Philip Lowe: Dinner remarks to A50 Australian Economic Forum

Dinner remarks by Mr Philip Lowe, Governor of the Reserve Bank of Australia, to the A50 Australian Economic Forum, Sydney, 9 February 2017.

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I would like to offer you all a very warm welcome to Sydney for the A50 Forum. To those of you who have travelled to our shores from afar, thank you for visiting. I am confident that you will find your investment in time a worthwhile one. In just a short period, you will hear from the leaders in the worlds of politics, business, the policy institutions and the investment community. You will find an openness and transparency that is not always seen elsewhere around the world and you will experience a genuine desire to share perspectives.

You also find a country that is prosperous and wealthy; Australians enjoy a standard of living that relatively few people around the world enjoy.

You find a country that has grown consistently for some decades now, despite a pretty volatile global environment. Australia's year-ended growth rate has been in positive territory since 1991.

You find a country that has a strong and stable banking system. We have deep and liquid financial markets. The public here question why banks are so profitable, not why they performed so badly during the global financial crisis.

You find a country that is well placed to benefit from growth in Asia, not only because of our natural resources base, but also because of stronger demand for our food and a wide range of services.

You find a country with a growing and diverse population and one that has a high degree of social cohesion. Our population has recently been growing at around 1½ per cent a year, and around 40 per cent of us were either born overseas or have one parent born overseas. This brings a dynamism that isn't there in countries with stagnant and less diverse populations.

You also find a country with strong public institutions and whose economy is resilient and flexible. We have a demonstrated capacity to address our problems and to adjust to the changing world that we live in. In the past decade, our flexibility has meant that we have been able to maintain economic stability through the biggest investment boom in the resources sector in more than a century, and the subsequent unwinding of that boom.

You also find a country with positive interest rates and a conventional monetary policy framework. The central bank is independent, analytical and pragmatic. Our inflation target is focused on medium-term outcomes. This approach means that we have the flexibility to pursue our price stability objective while taking into account developments in balance sheets in a way that can be difficult to do in more rigid monetary policy frameworks.

So that is Australia. Welcome. There is a lot to like here.

In the spirit of openness and transparency though that I mentioned a moment ago, we are not without our challenges. I will talk about a few of those in a moment.

I first want to say a few words about openness to trade and investment and its role in Australia's prosperity.

Australia is a country that has benefited greatly from the open international trading system. Our ability to sell to the rest of the world goods and services that we can produce really well has boosted our living standards. We also benefit from being able to buy goods produced overseas. And the need to compete with others is one of the things that leads us to strive to do things better.

Australians have also benefited from the relatively free flow of financial capital. Year after year, for more than two centuries now, capital from the rest of the world has helped build our country. If we had had to rely on just our own resources, we would not be enjoying the prosperity that we do today. Our asset base and our productive capacity would be lower, and so too would our standard of living. As investors, Australians have also benefited from being able to diversify our portfolios by buying foreign assets and by building strong businesses overseas.

So, again, that is Australia. We provide a very good illustration of how a medium-sized country that is committed to an open international order, has a strong role for markets and a floating exchange rate, a largely open capital account and a dynamic and innovative financial sector can prosper in today's complex world.

I promised openness and transparency. So now to some of the issues, or challenges, that we face.

The first is to reinvigorate productivity growth. Australia, like many other advanced economies has experienced slower productivity growth over the past decade. In our case, this has been partly due to a large increase in mining investment in response to soaring commodity prices. In recent years though, as the new production made possible by all this investment has come on stream, the productivity figures have improved. This is clearly good news, although underlying productivity growth remains relatively modest. A number of structural factors are at work here. If we do not address these factors, then we will have to adjust to noticeably slower growth in our average incomes than we have become used to. In some ways, this adjustment has already started and it is proving difficult. On the more positive side, there is no shortage of things that could be done to lift our performance. The challenge is that most of these ideas require difficult political trade-offs.

A related challenge is how best to capitalise on the opportunity that the economic development of the Asian region provides. We have benefited from the surge in commodity prices driven by the rapid industrialisation of China, and from the increased demand for our food products, tourism, education and other services as incomes in Asia have grown. But it is a competitive world out there, and other countries see these opportunities too. So we need to find ways of building upon our strengths to bring goods and services to growing Asian markets at competitive prices. Lifting our productivity is a good place to start.

A third issue is the task of providing adequate high-quality infrastructure to help our citizens be as productive as they can and enjoy a high quality of life. As I said earlier, our population is growing strongly which is a source of dynamism for our economy. But this growth can put strains on our infrastructure, including on transport infrastructure. These strains can reduce public support for a growing population. They can also impair our ability to compete and to be as productive as we can be. Good transport infrastructure, for example, opens up opportunities for people and opens markets. It also improves communities. Investment in transportation infrastructure can also play an important role in addressing housing affordability, which is an increasingly important issue.

Infrastructure investment does of course need to be paid for. The positive news here is that there is no shortage of finance for the right projects. The task we face then is to identify the best possible projects, harness the planning capacity of government, design the best deal structures to attract private finance where it makes sense to do so, make sure that the construction process is as efficient as possible and price use appropriately. These are challenging things to do, but they are not beyond our capabilities.

The final issue that I will mention this evening is that of ensuring that our public finances are on the right track. Australia has a good historical record here. Net government debt, as a share of GDP, is still low, although it is higher than it used to be. Our good record has provided us with a form of insurance. It meant that when difficult times did strike last decade, fiscal policy had the capacity to play a stabilising role. We had options that not all other countries enjoyed.

Looking forward, we need to make sure that we continue to have this insurance. We can do this by rebuilding our fiscal buffers. This too is a challenging thing to do, particularly given the additional demands being placed on government. A related complication is that simultaneously we need to make sure that that our tax system is internationally competitive. One example of this complication is in the area of corporate tax, where there is a form of international tax competition going on in an effort to attract foreign investment. Like other countries, we face the challenge of responding to this, while achieving a balance between recurrent spending and fiscal revenue.

So those are some of the issues we face. Of course, there are others too. No doubt you will discuss these over the course of this conference.

I would like now to turn to the near-term outlook for the Australian economy. The Reserve Bank will be releasing updated detailed forecasts tomorrow in our quarterly Statement on Monetary Policy.

For 2017 and 2018, these forecasts will show little change from our earlier forecasts. Over the next couple of years we expect GDP growth to be around the 3 per cent mark. In both years it will be boosted by a significant pick-up in LNG production. And the headwinds that we have been experiencing from the unwinding of the biggest mining investment boom in a century will blow themselves out. Indeed, we are already around 90 per cent of the way through the fall from the peak to expected trough in mining investment. Another headwind we have had over recent years – that is the decline in our terms of trade – has already stopped. Since earlier last year, a rise in global commodity prices has provided a boost to our national income. And the improvement in the global economy since late last year should also help us.

So, with the end of the unwinding of the mining investment boom in sight, the economy is in reasonable shape. Unexpectedly, GDP did fall in the September quarter last year, but this largely reflected a confluence of temporary factors. We expect that in the December quarter, the economy returned to reasonable growth.

Inflation remains low, running at around 1½ per cent in both headline and underlying terms. Importantly, inflation is not expected to fall further. Instead, our central forecast is for underlying inflation to gradually rise over the next couple of years, and for headline inflation to increase a bit more quickly, boosted by increases in oil and tobacco prices.

We continue to pay close attention to the housing market and to household balance sheets. The picture varies widely across the country. Prices for houses in Sydney and Melbourne are rising strongly, but apartment prices in some cities, including Perth and Brisbane have fallen. The population is growing strongly, but there is a large number of additional dwellings to come onto the overall market this year. Growth in rents is weak, but vacancy rates in most markets are not unusually high. And investor demand looks to have strengthened in the closing months of 2016. So it is a complex picture.

One reason for trying to understand this complex picture is that the level of household debt is relatively high. Overall, households are coping reasonably well with this. But there are clearly risks. So it is a positive development that over the past couple of years, banks have tightened their lending standards in some areas. This tightening was partly prompted by the supervisory measures put in place by the prudential regulator, APRA, and the Reserve Bank and APRA continue to work closely together monitoring developments.

Another issue that we are paying close attention to is developments in the labour market. Employment growth slowed over 2016 and the growth that did take place was almost entirely in part-time employment. As is the case with the housing market, conditions vary across the country. Looking forward, the number of job vacancies and job ads suggest that some strengthening in employment growth might be in prospect. Our central forecast though is for the unemployment rate to remain close to its current level for some time to come.

In summary then, the Bank's central scenario is for some pick-up in economic growth and for inflation to move gradually higher. As always, though, there are risks around that outlook. As our record demonstrates, our economy does have a degree of resilience and flexibility that has allowed us to maintain stability during a pretty difficult time in the global economy. There is no reason that this can't continue. But we do need to continue to build that resilience, while we take advantage of the considerable advantages that we have as a nation.

Thank you. Welcome again. I hope you enjoy your time in Australia.