# MARKET SNAPSHOT

## Latest Developments & Thoughts on the Credit Crisis

**Monday, 13th October 2008**

Central banks and governments around the world continued to announce a stream of new policy initiatives to help fight the credit crisis. Global co-ordination to stem the credit crisis on most accounts appears to be strengthening.

The more recent measures cover recapitalisation, liquidity and funding.

The measures from the Australian government announced on October 12 include:

(1) A guarantee of all deposits in Australian banks, building societies and credit unions and Australian subsidiaries of foreign-owned banks. This guarantee will operate for a period of three years and is similar to the action that has been taken in a number of countries. (Note: European governments have moved to insure 100% of eligible deposits and other jurisdictions have significantly increased their deposit insurance caps).

(2) Guaranteeing wholesale term funding of Australian incorporated banks and other authorised deposit-taking institutions.

(3) Directing the Australian Office of Financial Management (AOFM) to buy an extra A$4 billion in Residential Mortgage Backed Securities (double the earlier announced amount).

The measures announced by the Euro-area heads of State over the weekend include steps to guarantee bank liabilities and provide for public equity injections. It follows in a general sense a similar template to that of the plan earlier announced by the UK government. And it follows the United States government on Friday stating it is developing plans to buy equity stakes in financial institutions. The most advanced plan to pour capital into the banking sector so far sits with the UK; the UK plan is to pour GBP50 billion into its banks and underwrite interbank lending.

We view these new measures as a step in a favourable direction.

More concrete details of all the plans need to be revealed, however, for the market to digest and better work out the mechanics. These details will likely come over the next few days. A better understanding of the mechanics and confidence in how this will work may be needed to help ease some of the pressures. It's too early to tell yet if these new measures collectively will be enough to help bring significantly greater stability to global financial markets without a more concrete understanding of the details.

We can say though that it's possible that the sum of all the measures may help to start to bring about some easing in the intense funding strains. At this point in time, the market remains far from functioning normally and/or fully.

One of the litmus tests will be how European and US markets perform later tonight, especially the LIBOR markets.

The reaction in financial markets during today's Asian session was somewhat mixed.

The Australian equity market finished in the black, although we need a longer run of 'up' days to help halt the cash-demand out of equity markets. Other share markets in Asia finished the day mixed.

The local share market, especially bank shares, reacted a lot more favourably to the measures than did funding spreads in the Asian session. For example, the three-month SIBOR spread fixed in today's

Asian session at around 478bp, down just 3bp from Friday's fixing of 481bp, indicating a muted response so far to the measures announced over the weekend across the globe. In the short-term domestic money market, there was a modest response. For example, the Australian three-month BBSW-OIS spread is currently at 103bp, from 112bp on Friday. Again, greater details of measures may be needed, and also to some extent, local market players may be waiting for the offshore lead.

In currency markets, the AUD seemed to find support early on before selling ensued. The AUD remains subject to considerable volatility in what remain thin markets. And in bond markets, bond prices sold off with some of the longer-term implications of these measures also likely playing an influence.

In terms of the economic outlook, these measures may help mitigate further downside risks, but it seems unlikely that the world, including Australia, can avert the marked economic slowdown already underway. More rate cuts in the major economies are likely; we also look for more easing from the RBA in Australia.

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