Week Commencing June 18, 2007

HSBC

AUSTRALIA & NEW ZEALAND WEEKLY

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Interpreting the RBA's Stevens

The pieces don't quite fit

Following RBA Glenn Stevens speech last week the market has eliminated the chance of a rate increase next month and sharply reduced it for the rest of this year, while leaving the risk of further tightening next year. The market may well be right, but the pieces don't quite fit together. It is troublingly difficult to reconcile Stevens' views of today's policy risks with no change in the cash rate before the first board meeting next year. That meeting is after all nine months away. For one thing, Mr. Stevens rightly suggested that the strong numbers we have seen this year - which include a 1.6% increase in first quarter GDP, a 4.5% gain in domestic demand in the year to that quarter and another big jobs gain in May - have "given more credence" to the Bank's forecast that inflation will rise next year. He is also (and again rightly) confident that output growth will remain strong. As he said, the US housing bust has had little effect on other elements of US output, and the rest of the global economy is thriving. Australian incomes have been swollen by an improvement in export prices compared to import prices. The property market is "firming again" and borrowing is "proceeding apace". Sooner or later dwelling construction will "pick up" (if it hasn't already done so) because the rate of home construction is below underlying demand. He might have added that exports will also probably pick up, that business investment has not faded in the way earlier expected, and that given the strength of employment, incomes and borrowing, household consumption growth cannot be expected to slow. He didn't offer a GDP forecast, but if he did it would surely have to have increased to at least 4% in 2008 – well above the rate the RBA has recently considered consistent with sustainable output growth. He did say that "if strong demand growth persists" the risks of higher inflation will increase. There was nothing at all in his speech to suggest that strong demand growth would not persist. The RBA board, he said, does ask itself whether the "current settings are restrictive enough". Given the strength of demand output and employment growth the answer could only be they are not very restrictive at all. The Bank's core inflation forecast for this year is 2.5%, the mid point of the target range. Mr. Stevens is saying that he now more confidently believes that inflation will move above the mid point of its target range through 2008, given the current setting of the cash rate. This means the cash rate will go up and the only question is when.

The market has rubbed out a tightening soon because Mr. Stevens also seemed to be saying that the moderation of inflation in recent quarters and the decline in the annual headline rate expected through this year (as the big numbers from last year drop out) gives the Bank time to watch and wait. If inflation accelerates it will do so from a lower level. But that is not necessarily true of the core rate. There is no particular reason to expect it to decline in quarterly terms this year. And Mr. Stevens did not change the forecast for it in his speech. It is still forecast to be at the mid point of the band over the four quarters of this year.

In a normal year we would expect the risks to build from month to month and result in a tightening around September or October at the latest. This year isn't normal, however, because there will be a federal election in November or December. Mr. Stevens says the election doesn't matter, but it does. It is quite unreasonable for a central bank to increase interest rates soon before an election campaign, or during it – especially if it can with a little foresight make the move well before. A tightening so heedless of its impact on the fortunes of the government would reflect on the judgment of the Bank, and ultimately undermine its independence That is why we thought the July meeting was a possibility. We have to concede the language used by Mr. Stevens is not consistent with a tightening in two weeks. August will be difficult, because the second quarter CPI result at the end of July will likely be quite moderate and inconsistent with further tightening soon after its release. Then we are through to September and the last quarter of the year, when a rate increase in the presence of a national political contest would require a more dramatic and urgent development in inflation or growth than we are likely to see. Reluctantly we conclude it has to be the February meeting next year - at which point the RBA risks being a long way behind the game. Mr Stevens' does not like to be behind the game – another reason we think the pieces do not quite fit together.

John Edwards

Weekly Calendar

Week commencing Monday June 18, 2007

Country/ Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Actual Previous
Monday June 18, 2007						
US	NAHB housing market index (18:00 BST)	Month	Jun	30	30	30
Tuesday June 19, 2007						
AU	Preliminary BoP Imports		May			
GER	ZEW survey (10:00 BST)	Expectations	Jun	82.0	86.0	88.0
CAN	CPI (12:00 BST)					
US	Housing starts (13:30 BST)	Housing starts (000's)	May	1460	1480	1528
		Building permits		1460	1478	1457
Wednesday June 20, 2007						
AU	Westpac Leading Index		Apr			
AU	DEWR Skilled Vacancies		Jun			
AU	Dwelling Starts		Q1			
NZ	Visitor Arrivals		May			
JP	MoF business outlook survey (00:50 BST)	All industry, large firm	Q2	5.8%		6.2%
SWE	Riksbank rate announcement (08:30 BST)	Rate	Jun	3.50%	3.50%	3.25%
UK	Bank of England minutes (09:30 BST)					
Thursday June 21, 2007						
JP	Trade balance (00:50 BST)	Surplus, NSA	May	581.1	590.0	922.8
UK	CBI industrial trends (11:00 BST)	Volume of output (% net balance)	Jun	+18		+18
US	Jobless claims (13:30 BST)	Week (000's)	Wk 16 Jun	315		311
US	Philadelphia Fed (17:00 BST)	Month	Jun	6.0	6.0	4.2
Friday June 22, 2007						
NZ	Credit Card Spending		May			
GER	IFO business climate (09:00 BST)	Index	Jun	108.3	108.4	108.6

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 25, 2007

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)

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)

Monthly Economic Calendar (continued)

Week commencing Monday June 25, 2007

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)
Monday July 16, 07	**Tuesday July 17, 07**	**Wednesday July 18, 07**	**Thursday July 19, 07**	**Friday July 20, 07**
NZ Consumer Prices (2Q) NZ Food Prices (JUN) US Empire Manufacturing (JUL) EC Euro-Zone CPI (JUN)	AU Preliminary BoP Imports (JUN) UK CPI (JUN) US Fed's Moskow Speaks to Economists in Philadelphia US Producer Price Index (JUN) US PPI Ex Food & Energy (JUN) US Net Long-term TIC Flows (MAY) US Industrial Production (JUN) US Capacity Utilization (JUN) EC ZEW Survey (Econ. Sentiment) (JUL)	AU Westpac Leading Index (MAY) UK Bank of England Minutes UK ILO Unemployment Rate (3mths) (MAY) US NAHB Housing Market Index (JUL) US ABC Consumer Confidence (JUL 16) US MBA Mortgage Applications (JUL 14) US Consumer Price Index (JUN) US Housing Starts (JUN) US Building Permits (JUN) JN BoJ Monetary Policy Meeting Minutes for June	UK Retail Sales (JUN) US Initial Jobless Claims (JUL 15)	AU Import price index (2Q) AU New Motor Vehicle Sales (JUN) AU Export price index (2Q) NZ Visitor Arrivals (JUN) UK GDP (2Q A) US Philadelphia Fed. (JUL) US Minutes of June 28 FOMC Meeting (Text)

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