

Australia: RBA Hikes by 25bps

The Reserve Bank of Australia raised its benchmark interest rate to 4.00%. In its monetary statement, Governor Glenn Stevens highlighted that "The global economy is growing; global financial markets are functioning much better than they were a year ago; and in Australia, economic conditions in 2009 were stronger than expected."

The decision to hike was widely expected, though there was to some extent uncertainty about whether the RBA will raise rates, having paused at its February meeting. At the February 2 meeting, RBA Governor Glenn Stevens said policymakers wanted to assess the impact of the previous three rate hikes, with concerns about sovereign debt risks in Greece and Dubai playing at the margins. The Australian central bank became the first G20 nation to increase interest rates since the onset of the global financial crisis, lifting by 25 basis points at each of its October, November and December meetings. The central bank does not meet in January.

Still, the central bank's decision this morning was not surprising. The economy is in much better shape than was expected when rates were slashed to a historic low of 3.00% a year ago; and economic data of late highly suggests that the Australian economy is recovering at a much faster pace than expected. Employment has been far stronger-than-expected, rising by almost 200,000 in the past five months, and driving the jobless rate down to 5.3%. Consumer and business confidence are both buoyant. A report published last week showed business investment jumped in the fourth quarter at almost three times the pace predicted by markets. And manufacturing expanded last month at the fastest pace in more than two years – the performance of manufacturing index increased 2.8 points from January to 53.8, according to the Australian Industry Group and PricewaterhouseCoopers. 4Q GDP figures will be released tomorrow (March 3) and it is expected that the Australian economy will grow 0.9% from the previous three months, when it gained 0.2%. Year-on-year, the economy probably expanded 2.4%.

Nevertheless, concerns over the sovereign debt problems in the Eurozone have intensified globally. And by contrast, US Federal Reserve Chairman Ben Bernanke said last week that the US is in a "nascent" recovery that still requires low interest rates. Hence, going forward, we think the RBA will continue to walk its path carefully as it continues the "normalization process" or to return to "average" levels. Being ahead of the other central banks, they could well afford, anyway, to wait and receive more confirmation on how the economy was responding to the tightening so far. That said, we maintain our view that rates in Australia will be around 4.50% by the first half of 2010. On the Aussie currency, supported by the diverging outlook for policy at home and abroad, we look for the AUD/USD to trade comfortably around the 0.930-levels by mid-2010.

	End 1Q10	End 2Q10	End 3Q10
Overnight Cash Rate	4.00	4.50	4.75
AUD/USD	0.910	0.930	0.940
Source: UOB			

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