

AUSTRALIA & NEW ZEALAND WEEKLY

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RBA's *Statement on Monetary Policy*

Too soon to assume another tightening

Today's *Statement on Monetary Policy* will offer more clues but we don't share the widespread view that the Reserve Bank of Australia will soon tighten again. Our view remains that 7% may well be the top. It is, after all, the highest cash rate since the sharp tightening episode in the middle of the last decade. Because of the global reappraisal of risk, the spread between overnight cash and other rates is now wider than it was in the mid nineteen nineties. The standard variable interest rate on home mortgages is now around 9%, which is beginning to be formidable. Offshore, the downturn is sharper than we expected. The declines in US employment growth and measures of industry sentiment have both been very swift. So, too, the deterioration in the outlook for the UK and Europe. In the mid nineteen nineties, when the cash rate was last this high, the Reserve Bank was acting in concert with other central banks to restrain a global boom. It was dealing with an episode in which Australian headline inflation reached 5% and real GDP growth reached 6.5% - well below the 4% or so GDP growth experienced today, or the 3% headline inflation rate.

Contrary to some reports, last week's note by RBA Governor Glenn Stevens explaining the 25 bp tightening left the next move completely open. It did indeed say that inflation would increase, but that was explicitly a reference to through the year inflation rather than the quarterly rate. The annual inflation rate will certainly be higher for the year to March, because very low results for March of last year drop out of the calculation. This is true even if the rate for the quarter ended March is slower than for the quarter ended December. For the trimmed mean, for example, the quarterly increase that drops out is 0.6%, so if the number for the current quarter is 0.8% the annual rate will increase from 3.4% to a scary 3.6%. But 0.8% would be less than the 1% recorded for the December quarter, and the lowest outcome in twelve months. The impact of the arithmetic is even more pronounced for the headline rate because the March quarter 2007 number that drops out is 0.1%. If headline inflation this quarter falls from 0.9% in the December quarter to 0.7% - a pretty good result - the headline annual rate would nonetheless bounce up to 3.5%. Despite the higher annual rates, quarterly rates like these would be an argument against further tightening.

It also true that Mr. Stevens said that lower inflation will require a reduction in demand growth, a statement which figured prominently in excited reporting the following day. But Mr. Stevens said the same three months ago. It is significant, but not new. As it has for many months, everything depends on the evolution of the data. It's true that in all the recent data there has been only one number that even begins to suggest some slowdown. It was quite an interesting number, however, because it occurred in

housing construction. Last week we learned that housing approvals for December fell sharply, breaking a trend increase which had been apparent since mid 2007. Unless the Labour Price Index issued February 20th indicates an acceleration of wages growth, we doubt the RBA will tighten in March. There will not be enough new local data to rationalise a move, and the global data will we expect depict deepening gloom. Since wages growth has been remarkably moderate for a very long time, our best guess is that it will remain so in the February 20th release.

Given the global downturn the next big decision is likely to be the May board meeting rather than March or April. By then the Bank will have seen the first quarter consumer price index (out April 23), the March quarter national accounts (out March 5) and another business investment survey, as well as more on retail sales, credit growth, building approvals and so forth. We would expect by then to see more evidence of a global slowdown, and some hesitation in Australian demand.

Our base case remains that 7% is the top. We freely admit is not at all a confident forecast, and that risk is it could be higher. If the growth numbers remain as firm as they were through 2007, for example, the cash rate could easily reach 7.5% by mid year and 8% by the end of the year. That's not an outcome we expect, but prudent clients will allow for the risk.

Firm NZ data will trouble RBNZ

Wages growth at new high

Australia has been getting more international attention in recent weeks, but the New Zealand story is equally at odds with gloom in the rest of the developed world. Australia is well into the seventeenth year of uninterrupted expansion; New Zealand the tenth. Although RBNZ Governor Alan Bollard doesn't need to make a decision until shortly before his March 6th Monetary Policy Statement he must already be pondering the quite firm results in recent data. There is no doubt housing is continuing to slow. Price growth is falling and time to sale extending in the market for established homes, while approvals sought for new home construction tumbled in the second half of last year. That is one sector going in Dr Bollard's desired direction. But retail sales have been pretty firm, and trend exports have been increasing swiftly despite the high exchange rate. Last week we saw that employment gained in the fourth quarter after falling the third quarter, and unemployment again fell. New Zealand now has the lowest unemployment rate in 20 year history of the statistical series, despite also having the highest participation rate. The number of people with jobs is the highest in New Zealand history. While wages

growth has been fairly moderate despite very low unemployment, towards the end of last year it began to pick up. In the last three months of last year the broadest measure of wages growth increased 1%, to take annual private sector wages growth to 3.5% - a new high in the 4 year history of this series. It would take quite a few strong numbers to persuade Dr Bollard to lift the already high 8.25% cash rate on March 6th. There is a question mark there now that wasn't there two months ago.

John Edwards

Weekly Calendar

Week commencing Monday February 11, 2008

Country /Region	Event or Economic Release		Period	HSBC	Mkt F'casts Cons	Actual Previous
Monday February 11, 2008						
AU	Reserve Bank Quarterly Monetary Policy Statement (11:30)					
AU	Home loans (11:30)		Dec			4.0%
AU	ANZ job advertisements (11:30T)		Jan	-1.0%	-1.0%	7.1%
AU	Investment lending (11:30)		Dec			-2.8%
JP	Public holiday National Foundation Day					
Tuesday February 12, 2008						
AU	NAB business confidence (11:30)		Jan			5
AU	NAB business conditions (11:30)		Jan			17
US	Fed's Poole speaks about being Fed Bank President in St Louis					
UK	CPI (09:30 GMT)	CPI - year	Jan	2.4%	2.3%	2.1%
		RPI - month		-0.6%	-0.6%	0.6%
		RPI - year		4.0%	4.1%	4.0%
		RPIX - year		3.4%	3.3%	3.1%
GER	ZEW survey (10:00 GMT)	Expectations	Feb	-45.0	-43.5	-41.6
		Current conditions		50.0	50.0	56.6
Wednesday February 13, 2008						
AU	Westpac Consumer Confidence		Feb			-8.3%
NZ	Producer Prices (08:45)	Inputs	Q4			2.3%
		Outputs	Q4			1.6%
US	Fed's Yellen speaks on Economy in San Francisco (03:05)					
UK	RICS house price balance (00:01 GMT)	Prices rising / falling (Net bal)	Jan	-62.5%	-	-49.1%
SWE	Riksbank rate announcement (08:30 GMT)	Repo rate	Feb	4.00%	4.00%	4.00%
UK	Bank of England quarterly Inflation Report (10:30 GMT)					
US	Retail sales (13:30 GMT)	Month	Jan	-0.1%	0.0%	-0.4%
		Ex-autos		0.6%	0.2%	-0.4%
		Ex-autos & gasoline		0.6%	-	0.4%
JP	GDP (23:50 GMT)	Quarter	Q4, prelim	0.5%	0.4%	0.4%
		Annualised		1.9%	1.5%	1.5%
		Year		1.2%	-	1.9%
Thursday February 14, 2008						
AU	Consumer inflation expectation		Feb			13.7%
AU	Employment (11:30)	Change	Jan	15k	15k	20.1K
		Unemployment rate		4.3%	4.3%	4.3%
AU	Participation rate (11:30)		Jan	65.2%	65.2%	65.2%
NZ	Food prices (08:45)		Jan			0.9%
NZ	Business NZ PMI (10:00)		Jan			53.8
NZ	Non Resident bond holdings (13:00)		Jan			72.6%
US	Bernanke testimony					
EMU	GDP (10:00 GMT)	Quarter	Q4, advance	0.3%	0.4%	0.8%
		Year		2.2%	2.2%	2.7%
US	Initial jobless claims (13:30 GMT)	(000's) Initial claims (09/02)	Wk 9 Feb	330	-	356
		(000's) Continuing claims (02/02)		2830	-	2785

Weekly Calendar

Week commencing Monday February 11, 2008

Country /Region	Event or Economic Release		Period	HSBC	Mkt F'casts Cons	Actual Previous	
Friday February 15, 2008							
NZ	Retail Sales (08:45)		Month	Dec	0.4%	-	2.0%
			Ex-Auto	Dec	0.4%	-	0.9%
			Ex Inflation	Q4	0.4%	-	2.0%
US	Fed's Evans speaks on US Economic Outlook in Chicago (05:30)						
US	Former Fed Chairman Greenspan on Economy in Houston, Texas (11:30)						
JP	Bank of Japan rate announcement	Overnight call rate	Feb	0.50%	0.50%	0.50%	
US	Empire manufacturing (13:30 GMT)	Index	Feb	11.0	8.0	9.0	
US	Industrial production (14:15 GMT)		Month	Jan	0.1%	0.1%	0.0%
			Capacity utilisation		81.4%	81.4%	81.4%
US	University of Michigan confidence (15:00 GMT)	Index	Feb, prelim	76.0	76.3	78.4	

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 February 18, 2008

Mon – February 18, 08	Tue – February 19, 08	Wed – February 20, 08	Thu – February 21, 08	Fri – February 22, 08
NZ New Zealand's January Performance of Services Index	AU Imports (JAN)	AU Westpac Leading Index (DEC) AU DEWR Skilled Vacancies (FEB) AU Wage Cost Index (4Q)	AU New Motor Vehicle Sales (JAN) AU RBA Foreign Exchange Transactn (JAN)	
Mon – February 25, 08	Tue – February 26, 08	Wed – February 27, 08	Thu – February 28, 08	Fri – February 29, 08
		NZ Building Permits (JAN) AU Construction Work Done (4Q)	AU Private Capital Expenditure (4Q) NZ NBNZ Business Confidence (FEB)	NZ Trade Balance (JAN) AU Private Sector Credit (JAN)
Mon – March 03, 08	Tue – March 04, 08	Wed – March 05, 08	Thu – March 06, 08	Fri – March 07, 08
AU TD Securities Inflation (FEB) AU TD Securities Inflation (FEB) AU Company Operating Profit (4Q) AU Inventories (4Q) AU RBA Commodity Index SDR (FEB)	AU Retail Sales (JAN) AU Current Account Balance (4Q) AU RBA Cash Target (MAR)	AU Gross Domestic Product (4Q)	NZ Reserve Bank of New Zealand Reviews Official Interest Rate AU Trade Balance (JAN) AU Building Approvals (JAN) AU Exports (JAN) AU Building Approvals (JAN) AU Exports (JAN)	AU Foreign Reserves (FEB) 7-13 MARCH NZ REINZ House Sales (FEB)
Mon – March 10, 08	Tue – March 11, 08	Wed – March 12, 08	Thu – March 13, 08	Fri – March 14, 08
AU HIA New Home Sales (JAN) AU ANZ Job Advertisements (FEB)	NZ Terms of Trade Index (4Q) AU Home Loans (JAN) AU Investment Lending (JAN)	NZ Food Prices (FEB) AU Westpac Consumer Confidence (MAR)	NZ Retail Sales (JAN) NZ Retail Sales Ex-Auto (JAN) NZ Business NZ PMI (FEB) AU Consumer Inflation Expectation (MAR) AU Employment Change (FEB) AU Unemployment Rate (FEB) AU Participation Rate (FEB)	NZ Manufacturing Activity (4Q) NZ Non Resident Bond Holdings (FEB)

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