Perpetual knowledge bank series: Cash Rate

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Interest is the monetary charge for borrowing money, which is generally expressed as a percentage or cash rate. The cash rate has a big impact on the cost of loans and, as a result, can be used by central banks to speed up or slow down a country's economy. Typically, a consumer borrows money from a bank when they take out a home mortgage while banks borrow money from their clients in the form of deposits. In both cases, the cash rate determines how much extra the borrower pays back on the loaned amount.

Monetary policy decisions in Australia involve the Reserve Bank Board setting a target for the cash rate. A media release is issued at 2.30 pm after each Reserve Bank Board meeting, with any change in the cash rate target taking effect the following day. The cash rate functions as the interest rate on unsecured overnight loans between banks and determines the benchmark rate for the Australian dollar.

A low cash rate has some obvious impacts as it stimulates the demand for real estate, savings rates fall as savers find they get less interest on their deposits, and markets benefit from the resulting willingness to invest this capital elsewhere. Low rates also make business loans more affordable, which encourages business expansion and promotes hiring. However, a low cash rate can cause inflation if too much liquidity sees demand outstrip supply and prices rise.