Speech

Opening Statement to the House of Representatives Standing Committee on Economics

RESERVE BANK OF AUSTRALIA

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– Check against delivery –

Good morning, Chair and members of the Committee.

My colleagues and I are pleased to be here today to answer your questions.

As you know, on Tuesday the Reserve Bank Board decided to lower the cash rate target – our key monetary policy tool – by 25 basis points to 4.1 per cent. The cash rate had been at 4.35 per cent since November 2023. I will start with some background to this decision and explain the Board's strategy. I'll also talk about the outlook for the Australian economy and some of the risks and uncertainties. I will then make some remarks on the payments system, including the RBA's consultation on retail payments regulation and the status of work in the cash distribution space. Finally, this week's meeting was the last meeting of the Reserve Bank Board. From 1 March, the amended *Reserve Bank Act 1959* will come into force, creating a new Monetary Policy Board and a separate Governance Board. So I will finish off with an update on our preparations for these new arrangements and implementation of the recommendations from the Review of the RBA more generally.

Inflation

The Reserve Bank Board's mandate is to contribute to the welfare of the Australian people by delivering price stability and full employment.

What is meant by price stability is set out in the *Statement on the Conduct of Monetary Policy* agreed between the Australian Treasurer and the Reserve Bank Board in late 2023. To achieve low and stable inflation, the Board sets policy to return inflation to the midpoint of the 2–3 per cent target range. But there is flexibility around the timeframe in which we meet our inflation objective to balance this with meeting our full employment objective – achieving the maximum level of employment that is consistent with low and stable inflation. The Board's strategy over the past three years has been to try to bring inflation sustainably back to target within a reasonable timeframe while preserving as many of the jobs created over prior years as possible.

Looking over the past three years, I think we can be satisfied with the progress made so far – though our job is definitely not done.

Inflation has fallen substantially since the peak of 7.8 per cent in 2022 and there has been welcome progress since we last met in August. Inflation was 2.4 per cent at the end of 2024 and underlying (trimmed mean) inflation, which removes the more volatile components of the index, was 3.2 per cent. Underlying inflation has eased over the past three quarters, and in the December quarter it was a bit lower than we had forecast. This has increased our confidence that inflation is heading in the right direction. At the same time, the unemployment rate has remained close to 50-year lows and the share of the population with a job has risen to a record high, which is good news. Growth in private demand has, however, been weak and wage pressures have eased. Collectively, this information suggests that higher interest rates have been working as anticipated, restricting economic activity and putting downward pressure on inflation.

The Board's recent decision

When we previously met with this Committee in August, the cash rate target was at 4.35 per cent. It had been at that level since November 2023, when the Board increased the cash rate by 25 basis points. At that time, there were signs of upside risks to the inflation outlook, so the Board decided it was prudent to take out some insurance against those risks. The Board's decision on Tuesday to unwind the November 2023 increase reflects its assessment that this insurance is no longer required.

Looking ahead, the Board is committed to being guided by the incoming data and our evolving assessment of the risks. While the strong employment growth is good news for jobseekers, we are alert to the possibility that it is signalling a bit more strength in the economy, which could delay or derail the disinflation process. We have not pre-committed to any particular course of action on interest rates. But in the forecasts published this week, the central projection suggests that if monetary policy is eased too quickly or by too much, disinflation could stall and inflation would settle above the midpoint of the target range. So the Board remains cautious about prospects for further policy easing.

Economic outlook

Our forecasts for the economy, which are conditioned on the market implied cash rate path, have growth strengthening over the course of this year, the unemployment rate rising a little before stabilising at 4¼ per cent, and underlying inflation coming down further to a little above the midpoint of our 2–3 per cent target range from late 2025 onwards. Real earnings are also expected to begin to recover.

However, the economic outlook remains uncertain. This is especially so the further into the future we look. Recognising this, we highlighted a number of key risks in the February *Statement on Monetary Policy*.

While our central projection is for growth in household consumption to increase as income growth rises, there is a risk that any pick-up is slower than expected. If so, it would continue to weigh on output growth and could result in a sharper deterioration in the labour market than currently projected. Alternatively, labour market outcomes may continue to be stronger than expected, given the signal from a range of leading indicators. This could result in upward pressure on wages and inflation. A key uncertainty here is how much spare capacity there is in the labour market, since the answer to that will have a material bearing on the future path of inflation. We also hear from liaison that weak demand has been putting pressure on business margins, helping to restrain inflation. As demand picks up, those constraints could ease and businesses might find it easier to raise their prices.

More broadly, there are uncertainties regarding the lags in the effect of monetary policy. Another question is how firms' pricing decisions and wages will respond to the slow growth in the economy and weak productivity outcomes while conditions in the labour market remain tight. In particular, growth in unit labour costs – which is what matters for business costs – remains high because of weak productivity, even while wages growth has eased.

There's also a lot of uncertainty around the global outlook at present. We're cautious about the possibility that global policy uncertainty may itself bear down on activity in many countries if households and firms delay expenditures pending greater clarity on the outlook. Our February *Statement on Monetary Policy* provides some scenarios to show different paths through which Australia could be adversely affected by changes to global policy settings. But, at present, it is too soon to tell how this will play out.

Before I move onto other areas of activity at the RBA, I want to assure members that the Board is conscious that households with mortgages have had to adjust following rate increases since the pandemic. And the impact of high inflation over the past couple of years has permanently increased the price level. That has hurt everyone but particularly those on lower incomes and the more vulnerable.

We have made good progress on inflation, however, the Board needs to be confident that it is returning to the target range sustainably.

Payments system

Another critical area of work for the RBA is our regulation and oversight of the payments system. We are currently conducting a review of surcharging and merchant card payment costs, which I know has attracted considerable attention. We published an Issues Paper late last year and received over 90 submissions in response. A wide range of views was set out in these submissions and we have valued the strong engagement from stakeholders and the broader community in the consultation process. We are now actively exploring options to best support competition and efficiency in the payments system with the public interest firmly in mind, and will be discussing options and their trade-offs with the Payments System Board in early March. We aim to release a consultation paper in mid-2025 that will outline the Board's preferred policy options and seek feedback.

One other issue that I would like to bring to the Committee's attention is the work we are doing to identify the risks associated with the payments industry's intentions to decommission the Bulk Electronic Clearing System, or BECS. This system processes large volumes of critical payments, including pension and welfare payments and most of Australia's salary payments. While BECS is considered a legacy payment system, a transition away from BECS to more modern alternatives, if not carefully planned, raises risks for the reliability, efficiency and competitiveness of the payments system. We discussed some of our initial concerns publicly in December following a period of extensive consultation with stakeholders, and next month will publish a report outlining our key findings and recommendations. Among these will be a recommendation that the industry and government work to establish a shared vision for the future of these payments and establish coordination and governance mechanisms to manage the transition. It is in all our interests that this issue is managed in an orderly fashion.

Banknote distribution

Another issue I would like to update the Committee on is recent developments in the cash distribution system. While the use of cash for everyday payments has declined in recent decades, it remains an important means of payment for many Australians. Cash is used as a store of wealth, particularly during periods of economic uncertainty, and can be a useful backup for electronic methods of payment. The RBA is committed to supporting the Australian Government's policy objective to ensure cash remains a viable means of payment for as long as Australians want or need to use cash.

As you are aware, the cash distribution system has faced considerable challenges over the past year or so. The key issue is that as use of cash for transactions declines, it is becoming more expensive to store, process and distribute cash around the country. At present, we have a single firm, Linfox Armaguard, that provides these services and it has experienced financial difficulties because the revenue it is receiving for these services is not meeting its costs. In response, in June 2024, an industry support package of approximately $50 million over

12 months was agreed between Linfox Armaguard and its major banking and retail customers. This was designed to reduce the near-term risk of a major disruption to the supply of cash services and provide time for Linfox Armaguard and its major customers to improve efficiency and develop other measures to support Armaguard's financial position.

Although there has been progress, there is still considerable work to be done to establish a model for cash distribution that is sustainable. The RBA has a specific role in the cash distribution system: we issue wholesale quantities of banknotes to the banking sector so that they can meet their customers' needs, and we provide incentives to the system to support appropriate banknote holdings and quality around the country. We are currently reviewing these incentives to ensure they are fit for purpose in the evolving landscape of cash usage. On the other hand, the logistics of moving cash to bank branches, ATMs and retailers is undertaken by cash-in-transit companies. Work towards more sustainable cash distribution arrangements is ongoing; importantly, it requires cooperation across all industry participants with the needs of the community in mind.

Implementation of the recommendations from the Review of the RBA

This appearance is our first since the Parliament passed amendments to the Reserve Bank Act late last year, which will take effect on 1 March. The amendments mean that the meeting of the Reserve Bank Board earlier this week was its last, drawing to a close 65 years of central banking history in Australia.

Preparations are well advanced for the start of the new era of governance for the RBA, which begins on 1 March. In many ways, the new Monetary Policy Board will look very familiar to transitioning members when it first meets in March. But it will look noticeably different for those who served on the Reserve Bank Board in earlier times. Since the start of last year, the meetings of the Reserve Bank Board to deliberate on monetary policy have taken place over two days rather than one day. This has allowed the Board more time to carefully consider and debate the implications of the evolving information on the economy and financial markets, and how best to respond. The Board has been closely involved in preparing the media release announcing its policy decision and members are also more engaged with staff in the period between meetings. And the papers prepared for the meetings include a greater focus on strategy, the options available to the Board and the key judgements that underly the staff's advice. This material is also reflected in our communications, including the *Statement on Monetary Policy* and the monetary policy minutes.

The most significant change from 1 March will be the establishment of the Governance Board, which will support the efforts we are making to lift risk management practices, oversee our large project portfolio and assist us in meeting the challenges of a modern central bank. We recently held an induction briefing day with the members appointed to the Governance Board and it was clear from this that the RBA will be well supported by the new Board.

More generally, we have completed work on more than half of the recommendations of the Review of the RBA and are well advanced on preparing responses to most of the other recommendations. As a result, there have been noticeable changes to the culture of the RBA, driven by a commitment to be more open and dynamic, which we will build on in coming years. The Governance Board will report on our progress on implementing the reforms by the end of this year. These changes are all designed to strengthen our ability to do our work and enhance the welfare of the Australian people.

Thank you for listening. My colleagues and I look forward to answering your questions.