

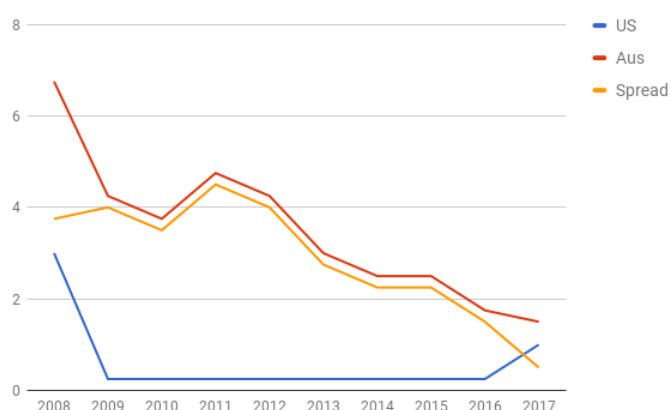
THE GLOBAL INTEREST RATE QUESTION

A strong AUD against the USD remains a challenge for the economy and not least the RBA in setting monetary policy. The economic, and indeed our commentary here, has been repetitive of late in outlining the downward (consumer pressures) and upward drivers (getting back to "normal" settings) of interest rates.

Whilst no-one can accurately predict exchange rates let's bravely assume that the current spike is not sustained, and isolate another factor - global interest rates.

This writer was fascinated by the RBA's recent comments pushing back against expectations for an early rate hike in Australia. There was no sense of urgency to raise rates and then the suggestion that "just because foreign central banks raise rates doesn't mean Australia will".

With sentiment overseas, Canada and U.S. in particular, for increased rates it is interesting to look at a recent history of the U.S. and Australia central bank cash rates.



Outlined above is a short history of comparing Australian and US cash rates, with the "Spread" showing the difference between the two.

Whilst drivers for both rates are different, the spread at present is as narrow as it has been since the early 2000's.

A lot of commentary in recent years has been at pains to state how we have "de-linked" from central rates overseas due to our relatively strong relative economic performance. In a sense that is true, and many of the issues we face here are "local" in nature.

The RBA, to its credit, have shown a capacity to act independently, and aside from the crazy 1990 period, movements in rates have not been nearly as pronounced or dramatic. They have made historically some sound decisions on rates, though I sense they would be regretting 2016's two cuts right now.

Reality though, might push the RBA's hand in the longer term with higher rates overseas putting upward pressure on local rates. This is unless we can see a world where Australia has sustained lower interest rates than the U.S. whilst maintaining an optimal exchange rate.

The challenge at some point to this could be the exchange rate. A stronger than desired AUD makes this lack of spread very convenient for now, but if it falls below optimal range, pressure to increase interest rates could intensify.

