ANDBANK RESEARCH

Global Economics &
Markets

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Working paper - 45

Australia – "The party is over … at least for a while".
Six reasons to jump the wagon.

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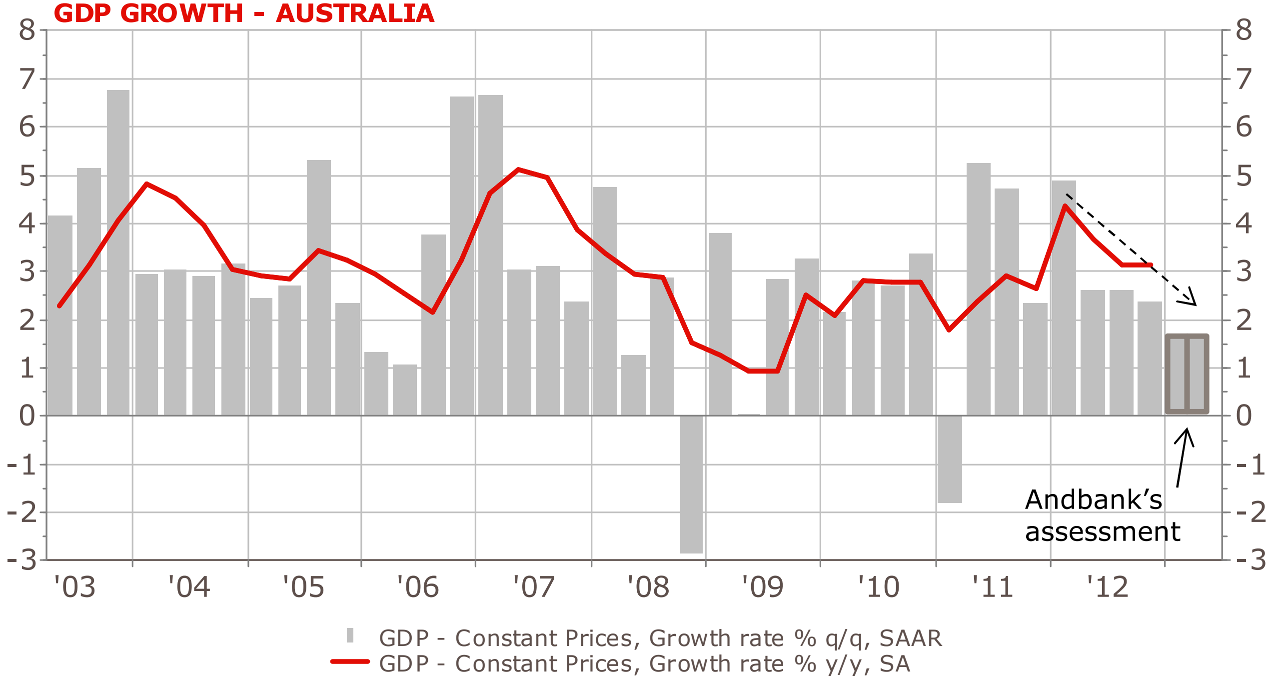
Private Bankers

1st. Growth looks to have remained below trend in the first half of the year.

RBA has cut its cash rate by 25 bp to a historic low of 2,75% (the first time the central bank puts rates below 3% since it began setting monetary policy in 1990. That simply means something.

In its accompanying statement, RBA said that weakness have extended through 2013.



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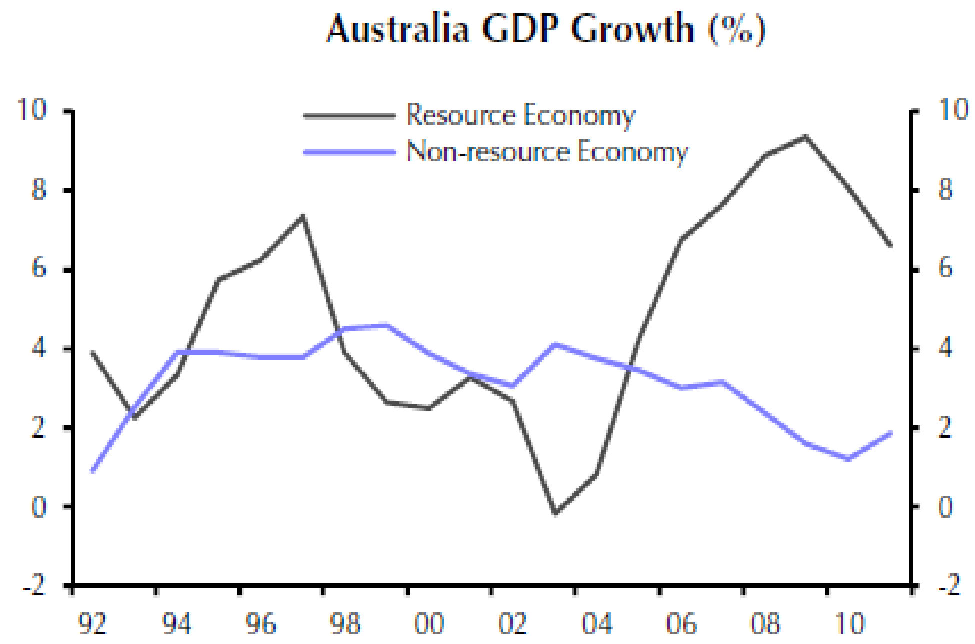
2nd. A two speed growth model that brings you to nowhere



Source – RBA

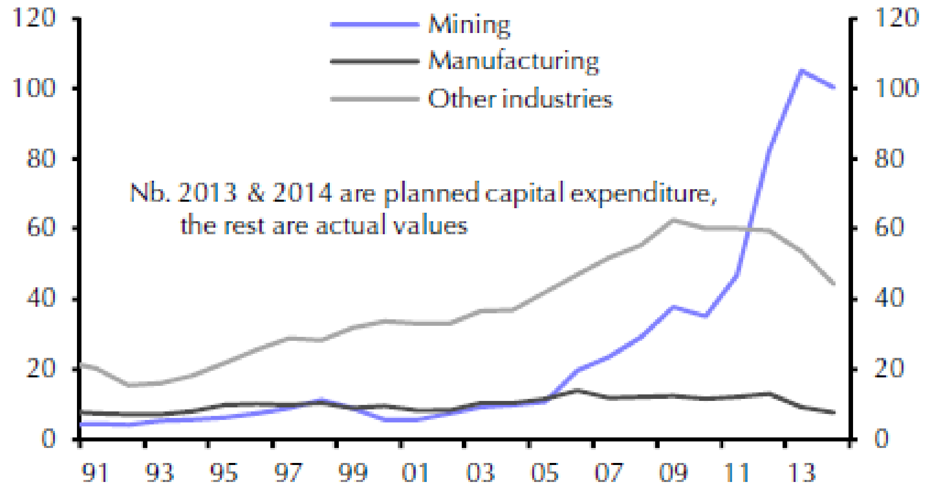
Between November 2011 and December 2012 the RBA cut its policy rate by 175 bp, initially to compensate weaker global demand …

… but recent cut aims to stimulate the non-mining sector ahead of an impending cooling of the mining investment boom

3rd. Despite RBA actions, it is now too late to expect positive surprises from cuts in policy rates

- ✓ Mining investment has been the main driver for growth in recent years, allowing the "Resource economy" to expand at an average 8% a year since 2006 …
- ✓ Investment in the mining sector has come to account for an estimated 62% of total investment in 2012-13 (compared with 17% in 2004-05)
- ✓ Mining investment is set to decline (due to the apparent excess capacity and according to the most recent survey of investment intentions). This will pose doubts over the general economy, whatever the RBA's decision will be.

Australia Capital Expenditure (A$bn)



Source – ABS

4th. Other sources of growth will be needed to avoid a significant overall slowdown. However, we believe it is difficult to find an alternative.

1. **Housing market?** There have been some signs that the housing market is picking up but we consider they are not convincing
   - ✓ House prices rose by 2,6% y/y in Q1 2013, indeed the fastest in two years but hardly a roaring pace.
   - ✓ Similarly, recent recovery in building approvals seems to have stalled now (falling to a six-month low of 12,599 units in March)

2. **A consumption pick up as a result of rate cuts?**
   - ✓ RBA noted in its last decision that lower rates have not spurred lending. Private credit growth remains subdued at a 3,2% annual rate.
   - ✓ Additionally, unemployment rate reached the 5,6% level (although apparently low, is the highest rate in 3 years). Against this backdrop, we see no catalysts that could cause a rapid acceleration in consumption.

3. **Manufacturing sector?** Purchasing managers of manufacturing industries responded negatively to the last PMI survey, that fell to a record low in April. They continue to struggle in the face of strong AUD, which has held unusually well as commodity prices have fallen.

We consider that none of these sources will arise to pick up mining investment's baton to fully compensate the impending slowdown in the "resource economy".

5th. There is more scope for further loosening in policy rates, what should put downward pressure on the AUD, and thus, on the appetite of foreign capital for AUD denominated assets.

- ✓ Inflation seems contained (2,5% y/y)…
- ✓ … and we expect it to cool over the coming quarters in response of stability (or even further declines) in commodity prices and …
- ✓ … also, due to the fading effects of the carbon tax introduced in 2012
- ✓ A significant reduction in mining investment looks inevitable and this will negatively influence the economy, which will influence the RBA to continuing cutting rates.

6th. Australian equity market is among the most expensive in the world

	P to Book		Price to Earnings		Price to dividend		EV to EBITDA		Real yield ratio		VALUATION composite	
	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy
World												
Hong Kong	-1.48	4	-0.43	8	-0.71	5	-0.74	5	1.17	2	4.8	1
Russia	-1.83	1	-2.03	1	1.77	26	-2.17	1	2.83	1	6	2
Germany	-0.62	14	-1.31	3	-0.48	7	-0.32	9	0.94	3	7.2	3
South Korea	-1.74	3	-0.94	4	-1.19	3	-0.06	11	-0.36	19	8	4
India	-0.28	15	-0.76	5	-0.10	12	-0.77	4	0.65	6	8.4	5
China	-0.83	11	-1.56	2	0.41	18	-0.71	6	0.75	5	8.4	5
Japan	-1.06	7	-0.47	7	-0.39	9	-0.61	7	-0.19	16	9.2	7
Italy	-1.78	2	1.19	20	0.43	19	-1.16	2	0.63	7	10	8
Israel	-0.67	13	0.26	12	-0.70	6	0.38	15	-0.28	17	12.6	9
Taiwan	-0.01	16	0.23	11	0.10	16	0.04	13	0.53	8	12.8	10
Poland	-1.43	5	-0.48	6	4.89	28	-1.01	3	-1.33	23	13	11
Eurozone	-0.81	12	1.01	19	-0.02	14	-0.03	12	0.32	10	13.4	12
Brazil	-0.86	9	0.30	13	0.49	20	1.31	23	0.81	4	13.8	13
France	-0.98	8	1.35	23	0.51	22	0.22	14	0.41	9	15.2	14
Malaysia	0.56	19	0.03	10	-0.01	15	-0.21	10	-1.39	25	15.8	15
Indonesia	2.57	28	0.46	14	-1.28	1	0.74	18	-0.34	18	15.8	15
Spain	-1.18	6	2.17	27	2.31	27	-0.39	8	0.31	11	15.8	15
Turkey	0.68	20	0.89	17	-0.23	11	1.35	24	0.09	12	16.8	18
United States	1.97	25	1.00	18	-0.26	10	0.74	19	-0.11	14	17.2	19
Canada	-0.85	10	-0.36	9	1.10	25	0.96	21	-0.66	21	17.2	19
United Kingdom	0.24	18	1.31	22	-0.07	13	1.19	22	0.05	13	17.6	21
South Africa	1.04	23	0.55	15	0.54	23	0.67	17	-0.13	15	18.6	22
Australia	0.07	17	0.73	16	0.60	24	0.82	20	-0.47	20	19.4	23
Mexico	2.49	27	1.56	25	-1.26	2	1.45	26	-1.34	24	20.8	24
Thailand	2.36	26	1.43	24	-0.72	4	1.86	28	-0.87	22	20.8	24
Sweden	0.90	21	1.31	21	0.50	21	0.44	16	-1.68	27	21.2	26
Chile	0.96	22	2.94	28	-0.42	8	1.83	27	-1.86	28	22.6	27
Switzerland	1.58	24	2.03	26	0.31	17	1.39	25	-1.46	26	23.6	28

CHEAP

EXPENSIVE

In summary, the reasons to jump the wagon of Australian assets are:

1. Growth looks to have remained below trend in the first half of the year.

2. A two speed growth model that brings you to nowhere

3. Despite RBA actions, it is now too late to expect positive surprises from cuts in policy rates. We consider that an overall slowdown seems inevitable in the short to medium term for the Australian economy and the rest of producers facing global oversupply, resulting from their excess capacity.

4. Other sources of growth will be needed to avoid a significant overall slowdown. However, we believe it is difficult to find an alternative. We expect GDP growth to be around 2,5% in 2013 and 2014 (below the 3% of consensus)

5. There is more scope for further loosening in policy rates, what should put downward pressure on the AUD, and thus, on the appetite of foreign capital for AUD denominated assets.

6. Australian equity market is among the most expensive in the world

However, with a longer term view, we keep our positive stance on the region Asia-Emerging, what should help the country to set a floor.

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