

Interest rate drops in sight

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Stephen McMahon

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INTEREST rates may drop back to 6 per cent by late next year as the latest economic data shows a significant slowing in the economy.

NAB chief economist Alan Oster said there is a 30 per cent chance the Reserve Bank of Australia will begin cutting rates this year as economic growth deteriorates.

As the RBA looks to have won another round in its heavyweight fight against inflation, Mr Oster is forecasting interest rates will fall steeply in 2009 from a 13-year high of 7.25 per cent back to 6 per cent.

"An interest rate cut this year is a possibility, but there may not be enough of a slowdown," Mr Oster said.

"But we think that by the late 2009 they will be down to about 6 per cent."

This view comes as the latest NAB business survey shows spending patterns are slowing and business conditions have plummeted to the lowest point since late 2002.

Mr Oster said the economic downturn is now "broad-based" and the "deceleration is gaining momentum" after the RBA's back-to-back rate rises in February and March.

The business survey showed a double-digit fall in business conditions for retailing, transport, finance and property.

Mr Oster expects the slowdown will result in unemployment levels jumping from just over 4 per cent to about 5 per cent next year.

This follows Monday's job advertisement survey that registered its fourth consecutive month of declines as employers pare back hiring.

Citigroup co-head of market and economic analysis Paul Brennan said the upcoming consumer price index on April 23 will show inflation is still very high but that the RBA will look through the data.

"There is still a lot of inflationary pressure in the economy from the strong growth in the second half of 2007 but inflation pressures should begin to moderate in the next few months," Mr Brennan said.

"The RBA is adopting a wait-and-see approach because there has been a lot of tightening and this takes time to work its way through the system."

Sydney Futures Exchange traders have priced in a greater than 50 per cent possibility of interest rates falling to 7 per cent in November.

But Mr Brennan forecast that rates won't start falling until early next year and will drop to about 6.5 per cent by the end of 2009.

Deutsche Bank economist Phil O'Donoghue said it is "a bit early to be talking about rate cuts" as the finance house is still forecasting another rate rise to 7.5 per cent later this year.

He points to the surge in coal prices as being a major threat to inflation as it could push the terms of trade even higher than February's record \$3.3 billion trade deficit.

Australian coal exporters are expected to secure a tripling of coal prices.

The higher terms of trade, tax cuts in next month's federal budget and a rebound in farm prices are expected to offset some of the recent downturn in economic growth and bolster inflationary pressures.

Despite his short-term reservations, Mr O'Donoghue said the RBA is getting on top of inflation and in time the bank's tightening bias will begin to soften.

He is predicting that as the economy slows the RBA will be forced into a series of rapid interest rate cuts next year to take official cash rates to about 6 per cent by late 2009.

The Australian economic slowdown will also be aided by the global economic slowdown stemming from a recession in the US.