

## RBA hold rates steady but future hikes cannot yet be ruled out

06 May 2008

### Authors:

**Saul Eslake**  
Chief Economist  
+61 3 9273 6251  
Saul.Eslake@anz.com

**Warren Hogan**  
Co-Head of Australian Economics  
and Interest Rate Research  
+61 2 9227 1562  
Warren.Hogan@anz.com

### Our Vision:

For Economics@ANZ to be the most respected, sought-after and commercially valued source of economics research and information on Australia, New Zealand, the Pacific and Asia.

- **The RBA decided to keep rates at 7.25%** following the monthly Board meeting today. This outcome was expected by the market and ANZ.
- **The Statement released at the time of the announcement suggests to us that the case for a further policy tightening has strengthened since the April meeting.** We make this assessment on the basis that the only innovation in this statement was a reference to **wages**: "*should expectations of high ongoing inflation begin to affect wage and price setting, that outlook would need to be reviewed*".
- If a wage-price spiral develops it would take a considerable tightening of monetary policy to purge it from the economy. By introducing this factor into the statement we believe **the RBA is signalling that its patience around high inflation will not last long.**
- The bottom line is that following the shock print on core inflation in Q1 the RBA needs something to happen (domestic demand to slow) and something not to happen (high inflation expectations to impact wages) for policy to remain on hold. **Now that we have two potential triggers for a further rate hike we think the balance of risks around the monetary policy outlook has shifted, albeit modestly.**
- **ANZ expects rates to remain on hold for the rest of the year.** Largely because we seen a further slowing in domestic demand as our central case view on the economy but also because we have no particular insight into whether wage growth will accelerate from here. We are prepared to wait for Friday's *Statement on Monetary Policy* to garner more information on what the RBA is thinking and then for next week's budget and the Q1 Wages Price Index the next day (14th May) before considering any alterations to our view.
- **All the risks are heavily skewed to a rate hike over the months ahead** and with the introduction of wages as a key information factor for monetary policymakers at present, **that move could be as soon as June.**

### Some key points to note

- By its (non-)action and its words, **the RBA has today sought to sever the link between quarterly CPIs and changes in the official cash rate.** In the past few years they've tightened when the CPI has been higher than expected and refrained from tightening when it's been lower than expected).
- The RBA are making the judgement, at least until evidence suggests otherwise, that the tightening of financial conditions over the past nine months will outweigh the effects of the (larger-than-previously-expected) further increase in the terms of trade, so that **domestic demand will eventually be 'significantly slower than it was in 2007'.**
- However they acknowledge that **there is 'considerable uncertainty' around that judgement,** which essentially depends on how much weight is attached to each of these 'opposing forces'.
- The most plausible scenario for monetary policy for the rest of this year is 'rates on hold'. However, **we should be alert to the possibility that if there is going to be a further tightening of policy, it could occur in any month, rather than only in August or November.**

## Key Quotes

- *"In order to reduce inflation over time, growth in aggregate demand needs to be significantly slower than it was in 2007. Evidence is accumulating that this is occurring."*
- *"The rise in Australia's terms of trade currently occurring, which is larger than had been expected a couple of months ago..... will add substantially to national income and ability to spend"*
- *"Given the opposing forces at work, considerable uncertainty remains about the outlook for demand and inflation"*
- *"Should demand not slow as expected or should expectations of high ongoing inflation begin to affect wage and price setting, that outlook would need to be reviewed."*

**Important Notice**

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

10th Floor 100 Queen Street, Melbourne 3000, Australia

Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

This document ("document") is distributed to you in Australia and the United Kingdom by Australia and New Zealand Banking Group Limited ABN 11 005 357 522 ("ANZ") and in New Zealand by ANZ National Bank Limited ("ANZ NZ"). ANZ holds an Australian Financial Services licence no. 234527 and is authorised in the UK by the Financial Services Authority ("FSA").

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZ S") (an affiliated company of ANZ), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any securities referred to herein should contact ANZ S, not its affiliates.

This document is being distributed in the United Kingdom by ANZ for the information of its market counterparties and intermediate customers only. It is not intended for and must not be distributed to private customers. In the UK, ANZ is regulated by the FSA. Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZ, ANZ NZ, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZ, ANZ NZ, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will directly or indirectly relate to specific recommendations or views expressed about any securities or issuers in this document. ANZ, ANZ NZ, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.

Where the recipient of this publication conducts a business, the provisions of the Consumer Guarantees Act 1993 (NZ) shall not apply.