

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, Perth, 4 September 2018.

* * *

Good evening.

On behalf of the Reserve Bank Board I would like to warmly welcome you to this community dinner. It is very good to be in Perth again. The Board met this morning at our office on St Georges Terrace. This dinner is an opportunity for us to hear directly from you about how things are going in Western Australia. So thank you for joining us.

As you have probably already heard, the Board left the cash rate unchanged at 1.5 per cent at its meeting this morning. I doubt that this decision surprised anybody. The cash rate has been at 1.5 per cent for more than two years now and the Board expects it to remain there for a while yet.

Lest you think that keeping interest rates unchanged for an extended period means that life at the Reserve Bank of Australia must be very quiet, we are always closely tracking domestic and international developments and we have other important responsibilities that don't attract the same spotlight as our monthly interest rate decisions.

The RBA is responsible for the issuing of Australia's banknotes. We are currently undertaking a major upgrade of our notes to protect against counterfeiters. All up, there are 1.6 billion individual banknotes on issue – that's an average of around 65 notes for each of the 25 million people in Australia. Despite the growth of tap-and-go and other forms of electronic payments, the value of notes on issue as a share of GDP is the highest in more than five decades. This highlights the continued importance of banknotes as a store of value as well as a payment mechanism. So the upgrade of the notes is a major logistical exercise.

The RBA is also the banker for the Australian Government. We operate the government's core accounts and we are the transactional banker for many government departments. So if you get a Medicare or tax refund, it comes from the government's accounts at the RBA.

We operate the core of Australia's payments system. The way that money moves from one bank to another is through the accounts that financial institutions hold at the RBA. In addition, we operate a key part of the infrastructure supporting Australia's new payments system, generally referred to as 'the NPP'. This system allows you to move money between bank accounts in real time on a 24/7 basis using an easily remembered 'PayID', such as a mobile number, to address the payment. BSBs and account numbers can still be used, but if you have not already done so, I encourage you to contact your bank to register a PayID, which makes it easier to use the new system.

The RBA also regulates key parts of Australia's financial market infrastructure, including the central counterparties at the ASX. In addition, we have broad responsibilities to promote competition, efficiency and stability in Australia's payments system. As a result of decisions of the Bank's Payments System Board there have been significant changes to the ATM and debit and credit card systems over recent times.

The RBA also operates in financial markets every day to ensure the system as a whole has adequate liquidity. We also have a broad responsibility for financial stability, including acting as the lender of last resort in a financial crisis to provide liquidity to solvent institutions. Finally, we manage Australia's foreign exchange reserves.

These are all important functions that we carry out in the public interest. They are all critical to the

functioning of our successful modern economy and financial system. I can assure you, we take these responsibilities very seriously. This means that even when interest rates are being held steady, we have a lot of things on our plate. But it is interest rates that mainly keep us in the news.

At its meeting this morning, the Board's assessment was that the Australian economy is moving in the right direction. Over the past year, GDP increased by 3.1 per cent and inflation was around 2 per cent. The unemployment rate is currently 5.3 per cent, which is the lowest it has been in nearly six years. In the broad sweep of our history, these are a pretty positive set of numbers.

We will get another reading on the pulse of the economy tomorrow with the release of the June quarter national accounts. We are expecting that this will confirm that over the first half of 2018, the economy expanded at a faster than trend pace, making inroads into spare capacity. Our central scenario is that economic growth this year and next will be a bit above 3 per cent, which should see the unemployment rate come down further. So things are moving in the right direction.

One of the factors helping us is that the global economy is expanding quite strongly. Many of the advanced economies are growing quite strongly and unemployment rates in a number of them are at multi-decade lows. The Chinese economy is also growing solidly, although the pace of growth has slowed, partly as a result of efforts to put the financial sector on a more sustainable footing.

The United States is most advanced in the process of monetary policy normalisation. This has led to a broad-based appreciation of the US dollar this year. As a consequence, the Australian dollar has depreciated. If sustained, this could be expected to improve the outlook for both inflation and growth.

Notwithstanding the positive global picture, there are a number of international uncertainties that we are monitoring closely. One is the possibility of an escalation in the current trade disputes. If this were to happen, it would materially affect trade flows and investment plans around the world. As a country that has benefited greatly from an open rules-based international system, Australia has a strong interest in this not happening.

Another uncertainty we are watching closely is the possibility of a material lift in inflation in the United States. The United States is experiencing a large fiscal stimulus at a time when the economy is at full employment and is growing quickly. This is an unusual combination to say the very least. Past experience suggests that it could lead to inflation increasing significantly. Financial markets are, however, heavily discounting this possibility, which means that if it did take place it would come as quite a surprise, with repercussions for markets and the real economy.

We are also monitoring carefully the financial and economic problems in a number of emerging market economies with structural or institutional weaknesses, including Turkey, Brazil and Argentina. If these problems were to escalate, they could put strains on parts of the global financial system.

So these are some of the international issues we are keeping an eye on at the moment.

Domestically, the Board is closely monitoring housing markets across the country and trends in housing finance. Housing credit growth has slowed, which, from a medium-term perspective, is a positive development. Our assessment is that this slowing largely reflects reduced demand for credit by investors, although there has been some tightening in the supply of credit as well. With housing prices falling in a number of cities, largely due to a shift in the underlying fundamentals, investors no longer find it as attractive to invest in residential property as they once did. This is a normal part of the cycle. While credit standards have been tightened, mortgage credit remains readily available.

I would note that some banks have increased their mortgage rates recently in response to somewhat higher interest rates in short-term wholesale markets. A much less remarked upon fact is that the average mortgage rate paid in Australia has fallen since August last year, as lenders have increased their discounts. I encourage anyone with a mortgage to shop around: there are some very good offerings out there. We can all play a role in promoting strong competition in our financial sector by shopping around and taking advantage of the good deals that are out there.

Another set of issues that the Board continues to pay close attention to is the outlook for wages growth and inflation. Wages growth has been quite low recently. For some time my view has been that some increase in aggregate wages growth would be a welcome development, especially if it is backed by stronger productivity growth. Many business people that I speak to recognise that a pick-up in overall wages growth would be a positive development from a macro perspective, although not from the perspective of their individual business. So there is a tension there. Our expectation is that wages growth will pick up from here, but the pick-up is likely to be only gradual. Firms are currently reporting a record number of job vacancies and increasingly telling us that it is hard to find workers with the right skills. One way of dealing with this increasing tightness in the labour market is, of course, to lift wages. We expect that as this happens, inflation will also lift towards the midpoint of the medium-term inflation target, although this, too, is likely to be a gradual process.

Against this background, this morning the Board again decided to keep the cash rate steady at 1.5 per cent. We are seeking to be a source of stability and confidence, as further progress is made towards full employment and having inflation return to around the midpoint of the target range. As that progress is made, you could expect the next move in interest rates to be up, not down. This would be a sign that overall economic conditions are returning to normal and would take place against the backdrop of stronger growth in household income. But any move still seems some way off, given the gradual nature of the progress expected on unemployment and inflation.

At this morning's meeting, as well as a thorough review of the international and Australian economies, we had a detailed discussion on the Western Australian economy. We pay close attention to what is going on here: Western Australia accounts for a little over 14 per cent of Australian GDP and 35 per cent of our exports, so it is important. Reflecting this, this is my third trip to, and public speech in, Perth in the past year.

This morning we heard that while the Western Australian economy is still feeling the effects of a decline in the level of mining investment, there are some positive signs. The level of mining investment has further to fall as some large liquefied natural gas projects are completed. But elsewhere in the resources sector things are looking brighter. Sustaining capital expenditure, particularly in the iron ore sector, is picking up with positive spillover effects. Higher prices for a number of minerals have also led to increased exploration activity, including for gold and lithium, and an expansion of some existing mines is taking place. For the first time in a number of years, we are hearing reports through our liaison program in Western Australia that it is difficult for firms to find workers with the right skills, including project engineers and related occupations. Business conditions – as measured by surveys – have also risen significantly and are now above average.

At our meeting, we also discussed the population dynamics here in Western Australia. At the peak of the resources boom, annual population growth reached almost 3½ per cent, which is very fast. People moved here from overseas and from the rest of Australia to meet the needs of your rapidly growing economy. In contrast, over the past year, population growth has slowed sharply, to around ¾ per cent, which is almost the slowest of any state in the country. There is now a considerable net flow of people from Western Australia to the eastern states.

This change in population dynamics has had a significant effect on housing markets in Western

Australia. The earlier strong growth in population contributed to a sharp rise in housing prices and rents, and then a bit later to a surge in housing construction. With the resources boom now in the past, some of the earlier increases in prices and rents have been reversed and residential construction activity has been low. Western Australia has seen this type of cycle before, and I expect it will see it again at some point in the future. Our liaison, though, suggests that a stabilisation of conditions is in prospect. If so, this should help support consumer confidence and household spending and reinforce the recent more positive news from the resources sector.

Finally, as I mentioned earlier, we are currently upgrading Australia's banknotes. I am pleased to be able to announce that the new \$50 note will be released on 18 October. We are proud to have a prominent West Australian on this note – Edith Cowan – as well as the Aboriginal writer and inventor David Unaipon. The redesigned \$50 note celebrates the fact that Edith Cowan was the very first female member of an Australian Parliament. The microtext on the note will include an extract from her first speech to the Western Australian Parliament. When the note is released, those of you with great eyesight might be able to read this microtext without a microscope. But for those who will struggle to read it, I would like to quote a little from the text. In 1921 Edith Cowan said:

I stand here to-day in the unique position of being the first woman in an Australian Parliament... If men and women can work for the same state side by side and represent all the different sections of the community... I cannot doubt that we should do very much better work in the community than was ever done before.

Nearly one hundred years on, this sentiment is just as relevant as it was back in 1921. We are proud to have this text on the new \$50 note and to recognise Edith Cowan's achievement. The note will also have a seating plan of today's Western Australian Legislative Assembly. It will also recognise Edith Cowan's lifelong advocacy of women. Western Australia's official bird emblem – the iconic black swan – will also appear on the note a number of times. If the note is tilted you will be able to see the colour of the swan change and its wings move. So I am sure that people here in Western Australia will feel a great affinity for the note and enjoy spending it.

Once again, thank you for joining us and please enjoy the evening.