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

House of Representatives Standing Committee on Economics

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Foreword

In September 2008, as the impact of the Lehman Brother collapse became clear, countries around the world tried to protect their economies from the downturn. The Governor of the Reserve Bank noted that by February 2009 ‘the resulting contraction in economic activity in the December quarter was severe in many countries, and that global growth had suffered its biggest setback in decades.’

Just twelve months later the Australian economy proved its resilience by avoiding a recession. At the August 2009 hearing the Governor was optimistic about the Australian economy and noted that Australia had several advantages including ‘a sound financial system, an absence of the worst of the problems afflicting some other countries, exposure to an emerging China, and scope to use macroeconomic policies to cushion the downturn.’

In addition, the Reserve Bank acted decisively through its monetary policy decisions. In September 2008 the policy cash rate was at a contractionary level of 7.25 percent. With the collapse of Lehman Brothers it became self evident that rates would need to be cut. Where the Reserve Bank showed leadership was through the size and speed of the cash rate reductions that occurred. Between September 2008 and April 2009 the Reserve Bank reduced the policy cash rate by 425 basis points. Three rate reductions were of the order of 100 basis points each. It is also notable that the Reserve Bank held off when the policy cash rate reached three per cent. Financial markets were at one point factoring in a cash rate of less than 2 per cent. The contribution that the Bank’s monetary policy made to underpinning the economy during the height of the downturn can not be underestimated and it will certainly be a benchmark response for future Governor’s of the Reserve Bank to note.

While the Reserve Bank’s approach to monetary policy during the height of the global financial crisis showed sound leadership the period ahead is no less challenging. It is now apparent that the Bank has turned to its core objective of inflation targeting. In October 2009 the Reserve Bank was possibly the first

amongst central banks to increase rates. The Governor has made it clear that the 'emergency rates' during the crisis would be inappropriate as the economy started to grow. The Bank's objective is now to lift rates to a 'normal' or neutral setting that will provide for long term growth and core inflation in the target band.

The management of monetary policy, however, during the next six to twelve months will be associated with some risks. The first challenge for the Board is the timing and size of the rate increases. The Governor commented that 'the timing and pace of those adjustments, if and when they come, will be a matter of careful consideration, taking into account all the relevant factors, including what might be happening with market interest rates.' While the economy is returning to higher levels of growth there is still some fragility in the economy. Unfortunately unemployment could still rise and manufacturers and other export based industries are under pressure from the strong Australian dollar.

The bank must be certain that any rate rises during the next 12 months do not work against the economy's return to trend levels of growth. Conversely, the Reserve Bank needs to ensure that inflationary forces are kept in check and that medium to long term inflation is forecast to be in the target band. These challenges are why the next hearings with the Reserve Bank in February and later in August 2010 are significant. The Reserve Bank has an important responsibility to the Australian community and it will need to account for its performance particularly during the cycle ahead.

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 14 August 2009. The next public hearing will be held on 19 February 2010 in Canberra.

Craig Thomson MP
Chair



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Terms of reference

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



List of abbreviations

ABS	Australian Bureau of Statistics
ATM	Automatic Teller Machine
CPI	Consumer Price Index
EFTPOS	Electronic Funds Transfer at Point of Sale
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
TWI	Trade Weighted Index
UK	United Kingdom
US	United States of America
WTI	West Texas Intermediate