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Review of the Reserve Bank of Australia Annual Report 2007 (Second Report)

House of Representatives Standing Committee on Economics

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Chair's foreword

On 2 September 2008 the Reserve Bank of Australia (RBA) announced a 25 basis point reduction in the official cash rate. The first rate cut since December 2001. Since the start of the US sub-prime mortgage crisis there has been severe instability in global financial markets. The level of uncertainty and fluidity in international financial markets has provided a challenge for financial regulators around the world.

In April 2008 when the RBA previously appeared before the committee the focus was on the underlying rate of inflation and the need to bring this under control with a restrictive monetary policy setting.

The change in economic conditions between April and September provided the RBA with the evidence to cut rates. The Governor of the RBA in his statement announcing the 2 September rate cut noted the tighter financial conditions but also Australia's terms of trade which were working in the opposite direction.

A measure of the volatility in global financial markets is the significant downturn in conditions that occurred between the 2 September and the 7 October meetings of the RBA Board. The series of events that occurred during this period led the RBA Board to cut the official cash rate by 100 basis points, the largest single reduction since 1992. It was evident that there was a shift in emphasis from inflation to growth.

One of the key functions of the committee in scrutinising the RBA is to hold it to account for its conduct of monetary policy and, in particular, that its decisions are in the best interest of the economy. In line with this objective, the committee was intent on examining the need for the official rate increases of 25 basis points each that occurred in February and March 2008. There was concern that these rate rises may have been too much for the economy to tolerate. The RBA defended its decision to raise rates on both these occasions based on the information that was available.

The conduct of monetary policy during the previous 12 months demonstrates the uncertainty that the Reserve Bank can be subject to as a result of volatility in financial markets. More than ever, this underpins the need for robust and effective scrutiny of the RBA. The next hearing with the RBA will provide further opportunity for the RBA to account for its conduct of monetary policy and its forecasts for growth, inflation and employment.

On behalf of the committee, I would like to thank the Governor of the Reserve Bank, Mr Glenn Stevens and other representatives of the RBA for appearing at the hearing on 8 September. The next hearing will be held on 20 February 2009 in Canberra.

Craig Thomson MP
Chair

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Membership of the Committee

Chair	Mr Craig Thomson MP	
Deputy Chair	Hon Chris Pearce MP	
Members	Hon Julie Bishop MP (from 25/9/08)	Mr Richard Marles MP
	Mr David Bradbury MP	Ms Julie Owens MP
	Mr Steve Ciobo MP (from 28/8/08)	Hon Tony Smith MP (from 25/9/08)
	Hon Peter Dutton MP (to 25/9/08)	Hon Malcolm Turnbull MP (to 28/8/08)
	Ms Sharryn Jackson MP	Mr Jim Turnour MP
	Mr Michael Keenan MP (to 25/9/08)	

Committee Secretariat

Secretary	Mr Stephen Boyd
Research staff	Mr Paul Zinkel
Administrative Officer	Ms Natasha Petrovic

Terms of reference

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

List of abbreviations

CAD	Current Account Deficit
CBA	Commonwealth Bank of Australia
CPI	Consumer Price Index
CPRS	Carbon Pollution Reduction Scheme
GDP	Gross Domestic Product
GST	Goods and Services Tax
IMF	International Monetary Fund
RBA	Reserve Bank of Australia
US	United States of America

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Introduction

Background

1.1 The House of Representatives Standing Committee on Economics (the committee) is responsible for scrutinising the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the community, and the financial sector.

1.2 The RBA Governor's appearances before the committee at biannual public hearings are an important element of the Bank's accountability framework. The details of this framework are set out in the *Fourth Statement on the Conduct of Monetary Policy,* agreed between the Treasurer, the Hon Wayne Swan, MP, and the RBA Governor, Mr Glenn Stevens. The statement formalises the biannual appearance before the committee. The statement, which is reproduced at Appendix C, states:

> The Governor has also indicated that he plans to continue to be available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics, Finance and Public Administration. The Treasurer expresses continuing support for these arrangements, which ensure the continued transparency and accountability of the Reserve Bank's conduct of monetary policy—and therefore the credibility of policy itself.[1]

1 RBA, *Fourth Statement on the Conduct of Monetary Policy*, December 2007.

1.3 A second procedural mechanism for achieving this accountability is set out in the Standing Orders of the House of Representatives, which provide for the referral of annual reports within a committee's area of portfolio responsibility for any inquiry the committee may wish to make. Accordingly, the committee may inquire into aspects of the annual reports of the RBA.

Scope and conduct of the review

1.4 The second public hearing of the committee with the RBA during the 42nd Parliament was held in Melbourne on 8 September 2008.

1.5 The proceedings of the hearing were audio streamed over the internet through the Parliament's website, allowing interested parties to hear the proceedings as they occurred. The Governor's opening statement was taken as a submission and the transcript of the hearing is available on the committee's website.[2]

1.6 Before the hearing, the committee received a private briefing from Mr Shane Oliver, AMP Capital. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Oliver's cooperation and assistance.

1.7 The committee also appreciates the provision of additional briefing material from Mr Scott Kompo-Harms of the Parliamentary Library Research Service.

1.8 The hearing was well attended by members of the public and staff and students from Loreto Manderville College, Scotch College, Camberwell Grammar, Xavier College, and Balwyn High School.

1.9 The public hearings with the RBA continue to bring issues of monetary policy into the public arena, and have assisted in providing a public face to parliamentary committees and the RBA. The committee welcomes the Governor's frank and open comments at the hearings. In addition, the hearings are an important means whereby financial markets can be better informed on the current thinking of the RBA.

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

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2 See: <http://www.aph.gov.au/house/committee/efpa/index.htm>

3 See: <http://www.rba.gov.au>

Next public hearing with the Reserve Bank of Australia

1.11 The committee will conduct the next public hearing with the RBA on 20 February 2009 in Parliament House, Canberra. More details will be circulated in the weeks leading up to the hearing.

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Monetary policy and other issues

Overview

2.1 On 2 September 2008 the Reserve Bank of Australia (RBA) announced a 25 basis point reduction in the official cash rate. The first rate cut since December 2001. Since the start of the US sub-prime mortgage crisis there has been severe instability in global financial markets. The level of uncertainty and fluidity in international financial markets has provided a challenge for financial regulators around the world.

2.2 In April 2008 when the RBA previously appeared before the committee, the focus was on the underlying rate of inflation and the need to bring this under control with a restrictive monetary policy setting. At the April hearing, the RBA advised that 'current policy settings should remain unchanged' but 'there exists some evidence that a moderation in demand is occurring, which should, in due course, slow price growth.'[1]

2.3 The change in economic conditions between April and September provided the RBA with the evidence to cut rates. The Governor of the RBA in his statement announcing the 2 September rate cut noted the tighter financial conditions but also Australia's terms of trade which were working in the opposite direction. The Governor stated:

> Given the opposing forces at work, considerable uncertainty has surrounded the outlook for demand and inflation. On balance, however, it is looking more likely that household demand will

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1 Mr G Stevens, Governor of the RBA, *Transcript*, 4 April 2008, p. 5.

> remain subdued and overall economic growth slow over the period ahead. Inflation is likely to remain relatively high in the short term, with the CPI affected by the high global oil prices in mid year and other increases in raw materials prices. But looking further ahead, the outlook for demand suggests that inflation in both CPI and underlying terms is likely to decline over time, provided wages growth remains contained. The Bank's forecast remains that inflation will fall below 3 per cent during 2010.
>
> Weighing up the available domestic and international information, the Board judged that there was now scope for monetary policy to become less restrictive.[2]

2.4 A measure of the volatility in global financial markets is the significant downturn in conditions that occurred between the 2 September and the 7 October meetings of the RBA Board. The series of events that occurred during this period led the RBA Board to cut the official cash rate by 100 basis points, the largest single reduction since 1992. The Governor, in announcing the 7 October decision, stated:

> Conditions in international financial markets took a significant turn for the worse in September. Large-scale financial failures in several major countries were accompanied by serious dislocation in interbank markets and heightened instability in other markets, including sharp falls in share prices. Official actions in a number of countries have been aimed at restoring stability, by adding to short-term liquidity and laying a foundation for longer-term recovery in the health of balance sheets. Nonetheless, financing is likely to be difficult around the world for some time ahead. This is also affecting Australia, albeit by less than in many other countries, given the relative strength of the local banking system.[3]

2.5 In particular, the Governor noted that 'economic activity in the major countries is also weakening, and evidence is accumulating of a significant moderation in growth in Australia's trading partners in Asia.'[4]

2.6 The RBA seemed confident that inflation was under control but noted that the year ended September CPI would come in about 5 per cent but would start to decline in 2009. The Governor's statement announcing the 7 October decision was now very much focused on growth. The Governor stated that 'the recent deterioration in prospects for global growth,

2 RBA, *Media Release*, 2 September 2008.

3 RBA, *Media Release*, 7 October 2008.

4 RBA, *Media Release*, 7 October 2008.

together with much more difficult market conditions even for creditworthy borrowers, now present the risk that demand and output could be significantly weaker than earlier expected.'[5] The Governor concluded:

> Given that background, the Board judged that a material change to the balance of risks surrounding the outlook had occurred, requiring a significantly less restrictive stance of monetary policy. The Board also took careful note of movements in funding costs in wholesale markets. Having weighed these considerations, the Board decided that, on this occasion, an unusually large movement in the cash rate was appropriate in order to bring about a significant reduction in costs to borrowers. The Board does not, however, regard that movement as establishing a pattern for future decisions.[6]

2.7 On the upside, and compared to the impact the global financial crisis is having on other advanced economies, the Australian economy and financial system was notable for its robustness. The Governor stated:

> …what we see in Australia is an order of magnitude less troubling than what we see abroad. That, I think, is an important point to emphasise. The balance sheets of the bulk of corporate Australia are not overgeared. Australian financial institutions continue to present a contrasting picture to their peers in the US, Europe and the UK. They have adequate access to offshore funding, albeit at higher prices than a year ago. They have tightened credit standards for some borrowers, particularly those associated with property development and some other high-risk areas, and are holding a higher proportion of their balance sheets in liquid form. Some have had to make provisions for unwise exposures that had been accumulated earlier. But even in those cases, capital, asset quality and profitability remain very sound.[7]

2.8 The International Monetary Fund (IMF) in its October 2008 World Economic Outlook commented in relation to both Australia and New Zealand that 'sound fiscal positions provide scope for allowing automatic stabilizers to operate in full and for judicious use of discretionary stimulus if the outlook deteriorates further.'[8]

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5 RBA, *Media Release*, 7 October 2008.

6 RBA, *Media Release*, 7 October 2008.

7 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 3.

8 International Monetary Fund, *World Economic Outlook, October 2008, Financial Stress, Downturns, and Recoveries*, p. 63.

Forecasts for 2008-2009

2.9 The RBA's forecasts, are more so than in previous reporting periods, subject to the volatility of the global economy. The IMF October 2008 World Economic Outlook highlighted the depths of the global downturn by comparing it to the experience of the 1930s. The IMF stated:

> The world economy is now entering a major downturn in the face of the most dangerous shock in mature financial markets since the 1930s. Against an exceptionally uncertain background, global growth projections for 2009 have been marked down to 3 percent, the slowest pace since 2002, and the outlook is subject to considerable downside risks. The major advanced economies are already in or close to recession, and, although a recovery is projected to take hold progressively in 2009, the pickup is likely to be unusually gradual, held back by continued financial market deleveraging. In this context, elevated rates of headline inflation should recede quickly, provided oil prices stay at or below current levels.[9]

2.10 The IMF noted that 'the financial crisis that erupted in August 2007 after the collapse of the US sub-prime mortgage market entered a tumultuous new phase in September 2008 that has badly shaken confidence in global financial institutions.'[10] The RBA's output and inflation forecasts shown in Table 2.1 below were included in the August 2008 *Statement on Monetary Policy*.

Table 2.1 RBA Output and Inflation Forecasts

Percentage change over year to quarter shown

	Dec 2007	Mar 2008	June 2008	Dec 2008	June 2009	Dec 2009	June 2010	Dec 2010
GDP	4.3	3.6	2¾	2	2¼	2½	2½	2¾
Non-farm GDP	4.2	3.6	2½	1.5	1¾	2½	2½	2¾
CPI	3.0	4.2	4.5	5	3¾	3¼	3	2¾
Underlying inflation	3.6	4.2	4.4	4.5	3¾	3¼	3	2¾

Actual GDP data to March 2008 and actual inflation data to June 2008. Underlying inflation refers to the average of trimmed mean and weighted median inflation. For the forecast period, technical assumptions include A$ at US$0.91, TWI at 70, cash rate at 7.25 per cent, and WTI crude oil price at US$118 per barrel and Tapis crude oil price at US$122 per barrel.

Source *Reserve Bank of Australia, Statement on Monetary Policy, August 2008, p. 62.*

9 International Monetary Fund, *World Economic Outlook, October 2008, Financial Stress, Downturns, and Recoveries*, p. 1.

10 International Monetary Fund, *World Economic Outlook, October 2008, Financial Stress, Downturns, and Recoveries*, p. 1.

2.11 The Governor noted in his 7 October statement announcing the October rate cut that the CPI is likely to increase to 5 per cent over the four quarters to September. The August *Statement on Monetary Policy* advised that 'the current forecast profile implies that year-ended inflation will remain outside the target range until mid 2010.'[11] However, the Governor in his October statement noted that the recent deterioration in the prospects for global growth 'now present the risk that demand and output could be significantly weaker than earlier expected.' The Governor concluded that 'should that occur, inflation would most likely fall faster than earlier forecast.'[12]

2.12 Table 2.1 shows GDP declining to 2 per cent over the year to the 2008 December quarter and staying in the 'twos' through to the 2010 December quarter. The RBA noted that the unemployment rate is forecast to rise in line with slowing domestic activity and employment.[13] As part of the September hearing, the Governor advised that during economic slowdowns, 'the rate of unemployment growth will slow.'[14] When the Governor was pressed on the extent to which unemployment would increase he referred to the experience of the mid cycle pause in 2001. The Governor stated:

> …we could see what is going on at the moment as rather akin to the mid-cycle pause in 2001. In that episode the rate of unemployment rose by a percentage point over a year to 18 months. I am not setting that up as a precise forecast but, qualitatively, that sort of episode I think is probably what we are experiencing now.[15]

2.13 During the hearing, the RBA was questioned about the impact of a carbon pollution reduction scheme (CPRS) on CPI forecasts. The RBA noted in its August Statement on Monetary Policy that the forecasts do not incorporate the effects of a CPRS. The RBA reported that 'the introduction of the proposed measures would be expected to boost CPI inflation near the end of the forecast period.'[16] The RBA concluded that it 'will incorporate estimates of initial and ongoing effects into its forecasts as further details are released.'[17]

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11 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 62.

12 RBA, *Media Release*, 7 October 2008.

13 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 63.

14 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 11.

15 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 11.

16 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 63.

17 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 62.

2.14 The Governor did not consider that the introduction of a CPRS would create serious problems for managing monetary policy and compared the potential effect of a CPRS with the introduction of the GST. The Governor stated:

> I do not at the moment assume that we are going to have a serious problem for monetary policy here at all. I think if it is well handled we will be fine, the way we were with the GST. With that there was quite a big one-time rise in the CPI but within a year it was out of the inflation rate. We looked through that, the community looked through that, and we kept on about our lives without getting pushed seriously off track.[18]

Inflation targeting and monetary policy

2.15 The *Fourth Statement on the Conduct of Monetary Policy*, agreed on 7 December 2007 between the Treasurer and the Governor of the Reserve Bank, outlines the objective of monetary policy and provides an inflation target.

2.16 The goals of monetary policy as set out in the *Reserve Bank Act 1959* require the Reserve Bank Board to conduct monetary policy in a way that, in the Board's opinion, will best contribute to:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia.

2.17 The Fourth Statement on the Conduct of Monetary Policy also states that:

> In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the cycle. This formulation allows for the natural short-run variation in inflation over the cycle while preserving a clearly identifiable performance benchmark over time.[19]

2.18 One of the key functions of the committee in scrutinising the RBA is to hold it to account for its conduct of monetary policy and, in particular, that its decisions are in the best interest of the economy. In line with this

18 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 18.

19 RBA, *Fourth Statement on the Conduct of Monetary Policy*, December 2007.

objective, the committee was intent on examining the need for the official rate increases of 25 basis points each that occurred in February and March 2008. There was concern that these rate rises may have been too much for the economy to tolerate. The RBA defended its decision to raise rates on both these occasions based on the information that was available. The Governor stated:

> I do not think they were unnecessary. I think they had to be done. If you think back to the information that was coming in at that time and that has continued to come in, particularly on inflation, I think the likelihood that we were going to be able to credibly sit through one bad CPI, then another and then a third—and there is actually a fourth coming that will not look too good—and not respond at all was pretty unlikely. When inflation is rising like that you have to respond. The earlier you respond the sooner you can get to a position where you can sit and say, as we did, 'That's tight. That will do the job. It will take time but it will work.' I do not think we would have been in that position without those two changes at the beginning of the year. In fact, I think we could well have found ourselves much later in the year agonising over whether we should be raising rates even then rather than being in the position that we were in—being steady and then starting to think about coming down a bit.[20]

2.19 The action of monetary policy in seeking to slow growth and bring down inflation can be a balancing act and there may be marginal difference in achieving a 'soft landing' as opposed to a recession. In response to the possibility that the Australian economy may be verging on the edge of recession, the Governor stated:

> I do not think we are in recession now. I do not think there is the evidence to suggest that. We are in a period of slow growth, rather like two or three episodes of that nature that I can recall over the years. I think it would be dishonest to deny that there is any possibility at all that we could have a recession. There is clearly some probability of that, but I think the most likely outcome continues to be the one that is in the outlook that we have put out over the last six months publicly.[21]

2.20 During the hearing, the committee contrasted the Governor's confidence in the economy with business confidence surveys. The RBA's August 2008 Statement on Monetary Policy includes a business confidence survey

20 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 6.

21 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 10.

which shows that business confidence has fallen to minus 15, the lowest result since 1991. The Governor was asked to reconcile the current low business confidence with his broader view of the economy. The Governor stated:

> I am saying that business confidence has come down. I think, regarding the differences between what we see thus far and what we see in some of these other episodes, the number is a bit lower, but I am not sure that is a major statistical difference. It is true that it was minus 15 in 1991. By that stage we had had a recession, actually. By this time of the year in 1991 the recovery was underway. I do not think this is going to be like the early 1990s again. I think that is highly unlikely. Confidence is down, though. The top panel shows what they say is actually happening as opposed to what they feel; I am not saying what they feel is unimportant, but what is happening on the ground has come down to a bit below average, and it is probably going to go a bit lower.[22]

2.21 A further issue that was examined during the hearing was the continuing effectiveness of monetary policy to influence the market if there has been a 'de-coupling' between the official cash rate the decision of the commercial banks to pass on rate cuts. The RBA was quick to point out that there is no formal link between movements in the cash rate and commercial bank interest rates. The Governor noted that for the last decade there has been a form of coupling between mortgage rates and the cash rate but this was not the case in the 1990s. The Governor stated:

> …if you go back into history earlier than just the past 10 years or so, it was not like that to anything like the same extent. There was less of a coupling—to use that word—in those days. The market conditions that we have seen in the past year have been such that that relationship has not been as close as it was for some years…
>
> There is not any law that says banks can only adjust interest rates when we do. It is just that most of the time in the past decade what the Reserve Bank has done has been a pretty close proxy for what all the other funding costs did, so the practice grew up the way that it did.[23]

2.22 The Governor was confident, however, that movements in the cash rate would still exert influence over the economy. In addition, he noted that

22 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 34.

23 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 14.

Australia was in a better position than some other advanced economies. The Governor stated:

> As for whether monetary policy gets less effective if the coupling, as you call it, is not as strong, yes, to some extent, but it strikes me as still pretty likely that movements in the cash rate will still have a fair amount of influence, even if not exactly one for one. You can compare the situation that we are in with that of the United States, where it is actually long-term rates that matter most for borrowers. The Fed has got the fed funds rate at a very low level, but in fact mortgage rates for borrowers have declined hardly at all, if at all, because they key off those five-year or 30-year Treasury yields plus a margin. So in that case the capacity of the central bank to affect a lot of the rates that borrowers actually pay is much less direct than we have, even now that, in our case, the cash rate and some loan rates are not exactly one for one necessarily every time but there is still quite a lot of influence there compared with what you see in some other countries.[24]

2.23 In relation to independent rate increases by the commercial banks, the Governor noted that the funding costs of banks is complex and it was probably 'unlikely that banks will volunteer reductions in loan rates independently of the Reserve Bank lowering the cash rate, because the quantum of additional market funding costs that went into the system earlier in the year mostly is still there.'[25] The RBA 100 basis point rate cut of 7 October resulted in the major banks cutting their rates by 80 basis points. The Commonwealth Bank of Australia (CBA) in announcing its rate cut commented on future reductions. The CBA stated:

> While we are not reducing our variable home loan rates by as much as the RBA reduction, we do expect global financial markets to normalise over time and once that does occur we will be able to reduce rates by more than the RBA adjustments.[26]

2.24 The CBA's announcement is positive and it will be important to note if the other banks match or better this commitment. The committee will certainly be observing the actions of the commercial banks as global markets normalise.

2.25 The issue of competition in the banking and non-banking sector was also raised. In particular, the RBA was asked about the ability of the non-bank

24 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 14.

25 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 7.

26 Commonwealth Bank of Australia, *Media Release*, 7 October 2008.

lenders to regain some market share. The Governor was optimistic and stated:

> As those short-term market yields have come down, I think prospects are improving. They are probably not quite there yet for them to be highly profitable, but I think things are moving in the right direction there. Our feeling is that securitisation will at some point be, once again, a feature of the system—one piece of competition in the mortgage market particularly. It may not be at the pace that we saw, which was very rapid until the international turmoil began, but I do not think securitisation is dead forever. I think it will get going again.[27]

2.26 A further issue raised was the possible impact of wages growth in causing inflationary pressures. The RBA has raised this as a concern, particularly during previous periods of high capacity utilisation.

2.27 The RBA in discussing its outlook for inflation still advised that its 'assessment hinges to no small extent on growth in overall labour costs not picking up further.'[28] The RBA stated:

> Relative wages have been shifting over recent times, as would be expected given the nature of the forces that are affecting the economy, but overall the pace of growth in labour costs to date has been fairly contained, considering how tight the labour market has been. With pressure coming off the labour market in the period ahead, we think, an assumption that that moderate behaviour will continue appears to be a reasonable one at this point, but it is a critical one. The outlook also hinges on the expectation that demand growth will remain quite moderate in the near term so that pressure continues to come off productive capacity.[29]

2.28 The RBA was asked about the current rate of industrial disputation and its impact, if any, on GDP growth. The Governor noted that while there has been an increase in industrial disputation, 'I would not say that that is remarkably different behaviour from history'.[30]

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27 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 10.

28 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 4.

29 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 4.

30 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 26.

Exchange rates and external trade

2.29 In mid July the Australian dollar reached a post-float high against the US dollar of just over 98.5 cents. Since that time, however, the Australian dollar has depreciated particularly during late September and early October 2008. At the time of the hearing, the Australian dollar was trading at about 83 cents against the US dollar. By 10 October the Australian dollar had fallen to less than 70 cents against the US dollar.

2.30 A higher Australian dollar helps at the margin to contain inflation but there will be less help as the exchange rate falls. The Governor did not believe that 'what has happened to date is going to seriously derail us on inflation.'[31] On the upside, the lower exchange rate is positive for Australian exporters and the tourism industry.

2.31 The RBA reported that 'Australia's terms of trade are expected to have increased by around 20 per cent over the year to the September quarter but are then forecast to gradually decline.'[32] The RBA stated:

> Basically we think that the terms of trade will fall by around five per cent in the coming year. Basically what has happened in the past six months or so is that we have locked in a set of higher prices for the bulk commodities. The outlook for those is still good. Spot prices for coal and iron ore are still above the current contract prices, so there is a fair likelihood that those prices will stay high in the year ahead. But those markets have softened in the last couple of weeks. I think we are seeing the effects of the slowdown in global growth starting to come through in those markets and probably also the effects of the expanded supply putting some downward pressure on prices.[33]

United States, China and the global economy

2.32 The condition of the United States (US) economy as a result of the sub-prime mortgage crisis has been well documented. The RBA noted that 'conditions in the United States remain weak, with continuing falls in employment, housing market activity and consumer sentiment over recent

31 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 23.

32 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 59.

33 Dr M Edey, Assistant Governor of the RBA, *Transcript*, 8 September 2008, p. 28.

months.'[34] One of the prevailing questions is whether the US is in recession or will soon be. The RBA reported that the 'preliminary June quarter national accounts suggest that GDP growth was a little stronger than in the previous two quarters, although growth in domestic demand remained weak.'[35]

2.33 The RBA commented that despite the federal government's economic stimulus package, with around US$92 billion of tax rebates, 'consumer confidence is very low, and a period of household balance sheet repair now appears to be underway, as consumers adjust to higher inflation, rising unemployment and sizable declines in financial and housing wealth.'[36]

2.34 The Governor noted that while the US was one of the strongest performing G7 countries in the June quarter, 'most forecasters continue to be pretty cautious about prospects for the US economy in the second half of the year and are now also concerned about the sorts of credit losses that are routinely associated with a period of weak macroeconomic conditions.'[37]

2.35 China expanded rapidly during 2006 and 2007 but growth is now slowing. The RBA reported that 'year ended growth has declined from a peak of over 12 per cent in mid 2007 to around 10 per cent in the June quarter of this year.'[38] The Governor stated:

> China wanted to slow down and needed to slow down. There has, I think, been pretty clear evidence of overheating in that economy. How far will they slow? I do not know. The latest growth figure would be about 10 per cent over the year. I think most forecasters probably have a slightly lower number for the year ahead but still not that much lower. Another question which is important for Australia is the extent to which China suffered from the loss of exports to the US and Europe. They clearly have suffered, and I think we can see that in the figures.[39]

2.36 Globally, growth is expected to decline in comparison to forecasts just six months ago. The Governor commented that 'the world economy actually expanded a little faster than we had expected into the early part of 2008,

34 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 6.
35 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 6.
36 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 6.
37 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 3.
38 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 8.
39 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 32.

but recent data for a number of countries have been weaker and we are assuming that weakish performance will probably continue in the near term.'[40]

Housing and household debt

2.37 The RBA reported that while household consumption increased moderately in the March quarter rising by 0.7 per cent to be 4.3 per cent higher over the year, it still represented a noticeable slowing from average quarterly growth of around 1.25 per cent during 2007.[41]

2.38 Measures of consumer sentiment have declined to levels not seen since the early 1990s. The RBA commented that the 'slowing in the pace of household spending is consistent with slower growth in disposable incomes and recent falls in household net worth.'[42]

2.39 In relation to household borrowing, household credit growth has slowed from an annualised rate of around 15 per cent in mid 2007 to an annualised rate of 7 per cent over the three months to June 'which is the slowest pace of growth since the early 1990s.'[43]

2.40 Some economists have pointed to the historical high level of household debt as a potential future problem for the economy. The RBA was more optimistic and stated that:

> …while household indebtedness is around historical highs and the interest burden has risen in the past few quarters, the latest data to June suggest that only a relatively small proportion of households are in arrears on their loans: non-performing loans account for around 0.4 per cent of the value of housing loans on banks' domestic books.[44]

2.41 In relation to housing prices, the RBA reported that residential property markets have weakened across the country since the beginning of the year. The RBA stated that 'nationwide house prices fell slightly in the June 2008 quarter, after rising by around 13 per cent over 2007.'[45]

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40 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 4.

41 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 26.

42 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 27.

43 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 27.

44 RBA, *Statement on Monetary Policy*, 11 August 2008, pp. 27-28.

45 RBA, *Statement on Monetary Policy*, 11 August 2008, p. 28.

Capacity constraints

2.42 For several years the RBA has been discussing the risks associated with growing capacity constraints in the economy. The committee has previously noted that the economy has been growing for 17 years and capacity utilisation is close to full. At the February 2007 hearing, for example, the RBA reported that 'the factor most constraining further expansion is not insufficient demand but insufficient capacity, either of labour or capital or both.'[46]

2.43 Capacity constraints will lead to increasing prices and inflationary pressure. In particular, where growth is 4, 5 or 6 percent these capacity constraints will be reached more quickly. With growth reducing to the between two and three per cent, capacity constraints become less of a problem. The RBA confirmed that the risks to the economy from capacity constraints are reducing. The Governor stated:

> In some senses, it is a sign of success—by which I mean you actually want to be at full employment. You do not want to have huge amounts of spare capacity in the economy. But once you get to the buffers you have to slow down to not overdo it. That is what we were trying to say and trying to achieve. Now I think capacity constraints are easing a bit across a number of sectors. That is what the surveys are telling us. That is what you would expect if output growth has slowed down and will likely stay more modest for the next little while. The capacity constraints ease up; therefore the inflation pressure eases up and so on.[47]

46 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 2.

47 Mr G Stevens, Governor of the RBA, *Transcript*, 8 September 2008, p. 30.

Conclusions

2.44 The economic downturn arising from the US sub-prime mortgage crisis and the severe financial instability that arose in September 2008 focused the attention of governments around the world. A range of measures have been taken domestically and internationally to stabilise markets and provide financial certainty.

2.45 It is evident that the Australian economy is slowing. At the next hearing, the committee will scrutinise the Reserve Bank of Australia on its key forecasts for growth, inflation and employment.

Craig Thomson MP
Chair
23 October 2008

A

Appendix A — Submission

Number	Provided by
1	Reserve Bank of Australia (*Opening Statement to House of Representatives Standing Committee on Economics, public hearing Melbourne, 8 September 2008)*

B

Appendix B — Hearing, briefing, and witnesses

Public hearing

Monday, 8 September 2008 – Melbourne

Reserve Bank of Australia

Mr Glenn Stevens, Governor

Dr Malcolm Edey, Assistant Governor, Economic

Dr Philip Lowe, Assistant Governor, Financial System

Mr John Broadbent, Head, Domestic Markets

Private briefing

Thursday, 4 September 2008 – Canberra

Mr Shane Oliver, AMP Capital

C

Appendix C — *Fourth statement on the conduct of monetary policy*

The Treasurer and the Governor of the Reserve Bank

7 December 2007

This statement records the common understanding of the Governor, as Chairman of the Reserve Bank Board, and the Government on key aspects of Australia's monetary policy framework.

Since the early 1990s, inflation targeting has formed the basis of Australia's monetary policy framework. Since 1996, this framework has been formalised in a Statement on the Conduct of Monetary Policy.

Monetary policy is a key element of macroeconomic policy and its effective conduct is critical to Australia's economic performance and prospects. For this reason, it is appropriate and timely for the Governor, and the Treasurer on behalf of the new Government, to outline their mutual understanding of the operation of monetary policy in Australia.

This statement should continue to foster a better understanding, both in Australia and overseas, of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Reserve Bank.

Relationship between the Reserve Bank and the Government

The *Reserve Bank Act 1959* (the Act) gives the Reserve Bank Board the power to determine the Reserve Bank's monetary policy and take the necessary action to implement policy changes. The Act nominates the Governor as Chairman of the Reserve Bank Board.

The Government recognises the independence of the Reserve Bank and its responsibility for monetary policy matters and will respect the Reserve Bank's independence as provided by statute.

The Government will implement two new initiatives to further enhance the Reserve Bank's independence.

The positions of the Governor and Deputy Governor will have their level of statutory independence raised to be equal to that of the Commissioner of Taxation and the Australian Statistician. As such, their appointments will be made by the Governor-General in Council, and could be terminated only with the approval of each House of the Parliament in the same session of Parliament.

The Secretary to the Treasury and the Governor will maintain a register of eminent candidates of the highest integrity from which the Treasurer will make new appointments to the Reserve Bank Board. This procedure removes the potential for political considerations in the appointment process and ensures only the best qualified candidates are appointed to the Reserve Bank Board.

Section 11 of the Act prescribes procedures for the resolution of policy differences between the Reserve Bank Board and the Government. The procedures, in effect, allow the Government to determine policy in the event of a material difference; but the procedures are politically demanding and their nature reinforces the Reserve Bank's independence in the conduct of monetary policy. Safeguards like this ensure that monetary policy is subject to the checks and balances inherent and necessary in a democratic system.

In addressing the Reserve Bank's responsibility for monetary policy, the Act provides that the Reserve Bank Board shall, from time to time, inform the Government of the Reserve Bank's policy. Such arrangements are a common and valuable feature of institutional systems in other countries with independent central banks and recognise the importance of macroeconomic policy co-ordination.

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

Objectives of Monetary Policy

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

a) the stability of the currency of Australia;

b) the maintenance of full employment in Australia; and

c) the economic prosperity and welfare of the people of Australia.

The first two objectives lead to the third, and ultimate, objective of monetary policy and indeed of economic policy as a whole. These objectives allow the Reserve Bank Board to focus on price (currency) stability while taking account of the implications of monetary policy for activity and, therefore, employment in the short term. Price stability is a crucial precondition for sustained growth in economic activity and employment.

Both the Reserve Bank and the Government agree on the importance of low inflation and low inflation expectations. These assist businesses in making sound investment decisions, underpin the creation of jobs, protect the savings of Australians and preserve the value of the currency.

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

Since the adoption of inflation targeting in the early 1990s inflation has averaged around the midpoint of the inflation target band. The Governor takes this opportunity to express his continuing commitment to the inflation objective, consistent with his duties under the Act. For its part the Government indicates that it endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving such an outcome.

Transparency and Accountability

Monetary policy needs to be conducted in an open and forward-looking way. A forward-looking focus is essential as policy adjustments affect activity and inflation with a lag and because of the crucial role of inflation expectations in shaping actual inflation outcomes. In addition, with a clearly defined inflation objective, it is important that the Reserve Bank continues to report on how it sees developments in the economy, currently and in prospect, affecting expected inflation outcomes. These considerations point to the need for effective transparency and accountability arrangements.

The Reserve Bank takes a number of steps to ensure the conduct of monetary policy is transparent. Changes in monetary policy and related reasons are clearly announced and explained. The Reserve Bank's public commentary on the economic outlook and issues bearing on monetary policy settings, through public addresses, its quarterly statements on monetary policy and monthly bulletins, have been crucial in promoting increased understanding of the conduct of monetary policy. The Reserve Bank will continue to promote public understanding in this way.

The Governor has also indicated that he plans to continue the practice of making himself available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics, Finance and Public Administration.

The Governor has announced that the Reserve Bank Board will release a statement explaining the reasons behind its decision on monetary policy following each meeting, irrespective of whether there is a change in the cash rate target. This statement will be made on the afternoon of the day of each Board meeting (rather than the morning of the following day), with the minutes of the Board meeting being released publicly as soon as possible after the meeting.

The Governor has also indicated that the Reserve Bank will continue to extend the scope of the economic forecasts in its quarterly statement on monetary policy to enhance public understanding of the conduct of monetary policy.

The Treasurer expresses support for these arrangements, which bring the transparency and accountability of the Reserve Bank's conduct of monetary policy into line with international best practice, further enhancing the public's confidence in the independence and integrity of the monetary policy process.

D

Appendix D — Glossary of terms

Australian Competition and Consumer Commission (ACCC). A Commonwealth statutory authority responsible for ensuring compliance with the *Trade Practices Act 1974* and the provisions of the Conduct Code and for administering the *Prices Surveillance Act 1983*. The Commission's consumer protection work complements that of State and Territory consumer affairs agencies.

Australian Payments Clearing Association Limited (APCA). A public company owned by banks, building societies and credit unions which has specific accountability for key parts of the Australian payments system, particularly payments clearing operations

Australian Prudential Regulation Authority (APRA). APRA is the prudential regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry

Australian Securities and Investments Commission (ASIC). One of three Australian Government bodies (the others being the Australian Prudential Regulation Authority and the Reserve Bank of Australia) that regulates financial services. ASIC is the national regulator of Australia's companies. ASIC has responsibility for market protection and consumer integrity issues across the financial system.

accrual accounting. Revenues and expenses are recorded as they are earned or incurred, regardless of whether cash has been received or disbursed. For example, sales on credit would be recognised as revenue, even though the debt may not be settled for some time.

acquirer. An institution that provides a merchant with facilities to accept card payments, accounts to the merchant for the proceeds and clears and settles the resulting obligations with card issuers.

average weekly earnings*.* Average gross (before tax) earnings of employees.

average weekly ordinary time earnings (AWOTE)*.* Weekly earnings attributed to award, standard or agreed hours of work.

average weekly total earnings*.* Weekly ordinary time earnings plus weekly overtime earnings.

balance on current account. The difference between receipts and payments as the result of transactions in goods, services, income and current transfers between Australia and the rest of the world. A current account deficit means that total payments exceed total receipts, while a current account surplus means the reverse.

bankruptcies. Bankruptcies and Administration Orders under Parts IV and XI of the Bankruptcy Act.

basis point. A basis point is 1/100th of 1 percent or 0.01 per cent. The term is used in money and securities markets to define differences in interest or yield.

BPAY. BPAY is a payments clearing organisation owned by a group of retail banks. Individuals who hold accounts with a BPAY participating financial institution can pay billing organisations which participate in BPAY, using account transfers initiated by phone or internet. The transfers may be from savings, cheque or credit card accounts.

business investment. Private gross fixed capital formation for machinery and equipment; non-dwelling construction; livestock; and intangible fixed assets.

card issuer. An institution that provides its customers with debit or credit cards.

cash rate (interbank overnight). Broadly defined, the term cash rate is used to denote the interest rate which financial institutions pay to borrow or charge to lend funds in the money market on an overnight basis. The Reserve Bank of Australia uses a narrower definition of the cash rate as an operational target for the implementation of monetary policy. The Reserve Bank of Australia's measure of the cash rate is the interest rate which banks pay or charge to borrow funds from or lend funds to other banks on an overnight unsecured basis. This measure is also known as the interbank overnight rate. The Reserve Bank of Australia calculates and publishes this cash rate each day on the basis of data collected directly from banks. This measure of the cash rate has been published by the Reserve Bank of Australia since June 1998.

cash rate target. As in most developed countries, the stance of monetary policy in Australia is expressed in terms of a target for an overnight interest rate. The rate used by the Reserve Bank of Australia is the cash rate (also known as the interbank overnight rate). When the Reserve Bank Board decides that a change in monetary policy should occur, it specifies a new target for the cash rate. A decision to ease policy is reflected in a new lower target for the cash rate, while a decision to tighten policy is reflected in a higher target.

charge card. A charge card is a card whose holder has been granted a non-revolving credit line enabling the holder to make purchases and possibly make cash advances. A charge card does not offer extended credit; the full amount of any debt incurred must be settled at the end of a specified period.

consumer price index. A measure of change in the price of a basket of goods and services from a base period. Changes in the Consumer Price Index are the most commonly used measure of inflation.

collateralised debt obligations. Collateralised debt obligations (CDOs) are securities that are exposed to the credit risk of a number of corporate borrowers. In the simplest form of a CDO, this credit risk exposure is generated in the same way as for any asset-backed security (ABS): the CDO is backed by outright holdings of corporate debt, such as corporate bonds and corporate loans. Increasingly, however, the exposure to corporate credit risk is synthesised through the use of credit derivatives. Unlike other forms of ABS, where the collateral pools usually consist of loans with broadly similar characteristics, CDO reference pools are typically quite heterogeneous, with exposures to a variety of borrower types and credit ratings and across a number of countries. A CDO will usually have exposures to between 50 and 200 bonds or large corporate loans, or up to 2,000 loans to small and medium-sized businesses.

The simplest forms of CDOs are known as ‘cash' or ‘vanilla' CDOs, and are similar to other forms of ABS. A special purpose vehicle buys loans and securities from financial institutions and other market participants, and funds these acquisitions by selling securities to investors. The manager of the CDO vehicle will usually deduct fees and expenses from the interest income received from the assets in the collateral pool, with the remainder used to make regular coupon payments to investors. The term to maturity of the loans and bonds in the collateral pool will determine the maturity of the CDO securities sold to investors..

credit card. A credit card is a card whose holder has been granted a revolving credit line. The card enables the holder to make purchases and/or cash advances up to a pre-arranged limit.

The credit granted can be settled in full by the end of a specified period or in part, with the balance taken as extended credit. Interest may be charged on the transaction amounts from the date of each transaction or only on the extended credit where the credit granted has not been settled in full.

debit card. A debit card is a card that enables the holder to access funds in a deposit account at an authorised deposit-taking institution.

derivative. A financial contract whose value is based on, or derived from, another financial instrument (such as a bond or share) or a market index (such as the Share Price Index). Examples of derivatives include futures, forwards, swaps and options

employed persons. Persons aged 15 and over who, during a period of one week, worked for one hour or more for pay or worked for one hour or more without pay in a family business or on a family farm.

G-10. Group of Ten countries: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, and USA; plus Bank for International Settlements (BIS), European Commission, International Monetary Fund (IMF), and the Organisation for Economic Co-operation and Development (OECD). It was formed in conjunction with the establishment of the General Arrangements to Borrow, under which members agreed to make resources available to the IMF.

G-20. Group of Twenty Forum: Members are finance ministers or central bankers from - Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK and US; plus representatives of the IMF, European Union and World Bank. The G-20 aims to broaden the dialogue on key economic and financial policy issues among systemically significant economies, and promote co-operation to achieve stable and sustainable world economic growth.

G-22. Group of Twenty-two. The G-22's aim was to advance issues related to the global financial architecture. It operated through three Working Parties - on Transparency and Accountability, International Financial Crises, and Strengthening Financial Systems. The group made its recommendations in 1998, and its work has since been taken up in other forums.

G-7. Group of Seven countries: Canada, France, Germany, Italy, Japan, UK and USA. The G-7 Summit deals with issues covering macroeconomic management, international trade, international financial architecture, relations with developing countries, and other global issues.

G-8. Group of Eight countries: G-7 countries and Russia.

gross domestic product. The total market value of goods and services produced after deducting the cost of goods and services used up in the process of production but before deducting for depreciation.

gross domestic product—chain volume measure. Also known as *real GDP*, this is a measure used to indicate change in the actual quantity of goods and services produced. Economic growth is defined as a situation in which real GDP is rising.

gross domestic product at factor cost. Gross domestic product less the excess of indirect taxes over subsidies.

gross foreign debt. All non-equity financial claims by non-residents on residents of Australia. The major component of gross foreign debt is the amount of borrowings from non-residents by residents of Australia.

household debt ratio. The amount of household debt at the end of a quarter expressed as a proportion of annual household gross disposable income.

household gross disposable income. The amount of income that households have available for spending after deducting any taxes paid, interest payments and transfers overseas.

household net disposable income. Household gross disposable income less depreciation of household capital assets.

household saving ratio. The ratio of household income saved to household net disposable income.

housing loan interest rate. The variable rate quoted by banks for loans to owner-occupiers.

implicit price deflator for non-farm gross domestic product. A measure of price change that is derived (hence the term implicit) by dividing gross non-farm product at current prices by gross non-farm product at constant prices.

index of commodity prices. A Reserve Bank of Australia-compiled index (based 2001/02=100) which provides a measure of price movements in rural and non-rural (including base metals) commodities in Australian Dollars (AUD), Special Drawing Rights (SDR) and United States Dollars (USD).

inflation. A measure of the change (increase) in the general level of prices.

inflation target. A tool to guide monetary policy expressed as a preferred range or figure for the rate of increase in prices over a period. In Australia, the inflation target is between 2 and 3 per cent per annum on average over the course of the business cycle.

interchange fee. A fee paid between card issuers and acquirers when cardholders make transactions

interest rate. The term used to describe the cost of borrowing money or the return to the owner of the funds which are invested or lent out. It is usually expressed as a percent per annum of the amount of money borrowed, lent or invested.

labour force. The employed plus the unemployed.

labour force participation rate. The number of persons in the labour force expressed as a percentage of the civilian population aged 15 years and over.

labour productivity. Gross domestic product (chain volume measure) per hour worked in the market sector.

long-term unemployed. Persons unemployed for a period of 52 weeks or more.

macroeconomy. The economy looked at as a whole or in terms of major components measured by aggregates such as gross domestic product, the balance of payments and related links, in the context of the national economy. This contrasts with microeconomics which focuses upon specific firms or industries.

market sector. Five industries are excluded from the market sector because their outputs are not marketed. These industries are: property and business services; government administration and defence; education; health and community services; and personal and other services.

monetary policy. The setting of an appropriate level of the cash rate target by the Reserve Bank of Australia to maintain the rate of inflation in Australia between 2 and 3 per cent per annum on average over the business cycle.

natural increase. Excess of live births over deaths.

net foreign debt. Gross foreign debt less non-equity assets such as foreign reserves held by the Reserve Bank and lending by residents of Australia to non-residents.

net overseas migration. Net permanent and long-term overseas migration plus an adjustment for the net effect of 'category jumping'.

non-farm gross domestic product. Gross domestic product less that part which derives from agricultural production and services to agriculture.

overseas visitors. Visitors from overseas who intend to stay in Australia for less than 12 months.

prime interest rate. The average rate charged by the banks to large businesses for term and overdraft facilities.

profits share*.* Gross operating surplus (the excess of gross output over costs incurred in producing that output) of all financial and non-financial corporate trading enterprises as a percentage of gross domestic product at factor cost.

real average weekly earnings. Average weekly earnings adjusted for inflation as measured by the Consumer Price Index.

real prime interest rate. The prime interest rate discounted for inflation as measured by the Consumer Price Index.

seasonally adjusted estimates*.* Estimates in which the element of variability due to seasonal influences has been removed. Seasonal influences are those which recur regularly once or more a year.

terms of trade*.* The relationship between the prices of exports and the prices of imports. The usual method of calculating the terms of trade is to divide the implicit price deflator for exports by the implicit price deflator for imports.

trade weighted index*.* A measure of the value of the Australian dollar against a basket of foreign currencies of major trading partners.

turnover. Includes retail sales; wholesale sales; takings from repairs, meals and hiring of goods; commissions from agency activity; and net takings from gaming machines. From July 2000, turnover includes the Goods and Services Tax.

unemployed persons*.* Persons aged 15 and over who, during a period of one week, were not employed but had actively looked for work in the previous four weeks and were available to start work.

unemployment rate. The number of unemployed persons expressed as a percentage of the labour force.

wage price index. A measure of change in the price of labour (i.e. wages, salaries and overtime) unaffected by changes in the quality or quantity of work performed.

wages share*.* Wages, salaries and supplements (the total value of income from labour) as a percentage of gross domestic product at factor cost.

youth unemployment. Number of 15–19 year olds looking for full-time work.

youth unemployment rate. Number of 15–19 year olds looking for full-time work expressed as a percentage of the full-time labour force in the same age group.

Source: Parliamentary Library and Reserve Bank of Australia