

# First interest rate cut in 31 months

## Reserve Bank Board meeting

- **The Reserve Bank Board has cut the cash rate for the first time in 31 months. The cash rate was trimmed by 25 basis points (quarter of a percent) to an 18-month low of 4.50 per cent. The next meeting is on December 6 2011.**
- **In response to lower-than-expected inflation, the Reserve Bank concluded that there was scope to ease financial conditions. If passed on by banks, repayments on a \$300,000 mortgage will fall by \$49.10 a month.**

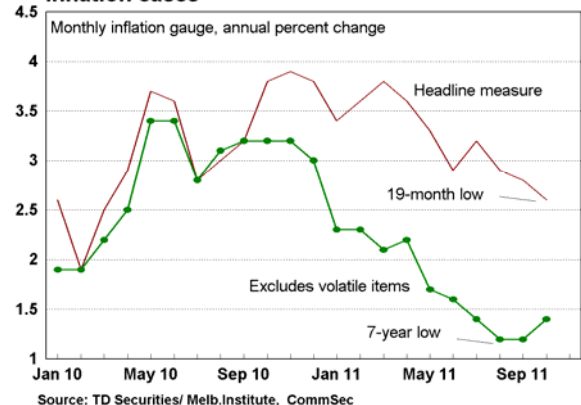
### What does it all mean?

- This is clearly the best news that many people have had in quite a while. The past year has seen the worst floods and cyclones in a generation, a European debt crisis, rising power and water bills and a rash of industrial disputes. So a rate cut will be warmly greeted by consumers and businesses alike. We are pleased that the Reserve Bank rejected its inherent conservatism, listened to the concerns of Australians, and delivered an early Christmas present.
- It is important to stress that the Reserve Bank is cutting rates from a position of strength, rather than weakness. The RBA can cut rates simply because inflation is under control, inflation is expected to remain under control and because financial conditions were a little too tight given the favourable position of inflation.
- Effectively the Reserve Bank has admitted that it got it wrong. In August the Reserve Bank was set to hike rates. But it has become abundantly clear that inflation was under control and financial conditions were tighter than necessary.
- Looking across the Four Financial Indicators (FFI) over the past month, it is clear that financial conditions have tightened. Dwelling prices continue to fall, the Australian dollar rose by US10 cents and 3-year swap rates have lifted almost 50 basis points. However credit growth lifted modestly over the past month. Overall, if the Reserve Bank hadn't cut rates, consumers and businesses would have experiencing more challenging conditions.
- While rates have been cut, no one should expect a follow-up move any time soon. This rate cut may be similar to the reduction made in December 2008 – the only interest rate change delivered in a 27-month period. Certainly the November rate hike of last year was the only rate change delivered in a 17-month period, so the Reserve Bank isn't averse to remaining on the interest rate sidelines for an extended period.
- The Reserve Bank has signalled that it is more comfortable with economic conditions. The global economy has softened, the terms of trade has peaked and *"inflation is likely to be consistent with the 2–3 per cent target in 2012 and 2013."*
- The Reserve Bank has now moved back to a more neutral stance – that suggests rates could move either way in coming months. If rates are moving anywhere in the short term, clearly it's down, rather than up.

### Interest rate decision and past cycles

- The Reserve Bank Board has cut the cash rate for the first time since April 2009 – the first time in 31 months. The cash rate has been reduced by 25 basis points to

**Inflation eases**



**Craig James – Chief Economist (Author)**  
**(612) 9118 1806 (work)**

Produced by Commonwealth Research based on information available at the time of publishing. We believe that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made as at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, neither Commonwealth Bank of Australia ABN 48 123 123 124 nor any of its subsidiaries accept liability to any person for loss or damage arising from the use of this report.

The report has been prepared without taking account of the objectives, financial situation or needs of any particular individual. For this reason, any individual should, before acting on the information in this report, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice. In the case of certain securities Commonwealth Bank of Australia is or may be the only market maker.

This report is approved and distributed in Australia by Commonwealth Securities Limited ABN 60 067 254 399 a wholly owned but not guaranteed subsidiary of Commonwealth Bank of Australia. This report is approved and distributed in the UK by Commonwealth Bank of Australia incorporated in Australia with limited liability. Registered in England No. BR250 and regulated in the UK by the Financial Services Authority (FSA). This report does not purport to be a complete statement or summary. For the purpose of the FSA rules, this report and related services are not intended for private customers and are not available to them.

Commonwealth Bank of Australia and its subsidiaries have effected or may effect transactions for their own account in any investments or related investments referred to in this report.

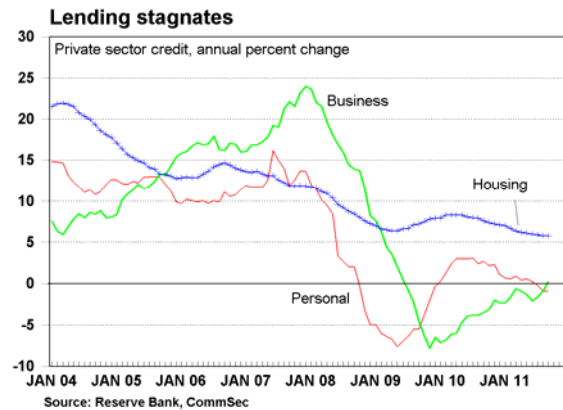
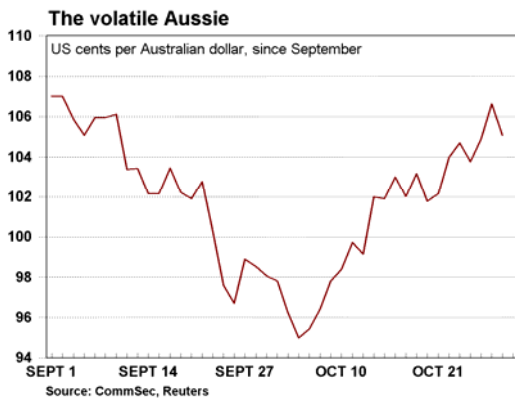
4.50 per cent. The Reserve Bank had previously lifted rates seven times from October 2009 to November 2010 – a total of 1.75 percentage points, from 3.00 per cent to 4.75 per cent. Before today’s move, there had been only one rate hike in the past 17 months.

- In the last rate-cutting cycle the cash rate fell to a low of 3.00 per cent in April 2009. In the previous rate-cutting cycle the cash rate fell to 4.25 percent in December 2001. In the two previous rate-cutting cycles, the cash rate fell to lows of 4.75 per cent.
- The Reserve Bank now looks more closely at the variable housing rate to gauge how close rates are to “normal”. Currently the average bank variable housing rate stands at 7.80 per cent, well above the long-term average or “normal” rate of 7.15 per cent.
- Since hitting lows of 4.00 per cent on October 4, 3-year swap rates have lifted to 4.41 per cent.

**What are the implications of today’s decision?**

- For a more detailed explanation of the Reserve Bank’s decision, attention will now shift to the Statement on Monetary Policy, to be released on Friday. This report will contain the Reserve Bank’s latest forecasts on economic growth and inflation.
- Investors will need to carefully consider the implications of the rate cut. If banks pass the full rate cut on to borrowers, they are also likely to pass it on to savers in terms of lower term deposit rates. Dividend yields on bank stocks remain attractive, holding near 6.50 per cent, while the property market will receive a boost from the latest rate cut.
- The rate cut is especially good news for the beleaguered retail and housing sectors. But even tourism and export sectors receive a boost as the rate cut keeps a cap on the Aussie dollar.

Craig James, Chief Economist, CommSec  
 Work: (612) 9118 1806



## Comparing the two most recent statements

- The statement from the October meeting is on the left; the statement from today's November 2011 meeting is on the right. Emphasis has been added to significant changes in wording in the recent statement.

### MEDIA RELEASE

**No:** 2011-21  
**Date:** 4 October 2011  
**Embargo:** For Immediate Release

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

At its meeting today, the Board decided to leave the cash rate unchanged at 4.75 per cent.

Conditions in global financial markets have continued to be very unsettled, with uncertainty increasing about both the prospects for resolution of the sovereign debt and banking problems in Europe, and the outlook for global economic growth. While temporary impediments that had contributed to a slowing in growth in some countries over recent months are lessening, recent data suggest a continuing period of soft economic conditions in both Europe and the United States. Moreover, the uncertainty and financial volatility have reduced confidence, which could result in more cautious behaviour by firms and households in major countries.

It will take more time for evidence of any effects of the recent European and US financial turbulence on economic activity in other regions to emerge. Thus far, indications are that **economic activity is continuing to expand in China** and most of Asia. Nonetheless, recent events have led forecasters to reduce their estimates for global GDP growth, which is now expected to be about average this year and next. Prices for commodities have declined over recent weeks, though in general they remain high.

Australia's terms of trade are very high, which has increased national income considerably. Investment in the resources sector is picking up very strongly and some related service sectors are enjoying better than average conditions. In other sectors, cautious behaviour by households and the earlier rise in the exchange rate have had a noticeable dampening effect. The impetus from earlier Australian Government spending programs is now also abating, as had been intended. While there remain good reasons to expect solid growth over the medium term, the indications are that the pace of near-term growth is unlikely to be as strong as earlier expected, due both to local and global factors, including the financial turmoil and related effects on business confidence.

Underlying inflation stopped falling and began to increase earlier this year. The Board has been concerned about the prospect of a further pick-up over the period ahead, but over recent months has been weighing the question of whether a period of weaker than expected conditions would contain that pick-up in inflation. Recently revised data show a pick-up to date in the underlying pace of price rises that was less sharp than initially indicated. Moreover, with labour market conditions now a little softer and households more concerned about the possibility of unemployment rising, the likelihood of a significant acceleration in labour costs outside the resources and related sectors is lessening.

Taking into account all the recent information, the path for inflation may now be more consistent with the 2–3 per cent target in 2012 and 2013, abstracting from the impact of the carbon pricing scheme. This assessment will be reviewed on receipt of further data on prices ahead of the Board's next meeting. **An improved inflation outlook would increase the scope for monetary policy to provide some support to demand, should that prove necessary.**

The Board noted that financial conditions have been easing somewhat, with interest rates for some housing and business loans declining slightly due to increased competition and the fall in some funding costs in financial markets. The exchange rate has also declined from the very high levels of a few months ago. Credit growth remains low, however, and asset prices have declined.

At today's meeting the Board judged the current cash rate remained appropriate. As always, the Board will continue to assess carefully the evolving outlook for growth.

### MEDIA RELEASE

**No:** 2011-24  
**Date:** 1 November 2011  
**Embargo:** For Immediate Release

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

At its meeting today, the Board decided to lower the cash rate by 25 basis points to 4.5 per cent, effective 2 November 2011.

Recent information is consistent with a moderation in the pace of global growth, though fears of a major downturn have not been borne out so far. The pace of US economic expansion picked up in the September quarter, but is still only moderate and leaves considerable spare capacity. China's growth has slowed, as policymakers there had intended. Output in Asia has now recovered from the effects of the Japanese earthquake, and domestic demand in the region is generally expanding. Trade performance, however, is starting to see some effects of a significant slowing in economic activity in Europe, where the prospects are for economic weakness to continue. Commodity prices, while still at high levels, have generally declined over recent months.

Financial markets have recovered somewhat from the turmoil of recent months, helped by stronger economic data in the United States and by signs that European governments are making progress in their efforts to deal with the sovereign debt and banking problems. Equity markets have gained ground and the Australian dollar has risen significantly as risk aversion has lessened. But it is likely to be some time yet before concerns about the European situation can definitively be laid to rest and the effects of the recent turmoil on confidence may result in a period of precautionary behaviour by firms and households.

Information about the Australian economy suggests moderate growth overall. **The terms of trade have now peaked and will decline somewhat in the near term**, but they remain very high. In response, investment in the resources sector is picking up very strongly, with much more to come. Some related service sectors are enjoying better-than-average conditions. In other sectors, cautious behaviour by households and the high exchange rate have had a noticeable dampening effect. The unemployment rate has increased a little over recent months, though it remains close to 5 per cent.

After underlying inflation started to pick up in the first half of the year, recent information suggests the subdued demand conditions and the high exchange rate have contained inflation more recently, notwithstanding continuing sizeable increases in utilities charges. CPI inflation on a year-ended basis remains above the target, due to the effects of weather events last summer, but is now starting to decline as production of key crops recovers. Moreover, with labour market conditions now softer, the likelihood of a significant acceleration in labour costs outside the resources and related sectors in the near term has lessened. **Accordingly, the Bank's current judgement is that inflation is likely to be consistent with the 2–3 per cent target in 2012 and 2013, abstracting from the impact of the carbon pricing scheme.**

Financial conditions have been easing somewhat recently, with market interest rates declining a little and competition to lend increasing. But overall conditions have remained tighter than normal, with borrowing rates still a little higher than average, credit growth subdued and asset prices lower than earlier in the year. The exchange rate has been very variable over the past few months, but on the whole has remained at historically high levels.

**Over the past year, the Board has maintained a mildly restrictive stance of monetary policy, in view of its concerns about inflation. With overall growth moderate, inflation now likely to be close to target and confidence subdued outside the resources sector, the Board concluded that a more neutral stance of monetary policy would now be consistent with achieving sustainable growth and 2–3 per cent inflation over time.**

**Implications for home buyers**

- If the rate cut is passed on, the following table highlights the impact on mortgages.

**MORTGAGE CALCULATOR (Monthly repayments, 25 years)**

Mortgage	Change in Interest Rates						
	7.80	-0.25% 7.55	-0.50% 7.30	-0.75% 7.05	-1.00% 6.80	-1.25% 6.55	-1.50% 6.30
\$100,000	\$758.61	\$742.25	\$726.03	\$709.97	\$694.07	\$678.33	\$662.76
\$150,000	\$1,137.92	\$1,113.37	\$1,089.05	\$1,064.96	\$1,041.11	\$1,017.50	\$994.15
\$200,000	\$1,517.23	\$1,484.49	\$1,452.06	\$1,419.94	\$1,388.14	\$1,356.67	\$1,325.53
\$250,000	\$1,896.54	\$1,855.62	\$1,815.08	\$1,774.93	\$1,735.18	\$1,695.84	\$1,656.91
\$300,000	\$2,275.84	\$2,226.74	\$2,178.09	\$2,129.92	\$2,082.22	\$2,035.00	\$1,988.29
\$350,000	\$2,655.15	\$2,597.86	\$2,541.11	\$2,484.90	\$2,429.25	\$2,374.17	\$2,319.67
\$400,000	\$3,034.46	\$2,968.99	\$2,904.13	\$2,839.89	\$2,776.29	\$2,713.34	\$2,651.05
\$450,000	\$3,413.76	\$3,340.11	\$3,267.14	\$3,194.87	\$3,123.32	\$3,052.51	\$2,982.44
\$500,000	\$3,793.07	\$3,711.23	\$3,630.16	\$3,549.86	\$3,470.36	\$3,391.67	\$3,313.82
		<b>Change in repayments per month</b>					
\$100,000		-\$16.37	-\$32.58	-\$48.64	-\$64.54	-\$80.28	-\$95.85
\$150,000		-\$24.55	-\$48.87	-\$72.96	-\$96.81	-\$120.42	-\$143.78
\$200,000		-\$32.74	-\$65.17	-\$97.28	-\$129.08	-\$160.56	-\$191.70
\$250,000		-\$40.92	-\$81.46	-\$121.61	-\$161.36	-\$200.70	-\$239.63
\$300,000		-\$49.10	-\$97.75	-\$145.93	-\$193.63	-\$240.84	-\$287.55
\$350,000		-\$57.29	-\$114.04	-\$170.25	-\$225.90	-\$280.98	-\$335.48
\$400,000		-\$65.47	-\$130.33	-\$194.57	-\$258.17	-\$321.12	-\$383.40
\$450,000		-\$73.66	-\$146.62	-\$218.89	-\$290.44	-\$361.26	-\$431.33
\$500,000		-\$81.84	-\$162.92	-\$243.21	-\$322.71	-\$401.40	-\$479.25

Source: CommSec