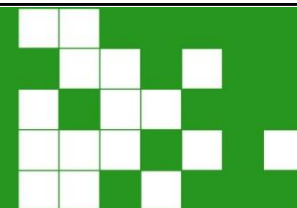




# Macquarie Research Strategy



## Macquarie's Snapshots of Australian, US and Global Economies and Financial Markets

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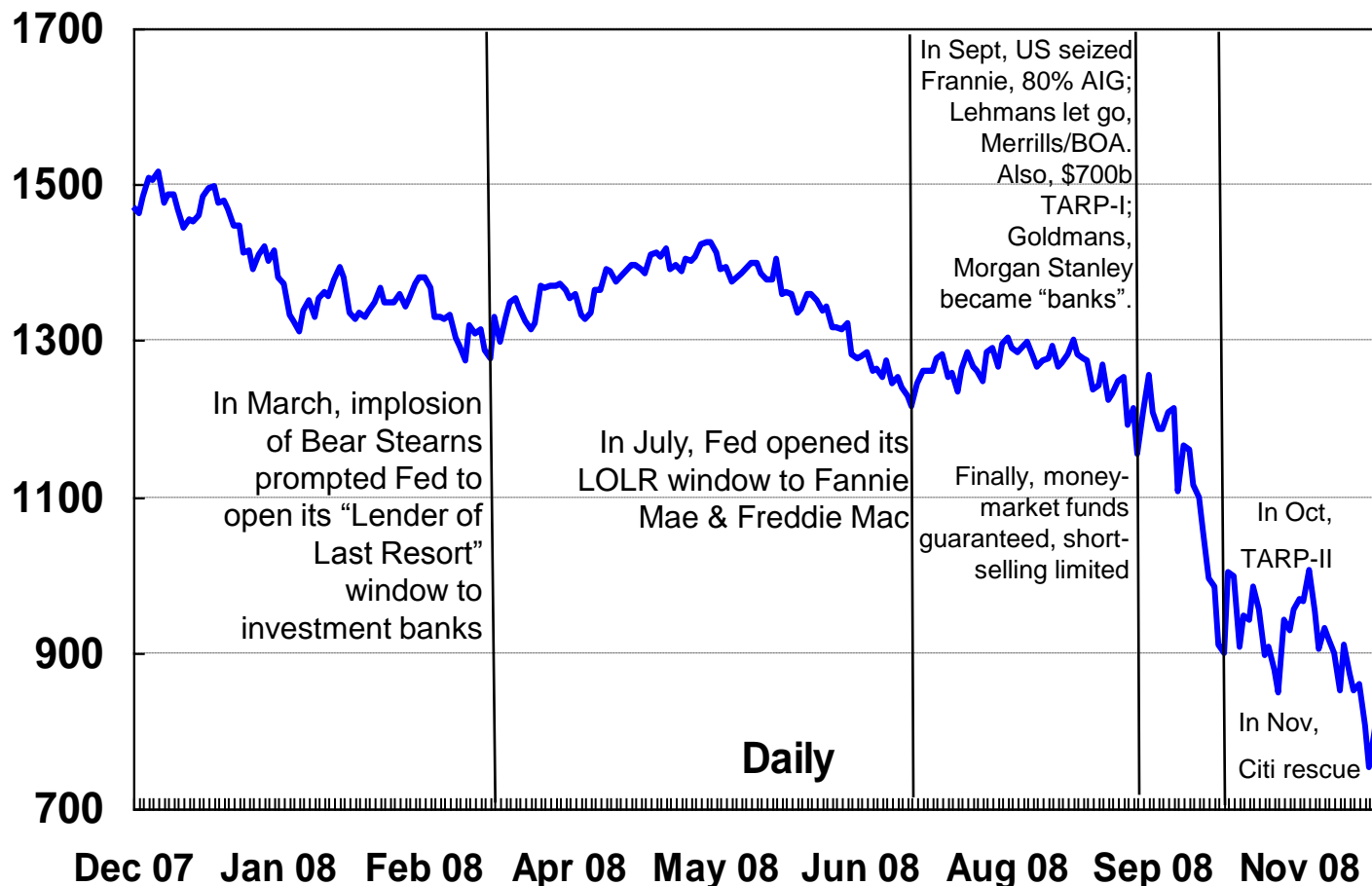
In preparing this research, we did not take into account the investment objectives, financial situation and particular needs of the reader. Before making an investment decision on the basis of this research, the reader needs to consider, with or without the assistance of an adviser, whether the advice is appropriate in light of their particular investment needs, objectives and financial circumstances. Please see disclaimer.



# US interventions and equity prices

(S&P 500 highly correlated with global equity prices)

S&P 500  
Index



Source: Bloomberg, Macquarie, November 2008

## How bad is “global credit crunch”?

***...we are passing through the most prolonged period of financial turmoil that most of us can remember.***

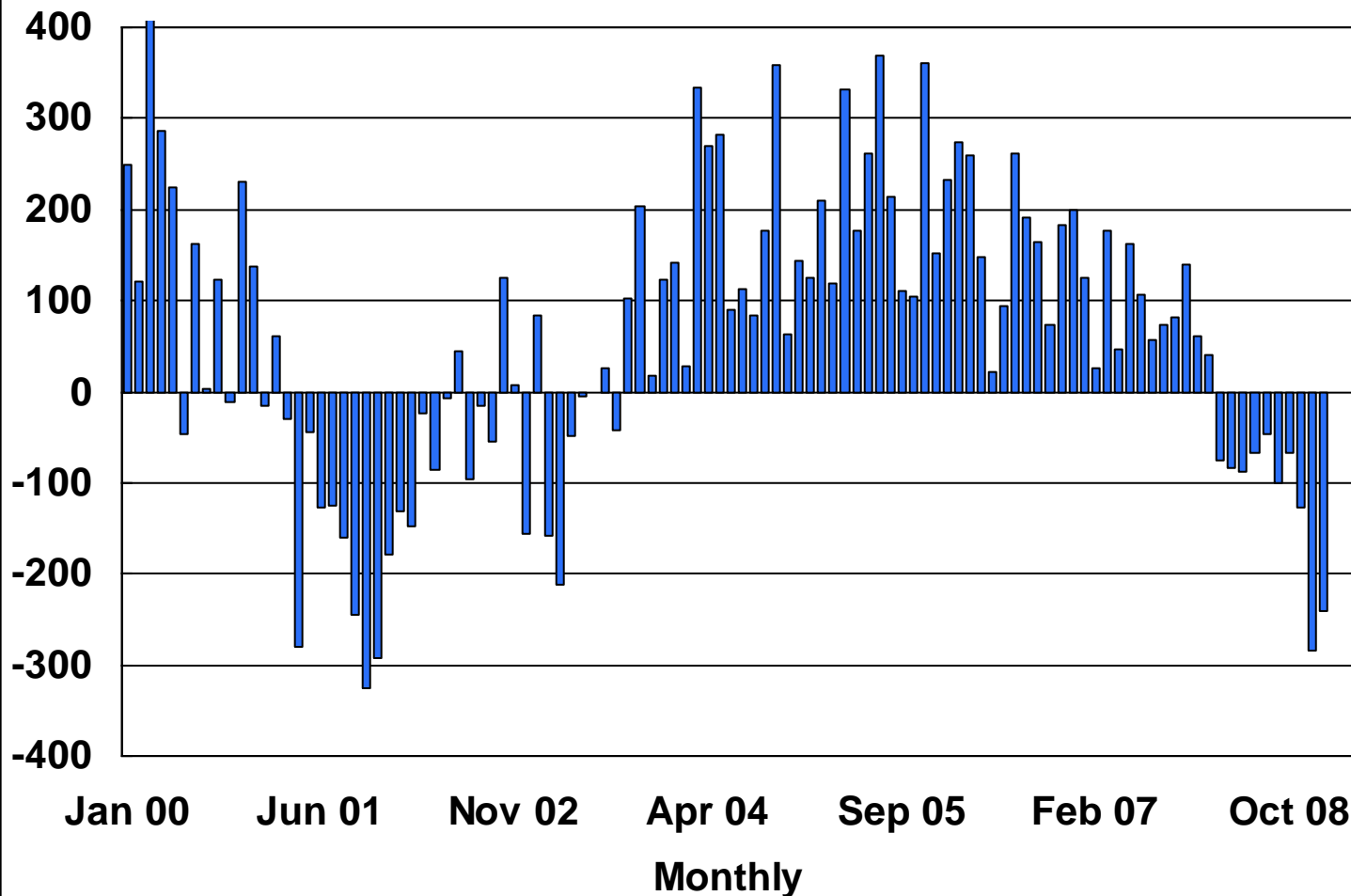
***Whether, as the IMF has argued, it is the worst period of financial stress since the 1930s is too early to judge.***

***After all, the crisis is not yet over.***

BOE Governor Mervyn King (10 June)

# US non-farm payroll employment

Chg on Prev Mth, 000s



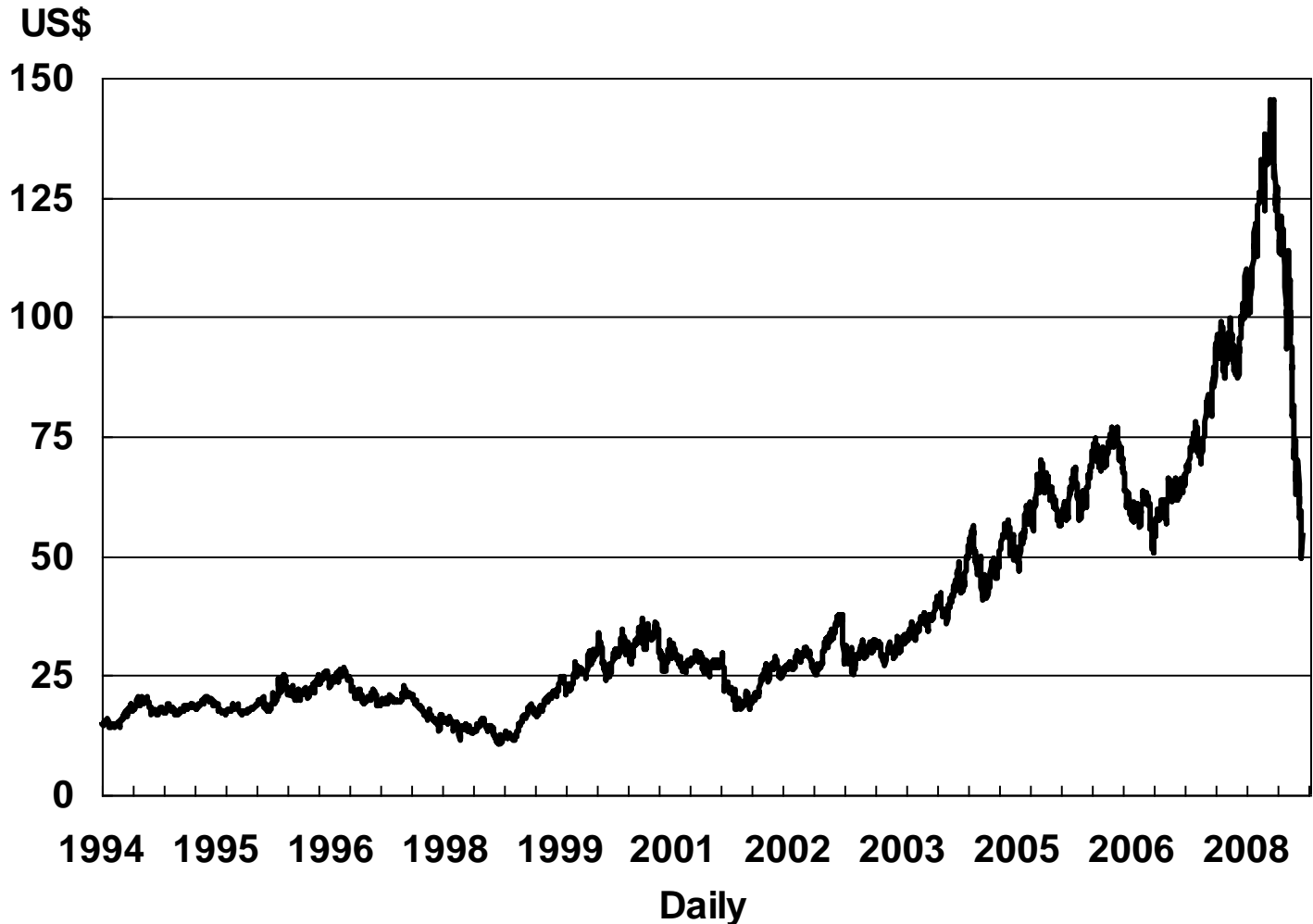
Source: BLS, November 2008

## Global recession via intensifying credit crunch

- **US & UK economy in increasingly severe recessions.** Rest of G7 - Canada, Japan, Germany, France & Italy – also shrinking. Ditto Spain, Portugal, Ireland, Iceland & NZ. OECD GDP shrinking, while big developing economies – BRICs – slowing fast
- **Main problem: intensifying “credit crunch”.** Credit availability tightening everywhere, forcing weaker spending and jobs growth
- **China’s GDP growth moderating from 12-13% pace in 2007.** Timely data elusive but China’s GDP growth (say) halving to 6% growth is a big deal for Oz. Ditto slowdown across rest of BRICs
- **After collapse of Lehmans in mid-September,** commodity prices – like equities and non-US\$, yen currencies - downshifted sharply as longstanding positions liquidated
- **Main good news: global inflation no longer a problem, killed by rising global unemployment. Third “oil shock” over for now. Policy interest rates coming down fast**

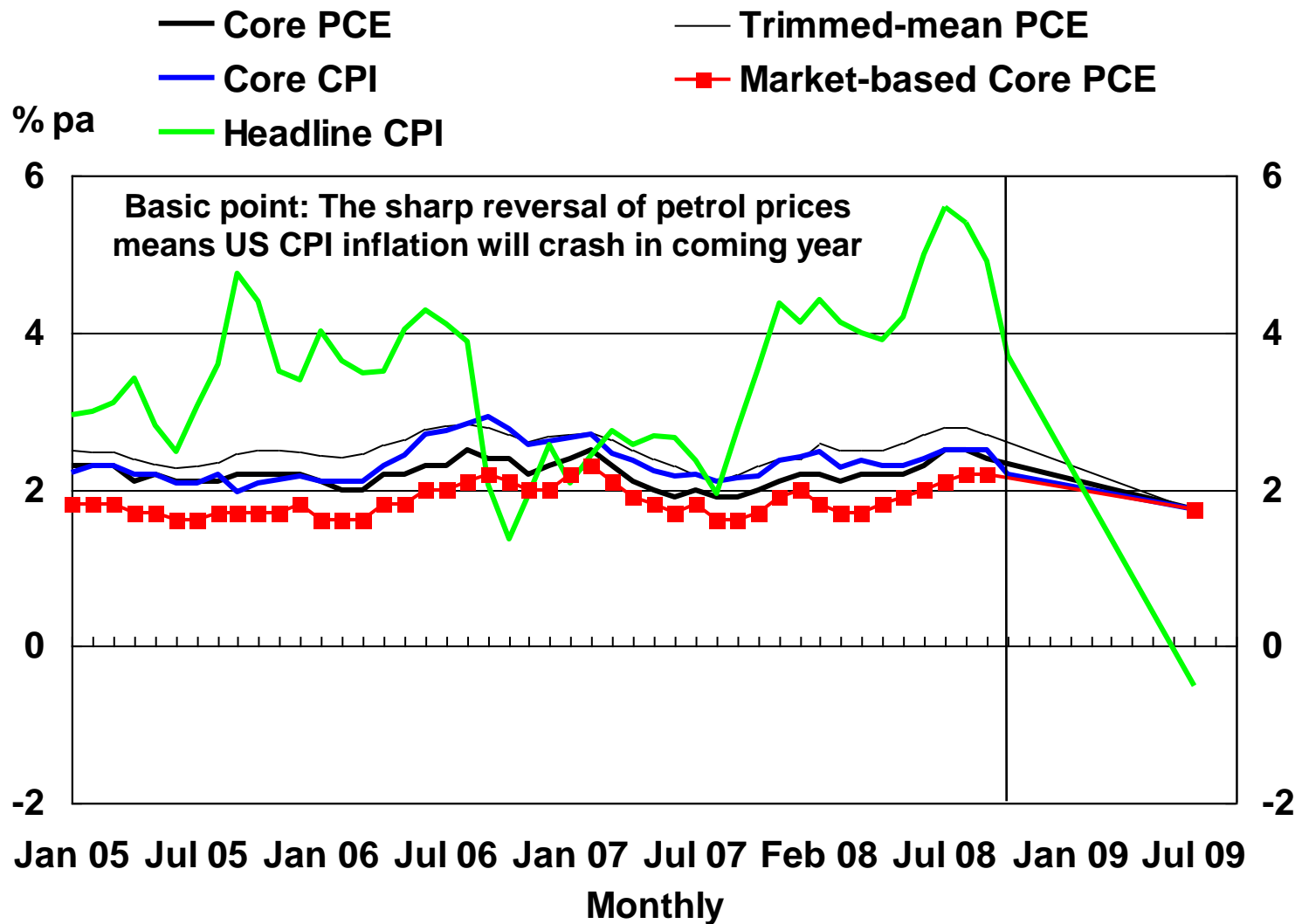


# Oil (US\$, West Texas Intermediate)



Source: Datastream, November 2008

# US measures of inflation



Sources: BEA, BLS, Dallas Fed, MBL guesses, November 2008



## Global credit crunch driving global slowdown

- Past 1-1/2 decades the most prosperous in human history
- Perceptions of “risk” dulled as good times went on & on & on
- Banks were happy to “gear up” anyone with asset or cash flow
- One can’t be too highly geared when asset prices trending higher
- But, as is typical, many bad loans made in good economic times
- “Sub prime” mortgages basically just another big cyclical blunder
- In August 2007, “the music stopped” in money and credit markets
- Drops in US home/MBS prices prompted global shift to risk aversion
- With credit suddenly scarce & expensive, many entities unviable
- Hello “hunkering down”, de-leveraging, sales of “non core” assets
- World banking system now “capital constrained” & rationing credit
- **Problem: credit growth a key driver of GDP growth & asset prices**
- Credit, consumption and jobs decelerating across Western world
- “Feedback loop” as weaker revenues add to problem of excess debt
- Good news: Rising global unemployment killing inflation pressures
- Bad news: Happy ending unavailable to many, insolvencies rising
- Rates: US 1%;Canada 2.25%;Europe 3.25%;UK 3%;Oz/NZ 5.25/6.5%
- New lows in rates: US&Canada 0-1%,Europe&UK 1-2%, Oz&NZ 3-4%

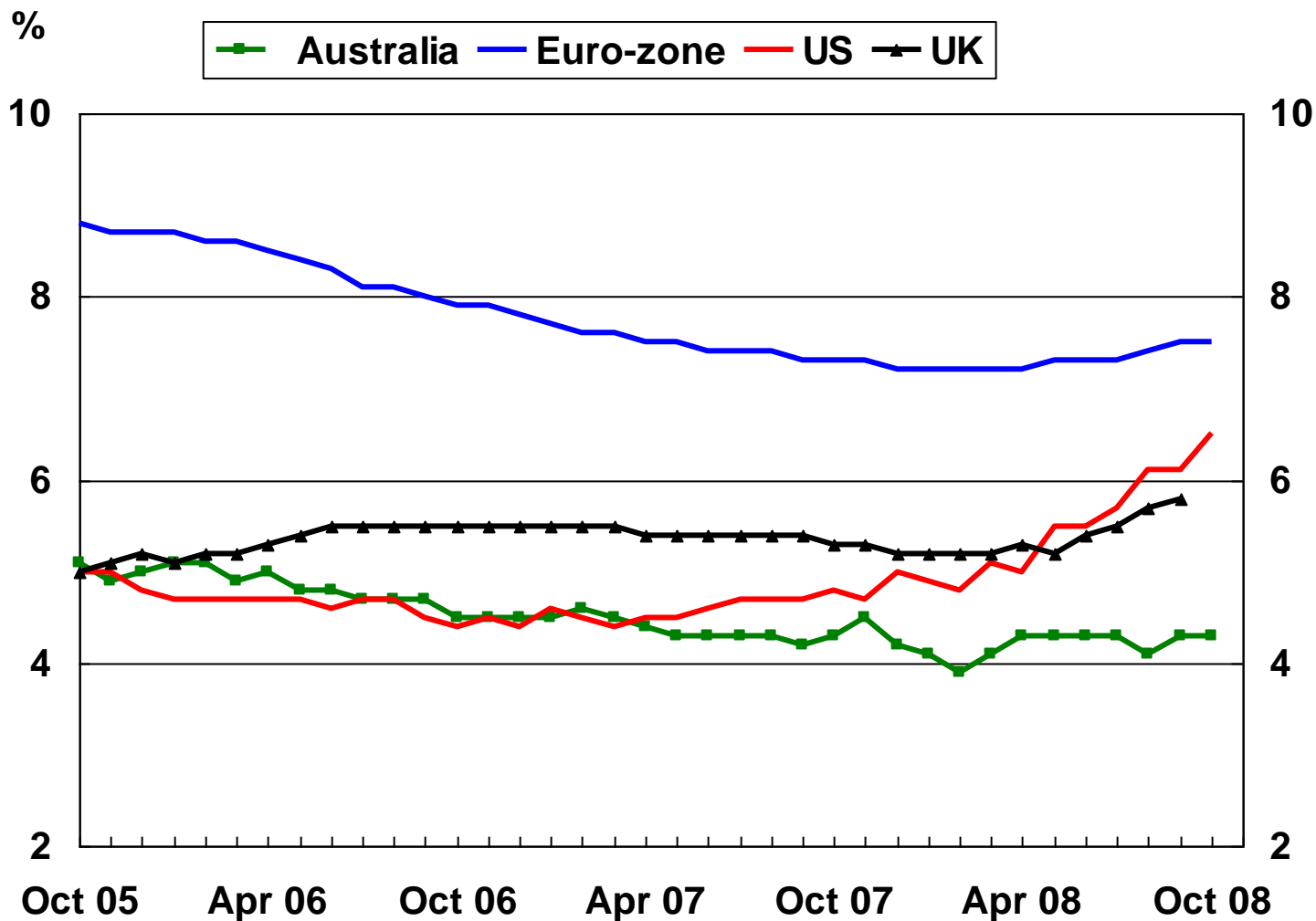


# Why so much focus on banking?

- **Functioning banking and payments systems obviously critical for ability of any economy to function and grow**
- **If lenders won't lend, then economies can't grow. Critically, availability/price of credit is a key driver of asset prices**
- Past financial panics have involved “runs” on banks, so governments around world **guaranteeing deposits**
- Banks everywhere having trouble accessing “term funding”, so governments in many nations assisting with **loan guarantees**
- Government efforts designed to **rebuild investor confidence in solvency of banks and stability of the system**, to avoid disengagement, to stop damaging “hunkering down”
- **US is epicentre of global problems, but spending/revenue growth down and asset prices downshifting everywhere.**  
With interest rates and A\$ down sharply, Australia in better shape than most places



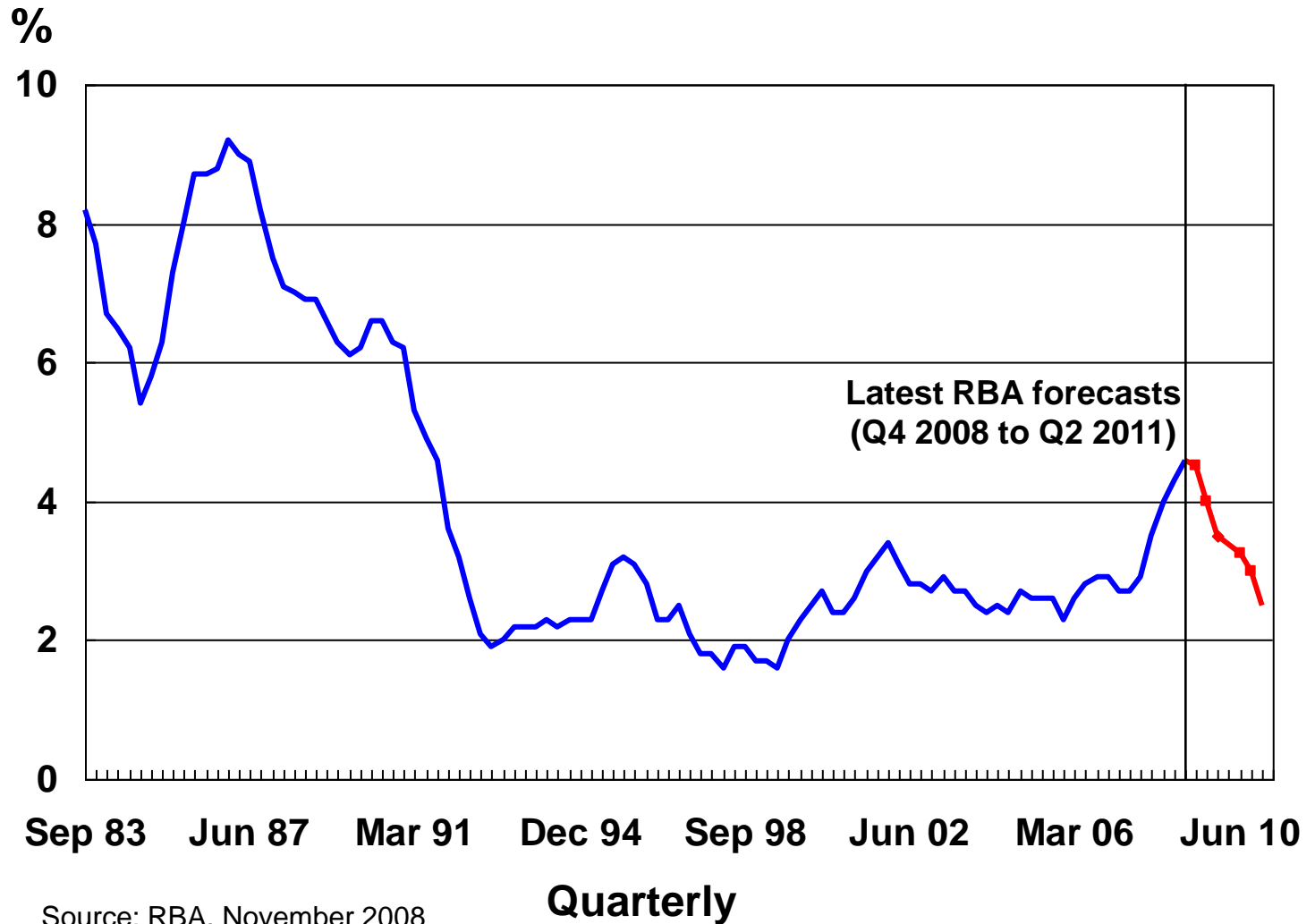
# Unemployment in Oz, E-zone, US & UK



National sources, November 2008

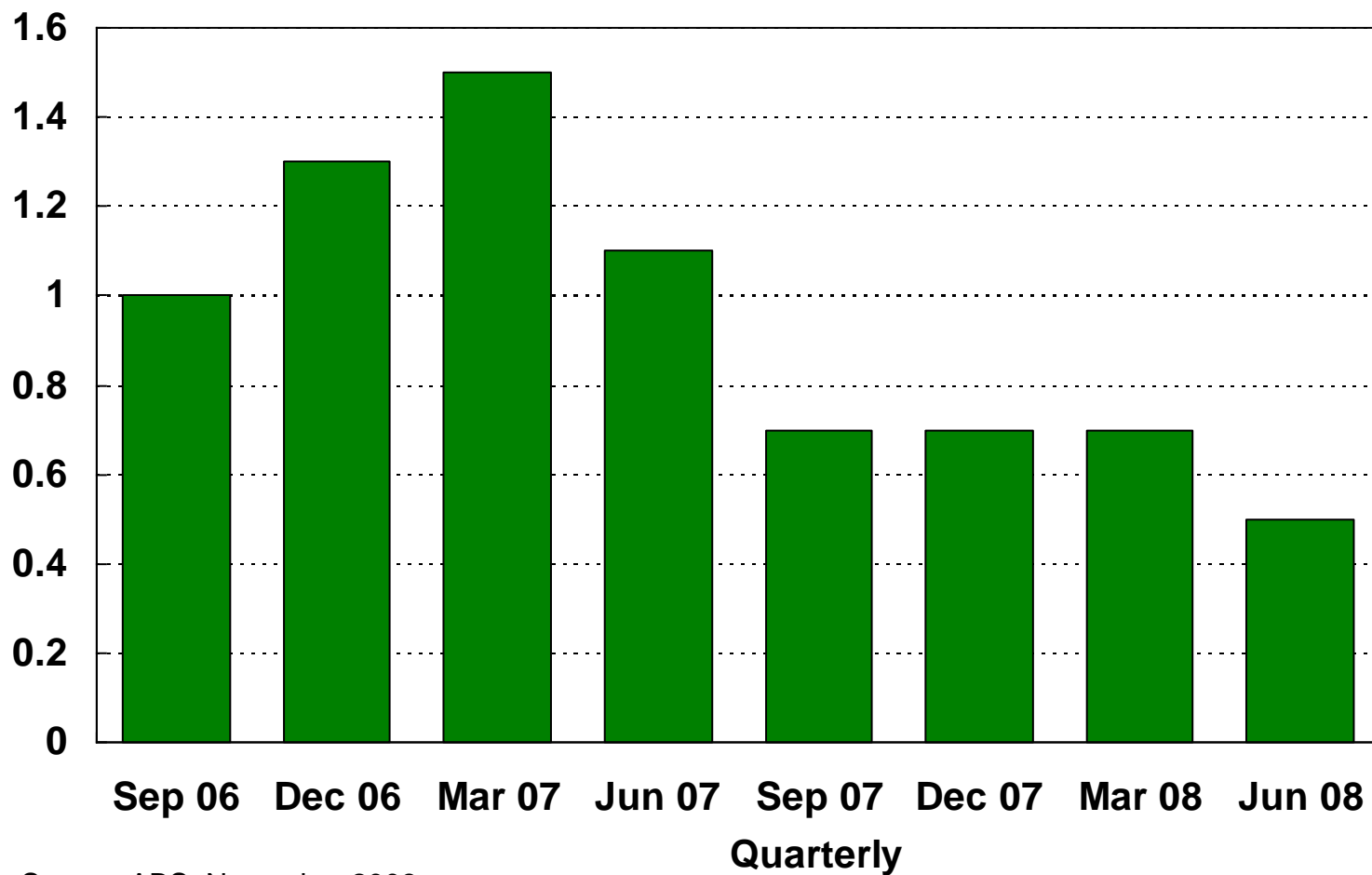


# RBA confident inflation under control ("Trimmed mean" or trend measure)



# Oz Non-farm GDP growth

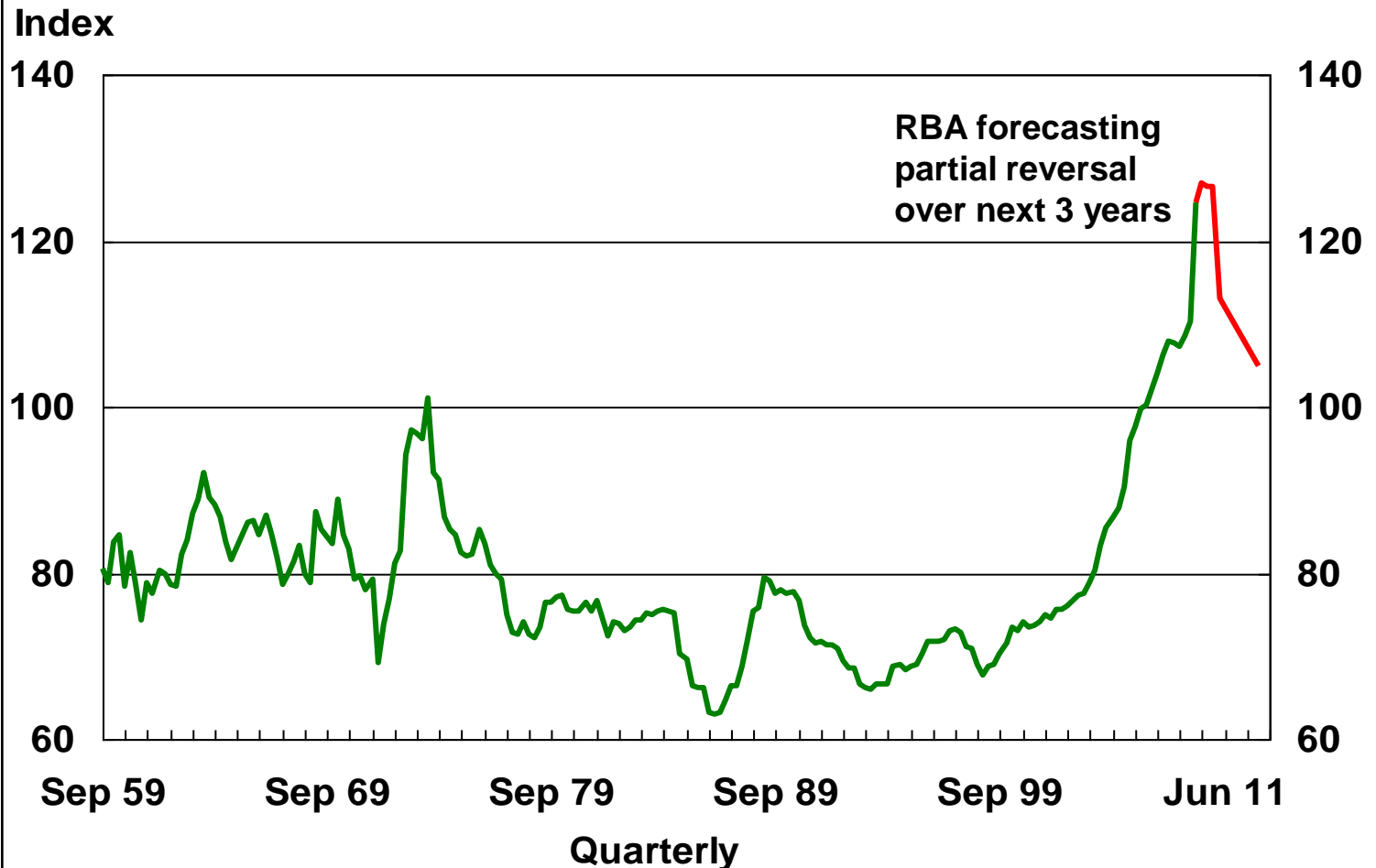
Q/Q % change



Source: ABS, November 2008

# Terms-of-trade boom tough to manage

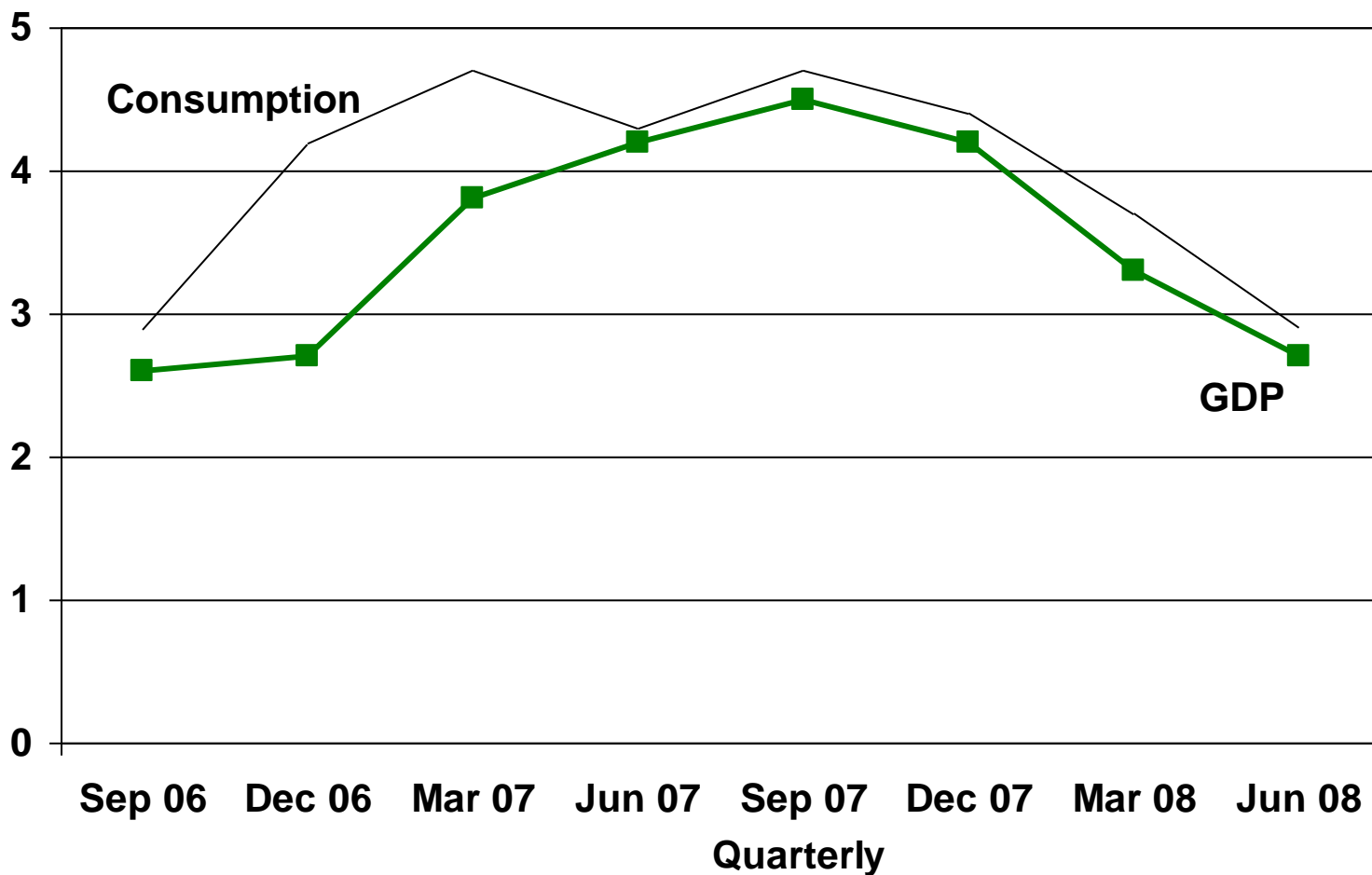
(Export prices/import prices)



Sources: ABS, RBA forecast, November 2008

# GDP and consumption growth

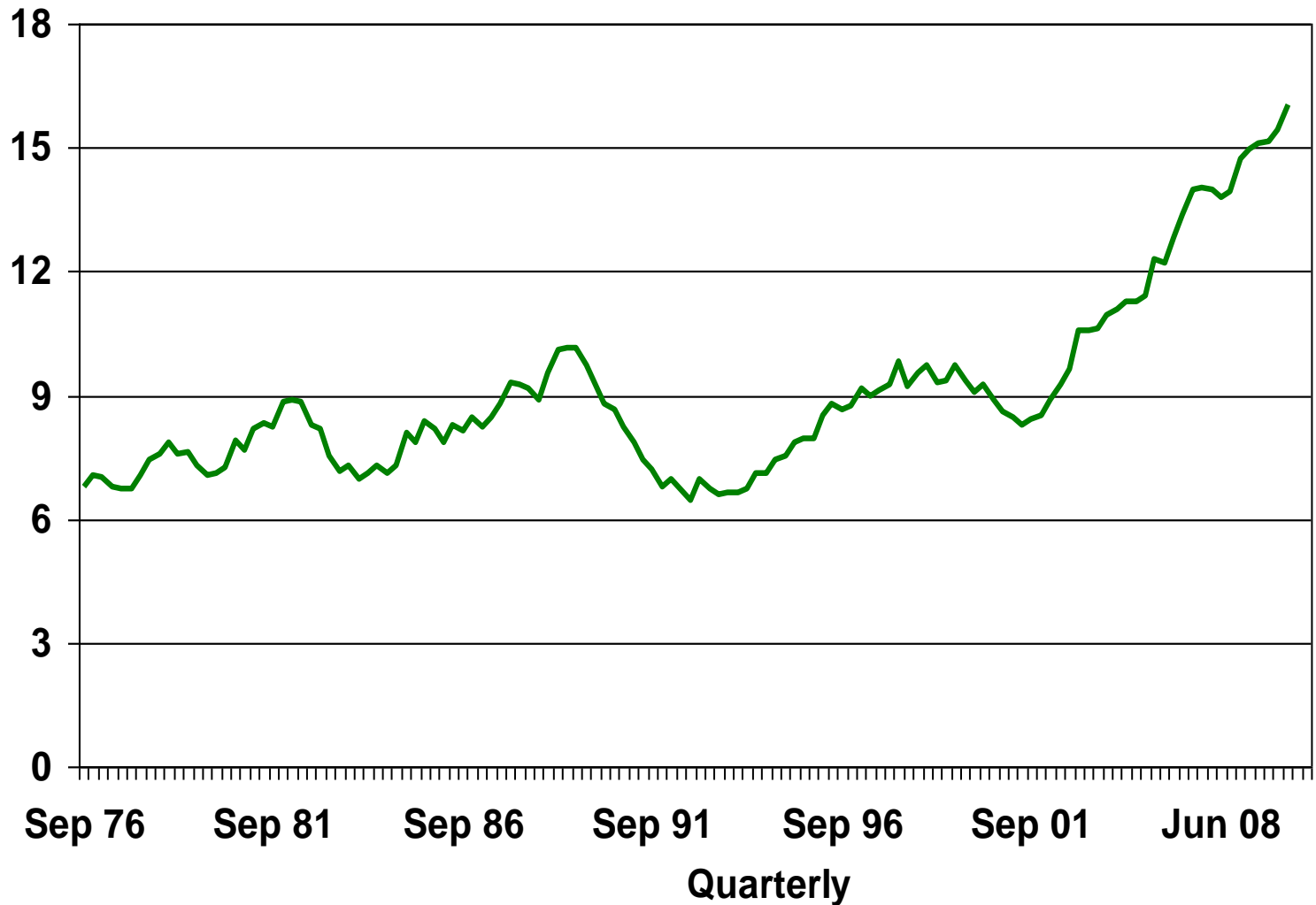
Year-to % change



Source: ABS, November 2008

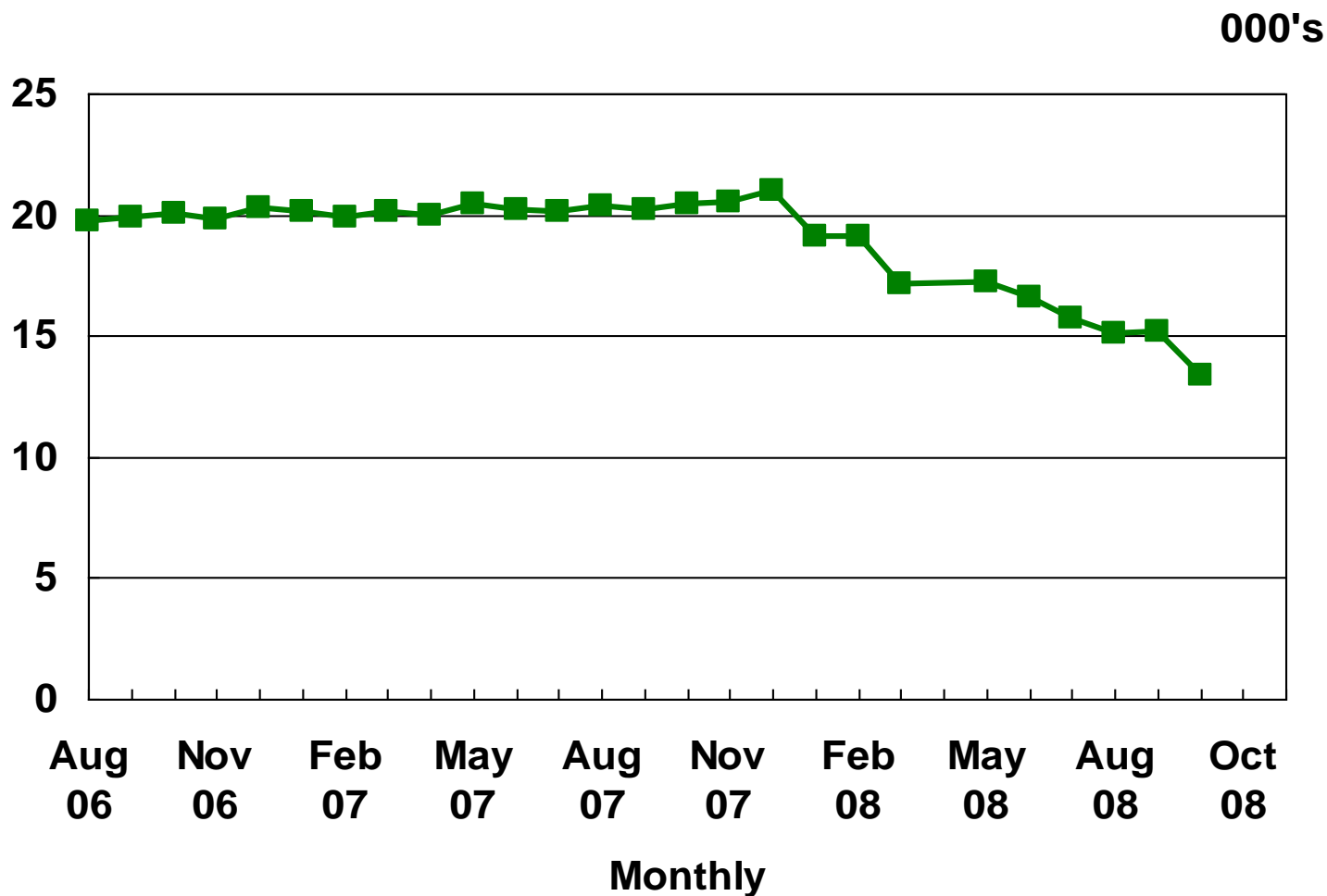
# Business investment is weakest link

% of real GDP



Source: ABS, November 2008

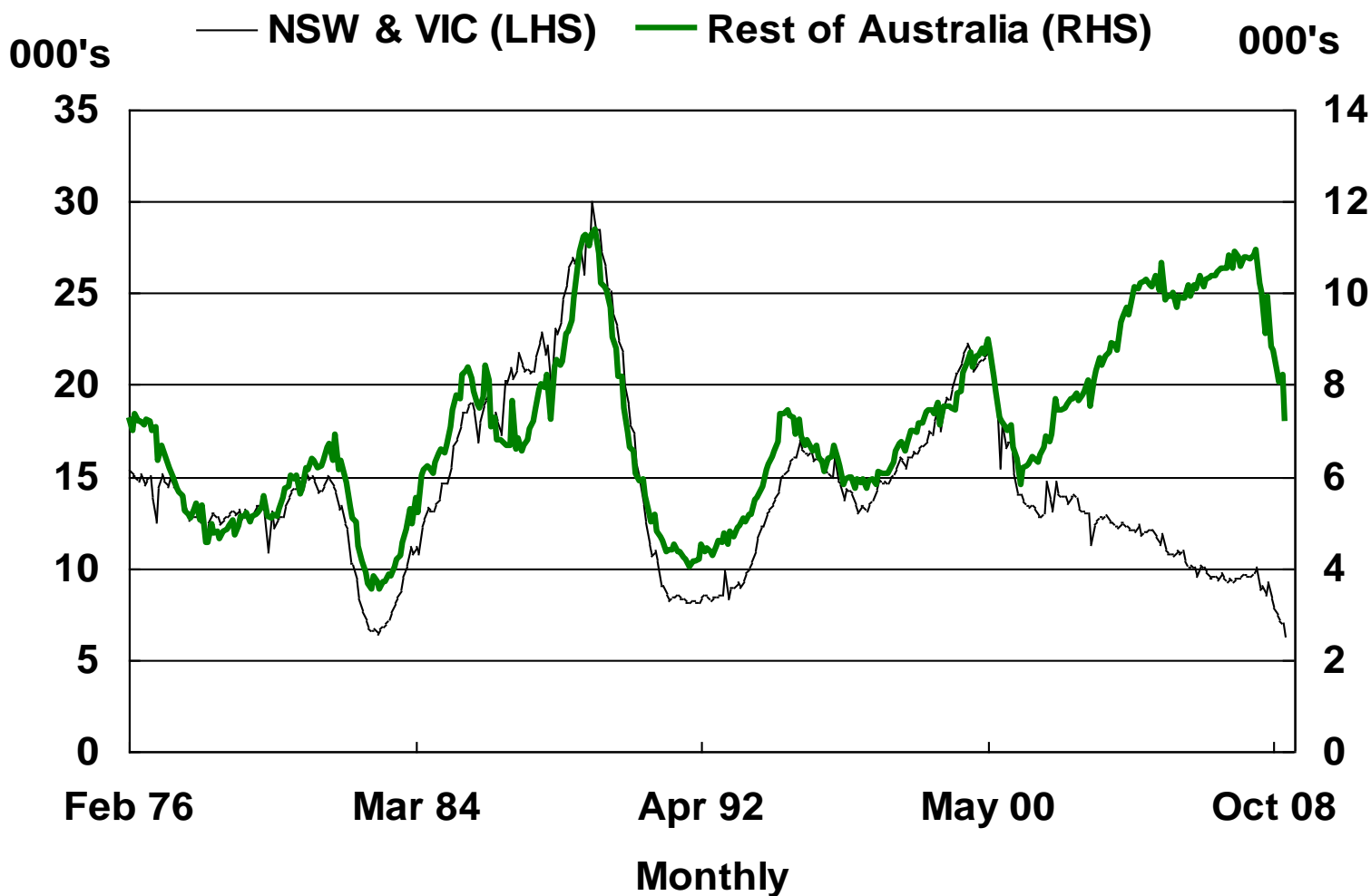
# ANZ newspaper job ads\*



Source: ANZ Bank, November 2008 \*MBL smoothed to exclude crazy "early Easter" 2008 reading



# ANZ newspaper job ads



Source: ANZ Bank, November 2008

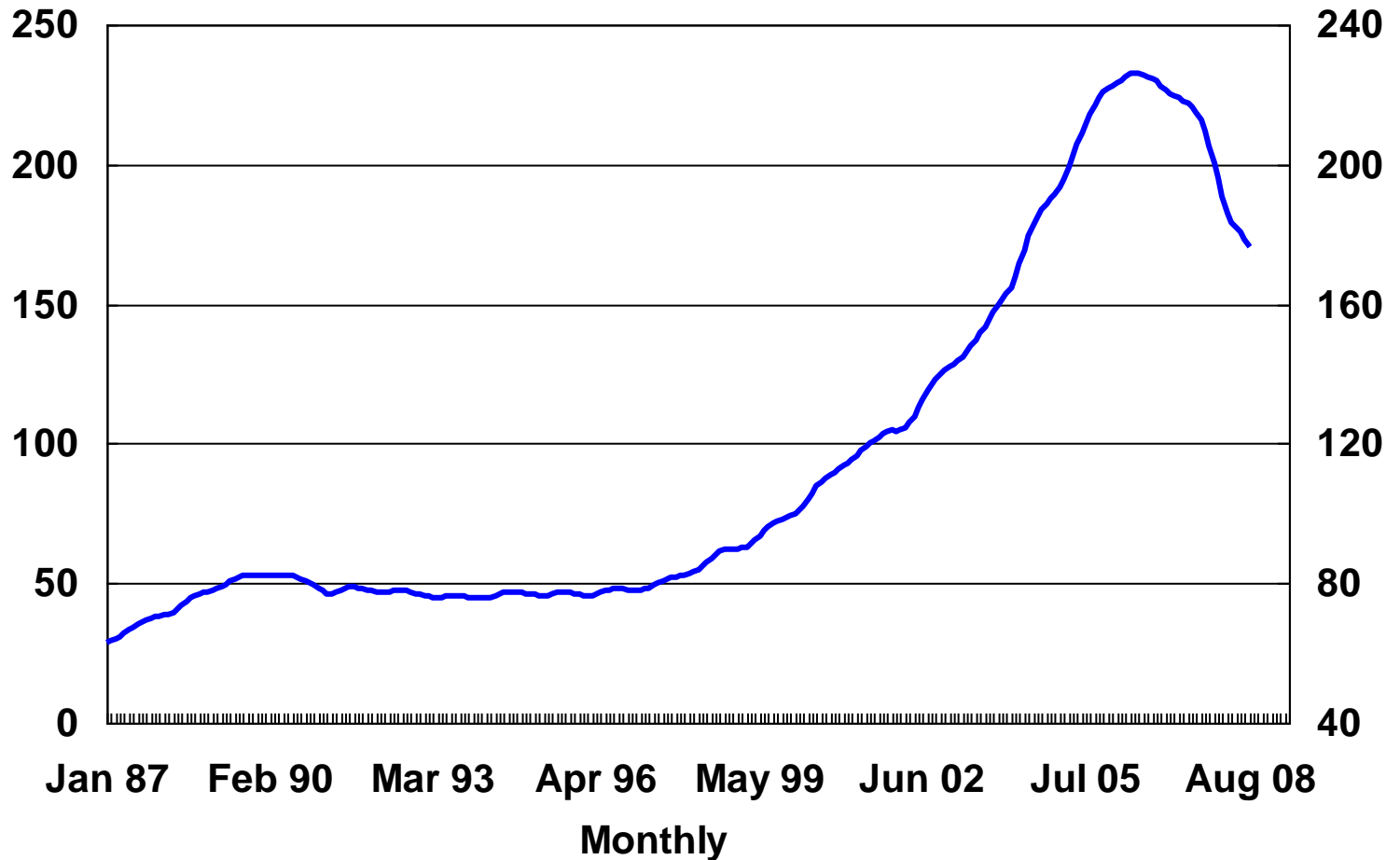
# Australia in better shape than most

- ➔ **(1) Much of the weakness in Oz economy to Q3 was desired**, a product of extremely tight RBA monetary policy to contain inflation
- ➔ But with global situation having deteriorated so alarmingly, inflation now is under control. **So RBA's priority is to limit downturn**
- ➔ **(2) RBA has cut cash rate by 2pp, to 5.25%, on way to 3.25%.** Big drops in mortgage rates and lower business rates designed to sustain consumption spending and home prices as BFI declines
- ➔ Big rate cuts, full-recourse loans and lack of Oz overbuild offer protection against big home-price falls, defaults, damage to banks
- ➔ **(3) A\$ has dropped sharply (TWI 53 v 74)**, making it much easier for our tradeables sector in face of serious global weakness
- ➔ **(4) Canberra and States go into this with pristine balance sheets.** No net debt means government guarantees are credible, and there's heaps of room for short-term spending, tax cuts, and "nation building" infrastructure projects
- ➔ **Unfortunately, most economies across globe shrank in October**, as turmoil & "hunkering down" intensified after Lehmans collapsed in mid-September. **Oz GDP may well decline in Q4.**
- ➔ **The positive factors listed above will limit Oz weakness, but if the global recession is severe enough...**



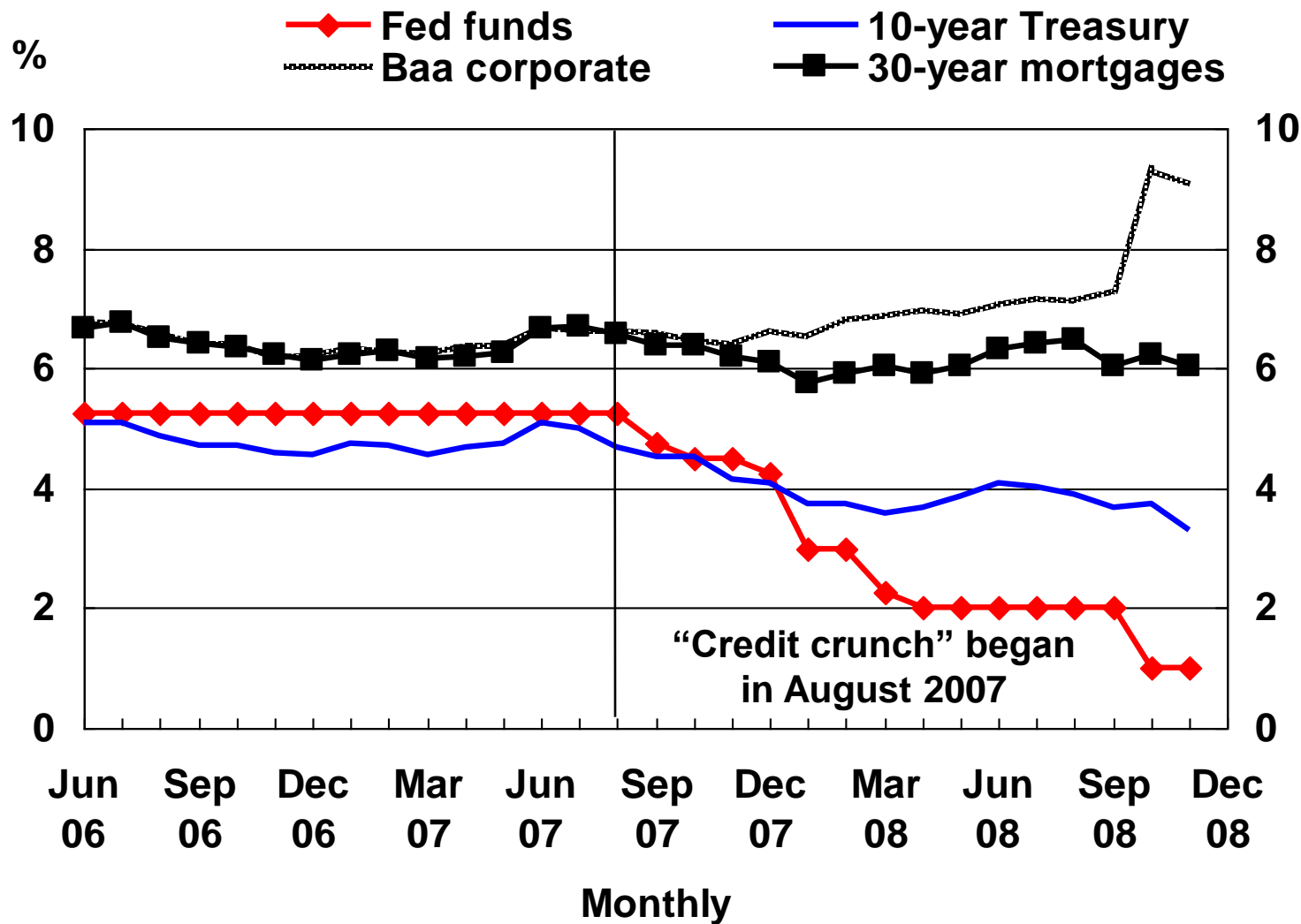
# US home prices (S&P-Case/Shiller, 10-City Index)

Index = 100 in Jan 2000



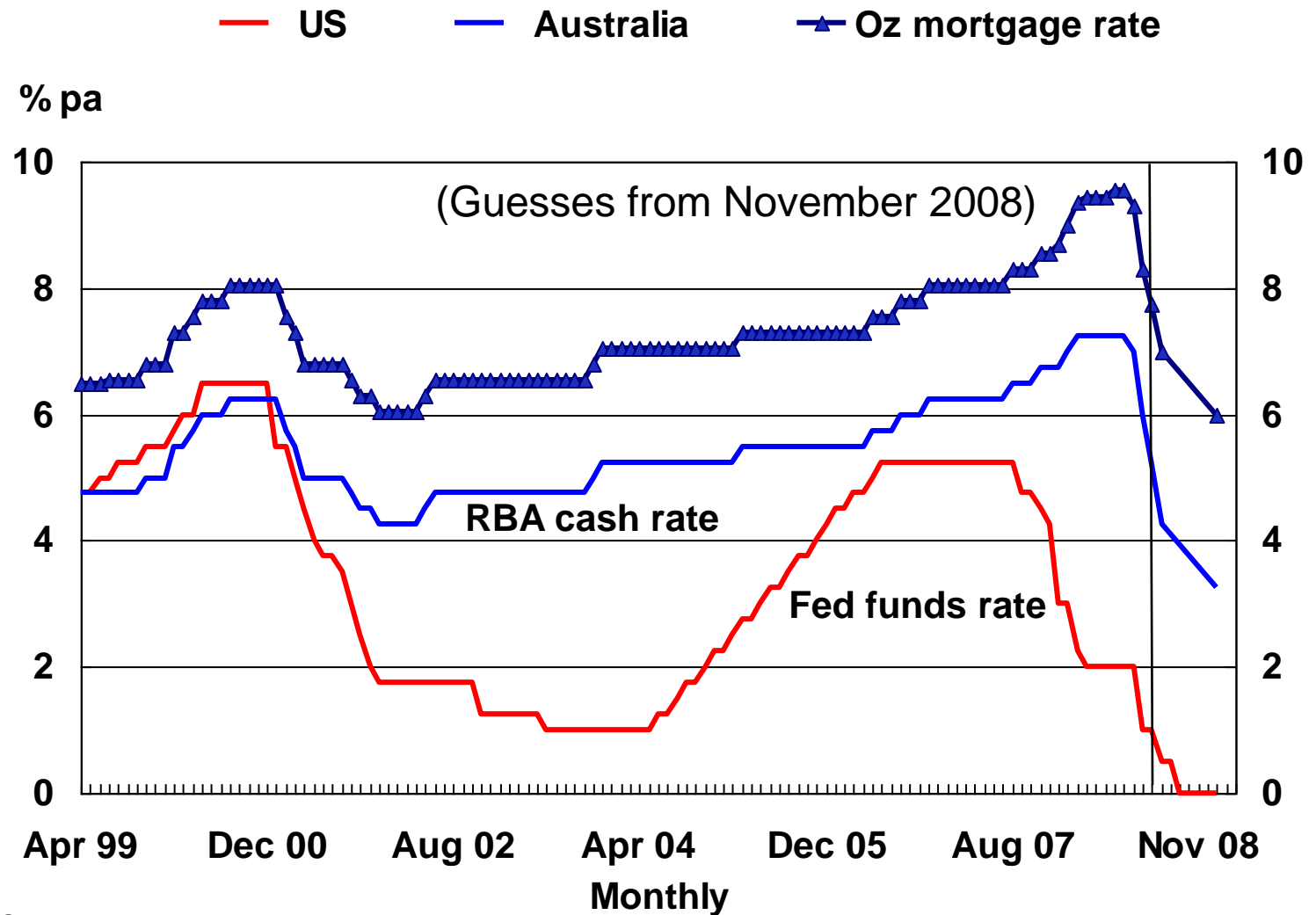
Source: S&P-Case/Shiller, November 2008

# Fed cut to 1%, but key rates flat/up



Source: Federal Reserve, November 2008

# RBA slashing mortgage rate towards 6%

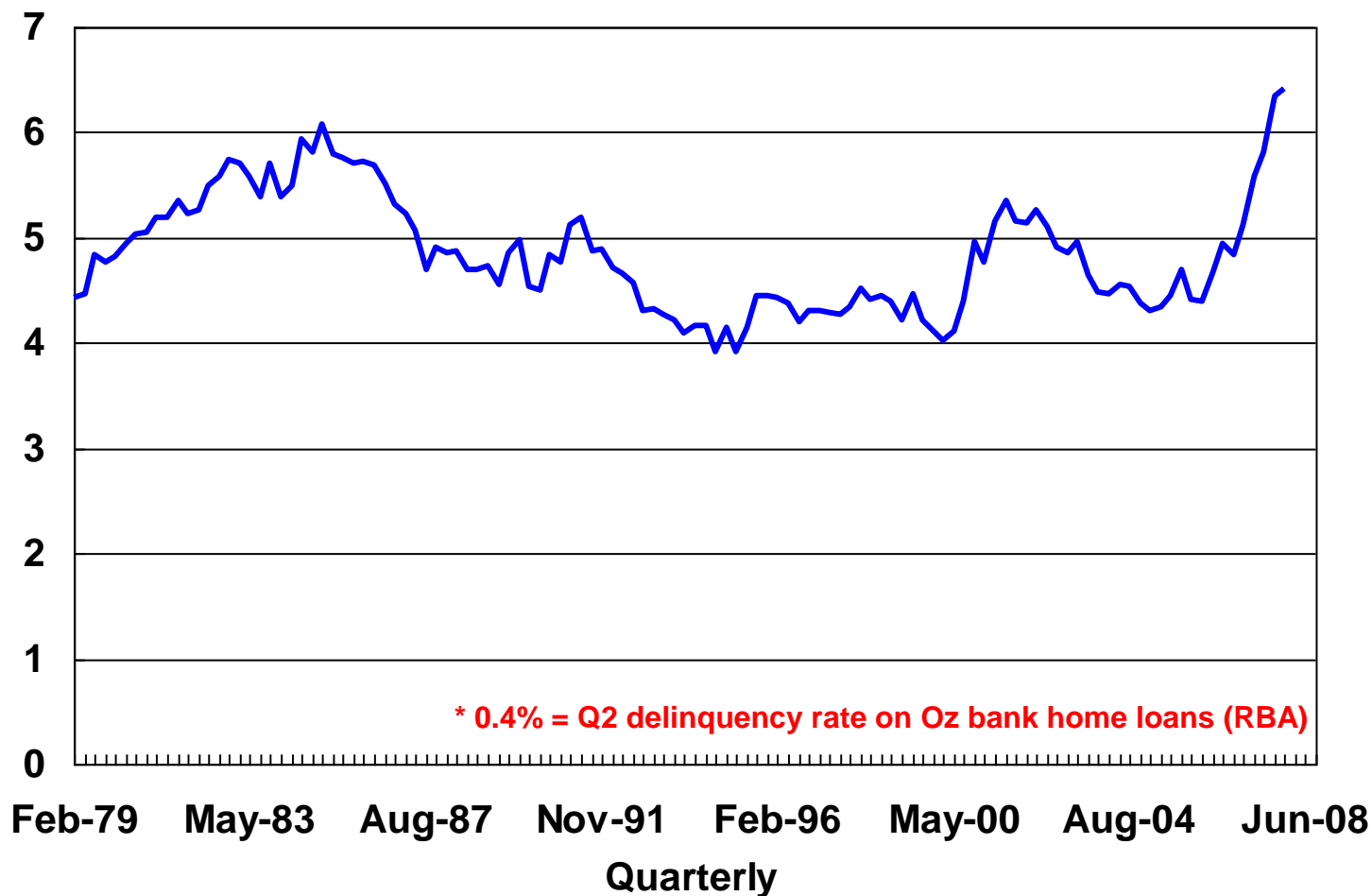


Sources: RBA, MBL, November 2008



# US mortgage delinquencies

% of all housing loans



Source: Mortgage Bankers Association, November 2008

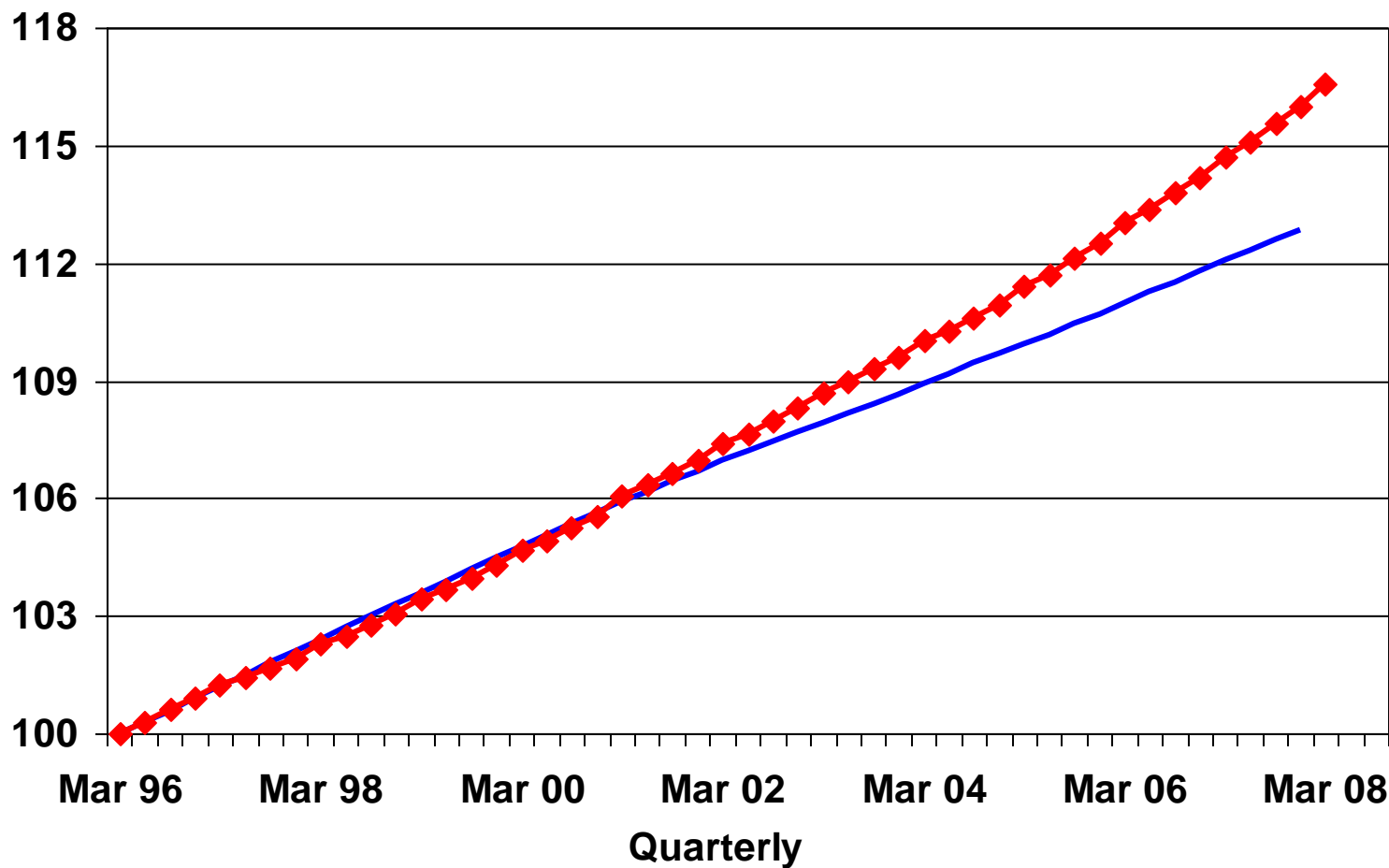




# Oz and US populations

Index, Q1 1996=100

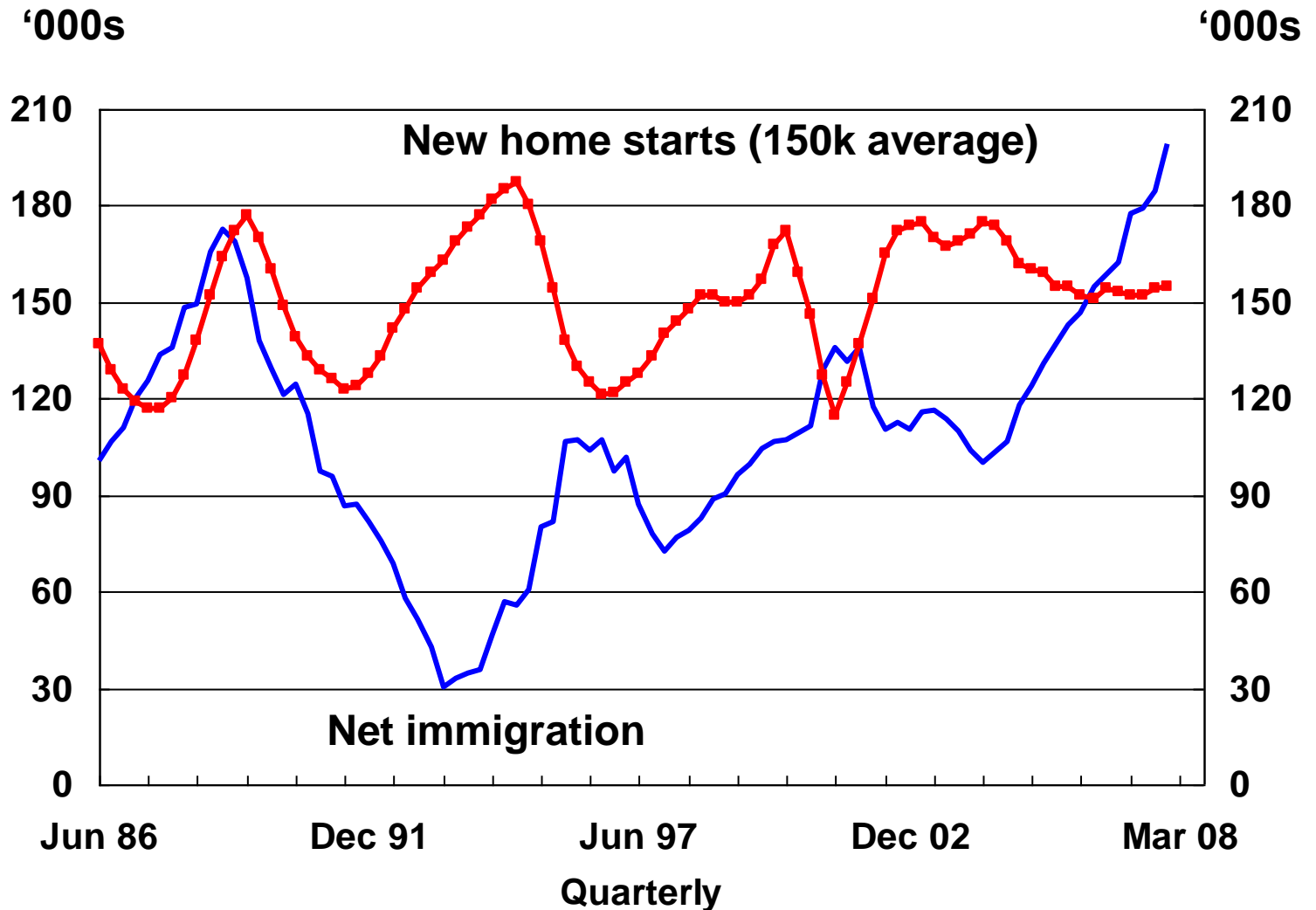
— US —♦ Australia



Source: ABS, S&P Case Shiller, November 2008

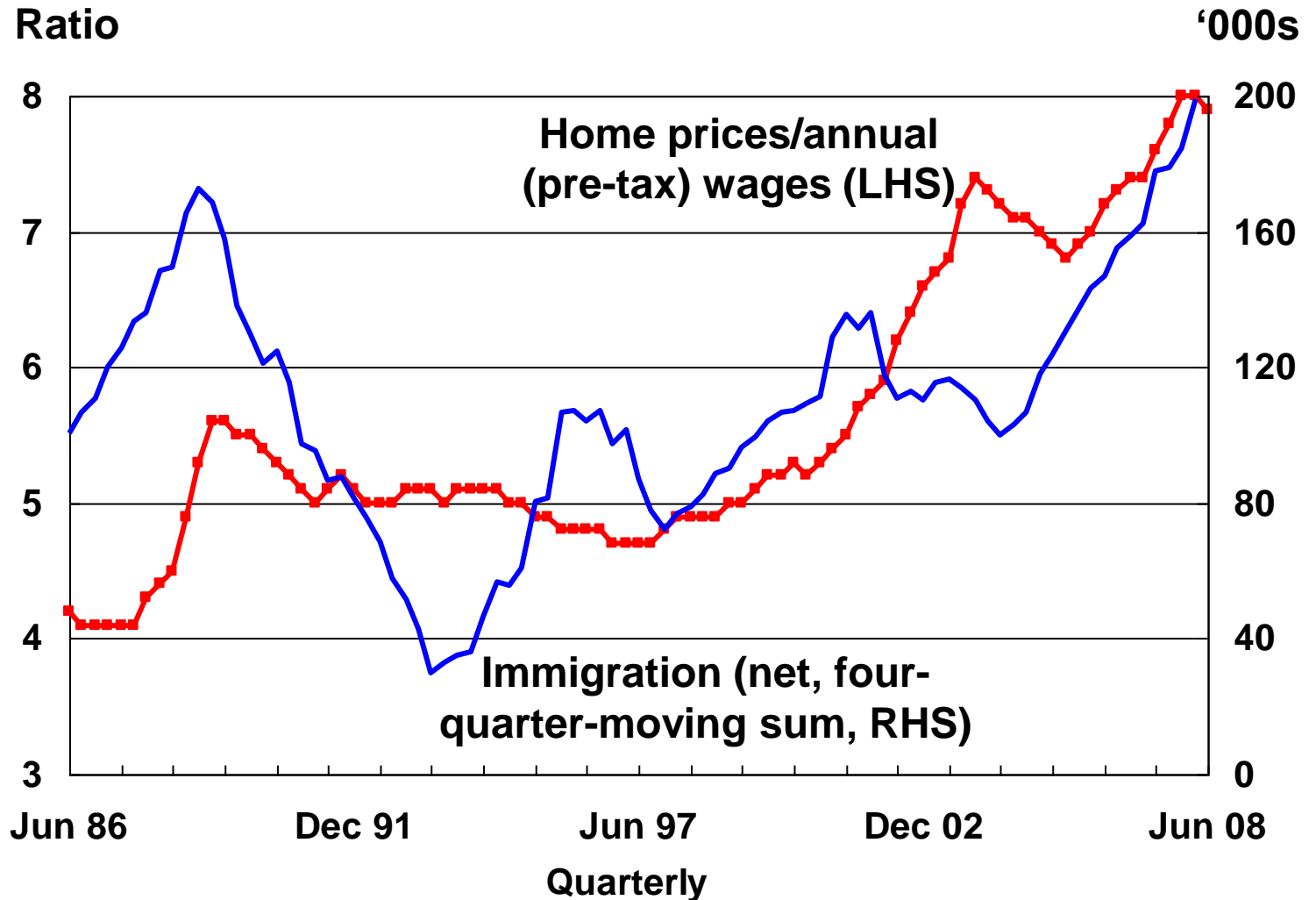


# Unlike US, no overbuild in Oz housing



Source: ABS, November 2008

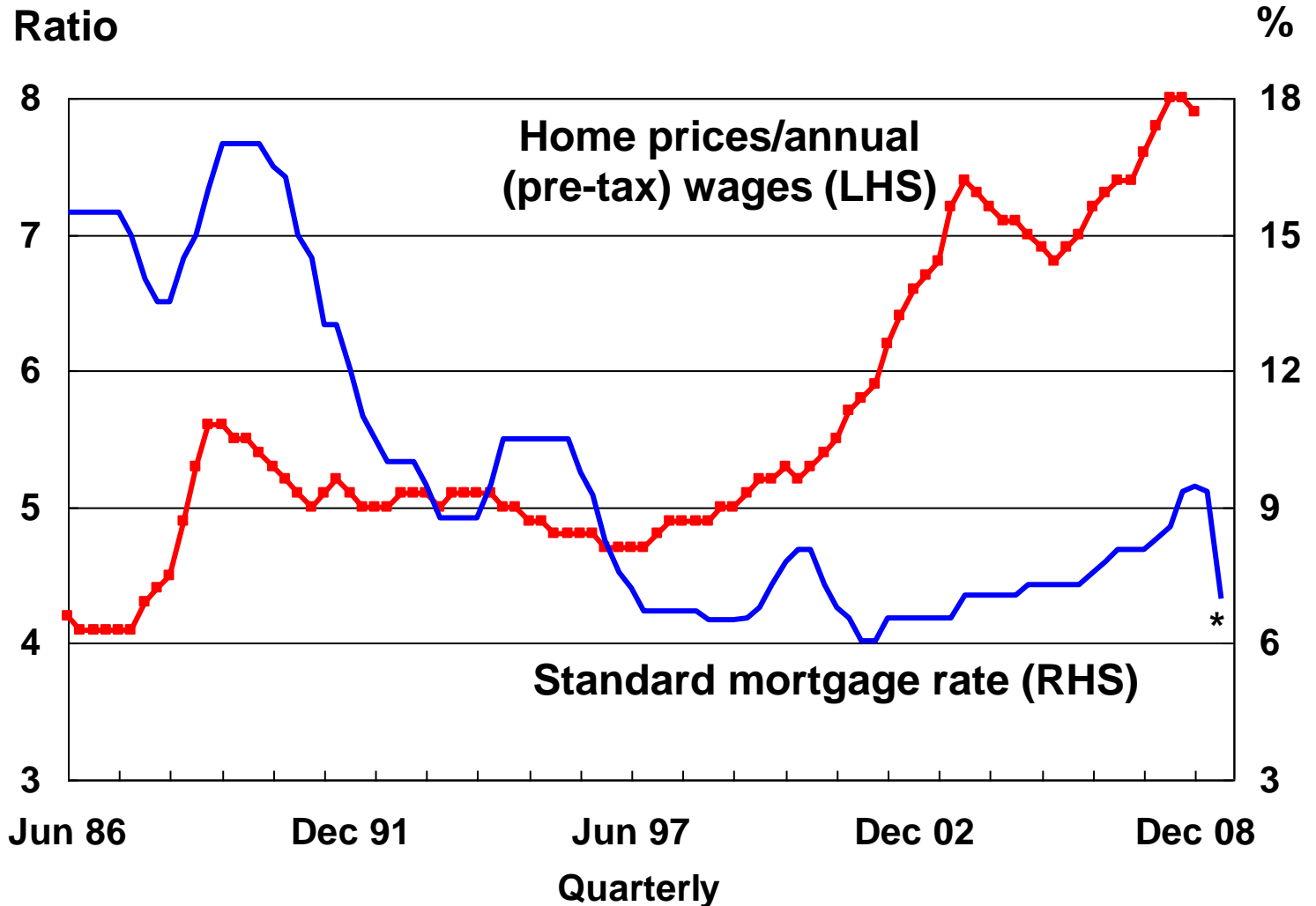
# Oz immigration and real home prices



Sources: ABS (Wages = AWOTE), October 2008

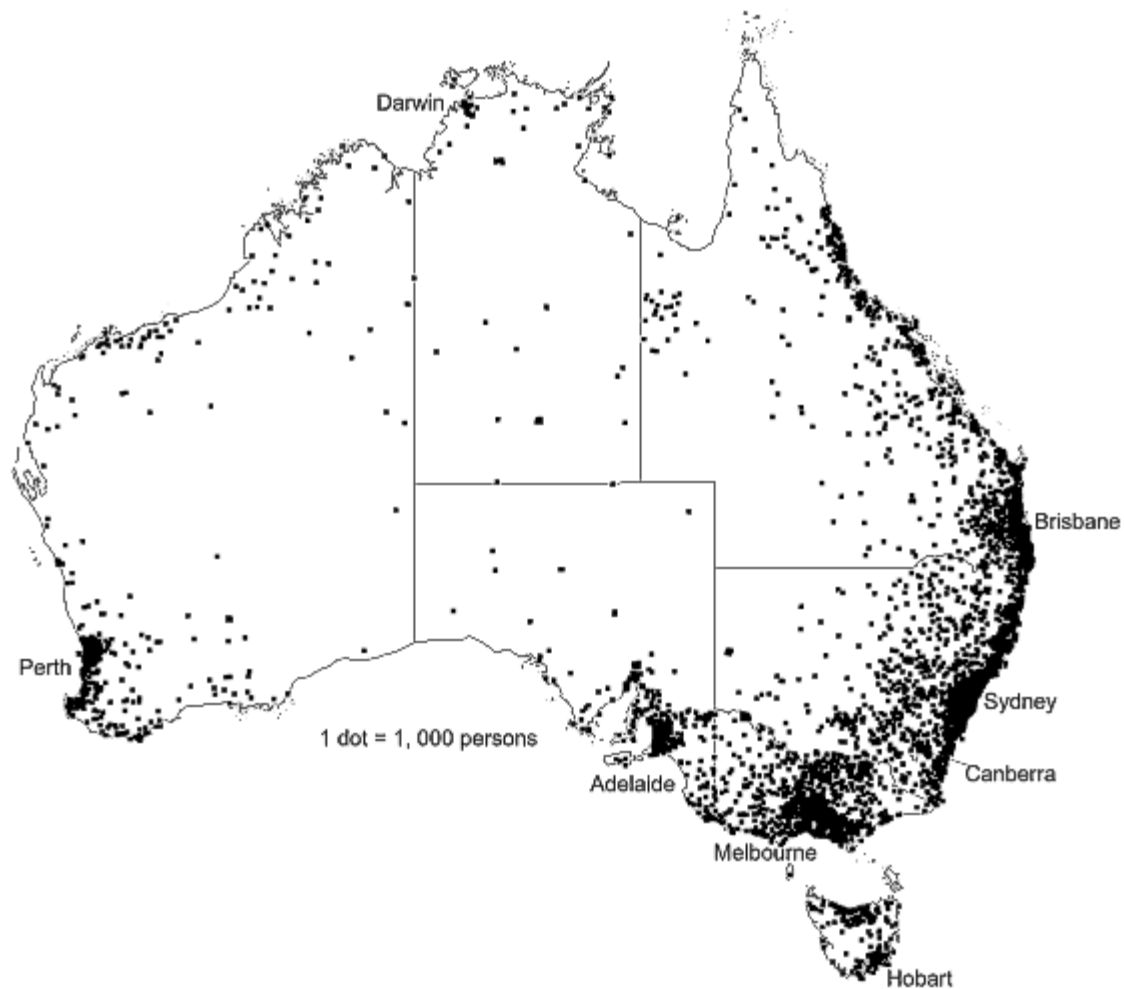


# Oz mortgage rate and real home prices



Sources: ABS (Wages = AWOTE), \*RR guess of 7% in December

# Population density



Source: ABS 1301.0 (*Year Book Australia*, 2006)

# International housing affordability

(Rankings by 2007 home price/income ratios)

**EXPENSIVE:** 1. Los Angeles, 3. San Francisco, 4. Honolulu, 6. Mandurah (WA), 9. Bournemouth & Dorset, 11. Sydney, 15. Vancouver, 16. Exeter & Devon, 18. **London**, 19 Perth, 22. **Melbourne**, 24. Rockingham (WA); 25. **Miami**, =28. **NYC** & Wollongong, =31. **Auckland**, Bristol-Bath, 35. Adelaide; =36. Brisbane & Cairns, = 40. Hobart & Newcastle, 45. Townsville, =46. **Boston**, Fresno, Newport (UK) & Mackay

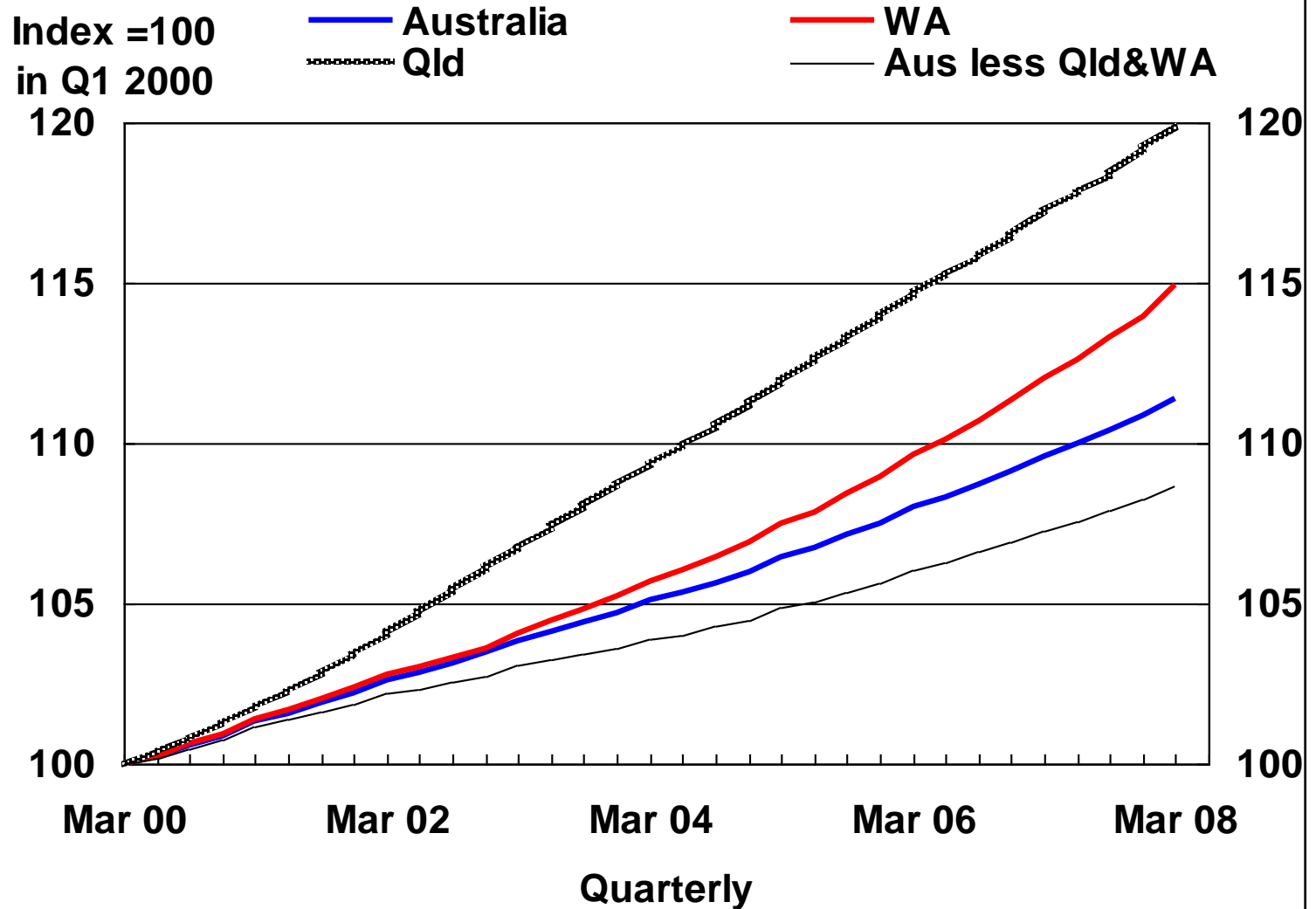
**AFFORDABLE:** 1. Thunder Bay (Cda), 2. Youngstown\*, 3. Fort Wayne\*, 4. Saguenay (Cda), =5. Flint\*, Toledo\*, 9. Rochester\* Indianapolis\*, =12. Buffalo\*, Akron\*, Detroit\*, =19. Dayton\*, **Dallas-Fort Worth**, =23. Cleveland\*, Augusta, 29. St Louis\*, 43. **Houston**, =49. Memphis, Nashville, Oshawa (Cda)

**Key:** **Global (bold)**, coastal (underlined), \* Rust Belt city  
(Classifications via [www.wikipedia.com](http://www.wikipedia.com) and [www.maps.google.com](http://www.maps.google.com))

**Source:** [www.demographia.com](http://www.demographia.com); Survey of larger centres in US, UK, Canada, Australia, NZ and Ireland



# Population growth by State



Source: ABS

# Oz versus US housing markets

- ➔ **US home prices -20% from mid-2006 peak. Oz home prices -2% in Q3.** Main thing that hurt Oz home prices & economy over year to Q3 was RBA's fight against inflation (150bp mortgage hike to 9.5%, now reversed)
- ➔ **US home prices hurt by boom turning to bust, including US mortgage-market meltdown via borrowers' & lenders' complete lack of discipline**
- ➔ **In US, crazy “non-recourse” loans and “originate to distribute” model featured;** in Oz, only full-recourse lending, banks hold vast majority of loans
- ➔ **US has big “over build” problem. Any excess supply in Oz is limited** (Consensus reckons Oz problem is “under build”, given high immigration)
- ➔ **RBA has reduced cash rate by 2pp, Oz mortgage rates down by 1.8pp.** Fed, BOE and ECB can only dream of 90% pass-through. Fed largely impotent: cut from 5.25% to 1% yet 30-yr mortgage rate unchanged at 6%
- ➔ **RBA cash set to fall towards 3.25%. Sub-6% mortgage rates** (and reduced business rates) will provide support to Oz home prices & spending
- ➔ **Big rate cuts, full-recourse loans and absence of overbuilding offer strong protection from Prof. Keen's forecast of 40% drop in Oz-wide home prices.** Of course, the halving of equity prices means many high-end homes and beach houses will fall by 40% or more (but not broader market)
- ➔ **RBA knows 20%+ price drops must not happen here.** Big home-price falls & rising bad loans poisoned US & UK banking systems & economies



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