

# DATA SNAPSHOT

## RBA Statement on Monetary Policy (SOMP)

Friday, 6 November 2009

- The tone in today's statement continues to show a more upbeat central bank. The RBA has upgraded its growth forecasts and expects the economy to be close to trend (estimated at around 3.5%) next year. In its August statement, the RBA had only expected this to occur in 2011.
- In year average terms, GDP growth is expected to be around 1.5% in 2009/10, 3.0% in 2010/11 and 3.50% in 2011/12. These are significant upward revisions from August.
- Headline inflation is expected to pick up to the target band of 2-3% by Q4-09. Core inflation has broadly moved in line with RBA forecasts. From current above target rates, the RBA sees it moving to the band by mid 2010.
- We still see a reasonable chance of a 25bp December RBA interest rate hike and see rates moving to 5.00% by end 2010.

Comments made in today's statement are in line with recent RBA rhetoric. Overall, the tone of the statement is clearly more upbeat than the last SOMP in August. The RBA acknowledges that "The global economy is growing again" while in August it had merely noted that "The global economy is stabilising". Meanwhile, it states that risk aversion has abated and confidence is gradually returning. Indeed, since the low point in March, major global share markets and equities in Australia have improved around 40% - 60%.

The RBA highlighted that Asia has been the frontrunner in the global recovery with growth in China and India particularly strong. Meanwhile most of the advanced economies look to have grown in the September quarter. Indeed, signs are that the world's top two largest economies, the US and Japan, have exited their recessions. The RBA, however, also cautioned that it is still a long way to go before conditions could be described as normal and monetary policy is likely to remain very accommodative for some time yet.

### Growth Forecasts

The RBA notes today that the Australian economy has fared better than expected and continues to outperform the developed economies. In contrast to the latter, GDP here is estimated to have expanded modestly in H1-09 and it looks like the expansion is continuing in H2-09. RBA GDP growth forecasts in the year ahead have been upgraded by as much as 1.25 percentage points. The economy is anticipated to move closer to its long-term average, or full potential, next year. That would argue for interest rates to be taken up closer to neutral, i.e. a level that neither restricts nor promotes growth, by this time.

### Inflation Forecasts

The central bank notes that, "The slowdown in wage growth and lower prices for imported goods resulting from the recent appreciation of the currency suggest that a further moderation in underlying inflation is likely over the period ahead". Accordingly, it expects underlying inflation to ease to around 2.25% by late 2010 before gradually moving higher to 2.50% over 2011. It said that headline inflation is likely to pick up in coming quarters as the "temporary factors that have held it down fade". These temporary factors include petrol prices and the deposit and loans component (which is linked to interest rates). Both petrol prices and interest rates were falling earlier this year but have recently become contributors to quarterly CPI outcomes. Headline inflation is projected to be similar to underlying inflation in 2010.

Please refer to page 3 for the RBA's detailed growth and inflation forecasts.

### Interest Rate Outlook

The RBA stated today that the Australian economy is operating with less spare capacity than earlier thought likely and the outlook for the next few years have improved. Accordingly, it judged it prudent to unwind the emergency monetary stimulus that was implemented when the outlook appeared much weaker. So far, the RBA has raised rates by 25bp in both October and November. It notes that even with these increases, the cash rate remains at a low level and “a further gradual lessening of monetary stimulus is likely to be required over time”. So it is clear that interest rates could move higher in the year ahead. The key issue now, however, surrounds the timing of these rate hikes and how high interest rates will rise. We believe that rates could reach 5.00% by the end of 2010. In the near term, we still see a reasonable chance of a 25bp December rate hike.

#### **Some other key points made on global economic and financial conditions include:**

- \* Recent earnings results, both in the US and Australia, have on average exceeded analysts' expectations.
- \* Credit conditions continue to normalise, with spreads on corporate paper as well as emerging-market government debt narrowing considerably. Corporate bond issuance has picked up and the issuance of government-guaranteed bank debt has declined markedly as it has become more cost-effective to issue unguaranteed paper.
- \* Housing markets have improved in a range of countries, with prices rising reasonably strongly in some markets.
- \* Commodity prices have also generally moved higher over the past six months.
- \* Significant risks, nevertheless, remain. Activity has recently been boosted by temporary fiscal measures...with the durability of the pick-up in growth remaining uncertain. Banking systems in a number of countries are still some way from full health and further bad news in the financial sector cannot be ruled out. But prospects for the Asian economies are noticeably better and downside risks appear to be lower.

#### **Some other key points made on domestic economic conditions include:**

- \* Investment in Australia has held up reasonably well. Investment in the resources sector is at historically high levels and is expected increase further, particularly as the LNG sector expands.
- \* One area of continuing weakness in the business sector is commercial property, where financing constraints remain a significant issue. But the effect of this on overall construction activity is, however, being partly offset at the moment by increased building in the education sector as the result of fiscal measures.
- \* There has been a substantial shift in the structure of business financing over the past year, with many large firms raising external equity to reduce their leverage in an environment of tighter lending standards.
- \* Growth in household spending has been slower over H2-09 than H1-09 when we had the government transfer payments. But spending has still held up reasonably well, due to high levels of consumer confidence and higher asset prices.
- \* A recovery in housing construction is now clearly under way although financing issues are constraining activity in the apartment market.
- \* Conditions in the labour market have generally not been as weak as earlier forecast. The rise in unemployment has been contained by greater flexibility in the labour market as well as a decline in the participation rate.

### **RBA Forecasts (November 2009)**

**Table 13: Output Growth and Inflation Forecasts<sup>(a)</sup>**  
Per cent, over year to quarter shown

	June 2009	Dec 2009	June 2010	Dec 2010	June 2011	Dec 2011	June 2012
GDP growth	0.6	1¾	2¼	3¼	3¼	3¼	3½
Non-farm GDP growth	0.5	1¾	2	3¼	3¼	3¼	3½
CPI inflation	1.5	2	2½	2¼	2¼	2½	2½
Underlying inflation	3¾	3¼	2½	2¼	2¼	2½	2½

(a) Actual GDP and inflation data for June 2009. For the forecast period, technical assumptions include A\$ at US\$0.91, TWI at 70, WTI crude oil price at US\$85 per barrel and Tapis crude oil price at US\$88 per barrel.

Sources: ABS; RBA

### **RBA Forecasts (August 2009)**

**Table 14: Output and Inflation Forecasts<sup>(a)</sup>**  
Per cent, over year to quarter shown

	Mar 2009	June 2009	Dec 2009	June 2010	Dec 2010	June 2011	Dec 2011
GDP growth	0.4	¼	½	1	2¼	3¼	3¾
Non-farm GDP growth	0.0	0	¾	¾	2¼	3¼	3¾
CPI inflation	2.5	1.5	2¼	2¾	2	2	2
Underlying inflation	4	3¾	3¼	2½	2	2	2

(a) Actual GDP data to March 2009 and actual inflation data to June 2009. For the forecast period, technical assumptions include A\$ at US\$0.84, TWI at 66, and WTI crude oil price at US\$80 per barrel and Tapis crude oil price at US\$83 per barrel.

Sources: ABS; RBA

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