

Ai GROUP ECONOMICS WEEKLY

Week in Review: 20 September to 24 September 2010

- In an address to the Foodbowl Unlimited Forum Business Luncheon in Shepparton on Monday, the **RBA Governor Glenn Stevens** warned that monetary policy would be needed to manage what was likely to be a fairly robust upswing in the Australian economy should downside possibilities not materialise.
- The minutes of the August **Reserve Bank of Australia Board meeting** indicated that the RBA retains its positive view on the medium term outlook for the domestic economy, with the investment upturn in the resources sector expected to have significant flow-on effects to the broader economy. The Board indicated that the resources/business investment boost would lead to high levels of resource utilisation and that this was likely to have an inflationary impact. The Board also noted the risks to the economic outlook, including *“that the recent loss of momentum in the United States could develop into a renewed downturn or that the moderation of growth in China and East Asia could prove to be larger than expected.”* Nevertheless, while remaining alert to these risks, the Board assessed that *“with the economy currently growing at around its trend rate, underlying inflation having moderated and lending rates at around average levels the current setting of monetary policy remained appropriate for the time being”*.
- The **Westpac-Melbourne Institute Leading Index** (which indicates the likely pace of economic activity three to nine months into the future) registered an annualised growth rate of 6.8% in July 2010. Although this was well above its long term trend of 3.2% it was the fourth consecutive month that the growth of the Index has slowed. However, the growth rate of the Index is still high and its rise points to the likely improvement in economic growth in the months ahead. Westpac is forecasting that year average growth in 2010 will be 3.5%, slightly above trend which is assessed at 3.25%. In 2011, Westpac has raised its year average growth to 4.0% from 3.5%. This is in line with the Reserve Bank’s current forecast for growth in 2011.

How this affects you

Given that the RBA is forecasting rising inflation and continued growth of the Australian economy at a trend rate (or slightly above) over the next few years, the bias for interest rates remains on the upside. The main question is when.

The minutes of the RBA Board show that there is an increase in the Bank’s degree of urgency with regard to monetary policy, particularly given its conviction that the strong projected increase in mining investment will be pushing up against capacity constraints in 2011 and 2012 and that this is likely to put upward pressure on inflation and inhibit sustained economic growth.

Following the release of the latest RBA Board meeting minutes, the interbank futures have suggested that there is close to a 25 per cent chance that the RBA will increase rates at their next meeting on October 5, and an 80 per cent chance of an interest rate rise by the end of the year. The general assessment is that interest rates will be above 5 per cent (from the current 4.5%) by the middle of 2011, and that three more rate hikes, combined with fiscal tightening and constrained credit, will be sufficient to allay the Bank’s current inflation fears.

Latest data*

Official cash rate	4.50 per cent -
AUD/USD exchange rate	\$0.9264 ▲
Oil price	USD 74.58 per bbl ▼
Annual growth in GDP	3.3 per cent -
Unemployment rate (%)	5.1 per cent -
Annual growth in headline CPI	3.1 per cent -
Copper price	AUD 8,250.93 ▲
Australian PMI (August)	51.7 -
Australian PSI (August)	47.5 -
Australian PCI (July)	43.2 -

Week in Preview: 27 September – 1 October 2010

- Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI®**) for September 2010 on Thursday.
- On Thursday, the ABS **Building Approvals** data for August 2010 and HIA **New Home Sales** data for July 2010 will be released.
- Data for August on total credit provided to the private sector by financial intermediaries Reserve Bank will be made available on Thursday with the release of the latest Reserve Bank of Australia **Financial Aggregates** publication.
- ABS estimates of **Job Vacancies** for the private and public sectors will also be published on Thursday.

* Arrows represent directional movement relative to previous week's issue.