Non-technical summary for 'The Yield and Market Function Effects of the Reserve Bank of Australia's Bond Purchases'

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Background

The Reserve Bank used a range of policy measures to support the economy through the COVID-19 pandemic, including purchasing government bonds. Unlike many other central banks, the Reserve Bank had not used bond purchases as a monetary policy tool prior to the pandemic. In the first stage, bond purchases should push up the prices of the bonds that are purchased and, equivalently, pull down the interest rates on those bonds. The lower interest rates on the bonds then influence many other rates throughout the economy, including the exchange rate and borrowing rates for households and businesses. The changes in these interest rates can then lead to greater economic activity as households and businesses either borrow more money to spend or have greater cash flow as a result of the lower interest payments.

Bond purchases by the central bank can also affect how well the bond market works. In particular, when the bond market is not functioning well, an intervention by the central bank can help bring it back to order. This is important as the bond market is where governments raise money to pay for spending, and is also central to the transmission of monetary policy to the wider economy.

Our findings

A key question is whether bond purchases by the Reserve Bank were effective. In particular, we ask:

- Did the announcements about bond purchases lower bond yields?
- Did the purchases lower yields when they occurred?
- Did the purchases affect the functioning of the bond market?

The answers to these questions differ depending on the type of bond purchases involved but, overall, we find that the Reserve Bank's bond purchases mostly worked as intended.

In more detail, the Reserve Bank implemented three policy measures that involved purchases of government bonds:

1. Purchases to support bond market function, totalling $51.3 billion.
2. Purchases to support the three-year yield target, totalling $29 billion.
3. The bond purchase program to lower longer-term yields, totalling $280.7 billion.

These amounts equated to around one-third of outstanding government bonds.

We find that the purchases tended to lower government bond yields, and those purchases that were designed to support market function achieved their aim, but that purchases to support the yield target appeared to have had a detrimental effect on market function for a time. Specifically, we find that:

- for purchases to support bond market function:
  - the announcement lowered yields on shorter-term bonds but not on longer-term bonds
  - the purchases themselves lowered bond yields
  - measures of market function improved a lot, for the bond market and the bond futures market.
- for purchases to support the three-year yield target:
  - the announcement lowered the targeted yield by around 20 basis points
  - but the announcement was not enough by itself to achieve the target; occasional purchases lowered the three-year government bond yield by around 1 basis point per $1 billion purchased, though this effect dissipated over time

    - the purchases appear to have detrimentally affected the function of the bond and futures markets for a time.
- for the bond purchase program:
    - the announcement lowered longer-term yields by around 30 basis points
    - the purchases themselves did not have much of an effect on yields
    - some measures of market function deteriorated slightly.