

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

**Rory Robertson**

[\(rory.robertson@macquarie.com\)](mailto:(rory.robertson@macquarie.com))

0414 703 471

**Interest Rate Strategist  
Macquarie Bank, Sydney  
25 November 2008**



# US interventions and equity prices

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

S&P 500  
Index

1700

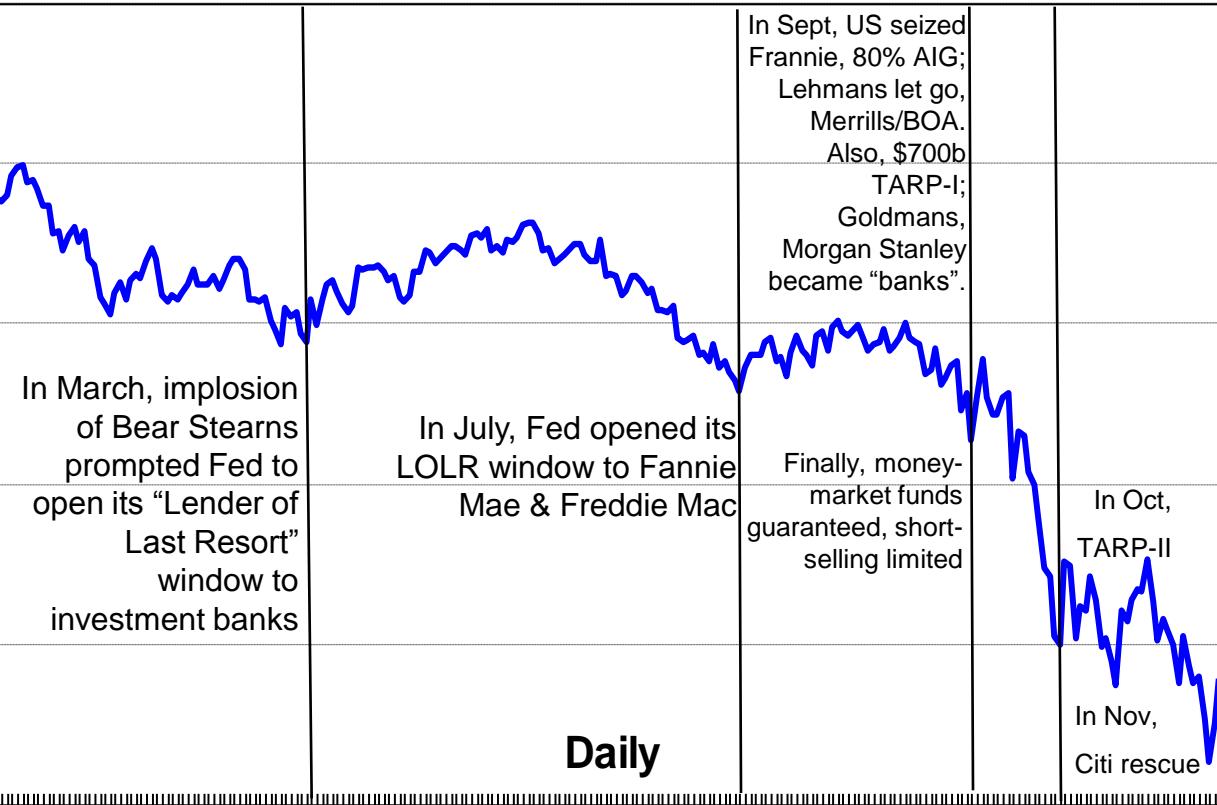
1500

1300

1100

900

700



Dec 07 Jan 08 Feb 08 Apr 08 May 08 Jun 08 Aug 08 Sep 08 Nov 08

Source: Bloomberg, Macquarie, November 2008



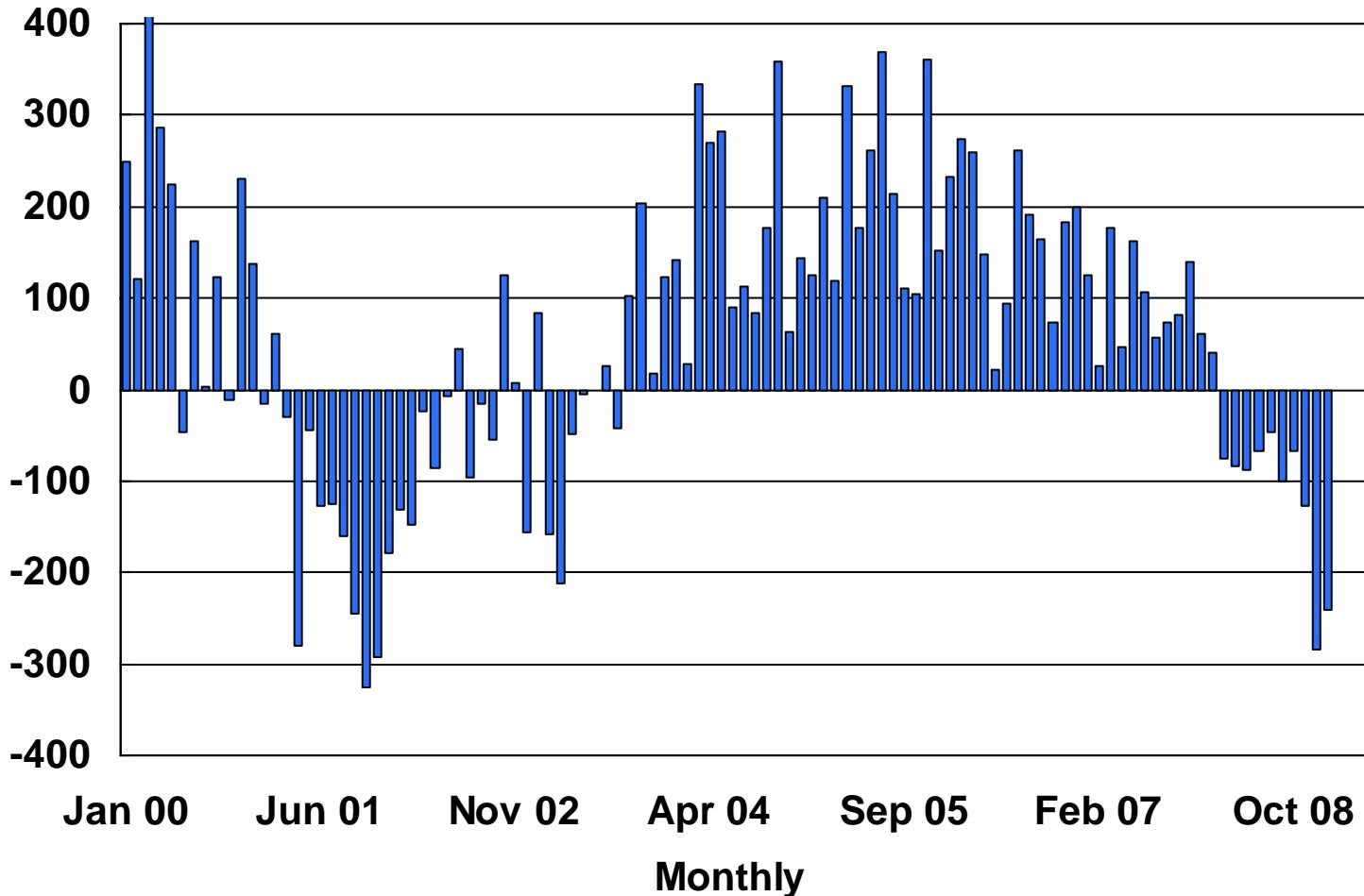
## How bad is “global credit crunch”?

*...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

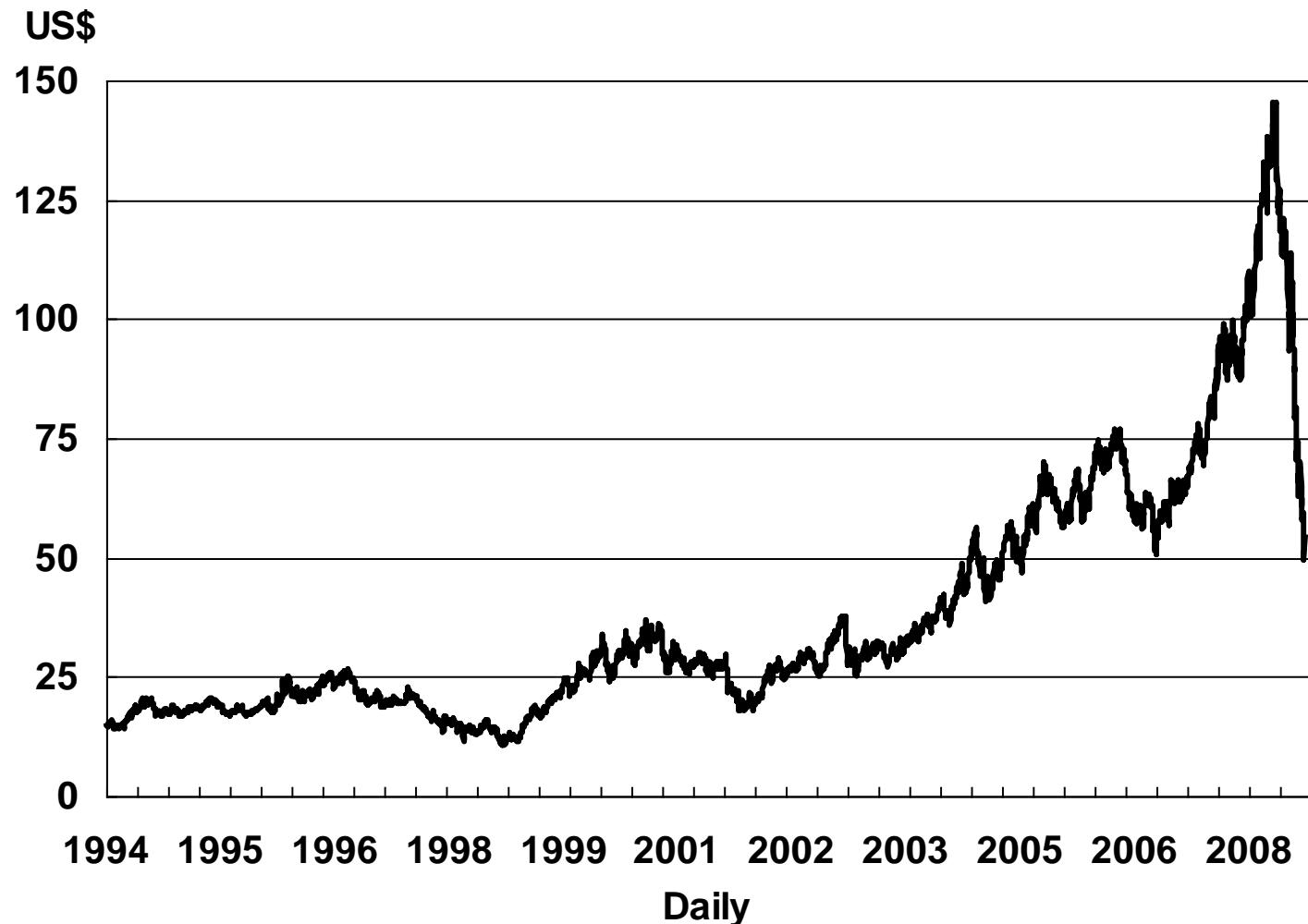


Source: BLS, November 2008

## Global recession via intensifying credit crunch

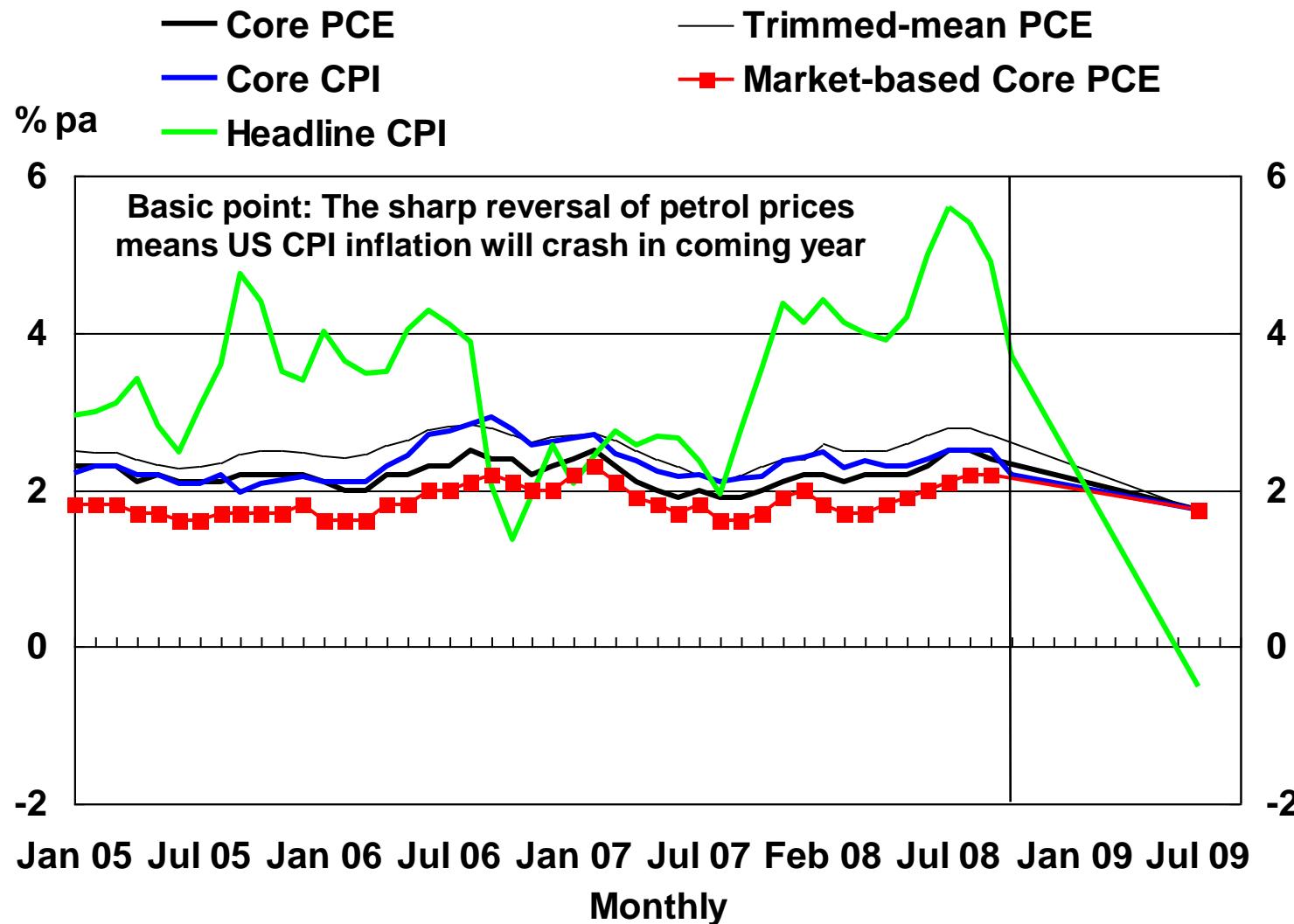
- **US & UK economy in increasingly severe recessions.** Rest of **G7 - Canada, Japan, Germany, France & Italy – also shrinking.** Ditto Spain, Portugal, Ireland, Iceland & NZ. OECD GDP shrinking, while big developing economies – BRICs – slowing fast
- **Main problem: intensifying “credit crunch”.** 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

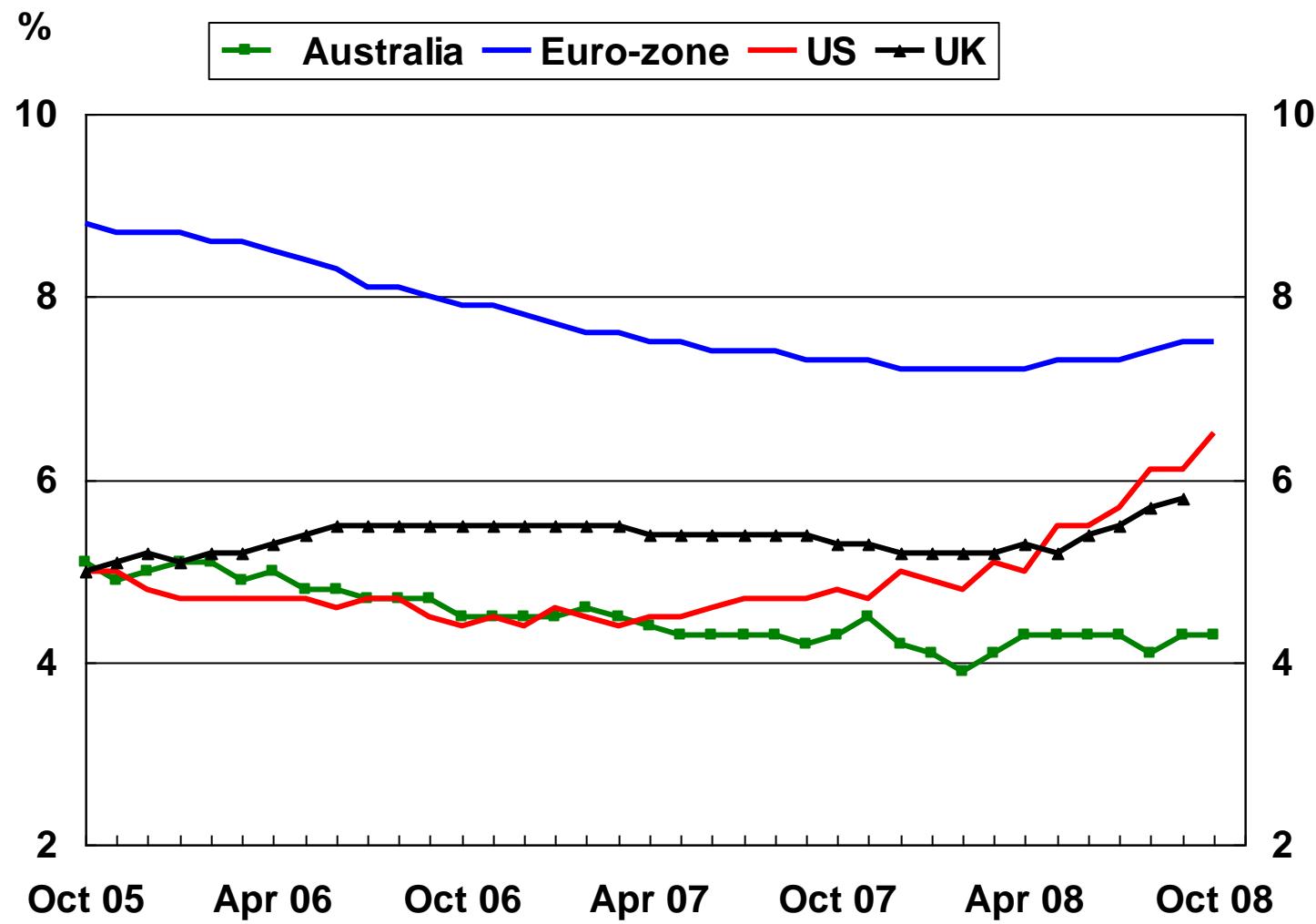
# Global credit crunch driving global slowdown

- 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

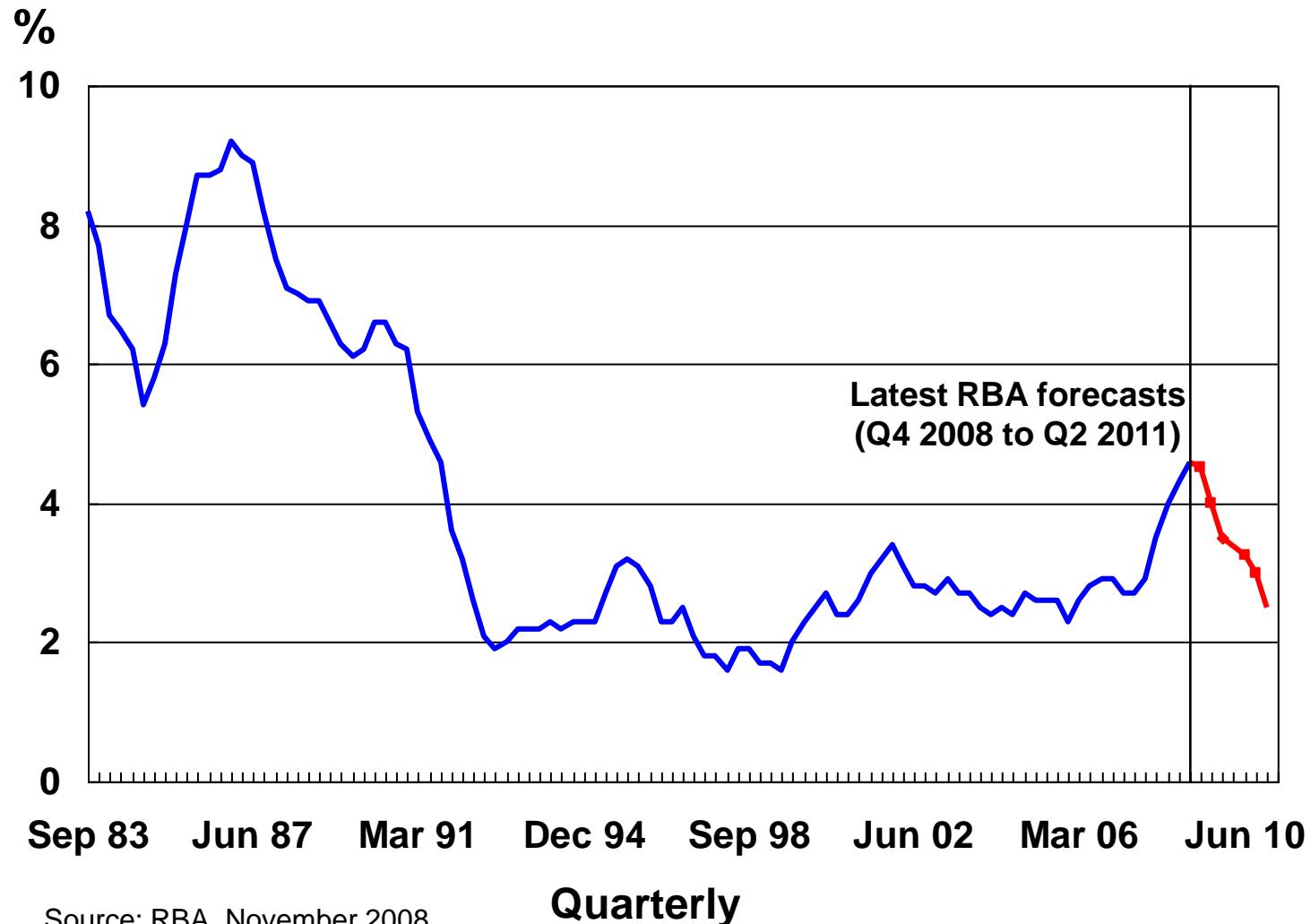
# Unemployment in Oz, E-zone, US & UK



National sources, November 2008

# RBA confident inflation under control

(“Trimmed mean” or trend measure)



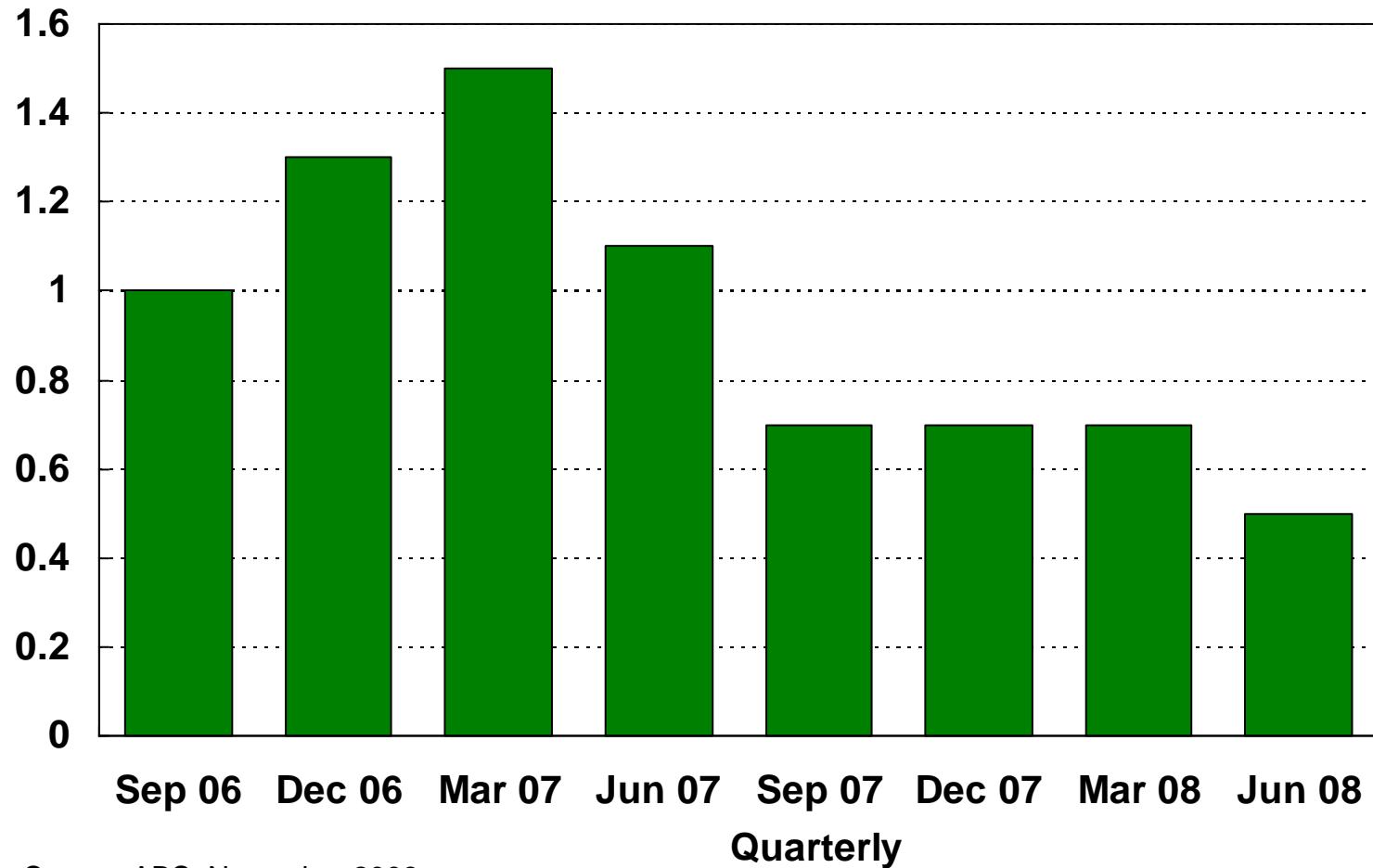
Source: RBA, November 2008

Quarterly

# Oz Non-farm GDP growth

Macquarie Research Strategy

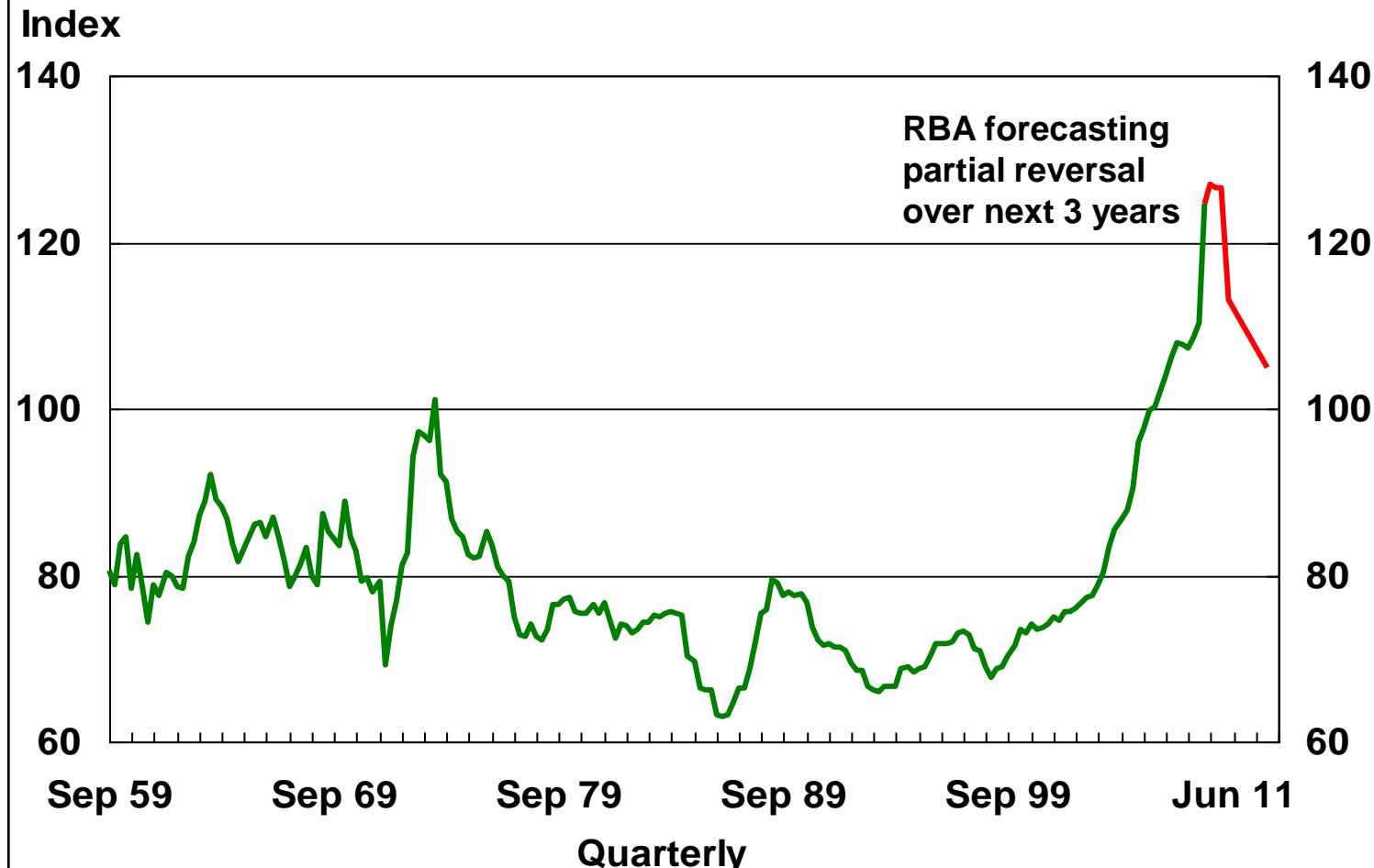
Q/Q % change



Source: ABS, November 2008

# Terms-of-trade boom tough to manage

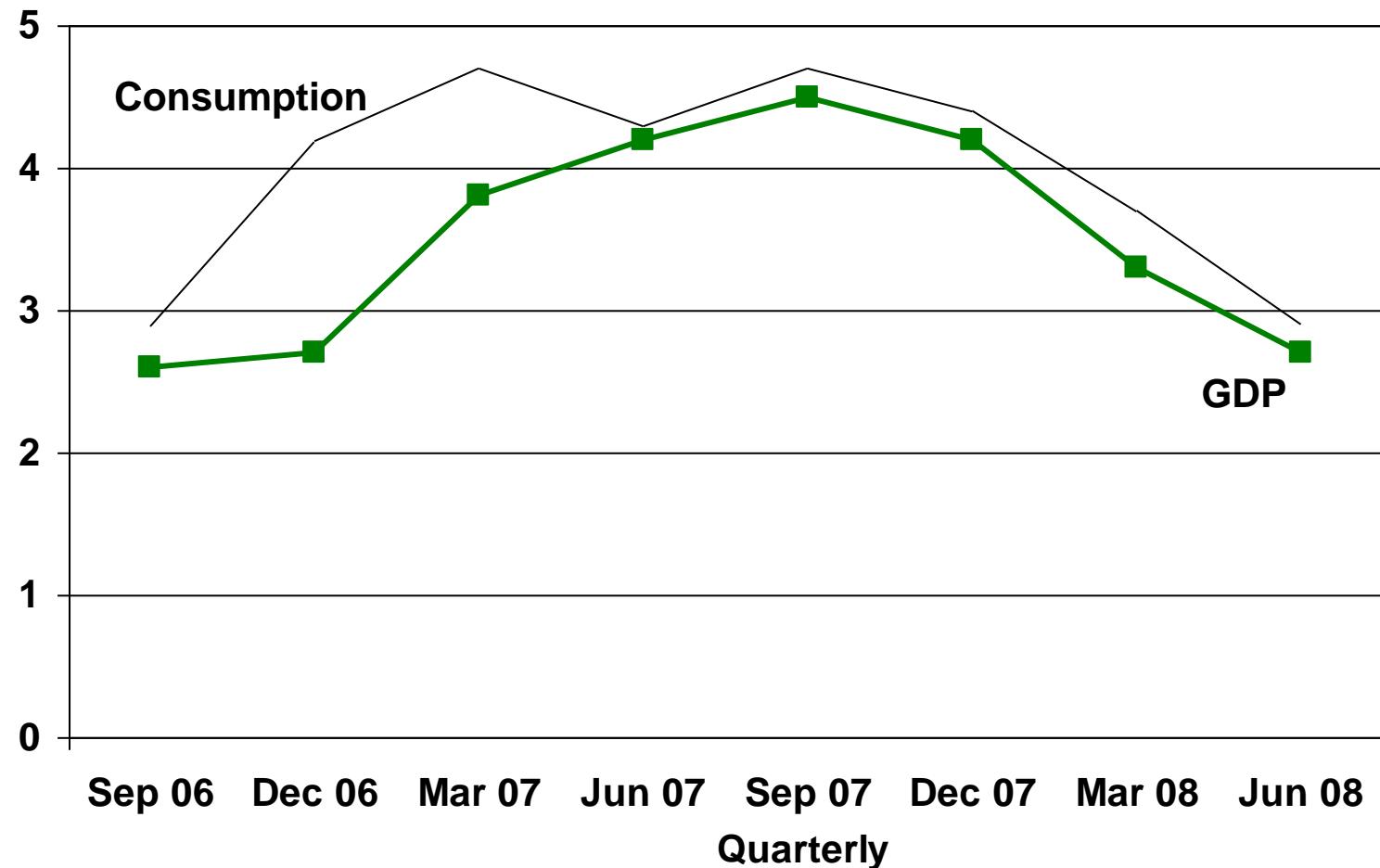
(Export prices/import prices)



Sources: ABS, RBA forecast, November 2008

# GDP and consumption growth

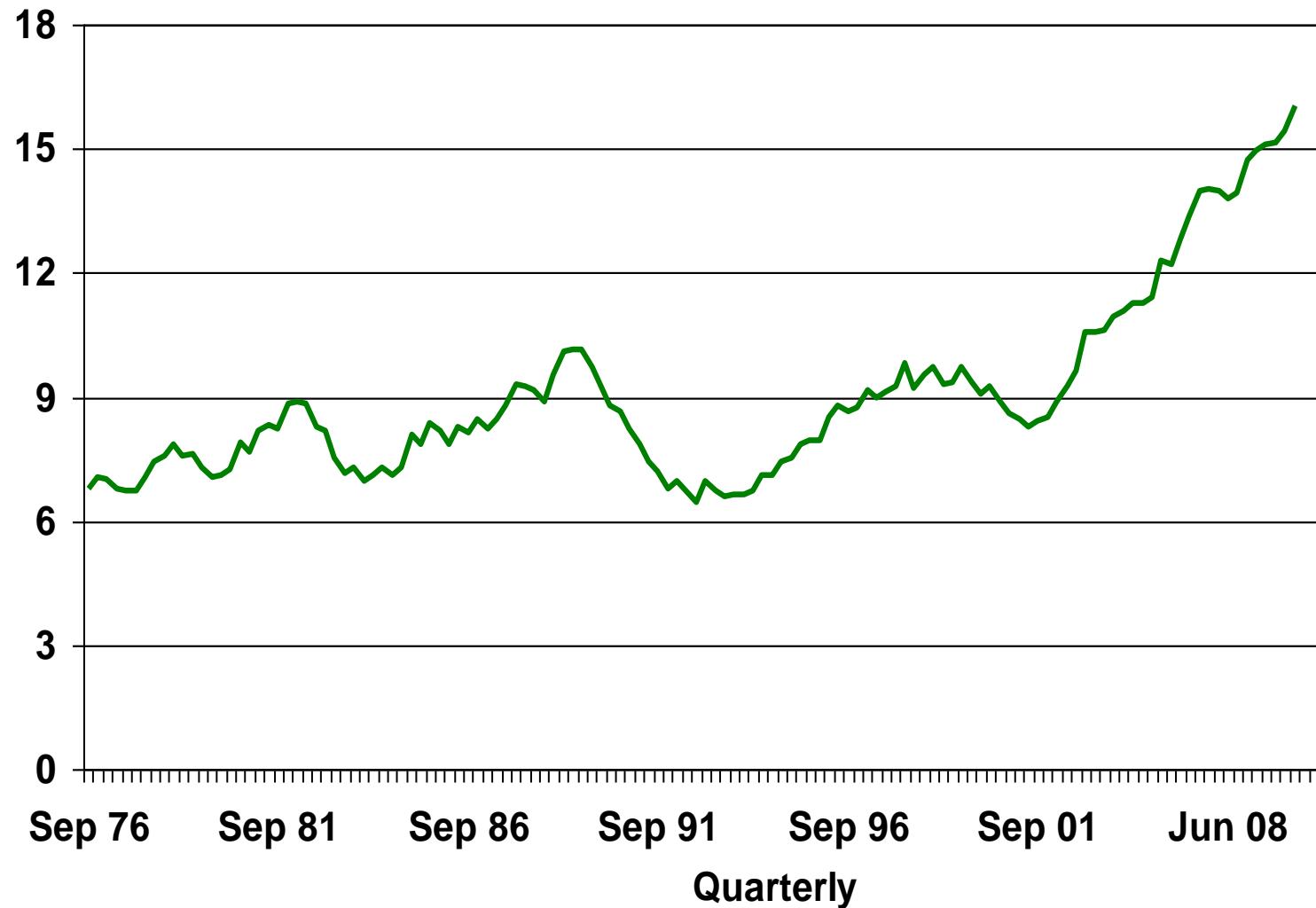
Year-to % change



Source: ABS, November 2008

# Business investment is weakest link

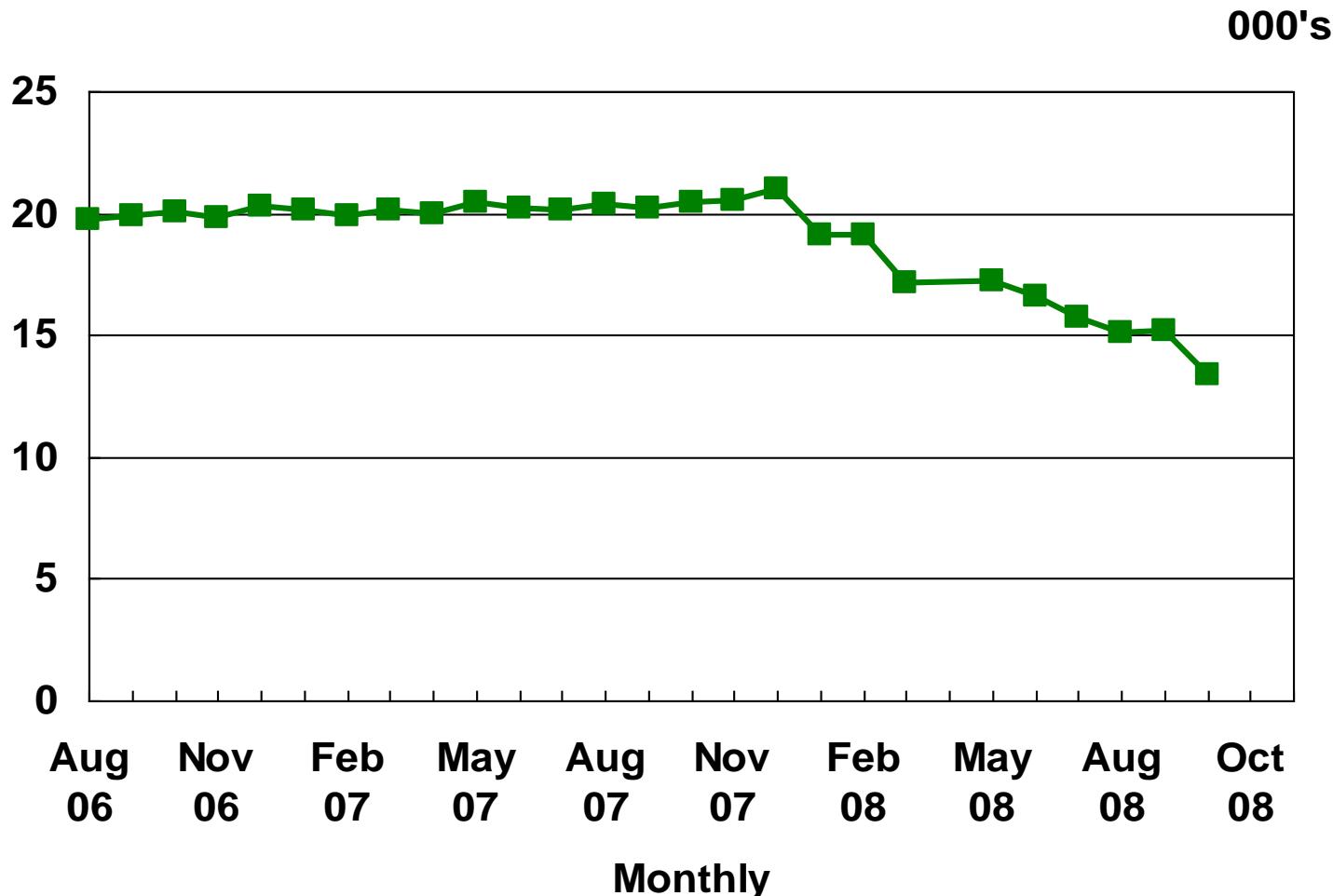
% of real GDP



Source: ABS, November 2008

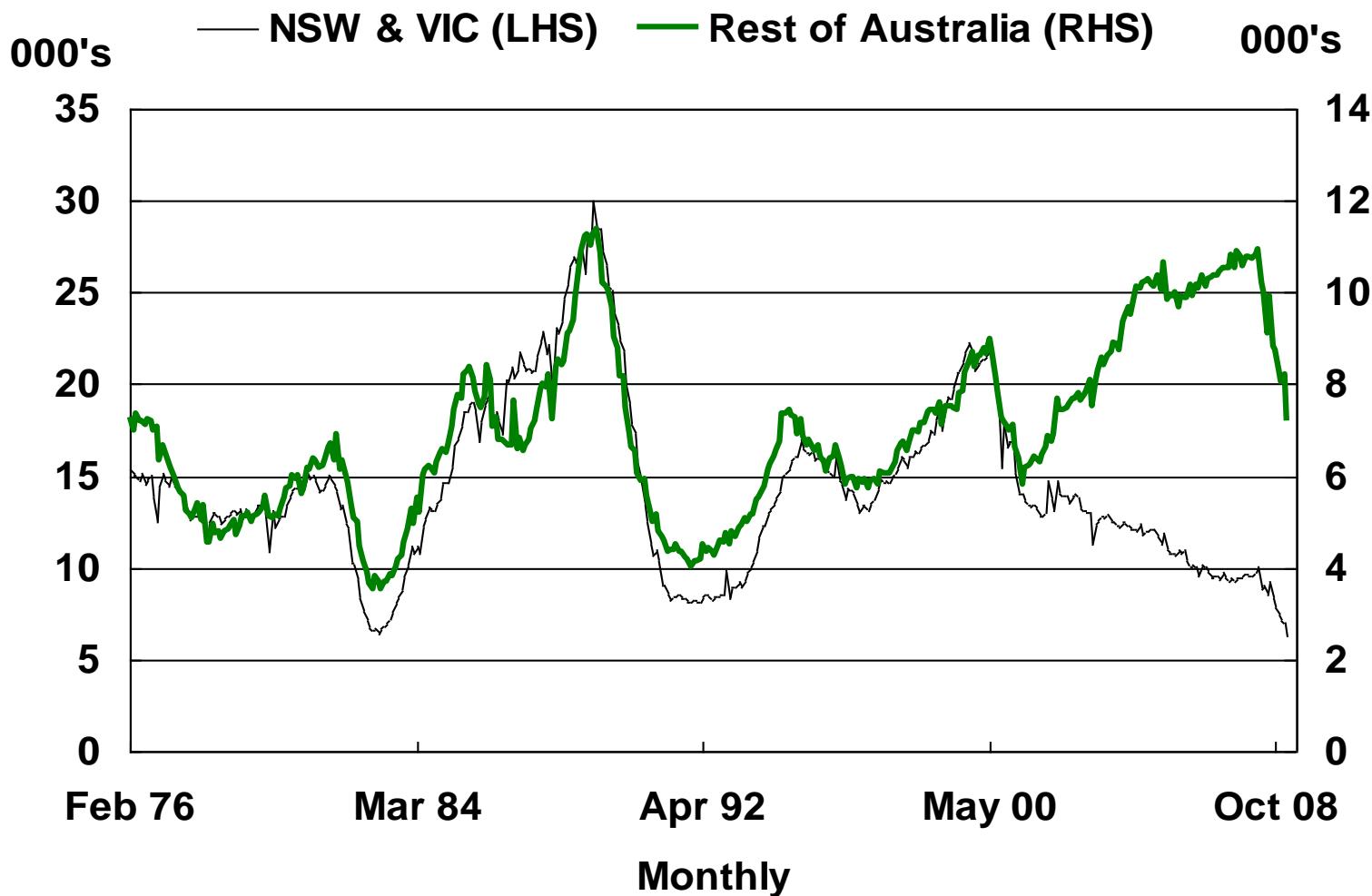
Quarterly

# 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

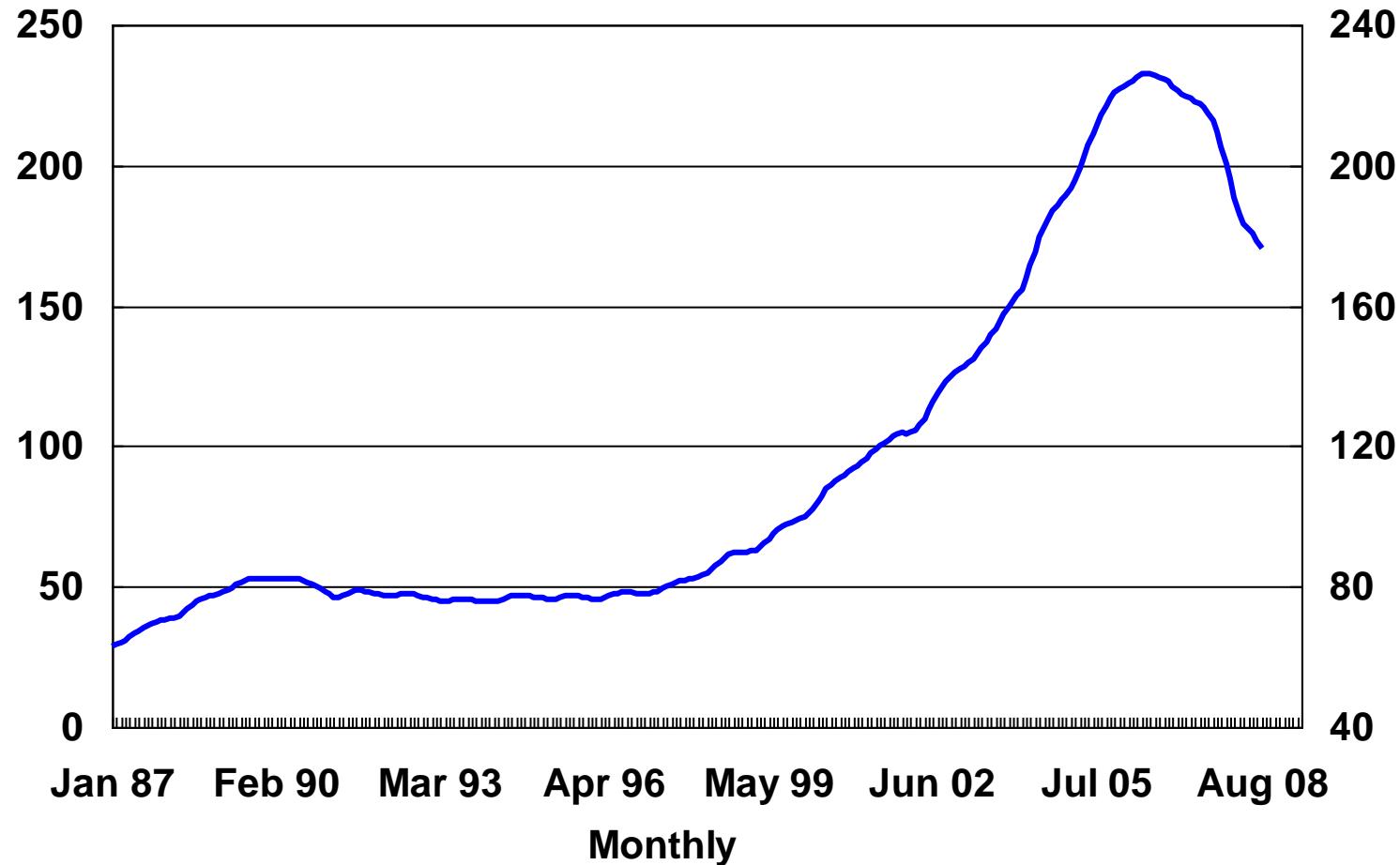
# Australia in better shape than most

- **(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

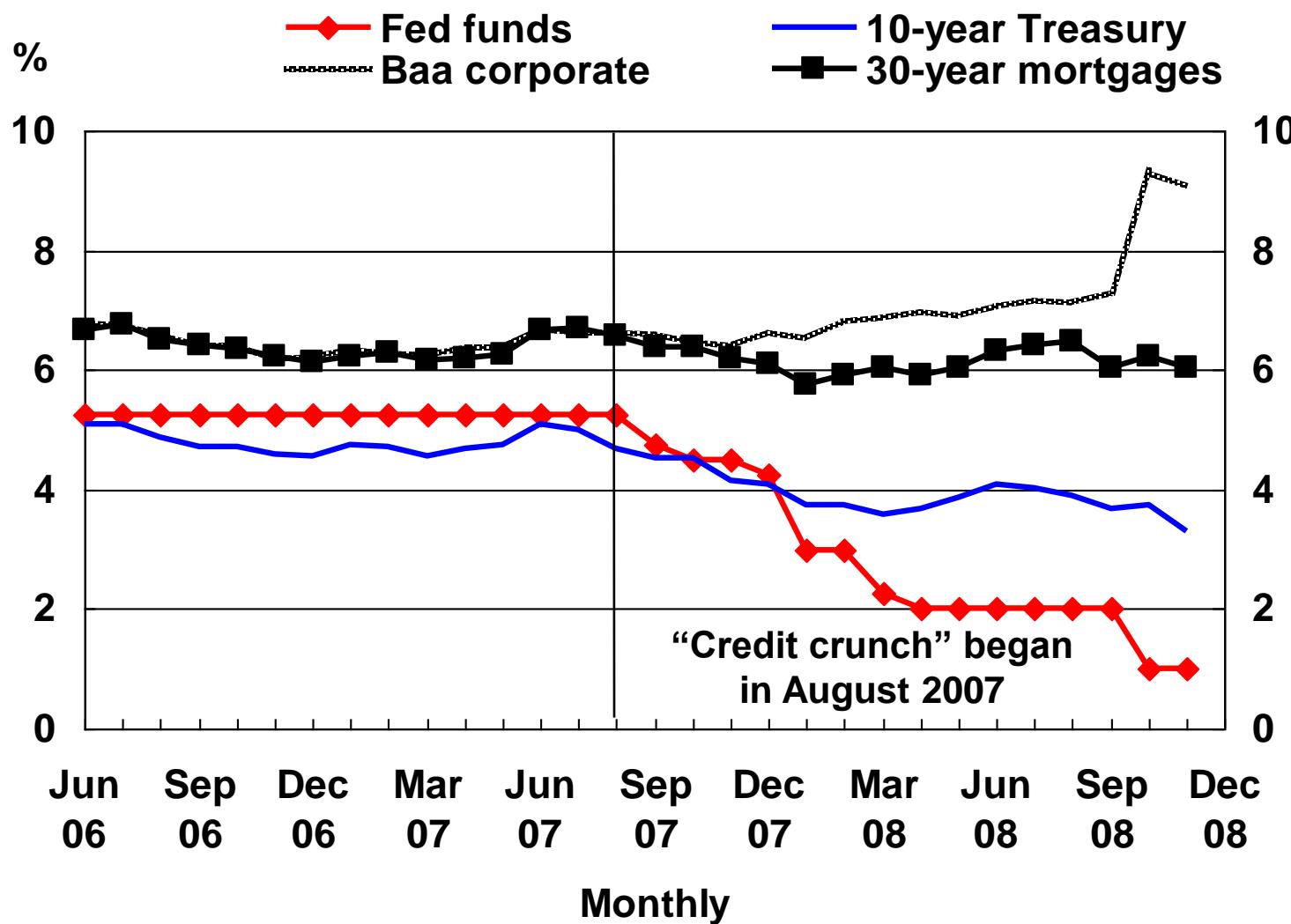
(S&P-Case/Shiller, 10-City Index)

Index = 100 in Jan 2000



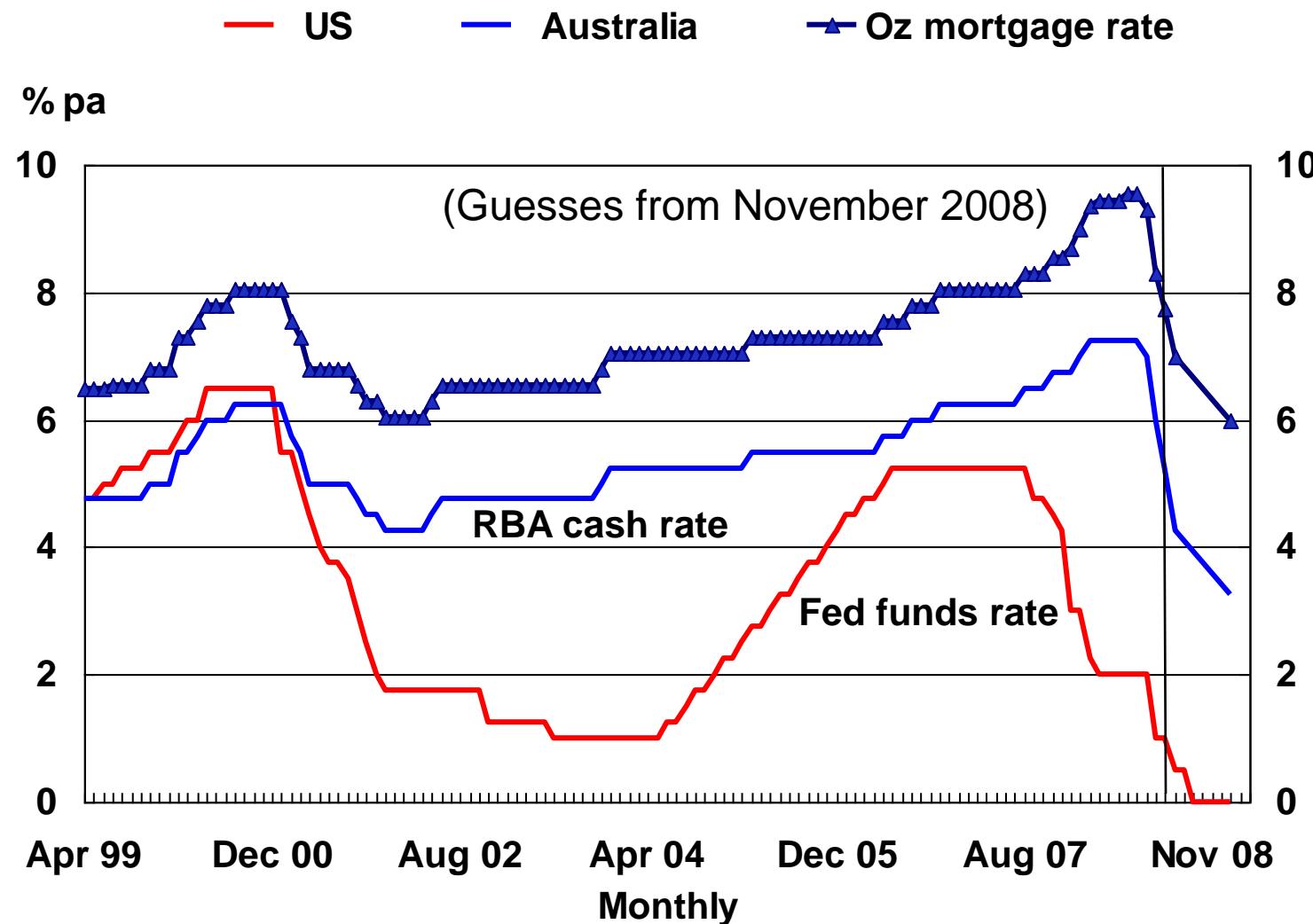
Source: S&P-Case/Shiller, November 2008

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



Source: Federal Reserve, November 2008

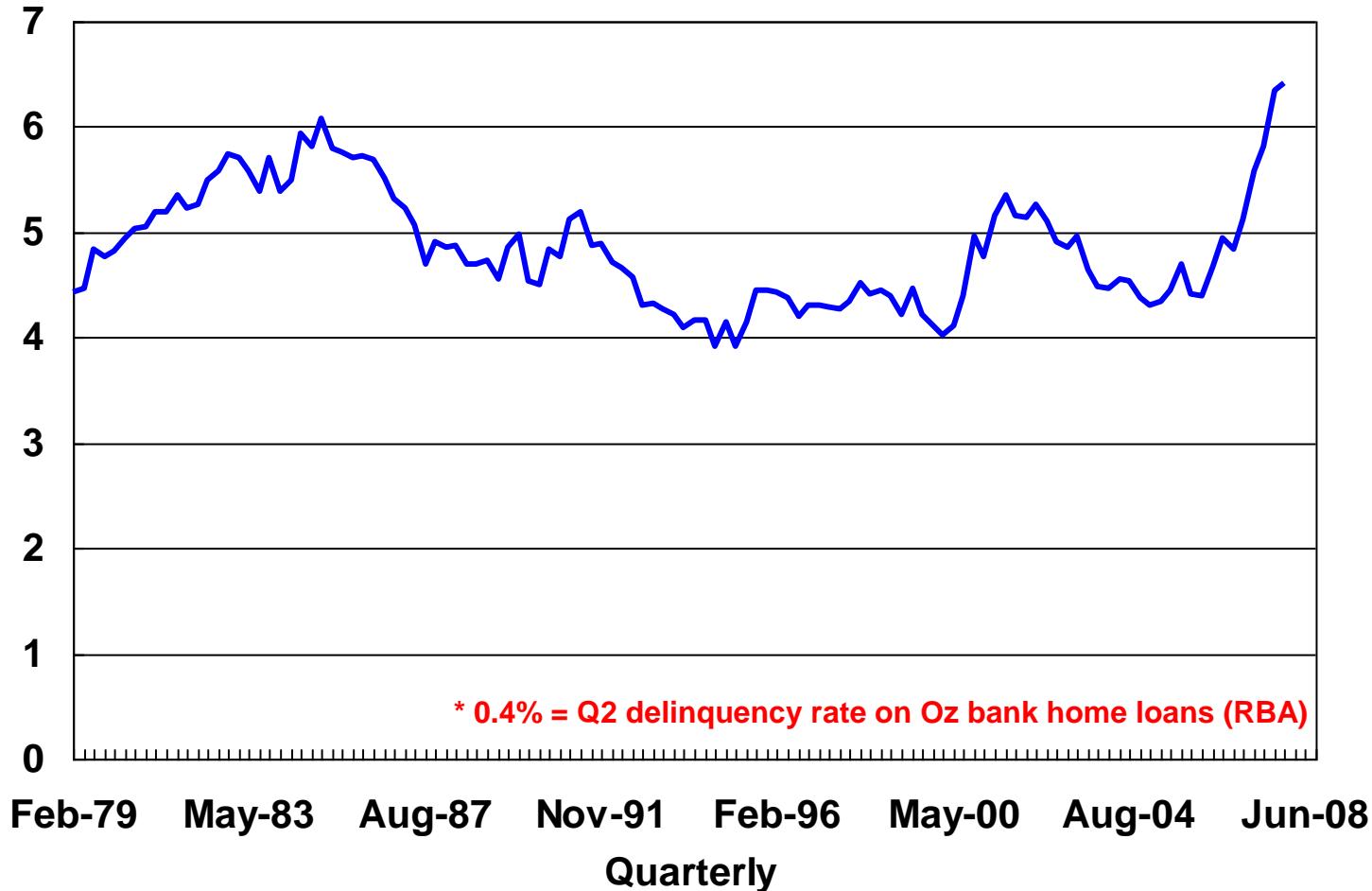
# RBA slashing mortgage rate towards 6%



Sources: RBA, MBL, November 2008

# US mortgage delinquencies

% of all housing loans



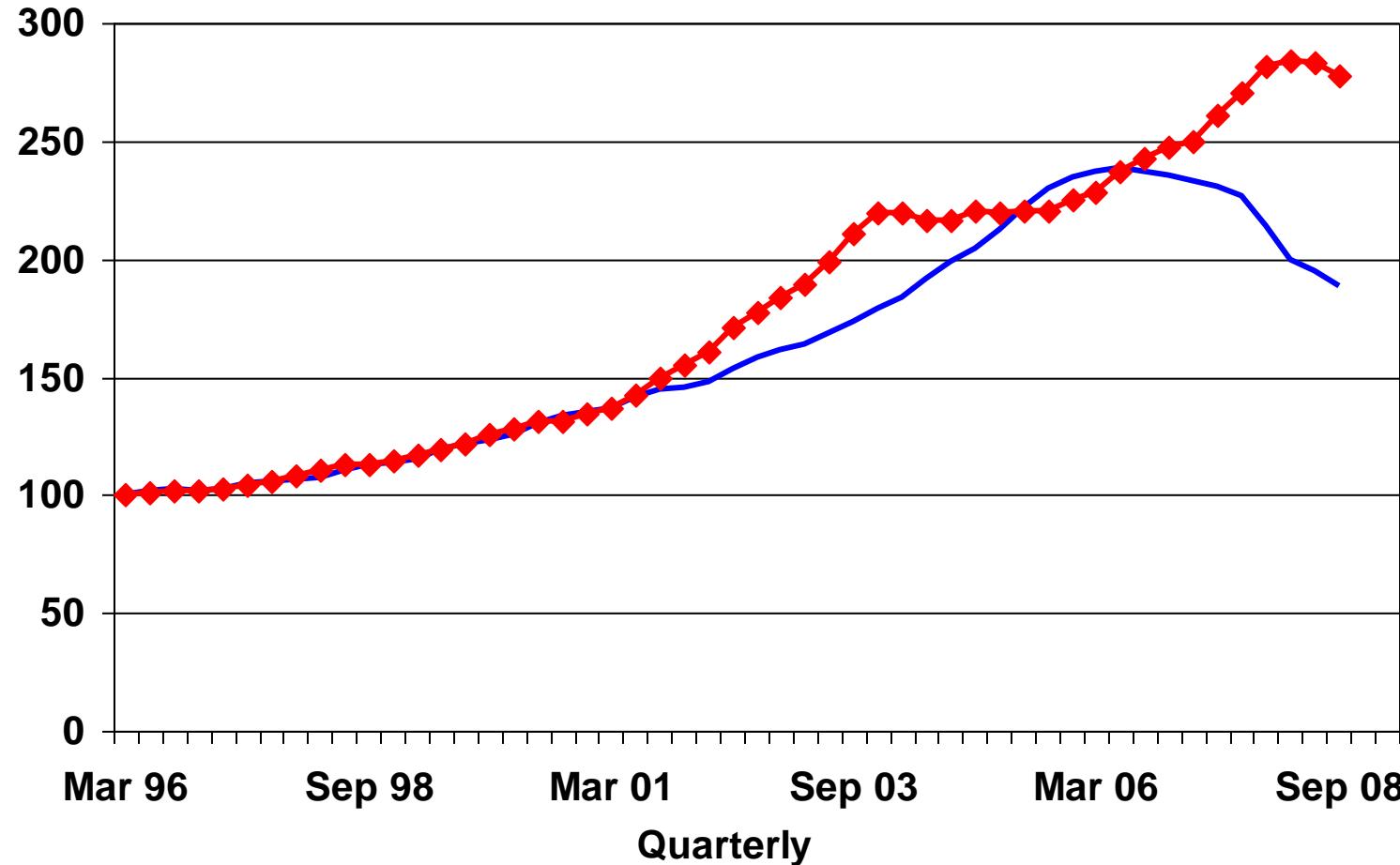
Source: Mortgage Bankers Association, November 2008



# Oz and US home prices

Index, Q1 1996=100

— US (Case-Shiller) — Oz (ABS)

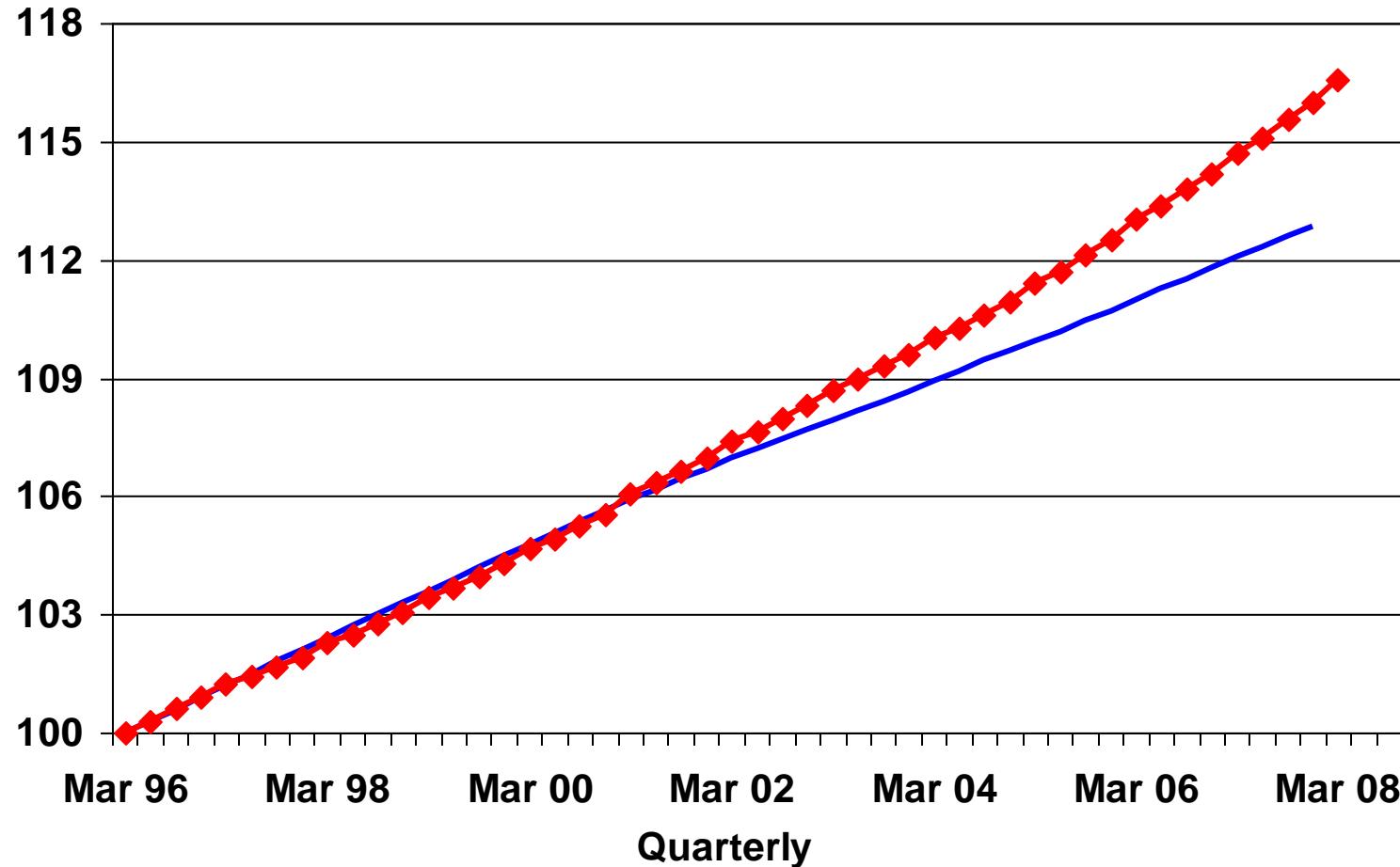


Source: ABS, S&P Case Shiller, November 2008

# Oz and US populations

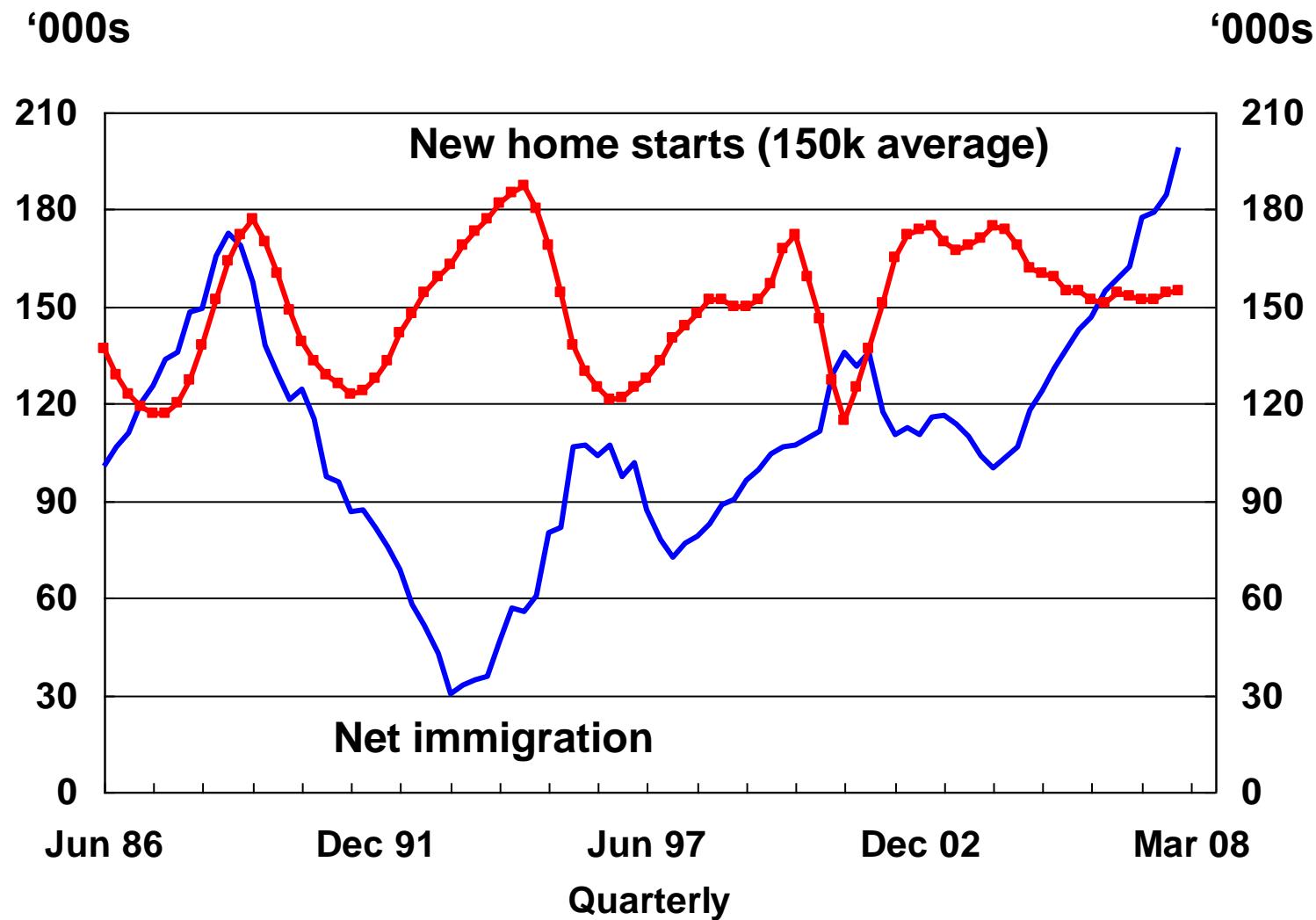
Index, Q1 1996=100

US Australia



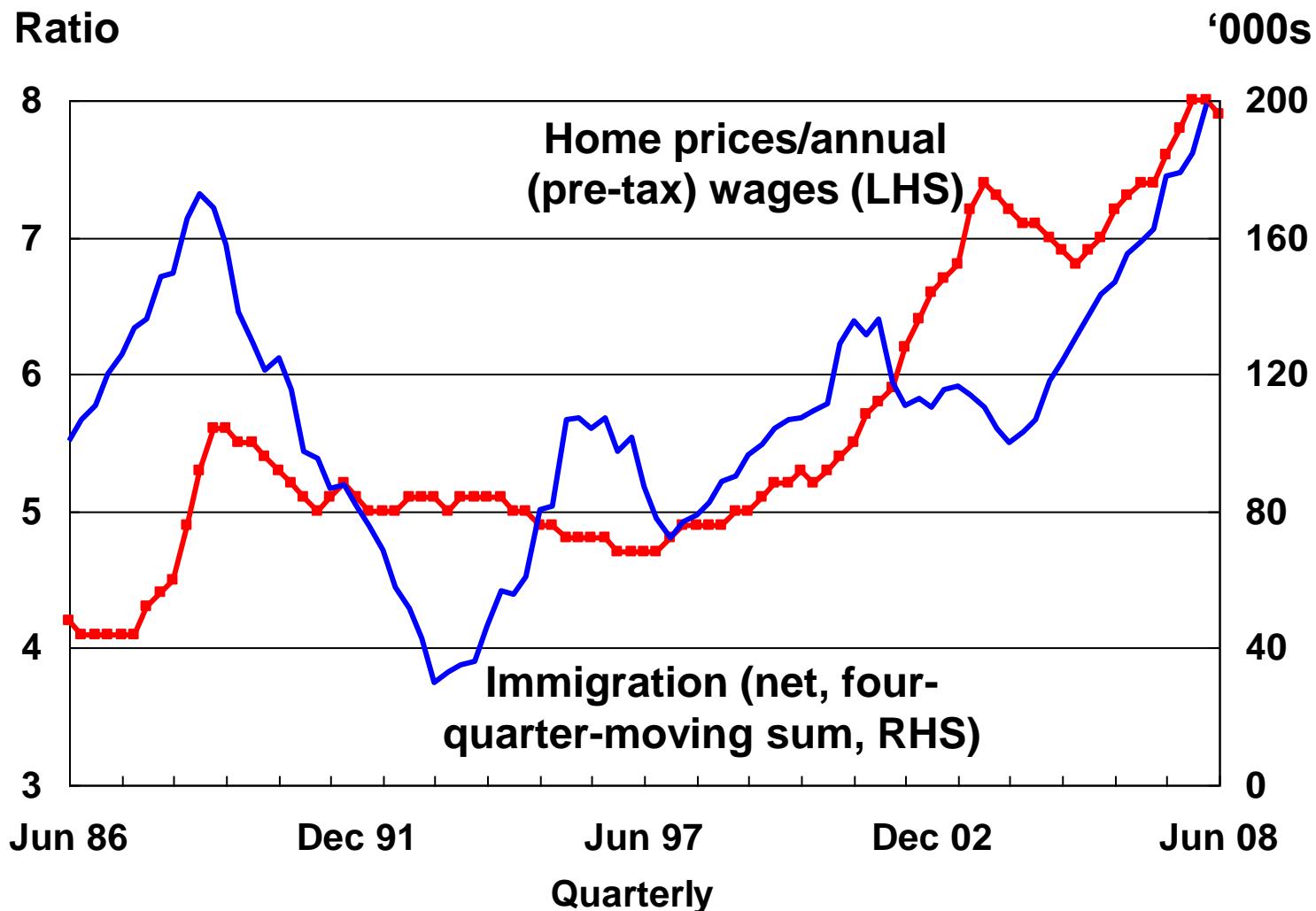
Source: ABS, S&P Case Shiller, November 2008

# Unlike US, no overbuild in Oz housing



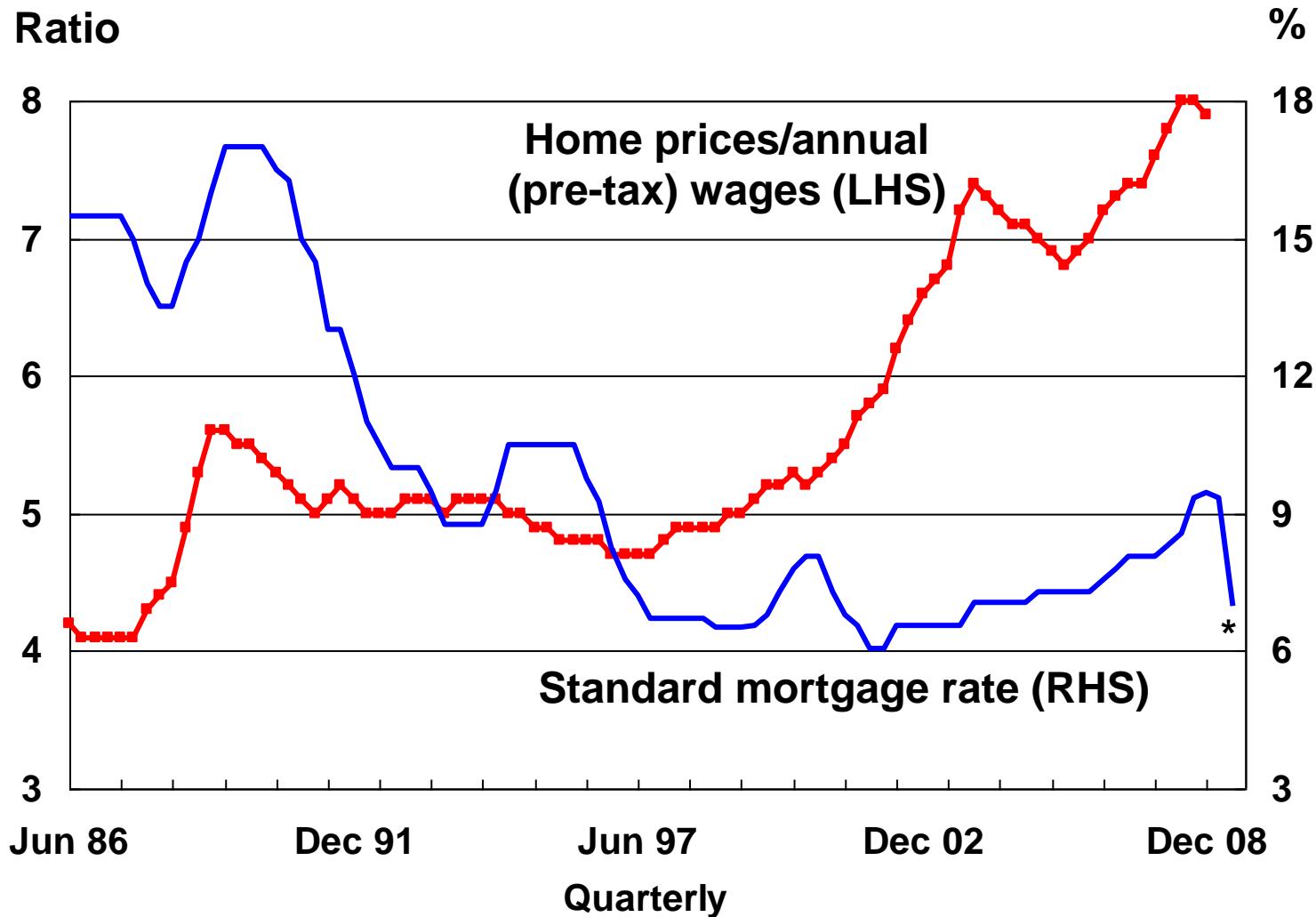
Source: ABS, November 2008

# Oz immigration and real home prices

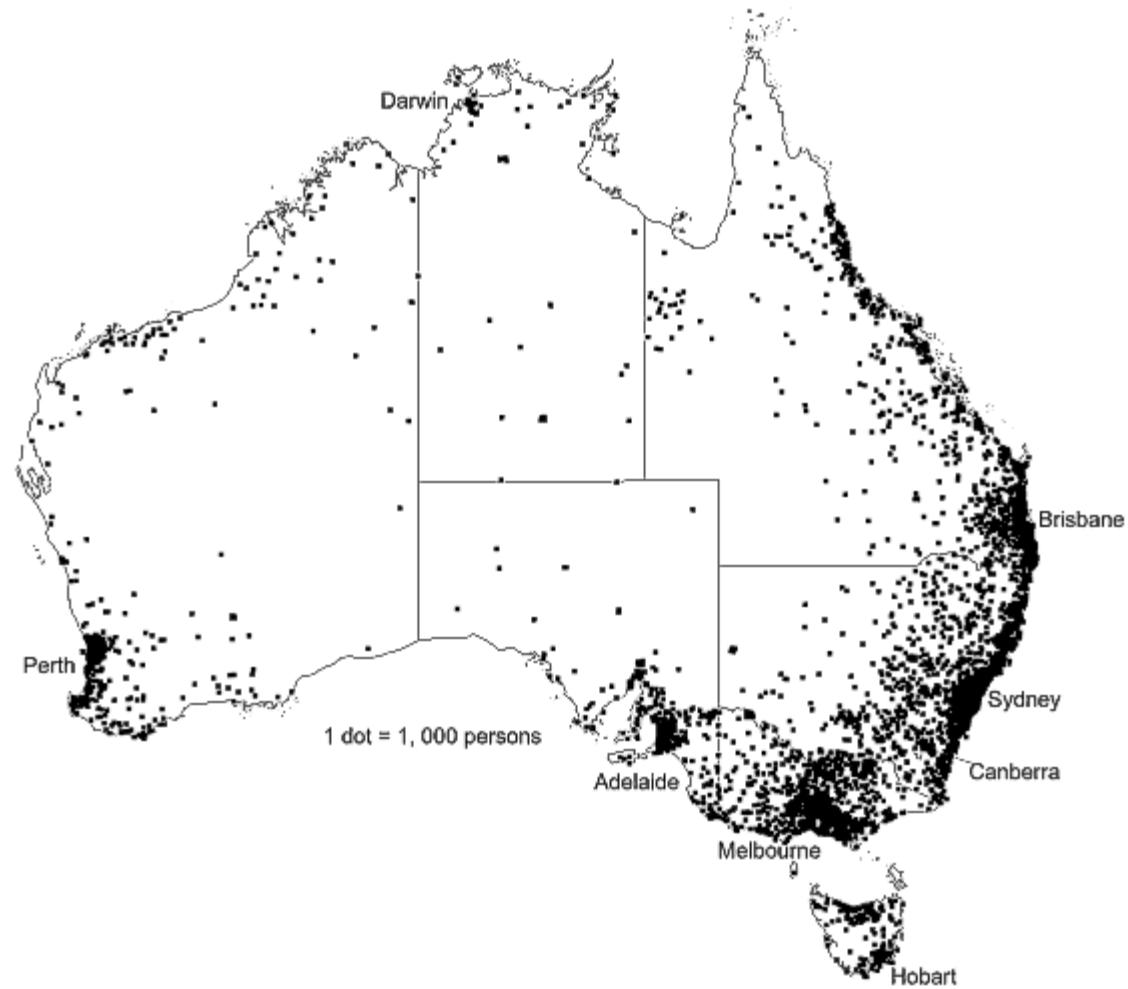


Sources: ABS (Wages = AWOTE), October 2008

# Oz mortgage rate and real home prices



# 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))

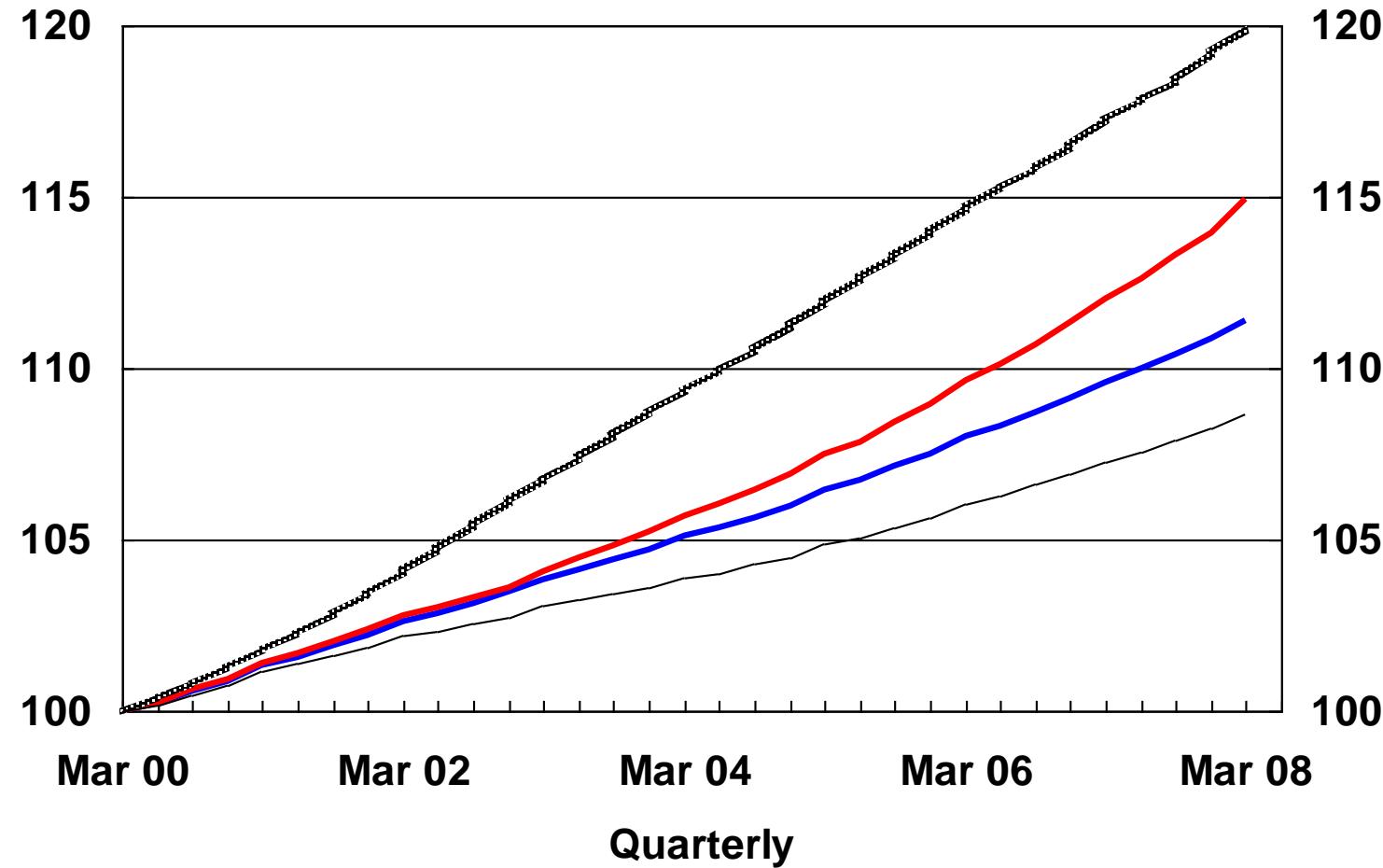
**Source:** [www.demographia.com](http://www.demographia.com); Survey of larger centres in US, UK, Canada, Australia, NZ and Ireland

# Population growth by State

Index =100  
in Q1 2000

Australia  
Qld

WA  
Aus less Qld&WA



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



*This information has been prepared on a strictly confidential basis by Macquarie Bank Limited ABN 46 008 583 542 ("Macquarie") and may neither be reproduced in whole or in part, nor may any of its contents be divulged to any third party without the prior written consent of Macquarie. This information is not intended to create legal relations and is not binding on Macquarie under any circumstances whatsoever. This information has been prepared in good faith and is based on information obtained from sources believed to be reliable, however Macquarie does not make any representation or warranty that it is accurate, complete or up to date. The information may be based on certain assumptions or market conditions. If those assumptions or market conditions change, the information may change. No independent verification of the information has been made. Any quotes given are indicative only. Any reference to past results is not necessarily indicative of future results. No part of this information is to be construed as a solicitation to buy or sell any product, or to engage in, or refrain from engaging in, any transaction.*

*To the extent permitted by law, neither Macquarie and its related bodies corporate ("Macquarie Group") nor any of its associates, directors, officers or employees, or any other person, makes any promise, guarantee, representation or warranty (express or implied) to any person as to the accuracy or completeness of this information, or of any other information, materials or opinions, whether written or oral, that have been, or may be, prepared or furnished by Macquarie Group, including, without limitation, economic and financial projections and risk evaluation. No responsibility or liability whatsoever (in negligence or otherwise) is accepted by any person for any errors, mis-statements or omissions in this information or any other information or materials. Without prejudice to the foregoing, neither Macquarie Group, nor any of its associates, directors, officers, employees nor any other person shall be liable for any loss or damage (whether direct, indirect or consequential) suffered by any person as a result of relying on any statement in or omission from this information. Nothing in this information should be construed as legal, financial, accounting, tax or other advice. Macquarie Group or its associates, directors, officers or employees may have interests in the financial products referred to in this information by acting in various roles including as investment banker, underwriter or dealer, holder of principal positions, broker, lender or adviser and may receive fees, brokerage or commissions for acting in those capacities. In addition, Macquarie Group and its associates, directors, officers or employees may buy or sell the financial products as principal or agent and as such may effect transactions which are not consistent with any recommendations in this information. This information is distributed in the UK by Macquarie Bank Limited, which is authorised and regulated by the Financial Services Authority. This information is distributed in European Economic Area by Macquarie Bank International Limited (MBI), which is authorised and regulated by the Financial Services Authority. This information is distributed in the US by Macquarie Capital (USA) Inc. ("MC(USA)"). If this information is distributed in Taiwan, it is strictly for the benefit of the intended recipients as institutional investors only and is not for public circulation in Taiwan. Macquarie is not an authorized institution under the Banking Act and does not carry on banking business in Taiwan and hence, not subject to the supervision of the Taiwan Financial Supervisory Commission. Distribution in New Zealand is by Macquarie New Zealand Ltd ("MNZL"), in Hong Kong by Macquarie Securities Limited ("MCSL") and in Singapore by Macquarie Capital Securities (Singapore) Pte Ltd (Company Registration Number: 198702912C) ("MCS(S)PL"). If the information is distributed in Hong Kong, this information is for the general information of professional investors only. Macquarie does not carry on banking business in Hong Kong, is not an authorized institution under the Banking Ordinance and not subject to the supervision of the Hong Kong Monetary Authority. MC(USA), MCSL, MCS(S)PL, MBI and MNZL are not authorised deposit-taking institutions for the purposes of the Banking Act 1959 (Commonwealth of Australia), and their obligations do not represent deposits or other liabilities of Macquarie. Macquarie provides a limited guarantee to the Monetary Authority of Singapore in respect of Macquarie Capital Securities (Singapore) Pte Limited for up to SGD25m under the Securities and Futures Act 2001 (A42/2001). Macquarie does not guarantee or otherwise provide assurance in respect of the obligations of any of the other named entities. © Macquarie Group 2008*