

# Australian economic update

## RBA's Edey maintains hawkish tone

RBA assistant governor Malcolm Edey in a speech to the Committee for Economic Development of Australia earlier today largely restated the economic assessment offered in the bank's quarterly Statement on Monetary Policy last week, reaffirming widespread expectations that interest rates will rise further.

Mr. Edey acknowledged that the housing-driven slowdown in the US economy was feeding back into employment and incomes, but noted several positive forces likely to support US economic growth going forward. The weak USD will continue favouring the export sector; there is significant fiscal stimulus in the pipeline; and interest rates have fallen sharply, and are likely to fall further. Mr. Edey recognized, however, that the weakness being experienced in some major industrial economies would have a dampening effect on the Asian region. The RBA forecasts that Australia's trading partners will slow to a below-trend 4% in 2008 and 2009, down from 5% last year, mainly due to weak growth in G7 economies. He reiterated, though, that the weakness in developing countries is less pronounced, highlighting China's strong growth, which is being primarily driven by domestic demand, and firm conditions in other Asian economies.

### RBA output and inflation forecasts

%oya

	GDP	Consumer price index	Underlying inflation
Sep-07	4.30	1.90	3.00
Dec-07	3.50	3.00	3.60
Jun-08	3.25	3.50	3.75
Dec-08	3.25	3.50	3.50
Jun-09	3.00	3.25	3.25
Dec-09	3.00	3.25	3.25
Jun-10	3.00	3.00	3.00

Source: RBA, ABS

Mr. Edey said that economic growth in Australia remains robust and recent indicators suggest that this growth will be sustained. In particular, the terms of trade will remain a significant stimulus to the domestic economy, with the RBA forecasting that the terms of trade will rise another 5% this year. Strong demand and tight capacity, rising commodity prices, and faster wages growth, continue to fan inflation. **The RBA forecasts the underlying trend in inflation is now around 3.5%.** The moderation in economic growth forecast by the RBA (see table) should, however, help curb inflation, but the threat that rising inflation might feed back into domestic wage and price expectations is one thing Mr. Edey said the bank will be keeping a close eye on.

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