 5/5 ABS House Price Index -2.2% q/q, Consensus 0.0% 4/5 RBA Credit +0.1%, Consensus +0.3% 30/4 CPI +0.1% q/q, Consensus +0.5% 22/4 PPI -0.4% q/q, Consensus +0.6% 20/4 NAB Business Confidence -17, previous -20 14/4 Employment -34.7k m/m, Consensus -25k 9/4 ANZ Job Ads -8.5% m/m, Previous -10.4% 6/4 TD-MI Inflation -0.1% m/m, Previous +0.7% 6/4 WMI Consumer Confid -0.2% m/m, Previous -4.6% 11/3</p> <p>February 2009 Trade Balance \$2.1bn, Consensus \$0.7bn 2/4 Retail Sales -2.0% m/m, Consensus -0.5% 1/4 Building Approvals +7.8% m/m, Consensus +1.8% 1/4 Private Sector Credit 0.0% m/m, Consensus +0.5% 31/3 Employment Change 1.8k, Consensus -20k 12/3 NAB Business Confidence -22 pts, Previous -32 10/3 TD-MI Inflation Gauge 0.7% m/m, Previous 0.8% 2/3 WMI Consumer Confidence -4.6% m/m, Previous 2.2% 11/2</p>
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Upcoming Data and Events – Australia & US

Australian Data / Events Underlined

<p>June 16 <u>AU RBA Board Minutes, June</u> US PPI, May US Housing Starts, May</p> <p>June 17 <u>AU Dwelling Commencements, Q1</u> <u>AU WMI Leading Index, Apr</u> US Consumer Price Index, May US Current Account Balance, Q1</p> <p>June 18 <u>AU RBA Monthly Bulletin</u> <u>AU Merchandise Imports, May</u> US Initial Jobless Claims, June 13 US Leading Indicators, May US Philadelphia Fed Mfg Index, Jun</p>	<p>June 22 <u>AU New Motor Vehicle Sales, May</u></p> <p>June 23 US House Prices, May US Existing Home Sales, May US Richmond Fed Mfg Index, June</p> <p>June 24 US Durable Goods Orders, May US New Home Sales, May US FOMC Interest Rate Decision</p> <p>June 25 US GDP, Q1 Final Estimate US Personal Income, Q1 US Initial Jobless Claims, June 21</p> <p>June 26 US Personal Income, May</p>	<p>US UoM Consumer Sentiment, Jun</p> <p>June 30 <u>AU HIA New Home Sales, May</u> AU RBA Private Sector Credit, May US S&P/CS Home Prices, April US Chicago PMI, June US Consumer Confidence, June</p> <p>July 1 <u>AU Retail Sales, May</u> <u>AU Building Approvals, May</u> US ADP Employment, Jun US Pending Home Sales, May</p> <p>July 2 <u>AU Trade Balance, May</u> US Non Farm Payrolls, Jun</p>
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Forecasts

End Period:	2008		2009			2010		
	Q3	Q4	Q1	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)
RBA Cash, %	7.00	4.25	3.25	3.00	2.50	2.50	2.50	3.00
3 Year Bond, %	5.09	3.90	3.40	3.80	3.90	4.10	4.30	4.50
10 Year Bond, %	5.40	3.99	4.42	5.10	5.40	5.90	6.10	6.20
AUD/USD	0.7924	0.7073	0.6913	0.7800	0.8000	0.8300	0.8500	0.8600
USD/JPY	106.11	90.60	98.96	102.00	104.00	106.00	107.00	108.00
EUR/USD	1.4092	1.3978	1.3250	1.3800	1.3900	1.3800	1.3800	1.3800
GBP/USD	1.7805	1.4626	1.4323	1.6600	1.7000	1.7200	1.7400	1.7600
USD/CHF	1.0644	1.0669	1.1394	1.1000	1.1200	1.1300	1.1400	1.1500
USD/CAD	1.1221	1.2165	1.2602	1.1300	1.1500	1.1600	1.1650	1.1700
NZD/USD	0.6698	0.5835	0.5595	0.6400	0.6700	0.6900	0.7000	0.7100
USD/CNY	6.8460	6.8225	6.8339	6.8300	6.8200	6.8100	6.8000	6.7900
AUD/EUR	0.5623	0.5055	0.5217	0.5650	0.5760	0.6010	0.6160	0.6230
AUD/JPY	84.08	64.03	68.41	79.60	83.20	88.00	91.00	92.90
AUD/GBP	0.4451	0.4835	0.4827	0.4700	0.4710	0.4830	0.4890	0.4890
AUD/CHF	0.8892	0.7549	0.7877	0.8580	0.8960	0.9380	0.9690	0.9890
AUD/CAD	0.8435	0.8604	0.8712	0.8810	0.9200	0.9630	0.9900	1.0060
AUD/NZD	1.1830	1.2109	1.2356	1.2190	1.1940	1.2030	1.2140	1.2110
AUD/CNY	5.4248	4.8256	4.7243	5.3270	5.4560	5.6520	5.7800	5.8390

Source: Bloomberg for historical data. St George forecasts are effective 7 April 2009 and AUD cross exchange rates have been rounded.

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