Michele Bullock: Opening statement - House of Representatives Standing Committee on Economics

Opening statement by Ms Michele Bullock, Governor of the Reserve Bank of Australia, to the House of Representatives Standing Committee on Economics, Canberra, 9 February 2024.

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Chair and members of the Committee.

This is my first appearance before the Committee as Governor. I have of course been here before, first as Assistant Governor, Financial System and more recently as Deputy Governor, so I am familiar with the process. These hearings are an important part of the accountability process for the Reserve Bank. Like Governors before me, I welcome the opportunity to answer your questions, as do my colleagues.

Quite a bit has changed at the RBA since we last appeared before the Committee in August 2023. My seven-year term as Governor started last September and a new Deputy Governor, who has been appointed from outside the RBA, takes up duties next week. We have a new Statement on the Conduct of Monetary Policy, agreed between the Reserve Bank Board and the Treasurer, which makes explicit our mandate for price stability and full employment and requires us to explain regularly how we are meeting these objectives. We have had the first of our Board meetings under the new format – eight meetings a year, each over an afternoon and the following morning. The media statement following the decision on Tuesday was issued by the Board rather than the Governor and I held my first media conference, which will be a regular occurrence following each Board meeting. The RBA also released its Statement on Monetary Policy at the same time as the monetary policy decision, rather than a few days later as in the past. The Statement on Monetary Policy sets out our assessment of current economic conditions, our forecasts and risks around them, and the key issues featuring in the Board's monetary policy decision. On our previous timetable, the Statement on Monetary Policy would have been released while this hearing was taking place. I hope this change has been valuable in enhancing the transparency of our decision on Tuesday and that it was also of some benefit for you all.

Inflation

One thing that has not changed since the previous hearing in 2023 is the challenge presented by high inflation. We all remain acutely aware that the cost of living is rising much faster than it has over recent decades. It's been evident over the past couple of years in many of the essential goods and services we all buy but also in a myriad of other goods and services that we might regard as discretionary. At its peak, almost 80 per cent of items in the Consumer Price Index (CPI) were recording price rises of more than 3 per cent per annum. So, the problem has been a broad-based one.

This is why the Board is focused on bringing inflation down. The Board understands that the rise in interest rates has put additional pressure on the households that have mortgages. But the alternative of lower interest rates and high inflation for a prolonged period would be even worse for these households, as well as all the households without mortgages. It would also make it more likely that inflation expectations would adjust upwards. And if this were to happen, it would be much more costly to address, involving high inflation for longer and even higher interest rates and a larger rise in unemployment to bring it down.

Recent developments in inflation are encouraging. Since peaking at 7.8 per cent in the December quarter of 2022, inflation declined to 4.1 percent at the end of 2023. Nevertheless, inflation is still too high. As you know, since the early 1990s the Board has had a target for annual consumer price inflation of between 2 and 3 per cent on average over time. The new Statement on the Conduct of Monetary Policy endorses this but makes it more explicit that we should be aiming for the middle of the range – 2.5 per cent. So, we have some way to go to meet our target.

I should add here that we are not unique in experiencing a period of above-target inflation. Inflation has been a challenge in most economies around the world – particularly those with which we typically compare ourselves. At least initially, this was a result of global supply chain issues coupled with strong demand for goods and rising energy prices. This saw inflation around the world rise to rates not experienced for many years, if not decades. As these influences have subsided, global inflation has eased and there has been encouraging progress towards central banks' targets. But services sector inflation remains high in many countries, partly reflecting demand remaining above supply and the associated tightness in labour markets.

On Tuesday, we released our updated forecasts for the economy and inflation. These forecasts have inflation returning to within the top of the target range – 3 per cent – in 2025 and to reach the midpoint of the target range in 2026. Importantly, these forecasts are conditioned on the assumption that inflation expectations remain anchored around the midpoint of the target range. Furthermore, these are our central forecasts and there remains a great deal of uncertainty around inflation outcomes that far out. Even if the economy evolves along the central path, inflation will still have been outside the target range for four years. The longer inflation remains high and outside the target range, the greater is the risk that inflation expectations of households and businesses adjust higher. And if that happens, then the risks of inflation becoming entrenched at a higher level rise. This is the balancing act that the Board is focused on. We are trying to bring inflation back to target without slowing the economy more than necessary on the one hand or risking high inflation for longer on the other hand. This leads me to the Board's thinking and its recent decisions.

Recent Board decisions

At the time we last met in August, the cash rate target was at 4.1 per cent. The Board had left the cash rate at that level since June and indeed continued to hold until November when it increased the cash rate by a further 25 basis points. The decision to raise the cash rate at that time was based on information that had been coming through on inflation, the labour market and economic activity. The weight of that information, plus the RBA's updated forecasts, suggested that the risk of inflation remaining higher for longer had increased. The Board noted that while the economy was experiencing a period of below-trend growth, it had been stronger than expected over the first half of 2023. Underlying inflation was higher than expected at the time of the August forecasts, particularly in services, and conditions in the labour market had eased but remained tight. In addition, housing prices were continuing to rise across the country. These factors, plus the fact that inflation was projected to remain above 3 per cent for another two years led the Board to increase interest rates to be more assured that inflation would return to target in a reasonable timeframe.

Since then, we have received more information on the economy and inflation.

First, to the economy.

Tighter monetary policy has contributed to a further slowing in demand. Weak household spending growth, particularly in per capita terms, has been only partly offset by strong growth in business investment and public demand.

That said, labour market conditions remain tight but have continued to ease over recent months in response to slower economic growth. The unemployment rate and the underemployment rate have both increased by around ½ percentage point since mid-2023, albeit from low levels. Wages growth remains strong by the standards of the past few years, although there are signs that it is slowing in some segments of the labour market. Firms now expect wages growth to ease over the year ahead. However, recent very weak productivity outcomes have contributed to a sharp increase in labour costs per unit of output.

Putting this together, our overall assessment is that the aggregate level of demand has remained above the economy's supply capacity and that conditions in the labour market are still tight relative to what would be consistent with sustained full employment and inflation at target. This means that the slowing in aggregate demand that we are observing is helping to ease inflationary pressures, but we are not yet where we need to be.

Consistent with this, inflation has moderated. Headline and underlying inflation were both lower in the December quarter than had been expected at the time of the November Statement on Monetary Policy. Goods price inflation was softer than expected, a pattern also seen overseas. Services price inflation remains high. Indeed, while inflation was lower than we were expecting in November, this is largely attributable to softer-than-expected goods inflation – services inflation was pretty much where we had forecast it to be. High services inflation is reflecting strong growth in both labour and non-labour input costs.

Historically, services inflation typically runs above goods price inflation. In the couple of decades prior to the pandemic, inflation averaged around 2½ per cent. But within that, goods price inflation averaged around 2 per cent, while services inflation averaged around 3 per cent. So, while we don't necessarily need services inflation to be at the midpoint of the 2–3 per cent range to meet our target, we do need it to be quite a bit lower than it currently is.

One issue I haven't mentioned yet is the other part of our mandate – full employment. While full employment has always been part of the RBA's mandate, the new Statement on the Conduct of Monetary Policy (and the Reserve Bank Bill) makes it more explicit. It says the RBA will conduct monetary policy in a way that will best contribute to both price stability and full employment. Full employment is the current maximum level of employment that is consistent with low and stable inflation. I have spoken in the past about this, emphasising that our two objectives are mostly complementary – over the longer term, low and stable inflation is necessary to achieve sustainable full employment. This is also front of mind for Board members as we battle inflation. The Board is attempting to bring inflation down while preserving as many of the recent gains in the labour market as possible – what my predecessor called 'the narrow path'. So far, we are observing that labour market conditions are easing, although they remain tighter than we think is consistent with low and stable inflation. Our forecasts are for employment to continue to grow but more slowly than over the past few years. But these outcomes are dependent upon inflation returning to target in a reasonable timeframe and inflation expectations not drifting up. If that were to occur, it will be much more costly in terms of employment to get inflation down.

In summary, while there are some encouraging signs, Australia's inflation challenge is not over. An inflation rate with a '4' in front of it is not good enough and still some way from the midpoint of our target. Given this, the Board held the cash rate target at 4.35 per cent at its meeting earlier this week. It noted that the path of interest rates that will best ensure that inflation returns to target in a reasonable timeframe will depend upon the data and the evolving assessment of risks. At this stage, the Board hasn't ruled out a further increase in interest rates but neither has it ruled it in. However, given the substantial costs to the economy and the Australian people of continued high inflation, the Board is committed to bringing inflation back to target in a reasonable timeframe.

Before I finish, I briefly want to address three further issues. We spend most of our time in these hearings talking about monetary policy and I understand why given the visible impact it has on the Australian people and the economy. But we have many other responsibilities at the RBA, including oversight and regulation of the payments system and the issuance of Australian banknotes.

Payments system

First, to the payments system. As you are probably aware, the Reserve Bank has had the power to regulate the payments system since 1998. It does so to promote competition, efficiency and safety in the Australian payments system. But in recent years, the payments system has changed dramatically. It has moved from a system that was predominantly serviced by large established financial institutions and card schemes to a vibrant and innovative ecosystem, with participants ranging from traditional financial institutions to small start-ups to large tech companies.

Given this, the legislation that gave the RBA the powers to regulate in this area was no longer fit for purpose. The Government is addressing this issue by modernising the legislation to allow the RBA to regulate the new and diverse set of participants more effectively. Once this legislation is passed, we will be embarking on a wholesale review of our retail payments regulation to identify any areas where competition, efficiency and safety could be improved. There is also legislation in the making that will provide a licencing regime for non-bank payment service providers and will implement common access requirements for payment systems. These changes will also help to promote competition in the payments system.

Banknote distribution

Another issue that I would like to update the Committee on is the work that is underway to address challenges in the cash distribution system. As the use of cash for transactions has declined, the economics of cash distribution has come under pressure. This was one of the main factors behind the merger of the two largest cash-in-transit providers last year, which the ACCC approved subject to a three-year undertaking regarding pricing and service levels. However, Linfox Armaguard has since indicated that, despite this, its cash distribution business remains unsustainable.

The RBA places a high priority on the Australian community continuing to have good access to cash withdrawal and deposit services. Late last year, I convened several discussions with businesses in the industry to consider what more could be done to support access to cash for those who need or want it, and to promote a sustainable model for cash distribution in Australia. These discussions are being conducted in line with an Interim Authorisation from the ACCC enabling relevant parties to develop and evaluate industry responses to support the viability of wholesale cash distribution and access to retail cash services. They are likely to continue for some months. Developing a model for cash distribution that is sustainable in the long term requires addressing complex issues that will take some time to work through. I have encouraged the major participants in the cash distribution system to approach these issues with the public interest in mind.

$5 banknote redesign project

Finally, I would also like to update the Committee on the work underway to redesign the $5 note. Last year, we announced that we would be taking the opportunity to feature a new design on the $5 note that honours and celebrates the culture and history of First Nations peoples. As a first step in determining the design, we will be asking members of the public, over the course of March and April, to share with us what they think should be on our $5 banknote to represent First Nations culture and history in Australia. In recent weeks, we have also begun visiting First Nations community organisations in key regional and remote locations across Australia and the Torres Strait, to engage with local communities about the theme nomination process. I encourage all Australians to be involved in contributing to this important endeavour.

I will finish on that note. My colleagues and I look forward to answering your questions.