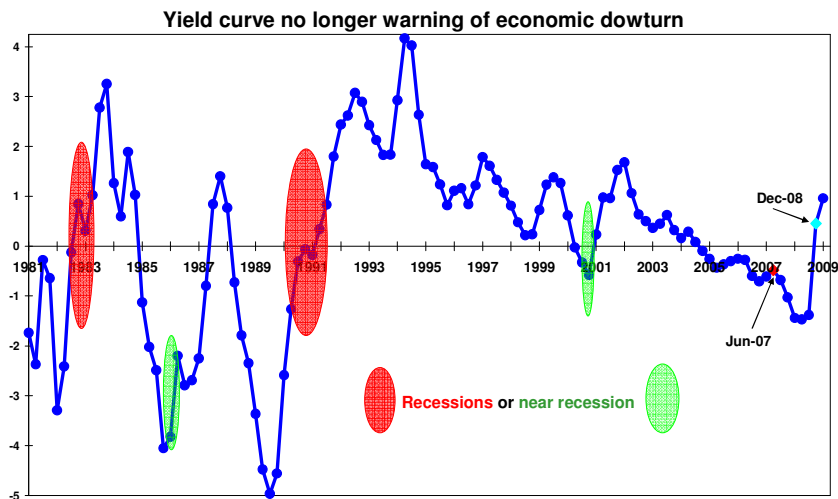


No recession**3 February 2009**

The additional fiscal and monetary stimulus announced today add to my concern that there is more than enough stimulus to reflate the Australian economy. In announcing a 100 basis point cut in the OCR to a lowly 3.25% today the Reserve Bank “Board took into account the package of measures announced by the Government earlier today. The combination of expansionary monetary and fiscal policies now in place will help to cushion the Australian economy from the contractionary forces coming from abroad.” At the risk of sounding like I agree with them and after warning about a recession since 2007, I now doubt Australia’s economy will recede. In the past thirty years there have been two major recessions and a few near-miss recessions, the last near-miss was in the second half of 2000. “Everyone” is saying the economy is in or about to have another of those episodes (full blown or near-miss). These “everybodies” would have more credibility if they had not been cheering the RBA last year when it kept raising rates and were urging even more hikes through the middle of 2008. Yet because the yield curve (YC) and the economic data were telling me otherwise, I had been expecting an economic slowdown.



The warning signals began in 2006 but the economy appeared resilient. The resources boom was artificially giving the impression that the economy was stronger than it was; the resources boom’s “terms of trade” effect boosted National Income and Exports which then boosted the headline GDP. However when the YC began to re-invert more noticeably in mid-2007 the economy’s headline fortune looked in jeopardy. In the past 30 years, each time the economy has had a recession or near-miss the YC has also inverted quite sometime before: In the 1982/83 Fraser/Howard recession the YC inverted 6 quarters before; in the 1990/91 Hawke/Keating recession the YC inverted 8 quarters before; in the 2000 Howard/Costello near-miss recession the YC had inverted 2 quarters before the negative GDP in the December quarter 2000. Then the YC turns from inversion to positive after interest rates start to be cut in response to the economic weakness; that turn in the YC is a signal of better economic times ahead. In the 1980’s recession the YC became positive 3 quarters before the recession ended; in the 1990’s recession the YC turned positive 2 quarters before the recession ended. A rapid reversal of monetary policy at the start of 2001 saw the YC turn positive (and with it the economy) in the next quarter after the first and only quarter of negative growth. In the current episode the YC has already turned positive in the December quarter (October) 2008 and I believe that is also a positive signal. There has not yet been any negative quarterly growth, and while the December quarter GDP data won’t be released until early March 2009, I believe the positive turn in the YC (and other economic data) give good reason to be more optimistic about the economy’s fortunes than the consensus believes. In addition with the Government seriously worried about (their) jobs in 2010, the prospect of even more fiscal and monetary stimulus should underwrite that forecast of no recession.

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