TRANSCRIPT OF QUESTION & ANSWER SESSION WITH

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RESERVE BANK OF AUSTRALIA

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MODERATOR: Perhaps I'll kick off with first question and we were just talking over dinner about the phase in the market we're at where confidence is starting to be regained, particularly by business, but we still seem to be a little bit risk averse and people are a little bit reluctant to make investment decisions. Is that something you'd normally see and how long would you normally see that go for in a cycle like this?

MR STEVENS: I think there are – it is pretty normal in most business cycles to have these periods where conditions are in place for stronger growth but it takes time to emerge. My memory of previous cycles, and I've lived through a few now, is that that's often the case and sometimes, particularly with business capital spending, we find a few years later that we look back and it actually was starting a bit earlier than we knew at the time once all the data are in, because this is a hard thing to measure. So I think qualitatively it's perhaps not that surprising. And if you add to that the fact that we did have a major international financial crisis – it didn't affect us terribly badly but did have some effect – and people remember that and people were understandably I think more circumspect for some time after that. So you add all these things up – you can understand it.

The thing is you know we need to get by it. We need to get past it at some point and get to a stage where shareholders are not saying to the Board just keep giving us the dividend and give our capital back but are saying, you know, what are you doing to invest our money for future growth? I think that will come. I can't tell you exactly when or quite what the trigger will be, because there is no direct trigger for those things that we have. So we need to get to that point and as I say the timing of that is inevitably just not knowable.

MODERATOR: We just need a first mover, someone who can get it rolling.

MR STEVENS: We do, I think a lot of boards know that someone needs to move and they're saying, 'after you'.

MODERATOR: Some questions, I think we've got one over here.

QUESTION: Hi Glenn.

MODERATOR: Just identify your name and where you're from.

QUESTION: Warren Hill from Data 3. Thank you very much for the presentation, very interesting. I was curious, the press release came out yesterday and hit the nail on the head I think with the request to drop the interest rate below 2 per cent. I think we need to get another percentage off as quickly as we can just to get some stimulus into the market place. And primarily – one of the items that you didn't address and I'd like to get your views is the unemployment rate, which is rising far quicker than the housing rate at this point in time, and how that's affecting our economy moving forward?

MR STEVENS: The unemployment rate's been going up very gradually for probably about 18 months. That's because the economy hasn't quite turned in the output growth that we need to absorb the growth in labour force and as we've said it will probably be a little while yet I think before we see that turn down. I think we will see it turn down but it will be a little while ahead before that occurs and that's what we've been saying pretty consistently for quite a while now.

MODERATOR: More questions, one here down on the floor.

QUESTION: Edward Smith from Australian Unity. Just suppose in theory you were thinking about the possibility of macroprudential tools to reign in the housing market, what sort of shape might some of those tools take?

MR STEVENS: Well let's remember what I said this wasn't about. It's not about reigning in the housing market broadly defined; it's about making sure that the flow of credit to investors which has picked up continues to be lent on a prudent basis. So the tools, which would be deployed by APRA when the time comes, would be things that would be calibrated sensibly and in a targeted way to do that. They would be very unlikely to be some of the tools that have been mooted in public by some commentators. Loan-to-value ratio limits, for example, probably is not the tool to be used in this instance because high LVR lending mainly that's actually to new owner occupiers and they're not the problem, so you wouldn't do something that's aimed at them. It would be more something aimed at just ensuring that lending standards and capital adequacy for investor-type loans are up to scratch and when it's time for something to be said about that I'd expect that APRA will be saying something. But I'm not here to say it tonight.

MODERATOR: Some other questions. At the back, thank you.

QUESTION: Rod Matic from CEDA Board. My question is why has the Australian dollar stayed higher for longer than the banks seem to expect, and most commentators expect? What's the in-house view on the currency?

MR STEVENS: The view we have which ought to be pretty clear is that it's, on pretty much any fundamental metric that you can come up with, its above that. Depending on which metric you choose it's noticeably above or not that far above, and those metrics vary, but it's pretty clear which side it's on. It's – I think the answer to why that's so, that's a very interesting question and put 10 economists here, you'll get at least 10 answers, maybe more.

But I think it has a lot to do with the fact that we live in a very unusual environment globally, we have exceptionally low rates of return in the major countries not just on their money market rates that the central bank sets, but on all the assets they have. And the assets in this country, everything not just the overnight rate but the whole spectrum of financial instruments, real assets, property, commercial property et cetera, all those rates of return look very attractive, even though they are by our standards historically they're low, and I still get plenty of mail complaining about how low. To foreigners these yields look good. And so there's you know that tendency for capital to come and seek those yields. We can't change that, that's a feature of the world we live in. But the thing we have said is that – and I've said this more than once and I'm happy to repeat it – I think investors in the foreign exchange market and international capital markets have been underestimating the likelihood of a decline in the Australian dollar over time. I think they were underestimating it and it has declined and I suspect there's probably further decline to come at some point in time, I just can't tell you exactly when.

MODERATOR: Other questions, over here.

QUESTION: Governor thank you very much for your comments. My question is as you know the Americans very aggressively have used quantitative easing as an instrument of policy, certainly the extent we've seen recently, the Japanese have as well, Europeans, and none of it has really produced inflation. Why have we not been as aggressive here in terms of using quantitative easing and can you give me some of your views on this?

MR STEVENS: Well it's certainly true that thus far the balance sheet measures or QE that the Fed and others have used haven't produced inflation. In fact, their intent was to ward off deflation or inflation being too low, not entirely without success it would appear. Why don't we use QE? Well we don't need to. QE is a thing you use when interest rates get to zero which is not a point that we've reached, not a point I think we're likely to reach and so apart from a very brief period in the heat of the crisis when we did expand our balance sheet to provide liquidity at a time of acute tension, and that was very quickly subsided and we reversed that, but apart from that we haven't needed to use balance sheet measures here for the simple reason that we have a positive interest rate, it can go down if it needs to, it hasn't got to the zero bound, and it's at the zero bound where quantitative measures are really seriously under consideration.

MODERATOR: More questions up the front and if you could say your name and organisation too please.

QUESTION: Nick Proud from the Residential Development Council, which is a division of the Property Council. Governor the forecast for this calendar year for residential starts was around about 158 to 160,000 starts. As of the end of June we were hitting 182,000 starts. So we're about 20,000 to 30,000 above the average, but 20,000 above the actual forecasts and we have a great opportunity to leverage the strong position of the residential industry at the present point in time. And just bringing in the new CEDA Chair's position, Paul McClitock, can we use the review of Federation with tax and areas such as development assessment reform to seize the opportunity with such a strong set of conditions around such a critical part of the economy which is construction and residential development?

MR STEVENS: I think that was a comment, but and it wasn't actually mainly directed at me, I don't think, which is a nice change.

MODERATOR: I don't think I could figure out a question out of that one. Any other questions or comments? Over here thank you. Again if you could have your name and organisation please.

QUESTION: Hello my name is Guy Dickson from NINA. Governor I'd like to ask – raise the issue of productivity. In your opinion are we sufficiently focused on those aspects of the economy that are showing signs of being laggards in terms of increasing productivity? The one that's of particular interest to me is utilities distribution. We see a break out across the world at the moment of a need for rising utility prices at a time of reducing demand, which seems to be impacting on our productivity growth. Are we sufficiently focused at this point in time on productivity?

MR STEVENS: Good question. We've certainly tried to put the focus on productivity as really the only source of long-run growth in living standards. I've been talking about this for a few years and my colleague in the Treasury, Martin Parkinson, has been a very powerful advocate of this focus as well.

I think as I said in the presentation that the evidence is that productivity in enough sectors of the economy is starting to improve that we're seeing some tangible signs of results in the data, so that's encouraging. Is it enough? I think this process really has to continue for quite a long time. I think that across a broad range of fronts in the economy – it isn't so much that governments can introduce a program that boosts productivity, that's not how it works. I've said this before in this audience: the productivity actually comes from you, from business. But it comes when you're prompted and able to make the adjustments in the way you do things that produce better output per unit of labour and of capital.

On the utilities issue per say I'm not an expert in this field by any means. My understanding is that there are some regulatory issues surrounding the way pricing is done and returns on capital are computed and so on, and that's led to some probably undesirable outcomes in terms of gold plating and price rises and so on. The way to address that presumably is to look at the regulatory space. That's beyond my level of responsibility or expertise but presumably that's where you'd go looking in that specific area.

But more generally productivity comes from using better technique, better ways of doing things, better equipment, more highly trained workers and better practices and processes every day, that's where it comes from. So in other words it comes from you. And thank you for doing it, and please keep doing it.

MODERATOR: More questions, over here thank you. A microphone's coming.

QUESTION: Hi Glenn, Alexis Gray from Vanguard. So the Australian economy has performed pretty well, we haven't had a recession since the early 90s. So I was just wondering what your greatest concerns are about the medium-term outlook, so the next five to 10 years, given that we've been performing so well for so long?

MR STEVENS: Well I think in the next two or three years we have to complete this transitional period as the mining capital spending tails off. That has a long way to go and we need more balanced growth in the economy, and I've talked about that at some length this evening and in other places as well, so that's doing what we can to foster that. Let's be under no illusion that we can fine tune this, certainly the central bank can't but we do what can reasonably and responsibly be done. I think part of that will involve making sure that we don't overdo the enthusiasm on housing values, as I've been talking about, there's nothing wrong with prices having gone up a bit and it's good to see construction but what we want here is a long steady upswing, not a huge boom and bust because that will set us back on the transition that we want.

Beyond that I think the issues come to basically the things I'm trying to talk about in the latter part of my address, our general capabilities, competencies and our confidence in ourselves to use that. You know if we get those things roughly right then there are many reasons to be optimistic. There will still be a business cycle, and I think it is a mistake for us to keep telling this story of 23 years with no recession, I don't actually think it's accurate for a start. I think but for the vagaries of quarterly national accounting we might well have called the end of 2000 a recession and we would have called the end of 2008 one, in fact I would call it that. I think we had a recession then, but it was a brief one. It wasn't terribly deep and we got out of it quickly and the question to ask isn't how you can go another 20 years without a recession; it's how you can have small ones and get out of them quickly. What are the preconditions for that and that's a conversation worth having.

I personally think it's a mistake to keep telling ourselves this myth of the 23 years, because we're bound to have a downturn at some point. I don't know when or exactly why but it's very likely that at some stage that will occur and we will need to think sensibly and in a mature fashion about that when it comes. And I think having told this story that we don't have recessions, I don't think that's actually a very good way to start that conversation, that's a general point. But our biggest issues are can we be competent and productive and apply those capabilities, have a bit of confidence in ourselves and take some well-calibrated risks for prosperity, that's the question.

MODERATOR: Question over here. Again if we could have your name and organisation please.

QUESTION: My name is Dean Rolfe I work at PWC. Mr Stevens I was interested in your comments around achieving more balanced growth in the economy and particularly bearing in mind unemployment of course is a lagging indicator. My question goes to tax reform. It's obviously a very topical issue at the moment, but in a global economy where movement of capital is very easy and increasingly offshoring of jobs as well and the digitisation of the economy, I'm just curious as to your views on perhaps the state of the debate around tax reform in Australia and where you think we should head?

MR STEVENS: On the international side of course the G20's got this commitment to work together to try to address this issue of revenue shifting. I think that's very important. The bigger question of in the long run how feasible it is to tax capital in general versus the immobile factors of production and so on, that's quite a big question. I don't really want to buy into it because I'm not qualified to do so. On tax reform generally well there's going to be I think government work on this in the period ahead so presumably these issues of the base, the kind of tax and the rates you levy it at will all be taken account of in that work and we should hope that that's done thoroughly and await the outcome.

MODERATOR: I think we've got time for probably one more question, over here.

QUESTION: Hi Justin Fabo from ANZ. When you put your forecasts together I presume you think about the risks being pretty symmetric to the outlook. I guess my question is whether you deep down in your gut you think that's the case at the moment, particularly when – it's very heartening to see your first chart was around the terms of trade and we all underestimated every year, year in, year out, on the way up how high those terms of trade went and on the way down so far my guess is that most of us have underestimated how quickly they've fallen, and we've all got forecasts for a pretty benign outcome I think, or most of us. Do you think the risk to the growth forecast, you know which matters for monetary policy for the next couple of years, are skewed to the downside for the next couple of years, particularly around the terms of trade outlook? And also is it your view that the currency is just a shock absorber? So the currency helps in rebalancing but for overall growth it's actually just helping around the edges at the moment and over the next couple of years, thanks.

MR STEVENS: So there's two questions there, one's on the balance of risk. Well it's in the *SMP*, which I know Justin – most people here would be put to sleep by reading that section but you I know are energised by reading it – so it's all there. Personally I think I'm less worried by the prospect that things will be too strong and by the possibility that they'll be too weak, in the period in the near term. But the risks are all set out and you can think of upside ones as well as downside ones and make your own view about which way they might fall.

On the exchange rate being a shock absorber well I think it's – I think it still is. You know we could have done with it doing a little bit more shock absorbing in the past year or two than it did do, but actually over the broad sweep of time I think it will still do that job, it may not always do it just on cue when we think we want it too but then we've got to remember and I've – my view is the market generally in the past 30 years more often than not has done a better job of setting that price than I would have done if it had of been my job to try to set it. So you know we've got a float, we have to go with that and occasionally it's a bit irritating or a bit concerning. It's a new phenomenon for it to be a concern that it seems a bit high, for most of my career the concern was the other way, but there it is and I still think really that over time the flexible rate is probably going to do the job that we need it to do.

MODERATOR: One last question.

MR STEVENS: Just to say again, you know I still think there's a pretty material risk that it goes lower than where it is today.

QUESTION: Glenn, Phil Graham from Mercer. You haven't spent too much time talking about the global economy today – tonight, you've obviously had the benefits of the G20 meeting over the weekend to talk to many interesting people about that and just in the last little while we've had the news from Japan about going back into recession. Back in September/October it was concerns about Europe and Germany and we also know Russia's having its problems; Brazil not looking great; it's only the US that's really keeping things going at the global level. I just wonder if you could share any updated thoughts that you may have on the global outlook?

MR STEVENS: Well thanks Phil. I don't think I've got much to add really to what we published only a couple of weeks back. I think the news in Japan I guess was a bit weaker than the market consensus. Overall I think we're still searching for a good sense of how well Japan's coming back after the tax increase and I think we're going to be grappling as well with what the possible implications are of the BoJ stepping up the QE. Personally I think this is an issue which should get more attention than it does. BoJ is going to be doing nearly as much QE as the Fed was at their peak. If we thought that what the Fed was doing was important it must follow that what BoJ is doing is important as well. And the fact that the US is on apparently one course of monetary policy, Japan is on another and Europe is probably also you know on its own track as well, which won't see interest rates rise for quite a long time at best, I think that matters for financial markets and I suspect we'll continue to see markets grappling with what all that means over the period ahead. So it could be a bit of turbulence there.

The country I don't think you mentioned was China, which really is I think still proceeding pretty well. It's probably going to achieve growth something like the authorities target this year it would appear, they've already reached their annual target for employment growth already, before we've got to the end of the year. There's uncertainty around how the property side and all the debt that's built up there how that will all work out, that's probably the key uncertainty in China in my opinion, but so far they've continued to turn in pretty decent growth performance even by their standards let alone others, so they're doing pretty well. The US I think's doing quite well. It's certainly true that Europe's struggling but the environment for us is not as great as it was but it's still quite manageable I think and it's up to us to manage it.

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