

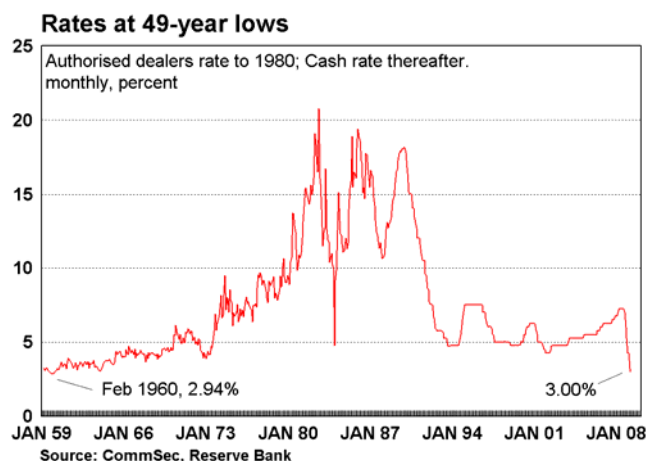
# Rates at 49-year low, but end point in sight

## Reserve Bank Board meeting

- The Reserve Bank today cut the cash rate by 25 basis points to 3.00 per cent. The cash rate is at the lowest levels since February 1960 when it stood at 2.94 per cent.
- The decision to cut rates has a positive “announcement effect”, lifting confidence, but limits the risk of over-stimulating the economy.
- The Reserve Bank may not have reached the end point for rates but it isn't far away. CommSec believes that the cash rate could still fall between 25-50 basis points if warranted over 2009.

### What does it all mean?

- This is a very smart decision. Rates have been cut, confidence has received a boost and the Reserve Bank has left the door open for more stimulus if needed. The Reserve Bank strategists must have been up all night running through the options, and it looks like they have come up with a winner.
- The Reserve Bank is now playing out the end game for rates, and still with Australian rates three percentage points higher than the US. Still, Australia is under-supplied with homes, not over-supplied like the US. Australian banks are the strongest in the world, and not being bailed out as in the US or UK. And government finances are solid in Australia not haemorrhaging as in the US.
- The interest rate decision is nicely balanced. The rate cut will provide another much-needed boost to confidence levels but the modest nature of the fall limits the risk of over-stimulating the economy.
- The \$900 cash handout to consumers, the upcoming Budget and forthcoming tax cuts would have been significant factors causing the Reserve Bank to hasten slowly on further rate cuts.
- If there is one thing the Australian economy is short of, it's confidence. In parts of the world like the US and the UK, there are reasons to be gloomy, with banks failing and home prices falling. But in Australia, the banking system is strong and home prices are rising. The problem is that Australians are seeing the news from abroad and wrongly believing that what is happening abroad is happening here.
- The fact that rates have been cut by just 25 basis points, not 50 basis points should be very well received. A larger reduction in rates may have signalled to some people that the economy was in bad shape and that worse news lay ahead. And if the Reserve Bank had left rates on hold, it wouldn't have achieved the same media coverage and boost to confidence levels.
- Remarkably, Australian interest rates are at the lowest levels in almost half a century, but still has the highest interest rates in the developed world.
- There is no doubt that rate cuts are working their magic in the economy. Home lending is soaring, with the increase in buyer numbers creating mini booms in some parts of Australia. The key reason that the Reserve Bank didn't cut rates by 50 basis points or even more is because Board members felt that it wasn't warranted.
- The Reserve Bank hasn't shut the door on future



Craig James – Chief Economist (Author)  
(612) 9312 0265 (work)

Produced by Commonwealth Research based on information available at the time of publishing. We believe that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made as at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, neither Commonwealth Bank of Australia ABN 48 123 123 124 nor any of its subsidiaries accept liability to any person for loss or damage arising from the use of this report.

The report has been prepared without taking account of the objectives, financial situation or needs of any particular individual. For this reason, any individual should, before acting on the information in this report, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice. In the case of certain securities Commonwealth Bank of Australia is or may be the only market maker.

This report is approved and distributed in Australia by Commonwealth Securities Limited ABN 60 067 254 399 a wholly owned but not guaranteed subsidiary of Commonwealth Bank of Australia. This report is approved and distributed in the UK by Commonwealth Bank of Australia incorporated in Australia with limited liability. Registered in England No. BR250 and regulated in the UK by the Financial Services Authority (FSA). This report does not purport to be a complete statement or summary. For the purpose of the FSA rules, this report and related services are not intended for private customers and are not available to them.

Commonwealth Bank of Australia and its subsidiaries have effected or may effect transactions for their own account in any investments or related investments referred to in this report.

rate cuts but it has signalled that the end point is near. CommSec believes that rates could still be cut 25-50 basis points over 2009, but only if conditions deteriorate abroad.

### Interest rate decision and past cycles

- The Reserve Bank has cut the cash rate by 25 basis points (quarter of a percent) to a 49-year low of 3.00 per cent.
- The cumulative rate cuts of 4.25 percentage points since September 2008 represent the most aggressive easing cycle ever undertaken.
- The cash rate of 3.00 per cent is the lowest since February 1960 when the short term money market yield averaged 2.94 per cent.
- Consistent data on short-term money market rates extends back to August 1961. The low point was January 1964 when the weighted average rate stood at 3.02 per cent. Before August 1961 there were minimum and maximum short-term money market rates. In February 1960 the simple average cash rate stood at 2.94 per cent.
- Before the September rate cut there had been twelve rate hikes in the cycle extending back over five years (since May 2002), the last occurring on March 4. Over that period, rates lifted 3 percentage points to 7.25 per cent.
- Just like 2000/01 there was a gap of six months between the last rate hike and first rate cut. In the 2001 rate cut cycle, rates were cut by 2 percentage points in the space of 11 months (to 4.25 per cent).

### Comparing the two most recent statements

- The statement from the March meeting is on the left; the statement from today's April 2009 meeting is on the right. Emphasis has been added to significant changes in wording in the recent statement.

#### MEDIA RELEASE

**No:** 2009-05  
**Date:** 3 March 2009  
**Embargo:** For Immediate Release

#### STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to leave the cash rate unchanged at 3.25 per cent.

Recent data confirm that the world economy has remained very weak following the sharp decline in demand that occurred late last year. The major industrial economies reported large contractions in output in the December quarter, as did a number of emerging market economies across Asia and eastern Europe. Many countries are likely to be experiencing further falls in output in the current quarter.

Conditions in global credit markets have improved since November, but **sentiment remains fragile**. Share prices have weakened and banking systems in several major countries are still under pressure, as authorities work towards a resolution of the balance-sheet problems. Significant macroeconomic policy stimulus is being put in place around the world, but it is too soon to see the effects of those measures.

In Australia, **demand has not weakened as much as in other countries** and, on the basis of currently available information, the Australian economy has not experienced the sort of large contraction seen elsewhere. **The Australian financial system remains strong** and the monetary policy transmission process is working to deliver large reductions in interest rates to end borrowers. Nonetheless, economic conditions are clearly weak, and given the speed and scale of the global economic deterioration and its effect on confidence, weak conditions are likely to continue in the near term. Inflation is likely to decline over time.

In response to that outlook, there has already been a major change in both monetary and fiscal policy. Market and mortgage rates are at very low levels by historical standards and business loan rates are below recent averages, reducing debt-servicing burdens considerably. **Together with the substantial fiscal initiatives, the cumulative decline in interest rates will provide significant support to domestic demand over the period ahead.** On this basis, notwithstanding evident economic weakness at present, the Board judged that the stance of monetary policy was appropriate for the moment. The Board will consider the position again at its next meeting.

#### MEDIA RELEASE

**No:** 2009-06  
**Date:** 7 April 2009  
**Embargo:** For Immediate Release

#### STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to lower the cash rate by 25 basis points to 3.0 per cent, effective 8 April 2009.

Recent information from abroad indicates that the contraction in the global economy continued during the first few months of this year, and most assessments of the near-term outlook have been further marked down. **Considerable economic policy stimulus is in train** in most countries, the full effects of which are not yet discernible, but which should help contain the downturn over the rest of the year. There are tentative signs of stabilisation in several countries, including China, though it is too early yet to judge how durable these will prove to be.

Conditions in global financial markets have continued to improve gradually, helped by progress towards a resolution of banking system difficulties in the United States and other major countries. **Sentiment remains fragile**, however, and the contraction in economic activity is affecting asset quality of financial institutions.

The Australian economy is contracting, though by less than those of its trading partners. Capacity utilisation has fallen from its peak, and will decline further over the rest of the year. With demand for labour weakening, growth in labour costs will probably also fall. Hence inflation over the medium term is likely to be lower than it has been over the past two years. Demand for credit is weak overall, though **credit for owner-occupied housing is picking up**.

**There has already been a major change in both monetary and fiscal policy in Australia.** Market and mortgage rates are at very low levels by historical standards and business loan rates are below recent averages, reducing debt-servicing burdens considerably. Nonetheless, the Board judged that there was scope for a further modest adjustment to the cash rate. The stance of monetary policy, together with the substantial fiscal initiatives, will provide significant support to domestic demand over the period ahead.

**Reaction: Sharemarket eases; AUD rises, future rate cuts re-assessed**

- The All Ordinaries index eased from 3672 points just ahead of the decision, to 3656 in late afternoon trade. Still, the sharemarket had been lower by around 1.0 per cent over most of the day, so there was little perceptible impact.
- The Australian dollar rose from near US70.80 cents to US71.35 cents in immediate reaction to the rate cut announcement before steadying near US71.25 cents.
- The overnight indexed swap market is now pricing in a cash rate of 2.75-3.00 per cent over the next four months. Implied yields rose by around 8 basis points after the decision.

**What are the implications for interest rates and investors?**

- We had expected a 50 basis point rate cut, believing that banks would only pass on some of the move. The Reserve Bank also would have assumed banks wouldn't be able to pass on all the rate cut but clearly didn't want mortgages cut significantly, opting for a smaller cut in the cash rate.
- Last month we indicated that the end point for rates wasn't far away. Now we are even more certain. If borrowers are wanting to lock in rates, they need to think seriously about doing it. Property investors should also be more motivated to act.
- The Australian dollar now has a floor. Interest rates won't fall much further provided there isn't a fresh bout of instability in the US banking system. At the same time if confidence levels rise, boosting sharemarkets, then the Aussie dollar will rise also. Our CBA strategists are pencilling in US77 cents by end year.

Craig James, Chief Economist, CommSec  
 Work: (612) 9312 0265;

