

A question of timing

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Inside:

Macroeconomic update 2
Forecasts 4

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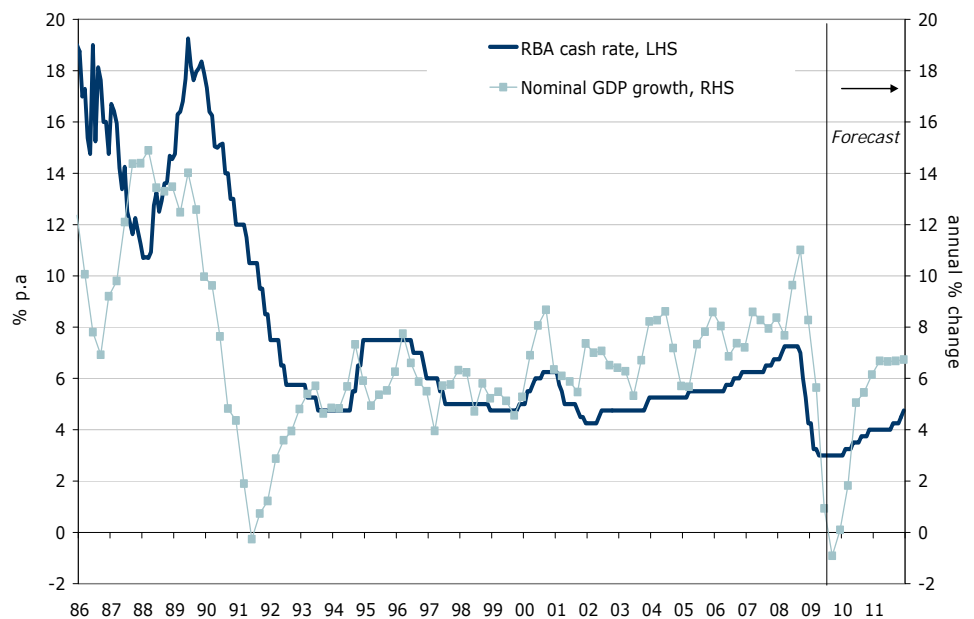
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Macroeconomic update: The RBA's First Move

- A rebound in business and consumer confidence and the impact of monetary and fiscal stimulus have led markets to price in one rate rise before Christmas and a further four by the end of the financial year.
- History favours a tightening in either November or December, but one in February next year also seems a good possibility as well. We continue to expect the first move to be in February, but acknowledge the risk around an earlier move in November or December.

Chart of the week: when should the RBA begin?

Figure 1: Australian nominal GDP growth and the RBA's cash rate



Source: ABS and ANZ.

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Setting the Platform for a Lift in Rates

In Australia, household confidence and business confidence have both rebounded strongly in recent months and this has lifted the outlook for both business investment and consumer spending. Indeed, the rebound in general confidence with the support of the monetary and fiscal stimulus should set the platform for continued recovery from the economic slowdown.

Household wealth has been rebuilt on the back of stronger equities and improvement in house prices. Government spending will continue to support growth over the medium term even though the target for this spending has shifted from the household sector to the construction sector and because of this the broader economy's response to the stimulus will take longer going forward.

Despite the stronger economic performance in recent months, consumer spending will probably slow somewhat after the impact of the cash handouts fade and demand for housing from first home buyers will likely slow as well as the grant begins to unwind at the end of this month.

The labour market has softened and created some spare capacity and it should remain soft for at least the remainder of the year. However, this week's skilled vacancy data showed two consecutive months of growth and this may indicate a turning point in hiring intentions.

Nonetheless, the outlook for the global economy remains uncertain, despite the pickup in growth during the current quarter.

Globally, the policy-induced improvement in financial conditions, the fiscal stimulus, and the need for restocking have lifted growth recently and these levers should continue to support global growth for the remainder of this year.

However, next year the outlook remains more uncertain. Demand will still probably be relatively weak and the restocking currently taking place will have mostly run its course and this may induce a period of slower growth next year. But on the other hand, financial conditions should continue to improve provided there is no other shock to confidence and policy will remain supportive.

Even with several areas of expected weakness over the medium term, the balance of risks about whether the current setting of monetary policy is appropriate has clearly shifted.

On the domestic inflation front, the RBA's latest forecast is that underlying inflation will ease back to the middle of the target band by the middle of next year and slow further to 2% by year end. However, better-than-expected growth in the domestic and global economies would place upside risk to this forecast.

Still, leaving the inflation outlook aside, there is little sign that the current policy setting is excessively pushing up asset prices and this probably leaves the RBA with no immediate pressure to begin normalising policy and one reason why we favour a February move.

Picking the Month for the First Move

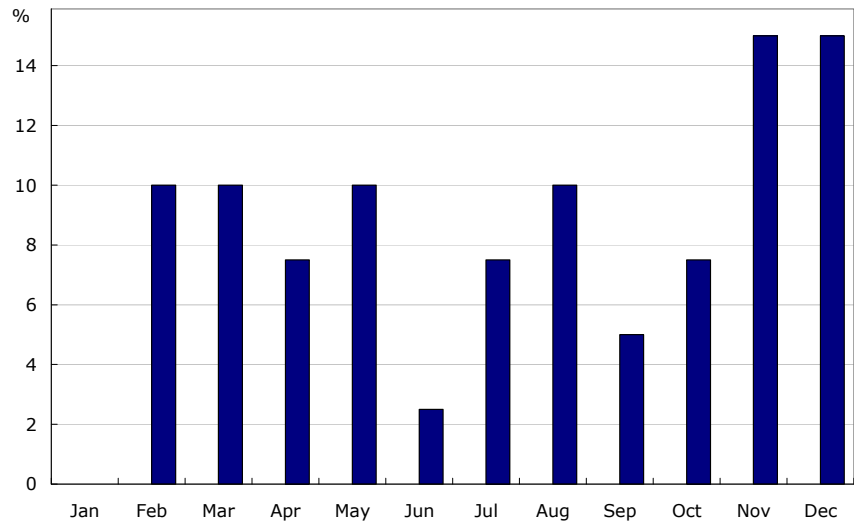
Financial markets have repriced the balance of risks around the coming tightening cycle. Indeed, the debate is now centred on when, rather than if, the bank begins to raise its target cash rate. It is then worthwhile looking at patterns in past changes of policy.

The RBA has changed monetary policy 40 times since inflation targeting began in 1993, with 15% of these moves occurring in November and 15% in December (Figure 2). There have been no changes in policy during January because there is no board meeting in that month and only 2.5% of the changes have occurred in June.

Another trend in changes in monetary policy is shaped by the release of the quarterly CPI. During the inflation targeting period, the CPI has been released in April, July, October and January. Moreover, 45% of the changes in policy have occurred in the month following the CPI releases (Figure 3).

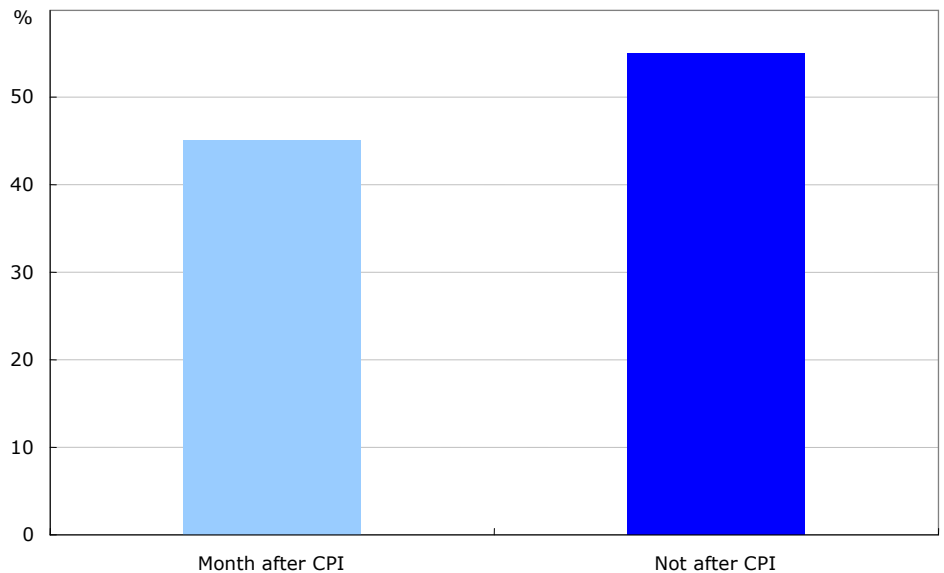
While the timing of the first rate rise in the upcoming tightening cycle remains open for debate, the history of past policy moves favours a November, December or February move.

Figure 2: Distribution of change in monetary policy



Source: ANZ, RBA Bulletin

Figure 3: Distribution of changes in monetary policy around CPI releases



Source: ANZ, RBA Bulletin, ABS

Data wrap

- **New Motor Vehicle sales** were up 0.3% in August.
- **DEWR Skilled Vacancies** were up 1.2% in September
- **DEWR Wage Agreements** increased 3.9% in the June quarter
- **HIA New Home Sales** spiked 11.4% in August.
- **The RBA released the Financial Stability Review**, which highlighted "significant improvement" in the global financial system since March.

ANZ economic and financial market forecasts

Australian economic indicators	2008	2009f	2010f	2011f
Economic activity (annual % change)				
Private final demand	4.4	-0.4	1.3	3.8
Household consumption	2.6	1.4	1.6	3.0
Dwelling investment	2.8	-7.6	5.3	5.9
Business investment	13.9	-3.7	-1.4	5.6
Public demand	6.2	2.6	7.1	4.4
Domestic final demand	4.8	0.3	2.6	3.9
Inventories (contribution to GDP)	-0.7	-0.3	0.6	0.0
Gross National Expenditure (GNE)	4.1	0.0	3.2	3.9
Exports	3.8	1.1	1.4	4.6
Imports	11.3	-9.6	6.9	9.5
Net Exports (contribution to GDP)	-1.8	2.6	-1.2	-1.3
Gross Domestic Product (GDP)	2.4	0.8	1.6	3.2
Prices and wages (annual % change)				
Inflation: Headline CPI	4.4	1.8	2.5	2.0
Underlying*	4.4	3.7	2.4	2.1
Wages	4.2	3.6	2.9	3.3
Labour market				
Employment (annual % change)	2.2	0.0	-0.3	1.8
Unemployment rate (%)	4.3	5.9	7.2	7.1
External sector				
Current account balance: A\$ bn	-54.5	-48.4	-55.8	-62.1
% of GDP	-4.6	-4.0	-4.4	-4.6

*Average of RBA weighted median and trimmed mean statistical measures.

Australian interest rates	Current	Dec 09f	Mar 10f	Jun 10f	Sep 10f	Dec 10f
RBA cash rate	3.00	3.00	3.25	3.50	3.75	4.00
90 day bill	3.31	3.45	3.55	3.80	4.30	4.30
3 year bond	4.67	5.00	5.15	5.10	5.20	5.25
10 year bond	5.30	5.60	5.65	5.60	5.80	5.85
3s10s yield curve	0.62	0.60	0.50	0.50	0.60	0.60
3 year swap	5.28	5.30	5.45	5.40	5.67	5.72
10 year swap	5.98	5.95	5.95	5.90	6.35	6.40
International interest rates						
RBNZ cash rate	2.50	2.50	2.50	2.50	3.00	4.00
NZ 90 day bill	2.78	2.80	2.80	2.80	3.63	4.47
US Fed funds note	0.25	0.25	0.25	0.25	0.50	0.75
US 2 year note	0.96	1.00	1.25	1.50	2.00	2.25
US 10 year note	3.41	4.00	4.15	4.30	4.50	4.45
Japan call rate	0.10	0.10	0.10	0.10	0.25	0.25
ECB refinance rate	1.00	1.00	1.00	1.00	1.00	1.25
UK repo rate	0.50	0.50	0.50	0.50	0.50	1.00

For additional information on interest rates please refer to ANZ's *Interest Rate Strategy Weekly*.

Foreign exchange rates	Current	Dec 09f	Mar 10f	Jun 10f	Sep 10f	Dec 10f
Australian exchange rates						
A\$/US\$	0.87	0.89	0.92	0.91	0.89	0.87
NZ\$/US\$	0.72	0.71	0.72	0.71	0.69	0.68
A\$/¥	79.3	78.3	79.1	80.1	80.1	80.0
A\$/€	0.59	0.60	0.61	0.61	0.60	0.59
A\$/£	0.53	0.53	0.55	0.55	0.54	0.53
A\$/NZ\$	1.21	1.25	1.28	1.28	1.29	1.28
A\$/CA\$	0.94	0.95	0.95	0.95	0.93	0.91
A\$/CHF	0.90	0.92	0.94	0.96	0.93	0.93
A\$/CNY	5.96	6.08	6.28	6.22	6.07	5.92
A\$ Trade weighted index	67.5	68.5	70.2	69.8	68.3	66.9
International cross rates						
US\$/¥	90.8	88.0	86.0	88.0	90.0	92.0
€/US\$	1.47	1.48	1.52	1.50	1.48	1.47
€/¥	134	130	131	132	133	135
£/US\$	1.64	1.67	1.67	1.65	1.64	1.65
€/£	0.90	0.89	0.91	0.91	0.90	0.89
US\$/CA\$	1.07	1.07	1.03	1.04	1.04	1.05
US\$/CHF	1.03	1.03	1.02	1.05	1.05	1.07
US\$ index	76.3	75.5	73.8	74.8	75.7	76.4
Asia exchange rates						
US\$/CNY	6.83	6.83	6.83	6.83	6.82	6.80
US\$/HKD	7.75	7.75	7.75	7.76	7.77	7.80
US\$/IDR	9645	9750	9500	9625	9250	9000
US\$/INR	48.2	48.0	47.0	47.5	47.0	47.0
US\$/KRW	1196	1125	1175	1150	1100	1050
US\$/MYR	3.48	3.50	3.48	3.45	3.40	3.40
US\$/PHP	47.5	48.0	48.0	47.0	47.0	46.0
US\$/SGD	1.42	1.46	1.45	1.44	1.44	1.43
US\$/THB	33.58	34.00	34.00	34.00	33.50	33.50
US\$/TWD	32.42	32.50	32.00	31.50	31.00	30.30
US\$/VND	17841	18500	18500	18500	18500	19300
Pacific exchange rates						
PGK/US\$	0.373	0.374	0.392	0.381	0.395	0.386
FJD/US\$	0.515	0.523	0.534	0.528	0.519	0.512

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