

# AUSTRALIA & NEW ZEALAND WEEKLY

**John Edwards**  
Chief Economist

Phone: +612 9255 2744  
[john.k.edwards@hsbc.com.au](mailto:john.k.edwards@hsbc.com.au)

Australia & New Zealand research is  
available online at:-

[www.hsbc.com.au](http://www.hsbc.com.au)

[www.hsbcnet.com](http://www.hsbcnet.com)

## Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure Appendix, and with the Disclaimer, that form part of it.

## In this week's issue

**The RBA tightens** See page 2

Australia's real  
circumstances are not  
apparent

**New Zealand shows** See page 5

the way  
Sitting it out

**Weekly Calendar** See page 6

**Monthly Calendar** See page 8

**Disclaimer &  
Disclosures**

## The RBA Tightens

### Australia's real circumstances are not apparent

After fifteen years of uninterrupted prosperity, last week's shock increase in Australian second quarter inflation might be taken to be the beginning of the end. Excluding the impact of the 2000 sales tax, it was after all far and away the highest quarterly and the highest annual increase since the year before Ian Macfarlane became Reserve Bank of Australia governor a decade ago. His likely successor in six weeks, Deputy Governor Glenn Stephens, must ruefully ponder that the next ten years are hardly likely to be as good as the last ten.

It is of course true as the Prime Minister and Treasurer repeatedly claim that bananas and oil accounted for most of the increase in second quarter consumer prices. Without either and without other volatile components, the increase would have been 0.6% instead of 1.5%, and inflation would be 2% instead of 4%. They might add (though they do not) that they themselves are responsible for the 250% increase in banana prices. Cyclone Larry devastated Australia's crop, but there are plenty of bananas elsewhere. Banana prices increased so much because federal government refuses to permit banana imports, despite the competent authority finding years ago that with proper quarantine procedures Philippines bananas pose no disease risk to the Australian industry.

If bananas and oil were all, Tuesday's RBA board meeting could well leave the 5.75% cash rate unchanged. But they were not all. Even excluding all volatile items, the rate of increase in the index of market prices for the remaining items doubled compared to the preceding quarter. The annual rate does not matter, but the acceleration does. On the weighed median measure calculated by the RBA the quarterly rate rose to 0.8% and the annual rate to 3%.

We think another 25bp rate increase announced Wednesday is all but certain, given the increase in the RBA's own measure and the evident strength of employment growth, profits and business investment. But we also think it is important to recognise this is not runaway inflation, it is not stagflation, it is not beyond remedy, and it is most decidedly not the beginning of the end for Australia's long running expansion. Headline inflation has probably peaked 4%. The consumer price index for the current quarter may include some further petrol price increases, but they are unlikely to rise over 11% or contribute 0.5% to the total CPI increase as they did for the June quarter. Banana prices remain high, but haven't further increased and account for a tiny share in the index. Increased health fund charges imposed in April were included in the June quarter CPI but will not be repeated for the September quarter. Everything that conspired to drive inflation up in the second quarter conspire to arrest it in the third quarter. The headline increase for the last September quarter was 0.9%. So long as the outcome for the current quarter is no higher – and without an oil price calamity it won't be – the headline inflation

number released October 25 will confirm that the peak was reached in the June quarter. The annual headline result may be under 4%, and perhaps well under.

The same cannot be said of the weighted median rate, which may increase. The quarterly number that drops out is 0.6%, and the more recent numbers have been higher, so given the impetus in the central tendency which this technique is supposed to capture, the annual rate will increase. This will be so even if the quarterly rate stays the same or falls by only a decimal point. So long as inflation pressures are thought likely to abate, however, there is no reason the RBA would respond to another high underlying reading with another tightening. We would accordingly expect Friday's RBA Statement on Monetary Policy to acknowledge that inflation is stronger than expected and it will take longer to come back to the 2.5% mid point of the band. We would expect a tightening bias to remain. But we would not expect the Statement to encourage a view that further rate increases will be necessary. We ourselves doubt further increases will be necessary, for the reasons we offer below.

The decision we expect Wednesday will not be the beginning of a new and difficult episode of monetary policy. It will be the seventh in a sequence of 25 bp increases over the last four years. Not all have been rationalised in quite the same terms, but they have all been in direction. Wednesday's increase will be only the recent move in the now accustomed operation of inflation targeting procedures, which will in due course see inflation moderating at the expense of a somewhat lower rate of output growth than we would otherwise expect. It was only three years ago that the annual rate for weighted median went all the way out to 3.3%, largely driven by the lagged impact of the earlier Australian dollar collapse on import prices. The response then as now was a gradual increase in the cash rate, with most of the fall in inflation due to currency appreciation. Whether it will take one or more increases beyond Wednesday's to change the direction of consumer price inflation now depends on the evolution of the economy.

Part of the complication in assessing Australia's circumstances over the coming year is a widespread misunderstanding of its circumstances today. Despite the evident facts to the contrary it is still reported and widely believed that Australia is enjoying an economic boom supported by high commodity prices. In fact mining output contracted by over 2% in the year to March, the total volume of Australian exports over the same period rose by less than 2%, and exports over the period contributed less than 0.2% to output growth. For the year to May – despite record high commodity prices – the value of Australian exports increased less than 10%. If one wonders how these numbers can be reconciled with Australia's boom, there is an easy answer: there is no boom. In the year to March Australian real output growth was 3%, well under the growth rates for Japan and the US over the same period, and well under Australia's average growth over the whole of the fifteen year expansion to date. Commodity prices are indeed high, but neither coal and nor iron ore miners have been able to increase output as quickly as they wished, farm exports are still ravaged by drought, and for different reasons both manufacturing and services

export growth has been slow. Meanwhile the residential construction industry continues to contract (as it has in all but one of the last eight quarters), and households are struggling to rebuild savings after a vast increase in indebtedness during the housing boom. Business investment alone is strong, and it accounted for almost all GDP growth in the year to March.

But while Australia is by no mean enjoying a boom, the uncertainty in predicting future cash rate moves is that the trend for output growth is probably up. In this respect Australia's circumstances are quite different from those in the US. There, trend growth must almost certainly slow. In contrast to the US home building industry, which was still moderately expanding into the first quarter of this year, the Australian home building industry is contracting. In the year to the March quarter US export volumes rose at more than five times the rate of Australian exports. Exports have been disappointing for a very long time but given the strength of the world economy and the amount of business investment in expanding capacity, Australian export volumes will quite likely demonstrate a quite solid increase into the fourth quarter of this year. The decline in Australian residential building approvals ended late last year, and by the first quarter of next year we would expect to see some modest growth in residential construction. With reasonably firm investment and with recent strong employment growth plus tax cuts supporting household consumption, it would be surprising if GDP growth didn't strengthen into 2007. As a result the path of the cash rate is by no means clear. With a higher expected cash rate the Australian dollar is firmer than it was two months ago, restraining import price increases outside of oil. Bond rates have been rising, in line with the global increase. We expect inflation to begin to decline before output growth markedly accelerates, an outcome consistent with a 6% cash peak.

**John Edwards**

## New Zealand shows the way

### Sitting it out

New Zealand has suffered by comparison with the Australian economy over the last year or two, largely because inflation in New Zealand was markedly higher and in the second half of last year growth was markedly slower. No longer. As of the June quarter they have the same headline inflation rate, 4%. And while Australia is probably now growing faster than New Zealand, the growth mix is New Zealand is exactly what the Reserve Bank of New Zealand wants. Through the second quarter exports picked up 9.4% while import growth fell to 1.2% – outcomes Australia may not be able to match. Friday's data showed that residential building permits continue to trend down, which won't trouble the RBNZ at all. Next week's second quarter employment and wages growth numbers will be key to assessing the direction, but last week's RBNZ statement on the cash rate review was on the money. In leaving the 7.25% cash rate unchanged RBNZ Governor Alan Bollard reiterated his conviction that inflation will be moderated by slowing demand over the coming year. His statement acknowledged that it would be some considerable time before headline inflation came back within the 1% to 3% target but in no way supported suggestions the RBNZ would contemplate further tightening. Dr Bollard is no doubt reluctant to encourage any serious appreciation of the NZD, with its current level viewed as useful in encouraging exports. He now has the assistance of somewhat higher global rates, the New Zealand dollar has stabilised, and the long-sought rebalancing from domestic demand to exports is now underway. Output growth has picked up, but even so it is quite modest. House price growth is slowing, as is housing construction. Retail sales (including petrol) have been growing at an annual rate of around 5% - an untroubling rate. We stick to our view that 7.25% is indeed the top, but that it will be the first quarter of next year before the RBNZ even seriously considers a reduction

**John Edwards**

# Weekly Calendar

Week commencing Monday July 31, 2006

Country/ Region	Event or Economic Release		Period	HSBC	Market Fcasts Cons	Range	Actual Previous
<b>Monday July 31, 2006</b>							
AU	TD Securities Inflation (11:30 AEST)		Jul				
JPN	Industrial Production (00:50 BST)	Month	Jun	1.5%			-1.3%
		Year		4.4%			3.9%
JPN	Housing starts (06:00 BST)	Year	Jun	6.2%			6.7%
JPN	Construction orders (06:00 BST)	Year	Jun	8.0%			9.1%
UK	Consumer credit & mortgages (09:30 BST)	Consumer credit GNPbn	Jun	1.0	1.0		1.2
		New mortgages ('000s)	Jun	116	115		117
EMU	Confidence indicators (10:00 BST)	Consumer confidence	Jul	-8.0%	-8.0%		-9.0%
		Business climate	Jul	1.3	1.2		1.41
EMU	CPI (10:00 BST)	Year	Jul, flash	2.4%	2.4%		2.5%
UK	Gfk consumer confidence (10:30 BST)	Balance	Jul	-4	-4		-4
US	Chicago PMI (15:00 BST)	S.A. ('000s)	Jul	-92	-30		-49
		N.S.A ('000s)	Jul	10			-138
<b>Tuesday August 01, 2006</b>							
AU	Reserve Bank August Policy-setting meeting		Jul				
AU	AU AiG Performance of Mfg Index		Jul				
AU	AU Building Approvals (11:30 AEST)		Jun	-3.0%	0.2%		3.3%
UK	Nationwide house prices (07:00 BST)	Month	Jul	0.4%	0.5%		0.3%
		Year	Jul	5.3%	5.4%		5.0%
GER	Unemployment (08:55 BST)		Jul				
EMU	PMI Manufacturing (09:00 BST)	Index	Jul	57.0	57.5		57.7
UK	PMI Manufacturing (09:30 BST)	Index	Jul	54.5	54.5		55.1
EMU	Unemployment (10:00 BST)	Rate	Jun	7.9%	7.9%		7.9%
US	Personal income & spending (13:30 BST)	Personal income	Jun	0.7%	0.6%		0.4%
		Personal spending	Jun	0.2%	0.4%		0.4%
		Core PCE deflator - Month	Jun	0.2%	0.2%		0.2%
		Core PCE deflator - Year	Jun	2.2%	2.2%		2.1%
US	Construction spending (15:00 BST)	Month	Jun	0.4%	0.1%		-0.4%
US	ISM manufacturing (15:00 BST)	Month	Jul	54.0	53.5		53.8
		Prices paid	Jul	75.0	75.0		76.5
US	Pending home sales (15:00 BST)	Month	Jun	0.0%	0.0%		1.3%
<b>Wednesday August 02, 2006</b>							
AU	RBA Cash Target (09:30 AEST)		Aug	6.0%	6.0%		6.0%
AU	AU Retail Sales Ex Inflation (11:30 AEST)		Q2	0.5%	0.7%		1.66%
AU	AU Retail Sales (11:30 AEST)		Jun	0.5%	0.5%		-0.3%
EMU	PPI (10:00 BST)	Month	Jun	0.1%	0.2%		0.3%
		Year	Jun	5.6%	5.7%		6.0%

# Weekly Calendar (continued)

Week commencing Monday July 31, 2006

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Range	Actual Previous
<b>Thursday August 03, 2006</b>							
AU	AiG Performance of Service Index		Jul				
EMU	PMI services (09:00 BST)	Index	Jul	60.0	59.8		60.7
UK	PMI services (09:30 BST)	Index	Jul	58.5	58.5		58.7
EMU	Retail sales (10:00 BST)	Month	Jun	1.0%	0.4%		-0.6%
		Year	Jun	1.7%			0.8%
UK	Bank of England rate announcement (12:00 BST)		Aug				
EMU	ECB meeting and press conference Rate announcement (12:45 BST) Press conference (13:30 BST)		Aug				
US	Jobless claims (13:30 BST)	Week ('000s)	Jul 29	300	310		298
US	Factory orders (15:00 BST)	Month	Jun	1.8%	0.9%		0.7%
US	ISM non-manufacturing (15:00 BST)	Month	Jul	58	57		57
<b>Friday August 04, 2006</b>							
AU	AU Reserve Bank Quarterly Monetary Policy Statement (11:30 AEST)						
GER	Factory orders (11:00 BST)	Month	Jun	0.0%	1.4%		-1.2%
		Year	Jun	7.8%	10.0%		10.9%
US	Non-farm payrolls (13:30 BST)	Non-farm payrolls ('000s)	Jul	175	145		121
		Unemployment rate	Jul	4.5%	4.6%		4.6%
		Average hourly earnings – Month	Jul	0.4%	0.3%		0.5%
		Average hourly earnings – Year	Jul	3.9%	3.8%		3.9%
<b>During the Week</b>							
UK	HBOS house prices	Month	Jul	0.6%			-1.2%
		3M/year	Jul	9.0%			9.4%

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 August 07, 2006

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
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)

# Monthly Economic Calendar...(continued)

Week commencing August 07, 2006

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) UK GDP (2Q P) US New Home Sales (JUL) JN National Consumer Prices (JUL)
Monday August 28, 06	Tuesday August 29, 06	Wednesday August 30, 06	Thursday August 31, 06	Friday September 01, 06
EC Euro-Zone M3 (JUL)	AU Conference Board Australia June Leading Index JPN Jobless Rate (JUL) JPN Overall Hhold spending (JUL)	AU Construction Work Done (2Q) AU Retail Sales (JUL) NZ Building Permits (JUL) NZ NBNZ Business Confidence (AUG) UK Mortgage Approvals(JUL) UK CBI August Distributive Trades Report US Consumer Confidence (AUG) US Minutes of Aug. 8 FOMC Meeting US ABC Consumer Confidence (AUG 29) US MBA Mortgage Applications (AUG 26) US ADP Employment Change (SEP 1) US GDP Annualized (2Q P) US GDP Price Index (2Q P) US Personal Consumption (2Q P) US Core PCE (2Q P) JPN Retail Trade (JUL)	AU Private Sector Credit (JUL) AU Private Sector Credit (JUL) AU Private Capital Expenditure (2Q) AU Housing Industry Association July New Home Sales UK GfK Consumer Confidence Survey (AUG) US Personal Income (JUL) US Personal Spending (JUL) US PCE Deflator (JUL) US Initial Jobless Claims (AUG 27) US Continuing Claims (AUG 20) JPN Industrial Production (JUL P) JPN Housing Starts (JUL) JPN Construction Orders (JUL) EC Euro-Zone GDP (2Q P) EC ECB Announces Interest Rates (AUG)	AU AiG Performance of Mfg Index (AUG) AU Current Account Deficit (2Q) UK PMI Manufacturing (survey) (AUG) US Factory Orders (JUL) US Chicago Purchasing Manager (AUG) US Bernanke Speaks to Clemson University Leadership Program US Change in Nonfarm Payrolls (AUG) US Unemployment Rate (AUG) US Average Hourly Earnings (AUG) US U. of Michigan Confidence (AUG F) EC PMI Manufacturing (survey) (AUG) EC Euro-Zone Unemployment Rate (JUL)

The research analyst(s) who prepared this report certifies (y) that the views expressed herein accurately reflect the research analyst's(s') personal views about the subject security(ies) and issuer(s) and that no part of his/her/their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.

**Disclaimer**

The research analyst(s) who prepared this report certifies(y) that the views expressed herein accurately reflect the research analyst's(s') personal views about the subject security(ies) and issuer(s) and that no part of his/her/their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.

*In this publication, HSBC Group means HSBC Bank plc, its subsidiaries and associate undertakings, and any of their branches.*

This document is issued in Australia by HSBC Bank Australia Limited (ABN 48 006 434 162) AFSL No. 232595 and HSBC Bank plc – Sydney Branch (ABN 98 067 329 015) AFSL 232596 (together "HBAU") for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). It makes no representations that the products or services mentioned in this document are available to persons in Australia or anywhere else or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient.

It is issued in New Zealand on behalf of The Hongkong and Shanghai Banking Corporation Limited and is being provided to recipients otherwise than as a member of the "public" under the Securities Act 1978 (the Act). By accepting this document in New Zealand each recipient is deemed to have acknowledged that the recipient is a person whose principal business is the investment of money or the recipient in the course of and for the purposes of the recipient's business habitually invest money in terms of section 3(2)(iii) of the Act. All recipients are prohibited from copying or distributing any material in this document to any person and in particular should not distribute any material in this document to any member of the public in New Zealand in terms of the Act.

Any distribution of this document in the United Kingdom is intended for persons of a kind described in Articles 11(3) of the Financial Services Act 1986 (Investment Advertisements)(Exemptions) Order 1966 (as amended). The protection afforded by the regulatory regime in the United Kingdom are available only to those dealing with a representative of HSBC Bank plc in the United Kingdom.

Any distribution of this document in the United States is intended solely for "major US institutional investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934). Such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. Each major US institutional investor that receives this document by such act agrees that it shall not distribute or provide a copy of this document to any other person.

This document is not and should not be construed as an offer to sell, purchase or subscribe for any investment or a solicitation of such an offer.

The information in this document is derived from sources HBAU believes to be reliable but which have not been independently verified. All charts and graphs are from publicly available sources or proprietary data. HBAU makes no guarantee, representation or warranty and accepts no responsibility or liability as to the accuracy or completeness of any information. HBAU is not responsible for errors of transmission of factual or analytical data, nor shall it be liable for damages arising out of any person's reliance upon any information in this document. The opinions in this document constitute the present judgement of HBAU and are subject to change without notice.

A member of the HSBC Group and its affiliates and/or their officers, directors and employees may have positions in any securities or instruments or related investments mentioned in this document and may from time to time add to or dispose of any such securities instruments or investments. A member of the HSBC Group and its affiliates may act as market maker or have assumed an underwriting commitment in the securities or instruments of any companies, or in any securities or instruments or related investments, mentioned in this document; or may sell or buy them on a principal basis. Brokerage or fees may be earned by a member of the HSBC Group or its affiliates in respect of any business transacted by them in all or any of the securities or instruments referred to in this document. A member of the HSBC Group may also perform or seek to perform banking or underwriting services for or relating to any companies mentioned in this document.

This document is intended to be distributed in its entirety. It may not be further distributed in whole or in part for any purpose.

Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document.

© Copyright. HSBC Bank Australia Ltd 2004, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Bank Australia Ltd. (May 2004)

**HSBC Bank Australia Limited**

**HSBC Centre**  
**580 George Street**  
**Sydney, NSW 2000**  
**Australia**  
**Telephone: +61 2 9006 5888**  
**Fax: +61 2 9255 2205**  
**Website: www.hsbc.com.au**

**The Hongkong and Shanghai Banking Corporation Limited**

**1 Queen Street**  
**Auckland**  
**New Zealand**  
**Telephone: +64 9 308 8888**  
**Fax: +64 9 918 8699**  
**Website: www.markets.hsbc.com**