Glenn Stevens: Remarks to the American Chamber of Commerce in Australia (AMCHAM)

Remarks by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to the American Chamber of Commerce in Australia (AMCHAM), Melbourne, 20 March 2015.

* * *

Thank you for the invitation to join you today.

In an audience of business leaders exposed to the American and Australian business scenes, I might be expected to attempt some comparisons of the two economies.

So I offer the following snapshot.

- In America, growth has improved over the past year, having been much slower than policy makers would have liked for quite a few years, after a very deep recession in 2008–09. Real GDP per head is 2¾ per cent above its previous peak in December 2007.
- In Australia the economy is growing, but has been somewhat slower than we would have liked for a while. We haven't had a deep downturn for more than twenty years. Real GDP per head is about 5½ per cent higher than in December 2007.
- In America, the unemployment rate peaked at 10 per cent in October 2009 and is now at 5½ per cent. The average rate in the new century to date (ie since 2000) is 6½ per cent.
- In Australia the unemployment rate in October 2009 was about 5½ per cent. It fell, then gradually rose again to be 6¼ per cent now. The average in the new century to date is 5½ per cent.
- In America, inflation is low and asset values have been rising. Interest rates are extremely low, but the central bank is talking about raising them.
- In Australia, inflation is low and asset values have been rising. Interest rates are very low, and the central bank has talked about lowering them further.
- In America, international competitiveness is declining due to the rising US dollar.
- In Australia, international competitiveness is improving, due to the declining Australian dollar.
- In America, there is political partisanship across a range of issues, and budget stalemate.
- In Australia, there is political partisanship across a range of issues and, over the past year, budget stalemate.

The result?

American businesses and households seem to be getting more optimistic about the future. But Australian businesses and households seem to be getting less optimistic about the future. It would be an interesting lunch conversation to talk about how all those facts lead to the two differing conclusions about the future.

Admittedly, the global backdrop in some respects is less supportive to Australia than it had been some years ago. Our terms of trade are falling. They have been doing so for about 3½ years. It had always been understood that this would occur, even if we were not very accurate in predicting its timing (we predicted it way too early) or its extent: some key resource prices initially fell a little more slowly, but more recently a good deal more quickly, than either official or private consensus forecasts had assumed. Nonetheless, the actual event has been getting much attention. The various ramifications – declining mining investment, the effects on incomes and government revenues – are the subject of daily news.

In some other respects, not a lot has changed lately. China continues to grow in size and importance and to open up. Much was made of China "missing" its 2014 growth target, by one tenth of a percentage point. (Let us in Australia hope our target misses are all only of that size.) Much was also made of the lower target set for 2015, but this was always going to occur, and successive growth objectives are likely to get progressively lower over the years ahead. An economy as large as China is unlikely to sustain the sorts of growth rates seen in earlier years. No one grows at 10 per cent forever. Even growth a bit below this year's objective would still be a considerable impetus to global demand and output. That said, the outworking of some of the excesses of the earlier period of rapid growth, especially the period just after the financial crisis of 2008, remains a work in progress and a source of risk.

But in other ways, one could argue that the global backdrop has improved. As I have noted, the US economy – still the world's largest and most innovative – has gained momentum over the past year, looking through the temporary ups and downs of the data. For all China's great importance to Australia these days, a healthy US economy should not be underestimated as a driver of business thinking and as a trend-setter for financial markets. In addition, the fall in oil prices, which is mostly the result of more oil being available than used to be the case, is mainly a bullish development for the global economy in the short term, problems for producer states notwithstanding. It is a bonus for American consumers certainly.

It is expected that the Federal Reserve will, some time this year, lift the federal funds rate accelerator off the floor. If that happens there will no doubt be some disruption, as always, and more so as it will be the first Fed tightening for nine years and the ECB will be easing policy at the same time. So there is likely to be some turbulence in asset and foreign exchange markets. On the whole, though, I think we should regard the Fed's likely actions as a positive development. Fed policy is still likely to be quite expansionary for some time. The punch bowl isn't being taken away, its contents are just being made a little less potent.

While that is going on our own economy continues its adjustment to the end of the investment phase of the "mining boom". The massive run-up in resources sector capital spending that was a natural response to earlier very high prices is reversing, causing a drag on demand. So we hope for other sources of demand to speed up to help make up the difference. Some of them are, though not as seamlessly as any of us would like. I've talked a lot about this before so I won't labour the point. It is a major transition. We can hope to assist it, and the Reserve Bank is doing that, and will continue to lend what support it can, within the limits of its powers and consistent with its mandate. The decline in the exchange rate is assisting the transition (as it assisted in absorbing the earlier phase of the mining boom). But we have always said we cannot hope to fine-tune this transition, however much we may wish otherwise.

Looking back at the history of such episodes, of which there have been a few over the past century or more, if we come through this terms of trade event with neither a major outbreak of inflation in the upswing nor a major crash in the downswing, even if we have a period of sub-average growth in the process, we will have done far, far better than in any previous event of this kind, let alone one of this magnitude. I still think that is the most likely outcome.

Even so, the lower terms of trade mean that, all other things equal, the path of future incomes is not as high as it might have looked a few years ago. Even allowing for the fact that we all knew, intellectually, that at least part of the boom was not permanent, there is a human tendency to project what we see now (good or bad) into the future. Eventually reality intrudes and we have to re-evaluate. That has happened countless times before and will again, no doubt.

It means that attention needs to be given to the things that help our economy work to deliver what we need even with a lower terms of trade. These were the sorts of things that made a difference before the mining boom. They are not my field of expertise. I can simply observe that things such as:

- open, competitive markets;
- education and skill building;
- flexibility and adaptability;
- quality public infrastructure;
- strong public institutions, and pragmatic, balanced regulatory arrangements; and
- rewards for entrepreneurial risk-taking

are likely to give us the best chance for the kind of prosperity we seek. Public policy will have its own contribution in fostering such an environment, but it is businesses (large and small) and individuals making their own choices that will ultimately deliver whatever success we are capable of.