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Members in attendance: Mr Bandt, Mr Falinski, Mr Keogh, Mr Thistlethwaite, Mr Tim Wilson, Mr Josh Wilson.

Terms of Reference for the Inquiry:
To inquire into and report on:
Review of the Reserve Bank of Australia Annual Report 2018
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 2018 Annual Report of the Reserve Bank of Australia.
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ELLIS, Dr Luci, Assistant Governor (Economic), Reserve Bank of Australia

LOWE, Dr Philip, Governor, Reserve Bank of Australia

Committee met at 09:30

CHAIR (Mr Tim Wilson): I declare open this hearing of the House of Representatives Standing Committee on Economics and welcome representatives of the Reserve Bank of Australia, members of public—the few of you—and of course the media. Since the previous hearing with the Reserve Bank of Australia in August 2018, monetary policy has remained accommodative, with a cash rate of 1.5 per cent. Following the RBA's recent decision to leave interest rates unchanged, commenting on the decision to keep rates on hold, the Governor of the RBA noted:

The central scenario is for the Australian economy to grow by around 3 per cent this year and by a little less in 2020 due to slower growth in exports of resources.

The governor commented:

The housing markets in Sydney and Melbourne are going through a period of adjustment, after an earlier large run-up in prices. Conditions have weakened … in both markets and rent inflation remains low.

In relation to the inflation outlook, the governor stated:

Underlying inflation is expected to pick up over the next couple of years, with the pick-up likely to be gradual and to take a little longer than earlier expected. The central scenario is for underlying inflation to be 2 per cent this year and 2¼ per cent in 2020.

The governor concluded:

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

The governor, at a speech on 6 February, commented that 'today the probabilities appear to be more evenly balanced' between an increase and a decrease in rates. It is also notable that in December the deputy governor commented:

Quantitative easing is a policy option in Australia, should it be required …

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

I remind you that, although the committee does not require you 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.

Dr Lowe, would you like to make your opening statement before we proceed to questions?

Dr Lowe: Thank you very much, Chair, and good morning to members of the committee. My colleagues and I welcome this opportunity to share our views on the Australian economy and the RBA's important public policy responsibilities. We view these hearings as an essential part of the accountability process.

Two weeks ago, we released our latest forecast for the Australian economy. Our central scenario is for GDP growth of around three per cent this year and around two and three-quarters per cent in 2020. The outcome for the year just past is expected to be a bit below three per cent. These numbers are lower than the ones we were expecting at the time of the previous hearing, in August.

By contrast, the labour market outcomes have been quite a lot better than we earlier expected. When we met six months ago, we were not anticipating the unemployment rate to reach five per cent until 2020, but it's already been around that level for some months, and we had further welcome confirmation of that yesterday. The number of jobs created has also exceeded our earlier expectations, and we continue to expect the unemployment rate to move lower over the next couple of years to reach four and three-quarters per cent.

In terms of inflation, the recent outcomes have been a bit lower than we had been expecting. In the September quarter, the childcare cost declined substantially due to government policy changes. In the December quarter, petrol prices fell, due to global developments, and a further decline in petrol prices is expected in the March quarter. In underlying terms, inflation is above its trough of a couple of years ago, but the pick-up is more gradual than we had previously expected, and by the end of 2020 inflation is now forecast to reach 2¼ per cent.
Putting all this together, our central scenario for this year is for growth of around three per cent, inflation of around two per cent and unemployment of around five per cent. In the broad sweep of our economic history, that's not a bad set of numbers. Indeed, in many years over the past four decades, we would have welcomed such an outcome, and it's important that we don't lose sight of that. The economy is benefiting from increased spending on infrastructure and a pick-up in private investment as capacity utilisation has tightened. The strong growth in jobs is also supporting spending, as is the sustained low level of interest rates.

Globally, the central scenario also remains a reasonable one. Inflation is low, and unemployment rates in many advanced economies are the lowest in many decades. Recently, however, the focus has not been on this, but it's been on the downgrading of the forecast for global growth by the International Monetary Fund and others. What sometimes gets lost, though, is that the latest forecast is for global growth to be around average, not below average. We need to remember that growth around average at a time of low unemployment is a reasonable outcome.

What is of more concern, though, is the accumulation of downside risks. There are two major areas of risk globally that the Reserve Bank Board has been keeping an especially close eye on of late. The first is what I will label political risks. Here the list includes the trade and technology tensions between China and the United States, Brexit, the rise of populism, and strains in some Western European economies. It's hard to be certain about how these various issues will play out. But it is conceivable that one or more of these political risks crystallises in a way that damages confidence and the global economy. It is of course also conceivable that political leaders respond to the mounting economic risks in a way that restores confidence. Ultimately, time will tell.

In working through the various possibilities, one issue that many people have focused on is the resilience of the global economy to a severe shock, whether it's generated in the political sphere or elsewhere. In many countries, both public and private debt levels are already very high, and real interest rates are also already very low. This means that there are fewer buffers in the global system than there were once upon a time, so there is less room for manoeuvre if something goes wrong, although in a number of important dimensions the global financial system is more resilient than it used to be.

The second international risk that we are monitoring carefully relates to the Chinese economy. Growth there has slowed, probably by more than the authorities had been expecting. The economy is feeling the effects of tensions with the United States and the squeezing of finance to the private sector as the authorities clamp down on non-bank financing. The authorities have responded by easing policy in a number of areas, but they are walking a very fine line between supporting the economy in the near term and addressing the medium-term debt problems.

Turning now to the Australian economy: the board has recently been paying particularly close attention to the strength of household spending and to developments in the housing market. Household consumption accounts for almost 60 per cent of total spending in the Australian economy, so what happens on that front is important. Recently, determining the underlying strength of consumption has been complicated by volatility in the consumption data in the national accounts, as well as by notable revisions to the history of both consumption and income in the national accounts. On balance, though, the available data does suggest that the underlying trend in consumption growth is softer than it earlier looked to be, and this has affected the outlook for the economy.

There are a couple of important considerations here. The first is the protracted period of relatively low growth in household income, and the second is the decline in housing prices in our larger cities. Since 2016, aggregate household disposable income has grown at an average rate of just two and three-quarters per cent per year. That's down from average growth of six per cent per year the preceding decade. That's quite a large change. It's plausible that households have responded to this extended period of weaker income growth by progressively downgrading their spending plans. For many people, it has become harder to see the lower growth in income as just a short-term development that they can look through, and I think they've adjusted their spending in response to that.

On this front, though, we are expecting better news ahead, with growth in disposable income forecast to increase. Wages are rising more quickly in almost all industries and in all states than they were a year ago. This is good news, and we expect this gradual lift in wage growth to continue. Disposable income will also be boosted by the announced tax cuts, and this faster income growth will support household spending. From a longer-term perspective, though, the key to boosting the real income of households is lifting productivity, and I encourage you to keep examining ways to do this.

Looking beyond income growth, developments in the housing market can also affect overall spending in the economy. Lower turnover means less of the spending that occurs when people move homes. Declining housing prices also make some people feel less wealthy so they spend less, although this effect doesn't look to be particularly large. Lower housing prices are also associated with less construction activity in the economy, so these are the areas that we're keeping a close watch on.
We do need to keep things in perspective, though. The adjustments in the Sydney and Melbourne housing markets are occurring at a time of low unemployment, low interest rates and strong population growth. What we're witnessing is largely the working through of shifts in supply and demand for housing due to structural factors. In both markets it took a long time for supply to respond to faster population growth, so prices went up. This shouldn't have been a surprise. And now that supply has responded, some of the earlier increasing prices have been reversed. Again, this shouldn't be a surprise. I understand that these swings in housing prices are difficult for some in the community. We should, though, take some reassurance from the fact that our economy and our financial system are resilient. This adjustment in the housing market is not expected to derail our economy. It will put our housing markets on more sustainable footings, and it will allow more people to purchase their own home. So there's a positive side too.

I'd now like to turn to monetary policy. The Reserve Bank Board has held the cash rate steady at 1 1/2 per cent since August 2016. This is a stimulatory setting of monetary policy and it's helped support job creation and a gradual lift in inflation. When we met with this committee six months ago, I said that if further progress on achieving our goals of full employment and returning inflation targets, you could expect the next move in interest rates to be up rather than down. I also said that the board did not see a strong case for a new-term adjustment in the cash rate, given that the progress towards our goals was expected to be only gradual. Today, the probability of the next move is up and the probability that it is down are more evenly balanced than they were six months ago. This shift largely reflects the change in the outlook for consumption that I just spoke about.

It's important to point out, though, that we are still expecting further progress towards our goals. The unemployment rate is forecast to decline further, and inflation is forecast to increase only gradually. If we do make that progress, it remains the case that higher interest rates will be appropriate at some point. But it's also possible that the economy is softer than we expect and that progress towards our goals is limited. If there were to be a sustained increase in the unemployment rate and a lack of further progress towards the inflation objective, lower interest rates might be appropriate at some point. We have the flexibility to do this if needed, and we're not on a predetermined course.

The board maintains its strong focus on the medium term and is seeking to be a source of stability and confidence in the Australian economy. As was the case six months ago, the board does not see a strong case for a near-term adjustment in the cash rate. With monetary policy already providing considerable support to the Australian economy, it is appropriate to maintain the current policy setting while we assess developments. Much will depend on what happens in our labour market.

I'd now like to turn to some other issues. Some years ago, this committee held extensive hearings into the foreign bribery issues at Note Printing Australia and Securency. The legal proceedings against former employees of these companies were finally completed last November. As a result, the Supreme Court of Victoria lifted longstanding suppression orders. This allowed the RBA to disclose that in 2011 NPA and Securency entered guilty pleas to charges of conspiracy to bribe foreign officials between 1999 and 2004. We were also able to disclose that the two companies paid substantial fines and penalties, including under proceeds of crime legislation.

I have sought to deal with these difficult matters as openly and transparently as possible. The corrupt and unethical behaviour that was uncovered runs counter to everything that we stand for, so it's been an incredibly difficult matter to deal with. A number of years ago we sold our half share in Securency, the manufacturer of the polymer material that the notes are printed on. Securency is now owned by a Canadian firm. NPA remains a wholly-owned subsidiary of the RBA, and it prints Australia's banknotes in Melbourne. The company has undergone a top-to-bottom overhaul of its governance arrangements and business practices. I'm confident the company is operating to the very high standards that we demand, and that it will continue to do so.

On a more positive front, over recent months NPA has been printing Australia's new $20 banknote. We are today releasing the design of the new note, and it will be issued into circulation in October. It will have the same world-leading security features as the other new notes. It will also have three raised bumps along the edge to assist people who are blind or who have low vision. I have some note that are hot off the printing press, which I could share with you at the break if you would like.

**CHAIR:** They are designs only, I hope—not actual notes?

**Dr Lowe:** No, they are notes straight off the printing press.

**CHAIR:** We'll have to give them back!

**Dr Lowe:** Yes, I won't be able to give them to you, but you can look at them! These new notes will continue to recognise two very significant Australians: Mary Reibey and Reverend John Flynn. Mary Reibey was a
remarkable woman. She arrived in the colony of New South Wales in 1792 as a 15-year-old convict. Then, through hard work and determination, she rose to become one of the colony's most successful entrepreneurs. Of course, John Flynn is best known for establishing what we know today as the Royal Flying Doctor Service. This service has helped countless Australians and is now the largest aeromedical service in the world. We're really proud to be able to celebrate the entrepreneurship and the ingenuity of these two great Australians on the $20 note.

The Reserve Bank also continues to work on upgrading Australia's electronic payment system. We want to see a system that is reliable, secure and efficient and that meets the needs of Australians. It's now one year since the New Payments Platform was launched. Over 2½ million Australians have registered pay IDs, and the banks are progressively adding functionality to the new system. Many people are already benefiting from faster and more flexible payments. We have, however, been disappointed that some of the major banks have not met the originally agreed time lines. This delay has, regrettably, slowed the pace of innovation in the overall system, given the substantial network effects that exist in payment systems. Late last year I wrote to the CEOs of the major banks on behalf of the Payments System Board, expressing our concerns and seeking a commitment that the updated time lines be satisfied. It's important that these commitments are kept. Notwithstanding these delays, I remain confident that the NPP will provide the backbone for substantial innovation in our payment system for years to come. Thank you very much. My colleagues and I are here to answer your questions.

**CHAIR:** Thank you very much, Dr Lowe. Thank you for appearing and also for bringing to a head some of the events that have occurred only in the past 24 hours. You made a series of statements on what you think about the opportunities for the Australian economy and it's strength and resilience—or not. In the past 24 hours we have seen potentially quite dramatic events, where China is now blocking thermal coal imports. Are you expecting that that would have a dramatic effect on your confidence in the Australian economy?

**Dr Lowe:** I'm not expecting it to have a dramatic effect. I think it's important we place in context what's happening here, and that is that the backgrounder is really developments in the Chinese steel industry. The authorities have been trying to contain production of steel for environmental reasons, and they've had difficulty in doing that. One way that they can control the amount of production is to control the amount of inputs, and coking coal is an important input into steel production. So one interpretation of what's going on is that this is a way of controlling Chinese steel production. Another possible interpretation is that the Chinese coal industry is not particularly profitable at the moment and containing imports might boost the domestic prices and help the Chinese coal industry. That would be another interpretation of what's going on. It's really to do with environmental protection and the Chinese coal industries, and it's not specific to Australia. We're still not sure about—

**CHAIR:** Media reports that I'm reading online, and I accept that this is on the hop, suggest otherwise—that it is targeted towards Australian imports. I understand the point you're making, but what do you believe would then be the impact or revision you'd need to make potentially to the Australian economic forecast?

**Dr Lowe:** My understanding is that the amount of coal that's been blocked is the equivalent of two months of exports from Australia to China. It's entirely possible that if that cannot enter the Chinese market then it can go to other markets. There are other markets in the world for Australia's coking coal. A lot of other countries are making steel, which is what they need coking coal for, and we'll find another market perhaps at a lower price. If that's all we're talking about—the blocking of a couple of months of coal imports—that's not going to derail the Australian economy. If it were to be the sign of a deterioration in the underlying political relationship between Australia and China, that would be much more concerning. I think we've still got to wait to see what the underlying issues are, because I do know the Chinese authorities who wanted to contain steel production have had trouble doing that, and they have had concerns about the profitability of the coking coal industry. I wouldn't jump to the conclusion yet that this is something directed to Australia. It may well turn out to be that it's being driven by concerns about the environment in China and the profitability of the coal industry in China. We have to wait and see.

**CHAIR:** You said that the trajectory you outlined for interest rates has been rebalanced—I'm paraphrasing—back towards it being more or less even that it could either go up or could go down, based principally off the back of household consumption. What do you see as the underlying trends that are influencing household consumption at the moment?

**Dr Lowe:** The two that I outlined in my remarks are weak income growth, which is the primary story, and housing prices, which is the secondary story. Income growth over recent years has been sub three per cent. It used to be six per cent. When your income is not growing as fast as it used to, you have to curtail your spending. That's the primary thing that's going on. As income growth has been slow year after year, more and more of us have realised that the old days are not coming back anytime soon and we have to adjust our spending plans. This is one
reason that I've been keen to see a pick up in wage growth and, more importantly, a pick up in income growth. If wage growth picks up and income growth picks up, we'll all start feeling a bit better again and we'll be prepared to spend. That's the first-order issue.

The second-order issue is what's going on in the housing market. There are some wealth effects from declining housing prices, but they're relatively small. We've got to remember that in Sydney and Melbourne prices are still up 70 or 80 per cent over a decade, so most people are sitting on very substantial capital gains. People who purchased in the last year or 18 months are not, but most people are sitting on substantial capital gains, so there are still positive wealth effects coming from that. It's largely the income story which doesn't get talked about enough, because the media love talking about property prices, but year after year of weak income growth finally weighs on our spending plans, so both the pick-up in wage growth and the tax cuts will boost disposable-income growth.

CHAIR: In the past 24 hours the CEO of Wesfarmers, Rob Scott, has raised concerns about weak consumer behaviour, and it fits not only part of a wage story but also, potentially, income availability, particularly for Australian retirees depending on policy around refundable franking credits. Do you have any comments on his remarks—that there's a potential impact should retirees see a significant reduction in their disposable income?

Dr Lowe: You've got to think about this as a package of reforms if the current opposition were to become the government and enact that policy. You'd have to think about the effect of that in the context of all its policies combined. I wouldn't like to just pick out one that saw a reduction in income without some other offsets. I think he's right, though, to focus on weak household income and the effect of that on consumption. That is the first-order issue. We need to see a pickup in income growth if consumption growth is to be at the level we want. The key to that is wages.

CHAIR: The key to that is wages. How much would you say is the share between that and other types of income support that people might have? We have many Australians who are dependent on nonwage income as the basis for their consumption behaviour.

Dr Lowe: Obviously, if their incomes are not growing quickly or they're declining, that will affect their consumption behaviour.

CHAIR: The other potential issues that could arise could also come out of increasing consumption on pre-existing activity—for instance, an increase in the costs associated with servicing debt, depending on what happens with interest rates, at the cash rate level but also at the retail level. We also had discussions around whether we're going to have more or less competition in the marketplace associated with how retail financial products are sold, particularly around mortgage brokers. Do you have a comment on the likely impact of that on household consumption?

Dr Lowe: If interest rates were to rise, that would have a negative effect on household consumption, but they'll only rise because of what we did—if household income is growing strongly, the labour market is strong and inflation is increasing. If interest rates increase because of a policy decision by the Reserve Bank, it will be in the context of stronger household income growth. That's not a particular concern. Over the last year or so, a number of banks have raised their mortgage rates by, on average, 10 to 15 basis points, and that's obviously had some effect, but what is reported less is that competition amongst the banks has picked up. The banks are offering bigger discounts. The actual rate that people are paying on average has hardly moved at all—it may be up three or four basis points. So there are the headline rates that the banks post up quite a lot, but the banks give you discounts off the headline rates, and those discounts have increased and people have become better at switching to lower interest rate products. I encourage everyone to go to their bank and ask for a better deal than the one they have. When people do that, they often find that the bank will be prepared to give them a lower interest rate.

Mr Falinski: Maybe their mortgage broker too.

Dr Lowe: Yes. Despite the banks having put up their posted rates, the average rate that Australian households are paying has hardly moved at all, and that type of change really hasn't had any effect on household spending.

CHAIR: You make the point around competition in the retail mortgage environment. Do you think that, if there were changes to the structure of how a lot of Australians access their retail mortgages, like through changes to law around how mortgage brokers can operate, it would lessen or increase competition?

Dr Lowe: The royal commissioner made a number of recommendations on mortgage brokers and, broadly, I would support them. The end of trail commissions, making sure that brokers have an obligation to act in the best interests of the person that they're helping, and subjecting them to the requirements of financial advisers—they all make a lot of sense to me. Who should pay the fee? That remains an open question. I think it's worth taking time to get that right, because many of the smaller lenders in the country rely very heavily on brokers—for some of
them, 80 or 90 per cent of their loans are generated through the broker. So, if the broker channel wasn't working effectively, then the smaller lenders would have trouble and there would be less competition in the market. So, as we transition to the new model, it's worth taking the time to make sure we get this right, because I wouldn't like to see the brokers undermined and not being able to provide that service to enable competition in the market. I think a shift to a 'borrower pays' model could in principle work, but it would need to be managed very carefully. It is not something that should be done quickly.

**CHAIR:** Considering the uncertainty of the interest rate environment, why was it that the RBA flagged the potential for quantitative easing?

**Dr Lowe:** Can I pass that to Guy.

**Dr Debelle:** I think my point was that it's prudent to look at it from a risk management perspective. I think it's highly unlikely. On the basis of the forecasts that Phil described earlier and our outlook, that is not a situation we expect to find ourselves in. However, we have seen the experience of a number of countries around the world over the past decade or so, where they've reached the limits of what can be achieved through lower interest rates and they have to look at other measures. I think that, from a risk management perspective, it's prudent for us to look at what we can learn from their experience, assess the effectiveness of the sorts of things that they've done and consider how they might play out in the extremely unlikely scenario that we might find ourselves here in that position. But that is not anywhere where we expect to be. I was doing that in the context of looking back over the 10 years globally, and that has been a feature of the global environment over the past decade or so.

**CHAIR:** But has the RBA previously flagged the possibility of quantitative easing as part of the discussion around Australian policy?

**Dr Debelle:** As I recall, I believe at this committee sometime in the past you have asked us whether we have looked at it, and I think we said yes, from memory. I may be wrong on that, but I believe this was flagged a few years back, particularly when other countries were doing this—probably nigh on eight, nine or 10 years ago. It was asked, 'Have you, the RBA, looked at it?' We made the point, which I make again now, that we are not in that circumstance and we don't expect to find ourselves in that circumstances, but we need to think, from a scenario-planning point of view, about what we would want to think about should we find ourselves in that circumstance.

**CHAIR:** At what point would the RBA consider quantitative easing in terms of lowering of interest rates? What would the interest rate have to be before the discussion about QE started?

**Dr Debelle:** I think that's still, again, a function of the circumstance that we find ourselves in. Clearly, it would be a lower interest rate than where we are now. But we've looked at the experience that other countries have had, including those that have implemented negative interest rates, and it's partly a function of our financial system and how that's set up, which is different from those. I think it's also a question which the other countries found themselves in: as you move your interest rate down, you start to see different dynamics happening. So that's what I mean about the function of the circumstance: it will depend on what the circumstances are should we get somewhere close to that point. We are not at that point now.

**CHAIR:** You've said you've flagged the potential that it could happen as part of preparing scenarios. Are there any scenarios that you have presented where it would be considered as part of a policy response by the RBA?

**Dr Debelle:** As I said, it's a scenario where the Australian economic is a hell of a lot weaker than it is today. That's not where we are now, and it's not where we expect to be in the foreseeable future.

**CHAIR:** You don't have a predetermined idea that, if interest rates were to drop to a particular number, it would then be entertained as part of the discussion? Is it just a live conversation?

**Dr Debelle:** I think that's a good way of describing it. It's not a live conversation in the sense that it's alive now. It would be a conversation which would evolve as the circumstances change and depending on how those circumstances change.

**Dr Lowe:** Just to be clear, we weren't flagging that we were thinking of doing this. We get asked a lot, including by this committee in the past and publicly, about what lessons we've learnt from the experience of other countries. What Guy was doing in that speech was outlining the lessons that we have drawn from the experience of other countries. I think it's appropriate we do that, and it's appropriate we share that publicly. They're important questions, as you're asking now. We thought it would be useful for transparency and public discourse to have our assessment out in the public domain. I would very much hope that we don't have to go down that route. If the economy were to slow significantly, there are multiple margins of adjustment—things that could be done. We could lower interest rates further; of course, there could be a fiscal stimulus; and the exchange rate would adjust. So all those margins of adjustment could take place before we would need to consider this, but in extremis there are scenarios where that would have to be seriously considered.

**ECONOMICS COMMITTEE**
**CHAIR:** But can you understand why some people—and I include myself in this camp—would be concerned, when we have the RBA governor saying, 'We—the international community as well as us—have limited policy levers should there be a downturn because of the fiscal situation as well as relatively low long-term interest rates,' that there's the socialisation of quantitative easing as a policy response?

**Dr Lowe:** It's a possibility. There are other possibilities that I think would be useful to explore before that, including a fiscal stimulus, in this scenario where the economy is very weak. And the exchange rate would adjust, I would expect, which would help as well. The history of the last 30 years of a flexible exchange rate is that the exchange rate is the great stabiliser. In an environment where our economy was very weak I'd expect the exchange rate to depreciate, and that would help. But there are extreme scenarios where we would have to look at other monetary options if these other margins of adjustment weren't working. It's not something that we would do lightly.

**CHAIR:** If you're saying it's something you wouldn't do lightly, would it be because you'd exhausted all other options or would it just be as part of a policy mix?

**Dr Lowe:** The other margins of adjustment are fiscal policy, the exchange rate and lowering interest rates. If we'd done all those things and the economy was still very weak, we would have to look at whether other monetary tools could work.

**Dr Debelle:** Other countries have reached the limit where they've assessed that they couldn't lower interest rates any further, and they've looked at these other options—including quantitative easing—implemented them and had some effect on the macroeconomies as a result. That—in seeing what they've done—gives us some sense as to how this may play out and the other effects it may have on the economy.

**CHAIR:** I understand. I have a deep concern that we're inflating and protecting asset prices for those who are already established at the expense, largely, of young Australians who want to do things like get into the market and buy homes. That has certainly been the experience over the past decade. So when you have the RBA flagging at least a discussion or consideration of such a policy that would perpetuate that and undermine the opportunity for home ownership for young Australians—

**Dr Debelle:** Could I jump in. The issue of distribution comes up a lot in quantitative easing. As you note, one of the channels through which it works is asset prices. One of the other channels it works through is boosting employment, which disproportionately benefits young people. Another channel that it works through is boosting wages and incomes, which also has effects on income distribution. So I would say it's important to focus on the fact that there are a number of different channels through which this works—as does monetary policy generally, actually. The intent is to boost employment and incomes. It does have an effect on asset prices. It also has an effect on interest rates, and the effect of that depends on whether you're a borrower or a saver. The extent to which interest rates are lower as a consequence of this also benefits people who are looking to enter the market. So I think it's important to look at the fact that there at least four channels of effect here.

A number of studies have looked at how that has played out in some other countries. If I can cite just one: the Bank of England have looked at how this has played out in the UK over this period. The conclusion they get to is: yes, it does have these different impacts and, yes, there is this effect on asset price, and that has an effect on one aspect of income or wealth inequality, but then you've always got to remember that the effect on employment and wages is particularly strong at the other end of income distribution. The assessment is that, looking at all these things together, there isn't much overall effect on income and wealth inequality. Whatever your distribution of wealth or income was beforehand, they don't seem to have seen it change much afterwards. It doesn't affect things much one way or the other. It has differing effects depending on where you sit in income and wealth distribution.

**CHAIR:** My final question before I hand over to the deputy chair is: why is the detail around interest rate movements made public the way it is? You have your decision statement and then you have the detail following in speeches and a monetary statement. Why is there a delay between those? Do you think it's beneficial for the market to have a delay in that information?

**Dr Lowe:** The Reserve Bank Board meets, it finishes its meeting close to one o'clock and the statement comes out at 2.30. The philosophy there is to let the market know as quickly as possible after the decision and to let the market know the facts upon which the decision is made. We do that in a short statement—one to 1½ pages.

The discussion around monetary policy and the likely next move, that tends to take place through speeches and through the minutes. If we were to change the current model, it would require that statement straight after the meeting to be delayed, and longer. The judgement that we've made, for better or worse, is it's better to let people know straight after the meeting what we've decided and the facts we've used to make that decision, and then take opportunities, including speeches and minutes, to lay out in a much more detailed way the various considerations.
in how we are balancing those. It's certainly true we could do it in a different way, but I'm comfortable with what we're currently doing at the moment.

Mr THISTLETHWAITE: Mr Lowe, in the recent board minutes there was a discussion about China and GDP growth. The minutes state:

GDP growth in China had slowed in 2018, as had been expected given the earlier tightening in financial conditions. However, there were signs that underlying momentum in the Chinese economy had slowed by more than suggested by the GDP data.

Could you just elaborate on that statement? Are you referring to particular indicators here?

Dr Lowe: Would it be okay if I asked Luci to answer that?

Mr THISTLETHWAITE: Yes, of course.

Dr Ellis: In looking at the data for China, we had, for a long time, been expecting that GDP would slow because of structural reasons: their population is ageing; as they get richer, you generally find a slowdown as you reach the front tier of possibility for production. We've always expected that. On top of that has been the effects of some of their tightening of financial policy in their response to financial risk there.

What we noticed in the run of monthly data more recently was that some of the data around investments and the data on retail spending had just been a little bit lower and had slowed further than what GDP had slowed. That sentence is simply an assessment of the whole range of official statistics, many of which did indeed slow a little bit more than the very gentle slowing that we saw in the overall GDP numbers. So some of the indicators for the industrial sector, some of the indicators for retail spending have slowed a little bit more. Both official statistics and some of the private sector or third-party statistics around China have been saying that, and it certainly conforms to the atmospherics that we're hearing from our contacts in China.

Mr THISTLETHWAITE: Dr Lowe, the chair asked you questions about the news overnight regarding the stoppage of some coal exports at a particular port. Your comment was that it was only two months worth of exports at that particular port. Isn't that alarming in itself, that a relatively 'smaller amount', in your words, can have such a dramatic effect on the Australian dollar?

Dr Lowe: I was surprised at the reaction of the Australian dollar. I think when the news came out, people were unsure about how to interpret it. Some people interpreted it as a fundamental souring of the relationship between China and Australia. If that was what was taking place, I can understand why the currency would move quite a long way. But I wouldn't jump to the conclusion that that's what is actually taking place here. As I said, it could be as a result of what the Chinese—they've been trying to contain steel production and improve the profitability of the coal industry, so it may be that there's a more benign explanation for what's happening. We need to wait and find out more.

Mr THISTLETHWAITE: Do you think that Australia's growth model is too reliant on China and too vulnerable in that respect?

Dr Lowe: I don't think our growth model is too reliant on China. A lot of exports certainly go to China, and that's been a source of tremendous wealth and prosperity for our country. The big rise in the terms of trade, the big increase in national income and the big increase in investment are all because China is growing very well and we've been incredibly well placed to take advantage of that. Many of our service industries are doing fantastically well because of China. Tourism in many parts of the country is doing very well because of Chinese tourists and Chinese students coming to study in the country. That's been to our advantage as well. We've benefited as a country tremendously. Diversification is always good. I would hope, over time, we would develop strong links with India and Indonesia. We'll benefit in the same way that we've benefited from the growth of China. A deterioration in the relation between Australia and China would be very difficult for us, I agree.

Mr THISTLETHWAITE: Isn't the danger here the fact that China can do this—that they can just make a decision to stop an export overnight, an export that you, yourself, have said is such an important driver of growth to the Australian economy?

Dr Lowe: It's certainly undesirable. Whether it's a disaster, I think we've got to wait and see. It really depends on whether it's a result of a deterioration in the underlying political relationship or something to do with the coal and steel industries.

Mr THISTLETHWAITE: I just want to turn to the domestic scene. I've talked to quite a few economists and commentators. Since we last met, I'd say that there's been a definite shift and that, on balance, the outlook for the Australian economy is now more negative than positive. That's reflected in a number of indicators. You've mentioned consumption and others. What struck me was the statement that you made earlier on—that is, that the probability of the next move in rates being up is more evenly balanced with the probability of it being down than
it was six months ago. That single statement and the change in language from the RBA point to the fact that the outlook is now more negative than positive, doesn't it?

Dr Lowe: I wouldn't say it's more negative than positive. The central scenario is for growth of three per cent, inflation of two per cent and unemployment of five per cent, as I said in my introductory comments. In the broad sweep of our history, that would be a good outcome. The central scenario is a good outcome for the Australian economy—more people finding jobs, inflation low and the economy growing at least at trend and probably a bit more than trend, and eating into spare capacity. That's the central scenario, which I think is a positive one.

Mr THISTLETHWAITE: Is it fair to say that the outlook is more negative than it was the last time we met?

Dr Lowe: I would put it slightly differently. It's not as positive. It still positive—

Mr THISTLETHWAITE: Even though unemployment is at that level, Australians aren't feeling positive about their lot in life at the moment. A lot of that is related to the fact that wages growth and income growth have been so low for such a protracted period of time and there are high levels of household debt. They're not feeling the love when it comes to their outlook about the economy at the moment. Is that something that you understand?

Dr Lowe: I certainly understand that and I've spoken extensively about that publicly. As you pointed out, the underlying issue is the lack of income growth. Aggregate household income used to grow at six per cent. It's growing sub three. That's a big difference. If you accumulate that over three or four years, income is eight per cent, 10 per cent or 12 per cent lower than it would have been if we'd been on the old trajectory. Many people borrowed, consuming their incomes would grow at the same rate, and they haven't. They've having more difficulty. They've got less free cash, so they can't spend in a way. This is why I've put so much emphasis on the need for a pick-up in wage growth. Our strategy here has been twofold. The first is for me to talk publicly about the benefits of stronger wage growth to try and raise wage expectations. It's not a conventional thing for the central bank governor to be saying, 'We want stronger wage growth.' So hopefully lift wage expectations—that's the first part of the strategy. The second is to keep interest rates low, stable for a long period of time, hope the labour market tightens up and wage growth picks up. I see evidence of that strategy working. The unemployment rate has come down more than we thought six months ago and wage growth is gradually picking up. Private sector wage growth is the fastest in four years. When you look at wages including bonuses it's rising, still at a fairly low rate but a faster rate than before. So I think the strategy is working. We're having to be patient, I know that's not very satisfactory for many people in the community, but I think the underlying strategy is working here.

Mr THISTLETHWAITE: We've had a discussion in the past about the NAIRU, the non-accelerating inflation rate of unemployment. I think you've said in the past that it was five per cent. Has that view changed within the bank? Is it now in the fours?

Dr Lowe: If I said it was five, I would have misspoken, because I'm so unsure what the actual number is. Normally there's quite a large ball of uncertainty.

Mr THISTLETHWAITE: I think you said the conventional wisdom was that it was five.

Dr Lowe: And the central point of that ball of uncertainty we used to think was around five; I now think it's lower than that. The ball of uncertainty is quite large. It sits solidly in the fours. I think this country can have an unemployment rate close to 4½ per cent without wage growth causing problems for inflation.

Mr THISTLETHWAITE: I think in the past—correct me if I'm wrong here—you've said that you'd like to see wage increases with a '3' at the beginning of them nationally in terms of wage price index data. In the recent statement on monetary policy, there's a box—Box A—on minimum wage developments in advanced economies. It indicates that a lot of advanced economies have now undertaken quite high increases in their minimum wages: South Korea above 40 per cent, New Zealand above 20 per cent, Spain above 20 per cent. Australia is looking like a bit of a laggard now when it comes to minimum wage increases. Given that I think, on average, over the last few years minimum wage increases have been at the two to three per cent level in Australia, is that something that you think it's time for us as legislators to look at in terms of the objects? I know that it's done independently of government by the Fair Work Commission, but do you think it's something that we should be looking at as
legislators in terms of the objects that we provide to the Fair Work Commission to look at to perhaps encourage some growth in those minimum wages?

Dr Lowe: That's entirely a matter for the parliament, but I've been quite comfortable with the minimum wage adjustments over the last few years. Last year it was 3½ per cent. The year before it was 3.3. In these other countries that have had very large increases in their minimum wages, it's partly because the level of their minimum wage was quite low and they've had to lift them up. The benefit of regular adjustments in our minimum wage is they haven't got too low relative to the median wage in the economy, so we haven't had to have big-step jump-ups. But I think minimum wage increases starting with a '3', even though average wage increases are 2½ to three, make a lot of sense.

In terms of what I would like to see, when I spoke about this before I made the point that, over time, the Reserve Bank is supposed to deliver for you average inflation of 2½ per cent. I would expect labour productivity growth to at least average one per cent—I hope we can do better, but I think we should be able to manage labour productivity growth of one per cent. And if workers get their normal long-run share of that then their real wages should rise by one per cent a year. So 2½ per cent for inflation plus one per cent, at least, for productivity growth would give 3½ per cent wage growth. For me, that's the best steady state—3½ per cent, maybe a bit faster than that, with 2½ per cent inflation. Recent increases in the minimum wage have been 3¼, 3½, which is broadly consistent with that, and I think that's the sensible and the right policy.

Mr THISTLETHWAITE: In that particular analysis, graph A2 looks at the minimum wage comparable to the median wage and it indicates that, on that measure, Australia is falling. Is that something that would be a cause for alarm?

Dr Lowe: No, I think the changes are fairly small. And, in the last two years, the minimum wages have risen more quickly than the median wage. I haven't got that particular graph in front of me, but minimum wages in the last two years have risen more quickly. There are a couple of years previous to that where that was not the case, but, in the last two years, minimum wages have risen more quickly, which I think, given the circumstances we find ourselves in, is a reasonable outcome. Regular increases in the minimum wage around this three or 3½ per cent benchmark, I think, make sense.

Mr THISTLETHWAITE: Underemployment is still a great cause for concern for us. Is there a level that you think underemployment needs to get to before we'll start to see a turnaround in wages growth across the economy?

Dr Lowe: It's really in the same kind of ball of uncertainty they talked about—the NAIRU. The main source of underemployment is people who are working part-time who want more hours. So, at the moment, roughly one-third of the workforce work part-time and most of these people actually want to work part-time, but, of that one-third, about one-quarter want more hours than they have at the moment and, on average, they want two extra days a week. So it would be good to see sufficient demand in the labour market to allow those people to continue to work part-time and have the hours they actually want to work. We don't have a critical number here. It would be good to see that number come down, though.

Mr THISTLETHWAITE: I'll move to housing. We've seen some substantial falls in asset prices particularly in the Sydney and Melbourne markets over the last two years—some up to 20 per cent falls in year-on-year averages. If prices in those markets fell by another 20 per cent, what would the bank do?

Dr Lowe: What we do will be governed by what happens to the outlook for inflation, unemployment and growth. You've got to put this in perspective. In the last year, we've had a 10-plus percentage point decline in Sydney house prices, yet the unemployment rate in New South Wales is 3.9 per cent, so there are other things going on that are offsetting the decline in housing prices and the effect of that on people's consumption, so we're looking at the whole economy and what's going on with output, inflation and unemployment. I don't think a further decline in housing prices in Sydney and Melbourne is going to derail the central scenario that I've talked about. There are enough other things going on, as they have over the past year, that will offset that. It's certainly possible that the confidence in the housing market is undermined and prices fall and people will become very negative, and that has a bigger effect on the economy, but that doesn't look like what's happening to me.

We had, as I've spoken about a number of times, a big pick-up in population growth in New South Wales and it took the better part of a decade for the rate of home building to respond to that. Prices went up—hardly surprising—but, finally, the supply side did adjust. There were changes at local governments and by the New South Wales government, and the rate of home building at the moment is the highest that it's been in decades, so the rate of addition to the housing stock is very high. And population growth has slowed a bit, so prices are coming down. I don't see signs of fundamental disequilibrium between supply and demand now in the market. In
some parts of Sydney, maybe there are a few too many apartments, but, if you look at Sydney as a whole, I don't think we've built too many dwellings.

**Mr THISTLETHWAITE:** The NAB is of the view that we've got an oversupply of apartments in Sydney and Melbourne. Are you saying you have a different view?

**Dr Lowe:** I don't think so. One of the things that's happening is, as prices come down, new households can form. The rate of household formation has been quite low when prices were very high. This is the behavioural relationship: if house prices are lower and rents are a bit lower, households form and are moving to the newly constructed housing. So that's quite plausible. I don't see signs of widespread overbuilding of dwellings in this country.

**Mr THISTLETHWAITE:** APRA have changed some of the measures that they put in place some years ago around the rates of interest-only and investment loans. Do you think that, in hindsight, APRA used a sledgehammer to crack a nut and that they went too far and it went for too long?

**Dr Lowe:** Not at all. APRA's measures, I think, had very little effect on housing price dynamics. The dynamics have been driven by population growth and inflexibility on the supply side. When prices were rising very quickly, investors were rushing into the market, because why wouldn't you? Prices were rising quickly. You could buy an asset whose price was going to go up, and interest rates were very low. So investors were rushing into the market, and that was amplifying the upswing that was being caused by the supply-demand dynamics that I talked about. APRA, with our encouragement, came to the view that that extra impulse that we were getting from investors needed to be scaled back a bit, so in 2014 the 10 per cent limit was put in place, and then in 2017 the cap on interest-only lending. Both of those things were entirely appropriate with what was going on. The decline we're seeing in house prices has very little to do with APRA's measures. They were both targeted and temporary, and that was appropriate. The decline in prices we're seeing now is the supply response that took place almost a decade too late.

**Mr FALINSKI:** Governor, do you have any insight as to why supply was so slow to respond to increasing population in the Sydney and Melbourne markets? Actually you are talking about Sydney specifically.

**Dr Lowe:** In Melbourne the supply side was a bit more flexible, but still the population growth there picked up a lot. This is not my core area of competence. I'd observe that few people forecast the pick-up in population growth. It almost came endogenously out of a strong economy. We certainly look back now and say there was a big pick-up in population growth and where did that come from? With people not knowing it was on the agenda, the supply side wasn't able to plan for the pick-up in population growth. There are longstanding problems that others have talked about with land release in Sydney and rezoning in Sydney. It takes time.

**Mr FALINSKI:** I think you're gently trying to indicate that government regulation in New South Wales was the thing that most impacted supply responses.

**Dr Lowe:** Luci, you've probably studied this more closely than I have, but I think broadly what you're saying I'd agree with.

**Dr Ellis:** If you're looking to compare what was happening in New South Wales versus in other states, obviously differential planning regulation matters. But what I would want to put in context is, firstly, supply and demand for housing is supply and demand for a stock of housing, and most of it is already there. So however much you can build in any one year doesn't add much proportionately to the supply. If you're used to having population growth of 0.8 or one per cent and it quite rapidly goes up to 1.5 to 1.7 per cent, that's sort of saying you almost need to double the amount of construction that's happening. That takes some doing, particularly if you haven't been warned that that's going to happen. There are just inherent delays in being able to marshal that degree of expansion in your incremental supply. There is always just a stock versus flow issue. No matter what you do with rezoning and other regulation, you will always have a situation where, if you double the rate of population growth, you will, for a time, see higher housing prices.

The other point I'd make there is that Sydney, relative to some other cities, is relatively constrained. I'm a Melbourne girl. I grew up back when a number of places like Lara were not easily accessible to the centre of the city. They were considered outside of Melbourne. One of the things that's happened in Melbourne is that they've discovered that they've got all this relatively flat land to the west and south-west, and that is developing quite rapidly. There has been room to expand detached housing on the fringe.

There has been relatively less apartment development in Melbourne, and there are many municipalities quite close into the centre that prevent that, whereas in Sydney, it's actually quite hard to expand Sydney much further: you hit mountains, or ocean or national park. But it has been easier to put apartments all the way through the city and so you have seen a rather different supply response, but it's one that has involved more delays because you
have to realise: 'Hey, there are areas where we never used to have apartments that we need to rezone, and we need to think about that. We need to think about the transport and infrastructure.' It's just not something that happens overnight.

**Mr Falinski:** Can I put words in your mouth for a moment? What you're saying is that the federal government's rapid expansion of immigration in 2008 is most responsible for the increase in house prices that we saw in Sydney and Melbourne?

**Dr Ellis:** There are a number of factors, but that is an important one. To the extent that population growth did increase, that was a reason why we were starting to hit those inherent supply constraints, some of which could have been improved with different zoning regulations. But some of them are just mountains and national parks. And so Sydney was more likely to experience that rapid population growth resulting in high housing prices because population growth moved. But sometimes population growth does fluctuate, regardless of policy.

**Dr Lowe:** We certainly could have had different outcomes in the housing market if society had understood that population growth was going to pick up and we planned for it—if local and state governments planned for it. But we didn't really plan for this pickup in population growth. It kind of crept up on us and then we found that the housing market was very tight and we needed to build more apartments or houses, and that we hadn't had the supply side—

**Mr Falinski:** Didn't we go from 170,000 migrants to 400,000 migrants within a very short period of time?

**Dr Lowe:** I don't know whether those numbers are right, but there was a big pickup in population growth.

**Mr Falinski:** In the '08 period?

**Dr Lowe:** Yes.

**Mr Falinski:** Okay.

**Dr Ellis:** I think it's also important to remember that a lot of the fluctuation in net overseas migration is actually people arriving on student visas. And so, in some sense, it was understanding the implications of the success of our education export industry.

**Mr Falinski:** Okay. Governor, you mentioned that there's greater discounting among providers for interest rates at the moment. Do you keep any data on that, or is that just a sense that the—

**Dr Lowe:** No, we do keep data on it. We have a database called the 'securitisation database', which collects data, I think, on—

**Dr Debelle:** Two million.

**Dr Lowe:** Two million loans. And I think we publish data in the Statement on Monetary Policy—the average rates—

**Dr Debelle:** In the Financial Stability Review.

**Dr Lowe:** In the Financial Stability Review—the rates that people actually pay. We're currently implementing a new data collection from the banks which will give us much finer disaggregation of what people are actually paying. We plan to publish that later this year as well.

**Mr Falinski:** That'd be good.

**Dr Lowe:** I've thought it really important that the community understands what people are actually paying on their mortgages—

**Mr Falinski:** As opposed to—

**Dr Lowe:** because there are actually some very good deals out there. The best thing the 25 million of us can do for bank competition is to go and demand those good deals and, when banks offer them, to respond, switch and move. It turns out that when you do that you can actually do quite a lot better than what you've got. I encourage everyone who has a mortgage, if they haven't done so recently, to go and ask their bank for a better deal. And if the bank says no, go look for another bank.

**Dr Debelle:** Or a non-bank.

**Dr Lowe:** Or a non-bank, as Guy says!

**Dr Debelle:** A non-bank lender—

**Dr Lowe:** Or a non-bank lender. So there are plenty of very good deals out there, and if we want the banks to compete then we have to respond to those good deals.

**Mr Falinski:** What deals should we be looking at? Are there any particular—
Dr Lowe: I'm not going to go there!

Mr FALINSKI: On switching between accounts: you mentioned that the rate of switching between accounts has picked up. Do you publish any data on that? Or do we find that in the Statement on Monetary Policy?

Dr Lowe: We have data on refinancing, but I don't know whether it's refinancing—

Dr Debelle: Yes, there is the data on refinancing, which is actually published by the ABS every month.

Mr FALINSKI: Yes.

Dr Debelle: Most, but not all, of those deals are refinancing to a better deal, but that's when you switch from one bank to another. But if you stay with your existing bank and, possibly, threaten to switch and then get a better deal, that's not in that data. We see that in this database that Phil mentioned earlier—this is loan-by-loan data. In one month it has one rate and then the next month it has a lower rate, so we can keep track of that.

Mr FALINSKI: I understand that that would give you information on discounting, but switching.

Dr Debelle: That's in the refinancing—

Mr FALINSKI: But that could just be—I've come to the end of my term with principal-only and now I have to refinance to interest-only. But I may not change provider. The interesting thing is that if you have data that shows that people are switching between providers then that runs counter to the Hayne royal commission's finding, which was effectively that we don't have competition in the Australian financial service market; we only have the appearance of it. So, is there—

Dr Lowe: Well, I think we do have competition. The competition would be more effective if more of us switched. People are switching all the time. There are enough people who've taken the advice and—

Mr FALINSKI: As a humble backbencher, if I wanted to go and find and track where switching is occurring, is that information implied in other data, such as refinancing?

Dr Lowe: It's implied in the refinancing data.

Mr FALINSKI: But you agree that it might not actually be capturing switching? Perhaps you'd like to take that on notice and come back to us.

Dr Lowe: Yes, I can provide you with more details of what the refinancing data actually includes and how to interpret it.

Mr FALINSKI: That would be fantastic. The other thing is that the Hayne royal commission pointed very early on to the fact that you have a blizzard of products—I think the number 4,000 was mentioned in terms of mortgage products in the Australian financial market—and a blizzard of brands which are effectively owned by four major providers. What this is creating in the marketplace is consumers who are confused and therefore stick with what they know or understand, because venturing forth into that market just becomes too difficult. This is a psychological phenomenon that I think Mr Krugman has mentioned on several occasions. Why then would we not want to encourage mortgage brokers?

Dr Lowe: I think mortgage brokers play a very important role in the system. They help the smaller lenders. They bring competition that way. But they also help each of us to work through the maze of these thousands of products. That's their job—to kind of understand the thousands and work out which are the best deals. So, mortgage brokers play a very important role in facilitating competition.

Mr FALINSKI: So, when the Netherlands moved to a system for mortgage brokers similar to the one that the royal commission has recommended—which is that consumers pay the fees, not the provider—did that not lead to the decline in mortgage broking business and the number of brokers available in that financial market?

Dr Lowe: I haven't studied it, but I have spoken to the governor of the central bank there, and he said there were some teething problems but the market has adjusted. People pay the fee and it's capitalised into the loan and they pay it off over time. The Netherlands mortgage market's more complicated, because often the mortgage is somehow tied up with your pension, so it's much more complicated than our market. I think in principle we could move to a model where the borrower pays the fee and capitalises and you pay it off over time. But I'd be wary of doing that too quickly. We'd need to look at it very carefully before we did that, because the brokers play such an important role in facilitating competition.

Mr FALINSKI: So, you agree that it's a critical role in the market that we've ended up with at the moment.

Dr Lowe: Yes. I'd also agree that different models of who pays can work, but you wouldn't want to change too quickly without having made sure that you understood all the implications.
Mr FALINSKI: In the three minutes that I have left, I'm going to venture forth into a particular area that we could talk about for the next hour and a half, which is household debt. In particular, interest rate movements could be taken out of the hands of the RBA, couldn't they?

Dr Lowe: Well, how would that happen? Certainly banks adjust their mortgage rates every now and then by relatively small amounts, and that tends to get unwound by competition.

Mr FALINSKI: Let's say there was a trade war between two major economies globally and that created an exogenous event where debt markets suddenly became more expensive. That would feed through into the Australian marketplace, wouldn't it?

Dr Lowe: If credit spreads rose and the spread that the banks have to pay to raise their money increased.

Mr FALINSKI: You're at 150 basis points at the moment. You have little room to move in terms of trying to absorb some of that shock at the Australian level.

Dr Lowe: We do have some room. If the credit spreads rose further and we didn't want to see mortgage rates rise, then we could lower the cash rate, and we still have room to do that.

Mr FALINSKI: But compared to 2008, you don't have as much headroom.

Dr Lowe: That's mathematically true. If we found ourselves in this situation, then, as we were talking about before, there are other margins of adjustment. It's not just monetary policy that can stabilise the economy. Fiscal policy can play a role as well, and so can the exchange rate adjustments. We shouldn't have a mindset that monetary policies are going to solve all these problems.

Mr FALINSKI: I understand.

Dr Lowe: We've got fiscal policy and exchange rate adjustments as well.

Mr FALINSKI: But what I'm interested in is your view. We have a highly indebted household sector, by some measures the most indebted in the world. If we then had an exogenous event which drove up interest rates, what would that do to consumer confidence and to spending in the economy?

Dr Lowe: Higher interest rates—

Mr FALINSKI: As a parliament, should we be cognisant of the fact that we don't introduce policies that impact consumer spending negatively or impact housing prices negatively in the short term?

Dr Lowe: My answer to that question, whenever it's asked, is yes. We want the parliament to do things that reassure households, support household income and give people confidence and businesses confidence to employ and invest in people. We always encourage the parliament to do that.

Proceedings suspended from 10:46 to 11:00

CHAIR: We will now resume. Just for clarity, particularly for the precocious and humble member for Mackellar, the time allotted for each member of the committee is equal, except for the chair and deputy chair, who get 20 minutes. Everyone else gets 15 minutes, and therefore I hand the next 15 minutes over to Mr Keogh, the member for Burt.

Mr KEOGH: Thank you, Chair. Thank you, RBA team. No doubt you would have observed that there were some articles referring to an NAB outlook that said rates would stay the same for the next decade. Then we had a story this morning regarding Westpac's view that there'll be two cuts this year. It strikes me that there are three options: neither of them are right, or one of them is right. Which?

Dr Lowe: I think there are a lot of different scenarios, so we have to weigh these and assess them each time the board meets, and that's what we do.

Mr KEOGH: Thank you, Chair. Thank you, RBA team. No doubt you would have observed that there were some articles referring to an NAB outlook that said rates would stay the same for the next decade. Then we had a story this morning regarding Westpac's view that there'll be two cuts this year. It strikes me that there are three options: neither of them are right, or one of them is right. Which?

Dr Lowe: I think there are a lot of different scenarios, so we have to weigh these and assess them each time

Mr KEOGH: I get the impression you don't necessarily agree with NAB or Westpac, from the statement that you made in your opening remarks. In which ways are they wrong? What are they putting too much emphasis on or not enough emphasis on?

Dr Lowe: I don't think of it as being wrong or right. I think of this more in probabilistic terms. There's a possibility that rates will need to go up. I think it's unlikely that that would occur this year, because the inflation outlook looks so benign. But if things turn out broadly along the lines of the central scenario—the unemployment rate comes down and inflation rises, and that happens gradually—then at some point next year it may well be appropriate to increase interest rates. So that's certainly possible, but it's also possible that we end up with weaker consumption growth, wage growth doesn't pick up, the housing adjustment weighs on spending more than we think, and we need to consider lower rates. So I don't think either one is right or wrong. Both are possible. What we do every month at the Reserve Bank board is to discuss those possibilities and see how the probabilities have shifted. When we see the probabilities shift as part of our transparency, we articulate that to the public. We don't
have a crystal ball, so I can't say what's right or wrong. All I can do is say how I see the probabilities of these scenarios.

**Mr KEOGH:** What do you see as the impact, or are you in any way concerned about the impact, of having two major bank economists give, at best, a status-quo-only prediction or basically a negative prediction going forward? There's no-one saying rates are going to go up and, by that, implying that the economy's about to take off. They're saying either 'two cuts this year' or 'no change for a decade'. Are you concerned about what that is then saying to the country about what might be occurring and whether that therefore has a negative impact going forward?

**Dr Lowe:** I don't think so. Everyone's entitled to their opinion.

**Mr KEOGH:** Yes, but it's quite different when humble backbenchers like Jason and me express an opinion, as opposed to the chief economists of two of our major banks, or when you express an opinion for us.

**Dr Lowe:** My opinion is that the probabilities of rates going up and going down are broadly balanced, and what we'll do at every meeting is discuss those probabilities. When we change our view, I'll articulate that publicly, and everyone else is entitled to their own view. It doesn't worry me too much if some people have one view and other people have another.

**Mr KEOGH:** Would it be true to say that you would be, or are, less concerned about a long-term trend developing of inflation being below or at the very bottom end of the target band than if it were to be at the top end or above the target band?

**Dr Lowe:** I haven't had to contemplate that, inflation being at the top end.

**Mr KEOGH:** Well, not for a while.

**Dr Lowe:** For quite a while.

**Mr KEOGH:** But there seems to be a pattern that what is developing is a trend of it being below or occasionally getting just into the band.

**Dr Lowe:** Yes.

**Mr KEOGH:** And that's not something that I see the board expressing any concern about, whereas, historically, when we've seen it staying at the upper end or popping up above the band, that is something that immediately we hear concern expressed about.

**Dr Lowe:** If I thought inflation was going to stay sub two per cent indefinitely, then I would be quite concerned about that, because what would happen is inflation expectations would become lower and it would be hard to get inflation up eventually. So I would be concerned if inflation was going to stay for a long, long period below two per cent. But that's not our central forecast. We see inflation gradually picking up. And, as I said before, the strategy is really around keeping interest rates low, having the labour market tighten up, wage growth pick up and inflation picking up. Broadly, that scenario is working — that strategy is working. I'd like it to work more quickly, but—

**Mr KEOGH:** On that, and it comes back to some of the questions that were raised earlier about the NAIRU and answers you have given this committee previously, I'm going to put a proposition to you. I want to see what you think about it. The concept of the NAIRU being at around five per cent, which I know we're not so certain about now, is premised on the basis of a particular mix in the economy of full- and part-time employment and permanent employment versus casualised employment, with an overlay of a degree of job security that comes, in particular, with permanent employment. Over more recent times, we've seen not only an increase in part-time employment and in the rate of casualisation in employment but also, even for those who have nominally permanent employment, a decreased level of job security in that employment. I'm not talking about whether any of those things are good or bad, but about the change in that make up of the employment mix. Therefore, when we talk about a particular rate of unemployment it is quite a different context and concept to what might have been spoken of a decade or two ago. For that reason, the rate at which you would see inflationary pressure from a particular rate of unemployment is much lower than we've traditionally thought.

**Dr Lowe:** I would agree with that. That's why I said before I think the country can have an unemployment rate around 4½ per cent without causing wage growth that's so fast that it causes problems for inflation, largely because of the factors that you are talking about. It's a global story. Workers and firms right around the world feel like there's more competition, and they feel more uncertain about the future because of technology and
competition. That affects everyone's pricing power and pricing decisions, including workers and firms. So the
global system seems less inflation prone to me, because of globalisation and technology, and workers in Australia
are feeling that just as they are right around the world. And you have to have the labour market to be quite tight—
much tighter than we used to think—to get people to move beyond the concerns about competition and

technology.

Mr KEOGH: In your opening remarks you talked about the key to boosting real income being lifting
productivity. You spoke a bit about labour productivity before. But we have seen some substantial jumps in
corporate profitability over the last few years not flowing into that wage growth. Picking up the point you just
made, do you think it's that uncertainty and the concerns about competitiveness that's meaning that even though
there have clearly been increases in productivity leading to profitability, we are not seeing that reflected in wage
growth?

Dr Lowe: That's certainly possible. If you look at the last five years, the rate of underlying productivity
growth the economy has generated would justify faster nominal wage growth, but if you look at the past 10 years
that's not the case. In the previous five years real incomes of households rose more quickly than justified by
underlying productivity growth—we had the big rise in the terms of trade and the mining investment boom. So
many of the community got wage rises beyond what productivity growth would have justified, because the
economy was doing so well because of the resources boom. So what we've seen in the last five years is the
reversal of that. When I look at that whole 10 years together, workers have basically got their normal share of
productivity growth, but it's quite different over the two five-year periods. It may be we're just seeing the
workings out of the resources boom, or it's also plausible that these forces of competition and technology are
meaning workers aren't getting a normal share.

Mr KEOGH: Isn't part of that that, when you go through what we saw in Western Australia, principally in
terms of a mining expansion and mining construction boom, just looking at the productivity figures, as you might,
traditionally and simplistically completely masks what's going on, because it doesn't look productive because
you're investing all this money for which you don't see any income for another decade or after it's finished.
There's quite a tail there. You're talking about a very different understanding of productivity and the relationship
to wages, because the wages come first and the income comes much later.

Dr Lowe: I agree with that, and Western Australia has got its own issues continuing at the moment. But, over
10 years, productivity growth in the Australian economy has broadly matched changes in real wages.

Mr KEOGH: So it aligned, even though there was that disconnect?

Dr Lowe: Real wages ran ahead of productivity growth. I remember giving speeches saying that we're getting
improvements in our living standards even though we're not becoming more productive.

Mr KEOGH: Because we were becoming more productive, but it didn't come until that investment.

Dr Lowe: Because we were selling our rocks for a higher price. So that meant our real wages could rise, and,
once we are selling the rocks at a lower price, that gets reversed.

Mr KEOGH: Except we're selling a lot more of the rocks?

Dr Lowe: We're selling more. In the broad sweep of history, this has worked out okay, although we have had
five years when people's wages have not been rising at the rate of productivity growth, and that partly underlies
the unhappiness that we're seeing in the community.

Mr KEOGH: To pick up on that point, effectively what you're saying is that, because the nature of that
productivity is one where there's a significant up-front investment, wages go up, there's an investment in capital in
expanding these mines and whatever else was going on, and then the income flows. So it's not about the price of
the commodity, but there's such a much larger volume that the income went up first, the productivity then
matched—which you would presume is what all those mining companies were anticipating would occur.

Dr Lowe: The issue we've discussed internally is: is that 10-year adjustment now completed? Hopefully we're
going to go back to a period where real wage growth matches labour productivity growth. It's a big question about
whether that takes place. I certainly hope that takes place, but you can't be certain.

Mr KEOGH: So does the nation. You mentioned before that Western Australia has some unique issues. Your
comments and other comments have talked about a correction in housing prices within Sydney and Melbourne,
and that's been a key focus. What's happening in Perth?

Dr Lowe: I went to Perth a couple of times last year, and, especially earlier in the year, I saw signs of things
bottoming and maybe even picking up, but the housing market in Perth has deteriorated again. I noticed the rental
vacancy rate is coming down, so that's good news, but prices are still declining and employment growth has
stalled over the past year in Perth, after having been reasonable in the previous year. So I'm having a bit of trouble putting all the pieces together, because I know the agricultural sector has done very well. The wheat crop in Western Australia, as opposed to eastern Australia, has been at a record high, so they're benefiting from a lot of production, higher prices and a fairly low exchange rate. So the agricultural sector is good. In the resource sector, we're hearing more positive stories all the time. A number of firms we're talking to are speaking about expansion plans, more sustaining capital investment and some are even thinking about expanding production. So they've got the resource sector and the agricultural sector doing quite well, but the housing market and the labour market seem to have softened again, and I'm having trouble putting all those pieces of the puzzle together.

Mr KEOGH: So are we. That's why I asked the question. To pick up on the other point you made that, in Sydney and Melbourne, the declines are not having the wealth-effect impact because, over the 10 years, house prices are still so much higher, that's not the case in Perth. Are you seeing significant wealth-effect impacts in Western Australia, where people don't have that advantage?

Dr Lowe: It's hard to tell because the state based data are very noisy, and, when you try and estimate these relationships, it's much harder to find them. But it's quite plausible that the protracted period of price declines in Perth is having an effect on consumption, and the labour market is part of that. I'm a bit more optimistic because of what I hear from the resource sector: the expansion plans; the sustaining capital spending seems to be kind of flowing. I think that it's reasonable to expect that that will flow back through the rest of the economy. We'll have to wait and see.

Mr KEOGH: You noted in your opening remarks PayID and the changes to the payments system to allow instantaneous transfers and connection of accounts to mobile phones. I was going to ask you what the uptake was. Clearly, it's not that great, and that's because banks haven't implemented it, I gather from what you've said in your opening remarks. Have there been reasons provided for why they haven't implemented it?

Dr Lowe: There are always reasons.

Mr KEOGH: Any good ones?

Dr Lowe: Perhaps I can ask Michele to talk about this, as she's closer to it than I am.

Ms Bullock: Sure, there are always reasons, and I think the main reason that seems to be coming back is that their legacy systems are just much more complicated than they thought they were going to be. I think there's probably some truth in that, but I also think that they've had a very long time to address this issue, and they should have been, really, a bit more ahead of the game.

Having said that, I would say that I think there's a good story here. Increasingly, you're seeing more volume going through the NPP. There are about half a million transactions a day that go through. I think Phil mentioned 2½ million PayIDs. I think what's really interesting, in fact, is that the Department of Human Services are now using it to make urgent and disaster payments. In fact, I'm told that they have made about 1,800 NPP payments to people who've been involved in the floods and the bushfires recently. That's really positive. They can do it on weekends. The people get it pretty much instantaneously. This, I think, is really good.

We've got this system now. People aren't waiting for cheques in the mail anymore. The money is there when they need it. So I think there are some good stories. There's more to go, but I think it's really positive.

Mr KEOGH: My final question in this round is related to an earlier issue. It goes to this competition point—made probably more in Western Australia than, say, some other places—where, whilst homeowners might not be underwater on their mortgages, they have now slipped to a position where their LVR is such that they're finding it very difficult or in fact impossible to refinance, or at least impossible to refinance with a different bank. Are you seeing that show up in your data? Are you concerned about the competition issue, in that it's all well and good to threaten to go to another bank, but, when your LVR is 92 per cent, there's no opportunity to go to another bank?

Dr Lowe: I'd agree with that, and you really have to stay with the bank you've got, because in the current environment—

Mr KEOGH: It's very hard to say, 'Give me a discount on the interest rate.'

Dr Lowe: It is, but most people are not in that circumstance. Some are, and they have fewer options. Yes, that's true, but most people are not in that circumstance.

Mr BANDT: I think I read in a Peter Hannam piece in Fairfax over the weekend, Dr Debelle, that you're giving a speech soon on climate change. I've got a few climate change questions, so should I direct them to you?

Dr Debelle: Sure.

Mr BANDT: Thank you. The bank is obviously aware that Australia has signed up to agreements that include temperature limits around global warming. For warming the planet, 1½ and two degrees are referred to in the
Parliamentarians have raised concerns about the potential impacts of climate change policies on the Australian economy. APRA said in a speech a couple of years ago that policymakers, regulators, and companies ought to treat those limits as a lodestar, in a sense. We know that we want to limit warming to that, so what needs to be taken into account not only by companies but also by regulators? That is not just whatever government's policy might be right now but also having to factor in policy risks, changes over the next period of time — things that might have to happen in order to stay below that limit. Has the bank considered or discussed at all the IPCC report that was released late last year? It has?

Dr Debelle: Yes is the short answer to that question.

Mr BANDT: In that IPCC report, they make the point that we've already warmed by one degree, and they say that to stay below the limit of 1½ degrees they've got a few scenarios, which they map out. All of those scenarios say that by 2030 there is going to be a rapid decline in the amount of primary energy produced from coal. The range in the scenarios is that it will reduce by between 59 per cent and 78 per cent — on average, around two-thirds. Is that the bank's understanding of the IPCC report?

Dr Debelle: I've read it; and that's what they say, yes.

Mr BANDT: That would have significant impacts for Australia if the world, including Australia, stuck with policies that were consistent with the IPCC report because it would mean in Australia a two-thirds decline in thermal coal use and exports.

Dr Debelle: Yes.

Mr BANDT: Do you think it would be a good idea for the Australian government to have a plan to deal with the managed phase-out of thermal coal exports consistent with the IPCC?

Dr Debelle: I'm not sure I'm qualified enough to answer that specific question. I would make a couple of points related to what you have said. Firstly, what is the nature of the adaption, both in that sector and other sectors, to what's going on? That's what we are thinking of from our perspective. We can't influence things along the lines of what you are talking about, but we can look at and try and get a sense of how other people are responding to what has happened and also what is in prospect. Around the energy side of things, one thing we have spent a fair bit of time looking at which is evident and having a macro-economic impact — what I mean by that is that it is big enough that it actually shows up in the GDP numbers, in the growth numbers — is renewables investment. That is now large enough that it is actually having a material impact on the investment numbers and also on the economy as a whole. From our point of view, we can look at the scenarios which deliver the sorts of outcomes you are saying on that sector. We also have to think about what other adjustments may or may not occur, and try to aggregate them together.

Mr BANDT: If we grew a hydrogen export industry, for example, that could have huge benefits for Australia. So it might be of benefit to have a plan around that. But I want to come back to the question of thermal coal. We have seen that the dollar can move significantly on what you have put as a small decision; that can have reasonably significant impacts in the short term. If, hypothetically, Australia had signed up to an agreement that said iron ore exports have to be cut by two-thirds in 10 years I imagine everyone would be saying 10 years is only a few short-term or medium-term outlook terms away so we had better have a plan to deal with that. I am a bit surprised that the bank accepts that we have signed up to agreements that say we could see a marked decline in thermal coal in just over 10 years, not a long time, but you don't think it is useful for us to start planning for that.

Dr Debelle: You are the parliament. Your job is to decide those things. Let me flip it around. We, as a central bank, have to take what the policymaking framework is and fact that into our considerations —

Mr BANDT: You agreed with APRA's characterisation. APRA said it is now the role of regulators, including yourselves, to start thinking about these things. If one agrees with that —

Dr Debelle: What I am trying to say is that we are thinking about them. We have to think about these scenarios and what they mean through the somewhat narrow lens through which we look at things, which is the impact on output in the Australian economy and inflation. But, for better or worse, to some extent we have to take whatever the policy responses are, which we don't control, as a given in thinking about that. As they change — if they change — we need to factor that into our thinking as well.

It's taking these sorts of scenarios, which have that sort of horizon, and mapping them back into the way we look at things in terms of the impact on the Australian output and the economy, and saying: "Well, okay, if that's going to happen, what does that imply for the future outlook for the economy? What does that imply for what we might do? What are the other adjustments which may occur?" including, apropos the last 24 hours — if something like that happens and the exchange rate is part of the adjustment mechanism.
Mr BANDT: I'm not asking for your view about what your plan should look like. I guess that the Reserve Bank has been comfortable about encouraging parliament to have a plan to increase productivity and a plan to deal with population growth. We should have plans, without diving into the political sides about which way those plans could go—

Dr Debelle: No.

Mr BANDT: You've encouraged us to think about some of those other things. I want to know why—

Dr Debelle: The government—

Mr BANDT: you're not encouraging us to think about plans around what could be a very significant disruption to the Australian economy if it's not planned?

Dr Debelle: But, as you mentioned, the government has committed to the Paris accord. Then, the IPCC report, as you noted, informs what the scenarios and prospects look like under the Paris accord, with that 1½ degrees of warming and what that implies for particular interests. Given that, it would seem to me to be reasonable to assume that if we take those scenarios then you, as a parliament, should be planning around those scenarios, yes.

Mr BANDT: Have you done any scenario planning around what, on average, a two-third decline in thermal coal exports by 2030, as suggested by the IPCC, might mean for the economy?

Dr Debelle: That is the sort of stuff we're looking at right at the moment—including things like that. I think that report was interesting, in saying: 'Okay, this is,—and I was going to use the words 'baked in', that's not exactly the right term to use here!—'what appears to be in prospect. Given that, these are the sorts of outcomes.'

The challenge for us is mapping, as I said, and looking at the different scenarios. That's one scenario which may well be plausible. Then we need to think about, 'Over that same 10 years, what are going to be the adaptations of other parts of the economy?' It's to what extent, if at all, those will provide offsets. The reason I went back to renewables is that there is one thing that is interesting in that space, and that is the price of investing in renewables. One of the reasons why we're seeing so much of it—that increase in it at the moment—is because the price has declined dramatically, even in the past 12 months, let alone in the past five years. One of our challenges is saying that it's probably not going to be the case that everything else remains the same. So, if we take this thing that's going on in this part of the economy, and we have these other things going on in that part of the economy, our challenge is to combine them into our overall view. In the end, we're concerned about the aggregate effect on both the economy as a whole and on inflation. So that is the challenge we have in front of us.

Mr BANDT: Yes, I understand. I'm particularly interested in the exports question. You said that you're doing some of that work at the moment. Is that something where you think that in the short term, or the next time you come back before the committee, the bank will be able to say, 'We've modelled some of these scenarios'?

Dr Debelle: I can share some of the potential thinking around that, for sure. The challenge we're having is that a lot of the modelling there has been done in a framework which doesn't translate. Our challenge is translating to the tools that we've used, traditionally, to some extent, and trying to look at what others do. We don't have full expertise in this area, but we try to look at some of the other models that other people have built to try to help us understand that. So that's where we're devoting time and resources now, to try to get a better handle on that, for sure.

CHAIR: Dr Ellis, did you want to jump in and say something?

Dr Ellis: We've run scenarios about this before, using external scenarios about the decline in thermal coal. We have run those. If it is drawn out, then you see it in coal exports but you don't really see it in GDP to any material extent—if it's drawn out enough. So the issue is, really, the phase over which that takes place. And, as Guy mentioned, other things are coming on to adjust to that in the movement to renewables.

The other comment I'd make is that, at the moment, thermal coal has come off since we last met by about 15 per cent, but it's still roughly double where it was in 2015-16. The reason why global thermal coal prices are still very high is because all of the producers got the message that one day this would fade away and that you didn't want to be investing in expanded capacity. But many of the consumers of thermal coal in the electricity-generation industry around the world have not yet made that adaptation. We were discussing what was going on with coking coal in China, but certainly China is also looking to try to switch from coal-fired generation to both renewables and gas, and you see similar shifts both here and elsewhere.

Mr BANDT: Governor, if I can just come back to this question that's been flagged before about underemployment in particular. We're talking about if and when wages pick up. It seems like we're waiting for Godot. We've had this conversation many times. You mentioned unemployment several times in your opening statement but didn't mention underemployment once. We've had previous exchanges where you've said that, if it's
the case that someone who's working five hours who might want six or seven, that's one thing, but you've also referenced that people are now, on average, wanting two extra days per week. When we used to measure full employment with respect to unemployment only, employment was probably a reasonably good proxy for having a full-time job. Now it's not. It seems to me that we now need a new measure that doesn't just take into account unemployment but takes into account underemployment. It feels to me that the RBA is underplaying underemployment. You're not mentioning it when we're talking about when we're getting to full employment. So what I want to ask is: you've said maybe in the fours is what would count from the unemployment side, but what's the number with respect to underemployment that allows us to say we're at full employment?

**Dr Lowe:** There are a couple of things. There is a pick-up in wage growth taking place. The current rate of wage growth is the highest in four years. It hasn't been a marked pick-up, but it is actually gradually picking up. I suspect that will continue. The vacancy rate at the moment, so there are a number of vacancies that firms have relative to the size of the labour force, is the highest that it's ever been in the whole history. In the business surveys, more firms than at anytime in the past decade are saying that it's hard to find workers, and businesses are also reporting that they're going to increase their hiring at quite a fast rate. So I'm expecting that the labour market will continue to tighten and this gradual pick-up in wage growth will continue, so it is happening.

You're correct: I didn't mention the word 'underemployment' in my prepared remarks. That was really because I was trying to be as succinct as I possibly could. But if you look at any of our documents, you'll see a discussion of underemployment. I can assure you that at every board meeting when we talk about unemployment, we see a graph of underemployment and we talk about the issues that you and some of your colleagues were discussing earlier on. I want to assure you that we give a lot of attention to it, and particularly to these part-time workers who want more hours. Our strategy is to keep the labour market tight so that more of these people will be offered the hours they really want.

**Mr BANDT:** Because of this question of underemployment—so many people are working part-time or in insecure work—and this general puzzlement about why wages haven't grown fast enough over the recent few years, it seems to me that perhaps neoliberalism is having its stagflation moment. There are things that are occurring that should not be, and wages are not growing, despite low levels of unemployment, precisely because their work is now so insecure—there are so many people doing part-time work. The spare capacity in the labour market is massive, and we are going to find it very, very hard to find our way out of this without some different thinking.

**Dr Lowe:** I wouldn't go that far. The vast bulk of people who work part time want to work part time and are happy with the hours they work. I think we've got to get away from this rather old-fashioned concept that there are full-time jobs, which are good jobs, and part-time jobs, which are bad jobs. The vast bulk of people who work part time want to work part time for personal or family reasons or they're studying or something. It's only around one-quarter of those people working part time who really want more hours, and that's a legitimate issue. As I said, our strategy is to make the labour market tight enough so that they get jobs.

I wouldn't agree with the proposition that wage growth isn't picking up. As I've said, we've seen it pick up here, and overseas—in the United States and in Germany now, and even in the UK—wage growth has picked up as the labour market's tightened. The frustration that I have, and that many others have, is this is taking longer than it used to. It is still working, it's just taking longer. From where we sit we've got to be patient. We're looking at the long term and I think we're getting there, it's just taking a long time.

**Mr JOSH WILSON:** Thank you all for coming out. I'll pick up on some of those questions. You've referred to, when you use the term not a beautiful set of numbers, but a nice set of numbers—

**Dr Lowe:** Reasonable.

**Mr JOSH WILSON:** Reasonable? 'A reasonably nice set of numbers'—five, three and—

**Mr FALINSKI:** The inherent view!

**Mr JOSH WILSON:** It's in the eye of the beholder. I just want to go back to what you said, when we met this time last year, around the proposition of the labour market tightening, and whether or not there's spare capacity. I'm just interested in your view about the range of measures that you could look at—average hours worked per month et cetera, but also, coming back to what Mr Keogh was saying, not just full-time and part-time work, but also an understanding of how the labour market has shifted. You've got permanent ongoing employees and you might have full-time contract employees, that sort of distinction that gives a little bit more sophistication to the labour market picture, and perhaps helps explain why we're all a bit dumbfounded that the apparent tightening in the labour market is not producing the effects that people say it should.
**Dr Lowe**: As you can imagine, we look at a whole range of labour market indicators. The headline one is the unemployment rate, but we pay equal attention to the underemployment rate. We pay a lot of attention to the series on vacancies, the series on job ads and there are many business surveys that ask firms if they're going to hire workers and how hard they're finding it to find people with the right skills. We look at the whole suite of labour market indicators. We also look at trends in contract employment: is employment in the gig economy rising; is the number of sole traders rising; what's the level of employment security that people have? These are all things that we monitor.

Having done all that, I still think the underlying issues are perceptions of competition and uncertainty. If you feel like there's more competition, you're less likely to put your price or your wage up, and people feel like there's more competition because of globalisation and changes in technology. That makes both businesses and workers less likely to put their prices up. This is a global story. It's not something we talk about just in Australia; at every kind of international meeting I've gone to in the past five years we've discussed this same issue—that is, why it is that wage growth is slow to pick up? It's competition and uncertainty.

**Mr JOSH WILSON**: The things that interest me about that are the three factors that you've previously outlined in relation to low wage growth: spare capacity, this anxiety about competition globalisation and bargaining conditions. It's the first and the third that are a bit more measurable. The middle one, that uncertainty or anxiety, is a state of collective consciousness or something. It just seems to me that you pick that one out, rather than—on the spare capacity side Alan Oster says that if you take underemployment and people who have just stopped looking for work then unemployment is really 13 per cent and not five per cent. And if you look at the actual circumstances in relation to bargaining conditions—enterprise agreements that are being rolled over, locking in low wage rises—these are the structural things. Why is that you pick the more nebulous 'anxiety' rather than those other structural things that we could presumably do something about?

**Dr Lowe**: I think the change in bargaining power has had an influence. I think these other things are more important. I say that partly because this phenomenon we're talking about is a global one. It's in almost every advanced economy. When I go to Basel, as I do six times a year to have roundtable meetings with all the other governors, this is the most frequently discussed issue. And these countries have very different industrial relations systems. Probably in most of them there's been a decline in the bargaining power of labour. But my sense is that that's not the primary thing, although I'm sure it's played some role.

**Mr JOSH WILSON**: I would say that some of those structural things are the same there—

**Dr Lowe**: Sorry, just one more comment—I want to repeat the point that, as the labour markets have tightened up around the world, we have seen wage rises pick up, and we're seeing that here. So the underlying forces are still working; they're just working more slowly than we've used to seeing.

**Mr JOSH WILSON**: But in your statement you say that wage rises are happening more quickly in all states than they were this time last year, but they're not happening more quickly than you had anticipated. So that's one thing I'd be interested in a response to. The second thing is: if that's occurring, why is discretionary spending in retail diving? Why has the NAB consumer-spending-pattern survey just recorded, for quarter 4 of 2018, the worst consumer anxiety result they've ever had since they started the measure in 2013?

**Dr Lowe**: I'm not sure which series that is, but the aggregate measures of consumer sentiment and confidence are still fractionally above average. In the period of December there was a lot of anxiety, both domestically and globally. Domestically there was a lot of discussion about falling house prices. There were some problems in Canberra as well. Share markets globally were falling, and credit spreads were rising. The IMF had come out with forecasts downgrading global growth to average. All this made for a very negative environment in December, and I think that had an effect on confidence and spending. I have to say that since the new year turned there's been a stabilisation. Equity markets are up here; they're up a long way in the United States. Even in some of the survey measures we see from overseas, they're no longer falling and some have actually picked back up. Many people were particularly anxious during that period around the turn of the year, and I'm sure that had an effect on spending.

**Mr JOSH WILSON**: But retail spending has been falling, on a 45 degree angle, since the middle of 2017.

**Dr Lowe**: It's certainly slow.

**Mr JOSH WILSON**: Well, you couldn't describe it as slow.

**Dr Lowe**: The broader measures are in the national accounts, and it's been quite hard for us to tell what's going on there, because we've had a strong quarter, a weak quarter, a strong quarter, a weak quarter. We're going to be looking very carefully at the next set of national accounts, which are out fairly soon, to see what consumption is doing. There have also been substantial revisions to the history of consumption in the national
accounts. We thought consumption was growing at close to three per cent, but when the September quarter accounts came out the whole history for the last few years had been revised down. So it's hard to know exactly what's going on.

**Mr JOSH WILSON:** From what I understand, the big risk that you identify, and the big change in the 12 months since we last met, is around those downside risks. We met this time last year, and you talked about the risk that our economy, which is heavily dependent on consumption, could find itself tipping the wrong way if consumption doesn't improve, or perhaps gets worse. The bank has moved to a position now where you say that it's sort of balanced between a cut and a rise, and all the language in your statements suggests that your concern around consumption has got worse if anything. But you just said you think that perhaps the consumption picture is not as bad as we had thought, because we've had a closer look at it.

**Dr Lowe:** It's certainly not as positive as we thought six months or 12 months ago, and thinking about the domestic risks, that is clearly the most important one.

**Mr JOSH WILSON:** Is there not a risk—further, I suppose, on that risk—that if the projections are that growth in the economy is sort of returning to trend, potentially, either not much above trend or trend—then we're not going to see many more jobs created, if that's the case, and therefore we don't really get much follow-through in wages and the fall in discretionary spending and that kind of consumer anxiety continues?

**Dr Lowe:** There is a risk of that, of course. But there is also a risk that employment growth turns out once again to be stronger than we thought. Certainly since we met last time employment growth has been much stronger. We didn't expect that the unemployment rate would be five per cent until towards the end of next year, and we've been here for four or five months. As I said in response to Mr Bandt's comment, the vacancy rate is the highest it's ever been. So, when firms are asked how many jobs they've got vacant, as a share of the existing labour force that's very high. And firms are saying in the business survey that it's very, very hard to get workers, and the unemployment here in New South Wales is 3.9 per cent.

Those things give you some confidence that the labour market is going to continue to be okay, and it's quite possible that employment growth again surprises on the upside. It's possible that the scenario you paint turns out as well, and it's possible that the alternative one plays out. What we're doing at the Reserve Bank is trying to assess those scenarios all the time and be as clear as we can publicly how we're viewing the balance of probabilities.

**Mr JOSH WILSON:** Does the current record-duration interest rate plateau have any global precedence or contemporary global analogues?

**Dr Lowe:** Oh, yes. Some central banks have held their rates much lower and longer than we have. After the financial crisis, central banks got their rates down and then just held them.

**Mr JOSH WILSON:** Held them flat?

**Dr Lowe:** Yes, held them flat. And how long was the Fed flat for? Years and years—

**Mr JOSH WILSON:** Near enough to 10.

**Dr Lowe:** And the Bank of Japan—

**Dr Debelle:** The Bank of Japan's about 20-something, effectively—and still counting.

**Dr Lowe:** It's a long time for us, but globally it's not unusual to see central banks hold interest rates steady for a long period of time. And I think in the current environment the Reserve Bank board is conscious of being a source of stability and confidence, looking at the medium term, having a clear strategy and evaluating that strategy every month, and so far I think it's working. As the balance of probabilities shift we'll have to reassess, but I think so far it's been working.

**Mr JOSH WILSON:** Is it fair to say in relation to the inflation target that you have a kind of bandwidth—and it just seems that in terms of the combination of all the numbers you were much more sanguine about it being on the low end of that spectrum than you would if it was on the high end—but in order of the various targets that you've got, the fact that inflation has been persistently at the low end is something that the bank is prepared to discount or make a low-priority concern considering the other numbers?

**Dr Lowe:** No, I wouldn't say it's a lower-priority concern. I want to deliver for the Australian community an average inflation rate of two point something, and hopefully close to 2½ per cent. I'm confident that we'll do that. But over a fairly long period of time—since we've had the inflation targeting regime—we've delivered an average rate of inflation of 2.4-something. So, we want to do that, but we're realistic enough that it's going to take time. This is kind of what happens in every other country. Inflation's come down and it's taking time to get it back up. Whether I'm more relaxed—whether it's lower or higher—I don't know.
But what I have been concerned about is the labour market. And whenever the country is generating jobs and the unemployment rate's coming down, having inflation a bit low is not particularly problematic. It'd be good to see it higher, and we want to see it higher, but the most important thing is that people are getting jobs and their incomes are rising. Most people in the community don't care too much whether inflation's 2.42 per cent or—many people think it's four per cent. So I don't think too many people in the community really worry too much if inflation is a bit low. It would be good if it were 2½ per cent, but they don't worry too much. What they really worry about, and what I really worry about, is if people aren't getting jobs, and on that score we're doing okay.

Mr JOSH WILSON: Does the bank give some consideration to how improvement in income flows into stronger consumption across segments? Is it fair to say that, while we'd like to see wages and incomes more broadly—non-wage income—rise to underpin greater strength in consumption, there are some parts of the income spectrum where those rises are more beneficial because of the way that they flow into consumption?

Dr Lowe: Yes, people on lower incomes tend to spend more of any incremental increase in their incomes than people on high incomes. So that's true, but if the labour market tightens up then wages will rise right across the spectrum and people will spend more.

Mr JOSH WILSON: So do you think the box that's included around minimum wages is one of the reasons? I think that in Australia the percentage of the workforce that receives the minimum wage is comparatively small. In South Korea, I think the stat was something like 40 per cent, and here it's two per cent.

Dr Lowe: Yes.

Mr JOSH WILSON: But presumably one of the ways those countries are looking at their consumption issues is to ensure that it's actually lower income households that are seeing an increase in income.

Dr Lowe: Yes. Of course, very sizable one-off shifts in the minimum wage can have negative employment effects. I think the evidence is that, if you do regular and modest increases in the minimum wage, the employment effects aren't negative or positive, really. So I'd be more concerned with very large step increases in minimum wages because of the employment effects. I strongly support the approach that's been adopted in Australia, of minimum wage increases around the 3½ per cent mark on a regular basis. It keeps the wages of the bottom part of the labour market rising in step with or even faster than everyone else's and avoids the need for these very large one-off adjustments, which I think could in certain circumstances be disruptive.

Mr JOSH WILSON: I have a final question; it's a little bit tangential. In terms of looking into our short- and medium-term future and the kinds of things that likely have an impact on Australia's overall productivity and competitiveness, has the bank done some work on or looked at the National Broadband Network and how it's being delivered as we get close to the completion of the rollout, as the single largest infrastructure project in Australia at the moment?

Dr Lowe: I'm not aware that it has. If it has, it hasn't come across my desk.

Dr Ellis: We have not done a particular analysis saying what would happen to the productivity of this country if we had faster internet. That has not been something that the staff have done in recent years. With the National Broadband Network, you can see it in the numbers in terms of public investment. If you look at the investment numbers and infrastructure investment, you can see it. There's a telecommunications component, and that is observable; you can sort of see that that's high at the moment. But I would note that we've also been making statements that public demand generally, and public investment in particular, has been a source of growth, as observed in the national accounts. Infrastructure spending by both state and federal governments has been quite strong, and that has been primarily transport infrastructure rather than the NBN. The NBN isn't the only game in town in terms of the high levels of public infrastructure spending that have been happening.

CHAIR: Dr Ellis, just for clarity, can I go back to an answer you gave earlier to Mr Bandt, related to impact on GDP as a consequence of reductions in thermal coal exports. You say that over time there wouldn't be an impact.

Dr Ellis: It wouldn't be a large impact. Essentially, we have done scenarios. Guy referenced that there's been some more recent work done that's all in progress, but about 18 months ago we did a couple of scenarios based on some private sector assumptions about global coal consumption and what that would mean in terms of our exports and production. It's an arithmetic thing really. If you shut down your coal industry over 30 years, in terms of impact on annual growth, you would definitely see it in coal exports and coal production but you wouldn't see a very big impact arithmetically on GDP growth. The scenario we did 18 months ago didn't look at what would happen with renewables and what that would imply. It simply said: if coal exports did this, how big is it? The answer is: it is a small fraction of GDP in a year, so it's detraction from GDP growth is arithmetically small if you do it over a long period of time, but you would see it if you did it over three years.
CHAIR: I guess the point is that there is also a series of assumptions that have to underpin that round things that are displaced and replaced—

Dr Ellis: That's right. That particular scenario was quite a simple one. We just said: if coal exports fall to a very low number, what's the numerical impact?

CHAIR: Over 30 years.

Dr Ellis: Yes. It was essentially a sensitivity test. But our current forecast horizon, which is based on our forecasting technology and where we can get a non-embarrassing level of accuracy—these are outside the normal scenario.

CHAIR: I guess one of the challenges in this space is that it is almost impossible to project what will replace those types of exports over 30 years. We can take projections for renewables as an energy source and everything else, but it is highly hypothetical.

Dr Ellis: Exactly. The pure numerical impact on GDP growth in any one year from running down your coal exports over a long enough period is small. That is just the simple arithmetic of it.

CHAIR: The Reserve Bank of New Zealand has recently released a paper around capital requirements and capital ratios. My understanding is that there is also an announcement that they want significantly higher minimum capital ratios. Is it the intention of the RBA to head in a similar direction?

Dr Lowe: In Australia the capital requirements are set by APRA, not by us, so it is really a matter for APRA. APRA has already had a consultation document about higher loss-absorbing capacity and requiring banks to hold more tier 2 capital. We have discussed this a lot at the Council of Financial Regulators and we think that, in the Australian circumstances, that is the right thing to do. It will make sure the Australian banks are in the top tier of safety and soundness around the world, which is appropriate, but we will do that in a way that won't distort the capital markets. APRA will be increasing the buffer that banks have but in a way that is achievable and makes sense.

CHAIR: So you are agreeing with the APRA approach?

Dr Lowe: I am. They've still got to do final consultation on the extra loss-absorbing capacity in the tier 2 instruments because they haven't taken a final decision. In many other countries, the regulators are forcing banks to issue bonds that can be converted to equity in a crisis. So this is extra loss-absorbing capacity. In Australia we've decided to get banks to issue more of these tier 2 instruments.

CHAIR: When was the last time the RBA did an audit of Australia's gold holdings?

Dr Debelle: We intend to do our next one this year.

CHAIR: Physical?

Dr Debelle: Yes, a physical audit.

CHAIR: When was the last one?

Dr Lowe: In 2013. We have 80 tonnes of gold, which has a market value of $4 billion, and it is stored for us very safely at the Bank of England.

CHAIR: Why do we store it at the Bank of England?

Dr Debelle: The gold market, as you may know, is centred in London—it has been for a few centuries.

CHAIR: I want to tease this out.

Dr Debelle: Outside of Fort Knox, literally, and a few other places, most of the world's gold holdings are in London because that's where the bulk of the transactions occur. We haven't transacted in gold for a long time now, but the bulk of the transactions occur there, and the bulk of the storage of the physical gold is there. It's actually in, basically, two or three sites, one of which is the Bank of England's and the other one JPMorgan's. In terms of ease of transaction and shifting of ownership—not that we intend to be doing that—that's why it's in London and has been so for a very long time.

CHAIR: Just to clarify: when was the last time we did an audit of it?

Dr Debelle: 2013.

Dr Lowe: 2013, and the next one is due in June this year.

Dr Debelle: Sorry, that's in terms of auditing by actually going in and—

CHAIR: Counting—one, two, three, four, five, six?
Dr Debelle: Or prodding. Weighing, actually, is relevant there too. Counting only gets you so far. You're actually at least as interested in the weight as you are in the number. If you think about the assets that we hold in our reserves, we have a whole bunch of US treasuries. We audit them from a financial point of view as part of our annual accounts, and we do the same to the gold from a financial point of view. That is audited every year as part of a—not just by us.

CHAIR: But the physical inspection—
Dr Debelle: The actual physical—
CHAIR: is, what, over seven years?
Dr Debelle: No, six years, actually.
CHAIR: Every six years.
Dr Debelle: We were the first country that the Bank of England—you can debate this with them—allowed to audit their gold stocks, and then subsequently everyone else has joined that bandwagon, and now it's back to us again.

CHAIR: For clarity: when the audit was done, was there any discrepancy between what we thought we held and what we actually held?
Dr Debelle: No.
CHAIR: It was exactly the same?

Dr Debelle: Yes.

CHAIR: Do we engage in gold leasing?
Dr Debelle: Yes.

CHAIR: Can you explain to me why?

Dr Debelle: To add a rate of return to the reserves that we hold on the part of the Australian people, which flows pretty much straight through to you, the parliament. Gold, if you just leave it sitting there, unlike a treasury bond, for instance, earns no rate of return, whereas a bond does. A way of delivering a slightly larger rate of return—it's not that large at the moment, but it's positive—on those holdings of gold is to lease it for periods of time.

CHAIR: Just for clarity: do we lease gold?
Dr Debelle: Yes.

Mr JOSH WILSON: We don't borrow it; we lease it.
Dr Debelle: No, we own it.

Mr JOSH WILSON: We lease it out?
CHAIR: We lease it out, but we don't lease gold in.
Dr Debelle: Yes.

Mr KEOGH: It doesn't actually move anywhere, does it?
Dr Debelle: No, that's the other thing. The other point I was going to make is that—

Mr JOSH WILSON: We're the lessor.

Dr Debelle: in those gold vaults, when people buy and sell gold, by and large the gold never goes anywhere. It doesn't even necessarily get moved around too much, because every time you move gold you can lose a bit of it. I mean that literally—the gold dust.

Mr KEOGH: It weighs less?
CHAIR: How do you lose it when you move it?
Dr Debelle: Little bits—
CHAIR: Fragments? Ounces?
Dr Debelle: absolutely minute fragments, come off. However, the storer of the gold has the obligation to make that good to the owner of the gold, so the weight of our gold is always what we own. What I mean is that they minimise the number of times they move the gold.

CHAIR: Understood. The next audit is next year. How much are we charged on an annual basis to store the gold?
Dr Debelle: I will have to take that question on notice. I can't remember.
Dr Lowe: I do know we earned three-quarters of a million dollars last year from the leasing, and that got returned to the taxpayer.

Dr Debelle: Can I come back to you on the cost for the storage?

CHAIR: Yes.

Mr KEOGH: Presumably we earned more than it costs to store.

CHAIR: That's why I'm asking.

Dr Lowe: If it weren't stored at the Bank of England, we'd have to store it here in our vaults, and there'd be extra guarding. It's quite efficient to store most of the world's gold in one spot. We used to do that.

Dr Debelle: Yes, but we did make the assessment, back in the day, that actually it was cost-effective to store it there, because in gold storage there are some economies of scale.

CHAIR: There would be economies of scale. I imagine also that there are ceiling costs in moving it as well—

Dr Debelle: Indeed.

CHAIR: if we were to ship it here or anywhere else.

Dr Debelle: Yes.

Dr Lowe: And if we have to store it here in Martin Place or at some other location. So there'd be costs associated with that.

Dr Debelle: But we can come back to you on the exact cost.

CHAIR: Yes, I'd like that—thank you, very much. We don't have any intention to purchase more gold?

Dr Lowe: No. As I said, we've got 80 tonnes—

Dr Debelle: Two thousand and three—

Dr Lowe: We've had 80 tonnes for quite a while and I don't intend to either buy or sell—just to lease.

CHAIR: Okay.

Mr THISTLETHWAITE: Dr Lowe, we haven't discussed the United States—in particular, the US federal budget deficit, which I understand is projected to grow to $985 billion in fiscal year 2019. That's an 18 per cent increase on the previous year. Why isn't there more alarm in the international community about that—particularly given that the US economy has been growing? One would think that it's a time to undertake some fiscal consolidation.

Dr Lowe: Exactly, and I don't have an answer! I share your concern about budget deficits that are four or five per cent of GDP at a time when you have the lowest unemployment rates since the late 1960s. The projections are that the budget deficit there is going to stay at four or five per cent of GDP indefinitely, and people seem to be turning a blind eye to it. How long that will continue, I don't know.

Mr THISTLETHWAITE: It becomes more acute, doesn't it, given that, reading a lot of commentators, the forecasts for the US are for increasing downside risks? I think the markets are factoring in one more rate rise and then looking towards rate cuts. If there is a downturn in the US and they're saddled with this massive budget deficit, it really ties their hands in terms of what they can do to stimulate their economy and avoid some of the risks.

Dr Lowe: It certainly does. We saw in the financial crisis that countries which went into the crisis with a bad fiscal position actually had to tighten fiscal policy rather than stimulate. That caused their downturn to be much more pronounced. We were able to stimulate, which I think did help here.

So the US is running very close to the edge, and its ability to stimulate in the next downturn through fiscal policy is becoming more constrained. This is one reason why, whenever asked about our fiscal policy in Australia, I've said it's important that we maintain discipline and have a reasonable balance in the budget, because we really need fiscal policy to be a form of insurance. The ability to spend in a downturn is really important. If we don't have that option, then these other options we were talking about before, including quantitative easing, become more likely. We're better off using fiscal policy than extreme monetary policy. But you can only do that if you've behaved yourself in the good times. My judgement is that the US is not.

Mr THISTLETHWAITE: Is that something that the international community—and, indeed, Australia—should be paying more attention to, to the risk associated with that for the global economy?

Dr Lowe: At all the Financial Stability Board meetings I go to, people say, 'Look, if we have a downturn, in many countries there is not much flexibility—not much policy space—either on fiscal policy or monetary policy.'
So people do turn their attention to it, but the political system in the United States seems to have trouble exercising budget discipline.

Mr THISTLETHWAITE: Thanks.

Dr Debelle: Any discipline—

Dr Lowe: Any discipline! Yes, it's a discipline, so why don't—

Mr THISTLETHWAITE: That's a perfect way to sum it up—

Dr Lowe: In a simple banking world, all we can do is look at that and sigh! But I hope our Australian parliament doesn't go in the same direction.

CHAIR: I note that the speech by Dr Debelle did say that in terms of government public debt it's sustainable until it's not.

Dr Debelle: Yes.

CHAIR: It's an interesting observation, but it also highlights the challenges that we all face around what levels of debt are appropriate.

Mr THISTLETHWAITE: Just in terms of the labour market figures—the unemployment rates—in Australia: is there a risk that, because employment is a lagged indicator, those rates are reflecting the periods of higher GDP growth, and that those unemployment figures could tend upwards, given that you've forecast downwards growth?

Dr Lowe: I've thought about that as well, because GDP growth was quite strong in the first half of 2018 and it did seem to slow in the second half. It's possible that the labour market is really reflecting what happened in the first half of 2018 and will slow. I take some comfort, though, from the job vacancies and the job ad series. As I've said, I think, twice already, the number of job vacancies is at a record high, and job ads are fairly high as well. That suggests that the current demand for labour remains strong. We hear this in our Business Liaison Program as well: firms still want to hire more workers. They're finding it harder to get them, but they want to hire them. What you say is a possibility, but I'm not particularly concerned about that at the moment.

Mr THISTLETHWAITE: The NAB survey of business conditions is looking quite bleak. Basically, since the beginning of 2018, their survey of business conditions indicates that there have been substantial falls down to what they consider the long run average conditions now. Is that something of a concern for the bank as well?

Dr Lowe: It certainly caught my attention when that series was published. You've got to remember the background of what was happening in December when the survey was taken. The share prices around the world were tanking—the US prices fell 20 per cent and we had fair decline here. There was political tension in Canberra, if I can say it diplomatically. There was a lot of discussion in the media about falling house prices and people not spending. There was a lot of negativity in December, and it's not surprising that it was reflected in the business surveys. I am hopeful that as things have stabilised as we've gone into 2019 that we won't see further falls there. Have we seen another reading of that yet?

Dr Ellis: Yes. The monthly number kicked up. It didn't fully reverse. The survey was actually taken in the early weeks of January. The AIG survey had a similar pattern in that first half of January. But we do have a later version of the NAB survey, a later data point, and it did come back a little bit.

Dr Lowe: We're seen this pattern globally. In December and early January, all the business surveys moved south. Now, maybe, as we're going into January and February, things have stabilised a bit and some of them are kicking back up. You see the same pattern in equity markets. In commodity markets, the prices fell, and they have risen again. The credit spreads rose, and they've have come back again. There was a bit of panic in December, but there's been stabilisation subsequently, and I hope to see that in the business surveys going forward.

Mr THISTLETHWAITE: I want to finish on an issue that was highlighted by Jacqui Dwye in a speech that she recently gave on 29—

Dr Debelle: It was a while ago. It was reported recently.

Mr THISTLETHWAITE: It was on 29 July 2017. It was quite an interesting analysis of the study of economics amongst high school students in Australia. I was quite alarmed to read the decline in the number of students studying economics in Australia from about 40,000 enrolments in the early 1990s to around 10,000 in 2016. What was even more alarming was the fall in females that were studying economics relative to males—as someone with a degree in economics, I happen to think economics is very, very important for our nation. Is this an alarm for the RBA? What do you think we can collectively—the government and the bank—do to arrest that decline in the study of economics?
CHAIR: Just for clarity, I'm glad that the deputy chair of the Economics Committee thinks that economics is important.

Mr THISTLETHWAITE: I do.

Dr Lowe: We've been very concerned about it. There are multiple dimensions. As you say, the decline in the absolute numbers and the gender balance going into economics—for every young girl that studies economics there are two-plus boys who are studying. There's also the fact that economics is increasingly taught largely in the private school system rather than the state school system, so the demographics of people who are studying economics is changing in a way that I think is not helpful. What can be done about it? That's a good question. What we're trying to do is raise the issue publicly to get people discussing it. We are working with some of the state education departments to try and put economics in the curriculum. We're providing material through our website and other resources to teachers to try and make economics more useful to individuals when they are studying it and to give the teachers material to make it real-world applicable.

Dr Debelle: One thing we're doing here in Sydney, New South Wales, is we're just about to send out a survey to young high school kids to find out what their attitude is to economics and why is it that they're not looking to take it up. We also send out a lot of our staff, our junior staff in particular, to schools, and not just to the economics classes. To some extent, you want to try to convince people more generally that it's worthwhile. The other thing, though, which we have noticed and we are working with the curriculum boards in the different states on, is just making the material more relevant, for want of a better term. As Phil said, we are providing online materials, which we're able to do with the resourcing we have but an individual teacher can't. We've been doing that for a couple of years now, and that's proven to be quite helpful. Jacqui's got a small team of people who are pretty much focused full time on this and trying to do something. I think there's an issue from the country as a whole. We obviously clearly have a fair amount of self-interest here that it's a market where people in the future could work for an organisation. Economists aren't the only people we recruit, but it would be good to have a stream of educated people and educated economists for us to draw from. But I do think, to some extent—echoing what you said—it is useful for the country as a whole to have people with that skill set, and we are concerned about the decline that's there.

Mr THISTLETHWAITE: Does the Reserve Bank run a work experience program or an internship program for graduates?

Dr Debelle: Yes—both.

Dr Lowe: We have not only a school work experience program but also a summer intern program. We take 30 a year—

Dr Ellis: About that.

Dr Lowe: and then we support them through their final year at university.

Mr THISTLETHWAITE: That's good to know.

Dr Lowe: We're increasingly providing resources to help teachers.

Mr FALINSKI: Governor, I was just wondering—back to wages for a little bit—what happens if you put up wages without productivity improvements?

Dr Lowe: Prices tend to go up. At the moment, the lack of productivity growth isn't the issue. As I said before, the rate of productivity growth over the last five years, just looking at that in isolation, would have justified faster wage growth. So workers over the last five years have not got their normal share of productivity growth. Over the last 10 years they have, and I think this is one reason why prices have been so low and inflation has been so low for the last five years.

Mr FALINSKI: So looking over 10 years, productivity growth has explained wage increases?

Dr Lowe: Real wage increases broadly. You've got to be careful which years you actually pick, but the broad stories over the period that encompasses the beginning of the resources boom to today is that the increase in real wages in Australia has broadly matched the increase in labour productivity, so that's good news, but it hasn't over the last five years. As I said in response to an earlier question, the issue we're grappling with now is: what are the next five years going to look like? Are we going to have another five years where there's reasonable productivity growth in the economy and workers don't get their normal share? If that's what happens, I think we're going to have problems. I certainly hope that that does not happen, but it's possible. But it may be that the last five years are the aberration. It's really then about unwinding what happened the five years before. It's a really big question for us because it affects the rate of inflation. I think it's a really big issue for society in general, because if we have another five years where workers don't get their normal share of productivity growth, we'll have all sorts of
economic, social and political problems. Besides the immediate outlook for consumption, how wage growth is going to track productivity growth over the next five years is the next big issue.

Mr FALINSKI: Productivity growth, though, in the economy is lower than it has been in the previous 20 years, isn't it?

Dr Lowe: It's certainly lower than it was in the nineties. It's low, but it's reasonable. It would be better if it was stronger, but it is what it is. It is lower.

Mr KEOGH: But is it true that there was still the lower-hanging fruit in the nineties to deal with?

Dr Lowe: There were also significant reforms by the government and the parliament.

Mr FALINSKI: Are you referring to labour market reforms?

Dr Lowe: There were many reforms in the—

Mr FALINSKI: So the nineties were a delay from the Hawke-Keating reforms, were they?

Dr Lowe: Yes, there is a large part of that—

CHAIR: Order! The purpose is to hear from the Reserve Bank governor, not to have some sort of fight we could otherwise have in the parliament.

Dr Lowe: So we're getting reasonable productivity growth. There are things that could be done. There's been no shortage of reports giving both business and the parliament ideas of what could be done, and my observation would be that not many of those things are being done. While ever that's the case, I think productivity growth will be less than it could be. It'll be okay but less than it could be.

Mr FALINSKI: What are some of those things?

Dr Lowe: There are endless reports. The Productivity Commission has a long list of things: the provision and pricing of infrastructure, the way we educate our students, the incentives we set up through the tax and other systems through innovation, and the way we deal with science and the funding of science. The IMF, in its various reviews of Australia, talks about the tax system, the balance between income and consumption tax and, importantly, the way we tax land. So, if you really had a laser-like focus on lifting productivity growth in the country, there is no shortage of ideas that could be pursued. Not all would be politically popular, but there's no shortage of ideas. In the absence of following those ideas, I think we'll have okay but not really good productivity growth, and that means okay growth in real wages, not fantastic growth in real wages. There's very little a central bank can do about that. We have to take the underlying growth in productivity as a given and respond to that. But both the parliament and business can do things that change the growth profile for people's real incomes.

Mr FALINSKI: Do you think some of the industrial relations settings at the moment, which are discouraging business from negotiating directly with their workforces and vice versa, are having an impact on productivity?

Dr Lowe: I'm not sure. I don't think it's the first-order issue. I think the first-order issues are the pricing and provision of infrastructure, the way we accumulate human capital, the incentives we have for innovation and the tax system. They're the first-order issues. It certainly might be the case that there are things in the industrial relations system which limit the productivity of individual businesses, and if there are then there's a case for addressing them, but it's not the first-order issue. The first-order issues are the other four things I talked about.

Mr FALINSKI: When you're talking about pricing of infrastructure, you mean road tolls, don't you?

Dr Lowe: Road, rail and airports—transportation infrastructure—and even electricity. The Productivity Commission's done some very interesting work about how we price the use of our infrastructure, and it's not optimal.

Mr FALINSKI: But most of those things sit with state governments, don't they?

Dr Lowe: They may well. I'm not trying to assign responsibility here. These are the issues that have been identified.

Mr FALINSKI: No, but it is genuinely interesting, because of course you, the Reserve Bank, are saying, 'It is what it is; we'll deal with what we've got.' You're talking to a bunch of federal parliamentarians, but many of the Productivity Commission reports to which you refer, with one or two exceptions, actually sit with state governments around the country.

Dr Lowe: They do. They're a shared responsibility. The Productivity Commission report—I think it was called *Shifting the dial*—talked a lot about the delivery of services by the public sector, because the economy is
increasingly a service-sector economy. A lot of those services are delivered by the public sector, and the Productivity Commission’s judgement is that it’s not as efficient as it could be and that better use of data and more efficient techniques would deliver better services. Some of those services are delivered by the federal government, and many others are delivered by the state governments.

Mr FALINSKI: That’s not quite true, though, is it? Most of Shifting the dial refers to services provided by state governments.

Dr Lowe: Yes, but in a number of areas, including health and education, the federal government—

Mr FALINSKI: Could influence.

Dr Lowe: shapes the framework, let’s say. I don’t want to get into a debate about where the responsibility lies. These are the issues.

Mr FALINSKI: Yes.

Dr Lowe: My general call is for both business and the political class to take those issues seriously, because if in the next 10 years we want strong growth in our real incomes then this is what we should be doing.

Mr FALINSKI: The Harper report on competition made the point that competition policy doesn’t apply—or hasn’t to date—to the state government provision of services, like health, education, infrastructure et cetera, and that it should. Is that a recommendation that the RBA would endorse?

Dr Lowe: Well, Ian is a board member of mine, so—

Mr FALINSKI: I had no idea when I asked that question!

Dr Lowe: I don’t know enough about the details, but I think the general principle of bringing the same focus on competition to the delivery of state government services must be right.

Mr FALINSKI: Must be right?

Dr Lowe: As to the specifics, I don’t know. I have great respect for Professor Harper, so if he wrote it I would tend to agree with it.

Mr KEOGH: Ms Bullock, with my previous questions you mentioned that DHS is now also involved with the PayID scheme so that it can make instant relief payments when there are natural-disaster-type situations, which is a very good outcome. I presume though that they can only do that if the person receiving the payment is using a bank where they can register for PayID themselves?

Ms Bullock: You don’t actually need a PayID to get instant payments. It’s a service that’s offered to people that don’t want to give out their BSB and account number. I can’t remember it, but fast payments can occur with just BSB and account numbers; you don’t need PayIDs.

Mr KEOGH: How does a customer get access to making a fast payment between, say, their own accounts at two different banks?

Ms Bullock: It depends on which bank you’re with; that’s the point we were making earlier. Some banks are a little bit ahead of others. With some banks, you need a PayID to make a fast payment. For others, you don’t; you can just use your BSB and account number to make a transfer. So it depends a little bit on where the banks are with their systems. But, ultimately, when the system is completely built out you will be able to make a fast payment to any account, whether it be your own account at another bank or someone else’s, using either a PayID or a BSB and account number.

Mr KEOGH: In order for that to work, both banks would need to be on the system?

Ms Bullock: Correct. This is back to a point Phil made: the network effect is very important here. If you’ve only got one bank then you can’t make any payments.

Mr KEOGH: Which banks aren’t doing this?

Dr Lowe: I’d rather not single out a particular bank.

Mr KEOGH: I would rather you do single them out. And, to be clear to all of the government-relations people at the big banks listening: I will ask you this question in a week or so. But, for the simplicity of everyone else, which of the big four are not doing this?

Ms Bullock: All of the big four are now in the NPP. They’re all in there. They’ve all come in at different speeds. When it first started a year ago, ANZ and Westpac—and this is public knowledge—were not ready to enter the New Payments Platform. They are now in there, and they’re progressively bringing on all of their different customers.

Mr KEOGH: So they’re in it, but you may not have access to it if you’re a customer.
Ms Bullock: Not all customers will necessarily have access to it; it depends. Some of the banks have brought on particular groups of customers first. Some business customers might have access; some others might not. It's all just a process. Our ultimate aim—and we'll get there—is: for any payment you can make using internet banking at the moment, you'll be able to make it fast.

Mr KEOGH: And that will be the case whether you're doing it through account number and BSB or the telephone—whether you link another number?

Ms Bullock: Yes. You don't need the phone number or the email. That's a convenience and it's helpful—

Mr KEOGH: You alluded to this before, but just to clarify: some banks are only going to make it available if you've created a PayID as opposed to using your BSB and account number?

Ms Bullock: Some of them, in setting up their systems, have prioritised some bits over others. Some have prioritised getting it out on the PayID. Some have prioritise getting it out to particular groups of customers. Some have prioritised it on mobile apps and some on internet banking. It just depends.

Dr Lowe: You see, none of them are perfect.

Mr KEOGH: I don't think anyone was making that assumption, Governor. Is this a situation where banks come on at an ADI level, or are there going to be differences between, say, the nominal brand bank—to pick an example, Westpac—versus St. George; Commonwealth versus Bankwest?

Ms Bullock: There are differences there. Westpac has brought on its main brand. Customers of some of their subsidiary brands are going to be brought on, but they're being brought on a bit slower. There's another point that I would like to make, though, and that is that one of the great successes early on in this has been the number of small institutions that are on.

Mr KEOGH: I was going to go there.

CHAIR: Well, you'd better go there in your final question.

Ms Bullock: Because there are aggregators; there are a number of institutions that offer services to small ones. And from day one we had about 60 small banks and financial institutions who were able to offer that to the customers.

Mr KEOGH: For my final question I was going to follow up on Mr Thistlethwaite's questions about economics education. You mentioned programs like internship and work experience opportunities and having staff go out to schools, and you were talking about the need to have diversity in economics education, so it's not just all the boys at the private schools but also girls in the public schools and everywhere else. Are we getting diversity of geography, or is it only schools located close to Sydney?

Dr Debelle: No.

Mr KEOGH: Do Western Australian students also get this opportunity?

Dr Debelle: Yes.

Mr KEOGH: In their schools, or just the opportunity to apply?

Dr Debelle: Both.

Mr FALINSKI: What's all this about WA?

Mr KEOGH: You might've noticed that it takes up a third of the landmass, Mr Falinski.

CHAIR: Order!

Dr Lowe: The University of Western Australia has been a great education university for us.

CHAIR: Do we have an answer, or is that sufficient?

Dr Debelle: Yes is the answer.

Dr Lowe: It's very wide.

CHAIR: We like short, sharp answers, particularly at this time of day. Thank you very much for coming and presenting to the Economics Committee. There have been a lot of interesting answers amongst all of the commentary, and you provided such a comprehensive outline at the start, which I suspect will give us and all of the economics writers plenty to write about. Hello to all the people—I've been reading the live tweets that have been going on as well. Thank you to the committee members and of course to the secretariat, who always do a wonderful job.

Resolved that the proceedings be published.

Committee adjourned at 12:31