The best price signaller in the land

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Now that both sides of politics have decided to crack down on the evil practice of price signalling we might as well ask who does it and why. Because some people may not be aware that the biggest price signaller is not the Commonwealth Bank or Westpac or any of the other "evil" commercial banks. The biggest price signaller in the interest rate market is the Reserve Bank, the one the government owns.

When its board meets it decides whether it wants to move the rate the banks charge each other on overnight loans. Then it announces that rate. The banks act on that signal and move to the targeted rate. If they refused to do so, the Reserve would have to try to produce the desired outcome by releasing or withdrawing funds. But it is quicker and cleaner for everyone to act on a price signal.

The established practice is that the banks also use that signal to move other rates, particularly the sensitive standard variable home loan rate. When the Reserve announced on Melbourne Cup Day it wanted to increase the cash rate there was no reason to put up my mortgage. The bank lent me money years ago to pay the person who sold me the home. That money did not get more expensive to the bank on Cup Day. But it got more expensive for me. We have all been conditioned to accept that a price signal from the Reserve justifies an increase in our mortgage rate.

Some have suggested in this current round of bank bashing that we should ban the variable mortgage. So let me take off my consumer hat and make an extremely important point about macroeconomic management. The variable mortgage rate - which moves on the price signal of the Reserve - allows it to tighten and loosen family finances by the issue of a press release. If we all had 30-year fixed mortgages - as is the general practice in the US - we would be largely unaffected by small movements in the cash rate. It would take a much longer time and a much greater movement to transmit monetary policy to the real economy. Our arrangements in Australia give authorities a highly sensitive lever for stimulating or dampening economic activity.

The difference, or spread, between the cash rate and the variable mortgage rate has varied over time. In 1996 it was 300 basis points (3 per cent). By encouraging competition, particularly from mortgage originators, and a bit of jawboning it came down to 180 and stayed there for about eight years from 1999. When Labor was elected in 2007 the banks took the opportunity to widen spreads. By July 2008 - before the Lehman crash and global financial crisis - it had risen to 235 points. Through 2008 mortgage originators were struggling to write new business and after the Lehman crash government guarantees gave banks a privileged position over competitors. They widened spreads again. Now they are more than 300 points and right back where they were in 1996.

The recent outrage has not been that the banks acted on price signals but that they acted outside them. When the Reserve gave a price signal of 25 points on Melbourne Cup Day the Commonwealth Bank moved its rate by 45, nearly double. It has been unable to explain why in any convincing way. This has been a public relations disaster. A bank prepared to pay $16 million salaries cannot supply anyone who sounds credible on this issue.

Yet all is not disaster. In the midst of this public outrage, the ACCC helpfully suggested an increase in its powers - to combat price signalling. And, of course, with new powers it will need an increase in its budget.

Do you think this will fix the problem? Do you really think bank executives sit around reading transcripts of each other's interviews looking for coded messages? Apart from everything else, this debacle teaches us that they are hardly canny media operators.

So the public is outraged that a bank has thumbed its nose at the price signal. Parliament steps in to crack down on price signalling. The regulator gets new powers and a bigger budget. Little fish get drawn into the net of ACCC investigations. And the banks remain unaffected.

Business as usual in the national capital.