Interest rates must keep coming down

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AFTER 18 years of driving down Prosperity Street, we have reached a crossroads.

Where are we? On the left we have alarmingly high inflation and on the right we can see a recession looming ominously on the horizon.

In the September quarter, core inflation grew to 5 per cent, well outside the central bank's target comfort zone of 2-3 per cent.

The last time inflation was this high was in the middle of the 1990-91 recession.

Normally, when inflation rises too high, the central bank jacks up interest rates to cut people's spending and get prices to fall back as demand begins to slow again.

However, times are not normal and the central bank is more worried about the global financial meltdown and looming recession than keeping the inflation genie in the bottle.

This time, the RBA is cutting rates deeply to get Australian consumers to keep spending and buying houses.

But people are worried about their jobs, the economy and rising prices, and are saving like never before.

One of Australia's most experienced interest rate strategists, Rory Robertson of Macquarie Bank, is in Brisbane this week speaking to the networking group Girls Learning About Money (GLAM).

A leading market economist, Robertson says avoiding a recession will not be easy, if it's not already too late.

Recession is deemed to be two quarters of negative growth for the country.

Robertson says "animal spirits", the description given by famed economist John Maynard Keynes to the vibes that drive investment spending, have been crushed in recent months in pretty well every corner of the globe.

"My attitude remains that the alarming deterioration of the global outlook – and so sharply increased risk of recession in Australia – means there is plenty of room for both further cuts in interest rates and Canberra's recently announced fiscal easing," he says.

"And I take little comfort from the fact that the available official data to September show the Australian economy to be fairly stable. Despite lower interest rates, fiscal stimulus, and the weaker Australian dollar, avoiding recession will be no mean feat, if indeed one has not already begun."

The Housing Industry Association, Australia's largest building industry association, welcomed the Reserve Bank's decision on Melbourne Cup day to lower interest rates by 0.75 per cent to 5.25 per cent as it is hoped the cut will be a catalyst to spark housing prices up again.

Robertson expects a further 50-75 basis point cut to the official cash rate in December, dropping it to 4.5-4.75 per cent.

"Beyond December, my targeted cash rate of 4.25 per cent clearly is only a matter of time. And, again, if the global credit crunch continues to intensify, and the global economic downturn becomes as severe and long-lasting as well it might, the RBA will find itself cutting to 3 per cent, with mortgage rates falling well below 6 per cent."

Investment bank JPMorgan was the first major forecaster to say the economy would contract in the December quarter and the next – satisfying one of the most common definitions of recession.

Deutsche Bank, too, expects the economy to contract in the present quarter despite the Government's $10.4 billion economic stimulus package, much of which will hit consumers' pockets in December.

This Thursday at the Suncorp Centre at 5.45pm, Rory Robertson will give an overview of the origins of the credit crunch and his economic outlook. Tickets $30. Register at www.girlslearningaboutmoney.com