# Philip Lowe: Opening statement to the House of Representatives Standing Committee on Economics

Opening statement by Mr Philip Lowe, Governor of the Reserve Bank of Australia, to the House of Representatives Standing Committee on Economics, Sydney, 24 February 2017.

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Chair

Members of the Committee

Thank you for the opportunity to appear today to explain how we see the Australian economy as well as to discuss some of the work we have been doing at the Reserve Bank.

At the equivalent hearing a year ago, the tone of the global economy was pretty sombre. We had seen turbulence in Chinese financial markets. Commodity and equity prices were declining. Some overseas central banks had pushed their interest rates into negative territory. And global growth forecasts were being lowered again.

Twelve months on, the global economy looks to be on a firmer footing. In China, the growth target for 2016 was achieved despite the nervousness early in the year. In the United States, growth has strengthened and the economy is operating at close to full employment. And in Europe, the recovery is continuing, although it has a fair way to go in some countries. The Federal Reserve increased interest rates in December and further rises are expected this year. Elsewhere in the major economies there is no longer an expectation of further monetary easing, although some central banks are still continuing to expand their balance sheets. Commodity prices have moved higher. Long-term bond yields have also increased and most investors are no longer paying governments to look after their money for 10 years. Headline inflation has risen in most countries, and is much closer to target than it has been for some years. And forecasts for global growth have been revised up over recent months. This is the first time this has happened for quite a few years.

So, overall it is a more positive picture. That is the good news. There are, though, still a number of significant risks on the horizon.

In China, the growth target was achieved last year partly through a further build-up in debt especially to finance infrastructure investment and property development. This strategy was clearly helpful in the short run and it supported commodity prices, and Australia has benefited from that. But it runs counter to the Chinese authorities' goal of addressing the high levels of debt and getting domestic finances on a more stable footing. So we can't be sure about the longer-run implications. Recently, the Chinese authorities have taken some steps to tighten things up a bit. They have also been managing a depreciation of their currency against the US dollar and increased capital outflows as Chinese citizens send funds abroad. It's a difficult balancing act.

Turning to the United States, we can't be confident about how things will play out. It is possible that the new administration's policies could boost US and global growth. More infrastructure investment, tax reform and deregulation could all work to that end. On the other hand, if there were to be a retreat from the open international trading system, that would be damaging to the global economy, including to us here in Australia. We have much to lose if this were to occur. It is too early to tell which way things will go. Like others, we are in 'wait and see' mode.

In Europe, while there have been no major problems for some time, there are still a number of faultlines. Some of these could be put under pressure in the year ahead, in many cases depending on the outcomes of elections.

So there are still a number of risks in the global economy, although they no longer seem tilted to the downside. There are reasonable scenarios in which global growth picks up further and other scenarios in which it disappoints again.

I would now like to turn to the domestic economy.

A year ago, we were expecting the Australian economy to grow by around 2½–3 per cent in 2016. We haven't yet received the final figures for the year, but the outcome is likely to be lower, at around 2 per cent. The September quarter was surprisingly weak, largely reflecting temporary factors. We are not expecting a repeat of this for the December quarter, with most of the available indictors suggesting a return to reasonable growth in the quarter.

Looking forward, we still expect the Australian economy to grow by around 3 per cent this year and next. For most of the time since 2012 we have been facing headwinds from declining mining investment and falling commodity prices. Then, around the middle of last year, the headwind from falling commodity prices turned into a gentle tailwind as commodity prices lifted. And the headwind from falling mining investment should blow itself out before too long as mining investment returns to more normal levels. We will also benefit over the next few years from large increases in production of liquefied natural gas.

Economic conditions continue to vary significantly across the country. They are weaker in those parts of the country adjusting to the lower levels of mining investment and they are stronger elsewhere. Nationally, measures of business conditions have picked up noticeably recently. For some time we have been waiting for a lift in non-mining business investment. It has been a long time coming. Encouragingly, in New South Wales and Victoria we have now seen a reasonable pick-up in investment. However, we are yet to see this in most other states, where the unwinding of the mining investment boom continues to affect the overall business climate. With the decline in mining investment coming to an end, we hope to see a broader pick-up over time.

One area that we are watching closely is the cycle in residential construction activity, as the upswing has helped support the economy over recent years. The rate of new building approvals has slowed, but there is a large amount of work still in the pipeline, particularly for apartments, so we still expect some further growth in this part of the economy this year. There has, however, been some tightening in conditions for property developers in some markets.

In the broader housing market, the picture remains quite complicated. There is not a single story across the country. In parts of the country that have been adjusting to the downswing in mining investment or where there have been big increases in supply of apartments, housing prices have declined. In other parts, where the economy has been stronger and the supply-side has had trouble keeping up with strong population growth, housing prices are still rising quickly. In most areas, growth in rents is low. And recently we have seen a pick-up in growth in credit to investors, which needs to be watched carefully.

In terms of consumer prices, a year ago we had expected the inflation rate to remain above 2 per cent. It has turned out to be lower than this last year, at around 1½ per cent. Wage growth has been quite subdued, reflecting spare capacity in the labour market and the adjustment to the unwinding of the mining investment boom. We anticipate the subdued outcomes to continue for a while yet. Increased competition in retailing is also having an effect on prices, as is the low rate of increase in rents.

We do not expect the rate of inflation to fall further. Our judgement is that there are reasonable prospects for inflation to rise towards the middle of the target over time. The recent improvement in the global economy provides some extra assurance on this front. Headline inflation is expected to be back above 2 per cent later this year, boosted by higher prices for petrol and tobacco. The pick-up in underlying inflation is expected to be more gradual.

Since we appeared before this Committee last September, the Reserve Bank Board has kept the cash rate unchanged at 1.5 per cent.

At its recent meetings the Board has been paying close attention to the outlook for inflation as well as two other issues: trends in household borrowing and in the labour market.

One of the ways in which monetary policy works is to make it easier for people to borrow and spend. But there is a balance to be struck. Too much borrowing today can create problems for tomorrow, because debt does have to be repaid. At the moment, most households with borrowings do seem to be coping pretty well. But the current high level of debt, combined with low nominal income growth, is affecting the appetite of households to spend, and we are seeing some evidence of this in the consumption figures. The balance that is required is to support spending in the economy today while avoiding creating fragilities in household balance sheets that could cause problems for the economy later on. This is also something we need to watch carefully.

Trends in the labour market are also important. As in the housing market, the picture in the labour market varies significantly around the country. Overall, the unemployment rate has been steady now for a little over a year at around 5¾ per cent. In a historical context this would have been considered a good outcome, although, today, a sustainably lower unemployment rate should be possible in Australia. The other aspect of the labour market that is worth noting is the continuing trend towards part-time employment. Over the past year, all the growth in employment is accounted for by part-time jobs. There is a structural element to this, but it is also partly cyclical. We expect that the unemployment rate will remain around its current level for a while yet.

The Reserve Bank Board continues to balance these various issues within the framework of our flexible medium-term inflation target, which aims to achieve an average rate of inflation over time of 2 point something. Our judgement is that the current setting of the cash rate is consistent with both this and achieving sustainable growth in our economy. We will continue to review that judgement at future meetings.

I would like to turn to some other aspects of the work we do at the Reserve Bank.

In the area of payments, the Reserve Bank is continuing to work with industry on the development of the new payments infrastructure that will allow us all to move money around and make electronic payments more easily. The Bank is building part of the infrastructure that stands at the centre of this new system that will allow funds to be exchanged instantaneously so that customers can have very quick access to their funds. Our work is on schedule and is now being used in industry testing. Financial institutions are also working hard on their internal systems so that customers can take advantage of the new system. Developments look to be on track to allow the first payments to be made through this new system towards the end of the year.

A related focus of the Payments System Board is the important role that new technologies can play in promoting efficiency and competition. In recent meetings the Board has discussed the opportunities that distributed ledger technology could offer in the payments system and in financial market infrastructures. And it is also interested in the potential for fintech to deliver improved customer experiences. The Board is therefore taking a keen interest in the work being done by the Australian Payments Council on digital identity and customers' access to their banking and payments data.

I hope that you have all come across the new \$5 banknote, which was issued by the Bank from early September last year. The note was well received by the community. You might also have noticed that last Friday we released the design for the new \$10 banknote. Like the new \$5, the new \$10 will have world-leading security features, including the clear top-to-bottom window and a rolling colour effect that changes as the banknote is tilted. It will also have two raised bumps to assist people with vision impairment. Just like the current \$10 note, the new note will feature two of Australia's most famous writers, Dame Mary Gilmore and Banjo Paterson. The printing presses are busy printing the new notes and they will be issued from September this year. We are also finalising the design of the new $50 banknote, which we plan to issue next year.

One other matter that I would like to bring to your attention is that we are in the process of commissioning an external review of the efficiency of our operations. We want to make sure that we are continuously improving as an organisation and we are seeking outside assistance to identify opportunities for improvement. The review will be focused primarily on operational and administrative matters and not on our policy frameworks. It will commence within the next month and I will be in a position to share the key conclusions with the Committee when we meet later in the year.

Finally, at previous hearings members of the Committee asked about the number of women at senior levels of the Reserve Bank. I am pleased to be able to report that we have made further progress here. Of the three assistant governors responsible for monetary and financial policies at the Reserve Bank, two are women. And women run over a third of the departments in the Bank, including those responsible for the Bank's economic analysis function and for the implementation of monetary policy. So it's quite a big change from days gone by when almost all of these important positions were held by men. I want to highlight these changes in the hope that they might provide some inspiration to women who are thinking of studying economics, finance and business. There are fantastic career opportunities out there and it would be great to see more women studying these disciplines, and perhaps considering a career at Australia's central bank. We are currently working on some initiatives to encourage this, at both the school and university level.

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