▪ Australia

UOB Economics Projections	2007	2008F	2009F	2010F
GDP	4.0	2.4	0.2	2.4
CPI	2.4	4.4	1.2	2.3
Unemployment Rate (%)	4.4	4.2	6.1	8.0
Current account (% of GDP)	-6.3	-4.3	-3.6	-5.4

Australia continues to exhibit considerable resilience. The nation's second quarter economic performance was unexpectedly strong – real GDP rose by 0.6% in the second quarter from the previous three months where it grew 0.4%.

In spite of these signs of improvement, sentiment remains soft and questions remain about the sustainability of the current turnaround in markets.

Upward momentum in the AUD/USD has continued to be strong in the last quarter. We assume that as the global recovery scene takes centre stage, growing interest rate differentials and rising commodity prices should see the AUD/USD moving higher in the coming quarter.

Whilst the RBA will be looking out for clearer prospects of global as well as domestic growth before it decides to move interest rates north, we look to it as being the leader in reversing present monetary conditions.

Australia Has Proven to Be More Resilient Than Most Had Thought

Despite the harsh external environment, Australia continues to exhibit considerable resilience. The country only suffered from one negative quarter of growth (in the final quarter of 2008). Furthermore, data releases in the last couple of months have been heartening. The nation's second quarter economic performance was unexpectedly strong – real GDP rose by 0.6% in the second quarter from the previous three months where it grew 0.4%. The headline figure was higher than markets' consensus of 0.2%. Year-on-year, GDP grew by 0.6% as well, higher than a revised 0.3% in the first quarter.

Consumer confidence in September jumped to the highest level since July 2007. The sentiment index – according to a Westpac Banking Corp. and Melbourne Institute survey of 1,200 consumers conducted between 31 August and 6 September – gained 5.2% to 119.3 points. The index, which has climbed 34.4% since May, echoed a rise in business confidence. The business confidence index rose 8 points to 18, the highest level since October 2003. The surge in these numbers came from the back of the government's A$20 billion of cash handouts of to consumers and increased grants to first-time home buyers.

Jobless figures have also surprised on the downside. The unemployment rate held at 5.8% in July as employers unexpectedly added 32,200 workers. In the coming quarters, the government will be spending the other A$22 billion on roads, railways and schools out of its $42 billion fiscal stimulus.

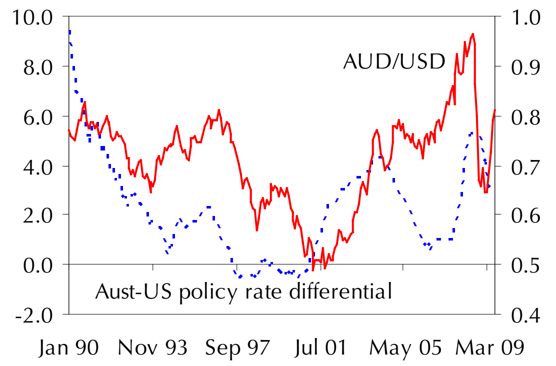
In spite of these signs of improvement, Australia has not been spared from the crisis. The cautious theme lingers, as questions remain about the sustainability of the current turnaround in markets. Australian retail sales unexpectedly fell in July by 1.0% and home-loan approvals ended a record nine-month run of gains. The number of loans granted to build or buy houses and apartments fell 2.0%. These numbers had been climbing since late last year on the back of the government cash handouts; and there are growing concerns that retail sales growth will slump further if the government withdraws its stimulus. The A$10.4 billion stimulus package rolled out late last year in response to the financial downturn was initially thought to be sufficient, but turned out to be more of a short term halt for the economy, proving otherwise.

And although the package was aimed to support 90,000 jobs, the outlook on the Australia's labour market remains bleak. According to reports by the Organization for Economic Cooperation and Development (OECD), the nation's jobless rate would be between 1.4% to 1.9% higher in 2010 in the absence of government handouts to consumers and infrastructure spending. We are looking at the jobless rate to rise higher from the current 5.8% to peak around 8.0% next year. This, unfortunately, would continue to dampen consumers' spending in the coming months.

Aussie Continues to Trade at Elevated Levels

Nevertheless, the turnaround in markets since March this year has been the major driver of movements in currency markets, which is consistent with an increased appetite for risk. The greenback has weakened against most major currencies and in line with these developments, upward momentum in the AUD/USD has continued to be strong in the last quarter. The pair after touching lows of 0.7703 earlier in the quarter (on 13 July), has since moved in an upward trajectory, hitting highs of 0.8789 on 23 September.

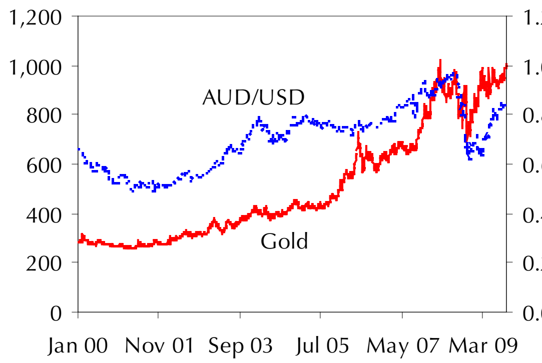
Interest Rate Differentials An Important Driver of FX



Source: CEIC

Central banks around the world have reportedly been hoarding on the Aussie as a means to diversify their foreign-exchange reserves. Indeed, markets are turning away from the greenback to the higher-yielding Aussie. And whilst markets are increasingly confident of policy rate increases from major central banks, Australia in particular, faces the likelihood of higher interest rates in the near term. Hence, growing interest rate differentials will support the Australian currency going forward. Unlike its fellow peers in New Zealand or Canada, Australian policymakers have shown little distress about the gains in its currency. We project that the AUD/USD would comfortably hover at the 0.880-levels by the end of Q409.

Correlation Between AUD/USD and Gold Prices



Source: CEIC

The run upwards has also been supported in part by commodities, which have rallied over the past few months as prospects for the global economy improve. Like the Canadian and the New Zealand dollars, the Australian dollar is a commodity currency. Being one of the world's largest producers of gold, Australia's exports comprise over 50% of commodities, including precious metals. Whether or not commodity prices and, by extension, the AUD/USD, can continue to rise will largely depend on the future of global economic growth. We assume that as the global recovery scene takes centre stage, commodity prices should rise gradually in line with the improvement in global activity. That should in turn see the AUD/USD supported in the coming quarter.

Watch for the RBA Being the Leader in Moving Policy Rates North

The RBA held benchmark rates steady at 3.00% at its board meeting in September. In its statement, the RBA said that "the present accommodative setting of monetary policy remains appropriate for the time being". It added that "the Board will continue to adjust monetary policy so as to foster sustainable growth in economic activity and inflation consistent with the target".

All in all, the RBA has slashed the overnight cash rate target by 4.25 percentage points over six times between September 2008 and April 2009. Since April, Australian central bank Governor Glenn Stevens has kept interest rates unchanged. While the board of the bank is itself uncertain about the timing of an interest rate rise, rate hike expectations have increased significantly over the last quarter though, given the improving outlook for the domestic economy. And despite the soft labour market outlook, Stevens in July had said that there was no rule that requires the RBA to wait for unemployment to peak before raising rates; and in August, he said that at some point rates would have to move away from their present ''emergency setting''

If we recall, the focus at the August monetary policy meet was about removing the easing bias. However, the RBA at its September meeting had signaled its next move as being upwards, though that message was not as clear in the post-meeting statement as compared to the minutes released on 15 September. Nevertheless, the RBA in the September minutes, highlighted the need of avoiding a "prematurely tightening" of monetary policy. Implications of this, if any, would be that rate hikes should come later than markets are anticipating. As such, we think that the Australian central bank will be looking out for clearer prospects of global as well as domestic growth before it decides to move interest rates north. This has not changed our view, though, that Australia would take the lead among the other central banks in reversing present monetary conditions. We are expecting the RBA to raise rates by 150bps to 4.50% by end-2010.