

AUSTRALIA & NEW ZEALAND WEEKLY

John Edwards
Chief Economist

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

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RBA's puzzling growth forecasts

Sources of slowdown not apparent

Commenting summarily on last week's Reserve Bank of Australia's *Statement on Monetary Policy* we overlooked a paragraph on GDP growth forecasts and supposed they had not been offered at all. We were wrong. Having found them, however, we are not convinced that they sit comfortably with the Bank's commentary on the individual components of demand. The Bank's growth forecasts are now more important because, as it reiterated last week, inflation will be hard to contain "if domestic demand does not moderate". Since the Bank is already forecasting that core and headline inflation will still be at the top of its 2% to 3% target range at the next year, only a slowdown in domestic demand will prevent of several more tightenings. The Bank's forecasts suggest the moderation will be achieved. It's commentary on the individual components of demand leave us wondering how.

The Bank thinks overall GDP growth "could be" 3.75% over 2007/08 and 3.5% for 2008/09. The 2008/09 forecast is the same as Treasury's forecast in the recent mid year economic and fiscal outlook (MYEFO), but the 3.75% is now well under the 4.25% revised Treasury forecast in MYEFO. While Treasury has increased the 2007/08 forecast from 3.75% in the May Budget to 4.25% in MYEFO, the RBA has gone exactly the opposite way and cut its forecast from 4.25% in the August *Statement* to 3.75% in last week's *Statement*. The differences may simply be due to changing news about drought, with the RBA noting that the forecast recovery in the farm sector is "now delayed and more gradual" compared to the last *Statement*. It is certainly quite a big difference with Treasury given the forecasts are offered a couple of weeks apart and we are getting on to half way into the fiscal year.

Those numbers are all the Bank offers in the way of GDP forecasts— it does not have numbers for exports, consumption, business investment, home building and so forth. It does, however, comment on these components elsewhere in the *Statement*. We have some trouble reconciling the RBA's comments on the individual components with its view that year average output growth this year will be (or "could be") only 3.75% this year and 3.5% next year. It's true that year average growth for 2006/07 was only 3.4%. Through the year growth was 4.3%, however, and that gives a better sense of the momentum of output growth coming into 2007/08. Though the year growth of 4.3% was achieved despite a 26% fall in farm output, a very modest 2.4% increase in export volumes and 3.8% increase in home construction.

The RBA does expect a slower global economy next year, but not much slower. It notes that the IMF expects world growth to slow to 4.8% next calendar year from 5.2% this year, and that the forecast for

next year is still above the average. Closer to home it says that “Overall the outlook for the domestic economy remains strong, partly reflecting the large increases in the terms of trade in the current commodity cycle”. It notes that household balance sheets are strong, that consumption growth is quite firm, and that “..the Bank’s liaison indicates continued strength in spending across retailers.”. The big driver of 3.9% consumption growth in the year to June was a sharp increase in employment. “Looking ahead” says the Bank “ a number of indicators suggest that strong labour market conditions are set to continue”. It adds that “The strength of labour demand is also evident in employment surveys and the Bank’s liaison with firms, which continue to report strong employment intentions and labour shortages”.

It says that home construction will “remain flat in the short term” but that “..looking further ahead, residential construction activity is expected to pick up as the number of dwellings being built is currently well below estimates of underlying demand”. Business investment has accounted for a good deal of output growth in recent years. The Bank says that “Forward-looking indicators of private business investment suggest further solid growth”, and that “..the current upswing in office construction seems likely to continue for some time yet..”.

The recovery is more muted than assumed in the August Statement, but even so “farm output is expected to rise by around 5% in 2007/08”. Exports were weak in the year to June. The Bank has adjusted reported export values through the year to September by the export price deflator over the period to show export growth strengthened to 5% in the year to the third quarter. It believes that “..resource export volumes are expected to grow strongly in the period ahead..”.

So, if exports are up, home construction is up, farm output expands, business investment is firm and employment is strong, what slows? It’s not clear. It is no doubt true, as the Bank says, that “tighter financial conditions” will trim private spending – but this must surely be compared to what it might otherwise be rather than the experience of 2006/07. There is after all a double round of tax cuts to come into effect in July 2008, to add to the stimulus of rising employment and good export prices. We don’t disagree with any of the RBA’s points about the components of demand, but we do struggle to fit them into a forecast of only 3.75% GDP growth this year slowing the 3.5% the following year. Of course domestic demand is different, because much of the output growth is accounted for by exports. Domestic demand increased 4.5% year average for 2006/07, or 5.6% through the year. It is certainly possible to think that domestic demand growth will slow from 5.6%, but if the Bank is right about business investment, farm incomes, home construction and household consumption, it won’t slow by much.

Perhaps we read the forecasts the wrong way. Unlike other forecasters the RBA is in a position to make its forecasts come true. In that case 3.5% year average growth in 2008/09 could be interpreted as a speed limit and we would expect several more tightenings to enforce it.

We think there is a solid case for the RBA to be more open with its forecasts. There was a time it was reluctant to offer a GDP forecast at all, fearing a public conflict with Treasury. Since it now offering forecasts which appear to be slightly different from Treasury's (though not in the expected direction) it is evidently losing that inhibition. But at a time when the US FOMC is switching from semi-annual indications to quarterly reporting of output forecasts in some detail, and when other central banks routinely offer considerable detail on their forecasts for demand and its components, the RBA continues to offer only the barest outline of a GDP forecast. It may be said that its brief is to focus on inflation, not output. But inflation is not independent of the outlook for the real economy. This is especially true now that the RBA has identified moderation of domestic demand as the key to containing inflation over the next few years.

John Edwards

Weekly Calendar

Week commencing Monday November 19, 2007

Country /Region	Event or Economic Release		Period	HSBC	Mkt F'casts Cons	Actual Previous	
Monday November 19, 2007							
AU	Preliminary BoP Imports		Month			-4.0%	
NZ	New Zealand's October performance of services index						
US	NAHB Housing Market Index (18:00 GMT)	Index	Nov	18	17	18	
Tuesday November 20, 2007							
NZ	Visitor Arrivals		Oct			-3.2%	
UK	CBI industrial trends (11:00 GMT)	Volume of output (% net balance)	Nov	-10		-6	
US	Housing starts (13:30 GMT)	Housing starts ('000s)	Oct	1170	1160	1191	
		Building permits		1200	1190	1261	
US	FOMC minutes (19:00 GMT)						
Wednesday November 21, 2007							
AU	Conference Board Leading Index		Sep			0.7%	
AU	Westpac Leading Index	Month	Sep			0.6%	
AU	Motor vehicle sales	Month	Oct			1.8%	
NZ	Credit card spending	Year	Oct			9.5%	
UK	Bank of England minutes (09:30 GMT)						
US	Initial jobless claims (13:30 GMT)	Month ('000s)	Wk 17 Nov	335		339	
US	University of Michigan confidence (15:00 GMT)	Index	Nov, final	75	75	75	
Thursday November 22, 2007							
US	Public holiday Thanksgiving Day						
GER	GDP (07:00 GMT)	Quarter	Q3, final	0.7%	0.7%	0.3%	
		Year		2.5%	2.5%	2.5%	
UK	Total business investment (09:30 GMT)	Quarter	Q3, prelim	1.5%		0.4%	
		Year		6.1%		7.8%	
Friday November 23, 2007							
JP	Public holiday Labour and Thanksgiving Day						
EMU	PMI surveys (09:00 GMT)	Index	Manufacturing	Nov, flash	51.7	51.0	51.5
			Services		54.5	55.2	55.8
UK	GDP (09:30 GMT)	Quarter	Q3, prelim	0.8%	0.8%	0.8%	
		Year		3.3%	3.3%	3.3%	

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 November 26, 2007

Mon - November 26, 07	Tue - November 27, 07	Wed - November 28, 07	Thur - November 29, 07	Fri - November 30, 07
<p>NZ Trade Balance (OCT) UK Nat'wide House prices (NOV)</p>	<p>UK BBA Loans for House Purchase (OCT)</p>	<p>US MBA Mortgage Applications (NOV 24) US S&P/CaseShiller Home Price Ind (SEP) JN Retail Trade (OCT)</p>	<p>AU Private Capital Expenditure (3Q) NZ NBNZ Business Confidence (NOV) UK U.K. CBI November Distributive Trades Report US Durable Goods Orders (OCT) US Existing Home Sales (OCT) US Fed's Beige Book 11/29 8:45 9) NZ Building Permits (OCT) JN Industrial Production</p>	<p>US Initial Jobless Claims (NOV 25) US GDP Annualized (3Q P) US New Home Sales (OCT)</p>
Mon - December 03, 07	Tue - December 04, 07	Wed - December 05, 07	Thu - December 06, 07	Fri - December 07, 07
<p>AU AiG Performance of Mfg Index (NOV) AU TD Securities Inflation (NOV) AU Trade Balance (OCT) AU Company Operating Profit (3Q) AU Inventories (3Q) UK HBOS House Price 3Mths/Year (NOV) UK PMI Manufacturing (NOV) EC Euro-Zone Unemployment Rate (OCT)</p>	<p>AU Reserve Bank Rate-Setting Board Meeting AU Building Approvals (OCT) AU Retail Sales (OCT) US ISM Manufacturing (NOV)</p>	<p>AU AiG Performance of Service Ind (NOV) AU Gross Domestic Product (3Q) AU Gross Domestic Product (3Q) NZ ANZ Commodity Price (NOV) UK Bank of England's Monetary Policy Committee US ABC Consumer Confidence (DEC 3) US MBA Mortgage Applications (DEC 1)</p>	<p>NZ RBNZ Official Cash Rate (DEC 6) UK Industrial Production (OCT) UK BOE announces rates (DEC 7) US Nonfarm Productivity (3Q F) US Unit Labor Costs (3Q F) US Factory Orders (OCT) EC ECB Announces Interest Rates (DEC 7)</p>	<p>AU AiG Perf of Construction Index (NOV) US Initial Jobless Claims (DEC 2) US Continuing Claims (NOV 25) US ICSC Chain Store Sales (NOV) JN Gross Domestic Product (3Q F)</p>
Mon - December 10, 07	Tue - December 11, 07	Wed - December 12, 07	Thu - December 13, 07	Fri - December 14, 07
<p>AU ANZ Job Advertisements (NOV) AU Home Loans (OCT) UK PPI Input s.a. (NOV) UK DCLG UK House Prices (OCT)</p>	<p>AU NAB Business Confidence (NOV) NZ REINZ House Prices (NOV) UK Total Trade Balance (GBP/Mln) (OCT) US Pending Home Sales (OCT) US Mortgage Delinquencies (3Q)</p>	<p>AU Westpac Consumer Confidence (DEC) AU RBA Governor Glenn Stevens to speak at Sydney institute NZ Food Prices (NOV) US Fed's Open Market Committee Meets on Interest Rates, Economy US FOMC Rate Decision Expected (DEC 12) US ABC Consumer Confidence (DEC 10) US MBA Mortgage Applications (DEC 8) JN Current Account Total (OCT) EC Eurozone Employment</p>	<p>AU Consumer Inflation Expectation (DEC) AU Employment Change (NOV) NZ Retail Sales (OCT) NZ Business NZ PMI (NOV) UK RICS House Price Balance (NOV) UK Retail Sales (NOV) US Trade Balance (OCT) JN Industrial Production (OCT F) EC ECB Publishes Dec Monthly Report (Text)</p>	<p>US Producer Price Index (NOV) US Initial Jobless Claims (DEC 9) JN Tankan Lge Manufacturers Index (4Q) JN Tankan Non-Manufacturing (4Q)</p>

Monthly Economic Calendar (continued)

Week commencing Monday November 26, 2007

Mon – December 17, 07	Tue – December 18, 07	Wed - December 19, 07	Thu – December 20, 07	Fri – December 21, 07
AU Dwelling Starts (3Q) NZ New Zealand's November Performance of Services Index	AU HIA New Home Sales (NOV) AU Preliminary BoP Imports (NOV) NZ NBNZ Business Confidence (DEC) UK CPI (NOV) US Current Account Balance (3Q) US Empire Manufacturing (DEC) US Net Long-term TIC Flows (OCT) US NAHB Housing Market Index (DEC)	AU Westpac Leading Index (OCT) NZ Visitor Arrivals (NOV) UK Bank of England Minutes UK Total Business Investment (3Q F) US Housing Starts (NOV) US Building Permits (NOV) US ECB's Trichet Addresses European Parliament in Brussels US MBA Mortgage Applications (DEC 15) JN BoJ Monetary Policy Meeting	NZ Current Account Balance (3Q) UK GDP (3Q F) UK BSA Mortgage Approvals (NOV) JN Merchnds Trade Balance Total (NOV) JN BOJ Target Rate (DEC 20) JN BOJ Monthly Report 20-24 DEC EC PMI Manufacturing (DEC A) 20-24 DEC EC PMI Services (DEC A)	AU Conference Board Leading Index (OCT) AU New Motor Vehicle Sales (NOV) NZ GDP (3Q) US Initial Jobless Claims (DEC 16) US GDP Annualized (3Q F) US Continuing Claims (DEC 9) US Philadelphia Fed. (DEC)

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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