

## **Reserve Bank of Australia initiates "gradual" tightening with 25bp rate hike to 3.25% – another 25bp in November**

### **STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY**

At its meeting today, the Board decided to raise the cash rate by 25 basis points to 3.25 per cent, effective 7 October 2009.

The global economy is resuming growth. With economic policy settings likely to remain expansionary for some time, the recovery will likely continue during 2010 and forecasts are being 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 has continued to improve. 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. As those effects diminish, 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 is also starting to provide more support to spending. Overall, growth through 2010 looks likely to be close to trend.

Unemployment has not risen as far as had been expected. The weaker demand for labour over the past year or so nonetheless has seen a moderation in labour costs. Helped by this and the earlier fall in energy and commodity prices, inflation has been declining, though measures of underlying inflation remained higher than the target on the latest reading. Underlying inflation should continue to moderate in the near term, but now will probably not fall as far as earlier thought.

Housing credit growth has been solid and dwelling prices have risen appreciably over the past six months. Business borrowing has been declining, as companies have sought to reduce leverage in an environment of tighter lending standards. But large firms have had good access to equity capital and access to debt markets appears to be improving, helped by the better-than-expected economic conditions and increased willingness on the part of investors to accept risk. Share markets have recovered significant ground.

Interest rates facing prospective borrowers on fixed-rate loans have already risen to some extent, as markets have anticipated a higher level of the cash rate. For many business borrowers, increases in risk margins will still be occurring for some time yet. In addition, the exchange rate has appreciated considerably over the past year, which will dampen pressure on prices and constrain growth in the tradeables sector. These factors have been carefully considered by the Board.

In late 2008 and early 2009, the cash rate was lowered quickly, to a very low level, in expectation of very weak economic conditions and a recognition that considerable downside risks existed.

That basis for such a low interest rate setting has now passed, however. With growth likely to be close to trend over the year ahead, inflation close to target and the risk of serious economic contraction in Australia now having passed, the Board's view is that it is now prudent to begin gradually lessening the stimulus provided by monetary policy. This will work to increase the sustainability of growth in economic activity and keep inflation consistent with the target over the years ahead.