

Monetary policy and other issues

Overview

- 2.1 On 7 August 2018, the Reserve Bank of Australia (RBA) decided to leave official interest rates unchanged at 1.50 per cent. The cash rate has remained unchanged since the committee's last hearing with the RBA in February 2018. The most recent movement in official interest rates was the RBA's reduction of the cash rate by 25 basis points on 4 August 2016.¹
- 2.2 In his opening statement to the committee, the Governor remarked that 'this setting of monetary policy is helping support economic growth, allowing for further progress to be made in reducing the unemployment rate and returning inflation towards the mid-point of the target range.'²
- 2.3 The Governor said the Australian economy has 'continued to move in the right direction' since the RBA last met with the committee in February.³ He commented:
- According to the most recent data, GDP growth is 3.1 per cent, inflation is around two per cent and the unemployment rate is now clearly below 5½ per cent. In the broad sweep of our economic history, these are a pretty good set of numbers.⁴
- 2.4 The RBA expects growth in the Australian economy to average just above 3 per cent in 2018 and 2019, which the RBA considers will further reduce spare capacity in labour markets.⁵ Inflation continues to be low, with

1 Reserve Bank of Australia (RBA), Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2018-01*, 7 August 2018.

2 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 3.

3 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 1.

4 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 1.

5 RBA, *Statement on Monetary Policy*, August 2018, p. 1.

underlying inflation expected to increase gradually to be around 2¼ per cent by 2020.⁶

- 2.5 The RBA reported that the global economic expansion is continuing, with a number of advanced economies growing at above-trend rates with low unemployment. The Governor said that while inflation remains low globally, it has picked up in some countries and is expected to increase, given tight labour markets.⁷
- 2.6 The RBA reported that business conditions in Australia remain positive and that non-mining business investment increased by 10 per cent over the year to the March quarter. The RBA expects mining investment to reach its trough in late 2018 or early 2019, before picking up moderately.⁸
- 2.7 The August Statement also noted that trade tensions between the United States and China have increased in recent months. The RBA said that, while the measures announced to date are unlikely to have a major effect on global trade and output, 'the risk is that uncertainty and the threat of further measures could weigh on growth through lower investment.'⁹
- 2.8 During the hearing, the committee scrutinised the Governor on the RBA's monetary policy settings and the likelihood of a pick-up in inflation and wages growth. The committee also examined the RBA on the impact of trade tensions and other potential risks to the Australian economy.

The cash rate and monetary policy

- 2.9 At its meeting on 7 August 2018 the RBA decided to leave the cash rate unchanged at 1.50 per cent. In his statement on the decision, the Governor said:

The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual.¹⁰

- 2.10 In its August Statement the RBA noted softer than expected inflationary pressures in the Australian economy in the near term, and said it did not

6 RBA, *Statement on Monetary Policy*, August 2018, pp. 2-3, 63.

7 RBA, *Statement on Monetary Policy*, August 2018, p. 1.

8 RBA, *Statement on Monetary Policy*, August 2018, p. 2.

9 RBA, *Statement on Monetary Policy*, August 2018, p. 2.

10 Reserve Bank of Australia (RBA), Statement by Philip Lowe, Governor: Monetary Policy Decision, *Media Release No. 2018-17*, 7 August 2018.

expect underlying inflation to reach the middle of its 2-3 per cent target band until the end of its forecast period in 2020.¹¹

2.11 The RBA stated that, beyond the September quarter, its forecasts for inflation are unchanged with CPI inflation picking up to be around 2¼ per cent in 2019 and 2020. Underlying inflation is expected to increase from close to 2 per cent over the year to June 2018 to about 2¼ per cent in 2020.¹²

2.12 The committee questioned the Governor on whether the RBA's inflation target needed to be adjusted, given that inflation has remained low for some time. The Governor replied:

I can't see a strong argument for changing the inflation target. Remember, as well, at the moment the inflation rate is 2.1 per cent. That's between two and three. We think over the next two or three years it will average between two and three and will deliver you, the community, an average rate of inflation of two point something. I think that's the right place to be, and I don't see the changes in the labour market as invalidating any of these arguments.¹³

2.13 The Governor was asked whether recent reductions in the cost of child care and falling electricity prices in some states were reflected in the weak inflation numbers. In response, the Governor noted that price reductions in childcare are a reflection 'of decisions that governments are making to reduce the cost-of-living pressures on households' and said that this will give people more money to spend on other things.¹⁴ He explained:

That will create more demand elsewhere in the economy and it will gradually lift spending and prices elsewhere in the economy. So it's good news in the short run. If you're looking for inflation to pick up quickly to 2½ per cent, you might think it's not so helpful, but I think it's good news, even if it means inflation is going to be a bit lower for a bit longer.¹⁵

2.14 When asked about price changes in electricity, the Governor said that 'the trend has been up for a long period of time and we've seen in the current quarter a decline in Brisbane'.¹⁶ He commented 'one would hope that we'll see further declines right across the board. It remains to be seen whether

11 RBA, *Statement on Monetary Policy*, August 2018, p. 4.

12 RBA, *Statement on Monetary Policy*, August 2018, p. 4.

13 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 15.

14 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 6.

15 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 6.

16 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 6.

that will happen', noting the government is currently considering changes to energy policy.¹⁷

- 2.15 The Governor was asked about cost of living pressures, given the current environment of low inflation and accommodative monetary policy settings. The Governor said that it is 'largely an income story' due to slow growth in wages.¹⁸ He explained 'it's not that the aggregate price index is going up too quickly; it's the fact that our incomes are not going up quickly enough.'¹⁹
- 2.16 While acknowledging that many costs are increasing the financial burden on families, the RBA noted that the price of a range of consumer goods, such as television sets, has fallen while the food grocery basket price 'basically hasn't moved in seven years.'²⁰
- 2.17 The Governor was asked about the prospects of a falling Australian Dollar, given that the United States Federal Reserve was tightening monetary policy and the US dollar was appreciating. He noted 'for some time I've been saying that a lower exchange rate would be better than a higher one', and explained:
- ...a lower exchange rate would lift inflation, getting the inflation rate closer to the midpoint of the target, and it would also stimulate the economy. It would make our exports more competitive and imports less competitive, and that would create more jobs and wealth and income. So, from the perspective of getting back to full employment and getting inflation back to the midpoint of the target range, a lower exchange rate would be helpful.²¹
- 2.18 The committee was interested in the RBA's contingency plans for monetary policy, including what circumstances would move the RBA to reduce the cash rate below 1.5 per cent. The Governor said that the most likely scenario 'was something going wrong at the global level, particularly something going wrong in China', but added that this was a low probability of occurring.²²
- 2.19 From a national economic perspective, the Governor said that a sharp adjustment to the housing market could be a reason for it to cut rates. However, he remarked that 'if we were ever to have an adjustment in the

17 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 6.

18 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

19 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

20 Dr Guy Debelle, RBA Deputy Governor, *Transcript*, 17 August 2018, p. 9.

21 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 8.

22 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 15.

housing market – and we do need one – the current environment is basically as good an environment as you could have’.²³

- 2.20 The committee asked the Governor what other strategies the RBA could pursue in a major economic downturn, other than lowering the cash rate to zero. The Governor said the RBA had examined the experience of other countries, including ‘where the central banks have bought assets from the private sector, including government securities’ and said that the RBA was prepared for a scenario where it would need to provide funding to the banking sector in order to maintain the supply of credit in the real economy.²⁴ The Governor added that while ‘the probability of us having to do these things is low’, the RBA has ‘a sense of what works and what doesn't work so that we're prepared in case we find ourselves there.’²⁵

Forecasts

- 2.21 In its August Statement, the RBA forecasts Australia’s GDP growth to increase to just over three per cent during 2018 and 2019. Inflation remains low, with underlying inflation expected to increase gradually to be around 2¼ per cent by 2020 (see Table 1).²⁶

Table 1 Output Growth and Inflation Forecasts (per cent)(a)

	Year-ended					
	Jun 2018	Dec 2018	Jun 2019	Dec 2019	Jun 2020	Dec 2020
GDP growth	3	3¼	3¼	3¼	3	3
Unemployment rate	5.5	5½	5¼	5¼	5¼	5
CPI inflation	2.1	1¾	2	2¼	2¼	2¼
Underlying inflation	2	1¾	2	2	2¼	2¼
	Year-average					
	2017/18	2018	2018/19	2019	2019/20	2020
GDP growth	2¾	3¼	3¼	3¼	3¼	3

Source Reserve Bank of Australia, *Statement on Monetary Policy, August 2018, Table 5.1, p. 60.*

(a) Technical assumptions include A\$ at US\$0.74, TWI at 64 and Brent crude oil price at US\$73 per barrel.

23 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 16.

24 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 18.

25 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 18.

26 RBA, *Statement on Monetary Policy, August 2018, pp. 2-3, 63.*

2.22 The Governor was asked what effects the current drought would have on GDP growth. He responded:

It's hard to come up with some specific numbers of the effect on the economy. We've looked back at the very serious drought around the turn of the century. In 2002 and 2003 farm output fell by around 25 per cent, and that knocked a full one percentage point off GDP growth. We saw large redundancies across the rural workforce. In that year food prices rose by 4½ per cent, so it had first-order effects on the economy. The current drought is not as serious as that one, and we all certainly hope it won't be.²⁷

2.23 The Governor said the RBA was monitoring the situation closely, and that while Western Australia was experience good conditions and parts of Northern Queensland have received some recent rain, New South Wales, southern Queensland and Victoria were badly affected. He commented:

We're trying to understand the implications of it. It looks at the moment that slaughter rates are increasing as farmers have to sell their livestock to markets, so we'll see in the short term some boost in our exports, but that's only a short-term boost. That will be offset to some degree because grain exports will be lower because production is lower and some grain has to be diverted to feed stock. There will be less income in rural communities so there will be less spending.²⁸

2.24 The RBA was asked about recent export trends and its expectations for growth in iron ore export volumes. The RBA responded:

We have had a number of years of ramp-up in export volumes as some of the new production capacity came online. In the case of iron ore, that is more or less done. There is a little bit more to go because some of the sites seem to be able to get some productivity improvements. But essentially all of the expansion has happened. We hear of one or two projects that are on the drawing boards now or about to commence construction. That may expand production in further years. But, for the time being, we expect the volume of iron ore exports to remain broadly flat. So it is not that they are soft; it is just that they were expanding very quickly, by a very large percentage, to a level and we have more or less reached that level.²⁹

27 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 11.

28 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 11.

29 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 12.

- 2.25 When questioned on the outlook for coal exports, the RBA noted that ‘the main reason we have modestly upgraded our terms of trade forecast is that thermal coal prices have stayed a bit higher for a bit longer than we had previously anticipated.’³⁰ The RBA explained ‘that is partly because there has been quite strong global demand, particularly in Asia.’³¹
- 2.26 The RBA noted that ‘a lot of countries are trying to move to a less carbon intensive economy. That hasn't happened yet. So, at the moment, electricity demand means thermal coal demand.’³² The RBA also reported that supply disruptions in Australia, Russia and South Africa have maintained the thermal coal price above the level it had previously been forecasting.³³

Population growth

- 2.27 The Governor was asked about the importance of a growing population to the continued strength of the Australian economy. The Governor referred to population growth as ‘a first-order variable that's affected how the Australian economy performs.’³⁴ He commented:

We've had 27 years without a recession. There are a lot of reasons for that, but one of those reasons is that the population has been growing, on average, 1½ per cent a year. If our population had been growing at 0.2 per cent a year, as many other advanced economies have, we would have had less growth over that period.³⁵

- 2.28 The Governor said that the strength of Australia's immigration program over recent years has developed our human capital and changed our demographics, which reduces the cost of supporting an ageing population in the future. He explained:

We are now one of the youngest of the advanced economies and we're going to stay one of the youngest countries for the next 20 years because of the immigrants. The median age of Australians is 37. The median age of new immigrants is somewhere between 20 and 25. We've been doing this for a decade and it's affecting the rate at which our country's ageing. We used to be ageing in the middle of the pack with other countries. The ageing over the next

30 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 12.

31 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 12.

32 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 12.

33 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 12.

34 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 18.

35 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 19.

20 years is going to be noticeably less than most other advanced economies. In 20 or 30 years, there'll be an echo effect of this. For the next 20 or 30 years, we're ageing quite slowly and that will help government financiers. It helps the government budget.³⁶

2.29 The Governor was asked to explain what the consequences of a significant reduction in Australia's immigration intake would be for future economic growth. He said 'if the population were to only grow at 0.7 per cent a year rather than 1.7 per cent that would have a noticeable effect on our average growth rate.'³⁷

2.30 In addition, the Governor acknowledged the significant social and economic contribution immigration has made to this country:

I think another benefit we've got from immigration is that our society is more dynamic and more diverse, and that diversity is positive from the long-term perspective. In the most recent census, nearly 50 per cent of us either were born overseas or have one parent who was born overseas. So half the population have some direct connection to families and businesses living in other countries, and often they speak another language as well. I see that as one of Australia's huge assets. That diversity, those business connections and those overseas connections that we have are one of the country's great assets and a slower rate of population growth over time would not build on that asset at the rate that we've been building on it.³⁸

Business and the labour market

2.31 The Governor reported that over the first half of this year, the Australian economy has grown 'quite strongly', business conditions were positive and non-mining investment is increasing.³⁹ He said recent data showed the labour market is continuing to tighten, which the RBA expects will push up wages gradually.⁴⁰

2.32 When questioned on the indicators of positive business conditions, the Governor noted that the RBA tracked a number of business surveys, and remarked 'at the moment, confidence is quite high. When you ask

36 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 19.

37 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 19.

38 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 19.

39 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 1.

40 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

businesses about current conditions, they're actually reporting that conditions are above average, and it's right across the country'.⁴¹

2.33 In August, the RBA reported that Australia's labour force participation rate is currently at around 65.5 per cent, which is close to its historical high.⁴² The committee was interested in the reasons why Australian labour market has performed so well recently. The Governor said that a number of factors were causing the job market to tighten, including current growth in the global economy, strong commodity prices and a lift in infrastructure investment, and further noted that the low level of interest rates is helping.⁴³

2.34 The Governor explained that the pick-up in non-mining investment is increasing the demand for labour because, 'now that the resources boom is over, there's more scope for businesses outside the resources sector to increase their capital spending'.⁴⁴ The Governor said 'those factors are generating strong demand for labour, and we're now seeing that in the unemployment rate, which is very good news'.⁴⁵

2.35 The Governor noted that the unemployment rate was currently around 5.3 per cent and said this was another sign of a strong labour market. He explained that the improvement has been broad based:

Over the past year, employment's up nearly 2½ per cent. The labour force is probably growing at 1¾ per cent, so that's seen the unemployment rate come down, and the participation rate is also rising. One of the factors that I've been talking about recently is the big rise in the participation by older workers, so the stronger labour market is creating opportunities for older people to stay in the labour market. Encouragingly, at the other end of the distribution, there's been a marked decline in youth unemployment in the last six months. Youth unemployment has been high for a long period of time, but it's finally starting to come down, which is good news.⁴⁶

2.36 The committee questioned the Governor on labour mobility patterns, particularly whether workers were reluctant to leave their jobs. The Governor noted that currently, very few people were losing their jobs involuntarily and 'relatively few people were leaving jobs for voluntary

41 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 16.

42 RBA, *Statement on Monetary Policy*, August 2018, p. 38.

43 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 4.

44 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 4.

45 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 4.

46 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 4.

reasons'.⁴⁷ The Governor commented that 'it is a puzzle why, in such a tight labour market, workers are not jumping firms in the way that they used to.'⁴⁸

- 2.37 The committee asked if women's labour force participation was improving. The RBA noted that 'each generation of women is participating in the labour force to a greater extent than the one that went before. Unlike in some other Western countries, that process is still continuing in Australia.'⁴⁹ The RBA reported that there has been an increase in labour force participation among women aged over 50. It said this reflects a broader structural change where older workers are working for longer.⁵⁰
- 2.38 The Governor was asked which Australian industries were currently experiencing the tightest labour markets. He said the strongest demand for labour was in several occupations linked to infrastructure, such as those requiring IT security and project management skills.⁵¹ However, the Governor remarked that 'in many occupations, wage increases still seem to be around the two per cent mark, and, in the most recent aggregate enterprise bargaining results, the increase was still quite low'.⁵²

Wages growth

- 2.39 The committee asked the Governor about the prospects for wage increases in Australia. The Governor responded:

At the moment, the number of job vacancies that firms have as a share of the labour force is the highest on record. Firms are advertising a lot of jobs. They're telling us that it's hard to find workers. In that environment, you would expect the laws of supply and demand gradually to kick in – that wage growth would pick up – and we do hear this in our business liaison program. In the areas of project management skills, IT security and some engineering occupations, where there's strong demand for workers and the supply of workers with the skills is not there, wages are starting to move. I think that will become a more general story, but it's going to be a fairly gradual process.⁵³

47 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 14.

48 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 14.

49 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 5.

50 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 5.

51 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 5.

52 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 5.

53 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

2.40 The committee asked if there was any difference in wages growth between the public and private sectors. The Governor noted that there had been a consistent trend over the last few years in which 'public sector wages on average have been growing at least half a per cent faster than wages in the private sector.'⁵⁴ However the Governor said he 'wouldn't overstate the size of the difference.' He explained:

Within the public sector, there's quite different experiences. Here in Canberra, the increases are two or below and in some of the state government areas they are 2½ to three. Some state governments, because their budgets are in reasonable state, are paying higher wages to nurses, teachers, [and] police.⁵⁵

2.41 When asked if changes to labour organisation was holding back wage growth, the Governor noted that the 'decline in bargaining power of labour because of changes in industrial relations is probably part of it' but said that there were global, competitive forces at play.⁵⁶ He explained:

We all feel that there is more competition. Workers in Sydney, Melbourne and Canberra, who used to not worry about international competition, now have to worry about it, in many service occupations and in engineering. I even see examples of where large firms in Sydney have relocated their PAs to the Philippines, and they say they can do that because of technology: it's cheaper, and they can have the PA on a screen sitting outside their office, rather than have them physically outside the office. So, workers everywhere, because of changes in technology and globalisation, feel as though there's more competition, and somehow that affects the bargaining process.⁵⁷

2.42 The Governor was asked if he was confident wages would rise, given that a number of conditions considered to be conducive to stronger wage growth had been in place for some time. The Governor remarked:

Things are operating differently, but I don't think they are undermining the basic principles that we're using. Where labour markets are tight, wages still do move, so that basic principle of economics of supply and demand still works. We see examples of that in local labour markets; it's just taking time for that to work through the rest of the economy.⁵⁸

54 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 12.

55 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 12.

56 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 12.

57 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 14.

58 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 15.

2.43 The committee asked the Governor if the RBA had done enough to advocate for higher wages. He responded:

I have certainly been talking for a couple of years about the benefits of stronger wage growth. I was concerned at the beginning of last year that we'd slipped from 2½ per cent wage growth to two per cent, and maybe we'd even slip to 1½, because we'd been hearing about some wage outcomes that were starting with a one and I thought that was problematic.⁵⁹

2.44 The Governor said that the RBA's strategy was twofold: to 'talk publicly about the benefits of stronger wage growth' and 'to keep interest rates low for a long period of time so that we get more and more pockets of tight labour markets where wages start moving.'⁶⁰

2.45 The Governor was asked if the Budget forecasts for wage growth reaching 3¼ per cent in 2019-20 were overly ambitious. He replied:

I think that there is a prospect that average earnings can rise at that type of rate. Whether the wage price index rises at that rate, I don't know. There is quite a lot of compositional shift going on in our labour market and the wage price index doesn't capture that. There are kinds of bonuses and other payments that the standard measure of the wage price index doesn't capture. So I think it's possible and even probable that aggregate earnings per hour will grow at that rate.⁶¹

Investment and infrastructure

2.46 The August Statement noted that private infrastructure investment has increased, led by investment in electricity projects. It reported that spillovers from public sector infrastructure spending have helped growth in the private sector, particularly in construction and business services.⁶²

2.47 The RBA was asked if it had concerns about the efficiency of current infrastructure spending. Noting that project evaluation was not its area of expertise, the RBA said it 'would expect Australia to be less at risk from making poor project evaluation decisions than some other countries' because we had an independent statutory authority (Infrastructure Australia) that provides 'independent insight into project design'.⁶³

59 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 10.

60 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 10.

61 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 11.

62 RBA, *Statement on Monetary Policy*, August 2018, pp.2-3.

63 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 13.

- 2.48 The committee was interested in the Governor's views on how infrastructure spending, particularly by the states, could be accelerated. The Governor noted that good governance around infrastructure was critical, but that it 'requires political commitment and very practical decisions to be made.'⁶⁴
- 2.49 The committee was interested in hearing about current, strong investment in new electricity generation, particularly renewable energy projects. The RBA reported that the amount of private investment in renewables at the moment or planned for the current year 'is equivalent to the previous couple of years of annual investment in the entire electricity generation industry'.⁶⁵
- 2.50 When asked if this could be an artificially high number driven by subsidies, the RBA commented that 'the relative price of renewable energy generation has dropped relative to that of carbon based electricity generation', noting that high coal prices were the alternative.⁶⁶
- 2.51 The Governor was asked about the government's plan to reduce the corporate tax rate to 25 per cent for all businesses, in particular if the RBA considered this could be achieved while returning the Budget to surplus. The governor noted that there was international competition for business investment and that other countries, such as the United States, had lowered their corporate tax rates. He said that if the Parliament were to respond by lowering Australia's headline rate, it should ensure 'the budget stays on a reasonable track, and at the moment it looks like it is.'⁶⁷

Household sector

- 2.52 The RBA's August Statement reported that while household consumption growth has been low, it was expected to increase steadily, at a rate a little above the average of recent years.⁶⁸
- 2.53 The committee asked if consumption growth would mean that people would be dipping into their savings. The Governor noted that the saving rate has remained positive, and said growth in household consumption suggests 'people have some reasonable confidence about the future, which

64 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 21.

65 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 13.

66 Dr Luci Ellis, RBA Assistant Governor - Economic, *Transcript*, 17 August 2018, p. 13.

67 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 6.

68 RBA, *Statement on Monetary Policy*, August 2018, p.3.

is good. They're prepared to spend a bit more today, because they see the economy picking up, and this is really what we want to happen.'⁶⁹

- 2.54 The August Statement also reported that dwelling investment has remained strong, particularly in the south-eastern states, and is expected to stay that way over the next few years. The RBA said 'conditions in the established housing markets in Sydney and Melbourne continue to ease, but the declines in prices from their peaks remain modest overall.'⁷⁰ The RBA further noted that housing prices remain subdued in the other mainland capitals.⁷¹
- 2.55 In his opening statement, the Governor noted concerns about previous trends such as rising house prices, rapidly rising debt and declining housing affordability. He said these 'trends were not sustainable and they were posing a medium-term risk to our economy'.⁷² The Governor said 'it's good news that this adjustment is taking place at a time when global growth is strong, the Australian labour market is positive and interest rates are low.'⁷³
- 2.56 The Governor observed that the slowing of the housing market has reduced demand for credit among investors. He said 'the average variable interest rate paid by borrowers has declined further over the past six months to be around 10 basis points lower than it was a year ago.'⁷⁴
- 2.57 The Governor was asked whether there had been some tightening in the supply of credit, partly in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. He responded, 'it's true that the Royal Commission has had some effect on the supply of credit. Financial institutions are becoming more risk averse; it's understandable.'⁷⁵ The Governor also remarked that lenders were 'doubling down on their processes, which is actually a good thing.'⁷⁶ However, he said this meant loan approvals may take longer to complete and that more loans were likely to be rejected.⁷⁷
- 2.58 When asked if the banks have overreacted in tightening the supply of credit, the Governor said that it was important there was a response to the examples of misconduct highlighted by the Royal Commission. However,
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69 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 15.

70 RBA, *Statement on Monetary Policy*, August 2018, p.3.

71 RBA, *Statement on Monetary Policy*, August 2018, p.3.

72 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

73 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

74 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

75 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

76 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

77 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

he noted that Australia has a strong financial system and cautioned against overregulation, which could stifle innovation. The Governor commented 'in responding to the terrible examples of behaviour that we've seen, we need to strike a balance so the next six months and the recommendations from the commission are going to be critical there.'⁷⁸

Trends in the global economy

- 2.59 In his opening statement, the Governor reported that the global economic outlook remains positive. He noted that several advanced economies are growing at above trend rates, that unemployment rates in some countries are at multi-decade lows, and that there has been a gradual pick-up in wages growth.⁷⁹
- 2.60 The Governor noted that monetary policy among advanced economies is currently varied. While monetary stimulus in the United States is being withdrawn gradually, the Governor said official interest rates in the Euro area, Japan, Sweden and Switzerland all remain negative almost a decade after the Global Financial Crisis. The Governor reported that growth in China has slowed a little and, while Chinese authorities are responding to this, 'they're still facing the challenge of addressing risks in the financial system.'⁸⁰
- 2.61 The Governor said that several risks and uncertainties have emerged in the global economy, including the possibility of an escalation in global trade tensions and the potential for a large, unexpected pick-up in inflation in the United States. The Governor noted further risks associated with the economies of Argentina, Brazil, Italy and Turkey in which 'there have been episodes of market volatility associated with each of these countries' in the past month.⁸¹

US fiscal and trade policy

- 2.62 The Committee questioned the Governor on the direction of public finances in the United States, in particular whether fiscal stimulus has gone on too long. He responded:

I don't really want to pass judgement on it. I would make the observation though that in the United States the budget deficit as a

78 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 13.

79 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

80 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

81 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 2.

share of GDP is now four or five per cent and is likely to stay there for the foreseeable future. This is at a time when the US economy is below full employment, growing above trend and has a very high level of public debt, partly as a legacy of the spending during the financial crisis and the inability of the US system to reform entitlements. I think public finances in the US are looking problematic.⁸²

2.63 The Governor explained that it was unorthodox for a country to 'have a very big fiscal expansion when the economy is already at full employment'.⁸³ When asked who was driving this unorthodox approach to fiscal policy in the United States, the Governor said 'I don't think it's coming from the Federal Reserve. The Federal Reserve [is] gradually tightening up as inflation rises, as is appropriate for them to do.'⁸⁴

2.64 The committee asked the Governor if this fiscal expansion risked a significant increase in inflation in the United States. The Governor noted that investors 'largely think that inflation is going to stay very low in the US', but said that if inflation and long-term bond yields were to rise sharply, there could be some disruption.⁸⁵ He explained:

One reason that asset prices have been so high right around the world recently is that long-term bond yields are so low. Partly, this is the term premium story. So, if long-term bond yields were to rise a lot, there would have to be repricing of a lot of assets, and markets are not prepared for that. We've seen in the past that, when periods of repricing occur, it's quite disruptive.⁸⁶

2.65 The committee asked the Governor if the RBA was concerned by the escalation of trade tensions between the United States and China, in particular whether it would affect global growth forecasts. The Governor said that concerns about trade were the likely cause for a small recent downgrade in global growth by international forecasters, and remarked:

I can't think of a single country that has made itself wealthier by building barriers. I can think of a lot that have made themselves wealthier by inviting the world in, having more competition, more capital, more people, more goods and services. I can think of one, in particular, that's done remarkably well from that, and that's

82 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

83 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 8.

84 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 8.

85 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 8.

86 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 8.

Australia. So this is not a path to make ourselves or anyone wealthier.⁸⁷

2.66 The Governor added that it was too early to tell how trade tensions would play out, noting that 'it's very hard to put probability on these three scenarios: a benign one, a terrible one and one that works out okay. I think we're all waiting and watching to see what happens.'⁸⁸

2.67 Given the current global context, the Governor was asked how important it was for Australia to maintain its strong, bilateral relationships. The Governor noted that both the United States and China were vitally important to the Australian economy, and commented 'we all have a very strong interest in China and the US working out their difficulties, and I think that requires movement on both sides.'⁸⁹ He explained:

In China, there is a legitimate issue about the protection of intellectual property. The Chinese authorities have acknowledged that. They're moving, and the Americans are trying to push them more quickly. I think it's in the interests of both China and the United States for that issue to be resolved and for the trade tensions not to escalate.⁹⁰

2.68 The Governor said that the shift in trade and fiscal policy by the United States administration meant that it was important for Australia, along with Canada and New Zealand, to 'speak up for the relatively free flow of goods, people and capital and to talk about how that makes us more prosperous and increases our living standards.'⁹¹ The Governor remarked that 'we are three very prosperous countries where people enjoy high living standards because of openness', and that this is an important story to promote internationally.⁹²

Other issues

Royal Commission

2.69 The Committee asked the Governor to comment on what impact the Royal Commission was having on the banking and finance sector. He said:

87 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

88 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

89 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

90 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 9.

91 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 20.

92 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 20.

I would have to say, I'm incredibly disappointed and, in many cases, I've been appalled at the behaviour that's come out through the royal commission. I think the whole process is really showing the benefit of sunlight, showing a kind of microscope on behaviour. I think the community is getting a better understanding, and we'll get better outcomes in the financial sector as a result of this. Sunlight is acting as a very good disinfectant here. We need this disinfectant and it is actually working.⁹³

2.70 The Governor said it was a high priority that financial institutions dealt with conflicts of interests and remuneration and incentive structures in order to rebuild trust in the services they offer. He commented that 'we need to have a very strong focus on delivering service rather than sales, and risk management.'⁹⁴

2.71 The Governor was asked to comment on evidence before the Royal Commission about AMP Super being slow to transfer its customers onto lower costing superannuation products. The Governor said the issue was concerning, and noted 'trustees have a fundamental duty to act in the best interests of members, not in their owner's interests and not in the best interests of related parties.'⁹⁵ Without commenting on specific cases, the Governor said 'It's really problematic because it diminishes confidence in the system. Trustees actually need to do their job'.⁹⁶

Council of Financial Regulators

2.72 The Committee was also interested in the Governor's views on whether there was enough transparency around the meetings and considerations of the Council of Financial Regulators, noting a recent recommendation of the Productivity Commission.⁹⁷ The Governor said that, since the council discussed 'very confidential market-sensitive information and sometimes even about individual institutions', it would be inappropriate for it to publish minutes. However, the Governor noted the council was considering issuing a post-meeting statement that outlines the general issues that the council is working on and commented 'I think it would

93 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

94 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 7.

95 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 20.

96 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 20.

97 Productivity Commission, *Competition in the Australian Financial System*, 3 August 2018, Recommendation 17.2, p. 479. The recommendation calls for the Council of Financial Regulators to publish its competition analyses, as well as the minutes of council meetings.

help the community understand what we're working on, and hopefully we'll do this fairly soon.'⁹⁸

Conclusion

- 2.73 Australia's economy continues to grow strongly and the RBA expects GDP growth to average around 3¼ per cent by the end of 2018 through to the end of 2019, reflecting above trend growth in a number of major economies. This is being supported by a pick-up in non-mining investment, strong commodity prices, growth in investment in energy projects and public sector infrastructure, low interest rates and the tax cuts already in place for small and medium businesses.
- 2.74 The combination of strong output growth, low inflation, low interest rates and low wage growth has been persistent in many economies in recent years. The RBA remains confident that the basic principles of supply and demand are still functioning and that, where labour markets are tight, wages are rising. Australia's labour market has continued to strengthen with the labour force participation rate currently at around 65.5 per cent, which is close to its historical high. Strong, continued growth in employment is expected to further reduce spare capacity in labour markets and generate a gradual increase in wages and inflation.

Mr Tim Wilson MP
Chair
19 September 2018

98 Dr Philip Lowe, RBA Governor, *Transcript*, 17 August 2018, p. 18.