

AUSTRALIA & NEW ZEALAND WEEKLY

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Australian growth remains strong

Q1 2008 tightening still probable

The downward revision to earlier numbers in the third quarter GDP release together with RBA governor Glenn Stevens statement of reasons for not increasing the overnight rate Wednesday saw the front end of the curve rally last week as the market lost confidence in further tightening in the first quarter of next year. Rate cuts in Canada and the UK added weight to the market view. We read last week's news differently. It's true Mr. Stevens referred to the higher spreads caused by the US subprime fall-out and the possibility that more increases may be passed on to corporates and households. It's true he mentioned that global growth will be "closer to trend" next year, after several years of above trend growth. But these were, after all, exactly the factors widely cited (including by us) in advising that the Bank was unlikely to tighten last week. Mr. Stevens also reiterated, however, that the RBA expected headline and core inflation to be above the top of the 2% to 3% target band in the first half of next year. The simultaneously published minute of the previous board meeting confirms that the Bank's forecast is that inflation will "settle at a rate just above 3% by the end second half of 2008". The Wednesday statement added that "high prices for food, energy and natural resources" pose a risk to global inflation.

In its most recent Statement on Monetary Policy the RBA said lower inflation would need a slowdown in domestic demand growth. After revisions to earlier quarters the annual GDP increase to the third quarter was 4.3%, the same as the year to June. The quarterly rate however was 1%, which was close to the 1.1% we expected (after adjusting for last week's inventories number) and quite a firm result. While the quarterly rate of growth of domestic demand did indeed slow for Q3, the through the year rate accelerated to 5.4% (from 5% in the year to June). This is the fastest rate in three years. The Reserve Bank will also have noticed the acceleration in labour costs in recent quarters. Because productivity growth is down and wages growth is a little faster, the nominal labour cost per unit of output is rising quite quickly. In the year to September it was up 4.1%. In the first half of the period, however, the growth was very slow. The annualized rate for the six months to September was just short of 8%, which is formidable. The Bank is aware that some sources of output growth are likely to be stronger in 2008. Dwelling construction accounted for only one tenth of output growth in the September quarter. With the trend in approvals now increasing, housing is likely to be stronger next year. So too export volumes, which increased only 4.7% in the year to September – not much faster than GDP as a whole. Exports do not add to domestic demand, but sustained profit and wages growth in the commodity sectors does. Put it all together and we think it will take a sharp fall in the global economic outlook to convince the RBA no further rate increases are necessary. We certainly expect slower US growth, but not slow enough for long enough to materially change the outlook for Australian growth through 2008.

Hawkish tone from RBNZ

Inflation forecast higher

As expected Reserve Bank of New Zealand Governor Alan Bollard left the 8.25% cash rate unchanged in last week's review but the accompanying policy assessment in the Monetary Policy Statement was more sombre than we thought likely. Dr Bollard did acknowledge that the housing market has "clearly slowed" but also said that "inflation pressures have increased". He pointed out that oil prices were nearly one third higher than assumed in the September Statement, and "rapidly rising global food prices are likely to result in headline inflation above 3% for much of next year". Dr Bollard is also bothered by the likelihood of considerable tax cuts in the run-up to the 2008 election in New Zealand. The government has proposed an emissions trading scheme which will "add to upside risk on inflation". The discussion in the Statement is more nuanced and detailed but the summary assessment registers only mild concern about global financial and growth risks. It says that global financial markets "remain unusually turbulent, posing significant downside risk for some of our key trading partners". The hawkish tone of the Statement and assessment confirm our view that while the 8.25% cash rate is unlikely to be increased it is unlikely to be cut for some considerable time. As Dr Bollard says "interest rates are now likely to remain around current levels for longer than previously thought". Dr Bollard's assessment today reminds us that the Australian and New Zealand economies, running at the limits of their capacity and with already elevated inflation, face quite different circumstances to those in North America and Europe.

Australian economic policy

Changing form and substance

We'll learn more in RBA Governor Glenn Stevens speech Tuesday and then Treasurer Wayne Swan's Friday but it is already apparent that both the substance and form of Australian economic policy are rapidly changing. The changed communications policy for the central bank is the most dramatic instance of changed procedure. As it announced last week the Bank will henceforth issue a statement following each board meeting, whether or not it changes the cash rate. The statement will be issued at 2.30 in the afternoon of the day the board meets, ending the practice of announcing changes in rates at 9.30 the following morning. Two weeks after each meeting the Bank will issue what it describes as the minutes of the meeting. The minutes are a summary of the Bank's briefing on the current economic circumstances and outlook (sent to board members on the Friday before the monthly Tuesday meeting), together with the Governors recommendation to the board. Individual contributions will not be identified and votes will not be indicated. In the minute published last week very little discussion was

reported. Members of the board were said to “take note” of certain points, discussion was said to “then turn to” another subject, members “judged” and “considered” but if there was any dissent, any questions, any actual exchange of views or discussion, it did not make it to the published minutes. A typical golf club committee meeting could report a more spirited debate. It’s a start, however, and it would be ungrateful for a market economist to complain.

Somewhat greater candour at the RBA was not the only big change. Late last week the Treasurer and the Governor reaffirmed agreement on the central bank’s independence to pursue an inflation target of 2% to 3% “on average over the cycle”. At the same time it was announced that the legislation covering the appointment of the governor and deputy government will be altered so that the appointment is explicitly made by cabinet rather than the treasurer. The power of dismissal will also be taken away from the treasurer. After amendment the governor and deputy can only be dismissed by vote of both houses of parliament within the same session. The changes were said to bring the RBA into line with “international best practice” in “transparency and accountability”. As we pointed out a peculiarity of the Australian arrangements is that the inflation target is now described as a “clearly identified benchmark” but after the promised legislative amendments there will be no practical way of dismissing a governor who fails to meet it. The board cannot sack the governor, and after amendment the treasurer will not be able to either.

The effect of these changes is to markedly enhance the authority of the central bank. The top officials will now share the level of independence now enjoyed by the Commissioner for Taxation. The monthly publication of a minute implicitly extends the scope of RBA influence because of the range of issues discussed. This was apparent in the minute of the November board meeting, for which the Bank had prepared an estimate of the fiscal policy impact of tax cuts proposed on the first day of the election campaign. Hitherto the Bank has been discreet in commenting on fiscal policy. It will remain discreet in testimony and speeches. But the subject has to come up at board meetings, and when it does it will be recorded. So too one would expect to see over time more material on Bank output and demand growth forecasts, which it has been shy of revealing in any detail.

There is no change in the substance of policy at the Bank, as we argue above. It is still bothered by high inflation, which Mr. Stevens identified as the central challenge to monetary policy when he first got the job a little over a year ago. But there has been a change in policy in Canberra. Unlike his predecessor Peter Costello, Labor Treasurer Wayne Swan has identified high inflation as the central challenge to fiscal policy as well. He will go ahead with the promised tax cut from July 1 next year but he and his colleagues are now looking for more substantial cuts to the previous government’s existing spending

plans. He will also give higher priority to those aspects of the Labor program which may in the longer term increase supply, including workforce training and reducing infrastructure bottlenecks. He will presumably have more to say about this approach Friday.

John Edwards

Weekly Calendar

Week commencing Monday December 10, 2007

Country /Region	Event or Economic Release		Period	HSBC	Mkt F'casts Cons	Actual Previous	
Monday December 10, 2007							
AU	ANZ Job Advertisements		Nov				
AU	Home Loans		Oct	3.6%	1.0%	-2.4%	
US	Pending home sales (15:00 GMT)	Month	Oct	-0.5%	-1.0%	0.2%	
Tuesday December 11, 2007							
AU	NAB Business Confidence		Nov				
NZ	REINZ House Prices		Nov				
GER	ZEW survey (10:00 GMT)	Expectations	Dec	-33.0	-35.0	-32.5	
		Current conditions		65.0	66.3	70.0	
US	FOMC rate announcement (19:15 GMT)	Rate	Dec	4.25%	4.25%	4.50%	
JP	Current account balance (23:50 GMT)	Yen (bn)	Oct	2242.8	2063.2	2883.1	
Wednesday December 12, 2007							
AU	Westpac Consumer Confidence		Dec			-4.2%	
AU	RBA Governor Glenn Stevens to speak at Sydney institute						
NZ	Food Prices		Nov				
NOR	Norges Bank rate announcement (13:00 GMT)	Rate	Dec	5.00%			
US	Trade balance (13:30 GMT)	Month (USDbn)	Oct	-57.5	-57.3	-56.5	
US	Import price index (13:30 GMT)	Month	Nov	2.2%	2.0%	1.8%	
		Year		11.5%	11.0%	9.6%	
Thursday December 13, 2007							
AU	Consumer Inflation Expectation		Dec				
AU	Employment Change	000's	Nov	10	20	12.9	
NZ	Retail Sales		Oct	0.5%		1.0%	
NZ	Business NZ PMI		Nov				
UK	RICS house price balance (00:01 GMT)	Prices rising / falling	Nov	-33.0%		-22.2%	
SWZ	SNB rate announcement (08:30 GMT)	Rate	Dec	2.75%	2.75%	2.75%	
US	Initial jobless (13:30 GMT)	Week (000's)	Wk 8 Dec	340		338	
US	Retail sales (13:30 GMT)	Month	Nov	0.6%	0.5%	0.2%	
		Ex-autos		0.7%	0.6%	0.2%	
		Ex-autos & gasoline		0.3%		0.1%	
JP	BoJ Tankan survey (23:50 GMT)	Business Outlook					
		Large Firms					
		Manufacturers	Q4	21	21	23	
		Non-manufacturers		18	18	20	
Friday December 14, 2007							
US	CPI (13:30 GMT)	Headline	Month	Nov	0.6%	0.6%	0.3%
			Year		4.1%	4.1%	3.5%
		Core	Month		0.18%	0.2%	0.2%
			Year		2.2%	2.3%	2.2%
US	Industrial production (14:15 GMT)	Month	Nov	0.2%	0.1%	-0.5%	
		Capacity utilisation	Nov	81.7%	81.7%	81.7%	

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 December 17, 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)
Mon – December 24, 07	Tue – December 25, 07	Wed - December 26, 07	Thu – December 27, 07	Fri – December 28, 07
		JN BoJ Monetary Policy Meeting Minutes	US S&P/CaseShiller Home Price Ind (OCT) US Richmond Fed Manufact. Index (DEC) US ABC Consumer Confidence (DEC 24) 7-31 DEC UK Nat'wide House prices nsa (DEC)	US Initial Jobless Claims (DEC 23) US Durable Goods Orders (NOV) JN Natl CPI (NOV) JN Industrial Production (NOV P) JN Retail Trade (NOV)
Mon – December 31, 08	Tue – January 01, 08	Wed – January 02, 08	Thu – January 03, 08	Fri – January 04, 08
AU Private Sector Credit (NOV)	US Chicago Purchasing Manager (DEC) US Existing Home Sales (NOV) US NAPM-Milwaukee (DEC) US Existing Home Sales (NOV)	US MBA Mortgage Applications (DEC 29) EC PMI Manufacturing (DEC F) 2- 8 JAN - UK HBOS Plc house prices (DEC)	US ISM Manufacturing (DEC) US ABC Consumer Confidence (DEC 31)	UK Mortgage Approvals (NOV) US Initial Jobless Claims (DEC 30) US Factory Orders (DEC) EC PMI Services (DEC F)
Mon – January 07, 08	Tue – January 08, 08	Wed – January 09, 08	Thu – January 10, 08	Fri – January 11, 08
NZ Trade Balance (NOV)	AU Building Approvals (NOV)	AU Retail Sales (NOV) US Fed's Plosser Speaks on Economic Outlook in Pennsylvania US Pending Home Sales (NOV) US MBA Mortgage Applications (JAN 5) EC Euro-Zone GDP (3Q F) EC European Commission GDP Forecasts (Table)	AU Trade Balance (NOV) UK BOE Announces Rates (JAN 11) EC ECB Announces Interest Rates (JAN 11)	US Initial Jobless Claims (JAN 6) US Fed's Hoenig Speaks in Kansas City on U.S. Economic Outlook

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