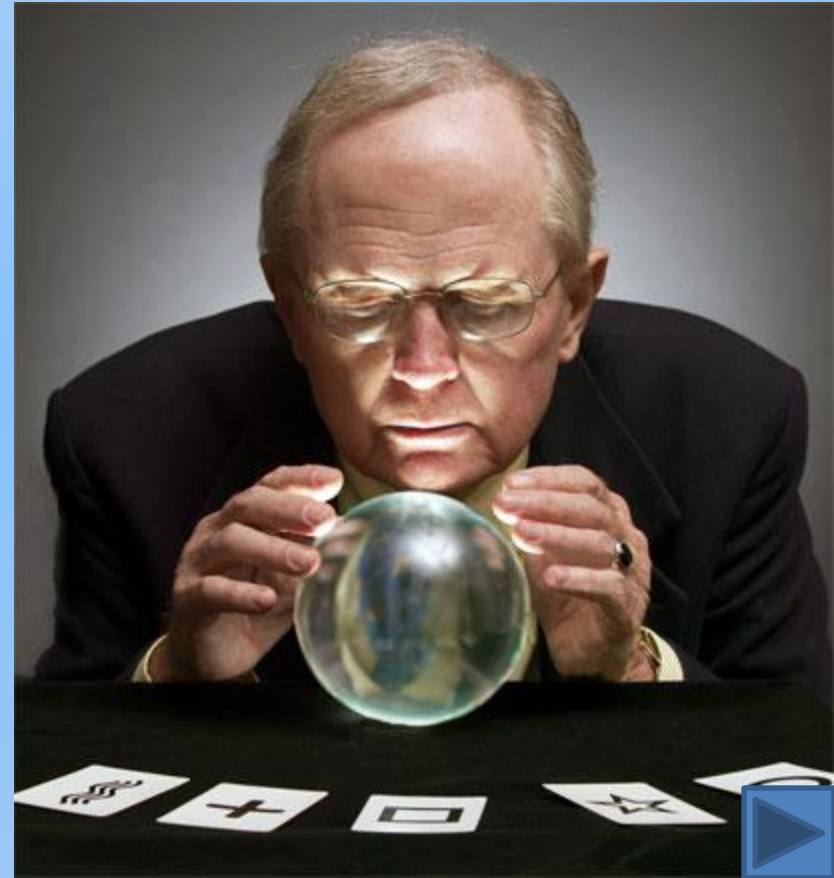


Michael Darby's helpful guide to the



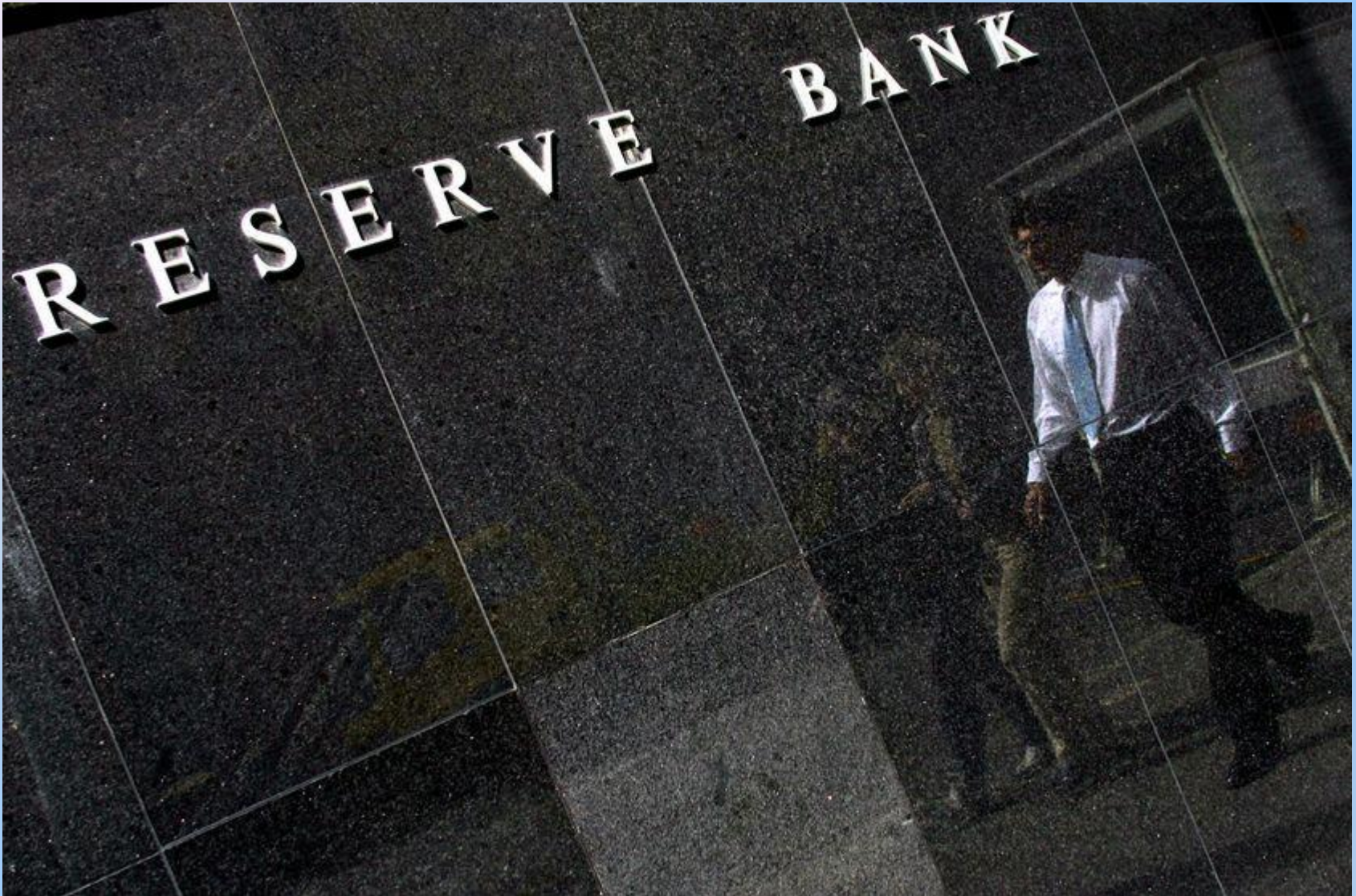
**RESERVE BANK
OF AUSTRALIA**

**Never take yourself
too seriously**





Who's running the country Kevin O'Shevin? You or the . . .





Seventy two percent of Australians believe that the Reserve Bank has only one job, which is randomly jacking up interest rates when we owe money, and randomly bringing down interest rates when we don't owe money.

Twenty four percent of Australians don't know the difference between a Reserve Bank and a reserve tank.

Four percent of Australians might know what the Reserve Bank really does.





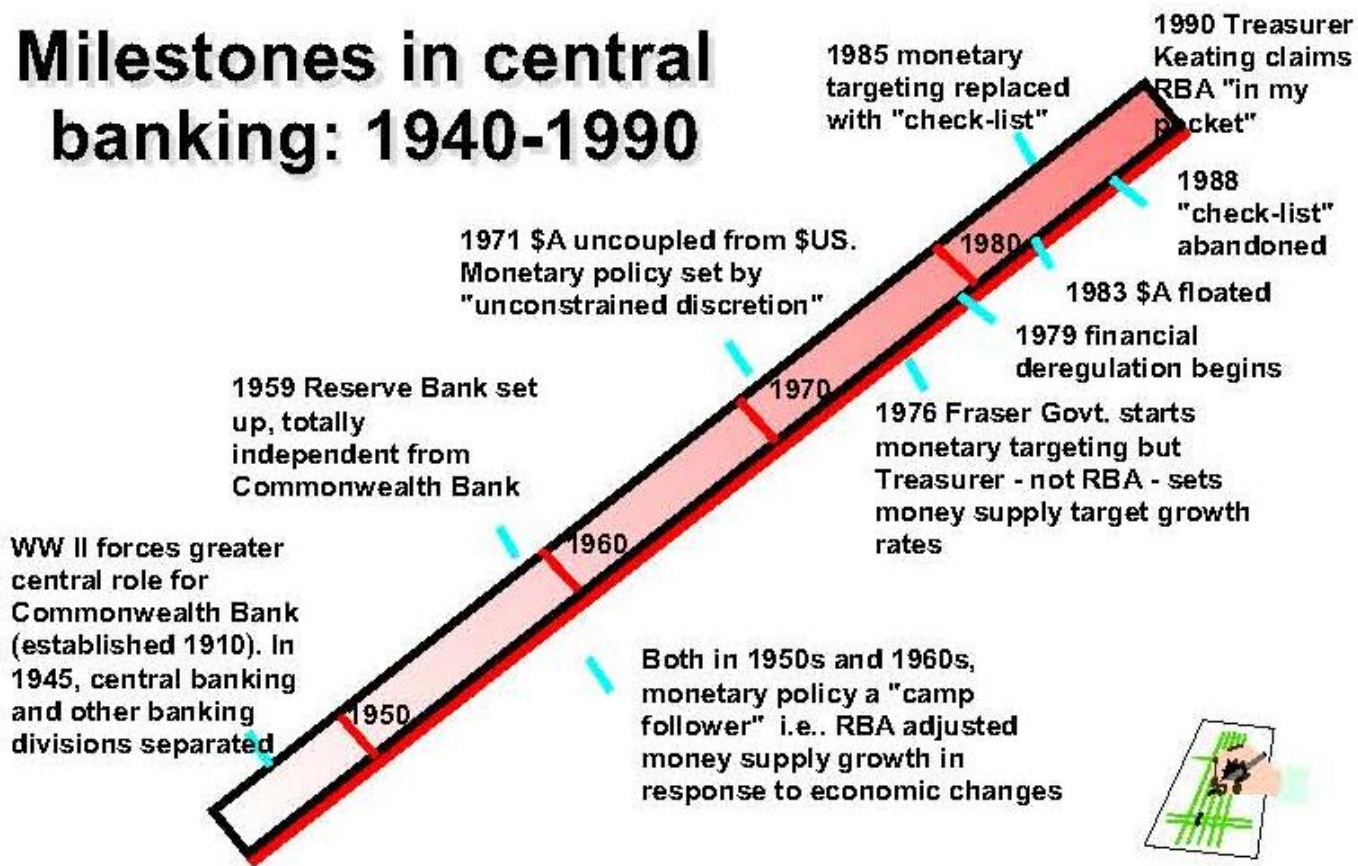
Popular cartoonist Andrew Weldon has earned his reputation for accurately interpreting the mood of the Australian people.



First of two excellent timelines by Dr David Clark School of Economics, University of NSW.



Milestones in central banking: 1940-1990



HISTORY of the RBA part 1

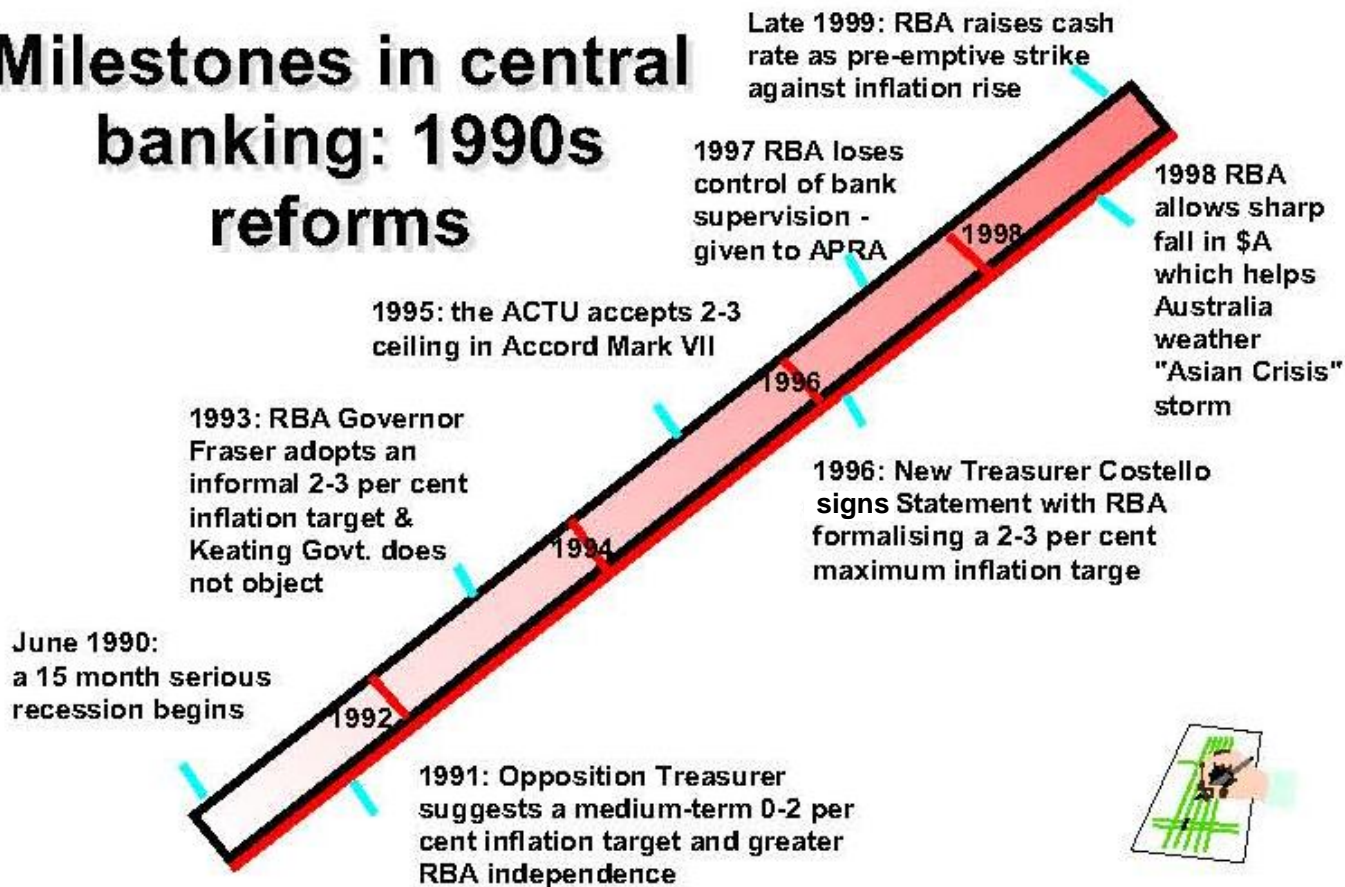


Second of two excellent timelines by Dr David Clark School of Economics, University of NSW.



HISTORY of the RBA part 2

Milestones in central banking: 1990s reforms



Because of governmental misinformation over decades, most Australians have an erroneous concept of inflation which actually relates to the symptoms of inflation. For decades we have been accustomed to hearing the deceptive mantra *inflation as measured by the consumer price index*. Let's call this the **perceived rate of inflation**.





The real definition of inflation has been concealed by a succession of Governments. Inflation is an increase, directed by the Reserve Bank, in the face value of currency, which flows through to the expansion of the money supply M3; and this rate of expansion has been running as high as twenty percent per annum. Let's call this expansion of M3 the **gross rate of inflation**.





Recent Australian governments did nothing to restrain perpetuation of the myth that upward manipulation of interest rates has some efficacy in combating inflation. Use of the interest rate to reduce demand can only exert downward pressure on some prices, wages and profits. Downward pressure on prices, wages and profits does nothing about the cause and actuality of inflation; all it can achieve is a temporary suppression of some of the symptoms of inflation.

Interest rate manipulation persecutes some Australians and benefits others, not a good idea in the nation of the *fair go*.





One can discount the gross rate of inflation by estimating the percentage of the currency which is lost, destroyed, hoarded or collected. One can also discount the gross rate of inflation by taking into account the rate of population increase. Let's call the resultant figure the **nett rate of inflation**. There is a case for describing the nett rate of inflation as the **real rate of inflation**.

With the **gross rate of inflation** so high at over 20%, there is inevitably a large gap between the **nett rate of inflation** and the **perceived rate of inflation**. What fills the gap? Who or what picks up the tab?



The perceived rate of inflation can be very much lower than the nett rate of inflation because of a range of factors including:

- Persistent real reduction in the price of technology as the result of entrepreneurial activity. A spectacular example is the price of electronic data storage which for decades has dropping consistently at around 30% per year.
- Productivity increases as the result of improved work practices.
- Productivity increases through technology. Mining and agriculture plus land, sea and air transport are among the industries where cost reductions are continuous and obvious.





More factors making the perceived rate of inflation lower than the nett rate of inflation

- The inflation-induced chronic erosion of living standards for individuals on fixed incomes
- Similarly, the longer hours and reduced profits of small business people who cannot readily increase their prices to match rising costs. Their stress absorbs a great deal of inflation.
- Improved corporate efficiency and hence lower prices achieved through mergers and acquisitions, noting that mergers and acquisitions do not guarantee lower prices
- Improved efficiencies and hence lower prices achieved by denationalisation, noting that denationalisation does not guarantee lower prices.



More factors

- Price falls (especially on imports) because of appreciation of the Australian dollar against other currencies. The corollary is a reduction in purchasing power of incomes earned through exports including farming, mining, manufacturing, tourism and education.
- Price falls because of the removal of tariffs.
- Reduction in the tax component of prices.

The last two items were significant in holding back the perceived rate of inflation through most of the Howard years. When tariff reduction effectively ended and tax reform slowed, perceived inflation began catching up with nett inflation. The Howard Government did not seize the opportunity of continuing with the momentum by reducing the rate of GST, or even better, by phasing out the GST.





The perceived rate of inflation has from time to time been adversely influenced by wars, by strikes and by natural disasters. The Reserve Bank has been allowed to get away with using the interest rate weapon to punish the economy for natural disasters.

Australians who write cogently on these matters include (in alphabetical order) Gerard Jackson, Ron Kitching, Ron Manners and Doug Robertson.





Members of the Reserve Bank Board attending the August 2007 Board meeting at the Bank's Head Office in Sydney. From left to right, Graham Kraehe, Warwick McKibbin, Jillian Broadbent, Glenn Stevens (Governor and Chairman), Ric Battellino (Deputy Governor), Ken Henry (Secretary to the Treasury), Donald McGauchie and Roger Corbett.

Here they all are, *Club Diocletian*, a nice bunch of people including a solitary woman. Let's find out what the Reserve Bank really does, from the Reserve Bank Act.






RESERVE BANK ACT 1959

8 General powers

The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:

- 
- a. to receive money on deposit;
 - b. to borrow money;
 - c. to lend money;
 - d. to buy, sell, discount and re-discount bills of exchange, promissory notes and treasury bills;
 - e. to buy and sell securities issued by the Commonwealth and other securities;

These functions are better performed openly in the marketplace by private institutions and investors.





RESERVE BANK ACT 1959

8 General powers (continuing)

The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:

- f. to buy, sell and otherwise deal in foreign currency, specie, gold and other precious metals;



This provision allows the Reserve bank to speculate against the A\$ or to ramp up the \$A at will.



RESERVE BANK ACT 1959

8 General powers (continuing)

The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:

- g. to establish credits and give guarantees;
- h. to issue bills and drafts and effect transfers of money;
- i. to underwrite loans; and



More functions which are better performed openly in the marketplace by private institutions and investors.



RESERVE BANK ACT 1959

8 General powers (continuing)

The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:

- j. to do anything incidental to any of its powers.




Those nice people in the photo have a blank cheque.
Just as well there is a woman on the team .



RESERVE BANK ACT 1959

34 Issue, re-issue and cancellation of notes

- 
- (1) Subject to this Act, the Bank may:**
 - a. issue Australian notes;**
 - b. re-issue Australian notes; and**
 - c. cancel Australian notes.**

 - (2) Australian notes shall be printed by, or under the authority of, the Bank.**


There it is, in Clause 34 brackets one. The Reserve Bank may issue Australian notes. No restrictions. No limitations. Not even a concession to the bleedingly obvious point that every note issue dilutes the value of the existing notes.





RESERVE BANK ACT 1959

35 Denominations of notes



Australian notes may be issued in any of the following denominations, namely, One dollar, Two dollars, Five dollars, Ten dollars, Twenty dollars, Fifty dollars or One hundred dollars or in any other denomination that the Treasurer, by instrument in writing published in the *Gazette*, determines

In 1966 when Australia adopted decimal currency no-one imagined that there would be a fifty dollar note or a one hundred dollar note, or that the one dollar and two dollar notes would be abolished. Without even an Act of Parliament, Australia can have a \$1,000 note. \$10 in 1968 could buy around 50 meat pies. Forty years later, \$10 might buy three meat pies. Thank you, Reserve Bank.



RESERVE BANK ACT 1959

44 Other persons not to issue notes

(1) A person shall not issue a bill or note for the payment of money payable to bearer on demand and intended for circulation.

Penalty: 50 penalty units.

Note: Chapter 2 of the *Criminal Code* sets out the general principles of criminal responsibility.

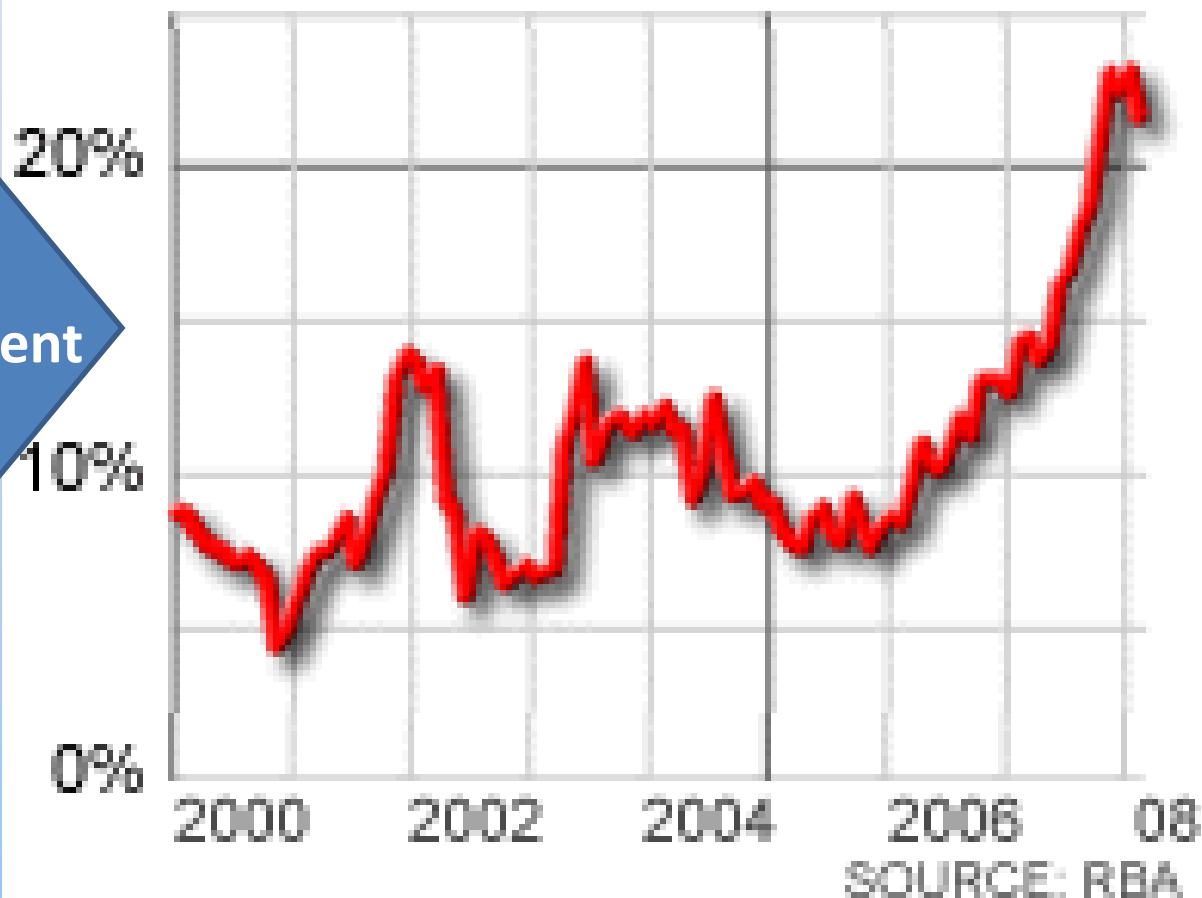
(2) A State shall not issue a bill or note for the payment of money payable to bearer on demand and intended for circulation.

This is the provision which guarantees the Commonwealth Government its monopoly on counterfeiting. Inflation was never a problem when private companies issued notes backed by genuine assets.



Expansion of
the money supply
is the essential element
of inflation

M3 money supply growth % change year-on-year



Wanton expansion of the Money Supply is a bad thing. Doubling the rate of expansion is highly irresponsible. Yet in accusing the former (Howard) Government of causing inflation, the current (Rudd) Government has failed to mention the expansion of the money supply. Who is kidding whom?



This is where
chronic expansion
of the money
supply can lead



Paying for lunch for eight with Z\$6m in Zimbabwe, Friday 21 Sept 2007



The five hundred billion dinars note (Serbia 1994)



An outcome of
chronic expansion
of the money
supply

With hyper-inflation, as in Serbia in 1994 and as in Zimbabwe currently (April 2008) most currency notes buy less than their own weight in toilet paper. Australians ignore at their peril the risk of hyper-inflation.

If it has any reason to exist, a Reserve Bank's first responsibility must be to preserve the value of the currency. Outrageous examples of irresponsible behaviour of other Reserve Banks constitute no defence to the charge that the Reserve Bank of Australia demonstrates inadequate commitment to preserving the value of the currency and maintaining the purchasing power of savings.

A German woman heats her house with worthless money, 1924





RESERVE BANK ACT 1959

34 Issue, re-issue and cancellation of notes

- (1) Subject to this Act, the Bank may:
- a. issue Australian notes,
 - b. re-issue Australian notes; and
 - c. cancel Australian notes.

Let's take another look at Clause 34 (1), which imposes no restrictions or limitations on the power of the Reserve Bank to issue Australian notes, and which opens the door to rampant inflation.





RESERVE BANK ACT 1959 AS AMENDED 2008

34 Issue, re-issue and cancellation of notes

Here's a suggestion for an overdue amendment to the Reserve Bank Act.

- (1) *Subject to this Act, and subject to the qualification that any percentage increase in the total note issue in any financial year must not exceed the percentage increase during the previous financial year of the total Australian population plus the replacement of destroyed and damaged notes; the Bank may:*
- a. issue Australian notes,
 - b. re-issue Australian notes; and
 - c. cancel Australian notes.

April 2008

<http://michaeldarby.net>

michael@michaeldarby.net