

AUSTRALIA & NEW ZEALAND WEEKLY

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CPI shocker and the RBA

Demand impulse key to August 1 board meeting

Wednesday's Australian second quarter consumer price number will almost certainly drive the annual headline increase above 3% and probably well above it. Petrol prices rose over 10% over the quarter, and fresh food prices also increased. Higher petrol prices made up around half of the shock 1.5% increase in the New Zealand CPI over the June quarter, and the Australian impact would have been similar. If the overall headline increase was the same as the previous quarter's 0.9%, the annual rate will increase from 3% to 3.3%. We expect a 1% headline increase taking the annual rate to 3.4%, with a risk it is higher. This is of course well above the Reserve Bank of Australia's 2%-3% target, but that result would not motivate a further 25bp tightening from the RBA board meeting on Tuesday next week. If the direct impact of oil price increases were the only issue, the RBA would not have tightened in May and won't in August. So far as inflation is concerned the RBA will look more closely at its own trimmed and weighted mean measures, which remove from the headline index the biggest changes above and below its central tendency. For the year to March the trimmed mean increased 2.6% and the weighted median 2.8%. These were both a little higher than the previous annual reading, and rationalised the 25bp RBA tightening in May. We would be surprised to see the annual result fall back for either series.

Inflation will we think offer a rationale for another tightening, but it won't of itself determine next week's rates decision. The target is after all inflation in the next twelve months, not the last twelve months. The real decision for the RBA is whether demand growth is sufficiently strong to raise a big risk of core inflation continuing to increase over the coming year. If the RBA thinks this it is, it will certainly tighten next week. We expect a tightening, but we acknowledge the case is by no means clear cut. Employment gains have certainly been strong in recent months, with nearly 200,000 full time jobs created since last October, and around 100,000 jobs over May and June. Unemployment is at a thirty year record low. Housing finance has also been exceptionally strong, with the rate of growth of lending (excluding refinancing) up 25% in the year to May – the highest annual rate for three years. This is lending for owner occupation only, however, and reflects both the high level of prices of established houses and the sale of a bulge of new dwellings from a building boom which is now long over. The RBA figures on the growth of mortgage lending overall, which includes investment property lending, are much more modest. That measure is running at an annual rate of only 13%. It hasn't changed much in the last eight months and is well down on the 20% plus rates of three years ago. Most other indicators suggest demand and output growth is only moderate. May exports were lower than December of last year, continuing the

disappointing export performance evident now for five years. Imports are very strong indeed, with April and May imports growing at a monthly rate of over 3%. That might suggest strong household except that oil price increases are a large part of the increase, and in anycase Australia always sees high imports when – as now - business investment is firm. Retail trade growth has been pretty slow, with May turnover only 5% over May last year. This is partly the impact of higher value of petrol sales, which are not included in the Australian retail trade series. Big tax cuts from the beginning of this month will support consumption over the remainder of the year, though it has to be said last year's tax cuts were mostly saved. Home building is still weak. Home construction has been falling for two years, and while approvals for new construction bottomed out in the second half of last year the monthly level hasn't much changed since. It will be well into 2007 before we see the dwelling upswing.

It's commonly said that the sharp divergence in growth rates between the states poses a big problem for the RBA. It's certainly true that there is some divergence in output growth. Queensland for example was growing at three times the national average in the year to March, and business investment in that state was increasing more rapidly than in China. NSW by contrast is hardly growing at all. But there is a very high degree of market integration in Australia. Brisbane's inflation rate for the year to March was 2.9%, very close to the 2.7% for Sydney and 2.8% for Melbourne. In each of them headline inflation is close to the national average. The three East coast states of which these cities are the capitals together account for over three quarters of Australian GDP. Perth is certainly an outlier with 4.2%, but Western Australia accounts for only one tenth of national output. So too the other outliers are Canberra (3.5%) Darwin (3.4%) and Adelaide (3.1%), account for quite small shares of national GDP. So long as Queensland, NSW and Victoria have similar inflation rates, the RBA has no problem

All up we think the RBA will tighten, mainly because unemployment is very low, employment growth has been brisk, the tax cuts will support consumption, the pickup in housing lending for owner occupation is unwelcome, the May increase had little lasting impact on consumer confidence, and while exports are disappointing they are likely to increase. The outlook is in this respect quite opposite to the US, which is only now seeing the first signs of the end of a housing boom. In Australia the boom ended two years ago, and the sector will pick up again over the coming year. The August 1 decision won't be an easy one for the RBA, and if indeed it does take the cash rate to 6% it is unlikely to want to seriously ponder another change until next year.

Bollard will keep cash at 7.25%

High inflation, but demand growth has slowed

RBNZ Governor Alan Bollard would have no difficulty rationalising another tightening for the cash rate review Thursday, though we think he will leave the rate unchanged. If he chooses, inflation alone gives him an excuse to tighten. The June quarter increase took the annual headline inflation rate to 4%, a long way above the target range of 1% to 3%. It will be many quarters before the annual rate is back below 3%, let alone at the informal target of 2.5%. And while output growth was zero in the second half of last year, the evidence since is that New Zealand is a long way from a recession. May retail sales were up 1.3% on April, seasonally adjusted May building approvals were up a formidable 12.7% on the previous month, trend exports for May continued the vigorous expansion apparent since the beginning of the year, inward migration has been stronger than expected, and annual credit growth to May was still increasing twice as fast as nominal GDP. But these recent numbers are unlikely to change Dr Bollard's view that domestic demand is slowing. While May building approvals were strong, they followed two months of sharp decline. The average level of approvals remains well down on the boom a few years ago. We expect Friday's June approvals to be back down again. So too credit growth is well down on the annual rate in recent years and continues to decline, and retail sales in the year to May were up only 5% (and in the New Zealand case include petrol). The trend to higher exports is persistent (and we expect to see it confirmed in the June numbers Wednesday) but it is also exactly what Dr Bollard wants. There's little doubt that trend growth in NZ is well down on 2003 and 2004. Meanwhile the slow global increase in rates has at last seen an increase in NZ rates from three to five years. Like Federal Reserve Chairman Ben Bernanke, Dr Bollard can claim there is more to come in the pipeline impact of the rate increases already made, particularly as New Zealand property owners refinance at higher rates. As he said recently, the NZ tightening episode ended at the beginning of this year. There is no compelling case to restart it in a slowing economy.

John Edwards

Weekly Calendar

Week commencing Monday July 24, 2006

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Range	Actual Previous
Monday July 24, 2006							
AU	Producer Price Index		Q2	1.1%	1.1%	-	0.7%
Tuesday July 25, 2006							
US	Consumer confidence (15:00 BST)	Month	Jul	104.0	104.5	-	105.7
US	Existing home sales (15:00 BST)	Month	Jun	6.65m	6.60m	-	6.67
Wednesday July 26, 2006							
AU	Consumer Prices		Q2	1.0%	1.0%	-	0.9%
		Y/Y		3.4%	3.4%	-	3.0%
NZ	Trade Balance	NZD	Jun	-500m	-	-	-104m
JPN	Trade balance (00:50 BST)	NSA (JPYbn)	Jun	890.4	820.0	-	382.8
JPN	Corporate service prices (00:50 BST)	Year	Jun	-0.1%	-	-	-0.2%
GER	Ifo business climate (09:00 BST)	Index	Jul	105.9	105.9	-	106.8
		Current conditions		109.6	108.6	-	109.4
		Business expectations		102.3	102.5	-	104.2
UK	HSBC consumer index (09:30 BST)		Jul				
UK	CBI industrial trends (11:00 BST)	Volume of output (% net balance)	Jul	+12	+12	-	+14
US	Beige Book (19:00 BST)						
Thursday July 27, 2006							
NZ	RBNZ Official Cash Rate		Jul 27	7.25%	7.25%	-	7.25%
JPN	Shoko Chukin Bank Survey (06:00 BST)	Business sentiment DI	Jul	50.3	-	-	50.1
US	Durable goods orders (13:30 BST)	Month	Jun	2.0%	2.0%	-	-0.2%
		Ex-transportation		0.6%	0.7%	-	0.8%
US	Initial jobless claims (13:30 BST)	Week ('000s)	Wk 22	300	-	-	304
US	New home sales (15:00 BST)	Month ('000s)	Jul	1150	1180	-	1234
Friday July 28, 2006							
NZ	Building consents (sa)		Jun	-6%	-	-	12.7%
JPN	CPI (00:30 BST)	Total - month	Jun/Jul	0.0%	-	-	0.3%
		Total - year		1.0%	-	-	0.6%
JPN	Unemployment (00:30 BST)	Unemployment	Jun	4.0%	4.0%	-	4.0%
JPN	All household spending (00:30 BST)	Nominal	Jun	-2.3%	-	-	-1.2%
		Real		-1.3%	-	-	-1.8%
JPN	Retail sales (00:50 BST)	Large stores	Jun, prelim	-1.0%	-	-	-1.6%
		Retail trade		0.5%	0.5%	-	0.1%
EMU	M3 (09:00 BST)	M3	Jun	8.9%	8.7%	-	8.9%
US	GDP (13:30 BST)	Quarter	Q2, advance	3.5%	2.9%	-	5.6%
		GDP price index		3.5%	3.6%	-	3.1%
US	Employment cost index (13:30 BST)	ECI	Q2	1.0%	0.8%	-	0.6%
		Wages & salaries		0.9%	-	-	0.7%
		Benefits		1.2%	-	-	0.5%
US	Michigan sentiment (14:45 BST)	Month	Jul - final	83	83	-	83

Weekly Calendar (continued)

Week commencing Monday July 24, 2006

Country/ Region	Event or Economic Release	Period	HSBC	Market Fcasts Cons	Range	Actual Previous	
During the Week							
UK	Nationwide house prices	Month	Jul	0.4%	0.4%	-	0.3%
		Year		5.2%	5.5%	-	5.0%

Source:- Dow Jones, Reuters, Bloomberg

Notes:- p=preliminary, r=revised, n.f.=not forecast, n.s.a.=not seasonally adjusted, ann.=annualised, bn=billion, m=million

Monthly Economic Calendar

Week commencing July 31, 2006

Monday July 31, 06	Tuesday August 1, 06	Wednesday August 2, 06	Thursday August 3, 06	Friday August 4, 06
AU TD Securities Inflation (Jul) JPN Industrial Productions (Jun P) UK Net Consumer Credit (Jun) UK Net Lending Sec. on Dwellings (Jun) UK Mortgage Approvals (Jun) EC Euro-Zone Indust. Confidence (Jul) EC Euro-Zone Consumer Confidence (Jul) EC Euro-Zone CPI Estimate (Jul) US Fed's Poole Speaks to Southern Legislative Conference	AU Reserve Bank August Policy-setting meeting AU AiG Performance of Mfg Index (Jul) AU Building Approvals (Jun) UK PMI Manufacturing (survey) (Jul) EC PMI Manufacturing (survey) (Jul) US Chicago Purchasing Manager (Jul) US Personal Income (Jun) US Personal Spending (Jun) US PCE Deflator (Jun)	AU RBA Cash Target (Aug) AU Retail Sales Ex Inflation (2Q) AU Retail Sales (JUN) JPN Monetary Base (Jul) UK Bank of England's Monetary Policy Committee Meets EC Euro-Zone PPI (Jun) US ISM Manufacturing (Jul)	AU AiG Performance of Service Idx (Jul) UK BoE Announces Rates (Aug 4) EC ECB Announces Interest Rates (Aug) EC Euro-zone July Services PMI US Initial Jobless Claims (Jul 30) 3 – 9AUG UK HBOS Plc house prices (Jul)	AU Reserve Bank Quarterly Monetary Policy Statement US Factory Orders (Jun) US ISM Non-Manufacturing (Jul) US Non-farm Payrolls (Jul)
Monday August 07, 06	Tuesday August 08, 06	Wednesday August 09, 06	Thursday August 10, 06	Friday August 11, 06
AU ANZ Job Advertisements (JUL) NZ Labor Cost Private Sector UK Industrial Production (JUN) UK Industrial Production (JUN) JPN Leading Economic Index (JUN P)	UK BRC July Retail Sales Monitor US Consumer Credit (JUN) US Nonfarm Productivity (2Q P) US Unit Labor Costs (2Q P) US Fed's Open Market Committee Meets on Interest Rates, Economy JPN Bank Lending (JUL) JPN Machine Tool Orders (JUL P)	AU Home Loans (JUN) UK Bank of England Quarterly Inflation Report US FOMC Rate Decision Expected (AUG 9) US ABC Consumer Confidence (AUG 8)	AU Employment Change (JUL) NZ Unemployment Rate (2Q) NZ ANZ-Business NZ PMI (JUL) US Trade Balance (JUN) US Initial Jobless Claims (AUG 6) US Continuing Claims (JUL 30) JPN Current Account Total (JUN) JPN BoJ Monetary Policy Meeting EC ECB Publishes Aug. Monthly Report	AU Trade Balance (JUN) US Import Price Index (JUL) US Import Price Index (JUL) US Advance Retail Sales (JUL) JPN Gross Domestic Product (2Q P) JPN BoJ Monetary Policy Announcement JPN Industrial Production (JUN F) JPN Capacity Utilization (JUN F) JPN BoJ Monthly Report

Monthly Economic Calendar...(continued)

Week commencing July 24, 2006

Monday August 14, 06	Tuesday August 15, 06	Wednesday August 16, 06	Thursday August 17, 06	Friday August 18, 06
NZ Retail Sales (Jun) UK PPI. (Jul) EC Euro-Zone GDP s.a. (2Q A)	NZ Producer Prices-Inputs (2Q) NZ Producer Prices Outputs (2Q) UK RICS House Price Balance (Jul) UK CPI (Jul) US Producer Price Index (Jul) US Empire Manufacturing (Aug) US Net Foreign Security Purchases (Jun)	AU Westpac August Consumer Confidence AU Wage Price Index (2Q) NZ Non Resident Bond Holdings (Jul) UK Bank of England Minutes UK Avg Earnings inc bonus (Jun) UK ILO Unemployment Rate (Jun) UK Manu.Unit Wage Cost (Jun) US NAHB Housing Market Index (Aug) US ABC Consumer Confidence (Aug 15) US MBA Mortgage Applications (Aug 12) US Consumer Price Index (Jul) US Housing Starts (Jul) US Building Permits (Jul) US Industrial Production (Jul) US Capacity Utilization (Jul) JPN BoJ Monetary Policy Meeting Minutes	AU Melbourne Institute Consumer Inflation Expectations for August AU Reserve Bank of Australia July Bulletin AU Average Weekly Wages (May) UK Retail Sales (Jul) US Initial Jobless Claims (Aug 13) US Continuing Claims (Aug 6) EC Euro-Zone CPI (Jul) EC Euro-Zone CPI (Jul) EC Euro-Zone Ind. Prod. sa (Jun)	AU RBA Governor Macfarlane Speaks: House Economics Committee NZ Visitor Arrivals (Jul) UK CML, BBA & BSA Mortgage Lending Figures US Philadelphia Fed. (Aug) US U. of Michigan Confidence (Aug P) EC Euro-Zone Trade Balance (Jun)
Monday August 21, 06	Tuesday August 22, 06	Wednesday August 23, 06	Thursday August 24, 06	Friday August 25, 06
		AU Westpac MI Leading Index For June AU DEWR Skilled Vacancies (AUG) UK U.K. CBI August Industrial Trends US Richmond Fed Manufact. Index (AUG) US ABC Consumer Confidence (AUG 22) US MBA Mortgage Applications (AUG 19) JN Machine Tool Orders (JUL F)	AU Australia House Price (2Q) NZ Trade Balance (JUL) UK Total Business Investment (2Q P) US Existing Home Sales (JUL) US Durable Goods Orders (JUL) US Continuing Claims (AUG 13)	NZ Food Prices (JUL) US New Home Sales (JUL) JN National Consumer Prices (JUL)

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