

INTERVIEW WITH ORIEL MORRISON

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ORIEL MORRISON:

Well, as we approach the end of the financial year, here on Squawk Australia we're taking a look back at the events that have defined where we are today.

So, let's kick it off with a check on just how the Australian economy has fared in the past financial year.

This time last year, the Australian economy was a completely different landscape. We were still enjoying solid growth, and the Australian dollar was reaching unprecedented highs.

But all that has changed as the global financial crisis took a turn for the worst, and economies around the world fell deeper into recession.

Here in Australia we've managed to stave off a technical recession, helped in part by over 50 billion Aussie dollars in government stimulus.

The Reserve Bank meanwhile shifted its attention away from inflation, instead focusing on easing monetary policy, embarking on around a 425 basis points of rate cuts over eight months.

Banks followed in turn, but recent rate rises by the big banks leaves some now expecting further RBA cuts in order for the savings to be passed on to the all important consumer.

And, while we haven't hit a recession yet, with unemployment rising to its highest levels in seven years, the question goes begging - how long will we be able to keep the worst of it away?

Well let's get more on this now with the Assistant Treasurer Nick Sherry, who is coming to us live from Canberra. I'm also joined by Bill Evans, the global head of economics at Westpac, who joins me now on set.

Welcome, to the both of you.

Senator, let me start off with you. Interesting to watch the Australian economy and how it's panning out.

We clearly have just recently managed to avoid a technical recession here in Australia, but we've also started to see this pull back on the market, which of course is going to impact consumer confidence going forward.

As you see things, and as they stand right now in Australia, what is your view on the economy, and when do you believe that we're going to start seeing an economic recovery?

SENATOR NICK SHERRY:

Well good morning Oriel, and good morning Bill.

Well there's no doubt it's been an incredible year in the run up to the end of this financial year with the impact of the global financial and economic crisis.

I think in summary, the Australian economy, as shown, has avoided a technical recession with growth of 0.4 per cent in the March quarter, in marked contrast to most other comparable economies which have entered recession.

It's been an amazing year. But Australia has still stood up well compared to what's happened in comparable economies, in large part I think due to the decisive actions taken by the Rudd Government - the bank guarantee; our stimulus package, which has assisted the retail and construction industries.

So, notwithstanding what's been the most amazing year in 75 years, Australia is comparatively doing, doing well compared to other economies.

ORIEL MORRISON:

Senator, you've been talking about the stimulus there. The current unemployment rate is 5.7 per cent. In the May budget it was forecast to rise to eight and a half per cent by around the middle of 2011.

A lot of chatter about just how much the stimulus that we've already seen go into the economy is already starting to fade out. Can we expect further stimulus from the government going forward?

SENATOR NICK SHERRY:

Well, we've seen the impact of the stimulus. The detailed labour market figures that were released last week show that, in the retail sector for example, jobs in retail over the six months to the end of March actually

grew in Australia, and in the construction sector for the three months they also grew.

Now, that's in marked contrast again to most other comparable countries where jobs in those sectors have fallen off a cliff. That hasn't happened in Australia.

What is important is that the May budget figures, as you've indicated, forecast a peak unemployment rate of around eight and a half per cent in two years.

Now at this point in time we see no reason to vary those forecasts. There will be updated forecasts in November with the mid-year economic forecast.

But we've delivered a stimulus package. We believe that it's helped the economy, and that's where our focus has been.

ORIEL MORRISON:

Bill.

BILL EVANS:

Senator, you, you're confident about that eight and a half per cent forecast, but what we're seeing with our customers is that the link between domestic spending and unemployment might be a bit different in this cycle, mainly because it was only a year, a year and a half ago that they saw labour shortages as being the major constraints on their businesses.

We're now hearing that they're trying a lot harder this time to retain employees; put them on shorter working periods; just to try and retain these highly valued workers.

So, there is a possibility that the unemployment rate won't rise as much as that, and that of course will have huge implications for instance for interest rates.

SENATOR NICK SHERRY:

Well in terms of unemployment, I hope that you're right. Look, I've certainly detected, in my local community in Tasmania, a much stronger focus on keeping employment and an understanding that we face, or the global economy, faces the worst circumstances in 75 years.

But, as to any change in forecasts for unemployment, certainly my hope is that the forecast of eight and a half per cent comes in on the lower side.

But we haven't changed our forecasts yet. It's still, still forecasting a peak unemployment in two years of close to eight and a half per cent – I might say this is a forecast considerably below other advanced economies.

ORIEL MORRISON:

Senator, let me jump in here with a question about the banks and interest rates.

Now, the RBA said last week when they were looking at the Australian banks that net interest margins had expanded. But we are still seeing our Australian banks actually lift interest rates.

Of course, we saw the CBA kick this off last week. The government called that move selfish. We then saw some of the other banks follow suit - certainly with their fixed loans anyway.

What is your view on where interest rates sit with the Australian banks? And do you think we're going to get further rate rises?

SENATOR NICK SHERRY:

Well, the rise by the Commonwealth - 0.10 per cent - as you've indicated, we regard that as selfish, during these economic times, particularly given our banking system has a guarantee - our banks, credit unions and building societies do have a guarantee.

And, our banks, the four main banks in Australia, are very very strong, and again by any world standards I think they are four of the strongest banks in the world, in the top 12.

So we just don't see a need, given the economic circumstances that we face, which are the most difficult in 75 years, for banks to be increasing any sort of interest rate in these circumstances.

ORIEL MORRISON:

Bill, let me jump in and ask what this actually means for interest rates in Australia and the Reserve Bank's decision on rates.

BILL EVANS:

Well I think the Reserve Bank is very much focused upon that point I made before about unemployment.

I think the Reserve Bank realises that if the unemployment rate does go to eight and a half per cent, then they're going to want to be seen to be acting to offset some of that to provide some boost to confidence.

Bear in mind last time we had a sharp rise in the unemployment rate in 1990/91, the Reserve Bank cut interest rates by 500 basis points.

So my view is that if Senator Sherry's forecast is right on the unemployment rate, then the Reserve Bank will be cutting rates rather than raising rates, which of course is the current forecast by the markets. The markets have an extraordinary 150 basis point rate hike priced in for the Reserve Bank next year, and I just find that fantasy land stuff.

ORIEL MORRISON:

[Laughs] Alright. Fantasy land stuff. Alright.

Senator, let me jump in with another question for you. We are hearing reports that the Treasury is looking at ways to actually scale back the banking guarantee. It could be replaced with something else like a double A rated mortgage bond.

What is that situation looking like right now?

SENATOR NICK SHERRY:

Well, certainly Treasury - and this has been ongoing - have been examining the, the circumstances of the bank guarantee.

However, the bank guarantee was absolutely critical in delivering certainty and security to our financial institutions; not because our banks or building societies or credit unions were weak in Australia, they were strong; but because of the international circumstances.

Once we saw a guarantee go on in Ireland and then the UK and spreading around the world, given the international movement of capital, free-flow of capital, Australia had to introduce a guarantee.

So, certainly Treasury are looking at the outcomes of that guarantee. But the guarantee itself is, has been very very important and is still very important in maintaining confidence.

What we learned from The Great Depression was that, if confidence in banks collapses, and banks themselves go under, then the economy goes under. We learnt that from The Great Depression.

And, that bank guarantee is important, and will be important ongoing. Whether or not the details of implementation are varied will be something that the Treasury will provide advice to government on.

ORIEL MORRISON:

Senator, thank you so much for joining us today.

Just very briefly before I let you go; it is of course the final week of parliament before the winter break. Clearly it's quite a volatile situation. What's going to be on your radar this week?

SENATOR NICK SHERRY:

Oh look, I think, an email; claims about an email from the Prime Minister's office about a particular car firm I think will have some focus. But of course this email doesn't exist. It's a fake. It's a forgery, so there'll be some pressure on the Opposition leader Mr Turnbull to justify his over the top criticisms, given the absence of the email.

But, but notwithstanding all of that course, myself and my colleagues - the Treasurer, the Prime Minister - will be focusing on making sure that the economy of Australia is cushioned against these very difficult international, financial and economic circumstances to maximise economic growth, minimise job losses. That's where our central focus has been and always will be.

ORIEL MORRISON:

Alright. Senator...

SENATOR NICK SHERRY:

Good morning.

ORIEL MORRISON:

Great to have you with us on Squawk Australia this morning. Thank you so much for joining us.

SENATOR NICK SHERRY:

Thanks Oriel. Good morning, and good morning to you Bill.

ORIEL MORRISON:

Assistant Treasurer with me there - Nick Sherry.

Bill, a lot of comments there from the Senator about where the economy is headed.

Interested to see his view on the unemployment rate.

I mean he was agreeing with you that he did expect to see, potentially anyway, a lower unemployment going forward.

BILL EVANS:

Yes. Well I think what we have seen is that one of the things we need to look at is what happened in New Zealand.

New Zealand - the reason why we're forecasting this rise in the unemployment rate is very much based upon the lead indicators that we have from business surveys, from job ads, and also from our view on growth in spending.

But that relationship might break down this time, and we saw that in New Zealand - New Zealand had similarly dire forecasts a year ago. They've been in recession for a year. And their unemployment rate held down remarkably well.

So, that will be one of the big debates for the markets.

We've seen two numbers in a row that have been better than expected in the employment numbers. A third one might really start to, start to raise some questions.

We still believe that Senator Sherry's forecast is going to be about right, but I have to say we keep focusing on that and we keep stressing and talking to our customers who are now saying that they are trying to keep as many people in employment as they can.

But, if demand continues to weaken, as I expect it will, I think eventually they'll reach the breaking point and they'll have to cut more people than they're currently hoping to.

ORIEL MORRISON:

Okay. Well it certainly is an interesting situation with the unemployment going forward.

Just very briefly Bill; we do of course have, have had our minutes - RBA minutes out last week - we've got a meeting coming up. What sort of bias do you expect the RBA to have?

BILL EVANS:

Oh look, they're going to keep their easing bias. I don't think there's any doubt about that. I think they realise that there's too much uncertainty out there at the moment. If we were to see them for instance say we've now got a neutral bias, that may encourage the market to sell off even further, and that would be unhelpful from the RBA's perspective, in terms of trying to encourage a growth recovery.

ORIEL MORRISON:

Absolutely. Alright, Bill, thank you so much for joining us today. Great to have you with us.

Bill Evans there from Westpac, joining me there.