

Dec 4, 2012 Reserve Bank decides to cut official cash rate to record low of 3%

Background:

- Mining sector growth is fading
- Business and consumer confidence still below average
- Employment growth is subdued
- Housing indicators are below past standards

What Investors may expect :

- Term deposit rates are likely to drop below 4%
- Record low bond yields means bonds are poor value for investors and yields are likely to remain low as cash rates decline
- Shares are offering an increasingly higher yield than bank deposits.
- Australian shares look like continuing to benefit from lower interest rates
- Pressure is off the \$A , but likely to remain in the \$1 range (+ or – 5 to 10 cents)

Statement by Glenn Stevens, Governor: Monetary Policy Decision

At its meeting today, the Board decided to reduce the cash rate by 25 basis points to 3.0 per cent, effective 5 December 2012.

Global growth is forecast to be a little below average for a time. Risks to the outlook are still seen to be on the downside, largely as a result of the situation in Europe, though the uncertainty over the course of US fiscal policy is also weighing on sentiment at present. Recent data suggest that the US economy is recording moderate growth and that growth in China has stabilised. Around Asia generally, growth has been dampened by the more moderate Chinese expansion and the weakness in Europe.

Key commodity prices for Australia remain significantly lower than earlier in the year, though trends have been more mixed over the past few months. The terms of trade have declined by about 15 per cent since the peak, to a level that is still historically high.

Sentiment in financial markets remains better than it was in mid year, in response to signs of progress in addressing Europe's financial problems, though Europe is likely to remain a source of instability for some time. Long-term interest rates faced by highly rated sovereigns, including Australia, remain at exceptionally low levels. Capital markets remain open to corporations and well-rated banks, and Australian banks have had no difficulty accessing funding, including on an unsecured basis. Borrowing conditions for large corporations are similarly attractive and share prices have risen since mid year.

In Australia, most indicators available for this meeting suggest that growth has been running close to trend over the past year, led by very large increases in capital spending in the resources sector, while some other sectors have experienced weaker conditions. Looking ahead, recent data confirm that the peak in resource investment is approaching. As it does, there will be more scope for some other areas of demand to strengthen.

Private consumption spending is expected to grow, but a return to the very strong growth of some years ago is unlikely. Available information suggests that the near-term outlook for non-residential building investment, and investment generally outside the resources sector, remains relatively subdued. Public spending is forecast to be constrained. On the other hand, there are indications of a prospective improvement in dwelling

investment, with dwelling prices moving a little higher, rental yields increasing and building approvals having turned up.

Inflation is consistent with the medium-term target, with underlying measures at around 2½ per cent. The introduction of the carbon price affected consumer prices in the September quarter, and there could be some further small effects over the next couple of quarters. Partly as a result of that, headline CPI inflation will rise above 3 per cent briefly. Looking further ahead, with the labour market softening somewhat and unemployment edging higher, conditions are working to contain pressure on labour costs. A continuation of moderate wage outcomes and improved productivity performance will be needed to keep inflation low, since the effects on prices of the earlier exchange rate appreciation are now waning. The Bank's assessment remains that inflation will be consistent with the target over the next one to two years.

Over the past year, monetary policy has become more accommodative. There are signs of easier conditions starting to have some of the expected effects, though the exchange rate remains higher than might have been expected, given the observed decline in export prices and the weaker global outlook. While the full effects of earlier measures are yet to be observed, the Board judged at today's meeting that a further easing in the stance of monetary policy was appropriate now. This will help to foster sustainable growth in demand and inflation outcomes consistent with the target over time.