

Australian central bank says inflation set to fall in 2009

21 hours ago

SYDNEY (AFP) — Australia's inflation rate is "uncomfortably high" but will fall in 2009 as the economy slows amid lower oil prices and a modest slowdown in China, the nation's central banker said Monday.

Reserve Bank of Australia (RBA) governor Glenn Stevens said inflation was likely to peak in the September quarter at about 5.0 percent -- well above the bank's preferred range of 2.0-3.0 percent. He told a parliamentary committee in Melbourne that strong demand and record prices for Australian resources over recent years meant "headline inflation figures will remain uncomfortably high for a little while yet."

"But with international oil prices below their mid-year peaks and signs that the pace of food price increases are abating, it is reasonable to expect that CPI (consumer price index) inflation will thereafter start to fall back," he said.

"With demand growth slower, capacity utilisation, while still high, is tending to decline. Trends such as this usually dampen underlying price pressures over time, and those effects should start to become apparent during 2009 and continue into 2010."

Stevens said if wage growth did not accelerate and demand growth remained moderate in the near term, the prospects for inflation gradually returning to the bank's target zone were improving. He said while growth in the economy was running at a pace slower than last year, and slower than trend, Australia was unlikely to face a recession.

He said the risk of recession was not "zero," but added the economy was in a "slow growth-like period" and that unemployment could rise over the next 18 months.

The RBA has forecast economic growth of 2.0 percent for 2008, lower than last year's expansion. Stevens said the forecast had contributed to the bank's decision last week to cut interest rates from a 12-year high of 7.25 percent to 7.0 percent -- the first reduction in close to seven years.

"The economy is the process of changing lanes, so the steering has to be adjusted," he said. "It's simply that at this point of the cycle it was prudent not be pressing on the brake as hard as we were."

He defended the previous 12 consecutive rate rises, saying "when inflation is rising like that you have to respond."

But he said the trend would now be in the opposite direction as the RBA attempted to manage a softer landing as the economy slowed.

"Unless something quite surprising happens, it seems to me unlikely that we will be reversing course up again in the near term," he said.

Stevens noted that Australia's terms of trade, the ratio of export to import prices, was likely to fall as China's strong economic growth moderates.

"China is slowing down," he said. "The assumption we've made (is for) some modest decline in the terms of trade after five phenomenal years."

But he said China's demand for raw materials would continue even if the economy slowed.

Stevens said he expected more subdued growth internationally after the world economy expanded faster than expected in early 2008.

"We are assuming that weakish performance will continue in the near term," he said.

Source: AFP