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Australia Inflation Risk Seen in Tomato Price Jump (Update2)
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(Updates with employment figures in fourth-to-last paragraph.)

By Michael Heath and Daniel Petrie

Jan. 13 (Bloomberg) -- Reserve Bank of Australia Governor Glenn Stevens can glimpse the inflation threat he faces from the nation's floods at the produce shop near his suburban Sydney home in Sylvania Waters.

Tomato prices soared 20 percent in the past week and bananas, grapes and sweet potatoes are up 10 percent, said Maurice Sorace, owner of Sylvania Best Fresh, who gets about a third of his fruit and vegetables from flood-ravaged Queensland state. "Prices will be higher in the next week" as the deluge drowns more crops and clogs roads, he said.

The crisis may force the RBA to accept higher inflation in coming months as the floods spur food and commodity costs and slow growth in a disaster zone the size of Egypt. A gauge of inflation in the bond market showed the expected rate surpassing the RBA's target as the damage, along with future rebuilding in a country already near full employment, risked stoking prices.

"At a time when the economy does not have a lot of spare capacity and a mining and energy-investment boom is also expected over the next few years, the RBA will face an even greater challenge to manage medium-term inflation pressures," said Paul Brennan, an economist at Citigroup Inc. in Sydney. Citigroup forecasts the next rate move in the second quarter.

Downtown Brisbane

Brisbane, Australia's third-largest city, is suffering its worst flooding since 1974 after muddy water inundated about 15,000 properties, smashed roads and shuttered the city center.
The Brisbane River, which bisects the Queensland state capital, became a torrent of brown water filled with shattered pontoons, trees and boats broken from moorings. Floodwaters peaked today.

"Now the floods are urban, much greater damage to infrastructure is likely," Roland Randall, an economist at TD Securities Inc. in Singapore, said in a note to clients yesterday. "We have pushed out our expectation for the RBA to resume tightening monetary policy to April or May" from a previous call of March, he wrote.

Investors are increasing bets price gains will accelerate.
The extra yield of Australian inflation-linked bonds maturing in five years compared with nominal five-year government debt -- a gauge of the inflation investors expect over the period -- reached 3.01 percentage points today, the highest level since February 2007, according to data compiled by Bloomberg.

Flooded Mines

The rain that closed coal mines and cut railways also drove the Australian dollar to its biggest weekly loss since November last week. It traded at 99.64 U.S. cents as of 12:41 p.m. in Sydney, little changed today after slipping earlier in the wake of a government report showing fewer jobs than forecast were created in December.

The cost to the nation may total as much as A$13 billion ($12.9 billion), or 1 percent of gross domestic product, said Stephen Walters, chief economist for Australia at JPMorgan Chase & Co. in Sydney, who has changed his forecast for the next rate rise to May from February. RBA board member Warwick McKibbin said such a hit to GDP “is not out of the question,” the Sydney Morning Herald reported yesterday.

Much of the economic damage assessment is incomplete. The Port of Brisbane remained closed yesterday and all ships were directed out of the harbor, which lies 24 kilometers (15 miles) from the city’s central business district, as debris littered the waterway.

The rains forced Caltex Australia Ltd., the nation’s biggest oil refiner, to idle a refinery that supplies about a third of Queensland’s fuel needs. The shutdown was expected to cost A$5 million to A$10 million in 2011, Caltex said.

Coal Prices

Mining companies including Rio Tinto Group, BHP Billiton Ltd. and Xstrata Plc have deferred deliveries of coal, driving up the price for steelmaking and power coal. Thermal coal prices have already risen to the highest since September 2008.

Cattle prices in Australia, the second-largest beef exporter, jumped to near a record. The Eastern Young Cattle Indicator, which measures prices at sales, gained to A$4.108 per kilogram yesterday, reaching the highest level since October 2005, Tim McRae, economist at Sydney-based Meat & Livestock Australia said.

Once Stevens does resume raising rates, the rise in borrowing cost would pose an additional burden on farmers and homeowners with floating-rate debt, after the RBA already boosted rates faster than any Group of 20 nation since the end of the crisis.

Inflation Mandate

Stevens has a mandate to keep inflation in a range of 2 percent to 3 percent. In July to September, the consumer price index rose at a quarterly pace of 0.7 percent. It may rise 1.2 percent in the first quarter of this year, according to the median of six estimates in a Bloomberg News survey, compared with a pre-flood estimate of 0.9 percent.

The projected pace would be the fastest since the third quarter of 2008, when the RBA’s cash rate target was at 7.25 percent, compared with its current level of 4.75 percent.

GDP growth in the first three months this year will be half as high as the pre-flood forecast, at 0.4 percent, a survey of seven economists showed.

The reconstruction efforts may suffer from skill shortages already straining mining operations, threatening to push up wages for some workers.

While Australian employers added 2,300 workers in December, fewer than forecast by all 17 economists surveyed by Bloomberg, the unemployment rate dipped to 5 percent.

Bank of America Merrill Lynch economists said the RBA would resume raising rates “from the middle of the year, assuming that weather normalizes in about April.”

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