

SUNCORP Group Treasury

**Suncorp Economic Outlook
IPSWICH**

Australian Economy into 2008 & beyond
Eve of the Federal Budget May 2008

SUNCORP **Agenda**

- Global Snap Shot
- Credit Crunch & World Inflation
- Australian Economy into end 2007
- Why the RBA tightened
- Interest rate scenarios
- Equities and A\$ Risks into 2008-09
- Disclaimer

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SUNCORP **Global Snap Shot**

- The G3 picture has certainly deteriorated
 - Especially for the US economy
- But the developing world this is not the Asian financial crisis, the crisis is America's not theirs!
- Most of Australia's main customers are doing fine thanks very much!
- Commodity prices in the main appear to have peaked
- Corporate credit spread expansions of the past 9 months also appear to have peaked
 - But the return to 'normal' credit spread levels is unlikely to be either soon or substantial this (new quarter)

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SUNCORP **World growth forecasts updated**

Table 1: World GDP
Year-average percentage change^(a)

	2006	2007 estimates	2008 IMF forecasts ^(d)
United States	2.9	2.2	1.5
Euro area	2.9	2.6	1.6
Japan	2.4	1.9	1.5
China	11.1	11.4	10.0
Other east Asia ^(b)	5.4	5.6	4.9
India	9.6	8.6	8.2
World	5.0	4.9	4.1
Australia's trading partners ^(c)	5.2	5.1	4.4

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SUNCORP **Key thing is Our trade flows is not in the G7**

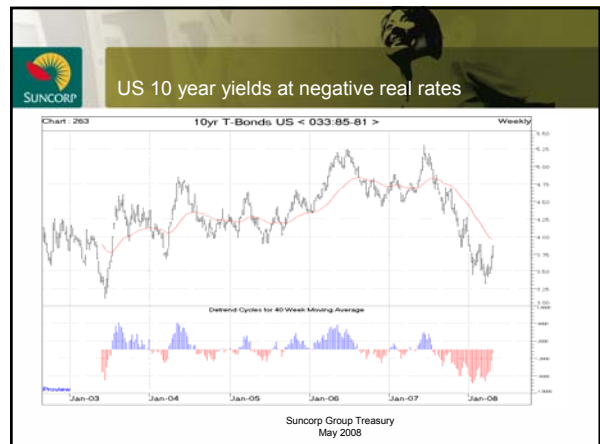
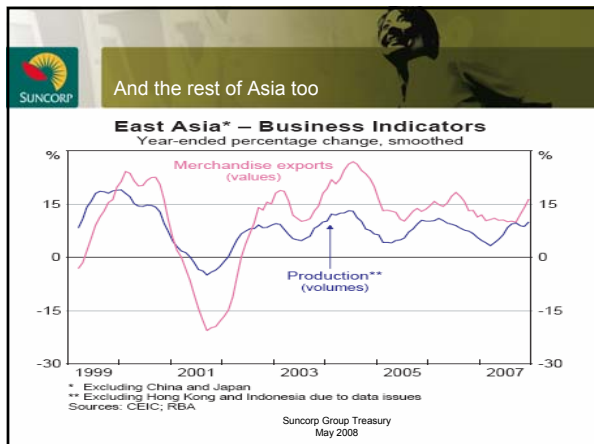
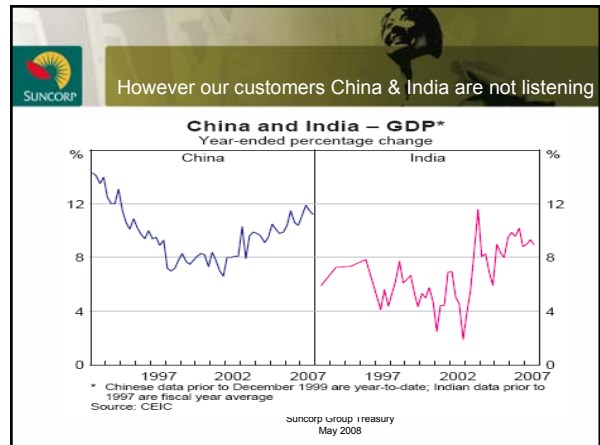
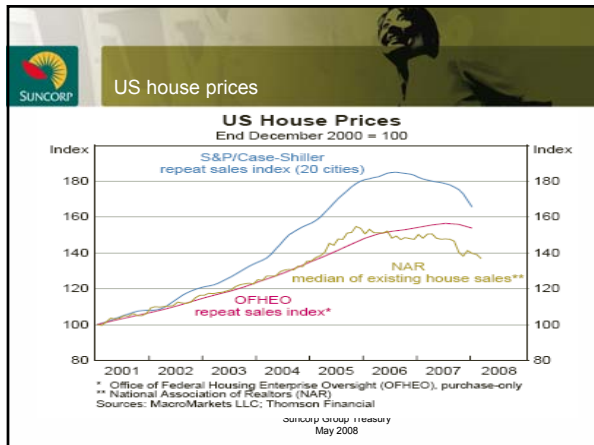
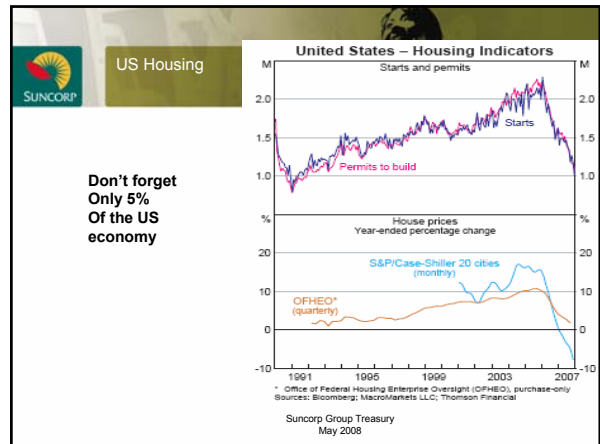
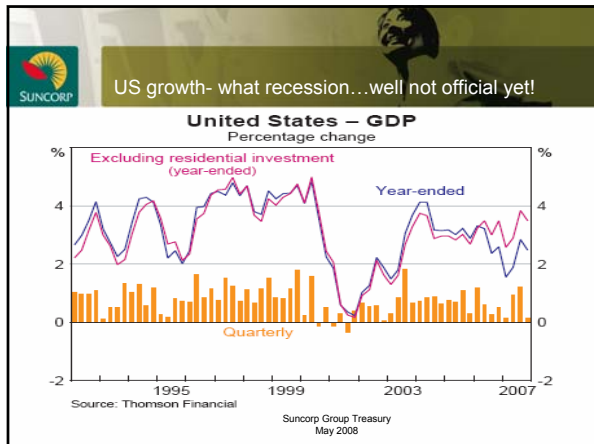
Australia's Trading Partner GDP
Merchandise export-weighted, year-average percentage change %

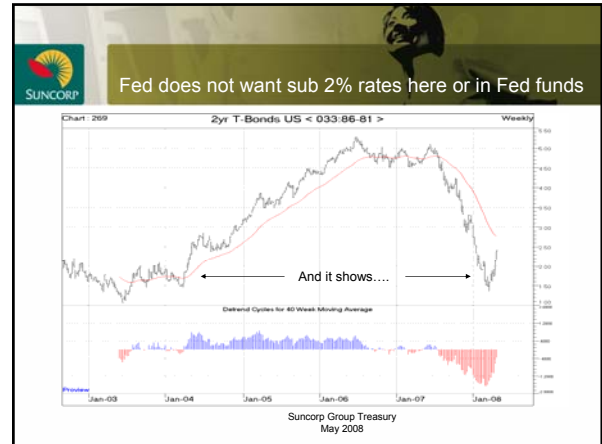
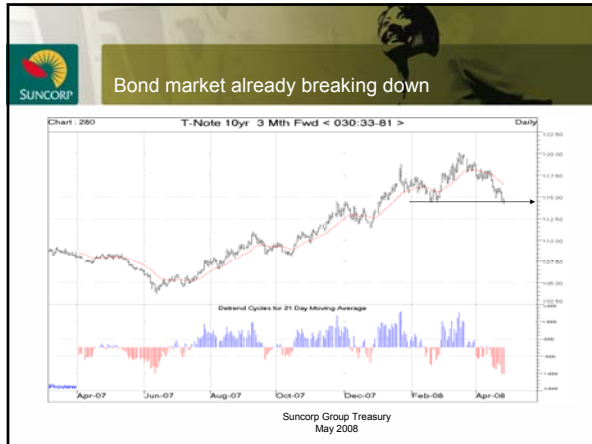
Sources: CEIC; RBA; Thomson Financial
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SUNCORP **Terms of Trade: RBA gives up picking tops**

Terms of Trade
2005/06 = 100

Sources: ABS; RBA
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The Real Scenario:
US decelerated from strong 2007 growth into its 31st Dec 2007 end
and now 'pans' out 1st & 2nd quarter 2008

While the rest of the world keeps growing
 This is NOT a recession...

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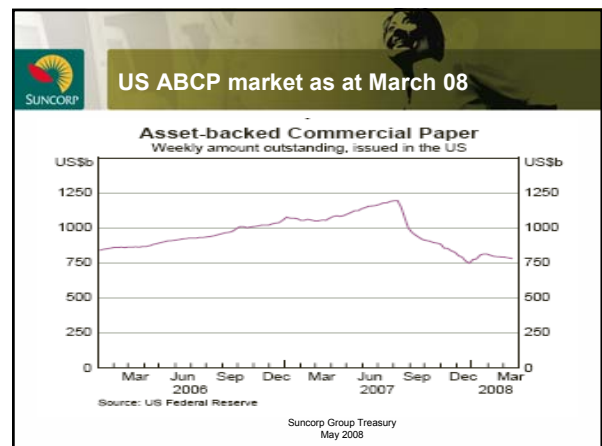
Credit Crunch Update
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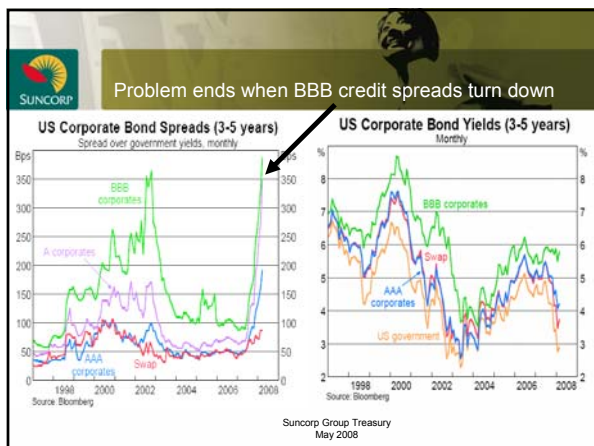
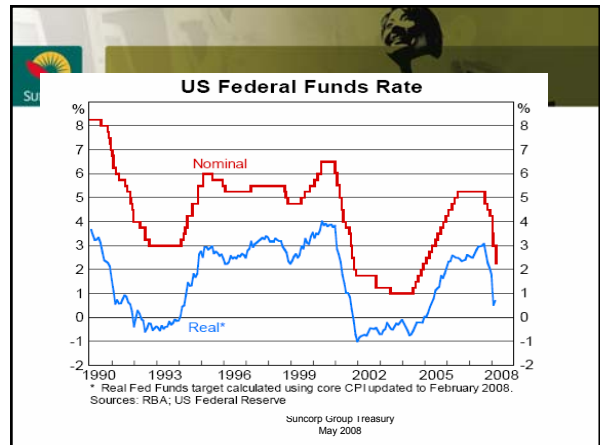
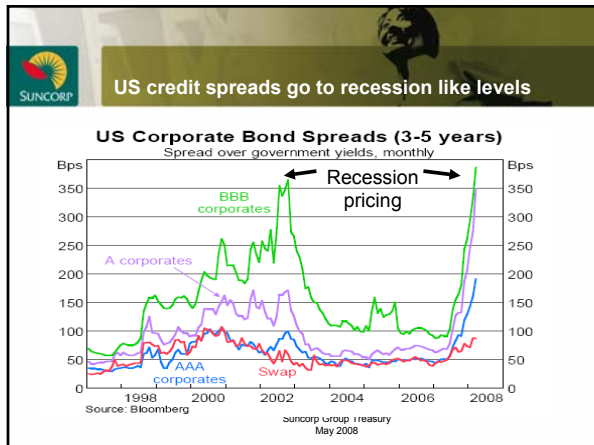
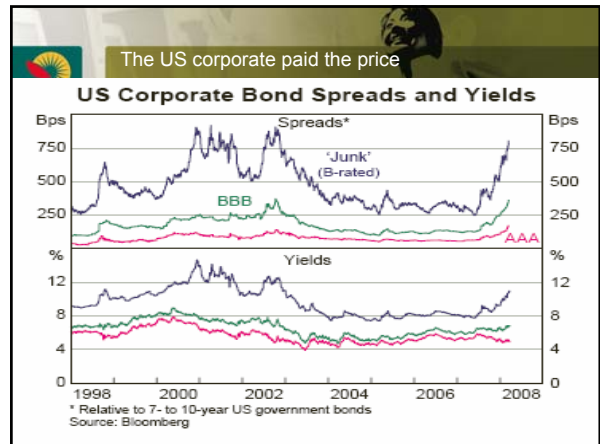
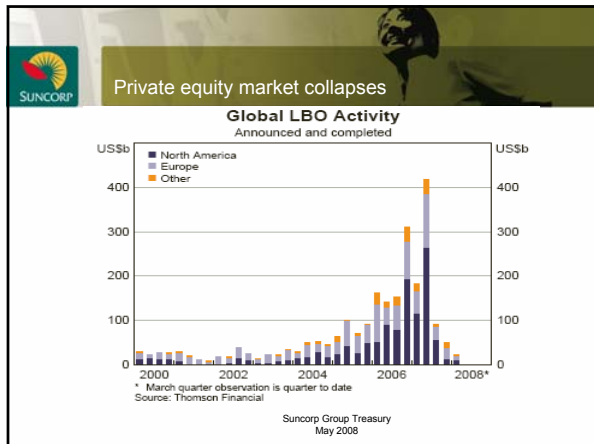
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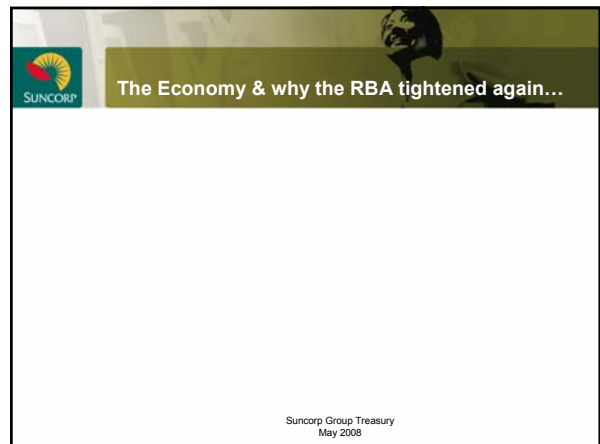
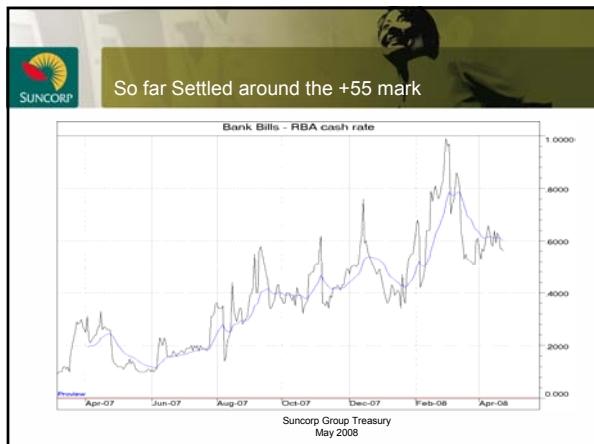
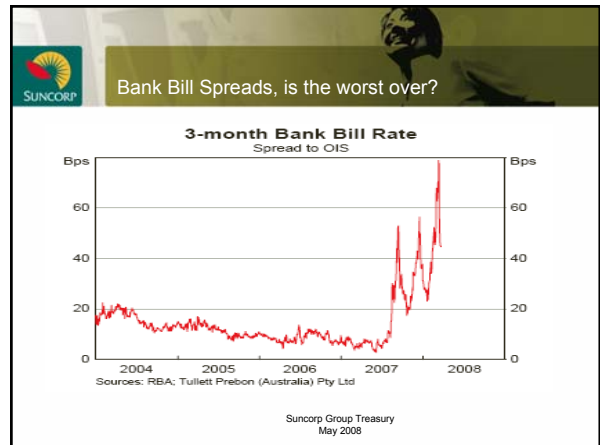
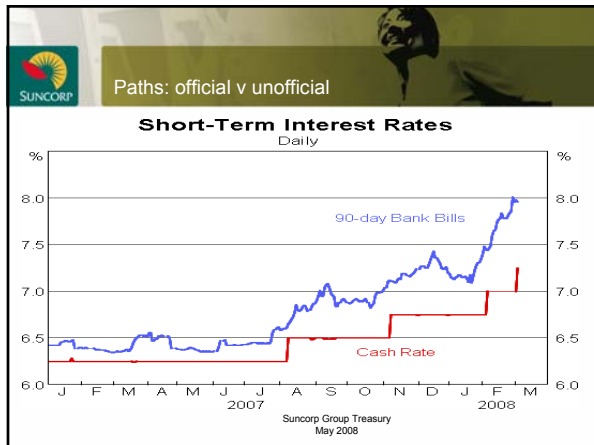
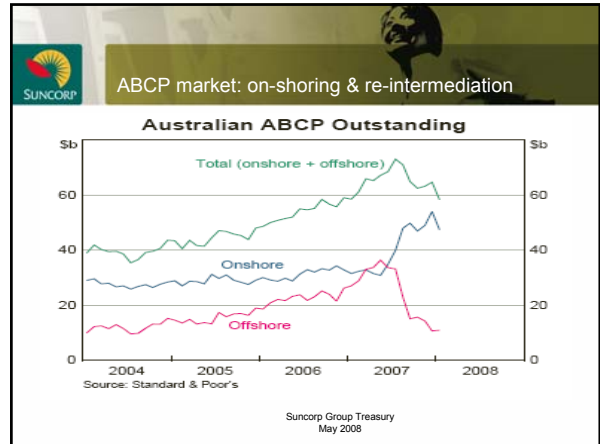
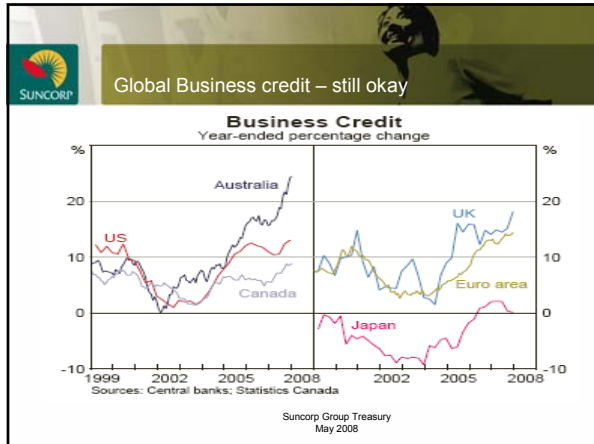
Credit Crunch Update – A summary

- The US ABCP market has stabilized and has not gotten any worse
- Credit costs regardless had continued to rise
 - In its aftermath – till recently
- Australia has had no problems with quantity of credit accessed
 - The problem remains it heightened cost
- Credit Spreads appear to have 'peaked' finally

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Australian Economy at end 2007

- Buoyed by overseas + improving trade flows
- The fully employed household was still confident and spending
- So too for Aussie businesses, running at capacity with robust expansion plans
- Federal and State spending intentions will carry this into late 2008/early 2009

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The RBA's CPI at a 16 year high...

Underlying Inflation*
Year-ended

* Excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999-2000
Sources: ABS, RBA

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RBA's February 2008 CPI forecasts

Table 15: Output and Inflation Forecasts^(a)
Percentage change over year to quarter shown

	Sep 2007	Dec 2007	June 2008	Dec 2008	June 2009	Dec 2009	June 2010
GDP	4.3	3½	3¼	3¼	3	3	3
Non-farm GDP	4.5	3¾	2¾	2¾	2¾	3	3
Consumer price index	1.9	3.0	3½	3½	3¼	3¼	3
Underlying inflation	3.0	3.6	3¾	3½	3¼	3¼	3

(a) Actual GDP data to September 2007 and actual inflation data to December 2007. Underlying inflation refers to the average of trimmed mean and weighted median inflation. For the forecast period, technical assumptions include A\$ at US\$0.94, TWI at 69, cash rate at 7.0 percent, and WTI crude oil price at US\$86 per barrel and Tapis crude oil price at US\$90 per barrel.
Sources: ABS, RBA

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RBA's new 'improved' CPI forecasts

Percentage change over year to quarter shown

	Dec 2007	Mar 2008	June 2008	Dec 2008	June 2009	Dec 2009	Jun 2010	Dec 2010
GDP	3.9	3	2½	2¼	2¼	2½	2½	2¾
Non-farm GDP	4.0	3	2¼	1¾	2¼	2½	2½	2¾
CPI	3.0	4.2	4¼	4½	3½	3¼	3	2¾
Underlying inflation	3.6	4.2	4¼	4	3½	3¼	3	2¾

(a) Actual GDP data to December 2007 and actual inflation data to March 2008. Underlying inflation refers to the average of trimmed mean and weighted median inflation. For the forecast period, technical assumptions include A\$ at US\$0.94, TWI at 71, cash rate at 7.25 percent, and WTI crude oil price at US\$116 per barrel and Tapis crude oil price at US\$120 per barrel.
Sources: ABS, RBA

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Labour market tightens – despite this

Labour Force

Source: ABS

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Vacancy rates were soaring

Vacancies and Employment

* Per cent of labour force; Sept quarter 1990 = 100
Sources: ABS, ANZ, DEEWR

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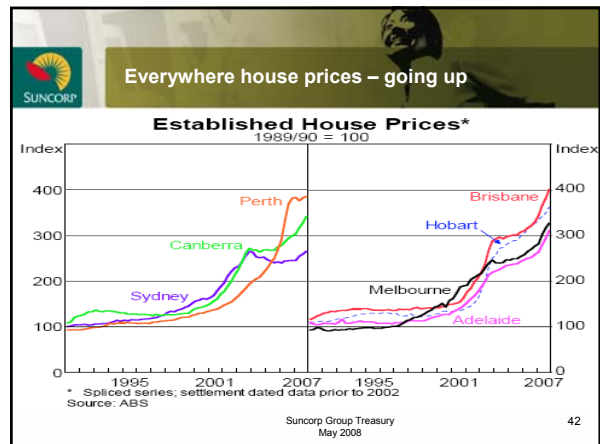
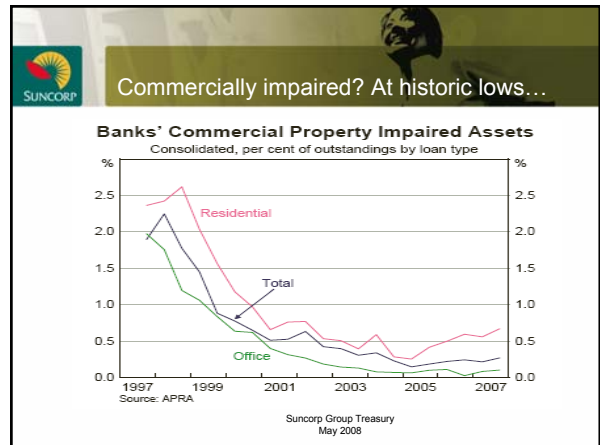
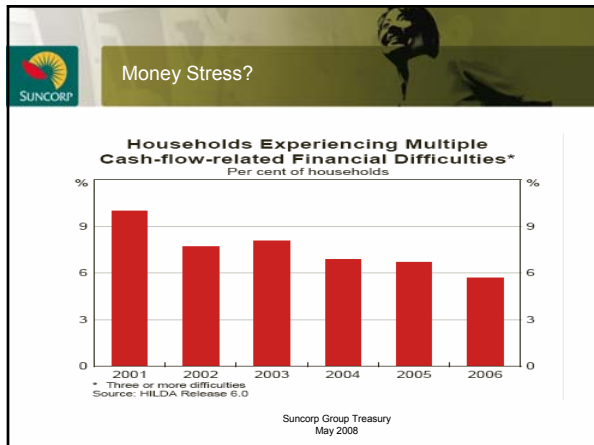
Expectations by Demographic

	Year to December 2008			Year to December 2009
	August 2007	November 2007	February 2008	February 2008
Market economists ^(a)	2.7	2.7	3.0	2.7
Union officials ^(b)	3.0	3.0	3.5	3.4

(a) RBA survey
(b) Workplace Research Centre

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Meanwhile Australian businesses

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Credit: a tale of two sectors

Bank Credit*
Six-month-ended annualised percentage change

Source: RBA

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Its because of business

Credit by Sector

Source: RBA

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Capacity Utilization

High capacity rates will underpin investment plans

Non-farm Capacity Utilisation

Sources: NAB, RBA

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Coupled with our own Asset bubble boom here...

National Office Property Indicators*

* Capital city CBDs (excluding Hobart)
Sources: Jones Lang LaSalle, Property Council of Australia, RBA

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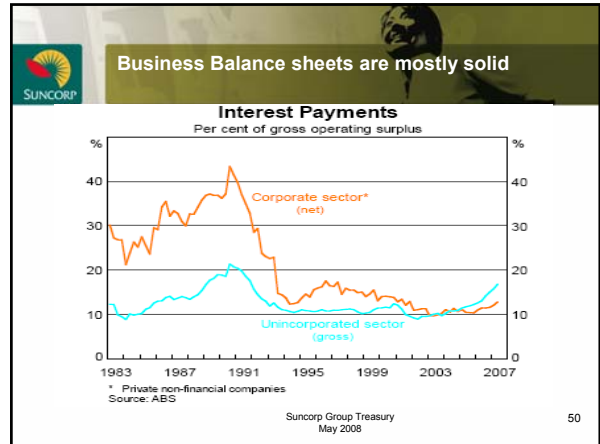
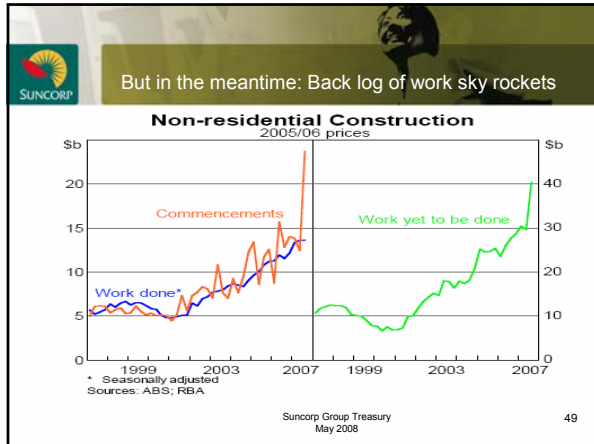
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Property Indicators into 2008 is still robust

Office Property Indicators

Sources: ABS, Jones Lang LaSalle, RBA

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Australian Economy at end 2007

Risks are: on the Eve of the May 2008 budget

- An overleveraged household sector (Is it?)
- Too pre-emptive RBA rate rises
 - Does not like the tax cuts to come
- A wages break out
- Getting ready for the end of the world...

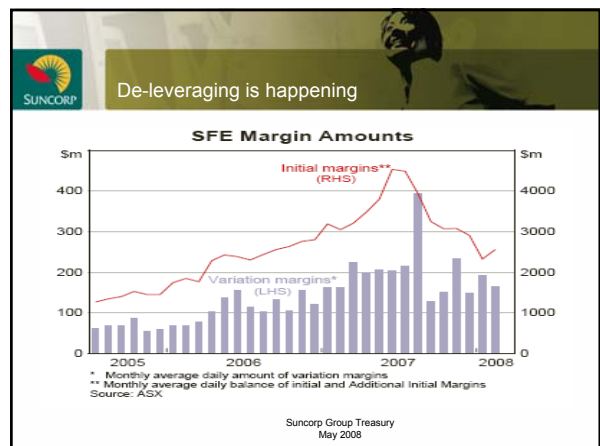
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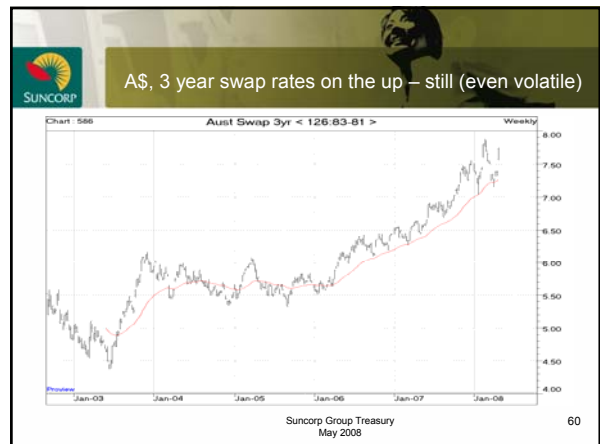
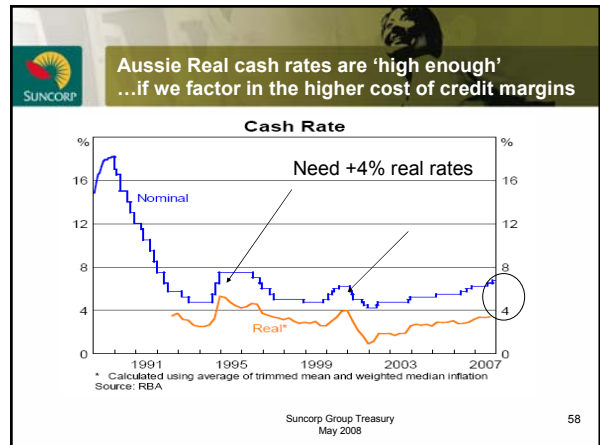
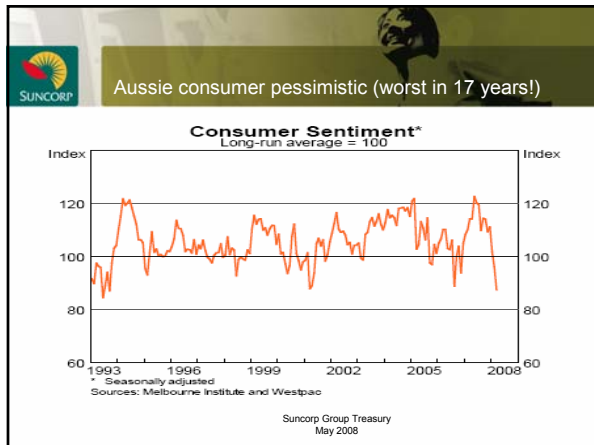
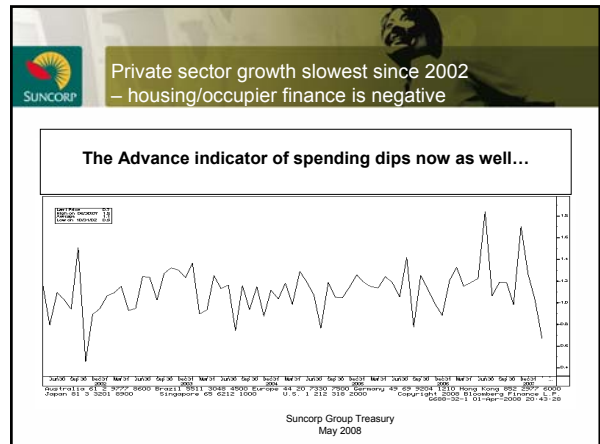
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And why the RBA will not tighten for a while...

The Economy Into 2008

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Interest rate risks for the rest of 2008

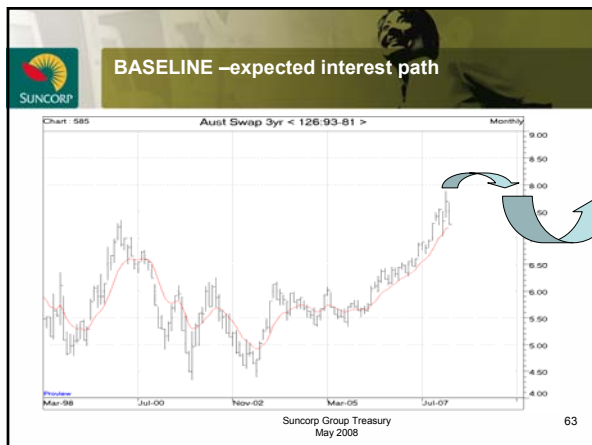
- While the next 6-9 months will appear mixed
 - There will be lots bad ex-post rate rise news
- We expect another 25 pip rate rise to 7.50% by end September 2008 possible (at earliest)
 - Assumption is modest
 - Risks are corporate spreads widen further
 - This 'new' government/administration does not materially tighten policy and will push the risks above the +7.50% range
 - Can get uglier if the overseas markets are not kind to us anymore (which world inflation risks suggest)
- Early 2009 gets very interesting...
- Risk of +7.50% cash rates around Xmas 2008, cant be ruled out, but then long sideways begins...

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(Possible) Interest rate Outlook to 2010

- Official cash rate risk to 7.50% by Sep 08 is the base line scenario
- May 2008 budget may force the path higher into 2009-10
- Likely scenario that it is looser than previous
- Coupled with continuing world growth
- Sees the 3 year bank swap rate risk back towards +8.00%
- Kiwi as possible ghost of Christmas future
 - Cash @ 8.25%
 - Unemployment at 3.6-9% national average, triggers a wages break to justify the above cash rate
 - AS has a go at 8875 highs again and again in the meantime
- Back end of 2009-10 time will be to fall with business cycle dip
 - Question is - from what level?

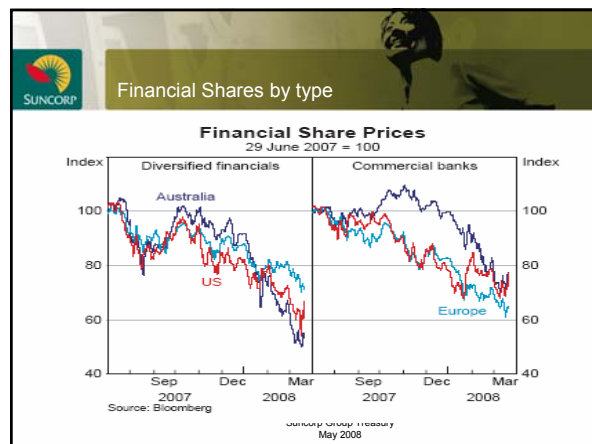
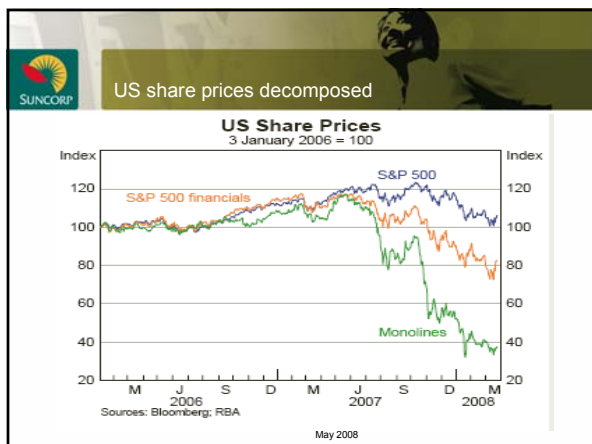
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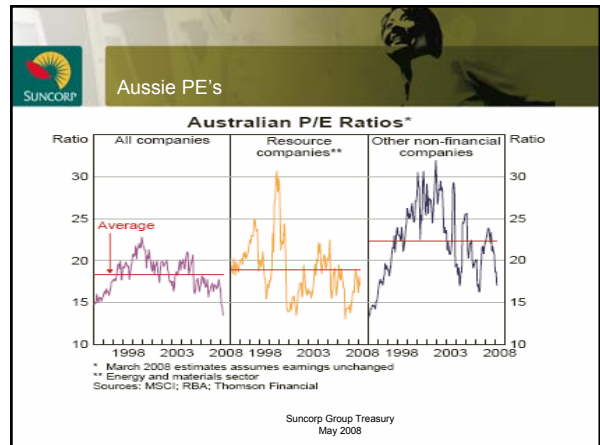
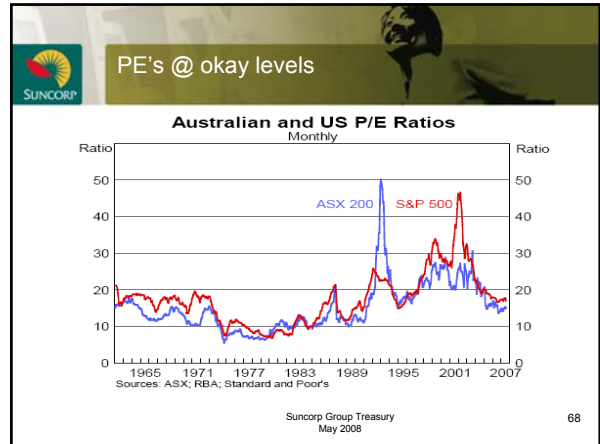
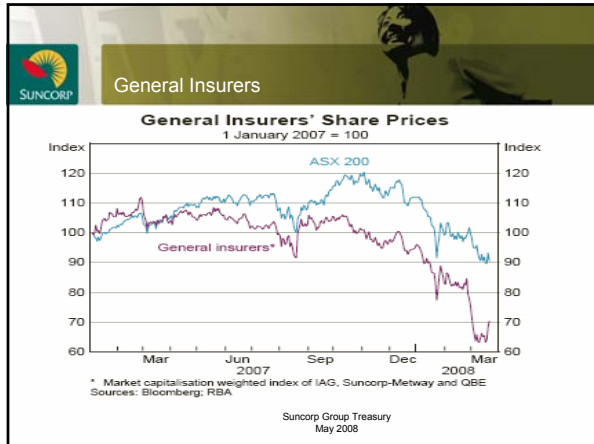


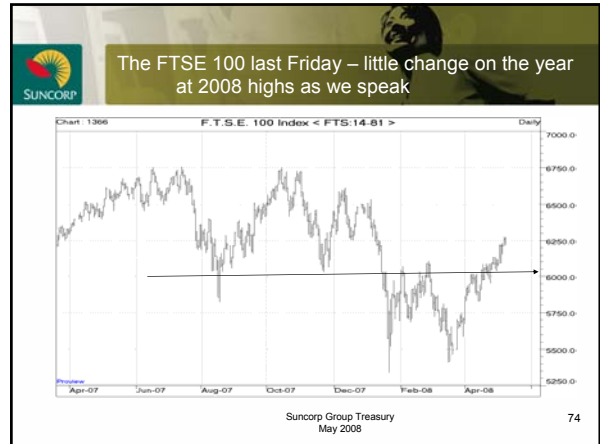
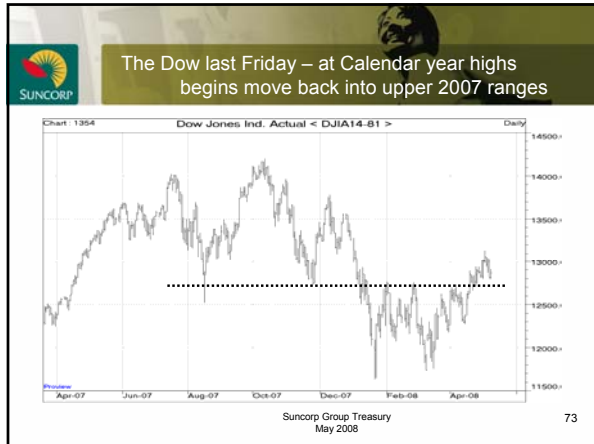
Equity markets

- Fair values suggest equities here and abroad remain undervalued by conventional criteria
- Equity cycles should mirror the credit spread cycle
 - go up when spreads compress
 - Fall when spreads expand
- Longer term, do not expect sustainable new highs
 - More a ranging market to follow, both here and off shore
- June quarter risk is of short squeeze rally to middle/upper end of late 2007 ranges
- New highs dependant on a dramatic improvement in credit spreads into the 2nd half of 2008. hard to see at this stage

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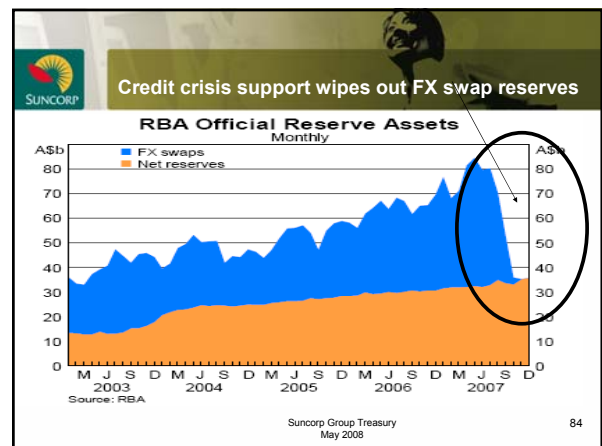
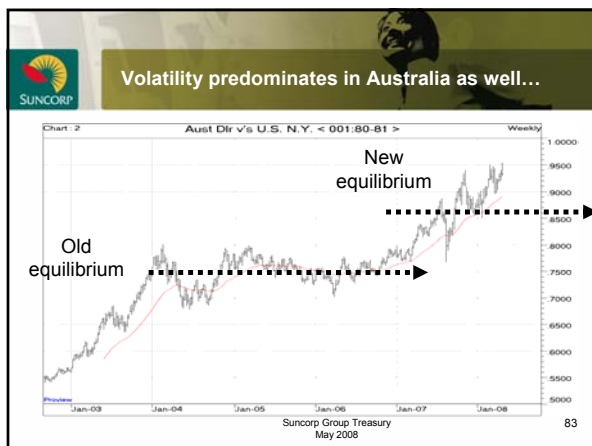
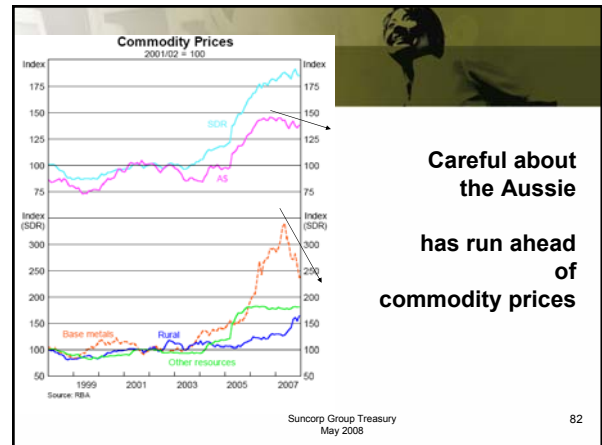
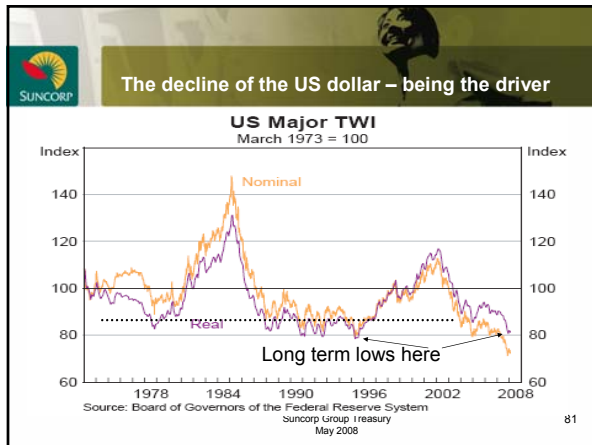
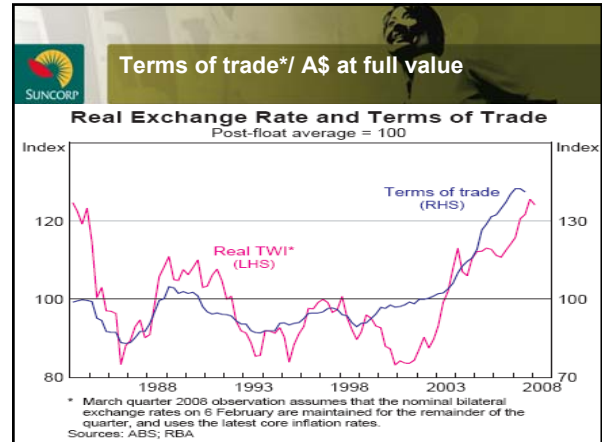


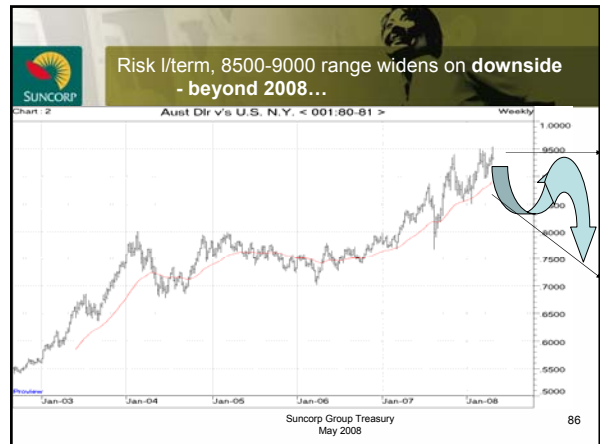
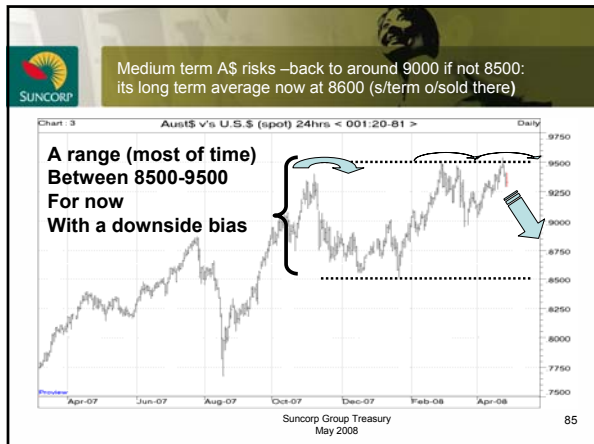


A\$ Prospects into 2008-09

- **A\$ strength consistent with RBA objectives**
 - But ahead of fundamental values
- **Moves over 8500 arguably are though dis-inflationary**
- **US\$ now super cheap may invite intervention to stop it falling further – will be an anti-A\$ phenomenon into 2008**
 - Trichet/ECB/G7 not happy with Euro levels
- **Bottom-line A\$ is likely to range sideways till well into 2008**
- **i.e. +9000 levels will be hard to sustain, even if the overall picture 'looks' positive**
- **Bulk of price action will be a 8500-9000 range for now**
 - Risk it widens on the downside (later)

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