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## **Pressure grows for rate cuts as retail spending crashes**

David Uren, Economics correspondent | August 01, 2008

**CONSUMER spending and bank lending have slumped to recession levels, putting pressure on the Reserve Bank to start cutting interest rates before it has inflation under control.**

Retailers suffered their worst month in seven years in June as the money through the till dropped by 1 per cent under the weight of rising mortgage costs and soaring petrol prices.

The Reserve Bank separately released figures showing growth in home lending at its lowest level in 25 years, while other personal and business lending was also weak.

Financial markets now believe there is a 75 per cent chance that the Reserve Bank will cut interest rates by October. Markets expect two rate cuts from the current 12-year high of 7.25 per cent by early next year.

"This economy is slowing a lot quicker than we all thought," National Australia Bank chief economist Alan Oster said yesterday.

He said that with world credit markets in bad shape, it was possible that the Reserve Bank would start reducing rates with a 0.5 percentage point cut, to make sure that the benefit was passed on to borrowers.

The Reserve Bank board meets in Sydney on Tuesday and is not expected to shift rates but governor Glenn Stevens may give an indication of the seriousness with which the board views the economic downturn.

The value of the Australian dollar dropped to US94.5c yesterday as markets started weighing the possibility of a recession. Analysts said it might continue falling towards US90c.

Wayne Swan yesterday said retail figures to June did not take account of the budget tax cuts, which took effect from July 1. "We shouldn't be surprised by these figures, given family budgets have been hit for six by eight interest rate rises in just over three years, and sky-high global oil prices," he said.

As well as tax cuts, the economy will also be supported over the rest of the year by increased income from the coal and iron ore miners which will be distributed to governments, shareholders and employees.

The dimensions of that boost were shown through Australia's trade recording a \$412 million surplus in June. Over the past three months, the trade surplus has totalled \$765 million, whereas in the previous three months there was a deficit of \$7.6 billion.

Yesterday's retail figures show that merchants have been relying on inflation to deliver revenue growth throughout this year. The volume of goods being sold has been falling since the beginning of the year. There was a 0.3per cent fall in the March quarter and a 0.6 per cent drop in the June quarter.

"Retailers have experienced the weakest start to a year in nearly 30 years," CommSec equities economist Savanth Sebastian said.

Retailers started their winter sales two weeks early to try to clear volume, but ABS figures released yesterday show they did not succeed.

The consumer spending cutback has been the most savage for department stores and clothing retailers, where sales slumped by 5 per cent in June. Excluding the ABS seasonal adjustment, clothing sales were down by 9.3per cent in the month.

Spending on food dropped by 0.2 per cent.

Economists said that if the downturn in consumer spending continued, unemployment would start rising.

"It can only be a matter of time before retailers - the largest single employer in the country - start to fire their workers," Morgan Stanley chief economist Gerard Minack said.

Lending to business, which was rising at an annual rate of 23.7 per cent as recently as January, had managed an annual growth rate of only 4 per cent over the past three months.

Major banks were rationing credit to larger corporations and demand from smaller businesses had evaporated.

The growth of lending for housing is down to an annual rate of 9.9 per cent. It is the first time it has been in single figures since 1982. New personal lending is showing annual growth of only 4.1 per cent, the lowest since the end of the 1992 recession.

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