COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

# HOUSE OF REPRESENTATIVES

## STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

**Reference: Reserve Bank of Australia annual report 1999-2000**

FRIDAY, 11 MAY 2001

MELBOURNE

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**HOUSE OF REPRESENTATIVES**

**STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION**

**Friday, 11 May 2001**

**Members:** Mr Hawker *(Chair)*, Mr Albanese, Ms Burke, Ms Gambaro, Mrs Hull, Mr Latham, Ms Plibersek, Mr Pyne, Mr Somlyay and Dr Southcott

**Members in attendance:** Mr Albanese, Ms Burke, Ms Gambaro, Mr Hawker, Mr Latham, Mr Somlyay and Dr Southcott

**Terms of reference for the inquiry:**

Review of the Reserve Bank of Australia annual report 1999-2000.

## WITNESSES

**Committee met at 10.04 a.m.**

**CHAIR—**I declare open the public hearing of the House of Representatives Standing Committee on Economics, Finance and Public Administration. I welcome everyone here today. I offer a special welcome to a number of invited guests, the first of whom is the Speaker of the House of Representatives, the Hon. Neil Andrew. I would also like to officially recognise the President of the Legislative Council, the Hon. Bruce Chamberlain. We also have Mr John Lenders, who is the Parliamentary Secretary to the Treasurer, and some members of the opposition treasury and finance policy committee. We also have many members of the media here today.

I offer a very warm welcome to the representatives of the Reserve Bank and to a number of students, who I would like to recognise. We have students from Loreto Mandeville Hall, Melbourne Girls Grammar, Melbourne Boys Grammar, Presentation College, Ruyton Girls School, St Kevin’s College, Strathcona Baptist Girls School and students from the University of Melbourne. It is terrific to see you here today, and I am sure you will find it extremely interesting.

We are also very pleased to see the response of students here, and I think it does add something. Having it in this chamber makes it very special, as part of the Centenary of Federation and centenary of parliament celebrations. We are very pleased to have everyone here on what I think is quite a historic occasion.

In 1996 the government and the Reserve Bank agreed that, twice a year, the governor would appear before the committee to answer questions about the conduct of monetary policy and issues outlined in the bank’s latest statement on monetary policy. The Reserve Bank’s annual report for 1999-2000 and the second annual report of the Reserve Bank’s Payments System Board form part of the discussion. It is indeed, as I said, most appropriate to have this hearing in the majestic Legislative Council. The chamber of the council is rich in symbolism. From 1901 until the opening of federal parliament in Canberra in 1927, this chamber was used by the Australian Senate. I believe that this is the first time a public hearing has been held in this chamber, so it is even more historic. I would like to particularly thank the Hon. Bruce Chamberlain for making this possible and for all the assistance that he has given to the committee.

It is also significant that in this chamber in 1928 Sir Robert Menzies began his political career before he went on to the lower house and then to the House of Representatives. This hearing is a Centenary of Federation, a national and a Victorian event. We thank the organisers of both the national and the Victorian committees for including the hearing in these historic celebrations.

On Wednesday, in the Royal Exhibition Building, we marked the centenary of the first meeting of the Commonwealth parliament in 1901. Yesterday, in the Legislative Assembly and the Legislative Council chambers we had the centenary of the first meetings of the houses of the Commonwealth parliament. Today, in the Legislative Council chamber, a parliamentary committee is in operation.

It is of interest to note that, at the opening of the first federal parliament in 1901, the Governor-General stated that a banking bill would be brought in as soon as possible. It eventually was introduced in 1911 to form Australia’s first central bank. It is interesting to note that monetary and banking issues have played, and continue to play, a very important role in the first centenary of Australia. There was the challenge of what to do in the Depression in the 1930s. Wartime controls had to be instituted. There were attempts at bank nationalisation, and there was the creation of the Reserve Bank itself in 1960. Since then we have had some very significant reports from both the Campbell and the Wallis committees, which have led to major reforms.

It is also significant today to hear the news that both the Bank of England and the European Central Bank have cut their interest rates by one-quarter of one per cent. I do not know whether we will add some more history as the day unfolds. As is usual practice, today’s hearings will be divided into two parts: the first looking at monetary policy, and the second covering other matters related to the bank’s responsibilities.

[10.09 a.m.]

**BATTELLINO, Mr Richard, Assistant Governor (Financial Markets), Reserve Bank of Australia**

**LAKER, Dr John Francis, Assistant Governor (Financial System), Reserve Bank of Australia**

**MACFARLANE, Mr Ian John, Governor, Reserve Bank of Australia**

**STEVENS, Mr Glenn Robert, Assistant Governor (Economic), Reserve Bank of Australia**

**CHAIR—** I welcome the representatives from the Reserve Bank of Australia to today's hearing. Mr Macfarlane, I am sure you would like to make an opening statement.

**Mr Macfarlane—**I will continue with my custom of making an opening statement. The first thing I would like to do is to endorse your thanks to the Victorian government for making this magnificent chamber available to us today for our meeting. A lot has happened to the economy since we last met in Wagga Wagga at the beginning of December. This has resulted in a significant shift in the stance of monetary policy, and I think I owe it to the committee to give a full account of these developments and the thinking that lay behind the Reserve Bank's reactions.

Two major changes to the economic landscape occurred shortly after we met in December. The first was that the outlook for the world economy changed rather sharply in a downward direction at the turn of the year. This was mainly a result of developments in the United States, but it was widespread enough to cause significant downward revisions to world growth prospects. The second major change was that it became apparent that the Australian economy had been a lot weaker in the second half of 2000 than we had formerly thought. Although this was information about a period that had passed and was mainly due to a transitory factor, it had significant implications for the development of the economy in the period ahead. I would now like to explain these two developments more fully. I will then move on to our monetary policy reaction before concluding with some comments on the current outlook.

The slowdown in the US economy is something that had been widely expected for a few years, but it did not seem to happen—it kept surprising everyone by powering ahead. Almost six months ago—that is, at the turn of the year—it became apparent that the slowdown was in process and that it had the potential to be very pronounced. The United States had several economic imbalances that, fortunately, we do not have. Their share prices were, and still are, very high by historical standards. They had had an investment boom, particularly in information technology and telecommunications, which was so strong that it was almost certainly unsustainable and, as we all know, the US dollar was high and rising. Faced with those circumstances, the US central bank, the Federal Reserve Board, moved very quickly to lower interest rates. Such an action could not be expected to prevent a slowing in the United States economy, but it would reduce the chances of something more serious, such as a recession, occurring.

The first Fed easing on 3 January was a clear recognition that the world business cycle had entered a new phase. This had implications for all countries. We soon saw easings in monetary policy in Canada, the United Kingdom, New Zealand, Switzerland, Sweden, most Asian countries and, of course, Australia. My text says the Euro area was the exception, but of course, as the chairman pointed out, last night the European Central Bank and the Bank of England both reduced their official rates by one-quarter of a per cent.

The slowing US economy, and particularly the cut-backs in investment and computing and electronics, also had an impact on exports from Asia, with the result that aggregate East Asian GDP growth, leaving aside the special case of China, looks to have been about zero by the end of last year. The euro area has been less affected, but there is evidence from the manufacturing sector and from some business surveys that growth is starting to edge down in Europe.

So much for the rest of the world. I now turn to the second factor, namely the weakness in the Australian economy in the second half of 2000 and its flow-on effects into the first half of this year. As I have conceded before, we did not foresee the extent of this weakness, and I am not aware of anyone who did, although some probably got closer than we did. If you had told me before the event that the fall in house building, a sector which accounts for only five per cent of the economy, would be large enough to outweigh reasonable growth in the other 95 per cent of the economy, I would not have believed you. Our analysis of other countries' GST experience had suggested a much smaller fall in housing than occurred here. I am not saying that the housing contraction was the only thing that happened to the economy; other things have also clearly slowed, but it was the thing that turned a relatively unexceptional slowdown into a small contraction. What we were witnessing was not the normal cyclical development of an economy but the transitional effects of a once-in-a-generation structural change to the tax system. The fact that it led to a negative number for the change in GDP had a big effect on people's confidence. We saw this most clearly in the reaction to the release of the December quarter national accounts figure in early March. The Australian dollar lost 3c over the next 10 days to fall below 50c for the first time. At about the same time consumer confidence, which had until then held up at above its long-term average, fell sharply to well below that average. The reaction was so large at that time that a number of commentators raised the possibility that the country could talk itself into a recession. I am pleased to say that the mood has improved a good deal since that time.

There were some other signs of weakness during the second half of last year, such as the fall in business confidence. You may remember that we discussed that at some length at our meeting in Wagga Wagga. I suggested that it could be largely due to the fall in house building and the resulting reductions in sales by those parts of the manufacturing sector which service the housing sector. We were able to put forward that explanation at the time even though we did not know just how big the fall in house building had been.

It was difficult for a while to discern the trend in consumption behaviour in Australia because of shifts in spending patterns caused by the introduction of the GST and the Olympic Games. But now that the dust has settled it is clear that consumption, whilst doing quite well over recent months, is no longer growing at the heady rates it was a year or 18 months ago. Employment also fell for a few months in the second half of 2000. There is no doubt that the labour market has softened following the strong growth recorded in the middle two quarters of 2000. Again, however, the construction sector is the main explanation for the weakness in the second half of last year. Over the period from August last year until February this year construction employment fell by 48,000, while employment in those parts of the economy other than construction rose by 41,000.

At the same time as we were receiving this information on business confidence, spending and employment, we were also receiving news on inflation. Here the most important data were the CPIs for the September and December quarters, both of which were below our expectation. They suggested that inflation was well under control. In fact we lowered our estimate of underlying inflation upon receipt of the December quarter figure in late January. The CPIs also pointed to the possibility that business profit margins were being squeezed—they did not prove it but suggested that there was a possibility. They thus reinforced the impression that was building of an economy that was slowing more than expected in a world that was slowing more than expected, and where current inflation and future inflation were within the target zone we aimed for under our inflation targeting regime for monetary policy.

The decision to ease monetary policy at our first meeting this year was a relatively easy one. As you know, we eased again at the following two meetings so that the cash rate fell by 125 basis points in a little over two months. Collectively, this represented an uncharacteristically large move and therefore deserves some explanation. Basically, we realised, in view of the two preceding events, that a significantly lower level of real interest rates was required so that the stance for monetary policy would be clearly expansionary in that it would be supportive of economic activity.

We felt we should, and we could, get to such a position relatively quickly for two main reasons. The first one is, as I have explained, that we had undergone a relatively abrupt change in our view of the world. As I said before, it became clear that the world was entering a new phase of its business cycle, a fact that was recognised in most countries. Of course, here the fall in house building, because it brought forward our own slowdown, reinforced the message we were getting from the rest of the world. That was the first reason and that what was why we should. The reason why we could move quickly was because inflation was not threatening to rise above our target. We had no conflict of objectives and so could act quickly.

In view of what I have said to date, you will not be surprised to hear that the forecast of GDP growth that I put before the committee six months ago has been well and truly overtaken by events. I said that I would not quibble with Treasury’s figure of four per cent for year-on-year growth in the 2000-01 financial year. It now looks like being about half that figure, but we would expect considerably stronger growth in the following year, probably somewhere between three and 3½ per cent.

Incidentally, this is only the second time out of the eight occasions that I have been putting forward these reviews of our forecasts that we have overestimated the outlook for growth. On the other six occasions we had a small underestimate. On inflation I said last time that it could be approaching three per cent by the second half of 2001, that is, after the impact of the GST has dropped out of the four-quarter ended growth rate. Our current guess, now that we have two more quarters of CPI data behind us, is that we are expecting about 2½ per cent for the same period.

So far I have spent most of my time covering events leading up to our decision to ease monetary policy, so it is time I moved on to more recent events. As I said before, March was a bad month for the economy, mainly because people received the news that there had been a decline in GDP in the December quarter. This was a great disappointment to most people—or most people who follow these things—and they could not easily understand how such an outcome could have happened so soon after the buoyant conditions of midyear, and inevitably it affected people's confidence and their views of the future.

Apart from consumer confidence, which I have already referred to, the area where this lack of confidence showed up most visibly was in the exchange rate. On 6 March, the day before the release of the national accounts data, the Australian dollar was worth 52.2c and was 49.1c in trade weighted terms. By 3 April, about a month later, it had fallen to an intra-day low of US47.75c and 46.6 in trade weighted terms. That is a fall of nine per cent against the US dollar in a month and five per cent against the TWI. In the process, the Australian dollar set new low points on both these measures, although against the TWI it was only by a tiny margin.

I mention these details because I want to make two points. The first is that at a very detached and macroeconomic level, we all know that a low and hence competitive real exchange rate helps a country cope more easily with external adversity. Indeed, a floating exchange rate has as one of its virtues its capacity to automatically bring this about. This is one reason why our exports have been so strong and why there is a widespread opinion that the exchange rate is a factor supporting future growth in the Australian economy.

The second point is that when you already have a low exchange rate further falls can be very unsettling, especially if they are accompanied by headlines about new lows being reached and new barriers being breached. People inevitably see this as a loss of international confidence in their country and they in turn lose confidence. The falling Australian dollar was a widely cited reason by respondents to the consumer sentiment survey for why their confidence had fallen. The fall of the Australian dollar in March did not do the country any good and it is pleasing to see that it has been reversed.

April was a much better month than March. It is possible to discern some signs that confidence is returning. Internationally, all eyes are still on the United States, where financial markets have gained confidence over the past month. All the US share indices have risen appreciably, as have bond yields. Consumers have continued to spend, and the first quarter GDP figure was better than expected. These developments are good news for Australia, at least in the short run. On the other hand, US employment has fallen over the past two months, and businesses do not seem to be anywhere near as cheerful as financial markets are. There is still a lot of uncertainty overhanging the outlook for the US economy.

Domestically, we have also had some developments indicating greater confidence in the outlook. The stock market has risen by seven per cent since late March and it is again close to record levels. Bond yields have risen. We have also had the recovery in the exchange rate that I referred to. Here, as in the United States, greater confidence returned to financial markets, even if wider measures of business confidence have not yet shown it. There are also some indications from banks and from the Housing Industry Association that house building, which had been the chief contractionary force, is in the process of turning around and that its upswing could be very pronounced.

Under these circumstances it was perhaps not altogether surprising that financial markets' expectations about monetary policy began to change—they became less sure that we would ease again in May—and in fact, by the time of our meeting, the majority of economists surveyed expected no change in interest rates. In our own thinking, we asked the question, 'What behaviour of ours can most contribute to building confidence?' At the earlier meeting—the April one—knowing that we still had some more work to do to get interest rates down to levels that were clearly expansionary, we decided that a move larger than some people expected would probably be preferred to a more cautious approach and might foster confidence. Things had changed by May.

By May, we had three moves in quick time under our belt. We knew that interest rates were not acting as a constraint on the economy, but rather were at levels likely to assist growth. With financial markets slightly more up-beat about the outlook, we felt that a steady setting of monetary policy would help confidence. We were also sensitive to the possibility that, on this occasion, a surprise fall in interest rates could easily cause people to think, 'Things must be worse than we thought,' and prompt the question, 'What does the Reserve Bank know that we don't?' Such a reaction, had it occurred, would of course have been counterproductive.

What can we say about the future? Inevitably, we can say less, I suspect, than you would like. Policy has been returned to an expansionary setting, with the easing 'front-loaded'. Interest rates are close to the low points reached in the two most recent episodes of monetary policy easing. Given that fact, and given that we see some promising signs in the economy and financial markets, there is a reasonable chance that the current stance of policy will turn out to be easy enough to achieve the desired results.

But equally, while it is reasonable to expect that the promising trends of late will develop into stronger momentum for growth, we cannot as yet be confident. This in turn means that we cannot be sure that further monetary policy easings will not be required. Our growth outlook rests on various assumptions; not least that international conditions stabilise before too long and improve somewhat during 2002. That is a reasonable assumption on which to make a central forecast, but we need to be, and are, alert to the possibility of a weaker outcome which would have implications for Australian monetary policy.

I will have to conclude in the normal way: that is, by reminding everyone that we will continue to evaluate new information as it arrives, particularly as it bears on the outlook for growth and, of course, inflation, as compared with our target. We remain prepared to adjust monetary policy in response to changes in the balance of risks.

**CHAIR**—Thank you, Mr Macfarlane, for that very comprehensive introduction. I must admit, I detect a very cautious approach to making any forecasts after recent experiences. When you were talking about the difficulty in relation to what has happened between December and now, and what you did not read into the economy, you did not refer to the price of oil. I wonder why you did not think it sufficiently important to include it.

**Mr Macfarlane**—The price of oil has been very important. I do not have the exact figures at my fingertips, but through the year 2000 there is no doubt that the rising price of oil pushed up inflation by a percentage point—we know that; it is easy to measure—and it was also contractionary in that it meant that a bigger proportion of the household budget was spent on petrol and therefore less was left over to buy other goods. It is true that the rising price of oil was an important factor through 2000.

I am not sure that it has necessarily been a particularly important factor so far in 2001—and Glenn can correct me if I get this wrong—because, as I understand it, it actually came down. This was shown, for example, in the March quarter CPI when the price of oil to the consumer actually fell. It has not fallen as much as some of us thought it might because it is not just a matter of the world price of oil; it also involves the international price of refined petroleum, which is turning out to have a life of its own because of limits on refining capacity. I agree with you, Mr Chairman, that in explaining what happened last year, the price of oil was an important consideration. If anything, what has happened so far this year has been mildly beneficial, although you cannot say that with any confidence because oil is never out of the headlines. There is always some occasion when it is going up and people do not expect it to go up. However, overall, it was mainly a story of 2000.

**Mr Stevens**—That is true. You could also say that the fall in the Aussie dollar amplified the impact of rising global oil prices into Australia. It should also be recorded that petrol prices have gone up again of late and it would appear that there will be a positive contribution there into the June quarter CPI, on what we know at the moment.

**CHAIR**—When I refer to the oil price, I include consumer confidence. While you may be right in one respect to say that there has been a slight easing in the last few months, for consumers there has been a quantum leap in petrol prices which still remains. When it comes to looking at the growth prospects, with hindsight, is it a concern that that impact was underestimated? You talked about the housing impact and how it was far greater than was initially anticipated and forecast. I wonder whether that impact on consumer confidence and the spin-off from it has been underestimated. In hindsight, should that factor have been given greater emphasis?

**Mr Macfarlane**—I think you are right to say that it was underestimated, because people did not know that it would keep rising. However, it is nowhere near the order of magnitude of the fall in housing. In respect of the fall in housing, we are talking about a subtraction from half a year's GDP of nearly 2¼ percentage points. That is what you would normally expect to get, taken out in half a year by one item. You would expect to see the contractionary effects of the rise in oil price on household consumption, and household consumption did slow. It was slower than it was in 1999-2000. It certainly slowed a bit, but it was still positive throughout and we expect a good, positive figure in the March quarter national accounts when they come out.

I agree that it would have adversely affected consumer confidence, but the interesting thing about consumer confidence is that it stayed up above its average level right through until March. March was the first observation where consumer confidence fell appreciably below past averages. I accept your point that oil prices played a bigger contractionary effect than people, including us, had expected, but the magnitude was small compared to the contraction in housing.

**CHAIR**—As I remarked when you finished your opening statement, there seemed to be an added degree of caution in forecasting. I do not know whether that is just the result of recent experience or is more a reflection of the world outlook, and I was wondering if you would like to expand on that. I have just been looking through the May statement and I think the choice of words on pages 44 and 45 indicates something of a slight change in the confidence level of the bank. You use words like 'the downward price effects in subsequent quarters' perhaps being because the falls in wholesale sales tax 'had been passed on more quickly than assumed'. You say:

Alternatively, it was possible that the long-run price level increase associated with tax reform had ... been overestimated.

You say the net tax effects 'were broadly as expected, but that the underlying rate of inflation net of taxes had unexpectedly fallen—though whether this was temporary or persistent was unclear.' With the tone of these words are you trying to signal that we are going into a more difficult period or that maybe we have been overconfident in the past in the sorts of levels we have been forecasting?

**Mr Macfarlane**—I should answer this question in two parts. The first part that you are referring to is quoting something about the future of inflation. There is no doubt that when we received the September quarter CPI, which was the one everyone had been waiting for because that was the one that had the GST effects in it, we were all surprised that it was lower than we thought. We thought that when the December quarter one came out we might get a payback and it might be higher. In fact, if you remember the December quarter one, it was even lower relative to people's expectations. That clearly meant that we revise down our forecasts for inflation. It also meant that we started to worry a bit about if there had really been a much bigger squeeze than we thought on businesses and if there had been important cost increases they had not been able to pass on. So we waited for the March quarter CPI to come out and when it came out a good deal higher than people's expectations, as you are aware, we were actually in some sense relieved. It would have been more worrying if we had got a third in a row that was lower than our forecasts. So the fact that it was higher than our forecasts, which normally you would think would make a central bank very worried, was actually nowhere near as worrying as if we had had a third one that was lower. We did revise back a little our forecast of what current underlying inflation was. It is that tone that we were trying to bring out in those words about inflation that you quoted. So that would be my answer to the first question.

The more general question—and this is a very big one—is about the whole future of our economy over the next 18 months and how dependent it really is now on the world economy and how the world economy is looking so much towards the US for its lead. We went through a period when all the action was in emerging markets in Asia; that was in 1997 and 1998. Now we are in a situation where all the attention is on the US and a lot of people's judgments about the future are heavily influenced by what they think is happening to the US economy. So far what has happened to the US economy has been very conventional; it is what the Fed has said. So far what has happened is consistent with a soft landing. They have had an inventory cycle; that is the normal thing you get in a mild business cycle. They have had an inventory cycle: they have produced too much, inventories ran up, they cut back their production and so we saw for a number of months manufacturing output falling—I think for about six months—and then the inventories came down again. That is straight out of the textbook.

The second thing that has happened is that business investment—which I referred to as having been booming and growing too fast—has started, firstly, to slow down and then to fall. So we saw in the March quarter that the trendy part of business investment, IT and telecommunications, fell by about six per cent. Again, that is all part of the regular script you would write for a small slowdown in an economy.

The third big item that you always look to, and which normally provides stability, is consumption: 60 per cent of GDP. That does not usually jump around in the way that inventories jump around. It does not move anywhere near as much as investment. That is what provides the stability. So far, US consumption has provided stability. If you look purely at what has happened, it supports the hypothesis of a soft landing—in other words, a moderate slowdown. But we all know that there these imbalances. We all know that there is a risk that fall in investment may not just be an ordinary sized fall in investment but that it might be a very big one, because of the excesses that preceded it.

The other thing that hangs over it is the fact that the American consumers, although they have continued to consume, have consumed more than their income: they have actually consumed out of savings, out of their financial wealth. We are all conscious of the fact that American financial wealth is based on the stock market, which is still at very high PE ratios, compared to historical trends.

So we have these sorts of things hanging over us that we fear could happen; that is, that the contraction in investment could be much greater than thought; or that the consumer might finally go into their shell. If that were to happen, then of course you are talking about a straight recession scenario for the US. It is almost as though you have two paths ahead of you, and in fact the world faces two paths: one which is based on modest slowdown for the US, as has happened to date—and all the evidence is still pointing in that direction—and the alternative path is US recession, in which case everyone would feel the effects of that.

**CHAIR**—Thank you for your answer. The deputy chair has some questions.

**Ms BURKE**—At the outset, I would like to welcome Monica Gould, the Minister for Industrial Relations and the Leader of the House. I welcome Monica into her own house.

My first question goes to the things that we have been discussing. You mentioned yourself that the last time we met, in Wagga Wagga, you had no quibble with the MYEFO update to four per cent. You were slightly dismissive of business confidence surveys at the time. Prior to that, in a CEDA speech, you had been critical that people were indicating that the economy was weakening, and you were still sticking to the four per cent forecast at that time. Given that the actual growth in the quarter, during that time that you were making that observation, was actually minus 0.6 per cent, how do you explain the errors, and are you concerned about both Treasury's and the Reserve Bank's ability to get estimates so wrong?

**Mr Macfarlane**—The explanation for why the second half of the year, not just the quarter, was a minus is one I have given on numerous occasions. It is basically because the fall of 37 per cent in house building was so huge, even though it is only five per cent of the economy, that it created that outcome. If you take that five per cent out of the economy and look at the other 95 per cent of the economy, then it grew during the second half of the year at about two per cent actual rate or four per cent annual rate. So I do not think it controversial that the explanation for why we had that low figure in the third quarter and the negative figure in the fourth quarter—neither of which figures we had seen—was the extraordinary behaviour of house building.

We were forecasting some fall in house building, and in fact we were forecasting quite a big one—but nothing like that. We have never seen a fall as big as that. It has never been recorded in our 40 years of national accounts. Our observation of what had happened in other countries who had introduced a GST had not let us to believe that that would be the particular result. The major effect on people's decision making was a transitory result, but the major effect in Australia was on house building. In some other countries, the major effect was on consumption, as you would expect; in some other countries, the major effect would be on inflation; and in fact a lot of people thought that was what was going to happen here. A lot of the questioning I received during the year was along those lines.

So yes, we plead guilty to having got those figures wrong and we think you can explain the vast majority of it through that factor: we were dealing with a once in a lifetime or once in a generation change and we were not able to predict exactly what the outcomes would be. The former Governor of the Bank of Canada, who is a friend of mine, had been through introducing a GST and said, 'You have to be careful; something will happen. And it will be bigger than you think, but I don't know what it will be.' That was very helpful!

**Mr ALBANESE—**We like the politics of the Canada analogy.

**Mr Macfarlane—**But it turned out to be correct. That is the main answer. You made another reference to the business surveys. It is good that you asked about that because, with the benefit of hindsight, people think that all the business surveys were showing that everyone was extremely pessimistic throughout the second half of last year. In fact, although the business surveys definitely moved in the right direction, you could not get any unambiguous indication that business confidence was lower than it had been, for example, in 1998 or in 1996, until about late November. We have gone through the business surveys exhaustively, as you would imagine, in doing post-mortems. They had fallen from very high levels, but they were still at levels which were consistent with good growth. In fact, some of them still are. Some of the well regarded ones that have got a lot of history still have not fallen below their 1998 levels—and we know that led to nothing bad—or 1996 levels. A couple of them have, and those have received a lot of publicity, but even with those, it did not come until mid-November. So the business surveys were really only telling you a story—and it was not even a clear story because it involved a minority of them—very late in 2000. That is one of the things that is unusual about events over the last year, not just here but in the US. It is how concentrated the information was—how it was possible to have a very big change of view essentially in the December-January period.

It is exactly the same in the US. When we met in Wagga, the US Fed had, as its operating instructions which it gives itself, not lowered interest rates and it had what is called a bias to tighten. It still had as its standing instructions from its previous meeting the statement that the biggest risks to the US economy were coming from the inflationary and expansionary side. That was at the time that we met in Wagga. As you know, a month later, they had met, they had taken off that inflationary bias and then, on 3 January, they had reduced interest rates by 50 basis points. It was extraordinary how quickly this change of world view occurred.

**Ms BURKE—**Given that, and given, as you have already outlined, that going forward is so unpredictable as well, and given that the markets hang on your every word, as shown by the people turning up in Melbourne and not in Wagga Wagga, do you have confidence going forward that yourselves and Treasury are able to forecast and predict where we are going?

**Mr Macfarlane**—No more and no less than it has always been. Economic forecasting is a very imperfect art—I would not use the word ‘science’. It, by and large, has not improved in 30 years. I have been through all the various attempts to improve it—all the large econometric models, the small econometric models, the leading indicators, all the surveys of expectations—and basically it is about the same as it always was.

I think what you have to do is have policies that are able to cope with the fact that forecasting is imperfect, rather than trying to improve the forecasting and then taking a punt on the new forecast. I think by and large we have, if you look at both monetary and fiscal policy. Or first of all look at the development of the economy—low inflation is a huge help. Low inflation means that things do not move about as fast as they used to; it means that the economy itself is a bit more stable; and it means that policies do not have to move anywhere near as far as they did in the past. In the period we are talking about, the rise and fall of interest rates is the smallest cycle we have ever had. We have never moved up by a smaller amount or down by a smaller amount.

Similarly with fiscal policy, we have not been through one of those big cycles that we went through in the 1970s where we went into massive deficit and then there was a huge amount of work to get rid of it. The same thing happened in the 1980s, going into massive deficit. There was a huge amount of work at the end of the decade to get rid of the deficit. The same thing happened again in the early 1990s. There was a massive deficit and there was all the belt tightening to get rid of it. We have not been through that.

The actual policies have moved by very small amounts. That was what was behind one of the things that I said at the meeting in Wagga, that we have not had a boom/bust cycle in economic policy. We have had relatively small movements in economic policy. If you have very big movements and they turn out to be in the wrong direction, you have to unwind it with another really big movement, but we have not had that.

The question, which is a good question, is what is the most productive approach? Is it to throw massive amounts of resources into trying to get better forecasts, or is it to design a system which is relatively stable in face of the fact that forecasts will turn out to be wrong? I think the latter is a much more productive approach.

**Ms GAMBARO**—As we have so many friends from the media here today, I would like to just ask you a question about the talk of a recession. I know you covered very briefly in your statement the media talk of a technical or other recession and the effect that it has on consumer and investment confidence. Do you have any data that showed that consumer and business confidence dived after media reports of recessions?

**Mr Macfarlane**—Consumer confidence did dive after the December quarter national accounts were reported by the media, but it was not necessarily because of the way the media reported it. It may simply have been because of the content that was contained therein, namely that there had been a fall in GDP in the December quarter. I do not think we can blame the media for the fact that the consumer confidence declined at that time.

I think there is something in your question. There is a tendency in Australia to look on the gloomy side of things, particularly if you compare us with the United States. Maybe we are normal and the United States is just incredibly optimistic, I do not know, but there is certainly a big difference between the two countries in the way they perceive economic developments.

**Ms GAMBARO—**There was a tendency in the housing sector by builders, real estate agents and a number of people actively involved to advertise and promote getting in early and building a house before the GST came into effect. Do you think that that over-enthusiasm by the building sector also led to consumers avoiding building houses after the GST? I just want to touch on the interest rate cuts and the $14,000 increase in the first homebuyer’s scheme. When do you think the flow-on effects will start to show in the economic figures there?

**Mr Macfarlane—**The first part of the question was about the building in anticipation of the GST and the attempt to get as much built before 30 June as possible. There is no doubt that it happened on a huge scale. We all know anecdotes about it, and we know things that happened in our street or through our friends. We know it happened. I do not know whether it was just the prospective owner who wanted to do it or whether it was the builder, but we do know it happened on a huge scale.

One of the interesting things is that we also know that a lot of the stuff did not get completed in time. That is one of the reasons why we underestimated the fall in house building. That sounds perverse, but in our discussions with the building industry they kept saying that there was a huge backlog still to be completed that did not get finished by 30 June. We assumed that there would not be a big fall away in house building, and there would not be as big a fall away as the approvals data suggested. In fact, I am still surprised at how big a fall away there was, given that we all know there was a big backlog that had to be completed.

The second question was when do we think the combined effect of the lower interest rates and the $14,000 grant for purchase or construction of a new home will show up in the figures? I think the answer is that they should start showing up probably by the June quarter. We look at leading indicators of housing and we look at approvals for loans and approvals for housing. Of course, these are the things that fell very sharply during 2000 and indicated the weakness. Towards the end of 2000 they started to pick up again, and then they stuttered for a while, and now I think they are on their way up again. We know the last housing approvals figure was a good one of six or seven per cent. We are pretty sure, from what we know about housing lending, that that is up and running again very quickly. The biggest single piece of evidence that the thing is up and running is what the Housing Industry Association itself has said. In March they said they had basically doubled and had a 100 per cent increase in house sales. When a lobby group says to you that things are really booming in their industry, you have to accept it.

**Dr SOUTHCOTT—**I wanted to ask you about housing investment and you have already talked about how five per cent of housing investment outweighs the 95 per cent of the economy that was growing. We had looked at the comparisons of Japan, Canada and New Zealand, who all had experience of introducing a value added tax in the previous 10 years. Does the Reserve Bank have any feeling for why there was a difference in Australia and why it was specifically in housing investment that we saw the decline?

**Mr Macfarlane—**With the benefit of hindsight, we might have a few ideas.

**Mr Stevens**—I am not sure that we have a good explanation for that. In essence, that is why what occurred in the housing sector was such a surprise. Probably the most relevant comparison out of those three that are in the chart comparing the countries is New Zealand, whose tax changes were most like ours. There was definitely an effect there, but nothing like what we saw. If anything, the other part of the surprise was that there was not more impact here on consumption. The effect on consumption of the GST was, if anything, more muted than you might have thought on these international comparisons. I think that remains a puzzle, and I suspect that certainly in some parts of the country and around Sydney, in particular, the fact that the Olympics came along also was an additional complicating thing that makes these comparisons much harder to do. I am not sure that I can do much better than that.

**Dr SOUTHCOTT**—I would like to ask you about your opening statement—and I do not want to misquote you for I do not have a copy of the statement in front of me. You touched on the changes in the Australian exchange rate and the historic low point reached in April, and you made the comment that the decline in the Australian exchange rate was not helping the Australian economy—again, I do not want to misquote you. What did you mean by that?

**Mr Macfarlane**—I made two comments about the exchange rate. Firstly, I said that at the detached macroeconomic level we know that a low exchange rate makes your traded goods sector—your exporters and your import competing sectors—more competitive, and that is good for growth. I also wanted to remind people that it is a sad fact of life that when the exchange rate is low and falling it has a bad effect on people's confidence, on consumer and business confidence. People say, 'The rest of the world does not like us, it is voting with its feet, we are a crummy economy,' and people lose confidence. So there are these two competing things that you have to weigh up. My conclusion was that once it is already low and you are confident that it is making your industries very competitive it is not at all clear that you are getting any value at all out of it falling further because the effects on confidence may be more damaging than the gains that industry gets from it.

**Dr SOUTHCOTT**—Just on that point, you also touched on the impact that interest rate cuts can sometimes have on consumer confidence, that sometimes a cut in interest rates can also have a bad effect on consumer confidence.

**Mr Macfarlane**—I was not particularly thinking of consumer confidence there. What we were doing, essentially, was giving an explanation for why we thought it was a good idea to hold interest rates steady in May. One of the reasons—an important reason—was if we had cut there, given that people were not expecting cuts because they were reading the signs that things were getting a little better and maybe a fourth one was not required, if we had come out and surprised them in those circumstances it was quite possible, as I said, that people would have said, 'Things must be worse than we thought. What does the Reserve Bank know that we do not know?' So that is a situation where you do have to pay attention to what people are thinking. Often you do not. Often you just feel that there is an overwhelming case to do something and, even though it is going to surprise some people, you go ahead and do it. But there are occasions—not necessarily many but we think that May was one of them—when even if we had wanted to, which we did not, you would have had to think again because the act of doing it may well have had a bad effect on people's confidence.

**Mr LATHAM**—In your opening statement you described March as a bad month for the economy. Was March also a bad quarter for the economy? Has Australia experienced a recession through the December and March quarters?

**Mr Macfarlane**—I think the March quarter will be a much better quarter than the December quarter. We do not know, of course. You are forcing me to make a forecast of something regarding which you will be able to tell me whether I am right or wrong in about a month's time. But I think the March quarter is shaping up reasonably well. Consumption is 60 per cent of GDP. The volatile component of consumption is retail trade, and that has got a good strong figure for the March quarter. We think the other parts of consumption, apart from automobiles, will be good. We think we are going to get a positive contribution from the external accounts. In normal circumstances you would say that that will give you the good underpinning for a reasonable result. There is always a wild-card around, like inventories, but unless a wild-card comes along, I suspect we will get a reasonable number.

**Mr LATHAM**—On this question of housing and your claim that there was an unexpected slump, I take you back to your opening statement at our meeting in Wagga on 1 December, when you said:

On the domestic front, the area of weakness that many people point to is housing construction. There is no doubt that there will be a big contraction in that sector.

Isn't there an element of rewriting history here? You were predicting in December a big contraction in that sector. Doesn't it indicate that the policy settings were just plain wrong?

**Mr MacFarlane**—A big contraction is maybe 10 per cent, not 37 per cent. That is what we got—37 per cent in the half year. We did not forecast anything as big as that. The other thing, too, is that if it is a pure transition thing, if it is a V-shape and you know a lump is going to come out and then it is going to go back six months later, it does not necessarily have very big implications for monetary policy. My main answer to that is, yes, we were forecasting a big contraction. I do not know what the number was—maybe 10 per cent or 12 per cent or even 15 per cent—but we were not forecasting 37 per cent, and that is the thing. The difference between those two numbers is enough to turn you into negative.

**Mr LATHAM**—What are the factors—expected and unexpected? In his speech in Tokyo in March, Dr Grenville, the Deputy Governor, pointed to:

... the degree of confidence-sapping annoyance with the administration of the GST.

You have not made mention of that as a factor today. Do you agree that there has been a confidence-sapping annoyance with the administration of the GST that has added to the economic slowdown?

**Mr Macfarlane**—I do not know the answer to that. I do know that a GST, or any change to the tax system of this magnitude, is an enormous undertaking and it requires a lot of adjustment from everyone. As you know, the consumers seem to have adjusted remarkably well. After the GST had been in for a couple of months, everyone was saying, 'What was the fuss? Everything seems to be going quite smoothly.' In our case, that was a false dawn because others had to do the adjustment and they did not do it as smoothly. Businesses had to make the adjustment. The changes involved in a structural shift in the tax system as big as that are bound to cause extra work and inconvenience for people, and I accept that. I do not think there is any way that you could have had such a big change to the tax system without more paperwork, more accounting and more overall work for businesses. That has clearly occurred and has caused some resentment amongst some of them. No-one can deny that.

The other issue is—and this is something I do not know anything about; I am not close enough to judge—was there a way of doing it that would not have caused extra work and some resentment? I do not know whether there was an alternative. If you had searched the world and found the most experienced designer of tax systems that you could ever find—someone who has had the experience five times before and has designed the perfect compliance procedures and perfect forms—we may still have had a huge amount of unhappiness and resentment about having to do extra work. From what I can see and from what my expertise enables me to judge, I do not think that there was anything different about this GST to anyone else's GST. It is always going to be upsetting to have to do extra work.

**Mr LATHAM**—But how can your Deputy Governor state with confidence that there was 'confidence-sapping annoyance with the administration of the GST' that led to economic slowdown when, as Governor, you dance around that statement and do not necessarily agree with it?

**Mr Macfarlane**—I suppose that what we are saying is not all that different. When I am saying that it causes resentment, he says that it reduces their confidence. I suppose if you are annoyed about an extra burden, it does reduce your confidence. But I do not think that that was an important factor. I think the important factor about the GST is that it shifted the house building that would have been done in the second half of the year into the first half of the year. I do not think there is any dispute about that. That is the first point. The second point is that, yes, it does involve more paperwork and that, of course, will cause some people some resentment and annoyance. But I think that is small compared with the bit that we can measure, which is this big shift in house building from one half of the year to the other half of the year.

**Mr LATHAM**—Finally, in your further analysis of GST impacts, what conclusion would the bank reach about its impact on profitability? There seems to be a lot of speculation about cash flow squeezes. Does the bank regard the GST as something that has reduced profitability and therefore added to economic slowdown?

**Mr Macfarlane**—No, I do not think we can say that. I have indicated that when we got those two low CPIs for the September and December quarters there was some very general, tentative evidence that there might have been a squeeze on profitability in that at least three separate price effects had to be passed through, the GST being one, oil being another and the exchange rate effects being a third. There did appear to be, at that stage, some evidence that the sum of these three may not be being passed through as quickly as normal. They always take time to pass through anyhow; they do not happen instantaneously. There was some evidence at that stage that the sum of the three may not be being passed through. When we got the March quarter CPI we became more confident that the sum of these three things was being passed through.

You will never know the answer; no one can tell the answer. It depends on the state of the industry at the time, it depends on how competitive things are, it depends if they are in a discounting war. No one can go along and say, ‘The theoretical amount your prices should have gone up was 10 per cent and if you went up by less than 10 per cent that was because you could not pass it through’, or ‘If you went up by more than 10 per cent it was because you were gouging.’ We will never know. But you are right to say that there was a time, particularly when we received those CPIs for the second half of last year, where we thought that there was some evidence that the totality of cost increases was not being passed through.

**Mr LATHAM**—Dr Grenville said in March that the GST squeezed cash flows and profits and that led to the fall in the December quarter, that contributed to the negative growth in the December quarter. You might have a different assessment for March and June quarters, but does the bank confirm the statement by Dr Grenville that, for the December quarter, the GST squeezed cash flows and profits?

**Mr Macfarlane**—I do not like to contradict my deputy, but I do not think we have any firm evidence that that happened. I think he was going through possible things that you might look at, but I do not think we have any firm evidence that that happened.

**Mr LATHAM**—It was a pretty definitive statement: he was setting out the reasons why.

**Mr Macfarlane**—That is not the way I read it.

**Mr SOMLYAY**—The income tax cuts which were part of the new tax system came to $12 billion. Some concern was expressed at the time that they would be expansionary and impact on inflation and possibly that could have been a factor in the rise in interest rates by the Reserve in the latter part of last year. What actually happened to those tax cuts—were they saved or spent? Do they remain a sleeper in the equation? If consumer confidence increases, is it possible that could be expansionary again?

**Mr Macfarlane**—The first thing is that they were not a factor behind the rise in interest rates. The second point is that there was a lot of criticism levelled at the government for this expansionary move in fiscal policy—in other words, for giving tax cuts that would more than compensate for the GST—because people believed that the economy was booming ahead and that this would be irresponsible. I think it indicates just how widespread the belief was that the economy was booming ahead at that time that the critics were able to make this point. It is true we did not predict the size of the contraction in the second half of the year, but we did always have a slowdown: we were growing at nearly five per cent—at 4.9 per cent—in the year to the June quarter and we always assumed that the next year was going to be slower than that. So we always had some sort of slowdown built in, and so we did not think that it would be fiscally irresponsible to have a fiscal expansion at that time, although, as you said, a lot of people did.

The question is: what has happened to all those tax cuts? The first thing I want to mention is that, in fact, in the September quarter there was a very big increase in taxes not just at the federal level but also at the state level, which at the time was one of the many reasons why people assumed that this was based on a strong economy. Normally if your taxes are coming in faster than you think, the first thing you think of is: ‘The economy is growing faster than I think.’ So there was an increase in taxes in the September quarter which caused the government to revise up its estimate of taxes for the year, when it put out its mid-year financial statement, compared to what it had in the budget. But that was a once-off thing that happened in the September quarter. And, as far as we know, from then on taxes have been running exactly according to forecasts.

Our conclusion is that the tax cuts are still there. They were expansionary and even though more came in earlier in the year than was thought likely, we think that overall there will still be an expansionary influence from the tax cuts. Of course, now that the economy has slowed down so much I do not think that we are seeing people going around saying that this was an irresponsible thing to do. I think some of the cynics are saying, ‘You got it right but it was a fluke.’ But they are not saying, ‘You have got it wrong. You did the wrong thing.’

**Mr ALBANESE**—Just following on from that, Governor, given you have said that the changes you made in increasing interest rates last year were not due to inflationary concerns about the impact of the GST, do you accept the Prime Minister’s assessment that it was an error of judgment by the bank to raise interest rates last year?

**Mr Macfarlane**—I am not sure that he said it was an error to raise them at all. I think he said that he disagreed with some of our judgments.

**Mr ALBANESE**—‘Errors’ of judgment—multiple.

**Mr Macfarlane**—I do not think that that means all of them. No, I do not. The main reason for tightening was that our starting point, when we had a cash rate of 4.75 per cent, was in our view—and it still is when we look back in our view—an expansionary setting of monetary policy. It was basically at that expansionary setting because that is what we inherited—and that is what we kept it at—from the Asian crisis and its immediate aftermath. Whilst it was appropriate for that particular period, we did not see that it was appropriate when we looked ahead. We weathered the Asian crisis better than anyone had predicted. We had been growing at over 4½ per cent per annum for three years. We are in the ninth year of an expansion and about to go into the 10th. We knew we were facing three factors, not one, that some people would say were inflationary. I would say they would raise the price level. GST was one of them. That was one that we knew something about and we already knew was going to happen.

We also had a big fall on the Australian dollar, which was pushing price increases through, and we had rising petrol prices. Our view was that the balance of risks at that time was in the inflationary direction and the safest course of action was to move from an expansionary setting of monetary policy to a neutral one and then to one that was slightly tighter than neutral. This is the response that is in keeping with our inflation targeting methodology which we have been using since 1993. I think we made the right decisions on the information that was available at the time.

I do not think that the Prime Minister was saying that we should not have done any of those increases in interest rates. In fact, I am not sure whether anyone is. But there may possibly be people who say, ‘You should have kept your interest rates back at 4.75 per cent and you should not have had any increases at all.’ I do not think that is a tenable argument. The problem is that we know the path that the economy actually took but we do not know the path that the economy would have taken if there had been no increases in the interest rates. We do not have an opportunity to go back and look at that. My guess is that if we did the experiment it would not have been a very happy outcome. My guess is that if you had attempted—even if you had intended—to have had no increase in interest rates, you would at some point have had to change course and increase interest rates.

To have followed the alternative scenario of keeping them where they were, back at 4.75, would have involved keeping a clearly expansionary stance of monetary policy while every other country of significance was tightening, while your exchange rate was falling against all of them and petrol price rises were coming through. If you had attempted to do that you probably would not have succeeded. The exchange rate reaction would have been so overwhelming that you would have been forced into raising interest rates somewhat. If you tried to hold out against it in those circumstances, then people both overseas and in Australia would be wondering what sort of central bank you had.

It would have been an extremely risky course, and that is why I do not think it would have been something that could have been adhered to. You could argue an intermediate case and you could say: ‘Some rises in interest rates were appropriate, and it would have been impossible to have none, but maybe you should have had less. Maybe you should not have done one in August, or you should not have done one in May.’ We can argue about that, and I am happy to discuss that. But if we do that, we are talking about relatively fine shades of difference, rather than black or white.

**Mr ALBANESE—**So you don’t begrudge any of the rate increases last year.

**Mr Macfarlane—**That is probably right. The right thing to do in our system is, if the weight of evidence says that the risks are on the inflationary side, you tighten. We did not tighten by all that much. As I say, it was the smallest tightening we have had. You do that, and if the evidence changes you are prepared to change interest rates quickly and take away any element of tightening you have put in. That is a better way of doing it than having tried to sit still with those interest rates we had in 1999, which I do not think would have been possible.

Even if someone said, ‘You should not have raised interest rates by a quarter of a per cent in August’, you can make that case. It is a legitimate case. I thought the evidence argued in favour of doing that. If you did it and then you subsequently decided that you should not have or you did not need to, you can change direction quite quickly, because it is not as though you have put a lot of financial stringency into the economy. If you had done that, if you had tightened monetary policy to the extent where you had actually produced genuine financial stringency, you would be worried. But when we see what has happened and we look at the channels that monetary policy goes through, I do not think you can claim that happened at all. Credit continued to grow at a fast clip. It continued to grow at about 10 per cent.

Another channel through which monetary policy operates is asset prices. There was no shake-out in asset prices. Our share market was one of the strongest in the world over that time. Another traditional channel through which monetary policy operates is through pushing up the exchange rate. That clearly did not happen. The exchange rate was very low. In the surveys that are done of businesses where you ask them, ‘What was constraining your profitability of your sales?’ they do not say it was monetary policy. So I think the right approach was to move monetary policy in the direction indicated by where you thought the balance of risks were. If the balance of risks change, you move monetary policy in the direction that the new balance of risks suggests.

**CHAIR**—Mr Macfarlane, I go back to your opening remarks. You were talking about interest rate settings now. I think you described it as an expansionary level. You went on to talk at some length about what may occur with the United States. We have seen another interest rate cut in the United States since the last cut in Australia. We have now seen two cuts overnight, in Europe and in the UK. I am just trying to get a feel for this. If you say it is expansionary then you would be indicating that if there were to be any move in interest rates—and I am not saying you were, but if you were to move them—it might be up rather than down. Yet our major trading partners have moved them down, and Japan has moved them down too. Could you clarify exactly what you mean by those differing statements?

**Mr Macfarlane**—There are two issues there. It seems to me that you are asking me to comment on the extent to which we have moved compared with other countries. The answer is that, in terms of distance and speed, the US has moved more than anyone, and we are No. 2. We have not moved as much as the US, because we do not believe we have hanging over us the vulnerabilities that the US has—the ones I mentioned before: the high share prices, the high dollar and the possibility of an investment shake-out. But we have moved further and faster than any others, and that is our assessment of our position. I think one of the reasons we have moved further than any of the others is that this housing fall brought forward our cycle; it made it occur a bit quicker than it would have otherwise occurred.

The other issue is: what is expansionary and what is not expansionary? I think the simple way of answering that is really in terms of real interest rates compared with what you would judge to be some sort of rough neutral level—a neutral level based on what real interest rates have been during the average of the low inflation period; that is, since about 1992. If we have an idea of what the average was then—and that average was good, because it was consistent with maintaining low inflation and good growth—and compare ourselves with that average, we were below that average when we were at 4.75, we were a little bit above it when we were at 6.25, and we are well below it again now.

**CHAIR**—The average would be—

**Mr Macfarlane**—Probably around 3½.

**Mr LATHAM**—Is that your new rule of thumb for how—

**Mr Macfarlane**—I knew that I should not have said it. This is the problem: you have to be open and accountable but, as soon as you say something, it is a new rule of thumb. No, it is a very broad brush sort of thing that we would look at. We certainly have always said that we would look at real interest rates—and yes, we do. The problem with it is that it is not a rule of thumb for several reasons. One is that you can argue about what that average should be. The other big problem is that you have to make an assessment of what inflationary expectations are, what people think is going to happen, not just what inflation has done. So you can argue about how you assess that. So it does not boil down to a nice simple rule of thumb. But I only mention that to say that we did not just make up this idea that it was expansionary, then it was mildly contractionary and now it is expansionary; there is more to it than that.

**CHAIR—**You have still used that word ‘expansionary’. Is it still expansionary in the current climate?

**Mr Macfarlane—**I would say that monetary policy is expansionary, yes. I do not know of anyone who is saying that it is not. I do not know of anyone who is saying that monetary policy is inhibiting their expansion plans, their spending plans or their house buying plans. I do not know of anyone who is saying that.

**Proceedings suspended from 11.28 a.m. to 11.48 a.m.**

Resolved (on motion by **Mr Albanese**), seconded by **Mr Somlyay**):

That the opening statement by the Governor of the Reserve Bank of Australia be accepted as exhibit No. 1.

**CHAIR—**Mr Macfarlane, I think we will probably have a few more questions in relation to monetary policy and then we will try and move on to some other areas. One of the more general questions that I would be interested to hear your views on is this: given the reforms that have been going on in Australia for the past 10 or 15 years, and the until recently sustained rate of growth of around four per cent, is it reasonable to assume that, when the economy does recover, the sustainable rate of growth should be above four per cent when in the past, if it was much above three per cent, we seemed to run into trouble? Are you confident that that is now the case?

**Mr Macfarlane—**That is a difficult one. It certainly was the case during the nineties that we were able to grow on average slightly over four per cent without creating inflationary pressures. We attributed the higher productivity that underlay that to the various reforms that had occurred. We do not know how long lasting the reform effects are going to be, but, like you, I would expect that our sustainable rate of growth is now above four per cent; even though our workforce does not grow as fast as it did before, our productivity is higher.

The other relevant element is that, when the US had a pick up in productivity, they attributed it essentially to the benefits of the new technologies—the IT and telecommunications technologies. We did not attribute ours to that; we attributed it to various types of deregulation and reform. That might mean that if the US type lift in productivity is genuine—and I think it is—we have yet to get that. In other words, that is still in store for us. In that sense, the outlook for productivity in Australia is perhaps better than in the US because it is still in the pipeline for us. The extent to which new technology lifts productivity is a function of the application of the technology and Australia has applied the new technologies quite rapidly. Although we are not as highly advanced as the US, and on some measures not as high as some of the Scandinavian countries, on a lot of other measures we are up there with the US and the Scandinavian countries.

**CHAIR—**Returning to the question of confidence, and we have talked quite a bit about various aspects that contribute to confidence, in your assessment from an economic point of view, how much does the lead-up to a general election affect consumer confidence? Does that put pressure on political parties to have a clearer view of policies earlier rather than later?

**Mr Macfarlane**—I am not sure how I am going to answer that one. I am not even sure whether an election year affects consumer confidence. I do not know the answer to that one. As I do not know the answer to that one, I do not think I am in a position to answer the second one.

**Ms BURKE**—Referring to overall economic development, are you aware of any other major developing economy which exhibited negative growth in the December quarter 2000?

**Mr Macfarlane**—I do not think so. That was a peculiar Australian event and that is why there was so much surprise and disappointment. I was surprised and disappointed because my reading of the fundamentals of the economy, as I have made clear in a number of speeches, was that we were in better shape than just about everyone else in terms of medium-term fundamentals, particularly when comparing our position with our position in earlier expansions. We did not have problems with inflation, wages, balance of payments, overinvestment or overheated asset prices. I mentioned all those things in numerous speeches. As I said, that put us in a stronger position than we had been in in the past, and in a much more resilient position in comparison to the US. That is why, in a sense, I think we were rather unlucky to have this structural event come along. I am not disputing the need for that structural event; I am just saying that, whenever it was to come, there were going to be transition effects, and we copped one in the second half of last year.

**Ms BURKE**—Leading on from that, in your opinion has Australia's domestic slowdown been the result of cyclical factors or policy error?

**Mr Macfarlane**—Everyone is having a cyclical slowdown. The thing that was different about us was that, instead of it being a slowdown, we had that negative quarter, and that negative quarter, I would say, was due to the transition effect of a basically sensible policy which had short-run costs.

**Ms BURKE**—In your speech on 10 April you said,

> Let me make a disclaimer before I go any further, lest anyone think I am trying to blacken the name of the GST and imply it was all a horrible mistake. I have always thought that a GST is a good thing for the economy ...

I would like you to explain where you have said that before, since we have obviously teased you on that on numerous occasions. I have been back through my notes extensively and I cannot see where you have made any other statements about the GST. Subsequent to that, why was there the need for the Governor of the Reserve Bank to make such a blatantly political statement?

**Mr Macfarlane**—Your research must be more thorough than mine—I thought I had said that before. I did not really see it as blatantly political, because it seems to me that, in the history of Australia over the last 20 years, GST has been a big issue, and at various stages both parties have been strong advocates of it. I took a longer view and did not regard that as a partisan political statement.

**CHAIR**—We had better move on to something less controversial. With the CPI measurement—I think you mentioned earlier the variation in different parts of Australia—in the past we have raised a question about the fact that inflation and growth can vary quite widely across different parts of the economy, in different regions and so on. As you would be aware, in our last report we recommended that the ABS expand its collection of statistics to include more than just the six capital cities when it measures CPI movements. Do you have any evidence, given your expanded regional offices, to have concern about the way in which the CPI is being collected and the way in which growth is being measured in terms of the variation across the regions and different parts of the economy?

**Mr Macfarlane**—On the latter point, we are certainly conscious about growth. We think that there are obviously significant differences in growth rates between states and between regions within states, and we are trying our best to get a handle on that. My feeling is that the variation in growth rates is much greater than the variation in inflation, so I would not have put such a high priority on having an expanded CPI to go outside the capital cities than on getting an understanding of economic growth outside the capital cities.

**Mr Stevens**—The real activity data tend to show more variance across states than do prices. The CPI is running at about six for the nation. The lowest state is 5.3 and the highest is 6.5. That is not a lot of difference, especially given some of the ups and downs in various components over the past year. You get a lot more variation than that if you look at employment, housing or something like that. The variation around regions is more likely to be on the activity side than on the price side, and calculating the CPI is very costly, so we would need to come up with some more resources for the ABS if you want to have a wider CPI.

**Mr Macfarlane**—Can I ask the chairman: what is the assumption? Are you working from the assumption that inflation is higher or lower in non-metropolitan areas?

**CHAIR**—It is not a question of an assumption; it is a question of not knowing the real answer—whether in a trend line over a longer period there may be a difference. I accept the point that on a quarter by quarter basis the variation would be small, but over a longer period there could be quite a difference.

**Mr Macfarlane**—Do we know in which direction? Do we have any—

**CHAIR**—That is what I do not know. That is what we would like to find out.

**Mr Stevens**—There is no doubt that some things cost more in remote regions and other things cost less, like houses. But there are probably persistent level differences in both directions there, without that necessarily meaning that rates of growth through time would be very different. I suspect they probably are not that different.

**CHAIR**—You could demonstrate very clearly that there has been quite a divergence of price increases in the last five years.

**Mr Macfarlane**—There has been, certainly.

**Mr LATHAM**—Mr Macfarlane, you have mentioned that tax reforms had the short-term cost of economic slowdown. Isn’t it more serious than that in that it seems to have triggered a return to boom and bust conditions led by the housing sector? This is a longstanding problem in this nation’s history—boom and bust, led by housing. You mentioned the extraordinary downturn—30 to 40 per cent. You also made mention earlier of the possibility of a pronounced upswing. Beyond the short term, is it going to be very hard to work our way out of a boom-bust cycle led by the volatile housing sector?

**Mr Macfarlane**—Housing has always been extremely volatile. It has always had very marked swings up and down. It had them in the old days when we had a heavily regulated financial system because credit was rationed. We deregulated it and mortgages are available now for anyone who wants them—there is a very competitive mortgage industry—and we have still had the same swings. You are right to say this most recent downswing is bigger than any of the others: I have already mentioned that. And, yes, it made life difficult for us. But I think the fact that we are expecting a big upswing in the course of this year will actually not be disruptive. I think it will be a stabilising influence on the economy if we get a very big recovery in housing this year, which is what we expect through the course of this year.

**Mr LATHAM**—On a separate issue: in the past you have issued warnings about a bidding war in terms of fiscal policy. In December you restated that position; yet, in recent months, there has been an extraordinary loosening of fiscal policy with a whole range of big spending items on the government's agenda. We are coming into a budget in the next couple of weeks and, as the chairman mentioned, an election campaign. What is your update on the bidding war?

**Mr Macfarlane**—I think the answer to that is what sort of budget surplus or budget deficit or what sort of total budgetary position is the one that is appropriate for the present circumstances. The first thing is that, with a weaker economy than we assessed as having when I made that statement back in August last year, obviously a more expansionary stance of fiscal policy makes more sense now than it did back in August last year. I think we should judge it essentially by what sort of figure comes out. Although there is no magic figure, there are a number of things which have moved the surplus down—moved fiscal policy in the expansionary direction—which are no bad things. For example, the automatic stabilisers that cause surpluses to shrink or deficits to widen as an economy slows should certainly be allowed to operate. It would be foolish to try and offset those.

I think that the very short-term things that have got a sunset clause on them and direct demand into areas with excess capacity are also not unreasonable policies. For example, the grant for the new house purchase is a sensible use of fiscal policy. What I was referring to back in August was that there is a danger, when the economy is a bit weaker, that all sorts of people come out of the woodwork with their favourite spending proposal and advance it as a countercyclical policy. The thing is that often they are not really countercyclical; often they are things that take a long time to get through legislation and what have you. They end up putting the expansion into a period down the track when the economy has already recovered and have an effect on the overall structural budgetary position. There is always a risk of that happening, but at the moment, from what I can see, fiscal policy has made a movement in an expansionary direction and I would not resist that.

**Mr LATHAM**—One of the criticisms of the bank in recent times has not just been about the direction of monetary policy but also about the volatility. You mentioned automatic stabilisers, for instance. Professor Tom Valentine from the University of Western Sydney has argued in the national media that monetary policy also has automatic stabilisers through market long-term interest rates and the like, and that the best policy may well be a more passive stance; that the bank should resist the urge to be fiddling too much and certainly resisting the urge to get into demand management—demand management being one of your stated policy goals in your April adjustment to interest rates. Don't you think this is wise counsel—that, because of the lags in monetary policy, demand management is not feasible, that there can be a temptation to move interest rates much too readily, and if in doubt they should remain stable?

**Mr Macfarlane—**Yes. As a general observation, I think that is quite sensible. I would point out, of course, that we are actually less activist. We move our interest rates less often than other major countries. I do not have the paper in front of me, but I could provide it if you want me to. In the 1990s we have been less inclined to move interest rates than others. The criticism, as I see it, would be a criticism directed at modern monetary policy in general rather than at what the Reserve Bank of Australia is doing. Then again, even there, I am not sure that it really is on the mark because you only have to look back at what happened in the seventies and eighties to see the huge swings that were occurring. I have already referred to the huge swings in fiscal policy when I answered a question that Anna Burke raised.

If you look at the seventies and eighties and the huge swings that used to occur in monetary policy, whether you measured monetary policy by an aggregate such as credit or whether you measured it by interest rates, what has happened in the 1990s is that these swings have gone away. They have not gone away completely but they have become much smaller. If you have a high inflation environment with volatile asset prices, as we had in the eighties, you could have interest rates moving up by 700 basis points and then down by 1,400 basis points. What we are talking about now is an environment where an upward move of 150 basis points causes a great deal of discussion. I think the observation to make, if you look at how monetary policy is conducted now compared to how it was conducted in earlier decades, is how small the swings are.

**CHAIR—**You made reference to a paper?

**Mr Macfarlane—**We did some back-of-the-envelope calculations at one stage and measured it, but if you want a paper, I will provide you with one.

**CHAIR—**You could refresh our memory about where we would find it.

**Mr LATHAM—**Professor Valentine's comments were reported in the *Financial Review* on 8 February.

**Mr ALBANESE—**Following on from Mr Latham's question about fiscal stimulus that has been going on due to policy reversals of the government, given the changes that have already occurred, do you think it would be responsible, as part of the election year bidding war, for income tax cuts to be offered?

**Mr Macfarlane—**You are trying to get me to speculate about a budget which I know nothing whatsoever about. I reiterate my main point—

**Mr ALBANESE—**We know the surplus has been shot to bits.

**Mr Macfarlane—**I know the surplus will be lower. I have said that I think that is an appropriate movement in fiscal policy in the circumstances where the economy has softened more than you thought.

**Mr ALBANESE—**But no comment on the income tax cuts?

**Mr Macfarlane—**Are you asking me to speculate about a policy which I know nothing about? It may not even be a policy.

**Mr ALBANESE—**I am asking whether it would be responsible for any political party to offer income tax cuts, given the current economic environment and the state of the budget.

**Mr Macfarlane—**I put it this way: I think it would not be responsible to have a further major expansion of fiscal policy at the moment that pushed it significantly into the red. I think that a large deficit would be an overreaction.

**Dr SOUTHCOTT—**Previously you have spoken about stability in the settings of monetary policy, and you touched on this in the answer to Mark Latham's question. If the impact on housing was a transitional effect of the GST, doesn't that have no real implications for monetary policy if you are expecting it to come back to the long-run average?

**Mr Macfarlane—**I said in an earlier speech that if it had been a pure timing thing, and even it had have been much bigger than we thought but it was going to be a clearly identifiable V, and if the rest of the world had not changed, there may well be no implication for monetary policy. But there are two problems with that. Firstly, the rest of the world has changed and, secondly, it is very hard to have a pure V. Some things that are temporary still affect people's expectations and confidence, and what have you. They are not to know that they are temporary, so it is not as simple as that.

**Dr SOUTHCOTT—**In terms of Australia's performance in productivity growth over the 1990s, you earlier spoke about the contribution that had been made by deregulation and the opening of the economy and the fact that the United States feels that theirs has largely been due to technological changes. But you have also said that Australia is an early adopter. Are you saying we are just behind on the technology frontier and, if so, what do you anticipate in terms of productivity growth in the future from the adoption of new technology?

**Mr Macfarlane—**There are two possible outcomes. One I alluded to before, which is that we have not got any of that productivity gain yet and we will get it in the future, which would be good. The other thing is we have already got a fair bit of it and it is already in there, in our underlying figures. I think the truth is somewhere between the two.

**Dr SOUTHCOTT—**Has the Reserve Bank done any work on that?

**Mr Macfarlane—**We have certainly done a lot of work on productivity. We have even done the same work that is done in the US which concluded that productivity had risen and a lot of it was due to technology. We have done that. If you believe it literally, it shows that some of the productivity gains have already come though.

**Dr SOUTHCOTT—**Historically, Australia has had growth choked off by inflationary rises or blow-outs in the balance of payment. What is the Reserve Bank's outlook for inflation and the balance of payments?

**Mr Macfarlane—**On the inflation one, I think I gave the figure in my opening address, and we are still expecting that. When we reach this period when we will be able to see what has happened and the results are no longer contaminated by GST effects, we are expecting to see inflation running at 2½ per cent. The current account, as you know, is about as low as it has been in the last 20 years, and we would expect it to stay there or possibly even become lower.

**Dr SOUTHCOTT—**So based on that, you do not see any future impediments to the current growth cycle continuing?

**Mr Macfarlane—**I do not see any impediment from those two sources.

**Ms BURKE—**Do you see impediments from other sources?

**Mr Macfarlane—**I think the rest of the world is the big unknown.

**Ms BURKE—**Going back to productivity and looking at your statement on monetary policy, you have said that growth in labour productivity has eased over the past couple of years, from a rate of around 3½ percent two years ago to around three-quarters of a percent over the year to December quarter 2000. Given that easing and what you have just said, what do you believe has caused this? To what extent do you believe it is related to disinvestment in education, training and innovation by the federal government?

**Mr Macfarlane—**It is entirely cyclical. It is the same in the US. Basically, productivity is GDP divided by the growth of employment. If your GDP growth slows down by more than the slowdown in your employment, your productivity falls; and that is what has happened. So, every time that you have a cycle where GDP growth slows down, productivity slows down. Then, when you have the recovery and you go into the expansion, productivity picks up again. That is why you have to try to take out the cyclical effect, if you are trying to measure underlying productivity. But what we have seen here and in the US over the past six to 12 months is cyclical.

**Ms GAMBARO—**Governor, the commodity prices at the moment are at the highest level in more than two decades. Just carrying on from Dr Southcott's questioning of the current account and the trade balance, the trade balance figures were $212 million in the March quarter. They grew by 17 per cent to the March quarter as well. What is your outlook for the trade balance? In your statement you say that in the period ahead the external factors will be affected by the opposing forces of a more subdued outlook for world growth and the low exchange rate. How will those opposing factors come into play?

**Mr Macfarlane—**This is getting quite technical. Do you want to try, Glenn?

**Mr Stevens—**We are facing a world economy that is at the moment is decelerating. Up to the present, our exports have done exceptionally well, in the past two years or so. All other things given, a slower world economy will most likely lead to some slowing in that export growth.

What is helping to prevent that from being too big a slowing is that the currency is very low, and that helps the export sector and those who compete with imports. As to which way the trade balance will go, it depends on the extent to which growth proceeds here relative to abroad, of course. If we pick up quite quickly and the rest of the world remains a bit slow, you can imagine a scenario where imports would grow faster and the trade balance would perhaps go back into a small deficit. At the moment we think that not a lot of change in where it is at present is the most likely outcome. That is based on a gradual pick-up in growth here and on things turning up in the world economy over the next year or so as well.

**Mr Macfarlane**—You also asked something about commodity prices. It is true that we often complain about our bad luck, but I think we have had some quite good luck on commodity prices. I think that Australian commodity prices have been in reasonably good shape. The most recent one, which came through in April for both coking and steaming coal and iron ore and which has had big increases in US dollar prices, is extremely good for the economy.

**Ms GAMBARO**—Do you see that continuing?

**Mr Macfarlane**—They renegotiate them every year, so at least it is going to continue for a year. My understanding is that spot prices are higher than the contract price at the moment and so, if anything, there is upward pressure; so that is a very good sign for the economy.

**CHAIR**—Mr Macfarlane, I just want to pick up one point. When I asked you earlier about the function of the new regional offices you did not actually get back to that point.

**Mr Macfarlane**—That is coming on very well. The Melbourne, Perth and Brisbane ones have been established. We have very good people to staff them. They are working very well and enthusiastically. They are meeting as many people and interest groups they can. They are reporting back to Glenn. They are actually members of his staff. Even though they are remote from his department they report directly to his department, which is a big improvement on what we had before when we had an economist in each state but they reported to the manager of the state. The manager was really a banker whose main expertise was in providing banking services to government departments. We are very happy with the way it is going. We have had board meetings in two of those branches already in the last couple of months, one here and one in Perth. We think the system is going to work very well. Ironically, of course, having decided that we have got to get out and find out what things are happening—because people say we are too much centred on New South Wales and on capital cities—since we set this up, New South Wales has probably been the weakest economy, along with Western Australia, and the rural sector has done extremely well compared with capital cities.

**CHAIR**—You are not attributing the connection, are you? On the question of the Australian dollar, you have said in the past that the behaviour has been difficult to explain. Are you now in a position to give us a better explanation of why the Australian dollar has been behaving the way it has and what is constraining it in terms of where it is at the moment?

**Mr Macfarlane**—I do not know that I am in a better position to explain it. I have said recently that, if the Australian dollar is difficult to explain, the US dollar is even more difficult to explain. The big anomaly in the world of financial markets at the moment is the continued strength of the US dollar, and no-one has been able to explain that satisfactorily. I said before that I thought that that latest rundown in the Australian dollar from 52 to 47 was really, in some sense, totally unnecessary. It was due to a bout of pessimism that was brought on by the December quarter national accounts, but that has since been reversed. We can almost look back on that episode as though it did not happen. Certainly, with what has been happening over the last six weeks or so, the Australian dollar seems to make sense to me.

**CHAIR—**It would still be well below what you would call a long-term average. One would have thought that 65c would be more—

**Mr Macfarlane—**So it is still well below fair value. I do not want to join in the competition for yet another explanation. We had so many explanations last year for what was happening to the Australian dollar. Everyone who had a pet project to push attributed the fall in the Australian dollar to the failure to have implemented their pet project. I do not think I want to add to all those things.

**Ms BURKE—**Given that some of those theories were running at the issue of Australia not being able to attract foreign investment, our current account deficit and also our lack of national savings—it seems you do not want to go into that—I would ask what your view is of the government's decision in respect of the Shell takeover of Woodside and what impact you believe that will have on the Australian dollar in terms of its ability to attract foreign investment. Did you agree with the government's decision in respect of that?

**Mr Macfarlane—**I do not want to answer that one yes or no because I would be either endorsing or opposing the government, and I do not think that would do anyone any good. However, I do want to say that I think its effect on the exchange rate was minimal.

**Ms BURKE—**Would you hold that view in the long-term?

**Mr Macfarlane—**I would not know about the long-term. There were people who were predicting it would have a devastating short-term effect on the exchange rate. I was not one of those and, in the event, it had a relatively minor effect on the exchange rate.

**CHAIR—**It does not seem to have worried Heineken.

**Ms BURKE—**Let's not talk about Arnott's.

**Mr LATHAM—**Mr Macfarlane, I invite your response to the comments of Professor Adrian Pagan earlier this year as an outgoing member of the Reserve Bank board. Professor Pagan was painting a picture indicating that board members do not have enough research capacity and that they are not able to effectively challenge the recommendations that you might bring to board meetings. In the press he wrote that the only member of the board who has the capability of mounting such a case—a case in opposition to you—is the Secretary to the Treasury, and that this is not a healthy situation. How do you respond to these comments? What can the bank do to provide better briefings, research capacity and active involvement for its board members, other than for those who officially work for the bank or those who work for the Treasury?

**Mr Macfarlane—**Professor Pagan's views on the appropriate governance arrangements for a central bank are very heavily influenced by the Bank of England. If you read the article, it is basically an argument in favour of that. I think we have to be a little sceptical at this stage on the Bank of England model for several reasons. We must remember that the UK was the last country to adopt the principle of central bank independence. Being the last one to do it, they have come up with a model which I think shows the usual zealousness of the recent convert. The Bank of England model has a board which basically consists of professors of economics, so it is not at all surprising that a professor of economics is very much in favour of that model. Of course, it has some advantages. There are some strengths in such a model in that it does mean that the board members are going to be well-educated in monetary economics. The argument against it, from broad democratic principles, is that it means you have a board which is not really very representative of the country—it does not represent a whole lot of different experiences or approaches. It basically means that you add another four monetary economists to the three monetary economists who are already on the board. So you have more expertise but you have it drawn from a very narrow range of possible disciplines.

It is the sort of issue that is not up to the central bank or me to decide. You are really asking about the legislation that we have in Australia where we have a board which is a genuine external board that is part-time. The Bank of England board is not external—they are full-time employees. Obviously the primary activity of all the people on the Reserve Bank board is in doing something else. These days, the Bank of England board member does not, by and large, have any other activity other than being a board member. The question is: what is the better approach? Is it better to have a breadth of experience—part-time experience, as you would with a company board, which is really what ours is like—or is it better to have a full-time board, all of whom are monetary economists? You could argue this at length. You could argue what is the most efficient of these two and you could argue which one has the most democratic legitimacy. I do not know the answer to that but, in this country, we have chosen to go down the path of a part-time board of people who have a different experience base to the executive members of the board. I think it works well but you could argue for the alternative. I certainly feel that the current system works well enough not to require legislative change.

**CHAIR—**There is the twice-yearly appearance before this committee.

**Mr Macfarlane—**There are a whole lot of other things. One thing is that I think the Reserve Bank is under intense scrutiny. Every day there are stories about whether we are going to do this, whether we do that, did we get this right, did we get that wrong? We are under public scrutiny here through committee procedures like this. I am always willing to hear new views on different ways of doing it.

Every central bank is different—this is the interesting thing. There is no first best that we all have to try and catch up with. I think some of the British press try and give the impression that the new Bank of England is the first best that you have to catch up with, but I do not really believe that is necessarily the case. If you had to find a first best, I think it would probably be the Fed. But the only way you could emulate the Fed would be to be a massive country like the US and have massive regional central banks, and we really are not in a position to do that. The only other country that was in a somewhat similar position was Germany; the structure of the Bundesbank was somewhat like the structure of the Fed, which I think is probably the best structure. This is a very interesting subject, and everyone is entitled to their own view. The big danger though is that people look at all the central banks and say, ‘I would like this feature from that one, that feature from that one and this feature from this one,’ and put them together, and it is not clear that they would coexist all that well. But that is basically the choice: do you want expertise or breadth?

**Mr LATHAM**—I think Professor Pagan had a different point. That was that some board members are not contributing anything to deliberations; that they are not capable, either in a research capacity or from their own expertise, of challenging recommendations that you might bring before the board. I think the public would have a concern that some board members are not contributing. This committee, I am sure, would have a concern. Also, it would express strong interest in the specific recommendation of Professor Pagan that the bank make available certain research capacity for every member of the board so that they can undertake some gathering of information, commission some research that they can bring to board meetings to ensure it is a lively forum—a forum of experts instead of a forum composed of some Trappist monks.

**Mr Macfarlane**—It is interesting that you use that religious analogy. I think the danger of the British system is that it is the opposite; people would say, 'We're run by a priesthood'—everyone has the same intellectual background. That is what I think is the risk of that system, whereas we do not have that situation. I do not think it is true to say that Professor Pagan has said the other members of the board are not contributing; that is not right. It is true to say that they would not understand the sort of simulation exercise or model building that Professor Pagan does, but that does not mean that they are not contributing to monetary policy or to our assessment of the economy.

**Dr SOUTHCOTT**—Is it open to members of the committee to commission research from the Reserve Bank, if they wish?

**Mr Macfarlane**—Within reason. In fact, my understanding is that Professor Pagan spent quite a lot of time in the research department discussing things with economists and arguing things. It is open to anyone who wants to do that.

**Mr LATHAM**—Do board members need to go through you to make themselves familiar with that material within the bank?

**Mr Macfarlane**—I do not think so. I think it would go straight to Glenn, Rick or John, if they wanted to.

**Mr LATHAM**—Other than Professor Pagan, how many board members have availed themselves of that service?

**Mr Macfarlane**—Some have from time to time.

**Mr LATHAM**—Once or twice a year? Can we get an idea?

**Mr Macfarlane**—They get a massive amount of material that we prepare for them. Their board papers are a huge amount of stuff. At board meetings they are able to request special papers on this or special papers on that. So they do get information; they do get information that they initiate rather than just the information that we just give them.

**Ms BURKE**—We have often talked about board minutes and that information being made available. Does the information that you are providing to board members appear later in the semi-annual statements?

**Mr Macfarlane**—Yes, it does. There would be six board meetings, and the sort of material that comes in the semi-annual statement is the sort of material that the board members would receive. They would not receive it in one big document; they would receive it in smaller documents dealing with particular aspects of the economy. So they might get three or four papers, but it would be similar sort of material.

**Ms BURKE**—Given that we have had some queries, as have the press, about the basis of your decision making—what is underlying going up and down, with criticism coming from all quarters—would it not be wiser then to say, 'This is the underlying information that we've actually used to arrive at the decisions the board has in respect of monetary movement'?

**Mr Macfarlane**—I think that is what it is, yes.

**Ms BURKE**—It forms the basis of the papers, it forms the basis of your monetary statement—that is where I suppose I am going. But we have to second-guess that that is the information you have used in the board—

**Mr Macfarlane**—It is not literally the information, but it is the same type of information. Obviously, the semi-annual statement was produced after the board meeting, but it bears a very strong resemblance to the material that was produced the week before the board meeting. It has been updated, but they are very similar.

**Ms BURKE**—Do you also think we should have a statement after board meetings where you make no change?

**Mr Macfarlane**—I myself do not, although I know that there are a number of differing opinions on this question. The first thing we have to make clear is that no-one is in any doubt as to what we do. If we are going to change interest rates, we say that we are changing interest rates. If at 9.30 we do not say that we are going to change them, everyone knows that interest rates are stable. It is not as though people are confused about what we are going to do. They know that. The problem is that people have said, 'We not only want to know what you are going to do, we want to know why you are doing it.' If we do not do anything, they still want to know why we are not doing anything. It is legitimate to ask that.

I do not know any country in the world where they actually give you anything resembling a reasonable amount of information on that question. The reason behind that is that it is very difficult to do so. First of all, sometimes you can go for 18 months without making a move and, if at every meeting you have to give an explanation, you run the risk that everyone will compare what you said this month with last month. It concentrates everyone on short-term monthly data. That is the bit that worries me. It concentrates the debate on the fact that such and such went up this month or such and such failed to go up this month. I think that is a bad thing.

The other thing is that I think it would be extremely difficult month after month to put out reasons why we did not do anything this month that are any different to the reasons we put out in the previous month. I think you would be inviting people to try and read subtle messages into slight changes in wording, and I myself do not think it would actually contribute to a better-informed market. I would not rule it out if I felt there was a widespread demand for it other than from the press. I would certainly consider it. The only harm it would do is that it would unduly concentrate the discussion and debate onto very short-term indicators. Apart from that I do not suppose it would do all that much harm.

**CHAIR—**Do you feel that it might already be the case that there is too much focus on the short-term? It is not just the Reserve Bank saying it; every bank seems to have an economist who wants to give us their wisdom at every opportunity they are able to get airplay.

**Mr Macfarlane—**That is right. There is too much concentration on very short-term things. It is because the people who are most interested and most informed are people whose jobs depend on picking the day of a particular change and for whom the difference between a half and a quarter is phenomenally important in terms of what happens to the money market that day, whereas to understand the economy and the role of monetary policy, you have got to look at a much longer horizon. But there are not that many people out there who can be paid for taking a longer horizon view.

Nearly all of the private sector economists in Australia now work in financial institutions. There are very few who do not work in a financial institution. If they are out there, they keep quiet. Twenty years ago, I think ICI used to have an economist and BHP had a prominent economist and there were a lot of economists spread all over the economy, whereas now I think there are more in total but they are almost exclusively working for financial institutions. I have probably done someone a terrible disservice but, by and large, the vocal ones all work for financial institutions and knowing about very short-term movements in interest rates and exchange rates is their bread and butter. It is what they get paid for.

**CHAIR—**Do you think this is a bit unhealthy?

**Mr Macfarlane—**It would be nice if there was another group of people who had a much longer horizon. In fact some of the people who have a very short-term horizon can sometimes distance themselves from that and can write good pieces and more thoughtful pieces taking a longer term view. But I think they are always conscious of the fact that they cannot spend too much time doing that because they have got to earn a living looking at the day-to-day stuff.

**Ms GAMBARO—**Just going back to earlier questions about resources: do you think you are adequately resourced to do your job properly? How do your resources compare with, say, the Treasury resources?

**Mr Macfarlane—**I think we are adequately resourced to do the job because it is our decision. We do not have to go cap in hand to anyone and ask for an appropriation. We make the decision ourselves as to what we think is the appropriate level of resources and so we are at what we think is the optimal level. It is always a struggle to keep the best people—we know that. We think that, by and large, we win on enough occasions to keep up the standard. We have the resources: we cannot complain that we are short of resources.

**Ms GAMBARO**—Are those resources—and I think Mr Latham asked this—available to any board members freely?

**Mr Macfarlane**—Yes. One can always consult the people from the policy departments of the bank.

**Mr LATHAM**—I want to focus on interchange fees and an update on the recommendations of the report that was commissioned and the recent decision of the ACCC to pass on responsibility to the Reserve Bank. I notice that you have announced an impending designation of interchange fees and a new payment system for credit cards. When will something be done about the outrageous mark-up in ATM fees and, also, EFTPOS? Those two areas were a major concern in the earlier report and are of huge concern to Australian consumers. We would like to see prompt action, I am sure.

**Mr Macfarlane**—Our judgment was that credit cards are the biggest issue at the moment. It is true that we did make some comments about ATMs and about EFTPOS, but our feeling was that real action was on credit cards, for several reasons. One of the reasons was that our act charges us with responsibility for the efficiency of the payments system. We want to see a payments system where the lowest cost and most efficient payments instruments prevail at the expense of the higher cost ones. To some extent that had been happening for a time as EFTPOS was growing very rapidly. But recently, for the reasons that are outlined in our report, we found that credit cards, which the banks tell us are a much more expensive way of providing payment services, were growing more rapidly than EFTPOS. So we thought that was our number one priority.

**Mr LATHAM**—Are you going to take action about ATM fees? Your report showed that the mark-up for foreign ATM fee transactions is 175 per cent. You can talk about the trend and where the market is moving—a substantial number of Australians are paying a mark-up of 175 per cent for using an ATM from another bank. In any industry, at any level of public administration, that would be regarded as unacceptable. I would think that most ATM consumers in this country are looking to you for action to do something about that extraordinary level of mark-up.

**Mr Macfarlane**—The answer is, yes, we will do something. We will have an inquiry into ATM fees. There is a little bit of action afoot. Some of the banks have also agreed that the foreign ATM fees are too high. Some banks are discussing with other banks ways of doing something about that. I think the ATM one is different in that sense from the credit card question.

The other thing that you have to bear in mind is that credit cards became important because the ACCC found that there was a per se case of price fixing, as I think it was called. That was their view on credit cards. Credit cards are in a scheme—Visa, MasterCard and Bankcard—where firms that are otherwise competing with each other sit around a table together and set a common wholesale price among them.

The ATMs and EFTPOS are different in that respect, in that each bank negotiates with each other bank. It is just a multitude of bilateral arrangements. Since they are all bilateral, the argument about price fixing did not apply to those two. Basically, we felt it was better to do it thoroughly and do it in order, rather than try to do all three at the same time. So the one that clearly was the top priority—both for the reason I mentioned before, because there were efficiency aspects, and because of the price fixing dimension to it—was credit cards, so that is the one we are going to do first.

**Mr LATHAM**—It is true that the ATM is a bilateral rip-off, whereas the credit cards are a cartel rip-off, but it is important nonetheless. Can you provide a rough timetable for when you expect action to be taken about ATM fees and also EFTPOS?

**Mr Macfarlane**—I think the answer would be ‘after we finish with credit cards’, and I think the credit card thing will probably take the remainder of the year.

**Mr LATHAM**—So next year until ATM.

**Mr Macfarlane**—Yes.

**Mr ALBANESE**—Just on that, there is an equity component here as well, in terms of its support of people who get hit in terms of ATM charges; whereas people who have credit cards are people like us, who have easy access to that. Surely there should be a total policy approach, whether they are credit cards, debit cards, ATM or EFTPOS. You need a total policy approach if you are going to attack this and not distort the market.

**Mr LATHAM**—Hear, hear!

**Mr Macfarlane**—I agree with that, but I think the way to do it is one at a time, because this is such a complex issue. One thing I will take issue with there is that you said you thought the poor people were losing out of ATMs but not out of credit cards.

**Mr ALBANESE**—No, I did not say that.

**Mr Macfarlane**—Sorry, I misinterpreted you. But I will go on anyhow to make that point that I think the big losers out of credit cards are poorer people who do not have a credit card, poorer people who have a credit card and because of their circumstances find themselves having to borrow on the revolving line of credit. The other one is the retailers, who pay the merchant service fees. The one winner out of credit cards is probably reasonably well-off smart people who use the credit card, pay no transaction fees and in some cases get paid to use the credit card through loyalty schemes. All the costs go onto those other groups that I mentioned.

**Mr ALBANESE**—This is why I mention the ATM issue. I would be surprised if my colleagues across the political spectrum did not agree that the feedback and complaints that we have are far more about ATMs—

**Mr Macfarlane**—It may well be because it is much easier and more obvious to see the distortion; whereas the credit card one is much more complex. I do not know anyone who has looked at it who has been able to understand it at first glance. It takes a lot of work to understand all of the cross-subsidies involved in the credit card schemes.

**CHAIR—**Mr Macfarlane, on the question of interchange fees, how confident would you be that if you can get some savings in those charges they will in fact be passed on to consumers and not held, particularly by large retailers?

**Mr Macfarlane—**I am pretty confident about that. One of the things we have learned in the last couple of years is just how competitive those retail markets are. That is one of the reasons we have been surprised a few times with these CPIs being lower than we thought. One of the things we are talking about is the difficulty for businesses to pass on costs. The markets are very competitive, and I think they would be passed on.

**Ms GAMBARO—**Governor, I know we have asked you about loyalty programs in the past. I think one institution we spoke to told us that they cost about $300 million a year to administer. How do the consumers pay for those? Do they pay them through increased fees and charges, or does the interchange scheme come into play here? I am not sure how they are funded and how the consumer pays.

**Mr Macfarlane—**It is through the interchange fee. In other words, the merchant retailer pays a fee to their banker and the first part of the fee is the interchange fee, which is between 80c and $1.20. It is a percentage point, which would be $1 on a $100 transaction. That interchange fee is paid to the card issuer and the card issuer also gets money from the interest rate on people who have borrowed and they pay an annual fee. The sum of those sums of money is sufficient and so generous that they can discount and they can use that flow of money to provide loyalty points to the cardholder.

The crucial element in that is that you do not get anything for nothing. We know that. Someone is paying for that. Who is paying for it? The merchant is paying for it. What does the merchant do about it? The merchant puts their prices up to cover it. So you are really paying for it in the price of the goods. You are paying X per cent more for your goods and you are getting something less than X per cent back as a loyalty point. If the interchange fee went down, the amount of loyalty points would go down, but the price of the products would go down.

This is one of the points that I was making when I was answering Mr Albanese: there is a very complex flow of cross-subsidies involved in this, which is very difficult for people to see from the surface. One of the questions that you should ask yourself, if you want to wonder what is going on here, is that, with EFTPOS, you are using your own money. You are simply drawing on your own money and you get charged a transaction fee to draw on your own money. With a credit card, the bank is lending you some money interest free, and paying you for being able to lend some money to you interest free through a loyalty point. It is a very strange world. There is a very complex set of pricing decisions and cross-subsidies that underlie it.

**Ms GAMBARO—**On the loyalty programs, I have a hypothetical question: how willing do you think consumers would be to give up loyalty programs? Would they trade that off with lower interchange fees or lower fee charges?

**Mr Macfarlane—**They did not have loyalty programs until five years ago. How long ago did the loyalty programs come along?

**Dr Laker—**It was 1995-96.

**Mr Macfarlane**—Either the credit card is an efficient payments instrument—and it is; it is a very good payments instrument—or it is not. People should choose to use this payments instrument—whether it is a good one or it is not—rather than, as I think the banks imply, only using their credit cards because they get loyalty points. That is pretty close to saying that it is a crummy payments instrument unless you get bribed with a loyalty point. We think it is actually a very good payments instrument and people would continue to use it, as they did before loyalty points came in.

**Mr LATHAM**—Regarding the reforms that you are planning in the credit card area, some of the credit unions have expressed concern that they could be squeezed out. Are you confident that reform can be implemented which delivers significant gains for consumers, as well as maintaining a strong viable network allowing credit unions to continue their good work?

**Mr Macfarlane**—This is an argument that essentially says, ‘Competition is very good and we want competition. The only way we can continue to have this competition is to make sure that we put the price up, or we make sure that we maintain a very high price level.’ In which case you ask the question: what is the value of competition if the only way you can have more players is to keep the price at a high level? I think that, firstly, the credit unions and the building societies will be able to survive and, secondly, they will also be able to remain in that business, even if interchange fees were lower.

**Dr SOUTHCOTT**—The Canadian dollar has moved from being a currency which follows commodity prices to one that now is measured more on its own fundamentals. Australia is a similar economy. Are we seeing, with the rising commodity prices and without a corresponding rise in the Australian dollar, a break in that nexus between commodity prices and the Aussie dollar?

**Mr Macfarlane**—Yes, it appears to have happened. I cannot tell you any more than that, other than, yes, the fall of the Australian dollar last year was not consistent with the normal factors that have tended to influence it in the past, principally commodity prices.

**CHAIR**—Mr Macfarlane, one area where you do have some involvement—personally anyway, if not through the Reserve Bank—is with APRA, the Prudential Regulation Authority. With the benefit of hindsight, at the time it was splitting up, had the bank been in the position to still be in there supervising would you have been able to detect faster the HIH problem?

**Mr Macfarlane**—I would love to say, yes, but the answer is no: firstly, because we were never an insurance regulator and we never wished to be an insurance regulator. I am glad you have raised this general subject because I sit on the board of APRA—and this is an interesting ideological grouping being formed over here—as does Dr Laker. We come from a background where we know a fair bit about bank supervision, but we do not know much about insurance supervision. We were put on the board of APRA not because we were experts in particular institutions but because we are responsible for overall system stability, and we want to look across the whole range of financial institutions. One of the things that has become apparent to us is the difference in the standards of supervision of different types of institutions.

APRA is responsible for supervising banks and other deposit taking institutions like building societies and credit unions, life insurance, general insurance and the superannuation industry.

Because of the way history has turned out, the body of legislation and regulations and the prudential supervision is of a very high standard for the supervision of banks and for other deposit taking institutions like building societies and credit unions. They had their crisis back in the late 1980s and early 1990s and we have learnt a huge amount since then. There has been constant updating and improvement and they are in very good shape. The standards of supervision and the underlying laws and regulations behind it are excellent. I think to some extent you could say the same for the life insurance industry where the legislation was updated in 1995.

When we move to general insurance we really have to come down from that level. We are dealing with a piece of legislation that is pretty old—it dates from 1973—and an awful lot of changes have occurred since then. Firstly, the ISC and then APRA have tried extremely hard to update that legislation and body of regulation, and they have met with considerable opposition from the industry—a degree of opposition that has surprised me, considering my experience with the banking industry. If there is one good thing that has come out of HIH, it is that that opposition has now finally retreated and we are going to see some action there pretty soon.

APRA has already worked out what the regulations should be. They have had all the discussion papers and they have got a new model. They are just waiting for the legislation. I think there will be some improvement there. It has really happened, in a sense, only because we have had the same sort of episode that affected the State Bank of Victoria, the State Bank of South Australia and Pyramid Building Society, et cetera, a decade ago. It has really happened in the general insurance industry in the last year, and it is not just HIH but GIO.

**Ms BURKE**—Through this committee I have been fairly critical of APRA and its lack of establishment—the legislative framework—and its inability to attract and retain decent staff has been a huge problem. Is it not a pity that we have had to have the collapse of a company that is going to cause long-term damage not only to individuals—I can cite chapter and verse the ones coming through my office—but also to the economy overall?

**Mr Macfarlane**—That may be the case. APRA has worked very hard on trying to bring the supervision of general insurance up to date—to drag it into the 21st century—as I have said, against considerable opposition. The problem at the moment is not that APRA does not have staff or that APRA has recently been created. The problem is that they have worked with an act that gave the general insurance industry enormous flexibility in the way they value their assets and liabilities and gave APRA very little power to do the sort of things that you could do with bank supervision. That is going to be changed, and the new legislation will overcome both of those problems.

**Ms BURKE**—Do you see some HIH implications in the economy down the track?

**Mr Macfarlane**—At the moment there is a lot of discussion going on at federal and state government level and in the insurance industry about what will be done. I am not party to that discussion, so I do not want to comment on it. I will make another observation, though, while I have the floor and have an opportunity to talk about general insurance: I also think that in superannuation the public's expectation of what APRA can do and what APRA actually have the powers and resources to do are very different things.

**CHAIR**—Could you expand on that?

**Mr Macfarlane**—You have three different areas of superannuation: you have the big end of town, where the big public-offer funds and the industry funds are. Our general assessment is that they are in pretty good shape and that there is nothing very pressing there at all—people's money is safe there. At the very small end you have the superannuation funds of mainly just the single person—the private superannuation funds—or funds of five or fewer people, which are usually family funds. They report to the tax office, and the only issue is whether they comply with the tax laws, and no-one is suggesting for a moment that there is a perception problem there.

But there is an intermediate group, which are small, self-managed superannuation funds with more than five people, and they report to APRA. The problem is that there are about 10,000 of them. The majority, of course, would no doubt be extremely well run, but there will always be a fringe that are not, and it is extremely difficult to identify where that fringe is, because the numbers are so huge. There is no licensing requirement and no capital requirement. They have to submit an annual return six months after the end of the year or so. APRA can look at the return, but that does not necessarily tell you what the underlying assets are.

A couple of recent cases have attracted attention. These smaller funds are often company based. They might have 20, 50 or 100 people in them. There have been cases where, obviously, some very irresponsible financial transactions and related-party transactions have taken place. The public has a right to think that that should not happen, because, if you were a member of that fund, you could lose your life savings. There is the public expectation that that should not happen—and I entirely agree with the public expectation that that should not happen—but, with the resources that APRA has, it cannot make an inspection of each fund every year; it would be physically impossible. Somehow or other, we have to find a way of reducing the number of them by imposing some licensing standards, some capital requirements and what have you—either that, or just find a massive amount of new resources for APRA.

**Ms BURKE**—I know that time is running out and I want to address other issues, but I have a question from my school group, my old alma mater, on whose behalf I have already asked a question: with technology advancing as it is nowadays, why does it take three days to clear a cheque?

**Mr Macfarlane**—I am afraid that I am going to have to pass that one to Dr Laker. It used to be five days; they have got it down to three.

**Dr Laker**—Essentially, it is to give the bank which is paying out the money the opportunity to check and be assured that the cheque is valid, that there are funds in the account and that it is the right signatory. Because there is an exchange of paper in this process, it takes three days. Looking ahead, if it was done more electronically through what is called cheque truncation, you could do it much quicker. It would take a substantial capital requirement for the industry to do that. They have moved much more rapidly to using electronic techniques to cut that period down and make the funds available to their customers in most cases—although not all—in three days. That has been a big step forward. Over time, they could continue to narrow that down, but quite a lot of technology would be involved.

**Ms BURKE**—As we are running out of time, my other broad-brush question is: do you have any comments on the rather bizarre set of employment figures announced yesterday? What is your forecast for unemployment over the year? Some analysts have it as high as seven per cent.

**Mr Macfarlane**—I would preach the sermon again about not trying to overinterpret monthly figures. If ever there was a monthly result where one should remember that, this is the one. We said in the statement that our reading of the leading indicators in the labour market was such that the unemployment rate would probably increase further in the period ahead, and that was before we had yesterday's figure. I think that is still true. I think that it is encouraging that the number of people in employment rose, but we are in a period where the economy has been growing considerably slower than its potential, and the unemployment rate has been edging up. That is still occurring and I do not think that one could rule out it rising somewhat further yet before it starts to come down.

**Ms BURKE**—Given the various explanations of how you get to a recession, one being two quarters of negative growth, and another being a one per cent rise in unemployment over a 12-month cycle, do you share those views? Is the unemployment issue a fairly sour note for the economy going forward?

**Mr Macfarlane**—I do not believe either of those definitions of recession. Even the first definition, which is widely quoted, has no intellectual support. I do not know who made it up. It was made up some time ago and you only need to think about it for a moment to realise how absurd it is. You could have two tiny falls and say it was a recession. There might be a massive fall in another country, a rise of 0.1 per cent and then another massive fall and you would say that they have not had a recession. It does not really make sense. I have not heard the definition in relation to unemployment. If you wanted to think about defining it there are many ways to do it, and I suppose you could, but I do not have faith in either of those definitions.

**Ms GAMBARO**—I have a question on the employment figures that were released yesterday. Part-time work grew by about 40,000—

**Dr SOUTHCOTT**—Eighty thousand.

**Ms GAMBARO**—Why has there been that increase in part-time work? Is it due to the present industrial relations situation?

**Mr Stevens**—I think what we are observing in yesterday's data is a good example of short-term statistical volatility. The figures, literally, speaking said that part-time employment rose 80,000 and full-time employment fell 40,000, having increased in earlier months; and the total was up 40,000. These data have noise in them month to month. The cut-off for full-time versus part-time work is 35 hours. So, if you have a slight diminution in your hours, you can flip over the line from full- to part-time work. When that happens I do not think it signifies all that much. The thing I would say about yesterday's figures is that there is a lot of statistical noise here, and I would not overinterpret the monthly numbers. There is a trend towards more part-time employment over the long run—that is very clear; it has been in place for 10 or 15 years at least—which I think is due to a whole lot of factors—social, women wanting to work part time because it suits them, and so on. Industrial relations arrangements may have something to do with that, but I think social trends are probably equally important in that. That is a long-run trend. I do not think yesterday's numbers tell us much about that sort of issue.

**Ms BURKE**—In your annual report you talk about the sale of foreign currencies, which would indicate that you are sitting on a nice reserve. When are you going to pass on your dividends to the government? Is there a set period? Have they asked for them, and when is that going to happen?

**CHAIR**—I am sure he sits on a nice reserve.

**Ms BURKE**—He does; it is the most profitable bank in the country!

**Mr Macfarlane**—We maintain an internal contingent reserve, which is fully met at the moment. Any profits that are above that are passed through to the government automatically and always have been.

**Ms BURKE**—When will you be doing that?

**Mr Macfarlane**—Payment has to occur after the end of the financial year because we have to work out what our profit is at that stage, and then the payment is usually made in August.

**CHAIR**—I think we have had a pretty good innings. In wrapping up, there is just one other point, Mr McFarlane: you indicated to Mrs Hull, who, unfortunately, could not be out here due to an illness in the family, that you were doing some work on small business confidence in employment. You said something in Wagga Wagga about that. I will put that on notice for you, if you like.

**Mr Macfarlane**—Yes. There is a copy of it.

**CHAIR**—That is right—it is at the back of the statement.

**Mr Macfarlane**—If you look at the graph comparing the confidence indicators for small business with medium sized business and large business, it is clear that the confidence of small business has declined more than medium and large, but it is also true that small business always seems to be less confident than medium and large.

**CHAIR**—I would like to thank everyone who has come before the committee today—Mr Macfarlane, Mr Stevens, Mr Battellino and Dr Laker. It has been very rewarding to have so many people prepared to come here today. This is an historic public hearing, as I said at the beginning, associated with the Centenary of Federation celebrations. It may have seemed very different in 1901, but that was a long time ago. We ought to pay some tribute to those who had the foresight to include such a magnificent building as this in Australia's development.

I would like to thank the Hon. Bruce Chamberlain for having us in the chamber. My thanks to the staff of the Legislative Council, especially Dr Ray Wright, the Usher of the Black Rod, for their assistance in ensuring the smooth running of the hearing. I would also like to thank Mr Bernie Harris, who has been the executive coordinator for the Centenary of Parliament and who has helped to facilitate this hearing becoming a Centenary of Federation event. Finally, I would like to thank all the staff in the federal parliament who have assisted today, particularly Bev Forbes and the committee secretariat and, of course, all committee members. Thank you everyone for coming along. I think it has been a very successful hearing and, no doubt, we will look forward to matching the standard at the next one.

Resolved (on motion by **Mr Hawker**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

**Committee adjourned at 1.15 p.m.**