DATA SNAPSHOT

RBA Semi-Annual Testimony

Friday, 20 February 2009

- **We continue to look for more RBA rate cuts in coming months, but believe that the size of the cuts will be smaller and there may be some pauses between meetings. RBA Governor Stevens indicated that the central bank will ease rates again if needed.**
- **Our low point for the cash rate this year remains 2.25%. The low point will be crucially dependent on developments in the world economy.**
- **Australia cannot remain immune to the severe synchronised downturn in the world economy, but RBA stimulus is needed to help cushion the slowdown underway in the Australian economy.**

We continue to look for more RBA rate cuts in coming months, but believe that the size of the cuts will be smaller and there may be some pauses between meetings. Importantly Stevens noted that the effects of the stimulus to date "are only beginning". It means that the stimulus should be felt greater in coming months. This implies that the RBA would be more cautious in delivering very aggressive rate cuts.

Our low point for the cash rate this year remains 2.25%. The range of consensus forecasts for the low point currently ranges between 2% and 3.25%.

The low point will be crucially dependent on developments in the world economy. Australia cannot remain immune to the severe synchronised downturn in the world economy, but RBA stimulus can help to cushion the slowdown underway in the Australian economy. As Stevens noted "the deterioration in international economic conditions was so rapid that no policy response could prevent a period of near-term weakness in the Australian economy". The world economy is facing its worst downturn since WWII. Not surprisingly then, the IMF expects the world economy to grow by only 0.5% this year, a marked step down from growth of 3.4% last year and 5.2% in 2007.

Despite the slowdown underway in the Australian economy and the dampening influences continuing to pervade the economy, Australia remains better positioned than many countries to ride out the international storm. The RBA notes the key reasons for this stance and why it believes that the Australian economy will come out of this episode "not unscathed, but well placed to benefit from a renewed expansion". These reasons include:

(1) Australia's "major financial institutions are still in a strong position, have access to debt and equity markets, are still earning good profits, and are in position to lend for sound proposals".

(2) Australia's housing sector is characterised by "considerable pent-up demand, and [housing] affordability is improving quickly".

(3) "Most of the corporate sector is not over-geared".

(4) "The scope to use macroeconomic stimulus was bigger than for most countries" in Australia and "that scope is being used".

(5) The transmission mechanism for monetary policy is "still working".

Other key comments made by RBA Governor Stevens on the Australian economy include:

- Terms of trade (value of exports over imports): rose by 65% over five years but estimated to fall by up to 20% during the next year. That, however, would still leave them at a historically high level.
- Commodity prices and mining companies: Several important commodity prices have stabilised over the past few months after steep falls. Stronger mining companies will still earn good profits at these levels.

- **China:** There are some tentative indications of a turn for the better in China in some of the most recent data. But it is too early to tell if this will continue. China's emergence has not finished, it still has years to run and Australia will benefit from this.

- **Business conditions and business confidence:** Business are anticipating tougher times ahead with business confidence having deteriorated sharply. Indications are that investment plans are being quickly curtailed amid tougher credit conditions.

- **Households:** Affected by a "significant" loss of wealth, especially over the later part of last year. Consumers are more inclined to save and pay down debt. But measures of domestic consumer confidence and consumer spending have held up much better than in many other countries.

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