RESERVE BANK OF AUSTRALIA

Implementing Monetary Policy

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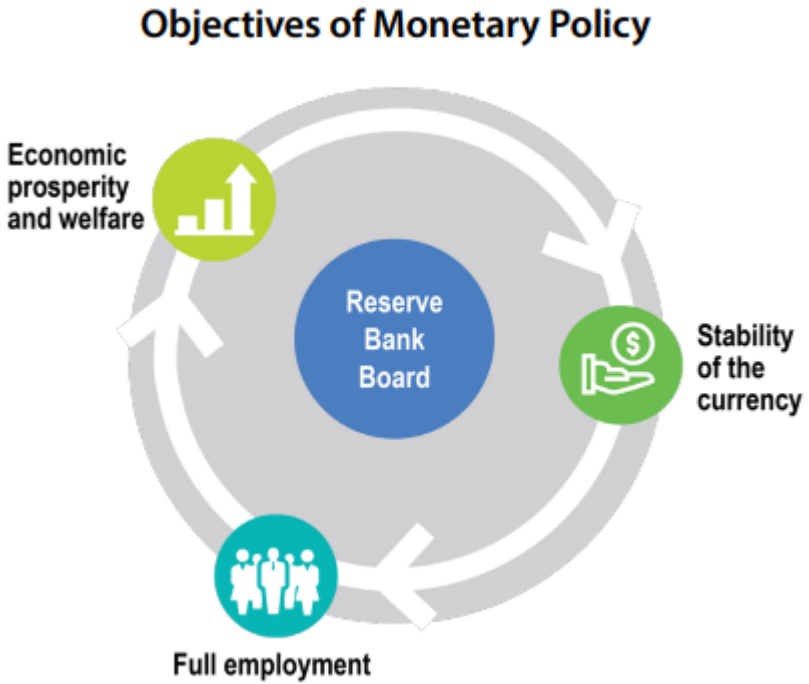
Education

Today's journey

- What are the objectives of monetary policy?
- What conventional and unconventional tools does it have?
- How do they work? And how are they implemented?
- Do they work?
- Example: RBA's policy packages implemented in 2020



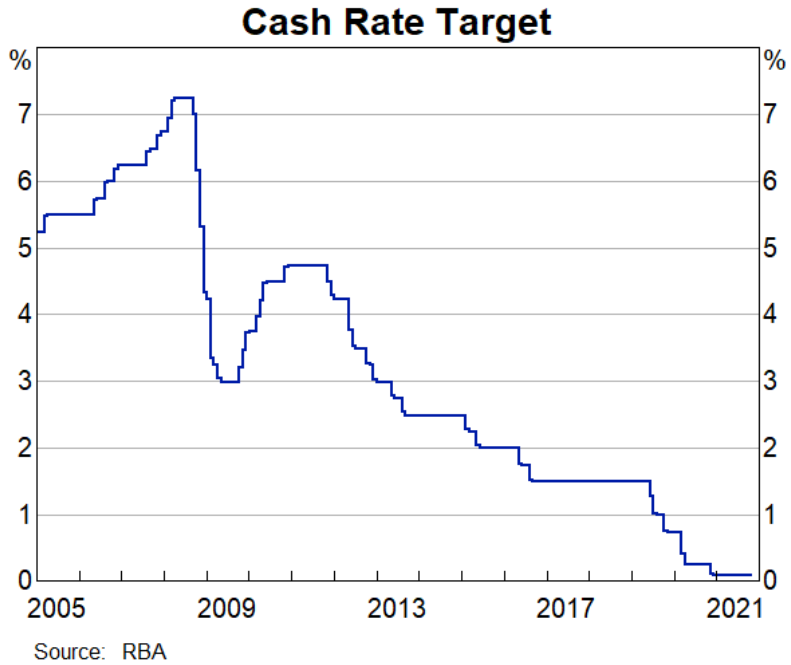
→ **Achieving inflation target**

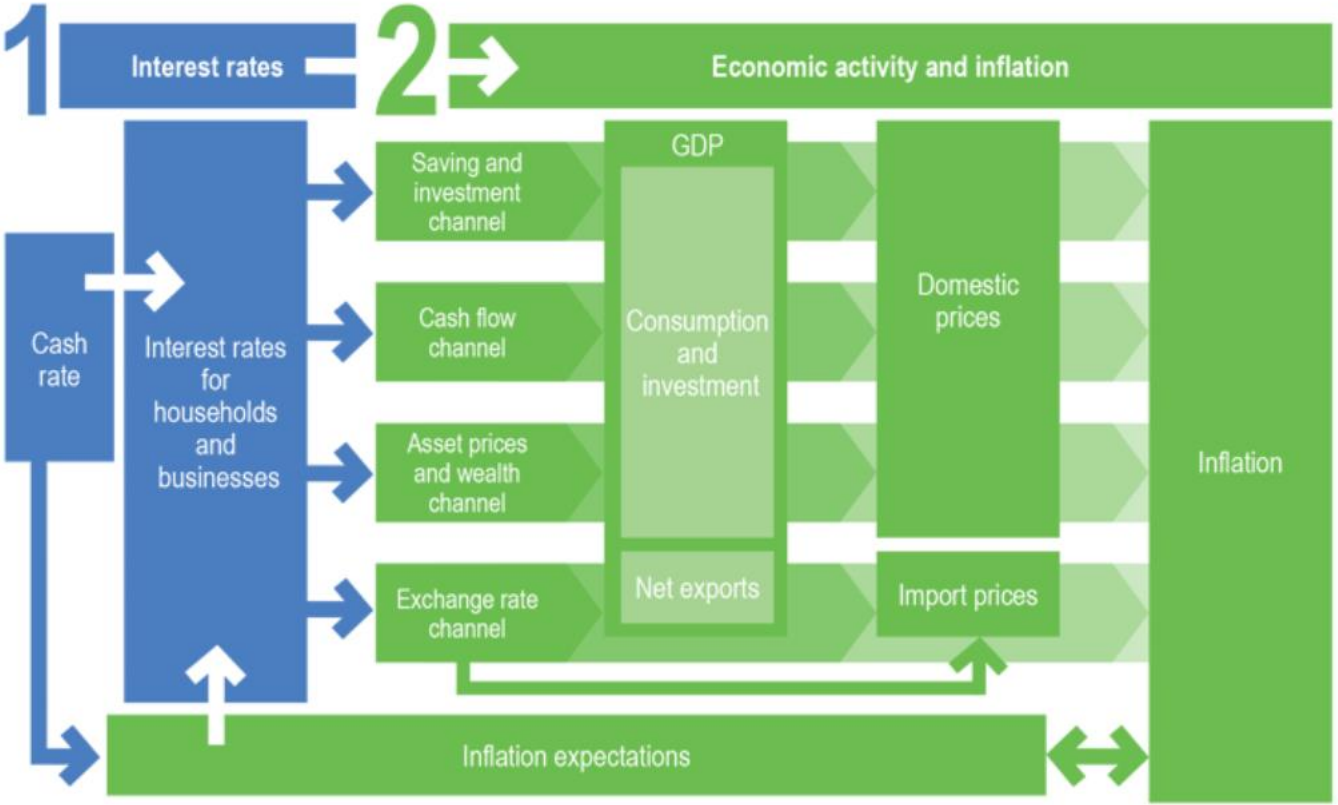
RBA Packages of Policy Measures in 2020

Included conventional and unconventional tools:

- Reduce the cash rate target and forward guidance
- Yield target for 3-year Australian Government bonds (AGS)
- Bond purchase program
- Term Funding Facility (TFF)

How do these tools work? Conventional



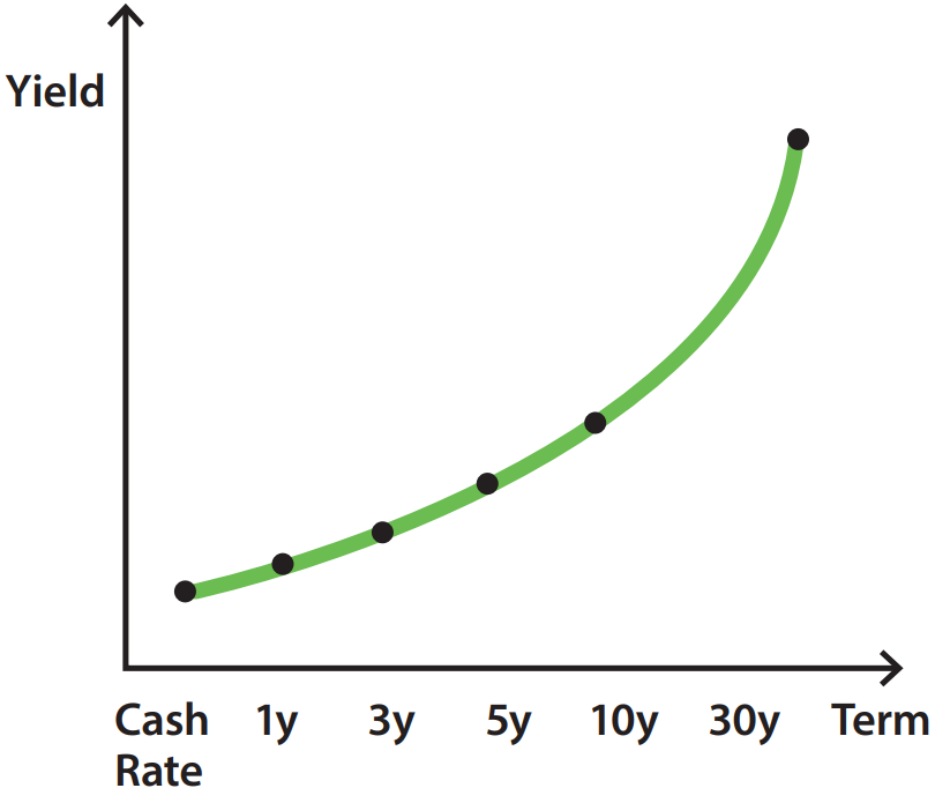

1
Interest rates
2
Economic activity and inflation
Cash rate
Interest rates for households and businesses
Saving and investment channel
Cash flow channel
Asset prices and wealth channel
Exchange rate channel
GDP
Consumption and investment
Net exports
Domestic prices
Import prices
Inflation
Inflation expectations

How do these tools work? Unconventional (1)

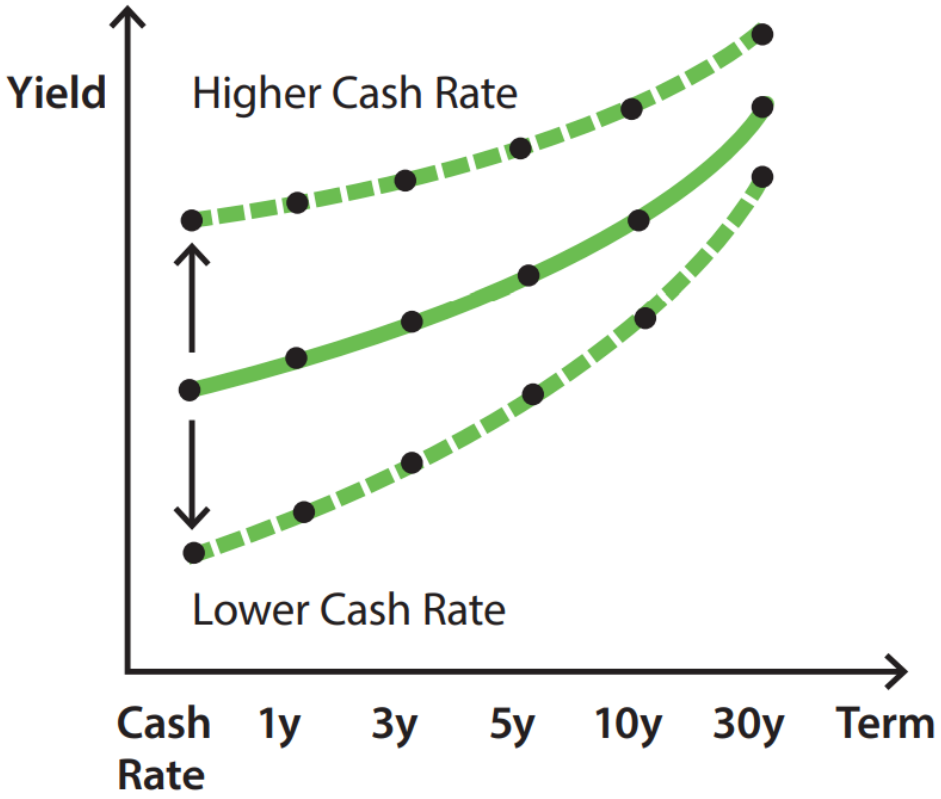
- Reduce the cash rate target and forward guidance
- Yield target for 3-year Australian Government bonds (AGS)
- Bond purchase program

→ work all through risk-free rates

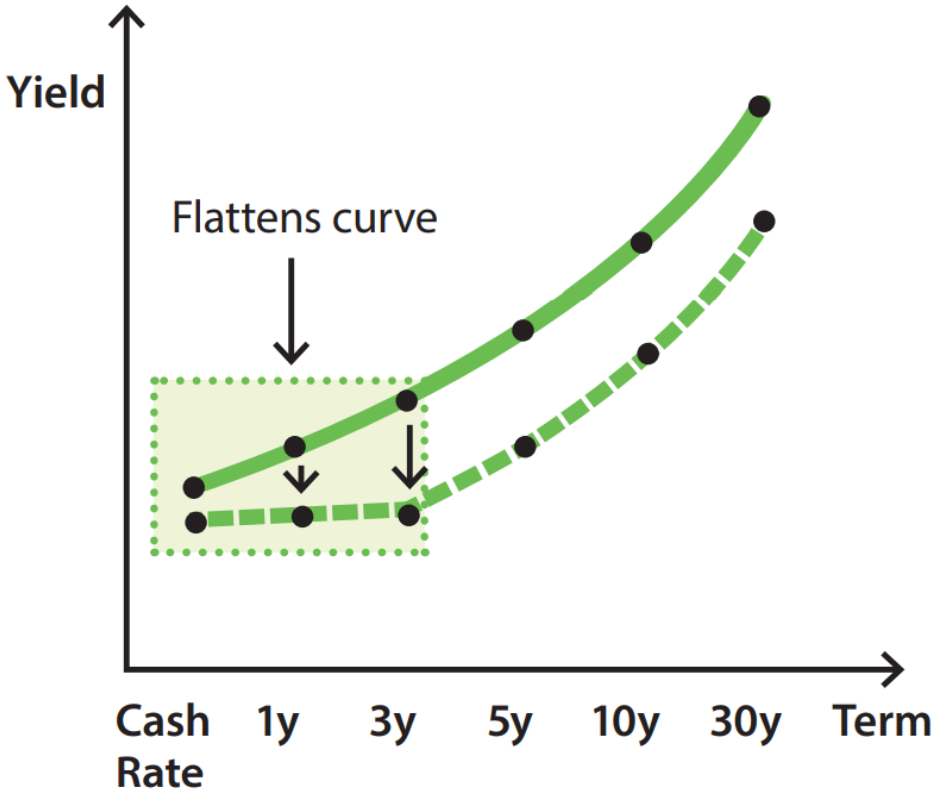
The Yield Curve



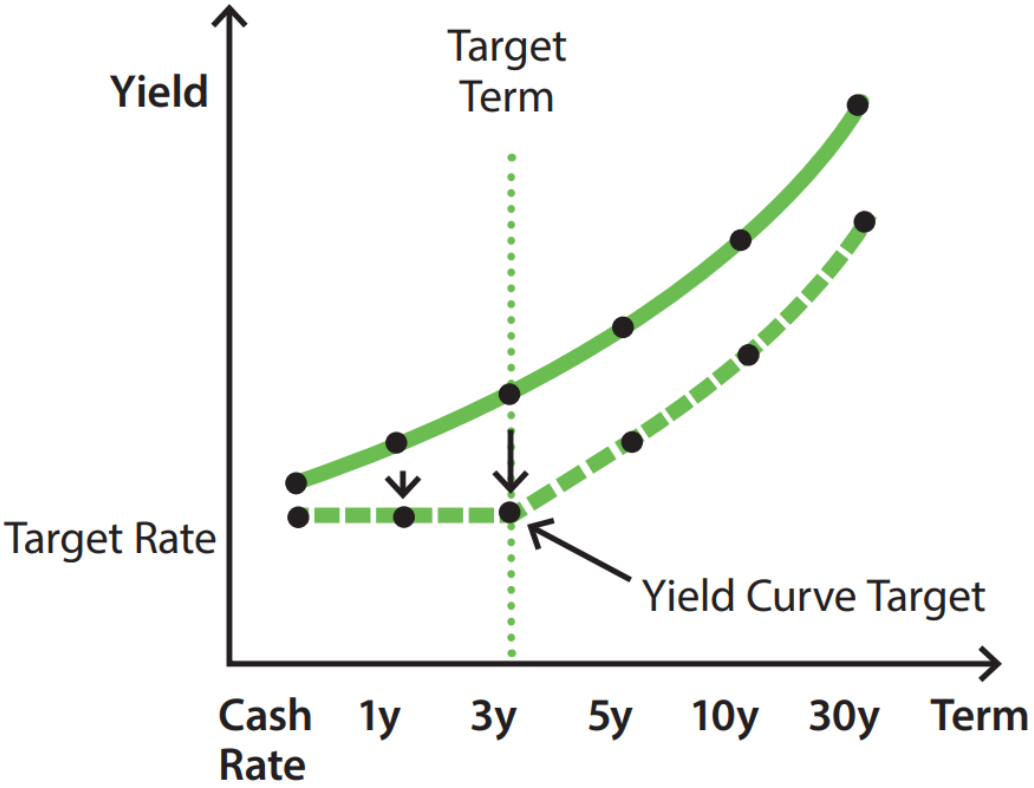
Policy Interest Rate



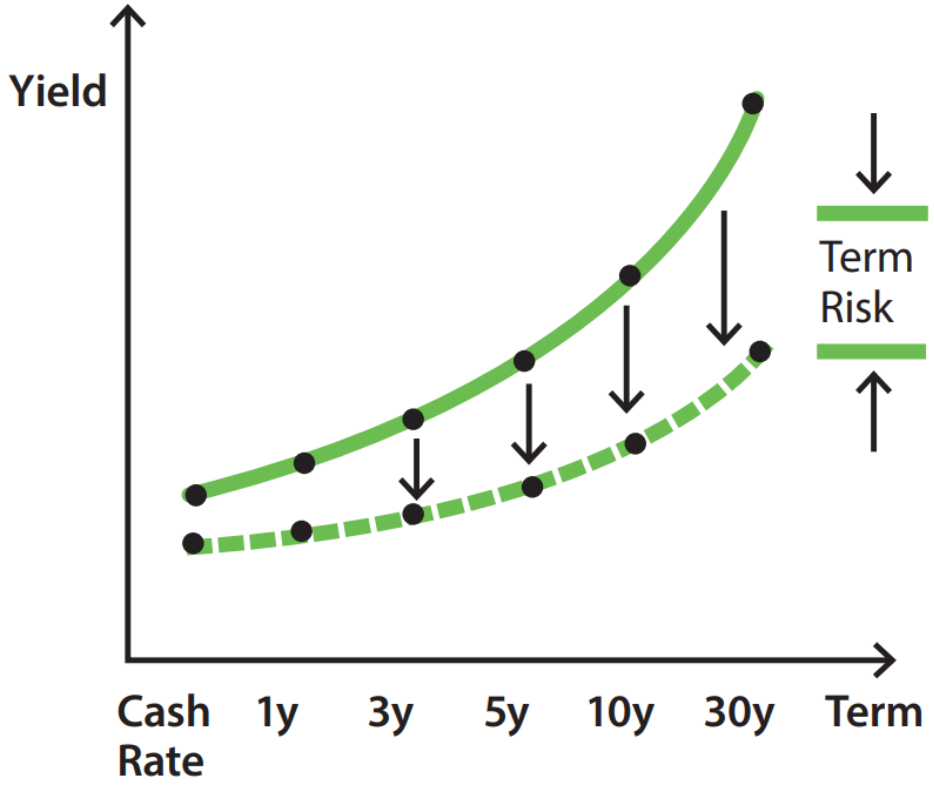
Forward Guidance



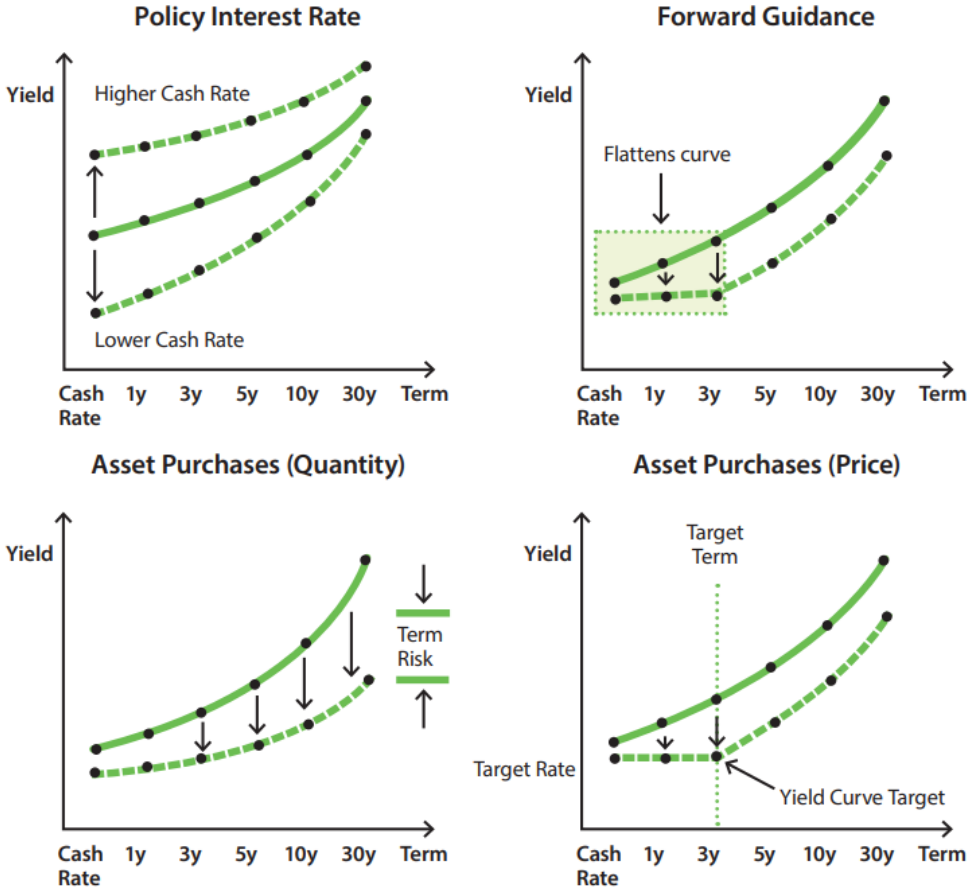
Asset Purchases (Price)



Asset Purchases (Quantity)



Monetary Policy and the Yield Curve

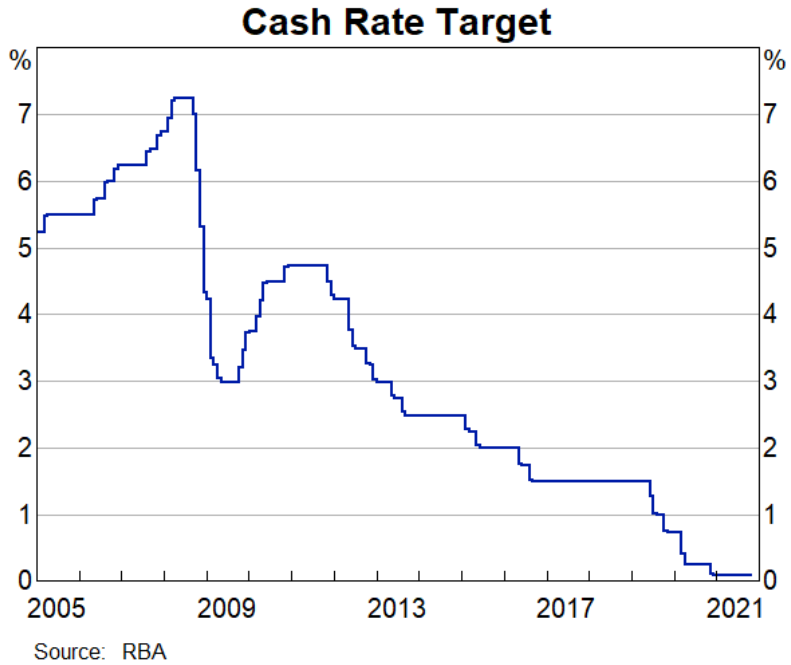


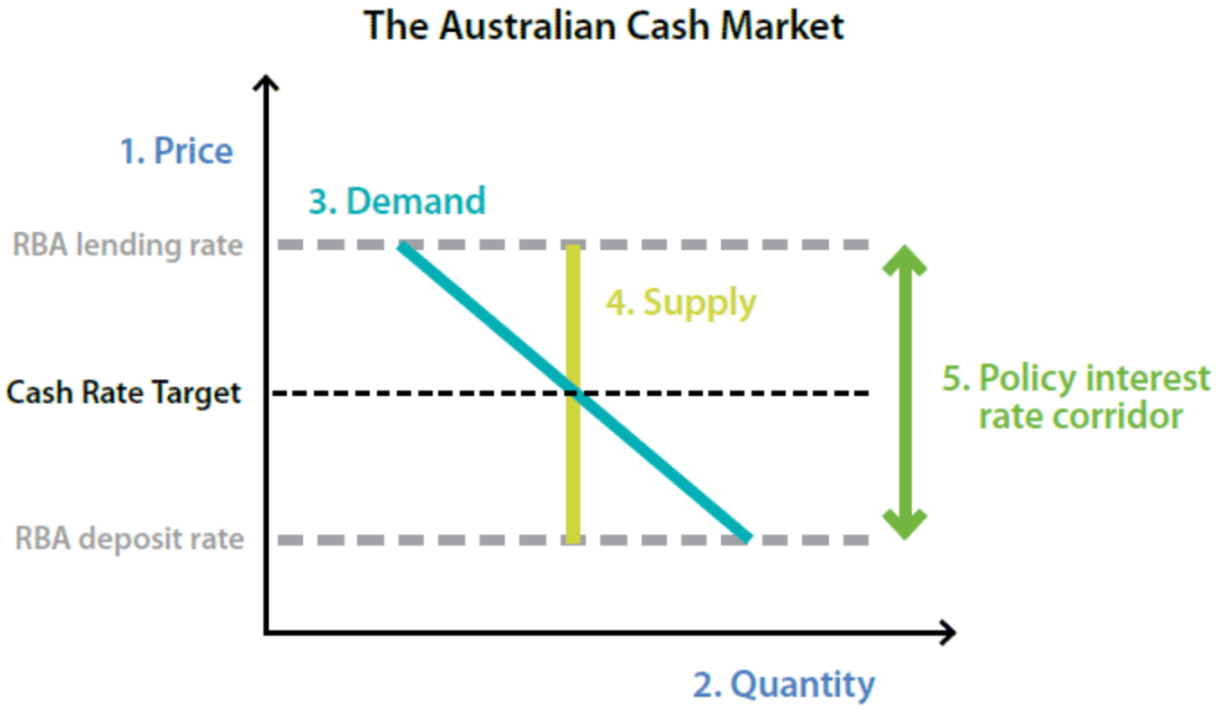
How do these tools work? Unconventional (2)

- Term Funding Facility (TFF) for banking system
  - 3-year funding at very low fixed rate
  - Additional funds available if increase in business lending, especially to small and medium-sized businesses

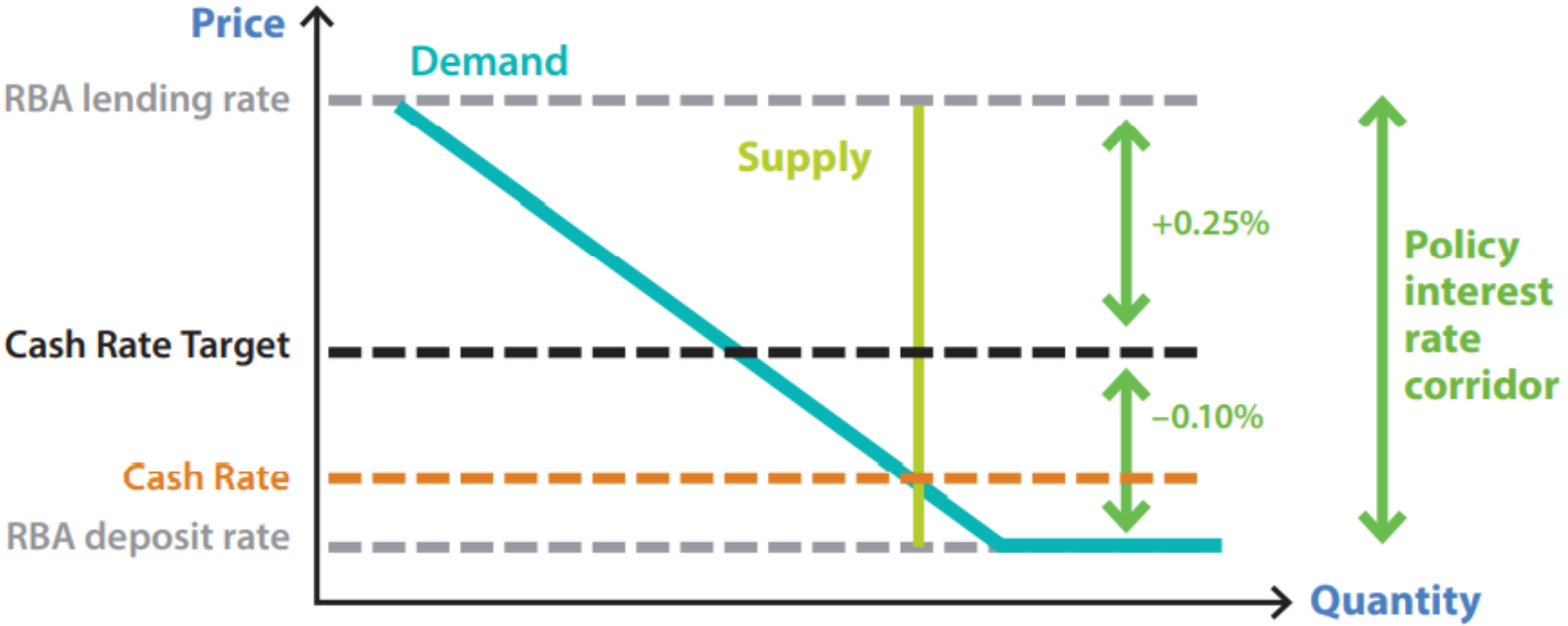
→ works through bank funding costs, reducing borrowers rates

How do we implement these tools? Conventional




The Australian Cash Market
1. Price
3. Demand
RBA lending rate
4. Supply
Cash Rate Target
5. Policy interest rate corridor
RBA deposit rate
2. Quantity

The Australian Cash Market



How did we implement …. Forward guidance?

- Explicit longer-term guidance on low cash rate, conditional on achieving objectives (expectation for around 3 years initially)
- Reinforcing with other unconventional tools

How did we implement …..Yield target?

- Yield (price) target for 3-year AGS
  - Most borrowing/lending done at terms up to 3 years
  - Bought bonds as required to achieve the yield target
  - Bought in secondary market, with auction.
- RBA bond holdings (yields lower), increase system liquidity (creates ES balances)

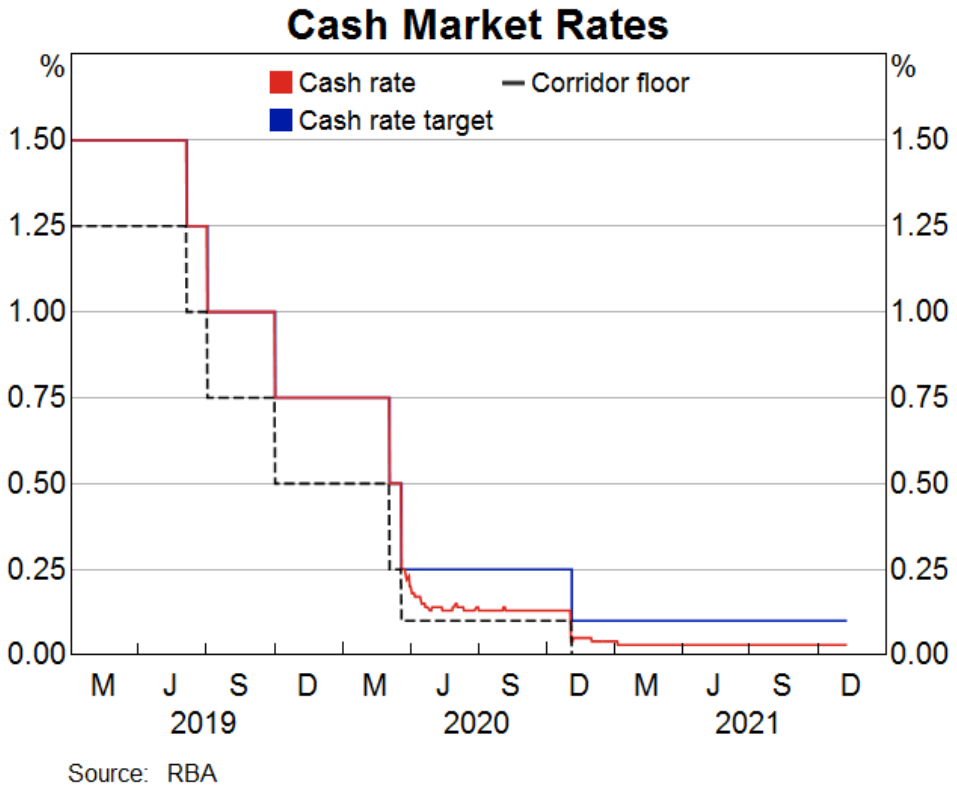
How did we implement …..Bond purchases?

- Bought set quantity of bonds at scheduled, regular pace
- Bought in secondary market, with auctions three times per week; 3-10 years maturity
- Channels: signalling & portfolio rebalancing
- Total expected purchases matter & are priced in immediately
- RBA bond holdings (yields lower); increase system liquidity (ES balances)

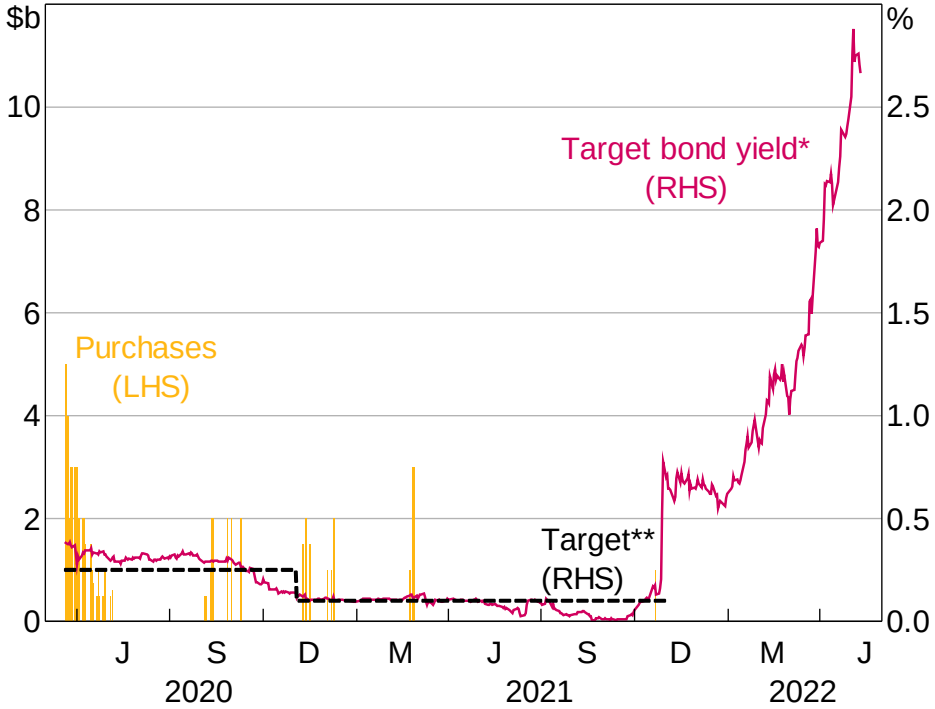
How did we implement …..TFF?

- Undertook collateralised loans (repos) with banks
- Fixed rate, for three years.
- Banks had allowance (fixed and increasing with new business lending)
- Banks chose when and what to draw down.
- Take collateral, increase system liquidity (ES balances)

Did these tools work?



Target Bond Yield and Bond Purchases



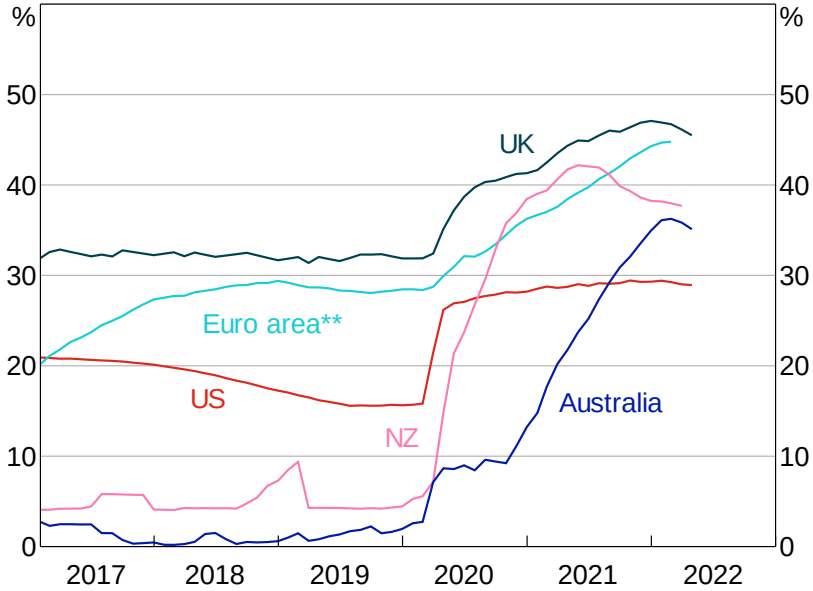
* Yield target bond is the April 2023 Treasury bond until 20 October 2020, and the April 2024 Treasury bond until 2 November 2021

** Target was discontinued on 2 November 2021

Sources: RBA; Yieldbroker

Central Bank Government Bond Holdings*

Per cent of eligible stock outstanding



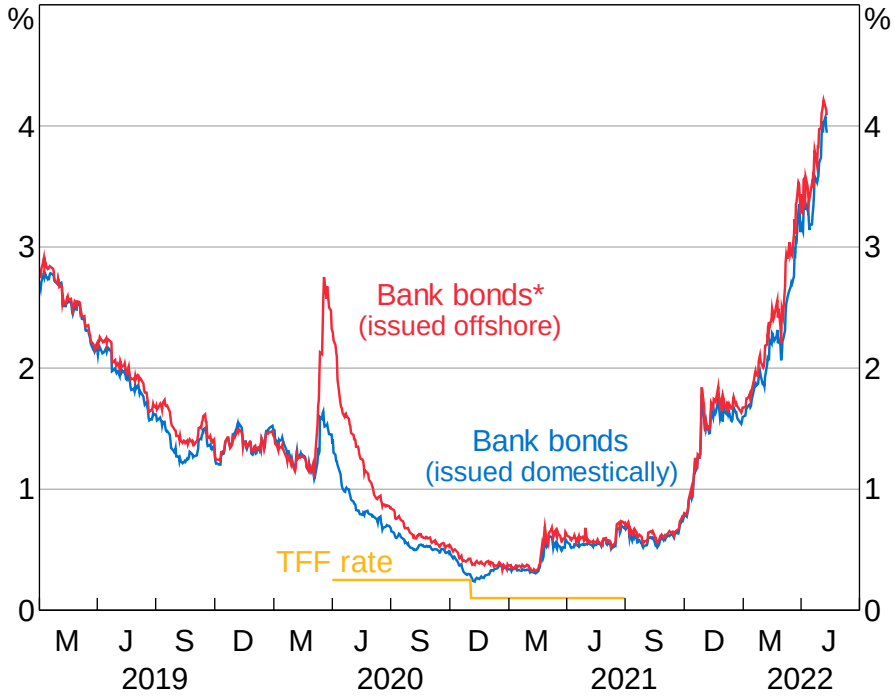
* Central government debt only for all countries except the euro area.

** Holdings data for euro area only include bonds held as part of asset purchase programs; holdings for other central banks also include bonds held for operational or liquidity purposes.

Sources: Central banks; debt management offices; RBA; Refinitiv

Cost of Major Banks' Funding Sources

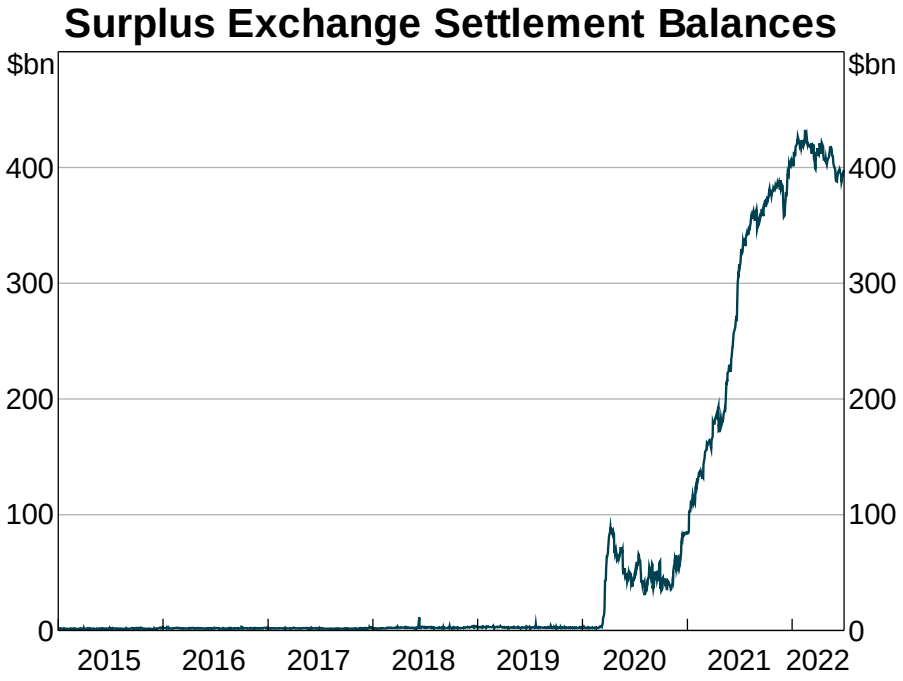
RBA estimates; three-year funding; marginal



* Adjusted for cross-currency hedging

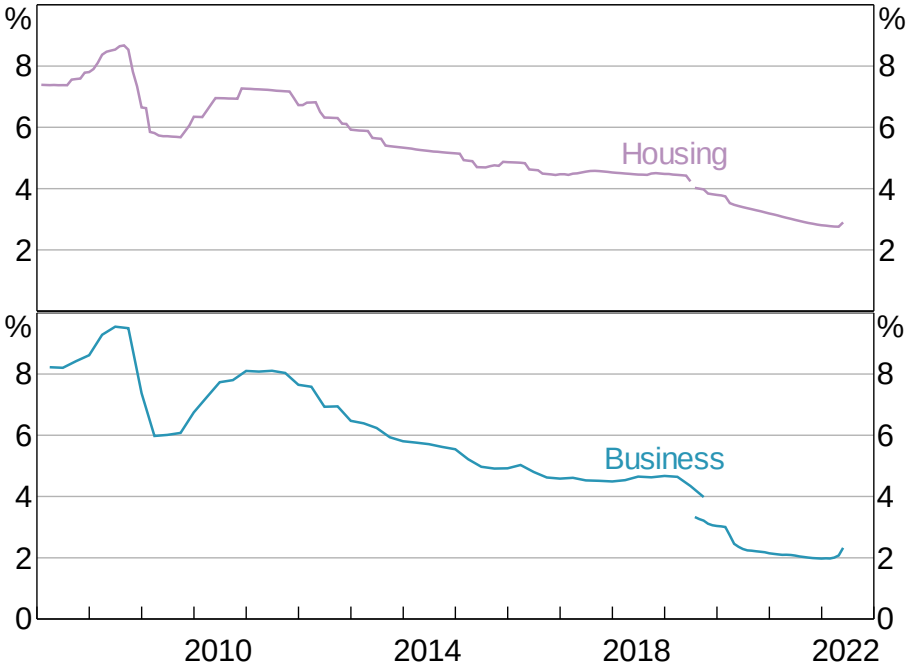
Sources: Bloomberg; RBA

And system liquidity increased



Source: RBA

Outstanding Lending Rates



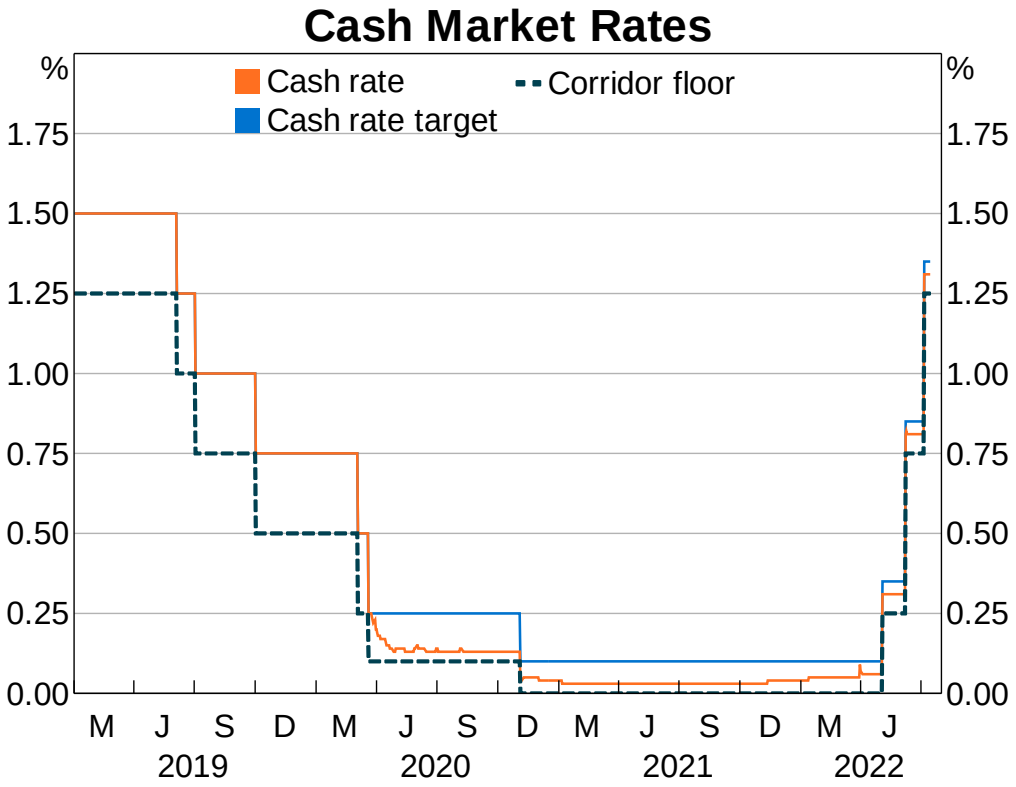
* Data from EFS collection from July 2019

Sources: APRA; major banks websites; RBA; Securitisation System

What happened as economic outlook improved?

- Yield target for 3-year AGS: discontinued in Nov 2021
- Bond purchase program: purchases ended in Feb 2022; holdings gradually decline over 10 years ($350 bn total)
- TFF: closed since Jun 21; $188 bn lent until Sep 23/Jun 24
- Stimulus and large ES balances in system for a number of years
- Liquidity operations weekly and at fixed rate (no daily target liquidity)

How did we raise the cash rate? ..as usual



Source: RBA