

# Recession, but light at the end of the tunnel

## RBA Board minutes

- **The Reserve Bank Board has revised down growth forecasts for 2009, assuming negative GDP growth in the March quarter – confirming a domestic recession. Despite the more pessimistic view, board members decided on only 25bps rather than a larger amount.**
- **The Board has indicated that while growth is expected to soften in the near term, the longer term view is much more favourable. As such highlighted a raft of positive trends including tentative signs of a global economic recovery.**
- **CommSec expects the Reserve Bank to keep rates on hold at the May meeting. At this stage we are pencilling in another quarter of a per cent rate cut in June.**

### What does it all mean?

- It is pretty clear that the Reserve Bank Board expects a further deterioration of domestic activity. Reserve Bank growth forecasts have once again been revised lower for 2009, and hence “a modest reduction in the cash rate” was necessary as further insurance against the possibility of a prolonged global downturn. The fact that the Reserve Bank did not make a larger rate cut suggest that they want to keep ammunition on hand for later in the year.
- Reserve Bank members appear more upbeat about prospects for the domestic economy towards the end of 2009, having noted tentative signs of an improvement in the US retail spending and in particular a pick up in Chinese steel production and business activity.
- The quarter of a per cent rate cut seem to be more to appease market expectations – that is, to provide the domestic banks with a degree of latitude than to have a real impact on the economy.
- Despite expecting the economy to fall into recession, the Reserve Bank Board only cut rates modestly. The Board clearly believes the Australian economy has been front loaded with more than enough ammunition over the last few months to combat the current downturn. Indeed it is expecting an improvement in economic activity toward the end of the year. As a result the Reserve Bank decided the more prudent course was to provide a further modest stimulus in the short term.
- The Reserve Bank Board certainly hasn't closed the door to further rate cuts. But neither is it flagging that another significant rate cut is on the agenda. A raft of positives were noted across sectors from the pick up in housing activity, double digit growth in business investment, stabilisation of base metal prices, a relatively high terms of trade, and an improvement in credit market conditions over the last month.
- CommSec is factoring in the possibility of another rate cut of 25 basis points over the next few months. At this stage the Reserve Bank looks likely to hold rates steady in May and reassess the situation in subsequent months.

### What do the figures show?

#### Minutes from the February Reserve Bank Board meeting

##### Key Comments:

- *“Members were briefed on the main features of the December quarter national accounts, which had been released on the day following the previous meeting. Output had declined by 0.5 per cent in the quarter, though GDP rose by 0.3 per cent over the course of 2008. Non-farm GDP had been somewhat weaker in the quarter,*

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*and higher output in the farm sector had supported overall GDP. The latest set of indicators suggested that GDP was likely to have fallen again in the March quarter.”*

- *“Retail sales had fallen in February, but, as this had followed strong growth in the previous two months, the level of sales was still higher than prior to the fiscal stimulus late in 2008. The year-ended growth of retail sales in New South Wales was now approaching that of the rest of the country, after a period of over a year in which it had lagged considerably.”*
- *“..Household spending had been supported by a sharp decline in interest payments. As a share of household disposable income, these had fallen by several percentage points in the past six months. However, household net worth was estimated to have fallen further in the March quarter.”*
- *“On a more positive note, members observed that metals prices had stabilised since late 2008, with prices for several base metals having risen noticeably in the past month or so. Indicators of freight costs had also stabilised after falling very rapidly in the second half of 2008, which suggested the decline in world trade had been arrested....”*
- *“China, however, there had been signs of improvement in the economic data, with a key measure of business activity picking up relatively sharply in the past two months. Steel production had also increased, as had industrial production more generally, though the timing of the Chinese New Year meant these data needed to be interpreted with caution. Elsewhere in east Asia, key monthly indicators of production and exports appeared to have bottomed in the early months of 2009 after very sharp falls in the December quarter..”*
- *“In Australia, conditions in credit markets had become more positive over the past month. Spreads on short-term debt had fallen considerably. In other signs of generally improving conditions, banks’ demand for funds at the Reserve Bank had declined,.*
- *“Conditions in the labour market had continued to soften. While part-time employment had increased in recent months, the full-time component had fallen steadily since mid 2008 and the unemployment rate had risen. Further falls in employment and rises in unemployment were expected.”*
- *Despite the weakening labour market, wages, as measured by average earnings in the national accounts, had risen by around 6 per cent over 2008, well above its recent average*
- *“Domestically, information over the past month had confirmed that the economy had contracted in the December quarter, though the fall in GDP had been considerably less than that of Australia’s trading partners. Data for the March quarter thus far suggested another weak outcome for demand and output, though members noted that consumption had held up relatively well following the boost to spending late in 2008..”*
- *“As a consequence of the contraction in aggregate demand and output, capacity utilisation had continued to decline and the demand for labour had weakened. Members noted that the staff forecast for growth had been revised lower from that published in the February Statement on Monetary Policy. Inflation over the medium term was expected to continue to decline”*
- *“..the near-term outlook for demand and output in Australia was now weaker than earlier expected, though a recovery in demand was likely towards the end of the year.”*

### **What is the importance of the economic data?**

- The Reserve Bank releases minutes of its monthly Board meeting a fortnight after the event. The minutes give a guide to Reserve Bank thinking on interest rate settings.

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

- Future rate cuts will all depend on the state of financial markets and global economic at the time of each Reserve Bank Board meeting. At some point the Reserve Bank is likely to call a low for interest rates with money markets expecting it to be around 2 -2.5 per cent.
- The Board clearly believed that with interest rates now at 49 years lows and significant fiscal stimulus currently been undertaken, it will have an expansionary effect on the Australian economy in the longer term.
- CommSec expects another reduction of 25 basis points to be delivered at the June Reserve Bank Board meeting.

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