COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Reserve Bank of Australia annual report 2019

(Public)

FRIDAY, 14 AUGUST 2020

CANBERRA

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Members in attendance: Mr Bandt, Mr Falinski, Mr Craig Kelly, Dr Leigh, Dr Mulino, Mr Ted O'Brien, Mr Tim Wilson.

Terms of Reference for the Inquiry:
To inquire into and report on:

The Standing Committee on Economics, which can inquire into and report on any annual reports referred to it by the House of Representatives, has agreed to undertake an inquiry into the 2019 Annual Report of the Reserve Bank of Australia.
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ECONOMICS COMMITTEE

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
KENT, Dr Christopher, Assistant Governor (Financial Markets), Reserve Bank of Australia
LOWE, Mr Philip, Governor, Reserve Bank of Australia

Evidence was taken via teleconference—

Committee met at 09:32

CHAIR (Mr Tim Wilson): I declare open this hearing of the House of Representatives Standing Committee on Economics for the review of the Reserve Bank of Australia annual report 2019. I welcome representatives of the Reserve Bank of Australia as well as members of the public and the media watching the webcast. It would be fair to say that there is a high degree of interest in this hearing, so we welcome you all.

Since the RBA appeared before the committee in February 2019, the COVID-19 pandemic has had a significant impact on the Australian economy. In March, the RBA responded with a range of measures to support the Australian economy through this challenging period, including a reduction in the cash rate; a target yield on three-year Australian government bonds of around 0.25 per cent; a term funding facility for the banking system, with particular support for credit for small and medium businesses; and exchange settlement balances at the Reserve Bank will be remunerated at 10 basis points rather than zero as would have been the case under the previous arrangements.

At its meeting last week the RBA decided to maintain the current policy settings, including the targets for the cash rate and the yield on three-year Australian government bonds of 25 basis points. Commenting on the decision, the RBA governor said:
The global economy is experiencing a severe contraction as countries seek to contain the coronavirus. Even though the worst of this contraction has now passed—
that in itself is an interesting statement—
the outlook remains highly uncertain. The recovery is expected to be only gradual and its shape is dependent on containment of the virus.
The governor noted:
The Australian economy is going through a very difficult period and is experiencing the biggest contraction since the 1930s. As difficult as this is, the downturn is not as severe as earlier expected and a recovery is now underway in most of Australia—
although of course not in the great state of Victoria at this time—
This recovery is, however, likely to be both uneven and bumpy—
because of further outbreaks—
The governor explained:
Given the uncertainties about the overall outlook, the Board considered a range of scenarios at its meeting. In each of the scenarios considered by the Board, inflation remains below 2 per cent over the next couple of years.
The governor added:
As Australians deal with the coronavirus, the economy is being supported by the substantial, coordinated and unprecedented easing of fiscal and monetary policy. … It is likely that fiscal and monetary stimulus will be required for some time given the outlook for the economy and the labour market.
The governor stated:
The Board is committed to do what it can to support jobs, incomes and businesses in Australia. … This accommodative approach will be maintained as long as it is required. The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band.
These and other issues will be scrutinised by the committee today as we focus on the recovery from coronavirus and other issues that existed pre the coronavirus.

I now welcome representatives of the Reserve Bank of Australia. I remind you that, although the committee does not require to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. Governor, I invite you to make an opening statement.
Mr Lowe: Good morning, and thank you for organising this hearing by videoconference. Our thoughts are very much with members of this committee who are in Victoria, and we wish you all the best. As you know, much has changed in the world since we met in February. We've experienced a global pandemic, the biggest peacetime contraction in the Australian economy in nearly 100 years, and extraordinary monetary and fiscal policy measures. This all means that many of the challenges that we face today were hardly imaginable just six months ago. As I'm sure you will appreciate, economic forecasting is very difficult at a time like this. But the RBA released its regular economic update last Friday and a statement of monetary policy. I would like to begin this morning by highlighting some of the main points from this update and then turn to the policy response over recent months.

As you would know, we do not yet have the GDP data for the June quarter. But it will show the biggest economic contraction in many decades; it is likely to be around seven per cent. If there is any good news at all to be found here, it is that this decline is not as large as we initially feared; it's also not as large as what we're seeing in many other countries at the moment. Similarly, while the labour market outcomes have been very poor, they have not been as bad as was expected. Hours worked were initially expected to fall by a staggering 20 per cent over the first half of this year. The actual fall has only been around half of this, largely due to Australia's initial success in containing the virus and the earlier than expected easing of some of the restrictions.

Looking forward, there is a high degree of uncertainty about the outlook, and our economic recovery depends on how successful we are in containing the virus. In our baseline scenario, we are expecting the Australian economy to contract by around six per cent this year and then grow by five per cent next year and four per cent in 2022. It is certainly possible that we'll do better than this if there's a near-term success in containing the virus or there are medical breakthroughs. But, on the other hand, if we were to see further setbacks in containing the virus, the recovery would be delayed even further.

Given this uncertain outlook, we need to be prepared for a recovery that is uneven and bumpy. The recovery is also likely to be more drawn out than was initially expected, despite the downturn being less severe than expected. There are a few factors at work here. The most obvious is the outbreak in Victoria. At a personal level, this is very distressing, and on behalf of the RBA I extend very best wishes to everyone in Victoria. On the economic front, we expect the outbreak will reduce GDP growth in the September quarter by at least two percentage points. This will broadly offset the recovery that's been taking place in most other parts of the country and, as a result, we are not expecting a lift in economic growth until the December quarter.

Another consideration is the growing impact of an extended period of weak aggregate demand. In the initial phase of the pandemic, some firms were able to keep going because they had a pipeline of work to keep them busy. The construction industry is a good example of this. But with few contracts having been signed over recent months, this pipeline is now being emptied for many firms and they're having to scale back and cut back jobs. Critical to reversing this is stronger growth in aggregate demand.

A third consideration is that people's attitudes to spending are changing because of the pandemic. It's probable that households and businesses will remain more cautious than they were before, and this will affect both consumption and investment. How long this change might last is hard to tell, but we are unlikely to see a quick return to the previous patterns of spending.

Given these considerations, our baseline forecast is that the unemployment rate continues to increase to around 10 per cent later in the year. The unemployment rate would have been substantially higher than this if it were not for the JobKeeper program and other income support programs. And if we take into account people who are on zero hours, the true unemployment rate is higher than the published measure. We're expecting the published unemployment rate to decline gradually from its 10 per cent peak but still to be around seven per cent in a few years time. As I'll come back to later, addressing this high unemployment rate should be very high on our list of national priorities.

In all three scenarios published in our latest update, inflation is likely to be very low. Inflation fell into negative territory in the June quarter for the first time since the early 1960s. While grocery prices and the prices of some other items rose, this was more than offset by the decline in oil prices and government's decisions to make child care free. We're expecting inflation to return to positive territory in this quarter, but to average between only one and 1½ per cent over the next few years. Wage growth is also expected to be low, averaging 1½ per cent over the next two years, so it's a pretty sobering outlook.

I'd now like to turn to the economic policy response. As the pandemic evolved in the early days of March it became clear that a very significant monetary and fiscal response would be required. By virtue of my role as Governor of the RBA, I've been able to see firsthand how this support has been put in place. What struck me from the outset was the very strong sense of common mission from our political leaders, our regulators, our banks and...
the RBA itself. That common mission was to support the Australian economy through this difficult period. The level of cooperation and coordination was extraordinary, and it was a real 'Team Australia' mindset. In my view, this reflects positively on both Australia's political system and our institutions, and we shouldn't forget that.

From the outset, there was a very strong sense that we needed to build a bridge to the other side when the virus is contained. As things have turned out, that bridge has had to be longer and stronger than we might have hoped would be necessary. Even so, it's been the right strategy. At some point the virus will be contained and those foundations that have made Australia such a prosperous country will still be there. We will be better placed to build on those foundations if we've limited the damage to the fabric of our economy and to our society while we're battling the pandemic.

In terms of the RBA's own response, that began with a cut in the cash rate at our regular meeting on 3 March. The Reserve Bank board then held an extraordinary meeting just two weeks later where it decided on a comprehensive package, including a further reduction in the cash rate to 25 basis points; the introduction of a target on three-year Australian government bonds of 25 basis points; a term funding facility for the banking system in which funds can be provided for three years at 25 basis points; the continued use of our open market operations to make sure the financial system had a high level of liquidity; and the modification of the interest rate corridor system, with the rate paid on exchange settlement balances set at 10 basis points rather than zero. This package is designed to keep funding costs low right across the country and support the provision of credit, especially to small and medium-sized businesses. To support these businesses, the term funding facility provided banks with an initial $5 of low-cost funding for every extra dollar of credit extended to small and medium-sized businesses. Many other central banks have announced similar packages, although the Bank of Japan is the only other central bank with a yield target; in their case, they have a target for 10-year yields.

In announcing our yield target for three-year bonds, the bank indicated that we're prepared to buy bonds in the secondary market in whatever quantities were needed to achieve that target. To date, overall bond purchases have totalled around $55 billion, and most of these bonds were bought in March and April. These purchases have had the desired effect: they have lowered yields and they've eased market dislocation, which was apparent at the time. In the past week or so, we've again purchased bonds, buying around $6 billion. We've done this following a few weeks in which the yield on three-year bonds had been trading consistently a little above 25 basis points. The yield is now closer to 25 basis points, and we are committed to maintaining the target.

In taking the decision in March to target the three-year yield, the board considered the possibility of instead undertaking a regular program of bond purchases, buying a set amount of bonds each week. This is what is a number of other central banks have done. We chose the yield target for a couple of reasons. The first is that it's a more direct way of achieving our objective of low funding costs right across the country. A bond-purchasing program would have also lowered bond yields, but it would have done this indirectly and there would have been challenges in calibrating the required size of the purchases. Directly targeting a longer-term risk-free interest rate is also a natural extension of our target for the cash rate, which is the risk-free interest rate at the very start of the yield curve.

The second reason is that this target reinforces the forward guidance regarding the cash rate. The board has clearly indicated that it will not increase the cash rate until progress has been made towards full employment and it's confident that inflation will be sustainably within the two to three per cent target range. Given the outlook I sketched earlier, these conditions are not likely to be met for at least three years, so it's highly likely that the cash rate will be at this level for some years, and having a target for three-year yields of 25 basis points reinforces this message.

So that was our rationale. We have not ruled out a separate bond-buying program or other adjustments to the mid-March package, but, for the time being, the board's view is that the best course of action is to continue with the current package. The board recognises that, in the unique circumstances in which the country currently finds itself, the solutions to the challenges we face lie in areas other than monetary policy.

Having said that, the mid-March package is providing material help right now and will continue to do so. Interest rates are lower than they've ever been before, and the financial system is flush with liquidity. Also helping is the fact that Australia's financial system is in good shape. We went into the pandemic with strong balance sheets and high levels of capital in the Australian banking system, and this means that our financial institutions are well placed to provide the credit that the economy will need in the recovery phase.

One monetary policy option that has been the subject of recent discussion is the possibility of the RBA creating money to directly finance government spending—so-called MMT. To some, this offers the possibility of a free lunch. The harsh reality, though, is there's no free lunch. There's no magic pudding here and there's no way of putting aside the government's budget constraint permanently.
As I spoke about in a talk last month, it's certainly possible for a central bank to use monetary financing to affect when and how government spending is paid for. Depending upon how things are managed, it can be paid for through the inflation tax, by implicit taxes on the banking system or by higher general taxes in the future—but it does have to be paid for at some point. I want to make it clear that monetary financing of the budget is not on the agenda in Australia. The separation of monetary policy and fiscal financing is part of Australia's strong institutional framework, and it has served the country well and will continue to do so. The Australian government and the states and territories have ready access to capital markets and they can borrow at historically low rates of interest, and that's how they should finance themselves.

I'd like to mention a couple of other areas where, at a more practical level, the RBA has been providing assistance to Australia's COVID-19 response. The first is that, over recent months, as the transactional bank of the Australian government, the RBA's banking systems have been used to make record numbers of payments, processing the government's income support to households and to businesses. We've done this with around 90 per cent of our staff working from home, and it has been a great effort by the RBA's banking and payments teams. The second is meeting increased demand for banknotes. While COVID-19 has accelerated the shift to electronic payments, there has paradoxically also been record demand for banknotes. It seems this is because people want to hold a few more dollars at home. The result has been that the stock of banknotes on issue has increased from $83 billion in February to $94 billion today. That's a large increase in a short period of time. We've met this extra demand despite our main storage vault being located in one of the coronavirus hotspots in Melbourne.

I'd like to close now with some general comments about the economic policy response to the pandemic. While monetary policy has played an important role, it's been fiscal policy that has provided much of the support to the Australian economy. This is quite a change from how things have worked over recent decades, and it's been accompanied by a significant increase in public borrowing as governments work to limit the hit to people's incomes. This shift in fiscal policy is quite a shock for a country that's got used to low budget deficits and low levels of public debt. In that context, it's worth making a few points. The first is that, by borrowing today to support the economy, we're avoiding an even bigger loss of output and jobs that would damage our economy and our society for years to come, and this would also put ongoing strain on the budget. Second, Australia's public finances are in strong shape, and public debt here is much lower than in most other countries. Third, the overall national balance sheet is also in a strong position after decades of good economic performance. And, fourth, government's financing costs have never been lower, with interest rates being the lowest since Federation.

This all means that the expected increase in public debt is entirely manageable and it's affordable. It's the right thing to do to borrow today to help people, to keep them in jobs and to boost public investment at a time when private investment is very weak. Of course, there will always be debates about the precise nature of the programs and about how much support should be provided, but the general direction, the general strategy, that we have right now is the right one.

Looking forward, an important priority will be to boost jobs. Based on the forecast I discussed earlier, high unemployment is likely to be with us for some time, and I think it should be a concern for us all. The Reserve Bank will do what it can, with its policy instruments, to support the journey back to full employment. Beyond that, government policies that support people's incomes, that add to aggregate demand through direct government spending and that make it easier for firms to hire people all have important roles to play. As I have said a number of times before, we need to make sure that Australia is a great place for businesses to expand, to invest, to innovate and to hire people.

Thank you very much. My colleagues and I are here to answer your questions.

CHAIR: Thank you very much, Governor, for those opening remarks and for appearing with the deputy governors today. You have said a number of things in your opening statement which I want to briefly explore. You said that you don't see the solutions around economic recovery being realised through monetary policy. Is that a correct reflection of your remarks?

Mr Lowe: Monetary policy is playing a supporting role. The fact that interest rates are as low as they've ever been before is helpful. The bank system is flush with liquidity; that's helpful. And the banking system is in a strong position. So that's all helping. But, looking forward, there are limits to what more we can do. I think the main policy instrument we really have now is fiscal policy. It's supporting people's incomes, adding to aggregate demand through government spending and structural reforms that make it attractive for businesses to hire people; that's what we've got to focus on now.

CHAIR: I'm not disagreeing with your assessment, but it sounds to me like you're saying that monetary policy is exhausted, in terms of what can be done to provide economic recovery.
Mr Lowe: I wouldn't say it's exhausted; I think there are limits to what more it can reasonably do. We could make some adjustments to the package we introduced in March. I don't think that at the moment we would get any traction from making adjustments. But the main thing going forward is going to be fiscal and structural policy; that's the reality we face.

CHAIR: You then said, just at the end of your remarks, that you see the solution being the promotion of an environment that enables business to expand, invest and innovate. Do you want to outline for us where you see possible or important reforms that can enable industry, businesses and enterprise to do so?

Mr Lowe: I don't have a shopping list of things that I would like to do, but I have a shopping list of general areas. One is the industrial relations system. I think there's a process going on at the moment to try to make the enterprise bargaining system more flexible so we can get back to a world where businesses and employees can get together and make their businesses work effectively rather than be weighed down by process, which is what happens at the moment. So industrial relations is one. I think the general approach we have to innovation—the financing of research and development—is an area to look at. Another area is the general approach to regulation. There are many examples at the moment of projects taking a long time to be approved. That slows down the dynamism of the economy. Planning and zoning restrictions I think is another area where we could do things to make the system and the economy more dynamic, as is, over time, making sure that we have a workforce that has the right skills and that is adaptable. So it's human capital, physical capital, skills, regulation and the labour market; they're the areas that we should be focusing on.

CHAIR: And tax?

Mr Lowe: Tax, yes. One that I've talked about on previous occasions is stamp duty. That's a tax on mobility—on people moving location. If we're looking for an economy that's dynamic and vibrant, we want to remove taxes on mobility. Many people who look at the structure of the Australian tax system say the balance between taxes on land, income, wealth generation and consumption isn't optimal. This is an issue that's been debated in Australia for a long period of time. There are many political issues here, but I think we know the general areas we should be looking at; the challenge is to actually implement some of those ideas in difficult times.

CHAIR: The reflection I'd make is that you don't see that it's necessarily your job to do that; that's up to the government and the parliament to decide—which I do respect and understand. But getting those on the record around freeing up the economy is very important. You made some very specific comments about debt and the opportunity for borrowing, and the importance of fiscal measures to carry us through this period. Do you think the states should be doing more? When you've got the Commonwealth currently spending about $314 billion and the states only contributing about $44.8 billion so far in spending to assist, would an increase or a shift in responsibility to the states help aid the economic recovery?

Mr Lowe: I think we need both the federal government and the state governments carrying their fair share. The federal government, I understand, has announced measures so far equivalent to roughly seven per cent of GDP. That's been very important in getting the country through this. And we're going to see a budget deficit next year of probably close to 10 per cent of GDP. So there's been very significant fiscal stimulus from the federal government. The measures to date from the state governments add up to close to two per cent of GDP. So, in aggregate, those measures are smaller; they've largely focused on supporting businesses through the difficult period and extra spending on health, and in some states there's been extra spending on infrastructure and on housing and skills development.

In going forward, the challenge we face is to create jobs, and the state governments do control many of the levers here. They control many of the infrastructure programs. They do much of the health and education spending. They're responsible for much of the maintenance of much of Australia's infrastructure. So I would hope, over time, we would see more efforts to increase public investment in Australia to create jobs, and the state governments have a really critical role to play there.

To date, I think many of the state governments have been concerned about having extra measures because they want to preserve the low levels of debt and their credit ratings. I understand why they do that, but I think preserving the credit ratings is not particularly important; what's important is that we use the public balance sheet in a time of crisis to create jobs for people. From my perspective, creating jobs for people is much more important than preserving the credit ratings. I have no concerns at all about the state governments being able to borrow more money at low interest rates. The Reserve Bank is making sure that's the case. The priority for us is to create jobs, and the state governments have an important role there, and I think, over time, they can do more. But the federal government may be able to do more as well. We may need all shoulders to the wheel.
CHAIR: Well, it'll be an interesting balancing exercise, but there is clearly currently an imbalance between the contributions of the Commonwealth and the states, in terms of the economic recovery or sustaining the situation and leading towards economic recovery, on those simple numbers, and you've outlined that they control many of the levers. How do you see the economic impact of the border closures at the moment?

Mr Lowe: There are two sides to this coin, aren't there? The border closures clearly have an effect on economic activity right at the moment. I know that, in the agricultural industry, it's creating problems because workers moving between states are often important for dealing with crops. So that's creating an issue. At the Reserve Bank itself, we've had issues with some of our projects where we've required people in Queensland to come down and provide services and they can't come down, so things get put on hold. It's clearly having a significant impact on economic activity. So that's one side of the coin.

The other side of the coin is: in those states where the border restrictions are in place, the coronavirus numbers have come right down—in some cases, to zero—and that's creating a sense of confidence in those states and increasing spending there, and if closing the borders does help contain the virus then in the end we'll benefit from that. So there's short-term cost, perhaps, but there are some short-term benefits as well because it's generating greater levels of confidence. I think we see, in Western Australia now, and Tasmania to some extent as well, people feeling a bit better, and spending's picking up. That's partly because of the border closures. So that's the positive short-term gain. Perhaps the longer term gain is we're more successful in containing the virus nationally. I don't know what the medical advice there is, but it's certainly possible. So there are two sides to this.

CHAIR: I don't dispute there are two sides, but how much economic impact do you think there will be to have ongoing state border closures, if they were to, say, continue for the remainder of 2020? And do you think there is a point at which it can become imbalanced against the economic recovery of the nation?

Mr Lowe: It certainly could be. There could be a point where the benefits that we get on the health front aren't sufficiently large to offset the short-term economic costs. That's certainly conceptually possible. The reality we face, though, is that the economy is not going to recover until we get on top of the virus. We'll have these periodic shutdowns. People are very nervous so they aren't going to spend. Even if there are restrictions in place, people are not going to spend if they're nervous about the virus. I'm not privy to the medical advice about how effective the border restrictions are in slowing the spread of the virus—

CHAIR: But, looking at the example of New Zealand, where they effectively achieved elimination, they had very strong border closures and, obviously, are substantially two core islands. But, ultimately, if you keep your borders closed it still doesn't even address it. So do you see risk management in living with the challenges of the virus as a more sustainable alternative rather than the hope that you can either eliminate it and/or have hard border closures.

Mr Lowe: I certainly do. I think that New South Wales is proving to be a really important test case, because if New South Wales can manage some limited community transmission with first-rate testing, contact tracing and isolation when cases arise—if that can work—then we should be able to open up the economy. I think it should give us confidence that we can keep on top of it. And if we can develop that confidence, I would hope that from an economic perspective we could open our borders and that, as a country, we have enough ability and confidence in our capability to keep the virus under control when it pops up.

If New South Wales can't make this a success then I think we're going to face a whole lot more challenges. So what's going on in New South Wales is still very important and we have a lot resting on that being successful—this demonstration effect that you can open up, give people some freedom, have economic activity return to a type of normality and keep the virus under control—and open the borders. Let's hope New South Wales can make it work.

CHAIR: Let's hope they can indeed. One of the most important actions—and I agree with you about the RBA's facilities to help the retail banks particularly—is supporting loan deferrals for SMEs and, of course, household mortgages. That has been critical, but where do you see the trajectory around the growth in credit and the issues around loan deferrals? There has been an extension from the original September deadline for another four months, in certain circumstances, where retail banks are prepared to provide it. How sustainable do you see that? And do you see the possibility of further deferral options?

Mr Lowe: I think it's too early to be talking about further deferrals at this stage. Around 10 per cent of mortgage customers deferred; that's a significant number, but it's not the majority. It's 10 per cent. And, of that 10 per cent, roughly a fifth have already started repaying their mortgages again on the regular schedule. So that's positive. The banks tell us that there are other customers who have deferred who would be in a position to start their mortgage payments again but they're just choosing not to because they want to build up cash reserves. So
there are significant numbers of people who can't start paying their mortgages again but we're not talking about the majority of bank customers.

Recently, I've spoken to the CEOs of most of the banks and the credit unions. I know they're all paying very close attention to this issue, as is the ABA. There is a very broad agreement that it's in no-one's interest to have widespread loan defaults and forced sales. It's not in the banks' interests, it's not in their customers' interests and it's not in the country's interests. So the banks are working with their customers on how they can service the loans. There are a few options here: in some cases, principal and interest loans can be turned into interest-only loans and that reduces the repayment burden. Many households have built up substantial buffers over time in their offset accounts or in other deposit accounts and they can use that to pay down their loans. In some cases there is the possibility to lengthen the term of the loan, to reduce the rate of the repayment. In some cases, if it's an investment property, if someone has two or three investment properties, they can sell those investments properties to put their balance sheet back into a more sustainable position. So there are a whole range of options, and banks are working with all their customers to work out which is the best option. There will no doubt be some borrowers who can't pay back their loans and will have to sell the property. The banks are very conscious to make sure that doesn't occur in a rush and that the process is managed and smooth. Whether there need to be further deferrals, I think time will tell, but, at the moment, the banking industry has this issue right at the top of its mind. They've hired a lot more people and they're working with their customers to make sure that this is all manageable.

The last point I'll make here is that the solution isn't loan deferrals; it's more jobs. The solution to most of the problems we face is creating jobs, and that gets us back to where we were before: aggregate demand, an environment that's conducive to hiring people, and income support. That's the solution. If you're worried about loan deferrals, it comes back to creating jobs.

CHAIR: I don't disagree with that. The main reason people are likely to default on their mortgage is if they don't have employment anymore. But do you have any concern about the volume of debt that's now being accrued as a consequence, or do you have a high degree of confidence that the banks are sufficiently on top of it and have the necessary capital and flexibility to address any problems?

Mr Lowe: I don't have any concerns at all about the stability of the banking system. The banks went into this episode with the highest level of capital they've ever had. The capital buffers are strong. The banks are in a robust position. They've started making provisioning for extra loan defaults, and I think that will be sufficient. They're in a strong position to provide the credit the country needs. The issue is more the stress that this is going to cause for individual households, as their incomes come down, they've got debt and they can't pay it back. That's a very stressful situation. The banks understand that, and they're working through it, using the mechanisms I've just talked about, with their customers. But I don't have any concerns at all about the stability of the banking system.

CHAIR: You said before, and rightly, that employment and job creation are a critical part of the discussion around economic recovery and addressing issues of aggregate demand. The RBA has previously flagged with this committee that it was doing research on the compulsory super guarantee and its viability as a deferral of wages. Do you have a view as to whether it's a good idea or a bad idea to defer the increase in the compulsory super guarantee at this time?

Mr Lowe: I'm not going to offer an opinion on whether it's a good or bad idea. All I would note is that it's in legislation, and I'm not aware of a proposal by any political party to change that legislation, so I'm not going to offer an opinion. I think the evidence is that increases of this form do get offset by lower wage growth over time, and we haven't done any work since the last hearing to contradict that conclusion.

CHAIR: But, if we increase the compulsory super guarantee, do you think it will have a negative effect on employment and growth in employment in the economy?

Mr Lowe: I don't know whether it would have a negative effect on employment. It would certainly have a negative effect on wages growth. If this increase goes ahead, I would expect wage growth to be even lower than it otherwise would be. So there will be an offset in terms of current income. Some people say that's perfectly fine because people will have higher future income. There's a trade-off: do we want people to have income now, or do we want them to have it later on? Different people will view that trade-off quite differently, and I don't want to enter into that debate, because it's potentially politically controversial. Although, at the moment, both parties support the legislation; that's my understanding. Whether that remains the case [inaudible].

CHAIR: But it's not illogical to say that an increase in the compulsory super guarantee is likely to have a negative effect on jobs growth.

Mr Lowe: There will be less current income. If there's less income there may be less spending, and if there's less spending there may be fewer jobs. That's a whole sequence of chains that have to work out, but it's certainly
possible. As has always been the case with superannuation, it's a trade-off between current income and future income.

CHAIR: The Productivity Commission recently did a report looking at employment amongst young Australians. Are you familiar with that report?

Mr Lowe: I'm familiar with the fact that there was a report, but I haven't read it.

CHAIR: It said there has not been income growth among Australians under the age of 35 since the early 2000s in the context of a competitive labour market. Do you have any reflections on that?

Mr Lowe: As I said, I haven't read the report, but we have talked at this committee before about the lack of wages growth and low wages growth over a long period of time. That's been particularly pronounced for younger workers. That's made their position more difficult. It's clearly the situation we've been in. When we've talked about this issue before, there have been a number of factors. One is a very big increase in labour supply. There's been a strong increase in demand, but there's been a big increase in supply that's put downward pressure on wages. I think the nature of technology has had an effect as well. So there's been a lack of wages growth across the entire community, and wages for young people are no exception. In fact, their wage growth has been even weaker on average. It's a problem that I've been calling out for at least two or three years. That problem is going to be even more acute over the next couple of years. But it's been, in my view, overtaken by a bigger problem, and that is getting people to have jobs. Let's get them to have jobs and then we can worry about the wages. The first priority at the moment is to make sure people over the next couple of years have jobs. If they don't have jobs, it hurts the economy, it hurts society and it creates all sorts of problems. So the priority now is to make sure people have jobs. I think that should be our singular focus.

CHAIR: When it comes to the environment of job creation, particularly for small and medium-sized businesses to be able to employ people with a degree of confidence, there are currently insolvency provisions to assist small and medium-sized businesses, particularly in this disruptive time. Do you think that they should be extended?

Mr Lowe: While ever we're in this unique position, with parts of the country being shut down because of a once-in-a-century pandemic, there are strong arguments that normal rules shouldn't apply. If that means an extension of these provisions I think that would be sensible. At some point, though, we'll have to confront the reality that there are firms in Australia that are no longer viable because of the pandemic and they will need to be wound up. We're going to be better off if that's a managed process that takes place over time rather than occurs because we go over a cliff because of some change in regulation. So there will be insolvencies. There will be bankruptcies. There will be some businesses that will not recover. That's the harsh reality of an economic downturn that's the worst in 100 years. They're going to be better off if that process is staggered and managed rather than occurring in a short period of time. I would hope an extension of these provisions would allow that process to be managed.

CHAIR: One of the areas to promote jobs growth is in the context of construction, which is very important for economies, particularly in places like Victoria and New South Wales. The RBA recently published a report called The apartment shortage, which went through the practical costs of apartment dwellings, particularly looking at, if I'm not mistaken, New South Wales. Essentially, in the final price, only 68 per cent reflected the cost of actually constructing the property. The remaining difference of 32 per cent, nearly a third, is essentially a direct result of regulatory costs, particularly around planning and zoning. Do you see deregulation around zoning and planning as a critical part of stimulating construction, which will have the effect of lowering house prices but also promoting job creation?

Mr Lowe: The short answer to that is yes, but I will ask Lucie to respond to that in more detail because she's much closer to the research than I am, if that's okay.

Dr Ellis: Thanks, Phil. The first point I'd make is that we have a long tradition at the Reserve Bank of releasing research discussion papers to stimulate discussion. They're not necessarily the views of the bank; they are staff work that is intended to stimulate broader discussion. That's the first point I'd make.

The second point I'd make is that that paper is not intended to be the whole answer in working out what to do. It wasn't advocating any particular policy stance. It identified that in Sydney there was a gap between price and marginal cost in the apartment market, much as one of the same authors had, with a different co-author, found for the detached housing market in an earlier paper. Interestingly, you don't find that same gap in Brisbane, so it's just a matter of understanding what it is about the different markets that is causing that gap. Quantitatively, the change in housing prices that even doubling the apartment supply would create is not a magic bullet; it's not going to halve the cost of housing. So the contribution of that paper was to quantify the cost of what we think is probably
the zoning regulation; there could be other things going on, but, given the pattern across cities, it seems it's most likely to be zoning. It quantifies the cost in terms of higher prices that people are ending up paying. What it doesn't do is quantify the benefits that people are seeking to obtain by having zoning regulations and mediating the scarcity of land supply. In that I would remind everyone that, relative to Brisbane and Melbourne, Sydney is more constrained by geographic features, so you can understand that the political system and the social fabric may want to mediate how that supply of land is allocated. Then the question is: is that being done in the right way?

**CHAIR:** Just quickly, I have a final question for the governor before I hand over to the deputy chair: do you think that in the post-COVID economic recovery there's a role for the Commonwealth and the states to work together to address the issues around planning and regulation which are increasing housing supply and potentially suppressing the number of jobs in construction?

**Mr Lowe:** I think those issues should be addressed. As to whether it's the federal government and the state governments coming together to do it, I'm not sure enough about the political economy of how all that works. But all the research that we and others have done says that the zoning restrictions and the planning restrictions make housing supply less adaptable and over time they increase housing prices. So, if we can do something about that, that would be good.

The other thing that's increased housing prices over time is inadequate investment in public and private transport, because, as this paper identifies, the main cost of housing in many parts of the country is the price of the land, and the land prices are higher because there's strong demand for well-located land. The supply of that pushes up the price, and we can increase the supply of well-located land through good investment in transport. So the best way of making housing affordable for people, I think, is transport policy and zoning and planning rules. The tendency always is to give people money to try and make housing more affordable. That affects the demand side, and I understand why that's the response, but the best response is on the supply side, whether it's transport, zoning or planning. Whether there's a role for the federal and state governments working together I'm not sure, but what I'm sure of is that the issue exists, and it would make a difference to our housing prices in a way that makes housing more affordable for people.

**CHAIR:** Thanks, Governor.

**Dr LEIGH:** Governor, thanks to you and your colleagues for joining us today. As we discussed in the last hearing, throughout your time as governor inflation has been below the target band and unemployment has been above the natural rate. Now you have put out forecasts that have core inflation remaining below the target band for the entire forecast horizon, meaning that you could conceivably go from your appointment in 2016 to the end of your second term in 2023 basically without once bringing inflation within the target band—your central mandate. It is pretty clear that other central banks are doing more, given where Australia's exchange rate is at. We've had a quarter of negative inflation. I want to ask you, in that context, about your decision to rule out negative interest rates. That's been criticised by a number of commentators—Stephen Kirchner and Bill Evans. You have the experience of other central banks around the world. There was a BIS survey, which you would know well, since you wrote the foreword, which found that other central banks that had taken rates negative thought the policy helped to achieve their goals, and the side-effects were contained. Governor, wouldn't a year of negative rates be better than a decade of zero rates?

**Mr Lowe:** I don't quite see the trade-off quite like that. I make it clear that I haven't ruled out negative rates. What I've said is that they are extremely unlikely. In a world that is so uncertain and so fluid I don't think it is prudent to rule it out, but it is extraordinarily unlikely. If I can explain why that is the conclusion we have reached. On the positive side of the ledger, I think the main benefit from negative rates is downward pressure on the exchange rate. If we were to have lower rates then I think we'd see a lower currency, as well. That is the benefit and that would be a material benefit.

You've got to weigh that against the costs, and there are two here that I reference. The first is that negative interest rates in most countries do impair the profitability and efficiency of the financial system and ultimately its ability to provide credit to the real economy, which is really important. We're seeing this in Europe now. There are a lot of problems in the European banking system, but there are structurally low profits and it's quite difficult for them to provide the credit to the economy that's needed. So, the banking systems don't work as well with negative interest rates. They would also create distortions in our financial system, because deposit rates would effectively be bounded at zero. That's what happens in other countries, as well, for most depositors. So, a bank that financed itself with a lot of deposits would be at a competitive disadvantage to one that finances itself in wholesale markets at negative interest rates. So, there'd be distortions within the financial systems there. I don't think credit supply would be enhanced by negative interest rates.
A second negative I want to mention is that in many countries there is increased concern that negative interest rates encourage people to save more, not spend more. Imagine I tell you that you can put $100 in the bank and in five years time I'll give you back $95. That's what negative interest rates mean. In response to that, we're seeing in some European countries—and in Japan there is some evidence of this as well—that people say, 'Because I'm going to get less from the bank in three or four years time I have to save more.' So, reduced supply of credit, and maybe some people save a bit more, versus the benefit of the exchange rate. In the current situation I don't think the cost-benefit justifies negative interest rates. Since we've had the pandemic, no central bank that's had positive interest rates has gone negative and no central bank with negative interest rates has gone more negative. I think that tells you that the consensus amongst the central banks is that, really, there is not that much to be gained from doing this, and perhaps the costs are greater than the benefits. If that consensus were to change, then, as I said, we haven't ruled it out, but I think it is extraordinarily unlikely.

Dr LEIGH: Can I take you up on two responses there, first of all on the impairment of the financial sector. It seems to me you are effectively there putting bank profits ahead of jobs, and in an environment in which our major banks have been unusually profitable, both compared to Australian corporates and compared to their international counterparts. That seems a mistaken call. Secondly, your contention that it encourages saving rather than spending seems at odds with your evidence to this committee last time, in which you said that lower interest rates boost spending, on aggregate. One could tell some kind of a behavioural story as to why that changes at zero, but the bank, so far, has not attempted to do so and your public statement on this haven't made clear as to why the direction of the effect suddenly switches when you go negative?

Mr Lowe: It's an emerging area of research, and, at least when I talk to my peers about negative interest rates, some of them say that in their countries there's evidence that something changes with negative interest rates—the mindset switches. When you tell people they're going to get less from their bank than they put in, that worries them and they start to save more. So I think there is something different about going into negative territory. The evidence is still emerging, because the experience with this is fairly limited, but I think it's plausible and people are worried about it, and we're not seeing people go more negative as a result.

I take issue with the contention that I'm putting bank profits before jobs. What I want to see is the credit supply process work effectively, because we need banks that are profitable and are willing to supply credit—and that the credit supply markets are not distorted. My concern, at least at the moment, is that negative interest rates would make credit supply more difficult and that would hurt jobs. So it's not about bank profits; it's really about jobs. My current view is that negative interest rates wouldn't help jobs, and, arguably, could make things worse. If that judgement changes, then we'll move.

Dr LEIGH: Let me ask you about the Term Funding Facility. It was aimed, principally, at increasing lending to small businesses, but Reserve Bank statistics released show that over the year to June small business lending fell while lending to large businesses grew by eight per cent. Does that suggest the Term Funding Facility was too small to provide sufficient support to small businesses?

Mr Lowe: No, that's not a conclusion I would draw at all. The demand for credit by small businesses at the moment is quite weak—

Dr LEIGH: [inaudible] large businesses?

Mr Lowe: I'm sorry, I didn't catch you.

Dr LEIGH: Is it really plausible that the demand for credit by small businesses during this pandemic is smaller than the demand for credit by large ones? I'm talking about the underlying, rather than the loan applications.

Mr Lowe: What we saw at the beginning of the crisis was many large banks draw on their credit lines. Because they wanted liquidity, they borrowed money from the bank and put that in their deposit accounts so they could be sure that they would have enough money at hand to pay their bills. So credit to large businesses did increase very quickly at the beginning of the pandemic. Now, some of that credit is being paid back. Clearly, credit supply to small businesses is an issue. It's one that's been with us for years and years. At the moment, our sense from talking to the banks and even to some of the small business associations is that not many businesses want to borrow. They don't want to borrow because they're so uncertain about the future they're not investing. They are really in preservation mode. The Term Funding Facility is making a difference. It makes sure the banks have plenty of liquidity to provide the credit if they need to. I think that's working, but it's really the demand side that's the problem.
Dr LEIGH: Demand's a function of price. Have you considered alternatives like lowering the interest rate in the Term Funding Facility to below zero? The ECB does that with their targeted longer term refinancing operations. Have you looked at options like that for extending the flow of credit to small businesses?

Mr Lowe: It's the same kind of issue about negative interest rates. It would be curious for us to lend to banks at a negative interest rate when the government interest rate was positive. If we moved to negative rates, that would be an option. But I don't think the lack of growth in small business credit is because the interest rate's too high. They're as low as they've ever been. What we hear is that in the particular environment we're in at the moment the demand for credit is weak. It's not surprising. Why would you go and borrow at the moment, when there's so much uncertainty about the future?

Dr LEIGH: Well, large businesses are and small businesses aren't. To me, that points towards a pricing problem. Clearly that's not the read you take out of the data. The yield curve control has been fairly effective in lowering medium-term interest rates. What would lead you to extend yield curve control to a longer maturity, such as lowering five-year yields to 0.25 per cent?

Mr Lowe: We chose three years for a couple of reasons. One is that the three-year bond rate influences corporate and bank borrowing rates. Quite a few companies that borrow in the bond market would do it for around three years, and banks raise a lot of funding around the three-year mark. So, by lowering the three-year bond rate, we lower the funding costs right across the country. That's the primary consideration. The second consideration was linked to the forward guidance point. I feel reasonably confident in saying that I think the cash rate is going to be at its current level for three years. The forecast that we talked about earlier on would certainly suggest that the cash rate is not going to increase for three years, and having a three-year target is consistent with that.

Am I confident the cash rate is going to be where it is for five years? Maybe, maybe not—I would certainly hope not. So I think the target for the risk-free government yield curve should be broadly consistent with your expectations for your own policy instrument. It's possible that the cash rate is where it is for five years. I hope it isn't, but it's possible. If I had a very high degree of confidence that the cash rate was going to be here for five years, then there would be stronger argument to target a five-year yield, but let's start with the three and see where that goes and how the economy progresses.

Dr LEIGH: Suppose your goal is to get inflation within the target band by the end of your term, wouldn't extending yield curve control to a longer maturity help achieve that?

Mr Lowe: It may or may not. I don't know that we would get much more traction at the moment from having the five-year yield curve at 10 or 15 basis points lower than where it currently is. But, if we're going to have a target for a five-year yield, I think it needs to be consistent with our expectations for the cash rate.

Dr LEIGH: I'm interested in your purchases of state bonds. When I look at the share of state bond purchases and compare them to the population distribution, the thing that jumps out at me is that you're buying a smaller share of New South Wales and Victorian state bonds than their proportionate share of the population. What explains why you're buying relatively fewer New South Wales and Victorian state bonds?

Mr Lowe: I'll ask Chris Kent, who's on the phone or on the video, to answer that because he heads that area that's in charge of the bond-buying program.

Dr Kent: Essentially, the whole point of this program to purchase these bonds was to counter the bond market dysfunction that we were seeing in both the federal government and the semi-government markets. It was to counter market dysfunction rather than fund the states in particular. What made sense for us is to calibrate it according to the stock of bonds outstanding as the more relevant metric. Certainly, investors typically don't hold bonds in proportion to something like gross state product; they're more likely to follow something which is weighted according to the outstanding stock of bonds. The shares that we ended up allocating to the different states—New South Wales and Victoria, with around 45 per cent of our buying program—were in accordance with the value of bonds outstanding and a bit less than something like the share of those states in, say, output of the economy.

Dr LEIGH: Thank you for that. Governor, I want to take you to the human toll of the downturn. You've stated recently that the scarring impact on Australian workers will be larger than anticipated. Can you talk a bit about what Reserve Bank research reveals about the impacts on young workers, particularly, of extended periods of joblessness over the course of their career?

Mr Lowe: It's not just our research. It's the research by many others that says that, if you enter the labour market in a time when there's high unemployment, that affects your income and your job prospects for years. If you don't get onto that first rung of the job ladder, it's harder to climb up the job ladder in later years and your
income suffers. The research, not just from us but by others, is that there are mental health and physical health issues as well from long periods of unemployment, which can reduce people's employability and success in the labour market. This is why I've said a number of times already through this hearing that the priority needs to be to get people into jobs, because that's where the scarring comes from, in terms of both people's economic performance but also their success as a member of society. If you have a long period of unemployment, there are a lot of issues with that.

**Dr Leigh:** So if you knew that this was going to be a deep and prolonged recession and that we were going to be at the zero lower bounds for an extended period, would that change how you thought about unconventional monetary policy? At the moment, you're being relative conservative compared to many of your central bank peers. Would you be inclined to be more aggressive and, if so, on which of the three areas we've discussed this morning?

**Mr Lowe:** We are prepared to do more if we think that doing more would get extra traction. Judgement at the moment is that, given the nature of the problems the country faces, us moving interest rates by five or 10 basis points isn't really going to make a material difference. There's not going to be much traction from that; the problems are elsewhere. If we get to the point where the board's judgement is that we would get traction from further adjustments in policy, then we're prepared to do that. In a speech that I gave a few weeks ago, I said it would be possible to cut the interest rates that we're currently set at 25 basis points down to 10. As I said before, we haven't ruled out negative rates, although it's extraordinarily unlikely. It's possible that we could complement the [inaudible] yield curve target with a program of bond buying further out the yield curve, not targeting the five-year rate as you suggest but buying five- and 10-year bonds to try to get those yields down a bit more. It's possible we could do that. If we get to the point where we think that would get traction and make a difference to jobs and economic performance, then we're prepared to do it. But I think that right at the moment we're not at that point. It's not the cost and availability of credit that's causing the weak economic activity; it's the lack of confidence; it's the shutdowns; it's the pandemic. Hopefully, we get to a point where people again are focusing on the cost and availability of credit and they want to invest and expand, and it may be at that point that further monetary measures do gain traction. If that's our judgement—

**Dr Leigh:** I want to ask you about what's coming back on a couple of issues through your liaison program. What are you hearing through your liaison program about the potential for a wave of insolvencies when insolvency laws change at the end of September? Secondly, what is your liaison program telling you about landlords refusing to negotiate with small businesses on rent reduction, given that the federal government has left rent reduction to be negotiated on an individual, business-by-business basis?

**Mr Lowe:** Maybe I'll ask Luci to come in on landlords. But, on the wave of insolvencies, it's certainly a concern for many businesses that, once this temporary restriction is removed, they will have to be put into insolvency. So there's an argument for extending the special provisions, as we talked about before, that currently exist. It's an issue that's going to need to be managed. My hope is that, to the extent that businesses are going to fail, and there will be failures, this can be smoothed out over time, because it's in no-one's interest for large numbers of firms to go bankrupt at the same time. The banks are very conscious of this. We talked about it in terms of the mortgage customers. They're also conscious of it in terms of small businesses. So it's a process that's managed, but we do need to face the reality that some businesses will go bankrupt. That's what happens when you have the biggest downturn in 100 years. It's the unfortunate, and the harsh reality and the human cost. We know many small businesses around the country are very worried about it. So it's important that support measures remain in place and that, as they're gradually wound down, it's a staggered process rather than going over a cliff. The banks are aware of that. The government is aware of that. I know it's very difficult, but I think it's manageable. Luci, on the rent issue, I haven't been on top of the discussions there. You may be a bit closer to it than I am.

**Dr Ellis:** We're not hearing a pattern of firms that have actually experienced a downturn in revenue being refused rental reductions. We have heard from some landlords that some firms, tenants, that are actually doing okay have nonetheless been asking for rent reductions. So we do hear both sides of the story in our liaison program. Certainly some landlords have seen very large declines in rental income, particularly in the retail sector, because they have been offering rental reductions. Some rental contracts already have an automatic factor to allow for turnover anyway. We haven't been hearing a consistent set of stories that businesses that are genuinely in distress are being refused. But I'm sure there will be cases of that where there is a difference of opinion about just how much distress or just how much of a decline in revenue a tenant has experienced.

We have also seen a lot of reductions in rent for households. Yes, we do hear from our liaison contacts that they're worried that there will be many insolvencies, particularly in construction, retail and hospitality—but we
haven't seen it yet. That's partly because of the rules and partly because of the many other measures to tide people over during this difficult period. In fact, the insolvency practitioners in our liaison program, whilst not exactly twiddling their thumbs, are not seeing the flow of business that they were expecting from either businesses or households.

**Dr LEIGH:** Yes. I think that's got to do with a pause in the rules. I want to conclude with a final question about what I think must rank as the worst market decision in Reserve Bank history: the decision in 1997 to sell 167 tonnes of gold when the world gold price was US$400 an ounce. The gold price is now about five times as high, around $2,000 an ounce. So, had Australia held onto that gold, it would be worth about US$9 billion more now than it was back then. Do you acknowledge that, in retrospect, that was a lousy decision? What will guide you in future as to the Reserve Bank's decision to buy or sell gold?

**Dr Debelle:** While your price calculations are completely correct, there a couple of points I'd make. The proceeds from that sale generated returns subsequently. You're correct that if we sold it now it would be at a higher price, but in the meantime those proceeds allowed us to invest in US treasuries, which earned a rate of return—unlike gold, which earned a zero return. So we earned interest income in the intervening 20-odd years. That also has allowed us to pay higher dividends to the government. So one way you could think about this is that the result of the proceeds of the sale but also the interest income we've earned on those alternative assets that we've held. The dividends we paid to the government allowed them to do whatever they were going to do without having to borrow at a rate of around five or six per cent. I leave the compounding of that to you. But when you do that calculation the decision is not quite so dramatic as the way you just framed it.

**Dr LEIGH:** Do I take it there are no lessons that the Reserve Bank has drawn from that episode, then?

**Dr Debelle:** The idea is always to sell an asset at its highest price. That is indeed a good thing to try to aim for. I think trying to predict the future of gold prices is difficult. It may have been a more sensible decision to turn around and take all those proceeds and invest them in Apple shares. We possibly would have earned an even higher rate of return. My point there is that the future is indeed uncertain, particularly future asset price movements, and hindsight is always the greatest investor. That is one lesson that one can always draw from such calculations.

**Mr Lowe:** Perhaps I could make one final point: the Reserve Bank is not an investment bank. We don't hold a portfolio of assets to try and make the highest return, and we're not speculating on the prices of assets. We're holding these assets in the national interest, and the judgement we made back in the 1990s was that holding large stocks of gold in our vaults was probably not in the national interest. We're better off converting those gold holdings to foreign currency, because we need foreign currency for policy purposes: occasionally intervening in the foreign exchange market in the national interest—not very often, but sometimes we want the capability to do that—and generating a flow of income to the government, which holding US Treasuries, as Guy said, has done. So from the point of view of maximising the value of our assets, if that were our objective, I accept your criticism, but, from a public policy perspective, I think it was the right decision.

**Dr LEIGH:** Thanks. I'll have other questions if there's time later.

**CHAIR:** Thank you, Deputy Chair. I take it you purchased gold in 1997 and you have held onto it dutifully thereafter because you think it's the right strategy. Just for Shane Wright at *The Sydney Morning Herald*, I need to clarify they were dishes in the drying rack. Now I'll hand over to the member for Fairfax, Ted O'Brien.

**Mr TED O'BRIEN:** Thank you, Governor, and your team. We all love hindsight. If you do find that crystal ball, could you please share it with me, and then we'd both be very happy for the rest of our lives, I'm sure.

**Mr Lowe:** Yes, sure.

**Mr TED O'BRIEN:** I will start by following up on something raised by the chair and the deputy chair, and that's around insolvencies. I take your point, which was wisely put, about the need to manage the process and that business failures are inevitable. We don't want zombie businesses roaming the countryside any longer than they need to. My question therefore goes more to whether or not you're of the view that we should be transitioning, over whatever time it is, back to the insolvency regime we had pre COVID or whether, in fact, we need a different regime. I ask the question knowing that some in the industry believe that Australia has harsher insolvency laws compared to elsewhere.

**Mr Lowe:** I'm afraid I can't really answer that question very effectively because it's beyond my area of expertise about insolvency law. The current suspensions are clearly helping us, and I think there's an argument to extend that while we're in this particular unique circumstance. If it is the case that the insolvency law is kind of inflexible and harsh, I think that's worth looking at; it must be as a matter of principle. It's linked to my other longer-term concern that the economy is becoming less dynamic. It would be interesting to explore—and I haven't
done this—what role the insolvency laws are playing in that. We're becoming less dynamic. The rate of new firm creation and firm exodus is low. I worry—and I've spoken about this on other occasions—that we're becoming less dynamic, and maybe the way the insolvency laws play out is part of that. I'm not expert enough to specifically answer your question; I'm sorry.

Mr TED O'BRIEN: That's okay. Am I right, though, in taking it that the RBA's estimate of both economic growth and unemployment assumes that the current relaxations do end at the end of September?

Mr Lowe: I think that must be right, because our general approach is to take current laws and regulations as given.

Mr TED O'BRIEN: Yes, okay. I will move to some international issues. Reflecting on the GFC, I know there was a lot of analysis post GFC about why Australia did well, and frequently people point to the fact the government started with a very good set of accounts, so they had room to move, and to the very strong, stable financial and banking system. Thirdly, people often talk about the demand that came from China. The enormous amount of stimulus out of the PRC created an insatiable demand for Australian products—resources in particular. If it's looking—and it is—as if China is looking at not going down a similar path but being more cautious with their monetary stimulus, what impact do you see that having on our ability to recover?

I appreciate the fact that iron ore is looking really strong at the moment—the price—but if China is not going to be the stimulus that it was in the GFC, what impact do you see that having on the Australian economy?

Mr Lowe: You're right that in the GFC, the China boom, the strong balance sheets that we had in Australia and the ability to deliver a big fiscal monetary response—and the fact that our banking system was in a really good position—all helped us get through it better than most other countries. At the moment China, again, is doing better than most other countries. It had a contraction, obviously, in the first quarter, but in the second quarter it bounced back. The high-frequency flow of data out of China in the last couple of months has, on the whole, surprised on the upside. There seems to be more strength in the Chinese economy than many people expected. We're seeing the effect of that, as you said, in iron ore prices, which are very high. And the prices of many of the base metals have also risen over the past couple of months, partly due to strong Chinese demand. And we're actually seeing elsewhere in North Asia, in the countries that have managed to contain the virus, that economies are picking up. So there is almost a virtuous circle: as you get in control of the virus then economic activity can return to normal and there is extra investment, trade and so forth. So that's working reasonably well.

You're right: the Chinese authorities are not stimulating to the same extent that they did in the GFC—I think they learned their lesson—but they are stimulating. There is increased spending on infrastructure, which is positive, and they've set a higher target for growth in credit than last year's target. It's not the super growth in credit we saw in the GFC, but they're allowing more credit extension in the economy—that's stimulatory—and they're spending on infrastructure. That's helping us now, as is the recovery in some of the north Asian countries, in Taiwan and South Korea. We're not going to get the huge hit we got from China but, once again, the growth in China is helping us.

Mr TED O'BRIEN: Thank you. What about foreign direct investment, which has obviously taken a hit anyway, globally? Can I just get your comments on what the international flows might look like for Australia in the RBA's view; whether or not COVID hitting other countries—particularly emerging nations—provides an opportunity for Australia to be effectively a safe haven in relative terms, but probably having an absolute decline in inbound FDI. I wouldn't mind getting your commentary on any of that.

Mr Lowe: At the moment, net foreign investment in Australia has turned around because we're running a current account surplus for the first time in many decades, and the counterpart of the current account surplus is the capital flow. That's turned around for the first time in many decades.

Your question, though, is really about foreign direct investment—

Mr TED O'BRIEN: That's right.

Mr Lowe: and that is weak at the moment because investment in physical capital is weak. We understand why it's weak: firms don't want to invest at the moment at the peak of the COVID pandemic.

Going forward: whether overseas firms want to undertake foreign direct investment in Australia will come back to how our economy performs. It will come back to the opportunities we have, our workforce, our skills, our tax system and the ability to extract our natural resources. Those are things that are going to drive foreign investment in Australia. If we have higher levels of investment in Australia, we'll see higher levels of foreign direct investment. So we have to get the economy back running again and domestic firms wanting to invest. Investment is very, very weak at the moment and I think it's going to stay weak for a while. But if we can get the settings right and investment comes back then I think we'll see foreigners finding Australia a very attractive place...
to deploy their capital and to build new physical assets. At the moment, there's continuing strong demand for Australian government securities, and foreign investors find Australia a very well run place—strong institutions, strong balance sheets—and so there's strong demand for Australian government securities, which is keeping interest rates down. But the key is to make Australia an attractive place for firms to invest—both domestic firms and foreign firms—and it comes back to some of the issues we were discussing before.

Mr TED O'BRIEN: You were talking about your confidence in the stability of the banks, and you mentioned some of the risks around household debt, which is particularly high. It seems to me that households are somewhat caught between economic needs. On one hand, they're so indebted that they don't want to expose themselves further but, on the other hand, we want them to spend. Which is it? Which do you think the priority should be? Do we need Australian households to be spending right now or to be paying down their debt?

Mr Lowe: I want them to do both and I think they can do both. The saving rate is kind of positive. In fact at the moment the saving rate is as high as it has ever been because household income has held up, largely due to the government transfers, and spending has been depressed by the restrictions and the uncertainty that people feel. So the saving rate has gone up, and that's helping to improve people's balance sheets. If our income growth is strong enough we can both spend and pay down our pay down our debt. I'm always circling back to income growth, and that comes back to investment in jobs. We can do both, and at the moment households are using a lot of the extra income they've got through the government support programs to improve their balance sheets. We hear from the banks that, when the government makes the payments to people, in a lot of cases it goes off their mortgage or goes into their offset account and they pay down their credit card, because credit card debt is declining a lot. People are paying back that because they got the income through the government support programs and they're trying to get their balance sheets into better shape, which is good. Most of the debt that the household sector have hasn't come because we've consumed too much. Most of the debt we have is because we've borrowed it to buy high-priced houses and apartments, which is another issue, but spending consumption is not being financed by debt in Australia and hasn't been for a long period of time by and large.

Mr TED O'BRIEN: I'll go back to where my little session started, which was the crystal ball. If you did have a crystal ball, what would be the one uncertainty we currently face that you'd love an answer to?

Mr Lowe: I have kind of two big uncertainties. One is obvious—the pandemic—because the economy will not return to normal until we get on top of the pandemic. Even if we don't have restrictions, people are nervous, and when you're nervous you don't spend and firms don't invest, we don't get the foreign direct investment you were talking about. So the biggest uncertainty is control of the pandemic. Once we get through that, the next big concern is the commitment of the global economies to an open, rules based trading system. I'm sensing a retreating commitment in some countries, which I find incredibly worrying. Australia has benefited from an open rules based system more than perhaps any other country in the world. It's the source of much of our prosperity. So if there's a retreat from that I think we'll pay a big price. The world needs to come together to solve some really big problems. I'd list there the pandemic, climate change, the taxation of the global economy and dealing with some debt problems in some very poor countries. These are issues that are first-order that need a global solution, and if we're retreating from globalisation and the ability to come together, then the global economy will be weaker and Australia will be less prosperous. So that worries me in the medium term. Once we get through the pandemic, we'll have to deal with making sure that the countries of the world can effectively come together to make sure our economies are strong, deal with climate change, with the taxation issues and with some really chronic problems in some very poor countries which ultimately could come back to hurt us all. 

Mr TED O'BRIEN: Thanks very much, Governor.

CHAIR: We're now just going to take a quick 10-minute break.

Proceedings suspended from 11:05 to 11:15

CHAIR: We'll now resume the Standing Committee on Economics hearing on the Reserve Bank of Australia's annual report. I will now hand to Dr Mulino for 15 minutes.

Dr MULINO: Thanks, Chair, and thank you, Governor and the Reserve Bank team, for coming here to give evidence today. My first question is about the nature of this recession. As you've already indicated, it's likely to be the deepest economic downturn for many decades. Obviously every recession is unique, and that's one of the challenges of macroeconomics. But my sense is that this recession will probably be more uneven in many respects than most economy-wide recessions, in part because it's being driven by our health response, as it rightly should. I think that means that, in terms of both the geographic impacts and the sectoral impacts, there are highly uneven impacts—for example, where there are statewide or regional geographic lockdowns that are harsher than for the economy as a whole or where sectors that depend upon interpersonal contact are being shut down. I'm interested
in your thoughts. Would you agree that there's a highly uneven set of impacts arising from this recession, compared to other economic downturns?

**Mr Lowe:** I think that's 100 per cent right. Most previous recessions have been caused by some type of macroeconomic policy mistake, problems in the financial system or a global shock. They tend to affect the economy as a whole—a bit differentially, but largely the effect is pretty uniform across the country. This one is very, very different. The virus hit certain parts of the country and not others, and we've had differential success in containing it. Obviously, being in Victoria, you know that it's affecting Victoria very differently than Western Australia and Tasmania at the moment. The effect is very uneven. As we come out of it, though, I think there will be a common issue that the whole country faces, and that's weak aggregate demand. While the immediate effect is very different, depending on the health outcomes and the industry structure of particular areas, my biggest concern going forward is that there's going to be weak aggregate demand because people are going to be nervous, and when people are nervous they don't spend—consumers don't spend and businesses don't invest. As we come out of this and some of the unevenness starts to dissipate, as we get on top of the health situation, it will be the issue of aggregate demand. Weak aggregate demand is a common factor we face in all recessions. So it's certainly uneven at the moment—unfairly uneven—but there will be a phase when we'll face the common need to increase aggregate demand right across the country.

**Dr MULINO:** I think you're right: aggregate demand should be a key focus and that will tend to lift all boats. Looking at geographic unevenness as one example, a lot of the media commentary focuses on the unevenness across states. That's understandable, because state borders are such a focus, but there are other, more granular areas of unevenness, which I think are just as important. One example would be regional Queensland areas which might have been very heavily dependent upon international tourism. I'm interested in your response. Is it fair to say that some areas, at a more granular level like that, may not benefit from aggregate demand rising as much as we hoped it would and that not so much monetary policy but overall government policy and fiscal policy should pay attention to that level of granular unequal impact?

**Mr Lowe:** As you rightly point out, the effect's very uneven, and northern Queensland, where there's a lot of reliance on foreign tourists, is particularly hard hit. Another part of the economy that's being hard hit at the moment is businesses serving the CBDs where people go into offices because, in many offices, the occupation rate is 10, 15 or 20 per cent, so the businesses that serve CBD offices are very weak. I see this in the businesses even around the Reserve Bank here in Martin Place. Other parts of the country are doing relatively well, and some industries are doing quite well at the moment. The industries supplying the grocery stores are mostly doing well. The resource sector, by and large, has been relatively unaffected. Parts of agriculture are doing well. They've got labour shortages at the moment, particularly as we come into harvest season. So the effects are very, very differential. As we come out of this, it will be an issue for governments around the country as to whether they try and offset those differential effects with industry or regional specific policies. That's something we'll have to confront going forward. But from a macro perspective, my main concern is to make sure that aggregate demand is sufficient to give firms the confidence to invest and people the confidence to spend.

**Dr MULINO:** Looking at fiscal policy from that macroeconomic perspective and its impact on aggregate demand, I think you've said there is obviously an ongoing role for monetary policy and there's still more that it might do, but, in the short to medium term, it's likely that fiscal policy will probably do more of the heavy lifting over the short to medium term. Obviously, one of the key aspects of fiscal policy that we focus on is how much is being spent, but another dimension of fiscal policy is the analogy to your forward guidance, which is providing people with certainty as to how long benefits might be in place. That will provide people with more confidence to spend. We've had a little bit of forward guidance provided recently as to the extension of JobKeeper, albeit at lower levels, until December and then March and the jobseeker supplement until the end of December. Is it fair to say that any amount of fiscal stimulus is going to be more effective to the extent that it provides people with more guidance and more confidence so that they can make plans and, ideally, have more confidence to spend?

**Mr Lowe:** I think, as a general principle, what you say must be right. At the Reserve Bank, we're very conscious of the value of being clear about what we're likely to do in the future and the framework that we're using. So, on a monetary front, that works well. The same lesson can be applied to fiscal policy to provide guidance where you can and to make it very clear to people what the framework we're operating under is. Government, I think, has done a reasonable job of doing that. It does, though, face the challenge at the moment that the situation is very fluid. Just four or five months ago, we thought this was all going to be relatively manageable, but the situation can change very, very quickly. In that world, it's very hard to be very specific about what you're likely to do in the future. I think what we can do is to provide guidance about the framework and the strategy, and the government has been working on that. You might ask for more, and, in time, we may see more,
but we need to remember that, at the moment, the situation is very fluid. It's possible that, in three or four months
time or when we meet next year, we'll be talking about a vaccine and the boom in the global economy that's
coming from that. On the other hand, we may be talking about renewed outbreaks that we're having trouble
containing. So they're huge first-order uncertainties, and I think we've got to retain some flexibility. But clarity
around the strategy, I agree with you 100 per cent, is important.

Dr MULINO: I totally agree with you that the situation is fluid and difficult to predict. But, if you look at
Newstart, for example, I would have thought that most people now agree that returning to the old level is
probably not going to happen. People on Newstart have been given a bit over three months of forward guidance.
It just seems as though, given that they are people who are on very low incomes and also have a very high
marginal propensity to consume, it will be critical to sustaining consumption levels. It would seem as though a bit
more forward guidance there would be very, very easy to accommodate within the fiscal envelope. We may see
more in the budget, of course, but that would seem like an obvious area where it would be very easy to foresee
that payment levels will be sustained beyond December.

Mr Lowe: There is, I think, a fairly broad consensus across society that some increase in the level of the old
Newstart is appropriate. I would join that consensus. I note that the Prime Minister has said on a number of
occasions that the government is leaning in very heavily towards some further extension. I think that makes sense.
We'll see what the government announces over coming months.

Dr MULINO: I have a quick question on the currency. There's obviously a lot of factors at play. One is
demand for resources, which, as you've noted, is probably a bit higher than we might have expected in some
areas, due to the slightly faster recovery in China than we were expecting a few months ago. There's obviously the
US currency, which is behaving in certain ways based upon people's reaction to its prospects, and then our
relative interest rates. I guess I'm just curious on what you see as the main key risk factors, both upside and
downside, and where you see the balance of risks at this point, albeit acknowledging there's a lot of uncertainty.

Mr Lowe: On the currency, I see the balance of risks as being balanced, with no particular risks in either
direction. I would like the currency to be lower because I think a lower currency would help the economy and
would create more jobs—the critical priority— and would also lift inflation a little bit. So a lower currency would
be beneficial. Can I say the currency is overvalued? I can't say that. I think it's broadly fairly valued. When we run
our various economic models, with the currency being determined by the interest differential and commodity
prices, the current value is broadly in line with the value that those models generate. Over the past couple of
months, the prices of our commodities, the key exports, have risen. Iron ore is the highest it's been in many years
and many of the base metals have risen. As to food prices, some have risen and some are down. But commodity
prices are holding up better than we'd thought. The Australian economy is also doing better than many had
thought. We can't really discuss today the economic data from other countries, but last night or the night before
there were data saying the UK economy had fallen by 20 per cent in the June quarter.

Dr MULINO: Yes.

Mr Lowe: The Spanish economy is down 18; the Mexican economy, 17; US and Germany, roughly 10;
France, 13. We haven't got our numbers yet, but it's probably around seven for us. So, as horrible as that seven per
cent decline is, it's much smaller than what most other Western countries have experienced. We've managed the
crisis, the pandemic, better than many other countries. Our economy is stronger. We've got strong fundamentals, a
strong public debt position, a strong national balance sheet, and the capability to respond—and we've done that
better than most. And the commodity prices have lifted. So it's no surprise to me that the currency is where it is.
I'd like it to be lower. I don't really have the effective tools to get it lower, and we're not prepared to intervene in
the foreign exchange market unless we think our currency is misaligned, and I don't think it is. You asked about
the balance of risks. I'd say they're balanced. Much depends upon commodity prices and whether we can continue
with relatively good economic performance compared to our trading partners.

Dr MULINO: I've just two more quick questions. One is: like all macroeconomic agencies that are
forecasting the short and medium term, it's very difficult at the minute. And one has to make certain assumptions
for the core forecast. There are obviously some scenarios, both on the upside and the downside, that one also
would bear in mind. Do you run scenario analysis on certain outcomes on the upside and downside, outside of
your core forecasts?

Mr Lowe: Outside of our core forecasts—in the statement of monetary policy that we put out last Friday,
there was an upside and a downside scenario, and we articulated what we thought growth, unemployment and
inflation would be under those scenarios. I don't know whether you're asking about that or much more extreme
scenarios.
Dr MULINO: I am thinking of more-specific outcomes, like an outbreak in a particular state leading to a long-term shutdown. Do you try to model the impacts of specific outcomes to see what the sensitivity of the economy might be to those?

Mr Lowe: As best we can, we do. Luci, could you say what assumptions we used in the downside scenario that we put in the statement of monetary policy last week? That might give an idea of the type of work we are doing.

Dr Ellis: In the short term for these forecast you're always trying to calibrate the initial contraction in activity to the activity restrictions that are going on. As they lift you allow for some bounce-back, and then with some concerns over the virus lingering—so, you have a slower recovery—if you're in a scenario where you're modelling the virus not being under control versus a relatively quick recovery and a quick control of the virus. The specific assumptions we made for the downside scenario were—you can get it a number of different ways, but one way you can get the result we put out as the baseline is 10 additional weeks, beyond what has already been announced, of stage 3 or 4 restrictions in Victoria and in New South Wales. So, it is a reasonably 'downsidy' downside. You can imagine even worse outbreaks, but we thought that was a sufficiently downside one to be illustrative.

Dr MULINO: I'm conscious that my time allocation is coming to a close. At a very high level, it's obviously a very uncertain and fluid environment. What are the three key risks that keep you awake at night?

Mr Lowe: I think we have covered many of these. I only really have two—although they don't keep me up at night. The pandemic: how are we able to control that, and, then, when we do, is there enough aggregate demand to keep the economy growing sufficiently to generate the jobs we need. That's the first-order issue. The second one is the international one I talked about—the fracturing of the global [inaudible] just to solve problems. They're the two big-picture issues I worry about.

Mr FALINSKI: Governor, thank you for your time. In March this year you announced the term funding facility to assist ADIs to continue the flow of credit. You said it was an initial allowance, up to 30 September 2020. Given everything that's going on in Victoria, and border shutdowns in WA and Queensland, is the RBA considering extending this facility, maybe to 31 March next year?

Mr Lowe: Chris, are you still on the line? Given you're the keeper of the term funding facility you might like to answer that.

Dr Kent: Yes, I am here. I didn't quite hear the end of the question.

Mr FALINSKI: Are you thinking of extending the facility from the end of September this year to the end of March next year?

Dr Kent: As you may know, we haven't had a full take-up of the facility—the initial allowance that's been provided to banks. We do expect that to be taken up by the end of September, and the take-up is starting to increase now. There is also quite a lot of additional allowance that has been generated for some banks that have managed to increase their business credit, including some banks to small- and medium-sized enterprises. That runs until the end of March. I just refer you back to the governor's earlier comments about the possibility, if the situation demands it, of providing a little bit more extra stimulus to our existing package. Extending or adjusting the term-funding facility could be one aspect of that. But at this stage, with all of that extra funding still to be untapped, I think it's probably just a bit premature to be speculating about that.

Mr FALINSKI: So, would it be fair to say that, yes, it's under consideration?

Dr Kent: Sorry, I'm struggling to hear you.

Mr Lowe: I will take that, Chris. It's one of the options that's on the table. If we thought that would improve the outcomes, we would be prepared to adjust it. The initial allowance is $90 billion, and that has to be drawn by the end of September. My understanding is that most financial institutions are on track to do that. And then there will be further drawings available, which are now running at at least $50 billion, if banks have extended additional credit to small and medium sized businesses. So they are going to have months to take that. They might suddenly take it a bit earlier than they thought and just leave in in their account with us. I think that's entirely manageable, but we'll see.

Mr FALINSKI: Can I move on to least-cost routing, an issue I know you have been very excited about for a number of years. There have been some recent announcements around that. Are you happy with where the financial institutions are moving in that regard? If you're not happy, are you considering any further action that you might take to embed low-cost routing for consumers?

Mr Lowe: Thank you very much for asking about that.
Mr FALINSKI: Can I just remind you that I only have 15 minutes to ask you questions. I know that you can expand on this issue for a long time, because you have detailed knowledge, but please don't use up all my time.

Mr Lowe: Michelle, could you give a very short answer.

Ms Bullock: Yes, Phil. Up until this point, we haven't been very happy with the way banks are dealing with least-cost routing. We would like to see them more proactively market it to their customers. You're right that one bank has in fact decided to do that. We are very pleased with that, and we'll be continuing to encourage it.

Mr FALINSKI: Would you consider taking further action if other financial institutions don't follow suit?

Mr Lowe: That's an option. We've got a payment system review currently underway. We've put it on hold because of the pandemic but we're going to come back to it later in the year. Introducing regulation here to make sure merchants get a great deal is one of the options under consideration. So it is not the preferred option. The preferred option is that the banks actually get out and serve their customers as they should. If they don't do that, we'll have to look at—

Mr FALINSKI: Can I pick you up on one thing there—and I didn't really want to go down this track: the banks aren't the only people providing routing these days; there are a whole bunch of other providers in the marketplace. Is the payment system review also trying to uncover why it is that the dominant providers of these services are so sticky in our marketplace?

Mr Lowe: I think we understand why that is largely the case. You're right, there are some new providers—what we call 'acquirers'—who are providing a great deal to many merchants. There are some very good offerings out there, and we will always encourage merchants to make sure they have a look at those. There is stickiness, though, because often the acquiring business is linked with the loan business—the overdraft and the credit facilities. They are all bundled up, and it's hard for small businesses to unbundle the various financial services that they get. So they go to one institution for it.

Mr FALINSKI: In the old terms, that was called 'third-line forcing'. I'm not accusing financial institutions of doing that, but is there more that we can do to make it easier for consumers to unbundle these services?

Mr Lowe: I don't know that there can be any regulatory intervention that can be made. I think we've got to both keep the pressure on financial institutions and give the information to merchants so that they know there are better deals out there. If people have more information about better deals then gradually they respond. We are seeing this in the mortgage market right now, with huge amounts of refinancing.

Mr FALINSKI: I would like to go to your excellent report on planning. As a regular consumer of Reserve Bank publications, I found your report on planning and overregulation of our property market in Australia incredibly clear and quite devastating in terms of what it says about cost. If I had one complaint, though, it would be that you don't really talk about this cost in human terms. The Economist earlier this year made the point that when the Japanese government undertook planning reform it reduced homelessness by 80 per cent in Tokyo. We've had retirement income survey after retirement income survey demonstrate that one of the best ways to secure people's financial security in retirement is for them to either own the home in which they're living or have a very large equity stake in it. Shouldn't this be a massive priority for all governments in Australia?

You talked today about the alignment of transport and zoning, but there are certain tax systems and incentive systems in other parts of the world—value sharing, value capture, infrastructure improvement bonds, for example. Is this not an area that the RBA could be looking at increasingly as well?

Mr Lowe: Thank you, I'll pass the comments on to the authors. I'm glad to hear you found it useful. The extra comments you make about the human costs are perfectly valid and ones that I share. The high cost of housing for many people comes at a huge detriment to their lifestyle and their budget and their family. It should be a priority to make housing more affordable. I've been discussing it at this committee for as long as I've been attending it. As I said before, I keep on saying, it's a failing of trends for modern zoning, but it's about taxation as well, and negative gearing factors in to this. It's been a politically contested area in Australia. It's not the Reserve Bank's role to get into how the tax system should be designed. How to make housing more affordable is about supply—supply, supply, supply—that's our observation: doing what we can to make the supply of land and housing, and that comes through zoning and the flexibility of the zoning requirements, more flexible. That's how we fix the problem. It would be for me in many ways the single biggest thing we could do for people's welfare. I agree with you, but this is—

Mr FALINSKI: Can I make the point that there are calls for the federal government, always, to spend hundreds of millions of dollars more on social housing. Here we have an example of bad regulation that is in another country, being Tokyo, increasing the amount of homelessness by five times what it could been if there'd
been proper regulation. Isn't this just an example of if you're serious about improving the outcomes of the welfare of vulnerable Australians, you need to fix bad regulations in the economy?

Mr Lowe: I agree with the general principle. On the other hand, the fact that we have these zoning areas, these zoning restrictions, makes some areas of our city very attractive for certain people to live in. They value the amenity that comes from low-density housing and having trees and parks. So there is some value from it.

Mr Falinski: But that cost is being borne by vulnerable Australians.

Mr Lowe: It's borne by others. Some Australians obviously get very significant benefit from these zoning restrictions—

Mr Falinski: They typically tend to be wealthier Australians.

Mr Lowe: They tend to be. But there is a cost to the rest of the society from the amenity that these people enjoy, and it's really up to you as the politicians to balance those. All the Reserve Bank can do is draw attention to them, and this is what we'll continue to do.

Mr Falinski: And I congratulate you for drawing attention to something that people have deliberately ignored for too long, but while we're on the point of bad regulations and unintended consequences, we, the federal parliament, introduced not long ago responsible lending obligations, which essentially have the principle that the lender is responsible for decisions that the borrower makes. Is it your evidence to this committee and to the parliament that that law is not having any impact on credit creation and lending to small business and to those enterprises that are taking a risk in starting new enterprises?

Mr Lowe: That's not my evidence. I think it is having an effect. Just to go back to the legislation the parliament passed, which at a very high level is eminently reasonable, it says that, when extending credit, the loan can't be unsuitable—who could argue with that?—and in making the loan you've got to take reasonable steps that the borrower can repay. Well, who could disagree with those two broad principles? I find it very hard to disagree with them. What has happened is that those principles have turned into hundreds of pages of guidance. Once the compliance people, the lawyers, the regulators and the media get involved, these high-level principles put in law get turned into a lot of guidance, because people don't want to offend these kinds of regulatory requirements.

Mr Falinski: Can I humbly put it to you that you're being very generous. Wasn't it the interpretation of the courts, until the recent ASIC v Westpac case, that what this actually did was put the obligations back on lenders to understand absolutely and completely the capacity of borrowers to service a loan? That's why it turned into hundreds of pages and, when this was tested before the courts, especially the lower courts, that's what they found. I guess that's why we say the principle makes sense but the unintended consequence was that it restricted lending in the Australian capital markets.

Mr Lowe: I agree with you. I think the principles in the legislation are sound, but I think the way we've translated those principles into reality needs looking at again. If we can't do that properly, maybe we need to look at the legislation. We can't have a world in which, if a borrower can't repay the loan, it's always the bank's fault. On a portfolio basis, we want banks to make some loans that actually go bad, because if a bank never makes a loan that goes bad it means it's not extending enough credit. The pendulum has probably swung a bit too far to blaming the bank if a loan goes bad, because the bank didn't understand the customer; if it had done proper due diligence—this is the mindset of some—the bank would never have made the loan. So some of the banks have had this mindset, 'Well, we can't make loans that go bad.' I would have to say, though, that in the past three or four months I've heard fewer concerns from the banks about the responsible lending laws. ASIC introduced new guidance. Institutions are gradually coming to grips with those.

Mr Falinski: That might be because, under the extraordinary powers we granted the Treasurer, he has given them relief from RLOs. Do I have time for one more question, or not really?

Chair: Very quickly.

Mr Falinski: We've had evidence from you, from the Productivity Commission and from a whole bunch of other people that those countries that have more agile capital markets and more competitive economies generally are going to be able to bounce back from the pandemic. There is a recent study—when I say 'recent', I think it's about 15 years old—from an economist by the name of Jose Azar who made the point that your capital market structure can have a real impact on what competition looks like. He undertook a study between institutional holdings in different airlines in the United States. Where you had airlines that were largely owned by big institutions, competing in a particular route, you could have ticket prices that were 35 per cent higher. Is this something that the RBA is considering or looking at in terms of competition policy and efficiency of our capital markets?
Mr Lowe: I'm not aware of that particularly study. The general issue is obviously important to us. An ongoing question is the lack of depth in our corporate bond market. There've been many studies into this. I think our equity markets work remarkably well. You have super funds investing in equity, and in recent months we're seeing more equity raisings as a share of GDP in Australia than in many other countries. So the equity market works really well. Our bond market works okay but not really well, and we and others keep trying to think of things to make the bond market work more effectively. But, largely, Australian bond markets work well.

Mr Falinski: Thank you.

Mr Bandt: Thank you Governor and others for appearing. We've talked a bit about the human cost of the pandemic. You may have alluded to this, and you probably agree that a lot of this is falling disproportionately on young people. Job losses amongst young people are higher, and they went into the pandemic with more than three out of 10 young people either not having a job or not having enough hours of work. So things weren't rosy before. Not only have we seen a lot of young people lose their jobs—as have many others in Australia, but it's falling pretty hard on young people—we're also facing massive challenges because a lot of the industries that young people would be employed in, or might expect to find jobs in—hospitality and the arts and so on—may not get back on their feet for a very long time, because of the social distancing restrictions as we deal with the crisis. In my view, one of the answers to that has to be the government stepping in with some big nation-building and job-creating projects that offer a jobs guarantee to young people. The question then becomes how we would finance that. In your opening comments, you came out swinging against unconventional monetary theory and said there's no such thing as a free lunch. But, equally, we could say that, in the middle of a pandemic, we shouldn't charge Australians more for their food than we have to, and you certainly wouldn't deny food to someone who's starving. Given that the government could get better rates by effectively having you finance the debt rather than by going to the private markets, why shouldn't we be looking now at getting people back into work through having the Reserve Bank assisting with the financing of some government debt?

Mr Lowe: I agree 100 per cent with you that we should be looking at programs to get people back into work. I, like you, am very concerned about young people. In a way, they're paying the price to keep the rest of us safe. We talked earlier about the uneven nature of what's going on. There are many people who still have jobs and who have been going about their lives reasonably well, and there's another group of people who are suffering tremendously. I see those people as really paying the price so that the rest of us can stay safe and the economy can eventually rebound. We need to protect those people who are paying the price right now. So I agree with you. The solution, though, I don't think is monetary financing by the central bank. As I said in the introductory remarks, if we were to finance the government it doesn't change the intertemporal budget constraints; the government would still have to ultimately pay for the spending. There would either be inflation if we didn't control it properly, or the banks would pay through implicit tax, or there would have to be higher taxes later on for the government to pay back the money the Reserve Bank had extended to it. The financing is not an issue. The government can borrow this morning for 10 years at 0.9 of one per cent and can borrow for three years at one quarter of one per cent. So the financing is not the problem here. The first order issue—and I think this comes back to modern monetary theory as well—is the idea that the government should just keep spending to achieve its objectives. It's called modern monetary theory; it's really some propositions about fiscal policy. The first proposition is that the government should just keep spending to achieve their objectives—either full employment or inflation or whatever. The second proposition is that it shouldn't worry about financing. But the first proposition is that the government should keep spending. So modern monetary theory really isn't about anything monetary; it's really about fiscal. I think that's where the debate needs to be: how much government spending should there be? Resolve that answer, and I'm not worried at all about the financing. The Australian and state governments will be able to finance themselves at extraordinary low interest rates for a long period of time. So the financing constraint is not the issue.

Mr Bandt: In Indonesia, the central bank has basically just agreed to a $40 billion program at zero per cent interest. That's certainly cheaper than what the government could get if it was forced to go out into the markets. At the moment, you're carrying about $54 billion, I think it is, of various government debts. You can do something that other creditors can't—you could agree to write off that debt. You could not insist on it, and that would go a huge way to helping the government at the moment. Conversely, some of this debt is starting to fall due within this financial year. If you insist on the government repaying it, then isn't the government going to have to go out and borrow more, given its current budgetary situation, and aren't you then going to have to go out and purchase more bonds to meet the yield target? Aren't we going to have the situation, same as in the US, where, effectively, the amount of government debt that the Reserve Bank holds on its books is going to be roughly equal to what the government has to borrow, and you're going to end up having to financing it anyway—it just gets washed through the banks and they take a clip, and the government pays more than it otherwise would have to?
Mr Lowe: There are a lot of layers to that argument. You started off by saying that we could just say to the government, 'You don't need to pay back these bonds.' Just think then about the balance sheet of the central bank. We're holding these bonds. They're an asset. We've got the liability on the other side, which is the bank deposits, and we write off the asset. The central bank balance sheet is then hugely in negative territory. We can operate for a while with negative equity, but it's not the right way of doing things. And, if you continue to do that, the central bank balance sheet would go more and more into negative equity, which would be very problematic in the end. It could destroy confidence in the country, and institutional arrangements would come under question.

So the right way to do this is for the government to borrow—at the lowest interest rate since Federation. The borrowing costs are not a constraint on government at the moment. Governments aren't deciding they don't want to spend more because of the cost of borrowing; the cost of borrowing is incredibly low and it's going to stay low. So the first-order question is how much the government should be spending. Let's decide that. The financing is going to look after itself in a country like Australia.

Mr BANDT: Would you consider something like the Indonesian approach, where the central bank has effectively provided zero per cent loans to the government, which is clearly cheaper than forcing the government to go through the mechanism that you're proposing?

Mr Lowe: There's less cash flow expended in the short run; that's right. You're not paying interest on these bonds, and, if you issued in the market, you would have to pay interest. But now the central bank has an asset that's earning no money, and then, over time, there will be lower profits at the central bank and lower distributions to government, and there will have to be a tax compensation for that. So it's incorrect to think that providing this financing the other way ultimately lowers the total cost of finance. It doesn't. It can delay the time when the government ultimately pays for the cost of financing. It's certainly possible to do that and, in some circumstances, it could be warranted to do that. But they're not the circumstances that Australia faces, with borrowing at the lowest rate since Federation. And financing is not a constraint on government fiscal policy.

Mr BANDT: If full employment was the aim—so it's not about spending until we reach the government aim, but we just take the existing charter of the Reserve Bank, which is the requirement to promote full employment. If the government wanted finance for a program to get us to full employment but needed to borrow more in order to do it, would the only reason you wouldn't consider financing that, and financing the debt to do that, be to ensure that the pure theory of reserve banking was adhered to? In the speech you referred to earlier, you said the only reason we couldn't explore unconventional monetary theory was that government can borrow cheaply at the moment. But, if we still haven't reached full employment and the government can embark on programs that will get to full employment more cheaply through you than by going to the marketplace to borrow money and going further into debt, shouldn't we be doing that?

Mr Lowe: I take issue with the idea that the government can borrow more cheaply through us. Certainly, the financing costs this year would be cheaper if we gave them interest-free loans. But, ultimately, that still has to be paid back, and there would have to be some adjustment in the system—there would have to be higher taxes or something—to compensate for that. Money creation doesn't change the ultimate amount of resources the government has to raise to pay for its spending. I think it's wrong to look at just the current year; you've got to think about this in an intertemporal context. So it doesn't change that. It does offer a benefit in the cash flow in the short period, and, in some circumstances, that benefit may be worth taking. But that's not the situation that Australia's in.

Mr BANDT: Can I come back to the point you raised earlier about the potential negative consequences to the RBA. Isn't another way of looking at this that, in the years that the government has to pay the face value of the debt, you could consider giving a dividend back to the government in those particular years? Isn't one of the central points—which you are challenging very strongly—that the RBA and the government effectively share a balance sheet? If you're printing money to finance government debt, and that is being used to put to use some of the spare capacity in the economy—for example, by getting people into work—it's not going to lead to inflationary pressures, it's not going to damage the position of the bank and it's not going to damage the position of the government. It will be expanding the money supply, but that's done to get people into work without the consequences for inflation.

Mr Lowe: What gets people back into work is the fiscal spending. I agree with you that that is something we should be looking at—how much fiscal spending we have to get people back into work. I think where we disagree is on how that should be financed. I do not see monetary financing changing the total amount of resources that need to be raised by the government in the end; it just changes when and how they are raised. I do not see any benefit at all in us financing the government right now and changing the way the government pays for its fiscal spending.
Mr BANDT: There's a good benefit for the government, though, isn't there. When this $54 billion debt falls due, the government is going to go out and borrow more in order to pay back another arm of government—the Reserve Bank. We've effectively got debt financing going; it is just being washed through the banks. Isn't there a simple way of doing it? Wouldn't it be better for us to be honest about it and, rather than going through the process we are going through at the moment, work out a way where we can have a sensible debt-financing arrangement to get people back to work? That's a way to grow the economy—getting more people into work.

Mr Lowe: The fiscal spending will get people back to work. I agree with you there. If we're being honest, my perspective is that monetary financing does not change the inter-temporal budget constraint; it doesn't change how much the government ultimately has to raise. At the moment, us making debt available to the government at an interest rate of zero is not going to change the total amount of government spending and it's not going to make Australia's position easy over years of raising debt in the capital market. I do not see any benefit in going down the route you suggest. I see benefit in thinking about how much fiscal spending there should be. And I am confident that the Australian government will be able to raise money in the capital markets, at very low interest rates, to finance whatever level of spending is required. It's true that, when they have to repay those bonds to us, they'll have to raise money in the market. They'll be able to do that. There's very strong demand for these securities. The best way of doing this is the government entering the market, paying these low interest rates and deciding how much it wants to spend.

Mr BANDT: Do you think enough is being borrowed and invested at the moment to get us back to full employment?

Mr Lowe: That is the critical issue: how much fiscal stimulus do we need to get the country back to full employment? The federal government has had a very large fiscal stimulus—roughly seven or eight per cent of GDP—and we have had another couple of per cent from the states and territories. What the governments are going to have to grapple with over coming months and perhaps years is whether they need to keep that fiscal stimulus going and whether they can add directly to aggregate demand. We are seeing in a number of countries now—New Zealand is an example of this and Germany to some extent—governments deciding that, in the recovery phase, because of some of the issues I've been talking about, they're going to need to add to aggregate demand directly themselves through their own spending. Transportation infrastructure, energy, health, education—there are a whole bunch of areas where governments could decide to add directly to aggregate demand, and that would create jobs and help in the recovery. How much of that we should have is a debate we should have in Australia at the moment. That's the right question to be focusing on, rather than trying to come up with some trickery in financing, which is what I view this kind of modern monetary theory as. The question, really, is the fiscal one, and that's the one we should be discussing. The financing thing is going to take care of itself; I think it's neither here nor there, really. We should focus on how much fiscal support we are going to need to get people back into jobs, and that's an issue for the parliament.

Mr BANDT: Thank you.

CHAIR: 'Financial trickery', a phrase I am quite happy to see taken on board!

Mr CRAIG KELLY: Good afternoon, Governor. I hope you're well. You made some comments earlier about being concerned—and I know we've discussed this before—that the economy isn't as dynamic as it should be and that there's not enough new business creation. Could you expand on that a little bit, please.

Mr Lowe: We've seen over recent years a decline in the rate at which new businesses are formed and exit. There's been a decline in job mobility, so people don't switch jobs at the same rate they used to. The share of people who are self-employed has gradually declined. R&D spending as a share of the economy is fairly low in Australia and, on some metrics, has declined. If you put all of that together, it suggests the economy is being less dynamic and a bit less innovative, and in the end I think that catches up with us in a slower growth rate. That's the situation.

One of my concerns is the that the COVID experience is going to reinforce some of those trends, because it's going to make us as a society more risk averse, less willing to take risk. That's a challenge. What do we do about it? It's hard to know. Culturally, one of the issues here is our tolerance for mistakes. If, every time there's a mistake in business or finance, you flog people in the public square they're going to take less risk. The way we regulate, and we talked about project approval, zoning and labour market flexibility—those areas are not designed to make it as flexible as we can be. I think there are incentives in the tax system that can be tweaked to make research and development more attractive. I mentioned before that stamp duty is a tax on mobility. We want to make sure the workforce not only has the skills to do the jobs but also is very adaptable and people are prepared to move around. They're the areas we should be focusing on.
Mr CRAIG KELLY: You mentioned that the number of self-employed people has declined. Do you have any of those numbers off the top of your head?

Mr Lowe: I do in my briefing but I probably can't get them straight away. Luci, do you have those? There has been an increase in some types of self-employment—say, the Uber driver and those in the gig economy. I can get that data for you and send it through.

Mr CRAIG KELLY: Thank you. If we look at what's happening with the COVID restrictions and changes to the economy, we hear the phrase 'we're all in this together'. However, to me it seems there is a reasonably small group, the group of self-employed, dynamic individuals, that is really being hit by the economic restriction being placed. We, as public servants, haven't had our incomes affected one dime. Other workers, with JobKeeper and other government payments, have been well secured. Those on pensions have bonuses of $750. Those who are self-employed, the very people you say we should be trying to encourage with the reforms, seem to be the ones worst hit by this—would you agree with that?

Mr Lowe: Whether they're worst hit, I'm not sure. They're certainly very severely hit. Many small businesses are hit, and people in the tourism sector are as well, and, as we discussed earlier, young people in many parts of the economy are being severely impacted as well. There are a group of people who are paying a very heavy price to keep the rest of us safe; that's the reality we face. It's very uneven and, from a public policy point of view, I think there's a strong argument to try to protect those people and to help those people who are paying the price to keep the rest of us safe.

Mr CRAIG KELLY: What about the effects on the long-term dynamism of the economy. If I'm at the university now and I'm thinking what my future career would be, if I look at it and I go down the track of the Public Service, I'm not affected economically by something like a pandemic. But if I'm in a small private enterprise, it could wipe me out. Doesn't that tend to tip the balance towards less dynamism in the economy?

Mr Lowe: Over time, I think it will. People will be more risk averse and they will be looking for opportunities, at least for a while, that offer them greater security. That is as it is. There's nothing we can do about that while we're in the midst of the worst pandemic in 100 years. On the other side, we need to give focus to how we can make ourselves more dynamic and get people with incentive to take risk and build new businesses, employ people and invest, because that's what we're going to have to do: employ people and invest again. At the moment, it's understandable that businesses aren't investing and employing people, so it's not the issue to resolve today. But we will get on top of this pandemic at some point, because we contain it or because there's a medical breakthrough, and then we'll need to start rebuilding businesses and getting them to invest and hire people; you're right.

Mr CRAIG KELLY: On your bond raising—you may have mentioned this earlier; I'm sorry I wasn't on the earlier part of the call—what's your schedule for bond raising over the next 12 months?

Mr Lowe: The AOFM does the bond raising for the government, so we don't raise the bonds for the government.

Mr CRAIG KELLY: I'm sorry. Okay.

Mr Lowe: The staff at the RBA and the AOFM are in close contact. I'm not sure what the schedule is, but the government has already preborrowed quite a lot of money.

Mr CRAIG KELLY: Is there any signal that you're having difficulty selling those bonds, or is it that, basically, whatever's put to the market seems to be snapped up quite easily?

Mr Lowe: Yes, the latter. There's no trouble at all in the government financing itself at the lowest rate since Federation; that is the point I was making in response to Mr Bandt. There's very strong demand for Australian government debt, as there should be.

Mr CRAIG KELLY: Our bond rate is now lower than that of, I think, the US, and many other countries as well. Where do we stand internationally on comparative rates?

Mr Lowe: Our 10-year rates are a little higher. At the moment—I think, this morning—our 10-year bond rate is 90 basis points. In the US—correct me if I'm wrong, Chris—it is around 70. So there's a bit of a wedge there, but the deferential between our bond rates and others is quite low. We're a little higher—

Mr CRAIG KELLY: That is different to what it has been historically over the last decade and a bit.

Mr Lowe: It has moved up and down over time, but all interest rates right around the world are very low. Some governments in Europe will borrow at negative interest rates, so you give the government the money and then they give you back [inaudible] 10 years time. We talked about that before. We're not in that position yet.
Mr CRAIG KELLY: Let's hope not. I know there are a few others who want to ask questions, so I'll leave it there. Thank you for your time.

CHAIR: Thank you very much, Mr Kelly. We always welcome time back. I invite Dr Leigh for about six minutes.

Dr LEIGH: Thank you, Chair. I just want to come back, Governor, to the question of exchange rates. You acknowledged in your statements that a lower exchange rate would help to boost growth in the economy and add to jobs. The Reserve Bank could easily depreciate the Australian dollar to stimulate the economy; a large depreciation would be well within the historical levels and it would boost every export-oriented business. Have you considered a sustained intervention into the value of the dollar?

Mr Lowe: I don't share your optimism that we could easily get the Australian dollar down. The market for the Australian dollar is a very deep market. We have one of the most actively traded currencies in the world and the value at the moment is around its fair value. So for the central bank to influence a price away from its fair value in a very deep and liquid market, we would need, if we could, to use huge amounts of foreign exchange intervention. And it's going to be very hard to keep the currency away from its fair fundamental value for a long period of time. I'm not optimistic that we could do it.

Intervention can be successful when the market is dislocated—when the trading is not working properly and the market isn't deep and liquid—and we've done that in the past. Or it can be successful if the currency is away from its fundamental value and some distortion is leading to the currency being undervalued or overvalued. We'd be prepared to enter the market in that case, but when it's at its fair value it's going to be very hard to shift on a sustained basis. I don't think it's a successful strategy. It's costly and risky.

Dr LEIGH: A lot of risk is being borne by Australian businesses and workers who are looking at sustained periods of joblessness, so there is risk throughout the economy in not acting as well as in acting. Do you regard this as different from past instances in which the Reserve Bank has intervened in the currency markets?

Mr Lowe: The past episodes have been either because the market was dysfunctional and we were trying to restore balance and function to the market, or, as I said, the currency was a long way away from where it should be in the market—where it's equilibrium value is. In those cases I think intervention can be successful, but the idea that we could move the currency a material amount away from its fair value through using our balance sheet I think is not right.

Dr LEIGH: I also wanted to ask you about the consequences of the early release superannuation scheme. We have seen a pretty significant transfer of funds moving from the superannuation sector into the banking sector, have we not?

Mr Lowe: We've seen over $30 billion withdrawn so far. Just to put that in context for you: that's the equivalent of 10 per cent of quarterly household disposable income. So $30 billion is a large amount of money. It's been manageable for the super industry. It amounts to 1.7 per cent of total funds under management. For some funds it's five or six per cent, but on average it's under two per cent.

Initially, there were concerns by the super funds that they would have liquidity issues in dealing with these withdrawals. We had extensive discussions with them but I was always confident that if they had time to adjust their portfolios they'd be able to manage it, and that's worked out reasonably well. So it's been a very substantial amount of money.

Dr LEIGH: Have you looked at the issue of investment drag—the impacts on other investors of superannuation funds now moving more strongly into cash?

Mr Lowe: The super funds have had to move into cash, that's true. But I'm not sure what the actual issue is that you're getting at here.

Dr LEIGH: The issue is that superannuation funds can invest in growth assets or in cash. In an environment in which they need to be prepared for an early release scheme, they need to move more money into cash. That has implications for the returns not only for those who are getting their money out but also for those who are putting their money in.

Mr Lowe: Certainly, they have had to shrink their portfolios—that's true. The average fund has had to shrink its portfolio by under two per cent. I think that's manageable. In the short period you have to hold more liquid assets, that's true, but once you're back to the lower value of assets under management you can, over time, go back to the original portfolio structure. I don't have any particular concerns that the funds are going to go into worse assets or lower-yielding assets than they previously did. This is all manageable. It is a period where they...
had to take a lot of liquidity and over time they can go back to their original portfolio, if that's what they want to do.

Dr LEIGH: You return to that original portfolio structure, but because you have been unable to grow that asset for a period, you get lower returns. Let me move to the issue of so-called dividend keepers—the instance where a number of firms have received wage subsidies and they are now paying significant dividends to shareholders. Is it a concern to the Reserve Bank that the JobKeeper program is flowing through to shareholders?

Mr Lowe: I think the JobKeeper program is really about keeping people in jobs, isn't it? It's done a remarkably good job at that. And—

Dr LEIGH: I would agree [inaudible] be concerned about firms that are paying two-thirds of the amount out in dividends?

Mr Lowe: Well, money is fungible, isn't it? The profits come from other parts of their business. We want our businesses to be profitable and even if you're taking JobKeeper it's good that you're still profitable. And if you're profitable then the shareholders, in some cases, it's appropriate to pay them a dividend.

Dr LEIGH: You're not concerned about a firm that pays the equivalent of two-thirds of the JobKeeper receipts out as a dividend? That doesn't trouble you?

Mr Lowe: It would depend upon the specific circumstances. If the business has taken the JobKeeper payments in line with the rules and kept people in employment, that's what I'm really focused on—making sure the employment relationship is protected and people are kept in jobs and are in a position to come back into employment when the business recovers. That's my focus. I haven't focused particularly on whether these companies are profitable and what they do with their profits. The priority is jobs, and the focus is understanding how we keep people in jobs. It's good that companies are profitable. What companies do with their profits is a matter for them and their boards.

Dr LEIGH: Would it concern you if JobKeeper was flowing through to higher executive remuneration, or, again, you'd just take a laissez faire approach to that?

Mr Lowe: That's certainly not the intention. The intention is to keep people in jobs and keep the employment relationship working. I understand that's how it's worked so far. It's a matter for each individual company about how they pay their executives and what they do with their profits. I haven't seen any evidence that the JobKeeper program is being systemati
cally rorted and used inappropriately. If there were such evidence I would be concerned, but I haven't seen it.

Dr LEIGH: Governor, you spoke before about the impact of superannuation guarantee increases in wages. Isn't it true the only wage increases that are going to be paid over the [inaudible] next year will be those that are already set in train in awards—that is, that there's very little discretion taking place in the economy over wage rises right now?

Mr Lowe: Right now, that's the case. I'm hoping that will not remain the case. But, as we go into next year, hopefully we've had more success in containing the virus, the labour market's improving a bit and there can be some modest wage increases for people. But, at the moment, you're right. The only wage increases that are occurring are from the enterprise bargaining system and some very small segments of the labour market where there is a tight supply of workers. But I don't imagine that that is going to remain the case.

CHAIR: Mr Kelly mentioned the decline in the number of businesses created and the decline in the number of self-employed Australians and you gave an answer, I think, based on getting more research. Can we assume you're taking that question on notice?

Mr Lowe: Yes, I will. I have some briefing, but with all the briefing I have here I can't quickly find it for you.

CHAIR: That's fine.

Mr Lowe: So I will forward you some facts and figures.

CHAIR: That's helpful. Thank you. I'm just wondering: has the Reserve Bank seen any cost-benefit analysis on lockdowns to inform decision-making?

Mr Lowe: Not explicitly, because the cost-benefit analysis really is driven off what you think the health benefits of the lockdowns are, and this is not an area that we have any competency in, so this is a matter for the health officials. It's very hard to do that cost-benefit analysis. I assume it's done by government, which has broader access to information than we have.
**CHAIR:** Obviously, in your statement of monetary policy you have to make judgements about potential scenarios of recovery and included in that has to be a model component around the possibility of a vaccine. Is that correct?

**Mr Lowe:** Certainly that's possible. In the upside scenario that we articulated in the latest statement of monetary policy, we didn't have a vaccine explicitly in there. What we assumed was that we'd gradually, or maybe even quickly, get on top of the virus and that people could go back to their normal way of living to some extent. I think that if we got a vaccine then things could change around very quickly, especially if it were a vaccine in the very near term that was effective and could be widely distributed, because household income has held up okay, interest rates are low and there's been a lot of fiscal stimulus. Confidence could return. Capital markets are open. So, if we did get a vaccine, I think things could turn around quickly, but that's a very big if, isn't it?

**CHAIR:** It is. That's why I'm asking you: you haven't modelled the possibility or the likelihood of a vaccine, then, in your modelling?

**Mr Lowe:** No. It's so hard to do, isn't it? When would the vaccine come in? Would it be widely distributed? How effective would it be? What effect would it have on confidence? I think we know the direction of change, but it would be artificial precision to say we know how the economy would perform if there were a vaccine developed. But I think we can tell you the direction of change, and that's up, and probably quite strongly up.

**CHAIR:** Understood. Just quickly going back to a number of comments you've made throughout the day about the potential of fiscal policy being used already to cushion the impact of the COVID-19 crisis but also in terms of economic recovery, you outlined particularly some of the economic downturns that other countries experienced, which are double if not triple what we're projecting here for Australia. Is one of the core reasons we have been able to cushion the economic impact that we have had fiscal space to do so because there was a certain degree of prudence in the lead-up to this crisis? If we were to take on more debt, at what point would you say debt would become too high such that we wouldn't be being prudent in making sure we were prepared if there were another crisis—another pandemic or some other event—where we need fiscal policy as a lever to support people?

**Mr Lowe:** You're right: in principle, the level of debt could be so high that you don't have that option in the future. I'm not worried about that at all in the foreseeable future, though. The starting position here was very good. The more pressing issue is, I think, what the next couple of years look like. I think we need to have all shoulders to the wheel to make sure that the unemployment rate comes down quickly, particularly if we can get on top of the virus. I think that would be the right thing to do, and it's the right thing to do to borrow to do it. I'm not concerned that we'll borrow too much over the next two years to a point that would imperil our medium-term position. It's possible, if the borrowing went on and on and on, that we could imperil our medium-term position, but I think getting the economy on an even keel over the next couple of years and being prepared to borrow is exactly the right thing to do, because we have a good starting position and we can afford to do it, and the government can borrow at record low interest rates. It obviously can't do it forever, but for the next two years, absent this very positive upside scenario with the vaccine, I think it's the thing to do. To date it's been income support, and over time in the recovery phase there will need to be greater focus on direct creation of jobs through government spending and through improving the investment and hiring environment. That's more than just giving people money to help them through, which is what the focus has been on so far.

**CHAIR:** Just quickly going back to what you called the 'financial trickery of modern monetary theory'—and I very much welcomed the comments you made in your opening statement which clarified that rather than having to go through a long line of questioning—I draw your attention to the paper that was done by Saunders and Tulip. We discussed this at our hearing last August. It shows that one of the key reasons for house price increases has been inflation and ultimately the absorption of inflation in comparison to consumer products, which sit mobile in a global pricing environment. Is one of the potential very serious impacts if we go down the modern monetary theory pathway that there would be inflation but it would be absorbed in asset prices, not in consumer goods, and would therefore be hidden?

**Mr Lowe:** That's certainly conceptually possible. Monetary financing of the budget deficit can lead to inflation, and that has all sorts of problems. It's not guaranteed that we end up in the high-inflation situation for monetary financing, but it's certainly possible. As I said in response to Mr Bandt's questions, modern monetary theory, for me, is as much about fiscal policy. We call it 'modern monetary theory' but it's about fiscal policy because the very first proposition is that the government should keep spending to achieve its objectives. The second proposition is that it shouldn't worry about financing.

Do we think it is okay for an economic system to run in a way where the government has its objective to use fiscal policy to keep things on a very even keel? I would say the history of that in the past has not been
particularly good. Neither has the history of governments being able to stop doing this when inflation starts to rise. That's why we ended up with the monetary arrangements we have. So, as I said, it's really about fiscal policy. We should be having the debate—and we have been discussing this during the course of this hearing—about how much fiscal support there should be. We decide the answer to that through the parliament and the government, and then the financing is going to look after itself in Australia. I'm not worried at all that governments will have to pay too much for debt or won't be able to borrow or will have to pay too high a price. The best way for government to meet its spending commitments is to borrow in the market rather than going to the central bank, and we can do that.

CHAIR: Thank you, Governor. I know that other members have further questions, as do I. As always, we appreciate very much your insights, as well as those of the deputy governors, and the work that has been done by the RBA. Frankly, I think it has been one of the most illuminating hearings we have had. Obviously we are in a critical time and people are excited about monetary policy, which we should all be happy about. Thank you for appearing today. The committee secretary will be in touch with you in relation to any matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence, to which you can make any corrections of grammar or fact. I declare this public hearing closed.

Resolved that these proceedings be published.

Committee adjourned at 12:33