

Ignoring the evidence

11 November 2010

With the leading indicators in the domestic economy showing signs of slowing it is not surprising that the rate of growth in employment is slowing down (see Chart 1). Male full time employment is also not so robust and in Western Australia, supposedly the recipient of resources stimulus, MFT job growth is barely positive see red line in Chart 2 below. Also it is not surprising that the unemployment rate has stopped falling and is showing early signs of trending up and away from 5% the point at which the RBA thinks the economy sails off the end of the earth, where “inflation” takes-off (see Chart 3 below). Yet the RBA increased the cash rate this month because they think the economy and the unemployment rate is going the other way despite what the facts suggest.

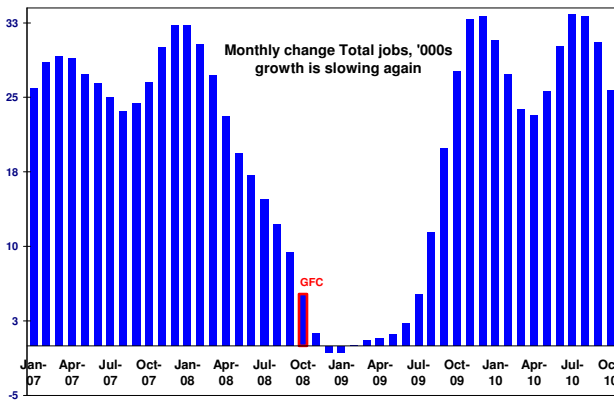


Chart 1

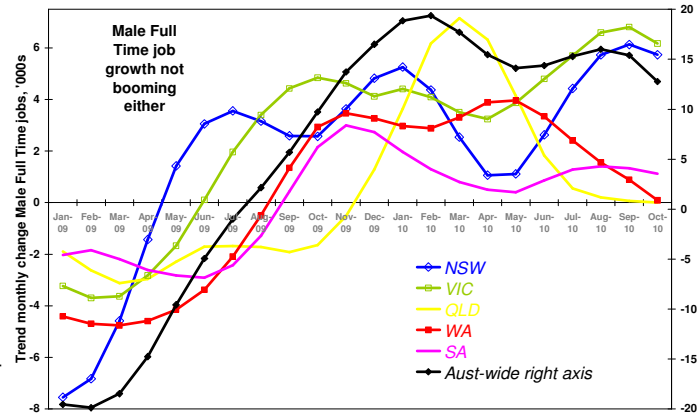


Chart 2

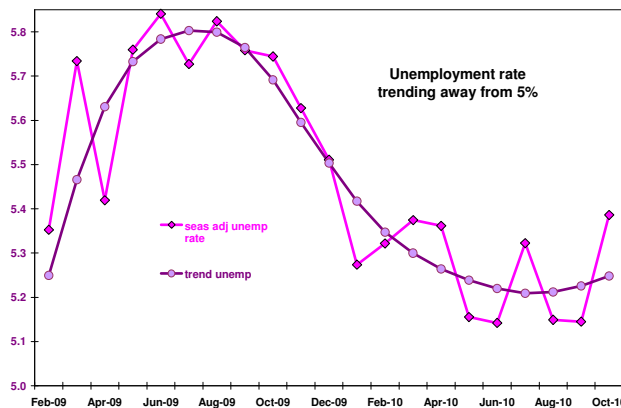


Chart 3

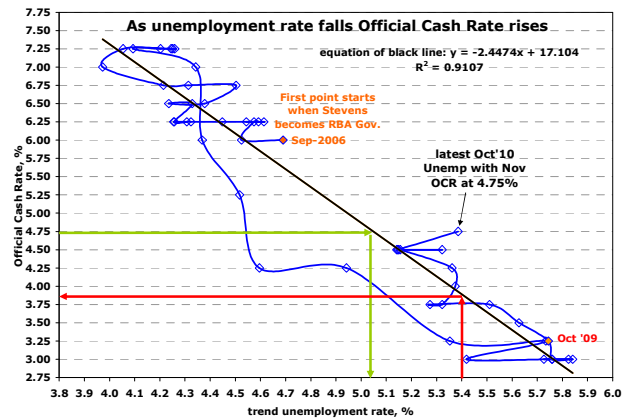


Chart 4

If fact based on a naïve model showing the path of the OCR and unemployment rate since Mr Stevens became the governor of the RBA (see Chart 4) it suggest that the current cash rate is set as if the unemployment rate was closer to 5% (look horizontally along the green arrow from 4.75% to the solid black line then down to the unemployment rate). However the unemployment rate is now 5.4% in the latest data released today (for the month of October). Alternatively in Chart 4 look vertically up along the red arrow from the unemployment axis starting at 5.4% then up to the black line then left across to the OCR axis to get an interest rate of just under 4%; about the level it was in March when I began to worry about an overzealous RBA see *Faith based policy* 31 March 2010 http://roneconomics.com/docs/2010/estar_98zx.pdf. Back then I thought the economy may handle a few more rate rises but I was worried and now as more evidence shows the current cash rate seems to be set too high. That is problematic for investors in Australian growth assets and a warning signal.

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