Reserve Bank of Australia Takes Interest Rates to 4%

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Yesterday, the Reserve Bank of Australia (RBA) shocked markets, bankers, politicians, economic commentators and the general public with a 2.5% increase to the official cash rate.

Australia's cash rate is now 4%.

In a refreshing departure from the usual 'cut and paste' blah, blah, blah statements 'on maintaining an accommodative rate policy,' the RBA's statement was both frank and forthright in explaining the Board's reasoning behind the surprise announcement.

This is an extract from the RBA statement:

> 'The Board did not take this decision lightly. We accept that many Australian households will tonight be reassessing their financial situation. However, we take this opportunity to remind Australia that it was only five years ago, in April 2012, that the official cash rate was 4.25%.
>
> 'Since then, Australian households have increased their debt load by a further $800 billion.
>
> 'The Reserve Bank acknowledges that its slavish and blind adherence to Keynesian "group think" was instrumental in encouraging households to delude themselves into thinking they could live beyond their means indefinitely.
>
> 'For this, we offer our profound apologies.
>
> 'However, our decision to normalise interest rates — to achieve a balance between rewarding savers and ensuring borrowers maintain responsible debt levels — was actually based on the insights of John Maynard Keynes.
>
> 'It was Keynes who said "When the facts change, I change my mind. What do you do sir?"
>
> 'The RBA has looked at the facts, and we've come to the realisation that the curtain must be drawn on the era of unbridled debt accumulation.
>
> 'We accept that our obsession with pushing rates lower has, in turn, pushed household debt higher. It's no coincidence that Sydney and Melbourne property prices have risen in tandem with every lowering of the official cash rate.
>
> 'Our policies have aided and abetted the functioning of the greatest Ponzi scheme in Australian history…an ever-expanding debt base is required to support the system.
>
> 'The Board recognises the folly in continuing with an interest-rate policy based solely on "debt encouragement" to achieve economic growth.
>
> 'It's evident that we've created an economic "monster". One that needs to be fed more and more debt to make even glacial progress.
>
> 'In real terms (after you deduct the debt added to the system), the world is actually experiencing negligible economic progress.
>
> 'After recognising this fact, the Board determined that it is both illogical and irresponsible to further encourage households to

continue on this path to financial ruin.

'The Board could have opted for the easy decision, gradually increasing rates over a two-and-a-half year period…a 0.25% increase every quarter. However, the time to act is now. Another two years would only make a bad and sad situation much worse.

'The RBA accepts that it must be the responsible adult and make the hard decisions. No child wants its lolly taken from them. No teenager wants the party shut down. And in this Keynesian world, no adult wants to live within their means.

'We understand the psychology and appreciate how difficult this about-face in discipline must be to accept. But we ask you to trust us.

'In the short-to-medium term, there will be pain. There is no hiding or escaping this fact.

However, in the longer term, Australia will be much stronger for the actions we have taken today.

'The RBA is ashamed at the role it has played in making Australian households the most indebted in the world (as a percentage of GDP). This is a global recognition none of us can be proud of.

'The RBA would like to sincerely apologise to Australian savers. We know that, since 2008, savers have endured an 80% reduction in the return on capital (with interest rates falling from 7.25% to 1.5%). They have suffered in silence while we pursued the misguided policy of encouraging households to borrow and spend more, while saving less.

'Our decision today, to normalise rates, is the start of us righting this wrong.

'The decision to take the cash rate to 4%, effective immediately, will more than likely mean Australia's recession-free run is over.

'However, the truth is that this economic success was an illusion.

'Was it a coincidence that our two "world records" were achieved at the same time? No.

'Our world championship in household indebtedness, as well as our almost world record-breaking recession-free run are practical examples of economic cause and effect.

'Going deeper into debt inflated the GDP numbers well beyond what our underlying economy was producing.

'We sincerely apologise for this statistical deception.

'The Board recognises that in creating the perception of economic success, this then became the public's reality. Complacency and hubris has led us to the rather awkward and difficult position we find ourselves in today…acknowledging the multi-decade-long experiment in debt-fuelled prosperity has failed.

'It's with a heavy heart that we recognise today's decision will inflict significant financial distress on many households and businesses. However, if we'd continued down the path of low interest rates and higher debt levels, many more would have become victims of this misguided "growth" policy.

'When faced with the decision of making some sacrifices today rather than many more tomorrow, we opted for the former.

'If, as they say, "the most difficult decisions are usually the correct ones", then, today's very difficult decision was the right one to make in the long-term interests of our nation.'

Well folks, you guessed it; today's *Daily Reckoning* (up to this point) is genuine FAKE news.

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However, *this* is real news:

From Reuters, dated 3 April 2017: 'IMF chief warns slowing productivity risks living standards drop' (emphasis mine):

> '*"Another decade of weak productivity growth would seriously undermine the rise in global living standards,"* [Christine] *Lagarde told an audience at the American Enterprise Institute, a pro-business think tank in Washington.*
>
> '*"Slower growth could also jeopardize the financial and social stability of some countries by* ***making it more difficult to reduce excessive inequality and sustain private debt and public obligations****," she added.*'

And this line from the front page of today's *Australian*: 'Economy at risk as debt bomb grows'.

Here's an extract:

> '*The rampant debt-fuelled surge in the Sydney and Melbourne property markets will threaten the health of the national economy if it continues, Reserve Bank governor Philip Lowe has warned.*
>
> '*The RBA is worried that housing debts are rising more than twice as fast as household incomes and that banks are lending to people who cannot afford to repay their debts.*
>
> '*"The concern has been that the longer the recent trends continued, the greater the risk to the future health of the Australian economy," Dr Lowe told a business dinner in Melbourne last night. "Stretched balance sheets make for more volatility when things turn down.*
>
> '*"For many people, the high debt levels and low wage growth are a sobering combination."*'

In reading the article, I didn't see anything that describes the RBA's role in creating this debt bomb.

Sure, the banks should exercise more restraint in who they lend to and how much debt they burden people with.

Yes, the government could rein in tax concessions associated with negative gearing.

However, these are the 'effects' of the cause. The reason people — homeowners and investors alike — are lining up at banks is because the cost of money is so damn cheap.

Which institution sets the cost of money?

Hmmm, if I'm not mistaken, I think it's the RBA.

The RBA cannot defuse this debt bomb…it's already packed with $3.4 trillion of private sector TNT.

The best they can do is to stop more debt explosives being added.

The only way this can happen is to significantly increase the cost of debt — a shock tactic to bring our society to its senses.

Yesterday's decision to keep rates on hold indicates that the RBA is not serious about rectifying the problem it's been instrumental in creating.

If the institution charged with ensuring the long-term safety of our financial system is abdicating its role as the 'responsible adult', then it becomes your individual responsibility to protect your financial position.

This warning is from an article in *The Australian:*

> '*The chairman of the government's Financial System Inquiry, former Future Fund chairman David Murray, yesterday sounded a further alarm on the housing boom, saying a crisis on the scale of the 1890s great property collapse could not be ruled out. "What people should do is look at the 1890s, which was caused by a housing land boom," he told The Australian. "To say it won't happen and simply ignore it is wrong."*'

Sadly, David Murray's warning, and that of the IMF chief, is a case of too little, too late.

People have already loaded up on cheap debt in the mistaken belief that this is how a 'successful' economy functions.

An ounce of prevention would have been far better than this belated 'ton of cure'.

The only remedy for a debt problem is to reduce debt.

The problem with that solution is that it would deny the economy its sole source of growth.

We are in a bind that none of our political and banking institutions can extract us from with their current beliefs and policy settings.

Therefore, this intractable debt problem must reach its logical end…the market will correct the excesses.

And that, dear reader, is going to be an extremely painful outcome for far more people than it needs to be.

If only the RBA would raise rates to 4% now.

Instead, we're likely ing for *this*.

Regards,

Vern Gowdie,
Editor, *The Daily Reckoning*