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Review of the Reserve Bank of Australia *Annual Report 2003* – Interim Report

House of Representatives
Standing Committee on Economics, Finance and Public Administration

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Foreword

The Committee's December 2003 public hearing with the Governor of the Reserve Bank was held at an interesting time for Australian monetary policy. The value of the Australian dollar was rising rapidly, household debt had increased to all time highs, and there was continued growth in the Australian economy.

Immediately prior to the hearing the RBA increased the cash rate twice – in November from 4.75 to 5 percent and in December from 5 to 5.25 percent. These were the first increases in 17 months. Much of the focus at the hearing was on the RBA's decision to increase interest rates at this time, and the tension between the rising exchange rate and the rapid rise in household debt when determining monetary policy settings.

The Brisbane hearing, like previous ones, was a very important part of the ongoing accountability of the Reserve Bank of Australia to the Federal Parliament and the wider community. I would like to thank the Governor of the Bank, Mr Ian Macfarlane, for his frank comments on monetary policy and other issues at the hearing. I also congratulate the Governor on his subsequent appointment as a Companion in the Order of Australia, a well-deserved honour.

The December hearing – the first ever in Brisbane – followed the Committee's practice of holding every second hearing in a centre outside Sydney or Melbourne. We welcomed members of communities in the Brisbane area and students of Queensland schools and universities who attended the hearing.

I would like to thank the RBA for its ongoing support for the biannual hearings, and acknowledge the continuing assistance the Committee receives from David Richardson from the Parliamentary Library and Geoff Dodd from the House of Representatives Liaison and Projects Office. I would also like to thank Dr Barry Hughes from Credit Suisse Asset Management for the valuable briefing he gave the Committee before the hearing.

Despite the recent two rises in official interest rates, as at February 2004 speculation continues that there will be a further rise within the next few months. The Committee looks forward to questioning the RBA on this and other issues at the next public hearing, likely to be held shortly after the Bank’s June Board meeting.

David Hawker MP
Chair

Membership of the Committee

Chair	Mr David Hawker MP	
Deputy Chair	Ms Anna Burke MP	
Members	Mr Anthony Albanese MP	Mr Peter King MP
	Mr David Cox MP	Mr Gary Nairn MP
	Ms Teresa Gambaro MP	The Hon Alex Somlyay MP
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Terms of reference

The House of Representatives Standing Committee on Economics, Finance and Public Administration is empowered to inquire into, and report on, any matter referred to it by either the House or a Minister, including any pre-legislation proposal, bill, motion, petition, vote on expenditure, other financial matter, report or paper.

Annual reports of government departments and authorities tabled in the House stand referred to the relevant committee for any inquiry the committee may wish to make. Reports stand referred to committees in accordance with a schedule tabled by the Speaker to record the areas of responsibility of each committee.

The Reserve Bank of Australia's *Annual Report 2003* was tabled in the House of Representatives on 11 September 2003 and the Payments System Board's *Annual Report 2003* was tabled in the House of Representatives on 7 October 2003.

List of abbreviations

ACCC	Australian Competition and Consumer Commission
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
CAD	Current Account Deficit
GDP	Gross Domestic Product
RBA	Reserve Bank of Australia
US	United States

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Introduction

Background

1.1 The House of Representatives Standing Committee on Economics, Finance and Public Administration is responsible for monitoring the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the financial sector and the community as a whole.

1.2 The Reserve Bank Governor's appearances before the Committee at biannual public hearings are an important element of the Bank's accountability framework. These biannual appearances are provided for by two means:

- the August 1996 *Statement on the Conduct of Monetary Policy,* agreed between the Treasurer, the Hon Peter Costello MP, and the Governor, Mr Ian Macfarlane.[1] The statement formalised the Bank's accountability framework and the biannual appearance before the Committee; and
- 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. The House Economics Committee may inquire into

1 A second *Statement on the Conduct of Monetary Policy* was released in July 2003, building on the 1996 Statement. Both documents can be viewed on the RBA's website at www.rba.gov.au/MonetaryPolicy.

aspects of the annual reports of the RBA and the Bank's Payment Systems Board.

1.3 The biannual hearings typically coincide with the release of one of the RBA's quarterly statements on monetary policy. At the December 2003 hearing in Brisbane, the Committee scrutinised the RBA's *Statement on Monetary Policy* for November 2003.

1.4 As with previous reports, this report focuses on matters raised at the public hearing. The report does not repeat in detail the commentary in the RBA's *Annual Report* and statements on monetary policy. These documents may be viewed through the Bank's website.[2]

Scope and conduct of the review

1.5 Following the tabling of the RBA's *Annual Report 2003*, a public hearing was held at Queensland State Parliament House in Brisbane on 8 December 2003.

1.6 Proceedings for the hearing were streamed over the internet through the Parliament's website. This is now standard practice for the Committee's RBA hearings.

1.7 The Governor's opening statement and the transcript of the hearing are available on the Committee's website.[3]

1.8 Before the hearing the Committee received a private briefing from Dr Barry Hughes, Chief Economist at Credit Suisse Asset Management. The briefing was of great assistance to the Committee in highlighting issues for discussion at the public hearings.

1.9 The hearing in Brisbane is the third to be conducted outside Melbourne, Sydney or Canberra – the first was the December 2000 hearing in Wagga Wagga in NSW and the second was the December 2002 hearing in Warrnambool in VIC. These hearings have played a valuable role in involving regional Australia in the parliamentary committee system.

1.10 The Committee was delighted that many members of the public from the Brisbane area attended the hearing. Also, several students from

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2 www.rba.gov.au/PublicationsAndResearch/.

3 http://www.aph.gov.au/house/committee/efpa/RBA2002_03/index.htm.

secondary schools and universities accepted the Committee's invitation to attend the hearing.

1.11 The Committee's public hearings with the RBA have helped to bring issues of monetary policy into the public arena and have assisted to provide a public face to parliamentary committees and the RBA. The Committee welcomes the Governor's frank and honest comments at the hearings. The hearings are also an important means by which markets can be better informed of the current thinking of the RBA on a range of current economic and banking issues.

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Monetary policy and related issues

Review of the 2003 year

2.1 The Governor of the RBA described the 2003 calendar year as 'a very unusual one for the world economy'. Uncertainty on the world economy stemming from issues such as possible deflation in the USA, a weakening European economy, and a SARS outbreak in Asia, saw weaknesses in the first half of the year. In the June quarter most major countries saw declines in GDP. This prompted many central banks, including in the USA, England, Canada and Europe, to reduce interest rates.

2.2 However, the Governor stated that this was followed by a sharp turnaround and by the September quarter those economies were growing strongly.

> Talk of deflation ceased and the short-lived bout of monetary policy easings stopped. Business and consumer confidence around the world rose back to levels which were consistent with reasonable economic growth.[1]

2.3 On the domestic front, the RBA revised its forecasts for GDP due to higher growth in the second half of the year, including a growth in domestic spending. At the public hearing in Melbourne in June 2003, the RBA forecast that GDP would grow by 3 percent in real terms

1 *Official Hansard*, 8 December 2003, Brisbane, p. 2.

over the course of the 2003 calendar year. The RBA's revised forecasts at the December 2003 hearing were for GDP growth to finish a little higher at 3.5 percent.

2.4 The RBA also revised its expectations on the CPI largely due to the exchange rate being higher than earlier forecast - at the hearing in June 2003 the RBA expected the CPI to increase by 2.5 percent over the calendar year 2003, however, at the December 2003 hearing the RBA expected the CPI to be a little lower at 2.25 percent.

2.5 With perceptions about the world economy raised and economic indicators in Australia improving, the cash rate was raised:

> Economic conditions here and abroad had returned to something relatively normal, and, as a consequence, we judged that we no longer needed such an expansionary setting of monetary policy, so interest rates were raised accordingly in November and December.[2]

2.6 The two increases in interest rates preceding the 8 December 2003 public hearing were in November (from 4.75 to 5 percent) and in December (from 5 to 5.25 percent). These were the first rises in official interest rates for 17 months. In reaching the decision to increase the cash rate in December, the RBA stated that it took into account the following considerations:

- economic conditions around the world continued to improve;
- the economy strengthened considerably in Australia with consumer spending accelerating, business confidence high, and the labour market firming;
- the inflation rate was close to the RBA's target mid-point and a rising trajectory on CPI inflation was expected once the effects of the higher exchange rate fades; and
- domestic credit continued to expand due to the cash rate remaining 'below neutral'.[3]

2 *Official Hansard*, 8 December 2003, Brisbane, p. 2.

3 *Statement by the Governor, Mr Ian Macfarlane on Monetary Policy*, 3 December 2003.

Forecasts for 2004

2.7 Looking ahead, the RBA expects GDP to grow by 4 percent over the course of 2004. If the world economy continues to strongly grow, the RBA expects that GDP growth could be even higher.[4]

2.8 Over the course of 2004 the RBA expects the CPI to increase by 2 percent overall, with the higher Australian dollar impacting in the first half of the year. In other words, the profile for inflation will be U -shaped:

> … falling from its present 2½ per cent to below two per cent in mid-2004, then rising back to two per cent by end 2004, 2½ per cent by mid-2005 and, in our view, being under upward pressure thereafter.[5]

2.9 At the Brisbane hearing the Committee questioned the Governor about a solution to the current account deficit (CAD) at over 6 percent of GDP. Mr Macfarlane referred to the 6 percent as a peak and forecast the CAD would fall as the world economy grows and Australia's rural exports pick up.[6]

Inflation targeting and monetary policy

2.10 The *Second Statement on the Conduct of Monetary Policy* of July 2003 reaffirmed the understanding between the Treasurer and the Governor of the RBA on the operation of monetary policy in Australia. It states:

> In pursuing the goal of medium term price stability, both the 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 benchmark performance over time.[7]

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4 *Official Hansard*, 8 December 2003, Brisbane, p. 2.

5 *Official Hansard*, 8 December 2003, Brisbane, p. 3.

6 *Official Hansard*, 8 December 2003, Brisbane, p. 34.

7 *Second Statement on the Conduct of Monetary Policy*, June 2003 [Online: http://www.rba.gov.au/MonetaryPolicy/second_statement_on_the_conduct_of_monetary_policy_2003.html].

2.11 The RBA has conducted monetary policy by targeting an underlying inflation rate of between 2 and 3 percent since 1993. At the Brisbane hearing the Governor stated that it is that average of 2 to 3 percent by which the RBA should be judged or made accountable. Over this 10 year period, inflation has averaged 2.4 percent.[8]

2.12 At the May 2002 hearing the Governor suggested that a neutral interest rate is inflation plus between 3 and 3.5 percent.[9] At the most recent hearing in Brisbane, however, the Governor added a caveat to the idea of a 'normal' interest rate: it is a general guide only and it is not essential to fit within the range 'come what may'.[10]

2.13 Mr Macfarlane referred to the RBA's most recent moves in interest rates as a gradual process of 'returning interest rates to more normal levels'. The Governor explained that if the RBA had maintained the low level of interest rates, there would have been a gradual build-up in inflationary pressures as the growth rates of the world and Australian economies rose.[11]

2.14 The Governor emphasised that the RBA does not try to finetune inflation:

> What we try to do is get the impression of where we think the forces are coming from. In our view, had we persevered with that lower level of interest rates then, in time, forces would have built up which would have meant that, in that two- to three-year horizon, in all probability inflation would be on an upward trajectory—and not just a temporary one but one that you would have to do something about. So that is why we did it early.[12]

2.15 The Governor claimed the RBA had been accused of setting monetary policy in relation to the Sydney and Melbourne housing markets and ignoring the rest of the country. He stated, however, that this cannot be true given housing prices in Sydney and Melbourne had already started to fall. The Governor also made it clear that the purpose of tightening monetary policy was not to cool down the property market.

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8 *Official Hansard*, 8 December 2003, Brisbane, p. 13.

9 *Official Hansard*, 31 May 2002, Sydney, p. 6.

10 *Official Hansard*, 8 December 2003, Brisbane, p. 36

11 *Official Hansard*, 8 December 2003, Brisbane, p. 3.

12 *Official Hansard*, 8 December 2003, Brisbane, p. 10.

> It was only when it became clear that good economic growth had returned both globally and domestically that rates were raised. I have often stressed that monetary policy has to be set taking into account the average of all the parts of the economy, not just what is happening in one sector.[13]

2.16 In summarising the RBA's monetary policy framework, the Governor stated:

> I want to assure the committee that the bank remains committed to the inflation targeting framework and that decisions taken over the past 18 months have been fully consistent with that approach. It does not seem plausible to us to argue that the bank could have been confident of meeting its inflation commitments if interest rates had been held at 30-year lows in the face of the pick-up in the international and domestic economies that is currently under way.[14]

Monetary policy in other countries

2.17 In discussion on comparisons with central banks in other world economies which had not increased interest rates, the Governor maintained that Australia's economy 'is in much better shape'. The Governor claimed that many economies are still recovering from the aftermath of bursting asset price bubbles or recessions, and therefore may not change interest rates before they are fully confident of recovery.

2.18 The Governor claimed that, even though the RBA has increased interest rates, Australia's economy has been growing better than comparative countries around the world and this is something to be pleased with:

> I think we should in some sense rejoice in that rather than look on the gloomy side of things and say, 'Oh, but our interest rates are higher.' The two things go together, and I know which one I would prefer to have—a good healthy economy with normal interest rates, rather than a sick economy with low interest rates.[15]

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13 *Official Hansard*, 8 December 2003, Brisbane, p. 3.

14 *Official Hansard*, 8 December 2003, Brisbane, p. 5.

15 *Official Hansard*, 8 December 2003, Brisbane, p. 7.

Household debt

2.19 Household credit continued to grow strongly in 2003, at about 21 percent over the year to September 2003. Of this, housing credit was growing at an annualised rate of 25 percent.[16] About 85 percent of household debt is housing debt and credit card debt makes up around 6 percent.

2.20 About 30 percent of households in Australia have a mortgage, 40 percent own their house outright, and 30 percent are renting. The Governor noted that about 1.3 million people have invested in rental property and it is sections of this group which may be vulnerable to interest rate rises; even modest rises in interest rates and falls in certain sorts of property prices will cause distress. [17]

2.21 The Governor stated he did not believe the distress will be for owner-occupiers, although some who have taken out the most expensive mortgage they can afford may be vulnerable:

> Of the people with a mortgage, somewhere between 50 and 60 per cent probably will not actually have their weekly payment go up, because they are already ahead on their repayment schedule. So, rather than 30 per cent, it is maybe 15 per cent of households that will see their monthly mortgage payment go up. I feel sorry for people who have just taken out a mortgage and interest rates go up, but you cannot really make economic policy on the basis of that.[18]

2.22 The Governor emphasised that there are always people at the margin who are going to be vulnerable to either a rise in interest rates or a fall in interest rates. For example, self-funded retirees may be vulnerable to a decrease in interest rates. The Committee notes the Governor's comment in Brisbane that "at the end of the day we have to make the monetary policy decision on what we think is best for Australia".[19]

2.23 In discussion on the effect a half-a-percent increase in interest rates would have on the behaviour of borrowers, the Governor stated:

> It is not a very big squeeze on people, but in some areas it has already had quite a big impact on people's expectations about

16 *Statement on Monetary Policy*, November 2003, pp. 20-23.

17 *Official Hansard*, 8 December 2003, Brisbane, p. 18.

18 *Official Hansard*, 8 December 2003, Brisbane, p. 22.

19 *Official Hansard*, 8 December 2003, Brisbane, p. 23.

> whether they want to borrow. It is not whether they can afford to; a lot of it is whether they really want to borrow at the same rate. If a lot of this borrowing was generated by housing, there is evidence that attitudes have changed to some extent—not a lot.[20]

Exchange rates

2.24 **Over the last two years the Australian dollar has risen 45 percent against the US dollar.** The Governor assured the Committee that these factors are taken into account, along with many other variables, when making assessments on monetary policy.

2.25 The Governor also made the point that the Australian dollar did not rise due to interest rates rising. Rather, it can be explained by two factors – firstly, the return from a very low figure during the Asian economic crisis, and secondly, the fall of the US dollar against all currencies:

> The US dollar has fallen by 23 per cent against [the major floating currencies] and it has fallen by 29 percent against the Australian dollar – or ours has risen by 29 percent against the US dollar. In other words, 23 of the 29 is basically the US dollar falling against everyone.[21]

2.26 Besides these two factors, the Governor claimed that the recent lift in the Australian dollar is also influenced by the growing world economy and Australian economy and the rise in many commodity prices. The Governor stated that while interest rates do have an effect on the exchange rate, these other factors are driving it:

> I do not want to use that to say that interest rates do not matter, because they normally do. They are normally quite important. They are a bit difficult to quantify over any particular period but quite important. At the moment I think the big dynamic on the Australian dollar is being driven by the weakening US dollar, the strengthening world economy and rising commodity prices. They are doing most of the work. Even if we were to change our view of the world and say that we are no longer going to conduct monetary policy

20 *Official Hansard*, 8 December 2003, Brisbane, p. 16.

21 *Official Hansard*, 8 December 2003, Brisbane, p. 9.

> for the whole economy but we are going to try and direct it at what is happening to the exchange rate—that is, by not raising interest rates—I would doubt whether it would have much effect, just as in New Zealand the fact that they did not put up their interest rates had no effect.[22]

2.27 The Governor also claimed that moves in the exchange rate do not have the same effect on inflation as they have done in the past:

> We do spend a lot of time looking at this issue of how changes in the exchange rate flow through to inflation. We are finding that it is symmetrical, that the falls in the exchange rate were not as inflationary as they would have been 10 or 20 years ago and the rises in the exchange rate are not as disinflationary as they would have been.[23]

2.28 The Governor also stated that rises or falls in exchange rates have not affected product prices to the same extent as in past years; businesses are absorbing the changes in profit margins.[24] However, the Committee notes the growing pressure on many exporters, particularly as in January 2004 the Australian dollar went up to US80c.

2.29 At future hearings the Committee will revisit this issue, and the tension between the exchange rate (including the effect on the export sector) and the rapid rise in household debt in determining monetary policy settings.

Unemployment

2.30 The Governor noted that long and stable expansions in the economy can produce lasting reductions in unemployment. He claimed that past damage to the unemployment rate in Australia was due to three recessions within seven or eight years of each other – these recessions took unemployment up sharply and it took years for it to go down again. He stated that the best thing the RBA can do to get unemployment down is to have monetary policy settings conducive to long expansions.

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22 *Official Hansard*, 8 December 2003, Brisbane, p. 9.

23 *Official Hansard*, 8 December 2003, Brisbane, p. 12.

24 *Official Hansard*, 8 December 2003, Brisbane, p. 11.

2.31 The Governor stated that there are skills shortages in some industries, for example, the building industry. The wage cost index is not showing any major rises, however, at the margin it is there. The Governor stated that it is certainly something that is considered when the RBA makes a judgement about where inflation will be in two years time.[25]

25 *Official Hansard*, 8 December 2003, Brisbane, p. 15.

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Other matters

RBA Board voting

3.1 In response to a query as to whether the two recent rate rises were unanimous decisions of the Board, the Governor asserted that he was unwilling to answer, the reason being that the basis of the current system is that voting patterns are not disclosed. Mr Macfarlane stressed that he felt quite strongly about the principle of nondisclosure of voting patterns.

3.2 The rationale behind this policy is that the RBA's Board is comprised of people representing the broader community, from such sectors as retailing, agriculture and mining, and it would be impossible for them to do their job if their vote were disclosed.

> When these people come to the Reserve Bank board, they have to forget their sectional interests. They have to come along and say, 'I am making a decision for the whole economy; I am not making a decision for the sector that I come from.' To get them to do that, you have to provide them with the fact that their statements and their votes are confidential, otherwise they will be put under public pressure to revert to being simply sectional advocates.[1]

1 *Official Hansard*, 8 December 2003, Brisbane, p. 10.

RBA in regional areas

3.3 The RBA's regional offices, located in Brisbane, Melbourne, Perth and Adelaide, conduct meetings with businesses, industries and local government and provide feedback at regular meetings held in Sydney. The information gathered is discussed and collated, so that it can be utilised within the forecasts and assessments that the economic department of the RBA makes.[2]

3.4 In terms of expanding the reporting role of the RBA's regional offices, to resemble that of the US Federal Reserve District System, the Bank asserted that such a move is beyond its capabilities and resources. In comparison each US Federal Reserve District has more resources:

> They are really quite large organisations and they can support a body of economists—there are perhaps a dozen economists in each one—and it is a massive infrastructure, which we do not have. I think it would be a bit ambitious for us to do anything that resembles what is in the [US Federal Reserve] beige book. But I take your point that maybe we should make more reference to regional differences where the regional differences are significant enough to influence our interpretation of how the national thing is moving.[3]

Regulation of borrowing mechanisms

3.5 The issue of whether there needs to be increased regulation in the methods by which financing can be obtained was raised by the Committee at the Brisbane hearing. A number of financing instruments currently available, for example deposit bonds, do not fall under the jurisdiction of authorised deposit-taking institutions (ADIs) and as such are not subject to Australian Prudential Regulation Authority (APRA) rules and regulations.

3.6 Mr Macfarlane commented that he was not sure how the RBA would handle this. He noted for instance that financing with deposit bonds, particularly for people who use them to buy something that they resell before settlement, would be quite difficult to regulate. However, in regards to the use of this specific borrowing mechanism, the

2 *Official Hansard*, 8 December 2003, Brisbane, p.13.

3 *Official Hansard*, 8 December 2003, Brisbane, pp. 34-35.

Governor remarked that its use was declining, as illustrated by many developers and vendors not accepting them as evidence of a deposit.[4]

3.7 The Governor also stated that he was unsure how to approach the new trend whereby lenders make loans and, rather than retain them on their books, securitize and sell them onto the market. He claimed that whilst some of these lenders are doing an excellent job, there are some at the fringe whose actions are reckless. In terms of tackling this group he did not have a suggestion. However, Mr Macfarlane asserted that APRA was attempting to remedy this situation, by examining the practices of institutions which fall under its regulatory jurisdiction.

3.8 The Committee has resolved to review APRA's *Annual Report 2003* and will pursue this matter further during the relevant public hearing.

Credit cards

3.9 The RBA informed the Committee of its progress in the reform of credit cards. The Governor noted that, since the last public hearing in June 2003, the legal challenges brought against the RBA's reforms to credit card schemes by MasterCard and Visa were dismissed by the Federal Court. Moreover, whilst both schemes appealed, Visa has subsequently decided to cease its action.

3.10 The new interchange fees for Bankcard, MasterCard and Visa which came into effect at the end of October 2003 have achieved almost a 50 percent reduction in interchange fees. The RBA is now monitoring the flow-on of these savings to merchant service fees. The Governor asserted that whilst data in this area was still being collated, anecdotal evidence collected thus far 'suggests that merchants are starting to see a reduction in the merchant service fee they pay to banks'.[5]

3.11 **According to the RBA, credit cards are, for both cardholders and merchants, the most expensive way of making a payment. The Governor noted that the banks make greater profits from credit card transactions than cash, cheque, EFTPOS or direct credit transactions**. The Governor commented on the marketing strategy of the banks:

4 *Official Hansard*, 8 December 2003, Brisbane, p.19.

5 *Official Hansard*, 8 December 2003, Brisbane, p.5.

> Their marketing strategy was to make it as cheap as possible for the cardholder so that the cardholder would want to use their credit card all the time. Therefore, each time the credit card got used, the merchant would have to pay over a significant sum of money to the banks. That was the marketing strategy. We did not like that strategy because the cardholder was not seeing the true cost of what they were doing.[6]

3.12 The RBA asserted that through reform it is endeavouring to make the true cost of credit cards visible to customers. By reducing credit card interchange fees, the banks are being forced to increase direct charges to credit card holders. The Governor contended that this move is necessary to bring credit cards more into line with other payment systems.[7]

3.13 In response to questions from the Committee about whether competitive pressures in the credit card sector are adequate, the Governor responded that 'if that competitive pressure comes from someone outside the industry, it is very effective'.[8]

3.14 Mr Macfarlane stated that he was unsure as to which outside, non-traditional players would have the capacity to provide the necessary competitive pressure in this sector. However, the RBA drew attention to the experiences of the US where commercial rivalry has been relatively successful, due to a number of non-traditional firms recognising that providing credit card services to merchants can be a profitable business. In fact over the last 15 or 20 years non traditional players have increased their participation in this sector to such an extent that they now perform more than half of it.

3.15 The RBA suggested that specialisation in the business of issuing credit cards is also likely to develop in Australia due to its reforms. However, the Bank did emphasise that change in this area will not occur immediately, and that society will need to be 'patient to see the effects of increased competition'.[9]

3.16 The Committee will consider inquiring into aspects of competition and transparency in the credit card sector in 2004.

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6 *Official Hansard*, 8 December 2003, Brisbane, p.24.

7 *Official Hansard*, 8 December 2003, Brisbane, p.24.

8 *Official Hansard*, 8 December 2003, Brisbane, p.25.

9 *Official Hansard*, 8 December 2003, Brisbane, p.26.

3.17 In respect to the issue of whether the RBA's reforms have created an uneven playing field, advantageous to closed card schemes such as Diners Card and Amex, the Governor asserted that this is not the case as the RBA has not only reduced the interchange fee on four party schemes but has also ended the prohibition that the closed card schemes imposed on merchants passing on their costs to customers. These moves should lead to greater competition, as merchants can now afford to utilise not only four party systems but also three party card systems, by charging customers more for using credit cards.[10]

BPay

3.18 The RBA's original study on interchange fees (conducted in 1999-2000 in partnership with the ACCC) did not include BPay, due to its relatively small size at that time:

> The figures showed that the average bank customer had three BPay transactions a year whereas they had 50 or 60 credit card and debit card transactions a year.[11]

3.19 In its November 2003 report, the Committee noted its concern with the apparently high level of the BPay interchange fee. The Committee was of the view that the RBA should undertake an immediate review with the objective of ensuring that BPay interchange fees are reduced to a reasonable level.[12]

3.20 The RBA at the Brisbane hearing did however stress that this situation is in the process of being remedied. The RBA is talking to the banks about BPay and intends to conduct a thorough study of the economics of this payment system in order to determine whether the current interchange fee is reasonable or whether there should be an interchange fee at all.[13]

3.21 The Committee will pursue this matter further with the RBA at the next hearing.

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10 *Official Hansard*, 8 December 2003, Brisbane, p.27.

11 *Official Hansard*, 8 December 2003, Brisbane, p.27.

12 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Review of the Reserve Bank of Australia Annual Report 2002*, November 2003, p.31.

13 *Official Hansard*, 8 December 2003, Brisbane, p.27.

ATM fees

3.22 Currently, someone wishing to utilize a foreign ATM – that is, an ATM not owned by their bank or financial institution - is charged a foreign ATM fee. Most customers are unaware as to what this fee is until after the transaction has taken place, usually when they receive a statement.[14]

3.23 The RBA indicated that the banks are likely to shortly approach the ACCC in order to propose the elimination of the current interchange fee of approximately one dollar, which underpins the average foreign fee of about $1.35.[15]

3.24 The aim of this reform is to achieve greater transparency and competition in relation to ATM fees. It may lead to ATM owners using signs on their machines to set out foreign ATM costs to customers. Individuals would then have the necessary information to decide whether or not to make a transaction on a particular machine.

3.25 Progress on this reform will be further discussed with the RBA at the next hearing.

RBA Board composition and attendance

3.26 The Governor commented at the Brisbane public hearing that he was quite happy with the current board membership, which in terms of its composition is quite unique when compared to other central banks throughout the world.

> … our board is unusual by the standards of most central banks in that it is a lay board and yet it is a decision-making board. It is not just a group of economists, and I am comfortable with that.[16]

3.27 The Committee queried whether the RBA Board is in need of greater expertise. In reply, Mr Macfarlane stated that whilst he did not personally think that this was necessary, he noted that there are some people who do. Moreover, the Governor asserted that the current approach to the Board's composition is the most appropriate, given

14 *Official Hansard*, 8 December 2003, Brisbane, p.29.

15 *Official Hansard*, 8 December 2003, Brisbane, p.29.

16 *Official Hansard*, 8 December 2003, Brisbane, p.31.

that Australia has a history of this type of board and it has gained widespread acceptance:

> … in Australia people take comfort from the fact that it is not just a lot of high priests sitting up there making this decision, that there are practical people who have to be persuaded and who come at the issue from a different direction. I think that gives it strength.[17]

3.28 In respect to attendance at RBA Board meetings, Mr Macfarlane noted that currently it is quite good, stating that 'if you went back 10 or 20 years, the attendance was never as good as it is now'.[18]

3.29 The Governor also referred to his communications with the Treasurer before and after board meetings. The Governor has a regular pattern of meetings with the Treasurer after board meetings to discuss the economy and any possible risks. Also, the Secretary of Treasury as a member of the board is sent a board paper prior to meetings; therefore, the Treasurer would be informed prior to board meetings about recommendations to be put to the board regarding interest rates.[19]

Foreign exchange market

3.30 In recent times the RBA has been successful in the foreign currency exchange market, a point substantiated by the fact that it has made considerable gains via the purchase of Australian dollars at 47c and 50c and their subsequent sale at 73c.[20]

3.31 In respect to this success, the question was raised by the Committee at the Brisbane hearing as to whether the appreciation of the Australian dollar will notably impact upon the RBA dividend to the government. The Governor stated that in the short term the bearing on the dividend would be small.

> … the profit is not realised until we actually sell the foreign currency. The profit is realised when we sell foreign currency, not when we buy it. That means that the profit is actually realised during the periods when the Australian dollar is

17 *Official Hansard*, 8 December 2003, Brisbane, p.31.

18 *Official Hansard*, 8 December 2003, Brisbane, p.31.

19 *Official Hansard*, 8 December 2003, Brisbane, p.30.

20 *Official Hansard*, 8 December 2003, Brisbane, p.32.

> weak, when we are selling foreign currency to buy Australian dollars. We can re-establish a profitable position when the Australian dollar is strong, but it is only an unrealised profit. It becomes a realised profit when we sell the foreign currency.[21]

Regulating property investment promotions

3.32 In light of the recent demise of a prominent property investment promoter, the Committee at the Brisbane public hearing raised the issue of whether there is a need for both Commonwealth and state regulation in the area of property investment promotions. The Governor noted that the situation has evolved where many people who claim to be real estate agents are making money out of financial advice, often in situations involving a considerable conflict of interest because course participants are encouraged to purchase property off seminar convenors.

3.33 The Governor commented that he was not sure what the final solution to the problem should be, however, he stressed that a system must be implemented in some form in order to regulate people who are essentially giving financial advice, and to ensure that people who give financial advice are regulated equally.[22]

Conclusion

3.34 The public hearing in Brisbane again demonstrated the value of the Committee's biannual hearings with the RBA. The hearing was well-attended by the public, student groups and others, and as always attracted considerable interest from financial markets and the media. The Committee looks forward to continuing this productive process at its next hearing with the RBA.

David Hawker MP
Committee Chair

March 2004

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21 *Official Hansard*, 8 December 2003, Brisbane, p.32.

22 *Official Hansard*, 8 December 2003, Brisbane, p.32.

A

Appendix A – Submission

No.	From
1	Reserve Bank of Australia *Opening Statement to House of Representatives Standing Committee on Economics, Finance and Public Administration, Brisbane, 8 December 2003.*

B

Appendix B – Briefings, hearings and witnesses

Public hearings

Monday, 8 December 2003 – Brisbane

Reserve Bank of Australia

Mr Ian Macfarlane, Governor
Mr Richard Battellino, Assistant Governor (Financial Markets)
Dr Malcolm Edey, Assistant Governor (Economic)
Mr Glenn Stevens, Deputy Governor
Dr John Veale, Acting Assistant Governor (Financial System)

Private briefings

Thursday, 4 December 2003 – Canberra

Dr Barry Hughes, Chief Economist, Credit Suisse Asset Management