

# Economics Report

1 October 2009

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## Caton's iCorner 2.0: October 2009

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Last month I wrote that August seemed like a repeat of July; the view strengthened that the recessions around the world had ended, and markets continued to rise. There wasn't all that much difference in September. For the month, the US share market rose by 3.6%, and is now up by 57% from its early-March low. The Dow Jones average has just had its best quarter (up 15%) in more than 10 years. The Australian market, as measured by the ASX200, rose by 5.9% in September, after gains of 5.5% and 7.3% in the previous two months.

The view remains that markets have perhaps overdone it, and that a correction is inevitable in the near future. There is no doubt that the pace of growth has been astonishing. The Australian market has had its strongest turnaround ever (although not by much) and the 6-month performance of the US market has been exceeded just six times in the past 100 years. There is also no doubt that this pace will not continue.

In my opinion, while a near-term correction is possible, it is by no means inevitable. Importantly, markets will receive support in the months ahead from further upward revisions to expected world (and Australian) economic growth in the next year or so. Growth forecasts have been on an upward trend since May, and this process is not over. Despite the lingering problems in financial sectors around the world, economic recoveries have generated a fair bit of momentum, and this is likely to continue for some time.

### On the home front

In the past month, the Reserve Bank (RBA) has given a tick to the performance of the financial system in Australia, and there is no doubt that we have done remarkably well on a comparative basis. It now seems unlikely that the RBA will raise the short-term cash rate in October, although "usually reliable sources" suggest that we won't get past Melbourne Cup Day without an increase.

Also in September, we learned that the Australian economy grew moderately in the June quarter. It is now unlikely to record the two successive quarters of negative growth that is supposed to mark a "technical" recession. I remain of the view that the Australian economy has been in recession, mainly because of the 2% rise in the unemployment rate. But if the early-1990s recession was the one we "had to have", this is the one we hardly had. In my view, the Australian economy is not doing well, but it is doing **far better than anyone would have dared to hope just a few months ago**. Indeed, there is now a small chance that the unemployment rate is already close to its peak, at less than 6%. At Budget-time, in May, the government forecast that it could climb to close to 9% by late-2010.

The better performance and outlook for the economy is feeding through into the Budget result. The deficit for 2008-09 was \$5 billion less than expected, and we are now on track to return to surplus by

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2013-14, two years earlier than previously expected. Inter alia, this means that Federal debt may well turn out to be up to \$100 billion less than previously expected, which should quieten the brouhaha from some quarters about exploding public debt!

The improved outlook for the economy has led to cries to withdraw the stimulus, on the grounds that it is no longer needed. It's worth pointing out that the stimulus was crafted to reduce in importance over time in any case, and the economy isn't exactly racing away from us!

Incidentally, there has been one other important landmark this year: China is now our most important export destination. You may have thought this has been true for some years, but until this year Japan held the number 1 ranking. The leadership doesn't change hands often; Japan took over from the United Kingdom as our biggest export market as long ago as 1966 (and it is possible that the UK held No 1 position from 1788 until 1966!). 1966 was, of course, the last year in which St Kilda won the Grand Final -- so much for omens!

Finally, the recent G20 meetings in Pittsburgh (once deemed to be the US's "most liveable" city—presumably by someone who's never actually been there) led to an endorsement of the G20 as the appropriate body to be leading the way in international economic co-operation. This is good news and bad news. It increases the weight of Australian views on the international stage, but it adds to the risk of policy-making by a "too large" committee.

**Chris Caton**

**Chief Economist**

**The views expressed herein are those of the author and should not be otherwise attributed.**

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