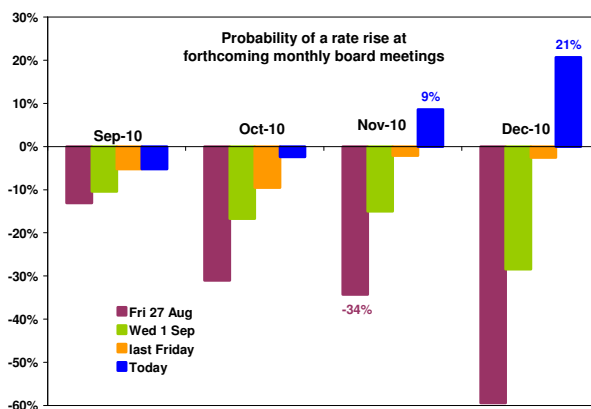


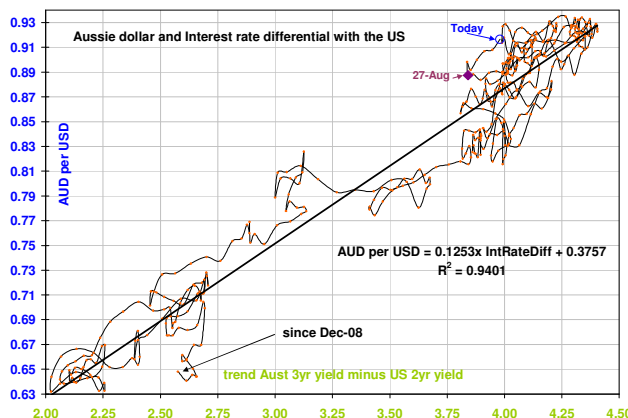
Is tomorrow soon enough?

6 September 2010

I am not referring to the gang-of-three's attempt to subvert our Westminster Parliamentary system by trying to impose a fixed term of government, instead of allowing the continuing confidence of the House to determine the timing of the next election; that may well occur tomorrow too. Instead tomorrow could be when the RBA reasserts its inclination to raise rates sooner rather than later. That could come in the statement the RBA releases following its monthly monetary policy board meeting. In just over a week, from Friday August 27, the short term money market has swung nearly fifty percentage points from no chance of a rate hike this year (technically a chance of a rate cut) to today's small chance of a rate hike at the November board meeting. See first chart below which shows the swing in probabilities based on the 30 Day Interbank Cash Rate futures market over the past week or so, of a rate hike at future monthly RBA board meetings.



Not only has the short term money market had a change of mind, the Australian dollar has also rallied against the US dollar, by almost three US cents over the same period. Uncannily my model of the exchange rate which is rarely aired in public predicts just such a rise: It suggests that for each 25 basis point rise in Australian over US short term bond yields, the Australian dollar should rise by almost three cents. See second chart showing the rise in the currency from August 27 to today.



A change in rates at the November meeting on Melbourne Cup day would not be unusual; the RBA have changed rates for the past four Cup days in a row and on 6 of the last 10 Cup days. While that seventh rate rise would not necessarily be a disaster, I would have to seriously rethink about the risks of staying heavily invested in Australian growth assets into the New Year should the seventh rate rise look like being followed by several more. Tomorrow will come soon enough.

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