

Glenn Stevens: Recent economic and financial developments in Australia

Opening statement by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to the Senate Economics References Committee, Sydney, 28 September 2009.

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Thank you Mr Chairman. I have just a few opening remarks.

Economic conditions in Australia were generally quite subdued in the second half of 2008 and the first part of 2009. Output was sluggish, hours worked in the economy declined, unemployment rose and inflation started to abate.

By the standards of past recessions, however, this was a mild downturn. Although the evidence is as yet incomplete, this episode has been much less serious than those in the mid 1970s, the early 1980s and the early 1990s. It also has been very mild indeed in comparison with recent outcomes in many other countries, where deep recessions have been experienced. For the G7 group of advanced countries, for example, a cumulative contraction in real GDP of nearly 5 per cent was experienced over the four quarters to June this year. The Australian economy recorded a small net expansion in GDP over the same interval.

So I think it is reasonable to conclude, against the benchmarks of historical and international experience, that Australia has done quite well on this occasion.

Why was that so?

The key factors have been articulated before, but it may help to frame our discussion here today if I recount them.

First, our financial system was in better shape to begin with, being relatively free of the serious problems the Americans, British and Europeans have encountered. Lenders have some problem loans, as always occurs during a downturn, but these are manageable. The banking system has continued to earn a positive return on its capital, unlike those in some key countries. The system has been affected by the spillovers from the global crisis, through tighter borrowing conditions in international markets, higher spreads and so on. But these too have been manageable and various policy responses have helped the system to cope. The Reserve Bank was prepared to expand its balance sheet to assist in maintaining liquidity and the government guarantees were important in shoring up confidence and maintaining access to wholesale funding.

Second, some key trading partners for Australia have proven to be relatively resilient through this episode. The Chinese economy did slow sharply in the latter part of 2008, but quickly resumed very strong growth. China will easily achieve her 8 per cent growth target this year, led by domestic demand. Many of our other Asian trading partners have also returned to growth recently.

Ongoing strength in demand for resources has kept Australian exports expanding. Australia's terms of trade, even though well off their peak, remain high by historical standards. Confidence about the future for the resources sector is building quite strongly.

Finally, Australia had ample scope for macroeconomic policy action to support demand as global economic conditions rapidly deteriorated, and that scope was used. The Commonwealth budget was in surplus and there was no debt, which meant expansionary fiscal policy measures could be afforded. In addition, monetary policy could be eased significantly, without taking interest rates to zero or engaging in the highly unconventional policies that have been necessary in some other countries.

I have maintained throughout that Australia's medium-term prospects remained good and that we should not lose confidence. More people seem to be taking that same view. Measures of business and household confidence have shown a very substantial pick-up from the low points reached earlier this year. Share prices have risen by almost half. House prices have risen rather than fallen, though commercial property prices have fallen. People are realising that, though things have been tough, the worst has not occurred and the future is looking brighter. Earlier plans for drastic cuts to capital spending look like they are being re-considered. Economic growth forecasts are being revised up. A straightforward reading of the economic outcomes would suggest that the various policy measures have been effective in supporting demand.

In due course, both fiscal and monetary support will need to be unwound as private demand increases. In the case of the fiscal measures, this was built into their design. The peak effect of these measures on the rate of growth of demand has probably already passed. The extent of support will tend to tail off further over the next year. In the case of monetary policy, the Bank has already signalled that interest rates can be expected, at some point, to move off their current unusually low levels, as recovery proceeds.

These adjustments back towards more normal settings for both types of macroeconomic policy are what should be expected during the recovery phase of a business cycle. Our most recently released set of forecasts assumes they occur. Such an outcome would mean that fiscal and monetary policy would be acting broadly consistently, as they did when they were moved in the expansionary direction when the economy was slowing.

In both cases a degree of policy discipline will be needed. Policy frameworks will be valuable in enforcing that discipline. On the fiscal side, the forward estimates provide an indication of the restraint needed to move the budget back towards balance and eventual surplus over time, as required by the Government's medium-term fiscal commitment.

On the monetary side, the inflation targeting framework the Reserve Bank has been following for a decade and a half will guide adjustments to interest rates. These will be timely and ahead of a build-up of imbalances that would occur if interest rates were kept low for too long.

These frameworks will, in other words, prompt the needed adjustments. It was the preparedness to make those adjustments in the past, guided by these very frameworks, that contained the build-up of imbalances in the upswing and which in turn earned us the scope to take bold measures to support demand when a recession loomed. A continuation of that approach into the future will serve us well.