

Week Commencing June 11, 2007



# AUSTRALIA & NEW ZEALAND WEEKLY

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# RBA's Stevens key speech Thursday

## Pondering a July tightening

When announced in early May RBA Governor Glenn Stevens Thursday speech on the economic outlook was probably planned as a routine performance in which he would reiterate the views already expressed in the May 4 *Statement on Monetary Policy*. No longer. Last week's first quarter GDP and May employment reports, cash rate increases in Europe and New Zealand and the bond and equity market sell-offs have imposed an entirely different context for the speech. There is accordingly now a serious possibility that he will use the opportunity to prepare the ground for rate increase as soon as next month. If he does not begin to prepare the ground Thursday, he runs a real risk of being unable to move until next year.

Following on last Wednesday's reported 1.6% increase in first quarter GDP, Thursday's May jobs number substantially increased the pressure on Mr. Stevens. We expected an employment increase of 10,000, after the exceptionally large April increase of just under 50,000. Instead the increase in jobs was 39,400. Full time employment rose an astonishing 66,800 in the month. Part time employment fell 27,400, confirming the recent trend for part time workers to convert to full time workers as the labour market tightens. Unemployment fell from an exceptionally low 4.3% to 4.2% - a number last seen before many of today's employees were born. Workforce participation, however, increased. In the year to May employment has increased 3.1% in the last year. You don't need to think there is a specific rate of unemployment associated with a sudden acceleration of wages growth (and we don't) to recognise that continuing employment growth of this order was not part of the outlook offered in either the May 4 *Statement on Monetary Policy* or the Budget economic forecasts the following week. (The increasing salience of wages data means Tuesday's federal government report on collective bargaining wage increases in the first quarter will get much more attention than usual)

The pattern and strength of first quarter GDP was also unexpected, though that report was we think painfully misinterpreted. The apparent big increase in private sector investment for example is distorted by the inclusion of Telstra, and public corporations investment is correspondingly reduced. The contribution of non-dwelling investment overall was a substantial 0.4% but very much less than the 1.2% contribution of business investment alone. Of the 1.6% increase in GDP 0.5% was contributed by increased inventories. Though a little better than in recent quarters, the 1.4% increase in export volumes in the quarter was still derisory. Far from showing strong increases in production the first quarter saw further fall in rural output, a fall in manufacturing output, and the weakest increase in mining output (0.7%) in five quarters. The production strength was in retail trade, accommodation and so forth, which

corresponded to the major contribution to GDP growth (0.9%) coming from increased household consumption.

The 1.5% increase in household consumption was the biggest since Australia came out of what the central bank regarded as an unsustainable consumption boom three years ago. This big contribution from strong household consumption is what will bother the RBA. It will also be bothered by the further fall in unemployment and the startling increase in employment. It hasn't yet happened, but the threat of accelerating wages growth continues to worry the RBA.

There is no doubt the Australian economy is doing well. Mr. Stevens must now be thinking, however, that it will do just as well but for even longer if monetary policy was a little more restrictive. It is certainly evident that the three rate increases last year have not made it so. In responding to the evident strength of demand, however, Mr. Stevens confronts several difficult issues. One is about the strategy of monetary policy. Like the Federal Reserve but unlike the Reserve Bank of New Zealand, the Reserve Bank of Australia likes to feel its way. It puts little weight on model based forecasts for output gaps and their supposed link to inflation a year or so ahead. It has preferred where possible to link the timing of cash rate changes to consumer price index news, partly to link the two in the public mind but also because it values contemporary core inflation as an indicator of where headline inflation will be in several quarters. But the RBA and particularly Mr. Stevens have always been attentive to the pace of domestic demand, and the RBA in recent years has repeatedly stressed the increased inflation risks after nearly sixteen years of continuous expansion, very low unemployment and evident capacity constraints in some areas.

Last year Mr. Stevens worked around the conundrum that inflation was rising but GDP growth was faltering. His argument for rate increases then was that inflation was too high, and the growth pause temporary. He now has the opposite problem. Growth has accelerated, while inflation has moderated. The second quarter CPI published towards the end of July will likely be moderate, like the first quarter CPI published late April. If Mr. Stevens waits until the August RBA meeting a tightening might well be blocked by a very modest inflation report. In normal circumstances he could wait until later in the year, but each passing month brings him closer to the end year election campaign and increases the volume of political controversy which would follow a tightening. This is why a July tightening is a serious risks – before the CPI, and well before the campaign gets under way. If Mr. Stevens is now figuring on July it ought to be apparent Thursday.

# The RBNZ style

## Beyond 8%

The stark difference between the style of the Reserve Bank of Australia and the style of the Reserve Bank of New Zealand was evident last week as RBNZ governor Alan Bollard took the cash rate to 8%. One reason Dr Bollard is forced to impose such a lofty rate is that New Zealanders are so little affected by it. They are smart enough to borrow fixed, and the increase in three year fixed rate loans over the last few years has been very much less than the increase in the cash rate. But another reason is stylistic. Australia and New Zealand have very similar inflation rates, in both core and headline terms. The trajectory is also similar, and both measures in both economies have been moderating in the last few quarters. There is an apparent difference in the inflation target, in that New Zealand's is 1% to 3% and Australia's between 2% and 3%, but in practice both agree that 2.5% is a very satisfactory outcome. Yet despite these similarities of contemporary inflation experience and of inflation targets, the New Zealand cash rate is now 1.75% above Australia's. It's true Australia's may well go higher, but so may New Zealand's. The philosophical difference which explains part of the cash rate gap is aptly expressed in last week's RBNZ *Monetary Policy Statement*, which declares with unambiguous clarity that "a sustained period of slower growth will be needed to alleviate inflation pressures". These "inflation pressures", it is evident on a reading of the text, are actually output or demand pressures, which in RBNZ thinking are effectively the same thing as inflation pressures. This is the style of thinking which arises from basing inflation forecasts strictly on output gap forecasts. Even if they thought it, RBA officials would be reluctant to declare that Australia needed a prolonged period of slower growth to alleviate inflation pressures. They would be particularly reluctant if in fact inflation had moderated, as it has in both Australia and New Zealand. The RBA this week may well move a little closer to the RBNZ position, emphasising that strengthening demand at a time resources are fully employed risks higher inflation. For its part, however, the RBNZ is content to conflate inflation and output growth, leaving it reluctant to address the fact that while output growth may be stronger than it expected, core inflation is not.

**John Edwards**

# Weekly Calendar

Week commencing Monday June 11, 2007

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Actual Previous
<b>Monday June 11, 2007</b>						
AU	Public holiday Queen's Birthday					
NZ	Terms of Trade Index		Q1			
UK	PPI (09:30 BST)	Input month	May	1.2%	1.2%	0.7%
		Year		1.4%		-0.2%
UK	DCLG house prices (09:30 BST)	Year	Apr	10.9%		10.9%
<b>Tuesday June 12, 2007</b>						
AU	NAB Business Confidence		May			
AU	Trends in Federal Enterprise Bargaining		Q1	3.9%		3.7%
UK	CPI (09:30 BST)	CPI – year	May	2.5%	2.6%	2.8%
		CPI - month		0.3%	0.4%	0.5%
UK	Trade in goods and services (09:30 BST)	Global (GBPbn)	Apr	-7.0	-7.0	-7.0
		Non-EU27		-4.0		-4.0
EMU	Industrial production (10:00 BST)	Month	Apr	-0.2%	0.2%	0.4%
		Year		4.1%	4.3%	3.7%
<b>Wednesday June 13, 2007</b>						
AU	Westpac Consumer Confidence		Jun			
NZ	Food Prices		May			
JP	Current account balance (00:50 BST)	NSA (JPYbn)	Apr	2140.0	1755.3	3317.2
CHI	Retail sales (03:00 BST)	Year	May	15.3%	15.3%	15.5%
JP	Industrial production (05:30 BST)	Month	Apr, final	-0.1%	-0.1%	-0.1%
		Year		2.3%		2.3%
UK	Unemployment (09:30 BST)	<b>Claimant count</b> Change (000's)	May	-5.0	-9.0	-15.7
		<b>ILO</b> Rate		2.8%	2.8%	2.8%
UK	Average earnings (09:30 BST)	Rate	Apr	5.5%	5.5%	5.5%
		Headline (3m-Year)	Apr	4.4%	4.5%	4.5%
		Ex. bonus		3.5%	3.7%	3.7%
US	Retail sales (13:30 BST)	Headline	May	0.6%	0.7%	-0.2%
US	Business inventories (15:00 BST)	Month	Apr	0.4%	0.3%	-0.1%
US	Fed's Beige Book (19:00 BST)					
<b>Thursday June 14, 2007</b>						
AU	Consumer Inflation Expectation		Jun			
AU	RBA's Stevens speaks on Economic Outlook					
NZ	Retail Sales		Apr	-0.3%	0.0%	1.3%
UK	RICS housing market survey (00:01 BST)	Prices rising / falling (Net balance)	May	+26.0	+25.0	+28.9
CHI	Industrial production (03:00 BST)	Year	May	17.5%	17.0%	17.4%
SWI	SNB rate announcement (08:30 BST)	3-month target rate	Jun	2.50%	2.50%	2.25%
UK	Retail sales (09:30 BST)	Month	May	0.4%	0.4%	-0.1%
		Year		3.9%	3.9%	4.2%
US	PPI (13:30 BST)	<b>Core</b> Month	May	0.2%	0.2%	0.0%
		Year		1.6%	1.5%	1.5%
US	Initial jobless claims (13:30 BST)	Week (000's)	Wk 9 Jun	315		309

# Weekly Calendar (continued)

Week commencing Monday June 11, 2007

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Actual Previous
Friday June 15, 2007						
NZ	Manufacturing Activity		Q1			
JP	BoJ rate announcement	Overnight call rate	Jun	0.50%	0.50%	0.50%
CHI	Fixed asset investment (03:00 BST)	Year-to-date	May	25.8%	25.2%	25.5%
US	CPI (13:30 BST)	<b>Headline</b> Month	May	0.6%	0.6%	0.4%
		Year		2.7%	2.6%	2.6%
		<b>Core</b> Month	May	0.16%	0.2%	0.2%
		Year		2.3%	2.3%	2.3%
US	Current account balance (13:30 BST)	Quarter (USDbn)	Q1	-201.0	-202.8	-195.8
US	Empire manufacturing (13:30 BST)	Month	Jun	12.0	10.5	8.0
US	Industrial production (14:15 BST)	Industrial production	May	0.1%	0.2%	0.7%
		Capacity utilisation		81.5%	81.5%	81.6%
US	University of Michigan confidence (15:00 BST)	Month	Jun, prelim	87.0	88.0	88.3

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 June 18, 2007

Monday June 18, 07	Tuesday June 19, 07	Wednesday June 20, 07	Thursday June 21, 07	Friday June 22, 07
4-29 JUNE UK Nat'wide House prices sa (JUN)	AU Preliminary BoP Imports (MAY) US NAHB Housing Market Index (JUN) US Housing Starts (MAY) US Building Permits (MAY) EC ZEW Survey (Econ. Sentiment) (JUN)	AU Westpac Leading Index (APR) AU DEWR Skilled Vacancies (JUN) AU Dwelling Starts (1Q) NZ Visitor Arrivals (MAY) UK Bank of England Minutes UK CML, BBA & BSA Mortgage Lending Figures US MBA Mortgage Applications (JUN 16) US ABC Consumer Confidence (JUN 18) JN All Industry Activity Index (APR) JN BoJ Monetary Policy Meeting Minutes for May	US Continuing Claims (JUN 10)	NZ Credit Card Spending (MAY) US Philadelphia Fed. (JUN)
Monday June 25, 07	Tuesday June 26, 07	Wednesday June 27, 07	Thursday June 28, 07	Friday June 29, 07
	NZ Westpac NZ Consumer Confidence (2Q) US Existing Home Sales (MAY) EC ECB Euro-Zone Current Account (APR)	NZ Trade Balance (MAY) UK CBI June Distributive Trades Report US MBA Mortgage Applications (JUN 23) US Durable Goods Orders (MAY) US New Home Sales (MAY) US Consumer Confidence (JUN) US Richmond Fed Manufact. Index (JUN) JN Retail Trade (MAY)	AU Job vacancies (MAY) NZ Current Account Balance (1Q) NZ Building Permits (MAY) US Initial Jobless Claims (JUN 24) US Fed's Open Market Committee Meets on Interest Rates, Economy JN Industrial Production (MAY P)	AU Private Sector Credit (MAY) NZ NBNZ Business Confidence (JUN) NZ Gross Domestic Product (1Q) UK GfK Consumer Confidence Survey (JUN) UK Current Account (BP) UK Net Lending Sec. on Dwellings (MAY) UK Mortgage Approvals (MAY) US FOMC Rate Decision Expected (JUN 29) US Personal Income (MAY) US PCE Core (MAY) US Chicago Purchasing Manager (JUN) JN Natl CPI (MAY) JN Housing Starts (MAY) EC Euro-Zone Consumer Confidence (JUN) EC Euro-Zone Indust. Confidence (JUN) EC Euro-Zone CPI Estimate (JUN) EC Business Climate Indicator (JUN) EC Euro-Zone Economic Confidence (JUN) EC Euro-Zone Services Confidence (JUN)

# Monthly Economic Calendar (continued)

Week commencing Monday June 18, 2007

Monday July 02, 07	Tuesday July 03, 07	Wednesday July 04, 07	Thursday July 05, 07	Friday July 06, 07
AU AiG Performance of Mfg Index (JUN) AU TD Securities Inflation (JUN) UK PMI Manufacturing (survey) (JUN) UK Index of Services (APR) JN Tankan Lge Manufacturers Index (2Q) EC PMI Manufacturing (survey) (JUN)	AU Building Approvals (MAY) AU Retail Sales (MAY) US ISM Manufacturing (JUN) EC Euro-Zone PPI (MAY)	AU AiG Performance of Service Ind (JUN) AU RBA CASH TARGET (JUL) AU Trade Balance (MAY) UK Nationwide Consumer Confidence (JUN) UK Bank of England's Monetary Policy Committee Meets UK PMI Services (survey) (JUN) US Pending Home Sales (MAY) US Factory Orders (MAY) EC PMI Services (survey) (JUN) EC Euro-Zone Retail Sales (MAY)	UK BoE Announces Rates (JUL 6) US MBA Mortgage Applications (JUN 30) US Initial Jobless Claims (JUL 1) EC ECB Announces Interest Rates (JUL 6)	AU AiG Perf of Construction Index (JUN) UK Industrial Production (MAY) US ISM Non-Manufacturing (JUN) US Change in Nonfarm Payrolls (JUN) US Unemployment Rate (JUN)
Monday July 09, 07	Tuesday July 10, 07	Wednesday July 11, 07	Thursday July 12, 07	Friday July 13, 07
AU ANZ Job Advertisements (JUN) UK PPI Input (JUN)	AU Home Loans(MAY) AU NAB Business Confidence (JUN) NZ NZIER Business Opinion Survey (2Q) UK BRC June Retail Sales Monitor	AU Westpac Consumer Confidence (JUL) US MBA Mortgage Applications (JUL 7) JN Domestic CGPI (JUN) JN Current Account Total (MAY) JN BoJ Monetary Policy Meeting JN Consumer Confidence (JUN)	AU Consumer Inflation Expectation (JUL) AU Employment Change (JUN) UK RICS House Price Balance (JUN) US Trade Balance (MAY) US Initial Jobless Claims (JUL 8) JN BOJ Target Rate (JUL 12) JN Industrial Production (MAY F) EC ECB Publishes Jul. Monthly Report EC Euro-Zone GDP (1Q F)	NZ Retail Sales (MAY) NZ Consumer Prices (2Q) US Advance Retail Sales (JUN) US U. of Michigan Confidence (JUL P) US Business Inventories (MAY)

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