

Investment markets research – Economic note

8 May 2009

RBA holds fire, as data stabilises

The Reserve Bank of Australia (RBA) held the official cash rate steady at 3.0% at its Board meeting earlier this week. In the accompanying statement, the RBA noted that “the global economy has contracted further during the first few months of this year (and) the near-term outlook remains weak”. However, the RBA also stated that “there are further signs of stabilisation in several countries” with the Chinese economy, in particular, picking up.

The RBA also highlighted the view that there has been “considerable economic policy stimulus”, which should help contain the downturn and support an eventual recovery and that while financial markets are improving, confidence remains fragile and balance sheets remain under pressure. Importantly, despite the higher-than-expected underlying inflation data for Q1 09, the RBA stated that we are “likely to see inflation continue to abate”, given lower capacity utilisations and rising unemployment.

The RBA also noted that “monetary policy has been eased considerably” and debt servicing burdens have been eased significantly. Looking ahead the RBA noted that “the stance of monetary policy, together with the substantial fiscal initiatives, will provide significant support to domestic demand over the period ahead”. The RBA will consider how economic and conditions unfold in the period ahead and how this may impinge on prospects for a sustainable recovery in economic activity in assessing whether further interest rate cuts are required.

In today’s “Statement on Monetary Policy” (SMP), the RBA provided some more details on its outlook for policy and the economy, most specifically via an update of its growth and inflation forecasts (see table below for details).

The overall tone of today’s SMP is one that suggests the RBA thinks it is near the end of the monetary policy easing cycle and is consistent with its efforts over recent weeks to assist in building confidence. The RBA noted today that “while near-term outcomes (for the Australian economy) are likely to be weak, there are reasonable grounds to expect that a recovery will begin by the end of the year, provided global conditions continue to stabilise”.

The final part of this sentence is obviously critical – if the global economy stabilises then the RBA may be near the end of its easing cycle, but if global conditions deteriorate again (ie. another financial market event in the US and/or Europe, or the apparent recovery in China fails to take hold), then the RBA has further room to ease policy again if necessary.

In addition, the RBA again highlighted the view that the policy stimulus to the Australian economy (both monetary and fiscal) over the past year has been significant and that this easing took place in expectation of the current weak economic conditions and before the emergence of clear evidence that inflation was declining.

In terms of the RBA’s forecasts, the following table provides details. What is most interesting is that the RBA is now officially forecasting a recession in the 2008/09 and calendar 2009 years, at -1.25% and -1.0%, respectively. The economy is then expected to recover to growth of 2.0% in 2010 and an-above trend rate of 3.75% in 2011. These forecasts fit the profile of a gradual recovery, with the RBA noting that “the recovery, however, is likely to be gradual at first, largely reflecting developments abroad, where growth is forecast to be below trend for some time.”

The RBA has also revised its inflation forecasts. Headline inflation is now forecast at just 2.25% at the end of 2009, 2.0% at the end of 2010 and just 1.5% for 2011, clearly reflecting the gradual nature of the economic recovery. Underlying inflation, however, is forecast to remain above the top end of the 2%-3% target range for 2009, before falling quickly during 2010 and 2011.

RBA economic and inflation forecasts, Current and (previous)

| %/yr | June 2009 | Dec 2009 | June 2010 | Dec 2010 | June 2011 | Dec 2011 |
|-------------|--------------|-------------|------------|-----------|-------------|-----------|
| GDP | -1.25 (0.25) | -1.0 (0.5) | 0.5 (1.25) | 2.0 (2.5) | 3.25 (3.25) | 3.75 (na) |
| Nonfarm GDP | -1.5 (0.0) | -1.0 (0.25) | 0.5 (1.25) | 2.0 (2.5) | 3.25 (3.25) | 3.75 (na) |
| CPI | 1.5 (1.75) | 2.25 (2.5) | 2.5 (2.75) | 2.0 (2.5) | 1.5 (2.0) | 1.5 (na) |
| Core CPI | 3.75 (3.5) | 3.25 (3.0) | 2.5 (2.75) | 2.0 (2.5) | 1.5 (2.0) | 1.5 (na) |

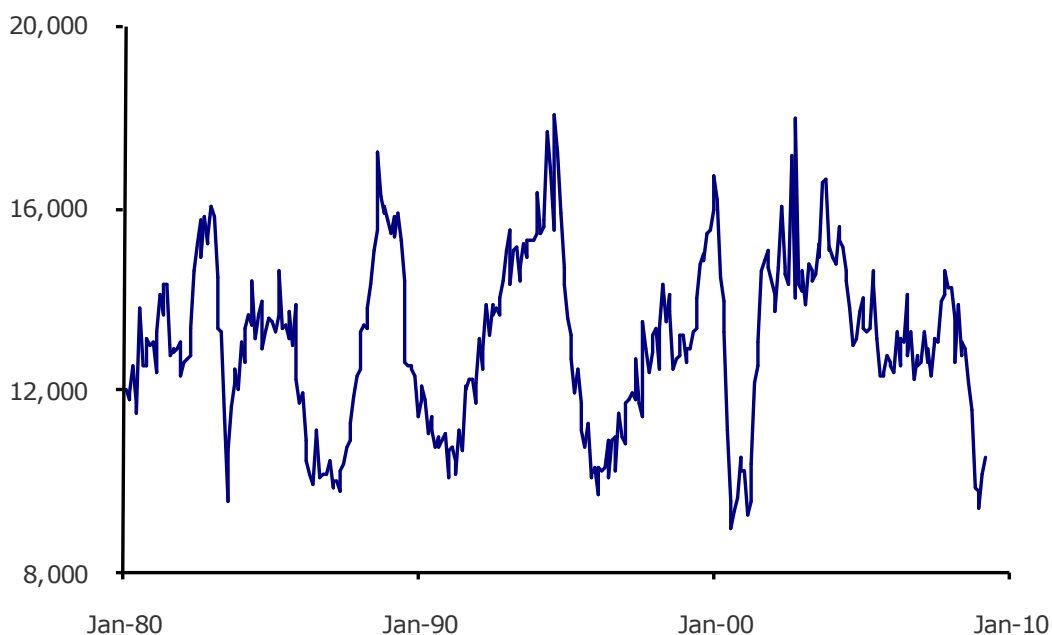
Source: RBA

In addition to today's RBA statement, the past week has seen a steady flow of economic data on the Australian economy that is noteworthy, especially as much of the data was better than market expectations and fits in with the RBA's "pause". Below we provide some details on this data flow:

Building approvals

- Australian building approvals rose 3.5% for the month of March, continuing on from an 8.0%/mth gain in February. However, on a year-on-year basis, approvals are down 16.5%.
- Looking at the breakdown, the gains were driven by both private sector houses (+2.8%/mth and the highest number of approvals since October 2008) and other dwellings (+2.8%/mth).
- Non-residential buildings fell 9.8%/mth and the small public sector also bounced another 36.0%/mth.
- On a state by state basis, the biggest gains on a monthly basis were in SA (+5.2%), Qld (+4.6%) and NSW (+4.1%). WA (-1.9%) declined on the month.

Building approvals – total number of approvals

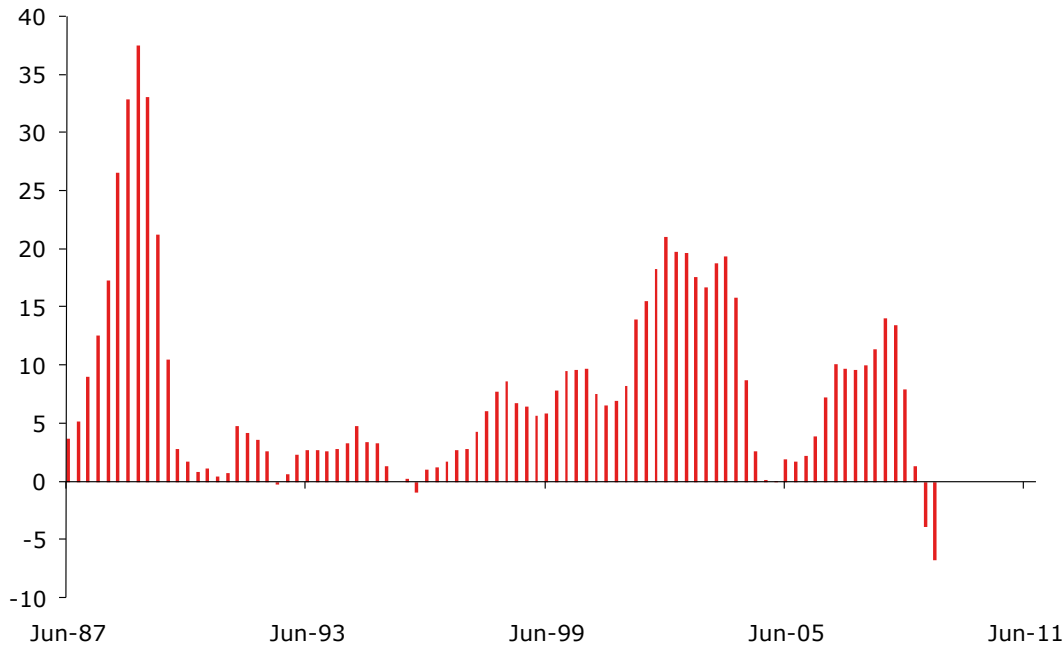


Source: ABS. Data to 31 March 2009

House prices

- House prices (as measured by the Australian Bureau of Statistics) fell by a larger-than-expected 2.2%/qtr in Q1 09.
- This took the 12-month change to -6.7%/yr, the worst outcome since the series began in 1987.
- Over the quarter, Perth experienced the sharpest falls (-3.6%), followed by Sydney (-2.9%), Melbourne (-2.3%), Brisbane (-1.1%) and Adelaide (-0.8%). Hobart (+0.1%) and Darwin (+2.2%) both managed increases.
- Over 12 months, Perth experienced the sharpest falls (-10.1%), as the resources boom slows. Sydney (-7.3%), Melbourne (-6.7%) and Brisbane (-6.3%) also experienced large falls, while Adelaide (-1.9%) experienced a more muted loss. Hobart (+0.6%) and Darwin (+10.8%) were the only capital cities to see gains.

Housing prices – y/y%

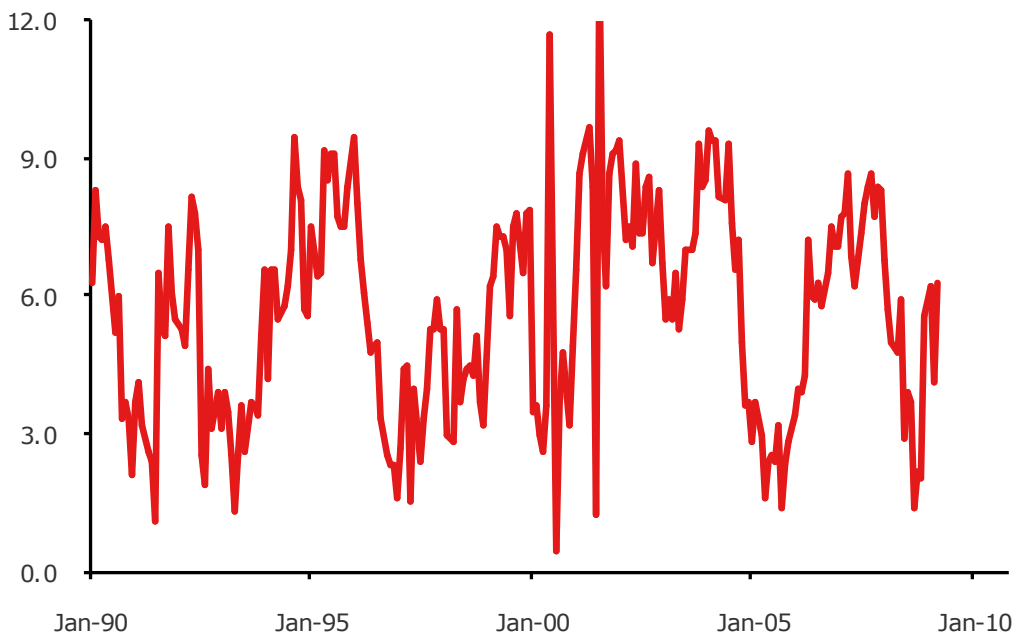


Source: ABS. Data to 31 March 2009

Retail sales

- Retail sales rebounded relatively strongly over March, as the government’s direct cash payments (which began in April) spurred spending. On a seasonally adjusted basis, retail sales rose 2.2%/mth, following on from a 2.0% fall in February. This took the annual pace of retail sales to 6.3%, from 4.1% in February, the highest level since February 2008.
- On an industry basis, the strongest gains were seen in department stores (+13.2%) and apparel (+6.4%), while gains also occurred in cafes and restaurants (+1.4%) and household goods (+1.3%). Food also saw a small +0.4% gain.
- Among the states, all but the ACT (-0.1%) rose, with Northern Territory (+4.2%), Queensland (+3.2%), Victoria (+2.7%) and South Australia (+2.4%) rising strongly. NSW had a more muted +1.2% monthly increase.

Retail sales – y/y%



Source: ABS. Data to 31 March 2009

Trade balance

- Australia's trade balance came in at a larger-than-expected at \$A2.5bn in March, the second largest surplus on record and up from a revised \$A1.75bn in February.
- Gains came from an increase in cereal grains exports and a fall in the import of capital goods, reflecting the expected fall in business investment over 2009.

Employment market

- Australia's April employment report was considerably stronger than expected. The unemployment rate surprised at 5.4% in April (consensus was 5.9%), falling from 5.7% in March.
- There was an unexpected 27,300 jobs created on the month, with a rebound in full-time employment. Despite the gain in employment on the month, the annual employment growth rate continued to slow, down to 0.1%/yr in April from 0.2% in March.
- Full-time employment jumped by 49,100, while part-time employment fell 21,800. The participation rate was marginally lower at 65.4% compared to 65.5% in March.
- On a state by state basis, NSW saw a large fall in the unemployment rate, 6.1% compared to 7.0% in March. Victoria was 5.9% compared to 6.0%, Queensland was 5.5% compared to 5.1%, South Australia was 6.2% compared to 5.7%, WA fell from 5.3% to 4.7%. Tasmania rose from 4.4% to 5.4%, while the NT rose slightly, from 4.5% to 4.6%. Canberra also fell to 2.9% from 3.8%.
- Female unemployment fell heavily, from 6.1% to 5.4%. Male unemployment falls were less muted, down to 5.7% from 6.0%.
- Like any month, the employment numbers can be very volatile and need to be read with some caution. The general market expectation is for unemployment to deteriorate further in 2009 and into 2010.

Employment annual growth rate and unemployment rate

Unemployment rate, % (LHS)

Employment growth, % (RHS)



Source: ABS. Data to 30 April 2009

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