RBA's insurance against overseas crises

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AFTER the past month of market turmoil, it is wise for the Reserve Bank to be taking precautions against slowing world growth.

Although Europe continues to resemble an unexploded financial bomb, it is the deterioration in the outlook for China that marks the biggest change in the RBA's view of the world in the past month.

Markets, and the Chinese government, have so far been reacting to a fairly isolated set of figures for business investment, international trade and indicators of output covering little more than the month of April.

There are still those, among them Wayne Swan, who expect the outlook in China to improve over coming months.

Goldman Sachs' widely respected chief economist, Jim O'Neill, says China remains the "beacon of light" with growth likely to exceed the government's target of 7.5 per cent. However, the RBA is plainly concerned that China's economy is more threatening to the Australian outlook and may drag its regional neighbours down as well.

The next round of updates on the Chinese economy starts this week and will help clarify the extent of the softening.

The European crisis also looks increasingly dangerous, as Spain moves closer to seeking a bailout that would dwarf those arranged for Greece.

The RBA has struggled to find a coherent narrative for its policy over the past six months. Its two rate cuts late last year were, like yesterday's move, precautionary, in the face of global uncertainty.

In February it gave the impression it was happy with rates where they were, and there was even some talk that the next move might be a rise.

The 50-basis-point cut last month reflected what many thought was a belated recognition that domestic demand in the non-mining majority was weakening.

The bank now sees the domestic economy as broadly stable, but is again focused on the worries of the world. It has given no indication of the likely future path for rates because it simply does not know. It has taken out some insurance, just in case.