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Economics, Finance & Public Administration Committee

Review of the RBA Annual Report

Ms GRIERSON (Newcastle) (12.48 p.m.)—I rise to speak on the report of the House of Representatives Standing Committee on Economics, Finance and Public Administration—Review of the Reserve Bank of Australia annual report 2006, which deals with the public hearing held in August on the Gold Coast. It was our second public hearing with Governor Stevens, who was frank and open with the committee and also, to the regret of some of us, very adroit at avoiding the politically partisan questions of the committee. However, Governor Stevens took the opportunity at that hearing to strongly reinforce some important principles of the Reserve Bank's operation. When asked if he would increase interest rates during an election, the governor stated his independence and reinforced the independence of the Reserve Bank from the government when he said:

"If it is clear that something needs to be done, I don't know what explanation we could offer the Australian public for not doing it, regardless of when an election might be due. I don't think there is any case for the Reserve Bank board to cease doing its work for a month, in the month the election's going to be."

Governor Stevens also reinforced the Reserve Bank's strict adherence to an inflation target of between two and three per cent in applying monetary policy. He said:

"My statement is a statement of long run tendencies. Our job is to anchor inflation at two to three per cent. I think both sides of politics agree with that. We are independent to do that. If we are successful in doing that, the nominal interest rate would be driven by that."

Again he said:

"...as a long run proposition, the rate of interest goes with the rate of inflation."

Interestingly, his comments reflected the bipartisan approach to monetary policy—and I think that was strongly welcomed by all parties. His statements certainly dispel any election myth about returning to the very high interest rates that were experienced by both major parties in government prior to the economic reforms of the Hawke-Keating era. When asked if it was fair to say that we were unlikely to see those types of very high interest rate rises and that end point again, Governor Stevens responded:

"I would not promise that every increment will be 25 points, but it strikes me as not that likely that we will have 100 point increments any time soon. Something very dramatic has occurred if that needs to be done."

The hearing with Governor Stevens took place at a very interesting economic time following, as it did, the Reserve Bank's decision in August to increase the cash rate by 25 basis points to 6.5 per cent—the fifth interest rate rise since the 2004 election. In the context of our August public hearing, problems had also emerged in the US subprime lending market. I had the great fortune of being in America at the time when those problems emerged. It was fascinating to watch that play out and to see the very cautious comments of the Federal Reserve, the US equivalent of our Reserve Bank of Australia. It was interesting to see the confident comments of President Bush and the speculation by economic commentators on just what might happen in terms of credit risk and what impact that might have on the US economy. To be reading about it in the *Wall Street Journal* and the *New York Times* et cetera was an amazing experience.

That aside, Governor Stevens took the opportunity to explain the interest rate rise by saying that it was due to strong economic conditions putting increased pressure on inflation—in spite of the dampening effects of the higher exchange rate and indeed other factors. He said that:

"...ongoing strength of demand in a fully employed economy might leave us with inflation pressure that is harder to manage than expected."

He continued:

"If you face an economy in our circumstances, we are clearly very fully employed. We are getting a stimulus from the rest of the world which is quite powerful and which is, I would say, beyond in some sense the normal cyclical ups and downs of our terms of trade. So there is quite a big set of forces at work there. I think you would have to be feeling that, in that world, you have got to be on the look-out for inflationary pressures. So, if that is the world we face and that is the world we are assumingly facing in putting these forecasts together, we are at a point where we are certainly more worried about inflation being too high than we would be about growth being too low."

Well, that was the situation then. A month is a long time in economics as well as in politics. When discussing the possible dampening effect of the US

subprime market then he also commented that if the US economy slows then it could be anticipated that that slowing would be counterbalanced in the global economy by the continued increased growth of China and other major economies. Interestingly, though, he also made the point—and I thought this was an amusing one:

“As I have said to many people in the past year, if you took a selection of central bank governors, supervisors, securities regulators and people responsible for stability around the world, put them in a room and asked them, ‘What is it that you keep awake at night about?’ it would have been that people are underappreciating risk and taking more risk than they realise and at some point in time that will do some damage.”

I suppose we are at that point in time right now.

Governor Stevens also said that, if the subprime pressure were to have a dampening impact on Australia’s economy, it would be due to a decrease in the availability of credit. At that time, it was the very early days of the subprime situation. He said:

“I doubt that we are likely to see a big impact on the confidence of mainstream businesses from this financial volatility in the near term. The longer term risk would be if there were a serious tightening of credit conditions globally that then led to a withdrawal of credit provision in the real economy. I do not think that is happening at the moment. Clearly, that is a risk one has to be on the alert for, and we are.”

Certainly, he is alert to that risk and his comments yesterday suggested that he is considering a heightened risk at the moment. He commented yesterday that the risk has increased and that credit has tightened. A report released yesterday on mortgage stress said that mortgage stress was rising at alarming rates, with eight per cent—or 600,000 households—likely to experience at least mild mortgage stress by the end of the year. I take this opportunity, then, to recommend to the House the economic committee’s recent report on housing and lending. But, clearly, risk or credit is being repriced.

We have witnessed just this week a run on the Northern Rock bank in England and some speculation in our own media about the position of regional banks regarding their liquidity and assets held. Interestingly, the governor has suggested that the big Australian banks disclose—he actually called on them to do so—the degree of their exposure to the risk from the subprime fallout. I think it is terribly important that the governor is making that statement. It suggests that both the market and the public have a right to know if there is a risk and what that level of exposure is. Those disclosures would be welcomed.

In reflecting on the latest RBA interest rate rise, the governor detailed the constraints on our domestic economic growth, noting that labour shortages continue to be the single most important factor constraining further economic growth in our current economic situation. The Reserve Bank governor acknowledged the bipartisan approach to labour market priorities, in answer to a question that I put to him, when he said:

“My view is that the Australian labour market is very different from the animal we saw in the episode that Dr Emerson referred to in the late seventies and early eighties. I think it is obvious that two successive governments of differing political persuasions have moved things in the direction of less centralisation, more flexibility, more focus on productivity and so on. I do not think an objective observer would conclude differently.”

The governor highlighted the constrained economy and the inflationary effects of that, when he pointed to the current situation with labour shortages. It is a tradition of advice that our governors have adhered to, during this term of parliament at least, pointing out the constraints on growth brought about by a lack of attention to skills, infrastructure, housing and land release policies, the productivity dilemma and now of course the shortage of labour. But these are elements of fiscal policy that require the government to respond and intervene. Unfortunately, when you consider the constraints on growth that we are presently experiencing, the government’s response has been clearly inadequate.

I take these last moments to conclude and thank the Reserve Bank governor and his team for the excellent interchange. I congratulate the secretariat, which deserves special recognition for its excellence in supporting our committee. And, lastly, I give my best wishes to the chair, Mr Bruce Baird, on his retirement and thank him for the professional approach he has always taken to the economics committee of parliament.