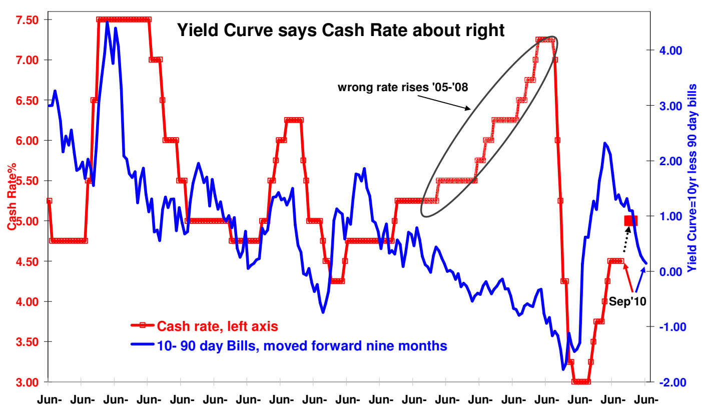
Errors and omissions 1 September 2010

Two week's ago today while the outcome of the Federal Election had not been decided by the three independents, the RBA released a statement which omitted six words "*higher interest rates would be required*"; these six words have become public today. I can not think of an honest reason or policy reason why these six words were omitted from the statement following the RBA's board meeting held that day two week's ago. After that meeting I correctly made a big deal about nine words that were added to that day's statement compared to the one after the August meeting which was held during the Federal Election campaign. The August intra-election campaign meeting implied there would be no rate hikes for the foreseeable future. Then after the election at the September meeting, the extra nine words indicated to me at least, that higher rates were on the way, although for most other commentators they were less certain of that.

Today, we now find that the September meeting show another extra six words were added but omitted from that day's statement released at 2.30pm; the words omitted are that "*higher interest rates would be required*" in the not too distant future. Now I can not think why it was necessary to delay releasing those six words by a fortnight; but I do remember what else was happening the day the RBA was meeting. The RBA publicly released their statement at 2.30pm. Up until then the election outcome was still unknown as the three incumbent independents were still deciding which party was to form the next government. Messrs Rob Oakeshott, Tony Windsor and Bob Katter finally made public their decision the same day as the RBA September meeting. In fact Messrs Oakeshott and Windsor did not make their decision public until half an hour after the RBA had issued their press release; Bob Katter made his decision about 50 minutes before the RBA's release.



We will probably never know why the six words were omitted from the statement issued two weeks ago when the RBA said the current "*setting of monetary policy to be appropriate for the time being.*" Yet the minutes of that meeting released today show that six key words were omitted. Here is what the minutes say today: Under their "*central scenario…it was likely that <u>higher interest rates would be required</u>, at some point* [but] *the current setting of monetary policy remained appropriate for the time being*"; underlining added. Whatever the reason for the omission, the yield curve (YC) is still warning that the cash rate is about right. In the chart above more rate rises, shown as the red square, would imply the red line would slice up through the blue line (YC) which could be the first steps along the way to repeat the mistakes of 2005 to 2008 which almost caused a recession in Australia. Thus if that next and seventh rate rise were to be followed by more then I would have to reassess my view on staying over invested in growth assets. Remember, unlike errors and omissions, mistakes caused by bad monetary policy are difficult to insure against.