The Evolution of Central Bank Communications

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Reserve Bank Governor Bernie Fraser, March 1993:
One lesson that has been hammered home to me over the years is that policy flexibility is the best defence against shocks of various kinds (including major forecasting errors!). It is a simple lesson but, in economics as in other fields, the simple lessons are often the last to be learned.[1]

Treasury Secretary Ted Evans quoted in 2008:
The cult of the independent central bank will pass. It is too much power with not enough accountability.[2]

Reserve Bank Governor Ian Macfarlane from 2009:
It's not only in the central bank's interest, it's actually in the government's interests that central banks should be the ones putting up interest rates. But politicians can't really let it go. They take the credit for interest rate falls and blame the bank for interest rate rises.[3]

The modern era of Reserve Bank of Australia public communication began the day after a rare and perhaps even unprecedented January Board meeting in 1990 when the Governor of less than four months, Bernie Fraser, released a press release announcing that: *The Bank had operated in the*

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[1] *Bernie Fraser, Some Aspects of Monetary Policy, Talk to Australian Business Economists, 31 March 1993*
[2] *Peter Costello with Peter Coleman (2008) "The Costello Memoirs". Melbourne University Press. Page 114.*
[3] *Karen Maley, VJ Carroll, Alan Mitchell On the money, The Australian Financial Review 30 November 2009*

domestic money market this morning to bring about a modest reduction in interest rates … Although there can be no precision in such matters, the Bank will be seeking in its market operations to reduce unofficial cash rates by between one half and one percentage point from their average levels of recent months.

Fraser said the reduction in cash rates “can be expected to flow through to security yields and interest rates charged by intermediates”, presumably including interest rates for mortgage and business borrowers. However, he did not specify the level from which the cash rate was being cut, or the level it was being cut to. Similar vagueness was applied to a further cut in cash rates - of “up to 0.5 percentage points” - announced the following month. Revealing a third cut a day after the April Board meeting, Fraser added a reference to the actual level of the cash rates now being targeted. The Bank would operate in the domestic money market “with a view to reducing cash rates” from their average in recent weeks of “a little under 16½ per cent” to within the range of 15 to 15½ per cent”. Announcing the April rate cut, Fraser said the “Bank believes that a further reduction of the order indicated is warranted by the fall in domestic demand that is occurring, and is consistent with the medium-term objectives of lowering inflation and the current account deficit”. This was the beginning of the RBA publicly communicating changes in its then barely-understood operating price instrument of the cash rate. Around that time, I explained in *The Australian Financial Review*[4] how, at 10.30am on that January morning, the RBA’s market operations did not soak up all of the $900 million surplus of overnight bank exchange settlement funds at the central bank. Today my 17-year-old son learns about this in his secondary school economics course.

Fraser’s cash rate announcement on Tuesday, January 23, 1990 also marked the lead-up to a monetary policy regime based around an operationally-independent central bank targeting a flexible low inflation target, in this case 2-3 per cent, over the medium-term. The new transparency announced that monetary policy had been changed by a discrete amount within hours or a day of being decided by the Board. One striking technical result of the transparency was that the announcement appeared to significantly reduce

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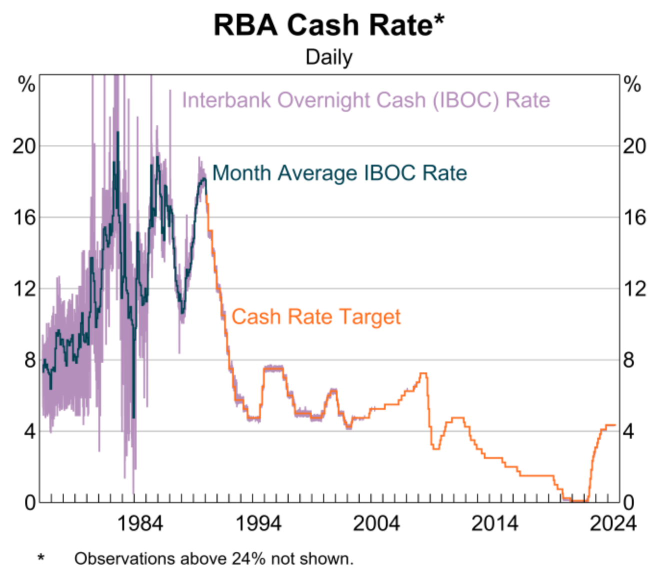
[4] *Michael Stutchbury (1991) How the Reserve Bank controls interest rates in Boom to Bust – The recession Australia had to have? Economics Extra ‘91. Pages 82-86 Publisher: The Australian Financial Review.*

Tim Dixon and John O’Mahony The Market Economy 2024 Pearson Economics 11, Pearson Australia pages 201-204.

the daily volatility of actual cash rates, ensuring that the RBA's market operations could in fact deliver a target cash rate with precision. Over time, the references to "cash rates" were narrowed to a target for "the cash rate". It was an early example of how central bank policy communication has been an increasingly important part of policy transmission and effectiveness.[5]



In the initial 1990 announcement, Fraser said that the previous tightening cycle had been directed toward "restraining the growth in domestic spending" and, through that, "improvements in inflation and the current account" of the balance of payments. By that time, however, there was clear scepticism within the RBA over whether monetary policy could, in fact, have any impact on the balance of payments which had so dominated debate on economic policy since a big fall in commodity export prices had prompted Treasurer Paul Keating's "banana republic" warning of 1986. Higher interest rates would restrain demand and hence imports. But higher interest rates also would tend to hold up the exchange rate, which would encourage imports (and discourage exports). Instead, thinking with the RBA had moved toward primarily targeting monetary policy at maintaining low inflation over the medium term. It would become the policy regime to correct Australia's inflation failure since the advent of "stagflation" in the early 1970s.

In his January 23, 1990, statement, Fraser noted that he had "consulted the Treasurer following the

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[5] *A detailed account of the introduction of inflation targeting in Australia, including this paper's references to speeches by senior RBA officials is provided by Selwyn Cornish (2018) [The Evolution of Inflation Targeting in Australia](), Centre for Economic History Discussion Paper No 2018-11. The Australian National University.*

[Board meeting] that had decided to reduce interest rates: implying that the decision had been independently taken by the central bank and its board. A parallel statement from Treasurer Keating provided a different slant, saying: “Following consultations which I have had with the Reserve Bank, it has been decided to ease monetary policy”. Nevertheless, the editorial in *The Australian Financial Review* gave a cheer for “the upfront manner” in which the Reserve Bank Governor had “told the world what was happening”. It continued: *In doing so, he has established a most welcome and overdue precedent: he put the bank on the public record, immediately after a decision was made - ending years of foggy fun and games for the markets as they strained to catch the nuances of Reserve Bank adjustments.*

Nevertheless the Financial Review’s editorial was still headed “Two cheers for Mr Keating” [6]. And the front page headline the next day still heralded it as a government policy decision: “Keating eases the screws”. In these circumstances, the RBA took little political flak for the subsequent deep economic recession. Claiming to have the RBA “in my pocket’, Keating called it “the recession we had to have”, subsequently successfully challenged Bob Hawke for the Labor leadership and even won the March 1993 federal election.

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[6] *The Australian Financial Review [Two cheers for Mr Keating] Wednesday, 24 January 1990.*

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Keating eases screws

Labor bets all on lower rates

By GEOFF KITNEY

The Federal Treasurer, Mr Keating, has delivered to the Labor Party its best hope for political survival – a fall in interest rates.

The reduction in cash rates announced formally by the Government and the Reserve Bank yesterday should lead to a drop in home mortgage rates before an April or May election.

The surprise timing of the move has maximised the distance between the announcement of lower interest rates and the announcement of the election date, which minimises the risk that the decision will be seen as political expediency.

But the political implications of the decision are massive.

Although Mr Keating said yesterday that he did not think a fall in home mortgage rates was essential to Labor's re-election hopes, no-one else in the Labor Party believes that.

The Labor Caucus has been sweating on lower rates and there is not one Labor MP in a marginal seat who does not believe his chances of holding the seat will be improved by an interest rate fall.

The Labor Party will now be looking to the banks to lower home lending rates as soon as possible which means the banks now become key players in the way the political climate develops in the lead-up to the election.

Mr Keating said he did not expect that adjustments of the magnitude announced yesterday would send the banks scurrying immediately to bring down home interest rates.

But he expected that ultimately there would be "some impact" on mortgage rates.

His move to publicly announce the easing of policy – in contrast to the secretive way that adjustments to monetary policy have been handled previously under Mr Keating's administration – puts great pressure on the banks. This may well be one reason for making a major media event of the easing of policy.

Mr Keating has now created an expectation of falling home mortgage rates.

The banks, already burdened by a serious public relations problem caused by the coincidence of record interest rates and record profits, will find it very difficult to explain to their customers that home rates cannot come down when other rates are falling.

These pressures should ensure that home rates will come down in time for the Prime Minister, Mr Hawke, to have the federal election in May, which has always been his personal preference. The fall may happen early enough to give him the chance to go on April 7 – the date preferred by some others in the Government because it gets the election over before the distractions of Easter holidays and the Prime Minister's visit to Turkey in April for Anzac Day commemorations.

The risk in yesterday's easing of monetary policy is that it may prove to be premature and that economic developments between now and the election will show the rate reductions to be unsustainable.

Continued page 2

RBA reduces cash rate . . . and the markets go wild

Rates slide — 90-day bank bills for the past 15 trading days (%)

Dollar plunges — 24 hrs from 6pm Monday (USc)

Bourse rebounds — All Ords from 4pm Monday — Rates eased

Timing surprises markets

By TIM DODD

The Federal Government and the Reserve Bank of Australia moved yesterday to protect the economy from an interest rate overkill by easing monetary policy early.

Although the decision to ease policy and lower interest rates was widely expected in response to slowing demand, the timing took the markets by surprise as the move came before the publication of next week's economic statistics.

In a statement issued just after noon, the Governor of the Reserve, Mr Bernie Fraser, confirmed market suspicions that the bank had been operating in the domestic money market in the morning "to bring about a modest reduction in interest rates".

"Although there can be no precision in such matters, the bank will be seeking in its market operations to reduce unofficial cash rates by between one half and one percentage point from their average levels of recent months," he said.

"A modest reduction of this order is judged to be appropriate having regard to the slowing in the economy which has occurred and is in prospect, and the continuing role which monetary policy must play in moderating demand and containing inflationary pressures."

The announcement robbed the Australian dollar of the support of high domestic interest rates, and it lost nearly US2¢ as markets viewed the prospect of a narrowing gap between falling domestic rates and rising rates overseas.

After a morning high of 0.7958¢ the Australian dollar dropped to 0.7775 before closing at 0.7803.

The change in monetary policy will bring some quick relief to companies borrowing at commercial rates but is unlikely to flow through to the politically sensitive home-loan

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The late 1980s tightening cycle - the recession we had to have

It was an opportune time for a central bank governor to start communicating every change to its official cash rate. From around April 1988 and into 1989, the RBA had increased the cash rate from about 11 per cent to about 18 per cent to counter strong domestic demand, a debt-fuelled asset price bubble and higher consumer price inflation. The steady rise in the cash rate was noticed by the financial markets and the financial press and was reflected in other key interest rates, such as for residential mortgages. But the string of cash rate increases were not publicly announced by the government nor by the central bank.

Even in its annual report, the RBA only admitted that "monetary policy had been tightened in a series of steps" without tying this directly to the increase in the cash rate. In the *Financial Review* at the time, I reported that the surreptitious increase in official interest rates was being referred to as "snugging"[7]. The muffled public communication of the sharp tightening cycle was thought to have lost any announcement effect, hence reducing its effectiveness in containing the excess of aggregate demand and the speculative inflation of asset prices.

Greater transparency and increased communication is bound to be caught up in political discussion, as it has from time to time over the following three decades, and more so when the central bank is formally given responsibility for increasing or decreasing interest rates. Leading up to the first cash rate change, the RBA was portrayed by some as being politicised by being too close to the Labor government. Governor Fraser previously was Treasury secretary and close to Keating. Pitching for the Labor leadership, the Treasurer famously told a Canberra press gallery dinner in December 1990, that he had the subservient RBA, along with other institutions, in his "back pocket" after previously saying of the central bank that "they do what I say".

Unlike today, the central bank took little public or political flak from the seven percentage point increase in the cash rate as "monetary policy" for decades had been regarded as the responsibility of the government, rather than of technocrats. Moreover, the central bank had not been regarded as being in the front-line of economic management. The monetarism of the 1970s - inflation was "always and everywhere a monetary phenomenon" claimed Milton Friedman - lost its effectiveness as financial deregulation broke the stable relationship between measures of the money supply and prices. The money supply targeting adopted by the Fraser government in 1976 was abandoned in 1985. Under the Hawke-Keating government Labor government from 1983, monetary policy became subservient to the Labor government's incomes policy - the wages "Accord" with the ACTU. As part of the August 1988 budget, Keating claimed that a looming wage-tax tradeoff under the Accord would reduce inflation to 3-4 per cent by 1990, which didn't happen, leaving him with a mistrust of inflation targets. Amid a policy

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[7] *In early 1989, I reported three periods of announced tightening: "a sharp lift in short-term rates in April-May; a gradual 1 per cent "snugging" between August and early November; and then a final discrete 1 per cent tightening in the second week of November. Michael Stutchbury, Rising currency the economy's wildcard, January 6, 1990,* The Australian Financial Review.

vacuum, the RBA confusingly cottoned on to targeting a mixed-up “check list” of things including inflation, asset prices, interest rates, the exchange rate, the monetary aggregates, economic activity, business investment and employment. Public understanding of the monetary policy instrument of the cash rate - as opposed to various quantitative lending controls of the 1960s and ‘70s - was low. During the unannounced late 1980s increase in the cash rate, an acting Labor Treasurer (John Dawkins) claimed that, amid financial deregulation and a floating exchange rate, interest rates were “purely in the hand of the market”.

Recession we had to have snaps the inflation stick, facilitates the target

The early 1990s recession did succeed in “snapping the inflation stick”. Until then, Australia’s economy had been notoriously inflation-prone. After the advent of “stagflation” the (Malcolm) Fraser Coalition Government’s “fight inflation first” policy of restrictive fiscal policy and relatively tight money was blown up by the energy-related resources boom late in the decade following the second OPEC oil shock. So Australia did not join the global disinflation led by the Paul Volcker-led US Federal Reserve. Labor’s 1980s incomes policy aimed to contain wage inflation while “setting the sales for growth” but ended up being blown up by the inflationary impact of a big exchange rate fall and by a debt-financed asset bubble facilitated by financial deregulation.

Other countries with similar poor inflation records were looking for new solutions. In the spirit of the economic reforms of Labour Finance Minister Roger Douglas, the Reserve Bank of New Zealand adopted a 0-2 per cent inflation target in early 1990 as part of legislation that guaranteed its political independence. In similar spirit, Liberal leader John Hewson went to Australia’s federal election in 1993 with a Fightback! policy manifesto that included a commitment to “the medium-term objective or price stability, universally conceded to be an inflation rate of 0-2 per cent” and to RBA independence “within the context of the Government’s overall economic management”.

In the meantime, the monetary policy-induced recession had finally clubbed Australian inflation, prompting Governor Fraser to say by late 1990 that “we must not allow this once-in-a-decade opportunity to slip through our fingers”. By August 1992, Fraser first mentioned what became the official 2-3 per cent target: *Inflation has come down faster than everyone expected, but it is not just the recession, or a fluke* *that has caused it to decline. Policy has been important, and the costs substantial. Price expectations, which are now seen as occupying a central role in the inflation process, have been cracked: given this, together with continued policy vigilance, there is no reason why the current underlying rate of 2 to 3 per cent cannot be sustained.*

In March 1993, Fraser added that it would be a "good outcome" to hold inflation to an average of 2-3 per cent over a period of years. But, similar to Paul Keating, he also admitted to being "rather wary of inflation targets" because they could reduce policy flexibility in the face of shocks. Nevertheless, Australia's evolutionary entry into the new inflation targeting central banks in New Zealand, Canada, the UK and Sweden is often traced back to 1993. In Australia, the birth of low inflation targeting was opportunistic, taking advantage of the pain already administered under what many assumed to be the orders of the government.

As the economy rebounded from recession, Fraser laid out some of the operational principles of the emerging inflation targeting regime. If inflation threatened to rise "noticeably above the 2 per cent to 3 per cent range", he said in March 1994, "corrective action would have to be implemented" in the form of "upward adjustments in interest rates". "After a 20-year struggle to regain the low inflation key to sustained growth, it would be irresponsible to lose it now". In August, the first tightening of the inflation targeting regime amid the RBA's assessment that "pressures on prices and wages can be expected to intensify". A 75 basis point increase in the cash rate to "around 5 ½ per cent" aimed "to help keep underlying inflation around 2 to 3 per cent over a long period".

The new regime was endorsed by the Labor government in November 1994 as Treasurer Ralph Willis said in parliament that "the Reserve Bank and the government have established a target of keeping the underlying rate of inflation at 2 to 3 per cent over the course of the cycle". The following year, the new version of the Accord agreement between the government and the ACTU incorporated the 2-3 per cent target. Official endorsement of RBA operational independence in pursuit of the target came with the first Statement on the Conduct of Monetary Policy[8] jointly issued by new Liberal Treasurer Peter Costello and new Governor Ian Macfarlane in August 1996 following the election of a Coalition government.

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[8] *See The Treasurer and the Governor (designate) of the Reserve Bank, Statement on the Conduct of Monetary Policy 14 August 1996. The RBA website includes this and subsequent versions of the SCMP.*

The formalised target was described as: *In pursuing the goal of medium term price stability the Reserve Bank has adopted the objective of keeping underlying inflation between 2 and 3 per cent, on average, over the cycle.*

Noting the RBA's requirement under its 1959 legislation to also contribute to the maintenance of full employment, the Statement said the wording of the 2-3 per cent inflation target would allow the central to bank to focus on its price stability requirement "while taking account of the implications of monetary policy for activity and, therefore, employment in the short-term". Price stability was "a crucial precondition for sustained growth in economic activity and employment."

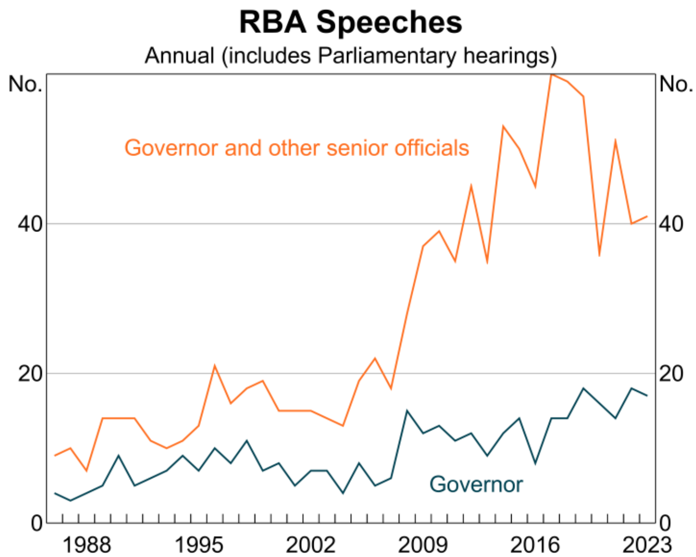
In the Statement, the government said it intended to respect the RBA's independence. While reserving the right to comment on monetary policy, the government would no longer make parallel announcements on cash rate changes. Costello later said that withdrawing the parallel announcement intended to make clear that government would not exercise influence or veto of RBA decisions behind the scenes. The Statement on the Conduct of Monetary Policy has been an enduring feature of the inflation targeting regime. Refined versions of the Statement and the 2-3 per cent inflation target have been issued by successive Treasurers and Governors in 2003, 2006, 2007, 2010, 2013, 2016 and 2023. It is relevant though that, in the history of Australia's economic reform period from 1983 to the early 2000s, the first Statement on the Conduct of Monetary Policy marks the 2-3 per cent inflation target as more of a political creation of the Liberal side of politics.

The new framework was an attempt to impose some low inflation discipline where other policy regimes had failed. The discipline would be the operational threat to increase the cash rate if inflation showed signs of veering above the target. Because the political process had failed to deliver this, the discipline would be imposed by central bank technocrats who would be given the operational independence to deliver it. The 2-3 per cent band was wider and a bit higher than most other comparable central bank regimes, the target was to be hit over the medium-term and the target band's fuzzy or soft edges could be temporarily breached without excessive cash rate response: all reflecting the Australia central bank's practical and flexible approach and the volatility of a commodity-exporting economy.

Increased supply of communication underpins policy achievement

The operational independence marked a radical change for the RBA which since being established as a standalone central bank in 1960 had played a subservient role in economic policy making. Until the early 1980s, official interest rates and the exchange rate were set by the government: basically ministers with the backing of the federal Treasury. By 2007, the RBA felt politically independent enough to increase interest rates during a federal election campaign, hurting the political prospects of the Coalition government.

Going into the regime, communication comprised a modest number of speeches a year mostly by the Governor and the Deputy Governor and some articles in the monthly RBA Bulletin. The number of speeches increased from an average of about 10 a year to 40 or more by the Governor, the Deputy Governor and other senior staff. From 1997, following the first SCMP, the Governor and senior staff commenced regular semi-annual appearances before a parliamentary committee. From 2001, the RBA staff instituted a regular liaison program with businesses, governments, and community organisations. A half-yearly Financial Stability Review was designed to feed into meetings of the Council of Financial Regulators from 2004. A quarterly statement on financial markets and the economy published in the monthly Bulletin was broken out into a separate quarterly Statement on Monetary Policy from 2006. As a former governor has noted, the monetary policy statements of the early 1990s ran to four to five pages. By the mid-1990s, they expanded to 15 to 16 pages. By 2011, they took up 75 pages or more. The Governor started issuing a statement after every Board meeting - even ones without a cash rate change - from November 2007. From December 2007, minutes of the 11 monthly Board meetings a year were published with a two-week delay (including previous Board meetings back to from October 2006). From 2007 and 2008, the SMP included two-year-ahead forecasts on inflation and the GDP growth. By 2018, it had added detailed forecasts extending to variables such as household consumption, dwelling investment, business investment, public demand, imports, exports, household disposable income and wages.



Late in 2012, Governor Glenn Stevens took part in an extended interview with senior editors and writers at the *Financial Review*, which published the full transcript in front of its paywall. Similar interviews took place each year until a September "exit interview" in 2016, with Stevens calling them "a tradition"[9].

In 2018, then RBA deputy Governor Guy Debelle[10] nominated the amount and content of central bank communication as among the most substantive of the changes flowing from the first 25 years of inflation targeting in Australia. Given the poor previous track record of monetary policy, increased communication and transparency had been important to building credibility as quickly as possible, to enhance the effectiveness of monetary policy, to anchor inflationary expectation and to deliver increased accountability for a more independent central bank. It was important that businesses, households and financial market participants had confidence in how central bank actions would affect interest rates. The effectiveness of communication or transparency could be measured by whether interest rate changes came "from unexpected developments, not unexpected actions by the central bank".

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[9] *See for example Glenn Stevens 2016 Financial Review interview article, Jacob Greber, RBA Governor warns growth is not a game, 9 September 2016. Stevens 2015 interview article Jacob Greber, RBA Governor Glenn Stevens upbeat on growth, jobs 16 December 2015 and transcript. Stevens 2014 interview article and transcript. Stevens 2013 interview transcript. Stevens 2012 interview transcript.*

[10] Guy Debelle (2018) Twenty-five years of Inflation Targeting in Australia, RBA Conference 12 April 2018.

In the first quarter of a century monetary policy targeting, this model of a politically independent central bank using a single "cash rate" instrument to pursue a clearly-communicated low inflation target became a macro-policy foundation of Australia's under-appreciated modern prosperity, as commented upon by new RBA Deputy Governor Andrew Hauser.[11] The micro-economic supply-side reforms of the 1980s and '90s helped, such as by opening up the domestic economy to more foreign competition and by the stabilising effect of the floating exchange rate. Economic growth was unbroken through the East Asian financial crisis of 1997, the Wall Street tech-wreck of the early 2000s, and the Global Financial Crisis that began in 2008. The RBA was able to "look through" the inflationary impact of the 10 per cent Goods and Services Tax in 2000 without raising interest rates. And, unlike in the mid-1980s, the slump in the Australian dollar to US50c and briefly below in 2001 did not provoke inflationary fears for monetary policy. Unlike the coal-based resources boom of the late 1970s, the China-based resources development boom of the 2000s did not end in inflationary tears.

Context of the new inflation target challenge

After this achievement, it has taken a once-in-a-century global pandemic to confront the low inflation target regime with its most-challenging test after the extraordinary fiscal and monetary stimulus of the crisis, partly imported from abroad, spilled over into the sharpest inflation since the late 1980s. That, in turn, provoked the sharpest cash rate rise - from the extraordinary low of 0.1 per cent to 4.35 per cent - since the years leading up to the start of the regime. The RBA retains considerable public respect and credibility. But, in March 2023, The Australian Financial Review/Freshwater Strategy business survey found that 49 per cent of 633 companies surveyed believed the RBA had done a "bad job" in "communicating how they intend to manage inflation". That outnumbered the 33 per cent who believed the central bank had done "a good job". Among broader criticisms, the external Review of the RBA Review[12] commissioned by Treasurer Jim Chalmers and released in April 2023 concluded that "the RBA's regular communications are less transparent than those of some other peer central banks" and that "communication with the public is not as effective as it could be".

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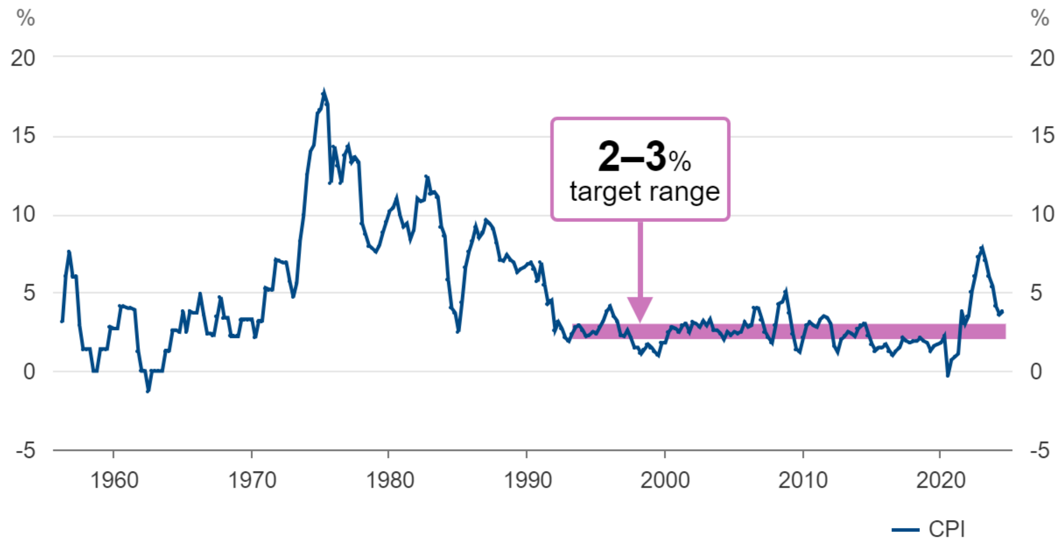
[11] Andrew Hauser (2024) Strangers in Paradise, Speech at the Opening Dinner for the Citi A50 Australian Economic Forum 2024, 27 June, Sydney.

[12] RBA Review Review of the Reserve Bank of Australia, Australian Government, March 2023

Inflation

Year-ended percentage change, excludes interest charges prior to September quarter 1998 and adjusted for the tax changes of 1999–2000



Sources: ABS; RBA

There are several reasons for this. First, unlike in the late 1980s tightening cycle that facilitated the opportunistic adoption of the inflation targeting regime, the RBA has had to take some political accountability for the inflation outbreak, the interest rate increases and the biggest fall in household incomes in three decades. The success of the regime over the nearly the past three decades means that much of the Australian population has little experience of inflation. Many mortgage borrowers are puzzled by why the cost of reining in consumer price inflation is falling on them in the form of higher interest rates. The political process is reacting to this political pain in part by looking for scapegoats, from supermarkets to the central bank. That comes after the success of the regime has tended to throw more of the onus for fighting inflation, sustaining economic growth and even reducing unemployment and generating higher wages onto the central bank and its single monetary policy lever. As the formal fiscal policy framework has fallen away, other arms of policy risk working against monetary policy. Yet, if anything, in the face of new and large shocks, the RBA itself has implicitly taken on more responsibility and arguably pushed its policy beyond its useful limits. That includes the communications and policy over-reach of the forward guidance that the cash rate would stay at effectively zero for at least three years. This now challenges the credibility of the current communication message that interest rates need to remain elevated for some time to get inflation back down into the 2-3 per cent target before interest rates can fall.

This is occurring amid a different political and economic context from when the regime began three decades ago. The labour-capital divide of politics - between parties of labour (on the left) and capital (on the right) has transformed into the tribal politics of culture and identity. The democratisation of social media gives everyone a platform for personal complaint. The main political parties are losing their traditional bases and struggling to form a majority government. The political debate tends to become more populist and polarised. The internet has weakened traditional media and encouraged the polarisation of social media. The return of geo-politics - played out in Ukraine, Gaza/Israel and the South China Sea - is unravelling the post-Cold War era of trade globalisation that helped keep inflation low. Decarbonisation – a particular challenge for Australia’s fossil fuel-intensive economy - adds to the greater supply-side disruption and volatility that further complicates the operation and communication of the low-inflation target regime. The demographic ageing of the population, combined with the trend increase in housing prices, has sharpened the distributional divide of monetary policy between asset rich baby booms and younger generations struggling to buy a home. Interest rate changes will always hurt one of these two generational groups.

There is a particular point to make about Australia here. The media politics of monetary policy in Australia is sharper than in most other comparable countries. This reflects the higher prevalence of floating rate mortgages in Australia compared to the United States, the United Kingdom, Canada and New Zealand; the quicker flow-through of Australia’s central bank policy decisions to floating rate mortgages; the relatively high level of household debt in Australia; and Australia’s cultural obsession with residential property (as highlighted by prominent television shows such the “The Block”). RBA cash rate decisions tend to be bigger popular news than in most other comparable countries. That can embroil the RBA, and its Governor, in the sometimes-febrile political news cycle. Economics in general is bigger news in Australia, perhaps reflecting the nature of a commodity-exporting and traditionally capital-exporting economy. The federal budget is bigger news. As the saying goes, dinner parties traditionally discuss house prices more, particularly in Sydney.

The sharpness of the public interest rate debate can become personally directed at the central bank governor. During the cash rate increase cycle of 2022 and 2023, television news cameras parked outside the home of Governor Philip Lowe on the mornings of rate-setting Board meetings. Lowe was attacked for suggesting that higher rents would ease the housing shortage by increasing the average number of people living in each dwelling to rise, as “kids don’t move out of home because the rent is too expensive, or you decide to get a flatmate or a housemate”.[13]

Yahoo! Finance reported[14] that: *Many commentators on Twitter suggested that Lowe, who earns over $1 million as head of the Reserve Bank and lives in a 5-bedroom house in the upmarket Sydney suburb of Randwick where the median house price is over $3 million, should open up his own home to a few flatmates.*

The lead up: resources boom to GFC to boom again

The inflation target framework was tested by the China-driven resources investment boom from the middle of the 2000s that pushed annual CPI inflation well above the target band to 5 per cent in 2008: its highest rate since the 2-3 per cent target began. Strong aggregate demand growth and labour shortages prompted the board to increase the cash rate by 0.25 percentage points to 6.75 per cent in November 2007 during a federal election campaign that the incumbent Howard Coalition government lost. It undermined the Liberals’ political claim to be the party of lower interest rates. While not an ongoing controversy in itself, it helped make the central bank itself a political target. As the cash rate continued to climb into 2008, Sydney’s The Daily Telegraph tabloid newspaper splashed Governor Glenn Stevens’ face over page one with the heading: ‘Is this the most useless man in Australia”. The political noise was overtaken by the change of government and then by the Global Financial Crisis that hit later in 2008, prompting the RBA to aggressively reduce the cash rate. Unlike many other economies, Australia escaped a recession. As the terms of trade recovered thanks to Chinese iron ore demand, in October 2009 the RBA became one the first of the first central banks to start to reverse its cash rate cuts. The terms of trade rose to record highs by 2011, when the iron ore price hit $US180 a tonne, in the process pumping up national income and domestic demand. But, unlike in some previous export boom episodes, the central bank received help from the floating $A, which soared to $US1.10. The stronger currency squeezed the traded goods sector, effectively spelling the end of the local car manufacturing industry.

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[13] *Senate Economics Legislation committee 31 May 2023*

[14] *Yahoo! Finance RBA boos slammed for being out of touch 31 May 2023*

But any political fallout on the central bank was limited because the exchange rate appreciation was seen as being driven by the market, not by RBA nor government policy.

The lead up: undershooting the target: 2016 to 2019

This was a period of relatively weak economic growth globally amid renewed talk of "secular stagnation". Australian inflation undershot the 2-3 per cent inflation target modestly but persistently, averaging 1.7 per cent. From the peak of the terms of trade boom in October 2011, the Reserve Bank cut the cash rate 16 times from 4.75 per cent to 0.75 per cent by October 2019 which helped mortgage borrowers but punished savers, including retirees. Unusually, Governor Lowe publicly made the case[15] for workers to demand bigger pay rises even amid perceived technology threats to job security.

The early 1990s discussion around the 2-3 per cent inflation target hardly canvassed the possibility of an extended under-shooting of the target. Now, for months on end, the Governor's post-Board meeting statements did not explicitly mention the numerical range of the target. It was also the period that sparked the initial Labor commitment to conduct an external review of the RBA, based on the idea that it should have cut the cash rate further and earlier to stimulate demand, reduce the economy's spare capacity, get inflation back into the band and reduce unemployment at a time when the estimated NAIRU (the non-accelerating inflation rate of unemployment) was falling. It led to the Review's recommendation for the RBA to more clearly target the 2.5 per cent midpoint of the target band, rather than be satisfied with getting just inside it. The RBA Review said that "most people" it consulted had concluded that "monetary policy did not sufficiently support the economy between 2016 and 2019", including the 30 consecutive board meetings that held the cash rate steady at 0.75 per cent. A modelling study co-authored by Labor MP Andrew Leigh found that employment forgone by tighter-than-necessary monetary policy was equivalent to about 270,000 people out of work for a year. As well, the divergent external views on the Reserve Bank's monetary policy decisions highlighted that aspects of its policy framework and regular communication "have not always been clear or detailed enough".

From the end of the GFC to the advent of the pandemic, Governors Lowe and Stevens resisted following other central banks, including the Bank of England and the US Federal Reserve into large-scale bond

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[15] *Jacob Greber Workers must demand a greater share of pie, says RBA Governor Philip Lowe. 19 June 2017.*

purchases, or quantitative easing, and related unorthodox monetary policy tools. Stevens used his end-year interviews with the Financial Review in 2013 and 2014 to try to talk down the Australian dollar past the peak of Australia's resources boom and as other central banks were cutting their interest rates much lower and venturing into QE. Australia's low interest rates already had fuelled house price speculation and prompted the Australian Prudential Regulatory Authority to reintroduce interventionist mortgage lending controls on banks.

Three years later, as the external RBA Review noted, Governor Lowe asked a House of Representative committee in February 2017: *With household debt as a share of household income already at a record high, is it really in the national interest to get a little bit more employment growth in the short run at the expense of creating vulnerabilities which could become quite dangerous in the medium term?*

The RBA Review found that the Reserve Bank's board deliberations and external communications ought to have provided more detail of the financial stability risks involved in very low interest rates; on whether such financial stability risks could have been targeted with other micro and macro-prudential controls; and on the trade-offs with inflation, employment and financial stability.

On the other hand, the RBA's riding instructions during this period were influenced by the financial shock of the GFC. In 2010, the SCMP between Treasurer Wayne Swan and Governor Glenn Stevens added that the RBA would "use its powers where appropriate to promote the stability of the Australian financial system" without compromising the price stability objective. As inflation sagged below target, the 2016 SCMP between Treasurer Scott Morrison and Governor Stevens said the "medium-term focus" of the 2-3 per cent inflation target provided the "flexibility" to "best achieve its broad objectives, including financial stability".

At the time, the *Financial Review* doubted that cutting the cash rate from an already very low 0.75 per cent would actually squeeze enough more activity and employment juice from the monetary policy lemon to justify the hard-to-quantify increased risk of capital misallocation and speculation from a near zero cost of money. Moreover, a political economy dynamic meant that, the longer it succeeded in keeping inflation low, the more that the political process relied on the inflation targeting regime to support economic growth. For example, the Rudd-Gillard Labor government of 2007 to 2010 changed the system of workplace regulation that made it harder for enterprise pay bargaining to generate wage rises.

The pandemic response

The arrival of the deadly COVID-19 virus in Australia in early 2020 prompted a quick policy response from both the government and the RBA. However, the previous inflation undershooting period meant that the central bank had limited interest rate ammunition left to deploy. At its scheduled 3 March meeting, the Board cut the cash rate by 25 basis points to 0.5 per cent. The governor's statement said the global outbreak of the coronavirus was expected to delay progress toward full employment and the inflation target. The Board was "prepared to ease monetary policy further to support the Australian economy". On March 12, the Prime Minister and Treasurer announced a $17.6 billion cent package of fiscal support, including a one-off $750 payment to welfare recipients, tax breaks for small and medium-size businesses and assistance for exposed industries such as tourism.

The dire warnings from health experts and officials of potential death tolls from the virus quickly gave way to warnings of the most grim economic outlook since the 1930s Depression. Governments that imposed severe restrictions on people movements were politically supported. Australia was one of the few countries to pursue a net-zero COVID suppression strategy until late 2021, even after national vaccine strategy had been kicked off early that year. As social distancing rules, lockdowns and border controls were imposed, Australians were shocked by the sudden appearance of long dole queues. Budget and monetary policy aimed to minimise the damage by building a "bridge" to the other side of the pandemic and take out insurance against the severe downside risks. After a second previously unscheduled March 20 Reserve Bank board meeting, Governor Lowe announced a further 25 basis point cut to the cash rate to a record low 0.25 per cent as the scope of the health threat and the various controls on people movement became alarmingly clear. The Governor introduced a soft form of announced forward guidance, saying that the cash rate would not increase until progress was being made toward full employment and it was confident that inflation would be sustainably within the target band. The *Financial Review* described the package as "unprecedented emergency actions". In addition, the Governor announced a 0.25 per cent target for the yield on three-year Australian government bonds; a $90 billion term-funding facility for authorised deposit-taking institutions at an interest rate of 0.25 per cent[16]; and that it would pay 0.1 per cent, rather than zero, for exchange settlement balances on deposit at the RBA. The Governor held a press conference at 4pm.

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[16] *Matthew Cranston and Jonathan Shapiro RBA cuts to 0.25pc, provides $90b funding for SMEs, The Australian Financial Review, 19 March 2020*

On 30 March, Prime Minister Scott Morrison unveiled[17] one of the biggest federal government fiscal and labour market support packages ever. Roughly one-third of the workforce would receive $1500 a fortnight for the following six months under a $130 billion wage subsidy, described by the PM as an "economic lifeline". The "JobKeeper" program was extended, though also wound back, in September and again in January to eventually end in March 2021. The final budget cost ended up significantly less than initially expected at $88.8 billion. This was just part of an unprecedented package of fiscal support.

At the time of the initial JobKeeper announcement, March 2020, the federal Treasury was preparing for a June quarter contraction in GDP of up to 12 per cent and a jobless rate increase to 15 per cent. The April labour force release estimated that a shocking 594,000 people had been tossed out of work in the month, a record by a huge margin. In May, the RBA forecast the jobless rate would top 10 per cent. Instead, June quarter GDP fell 7 per cent and the jobless rate peaked at 7.5 per cent in July 2020. As the economy rebounded surprisingly quickly, employment recovered to its pre-Covid level by March 2021. The jobless rate fell sharply to near 50-year lows of 3.4 per cent by the following July.

Forward guidance

After the Board's 6 October 2020 board meeting, Governor Lowe foreshadowed the shift toward more ambitious forward guidance designed to wring out more monetary stimulus as the cash rate approached the "lower bound". The Board continued "to consider how additional monetary easing could support jobs as the economy opens up further". Lowe followed this up with a 15 October speech that included what the Financial Review's economics editor John Kehoe[18] called an "historic RBA policy pivot". The Governor said the Board would not increase the 0.25 per cent cash rate "until actual inflation is sustainably within the target range". It would not be enough for inflation to be forecast to return to the 2-3 per cent target band. "So we will now be putting a greater weight on actual, not forecast, inflation in our decision-making," he said. Moreover, the Board viewed "addressing the high rate of unemployment as an important national priority". The Board did not expect to increase the cash rate "for at least three years",

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[17] *Phillip Coorey Morrison's $130b to save six million jobs, [The Australian Financial Review](), 30 March 2020*

[18] *John Kehoe Lowe's message signals historic RBA pivot, [The Australian Financial Review]() 15 October 2020*

though this did not initially attract as much attention as the indication that the central bank was considering its first serious foray into “quantitative easing”: buying longer-dated government bonds in the secondary market to hold down interest rates further out of the yield curve.

Notwithstanding an “encouraging” improvement in the economic outlook, the 3 November 2020 Board meeting decided on a series of further extraordinary measures “to support job creation and the recovery of the Australian economy from the pandemic”. These included the Reserve Bank’s first foray into full-scale quantitative easing through a $100 billion program of purchases of five to 10-year government bonds purchases over the following six months. The 0.25 per cent cash rate was cut to the lower bound of 0.1 per cent, backed by a stronger form of forward guidance: *Given the outlook for both employment and inflation, monetary and fiscal support will be required for some time. For its part, the Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. Given the outlook, the Board is not expecting to increase the cash rate for at least three years.*

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▶ Lowe pledges 0.1pc cash rate for three years ▶ Launches $100b of bond buying QE ▶ Borrowers to ‘negotiate’ with banks

RBA nails low rates to the floor

Matthew Cranston
Economics correspondent

The Reserve Bank has promised to keep its official cash rate at 0.1 per cent for at least the next three years and will buy $100 billion of bonds in the coming six months to force cheaper bank lending to boost the economy’s jobs recovery.

RBA governor Philip Lowe announced a $5 billion per week buying program – worth about 5 per cent of GDP in total – along with a suite of lower rates for bank funding, while also upgrading forecasts for economic growth from 4 per cent to 6 per cent by June next year.

The Australian dollar fell to as low as US70.40¢, while bond yields were also driven lower in expectation of the ramp up in purchases by the bank.

However, the governor said that a slower jobs recovery as well as upward pressure on the Australian dollar from trillions of dollars in bond purchases from other central banks meant the trigger now had to be pulled on the country’s first formal quantitative easing program.

“The lower interest rates and our plan to buy $100 billion of government bonds over the next six months will help people get jobs and support the recovery of the Australian economy,” Dr Lowe said.

“A sharp bounce-back in jobs is unlikely and it will take time to return to where we were before the pandemic. Even if Victoria had not gone into lockdown we still would have made this decision because the outlook for the labour market required further action.”

In addition to the official cash rate cut, the central bank lowered the interest rate it charges commercial banks on loans through its $200 billion Term Funding Facility (TFF) from 0.25 per cent to 0.10 per cent. It also lowered its target on yields for the 3-year bond – a benchmark borrowing rate for banks and business – from 0.25 per cent to 0.1 per cent.

The major banks may not slash their standard variable rates to follow the RBA’s cash rate cut from 0.25 per cent to 0.1 per cent but they are considering reducing their fixed-rate home loan offers.

Dr Lowe said he expected the “banks to pass on the cheaper funding benefits but that such reductions were more likely to come through negotiating and switching loans rather than general reductions.

Continued p4

Asset inflation

The historic move by the RBA to quantitative easing will light a fire under asset prices and force savers to take more risks to find yield. **Chanticleer p40**

It has ‘arisen from its monetary slumber and its long, fruitless search for the inflation dragon’. **Paul Keating p7**

Firepower

- Cash rate cut from 0.25 per cent to record low of 0.1 per cent.
- Launches quantitative easing program, buying $100 billion of 5 to 10 year government bonds over next six months.
- Yield target on 3-year government bonds lowered to 0.1 per cent.
- Interest rate charged on loans to commercial banks under the term funding facility cut to 0.1 per cent.
- Rate paid on commercial bank deposits in exchange settlement accounts cut to zero.

Philip Lowe, RBA governor

$100 billion is the magic number for QE

Analysis

John Kehoe

By launching a historic and larger-than-expected $100 billion, initial six-month government bond buying program the Reserve Bank is crossing the Rubicon.

Yet governor Philip Lowe is dismissing the growing perception the central bank’s creation of money out of thin air (money printing) is now financing the ballooning budget deficits of federal and state governments.

Lowe also clarified that the RBA does not believe the recession is over and warned there is a “long and bumpy” road ahead for the hundreds of thousands of unemployed Australians hit by the COVID-19 recession.

That’s despite the RBA upgrading its economic growth forecast to 6 per cent, from 4 per cent, in the year to June 2021 and the unemployment rate now expected to peak at 8 per cent, not the 10 per cent previously forecast.

Lowe is determined to do whatever the bank reasonably can to support the government in the COVID-19 economic recovery that is better than glacially muddling our way out of the deepest recession in 100 years.

The nominated $100 billion figure over six months in Commonwealth and state government bond purchases was chosen by the RBA not just

Continued p5

The forward guidance was rhetorically reinforced at subsequent Board meetings. After the February 2021 meeting, Governor Lowe said the Board did not expect conditions for a cash rate increase - actual inflation returning sustainably to the 2-3 per cent target - to appear until "2024 at the earliest".

In its internal review of the QE package, the RBA explained that an "important decision" was that Australia was one of the few advanced economies not to have a bond purchase program. That contributed to Australian yields being higher than elsewhere, putting unwanted upward pressure on the exchange rates. It is worth recalling the public reaction at the time, beginning with the November 2020 package. The Labor Opposition did not question the package. Shadow treasurer Jim Chalmers said the Reserve Bank was "being forced to contemplate further and more extreme measures" because the government was tapering its fiscal stimulus as JobKeeper was extended but wound back. In the days before the November package, Paul Keating accused the RBA of indolent incrementalism[19], claiming he had wanted it to tighten earlier than it did in 1988, thus making the early 1990s recession worse. Given that monetary policy could no longer itself add to demand, the former treasurer said, the central bank should "fund" the fiscal policy measures.

But there were doubters, too, in response to the November 2020 package. Much of the focus continued to be on the QE program and the cash rate cut to 0.1 per cent, rather than the forward guidance of no rate increase for at least three years. At the time, private economist Warren Hogan cautioned that the "RBA is having to be bolder with its policy actions but at the same time is taking more and more risk with unintended consequences". Hogan complained that the RBA's communications did not extend to the impact on financial stability, the health of the banking system or economic efficiency. Very much from the real world, leading electronic and furniture retailer Gerry Harvey[20] called the Reserve Bank's package "overkill" given the economy and the real estate market already were showing signs of picking up. "The goods we have in our stores are selling like crazy, like never before", Harvey said. "I think confidence is not too bad out there at the moment. Look what's happening with real estate.

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[19] *Phillip Coorey and John Kehoe Keating says RBA should "fund" government's budget deficits. The Australian Financial Review 23 September 2020*

[20] *Gerry Harvey. Simon Evans Gerry Harvey thinks RBA may have gone too far, The Australian Financial Review 3 November 2020*

The Financial Review editorial ("RBA's uncertain leap into the unknown"[21]) queried why other arms of policy - such as workplace regulation and tax reform - were not being used to attack high unemployment before the central bank steered Australian into such uncertain territory. The editorial quoted former Board member, economist Bob Gregory, warning of the uncertainty about the side effects of unconventional monetary policy, let alone whether it would work. It warned that QE could reignite housing prices. It said that Governor Lowe's suggestion that the cash rate could remain at 0.1 per cent for up to five years was improbable. "Regrettably, this is unlikely to play out smoothly," it said.

The inflexibility of the extended forward guidance was out of character for a Reserve Bank that had fashioned a relatively flexible inflation target - with a relatively wide and high band of 2-3 per cent and with fuzzy boundaries that could be temporarily breached. After all, recall how the unexpected economic rebound after the October 1987 stock market crash gave way to an asset price boom that required an even sharper increase in official interest rates within the following year.

After the February Board meeting, the Financial Review editorialised that: *For the normally cautious, flexible and prudent central bank, the timeline for keeping the cash rate nailed to the floor is extraordinarily prescriptive, particularly amid the great uncertainty of a post-pandemic world.*

As the economy rebounded, the masthead editorialised by June that the extended forward guidance "never passed the pub test".

At an address to the National Press Club in February 2021, Lowe took issue with a journalist's question that described the forward guidance communication as a "pledge": *I haven't pledged anything. All I've said is that we're going to keep interest rates where they are until inflation is sustainably with 2-3 per cent and I don't think that's going to be until '24. So that's what I've said. You might have a different view and you might think that inflation is going to get back there next year. Maybe. But that's not my view so I'm just … I'm big on openness and transparency so I wanted to share my view with you, but I'm certainly not pledging that … I'm giving you my best guess.*

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[21] *The AFR View RBA's uncertain leap into the unknown, The Australian Financial Review, 4 November 2020*

By February 2023, amid a controversy over Lowe's attendance at private banker's lunch, the *Financial Review* said it was ironic that the increased openness from RBA Governor's during the inflation targeting era had gotten him into trouble by extending this into his extreme forward guidance on interest rates. The AFR View commented[22]: *The immediate issue is what is the most effective way of communicating central bank policy thinking to the market while being publicly accountable. But the broader lesson that the Reserve Bank needs to communicate is that being forced to stretch its limited tools too far can come with costs.*

Communications textbooks would predict that the Governor's fine print qualifications would be ignored, particularly in the event that the "best guess" did not come to pass. The external RBA Review said it heard from people who interpreted the eventual decision to increase interest rates in May 2022 as a "broken promise". That has opened up the RBA to questions over the apparent lack of questioning of the forward guidance with the staff and on the Board - and to the Review's call for greater contestability of views within both. The element of the "broken promise" not to increase interest rates is being exploited by those who oppose today's tighter monetary policy as unnecessarily dampening economic growth. If the Reserve Bank got its inflation forecasts wrong before, it could be wrong again now.

The external Review urged that the RBA should "avoid being trapped by previous narratives", including by communicating new views and adjusting policy in a timely way as circumstances changed. Compared to other central banks, the RBA's forward guidance applied to a long time-horizon and was not updated as the economic outlook improved. Moreover: it said: *For a time, forward guidance appeared to be employed more or less as an independent policy tool as opposed to a communication tool meant to explain more clearly the actual and projected, state-contingent policy actions. Unsurprisingly, this proved unhelpful. As conditions evolved during the pandemic, the RBA recognised (with a delay), that it needed to adjust policy in a manner that differed from the time-based communication it had provided earlier. This had a negative impact on the Bank's credibility that could have been avoided with a better communication strategy. Going forward, it would be advisable to avoid treating forward guidance as a separate policy tool, and instead place greater emphasis on ensuring that the Bank's policy reaction function to the evolving macroeconomic outlook is better understood.*

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[22] *The AFR View, Everyone needs to get the right RBA message, The Australian Financial Review, 12 February 2023*

It could be argued that the RBA adapted the stated purpose of the monetary policy to take advantage of the opportunity to push unemployment to decades-low levels and keep it there. That could be seen as a form of mission creep. Three decades earlier, the vigorous tightening that punctured the asset price boom delivered the opportunity to use a low inflation target to entrench Australia back into the low inflation world of the late 1960s. Now, the pandemic stimulus had unexpectedly provided the opportunity to drive the jobless rate significantly below 5 per cent for the first time since the labour market fallout from the Whitlam government's 1974 credit squeeze. With good news on a vaccine and the US passing a big budget stimulus, in March 2021 the *Financial Review* reported that Governor Lowe and Treasury secretary Steven Kennedy were signalling that the Morrison government could afford to set a lower unemployment target before tightening budget spending[23]. Kennedy revealed that Treasury had reduced its estimate of the non-accelerating inflation rate of unemployment (the NAIRU) from 5 per cent to 4.5 per cent. "In years to come, we will see how low we will get this unemployment rate," he said. Lowe told the *Financial Review's* Business Summit "it's not inconceivable that we could sustain an unemployment rate in Australia starting with a 3".

The RBA did not bear the political cost of the early 1990s recession that facilitated the introduction of the low inflation target regime. But, this time, it did have its fingerprints all over the unexpected sharp rise in inflation to just under 8 per cent that forced it to increase its cash rate by 13 times within the time frame of the no-rise forward guidance. The beginning of the end of three-year forward guidance came within 12 months with the "Red October" bond market revolt against the related yield curve control target that aimed to keep the yield on the three-year, April 2024, bond at 0.1 per cent. A month before, in September 2021, Governor Lowe scolded market traders for taking bets that the Reserve Bank would lift its cash rate as soon as early as 2022. "I find it difficult to understand why rate rises are being priced in," he said. On October 27, the Reserve Bank's preferred measure of annual inflation lifted into the 2-3 per cent target band for the first time in six years. The Financial Review reported this as a sign that "global supply chain disruption is pushing inflation into the central bank's target zone quicker than its forecasts".

[23] *John Kehoe More jobs can help the RBA fight the next recession, The Australian Financial Review, 24 March 2021*

The bond market pushed the three-year bond yield above 0.7 per cent in what the external Review later described as "disorderly" market conditions that "caused some reputational damage to the Bank". After the 2 November 2021 Board meeting the following week, Governor Lowe formally announced that the Board had made "the difficult choice' to abandon its yield curve control altogether. And he eased the related three-year forward guidance from the previous month's insistence that the "central scenario" was that the conditions for increasing the 0.1 per cent cash rate "will not be met before 2024". The Governor's statement said: *The Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. This will require the labour market to be tight enough to generate wages growth that is materially higher than it is currently. This is likely to take some time. The Board is prepared to be patient, with the central forecast being for underlying inflation to be no higher than 2½ per cent at the end of 2023 and for only a gradual increase in wages growth.*

Three months later, Russia invaded Ukraine, sending international oil prices higher and signalling further disruptions to global supply chains. On 4 May, 2022, Lowe announced a 25 basis point increase in the cash rate to 0.35 per cent. It was the second time that a cash rate had been announced during a federal election campaign and the first increase for 11 ½ years. Governor Lowe's statement said that "a further increase in interest rates" would be required in the period ahead. Headline inflation already had increased to 5.1 per cent and was forecast to rise further to 6 per cent. The unemployment rate was forecast to fall to close to a 50-year low of 3 ½ per cent by early 2023. National income was being boosted by higher commodity export prices that were pushing the terms of trade to record highs. With the cash rate at a record low 0.1 per cent, no wonder the Board had decided that "some withdrawal of the extraordinary monetary support provided through the pandemic is appropriate".

At a 4pm press conference, Lowe said the election had "no influence at all" on the rate rise announcement made 90 minutes earlier, adding that, while not the case in every other country, it was: "*testimony to the political culture in Australia that the Reserve Bank can take its decisions completely independently of politics. … I know those decisions are not always popular. They're contested and in some cases they're controversial …. The government of the day appoints nine Australians to make those decisions and we take them in the national interest with no political interference.*

Questioned about the forward guidance, Lowe said: *We were faced with a global pandemic. We were being told that it would take many, many years for vaccines to be developed, that people could be locked* *down for a long period of time. That tens of thousands of Australians would die from the pandemic, that our hospitals would be full, that we would have double digit unemployment, perhaps 15 per cent unemployment, that there would be deep scarring that would last for years, perhaps decades. That was the situation we were making decisions in, in 2020. And in that situation, the board decided that it wanted to do everything that it could possibly do to help the economy through what was a truly horrific outlook. I didn't want to leave any stone unturned in that very difficult situation. The Reserve Bank wanted to do everything it could do to help the economy through that period. And one of the things that we could do is to be very clear about what we saw as the outlook for interest rates, that we would keep them low for as long as was necessary and at the time, we thought it was going to be necessary out to 2024.*

Lowe added that "thankfully, we were wrong" and the economy had turned out much better than feared. The RBA had taken "every possible step" in the "full knowledge that if things turned out better, we'd have to reverse the policy stimulus more quickly". Asked about what he would say to those who had taken out a mortgage on the understanding of the RBA's forward guidance, Lowe said: *Australians have understood that interest rates would go up at some point. None of us understood really at what point that would be, but I think we all understood that at some point interest rates would go up. They didn't know but they knew that would go up and they responded appropriately. Over the past couple of years, households have saved an extra $240 billion over and above what they otherwise would've saved. They've squirrelled that away, it's in bank accounts, and the average owner-occupier with a mortgage is more than two years ahead of their mortgage repayments. Back in 2018, they were only one year ahead. So they've saved a lot of extra money and they're ahead, many people are ahead of their mortgages. Loan arrears at the moment are very low. So people have understood that interest rates would go up. It's happening earlier than I expected. I'm sure it's happening earlier than many borrowers expected. But I think we all knew that interest rates couldn't stay at this current level forever, and many people have saved in advance of that day and I think that's very sensible behaviour.*

The RBA moved a few months after most comparable central banks, which all scrambled to respond to the unexpected inflation breakout. The first standard-size cash rate increase was quickly followed by four successive double-sized 50 basis point hikes at each of the four following monthly Board meetings. All up, the RBA delivered 13 rate increases by November 2023, lifting the cash rate to 4.35 per cent. That peak was close to a percentage point below the peak reached by comparable central banks. Yet, by the 12th rate rise – to 4.10 per cent in June, 2023, the political tensions were evident in Treasurer Jim Chalmers' response: *I do expect that there will be a lot of Australians who will find this decision difficult to* *understand and difficult to cop. The Reserve Bank's job is to squash inflation without crunching the economy. And they will have lots of opportunities of course to explain and defend the decision that they've taken today.*

Post-pandemic 2-3 per cent inflation target

Post-pandemic monetary policy and its communication is framed by the Statement on the Conduct on Monetary Policy between Treasurer Chalmers and the Reserve Bank Board (as opposed to the Governor) released in December 2023. The SCMP retains the core of the existing framework but with some significant differences, in part reflecting the recommendations of the external Review to among other things increase the contestability of views within the RBA and the Board. It recognises the "substantial independence" of the RBA to achieve its price stability goal, endorsing a "flexible inflation target" and "an appropriate goal" of "consumer price inflation between 2 and 3 per cent". That is, after 30 years and seven agreements between the Treasurer and Governor of the day, the 2-3 per cent target has remained the central plank of monetary policy, receiving bipartisan political support and no serious opposition. This time, if anything, the target band was reinforced, reflecting the external Review, through the Treasurer and the Board agreeing that monetary policy should aim to return inflation to the midpoint of the target (rather than lingering, for example, near or below the bottom of the target as in 2016-19). They agree that the appropriate timeframe for this "depends on economic circumstances and should, where necessary, balance the price stability and full employment objectives of monetary policy". The statement reflects the external Review's recommendation on the RBA's "dual mandate" of price stability and full employment, though without its call for "equal consideration" of the two objectives, whatever that might mean. It notes the Government's objective of "sustained and inclusive full employment where everyone who wants a job can find one without searching for too long". But it says that the Government and the Board agree that the Board's role is "to focus on achieving sustained full employment, which is the current maximum level of employment that is consistent with low and stable inflation". That leads to the conduct statement's communication guidance in which the Board commits to "clearly communicating how it is balancing its inflation and full employment objectives":

More generally, when inflation is expected to be significantly away from the midpoint of its target of between 2 and 3 per cent or labour market conditions are expected to deviate significantly from those consistent with full employment, the Board commits to communicating how long it expects it will be before it again meets each of its objectives and why.

The SCMP says the primary approach to implementing monetary policy “will be through varying the level of the cash rate target”. Reflecting the failure of the three-year forward guidance and the yield curve control, the Board will communicate a framework to guide any use of “other monetary tools”, including the benefits, costs and risks. This will draw on “international experience, independent assessments and lessons from the Reserve Bank’s use of additional monetary tools”. The decision-making framework for using and exiting such tools should include “how monetary policy will work with other arms of policy”. The Board “will continue to contribute to financial stability by setting monetary policy to achieve its inflation and full employment objectives”.

Amid the mission creep, the failure of the forward guidance and the political tension over the regime’s steepest increase in interest rates, the fundamental communication task would seem to be to, first, explain why inflation increased so sharply in 2022 and 2023 and, second, why higher interest rates, including for mortgage borrowers, are required to get inflation back into the 2-3 per cent target by 2025. The public debate is confused on this, diverted by example by political claims that inflation is being driven by corporate profit and price gouging, particularly by big supermarkets. Media coverage struggles to reconcile the RBA assessment that the economy is operating beyond full capacity and full employment, and so is “hot”, with the idea that economic growth is being smashed by its higher cash rate. Some query whether the RBA cash rate instrument designed to influence aggregate demand can tackle strongly rising prices for CPI items such as insurance and rents.

The narrative still to be fleshed out is that, in the face of the terrifying downside risks of the pandemic, the enormous fiscal and monetary stimulus, both in Australia and in other countries, pumped up aggregate demand. As the virus subsided and economies reopened, that aggregate demand spilled over the economy’s aggregate supply capacity - again in Australia and globally, that had been disrupted by the shock of the pandemic. The result of this continues to be higher inflation, made worse by developments such as the Russian invasion of Ukraine, rising electricity bills amid the low carbon transformation, a stalling of productivity (which is pushing up unit labour costs), a shortage of housing caused by supply-side constraints and continued strong public sector demand, including a boom in state government infrastructure construction.

This sort of communication narrative, however, does feed into the greater emphasis on the balance of aggregate demand and supply in the external RBA Review, the SCMP, the 2024 instalments of the

Statement on Monetary Policy and the Governor's post-Board meeting press conferences. The SCMP commits the RBA to regularly publish its "assessments of potential output and full employment". The February 2024 SMP discussed this at length, committing to regularly provide the RBA assessment of spare capacity in the economy, including of output relative to potential output, and employment relative to full employment as well as other indicators of resource utilisation. As it explained:

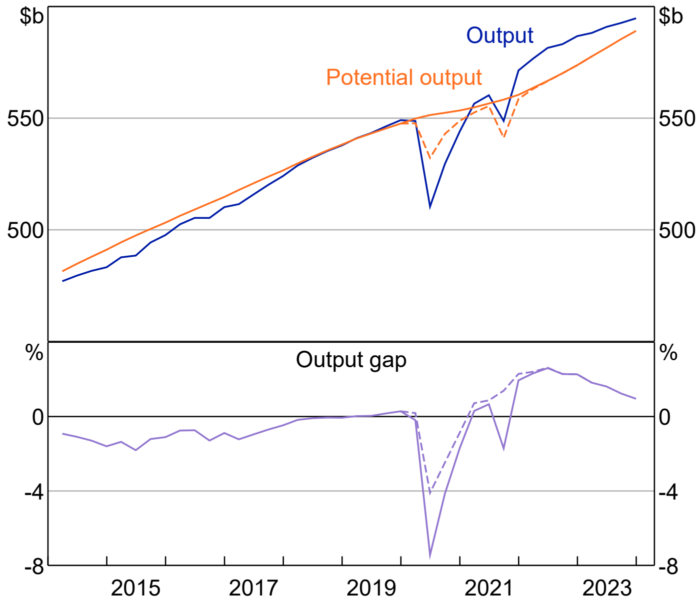
The RBA uses monetary policy to achieve a balance between demand and supply in the labour market and in the markets for goods and services. Monetary policy influences aggregate demand – that is, total spending on goods and services in the economy. A shortfall in aggregate demand relative to supply leads to a relative lack of demand for labour, more limited work opportunities and low wages growth, putting downward pressure on inflation. Conversely, if total spending is high relative to supply, inflation will typically rise above target, wage pressures will increase in the face of high vacancies and staff turnover, and firms may struggle to meet demand for their products. Additional spending beyond what is consistent with full employment increases inflationary pressure without a sustainable improvement in living standards, so at any given point in time there is a limit to the level of economic activity that can be sustained.

The SMP discussion notes there can be a trade-off between the two objectives in the short-term. If inflation is above target for too long, inflationary expectations will tend to drift up, requiring higher interest rates and higher unemployment. But the longer inflation is above the target, the more likely it is that inflation expectations will drift higher. And if they do, it will require higher interest rates and unemployment to bring inflation back to target than otherwise. So, even when there are short-term trade-offs, over a longer horizon the two monetary policy objectives tend to align. But the SMP says the Board has "sought to slow demand gradually, opting for a measured pace of returning inflation to the target range to preserve the employment gains of recent years in a sustainable manner".

This aggregate demand and supply focus has come with model-based assessments and new graphical treatment such as in the May SMP.

Aggregate Demand and Supply*

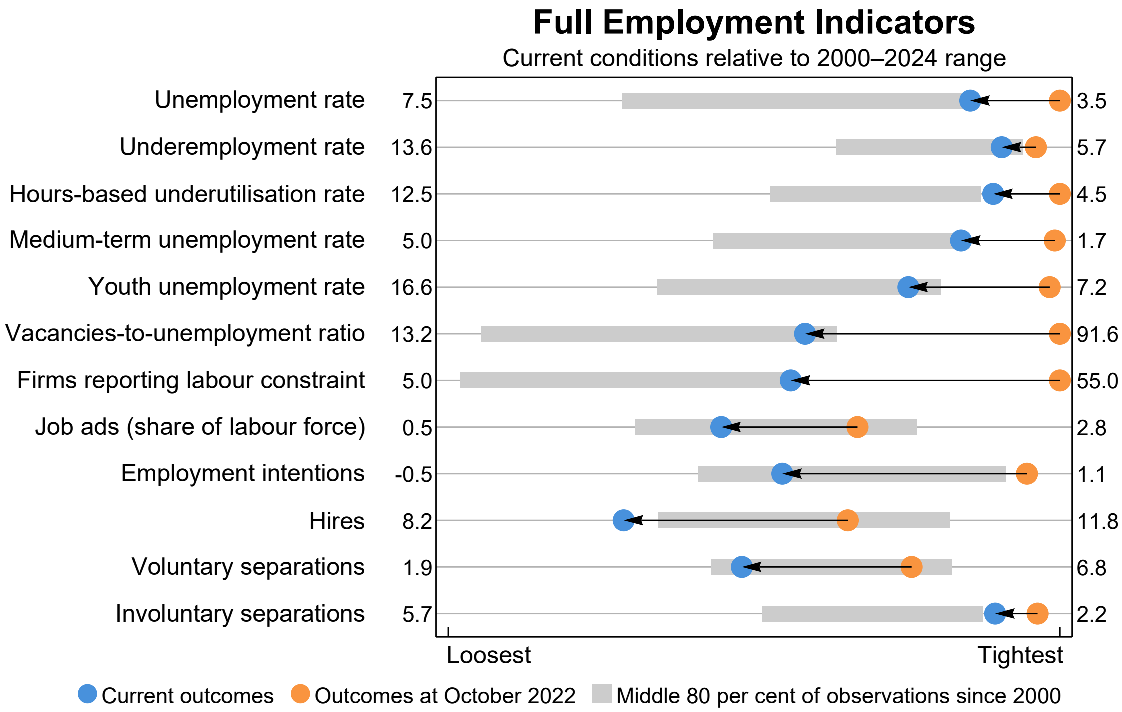
Selected model estimates



* Estimates of potential output and output gap from one of the models in the RBA's suite; dashed lines include an illustrative adjustment for pandemic activity restrictions; levels reflect 2021/22 prices.

Sources: ABS; RBA.

The SMP discussion says the RBA does not have a numerical target for full employment. The concept of the non-accelerating inflation rate of unemployment, or NAIRU, that has featured in previous debates is now hardly mentioned. Instead, the August SMP presents a largish range of measures on the degree of tightness in the labour market, such as various under-utilisation, underemployment, vacancy and hiring rates, as in the August SMP. These will be more scrutinised if the most publicly-noticed indicator - the unemployment rate - increases modestly over 2025 as forecast by the RBA staff.



Sources: ABS; JSA; NAB; RBA.

The focus on the capacity constraint as a driver of inflation is reflected in the expansion of variables in the SMP's Detailed Forecast Table, including the RBA staff forecast for hours-based labour utilisation, real wages growth and productivity. The forecast table now also includes the assumed path for the cash rate (reflecting market pricing and professional economist surveys), the exchange rate, oil prices and population growth.

The RBA's changed governance arrangements reflect the external Review's critique that the Board needs to more vigorously contest the Governor and the RBA staff: that is, why was there no apparent strong internal opposition to the forward guidance. The statement from the Board meetings - reduced from 11 to eight a year - now comes from the Board rather than the Governor. The conduct Statement says that, once established, the proposed Monetary Policy Board will publish the (unattributed) votes of its members, who will be expected to give at least one speech or make a similar public appearance per year. The Monetary Policy Board would convene and engage with "an expert advisory group of monetary policy" to provide "a wide range of external views" that could contrast with the RBA staff forecasts.

The Governor's media conferences as the new communications loudspeaker

The proposed new governance arrangements potentially could confuse the monetary policy message coming from the Board. On the other hand, the new requirement for the Governor to hold a media conference after each Board meeting already has provided a more prominent platform for the Bank's most public figure. New Governor Bullock was prominently endorsed on the announcement of her appointment by both Prime Minister Albanese and Treasurer Chalmers in the PM's parliament house office. The Governor's press conferences will reinforce her as the public face of the monthly Board decisions and the quarterly Statement on Monetary Policy. The Governor's performance will be commented upon, including her level of interest rate empathy or anti-inflation determination. At the same time, the potential for individual Board members to become more vocal - and perhaps differ from the Governor or the RBA staff – has prompted the *Financial Review* to "pap" photograph them going into the two-day Board meetings.

The media conferences, all so far held at the RBA's temporary office in Sydney, start at 3.30pm, an hour after the 2.30pm release of the Board meeting statement, and last about an hour. Before four of the eight media conferences, the quarterly SMP is released in a preceding media lock-up that ends with the written Board meeting statement. The media conference is televised live. A transcript is published soon after on the RBA website under the heading "Monetary Policy Decision". To date the Governor opens with some relatively brief remarks and does not present any graphs or similar to talk to. In order of pre-arranged seating, questions then come from 20 to 25 journalists, similar to the longer-standing media conferences held by the Bank of England Governor and the US Federal Reserve Chair. Perhaps not surprisingly, the questions asked at the RBA press conference tend to be less wonky than asked of the Bank of England and Federal Reserve, in part reflecting the more direct link between the Australian central bank's cash rate decision and mortgage interest rates.

At the press conference after the February 2024 Board meeting that held the cash rate at 4.35 per cent, Governor Bullock made some introductory remarks that canvassed the inflation outbreak, the RBA's rapid cash rate rises and the cost-of-living squeeze. She said the Board understood that "people are doing it tough" but that "inflation hurts all Australians", including mortgage borrowers and renters. She drew attention to the new-look SMP that she hoped would be seen as more accessible, plain-speaking and drew people's attention to what the Board thought was important.

Bullock went through the SMP forecasts for inflation to come back into the target band but noted that inflation "still had a 4 in front of it". In terms of lifting or cutting the 4.35 per cent cash rate, "we haven't ruled anything out and we haven't ruled anything in". The journalists' questions struggled with the SMP forecast assumptions of more than one cash rate cut in 2024, based on financial market pricing. Bullock's tone was less dovish, pointing to a labour market that was still "a little bit overtight" and the risk that inflation expectations could drift up. The *Financial Review's* page one headline said: 'Job is not done, says RBA boss", with an overline noting Bullock's line that a further cash rate rise "can't be ruled out".

At the second media conference in March, journalists queried the change in the Board statement's language. The phrase that a "further increase in interest rates cannot be ruled out" had been replaced by "the Board is not ruling anything in or out". Had a tightening bias been replaced by a neutral bias? Was the RBA talking rate rises off the table for now? The Board was uncertain, Bullock replied, but that consideration of a rate cut would require more confidence that inflation was coming back into the target band. "I won't be giving forward guidance," she said. The Financial Review page one headline read "RBA keeps rate rise in reserve", although the story suggested the Board had shifted to a more neutral stance.

It all became clearer at the subsequent June media conference, following the release of the March quarter national accounts. In direct answers to questions, Bullock said that, yes, the Board did discuss the case for increasing the cash rate and, no, it did not consider a rate cut, while also "not ruling anything in or anything out at the moment". Amounting in this case to a form of tightening bias, this formulation was shaping as a communications template Q&A for future meetings. (This turned out not to be the case as Bullock subsequently rejected the template, instead saying that Board meetings had instead discussed whether conditions had developed in ways that would change the current policy stance.) At the June meeting, the Board also reinserted a line in its statement that it "will do what is necessary" to return inflation to target.

The sub-headings in the Board statement, a part of the communications evolution, read "Inflation remains above target and is proving persistent", "The outlook remains highly uncertain", and "Returning inflation to target is the priority". Immediately, after a reference to the upside risks from persistent inflation, the statement said that "recent budget outcomes may also have an impact on demand", even though federal and state government energy rebates would temporarily reduce headline inflation. At the press conference, Bullock repeated the assessment that aggregate demand remained above aggregate supply. This naturally provoked the question of whether government fiscal policy may be adding to the excess of demand. Bullock brushed off a question about this, suggesting that the next set of staff forecasts in August could take budgets “holistically into account”. In what the *Financial Revie*w called a hastily arranged press conference, Treasurer Chalmers also brushed off suggestions that expansionary fiscal policy may adding to demand. “I don’t tell her how to do her job, and the Governor doesn’t tell me how to do my job,” Chalmers said. The Financial Review’s page one heading read: “RBA warns on public spending”[24]. The article said that the August Board meeting was now “live” in terms of a possible cash rate increase, in contrast to the reductions that had been priced in by financial markets.

The August Board meeting kept the 4.35 per cent cash rate on hold. But the SMP released on embargo in the journalists’ lockup revealed a sharp upward revision in the RBA staff’s forecast for public demand real growth over the four quarters to the December quarter of 2024, from 1.5 per cent to 4.3 per cent. The Board meeting statement publicly released at 2.30pm commented that the SMP’s central forecasts were that inflation would return to target slightly more slowly than forecast in May, based on estimates that the gap between aggregate demand and supply were larger than previously thought. That partly reflected an increase in forecast demand (which the detailed tables showed included higher public demand). But it also reflected “a judgement that the economy’s capacity to meet that demand is larger than previously thought, evidenced by the persistence of inflation and ongoing strength in the labour market”. The obvious implication was that monetary policy would have to work harder to get the stronger-than-expected demand, which it could influence through its cash rate lever, back into balance with the weaker-than-expected supply, which the RBA could not influence.

In her press conference, Bullock said in her longer-than-usual introductory remarks: *“Make no mistake, inflation is still too high and the Board does remain concerned about the degree of excess demand in the economy. What I mean by that is that the amount of goods and services that households and businesses can buy and need, that’s more than the amount that the economy can sustainably provide supply, if you like”.*

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[24] *Michael Read RBA warns on public spending splurge The Australian Financial Review 18 June 2024*

After some further discussion on the state of the economy, Bullock noted the higher degree of uncertainty and volatility that had followed the period of extraordinary supply shocks, the near zero cash rate in 2022, the massive fiscal support (and, she could have added, the 13 cash rate increases). Then the Governor gave some short-term guidance seemingly designed to tell financial markets that they had got "a little bit ahead of themselves" in pricing in cash rate reductions.

So based on what I know today and what the Board knows today, what we can say is that a near-term reduction in the cash rate doesn't align with the Board's current thinking.

Pressed on what "near-term" meant, Bullock said: *I'm going to obviously preface this by saying no forward guidance, but near term – I think what the Board's feeling is that the market path at the moment is pricing in interest rate reductions by the end of this year. I think the Board's feeling is that the near term, by the end of the year and the next six months, given what the Board knows at the moment and given what the forecasts are that that doesn't align with their thinking about interest rate reductions at the moment.*

Although the Governor protested that she was not giving forward guidance, she also needed to deal with the point made by deputy Governor Guy Debelle in 2018 : that the success of RBA communication policy would be marked by whether it minimised the surprise element of interest rate changes. That could extend to countering misplaced market or public expectations of a cash rate cut over coming months. Bullock added: *Now, I understand that this is not what people want to hear. I know there are many households and small businesses that are struggling with interest rates where they are. Many people are doing it tough and we're very conscious of that. The Board is very conscious of that. But really, the best thing we can do, and I've said this before, the best thing we can do is to bring inflation back down to target because we can't let inflation get away— It hurts everyone, it particularly hurts people on lower incomes. This is why we need to stay the course on bringing down inflation until it's sustained in the band of 2 to 3 per cent.*

Pressed again on whether fiscal policy, or public spending, was keeping interest rates higher than longer, Bullock said that, yes, public demand had been revised up, but this was partly offsetting other elements of demand that had been revised down. The apparent new working arrangement is that the Treasurer comments about fiscal policy (but not monetary policy), and the Governor talks about monetary policy (but not fiscal policy). "I'm not telling governments what to do with their fiscal policy," Bullock now says.

“That’s very much theirs”. In contrast, the RBA Review called for “stronger coordination between fiscal and monetary policy, without undermining monetary policy’s operational independence”. Any belief that inflation and employment was “solely under the control of monetary policy risks diminishing the responsibility of Government and setting unrealistic expectations of the RBA”. The Statement on the Conduct of Monetary Policy committed the RBA and the Government (through Treasury) to work together on understanding how the two arms of macro policy affect the economy. However, the politicised nature of both the interest rate and budget levers mean that this cannot be carried out in public.

Much will depend on whether the current disinflation cycle leaves the economy on the RBA’s hoped-for “narrow path” of avoiding a sharp rise in unemployment. But the fiscal policy question leads to a further question for monetary policy and its communication. What if the constraint on a return to non-inflationary economic growth is less about demand per se, and more about ongoing supply constraints, some of them policy-induced? While aggregate demand now exceeds supply, it seems odd to describe demand itself as “hot’, even if propped up by state government infrastructure investment, public sector pay rises and higher social policy outlays. The Reserve Bank may get into the situation whereby it needs to explain that demand cannot increase much, and interest rates cannot fall much, because of the economy’s lack of supply-side capacity as suggested by the stagnation in labour productivity since 2016.

Conclusion

The Reserve Bank’s adoption of a 2-3 per cent inflation target in the early 1990s opportunistically took advantage of a recession driven by high interest rates but not blamed on the central bank. The framework, including through the Reserve Bank’s new operational independence to deliver the target was the answer to the recognition that Australia’s political process had failed to constrain inflation over the previous two decades. The formalisation of the policy framework promoted a substantial increased supply of central bank communication to promote monetary policy transparency, accountability and effectiveness. Thirty years later, there is no shortage of central bank communication.

Combined with a floating exchange rate, a mostly-disciplined fiscal framework and the productivity dividend from a microeconomic reform program, the monetary policy regime helped deliver three decades of uninterrupted economic growth and rising national prosperity. In the process it greatly enhanced the credibility of Australia’s central bank and its communications, including by focusing on its low inflation objective rather than, the balance of payments. However, the success of the monetary policy regime progressively weakened the responsibility assumed by other arms of policy for delivering low-inflation economic growth. From 2020, the terrifying downside risks of the COVID-19 pandemic hit prompted the RBA to over-reach into new monetary techniques, including quantitative easing and an ambitious forward guidance that the 0.1 per cent cash rate would not be raised for at least three years. Ironically, the increased communication designed to guide interest rate expectations three years ahead aggravated the fallout from the post-pandemic forecasting errors basically shared by most other central banks. The forward guidance ignored the lesson - such as from the rapid interest rate tightening cycle in response to the late 1980s asset price boom - of how quickly circumstances can change for a commodity-exporting economy. As the worst of the downside risks were averted, the RBA opportunistically sought to lock in the lowest jobless rate in half a century - a form of mission creep and a lessening of the primary focus on inflation.

The extraordinary global and domestic fiscal and monetary stimulus spilled over the economy's disrupted supply capacity to produce Australia's sharpest inflation outbreak since the inflation targeting regime began. With no recent experience of significant price inflation, public discussion struggled to understand why the RBA's operating instrument, the cash rate, needed to fall so heavily on mortgage borrowers, to get inflation back into the 2-3 per cent target. The squeeze on living standards provoked a political backlash that exploited the sense of the central bank's "broken promise", as the external Review of the RBA referred to the failure of the forward guidance.

No clear story about the inflation outbreak. Ironically, given the sharp increase in more accessible public communication, the general public's understanding about the cause of the post-pandemic inflation outbreak remains limited. There is no accepted political narrative about inflation having been caused by the extraordinary (and understandable) large scale of monetary and fiscal stimulus having pumped up aggregate demand that spilled over disrupted supply chains as the economy reopened. Surveys from other central banks confirm a lack of public understanding about the transmission of the key monetary policy lever: a sizeable minority of people may think that higher interest rates will worsen inflation. In a similar vein, political debate in Australia about the source of the recent inflation includes claimed price-gouging by supermarkets. One question is whether media reporting and public understanding will absorb the RBA's new communications explanation around the relatively simple, but also perhaps esoteric, macroeconomic concept of the balance between aggregate demand and aggregate supply. At her November 5, 2024, press conference, Governor Bullock, took the explanation to the microeconomic level, referring to a shortage of building trades workers holding up construction costs or the sudden rush of demand for restaurant meals as the economy reopened running into a shortage of restaurant staff. It would take time to train up the needed construction workers, she added, helping to explain why some areas of inflation were sticky.

How much communication. Central bank old-timers query whether the increased supply of central bank communication will lead the public to listen more, or less, to the key message. The extreme forward guidance of late 2020 and early 2021 - both a communication device and a policy instrument of sorts - may have locked the RBA into a policy narrative that was being quickly overtaken by events and exposed the central bank to a political backlash. How much certainty can increased communication provide in an inherently unstable world?

No policy coordination. The RBA underestimation of public demand in 2024 as federal and state governments increased their spending, underlined the lack of any coordination between fiscal and monetary policy, in contrast to the recommendation from the external RBA review. Fiscal expansion by federal and state governments facing election contests aimed to offset the cost-of-living squeeze from higher inflation. But, by keeping aggregate demand above aggregate supply, this of course keeps inflation above target. Armed with the megaphone of the governor’s post-board media conference, the challenge for RBA communication policy will be to explain why this limits the scope for interest rate reductions. This may extend to the broader range of policies - including planning restrictions, the tax system and workplace regulation - that limit the economy’s supply side capacity to generate non-inflationary economic growth and low unemployment. It is a reminder of why the central bank was made politically independent in the first place!