3 November 2022

RBA Review c/o The Treasury
Langton Crescent
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AUSTRALIA

By email: enquiries@rbareview.gov.au

Dear RBA Review Panel

Review of the Reserve Bank of Australia - Issues Paper

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on the Issues Paper issued by the RBA Review Panel. AFMA represents the interests of over 120 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations and traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

The Reserve Bank of Australia (RBA) is an Affiliate Member of AFMA and an active Observer on multiple AFMA Committees, however, our comments to the Review were prepared from AFMA Financial Member input and not with input from Affiliate Members.

AFMA's priority for engaging with the Review is in relation to the RBA's engagement with financial markets. This is both consistent with our mandate and it being an area in which we are well placed to make observations. While we consider all the questions put by the Review we have scoped our answers in terms of our focus on financial markets.

While we offer constructive suggestions in our comments below, these should be framed in the understanding that the RBA is held in very high regard by leading financial market participants as a globally leading central bank. RBA is a responsive and engaged participant in the markets and has a long history of working for their support and betterment.

In terms of its mandate, members are keen to stress that over the long and medium term past RBA has a formidable track record that has been of immeasurable benefit to Australia.

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These matters noted, we also support the validity of the external Review process and would support a similar process being scheduled on a recurring basis, perhaps every five years, to ensure that the RBA and its mandate remain an optimal fit for the challenges of the times.

We thank you for considering our comments and would be pleased to assist further as the Review progresses.

Yours sincerely

Damian Jeffree
Senior Director of Policy

Monetary policy arrangements

> **What changes, if any, should be made to the objectives set out in the *Reserve Bank Act (1959)*: stability of the currency, maintenance of full employment, and economic prosperity and welfare of the Australian people – or do these remain the right objectives?**

AFMA is broadly supportive of the objectives set out in the Reserve Bank Act. Updating the Act is not a priority matter for the financial markets at this time.

We note that if changes were to be made, that the 'welfare of the Australian people' is a matter that potentially has elements of political judgement to it and as such might be better suited to determination by the Treasurer. To assist RBA stay an appropriate distance from political matters, consideration could be given to linking this element more directly to the *Statement on the Conduct of Monetary Policy* given by the Treasurer: e.g. "welfare" as determined by the Treasurer in the *Statement on the Conduct of Monetary Policy* from time to time'.

AFMA is cautious about proposals to put an inflation rate target into the Act. Legislation is slow and difficult to change, and the *Statement on the Conduct of Monetary Policy* provides an appropriately balanced place in terms of formality and agility for the target to be expressed.

> **What adjustments, if any, are warranted to the RBA's flexible inflation targeting arrangement as described in the *Statement on the Conduct of Monetary Policy,* or what alternative arrangement is most appropriate, in light of current and future challenges? How should the RBA balance its objectives in its approach to monetary policy?**

AFMA notes that financial markets participants suggest that the *Statement on the Conduct of Monetary Policy* could provide greater formality in its statement of the target. Currently the target is stated as:

> appropriate goal is to keep consumer price inflation between 2 and 3 per cent, on average, over time. This formulation allows for the natural short-run variation in inflation over the economic cycle and the medium-term focus provides the flexibility for the Reserve Bank to set its policy so as best to achieve its broad objectives, including financial stability. The 2-3 per cent medium-term goal provides a clearly identifiable performance benchmark over time.

The RBA Board has stated it is "committed to returning inflation to the 2–3 per cent range over time"[1]. We note that the target statement reproduced above contains many words, such as 'average', 'over time' and 'variation'. These words allow flexibility in the RBA approach and can lead to a range of outcomes which may not compare well to the target, or which need to

[1] https://www.rba.gov.au/media-releases/2022/mr-22-33.html

be explained in the context of the target. Where there are ongoing deviations from the target the RBA should provide detailed information to explain whether it considers observed outcomes as being consistent with the target (or not) and why.

Financial market credibility may be more supported by increased clarity on the RBA target in the *Statement on the Conduct of Monetary Policy*, and this could also help clarify the reaction function.

AFMA notes the discussion around whether the RBA should move to a nominal income target and the relative costs and benefits of different target types in responding to demand side and supply side shocks. At this time, the consensus of market participants is that there is strong support for remaining with a sufficiently flexible inflation targeting regime, while noting comments above in relation to ongoing credibility of any targets set.

We note that other central banks have moved in the direction of RBA by having a more flexible target.

In terms of timing, we note that it is not an ideal time to move to a different target given globally, central banks are at a lower reputational point.

> **How should monetary, fiscal and macroprudential policies complement each other, including during economic downturns and when interest rates are close to their effective lower bound? What implications does that have for the design of Australia's monetary policy framework, and its interaction with fiscal and macroprudential policy arrangements?**

During the recent challenges of the COVID period monetary and fiscal policy worked well together to the benefit of the Australian economy.

Macroprudential policy coordination

Governance frameworks for coordinating macroprudential policy evolved organically given the pressing need through a bolstered Council of Financial Regulators (CoFR). CoFR generally performed well and could inform future structures, but given it was not created for the purpose it should not be assumed its structure is optimised for that purpose.

We note suggestions from others that APRA should be brought back within the RBA. Market participants do not see a pressing need for such action and suggest that more important than the formal structures, is that the interactions between APRA and RBA are appropriately structured and well-functioning. Other jurisdictions have shown that integration of the prudential regulator within the central bank does not clearly result in better communication, prudential or financial stability outcomes. Some more explicit communication around the trade-offs between macro-prudential objectives and macro-economic objectives may be desirable.

QE Governance

QE potentially encompasses issues around bond issuance (a part of fiscal policy), RBA balance sheet policy (monetary policy), and as it can significantly impact the sovereign risk premium hence a more formalised broadly based governance structure might be advised. There are a range of structures that could broaden the range of views informing the RBA Board's decisions.

Performance against objectives

> **What lessons can be drawn from the RBA's performance against its objectives to strengthen the future decisions and implementation of monetary policy?**

The quality of the execution of monetary policy matters very much from a markets perspective. Over the long-term RBA has been quite consistent in successfully achieving its monetary policy objectives.

Primary targets for the RBA must include maintenance of its reputation and credibility in relation to its operationalisation of monetary policy. This is needed for confidence in the bond market by foreign investors and issuers.

The RBA is very competent in its implementation of monetary policy and during normal periods the interaction with the markets functions well.

During the COVID period results were more mixed with some critically important successes and some matters and actions where outcomes were sub-optimal.

Market participants welcomed RBA's interventions in the domestic government bond market that assisted the markets recover liquidity and maintain functionality during the early days of the COVID crisis. These interventions helped keep money flowing and the economy moving.

The suite of QE functions together broadly achieved their objectives, and for the predicted impacts at the time were broadly appropriate. That the economy was fortunate not to have experienced the higher level of impacts expected from COVID should not undermine this view.

Some of the RBA's unconventional monetary policy, including the calendar based forward guidance along with related communications, and the exit from the Yield Curve Control (YCC) policy were less than optimal, as has been acknowledged by the RBA's internal reviews[2], and have resulted in ongoing decreased investor confidence in Australian markets and interest in Australian debt. This will increase the cost of capital for Australian governments and non-government issuers over the medium term as RBA rebuilds its credibility in these markets.

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[2] See https://www.rba.gov.au/monetary-policy/reviews/yield-target/index.html

The lessons to be learned in our view are mostly around governance and communications. We will outline more of the suggested changes responding to those questions in the consultation. For now, we note that the Board structure and its associated technical committees is important in ensuring, particularly during challenging times, a sufficient level of technical challenge to proposals. A Board structure with more challenging voices on technical matters, and in the case of the matters noted above, from Board members with strong markets expertise and technical knowledge could have led to more challenge, scrutiny and improved outcomes.

Market participants have limited insight into the internal processes of RBA, and so are reliant on the public statements of the Board to be confident that market feedback is appropriately informing Board decisions. AFMA suggests more Board commentary that goes to the Board's assessment of the state of markets and the potential effects of monetary-related interventions would be of assistance in building this confidence.

Where trade-offs arise between the RBA's objectives, how has the RBA managed these in the past, and how should it manage them into the future?

Participants note that macroprudential policy can help balance the objectives of the RBA when they are in conflict and has helped do so in the recent past.

What improvements could be made to the set of inputs the RBA draws on to support monetary policy decision making?

AFMA suggests that 'non-official' data that commercial banks produce could be better utilized by RBA in its policy decision making. This data is much timelier and can provide sounder and better-balanced insights than current business liaison inputs via the Board. While this data is used from time to time, the view is more ongoing use may be appropriate. If the RBA changes its governance approach to decision making, this 'non-official' data could be utilised to address any information loss associated with any move away from business representatives.

In relation to ensuring market participant provided feedback about market conditions makes it to the Board we note the RBNZ model where the bank surveys market participants about their views on a range of options it may or may not choose. While this has some risks of information leakage, these risks are reported to be managed in the New Zealand model. Arrangements could be considered that through similar mechanisms, or through monetary committee structures to increase RBA connectivity to a broader range of market views.

What monetary policy tools should the RBA use in pursuit of its monetary policy objectives, and how can it use them most effectively in the future?

AFMA maintains that the cash rate should remain the primary tool for the operationalisation of monetary policy. QE should be avoided where possible given its costs and risks to the markets and the economy. When it cannot be avoided it should be used carefully and adhering to predetermined guidelines that address execution and communication.

RBA should have publicly available clearly stated principles for its approach to markets that prioritise limiting the impact on market functioning, and particularly liquidity, as far as possible. These principles should apply both in normal times and should help guide QE interventions (or other irregular actions) should the need arise.

QE measures had deleterious impacts on multiple markets, particularly in relation to liquidity as it was implemented and as YCC was abandoned, on volatility.

AFMA supports RBA's systematic review of the elements of the unconventional monetary policy program, with reviews on the YCC and Bond Purchase Program (BPP) completed and a review on forward guidance due later this year. The conclusions in the reports so far appear appropriate.

We suggest RBA should make planned adjustments to managing QE, so that should it be required to be used again negative effects are minimised as far as possible. We suggest that these should include:

- Ensuring forward guidance is not implicitly or explicitly calendar based.
- Bond buying should be volume based and not yield based.
- QE related communications to markets need careful management:
    - Exits from YCC targets if unavoidable should be advised immediately to the market in an orderly way. This may require an extraordinary meeting of the RBA Board or QE governance entity.
    - Scheduled roll offs (e.g. TFF) should be carefully and actively managed for their impacts to markets as well as businesses and households.
- Governance around QE measures should be timely and heightened given the increased risks of QE when compared to normal open market operations.
- YCC is likely not available as a tool for the medium term given the outcomes experienced by the market and decrease in market confidence in RBA commitments.

Changes to the playbook for future QE implementation should be publicly and clearly communicated to markets to assist with rebuilding market confidence.

We note that the QE period has led to some improvements in RBA market practice. Previously the overnight rate was held unnecessarily tightly to the target by RBA. This was not necessary for the achievement of monetary policy outcomes and suppressed important price signal information. The meaningful deviations from the target that now occur in the overnight rate are helpful and represent a step towards minimising the market interventions of the RBA.

What aspects of the RBA's approach to communications have worked well and helped it achieve its objectives, and where could its communications be improved?

RBA's approach to communications had costs and benefits in recent times.

RBA’s YCC communications largely achieved their objective in monetary terms until November 2021. The unwind process, however, as we have noted above has resulted in increases to the cost of credit, YCC not being possible for at least the medium term, and a continuing adverse effect on the markets e.g. issuers of Australian debt have less appetite to utilise markets owing to their view of potential risks.

To achieve the level of credibility that is likely desirable RBA should aim to ensure its commitments are entirely within its delivery ability. While AFMA supports greater openness in the RBA Board Minutes, we would suggest that RBA should reduce the number and scope of communication commitments for the medium term.

Governance

> **What governance arrangements are best suited to discharging the RBA’s monetary policy and corporate governance responsibilities?**
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> **Given this, what appointments process, composition, professional experience, qualifications and tenure of the Reserve Bank Board is most appropriate for fostering internal deliberation and effective decision making?**
>
> **What communication practices would best promote accountability, transparency and support public understanding of the RBA’s policy strategy and decisions?**
>
> **Are there any other aspects of the RBA’s governance and accountability arrangements that the Review should consider?**

Governance is the key area for important reforms.

AFMA supports a reformed Board structure and a review of how decision making operates inside the Bank to agree the information and recommendations provided to the Board. In our view the RBA Board should have multiple monetary policy economists and separately multiple experts in financial markets, given that financial markets are the mechanism by which monetary policy is implemented and that market data helps inform monetary policy. With the data available today from banks there are far more efficient and accurate ways to gain the insights into business activity that were once provided by the current breadth of business representatives on the Board.

These economic and market experts would be particularly important for dealing with unconventional policy and its unwind.

The change to the Board composition would bring the RBA Board much more into line with its international peers and would allow for a more open dialogue on the range of views on monetary policy matters within the Board.

We do not suggest that it would be necessary to name individuals (unless they so desired) in relation to the variety of views expressed in the Minutes, but being able to see the range of views will assist the market in understanding how finely balanced decisions are and what potential they might have to change over time.

Given the structural adjustments to the economy to adjust to a low carbon world it may also be of assistance to have expertise on the Board relating to the economic challenges of climate change.

AFMA would support Bank of England type arrangements, where RBA Board members would be provided with direct access to staff to support them in providing challenge and in developing their positioning.

AFMA would also support the direct provision of credible non-official data sources and expertise as discussed above directly into the Board processes to increase the availability of external timely data points for the consideration of the Board and to increase the external views the Board considers.

Institution

> **To what extent does the institutional culture at the RBA reflect its values?**
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> **Are there any changes to the RBA's culture and/or values that would help it to foster high quality decision-making and more effectively achieve its objectives?**
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> **How well does the culture at the RBA balance clarity of purpose, institutional identity, and deep subject matter knowledge while also encouraging innovation and appropriate risk taking?**
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> **Does the RBA's management approach support staff engagement and effective decision making?**
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> **What kind of workforce does the RBA need, including in terms of skills, experience and diversity?**
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> **Are there changes the RBA should make in how it attracts, develops and retains staff, that would help it achieve the right mix of skills, experience and diversity?**

The RBA has a good constructive institutional culture. We do not see significant problems with the institution itself, noting comments above in relation to the benefits of broadening the range of external information presented at Board and any recommendations provided to Board.

The RBA is a good operator and engages well with the market. The bank already has some very good staff but further increasing financial markets expertise within the RBA would assist in ensuring a full picture of markets is understood.

AFMA notes the benefit of a two-way flow of people as occurs in other markets, where central banks hire from the sector as well as the other way around.