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, 22 February 2019.

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Chair

Members of the Committee

My colleagues and I welcome this opportunity to share our views on the Australian economy and the RBA's important policy responsibilities. These hearings are an essential part of the accountability process.

Two weeks ago, we released our latest forecasts for the Australian economy. Our central scenario is for GDP growth of around 3 per cent this year and around 2¾ per cent in 2020. The outcome for the year just past is expected to be a bit below 3 per cent. These numbers are lower than the ones we were expecting at the time of the previous hearing in August.

By contrast, the labour market outcomes have been better than we earlier expected. When we met six months ago, we were not anticipating the unemployment rate to reach 5 per cent until 2020, but it has already been around that level for some months. The number of jobs created has also exceeded our earlier expectations. We continue to expect the unemployment rate to move lower over the next couple of years to around 4¾ per cent.

In terms of inflation, the recent outcomes have been a bit lower than we had been expecting. In the September quarter, childcare costs declined substantially due to government policy changes. And in the December quarter, petrol prices fell due to global developments, and a further decline is expected in the March quarter. In underlying terms, inflation is above its trough of a couple of years ago, but the pick-up is more gradual than we previously expected. By the end of 2020, inflation is forecast to reach 2¼ per cent.

Putting this together, our central scenario for 2019 is for growth of around 3 per cent, inflation of around 2 per cent and unemployment of around 5 per cent. In the broad sweep of our economic history, this is not a bad set of numbers. Indeed, in many years in the past four decades we would have welcomed such an outcome. It is important that we do not lose sight of this. The economy is benefiting from increased spending on infrastructure and a pick-up in private investment as capacity utilisation has tightened. The strong growth in jobs is also supporting spending, as is the sustained low level of interest rates.

Globally, the central scenario also remains a reasonable one. Inflation is low and unemployment in many advanced economies is the lowest in many decades. Recently, however, the focus has not been on this, but rather on the downgrading of forecasts for global growth by the International Monetary Fund and others. What sometimes gets lost, though, is that the latest forecast is for global growth to be around average, not below average. We need to remember that average growth at a time when unemployment is low is a reasonable outcome.

What is of more concern is the accumulation of downside risks.

There are two major areas of risk globally that the Reserve Bank Board has been keeping an especially close eye on.

The first is what I will broadly label as political risk. Here the list includes: the trade and technology tensions between China and the United States; Brexit; the rise of populism; and strains in some western European economies. It is hard to be certain how these various issues will play out. But it is conceivable that one or more of these risks crystallises in a way that damages confidence and the global economy. It is, of course, also conceivable that political leaders respond to the mounting economic risks in a way that restores confidence. Time will tell.

In working through the various possibilities, one issue that many people have focused on is the resilience of the global economy to a severe shock, whether it is generated in the political sphere or elsewhere. In many countries, both public and private debt levels are already very high. Real interest rates are also already very low. This means that there are fewer buffers in the global system than there once were. So there is less room to manoeuvre, although in a number of important dimensions the global financial system is more resilient than it used to be.

The second international risk we are monitoring closely relates to the Chinese economy. Growth there has slowed, probably by more than the authorities had been expecting. The economy is feeling the effects of the tensions with the United States and the squeezing of finance to the private sector as the authorities seek to rein in non-bank financing. The authorities have responded by easing policy in some areas, but they are walking a fine line between supporting the economy in the near term and addressing the debt problem.

Turning to the Australian economy, the Board has recently been paying particularly close attention to the strength of household spending and to developments in the housing market.

Household consumption accounts for almost 60 per cent of total spending, so what happens on this front is important. Recently, determining the underlying strength of consumption has been complicated by volatility in the consumption data in the national accounts, as well as notable revisions to the history of both consumption and household income. On balance, though, the available data suggest that the underlying trend in consumption is softer than it earlier looked to be and this has affected the outlook for the economy.

There are a couple of important considerations here. The first is the protracted period of relatively low growth in aggregate household income. The second is the decline in housing prices in our largest cities.

Since 2016, aggregate household disposable income has grown at an average rate of around 2¾ per cent per year. This is down from an average of 6 per cent over the preceding decade. It is plausible that households have responded to this extended period of weaker income growth by progressively downgrading their spending plans. For many people, it has become harder to see the lower growth in income as just a short-term development that can be looked through.

On this front, we are expecting better news ahead, with growth in disposable income forecast to increase. Wages are rising more quickly in almost all industries and in all states than they were a year ago. This is good news and we expect this gradual lift in wages growth to continue. Disposable income will also be boosted by the announced tax cuts. Faster income growth will support household spending. From a longer-term perspective, though, the key to boosting the real income of households is lifting productivity. I encourage you to keep examining ways to do this.

Looking beyond income growth, developments in the housing market can also affect overall spending. Lower turnover means less of the spending that occurs when people move homes. Declining housing prices also make some people feel less wealthy, so they spend less, although this effect doesn't look to be very large. Lower housing prices are also associated with less construction activity. So these are the areas we are keeping a close watch on.

We do, though, need to keep things in perspective. The adjustments in the Sydney and Melbourne housing markets are occurring at a time of low unemployment, low interest rates and strong population growth. What we are witnessing is largely the working through of shifts in supply and demand for housing due to structural factors. In both markets it took a long time for supply to respond to faster population growth, so prices went up. And now that supply has responded, some of the earlier increase in prices has been reversed.

I understand that these swings in housing prices are difficult for some in our community. We should, though, take some reassurance from the fact that our economy and our financial system are resilient. This adjustment in the housing market is not expected to derail the economy. It will put our housing markets on more sustainable footings and allow more people to purchase their own home. So there is a positive side too.

I would now like to turn to monetary policy. The Reserve Bank Board has held the cash rate steady at 1½ per cent since August 2016. This is a stimulatory setting of monetary policy, which has helped support job creation and a gradual lift in inflation.

When we met with the Committee six months ago, I said that if further progress on achieving our goals of full employment and returning inflation to target is made, you could expect the next move in interest rates to be up, rather than down. I also said that the Board did not see a strong case for a near-term adjustment in the cash rate, given that the progress towards our goals was expected to be only gradual.

Today, the probability that the next move is up and the probability that it is down are more evenly balanced than they were six months ago. This shift largely reflects the change in the outlook for consumption that I have spoken about.

It is important to point out that we are still expecting further progress towards our goals. The unemployment rate is forecast to decline further and inflation to increase, although only gradually. If we do make this progress, it remains the case that higher interest rates will be appropriate at some point. But it is also possible that the economy is softer than we expect and that progress towards our goals is limited. If there were to be a sustained increase in the unemployment rate and a lack of further progress towards the inflation objective, lower interest rates might be appropriate at some point. We have the flexibility to do this if needed. We are not on a predetermined course.

The Board maintains its strong focus on the medium term and is seeking to be a source of stability and confidence. As was the case six months ago, it does not see a strong case for a near-term change in the cash rate. With monetary policy already providing considerable support to the Australian economy, it is appropriate to maintain the current policy setting while we assess developments. Much will depend on what happens in our labour market.

I would like to turn to some other issues now.

Some years ago, this Committee held extensive hearings into the foreign bribery issues at Note Printing Australia (NPA) and Securency. The legal proceedings against former employees of these companies were finally completed last November. As a result, the Supreme Court of Victoria lifted longstanding suppression orders. This allowed the RBA to disclose that in 2011 NPA and Securency entered guilty pleas to charges of conspiracy to bribe foreign officials between 1999 and 2004. We were also able to disclose that the two companies paid substantial fines and penalties, including under proceeds of crime legislation.

The Reserve Bank has sought to deal with this difficult matter as openly and transparently as possible. The corrupt and unethical behaviour that was uncovered runs counter to everything that we stand for.

A number of years ago, we sold our half share in Securency, the manufacturer of the polymer material the notes are printed on. Securency is now owned by a Canadian firm. NPA remains a fully owned subsidiary of the RBA and it prints Australia's banknotes in Melbourne. The company has undergone a top-to-bottom overhaul of its governance arrangements and its business practices. I am confident that the company is operating to the very high standards that we demand and that it will continue to do so.

On a more positive front, over recent months, NPA has been printing Australia's new $20 banknote. We are today releasing the design of the new note and it will be issued into circulation in October. It will have the same world-leading security features as the other new notes. It will also have three raised bumps along each edge to assist people who are blind or have low vision.

The new $20 note will continue to recognise two significant Australians: Mary Reibey and the Reverend John Flynn. Mary Reibey was a remarkable woman. She arrived in the colony of New South Wales in 1792 as a 15-year-old convict. Then, through hard work and determination, she rose to become one of the colony's most successful entrepreneurs. And John Flynn is best known for establishing what we know today as the Royal Flying Doctor Service. This service has helped countless Australians and is now the largest aero-medical service in the world. We are very proud to celebrate the enterprise and ingenuity of these two Australians on the $20 note.

The Reserve Bank also continues to work on the upgrading of Australia's electronic payments system. We want to see a system that is reliable, secure and efficient, and meets the needs of Australians. It is one year now since the New Payments Platform (NPP) was launched. Over 2½ million Australians have registered PayIDs and the banks are progressively adding functionality to the system. Many people are already benefiting from faster and more flexible payments. We have, however, been disappointed that some of the major banks have not met the originally agreed timelines. This delay has, regrettably, slowed the pace of innovation in the overall system, given the substantial network effects that exist in payment systems. Late last year, I wrote to the CEOs of the major banks on behalf of the Payments System Board expressing our concerns and seeking a commitment that the updated timelines will be satisfied. It is important that these commitments are met. Notwithstanding these delays, I remain confident that the NPP will provide the backbone for substantial innovation in Australia's payment system for years to come.

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