

## There's more to monetary policy than the cash rate

The ultra-low cash rate is an argument for an interest rate rise this year, but it is not the only way of gauging the stance of monetary policy. The futures market has factored in a lift in the cash rate, the overnight interbank loan rate used by the Reserve Bank of Australia (RBA) to influence borrowing and lending rates, to 3.5 per cent by the end of the year. The market shows the RBA is expected to give us a reprieve at its meeting this coming Tuesday, but will then jack the cash rate up by half a percentage point over the three subsequent meetings, held on the first Tuesday of every month except January. Two weeks ago, RBA governor Glenn Stevens told a parliamentary committee that the cash rate was pushed to its 49-year low of three per cent to cope with “a global situation that none of us has lived through before”, but suggested it may no longer be appropriate. “As the set of risks that you think you face start to shift, at some point you are going to have to make a response to move away from the emergency setting,” he said. But monetary policy is about more than just the cash rate. How much borrowing is being done at the current cash rate, the level of the exchange rate, and how much the current interest rate is affecting household and business cash flow are no less significant. The RBA's own figures show credit advanced to the private sector is growing at a snail's pace, edging up just 0.1 per cent in the past three months, the weakest growth over a quarter since 1992. Housing credit is growing in a market temporarily pumped up by enhanced first home owner grants, but other personal lending has fallen for 13 consecutive months and business credit fell in each of the five months ending June, the latest month of available data. A move in the exchange rate changes the price level in Australia relative to the rest of the world, affecting spending on Australia's output in a similar way as rising interest rates does. The Australian dollar is currently trading around 84 US cents, 21 per cent above the 69.4 cent average of the past decade. Against the RBA's trade-weighted index of foreign currencies the Aussie dollar is up by 12 per cent from that average. In other words, internationally exposed businesses are experiencing tight monetary policy notwithstanding the low cash rate. Household spending, with a big helping hand from the government's stimulus packages, is keeping the economy growing. Housing and consumer debt interest payments in the March quarter, the latest available figures until Wednesday, were 9.1 per cent of household disposable income (with interest payments added back). With the cash rate at a 12-year high of 7.25 per cent until early September last year, that proportion had been as high as 12.6 per cent. By that measure, the rate cuts last year and early this year represent a major policy easing. But at 9.1 per cent, that proportion of income going into interest payments was higher than it had been at any time before the September quarter of 2006. Even in late 1989, with the cash rate bumping up against 18 per cent, interest payments took only seven per cent of available income. And in bouts of easier monetary policy in the 1990s and earlier this decade, they were soaking up only four or five per cent. That means that, by this measure, not only is monetary policy tighter than it was back then, but any given rate move has twice the monetary impact as it did a decade ago and packs three times the punch as in the late 1980s. The RBA may well nudge the cash rate higher before Christmas, but the argument

that it has its foot flat to the floor is not as clear cut as the low cash rate alone might suggest.