

Another Rate rise why ? “After delivering more medicine, Reserve needs to take the economy's pulse “

Malcolm Maiden- The Age

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The Reserve Bank's rate rise statement is its most equivocal since it began pushing up rates again in August. It shows that the cumulative weight of the global credit squeeze and the world economic downturn it is engendering are beginning to be felt.

The statement broadly tracked the last three rate rise commentaries, in assigning more importance to raising rates and suppressing demand and inflation than responding to the more remote threats thrown up by the credit squeeze and the slowdown that centres on America's faltering economy. But there were some important tonal shifts.

The first was an accurate description of the fragility of the capital markets amid heightened fears that distressed securitised debt markets are not only still dysfunctional despite aggressive northern hemisphere rate cuts led by the US Federal Reserve, but dragging other higher-rated debt markets in. This is raising the spectre of a global credit squeeze as borrowers shift from frozen debt markets back to banks that could struggle to meet the demand.

The second was the clearest acknowledgement yet by the Reserve that the four 25 basis point rate increases it has served up since July are combining with higher wholesale funding costs caused by the global credit crunch to produce a "substantial tightening in financial conditions".

The comments do not make for an iron-clad argument that the Reserve is prepared now to wait. The Reserve still decided to raise rates after all. But they do suggest growing caution and, perhaps, an unstated wish that the option for a headline-grabbing, mood-altering, half a percentage point rate rise discussed a month ago had been taken as the coup de grace.

As it is, the Reserve is in a slightly uneasy position, signalling continuing resolve to fight inflation, but also a new wariness about what the cost of that fight might be. Anecdotal evidence that its rate rises are biting are accumulating, most recently yesterday with news that retail sales in January were unexpectedly flat.

The Reserve and the US Federal Reserve are facing the same inflation issue from different sides, because the entire world is importing inflation driven by Asian demand.

The Fed has cut rates from 5.25% at the beginning of August to 3%, and is headed to 2% as it attempts to revive the debt markets and keep the US economy ticking over.

It does not face the capacity constraints that are creating supply-side cost pressures here, because America is not at the front line of the commodity price boom, and because its economy has already slowed to a crawl. The risk, nevertheless, which rises with every rate cut, is that rate cuts will unleash inflation, and even stagflation, if America's economy refuses to respond to the medicine.