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The Parliament of the Commonwealth of Australia

# **Review of the Reserve Bank of Australia Annual Report 2019 (First Report)**

House of Representatives  
Standing Committee on Economics

March 2020  
Canberra

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## Chair's foreword

On 4 February 2020, the Reserve Bank of Australia (RBA) left official interest rates unchanged at 0.75 per cent. In making this decision, the Governor said the RBA judged that 'with interest rates having already been reduced to a very low level and recognising the long and variable lags in the transmission of monetary policy, the Board decided to hold the cash rate steady at this meeting.'

This decision by the RBA, and a range of other topics, were scrutinised at the committee's public hearing on 7 February 2020. The committee continued its work in providing public accountability and transparency of the operations of the RBA.

The RBA expects growth in the Australian economy to strengthen gradually, with the RBA's central scenario forecasting GDP growth of around 2.75 per cent over 2020 and 3 per cent over 2021. This outlook, the Governor commented, is being 'supported by accommodated monetary policy, a new expansion phase in the resources sector, stronger consumer spending and a recovery in dwelling investment later this year.'

Following on from global uncertainty caused by trade disputes between the United States and China, the phase one deal struck between these two powers has lessened tensions and the global economy has picked up again. This is expected to help drive growth in Australia with more certainty in export markets.

Inflation remains low in the Australian economy and underlying inflation has been below 2 per cent for around three years. CPI inflation was 1.8 per cent over 2019 and is forecast to lift gradually to around 2 per cent over the next year or so.

The labour market has continued its strong growth and the unemployment rate declined to 5.1 per cent in December 2019. The Governor stated that he expects this to fall to a little below 5 per cent as the economy grows. He noted that 'most of the forward-looking indicators, including job vacancies and hiring intentions, suggest there is going to be reasonable growth over the months ahead.'

The Governor explained that the labour force participation rate is the highest it has ever been, so even with strong job growth of an average of 2½ per cent, the unemployment rate has only come down slightly. The RBA noted that this means more Australians than ever before are in the workforce. As the economy grows, those workers seeking more hours should be able to take on more work, which will help address the issue of underemployment.

The impact of the drought, bushfires and COVID-19 coronavirus on the economy are expected to be significant in the coming months. The RBA has forecast a 0.2 per cent decline in GDP growth over the year due to the bushfires, a 0.25 per cent decline due to the drought and 0.2 due to the virus. The RBA advised the committee that the full impact of the coronavirus, in particular, is difficult to forecast as 'much will depend on the success of the various efforts to control the virus.'

Since the hearing the outbreak of COVID-19 has escalated. The risk it poses to the Australian economy is slowly being revealed, particularly for small and medium enterprises reliant on goods through supply chains and customers from China. Many SMEs face increasing risks to accessing stock for customers. It may take many months for supply chains to fill existing gaps and provide reliable supplies. Similarly, service-based businesses face increased risks from declining demand.

The consequences of the RBA's decision to lower interest rates in the second half of 2019 are now being realised. Money is already cheap and this leaves the RBA with limited flexibility to further reduce rates and adjust to unexpected shocks.

Since the hearing the RBA has reduced rates by a further 25 basis points to 0.50 per cent. While initial market reactions were positive and provided a degree of confidence, this is likely to be temporary. Reducing interest rates may build temporary confidence, but it is a solution to a misdiagnosed problem. The Australian economy does not face a problem of liquidity.

The temporary challenge the Australian economy faces relates to a crunch of supply in some sectors, and demand in others. In the short to medium term, COVID-19 will present serious challenges to SMEs in terms of meeting their financial obligations while maintaining employment levels. The banking sector faces a significant challenge to reassure customers and provide flexible financing options through a serious, but nonetheless temporary, event.

In light of the temporary nature of the challenge, and with a view towards retaining capacity to readjust amidst a recovery, the RBA should consider the efficacy of conditional longer-term funding options for retail banks. This would aim to enable SMEs to continue trading while the crisis is ongoing, thereby ensuring that SMEs are in the best position to maintain employment levels and lead a post-COVID-19 recovery. Doing so would also ensure the RBA does not continue tapping into the already 'empty well' of low rates.

The committee remains concerned about the impact of low interest rates on Australians who rely on interest-bearing products for income. The committee will continue to hold the RBA to account for the effects of interest rate decisions on all Australians and the Australian economy. The committee will also continue to closely examine the effects of the fires, drought and coronavirus as they develop.

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 7 February 2020. The next hearing will be on 14 August 2020.

**Tim Wilson MP**  
**Chair**





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## **Membership of the Committee**

<b>Chair</b>	Mr Tim Wilson MP
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## **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
QE	Quantitative Easing
RBA	Reserve Bank of Australia