

Monetary policy and other issues

Overview

- 2.1 Since the committee's previous public hearing in February 2012, global conditions have varied, with a general tendency towards weaker growth. The problems of the European economy remain unresolved, so growth throughout the Eurozone has been constrained, while the economy of the United States has grown at a modest pace. Growth in China also eased to a more sustainable rate.¹
- 2.2 The IMF forecasts world GDP to grow at a rate of about 3½ per cent in 2012, before increasing slightly next year. The Governor advised that this forecast seemed reasonable at this stage, 'though the risks still seem weighted to the downside'.²
- 2.3 There have also been episodes of anxiety within global financial markets. There was a general increase in aversion to risk, which saw bond yields on some European government debt rise, while yields for German, US and UK sovereign debt declined to record lows. Australia received a portion of the capital flight to safety and market yields on Australian sovereign debt declined to their lowest levels since Federation.³
- 2.4 The Governor summed up the global situation by saying that:
- It is worth noting that we have still not seen thus far the sort of collapse in production and trade across a wide range of countries that was observed in 2008. The global slowing we have seen has so far at least been of the more ordinary variety. That is not to make

¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

light of these developments; only to keep them in some sort of perspective.⁴

- 2.5 The Governor advised that Australia continued to experience reasonable overall growth, relatively low unemployment and low inflation. The governor explained that the Reserve Bank board had reduced the cash rate in May and June 2012, by a total of 75 basis points. As a result, borrowing rates are now a little below their medium-term average. Australian growth rates remain close to trend and the rate of inflation is consistent with the bank's target.⁵

- 2.6 The Governor stated:

Looking ahead, the peak of the resource investment boom as a share of GDP, the highest such peak in at least a century, will occur within the next year or two. After that the rate of resource investment is likely to decline while the export shipments of the resources themselves will pick up. By then we might expect that some other sectors that have been weak of late, like residential and non-residential construction, might be starting to pick up. Overall growth is forecast still to be close to trend, albeit with a different composition from that seen in the past year or two, and inflation consistent with the target.⁶

- 2.7 When questioned by the committee about how current Australian conditions compared to the past, the Governor summed up the nation's present situation as follows:

...we have an unemployment rate of a bit over five per cent; core inflation is two per cent; our government is AAA rated...our banks are strong; and we have been given, by the global economy, a huge gift, really, by the terms of trade rise...that is a very respectable position.⁷

Forecasts

- 2.8 Following the re-emergence of anxieties about both the sustainability of government budgets and the stability of the banking sector in the Eurozone, global growth slowed in 2012. This slow-down was especially marked in the Eurozone in the June quarter.⁸

⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 2.

⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 2.

⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 5.

⁸ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

- 2.9 Following this development in the June quarter, forecasters have revised down their forecasts for global growth. The IMF's most recent forecast (in April) cut global growth by 0.1-0.2 per cent. The IMF now forecasts global growth of 3.5 per cent in 2012 and 3.9 per cent in 2013.⁹
- 2.10 Australia's key trading partners are forecast to grow a full percentage point above the global rate in 2012 and 2013. Falling global growth has led to falling global demand, with a consequent fall in commodity prices.¹⁰
- 2.11 The Chinese economy has continued to grow at a marginally slower, but more sustainable, rate than previously. Overall export growth has slowed, in particular exports to Europe, but exports to the United States and emerging markets outside of Asia continue to grow. Domestic demand within China continues to grow. There has been a moderation in investment levels in trade-exposed industries, accompanied by an increase in investment in industries that cater for domestic needs alone.¹¹
- 2.12 In Japan domestic demand has grown, with motor vehicle sales staying at a high level and construction growth increasing. The latter is an effect of reconstruction spending. In India, GDP growth slowed to 5½ per cent over the year to the March quarter, which is well below the average of the past decade, with investment continuing to shrink and household consumption growth easing. This was brought about by relatively tight monetary policy aimed at reducing inflation. Rupee depreciation added to cost pressures and prices for food are expected to rise, following a disappointing monsoon.¹²
- 2.13 The outlook for Australia has barely changed since the *May Statement*. Real GDP growth is expected to slow over the second half of 2012, as growth in domestic demand in the first half of the year moderates. The forecast for growth in the second half of 2012 is similar to that in the *May Statement*, a surge in growth in the first half of 2012 has lifted the forecasted GDP growth over 2012 to 3½ per cent. This is expected to moderate a little in 2012, when the economy is expected to grow at around 3 per cent over 2013 and 2014.¹³
- 2.14 The outlook for inflation is expected to remain around its average over the inflation-targeting period. Inflation in the prices of tradable items is expected to rise as a long-term effect from the earlier appreciation of the exchange rate wanes. Together with the increase in the price level arising from the introduction of the carbon price in July, this is expected to push

⁹ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

¹⁰ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

¹¹ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, pp. 6-8.

¹² Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, pp. 8-9.

¹³ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

underlying inflation into the top half of the inflation target range over the year to mid 2013, easing to the middle of the target range thereafter. CPI inflation is expected to rise to 3 per cent over the coming year (as a result of previous volatility in fruit and vegetable prices and the carbon price) before also returning to the middle of the target range over the remainder of the forecast period.¹⁴

Table 1 RBA Output growth and inflation forecasts

		June 2012	Dec 2012	June 2013	Dec 2013	June 2014	Dec 2014
GDP growth		3¼	3½	2½–3½	2½–3½	2½–3½	2½–3½
Non-farm GDP growth		3¼	3½	2½–3½	2½–3½	2½–3½	2½–3½
CPI inflation		1.2	2¼	2½–3½	2–3	2–3	2–3
Underlying inflation		2	2½	2–3	2–3	2–3	2–3
Year-average							
		2011/ 2012	2012	2012/ 2013	2013	2013/ 2014	2014
GDP growth		3¼	3¼	3–3½	2¾–3¼	2½–3½	2½–3½

Technical assumptions include A\$ at US\$1.06, TWI at 79 and Brent crude oil price at US\$108 per barrel.

Source Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012.

2.15 Australia faces an important risk from developments with the exchange rate, which has been high for some time. There is a possibility that the persistently high exchange rate may exert a more contractionary influence on the economy than historical relationships would suggest.¹⁵

2.16 The bank acknowledged the limitations of forecasting. In his opening address, the Governor admitted that:

At a time of significant global uncertainty and of important structural changes in the Australian economy the degree of confidence we can attach to particular forecast is unavoidably reduced.¹⁶

2.17 The committee sought the Governor's advice on the precision of the bank's forecasts. The governor responded by stating that 'we cannot have

¹⁴ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 3.

¹⁵ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 4.

¹⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

great confidence in anybody's individual forecasts', but we should, instead, approach forecasts as 'prudent estimates'.¹⁷

- 2.18 The committee explored the resilience of the Australian economy and the likely impact of possible shocks. The Governor stated:

We are still fairly well equipped to handle some of the things that could go wrong – some of the things to do with, say, the need for foreign funding of the banks. I think our reliance on that is now lower than it was four years ago when, under what you would have to say was an extreme stress scenario globally, we coped. Because of the way the banks have changed their funding structure since then, we are probably in a better condition than we were.¹⁸

- 2.19 The Governor noted that the household sector was managing its debts very well. The Governor explained that scenarios to test the resilience of the banking system are routinely carried out by APRA. Such scenarios might involve a recession, a major downturn in house prices or rise in unemployment. The Governor insisted, however, that there was no reason why we should not remain quietly confident that the Australian economy would be able to manage such stresses and reassured the committee that the system here 'remains well and truly solvent'.¹⁹

Inflation targeting and monetary policy

- 2.20 The committee sought the bank's advice on the possibility that the current intervention of the European Central Bank (ECB) to counter the ongoing financial/monetary crisis in Europe might set off inflationary pressures. The Governor responded to this by saying:

That is a very important question because, in anything approaching normal times, for the central bank to be contemplating large-scale purchases of government debt in the market and so on, and putting the amount of liquidity into the system that they already have – let alone what they do in the future – every textbook I ever read said that in the long run and even in the not-so-long run that would be inflationary....the thing is that we are not in anything like normal times...it has to be extraordinary times for them to think about this and, even within the system, it is probably not without its controversy. I think

¹⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 5.

¹⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, pp. 5-6.

¹⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 6.

analytically the thing there is a potential downside scenario that would be deflationary. I think that is the idea, and that must be headed off, if at all possible, because that is very damaging. So what they are doing is certainly inflationary compared with that real deflationary possibility, and if they get it right they will keep inflation just positive but not high.²⁰

- 2.21 The RBA advised that governments could not solve the European economic problems by themselves; neither could the ECB do so alone. Together, however, they could. The RBA noted that the Europeans were making progress and that the support of the ECB was probably critical to the success of the whole process. The size of the intervention is significant with the ECB (as well as the central banks of Japan, the UK and the US) increasing its balance sheet by up to 20 or 30 per cent. Under normal conditions, this would be inflationary, but the bulk of the money in these swelling balance sheets was not doing anything but was sitting idle, and, hence, was not contributing any inflationary pressure on prices. So the intervention was 'not really doing very much to the global economy, other than forestalling a serious crisis'.²¹

Banking sector

- 2.22 The committee noted that the BIS Shrapnel annual report for 2012 found that Australian banks were the most profitable in the developed world for the second consecutive year and wondered to what extent Australians might need a greater degree of banking competition. The committee was interested in finding out if this profitability was merely a function of other banks in other parts of the world doing poorly, rather than Australian banks gaining unwarranted profits. The Governor stated:

As far as I know, it would still be the case that the return on equity to bank shareholders is good, but there are various other parts of the listed sector where it would be similar. So, on that test, I am not sure it would be obvious that profits are excessive...²²

- 2.23 The Governor warned that people appeared to have a preference for exploring this issue through 'the prism of mortgage finance' alone.²³ While this is an important issue, there are other considerations that need to be taken into view as well, such as the interest of depositors. The Governor noted that for many years depositors received limited returns by today's

²⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 6.

²¹ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 7.

²² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

standards, while at the moment there is considerable competition between banks to secure deposits. In the Governor's words, 'the depositors, with a bit of shopping around, enjoy quite considerable competition for their money. That is not something to be ignored or sneezed at.'²⁴

- 2.24 The Governor summed up his position by stating that to gauge the true nature of competition in the banking sector we need to look at both the provision of mortgages and business finance and at the receipt of deposits. This holistic perspective is best.²⁵
- 2.25 The committee sought the Governor's advice on the nation's contingent liabilities in relation to the bank guarantee deposits, their value and the charge the banks pay for that service.²⁶ The Governor advised that there were a number of guarantees in place: a guarantee for wholesale funding (which attracts a charge), a guarantee under the Financial Claims Scheme of ordinary deposits up to \$250,000 (which attracts no charge) and possibly a price guarantee, as well. The Governor was not able to say whether any of those are still outstanding. The Governor estimated (from memory) that the total amount of the guaranteed wholesale obligations peaked at around \$173 billion and is about \$90 billion now. The RBA noted that the total value of the deposits which have been underpinned by the financial claims scheme is now around \$620 billion. This is down from \$780 billion because the cap on the Financial Claims Scheme came down from one million to \$250,000 and there are still outstanding around \$32 billion of state government debt, which has been guaranteed. To date the government has collected nearly \$4 billion in revenue in guarantee fees.²⁷
- 2.26 The committee asked the bank about the relationship of these sums to national GDP. The RBA noted that if all the various liabilities were added up, you would get a number that is close to \$980 billion, which is the equivalent of about 75 per cent of GDP.²⁸
- 2.27 The committee asked if there has ever been a period in Australia's history when contingent liability was at 70 per cent of GDP. The Governor

²⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²⁶ This refers to the Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) which commenced in November 2008. The Scheme enabled authorised deposit-taking institutions to access funding during the global financial crisis. They ensured that Australian institutions were not placed at a disadvantage compared to overseas competitors that had access to government guarantees on bank debt. Once the crisis had passed and similar schemes overseas started to close, the Australian Government closed the Guarantee Scheme to new liabilities from 31 March 2010. Large deposits and wholesale liabilities guaranteed under the Scheme at that time remained under guarantee, for a fee, for the relevant term.

²⁷ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 16.

²⁸ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 16.

advised that public debt liabilities of public debt were in excess of 100 per cent of GDP, during wartime. The Governor went on to explain that the critical factor at issue is the similarity between the guarantee scheme and an insurance scheme: it is the expected amount of pay outs, not the gross volume of guarantees, which is important. Furthermore, the Financial Claims Scheme works so that if an institution is wound up, its assets would repay the depositors first, or they actually repay the scheme first because the scheme is paid out to the depositor. If there were not enough assets to cover obligations, then a levy can be put on the rest of the industry. Thus, there is a funding mechanism there to assist the government to pay. Finally, it is unlikely that any government could stand by and allow financial institutions to fail at the expense of their depositors. In the Governor's words: '...even if you did not have an explicit guarantee, you cannot just assume that there would never be any possibility of the taxpayers being on the hook in a big enough crisis.'²⁹

- 2.28 The committee sought the Governor's advice on progress with an International Monetary Fund (IMF) review of the Australian banking system.³⁰ The Governor responded by stating that the bank has met with them, various processes were undertaken and that 'I do not think there are serious concerns arising from that work'. One of the staple questions raised by such a review is the foreign funding for the banks coupled with the housing story. The review process is not yet complete, so the Governor was not able to elaborate in any great detail, but he did reassure the committee that 'I do not anticipate there being serious concerns arising from that when it is finalised'.³¹

Exchange rate

- 2.29 The committee referred to the current debate in the press about the merits of intervention in the exchange rate and sought the Governor's views on whether or not Australia should pursue a similar policy to that of the Swiss. The Governor advised that overseas demand for Australian sovereign debt has been strong; foreigners now hold nearly 80 per cent of the stock of Australian government debt. By global standards, the volume of that debt is not large, but it is rated AAA standard and offers a yield which is quite attractive to the alternative on offer in much of Europe,

²⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 17.

³⁰ *The Financial Sector Assessment Program (FSAP) analyses a country's financial sector. Established in 1999, the FSAP assessments are conducted in advanced economies by the IMF. In the emerging and developing economies, the World Bank is involved as well. For further details of the FSAP, see <http://www.imf.org/external/np/exr/facts/fsap.htm>.*

³¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 12.

which is now zero or negative. Furthermore, the flow of overseas investment into Australia is now greater than it once was because 'generally rates of return overall in this country are attractive'.³²

- 2.30 The Governor advised that the Swiss case is very different to ours. Switzerland is in Europe and they have a very open economy, so a very large share of their GDP is in the traded sector. They are experiencing consumer price deflation and their interest rates are at nothing. The Swiss National Bank's reserves are now approximately the equivalent of 70 per cent of Switzerland's annual GDP; Australia's reserves are \$45-odd billion, a tiny fraction of Australia's GDP.
- 2.31 The Governor warned that the risks involved in currency intervention are not inconsiderable. While such a policy may be plausible, in extremis, 'it is a big call and it is not a call that we have felt should be made to this point in time.'³³
- 2.32 The committee sought the Governor's views on whether the value of the Australian dollar is distorted. The Governor insisted that the current value of the dollar is not necessarily a distorted one and that the underlying rationale for the present condition was that global markets found in Australia an attractive place to invest: 'I think there is more tendency now for some official flows seeking high-quality assets.'³⁴
- 2.33 The Governor went on to note that in his opinion, the Australian dollar was:
- '...trading a bit above where I would have thought it would be... I would say it is probably a little on the high side, but in terms of the statistical relationships you can fit you cannot actually say that error is all that significant. It is just my instinct that suggests that it is a bit on the high side.'³⁵
- 2.34 The Governor also advised that one's perspective of the value of the dollar depended in large part on our understanding of the wider economic context, the situation with global relative prices. In the Governor's view:
- If you really think the whole thing is going to go away imminently – the mining boom is going to completely crash, the relative price shift is not there, the whole thing is not going to persist – then the Aussie dollar in that scenario presumably would need to be much lower than it is. It probably will go there if that scenario unfolds – that would be my guess. But in the interim, if

³² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 10.

³³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 10.

³⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 11.

³⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 11.

that was your view, you would probably be worried that it is too high.³⁶

Investment boom

2.35 The committee was interested in the bank's views on the valuation of the capital expenditure pipeline and forecasting for capital expenditure (CAPEX) in general. The Governor stated that there were no recent developments that might cause the RBA to revise its expected profile. The RBA noted that CAPEX will peak at a bit over nine per cent of GDP, which is equivalent to about \$145 billion per annum over the next two or so years. The Bank warned that we need to distinguish between different types of projects and how we come up with these sorts of numbers. There are two types: those which big resource companies have made a very strong commitment to and those without a firm commitment.³⁷

2.36 The committee asked the Governor to comment on the recent statement by the Treasurer, to the effect that this is the first time that Australia has had a AAA credit rating from all three major credit agencies. The Governor advised that he did not know – he had not checked the number of agencies involved in the past and insisted that:

I do not want to comment on things that the Treasurer said...for most of its history, apart from a period from somewhere in the mid-nineties through to about 10 years ago – I cannot remember when the upgrade happened – Australia has been known as a AAA country, and so it should have been.³⁸

2.37 The committee also asked the Governor to clarify matters regarding inflation. The committee was puzzled by the apparent disparity between the bank's public statements and public expectations, noting that while the statement on monetary policy notes about a two per cent on tradeable prices underlying inflation to its lowest level in the late 1990s, the public debate is about the rising costs of living and the rapid increases in prices. The Governor responded:

I have not seen evidence of late to suggest that there is a dislodging of inflation expectations. On everything we can measure they look like they are fine... There is always prominence given in the media to the things that have gone up...People are

³⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 12.

³⁷ Dr Christopher Kent, Assistant Governor of the RBA (Economic) *Transcript*, 24 August 2012, pp. 18-19.

³⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

invited to focus on the news that is bad. That is the nature of things. We can lament that, but I am not sure we have much hope of that changing. But I do not think that at this point we have a significant problem with inflation expectations being excessive, as best I can judge.³⁹

Productivity

2.38 The committee referred to a recent RBA publication that claimed that there are signs that productivity growth has picked up over the past year.⁴⁰ The committee asked the Governor to what extent he thought that this is within-sector productivity growth and what were his views on the productivity pick-up?⁴¹

2.39 The Governor advised caution, on the grounds that it is premature to become preoccupied with this, because productivity is notoriously difficult to measure. Furthermore, in order to comment with any confidence one would have to have low-frequency data. Thus we cannot be really sure at this stage if we have had a slowdown in productivity yet. This will be obvious several years after it has actually begun.⁴²

2.40 The Governor stated:

Personally I think it is to be expected that we will see higher productivity growth performance in this period, because I think that is really what structural change is. It is almost the definition of it. So I think it is happening...So my judgment would be that I believe it is likely to be happening.⁴³

Labour market

2.41 In relation to unemployment, the committee questioned the Governor about variation by region. The Governor advised that the bank tracks the dispersion of the rate of unemployment. There are quite a large number of regions where you can get this. On the basis of the figures available at the

³⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

⁴⁰ This appears to be a reference to an article by Patrick D'Arcy and Linus Gustafsson 'Australia's Productivity Performance and Real Incomes' that was published in the RBA's *Bulletin*, June Quarter 2012. This is available at <http://www.rba.gov.au/publications/bulletin/2012/jun/3.html>

⁴¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

⁴² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, pp. 19-20.

⁴³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 20.

hearing, about half the regions have unemployment at five per cent or less; 90 per cent of them have unemployment less than seven per cent as measured. There are very few regions, if any, with double digits. This confirms that the situation is indeed a patchwork.⁴⁴

- 2.42 In addition, the committee wanted to know if the decline in the terms of trade would reduce the extent of the patchwork nature of the economy. The Governor replied that:

Yes, I think it is fair to say that, to the extent that the impetus for growth shifts away a bit from where it has been to be more broadly focused, that is probably right: you might get some reduction in the so-called patchwork. In saying that, I think it is important to say as well that it is always a patchwork. It is not and never has been a seamless garment. There is always a patchwork nature. 'Patchwork' is a new word we have coined and it is a reasonable description, but it has always been there.⁴⁵

The payments system

- 2.43 The committee noted that the Payments System Board had recently made some comments in a release with respect to multifunctional cards and multi-network debit cards and that the Board appeared to have concerns about whether or not EFTPOS is able to take advantage of R&D that four-party schemes have undertaken with respect to contactless payment systems.⁴⁶ The committee asked the Governor for his advice in particular what his general view was concerning the IP that is being developed by the four-party schemes and whether or not EFTPOS should be able to piggyback on developments in contactless payments systems.
- 2.44 The Governor responded that he did not have a strong view about the IP issue and that the Board's starting point is an acknowledgement that the ability of a card to function in more than one way is a good thing. Ideally, the Board would prefer the industry to co-operate together to find a way

⁴⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

⁴⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

⁴⁶ *Transcript*, 24 August 2012, pp. 20-21. This refers to a media release of 17 August 2012 by the Payments Board entitled *Payments System Issues: Multi-Network Debit Cards*. These cards are issued by banks and other institutions for ATM usage and with debit functionality from more than one payments network. The release acknowledged concerns with rules that require the provision of commercially sensitive data about one network to a competitor network, the imposition of fees by one network on another network's transactions and disputes over the placement of network brands on cards and the emergence of a emerging issues between the various networks concerning contactless debit cards. The release is available in full at: <http://www.rba.gov.au/media-releases/2012/mr-12-20.html>.

so that this could happen. The Governor was disinclined to support regulatory intervention.⁴⁷

- 2.45 According to the Governor, the key issue with contactless cards is the ability for some of the schemes to reduce the ability of the merchant to help steer the consumer by networks. The board's position has been that, while the four-party schemes have got fine products, a legitimate business model and so on, we must ensure that both the consumer and the merchant are suitably empowered with choice as well. This is a potential issue with contactless cards because they are pre-programmed to go through one network.⁴⁸
- 2.46 The Governor characterised the state of discussion about these issues as follows: much of the debates come down to the piece of plastic *per se*. Who owns it? Whose logo can be placed upon it? Every party seems to claim that they own it: the schemes, EFTPOS and the issuing bank alike.⁴⁹
- 2.47 In the Governor's view, the optimal outcome would be for consumers to have a card which could function through more than one network, where no particular provider is in any way unfairly advantaged by the location of their logo for example. The Governor insisted that those who invest in developing such facilities have a right to earn a return on their investment. Equally, people who have a valid contribution to make of their own should not be put in a position of being artificially excluded from the card.

Conclusion

- 2.48 Australia's economic performance remains exceptionally strong, by global standards. Together with economic powers like the United States, Japan and the United Kingdom, Australia is an attractive destination for highly global mobile capital in uncertain times. The strength of our economy is now such that the international credit ratings agencies are unanimous in awarding Australia the much-coveted AAA standard.
- 2.49 The fundamentals of the Australian economy are strong. Public debt and unemployment are low, underlying inflation is at the midpoint of the inflation target range, and we have a significant pipeline of business investment remains to flow, particularly in the resources sector.
- 2.50 Over the medium-term monetary policy is expected to meet the goals of its long-standing inflation target, with inflation remaining within the 2 to 3 per cent band for most of the forecasting period.

⁴⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

⁴⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

⁴⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

Note Printing Australia and Securrency

Public hearing – 24 August 2012

- 2.51 The Governor reported on Note Printing Australia (NPA) and Securrency International. The Governor stated that it was desirable for him to offer a coherent and complete narrative of developments.⁵⁰ The Governor explained that in 2006, following developments at the Australian Wheat Board, the Board had asked questions about the policies for the use of overseas agents by the two companies.
- 2.52 These questions prompted NPA to begin a process of developing stronger policies. RBA management sought an update on progress with this in early 2007. To brief the bank, the NPA board requested a paper from their management on dealings with sales agents. After considering that paper, the NPA board resolved to audit past practices and compliance. That audit identified concerns and recommended that the NPA should discontinue the use of agents and investigate the role of management and staff in dealing with agents to ensure compliance with Australian law. On receiving this report, the NPA board took the decision to cease using agents. Acting through a subcommittee of the board, they also commissioned Freehills to assess questions of standards and compliance.⁵¹
- 2.53 At the same time, the RBA Board asked Securrency for its policies on agents. Consequently, the company adopted additional and stronger policies and procedures. Following the audit at NPA in 2007, the Securrency board requested a similar audit which led to the termination of one of the agents which it shared with NPA. That audit found that Securrency had a 'good and robust process' in place in relation to overseas agent contracts and payments. A follow-up audit was conducted in 2008. This audit made the same finding.⁵²
- 2.54 Because of the findings of this audit, neither the Securrency board nor the Bank discontinued the use of agents, as had occurred at NPA. However, the Reserve Bank was taken by surprise by the allegations published in mid 2009. It is now clear, however, from a KPMG report conducted for the Securrency board later in 2009, that information regarding agents was withheld from the audit teams and the Securrency board in 2007 and 2008.⁵³
- 2.55 At the same time that the audit of NPA was under way a member of NPA's management expressed his concerns over the company's conduct to

⁵⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

an RBA assistant governor who sat on NPA's board. The NPA manager was asked by the then Deputy Governor to make a written statement, which in turn was provided to Freehills. This document was held in strict confidence at the request of its author.⁵⁴

2.56 In the bank's view, it was imperative to investigate the issues identified by the audit and to ascertain the facts regarding the NPA manager's concerns. The board believed that neither the bank nor the NPA board should make such an assessment. This decision ensured a proper, independent and rigorous process, and that was the intention.⁵⁵

2.57 The Freehills report was highly critical of NPA's practices but it concluded that there was no evidence of a breach of Australian law. Consequently, there were no grounds for approaching the police. When the Australian Federal Police were called in 2009 by the Chairman of Securrency regarding the allegations made about that organisation, the 2007 NPA matters were all disclosed to the AFP. The Freehills report and audit reports were provided to the AFP when requested.⁵⁶

2.58 In relation to the statement made by an NPA manager, the Governor stated:

It has been claimed by some that the written statement by the NPA manager contained clear evidence of corrupt behaviour. In 2007, two senior legal practitioners from a leading law firm who received this material directly from the author as part of their review, and who interviewed the author and others, did not view it that way in coming to their conclusion that there was no evidence of a breach of the law.⁵⁷

2.59 The Governor was emphatic that though it is possible that a different conclusion might be drawn in future, it should be clear by now that there was no attempt to cover anything up by anyone in the Reserve Bank.

2.60 The Governor explained that there are a number of court orders in place that place restrictions on the documents that the bank is permitted to disclose. The non-publication orders have been made as a result of applications by the individuals facing criminal charges. These applications are designed to protect their right to a fair trial before an impartial jury. In addition, non-publication orders have been sought and obtained by the Department of Foreign Affairs and Trade and the Australian Federal Police. Among the material subject to such orders is the statement of the

⁵⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

NPA manager. The Governor received legal advice in relation to whether he could table the statement. That advice was that he could not.⁵⁸

2.61 The Governor insisted that the Bank is committed to transparency with this committee and with the community. The Bank indicated that it was available at any time to appear before the committee.⁵⁹

2.62 The committee sought advice from the Governor regarding reports by the Australian Broadcasting Commission (ABC). The Governor teased out the essential question, which was ‘when did I first learn about the allegations about Securrency?’ The Governor stated:

...when the papers published it. That was true. That has actually been misconstrued by many people as denying knowing anything about the events of NPA in 2007, but that is not what I was saying at all. I think we have been quite open with the committee about the 2007 matters.⁶⁰

2.63 The committee was also interested in pursuing issues arising from the sequence of disclosures and the priorities and reasons relating to the disclosure of specific documents during successive hearings of the committee. The Governor summed up his position as follows:

What I am saying today, given that there is so much controversy over these documents, is to this point what the Reserve Bank has done on these matters is cooperate with the police and keep our mouth shut because there are people on trial accused of crimes. It is, I think, therefore not appropriate for me to weigh in on these things and I know you all agree with that. So we have not thrown about documents and comments and so on. But if there is a feeling that the committee wishes to have these materials that we have, if I can possibly supply them I will because I think that is the situation we are at...⁶¹

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2.64 The Governor acknowledged the legal sensitivity of discussing matters that have led to criminal prosecutions currently before the courts, stating that: ‘It is very important that the bank does not say or do anything which would improperly impinge on any of those processes, particularly not in a public form.’⁶²

⁵⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁶⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 15.

⁶¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 15.

⁶² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 1.

- 2.65 The Governor discussed the detailed history of the two companies, the sequence of events that followed the Reserve Bank board asking about the use of overseas sales agents in April 2006 and an account of how the bank, NPA and Securrency reacted to the succession of allegations.⁶³
- 2.66 In order to clarify developments since April 2006, the committee posed a series of questions relating to specific events and the decisions made in response to these. These questions related to the pace of decisions, the provision of information to various parties, internal processes within the bank and mechanisms for transparency and accountability. For example, the committee sought an explanation as to why the board had requested that Freehills, rather than the Federal Police, inquire into the issues. The Governor responded:
- I would view the decision that the NPA board made to commission Freehills as, in the circumstance of the time, a reasonable decision...I would think it quite a normal thing to do for any commercial organisation, even one that is publicly owned but operating in a commercial space, having heard concerns, to seek to have serious people. There was a measure of independence in the subcommittee, because we had a person of unimpeachable integrity, an independent member of the RBA's audit committee – not on our payroll, not on NPA's payroll and no great admirer, one would have to say, of NPA's record in the audit space – to chair that. There were very independent, serious people on that committee. They engaged two senior practitioners with experience in the area from one of the country's leading firms. I think that would be quite a reasonable response in the eyes of most people who are experienced in these matters. I think that was a reasonable thing for them to do and to find out: 'Do we have evidence? What is it we have?' Then, of course, had they concluded something like, 'There is evidence of a breach of the law,' or, 'We think there are very strong suspicions that there may have been,' then I think there would have been a process where the NPA board would have felt, inevitably, 'We must now take this issue to the police,' but that was not the conclusion...I did not feel at the time, nor actually looking back, that part of the process itself was deficient.⁶⁴
- 2.67 The committee also asked why the bank used agents at all. The Governor explained that the use of agents was a common business model.⁶⁵ The bank elaborated his explanation by explaining that the use of agents was

⁶³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, pp. 1-5.

⁶⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 17.

⁶⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 16.

understood as a legitimate practice at the time the company (NPA) had begun to enter new markets in the western Pacific.⁶⁶

- 2.68 The committee asked the Governor if he believed that he had been derelict in his duties. The Governor responded:

Let's get right to it. No, I do not. I think my responsibilities as the chief executive of the organisation is always to satisfy myself that issues that come up are being dealt with properly by the relevant people. At each point in this very, very long process, which has taken me the best part of half an hour to read, I felt that the people who reported to me or were my colleagues were actioning appropriately the information that came to their attention and escalating the steps as needed. In fact, in some respects, they certainly did more than the minimum they might be expected to do, really.

- 2.69 The committee put the same question to the recently retired deputy governor, he responded in a similar vein, noting that on a number of occasions where he had intervened directly into NPA matters to escalate matters and that he was satisfied that the NPA board could not have done any more than they actually did.⁶⁷

- 2.70 The committee wished to know if the Governor had any regrets or could identify any lesson learnt from the issues under investigation. The Governor stated:

If pressed on this, I would have to say that there should have been more scepticism and more questioning of the managements of both companies earlier than there was. I think it is hard to avoid that conclusion. It is with that viewpoint I would say that this is why, in thinking about the future, we want Note Printing Australia to have a much more narrowly defined role and a closer link to the degree of risk tolerance that the Reserve Bank has. We really in the medium term have no business being an owner of Securrency. That is a successful company, but it no longer needs us. We have already said that we will be looking to exit that shareholding.⁶⁸

Conclusion

- 2.71 The committee, at six consecutive public hearings, has examined the Reserve Bank of Australia about the Bank's knowledge of and response to allegations of corrupt activity at Note Printing Australia and Securrency

⁶⁶ Mr Frank Campbell, Assistant Governor (Corporate Services), *Transcript*, 8 October 2012, p. 16.

⁶⁷ Mr Ric Battellino, former Deputy Governor of the RBA, *Transcript*, 8 October 2012, p. 18.

⁶⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 22.

International.⁶⁹ On 8 October 2012 the committee's examination of these matters continued for almost seven hours. In addition, a retired Deputy Governor was called to appear. This public examination was in the context of ongoing criminal proceedings relating to the alleged activity at Note Printing Australia and Securency. The committee, therefore, in conducting the public hearing was conscious of the need to apply the sub judice convention and ensure that matters were not discussed which could interfere with those legal proceedings.

- 2.72 The committee notes that while the criminal proceedings are in progress, the Bank is subject to certain court orders preventing it from releasing information. Notwithstanding this limitation the committee's scrutiny provided an opportunity to examine the effectiveness of the Bank's corporate governance. In particular, while the Governor argues that he was not derelict in his duties he acknowledged that, in hindsight 'there should have been more scepticism and more questioning of the managements of both companies earlier than there was.'
- 2.73 The committee, at future hearings, will continue to scrutinise the RBA over these issues. At the same time, it is expected that once the criminal proceedings are finalised the RBA will be able to release relevant documents which are currently subject to court orders. This will then provide further opportunity for detailed scrutiny by this committee.

Julie Owens MP
Chair
31 October 2012

⁶⁹ The relevant public hearings are 26 November 2010, 11 February 2011, 26 August 2011, 24 February 2012, 24 August 2012 and 8 October 2012.