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Reserve Bank seeks 3.5 per cent wage growth

Reserve Bank Governor Testimony

- **Reserve Bank Governor Testimony: Reserve Bank Governor Philip Lowe has appeared before the House of Representatives Standing Committee on Economics.**

Testimony by the Reserve Bank Governor can have a major impact on interest rate expectations.

What does it all mean?

- The Reserve Bank Governor said he had a two-pronged strategy. He wanted to keep interest rates low to reduce unemployment and lift wages. The second part of the strategy was that Governor Lowe wanted to talk of the benefits of stronger wage growth. He was concerned that annual wage growth near 2 per cent was seen as the new norm. Governor Lowe said that a 2.5 per cent inflation rate was consistent with a 3.5 per cent lift in wages.
- The Reserve Bank Governor has continued to emphasise that any lift in wage and price growth over 2018 will be gradual. While the next move in interest rates is expected to be up, there is not "*a strong case for a near-term adjustment of monetary policy.*"
- Questions centred on the job market. The Reserve Bank believes wages across the globe are less responsive to unemployment as we've seen in the past. Lower wage growth has implications for spending.

Prepared comments

- The prepared remarks by the Reserve Bank Governor can be found here. http://www.rba.gov.au/speeches/2018/sp-gov-2018-02-16.html
- **Global economy:** *"In a number of countries, the unemployment rate is now below conventional estimates of full employment. Inflation has remained low, partly reflecting the fact that wage growth has been quite subdued despite the low unemployment rates. Low inflation has meant low interest rates."*
- **Australia:** "*Over this year and next we expect GDP growth to be a bit above 3 per cent, which is faster than our current estimate of trend growth for the Australian economy. This outlook has not been affected by the recent volatility in the equity market."*
- **Unemployment:** "*The unemployment rate, though, is likely to remain above conventional estimates of full employment in Australia for some time."*
- **Household balance sheets:** *"We continue to look carefully at household balance sheets. On balance, our assessment is that there has been some containment of the build-up of risk in this area."*
- **Household debt:** *"While the Reserve Bank does not target housing prices or household debt, it would be a good outcome if we now experienced a run of years in which the rate of growth of housing costs and debt did not outstrip growth in our incomes in the way that they did over the past five years."*
- **Job market:** *"…we hear reports of pockets where the labour market is tight and firms are finding it hard to find workers with the right skills. In some of these areas wages are now rising more quickly than previously, but many firms remain wary of adding to their cost base in the current environment."*
- **Interest rate outlook:** *"Our central scenario for the Australian economy is for a further reduction in the unemployment rate and an increase in inflation towards the mid-point of the target range…"if this is how things play out, at some point it will be appropriate to have less monetary stimulus and for interest rates in Australia to*

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move up, as is already happening in some other countries. In other words, it is more likely that the next move in interest rates will be up, rather than down."

- **Interest rate outlook:** *"The timing of any future move will depend upon the extent and pace of progress that we make in reducing the unemployment rate and having inflation return to target. As things currently stand, we expect that progress to be steady, but to be only gradual. Given this assessment, the Reserve Bank Board does not see a strong case for a near-term adjustment of monetary policy. We will, of course, keep that judgement under review at future meetings."*

Selected questions & answers

- **Why the improvement in 'animal spirits'?** Factors include: lift in the global economy; unwinding of the end of the mining boom nearing an end; low interest rates; businesses starting to invest; infrastructure investment pickup.
- **Philip Lowe and Luci Ellis (Assistant Governor – Economics) reflected on increased participation rates**, especially by women. Confirmed that the "full employment" level is around 5 per cent.
- **Question on the need for Australia to have an open economy.**
- **Why the pickup in consumer sentiment?** The main factor has been the growth of jobs. A lift in wages would boost sentiment even further. Wages should lift over the next year.
- **A credit rating downgrade?** Lowe believes it would be more of a political rather than economic event. It would matter through a dent to confidence. "Let's hope it doesn't happen."
- **Question on APRA measures to slow home lending.** "Risks have been contained."
- **Question on factors responsible for the slowdown in Sydney home prices.** Lowe highlights the big lift in supply and less foreign investment. And Lowe cites "weight of gravity". Lowe is much more comfortable about the balance in housing markets.
- **Question on Luci Ellis' latest speech on "full employment" level.** Ellis says that there is considerable uncertainty about the 5 per cent estimate – it is non observable, need to re-assess the level with changes in wage growth. The current estimate of "full employment" is based on new improved models.
- **Question on wage forecasts.** Lowe says that central banks across the globe have been too optimistic on wage growth. Wages across the globe has not been as responsive as we've seen in the past to jobless rates.
- **Question on home building.** Over the last 20 years there has been a big lift in higher density housing, providing more choice and allowing more people to live near cities. Luci Ellis believes this has been a positive development.
- **Budget.** Lowe believes that it is important that the projected reduction in the budget deficit remain on track. It is important on the grounds of intergenerational equity. And a stronger fiscal situation is "a form of insurance" – Australia's good fiscal situation during the global financial crisis allowed us to weather the storm.
- **Question on low wage growth.** The Reserve Bank Governor said he had a two-pronged strategy. First, he wanted to keep interest rates low in order to reduce unemployment and lift wages. The second part of the strategy was that Governor Lowe wanted to talk of the benefits of stronger wage growth. He was concerned that annual wage growth near 2 per cent was becoming seen as the new norm. Governor Lowe said that a 2.5 per cent inflation rate was consistent with a 3.5 per cent lift in wages.

What are the implications for interest rates and investors?

- Official interest rates are set to remain on hold for some time. The job market – especially changes in wage growth – is the area to watch.

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