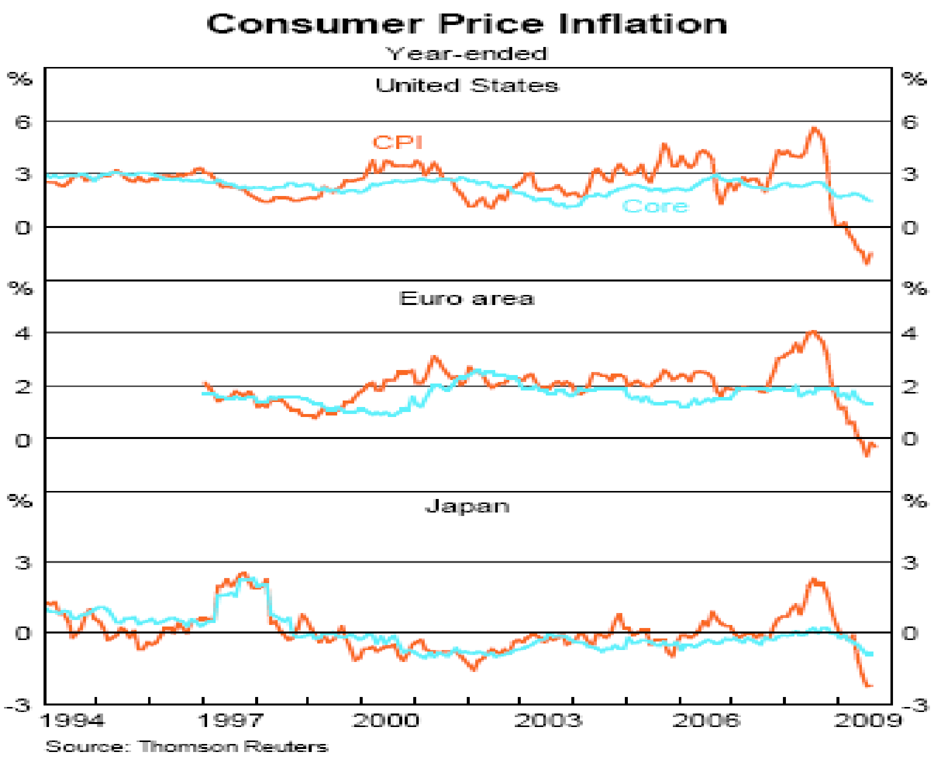
Australian recovery? A macro snapshot.

October 2009

Real GDP has ceased falling and in Australia remains positive

Australia's fortunes have been driven by a sharp rebound in China's economic activity

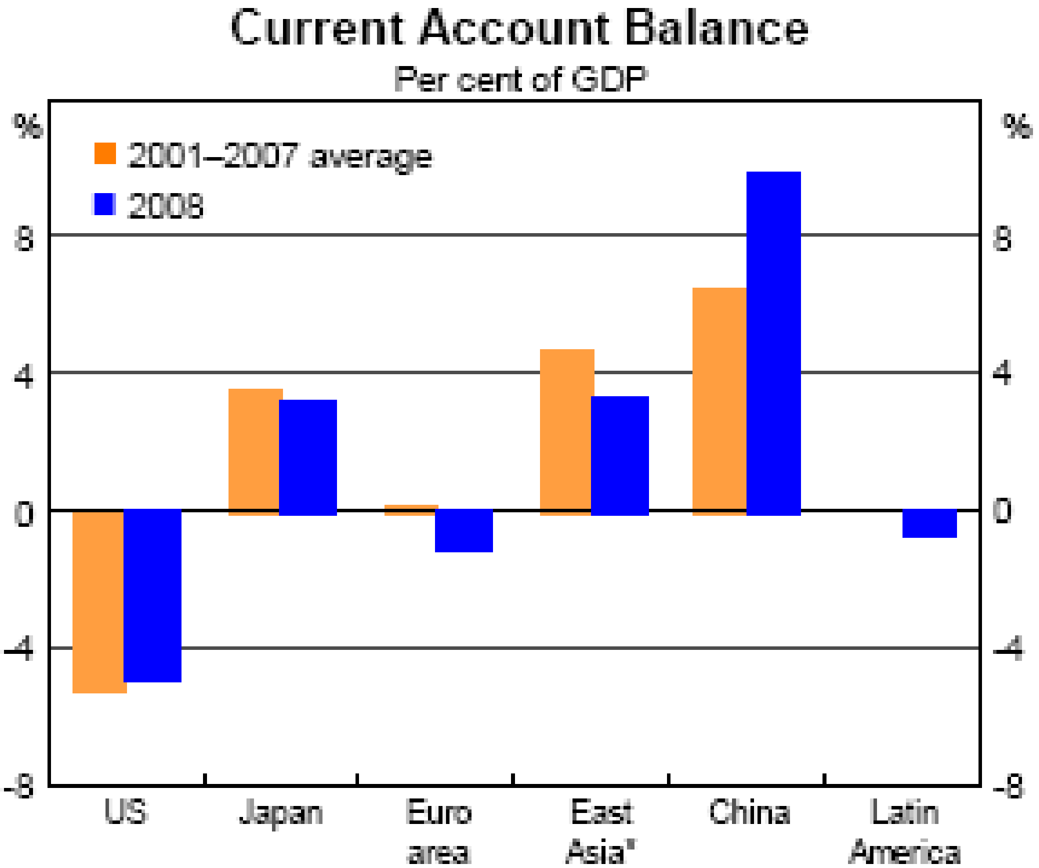
However the world is still gripped by deflationary risks



With significant rises in unemployment

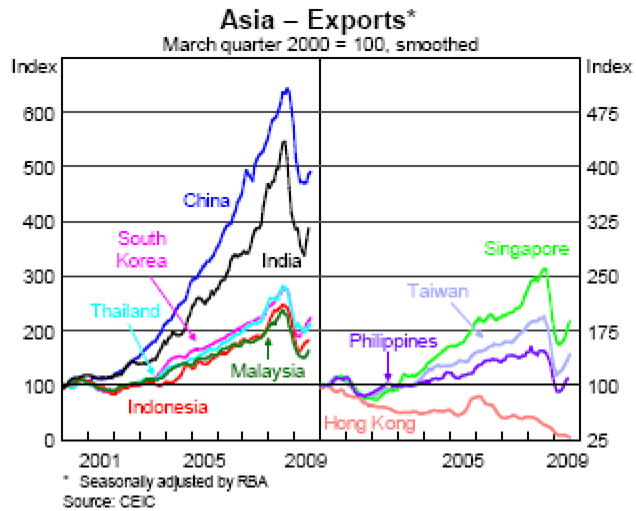
Sources: ABS; Thomson Reuters

And major imbalances persisting

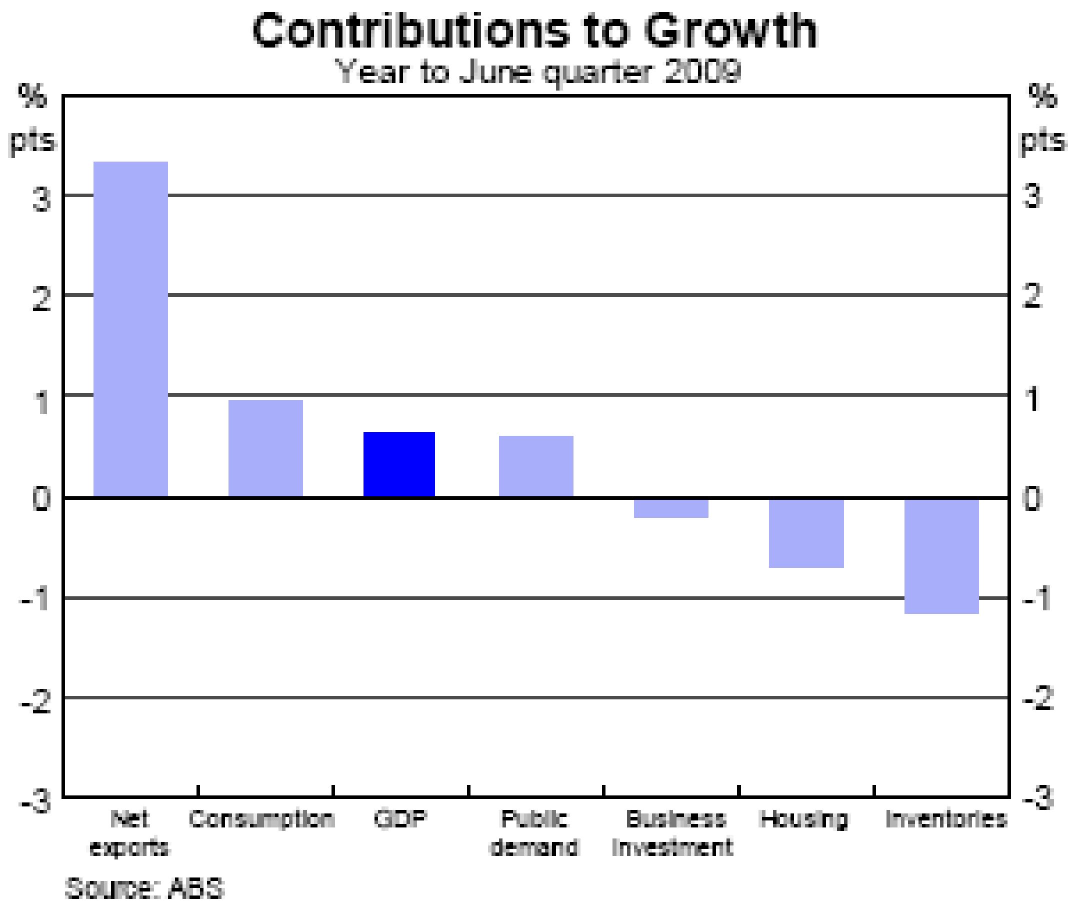


* Excluding China, Hong Kong and Japan
Sources: CEIC; Thomson Reuters

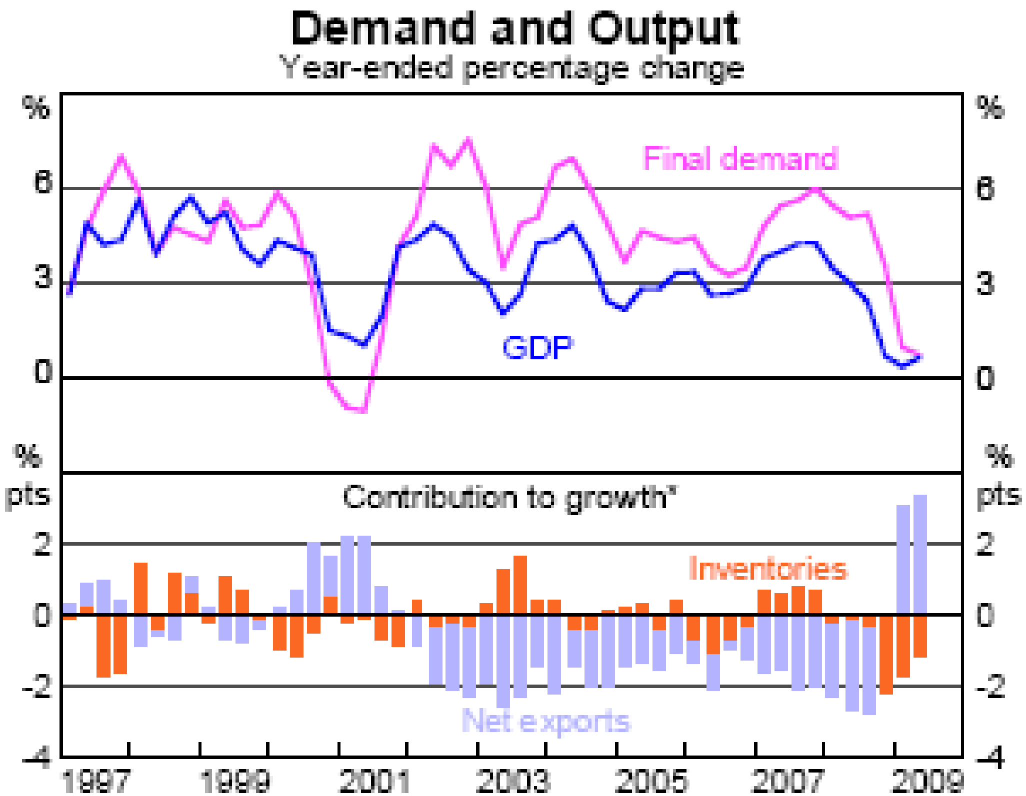
Australia is leveraged to the Asian growth story through commodity exports



Which can be seen in the contributions to GDP



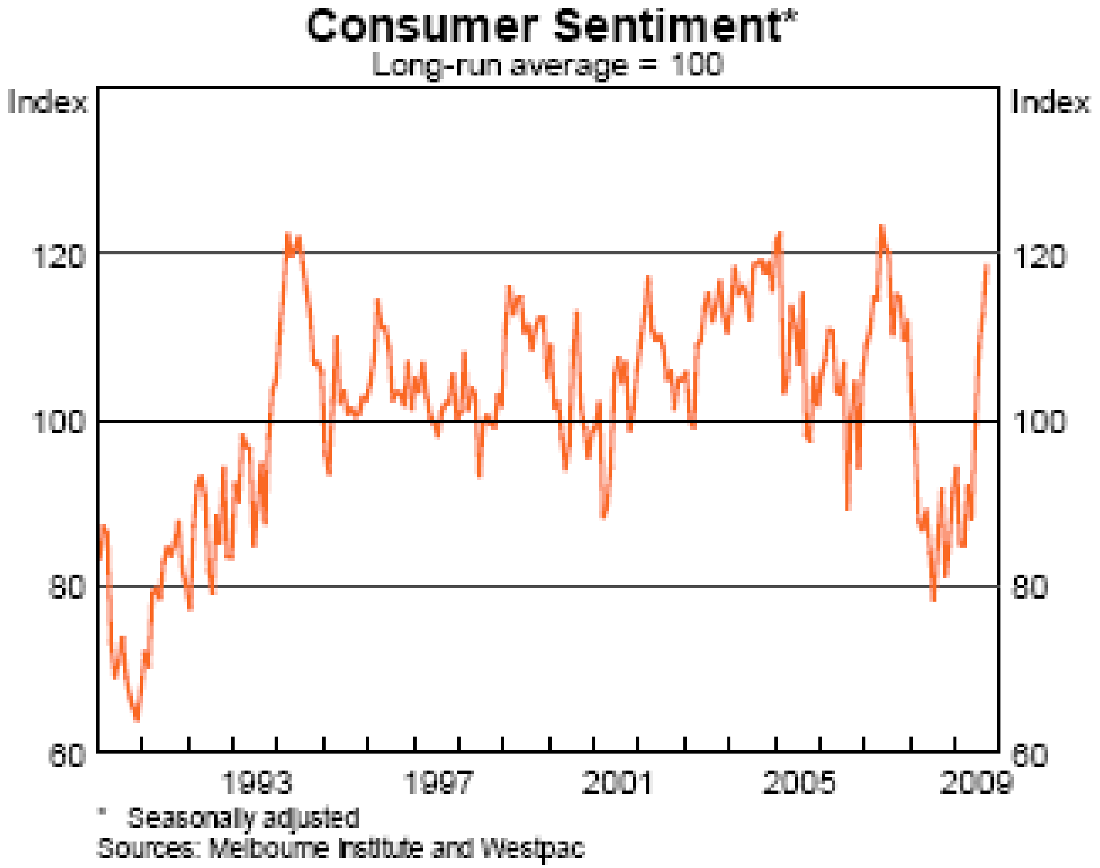
With the prospect of a turn around in housing and inventories Australian growth may be about to accelerate



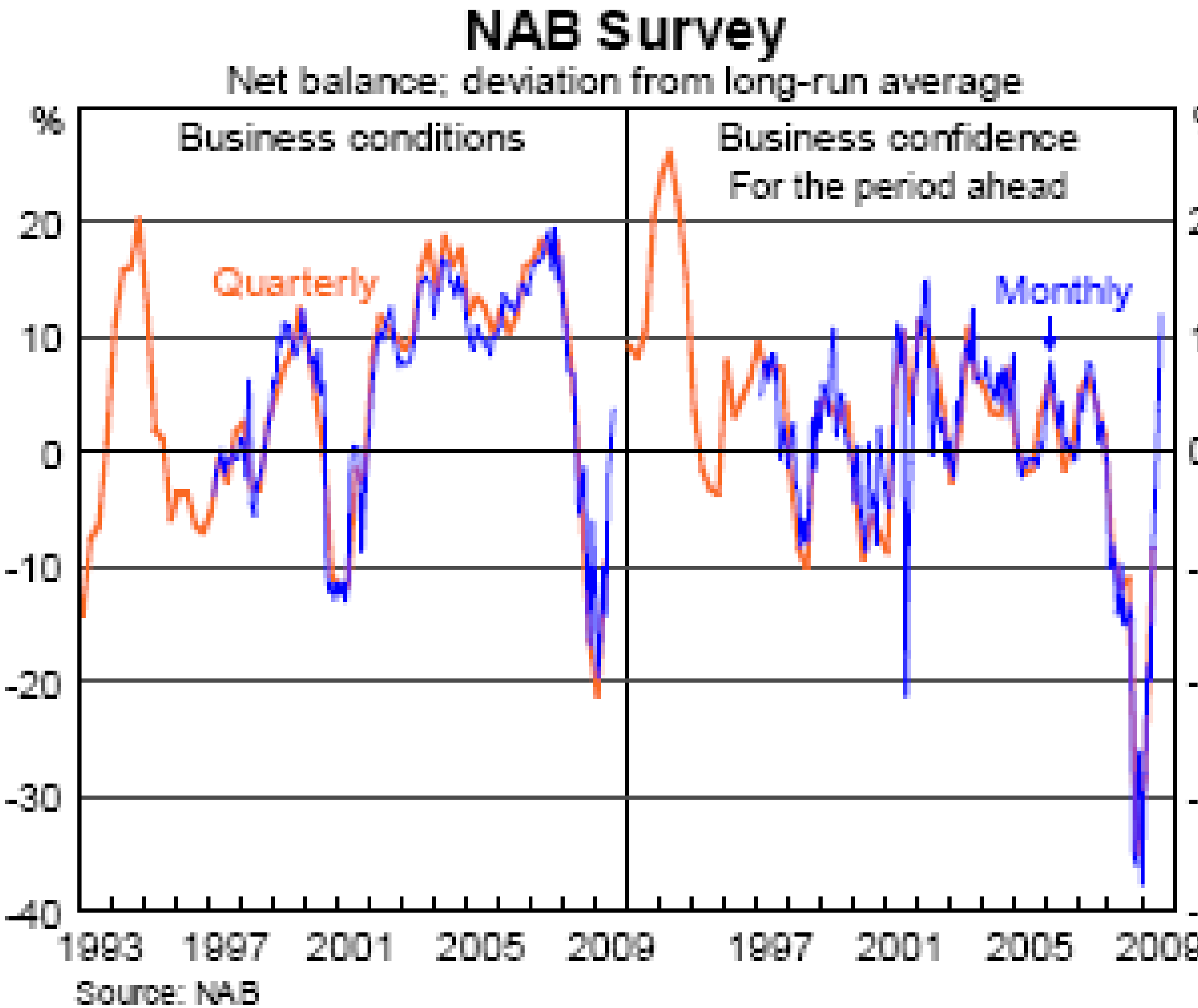
* Excludes RBA gold transactions

Source: ABS

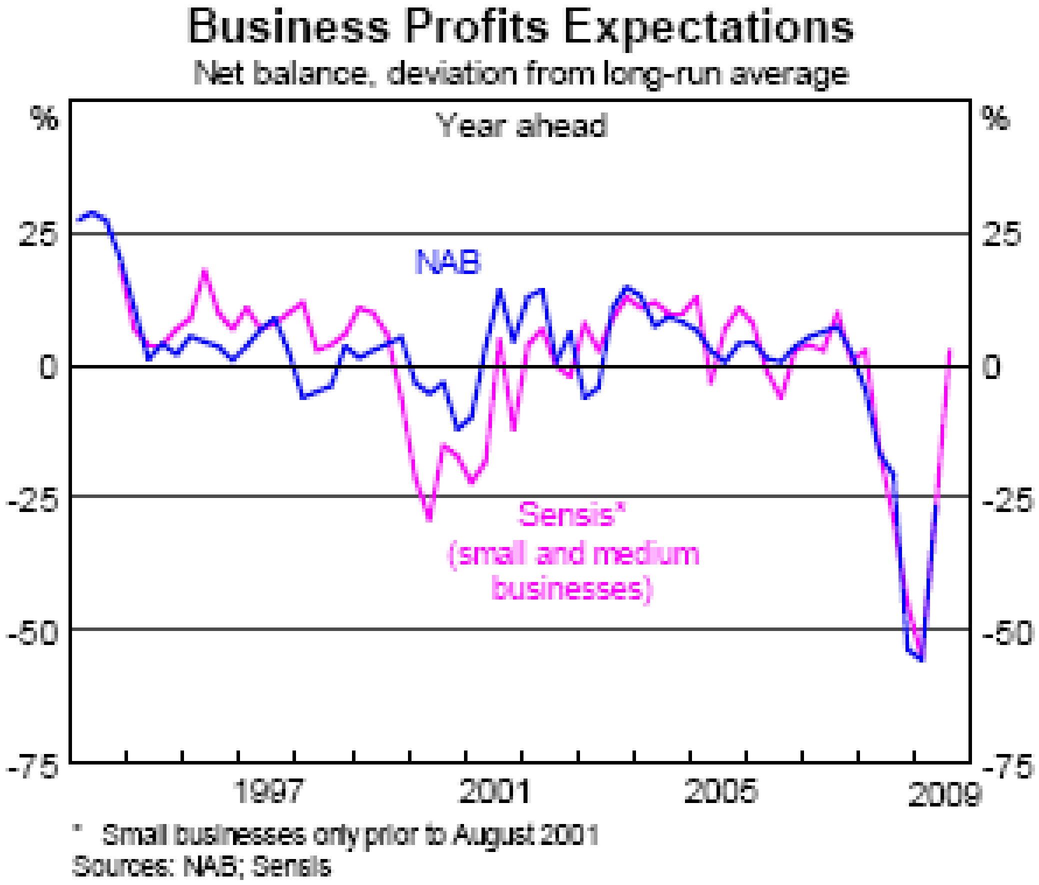
This is certainly supported by consumer attitudes



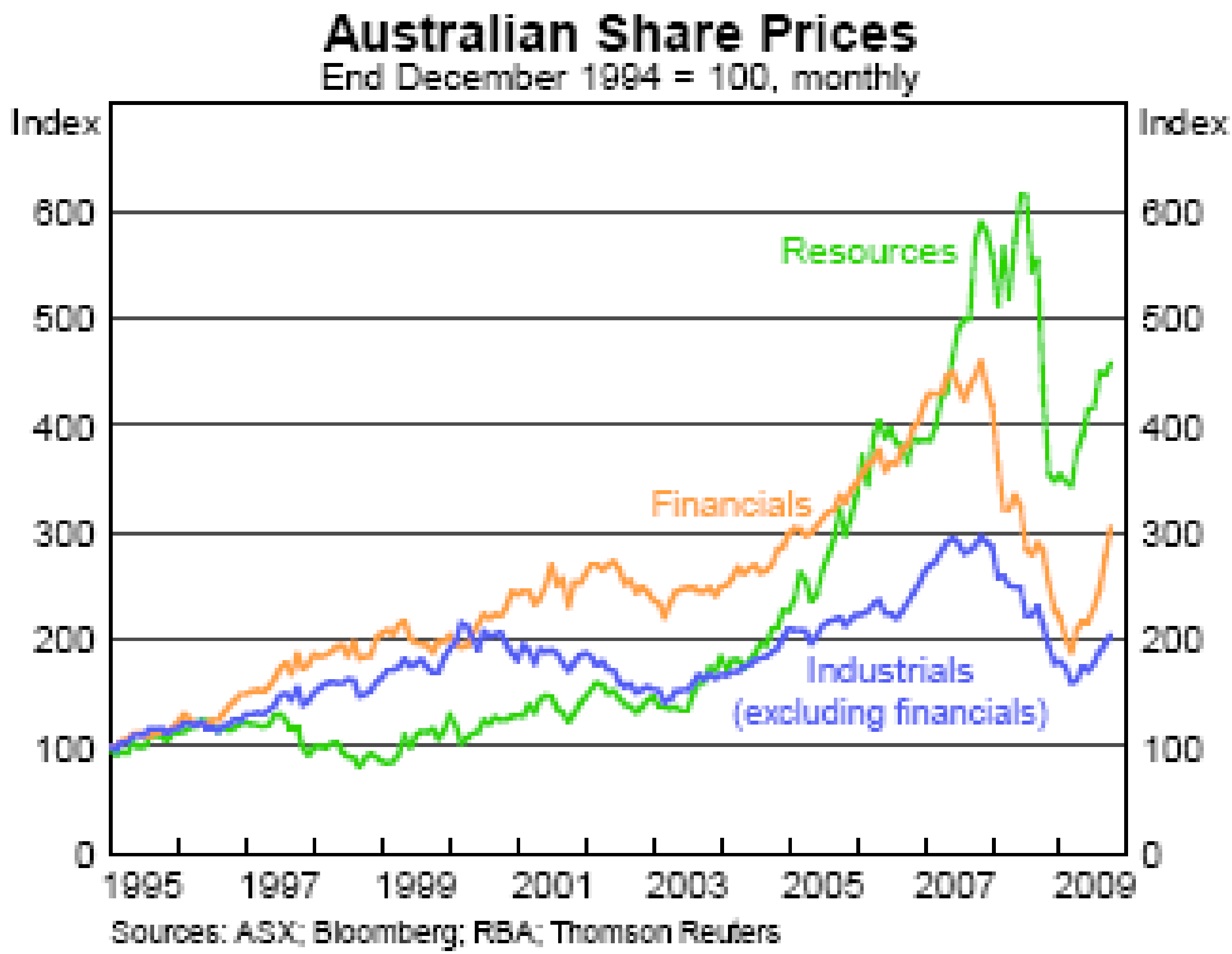
And by much improved business intentions



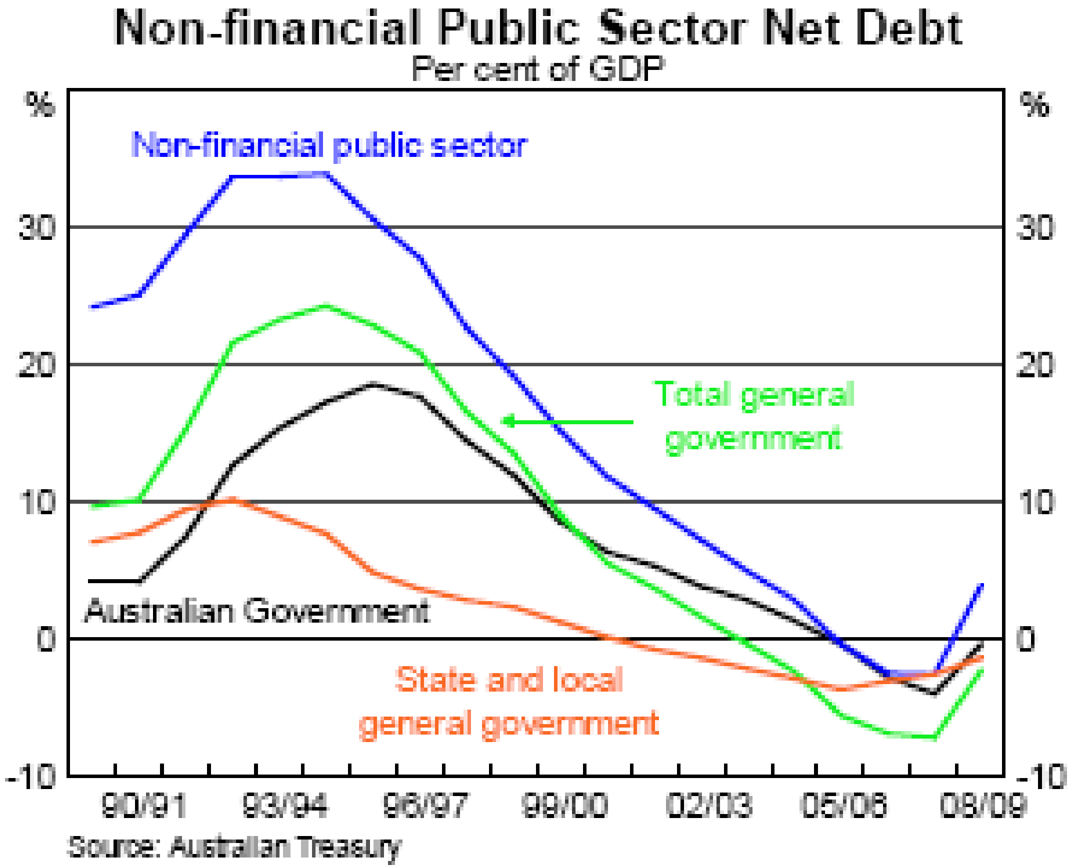
Which has flowed into profit expectations



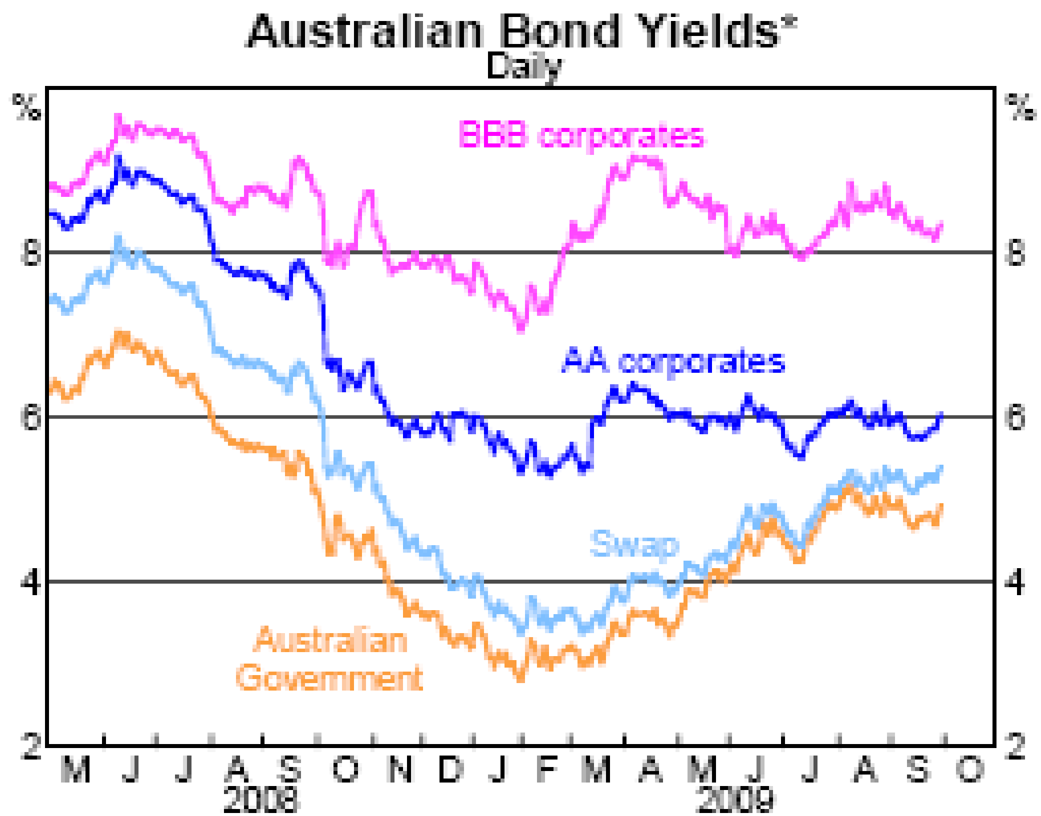
And markets


Australian Share Prices
End December 1994 = 100, monthly
Index
Index
600
500
400
300
200
100
0
Resources
Financials
Industrials
(excluding financials)
1995
1997
1999
2001
2003
2005
2007
2009
Sources: ASX; Bloomberg; RBA; Thomson Reuters

However risks remain, governments borrowing is increasing



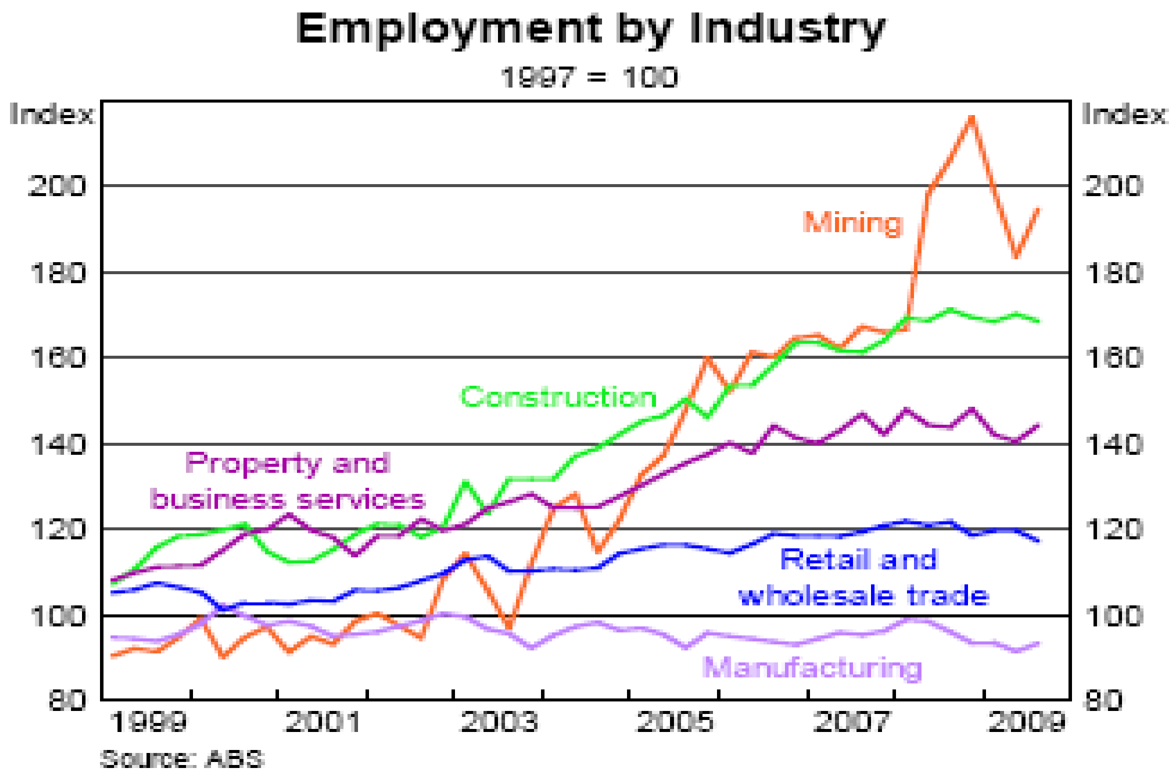
Which can drive up the cost of debt and therefore interest rates



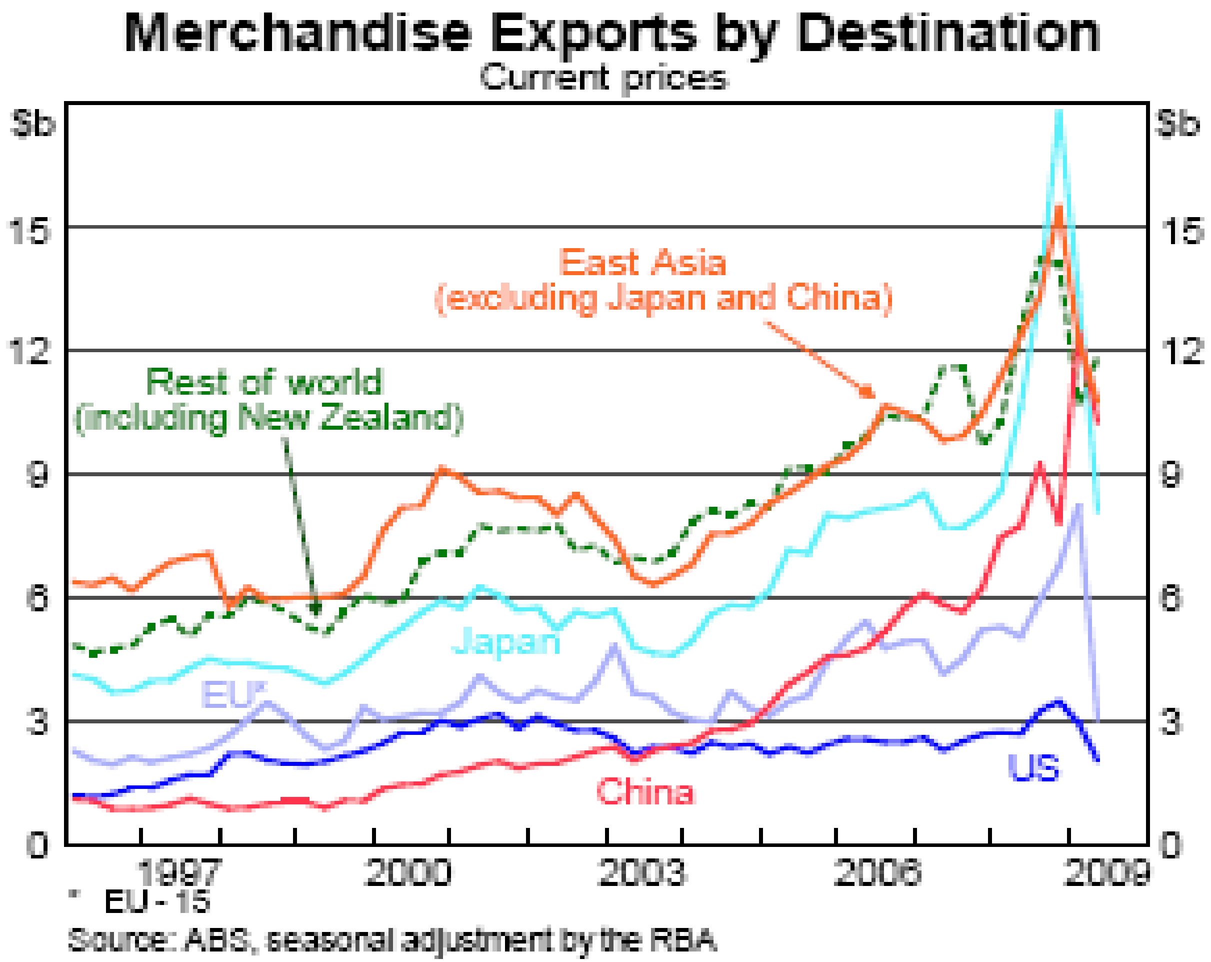
* Yields on bonds issued by the Australian Government and swap rates are 3-year maturities. Corporate bond yields are a weighted average of bonds with remaining maturities of 1 to 5 years; they include financial and non-financial corporates.

Sources: Bloomberg; RBA; UBS AG, Australia Branch

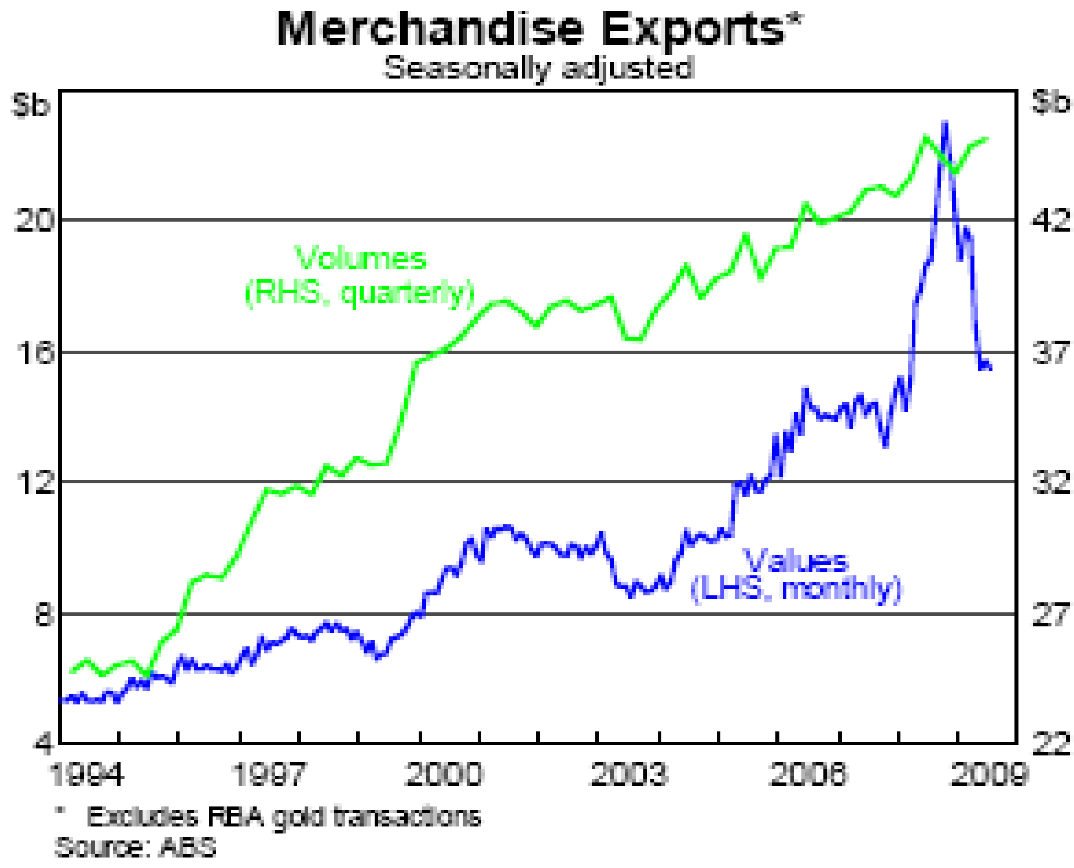
And improvements in employment are largely dependant on the commodities cycle having turned up again



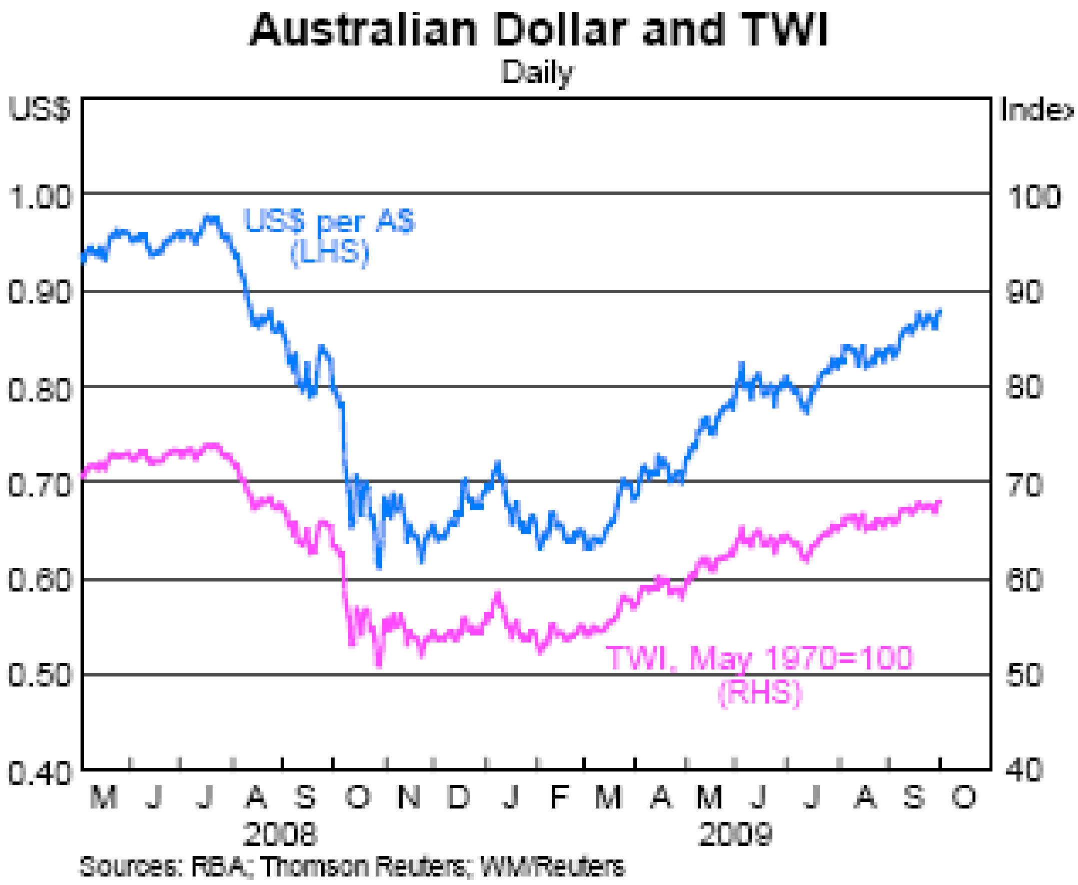
So this is still largely a China story



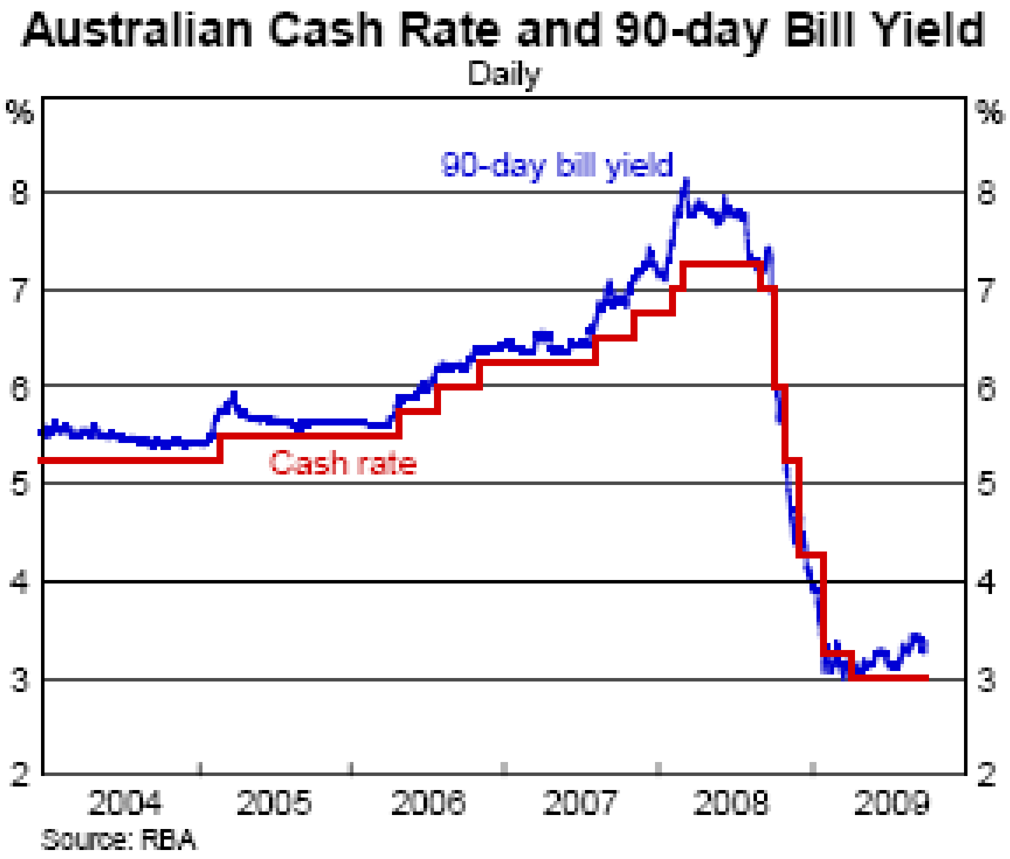
Whereas our $value of exports is still down despite volumes remaining high



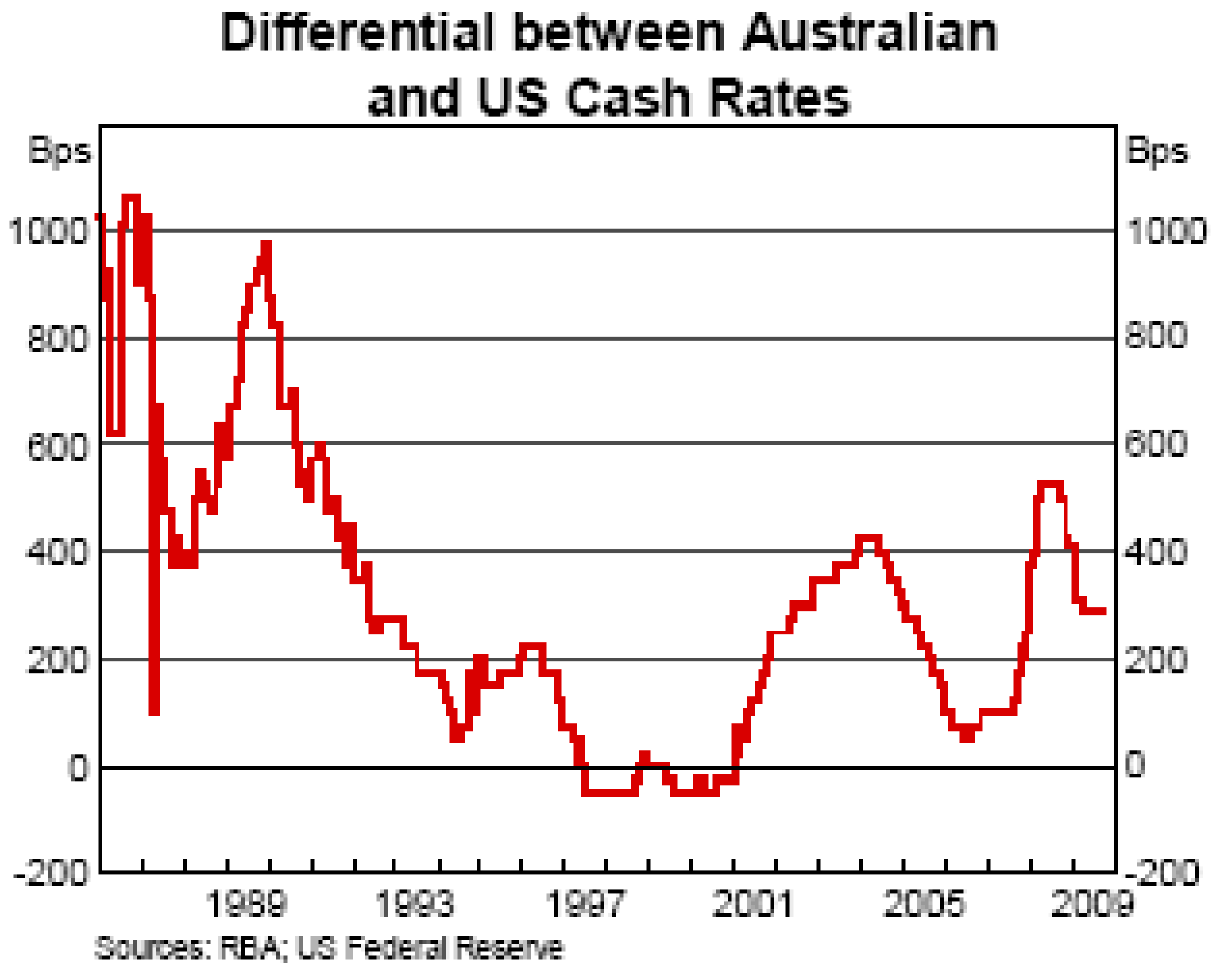
Which of course is the adjustment expected from a strong AUD against a weak USD



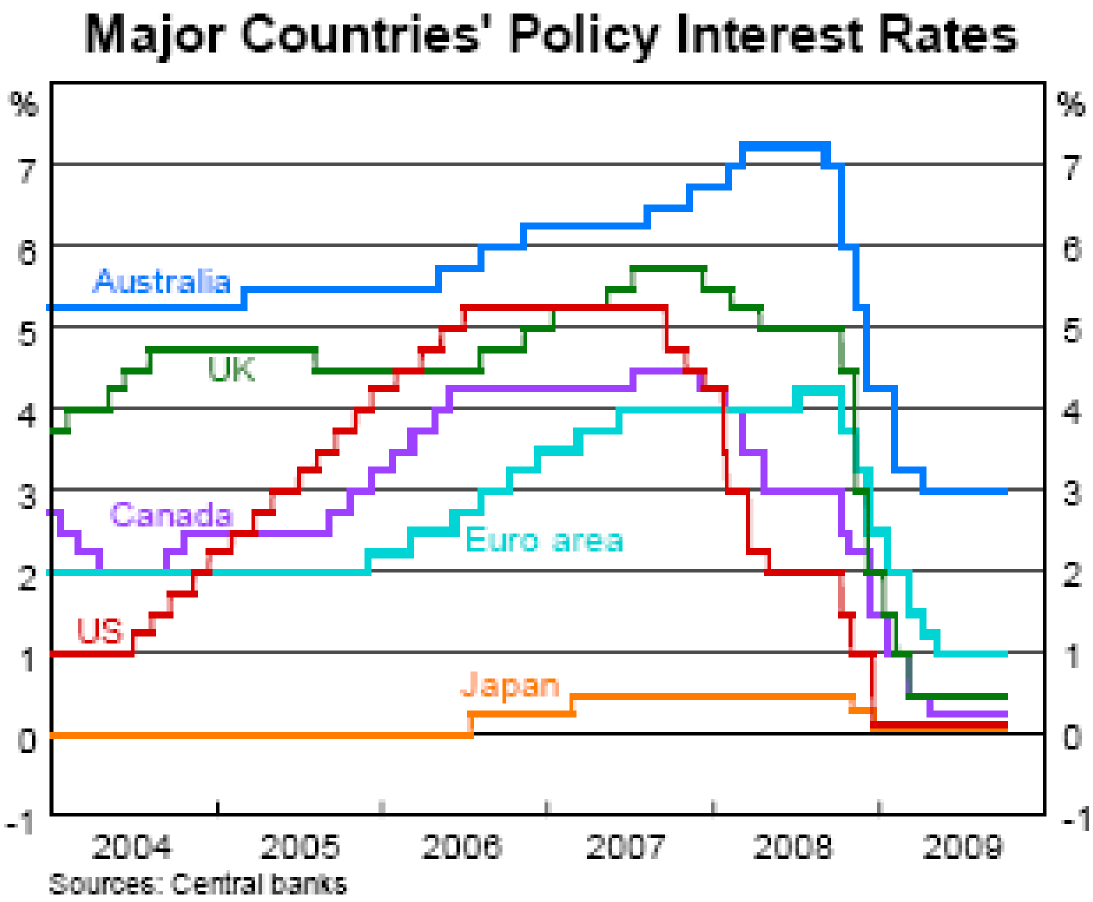
Together with the potential of rising interest rates



Makes for Australia as a great destination for speculators investing in the global carry trade



As Australia continues to tighten rates and be a performing commodities play, many OECD economies will continue to struggle and keep rates low



Conclusions

- Australia will continue to benefit in the near term from
  - Global demand for commodities
  - Domestic balance sheets generally being in good shape
  - Government stimulus flowing through to domestic and consumer demand
- However there are risks and pressures which make us vulnerable

Risks

- A bubble forming from the nexus between
  - RBA tightening to keep domestic demand in check
  - Australia being flavour for speculative money looking at the increasing IR differential and positive $A outlook
- This could choke off our export led recovery and increasing rates will hurt domestic demand
- Potentially causing a boom/bust beyond policy setters control
- Unfortunately the political cycle wont allow for the proper unwinding of fiscal stimulus leaving us vulnerable to big moves in monetary policy