
To Prevent Inflation, Australia Hikes Baseline Interest Rate

By Editor Test Tue, Nov 3, 2009

If the Australian economy continues to expand as expected, rates could return to "a more normal 5%" in the next year or two, one analyst said.

The move by Australia's central bank to raise rates to 3.25% from 3% by its central bank last month was not unexpected, as the Australian economy was the only one in the developed world to expand in the first half of 2009, according to press reports in IPE.com and elsewhere.

In fact, Australia managed to avoid recession, only seeing its economy contract in the last quarter of 2008. Its government has helped the economy with major stimulus spending of about US\$35 billion, consisting of infrastructure projects and cash handouts to retirees and low- and middle-income families.

This helped the economy to grow 0.4% in the first quarter of this year, and by 0.6% in the second, rebounding from the 0.5% contraction between October and December 2008.

Prior to the rise, interest rates had plunged to a 49-year low—an emergency rate designed to deal with an emergency situation. Though some economists and industry groups had argued that the emergency rate should be left in place to make absolutely sure that the recovery had taken hold, the bank decided that there was a risk of inflation and unsustainable borrowing if it did not act now.

"The Reserve Bank of Australia (RBA) had widely advertised it was near to edging up rates from their extraordinary lows, and now it's done so," said Rory Robertson, interest rate strategist at Macquarie. "It will be a gradual move from an emergency rate of 3%, to a still-easy 4%."

Mr. Robertson added that if the Australian economy continued to expand as expected, rates could return to "a more normal 5%" in the next year or two. Tuesday's move is the first time the Australian central bank has increased interest rates since March 2008.

The Australian economy has also managed to avoid falling into recession thanks to the strength of its mining sector, which has continued to see strong demand from China for its iron ore and other commodities.

"The Australian economy is outperforming other advanced economies, and I guess many economists will see the decision today as a consequence of economic recovery," said Federal Treasurer Wayne Swan.

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