

## [RBA signals gradual tightening of monetary thumbscrews](#)

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Aside from reminding us that November is not just a bad month for punters, but for borrowers as well, the Reserve Bank of Australia (RBA) has confirmed its intention to continue gradually tightening the monetary thumbscrews. The RBA confirmed the expectations of market economists with its decision to raise the cash rate a quarter of a percentage point to 3.5 per cent. The move followed an increase to 3.25 per cent from 3.0 per cent a month earlier. After the latest announcement on Tuesday, the upward path of interest rates built into cash rate futures traded on the Sydney Futures Exchange became a little less steep. Even so, the market still has cash reaching 5.0 or 5.25 per cent by the end of 2010. If that is indeed how things turn out, the RBA may still be raising interest rates late next year, so borrowers could still be absorbing punishment next November as cash rate hikes are translated into higher home and business loan rates. It turns out that November is a danger month for borrowers. Since the RBA began announcing its interest rate decisions in 1990, there have been 22 rate hikes. Five of them have now been in November, making it the most popular month for the infliction of monetary pain. Of those 22 hikes, 14 have been announced at the meetings immediately after the release of quarterly Consumer Price Index (CPI) data. As a result, a rate move is nearly five times more likely in the four months the CPI data is published - February, May, August and November - than in the other seven months RBA board meetings are held. (The RBA's board goes on holidays in January.) That does not mean there will be no hike in December, though - it has happened twice in the past 19 years. The futures market had been confident of another quarter percentage point hike in December ahead of the RBA meeting on Tuesday, but is now giving that only about a 50-50 chance. The change of heart, and the slightly slower pace of increase expected further out, appears to have been prompted by the absence of any pointer in the latest announcement to a more aggressive monetary policy approach by the RBA. In short, the market changed its mind because the RBA didn't. The statement issued by RBA governor Glenn Stevens was very similar to the announcement a month earlier, with no significant change to key elements. It summarised the improved outlook abroad, and at home noted "early signs" of better labour market conditions and indications that the contraction in business investment may not be as bad as had been expected earlier. "The Board noted that the rise in the exchange rate is likely to constrain output in the tradeables sector and dampen price pressures. "Nonetheless, growth is likely to be close to trend over the year ahead and inflation close to target," Mr Stevens said in the statement. The RBA also pointedly used the word "gradually", just as it did a month earlier, to describe how the cash rate was to be raised. "With the risk of serious economic contraction in Australia now having passed, the Board's view is that it is prudent to lessen gradually the degree of monetary stimulus that was put in place when the outlook appeared to be much weaker," Mr Stevens said. The obvious conclusions to be drawn are that rises in the near future will probably be of 25 basis points - a quarter of a percentage point - rather than 50, and that a long series of

such hikes is in store, provided the RBA's confidence in its forecasts grows in the months ahead. An economy growing at around its long-term trend rate generally implies interest rates somewhere around their long-term average, and so does an inflation rate drifting around within its target range. In the past decade the cash rate has averaged about 5.3 per cent. A return to that around norm would mean there is probably another 150 or 200 basis points in the pipeline, consistent with the futures market's built-in forecast of a quarter percentage point hike on average every couple of months or so over the year ahead.