# A contentious RBA decision

*The BoJ may set the tone into next week in a contentious decision that has the market divided but somewhat favouring no change in policy. How Kuroda characterises the forecasts on inflation, the reaction function to oil and potential for further policy moves will keep the market on its toes. We are wary of a surprise policy easing that would reignite USD strength. Eurozone data has generally displayed more resilience than expected and the German CPI on Thursday and recovery this week in oil may reduce the degree of policy easing anticipated by the ECB in December. EUR is creeping up, but now into a resistance zone. The market will struggle for direction ahead of the payrolls report next week. The Australian rates decision next week is also highly contentious, credit growth data today cloud the outlook showing strength and countering to some extent the weaker inflation report on Wednesday. It's a big RBA week ahead, and we are biased towards seeing a weaker AUD with the weak impulse from the commodity sector, reinforced by weaker Chinese demand, ebbing in the housing market and a lower CPI. Chinese PMI data this weekend may also impact sentiment.*

**EUR news flow supportive, but likely to settle ahead of key US data**

The EUR has been firming since the FOMC meeting. The recovery in oil prices and some better than expected Eurozone data may be reducing the degree of further policy easing expected from the ECB in December. Tonight we see the preliminary Eurozone CPI, a key indicator for the ECB as it aims to raise inflation back towards its 2% target. The German CPI released on Thursday night suggests in may be higher than expected. The Euro area business climate index was also firmer in September, at a high since 2011, against expectations it would begin to ease.

The key upside resistance for the EUR is the pre-FOMC level around 1.1080. And it is likely to start to encounter resistance around its current levels near 1.1000, which was around the lows on Friday and Monday.

**AUD facing another disrupted Melbourne Cup**

The rate decision on Tuesday next week in Australia is again a highly contentious one yet again likely to disrupt the annual Melbourne Cup horse racing carnival that stops a nation.

The credit growth data released this morning are keeping the market on edge showing a strong bounce in business credit and no overall slowing in housing credit, although there has been a rotation from investor to own-occupier house credit. But how much of this is a real slow-down in investor lending and how much is customer reclassifying loans is unclear.

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As such the data suggests that the RBA does not need to rush to rate cuts, contrasting with the significantly lower than expected CPI inflation data on Wedneday.

The market has priced this one as a line-ball call and economists are also divided and ambivalent in their calls. Central banks are certainly keeping us on our toes in recent weeks and the BoJ meeting today is also hard to call and likely to generate volatility.

Next week the RBA releases its quarterly Statement on Monetary Policy with new key economic forecasts on the Friday, after the rates decision on Tuesday, and Governor Stevens speaks on Thursday. As such there is plenty of scope for the central bank to adjust policy and/or set the tone for the policy outlook for coming months.

Even if they don't cut, they are likely to keep the market looking out for a cut based on a weaker growth outlook in China, weaker commodity price trends, a lower inflation outcome and some cooling in the housing market in recent months, as prudential measures tighten mortgage lending conditions somewhat. As such we are biased toward seeing a weaker AUD

The NZD has firmed in response to a further recovery in the ANZ monthly business confidence measure, recovering solidly for a second month to around its long run average levels, with improving trends in exports and investment. The data in New Zealand continues to throw doubt on the need to cut rates, but most analysts continue to call for a fourth rate cut this year in December, after the RBNZ held fire this week as expected.

Much of the expectation for a cut arises from the strength in the NZD over recent weeks and the low inflation outcomes of recent years. The NZD may tend to be better supported than other commodity currencies given a solid recovery in milk prices in recent months and recovery in domestic demand indicators.

**FOMC on a knife's edge watching data more intently**

The US FOMC has significantly raised the chances of a December rate hike. It appears ready to hike provided the domestic economy continues a moderate recovery.

Each data point is taking on more significance. The GDP report was as expected on Thursday and this was a relief to some that feared a lower outcome in line with the Atlanta Fed's GDPNow prediction. Attention will now turn to the key inflation reading (PCE Deflator) and its associated income and spending data today. The Employment Cost Index is also important given the tightening in the labour market and the possibility that at some stage this contributes to higher wage growth. The core PCE from the Q3 GDP report was a bit below expected, suggesting the Sep

monthly PCE deflator due tonight will not surprise higher. The FX market is likely to trade cautiously through the next week awaiting the payrolls data in a week's time

**What they said**

- ECB Governing Council Member Liikanen said that while domestic demand in the euro area "remains resilient", concerns about growth prospects in emerging markets "continue to signal downside risks to the outlook for growth and inflation."
- HSBC Australia economist Paul Bloxham: changed rate call from on hold to a cut in Q4, most likely next week.
- Westpac Australia economist Bill Evans: Stays with his no change call and next move in rates is up view even after the lower than expected CPI report.
- Nomura Australia rates Strategist Andrew Ticehurst: "If the RBA would like to lower the cash rate next week, they can mount a very solid case to justify the move." But he sticks to his cut in February call. (Westpac's Bill Evans says inflation drop not enough to force RBA cut – SMH.com.au)

**In the news**

- Origin Energy has advised its $24.7bn Australian Pacific Liquefied Natural Gas (APLNG) project should start "within a month", making the third of the state of Queensland's large gas export projects to begin production this year.
- ANZ bank share price fell significantly over the last two days, other Australian bank shares are weaker this morning on Friday. Several brokers lowered their outlook for ANZ, in part because of its higher exposure to Asia.
- Despite the lowest global oil prices in six years, the proposed budget deal reached by USA congressional leaders and the White House on Monday night calls for selling off about 8 percent of the nation's Strategic Petroleum Reserve. (Budget Deal Calls for Selling Strategic Oil Reserves – usnews.com)

**Economic news**

- Australia Credit growth rose 6.7%y/y in Sep, higher than 6.3% expected, up from 6.4%y/y in Oct, revised up from 6.3%y/y, to the highest annual growth rate since 2008. Business lendingaccounted for much of the surprise increase in overall credit lending. It rose 1.2%m/m in Sep, up from 0.5%m/m in Aug, the largest monthly increase since 2008. On a 3mth-yoy basis, business lending is up 5.6%, a high since 2009. Owner-occupier (core) housing credit rose 0.7%m/m, up from 0.6%m/m in Aug and 0.4/0.5% monthly gains over recent years. This lifted the annual rate of growth over the last few months to around 7.5% from 5.3% in Q2. Investor housing lending rose 0.5%m/m in Sep down from 0.7%m/m in the previous two months, and 0.9%m/m earlier in the year. Over the last three months its annual rate of growth has slowed to 7.9% from 11.4% in Q2. The slow-down suggests that prudential measures to slow investor lending since mid-year are having effect. However, some of this appears to be a shift in loan categories from investor to owner-occupier. Total housing lending has risen at an annual rate of

7.9% over the last three months, up a bit from 7.4% in Q2, showing no overall slow-down to the sector.

- Australia New Home Sales fell 4.0%m/m in Sep, after rising 2.3%m/m in Aug. The trend may be weaker with the average over three months -1.2%per month and -0.8% per month over six months.
- Japan CPI inflation ex-fresh food was unchanged at -0.1%y/y in Sep, higher than -0.2% expected.Less food and energy it rose from 0.8%y/y to 0.9%y/y in Sep, as expected. The Tokyo measuresfor the month ahead, were unchanged at -0.2%y/y in Oct, as expected for inflation ex-fresh food, and down from 0.6%y/y to 0.4%y/y in Oct, below 0.5%y/y expected for inflation ex-food and energy.
- Japan household expenditure fell 0.4%y/y in Sep, down from +2.9%y/y in Aug, below +1.1%y/y expected.
- Japan Unemployment was unchanged as expected at 3.4% in Sep. The jobs-to-applicants ratio rose from 1.23 to 1.24 in Sep, as expected.
- Japan Industrial production rose 1.0%m/m in Sep, above -0.6% expected. From a year earlier it was down -0.9%y/y. It has been trending down since Q1, down on average 0.3% per month over the last three months.
- New Zealand building permits fell 5.7%m/m in Sep, after falling 5.3%m/m in Aug, revised lower from -4.9%m/m, further correcting a 20.0% rise in July. As such the trend is still solidly rising.
- New Zealand business confidence, own respondents' outlook rose to 23.7 in Oct from 16.7 in Sep, the second rise in a row from a recent low of 12.2, to a high since May, still significantly below levels around 40 earlier in the year. Currently around its long run average. Exports rose to 22.4 from 17.9, investment rose to 12.0 from 7.2
- Korean industrial production rose 1.9%m/m in Sep, stronger than +0.3% expected. It has risen on average 0.6% per month over the last three months, showing improving momentum. From a year earlier it rose 2.4%y/y.
- Korean cyclical index rose 0.5%m/m in Sep, up for a second month, reversing falls in the previous two months.
- Korean business confidence was unchanged at 70 in the Nov reading, averaging 71 over the last six months well down on the average for the previous six months of 78, around the lows in 2012, the lows since 2009.
- Taiwan GDP fell 1.0%y/y in Q3, weaker than -0.5% expected, down from +0.5y/y in Q2, a low since 2009.
- USA GDP Q3 rose 1.5% q/q saar, slightly below 1.6% expected. Personal consumption rose 3.2%, slightly below 3.3% expected. The core PCE deflator rose 1.3% q/q saar below 1.4% expected
- USA pending home sales fell 2.3%m/m in Sep, weaker than +1.0% expected. They rose 2.5%y/y, down from +6.6%y/y in Aug.
- USA weekly consumer comfort index fell from 43.5 to 42.8, firmer than Aug/Sep levels but cooling in the last two weeks, around average for the year.
- Canada CFIB Business barometer of small and mid-sized firms rose from 56.0 to 58.9 in October. However this is a recovery from a low since 2009. A solid uptick, but still the second lowest reading since 2009.
- Eurozone EC Economic Sentiment index firmed from 105.6 to 105.9 in Sep, better than 105.1 expected, a high since June 2011.

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- Germany's preliminary EU harmonized CPI rose 0.2%y/y in Oct, above flat expected, up from -0.2%y/y in Sep
- German unemployment fell 5K, as expected and the rate was unchanged at 6.4% as expected.
- UK mortgage approvals fell to 68.9K in Sep, below 72.4K expected, from 70.7K in Aug, revised down from 71.0K.
- UK CBI retailing volume of sales survey index fell to +19 in Oct, below +35 expected, down from +49 in Sep, to a low since April
- UK Nationwide house price index rose 3.9%y/y in Oct, up from +3.8%y/y in Sep, a bit above 3.8% expected. Sales for this time of year were 5 in Oct, down from 17 in Sep, a low in a table of data back to March this year

**Markets on the Move**

- CAD firmer on oil prices. Oil prices bounced from around a two month low on Wednesday and firmed on Thursday, around mid-range for the last two months.
- Base metals prices have been drifting lower since mid-October and are towards the lower end of their range for the last few months. Iron ore and steel prices are also languishing near range lows over recent months although drifting slowly lower not demanding attention.
- US 2yr rates rose 1.3bp on Thursday, adding to the sharp 8.4bp rise on Wednesday after the FOMC. The 2yr-to-10yr US government yield curve steepened 5bp on Thursday with 10 year government yields up 7.1bp. The higher oil price helping stabilise medium term inflation expectations.
- Eurozone 2yr swap rate rose 2bp to -0.02%, from the record lows set ahead of the FOMC on Wednesday. The German government 2yr-to-10yr yield curve steeped by 7bp on Thursday with 10 year yields up 9bp from a low since April.
- Notwithstanding some recent weaker than expected UK data, 2yr UK swap rates rose around 8bp since the FOMC, not much behind the US reaction.
- New Zealand rates remained little changed over recent weeks, with limited reaction to the RBNZ policy statement on Thursday.
- Australian 3mth bill futures contract yield for March-16 fell by around 10bp on Wednesday after the lower than expected CPI, and has retraced 5bp of that, firming with US rates since the FOMC. The Credit Suisse probability index shows a 49% chance of a 25bp cut next week, down from around 85% immediately after the CPI data on Wednesday, up from around 60% earlier in the week, suggesting the rates decision is a contentious one.
- US stocks were little changed on Thursday, holding the gains made post the initial dip on the FOMC, to around the highs since August and back inside the range that prevailed in the first part of the year ahead of the Aug/Sep sharp set-back.
- Australian equities have been relatively weak falling in the last two sessions, including down 0.9% this morning in Asia. Bank shares weaker.
- Metals and mining, and steel sector equities in the US continue to lag the broader market, relatively stable over recent weeks. Energy sector equites have recovered a bit more, but are also relatively stable, not generating much uplift from the recovery in oil prices this week.

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