

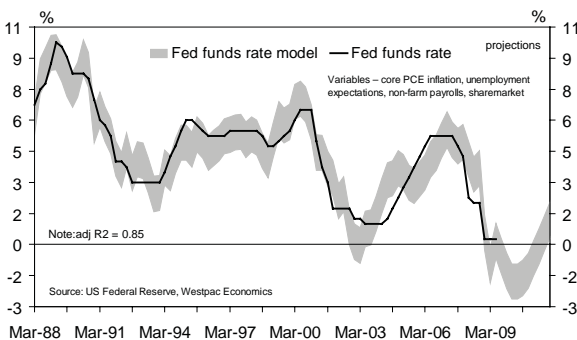
# US growth far from inflationary.

## The Fed can remain on hold though 2010.

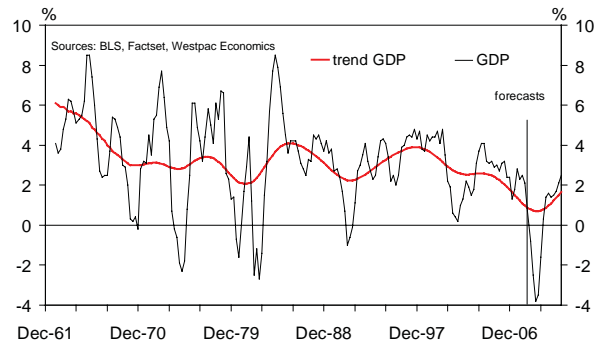
- We have updated our Fed Funds rate model to test the hypothesis that "green shoots mean early Fed hikes".
- The model uses fundamental variables to explain the Fed Funds rate (FFR): core PCE, non-farm payrolls, unemployment expectations and the share market. It does not include lags of the FFR nor market pricing.
- While not perfect, the model has broadly tracked the official FFR rate since the late 1980s. As such, it can be used to approximate future Fed behaviour that would be consistent with our current economic forecasts.
- Westpac is forecasting economic growth to contract almost 3% in 2009 before growing a very modest 1.2% in 2010, the unemployment rate to peak at more than 11% in late 2010 and core PCE inflation to moderate to a 1%/yr pace by mid 2010. We have assumed equities make only very modest gains over the next 12 months.
- The central tendency of our model points to the FFR bottoming at around -2% in mid 2010. Of course, the FFR can't go negative but the level of negativity is indicative of the relative magnitude of the quantitative easing (QE) required, in interest rate terms, to offset current events.
- This negativity may also highlight the possible two step process for tightening policy; that is removing QE first (negative interest rates) and then raising rates. So even if QE is removed though 2010, the model suggests that the Fed is unlikely to raise rate until the second half of 2011.

Justin Smirk, Senior Economist

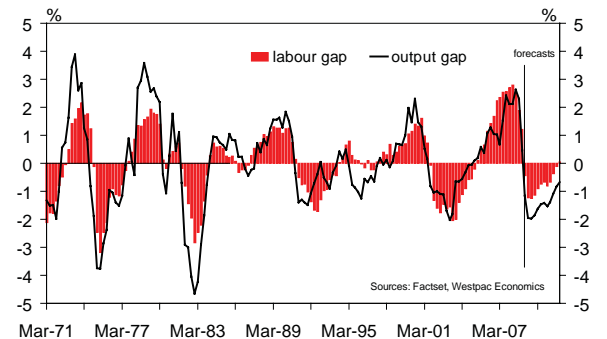
### Fed funds model



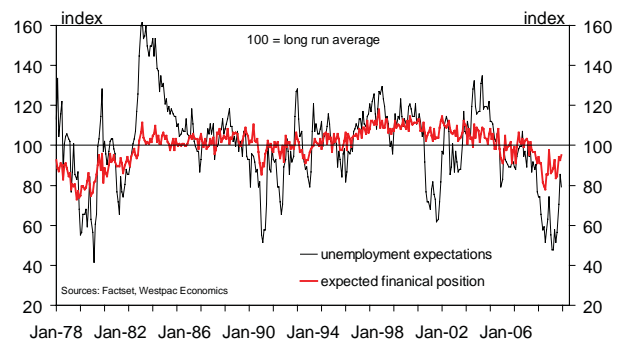
### US economic growth still contracting



### Disinflationary pulse to remain to 2011



### Households remain nervous about finance



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# Forecasts – United States

## Interest rate forecasts

	Latest (Jun 24)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
Fed Funds*	0.125	0.125	0.125	0.125	0.125	0.125
Market implied^	na	0.217	0.250	0.320	0.459	0.610
10 Year Bond	3.64	3.00	3.55	3.75	4.00	4.00

	Latest (Jun 24)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD vs						
<b>USD index*</b>	<b>100</b>	<b>101.76</b>	<b>102.43</b>	<b>101.10</b>	<b>99.80</b>	<b>97.75</b>
JPY	95.54	95	92	96	99	103
EUR	1.4038	1.38	1.36	1.39	1.42	1.45
AUD	0.7959	0.76	0.74	0.77	0.80	0.82
NZD	0.6407	0.60	0.59	0.62	0.65	0.68
CAD	1.1480	1.13	1.16	1.12	1.08	1.06
GBP	1.6469	1.59	1.58	1.64	1.69	1.75
CHF	1.0670	1.09	1.14	1.08	1.06	1.07
ZAR	8.1671	8.21	8.32	8.19	8.07	8.03
SGD	1.4550	1.45	1.44	1.43	1.42	1.41
HKD	7.7501	7.75	7.75	7.75	7.75	7.75
PHP	48.23	47.5	47.7	47.3	46.9	46.5
THB	34.13	34.5	34.5	35.1	34.8	34.3
MYR	3.54	3.51	3.51	3.49	3.48	3.46
CNY	6.8341	6.82	6.82	6.79	6.75	6.72
IDR	10450	10600	10600	10350	10100	9500
TWD	32.86	32.74	32.82	32.69	32.56	32.43
KRW	1283	1264	1288	1248	1228	1226
INR	48.54	47.70	47.23	46.98	46.73	46.49

% annualised, s/adj	2009				2010			Calendar years			
	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	2007	2008	2009f	2010f
Private consumption	-4.3	1.6	-0.9	-0.4	-2.0	0.8	1.2	2.8	0.2	-1.2	0.1
Dwelling investment	-22.7	-38.7	-25.2	-18.5	-7.8	-3.9	0.0	-17.9	-20.8	-24.9	-6.0
Business investment	-21.7	-36.9	-32.2	-20.3	-10.5	-5.8	-4.9	3.9	0.2	-23.9	-9.5
Public demand	1.3	-3.5	10.4	10.4	9.1	8.2	7.0	2.1	2.9	4.0	8.0
Domestic final demand	-6.1	-5.6	-3.3	-0.9	-0.9	1.5	1.7	1.8	-0.1	-3.6	0.6
Inventories contribution ppt	0.1	-2.3	-0.1	0.4	0.4	0.1	0.0	-0.4	-0.2	-0.3	0.6
Net exports contribution ppt	-0.1	0.5	0.3	-0.1	0.1	0.0	0.0	0.6	1.4	1.0	-0.1
<b>GDP</b>	<b>-6.3</b>	<b>-5.7</b>	<b>-2.6</b>	<b>0.6</b>	<b>1.4</b>	<b>1.9</b>	<b>1.7</b>	<b>2.0</b>	<b>1.1</b>	<b>-2.9</b>	<b>1.2</b>
%yr annual chg	-0.8	-2.5	-3.8	-3.5	-1.6	0.3	1.4	-	-	-	-
<b>Other macroeconomic variables</b>											
Non-farm payrolls mth avg	-426	-688	-401	-309	-263	-263	-263	103	-189	-415	-44
Unemployment rate %	6.9	8.1	9.5	10.2	10.8	10.8	10.8	4.6	5.8	9.7	11.1
CPI headline %yr	1.5	-0.2	-1.0	-2.3	0.1	1.0	1.2	2.9	3.8	-0.9	1.5
PCE deflator, core %yr	1.9	1.8	1.5	1.2	1.2	1.1	1.1	2.2	2.2	1.4	1.1
Current account %GDP	-4.4	-2.9	-2.3	-2.1	-2.0	-2.0	-1.9	-5.3	-4.9	-2.3	-2.0

Sources: Official agencies, Factset, Westpac Economics

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