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THE AUSTRALIAN

RECORD OF INTERVIEW

INTERVIEWERS:	**DAVID UREN** **JAMES GLYNN**
INTERVIEWEE:	**GLENN STEVENS**
LOCATION:	**RESERVE BANK OFFICES** **65 MARTIN PLACE, SYDNEY**
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MR D. UREN: So to start, we'd like to talk about the housing market. The hurdle for homeownership has been rising over the past decade and seems to be rising still. Many young people would be despairing about the hurdle in front of them. Do you think that there's a risk that future generations will find themselves increasingly locked out of home ownership?

MR G. STEVENS: Well, I do think that there are intergenerational issues in the housing area, and, indeed, I think that's actually a bigger question – that set of questions than questions like 'is there a bubble or not' and that sort of thing that people tend to spend a lot of time debating. That said, I guess it's always been hard to be that cohort that's trying to enter the market. There's always been a hurdle. It may be getting worse, though part of this is – I mean, there's a lot of things happening here. There's changes in preferences about how we want to live and how far out we want to live. There are decisions about zoning, transportation, infrastructure and all those sort of things that go to make up what's, I think, a pretty complex problem.

I think that a lot of people of my generation are actually going to find themselves, if they haven't already, helping their children into the housing market because that may be almost the only way that their children can enter the Sydney market, anyway, and be not too far from mum and dad. And I suspect that will happen a lot, and that, of course, means that for people of my age, that the wealth we think we have in our house, actually, we don't have quite as much as we thought because we're going to have to give some of it to the next generation. Of course, if we come from a rental household ourselves, then we're not going to have that equity to pass to the next generation, and certain types of disadvantage, therefore, are going to be perpetuated into that next generation. So I think there's a whole lot of issues there. Bit of food for thought. But I don't have the answers to all these problems.

MR UREN: So when you – the Reserve Bank cut rates week before last, it – part of its reasoning was that the risks in the housing market had diminished. How confident are you that lower rates won't see renewed pricing pressures in the housing market?

MR STEVENS: Well, the reason we said that we thought the risks had diminished – and we didn't say they'd gone away entirely; we said they'd diminished – was – I think it's clearer now that nationwide prices are probably still trending up, but not at the pace they were a year ago. There were some data issues to work through there before that was clear, but I think that is the case. The data on credit growth show that credit growth for housing has actually slowed down a bit in the past year. We know that lending standards applied by the lenders have tended to tighten, partly as a result of the work that APRA's done, but I think also some of the lenders – in fact, most of them probably now – are pre-emptively just being a bit more cautious in certain lending spaces because of the point of the cycle that we're at.

So all those things say that whatever you thought the risks posed to financial stability and macroeconomic stability might've been from the housing sector a year ago,

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they've probably diminished a bit since then. So that's the background to why we said what we said. Having made those points, this is still an area to watch very carefully, and you can't be 100 per cent confident that you won't see a resumption of pricing pressure, as you put it, but you can never be 100 per cent confident of anything, actually. So our job isn't – as I said recently, the job isn't to avoid all risk at one end of the spectrum and thereby run too many risks at another point; the job is to try to find a reasonable balance between all these risks, and the balance we thought was appropriate was for rates to be a little bit lower.

MR J. GLYNN: On a wider question, Governor, what – it's one of these questions – what keeps you up at night in terms of – is it the China corporate debt bubble or is it the bond market at the moment, the potential that inflation may eventually be sparked globally and there might be a problem confronting the bond market?

MR STEVENS: Well, it is the intent of monetary policies around the world, so far as I can see, to have a little bit more inflation than we have right now. It's hard to believe, as a central banker growing up when I did, that you could ever say this, but relative to announced targets, there's just a little bit too little inflation right now. Not a lot, but a little bit. It's a bit low. And it's the declared intention of most of the major jurisdictions – Japan, Europe, US – to have inflation come back up just a little bit to the declared objectives.

I think for us, people have talked a lot recently about Brexit, problems in Europe, etcetera, and they're genuine things to have some concerns over, but, for my money, what is ultimately going to happen in China is probably the thing that is more pause for thought, perhaps, because it's harder to work out what's happening there and what's likely to happen. We don't have the extent of data, the reliability of data, the extent of coverage and knowledge and understanding outside of China that you have, say, about America or Europe. That's not a criticism of the Chinese; it just really reflects the sheer speed with which China's become so important. But it has become important, and I think for all of us in the rest of the world we're paddling pretty hard to try to keep up with it and understand it, and the extent of the risk relative to the level of our understanding and knowledge is a bit uncomfortable.

MR UREN: It's that sort of unknown unknowns and - - -

MR STEVENS: Yeah.

MR UREN: Donald Rumsfeld - - -

MR STEVENS: Yeah. That would be a good way of putting it. Yeah.

MR GLYNN: Just quickly on that, is there one particular area of the Chinese dataset that you'd like to see more of or - - -

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MR STEVENS: Not one particular area, but, if you take the United States, there is just so much data with a long history and there's, a very large army of people skilled and experienced at interpreting all the ups and downs, I think probably over-interpreting, really.

MR GLYNN: Yeah.

MR STEVENS: In China I think it's still a work in progress. Not just compiling the data, but understanding its characteristics and, indeed, the characteristics of that economy. That's inevitable, but given that it's such a large economy now – and it's, of course, for us of particular importance – that leaves one feeling that you're always kind of running hard to try to keep up.

MR UREN: But is it the expansion of credit over the last – particularly since the financial crisis that is the thing that - - -

MR STEVENS: Well, that's a factor. As I've said many times, there was a lot of credit expansion. Whether those excesses can be gently landed without a crash, that's a very big question. The Chinese authorities are very conscious of that. It's not as though they don't realise the various risks that are there. They do. But it's quite a tall order to kind of bring all this back down to earth gently. In addition to that think about the transition that China's trying to make, from – they're trying to transition from the time-honoured and very successful Asian post-war model of a low currency, export of manufactures to the world, taking advantage of the lower cost structure, bringing in new technology, exporting to the west. That worked very well for Japan, for Korea, for any number of other smaller Asian countries.

China's too big to keep doing that. They're very large and the world won't be able to absorb that flow of product in the same way. They understand that. They're trying to change the model to more domestic demand, less reliance on investment, less reliance on exports and so on. So they get it , and they're making the transition, and I think they've made quite a bit of progress here, but nobody's done this transition on this scale this quickly ever before. There's no textbook that you go look up and say, "Well, here is how it was done". It hasn't been done. So how will this all turn out? We can't know. There is no way of knowing. And that's a source of discomfort and uncertainty, but it's inevitable.

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MR UREN: Yeah. So we want to do a bit of – look back at your term. So get you to talk a little about the biggest challenges that you feel that the bank has faced in your time here. Has it been navigating the highs and lows of the mining boom and, if so, is that task nearly drawing to a close?

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MR STEVENS: It'll be good to think it's drawing to a close. I think there's a bit to go. Probably in a year or so the rate of contraction in mining investment's going to start to taper out. That's what our forecasters think, and, actually, they've done a pretty good job of tracing the contours of the rise and fall, helped by very extensive liaison that they do with the large companies. So that will – that's probably about a year away. And the third phase, which, of course, is the export shipments, we're getting the big step up in LNG now. That step up will continue for a while and then reach a plateau a few years out.

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15 And I guess the mining boom proper is done then – has then come through the system and had all its phases and we've maybe reached somewhere closer to the new normal state of the world. I haven't mentioned the terms of trade there, and that's pretty unpredictable. They've fallen by a-third or so from the peak, but they're still 20 per cent higher than the long run average now, so whether that 20 per cent will come down or not I don't really know. I guess we're assuming not much change from here, but that's more an assumption than anything. So it's a pretty big event when you think about it. Ian [Macfarlane] was talking about things happening in China having implications for Australia's terms of trade in about 2004 or '05.

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25 MR UREN: '03 or '04, I think.

MR STEVENS: And the next governor is still going to be thinking about the final bits of that whole event in 2017. Quite a big event.

30 MR GLYNN: What will be the narrative, then, Governor in terms of a country that's transitioned? What - - -

MR STEVENS: Well, I think the big narrative is we've had a massive event that's made us as a country richer. Not as rich as it would've been had the terms of trade stayed at the peak, but that was never going to happen and nobody seriously expected that. But we've had a big shift in relative prices, big investment as we put in capacity we didn't have before. Unless you're an uber-pessimist about prices in the long run, I'd argue we're better for having done that investment, particularly since foreigners helped fund it, and we're a wealthier country than we would've been. So that's the long run point, it's still a wealth-enhancing thing for the country. And the second point is, compared with the way we managed such events in the past, going back over 100 years, these events in the past were always very disruptive. They invariably featured a period of very high inflation and overheating followed by quite a deep downturn.

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Now, we're not finished the episode yet, but so far as we can see at the moment, we managed without that economy-wide overheating and we're managing without the economy-wide slump in activity as well, and that is a far, far better outcome than we've managed in all these sorts of shocks in the past. You know, I've talked at various times about the things that have helped us do that, but that's actually something to be quite pleased about, I think. We've got some bumps and bruises and scratches, but we haven't actually totally blown up and crashed here, and on other occasions, we did.

MR UREN: Amongst the bumps and bruises and scratches, you probably collected a few in your first 18 months or so as governor, which was a very different period. It was a period of where the pressure – the threat of overheating seemed to be a very tangible one. Is it your sense that, in a way, the structure that we had put in place around inflation targeting was not fully understood and not accepted at that time or – how have you – was it a - - -

MR STEVENS: I think it was fairly well understood and we were – you know, inflation got to 5 per cent. That's too high. You have to respond to that. Everybody really gets that. And I think, looking back,– the bank had the right analysis of the problem and, you know, you can always quibble about a particular decision, but you have to respond to it and we did. I think that the framework (a) served us well, and (b) was reasonably well understood by most informed people. It's never popular raising rates - - -

MR UREN: Yeah.

MR STEVENS: - - - and I can tell you it's actually not that popular cutting them either. It's just that you're unpopular with a different group.

MR UREN: Yeah. And the – I mean, the politics of it were challenging during that period, weren't they?

MR STEVENS: Well, they – yes, but I think the politics of raising rates when the economy's strong, they're always somewhat challenging. This is why you have to have an independent central bank, because the challenges, they're not necessarily easy, but they're better met with this particular institutional set up. And so far as I can see, that's still pretty well supported out there.

MR UREN: Yeah.

MR GLYNN: Looking back at the – some of the darker episodes of the GFC, the collapse of Lehman Brothers was obviously one of those moments in history that everyone still refers back to. What are your recollections of that Monday morning, I believe it was? Was the bank surprised that Lehman Brothers was allowed to collapse?

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MR STEVENS: Well, there has been lengthy discussion about whether it was allowed to collapse, which, if you say it was allowed to collapse, your presumption is it could have been averted and then there are other people who say that the US authorities tried everything they could and couldn't save it. So you know, there are
5 differences there. But it certainly was – well, the aftermath of that - the way people retreated from accepting any risk at all, wouldn't deal with each other because they didn't know the state of other people's balance sheets, a very serious closing of many capital markets, that's certainly an event that you don't want to live through again.

10 MR GLYNN: So it's hard to say what contributed to it or - - -

MR STEVENS: Well, there are forests that have been felled to provide the paper for the books - - -

15 MR GLYNN: Sure.

MR STEVENS: - - - that are written about it all. But you know, I think there was too much leverage, not enough care with capital adequacyand funding availability, overconfidence and complexity and the system has then, kind of, built up a fragility
20 that, should the right sort of shock come along, is going to find it wanting and that shock did come.

MR GLYNN: Where were you when you heard the news?

25 MR STEVENS: The Lehman failure? Well, it happened on over the weekend, so when we came to work on Monday, that was - - -

MR GLYNN: I think it broke on the Monday morning.

30 MR STEVENS: That was the news, yeah. Monday morning our time.

MR GLYNN: Yeah.

MR UREN: Do you think that that whole episode demonstrated that central banks
35 globally had greater capacity to deal with crises than maybe one might have thought beforehand? I mean, do you think that – how do you think it changed the – you know, the standing – the sense of central bank capacity?

MR STEVENS: I don't think it changed that much. I mean, I would've thought
40 ahead of time that central banks know how to provide liquidity to markets and, actually, we know how to cooperate with each other within the limits of the powers that we have. The central bank cooperation at the operational level is actually quite good. It has been for a long time. The relevant people know each other. They meet each other pretty frequently. They cooperate on a whole range of things at the
45 operational level routinely. So there's good information sharing and the federal reserve, I think, displayed an admirable willingness to

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cooperate in the provision of dollar liquidity. It was in their interests to do that, but they understood the integrated, interconnected nature of global markets very well and those dollar swap lines, that were put in place pretty quickly, were a key part of containing the damage.

In their domestic remit, central banks provided liquidity against collateral in the way you're supposed to. That's what you're supposed to do and we all did that in the requisite amount fairly quickly and I didn't find that surprising or particularly new. That's what you're supposed to do and that's what we're trained to do. This was a bigger event than others have been for a long time, but I wasn't surprised by the – you know, the willingness to cooperate or the speed of response.

It was the subsequent period, where it morphed from being an emergency liquidity response to put a floor under something that could've been a catastrophe, as time went by, then it became more of a monetary policy question: "How do we restore demand?" and that's, I think, where the more unprecedented things have really been done and where there's room for debate about how effective we could ever have expected that all to be.

MR UREN: And is the fact that, eight years down the track, we're still looking at failing demand globally – is that a reflection of a failure in the capacity of the – or an unrealistic expectation of the capacity of central banks?

MR STEVENS: I think if it's anything, it's a demonstration that there's only so much that monetary policy alone can do. I don't think you could say that the Federal Reserve or the Bank of Japan or the Bank of England or the ECB and maybe some others were negligent in trying to think about new things they could do to help. The evidence is that they've been pretty inventive, actually, in deploying balance sheet tools and even most recently negative interest rates. So I don't think there's a kind of failure of imagination or willingness to act; far from it. I think what it does demonstrate is that there are certain situations or certain shocks, sets of events, where monetary policy's capacity to help is only going to take you so far.

I think this was when you think about it, always likely to be such a set of circumstances. You had a position of too much confidence, too much leverage ahead of the downturn. The central bank can help in the deleveraging process. It can bring rates down to speed up the adjustment, but it can't magically wave away the leverage that was there that people have to fix. And it can't make people borrow money if they're not inclined to.

When you're tightening you can always find an interest rate that's high enough that you'll stop them from borrowing, but when you're cutting, you can't assume there's a rate low enough that will restart it all, particularly if they started with too much debt to begin with. That's the situation that basically has been faced. And so I think it's definitely the case that the central bank action in the heat of the crisis put a floor under something that could've been much, much worse, but it was never reasonable to think that they were going to get things back to trend that easily given the

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other stuff that was facing us at the time, and it would be unrealistic to think otherwise, really.

MR UREN: Do you have financial stability concerns around the extent of some of the extraordinary measures? And I guess the area people usually talk about is risks on exit from QE, or is that not a particular .....

MR STEVENS: I guess, I suppose it depends what you think these exit risks are. The Fed certainly has given a lot of thought to the nature of exit. I don't think the problems are going to be of a technical nature, in technically managing the balance sheet. I doubt that's that big a problem. If you think the risk of exit is that somehow long-term interest rates will jack up suddenly in response to some Fed action, well, maybe, but that's always true. There's always that possibility with Fed action. And, I mean, it's unlikely they're going to dump all these bonds they own in a hurry. That's probably – that's pretty unlikely to happen.

So it will be the usual: what will bond markets make of the Fed signalling that, we're in a period of gradually taking back the easing. That's actually not a new problem. It may be bigger just because of the sheer length of time they've been so easy. But at least qualitatively that's not that new. If investors have taken on leverage or taken on risk with unrealistic expectations and then those expectations are dashed, well, that could in principle result in abrupt changes to capital market pricing. Again, that's not qualitatively a new problem. It's not as though we've never seen that before. It would simply be the sheer length of time that these unconventional and exceptional policies have been in place maybe. That's probably the issue.

MR GLYNN: Does that orderliness that you expect extend to the property markets .....

MR STEVENS: Well, let me be clear. I think you can probably expect some disorderly things to happen because they always do. You know, when we had the so-called 'taper tantrum', which occurred when the Fed said, "You know, at some point we'll probably start to taper down the bond purchases", which is obvious, really, when you think about it, markets went into a bit of a funk for a while, from which they eventually calmed down. Go back to the mid-nineties when the Fed started incrementally adjusting the Fed funds rate. Bond markets threw a bit of a tantrum at that point as well. So it's not unknown, and I suspect there will be some disorderly things happen somewhere. The real question isn't whether that occurs; it's whether it proves to be very damaging or not, and I don't think we can know at this stage.

MR GLYNN: In – sorry. In terms of the elevation of property prices worldwide because of the taxing of the asset - - -

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MR STEVENS: Well, whether a property price decline were to turn out to be very damaging or not will largely hinge on how much leverage there is behind it. Which is why, I think, in the discussion about asset values, be it housing or other property or other assets, you care, of course, whether asset prices seem divorced from their fundamentals. That's often in the eye of the beholder. But the thing you most care about is, is there a lot of borrowed money behind the assets, because – answer yes, that's much more risky; if the answer's no, it could still be risky, but it's going to be a lot less of a problem, I think, in the event prices fall if there's no leverage.

MR GLYNN: Would you put Australia in that risky category?

MR STEVENS: I'm not sure. I mean, I think people are more careful – it's typically been commercial property and lending , if you go back through multiple episodes in history, that's much more often what has gotten banking systems into trouble. And I think there's been suitable care there in this country really since the financial crisis of 2008. Housing, the debt being carried there is pretty significant now, but I don't think we're seeing another massive step up in leverage at the moment, and, as you know, we've been watching that fairly carefully. I suppose the best answer to your question is: every attempt to stress test housing portfolios that I'm aware of – APRA does these things periodically – none of those show a very bad outcome for the system.

Now, some losses get incurred, but by and large the system manages with that okay. That's a , I wouldn't say theoretical, but it's an ex ante exercise. It's done as rigorously as you can do it. That's not the same as the real event, so you can never be 100 per cent sure, but to the extent we can analyse these things ex ante, that's been done and the system would cope with a fairly significant decline in house prices along with some other stuff that went wrong, and we wouldn't have major institutions getting even close to failure. Not even close. They'd wear some losses and they'd have to, again, strengthen balance sheets at some point, but you wouldn't have a systemic event.

MR GLYNN: Some people talked about a 30-year super cycle in Australian property, beginning, I guess, in the eighties when financial deregulation took place. Is there any sense that this is ending?

MR STEVENS: Well, I think it's a hazardous business to make definitive predictions about housing prices. They have risen quite significantly over that 30 years, and you can point to a number of factors that contributed to that. Liberalisation would've been one. So was the fall in inflation and the associated fall in nominal interest rates. And our decision as a society that when those rates fell the ones of us that were indebted, we could've put that money into other stuff: travel, culture, theatre, better food, whatever. A fair bit of it we decided that we would put into trying to live in a better-located house or a bigger house, and, of course, for us all collectively to do that at once, that's not possible, so prices rise. So

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a bunch of decisions we took as well as some other factors that were going on. It's all part of the story. It's a big complicated story.

MR UREN: Just before we leave the financial crisis, one of – very signal feature of it was the rollout of pretty aggressive physical stimulus in Australia, but around the world. Reserve Bank wound up lifting rates while that stimulus was still being rolled out as the crisis proved to be perhaps less critical than had been feared in the darkest days of '08 – late '08/early '09. Do you – is your feeling that it was – you know, was it excessive? Are there learnings that you think we should be making from that exercise?

MR STEVENS: Well, I think the stimulus packages – the first one, which was in late 2008, and I think there was a subsequent one early the next year, particularly that first one – was probably the most effective and best-timed fiscal stimulus we've ever seen, certainly for a very long time, and it was quite effective. By the middle of 2009, it was quite apparent that, far from having a pretty significant recession in Australia, which was what we feared at the end of 2008, we'd had a brief downturn and then the economy had returned to growth, and so we were recalibrating our thinking about the appropriate interest rate.

That said, I think the highest the cash rate got to was the same number as the lowest it got to in the wake of the early nineties recession, so it wasn't that high. And then subsequently in 2011 it started to come down again. You could probably take – you know, different people will draw different lessons, I think, from that episode for fiscal policy. I think you could quite respectively draw the lesson that very early and targeted stimulus was quite effective. Another lesson you might draw was that the road back to fiscal consolidation, once it's clear that the immediate danger has passed, is actually a very difficult and long road. So it's proving to be: it's always hard to get that consolidation, and I think it's probably become harder in a world where terms of trade are weak, or weakening.at least, where inflation's low and where the nature of public discussion about particular measures is so partisan, as it is these days.

MR UREN: You spoke last week about inflation targeting as the most effective way of anchoring decision-making. The point at which you took up the governorship – the idea of the single target, the single instrument, central bank independence was sort of a very clear and straightforward framework. Now if you look at the world of central banking, financial stability is much higher up the list of priorities and there are multiple instruments from forward guidance, macroprudential ..... you know, are we back, in a way, to the much more complex world of central banking that prevailed until the 1990s?

MR STEVENS: Well, I think we're in a world that's more complex than a particular golden period for central banks, which actually wasn't that long in the historical sweep, but that period in the – you know, from some time in the early nineties through to say about 2006, there was a golden period for the global economy. This is the so-called 'Great Moderation' or, as Mervyn King calls it, the

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‘Great Stability’. It seemed as though just gentle tweaks on overnight interest rates were enough to keep everything on an even keel. I mean, when you think about it, we should never have really been lulled into thinking that it could be that easy indefinitely because it hadn’t been in the past, and, of course, it’s proved not to be
5 that easy or that straightforward subsequently.

I’d also say that the inflation target as adopted here, you said it’s a single target. Not quite, because the Reserve Bank’s always had the dual mandate, really, full employment – and you have to, of course, think about what you mean by that – as
10 well as stability of the currency, which we call price stability, and a broader ‘prosperity and welfare’ of the citizens leg. The way we configured the inflation target with its medium-term emphasis, you were supposed to care about what’s happening in the real economy and kind of build that into how you thought about your long-run target and your long-run outcomes, that was always a key feature of
15 our system.

So it was never an obsessive ‘inflation only and nothing else’. We never had that model, and that’s why when we were first adopting inflation targeting, some of the purists didn’t really think we were serious. But I think history shows that the
20 emphasis on medium term, adequate flexibility, but still something to discipline you over the long run, that was the right model. Financial stability, well, actually, if you look back at the record here and the sorts of things that we’ve said and the research that’s been done and the speeches that various of us have given, I think you should see that there was always a sense that these financial things matter, and an awareness
25 that the way monetary policy works is through a financial sector.

So we’ve always been trying to grapple with leverage and the way the financial system responds to what we do and the way asset prices interact with all that. We’ve always tried to grapple with that. I can’t say that we’ve had the perfectly neat set of
30 equations to describe that, no, but we’ve always thought about these things. And so the more complex world that we collectively as central banks find ourselves in now, I wouldn’t say that we foreshadowed or predicted all that, but these are things that we have tried to grapple with over the years, and we’ve tried to avoid being unduly doctrinaire in narrowing down inflation targeting. I think that was appropriate.
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MR UREN: Something you – when macroprudential was first spoken about in the wake of the financial crisis – obviously it’s been spoken about before that, but when it came to the fore, you expressed some scepticism about it and you – I think you mentioned that if it prevailed for too long, then it was basically going to be saying to
40 you that your pricing of credit was wrong. I think it’s getting on for three years now that APRA’s had its limits. Is that right? I think that is.

MR STEVENS: I think probably at the end of 2014 was when that was first being
45 articulated and, I defer to others on the exact timing, but 2015 was

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certainly a year in which the, the visits to the banks and the look at the standards and all that really got going in earnest. And you can see the effect of that in the way the banks started to reprice things, which was, I guess, a second half of 2015 phenomenon, I would say. But your point is that we're using these tools and time's
5 going by?

MR UREN: Yeah.

MR STEVENS: Yeah, well, that's right. Actually, I would say that the things that
10 have been done have probably been more effective than I had hoped at the margin, so that's good. I still think that if we have a world where credit is, in some sense, underpriced for a long period and you're attempting to kind of contain the borrowing by regulatory measures, I think, in the longish run, that probably doesn't work. And my reason for saying that is that's really what we were trying to do in this country for
15 quite a long time up until financial regulation occurred.

MR UREN: Yeah.

MR STEVENS: And I suspect that if we sought to contain credit growth for a
20 lengthy period with regulatory tools, we probably would end up relearning those lessons. But thus far, in the sort of horizon over which we have been using – or APRA has been deploying these tools, and ASIC also did some things, they have been of reasonable effect – that's been helpful, I think.

25 MR GLYNN: Would you describe it as a conversion of sorts, then, to macroprudential tools?

MR STEVENS: Not quite. But – I would describe it as we, as a group of regulators, tried to deploy the things that we had to deal with the situation and they
30 have had positive effects. And I would say, probably, the work that APRA did on lending standards, that may well have been more powerful than just the announce ment of the 10 per cent thing. I suspect it's that deeper work going to look at actual practices prompting some tightening up there. That's been of more durable value and that, of course, is worth doing anyway regardless of the macroeconomic
35 situation. So I mean, in a way, that's saying we're believers in proper, rigorous supervision and we always have been.

MR GLYNN: Moving on now to more contemporary Australian economy issues, I wanted to ask you about the Australian dollar. Once again, it seems like it's – it may
40 be becoming uncomfortably high and there is said to be a reflex in the markets to want to push it higher, given some of the forces in – elsewhere in the world, the relative interest rates and a – we'll call a misfiring US dollar. How do you

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characterise the Australian dollar at the moment and is it likely to become a thorn in the side of a - - -

MR STEVENS: Well, conditional on the forecast we have, including for terms of trade, growth and so on, we've been pretty clear, I think, every month that an appreciation in the exchange rate of a significant magnitude could easily complicate the transition that we're trying to achieve. So that's all been said. So taking that as a given, it's still the case that all manner of assets in this country are quite attractive to foreigners. The cash rate obviously matters and the assumed future path of rates has some bearing on the way the exchange rate behaves. That's certainly true. But it's other assets than just those that clearly matter here. Infrastructure assets, commercial property that yields 5 or 6 per cent, which is by historical standards, a low return for investors in this country, but if you're sitting in Frankfurt or Tokyo or New York looking for yield, that actually, probably, looks pretty attractive. Government bonds yielding 2-ish, that looks pretty attractive for many investors. So it's not just the rate we set, even though that does matter. It's a search for yield world and this country still looks attractive because other yields look so unattractive.

That's not something that the Reserve Bank can wave a wand and make go away. Australia wants to be open to foreign capital. That's our national philosophy. I think in that discussion, it would be helpful to think about the kind of foreign capital we want. Foreign capital that builds new assets, like some of the capital that funded the mining boom. That's one thing. Foreign capital that buys up the existing assets, I'm not saying that we should be closed to that, but that's not creating new capital for the country, that's just altering the allocation of who owns the capital that's here now. And I think when we all talk about – you know, we want capital inflow, we can probably have a bit of nuance and subtlety over what kind of inflow we mean and ask ourselves whether we're attractive enough to the kind of capital that actually builds new assets.

MR UREN: I mean, on that point, there seems to be a bit of a growing pushback on foreign investment. Do you think that there are risks to Australia in that or - - -

MR STEVENS: I think you're referring to the recent decision, but – and I have no comment - - -

MR UREN: No, I'm talking more – much more generally.

MR STEVENS: Well, let me be clear: I don't want to comment on those particular things because I don't know enough about them and it's beyond my brief. I think, as a country, we're probably a little bit two-minded about foreign investment. We get nervous when foreigners buy land or other assets, but I've never met a businessperson yet who doesn't think that foreign investment as a general thing is good. So that's why I say that, maybe, some more clarity about what we mean by foreign investment, what kinds of foreign investment are better than others, what kind helps us grow our capital stock and our country and how to manage all of these things, that's probably a constructive debate we might hope to have. Whether we will have it would hinge a lot on you gentlemen and others like you, of course.

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MR UREN: The issue about growth – look, for growth, we've got the housing boom, construction – housing construction is going to ease off, non-mining investment.

5 MR STEVENS: Eventually, yeah.

MR UREN: Non-mining investment has been – and has remained surprisingly weak here and around the world, I know, it's kind of a global issue.

10 MR UREN: But do you think that – and productivity remains – also remains very weak. Do you think that – somebody said that the growth challenges are going to be greater for Australia than maybe the inflation challenge, given that a period of – some form of weak pricing is actually not too bad for the economy.

15 MR STEVENS: Well, at the moment, it seems unlikely that our problem in the next couple of years is going to be inflation being too high. That seems unlikely, as best we can tell. And we still – we have reasonable prospects for growth over the next couple of years, I think. If it turned out that growth was a bit better than we expected, I think that would be welcome rather than a problem, because while the
20 unemployment rates – is in the fives, we still have some spare capacity that we could use up and it would be good if we could do that. As you know, whether monetary policy could just dial that up is something that I am a bit dubious about. We should do what we can do, but I'm not sure that what the central bank can do is in itself sufficient.

25

All that said, growth looks okay, but even more growth than we presently forecast would be good, actually, for a couple of years, at least, because we've got that output gap, if you want to put it that way, or spare capacity that we could use. And I rather doubt that inflation would be a problem over that horizon.

30

MR GLYNN: Do you see the scenario as being more likely as opposed to one that has low inflation and low growth?

MR STEVENS: Are you asking do I see higher than expected growth as more
35 likely than lower than expected?

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MR GLYNN: No, the scenario that has low inflation and low growth, given what's happening with the housing market and tapering off of the export volumes.

MR STEVENS: Well, there's going to be a lot of moving parts, right? So the drag from mining investment falling, that's going to finish. It's true that the surge in dwelling construction, that's going to fade. It has to, because there won't be much point building many more houses than we really need; you're just digging a bigger hole in some future year. And as you say, the surge in LNG exports also will tend to have – you know, reach a peak. Whether there's a neat coincidence of all those things, so the economy stays on a reasonable growth path, which of course is what forecasts say, or whether one will happen before the other, I mean, we just can't know. As best we can tell, it's going to work out not too badly. My point simply is that if it worked out with a bit more growth than we presently have, that's probably not going to overheat the economy seriously over a couple of years over the - two year horizon.

MR UREN: You've spoken about the difficulty of getting reform going in Australia and part of that, as was mentioned last week, is perhaps the lack of suitably hardnosed discussions in parliament. But you know, I'm just wondering whether you've got reflections on just why we are at this impasse. You know, is there something that – you know, we went through that fabulous period in the 80s and 90s where there seemed to be a consensus. Do you think that the consensus has broken down or are we short of – you know, in the 80s and 90s, we had a lot of ideas of what needed to be done. Is the – do we have less sense of what needs to be done?

MR STEVENS: I'm not sure. If we were to take productivity, there is the list that Gary Banks compiled several years ago now.

MR UREN: For you?

MR STEVENS: Well, for others, who wanted to know what was on my list.

MR UREN: Yeah, yeah.

MR STEVENS: So is it that we don't know what needs to be done? Is it that we don't have sufficient of a burning platform to prompt us to actually act? Is this unique to us? When I look around the world, I'm not sure that we're the only country that has – well, we're clearly not the only country that has a rather fractious political discussion, difficulty in building support across the community for difficult things that might need to be done. That's patently true in various other places as well and we all know – we could all name them. So it's not just us.

So I'm not sure that I have a – you know, an easy-packed answer to why we're not making progress. It's hard. Genuine reform is hard to do. It takes a combination of

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leadership, the right circumstances and being ready. When you think back to the period that we now look back on as the golden era, it probably looked a bit more messy when you were living through it than it might look, looking back. But you had strong leaders, for sure. You had a sense that we had no choice, we've got to do it. And I think you also had the opinion-shapers in the media and bureaucracy and politics who were ready. And they were ready to do things because there had been a very long period, stretching back a couple of decades, of individuals and institutions who were making the case for tariff reform for financial liberalisation and so on. Those people made that case for a long time before it actually was put into practice. You had to have, I think, that building up of the intellectual framework, the arguments, the evidence, the firepower. And when the moment came, you had a leadership who had absorbed all of that and knew what they wanted to do and you had a moment in time that they seized and a sense of a bit of a burning platform. You had all that come together and then very, very big decisions got taken. So it takes that combination.

MR UREN: Is part of the problem, as I think Mervyn King argues, is that the financial crisis has not given birth to the – you know, a new economics in, maybe, the way that the 1930s did? That we don't have that – we don't have the clear agenda?

MR STEVENS: Well, I would say the financial crisis has had us going back to some of the textbooks that drew on that earlier period and everybody's gone back to reading their Hyman Minsky and their Keynes and so on, quite rightly. And it's also given birth to a substantial – very large, actually, regulatory effort in the financial space. But it's true that it hasn't given us some – there's not some wonderful new vista of a new economics. I'm not sure it's realistic to expect that.

MR GLYNN: In bringing together that mindset, that impetus for reform, can the Reserve Bank be doing more to champion that or is it the case that it's doing enough – doing - - -

MR STEVENS: Well, the entities that did so much in the history I'm talking about were the old tariff board, IAC, that is now the PC – well, they're doing their job. Key people in the media – your Alan Woods and people like that. So, there's a legacy there for you guys. There were particular MPs who – some of these guys were only backbench figures, actually – Bert Kelly and so on. So it takes all of that. The central bank are – well, I'm going in a few weeks, but I've always felt our responsibility was to do our job, be clear about what we can't do and to lend our support within the limits of our remit to those who are trying to push the case in these other areas. I feel we've done that.

MR GLYNN: One might argue you've got a lot of capital to spend, you personally and in terms of – going to that discussion, maybe the new Governor has some of that to spend as well.

MR STEVENS: - - - it will be for him to determine how he wants to proceed, obviously. We stand for sensible economics, telling the truth, trying to get people to see the issues. We don't weigh in too much further, because, you know – yes, we – I think we do have a fair bit of credibility, but you don't keep that credibility if you

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don't use it wisely. And the issue for us is always how to contribute in a way that's constructive. But people might think "Well, that was constructive, but isn't the Reserve Bank kind of stepping in beyond its mandate and its remit," so we have to walk that line.

MR UREN: Yeah. So you mentioned last week the potential for targeted government spending in the infrastructure area.

MR STEVENS: Actually, I didn't say that, but I have said in the past that there's nothing wrong with borrowing for the right infrastructure.

MR UREN: Yeah, yeah.

MR STEVENS: I have said that, yeah.

MR UREN: Yeah. Is the – does that consideration bump into the consideration at the moment around Australia's Triple A credit rating as - - -

MR STEVENS: Look, I don't know – I'm not sure how the rating agencies would view more borrowing for infrastructure purposes, but I think it ought to be possible, in principle, to explain to the people who lend to us and who rate the debt,

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that this debt is against this set of assets and the money we spend on welfare and pensions and running the government and so on, we raise that in taxes. It strikes me that it ought to be possible to explain that, I'd have thought. And – so I guess I don't – I wouldn't easily accept that you can't be a AAA country and have an appropriate
5 amount of public debt against public assets.

Okay. Where's 'appropriate', and how are you going to govern it? The real questions here, as I've said before, aren't finding the money and I don't think the real questions are about credit ratings. They're "Are you doing the right projects? Are
10 you governing this correctly? Dare I say it: have you got the relevant decisions appropriately out of the day-to-day politics so that people can be confident 'Yes, this has been subject to appropriate cost-benefit scrutiny, we can trust that and we can trust the process that finds the funding to deliver it'? Have you done all that?" That's actually harder – that is much harder than finding the cash. There's a lot – I
15 mean, there's a lot of money out there looking for yield.

That's the easy part. It's these governance questions which the political process would have to structure appropriately in order for the citizens and the lenders and everybody else to feel confident that, yeah, it has all been done properly.
20

MR UREN: With that said, do you think it – could you comment on the importance of retaining the Triple A credit rating?

MR STEVENS: Well, I think it's important for us to retain credibility and
25 confidence in capital markets and the Triple A rating is a metric of that. It's probably not the only metric. You could look at what you're actually paying to borrow as well. But it's a metric. It's one that we ought to consider as one of a number of metrics. In this country, for 200 plus years, we've imported other people's capital and we've grown rich by doing that. We want to keep doing it and you need
30 to maintain confidence and credibility in order to do that. And whether it's by elevating the Triple A rating per se as the key metric or whether you should – I would favour having that alongside various other gauges as well. But you do want to retain that confidence, for sure.

35 MR GLYNN: In terms of the global economy, which is absorbing things like Brexit at the moment and all of the other dynamics that are in play, you look to the US at the moment. Would the world economy – or is the world economy ready for a US interest rate increase?

40 MR STEVENS: I mean, is it ever ready? It's probably as ready as it ever is and can be. You know, the first one was very well telegraphed. As I've said before, the most telegraphed Fed change in world history – and it actually went very smoothly, really. I don't see any reason why the second one, whenever that comes, would not go as smoothly. People understand the way the Fed's thinking about the economy,

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they understand there's going to have to be a return to normal – normal's not the same place now, but people know that normal isn't here. People know all that. So I can't see why the global economy is really any less ready for number two than it was for number one. It's as ready as it has ever been in any of the other episodes.

MR GLYNN: Do the central bankers still need to be brave in these decisions?

MR STEVENS: Well, it's always hard to raise rates, but that's not new. And I – you know, I'm not amongst those who – you know, want to criticise Janet Yellen for – I mean, they're doing their job. It's always hard to raise rates anywhere.

MR GLYNN: Is there some chance that you might get a perverse effect – rates are rising in the States, we're heading back to some sense of normality. Isn't that a reassuring thing?

MR STEVENS: Well, I would have thought so. I would have thought that. This is also something we've said many times: if the US economy doesn't need that much support now, if it needs a bit less, that's actually good news.

MR UREN: Are the risks around moving early or moving late symmetrical?

MR STEVENS: Well, the Fed has said not. As I understand it, they've said, the scope to ease again and to restart recovery if it faltered is considerably smaller than the scope to tighten if you end up seeing inflation. I think that's what they've said and you can see the logic to that. So they've said the risks are not symmetrical as far as I can see.

MR GLYNN: It seems to be a trend or a popular movement evident in the world economy now that seems to have the average person thinking they're not benefiting from trade agreements and globalisation. We see this maybe manifesting in the US election campaign and we see it manifesting, perhaps, in Brexit and other certain areas. Is this – does this trend concern you as a central banker who has watched the US – watched the world economy for a long time?

MR STEVENS: I think it is concerning that people – that, we haven't been successful enough in explaining to people what the benefits of trade are and it's also – I think it's a reasonable – it's legitimate for the community to be concerned that maybe the losers of not just trade, but technological change and so on – that these people in our community, most people would think they should get a bit of help to adapt and be part of the future. So those things are a concern. In the end, the gains from trade are really – in their purest sense, they're a gain of specialisation. I don't grow my own food and I didn't build my own house. If I had've, I would be starving and living in a shack. I do things that I'm better at and get paid to do it and other people built my house, grow my food, etcetera. And really, that's the oldest principle in economics, specialisation and, really, freer trade is just an international version of that.

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MR GLYNN: Are you concerned, though, the period ahead may see a push back on that and that – and an added head wound to global recovery?

MR STEVENS: It's concerning that – it has to be concerning to economists, I think,
5 and to policymakers that the cause for integration and trade seems so much more difficult to prosecute. I mean, yeah, that is a concern. But the question is "What do we do about that?" And I guess the answer to that is try harder to explain.

MR UREN: Thank you very much.
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