RBA rate rise can't arrest rising cost of living

3 May—The Reserve Bank of Australia today lifted its cash rate for the first time since November 2010, from 0.1 to 0.35 per cent. The move was all but guaranteed given the rapid and accelerating inflation of the consumer price index (CPI), the main metric by which the RBA is supposed to set its monetary policy, since the start of this year. The notion that the RBA can control inflation via interest rates, however, presumes that in an "efficient market", prices across the economy can be pushed up or down simply by increasing or reducing the supply of credit—a "rule" which, if it ever applied at all, certainly does not in these days of pandemic- and geopolitics-induced disruptions to the global supply chains on which we have foolishly made ourselves dependent. And even were that not the case, lifting rates to curb inflation would at the same time increase the *actual* cost of living for many Australians even faster, via increases to mortgage repayments. With many household budgets already strained almost to the limit, this could well result in a tsunami of forced sales and defaults which would collapse house prices, and the major banks along with them.

In his media release announcing the decision, RBA Governor Philip Lowe cited the supposed "resilience of the Australian economy … [as] evident in the labour market", stating that "While aggregate wages growth was subdued during 2021 and no higher than it was prior to the pandemic, the more timely evidence from liaison and business surveys is that larger wage increases are now occurring in many private-sector firms … to attract and retain staff, especially in an environment where the cost of living is rising". According to the RBA's figures, CPI or "headline" inflation was 5.1 per cent over the year to the March quarter. The RBA's target band is 2-3 per cent. "The Board is committed to doing what is necessary to ensure that inflation in Australia returns to target over time", Lowe declared. "This will require a further lift in interest rates over the period ahead."

Damned if you do …

Lowe acknowledged that inflation "has picked up significantly and by more than expected", and "largely reflects global factors". The RBA presumes, however, that after a further rise in the near term, "inflation is expected to decline back towards the target range of 2 to 3 per cent … as supply-side disruptions are resolved". This seems overly optimistic, given that as the bank itself admits, COVID disruptions are ongoing in China, Australia's largest buyer of commodities exports and supplier of finished goods; while the war in Ukraine— and more importantly, but which the bank fails to mention, US and allied governments' trade and financial sanctions on Russia—is further straining global supply of staple foods, fertilisers, oil and gas, and more. Furthermore, some logistics experts warn that the increased cost of containerised freight, which has driven up prices for imported manufactured goods, is likely both to get worse and to persist for years. The extent to which the RBA can influence inflation by lifting interest rates would therefore appear minimal at best. What it undoubtedly will achieve, though, is to send mortgage repayments through the roof, potentially tipping enough households into mortgage stress to destabilise the entire banking system.

The situation in New Zealand foreshadows where Australia is heading. Unlike the RBA, the Reserve Bank of New Zealand (RBNZ) is required by legislation to keep CPI inflation between 1 and 3 per cent on average over the "medium term", which is generally understood to mean 3-5 years. In mid-2021 New Zealand's CPI began rising rapidly, prompting the RBNZ to lift its overnight cash rate (OCR) four times since October, from 0.25 to 1.5 per cent, including a 0.5 per cent hike (the biggest in 20 years) last month. Inflation has continued to rise nonetheless, and is now over 7 per cent.

Meanwhile, interest.co.nz news editor David Hargreaves reported 20 April, New Zealand house prices rose 40 per cent (!) in 2020-21. Now, spurred by the rising OCR, New Zealand's banks have raised their floating mortgage rates by an average 0.6 per cent, and their three- and five-year fixed rates an average 1.9 per cent, since their respective lows in mid2021. "The upshot", wrote Hargreaves, "is that someone who took out a 30-year mortgage last May fixed for a year, and who is now looking to re-fix, could find their monthly payments will go *up by exactly a third*. … In dollar terms someone who took out an 'average-sized' mortgage (NZ$329,000 as of May 2021) could face an increase in their monthly payments of NZ$419 (over NZ$5000 for a year). An 'average-sized' first home buyer mortgage (NZ$548,000 as of May 2021) would cost an extra NZ$698 a month (well over $8000 for a year)." (Emphasis in original.)

In Australia, where the average mortgage is $600,000, the fallout could well be even worse. As analyst Peter Marshall, of investment comparison site Mozo, told Digital Finance Analytics principal Martin North in a 2 May interview, "costs are going up … [on] real things like power bills, fruit and vegetables—you know, you've got to be able to feed your family. And things are getting tighter at the moment. So adding increased interest costs to your household bills is going to be really tough for a lot of people." Marshall reported that more than two thirds of households surveyed by Mozo would find themselves in "financial stress" (i.e. their expenses would equal or exceed their income) were mortgage rates to reach 5 per cent, "which is not out of the question" given the longterm average is around 7 per cent. North added that his own rolling monthly survey of 55,000 households (the largest in the country) indicates some 1.5 million households nationwide already "have cashflow issues; they're getting by, but only just". Even without future increases to CPI, "if rates went up another 2 per cent, that would be another 500,000 households added to the list", North said, which would then add up to more than half of all mortgaged households. Former RBA economist Leith van Onselen reported

28 April for MacroBusiness that were the variable mortgage rate to rise by 1.15 per cent to 4.75 per cent, as predicted by Commonwealth Bank economists, then mortgage repayments on the median priced Australian home would go up by 15 per cent, or $400 a month. If the futures market's projection of a 3.4 per cent rise by August 2023 is correct, however, "average mortgage repayments would soar by 46 per cent, adding a whopping $1,250 to monthly mortgage repayments on the median priced Australian home".

Government intervention to deflate the bubble in an orderly manner, as the Citizens Party has proposed (p. 3), is urgently needed to avert the carnage that would ensue.

By Richard Bardon, Australian Alert Service, 4 May 2022