

## **RBA lifts rates for first time in 2010, more to come**

The Reserve Bank of Australia (RBA) has raised interest rates for the first time in 2010 as the economy continues to grow stronger than expected, economists say. The central bank lifted the cash rate by 25 basis points to 4.0 per cent following its board meeting on Tuesday. Eleven of 16 economists surveyed by AAP had tipped the RBA to lift the cash rate by 25 basis points. In a statement, RBA governor Glenn Stevens said the local economy had performed stronger than previously expected, hence the need to lift rates to contain the expansion in economic activity. "The board judges that with growth likely to be close to trend and inflation close to target over the coming year, it is appropriate for interest rates to be closer to average," Mr Stevens said.

"Today's decision is a further step in that process."

Trend growth in the Australian economy is considered around 3.0 to 3.25 per cent. The RBA uses monetary policy to keep inflation within its target band of two to three per cent over the course of economic cycle. Commonwealth Bank senior economist Michael Workman said recent data had suggested the economy continued to strengthen. Australia's unemployment rate fell 0.2 percentage points to 5.3 per cent, while retail sales rose 1.2 per cent, both in January, official data showed. "We have had a whole ream of information over the last few months that indicate the broad outlook for good growth of three per cent plus by the end of this year," Mr Workman said. Mr Stevens said the economy had performed better than expected in 2009 after a mild downturn a year ago.

"Labour market data and a range of business surveys suggest growth in the economy may have already been at or close to trend for a few months," he said. "There are some signs that the process of business sector de-leveraging is moderating, with the pace of decline in business credit lessening and indications that lenders are starting to become more willing to lend to some borrowers. "Investment in the resources sector is very strong." Mr Workman said he expected further rate rises during 2010, but not every month. "There is still another nine months this year and out of nine meetings we are expecting four 25 basis point rises," Mr Workman said. "They can gradually lift rates as conditions strengthen." He expects a cash rate of five per cent by the end of 2010.

National Australia Bank (NAB) senior economist Spiros Papadopoulos said the final paragraph of the RBA monetary policy decision statement was consistent with the message the bank has been sending for the past three to four months. "They obviously want to get interest rates back to a more normal type level and we've seen them use language such as normal and neutral and this month they've talked about average interest rates," he said. "So despite having paused last month, obviously they see ongoing strength in the economy going forward, they talk about growth being at trend over the coming year and inflation close to target, so I think it's really sending a message that the RBA has more to do. "Therefore, we expect them to be raising rates fairly steadily for the rest of this year." Mr Papadopoulos said the RBA would be cautious with its pace of interest rate increases given the current global conditions. "I think it will be fairly moderate given that they are still a bit cautious about the global recovery," he said.

“We still believe there will be gradual 25 basis point increases every two or three months. “The next most likely increase, we believe is in May, for the next CPI figures and that gives them a couple of months to assess the initial fallout from today’s move.” NAB forecasts three more 25 basis point interest rate increases, bringing the cash rate up to 4.75 per cent, by the end of the year. However, Mr Papadopoulos said he could not see the RBA raising rates significantly in the near future. ICAP economist Adam Carr said the central bank’s decision to raise the cash interest rate was appropriate for Australia’s current economic conditions. “This is clearly an economy that does not need rates at a stimulatory setting,” he said. “We need to get to neutral as quickly as possible and then think about whether we need to go into restrictive territory. “We can have a little more confidence that they’ll get us to the appropriate rate setting for this economy.” Most economists say a neutral interest rate is around 4.75 to five per cent. In February, the bank defied market forecasters by holding the cash rate steady at 3.75 per cent. “I was a little bit concerned in Feb that they’d kind of lost the plot a bit and had focused too much on press reports and not the data,” Mr Carr said. “Today’s statement and action shows they are knuckling down to do what they need to do for our economy.” JP Morgan economist Helen Kevans was expecting the central bank to leave the interest rate steady at 3.75 per cent, although she said her level of commitment to that forecast waned in recent days. “There was less than a 50-50 per cent chance of a hold priced into the market. “The statement was a little bit more downbeat on the global economy but is just as up beat on the Aussie outlook and the Aussie economy at present. “But the focus will be on the final few sentences of the statement today and that is that rates are too accommodative and further rate hikes will be needed.”