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The Parliament of the Commonwealth of Australia

# Review of the Reserve Bank of Australia Annual Report 2016 (First Report)

House of Representatives  
Standing Committee on Economics

March 2017  
Canberra

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## Chair's foreword

On 7 February 2017 the RBA decided to leave official interest rates on hold at 1.5 per cent. In making this decision, the Governor commented that 'holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.'

At the public hearing on 24 February 2017 the Governor noted that, given headline inflation has risen in most countries and is much closer to target than it has been for some years, the 'forecast for global growth has been revised up over recent months – and that is the first time that has happened for quite a few years.'

After a weaker than expected September quarter last year, Australia's GDP growth is expected to pick up, sustained by accommodative monetary policy and a lower Australian Dollar. The RBA forecasts that GDP growth will increase to 2½–3½ per cent during 2017.

While inflation remains low, it is expected to move closer to target, with the Consumer Price Index (CPI) forecast to rise to around two per cent by the middle of 2017.

Since its low point in January 2016, the Australian Dollar has appreciated by over 10 per cent against both the US dollar and on a trade-weighted basis. However, the Governor noted that the historical depreciation of the Australian dollar continues to support growth in a range of Australian industries, and has remained largely unchanged since the United States election.

The Governor's testimony suggests consumption growth is moderating and that wages growth continues to be restrained. Unemployment remains stable, with employment growth being driven by increases in part-time employment.

Housing markets across Australia have been mixed. While the Sydney and Melbourne markets continue to record strong growth, other markets such as Perth have experienced weaker conditions. There was a substantial improvement in the

number of building approvals in the last two years, mainly driven by strong growth in new apartments being built.

Australia's economic growth outlook is more optimistic than it was in March 2016, with evidence showing that the headwinds of declining mining investment and low commodity prices have eased. The RBA expects GDP growth in Australia of between two and three per cent by the end of 2017 to be supported by increases in the production of LNG and improving terms of trade.

On behalf of the committee, I thank the Governor of the Reserve Bank, Dr Philip Lowe, and other representatives of the RBA for appearing at the hearing on 24 February 2017.

David Coleman MP  
Chair



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## Membership of the Committee

Chair	Mr David Coleman MP
Deputy Chair	The Hon Matt Thistlethwaite MP
Members	Mr Adam Bandt MP Ms Julia Banks MP Mr Scott Buchholz MP Mr Trevor Evans MP Mr Kevin Hogan MP Mr Craig Kelly MP Mr Matt Keogh MP Ms Madeleine King MP

## Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Dr John White
Administrative Officer	Ms Jazmine Rakic





## Terms of reference

The House of Representatives Standing Committee on Economics is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee for any inquiry the committee may wish to make. The reports stand referred in accordance with the schedule tabled by the Speaker to record the areas of responsibility of the committee.



## Abbreviations

APRA	Australian Prudential Regulation Authority
BEPS	Base Erosion and Profit-shifting
CLF	Committed Liquidity Facility
CPI	Consumer Price Index
GDP	Gross Domestic Product
GFC	Global Financial Crisis
LNG	Liquified Natural Gas
NPP	National Payments Platform
OECD	Organisation for Economic Co-operation and Development
QE	Quantitative Easing
RBA	Reserve Bank of Australia

## Introduction

### Background

- 1.1 The House of Representatives Standing Committee on Economics (the committee) is responsible for scrutinising the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the community and the financial sector.
- 1.2 The appearance by the Governor of the RBA at biannual public hearings of the committee is an important element of the RBA's accountability framework. The details of this framework are set out in the *Seventh Statement on the Conduct of Monetary Policy*, agreed between the Treasurer, the Hon Scott Morrison, MP, and the RBA Governor, Dr Philip Lowe. The statement formalises the biannual appearance before the committee. The statement, which is reproduced at Appendix B, states:
  - ... the Governor will continue to be available to report twice a year to the House of Representatives Standing Committee on Economics, and to other Parliamentary committees as appropriate. The Treasurer expresses support for the continuation of these arrangements, which reflect international best practice and enhance the public's confidence in the independence and integrity of the monetary policy process.<sup>1</sup>
- 1.3 A second procedural mechanism for achieving this accountability is set out in the Standing Orders of the House of Representatives, which provide for the referral of annual reports within a committee's area of portfolio responsibility for any inquiry the committee may wish to make. Hence, the committee may inquire into aspects of the annual reports of the RBA.

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1 Reserve Bank of Australia (RBA), *Seventh Statement on the Conduct of Monetary Policy*, 19 September 2016.

## Scope and conduct of the review

- 1.4 The second public hearing of the committee with the RBA during the 45<sup>th</sup> Parliament was held in Sydney on 24 February 2017.
- 1.5 The proceedings of the hearing were webcast over the internet, through the Parliament's website, allowing interested parties to listen to the proceedings as they occurred. The transcript of the hearing is available on the committee's website.<sup>2</sup>
- 1.6 Before the hearing, the committee received a private briefing from Mr Paul Brennan, Chief Economist, Citi Australia. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Brennan's cooperation and assistance.
- 1.7 The committee also appreciates the provision of additional briefing material from the Parliamentary Library Research Service.
- 1.8 The hearing was well attended by members of the public and media.
- 1.9 The public hearings with the RBA continue to bring issues of monetary policy into the public arena, and have assisted in providing a public face to parliamentary committees and the RBA. These hearings are also an important means whereby financial markets can be better informed on the current thinking of the RBA.
- 1.10 This report focuses on matters raised at the public hearing, and also draws on issues raised in the RBA's February 2017 *Statement on Monetary Policy*. The *Statement on Monetary Policy* may be viewed through the RBA's website.<sup>3</sup>

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2 House of Representatives Standing Committee on Economics, *Past Public Hearings and Transcripts*, 24 February 2017, <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/House/Economics/RBA2016AnnualReport/Public\\_Hearings](http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBA2016AnnualReport/Public_Hearings)>, accessed 16 February 2017.

3 Reserve Bank of Australia, *Statement on Monetary Policy*, <<http://www.rba.gov.au/publications/smp/2017/feb/>>, accessed 16 February 2017.

## Monetary policy and other issues

### Overview

- 2.1 On 7 February 2017, the Reserve Bank of Australia (RBA) decided to leave official interest rates unchanged at 1.50 per cent. At the committee's last hearing with the RBA in September, the interest rate remained at 1.50 per cent after reducing the cash rate by 25 basis points on 4 August 2016.
- 2.2 In his February Statement on the decision, the Governor noted that the current circumstances called for monetary policy to remain accommodative. The Governor commented:
- Taking account of the available information, and having eased monetary policy in 2016, the Board judged that holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.<sup>1</sup>
- 2.3 The RBA noted that conditions in the global economy have improved recently and that 'above-trend growth is expected in a number of advanced economies, although uncertainties remain.'<sup>2</sup>
- 2.4 The Governor remarked in his opening statement that:
- Headline inflation has risen in most countries and it is much closer to target than it has been for some years. Given all this, forecast for global growth has been revised up over recent months – and that is the first time that has happened for quite a few years.<sup>3</sup>

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1 Reserve Bank of Australia (RBA), Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2017-02*, 7 February 2017

2 Reserve Bank of Australia (RBA), Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2017-02*, 7 February 2017

3 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 1.

2.5 The Governor added:

At the equivalent hearing a year ago, the tone for the global economy was pretty sombre. We had seen quite a lot of turbulence in the Chinese financial markets, commodity and equity prices were declining, some overseas central banks had pushed their interest rates into negative territory and the global forecasts for growth were being lowered yet again.<sup>4</sup>

2.6 The RBA expects domestic economic conditions to improve as the global economy strengthens, with GDP growth forecast to rise above two per cent in early 2017, to 2½–3½ per cent by year end.<sup>5</sup>

2.7 The Governor explained:

For most of the time since 2012, we have been facing headwinds from declining mining investment and falling commodity prices. Then, around the middle of last year, the headwind from falling commodity prices turned into a gentle tailwind as commodity prices lifted, and the headwind from declining mining investment should blow itself out before too long as mining investment returns back to normal levels. We will also benefit over the next couple of years from large increases in the production of LNG.<sup>6</sup>

2.8 Inflation has been lower than expected a year ago and remained at around 1½ per cent during 2016. The RBA forecasts inflation to pick up to 1½–2½ per cent over the year to December 2017.<sup>7</sup>

2.9 The Governor noted that Australia's terms of trade have improved, buoyed by higher prices for commodities, and this should encourage investment. These improvements, the Governor remarked, suggest the 'decline in growth in nominal income we have seen is not a permanent state of affairs'.<sup>8</sup>

2.10 In relation to households, the Governor stated 'we think consumption growth is going to be relatively modest but it is going to be strong enough to create ongoing demand and give firms enough confidence to invest.'<sup>9</sup>

2.11 During the hearing, the committee questioned the RBA on monetary and economic policy. Areas of discussion included the cash and exchange rates, inflation and the labour market, housing and household consumption, the growth performance of Australia's major trading

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4 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 2.

5 RBA, *Statement on Monetary Policy*, February 2017, p. 57.

6 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 2.

7 RBA, *Statement on Monetary Policy*, February 2017, p. 57.

8 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 1.

9 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 2.

partners, the price of commodities and corporate taxation and international competitiveness.

- 2.12 The Governor provided an update to the committee about the RBA's key projects, including the development of Australia's new banknotes and the New Payments Platform (NPP). Improvements in the gender diversity of the RBA's executive team and further progress in promoting women, an external review of efficiency of operations at the RBA, and other corporate governance issues were also examined.

## Forecasts

- 2.13 In its February 2017 *Statement on Monetary Policy*, the RBA reported that Australia's GDP growth is expected to pick up over 2017 to 2½–3½ per cent, and maintain at 2½–3½ per cent over the year to June 2018 (see Table 1).<sup>10</sup>

Table 1 Output Growth and Inflation Forecasts (per cent)(a)

	Year-ended					
	Dec 2016	June 2017	Dec 2017	Jun 2018	Dec 2018	Jun 2019
GDP growth	2	1½–2½	2½–3½	2½–3½	2½–3¾	2¾–3¾
Unemployment rate	5.8	5¾	5–6	5–6	5–6	5–6
CPI inflation	1.5	2	1½–2½	1½–2½	1½–2½	2–3
Underlying inflation	1.6	1¾	1½–2½	1½–2½	1½–2½	2–3
	Year-average					
	2016	2016/17	2017	2017/18	2018	2018/19
GDP growth	2¾	1½–2½	2–3	2½–3½	2½–3½	2¾–3¾

Source Reserve Bank of Australia, *Statement on Monetary Policy*, February 2017, Table 6.1, p. 57.

(a) Technical assumptions include A\$ at US\$0.76, TWI at 66 and Brent crude oil price at US\$56 per barrel.

- 2.14 The RBA's forecasts for the growth of Australia's major trading partners to remain little changed from the November Statement, and is expected to 'ease only slightly in 2018.'<sup>11</sup>
- 2.15 The RBA notes that a decline in GDP growth in the September 2016 quarter has meant that year-ended GDP growth of the Australian

10 RBA, *Statement on Monetary Policy*, February 2017, p. 2.

11 RBA, *Statement on Monetary Policy*, February 2017, p. 55.

economy was markedly lower than expected, and forecasts have been revised downward accordingly.<sup>12</sup>

- 2.16 When asked how robust the forecasts are, in light of concerns about the quality of data coming out of China, the Governor said:

The forecast three per cent number that I think is reasonable is really our central scenario. The central scenario is built on the Chinese economy this year continuing to track along at a reasonable pace and not falling off the cliff next year. If China turns out to grow much slower, that would have an impact on Australia – I accept that. I really do not see our forecasts as particularly optimistic. We have been expecting growth this year and next year of three per cent for a while, so we have not become fundamentally more optimistic about the Australian economy, but the downside risks seem much diminished compared to where they were when we met last year. There was a lot of pessimism at this time last year and it has gone away.<sup>13</sup>

- 2.17 However, the Governor also acknowledged that there were significant risks associated with a Chinese downgrade in the medium term, because it would have undesirable consequences for our economy if that were to occur:

If the Chinese economy were to slow very significantly, that would have implications for commodity prices, our exchange rate and growth – that is pretty clear.<sup>14</sup>

- 2.18 The Governor explained:

...the issue as it really has been for two decades now is a medium-term one, as we often talk about – 'This year China is going to be okay, but the risks are in the medium term.' I do not know how many years we have been saying that for, but I feel like it is at least a decade and probably longer. Each year we go along, I get more nervous about the medium-term risks.<sup>15</sup>

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12 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 56.

13 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 8.

14 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 8.

15 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 8.



2.19 The Governor added:

As we have been saying for many years, that risk is out there and it seems to be getting bigger, and if it did materialise it would have a first-order effect on our economy.<sup>16</sup>

2.20 The Governor was questioned whether there was more the RBA could do to improve its forecasts in the longer term. The Governor responded that the role of the RBA is to assist Australians to understand 'the broad contours of the forces shaping the economy'.<sup>17</sup> As a consequence of this, the Governor said the former Governor, Mr Glenn Stevens, and he both believed 'a focus on point forecasts is misplaced. We basically want to know if in 2019 we think the economy is going to be okay.'<sup>18</sup>

## The cash rate and monetary policy

2.21 At its meeting on 7 February 2017 the RBA decided to keep interest rates unchanged at 1.5 per cent, noting that:

Taking account of the available information, and having eased monetary policy in 2016, the Board judged that holding the stance of policy unchanged at recent meetings would be consistent with sustainable growth in the economy and achieving the inflation target over time.<sup>19</sup>

2.22 The committee asked whether the RBA thought it was likely that it would further ease rates. The Governor responded that he saw current market pricing for rates to remain constant this year as being a 'reasonable proposition'. However, he noted:

...there are clearly scenarios where they go up and there are scenarios where they would go down. The central scenario of a period of stability of interest rates, I think, where we stand today, is quite a reasonable one. I think it would be good if people focused on things other than quarter per cent movements in interest rates.<sup>20</sup>

2.23 The committee was interested in hearing about the factors at play in the RBA reaching its decisions on rates this year. The Governor said:

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16 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 8.

17 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 27.

18 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 27.

19 RBA, *Statement on Monetary Policy*, February 2017, p. 4.

20 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 6.

In terms of the issues that we are considering, the unemployment rate is a bit high – it is not terribly high, but it is a bit high. It would be better if it were lower. The inflation rate is a bit low, and we would be closer to the target if it was a bit higher. An argument could be made – and people argue this, including people on my own staff – that we could have lower interest rates today to try encourage a bit stronger growth in employment, get the unemployment rate down a bit and get inflation up a bit quickly. I think that is a respectable line of argument.<sup>21</sup>

2.24 The Governor was asked if the RBA took into account the distribution of wealth across the economy into its interest rate decisions. The Governor responded that while the RBA did sometimes discuss income inequality, for example the effect of inequality on the housing market, it was one of many factors that play into the RBA's considerations. The Governor emphasised the role of the RBA was '...to deliver for the community an average rate of inflation of 2½ per cent and to try to keep a reasonable degree of financial stability.'<sup>22</sup>

2.25 The Governor was questioned whether the RBA would be more likely to reduce rates if not for high house prices. The Governor responded that it is 'a balancing act' and that it was uncertain whether monetary policy can do much more in that space:

I think that if we did not have housing prices and credit growing as quickly as they are the argument at the margin would be stronger for lower interest rates. The issue, though, would be how effective lower interest rates at this point would be in stimulating demand and employment. I think there are probably more effective ways of doing that. It is not monetary policy; it is really in the hands of the parliament to create an environment where firms want to invest and people want to spend. Monetary policy at the margin can help you, but we are talking very much at the margin.<sup>23</sup>

2.26 When asked whether he was happy with the exchange rate at the moment, the Governor remarked 'I find it hard to say that it is fundamentally overvalued, but I would like it to be lower than higher if I had that choice.'<sup>24</sup>

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21 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 6.

22 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 20.

23 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 28.

24 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 4.

2.27 The Governor said that the long-run depreciation of the Australian dollar is supporting the Australian economy:

It is helping the tourism sector, it is helping the education sector, and even some parts of manufacturing now are feeling a bit better. They have gone through difficult times with the high exchange rate. Many manufacturing firms have done restructuring and have refocused on where their markets are. The fact that we have a lower exchange rate than a few years ago is making a first-order difference. It would be better if it were lower still.<sup>25</sup>

2.28 In its February Statement the RBA outlined general trends in the exchange rate since the previous Statement. It noted that the Australian dollar has remained largely unchanged since the United States election, and that since its low point in January 2016, it has appreciated by over 10 per cent against both the US dollar and on a trade-weighted basis. The RBA also noted that the 'real trade-weighted index has tracked the nominal index closely and is also noticeably higher over that period.'<sup>26</sup>

## Business and the labour market

2.29 According to the RBA February Statement, employment growth moderated during 2016 and 'the net increase in employment was entirely in part-time employment, although full-time employment increased in the December quarter.'<sup>27</sup>

2.30 In noting that the unemployment rate has remained steady at around 5¾ per cent for more than a year, the Governor remarked:

In an historical context, this would have been considered a pretty good outcome, although today a sustainably lower unemployment rate should be possible in Australia. The other aspect of the labour market that is worth noting is the continued trend toward part-time employment.<sup>28</sup>

2.31 The RBA described the composition of employment growth over 2016 as reflecting 'a strong contribution to growth from the household services sector, which has a high share of part-time workers.' The RBA noted that this may also 'reflect firms being hesitant to hire full-time workers until

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25 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 4.

26 RBA, *Statement on Monetary Policy*, February 2017, p. 24.

27 RBA, *Statement on Monetary Policy*, February 2017, p. 32.

28 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 3.

they see further evidence that demand for their output is likely to be sustained.’<sup>29</sup>

2.32 In relation to questioning on the weaker performance of housing markets in some parts of the country, the Governor noted that ‘things are no doubt difficult in Western Australia and parts of Queensland.’ However, the Governor was optimistic: ‘we are getting the sense that things have bottomed there and there are even some green shoots’.<sup>30</sup>

2.33 The Governor added:

As the mining sector has come off and that has had flow-through effects to the rest of the Western Australian economy, wage growth has been very weak, as you say. The issue is: is that going to continue indefinitely? I do not think so. But at some point these headwinds blow themselves out, and that is a different environment to one where they have been blowing very, very strongly.<sup>31</sup>

2.34 The committee questioned the Governor on the risks posed to the economy by low wages growth, and whether it would be a restraining factor on consumption growth. The Governor noted in his opening statement that, following a decade of consumption growing more than income, consumption growth is now expected to be modest because of a combination of high household debt and a lack of wages growth.<sup>32</sup>

2.35 The Governor explained:

One of the ways in which monetary policy works is that it makes it easier for people to borrow to spend, but we need to strike a balance here. Too much borrowing today can create problems for tomorrow because debt, ultimately, does have to be repaid. At the moment most households with borrowings seem to be coping reasonably well, but the current high level of debt combined with low wages growth is affecting the appetite for households to spend, and we are now starting to see some evidence of this in the consumption figures. The balance that is required, and that we are trying to seek, is to support spending in the economy today while avoiding creating fragilities in household balance sheets that could cause problems for us later on – so this is an area that we are also watching very carefully.<sup>33</sup>

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29 RBA, *Statement on Monetary Policy*, February 2017, p. 32.

30 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 16.

31 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 16.

32 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 1.

33 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 3.

2.36 The Governor was asked to comment on the recent decision of the Fair Work Commission in relation to penalty rates. The Governor suggested that there are two possible effects of the decision:

One is people have less income in their pocket and they are going to spend less. But it may be the case that more people have more money in their pocket.<sup>34</sup>

2.37 The Governor further explained that these effects were similar across the economy in relation to low wage growth:

Lower wage growth lowers spending, but lower wage growth may also create more jobs and I think this is one of the reasons we have managed in recent times in the aftermath of the mining boom with the unemployment rate sitting in the fives or low sixes most of the time. We have had wage restraint and that has allowed more people to have jobs. When more people have jobs, they feel like they have more security and are slightly more willing to spend. It is not just one way; it can work both ways.<sup>35</sup>

2.38 The Governor was questioned about the current state of business confidence, and whether the 'animal spirits' of entrepreneurship were increasingly present in the economy. The Governor responded that the RBA's surveys have been showing an uptick in business confidence in recent months, showing 'a very significant lift in how people are viewing the economy now and in the future. I think that is important, because for three years now I think people have been waiting.'<sup>36</sup>

## Trends in the global economy

2.39 The committee questioned the Governor on trends in the global economy including the growth of Australia's major trading partners, uncertainties about the economic and foreign policy stance of the new administration in the United States, and the Chinese economy.

2.40 The Governor said that the outlook for global growth was much better than expected 12 months ago, and outlined the following key contributing factors:

Twelve months on, the picture is a much more positive one, and the global economy looks to be on a firmer footing. In China the growth target for 2016 was achieved, despite the nervousness that

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34 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 14.

35 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 14.

36 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 22.

people had at the beginning of the year. In the United States growth has strengthened and the economy is operating at close to full employment, and in Europe the recovery is continuing, although it has a fair way to go. The Federal Reserve in the United States increased interest rates in December, and further rises are expected this year. Elsewhere in the major economies there is no longer an expectation that further monetary stimulus will be delivered, although some central banks are still expanding their balance sheets.<sup>37</sup>

- 2.41 In its February Statement, the RBA reported that overall growth in Australia's major trading partners was 'little changed in 2017 and to ease only slightly in 2018', and that 'growth in China is expected to slow and more than offset stronger growth in the advanced economies'.<sup>38</sup>
- 2.42 The RBA noted that monetary policy remains 'very accommodative' globally, with the European Central Bank and Bank of Japan keeping interest rates at low levels and the Bank of England further reducing interest rates. By contrast, the US Federal Reserve raised interest rates, however the RBA states that 'its policy rate is lower than had been expected at the beginning of 2016'.<sup>39</sup>
- 2.43 The Deputy Governor further explained:
- The balance sheets of Japan and the European Central Bank are still expanding, the Japanese quite rapidly. So those two are maintaining the pace of quantitative easing, but, as...[the Governor]...has remarked on a number of times recently, the general indication at the moment is that there is no expectation of any more easing – by anyone, actually – around the world than we have seen so far. So there is still quantitative easing going on in Japan and in Europe at roughly the same pace it has been for the last few years. But the US has stopped.<sup>40</sup>
- 2.44 The committee was interested in the Governor's view of uncertainties arising from political developments in the United States, specifically President Trump's economic and foreign policy priorities representing a significant departure from previous administrations.
- 2.45 The Governor remarked that there was considerable uncertainty on the direction the Trump administration would take on a number of issues, including its approach to free trade. The Governor said:

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37 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 1.

38 RBA, *Statement on Monetary Policy*, February 2017, p. 4.

39 RBA, *Statement on Monetary Policy*, February 2017, p. 13.

40 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 22.

It is hard to know how the international environment is going to play out. As the US has been equivocal about its support for free trade, what I have seen is more and more countries stand shoulder to shoulder in support of open, international trade.<sup>41</sup>

2.46 The Governor was questioned on issues relating to international trade and wealth distribution, noting that many people around the world may not be deriving benefits from free trade. The Governor said the issue that Parliament confronts is 'how to make the pie as big as we can but have the distribution in a way that we think, as an advanced, civilised society, serves our collective interest.'<sup>42</sup>

2.47 In responding to a question about whether the Trump administration would relax the financial regulations put in place by his predecessor in response to the Global Financial Crisis (GFC), the Deputy Governor said:

We do not know exactly how it will pan out...the fiduciary obligations may well be repealed, which is mostly an internal US issue. The Volcker rule has an effect on the global financial system, not just the US financial system.<sup>43</sup>

2.48 The Deputy Governor explained that it was uncertain whether the US financial system was, as a consequence of these changes, returning to the environment of heightened risks that were evident in the lead up to the GFC:

One thing I would say about the Fed and the Volcker rule and the banking system is that I am not convinced that, even if they change the Volcker rule, the core part of the banking system will go back to doing the sort of activities they were doing before because, as I said, other parts of the financial system have taken up these activities. It is not clear that the banks are actually going to want to move back to that...We will have to wait and see how exactly this pans out, whether it is just a small recalibration to something that is maybe more effective or, as you say, whether it takes us back to where we were 10-plus years ago.<sup>44</sup>

2.49 The Deputy Governor was asked whether the RBA was concerned about the United States moving away from Quantitative Easing (QE) over the last three years. The Deputy Governor noted that the size of the US Federal Reserve's balance sheet is an 'indicator of the status of policy', and

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41 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 29.

42 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 20.

43 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 11.

44 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 11.

that '...as it starts to decline it is tightening financial conditions'. The Deputy Governor added:

The question they are actively debating at the moment is whether they want to amplify that tightening by also letting their balance sheet shrink. That is an active discussion that you can see in the minutes of their discussions right at the moment. That is what is happening in the US.<sup>45</sup>

2.50 In relation to China, the Governor said that there are 'a number of significant risks still on the horizon':

...the growth target was achieved, partly through a further increase in debt to finance property investment and infrastructure. A strategy has helped growth in the short term and it has supported commodity prices, and Australia has benefited from that. But it does run counter to the longer-run ambition of the Chinese authorities to address the very high levels of debt in the country and to get their domestic finances on a more sound footing, so we cannot be sure of the long-run consequences of this.<sup>46</sup>

2.51 The Governor added:

Recently, the Chinese authorities have taken some steps to tighten things up a little bit, and they have also been managing a depreciation of their currency against the US dollar and increased capital outflow from China as Chinese citizens try and send funds abroad. So Chinese authorities still have quite a difficult balancing act.<sup>47</sup>

2.52 The Governor was asked about how trends in commodity prices and improvements in the terms of trade are likely to play out in the Australian economy. The Governor responded:

...when the terms of trade go up normally that encourages more investment in the resources sector. That is part of the way that rising terms of trade stimulates the economy. We do not think that is going to happen at the moment. There will be a bit more investment, but not very much.<sup>48</sup>

2.53 Despite this, the Governor was optimistic, explaining that other factors were supporting growth:

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45 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 22.

46 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, pp. 1-2.

47 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 2.

48 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 5.



Importantly to us, commodity prices have moved higher since mid-last year. Long-term bond yields have also increased, and most investors are no longer paying governments to look after their money for 10 years – I think that is good news. Headline inflation has risen in most countries and it is much closer to target than it has been for some years. Given all this, forecast for global growth has been revised up over recent months – and that is the first time that has happened for quite a few years.<sup>49</sup>

## Housing

### Supply

2.54 In its February 2017 Statement, the RBA outlined trends in Australian housing markets, noting that house prices have picked up over the second half of 2016, particularly in Sydney and Melbourne.<sup>50</sup>

2.55 The Statement includes a detailed discussion of current trends in the supply of residential dwellings and related infrastructure. The RBA notes that:

Dwelling investment has supported growth in output and employment over recent years, as the Australian economy continues to adjust to the large decline in mining investment. The pipeline of work to be done on residential dwellings has increased rapidly since 2013 to historically high levels, and this should continue to support dwelling investment over the next couple of years.<sup>51</sup>

2.56 Highlights of the RBA's examination of housing supply include:

- The value of work to be completed on residential dwellings was equivalent to 12 per cent of GDP by late 2016;
- number of dwellings to be completed grew to over two and a half per cent of the total dwelling stock by late 2016;
- in the last two years, residential building approvals have been nearly 50 per cent higher than their long-term average; and,

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49 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 1.

50 RBA, *Statement on Monetary Policy*, February 2017, p. 62.

51 RBA, *Statement on Monetary Policy*, February 2017, Box A: The Pipeline of Residential Dwelling Work, pp. 36-7.

- an unusually high proportion of recent activity has been concentrated in higher-density buildings, representing about half of all residential building approvals.<sup>52</sup>
- 2.57 The RBA notes that the shift towards higher-density housing include both supply side and demand side factors, including:
- [supply side] changes in planning policies and increased availability of former industrial (or 'brownfields') sites, which tend to support higher-density dwellings, relative to urban fringe (or 'greenfields') sites, which are mostly used for detached housing; and
  - [demand side] the lower cost of apartments relative to detached houses and rising demand for inner-city dwellings, partly because of demographic change and foreign purchases.<sup>53</sup>

## Infrastructure

- 2.58 The Governor was asked to comment on levels of infrastructure investment, particularly in relation to the provision of public transport and the increase in affordable housing supply. The Governor said that increased population density in cities and good public transport was important:

The population density in these world-class cities is not that high by global standards and it is growing quickly. Melbourne's population at the moment is growing over two per cent a year, so in five years' time there will be 10 per cent more people there. So, if you look at overseas experience, we have to make the cities denser. Not everyone likes that, but if we want to provide affordable housing to people we need more density, and with more density comes, typically, better public transport to make that work effectively.<sup>54</sup>

- 2.59 When asked whether greater investment in public transport would lift productivity and workforce participation, the Governor stated that the question hinges on whether or not there is a good business case:

Done properly, paid for properly, constructed properly and priced properly, the answer to that has to be yes – but if you do those

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52 RBA, *Statement on Monetary Policy*, February 2017, Box A: The Pipeline of Residential Dwelling Work, pp. 36-7.

53 RBA, *Statement on Monetary Policy*, February 2017, Box A: The Pipeline of Residential Dwelling Work, p. 36.

54 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 20.

things. If you do not do those things then the answer is no. You just waste public money.<sup>55</sup>

2.60 The Governor was also asked to comment on how Australia's current infrastructure spend is compared to other Organisation for Economic Co-operation and Development (OECD) countries. The Governor noted that according to the OECD's numbers, 'we are high, but it is largely in the resources sector, as best we can tell.'<sup>56</sup>

2.61 The Governor also remarked: that one thing the 'government can do that the private sector cannot is urban planning, marshalling resources to construct a viable business case'.<sup>57</sup> The Governor explained:

That is something, particularly on transport, that government can uniquely do. It does not necessarily need to be the government money, but the government needs to bring planning capacity. You see how that has worked in New South Wales. It has made a first-order difference to the economy here, and ultimately it will make people's lives better as well.<sup>58</sup>

## Uneven performance of housing sector

2.62 The Governor was asked about the uneven performance of the housing sector across the country in recent years. The Governor responded that:

In the broader housing market, the picture remains quite complicated, and there is not a single story right across the country. In parts of the country that have been adjusting to the downswing in mining investment, or where there have been big increases in the supply of apartments, housing prices are declining. In other parts, where the economy has been stronger and the supply side has had trouble keeping up with strong population growth, housing prices are still rising quite quickly. In most areas of the country, growth in rents is low, and recently we have seen a pick-up in growth of credit to investors, and we need to watch that very carefully.<sup>59</sup>

2.63 Dr Lucy Ellis, RBA Assistant Governor, added:

...there is, as you alluded to, quite a lot of regional differentiation. The states that were most affected by the mining boom and the end of the mining boom – Western Australia and Queensland – are

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55 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 20.

56 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 13.

57 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 13.

58 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 13.

59 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 2.

seeing rental growth both in commercial real estate and residential real estate very low or negative. Dwelling rents have declined everywhere, in all of the major cities, but the rate of growth is still a little higher in Sydney and Melbourne than it is in some of the other capitals.<sup>60</sup>

- 2.64 Given this background, the committee was interested in what effect any decline in infrastructure spending would have, particularly in relation to Western Australia. The Governor responded:

I can only answer analytically. You will have less spending in the economy than you otherwise would have but, in the political trade-offs that go on here, there may be some other compromises. I am obviously not in a position to comment on those but, if you have less activity, there is less spending.<sup>61</sup>

## Affordability

- 2.65 The Governor was asked about the impact of negative gearing and the capital gains tax discount on housing demand. The Governor stated the 'main point we have been making repeatedly for years is that we need to think about negative gearing and the concessional capital gains tax together.' He explained:

If we were to remove or alter that particular combination, I find it hard to know what effect it would have on the housing market. I think it is likely it would reduce investor demand for a while, because that combination is one of the things that encourages people to buy investment properties. If you have less demand, for a while you will have lower prices, and it would take some of the current heat out of the housing market. It may have other effects as well.<sup>62</sup>

- 2.66 The Governor was asked how growing levels of debt in Australia was effecting demand for housing. He noted the supervisory guidance issued by APRA in 2014, has had 'a first-order effect and investor credit growth slowed right down', explaining:

I am pleased that that guidance is still in place and we should still strongly support it. As to what the tax system can do to change the incentives, it is really a politically contested issue. Ultimately, that is up to the parliament. From our perspective, we can work with

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60 Dr Luci Ellis, Assistant Governor - Economic, RBA, *Transcript*, 24 February 2017, p. 28.

61 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 19.

62 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 9.

APRA to do our best to make sure that the credit aggregates are not growing too quickly.<sup>63</sup>

- 2.67 When asked about a proposal to tie rates of immigration to house prices, the Governor stated that it could make a difference if house prices were the only objective, however he noted that immigration is 'a source of national strength, so if you cut back immigration to address the short-term housing price issue we would lose that source of strength.'<sup>64</sup>

## Corporate taxation and international competitiveness

- 2.68 The Governor was questioned on whether Australia would gain a strategic advantage by reducing corporate taxation rates. The Governor's views on the international competitiveness of Australia's corporate tax rates, particularly in the post-GFC context, were also sought.

- 2.69 The Governor noted that there is a form of post-crisis advantage to be gained in reducing corporate tax rates, but recognised that any advantage is relative:

Australia has other advantages, and the tax system is supposed to deal with issues other than just attracting investment – there is equity and fairness and other considerations. But if you are just approaching this from the perspective of how we attract investment in the creation of new assets in Australia, the fact that there is international tax competition does have a bearing on that.<sup>65</sup>

- 2.70 The Assistant Governor added that while tax rates are important, investors 'think about more than just differential tax rates when they are making foreign direct investment decisions'.<sup>66</sup>

- 2.71 The Governor also recognised that significant work is being undertaken internationally to tackle base erosion and profit-shifting (BEPS), stating that '...a lot of time is spent on this trying to come up with some set of arrangements that limit the ability of multinational corporations to shift profits to minimise their tax inappropriately.'<sup>67</sup>

- 2.72 When questioned about the cost to the budget of cutting corporate taxes, the Governor commented:

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63 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 9.

64 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 18.

65 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 6.

66 Dr Luci Ellis, Assistant Governor - Economic, RBA, *Transcript*, 24 February 2017, p. 12.

67 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 6.

Well, everything is connected to everything. As I said in my remarks at the A50 conference, if we are going to do tax reform we need to do it in the context of balancing the budget, and there are various ways that that can be done. Some ways that that could be done would be deleterious to growth, and other ways would be perfectly fine and actually stimulate growth. It is really up to the design of the particular tax arrangements. You can certainly have a scenario where it would be bad, and there are certainly scenarios where it would be good.<sup>68</sup>

## New Payments Platform

2.73 The Governor outlined how work was progressing on the NPP, and what benefits consumers can expect when the system is rolled out. The Governor said that the NPP is on schedule to make its first payments later this year:

...the Reserve Bank is continuing to work with industry on the development of a new payments platform which will allow us all to move money around and to make electronic payments much more quickly. The bank is building part of that infrastructure, which stands at the centre of the system and which will allow funds to be exchanged instantaneously between banks so that we can all have very quick access to our funds. Our work on building this infrastructure is on schedule and it is now being used in industry testing. Financial institutions are also working hard on their internal systems so that customers can take advantage of the new system. Developments look on track to allow the first payments to be made through this new system towards the end of this year.<sup>69</sup>

2.74 The Governor outlined three things the NPP will do to benefit consumers:

- It is going to allow you and I to sit here and make payments to one another on my phone, and you would get your money hopefully within 10 seconds, even if you bank through a different bank.
- There are no longer payment delays, and you should have access to your money instantaneously. Another thing is: there will be no need to share our BSB numbers anymore. You can give me your email address or your phone number, and I can

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68 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 28.

69 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 7.

just put that into my payment app and then you get your money in 10 seconds.

- ...it will allow is for us to put much more information with payments....so you will be able to send files or PDF documents or invoices or long explanations for why the payment is there, and you will be able to do this 24/7.<sup>70</sup>

2.75 The Governor explained that the reason the current system has limited capacity to send information with payments is because it has its legacy in the manual punch card system:

When you go onto your internet banking application at the moment and want to send a payment, you have 14 characters that you can put in there. That is because the message length was originally 80 and then 120 characters. It was originally 80 characters because that was how many holes were on the punch cards when the system was developed – our payment system in 2017 has this long legacy from the punch cards.<sup>71</sup>

2.76 The Governor added that, when the new system is developed, ‘gone will be the days that you will have to wait till the next day or I make a payment to you at nine o'clock at night and it is not there till the next day’.<sup>72</sup>

2.77 The committee questioned the Governor about the security features of the NPP, particularly in relation to the risk of fraud. The Governor responded that work on the technical details is being progressed by ‘industry-wide working groups on fraud’:

This is one reason the whole thing is taking as long as it is; it is to make sure that the systems are built to address fraud. I do not know if someone pays away money to someone that they should not have, how that is going to be dealt with. The fraud issues that they are dealing with are really at the technology level.<sup>73</sup>

2.78 When asked if fraud would be more likely when payments are made instantaneously under the NPP, the Governor said that the current system carried similar risks, but that redress will be possible through the relevant measures. The Governor also explained that other payment mechanisms will still be available to consumers:

...Australia has lots of other payment mechanisms, so if you are worried about that particular issue and if you are nervous about

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70 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 7.

71 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 7.

72 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 7.

73 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 3.

who you are paying money to, then you probably should not use that payment mechanism. You can use the other payment mechanisms that we still have: cheques, the direct entry system [...] <sup>74</sup>

## Other issues

### Climate change and energy markets

2.79 When asked if the RBA took into account the Australian Government's ratification of the Paris Climate Agreement in its forecasts, the Deputy Governor commented that 'it is not dissimilar to government policy in the way we factor that into our forecasts'. The Deputy Governor explained:

The horizon we are looking at is the next two or maybe three years, and so, when actions are taken which have that impact, including in relation to the stuff you are talking about, absolutely that is factored in there. But, if we make policy and assessment of stuff that might happen over that horizon, that becomes more problematic. <sup>75</sup>

2.80 The Governor also remarked that a limitation for the RBA's modelling of climate change-related effects lay in the specialist and expert knowledge required, stating '...the issue is we cannot be experts in all these particular issues.' <sup>76</sup>

2.81 The Governor was questioned if the RBA worked closely with APRA on climate change and climate change risk to financial stability in Australia. The Governor responded that 'we have done some work with APRA' but that it 'is mainly an area of APRA's responsibility.' <sup>77</sup>

2.82 In response to a question about transition risks associated with the Paris Agreement, the Governor said:

...I do not want to get into the debate about what is causing these climate events, but the international focus is saying, 'There seems to be an increased incidence of climate events;' and societies are responding to that. That can leave assets stranded, and we need better disclosure around that. Whatever is causing these climate events and whatever is causing the society's response, they are

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74 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 3.

75 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 24.

76 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 24.

77 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 23.



things that are happening, and financial institutions need to disclose to their investors how to deal with that.<sup>78</sup>

2.83 The Governor added:

I think this is why the transparency is so important – to have financial institutions say how they are dealing with these issues. We would read those reports and assess the financial risks that come from that. Once that process is more developed, that could in time feed into our thinking, but, at the moment, really it is up to the financial institutions and business to tell us – that is, the broader community – how they are dealing with it. Once we have that information, we can factor that into our own thinking. At the moment, it is so diffuse and undefined. We need people who are kind of experts in this to tell us how it is actually affecting them.<sup>79</sup>

2.84 The Governor was also asked whether it was monitoring energy costs in Australia, compared to overseas, and how energy prices may affect our nation's competitiveness and the decisions of business to locate in Australia. The Governor stated that while this was outside of the RBA's area of expertise, he could provide the following analytical point:

...that energy is a cost of production, and if the cost is higher then you are at a competitive disadvantage. You might have other advantages, but, on energy costs – to the extent that those figures are accurate – then there is a competitive disadvantage. Others have made this point as well: that it seems remarkable that energy could be a competitive disadvantage for Australia, given the tremendous abundance of natural resources we have and the fact that we are supplying energy to supply a lot of the growth in North Asia.<sup>80</sup>

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78 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 23.

79 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 24.

80 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 17.

## Government bank deposit guarantee and the Committed Liquidity Facility

2.85 The RBA was asked about the Australian Government's guarantee for the deposits and wholesale funding of Australian deposit-taking institutions following the GFC. The committee was also interested in the RBA's Committed Liquidity Facility (CLF).

2.86 The RBA was queried if any modelling had been done on the potential cost of the bank deposit guarantee in the event of a financial crisis. The Governor said that 'back-of-the-envelope calculations of what various scenarios could look like' were made eight years ago, but the potential costs were small:

The actual costs from this for the federal government are likely to be quite small, because remember that depositors have first claim over the assets of a failed bank. What the insurance scheme would do is bring forward the payment of the depositors' money. But, in the event that the bank is liquidated, the first claim that depositors had would transfer to the government, who had extended the money to the depositors. So you would have to think of a scenario in which the losses were so bad that they would wipe out all the non-deposit liabilities for the federal government to incur a loss. In all the scenarios that I can think of, that seems so remote.<sup>81</sup>

2.87 In relation to the CLF, the committee was interested in whether Australian banks derive a commercial advantage from being able to access the CLF's liquidity. The Governor responded:

The banks get a benefit. A number of years ago there was a discussion, I think including at this committee, about whether there should be some levy. I am completely neutral about whether there should be a levy or not. You could say we should charge the banks for it, but as with any tax the issue is the incidence. You can levy it on the banks, but you will probably get a slightly lower deposit rate because the banks have to pay a fee, or they might pass the fee on.<sup>82</sup>

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81 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 10.

82 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 10.

## Corporate governance

2.88 The Governor was asked to provide his assessment of the RBA as an institution, to which he responded:

I see small improvement opportunities across the institution, but I was in the deputy governor role for five years, so many of the things that I thought needed addressing we have already done. The internal issue that takes up most of my time is the very heavy project workload that we have been undertaking.<sup>83</sup>

2.89 The Governor also informed the committee that the RBA was conducting an efficiency review of its operations, 'to make sure that we are continually improving as an organisation and we are seeking outside assistance to identify opportunities for improvement'. The Governor added that the review will 'focus primarily on operational and administrative matters, not on our policy frameworks'.<sup>84</sup>

2.90 The committee asked about the reviews scope. The Deputy Governor, who will be overseeing the review, responded:

It is partly seeking assurance, following up on what Dr Lowe said, as to whether we are doing things as well as we can. Our expectation is that it would be a bit surprising if absolutely everything was as good as it could be, but we are seeking assurance that what we are doing is appropriate, that we are using the public resources appropriately and that we are looking for improvements. Do we expect there is anything radical out there? Probably not, but nor do we anticipate that we are doing everything as well as we can. So we certainly expect there would be some reasonable improvement opportunities.<sup>85</sup>

2.91 The Governor also updated the committee on how the RBA is working to improve the gender balance in its executive ranks, and what message this is sending to young women studying relevant degrees:

Of the three assistant governors responsible for monetary and financial policies at the Reserve Bank, two are women, and women run over a third of the departments within the bank, including those responsible for the bank's economic analysis and for the implementation of monetary policy. So this is quite a big change from days gone by, when all of these important positions were held by men. I wanted to take the opportunity to highlight these

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83 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 7.

84 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 3.

85 Dr Guy Debelle, Deputy Governor of the RBA, *Transcript*, 24 February 2017, p. 8.

changes today in the hope that they might provide some inspiration to women who are thinking about studying economics, finance and business. There are fantastic career opportunities out there, and it would be great to see more women studying these disciplines and perhaps considering a career at Australia's central bank. We are currently working quite hard on some initiatives to encourage this, both at the school and at the university level.<sup>86</sup>

- 2.92 The Governor was asked whether the RBA has increased the number of women in senior positions based on targets, the Governor responded that a target of 35 per cent of management being women by 2020 'has really been important – it probably would not surprise you that the Reserve Bank is driven by numbers.' The Governor added:

...a decade ago, that number was around 25 per cent. At the moment, it is in the low 30s. So our target is 35 per cent by 2020 and then 40 per cent beyond that – and hopefully, beyond that, 50-50.<sup>87</sup>

- 2.93 In reference to the promotion of Assistant Governor, Dr Luci Ellis, the Governor remarked:

You could imagine a female looking at the Reserve Bank until five years ago, or even three years ago, and saying, 'Why would I think that is an attractive place in the end to work? All the senior people there are men.' I think Luci is the first woman who has appeared at this particular committee. So I hope that through our example we can provide hope to young women that this is something they can do.<sup>88</sup>

## Conclusion

- 2.94 Following a weaker than expected September quarter in 2016, Australia's economic growth is expected to pick up, supported by accommodative monetary policy and a lower exchange rate. Inflation remains low, but is expected to move closer to target, with the Consumer Price Index (CPI) forecast to pick up to around two per cent by the middle of 2017.
- 2.95 Consumption growth is likely to be more modest, however, as high levels of household debt accompany low wage growth. Unemployment remains

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86 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 4.

87 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 26.

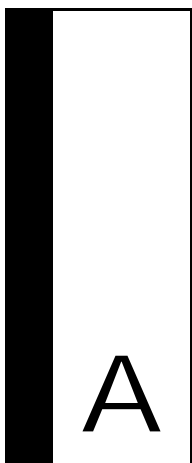
88 Dr Philip Lowe, Governor of the RBA, *Transcript*, 24 February 2017, p. 26.

stable, with employment growth being driven by increases in part-time employment.

- 2.96 Australia's housing markets remain mixed, with those states most affected by the downturn in mining investment recording poorer residential property market results compared to other capital cities, which continue to grow strongly. In the past two years there was a substantial improvement in the number of building approvals. However this has been mainly driven by strong growth in apartments, which is nearing oversupply in some markets.
- 2.97 Overall, Australia's economic growth outlook is more optimistic than it was at the same time last year, with the headwinds of declining mining investment and low commodity prices lessening in effect. Increases in the production of LNG and improving terms of trade are expected to lead to GDP growth in Australia of between two and three per cent by the end of 2017.

**Mr David Coleman MP**  
**Chair**  
**29 March 2017**





## Appendix A — Hearing, briefing and witnesses

### Public hearing

Friday, 24 February 2017 – Sydney

*Reserve Bank of Australia*

Dr Philip Lowe, Governor

Dr Guy Debelle, Deputy Governor

Dr Luci Ellis, Assistant Governor, Economic

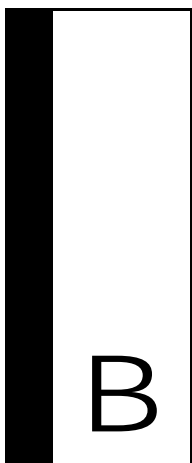
### Private briefing

Wednesday, 15 February 2017 – Canberra

Mr Paul Brennan, Chief Economist, Citi Australia







## Appendix B — *Seventh statement on the conduct of monetary policy*

### **The Treasurer and the Governor of the Reserve Bank**

**19 September 2016**

The Statement on the Conduct of Monetary Policy (the Statement) has recorded the common understanding of the Governor, as Chair of the Reserve Bank Board, and the Government on key aspects of Australia's monetary and central banking policy framework since 1996.

The Statement seeks to foster a sound understanding of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Reserve Bank.

The centrepiece of the Statement is the inflation targeting framework, which has formed the basis of Australia's monetary policy framework since the early 1990s.

The Statement has also been updated over time to reflect enhanced transparency of the Reserve Bank's policy decisions and to record the Bank's longstanding responsibility for financial system stability.

Building on this foundation, the current Statement reiterates the core understandings that allow the Bank to best discharge its duty to direct monetary policy and protect financial system stability for the betterment of the people of Australia.

## **Relationship between the Reserve Bank and the Government**

The Reserve Bank Governor, its Board and its employees have a duty to serve the people of Australia to the best of their ability. In the carrying out of their statutory obligations, through public discourse and in domestic and international forums, representatives of the Bank will continue to serve the best interests of the people of Australia with honesty and integrity.

The Governor and the members of the Reserve Bank Board are appointed by the Government of the day, but are afforded substantial independence under the Reserve Bank Act 1959 (the Act) to conduct the monetary and banking policies of the Bank, so as to best achieve the objectives of the Bank as set out in the Act.

The Government recognises and will continue to respect the Reserve Bank's independence, as provided by the Act.

The Government also recognises the importance of the Reserve Bank having a strong balance sheet and the Treasurer will pay due regard to that when deciding each year on the distribution of the Reserve Bank's earnings under the Act.

New appointments to the Reserve Bank Board will be made by the Treasurer from a register of eminent candidates of the highest integrity maintained by the Secretary to the Treasury and the Governor. This procedure ensures only the best qualified candidates are appointed to the Reserve Bank Board.

## **Objectives of Monetary Policy**

The goals of monetary policy are set out in the Act, which requires the Reserve Bank Board to conduct monetary policy in a way that, in the Reserve Bank Board's opinion, will best contribute to:

- a the stability of the currency of Australia
- b the maintenance of full employment in Australia, and
- c the economic prosperity and welfare of the people of Australia.

These objectives allow the Reserve Bank Board to focus on price (currency) stability, which is a crucial precondition for long-term economic growth and employment, while taking account of the implications of monetary policy for activity and levels of employment in the short term.

Both the Reserve Bank and the Government agree on the importance of low and stable inflation. Effective management of inflation to provide greater certainty and to guide expectations assists businesses and households in making sound investment decisions. Low and stable inflation underpins the creation of jobs, protects the savings of Australians and preserves the value of the currency.

Both the Reserve Bank and the Government agree that a flexible medium-term inflation target is the appropriate framework for achieving medium-term price stability. They agree that an appropriate goal is to keep consumer price inflation between 2 and 3 per cent, on average, over time. This formulation allows for the natural short-run variation in inflation over the economic cycle and the medium-term focus provides the flexibility for the Reserve Bank to set its policy so as best to achieve its broad objectives, including financial stability. The 2-3 per cent medium-term goal provides a clearly identifiable performance benchmark over time.

The Governor expresses his continuing commitment to the inflation objective, consistent with his duties under the Act. For its part the Government endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving medium-term price stability.

Consistent with its responsibilities for economic policy as a whole, the Government reserves the right to comment on monetary policy from time to time.

## **Transparency and Accountability**

Transparency in the Reserve Bank's views on economic developments and their implications for policy are crucial to shaping inflation expectations.

The Reserve Bank takes a number of steps to ensure the conduct of monetary policy is transparent. These steps include statements announcing and explaining each monetary policy decision, the release of minutes providing background to the Board's policy deliberations, and commentary and analysis on the economic outlook provided through public addresses and regular publications such as its quarterly Statement on Monetary Policy and Bulletin. The Reserve Bank will continue to promote public understanding in this way.

In addition, the Governor will continue to be available to report twice a year to the House of Representatives Standing Committee on Economics, and to other Parliamentary committees as appropriate.

The Treasurer expresses support for the continuation of these arrangements, which reflect international best practice and enhance the public's confidence in the independence and integrity of the monetary policy process.

## **Relationship between the Reserve Bank and the Government**

Financial stability, which is critical to a stable macroeconomic environment, is a longstanding responsibility of the Reserve Bank and its Board. The Reserve Bank promotes the stability of the Australian financial system through managing and providing liquidity to the system, and chairing the Council of Financial Regulators (comprising the Reserve Bank, Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Treasury).

The Payments System Board has explicit regulatory authority for payments system stability. In fulfilling these obligations, the Reserve Bank will continue to publish its analysis of financial stability matters through its half-yearly Financial Stability Review.

In addition, the Governor and the Reserve Bank will continue to participate, where appropriate, in the development of financial system policy, including any substantial Government reviews, or international reviews, of the financial system itself.

The Reserve Bank's mandate to uphold financial stability does not equate to a guarantee of solvency for financial institutions, and the Bank does not see its balance sheet as being available to support insolvent institutions. However, the Reserve Bank's central position in the financial system, and its position as the ultimate provider of liquidity to the system, gives it a key role in financial crisis management. In fulfilling this role, the Reserve Bank will continue to coordinate closely with the Government and with the other Council agencies.

The Treasurer and the Governor express their support for these longstanding arrangements continuing.