

Australia & New Zealand Economics Weekly

For the week commencing 3 March 2008

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RBA tightening Tuesday

Slowing Australian economy a tough job

In its most recent *Statement on Economic Policy* the RBA forecast that GDP growth would slow sharply from a probable outcome of around 4% through 2007, to 3% through this year and next. The RBA presumably requires this outcome to support its parallel forecast that core inflation can decline from well over 3% in the year to the coming June quarter, to 3% by the end of next year. The forecasts explicitly assume that the cash rate remains at 7%. Given that Australia is now certain to see an upsurge in farm production, that it will highly likely see much stronger mining exports, that household consumption is likely to remain quite firm and that it will be difficult to prevent some recovery in home construction, we very much doubt that the growth and inflation outcomes sought by the RBA will be attained with a cash rate of 7%. We expect it to peak at 7.5%, which was the peak in the tightening episode from 1994 to 1996. We expect a 25 basis point tightening to be announced after the board meeting Tuesday, and highly likely another after next month's board meeting. We cannot rule out increases beyond 7.5%.

Last month the RBA contemplated increasing cash 50bp rather than 25bp. The board will no doubt have a similar discussion Tuesday but we think it will again endorse a 25bp tightening. One reason is the sharp increase in bank funding costs in recent weeks. By the end of last week credit markets were beginning to stabilise, but this is not a good time to experiment with market sentiment. Last week one year funding cost St George Bank 45 basis points over the three month bank bill swap rate, which on Thursday last week popped up to 8%. There is nothing astonishing in St George's funding costs – compared to some of the gloomier market assessments in the last two weeks, it did very well indeed. But if banks fund themselves at 8.5%, they must lend at 10%. The rapid climb of the Australian dollar towards USD0.95 cents late last week is another reason to keep to the usual RBA pattern.

The big bunch of numbers out this week will underline the difficulty of slowing the Australian economy down to the extent required by the central bank. At 5.1%, the fourth quarter increase in business investment revealed last week was stronger than we expected. It came with the survey of investment plans pointing to continuing business investment growth over the coming year. We expect to see fourth quarter GDP up 1.1% in Wednesday's data. Growth through 2007 would then be 4%, and it is not at all obvious how it gets down to 3% by the middle of this year. This week we also see the fourth quarter current account deficit. With strong imports and flat exports, the trade deficit for the quarter was an all time record of \$6.9 billion. Add a plausible income deficit of \$11.6bn and the current account deficit for the quarter will be \$18.5 billion – about 20% bigger than the biggest ever so far. We also expect to see continuing retail sales growth in the January numbers out Tuesday. After the big fall in December we expect to see a small increase in January building approvals out Thursday. It looks like import growth was quite strong in January, and the trade deficit (also published Thursday) may not be much under \$3bn for the month. RBA Assistant Governor Malcolm Edey speaks on the economic outlook Wednesday; Assistant Governor Guy Debelle speaks on financial markets, also Wednesday. Both will be timely. Forecast details in our diary.

RBNZ will leave cash unchanged

Housing slowdown helps

At 3.2% for the year to December and with its own forecasts suggesting only a very gradual decline, retail price inflation is altogether too high for the RBNZ. The housing sector is slowing very rapidly, however, and the central bank will likely be content to leave the 8.25% cash rate unchanged in its review announced Thursday morning. Permits sought for new housing construction rose in January, but they were declining from the middle of last year and are 4.5% down on a year ago. In both December last year and January this year house prices began to slip, while time to sale lengthened and the number of sales fell. Retail sales growth has moderated, especially when the auto sector is excluded and especially compared to the continuing vigour of retail sales in Australia. It's true that export growth has been excellent, with values trending up from February of last year. It's also true that employment is firm and wage growth has picked up. But the wholesale funding market has also done a bit for work. The last RBNZ tightening was July 2007. Since the global financial market troubles started in August bank bills have put on an extra 40 basis. The currency meanwhile has reached a new post-float record high against the US dollar. We do not see a case for additional tightening – but RBNZ Governor Alan Bollard won't miss the opportunity of his Thursday *Monetary Policy Statement* to warn the market the cash rate will be high for quite a while to come.

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Note to readers

Dr Edwards has been granted leave of absence from HSBC to spend some time as a visiting adviser on financial markets in the Australian Commonwealth Treasury Macroeconomic Group. The Australia & New Zealand Economics Weekly will resume publication when he returns.

Weekly calendar

Events & economic releases

Week commencing Monday, 03 March 2008

Country/ region	Event or economic release		Period	HSBC	Market consensus	Actual previous
Monday, 03 March						
AU	TD securities inflation (10:30)	Month	Feb	-	-	0.3%
		Year	Feb	-	-	3.9%
AU	AiG Performance of Mfg index (09:30)		Feb	-	-	49.2
AU	Company operating profit (11:30)	Quarter	Q4	-	-	-2.1%
AU	Inventories (11:30)		Q4	-	-	1.3%
AU	RBA commodity index SDR (16:30)	Year	Feb	-	-	5.2%
US	ISM manufacturing (15:00 GMT)	Index	Feb	47.0	49.0	50.7
		Prices paid	Feb	72.0	72.0	76.0
Tuesday, 04 March						
AU	Retail sales (11:30)		Jan	0.4%	-	0.5%
AU	Current account balance (11:30)		Q4	-18,500m	-	-15,587m
AU	RBA rate announcement (14:30)	RBA cash target	Mar	7.25%	7.25%	7.00%
NZ	ANZ commodity price (13:00)		Feb	-	-	-1.4%
CAN	BoC rate announcement (14:00 GMT)	BoC rate	Mar	3.75%	3.50%	4.00%
JP	MoF corporate survey (23:50 GMT)	Private capital exp (yr)	Q4	-3.9%	-	-1.2%
Wednesday, 05 March						
AU	Assistant RBA Governor Edey gives speech on economy (09:00)					
AU	AiG Performance of service index (09:30)		Feb	-	-	54.9
AU	Gross domestic product (11:30)	Quarter	Q4	1.1%	-	1.0%
		Year	Q4	-	-	4.3%
AU	Assistant RBA Govern Debelle gives speech on Bond Market (14:00)					
NZ	RBNZ rate announcement	Official cash rate	Mar	8.25%	8.25%	8.25%
US	ADP employment change (13:15 GMT)	Month ('000s)	Feb	-50	40	126
US	ISM non-manufacturing (15:00 GMT)	Composite index	Feb	46.5	48.3	44.6
US	Factory orders (15:00 GMT)	Month	Jan	-2.5%	-1.0%	2.3%
US	Fed's Beige Book (19:00 GMT)					
Thursday, 06 March						
AU	Trade balance (11:30)		Jan	-2900m	-	-1936m
AU	Building approvals (11:30)	Month	Jan	2.0%	-	-16.0%
		Year	Jan	-	-	-0.9%
AU	Exports (11:30)	Month	Jan	2.0%	-	1.3%
AU	Imports (11:30)	Month	Jan	6.0%	-	0.1%
NZ	New Zealand tax receipts for January					
GER	Factory orders (11:00 GMT)	Month	Jan	0.4%	-0.3%	-1.7%
		Year	Jan	11.0%	9.9%	10.2%
UK	Bank of England rate announcement (12:00 GMT)	Bank rate	Mar	5.25%	5.25%	5.25%
EMU	ECB rate announcement (12:45 GMT)	ECB rate	Mar	4.00%	4.00%	4.00%
EMU	ECB press conference (13:30 GMT)		Mar			
US	Initial jobless claims (13:30 GMT)	Initial claims (01/03)	Wk 1 Mar	360	-	373
		Continuing claims (23/02)	Wk 1 Mar	2,860	-	2,807
US	Pending home sales (15:00 GMT)	Month	Jan	-1.0%	-0.5%	-1.5%
Friday, 07 March						
AU	AiG Performance of construction index (09:30)		Feb	-	-	58.3
AU	Foreign reserves (16:30)		Feb	-	-	A\$35.8B
JP	BoJ rate announcement	BoJ target rate	Mar	0.50%	0.50%	0.50%
JP	BoJ monthly report (06:00 GMT)		Mar	-	-	-
GER	Industrial production (11:00 GMT)	Month	Jan	0.3%	0.3%	0.8%
		Year	Jan	4.6%	4.5%	4.3%
US	Non-farm payrolls (13:30 GMT)	Non-farm payrolls ('000's)	Feb	-50	40	-17
		Unemployment	Feb	5.1%	5.0%	4.9%
	Average hourly earnings	Month	Feb	0.3%	0.3%	0.2%
		Year	Feb	3.7%	3.7%	3.7%
During the week						
NZ	07 – 13 March – NZ REINZ House sales	Year	Feb	-	-	-31.5%
UK	HBOS house prices	Month	Feb	-1.0%	-	0.0%
		3m-Year	Feb	4.0%	-	4.5%

Notes:- p= preliminary, r = revised, nf = not forecast, nsa = not seasonally adjusted, ann = annualised, bn = billion, m = million
Source: Dow Jones, Reuters, Bloomberg

Monthly calendar

Events & economic releases

Month commencing Monday, 10 March 2008

Monday 10 March	Tuesday 11 March	Wednesday 12 March	Thursday 13 March	Friday 14 March
AU HIA New Home Sales (JAN) AU ANZ Job Advertisements (FEB)	AU Home Loans (JAN) AU Investment Lending (JAN) NZ Terms of Trade Index (4Q)	AU Westpac Consumer Confidence (MAR) NZ Food Prices (FEB)	AU Consumer Inflation Expectation (MAR) AU Employment Change (FEB) AU Unemployment Rate (FEB) AU Participation Rate (FEB) NZ Retail Sales (JAN) NZ Retail Sales Ex-Auto (JAN) NZ Business NZ PMI (FEB)	NZ Manufacturing Activity (4Q) NZ Non Resident Bond Holdings (FEB)

Monday 17 March	Tuesday 18 March	Wednesday 19 March	Thursday 20 March	Friday 21 March
NZ New Zealand's February Performance of Services Index		AU Westpac Leading Index (JAN) AU DEWR Skilled Vacancies (MAR) AU Dwelling Starts (4Q) AU Preliminary BoP Imports (FEB) NZ Credit Card Spending (FEB)	AU New Motor Vehicle Sales (FEB) AU New Motor Vehicle Sales (FEB) NZ Visitor Arrivals (FEB)	

Monday 24 March	Tuesday 25 March	Wednesday 26 March	Thursday 27 March	Friday 28 March
		AU Conference Board Leading Index (JAN)	AU Job vacancies (FEB) NZ Trade Balance (FEB) NZ Current Account Balance (4Q)	NZ GDP (4Q)

Monday 31 March	Tuesday 01 April	Wednesday 02 April	Thursday 03 April	Friday 04 April
AU TD Securities Inflation (MAR) AU Private Sector Credit (FEB) AU HIA New Home Sales (FEB) NZ Building Permits (FEB) NZ NBNZ Business Confidence (MAR)	AU AiG Performance of Mfg Index (MAR) AU RBA Cash Target (APR)		AU AiG Performance of Service Index (MAR) NZ ANZ Commodity Price (MAR)	AU Retail Sales (FEB)

Disclosure appendix

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