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Review of the Reserve Bank of Australia Annual Report 2008 (First Report)

House of Representatives Standing Committee on Economics

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Chair's foreword

On 4 February 2009 the Reserve Bank of Australia (RBA) announced a 100 basis point reduction in the official cash rate bringing it down to 3.25 per cent. The RBA Board decided to reduce the cash rate when it became apparent that the global economic outlook was worsening. The collapse of the global financial services firm Lehman Brothers in September of last year was the catalyst that prompted a massive reassessment of risk globally.

The RBA took quick and decisive action over this time to reduce the official cash rate. Between September 2008 and February 2009 the official cash rate was reduced five times, a total decrease of 400 basis points since 3 September 2008.

In January, the International Monetary Fund took the unprecedented step of calling on governments of advanced and emerging economies to implement fiscal stimulus in order to support world growth.

Governments around the world have taken steps to bolster their financial systems with a number of domestic and international measures.

The Governor of the RBA in his statement announcing the 4 February rate cut noted the significant deterioration in world economic conditions late in 2008 and that substantial falls in commodity prices has had a significant dampening effect on confidence.

Australia's economy has been impacted by the deterioration in international economic conditions which has substantially slowed growth. While Australia's economy has slowed, comparatively the economic downturn has not been as severe as in other advanced economies.

These are the worst global economic conditions seen for some time and there is still considerable uncertainty about the economic outlook. It is therefore more critical than ever for the committee to scrutinise the RBA on its key forecasts for economic 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 20 February. The next hearing will be held on 14 August 2009 in Sydney.

Craig Thomson MP
Chair

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Membership of the Committee

Chair	Mr Craig Thomson MP	
Deputy Chair	Hon Kevin Andrews MP	
Members	Mr David Bradbury MP	Mr Richard Marles MP
	Hon Julie Bishop MP (to 25/2/09)	Ms Julie Owens MP
	Mr Jamie Briggs MP (from 25/2/09)	Hon Tony Smith MP
	Hon Joe Hockey MP	Mr Jim Turnour MP
	Ms Sharryn Jackson MP	

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Mr Paul Zinkel
Administrative Officers	Ms Natasha Petrovic
	Ms Renee van der Hoek

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

ATM	Automatic Teller Machine
BCDC	Business Cycle Dating Committee of the US National Bureau of Economic Research
CPI	Consumer Price Index
The Fed	US Federal Reserve
FHOG	First Home Owner Grant
G7	Canada, France, Germany, Italy, Japan, UK, and US
GDP	Gross Domestic Product
IMF	International Monetary Fund
RBA	Reserve Bank of Australia
UK	United Kingdom
US	United States of America
WEO	World Economic Outlook

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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's 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]

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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 third public hearing of the committee with the RBA during the 42nd Parliament was held in Canberra on 20 February 2009.

1.5 The proceedings of the hearing were webcast over the internet through the Parliament's website, allowing interested parties to watch 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 Rory Robertson, Macquarie Bank. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Robertson'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 Canberra College, Canberra Girls Grammar School, Canberra Grammar, Dickson College, Erindale College, Marist College, Narrabundah College, St Clares College and St Edmunds.

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.

2 See: <www.aph.gov.au/economics>

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]

Next public hearing with the Reserve Bank of Australia

1.11 The committee will conduct the next public hearing with the RBA on 14 August 2009 in Sydney. More details will be circulated in the weeks leading up to the hearing.

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

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Monetary policy and other issues

Overview

2.1 Shortly after the RBA appeared before the committee on 8 September 2008, there was further upheaval in global financial markets resulting in large falls in equity prices, disruption to wholesale funding markets and severe falls in business and consumer sentiment.

2.2 In September 2008 Lehman Brothers, a global financial services firm, filed for bankruptcy which 'triggered a massive reappraisal of risk around the world and ushered in a period of the most intense financial turmoil seen in decades.'[1]

2.3 As a consequence, a number of governments including Australia, the United States (US) and the United Kingdom (UK), implemented financial stability packages in an attempt to stabilise their financial systems.

2.4 The Governor noted the actions taken by governments to bolster their respective economic systems stating:

> …the extraordinary actions of governments and central banks in that period in supporting key institutions, supplying huge quantities of liquidity and offering guarantees on various obligations of banks helped to stabilise what could have been a catastrophic loss of confidence in the global financial system.[2]

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1 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 1.

2 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 2.

2.5 The dramatic change in economic conditions has shaken consumer confidence. The Governor noted that:

> Consumers have pulled back discretionary spending sharply, are more inclined to save and are looking to repay debt. Businesses around the world have seen the fall in demand and have responded very quickly to cut production and costs as well as putting on hold plans for expansion.[3]

2.6 In the February 2009 *Statement on Monetary Policy*, the RBA noted the progressive decline in the global market stating:

> Recent data point to a marked deterioration in world economic conditions in late 2008. Output contracted significantly in the December quarter in the major advanced economies as well as in a number of emerging market economies, and there were unusually sharp falls in international trade and industrial production.[4]

2.7 In particular, the RBA noted:

> Available GDP [Gross Domestic Product] data for the United Kingdom and United States show declines of 1 per cent or more in the December quarter, while monthly activity indicators point to large contractions in Japan and in the euro area in the quarter. Industrial production in several major countries has weakened sharply in recent months, while surveys of business conditions and consumer confidence have declined to multi-decade lows.[5]

2.8 In light of the downturn in global economic conditions, the RBA took quick and decisive action over this time to reduce the official cash rate. The Governor, noting the historically rapid decline, stated:

> The total decline of 400 basis points since August, which is as rapid an easing as any we have seen in Australia's history, takes monetary policy to an expansionary setting.[6]

2.9 Notwithstanding the threats to the domestic economy, the Australian banking system has remained resilient over these uncertain economic times. The Governor stated that:

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3 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 2.

4 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 1.

5 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 5.

6 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 3.

> …the Australian banking system...remains strongly capitalised, profitable and able to lend and it has good access to debt and equity markets. They have all been able to raise equity in the past number of months as they have needed to or wanted to. There are a dwindling number of AA-rated banks in the world. We have four of them.[7]

2.10 In his opening statement, the Governor commented on Australia's housing sector, noting that 'our housing sector is not overbuilt; instead there is considerable pent-up demand and affordability is improving quickly.'[8]

2.11 As a result of the government's stimulus package, and slowing growth, the budget will move into deficit in 2008/09. The RBA stated:

> Budget estimates in the *Updated Economic and Fiscal Outlook* are for an underlying cash deficit for 2008/09 of $22.5 billion, or 1.9 per cent of GDP. The Budget balance has also been revised down for subsequent years compared with the November *Mid-Year Economic and Fiscal Outlook*.[9]

2.12 While it appears that the budget will slip into deficit, the RBA's view is that 'the impact of the global crisis on Australia has to date been less than in other advanced economies.'[10]

Forecasts for 2009-2010

2.13 The International Monetary Fund (IMF) January 2009 update of the *World Economic Outlook* forecast that world growth is still expected to fall in 2009 to 'its lowest rate since World War II.'[11] The IMF stated:

> Global growth in 2009 is expected to fall to ½ percent when measured in terms of purchasing power parity and to turn negative when measured in terms of market exchange rates. This represents a downward revision of about 1¾ percentage point from the November 2008 WEO [*World Economic Outlook*] Update.[12]

7 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 30.

8 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 3.

9 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 39.

10 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 2.

11 International Monetary Fund, *World Economic Outlook Update*, 28 January 2009, p. 1.

12 International Monetary Fund, *World Economic Outlook Update*, 28 January 2009, p. 1.

2.14 While the economic outlook remains uncertain, the IMF has projected that the global economy will gradually recover in 2010. The IMF stated:

> Helped by continued efforts to ease credit strains as well as expansionary fiscal and monetary policies, the global economy is projected to experience a gradual recovery in 2010, with growth picking up to 3 percent. However, the outlook is highly uncertain, and the timing and pace of the recovery depend critically on strong policy actions.[13]

2.15 The IMF indicated that the emerging and developing countries are also experiencing severe economic downturn. The IMF stated:

> Growth in emerging and developing economies is expected to slow sharply from 6¼ percent in 2008 to 3¼ percent in 2009, under the drag of falling export demand and financing, lower commodity prices, and much tighter external financing constraints (especially for economies with large external imbalances). Stronger economic frameworks in many emerging economies have provided more room for policy support to growth than in the past, helping to cushion the impact of this unprecedented external shock. Accordingly, although these economies will experience serious slowdowns, their growth is projected to remain at or above rates seen during previous global downturns.[14]

2.16 The RBA also noted the effects of the economic downturn in emerging countries, stating:

> Emerging countries around the world that were relatively little affected by the crisis in the major countries until September are now suffering both the effects of weaker demand in the advanced world and the shock to domestic demand as their own citizens respond in the same way to the financial turmoil.[15]

2.17 The RBA remains optimistic about Australia's economic outlook, forecasting:

> …it is likely that the slowdown in Australia will be less severe than in many of our major trading partners. This partly reflects the stronger momentum in the Australian economy in the period leading into the global crisis.

13 International Monetary Fund, *World Economic Outlook Update*, 28 January 2009, p. 1.

14 International Monetary Fund, *World Economic Outlook Update*, 28 January 2009, p. 3.

15 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 2.

> Growth in GDP is now expected to slow from 1.9 per cent over the year to the September quarter 2008 to around ¼ per cent over the year to mid 2009. The economy is expected to begin to pick up from late 2009, with quarterly growth gradually recovering to around trend rates by late 2010. [Table 2.1]
>
> The projected weakness in real GDP coupled with the large fall in the terms of trade implies a sharp fall in real domestic income, which is forecast to contract by around 4 per cent over 2009.[16]

Table 2.1 RBA Output and Inflation Forecasts

Percentage change over year to quarter shown

	Sep 2008	*Dec 2008*	*June 2009*	*Dec 2009*	*June 2010*	*Dec 2010*	*June 2011*
GDP	1.9	1	¼	½	1¼	2½	3¼
Non-farm GDP	1.7	1	0	¼	1¼	2½	3¼
CPI	5.0	3.7	1¾	2½	2¾	2½	2
Underlying inflation	4.7	4.3	3½	3	2¾	2½	2

Actual GDP data to September 2008 and actual inflation data to December 2008. Underlying inflation refers to the average of trimmed mean and weighted median inflation. For the forecast period, technical assumptions include A$ at US$0.65, TWI at 54, cash rate at 3.25 per cent, and WTI crude oil price at US$55 per barrel and Tapis crude oil price at US$57 per barrel.

Source *Reserve Bank of Australia, Statement on Monetary Policy, February 2009, p. 65.*

2.18 The RBA also forecasts that household spending will initially remain subdued but will eventually return to normal levels stating:

> Growth in household consumption spending is expected to remain subdued over much of the forecast period, given an expected weakening in employment and the decline of around 10 per cent in net worth over the past year as a result of the sharp fall in the equity market and smaller fall in house prices. However, the significant fiscal stimulus to households will provide support to consumption over the first half of 2009 and growth in spending is subsequently expected to gradually return to more normal rates.[17]

2.19 The RBA forecasts that labour market conditions will weaken and that employment will fall over 2009 'although growth is expected to resume as the economy gradually recovers.'[18]

16 RBA, *Statement on Monetary Policy*, 6 February 2009, pp. 64-65.

17 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 65.

18 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 66.

2.20 The RBA is of the view that underlying and Consumer Price Index (CPI) inflation will also fall, stating:

> …underlying inflation is forecast to decline gradually to around 2 per cent by mid 2011. Reflecting falls in petrol prices and some other special factors, including a fall in the measured cost of deposit & loan facilities, year-ended CPI inflation is expected to decline more quickly in coming quarters. CPI inflation could fall to below 2 per cent later in 2009, but is then expected to move broadly in line with underlying inflation.[19]

Economic forecasting

2.21 During the hearing, the RBA was questioned on the uncertainty around the current forecasts. The RBA noted in its February 2009 *Statement on Monetary Policy* that 'given the extraordinary circumstances at present, the uncertainty surrounding the forecasts is significant.'[20] The Governor reported that:

> Historical experience is that economic forecasts are not particularly good around turning points. We have seen that at every turning point that I can recall. In my experience as an economist, some turns, we over predict and some we under predict. That is one. That is a normal sort of feature of forecasting the cycle.
>
> The second factor, and probably the more important, is that extent of financial instability globally that we saw and the complex and non-linear, unpredictable ways that those things can interact with economies. That is an additional point of uncertainty around anyone's forecasts at this particular time.
>
> But it is actually the case now that, if we are honest, there is tremendous uncertainty around any point number. That means that in thinking about policy you should be thinking about not just the central forecast but what the risks are either side and about how to respond to them.[21]

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19 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 67.

20 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 67.

21 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, pp. 10-11.

Inflation targeting, monetary policy and fiscal stimulus

2.22 The *Fourth Statement on the Conduct of Monetary Policy*, agreed on 6 December 2007 between the Treasurer and the Governor of the Reserve Bank, outlines the objective of monetary policy and provides an inflation target.

2.23 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.

2.24 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.[22]

2.25 During the hearing, the committee asked how important it had been for governments, both in the Australian context and globally, to implement various fiscal responses to the global credit crisis and for central banks loosening the ties on monetary policy. The RBA answered that the tremendous turmoil and instability in the global financial market and a large contraction of G7 GDP required 'a response by policy makers to the turmoil itself in order to stabilise the financial system and stop that spiralling down any further.'[23]

2.26 When asked about the consequences for the Australian economy if the government had not implemented a fiscal stimulus package, the Governor stated that:

> I do not think we would be seeing too many consequences of that right now. They would be coming later. The policy expansion cannot really head off whatever is happening in the economy today; it does not work that fast. But later in the year we are going to be seeing more and more effects of those measures. That is

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

23 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 5.

> when we would have seen the impact of a different course of action. The economy, I think, would have been considerably weaker than it will be, had that course of action been followed.[24]

2.27 In relation to whether the cash rate will be reduced further, the Governor noted that the current rate is higher than most other advanced countries, stating:

> We have an overnight rate of 3¼ per cent, which as it turns out is one of the higher ones in the world—in the advanced world, anyway—and if there is a need to use more interest rate stimulus, and if that is prudent, then we can. I do not really want to steer expectations about that particularly today; it is just that we have scope to do more if more is needed.[25]

2.28 The committee sought the Governor's views on whether any potential further reductions would have diminishing returns. The Governor stated that:

> …there probably is a point at which it starts to not do the same good that it did previously. My predecessor, Mr Macfarlane, used to say that there is kind of a normal range that monetary policy works pretty well in and that, once you start getting outside that, you get into areas where you can be less confident that you can anticipate what the effects will be—not that the effects are that precisely calibrated, anyway, even in normal times. I think that is probably right.[26]

2.29 In responding to the committee's question on whether the current fiscal stimulus package would be adequate if the global economic crisis worsens, the Governor stated:

> …if the economic slump globally is more protracted or deeper, then the outlook for Australia would be weaker and obviously macroeconomic policy then has to reconsider the appropriate stance that we all pursue. Likewise, if there were a sudden return to confidence and growth, policy would have to get out of the way of that smartly.[27]

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24 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 6.

25 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 7.

26 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 7.

27 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 11.

2.30 The committee also questioned the ramifications of having such a large monetary and fiscal stimulus so early in the cycle. The Governor noted that the RBA was seeking to cushion the economy from a major contraction that has been evident in a number of other countries, most notably Japan. The Governor stated:

> I trust, hope and expect that the main ramification is going to be that the path of the Australian economy is going to be considerably better than it would otherwise have been, and considerably better than a number of other countries around the world whom we can see contracting at a very large pace.[28]

2.31 The Governor added:

> …the point of using monetary policy early on the way down, as on the way up, is that you end up curtailing the down part of the cycle and you do not end up in the marathon—you make it more likely that, say, it is a short-term event and not a long term drawn out one. That is the intention.[29]

2.32 In response to the committee's further examination of whether monetary and fiscal stimulus policies should be implemented later if an economic downturn is protracted, the Governor stated that:

> I think you can also make the argument that, the longer you wait, the more ammunition you will end up having to use. These things can get a sort of self-fulfilling momentum behind them and we may or may not be able to head that off. But I think you should try to head that off, if that is possible—certainly, on monetary policy that is my thinking. The same thinking, of course, means that, if you frontload your measures, you are going to have to stop doing measures earlier than you did in other cycles, but that ought to be a good thing, because you hopefully will have got ahead of things.[30]

2.33 A further issue that was examined during the hearing was how the RBA and policymakers could effectively ascertain whether monetary and fiscal levers are working. The RBA pointed out that, while there are some uncertainties, it examines all available economic data against their economic projections and makes estimates based on what effects those measures will have.[31]

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28 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 23.

29 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 24.

30 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 24.

31 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 11.

2.34 The committee sought clarification on whether there is one data set, specifically employment and unemployment, which could indicate whether the fiscal stimulus package was effective. The Governor stated that 'there will not be a statistic you can look up that says that the effect of that policy measure turned out to be 90,000 or 900,000 or 9,000—or whatever—because you cannot observe the counterfactual that would have unfolded without the measures.'[32]

2.35 In relation to the previous point, the committee sought information on how to judge the effectiveness of the current fiscal stimulus package. The Governor elaborated on how the RBA analyses data to get a sense of how the economy is faring stating that:

> We track about two or three thousand data sets on a monthly basis and come up with, as best we can, an integrated view of what the economy is doing. We then ask ourselves, 'Is it doing what it should be?' and 'If not, what can we do to nudge it in the right direction?' There is no single data series, and I do not think there is even half a dozen individual indicators that you can look at to say, 'Yep, it's working,' or, 'No, it's not'—it will almost certainly never be that clear; it never is.
>
> In the end, from our point of view, we have an inflation target and a general desire to support durable growth and we assess that in a forward looking sense every month. But all those 3,000 data series go into forming the judgment about that.[33]

2.36 The committee also examined the Australian Government's guarantee of Australian banks. The committee asked if the RBA had any views on the impact of the deposit guarantees.

2.37 The Governor pointed out that the guarantee on all deposits had the desired effect of boosting both consumer confidence and international confidence stating:

> Some in the community were worrying: 'Gee, is my money safe in the bank?' People all over the world actually started to worry about that during that period, particularly when they saw a whole bunch of large European banks having to be rescued. Even in Australia—it certainly was not widespread—there were a few murmurings. People were ringing money programs on TV and so on. I saw some of them and they were saying, 'Is my money okay in the banks?' Of course the answer they were given was yes. For

32 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 12.

33 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 12.

> 999 people out of 1,000 in the community the guarantee just said, 'The money is safe,' and that issue went off the agenda and has stayed off, and that is good.
>
> The other part of the guarantee is the guarantee on wholesale obligations that banks issue in international markets. That has worked very well. I will ask one of my colleagues to talk about the details, but banks have returned to those markets globally. Australian banks, behind American banks, are the largest raisers of funds in those wholesale bond markets since November and they have mainly used the guarantee to secure that access. I think that has been very effective. The pricing is such that, when market conditions normalise, as we all trust they will eventually, the use of the guarantee will be too expensive in that world and the banks will just stop using it and will revert to issuing on their own, which is of course what we want to get back to.[34]

2.38 On that same point, the Deputy Governor added:

> …the guarantee has been of major benefit to the banks in their international bond raisings. In fact, very few banks in any country have been able to raise debt in markets around the world unless it has been guaranteed by their government. As Glenn said, our banks have made extensive use of it. Our banks are held in very high regard around the world and this has put them at a quite competitive advantage. It has been a very good thing for the banks.[35]

2.39 The committee questioned whether the guarantee had the additional impact of allowing banks to pass on cuts in the official cash rate to their customers. Mr Battellino responded:

> The main impact of the guarantee is that it has helped the banks secure their funding. It is not so much on the pass through of interest rates. In fact, the cost of this money is pretty high. The fact is that the cost of that money has not come down as much as the cash rate, which is one of the reasons why banks have not passed on the full effect to lending rates. The main thing it has done is make the banks very confident of their funding. It has allowed them to continue lending to customers. If you look around the world, in many countries banks have basically stopped lending because they are so uncertain of their own access to money that

34 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, pp. 17-18.

35 Mr R Battellino, Deputy Governor of the RBA, *Transcript*, 20 February 2009, p. 18.

> they cannot lend to customers. That is not the case for Australian banks, and that is really the most important thing because the economy cannot grow unless there is a flow of credit to the economy.[36]

2.40 The committee noted an article which appeared in the Australian Financial Review which quoted a spokesperson from the National Australia Bank who indicated that only a small number of bank customers have reduced their monthly mortgage payments and that 'over 90 per cent of their customers are still paying above the monthly minimum'.[37] The committee sought the RBA's views on whether this was having an impact on the stimulatory effect of an easing on monetary policy.

2.41 The Governor noted both the short and long term benefits stating:

> In a sense you could argue, I think, that the stimulatory effect would be bigger if everybody chose to just keep the payment at the minimum and then spend the discretionary income; obviously that is right. But this behaviour of leaving it constant happens in every down cycle, so it is not new, which means, I think, that the extent of stimulatory power today versus on other occasions will not be materially different.
>
> What that means is that their balance sheet is getting strengthened more quickly and the day when that mortgage is gone forever is also here sooner, or it might be the day when they feel that they are ready to step up to a bigger house or retire the debt and have more free income, and that would also have gotten closer. So that is still strengthening their balance sheet even though they have made the decision not to take a larger amount of free cash flow for the time being.[38]

2.42 The committee raised the question on the role of central banks in managing asset bubbles. The Governor explained that:

> …the question is about how we have all had a de facto inflation target. Even countries that do not have an explicit one have an implied one. The way in which we have run policy for 20 years is that, when the economy is strong and inflation will rise, you tighten; when it is weakened and inflation will fall, you ease. We have all known that there is a financial system out there that occasionally has low-frequency, long period swings of size and

36 Mr R Battellino, Deputy Governor of the RBA, *Transcript*, 20 February 2009, p. 18.

37 Searle J, 'Owners put pay before play', *The Australian Financial Review*, 4 February 2009, p. 10.

38 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 9.

> behaviour which impact on the real economy but often do not exactly coincide with the regular business cycle…There has been a big debate about: should you respond to that with monetary policy or not? Reasonable people differ on that. I have agonised over this privately a lot over the years. The fed's approach under Alan Greenspan was: 'We don't know if it's a bubble until it's burst. What we'll do is clean up the mess after, if it bursts, but we'll be agnostic until then.' That actually worked okay for a while. After the dotcom bursts, they were able to restart the US economy and clean up fairly well.
>
> In this episode it is proving harder, so the question is now back on the table as to asset prices. It is not so much the asset prices, in my view. It is the debt; it is the leverage behind it…It is the bubble where you have leverage and then the collapse happens—the borrower is under water and then so is the lender—where you have a big problem. Should you have lent into that bubble with tighter monetary policy, even though that would have meant slower growth, inflation below target and you would have had to explain why you were doing that—and that is not easy to do? Or should you attack this with regulatory arrangements? Should you use supervisory tools to lean into the asset bubble…Should you do both?...in the previous chapter the people who argued for doing more about asset prices did not win the day. The people who argued to let it run and then clean up won the day in the previous round, but now there is a new chapter. I suspect the answer may not be the same after this one is over. We will obviously need to keep in touch with that whole discussion.[39]

2.43 The committee also sought an explanation of when, and under what circumstances, a central bank would implement 'quantitative measures'. The Governor explained:

> The idea of 'quantitative measures'—the Fed [US Federal Reserve] has called what they are doing 'credit easing'—is that the central bank uses its balance sheet to actually buy assets. They may in extremis not sterilise those asset purchases so that the settlement funds that the banks have in their account with the central bank just go up. In that world, the overnight cash rate would collapse, because the banks have got all this spare liquidity. None of them would need to borrow overnight—they would all be up to here with it. They would all want to lend. No-one would want to

39 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 31.

> borrow and the cash rate would go to nothing. So the reason that you do not typically think of these measures while interest rates are still positive is that you would find it hard to keep them positive if you started doing these so-called printing money things.[40]

Labour market

2.44 In the February 2009 *Statement on Monetary Policy*, the RBA noted the softening of conditions in the labour market in the December quarter stating:

> Employment grew by 0.2 per cent in the quarter to be 1.6 per cent higher over the year, with the trend monthly figures for December showing no growth. Part-time employment accounted for all the growth in the quarter, with full-time employment estimated to have fallen. This could be consistent with the pattern of previous downturns…
>
> The unemployment rate has drifted up from a little more than 4 per cent in the March quarter last year to around 4½ per cent at the end of 2008.[41]

2.45 Commenting on the increased danger in policies that would re-regulate the labour market, the Governor stated that 'I think a wholesale return to days of much more intrusive centralised regulation, if that is in prospect, would be a retrograde step.'[42] However, he noted that:

> …there are two considerations which dovetail a fair way but occasionally are counter to each other. There is pure economic efficiency—and the text book says that minimal regulation points you towards the high-efficiency end of the spectrum—but there are also community notions of fairness and equity. Someone has to decide how to balance those two things. That is your job in the parliament, and that is what you are doing.[43]

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40 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 24.

41 RBA, *Statement on Monetary Policy*, 6 February 2009, pp. 40-41.

42 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 35.

43 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 35.

Exchange rates and external trade

2.46 The RBA reported that 'the Australian dollar has depreciated by 4 per cent against the US dollar and in trade-weighted terms since the last Statement to be 10 per cent below its long-run average in trade-weighted terms.'[44] The Australian dollar traded at US$63.94 cents as at the hearing date.[45]

2.47 Commodity prices have continued to decline in line with the downturn in global economic conditions. Overall, 'oil and base metals prices have moved noticeably lower, with developments mixed for coal, iron ore and rural commodities' while 'bulk shipping prices have shown tentative signs of stabilising after falling sharply over a number of months.'[46]

2.48 In particular spot prices for iron ore and thermal coal are 'around 20 to 35 per cent below the current contract prices' due to the 'global slowdown in industrial production'.[47]

2.49 Prices for base metals and oil have also declined with prices for base metals falling by '25 per cent over the past three months, led by aluminium, copper and lead'.[48] Oil has 'traded around US$40 a barrel, a level last seen in early 2005, after picking up to a record high of around $145 a barrel in mid 2008.'[49]

2.50 In contrast, the price of gold has continued to rise as investors continue to purchase precious metals while the financial markets remain uncertain.[50]

United States, China and the global economy

2.51 On 11 December 2008, the Business Cycle Dating Committee (BCDC) of the National Bureau of Economic Research[51] declared that the United States has been in recession since December 2007.[52]

44 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 26.

45 RBA website, 'Daily Statistical Release Exchange Rates', viewed on 25 February 2009, <http://www.rba.gov.au/Statistics/exchange_rates.html>

46 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 11.

47 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 11.

48 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 12.

49 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 12.

50 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 12.

51 The National Bureau of Economic Research is a US non-profit economic research organisation.

52 National Bureau of Economic Research website, Business Cycle Dating Committee, 'Determination of the December 2007 Peak in Economic Activity', viewed on 25 February 2009, <http://www.nber.org/cycles/dec2008.html>

2.52 A year on and the US economy continues to deteriorate. GDP has decreased at an annual rate of 6.2 per cent in the fourth quarter of 2008, compared with only a 0.5 per cent decrease in the third quarter of 2008.[53] The RBA stated that 'both the manufacturing and non-manufacturing ISM indices declined to very low levels in late 2008, before recovering somewhat in January.[54]

2.53 In relation to manufacturing production in the US, the RBA indicated that 'manufacturing production fell by 10 per cent in the year to December'.[55]

2.54 The RBA reported that household net worth was also estimated to have declined by more than 15 per cent in 2008, and that 'consumer credit contracted over the four months to November'.[56] The RBA also reported that 'housing starts fell by 28 per cent over the two months to December, to be well below previous cyclical lows.'[57]

2.55 On 17 February 2009 the US Government signed the *American Recovery and Reinvestment Act* into law, a US$787 billion economic stimulus package.[58]

2.56 The Governor believes that there are already signs that the US is in the early stages of recovery but that 'it will be later this year or next year by the time we have got clear evidence that a recovery is underway.'[59]

2.57 As noted earlier in this chapter, the economic downturn has started to affect the emerging economies. In particular, 'Korea and Singapore recorded exceptionally large falls in output in the December quarter'.[60]

2.58 Industrial production in some east Asian nations declined sharply with production falling 'by around 20 per cent in Korea and Thailand and by more than 25 per cent in Taiwan.'[61] The economies of several emerging European countries have also worsened considerably.[62]

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53 US Department of Commerce, Bureau of Economic Analysis website, media release, 'Gross Domestic Product: Fourth Quarter 2008 (Preliminary)', viewed on 6 March 2009, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>

54 RBA, *Statement on Monetary Policy*, 6 February 2009, pp. 5-6.

55 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

56 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

57 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

58 Recovery.Gov website, 'Timeline - Milestones at a Glance', viewed on 25 February 2009, <http://www.recovery.gov/>

59 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 21.

60 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

61 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

62 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

2.59 For China, the RBA reported that the 'weakness in the second half of 2008 saw year-ended GDP growth slow to just under 7 per cent, around half its pace as at mid 2007.'[63] The RBA is, however, optimistic about China's outlook and the flow on benefits to Australia. The Governor noted that 'there are some tentative indications of a turn for the better in China, in some of the most recent data, although it is too soon to know yet whether that will continue.'[64] Further, 'China has slowed a lot recently, but its emergence has years to run and Australia will benefit from that.'[65]

Housing and household debt

2.60 Between February and August 2008 the rise in interest rates and petrol and grocery prices put substantial pressure on Australian households. Household consumption fell rapidly during this time. However, the subsequent fall in interest rates and the cost of petrol has provided some relief. The RBA noted the impact of these reductions on household disposable income:

> Interest payments have fallen from a peak of 15 per cent of disposable income in June quarter 2008 to around 10 per cent in the March quarter and petrol prices have fallen by nearly 30 per cent from an average of roughly $1.60 per litre in mid 2008 to around $1.15 per litre, which is equivalent to a boost of around 1 per cent of real household income. The Government's one-off payments to pensioners, carers and low-to-middle-income families in December are estimated to have boosted disposable income by around 4½ per cent in the quarter.[66]

2.61 The RBA also reported that over 2008, household net worth has fallen by around 10 per cent and that households have started to save more and reduce their debt with deposit growth growing to an 'annualised pace of around 30 per cent in the three months to December, up from around 15 per cent a year earlier' and household credit growth dropping to an 'annualised rate of 3 per cent, down from 12 per cent a year earlier'.[67]

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63 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 6.

64 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 2.

65 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 4.

66 RBA, *Statement on Monetary Policy*, 6 February 2009, pp. 32-33.

67 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 33.

2.62 In relation to housing prices, the RBA reported that the residential property markets continued to weaken across the country through most of 2008. There are early indications of recovery in the housing market with the rate of approvals for new housing loans rising, especially for owner-occupiers.[68]

2.63 The RBA also observed the stimulatory effect of the increased First Home Owner Grant (FHOG) stating:

> …recent falls in interest rates and the increase in the [FHOG] that is part of the government's fiscal stimulus package are expected to lead to some recovery in the residential building industry in 2009. The number of payments for the FHOG increased sharply in December and January. The pick-up in first-home buyer activity, to the extent that it relates to the purchase of new housing, would be expected to flow through to a recovery in building approvals over coming months, and boost dwelling investment in the second half of 2009. Consistent with this, surveys indicate an increase in the proportion of households reporting that it is a good time to buy a dwelling, and the Bank's liaison with the housing industry also indicates a significant pick-up in interest from first-home buyers. Overall, standard measures of housing affordability are estimated to have risen to their highest level in a decade largely as a result of lower mortgage rates.[69]

2.64 During the hearing the committee asked about whether there was an increase in the rate of fixed rate mortgages taken out in the first half of 2008. The Assistant Governor noted that new fixed rate mortgages, which are normally about 10 per cent of all mortgages, went up to over 20 per cent early last year.[70]

2.65 In commenting on whether home owners fix their mortgages based on the prospect that inflation would rise, the Governor noted that home owners choose to fix their mortgages for many reasons stating that 'you would be inclined to fix based on your own assessment of what you can afford and what you think might happen and how much you want to worry about interest rates varying every month.'[71]

68 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 11.
69 RBA, *Statement on Monetary Policy*, 6 February 2009, p. 35.
70 Dr M Edey, Assistant Governor of the RBA, *Transcript*, 20 February 2009, p. 15.
71 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 15.

ATM interchange fees

2.66 The Governor, in his opening statement, commented on the reforms to Automatic Teller Machine (ATM) interchange fees. Currently, when cardholders use an ATM which does not belong to their bank, a so-called 'foreign' ATM, the bank pays the owner of the foreign ATM a fee. Under the new regulation, ATM owners will be able to charge the cardholder directly for using their ATM. The ATM owner must however display the fee prior to the transaction.[72]

2.67 The Governor stated:

> Now people will know exactly what the price of an ATM transaction is, and they will know it before they complete the transaction. There should be, in our view, no 'foreign' fees of any significance. And competition will be maintained, by allowing the independent ATM owners to remain viable and new competitors to enter more easily.[73]

2.68 On 23 February, the Commonwealth Bank announced that 'it would not be charging a foreign ATM access fee to its customers who use a non-Commonwealth Bank ATM in Australia.'[74] On 2 March 2009, the ANZ announced that it would also not be charging a foreign ATM access fee to its customers.[75]

2.69 To date, Westpac, the National Australia Bank and St George continue to charge foreign ATM access fees.

2.70 The reforms came into effect on 3 March 2009.[76]

Conclusions

2.71 The global economic crisis has prompted governments of many countries to implement a range of measures both domestically and internationally in an effort to stabilise markets, provide financial certainty and boost consumer confidence.

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72 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 4.

73 Mr G Stevens, Governor of the RBA, *Transcript*, 20 February 2009, p. 5.

74 Commonwealth Bank, *Media Release*, 23 February 2009.

75 ANZ, *Media Release*, 23 February 2009.

76 RBA website, 'ATM Fee Reforms', viewed on 26 February 2009, <http://www.rba.gov.au/PaymentsSystem/Reforms/ATMFeeReforms/>

2.72 It is still too soon to tell what effect these measures will have on the domestic and international economy. Australia appears to be managing the crisis relatively well in comparison to the other advanced economies.

2.73 A range of monetary and fiscal stimulus policies have been implemented in order to bolster the economy. With this in mind, the committee will scrutinise the RBA on its key forecasts for economic growth inflation and employment at the next hearing.

Craig Thomson MP
Chair
12 March 2009

A

Appendix A — Submission

Number	Provided by
1	Reserve Bank of Australia (*Opening Statement to House of Representatives Standing Committee on Economics, public hearing Canberra, 20 February 2009)*

B

Appendix B — Hearing, briefing, and witnesses

Public hearing

Friday, 20 February 2009 – Canberra

Reserve Bank of Australia

Mr Glenn Stevens, Governor
Mr Ric Battellino, Deputy Governor
Dr Malcolm Edey, Assistant Governor (Economic)
Dr Philip Lowe, Assistant Governor (Financial System)

Private briefing

Thursday, 12 February 2009 – Canberra

Mr Rory Robertson, Macquarie Bank

C

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

The Treasurer and the Governor of the Reserve Bank

6 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