2

Monetary policy and other issues

Overview

2.1 On 3 December 2013 the Reserve Bank of Australia (RBA) decided to hold official interest rates at two and a half per cent. In his statement on the decision, the Governor noted that:

> Overall, global financial conditions remain very accommodative. Volatility in financial markets has abated recently. Long-term interest rates remain very low and there is ample funding available for creditworthy borrowers.[1]

2.2 The Governor further noted in this statement that 'in Australia, the economy has been growing a bit below trend over the past year and the unemployment rate has edged higher'.[2] The Governor stated that:

> Recent data on prices and wages show inflation consistent with the medium-term target. The Bank's assessment is that this is likely to remain the case over the next one to two years.[3]

2.3 The Governor also commented:

> … the Board judged that the setting of monetary policy remained appropriate. The Board will continue to assess the outlook and adjust policy as needed to foster sustainable growth in demand and inflation outcomes consistent with the target.[4]

---

1 Mr Glenn Stevens, Governor of the RBA, *Media Release: Statement by Glenn Stevens, Governor: Monetary Policy Decision*, see: <http://www.rba.gov.au/media-releases/2013/mr-13-25.html>

2 Mr Glenn Stevens, Governor of the RBA, *Media Release: Statement by Glenn Stevens, Governor: Monetary Policy Decision*, see: <http://www.rba.gov.au/media-releases/2013/mr-13-25.html>

3 Mr Glenn Stevens, Governor of the RBA, *Media Release: Statement by Glenn Stevens, Governor: Monetary Policy Decision*, see: <http://www.rba.gov.au/media-releases/2013/mr-13-25.htm>

4 Mr Glenn Stevens, Governor of the RBA, *Media Release: Statement by Glenn Stevens, Governor: Monetary Policy Decision*, see: <http://www.rba.gov.au/media-releases/2013/mr-13-25.html>

2.4 During the hearing on 18 December 2013 before the committee, the Governor outlined his forecasts for both the global and Australian economies. The Governor noted in his opening remarks that:

> At the previous meeting we had with the committee early in the year, we noted several developments. The first of those was the fear of a break-up of the euro area, which had at an earlier time been quite real but had in fact abated. The United States economy was gradually recovering, and the slowdown in China appeared to have run its course.[5]

2.5 The Governor further noted that 'those outcomes were roughly as expected, but perhaps of greater significance at that time—and this was back in February—was the fact that various so-called downside risks had not in fact eventuated'.[6] The Governor stated:

> Global growth was running below average, though not disastrously so, and it was thought likely to pick up a little in 2013. The period since then could be described as more of the same.[7]

2.6 The Governor further commented in his opening remarks that 'looking ahead, the issue that most people are focusing on at the moment is the so-called tapering of US monetary policy'.[8] The Governor explained:

> What is meant by this is that the Federal Reserve is expected, at some point, to begin to moderate the rate at which it buys securities in the market. Presently that is US$85 billion per month. Eventually it is expected to stop those purchases.[9]

2.7 The Governor concluded in relation to US tapering that:

> We do not know when that process will begin … We can be fairly sure, though, that there is ample potential for this shift in direction to reverberate around global markets when it occurs. That is what usually occurs when the Fed changes course. The anticipation of this shift has already been a factor affecting markets over the past year at various times, including in particular in some important emerging market economies.[10]

2.8 The Governor expressed the view that Australian growth would be in the range of two to three per cent of GDP for 2013 and that this 'reflects quite

---

5 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.
6 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.
7 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.
8 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.
9 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.
10 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, pp.1-2.

subdued growth in private domestic demand, partly offset by strong growth in exports'.[11]

2.9 During the hearing, the committee questioned the Governor on a number of areas of fiscal and monetary policy and their impacts on the economy. The topics discussed included the current cash rate, the high exchange rate, the Reserve Bank Reserve Fund, productivity and economic reform and quantitative easing in the United States.

Forecasts

2.10 In its November 2013 *Statement on Monetary Policy*, the RBA concludes that 'the Australian economy has expanded at a bit below trend pace this year' stating that:

> Business surveys and the Bank's liaison suggest that current business conditions have been below average for some time. Consistent with this, business investment declined in the first half of the year; estimates suggest that much of this owed to a large fall in mining investment … [12]

2.11 This RBA statement goes on to say that 'for the Australian economy, there are both upside and downside risks for growth and so for inflation'.[13] The RBA comments that:

> There is uncertainty surrounding the profile for mining investment, which will depend on the viability and timing of some projects as well as any variations in costs for projects already underway. Also, it is difficult to predict the timing and strength of the expected upturn in non-mining investment.[14]

2.12 The RBA further states that 'the path of the exchange rate is also a significant source of uncertainty for the domestic economy', commenting that:

> The Australian dollar appreciated significantly over the past decade, as higher commodity prices led to increased capital inflows to fund the substantial increase in mining investment … A lower exchange rate is likely to be needed to achieve balanced growth in the economy. A lower exchange rate, if it came about,

11 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

12 RBA, *Statement on Monetary Policy*, November 2013, p. 2.

13 RBA, *Statement on Monetary Policy*, November 2013, p. 4.

14 RBA, *Statement on Monetary Policy*, November 2013, p. 4.

> would also see growth strengthening sooner than forecast and place some upward pressure on inflation for a time.[15]

2.13 The *Mid-Year Economic and Fiscal Outlook* (MYEFO) released by the Department of the Treasury on 17 December 2013 forecasts that 'the Australian economy will continue to transition from resources-investment led growth to broader sources of growth over the forecast period'.[16] The MYEFO states:

> While the fall in resources investment is expected to be sharper than previously forecast, the recovery in the non-resources sector is expected to be more gradual.
>
> As a result, real GDP is forecast to grow at a slower rate of 2½ per cent in 2014-15, compared to 3 per cent in the 2013 PEFO [Pre-Election Economic and Fiscal Outlook]. With domestic prices and wages also forecast to be softer than at the 2013 PEFO, nominal GDP has been revised down significantly.[17]

2.14 At the hearing, the Governor noted that RBA forecasts for growth in the Australian economy in 2013 were two to three per cent of GDP (see Table 1) and stated that:

> The very large run-up in mining investment has reached its peak, while non-mining investment remains, at this point, at a low ebb and dwelling investment spending is only in the early stages of an upturn. Consumer spending has been rising but at a little bit below average pace as people adjust to slower growth in income and look to contain or reduce debt.[18]

The Governor went on to say that 'inflation has remained consistent with the two to three per cent target' and that 'our assessment is that inflation will remain consistent with the target over the next one to two years'.[19] The Governor commented that resource sector investment is likely to fall significantly over the next few years and that there is 'scope for other forms of private spending to grow more quickly, the more so as government spending is scheduled to be subdued over this period'.[20] The Governor stated that:

15 RBA, *Statement on Monetary Policy*, November 2013, p. 4.

16 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook* (MYEFO), December 2013, p. 2.

17 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook*, December 2013, p. 2.

18 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

19 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

20 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

> Putting all of that together, our expectation is that the below trend growth in GDP we have seen for a little while now will probably continue for a bit longer. Over the more medium term, there are good grounds to think that growth can strengthen.[21]

Table 1 RBA Output growth and inflation forecasts (per cent)(a)

				Year-ended			
		June 2013	Dec 2013	June 2014	Dec 2014	June 2015	Dec 2015
GDP growth		2.6	2¼	2½	2–3	2¼–3¼	2¾–4¼
Non-farm GDP growth		2.7	2¼	2½	2–3	2¼–3¼	2¾–4¼
CPI inflation(b)		2.4	2½	2¾	2–3	2–3	1½-2½
Underlying inflation(b)		2½	2¼	2½	2–3	2–3	1¾-2¾
				Year-average			
		2012/ 2013	2013	2013/ 2014	2014	2014/ 2015	2015
GDP growth		2.6	2½	2½	2–3	2–3	2½–3½

(a) *Technical assumptions include A$ at US$0.95, TWI at 72 and Brent crude oil price at US$104 per barrel.*

(b) *Based on current legislation for the price of carbon*

Source *Reserve Bank of Australia, Statement on Monetary Policy, November 2013, p. 65.*

2.15 The RBA comments in its November 2013 *Statement* that 'growth in Australia's major trading partners in the September quarter looks to have been close to its average of the past decade'.[22] The RBA notes that economic conditions in China had picked up over the course of 2013, with growth likely to reach the authorities' target of seven and a half per cent, that economic activity had strengthened noticeably in Japan, the US economy appeared to have continued to grow at a moderate pace and that economic conditions in Europe seemed to have improved a little.[23]

2.16 As mentioned earlier, at the hearing, the Governor noted his advice to the committee at the previous RBA hearing in February 2013 that 'global

21 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

22 RBA, *Statement on Monetary Policy*, November 2013, p. 5.

23 RBA, *Statement on Monetary Policy*, November 2013, p. 5.

growth was running below average, though not disastrously so, and it was thought likely to pick up a little in 2013'.[24] The Governor stated:

> The period since then could be described as more of the same. The euro area economy contracted in the first part of the year but may be starting to grow again now. It still faces immense challenges with its banks and public finances and some years of uncertainty yet. But once again the worst fears have not been realised. The United States continues a path of gradual recovery, despite the budget 'sequester' and the divisive debate about the debt ceiling. The recovery is more gradual than policymakers there would like, but that is often the nature of things in the wake of a financial crisis. China is growing at a solid pace, roughly in line with policymakers' announced intentions, despite fears around the world that it might have slowed more sharply.[25]

The cash rate

2.17 The RBA Board decided to leave the cash rate unchanged at two and a half per cent at its meeting on 3 December 2013. At the hearing, the Governor informed the committee that 'monetary policy has been playing its part to support demand' commenting that:

> Because inflation has been consistent with the target, the board has been quite comfortable in easing policy by a significant amount. The cash rate has been reduced twice more since we last met with the committee, by a total of 225 basis points over the past two years. Borrowing rates are at their lowest levels in a long time … Low interest rates are doing the sorts of things we would normally expect them to do. This is the way expansionary monetary policy works.[26]

2.18 The Governor further informed the committee that 'the board has maintained an open mind about whether we may need to lower interest rates further'.[27] The Governor stated:

> At this point, however, there are few serious claims that the cost of borrowing *per se* is what is holding back growth. On the contrary, I think it is pretty clear that monetary policy is supporting growth

24 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.

25 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 1.

26 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

27 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

> by altering incentives between spending and saving, and working to create an environment in asset and credit markets that eases the restraints on the relevant sorts of activity.
>
> In the end, though, firms and individuals have to have the confidence to take advantage of that situation … Monetary policy can't force that process. We can't force spending to occur. That is why the conduct of other policies is also important.[28]

The exchange rate

2.19 The RBA notes in its November 2013 *Statement* that 'similar to other currencies, the Australian dollar has appreciated against the US dollar as market participants have adjusted their expectations about the timing of future reductions in asset purchases by the Federal Reserve'.[29] The RBA further states that:

> The Australian dollar has also been affected by a scaling back of market expectations for additional cuts to the domestic cash rate and broadly positive Chinese economic data. In trade-weighted terms, the Australian dollar nevertheless remains around 10 per cent below its April peak, though it is still at a high level.[30]

2.20 In his opening remarks to the committee, the Governor commented that: 'The bank has in recent times described the exchange rate as "uncomfortably high" and suggested that balanced growth in the economy would probably require a lower exchange rate.'[31]

2.21 The Governor was asked by the committee to provide his views on intervention policies in relation to the value of the Australian dollar and the floating currency. He stated that intervention can be useful at certain times but also commented that:

> It is not a substitute for sound monetary policy. It cannot fight against fundamentals but, on occasion, intervention can be useful. That has long been our position; it still is. It is just that we have lived through a very, very unusual episode here. I do not think it was the standard temporary period of high currency: 'Maybe we'll lean on it and then realise some profits later on when it goes down.' This has been quite a different episode and that is why,

28 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, pp. 2-3.

29 RBA, *Statement on Monetary Policy*, November 2013, p. 23.

30 RBA, *Statement on Monetary Policy*, November 2013, pp. 23-24.

31 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.

> although I have thought about intervention more than once through the past several years, we have by and large eschewed it to date. I do not want that to mean that we always will.[32]

2.22 The Governor commented in relation to the floating dollar that:

> On the question of 'when do we move to not having a floating currency' I do not think you are proposing that we would do that. I certainly would not. Despite the frustrations that we have often had about why it is doing what it is doing—there have been many such frustrations in both directions over the years—by and large it has worked very well, and I expect that it still will, over time.[33]

Reserve Bank Reserve Fund

2.23 The Australian Government announced on 23 October 2013 that it would make a one-off $8.8 billion grant to the RBA in order to 'strengthen its financial position'.[34]

2.24 The RBA annual report observes that the Reserve Bank Reserve Fund (RBRF) was:

> substantially depleted in 2009/10 and 2010/11 by large accounting losses as the exchange rate appreciated. Following these losses, the Reserve Bank Board considered the balance of the RBRF to be below a level appropriate to the market risks on the Bank's balance sheet.[35]

The RBRF stood at approximately $2.5 billion at 30 June 2013 (3.8 per cent of assets at risk) following distributions from earnings available that were transferred to the RBRF ($596 million in 11/12 and $588 million in 12/13) and paid as a dividend to the Commonwealth ($500 million in 11/12).

2.25 The RBA Board considered that 'further transfers to this reserve will be needed in future years to restore its balance to a level that adequately reflects the Bank's risks'.[36] The Governor explained the Board's view that it would be appropriate for the RBRF to hold an amount equal to 15 per cent of assets at risk.[37]

32 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 9.
33 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 9.
34 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook*, December 2013, p. 37.
35 RBA, *Reserve Bank of Australia: Annual Report*, 2013, p. 71.
36 RBA, *Reserve Bank of Australia: Annual Report*, 2013, p. 71.
37 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, pp. 4-5.

2.26 The Governor was questioned by the committee about the decision of the Australian Government to grant $8.8 billion to the RBA. He confirmed that the matter was discussed at a meeting between himself and the new Treasurer, shortly after the new Treasurer was sworn in.[38]

2.27 The Governor was asked about the Treasurer's decision to provide a one-off capital injection, rather than replenishing the capital over a number of years, to which he responded:

> I do not think I could say that it was ever my opinion that it was mandatory that it be done in one go. It was, in my opinion—how do I put this?—extremely important that it be rebuilt on as early a schedule as we could manage.[39]

This supported his views expressed in the February 2013 hearing in which he stated, from the RBA's viewpoint, 'the prudent and best course is to rebuild that reserve as quickly as we can'.[40]

2.28 The Governor explained that the $8.8 billion figure was 'based on projected balance sheet footings for the end of the year', calculated by staff of the RBA and the Treasury.[41] The Governor also explained that the intention was for the grant to be made before 30 June 2014, and when that occurred the Bank would advise the Treasurer 'to retain sufficient of that profit to make the fund up to the 15 per cent'.[42]

2.29 The Governor was asked by what mechanism the $8.8 billion was to be granted. The question was taken on notice, and after the hearing, the RBA provided a written answer to the committee stating that the money would 'be included in the annual appropriation bills to be presented to Parliament in February 2014'.[43]

2.30 The Governor was asked what effect a zero or negative balance in the RBRF would have. The Governor advised that the bank would continue to operate, and that there are central banks that have negative capital, but that he was 'concerned about the perception that that may create'.[44]

2.31 The MYEFO stated that 'the grant will ensure that the RBA is adequately resourced to conduct its monetary policy and foreign exchange operations

---

38 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 6.

39 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 12.

40 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 22 February 2013, p. 12. See also, House of Representatives Standing Committee on Economics, *Review of the Reserve Bank of Australia Annual Report 2012 (First Report)*, March 2013, p. 11.

41 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, pp. 8 and 12.

42 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 5.

43 Reserve Bank of Australia, *Submission 1*, Answer to Question on Notice, p. 1.

44 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 9.

in an environment of financial market volatility'.[45] The Governor was asked whether the injection of funds into the RBRF enabled the RBA to intervene in the market to influence the Australian dollar. The Governor responded by saying:

> I view the balance sheet strength as prudent resources against the risks that are on our balance sheet. It is certainly true that were we to end up at some point with a much larger foreign currency exposure, which we would if we decided to do large-scale intervention, that would be relevant. But the capital that is in prospect with this proposed transaction is … appropriate for the general balance sheet risk that exists.[46]

Productivity

2.32 In his opening statement, the Governor said that for a long time society has assumed that 'solid growth of the economy will simply continue' but that now was a time when 'that assumption has to be questioned'.[47] He further set out his views on the path that should be taken:

> The path of pro-growth, pro-productivity, confidence-building reforms would mean that the basis for investment and growth in real incomes would improve. That would mean that consumption could grow more strongly without recourse to excessive borrowing. That would provide a revenue base for governments to offer the services and infrastructure that the community needs and wants … The alternative path would be a much less attractive one.[48]

2.33 The committee was interested in the RBA's views on Australia's productivity growth compared to other developed countries. The Governor stated that Australia was not the only country that had 'suffered some slow-down'.[49] The Governor also indicated that it was difficult to compare levels of productivity across countries but it was the case that 'the level of output per hour worked in Australia is short of where it is in the leading countries, such as the US, in many sectors'.[50] The Governor

45 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook*, December 2013, p. 194.

46 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 12.

47 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 3.

48 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 3.

49 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 17.

50 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 17.

indicated that 'there must be some opportunities for relative improvement there'.[51]

2.34 On Australia's trends in productivity, Dr Phillip Lowe, Deputy Governor of the RBA, explained that the rate of productivity growth has basically halved since the 1990s. Growth in real effective income has not slowed down, however, because the price of resources being exported was rising very quickly compared to the price of goods being imported. Dr Lowe also explained that now the price of exports relative to the price of imports was falling, and if the rate of productivity growth did not pick up then society would notice a much slower growth of productivity. He saw this as an issue that monetary policy could not address.[52]

2.35 The Governor was asked for his views on the challenges that lie outside of monetary policy that are important to economic growth. In the course of his response, the Governor stated that:

> … the long-run source of our growth in prosperity does not come from manipulating interest rates or the exchange rate … it comes from the productivity efforts of the million-plus enterprises that are out there in the economy, how they manage themselves and how their workforces cooperate with them. That is where the improvements in the way things are done happens to produce the productivity that we need.[53]

2.36 The Governor reiterated this later in the hearing, saying that the 'ultimate path to prosperity is in skills, productivity and entrepreneurial dynamism in our business enterprises'.[54] Further, 'there is no productivity lever that anyone sitting here can pull … it is about incentives, capabilities and flexibilities out there in the enterprises in our country'.[55]

2.37 In commenting on this issue, Dr Lowe highlighted a list of things, identified by the Productivity Commission, that could be done to expand the supply side, including:

> … improving incentives for people to innovate and take a risk; to make workplaces more flexible; to build the infrastructure that we need so that people can connect with one another, both physically and electronically, more efficiently; … making sure the taxation system promotes innovation and growth.[56]

---

51 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 17.
52 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 17.
53 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 14.
54 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 17.
55 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 17.
56 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 14.

2.38 Dr Lowe explained the importance of 'improving the risk-taking and entrepreneurial culture of business, because ultimately the supply side of the economy only expands if business is prepared to take a risk'.[57] He also explained the impact on productivity of a lack of investment in transport infrastructure:

> … the lack of investment in transportation increases the cost of moving goods around our cities, makes it more difficult to get stuff to market, adds to the stress in people's lives and makes it more difficult for people to move around our cities to access opportunities. Many people who have looked at this say that we have underinvested in transportation infrastructure and that it is impacting our productivity.[58]

2.39 The committee was interested in the RBA's opinion on what the government should be investing in, in order to avoid capacity constraints in infrastructure and skills. Dr Lowe suggested that because we are entering a period of decline in business investment due to lower investment in the resource sector, this may give rise to opportunities to spend more on infrastructure, and particularly transportation infrastructure.[59]

2.40 The related issue of project selection was also canvassed with Dr Lowe, who stated that the process needed to be independent, rigorous and transparent, with clear cost-benefit analyses undertaken. This would encourage community support for borrowing for infrastructure or charging for the use of infrastructure.[60]

2.41 The committee was also interested in the RBA's views on what would occur if the rate of productivity growth was not lifted. Dr Lowe responded:

> We will have to get used to slower growth in our living standards. That means slower growth in wages, slower growth in profits, slower growth in asset prices and less money for the government to spend to deliver services to the community.[61]

57 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 17.
58 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 18.
59 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 8.
60 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, pp. 8-9.
61 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 18 December 2013, p. 18.

Quantitative easing

2.42 On 18 December 2013, the US Federal Reserve announced that it was to reduce its buying of mortgage-backed and Treasury securities from $85 billion to $75 billion per month, beginning in January 2014. This announcement was made after the hearing had concluded.

2.43 In his opening statement, the Governor speculated that in the first six months of 2014 the US Federal Reserve would begin to taper its bond buying program.[62] As mentioned earlier, the Governor told the committee:

> … there is ample potential for this shift in direction to reverberate around global markets when it occurs … The anticipation of this shift has already been a factor affecting markets over the past year at various times, including in particular in some important emerging market economies. It is sensible to assume that this will be the case over the period ahead, as tapering begins and as market participants try to ascertain its extent and pace.[63]

2.44 The Governor stated that it could have disruptive effects, or it may be that when tapering actually occurs, 'enough of the preview has already been absorbed and priced into things and that it is not disruptive'.[64]

2.45 In response to a question about the consequences for the world economy of long-term quantitative easing by the US, the Governor said 'that certainly would not fill me with enthusiasm'.[65] He also noted that it is not just the US Federal Reserve practicing quantitative easing but also the Bank of Japan.

2.46 The Governor painted his best case scenario for Australia as being:

> … the Fed see their way clear to start the taper soon and that they manage to do that without too much disruption in global markets so that they can therefore continue it and eventually end the buying of securities and, at some point after that, gradually start the process of the Fed's fund rate going back to a normal level.[66]

62 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, pp. 1, 21-22.
63 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 2.
64 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 10.
65 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 10.
66 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 18 December 2013, p. 20.

Conclusion

2.47 It is pleasing that there was positive economic growth in Australia and among Australia's major trading partners in 2013 and that, although below trend, this growth is set to continue for the next few years. It is clear however that Australia faces considerable challenges as investment in the resources sector is declining. Productivity gains and investment need to occur in non-mining sectors of the economy to sustain and increase future growth. The committee considers the current monetary policy settings to be appropriate but the Government and the RBA must ensure that sound decisions continue to be made to ensure that Australia's economy transitions successfully to a post-mining boom era.

Kelly O'Dwyer MP
Chair
12 February 2014