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Members in attendance: Mr Evans, Ms Henderson, Ms Kearney, Mr Craig Kelly, Mr Thistlethwaite.

Terms of Reference for the Inquiry:
To inquire into and report on:
BULLOCK, Ms Michele, Assistant Governor (Financial System), Reserve Bank of Australia
DEBELLE, Dr Guy, Deputy Governor, Reserve Bank of Australia
ELLIS, Dr Luci, Assistant Governor (Economic), Reserve Bank of Australia
LOWE, Dr Philip, Governor, Reserve Bank of Australia

Committee met at 09:30

CHAIR (Ms Henderson): Good morning, everyone. I declare open this hearing of the House of Representatives Standing Committee on Economics and welcome representatives of the Reserve Bank, members of the public, and the media.

Since the previous hearing with the RBA, in February 2018, monetary policy has remained accommodative, with a cash rate of 1.50 per cent following the RBA's recent decision to leave interest rates unchanged. In leaving rates on hold, the RBA governor said:

The low level of interest rates is continuing to support the Australian economy.

He noted:

Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual.

The governor reported that 'the global economic expansion is continuing' with 'a number of advanced economies are growing at an above-trend rate' with low unemployment. The governor said that, while inflation has remained low globally, it has picked up in some countries and is expected to increase, given tight labour markets. The governor expects growth in the Australian economy to average just above three per cent in 2018 and 2019, which should further reduce spare capacity in labour markets. 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.

In its August statement on monetary policy the RBA noted softer than expected inflationary pressures in the Australian economy in the near term and said it did not expect underlying inflation to reach the middle of its two per cent to three per cent target band until the end of its forecast period in 2030. The August statement also noted:

Trade tensions between the United States and China have increased in recent months …

The RBA said that, while the protectionist 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'.

The committee will examine these issues in more detail and will ask the RBA whether it remains confident that current monetary policy settings will encourage growth and inflation consistent with the target for coming years.

Dr Lowe, would you like to make an opening statement before we proceed to questions.

Dr Lowe: Thank you very much, Chair and members of the committee. Good morning, it's a pleasure to be back in Canberra again. Thank you for the invitation to appear before this committee. These hearings are an important part of the accountability process for the Reserve Bank of Australia. As usual, my colleagues and I are here to answer your questions to the best of our ability.

Since we last met, the Australian economy has continued to move in the right direction. 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. We would, of course, like them to be better. We're still short of full employment, and we would like to be more confident that inflation will be sustained at a level consistent with the target. But if things work out as expected we are likely to make further progress on both of these fronts over the next couple of years.

Over the first part of this year the Australian economy looks to have grown quite strongly. GDP increased by one per cent in the March quarter, and a reasonable increase is expected in the June quarter. Business conditions are positive, and we're in the midst of an upswing in non-mining business investment. Increased spending on infrastructure is also helping the economy. Resource exports are also increasing strongly as the new capacity
comes onstream, particularly for LNG. One important offsetting factor at the moment though is the drought in eastern Australia. While the prices of some farm products are currently quite high, which is helping farm incomes, the dry conditions are limiting farm production.

I thought it might be useful to make some introductory remarks on four topics that the Reserve Bank Board has devoted considerable time to recently. The first of these is the global outlook; the second is household debt and the housing market; the third is wages growth; and the fourth is the outlook for inflation.

The global outlook remains positive, although a number of risks have increased recently. The advanced economies are growing faster than trend and unemployment rates are at multidecade lows in many countries. A gradual pick-up in wages growth is also taking place. As is appropriate, the considerable monetary stimulus that has been place in the United States is gradually being withdrawn. At the same time though official interest rates in the euro area, Japan, Sweden and Switzerland are all still negative—and that's almost a decade after the onset of the financial crisis. In China growth has slowed a little. The authorities though have responded to this, but they're still facing the challenge of addressing risks in the financial system.

There are a few uncertainties that I think are worth highlighting for you. One is the possibility of an escalation in global trade tensions. The measures announced so far are unlikely to derail the global expansion. Even so, in some countries businesses are now delaying investment because of increased uncertainty. It's possible that this becomes a more general story. If this were to occur, this could be the channel through which the trade tensions sap the current positive momentum in the global economy.

Another uncertainty is the possibility of a large unexpected pick-up in inflation in the United States. The US economy is experiencing a sizeable fiscal stimulus at a time of limited spare capacity, so growth there could surprise on the upside. At the same time financial markets remain relaxed about the implications of this for inflation. I'd have to say that I am less relaxed. It is highly unusual to have such a fiscal stimulus at a time when the economy is already operating at very close to full capacity. One can't rule out the possibility that the Federal Reserve will have to withdraw monetary accommodation more quickly than currently projected, with possibly disruptive consequences for financial markets globally.

A third set of global risks originates from a number of individual economies with country-specific structural and/or institutional vulnerabilities, including Argentina, Brazil, Italy and Turkey. Over the past month there have been episodes of market volatility associated with each of these countries. We are watching developments in each of them very closely, as a further escalation of problems could be the catalyst for a period of increased stress in the global financial system.

The second issue is the Australian housing market and household debt. The housing markets in Sydney and Melbourne have clearly slowed and prices are coming down. While this has understandably concerned some people, we here do need to keep things in perspective. Not so long ago there was widespread concern in the community about rapidly rising house prices, rapidly rising debt and declining housing affordability. These earlier trends were not sustainable and they were posing a medium-term risk to our economy, so a pullback is a welcome development and it can put the market on a more sustainable footing. 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. All these things are helping with the adjustment in the housing market. We are, nonetheless, continuing to keep a close eye on housing market developments right across the country.

The slowing in the housing market has reduced the demand for credit by investors. There has also been some tightening in the supply of credit, partly in response to the royal commission, although the main story is one of reduced demand for credit. 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. You would not have expected to see this if it was supply constraints that were the main reason for the slower credit growth.

A third issue that the board has focused on recently is growth in wages. As I have discussed previously, a lift in aggregate wage growth would be a welcome development from a number of perspectives. It would contribute to inflation being closer to the mid-point of the inflation target; stronger income growth would also help in the context of high levels of household debt; it would also be of benefit to government finances and, more generally, it would strengthen our sense of shared prosperity; and, to the extent that stronger wage growth is backed by stronger productivity growth, it would boost our real incomes and our real living standards.

We had another reading on the wage price index just a couple of days ago, which showed a welcome pick-up. Over the past year, the wage price index increased by 2.1 per cent, and the broader measure, which captures bonuses, increased by 2.5 per cent. Both figures are up from those a year ago.
This week, we also received employment data for the month of July, while the month-to-month employment data are volatile, the unemployment rate has now fallen to 5.3 per cent, which is the lowest it has been for quite a few years. This is good news.

Taken together, these data are consistent with our view that wage growth and inflation will pick up gradually over the next couple of years as the labour market continues to tighten. This tightening is already evident in a number of indicators: the number of job vacancies as a share of the labour market is at a record high; firms are reporting that it is harder to find workers with the necessary skills; and survey based measures of hiring tensions remain quite positive. In our liaison program, we also hear reports of larger wage increases for certain occupations where workers with the necessary skills are in short supply, and we expect that we will hear more such reports over time. Even so, the pick-up in wages growth is still expected to be fairly gradual. We still have some spare capacity in our labour market, including part-time workers who would like to work more hours. There are also structural factors at work arising from technology and from competition, and we've discussed these at previous hearings. So, it is likely to be a gradual process.

The fourth and related issue is the outlook for inflation. The CPI inflation rate at 2.1 per cent is higher than it was a couple of years ago, although it is still below the medium-term average. Strong competition in retailing from new entrants is holding down the prices of many goods and low wage increases are holding down the prices of many services. Rent inflation across the nation is also at a very low level. Working in the other direction, over the past year there have been higher prices for electricity, fuel and tobacco. We're expecting inflation to move gradually higher over the next couple of years as the economy strengthens, and we remain committed to achieving an average rate of inflation over time of between two and three per cent. In the short term, though, we're expecting the headline rate of inflation to dip a little in the September quarter. Utility prices have declined recently in some cities and policy changes are likely to reduce the measured price of child care. There have also been some policy changes at the state government level that will influence some measured prices. Collectively, these changes will help with the cost of living pressures and free up income for households to spend on other things. From this perspective, these changes are good news, too.

These are some of the main issues that the Reserve Bank board has been working through. As you are aware, the board has kept the cash rate steady at 1.5 per cent since August 2016. 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. We have not sought to fine-tune outcomes but rather to be a source of stability and confidence as the economy moves along this path.

For most of this year, I have emphasised three points in communication about monetary policy. The first is that things are moving in the right direction. We are making progress towards full employment and having inflation return to around the midpoint of the target range, and further progress is expected this year and next. The second point is that, if we continue to make progress, you could expect the next move in interest rates to be up.

With the central scenario being for the economy to continue on its recent track, it is more likely that the next move in interest rates will be an increase, not a decrease. The last increase in the cash rate was back in late 2010, so an increase, when it occurs, will represent a significant change for many people. It's important to remember, though, that higher interest rates will be accompanied by faster growth in incomes than we've have seen for quite a few years now. In this sense, it will be a sign that things are returning to normal. Of course, higher interest rates will also be welcomed by many depositors, who've been earning low rates of return on their savings over recent times.

The third point I've been emphasising is that, because the progress that is being made is gradual and is expected to remain gradual, there is not a strong case for a near-term adjustment in interest rates. The board's view is that it is likely that we will hold steady for a while yet. It is likely to be some time before we are at full employment and that the inflation rate is comfortably within the target range on a sustained basis. We are prepared to maintain the current monetary policy stance until these benchmarks are more clearly in sight. So these are our three recent messages on monetary policy.

On other matters, we are planning to release the upgraded $50 banknote in October. The new note will have the same high-tech security features as the new $5 and $10 notes. All up, there are around 700 million $50 notes on issue—that's around 28 per person—so it's a big logistical exercise. You may have read in the press that there has been an industrial dispute at Note Printing Australia, which manufactures Australia's banknotes in Craigieburn, Melbourne. I am pleased to be able to report that an in-principle agreement on a new enterprise bargaining agreement was reached earlier this week and that we have sufficient notes to launch the new $50 in October as originally planned.
Finally, at previous hearings we have spoken about Australia's New Payments Platform—the new payments system that allows Australians to easily make information-rich, real-time, 24/7 payments to each other, without having to know BSB and account numbers. Since the system was launched in February, 1.8 million Australians have registered a PayID—usually their mobile phone number—that can be used easily to address payments in the new system. The take-up of the system has, however, been less than earlier industry projections. This partly reflects the fact that a number of the major banks have been slow to make the new system available to all of their customers. They are now making it available, so we expect take-up to increase. Interestingly, many of Australia's smaller financial institutions have done a better job, with more than 50 of them ready from day one. Despite the relatively slow start, we still expect that the new system will provide the bedrock upon which further innovation in Australia's payment system will be built. The Payments System Board is keeping a close eye on access arrangements so that those with new ideas and better ways of doing things can use the new system. Thank you very much. My colleagues and I are happy to answer your questions.

CHAIR: Dr Lowe, thank you very much. Before I proceed to questions, I want to make a correction to my opening statement. I misread a year: when I referred to your August statement on monetary policy and the expectation that you would reach a two to three per cent target band until the end of its forecast period, I said 2030; I meant to say 2020, so just to correct that.

I would like to begin by asking you about the most recent unemployment rate that was announced yesterday. Of course, we now have more than one million new jobs that have been created over the last five years. The unemployment rate is down to 5.3 per cent. Why do you think that the labour market has performed so well?

Dr Lowe: Over the past year, the economy's been growing faster than trend. We've been eating into spare capacity. Growth of three per cent in the economy should see the unemployment rate come down, and that's what's happening. There are a few things that are supporting that. The global economy's actually doing quite well at the moment. Most of the major economies are growing faster than average. So the global backdrop for Australia is quite positive. Commodity prices are higher than they were a year ago, although they have fallen in the last month or so, and that's creating extra income in Australia. There's been a very strong lift in infrastructure investment, particularly in the eastern states, and we hear through our liaison program that that's having spin-off effects right through the economy, so that's a positive. The low level of interest rates is also helping. For many years during the resources boom, firms outside the resources sector weren't doing very much investment, so Australia's capital stock was depreciating. Now that the resources boom is over, there's more scope for businesses outside the resources sector to increase their capital spending, and they're doing that. Collectively, those factors are generating strong demand for labour, and we're now seeing that in the unemployment rate, which is very good news. Over the past year, employment's up nearly 2½ per cent. The labour force is probably growing at 1½ per cent, so that's seen the unemployment rate come down, and the participation rate's 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. So the labour market is good.

CHAIR: We have seen some very good indicators, and also the participation rate by women is up as well, which is a very significant factor.

Dr Lowe: Yes.

CHAIR: Can I ask you to expand on the positive sentiments that you've echoed this morning in your opening statement on wages growth? You've indicated that you're positive about wages growth heading on the right trajectory. Can you expand a bit more on that, please?

Dr Lowe: I think it's heading in the right trajectory, but only slowly. 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 to gradually 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.

CHAIR: Can you expand on the sectors of the economy where you are starting to see that tightening of the labour market. You've mentioned IT and engineering. What about construction and other sectors more generally?
Dr Lowe: Not so much across the board in construction but in specific occupations that are linked to infrastructure, in particular, where there's a shortage of people with the necessary skills. In IT security and project management skills generally, there's strong demand for people with those skills and wages are picking up. But 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. But one imagines, as the economy grows above trend, the unemployment rate comes down and more and more firms say that it's hard to find workers, we will see firms bidding workers away from other firms, offering them higher wages or trying to keep their own workers by giving them bigger pay rises. That's how things normally work, and we're starting to see some signs that that's how it's working now, but it is going to be a gradual process.

CHAIR: Female labour force participation has recently reached record highs, female wage growth has been relatively strong and the gender pay gap has reached record lows, although of course there is more work to be done. Can you make any observations about this data?

Dr Lowe: Well, they're all positive developments, aren't they—the stronger labour market and the fact that firms are advertising jobs, people are finding them and, over recent times, more than the average share has gone to women and that's leading to higher labour force participation, as you suggest. There's a longer term structural change going on. Luci, do you want to talk about that? Each cohort, year after year, there's a greater share of women who stay in the labour force, and they stay in longer.

Dr Ellis: Yes, that's right. One of the things you can do is track through the labour force participation by age and sex. For each given age group, through time, you tend to see higher participation rates through time. So 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. You notice that particularly amongst women aged over 50, who had traditionally had quite low participation rates. You're seeing that come up quite noticeably.

Overlay on top of that longer term structural change is that, typically, when there are good labour market conditions, when employment growth is above average, you do see some increase in participation for cyclical reasons. When that happens, it's most obviously shown in the increased participation rates of women in their middle years, their child-bearing years, and older workers of both sexes. Essentially what's happening is that, for the older workers, they're staying in the workforce for longer—and that's also a longer term trend; the trend towards early retirement has diminished quite considerably. The governor talked about this in a recent speech, where he talked about the better health outcomes that may be driving that. But then, for women in their middle years, it's quite normal, during good economic times, that people notice that there are jobs available, and women who are currently not in the labour force decide to re-enter at a particular time. You can imagine that many of these women would have been out of the labour force, caring for children or studying—and, although it's interesting that most of the jobs that have been created in recent times, over the last year and half, have been full-time jobs, a lot of those have been going to women.

It's not irrelevant that employment in the health and social assistance sector has been growing quite strongly. Of course, that is a sector that employs a lot of women and typically hires people from out of the labour force rather than from unemployment. The flows are more likely to come from 'not in the labour force' into employment, rather than from unemployment into employment. Basically, you decide to get a job and you find the job, and you've already found the job by the time the ABS comes back and asks you whether you were looking but hadn't found a job yet. They find them pretty quickly if that's the case. This is actually one of the developments that's telling us that there's been a cyclical strong period in the labour market, because the areas where participation has picked up most recently have been the demographic groups where participation normally picks up during cyclical upswings in the labour market. But, as I mentioned, that's all overlaid over the longer term trend of stronger participation.

CHAIR: Dr Lowe, the June quarter CPI came in at 2.1 per cent. You've made some comments today about falling electricity prices in some states, and in other states I think they've remained relatively constant. You've described these changes this morning—along with reduced costs of child care, obviously introduced because of the government's recent changes to childcare policy—as good news. Could you expand on what you mean by that?

Dr Lowe: Many households have cost-of-living pressures. We hear about this all the time, and I'm sure you do as well. Lower electricity prices, lower cost of child care and, in New South Wales, lower cost for tolls and registration are all going to help with the cost-of-living pressures that households face. In the short term, they're going to lead to lower inflation. Some people will look at that and say, 'Inflation's too low, and this is going to make it even lower.' My perspective is a bit different. If we get lower inflation because of these reasons, it isn't
because the economy's doing poorly and there's no pricing pressure; it's because of decisions that governments are making to reduce the cost-of-living pressures on households. In time, as those cost-of-living pressures come down, people will have more money to spend on other things. 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.

**CHAIR:** In the last hearing, Dr Lowe, you expressed some concerns about electricity prices. Are you comforted by the change in the trend, with the lower electricity prices that you've now seen?

**Dr Lowe:** Well, is it a change in trend?

**CHAIR:** We hope so, Dr Lowe. That's the plan.

**Dr Lowe:** The trend has been up for a long period of time and we've seen in the current quarter a decline in Brisbane, and one would hope that we’ll see further declines right across the board. It remains to be seen whether that will happen. For a number of years, rising electricity and gas prices have put upward pressure on the CPI. They've put upward pressure on people's cost of living. So it would be good if those days were behind us. I certainly hope so. It is really up to the parliament and the states to see whether that actually happens, but it will be good news if it does. It's not just the CPI; it's the cost of production for many businesses, making sure that Australian business is competitive. Having some uncertainty about the future energy market will help investment as well. A number of firms have been delaying investment over recent times because they're unsure. That's not helpful, and the general high cost of electricity has reduced the competitiveness of Australian business, which also isn't helpful. So, from the CPI prospective, it would be good. For the cost of doing business in Australia, it would be good, and creating greater certainty about the investment landscape would be good as well.

**CHAIR:** Dr Lowe, you've previously told the committee that lower corporate tax rates shouldn't come at the expense of higher budget deficits but you were comforted by the fact that the budget is on a decent track. Are you still comfortable, given that the budget is now expected to return to surplus a year earlier than was previously forecast?

**Dr Lowe:** I think it's good news that the budget is on a sustainable track. I say that from two perspectives. The first is from the insurance prospective. Australia has gone a long time without having a recession, which is very good news, but one day we will have one and it will come as a shock to many people when that happens, after we've had more than a quarter of a century without one. When that day comes, it would be useful if the government had the financial capacity to help stimulate the economy so that the job isn't just left to monetary policy. If the government is going to have that capability, it needs to run disciplined budgets in good times. So, to the extent that we'll be back to an operating balance or surplus fairly soon, I think that will help build future capacity to respond, which is very positive. We saw in the global financial crisis that the countries that did not have that capacity cut back on fiscal policy in the downturn, and that made things worse in Australia. Because we effectively paid the insurance premium over a decade, we were able to respond and that helped the economy. I'm a big believer in insurance and I want us to have that insurance again. I think we're on track to do that. The second perspective is as the father of three teenage children. I worry about intergenerational equity, whether it's right for our generation to keep on financing expenditure and services delivered by the public sector, using debt which our children will have to pay back. So, to the extent we're not doing that, I think it's a good story.

In terms of the broader issue of corporate taxes, we've discussed it at this committee before. There is a form of international tax competition going on. The US has been the leader and there were big cuts. They have unambiguously stimulated the US economy and other countries are responding as well because they see the effect that it's had. It's really up to our parliament as to whether we respond as well. But, as you said, if we are to respond, then we need to make sure that, for the reasons that I articulated, the budget stays on a reasonable track, and at the moment it looks like it is.

**CHAIR:** Dr Lowe, you made some comments about the royal commission this morning, that there has been some tightening in the supply of credit partly in response to the royal commission. Can I ask you to expand on that? And more generally, could you make some comments about the impact that the royal commission is having, particularly with respect to the banks given the role that they play in the Australian economy?

**Dr Lowe:** Like most Australians, I have been following what's been happening very carefully. 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.

We have talked at this committee before about what I see as the foundations of finance. They are really trust, delivering service and good risk management in financial institutions. I think what we have seen through the royal commission are deficiencies in all those three areas. The trust between financial institutions and the community has been strained. There has not been enough focus on customer service. It has been more of a sales mentality than a service mentality, and risk management has not been all that it should have been in financial institutions.

We have seen a couple of common themes right through the royal commission. The first is the difficulty of dealing with conflicts of interest. They seem pervasive in the financial services sector, and dealing with those conflicts has not been top of mind in many financial institutions and it should have been. I think those conflicts can be dealt with, they can be managed but they need to be top of mind. If they're not top of mind in financial institutions then it continues to strain the bonds of trust between the institutions and the public. And there is not enough attention paid to kind of customer service, doing the right thing by the customer. So dealing with the conflicts of interest, I think, is a priority.

The second common theme that I've detected through the hearings is the role that remuneration structures inside institutions play in driving behaviour. We all know this. Remuneration and incentives drive behaviour, and we have seen remuneration structures that have driven quite poor behaviour in many cases and they need to be looked as well.

**CHAIR:** Just to clarify, the government has taken quite strong action in that respect through the BEAR regime.

**Dr Lowe:** It has been recognised, and the head of APRA, Wayne Byres, talked about it. So dealing with those two sets of issues, the conflicts of interests and the remuneration structures within financial institutions seem to me to be high priorities because we need to rebuild trust and we need to have a very strong focus on delivering service rather than sales, and risk management.

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. They now have very little appetite for internal process failures for the reasons we understand so they're doubling down on their processes, which is actually a good thing. But it does mean that it is a change from the previous process. The process for approving credit is slower, and more loans are probably getting rejected than previously would have been the case.

**CHAIR:** Even still, isn't it important that it the banks don't turn their eye on to consumers, that they spend a fair bit of time looking and examining their own conduct and their own internal processes rather than just imposing all of that so-called burden on the banking consumers?

**Dr Lowe:** I agree with you. It is incredibly important that they look at the processes from top to bottom and say how those processes are helping deliver good products to consumers. They're going through that process at the moment. The result of that is things are a bit tighter and that's inevitable. I don't think that's the main thing that's affecting the housing market or trends in credit. The main thing affecting the housing market is the shift in the underlying dynamics between supply and demand. There's been a lot of extra construction over recent years, and the number of dwellings is rising more quickly than it has for a long period of time. There's less demand from China. The level of price has got so high that people get to the point where they say, 'I'm just not prepared to keep bidding and pushing the price up further.' Those dynamics have changed, so prices are falling, and when prices are falling investors are not as keen to go to their bank to borrow to buy, because the value of the asset could be five per cent lower in six months time. There's been a reduced demand for credit from investors and that's having an effect on the flow of credit in the economy. In addition to that, there are these things on the supply side, but I don't think the supply side's the main story.

**Mr THISTLETHWAITE:** In your opening statement, you mentioned the US economy and the sizeable fiscal stimulus that's still occurring there with limited spare capacity. You mentioned that markets appear to be relaxed about the inflation implications of that, but you're not so relaxed. You talk about possible disruptive consequences in financial markets. Is it your view that that stimulus has gone on for too long?

**Dr Lowe:** 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 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. At this point in the cycle, with the economy doing well and very low unemployment, it's the time of the cycle that should be
back to budget balance, or maybe even better than that, in order to build insurance, as I talked about before, for the next downturn.

Mr THISTLETHWAITE: That's right—consolidation rather than expansion.

Dr Lowe: And the US is doing exactly the opposite, and they're doing that in an economy that's already at full employment. We're also seeing, I would say, a similar trend emerge in a number of other countries, where governments responding to the disillusionment in the electorate and the international tax competition—kind of coming from the US—feel like they're having to respond as well, by having to either cut taxes or spend more money. Amongst the OECD economies, more than half are having a fiscal expansion this year at a time when the world economy is doing well, unemployment rates are low and levels of public debt are very high. Australia's not doing that, thankfully, but I think it's problematic.

Mr THISTLETHWAITE: Is it fair to describe that situation in the US as unorthodox in terms of the way you approach economics?

Dr Lowe: I think that's a fair characterisation. Normally you do not have a very big fiscal expansion when the economy is already at full employment.

Mr THISTLETHWAITE: So where do you think this unorthodox approach is coming from? Is it coming from the President or the Federal Reserve?

Dr Lowe: I don't think it's coming from the Federal Reserve. The Federal Reserve are gradually tightening up as inflation rises, as is appropriate for them to do.

Mr THISTLETHWAITE: In your statement, you also said, further on, that you think that there's the possibility of disruptive consequences in financial markets. Could you elaborate on what you mean there? What could those disruptive consequences be?

Dr Lowe: Investors largely think that inflation is going to stay very low in the US. They think that the US economy can grow very strongly, have very low unemployment and low interest rates and that inflation will stay very low, and there's very little uncertainty.

People in financial markets talk a lot about the term premium. This is the extra benefit, the extra return, you get from holding a long-term asset rather than rolling a short-term asset. Over long periods of time, you would normally expect maybe to get one per cent extra from holding a long-term asset, because there's more risk. At the moment, you actually get more in expectation by rolling short-term assets than holding long-term assets. So the term premium is very compressed. One reason for that is that people don't see very much risk in the future. It's very low. That's very unusual. And it's quite possible that we return to the normal sort of term premium. If that were to occur, then long-term bond rates would move up quite a lot. Many financial prices would have to be restructured.

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. I'm not saying that's going to happen—

Mr THISTLETHWAITE: No, of course.

Dr Lowe: but the probability of it happening is rising.

Mr THISTLETHWAITE: A lot of Australians through their super funds have investments in some of those long-term assets that you've mentioned. Is this something that you think financial managers in Australia should be conscious of and, taking a prudent approach, should begin preparing for?

Dr Lowe: I'm not going to give financial advice. The only advice I give is: be diversified and be prepared for a whole range of circumstances. I think that's as far as I can go, but it is concerning.

Mr THISTLETHWAITE: Another consequence of the United States is that interest rates are beginning to rise. That's putting a differential in terms of where our rates are at. The Australian dollar has suffered as a consequence of the Turkish lira being hit in international markets. Are you concerned about what's going on with the Australian dollar, and do you think that there are further falls coming?

Dr Lowe: Well, again, I don't predict the currency. That's a very difficult thing to do. But for some time I've been saying that a lower exchange rate would be better than a higher one. The reason I've been saying that is that 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.
For some years, we have been hoping that what would happen is that the Federal Reserve would raise interest rates; the US dollar would appreciate as a result of that; the Australian dollar would depreciate; that would stabilise both inflation and jobs; and we could normalise interest rates. That process has taken a lot of time to occur. It may be that it's now occurring, although the Australian dollar has not moved that much. I still think a lower dollar would be helpful for both inflation and achieving full employment. To the extent that the Australian dollar has come down recently, I think that's actually good news. It would be problematic if it was depreciating in a crisis environment, but, outside that, I think some further depreciation would be helpful.

Mr THISTLETHWAITE: Is there a level that you'd like to see the dollar at?

Dr Lowe: I don't want to give a particular level. I just make the point again that a moderately lower currency would be helpful from the point of view of both inflation and employment.

Mr THISTLETHWAITE: Two of the international uncertainties that you mentioned in your opening address were the Trump trade war and the China growth forecasts. How concerned are you about those two issues, and is it time, do you think, to start looking at lowering global growth forecasts on the basis of that disruption?

CHAIR: I'm not sure that the governor used those exact terms, but I'm sure you'd like to clarify that.

Dr Lowe: Well, it's interesting. In the IMF's very most recent global forecasts, after having revised up global growth for maybe a year and a half, there was just a slight kind of downgrade, but still at a very high level. The concerns about trade, I think, lie at the heart of this kind of small recent downgrade by the international forecasters. As I've said a number of times previously, 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 Australia. So this is not a path to make ourselves or anyone wealthier.

It's very hard for anyone to know how it's going to play out on the trade front. We, as well as others, have thought about the various scenarios. Probably the most benign scenario, and it is the most likely one, is that we have 10 or 25 per cent tariffs between the US and China that slows growth in both countries a little bit but doesn't derail the global expansion. In that world, Australia would be moderately affected, because growth in China would be slower, but I think it would be manageable. There is a much worse scenario, where these tensions escalate, that would lead to businesses around the world being very nervous about the future and deciding not to invest or delay investing. Business hates uncertainty. When there is a lot of uncertainty, it's a good reason to delay taking investment decisions. We're starting to see some of that in North America—not on a massive scale, but it's starting—and that could escalate. If that occurred at the same time that financial markets became very jittery, that could be a very damaging cocktail which sees world growth slow a lot.

On the other side, if you put your rose-coloured glasses on, you can tell a positive outcome—that the tensions between the US and Europe lead to some liberalisation at the margin, that NAFTA gets reconfigured in a way that supports further integration—perhaps slightly different to what we have, but further integration—and, under pressure, the Chinese take more seriously the protection of intellectual property. So, if you put your rose-coloured glasses on, you can tell a scenario where this works out quite well. 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.

Mr THISTLETHWAITE: I can't see how anyone wins in a trade war, but anyway. I'll turn to domestic issues. You mentioned subdued wages growth once again. I want to quote to you some figures from the latest CPI report—and these are on annual basis for particular indices—housing, 3.4 per cent growth; health, 5.2 per cent growth; transport, 5.2 per cent growth; education, 2.7 per cent growth. And we all know what's been going on with electricity prices. They're the staples of any household. At the same time, wages, according to the latest wage price index data: 2.1 per cent growth. That's been the story of Australia for the last five or six years. Can you understand why families are doing it tough and why they're feeling left behind in this environment, with those figures?

Dr Lowe: I can. It's largely an income story. It's not that the prices are going up too quickly in aggregate. In aggregate, prices are only going up two per cent, and we want them, on average, to go up 2½ per cent. So, 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. If I can, I'll pass to Guy, because next week he's going to give a speech dissecting the CPI and its components. So, perhaps, Guy—

Mr THISTLETHWAITE: We're going to get a preview, are we?

Dr Lowe: can preview some of those remarks.
Dr Debelle: It will save everyone turning up next week to hear me speak! As the governor said, I think the main story is actually an income story rather than a price story. You quoted a number of prices which have been going up at rates higher than three per cent. One thing which is interesting is that the food basket basically hasn't moved in seven years. The food grocery basket hasn't moved. Your television set is a lot cheaper now than it was, so those prices have been falling. The cost of your phone has been coming down. The cost of your car has been coming down. So there's a bunch of other stuff which is falling; hence, the aggregate is what it is. The other thing that I think has had a particularly large effect is the cost of renting. If you're a renter—that's one-third of people—it's barely moved for the last few years. There are other things, including some infrequent purchases—maybe once a year or once every couple of years—where the prices are falling. The CPI is based on what households actually spend, so it does a reasonably good job of reflecting those price movements. As Phil said, or as you said, in aggregate it's growing a bit above two. I don't think that's so much the story. There are, as you highlighted, some particular prices which are rising faster than that. But I think the main story is that income growth isn't growing any faster than that, so you're in a world where you're not seeing any benefit because the growth in your income is being eroded by those admittedly small rises in prices. I'd really emphasise the slow growth in income rather than the outcome on the price side, because the outcome on the price side is just above two per cent. It's actually about where want it. As you note, there are a number of—for want of a better term—high-profile prices which are rising quite a lot faster than that.

The interesting ones, which we're looking at over the next period ahead—and we were talking about this earlier—are some of the utility prices. It looks quite conceivable that the dynamics on the electricity front are changing from where they've been over the last few years. We've already seen that. I think the visibility, in terms of the deals you can get from the electricity companies, is probably greater now than it has been for a while. That's not dissimilar to the story going on on the banking side, in terms of shopping around for a cheaper mortgage. That's a fairly important thing that people see a lot: the pricing dynamics may actually be changing in the period ahead. But there are some parts, and food is the most obvious one, where prices have basically been flat for the last seven years or so.

Mr THISTLETHWAITE: I take your point about aggregate prices. The issue we hear about a lot from constituents is that those indices that have been increasing above the aggregate rate make up such a large proportion of the household budget, particularly housing, education and energy costs. That's why people feel that they're just being left behind. If you're a worker working in the hospitality industry on a minimum wage, you've had your weekend penalty rates cut; you've had no other increase in your income; your wages are around two per cent growth, on average. You can understand why those people are really jacked off and angry at the moment.

Dr Debelle: Sure. But, as you just said, it's an income story. Even the prices you talked about have been going up. The rise in education cost is actually less than it's been for a while. The rise in insurance premiums is the lowest it's been in about 10 years. It's still decent. But I think it's primarily the income story. If people had higher income growth, I think you would be hearing a lot less of the story. The pain point is as much on the income side.

Mr THISTLETHWAITE: Do you think that the parliament and organisations like the Reserve Bank haven't devoted enough attention to the issue of low income growth and that we could be doing more to assist families and workers in this area?

Dr Lowe: I'm not going to say what the parliament should or shouldn't be doing. 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. The strategy from the Reserve Bank's perspective is two-fold. The first is to talk publicly about the benefits of stronger wage growth. That's controversial because most of my predecessors have had to talk about the dangers—

Mr THISTLETHWAITE: Do the opposite.

Dr Lowe: Exactly—the opposite, saying that stronger wage growth would mean higher inflation, higher interest rates and a slowdown in the economy. It's a reflection of how much the world has changed that the central bank governor is speaking publicly about the benefits of stronger wage growth. At an analytical perspective, what I see myself doing is trying to stop wage expectations from falling further and perhaps even lift them. That's one part of our strategy. The second part is 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. That becomes a general story and the aggregate wage growth lifts. They're the two things that the Reserve Bank of Australia can do. We can't do very much more than that. The parliament, if it so chooses, can do things. But I feel like we're doing what we can and should do.
**Mr THISTLETHWAITE:** I have one follow-up question then. The current budget forecasts have the wage price index data for this financial year at 2¼ per cent growth and then for the financial year 2019-20 at 3¼ per cent growth. Do you think there's any hope that we'll reach those targets? Are they overly ambitious?

**Dr Lowe:** 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.

As I said in my introductory remarks, the wage price index, including bonuses, is currently already growing at 2½ per cent. One of the things that's happening as the labour market is tightening up is that firms, rather than paying bigger wage increases right across the board, are finding particular workers that they want to give bigger bonuses to and are lifting their wages that way. You're now starting to see that in the wage price index.

**Mr THISTLETHWAITE:** No disrespect to you—

**CHAIR:** Mr Thistlethwaite, I'm sorry, you don't have the call anymore. Your time—

**Mr THISTLETHWAITE:** but average workers don't get bonuses.

**CHAIR:** Mr Thistlethwaite, I'm sorry, you don't—

**Mr THISTLETHWAITE:** They don't get bonuses. The majority of the workforce—

**CHAIR:** Mr Thistlethwaite, excuse me.

**Mr THISTLETHWAITE:** The majority of the workforce don't get bonuses.

**CHAIR:** Mr Thistlethwaite, you do not have the call. Your time has concluded. I'm sorry, Dr Lowe. I do now need to ask Mr Kelly to ask questions.

**Mr CRAIG KELLY:** Firstly, Dr Lowe, you mentioned the drought. What potential effect do you see that having on GDP? Has the Reserve Bank made any estimates of that?

**Dr Lowe:** It's a very significant issue. We're watching it very carefully. The agricultural sector is a very important part of the economy. It accounts at the moment for between 12 and 15 per cent of our exports. Hundreds of thousands of people work in the rural sector, and the rural sector is a source of income for many regional communities. So it is a first-order issue. We're watching things carefully. At the last meeting of the Reserve Bank Board we saw rainfall maps for the country, and we haven't done that for a number of years. We're taking it very seriously.

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.

**Mr CRAIG KELLY:** Sorry, you are saying economywide the current drought is not as serious as the 2002 one?

**Dr Lowe:** Yes, it's not. In Western Australia conditions are actually quite good at the moment. They've had a drought and it kind of broke last year.

**Mr CRAIG KELLY:** Yes, we seem to have good conditions in WA, but in some parts of New South Wales the drought would be as bad as it has ever been.

**Dr Lowe:** Yes, that's right. Parts of Northern Queensland have had a reasonable amount of rain recently as well. So there are parts of the country that are doing okay, but, as I said, across New South Wales and into southern Queensland and Victoria it's a really big issue. 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. We are trying to measure things as best we can.

**Mr CRAIG KELLY:** You talked about a hit to exports in the agricultural sector of about 15 per cent?

**Dr Lowe:** No. At the moment rural exports account for up to 15 per cent of Australia's total exports, so it's a fair chunk of our exports. That will obviously be lower in the next couple of years. In the short term though it could be higher because we export more—
Mr CRAIG KELLY: But over the next two or three years—depending on how long the drought goes—

Dr Lowe: I can't give you any specific numbers because it depends very much on the scenario you paint for rainfall. If things return to normal fairly soon, we could expect a rebound. But if it goes on like it did in the drought at the turn of the century then the effects on the economy are significant.

Mr CRAIG KELLY: You mentioned iron ore exports. You expect to see a decline, a softening, in the years to come?

Dr Ellis: We are not expecting iron ore export volumes to fall from here. 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. That is also true for coal. There is still a little bit to go for LNG. So this year and next year we expect some boost to overall GDP growth because some of the LNG exports are still ramping up. By the time we get to 2020, we think that process will also have stabilised.

In our statement on monetary policy that we put out in August, we had a box on some of the nonferrous metal exports that Australia is also quite an important producer of. They are a much smaller scale than coal and iron ore. They will be growing; we do expect quite strong growth in some of these minerals. There is a lot of interest in lithium at the moment, and a lot of expansion and exploration going on. But those are much smaller scale industries, so they won't add as much to exports growth and GDP growth as the two bulk commodities have done.

Mr CRAIG KELLY: What forecasts do you have for coal exports in the coming years?

Dr Ellis: You are looking for volumes?

Mr CRAIG KELLY: Volumes and dollars.

Dr Ellis: I am going to show a graph of that in my speech tonight. I don't have that graph right here.

Mr CRAIG KELLY: It is just that I have seen some headlines that coal will be our major export commodity.

Dr Ellis: Metals and minerals, which is primarily iron ore, is running at about $18 billion to $20 billion a year in current dollars whereas coke coal and briquettes is more like $8 billion or $9 billion. Iron ore is bigger than coal in these numbers. This is resource export volumes.

Mr CRAIG KELLY: Is that just coking coal?

Dr Ellis: That is coking coal and thermal coal. We mentioned in the statement on monetary policy 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. That is partly because there has been quite strong global demand, particularly in Asia. It has been a hot summer everywhere. That means people turn their air conditioners on, so they need more power. 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. There have also been supply disruptions in Australia as well as in a couple of the other major producers—Russia and South Africa have also had some supply disruptions—and that has served to hold thermal coal prices above what we had previously been forecasting. We reflected that in our forecast this time round.

Mr CRAIG KELLY: On wages growth, there seems to be a bit of a disjoint between the public sector and the private sector. The public sector is growing a lot quicker than the private sector. Is there any explanation you can give for that trend?

Dr Lowe: There is a difference but I wouldn't overstate the size of the difference. The private sector's WPI is two and the public is a bit higher than that. We're not talking huge differences. 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, police.

Mr CRAIG KELLY: Has that been a consistent trend over recent years?

Dr Ellis: Yes, it has. That's right.

Dr Lowe: For a number of years, public sector wages on average have been growing at least half a per cent faster than wages in the private sector; that's true.
Mr CRAIG KELLY: On the subject of the bank royal commission, are you concerned that there may be an overreaction or a swing of the pendulum too far the other way so that banks tighten up their loaning procedures, that loans for entrepreneurial projects that may have otherwise gone ahead might be stifled? Do you have any concern about an overreaction?

Dr Lowe: It is certainly possible. At the moment, I don't think there's been an overreaction. There has been a reaction. But there probably needs to be some tightening up, and my hope is that we move back to something that is more sustainable than the previous set of arrangements. It's going to be particularly important what happens over the next six months with the recommendations that come from the royal commission.

My understanding is that in round 7 of the hearings, the royal commission is going to turn its mind to what are the right policy responses and the recommendations are going to be critical. So you could imagine an overreaction coming out of this because the solution to the problems that we've currently seen, I don't think, is more and more regulation, but I can understand why that might be an outcome. There is a scenario where we regulate too much and stifle innovation in our financial system.

Despite all the terrible stories, Australia has a very good financial system. From a safety and stability perspective, it's very strong. When I go overseas, people often ask me about the success of Australia's financial system. It's done a reasonable job of intermediating between savers and investors to have our economy grow for 27 years. So despite the terrible shortcomings, we have a productive and effective, safe and secure financial system and we need to keep that. 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.

Mr CRAIG KELLY: You gave a speech, Dr Ellis, a week ago about infrastructure a few weeks ago.

Dr Ellis: That's right.

Mr CRAIG KELLY: Does the Reserve Bank have any concerns about the efficiency of the infrastructure spending that's going on at the moment? When I look around our major cities, there's a lot of infrastructure and roadworks but the question is still out whether we are getting value for money on that expenditure.

Dr Ellis: Thanks for the question. We aren't experts in project evaluation. Where Australia stands apart though is that we have an independent statutory authority staffed with experts on project evaluation and so, from a structural perspective, I would expect Australia to be less at risk from making poor project evaluation decisions than some other countries that don't have that kind of independent insight into project design.

Infrastructure is a G20 priority this year and will be next year. It's something that's important for the ongoing economic development of the economy. The governor, in an even more recent speech, pointed out that we do have a strongly growing population so people need somewhere to live, and they need roads and railways to get them to places. Our cities are growing quite quickly, particularly Sydney and Melbourne, so there is a need to ensure that the infrastructure is developed in those cities to hold and service the population, particularly as we have quite physically spread out cities.

Mr CRAIG KELLY: Also in that speech, you commented on the investment in renewable energy, and you put a little chart up, I noticed, that shows something like $9 billion of finance for renewable energy in 2017. That seems to be contrary to what we're hearing about the need for certainty of investment in new electricity generation; there seems to be a massive amount of expenditure currently in new electricity generation.

Dr Ellis: All I can say in that respect is that there's a sentence in that speech where I say that, according to the figures that we have available to us on the amount of private investment that's going into renewables at the moment or that's flagged for the current year, the amount that's going in is equivalent to the previous couple of years of annual investment in the entire electricity generation industry, whether that's generation or distribution and so forth. So it's in transition.

Mr CRAIG KELLY: On that, do you have some concerns that that may be artificially high number driven by subsidies?

Dr Ellis: I think one of the things that I've learnt over the last couple of years is just how much the relative price of renewable energy generation has dropped relative to that of carbon based electricity generation. I mentioned just before about high coal prices. Well, that's the alternative. So if that's getting more expensive to do and solar panels are getting cheaper to do—

Mr CRAIG KELLY: On that, do you have an estimate of what the levelised cost of energy from rooftop solar panels is?
Dr Ellis: I don't have that number in my head, but I'm pretty sure Infrastructure Australia does. Certainly, if you look at global costs of producing electricity through various means, renewable energy—

Mr CRAIG KELLY: I'm running out of time. Is that a number you could perhaps find out for us?

Dr Ellis: Yes, we can look. I know I've seen a graph of it, so we could definitely get it.

Mr CRAIG KELLY: Yes. It would be the levelised cost of rooftop solar panels, subsidised and unsubsidised. Thank you.

CHAIR: Obviously you'll take that question on notice. If you could provide that further information, we'd be grateful.

Proceedings suspended from 10:46 to 11:00

CHAIR: Welcome back to our hearing with the Reserve Bank of Australia. I'd now like to ask Ms Kearney to ask questions.

Ms KEARNEY: I'd like to start by going back to my colleague Mr Kelly's questions and comments. He's not here, but I'll try to be as faithful as I can to his questions. He asked about the difference between the wage rises for those in the public sector and in the private sector. My view, and I think it's a strongly held view, and it's quite a proven view, is that organised workforces—those that have a high density of unionism and have some bargaining power—often have a wage premium, or pretty much always have a wage premium. I think that would probably answer Mr Kelly's question about the public sector. It does have high density and those areas you mentioned do have a bit of bargaining power. And there have been some reports recently, in The Economist and the Australian Economic Review, suggesting that one of the problems with wages growth is that we do have lower union density, and workers don't have the strong bargaining power and that the balance of power in the workplace has shifted in favour of employers, and we probably need to do a bit more to build up organised labour in Australia; that would help with the wages growth. Do you have any thoughts on that?

Dr Lowe: I'm not sure that's the main thing going on. The reason I say that is that the phenomenon we are currently seeing in Australia we've seen in advanced economy after advanced economy over the past five or six years, despite having very different industrial relations systems. That, to me, suggests that there's something deeper going on. At the global level, one of the two big changes we've seen is increased technology, which is displacing jobs and changing the nature of the work. The other big change is increased global competition. Whether you're a worker or a firm, if you feel as though there's more competition you're going to have a lower price. I think that's affecting wage-setting dynamics in Australia and elsewhere, and that's leading to lower aggregate wage growth everywhere.

The decline in bargaining power of labour because of changes in industrial relations is probably part of it, but I think there's this deeper thing that's going on. 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.

Ms KEARNEY: Do you think it also feeds into consumer confidence? We know that one of the indicators of confidence in the economy is labour mobility, and we're seeing less inclination of workers to leave their jobs, because they're not quite so secure that they're going to get another one, so they're staying where they are in perhaps a lower-paid job rather than moving on. You haven't really mentioned labour mobility. Do you think that's—

Dr Lowe: We've worked at that recently, because some data came out of the ABS last week. The rate of involuntary job separation—people basically having to leave their jobs when they didn't want to—is actually very low at the moment. In terms of our history, there are very few forced separations going on at the moment. I think that's because of the strength of the labour market. There are also relatively few people leaving jobs for voluntary reasons. Now, whether that's because they're too scared to or because they're actually happy in their current job, we don't really know. We just see that the rate of voluntary job turnover is low. I'm expecting that that trend starts turning around. The reason I say that is the number of job vacancies out there at the moment, relative to the size of the labour force, is the highest it's ever been. One imagines, in that environment, that workers start looking at alternative jobs, and firms actually might even pay them more to get them. But it is a puzzle why, in such a tight labour market, workers are not jumping firms in the way that they used to.
Ms KEARNEY: Yes, so there are lots of indicators that aren't working the way they normally do. One of the messages I'm getting from you today is that the world isn't really operating as it quite should. Do you think that, because of that, it's time to readjust how we think about this? Is it time to change any of our indicators, like what actually is a marker of full employment? Do you ever think about changing the inflation target because, over time, the world isn't quite working as it should? Have you had those thoughts?

Dr Lowe: 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.

In terms of the inflation target, if I can answer that—because there's been a reasonable amount of commentary in the press recently about the level of the inflation target—in the academic literature at the moment there's a debate that inflation targets should be raised, not lowered, that they should be maybe three or four rather than two. The academic argument, which I think has some merit, is that if you have a higher average inflation rate then you will have on average higher interest rates. That might not sound good; but if you have higher average interest rates then you have more scope to reduce them in a downturn. If you have a very low average rate of inflation or have low average interest rates, you therefore have limited capability to lower interest rates in a downturn. So some people say: have a higher average to give you greater capability to lower—

Ms KEARNEY: to leverage it.

Dr Lowe: I'm not persuaded by that argument, particularly in the Australian context. We've had plenty of scope to lower interest rates to stimulate the economy. We haven't had to go to zero. We haven't had to do the unconventional things that other central banks have done. I think where we're placed at the moment is the right place to be.

Another consideration here is, if we were to change the inflation target now, after having had it for more than 25 years and having it work quite well, people would legitimately wonder whether we might change it again in the future. If, because inflation is a bit lower, we say we'll lower the target, what happens when inflation is a bit high? We say, 'Oh well, it doesn't really matter. We don't want to slow the economy to get inflation down. We'll just live with the higher rate of inflation.' If people come to worry about that then we lose the benefit of anchored inflation expectations. People are unsure about the future rate of inflation. Then there's a premium in interest rates, because people have to get compensated for that uncertainty.

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.

Ms KEARNEY: Thank you for that. With low wages growth—and I know we're all frustrated by it, because we would all like to see it rise for all the reasons that you outlined—it has been suggested to us that any consumption growth has meant a dipping into savings. Are you seeing that and are you worried about that?

Dr Lowe: No. I mean, the saving rate is still positive. People are still saving a fair share of their incomes. We partly see this in the build-up of balances in offset accounts that many people have against their mortgages. The rate of saving, though, is a bit lower than it was on the average of the last four or five years. It's lower, but people are still saving. It's not like people are running down their stock of wealth to support consumption. I think it suggests that people have some reasonable confidence about the future, which 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. I'm not worried that people are running down their savings to support current consumption.

Ms KEARNEY: Last week you indicated that the only thing that would trigger interest rate cuts would be a massive global shock. Do you think there's anything domestically that would trigger a cut?

Dr Lowe: We try and think through scenarios, obviously, about what the future interest-rate profile looks like. We try to think about what would have to happen for us to lower interest rates. As I said the other day, the most likely thing that could lead to a cut in interest rates is something going wrong at the global level, particularly something going wrong in China—slowing in China reverberating right through East Asia; commodity prices being lower; confidence in financial markets being shaken; and the growth outlook in Australia deteriorating. That's the most likely scenario that would lead to lower interest rates in Australia. I think it has a low probability, but it's possible.
It is much harder to think of what domestic shocks would cause us to lower interest rates, for growth to fall away and for the outlook for inflation to fall away. I struggle to think what those domestic-sourced shocks would be. The most likely, although still with a low probability, is the housing market—bigger falls there, that being a shock to confidence and people stopping spending as a result. That's possible but unlikely. As I said in my introductory remarks, if we were ever to have an adjustment in the housing market—and we do need one—the current environment is basically as good an environment as you could have for an adjustment in the housing market. The global economy is doing well. There are a lot of vacancies. The labour market is pretty firm. The unemployment rate is coming down. Interest rates are low. The housing construction cycle has probably peaked, so it's not like we're continuing to build too many houses. It's a fairly benign environment to have what I think is a needed adjustment.

Mr EVANS: Dr Lowe, towards the end of your opening remarks you talked about stability, certainty and confidence, and you said that you want the RBA and its decisions to be a source of stability and confidence. This is a critical point, I believe, after a decade of volatility and unpredictability, including that emanating from this place since around the GFC. One of the most important things that the government and its agencies can do is think first about stability and confidence. People, households and small businesses need to be able to bank on a medium-term plan to make decisions and foster those animal spirits that we want to see in investments, spending, risk-taking and entrepreneurship. You said in your opening statement that the Australian economy is moving in the right direction. You said that before us is a pretty good set of numbers, and of course we want them to be even better. When you think about that key question around stability and confidence, how do we know that stability and confidence is growing? What measures, what data do you look at as proxies for that?

Dr Lowe: In terms of the Reserve Bank's role, keeping interest rates constant or steady over a fairly long period of time and communicating that it's likely to stay that way—I think that does give people a sense of confidence that we're moving in the right direction and that we don't really have to worry about volatility and short-term interest rates for a while. It gives people confidence that we're going to keep on a steady path and communicate well in advance. We try and be predictable, logical, rational and reassuring. That's the role that I hope we're playing for the community—giving people confidence that things will gradually get better.

Mr EVANS: I guess I'm thinking more about outputs than inputs?

Dr Lowe: How to measure confidence? We track a lot of business surveys, and, at the moment, confidence is quite high. When you ask businesses about current conditions, they're actually reporting that conditions are above average, and it's right across the country, not just in New South Wales and Victoria. Business conditions have come off a little bit in the last couple of months, but they're at a high level. There are regular monthly, even weekly, surveys of consumers, and they show consumer confidence at a bit above average as well. So the hard metrics we can get—where firms and individuals are asked about how they feel, they are actually feeling okay at the moment. And they should be: there have been a lot of jobs generated, things are getting better, the economy is going above trend. There are a lot of positive things going on and people should be feeling positive about the future.

Mr EVANS: In response to a question you were asked earlier about household finances you said that it was more of an income story—I think those were the words you used. And you might have expanded a little bit about that on one of the questions you were just asked about the household savings rate. Given your answers to those questions, wouldn't it be most accurate to say that this is a disposable income story? Wage growth is certainly one input but another input would be, say, the amount of tax paid. I guess I am looking for confirmation that personal income tax cuts like those that have just been passed by this parliament do assist individuals and households with their after-tax purchasing decisions and that income strength story.

Dr Lowe: That will unambiguously help. People will have more money in their bank accounts as a result of the tax cuts, and some of that will be spent. Some of it will help repair the debt situation that some households have, but some of it will be spent. And that will stimulate the economy and help create jobs. So I agree 100 per cent with you. It still leaves the issue that nominal income growth of two per cent is problematic. My board is going to have trouble delivering for you an average rate of inflation of 2½ per cent if wages are only growing at two per cent. We are still getting reasonable labour productivity growth in this country; it would be better if we got more, but we are getting reasonable labour productivity growth. Unit labour costs—nominal wage growth less productivity growth—are quite low and have been so for a number of years. The current growth of unit labour costs is unlikely to be consistent with 2½ per cent inflation, so we do need a pick-up in nominal income growth as well.

Mr EVANS: Dr Debelle, in answer to an earlier question, you talked a little bit about how the CPI measures work, how they aggregate different baskets of goods and services—some of which are going up, some of which
are going down and some of which are stable. Are you confident that the measures of CPI, such as they are, do represent a good and accurate reflection of what people are actually spending their money on? Are you satisfied that they keep up-to-date with consumer and household spending trends, such as the trend towards more spending on services?

**Dr Debelle:** Yes. But the other point to note—and it is also relevant to the question Mr Thistlethwaite asked earlier—is that the ABS, which obviously does all of this, is updating that basket more frequently than it did in the past, so that it is more a reflection of what is going on now. The other point is they also publish cost-of-living indices, which are slightly different from the CPI in conception. But they publish it for different groups. What this partly gets to is that some people say: 'That's not what I spend my money on.' They look at it across pensioners, across people in different parts of the income distribution—or whether you are a home owner or a renter. So they look at cost-of-living differences across those different groups. The bottom line is that right at the moment—but historically too—they are not telling you anything much different. So the answer is yes, I do think the ABS does a pretty good job of getting that basket about right. As I said, I think the other thing which goes on is that people are well aware of the stuff they are buying every week and what is happening there. They are obviously very well aware of their utility bills and what is happening with those. There are probably some other price movements—the stuff they spend money on less frequently individually—which may be a bit less.

**Mr EVANS:** I have a follow-up question in relation to utility bills. In your statement of monetary policy just released I was really interested to read some comments towards the end, under the heading 'Administered price inflation has slowed'. It says that competition in the energy sector and the recent declines in wholesale prices have started to put downward pressure on utility bills, which is exactly what the government's been intending with its actions. I'm reading here—and this is the quote:

> Energy providers in some states have announced reductions to prices that will take effect in the September quarter. Can I get you to expand a little on that—where are we talking; what are we expecting?

**Dr Debelle:** Queensland was going to be my answer—I'm just checking.

**Dr Ellis:** Sort of flat to down in New South Wales and more noticeably down in Queensland. We're expecting there may be some price revisions also in Victoria in the March quarter—the timing for standing offer electricity contracts in Victoria is different from those other two states.

**Mr EVANS:** First of January is when they offer—

**Dr Ellis:** Precisely, so it hits the March quarter. In addition to those cuts that have been announced for standing offers, increasingly, households are shopping around and the discounts that are available, the market offers, are getting bigger. More households are taking advantage of those market offers, and so, consequently, that's being reflected in the prices in the CPI. The ABS does take the market offers into account, not just the standing offers, and so that's also one of the factors that we've integrated into our September quarter forecast.

**Mr EVANS:** Great; that's really good. We hear a bit of anecdotal evidence, so it's good to hear the authorities are also seeing that in their numbers. Can I change topic completely—just one last series of questions about the new payments platform. I think it's fair to say that the government hopes—and, indeed, probably lots of people in the community hope—that the new payments platform can help stimulate more competition in the banking sector to help encourage customer switching and provide innovative new systems to drive better offers and services. There were some comments in your opening remarks, Dr Lowe, about some of the major banks being slow to make the new system available to their customers. What reasons do you ascribe to their slowness?

**Dr Lowe:** Is it okay if I hand this to Michele?

**Mr EVANS:** Absolutely.

**Ms Bullock:** The main reason for the slowness—at least for a couple of them—is simply that their build turned out to be more complicated than they thought, and they had problems with service providers. They had many, many years to get on top of this and so to discover, as we were going live, that they weren't ready, was a bit disappointing really. Having said that, a couple of the majors who have not been on board to date are coming online, and we're starting to see volumes rise. The key to this is that, because it's a network, unless you've got everyone on board, it's really not going to get used because I'm not really going to be interested in joining it if I can't pay someone who banks with someone else. It's really critical that we have everyone on board and, in the next month or so, we will have all the majors on board and I think that will be a big stimulus.

**Mr EVANS:** Can I push you a little more on that response. Disappointment is one thing. Do you believe the bona fides of those explanations that were given about the complex build system? If the small banks, which are relatively unresourced by comparison, can be so ready and willing to participate from the opening, it surprises me...
that the most resourced banks would be the slowest. I put to you: there are claims that the major banks have been deliberately slow to roll out the new payments platform because they're afraid their customers will leave them when they are able to switch more easily or more easily become aware of new offers and services out there in the market.

Ms Bullock: I think there might be two separate questions that we're thinking about here. The first is the potential impact of open banking, which I think is a separate question. On the issue of: do I believe the bona fides of the banks? Yes, I do believe them and I do believe they have been running very fast, because the banks that haven't actually implemented yet are feeling the pressure from their customers and they have been trying very hard to catch up. There was in fact a view that, if two major banks weren't ready to go, then no-one should go. The fact that the system launched without two major banks was a big signal to the banks: 'Pull your socks up because you've got to get on board with this, and we're not waiting for you.' I think that's a very good message. If we're always waiting for the slowest participant, we'll be waiting for a long time. I think it's really important that that message gets through. The Payments System Board has been very forthright in letting the banks know that they've not been happy about this. The Reserve Bank has spoken to the banks themselves, and we've been reassuring ourselves that they are not standing down their teams and that they are continuing to work on it. They just need that extra push to get over the line, and they will get over the line in the next month or so.

Mr THISTLETHWAITE: The Productivity Commission, Dr Lowe, has recommended that the Council of Financial Regulators have a bit more transparency about their deliberations, similar to what occurs with the Reserve Bank Board and your publication of minutes. If there were more transparency and there were publications of deliberations of the Council of Financial Regulators, is that something that would be a positive in your view?

Dr Lowe: There is already quite a lot of transparency. In the bank's six-monthly Financial Stability Review we have quite a long discussion of issues that the council has been grappling with over the previous six months, and that discussion has been beefed up over recent times. At the last council meeting, we did discuss the possibility of issuing a post-meeting statement, and I'm inclined to go in that direction. We have to work out how to do that. It would be inappropriate to publish minutes of that meeting, because sometimes we're discussing very confidential market-sensitive information and sometimes even about individual institutions, so I think it would be inappropriate to publish minutes. But I do think it would be appropriate for us to publish a statement that outlines the general issues that the council has been grappling with. I think it would help the community understand what we're working on, and hopefully we'll do this fairly soon. In much the same way, the Payments System Board issues a statement after each meeting which tells the community the issues we've been grappling with. I think the same model could be used for the Council of Financial Regulators.

Mr THISTLETHWAITE: I look forward to reading the first one. In your speech last week to the Anika Foundation, you indicated that the RBA had considered other policies, apart from interest rates, to boost the economy. Can you elaborate on that a little bit?

Dr Lowe: I'm not exactly sure what you're referring to.

Mr THISTLETHWAITE: I think in the question-and-answer session you were asked about other policies, and you said that you'd considered other policies at the board level.

Dr Lowe: Maybe that was in the context of if we had a very bad shock and the global outlook deteriorated and we had to lower interest rates and we lowered them down to zero. At times in other countries they've moved below zero. But, if we reached whatever the lower bound was, we have considered what other things we could do. We've looked very much in recent years at the experience of other countries, where the central banks have bought assets from the private sector, including government securities and, in some other countries, other assets as well. We've looked at the terms and conditions under which we could provide funding to the banking sector so that they could continue to provide the credit that the real economy needs.

I think the probability of us having to do these things is low, but, as part of our contingency planning, we've studied the experience of other countries and we have a sense of what works and what doesn't work so that we're prepared in case we find ourselves there.

Mr THISTLETHWAITE: In that speech you went into some detail about the features of population growth in Australia over recent years. I got the sense that you were making the point that population growth has had a positive effect on the economic development of Australia. Do you want to elaborate on that a little bit?

Dr Lowe: Population growth has had a significant effect on our economy. It's having an effect on our society as well. I'm not advocating particularly for strong population growth or weak population growth. My job is to try to understand the effects of population growth on the economy. It's a first-order variable that's affected how the
Australian economy performs. What I was trying to do was to outline for the community some of those effects. They would include stronger economic growth. We've had 27 years without a recession. There are a lot 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. It's one of the first-order considerations in how the Australian economy has grown over recent times.

The fact that we've had a lot of population growth has added to the country's human capital. Most of the migrants who come to Australia come because they have jobs here and they have skills we need or they're studying at Australian universities. One-sixth of those who come to study at our universities tend to stay afterwards and contribute to our society. That has helped our human capital. It's changed our demographics quite a lot. 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 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 finances. It helps the government budget. They're some of the effects that the strong immigration has had. I also talked about the pressure that it's put on infrastructure, on housing. It took a long time for housing construction to adjust to stronger population growth. In fact, it took the better part of a decade. Population growth picked up and the rate at which we were building houses or dwellings didn't pick up. That speaks to the problems in the planning process, probably at the local and the state level. That pushed up housing prices, I'm sure. But, for a number of years, we have been adding to the dwelling stock at quite a fast rate, and that's one reason that the housing price dynamics have changed in the country for the better.

Another area where we were slow was infrastructure spending. As more and more people came into our cities, we didn't build the public and private transportation networks to move those people around efficiently. That did hurt our economy. It's one of the factors that has weighed on productivity. It made people's lives less pleasant and less productive. We're now starting to address that. It will take time, though. It has put pressure on our infrastructure, and I can understand why some in the community are unhappy about that. The effects are multilayered. What I was trying to do was set out some of those effects for the community. I'm not advocating one particular view or another; I just set the facts out.

Mr THISTLETHWAITE: You also made the point that the birth rate had remained quite steady over that period and that there'd been a pick-up in immigration to cater for things like the mining boom and the demand for additional labour. What would be the effect of a significant reduction in immigration in the short term? Would that have an effect on economic growth?

Dr Lowe: In a sense, mechanically it does. You can decompose the rate of growth of GDP into two components. The first is the rate of growth of the population or the workforce and the second is the rate of growth of productivity. 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. Some people would say, 'Does that really matter?' Arguably, what really matters is growth in income per capita. My own view is that the population has been growing strongly and the economy growing strongly has given people confidence. The pie is going to be bigger tomorrow. That gives you confidence to invest.

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.

Mr THISTLETHWAITE: Thank you. The final question I have relates to the story on the front page of the *Fin Review* today about the evidence that AMP gave in the royal commission yesterday, and it's about members on particular products in their super fund and about AMP being slow to transfer them over to products that cost less. Under questioning about that, Rick Allert, representing AMP, when he was asked why they weren't transferred over, said that they couldn't transfer them. This was the specific question: “You can't force the related-party companies to lower the fees?” counsel assisting the commission Michael Hodge, QC, asked AMP Super chairman Rick Allert.
Mr Allert's response was 'no'. Is that true? Is it true that they can't ask them or that they didn't want to ask them?

Dr Lowe: I don't know enough about the specifics to comment on them, but trustees have a fundamental duty to act in the best interests of members, not in their own interest and not in the best interests of related parties. Regrettably, we've seen too many cases where the trustees do not seem to have been acting in the best interests of the members. As to whether this is a case like that, I don't know enough about the detail. It's really problematic because it diminishes confidence in the system. Trustees actually need to do their job and, as I said in response to an earlier question, we're finding through the royal commission that entities inside financial institutions are having great trouble dealing with conflicts of interest. This is just another example of that. One of the things that need to come out of this whole process is that people within financial institutions need to take the conflict of interest issue incredibly seriously. It needs to be top of mind. It needs to be part of the culture of the financial institution: 'We've got this underlying fiduciary interest to our customers to provide service, and that needs to be top of mind.' It seems there are too many cases where that has not been top of mind. Top of mind has been maximising the financial return to the business. I think that's very problematic. The sunshine and the sunlight that the Royal Commission is bringing, I think, will lead to a change in culture in financial institutions, and I certainly hope so.

Mr THISTLETHWAITE: Thanks.

CHAIR: Dr Lowe, just in finishing, I've just got a couple of questions for you. You've spoken earlier about global trade uncertainty. Can I just ask you: what are the implications for emerging economies as well as Australia and developed economies? I guess I'm emphasising Australia's relationship with the United States. How important is that relationship in light of what is happening at the moment globally?

Dr Lowe: The relationship with the US is obviously incredibly important. The US and China are the two biggest economies in the world, so what happens in each of them is very important to global trade flows but also important to global financial markets. On the investment front, Australia has a very strong relationship with the US. That's very important. The US is a source of capital for Australia. The Australian banks obviously raise quite a lot of their funding in New York, and the US provides expertise, know-how and management technology to Australian businesses, so it's a very important relationship.

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. 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. If they did escalate, the ramifications under some scenarios, as we talked about before, are significant. Slower growth in China would ripple right through the production chain in Asia. The US is talking about placing 25 per cent tariffs on imports of many Chinese goods. That obviously makes Chinese production into the US less competitive. There'll be less of that, and that will ripple right through the Asian supply chain. In some scenarios, the effects of that could be very large. So we have a strong interest in them both working that out.

What can Australia do? The truth is, not very much, but we can be a loud voice for open, free, fair trade. In the international forums that I go to, that's one of the constructive roles that Australia can play: 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.

CHAIR: And I think that has been one of the hallmarks of our government.

Dr Lowe: We need countries to stand up in this environment and make those points. Australia, Canada and New Zealand are three countries that are ideally placed to do that. The three of us have a very positive story to tell about the benefits of openness. We are three very prosperous countries where people enjoy high living standards because of openness. So we have an important story to tell, and, in my own view, we should tell it. When I go to international meetings, I take every opportunity to tell that.

CHAIR: Dr Lowe, I want to move to infrastructure spending. You've spoken about the importance of infrastructure and also the role that infrastructure investment by governments, including our government, has played in jobs growth. I come from a large regional area—part of Geelong, the Surf Coast and the Bellarine—and we're growing at a very fast rate in the Geelong region, above that of Melbourne. The population growth rate is around 2.7 per cent. In the last couple of years, I have really been pulling my hair out that we haven't seen enough infrastructure investment by the state in our region and other parts of regional Victoria, despite the best efforts of the Commonwealth to deliver very substantial investment in infrastructure spending, such as better roads and rail. As it's generally state governments which make these decisions and manage the infrastructure spend, what
observations do you make about the importance of governments being ahead of the pack when it comes to infrastructure spending?

**Dr Lowe:** Perhaps I can make two observations. One is linking back to the issue of population growth. Over five years, our population has gone up nine per cent. That's a lot of extra people. And, in your part of the country, it's growing more quickly than that. That area between Melbourne and Geelong has been growing very well. When the population's growing like that, we need to invest. If we don't, people's lives are not as rich as they otherwise could be. Our businesses are less productive, and we sit in traffic. You know the story. So it's incredibly important we find a way of doing that.

For a number of years, I was frustrated that this investment was not taking place. From around 2013-14, both Glenn Stevens and I started talking publicly about it because we could see the pressures building. We could also see governments were very reluctant to borrow to build infrastructure, and we were trying to make it a bit easier to change the climate to allow governments to borrow to build infrastructure, hopefully with the support of the private sector. That's one observation.

The second observation, which really touches on a point that Mr Kelly made before, is the importance of the governance of infrastructure. I still don't think we've got that right. One of the reasons the public in the past have not wanted governments to borrow to build infrastructure is they were worried the governments would waste the money. If we're honest, we've seen examples of where the project selection wasn't all that it should have been to maximise productivity and welfare, the construction risk has not been managed as effectively as it could have been—we've got a good example of that in New South Wales at the moment; I live in Randwick, so I'm living with the tram continuously—and the pricing and use of the infrastructure has often not been what it would have to have been to be the most efficient service.

If we don't get the governance right then the public becomes distrustful of the government and the likelihood that the public will support large-scale infrastructure spending by the government is diminished. So, for a number of years, I've been repeating the point about the importance of devoting our collective minds to getting the governance of infrastructure investment right—the project selection, construction costs, management, the pricing and the risk sharing between the public and private sector. I think if we can do that then the public will have more confidence that when our money is ultimately used—and it's ultimately the taxpayers' money, often—we'll get value for money out of it. In the absence of being able to do that, there's this underlying scepticism in parts of the community, which I think is insidious. It's incredibly important, and the governance is important as well. That's the end of my lecture!

**Ms KEARNEY:** Dr Lowe, I want to reflect a little bit on the circumstances in my own region. The Commonwealth government has announced and committed $150 million, and $100 million of that was announced more than a year ago in the budget. We've seen this also with airport rail, where our government announced $5 billion towards the construction of an airport rail link between the Melbourne CBD and Tullamarine airport. There's enormous frustration that we're having those major commitments announced and yet they're either not getting matching funding from the state or they're having enormous delays. Just today there was an announcement by the state of some matching funding for a project in Geelong, the Geelong rail duplication project. Getting that funding took two or three years, and that $150 million was just sitting on the table and not being spent, even though our government had committed it. As you can probably tell, I'm very frustrated about the failure, certainly of the Victoria government, to invest in infrastructure at a sufficient rate in the regions. I ask you to perhaps reflect further on that: how can we speed up the rate of investment by state governments?

**Dr Lowe:** I don't know the answer to that, but I can understand your frustration. At a very high level, it comes back to the governance: how do we make the decisions about which project to do, get the money together, spend the money and spend it efficiently? That's the issue that you are grappling with. In other parts of the country, they are grappling with different pieces of that general picture. It's not my area of expertise—how to do governance of infrastructure—but I think it's in our collective interest to find a better way of doing it. The world faces lots of problems, doesn't it? This is not one of the biggest problems. Getting good governance around infrastructure should be something that, if we put our minds to it, we should be able to do. But it requires political commitment and very practical decisions to be made. I share your frustration, but it's not my core area of expertise.

**CHAIR:** In summing up, can I perhaps put it this way: this has been a pretty good report card for the Australian economy today.

**Dr Lowe:** Well, I would agree with that. As I said, growth of three per cent, inflation around two per cent and unemployment at 5.3 per cent—in the broad sweep of our history, it's a pretty decent outcome. I hope we can do better than that; I hope that when we meet next time it will be a bit better than that. But things are going well: the global economy is doing well and firms want to hire workers. Now we just need them to pay them a bit more!
CHAIR: Dr Lowe, thank you very much, and thank you to all members of the Reserve Bank of Australia for appearing before our hearing today—we very much appreciate it. We look forward to seeing you next time. I now declare this public hearing closed.

Resolved that these proceedings be published.

Committee adjourned at 11:50