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BUSINESS COUNCIL

## Reasons to be confident about the economy



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We all knew that, globally, economic conditions were weakening from the middle of last year, but then they took a sharp turn for the worse towards the end of the year.

All of the major economies contracted severely in the December quarter 2008 – the US by 1%, the UK 1½%, the EuroZone by 1½%, and the Japanese economy by 3% – demand from China slowed significantly and the downturn spread to other parts of the world, including Asia, Latin America and Eastern Europe. The IMF is now predicting world economic growth to be the lowest since World War II. We are facing an emerging global recession. 2009 is shaping up to be a difficult year indeed.

In Australia, the ACCI index of General Business

The Updated Economic and Financial Outlook published in February 2009 predicted that unemployment will rise to 7 per cent by June 2010, meaning an additional 300,000 Australians will be out of work. In the ACT Access Economics has forecast that unemployment will double from 2.6% to 5.4%.

Conditions fell further into negative territory over the December quarter to 35.8, the lowest level in the survey's 14 year history and almost 20 points below the five year average of 55.5. The Updated Economic and Financial Outlook published in February 2009 predicted that unemployment will rise to 7 per cent by June 2010, meaning an additional 300,000 Australians will be out of work. In the ACT Access Economics has forecast that unemployment will double from 2.6% to 5.4%.

### What happened?

In a speech to CEDA on 18 February the Assistant Governor of the RBA, Malcolm Edey, listed the main factors at work in this rapid global economic deterioration as a combination of the widespread loss of confidence in the wake of the collapse of the US investment bank Lehman Brothers, on 15 September 2008, and the failure or near-failure of other financial institutions in the United States and Europe; the uncertainty about the likely success of various rescue packages, the

tightening of credit including lending for consumer and business spending and the rapid transmission of these events around the world through the trade channel, as businesses cut back on production in response to reduced orders.

This confirms what most people in business already know – a restoration of CONFIDENCE is critical if we are to stem the slide into recession. This is particularly the case in Australia where there are good reasons to expect that the economy can continue to perform better than others in the difficult period that lies ahead. These include:

- Australia had more momentum than most comparable economies in the period leading into the crisis
- substantial monetary and fiscal measures have been taken to support growth and maintain confidence in our economy
- the Australian financial system remains in much better shape than its international counterparts
- we have been able to gain much more traction from cuts in official interest rates (from a high point of 7.25% in September 2008 to 3.25% on 3 February 2009) These cuts have been largely passed through to end borrowers, particularly for housing loans
- the depreciation of the exchange rate is another factor helping to insulate the domestic economy from events abroad
- the ACT economy, while not immune, may be cushioned from the impact of the global financial crisis providing public sector employment levels are maintained and the procurement of goods and services by both the Commonwealth and ACT Governments continues at pre-downturn levels.

Malcolm Edey suggested that the factors that will contribute to an upturn, over time, include the substantial set of expansionary measures that have been taken through conventional monetary and fiscal policies (interest rate cuts and large fiscal policy initiatives, steps to provide direct assistance to financial sectors – including the provision of government guarantees and the normal cyclical dynamics of the economy that will mean, at some point during a generalised loss of confidence, a range of markets will reach a level that is sufficiently cheap to encourage investors back into the market.

The encouraging fact is that governments in Australia and around the world are acting quickly to take significant steps to speed up this process and rebuild confidence in the economy.

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