



A very
different bank

Economics Update

Australia and New Zealand Banking Group Limited

29 January 2007

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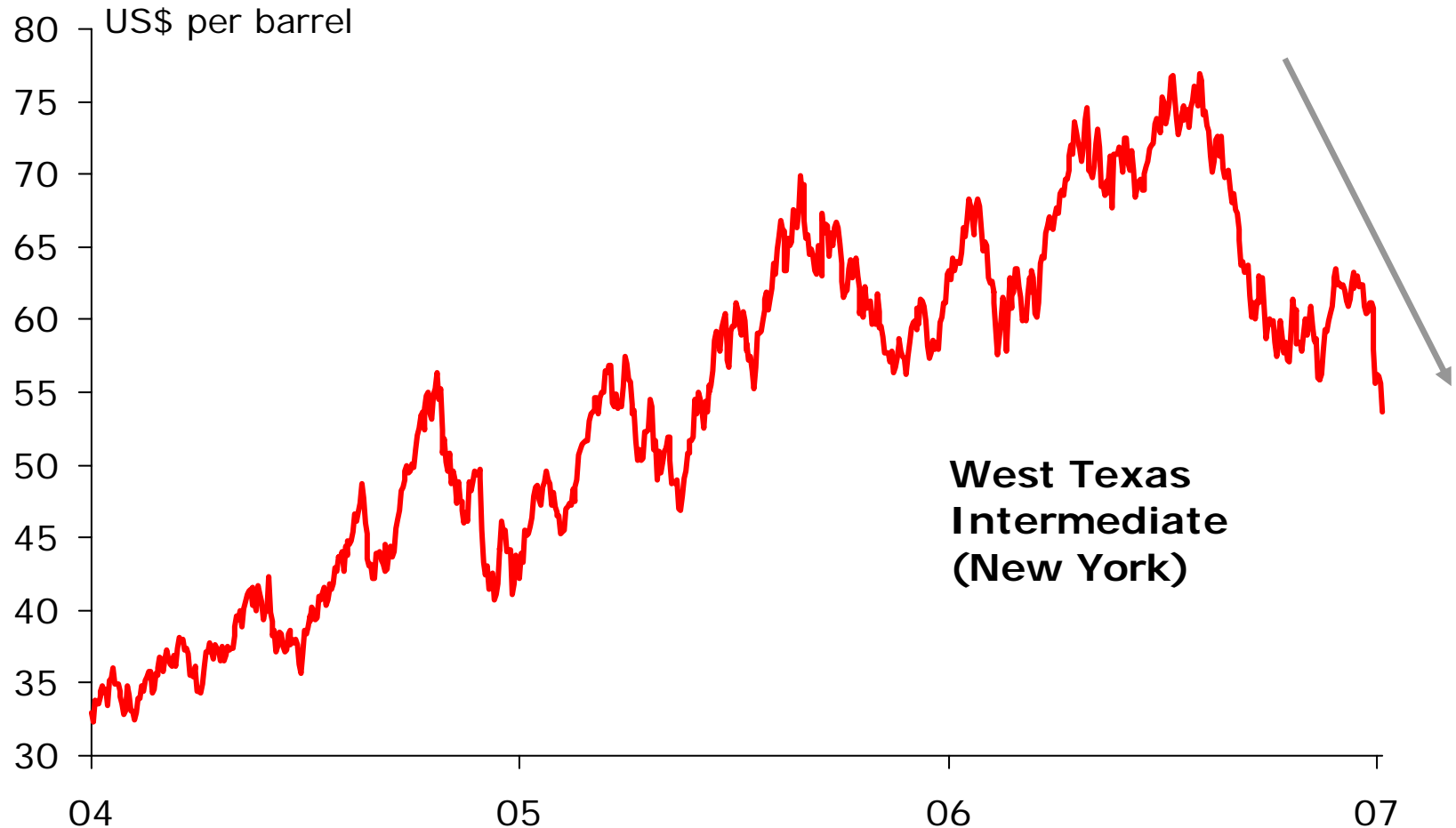
Summary

- Global economy remains sound led by Asia – has a big impact on domestic economies
- Australian and New Zealand economies remain resilient – increasing momentum forecast for FY08 & FY09
- FY07 credit growth forecast to remain at attractive levels; Australia 12%, New Zealand 9%
- Sowing the seeds for the next housing upturn

Global Economy

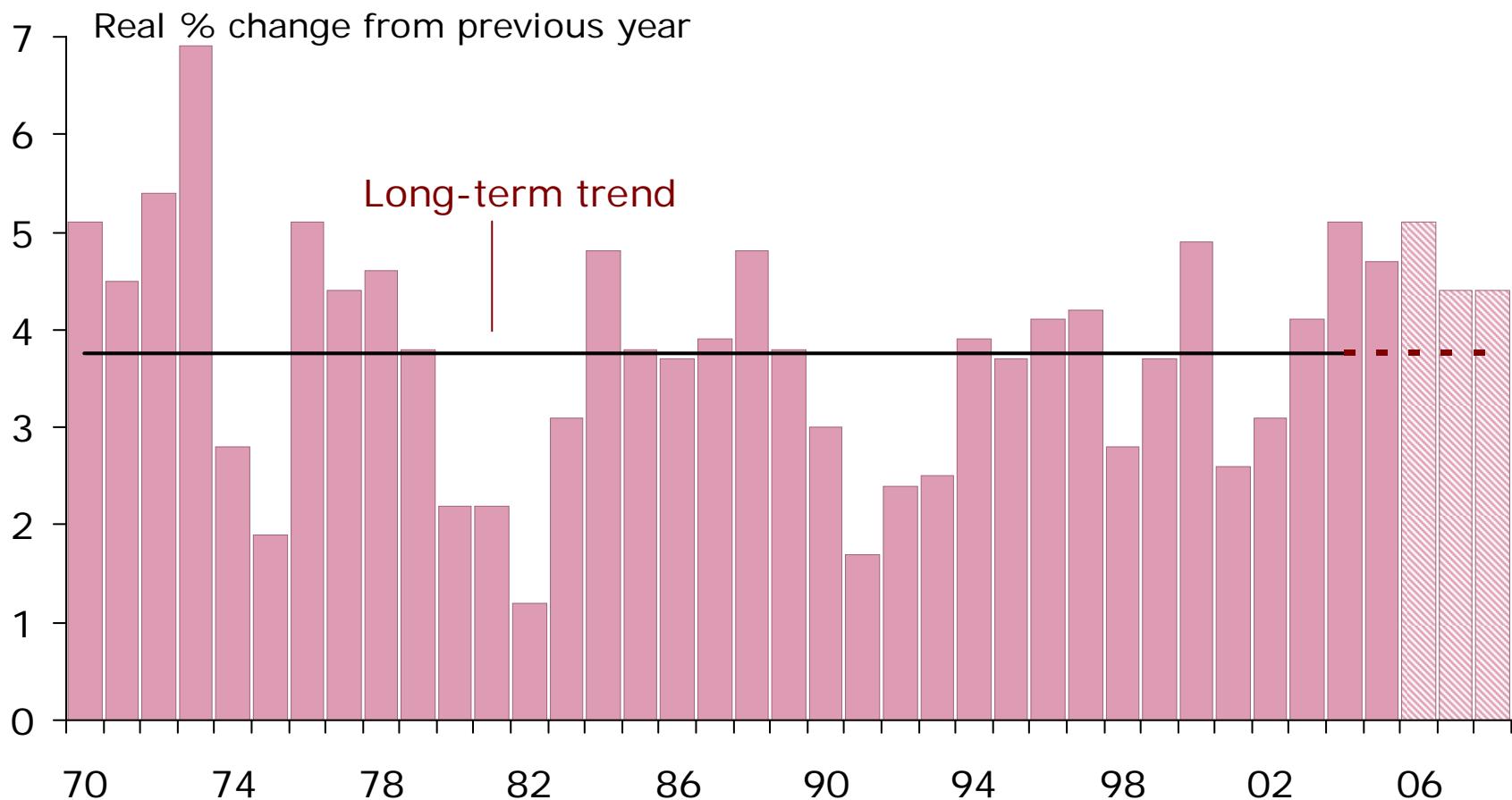
Crude oil prices have fallen substantially in recent months...

Crude oil prices



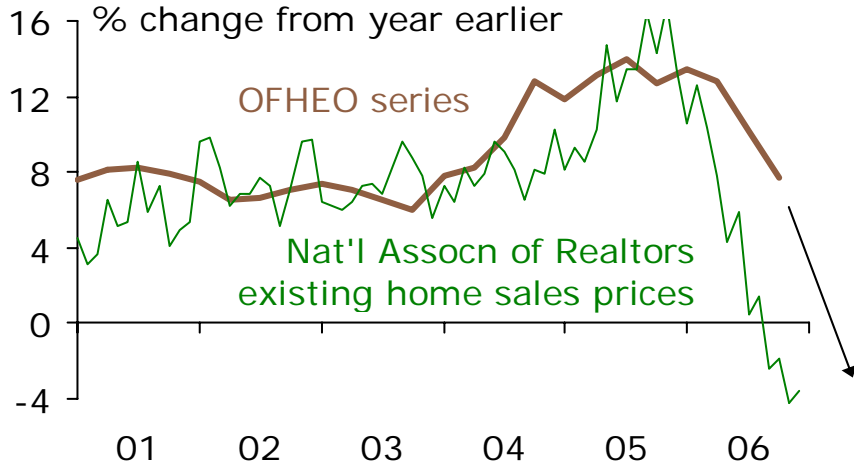
...and the global growth outlook remains solid

Global economic growth

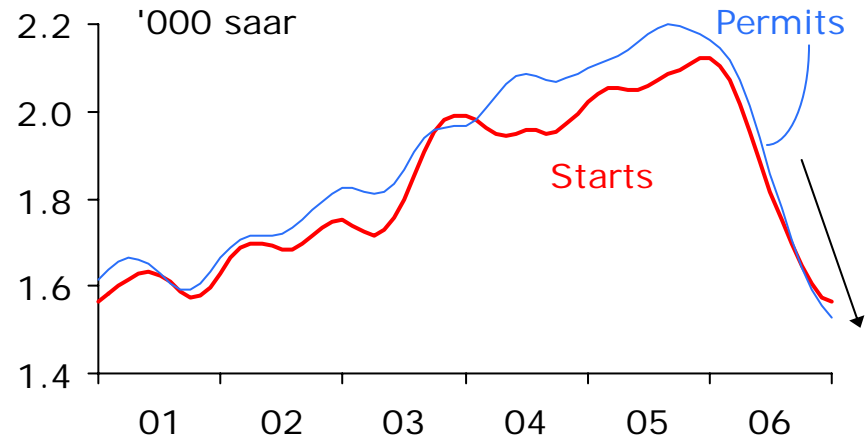


In the US, housing and autos are weak, but other sectors retain momentum

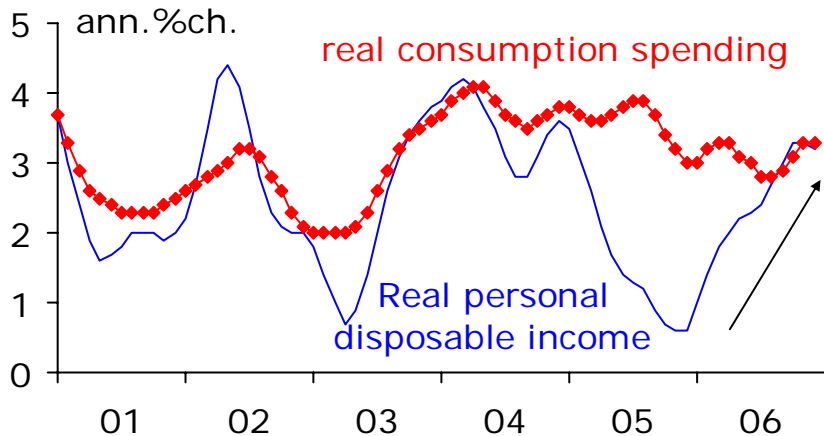
House prices



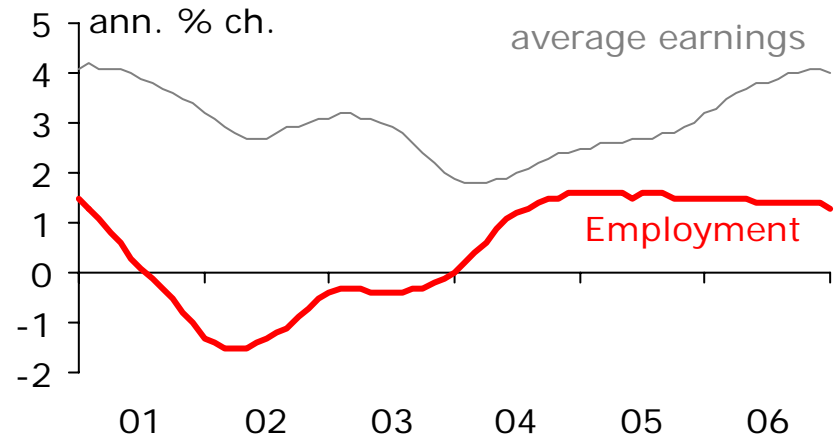
Housing starts vs permits



Household spending and income

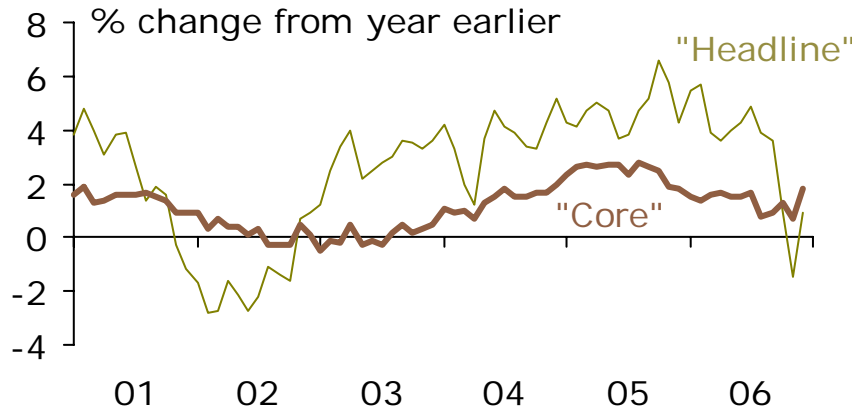


Employment and wages

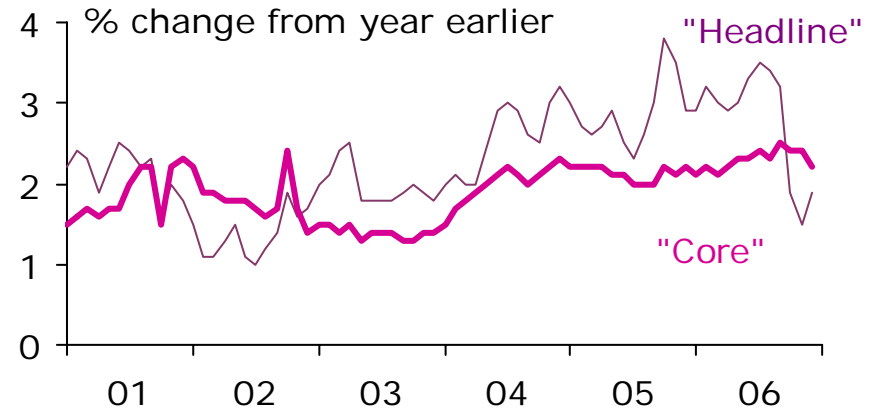


'Core' US inflation has eased substantially and unit labour costs now appear relatively contained

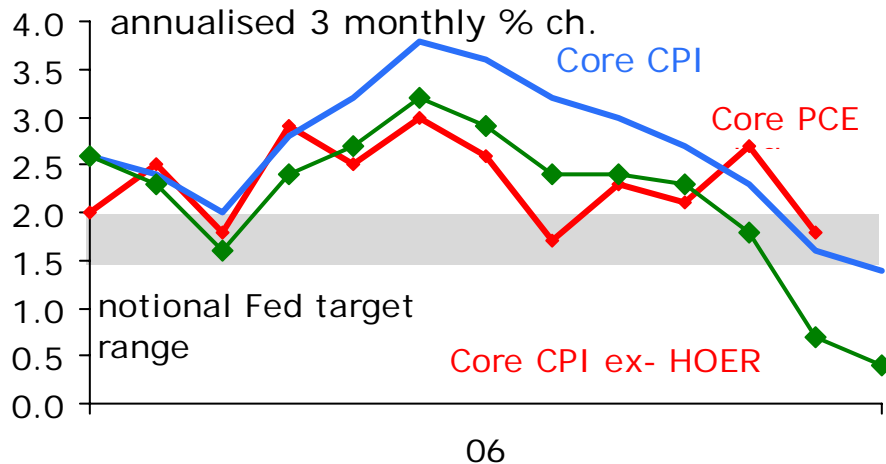
Producer prices – finished goods



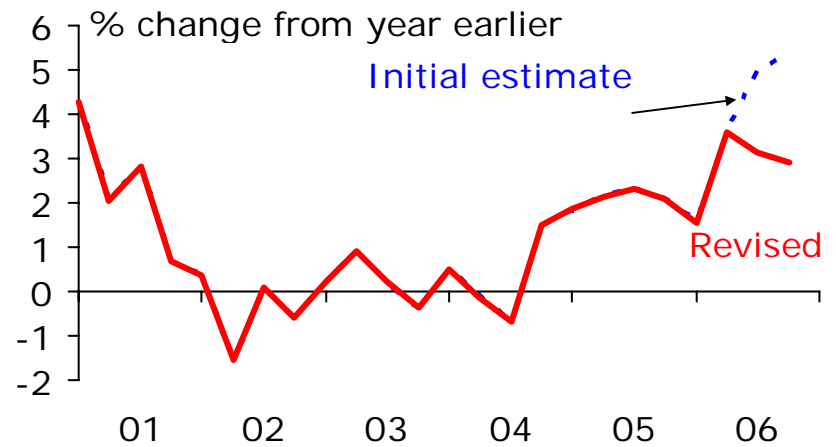
Consumption expenditure deflator



Consumer prices



Unit labour costs

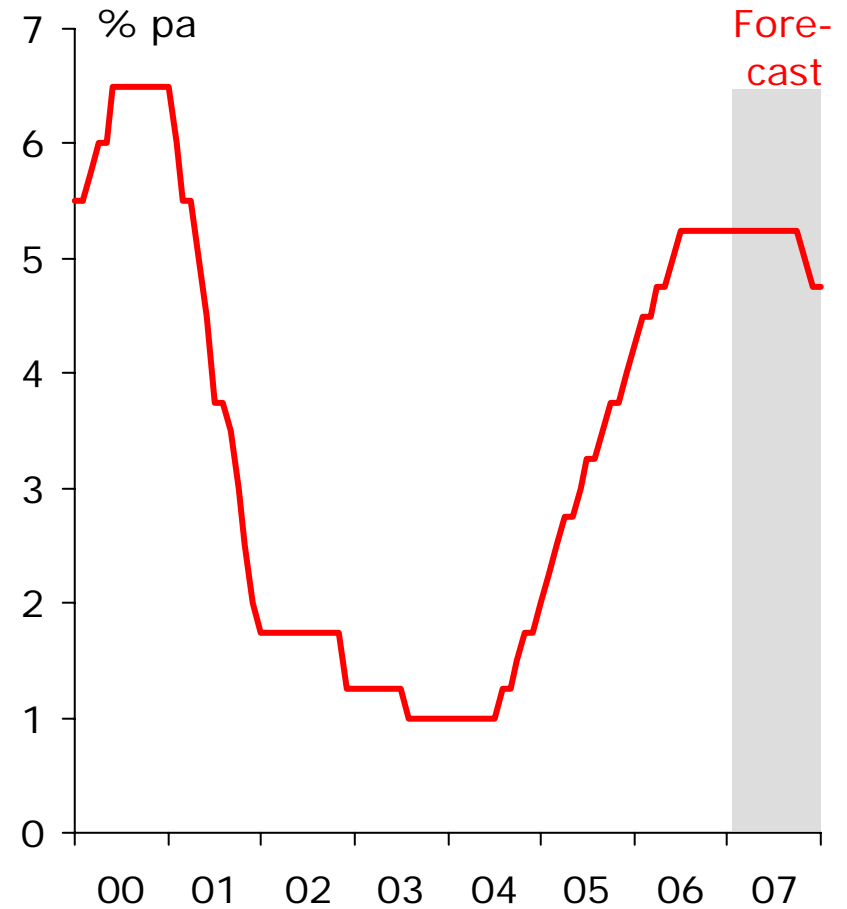


The Fed is now 'on hold', and short rates will fall in H2 2007

Yield curves

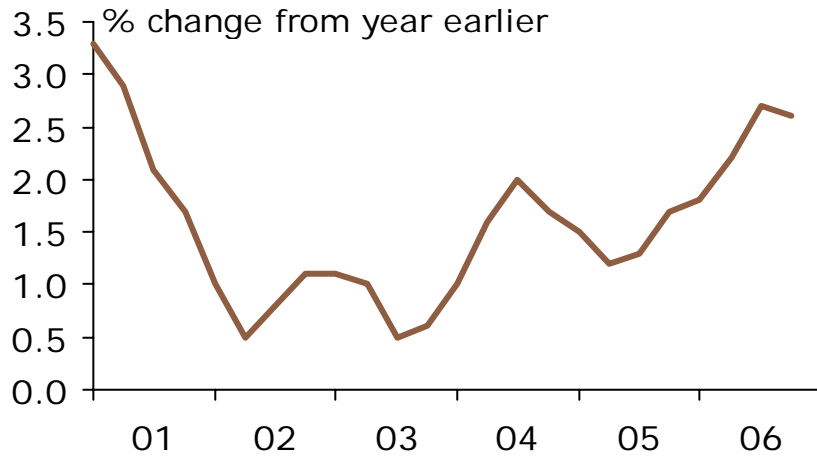


US fed funds rate

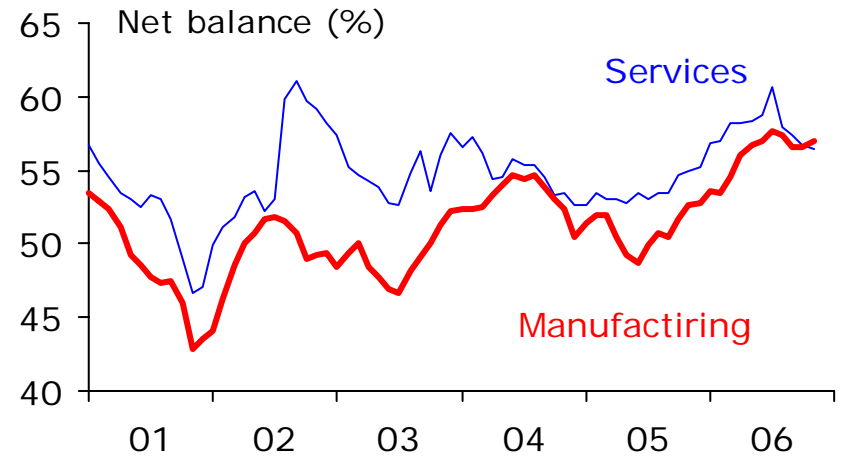


The euro zone is also picking up though tax hikes may slow the recovery in 2007

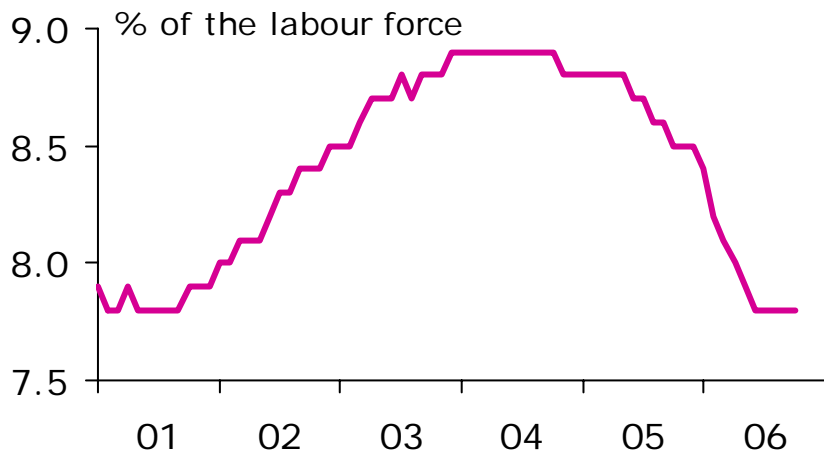
Real GDP growth



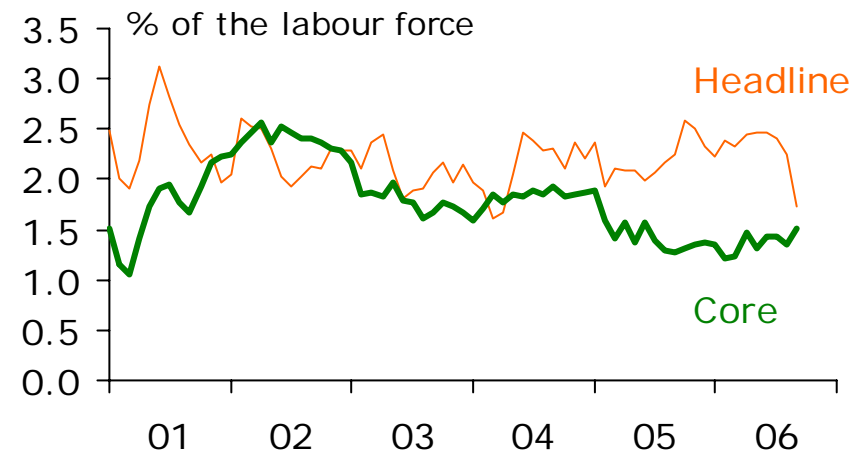
Purchasing managers' indices



Unemployment

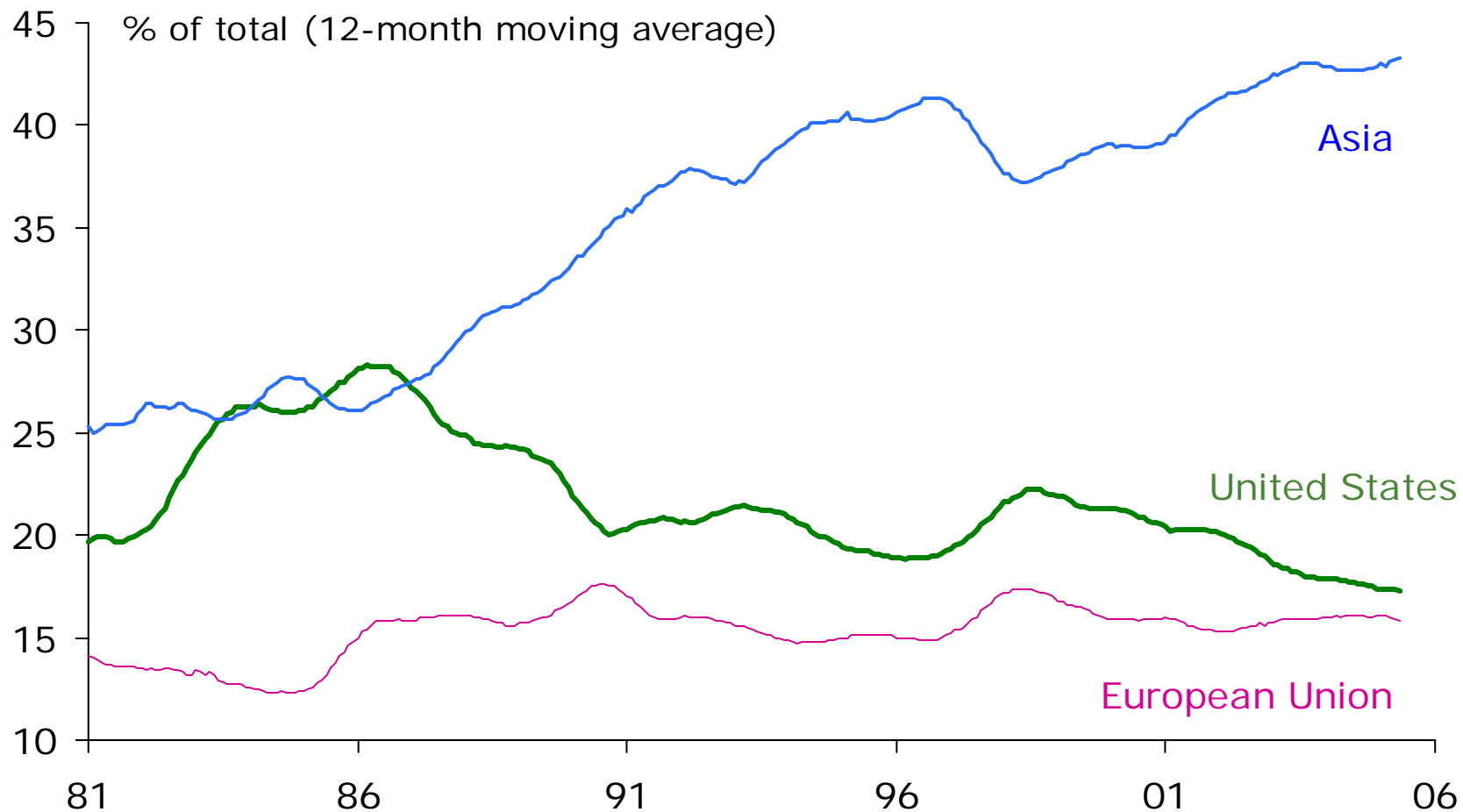


Inflation



Asia is becoming less dependant on the US as an export market

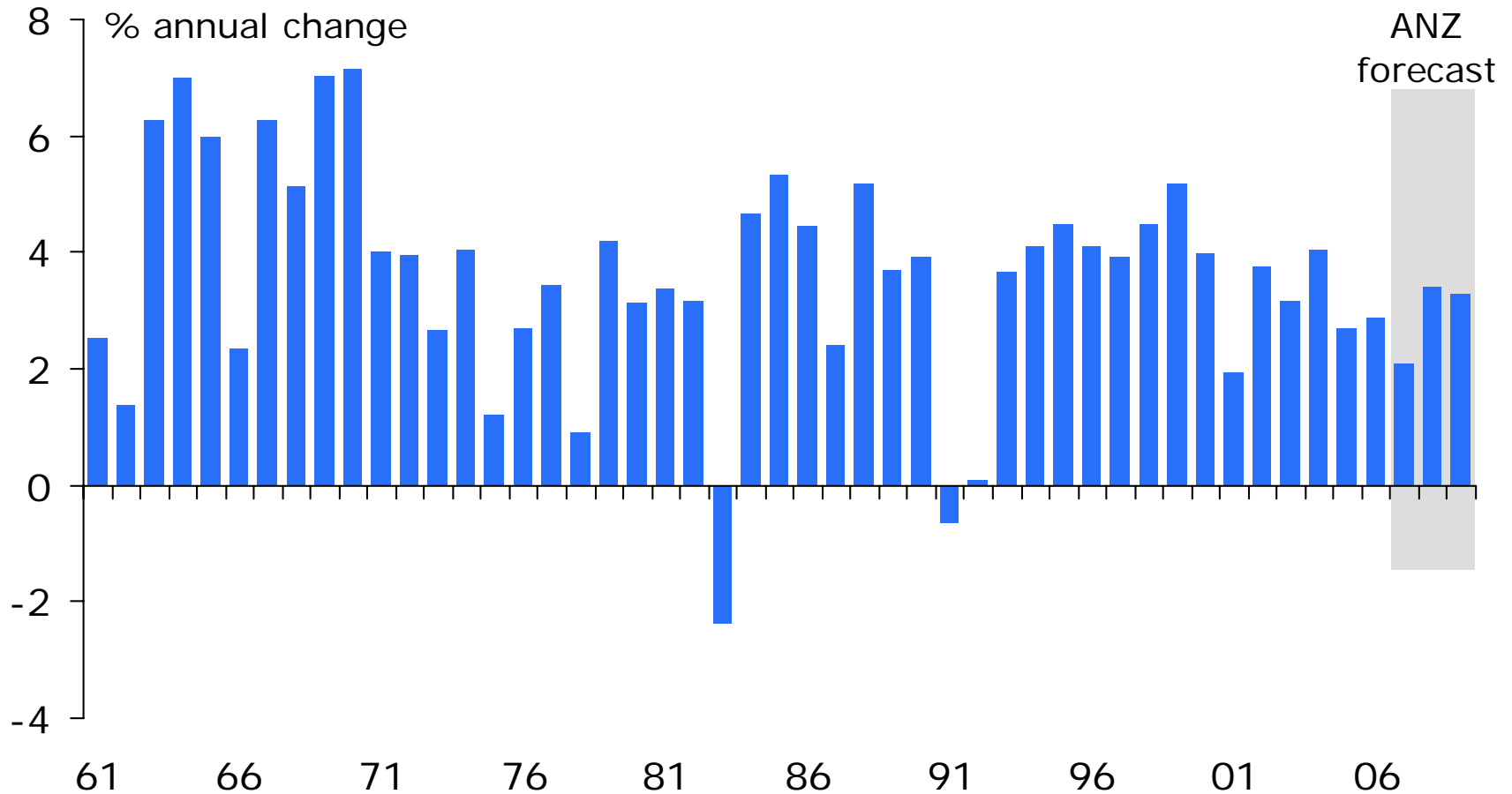
Destination of Asian merchandise exports



Australian Economy

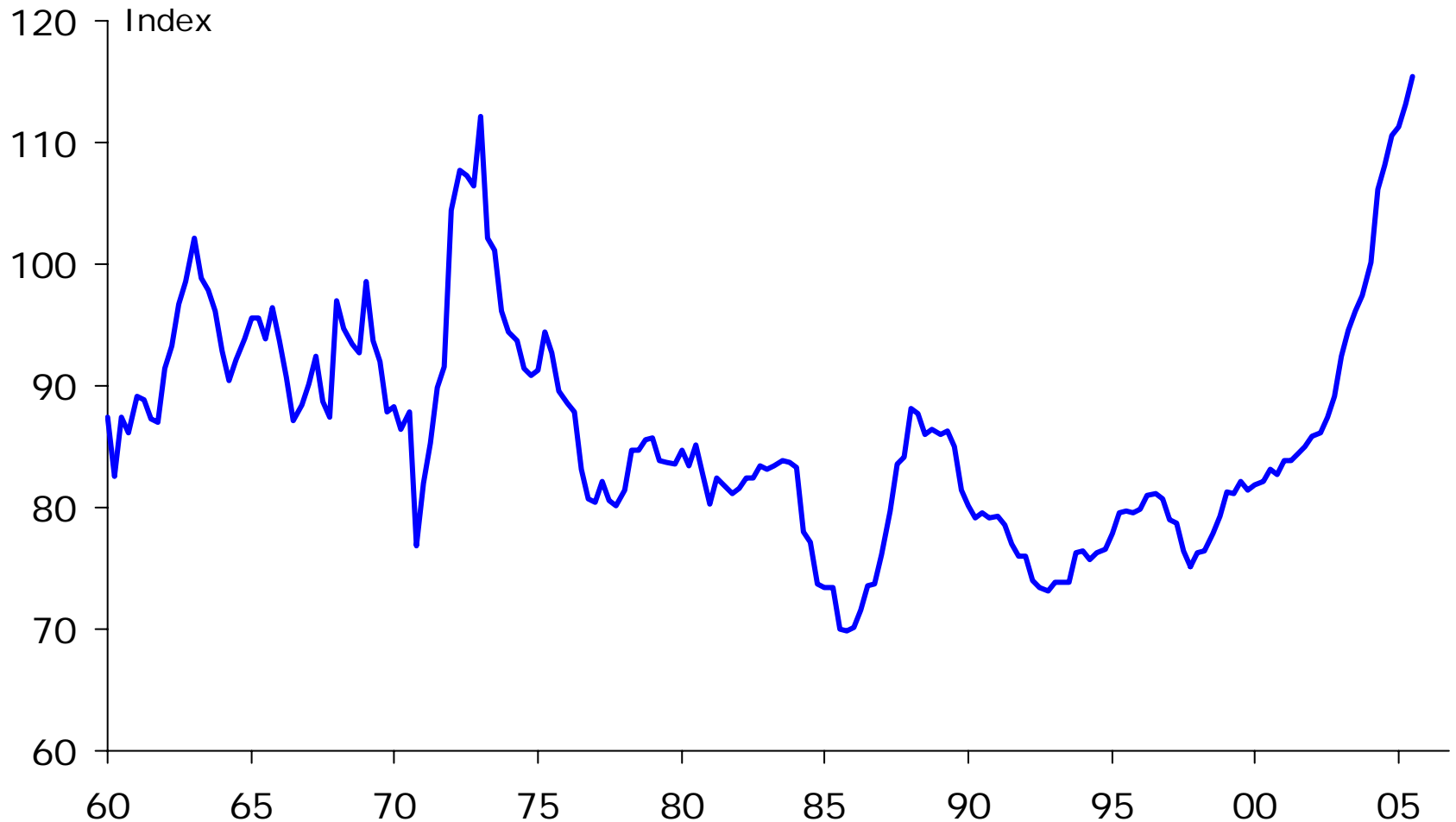
Australia is into the 16th year of continuous economic growth

Australian GDP



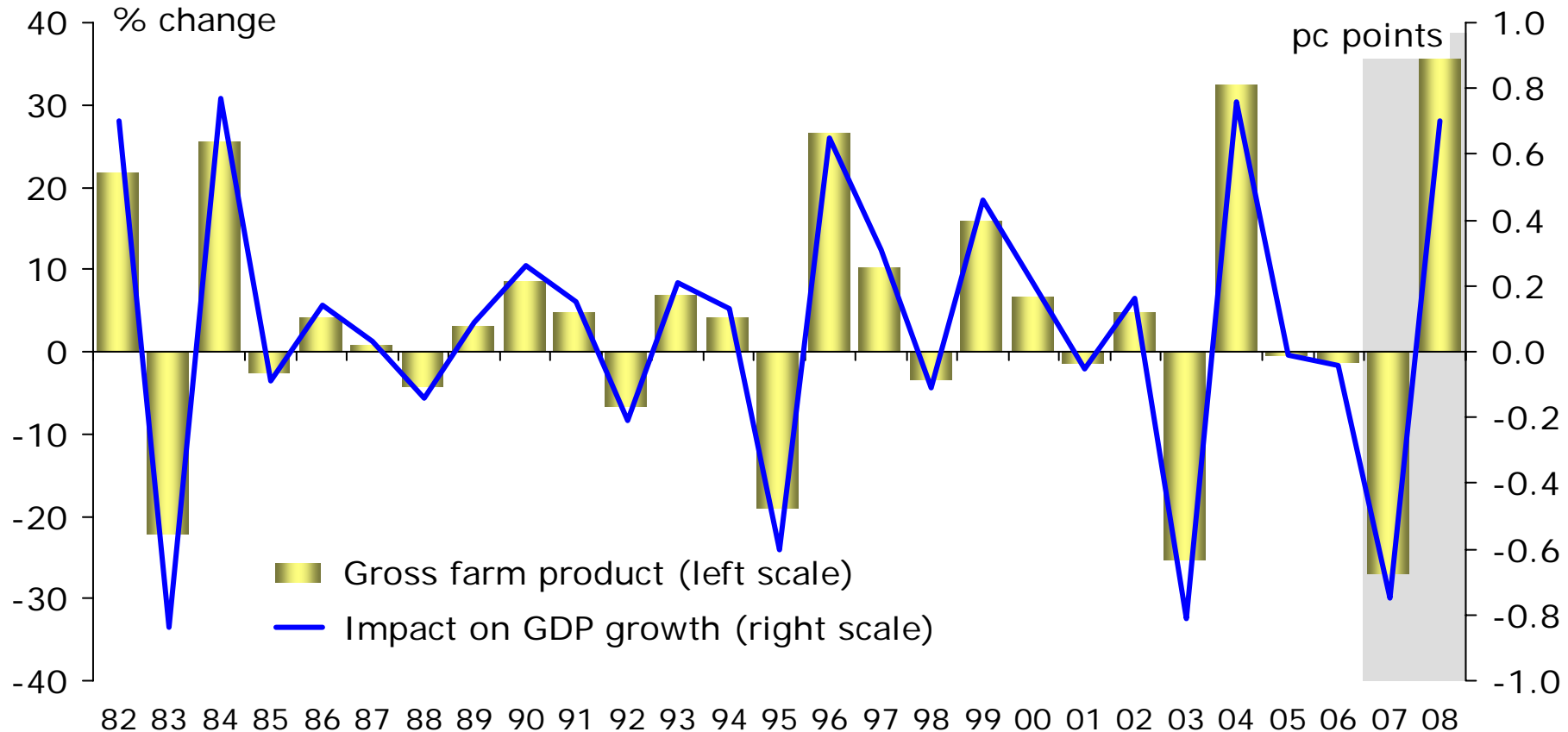
With a commodity price boom pushing the terms of trade to a record high

Terms of trade



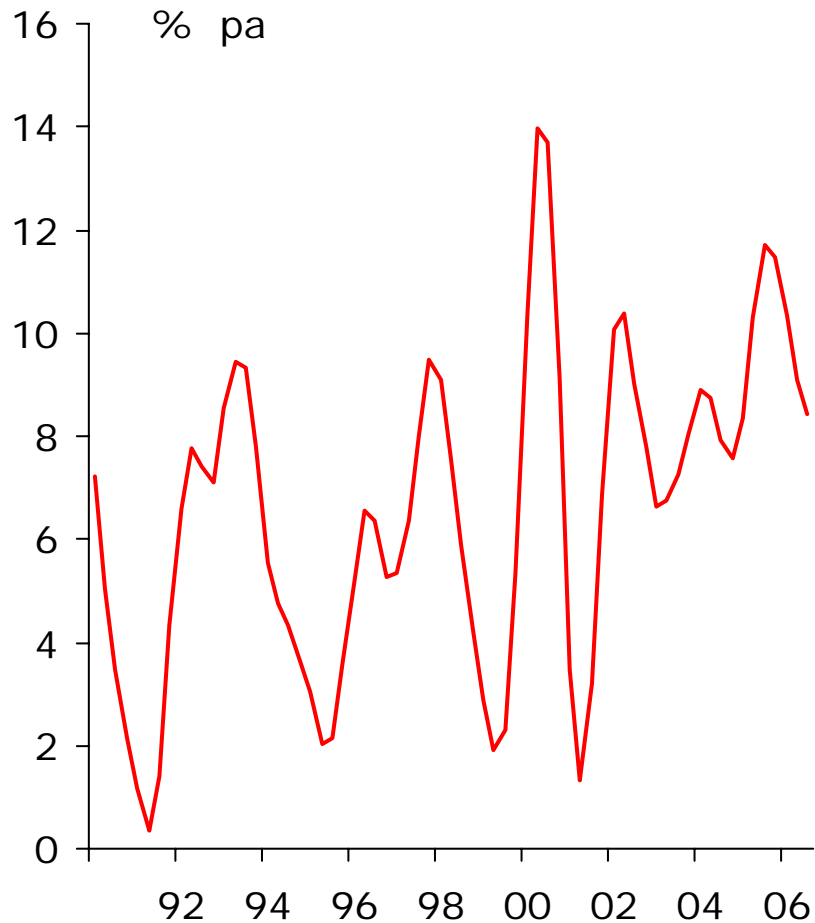
Drought will subtract around $\frac{3}{4}$ percent point from economic growth in 2006-07

Change in gross value of farm production and impact on overall economic growth (real GDP)

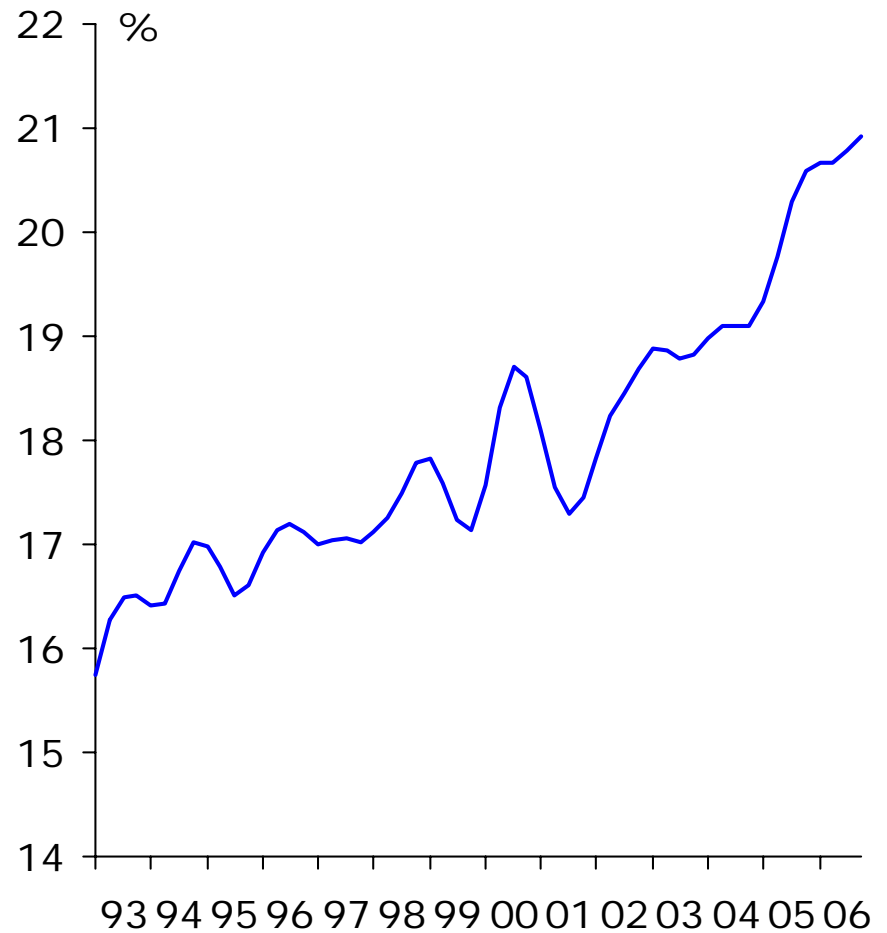


Business profit growth is strong and at a record high share of national output

Profit Growth

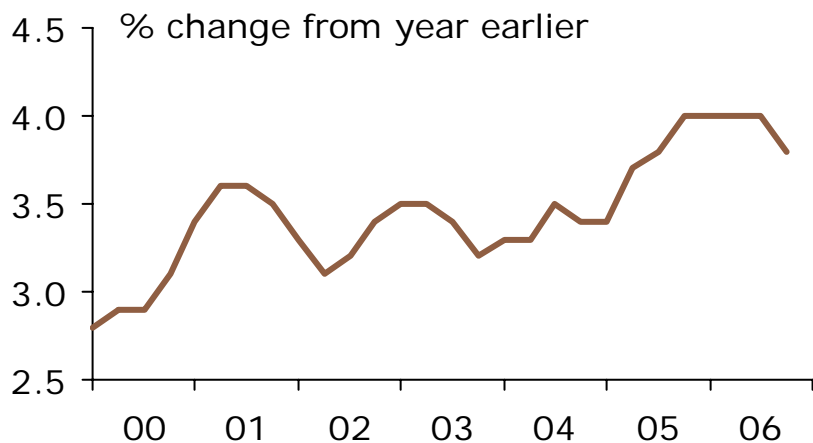


Profit share of GDP

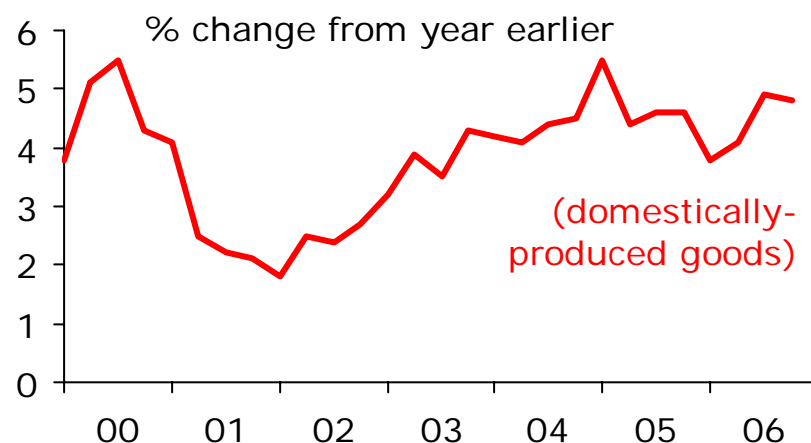


Labour costs and 'upstream' prices have been accelerating for some time...

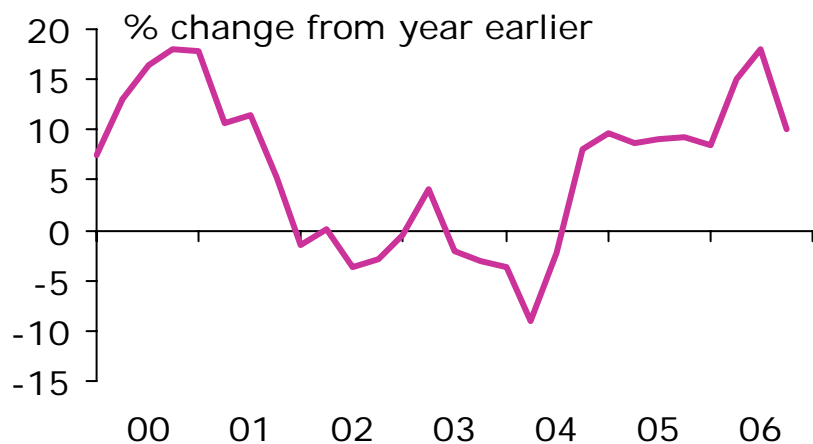
Private sector wage costs



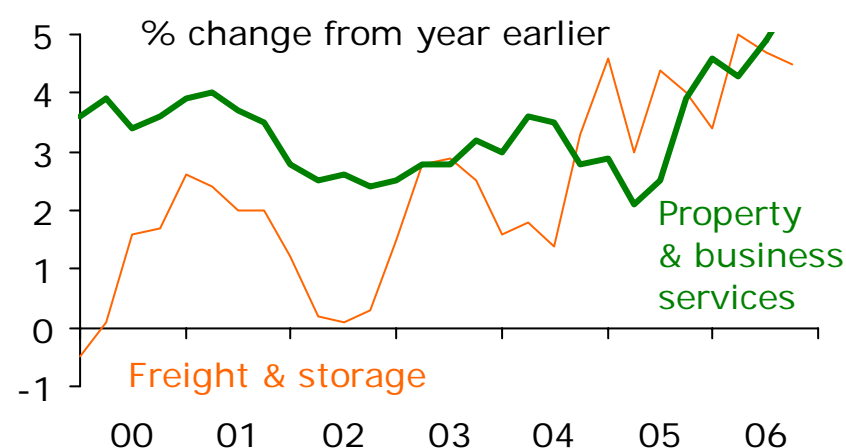
Producer prices - goods



Materials costs

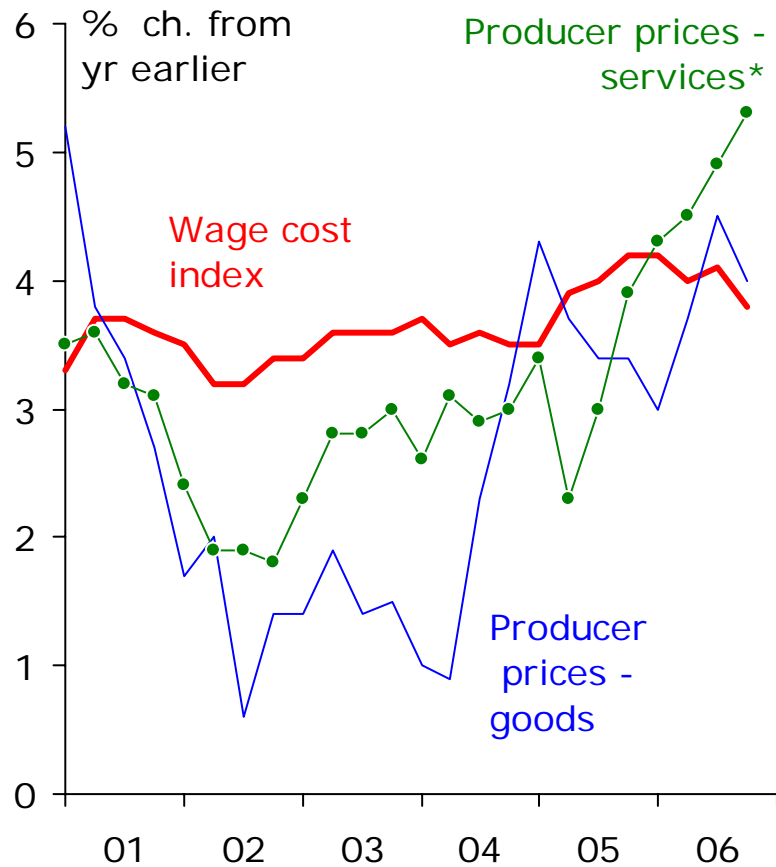


Producer prices - services

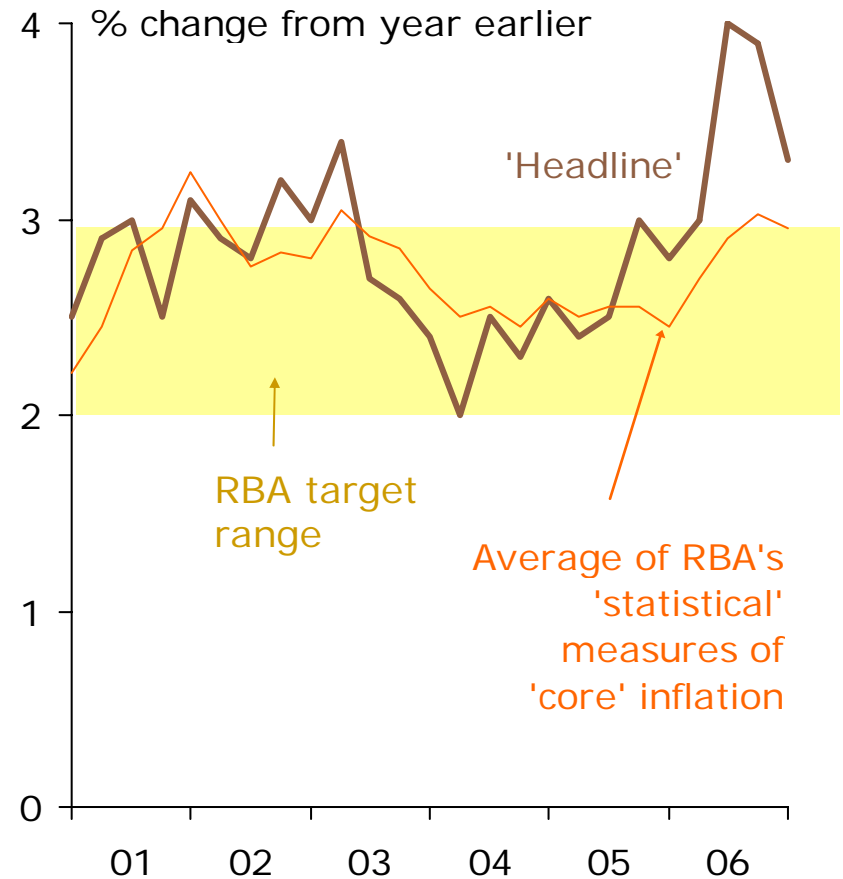


...but inflationary pressures have eased

'Upstream' inflation

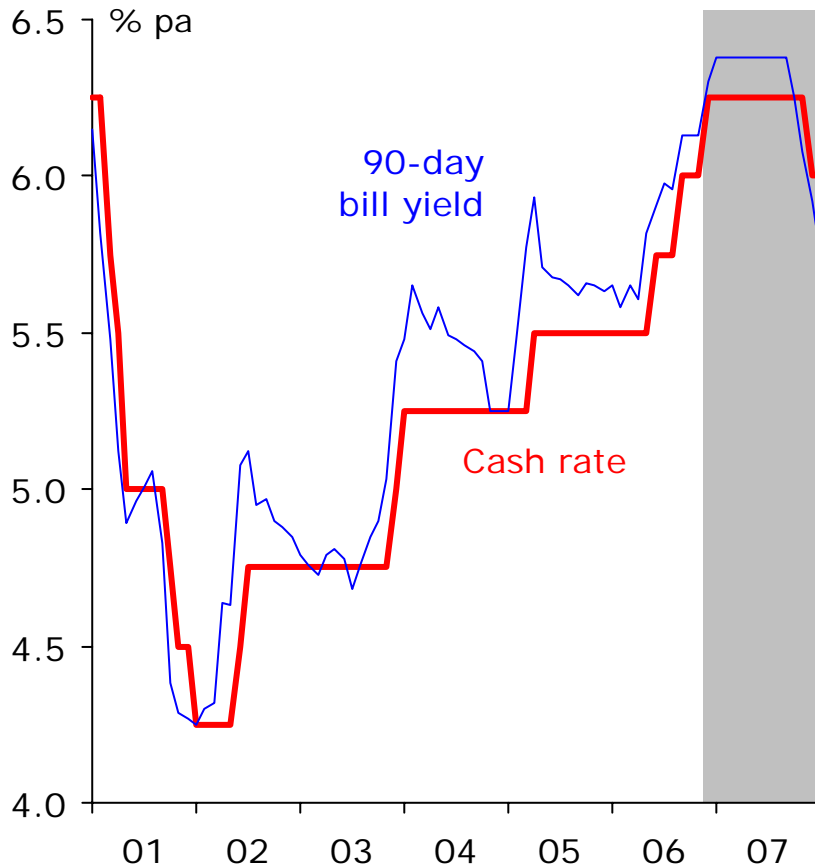


Consumer price inflation



Last November's rate rise should mark the peak of the interest rate cycle – next move down

Interest rates

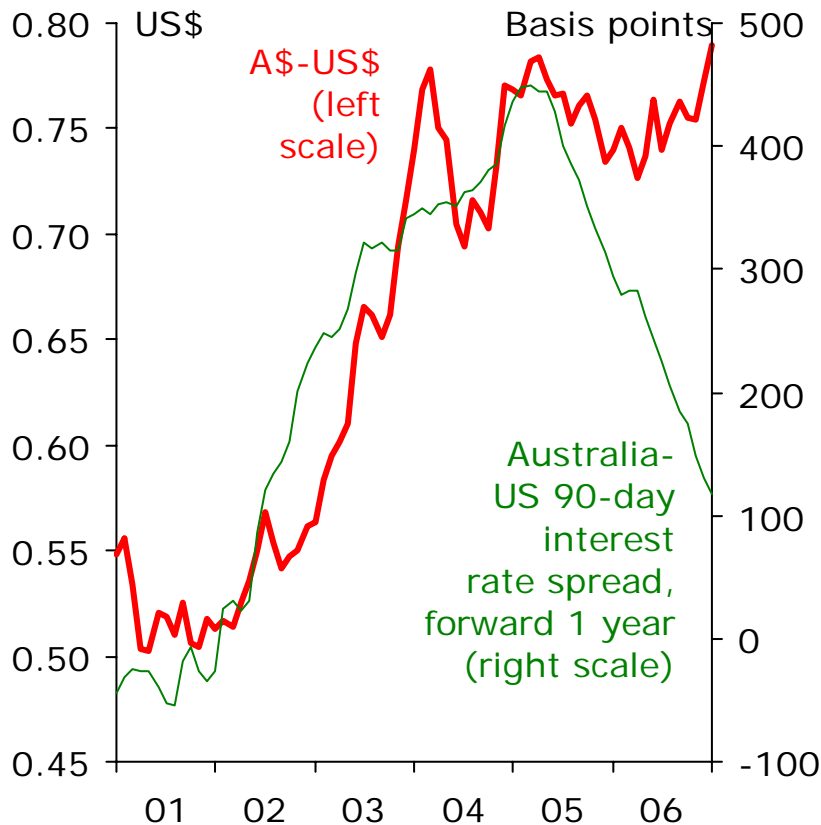


- The Reserve Bank raised the cash rate 3 times last year, and 8 times since the low point in 2002
- Another rate rise was inevitable once 'underlying' inflation exceeded 3%
- Inflation eased in late 2006
- There should be increased signs of higher rates impacting domestic spending over the next few months
- So provided the Government avoids the pre-election splurge, this will likely represent the peak in rates for this cycle
- Rate cuts late '07 and early '08

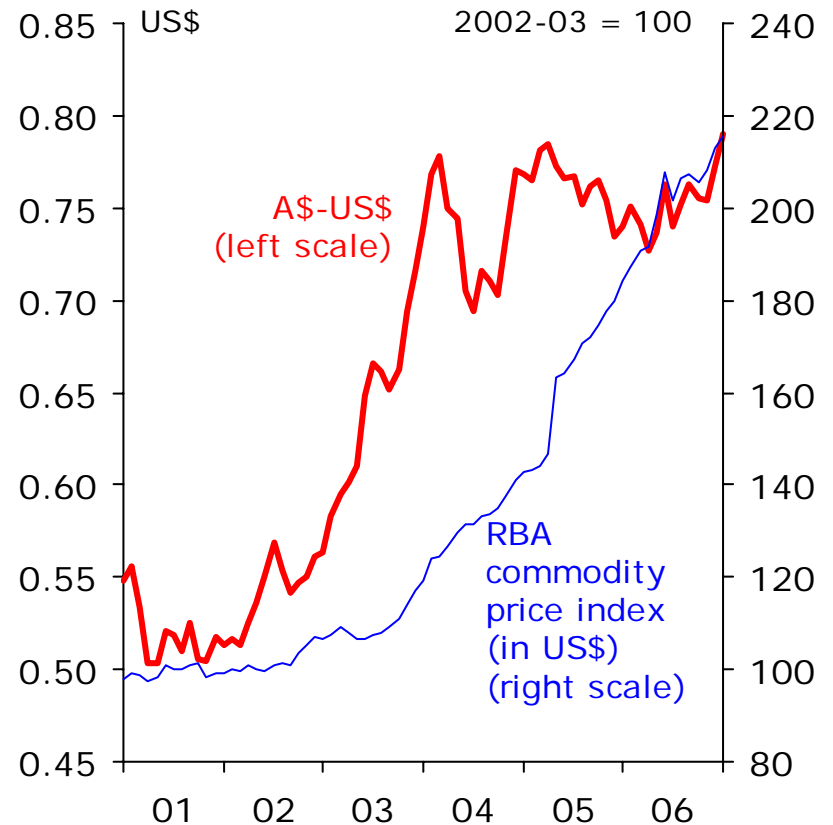
The resources boom is supporting the A\$

Economic influences on the value of the A\$

Interest rate spreads



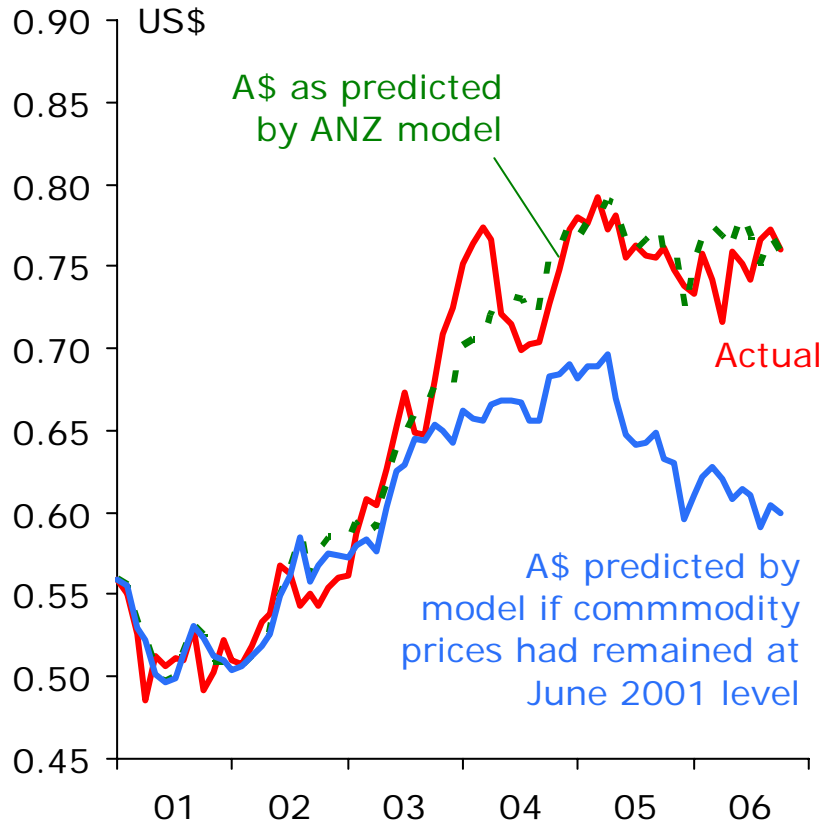
Commodity prices



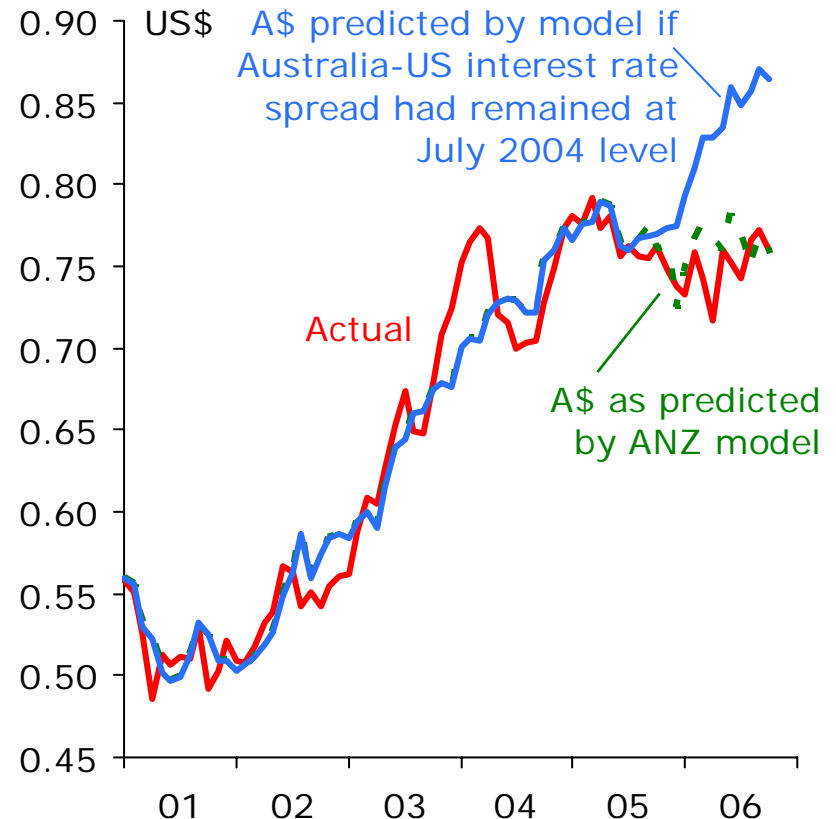
Commodity prices and interest rates working in opposite directions

Alternative hypothetical scenarios for the A\$

If commodity prices hadn't risen since June 2001



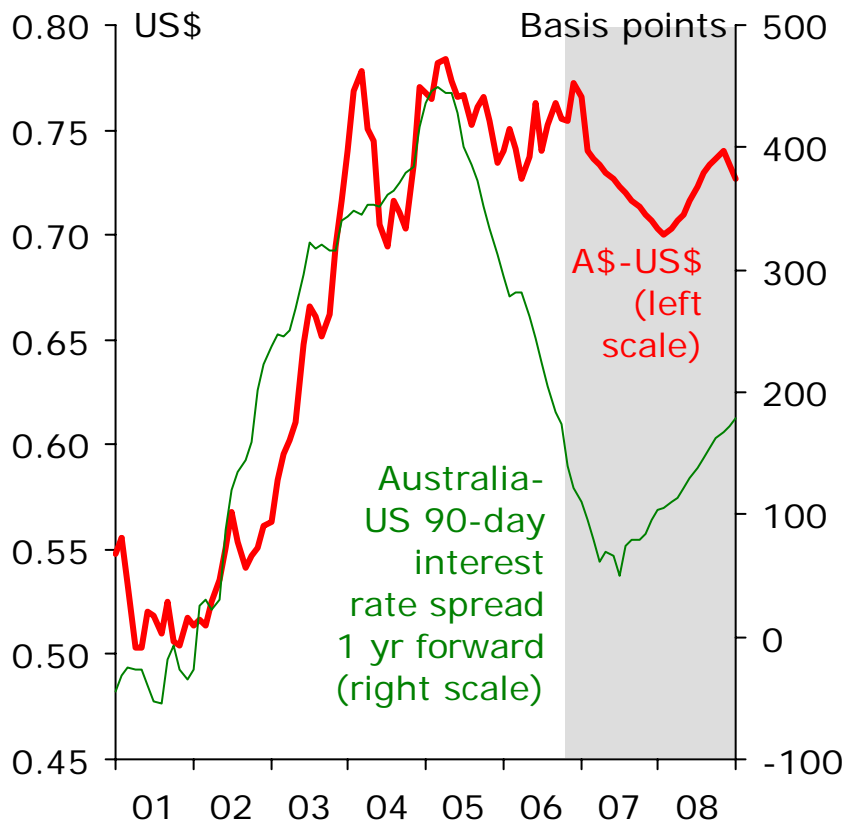
If the interest rate spread on the A\$ hadn't narrowed since July 2004



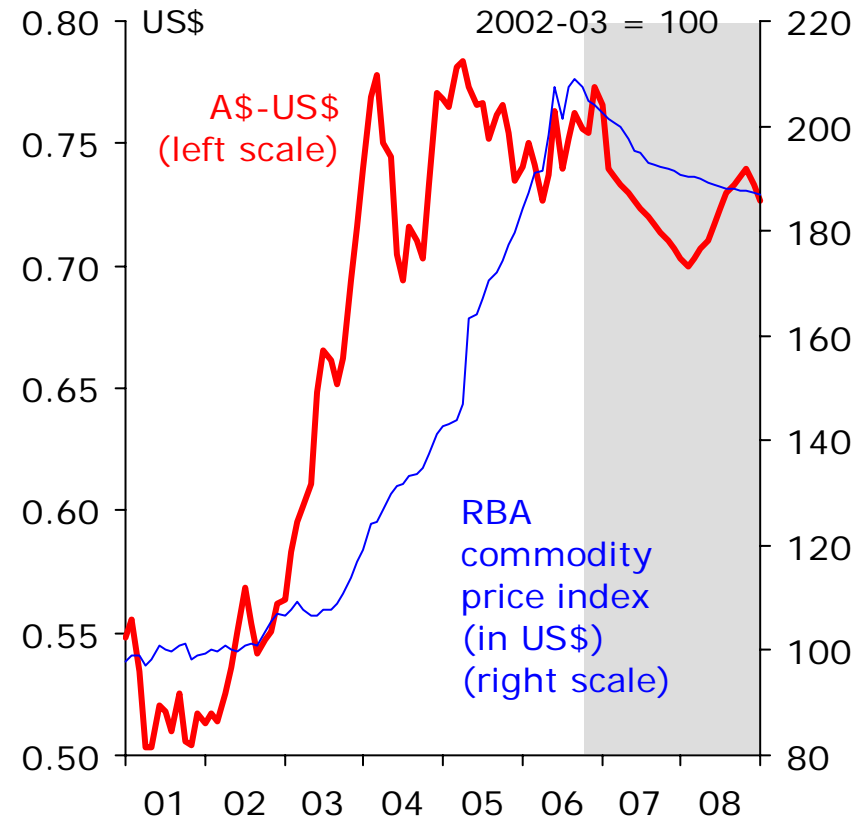
These factors will continue to oppose one another – from opposite directions

Economic influences on the value of the A\$

Interest rate spreads

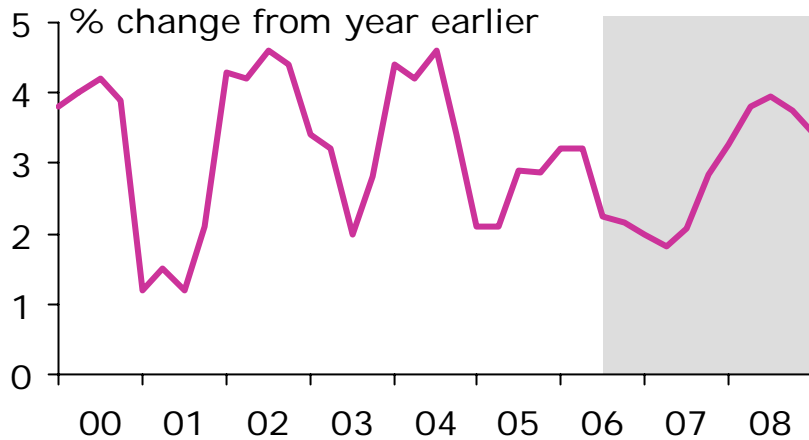


Commodity prices

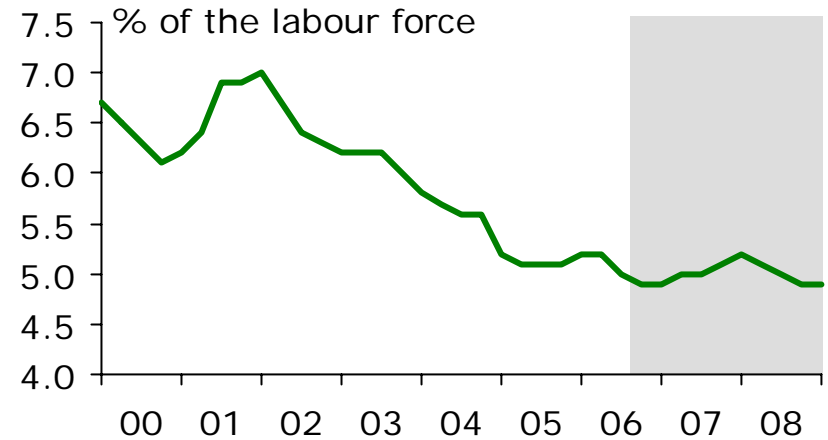


Growth in the Australian economy will remain subject to capacity constraints

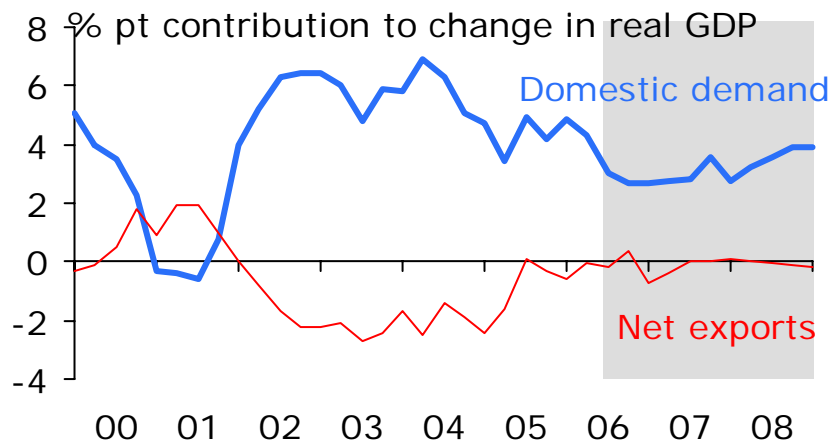
Real GDP growth



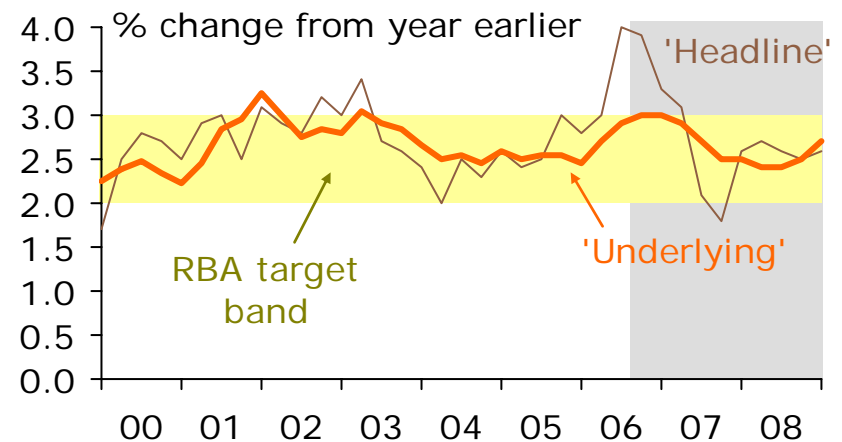
Unemployment



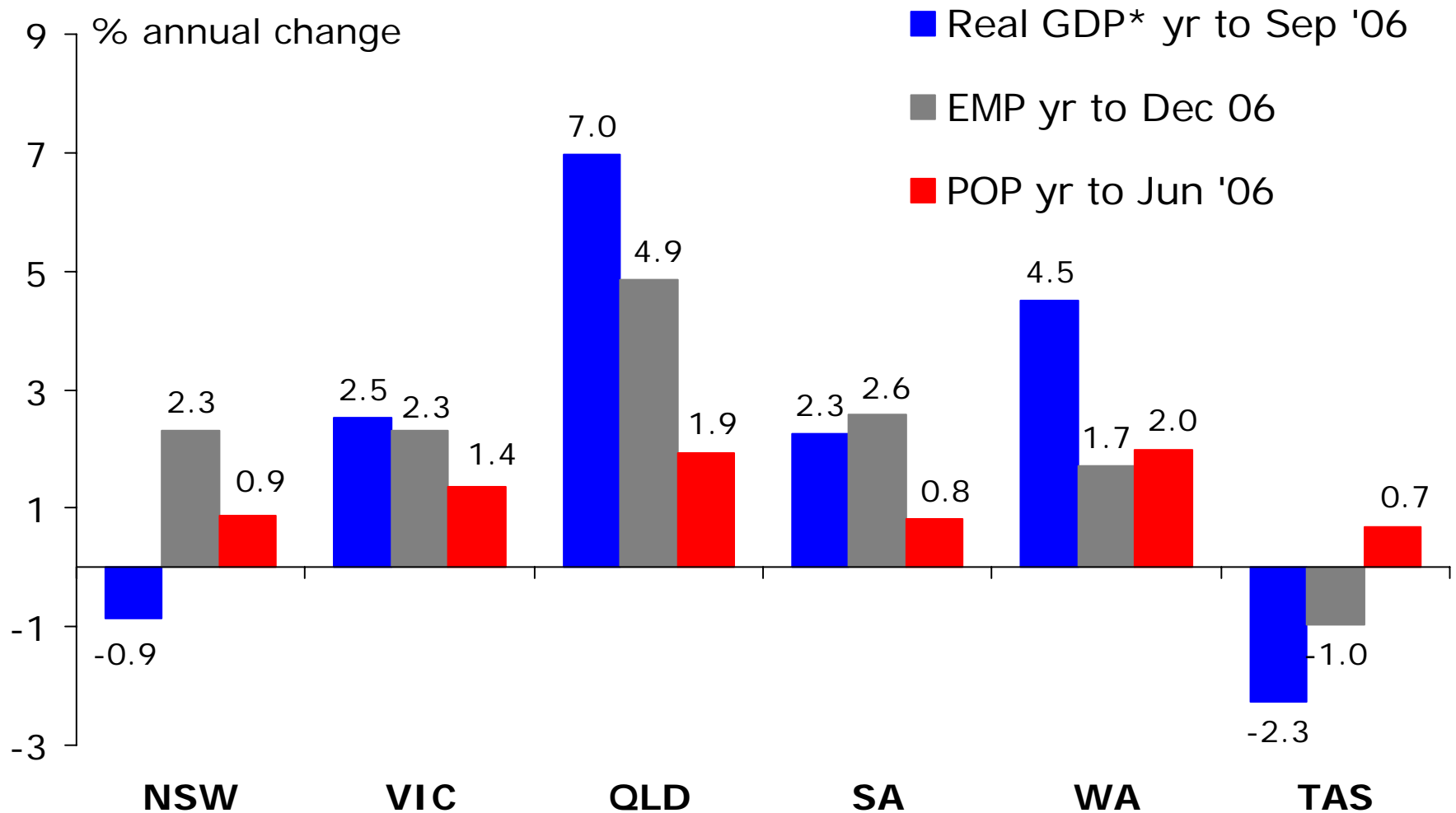
Major components of growth



Inflation



The NSW and Tasmanian economies have significantly underperformed

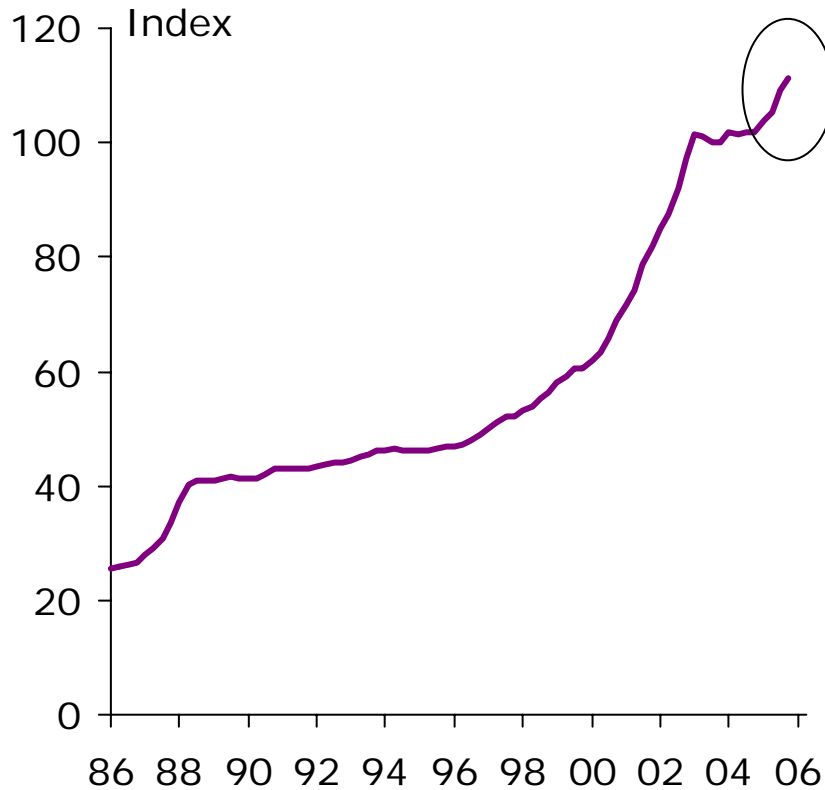


Solid economic and underlying housing fundamentals will drive next upturn

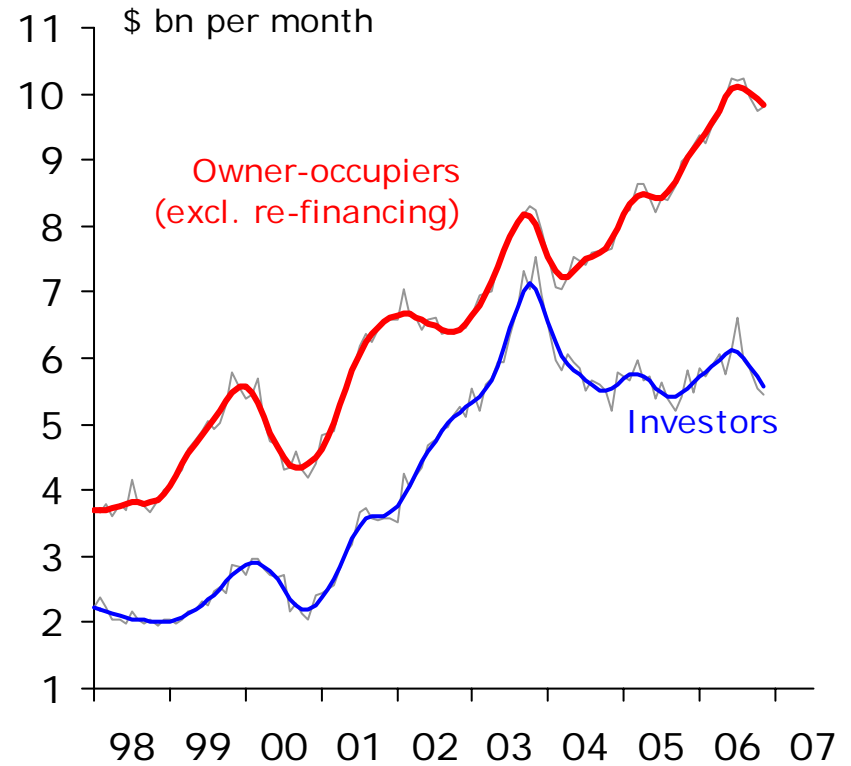
- Three interest rate hikes in 2006 softened buyer/developer sentiment/sales
- But, housing markets continue to tighten rapidly and prices have recovered
- Rental vacancies are already well below long term average
 - new supply will fall well short of demand in 2007
 - driving rentals higher, and providing the trigger for the next upswing
- Broad economic conditions remain healthy particularly in the household sector
 - solid employment/wages growth
 - unemployment rate at 30 year lows

The housing market strengthened in 2006 - prior to the three rate hikes

House prices

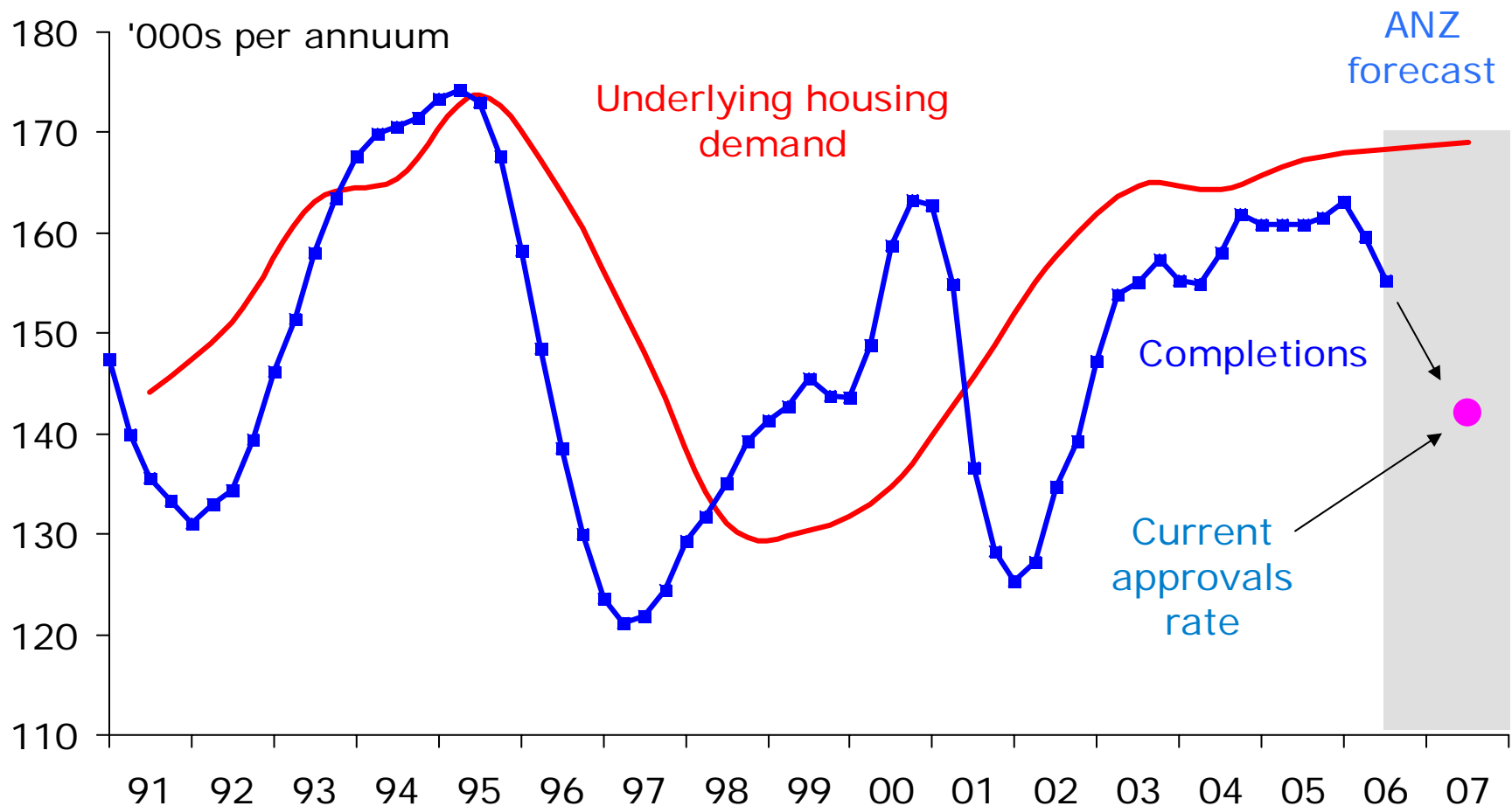


Housing finance commitments



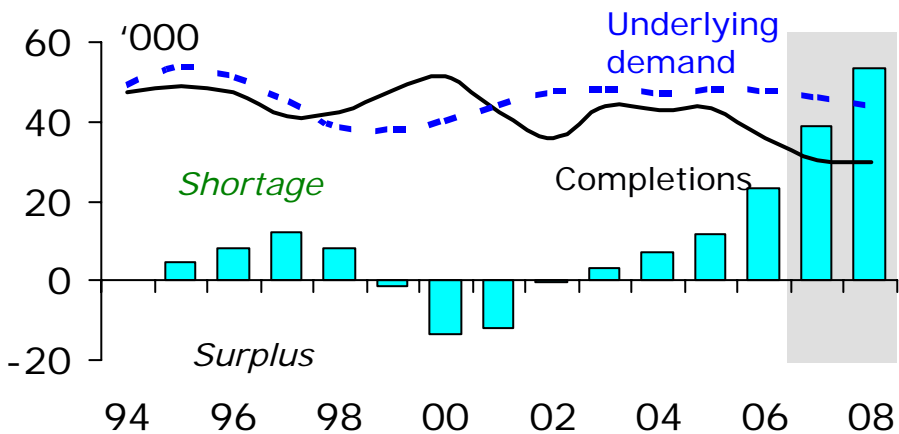
Negative developer sentiment has driven new dwelling approvals sharply lower

Housing demand vs housing supply

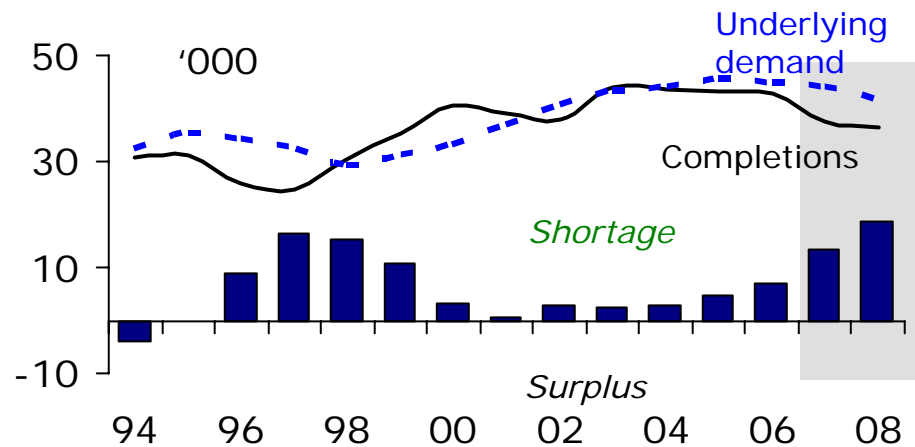


Housing market balance by state

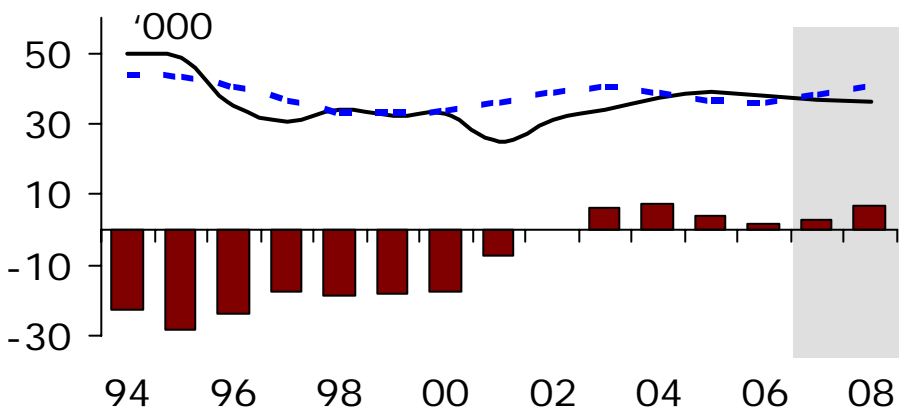
NSW



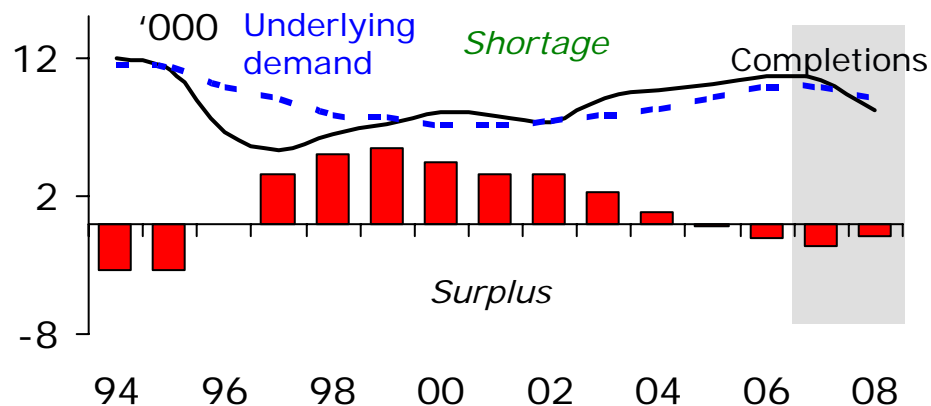
Vic



Qld

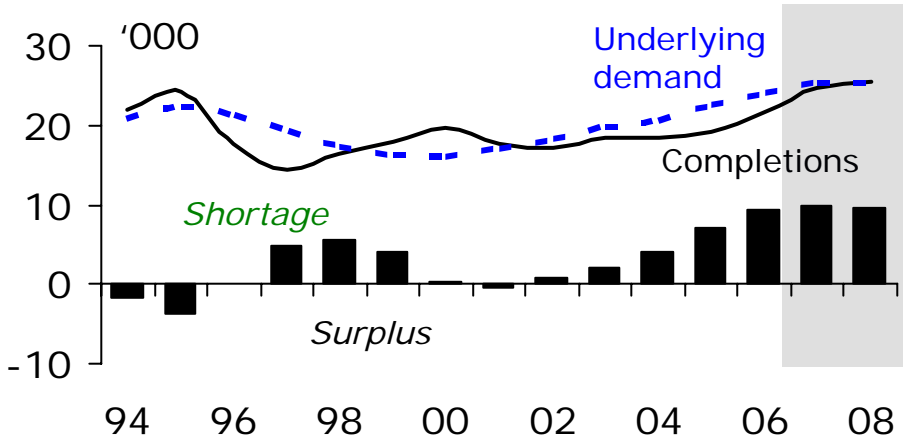


SA

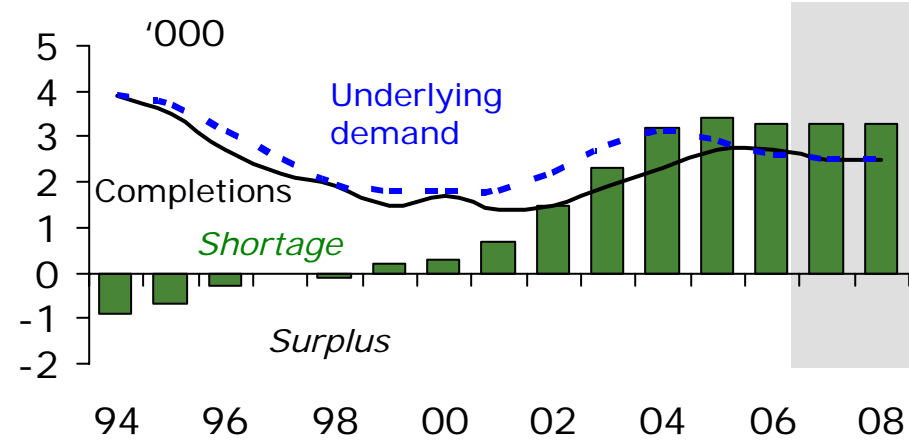


Housing market balance by state (cont.)

WA

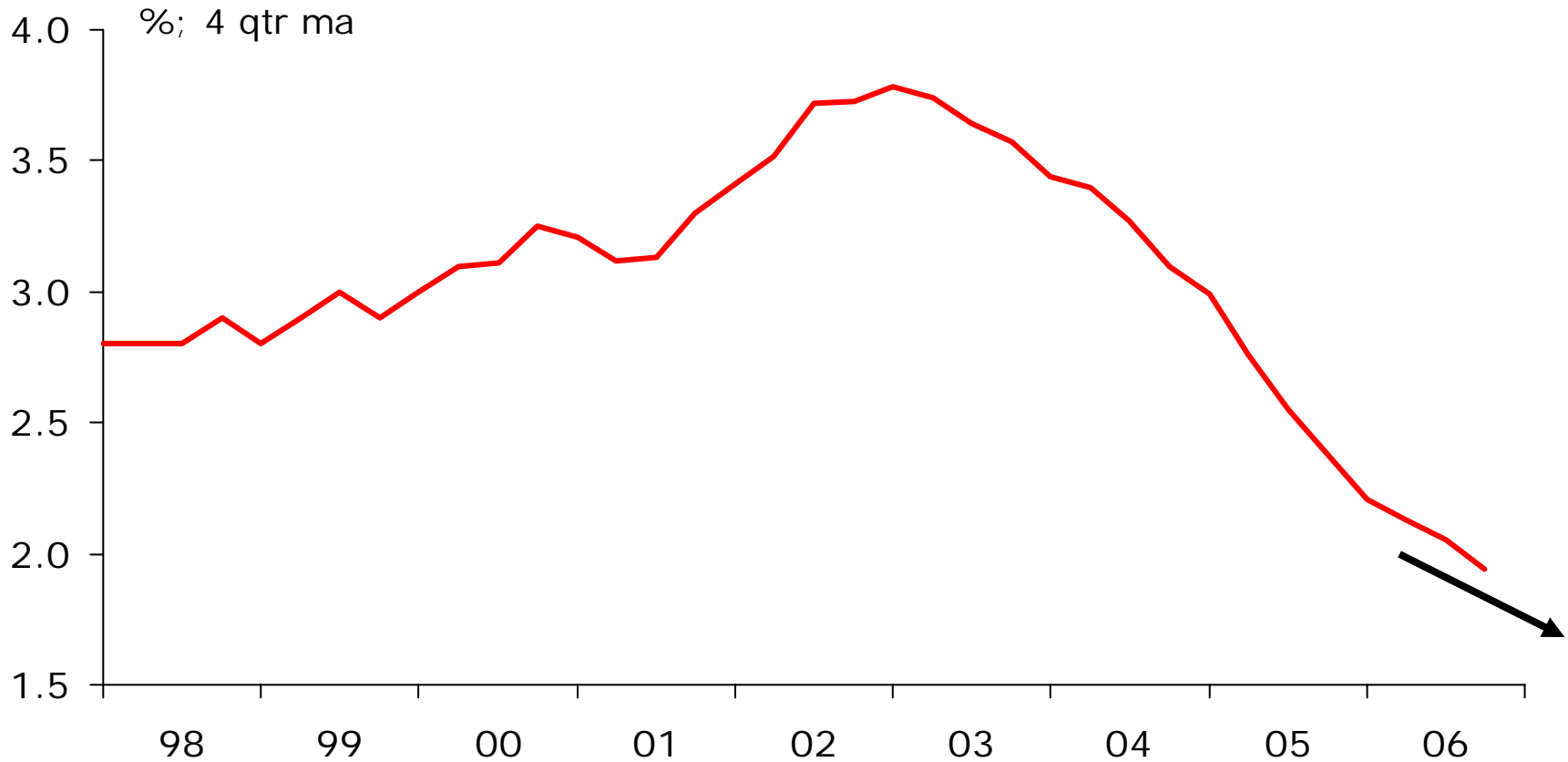


Tas



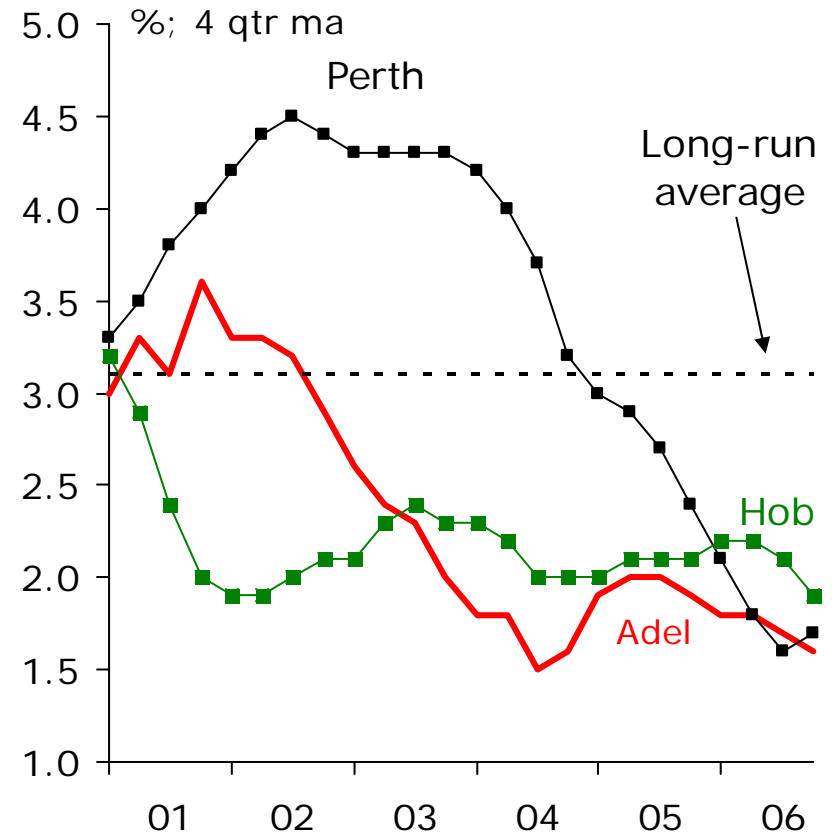
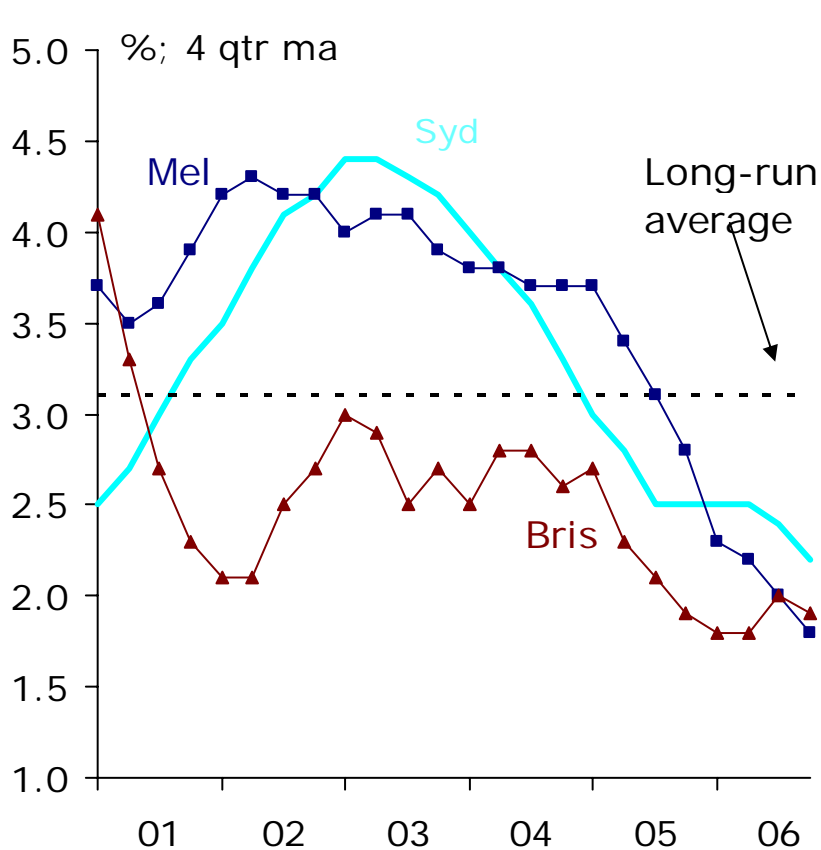
This tightening is reflected in falling rental vacancy rates...

Rental vacancy rate



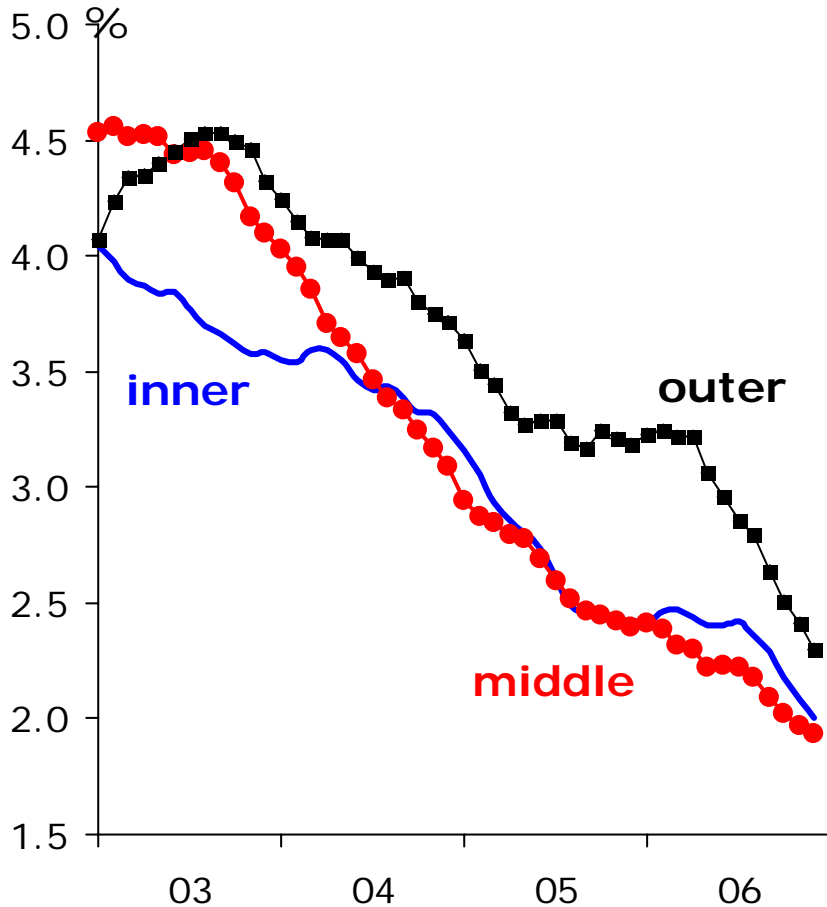
...in all state capitals

Rental vacancy rate

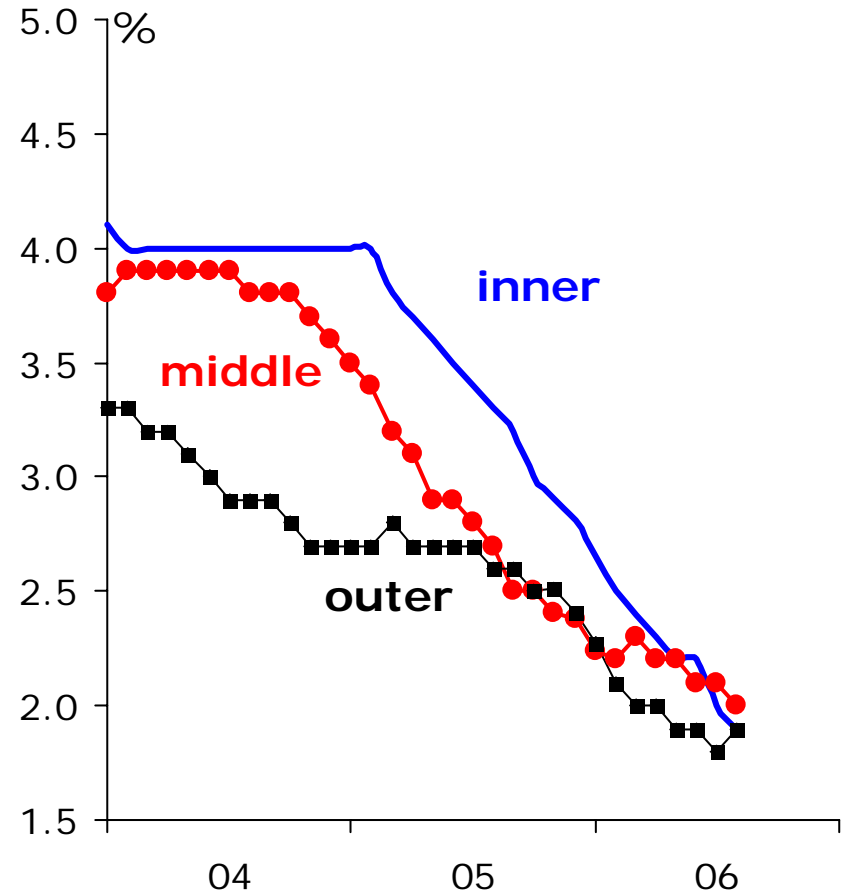


Even inner-city markets are tightening

Rental vacancy rates* Sydney

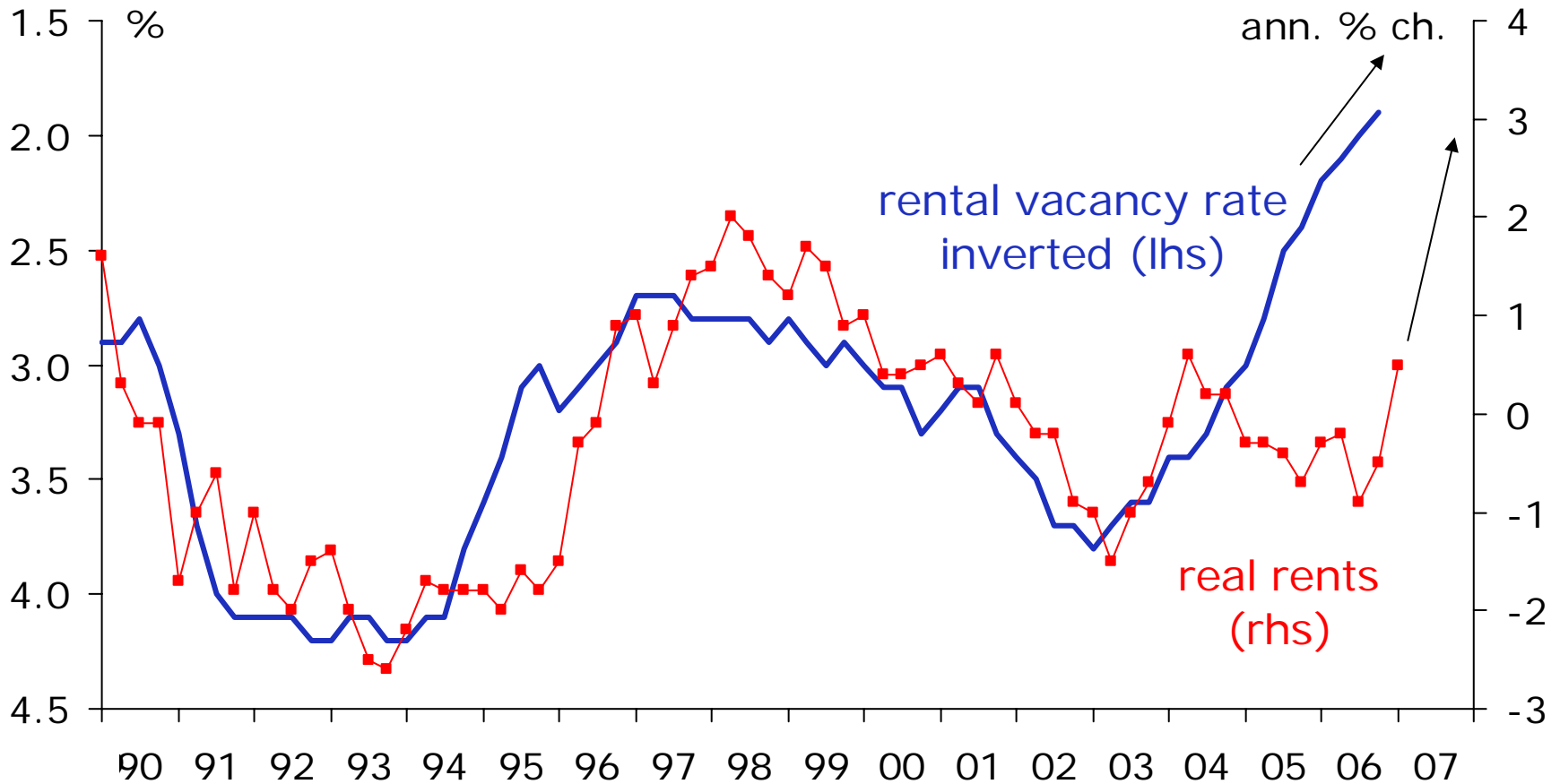


Rental vacancy rates* Melbourne



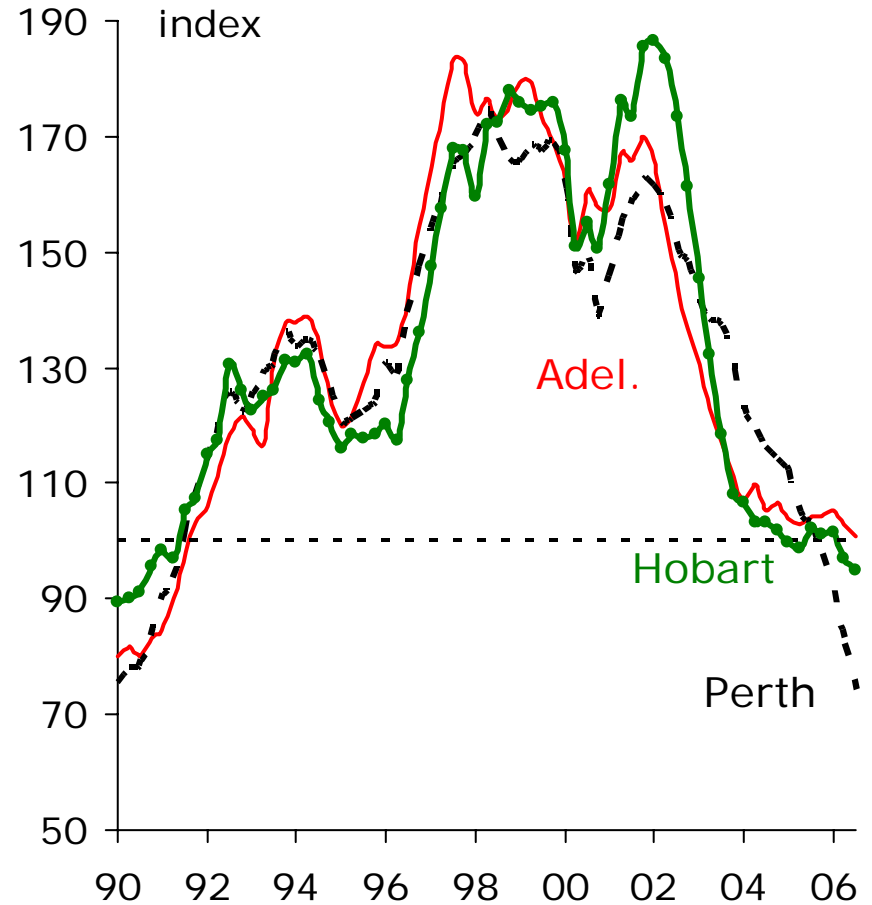
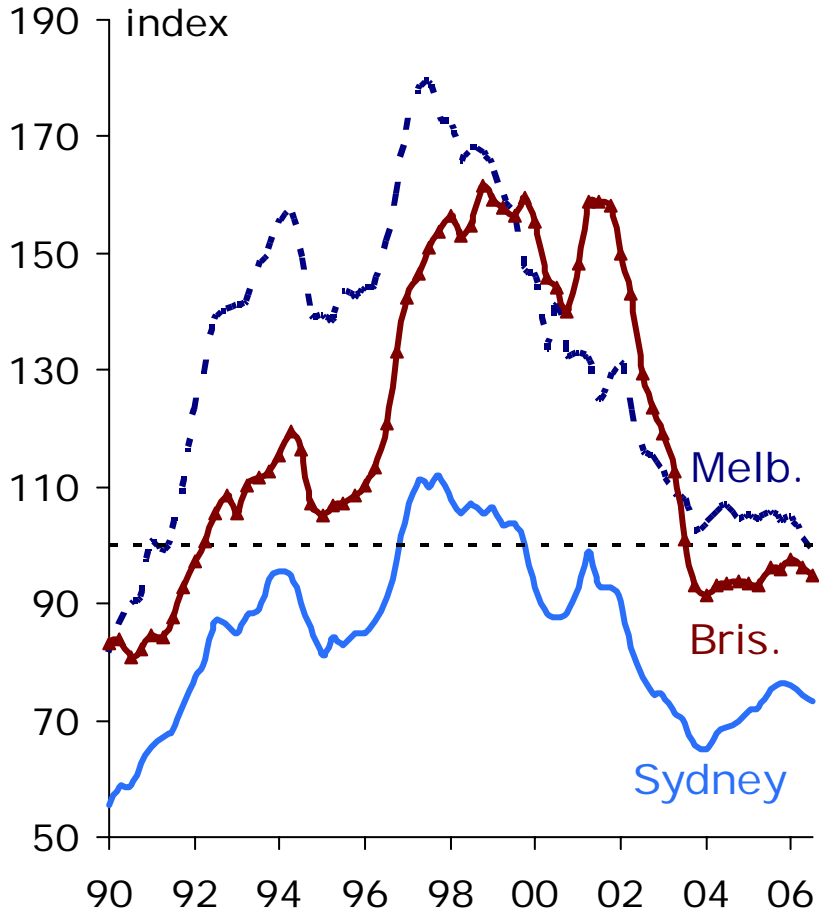
Tightening vacancies will eventually push rents higher

Rental vacancy rate versus real rents



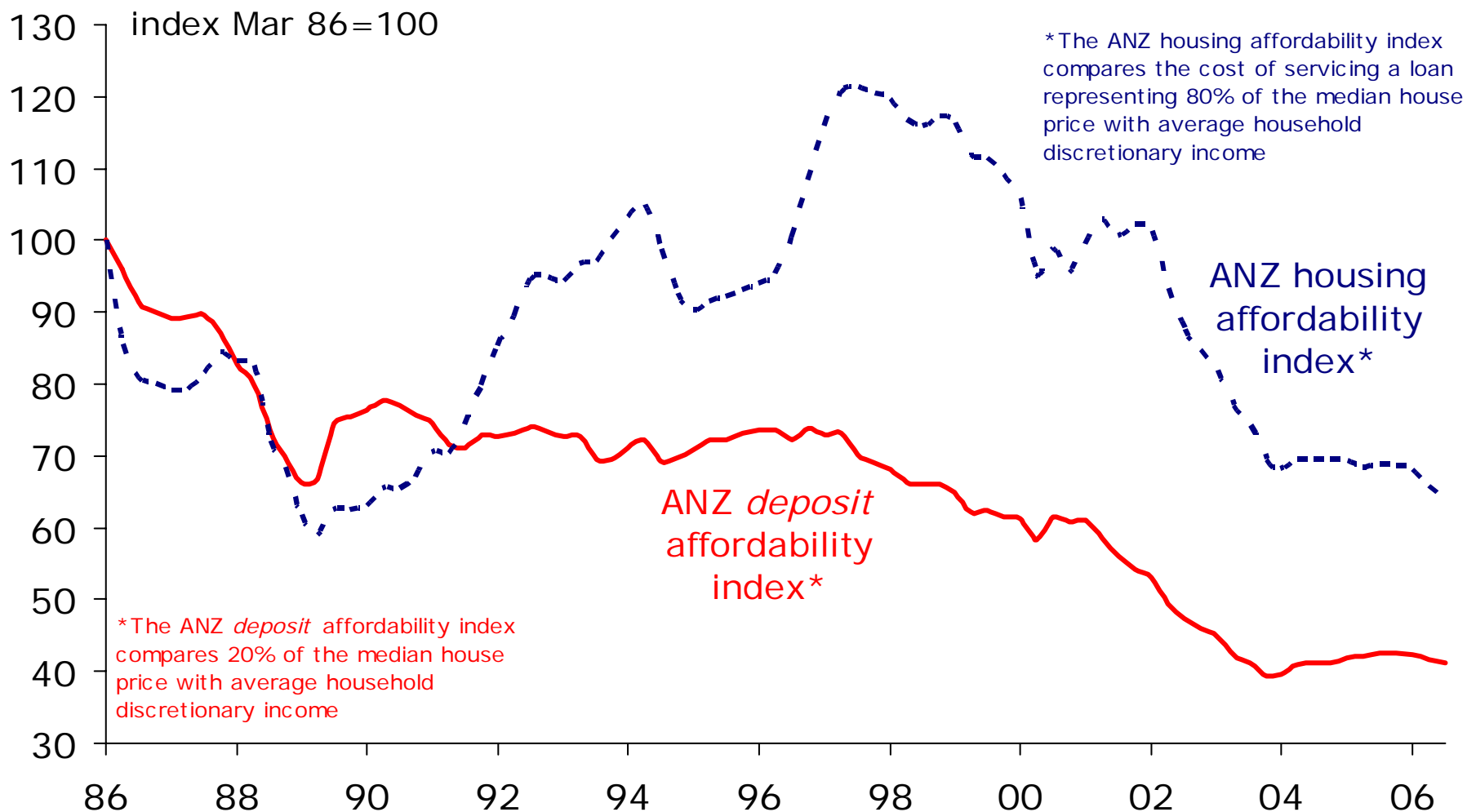
Housing affordability conditions remain tough – particularly in Perth

ANZ housing affordability index



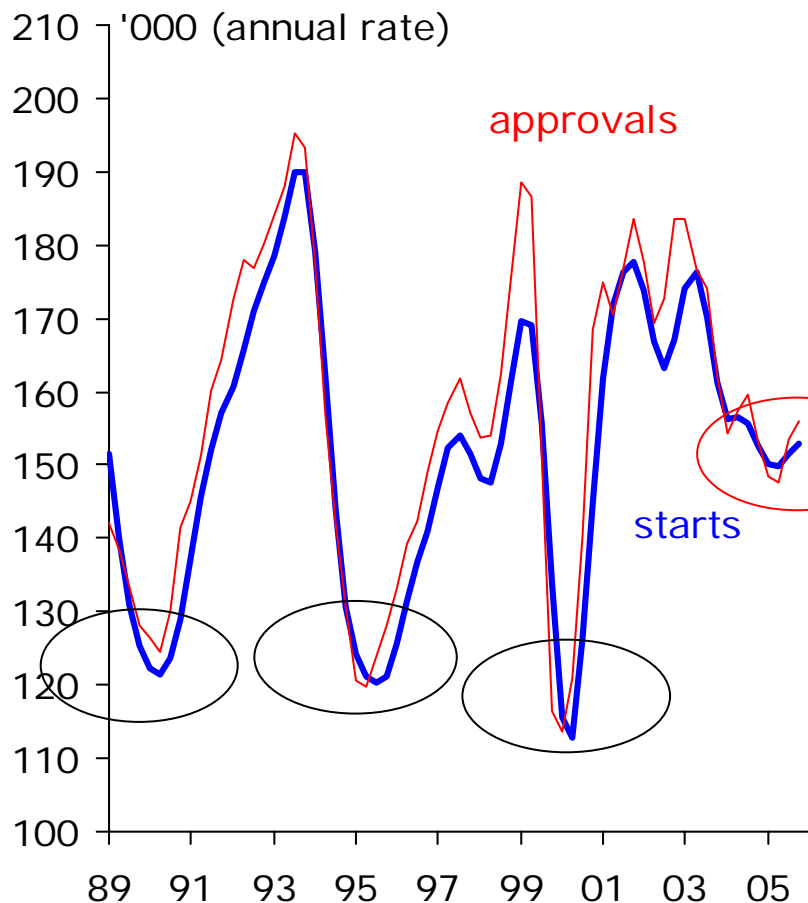
Housing affordability conditions have tightened - particularly for deposits

ANZ housing affordability indices

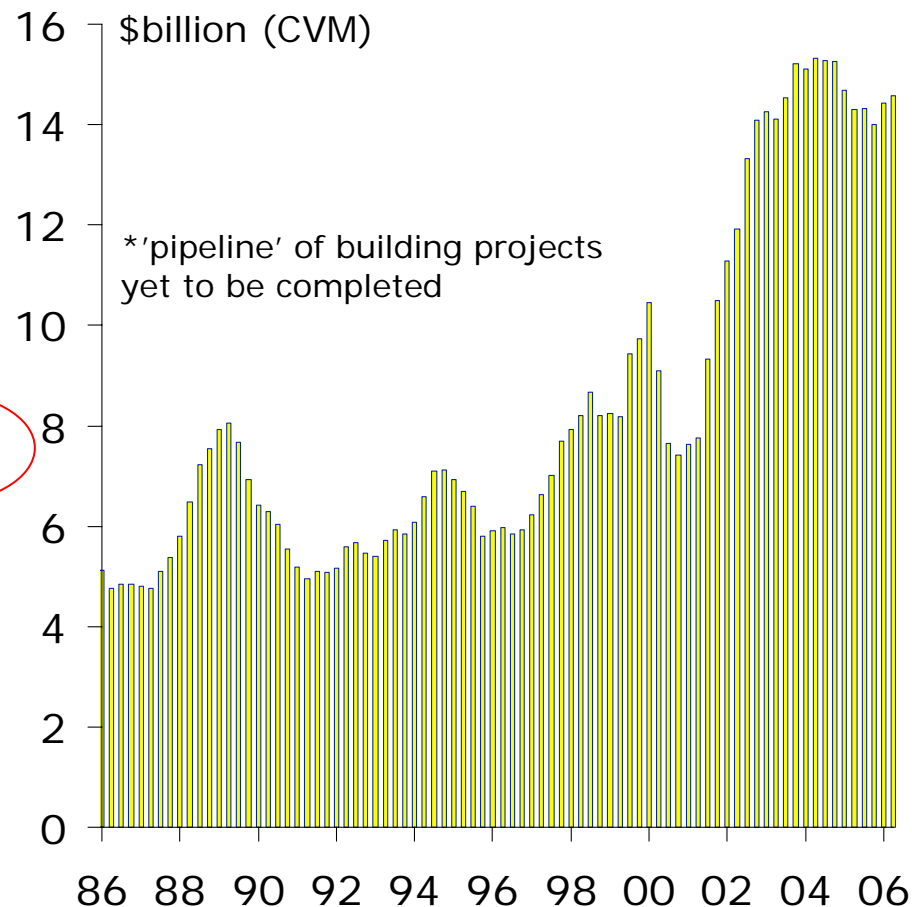


The current housing 'downturn' will be extremely mild by past standards

Australia

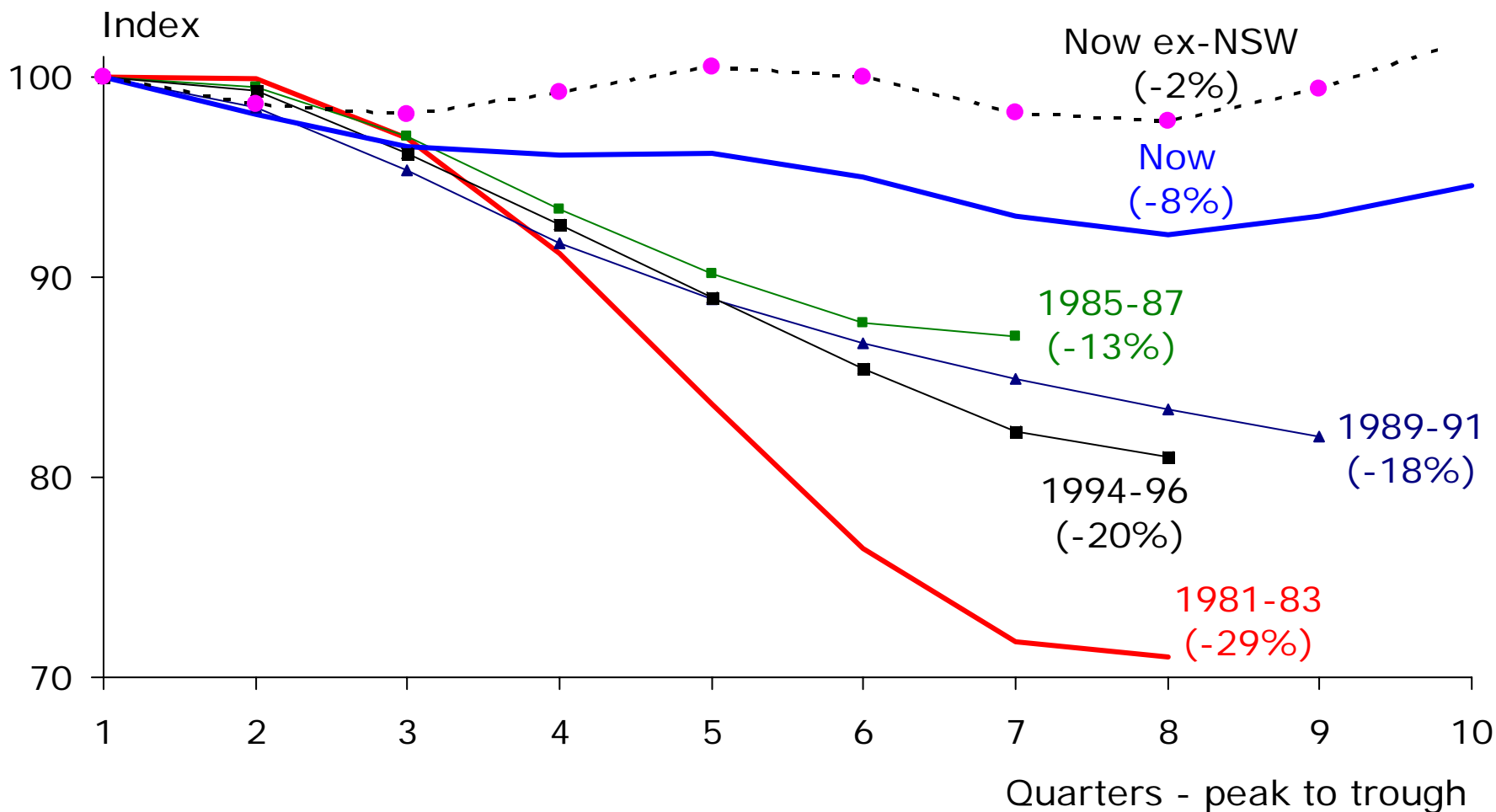


Work yet to be done*



The current housing 'downturn' will be extremely mild by past standards

Real dwelling investment

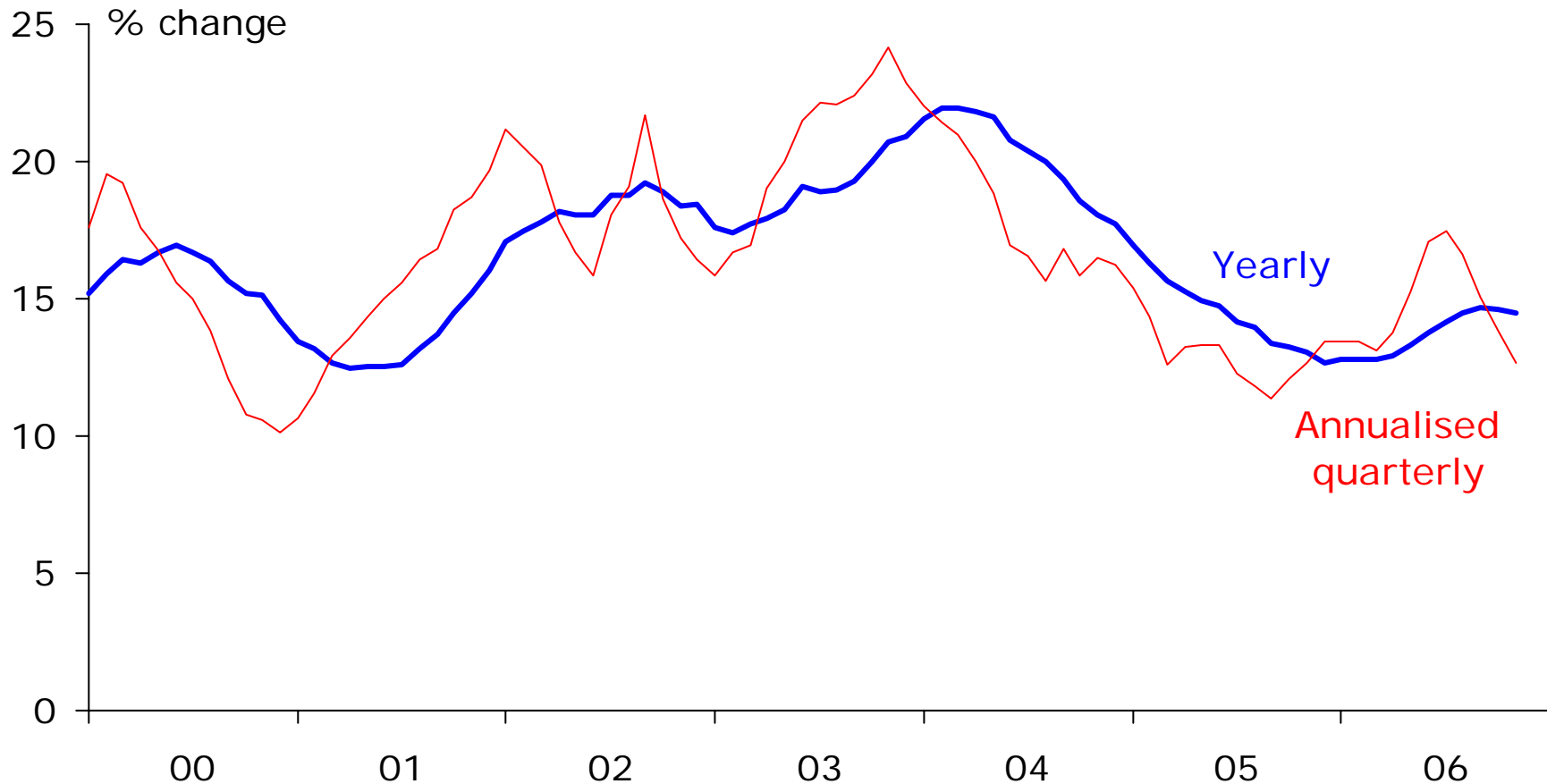


Sowing the seeds of the next housing upturn

- Housing markets have always been highly cyclical - tend to swing from over-development to under-development
- Approvals are currently running well below underlying requirements (145k cf 170k)
 - and housing markets are tightening rapidly, sowing the seeds of the next upturn
- Downside risk limited by positive economic and underlying housing fundamentals and the notable absence of the usual 'triggers'
- Rate cuts in 2007-08 will spur housing turnaround

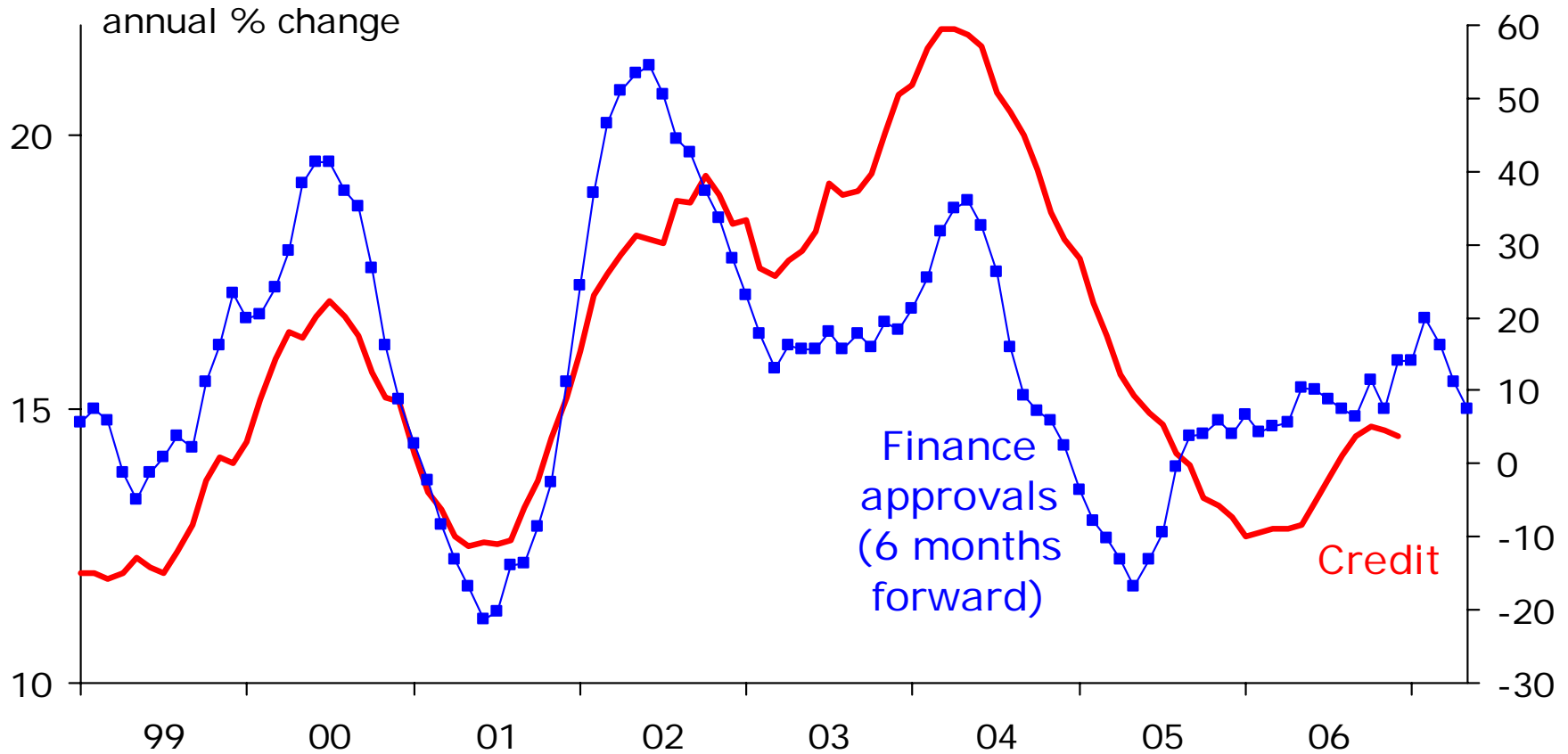
Finance approvals growth has slowed, but housing credit growth remains solid at 14.5%

Housing credit



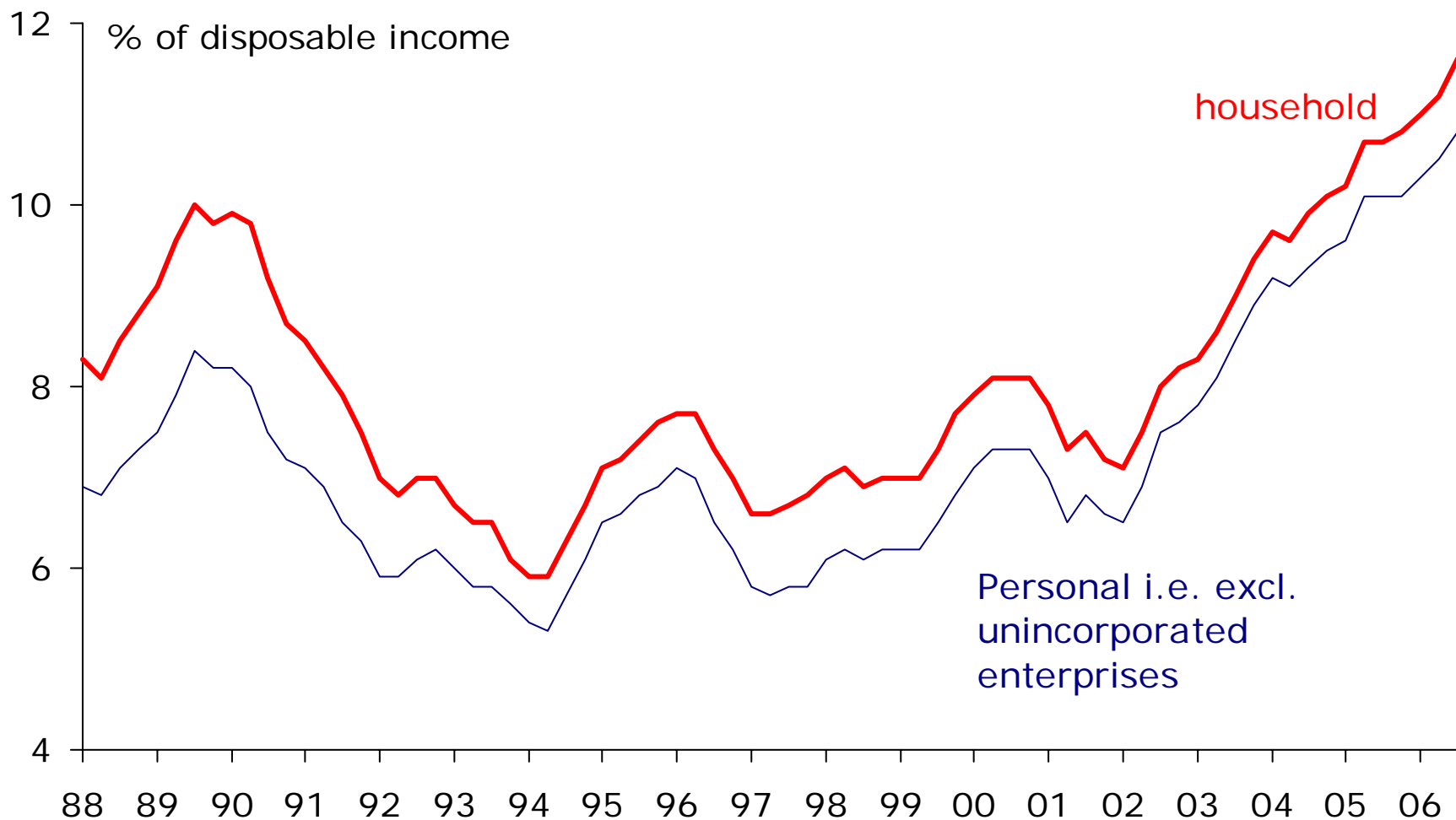
Solid housing finance growth early in 2006 will maintain robust credit growth

Housing credit and finance approvals



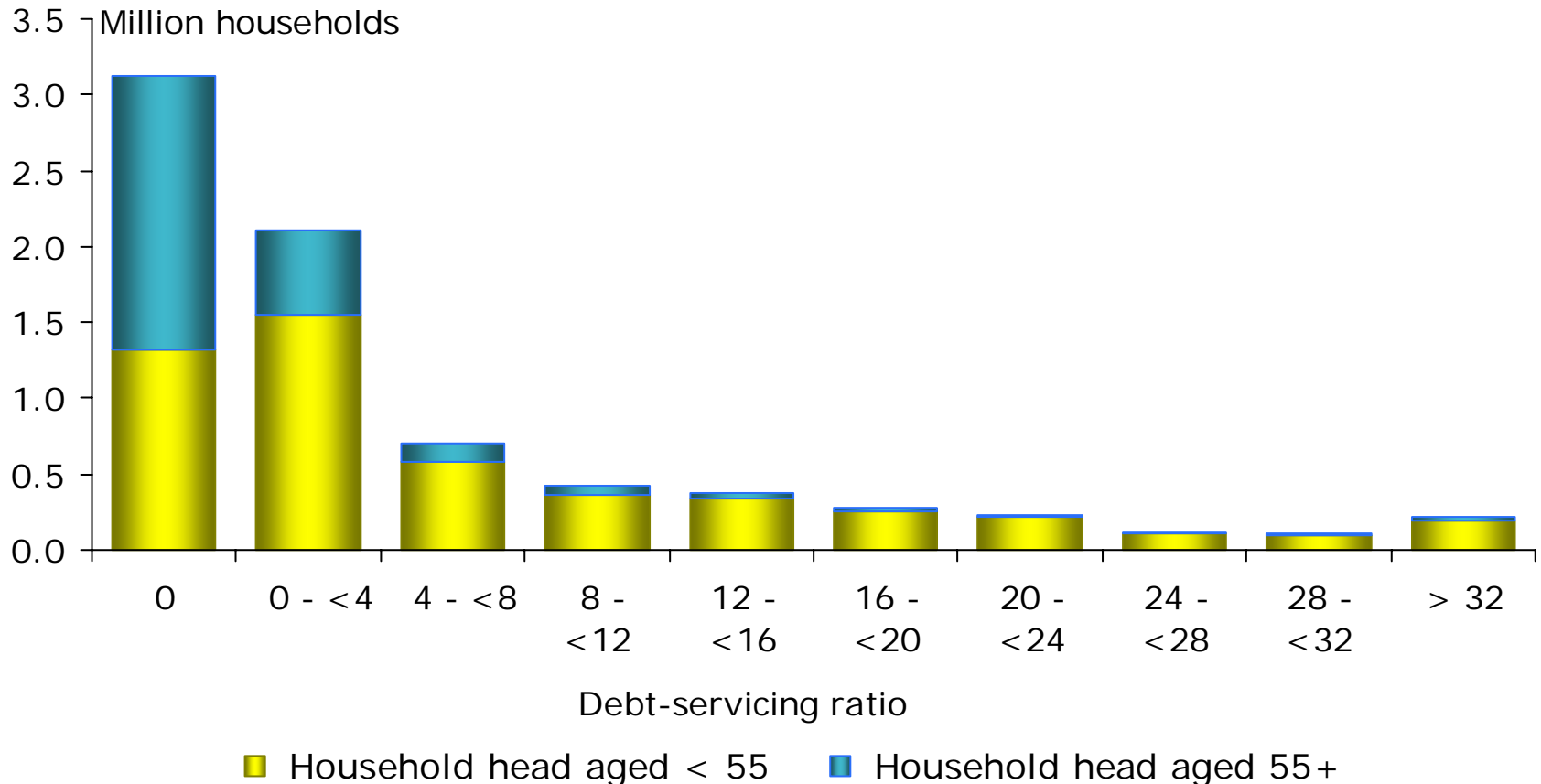
Debt servicing costs are now well above previous peaks...

Household debt service ratio



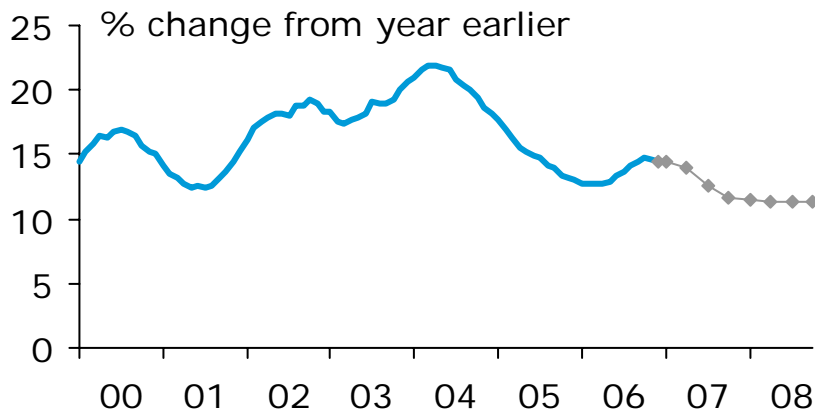
...but two thirds of Australian households have little or no debt

Debt service ratio by age of household head (2003-04)

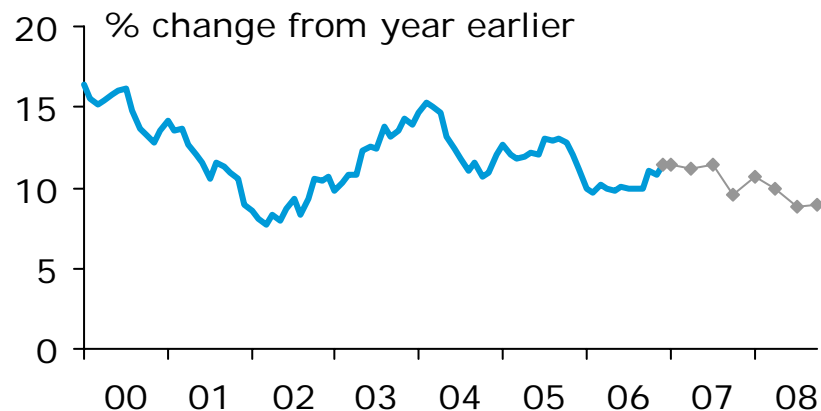


Credit growth will ease over the next 18 months, but remain double digit

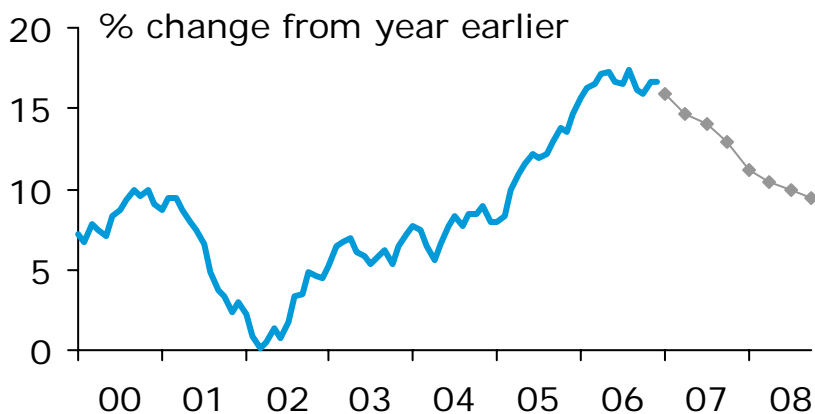
Housing credit



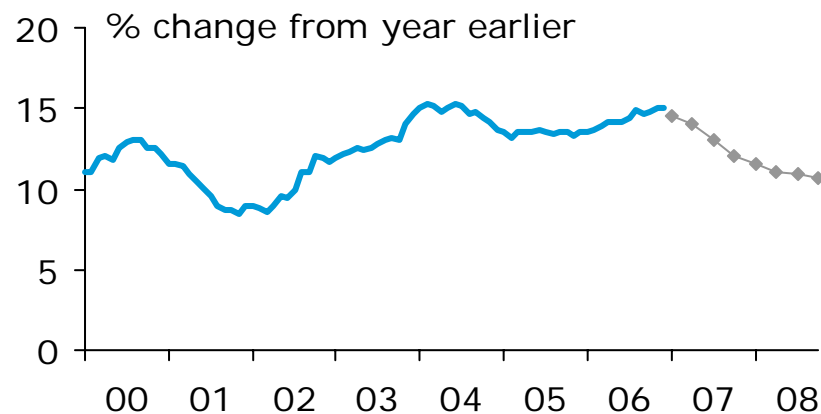
Personal credit



Business credit

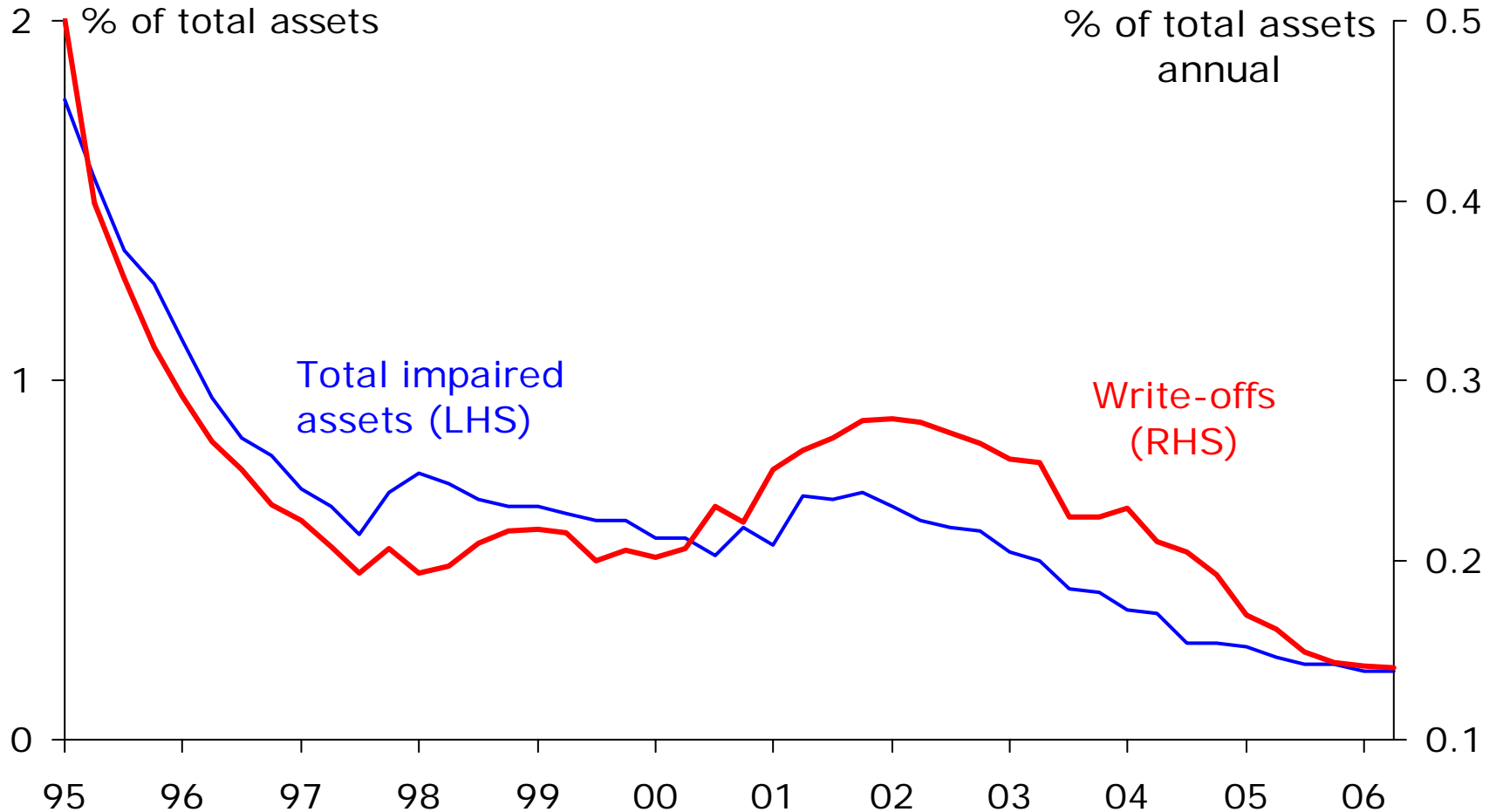


Total credit



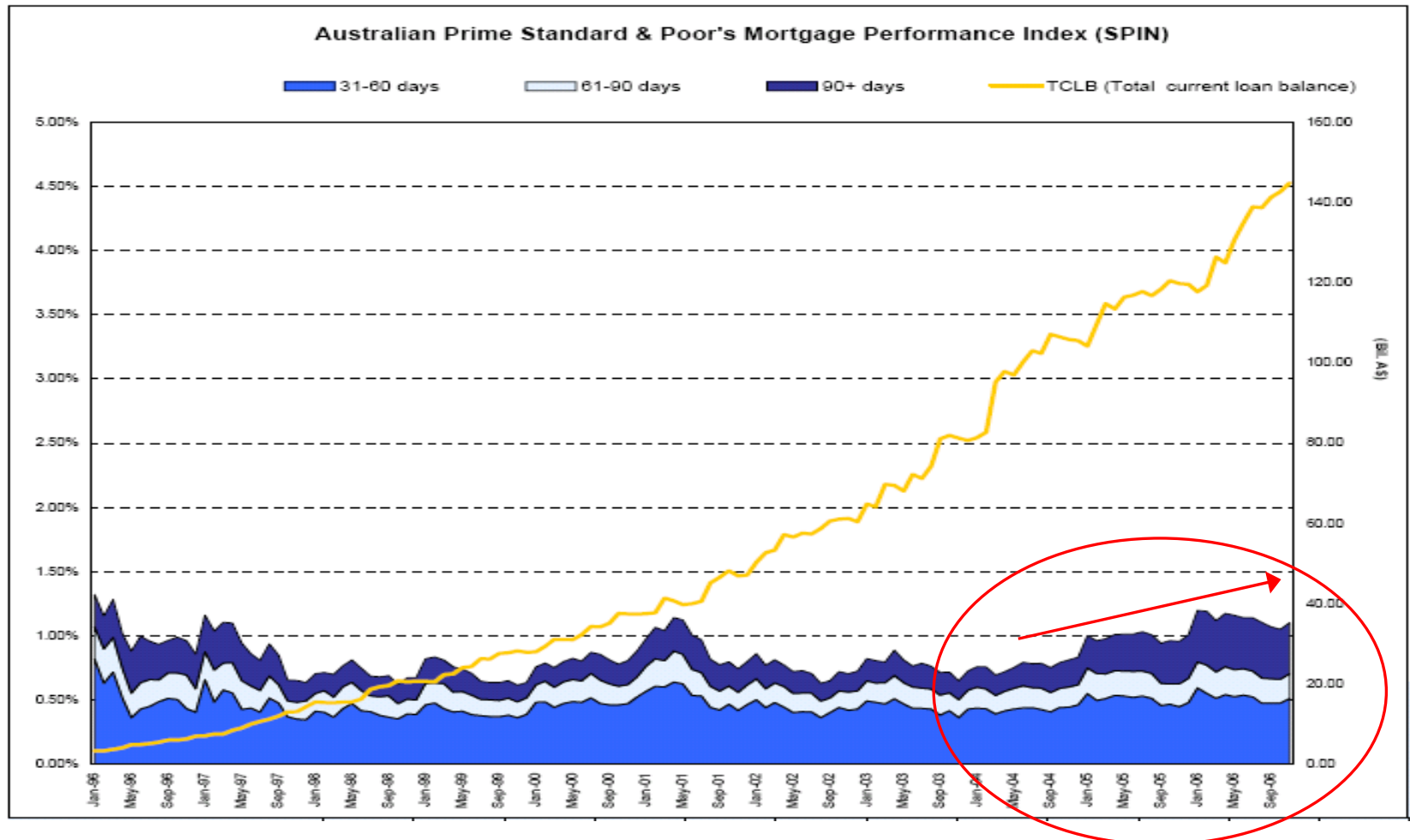
Total loan delinquencies and write-offs remain at extremely low levels

Impaired assets and write-offs: Banks



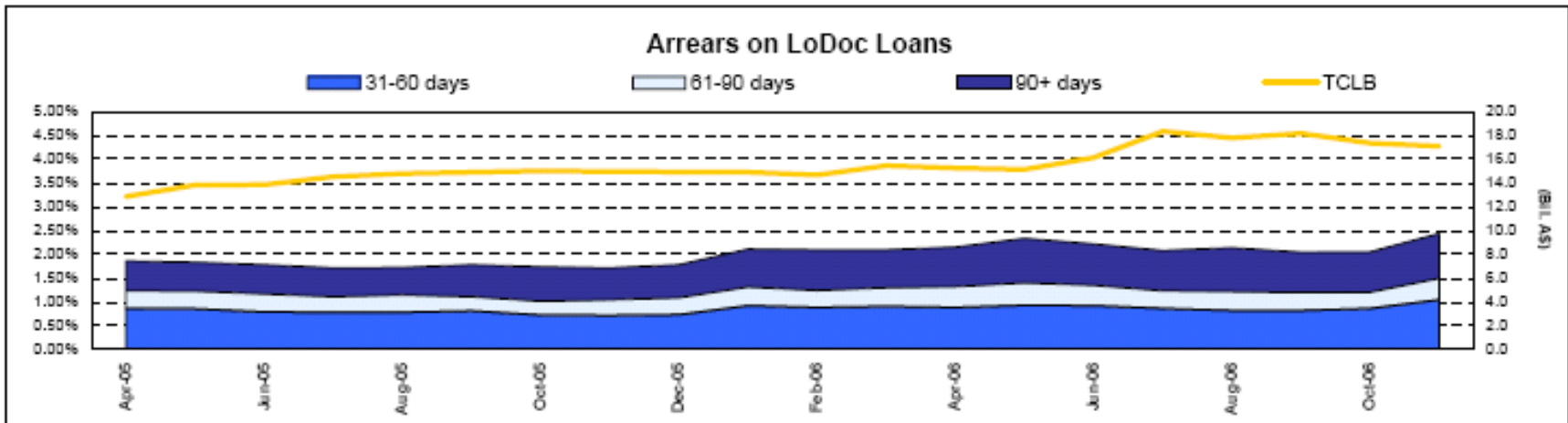
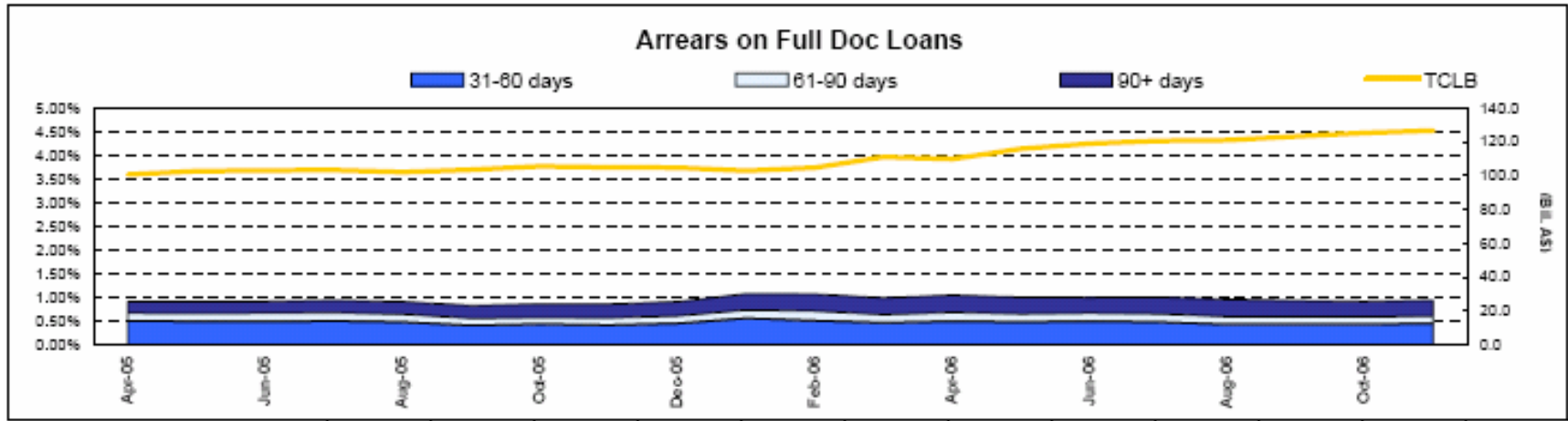
Many analysts getting excited about rising mortgage loan delinquencies

Arrears statistics: Prime



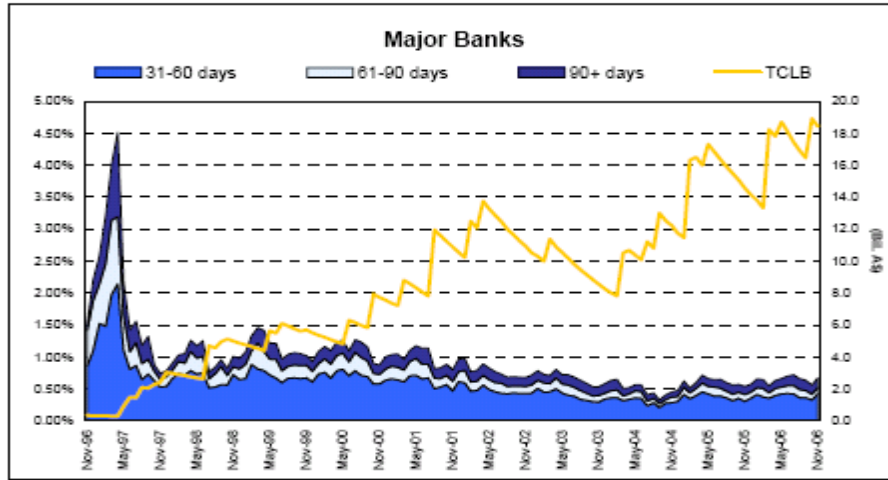
But arrears on prime full doc lending indicate the market remains sound

Arrears statistics: Prime

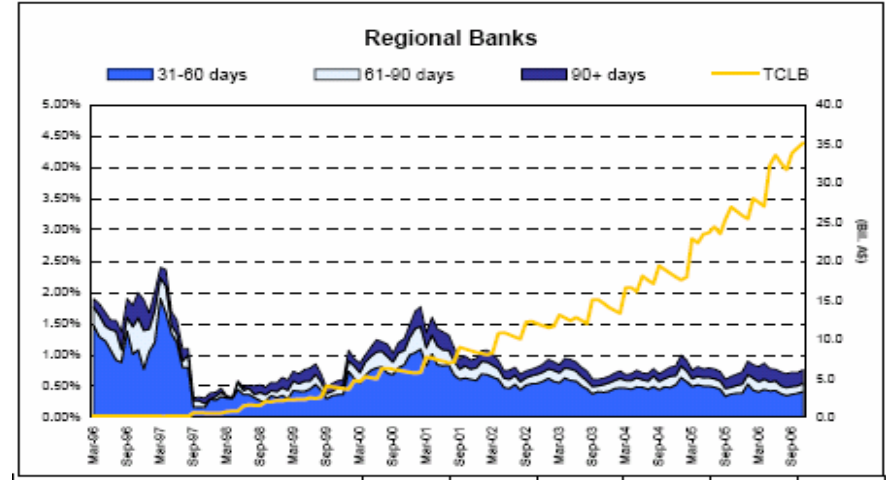


Rising mortgage loan delinquencies largely confined to certain channels/lenders

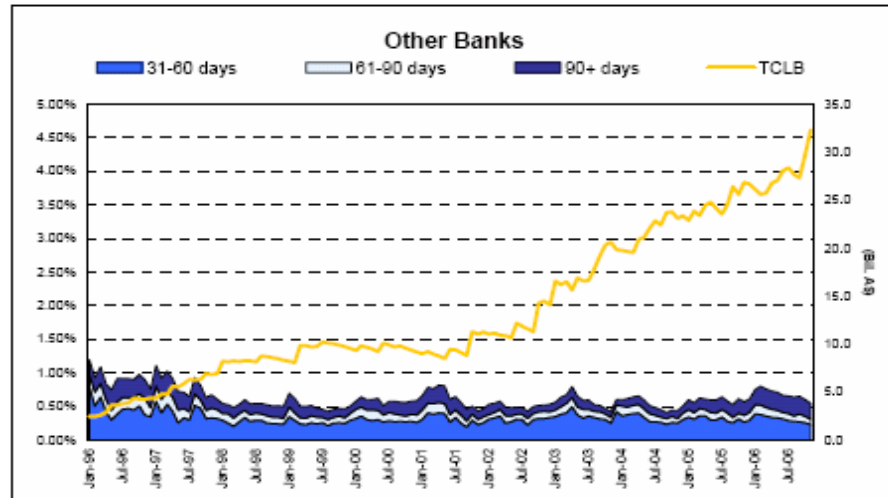
Major banks



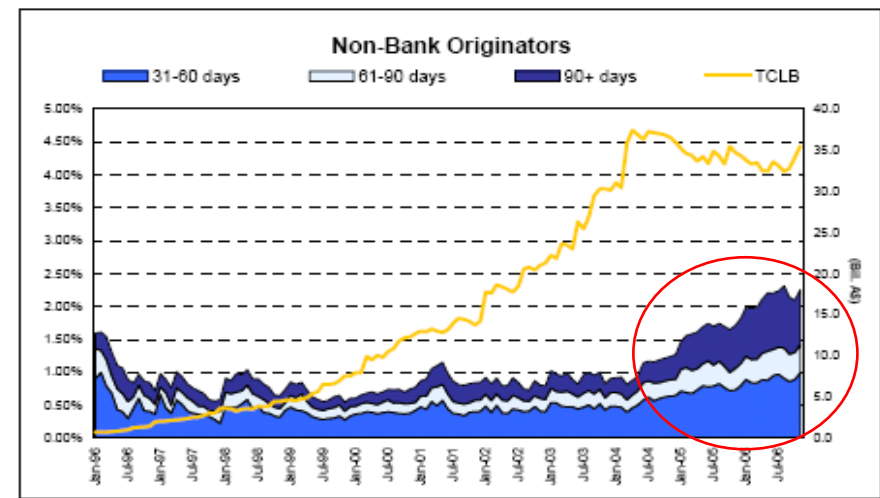
Regional banks



Other banks



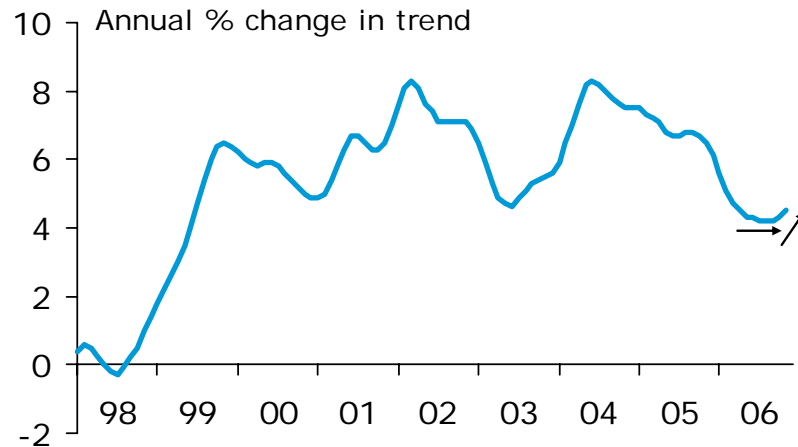
Non-bank originators



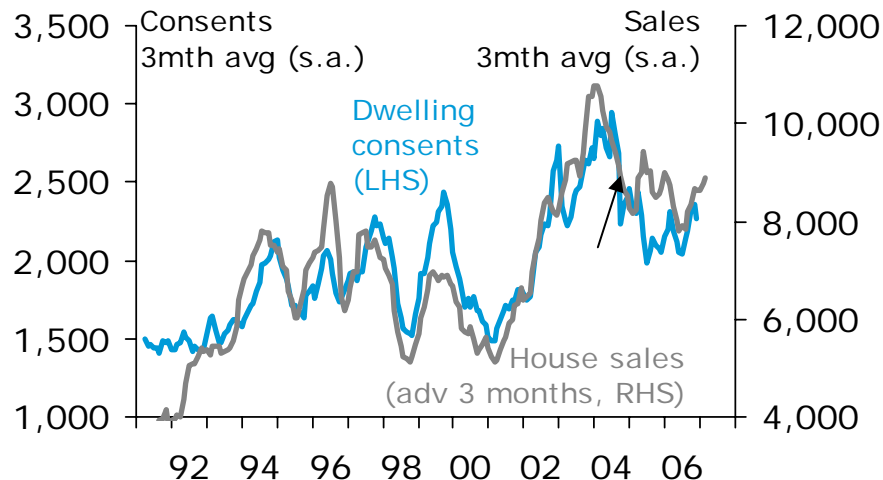
New Zealand Economy

The NZ economy is proving resilient

Retail spending ticking up



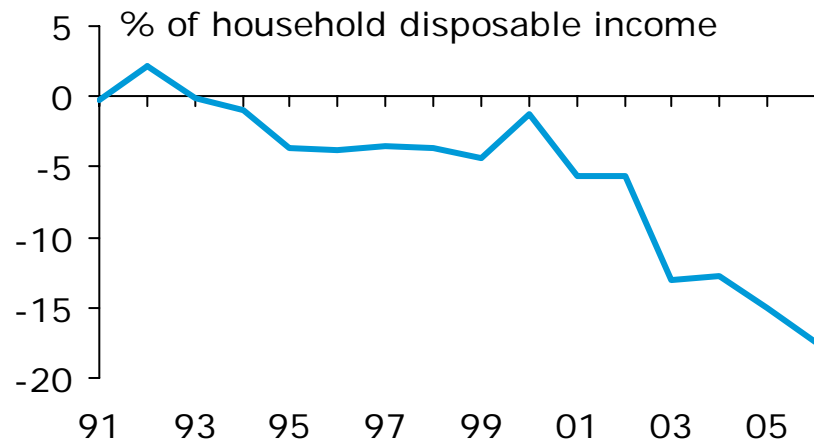
Housing market activity bounce



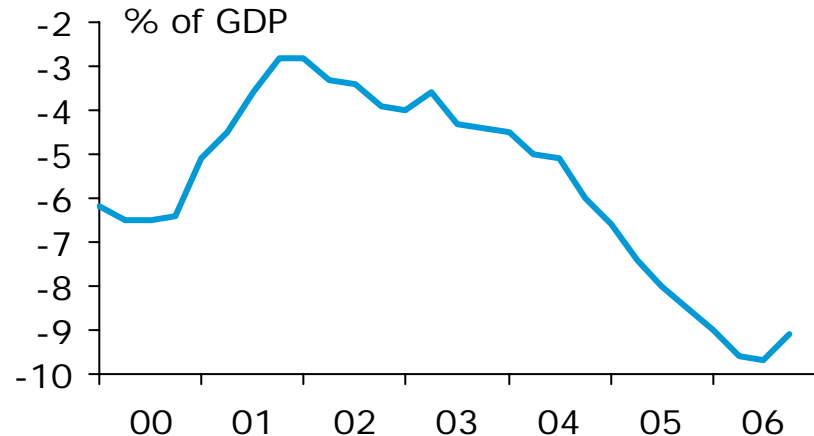
- As a starting point, overall GDP growth remains sluggish. September quarter GDP data recorded a 0.3% quarterly increase and annual growth has eased to below 1.5%.
- Looking forward, partial indicators suggest the economy may be reflating. An inventory run-down has suppressed growth. Domestic (housing) indicators have generally been stronger than expected. Business and consumer confidence have improved.
- The economy is currently at a delicate juncture where confidence gauges are pointing to stronger growth, yet imbalances (inflation and current account deficit) and financial conditions are calling for a further slowdown.

Wider economic imbalances can't be ignored

Household savings rate



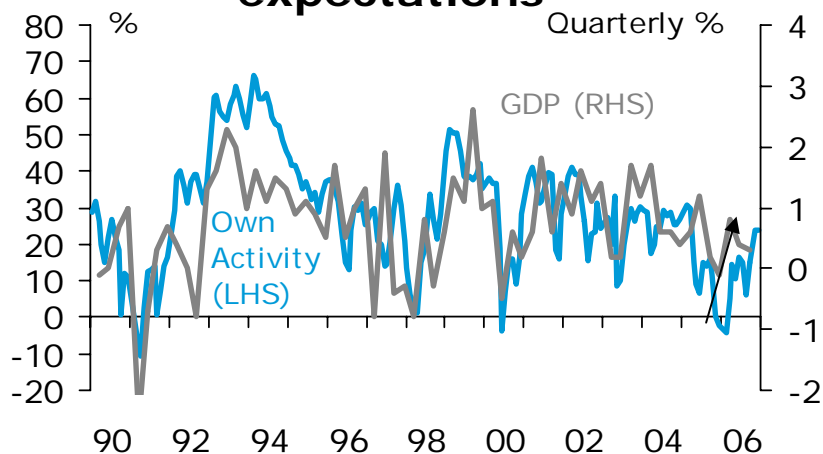
Current account balance



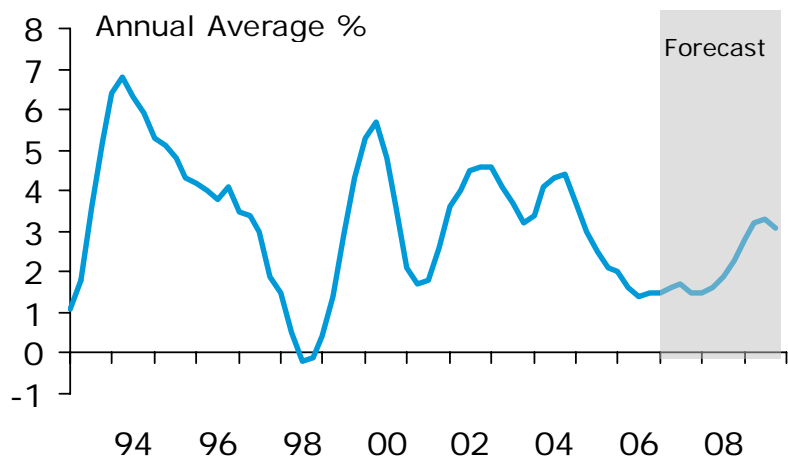
- Against the backdrop of reflation, the NZ economy is running some material imbalances. These imbalances include strong non-tradable inflation, a current account deficit above 9% of GDP and a perilously low household savings rate.
- Such imbalances are not hugely problematic provided growth is solid and the debt can be serviced.
- However, they do add a huge layer of vulnerability to the outlook if the economy was to be hit by a shock. They also leave the economy vulnerable to changes in sentiment and we note the material impact on the USD and funding their deficit when perception turned towards the economy.
- In the absence of a strong fiscal position, a current account deficit of 9.1% of GDP would be the *coup-de-grace* on a credit downgrade.

We continue to expect a period of solid yet subdued growth

GDP and firms' own activity expectations



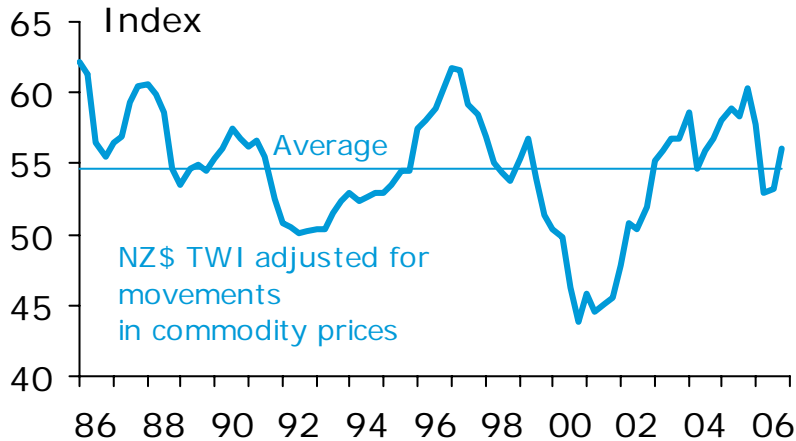
Subdued then rising GDP growth ahead



- Correcting the economic imbalances, particularly persistent non-tradable inflation, will require a prolonged period of sub-trend growth and interest rate settings reflect this at present.
- Nevertheless, the downside risks facing the economic outlook are being capped by a number of factors, suggesting a period of solid but subdued growth.
- Strong commodity prices for New Zealand's key exports are providing insulation to the external sector.
- Corporate balance sheets are in a much better position to cope with a slowing economy than at similar junctures of previous cycles. Fiscal policy is set to be stimulatory. Abundant liquidity, both domestically and globally, will help.
- In the absence of a shock these factors suggest the economy will record a similar growth outlook in 2007 as was experienced in 2006.

Downside risks for the economy appear capped

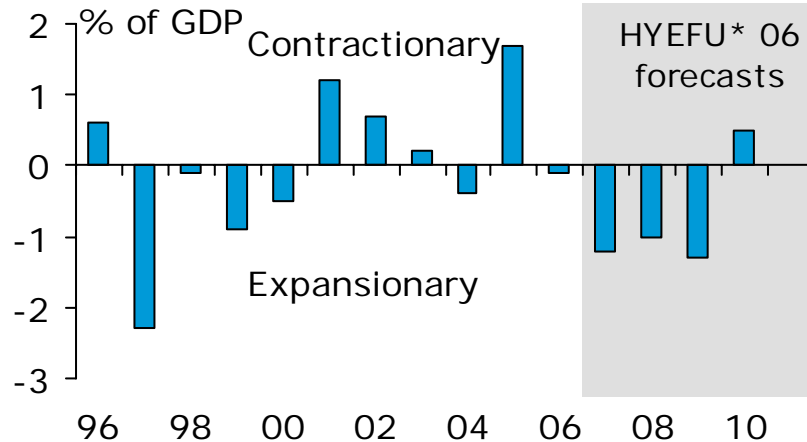
Commodity prices are providing some insulation from NZ\$ strength



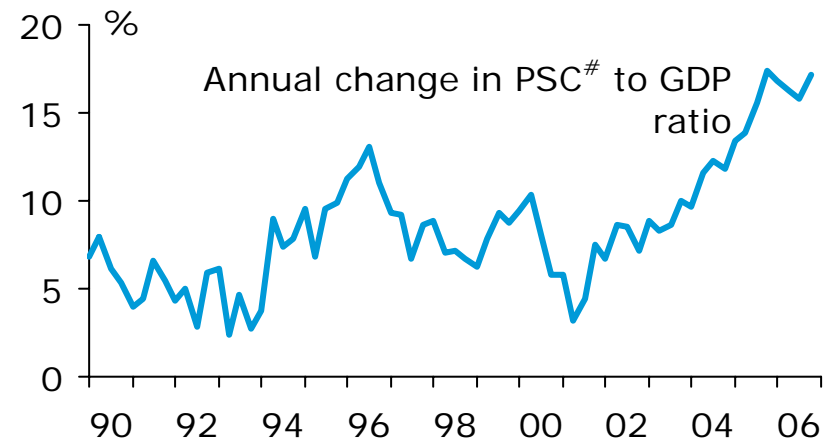
Everyone has a job



Fiscal policy will provide support

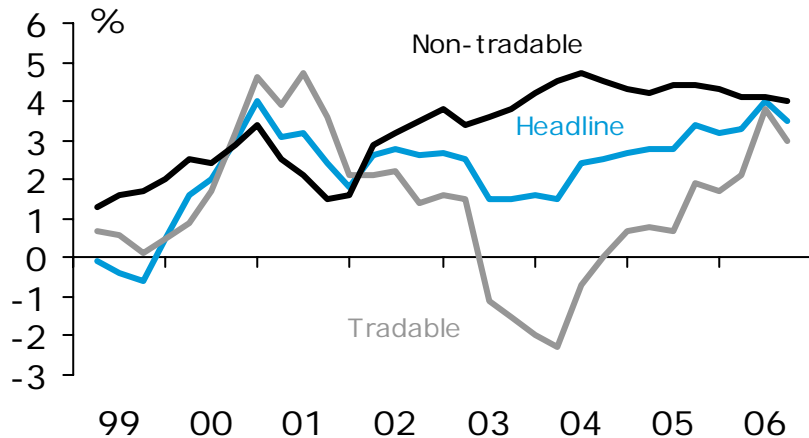


Liquidity is abundant

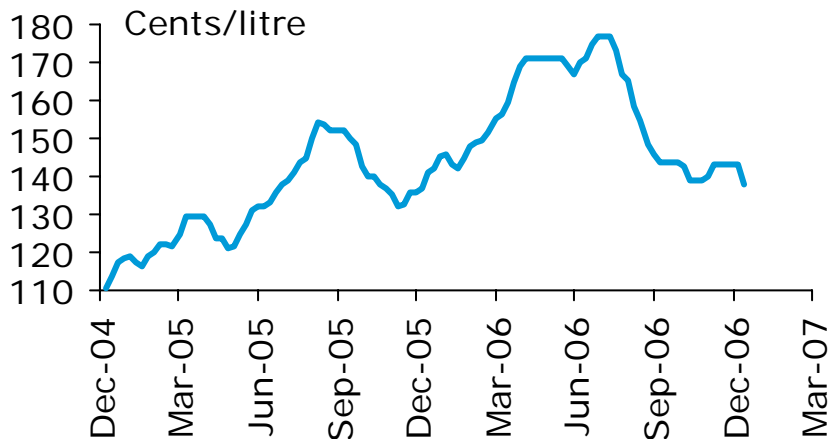


We expect a period of interest rate stability over the year ahead

Annual CPI inflation



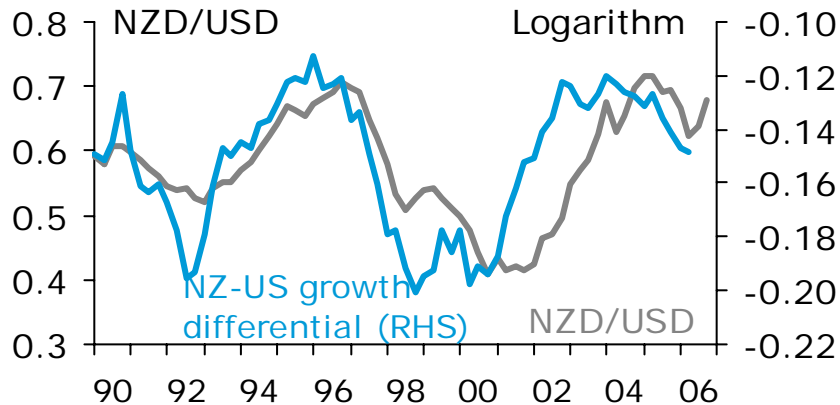
Retail petrol prices



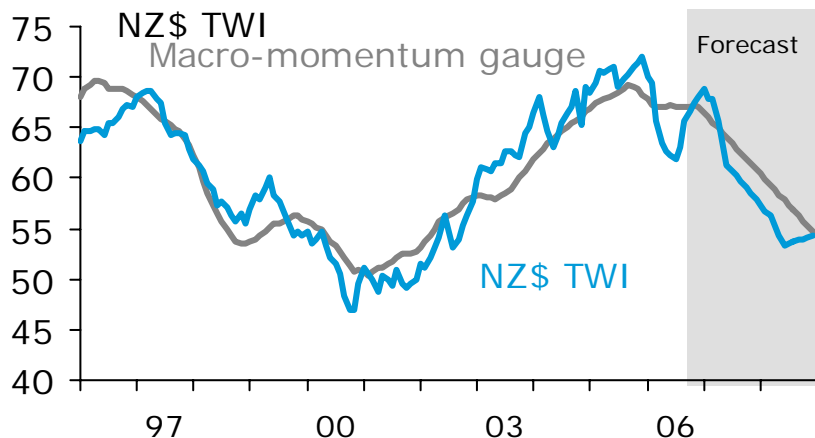
- Medium term inflation pressures remain persistent and elevated, resulting in the Reserve Bank signalling the prospect of further interest rate increases at their December Monetary Policy Statement.
- However, a weaker than expected GDP result in late December, a resurgent NZD, and further discounting of retail petrol prices and international airfares all place downside risks to the Reserve Bank's inflation forecasts.
- While a more restrictive monetary policy stance may be necessary if the economic slowdown does not alleviate the pressure sufficiently, we expect that the Reserve Bank will leave interest rates on hold over the year ahead as the recent fillip in indicators proves to be transitory.
- We ascribe a 30% probability to a January OCR increase.

Economic performance is key to watch on the currency front

NZD/USD v NZ-US growth differentials



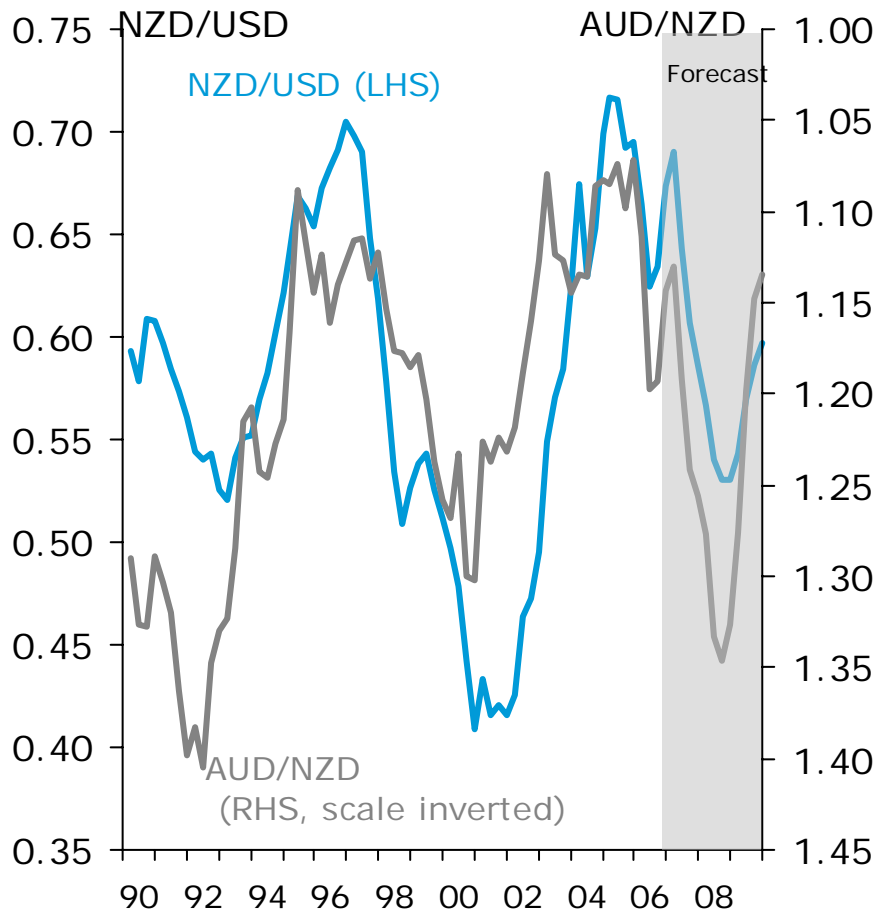
NZ\$ TWI macro-momentum gauge



- While conventional wisdom is that yield is the key driver of the NZD, it is growth that ultimately matters.
- The NZD/USD (and other crosses) have shown a strong correlation with relative economic performance. A key reason the NZD fell sharply in Q1 2006 was signs of weak growth.
- We monitor a currency macro-momentum gauge which is based on NZ's economic performance. Above trend growth or indicators sees the NZD rise and the converse also applies.
- The need to purge economic imbalances strongly suggests a sub-2% growth path over the coming 2 years. Based on historical correlations between the TWI and our gauge, this would take the NZD to 55 on a TWI basis.

Yield-related support to ultimately give way

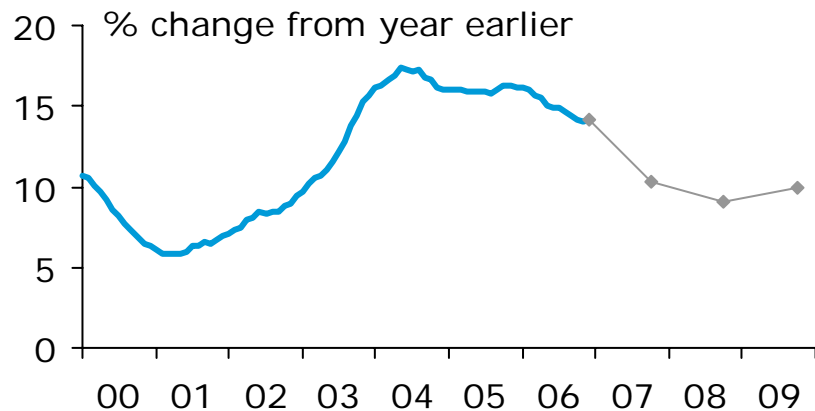
NZD/USD and AUD/NZD



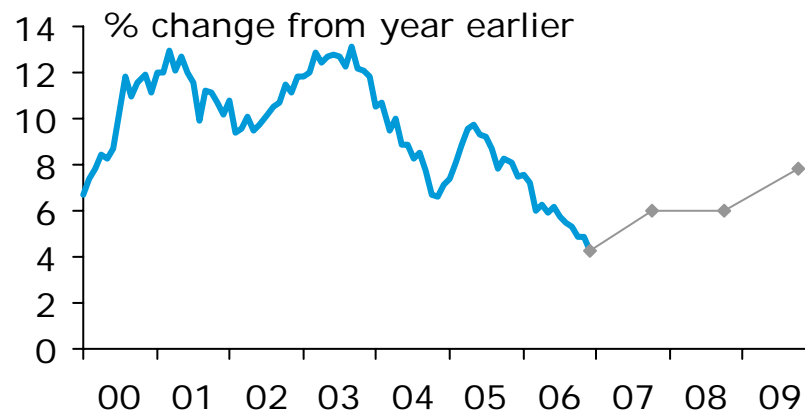
- Prospects for yield-related support are expected to provide support to the NZD in the near-term.
- When looking at the NZ economy, we expect the recent reflationary theme to prove to be transitory as wider economic forces (imbalances and the impact of the high NZD) weigh.
- We remain very wary how long risk aversion and appetites can remain low in an environment where global imbalances are rife, inflation contains more upside risk than down, and assets appear priced for perfection.
- We expect the NZD to turn aggressively in a similar fashion to early 2006. Timing at this stage looks to be mid-year.

Credit growth is expected to ease over the next 18 months, but remain solid

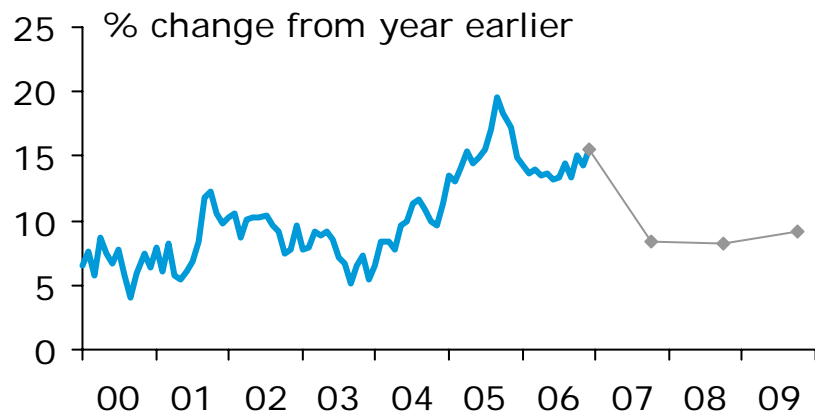
Housing credit



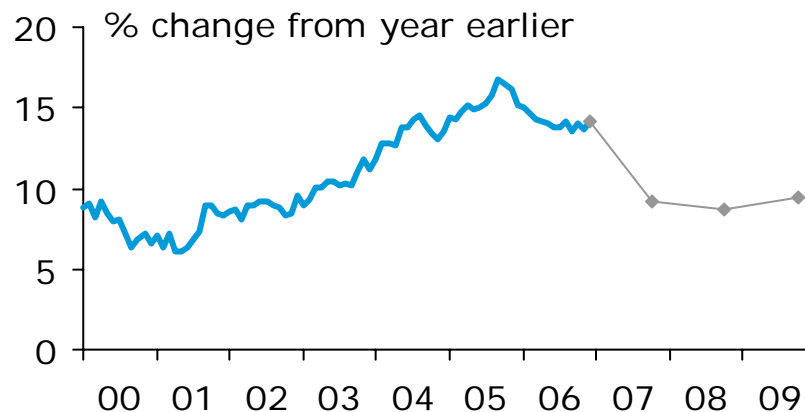
Personal credit



Business credit



Total credit



Summary of forecasts – Australia (bank year)

	2006	2007	2008	2009
GDP	2.7	2.2	3.7	3.1
Inflation	3.4	2.6	2.6	2.6
Unemployment	4.8	4.7	4.6	4.6
Cash rate	6.00	6.25	5.75	6.25
10 year bonds	5.5	5.8	6.0	6.5
A\$/US\$	0.75	0.75	0.71	0.67
Credit	14.8	12.1	10.8	9.8
- Housing	14.7	11.7	11.3	10.7
- Business	15.9	13.2	10.5	8.7
- Other	11.0	9.7	8.8	8.3

Summary of forecasts – New Zealand

	2006	2007	2008	2009
GDP	1.4	1.7	1.9	3.3
Inflation	3.5	1.9	2.8	2.7
Unemployment (Sept qtr, s.a.)	3.8	4.2	4.4	4.7
Current Account (% GDP)	-9.1	-7.8	-7.9	-7.4
Cash Rate	7.25	7.25	5.50	6.00
90 day bank bill	7.6	7.4	5.6	6.1
10 year bond rate	5.8	6.2	6.5	6.4
NZD/USD	0.65	0.60	0.53	0.59
NZD/AUD	0.87	0.80	0.75	0.88
AUD/NZD	1.16	1.25	1.34	1.14
Credit Growth	13.9	9.2	8.7	9.5
- Housing	14.1	10.3	9.1	9.9
- Business	14.6	8.4	8.3	9.2
- Personal	4.9	6.0	6.0	7.8

The material in this presentation is general background information about the Bank's activities current at the date of the presentation. It is information given in summary form and does not purport to be complete. It is not intended to be relied upon as advice to investors or potential investors and does not take into account the investment objectives, financial situation or needs of any particular investor. These should be considered, with or without professional advice when deciding if an investment is appropriate.

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