

Week Commencing October 1, 2007



# AUSTRALIA & NEW ZEALAND WEEKLY

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**The RBA board meets** See page 2  
Not this month, but tightening risk remains

**New Zealand slowing** See page 4  
But not the right way

**Weekly Calendar** See page 5

**Monthly Calendar** See page 6

**Disclaimer & Disclosures** See page 8

# The RBA board meets

Not this month, but tightening risk remains

He won't propose it this month but RBA Governor Glenn Stevens may well tell his board Tuesday there remains a risk he will need to ask for another tightening before the end of the year. It's true that most of the US numbers since Stevens' September 18 speech to the Asia Society have been weak, with durable goods orders, consumer confidence, new home sales and existing home sales all pointing to a further slowdown. It's true that sentiment has turned pessimistic in Germany, and that many analysts have revised down forecasts of growth in Japan. But it's also true that since Mr. Stevens' remarks the Federal Reserve has cut the cash rate 50 basis points to 4.75%, the level it was nearly eighteen months ago. We are not convinced it will be necessary, but there is little doubt that the Fed is prepared to cut further if US growth continues to falter. The European Central Bank has deferred a rate increase, probably for a long time to come. The Bank of England has also deferred a tightening, and may well cut. The structure of global cash rates is now more accommodating than might have been expected when the RBA last tightened August 8.

In his September 18 speech Mr. Stevens speculated that the credit market disruptions of August would leave behind a higher level of domestic interest rates. If so, it could substitute for another RBA tightening. As he remarked "...funding costs for intermediaries have risen beyond the adjustments associated with the rise in the cash rate on 8 August. Some borrowers are being asked to recognise this higher cost in the rates they pay for their loans, a trend that will continue if the higher funding costs persist. Hence it appears, at this stage at least, that we may well observe a further tightening of financial conditions in the Australian economy in the months ahead." The credit turmoil is fading, at least in the Australian market, but wholesale rates do remain higher than they were after the early August RBA tightening. At 6.94% late last week the three month banks bill swap rate was 20 basis points lower than the late August peak, but still 20 points above its pre-crisis level. They fell during the crisis, but bond rates have since increased. Late last week the three year bond yield for example was 10 basis points higher than before the crisis began. Australian bank senior debt costs 35 basis points more than it did before the crisis, and residential mortgage backed securitised debt 22 basis points more. Even so, retail rates are largely unchanged. None of the big banks have increased the variable home loan rate. Nor does there appear to be much change in yields on bank loans to business. Assuming that short term rates have a little way to fall as the markets return to normal, we would still expect

10 to 15 basis points increase in home loans and business lending. Credit availability, however, seems much as usual. RBA figures Friday showed business lending increased 2.7% in August to take annual business credit growth to a lively 22.4%. Housing lending during the month was up 0.9% - higher than the increase in previous month.

But it is in the Australian economic data that Mr. Stevens will be most concerned. As he said September 18 “..going into this episode, the economy was traveling very strongly, with the outlook for growth and inflation being revised higher over recent months. The data since the August decision to lift the cash rate indicate an economy at least as strong as the Board’s assessment at that time, with few signs of that momentum slowing.” The second quarter GDP increase of 0.9% took growth to 4.3% for the year, despite poor exports and falling rural production. Over 270,000 jobs have been created in the twelve months to August. The trend increase in retail sales is quite solid, and for all the distress in the industry the trend in residential building approvals has strengthened in the last five months. The most recent survey of business plans suggested investment will increase over the coming year. Export volumes remain disappointing and may disappoint again this week – but sooner or later they will pick up. Completing our forecasting round last week, we found it hard to expect GDP growth less than 4.8% through this year and 5.5% through next. Both numbers are well above the rates the Treasury and the Reserve Bank have in recent years either expected or thought consistent with low inflation. Food and petrol prices are rising. Import price increases will be offset by the appreciation in the Australian dollar, but over the whole of the September quarter the currency has been down as well as up. We don’t expect the October 24 third quarter consumer price index to force a tightening at the November board meeting, but it is unlikely to be sufficiently modest to take a tightening off the table. Mr. Stevens’ said all he needed to say on September 18 when he concluded that “Given the macroeconomic situation of the Australian economy thus far, some additional restraint would perhaps not be unwelcome. But just how much such restraint will occur as a result of a market tightening in credit conditions is not yet clear. Assessments of how much is warranted could be affected by changes in the international environment as well as by developments in the domestic economy. These are matters the Board will need to grapple with over the period ahead.”

# New Zealand slowing

## But not the right way

At 0.7% the production measure of New Zealand second quarter GDP published Friday rose a little more than our forecast of 0.6%. The through the year gain was 3.1%, and year average 2.2%. As expected the quarterly gain was well down on the first quarter gain of 1.2%. The expenditure measure of GDP was up 0.8%, just a notch below the Australian outcome over the same period. RBNZ Governor Alan Bollard would have been pleased to see that household consumption growth slowed to 0.7% in the quarter, compared to 2.2% in the previous quarter. He might also have been pleased to see that when adjusted for the impact of a single naval ship, import volumes were well down on the previous quarter. But the rest of the components won't please at all. Business fixed investment was down 2.9%, lead by a 5.9% fall in plant machinery and equipment investment. Residential construction by contrast was up, and by a substantial 3.8%. Because of weaker dairy and meat production, exports rose only 0.5% - well below the average of the previous three quarters. Service exports alone, principally tourism, kept exports as a whole from falling. This is not quite the rebalancing Dr Bollard has in mind. More contemporary indicators point to continuing solid demand. New residential construction consents were up in August, and business confidence has improved. The next big number is the third quarter consumer price index October 15 - ten days before the next RBNZ cash rate review. We expect no change in the cash rate at that meeting. The NZ CPI is nine days before the Australian CPI for the same period. Over the last year or so the Australian CPI has pretty closely followed the NZ CPI, especially for the trimmed mean. Ironically the NZ trimmed mean measure, which has persistently prefigured the Australian outcome, is of no interest to the RBNZ, but of every interest to the RBA.

**John Edwards**

# Weekly Calendar

Week commencing Monday September 24, 2007

Country / Region	Event or Economic Release		Period	HSBC	Market F'casts Cons	Actual Previous
<b>Monday October 1, 2007</b>						
AU	Public Holiday		-	-	-	-
UK	Consumer Credit and Mortgages (09:30 BST)	Consumer credit (GBPbn)	AUG	0.5	1.0	1.1
		New mortgages ('000s)	AUG	110	110	115
UK	PMI Manufacturing (09:30 BST)	Index	SEP	55.5	55.5	56.3
US	ISM Manufacturing (15:00 BST)	Index	SEP	53.0	52.5	52.9
		Prices paid	SEP	63.0	62.0	63.0
JN	BOJ Tankan Survey (00:50 BST)	<b>Business outlook Large firms</b>				
		Manufacturers	Q3	22	22	23
		Non-manufacturers	Q3	20	21	22
EC	PMI Manufacturing (09:00 BST)	Index	SEP F	53.2	53.2	53.2
<b>Tuesday October 2, 2007</b>						
AU	Reserve Bank Rate-Setting Board Meeting			-	-	-
AU	AiG Performance of Mfg Index		SEP	-	-	52.4
US	Pending Home Sales (15:00 BST)	Month	AUG	-2.0%	-2.0%	-12.2%
<b>Wednesday October 3, 2007</b>						
AU	RBA Rate Announcement (09:30 AEST)	RBA cash target	OCT	6.5%	6.5%	6.5%
AU	Retail Sales (11:30 AEST)		AUG	0.0%	-	0.9%
AU	Trade Balance (11:30 AEST)	(million)	AUG	-\$1603	-	-\$756
UK	PMI Services (09 :30 BST)	Index	SEP	55.0	57.0	57.6
US	ADP Employment Change (13 :15 BST)	Month ('000)	SEP	100	50	38
US	ISM Non-manufacturing (15 :00 BST)	Index	Sep	54.0	54.8	55.8
EC	PMI services (09 :00 BST)	Index	SEP F	54.0	57.0	54.0
<b>Thursday October 4, 2007</b>						
AU	AiG Performance of Service Ind		SEP	-	-	51.6
AU	Building Approvals (11:30 AEST)		AUG	2%	-	0.4%
UK	Bank of England Rate Announcement (12:00 BST)	Index	OCT	5.75%	5.75%	5.75%
US	Initial Jobless Claims (13:30 BST)	Week ('000)	SEP	310	-	298
			wk 29			
US	Factory Orders (15:00 BST)	Month	AUG	-2.4%	-2.4%	3.7%
EC	ECB Rate Announcement (12:45 BST)	ECB rate	OCT	4.0%	4.0%	4.0%
<b>Friday October 5, 2007</b>						
US	Non-Farm Payrolls (13:30 BST)	Non-farm payrolls ('000)	SEP	140	100	-4
		Unemployment rate	SEP	4.7%	4.7%	4.6%
US	Consumer Credit (20:00 BST)	Month (USDbn)	AUG	8.0	9.6	7.5

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 October 8, 2007

Monday October 8, 07	Tuesday October 9, 07	Wednesday October 10, 07	Thursday October 11, 07	Friday October 12, 07
<p>AU AiG Perf of Construction Index (SEP)            AU ANZ Job Advertisements (SEP)            AU NAB Business Condition Outlook (3Q)            UK PPI Input s.a. (SEP)            UK Industrial Production (AUG)</p>	<p>NZ NZIER Business Opinion Survey (3Q)            NZ ANZ-Business NZ PMI (SEP)            JN Machine Tool Orders (SEP P)            JN Eco Watchers Survey: Outlook (SEP)</p>	<p>AU Westpac Consumer Confidence (OCT)            AU Home Loans (AUG)            AU Investment Lending (AUG)            US IBD/TIPP Economic Optimism (OCT)            US Minutes of September 18 FOMC Meeting (Text)            US ABC Consumer Confidence (OCT 8)            US MBA Mortgage Applications (OCT 6)            JN BoJ Monetary Policy Meeting</p>	<p>AU Consumer Inflation Expectation (OCT)            AU Employment Change (SEP)            UK RICS House Price Balance (SEP)            US Trade Balance (AUG)            US Initial Jobless Claims (OCT 7)            US Import Price Index (SEP)            JN BOJ Target Rate (OCT 11)            JN BOJ Monthly Report            JN Current Account Total (AUG)            EC ECB Publishes Oct. Monthly Report (Text)            EC Euro-Zone GDP s.a. (2Q F)</p>	<p>NZ Retail Sales (AUG)            US Producer Price Index (SEP)            US Advance Retail Sales (SEP)            JN Domestic CGPI (SEP)            JN Consumer Confidence (SEP)</p>
Monday October 15, 07	Tuesday October 16, 07	Wednesday October 17, 07	Thursday October 18, 07	Friday October 19, 07
<p>NZ Food Prices (SEP)            NZ Consumer Prices (3Q)            UK Rightmove House Prices (OCT)            UK DCLG UK House Prices (AUG)            US Empire Manufacturing (OCT)            US Bernanke Speaks at Economic Club of New York            JN Industrial Production (AUG F)</p>	<p>UK CPI (SEP)            US Former Fed's Greenspan Speaks at Orlando Software Conference            US Industrial Production (SEP)            EC ZEW Survey (Econ. Sentiment) (OCT)            EC Euro-Zone CPI (SEP)            EC Euro-Zone CPI - Core (SEP)</p>	<p>AU Westpac Leading Index (AUG)            UK Bank of England Minutes            US NAHB Housing Market Index (OCT)            US ABC Consumer Confidence (OCT 15)            US MBA Mortgage Applications (OCT 13)            US Consumer Price Index (SEP)            US Housing Starts (SEP)            US Building Permits (SEP)            JN Machine Tool Orders (SEP F)</p>	<p>AU Reserve Bank Monthly Bulletin            UK Retail Sales (SEP)            UK BSA Mortgage Approvals SA (SEP)            US Initial Jobless Claims (OCT 14)            US Continuing Claims (OCT 7)            US Fed's Beige Book            AU Preliminary BoP Imports (SEP)</p>	<p>AU Import price index (3Q)            AU Export price index (3Q)            NZ Visitor Arrivals (SEP)            UK GDP (3Q A)            US Philadelphia Fed (OCT)</p>
Monday October 22, 07	Tuesday October 23, 07	Wednesday October 24, 07	Thursday October 25, 07	Friday October 26, 07
<p>AU Producer Price Index (3Q)            US Fed's Kroszner Speaks to Bankers in Washington</p>		<p>AU DEWR Skilled Vacancies (OCT)            AU Consumer Prices (3Q)            UK Nat'wide House prices sa (OCT)            US Richmond Fed Manufact. Index (OCT)            US ABC Consumer Confidence (OCT 22)            US MBA Mortgage Applications (OCT 20)            EC PMI Manufacturing (OCT A)            EC PMI Services (OCT A)</p>	<p>NZ RBNZ Official Cash Rate (OCT 25)            UK Nat'wide House prices nsa (OCT)            US Initial Jobless Claims (OCT 21)            US Durable Goods Orders (SEP)            US Existing Home Sales (SEP)</p>	<p>AU Conference Board Leading Index (AUG)            US New Home Sales (SEP)            US New Home Sales (SEP)            JN Natl CPI (SEP)            JN Industrial Production (SEP P)</p>

# Monthly Economic Calendar (continued)

Week commencing Monday October 8, 2007

Monday October 29, 07	Tuesday October 30, 07	Wednesday October 31, 07	Thursday November 1, 07	Friday November 2, 07
NZ Trade Balance (SEP) UK Mortgage Approvals (SEP) JN Retail Trade (SEP)	NZ Building Permits (SEP) UK U.K. CBI October Distributive Trades Report JN Overall Hhold Spending (SEP)	NZ NBNZ Business Confidence (OCT) UK GfK Consumer Confidence Survey (OCT) US MBA Mortgage Applications (OCT 27) US GDP Annualized (3Q A) US Employment Cost Index (3Q) US S&P/CaseShiller Home Price Ind (AUG) US ABC Consumer Confidence (OCT 29) JN BoJ Monetary Policy Meeting JN BOJ Target Rate (OCT 31) EC Euro-Zone Consumer Confidence (OCT) EC Euro-Zone CPI Estimate (OCT)	AU Trade Balance (SEP) AU Retail Sales (SEP) AU AiG Performance of Mfg Index (OCT) UK HBOS House Price 3Mths/Year (OCT) UK PMI Manufacturing (OCT) US Fed's Open Market Committee Meets on Interest Rates, Economy US Chicago Purchasing Manager (OCT) US Construction Spending (SEP) US NAPM-Milwaukee (OCT) US FOMC Rate Decision Expected (NOV 1) US Personal Income (SEP) US Initial Jobless Claims (OCT 28) US Personal Spending (SEP) US PCE Deflator (SEP)	US Pending Home Sales (AUG) US ISM Manufacturing (OCT) US Change in Nonfarm Payrolls (OCT) EC PMI Manufacturing (OCT)

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