

## MACROECONOMICS AT WORK EXERCISE

### INTEREST RATES

**REFERENCES:** ‘Looking back won’t change rate bias’; ‘RBA is bound to come off sideline’ (by Craig James), *Australian Financial Review*, 24 October 2002, pp. 27, 59.

**CHAPTERS RELEVANT TO THIS EXERCISE:** Chapter 13, 14, 16.

### OVERVIEW

These two articles (by the same author and in the same day’s *Australian Financial Review*) are concerned with the role of the Reserve Bank of Australia in setting interest rates. While in essence interest rates are set (or, strictly, influenced by the actions of) the RBA in response to the rate of inflation (see pp. 307-9) the actual decision to act is a complex one and influenced by a variety of other factors. At the current time the drought and the uncertainties in the global economic situation are of particular importance. It is in this light that it is pointed out that ‘interest rates must be set with an eye to the future...rather than yesterday’s inflation rate’, thus emphasising that the inflation target is a *long-term* one.

### QUESTIONS

1. What conclusions can be drawn from the latest inflation figures about the trend in inflation?
2. Why is it said that the latest inflation rate figure is only a ‘technical’ breach of the target level? What are the implications of this?
3. Explain the statement that ‘the Reserve Bank can’t operate monetary policy by looking in the rear-view mirror’.
4. Looking ahead, what are the major indicators which might suggest *upward* pressure on the rate of inflation. Are there any indicators of *downward* pressure?
5. What basis is there for the ‘clear conclusion’ suggested in one of the articles that interest rates are ‘headed higher’?
6. Comment on the graphs in each of the articles.