A fine line but RBA tipped to raise rates later

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THE ECONOMY

THE surprise return of inflationary pressures in the Australian economy is forcing analysts to hastily rethink their forecasts for interest rates.

And despite the nation's slow march to recovery, some economists say interest rate rises are now a real possibility this year.

The Reserve Bank is walking the tightrope on rates, analysts say, as it gauges whether to cut again to support the economy, lift to stave off further inflation threats or hold the line.

Weak employment figures have clouded the picture, with 31,600 full-time jobs erased in December despite the jobless rate clocking in steady at 5.8 per cent.

But this week's stronger-than-expected quarterly increase in the consumer price index of 0.8 per cent — broadly double most economists' expectations — has prompted many to question whether the RBA can maintain its "bias" towards rate cuts.

The official interest rate has been at a historic low of 2.5 per cent since August.

While maintaining his forecast for a year-end cash rate of just 2 per cent — at the bottom end of market consensus — Westpac chief economist Bill Evans on Thursday pushed back his forecast of a 25-basis-point cut to the second half of the year.

He previously tipped Glenn Stevens and other RBA directors would slash rates again before July. Mr Evans said Westpac's team believed the spike in inflation would prove to be fleeting "due to expected ongoing stability in the Australian dollar".

Elsewhere, JP Morgan's Ben Jarman said his team's 2.25 per cent tip now wouldn't be realised until at least the third quarter, after earlier plumping for a pre-March cut.

IG Markets analyst Chris Weston said he had "gone into a flat camp" on rates "for the foreseeable future" after last month factoring in a cut this year.

Their shifts echoed similar delay calls on a quarter-of-a-percentage cut from the Bank of America and Royal Bank of Canada.

Others saw the inflation figures as an immediate green light for rate hikes.

"(The RBA) could rise as early as March," Market Economics managing director Stephen Koukoulas said. "It's now two quarters where headline inflation's been a bit elevated, so it's not a one-month wonder."

Mr Koukoulas said the central bank would ramp up the cash rate to 3.5 per cent by the end of the year, which should be taken as a vote of confidence in the economy.

The climate will also prompt mortgageholders to assess the merits of variable and fixed home loans but already the major banks appear to have sniffed the wind. National Australia Bank and Westpac this week trimmed their three-year fixed rates by five basis points to 5.14 per cent in a bid to stay front of mind amid any consumer-driven rush for mortgage repayment certainty.

CommSec economist Savanth Sebastian said a year-end cash rate at the upper end of the broker's projected range — 2.25 per cent to 2.75 per cent — was now more likely, but the length of the jobless queue held the key.

NAB chief economist Alan Oster maintained another 25-basis point rate cut was coming this year, just later than previously expected.

He said the RBA would likely wait for the next CPI figure — due in April — before tackling the inflation genie.