Philip Lowe: Remarks at Reserve Bank Board Dinner

Remarks by Mr Philip Lowe, Governor of the Reserve Bank of Australia, at the Reserve Bank Board Dinner, Adelaide, 1 May 2018.

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Good evening.

It is great to be back in Adelaide today. On behalf of the Reserve Bank Board, I want to warmly thank you all for joining us at this community dinner. These dinners provide an opportunity for you to hear directly from the members of the Reserve Bank Board and for us to hear from you about how things are here in South Australia. So, welcome.

I would like to begin by paying tribute to Kathryn Fagg. Kathryn's five-year term on the Board comes to an end next week and so today was her final meeting. Over those five years, Kathryn has made an outstanding contribution to the Board's deliberations, drawing on her extensive experience in many different industries. Kathryn has also served as chair of the Board's Audit Committee and has been the Board's representative on the board of Note Printing Australia Limited. She has carried out these roles, not only to the highest professional standards, but also with the greatest humanity. Kathryn, you are going to be missed by your many friends and admirers at the Reserve Bank.

As you are aware, at our meeting today, the Board kept the cash rate unchanged at 1½ per cent. It has been at this level since August 2016 – that is for 21 months – which is the longest period without a change.

I sometimes read that the Board's job has become very easy: we just meet and do nothing. No doubt, the Board members here tonight will tell you a different story. They will assure you that each month when we meet, we diligently assess the pulse of the Australian economy. We also deliberate carefully over what setting of monetary policy will best deliver low and stable inflation in Australia. As we conduct those deliberations, we are conscious that our ultimate objective is enhancing the economic prosperity and welfare of the Australian people. This objective has been part of the Reserve Bank Act since it was written in 1959. Such a broad objective became unfashionable in most central banking circles around the world over recent decades. But in my view, it is an important part of the Australian policy framework and it has more than stood the test of time.

At today's meeting, when we measured the pulse of the Australian economy, we assessed it to be stronger than a year ago. Business conditions are around their highest level for many years and the long-awaited pick-up in non-mining business investment is taking place. There has been a large pick-up in infrastructure spending in some states. The number of Australians with jobs has also grown strongly over the past year. The unemployment rate is lower than it was a year ago, although there has been little change for the past six months. Growth in consumer spending has been solid, although it is lower than it was before the financial crisis.

Here in South Australia, we heard how the pulse has also quickened over the past year. This follows a number of years of difficult structural adjustment after the closure of the car industry. But over the past year, domestic final demand in South Australia increased by 5 per cent, which is a very positive outcome. As we have seen nationally, there has been a pick-up in business conditions and investment in South Australia. There are positive signs in a number of areas, including tourism, high-value food and beverage production and some parts of advanced engineering and manufacturing.

Helping the economy here in South Australia and elsewhere in Australia are the positive outcomes at the international level. Investment has picked up around the world and international trade is stronger than it has been for some time. As a group, the advanced economies are growing faster than trend and unemployment rates are low. And the Chinese economy is still growing strongly, although at a lower rate than in the past. So, at the moment, the international backdrop is pretty positive.

At our meeting today, we also discussed the latest inflation data, which showed that both CPI and underlying inflation were running marginally below 2 per cent. This was in line with our expectations and provides further confirmation that inflation has troughed, although it remains low. Strong competition in retailing is holding down the prices of many goods: for example, over the past year, the price of food increased by just ½ per cent, the price of clothing and footwear fell 3½ per cent and the price of household appliances fell 2½ per cent. Importantly, these outcomes are helping to offset some of the cost of living pressures arising from higher electricity prices, which nationally are up 12 per cent over the past year.

Another factor influencing recent inflation outcomes is the subdued growth in wages. Increases in wages of around 2 per cent have become the norm in Australia, rather than the 3–4 per cent mark that was the norm a while back. This is an issue we have been discussing around our board table for some time. While low growth in wages has helped boost employment, it has also put the finances of some households under strain, especially those who borrowed on the basis that their incomes would grow at the old rate. And in terms of the inflation target, it is difficult to see how a continuation of 2 per cent growth in wages is compatible with us achieving the midpoint of the inflation target – 2½ per cent – on a sustained basis. So from that perspective alone, a pick-up in wages growth over time would be welcome. Perhaps more importantly, sustained low wages growth diminishes the sense of shared prosperity that we have in Australia.

In our liaison with businesses, including here in Adelaide, many tell us about the very competitive environment in which they are operating. They tell us about how this competitive environment means that they have limited ability to pay bigger wage increases. At the same time, though, we are hearing a few more reports of larger increases in those areas where there is a shortage of workers with the necessary skills. After all, the laws of supply and demand still work. We also see evidence in the aggregate data that wages growth has troughed and we expect to see a further pick-up. This is likely to be a gradual process, though.

At today's meeting, the Board also reviewed the staff's latest forecasts for the economy. These will be published on Friday in our quarterly Statement on Monetary Policy. Those of you who are close readers of this document will notice some changes in this issue, as we seek to make the report more thematic.

The latest forecasts should not contain any surprises, with only small changes from the previous set of forecasts, issued three months ago. This year and next, our central scenario remains for the Australian economy to grow a bit faster than 3 per cent. This would be a better outcome than the average of recent years. If we are able to achieve this, we will make inroads into the remaining spare capacity in the economy and see a further modest decline in the unemployment rate. Inflation is expected to remain low, at around its current level for a while yet, before gradually increasing over the next couple of years, towards 2½ per cent. A key element here is the pick-up in wages growth that I just mentioned.

So, in summary, there has been progress in lowering unemployment and having inflation return to around the middle of the target range, and we expect further progress in these two areas over the next couple of years.

The other key point is that the progress we are making is only gradual: our central scenario is for a gradual pick-up in wages growth, a gradual lift in inflation, and a gradual reduction in the unemployment rate. While we might like faster progress, it is encouraging that things are moving in the right direction and are likely to continue to do so.

If this is how things turn out, it is reasonable to expect that the next move in interest rates will be up. This would reflect conditions in the economy returning to normal. In our discussions today, though, the Board again agreed that there was not a strong case for a near-term adjustment in the cash rate. This reflects our view that the progress in moving towards full employment and having inflation return to the middle of the target range is likely to be only gradual. The Board's view is that while this progress is occurring, the best contribution we can make to the welfare of the Australian people is to hold the cash rate steady and for the Reserve Bank to be a source of stability and confidence.

So that is where we are at the moment. At our meeting we also discussed some of the risks around this general outlook. These lie largely in the international arena.

One of the prominent ones is a possible escalation of protectionist measures in the United States and elsewhere. The very clear lesson from history is that this would be bad for growth. As a country that has prospered through openness, Australia has a lot resting on this not happening.

We also have a lot resting on the Chinese authorities successfully managing the very significant build-up of debt in their economy. Over recent times, they have paid increasing attention to this issue, which is a positive sign. Given the importance of this issue, it was the subject of an extensive discussion at our Board meeting today.

Domestically, for some time, we have seen the main risk to be related to household balance sheets. For a while, trends in household credit were quite concerning. On this front, things now look less worrying than they were a while back, although the level of household debt remains very high, which carries certain risks. In terms of financing, we also discussed the potential for some tightening in financial conditions in Australia. In the United States, the cost of US dollar funding has increased for reasons not directly related to monetary policy and this increase is flowing through into higher money market rates in Australia. We expect some of this to be reversed in time, although it is difficult to tell by how much and when. It is also possible that lending standards in Australia will be tightened further in the context of the current high level of public scrutiny. We will continue to watch these issues carefully.

So these are the issues we worked through today. I hope that they give you the sense that, even if we have not changed interest rates for a long time, we have a lot on our plate.

Before I finish, I'd like to say a few words about some of the Reserve Bank's other activities.

You would be aware that the Bank issues Australia's banknotes. We are currently undertaking a major exercise to issue a new high-tech series to make sure that we stay a few steps ahead of counterfeiters. We have already issued new $5 and $10 banknotes and the new $50 note will be issued later this year. This is a very big logistical exercise. All up, there are more than 700 million individual $50 notes on issue – that averages out to around 30 for every person in Australia. Not all of these, of course, are in active circulation. Many are located in ATMs and some are used as a store of wealth, perhaps stored under mattresses.

The $50 note is of special significance for South Australia. I say this because on one side it has the portrait of David Unaipon, a great Australian. David Unaipon was a Ngarrindjeri man born at Point McLeay in the Lower Murray Lakes and Coorong region and lived most of his life in South Australia. He was a great pioneer in many areas, pushing back against the injustice experienced by the Aboriginal people. David Unaipon was also Australia's first published Aboriginal author writing about, in his owns words, Aboriginal 'customs, beliefs and imaginings'. He was a tireless advocate for Aboriginal people, and wrote and spoke eloquently about how to make things better. And in what spare time he had he worked on various inventions – right up until his 90s – so much so that he earned a reputation as 'Australia's Leonardo Da Vinci'. So we are very proud to have David Unaipon on our $50 note. And we are equally proud to have Edith Cowan on the other side of the note, who was the first female member of an Australian parliament.

The first $50 note was introduced into circulation 45 years ago, in 1973. In today's money, it was worth almost $500 at the time, 10 times today's value! Reading back through our archives, the main argument for introducing such a high-value banknote was that it would help people conveniently pay for large household purchases, like cars, whitegoods, etc. It is yet another sign of just how much the world has changed.

Today, most of us don't need banknotes to make these types of payments. Many of us make the bulk of our small and large payments electronically. This is one reason why today's highest value banknote – the $100 note – is worth only a fifth of what the $50 note was worth when it was introduced.

This shift to electronic payments is being helped by another project the Reserve Bank has been involved in – that is the New Payments Platform. The Bank played an important policy role in getting this new system off the ground and has built a core piece of the supporting infrastructure. This new payments system allows near-instantaneous payments between bank accounts. Ultimately, it will provide the rails for innovative new payment services using its fast payments functionality. But its first service allows people to make payments to one another that will be received within seconds simply knowing somebody's mobile phone number or email. I hope that many of you have registered your PayID, which makes it easy to use this system. So far, almost 1.4 million Australians have done exactly this and they are now able to make efficient low-cost payments 24/7. If you have not already done so, I encourage you to look into it and register your PayID as soon as your bank offers you the service.

That is as close as I am allowed to get to giving you financial advice, so I think it is time to have dinner.

Again, thank you very much for joining us tonight.