

March 2010 Economic Quarterly

Key points

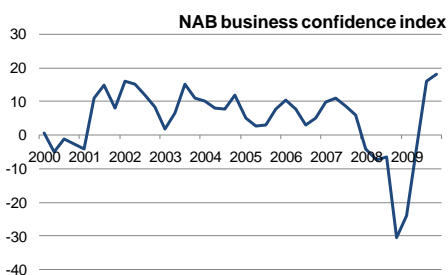
Highlights of last three months include: the RBA moves again and again in April; almost all data and comment points to upward pressure on our housing market; most local economic indicators remain robust; the US is on the mend and a sanguine belief Greece won't be allowed to default. (This appears to have occurred effective 13th April).

Statistics, statistics and more statistics (last month)

- Business confidence; consumer confidence (steady); unemployment (steady); new home building; job vacancies; vehicle sales (year to March).
- Housing finance; credit card transactions; new home sales; retail sales; manufacturing demand; trade deficit (increases).



Source: ABS



Source: NAB

Australia

Putting the last three months and the next 6-9 months in perspective:

- Local economic indicators imply the trend is positive and improving;
- The RBA is acting precipitously and there is evidence to suggest that monetary strategy should be less pre-emptive and more cautious;
- The Federal Government must act responsibly in framing the May budget and not in the light of the pending Federal election; and
- ROW is recovering and while some threats remain, the GFC is now the subject of text books and history.

There is not a statement to emerge from the RBA in recent months that is not ominously warning about housing demand and house price pressures; a strong commodity price cycle and potential skilled labour shortages in mining and related industries. And some of these concerns are clearly evident; although since October 2009 the RBA has increased the cash rate by 42% to 4.25bps.

But there are two schools of thought, the first of which is that the RBA is again

Rest of World

According to a report by BBC Business in September 2009, the world's largest economies have spent "US\$10k for every person in a bid to fix the financial meltdown of the past year." Based on IMF data, these countries have spent a total of US\$10T (currently US\$10.8T).

The UK and US beat the rest of the world hands down, although the UK was a lot more generous and spent 94% of its GDP, c/f 25% in the US.

Summary

The challenges for Australia over the next 12 months are modest and lie somewhere between a May budget that is political (although contractionary) and a trigger happy Central Bank. Everything else should look after itself.

The ROW will enter the Northern summer with most signs suggesting stabilization

jumping at shadows to kill the inflationary genie before it gets out of the bottle.

The second is that it is building up an expectation of higher rates in the future without any current intention of executing that strategy.

That is, it is trying to dampen expectations that could lead to inflationary pressures.

An analysis of recent data shows some remission in monthly economic harbingers, yet the overall trends remain robust and largely unchallenged. This brings into sharp perspective the role of the Federal Government in shaping Fiscal policy against a relatively healthy economy and hawkish monetary policy.

Economists feel it would be irresponsible of the Federal Government to not bring down a Budget in May 2010 that reigns in spending and targets a substantial reduction in the current and future budget deficits.

Australia has bathed in the warm glow of a strong resurgence in the Chinese economy which is likely to be reinforced by a broad based recovery across most developed countries in CY10.

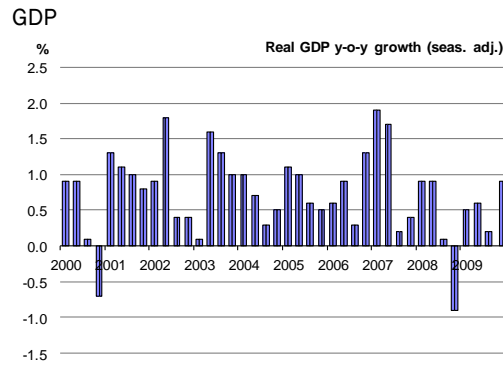
In all, Australia remains the lucky country.

The IMF is forecasting the global economy to grow by 3.9% in calendar 2010, following a contraction of 0.8% in CY09. While this is positive, challenges remain for some developed nations in Europe, namely the so called PIGS economies - Portugal, Ireland, Greece and Spain. In Portugal, unemployment is currently 10.4% and gross debt to GDP is 85%; Ireland - 13% and 83%; Greece - 9.7% and 125%; and Spain - 19.5% and 66%.

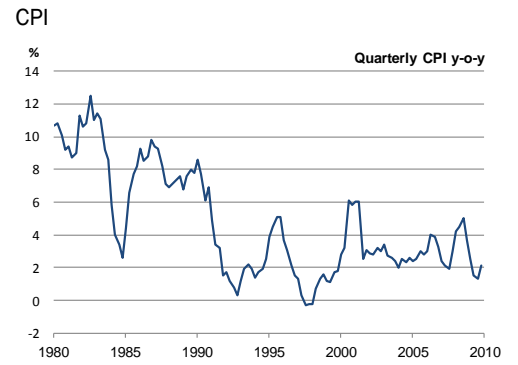
and a broad recovery across key metrics, such as unemployment and real growth. Once the sigh of relief is audible, 2011 may well be remembered as the year that Government's scramble to reign in debt while interest rates move upwards quickly. (That cycle could start at the end of CY10, if not sooner by the way).

9 April 2010

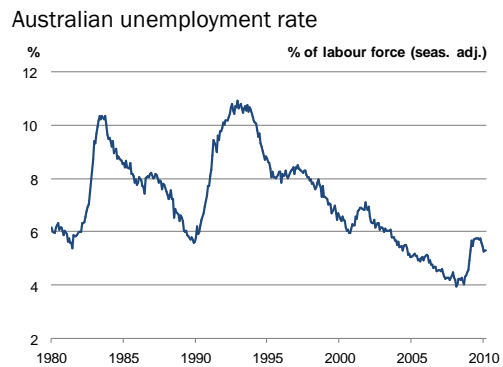
Big picture indicators



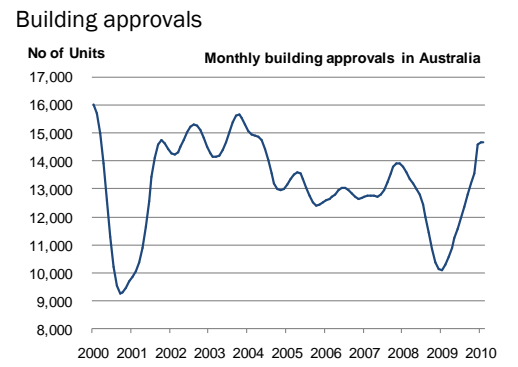
Source: RBA



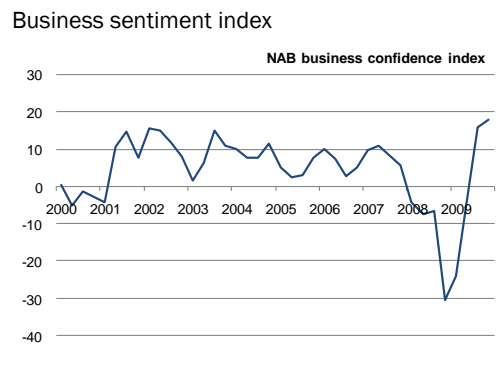
Source: ABS



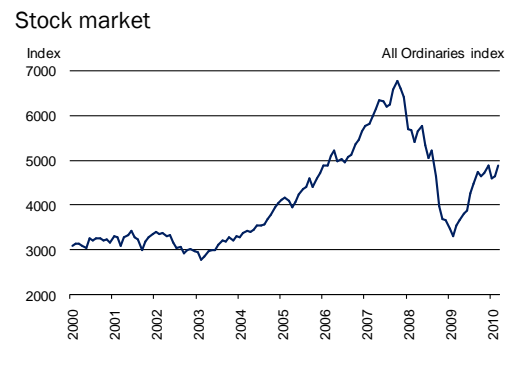
Source: ABS



Source: ABS



Source: NAB



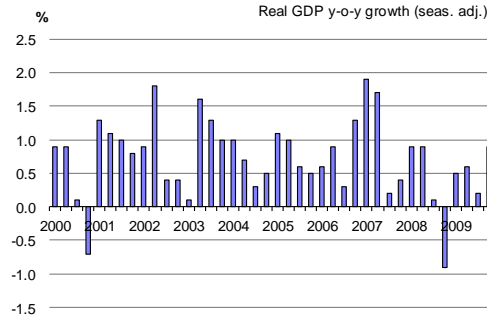
Source: IRESS

KEYPOINTS

- Most signs suggest improving economic conditions across most indicators.
- Critically, business confidence remains particularly strong (favouring the investment cycle) and unemployment remains low and thus underpinning the consumption cycle. What is not shown here though is the rate of underemployment, which is declining but remains high at 7.6%.

Economic Activity

Real GDP



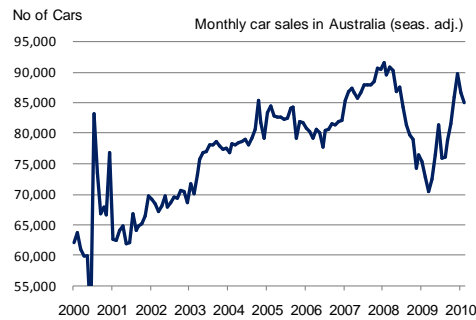
Source: RBA

Building approvals



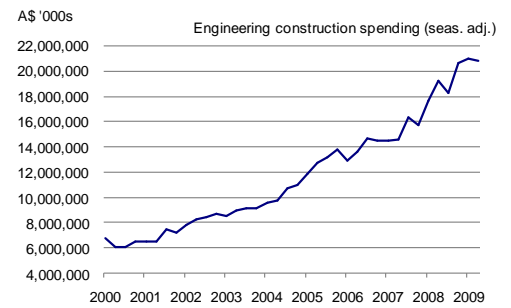
Source: ABS

Car sales



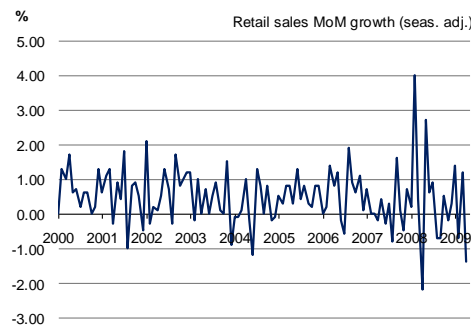
Source: ABS

Engineering construction spending



Source: ABS

Retail sales



Source: ABS

ANZ job ads



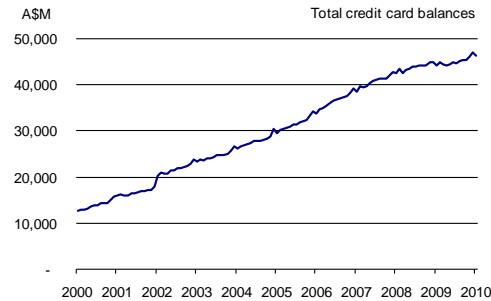
Source: ANZ

KEYPOINTS

- According to statistics from the Automotive Dealer Data Base car sales have recorded a strong three months to March 2010, up 18.2% on the pcp. This is not reflected in the RBA graph. While the figures from the ABS (above) only go up to February at present, the Federal Chamber of Automotive Industries (FCAI) has produced survey data showing a strong March 2010 and robust year-on-year figures. No doubt the Governments stimulus package allowing 50% tax deductions to SME's has had an impact.
- Retail sales remain volatile, although the growth in job ads, low unemployment (see previous charts) and relatively high US\$/A\$ should keep this trend positive. The potential dampener, however, is higher interest rates (thus mortgage payments and rents) which could crowd out retail sales.

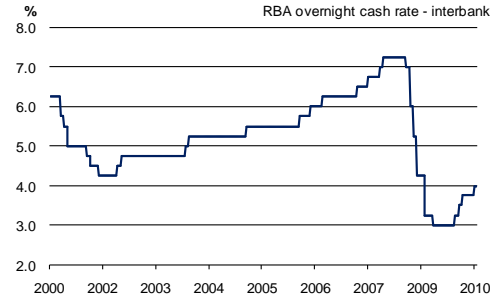
Finance

Credit card balances



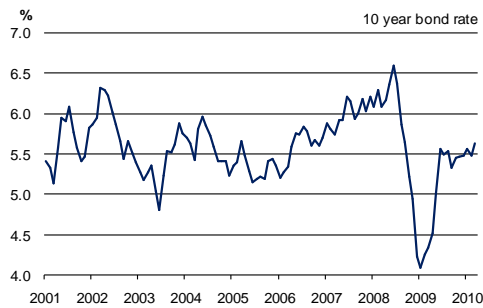
Source: RBA

Overnight cash rate



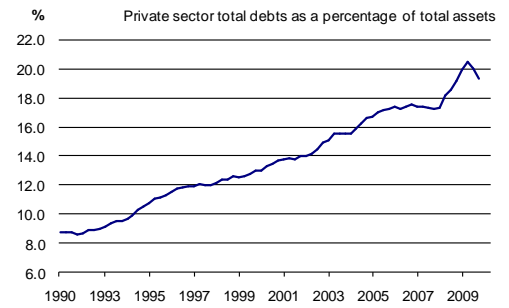
Source: RBA

10 year bond



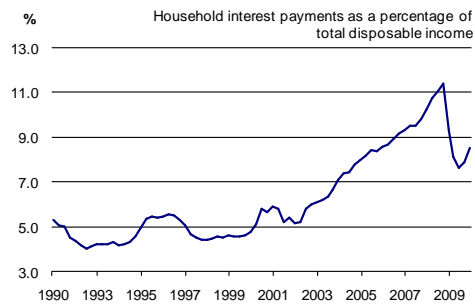
Source: RBA

Private sector debt



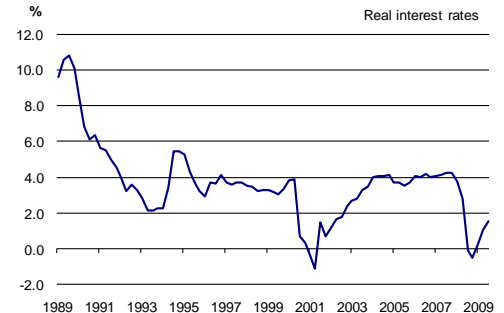
Source: RBA

Household interest payments



Source: RBA

Interest rates



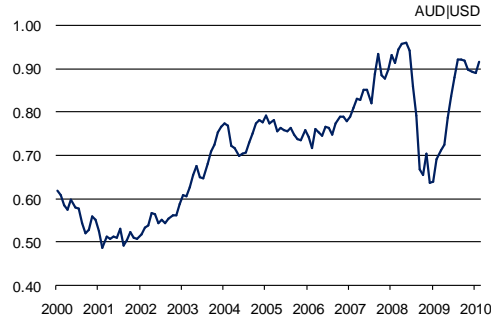
Source: RBA; KPM.

KEYPOINTS

- Real interest rates are increasing and this is contractionary. As noted on the front page, the Central Bank may need to temper its hawkish exuberance. Credit card debt is a real long term worry as rates rise and consumers still live off credit. Higher cost of living with electricity bills rising by as much as 60% could see this increase.
- This view is reinforced by the increasing proportion of disposable income absorbed by household interest payments. While credit card balances are increasing, private sector debt is falling. Business balance sheets are now a lot healthier than consumer balance sheets.

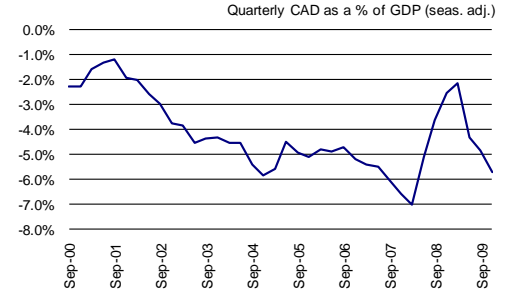
External

A\$ | US\$



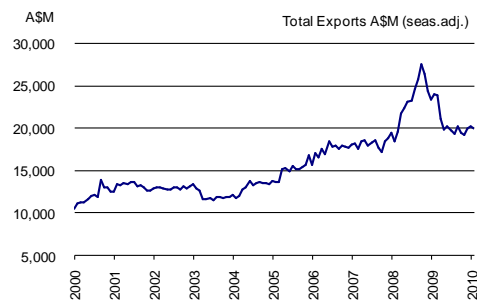
Source: RBA

CAD as a % of GDP



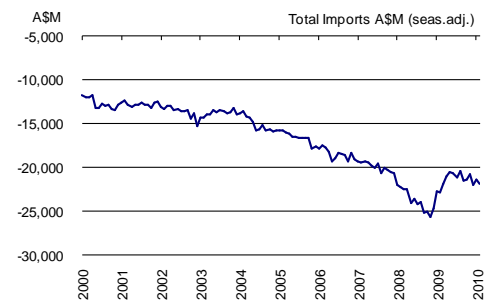
Source ABS, KPM

Exports



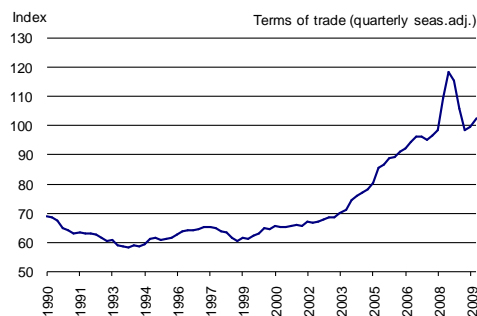
Source: ABS

Imports



Source: ABS

Terms of trade



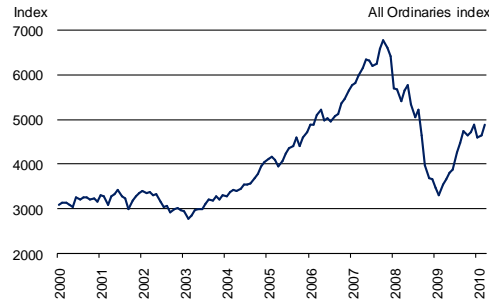
Source: RBA

KEYPOINTS

- It is interesting to watch both exports and imports as both appear to have plateaued. However, such an observation is flawed without similarly looking at exchange rates. Critically, imports are cheaper against the US\$ and the increase in imports coincides with the first graph which shows the strong improvement in the A\$/US\$ exchange rate over the last 12 months. The plateauing corresponds with the relative stability of that exchange rate relationship. The reverse is true of exports, which have become more expensive against the US\$. Again this coincides nicely with the first graph.
- But look at the trends – the A\$/US\$ has been on a strong upwards improvement since 2000, yet exports (relatively more expensive) have grown strongly. In a couple of words that can be largely described as “ the China syndrome.” Imports, on the other hand, have experienced a similarly increasing trend which is correlated with the exchange rate.

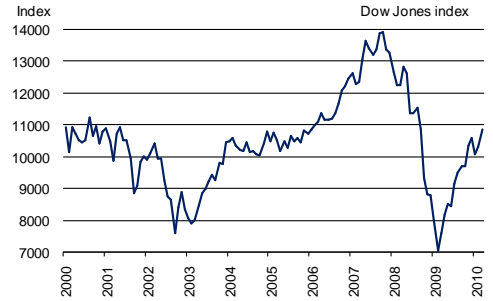
Markets

ASX



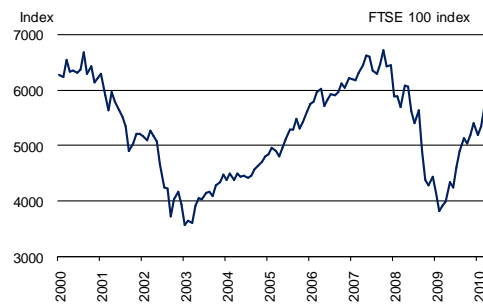
Source: IRESS

DOW



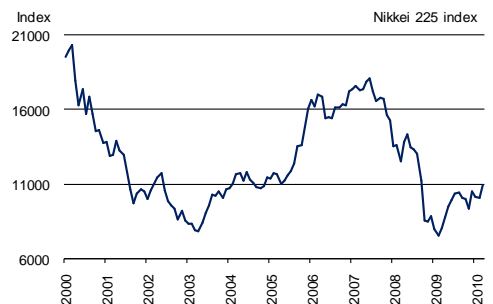
Source: IRESS

FTSE



Source: IRESS

Nikkei



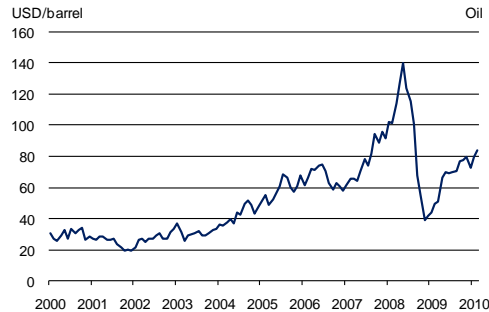
Source: IRESS

KEYPOINTS

- All markets have bounced and largely maintained that momentum. And potentially all indices (excluding the Nikkei) could reclaim their former pole positions in the next 1-2 years.
- However, a classic example of irrational exuberance and complete impotence of government policy to redress the resulting disaster can be viewed from looking at the Nikkei. It was just below 21,000 in 2000 and never again reached those same dizzying heights. It now has one of the worst debt/GDP ratios in the world and is clearly stagnating.

Commodities

Oil



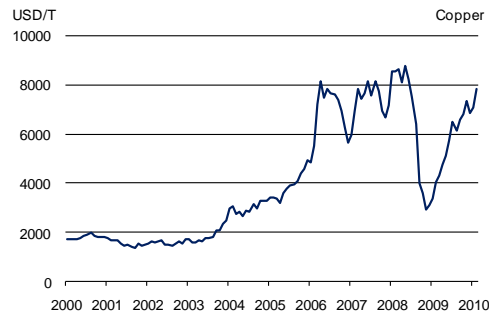
Source: Union Pacific

Aluminum



Source: LME

Copper



Source: LME

Gold



Source: RBA

Nickel



Source: LME

KEYPOINTS

- All commodity prices have rebounded and remain on upward trends. We would anticipate that outside of any ascetic shifts in Chinese growth policy, that the predicted broad recovery in the world's economies will underpin further price escalation.

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