

## **RBA's next rate hike looming closer**

Posted by [LC Team](#) Sunday, September 19, 2010

If, as seems likely, the RBA is going to start raising the cash rate in the next few months, then it may as well get cracking.

As this month began, the weight of opinion in financial markets favoured an extended period of steady interest rates.

But all that has changed, thanks mainly to a couple of strong-looking pointers on the economy - June quarter economic growth figures on the first of the month and August employment data on the ninth.

The futures market now says the cash rate, at 4.5 per cent since May, will be 4.67 per cent as 2011 begins.

That is about two thirds of the way to 4.75 per cent, the next likely level for the cash rate.

Beyond that, a move to 4.75 per cent is fully priced in by March.

And the RBA has done nothing to disabuse anyone of that expectation.

In the latest public appearance of a senior RBA official, the central banks assistant governor (economic) Philip Lowe, acknowledged the labour market was close to the limit.

“Based on the experience of the past decade my judgement would be that we’re almost at what would be considered full employment,” he told a conference on Thursday.

The full employment rate is widely thought to be around five per cent, and the latest reading from the Australian Bureau of Statistics (ABS) put it at 5.1 per cent in August.

In recent years, estimates of the non-accelerating rate of unemployment (NAIRU) “have tended to come down, just as the actual unemployment rate did”, Lowe’s boss, RBA governor Glenn Stevens said in 2008.

So the RBA is unlikely to be hung up on a precise level for full employment.

Even so, the RBA is likely to be on high alert for a pick-up in wage inflation as unemployment falls.

As it very likely will.

The economy grew at more than its long-run average over the first half of this year, and the RBA's forecasts - confirmed by Lowe at the conference in Sydney on Thursday - say it will do the same over the coming couple of years.

That means faster-than-normal employment growth and falling unemployment.

The kind of investment boom that only comes along once in a lifetime should see to that.

Whatever the full employment rate is, the economy will surely test it in the coming year or so.

The lead time for monetary policy is well known, and will be a key input into the RBA decisions on rates at its upcoming meetings on the first Tuesday of each month.

It is generally thought to be around two years before even half the effect of an interest rate change is felt.

So, all other things being equal, the time for pre-emptive action is now.

All other things are not equal, of course.

Anxiety is still having an effect on financial markets.

In a speech last week, RBA assistant governor (financial markets) Guy Debelle cited a number of measures of fragility in financial markets, including volatility in the Australian dollar, which was still elevated compared with pre-crisis levels.

So it's unlikely that the RBA has ticked all the boxes.

But at some point, the RBA will conclude that the increasing risk of rising domestic inflationary pressures outweighs the more nebulous fear of a new international calamity.

In the absence of genuinely bad news from abroad, that point may only be weeks away.

The RBA prides itself on its pre-emptive approach to monetary policy and so will want to act before it is too late.

The case for putting it off is getting weaker by the day.