RBA Review: Monetary policy mandate and governance*

PIIE Conference

Monetary responses to the post-pandemic inflation:

What happened and lessons learned

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CAROLYN A. WILKINS,

SENIOR RESEARCH SCHOLAR, GRISWOLD CENTER,

PRINCETON UNIVERSITY

Princeton University
Department of Economics

* Views expressed here are my own and do not necessarily reflect those of my Financial Policy Committee or other Bank of England colleagues

RBA Review completed March 2023

Key Attributes of RBA Review	
1. Independent from RBA and government	External review commissioned by government led by 3 independent reviewers (G. de Brouwer, R. Fry-McKibbin, C. Wilkins)
2, Motivation established pre-crisis	First review since IT was adopted, inflation under shoot over 2016-19 period had been widely criticized
3. Mandate very broad	1. Monetary policy goals and governance, including interactions with fiscal and macroprudential policies 2. Performance in meeting goals (including use of policy tools) 3. RBA culture and management

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RBA is a *highly-respected* institution sharing similar experience to its peers

Inflation targeting has generally been successful

- RBA had kept inflation near the mid-point of the 2 to 3% target range on average over the last 30 years (albeit with usual volatility)

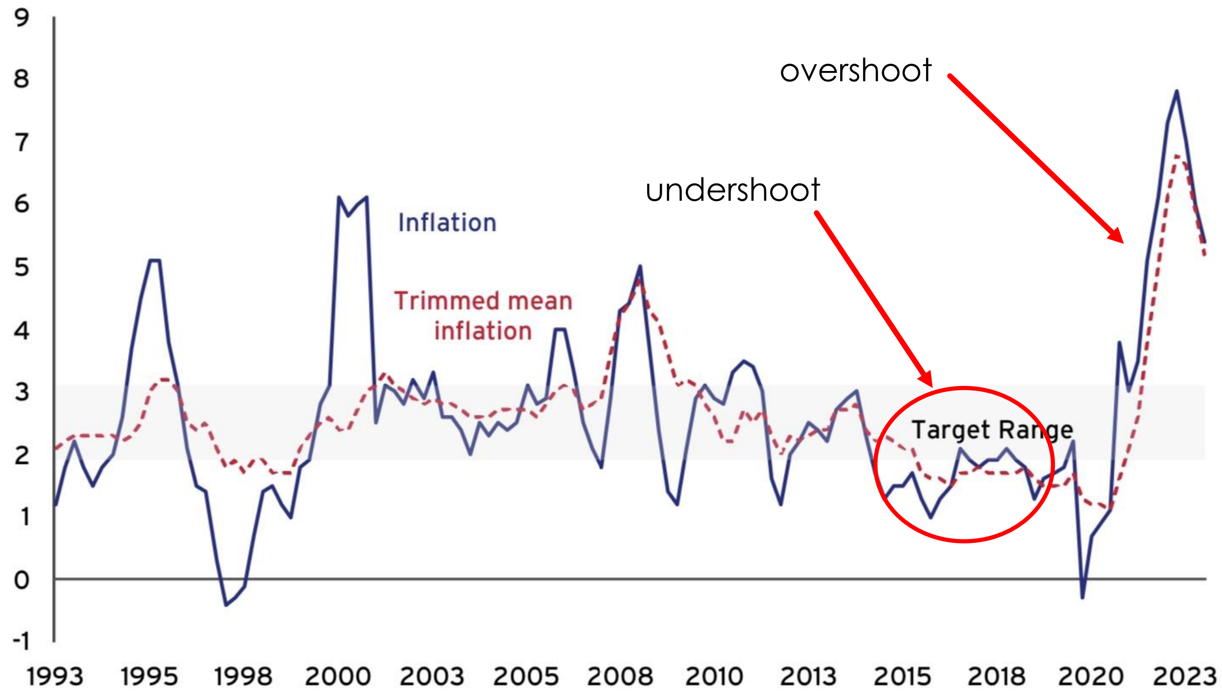
Prior to COVID, the concern was too-low inflation

- With a mid-point of the target range of 2.5% and full employment also part of the mandate, averaging around 1.7% 2016-19 was notable

After COVID, inflation overshot considerably

- peaked at 7.8% in December 2022

FIGURE 2 CONSUMER PRICE INFLATION AND TRIMMED MEAN INFLATION (%)



Notes: a) All values are quarterly from March 1993 to September 2023; b) Inflation values are year-over-year percentage change; d) Trimmed mean inflation is a measure of consumer price inflation that excludes the prices of goods and services with the largest movements (positive or negative).

Source: RBA Statistical Table G1.

RBA response had three phases, with varying degrees of success

Initial Response - *March-Sept. 2020*	• Reduced cash rate to ELB (0.25%), introduced a term funding facility, state-based forward guidance, and yield curve control (targeting 3-year gov't bond) • Policies over this period successfully buffered economic fallout of pandemic and reduced financing costs of government's response (Orphanides 2023)
Doubling down *-Oct. 2020-Aug. 2021*	• Extended YCC, introduced a time-based element to forward guidance (out 3 years), and introduced a gov't bond purchase program (GBPP) • Despite high uncertainty, it was unclear at the time that more stimulus was needed (Orphanides 2023)
Taming inflation - *Sept. 2021-Dec. 2023*	• YCC and forward guidance dropped abruptly in Oct 2021, last GBPP purchase February 2022, cash rate begins to rise May 2022 (cumulative increase 425bp) • Many limitations and lessons seen with hindsight

Three main limitations of the RBA response

1. **Forecasting errors and focus primarily on downside risks**
   - Forecasting errors were larger than normal and persistent (as with other central banks, see Bernanke report)
   - Desire to insure against downside risks may have contributed to prolonging YCC and forward guidance (dropping fwd guidance viewed by public as broken promise)
2. **Disorderly exit strategies**
   - Exit from YCC and fwd guidance abrupt (forced by market), with little ex ante consideration of exit strategies under different scenarios
   - GBPP targeted longer end of yield curve appears to have had small impact (RBA estimates)
3. **Unclear governance**
   - Important decisions taken without Board consultation (i.e. calendar-based forward guidance, extending the yield target in Sept 2020, and effectively dropping YCC in Oct 2021)

Focus on five main recommendations

1. Constitute an expert Monetary Policy Board with diverse perspectives and knowledge

- Publish criteria for selection of board members encompassing relevant skills and experience. Afford the Board with more time to consider and shape analysis, support from RBA staff, and inclusion in all monetary policy-related decisions. Create a separate board that would focus on governance of RBA (RBA Act change)

2. Clarify the monetary policy framework, and conduct review of framework and tools every 5 years

- Keep current FIT framework but clarify role of full employment (implies changes to both RBA Act and Statement of Conduct of Monetary Policy). Clarify financial stability goals are best met by other policies.

3. Improved transparency around monetary policy decisions to support accountability and public debate

- More fulsome minutes of Board meetings (e.g. unattributed voting records), regular press conferences at each decision point, making forecasts available in convenient formats, including for the NAIRU and potential output

4. Legislate the RBA's financial stability role, and reinforce cooperation agreements

- The role would be in cooperation with other government agencies, especially APRA, through arrangements such as the Council of Financial Regulators

5. Make regular use of cost-benefit and stress-scenario analysis, and research in Board discussions

- Invest in data and model development (e.g., supply side of economy, fiscal-monetary policy interactions), engage with external academics and other monetary policy experts (e.g., Advisory Group)

Still much to learn from COVID experience

- More time must pass before we can study the ***full*** costs and benefits of central bank policy actions (and actions of other authorities)
  - Still researching the Great Depression !
- High on the list should be an assessment of the design and implementation of extraordinary policy tools (e.g. QE, YCC, forward guidance).
- Need to invest in the next generation of models to improve forecasting performance and support:
  - scenario analysis
  - a better understanding of the optimal policy mix (fiscal, monetary and macroprudential)