

Australia & New Zealand Economics Weekly

Treasury, RBA's sombre forecasts

Week commencing 18 May 2009

| | |
|--|----------|
| Treasury, RBA's mild slump, weak recovery | 2 |
| Far from an optimistic scenario | 2 |
| Weekly calendar | 4 |
| Events & economic releases | 4 |
| Monthly Calendar | 5 |
| Events & economic releases | 5 |

John Edwards*

Chief Economist, Australia and
New Zealand

HSBC Bank Australia Limited

+61 2 9255 2744

john.k.edwards@hsbc.com.au

View HSBC Global Research at:

<http://www.research.hsbc.com>

*Employed by a non-US affiliate of
HSBC Securities (USA) Inc, and is not
registered/qualified pursuant to NYSE
and/or NASD regulations

Issuer of report: HSBC Bank Australia
Limited

Disclaimer & Disclosures

This report must be read
with the disclosures and
the analyst certifications in
the Disclosure appendix,
and with the Disclaimer,
which forms part of it

Treasury, RBA's mild slump, weak recovery

Far from an optimistic scenario

RBA Governor Glenn Stevens and Treasury Secretary Ken Henry may well develop the theme in their talks tomorrow, but it is already apparent from last week's Commonwealth Budget and the previous week's Reserve Bank *Statement* that the two major official forecasters now see eye-to-eye on how the economy will evolve over the next 18 months. Contrary to the widespread interpretation it is quite a sombre view, with important political and economic implications. It is emphatically not an overly optimistic depiction of the downturn. Only the RBA offers through the year forecasts, but the year average GDP forecasts of both institutions are identical so we can take the RBA through the year numbers as being those of the Treasury also. The RBA expects demand to pick up by the end of the year, but it also expects output to decline 1% in the year to December and to have expanded only half a per cent in the year to June. Through all of 2010 GDP expands by only 2%, and the rate of growth is still less than the average of the last decade by the middle of 2011.

This is the profile of a milder recession than those of 1981/82 and 1990/91, but in some respects comparable to the latter recession. All up there will be three or perhaps four quarters of contracting GDP on the RBA forecast. In the 1981/82 recession, by contrast, there were six quarters of contraction, and in 1990/91 five quarters, so in duration this downturn is forecast to be shorter. In the 1981/82 recession, the maximum fall of through the year GDP was 3.4%, and in 1990/91 it was 1.6%. In this downturn, and assuming the pattern described above, the maximum decline in through the year GDP would be 1.5% in the year to September. The decline is shorter and a little less, but the upswing is also milder. Coming out of both the earlier recessions growth was volatile, but there were some big bounces in the early quarters of recovery. On the RBA and Treasury forecasts, the recovery will for some time be quite slow. The RBA argues that the recovery will be slower because the global recovery will be slower, and that is because recessions brought on by financial crises are usually more prolonged.

There are two important political implications of the official view of the trajectory of the Australian economy over the next two years. The first is that despite the relatively mild downturn, unemployment will continue to accumulate. In both the earlier and more serious recessions, the unemployment rate increased from trough to peak by 5%. Taking it from the trough in February last year of 3.9% to the expected peak of 8.5% in 2011, the unemployment rate is forecast to increase nearly as much as in the earlier downturns. As a result of the 1980/81 recession, Australia lost 200,000 jobs from the employment peak to trough, and in the 1990/91 recession 300,000 jobs. The growth of the workforce today is not dissimilar to the growth going into the last two recessions. Treasury is forecasting actual job losses of around 160,000 through to the second half of next year. It would certainly be possible on the Treasury/RBA scenario for actual job losses to approach several hundred thousand.

The other important political implication of this mild prolonged recession with a feeble recovery is that the fiscal deficit continues to accumulate. The deficit in the fiscal year beginning 1 July 2009 will be a little under \$60bn, and be replicated again the following year. Thereafter it only slowly declines. At nearly 5% of GDP next financial year, the deficit compared to GDP is expected to be already higher than the biggest deficit coming out of the last recession. This is not so much the assumed severity of the downturn as the collapse of company tax and capital gains tax, on which the revenues of the

Commonwealth became increasingly reliant as personal income taxes were cut over this decade. The deficit is also higher sooner because this is a downturn to which the Commonwealth has responded with additional spending in its initial stages. In the last recession, the major discretionary spending programs were announced when the recovery had already begun. The forecast feeble recovery prolongs the big deficits until, on the Treasury scenario, GDP growth suddenly accelerates in 2011 to above 4%. Whether this is plausible or not is hardly worth debating, since it is so far off.

Treasury's budget forecasts for 09/10 are much more detailed than those of the RBA but can be broadly taken to represent the views of both institutions. Treasury assumes that household consumption remains very weak because consumers will be anxious about rising unemployment, and will anyway be rebuilding savings after the decline in asset values over the last two years. Treasury also assumes that business investment declines in a big way and that exports contract over the year. There is some offset from an upswing in housing construction and a big increase in government-related spending.

I think there is a reasonable chance the Australian economy will perform a little better than Treasury and the RBA now expect. Treasury believes that housing construction will remain flat through the coming fiscal year and not expand until 2010/11. But permits for new private house construction have been heading upwards since the beginning of the year, and housing lending is increasing quite rapidly. There is a fair chance we could see the housing upswing several quarters before Treasury expects it. I also doubt consumers will be as daunted as the official forecasters expect by the decline in the value of financial assets and housing. There is not much evidence in retail sales volumes over the last six months to suggest consumers have stopped spending. It is true that savings has increased, but that is largely because of sharply lower interest rates and large government cash payments and may be temporary rather than permanent. So far, job losses have been very modest. As we pointed out last week, unemployment increased 177,000 from February last year to April this year, but the net number of jobs actually increased 62,000 over the same period. No doubt there will be actual job losses in the coming year, but the largest and most dislocating shock to consumers and businesses is actually behind us rather than in front of us. It makes quite a difference to the expected trajectory of recovery if household consumption gains a little rather than deteriorates a little.

It will be extremely interesting to see how the domestic and international trends play out in the Australian economy this year, but I won't be around to comment on them. After 12 very stimulating and enjoyable years as HSBC's economist for Australia and New Zealand I am leaving the bank for a new role in economic planning in the Middle East. Over those years, over five or six hundred of these weekly notes, I've gained vastly more insight from our clients, from my colleagues and friends, from politicians, from reporters and economic commentators, from economic policy officials, than I could ever hope to impart. My heartfelt thanks to you all. Goodbye, and good luck.

Chief Economist, Australia and New Zealand: John Edwards +61 2 9255 2744 john.k.edwards@hsbc.com.au

Weekly calendar

Events & economic releases

Week commencing Monday, 18 May 2009

| Country/ region | Event or economic release | Period | HSBC | Market consensus | Actual previous |
|-------------------------|--|--------|------|------------------|-----------------|
| Monday, 18 May | | | | | |
| NZ | Producer Prices – Inputs (08:45) | QoQ | | | -2.20% |
| Tuesday 19 May | | | | | |
| AU | RBA Governor Stevens Speaks in Sydney (08:10) | | | | |
| AU | Reserve Bank's Board May Minutes (11:30) | | | | |
| AU | Treasury Secretary Henry Speaks on Economy (12:30) | | | | |
| Wednesday 20 May | | | | | |
| AU | Westpac Consumer Confidence (10:30) | | | | 8.30% |
| AU | Wage Cost Index (11:30) | QoQ | 1% | | 1.20% |
| Thursday 21 May | | | | | |
| Friday 22 May | | | | | |

During the week

Notes:- p= preliminary, r = revised, nf = not forecast, nsa = not seasonally adjusted, ann = annualised, bn = billion, m = million
Source: Dow Jones, Reuters, Bloomberg

Monthly Calendar

Events & economic releases

Month commencing Monday, 25 May 2009

| Monday 25 May | Tuesday 26 May | Wednesday 27 May | Thursday 28 May | Friday 29 May |
|---------------|----------------|------------------|-----------------|---------------|
|---------------|----------------|------------------|-----------------|---------------|

NZ Trade Balance APR

NZ Annual Budget MAY 27

AU RBA Deputy Governor
Battellino Speaks in Sydney MAY
28
AU Private Capital Expenditure
1Q
NZ NBNZ Business Confidence
MAY

NZ Building Permits MoM APR
AU Private Sector Credit MoM%
APR

| Monday 1 June | Tuesday 2 June | Wednesday 3 June | Thursday 4 June | Friday 5 June |
|---------------|----------------|------------------|-----------------|---------------|
|---------------|----------------|------------------|-----------------|---------------|

AU Company Operating Profit
QoQ 1Q
AU Retail Sales s.a. MoM Apr
AU Inventories 1Q

AU Building Approvals MoM Apr
AU Current Account Balance 1Q
AU RBA Cash Target Jun 02

AU Gross Domestic Product
QoQ
AU Gross Domestic Product YoY

AU Trade Balance Apr
NZ ANZ Commodity Price May

| Monday 8 June | Tuesday 9 June | Wednesday 10 June | Thursday 11 June | Friday 12 June |
|---------------|----------------|-------------------|------------------|----------------|
|---------------|----------------|-------------------|------------------|----------------|

AU NAB Business Confidence
May
AU ANZ Job Advertisements
MoM

AU Westpac Consumer
Confidence Jun

NZ RBNZ Official Cash Rate Jun
11
NZ Retail Sales MoM

| Monday 15 June | Tuesday 16 June | Wednesday 17 June | Thursday 18 June | Friday 19 June |
|----------------|-----------------|-------------------|------------------|----------------|
|----------------|-----------------|-------------------|------------------|----------------|

AU Reserve Bank's Board June
Minutes Jun 16

AU Dwelling Starts 1Q

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: John Edwards

This report is designed for, and should only be utilised by, institutional investors. Furthermore, HSBC believes an investor's decision to make an investment should depend on individual circumstances such as the investor's existing holdings and other considerations.

Analysts are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company, please see the most recently published report on that company available at www.hsbcnet.com/research.

* *HSBC Legal Entities are listed in the Disclaimer below.*

Additional disclosures

- 1 This report is dated as at 15 May 2009.
- 2 All market data included in this report are dated as at close 15 May 2009, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Chinese Wall procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

* *Legal entities as at 22 October 2008*

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhart AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiple, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited.

Issuer of report

HSBC Bank Australia Limited

Level 32

HSBC Centre

580 George Street

Sydney, NSW 2000, Australia

Telephone: +61 2 9006 5888

Fax: +61 2 9255 2205

Website: www.research.hsbc.com

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This material is distributed in the United Kingdom by HSBC Bank plc. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. Any recommendations contained in it are intended for the professional investors to whom it is distributed. This material is distributed in Japan by HSBC Securities (Japan) Limited. This material may be distributed in the United States solely to "major US institutional investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. Note, however, that HSBC Securities (USA) Inc. is not distributing this report, has not contributed to or participated in its preparation, and does not take responsibility for its contents. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF). This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. This document has been prepared without taking account of the objectives, financial situation or needs of any specific person who may receive this document. Any such person should, before acting on the information in this document, consider the appropriateness of the information, having regard to the personal objectives, financial situation and needs. In all cases, anyone proposing to rely on or use the information in this document should independently verify and check its accuracy, completeness, reliability and suitability and should obtain independent and specific advice from appropriate professionals or experts. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

© Copyright. HSBC Bank Australia Ltd 2009, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Bank Australia Limited. MICA (P) 258/09/2008

Global Economics Research Team

Global

Stephen King
Global Head of Economics
+44 20 7991 6700 stephen.king@hsbcib.com

Stuart Green
+44 20 7991 6718 stuart1.green@hsbcib.com

Europe

Janet Henry
Chief European Economist
+44 20 7991 6711 janet.henry@hsbcib.com

Astrid Schilo
+44 20 7991 6708 astrid.schilo@hsbcib.com

Germany

Lothar Hessler
+49 21 1910 2906 lothar.hessler@hsbctrinkaus.de

France

Mathilde Lemoine
+33 1 4070 3266 mathilde.lemoine@hsbc.fr

United Kingdom

Karen Ward
+44 20 7991 3692 karen.ward@hsbcib.com

North America

Ian Morris
+1 212 525 3115 ian.morris@us.hsbc.com

Ryan Wang
+1 212 525 3181 ryan.wang@us.hsbc.com

Stewart Hall
+1 416 868 7523 stewart_hall@hsbc.ca

Global Emerging Markets

Philip Poole
+44 20 7992 3683 philip.poole@hsbcib.com

Wietse Nijenhuis
+44 20 7992 3680 wietse.nijenhuis@hsbcib.com

Asia Pacific

Qu Hongbin
+852 2822 2025 hongbinqu@hsbc.com.hk

John Edwards
+61 2 9255 2744 john.k.edwards@hsbc.com.au

Robert Prior-Wandesforde
+65 6239 0840 robert.prior-wandesforde@hsbc.com.sg

Frederic Neumann
+852 2822 4556 fredericneumann@hsbc.com.hk

Seiji Shiraishi
+81 3 5203 3802 seiji.shiraishi@hsbc.co.jp

Prakriti Sofat
+65 6230 2879 prakritisofat@hsbc.com.sg

Song Yi Kim
+852 2822 4870 songyikim@hsbc.com.hk

Christopher Wong
+852 2996 6917 christopherwong@hsbc.com.hk

Yukiko Tani
+81 3 5203 3827 yukiko.tani@hsbc.co.jp

Sophia Ma

Sun Junwei

Emerging Europe, Middle East and Africa

Juliet Sampson
+44 20 7991 5651 juliet.sampson@hsbcib.com

Kubilay Ozturk
+44 20 7991 6045 kubilay.ozturk@hsbcib.com

Alexander Morozov
+7 495 783 8855 alexander.morozov@hsbc.com

Murat Ulgen
+90 21 2366 1625 muratulgen@hsbc.com.tr

Simon Williams
+971 4507 7614 simon.williams@hsbc.com

Latin America

Jonathan Heath
Chief Economist, Latin America
+52 55 5721 2176 jonathan.heath@hsbc.com.mx

Argentina

Javier Finkman
Chief Economist, South America ex-Brazil
+54 11 4344 8144 javier.r.finkman@hsbc.com.ar

Ramiro D Blazquez
Senior Economist
+54 11 4348 5759 ramiro.d.blazquez@hsbc.com.ar

Brazil

Andre Loes
Chief Economist
+55 11 3371 8184 andre.a.loes@hsbc.com.br

Tatiana G Gomes
Senior Economist
+55 11 3371 8183 tatiana.g.gomes@hsbc.com.br

Mexico

Juan Pedro Treviño
Chief Economist
+52 55 5721 2179 juan.trevino@hsbc.com.mx

Lorena Dominguez
Economist
+52 55 5721 2172 lorena.dominguez@hsbc.com.mx

Central America

Sergio Martin
Chief Economist
+52 55 5721 2164 sergio.martinm@hsbc.com.mx