The Parliament of the Commonwealth of Australia

# Review of the Reserve Bank of Australia Annual Report 2006 (First Report)

House of Representatives
Standing Committee on Economics, Finance and Public Administration

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Canberra

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# Chairman's foreword

Strong global commodity prices continue to fuel Australia's sustained period of economic growth. In these expansionary conditions, the role of the RBA is crucial in ensuring that inflation is controlled and monetary policy facilitates the stability of the Australian currency and the maintenance of full employment.

It is widely recognised that Australia is experiencing capacity constraints – shortages of capital and labour – as a result of its strong and extended period of economic growth. The unemployment rate remains very low by historical standards, and the effects of this are further heightened by record high labour participation rates.

Job vacancies continue to increase, and strong demand for labour is confirmed by a range of business surveys and liaison reports. A high level of business investment, however, is expected to bring about expansions in capacity, particularly in the resources sector.

Favourable conditions in global commodities markets have created an expansionary environment in Western Australia, however Mr Stevens highlighted the spread of these effects throughout the country. Resources have been shifting to areas where they are most needed, and employment growth is strong in all states.

In mid 2006, the economy experienced a mild pick-up in inflation as a result of solid economic growth and the associated capacity constraints. The RBA Governor reported that he was 'considerably more comfortable' with inflation expectations now than in August or November 2006 although the inflation challenge is far from over and vigilance will be required over the short to medium term.

I would also like to take this opportunity to commend Mr Glenn Stevens on his first appearance as the new Governor of the RBA and look forward to meeting with him  and other RBA representatives at the next public hearing on 17 August 2007 at the Gold Coast Convention and Exhibition Centre, Broadbeach.

The Hon Bruce Baird MP
Chair

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# Membership of the Committee

| | | |
|---|---|---|
| Chair | The Hon Bruce Baird MP | |
| Deputy Chair | Ms Sharon Bird (from 1 March 2007) | |
| | Dr Craig Emerson MP (to 1 March 2007) | |
| Members | Mr Steven Ciobo MP | Mr Stewart McArthur MP |
| | Mr Joel Fitzgibbon MP (to 7 February 2007) | Mr Patrick Secker MP |
| | Ms Sharon Grierson MP | The Hon Alex Somlyay MP |
| | Mr Michael Keenan MP | Mr Lindsay Tanner MP |

# Committee Secretariat

| | |
|---|---|
| Secretary | Mr Stephen Boyd |
| Research staff | Ms Sharon Bryant |
| | Mr Andrew McGowan |
| | Ms Amelia Johnston |
| Administrative Officer | Ms Natasha Petrovic |

# Terms of reference

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

# List of abbreviations

| | |
|---|---|
| CAD | Current Account Deficit |
| CPI | Consumer Price Index |
| GDP | Gross Domestic Product |
| GST | Goods and Services Tax |
| OPEC | Organisation of Petroleum Exporting Countries |
| RBA | Reserve Bank of Australia |

# 1

# Introduction

## Background

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

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

> The Governor has also indicated that he plans to continue to be available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics, Finance and Public Administration. The Treasurer expresses continuing support for these arrangements, which ensure the continued transparency and accountability of the Reserve Bank's conduct of monetary policy—and therefore the credibility of policy itself.[1]

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1 RBA, *Third Statement on the Conduct of Monetary Policy*, September 2006.

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

1.4 The biannual hearings coincide with the release of one of the RBA's quarterly *Statements on Monetary Policy*. At the February 2007 hearing in Perth, the committee scrutinised the RBA's *Statement on Monetary Policy* released on 12 February 2007.

## Scope and conduct of the review

1.5 The fifth public hearing of the committee with the RBA during the 41st parliament was held in Perth on 21 February 2007.

1.6 The proceedings of the Perth hearing were audio streamed over the internet through the Parliament's website, allowing interested parties to hear the proceedings as they occurred. The Governor's opening statement was taken as a submission and the transcript of the hearing is available on the committee's website.[2]

1.7 Before the hearing, the committee received a private briefing from Mr Richard Gibbs, Global Head of Economics, Macquarie Bank. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Gibbs' cooperation and assistance.

1.8 The committee also appreciates the provision of additional briefing material from Mr Richard Webb of the Parliamentary Library Research Service.

1.9 The Perth hearing was well attended by members of the public and staff and students from Carmel School and St Mary's Anglican Girls' School.

1.10 The public hearings with the RBA continue to bring issues of monetary policy into the public arena, and also have assisted in providing a public face to parliamentary committees and the RBA. The committee welcomes the Governor's frank and open comments at the hearings. In addition, the hearings are an important means whereby financial markets can be better informed on the current thinking of the RBA.

1.11 The report focuses on matters raised at the public hearing, and also draws on issues raised in the RBA's *Statement on Monetary Policy*. The *Statement*

2 See: <http://www.aph.gov.au/house/committee/efpa/index.htm>

*on Monetary Policy* may be viewed through the RBA's website[3], and the transcript of the hearing is available from the committee's website[4].

## Next public hearing with the RBA

1.12 The committee will conduct the next public hearing with the RBA on Friday, 17 August 2007 at the Gold Coast Convention and Exhibition Centre, Broadbeach, QLD. More details will be circulated in the weeks leading up to the hearing.

3 See: <http://www.rba.gov.au>

4 See: < http://www.aph.gov.au/house/committee/efpa/index.htm>

# 2

## Monetary policy and other issues

### Overview

2.1 Strong global commodity prices continue to fuel Australia's sustained period of economic growth. In these expansionary conditions, the role of the RBA is crucial in ensuring that inflation is controlled and monetary policy facilitates the stability of the Australian currency and the maintenance of full employment.

2.2 It is widely recognised that Australia is experiencing capacity constraints – shortages of capital and labour – as a result of its strong and extended period of economic growth. The unemployment rate remains very low by historical standards, and the effects of this are further heightened by record high labour participation rates. At the February 2007 hearing, the RBA Governor, Mr Glenn Stevens, took care to point out that full employment is a goal of monetary policy and as such, should be welcomed.[1]

2.3 Job vacancies continue to increase, and strong demand for labour is confirmed by a range of business surveys and liaison reports. A high level of business investment, however, is expected to bring about expansions in capacity, particularly in the resources sector.[2]

2.4 In the present environment of full capacity utilisation, the moderating growth and domestic demand that has been seen in recent quarters is

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1 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 2.

2 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 4.

considered a positive development. Mr Stevens emphasised that growth in aggregate demand needs to slow down to be more aligned with the rate of growth of the economy's productive capacity.[3]

2.5 Favourable conditions in global commodities markets have created an expansionary environment in Western Australia, however Mr Stevens highlighted the spread of these effects throughout the country.[4] Resources have been shifting to areas where they are most needed, and employment growth is strong in all states.

2.6 In mid 2006, the economy experienced a mild pick-up in inflation as a result of solid economic growth and the associated capacity constraints. This had been anticipated by the RBA with adjustments to interest rates in May and August. The Bank made a further adjustment in November 2006, taking the cash rate to 6.25 per cent.

## Forecasts for 2006/07

2.7 The RBA reported that the world economy is expected to continue growing strongly with 'most observers expecting world growth in 2007 to be a little below last year's pace, but still above trend.'[5] This solid global growth is expected to support an increase in Australian exports over the coming period, 'although in the near term higher resource exports will be offset by a decline in the volume of rural exports.'[6]

2.8 The RBA predicted that while farm GDP could reduce overall GDP growth by around half a percentage point in the coming year, conditions are expected to remain solid in the rest of the economy. The Australian economy has experienced an easing of its previous high rates of growth in business investment, but the RBA reported that the level of investment remains high and should continue to add to the nation's capital stock.[7] Household consumption and housing construction activity are both expected to exhibit growth, supported by firm underlying housing demand.[8]

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3 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 3.

4 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 22.

5 RBA, *Statement on Monetary Policy,* February 2007, p. 1.

6 RBA, *Statement on Monetary Policy,* February 2007, p. 27.

7 RBA, *Statement on Monetary Policy,* February 2007, p. 2.

8 RBA, *Statement on Monetary Policy,* February 2007, p. 27.

2.9 During the February 2007 hearing, Mr Stevens suggested that the RBA was 'considerably more comfortable'[9] with inflation expectations now than it was in August or November 2006. The RBA reported that a range of measures suggest that underlying inflation was around 3 per cent over 2006.[10] The Bank forecast underlying inflation to fall to 2¾ per cent in 2007 and 2008.[11] At the February hearing, Mr Stevens also discussed the RBA's forecast of headline inflation:

> We will see some very big movements in CPI inflation over the coming year. It will fall quickly over the next six to nine months, from over three per cent currently to less than two per cent on an annual basis, as falling petrol and banana prices have their effect. They are, of course, temporary impacts on the annual inflation rate and, as they fade, the CPI headline inflation rate, measured on an annual basis, will go back up again to, we think, around 2 ¾ per cent by this time next year and remain at around that rate after that – that is, it will be lower than the rates we have seen in the past year or so but closer to the top, rather than the bottom, of the two to three per cent target range.[12]

2.10 The RBA cautioned that 'many of the factors that have pushed up underlying inflation over the past few years persist.'[13] During the February hearing, Mr Stevens elaborated on these risks:

> Most of the indicators we have available still suggest a very fully employed economy, so there would be some risk of inflation remaining uncomfortably high were demand growth to be unexpectedly strong in the near term. The outlook for demand and the extent to which capacity constraints are being eased in a range of sectors will be key elements in forming a judgement about the inflation outlook and the appropriate stance of policy.[14]

2.11 The Governor was also asked whether interest rates were more likely to rise or fall. He responded:

> If you think the [underlying inflation] forecast is in the top part of the range and the distribution of possible surprises is symmetric – and that is what we would say at the moment – then the likelihood that you get some surprising set of events that takes us above the

9 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 7.
10 RBA, *Statement on Monetary Policy,* February 2007, p. 51.
11 RBA, *Statement on Monetary Policy,* February 2007, p. 55.
12 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 5.
13 RBA, *Statement on Monetary Policy,* February 2007, p. 55.
14 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 5.

> target is higher than the likelihood that you would get a set of events that takes us below. It follows more or less axiomatically from that that, as a statement of probability, a rise is more likely than a fall.[15]

## Inflation targeting and monetary policy

2.12 The *Third Statement on the Conduct of Monetary Policy*, agreed on 18 September 2006 between the Treasurer and the new Governor of the Reserve Bank, Mr Glenn Stevens, outlines the objective of monetary policy and provides an inflation target.

2.13 The goals of monetary policy as set out in the *Reserve Bank Act 1959* require the Reserve Bank Board to conduct monetary policy in a way that, in the Board's opinion, will best contribute to:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia. [16]

2.14 The Third Statement on the Conduct of Monetary Policy also states that

> In pursuing the goal of medium term price stability, both the Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 percent, on average, over the cycle. This formulation allows for the natural short run variation in inflation over the cycle while preserving a clearly identifiable benchmark performance over time.[17]

2.15 The statement also outlined the new Governor's intention to continue to report to the House of Representatives Standing Committee on Economics, Finance and Public Administration twice a year.

### The "neutral level" of interest rates?

2.16 During the August 2006 public hearing, the former governor, Mr Macfarlane, was asked whether the prevailing interest rate was 'neutral'. Interest rates are generally referred to as 'neutral' if they are not

15 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 6.

16 RBA, *Third Statement on the Conduct of Monetary Policy,* September 2006.

17 RBA, *Third Statement on the Conduct of Monetary Policy,* September 2006.

having an expansionary or contractionary effect on the economy. Mr Macfarlane responded:

> The best I can come up with is that there is a band called 'neutral' and we are probably near the top of the neutral band, but you could not really make a case that they are restrictive or contractionary yet. I think when I was first asked this question I said that the real interest rate that had prevailed over the low-inflation period was about three per cent. If we were at 2½ percent inflation, which is the average that you would hope that in the very long run you would come out at, that would give you a neutral rate of about 5½, plus or minus half a per cent for rounding error. So 5½ to six would be the neutral rate. We have an underlying inflation rate now of about three. Three plus three is six. We are either at neutral or at the top end of the neutral band.[18]

2.17 Since Mr Macfarlane appeared before the committee in August 2006, the Reserve Bank Board has increased the cash rate once, by 25 basis points, on 8 November 2006, to 6.25%. The RBA has reported that underlying inflation rate is currently 'around 3 percent'.[19]

2.18 At the February 2007 hearing, Mr Stevens indicated that current interest rates are 'mildly on the restrictive side of neutral'.[20]

## Monetary policy in an election year

2.19 During the hearing, Mr Stevens was asked whether the Reserve Bank would be sensitive to the fact that 2007 is an election year when considering possible adjustments in monetary policy. Mr Stevens stated:

> There seems to be a view abroad that there is some almost unspoken tradition that we do not adjust rates in an election year. I have seen a number of references to my predecessor supposedly having said that. I do not recall that he did say that. What I can recall is that he said we would not be all that keen to be changing them in the election campaign. I know that the political process often talks about being in permanent campaign mode, but what I think he meant by that was the formal campaign in the month prior. He also said that if it had to be done it would be. So I do not accept, and I do not think we ever could accept, the idea that in an election year – which, after all, is one year out of three – you

18 Mr I Macfarlane, Governor of the RBA, *Transcript,* 18 August 2007, p. 31

19 RBA, *Statement on Monetary Policy,* 12 February 2007, p. 55.

20 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 24.

> cannot change interest rates. When you think about that, I do not think any central bank could accept the notion that somehow a rate change is off limits for one year out of three. That would be crazy. So the answer to the question is: if in August it needs to be done it will be done.[21]

## Exchange rates and external trade

2.20 Australia's terms of trade, defined as the ratio of our export to import prices, continued to rise solidly through 2006 due to the strength of commodity prices, which drove export prices up by seven per cent in that year.[22] This rise brings the increase over the last three years to 30 per cent, and the terms of trade are now estimated to be at their highest level since the 1950s. However, the RBA noted an easing in the growth of commodity prices in recent months, resulting from expansions in supply and a possible slowing of growth in demand.[23]

2.21 At the February 2007 hearing, Mr Stevens indicated that 'our judgement remains that Australia's terms of trade will be higher on average over the years ahead than they tended to be through the 1980s and 1990s'.[24] Mr Stevens added:

> For macroeconomic policy, it is a matter of ensuring that the economy adjusts to the change as smoothly as possible. That task is considerably easier today than it once would have been. A more flexible economic structure, a floating exchange rate and a better macroeconomic policy framework mean that the adjustment is proceeding much more smoothly than it did on some other occasions in history when the terms of trade rose steeply. As a result, such adjustments to monetary policy as have been needed have been gradual.[25]

2.22 Export values have exhibited strong increases, predominately driven by growth in prices, accompanied by only modest increases in volumes. However, 'growth in the volume of overall resource exports is expected to pick up solidly over the coming year, supported by the completion of a

21 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 10.
22 RBA, *Statement on Monetary Policy,* February 2007, p. 13.
23 RBA, *Statement on Monetary Policy,* February 2007, p. 11.
24 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 4.
25 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 2.

number of additional projects and a further easing in infrastructure bottlenecks, especially in the case of coal'.[26]

2.23 The RBA reported that the domestic demand that has outstripped output 'for some time' has been largely met by imports.[27] The volume of imports increased sharply in the December quarter, bringing growth to around 10 per cent over the year.[28]

2.24 The Bank noted that oil prices have fallen by around 25 per cent since their peaks in July 2006. This decrease 'appeared to reflect a combination of increasing supply from non-OPEC countries, some softening in growth of demand, and some easing in speculative pressures.'[29]

2.25 The RBA reported that the Australian dollar, supported by increasing terms of trade, appreciated by around four per cent on a trade-weighted basis in 2006.[30] While volatility of the currency has intensified in recent months, it has remained low by historical standards.[31]

## United States, China and the global economy

2.26 The world economy continues to grow strongly. The RBA reported that 'the US economy has remained robust… [and] information on other parts of the world remains consistent with expectations of strong aggregate growth.'[32]

2.27 The RBA commented that 'consensus forecasts are for above-trend global growth of 4.7 per cent in 2007, down from 5.4 per cent in 2006, reflecting moderating in growth in most of the major regions.'[33]

2.28 The US economy remained healthy throughout 2005, despite concerns about a weak housing construction sector potentially bringing about a slowdown in economic activity. Mr Stevens stated:

> To date, at least, that risk does not seem to have materialised.
> Housing is quite weak there, but overall the US economy seems to

26 RBA, *Statement on Monetary Policy,* February 2007, p. 34.
27 RBA, *Statement on Monetary Policy,* February 2007, p. 2.
28 RBA, *Statement on Monetary Policy,* February 2007, p. 35.
29 RBA, *Statement on Monetary Policy*, February 2007, p. 12.
30 RBA, *Statement on Monetary Policy*, February 2007, p. 23.
31 RBA, *Statement on Monetary Policy*, February 2007, p. 24.
32 RBA, *Statement on Monetary Policy*, February 2007, p. 1.
33 RBA, *Statement on Monetary Policy,* February 2007, p. 5.

> have been recording growth pretty close to trend, even with that housing sector being weak.[34]

2.29 Inflation in the US has fallen since the middle of 2006 and the RBA reports that 'the Federal Reserve expects inflation to continue to ease as a result of lower energy prices and moderating domestic demand growth, although upside risks remain, especially from the tight labour market.'[35] US unemployment remains low at 4.6% in January 2007.

2.30 GDP in China continued to increase at around 10 per cent over 2006, for the fourth year in a row. The RBA reports that this growth 'has been concentrated in the business sector as rapid investment drives the development of the economy and the expansion of manufacturing capacity, and thereby exports.'[36]

2.31 During the February 2007 hearing, Mr Stevens discussed recent efforts in China to shift the emphasis from high levels of investment that it 'probably cannot sustain'[37]. Mr Stevens added

> There is always the risk, of course, that they somehow overdo it and the economy goes into a big slowdown. If that occurred, we would certainly notice that here, and so would the rest of the world. I think, for the past 10 years anyway, the authorities up there have done remarkably well managing things, given the rudimentary tools at their disposal. Even if China does have a big slump it will get up and run again pretty quickly because it is just that part of history where they are going to grow to be a very big economy. There will no doubt be a few trips along the way but they will get up and run again.[38]

2.32 GDP in the rest of east Asia continued to grow at a healthy pace in 2006, increasing by 5.3 per cent in the region.

## Housing and household debt

2.33 Amidst rising employment and increasing real wages, consumer spending strengthened slightly in the December quarter.[39] The RBA reported that

34 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 3.

35 RBA, *Statement on Monetary Policy,* February 2007, p. 7.

36 RBA, *Statement on Monetary Policy,* February 2007, p. 9.

37 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 31.

38 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 31.

39 RBA, *Statement on Monetary Policy,* February 2007, p. 2.

real retail sales increased sharply in the December quarter, and consumer sentiment was above long-run average levels.[40]

2.34 The RBA noted that dwelling commencements and investment increased over the September quarter although preliminary data for the following quarter suggest some slowing in activity in response to the 2006 increases in interest rates.[41] Mr Stevens outlined the RBA's expectation of a 'gradual expansion in residential construction activity'[42] in the coming year.

2.35 At the February 2007 hearing, concerns were raised as to whether the existing level of household debt posed a significant risk to the economy in the event of a downturn. Mr Stevens explained that greater household leverage would exacerbate the effects of an adverse shock to income levels. However, Mr Stevens stated that 'there is not a great deal we can do about that, other than point out the issue and try to keep people aware of it when they make their decisions.'[43]

2.36 Mr Stevens was later asked about the potential risk of the range of financial products available to households allowing greater leverage. The Governor responded:

> To some extent, I do not think there is a lot wrong with the idea that someone who is asset rich and income poor in the later stages of their life ought to be able to access some of the equity. The question is really to do with at what price they do that and whether they are fully cognisant of the risks that they run. That really is the main question in many financial issues. [44]

2.37 At the February 2007 hearing, the RBA commented on the issue of apparently low levels of household saving. While national accounts figures indicate very low levels of household savings, the RBA suggested that this is a misleading measurement:

> Australian and US households hold a huge proportion of their wealth in financial assets where the return is coming from capital gains. Basically, they hold their financial assets in the form of equity, and the national accounts deliberately do not pick up capital gains on equities as part of the return… Australian households are actually in very good financial condition. It is just

40 RBA, *Statement on Monetary Policy,* February 2007, p. 28.
41 RBA, *Statement on Monetary Policy,* February 2007, p. 29.
42 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 4.
43 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 29.
44 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 35.

> that the traditional measures that are used to measure saving do not really apply to countries like Australia and the United States.[45]

## Housing affordability

2.38 House prices rose by six per cent over the year to December across the nation, although there were significant differences between the states. The RBA reports that average capital city house prices have grown by around 175 per cent since the mid 1990s.[46]

2.39 At the August 2006 hearing, the then governor, Mr Macfarlane suggested that the public debate about housing affordability had placed too much emphasis on interest rate rises rather than the increasing cost of housing.[47]

2.40 At the February 2007 hearing, Mr Stevens was also asked about housing affordability, and he responded with a similar message:

> People worry greatly about affordability for those people and whether interest rates rises might make that affordability more difficult. But the real problem for those people is not that the rate of interest is high. We could argue about 25 or 50 points here or there but, by and large, interest rates today by historical standards, for those of us who remember earlier times, are low. The real problem is that house values are so high. Frankly, if one is really concerned about aspiring entrants to the home market, what you really want is lower prices.[48]

2.41 While the Governor emphasised that high house prices had a much greater effect on housing affordability than interest rates, he added that the effects are not independent. It was noted that the increase in house prices in the late 1990s was partially attributable to very low interest rates.[49]

2.42 With respect to the prospect of further increases in house prices, Mr Stevens reported that 'the evidence seems to be that the rate of growth of house prices has begun to slow down'.[50]

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45 Mr R Battellino, Deputy Governor of the RBA, *Transcript,* 21 February 2007, p. 29.

46 RBA, *Statement on Monetary Policy,* February 2007, p. 30.

47 Mr I Macfarlane, Governor of the RBA, *Transcript,* 18 August 2006, pp. 23-24.

48 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 25.

49 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 26.

50 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 8.

## Rental market

2.43 The RBA reported continuing tightening in residential rental markets, resulting in the lowest national vacancy rate since the early 1980s. Information on new rental contracts further suggest significant rent increases, which are yet to be reflected in the ABS measures.[51]

2.44 At the February 2007 hearing, Mr Stevens suggested that low vacancy rates have come about because rental prices have not kept pace with house prices. This has resulted in an approximate doubling in price-rent ratios or a halving in rental yields, making it less attractive for investors to supply rental property, resulting in a shortage of supply. Mr Stevens stated that:

> In the period when the investor was getting a return from price appreciation he was getting some of the return that way, although rental yield did not seem to matter so much. But it is hardly sustainable for a major asset market to continually give you most of your return through capital appreciation. That does not sound to me like a sustainable equilibrium. Ultimately, the running yield, the rental yield, has to be higher than it has been. That is what is starting to happen. In time, as the rental yield improves, I expect there will be more interest on the part of potential investors to supply rental accommodation, so the market will work. But at the moment, you have a tight supply situation because the rental yield is very low—historically quite low.
>
> One way or another it is going to need to rise. That could happen by the rentals going up; it could happen by the prices coming down… So one way or another that higher rental yield will need to be re-established and that will alleviate this excess demand situation.[52]

# Growth and productivity

2.45 The RBA reported that the non-farm economy continues to expand at a moderate pace, although the effect of the drought on the farm sector has slowed growth of the economy as a whole.[53]

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51 RBA, *Statement on Monetary Policy*, February 2007, p. 31.

52 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, pp. 8-9.

53 RBA, *Statement on Monetary Policy*, February 2007, p. 27.

2.46 After a protracted period of growth, the economy is experiencing capacity constraints. At the February hearing, Mr Stevens was confident that the economy was adjusting well – with a flexible economic structure, a floating exchange rate and a better macroeconomic policy framework allowing a smooth transition as labour and capital resources shift to where they are most needed.[54]

2.47 During the hearing, the Governor was also asked about the apparent slowdown in productivity. He agreed that, according to the latest figures at the time of the hearing, employment growth was growing faster than GDP growth. Mr Stevens continued:

> Of course, over short periods, productivity is not an easy thing to measure, and that short-run relationship can have a lot of slack. So I would be wary of drawing strong conclusions based on that snapshot. Having said that, there are quite careful measures of productivity which can be made over longer periods, and they certainly do, on the face of it, suggest a slowdown.[55]

2.48 Mr Stevens added 'we cannot know whether this trend of a couple of years is now going to be a permanent state of affairs or not.'[56] Since the hearing, the RBA has stated that:

> [The March National Accounts] go some way towards resolving the apparent conflict between earlier soft GDP outcomes and the increase in employment growth in the second half of the year. A corollary of that is that the figures show a pick-up in estimated productivity growth. The Statistician's measure of market-sector GDP per hour worked rose by 1½ per cent over the latest year. This is reasonably close to its longer-run average, though it is still the case that average productivity growth over the past two to three years has been lower than it was earlier in the current expansion.[57]

## "Two speed" economy

2.49 During the hearing, Mr Stevens was asked about the "two speed" domestic economy. He agreed that the impact of the relative change in the price of resources was not uniform across the economy. Western Australia

54 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 2.

55 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 16.

56 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 32.

57 Mr M Edey, Assistant Governor of the RBA, Address to the Australia and Japan Economic Outlook Conference 2007, 16 March 2007.

and Queensland are benefiting more than the Southeastern states – a trend that is exacerbated by the effect on local producers of the relative decline in prices for some manufactured products.[58]

2.50 At the August 2006 hearing, the former RBA governor, Mr Macfarlane, suggested that unemployment rates are the best test of dispersion, given that growth rates do not take into account different rates of population growth.[59] At the February 2007 hearing, Mr Stevens made the point that, although New South Wales is growing below average, its unemployment rate has fallen, suggesting that 'the differences across the states, while noticeable, are perhaps not quite as big as popular opinion and commentary like to say.'[60]

2.51 Mr Stevens suggested that some level of regional difference is inevitable, and that the economy is well-equipped to handle these changes. He stated:

> This adjustment is proceeding considerably better than it might once have done. Labour and capital resources are shifting to the strong parts of the economy where they are needed. Relative wages in those industries are rising relative to others, and that helps the labour resources flow. That is what is supposed to happen in a shock of this nature. While it is not without a few bumps on the road, this adjustment is not proceeding too badly. [61]

## Supply side (capacity) constraints

2.52 The RBA reported that businesses have been expressing difficulty in finding qualified staff for some time and maintain that 'the factor most constraining further expansion is not insufficient demand but insufficient capacity, either of labour or capital or both'.[62]

2.53 Mr Stevens noted at the February public hearing that the economy has 'approached what for practical purposes can be called full capacity, at least for the moment'.[63] However, business investment remains at a high

58 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 2.
59 Mr I Macfarlane, Governor of the RBA, *Transcript*, 18 August 2006, pp. 6-7.
60 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 8.
61 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, pp. 13-14.
62 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 2.
63 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 2.

level, 'adding to the capital stock of the country in a way which should, in time, ease capacity constraints'.[64]

## Wages growth and a deregulated labour market

2.54 The RBA reported that the underlying annual growth in wages remains 'quite well contained'[65] at around 4 per cent.[66]

2.55 At the February 2007 public hearing, Mr Stevens discussed explanations as to why wages have not experienced an explosion, despite record high participation levels and labour shortages across a number of important sectors.

> I think there are probably a few things at work. As I alluded to before, the fact that the system is less centralised means that industry or regional pressures do not flow over 100 per cent to other areas. A more enterprise focused set of labour market arrangements is also conducive to better outcomes. I think also that much better anchored expectations of inflation on the part of wage earners are also helpful in these episodes. If you think back to the mid-1970s, there was a very high rate of background inflation that was tending to give impetus to wage claims in a way that does not happen any more because inflation is so much better controlled now. It is our job, of course, to make sure that that continues to be the case. So there are a whole range of things at work to produce what to date has been a pretty good outcome.[67]

2.56 During the February hearing, the Governor was asked about the potential impacts of a tightening of the labour market. He responded that rigid labour markets are prone to large wage increases unconnected to productivity. This 'probably would constitute something of a problem for managing resource booms like we presently have.'[68] However, Mr Stevens went on to say:

> I am not sure whether you are suggesting that someone is proposing that outcome but, in that hypothetical case, I think that could be a problem. I am not sure that we will see that hypothetical outcome.[69]

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64 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 2.

65 Mr G Stevens, Governor of the RBA, *Transcript,* 21 February 2007, p. 13.

66 RBA, *Statement on Monetary Policy*, February 2007, p. 53.

67 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 13.

68 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 33.

69 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 33.

### "Full employment"

2.57 During the February 2007 public hearing, the Governor was asked about tackling the issue of a shortage of labour. Mr Stevens stated:

> Labour is a resource for the economy, and if you have not got enough of it, that does constrain your growth. If we are all working, that is it, there is no more additional supply of labour and presumably that does constrain the economy's growth rate from that point. But the question is: how big a problem is that? Everyone who wants a job can find one, that is what we want the labour market and the economy to do for us. The problem of full employment, as I said before, is a problem you would rather have—if 'problem' is the right word—than the alternative where there are a lot more workers than there are jobs for them to do. [70]

2.58 However, Mr Stevens also warned that aggregate demand must slow down when full employment has been achieved, or the economy faces the risks of 'overheating, inflation and eventually another downturn'. The RBA predicted that 'the more moderate pace of growth in the economy that we see today compared to a few years ago will be helping not to put further pressure on capacity'[71].

## Drought and the farming sector

2.59 At the February 2007 public hearing, Mr Stevens reported that rural production and incomes will be considerably reduced in 2007 due to the drought.[72] The RBA reported that while non-farm GDP increased by 0.6 per cent in the September quarter of 2006, farm GDP was estimated to have fallen by 10 per cent in the quarter.[73]

2.60 The RBA estimated that the drought will not have a large impact on the CPI or interest rates, as effects are temporary.[74] However, it is anticipated that farm GDP could fall by around 20 per cent in 2006/07, reducing GDP growth by 0.5 per cent.[75]

70 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 34.

71 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 26.

72 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 3.

73 RBA, *Statement on Monetary Policy,* February 2007, p. 27.

74 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 21.

75 RBA, *Statement on Monetary Policy,* February 2007, p. 27.

**The Hon Bruce Baird, MP**
**Chair**
**29 March 2007**

A

# Appendix A — Submission

| Number | Provided by |
| --- | --- |
| 1 | Reserve Bank of Australia<br>(*Opening Statement to House of Representatives Standing Committee on Economics, Finance and Public Administration, public hearing Perth, 21 February 2007)* |

B

# Appendix B — Hearing, briefings, and witnesses

## Public hearing

### Wednesday, 21 February 2007 – Perth

*Reserve Bank of Australia*

Mr Glenn Stevens, Governor
Mr Ric Battellino, Deputy Governor
Dr Malcolm Edey, Assistant Governor (Economics)
Dr Philip Lowe, Assistant Governor (Financial System)

## Private briefing

### Thursday, 15 February 2007– Canberra

Mr Richard Gibbs, Global Head of Economics, Macquarie Bank

C

# Appendix C — *Third statement on the conduct of monetary policy*

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

**18 September 2006**

This statement records the common understanding of the Governor, as Chairman of the Reserve Bank Board and the Government on key aspects of Australia's monetary policy framework. It builds on the 1996 and 2003 Statements between the Treasurer and the former Governor on the respective roles and responsibilities in the operation of monetary policy in Australia.

Monetary policy is a key element of macroeconomic policy and its effective conduct is critical to Australia's economic performance and prospects. For this reason, and given the appointment of a new Governor of the Reserve Bank, it is appropriate and timely for the Governor and the Treasurer on behalf of the Government to affirm their mutual understanding of the operation of monetary policy in Australia.

This statement should continue to foster a clear understanding, both in Australia and overseas, of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Bank.

**Relationship Between the Reserve Bank and the Government**

The *Reserve Bank Act 1959* (the Act) gives the Reserve Bank Board the power to determine the Bank's monetary policy and take the necessary action to implement policy changes. The Act nominates the Governor as Chairman of the Board.

The Government recognises the independence of the Bank and its responsibility for monetary policy matters and respects the Bank's independence as provided by statute.

Section 11 of the Act prescribes procedures for the resolution of policy differences between the Reserve Bank Board and the Government. The procedures, in effect, allow the Government to determine policy in the event of a material difference; but the procedures are politically demanding and their nature reinforces the Bank's independence in the conduct of monetary policy. Safeguards like this ensure that monetary policy is subject to the checks and balances inherent and necessary in a democratic system.

The Act also provides that the Board shall, from time to time, inform the Government of the Bank's policy. Such arrangements are a common and valuable feature of institutional systems in other countries with independent central banks and recognise the importance of macroeconomic policy co-ordination.

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

**Objectives of Monetary Policy**

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

a. the stability of the currency of Australia;

b. the maintenance of full employment in Australia; and

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

The first two objectives lead to the third, and ultimate, objective of monetary policy and indeed economic policy as a whole. These objectives allow the Board to focus on price (currency) stability while taking account of the implications of monetary policy for activity and, therefore, employment in the short term. Price stability is a crucial precondition for sustained growth in economic activity and employment.

Both the Bank and the Government agree on the importance of low inflation and low inflation expectations. These assist businesses in making sound investment decisions, underpin the creation of new and secure jobs, protect the savings of Australians and preserve the value of the currency.

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

Since the first Statement on the Conduct of Monetary Policy in 1996 inflation has averaged around the midpoint of the inflation target band. The Governor expresses his commitment to the inflation objective, consistent with his duties under the Act. For its part the Government indicates again that it endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving such an outcome.

**Transparency and Accountability**

Monetary policy needs to be conducted in an open and forward looking way. A forward looking focus is essential as policy adjustments affect activity and inflation with a lag and because of the crucial role of inflation expectations in shaping actual inflation outcomes. In addition, with a clearly defined inflation objective, it is important that the Bank continues to report on how it sees developments in the economy, currently and in prospect, affecting expected inflation outcomes. These considerations point to the need for effective transparency and accountability arrangements.

The Reserve Bank takes a number of steps to ensure that the conduct of monetary policy is transparent. Changes in monetary policy and related reasons are clearly announced and explained. The Bank's public commentary on the economic outlook and issues bearing on monetary policy settings, through public addresses, its quarterly statements on monetary policy and monthly statistical bulletins, promote increased understanding of the conduct of monetary policy. The Bank will continue to promote public understanding in this way.

The Governor has also indicated that he plans to continue the practice of being available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics, Finance and Public Administration.

The Treasurer expresses continuing support for these arrangements, which ensure the continued transparency and accountability of the Reserve Bank's conduct of monetary policy — and therefore the credibility of policy itself.

The Government and Bank continue to recognise that outcomes, and not the arrangements underpinning them, will ultimately measure the quality of the conduct of monetary policy.

D

# Appendix D — Glossary of terms

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

***G-10.*** Group of Ten countries: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, and USA; plus Bank for International Settlements (BIS), European Commission, International Monetary Fund (IMF), and the Organisation for Economic

Co-operation and Development (OECD). It was formed in conjunction with the establishment of the General Arrangements to Borrow, under which members agreed to make resources available to the IMF.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*Source: Parliamentary Library and Reserve Bank of Australia*