HSBC

Week Commencing February 26, 2007

AUSTRALIA & NEW ZEALAND WEEKLY

John Edwards
Chief Economist

Phone: +612 9255 2744
john.k.edwards@hsbc.com.au

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www.hsbcnet.com

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Key export, investment data this week

RBA focus now on demand, growth

RBA Governor Glenn Stevens expects demand and output growth to continue "at or a little below trend" over the coming year, a forecast which will be tested by two important releases this week. The first surveys business investment, the main driver of output growth over the past three years. The second is the December quarter balance of payments, which will also reveal the growth of export volumes for that period. One release will complement the other. As Mr. Stevens remarked last week, the high rates of growth of recent years are over. Treasury, RBA and indeed our own forecast of somewhat firmer (though still modest) output growth over 2007 depends on export volumes rising as business investment volumes flatten out. It should have happened already, but as a matter of fact it hasn't. Every year for the past five years Treasury has expected a markedly stronger export performance than was realised, and so have we.

Business investment peaked in the June quarter last year, and fell in the September quarter. The predominant component is equipment spending, which peaked more than a year ago. Spending on buildings and structures continued to increase, but it too began to fall in September. There is nothing remarkable or alarming in this development. Over the last six years Australia has enjoyed an astonishing boom in business investment. Inevitably, it is tapering off. The volume of business investment in the September quarter fell 6%. We expect to see no growth in the volume of business investment in the number released Thursday. It would confirm a gentle decline, which as Mr. Stevens said last week leaves a still high level of business investment contributing to the expansion of physical capital. We should add that the market is looking for an increase in business investment for the fourth quarter. We may well be wrong, and it is true that the increase in capital goods inputs over the quarter is consistent with an improvement in equipment investment. But given that this predominant component of investment has fallen for three successive quarters and a six year upswing preceded the peak, it would be surprising to see as big a bounce back as the market expects.

The flattening in business investment in the quarter is we think unlikely to be offset by a useful increase in export volumes. Over the quarter the value of exports rose only 0.7% while on one ABS measure export prices rose 0.2%. On that basis export volumes rose only 0.5%, another disappointing result. The deflator used in Friday's release may be a little different, but even so export volumes should not be up much more than 0.2%.

Mr. Stevens reiterated last week that household demand firmed in the second quarter. This assertion is not supported by retail sales turnover, which grew more slowly in the second half than the first. Nor is it supported by real household consumption, which grew only modestly in the third quarter and at a lower rate than the average of the first two quarters of the year. We expect to see subdued consumption growth evident again Friday in January retail sales. We expect a 0.4% increase – stronger than January, but not at all flash.

We don't see fourth quarter Australian GDP until next week and much can change as more numbers are published. But at this point it is not looking at all good. Import values rose and import prices fell in the quarter, so the increase in import volumes may have been as high as 6% or 7%. Exports rose only a bit, so net exports may take around 1% or even more off GDP growth. If business investment and residential construction were flat, only consumption and perhaps inventories will be making a positive contribution on the expenditure side. The average GDP measure will be helped by stronger incomes but even so it may not increase at all and may fall. A stronger result than we expect for business investment Thursday is essential to a respectable GDP increase the following Wednesday.

Following Mr. Stevens talk to the House Economic Committee last week, the likelihood that export strength will make up for business investment weakness has become a key question in monetary policy. Over the last few quarters we have focused on contemporary indicators of core inflation as a guide to the RBA's intentions. Mr. Stevens has now made it plain that he is looking at the demand and output indicators. He said then that the Bank board was now "more confident" that inflation would "moderate a little" in the period ahead. But since the Bank's inflation forecast of 2.75% was already above the mid point of the target band, it followed that in Mr. Stevens view an increase in the cash rate was "more likely" than a cut. (This is true only a technical sense, however and in our view the probability of any change is much lower than the probability that with subdued growth and moderating inflation there will be no change at all.) Mr. Stevens also said the economy is operating at "full capacity", it is still "very fully employed" and there would be "some risk of inflation remaining uncomfortably high were demand growth to be unexpectedly strong in the near term". Hence "the outlook for demand, and the extent to which capacity constraints are easing in a range of sectors, must be key elements in forming a judgment about the outlook for inflation, and the appropriate stance of monetary policy".

This statement is the key to both the politics of the May Budget, and the kind of information which will influence the RBA's decisions on rates. It suggests very strongly that an expansionary Budget in May would sharply increase the risks of subsequent interest rate rises. Already appalled by opinion polls suggesting considerable support for the new Opposition Leader Kevin Rudd, the Reserve Bank's signal will not have been welcomed in the Howard Government. Mr. Stevens' remarks also suggest that henceforward the market will have to put relatively more weight on indicators of domestic demand, and relatively less on the evident moderation in contemporary inflation.

There is no revolution here, but there is a subtle change of tone and one that is consistent with Mr. Steven's past emphasis on the rate of growth of domestic demand as a key element in inflation forecasting at a time of full employment. The message of his opening statement and the early exchanges with members of the committee is that rates are on hold, but may be increased if economic growth and particularly domestic demand proves stronger than the quite moderate increase expected. The implication is that rates might be increased even if contemporary inflation was not accelerating. Given the long decline in housing construction, the beginnings of the downturn in business investment, the long postponed and still not apparent upswing in export volumes and the modest growth in retail sales we doubt demand or output growth will be sufficient to rationalise another rate increase. But Mr. Steven's evidently thinks it is a risk, and it is his finger on the button.

Weak NZ data, high NZD to test market

The Cinderella trade

The last few numbers before the March 8 Reserve Bank of New Zealand *Monetary Policy Statement* are out today and Wednesday. They offer a faint hope of discouraging RBNZ Governor Alan Bollard from another rate increase. Today's January merchandise exports and imports are not seasonally adjusted. The trend rate of growth for exports levelled off mid year while the tend rate of growth of imports has continued to increase. Only a marked drop in both export and import growth would be relevant at this point, and the greater probability is that the flat export trend will continue while the rising trend in imports will slow. January building consents Wednesday will we think continue to fall in seasonally adjusted terms. The series fell in each month of the last quarter of last year. We expect to see another fall for January, of 2%. Even a small increase, however, would still see future residential construction heading down. Another thought which may give pause to the RBNZ is the elevated NZ dollar, which last week actually strengthened on news of the BoJ rate increase. We continue to think a rate increase March 8 would be a mistake, but betting against it is now a Cinderella trade.

John Edwards

Weekly Calendar

Week commencing Monday February 26, 2006

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Range	Actual Previous
Monday February 26, 2006							
NZ	Trade Balance	NZDbn	Jan	-0.63	-0.65	-	-0.43
Tuesday February 27, 2006							
AU	HIA New Home Sales		Jan	-	-	-	6%
NZ	NBNZ Business Confidence (23:00 local time)		Jan	-	-	-	7.7
US	Durable goods orders (13:30 GMT)	Month	Jan	-2.0%	-1.8%	-	3.1%
		Ex-transportation		-0.1%	-0.5%	-	2.3%
US	Consumer confidence (15:00 GMT)	Month	Feb	107	109	-	110.3
US	Existing home sales (15:00 GMT)	Month (m)	Jan	6.25	6.24	-	6.22
Wednesday February 28, 2006							
AU	Private Sector Credit (11:30 AEST)		Jan	1%	1%	-	0.9%
AU	Construction Work Done (11:30 AEST)		Q4	-	1.5%	-	-2.1%
NZ	Building Permits (10:45 local time)		Jan	-2%	-	-	-4.9%
JP	Industrial production (23:50 GMT)	Month	Jan, prelim	-3.0%	-1.5%	-	0.9%
		Year		1.4%	3.7%	-	4.8%
JP	Retail sales (23:50 GMT)	Large stores	Jan	-2.6%	-0.5%	-	-2.4%
		Retail trade		0.2%	0.2%	-	-0.2%
JP	Housing starts (05:00 GMT)	Year	Jan	7.0%	3.7%	-	10.2%
JP	Construction orders (05:00 GMT)	Year	Jan	5.0%	-	-	0.4%
UK	Gfk consumer confidence (10:30 GMT)	Balance	Feb	-7.0	-7.0	-	-7.0
US	GDP (13:30 GMT)	Quarter	Q4, 2nd est	2.3%	2.3%	-	3.5%
		GDP deflator		1.5%	1.5%	-	1.5%
US	Chicago PMI (14:45 GMT)	Month	Feb	50.0	50.0	-	48.8
US	New home sales (15:00 GMT)	Month (000s)	Jan	1080	1090	-	1120
Thursday March 01, 2006							
AU	AiG Performance of Mfg Index		Feb	-	-	-	51.3
AU	Private Capital Expenditure		Q4	0%	3.8%	-	-6%
AU	RBA Commodity Index SDR		Feb				
NZ	Visitor Arrivals		Jan				
EMU	PMI manufacturing (09:00 GMT)	Index	Feb	56.0	55.7	-	55.5
UK	PMI manufacturing (09:30 GMT)	Index	Feb	54.0	53.0	-	52.8
EMU	HICP (10:00 GMT)	Month	Feb, flash	0.4%	-	-	-
		Year		1.9%	1.9%	-	-
UK	CBI distributive trades report (11:00 GMT)	Reported sales (% net balance)	Feb	+18	+21.5	-	+30.0
US	Personal income & spending (13:30 GMT)	Personal income	Jan	0.3%	0.3%	-	0.5%
		Personal spending		0.4%	0.4%	-	0.7%
	Core PCE Deflator	Month		0.3%	0.2%	-	0.1%
		Year		2.4%	2.3%	-	2.2%
US	Initial jobless claims (13:30 GMT)	Week (000s)	Wk 24 Feb	330	-	-	332
US	ISM manufacturing (15:00 GMT)	Month	Feb	49.0	50.0	-	49.3
		Prices paid		54.0	54.0	-	53.0
US	Construction spending (15:00 GMT)	Month	Jan	-0.5%	-0.5%	-	-0.4%

Weekly Calendar (continued)

Week commencing Monday February 26, 2006

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Range	Actual Previous
Friday March 02, 2006							
AU	Retail sales (11:30 AEST)		Jan	0.4%	0.5%	-	0.3%
AU	Balance of payments – current account (11:30 AEST)	Quarter (AUD)	Dec	14.7bn	14bn	-	-12.08bn
JP	CPI (23:30 GMT)	Total – month (sa)	Jan/Feb	0.2%	-0.1%	-	0.0%
		Total - year		0.2%	0.0%	-	0.3%
		Core – month (sa)		0.2%	-0.1%	-	-0.1%
		Core - year		0.2%	0.0%	-	0.1%
US	University of Michigan confidence (15:00 GMT)	Month	Feb, final	93.0	93.7	-	93.3
During the Week							

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 Monday March 05, 2007

Monday March 05, 07	Tuesday March 06, 07	Wednesday March 07, 07	Thursday March 08, 07	Friday March 09, 07
AU AiG Performance of Service Ind (FEB) AU TD Securities Inflation (FEB) AU Company Operating Profit (4Q) AU Inventories (4Q)	AU Trade Balance (JAN) AU Building Approvals (JAN) AU Exports (JAN) AU Building Approvals (JAN) AU Imports (JAN) NZ ANZ Commodity Price (JAN) UK BRC February Retail Sales Monitor US ISM Non-Manufacturing (FEB)	AU AiG Perf of Construction Index (FEB) AU RBA CASH TARGET (MAR) AU Gross Domestic Product (4Q) UK Bank of England's Monetary Policy Committee Meets US Unit Labor Costs (4Q F) US Pending Home Sales (JAN) US Factory Orders (JAN) US ABC Consumer Confidence (MAR 5) US MBA Mortgage Applications (MAR 3)	NZ RBNZ Official Cash Rate (MAR 8) NZ Terms of Trade Index (4Q) UK BOE announces rates (MAR 9) US Fed's Beige Book US Consumer Credit (JAN) EC ECB Announces Interest Rates (MAR)	AU Home Loans (JAN) AU Investment Lending (JAN) UK Industrial Production (JAN) US Initial Jobless Claims (MAR 4) US Continuing Claims (FEB 25) JN Machine Orders (JAN) JN Machine Orders (JAN) EC Euro-Zone OECD Leading Ind. (JAN)
Monday March 12, 07	**Tuesday March 13, 07**	**Wednesday March 14, 07**	**Thursday March 15, 07**	**Friday March 16, 07**
AU ANZ Job Advertisements (FEB) NZ Food Prices (FEB) UK PPI Input s.a. (FEB) UK DCLG UK House Prices (JAN) JN Gross Domestic Product (Q4 F) JN Current Account Total (JAN) JN Adjusted Current Account Total (JAN)	AU NAB Business Conditions (FEB) NZ Retail Sales (JAN) US Advance Retail Sales (FEB) UK RICS House Price Balance (FEB) UK Total Trade Balance (GBP/Mln) (JAN) EC ZEW Survey (Econ. Sentiment) (MAR)	AU Westpac Consumer Confidence (MAR) US ABC Consumer Confidence (MAR 12) US MBA Mortgage Applications (MAR 10) US Current Account Balance (Q4) JN Industrial Production (JAN F)	AU Consumer Inflation Expectation (MAR) AU Employment Change (FEB) US Producer Price Index (FEB) US Initial Jobless Claims (MAR 11) US Continuing Claims (MAR 4) US Empire Manufacturing (MAR) EC ECB Publishes Mar. Monthly Report (Text) EC Euro-Zone CPI (FEB)	AU Preliminary BoP Imports (FEB) US Total Net TIC Flows (JAN) US Philadelphia Fed. (MAR) US Consumer Price Index (FEB)
Monday March 19, 07	**Tuesday March 20, 07**	**Wednesday March 21, 07**	**Thursday March 22, 07**	**Friday March 23, 07**
UK Rightmove House Prices (MAR) JN BoJ Monetary Policy Meeting	AU Dwelling Starts (4Q) NZ Visitor Arrivals (FEB) UK CPI (FEB) US Housing Starts (FEB) US Building Permits US NAHB Housing Market Index (MAR) JN BOJ Target Rate (MAR 20) JN BoJ Monthly Report	AU DEWR Skilled Vacancies (MAR) AU Westpac Leading Index (JAN) AU New Motor Vehicle Sales (FEB) NZ Credit Card Spending (FEB) US ABC Consumer Confidence (MAR 19) US MBA Mortgage Applications (MAR 17) UK Bank of England Minutes UK U.K. CBI March Industrial Trends Survey	US Fed's Open Market Committee Meets on Interest Rates, Economy US FOMC Rate Decision Expected (MAR 22) US Initial Jobless Claims (MAR 18) US Continuing Claims (MAR 11) UK Retail Sales (FEB) JN Merchnds Trade Balance Total (FEB) JN BSI Large Manufacturing (1Q)	JN All Industry Activity Index (JAN)

Monthly Economic Calendar (continued)

Week commencing Monday March 05, 2007

Monday March 26, 07	Tuesday March 27, 07	Wednesday March 28, 07	Thursday March 29, 07	Friday March 30, 07
NZ Trade Balance (FEB) NZ Imports (FEB) NZ Exports (FEB) UK Nat'wide House prices (MAR) JN BoJ Monetary Policy Meeting Minutes for February 6-29 MARCH NZ Westpac NZ Consumer Confidence (1Q)	AU HIA New Home Sales (FEB) UK Total Business Investment (4Q F) US New Home Sales (FEB) US S&P/CaseShiller Home Price (JAN)	NZ Building Permits (FEB) UK GDP (4Q F) UK Current Account (4Q) US Consumer Confidence (MAR) US Richmond Fed Manufact. Index (MAR) US ABC Consumer Confidence (MAR 26) US MBA Mortgage Applications (MAR 24) US Durable Goods Orders (FEB) US Durables Ex Transportation (FEB)	NZ Current Account Balance (4Q) NZ NBNZ Business Confidence (FEB) UK Mortgage Approvals (FEB) UK CBI March Distributive Trades Survey JN Retail Trade (FEB) US Initial Jobless Claims (MAR 25) US GDP Annualized (4Q F) US Personal Consumption (4Q F)	AU Private Sector Credit (FEB) AU Private Sector Credit (FEB) NZ Gross Domestic Product (4Q) UK GfK Consumer Confidence Survey (MAR) US Personal Income (FEB) US Personal Spending (MAR) US PCE Deflator (FEB) US Chicago Purchasing Manager (MAR) JN Overall Hhold Spending (FEB) JN Natl SA CPI (FEB) JN Industrial Production (FEB P) EC Euro-Zone Consumer Confidence (MAR)

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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