

# RBA on hold again

## Economic research note

5 October 2010

- The RBA surprised the market today, leaving the official cash rate on hold at 4.50%.
- The RBA did signal that “if economic conditions evolve as the Board currently expects, it is likely that higher interest rates will be required, at some point, to ensure that inflation remains consistent with the medium-term target.”
- It appears the RBA would like a bit more certainty in relation to domestic economic activity, particularly credit growth to move the official cash rate higher.

### RBA on hold in a surprise decision

After leaving the cash rate unchanged for the past four months, the Reserve Bank of Australia (RBA) today left interest rates on hold again at 4.50%. This was against the majority of market economists and market pricing. The expectations of a move higher came after several signals by RBA officials that higher interest rates were needed over the medium term.

Given financial markets were pricing in a chance of an easing only two weeks ago, the recent hawkish rhetoric by the RBA could have been an attempt to move financial market pricing back towards where the RBA believes interest rates need to go over the medium term. This could have been misinterpreted as a bias to tighten rates in October. It also means the RBA can wait and see Q3 CPI data released later in October.

In announcing the on hold decision the RBA stated that “asset prices are not moving notably in either direction, and overall credit growth is quite subdued at this stage”. It appears the RBA would like some improvement in credit growth, particularly business credit growth before lifting interest rates. There also could be some sense of uncertainty over the global economy and global financial markets for the decision.

The RBA also noted that given inflation appears to be running at 2.75% without any upward bias at the moment (with the strong AUD helping), “the current stance of monetary policy is delivering interest rates to borrowers close to their average of the past decade”.

Some softer data over the past week (ie. August building approvals, credit growth, weaker than expected retail sales) may have influenced the decisions. But the signal that interest rates would have to move higher (November is still a possibility), at some point is consistent with expectations that nominal GDP growth will be rising sharply over the remainder of 2010 and into 2011. This jump in nominal GDP growth will be driven by the income effects from Australia’s record high terms of trade – effects which the RBA believes have only now just begun to be felt on the economy.

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