

Australia & New Zealand Economics Weekly

RBA's cautious optimism

Week commencing 20 April 2009

| | |
|--------------------------------|----------|
| RBA's cautious optimism | 2 |
| Stevens speaks Tuesday | 2 |
| Leave it to Bollard | 3 |
| Unhelpful advice from the OECD | 3 |
| Weekly calendar | 4 |
| Events & economic releases | 4 |
| Monthly calendar | 5 |
| Events & economic releases | 5 |

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RBA's cautious optimism

Stevens speaks Tuesday

Speaking in Adelaide Tuesday, RBA Governor Glenn Stevens is likely to build on the cautiously optimistic tone of a recent speech by his deputy Ric Battellino. Most of the positive signs noted by Mr Battellino last month have been confirmed since. Some Australian reports portrayed China's first quarter numbers as disappointing but, as our China economics team made clear, they were in fact pretty good. The annual rate slipped as expected but growth in the first quarter was running at around twice the rate of growth in the previous quarter. Industrial production, retail sales, government-influenced investment and bank lending were all running strongly, suggesting that the ambitious program to support domestic demand is succeeding.

At the same time, US numbers have generally confirmed a slowing rate of deterioration. The most recent retail sales and durable goods orders reports were weak, but not weak enough to reverse the improvement in the trend since the beginning of the year. Consumer and business sentiment are a little stronger. New jobless claims have steadied. Lower grade borrowers are finding it very tough but blue chip corporations have been able to issue a trillion dollars in new debt since the start of the year, and at much better spreads. Equity prices are around 20% off their March low.

Other than the dip in February retail sales, the loss of full time jobs in March and slowdown in business credit, the Australian numbers have not been too bad. They have been consistent with zero growth rather than an accelerating decline in demand and output. February exports were up a little, housing lending continues to expand, approvals for the construction of new houses continue to increase modestly. The first income support payments for the government's \$42 billion package did not go out until earlier this month, and the impact of the rest of the package will not begin to become apparent until well into the second half. Mr Stevens knows it is coming, however, and he knows that for the Australian economy it is quite big. On Tuesday he may well warn that the expected decline in the terms of trade will weigh on the strength of any recovery, but we expect him to be on balance a little more cheerful than it has been possible to be in the last six months. A slightly brighter view would be consistent with leaving the cash rate at 3% for some time to come. It would not be consistent with the market expectation that the RBA plans to take it down to 2% or so in coming months.

Leave it to Bollard

Unhelpful advice from the OECD

Invoking the need for fiscal rectitude, the OECD and the New Zealand government last week told RBNZ Governor Alan Bollard that the recession is his problem, not theirs. The government reiterated that it was committed to Budget austerity, which in the current context really means it will not adopt any new discretionary spending or revenue measures to address New Zealand's recession, now in its sixth quarter. It has of course been impossible to avoid a substantial deterioration in the Budget given the prolonged slowdown and a tax cut commitment, but the New Zealand government has not seen its way to the direct and immediate support for private demand which Australia has adopted and which the IMF backs. In the same week as Prime Minister John Key reiterated his fiscal views, the OECD supported the government's commitment to fiscal discipline, while urging the RBNZ to take the cash rate down another 100 basis points to 2%. According to the OECD, "there is little room" for further fiscal expansion despite "a still moderate budget deficit this year". This absolves the government of responsibility for getting out of the recession, and hands it all to Dr Bollard. It hands it to Dr Bollard though the OECD report writers would certainly know that taking the cash rate down another 100 basis points will have zero impact on private demand. This is because New Zealand households opt for fixed-rate fixed-term mortgages, so the only households benefitting from lower cash rates are the one fifth who choose variable rate mortgages, or those whose fixed rate has expired and have refixed at a lower rate or a variable rate. A good deal of the marginal benefit of lower cash rates in New Zealand has been undone by a sharp increase in term rates, itself likely sparked by people fixing at what they probably think is close to the low for this episode. The OECD would have made a more useful contribution if it had urged Dr Bollard to try driving down two and three year rates. He might not succeed but it would make more sense than further futile cuts in the cash rate. OECD advice to do so would have legitimised what might be regarded as an unusual use of monetary policy in New Zealand.

As Dr Bollard indicated in explaining the most recent cut (and the OECD repeated several times in its survey), there is a risk with very low cash rates in New Zealand. It is running a current account deficit of around 9% of GDP with net foreign liabilities around 90% of GDP. If there is discovered to be a cash rate inflexion point at which foreign lenders lose interest in New Zealand dollar-denominated financial assets, it will be Dr Bollard who gets the blame – not the OECD, and not the NZ Government. A collapse in capital inflows might well help cut New Zealand's current account deficit towards the 4.5% of GDP the OECD estimates is consistent with stabilising net foreign liabilities to GDP, but the consequences of a sudden, calamitous adjustment would make the current recession look very mild indeed. As the OECD reported, New Zealand needs to be conscious of the risk of "triggering a disorderly or severe exchange rate adjustment", a stricture that sits oddly with its view that the RBNZ has "room to go further".

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Weekly calendar

Events & economic releases

Week commencing Monday, 20 April 2009

| Country/ region | Event or economic release | | Period | HSBC | Market consensus | Actual previous |
|----------------------------|---|-----|--------|-------|------------------|-----------------|
| Monday, 20 April | | | | | | |
| AU | Producer Price Index (11:30) | QoQ | 1Q | | 0.60% | 1.30% |
| AU | Producer Price Index (11:30) | YoY | 1Q | | 4.90% | 6.40% |
| Tuesday, 21 April | | | | | | |
| AU | Reserve Bank's Board April Minutes (11:30) | | Apr 21 | | | |
| AU | RBA Governor Stevens Speaks in Adelaide (13:30) | | Apr 21 | | | |
| Wednesday, 22 April | | | | | | |
| AU | Consumer Prices (11:30) | QoQ | 1Q | 0.50% | 0.50% | -0.30% |
| AU | Consumer Prices (11:30) | YoY | 1Q | 2.80% | 2.80% | 3.70% |
| AU | RBA Trimmed Mean (11:30) | QoQ | 1Q | 0.60% | 0.80% | 0.60% |
| AU | RBA Trimmed Mean (11:30) | YoY | 1Q | 3.60% | 3.80% | 4.2% |
| AU | RBA Weighted Median (11:30) | QoQ | 1Q | | 0.80% | 0.9% |
| AU | RBA Weighted Median (11:30) | YoY | 1Q | | 4.00% | 4.50% |

Thursday, 23 April

Friday, 24 April

During the week

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, 27 April 2009

| Monday 27 April | Tuesday 28 April | Wednesday 29 April | Thursday 30 April | Friday 1 May |
|-----------------|------------------|--|---|----------------------|
| | | NZ Trade Balance MAR NZ NBNZ Business Confidence APR | NZ RBNZ Official Cash Rate NZ Building Permits MAR AU Private Sector Credit MAR | AU Trade Balance MAR |

| Monday 04 May | Tuesday 05 May | Wednesday 06 May | Thursday 07 May | Friday 8 May |
|---|---|---------------------|--|--|
| AU House Price Index 1Q AU ANZ Job Advertisements APR | AU Building Approvals MAR AU RBA Cash Target | AU Retail Sales MAR | NZ Unemployment Rate 1Q NZ Employment Change 1Q AU Employment Change APR | AU Reserve Bank Quarterly Monetary Policy Statement |

| Monday 11 May | Tuesday 12 May | Wednesday 13 May | Thursday 14 May | Friday 15 May |
|---------------|---|--|-----------------|---|
| | AU NAB Business Confidence APR AU Home Loans MAR AU NAB Business Conditions APR AU Commonwealth Budget May-12 | AU Westpac Consumer Confidence MAY AU Wage Cost Index QoQ 1Q | | NZ Retail Sales (MoM) MAR NZ Retail Sales Ex-Auto (MoM) MAR NZ Retail Sales Ex Inflation (QoQ) 1Q |

| Monday 18 May | Tuesday 19 May | Wednesday 20 May | Thursday 21 May | Friday 22 May |
|---|--|---------------------------|-----------------|---------------|
| NZ Producer Prices – Inputs QoQ 1Q NZ Producer Prices - Outputs QoQ 1Q | AU RBA Governor Stevens Speaks in Sydney MAY 19 | AU Wage Cost Index YoY 1Q | | |

Disclosure appendix

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