

The Future System for Monetary Policy Implementation

Consultation Paper

April 2024

Contents

1. Overview	1
2. Background	3
3. Policy Considerations	7
4. Key Topics for Consideration	9
5. Next Steps	11
6. RBA Submission Guidelines	12

ISBN 978-0-6456221-5-7 (Online)

© Reserve Bank of Australia 2024

Apart from any use as permitted under the *Copyright Act 1968*, and the permissions explicitly granted below, all other rights are reserved in all materials contained in this publication.

All materials contained in this publication, with the exception of any Excluded Material as defined on the RBA website, are provided under a Creative Commons Attribution 4.0 International License. The materials covered by this licence may be used, reproduced, published, communicated to the public and adapted provided that the RBA is properly attributed in the following manner:

Source: Reserve Bank of Australia 2024 OR **Source:** RBA 2024

For the full copyright and disclaimer provisions that apply to this publication, see <https://www.rba.gov.au/copyright/>.

1. Overview

The RBA Board considered broad options for the future system for monetary policy implementation in Australia at its March 2024 meeting. It endorsed a plan to operate with ample reserves (also exchange settlement or ES balances), by meeting demands for reserves via full allotment auction at the RBA's open market operations (OMO) ('the ample reserves system' with 'full allotment OMO repo').¹

From the minutes of the Reserve Bank Board's March 2024 meeting:

Members endorsed a proposal to adopt an ample reserves system with full-allotment auctions. ... Consistent with these considerations, members agreed that it was appropriate for information on the broad shape of the new framework to be communicated to the public through a speech by the Assistant Governor, Financial Markets. Key details of the ample reserves system would need to be considered later in the year, including the configuration of the full-allotment open market operations and guidelines for the composition of the assets on the Bank's balance sheet. These decisions would be informed by the staff's future engagement with stakeholders, including via public consultation.

The broad rationale for the system endorsed by the RBA Board was discussed in a recent speech by Assistant Governor (Financial Markets) Christopher Kent.² He explained why an ample reserves system was preferred to either staying with an excess reserves system or returning to a scarce reserves system. The 'Background' section below provides detail on how the RBA's system for implementing monetary policy has changed over time.

From Assistant Governor Kent's speech on 2 April 2024:

The third option, which the Board has endorsed, is an ample reserves system in which banks' demands for reserves are satisfied via open market repo operations at a price near the cash rate target, in what are known as full allotment auctions. Together with the floor provided by the ES rate, these operations should keep the cash rate close to target. Setting the price of reserves in this way is in contrast with the scarce and excess reserve systems, where the central bank sets the quantity of reserves in order to affect the price. Under the ample reserves system, the supply of reserves can rise and fall in line with changes in demand, with minimal effects on the cash rate and other money market rates.

The detailed design of the system is underway and will be informed by public consultation and further analysis by RBA staff. The RBA will review written submissions from the consultation process and may meet with stakeholders.

This consultation paper presents some principles and options regarding design details of the system (see the 'Policy Considerations' section below), before providing a list of specific topics on which the

1 RBA (2024) '[Minutes of the Monetary Policy Meeting of the Reserve Bank Board](#)', Sydney, 18–19 March. For definitions of key terminology including repurchase agreement (repo), please refer to the [RBA Glossary](#).

2 Kent C (2024), '[The Future System for Monetary Policy Implementation](#)', Address to Bloomberg Australia, Sydney, 2 April.

RBA is seeking feedback ('Key Topics for Consideration'). For example, the paper discusses how six assessment principles were applied to the selection of an ample reserves system as the RBA's future system. These principles should also inform the detailed design of the future system.

The Key Topics for Consideration are not exhaustive. The RBA values feedback on any additional options that would be consistent with the assessment principles. In particular, though:

- **The RBA is seeking specific feedback on the detailed configuration of full allotment OMO repo**, which will provide the marginal source of reserves and guide the cash rate and other short-term market rates
- **The RBA is also seeking general feedback on other instruments that it could use to supply ES balances**, such as the potential use of foreign exchange (FX) and cross-currency basis swaps and outright purchases of government bonds to supplement the reserves supplied through full allotment OMO repo under the future system where required.

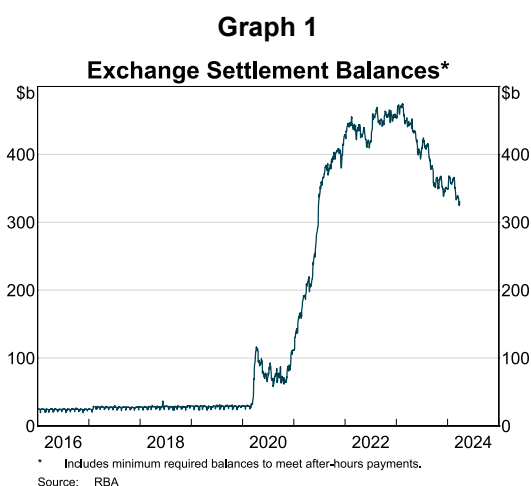
Stakeholders should provide written submissions to the RBA by no later than 10 May 2024 (see the 'Next Steps' section below). For questions about this consultation, please contact the RBA at mpisubmissions@rba.gov.au.

2. Background

2.1 The recent history of monetary policy implementation

Prior to March 2020, the RBA implemented monetary policy using a ‘corridor system’ with scarce reserves.³ Movements in the cash rate were limited to a range around the cash rate target through the RBA’s standing facilities. Banks could leave reserves on deposit with the RBA at the ES rate (25 basis points below the cash rate target) or obtain them overnight at a rate 25 basis points above the cash rate target.⁴ To ensure the cash rate traded at target (within the corridor set by the rates on the standing facilities), the RBA tightly managed the supply of reserves to match estimates of the demand for reserves near the cash rate target. In practice, the RBA supplied a small and fairly stable surplus of ES balances (above what it judged to be minimum required ES balances). It did this by conducting frequent OMOs, with the quantity of ES balances supplied to the financial system guided by detailed forecasts of daily payment flows between the RBA, the Australian Government and the private sector. During this period, OMOs primarily consisted of repurchase agreements (repos), but also included outright purchases of government bonds nearing maturity and foreign exchange (FX) swaps.

In March 2020, the RBA introduced a package of monetary policy measures to support the economy in response to the COVID-19 pandemic. These policy measures led to a rapid expansion in the supply of reserves,⁵ including through the RBA’s purchases of government bonds and provision of liquidity to banks via the Term Funding Facility (TFF).



As a result, the RBA transitioned from its longstanding ‘corridor system’ with a scarce supply of reserves provided primarily to facilitate payments, to a ‘floor system’ with an excess supply of reserves, well above any reasonable estimate of the underlying demands of the financial system (to meet payment

3 Debelle G (2021), [‘Monetary Policy During COVID’](#), Shann Memorial Lecture, 6 May.

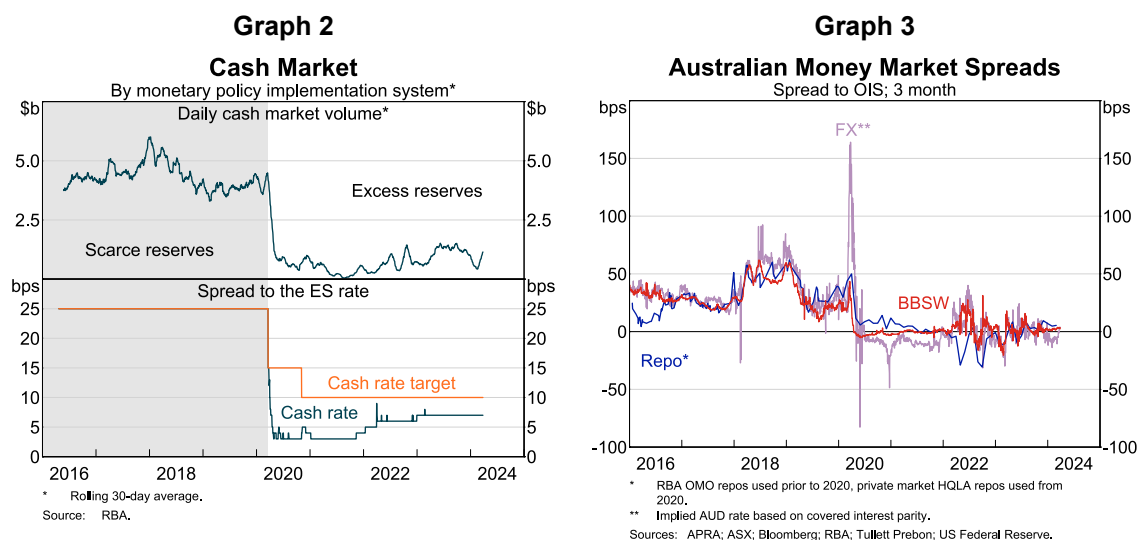
4 For simplicity, this document refers to the RBA’s counterparties as ‘banks’. However, the range of eligible counterparties with access to RBA OMO and standing facilities are not limited to banks, nor uniform across the RBA’s various operational facilities. For more details, see RBA, [‘Eligible Counterparties’](#).

5 See Debelle (2021), n 3.

needs and minimum liquidity requirements). ES balances rose from around \$25 billion and stabilised at around \$460 billion in 2022 (Graph 1).

An expansion in the supply of reserves to well above the underlying demands of the financial system has been common occurrence internationally and initially resulted from the unconventional monetary policies introduced in response to the Global Financial Crisis and later the COVID-19 pandemic. In those conditions, most banks held more reserves than they needed, which caused them to try and lend out their excess reserves.

In the Australian context, the increase in ES balances resulted in the cash rate and broader short-term market rates falling towards the ES rate as banks sought to lend out their excess reserves (Graph 2 and Graph 3). The ES rate acts as a ‘floor’ for short-term market interest rates because banks have no incentive to lend reserves out below this rate (which they could receive by depositing their excess reserves overnight at the RBA). In other words, the stance of monetary policy has been determined by the floor system with excess reserves since the sharp increase in reserves in early 2020.

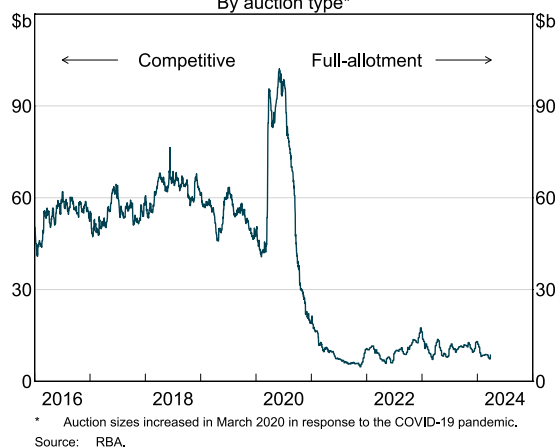


During the corridor and floor systems, the RBA has continued to supply reserves using OMO repos, but on different terms.⁶ During the corridor system, the RBA supplied a fixed quantity of reserves via competitive auctions through OMO. Because the supply of reserves was scarce, the price to obtain reserves at OMO and in private short-term markets was, at times, high relative to the overnight indexed swap rate (which measures expectations for the future cash rate). Cash market activity was high as participants recycled reserves among each other (Graph 2).

In April 2020, the RBA formally adopted using fixed-rate full allotment OMO to manage banks’ increased demand for reserves during a period of considerable stress in financial markets. This offered to meet banks’ demand for reserves in full beyond a minimum interest rate. Demand for OMO rose sharply at the onset of the pandemic, reflecting increased precautionary demand to hold reserves, which are the most liquid form of asset. Demand for reserves at full allotment OMO repo subsequently fell to very low levels as the supply of reserves expanded significantly through the TFF and the RBA’s purchases of government bonds and as earlier financial stresses eased (Graph 4). Recycling of reserves in the cash market also fell to low levels.

6 Kent C (2022), ‘[Changes to the Reserve Bank’s Open Market Operations](#)’, Remarks to Australian Financial Markets Association, Sydney, 22 February.

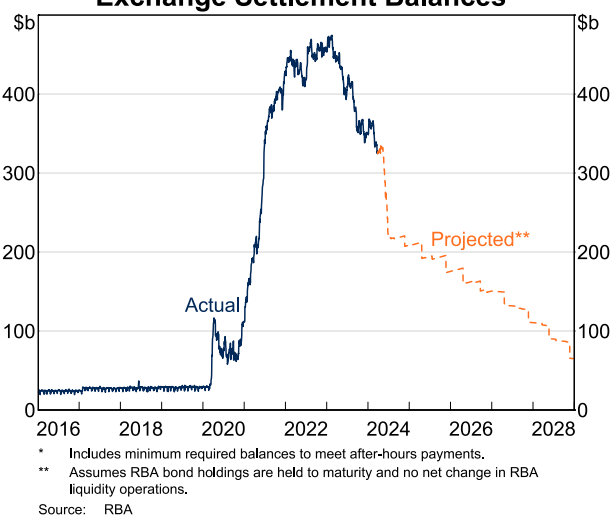
Graph 4
OMO Outstanding
By auction type*



2.2 The future of monetary policy implementation

ES balances have been falling since early 2023 and are projected to continue to do so in the coming years (Graph 5). Reserves are expected to decline sharply in June 2024 as the remaining TFF funding matures. After this, the level of reserves are projected to decline more gradually as the RBA’s bond holdings decline. At some point, in the absence of any other action by the RBA, the supply of reserves could fall below banks’ underlying demand for reserves and drive market rates above the cash rate target as banks seek to borrow the extra reserves they need.

Graph 5
Exchange Settlement Balances*



Given the changes ahead, the RBA is preparing the system it will use to implement monetary policy in the future to allow the Bank to keep the cash rate close to the cash rate target. Considering this, the RBA Board has endorsed the adoption of an ample reserves system with full allotment OMO repo. This system is demand-driven, because full allotment OMO repo supplies as many reserves as banks demand (against eligible collateral) at a price set by the RBA. In this way, the price of OMO repo provides a guide for the cash rate and broader short-term market rates. With this system, the RBA is not required to accurately estimate demand, nor control the supply of reserves directly. This is because supply will automatically respond when banks demand extra reserves at OMO repo, such that demand for reserves

is fully satisfied and reserves remain ample. The Bank of England, the European Central Bank and Sweden's Riksbank have also recently announced that they will operate systems of this nature going forward.⁷

The RBA currently offers full allotment OMO repo, though at present this is not used by most banks because the supply of reserves currently exceeds underlying demand. If no substantive changes were made to current OMO arrangements, the RBA would gradually transition to an ample reserves system as ES balances continue to decline.

7 For more information, see Ramsden D (2018), 'Finding the Right Balance', Speech at the Society of Professional Economists Annual Conference, London, 28 September; Schnabel I (2024), 'The Eurosystem's Operational Framework', Speech at the Money Market Contact Group meeting, Frankfurt am Main, 14 March; Sveriges Riksbank (2019). 'The Riksbank's New Operational Framework for the Implementation of Monetary Policy', July.

3. Policy Considerations

In its selection of an ample reserves system with full allotment OMO repo, the RBA was guided by six principles for the assessment of a monetary policy implementation system: effectiveness; resilience; neutrality; financial efficiency; financial stability; and operational effectiveness. The principles were informed by theory and the experience of peer central banks. Use of the principles was also supported by a review of the academic literature on the topic.⁸ Stakeholders are encouraged to refer to the principles in their written submissions.

This is how the assessment principles were applied to the RBA's selection of an ample reserves system:

1. **Effectiveness.** An effective system ensures that money market rates are anchored by the cash rate target and that there are enough reserves to facilitate payments.

An ample system under full allotment OMO can provide an effective anchor for the cash rate, money market rates and financial conditions more broadly. OMO repo is a close funding substitute to money markets for eligible counterparties with sufficient eligible collateral. Hence, it provides a good guide for money market rates. An ample system will also provide sufficient reserves to enable the payments system to function.

2. **Resilience.** A resilient system is effective at implementing the cash rate target regardless of changes to, or volatility in, the supply or demand for reserves (for example, due to changes to the payments system, changes to regulations or the use of balance sheet policies). Resilient systems help minimise the risk of liquidity shortages.

An ample reserves system can respond to developments that may change the supply of reserves (such as balance sheet policies by the RBA). Moreover, there is no need to accurately estimate the demand for reserves because all demands for liquidity from banks can be met at the RBA's regular OMO under an ample system with full allotment auctions. Banks will need to estimate their own demand for reserves and then have the option to obtain what they need. As banks change their demand for liquidity or access liquidity from different market operations (see the 'Key Topics for Consideration' section below), full allotment OMO will adjust to supply their residual demand.

3. **Neutrality.** A neutral system does not impede market functioning (for example, by disincentivising banks from transacting in private markets) or unintentionally alter the relative price of financial assets (such as government bonds); either of these occurrences could adversely affect the transmission of monetary policy to interest rates in key funding markets.

An ample reserves system is likely to lead to more cash and other money market activity compared with an excess reserves system, although not as much as under scarce reserves. Supplying just the reserves that are demanded will mean the RBA's balance sheet is no larger than it needs to be to implement monetary policy, with our footprint in financial markets smaller than in an excess reserves system.

⁸ See, for example, Bindseil U (2016), 'Evaluating Monetary Policy Operational Frameworks', *Federal Reserve Bank of Kansas City Jackson Hole Economic Policy Symposium*, Jackson Hole, Wyoming. Available at <https://www.kansascityfed.org/documents/7036/BindseilPaper_JH2016.pdf>.

4. **Financial efficiency.** A financially efficient system minimises financial risk (such as interest rate risk) of operations for the RBA's balance sheet.

The extent of the RBA's financial risk depends on the design and mix of market operations used to provide reserves. The RBA is likely to be able to supply an ample quantity of reserves using a combination of market operations that entail low interest rate risk.

5. **Financial stability.** A system can support financial stability (for example, by increasing liquidity provision and the ability of banks to source reserves during period of liquidity stress, including via use of their other high quality liquid assets).

Full allotment OMO under the ample reserves system offers a lower level of risk that liquidity shortages might disrupt monetary policy transmission compared to the previous corridor system. The full allotment mechanism can support financial stability at times of collective liquidity stress where demand for reserves can increase rapidly. Further, OMO could be designed to support financial stability in normal times, for example, through providing reserves to help banks manage day-to-day liquidity risk.

6. **Operational effectiveness.** An operationally effective system minimises operational risks and costs to the central bank and its counterparties.

An ample reserves system with full allotment OMO repo would be operationally effective, especially because the system does not rely on the RBA accurately forecasting and offsetting small changes in the underlying demand and supply of reserves. That said, in this system, banks will need to be operationally prepared to manage their liquidity carefully, including by obtaining sufficient reserves at OMO repo.

4. Key Topics for Consideration

The RBA seeks submissions on the policy considerations raised by the future system for monetary policy implementation, including stakeholders' views on some or all of the following specific topics.

The key details that remain to be selected for the RBA's future system are:

- the configuration of full allotment OMO repo, which will be the marginal source of reserves and anchor for short-term interest rates under the future system
- the medium-run composition of the assets on the RBA's balance sheet.

Topic 1

Please provide specific feedback on potential configuration of the RBA's full allotment OMO repo, including settings for the term, frequency, pricing and eligible collateral for the RBA's operations.

For reference, the RBA currently offers weekly full allotment OMO repo at a 28-day term and an interest rate equal to the cash rate target plus a small spread (which is currently set at 5 basis points, but could vary as needed by market conditions). Also consider the potential interactions between settings for the various aspects of OMO repo.

Topic 2

What effect would you expect the RBA's market operations to have on activity and pricing in financial markets, informed by the configuration discussed in answer to Topic 1? For example, what effect would you expect different settings for the pricing of OMO to have on financial markets relative to the current system, especially on the alignment of short-term rates in money markets with the cash rate target?

Topic 3

How has the demand for liquidity changed since the COVID-19 pandemic, including the demand for reserves for operational reasons (e.g. due to regulatory, precautionary and payments system developments)? How do you expect the demand for liquidity to change in future as the RBA's balance sheet declines? How might the design of the RBA's market operations affect the demand for reserves? Also consider (to the extent it is relevant) how your demand as an institution (where relevant) may have changed since the pandemic, relative to demand overall.

Topic 4

Please provide more general feedback on the possible medium-run composition of the RBA's assets, in light of the changing demand for reserves discussed in response to Topic 3. In particular, provide views on:

- the potential impacts of various instruments for supplying reserves, particularly on market pricing and functioning.

- how the design and mix of the RBA’s market operations could best support the stability of the financial system, beyond the operational factors considered in Topic 3.

For reference, the RBA can supply reserves via OMO repo, FX or cross-currency basis swaps, or outright bond purchases. While full allotment OMO repo will operate as the primary tool for supplying reserves under the future system, it may be appropriate to use other tools to achieve outcomes consistent with the assessment principles described above. For reference, the RBA has previously used FX swaps and purchases of near-to-maturity government bonds to manage the supply of reserves.

Topic 5

Please provide views on effects (if any) of the ample reserves system on money markets.

The cash market is where banks lend and borrow unsecured funds from each other overnight. The cash rate is the weighted average interest rate on transactions in the cash market and the RBA’s operational target. It is also an important financial benchmark for the risk-free rate in Australia. Given this:

- How important is the extent of activity in the cash market, from the perspective of your institution, and for financial markets as a whole, and why?
- What effect (if any) do you consider the RBA’s future MPI system will have on the cash market?

The bank bill market is an important funding market for banks and the bank bill swap rate (BBSW) is an important benchmark rate in the Australian financial system.

- Would you expect the design considerations for the RBA’s market operations to affect the bank bill swap market?

Topic 6

Do you have any other views on the RBA’s proposed approach to monetary policy implementation and the RBA’s interactions with financial markets?

5. Next Steps

Interested parties are invited to make written submissions by email or post by 10 May 2024. All submissions should be sent to:

mpisubmissions@rba.gov.au

or

Head of Domestic Markets Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

After reviewing submissions, the RBA may seek to meet with some stakeholders to discuss their submissions in more detail.

Please see below section ('RBA Submission Guidelines') for additional information, including submission document formats and how to make a confidential submission.

6. RBA Submission Guidelines

In the course of undertaking public consultation on policy or regulatory matters, the RBA may publish an issues or consultation paper (Consultation Paper) and invite interested parties to make a submission responding to issues raised in the Consultation Paper (a Submission).

These Guidelines set out general information about making a Submission and the RBA's processes for considering and publishing Submissions. The Guidelines apply to all Submissions, except to the extent that a particular Consultation Paper specifies any contrary information with respect to Submissions made in response to that Consultation Paper.

Making a Submission

A Submission should be made in writing and sent by post or by email to the addresses specified in the Consultation Paper. The RBA asks that, where it is practicable to do so, submissions are provided by email.

Submissions provided by email should be in a separate document, in Word or equivalent format. Submissions in PDF format must be accompanied by a version in an accessible format such as .rtf or .doc.

Submissions can be submitted to the RBA until midnight AEST on the closing date specified in the Consultation Paper or such later date agreed by the RBA.

What happens to Submissions?

Your Submission will be read by RBA staff working on, or involved with, the relevant consultation process to which your Submission relates.

In the interests of informed public debate, the RBA is committed to transparency in its processes and open access to information. Accordingly, the RBA aims to publish Submissions on its website where it is appropriate to do so. However, the RBA reserves the right to edit (for example, remove defamatory material or, where appropriate, de-identify personal or sensitive information), publish or not publish Submissions on its website at its own discretion. The RBA's publication of a Submission is not an indication of the RBA's endorsement of any views or comments contained in that Submission.

Most Submissions that are published on the RBA's website will include the name of the submitter (unless requested otherwise – see the Privacy section below). If a Submission is published, the information in it, including the submitter's name and any contact details, can be searched for on the internet.

You cannot withdraw or alter your Submission once the RBA has published it.

Submissions may be kept confidential

If you do not want some or all of your Submission to be published by the RBA, you should clearly indicate this (for example, by including the word **confidential** prominently on the front of your Submission) and provide reasons for your request. Automatically generated confidentiality statements in emails are not sufficient for this purpose.

Where some parts of your Submission are considered to be confidential, the RBA requests that you provide two versions of the Submission at the same time prior to the closing date – one for consideration by the RBA and one, with confidential information removed, for publication (this latter version may also have contact details or other personal information removed – see the Privacy section below).

Please also note that any Submission provided to the RBA may be the subject of a request under the *Freedom of Information Act 1982* (Cth). Any request for access to a confidential Submission will be determined by the RBA in accordance with that Act, including any applicable exemptions (for example, those relating to material obtained in confidence or involving an unreasonable disclosure of personal information).

Privacy

Unless requested otherwise, published Submissions will usually include contact details and any other personal information contained in those documents.

Where you provide a separate version of your Submission for publication with contact details or other personal information redacted or removed, this will be taken as a request for the RBA not to publish such personal information.

For information about the RBA's collection of personal information and approach to privacy, please refer to the Personal Information Collection Notice for Website Visitors and the RBA's Privacy Policy, which are both available at <http://www.rba.gov.au/privacy>.

Intellectual property rights

In making a Submission to the RBA, you grant a permanent, irrevocable, royalty-free licence to allow the RBA to use, reproduce, publish, adapt and communicate to the public your Submission on the RBA's website (except to the extent that you have specifically requested that all or part of your Submission is kept confidential), including converting your Submission into a different format to that submitted for the purposes of meeting relevant accessibility requirements.

To the extent that your Submission contains material that is owned by a third party, you warrant that you have obtained all necessary licences and consents required for the use of those materials (including for the RBA to use, reproduce, publish, adapt or communicate to the public such material), and have made arrangements for the payment of any royalties or other fees payable in respect of the use of such material.