Future Generation
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CommSec Executive Series Interview with Dr Philip Lowe

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Gillian Bowen, CommSec, and Dr Philip Lowe, Chair, Future Generation Australia (ASX: FGX)

Gillian Bowen: Hello and welcome to the CommSec Executive Series. For years, today's guest led the board that set the cash rate for the nation. Now, he's experiencing those decisions from the other side while overseeing investors' money and supporting the next generation of Australians.

Dr. Philip Lowe is Chair of Future Generation Australia and is a former governor of the Reserve Bank. And yes, we'll also get his take on inflation, interest rates, and what it all could mean for investors. Philip, welcome to the studio.

Philip Lowe: Thanks, Gil. It's great to be with you to talk about Future Generation Australia and the economy.

Gillian: Future Generation Australia is an ASX-listed investment company that combines investing with supporting disadvantaged young Australians. What drew you to the role as you moved on from the RBA?

Philip: When I finished at the RBA, the media would say that I was the most unpopular person in the country. So, when I finished, I thought I'd take a year off and just decompress. I promised my wife I wouldn't take any roles for a year, but I broke that promise for Future Generation Australia, and I'm very glad I did.

The 10 years or so that it's been in existence, the average return has been higher than the ASX 200. So, it's better than market return and the variance of the returns is lower. So, in finance, we like high returns, and less risk, and the dividends have increased every six months. For many investors, it's a very attractive product. You get access to a curated portfolio of boutique fund managers. You get higher than market returns, less risk, and steady and relatively predictable dividends.

The key feature of Future Generation Australia is that the fund managers manage the money for free. So that means that the fund can give 1% of its assets away each year to kids who are in need. And it can give the 1% away and still earn above-market return, and we're able to do that because of the generosity of people in the financial sector.

It used to annoy me when I was at the RBA that the media and actually the politicians would often talk about people in finance as evil, money-hungry people who would just take your money out of your back pocket while you were sleeping. I have come across many people in the world of finance who want to make the world a better place. In fact, most people in the world of finance want to make the world a better place. And here, in Future Generation, I found expression for that, where people are prepared to give up their time, their effort, their money, and their fees, so that we can give money to kids' charities. So, it was a perfect combination of attributes for me, and I'm really proud to be associated with Future Generation Australia.

Gillian: When people hear fund managers and the board work for free and that 1% of the company's assets go to charity each year, some assume returns come second. You've mentioned the returns there already. But as Chair, how does the board keep both goals in balance?

Philip: Well, we have an Investment Committee that curates the portfolio, and it makes sure, as best it can, that the average returns are high. A lot of work goes into the construction of the portfolio, and the evidence is that it works. It's worked for 11 years, with an average return 1% higher than the ASX 200. The fees that these

fund managers charge would often be a bit above 1%. So, the fact that we give 1% to kids' charities means that there's a bit extra left over. And that helps support the returns to investors.

Gillian: You've sharpened the focus. That is, Future Generation has sharpened its focus on supporting vulnerable children, something you've described as a sound long-term investment. Can you explain the connection?

Philip: All the evidence is that if a child experiences a severe adverse event in their first decade of life, there's a high probability that it will affect them for many years, perhaps their whole life. A severe adverse event could be domestic violence, a period of homelessness, a severe illness, or, in extreme cases, a parent going to jail. That can affect them for their entire life. I find this fundamentally unfair in a society that values egalitarianism and the idea that we should all have equal opportunity. Things happen to kids that they have no control over, and those things can affect them for their whole life. It's unfair.

I had the privilege of growing up in a stable, loving family in regional New South Wales. We didn't have much money, but my family valued education and was supportive, and I benefited from that in my life. There are a lot of kids who aren't as lucky, and it's unfair. The charities we support help kids who are at high risk of adverse events or have experienced an adverse event, so they can have a chance at productive, happy lives as well.

It's the unfairness of it that motivates me, and I think our board as well. Through Future Generation Australia, we can help kids who are at risk or who have experienced homelessness or domestic violence, so they can move beyond the shadow of that, and it doesn't affect them for their entire life.

We're able to help kids at risk. It's about overcoming this inherent unfairness in the system, because these kids can't control these events, and they can affect them for their whole life. It's wrong. I think people with means and opportunity have a responsibility to help these kids. I'm a huge advocate for what we're doing, and I think it's a testament to Geoff Wilson, who set it up in the first place, that we're able to do this.

Gillian: You also chair the ASX Advisory Group on Corporate Governance. What should investors know about that work, and why does it matter?

Philip: Australia has a reputation for being a well-governed country. I used to go to many international meetings, and people would say Australia is a well-governed country. The political system kind of works. We have good public policy institutions.

We've got the Productivity Commission and the Reserve Bank; they're good institutions. The rule of law works, and we actually have well-governed companies. They make mistakes every now and then, but those mistakes get surfaced and then they get fixed. A reputation for being well governed is important in drawing international capital and lowering the cost of finance to the country.

In the corporate space, the ASX's Corporate Governance Principles help support the good governance of Australian companies. These principles need to be updated every now and again. In my view, they become overly prescriptive. There was duplication with other regulations, and that became difficult to read.

So, what the committee I chair said is that we should simplify them, remove duplication, and make them easier to read and more straightforward, so they can continue to support well-governed companies. One issue we've spent a lot of time talking about is board and company culture.

Many of the corporate governance failures we've seen over recent times have come about because of a problem with the company's culture. The board has a responsibility to shape the culture of the firm and to monitor how management is shaping and managing it. We hope these revised principles will continue to support Australia's strong reputation for having well-governed companies.

Gillian: If we move to the broader economy, inflation has proved difficult to contain. Interest rates remain a major focus for our economy, investors and households. The cash rate is now at a level not seen in 18 years, at 4.85%. What do you make of the November RBA decision?

Philip: Well, the RBA had to do what it had to do. Can I just, in terms of the economy, talk about a couple of issues? One is longer term, which I think is actually the important one, and then I could talk about the short term.

Longer term, the issue is our living standards have stagnated. For seven years now, there's been no advance in per capita income. That's a long period with no growth in average living standards. It comes after 35 years of very strong advancement in living standards.

Over those 35 years, that advancement was driven by four tailwinds. We had advances in technology. We had bold public policy reform that made the economy more productive. We had the China boom, which pushed up the price of our exports, and we had very favorable demographics, with a higher share of the population of working age. Put all that together, and over 35 years, average growth in per capita incomes was 1.5% a year. Fantastic. Australia moved very close to the top country in terms of average living standards and per capita income. It was a fantastic period.

Unfortunately, now three of those tailwinds have turned into headwinds. On demographics, the population is now ageing, so over time the share of the population of working age will decline. On commodity prices and the China boom, that's over. Commodity prices are still high, so that's helping. But they're not rising anymore, and they're probably likely to decline. On public policy reform, I would say many of the reforms over the past decade have made the supply side of the economy worse rather than better. Governments are no longer focusing on reforms to boost growth. They're focusing on redistribution, and we're paying the price for that. Productivity growth has stopped.

We've had essentially no productivity growth at the aggregate level for seven years. That's why we've had no growth in our living standards for seven years. The policy reforms we're seeing out of Canberra and the United States aren't advancing productivity growth. Sometimes we're tinkering at the margins, but we're not changing the things that matter.

My concern is that this stagnation in our living standards is going to continue. Demographics aren't going to help. Commodity prices aren't going to help. Maybe technology will save the day. Unless we change public policy, I think productivity growth is going to stagnate. That's the dilemma the country faces.

After 35 years of fantastic growth with four tailwinds, now we've got three headwinds. We can do something about it. But at the moment, the political system doesn't seem to do that. I think we're on a path of stagnation in average living standards. The economy's growing because the population is rising, but the slice each of us gets hasn't moved on average for seven years. That's why we're unhappy.

Another way of saying this is that the speed limit of the economy is now much slower. It's now being driven by population growth because there's no productivity growth. It's remarkable that average output per head in Australia is the same as it was seven years ago. Terrible.

That's the source of the cost-of-living crisis. We can tinker around the margins, but unless we can make ourselves more productive, we're not going to have rising living standards. The speed limit of the economy is quite slow. That brings me to the current situation and interest rates. The speed limit of the economy is slow. That means demand growth has to be slow. You learn this in high school economics. If demand is greater than supply, prices go up. That's exactly what's happening. Supply growth is weak. That means demand growth has to be weak. Having weak demand growth is problematic when governments around the country are spending so much. Public demand growth has been strong.

At the federal level, public spending as a share of the economy is as high as it's been outside the pandemic, and the states have been spending a lot as well. There's been a lot of demand coming from the government sector, and that's putting pressure on the supply side of the economy, so prices go up as a result.

The longer the period of high inflation goes on, the more concerned people become about inflation expectations becoming unanchored. The RBA had to respond to slow growth in demand in the economy to get inflation back down, because inflation has been too high for too long.

Now they're saying it'll get back to the midpoint of the target in 2028. When I was there, we were worried that if inflation wasn't back to the midpoint by the end of 2025, people might start to worry about whether the Bank was serious about inflation coming back to target. Now they're saying, well, in 2028 it'll come back to the midpoint of the target. Let's hope that happens. But they need slower growth in the economy for that to happen.

This is my final point. The much better outcome would be stronger growth on the supply side of the economy. Then we can have everything. We can have demand growing strongly, people's incomes rising, and no inflation. That's what we had on average for about 30 years. But to get the supply side of the economy marching ahead, we need fundamental public policy reform. If we don't get that, and supply-side growth is limited to population growth, then demand growth has to grow at one point something. That's all we can do.

If government is spending a lot, the private sector has to retrench, and that happens through higher interest rates. I think it's highly regrettable, but that's the situation we find ourselves in.

Gillian: Investors around the world are pouring money into artificial intelligence. You've touched on that briefly just there and the RBA has also highlighted that it's contributing to domestic capacity pressures. What are you thinking about in relation to the AI trade?

Philip: It's highly uncertain. I think about it along three dimensions.

First of all, we all know that AI is revolutionising many tasks. It's going to make many businesses more productive, and it's opening up new opportunities for business. In other areas, such as medical research, I'm on the board of the Victor Chang Cardiac Research Institute, and I see the tremendous opportunities AI is opening up, not only in medical fields but in lots of fields. I'm optimistic about the new opportunities being created, which will hopefully help drive productivity growth over time.

The second thing I worry about is the financial stability implications, because AI companies, particularly in the US, are borrowing a lot of money. It's hard to know how that's going to work. It's hard to see them all being able to earn good returns on that money. Who knows what happens with the price of AI tokens? Some of the Chinese AI producers effectively sell their tokens for a small fraction of what the US companies are charging. So what happens to the price of AI tokens with all this money being borrowed? There's a financial stability side as well.

The third element I focus on is the potential for bad actors to use AI. We've seen examples of that recently, with hacking into medical records and, in Europe just this week, with the freezers in supermarkets. There's plenty of potential for bad actors to use AI, which means the good guys have to invest huge amounts in cybersecurity. I know the Commonwealth Bank and the Reserve Bank are doing that. So that's a deadweight loss. All these resources will have to go into protecting ourselves from the use of AI by bad actors.

In summary, things are highly uncertain. There's tremendous possibility, and if we do things well, we'll capture that possibility. But there are risks, both on the financial side and in protecting ourselves from the use of AI by bad people.

Gillian: So what's the productivity answer, then?

Philip: Fundamentally, we need to make Australia a great place for businesses to invest, expand, innovate and hire people. Business investment has been weak for a long period of time. The capital stock is eroding.

The best example of this, and the one that would be most familiar to people, is the housing capital stock. This is economist speak, but the population was rising at 2%. The stock of housing was rising at half a percent. What do you think happens? A lot of demand, not much supply. It's not rocket science. Prices go up and rents go up. We just weren't investing enough in the housing stock, in the number of houses, to deal with population growth.

But that's just one of many examples across the country. We have not been investing enough for population growth and for the dynamism we want in the economy. We need to make Australia a great place to invest, expand, innovate and hire people. There are a number of elements I could talk about. The first is taxation.

We tax income and wealth generation too highly and consumption too lightly. That means cutting income and corporate tax rates. A higher GST and fixing the way we tax land as well. There's a whole bunch of issues on the tax side. Mainly, we need to make it more attractive for people to earn income, and we need to tax consumption more highly.

Industrial relations. Through a series of reforms over the past decade, we've made the industrial relations system more complicated. It's harder for firms to hire people and restructure. That makes it less attractive to invest, innovate, expand and hire people.

The energy system: we know we have to make the energy transition, but the path we've chosen has turned what I think used to be a national asset, cheap and reliable energy, into expensive and unreliable energy. So we need to fix the energy system.

The fourth thing would be improving the way we design our cities and allowing them to grow with population growth.

The fifth thing would be the planning and approval process. Talk to any businessperson in the country and they'd tell you stories about how the planning process is so difficult and cumbersome.

Across those five areas, taxation, industrial relations, energy, planning and design of our cities, there are things we can do to get our mojo back. But they all require our politicians to find a way to do it. If they don't, then we're going to have a high living standard in Australia, but it's just not going to grow anymore. We're stagnating. That means the economy can't grow very quickly because the supply side isn't growing quickly. But the country has fantastic fundamentals.

We've got great natural resources, the rule of law, a stable political system, a growing population, good public policy institutions, strong, stable, well-regulated banks, strong trade links with Asia, and great natural resources. We've got all the things to allow us to once again have rising living standards. But I think we need to make some tough policy choices.

If we're not prepared to do it, then we just sit here with a high living standard. It's not growing, and we all get grumpy. That's where we are. We've been here for seven years. I don't see us getting out of that world without some policy change.

Gillian: You touched on trade there, and I think it's worth talking about how trade and security seem to be colliding more and more. Events a long way from home can hit us overnight, and then it can almost feel impossible to plan long term. You've seen a lot of cycles. Has the world always been so unpredictable, or does this feel different?

Philip: I think the world's always been unpredictable. Stuff happens, and we've got a lot of uncertainty at the moment. Through my career, we've had uncertainty about financial crises.

In the past 20 years, the main business-cycle, macroeconomic events have really been driven from the financial side. We had the Asian crisis, the global financial crisis, the tech boom and bust. The financial side had been driving the global macroeconomic environment for quite a while. That's not the case at the moment, because the financial sector has turned out to be more stable, and there are other events. But there are always events that come along that surprise us.

Gillian: The pandemic was one of them, something we didn't see coming. The bond buying from that time is back in the news, with rising bond yields contributing to losses at the RBA. Looking back, how do you weigh what those measures achieved against what they're costing now?

Philip: Yes, it's a good question, because hindsight is a wonderful thing. But let me put you back into the shoes we were in in 2020. We were being told that a vaccine for the virus would be five years away, even if it could be developed, and that tens of thousands of people would die.

I remember having conversations with health people saying that the Domain, the Sydney Domain opposite the Reserve Bank, would be turned into a temporary morgue because there were so many people in Sydney who would be dying. We started to see some of that happen in both Italy and New York.

With the vaccine being years away, we were going to be locked down for years. That was what we were being told. That was what we were facing. People were locked in their houses. Our mindset at the time was to do everything we could to prevent this becoming an economic catastrophe.

We wanted to support the Australian population in whatever way we could. We wanted to provide insurance against the really bad outcomes. Given what we knew about the health situation, I still think that was the right thing to do. The good news is that scientists found a vaccine. They found a vaccine quite quickly, though we had problems rolling it out here.

Basically, we all got vaccinated, and things got back to normal much more quickly than what the health people originally said and what was widely believed would be the situation. We got back to normal much more quickly, which meant that we didn't need all that insurance.

That's the nature of insurance: you pay the premium, and if things work out well, you never need to cash it in. You think, “Oh, I probably didn't need the insurance. I could have saved the money and spent it on something else,” but that's the nature of insurance.

The bond-buying program, the government's Job Keeper, and having interest rates go down to effectively zero were all part of the insurance package. It turned out, given what happened with the vaccine, that we didn't need as much insurance. Too much was done.

When you look at it after the event, you say, “Well, you did all this, and it caused problems,” and there's some element of truth to that. But when people make that criticism, I just ask them to put themselves back into the shoes we were standing in in 2020. We thought we were going to be locked down for years. Tens of thousands of us would be dead. We wouldn't be able to move from our homes, see our family and friends for a long period, or work from home. That was what we faced. Given the economic implications of that, we thought, “Well, we should do everything we can.”

A vaccine came along, and we had to pull it back, and that had implications as well. So it's hard to stand here today and assess everything.

Gillian: It almost feels like it didn't happen.

Philip: People come out ex post and say, “Well, you did too much,” which is true. We did do too much, and it had implications. But if we hadn't done what we did, I think the risks for the country would have been even more dramatic.

Gillian: What do you make of US Federal Reserve Chair Kevin Warsh's decision to stop giving forward guidance? It feels like that's the way forward for people in this uncertain time. He's reluctant to do it.

Philip: When you give forward guidance, people often take it as the truth. The forward guidance we gave during the pandemic was that we thought interest rates would stay low for three years.

This was on the basis that a vaccine wouldn't be developed, and we'd have to keep interest rates low for a long period of time. So it was always conditional upon the outlook for the economy. But people interpreted what we said as a promise. Many people said that I personally had promised that interest rates wouldn't move up until 2024. When they started going up, I had journalists outside my house asking my children why their dad breaks his promise. “Does he lie to them at home as well?” For some reason, financial markets find it difficult to deal with conditional statements.

I think in the US, interest rates aren't nearly as politicized or the subject of media attention as they are here.

When the RBA puts up rates, as we saw yesterday, mortgage rates go up straight away. In the US, if you put up interest rates, it doesn't affect you at all if you've got a mortgage, because they have fixed rates. So it's a very different dynamic. Here, people have difficulty dealing with conditional statements. The Reserve Bank, when I was there, suffered quite a lot of reputational damage because we raised interest rates earlier than 2024. Central banks want to avoid that kind of reputational damage.

So now they say, “Well, it's up to you to work out,” which is perfectly fine. But if everyone could understand the universe of conditional statements, I think the central bank giving its best guess of what it's likely to do is sensible. There is a downside to it. At the moment, the downside is perceived to be too high to continue on that path.

Gillian: We have covered a lot. I feel like we could keep talking for much longer, but I won't do that, conscious that people are watching and we don't want to run too long. If we sat down again in 10 years, what would you hope we'd be saying about Australia's economy and about the next generation?

Philip: I would hope we'd be saying we've addressed the problems and overcome the stagnation. In some ways, I see it a bit like the '70s. In the 1970s, Australia kind of stagnated. I finished high school in 1979, and I remember writing essays for the HSC: would Australia become the next Argentina? Our living standards have been slipping, slipping, slipping. In the '70s, people used to talk about things that could be done to fix ourselves: liberalise the financial markets, get rid of the tariffs, float the dollar, liberalise the labour market, change the tax system. All those things were considered kind of impossible to do.

But in the '80s and '90s, our politicians found a way to do them. We then had 30 years of sustained progress. I feel like we're in a similar situation now as in the second half of the '70s, where things have stagnated. People have identified a whole series of measures that could be taken. The political class can't do them. I'm hoping that in the next 10 years, like in the '80s and '90s, the political class finds a way to do some of these things, so we can build on the fantastic fundamentals I spoke about before and again propel living standards higher.

That's the best way to deal with intergenerational issues: make a bigger pie. If the pie is stagnant, all we're left with is arguing over who gets a bit. We can all have bigger bits if the pie gets bigger. I'm hoping that in some way in the next 10 years, the political class finds a way to make the pie bigger, so we can all be better off. We did it in the '80s and '90s. I'm optimistic about our ability to do it again, but it's going to take time.

Gillian: And what about the children, the target of investing and the fund that you're working for?

Philip: In terms of Future Generation Australia, I hope to grow the size of the fund. The fund has nearly $600 million at the moment. That means we can give $6 million a year away to kids' charities.

We have a goal of increasing the size of the fund, issuing new shares over time, bringing in new capital, and being able to support more kids at risk.

Gillian: Philip Lowe, thanks very much for your time.

Philip: Thanks very much. It's been fantastic speaking to you.

Gillian: And thank you for watching. You can find more CommSec Executive Series interviews on our website Or if you're watching this on our YouTube channel, CommSec TV, there's plenty more great content right here.