MARKET SNAPSHOT

RBA Governor Glenn Stevens Speech

Thursday, 20th November 2008

- **Interest rates are near neutral and RBA will consider at its December meeting whether policy should be on the expansionary side of neutral.**
- **More government spending may be needed to support monetary policy, even if it involves prudent borrowing.**
- **But it is still important for fiscal measures to pass the 'good policy' test.**
- **"The biggest mistake we could make would be to talk ourselves into unnecessary economic weakness".**

RBA Governor Glenn Stevens presented a speech last night entitled, "The Economic Situation". The Governor noted that, "What had been for over a year a serious dislocation in international financial markets, but one which seemed to be being managed, turned quite suddenly into a very serious crisis during the weeks following the failure of Lehman Brothers on 15 September". He added that, in a breathtaking turn of evens, "the financial landscape changed dramatically" with substantial weakness in share markets, large movements in currencies, further declines in commodity prices, increased risk aversion and more widespread constraints on credit. Accordingly, it is not a surprise then that economic growth forecasts have been in a state of almost continual downward revision.

But the RBA Governor warned that although the situation is serious, there is a risk of being overly pessimistic. He said that, "the biggest mistake we could make would be to talk ourselves into unnecessary economic weakness…the long-run prospects for the Australian economy have not deteriorated to the extent that might be suggested by the extent of some of the gloomy talk that is around". Stevens added, "If businesses remain focused on the long-term opportunities; if markets and commentators do the same; if banks remain willing to lend on reasonable terms for good proposals; if governments are able to so order their affairs as to continue supporting worthwhile – and I emphasise worthwhile – public investment, even if that involves some prudent borrowing; then Australia will come through the present period. We ought to go forward with some quiet confidence in our own abilities and in the opportunities that are on offer".

Stevens also noted that although the Chinese economy (as a strong contributor to Australia) is in a more pronounced slowdown than anticipated, it could be strengthening a year from now. Helping to offset the downside risks to the Chinese economy is their recently introduced hefty fiscal stimulus and noticeable monetary policy loosening in just the last two months. According to Stevens, it will be six to nine months before we can assess whether enough has been done but, "it is a safe bet that more will be done before long, if the recent comments by the authorities in various countries are any guide".

Stevens also noted that interest rates were near neutral. In our view, this indicates that there is still a way to go before monetary policy enters expansionary territory. Accordingly, it indicates that more aggressive rate cuts are likely. We project a further reduction of 0.75% next month. Thereafter we expect further easing so that interest rates reach a low point of 4.00% in H1 2009 (with sub 4.00% not to be ruled out). Credit market developments will be important in determining the low point for the cash rate.

Earlier, Assistant Governor Malcolm Edey had delivered a speech entitled "The Economy in Late 2008: Conditions and Prospects". Here, he reiterated previous RBA comments that the aggressive rate cuts, fiscal stimulus and weak Australian Dollar will help cushion the domestic economic slowdown but not prevent it. Edey pointed out that the forecasts released by the RBA last week still envisaged a "significant further slowing in the Australian economy from the pace recorded at mid-year". The Assistant Governor also cautioned that these forecasts are subject to uncertainty given extraordinary markets. Another key statement Edey made was that most of the significant interest rate cuts over the last three months have been passed on to end borrowers. "We do think that will have a significant supportive effect on the economy", he said.

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