2

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]

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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.

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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]

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]

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]

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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