The Parliament of the Commonwealth of Australia

Review of the Reserve Bank of Australia Annual Report 2015 (First Report)

House of Representatives
Standing Committee on Economics

April 2016
Canberra

ISBN 978-1-74366-457-5 (Printed Version)
ISBN 978-1-74366-458-2 (HTML Version)

Chair's foreword

On 2 February 2016 the RBA decided to leave official interest rates on hold at 2.0 per cent following the most recent rate cut in May 2015. In making this decision, the Governor commented that the current circumstances called for accommodative monetary policy, with inflation continuing to remain close to target and reasonable projections for continued economic growth.

At the public hearing on 12 February 2016 the Governor stated that the Australian economy is continuing to progress through significant adjustment challenges, with current growth being driven by the non-mining sectors of the economy, particularly the services sector. The RBA forecasts that year-ended GDP growth will be 2½–3½ per cent over the year to December 2016, increasing to 3–4 per cent over the year to June 2018. The Governor remarked that the modest growth of the economy has been producing more employment growth and lower unemployment than anticipated, while inflation remains low with the CPI rising by 1.7 per cent over 2015.

Given that current labour conditions have been better than expected, unemployment is likely to reduce further, while the participation rate is expected to increase over the coming years. Wage growth is not expected to increase substantially over the next few years due to spare capacity in the labour market. The RBA reports that household consumption growth has increased, which has been supported by lower interest rates and increasing employment. House prices, particularly in Sydney and Melbourne, have eased since their peak in September 2015. Substantial increases in higher density housing in recent years have led to slower growth in apartment prices, which has been linked to a rise in rental vacancy rates, while rental yields remain low.

While the Australian dollar has appreciated a little against the US dollar and on a trade-weighted basis from its lowest level in September 2015, the effects of the dollar's long-run depreciation are still coming through. The RBA anticipates the effects of the exchange rate depreciation will continue to put some upward pressure on CPI inflation over the course of the next few years. The Governor noted that, at its current level, the Australian dollar was supporting demand for locally produced goods and services, which has been reflected by strong growth in the services sector.

On behalf of the committee, I thank the Governor of the Reserve Bank, Mr Glenn Stevens and other representatives of the RBA for appearing at the hearing on 12 February 2016.

David Coleman MP
Chair

Contents

APPENDICES

TABLE

Membership of the Committee

Chair	Mr David Coleman (from 11 March 2016)
	Mr Craig Laundy MP (to 18 February 2016)
Deputy Chair	The Hon Ed Husic MP
Members	Mr John Alexander OAM MP
	Mr Scott Buchholz MP
	Mr Pat Conroy MP
	Mr Kevin Hogan MP
	Mr Craig Kelly MP
	Mr Craig Laundy MP (to 24 February 2016)
	Ms Clare O'Neil MP
	Mr Clive Palmer MP
	Ms Fiona Scott MP (from 2 March 2016)

Committee Secretariat

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

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.

1

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 *Sixth Statement on the Conduct of Monetary Policy,* agreed between the then Treasurer, the Hon Joe Hockey, MP, and the RBA Governor, Mr Glenn Stevens. 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.[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.

---

1 Reserve Bank of Australia (RBA), *Sixth Statement on the Conduct of Monetary Policy*, 24 October 2013.

Accordingly, the committee may inquire into aspects of the annual reports of the RBA.

Scope and conduct of the review

1.4 The sixth public hearing of the committee with the RBA during the 44th Parliament was held in Sydney on 12 February 2016.

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 Chris Richardson, Partner, Deloitte Access Economics. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Richardson'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 staff and students from Strathfield Girls High School, Burwood Girls High School, Inaburra School and Domremy College.

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 2016 *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, <http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBA_Annual_Report_2015/Public_Hearings>, accessed 15/2/2016.

3 Reserve Bank of Australia, 'Statement on Monetary Policy', <http://www.rba.gov.au/publications/smp/2016/feb/> viewed 15 February 2016.

2

Monetary policy and other issues

Overview

1.1 On 2 February 2016 the Reserve Bank of Australia (RBA) decided to leave official interest rates unchanged at 2.0 per cent. At the committee's last hearing with the RBA in September the interest rate remained at 2.0 per cent following the RBA's decision to lower the rate from 2.25 per cent in May 2015. In his February statement on the decision, the Governor noted that the current circumstances called for monetary policy to be accommodative, commenting that:

> At today's meeting, the Board judged that there were reasonable prospects for continued growth in the economy, with inflation close to target. The Board therefore decided that the current setting of monetary policy remained appropriate.[1]

1.2 The Governor remarked at the public hearing on 12 February 2016 that, despite considerable adjustment challenges, the Australian economy is continuing to grow at a modest rate and has been 'generating more employment growth and lower unemployment than we expected, while inflation has remained quite low.'[2]

1.3 The RBA reports that employment growth has been driven by strong growth in the services sector 'where Australia's exports of services have grown, while imports of services have fallen noticeably over the past couple of years.'[3]

1 Mr Glenn Stevens, Governor of the Reserve Bank of Australia (RBA), *Media Release: Statement by Glenn Stevens, Governor: Monetary Policy Decision,* 2 February 2016, <http://www.rba.gov.au/media-releases/2016/mr-16-01.html>, accessed 15/2/2016.

2 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

3 RBA, *Statement on Monetary Policy*, February 2016, p. 31.

1.4 Inflation is expected to remain low, despite the adjustment of the Australian dollar to lower commodity prices. The RBA expects low wage growth to continue to support employment and keep inflation contained:

> This is consistent with heightened competitive pressures, declines in the cost of business inputs such as fuel and some regulated utilities, and the fact that spare capacity in the labour market has been contributing to low growth in labour costs.[4]

1.5 The RBA reports that the housing market has eased since September 2015, particularly in Sydney and Melbourne where the strongest growth had occurred.[5] Household consumption growth has increased, supported by low interest rates and increasing employment.[6]

1.6 The Governor observed that, globally, there have been a number of important developments that have impacted on the Australian economy, including the United States Federal Reserve raising interest rates for the first time in nine and a half years, while the European Central Bank and the Bank of Japan have further eased their monetary policies. The Governor commented that 'policy trajectories among the major three jurisdictions are diverging, which creates the potential for market movements, not least in exchange rates.'[7]

1.7 The RBA noted that global financial markets have been increasingly volatile recently as a consequence of a range of factors, including 'diverging monetary policy trends among the major central banks, concerns about the challenges facing the Chinese authorities and large declines in oil prices.'[8]

1.8 During the hearing, the committee questioned the Governor and the other RBA officials who appeared on monetary and economic policy frameworks and their impacts on the Australian economy. Areas of discussion included the cash and exchange rates, inflation and the labour market, housing, the growth performance of Australia's major trading partners, reductions in the price of oil and other commodities, and volatility in global financial markets.

1.9 The committee also questioned the Governor about updates to security, procedure and oversight at Note Printing Australia, following a theft in 2012.

4 RBA, *Statement on Monetary Policy*, February 2016, p. 4.

5 RBA, *Statement on Monetary Policy*, February 2016, p. 32.

6 RBA, *Statement on Monetary Policy*, February 2016, p. 3.

7 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

8 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

Forecasts

1.10 In its February 2016 *Statement on Monetary Policy*, the RBA reported that there was little change to Australia's GDP growth forecasts since the November Statement. Australia's GDP growth is forecast to be 2½–3½ per cent over the year to December 2016, and to increase to 3–4 per cent over the year to June 2018 (see Table 1).[9]

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

	Year-ended					
	Dec 2015	June 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
GDP growth	2½	2-3	2½–3½	2½–3½	2½–3½	3-4
CPI inflation	1.7	1½	2-3	2-3	2-3	2-3
Underlying inflation	2	2	2-3	2-3	2-3	2-3
	Year-average					
	2015	2015/16	2016	2016/17	2017	2017/18
GDP growth	2½	2-3	2-3	2½–3½	2½–3½	2½–3½

Source Reserve Bank of Australia, Statement on Monetary Policy, February 2016, p. 61. (a)Technical assumptions include A$ at US$0.72, TWI at 62 and Brent crude oil price at US$35 per barrel.

1.11 The RBA forecasted growth of Australia's major trading partners (MTPs) to remain unchanged from the November Statement and is expected to stay close to its current rate, which is marginally below its decade average:

> Accommodative monetary policies and low oil prices are likely to support growth in Australia's MTPs which, for the most part, are net oil importers. Globally, core inflation has been stable at low rates, reflecting spare capacity in many labour, product and commodity markets. This, together with the decline in oil prices over the past three months, suggests that headline inflation rates will remain below central bank targets for some time yet.[10]

1.12 The RBA noted that labour market conditions have improved and leading indicators suggest further employment growth in the coming months. It reported that:

> While employment growth is expected to slow somewhat from the rapid pace seen in the December quarter, it is forecast to remain strong enough to reduce the unemployment rate further. The participation rate is likely to rise further over coming years as

9 RBA, *Statement on Monetary Policy*, February 2016, p. 60.

10 RBA, *Statement on Monetary Policy*, February 2016, p. 59.

> individuals are encouraged to enter the labour market as employment opportunities improve.[11]

1.13 Concerns have been raised recently by economists about the quality of labour force data being collected by the Australian Bureau of Statistics.[12] The committee asked whether the RBA was concerned with the accuracy of labour force data.

1.14 The Governor responded that these concerns are focussed on technical aspects of the data that should not substantially affect ratios of employment such as the rate of unemployment as a share of the labour force.[13] While noting that 'there are some reservations about data quality in the labour market', the Governor remarked that it is 'hard to ignore the conclusion that we have had more jobs growth and lower unemployment than we thought.'[14]

1.15 The RBA forecast that wage growth was not expected to increase much over the next few years 'given continued spare capacity in the labour market' and pressure on employers to contain costs.[15]

1.16 In his opening statement, the Governor commented that low wage growth was helpful in understanding why inflation has remained relatively low:

> As measured by the consumer price index, inflation was 1.7 per cent across the four quarters of 2015. That result was affected by falling prices for petrol and utilities, the latter, in part, due to government policy decisions. But even the underlying measures, which remove or down weight those affects—and they are running at about two per cent—are low. Price rises from non-tradeable items are at their lowest for many years, and that reflects, amongst other things, the modest growth of labour costs.[16]

1.17 Looking ahead, the RBA noted that domestic pressures on inflation were expected to remain subdued:

> Inflation in the prices of non-tradable items is forecast to pick up gradually but remain below its inflation-targeting average during the forecast period. This is consistent with the expectation that there will still be spare capacity in the labour market over the next couple of years, albeit less than earlier forecast, and growth of

11 RBA, *Statement on Monetary Policy*, February 2016, p. 62.

12 N Woolrich, 'Jobs data unreliable, recent employment surge unbelievable say economists', *ABC News Online*, 18 February 2016, <http://www.abc.net.au/news/2016-02-17/jobs-data-unreliable-as-unemployment-likely-to-be-steady/7176814>, accessed 18/2/2016

13 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.

14 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.

15 RBA, *Statement on Monetary Policy*, February 2016, p. 62.

16 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

> labour costs will remain low. Also, spare capacity in a number of product markets is likely to constrain the ability of many firms to expand their margins.[17]

1.18 The committee was interested whether the Chinese Free Trade Agreement had been factored into the RBA's forecasts. The Governor responded that there 'is not much effect over the horizon that we work on, which is 2½ years', and added that 'those effects start small and grow over time.'[18]

The cash rate and monetary policy

1.19 At its meeting on 2 February 2016 the RBA decided to keep interest rates unchanged at 2.0 per cent, noting that there were 'reasonable prospects for continued growth in the economy, with inflation close to target.'[19]

1.20 In making the decision to leave rates on hold, the RBA noted that current monetary policy settings were appropriate:

> The available data suggest that the accommodative stance of monetary policy and the depreciation of the exchange rate since 2013 have supported growth and assisted the rebalancing of economic activity towards non-resource sectors of the economy. This process has been particularly apparent in the labour market. Employment growth over 2015 was stronger than was expected a year ago and the unemployment rate fell by more than had been expected. Despite this, output growth has remained below average.[20]

1.21 The committee asked whether the RBA's bias for future monetary policy was towards easing rates. The Governor responded that:

> It is, I think, pretty unlikely we are going to be raising rates any time soon. The question will be should we sit or go down some more, and that has been the question for some years now. So, yes, if that is what we mean by biased to ease, then, yes, that is a correct understanding.[21]

1.22 The RBA noted that global monetary policy remains accommodative despite the United States Federal Reserve raising the federal funds rate

17 RBA, *Statement on Monetary Policy*, February 2016, p. 62.

18 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 5.

19 RBA, *Statement on Monetary Policy*, February 2016, p. 4.

20 RBA, *Statement on Monetary Policy*, February 2016, p. 4.

21 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 16.

target in December for the first time in nearly a decade.[22] The Governor remarked that:

> The last time the Fed actually commenced an upward phase of interest rates was as far back as 2004. The Fed's rationale for this change was that the US economy had sufficient strength that a zero interest rate was no longer needed. And, as such, it is a welcome development. The change had been very well telegraphed and was absorbed by financial markets without immediate disruption.[23]

1.23 The RBA commented in its February Statement that, despite the rate increase, 'the stance of policy in the United States remains very accommodative and the pace of future rate increases is expected to be very gradual.'[24]

1.24 The RBA noted that the European Central Bank (ECB) announced a package of measures designed to further ease monetary policy further, while the Bank of Japan also reduced 'the rate it pays on marginal reserves to –10 basis points while announcing that it would continue to expand its balance sheet over 2016 as planned.'[25]

1.25 The committee was interested in whether recent volatility in global financial markets will lead to a situation where regulators are uncertain of what lies ahead. In responding, the Governor remarked that:

> I think what we are seeing in global markets at present is markets are dropping their bundle. There are some latent issues that have been there all along, actually, on which people have now chosen to focus more strongly than they were a couple of months back. It is inevitably uncertain how that pans out. That is just the way it is in these financial market episodes, and I think policymakers are being honest enough to say that. That is just the reality of the world we live in, and I do not think we can really pretend that it is otherwise.[26]

1.26 The committee questioned the Governor whether the Australian banks were likely to raise their interest rates independent of the RBA's cash rate, and the conditions in which this would be likely to take place. While noting that 'I would not suggest to them that they move independently',

22 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

23 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

24 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

25 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

26 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 3.

the Governor commented that he did not currently see a case for banks to independently increase their lending rates:

> And it is true that, in wholesale markets, funding costs relative to the cash rate are up a little bit—it is only a little bit—and as best we can tell at present, to long-term debt, the new debt that is being sold to replace debt that is rolling over is still being sold into the market at a lower interest rate than the debt that it is replacing. So the marginal funding cost has gone up a bit, but it is still lower than the average funding cost in the stock that is outstanding. That is on the figures available to me. So I guess I have to say this: I do not see much of a case for independent increases in lending rates based on funding costs as they have evolved just lately. Of course, things may change as we go forward, but that is my take right now.[27]

1.27 When asked why the banks have previously moved their rates independently, the Governor said that, in the case of mortgage rates for investors, Australian Prudential Regulation Authority (APRA) controls have played a role. The Governor commented that, when asked to slow down their lending to investors, some banks have responded by increasing their rates.[28]

The exchange rate

1.28 In its February Statement the RBA outlined general trends in the exchange rate since the previous Statement. It noted that while the Australia dollar has appreciated a little on a trade-weighted basis, and despite having depreciated by 5 per cent against the US dollar in early January, overall it has been 'little changed against the US dollar.'[29]

1.29 The RBA noted that:

> Over this period, changes in the Australian dollar have reflected fluctuations in global sentiment and commodity prices, which have occurred alongside uncertainty about the outlook for China. Against the US dollar and on a trade-weighted basis, the Australian dollar is currently around 4 per cent higher than the low it reached in September 2015.[30]

27 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 8.
28 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 8.
29 RBA, *Statement on Monetary Policy*, February 2016, p. 28.
30 RBA, *Statement on Monetary Policy*, February 2016, p. 28.

1.30 In his opening statement, the Governor remarked that it is 'noteworthy that commodity prices are lower than they were' in September 2015, given that the Australian dollar has remained at about the same level during this time.[31] The committee was interested in the reasons for this, and asked why the dollar has remained so resilient. The Governor responded by stating:

> There was a period when we felt that the exchange rate was not quite doing the job we might have expected, and we said so. It then adjusted, and our language has of late been, 'It's adjusting.' I would still say that. I would also note that commodity prices are continuing to fall as we speak.[32]

1.31 In its February Statement, the RBA noted that the Australian dollar has been more volatile since the previous Statement, with the 'average intraday trading range for the AUD/USD exchange rate in January slightly higher than its post 2000 average.'[33]

1.32 When asked by the committee whether the depreciation of the Australian dollar was likely to increase CPI inflation, the Governor said that 'there are still, I think, further effects of the depreciation to come through.'[34] Assistant Governor Dr Christopher Kent added that any further pass-through of the exchange rate depreciation 'will take a couple of years, if history is any guide.'[35] Dr Kent explained that:

> It is there in underlying inflation, and the process can take a long time. The amount that you think you can measure coming through, say, trade or prices of goods and services is quite volatile from one quarter to the next. But yes, it should come through and our forecasts have it coming through in a gradual way over the course of the next couple of years.[36]

Business and the labour market

1.33 According to the RBA February Statement, employment growth during 2015 was above average and the unemployment rate declined by half a percentage point, which reflects, in part, 'the relatively strong growth of

31 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

32 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 19.

33 RBA, *Statement on Monetary Policy*, February 2016, p. 28.

34 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 21.

35 Dr Christopher Kent, Assistant Governor, Economic, RBA, *Transcript*, 12 February 2016, p. 21.

36 Dr Christopher Kent, Assistant Governor, Economic, RBA, *Transcript*, 12 February 2016, p. 21.

output in the more labour-intensive sectors of the economy, such as household services.'[37] The RBA added that:

> …the low growth of wages is likely to have encouraged businesses to employ more people than otherwise. Measures of job vacancies and advertisements point to further growth in employment over the coming months. In response to this flow of data, the forecast for the unemployment rate has been revised lower.[38]

1.34 The committee asked about the growth in non-mining sectors of the economy and whether this growth was being picked up in capital expenditure figures. The Governor said that 'capital spending, outside of mining, is considerably weaker now than I would have expected if I had made a forecast two or three years ago.'[39] The Governor added that 'some of the growth has been in areas where the amount of capital per head per person working that is needed to produce the output is a lot lower than it is in, say, manufacturing or the other industries.'[40]

1.35 The committee was interested in whether other countries that have transitioned away from resource-oriented growth have experienced an increase in employment in services, rather than manufacturing, and if this would result in capital investment forming a smaller proportion of GDP in the long term.

1.36 Reflecting on the experience of China, the Governor said that 'the general trend towards economies having a higher weight of services in their output is one that is quite common to advanced countries and even countries that are emerging.'[41] The Governor added that this trend towards services requires less capital investment.[42]

1.37 In its February Statement, the RBA noted that there is considerable uncertainty whether the recent rate of improvement in labour market conditions will continue. While employment growth is forecast to 'ease somewhat from the above-trend pace experienced over 2015', the RBA observed that it is possible this could go either way, with employment growth declining more than forecast, or the unemployment rate declining quicker than forecast.[43]

37 RBA, *Statement on Monetary Policy*, February 2016, p. 2.
38 RBA, *Statement on Monetary Policy*, February 2016, p. 3.
39 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.
40 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.
41 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.
42 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 10.
43 RBA, *Statement on Monetary Policy*, February 2016, p. 64.

1.38 The Governor remarked that while there have been concerns about the quality of labour force data, 'it is hard to avoid the conclusion that the labour market is a bit better than we thought it would be, which is of course good news.'[44]

1.39 Australia's terms of trade have declined considerably from their peak around 2012, and as a result of the drop in bulk commodity prices from late 2015, the RBA forecasts that Australia's terms of trade has been revised further downward.[45]

1.40 The RBA reported that, as anticipated, there was a further sharp decline in mining investment during the September quarter, while non-mining investment has changed little over the year. Iron ore exports have remained at a high level during 2015, while the growth in liquefied natural gas exports is expected to accelerate as more projects commence production.[46]

1.41 The Governor noted that while recent falls in the price of oil will benefit Australia's terms of trade in the short term, lower bulk commodity prices will continue to have a dampening effect on the terms of trade:

> A fall in oil prices at the moment is a positive terms-of-trade event for Australia. In the future, it will not be, because we will be a net energy exporter because of the gas that we talked about earlier. But at present a fall in the price of oil is a terms-of-trade gain for this country. The terms-of-trade loss is happening because of lower coal, iron ore and other metals prices.[47]

1.42 The committee asked whether lower oil prices would have an effect on investment in Australia, and what risks lower oil prices posed for Australia going forward. The Governor responded that:

> For the projects which are in train, my understanding is that there are contractual arrangements for their prices, but presumably, if oil prices remain low for an extended period, that will find its way into the contracts eventually.[48]

1.43 Dr Kent added that:

> The movement from oil prices through to LNG is fairly rapid, and you can see that LNG prices on spot markets have fallen a long way, albeit with a little bit of a lag. The nature of the contracts for LNG is really to supply certain quantities of gas, and there is also a

44 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 11.

45 RBA, *Statement on Monetary Policy*, February 2016, p. 2.

46 RBA, *Statement on Monetary Policy*, February 2016, p. 3.

47 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 18.

48 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 4.

> formula in there that links the price that the gas producers get for selling their gas to the oil prices, so they will definitely decline.[49]

1.44 The committee was interested in whether the fall in oil prices have left Australian banks exposed in terms of investment in production where the price has dropped, and the capacity of our banks to service those debts. In addition, the committee asked whether there were concerns for those banks that are exposed having to deal with bad debts.

1.45 The Governor said that he did not expect this to pose problems to Australian banks because they have relatively small exposure to the resources sector, while some international banks operating in Australia are more exposed. For the international banks that are more exposed, the Governor said that it will depend on the level of exposure and the financial resources they have to cover losses. The Governor remarked that 'at the moment, I do not think I see the oil price declines per se as likely to be a significant detriment to the global banking system.'[50]

1.46 The committee was concerned why lower oil prices have not been reflected in reduced prices for Australian consumers. Dr Kent said that the lower Australian dollar means that Australians are not seeing the full impact of the price decrease. Dr Kent also noted that 'refining and retail margins are a bit wider now than they were a year ago when oil prices began to decline', to the detriment of Australian consumers. [51]

1.47 The committee asked about the implications of major resource companies reassessing their dividend policies. The Governor emphasised that the resources sector is highly cyclical, and commented that it is important for companies to maintain strong balance sheets:

> My take is that their concern is to make sure that they continue to have a strong balance sheet in difficult times, and that is very much in the interests of the shareholders, even if it means the dividend is a bit lower for a while.[52]

1.48 The committee questioned the Governor about whether business confidence, or 'animal spirits', has improved, and whether this may have been caused by factors other than monetary policy. The committee was also interested in how this affected improved labour market outcomes.

1.49 The Governor responded that he 'would not say that animal spirits are absolutely ebullient, by any means, but I think they have improved.'[53] The

49 Dr Christopher Kent, Assistant Governor, Economic, RBA, *Transcript*, 12 February 2016, p. 4.

50 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 7.

51 Dr Christopher Kent, Assistant Governor, Economic, RBA, *Transcript*, 12 February 2016, p. 9.

52 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 7.

53 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 16.

Governor agreed that monetary policy played a role in business confidence, but said 'there are many factors that can play into how businesses feel about the future of their own business and the country.'[54] The Governor also stated that, in relation to labour market conditions, 'enough businesses around the country have had the confidence, the animal spirits, the need, whatever you want to call it, to employ some more bodies.'[55]

1.50 The committee asked whether policy makers have focussed too much on the demand side of the economy, rather than the expense side. The Governor commented that too much has been expected of monetary policy to deliver growth over the last six or seven years, when 'sustained and strong long-run growth in living standards comes from innovation, risk taking, productivity etc.'[56]

1.51 The committee asked the RBA's view on whether Australia's corporate tax rate was too high. Dr Phillip Lowe, Deputy Governor, commented that he did not think that was the key issue, and stated that the main question should be 'how do we create a pro-investment climate?'[57]

1.52 The committee also asked about the impacts on the Australian economy if bracket creep was not addressed. The Governor responded that, while he could not quantify what the incentive effect would be, or the longer-run growth impacts on the economy, the 'important thing here is incentives to work or not and to take risk or not.' [58]

Global economies

1.53 The RBA noted that while overall growth in Australia's major trading partners was 'little changed in 2015 at a bit below its decade average', growth in China has slowed, which has had knock-on effects in the region.[59] The RBA commented that the moderation in China's growth has, in part:

> …reflected excess capacity in heavy industry and the large stock of unsold housing, although a range of longer-term structural factors – such as falling productivity growth and a decline in the growth of the urban workforce also have contributed. Weakness in the real

54 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 16.

55 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 16.

56 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 17.

57 Dr Phillip Lowe, Deputy Governor of the RBA, *Transcript*, 12 February 2016, p. 13.

58 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 19.

59 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

> estate and industrial sectors led to a decline in aggregate investment growth over the year. Infrastructure investment growth also slowed but remained relatively rapid, supported by numerous project approvals and strong growth in government expenditure.[60]

1.54 In noting that current per capita income in China is about a quarter of that of the western world, the committee asked whether this provided significant opportunities for Chinese growth. The Governor responded that:

> There is no doubt that the potential for Chinese income per head to catch up to the Western world is massive. It is not guaranteed that catch-up happens. You have to do things right to realise the potential. [61]

1.55 The Governor commented that many observers have become more concerned about the Chinese economy, even though the 'softness in growth' in China has been occurring for some time:

> The more recent anxiety is probably best described as greater uncertainty over the intentions of Chinese policymakers and over whether they will be able to carry off the economic transition that China needs. This anxiety has been reflected in capital flows. In particular, there is considerable private capital seeking to leave China.[62]

1.56 The committee asked whether the RBA was concerned about recent policy changes in China, particularly how the Chinese currency is valued moving forward. The Governor spoke positively about recent moves by Chinese authorities towards a more flexible exchange rate:

> The Chinese authorities have made some changes to the exchange rate mechanism over the past six months or so. The initial one of those was back in August or September. To my mind, I was surprised at the extent of reaction to that around the world. The size of the adjustment they made was actually quite small, and in the rate itself. The focus that they have indicated in recent times towards thinking about their exchange rate, as it travels against a basket of other currencies, is actually eminently sensible.[63]

1.57 The Governor noted that 'the other area where the Chinese authorities have been seeking to calm things down was in the stock market. I think

60 RBA, *Statement on Monetary Policy*, February 2016, p. 1.

61 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 15.

62 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.

63 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 3.

that has proven much harder to do than they expected, and not altogether successful.'[64]

1.58 The Governor acknowledged the uncertainties facing the Australian economy because of China's transition away from export-led growth, and remarked on the challenges inherent in this transition:

> The key issue has become this uncertainty around what the policymakers actually want and whether they will be able to achieve it. When you think about the size of the economic transition that they are attempting here, this is a big thing. To transition away from the Asian model of export-led growth with a low currency to get to more domestic growth, less investment and more consumption, and for an economy of that size and the speed with which they are seeking to do this, it is probably without precedent in history. Inevitably, we do not know if they can land this.[65]

1.59 In the United States, the Governor noted that the decision by the Federal Reserve to raise interest rates had been well telegraphed and has been absorbed without too much disruption in financial markets.[66] Meanwhile the RBA notes that, in the United States:

> …labour market conditions continued to improve even though GDP growth declined towards the end of last year. Private consumption has been the key driver of expenditure growth, supported by further growth in employment and lower oil prices. Investment growth has also added to expenditure and business conditions have been generally positive, although the industries most exposed to oil prices and the appreciation of the exchange rate have experienced more subdued conditions.[67]

1.60 In Europe, the RBA reports that economic activity has continued to gradually recover with GDP growing at an above trend rate in recent quarters, although it is only just returning to its pre-crisis peak. The main contributors to growth of expenditure in Europe have been household and government consumption, while there has been little change to investment and no contribution to growth from net exports despite the Euro depreciating.[68]

64 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 4.
65 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 4.
66 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 2.
67 RBA, *Statement on Monetary Policy*, February 2016, p. 2.
68 RBA, *Statement on Monetary Policy*, February 2016, p. 11.

1.61 The committee was interested whether recent troubles experienced by the Deutsche Bank were indicative of broader problems in the European banking system. The Governor remarked that, regarding the European banking system, 'there remains some residual uncertainty—quite a bit of residual uncertainty—over the asset quality and the capital adequacy of the banks.'[69] The Governor added that 'while the Europeans have been making progress in assessing asset quality and getting capital adequacy up and so on, I think it is undeniable that they started that process much later than would have been ideal.' [70]

1.62 The committee asked whether the Japanese economy was improving, and what implications that has for the Australian economy. Dr Kent said that:

> Our assumption, more or less, over the next couple of years is more of the same, which is not terrible growth by historical standards for Japan but low by many other standards. Part of that is just the ageing of the population. Their population is actually shrinking and getting older and retiring. Having said that, Japan has been in this situation for quite a long time, yet they still are demanding an increasing amount of our commodities, including things like LNG. So it has not been too harmful to us.[71]

1.63 The RBA reported that GDP in Japan has grown moderately during 2015, which followed a small contraction in 2014 that has been mainly attributed to an increase in consumption tax.[72] The recent increase in the rate of growth in Japan has been assisted by 'expansionary monetary policy, the depreciation of the exchange rate over recent years, lower oil prices and the gradual improvement in labour market conditions.'[73]

Housing

1.64 Following the peak in national housing prices in September 2015, the established housing market in Australia has eased in recent months. The RBA reported that this has been most evident for detached houses in Sydney and Melbourne, which had experienced the strongest growth, and Perth, where prices have declined since early 2015.[74]

69 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 5.

70 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 5.

71 Dr Christopher Kent, Assistant Governor, Economic, RBA, *Transcript*, 12 February 2016, p. 15.

72 RBA, *Statement on Monetary Policy*, February 2016, p. 7.

73 RBA, *Statement on Monetary Policy*, February 2016, p. 8.

74 RBA, *Statement on Monetary Policy*, February 2016, p. 32.

1.65 The RBA noted that substantial increases in higher-density housing supply in recent years have led to slower growth of national apartment prices than that of detached houses. This increase in supply has been linked to a gradual rise in the national rental vacancy rate, while rental yields remain low.[75]

1.66 The RBA reported that household consumption growth increased during the September quarter and that indicators suggest that this pace of growth has continued.[76] The RBA remarked that 'household consumption growth has been supported by low interest rates, increasing employment and, to some extent, increased household wealth', while growth in labour income was subdued.[77] The RBA further noted that the household savings rate had declined over the last few years, although it 'remains at a relatively high level.' [78]

1.67 Following up on questions raised during the committee's last RBA hearing[79] in September 2015 regarding action taken by regulators to restrict the increase in borrowings on investment properties by 10 per cent, the committee asked whether this action has been sufficient.

1.68 The Governor responded by saying 'it has had a positive effect and it has worked as well as these things ever could be expected to.'[80] The Governor explained that:

> We have seen a step up in the level of prudence surrounding the decisions to lend, where that needed to occur. We have seen some moderation in the pace of growth of lending to investors—the banks have probably overachieved a little bit there, actually. But, I suspect, at the moment what we are starting to see is a bit of a step up again in competition to lend in that space, just at the margin. [81]

1.69 The Governor explained that there has been a significant amount of data revision, as a consequence of the changes, because:

> …the split between investors and owner occupiers became something of importance from a regulatory point of view, the people who were supplying the data out of the financial institutions took more interest in that split than they had done before and we had some pretty substantial revisions to the history

75 RBA, *Statement on Monetary Policy*, February 2016, p. 32.

76 RBA, *Statement on Monetary Policy*, February 2016, p. 3.

77 RBA, *Statement on Monetary Policy*, February 2016, p. 33.

78 RBA, *Statement on Monetary Policy*, February 2016, p. 33.

79 House of Representatives Standing Committee on Economics, *Review of the RBA Annual Report 2014 (Second Report)*, November 2015, pp. 17-9.

80 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 13.

81 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 12.

> of the data, as they tried to make it more accurate. We are probably still seeing some revisions flowing through, though, hopefully, the bulk of them are done. [82]

1.70 The committee asked whether the response to limit the pace of growth in lending to investors was timely. The Governor responded:

> I do not think it was late. I do not think there has been a very large build-up of very serious risks in bank balance sheets. There might have been had practices not improved, but that would have taken some time. I am not at all worried about the timing. I thought it was appropriate.[83]

1.71 Given the recent volatility in housing prices, there was some discussion at the hearing around the possibility of a counterbalancing mechanism, such as an instrument where negative gearing for property could be incrementally varied if interest rates were lowered, and vice versa, as a means of moderating investor activity and preventing price instability.

1.72 The Governor pointed out that for such an instrument to work, it would be difficult to ascertain what an appropriate range of property price inflation would be. Furthermore, the Governor doubted that there would be many economists 'who would be strongly supportive of a rate-of-price target for housing prices.'[84] Similarly, Dr Lowe said that 'there is generally little support for making that an explicit target of policy.'[85]

1.73 In relation to the proposed instrument, Dr Lowe said that while the disparity between income and housing prices is a legitimate public policy issue, housing supply is a critical issue:

> My own view is that that is largely dealt with on the supply side, that increasing the supply of housing is the main thing that you can do to reduce housing prices relative to people's income. And we are doing a reasonable job there now. [86]

1.74 The RBA's February Statement observed that, in the case of housing supply, some areas of Australia 'appear to be at risk of reaching a point of oversupply, particularly the inner-city areas of Melbourne and Brisbane.[87]

82 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 12.

83 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 13.

84 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 13.

85 Dr Phillip Lowe, Deputy Governor of the RBA, *Transcript*, 12 February 2016, p. 13.

86 Dr Phillip Lowe, Deputy Governor of the RBA, *Transcript*, 12 February 2016, p. 14.

87 RBA, *Statement on Monetary Policy*, February 2016, p. 65.

Corporate governance, accountability and transparency

1.75 The committee questioned the Governor about whether the RBA's procedures and security at Note Printing Australia were adequate, following the theft of $1 million at a note printing plant in Melbourne. The crimes allegedly occurred between May 2010 and May 2012.[88]

1.76 The Governor responded by noting that the recommendations of a consultant's report into the incident have been implemented:

> The failures that allowed the person concerned to do what he did were serious failures of procedure and security. The security, had it been implemented properly, would have prevented it, but there were serious lapses in its implementation. They have all been addressed so far as I know.[89]

1.77 In responding to the committee's concerns about whether appropriate oversight and accountability safeguards have been put in place, the Governor said:

> I think the board, through the audit process and other reporting, has had visibility of this matter and the bank's operations at Craigieburn generally. So I think their oversight is good. I think the way the matter was dealt with is that it came to our attention as a result, basically, of someone speaking up, the appropriate action was taken, the police were called, the relevant person concerned was charged and so on, and we have not sought to hide any of that.[90]

1.78 When questioned whether the RBA should have been more transparent about the issue, the Governor replied:

> I do not think we are in any way seeking to conceal, from this committee or anything else, that matter. It has been in the papers. It was appropriately dealt with by the authorities—police, prosecutors and so on. We are not hiding anything about it. We are quite happy to respond to questions about it. Most of the interest of the committee is usually on the things we talked about today.[91]

---

88 P Durkin, Police allege scientist stole damaged cash from Reserve Bank, *Australian Financial Review*, 29 November 2015, <http://www.afr.com/news/economy/police-allege-scientist-stole-damaged-cash-from-reserve-bank-20151129-glarra>, accessed 19/2/2016.

89 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 20.

90 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 20.

91 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 20.

1.79 The committee asked the Governor why the alleged theft was neither reported to the committee at earlier public hearings, nor mentioned in any RBA press releases or statements to the public or to the committee. The Governor responded that:

> …it is certainly true that we do not make public announcements that this has happened. That would be a new idea to me, frankly, that we should do that.[92]

1.80 In relation to the incident at Note Printing and subsequent responses by the RBA, the committee is concerned that the matter was not reported to the committee during a previous public hearing, nor was a media release issued to inform the public and the committee that the matter occurred and was under investigation. The committee's role is not just the scrutiny of monetary policy but also includes scrutinising and holding the RBA to account in relation to its corporate governance. This was best demonstrated when the committee, during the 43rd Parliament, scrutinised the RBA over the Note Printing Australia/Securency matter.

1.81 The RBA should consider issuing a formal statement regarding this matter, setting out what corrective measures it is taking to minimise any similar incidents happening again.

Conclusion

1.82 Australia's economic growth is expected to gradually increase over the next few years at just above the decade average rate, despite the anticipated reduction in mining investment. There are signs that the Australian economy is transitioning to more balanced growth supported by a lower Australian dollar and accommodative monetary policy. Employment growth has been above average, reflecting strong growth in more labour intensive sectors of the economy, including household services. Growth in dwelling investment is expected to ease following a period of relatively rapid growth over the last year.

1.83 Inflationary pressures are expected to remain subdued, with spare capacity in the labour market and some product markets helping to keep inflation low. Improvements in labour market conditions are expected to be sustained, and the forecast for the unemployment rate has been revised downward. A gradual pass-through of exchange rate depreciation is occurring, which is expected to place upward pressure on the price of

92 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 12 February 2016, p. 20.

tradeable items such as imported goods and services over the next few years.

Mr David Coleman MP
Chair
11 April 2016

A

Appendix A — Hearing, briefing and witnesses

Public hearing

Friday, 12 February 2016 – Sydney

Reserve Bank of Australia

Mr Glenn Stevens, Governor
Dr Philip Lowe, Deputy Governor
Dr Christopher Kent, Assistant Governor (Economic)

Private briefing

Wednesday, 10 February 2016 – Canberra

Mr Chris Richardson, Partner, Deloitte Access Economics

B

Appendix B — *Sixth statement on the conduct of monetary policy*

The Treasurer and the Governor of the Reserve Bank

24 October 2013

The Statement on the Conduct of Monetary Policy (the Statement) has recorded the common understanding of the Governor, as Chairman 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 inflation.

Low inflation assists business and households in making sound investment decisions. Moreover, low inflation underpins the creation of jobs, protects the savings of Australians and preserves the value of the currency.

In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the cycle. This formulation allows for the natural short-run variation in inflation over the cycle while preserving 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.

Financial Stability

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.