The Parliament of the Commonwealth of Australia

# Review of the Reserve Bank of Australia Annual Report 2013 (Second Report)

House of Representatives
Standing Committee on Economics

May 2014
Canberra

© Commonwealth of Australia 2014

ISBN 978-1-74366-166-6 (Printed Version)
ISBN 978-1-74366-166-6 (HTML Version)
Cover image courtesy of *Thinkstock.*

This work is licensed under the Creative Commons Attribution-NonCommercial-NoDerivs 3.0 Australia License.

The details of this licence are available on the Creative Commons website: http://creativecommons.org/licenses/by-nc-nd/3.0/au/.

# Chair's foreword

The RBA noted in its May 2014 Statement on Monetary Policy that 'overall economic activity picked up over the past six months with the economy looking like it grew at close to its long-run average pace over this period.' The RBA also commented that 'the outlook for Australia's trading partner growth is little changed since the February Statement' and that 'growth of Australia's trading partners in year-average terms is forecast to be around its long-run average in 2014 and 2015.'

Although the outlook for inflation appears to be a little higher than six months ago, the Governor remarked at the 7 March hearing before the committee that it remains consistent with the medium term target.

It is clear that the decline in investment by the mining companies is set to continue and that other sources of growth are needed for the Australian economy. The Governor expressed the view at the hearing that other areas of demand such as non-mining capital expenditure could partly offset this downturn.

The labour market is likely to remain soft for a while due to the current period of below trend growth but it is notable that the indicators in this regard have recently become more positive.

As noted by the RBA in its May Statement, the exchange rate remains a significant source of uncertainty for economic and inflation forecasting, although the Australian dollar is currently trading at about 10 per cent below its 2013 peak. The Governor noted that this price could not realistically be fixed in the long run but reiterated his view that the dollar was still overvalued based on costs and productivity relative to other countries.

Demand for new housing appears to have remained strong, including first home owner grants and loan approvals for new dwellings. The Governor commented that construction of new dwellings will probably rise strongly in the year ahead.

As Australia has been undersupplied in recent years in terms of new dwellings, increases in residential construction activity are to be welcomed.

In recent years, productivity growth has been somewhat sluggish in Australia. However, the Governor suggested that this is likely to improve with the ramping up of output growth in the resources sector.  It is likely that other drivers of productivity growth will also be needed.

The RBA Board decided to leave the cash rate unchanged at 2.5 per cent at its most recent meeting on 3 June. The Governor stated that in the Board's judgement, monetary policy was appropriately configured to foster sustainable growth in demand and inflation outcomes and that the most prudent course is likely to be a period of stability in interest rates.

On behalf of the committee I would like to thank the Governor of the Reserve Bank, Mr Glenn Stevens, and other representatives of the RBA for appearing at the hearing on 7 March 2014.

Kelly O'Dwyer MP
Chair

# Contents

## APPENDICES



## TABLE

# Membership of the Committee

| | |
|---|---|
| Chair | Ms Kelly O'Dwyer MP |
| Deputy Chair | The Hon Ed Husic MP |
| Members | Mr Scott Buchholz MP |
| | Dr Jim Chalmers MP |
| | Mr David Coleman MP |
| | Mr Pat Conroy MP |
| | Dr Peter Hendy MP |
| | Mr Kevin Hogan MP |
| | Mr Craig Kelly MP |
| | Mr Clive Palmer MP |
| Supplementary Members | The Hon Tony Smith MP |
| | The Hon Dr Andrew Leigh MP |

# Committee Secretariat

| | |
|---|---|
| Secretary | Mr Peter Banson |
| Inquiry Secretary | Dr Kilian Perrem |
| Research Officer | Ms Susan Dinon |
| Administrative Officers | Ms Jazmine Rakic |
| | Ms Sarah Tutt |

# Terms of reference

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

# 1

# Introduction

## Background

1.1 The House of Representatives Standing Committee on Economics (the committee) is responsible for scrutinising the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the community and the financial sector.

1.2 The appearance by the Governor of the RBA at biannual public hearings of the committee is an important element of the RBA's accountability framework. The details of this framework are set out in the *Statement on the Conduct of Monetary Policy,* agreed between the Treasurer, the Hon Joe Hockey MP, and the RBA Governor, Mr Glenn Stevens. The statement formalises the biannual appearance before the committee. The statement, which is reproduced at Appendix B, states:

> … the Governor will continue to be available to report twice a year to the House of Representatives Standing Committee on Economics, and to other Parliamentary committees as appropriate.
>
> The Treasurer expresses support for the continuation of these arrangements, which reflect international best practice and enhance the public's confidence in the independence and integrity of the monetary policy process.[1]

1.3 A second procedural mechanism for achieving this accountability is set out in the Standing Orders of the House of Representatives, which provide for the referral of annual reports within a committee's area of portfolio responsibility for any inquiry the committee may wish to make. Accordingly, the committee may inquire into aspects of the annual report of the RBA.

1 Reserve Bank of Australia, *Statement on the Conduct of Monetary Policy*, 24 October 2013.

## Scope and conduct of the review

1.4 The second public hearing of the committee with the RBA during the 44th Parliament was held in Sydney on 7 March 2014.

1.5 The proceedings of the hearing were webcast (audio only) over the internet, through the Parliament's website, allowing interested parties to listen to the proceedings as they occurred. The transcript of the hearing is available on the committee's website.[2]

1.6 Before the hearing, the committee received a private briefing from Mr Alan Oster, Group Chief Economist, National Australia Bank. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Oster's cooperation and assistance.

1.7 Public hearings with the RBA continue to bring issues of monetary policy into the public arena and provide a public face to parliamentary committees and the RBA. These hearings are also an important means by which financial markets can be better informed on the current thinking of the RBA.

1.8 This report focuses on matters raised at the public hearing in Sydney on 7 March, and also draws on issues raised in the RBA's February 2014 *Statement on Monetary Policy*. The *Statement on Monetary Policy* may be viewed through the RBA website.[3]

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

3 See: <http://www.rba.gov.au/monetary-policy/index.html>

# 2

# Monetary policy and other issues

## Overview

2.1 On 4 March 2014 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:

> Financial conditions overall remain very accommodative. Long-term interest rates and most risk spreads remain low. Equity and credit markets are well placed to provide adequate funding, though for some emerging market countries conditions are considerably more challenging than they were a year ago.[1]

2.2 The Governor further noted in this statement that 'In Australia, recent information suggests slightly firmer consumer demand and foreshadows a solid expansion in housing construction'.[2] The Governor stated that:

> Some indicators of business conditions and confidence have shown improvement and exports are rising. At the same time, resources sector investment spending is set to decline significantly and, at this stage, signs of improvement in investment intentions in other sectors are only tentative.[3]

2.3 The Governor further commented:

> The demand for labour has remained weak and, as a result, the rate of unemployment has continued to edge higher. Growth in

---

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/2014/mr-14-03.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/2014/mr-14-03.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/2014/mr-14-03.html>

> wages has declined noticeably. If domestic costs remain contained, some moderation in the growth of prices for non-traded goods could be expected over time, which should keep inflation consistent with the target, even with lower levels of the exchange rate.[4]

2.4 In relation to the Board's decision, the Governor concluded:

> In the Board's judgement, monetary policy is appropriately configured to foster sustainable growth in demand and inflation outcomes consistent with the target. On present indications, the most prudent course is likely to be a period of stability in interest rates.[5]

2.5 During the hearing on 7 March 2014 before the committee, the Governor noted in his opening remarks that:

> When we met just prior to Christmas, I suggested that from an international point of view 2013 could be described as a year that turned out to be not quite as good as hoped but certainly not as bad as had been feared at some times. I would say nothing has occurred since then to change that assessment.[6]

2.6 The Governor further noted that 'one prominent international event, of course, was that the US Federal Reserve has commenced the so-called tapering of its monthly asset purchases'.[7] The Governor stated:

> After all the anticipation of that change, the actual announcement itself in December did not really cause much disruption in markets.[8]

2.7 The Governor further commented in his opening remarks that:

> … forecasts for the global economy have not changed much. If anything they have inched higher, though not by very much, and they still suggest that 2014 growth globally will be higher than last year and perhaps at about average pace. More of that growth is coming from that advanced countries and proportionately a little bit less from the emerging world.[9]

---

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/2014/mr-14-03.html>

5 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/2014/mr-14-03.html>

6 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

7 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

8 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

9 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

2.8 The Governor stated in relation to the Australian economy that 'for some time our view has been that growth has been running below its trend pace.' The Governor stated:

> The national accounts released a couple of days ago do not significantly change that assessment. For the year to December, real GDP rose by about 2¾ per cent, which is roughly in line with the forecasts that we have had out there for a little while now, albeit slightly stronger.[10]

2.9 The Governor further commented that:

> At the present time, our judgement is that monetary policy is doing the things that it can reasonably do in the circumstances we face. And we have signalled the likelihood, if the economy evolves more or less as expected, of a period of stability in interest rates.[11]

2.10 During the hearing, the committee questioned the Governor and the other RBA officials who appeared on the current fiscal and monetary policy frameworks and their impacts. The areas of discussion included the cash and exchange rates, the labour market, productivity, housing and financial regulation.

## Forecasts

2.11 In its February 2014 *Statement on Monetary Policy*, the RBA comments that 'The economy looks to have expanded at a below-trend pace over the second half of 2013, although a range of indicators suggest that conditions have been more positive of late'[12] stating that:

> Below-trend growth has occurred against the background of declining mining investment, subdued growth of non-mining business investment, ongoing fiscal restraint and the high level of the exchange rate that had prevailed.[13]

2.12 The RBA further comments in this statement that 'The outlook for the domestic economy is a little stronger over 2014 than at the time of the November *Statement*.'[14] The RBA states:

> The revision reflects, in part, the effect of the lower exchange rate,

10 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

11 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 4.

12 RBA, *Statement on Monetary Policy*, February 2014, p. 2

13 RBA, *Statement on Monetary Policy*, February 2014, p. 2.

14 RBA, *Statement on Monetary Policy*, February 2014, p. 3.

> which is expected to provide some boost to activity in the traded sector. As foreshadowed by the improvement in a number of indicators of activity over recent months, GDP growth is likely to strengthen a little in 2014 though to a pace that is still only trend at best. Growth is then expected to pick up to an above-trend pace by mid 2016.[15]

2.13 The February statement notes that 'weakness in the labour market has seen growth of wages slow further.'[16] The RBA states:

> Various measures of wage growth are now around the lowest they have been over the past decade or longer. Wage growth is likely to remain moderate for some time given the weak labour market, with fiscal restraint also weighing on public sector wage growth.[17]

2.14 The RBA also comments in its February statement that 'the inflation forecasts have been revised higher in the short term, reflecting the effect of the depreciation of the exchange rate since November and the higher-than-expected December quarter CPI outcome.'[18] The RBA notes:

> Underlying inflation is expected to be close to 3 per cent over the year to June 2014. Given the slow growth of wages and limited domestic cost pressures more generally, underlying inflation is then expected to decline to be closer to 2½ per cent.[19]

2.15 The statement goes on to comment that interest rates for household and business borrowing continue to be maintained at historically low levels:

> Over the past few months, there have been further signs that very stimulatory monetary policy is working to support economic activity. This is clearly evident in the housing market and indications are that dwelling investment will pick up in the coming quarters. There have also been some recent signs of a modest improvement in consumer spending and a recent pick-up in business sentiment.[20]

2.16 At the hearing on 7 March, the Governor noted that real GDP growth for the year to December of two and three quarter per cent was roughly in line with the RBA forecasts that had been out for a while (see Table 1), albeit slightly stronger.[21]

---

15 RBA, *Statement on Monetary Policy*, February 2014, p. 3.
16 RBA, *Statement on Monetary Policy*, February 2014, p. 3.
17 RBA, *Statement on Monetary Policy*, February 2014, p. 3.
18 RBA, *Statement on Monetary Policy*, February 2014, p. 4.
19 RBA, *Statement on Monetary Policy*, February 2014, p. 4.
20 RBA, *Statement on Monetary Policy*, February 2014, p. 4.
21 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

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

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| ***Year-ended*** | | | | | | | |
| | | **Dec 2013** | **June 2014** | **Dec 2014** | **June 2015** | **Dec 2015** | **June 2016** |
| **GDP growth** | | 2½ | 2¾ | 2¼–3¼ | 2½–3½ | 3-4 | 3-4½ |
| **Non-farm GDP growth** | | 2½ | 2¾ | 2¼–3¼ | 2½–3½ | 3-4 | 3-4½ |
| **CPI inflation[(b)]** | | 2.7 | 3¼ | 2¼–3¼ | 2¼–3¼ | 2-3 | 2-3 |
| **Underlying inflation[(b)]** | | 2½ | 3 | 2¼–3¼ | 2¼–3¼ | 2-3 | 2-3 |
| ***Year-average*** | | | | | | | |
| | | **2013** | **2013/ 2014** | **2014** | **2014/ 2015** | **2015** | **2015/ 2016** |
| **GDP growth** | | 2¼ | 2½ | 2¼–3¼ | 2¼–3¼ | 2½–3½ | 3-4 |

*(a) Technical assumptions include A$ at US$0.89, TWI at 69 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, February 2014, p. 60.*

2.17 The Governor commented at the hearing that 'The drivers of growth, as we all know, are shifting.'[22] The Governor stated:

> We have been saying for some time—and this has been confirmed in the recent data on capital expenditure intentions by firms—that the very high level of investment spending by mining companies has now turned down and that decline will accelerate over the coming year.[23]

2.18 The Governor commented that other areas of demand could partly offset this downturn in mining investment. These included a strong growth in resource exports such as iron ore, the large recent increase in approvals to build private dwellings, improved consumer demand and early indications that non-mining capital expenditure is picking up. The Governor stated:

> The outlook contains many uncertainties, not least the handover so-called from mining investment spending to other sources of demand outside of mining. In some important respects the basis

22 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

23 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 2.

> for that handover is coming into place, as I have just said. The question really is whether that additional demand likely to be generated outside of mining as a result of all those trends will be just the right amount to offset the large decline in mining investment that we know is coming, so keeping the economy at near full employment. The honest truth is that no-one can answer that question with great confidence.[24]

2.19 The Governor informed the committee in relation to inflation that 'the recent data show inflation in underlying terms at about two and a half per cent over the past year and a pace somewhat above that in the second half of the year.'[25] The Governor stated:

> The view that I have taken so far pending any further evidence here is that there is probably a bit of both noise and signal in this result. Hence our assessment is that inflation is not quite as low as it might have looked six to 12 months ago but nor is it accelerating to the extent that a literal reading of the latest data might suggest. If you think about the general situation, 18 months of growth having been below trend, unemployment having gone up and wages growth having slowed, that is not one that would obviously be associated with a sustained rise in price pressure. So our view remains that the outlook for inflation, while a little higher than it was three or six months ago, is still consistent with the medium-term target.[26]

## The cash rate

2.20 The RBA Board decided to leave the cash rate unchanged at two and a half per cent at its meeting on 4 March 2014. At the hearing, the Governor informed the committee that 'accommodative monetary policy is doing the sort of things you would normally expect and it is playing its part in supporting sustainable growth in demand consistent with the inflation target.'[27] The Governor further commented that:

> At the present time, our judgement is that monetary policy is doing the things that it can reasonably do in the circumstances we face. And we have signalled the likelihood, if the economy evolves

24 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, pp. 3-4.

25 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.

26 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.

27 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.

> more or less as expected, of a period of stability in interest rates. I think as well as the low level of rates generally, a sense of stability, if we are able to offer that, is something that at the margins should be of some help to businesses and households as they make their own plans.[28]

2.21 The Governor was asked by the committee for his views on the likely interest rate trajectory. The Governor commented that 'on present indications the most prudent course appears to be likely a period of stability'[29] stating:

> I think that if it is possible for there to be a period of stability, that in itself at the margin is probably helpful to people. In terms of the data we look at, as you know, our framework is a medium-term target for inflation. We are achieving that target right now. Our present forecast is that that will continue to be the case, and that forecast is predicated on an assumption of no change. When the forecast changes then we have to rethink, but at the moment we are talking about a period of stability.[30]

## The exchange rate

2.22 The RBA notes in its February 2014 *Statement* in relation to the recent depreciation of the Australian dollar that 'if sustained, lower levels of the exchange rate will assist in achieving balanced growth in the economy.'[31] The RBA states:

> The Australian dollar has now depreciated by 14 per cent on a trade weighted basis since its peak in early April 2013, though it remains 9 per cent higher than its average over the past 15 years and 15 per cent higher than its 15-year average in real terms. The Australian dollar continues to be influenced by changes in market participants' expectations about the outlook for domestic and US monetary policy.[32]

2.23 At the hearing, the Governor was asked by the committee whether there was anything the RBA could be doing to lower the exchange rate. The Governor responded:

---

28 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 4.

29 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 8.

30 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 9.

31 RBA, *Statement on Monetary Policy*, February 2014, p. 2.

32 RBA, *Statement on Monetary Policy*, February 2014, p. 27.

> … you can lower interest rates, and in principle that is a thing that might be done; you can intervene in the market, and there would be a whole debate about that and there is ongoing debate about how effective that is; and I suppose the biggest thing you could do if you really want to lower the exchange rate, is have a weak economy and say that you do not want foreign investment. Seriously, with strong economies that are attractive to foreign investment, it is likely that you are going to have upward pressure on your exchange rate in that world.[33]

2.24 The Governor was also asked whether he felt the Australian dollar was above its long-run equilibrium value and about the currency manipulation practices of other countries. The Governor commented:

> I have said that I thought that in the 90s or over a dollar was rather higher than any plausible assessment you could come to based on our costs and productivity relative to other countries. I have not changed my view about that.[34]… Personally, I think that in the long run you cannot fix this price. We spent probably 10 years, from the early 70s to the end of 1983, pretty much trying every exchange rate regime there is before we eventually convinced ourselves that we could not just fix the price, we just had to let it go. I think that most countries probably will reach that point at some stage. But the ones that have to do a lot of intervention at the moment—and I think I can see why they have this way of thinking—see it as a destabiliser for their economy and they are much less comfortable about letting it move.[35]

## Inflation

2.25 The Governor commented in his opening statement that 'our assessment is that inflation is not quite as low as it might have looked six to 12 months ago but nor is it accelerating to the extent that a literal reading of the latest data might suggest.'[36] The Governor stated:

> If you think about the general situation, 18 months of growth having been below trend, unemployment having gone up and wages growth having slowed, that is not one that would obviously

33 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 10.
34 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 17.
35 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 19.
36 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.

> be associated with a sustained rise in price pressure. So our view remains that the outlook for inflation, while a little higher than it was three or six months ago, is still consistent with the medium-term target.[37]

2.26 The committee also asked the Governor why labour market weakness was not feeding through to lower non-tradeable inflation. The Governor remarked that 'that is in a sense the slight puzzle with the recent data.'[38] The Governor stated:

> … I think possible explanations are, firstly, you do get a certain degree of quarterly noise in these figures, so it could be that we have had just in the statistical sampling process an unusually high number that will be followed then by lower ones. Certainly, for quarterly outcomes in core inflation in a couple of quarters' time, we would have lower figures in our forecast. Another explanation that one has to consider is that the gap between the costs and the prices has widened because profit margins have gone up, to put it simply.[39]

2.27 The Governor was also asked by the committee whether Australia's higher inflation target than comparable countries would have a negative impact on competitiveness over time and whether Australia was too tolerant of inflation. The Governor commented in relation to the inflation target that 'it is true that some other targets are a bit lower, but they are not that much lower.'[40] The Governor stated:

> The Europeans have a formulation of close to but below two, so they are only a little bit lower. The US is similar. I think some other countries are one to three. So you are really talking about, amongst comparable countries, a half a per cent difference. In the emerging world they typically have higher targets than ours.[41]

2.28 In terms of competitiveness, the Governor commented that 'in the textbook, countries that have higher inflation typically have a trend decline in exchange rates over time.'[42] The Governor stated:

> … over time, you would expect that a country that is, in a sense, damaging its own competitiveness by high domestic inflation—or, for that matter, low productivity performance—at the end of a

37 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.
38 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 4.
39 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 4.
40 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 5.
41 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 5.
42 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 6.

> long period is going to also see that its exchange rate has gone down a lot and its purchasing power over foreign goods and services has similarly gone down to reflect that. That should neutralise over the long run, but I emphasise 'over the long run'. Realistically, genuine competitiveness, I think, comes from innovation, productivity, cost control and so on. It comes from those things more than from the inflation target you might choose, I would say.[43]

2.29 In relation to Australia's tolerance of inflation, the Governor commented:

> I think there was a long period of our history where we were too tolerant of inflation. From 1970 to 1990, the average inflation rate was eight per cent, which means the value of money halves about every nine years. That is way too high, and I think we were too tolerant of that for too long, but in the 20-plus years since then we have done rather better. I think that if we were to open a debate about, 'Is the inflation target in need of reconfiguration?' you are really only talking about half a percentage point. I have not felt any discomfort with the target. The main thing is to achieve it, which we have.[44]

## Housing

2.30 The RBA notes in its February 2014 *Statement* that 'the rise in housing prices over the past year or so is broadly consistent with the historical relationship between interest rates and housing prices.'[45] The RBA states:

> The reduction in interest rates has eased some financing constraints, reduced the user cost of housing and increased the attractiveness of investing in riskier, higher-yielding assets, resulting in stronger demand for residential property. Indeed, this effect of lower interest rates on housing prices is an important channel through which expansionary monetary policy supports economic activity.[46]

2.31 In his opening remarks to the committee, the Governor commented that 'over [these] past three months approvals to build private dwellings numbered almost 50,000'. The Governor stated:

43 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 6.

44 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 6.

45 RBA, *Statement on Monetary Policy*, February 2014, p. 39.

46 RBA, *Statement on Monetary Policy*, February 2014, p. 39.

> … that is 27 per cent higher than a year earlier. That is in fact the highest three-month total in the history of that time series, which goes back to 1983.[47]

2.32 The Governor further commented that:

> Construction of dwellings is set to rise, and probably quite strongly, over the year ahead. Our liaison suggests that lenders are becoming more accommodating to potential borrowers and relatively few people complain now about credit availability.[48]

2.33 The Governor was asked by the committee whether capital city house prices were being driven up by foreign investment. The Governor remarked that 'I suppose the question is really: how big a problem do you really think it is?'[49] The Governor noted that:

> Foreign investors are generally confined to buying new structures. That is where it is easiest for them to come in. It cannot be beyond our capacity over time to meet that demand and to meet the legitimate demands of our own citizens for structures as well, can it? If we cannot do that, if there is a supply side constraint, I would say that is an issue worth addressing in its own right. Beyond that, it probably goes to broader questions of how welcoming we wish to be to foreign investment generally. That can be a vexed issue at times. With all due respect, that is a matter for our parliament to manage.[50]

2.34 The Governor was queried on his previously held view that housing affordability had improved in recent years. The Governor replied that 'it did improve because prices stopped rising and went down, and interest rates came down.'[51] The Governor further commented that:

> … I think that metric has started to turn adverse again. Interest rates have not kept falling—they cannot keep falling indefinitely—and prices have risen. As I have said before, the biggest threat to affordability in this country would be if we get a very large increase in house prices, which those of us who have a house will enjoy. But, if we think about our children, we will be having second thoughts.[52]

---

47 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, pp. 2-3.
48 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.
49 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 6.
50 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 6.
51 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 8.
52 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 8.

2.35 In response to a question on investor versus owner-occupier purchasing, the Governor commented:

> I think they are both quite prominent. If we look at loan approvals, it is certainly true that investor loan approvals have risen quite significantly, but so have approvals for owner-occupiers. They have both risen quite a bit. I would say that the investors are probably doing more of the driving in certain locations. But the ordinary first-time buyers or trade-up buyers—and trade-up buyers will be most of the buyers—are doing a lot of the driving too, across the broader metropolitan areas of the country.[53]

2.36 In response to questions from the committee on whether the RBA would consider utilising macroprudential levers to intervene in the housing market, the Governor remarked that 'they are useful adjunct, but if we do use them we should go into this with a bit of realism.'[54] The Governor added:

> For a start, if we were to have, say, a loan-to-value cap, who do you think will be most affected by that? It will be first-time buyers. I can imagine at the political level you will find that uncomfortable, should we proceed down that track. Indeed, I think the New Zealand experience is that, when the central bank announced that, the government felt obliged to do some offsetting things. So this is not necessarily straightforward… The most effective tool could be that when banks test people for an interest rate, so you are supposed to be able to make the payments not just at the current rate but, say, 200 points higher, APRA [Australian Prudential Regulation Authority] could insist that the test be made 300 higher, or 400, or whatever, so that people do not get overcommitted.[55]

2.37 Dr Philip Lowe, Deputy Governor of the RBA, further commented in relation to interest rate testing that:

> I think the benefit of that type approach is it allows lower interest rates to feed through into lower servicing costs for both new and existing borrowers, but it does not mean that lower interest rates keep on increasing the size of the loan that people can get access to, because the bank is applying a bigger buffer to the actual interest rate you pay.[56]

---

53 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 8.

54 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 21.

55 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, pp. 21-22.

56 Dr Philip Lowe, Deputy Governor of the RBA, *Transcript*, 7 March 2014, p. 22.

## Labour

2.38 In his opening statement, the Governor remarked that 'with growth having been below trend for a while now, job vacancies declined, employment growth weakened and unemployment rose in 2013.'[57] The Governor stated:

> Some forward indicators here have stabilised and turned up just recently, and that is promising. Even with that, and even with the improved growth outlook, the labour market probably will remain rather soft for a while, given that it lags changes in economic activity. That softness has already seen a slow-down in the growth of wages that is quite noticeable.[58]

2.39 The committee asked the Governor about RBA forecasts that the unemployment rate would increase above the six per cent level reached in January 2014. The Governor commented that:

> I think that has been a feature of our forecast for a few months now and we have said in a few of the recent statements that, firstly, we thought below-trend growth would continue for a little while. It follows from that that unemployment would rise further. I would be hopeful not too much further and, as I said, we have seen most of the leading indicators of labour market conditions turn up lately.[59]

2.40 Dr Christopher Kent, Assistant Governor (Economic) of the RBA, further commented that:

> Roughly speaking, we see unemployment continuing to drift up a little bit from here but probably peak sometime around early 2015. It is a little hard to say. But it should stay at those levels for a while. In our forecast, according to the central tendency, it is not until late 2015 that there will be sufficient growth for that growth to make inroads into the unemployment rate. So we do see employment growth gradually increasing, but not sufficiently to bring the unemployment rate down.[60]

2.41 The Governor was asked by the committee to elaborate on the recent decline in wages growth. The Governor remarked that:

> It is at about its lowest rate of growth in a decade or so, at about

57 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.
58 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 3.
59 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 4.
60 Dr Christopher Kent, RBA Assistant Governor (Economic), *Transcript*, 7 March 2014, p. 13.

> 2.6 per cent—call it 2½ or 2¾—over the last year, and that is down from the most recent high of just under four per cent. It is below average and I think it is the lowest for at least a decade.[61]

2.42 Dr Kent added that 'I think it is about the lowest in the history of that particular series.'[62] Dr Kent stated:

> It is about a percentage point below the average over that period, so they are low… I think that series began in about 1997 or thereabouts.[63]

## Productivity growth

2.43 The Governor was asked by the committee for his views on Australia's productivity growth and how this was trending. He commented that 'as you know, we had quite a lengthy period—probably the best part of ten years—during which productivity growth had clearly slowed.' The Governor stated:

> My view is that productivity is likely to improve a bit. I think the data are consistent with that over the past couple of years, subject to lots of caveats—for example, it is hard to measure; it is highly volatile over short periods, even as long as a year; and it is even harder to do by industry. Subject to all that, I think what the data show is that, after that lengthy period of rather sluggish performance, things have been a bit better. I think that probably owes something to fact that the period of high investment but not much output in the resources sector is basically coming to an end—the output growth is really ramping up now.[64]

## Financial Regulation

2.44 The committee queried the Governor about the growth of shadow banking in China and its impact on Chinese investment into Australia. The Governor commented that 'we do put quite an effort into trying to understand what is happening in the Chinese economy and I think all the

61 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 13.
62 Dr Kent, RBA Assistant Governor (Economic), *Transcript*, 7 March 2014, p. 13.
63 Dr Kent, RBA Assistant Governor (Economic), *Transcript*, 7 March 2014, p. 13.
64 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 8.

issues with shadow banking are really the key issues right now.'[65] The Governor stated:

> That term 'shadow banking' is in some ways a bit apt because it is not terribly transparent, from this distance anyway, and so it is very hard to know and to form a good judgement here. All I can say is that we are acutely sensitive to that set of questions. On whether shadow banking in China is the source of Chinese investment in Australia, I do not know, but I suspect that the bigger force is probably that the Chinese population, or segments of that population, have become quite affluent pretty quickly and, as people do when that happens, one of the things they do is acquire assets in other places.[66]

2.45 In response to questioning whether this was a Chinese equivalent of the US subprime mortgage crisis, the Governor responded that the asset quality in some of the shadow banking entities was likely to be poor. He noted:

> It is very likely that—and I do not think that the authorities in China would deny this—the big surging credit they had during the financial crisis when everybody was stimulating their economies by pumping a lot of credit into the system is problematical. In fact it is virtually certain that some of those loans, if they have not gone bad yet, will go bad… The question will be how quickly they can get on top of it and get ahead of it. I cannot give you a very accurate answer to that, but my observation is that they are very competent people.[67]

2.46 The Governor was asked to update the committee on the recent activities of the Basel Committee on Banking Supervision, of which Australia is one of many global members. The Governor commented that there are a few items of particular note on the Basel Committee's agenda this year. One is the requirement for a net stable funding ratio which is about matching the term of your funding to the term of your assets a bit more closely. The Governor remarked:

> There has been some work on trying to pin that down, and that is an issue in which Australia has quite an interest because it affects the requirements on our banks for funding the mortgage book. I

65 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 9.

66 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 9.

67 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 9.

> think the outcome that has been reached there is a bit of a stretch for Australia but a manageable one, so that is okay.[68]

2.47 The Governor further informed the committee that:

> Other work that is going on involves understanding and narrowing the differences in the way the risk capital weights are applied across countries.
>
> … We do not want a world in which country A has tough standards and country B has lax standards and all the banking gets done in B. It comes across borders. So this is an important matter, and the Basel committee is working on how to narrow the unexplained gaps. I think that is important for the credibility of the regime.[69]

## G20 taxation reform

2.48 The RBA was asked about efforts between government to address multinational profit-shifting. Reflecting on the ability of current tax regimes to deal with profit-shifting, Dr Philip Lowe said:

> International tax rules have not kept pace with the change in the globalisation of business, and governments, as a result, are getting less tax revenue than they probably should be. Given the fiscal positions that many governments find themselves in, it is obviously an area that people want to fix.[70]

68 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 21.
69 Mr Glenn Stevens, Governor of the RBA, *Transcript*, 7 March 2014, p. 21.
70 Dr Lowe, Deputy Governor of the RBA, *Transcript*, 7 March 2014, p. 14.

## Conclusion

2.49 It is pleasing that growth is expected in the economy over the next few years, albeit below historical trends. The higher unemployment rate is a cause for concern and must be monitored closely but there are some positive indicators emerging in this regard. The decline in mining investment is a continuing challenge for Australia and it will be important to foster a policy and regulatory framework that helps to stimulate the non-mining sectors of the economy.

**Kelly O'Dwyer MP**
**Chair**
**28 May 2014**

A

# Appendix A — Hearing, briefing, witnesses and submission

## Public hearing

### Friday, 7 March 2014 – Sydney

*Reserve Bank of Australia*

Mr Glenn Stevens, Governor
Dr Philip Lowe, Deputy Governor
Dr Christopher Kent, Assistant Governor (Economic)

## Private briefing

### Wednesday, 5 March 2014 – Canberra

Mr Alan Oster, Group Chief Economist, National Australia Bank

## Submission

| | |
|---|---|
| Submission 1 | Reserve Bank of Australia (Answer to Question on Notice) |

B

# Appendix B — *Sixth statement on the conduct of monetary policy*

**The Treasurer and the Governor of the Reserve Bank**

**24 October 2013**

The Statement on the Conduct of Monetary Policy (the Statement) has recorded the common understanding of the Governor, as Chairman of the Reserve Bank Board, and the Government on key aspects of Australia's monetary and central banking policy framework since 1996.

The Statement seeks to foster a sound understanding of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Reserve Bank.

The centrepiece of the Statement is the inflation targeting framework, which has formed the basis of Australia's monetary policy framework since the early 1990s.

The Statement has also been updated over time to reflect enhanced transparency of the Reserve Bank's policy decisions and to record the Bank's longstanding responsibility for financial system stability.

Building on this foundation, the current Statement reiterates the core understandings that allow the Bank to best discharge its duty to direct monetary policy and protect financial system stability for the betterment of the people of Australia.

## Relationship between the Reserve Bank and the Government

The Reserve Bank Governor, its Board and its employees have a duty to serve the people of Australia to the best of their ability. In the carrying out of their statutory obligations, through public discourse and in domestic and international forums, representatives of the Bank will continue to serve the best interests of the people of Australia with honesty and integrity.

The Governor and the members of the Reserve Bank Board are appointed by the Government of the day, but are afforded substantial independence under the *Reserve Bank Act 1959* (the Act) to conduct the monetary and banking policies of the Bank, so as to best achieve the objectives of the Bank as set out in the Act.

The Government recognises and will continue to respect the Reserve Bank's independence, as provided by the Act.

The Government also recognises the importance of the Reserve Bank having a strong balance sheet and the Treasurer will pay due regard to that when deciding each year on the distribution of the Reserve Bank's earnings under the Act.

New appointments to the Reserve Bank Board will be made by the Treasurer from a register of eminent candidates of the highest integrity maintained by the Secretary to the Treasury and the Governor. This procedure ensures only the best qualified candidates are appointed to the Reserve Bank Board.

## Objectives of Monetary Policy

The goals of monetary policy are set out in the Act, which requires the Reserve Bank Board to conduct monetary policy in a way that, in the Reserve Bank Board's opinion, will best contribute to:

a. the stability of the currency of Australia;

b. the maintenance of full employment in Australia; and

c. the economic prosperity and welfare of the people of Australia.

These objectives allow the Reserve Bank Board to focus on price (currency) stability, which is a crucial precondition for long-term economic growth and employment, while taking account of the implications of monetary policy for activity and levels of employment in the short term.

Both the Reserve Bank and the Government agree on the importance of low inflation.

Low inflation assists business and households in making sound investment decisions. Moreover, low inflation underpins the creation of jobs, protects the savings of Australians and preserves the value of the currency.

In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the cycle. This formulation allows for the natural short-run variation in inflation over the cycle while preserving a clearly identifiable performance benchmark over time.

The Governor expresses his continuing commitment to the inflation objective, consistent with his duties under the Act. For its part the Government endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving medium-term price stability.

Consistent with its responsibilities for economic policy as a whole, the Government reserves the right to comment on monetary policy from time to time.

## Transparency and Accountability

Transparency in the Reserve Bank's views on economic developments and their implications for policy are crucial to shaping inflation expectations.

The Reserve Bank takes a number of steps to ensure the conduct of monetary policy is transparent. These steps include statements announcing and explaining each monetary policy decision, the release of minutes providing background to the Board's policy deliberations, and commentary and analysis on the economic outlook provided through public addresses and regular publications such as its quarterly *Statement on Monetary Policy* and *Bulletin*. The Reserve Bank will continue to promote public understanding in this way.

In addition, the Governor will continue to be available to report twice a year to the House of Representatives Standing Committee on Economics, and to other Parliamentary committees as appropriate.

The Treasurer expresses support for the continuation of these arrangements, which reflect international best practice and enhance the public's confidence in the independence and integrity of the monetary policy process.

## Financial Stability

Financial stability, which is critical to a stable macroeconomic environment, is a longstanding responsibility of the Reserve Bank and its Board.

The Reserve Bank promotes the stability of the Australian financial system through managing and providing liquidity to the system, and chairing the Council of Financial Regulators (comprising the Reserve Bank, Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Treasury).

The Payments System Board has explicit regulatory authority for payments system stability. In fulfilling these obligations, the Reserve Bank will continue to publish its analysis of financial stability matters through its half-yearly *Financial Stability Review*.

In addition, the Governor and the Reserve Bank will continue to participate, where appropriate, in the development of financial system policy, including any substantial Government reviews, or international reviews, of the financial system itself.

The Reserve Bank's mandate to uphold financial stability does not equate to a guarantee of solvency for financial institutions, and the Bank does not see its balance sheet as being available to support insolvent institutions. However, the Reserve Bank's central position in the financial system, and its position as the ultimate provider of liquidity to the system, gives it a key role in financial crisis management. In fulfilling this role, the Reserve Bank will continue to coordinate closely with the Government and with the other Council agencies.

The Treasurer and the Governor express their support for these longstanding arrangements continuing.

C

# Appendix C — Glossary of terms

***Australian Competition and Consumer Commission (ACCC).*** A Commonwealth statutory authority responsible for ensuring compliance with the *Trade Practices Act 1974* and the provisions of the Conduct Code and for administering the *Prices Surveillance Act 1983*. The Commission's consumer protection work complements that of State and Territory consumer affairs agencies.

***Australian Payments Clearing Association Limited (APCA).*** A public company owned by banks, building societies and credit unions which has specific accountability for key parts of the Australian payments system, particularly payments clearing operations.

***Australian Prudential Regulation Authority (APRA).*** APRA is the prudential regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry.

***Australian Securities and Investments Commission (ASIC).*** One of three Australian Government bodies (the others being the Australian Prudential Regulation Authority and the Reserve Bank of Australia) that regulates financial services. ASIC is the national regulator of Australia's companies. ASIC has responsibility for market protection and consumer integrity issues across the financial system.

***accrual accounting.*** Revenues and expenses are recorded as they are earned or incurred, regardless of whether cash has been received or disbursed. For example, sales on credit would be recognised as revenue, even though the debt may not be settled for some time.

***acquirer.*** An institution that provides a merchant with facilities to accept card payments, accounts to the merchant for the proceeds and clears and settles the resulting obligations with card issuers.

***average weekly earnings.*** Average gross (before tax) earnings of employees.

***average weekly ordinary time earnings (AWOTE).*** Weekly earnings attributed to award, standard or agreed hours of work.

***average weekly total earnings.*** Weekly ordinary time earnings plus weekly overtime earnings.

***balance on current account.*** The difference between receipts and payments as the result of transactions in goods, services, income and current transfers between Australia and the rest of the world. A current account deficit means that total payments exceed total receipts, while a current account surplus means the reverse.

***bankruptcies.*** Bankruptcies and Administration Orders under Parts IV and XI of the Bankruptcy Act.

***basis point.*** A basis point is 1/100th of 1 percent or 0.01 per cent. The term is used in money and securities markets to define differences in interest or yield.

***BPAY.*** BPAY is a payments clearing organisation owned by a group of retail banks. Individuals who hold accounts with a BPAY participating financial institution can pay billing organisations which participate in BPAY, using account transfers initiated by phone or internet. The transfers may be from savings, cheque or credit card accounts.

***business investment.*** Private gross fixed capital formation for machinery and equipment; non-dwelling construction; livestock; and intangible fixed assets.

***card issuer.*** An institution that provides its customers with debit or credit cards.

***cash rate (interbank overnight).*** Broadly defined, the term cash rate is used to denote the interest rate which financial institutions pay to borrow or charge to lend funds in the money market on an overnight basis. The Reserve Bank of Australia uses a narrower definition of the cash rate as an operational target for the implementation of monetary policy. The Reserve Bank of Australia's measure of the cash rate is the interest rate which banks pay or charge to borrow funds from or lend funds to other banks on an overnight unsecured basis. This measure is also known as the interbank overnight rate. The Reserve Bank of Australia calculates and publishes this cash rate each day on the basis of data collected directly from banks. This measure of the cash rate has been published by the Reserve Bank of Australia since June 1998.

***cash rate target.*** As in most developed countries, the stance of monetary policy in Australia is expressed in terms of a target for an overnight interest rate. The rate used by the Reserve Bank of Australia is the cash rate (also known as the interbank overnight rate). When the Reserve Bank Board decides that a change in monetary policy should occur, it specifies a new target for the cash rate. A decision to ease policy is reflected in a new lower target for the cash rate, while a decision to tighten policy is reflected in a higher target.

***charge card.*** A charge card is a card whose holder has been granted a non-revolving credit line enabling the holder to make purchases and possibly make cash advances. A charge card does not offer extended credit; the full amount of any debt incurred must be settled at the end of a specified period.

***consumer price index.*** A measure of change in the price of a basket of goods and services from a base period. Changes in the Consumer Price Index are the most commonly used measure of inflation.

***collateralised debt obligations.*** Collateralised debt obligations (CDOs) are securities that are exposed to the credit risk of a number of corporate borrowers. In the simplest form of a CDO, this credit risk exposure is generated in the same way as for any asset-backed security (ABS): the CDO is backed by outright holdings of corporate debt, such as corporate bonds and corporate loans. Increasingly, however, the exposure to corporate credit risk is synthesised through the use of credit derivatives. Unlike other forms of ABS, where the collateral pools usually consist of loans with broadly similar characteristics, CDO reference pools are typically quite heterogeneous, with exposures to a variety of borrower types and credit ratings and across a number of countries. A CDO will usually have exposures to between 50 and 200 bonds or large corporate loans, or up to 2,000 loans to small and medium-sized businesses.

The simplest forms of CDOs are known as ‘cash' or ‘vanilla' CDOs, and are similar to other forms of ABS. A special purpose vehicle buys loans and securities from financial institutions and other market participants, and funds these acquisitions by selling securities to investors. The manager of the CDO vehicle will usually deduct fees and expenses from the interest income received from the assets in the collateral pool, with the remainder used to make regular coupon payments to investors. The term to maturity of the loans and bonds in the collateral pool will determine the maturity of the CDO securities sold to investors.

***credit card.*** A credit card is a card whose holder has been granted a revolving credit line. The card enables the holder to make purchases and/or cash advances up to a pre-arranged limit. The credit granted can be settled in full by the end of a specified period or in part, with the balance taken as extended credit. Interest may be charged on the transaction amounts from the date of each transaction or only on the extended credit where the credit granted has not been settled in full.

***debit card.*** A debit card is a card that enables the holder to access funds in a deposit account at an authorised deposit-taking institution.

***derivative.*** A financial contract whose value is based on, or derived from, another financial instrument (such as a bond or share) or a market index (such as the Share Price Index). Examples of derivatives include futures, forwards, swaps and options.

***employed persons.*** Persons aged 15 and over who, during a period of one week, worked for one hour or more for pay or worked for one hour or more without pay in a family business or on a family farm.

***G-10.*** Group of Ten countries: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, and USA; plus Bank for International Settlements (BIS), European Commission, International Monetary Fund (IMF), and the Organisation for Economic Co-operation and Development (OECD). It was formed in conjunction with the establishment of the General Arrangements to Borrow, under which members agreed to make resources available to the IMF.

***G-20.*** Group of Twenty Forum: Members are finance ministers or central bankers from - Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK and US; plus representatives of the IMF, European Union and World Bank. The G-20 aims to broaden the dialogue on key economic and financial policy issues among systemically significant economies, and promote co-operation to achieve stable and sustainable world economic growth.

***G-22.*** Group of Twenty-two. The G-22's aim was to advance issues related to the global financial architecture. It operated through three Working Parties - on Transparency and Accountability, International Financial Crises, and Strengthening Financial Systems. The group made its recommendations in 1998, and its work has since been taken up in other forums.

***G-7.*** Group of Seven countries: Canada, France, Germany, Italy, Japan, UK and USA. The G-7 Summit deals with issues covering macroeconomic management, international trade, international financial architecture, relations with developing countries, and other global issues.

***G-8.*** Group of Eight countries: G-7 countries and Russia.

***gross domestic product.*** The total market value of goods and services produced after deducting the cost of goods and services used up in the process of production but before deducting for depreciation.

***gross domestic product—chain volume measure.*** Also known as *real GDP*, this is a measure used to indicate change in the actual quantity of goods and services produced. Economic growth is defined as a situation in which real GDP is rising.

***gross domestic product at factor cost.*** Gross domestic product less the excess of indirect taxes over subsidies.

***gross foreign debt.*** All non-equity financial claims by non-residents on residents of Australia. The major component of gross foreign debt is the amount of borrowings from non-residents by residents of Australia.

***household debt ratio.*** The amount of household debt at the end of a quarter expressed as a proportion of annual household gross disposable income.

***household gross disposable income.*** The amount of income that households have available for spending after deducting any taxes paid, interest payments and transfers overseas.

***household net disposable income.*** Household gross disposable income less depreciation of household capital assets.

***household saving ratio.*** The ratio of household income saved to household net disposable income.

***housing loan interest rate.*** The variable rate quoted by banks for loans to owner-occupiers.

***implicit price deflator for non-farm gross domestic product.*** A measure of price change that is derived (hence the term implicit) by dividing gross non-farm product at current prices by gross non-farm product at constant prices.

***index of commodity prices.*** A Reserve Bank of Australia-compiled index (based 2001/02=100) which provides a measure of price movements in rural and non-rural (including base metals) commodities in Australian Dollars (AUD), Special Drawing Rights (SDR) and United States Dollars (USD).

***inflation.*** A measure of the change (increase) in the general level of prices.

***inflation target.*** A tool to guide monetary policy expressed as a preferred range or figure for the rate of increase in prices over a period. In Australia, the inflation target is between 2 and 3 per cent per annum on average over the course of the business cycle.

***interchange fee.*** A fee paid between card issuers and acquirers when cardholders make transactions.

***interest rate.*** The term used to describe the cost of borrowing money or the return to the owner of the funds which are invested or lent out. It is usually expressed as a percent per annum of the amount of money borrowed, lent or invested.

***labour force.*** The employed plus the unemployed.

***labour force participation rate.*** The number of persons in the labour force expressed as a percentage of the civilian population aged 15 years and over.

***labour productivity.*** Gross domestic product (chain volume measure) per hour worked in the market sector.

***long-term unemployed.*** Persons unemployed for a period of 52 weeks or more.

***macroeconomy.*** The economy looked at as a whole or in terms of major components measured by aggregates such as gross domestic product, the balance of payments and related links, in the context of the national economy. This contrasts with microeconomics which focuses upon specific firms or industries.

***market sector.*** Five industries are excluded from the market sector because their outputs are not marketed. These industries are: property and business services; government administration and defence; education; health and community services; and personal and other services.

***monetary policy.*** The setting of an appropriate level of the cash rate target by the Reserve Bank of Australia to maintain the rate of inflation in Australia between 2 and 3 per cent per annum on average over the business cycle.

***natural increase.*** Excess of live births over deaths.

***net foreign debt.*** Gross foreign debt less non-equity assets such as foreign reserves held by the Reserve Bank and lending by residents of Australia to non-residents.

***net overseas migration.*** Net permanent and long-term overseas migration plus an adjustment for the net effect of ‘category jumping’.

***non-farm gross domestic product.*** Gross domestic product less that part which derives from agricultural production and services to agriculture.

***overseas visitors.*** Visitors from overseas who intend to stay in Australia for less than 12 months.

***prime interest rate.*** The average rate charged by the banks to large businesses for term and overdraft facilities.

***profits share***. Gross operating surplus (the excess of gross output over costs incurred in producing that output) of all financial and non-financial corporate trading enterprises as a percentage of gross domestic product at factor cost.

***quantitative easing.*** Quantitative easing involves central banks purchasing financial assets (such as government bonds, corporate bonds and mortgage-backed securities). It increases the money base with a view to driving down long-term borrowing costs.

***real average weekly earnings.*** Average weekly earnings adjusted for inflation as measured by the Consumer Price Index.

***real prime interest rate.*** The prime interest rate discounted for inflation as measured by the Consumer Price Index.

***reserve bank reserve fund.*** The bank's permanent general reserve, established by the Reserve Bank Act. Sums are credited to the fund from earnings available for distribution, as determined by the Treasurer after consulting the Reserve Bank Board. The balance of distributable earnings after any such transfer is payable as a dividend to the Commonwealth. The fund is essentially the bank's capital. Its primary purpose is to provide a capacity to absorb losses when it is necessary to do so.

***seasonally adjusted estimates.*** Estimates in which the element of variability due to seasonal influences has been removed. Seasonal influences are those which recur regularly once or more a year.

***terms of trade.*** The relationship between the prices of exports and the prices of imports. The usual method of calculating the terms of trade is to divide the implicit price deflator for exports by the implicit price deflator for imports.

***trade weighted index.*** A measure of the value of the Australian dollar against a basket of foreign currencies of major trading partners.

***turnover.*** Includes retail sales; wholesale sales; takings from repairs, meals and hiring of goods; commissions from agency activity; and net takings from gaming machines. From July 2000, turnover includes the Goods and Services Tax.

***unemployed persons.*** Persons aged 15 and over who, during a period of one week, were not employed but had actively looked for work in the previous four weeks and were available to start work.

***unemployment rate.*** The number of unemployed persons expressed as a percentage of the labour force.

***wage price index.*** A measure of change in the price of labour (i.e. wages, salaries and overtime) unaffected by changes in the quality or quantity of work performed.

***wages share.*** Wages, salaries and supplements (the total value of income from labour) as a percentage of gross domestic product at factor cost.

***west texas intermediate.*** A type of crude oil used as a benchmark in oil pricing and the underlying commodity of New York Mercantile Exchange's oil futures contracts.

***youth unemployment.*** Number of 15–19 year olds looking for full-time work.

***youth unemployment rate.*** Number of 15–19 year olds looking for full-time work expressed as a percentage of the full-time labour force in the same age group.

*Source: Parliamentary Library and Reserve Bank of Australia*