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Review of the Reserve Bank of Australia Annual Report 2018 (First Report)

House of Representatives
Standing Committee on Economics

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Chair's foreword

On 5 February 2019 the Reserve Bank of Australia (RBA) left official interest rates unchanged at 1.50 per cent. Commenting on the decision to keep rates on hold, the Governor stated that the central scenario is for the Australian economy to grow by around 3 per cent this year and by a little less in 2020 due to slower growth in exports of resources.

At the public hearing on 22 February 2019, the Governor noted that the RBA expects the Australian economy to continue to grow above trend, supported by rising business investment and higher levels of spending on public infrastructure. Inflation continues to remain low and stable with CPI inflation at 1.8 per cent over 2018 and underlying inflation at 1¾ per cent. The Governer noted that underlying inflation is expected to increase gradually to around 2¼ per cent by 2020.

Despite housing markets in the major cities going through a period of adjustment, the Governor noted they are occurring at a time of low unemployment, low interest rates and strong population growth. The RBA remains confident that the Australian economy and financial system remain resilient, and that lower house prices will open up the market for more people to purchase their own home.

In relation to quantitative easing, the Deputy Governor noted that while it was prudent to look at the option of quantative easing from a risk management perspective, the Australian economy is not currently in a situation that would call for it. The RBA does not expect the Australian economy to be in a circumstance that requires quantitative easing within the foreseeable future and has not proposed quantitative easing as a monetary policy response outside of extreme circumstances. This topic prompted discussion about its necessity and should be closely watched by future committees.

While the global economy is continuing to grow at a solid rate, the Governor reported that global growth moderated in the second half of 2018 and that risks to the global outlook have increased. The RBA listed trade and technology tensions between China and the United States, Brexit, the rise of populism, strains in some Western European economies, and the slowing growth of the Chinese economy as particular areas of concern. He noted that while the RBA was not concerned by the blocking of thermal coal imports from Australia to China, it was too early to tell as to how the situation would impact the Australian economy.

Outcomes in Australia's labour market have been better than forecast with the unemployment rate already reaching 5 per cent, and expected to move lower to 4¾ over the next couple of years. Wages are also growing faster in almost all industries and states than they were a year ago.

Although the aggregate household disposable income has grown at an average rate of 2¾ per cent per year since 2016, there is good news ahead with growth in disposable income forecast to increase, boosted by the announced tax cuts.

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 22 February 2019.

Tim Wilson MP
Chair

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Membership of the Committee

Chair	Mr Tim Wilson MP
Deputy Chair	The Hon Matt Thistlethwaite MP
Members	Mr Adam Bandt MP
	Mr Trevor Evans MP
	Mr Jason Falinski MP
	Mr Craig Kelly MP
	Mr Matt Keogh MP
	The Hon Craig Laundy MP
	Mr Ted O'Brien MP (from 18 February 2019)
	Mr Josh Wilson MP

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Dr John White
Research Officer	Ms Klara Fay
Office Manager	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

CPI	Consumer Price Index
GDP	Gross Domestic Product
IPCC	Intergovernmental Panel on Climate Change
NPP	New Payments Platform
RBA	Reserve Bank of Australia

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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 then Treasurer, the Hon Scott Morrison MP, and the RBA Governor, Dr Philip Lowe. The statement formalises the biannual appearance before the committee and is reproduced at Appendix B. It 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.[1]

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 sixth public hearing of the committee with the RBA during the 45th Parliament was held in Sydney on 22 February 2019.

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.[2]

1.6 Before the hearing, the committee received a private briefing from Mr Alan Oster, Group Chief Economist at the National Australia Bank. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Oster'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 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.

1.9 This report focuses on matters raised at the public hearing, and also draws on issues raised in the RBA's February 2019 *Statement on Monetary Policy*. The *Statement on Monetary Policy* may be viewed through the RBA's website.[3]

2 House of Representatives Standing Committee on Economics, *Past Public Hearings and Transcripts*, 22 February 2019, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBAAnnualReport2018/Public_Hearings>, accessed 5 March 2019.

3 Reserve Bank of Australia, *Statement on Monetary Policy*, February 2019, <https://www.rba.gov.au/publications/smp/2019/feb/>, accessed 8 February 2019.

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Monetary policy and other issues

Overview

2.1 On 5 February 2019, the Reserve Bank of Australia (RBA) decided to leave official interest rates unchanged at 1.50 per cent. The cash rate has remained unchanged since the committee's last hearing with the RBA in August 2018. The most recent movement in official interest rates was the RBA's reduction of the cash rate by 25 basis points on 4 August 2016.[1]

2.2 In his opening statement to the committee, the Governor said 'our central scenario for this year is for growth of around three per cent, inflation of around two per cent and unemployment of around five per cent.'[2]

2.3 The Governor noted that the RBA had revised down its GDP growth forecasts following weaker than expected growth in the second half of last year. He commented:

> Our central scenario is for GDP growth of around three per cent this year and around two and three-quarters per cent in 2020. The outcome for the year just past is expected to be a bit below three per cent. These numbers are lower than the ones we were expecting at the time of the previous hearing, in August.[3]

2.4 The Governor said the Australian economy is 'benefiting from increased spending on infrastructure and a pick-up in private investment as capacity utilisation has tightened.'[4]

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1 Reserve Bank of Australia (RBA), Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2019-01,* 5 February 2019.

2 Dr Philip Lowe, RBA, Governor, *Transcript*, 22 February 2019, p. 2.

3 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 1.

4 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

2.5 The RBA expects growth in the Australian economy to continue to grow above trend, despite a slowing in GDP growth during the September quarter. Inflation continues to be low, with underlying inflation expected to increase gradually to be around 2¼ per cent by 2020.[5]

2.6 The RBA reported that the tight labour market and a pick-up in wage growth are supporting consumption and adding to inflationary pressures.[6] The Governor reported that the vacancy rate is 'the highest that it's ever been in the whole history' and noted that businesses had indicated that they were planning to increase their hiring. The RBA expects the current gradual pick-up in wage growth to continue, however the Governor noted that it would be good to see a reduction in the level of underemployment.[7]

2.7 During the hearing, the committee questioned the Governor on the RBA's concerns about the protracted period of low growth in household income. The committee also examined the RBA on the impact of the current housing price adjustment on Australia's economy.

2.8 In the February Statement, the RBA reported that the global economy is continuing to grow at a solid rate. However it noted that global growth moderated in the second half of 2018 and that risks to the global outlook have increased.[8]

2.9 The Governor said that 'trade and technology tensions between China and the United States, Brexit, the rise of populism, and strains in some Western European economies' and the slowing growth of the Chinese economy were particular areas of concern for the RBA.[9]

2.10 The committee questioned the Governor on the blocking of thermal coal imports from Australia to China. The Governor said this was not likely to have a dramatic effect on the Australian economy as the amount of coal blocked is the equivalent of two months of exports which could be sold on another market. However, the Governor stated that 'if it were to be a sign of a deterioration in the underlying political relationship between Australia and China, that would be much more concerning.'[10]

5 RBA, *Statement on Monetary Policy*, February 2019, p. 1.

6 RBA, *Statement on Monetary Policy*, February 2019, p. 1.

7 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 20.

8 RBA, *Statement on Monetary Policy*, February 2019, p. 1.

9 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

10 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.

The cash rate and monetary policy

2.11 The Reserve Bank Board has continued to hold the cash rate steady at 1.50 per cent since August 2016. In his statement on the board's decision, the Governor said:

> The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual.[11]

2.12 The Governor reported that inflation has been lower than expected, with the cost of childcare declining substantially due to government policy changes in the September quarter. In addition, he noted that petrol prices fell in the December quarter due to global developments, and 'a further decline in petrol prices is expected in the March quarter.'[12]

2.13 In its February Statement the RBA noted that the inflation outlook has been revised lower as the December inflation outcomes were marginally lower than forecast in the November Statement.[13] The RBA stated that:

> …year-ended trimmed mean inflation is now expected to increase to 2 per cent by the end of 2019 (previously in mid 2019) and to 2¼ per cent by the end of 2020. This revision is consistent with the lower GDP growth profile and incorporates some of the previously flagged downside risk to administered and utilities price inflation in the near term.[14]

2.14 The committee asked the Governor whether he was concerned that inflation remained persistently low. The Governor responded that he wanted to deliver 'an inflation rate of two point something and hopefully close to 2½ per cent', and was confident the RBA could achieve that.[15]

2.15 The committee questioned the Governor on whether the outlook for the Australia economy is now more negative than positive. The Governor replied:

> I wouldn't say it's more negative than positive…The central scenario is a good outcome for the Australian economy—more people finding jobs, inflation low and the economy growing at least at trend and probably a bit more than trend, and eating into

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11 RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2019-01*, 5 February 2019.

12 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 1.

13 RBA, *Statement on Monetary Policy*, February 2019, p. 70.

14 RBA, *Statement on Monetary Policy*, February 2019, p. 70.

15 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 22.

> spare capacity. That's the central scenario, which I think is a positive one.[16]

2.16 The Governor was asked if he agreed with the recent forecast from National Australia Bank that interest rates were likely to stay the same for the next decade, or Westpac's view that there will be two cuts this year. The Governor replied:

> There's a possibility that rates will need to go up. I think it's unlikely that that would occur this year, because the inflation outlook looks so benign. But if things turn out broadly along the lines of the central scenario—the unemployment rate comes down and inflation rises, and that happens gradually—then at some point next year it may well be appropriate to increase interest rates. So that's certainly possible, but it's also possible that we end up with weaker consumption growth, wage growth doesn't pick up, the housing adjustment weighs on spending more than we think, and we need to consider lower rates. So I don't think either one is right or wrong. Both are possible.[17]

2.17 When asked if the RBA kept data on the discounting among lenders for interest rates, the Governor responded that the RBA maintains a securitisation database, which collects data on two million loans and publishes the data in the *Financial Stability Review*.[18]

2.18 The Governor further noted the RBA was in the process of collecting new data from the banks that will give the RBA a 'finer disaggregation of what people are actually paying' and that the RBA plans to publish this new data later this year.[19]

Forecasts

2.19 In its February Statement, the RBA forecasts Australia's GDP growth to be a little above trend at around three per cent over 2019 and 2¾ per cent over 2020. Inflation remains low, with underlying inflation expected to pick up to 2 per cent by late 2019, and to 2¼ per cent by 2020 (see Table 1).[20]

16 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 9.

17 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 14.

18 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 12.

19 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 12.

20 RBA, *Statement on Monetary Policy*, February 2019, pp. 65-66.

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

	Year-ended					
	Dec 2018	Jun 2019	Dec 2019	Jun 2020	Dec 2020	Jun 2021
GDP growth	2¾	2½	3	2¾	2¾	2¾
Unemployment rate (b)	5.0	5	5	5	4¾	4¾
CPI inflation	1.8	1¼	1¾	2	2¼	2¼
Underlying inflation	1.8	1¾	2	2	2¼	2¼
	Year-average					
	2018	2018/19	2019	2019/20	2020	2020/21
GDP growth	3	2½	2¾	2¾	2¾	2¾

Source Reserve Bank of Australia, Statement on Monetary Policy, February 2019, Table 5.1, p. 66.
(a) Technical assumptions include TWI at 62, A$ at US$0.72 and Brent crude oil price at US$63 per barrel; (b) Average rate in the quarter.

2.20 The RBA was asked, considering the uncertainty of the interest rate environment, why it flagged the potential for quantitative easing.[21] The Deputy Governor responded that it was 'prudent to look at it from a risk management perspective', however it was 'highly unlikely' that the Australian economy would be in a situation that would call for it.[22] He explained that:

> …we have seen the experience of a number of countries around the world over the past decade or so, where they've reached the limits of what can be achieved through lower interest rates and they have to look at other measures. I think that, from a risk management perspective, it's prudent for us to look at what we can learn from their experience, assess the effectiveness of the sorts of things that they've done and consider how they might play out in the extremely unlikely scenario that we might find ourselves here in that position. But that is not anywhere where we expect to be.[23]

2.21 The Deputy Governor was clear that 'we are not in that circumstance and we don't expect to find ourselves in that circumstance, but we need to think, from a scenario-planning point of view, about what we would want to think about should we find ourselves in that circumstance.' [24] The

21 RBA, Speech by Dr Guy Debelle, RBA Deputy Governor: Lessons and Questions from the GFC, *Address to the Australian Business Economists Annual Dinner,* 6 December 2018.

22 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 6.

23 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 6.

24 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 6.

Governor noted that there were other margins of adjustment including 'fiscal policy, the exchange rate and lowering interest rates', which could be employed in a similar circumstance.[25]

2.22 The RBA was asked if it had considered the implications of the most recent report of the United Nations Intergovernmental Panel on Climate Change (IPCC). The RBA responded:

> Around the energy side of things, one thing we have spent a fair bit of time looking at which evident and having a macro-economic impact—what I mean by that is that it is big enough that it actually shows up in the GDP numbers, in the growth numbers—is renewables investment. That is now large enough that it is actually having a material impact on the investment numbers and also on the economy as a whole.[26]

2.23 When asked if the RBA had done any scenario planning around what, on average, a two-third decline in thermal coal exports by 2030, as suggested by the IPCC, would mean for the economy, the RBA responded 'that is the sort of stuff we're looking at'.[27] The RBA explained:

> We've run scenarios about this before, using external scenarios about the decline in thermal coal. We have run those. If it is drawn out, then you see it in coal exports but you don't really see it in GDP to any material extent—if it's drawn out enough. So the issue is, really, the phase over which that takes place.[28]

2.24 The committee asked the Governor about productivity growth. The Governor responded that Australia was getting 'reasonable productivity growth', but that there were 'things that could be done' to ensure Australia achieves good productivity growth in the future.[29] The Governor explained:

> The Productivity Commission has a long list of things: the provision and pricing of infrastructure, the way we educate our students, the incentives we set up through the tax and other systems through innovation, and the way we deal with science and the funding of science. The IMF, in its various reviews of Australia, talks about the tax system, the balance between income and consumption tax and, importantly, the way we tax land.[30]

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25 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 7.

26 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 18.

27 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 19.

28 Dr Luci Ellis, RBA Assistant Governor, Economic, *Transcript*, 22 February 2019, p. 19.

29 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 29.

30 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 29.

2.25 The Governor added that in his observation, many of those things were not being done, meaning that productivity growth will be 'less than it could be.'[31]

Labour market and income growth

2.26 In his opening statement to the committee, the Governor reported that labour market outcomes had been a 'lot better than we earlier expected',[32] and noted 'income growth over recent years has been sub three per cent', having been below six per cent in the past.[33]

2.27 The Governor explained that 'six months ago we were not anticipating the unemployment rate to reach five per cent until 2020, but it's already been around that level for some months.'[34] In addition, the Governor stated:

> The number of jobs created has also exceeded our earlier expectations, and we continue to expect the unemployment rate to move lower over the next couple of years to reach four and three-quarters per cent.[35]

2.28 The Governor reported that the employment vacancy rate 'is the highest that it's ever been in the whole history', and commented that business surveys were indicating that 'more firms than at any time in the past decade are saying it's hard to find workers'.[36] The Governor noted that businesses had told the RBA that they are planning to 'increase their hiring at a fast rate', which he expects will tighten the labour market, supporting the current gradual pick-up in wage growth.[37]

2.29 The Governor was asked about the effect of a change in the makeup of the employment mix, in terms of the recent increase in part-time employment and the rate of casualisation in employment. The Governor said this would cause the rate at which inflationary pressures are impacted from a particular rate of unemployment, to be lower than traditionally thought.[38] He explained:

> I think the country can have an unemployment rate around 4½ per cent without causing wage growth that's so fast that it

31 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 29.
32 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 1.
33 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
34 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 1.
35 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 1.
36 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 20.
37 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 20.
38 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 15.

> causes problems for inflation, largely because of the factors that you are talking about.[39]

2.30 The Governor was asked if legislators should be encouraging growth in minimum wages. He said that he was 'quite comfortable with the minimum wage adjustments over the last few years', noting that in 2018 it was 3.5 per cent having increased from 3.3 per cent the year before.[40] The Governor noted that he believed this to be the 'sensible and the right policy', stating that 'in the last two years, the minimum wages have risen more quickly than the median wage.' [41]

2.31 In February, the RBA reported that Australia's underemployment rate has declined a little over the last two years, despite the labour force participation rate remaining at record highs in the latter months of 2018.[42] The committee expressed its concern with underemployment and asked the Governor if there was a level that underemployment needed to get to before the economy experienced a turnaround in wages growth.

2.32 The Governor explained that the 'main source of underemployment is people who are working part-time who want more hours'.[43] He noted that currently 'roughly one-third of the workforce work part-time and most of these people actually want to work part-time, but, of that one-third, about one-quarter want more hours than they have at the moment.'[44] The Governor said that while the RBA was not targeting a specific underemployment figure, 'it would be good to see that number come down.'[45] He added that the RBA's strategy is to 'keep the labour market tight so that more of these people will be offered the hours they really want.'[46]

Wages growth

2.33 In its February Statement, the RBA noted that wages growth increased to 0.6 per cent in the September quarter, to be 2.3 per cent higher over the year.[47]

39 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 15.
40 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
41 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
42 RBA, *Statement on Monetary Policy*, February 2019, p. 39.
43 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
44 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
45 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
46 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 20.
47 RBA, *Statement on Monetary Policy*, February 2019, p. 61.

2.34 At the hearing, the RBA stated that the current rate of wage growth was the highest in four years,[48] and reported that 'wages are rising more quickly in almost all industries and in all states than they were a year ago'.[49] The Governor noted that the RBA expects the gradual lift in wage growth to continue, however he commented that 'we need to see a pickup in income growth if consumption growth is to be at the level we want'.[50]

2.35 In addition, the Governor stated that 'disposable income will also be boosted by the announced tax cuts, and this faster income growth will support household spending.' He also noted that from a longer-term perspective, 'the key to boosting the real income of households is lifting productivity.'[51]

2.36 The committee asked if uncertainty and concerns about competitiveness were the reason that substantial jumps in corporate profitability over the last few years had not been reflected in wage growth. The Governor noted that over the last five years 'the rate of underlying productivity growth the economy has generated would justify faster nominal wage growth', but not if the scope was widened to the last 10 years.[52] He explained:

> In the previous five years real incomes of households rose more quickly than justified by underlying productivity growth—we had the big rise in the terms of trade and the mining investment boom. So many of the community got wage rises beyond what productivity growth would have justified, because the economy was doing so well because of the resources boom. So what we've seen in the last five years is the reversal of that. When I look at that whole 10 years together, workers have basically got their normal share of productivity growth, but it's quite different over the two five-year periods. It may be we're just seeing the workings out of the resources boom, or it's also plausible that these forces of competition and technology are meaning workers aren't getting a normal share.[53]

48 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 20.

49 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

50 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.

51 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

52 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 16.

53 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 16.

2.37 The committee asked the Governor if the RBA understood that some Australians feel that the trajectory of the economy is not benefitting them. He responded:

> I certainly understand that and I've spoken extensively about that publicly. As you pointed out, the underlying issue is the lack of income growth….Our strategy here has been twofold. The first is for me to talk publicly about the benefits of stronger wage growth to try and raise wage expectations. It's not a conventional thing for the central bank governor to be saying, 'We want stronger wage growth.' So hopefully lift wage expectations—that's the first part of the strategy. The second is to keep interest rates low, stable for a long period of time, hope the labour market tightens up and wage growth picks up.[54]

2.38 The Governor stated that the high vacancy rate and results on the most recent business survey give 'some confidence that the labour market is going to continue to be okay', and 'employment growth again surprises on the upside.'[55]

Household sector

2.39 The RBA's February Statement reported that household consumption growth has been weaker than earlier reported, at 0.3 per cent in the September quarter, easing to 2.5 per cent in year-ended terms.[56]

2.40 In his opening statement, the Governor noted concerns about the protracted period of relatively low growth in household income, and the decline in house prices in the major cities.[57] He said:

> Since 2016, aggregate household disposable income has grown at an average rate of just two and three-quarters per cent per year. That's down from average growth of six per cent over the preceding decade. That's quite a large change. It's plausible that households have responded to this extended period of weaker income growth by progressively downgrading their spending plans. For many people, it has become harder to see the lower growth in income as just a short-term development that they can

54 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 9.

55 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 22.

56 RBA, *Statement on Monetary Policy*, February 2019, p. 33.

57 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

> look through, and I think they've adjusted their spending in response to that.[58]

2.41 The committee questioned the Governor on the underlying trends influencing household consumption. The Governor noted that weak income growth was the primary story with household income currently growing at a sub three per cent, having grown at six percent in the past.[59] The Governor remarked:

> When your income is not growing as fast as it used to, you have to curtail your spending…as income growth has been slow year after year, more and more of us have realised that the old days are not coming back anytime soon and we have to adjust our spending plans.[60]

2.42 The Governor explained that 'if wage growth picks up and income growth picks up, we'll all start feeling a bit better again and we'll be prepared to spend.'[61]

2.43 The February Statement also reported that the high level of household debt remains a key consideration for household consumption, with more indebted households 'likely to be more sensitive to changes in their expected income growth and household wealth.'[62] The RBA further noted that indebted households were likely to be more sensitive to falling housing prices than to rising prices.[63]

2.44 The committee asked if consumption growth would be impacted by changes to how retail financial products are sold, as a result of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The Governor explained:

> If interest rates were to rise, that would have a negative effect on household consumption, but they'll only rise because of what we did—if household income is growing strongly, the labour market is strong and inflation is increasing. If interest rates increase because of a policy decision by the Reserve Bank, it will be in the context of stronger household income growth. That's not a particular concern. Over the last year or so, a number of banks have raised their mortgage rates by, on average, 10 to 15 basis

58 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

59 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 9.

60 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.

61 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.

62 RBA, *Statement on Monetary Policy*, February 2019, p. 73.

63 RBA, *Statement on Monetary Policy*, February 2019, p. 73.

> points, and that's obviously had some effect, but what is reported less is that competition amongst the banks has picked up.[64]

2.45 In addition, the Governor noted that 'despite the banks having put up their posted rates, the average rate that Australian households are paying has hardly moved at all, and that type of change really hasn't had any effect on household spending.'[65]

Housing market

2.46 The Governor was asked about the impact of the housing market adjustment on the Australian economy. The Governor reported that while there are 'some wealth effects from declining housing prices', they were relatively small.[66] He commented:

> In Sydney and Melbourne prices are still up 70 or 80 per cent over a decade, so most people are sitting on very substantial capital gains. People who purchased in the last year or 18 months are not, but most people are sitting on substantial capital gains, so there are still positive wealth effects coming from that.[67]

2.47 The Governor said that in part the current housing market adjustment was due to the 'big pick-up in population growth in New South Wales' in 2008 causing an undersupply of dwellings.[68] He explained:

> It took the better part of a decade for the rate of home building to respond to that. Prices went up – hardly surprising – but, finally, the supply side did adjust…the rate of home building at the moment is the highest that it's been in decades, so the rate of addition to the housing stock is very high. And population growth has slowed a bit, so prices are coming down.[69]

2.48 The committee asked the Governor if he considered there to be an oversupply of dwellings in the market. He said 'I don't see signs of fundamental disequilibrium between supply and demand now in the market.'[70] However, he further clarified that 'in some parts of Sydney maybe there are a few too many apartments, but if you look at Sydney as a whole, I don't think we've built too many dwellings.'[71]

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64 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.
65 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.
66 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.
67 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.
68 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
69 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
70 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 10.
71 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 11.

2.49 The Governor was asked if he thought that APRA's changes to the rates of interest-only and investment loans had impacted housing prices. He responded:

> Not at all. APRA's measures, I think, had very little effect on housing price dynamics. The dynamics have been driven by population growth and inflexibility on the supply side…The decline we're seeing in house prices has very little to do with APRA's measures…The decline in prices we're seeing now is the supply response that took place almost a decade too late.[72]

2.50 When asked if government regulation in New South Wales impacted supply responses, contributing to the increase in house prices, the Governor responded that:

> We certainly could have had different outcomes in the housing market if society had understood that population growth was going to pick up and we planned for it – if local and state government planned for it.[73]

2.51 The Governor observed that 'developments in the housing market can also affect overall spending in the economy', with lower turnover causing a reduction in the spending that occurs when people move home.[74] He also noted that a decline in house prices make people feel less wealthy, resulting in a reduction in their spending.

Mortgage brokers

2.52 The Governor was asked if proposed changes to the law around how mortgage brokers operate would lessen or increase competition. The Governor said that 'the Royal Commissioner made a number of recommendations on mortgage brokers and, broadly, I would support them.'[75] He explained:

> The end of trail commissions, making sure that brokers have an obligation to act in the best interests of the person that they're helping, and subjecting them to the requirements of financial advisers—they all make a lot of sense to me.[76]

72 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 11.
73 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 12.
74 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.
75 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.
76 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 5.

2.53 The Governor, pointed to the question of who should pay the fee as 'worth taking time to get that right', noting that many small lenders 'rely very heavily on brokers' with up '80 or 90 per cent of their loans' generated through the broker. He explained that if the broker channel was not working effectively, smaller lenders would have trouble, leading to less competition in the market.[77]

2.54 The Governor suggested that a shift to a 'borrower pays model could in principle work', but noted that it would need to be managed carefully to ensure it did not disrupt the market.[78]

Trends in the global economy

2.55 In his opening statement, the Governor reported that the global economic outlook remains reasonable. He noted that despite the focus being on the downgrading of the forecast for global growth by the International Monetary Fund, in many advanced economies inflation is low and unemployment rates are the lowest in many decades.[79]

2.56 The Governor noted that currently the primary area of concern for the RBA is the accumulation of downside risks. In particular, the Governor told the committee that the RBA has identified two major areas of risk globally which it is monitoring closely.

2.57 The first, labelled by the Governor as political risks, includes the 'trade and technology tensions between China and the United States, Brexit, the rise of Populism, and strains in some Western European economies.'[80]

2.58 Of these risks, the Governor said it is 'hard to be certain about how these various issues will play out,' but noted that 'in many countries, both public and private debt levels are already very high, and real interest rates are also already very low'.[81] This has caused there to be 'fewer buffers in the global system' than there once was and created 'less room to manoeuvre if something goes wrong.'[82] Despite this, the Governor noted that 'in a number of important dimensions the global financial system is more resilient than it used to be.'[83]

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77 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, pp. 5-6.

78 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 6.

79 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

80 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

81 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

82 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

83 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

2.59 The Governor told the committee that the second international risk the RBA was monitoring relates to the slowing growth of the Chinese economy. The Governor noted that the Chinese economy was 'feeling the effects of tensions with the United States and the squeezing of finance to the private sector as authorities clamp down on non-bank financing'.[84]

2.60 Despite the Chinese authorities easing policy in a number of areas. The Governor stated that 'they are walking a very fine line between supporting the economy in the near term and addressing the medium-term debt problems.'[85]

China and GDP growth

2.61 The committee ask the RBA to elaborate on a statement from the Minutes of the Monetary Policy Meeting of the Reserve Bank Board that said:

> GDP growth in China had slowed in 2018, as had been expected given the earlier tightening in financial conditions. However, there were signs that underlying momentum in the Chinese economy had slowed by more than suggested by the GDP data.[86]

2.62 The RBA noted that for a long time it had been expecting 'that GDP would slow because of structural reasons', primarily due to the aging population in China and the effects of 'some of their tightening of financial policy.' The RBA also noted that the recent monthly data had shown a slowing of investments and retail spending below the slowing of GDP.[87]

2.63 The committee asked the Governor if Australia's growth model is too reliant on China and too vulnerable in that respect. He explained:

> I don't think our growth model is too reliant on China. A lot of exports certainly go to China, and that's been a source of tremendous wealth and prosperity for our country. The big rise in the terms of trade, the big increase in national income and the big increase in investment are all because China is growing very well and we've been incredibly well placed to take advantage of that.[88]

2.64 The committee asked the Governor if the RBA was concerned by the blocking of thermal coal imports from Australia to China, in particular whether it would have a dramatic effect on the RBA's confidence in the

84 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

85 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 2.

86 RBA, *Minutes of the Monetary Policy Meeting of the Reserve Bank Board*, Sydney, 5 February 2019 <https://www.rba.gov.au/monetary-policy/rba-board-minutes/2019/2019-02-05.html>, accessed 7 March 2019.

87 Dr Luci Ellis, RBA Assistant Governor, Economic, *Transcript*, 22 February 2019, p. 8.

88 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 8.

Australian economy. The Governor said that he was not expecting it to have a dramatic effect, and remarked:

> The authorities have been trying to contain production of steel for environmental reasons, and they've had difficulty in doing that. One way that they can control the amount of production is to control the amount of inputs, and coking coal is an important input into steel production. So one interpretation of what's going on is that this is a way of controlling Chinese steel production. Another possible interpretation is that the Chinese coal industry is not particularly profitable at the moment and containing imports might boost the domestic prices and help the Chinese coal industry.[89]

2.65 The Governor noted that if the amount of coal blocked is the equivalent of two months of exports from Australia to China, then 'there are other markets in the work for Australia's coking coal' perhaps at a lower price. However, the Governor noted that 'if it were to be the sign of a deterioration in the underlying political relationship between Australia and China, that would be much more concerning. I think we've still got to wait to see what the underlying issues are.'[90]

Other issues

Note Printing Australia and Securency

2.66 The Governor reported that some years ago the House of Representative Economics Committee held a number of hearings into foreign bribery issues at Note Printing Australia (NPA) and Securency. The Governor stated that as the legal proceedings against former employees of NPA and Securency were completed in November 2018, the Supreme Court of Victoria has lifted the longstanding suppression orders. The Governor explained that this has allowed the RBA to disclose that:

> …in 2011 NPA and Securency entered guilty pleas to charges of conspiracy to bribe foreign officials between 1999 and 2004. We were also able to disclose that the two companies paid substantial fines and penalties, including under proceeds of crime legislation.[91]

89 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
90 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
91 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 3.

2.67 The Governor noted that Securency, the manufacturer of the polymer material used to make notes, is now owned by a Canadian firm, with the RBA having sold its half share in the company. He further noted that the NPA remains a 'wholly-owned subsidiary of the RBA', and has since undergone a 'top-to-bottom overhaul of its governance arrangements and business practices.'[92] The Governor stated that the 'corrupt and unethical behaviour that was uncovered runs counter to everything that we stand for', however he was now confident that the NPA is 'operating to the very high standard that we demand, and that it will continue to do so.'[93]

New Payments Platform System

2.68 In his opening statement, the Governor reported the RBA is continuing its work upgrading Australia's electronic payment system. The Governor stated that the RBA is working towards 'a system that is reliable, secure and efficient and that meets the needs of Australians.'[94]

2.69 The Governor stated that since the launch of the New Payments Platform (NPP) in February 2018, 'over 2.5 million Australians have registered pay IDs, and the banks are progressively adding functionality to the new system.'[95] The Governor noted that despite many people already benefiting from the new system though faster and more flexible payments, the RBA was disappointed that 'some of the major banks have not met the originally agreed timelines', slowing down 'the pace of innovation in the overall system'.[96]

2.70 The Governor reported that in 2018 he wrote to the CEOs of the major banks on behalf of the Payments System Board in 2018, 'expressing our concerns and seeking a commitment that the updated time line be satisfied.'[97] Despite the delays, the Governor noted that he remains confident that the NPP 'will provide the backbone for substantial innovation in our payment system for years to come'.[98]

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92 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 3.
93 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 3.
94 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
95 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
96 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
97 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.
98 Dr Philip Lowe, RBA Governor, *Transcript*, 22 February 2019, p. 4.

Australia's gold reserves

2.71 The RBA was asked when it had last conducted an audit of Australia's gold holdings. The RBA responded that the last audit was conducted in 2013. Australia's gold holdings amounted to 80 tonnes of gold which is being stored at the Bank of England, with a market value of $4 billion. The RBA reported that there had been no discrepancies in the amounts of gold in that audit.[99]

2.72 The RBA confirmed that it conducts physical audits of Australia's gold holdings every six years, and intended to conduct its next physical audit this year.[100]

2.73 The committee questioned the RBA over why it engages in gold leasing. The RBA responded:

> To add a rate of return to the reserves that we hold on the part of the Australian people, which flows pretty much straight through to you, the parliament. Gold, if you just leave it sitting there, unlike a treasury bond, for instance, earns no rate of return, whereas a bond does.[101]

2.74 The RBA told the committee that in 2018 it earned 'three-quarters of a million dollars from the leasing' which was returned to the taxpayer. It further noted that the RBA does not have any current intention to buy or sell gold, just to lease.[102]

Conclusion

2.75 Australia's economy continues to grow a little above trend with inflation forecast to increase only gradually. The RBA expects GDP to grow to around 3 per cent by the end of 2019, slowing to an increase of 2¾ per cent in 2020 due to slower growth in resource exports. This is being supported by an increase in infrastructure spending and a pick-up in private investment.

2.76 The combination of strong growth in jobs, decline in the unemployment rate to 5 per cent, and low level of interest rates is supporting spending. With wages growing at a faster rate than a year ago, boosted by the announced tax cuts, the growth in disposable income is also forecast to increase.

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99 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 24.

100 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 25.

101 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 25.

102 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 22 February 2019, p. 26.

2.77 Despite the recent housing market adjustment leading to declines in house prices in the major cities, the RBA is confident that the Australian economy and financial system remain resilient, and that lower house prices will open up the market for more people to purchase their own home.

Mr Tim Wilson MP
Chair
1 April 2019

A

Appendix A — Hearing, briefing and witnesses

Public hearing

Friday, 22 February 2019 – Sydney

Reserve Bank of Australia

Dr Philip Lowe, Governor
Dr Guy Debelle, Deputy Governor
Dr Luci Ellis, Assistant Governor, Economic
Ms Michele Bullock, Assistant Governor, Financial System

Private briefing

Wednesday, 20 February 2019 – Canberra

Mr Alan Oster, Group Chief Economist, National Australia Bank

B

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.