

MACROECONOMICS AT WORK EXERCISE

INTEREST RATES AND THE VALUE OF THE \$A

REFERENCE: 'Exporters lash out at rate freeze' (by Guy Mosel), *The Courier-Mail*, 3 July 2003, p. 27.

CHAPTER RELEVANT TO THIS EXERCISE: Chapter 17.

OVERVIEW

While the adjustment of the rate of interest by the Reserve Bank is to a large extent an 'automatic' adjustment in response to the level of inflation (see pp. 308–10), decisions by the Bank are influenced by many other factors. In mid-2003 this was certainly the case. One of the most significant was the implications of interest rates (and in particular the relative level of interest rates in Australia compared to those in overseas countries and most importantly the US) for the value of the \$A and the implications of this for exporters, and other identifiable groups, within the domestic economy. The decision to alter interest rates is also affected by a number of considerations other than simply the level of inflation.

QUESTIONS

1. Review the meaning of the term, and the process by which the Reserve Bank of Australia 'sets (and changes) interest rates'.
2. What is the differential between interest rates in the US and Australia? Why is this so? What is the significance of the difference?
3. Explain in general terms how different categories of individuals and businesses may 'gain' or 'lose' from an appreciating \$A, and comment on the table in the article giving some examples of firms who are 'helped' or 'hurt' by the rising value of the \$A.
4. What have been the major considerations, in addition to the implications of interest rates in Australia for the value of the \$A, that the Reserve Bank has taken into account in its deliberations on interest rates?
5. Analyse the statement attributed to the Australian Industry group chief executive that 'It is regrettable that the bank's apparent emphasis on the housing industry in making its decision was misplaced'.
6. Two firms have recently announced the suspension of plans for major investment projects (one a chemical plant, the other a coal mine project). Can these decisions be related to the question of interest rates? Should we be concerned?