

History making: Rates rise for third straight month Reserve Bank Board meeting

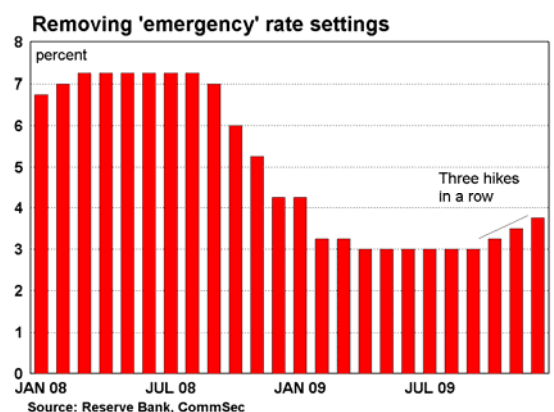
- The Reserve Bank (RBA) has increased interest rates for the third consecutive month – the first time it has ever lifted rates three months in a row. The cash rate was lifted from 3.50 per cent to 3.75 per cent.
- The RBA made two references to higher dwelling prices in the latest statement. The housing market will clearly be a central issue for the RBA in 2010.

What does it all mean?

- The latest rate hike will have its greatest impact on consumer sentiment & psychology rather than on household finances. According to the Commonwealth Bank more than 90 per cent of its home loan customers are ahead in their loan repayments. And while those who have taken out loans in the past six months may be up for higher repayments, few could say that they didn't see it coming.
- Aussie consumers have become more conservative, preferring to use their own funds (debit cards) when shopping rather than credit. And the latest lift in interest rates is likely to further entrench that conservative behaviour. Retailers will need to keep prices low to encourage consumers to part with their cash.
- For those with money in the bank, the latest rate hike will continue the run of good news. Over the past six months rates on 12-month term deposits have lifted by over three percentage points, providing \$250 a month in extra income for those with deposits of \$50,000. In fact some banks are now offering up to 7 per cent returns on term deposits with the attraction of monthly interest payments, well up from rates around 2 per cent in May this year.
- Reserve Bank policymakers know that there are few risks at present in lifting rates, merely removing stimulus rather than working to slow the pace of the economy. CommSec expects rates to keep rising in the New Year, pencilling in quarter percent rate hikes in both February and March. Once interest rates are back at 4.25 per cent, the Reserve Bank can then take its time in withdrawing any remaining monetary policy stimulus.
- Expect to see plenty of jawboning by the Reserve Bank on housing in 2010. The RBA knows that it can't solve the housing shortage, and it will keep pressure on governments to act.

Interest rate decision and past cycles

- The Reserve Bank has lifted rates for the third straight month – the first time in almost 20 years of rate targeting that the central bank has lifted rates three months in a row. Rates had stood at a 49-year low of 3.00 per cent before the decision in October to lift the cash rate. After quarter percent rate hikes in October, November and December the cash rate now stands at 3.75 per cent.
- Even with the latest move, cash rates are historically low. In the last rate cutting cycle the cash rate fell to lows of 4.25 percent in December 2001. In the two previous rate cutting cycles, the cash rate fell to lows of 4.75 per cent.
- If banks pass on the interest rate increase in full then repayments on a 25-year \$300,000 home loan will increase by \$46.71 a month. Even with the rate hike, monetary policy is still clearly expansionary. The Reserve Bank has previously indicated that the "normal" or neutral cash rate is around 5.00



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per cent. A neutral cash rate means that monetary policy is neither expansionary nor contractionary.

- The Reserve Bank said “these material adjustments to the stance of monetary policy will, in the Board’s view, work to increase the sustainability of growth in economic activity and keep inflation consistent with the target over the years ahead.”

Comparing the two most recent statements

- The statement from the November meeting is on the left; the statement from today’s December 2009 meeting is on the right. Emphasis has been added to significant changes in wording in the recent statement.

MEDIA RELEASE

No: 2009-25
Date: 3 November 2009
Embargo: For Immediate Release

STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to raise the cash rate by 25 basis points to 3.5 per cent, effective 4 November 2009.

The global economy has resumed growth. With economic policy settings likely to remain expansionary for some time, the recovery is likely to continue during 2010 and forecasts have been revised higher. The expansion is generally expected to be modest in the major countries, due to the continuing legacy of the financial crisis. Prospects for Australia’s Asian trading partners appear to be noticeably better. Growth in China has been very strong, which is having a significant impact on other economies in the region and on commodity markets. For Australia’s trading partner group, growth in 2010 is likely to be close to trend.

Sentiment in global financial markets is much better than earlier in the year. Nonetheless, the state of balance sheets in some major countries remains a potential constraint on their expansion.

Economic conditions in Australia have been stronger than expected and measures of confidence have recovered. Some spending has probably been brought forward by the various policy initiatives. With those effects now diminishing, these areas of demand may soften somewhat. Some types of capital spending are likely to be held back for a while by financing constraints, but it now appears that private investment will not be as weak as earlier expected. Medium-term prospects for investment appear, moreover, to be strengthening. Higher dwelling activity and public infrastructure spending are also starting to provide more support to spending. There have been some early signs of an improvement in labour market conditions. The rate of unemployment is now likely to peak at a considerably lower level than earlier expected.

Inflation has been declining for the past year. In underlying terms, inflation should continue to moderate in the near term, but now will probably not fall as far as earlier thought. Headline CPI inflation on a year-ended basis has been unusually low because of temporary factors, and will probably rise somewhat over the coming year. Both CPI and underlying inflation are expected to be consistent with the target in 2010.

Housing credit growth has been solid and dwelling prices have risen appreciably this year. Business borrowing has been declining as companies have sought to reduce leverage in an environment of tighter lending standards. For many business borrowers, increases in risk margins are still coming through. The decline in credit has been concentrated among large firms, which have had good access to equity capital and, more recently, to debt markets. Share markets have recovered significant ground.

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. 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. The adjustments at the October and November meetings will work to increase the sustainability of growth in economic activity and keep inflation consistent with the target over the years ahead.

MEDIA RELEASE

No: 2009-28
Date: 1 December 2009
Embargo: For Immediate Release

STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to raise the cash rate by 25 basis points to 3.75 per cent, effective 2 December 2009.

The global economy has resumed growth. With economic policies remaining expansionary, growth is likely to continue next year, though it will probably be modest in the major countries, due to the continuing legacy of the financial crisis. In China and Asia generally, where financial sectors are not impaired, recovery has been much quicker to date and prospects appear to be for good growth in 2010. **Financial markets have improved considerably during 2009, notwithstanding periodic setbacks**, and capital flows into Asia and other emerging market regions have been picking up.

In Australia, the downturn was relatively mild, and measures of confidence and business conditions suggest that the economy is in a gradual recovery. The effects of the early stages of the fiscal stimulus on consumer demand are fading, but public infrastructure spending is starting to provide more impetus to demand. Prospects for ongoing expansion of private demand, including business investment, have been strengthening. There have been some early signs of an improvement in labour market conditions. The rate of unemployment is now likely to peak at a considerably lower level than earlier expected.

Inflation has declined from its peak last year, helped by the fall in commodity prices at the end of 2008 and a noticeable slowing in private-sector labour costs during 2009. In underlying terms, inflation should continue to moderate in the near term, though it will probably not fall as far as thought likely six months ago. Headline CPI inflation on a year-ended basis has been unusually low because of temporary factors, and will probably rise somewhat over the coming year. Both CPI and underlying inflation are expected to be consistent with the target in 2010. The rise in the exchange rate during this year will have some impact in containing prices for traded goods and services in the period ahead, and will dampen growth in the trade-exposed sector of the economy.

Credit for housing is expanding at a solid pace, and dwelling prices have risen significantly this year. Business credit has fallen, as companies have reduced leverage in an environment of tighter lending standards, and as some lenders have scaled back their balance sheets. The decline in credit has been concentrated among large firms, which generally have had good access to equity capital and, more recently, to debt markets. **Share markets have recovered significant ground, which, together with higher dwelling prices, has meant a noticeable recovery in household wealth.**

The Board’s assessment of the outlook remains much as in the November *Statement on Monetary Policy*. Growth in 2010 is likely to be close to trend and inflation close to target.

With the risk of serious economic contraction in Australia having passed, the Board has moved at recent meetings to **lessen gradually the degree of monetary stimulus** that was put in place when the outlook appeared to be much weaker. These material adjustments to the stance of monetary policy will, in the Board’s view, work to increase the sustainability of growth in economic activity and keep inflation consistent with the target over the years ahead.

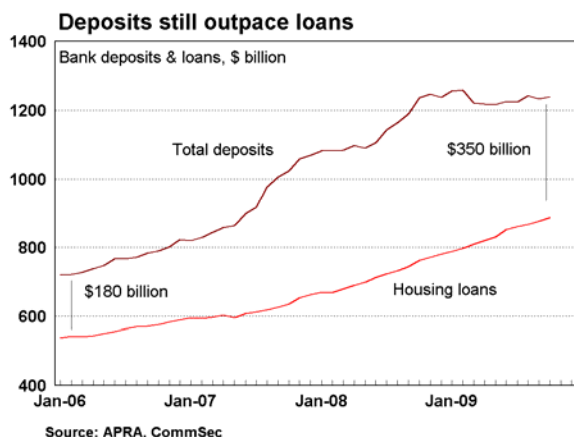
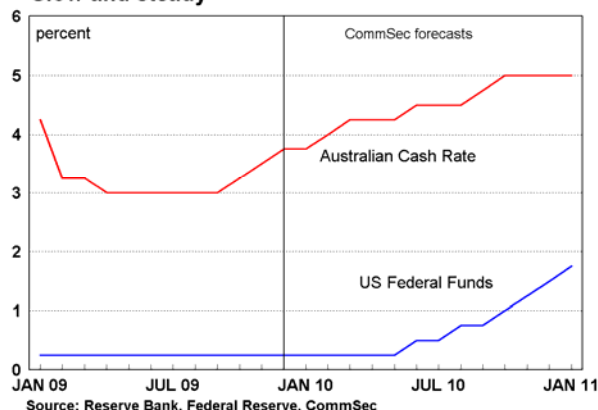
What are the implications for interest rates and investors?

- When rates were first cut in September 2008, many borrowers elected to keep repayments the same. And now rates are going up, these same home buyers are insulated from any pain on the household budget. Some recent borrowers may be negatively affected, but overall there shouldn't be a major impact on Christmas spending. Just over 94 per cent of those in the workforce have a job and the high Australian dollar is serving to trim prices of imported goods.
- CommSec expects further rate hikes in 2010. We are pencilling in two moves of 25 basis points in February and March and further moves in June, September and October. The cash rate should be near 5 per cent in a year's time.
- Banks will compete hard for domestic funds in coming months, providing attractive opportunities for savers.

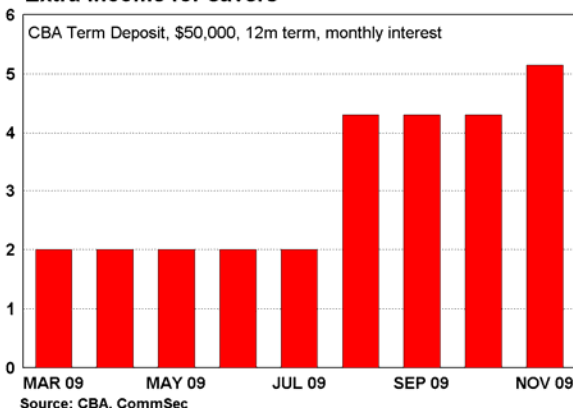
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Slow and steady



Extra income for savers



MORTGAGE CALCULATOR (Monthly repayments, 25 years)

Mortgage	Change in Interest Rates						
	6.30	+0.25% 6.55	+0.50% 6.80	+0.75% 7.05	+1.00% 7.30	+1.25% 7.55	+1.50% 7.80
\$100,000	\$662.76	\$678.33	\$694.07	\$709.97	\$726.03	\$742.25	\$758.61
\$150,000	\$994.15	\$1,017.50	\$1,041.11	\$1,064.96	\$1,089.05	\$1,113.37	\$1,137.92
\$200,000	\$1,325.53	\$1,356.67	\$1,388.14	\$1,419.94	\$1,452.06	\$1,484.49	\$1,517.23
\$250,000	\$1,656.91	\$1,695.84	\$1,735.18	\$1,774.93	\$1,815.08	\$1,855.62	\$1,896.54
\$300,000	\$1,988.29	\$2,035.00	\$2,082.22	\$2,129.92	\$2,178.09	\$2,226.74	\$2,275.84
\$350,000	\$2,319.67	\$2,374.17	\$2,429.25	\$2,484.90	\$2,541.11	\$2,597.86	\$2,655.15
\$400,000	\$2,651.05	\$2,713.34	\$2,776.29	\$2,839.89	\$2,904.13	\$2,968.99	\$3,034.46
\$450,000	\$2,982.44	\$3,052.51	\$3,123.32	\$3,194.87	\$3,267.14	\$3,340.11	\$3,413.76
\$500,000	\$3,313.82	\$3,391.67	\$3,470.36	\$3,549.86	\$3,630.16	\$3,711.23	\$3,793.07
	Change in repayments per month						
\$100,000		\$15.57	\$31.31	\$47.21	\$63.27	\$79.48	\$95.85
\$150,000		\$23.36	\$46.96	\$70.81	\$94.90	\$119.22	\$143.78
\$200,000		\$31.14	\$62.62	\$94.42	\$126.54	\$158.97	\$191.70
\$250,000		\$38.93	\$78.27	\$118.02	\$158.17	\$198.71	\$239.63
\$300,000		\$46.71	\$93.93	\$141.63	\$189.80	\$238.45	\$287.55
\$350,000		\$54.50	\$109.58	\$165.23	\$221.44	\$278.19	\$335.48
\$400,000		\$62.29	\$125.23	\$188.83	\$253.07	\$317.93	\$383.40
\$450,000		\$70.07	\$140.89	\$212.44	\$284.71	\$357.67	\$431.33
\$500,000		\$77.86	\$156.54	\$236.04	\$316.34	\$397.42	\$479.25

Source: CommSec