

Rates will rise as economy recovers: RBA

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Reserve Bank of Australia (RBA) governor Glenn Stevens says it would be a mistake to be "too timid" to raise interest rates in response to a brighter economy.

Speaking at a breakfast function in Perth on Thursday, Mr Stevens said the period of greatest weakness in Australia was "probably past" and the risks of really serious economic weakness had "abated".

In that environment, the central bank governor said monetary policy needed to be "recalibrated" to reflect the changing circumstances.

"If we were prepared to cut rates rapidly, to a very low level, in response to a threat but then were too timid to lessen that stimulus in a timely way when the threat had passed, we would have a bias in our monetary policy framework," Mr Stevens said in prepared remarks.

"Experience here and elsewhere counsels against that approach."

The RBA board took the first step to returning interest rates towards what Mr Stevens described as more normal levels last week, when it lifted the cash rate to 3.25 per cent, from 3.0 per cent.

Mr Stevens said the 425 basis points worth of cuts delivered between September last year and April was a quick, aggressive response to limit the downside risks to economic activity.

The RBA's actions, along with government stimulus measures and the recovery in China had helped head off the worst effects of the global recession, Mr Stevens said.

"The very low interest rate settings were designed for a weaker economy than we are in fact facing," Mr Stevens said.

"Plainly, the downside risks to which the Board was responding earlier have not materialised.

"This is not a problem. In fact, it is a very desirable situation."

Mr Stevens said that barring another serious international setback, the economy was likely to continue on a path of gradual expansion during 2010.

"Australia has had an experience that, even if labelled a recession, was a pretty mild one," Mr Stevens said.

Looking ahead, Mr Stevens said the focus needed to be on "encouraging the sustainability of that expansion" while keeping inflation low and fostering a long sustainable period of growth.

"There are still important matters of judgment in the timing and pace of how that is done," Mr Stevens said.

"The global outlook remains uncertain and the board is very conscious of that."

Mr Stevens said although inflation was forecast to fall, as of late 2009 the central bank was yet to see "whether inflation will be consistently back to target over a period of time".

"We think it will be, but, as yet, that remains a forecast," Mr Stevens said.

Mr Stevens described the RBA's large rate cuts during the depths of the global financial crisis in late 2008 as "fully consistent" with the central bank's flexible inflation targeting framework.

He said a more conventional approach - that is, to have lowered interest rates more slowly - would have been a "defensible" course of action, but one that would have posed additional risks.

"But the loss in economic activity would probably have been greater, and the risk of an even larger contraction would have been unaddressed," Mr Stevens said.

"Inflation might well have fallen not only faster, but ultimately further, than we needed it to."

Mr Stevens was speaking at the John Curtin Institute of Public Policy and the Financial Services Institute of Australasia public policy breakfast forum.

This story was found at: <http://news.smh.com.au/breaking-news-business/rates-will-rise-as-economy-recovers-rba-20091015-gy8x.html>