QUESTIONS ON NOTICE – PARLIAMENTARY HEARING ON 3 DECEMBER 2020

Question on Term Funding Facility

Mr SIMMONDS: The Term Funding Facility has obviously been an important tool—as we've spoken about before—in supporting liquidity. Do you have some extra data that you can provide to the committee about the use of the TFF by ADIs and the amount of lending backed by the TFF? In particular, on the commentary about one bank that said it has publicly exhausted its current allocation and will look to tap the allocation further. It is going to play a big part going forward, potentially.

Mr Lowe: It's quite an important program. It's making sure the banks have access to low-cost funding and it's helping to keep the whole structure of funding costs down. I don't have any extra information to share. I know that after we last met there was a question in writing to which we provided additional information about which institutions, by size, had been using it and how much of their allocations. I could update the data.

Mr SIMMONDS: Yes, an update of the data would be appreciated. Just take it on notice. Thank you, Governor, I appreciate it.

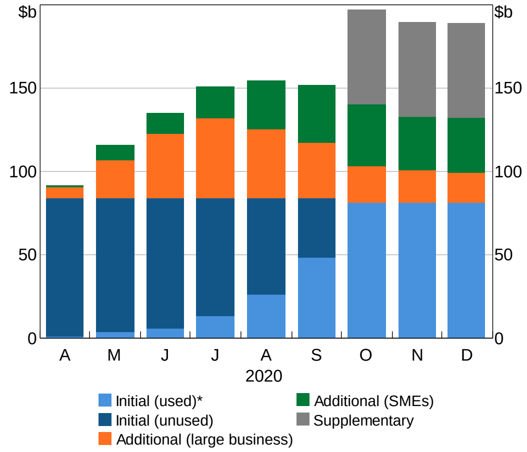
Answer

The Term Funding Facility (TFF) covers three types of allowances:

1. Initial allowance: This was fixed at the start of the scheme to be equivalent to 3 per cent of each authorised deposit-taking institution's (ADI's) total credit outstanding ($84 billion in aggregate for all ADIs). Access to the initial allowance closed on 30 September 2020.
2. Additional allowance: ADIs can access additional funding under the TFF if they expand credit that they provide to businesses, particularly for small and medium sized enterprises (SMEs; those with turnover of less than $50 million). For every extra dollar of loans an ADI makes to large businesses, ADIs can access one additional dollar of funding from the Reserve Bank. For every extra dollar lent to SMEs, ADIs have access to an additional five dollars of funding. ADIs are able to draw on their additional allowance, which is updated monthly, until 30 June 2021 (initially this deadline was 31 March 2021). The additional allowance is around $51 billion as of December 2020, around two-thirds of which is related to lending to SMEs.
3. Supplementary allowance: ADIs have been able to access the supplementary allowance since 1 October 2020 and can continue to do so until 30 June 2021. It was fixed at 2 per cent of each ADI's total credit outstanding over the three months to July 2020 ($57 billion in aggregate for all ADIs).

The total funding allowance under the TFF is around $190 billion as at December 2020, compared with $150 billion in August 2020 and $90 billion at the program's inception (see graph below).

TFF Allowances



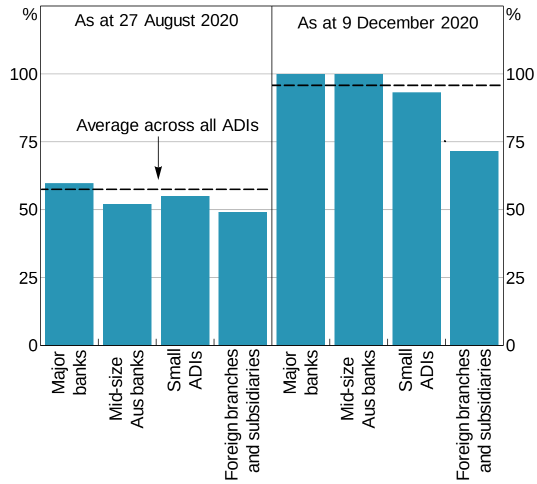
* Initial allowance use for April to September represents use at the beginning of the month; initial allowance use from October onwards represents final initial allowance use

Sources: APRA; RBA

As expected, take-up of the TFF accelerated ahead of the 30 September 2020 deadline for ADIs to draw down on their initial allowance. The first graph below shows two snapshots in time to provide an indication of how take-up of the initial allowance has changed. This graph compares take-up at the time of the Bank's previous appearance before the Economics Committee in August 2020 to take-up after the drawdown window for the initial allowance closed at the end of September 2020. Almost all of the funding available under the $84 billion TFF initial allowance was drawn down; the large Australian banks, mid-sized Australian banks and smaller ADIs drew down close to all of their initial allowances, while branches and subsidiaries of foreign banks used nearly three-quarters of their allowances. By number, around two-thirds of eligible ADIs accessed the TFF.

Initial Allowance Usage

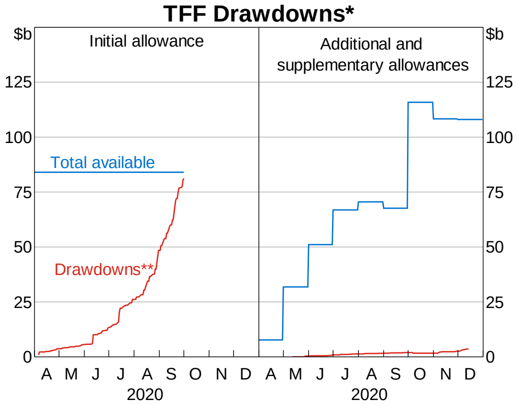
Per cent



Sources: APRA; RBA

Take-up of the additional and supplementary allowance has been modest so far (see graph below). ADIs have indicated that they are well funded. Similar to the approach taken by ADIs to the initial allowance, further TFF drawings are likely to be spread out across the remaining allowance period, but weighted towards the 30 June 2021 deadline.

The TFF continues to support low funding costs across the economy by providing the banking sector with low-cost term funding. ADIs have three broad options for using the funds from the TFF: write new loans to households or businesses; purchase securities such as government or corporate bonds (that is, lend through capital markets rather than directly); or replace other forms of funding, such as bank bonds. It is difficult to quantify the value of lending backed by the TFF, since the funding provided is fungible and can also be used to offset other bank liabilities, for example by replacing maturing wholesale funding. Notwithstanding this, the value of TFF drawdowns by ADIs is equivalent to around 3 per cent of the stock of credit outstanding.



For further information on the TFF see:

Kent C (2020) 'The stance of monetary policy in a world of numerous tools', Address to the IFR Australia DCM Roundtable Webinar, Online, 20 October. Available at: https://www.rba.gov.au/speeches/2020/sp-ag-2020-10-20.html

Alston M, S Black, B Jackman and C Schwartz (2020), 'The Term Funding Facility', RBA *Bulletin*, December. Available at: https://www.rba.gov.au/publications/bulletin/2020/dec/the-term-funding-facility.html

'Domestic Financial Conditions' chapter in the November 2020 *Statement on Monetary Policy*. Available at: https://www.rba.gov.au/publications/smp/2020/nov/domestic-financial-conditions.html

Box E in the August 2020 *Statement of Monetary Policy*. Available at: https://www.rba.gov.au/publications/smp/2020/aug/box-e-the-reserve-banks-term-funding-facility-tff.html.

Data on TFF drawdowns and allowances can also be found in RBA Statistical Table A3 'Monetary Policy Operations – Current – A3'. The tab 'Term Funding Facility' includes weekly cumulative drawdown data, the value of the total funding allowance and a breakdown of the funding allowance. The RBA Statistical Tables are available at: https://www.rba.gov.au/statistics/tables/.

Question on how long it will take the economy to return to previous peak in per capita GDP and to return to trend

Dr MULINO: You had indicated in earlier communications that your forecasts were that total GDP would return to roughly pre-COVID levels by the end of 2022 or a little bit less than that. Is that fair?

Mr Lowe: The level of GDP, we thought, was going to get back to the level it was at the end of last year by the end of next year. So two years, the end of 2021.

Dr MULINO: So it would take two years to get back to pre-COVID levels, where it was.

Mr Lowe: So, pre-COVID, let's say December 2019, and our forecast was we'd be back at that level December 2021. If we keep getting numbers like the 3.3 per cent, it will be a bit quicker.

Dr MULINO: Have you modelled how long it will take for the economy to get back to where it was in per capita terms and back to trends? The benchmark we have just talked about is an interesting benchmark. But people would also be interested, for example, in how long it will take for them to get back to GDP in per capita terms. Also, it's interesting to think about how long it will take for the economy to converge, in a sense, to where it was heading.

Mr Lowe: We have thought about that, but I don't have any specific answer, because it really depends on whether you think there is permanent damage to the productive capacity of the country because of the pandemic. I think it's quite plausible that there is—while not permanent damage—quite persistent damage. The level of investment is quite a lot lower than it was going to be, and lower levels of investment mean a lower capital stock, and lower capital stock means less output. So to get back to that previous trend, we have got to get the level of investment up a long way, which doesn't look likely anytime soon. So the capital stock will be lower. I think the level of output will be lower persistently.

There could be some scarring in the labour market. I have been a bit worried about that as well, that particularly young people who didn't get to training and job opportunities they otherwise would have had don't develop their human capital at the same rate as they otherwise would have and that we suffer some loss of productive capacity because of that. So there are mechanisms through which we have a lower level of output than we otherwise would have and it takes quite a few years to make those up. That's plausible.

Dr MULINO: Some of this might be to take on notice, but I would have thought the models that you would be using would be able to make assessments against some of these benchmarks that I'm alluding to. As you said, population growth is expected to fall significantly this year. I've seen a number of estimates. You talked about 0.1; I have seen 0.3 or 0.4, but we'll see. I think it's expected to bounce back a bit next year. If it would be possible to get an estimate of how long it would take for people's per capita GDP to recover—if that is different; it might be an extra year—I would be interested in—

Mr Lowe: It's very hard because I think it largely comes down to what you think's going to happen to the capital stock—both the physical capital stock from investment and the human capital stock from investment in education. We don't really have a very good handle on how quickly those capital stocks will get back to their previous trend, but I'll see what information we've had there.

Dr MULINO: That would be good.

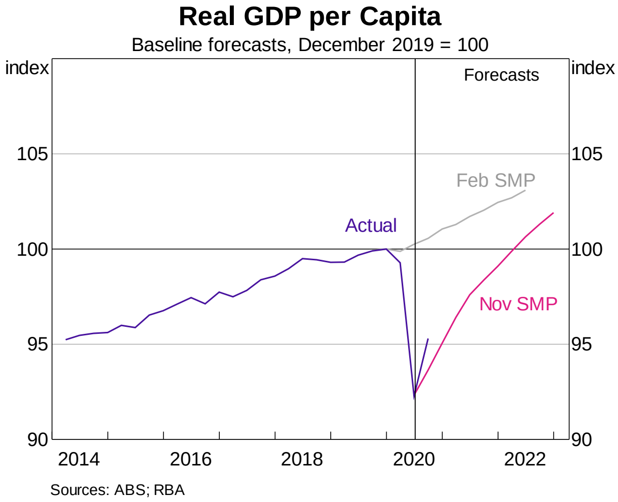
Mr Lowe: I'm just thinking on the fly here. It's hard to do modelling about that. You can make assumptions, and maybe that's the best way of doing it, saying, 'What type of assumptions do you need to make to get back to the previous trend we were on in terms of per capita incomes?'

Dr MULINO: Although if you're estimating total GDP to get to a certain point there must be an assumed capital stock underpinning that?

Mr Lowe: Yes, there is. I can unpack that and provide the details for you.

Answer

The forecasts at the time of the November 2020 *Statement on Monetary Policy* were for GDP per capita to increase to its pre-pandemic level by the June quarter 2022. This was based on the central scenario for aggregate GDP to increase to its pre-pandemic level by late 2021, and the assumption of slow growth in the population, in line with estimates prepared by the Australian Treasury. Under the central scenario, GDP per capita was forecast to remain below the pre-pandemic trend at the end of the Bank's forecast period in 2022.



In terms of the outlook for the capital stock, the forecasts for economic activity included a gradual recovery in non-mining business investment from the first half of 2021, led by spending on machinery & equipment. Dwelling investment was also expected to increase over coming quarters as the construction industry in Victoria resumes normal levels of activity and the HomeBuilder program supports detached building activity in most states. Finally, infrastructure spending is expected to support strong growth in public investment in coming years. Together with an assumption about the rate of depreciation of the capital stock, this outlook for investment implies modest growth in the capital stock over coming years.

Recent data on economic activity have been stronger than expected at the time of the November 2020 *Statement on Monetary Policy*. A full re-assessment of the economic outlook will be published in the February *Statement on Monetary Policy* on 4 February 2021.

Question on Sponsorships

Ms MURPHY: … I have one question. It's just something that jumped out at me that I found a little interesting and perhaps strange, perhaps not. The annual report, at page 119, talks about the Reserve Bank's research. I'll just read this paragraph so you know that I'm reading all of it when I ask the question:

> The Bank sponsors economic research in areas that are closely aligned with its primary responsibilities. This sponsorship includes financial support for conferences, workshops, data gathering, journals and special research projects, and encompasses areas of study such as macroeconomics, econometrics and finance.

All of that makes perfect sense, if I may say so. The report goes on to say:

> In addition, the Bank provides sponsorship to the Centre for Independent Studies and the Sydney Institute.

It then lists corporate memberships and memberships of various organisations, such as CEDA. My question is: what form does the sponsorship of the Centre for Independent Studies and the Sydney Institute take?

Mr Lowe: My recollection here is that these think tanks offer corporate membership and the Reserve Bank has a limited number of these corporate memberships. The Lowy Institute would be another one that we support. We take a fairly broad perspective here and sign up for corporate memberships of a number of these. We go to their functions, we listen to their material and we receive their reports. These are fairly small amounts of money in the overall scheme of things.

Ms MURPHY: I appreciate that. My interest is because the report does say:

… a corporate member of the Lowy Institute for International Policy and The Ethics Centre and an associate member of The South East Asian Central Banks (SEACEN) Research and Training Centre. The Bank is a member organisation of the Committee for Economic Development of Australia (CEDA) …

But it says 'sponsorship to the Centre for Independent Studies and the Sydney Institute'. That would suggest that it's something different to corporate membership.

Mr Lowe: I can't think of what the difference is. If it's okay, I'll have to come back to you in writing about the exact nature of it because I'm just not enough on top of the details of what the exact form of the contractual relationship is. From where I sit, it's the same treatment across all these entities, even if the words are slightly different, but I'll confirm that in writing or, if that's wrong, let you know.

Ms MURPHY: I'm also interested in why it's the Centre for Independent Studies and the Sydney Institute that receive whatever small or otherwise amount of financial support there is from the RBA and not, for example, the Grattan Institute, the Australia Institute or Per Capita, which are also think tanks and aren't, it would appear from this report, receiving the same sponsorship as the two institutes, which are, one would say, more conservative and lean towards right-wing thinking, that have been named in the report.

Mr Lowe: If it's okay, I'll have to come back in writing with more details about the overall approach here because I'm not close enough to the details. From where I sit in the discussions we have internally about the approach, we say we want to support think tanks right across the intellectual spread. I go and speak to various groups from the Left and the Right, if I'm allowed to use those words, and I try to be incredibly even-handed. I say that to my staff as well on the approach with these various entities.

Ms MURPHY: I appreciate that, Governor, and you would appreciate that is why that jumped out at me. They are the only two named as sponsors, which somewhat cuts across what I appreciate is absolutely the correct approach.

Mr Lowe: And you deserve a more full response and I will provide that in writing.

Answer

The Reserve Bank has a longstanding practice of providing financial support for research, policy analysis and education in the areas of the Bank's responsibilities, which contributes to economic and financial understanding in Australia more broadly. The Bank regularly receives requests from universities, research centres and independent not-for-profit institutions for the Bank to provide financial support for conferences, events, scholarships, surveys or research. In determining whether to provide the requested support, the Bank assesses whether the proposed activities help to further the Bank's mandate, which includes promoting the economic prosperity and welfare of the people of Australia. In addition to financial support, the Bank has engagement with a wide range of think tanks and policy institutes as it seeks to understand the factors affecting the Australian and global economies. This engagement ranges from attendance at functions to discussions on particular issues.

The total value of financial support provided for research and education in 2019/20 was $362,535.

The contributions to the Centre for Independent Studies and the Sydney Institute began in the early 2000s. At the time, there were not many think tanks in Australia and the Bank wanted to support independent not-for-profit institutions that were contributing to public policy debates that were relevant to our mandate. The annual contribution has been maintained at $20,000 since 2006. This amount is consistent with the typical cost of corporate membership: the Bank is a government member of the Lowy Institute (annual membership fee: $44,000); a member of the Ethics Centre's Ethics Alliance (annual membership fee: $16,500); a member of the Committee for Economic Development of Australia (CEDA; annual membership fee: $21,015); and an associate member of the South East Asian Central Banks Research and Training Centre (SEACEN; annual membership fee: US$5,000). The Bank receives reports published by these institutions, along with invitations to events. The Bank does not provide financial support to entities that have connections with political parties and seeks to be even handed with the purpose of supporting policy analysis from varying perspectives on issues important to Australia.

In 2019/20, the Bank provided $55,000 in financial support for research on population ageing being conducted by the Australian Research Council Centre of Excellence in Population Ageing Research (CEPAR), based at the University of New South Wales. The Reserve Bank contributed $99,000 towards the cost of a monthly survey of inflation expectations undertaken by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne. The Bank also contributed $5,280 to a quarterly survey of union inflation and wage expectations undertaken by the Australian Council of Trade Unions.

The Bank also supports universities and not-for-profit institutions by providing speakers for conferences and events relevant to the Bank's responsibilities. For instance, during 2019 and 2020, senior Bank officers – in several instances, the Governor – spoke at conferences and events hosted by the Anika Foundation, the Australian National University, the Australian Council of Social Service (ACOSS), CEDA, the Centre for Policy Development, the Economic Society of Australia, Griffith University, The McKell Institute, the University of Melbourne, the University of New South Wales and the University of Western Australia.

The Bank did not receive any requests for corporate membership or other support from the Grattan Institute, the Australia Institute or Per Capita during 2019/20.