COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Estimates

(Public)

MONDAY, 28 NOVEMBER 2022

CANBERRA

BY AUTHORITY OF THE SENATE

[PROOF COPY]

ECONOMICS LEGISLATION COMMITTEE

Monday, 28 November 2022

Members in attendance: Senators Bragg, Canavan, Dean Smith, Mckim, Rennick and Walsh

TREASURY PORTFOLIO

In Attendance

Senator Gallagher, Minister for Women, Minister for Finance, Minister for the Public Service

Department of Climate Change, Energy, the Environment and Water

Executive

Mr David Fredericks PSM, Secretary
Mr Dean Knudson, Deputy Secretary
Ms Luise McCulloch, Deputy Secretary
Ms Lyn O'Connell PSM, Deputy Secretary
Ms Jo Evans PSM, Deputy Secretary
Mr Simon Duggan, Deputy Secretary
Mr James Larsen, Deputy Secretary
Mr Sean Sullivan, Deputy Secretary

Corporate

Finance Division

Ms Michelle Crowther, Acting Chief Finance Officer

General Counsel Division

Ms Kate Lalor, Chief Counsel
Ms Jane Temby, General Counsel, Environment and Dispute Resolution Branch
Mr Sam Hush, Acting Branch Head, Environment Compliance Branch

Operations Division

Mr Lionel Riley, Chief Operating Officer

Portfolio Strategy Division

Ms Helen Bennett, Division Head
Ms Dana Sutton, Branch Head, Ministerial Liaison and Governance Branch

Outcome 1

Adaptation and New Industries Division

Mr Paul Trotman, Division Head
Mr Paul Murphy, Branch Head, Clean Technology Branch
Ms Nicole Mitchell, Branch Head, Climate Change Policy Branch
Ms Kathryn Smith, Branch Head, National Adaptation Policy Office

Emissions Reduction Division

Ms Kath Rowley, Division Head
Ms Alannah Pentony, Branch Head, Land and Climate Active Branch
Ms Melanie Ford, Branch Head, National Inventory Systems and International Reporting Branch
Mr Conrad Buffier, Acting Branch Head, Safeguard Mechanism Taskforce
Ms Edwina Johnson, Branch Head, Safeguard Mechanism Taskforce
Mr Matthew Ryan, Branch Head, Transport Branch

Electricity Division

Ms Beth Brunoro, Division Head
Mr Geoff Whelan, Branch Head, Electricity Markets Branch
Ms Melissa Pang, Acting Branch Head, Market Reform Branch
Mr James White, Branch Head, Renewables and Distributed Energy Branch
Ms Kirsty Gowans, Branch Head, Network Reform and Projects Branch

Mr Merrick Peisley, Branch Head, Forming Mechanisms Taskforce

Mr Paul Johnson, Principal Adviser, Rewiring the Nation

Energy Division

Mr Duncan McIntyre, Division Head

Mr Martin Squire, Branch Head, Energy Security and International Branch

Ms Leonie Horrocks, Branch Head, Energy Governance Branch

Dr Lesley Dowling, Branch Head, Industrial Energy Efficiency Branch

Ms Penny Sirault, Branch Head, Residential Energy Efficiency Branch

Ms Lila Oldmeadow, Branch Head, Energy Performance Strategy Branch

Gas and Liquid Fuels Division

Ms Michelle Croker, Division Head

Ms Miranda Lello, Branch Head, Liquid Fuels Branch

Mr Stuart Richardson, Branch Head, Gas Markets Branch

Mr Chris Videroni, Branch Head, Gas Security Branch

International Climate and Net Zero Pathways Division

Dr Sally Box, Acting Division Head

Ms Rachael De Hosson Branch Head, Net Zero Innovation and Partnerships Branch

Mr David Higgins, Branch Head, International Net Zero Branch

Ms Julia Gardiner, Acting Branch Head, Climate Negotiations and Engagement Branch

Ms Amanda Wormald, Principle Adviser on the Inflation Reduction Act, Net Zero Innovation and Partnerships Branch

Outcome 3

Australian Antarctic Division

Mr Kim Ellis, Director

Agencies and Statutory Authorities

Clean Energy Regulator

Mr David Parker AM, Chair

Mr Geoff Purvis-Smith, General Counsel

Ms Shayleen Thompson, Executive General Manager

Mr Mark Williamson, Executive General Manager

Ms Karen Najjar, Chief Operations Officer

Reserve Bank of Australia

Dr Phillip Lowe, Governor

Committee met at 10:01

CHAIR (Senator Walsh): I declare open this meeting of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of proposed expenditure for 2022-23 and related documents for the Treasury portfolio and the Industry, Science and Resources portfolio. The committee may also examine the annual reports of the departments and agencies appearing before it. For this additional hearing the committee has set 9 December 2022 as the date by which senators are to submit written questions on notice, and 27 January 2023 as the date for the return of answers to questions taken on notice. Under standing order 26 the committee must take all evidence in public session. This includes answers to questions on notice. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

The Senate, by resolution in 1999, endorsed the following test of relevance of questions at estimates hearings: any questions going to the operations or financial positions of the departments and agencies which are seeking funds in the estimates are relevant questions for the purposes of estimates hearings. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees, unless the parliament has expressly provided otherwise. The Senate has resolved also that an officer of a department of the Commonwealth shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. In particular, I draw the attention of witnesses to an order of the Senate on 13 May 2009 specifying the process by which a claim of public interest immunity should be raised and which I now incorporate in *Hansard*.

The extract read as follows—

Public interest immunity claims

That the Senate—

(a) notes that ministers and officers have continued to refuse to provide information to Senate committees without properly raising claims of public interest immunity as required by past resolutions of the Senate;

(b) reaffirms the principles of past resolutions of the Senate by this order, to provide ministers and officers with guidance as to the proper process for raising public interest immunity claims and to consolidate those past resolutions of the Senate;

(c) orders that the following operate as an order of continuing effect:

(1) If:

(a) a Senate committee, or a senator in the course of proceedings of a committee, requests information or a document from a Commonwealth department or agency; and

(b) an officer of the department or agency to whom the request is directed believes that it may not be in the public interest to disclose the information or document to the committee, the officer shall state to the committee the ground on which the officer believes that it may not be in the public interest to disclose the information or document to the committee, and specify the harm to the public interest that could result from the disclosure of the information or document.

(2) If, after receiving the officer's statement under paragraph (1), the committee or the senator requests the officer to refer the question of the disclosure of the information or document to a responsible minister, the officer shall refer that question to the minister.

(3) If a minister, on a reference by an officer under paragraph (2), concludes that it would not be in the public interest to disclose the information or document to the committee, the minister shall provide to the committee a statement of the ground for that conclusion, specifying the harm to the public interest that could result from the disclosure of the information or document.

(4) A minister, in a statement under paragraph (3), shall indicate whether the harm to the public interest that could result from the disclosure of the information or document to the committee could result only from the publication of the information or document by the committee, or could result, equally or in part, from the disclosure of the information or document to the committee as in camera evidence.

(5) If, after considering a statement by a minister provided under paragraph (3), the committee concludes that the statement does not sufficiently justify the withholding of the information or document from the committee, the committee shall report the matter to the Senate.

(6) A decision by a committee not to report a matter to the Senate under paragraph (5) does not prevent a senator from raising the matter in the Senate in accordance with other procedures of the Senate.

(7) A statement that information or a document is not published, or is confidential, or consists of advice to, or internal deliberations of, government, in the absence of specification of the harm to the public interest that could result from the disclosure of the information or document, is not a statement that meets the requirements of paragraph (1) or (4).

(8) If a minister concludes that a statement under paragraph (3) should more appropriately be made by the head of an agency, by reason of the independence of that agency from ministerial direction or control, the minister shall inform the committee of that conclusion and the reason for that conclusion, and shall refer the matter to the head of the agency, who shall then be required to provide a statement in accordance with paragraph (3).

(d) requires the Procedure Committee to review the operation of this order and report to the Senate by 20 August 2009.

(13 May 2009 J.1941)

(Extract, Senate Standing Orders)

CHAIR: Witnesses are specifically reminded that a statement that information or a document is confidential or consists of advice to government is not a statement that meets the requirements of the 2009 order. Instead, witnesses are required to provide some specific indication of the harm to the public interest that could result from the disclosure of the information or the document.

I ask members of the media to follow the established media guidelines and the instructions of the committee secretariat. As set out in the guidelines, senators' and witnesses' laptops, mobile phones, other devices and personal papers are not to be filmed or photographed. I remind everyone in the gallery that they are not permitted to speak or interfere with the proceedings or with witnesses at any point during the hearing. Security is present and they'll be asked to remove anyone who does not follow these instructions. Witnesses and senators who are seeking to table documents during the committee's hearing were requested to provide an electronic copy of those documents a day prior to the hearing so that all documents could be circulated electronically during the hearing. Please liaise with the secretariat if you need assistance.

Reserve Bank of Australia

[10:05]

CHAIR: The committee now welcomes the Reserve Bank of Australia and its representative, Governor Philip Lowe. In welcoming the RBA, the committee recognises the central bank's independence under the Reserve Bank Act of 1959, particularly in regard to its setting of monetary policy. The committee is cognisant that while the RBA does not receive annual appropriations, it does provide the parliament with opportunities to discuss its insight and performance, which the committee greatly welcomes. As such, no government minister will be in attendance at the committee while representatives of the RBA are present. On behalf of the committee, Dr Lowe, welcome to Senate Economics estimates. We understand it's the first time that you've appeared before the Senate Economics Committee in this forum. We're very grateful to you for making the time for us today. Would you like to make an opening statement, or would you like us just to proceed to questions?

Dr Lowe: Good morning and thank you for the invitation. It's the first time I've appeared before this committee. I don't have an introductory statement. I'm really here to answer your questions.

CHAIR: Thank you very much, Dr Lowe. Before I turn to colleagues, I'll give some indication of how I intend to handle the committee today. We'll start with 10-minute question blocks. At about 10 minutes, I'll let you know that you've got a final question. And as always, colleagues, we invite very respectful discussion in this forum. It's always a forum that runs well when witnesses are given the opportunity to answer questions after they've been asked a question, before another question is asked. So we'll certainly be following those rules today. With that preamble, I turn to Senator McKim.

Senator McKIM: Good morning, Dr Lowe. Thanks very much for coming in before the committee this morning. I want to start by going back to the forward guidance you issued in February 2021. I am aware of the review that the RBA has released recently—the review of your approach to forward guidance. In February 2021, you did say that the board would not increase the cash rate until actual inflation is sustainably within the two to three per cent target range, and that for this to occur, wages growth will have to be materially higher than it is currently. Do you accept that those conditions actually have not been met?

Dr Lowe: No, I don't accept that at all. Can I just take you back to our thinking. We were very clear that we were going to wait till we saw the evidence that inflation had picked up before we increased interest rates. We wanted people to understand that. Then, rightly, people were saying, 'Well, what would you require to see to conclude that inflation was sustainably in that two to three per cent range?' And our thinking was that we would need to see wages growth picking up from the low rates of 2 per cent, because we'd had four or five years where wages were growing at 2 per cent. That clearly wasn't enough to deliver inflation of two½ per cent, and we wanted to see wages growth pick up close to at least three per cent. If we're going to deliver an average inflation rate of two½ per cent, then I think wages on average have to grow at least three per cent. In early 2021, that was not the case. It was only in the first part of this year that it became evident to us that wages growth was picking up and we were confident that it would average at least three per cent over the course of this year. By the time those conditions were met, it was April or May this year, and we raised interest rates then.

Senator McKIM: Okay, but that's nominal wages. It's real wages matter to people, isn't it? Nominal wages can go up, but people's purchasing powers can still decline.

Dr Lowe: Well, of course, that's exactly right. But the job of the central bank is a nominal job. We've got to deliver you two½ per cent inflation. It'd be fantastic if we could have growth in real wages of one or two per cent a year, but that's not within my control. If we're going to have growth in real wages of one or two per cent a year, we've got to have strong productivity growth in the country. That's one reason why I keep on talking about the need to refocus on the productivity agenda—because we can only have growth in real wages over time if we get better at doing things, and that requires productivity growth and that requires reform. So I agree 100 per cent with you, but our job as the central bank is a nominal one.

Senator McKIM: You did say that it would be unlikely that would occur until 2024. I accept that's a caveated statement. But do you accept that the way that statement was broadly reported, which was without the caveats, had the effectively of inducing many Australians to take out mortgages in the belief that interest rates wouldn't rise until 2024? Now of course they're faced with seven months and potentially more of interest rate rises. Do you accept that you did in fact induce Australians to take out mortgages on the basis that interest rates wouldn't rise until 2024? And do you think you owe those people an apology?

Dr Lowe: I'm certainly sorry if people listened to what we said and then acted on what we'd said and now regret what they have done. That's regrettable. I'm sorry that happened. But if I can just take you back to the situation we were facing in 2020 and 2021, the country was in a dire situation. At the Reserve Bank we wanted to do everything we could to help the country get through that. We also had a strong insurance mindset. We were thinking, 'What could go wrong here?' And the thing that could wrong was really, really bad. We were talking about 15 per cent unemployment, a generation of young kids not being able to find jobs, people not being able to go to school and university. It was a dire time. We decided that we would do everything we could. That included the term funding facility and the bond purchase program—you know all the things we did. We also thought that, given the dire outlook, it was unlikely that inflation would pick up quickly, and we wanted to send a message that interest rates were going to stay low for a long period of time. At the time, I thought that was the right thing to do. Ex post, the economy recovered much more quickly than anyone expected and we've had to raise interest rates more quickly, and people who borrowed in those two years are now finding it much more difficult. I'm sorry that people listened to what we said and acted on that and now find themselves in a position they don't want to be in. But at the time, we thought it was the right thing to do. Looking back, we would have chosen different language. You're right: people did not hear the caveats in what we said. My language was always caveated. I thought it was clear, from the central bank kind of perspective, but the community didn't think it was clear. They thought it was clear that we weren't raising rates till 2024. That's a failure on our part. We didn't communicate the caveats clearly enough. We've certainly learnt from that, and if you've had a look at the review of forward guidance you'll have seen that we're changing our approach. We didn't get across the caveats clearly enough. The community heard 2024; they didn't hear the conditionality, and that's partly our fault. We weren't clear enough, I agree.

Senator McKIM: Thanks, Dr Lowe. I will have some questions about the TFF and some on the money printing side of things a little bit later. But I want to refer you to the speech you gave last week where you identified the higher likelihood of supply-side inflation pressures into the future, including as a result of climate change. Do you think that interest rate rises are an appropriate response to supply-side pressures?

Dr Lowe: Well, it depends. If you have a supply-side shock that pushes inflation up and the supply-side shock reverses, then you'd expect inflation to come back down and you don't need to raise interest rates. That would be a standard, textbook response to a supply-side shock. That would be the standard. The caveat, though, is if the period of high inflation leads to a shift up in inflation expectations—inflation rises and people think it's going to continue—then that gets factored into both wage-setting, behaviour and pricing decisions by firms, and then a temporary shock persists. And if it were to persist, then you would need higher interest rates to deal with it. In some countries around the world, it's clearly persisting. You've had a sequence of supply-side shocks, and price- and wage-setting behaviour has responded. Profit margins in some countries are going up and wages in many countries are rising at six per cent a year. And six per cent wage growth isn't consistent with two per cent inflation unless you have fantastic productivity growth, which no one's delivering. So it depends on what responses you see as a result of the supply shock. We're in this intermediate period now where we're unsure about what responses are going on in the labour market and pricing behaviour and how persistent they'll be. So it really depends upon the persistence of the supply shocks and what else changes as a result of that.

Senator McKIM: Thank you. I'll ask some questions around profit margins a bit later as well, Dr Lowe—just to flag that. But as a follow-up to the last question, in terms of tackling supply-side shocks or inflation driven, at least in significant part, by supply-side shocks, do you think that things like price caps or taxes targeted at those with a greater capacity to pay are more appropriate tools to tackle inflation driven by supply-side shock, as opposed to, for example, interest rate rises?

Dr Lowe: One way of tackling inflation induced by supply-side shocks is to address the supply side. At the moment there are two areas I think we could be focusing on. It's the supply of gas and electricity in the domestic market—what we can constructively do to increase the supply. I don't want to get drawn into what the right measures are, but just at the analytical level, increased supply of gas and electricity in the domestic market would be helpful. The other supply-side issue we're focused on is the supply of housing. Because the rental vacancy rate now is quite low and the population growth is picking up, I'm imagining that we'll see increased pressure on rents over the next year as population growth collides with fairly modest growth in the supply of housing. So the supply of gas and electricity and the supply of housing—if we can address those two issues, that will make a substantial contribution to bringing inflation back down over the next couple of years.

Senator McKIM: Understood. If I've got time, I've got some questions on housing as well that I'd like to ask. I've obviously got a bit to get through but I'm sure other members of the committee do too. As a follow-up to that, Dr Lowe, you've addressed supply side. But interest rate rises are designed in part to address demand in the economy—so wages. So in the context of the RBA taking action to address the demand-side pressures that you argue need addressing, don't you think that there are other tools in the toolkit, not necessarily in the RBA's toolkit but in the government's toolkit—for example, as I said before, price caps or taxes targeted at those with the greater capacity to pay—that are more appropriate tools than the blunt instrument of interest rate rises?

Dr Lowe: I don't see it as either/or. We've got demand in the economy that's putting pressure on the supply side of the economy. So demand is too strong relative to the economy's ability to produce goods and services. Higher interest rates affect the demand side, and there are things we can do on the supply side. I don't want to endorse the proposals you were just putting, but increasing the supply of gas and electricity and housing will make a difference to the price of gas, electricity and rent. We had to raise interest rates for two reasons. The first is that low interest rates were part of the insurance package. We didn't need the insurance package in the end, so we had to take back the insurance—so that was part of the story—and get interest rates back to something close to normal. And then in addition to that, we've had to increase interest rates because demand in the economy is very strong. So we took back the insurance and we've had to do a bit more because of the strength of demand. That's certainly part of the way we get inflation back down. If we can fix the supply side, that will help as well. But it's not a matter of choosing one or the other either. You've got to do both.

Senator DEAN SMITH: Welcome, Governor. Thank you very much for making your time available to the committee. Could you explain to the committee how the most recent budget has changed the central bank's inflationary outlooks?

Dr Lowe: The recent budget really has had very little effect on our inflation forecasts. Most of the improvement in the revenue was taken through to the bottom line—not all of it but most of it—and I think that was appropriate. So the current setting of fiscal policy is not impacting noticeably on monetary policy. The issue that we are focused on, and this is something over time, is the structural budget position. As a country, we've benefited over a long period of time from having a very sound medium-term structural budget position, and that gives us flexibility to respond to shocks. We've got more work to do to get the budget into a structurally strong position, but at the moment it's not affecting interest rate policy at all.

Senator DEAN SMITH: Would you characterise that as a missed opportunity to put downward pressure on inflation?

Dr Lowe: I'm not going to comment on the current budget. The best thing I think we can do to help get inflation back down is to address the supply side. The pick-up in inflation, at least half, is due to supply-side problems, and the other half is due to very strong growth in aggregate demand, broadly speaking. If we can do something on energy and rents next year, inflation will come down quickly. Managing aggregate demand isn't going to really change the dynamics there on energy and renters; it's fixing the supply-side issues.

Senator DEAN SMITH: Just focusing on one of those three elements, the housing part of your comments, how realistic is it that we might see downward pressure on rents over the short or medium term?

Dr Lowe: In the short term it's very hard because it takes a while to build houses and apartments. But the central bank always has a medium-term horizon. So I'm thinking that in the next two to three years we'll have less pressure on rents and upward pressure on housing prices if we can add to the housing stock. It's not something that's going to work in the next six months. It's not a solution to the current problem. But the high inflation, I think, is going to be with us for a number of years. So looking out over those two or three years, increasing the supply of housing will help.

Senator DEAN SMITH: Do you consider that expanding budget deficits over the medium term is expansionary fiscal policy?

Dr Lowe: In general, yes. If you're running larger budget deficits as a share of the economy, that is expansionary fiscal policy. But how material it is on the setting of interest rates really depends upon the scale of the expansion of fiscal policy. The issue, as I said before, is getting the medium-term budget back into good shape. As I said to the House Economics Committee a couple of months ago, the public understandably want all these services provided or funded by the government: aged care, education, disability care—things that the public want. And if the public want those and the government wants to provide them, then we need to find a way of paying for them. That's the main fiscal issue confronting the nation: how to pay for all those goods and services that the public want the government to provide for us.

Senator DEAN SMITH: Looking at the budget deficits over the medium term, is that helping the inflationary task or hindering the inflationary task?

Dr Lowe: I would say it's broadly neutral, because the swings in the budget deficit as a share of GDP are not that large in the out years. It's just persistent budget deficits. That's assuming the economy doesn't weaken a lot. If it were to weaken a lot, then the budget deficit would go up even more. But assuming the economy goes along the central track that we're forecasting, then we're going to see persistent budget deficits of a few percentage points of GDP. Over time, I think it would be better if we could get back into a more balanced position. I don't want to give you the impression it's a first-order issue affecting the setting of monetary policy. It's one of those background good housekeeping things that it's good to have done so that fiscal policy has the ability to respond in the future when we get hit by shocks. And we can only have that ability to respond as we did in the global financial crisis and in the pandemic if the structural position is good. It's the structural position that's my focus.

Senator DEAN SMITH: I do want to come to the risk or propensity for future shocks. You have mentioned that in your most recent speech and in some of the documents as well. But just going back to Senator McKim's question, in response to Senator McKim, you said the Australian economy had responded more quickly than expected. Can you explain to the committee what were the features that allowed the economy to respond more quickly following the pandemic?

Dr Lowe: Australia was one of the first countries to get back to the pre-pandemic level of output, and now we're considerably above the pre-pandemic level. In the UK, for example, the central forecast of the governor of the central bank is that they will not be back to pre-pandemic levels of output until the end of 2024, by which time we'll be six or seven per cent above where we were before. We've got the unemployment rate the lowest in 50 years. We've got to go back to 1974 to have a lower unemployment rate. So the economy's bounced back quickly and we're as close to full employment as we've been in 50 years. The employment to population ratio in Australia is the highest it's ever been. In other words, more Australians, as a share of the population, have a job today than ever before in our history. That's pretty impressive. Not many countries in the world are in that position. So Australia, while we've got some issues, I think is in a very strong position globally. How did we get there? Three things have helped. The way that governments around the country managed the pandemic helped. We didn't have the terrible health outcomes they had in the United Kingdom and the United States, and that has meant that people are prepared to participate in the labour market. So that has helped. The second thing is the insurance policy that the Reserve Bank and the government took out worked. In retrospect, as I said before, I think we probably over-insured; we provided too much insurance. But that's the nature of insurance. You insure against a really bad thing, it doesn't happen, and you think, 'I wish I'd taken out a bit less insurance.' That insurance involved very low interest rates and all the government spending. That created a lot of demand in the economy. Because the health situation is okay, people have been prepared to spend because they've had the income. So the nature of the insurance policy during the pandemic has helped. And the third thing that's helping is that our national income is being boosted by high commodity prices once again. I recall giving speeches more than a decade ago in the iron ore boom saying that our terms of trade—export prices relative to import prices—were the highest since the gold rushes of the 1850s and that this was a unique period in our history and we'd never see anything like it again. Well, here we are in 2022 with the highest terms of trade ever. So national income is being boosted. The insurance policy during the pandemic helped, and the health response worked. If you pull that together, we're in an enviable position relative to most other countries around the world.

Senator DEAN SMITH: I suppose the question that is top of mind for many people, Governor is: why couldn't or why didn't the RBA see such a quick positive rebound out of the pandemic? The use of the term 'insurance policy'—I'm happy to be corrected—is one of more recent times. Had the insurance policy reference been used during the pandemic, it might have given Australians a better understanding of some of that future risk that they've now seen in terms of escalating interest rates. So why was it not foreseen by the RBA? It makes perfect sense in hindsight, but your job is to see with much greater clarity than anyone else in the country the various strengths and weaknesses in the economy. So I'm a little confused as to why such a strong positive outcome was not foreseen.

Dr Lowe: It's a good question. Remember that in the middle of last year, running through to October, we had the Delta outbreak. In Western Australia it was different but in Sydney we couldn't move five kilometres from our house. People couldn't move out of their local government area, even for work, without getting a test. And in Melbourne they were locked down. That was right up to October, and it wasn't till probably November that we were getting back to freedom. So we kept on thinking it was possible that growth could come back, but then we kept on getting locked down again and there would be more outbreaks. By late last year, we thought maybe we'd get through this without further lockdowns. And then around Christmas time last year, you'll remember, we had the Omicron outbreak, and we were thinking, 'Is this going to be like Delta?' We're not experts on the health situation, so we were worried that this could be a rerun of Delta with lockdowns, restrictions on travel, and the economy being shut down again. And once it became clear that Omicron was not like Delta, we got through that okay and wage growth was picking up, we decided to move. But every time we thought things could be coming back, we got another outbreak and we got more lockdowns. When was this going to end? We didn't know. It's not our core competency. But we kept on getting more shocks and we wanted to keep the insurance going while ever that was happening. Except it would have been better if we'd understood the resilience and that Omicron wasn't going to be like Delta and that we'd come through that okay.

Senator DEAN SMITH: Actually, that's a very important point. If you had better understood the resilience of the economy that was underpinning or sitting beneath the various waves of the pandemic—again, I'm not quite convinced why you didn't see the underlying strength.

Dr Lowe: We were conscious that spending had been more resilient, but we kept on getting hit off the recovery path by outbreaks. We were quite concerned that, having come out of Delta—and that was pretty disruptive along the eastern seaboard; it was very disruptive. Then we were getting another variant. And when Omicron first came, people said, 'Well, this could be Delta all over again. We could be all locked down again in December, January and February'. I thought, well, if that's the case, the government can't keep the wage subsidy going forever and neither should it. So somehow the fiscal side had to be wound back at some point. It was responsible to do that. But if Omicron had been like Delta and the government couldn't keep the fiscal response going then we had to keep interest rates low. Clearly, if we'd known that Omicron was not going to be like Delta, there weren't going to be lockdowns and people could go about their lives pretty quickly, we would have considered a different path. But we didn't know that. I think that's the fundamental—Delta was shocking for the community. It was terrible.

Senator DEAN SMITH: I accept the point. The further we move away from the pandemic, the harder it is for people to perhaps appreciate what was actually happening at the time. I accept that.

CHAIR: Can I just ask a couple of clarifying questions. I just wanted to clarify some of the comments that you've made today and recently about inflation. You said today in answers to questions that housing and energy are out there as costs that are contributing to inflation. You used words to the effect that high inflation will be with us for years. I think last week you spoke about inflation starting to taper off. You've obviously forecasted a peak in December of CPI at eight per cent and then inflation starting to tail off a bit. Can you talk to us a bit more about some of the factors that you see contributing to a decline in inflation over the next couple of years and then I guess also just clarify where you see it going in the next year or two?

Dr Lowe: Thank you. I said inflation was going to be high for years. I should have said for some years—not indefinitely. Our job is to make sure that it does come back to the two to three per cent target over time. We're expecting inflation to peak at eight per cent later this year and then next year headline inflation to be four; then, in 2024, just a bit above three; and then, as we go out, back below three. There are three things that underlie the expected reduction in inflation. The first is the resolution of the supply problems in the global markets. We're seeing, in a lot of industry, shipping times come down and delivery times shortening. The disruptions to the supply chains which have been so prevalent for the last two years are gradually being resolved and the prices of many goods are no longer rising quickly. In fact, some are actually falling now. They rose too much when demand was very strong and supply was weak and now they're coming down. So that is going to help. The second thing that's going to help is that commodity prices have stabilised and actually come back down again. Most commodity prices are back to where they were in January before Russia invaded Ukraine. The price of oil in global markets is in the low 80s again, where it had got up to almost 120. So commodity prices have stabilised. As commodity prices stabilise and some fall, that eventually flows through the cost of production. So you don't get the big increases. Remember that inflation is the rate of change of prices. If the commodity prices are actually coming down then the rate of change of prices for some things could go negative. So that will help. The third thing that will help is the increase in interest rates. That is going to slow aggregate demand in the economy. That's the intention. Slower growth in aggregate demand will mean less pressure on capacity. So less growth in aggregate demand, the supply side fixing itself up in global markets and lower commodity prices together will bring inflation down. The two counters to that are the ones that I've already referred to: cost of energy and rents. Rents are one of the really large components in the CPI and they're now starting to move more quickly. So the other things are helping, but rents and energy are going to be working in the other direction. I think the other general point that I've been making over recent times, and other central banks are making the same point, is that the return of inflation to target will be smoother if growth in labour costs doesn't accelerate too much more. Aggregate growth in labour costs at the moment in Australia is consistent with inflation returning to target. Right at the moment, I don't think we've got a problem. Many other countries do. In the US, UK and Canada, wage growth is five or six per cent at the aggregate level. That's not consistent—those rates of increasing labour costs aren't consistent with inflation returning to target. Our rate of growth in labour costs here is still consistent with inflation returning to target. That's an important issue for us to watch what happens there.

CHAIR: Those comments have attracted some attention.

Dr Lowe: They have.

CHAIR: You're suggesting that, with inflation running or projected to run at eight per cent in December, you wouldn't want to see real wages of eight per cent in an effort to—sorry, nominal wages at eight per cent in an effort for real wages to keep up? Is that the concern that you're pointing to as opposed to, for example, people's nominal wages starting to pick up in the sort of range that used to be referred to as the RBA target range for wages?

Dr Lowe: Yes. For many years I've been complaining that wage growth was too low. We were under-shooting our inflation target. As I said in response to Senator McKim's question, wage growth was too low for too long. I've been giving public talks, and in various appearances before the House economics committee I've been saying, 'This is a problem we need to address'. So we're very glad to see it pick up in nominal wages growth. The aggregates at the moment are not particularly concerning. So that's good news. What I've been doing recently is flagging the risk that we could go too far. I don't think we're going to, but we could. I just invite you to think about the consequences of aggregate wage growth this year being eight per cent. This is kind of a hypothetical that you just raised. So let's say nominal wage growth—

CHAIR: It seems very hypothetical.

Dr Lowe: It is very hypothetical. But in many countries I'm saying wage growth is north of six. So it has happened in other countries where the labour market has got very tight and firms desperate to hire workers are paying much bigger increases. I said it's very hypothetical, but it's sensible for us to at least work through this and to draw attention to this risk. If that were to happen—if wage growth was seven or eight per cent, so real wages were maintained, then inflation next year would be six or seven per cent plus or minus a bit. Then, if workers had to keep real wages constant—wages of six or seven per cent—it just goes on and on. We were in this world in the 1970s and it worked out really badly. I don't think we're going to return to it, but in the meetings of central banks that I go to, and I talk to the governors of the other central banks a lot, this is something that everyone's talking about—this possible risk. Australia is in a better position than most others. We're not seeing that risk manifest and we had best not. I understand this is a really hard message for people to say inflation is eight and wages may be three or four, so your real wage is actually declining this year. It's a hard message for everyone, but the alternative is even more difficult.

CHAIR: Your November statement put CPI back at three per cent around.

Dr Lowe: Yes.

CHAIR: You've spoken about the supply-side challenges on energy and housing and you've talked about the factors that may see that decline from eight per cent down to three per cent. In that period of the next couple of years, you're saying that you're generally confident that inflation will decline down to that sort of level over the next couple of years?

Dr Lowe: Well, that's our job to make sure that happens. I'll just highlight a couple of other facts for you. In the last year, the cost of constructing a new home in Australia went up more than 20 per cent. That added almost two percentage points to inflation. I don't know what the cost of constructing a new home in the next year is going to go up to, but surely it won't be 20 per cent—maybe four or five, or maybe even some construction costs could come down a bit. That two percentage point contribution goes to just a fraction of that. Up until the September quarter, the price of petrol had gone up 37 per cent. In the year to September next year, I expect the price of petrol will probably be lower—who knows. But it's not going to be up another 37 per cent. So if you just take those two things out, inflation comes down. In fixing up other supply-side problems in global goods markets and reduced demand, inflation comes down as well. As long as we manage the price and wage-setting dynamics then we have a better chance than almost any other advanced economy of having a fairly soft landing. It's not guaranteed, but, from where I sit today, I think we've got a better chance than most other countries of pulling it off because the wage outcomes are still okay and the supply side here is being addressed.

CHAIR: Again, to try to clarify your comments around wages, because there's been a bit of discussion today about how things you say then get explained in the world, it's your job, hope and expectation that inflation will drop off over the next couple of years to hit that three per cent level. You don't want to see six to eight per cent real wages as that occurs because you think that will have a further impact on inflation. But when you look towards the December 2024 three per cent inflation figure, generally the RBA's target position has been for there to be real wage increases. So when we look forward over the next couple of years, is it the case that you want to see sustained nominal wage increases so that, as we get through this period, in the next couple of years we can get back to that target range of inflation and wages?

Dr Lowe: Of course, we want to see real wages growing. People get better living standards and they have more opportunities if real wages are growing. But we've got to be realistic about what's achievable when inflation is at the highest rate in 30 years. As difficult as it is, we're going to get better outcomes over the medium term by accepting some modest reduction in real wages this year. Then, by the time we get into 2024, if inflation's back to three, our expectation is that growth in labour costs would be around four and that's probably okay. So real wages and real incomes of people will be rising again as we go into 2024. But, if we seek to have no reduction in real wages this year, we'll have to have higher interest rates later on. Senator McKim asked me before about the right response to supply shocks and I said that as long as they can wash through the system without anything changing then you don't need to have a monetary policy response. But if everything changes in response to a supply shock, including wages and price-setting behaviour, then you've got to have a monetary policy response and that means weaker growth later on. So, as difficult as it is, I think the best outcome for the country is for wages growth to pick up as it has but not to go too much further, then let these supply-side problems fix themselves up and inflation will come down. Then, once again, we can come back to growth in real incomes for people. I think that's achievable. It's not achievable in many other countries, I think, because they've already gone past the point where wage growth is consistent with the inflation target. We're still there. So I'm encouraged by the position we're in. What I've been drawing attention to are the risks. I'm not saying those risks are going to eventuate or even that there's a high likelihood that they'll eventuate, but I feel in my job I have to draw attention to the risks, as unpleasant as that is. By drawing attention to them the hope is that we can avoid them.

Senator DEAN SMITH: Are those risks diminishing or increasing?

Dr Lowe: I don't know.

Senator CANAVAN: Thank you, Dr Lowe, for appearing before us today. I hope it's not your last visit to the Senate. I think your focus, as a former official in the Productivity Commission, on supply-side economics is admirable, but that's not your day job. Your day job is to control the aggregate demand side, if you like, of the inflation equation. To what extent are you and the Reserve Bank responsible for the first breakout in inflation we've had for decades?

Dr Lowe: To what extent are we responsible? As I said before, half of it is due to what's going on on the supply side and the other half is due to the COVID response. We didn't predict COVID and we didn't predict Russia's invasion of Ukraine. Both of those things have kind of pushed—

Senator CANAVAN: If I could bring you back to the demand side—obviously, Russia's invasion of Ukraine—

Dr Lowe: And then—so that's half the story—

CHAIR: Senator Canavan, can we let Dr Lowe answer the questions that are asked before we ask another question.

Dr Lowe: That's half the story. The other half is that the Reserve Bank and the government injected a huge amount of stimulus into the economy in the last two years. We did that for good reasons. Given what we knew at the time, I think it was the right thing to do. If we'd understood the dynamics of the whole situation, we probably would have done something different. But, given what we knew at the time—and that stimulus to income and the lower interest rates led to more demand, and that's pushing inflation up. So we're partly responsible for it. I accept that. But given what we knew at the time, I still think that policy response was the right thing to do.

Senator CANAVAN: I just get the feeling that the focus here on supply side is a bit of an excuse. Your speech to CEDA last week—I've had a look. You spent over 1,700 words talking about the supply side and just around 700 words on monetary policy, as I say, which is your day job. I know you're blaming COVID for it, for getting things wrong, but in March 2021 you told the *Australian Financial Review* that it was entirely possible that the non-accelerating inflation rate of unemployment might be in the three per cent range. I mean, that didn't seem to me to have much to do with COVID. You just got that horribly wrong. Obviously, the NAIRU was not in the three per cent range. In hindsight, how did the RBA get this so wrong?

Dr Lowe: I wouldn't accept that part of the story is wrong. We don't know what the NAIRU is yet. At three per cent I think we've gone beyond full employment, but it's some number around four. It's possible. We have to kind of see how this—

Senator CANAVAN: But we're not at three per cent. We've got inflation, including demand-side inflation, as you admit.

Dr Lowe: We have.

Senator CANAVAN: NAIRU is not in the three per cent range and never was.

Dr Lowe: It could be around four plus or minus a bit. We don't know. We used to think it was like seven and then five. We're chasing the actual experience. I think we can sustain an unemployment rate around four. I might be wrong on that.

Senator CANAVAN: You sound like an evolutionary economist now who says, 'What are the economic effects of the French Revolution: too early to tell'. I mean, it's pretty clear that the NAIRU is not in the three or four per cent range now. But we still don't know that, do we? And how are we setting monetary policy if we don't know that?

Dr Lowe: We don't know that, but let's not—we're setting monetary policy based on the actual inflation outcomes and our forecasts, so that's the NAIRU and the equilibrium real interest rate. These concepts that the academics like to talk about are useful frames of reference, but that's all that it is.

Senator CANAVAN: Again, you're saying the academics like to talk about that. I remember—and this article that I'm quoting from, in the *Australian Financial Review* on 11 March 2021, says that the RBA wants wage bounce before lifting rates. There was another article which said you were quoted, with the Treasury Secretary, Dr Steven Kennedy: 'more jobs can help the RBA fight the next recession'. You were using the NAIRU with Dr Kennedy to push the government to have looser fiscal settings at the time. That was exactly what was happening. I remember it distinctly. And, of course, you were also justifying the lax or the relatively expansionary monetary policy on the base of the NAIRU. This was not an academic debate. This goes to the core of how you got this wrong. I'm just a little concerned that I haven't got any evidence that the RBA now has learned from its mistakes, because there is a lot of fudging here—blame Ukraine and blame supply side when something horribly went wrong on the forecasting and predictions within the RBA and the Treasury.

Dr Lowe: Well, we did get the forecast wrong. I'm the first to admit that. We didn't predict the rebound in the economy and inflation has been much higher than we expected. We've done a diagnosis of what went wrong there. As I said, the supply side is half the story and we couldn't have predicted that. The other part of the story is, in hindsight, we did too much stimulus—in hindsight. You can have different views about whether we made the right call at the time and people will have different views about that—

Senator CANAVAN: And we all make mistakes—

CHAIR: Senator Canavan, I'm not sure Dr Lowe had concluded his answer.

Dr Lowe: I just wanted to remind you how difficult those things were in 2020 and 2021. The outlook for the country was dire. Remember, there was 15 per cent unemployment; tens of thousands of people were dead; we were locked in our homes for ages; and you weren't able to move more than five kilometres from your home. It was really scary. We decided to do everything we could to provide some assistance to the country. In retrospect we didn't need to do that. I admit that. We got that wrong. We provided too much stimulus and that's added to inflation. But it wasn't some concept of the NAIRU that was driving that. It was the idea that we wanted to do what we could to help the country.

Senator CANAVAN: Yes, but there were economists obviously out there at the time saying that there was too much stimulus, including in early 2021, and those fears were ignored. I don't want to spend all my time on spilt milk. The real question now is: given these very large and consequential mistakes are hurting Australians, do you believe the markets trust you sufficiently to fix this problem? Trust is so important to a central bank. When I speak to people in the market and to people in our country, there is a loss of trust in the RBA because you've had to backtrack on some very clear forecasts and predictions you made.

Dr Lowe: Yes, we didn't get the forecast right, but I'd say very few other people—in fact no-one—got the forecast right here either—

Senator CANAVAN: Well, I just mentioned—

Dr Lowe: There were some people saying we did too much, but I recall going to the House of Representatives economics committee and being chastised for not doing enough. Many people were chastising me for not cutting interest rates into negative territory.

Senator CANAVAN: If you'd come here, you would have had me chastising you about the NAIRU in 2021. I did that to the Treasury, but you weren't here.

Dr Lowe: In uncertain times, there's a wide variety of opinion about what the right policy response is.

Senator CANAVAN: I'll just come back to my question: do you think you are trusted to fix this problem?

Dr Lowe: I think so, yes. The expected rate of inflation as priced in financial markets over the next five years is kind of two per cent. So the people who are putting their money on the line and having to trade expecting inflation say it's going to come back. So that says that people still trust our institution. They recognise that we got the forecast wrong and they don't like the way we did our forward guidance, but they still trust us that inflation will come back to two per cent, which is the most important thing. So the answer to the question is yes.

Senator CANAVAN: I'll just move on. I will come back to supply-side issues. Dr Lowe, do you think renewable energy is the cheapest form of power?

Dr Lowe: I don't know how you measure the cheapest here. I think renewable energy is the way we need to go. As I said the other night in a speech, managing the transition is the key issue for us now. We need to go in that direction and we've got to manage the transition. If we don't manage the transition we're just going to have high and variable prices during it. It's going to be a problem for me at the central bank and a problem for the society.

Senator CANAVAN: But in the speech last week you said we could expect higher and more volatile energy prices during the transition to a more renewables-based energy supply. So, if renewables were the cheapest form of power, how come we'd end up with higher prices by investing in more of it?

Dr Lowe: Well, hopefully in the end we end up with lower prices. But that's not—we're not—

Senator CANAVAN: You don't want to plan on hope.

Dr Lowe: We're not doing this transition for lower prices. We're doing it for the health of the planet. We've got to make this transition.

Senator RENNICK: So you expect that it's going to increase prices?

Dr Lowe: I don't know in the long—it's not my area of expertise. But once we've completed this transition—

Senator RENNICK: That's what you said last week.

CHAIR: Senator Rennick, I will give you the call shortly, but you don't have it at the moment. Let's let Dr Lowe—

Senator RENNICK: I'm just holding him to account on what he said.

Senator CANAVAN: Yes, we could expect higher energy prices.

CHAIR: Thank you. Let's let Dr Lowe answer the question.

Dr Lowe: The point I was trying to make last week is we've got this existing capital stock that's used to produce energy. We've been able to do that for a long period of time and it's been stable. That capital stock that is used to produce existing energy is depreciating. We're trying to build a new capital stock and we're not getting quite the balance right there. If we don't get it right, the capital stock that is used to produce energy will come under stress periodically. We saw this a few months ago. That's the world we're living in. Building the new—

Senator CANAVAN: Can I ask for a quick clarification—

Dr Lowe: Sorry, building the new stuff while the old stuff depreciates and getting on the right path there is challenging.

Senator CANAVAN: When you say it's depreciating, it's doing that because of government decisions or policy decisions, is it not? We are making specific decisions to close plants or create an environment where coal-fired power plants and other power plants close before the end of their economic life. That's true, isn't it?

Dr Lowe: Well, government decisions and private business decisions—wherever those decisions are coming from, the existing capital stock is depreciating. We're building up a new one. But getting the balance right and making sure that we've got enough capital producing energy reliably at any given point in time is a tricky balance. When we make the transition, I think we'll be glad we've made it. But we've got to get there. The point I was making was that it could be quite a bumpy ride, and that's going to make the central bank's life harder because inflation could move around a lot more because energy prices are moving around.

CHAIR: Thanks, Dr Lowe. Before I give the call to Senator McKim, I just wanted to clarify your preferred title. I've been referring to you as Dr Lowe because you are a recipient of a PhD. But your name plate says 'Mr Lowe' and I'm advised that may be your preference.

Dr Lowe: I don't have a preference. As long as you're polite, I don't mind what you call me.

CHAIR: Senators can interpret that as they will.

Senator McKIM: You said earlier that corporate profits are going up overseas. I want to ask you what the RBA is doing to understand the role of corporate profits in driving inflation here in Australia.

Dr Lowe: What we're doing? We do quite a lot of analysis of the profit share of national income. That's very high at the moment.

Senator McKIM: A record high.

Dr Lowe: That's largely because of the record terms of trade that I talked about before. If you strip out the resources sector, the profit share has increased a little, but it's not material.

Senator McKIM: Wages share is at record lows.

Dr Lowe: Yes. That's the counterpart of the profit share being higher and high commodity prices. But if you strip out the resources sector, as best we can tell, the profit share hasn't moved that much. It's been in a fairly narrow range over recent times, so it hasn't moved that much. The issue that we're focused on isn't the profit wages share at the moment—it is the change in business psychology. For a decade a business person couldn't stand in the public square and say, 'I'm going to put my prices up'. If you did that, you'd be shouted down. It wasn't acceptable. Because you couldn't put your prices up, you wouldn't pay more in wages. So we're in this kind of world where things are very sticky. In today's world, it's now quite acceptable for business people to stand in the public square and say, 'I'm putting my prices up'. You've heard the list of reasons. We've talked about some of them already today. The community don't like it, but it's more accepting. In some cases, I think firms are taking the opportunity to put their prices up, not just to cover costs but probably to have a bit more profit as well. That would be understandable if they did that. So that shift in psychology is something that we're watching carefully. I think right at the moment it's probably adding a bit to some price pressures in some sectors, but it's not likely to be the source of ongoing inflation pressures, because profit margins can't keep widening. They might step up a bit for a while, but they're not going to keep widening indefinitely. So it's the whole shift in business psychology. We talk to a lot of businesses every month about how they're thinking about setting prices.

Senator McKIM: Did you say you speak to businesses every month?

Dr Lowe: Our staff do—about 100 businesses and business associations each month. We ask them about how they're thinking about prices. Most say, understandably, that they're passing on cost increases. A few firms, a few more than used to be the case, say, 'We're putting up prices to kind of claw back a bit of margin'. So it's something that's moving. I don't think it's going to be an ongoing source of inflation pressures, but it is putting up the pressure on some prices at the moment.

Senator McKIM: Okay, that's interesting. You say you speak to 100 businesses on a monthly basis. Does the RBA have a formal kind of mechanism or do people just ring you up out of the blue and chat?

Dr Lowe: We have a very structured business liaison program. We have a team of probably about 12 or maybe 15 people. We've got a number in Sydney, but we have officers in Melbourne, in Brisbane and in Perth and Adelaide. They have a small team in each of those cities whose job it is to go and talk to businesses, community and social services NGOs. So that's their job—to go and talk to people. They write a report every month before the board meeting, which we discuss internally, and they highlight key issues. As part of that, there's a structured series of questions they always ask, and then they have a free range of discussions and they report that back to me.

Senator McKIM: That's a very comprehensive framework to allow the RBA to engage with business. Are you hearing anything through your workers liaison program, Dr Lowe?

Dr Lowe: Our workers liaison program—that group talks to the ACTU. In years past, I've had quite a lot of discussions with the ACTU as well.

Senator McKIM: Okay. But it's not really the same formal framework, is it.

Dr Lowe: No, it's not. It's harder to have a workers liaison program.

Senator McKIM: Why is that?

Dr Lowe: Well, which workers do you pick? As I said, we talk to the ACTU.

Senator McKIM: Which businesses do you pick?

Dr Lowe: We have a way of doing it. If we could think of a structured way to do a workers liaison program that was going to be useful, I'd be more than happy to consider that. We talk with social service providers and some of the NGOs as well. In the past, I've been down to the ACTU and spoken their officers in Melbourne and senior people from the ACTU have come to see me. It's just harder to do it in a more structured way because there are 10 million workers.

Senator McKIM: Thanks. I've asked Ms Bullock from the RBA, I've asked the finance minister and I've asked the Department of the Treasury whether they'll accept that corporate profits are playing a role in driving inflation in Australia. I've asked all of those people repeatedly. None of them will go there at all. They've all refused to accept that corporate profits are playing a role in driving inflation in Australia. Is it your evidence to this committee that, in fact, corporate profits are playing a role in driving inflation in Australia?

Dr Lowe: Well, in some businesses, I think the change in psychology has led an increase in prices over and above cost. But I've got to put that in perspective. I do not think the higher corporate profits is a primary factor driving inflation. Right at the margin I think it's difficult to deny that in some cases it's a factor. It's a factor in the higher prices, but it's not going to be an ongoing factor in inflation in Australia. For corporate profits to continue to drive inflation, the profit share has to keep getting bigger and bigger every year. And there's a limit, even in our fairly anti-competitive markets, to that happening. It's a factor, but I don't want to give you the impression that it's a major factor.

Senator McKIM: Which sectors do you see that happening in?

Dr Lowe: I don't know that it's particular sectors, but it's not surprising. If demand is very strong for your product, you're going to put your prices up a bit more. You've seen it in some areas of retail and some goods and some services as well. But I don't want to point to some sector. I'm saying that because I don't think it's a first order issue. It's a marginal issue in some industries. I don't want to overplay it.

Senator McKIM: All right, thanks. That is the strongest comment I've had from all of those people that I've asked about it. But it's also, again, a heavily caveated comment that you've made. I just want to read you a comment from Paul Donovan, who is the chief economist of UBS Global Wealth Management. I think he's a pretty hard-headed economist. This is a quote he wrote in the *Financial Times* this month: 'This is the current inflation story. Companies have passed higher costs onto customers. But they have also taken advantage of circumstances to expand profit margins. The broadening of inflation beyond commodity prices is more profit margin expansion than wage cost pressures.' Is that a fair comment?

Dr Lowe: That wouldn't be how I would summarise it, partly because, when we look at the profit share of national income stripping out resources, it's not moving very much at all. It's really bouncing around in a fairly narrow range. If his assessment was correct, you'd expect to see the profit share rising significantly in a whole range of industries, and our reading of the evidence is that isn't the case. There's some increase, but it's really bouncing around in a fairly narrow range.

Senator McKIM: Robert Wright, former labour secretary to Bill Clinton has been around the block once or twice, I'd suggest. He says this: 'The underlying economic problem is profit price inflation. It's caused by corporations raising their prices above their increasing costs'. Is that a fair comment?

Dr Lowe: Again, if that were to be the case, outside of some specific businesses, you would see the profit share of national income outside of resources rising. In Australia it isn't. I mean, in the US maybe, but in Australia the profit share again, this narrow range, it's been—outside resources.

Senator McKIM: Just got one more quote for you, if you don't mind. It's from someone I'm sure you're familiar with—Adam Smith, from *The Wealth of Nations*. See what you think about this one: 'Our merchants and master manufacturers complain much of the bad effects of high wages in raising the price. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effect of their own gains. They complain only of those of other people.' Is that a fair comment?

Dr Lowe: Well, that's what he said.

Senator McKIM: It is. What's your response to that in the current context?

Dr Lowe: Well again, I'm just going back. Most business people don't like paying higher wages, do they? It increases their costs. But that's at a very—

Senator McKIM: That's exactly right.

Dr Lowe: The economists think about partial equilibrium. We just think about the partial equilibrium. You don't like paying higher wages because it eats into your profit. But, over time, I think businesses recognise that, in a productive economy, where productivity growth is rising, workers deserve a share of the productivity gains. So it's in business interest to have wages rising in real terms quickly over time.

Senator McKIM: They've been flat for a decade.

Dr Lowe: Well, they have. You know, if we'd been here five years ago, probably, I would have been talking to you about why wages growth was so weak and how it was problematic. More enlightened—well, that's probably the wrong word. There were people in the business community who were noticing this—the fact that workers were not gaining their fair share of the productivity gains was reducing support in the community for business and affecting the whole environment. In the partial equilibrium businesses don't like higher wages because it means lower profits. But in the broader general equilibrium business should be a strong supporter of rising wages, and most are. So I don't like this kind of class warfare angle. Both workers and businesses have a huge incentive for strong productivity growth and rising real profits and rising real wages. Most people in Australia share that vision.

Senator McKIM: It's not happening.

CHAIR: I can feel the supplementary questions welling inside Senator McKim, but he's kindly going to let me reallocate the call to Senator Smith.

Senator DEAN SMITH: Governor, we were talking about wages growth across the economy. You were talking about medium risks. Are you able to talk about the risks from a sectorial perspective rather than an economy-wide perspective? If there is likely to be growth in labour costs that is counterproductive, can you identify at the moment which sectors of the economy it might reveal itself first?

Dr Lowe: Our job is kind of the macro—the aggregate outcomes. We're seeing at the moment quite different wage outcomes in different sectors. In some parts of the construction sector and some professional services, wages have been rising pretty quickly. In the public sector in most states, wages are rising maybe three per cent. In the enterprise agreements that have been signed over the past six months, the average wage increase has been between three and three per cent. So the enterprise agreement stream is still eminently reasonable and public sector wage outcomes are in a three to four per cent range—no problem for anyone. There are some sectors—professional services, construction and some parts of project management—where they're growing more quickly. It's partly because there's strong demand there. But the focus of the Reserve Bank is really the aggregate outcome—making sure that, in aggregate, labour costs aren't growing at a rate that's inconsistent with the inflation target. We're going to have variation around that. That's what happens in a dynamic labour market and that's as it should be.

Senator DEAN SMITH: Is it true to say that increased industrial disputation across the Australian workplace would add inflationary pressures?

Dr Lowe: Well, it could. It would depend on how it was resolved. It might.

Senator DEAN SMITH: Meaning that the longer the industrial disputation occurred, the higher the inflationary risk?

Dr Lowe: I mean, it's hypothetical, isn't it?

Senator DEAN SMITH: Only for a little while.

Dr Lowe: Industrial relations problems can hurt the supply side of the economy, so there's less supply. Depending upon the effect of the disputes on aggregate wage growth, it could affect inflation outcomes as well. But aggregate industrial disputes in Australia have been low for a lot of years. What happens in the future, I don't know.

Senator DEAN SMITH: You can't see that?

Dr Lowe: I'm not making—it comes back to the previous discussion about our ability to forecast. I'm not going to make forecasts about what happens to industrial disputes in the future. The point I keep coming back to—

Senator DEAN SMITH: But a good insurance policy for the country would be if they remained low?

Dr Lowe: It would be good if wages growth remained consistent with return of inflation to target in a fairly painless way. How that comes about is up to the society.

Senator DEAN SMITH: Governor, am I correct to assume that you stand by your comments of last week at a CEDA address where you said, 'We will be better off if there is flexibility in our labour and product markets so that we can respond quickly and effectively'?

Dr Lowe: I certainly stand by that. I was making that in the context of broader points about how—I think the world facing central banks is going to be much more difficult in the next 20 years than it has been in the past 20 years. In the past 20 years, we really largely saw our job as moving interest rates up and down to manage aggregate demand in the economy. That was what we faced, and the supply side was actually helpful for bringing inflation down. I think that, in the next 20 years, the supply side is going to be quite difficult. Deglobalisation, changing demographics, climate change and having to make this energy transition—those things are going to make us subject to more supply or more price shocks. And in a world that's more volatile and more uncertain, we've got to be flexible. Who knows what the future is going to bring. But we need to be flexible.

Senator DEAN SMITH: So anything that might introduce rigidity into Australia's industrial relations regime would be seen as making your job more difficult?

Dr Lowe: I'm not going to comment on whether this is an issue that's currently before—

Senator DEAN SMITH: But the converse of flexibility surely is rigidity.

Dr Lowe: Well, I don't know whether the industrial relations changes are going to make things more flexible or rigid, and that's just one perspective. But the general point—

Senator DEAN SMITH: We can reflect on that at a future hearing.

Dr Lowe: But I think the general—I was making a general point, which I hope is not controversial, that in a world that's very variable and uncertain, we've got to have flexibility here.

Senator DEAN SMITH: It's not controversial to me.

Dr Lowe: But we've got to have wages that are rising on average probably three per cent, as long as we can generate decent productivity growth. So there are competing interests here.

Senator DEAN SMITH: Governor, just to be clear, are you concerned about a future wage price spiral?

Dr Lowe: I've drawn attention to the risk in the hope of avoiding it. Just to be kind of clear, I know it's a very unpleasant message, but just to set out—

Senator DEAN SMITH: I think it's an important risk.

Dr Lowe: I'm not concerned it's going to happen. We're not forecasting it's going to happen. But I am saying that, if it did, it's going to be quite difficult. Let's avoid it. That's my only point here.

Senator DEAN SMITH: There have been a number of surveys that have been released recently that look at wage growth across the medium and small business sector. Employment Hero's survey results suggested there would be 8.4 per cent wages growth. Another one called Xero said there'd be 5.2 per cent wages growth across some sectors. How does that relate to the feedback you are getting through the business liaison unit mechanisms that you talked to Senator McKim about?

Dr Lowe: We ask businesses what their expected increase in wages is next year and many are saying—they used to say two. Now they're more likely to say three to four. So there's been a step up, and I welcome that. We track all these business surveys, and you highlighted a couple. You've got to be careful in interpreting these, because there's often quite a lot of compositional change. So if you get more workers with higher salaries then the aggregate wage increase is higher. We've got staff who work on a number of—look at these surveys and try to control for the compositional things. But I think many businesses are gravitating now to around three to four.

Senator DEAN SMITH: And that is aligning with the wages price index methodology that the RBA uses?

Dr Lowe: Well, the ABS constructs the—

Senator DEAN SMITH: The WPI, yes.

Dr Lowe: Yes, so that's been increasing in around three, but that doesn't control for changes in the composition of jobs and that's for a fixed basket of jobs.

Senator DEAN SMITH: Where I'm getting to is: when we look at the WPI, are you comfortable or is the RBA comfortable with that as a form of a measurement or would you like to see some changes in the methodology?

Dr Lowe: No, I think as a statistical concept it's perfectly sound. You take a fixed basket of jobs and say, 'What's the average wage increase in that basket'. That's perfectly fine. We have another measure of wages from the National Accounts, which picks up all the bonuses and grade inflation and one-off payments that people get. So we've got that measure as well. That shows faster increases in the WPI because people are getting promotions or grade inflation or title changes and higher pay. So we've got the National Accounts measure and, as you drew attention to, we've got increasingly from the banks and some of the employment agencies these survey measures as well. Each of these measures has its pluses and minuses. We kind of put them all together and try and make a judgement about whether the current trend is sustainable. Our conclusion at the moment is that it is, but we don't want to go too much further.

Senator DEAN SMITH: Thank you. Just in your speech to CEDA, you also mentioned the productivity agenda as being very important. What does a future productivity agenda look like from your perspective?

Dr Lowe: Again, this is not my area of expertise.

Senator DEAN SMITH: We are making the most use of this very valuable opportunity, Governor.

Dr Lowe: The point I was making is that, in the end, growth in real wages and real profits comes down to doing things better. And productivity growth has slowed in the country.

Senator DEAN SMITH: Well, internationally.

Dr Lowe: Internationally. We had almost a golden period from the early 90s to the 2000s, where productivity growth was almost two per cent a year. That generated a huge increase in people's living standards. In the last decade it's averaged a bit less than one. Cumulate that over a decade and you've got one versus a 25—sorry, a 10 per cent increase in productivity over a decade versus 25. That's a big difference to the size of the economic pie that we have. So the question I think we all need to focus on—and I don't have the answers here—is what we can do to get productivity growth back above one per cent. We have a Productivity Commission. We have a number of think tanks and the other state productivity commissions as well. The IMF and the OECD have all written fantastic reports. I'd make the observation that most of the things they highlight are politically contentious and difficult, but there's no shortage of ideas there.

Senator DEAN SMITH: But not impossible?

Dr Lowe: Not impossible with the right focus. It's not just a matter for government; it's a matter for business to do things better as well. So it's challenging. But all the things that are in these reports—many of them I look at and I think, 'Well, that'd be sensible'. But it's difficult. It's difficult for you. It's in your lap, not mine.

Senator DEAN SMITH: So, Dr Lowe, you can see a second golden age?

Dr Lowe: I am by nature optimistic. I think that's at the moment backed up by two things. I think Australia does have, once we make this energy transition, tremendous possibilities there that we can take advantage of. The second reason I'm optimistic is technology. There's been tremendous advancement in the development of the tools of science, the use of information and new data processing capabilities. I think that, over time, better science and better information technology will deliver stronger productivity growth. But we've got to get the policy settings right in both the energy transition and technology data and training. If we can do that—there are a whole bunch of other issues that these reports identify. But they're the two that I would—

CHAIR: Senator Smith, I'm going to go to Senator McKim, who is at the mercy of the bells.

Senator DEAN SMITH: I've got no problem with Senator McKim having a fair go, particularly given he played a big role. But normally we would rotate. Given there are more senators on the coalition side it wouldn't be equal between coalition and Greens. I'm happy for him to go now, but I'm just mindful that—

CHAIR: That's fine. Senator McKim has advised me that this call may exhaust his questions and he's in the room.

Senator McKIM: The emphasis is on 'may', Chair. I thank the committee. Dr Lowe, just quickly, on wages, we sort of touched on it in our previous exchange. In June, you said three per cent is the kind of anchoring point that you'd like people to keep in mind. I presume that's still your view.

Dr Lowe: Let me just explain why I said that. We're supposed to deliver for you an average inflation rate of roughly two per cent. I hope we can deliver or the country can deliver at least the one per cent productivity growth that we were just discussing. So two plus one is three. So I think that's a reasonable benchmark to keep in mind for steady state growth in nominal wages, and we can vary around that from year to year. But that's a reasonable anchoring point.

Senator McKIM: Given that, you're not forecasting inflation to get back to that mark until 2024 at the moment on your latest forecast. So what you're basically saying is that real wages need to go backwards for at least the next two years. Is that right?

Dr Lowe: No, I'm not saying they need to.

Senator McKIM: But on your comments they will.

Dr Lowe: On our central forecast, growth in labour income per hour worked is going to be probably around four per cent in 2020. There are people getting bonuses and other supplements to their income. I think it's quite likely that wage growth will pick up to four per cent, and that's perfectly okay—three isn't a ceiling or a floor. I think of that as an anchoring point, and we can vary around that. Of course, when we've got the lowest unemployment rate in 50 years, it wouldn't be surprising if we're above that anchoring point for what we should be.

Senator McKIM: Well, inflation is running quite a bit above that at the moment.

Dr Lowe: Yes, but let's say aggregate wage growth goes to four, inflation goes back down to three, then we're back in 2024 into a world of real wages growth again. We've focused a lot on wages. We share your ambition to have real wages rising and people to have jobs. They're our two—it's going to make the society a much better place if people have got jobs and real wages are rising. We've got a role to play in that. But I just don't want you to have the impression that we're against wages rising. We're not.

Senator McKIM: I guess, Dr Lowe, we're in a situation where real wages now are where they were a decade ago. They haven't gone up at all. We had a period of very low inflation and a very low interest rate context over the last decade. Real wages are effectively exactly where they were a decade ago. The government's forecasting it to go backwards again this year, and in the four out years of the budget they're not projected to grow again. So that will be 14 years of flatlining wages in real terms during both low inflation and high inflation scenarios. We hear a lot from you and the Reserve Bank which, I would argue, is you jawboning down wages. When are you going to start jawboning down corporate profits a bit more?

Dr Lowe: Well, I don't accept your characterisation.

Senator McKIM: You don't?

Dr Lowe: Up until the pandemic, I gave lots of speeches saying wage growth is too low. We need to do something about this. I gave one speech, many speeches, saying this was damaging our sense of shared prosperity or the collective prosperity, because the economy was doing well and people weren't seeing their real incomes rising, and that was damaging. So I don't accept your characterisation about how the Reserve Bank has viewed this. We're talking about this now because I want to guard against the outcome of the high inflation becoming entrenched or highly persistent. If that happens, we're back into the world of—your very first question about how we respond to supply shocks. The answer to my question is if there are second-round effects from them, we raise interest rates. That will cause unemployment to go up and a recession, so as to lose the hard-won gains in unemployment. So I don't accept your characterisation. I share your ambition to have real wages rising.

Senator McKIM: Thank you. You said earlier today that you thought one of the responses to some of the supply-side issues that you just mentioned and that we spoke about earlier was for an increase in the supply of gas. Later on today you've said that managing the transition to renewables is a key issue. How do you square those two comments? I guess isn't the gas thing—the issue there is the cost of gas; it's not the supply of gas and not the quantity of gas supplied.

Dr Lowe: Well, price is determined by the balance of supply and demand, so—

Senator McKIM: Not always.

Dr Lowe: Well, you could—there are other ways of coming at this, but in most cases—

Senator McKIM: It's a heavily regulated market.

Dr Lowe: This is not my area of expertise. I was making the point earlier that electricity prices are going up a lot next year, and that is going to impact inflation. We can do something about increasing the supply of electricity. Over the medium term we've got to make the transition. As I said before, it's one of Australia's comparative advantages, I think, once we make that transition. But we've got to get there. My concern is that, if the path we take to get there leads to a lot of volatility in prices, it actually could reduce the community's acceptance of the need to make the thing. So we've got to manage the transition, and having a reasonable price of gas for a while is part of that, both in terms of job and I think getting community acceptance of the transition we have to make. So there's a short term and a long term there.

Senator McKIM: Sure, I do accept that supply and demand holds true in electricity. I actually don't accept that it does in the gas market in Australia at the moment, just for what it's worth. But can I ask you a broader question about climate change. We're cooking the planet at the moment—there's no doubt about that at all. Do you think that monetary policy should be directed to help fund the transition to a low-emission economy?

Dr Lowe: No, I don't. My job is to deliver for you an average rate of inflation of two per cent and try and get the economy close to full employment. I set the short-term interest rate. I don't really have many other instruments. While I like—I don't think there's much chance of the short-term interest rate being used to—I just don't know what else—

Senator McKIM: Can I respond to that?

Dr Lowe: Yes.

Senator McKIM: Section 36 of the Banking Act gives the RBA power to direct loans where it is necessary or expedient to do so in the public interest. I mean, you've just printed hundreds of billions of dollars. You've accepted that maybe that was overcooked a little bit. That's a paraphrase, not a direct quote, obviously. Are you aware of that power that you've got in section 36 of the Banking Act? Why hasn't and won't the RBA use that power to actually direct credit into more productive sides of the economy rather than the speculative side of the economy in terms of housing prices, which was actually turbocharged by your over-stimulus during the pandemic?

Dr Lowe: I am aware of that provision. It's one of those leftover—

Senator McKIM: That's a tool you've got.

Dr Lowe: Well, it's a leftover provision that didn't ever get—

Senator McKIM: It's in the act.

Dr Lowe: It wasn't—when we moved to the current macroeconomic policy framework and APRA became the bank supervisor, that provision was kind of left and never addressed.

Senator McKIM: It's still there.

Dr Lowe: It is there, but the idea that the Reserve Bank would now start directing credit policy of particular industries—that's not our job.

Senator McKIM: Who says?

Dr Lowe: Nor should it be. And then, once you've started that—people have put to me to support manufacturing in the country and infrastructure. So all of a sudden the Reserve Bank is here saying, 'Well, we're going to—people sitting in Martin Place can direct the allocation of credit and economy'. I think that would be a backward step. That's what happens in—

Senator McKIM: I think it would be tremendous, myself.

Dr Lowe: That's what happens in centrally planned economies. It typically doesn't work out that well.

Senator McKIM: Might I say, Dr Lowe, the laissez faire approach is actually cooking the planet as we sit here today. I think it's got a lot to answer for. I think over time you will see centralisation of some of these things. I think that would be actually good.

Dr Lowe: Well, let's hope we can deal with the planet issue without the Reserve Bank becoming responsible for—

Senator McKIM: Well, I think the Reserve—

Dr Lowe: credit allocation in the economy.

Senator McKIM: Well, just on that, if I might, I'm not sure if you've read all the submissions to the review that's currently underway of the RBA, but I do direct you to my submission and my suggestion that a fourth legislated objective be inserted into the act, which is that the RBA actually play a role in responding to the climate and ecological crisis that we are currently facing.

Dr Lowe: Yes, I've seen that. It won't come as a surprise to you that I don't support it, because we've got enough to do with controlling inflation and helping full employment. The tools that I have—while I share your ambition on climate, we've got to be realistic about the tools we have. We're doing what we can with the instruments we have. We're working with APRA on the risk assessments. We're working with ASIC on improving disclosure so the private market can do its job more effectively. We're looking at the carbon footprint of our own operation. So we're doing what we can with the tools we have. I think there are better ways of the society addressing this rather than the Reserve Bank going in a completely different direction.

Senator McKIM: Thank you.

Senator RENNICK: Given you've said earlier on today in your comments that there was a lot of certainty in early 2021 or in 2020-2021 around COVID, why did you come out and say that you wouldn't lift interest rates until 2024 when there was so much certainty, and why should you keep your job? In that context, who exactly are you accountable to?

Dr Lowe: A few things: we never said that we wouldn't raise rates until 2024. That's how it's widely interpreted. What we said was that we wouldn't raise rates until inflation was sustainably in the two to three per cent range and, given all the uncertainties, we didn't expect that to be until 2024. So it was a conditional statement. This is when we'd raise rates on this condition. We expected this condition to be met then. So that's what we said. I accept that people interpreted that as that we wouldn't raise rates until 2024, but that's not what we said. Who are we accountable to: we're accountable to the parliament and to the Australian people. I'm here today as part of that accountability exercise. I go to the House of Representatives economics committee as well, twice a year, where I answer their questions for three hours, as I'm doing today. So that's the accountability mechanism.

Senator RENNICK: I'll take that. I've only got five minutes, so I need to keep going. You said also a couple of times today that the supply side should fix itself. I know that one of the mandates of the RBA is price stability and currency stability. Ultimately, inflation is a product of supply and demand. I'll just pick up on one of your most recent comments today, which was that you're not in the business of supplying credit; you'll leave that to the private market. Yet that's exactly what central banks do. You give credit to the banks—in particular, the Federal Reserve and the ECB have printed trillions of dollars in the last two decades and then they hand it out to the prime banks and let the prime banks spray it around. What's wrong with using that section 36 of the Banking Act to actually let governments lend to governments and not waste money on a margin that the private banks always use? I mean, surely it's our own currency. Why are we then paying private banks that net interest margin to use our own currency or, even worse, using foreign currency and paying interest on foreign currency when we have the ability to issue credit in a responsible way? I'm not talking about lending to private markets here or the private sector. I'm talking about government debt—things like state debt. Why does the state—if you take the Belt and Road, for example, with the Victorian government. Why do they have to borrow from China when they should be borrowing from our own central bank?

Dr Lowe: There are a few issues there. Australian governments don't borrow from the banks, so they're not paying a bank margin.

Senator RENNICK: They buy bonds on—

Dr Lowe: Well, they pay a market rate of interest on the bonds—

Senator RENNICK: Exactly, which includes the margin.

Dr Lowe: and they have to pay interest. They pay the market rate of interest. This is back to the same kind of response to Senator McKim's question. I think it would be a retrograde step for the Reserve Bank to be sitting here making decisions about allocation of funding. We could do climate change; we could do infrastructure; we could do advanced manufacturing; we could do building hospitals. Then the Reserve Bank becomes the arbiter of who gets credit in the economy. The better way of doing it is for the governments to make decisions about where they want to spend money and then to raise the money in the capital markets. Ultimately there's no free lunch here.

Senator RENNICK: I agree with you—

Dr Lowe: There's no free lunch.

Senator RENNICK: No, but there is a margin. Banks have a net interest margin. I've been a treasury accountant at a bank. I know how it works. I agree with you. It's not up to the RBA on what decisions they make. But if parliament decides that, on central infrastructure like bridges and roads that are an asset that generates a return, the RBA can lend or issue credit within an infrastructure bank—I mean, companies go out and issue shares. They don't always go and issue new equity. They don't always go out and borrow money. If we've got an increase in population here that's increasing demand, we need to increase the volume of supply. The 1937 banking royal commission actually said central banks should control the volume of money in the system or have an oversight to it. You're completely washing your hands of that. To me, it's absurd that a government doesn't control—it just wants to outsource money supply to foreign banks.

Dr Lowe: The Australian government doesn't outsource money supply. We control the money supply.

Senator RENNICK: You control qualitative easing. You don't control—

Dr Lowe: If you just think of a world where we have accepted your proposition, the government wants to spend money and the Reserve Bank just gives it the money, that's—

Senator RENNICK: That's not what I'm saying. That's not what I said. Please don't put words in my mouth.

CHAIR: Senator Rennick, there's been quite a lot in your questions, and I think the governor is attempting to answer them, so we might just let him give an answer for a minute.

Dr Lowe: Let's say, in this hypothetical world, we would lend the government money. Then we would have to charge an interest rate and we'd charge the market interest rate. It would be the same as the—if we were lending 10 years, we'd charge the government the 10-year bond rate. So it wouldn't lower the government's cost of financing. It would just inject the central bank into the whole process. If we decided to lend to the government at below market interest rate then we're providing a subsidy. I don't think that's appropriate. And which projects would we provide the subsidy for? It's better for the government to go to the market and to borrow. There's no way that we can provide cheaper funding in the end. It's not the job of the central bank to subsidise government finance. If you do that, you end up with inflation.

Senator RENNICK: You're subsidising private banks. That's a bit hypocritical coming from you, because you're subsidising private banks. You've just lent $188 billion to our private banks here in Australia at 0.15 per cent and said to them, 'You don't have to repay it until 2024'. So they are creaming it. They're creaming billions of dollars. So you're hypocrite when you say that. Sorry, but—

CHAIR: Senator Rennick, that's not appropriate.

Senator RENNICK: Okay, I withdraw that comment. But that conflicts with what you just said.

CHAIR: Do you have a question?

Senator RENNICK: The question is: why do you then think it's okay to subsidise private banks? That's what happens with the Federal Reserve—they lend out to foreign banks. Why is it okay then for the RBA to subsidise private banks and not use quantitative easing, which is what effectively central banks in other countries do?

Dr Lowe: Well, we did undertake quantitative easing. We bought a couple of hundred billion dollars of bonds. During the pandemic, we thought the right thing to do was to pass the low cost of funding to banks so that they would pass it on to their customers.

Senator RENNICK: So you're subsidising banks—that's exactly my point.

Dr Lowe: We were not involved in credit allocation at all.

Senator RENNICK: And I don't think you should be.

Dr Lowe: No, we shouldn't be. We wanted, during the pandemic, as part of our insurance policy, to make sure the interest rates for borrowers were as low as they could possibly be to give people extra cash flow.

Senator RENNICK: So you accept that you subsidise private banks?

Dr Lowe: For a short period there during the pandemic, I thought or we thought that was the right thing to do.

Senator RENNICK: So you can subsidise private banks and not the taxpayer. Thank you. I'll take that as a comment.

Senator DEAN SMITH: If we could just change tack, Governor, and turn now to the review of the RBA, there's been some media commentary about the worthiness or otherwise of setting up an alternative panel around rate decisions. Rather than ask your personal view on that—I'd like to, but I guess you'd probably be disinclined to do so—what are the strengths and weaknesses of that approach?

Dr Lowe: Well, what's under consideration, I think, by the committee, is a separation of responsibilities for governors from monetary policy. So at the moment the Reserve Bank board is responsible for setting interest rates. Everyone understands that. But the Reserve Bank Act says that the governor manages the bank and the Reserve Bank board has relatively little oversight in terms of the management of the bank and in terms of the way we do projects and resource allocation within the institution. Some people look at that and say we'd be better off with a dual system where you have a governance board, which looks much like a corporate governance board, and then you have another group of people deciding on interest rates. That model works in some other countries. Whether it'd be better than the one we have now, people will have different views. What we've got now, I think, works well. These other models in other countries work well as well. For me, the main issue is: is it worth the cost of transition. Both models can work fine. If you were writing the Reserve Bank Act today, you wouldn't say the governor manages the bank with no details about how the board oversights me. That wouldn't meet the current standards of corporate governance if you were drafting legislation today. In 1959, people thought that was the right thing to do, and it's worked well for more than 60 years. But that's something that the committee is looking at. I don't have a strong view one way or the other, other than, if we are to change the model, there are transition costs. You'd want to make sure that the transition costs—the benefits are greater than the transition costs. It's not clear to me that they are.

Senator DEAN SMITH: Can you expand on what some of those transition costs are?

Dr Lowe: Well, first of all, you'd have to pass legislation through this building. That may be easy or maybe not, I don't know. That's in your hands, not in mine. Then you appoint a whole new group of people to the board of the central bank. People outside the institution may say, 'What's this about? Is it somehow reducing the independence of the Reserve Bank?' So there'd be discussion of the motivation of this. That could be handled, but it could also be damaging. You'd have to get people used to the new model. We've had a model that's worked well for 60 years. People understand it. So change—people say, 'What's this about?' What I know is that both models can work fine, but to get from one to the other can be problematic. And it's really up to the parliament—first of all the government and then the parliament as to whether they want to change the Reserve Bank Act. The Reserve Bank Act isn't perfect, but to make it perfect you've got to go through a process. Whether that's worth it, I don't know.

Senator DEAN SMITH: One of the criticisms of the rate-setting approach in recent times has been what some people have characterised as the poor communication. Does this alternative model necessarily fix that problem?

Dr Lowe: No, because you'd have kind of a separate group of people who are looking and making sure that I'm managing the bank appropriately and another group of people—maybe the same people we have now—setting interest rates. So it wouldn't go to the communication issue. It's really kind of should I, as the governor, have more oversight from the board. That's the issue.

Senator DEAN SMITH: Could it aggravate the communication problem?

Dr Lowe: We're now in the world of hypothetical.

Senator DEAN SMITH: You're a forecaster, Dr Lowe.

Dr Lowe: Not a very good one.

Senator DEAN SMITH: We're hoping that will improve.

Dr Lowe: In the annals of history—there's a reason—the bank's historian and others have looked at this. There's a reason why we have the legislation of June 1959. It was politically contested over decades about whether the governor should chair the board, whether it should be just what the responsibilities of the board would be. So there's a huge amount of political history in the 30s, 40s and 50s on this issue. To its wisdom, and I would say to its credit, the parliament in 1959 settled on a system that stood the test of time for 60 years. You can come to a different system, but I think the wisdom of the legislators in 1959 was profound. Most central banks have had to rewrite their acts multiple times. We've got something that has stood the test of time. I'm not advocating that the parliament spends a lot of time rewriting the central bank act. If you can improve it, thank you. But you want to make sure the improvements are solid because there will be costs to making a change.

Senator DEAN SMITH: Dr Lowe, in your earlier comments, you talked about the stimulus of the bank and the stimulus of government. Mr John Howard recently characterised the government stimulus measures as bipartisan. Would you agree with that characterisation?

Dr Lowe: That was my understanding. They passed and they also had the support of the states. I attended the National Cabinet meeting many times and with premiers of both political persuasions and there was broad acceptance of the direction. We all wanted—people can forget this now, but we were all scared for the country and we all wanted to do what we could to help. I knew at the Reserve Bank that there was a risk that we could do too much and we'd have to take it back, and that would be embarrassing, as it's turned out to be. But I thought that was a risk that was worth taking. I'd rather do too much than too little. If I did too much, you could take it back—embarrassing. But, if I did too little, the country would have paid a very, very heavy price—kids not having jobs for years; unemployment being high; businesses falling over left, right and centre. So I thought it was the better thing, thinking about whether to do too much or do too little. I thought it was better to do too much and take it back. It's embarrassing, but the government was broadly of the same view: do what we can to help people, because it was terrible.

Senator DEAN SMITH: Dr Lowe, if I understand your CEDA speech, in doing too little, the scars could have been more enduring than doing too much and then having to make some corrections.

Dr Lowe: That would be my view. In retrospect, as I said, we did too much and that's caused inflation, but it's also meant that the unemployment rate is at a 50-year low and that the employment to population ratio has never been higher. Youth unemployment is the lowest it's been in decades. We can forget about that. We shouldn't forget about it, though, because most people in Australia who want a job can get one—maybe not the job they want, but most people in Australia who want a job can get one. We haven't been able to say that for 50 years. So, sure, we'll focus on the legacy of high inflation, which is a problem, but there is a positive legacy in the labour market. In retrospect, we did too much, but at the time I thought it was the right thing to do, because better to do too much and take it back than not do enough.

Senator DEAN SMITH: Thank you.

Senator CANAVAN: I just wanted to go to the bond purchase program. First of all, what's the current estimate of the mark-to-market losses from the bond purchase program?

Dr Lowe: Well, you know, the accounting loss was 36 billion for the last financial year and bond yields have come down maybe 10 basis points since 30 June. So the loss is slightly smaller, but just a couple of billion smaller.

Senator CANAVAN: Have you evaluated the merits of an early exit of the bond purchase program—in particular, selling some of the bonds you bought during COVID?

Dr Lowe: We've exited—we're not buying the bonds, obviously.

Senator CANAVAN: No, I know, we still hold them I believe.

Dr Lowe: The issue is whether we should sell the bonds. We've thought about that, but I think the better strategy is just to let these bonds roll off over time. It doesn't change the valuation loss. We've already—

Senator CANAVAN: Well, it depends where interest rates go, obviously. There's a risk by holding them, of course.

Dr Lowe: There is—there's a risk by holding them.

Senator CANAVAN: I just note that other central banks have done this. They have unwound their positions and sold. So why—

Dr Lowe: Well, they've talked about it.

Senator CANAVAN: isn't the Australian Reserve Bank doing it?

Dr Lowe: The Reserve Bank of New Zealand is in the process of selling some bonds, and maybe the British will, but they're on a kind of different path. But the Americans haven't. The bank of Japan, the ECB and the Bank of Canada—most central banks are in a world now where they're just going to let the bonds roll off over time. Otherwise, we're kind of selling bonds into the marketplace when the AOFM is selling bonds as well. I think it's better to just have this roll off in the background.

Senator CANAVAN: But in the context that we're trying to tighten monetary policy now and we're trying to somewhat restrain the speed of the economy to bring down inflation, wouldn't this be another tool to help do that? Buying bonds was expansionary during COVID. Now we know we went too far, so why not sell them now to offset those mistakes we made and add to the contractionary policy settings we're trying to achieve?

Dr Lowe: Yes, I understand the question. One consideration is that the government, the AOFM, is also selling bonds at the moment, aren't they, to finance the budget deficit. So you've got two kind of—then you have the Reserve Bank and AOFM both issuing into the marketplace at the same time. That could complicate the AOFM stance and we don't want to do that.

Senator CANAVAN: Well, we've already got our hands dirty here. We've passed that Rubicon. You are an active participant in the government bond market. You've bought a lot of bonds—

Dr Lowe: We have.

Senator CANAVAN: and you hold still a lot of bonds. So I just wondered—you've obviously got a decision not to sell them at this stage and to hold them to maturity. But, if we're not doing that form of contractual monetary policy, doesn't that mean the cash rate has to be higher than otherwise? You've got a certain target and you want to get inflation down to a certain level. If you're not going to use this tool of selling the government bonds you own to help bring down inflation, you'll have to raise the cash rate higher than otherwise to achieve that objective.

Dr Lowe: I think it's pretty marginal. Our estimate is that, during the pandemic, buying all those bonds probably reduced the 10-year yields by 35 or 40 basis points.

Senator CANAVAN: So does that mean that selling them now would help alleviate a 35 to 40 basis point increase in the cash flow?

Dr Lowe: No, if we started selling the bonds now, that would obviously force the bond yields up.

Senator CANAVAN: And that's what you're trying to do, obviously, to a certain degree, by putting the cash rate up.

Dr Lowe: We're not at the moment trying to get the bond yields up, but during the pandemic we saw a benefit from buying the bonds, getting the bond yields down and getting the exchange rate down.

Senator CANAVAN: Well, when I put this to Ms Bullock at estimates, she seemed to indicate that about a half a percentage point, she felt. I don't know where that figure came from. But you don't have any analysis of what amount of monetary policy settings and what amount of cash rate rises a sale of the government bonds would alleviate or would stop? That hasn't been done?

Dr Lowe: What we've done is the effect on the government bond yields on the three to 10-year part of the yield curve. If we were to sell the bonds, we'd have higher bond yields of 30 to 50 basis points, probably. I just think it's better to—well, at least the consensus amongst the central banks at the moment is just to let these bonds roll off and focus monetary policy once again on the short-term interest rates—to go back to that world. I accept that there's an alternative way of doing this.

Senator CANAVAN: In your speech to CEDA last week you pointed out that, given where commodity prices are right now, we would probably expect a significant—or an increase. We haven't really had an increase in resources investment as a share of nominal GDP. Definitely that was our experience in the last commodity price boom. What do you think are the factors why we are not experiencing an uptick in resources investment, given these high prices, and is there anything that can be done to help achieve that, especially given the comments you made earlier about the need to increase productivity and increase our capital stock to do so?

Dr Lowe: I don't know the answer to that. There are various explanations that I've heard. People don't believe these high prices will be sustained. They'll come back down again. But they've been sustained quite a long time now. Particularly given what's going on in China, there's a lot of uncertainty about the direction of the Chinese economy, which is ultimately very important for commodity prices. So given the uncertainty about China and the possibility prices come down, firms don't want to invest more money—

Senator CANAVAN: You don't think ESG—

Dr Lowe: and it's a brave board at the moment that's going to commit a billion dollar investment to invest in hydrocarbons. And China and these prices may not go sky high together. Just sit on our hands for a while and see how things develop—that's the mentality of it.

Senator CANAVAN: Thank you.

Senator BRAGG: You said last year that you thought Stablecoins should be backed by high-quality assets and meet high standards for safety and security. What mechanism do you think there should be to regulate Stablecoins?

Dr Lowe: I'm hoping that over time, a regulator regime will be put in place so that Stablecoins can exist, people can have confidence in them and they can be used to promote financial innovation. How do we get there? Well, this building has to pass legislation. We don't at the moment have adequate legislation to deal with stored value instruments and then Stablecoins. On stored value, I've written reports to the previous Treasurer, and I've discussed with the current one, about the importance of putting in place a regulatory regime there and that can be used for Stablecoins as well. So I would encourage you and the parliament to turn your mind to putting in place a regime to do that.

Senator BRAGG: Why do you think it's taking so long?

Dr Lowe: I don't know. It's a matter for the government and the previous government. I mean, it's complicated to legislate, but some other countries have done it. It's complicated stuff and you've got a busy agenda in this building. But I encourage you—there's a whole bunch of issues in the payment space that I encourage the House committee and your committee to turn your minds to, because Australia has potentially a big advantage here. But we've got to put in place the legislative background and we haven't got it yet.

Senator BRAGG: In relation to the Chinese central bank digital currencies, which are basically the major example of CBDC so far, what sort of advice have you given to the government about the security and economic risks that this digital yuan places at our doorstep?

Dr Lowe: I personally haven't given any advice to the government on that issue. Maybe my staff have discussed with people in Treasury about it, but I don't know what discussions they've had. But that's not something that kind of gets discussed, at least at my level.

CHAIR: Thank you, Senator Bragg. Thank you very much, Dr Lowe, for coming in and answering our questions today. I also thank the senators for participating in the forum today. I again acknowledge the independence of the RBA but note also that you do give us these opportunities to ask questions of you and we very much appreciate it.

Committee adjourned 12:00