



RBA Statement on Monetary Policy (SMP), 12 November 2007.

Courtesy of Commonwealth Bank

Summary

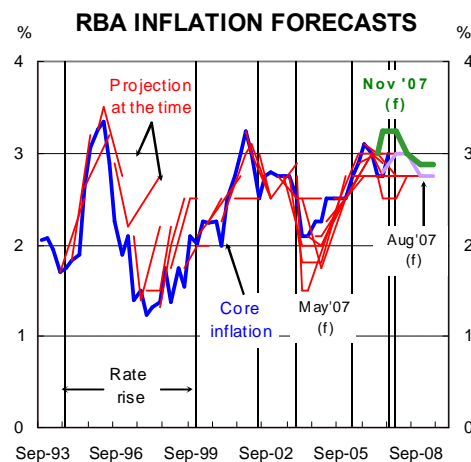
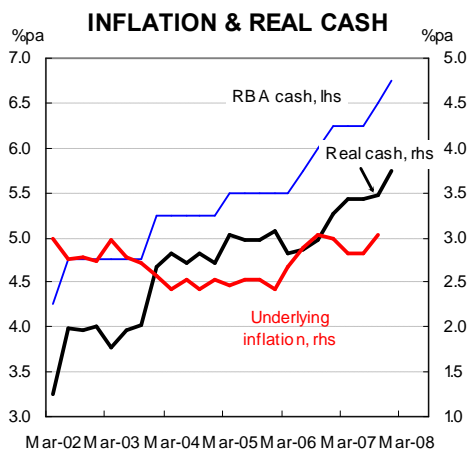
The RBA appears to have a strong tightening bias. It has lifted its underlying inflation forecast for early 2008 to 3.25%, or above the top of the target band, and expects it to stay there till late 2008. In our view another RBA cash rate rise to 7.0% is reasonably likely in February 2008. Two factors are driving the view. The first is a shift to the upside for the inflation risks because of more widespread price pressures. The second is a continued upbeat view on the non-farm growth outlook for the year to June 2008. The RBA expects overall 2007/8 GDP growth to be near 3.75%pa, with farm sector weakness offset by the non-farm economy running above 4%pa.

The December quarter CPI is released on 23 January and we expect another rate rise on 6 February.

Inflation

The RBA's inflation forecast drives decisions on the appropriate *level* of the cash rate and the timing of any changes to it. On that score the RBA now sees the *headline CPI* (1.9%pa in the September qtr) rising to 3¼%pa by mid 2008.

The RBA's *underlying* inflation forecast for mid 2008 has been also raised to 3¼%pa, a significant upward shift from the previous 3%pa forecast in the August 2007 SMP. An upward adjustment in inflation forecasts means higher nominal cash rates are required if real interest rates are to maintain a slightly restrictive policy stance, ie real cash above 3.5%, on economic activity.



Labour market

In the RBA's view conditions in the labour market have remained strong with employment rising by 0.5% over the three months to October, to be 2.7% higher over the year". The RBA also notes that the robust labour market performance, "has been shared across all states and territories. Looking ahead, the RBA sees strong labour market conditions continuing. Job vacancies remain at multi-decade highs. There has been a considerable expansion of the labour supply over the past few years from higher workforce participation and higher immigration levels which has helped satisfy labour demand. But business surveys continue to indicate that the most significant constraints on higher output are related to labour shortages.

Wages Outlook

On wages the RBA notes that consistent with the strong labour market conditions, the pace of wages growth has been firm". It also observed that while the WPI grew by 4%pa in QII, the "broader indicators of wages growth (as measured by the national accounts), have been somewhat stronger with average earnings in the national accounts - which include both wage and non-wage labour costs - lifting by 5.5%pa in QII".



International Outlook

The RBA remains reasonably sanguine about the global growth outlook - despite the recent ructions in global markets in wake of the US sub-prime debt meltdown and sharp slowdown in the US housing sector. It sees some moderation in likely global growth of over 5%pa in 2007 to something like 4.5%pa in 2008. The RBA also observes that the continuing strength of world demand should continue to bolster global commodity prices and Australia's terms of trade and underpin Australia's current firm growth pulse.

Domestic Growth

The RBA now expects a 2007/08 GDP outcome of 3.75%pa, from 4.5%pa in August. It said that overall growth in domestic demand should slow from its recent above trend pace over the next couple of years, with "tighter financial conditions trimming private spending, and public spending growth moderates in line with MYEFO projections for federal and state spending are borne out". Non-farm GDP is likely to expand by 3.5%pa over the next two fiscal years, according to the Bank's latest forecasts.

Financial Markets

Today, financial markets see only a 16% chance of another RBA rate rise next month, ie December, but about a 75% chance of rate rise to 7.0% in February 2008. So markets do not see the current cash rate as the cyclical peak. Note that recent credit market volatility may be dampening the market's view of future rate rise chances. The RBA warns that is also possible at this stage of a long economic expansion that inflation will be more difficult to contain, particularly if domestic demand does not moderate.

Michael Workman and John Peters 12 November 2007

Additional Disclaimer

Produced by Commonwealth Research based on information available at the time of publishing. We believe that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made as at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, neither Commonwealth Bank of Australia ABN 48 123 123 124 - AFSL 234945 - nor any of its subsidiaries accept liability to any person for loss or damage arising from the use of this report.

No person should act on the basis of this report without considering and if necessary taking appropriate professional advice upon their own particular circumstances. In the case of certain securities Commonwealth Bank of Australia is or may be the only market maker.

This report is approved and distributed by Commonwealth Bank of Australia incorporated in Australia with limited liability. Registered in England No. BR250 and regulated in the UK by the Financial Services Authority (FSA). This report does not purport to be a complete statement or summary. For the purpose of the FSA rules, this report and related services are not intended for private customers and are not available to them.

Commonwealth Bank of Australia and its subsidiaries have effected or may effect transactions for their own account in any investments or related investments referred to in this report.

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material.