Australian Government

An RBA fit for the future

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for the future

The Review of the Reserve Bank acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respects to their Elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples today.

Foreword

The Reserve Bank of Australia (RBA) is a central piece of Australia's economic architecture. It contributes to the welfare of Australians by supporting a strong macroeconomy that is resilient to a complex and changing economic environment. An important part of its role is to set monetary policy, which is a critical part of ensuring price stability and full employment.

In July 2022 the Treasurer, The Hon Dr Jim Chalmers, announced the Review of the Reserve Bank of Australia and set us an objective of identifying how to make the RBA 'the world's best and most effective central bank into the future'.

We understand the gravity of the task. This is the first independent and comprehensive review of the central bank since the current approach to monetary policy began in the 1990s.

Economic developments over recent years have placed monetary policy arrangements and central bank operations under increased pressure. We are delivering this Review at a time of particular scrutiny on the operations of the RBA. Public focus on monetary policy making is not unusual, both in Australia and overseas. This focus tends to intensify during periods of monetary policy tightening, when difficult decisions need to be made about how best to promote economic welfare across the nation.

This Review is not a judgement on the past 6 months. We have looked back over 3 decades. In doing so, our objective is to identify changes that strengthen Australia's monetary policy framework and the central bank culture to support ongoing public confidence.

The Australian public can be confident that Australia's monetary policy framework is broadly fit for purpose and that the RBA is a high quality, effective institution.

We have identified 4 ways the governance, monetary policy framework, culture and systems of the RBA should be reinforced.

1. The monetary policy framework is fundamentally sound but should be more clearly defined and regularly assessed for updates.

2. Monetary policy decision making should be strengthened, drawing on more expertise and with processes that promote deeper contestability of ideas.

3. The RBA should become more open and dynamic, through new internal structures and approaches.

4. The RBA's corporate governance should be strengthened, with contemporary governance structures that better manage risk and drive change.

Structures and policies can only achieve so much. To be fully effective, the RBA's leadership and Board need to drive these changes, through what they say, do, measure and report.

Our changes would fortify an already effective institution, making it better placed to face the challenges of the future.

We are grateful for the generous input we received ranging from members of the public to world-leading monetary policy experts. We have benefitted from hundreds of interviews and submissions, 12 focus groups and more than 1,000 survey responses.

Your contributions continue to challenge, inspire and remind us about the importance of the RBA and helped us formulate the changes we need to better prepare Australia's central bank for whatever the future holds.

Finally, our sincere thanks go to the members of the Secretariat who have facilitated discussions, guided the process and provided research, analysis and advice to bring this report to fruition.

Dr Gordon de Brouwer   Professor Renee Fry-McKibbin   Professor Carolyn Wilkins

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A monetary policy framework fit for the future

Flexible inflation targeting has contributed to lower, more stable inflation and unemployment. Clarifying this framework and strengthening RBA decision making will best serve Australians in the future.

A clear monetary policy framework

- Flexible inflation targeting operated by an independent RBA has generally worked well over three decades, contributing to **lower, more stable inflation and unemployment**.

- Some **modest improvements to the current** framework and objectives will ensure it remains well-suited to Australia's future challenges.

- The RBA should have **dual monetary policy objectives of price stability and full employment**, with equal consideration given to each. The economic prosperity and welfare of Australians now and in the future should be an overall purpose for the institution.

- The RBA should retain a **flexible inflation target of 2 to 3 per cent** and aim at the midpoint to maximise the chance that the target is met and best anchor inflation expectations.

- The RBA should systematically set out its **assessment of its full employment objective**, as reflected in a range of relevant indicators of labour market conditions.

- The RBA should clearly **explain how it is balancing its two monetary policy objectives**, including how long inflation is expected to be materially away from the midpoint of the target and why, and how long labour market conditions are expected to deviate from full employment and why.

- There should be increased **joint work between Treasury and the RBA on the relative roles of fiscal and monetary policy**.

- There should be **5-yearly reviews** of the RBA's monetary policy framework and policy tools.

- There should be **more formalised cooperation arrangements for financial stability policy** including by the RBA providing formal advice to APRA for its use of macroprudential tools.

Stronger monetary policy decision making and accountability

- Monetary policy decision making should be strengthened to deal with an **increasingly complex environment** that includes more supply-side shocks and a broader monetary policy toolkit.

- The Reserve Bank Board's composition and decision making processes have not sufficiently enabled it to **shape policy decisions, strategy, and the RBA's underlying analysis and judgements**.

- The Government should **form a Monetary Policy Board with greater economic expertise** and participation in decision making while maintaining diverse perspectives and knowledge.

- The Monetary Policy Board should move to **8 monetary policy meetings a year to allow more time to consider the issues** and engage with RBA staff within each meeting cycle.

- **Monetary policy processes should be more transparent**, with press conferences after each meeting, papers published after 5 years, and Board members occasionally speaking publicly about the work of the Board.

- The RBA should strengthen its strategic communications capability, with a new **Chief Communications Officer** position.

A high performing institution

The RBA is a strong and widely respected institution. It should build on its strengths to become more open and dynamic and improve its governance.

An open and dynamic RBA

- The RBA has high **calibre, deeply committed people** and a **supportive and collegiate culture**. It is **respected domestically and internationally** for its expertise, the quality of its work and the contribution it makes in global forums.

- The RBA should build on the steps it has already taken to become **more open and dynamic**.

- The RBA should appoint a **Chief Operating Officer**, focussed on improving systems and processes and creating a more agile organisation that better empowers staff.

- The RBA should improve its leadership capability with a compulsory **leadership training program**, externally facilitated **360 degree feedback** and **improved performance management**.

- The RBA should promote constructive debate and openness to diverse views through assessing how **leaders engage with staff** on ideas, **more openness to external hires**, and **diversity targets.**

- The RBA should strengthen the role of research in policy formulation by developing a **new research strategy** overseen by the Monetary Policy Board and establishing a **monetary policy strategy team**.

More robust corporate governance

- The RBA's corporate governance should be strengthened to deal with a **complex operating environment** and **drive change**.

- The Government should **establish an RBA Governance Board with an external chair** to support and oversee management, drawing on best practice elsewhere.

- The Governance Board's role should include **oversight of the RBA's organisational strategy, finances, strategic staff planning and risk management (including cyber risks)**. It should have no role in monetary, financial stability or payments policy or the day to day running of the RBA.

RBA leaders drive institutional and cultural change

- RBA leaders should be assessed on how they deliver and model cultural change, and measure change through **annual staff surveys**.

- The Governance Board should **assess progress on implementation** and report by June 2025.

- The RBA should participate in **5-yearly Australian Public Service capability reviews**.

Implementing the Review

- The Government should **legislate changes to commence from 1 July 2024**.

- The Government should make appointments to the Boards in a way that delivers **continuity of decision making** including by ensuring appointments fall due at regular intervals.

- The Government should **consult with the Shadow Treasurer** about the implementation of the recommendations of the Review.

- The RBA should develop a **roadmap to implement the changes**, with clear timelines and accountabilities.

Executive summary: an RBA fit for the future

Australia's economic performance has been strong in the 3 decades since flexible inflation targeting was introduced. Inflation and unemployment have been both lower and more stable than in the preceding decades. The monetary policy framework, and the RBA's actions, have contributed significantly to these outcomes. In turn, this success has underpinned confidence in the monetary policy framework and the RBA as a trusted central bank with a dedicated, high-quality staff. The RBA and its executives are highly regarded domestically and internationally and make important contributions in international forums.

Over recent decades the economic and financial environment has become more complex. Globalisation has led economies to be more interlinked, and financial innovation has raised the complexity of the financial system. More recently, geopolitical tensions, COVID-19 and Russia's invasion of Ukraine have disrupted economies worldwide. The ongoing process of climate change is likely to add to economic volatility and geopolitical tensions are likely to remain high, which could impact future patterns of global trade and capital flows.

Monetary policy itself has become more complex as, in many countries, interest rates declined until they hit their effective lower bound. Central banks have responded by using new tools such as asset purchases and forward guidance. Broad changes in demographics and inequality have added uncertainty to the future path of interest rates.

The more complex and uncertain environment has tested the RBA and its monetary policy framework. This has underscored some of the strengths of current arrangements. But, in a number of recent episodes, it has highlighted clear opportunities to improve systems and processes.

To be ready to face current and future challenges, Australia needs a clear and robust monetary policy framework, effective decision-making arrangements, and a high performing institution that best supports decision makers.

Taking the lessons from recent performance along with evidence gathered from submissions, consultations and engagement with RBA staff, the Review makes recommendations grouped into five themes that reinforce each other (Figure 1). Together they will deliver an **RBA that is fit for the future**.

Figure 1	Five themes
Clear framework	**A clearer monetary policy framework** ▪ Clear monetary policy objectives and toolkit ▪ A well-defined financial stability role
Effective policy decision making	**Stronger monetary policy decision making and accountability** ▪ A more expert Monetary Policy Board supported by better processes ▪ Greater transparency and accountability around decisions
High performing institution	**An open and dynamic RBA** ▪ A more agile and empowering culture ▪ More open and constructive debate **More robust corporate governance** ▪ A new Governance Board to support and oversee management **RBA leaders drive institutional and cultural change** ▪ RBA leaders drive change and are accountable for delivering

The rest of this executive summary sets out: the Review's assessment of the RBA's performance, the Review's 14 recommendations organised under the five themes, and implementation issues. A full list of recommendations appears at the end of this executive summary.

1. Monetary policy performance

Over the past 30 years, inflation has averaged around the midpoint of the RBA's target of 2 to 3 per cent, and the variability of output and unemployment has been lower than in earlier decades. Australia's very good performance is at least on par with other comparable economies.

Flexible inflation targeting, and the RBA's actions within this framework, have been successful overall. The RBA has played a particularly critical role during crises, where it has acted decisively and effectively to support the economy and protect against severe outcomes.

In recent years, however, a more challenging environment for policymaking has highlighted areas where Australia's monetary policy framework could be improved. The Review focuses on 3 episodes that were raised most frequently in consultations: the low inflation period between 2016 and 2019, the policy response to the COVID-19 pandemic, and the recent increase in inflation.

Rather than assess whether the overall stance of monetary policy was appropriate in these episodes, the Review looks at the performance of the monetary policy framework and decision-making processes, and the RBA's internal processes and governance, to learn lessons for the future.

The Review draws 3 key conclusions from this assessment:

- For the low inflation period between 2016 and 2019 there were divergent views among stakeholders on why monetary policy decisions were taken and whether the approach was consistent with the inflation-targeting framework. This highlights that some aspects of the framework and the RBA's regular communication have not always been clear or detailed enough.

- The decisions to implement additional monetary policy tools during COVID-19 would have benefitted from a Reserve Bank Board with more specialist expertise, support and time to fully test the proposed policies. The RBA's decisive actions at the start of the COVID-19 pandemic were critical in supporting Australia through the crisis. At the same time, stronger decision-making arrangements may have helped mitigate eventual shortcomings in the RBA's forward guidance, yield target, term funding facility, and bond purchase program.

- The RBA was initially slow to respond to rising inflation in 2022, along with many other central banks. An overemphasis on wages as a driver of persistent inflation, reliance on forecasting and modelling tools that offered limited insights on the supply side of the economy, and the way forward guidance and the yield target had been designed and used all contributed. Deeper consideration of monetary policy strategy, risks and opposing views, and use of a richer suite of models and data, may have reduced the risk of misjudging inflation.

2. A clearer monetary policy framework

Australia's existing monetary policy and financial stability frameworks have served Australia well in recent decades.

The monetary policy framework of an independent central bank undertaking flexible inflation targeting is well suited to the future challenges Australia can expect to face.

However, greater clarity in the framework would support greater accountability for the RBA.

Relatively modest changes to this framework should be made to:

- clarify the RBA's monetary policy objectives and toolkit, how it operates and explains its framework, and how monetary policy interacts with other branches of policy

- put the RBA's financial stability role on a firmer footing and strengthen cooperation arrangements with other agencies involved in financial stability.

Clear monetary policy objectives and toolkit

Affirm the RBA's independence and clarify its statutory monetary policy objectives (Recommendation 1)

The role and objectives of the RBA are defined through the *Reserve Bank Act 1959*.

It is critical that Australia retains the operational independence of the RBA to set monetary policy. Monetary policy decision making must be insulated from short-run political considerations. This independence has been a successful part of Australia's institutional arrangements since the 1990s.

To further support the RBA's monetary policy independence, the power of the Government to override decisions of the Reserve Bank Board should be repealed. This power detracts from the independent operation of monetary policy and the credibility of the monetary framework.

The Review also recommends the removal of the RBA's power in the *Banking Act 1959* to direct commercial banks' lending. This broad-ranging power is not necessary for the RBA to achieve its core mandate and, in the absence of a clearly specified purpose for its use, it should be removed.

The delegation of monetary policy to an independent body should be accompanied by **clearly defined objectives** for its use. The RBA's objectives for monetary policy should be clarified as a dual mandate to contribute to price stability and full employment. These objectives matter for the welfare of Australians, are enduring, and are what monetary policy can best affect. Together they require the RBA to strike a balance between controlling inflation and supporting employment, in both the short and longer term.

The economic prosperity and welfare of Australians, now and in the future, should be legislated to be the *overarching purpose* for the RBA in the exercise of all its powers. It is not suited to be an additional objective for monetary policy because this provides too much discretion to the RBA. Monetary policy can best contribute to this overarching purpose by focusing on full employment and price stability.

These changes are not a substantial departure from the status quo – senior RBA officials have indicated, at times, that they already consider the objectives of monetary policy in these terms. Compared to the RBA's current monetary policy objectives, this recommendation retains full employment and clarifies the existing objectives by:

- updating the RBA's current objective of 'the stability of the currency' to 'price stability'

- removing 'the economic prosperity and welfare of the people of Australia' as a separate legislated objective of monetary policy and making it an overarching purpose for the RBA, so that monetary policy is focused on price stability and full employment.

Keep a flexible inflation-targeting framework but clarify how it operates (Recommendation 2)

The RBA currently pursues its objectives through a flexible inflation target, which is specified in the *Statement on the Conduct of Monetary Policy* that is agreed upon between the Treasurer and the RBA Governor.

Flexible inflation targeting remains the best operational framework for monetary policy to pursue the dual mandate of price stability and full employment. Flexible inflation targeting has a good track record and is well established and understood in Australia.

A flexible inflation target remains suitable in a future where supply disturbances may be more common. The flexibility allows the RBA to weigh both its objectives, when they are in conflict in the short term. For example, if inflation is above target and employment below target following a supply disruption, the RBA can seek to return inflation to target more gradually than otherwise to achieve better employment outcomes. Equal consideration should be given to price stability and full employment in making such judgements.

Other frameworks such as price level targeting or nominal income targeting may, in theory, perform as well or better in some circumstances. However, there is currently insufficient evidence that alternative frameworks would outperform flexible inflation targeting in practice. Other jurisdictions that have considered alternative frameworks have also chosen some variation of flexible inflation targeting.

The price stability objective in the framework should continue to be to keep **consumer price inflation between 2 and 3 per cent**. This target is well understood in the community and keeping the same target over time supports anchored inflation expectations. To strengthen this anchor, the RBA should aim to return inflation to around the midpoint of its target when significant deviations occur, as this maximises the chance that the target is met.

Flexibility is an important part of the framework. Inflation and employment will vary around their target levels and in conflicting directions at times. Balancing the dual mandate requires judgement about how quickly to try to return inflation to around the middle of the target. This should be the RBA's judgement to make. The current wording of the inflation target is that inflation should be between 2 and 3 per cent 'on average, over time'. The reference to 'on average, over time' makes it harder to say whether or not the target is being met, limiting accountability, and should be dropped.

Instead, the RBA should be required to explain how it is using its flexibility. This should include how quickly it is aiming to return inflation to around the midpoint of the target, its assessment of full employment, and how, if at all, financial vulnerabilities or other considerations have factored into its decision.

Promote a better understanding of the relative roles of fiscal and monetary policy (Recommendation 3)

Both **fiscal and monetary policy** affect employment and inflation. The RBA and Government must determine their policy settings independently, considering their individual objectives and constraints. However, this independence does not mean fiscal and monetary policy should be set in isolation from each other – dialogue between policy makers supports each having a good understanding of the intentions of the other and informs better policy choices. There should be increased information sharing between the RBA and Government on risks, scenarios and policy constraints. As part of this, the RBA and Treasury should undertake joint scenario analysis exercises to prepare for challenging circumstances.

The RBA and Treasury should also **work more with outside researchers** to advance understanding of policy interactions by developing a program to promote applied research on monetary, fiscal and financial policy across universities and think tanks.

In recent years, the RBA has joined other central banks in using **additional monetary policy tools**. While the cash rate should remain the primary tool of monetary policy, the RBA should continue to consider using other monetary policy tools when the cash rate cannot go any lower. However, before deploying such tools, there should be better consideration of their costs and benefits, risk analysis and exit planning. The RBA should develop and publish a framework for the use of these tools to embed lessons from its recent experience.

Institute regular reviews of the monetary policy framework and tools (Recommendation 4)

To ensure that the RBA's approach to monetary policy remains appropriate in a changing economic environment, the Review recommends 5-yearly reviews of the monetary policy framework and tools. These reviews should be focused on a short list of questions related to the framework and tools, agreed by the Monetary Policy Board and Treasurer. The reviews should be led jointly by the RBA and Treasury, with transparent input from outside experts chosen to ensure a range of viewpoints is considered.

A well-defined financial stability role

Legislate the RBA's financial stability role and reinforce cooperation arrangements for promoting financial stability (Recommendations 5,6)

Responsibility for financial stability in Australia is shared by a small number of agencies. The Australian Prudential Regulation Authority (APRA) has a legislative mandate for financial stability and manages Australia's prudential policy levers, including minimum capital ratios and regulatory constraints on lending. The RBA contributes to financial stability by pursuing price stability and full employment using monetary policy. In addition, it has powers to provide liquidity support to markets and institutions, and contributes to financial stability through its responsibilities for payments system oversight and banknotes.

While these powers give the RBA an important financial stability role, this does not have a clear legislative basis. The Review seeks a **firmer foundation for the RBA's financial stability role** and clarification of the scope of its responsibilities.

The complex risks, overlapping responsibilities and distributed tools for financial stability demand clear accountability for the use of tools, and **close cooperation between regulators.** Cooperation arrangements should be reinforced by:

- Making it a clear responsibility of the Council of Financial Regulators to ensure there are no gaps in the framework.

- The RBA and APRA agreeing on mechanisms to ensure the RBA's assessment of financial stability risks, and any interactions with monetary policy, feed directly into APRA's macroprudential policy decisions. This will promote addressing concerns about financial vulnerabilities through macroprudential policy, where possible, so they do not constrain monetary policy.

Promoting understanding of the economic implications of climate change

The RBA should take account of climate risks but not use monetary policy to address them (Recommendation 7)

Climate change is a critical global concern and has important implications for the Australian economy and the RBA. The RBA should continue its work to **understand the implications of climate change** for the economy and the financial system, taking further steps to incorporate physical and transition risks into RBA analysis and modelling. It should also contribute alongside the other Council of Financial Regulators agencies to the adaptation of financial markets and institutions to these risks, including in international rule-setting bodies.

The Review does not, however, support a specific climate transition objective for the RBA as a whole or monetary policy in particular. Monetary policy tools do not provide a targeted response to the issue and using them for this purpose may inadvertently compromise the enduring objectives of price stability and full employment. Other government policies are better suited to target climate transition, and public policy choices in this area should be made by elected representatives.

3. Stronger monetary policy decision making and accountability

Alongside a clear framework, the RBA needs **effective monetary policy decision-making arrangements** to ensure the best possible outcomes for Australians. The Review identifies two key ways in which the current arrangements fall short.

- The Reserve Bank Board's composition and processes do not enable it to sufficiently scrutinise or challenge the RBA's underlying economic and financial judgements or policy advice.

- There is limited information available to the public about the factors driving the Board's decisions, or how alternative viewpoints or policy options are weighed. Accountability mechanisms for individual Board members are lacking.

These represent opportunities to improve the robustness of the policy process, and public trust and understanding of it. To address these gaps the Review recommends that:

- There should be a dedicated Monetary Policy Board with deeper economic and financial expertise, and more information, time and staff support to fully engage in the policy process.

- The transparency and accountability arrangements around monetary policy should be strengthened.

These recommendations aim to shift the nature of the Board from what is in effect an advisory body to one that proactively shapes policy decisions, strategy, and the underlying analysis and judgements. The Monetary Policy Board and its members should have a clear, strong and independent voice on monetary policy.

A more expert Monetary Policy Board supported by better processes

Constitute an expert Monetary Policy Board with diverse perspectives and knowledge (Recommendation 8)

Currently, the Reserve Bank Board provides only limited challenge to the RBA executive's view and its skillset is not matched to the complex and uncertain economic environment in which monetary policy will increasingly operate. The external members of the Board have been outstanding leaders in their fields. However, collectively they have less economic and financial market expertise, and spend less time on monetary policy, than decision-making bodies at comparable central banks.

Monetary policy involves making technical judgements and important trade-offs in an uncertain environment. Combining the judgement of a group of people with deep and relevant expertise provides the best chance of achieving good outcomes.

The Review seeks to raise the collective economic and financial expertise of monetary policy decision makers, while recognising the importance of retaining diverse perspectives and knowledge.

Monetary policy should be set by a dedicated Monetary Policy Board whose members bring an independent and informed perspective on monetary policy and are able to robustly challenge the views of others. Members should be able to make a significant contribution to decisions through expertise in areas such as open-economy macroeconomics, the financial system, labour markets, or the supply side of the economy, and in the context of decision making under uncertainty. The appointments process for Monetary Policy Board members should be made more open, transparent and skills-based to support this. It is expected that members could include business leaders or others with relevant expertise alongside academic and professional economists.

The Monetary Policy Board should oversee financial stability policy (excluding payments policy), but not the broader corporate governance of the RBA.

The Treasury Secretary plays a valuable role on the Reserve Bank Board and should remain a member of the Monetary Policy Board. Although this is unusual by international standards, the Review notes that the Secretary is well positioned to bring a different perspective and plays an important role as an information conduit between monetary and fiscal policy. However, it should be absolutely clear that the Treasury Secretary acts independently of Government in their role on the Monetary Policy Board. The RBA Act should specify that the Secretary cannot be directed by the Treasurer in this regard.

Improve processes to support deeper consideration of monetary policy decisions, strategy and research (Recommendation 9)

Effective decision-making depends on having both the necessary expertise and the right supporting processes.

The Reserve Bank Board's current processes do not provide members with enough information, time or support to sufficiently explore policy options and strategies or to challenge RBA views. Moreover, on some occasions the Board has not requested or been given information relevant to its decisions or has not been fully involved in significant policy decisions.

The RBA and Monetary Policy Board should make changes to **deepen the Board's deliberation on monetary policy** and ensure it is open to a wide range of inputs. These include:

- moving to fewer policy meetings but increasing the time spent on monetary policy and strategy
- providing opportunities for Board members to hear the views of a wider range of RBA staff and giving external Monetary Policy Board members staff support
- increasing the forecasting and macroeconometric modelling capability of RBA staff and ensuring that decisions are informed by the best possible data
- producing a richer set of briefing materials on strategy, policy options, costs, benefits and risk
- convening an expert advisory group to hear external views on the economy and outlook, policy issues and strategy, and research.

The development of improved monthly measures of inflation by the Australian Bureau of Statistics would support these changes, by boosting the RBA's understanding of current economic conditions.

There is an important link from these changes to the internal culture of the RBA. A more expert group of decision makers, engaging in a deeper consideration of the issues, and interacting more with staff, can be expected to increase the demand for analysis and research as supporting evidence for their policy choices. This will support a stronger culture of research, challenge and debate within the RBA, discussed under Section 4 of the executive summary.

Greater transparency and accountability around decisions

Strengthen monetary policy transparency and accountability (Recommendation 10)

Effective decisions are more likely where there are clear expectations of decision makers, and they are accountable for their actions. Transparency and clear communication support accountability, policy legitimacy and effectiveness.

Current arrangements do not adequately support transparency and accountability of the Reserve Bank Board and its members. The RBA's regular communications are less transparent than those of some other peer central banks, despite significant advances in recent decades. While the frequency of speeches and parliamentary appearances have increased, press conferences are infrequent, explanations of policy strategy lack important detail, and there is limited information available about the range of views within the Board. Accountability mechanisms for external Board members, such as an expectation that they should explain the Board's decisions in public, are lacking. More broadly, communication with the public is not as effective as it could be.

The RBA should better explain its policy choices through regular press conferences and increasing the amount of information available about policy deliberations, strategy, and the RBA's forecasts. The RBA's communications should include the reasoning behind decisions, what alternative policy options were considered, and how current policy settings fit into a broader strategy.

Monetary Policy Board members should be more accountable for their role in setting monetary policy. They should be expected to discuss the Board's decisions in public from time to time, and statements released after policy meetings should be agreed by them and published in their name.

Improved communication by the Monetary Policy Board would be supported by building the RBA's strategic communications capacity under a **Chief Communications Officer** reporting to the Governor. This will ensure the RBA has the depth of skills and expertise at a sufficiently senior level to provide strategic communications advice to the RBA's executive and boards.

The Review envisages that external members of the Monetary Policy Board would serve on a part-time basis, spending the equivalent of around one day a week in the role, and can be expected to have other employment and roles. There are clear benefits to the outside perspectives, networks and skills that external members bring. However, it is important that robust policies are in place to manage any potential conflicts of interest. Existing conflict of interest rules should be strengthened to buttress accountability, through more extensive description of situations where real or perceived conflicts could arise and tighter restrictions on financial transactions.

4. An open and dynamic RBA

The RBA's management, culture and operations determine how effectively it can support policy decision making and its other functions. It must recruit, retain and motivate a high-quality staff, organise and lead them in a way that produces outstanding policy advice and well-run financial infrastructure, and be able to reflect, adapt and grow to meet fresh challenges.

The Review's extensive consultations, including with current and former staff, identified many strengths of the RBA. It has a highly motivated and capable staff, with a commitment to rigorous analysis and quality outputs. It has a supportive and collegiate environment and staff are especially driven by their commitment to the public service.

The Review identified four broad areas in which the RBA could strengthen its management, culture and operations. These are all areas in which the RBA has taken steps over recent years. However, the Review's consultations indicate further action is needed. The Review's recommendations propose further concrete steps that are designed to help the RBA build an organisation that:

- is more dynamic and empowering of its staff
- raises the leadership capabilities of its staff
- is more welcoming of diverse viewpoints and constructive challenge
- makes more of the analytical and research capability of its staff in policy formulation.

A more agile and empowering culture

The RBA should further empower its staff and raise the dynamism of the organisation (Recommendation 11.1)

The RBA has a hierarchical culture which can slow down decision making and limit sensible delegation, and at times has an aversion to risk taking. This has resulted in some staff feeling disempowered. The RBA has invested in strengthening its corporate expertise and sought to improve organisational processes. However, organisational structures, resourcing, and processes are not as flexible as they could be, and so change is not always managed well.

A significant opportunity exists to make the RBA a more empowered and dynamic organisation.

To help realise this **the RBA should create a new Chief Operating Officer position**, at the same level as the Deputy Governor, to bring focus to driving the organisational change required.

This role should have responsibility for the RBA's corporate services and enabling functions and should sit on the RBA's Executive Committee and Governance Board. The Chief Operating Officer should have the seniority to take enterprise-wide decisions, direct resources, and raise the focus on strategic operational issues. The creation of this role will also free up more time for the Governor and Deputy Governor to focus on policy issues.

Ongoing priorities for the Chief Operating Officer should be to:

- consider the RBA's structure and internal processes for collaboration with a view to ensuring the RBA uses its resources effectively and efficiently, and can adapt to emerging risks and challenges

- consider spans of control, role responsibilities and accountabilities to ensure decisions are taken at the appropriate level

- oversee improvements to strategic workforce planning capability and people management processes including performance management and development, and succession planning

- take further steps to improve the risk culture and risk management across the organisation

- coordinate and help to drive the organisational changes the RBA needs to achieve.

The RBA should strengthen and extend its leadership capability (Recommendation 11.2)

The Review's engagement with RBA staff members highlighted that **the RBA needs to further improve its leadership capability** and better and more consistently recognise the value of leadership and management skills. Accountability for leadership performance and processes for upwards feedback are not sufficiently robust or well embedded. A lack of transparency around internal rotations and appointments limits staff members' agency in career development.

To get the most out of its talented staff, the RBA should:

- implement mandatory leadership training for all leaders, tailored to different levels of management, including executive leaders

- implement a formalised program of externally administered annual 360-degree feedback to better assess leadership behaviours and performance, followed up with leadership coaching

- strengthen and better embed performance management, development and career planning frameworks

- implement greater transparency for internal opportunities, rotations and appointments.

More open and constructive debate

The RBA should further encourage diverse viewpoints and constructive challenge (Recommendation 11.3)

The RBA has made extensive efforts in recent years to foster a culture where debate and challenge are encouraged. Nevertheless, many staff members perceive there to be incentives to express views that align with their direct managers and senior leaders. There is a risk of groupthink that can be driven by concentrated policy and operational decision-making processes and a lack of meaningful conversations with senior leaders about why decisions are taken. The RBA is also not as open as it could be to external views. While the RBA has introduced initiatives to encourage staff to speak up, these factors continue to inhibit constructive challenge and debate and stifle innovation and creativity.

These issues partly stem from underlying behaviours, such as how supported and safe staff members feel to speak up and challenge the status quo, and how they perceive promotion incentives. Changes in leadership behaviour play an important role in improving perceptions – particularly at the executive level, as discussed in Section 6 of the executive summary. But other factors, such as recruitment, induction and incentives can also make a difference.

To foster **a stronger culture of constructive challenge and openness to diverse views**:

- Leaders should be assessed for how well they listen to and engage with staff members, and welcome alternative views.

- The RBA should step up its existing efforts to increase hiring of experienced external candidates. It should also improve onboarding support for external hires to ensure they can be successful at the RBA and encourage and incentivise staff to complete external secondments.

- The RBA should develop additional targets for diversity in senior leadership positions, including for cultural and linguistic diversity to complement existing gender targets. This will help to ensure that decision-making benefits from a range of perspectives. The RBA should report on progress towards meeting these targets.

The RBA should strengthen the role of research in policy formulation (Recommendation 11.4)

Monetary policy decisions should as far as possible be informed by sound evidence, analysis and research. That requires a **strong research culture** in the RBA in which policymakers are open to and value research and analysis as an input to their decisions. It also requires the RBA to maintain the technical skills necessary to provide robust well evidenced policy advice that draws on RBA and external research.

At present, policy-setting does not utilise as fully as it could the RBA's technical capabilities, or outside views. For example, staff have limited opportunity to contribute to the development of monetary policy strategy, and evidence from research is not always well integrated into the policy process. The largely non-technical nature of the Reserve Bank Board's discussions and the fact that the Board has no role in endorsing or shaping the RBA's research agenda contribute to this. On the staffing side, the absence of a non-managerial career track for technical staff may limit their scope to contribute.

To address these issues:

- The RBA should establish a new team to advise the Monetary Policy Board on monetary policy strategy. This team should incorporate staff views on different policy options with supporting analysis and draw on relevant internal and external research.

- The Monetary Policy Board should oversee the development of a new research strategy which aims to improve the RBA's research capability, bring research insights more effectively into the policy process, shape a policy-relevant research agenda and promote greater engagement with universities and think tanks.

- To deepen its research and analytical capability the RBA should consider how best to recruit, develop, and incentivise staff with technical expertise. This may include technical career pathways, use of secondments, PhD study support, rewarding publications in peer-reviewed journals and using new channels to disseminate research insights to a wider audience.

These recommendations are complementary to increasing the openness to challenge and debate within the RBA and creating a more specialist Monetary Policy Board.

5. More robust corporate governance

A new Governance Board to support and oversee management

Effective governance and oversight arrangements can support and challenge management, bring a breadth of experience into the running of an organisation, and help push it to adapt and change.

Within the RBA the responsibility for running the institution is heavily concentrated in the Governor and, to a lesser extent, the Deputy Governor, with the Reserve Bank Board playing a very limited oversight role outside of monetary policy. Some aspects of internal governance – including the proper extent of the role of the Reserve Bank Board and responsibilities for risk management – are unclear.

These arrangements fall far short of contemporary good practice for running an organisation of the complexity of the RBA. The concentration of authority creates risk and may unintentionally contribute to institutional inertia and an environment in which debate and challenge are less likely to flourish.

More robust corporate governance arrangements would bring the RBA into line with best practice, reduce risk, clarify and increase accountability and increase its capacity to adapt to future challenges especially around people, technology and cyber risk. That is especially important in light of the significant agenda the Review has identified for strengthening the culture and processes of the RBA.

Update RBA oversight and accountability by establishing a Governance Board (Recommendation 12)

A Governance Board should be established to provide guidance and oversight for RBA management in the running of the organisation. In line with corporate governance best practice, it should comprise a majority of non-executive members, appointed via a transparent process, and should have a non-executive Chair.

The Governance Board's responsibilities should include oversight of organisational strategy, financial reporting, large IT and other projects, resourcing, strategic staff planning, risk management (including cyber risk) and delivery of banking and banknote services. More broadly, it should be responsible for oversight of the efficient use of the organisation's resources, holding the executive to account for delivering on the organisational strategy and change priorities (including the changes recommended by this Review), and assessing the performance of the RBA.

The Governance Board should have no role in monetary, financial stability or payments policy, which would be the responsibility of the dedicated policy boards, or in the day to day running of the RBA.

An important benefit of creating a Governance Board is to bring outside expertise and knowledge to bear on issues of organisational management. The RBA senior executive group is relatively homogeneous in terms of experience and knowledge. The Review's recommendation to create a Chief Operating Officer adds capacity for organisational management at a senior level. The Governance Board can provide further expertise, in an oversight capacity, in areas such as technology, human resourcing, and risk and financial reporting, helping to ensure robust organisational performance and importing best practices from other organisations.

The creation of a Governance Board complements the Review's recommendation to strengthen monetary policy decision making in two ways:

- It will contribute to maintaining the RBA as a high performing institution as it faces a complex and challenging environment in the future. A key part of that is overseeing the change program envisaged by this Review (see Recommendation 13).

- It will enable the Monetary Policy Board to focus solely on monetary and financial stability policy, and have expertise tailored to that task, without also performing some corporate governance functions.

There must be a **clear division of responsibilities within the RBA** between the Governance Board, Monetary Policy Board and Payments System Board. The RBA's 3 Boards should establish charters setting out their responsibilities and those of the executive. The Governance Board's charter should restrict its role to oversight and avoid any involvement in the day to day running of the RBA. The RBA's Boards should establish a memorandum of understanding with each other recording the common understanding of their legislative responsibilities and their expectations for information exchange and consultation on matters of mutual interest. This should be designed so that the ability of the policy boards to act, including in crises, is enhanced.

6. RBA leaders drive institutional and cultural change

The organisational and cultural changes recommended by the Review will only have their intended impact if:

- the RBA's leaders drive and model cultural changes, and measure and assess their impact through staff feedback

- the RBA as an institution transparently holds itself to account for achieving change and works to identify opportunities for further growth.

RBA leaders drive change and are accountable for delivering

RBA leaders should drive and measure change (Recommendation 13.1)

Many of the institutional issues highlighted by the Review have been previously identified by the RBA, and actions have been taken to address them. However, staff members have not always fully felt the intended impact of these changes. **Leaders' behaviours need to consistently support the culture the RBA needs to perform at its best**.

To help drive organisational change, leaders should:

- be assessed on how well they model adaptability and openness to change and demonstrate how to engage in constructive two-way challenge and debate

- in consultation with staff, develop a statement about the further cultural change they will pursue and a plan for achieving it

- seek feedback and measure progress, including through an annual staff engagement survey, and address remaining gaps.

The Governance Board should assess progress and report publicly (Recommendation 13.2)

While the RBA's executive leaders have responsibility for delivering organisational and cultural change, the Governance Board should oversee and support the process and **hold the executive accountable for delivery**. This includes supporting leaders in their efforts to effect change, monitoring progress and challenging senior leaders where progress is too slow, and ensuring senior leaders are open and transparent with staff on plans and progress.

A regular part of the Governance Board's role should be to identify priorities for organisational growth.

To meet these objectives:

- the Governance Board should assess the RBA's progress in implementing the recommendations and report publicly by June 2025

- the RBA should be included in 5-yearly Australian Public Service capability reviews to ensure it remains fit for purpose and able to meet future challenges.

7. Implementing the Review

The Review's recommendations aim to build on the RBA's many strengths, so that it is ready for future challenges. They should not be seen as responding to immediate events and issues.

Implementing the recommendations is a complex and important task that cannot be completed overnight. Fully implementing the Review's changes requires legislation, which will take time to put into effect. They will also require important investments on the part of the RBA. These changes should be carefully planned and paced to minimise disruptions to the RBA's core functions.

A roadmap for implementation

Ensure continuity through the implementation process (Recommendation 14)

Legislated changes should commence on or after 1 July 2024.

Transition arrangements should be put in place to **ensure the continuity of monetary policy and corporate decision making** through the implementation process:

- Interim appointments to the current Reserve Bank Board should have a similar process to that proposed for the two new Boards and should complete their terms on the Monetary Policy Board.

- Other existing Reserve Bank Board members should be asked to consider serving their remaining term on one of the two new Boards.

- The terms of appointees to the new Boards should be varied as needed to avoid bunching of future appointment dates.

Bipartisan support for the arrangements is important to ensure the enduring credibility of monetary policy. To support this, the Treasurer should consult the Shadow Treasurer on the implementation of the Review's recommendations.

Taking account of the Government's legislative plans, **the RBA should develop an implementation roadmap** that defines priorities, actions, accountabilities and governance for implementing the recommended changes.

Among the non-legislative changes, the RBA should in 2023 prioritise the changes that strengthen monetary policy decision making, communications and the RBA's management, culture and operations.

An updated *Statement on the Conduct of Monetary Policy* should be progressed by the Reserve Bank Board and the Government by the end of 2023.

Implementing the Review without legislation

Implementing 4 of the Review's recommendations (1, 5, 8 and 12) requires legislation.

The principles of an independent central bank conducting monetary policy, broad bipartisan support for the framework and a high degree of stability in the framework, are of absolute importance. The Review strongly supports legislative change, but only if the process can be expected to proceed without putting these principles at risk.

The Review has considered how those recommendations' intent could best be met in the absence of legislative change. These alternative approaches are set out in Chapter 7.

In some cases, it may be possible to achieve somewhat similar outcomes without legislation. However, in the absence of legislation, the benefits of a separately constituted Monetary Policy Board and Governance Board can be only very partially realised within the existing Board structure.

The best alternative approach, in this case, would be to focus on deepening the existing Reserve Bank Board's capacity and involvement in monetary policy decision making. A separate corporate governance advisory committee could be formed which would provide some additional assistance to the Governor in discharging their role managing the operations of the RBA, but this would not achieve the benefits of formal changes to governance accountabilities.

Attempting instead to deepen the existing Reserve Bank Board's involvement in both corporate governance and monetary policy decision making would compromise the achievement of necessary improvements in both areas.

Setting the RBA up to face the challenges of the future means implementing the best possible governance model. **The Review strongly supports legislative change to achieve the full benefits of its recommendations.**

Recommendations

A clearer monetary policy framework

Recommendation 1: Affirm the RBA's independence and clarify its statutory monetary policy objectives

1.1   The RBA should continue to have operational independence for monetary policy. The Government should remove the power of the Treasurer to overrule the RBA's decisions.

1.2   The Government should amend the *Reserve Bank Act 1959* such that:

- The RBA has dual monetary policy objectives of price stability and full employment.
- The 'economic prosperity and welfare of the people of Australia now and in the future' is an overarching purpose for the RBA rather than a separate objective for monetary policy.

1.3   The Government should remove the RBA's power (in the *Banking Act 1959*) to determine the lending policy of banks.

Recommendation 2: Keep a flexible inflation targeting framework but clarify how it operates

2.1   The RBA Monetary Policy Board (see Recommendation 8) and the Government should agree in the *Statement on the Conduct of Monetary Policy* that:

- Equal consideration should be given to price stability and full employment in setting monetary policy.
- There should be a flexible inflation target of 2-3 per cent.
- The Monetary Policy Board should aim for the midpoint of the inflation target in order to maximise the chance that the target is met and best anchor inflation expectations.
- The Monetary Policy Board should set out its assessment of its full employment objective, as reflected in a range of relevant indicators of labour market conditions.
- The Monetary Policy Board has the flexibility to vary the timeframes over which it aims to bring inflation back to around the midpoint of the target, taking into account the full employment objective, when significant deviations occur.

2.2   The *Statement on the Conduct of Monetary Policy* should outline how the RBA Monetary Policy Board will communicate its use of the framework's flexibility including expectations that the RBA will, in its regular communications:

- explain how long inflation is expected to be materially away from the midpoint of the target and why, how long labour market conditions are expected to deviate from full employment and why, and how it is balancing its two objectives

- explain the key factors affecting its decision making, such as financial stability risks which should be a consideration in monetary policy decisions to the extent that they may influence the price stability and full employment objectives.

Recommendation 3: Promote a better understanding of the relative roles of fiscal and monetary policy

3.1   The *Statement on the Conduct of Monetary Policy* should acknowledge the importance of both monetary policy and fiscal policy for macroeconomic outcomes. The Government (in particular Treasury) and the RBA should commit to:

- continue to regularly share information about the economic outlook, risks and policy constraints

- work together to analyse the impacts of monetary policy decisions on fiscal policy, and the impacts of fiscal policy decisions on monetary policy

- jointly develop scenario analysis that identifies the best combination of policy responses to economic challenges, in ways that do not compromise monetary policy independence

- identify how the RBA's monetary policy framework and the Government's fiscal approach can together best support good economic outcomes and acknowledge that fiscal policy may have a larger role in some circumstances, for example when the cash rate is at its effective lower bound.

3.2   The RBA and Treasury should develop an Australian Macroeconomic Policy Research Program to promote applied research and analytics on Australian monetary, fiscal and financial policy, working with universities and think tanks that have such programs.

3.3   The RBA should publish a framework for the use of additional monetary policy tools in the future. The *Statement on the Conduct of Monetary Policy* should set out what the framework will cover, including the expectations of the Government and RBA Monetary Policy Board around:

- transparency

- assessing costs and benefits

- managing risks

- considering exit strategies at the outset for different scenarios

- discussions on the appropriateness of fiscal policy as an alternative policy lever.

Within the agreed framework, the RBA should retain instrument independence.

Recommendation 4: Institute regular reviews of the monetary policy framework and tools

4.1   The Government and RBA Monetary Policy Board should instigate a formal review of the monetary policy framework and tools every 5 years, jointly led by the RBA and Treasury and including formal and transparent input from independent domestic and international experts with a wide range of viewpoints. The purpose of the review should be to ensure the monetary policy framework and tools remain appropriate, and it should inform the renewal of the *Statement on the Conduct of Monetary Policy*.

Recommendation 5: Legislate the RBA's financial stability role

5.1   The Government should specify in the *Reserve Bank Act 1959* that the RBA has a responsibility to contribute to financial system stability, in cooperation with other government agencies, especially the Australian Prudential Regulation Authority (APRA).

Recommendation 6: Reinforce cooperation arrangements for promoting financial stability

6.1   The Council of Financial Regulators should renew memorandums of understanding between its members so that there is:

- clarity on the outcomes the group is responsible for delivering and the specific roles of each agency

- a shared responsibility for identifying regulatory gaps at a 'whole of system' level

- a shared commitment to reduce the risks posed by such gaps.

6.2   The RBA Monetary Policy Board should commit to inform the Council of Financial Regulators when monetary policy is likely to affect, or be affected by, risks to financial stability. This should include formal advice from the RBA to APRA on its use of macroprudential tools. This advice to CFR and APRA should be published after 5 years.

6.3   The RBA and APRA should update their public memorandum of understanding so that it sets out clear and specific commitments to cooperation in promoting financial stability, including the way APRA consults the RBA on macroprudential policy settings.

Recommendation 7: The RBA should take account of climate risks but not use monetary policy to address them

7.1   The RBA should continue to:

- integrate the implications of climate change for the Australian economy and financial system into its analysis

- contribute more generally to the effective regulation of banking and finance on climate risk and natural capital management through the Council of Financial Regulators and international forums.

7.2   The Government should not make transition to a low carbon economy an explicit objective of monetary policy. The Government should set the mix of policies to pursue and manage the transition, rather than the RBA using its balance sheet or directing private lending to accelerate transition.

Stronger monetary policy decision making and accountability

Recommendation 8: Constitute an expert Monetary Policy Board with diverse perspectives and knowledge

8.1   The Government should constitute a Monetary Policy Board with responsibility for monetary policy decisions and oversight of the RBA's contribution to financial system stability (except payments system policy), but not broader corporate governance.

8.2   The Monetary Policy Board should comprise the Governor, Deputy Governor, Treasury Secretary and 6 external members, with the Governor as chair.

8.3   The Government should clarify in the *Reserve Bank Act 1959* that the Treasury Secretary acts on the Monetary Policy Board in their individual capacity not at the direction of the Treasurer. The *Statement on the Conduct of Monetary Policy* should state that the Treasury Secretary has a responsibility to provide insight on the outlook for the economy and for fiscal policy.

8.4   The Monetary Policy Board's external members should be able to make a significant contribution to monetary policy setting through expertise in areas such as open-economy macroeconomics, the financial system, labour markets, or the supply side of the economy, and in the context of decision making under uncertainty.

8.5 External Monetary Policy Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest, drawing on a matrix of required skills and experience. A panel comprising the Treasury Secretary, the Governor and a third party should recommend options for suitable candidates to the Treasurer.

8.6 External members of the Monetary Policy Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.

Recommendation 9: Improve processes to support deeper consideration of monetary policy decisions, strategy and research

9.1 The Monetary Policy Board should meet 8 rather than 11 times a year to allow for more in-depth discussions including of the forecast, strategy and other monetary policy issues. The meeting cycles should:

- allow sufficient time between initial discussion of the issues and the final decision for members to reflect on the issues and request follow-up analysis as necessary

- provide opportunities for the Monetary Policy Board to hear the views of a wider range of RBA staff on issues that would inform the decision.

9.2 The 6 external Monetary Policy Board members should have direct access to RBA staff for support on technical matters and additional analysis when requested.

9.3 The RBA should increase its forecasting and macroeconometric modelling capability, for example around the supply side of the economy and fiscal policy and continue to build on its use of new data sets. This will support better consideration of monetary policy strategy under uncertainty.

9.4 The Monetary Policy Board should convene and engage with an expert advisory group on monetary policy.

9.5 The Monetary Policy Board should receive, and request as necessary, briefings that more fully consider monetary policy strategy, alternate policy options, costs, benefits and risks.

Recommendation 10: Strengthen monetary policy transparency and accountability

10.1	The Governor should hold a press conference after each decision meeting to explain the Monetary Policy Board's view of policy and economic developments.
10.2	External Monetary Policy Board members should be expected to discuss the decisions and thinking of the Board publicly, including through at least one speech or public engagement a year.
10.3	The public statement after each Board meeting should be released by the Monetary Policy Board and approved by members as a fair reflection of the decision and discussion. The statement should report unattributed votes.
10.4	The RBA should publish more of the information underlying the Monetary Policy Board's decisions, including detailed forecast data and assumptions and insights from business and community liaison. Board papers should be published after 5 years.
10.5	The RBA should strengthen its professional capability in strategic communications to support both the Monetary Policy Board and the RBA executive.
10.6	The RBA should strengthen conflict of interest policies for members of the RBA's Boards to provide additional appropriate restrictions on financial transactions.

An open and dynamic RBA

Recommendation 11: Strengthen the RBA's management, culture and operations

11.1   The RBA should further empower its staff and raise the dynamism of the organisation. To support this, it should appoint a Chief Operating Officer, at Deputy Governor level, who:

- leads all corporate and enabling functions

- is tasked with improving delegation, strategic workforce planning, succession planning, the allocation of resources, risk management and driving cultural change.

11.2   The RBA should strengthen and extend its leadership capability through:

- mandatory leadership training for all managers

- annual externally facilitated 360-degree feedback mechanisms for managers with subsequent leadership coaching services

- ensuring its leaders are assessed for how effectively they deliver performance management and development processes that capture both the business outcomes and how those outcomes were achieved

- more routine and transparent processes for internal job and rotation opportunities.

11.3   The RBA should further encourage diverse viewpoints and constructive challenge, including by:

- ensuring its leaders are assessed for how well they listen to and engage with staff members, and welcome alternative views

- advertising management role vacancies externally as a default and better enabling external hires to succeed in the RBA through improved onboarding and support

- setting diversity targets and tracking progress against them.

11.4   The RBA should strengthen the role of research in policy formulation, including by:

- establishing a monetary policy strategy team

- increasing collaboration between policy groups, including through cross-departmental projects

- developing and executing a research strategy and agenda overseen by the Monetary Policy Board

- increasing engagement with universities and thinktanks

- deepening analytical capability by attracting, developing, and retaining technical expertise.

More robust corporate governance

Recommendation 12: Update RBA oversight and accountability by establishing a Governance Board

12.1	The Government should establish a Governance Board with responsibility for overseeing the management of the organisation, including organisational strategy, performance, finances, large projects, resourcing, remuneration, succession planning, risk (such as cyber risk), and delivery of banking and banknote services.
12.2	The Governance Board should be the accountable authority in respect of the PGPA Act and expand the Audit Committee to be an Audit and Risk Committee.
12.3	The Governance Board's membership should comprise the Governor, Chief Operating Officer and 5 external members. An external member should be chair.
12.4	External Governance Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest drawing on a matrix of required skills and experience. The process should be managed by the Secretary to the Treasury, the Governor and a third party.
12.5	External members of the Governance Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.
12.6	The RBA Boards should establish charters setting out their responsibilities and those of the RBA executive. A memorandum of understanding should be established between the 3 RBA Boards.

RBA leaders drive institutional and cultural change

Recommendation 13: RBA leaders should drive and measure change

13.1	The RBA's leaders should be assessed on how they deliver and model cultural change, including as measured through staff surveys.
13.2	The Governance Board should assess and report publicly by June 2025 on the RBA's progress in implementing the Review's recommendations and achieving its objectives. The Governance Board should also identify new opportunities for improvement through 5-yearly Australian Public Service capability reviews.

Implementation

Recommendation 14: Ensure continuity through the implementation process

14.1   For recommendations that require legislation, the Government should legislate the changes to commence on 1 July 2024, to allow time to plan and prepare.

14.2   The Government should make any new appointments to the existing Reserve Bank Board before 1 July 2024 using an interim skills and experience matrix, expressions of interest, and a process managed by the Treasury Secretary, the Governor of the RBA and a third party.

14.3   The Government should make Board appointments with a view to supporting the continuity of decision making now and in the future by:

- making new appointments to the existing Reserve Bank Board on the basis these members would complete their terms as members of the Monetary Policy Board
- asking other existing Reserve Bank Board members to continue their term on one of the new Boards
- varying the terms of appointees to the new Boards, as needed, to avoid bunching of future appointment dates.

14.4   The Government should consult with the Shadow Treasurer about the implementation of the recommendations of the Review, to ensure broad bipartisan support for the new arrangements.

14.5   The RBA should develop an implementation roadmap to progress the Review's recommendations that creates clear accountabilities and milestones and ensures continuity of the RBA's functions, taking into account the Government's legislative plans.

14.6   For recommendations that do not require legislation, the RBA should in 2023 prioritise implementing the recommendations that strengthen monetary policy decision making, communications and the RBA's management, culture and operations.

14.7   The Treasurer and the Reserve Bank Board should agree an updated *Statement on the Conduct of Monetary Policy* by the end of 2023.

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Chapter 1: Monetary policy performance

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Monetary policy performance

This chapter looks at the RBA's past performance against its objectives, which are set out in section 10(2) of the *Reserve Bank Act 1959*. This involved considering whether the decision making of the Reserve Bank Board was the best that it could have been, given information available at the time.

The chapter considers Australia's experience with inflation targeting over the past 3 decades. It focuses in on 3 time periods:

- the low inflation period between 2016 and 2019
- the COVID-19 pandemic from early 2020
- the period of high inflation from mid-2021 to the present.

The chapter also contains the Review's assessment of the RBA's communications strategy and how it has evolved to the present day.

Australia's economic performance has been very good since flexible inflation targeting was introduced in the early 1990s. Inflation has averaged around the midpoint of the RBA's target of 2 to 3 per cent. The variability of output and unemployment has been lower than in earlier decades. Australia's economic performance has been at least on par with other comparable economies.

There is broad consensus among those the Review consulted that the Reserve Bank Board's actions and the current monetary policy arrangements have contributed significantly to these outcomes.

The RBA is a highly regarded and respected institution in Australia and overseas. RBA leaders make important contributions to many regional and international bodies. For example, the current Governor is Chair of the Bank for International Settlements Committee on the Global Financial System. This continues a history of RBA Governors and Deputy Governors playing important roles in such bodies.

In recent years the environment in which the Reserve Bank Board sets monetary policy has become more complex and uncertain. Central banks have used a wider range of monetary policy tools, there have been large and persistent supply disruptions, and global trade patterns and geopolitics have changed.

This added complexity and uncertainty has tested the RBA and Australia's monetary policy framework. In some cases, the strengths of current arrangements have been underscored, including the independence of the RBA and flexibility in the inflation target. In other cases, the Review uncovered opportunities for improvement.

The key lessons drawn from the RBA's past performance include the need to:

- ensure a common understanding of the RBA's 3 objectives, including how the RBA pursues its inflation and employment mandate, how it manages trade-offs between its objectives, and how the pursuit of overall economic welfare and prosperity factors into decisions

- promote more constructive debate and challenge at the Reserve Bank Board and within the RBA

- continue to improve the Reserve Bank Board's communication of its policy decisions and strategy, including how trade-offs are being made between inflation and employment objectives and when flexibility is being used to account for other considerations such as financial stability

- clarify the framework for deciding on and implementing additional monetary policy tools, including by ensuring proper consideration of risks and exit strategies

- regularly review performance against objectives to identify opportunities for improvement, including in respect of forecasting.

The RBA has contributed to good economic outcomes through flexible inflation targeting

Monetary policy focuses on inflation and employment

The *Reserve Bank Act 1959* (s 10(2)) directs the Reserve Bank Board to conduct monetary policy in a way that, in its opinion, 'will best contribute to:

- stability of the currency of Australia;

- the maintenance of full employment in Australia; and

- the economic prosperity and welfare of the people of Australia.'

Since 1996, the Reserve Bank Board's approach to meeting these 3 objectives has been agreed upon with the Treasurer in the *Statement on the Conduct of Monetary Policy*. The approach is 'to focus on price (currency) stability... while taking account of the implications of monetary policy for activity and levels of employment in the short term.'

In assessing the RBA's performance against its objectives, the Review focused on the Reserve Bank Board's success in achieving its inflation and employment objectives. The Review recognises that these are not the only factors contributing to economic prosperity and welfare. Other factors include productivity growth, real wage growth, housing affordability, health outcomes, equality of opportunity and shared prosperity, and environmental sustainability.

Since monetary policy tools have limited power to directly affect these additional factors, the Review stresses that other government policies are critical to the economic prosperity and welfare of Australians.

Three decades of inflation targeting in Australia

Australia experimented with various monetary policy frameworks before adopting inflation targeting in the early 1990s (Cornish 2019). However, it struggled to achieve low inflation and strong real economic activity and employment (Fraser 1994). Throughout most of the 1970s and 1980s, the lack of a credible and coherent monetary policy framework, structural changes in the economy and perceptions of fiscal and monetary ill-discipline led to serious bouts of inflation and a high unemployment rate.

Inflation was brought under control in the early 1990s through tight monetary policy and a recession. The RBA adopted an inflation target around that time to mitigate a resurgence of inflation during the economic recovery. At that stage, an inflation target had already been introduced in Canada, New Zealand, Sweden and the United Kingdom. The RBA was granted formal operational independence to pursue its flexible inflation target in 1996, although, in practice, the RBA already had substantial informal independence (see Chapter 2 for details on flexible inflation targeting).

The RBA's independence and actions within these monetary policy arrangements contributed to superior economic outcomes compared to earlier decades (Bell 2004; Morley and Hartigan 2018; McKibbin 2018; OECD 2018; Cornish 2022). The Reserve Bank Board demonstrated it would respond decisively and in a forward-looking manner to inflationary pressures. It clearly communicated that it considered low inflation a precondition for sustainable increases in employment. Inflation has at times been above and at times below the 2 to 3 per cent target range, including the sharp increase in inflation since mid-2021. However, the average headline inflation rate since 1993 is 2.5 per cent (Chart 1.1). This compares with an average of almost 9 per cent in the preceding 2 decades (Table 1.1). Inflation expectations have, by and large, been well anchored, further reinforcing the environment of low and stable inflation.

Chart 1.1: Consumer price inflation
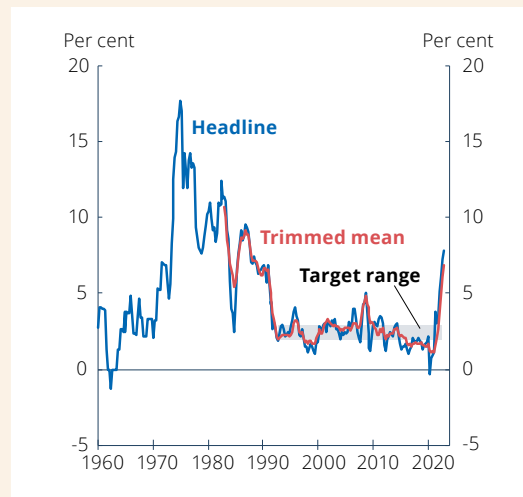
Chart 1.2: Unemployment rate
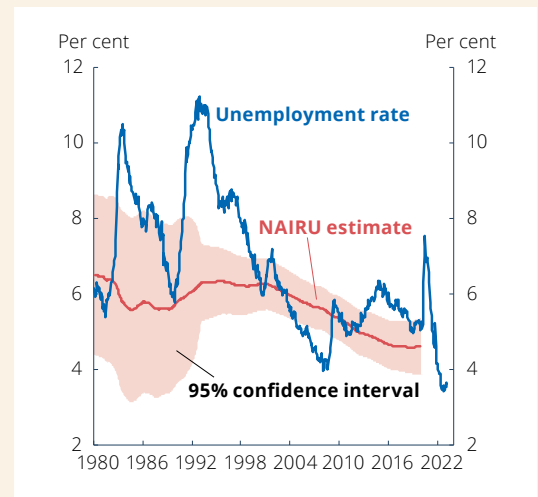
Note: Headline inflation excludes interest charges and is adjusted for the tax changes of 1999-2000. Trimmed mean inflation is a measure of consumer price inflation that excludes the prices of goods and services with the largest movements (positive or negative). Model-based estimate of the NAIRU up to the December quarter of 2019 from Bishop and Greenland (2021). The 95% confidence intervals are ±2 standard error bands. Source: ABS Consumer Price Index; ABS Labour Force Survey; Bishop and Greenland (2021); RBA Statistical Table G1.

Table 1.1: Macroeconomic outcomes in Australia

Measure	1973–1992		1993–present		2016–19	
	Annual average	Standard deviation	Annual average	Standard deviation	Annual average	Standard deviation
CPI Inflation (tty)						
Headline	8.9	1.2	2.5	0.5	1.7	0.2
Trimmed mean	3.6	0.5	2.5	0.3	1.6	0.1
Unemployment rate	6.8	2.2	6.2	1.6	5.4	0.3
Real GDP growth (tty)	2.9	1.2	3.1	1.0	2.5	0.3

Note: Data for inflation and GDP growth are on a through the year (tty) basis. Headline inflation excludes interest charges and is adjusted for the tax changes of 1999-2000. Trimmed mean inflation data begin in February 1983. Standard deviations for inflation and GDP growth are based on quarterly changes. Standard deviations for the unemployment rate are calculated from quarter-average data.

Source: ABS Consumer Price Index; ABS Labour Force Survey; ABS National Accounts; RBA Statistical Table G1.

At the same time, real economic growth has been less variable since the introduction of inflation targeting, and this has supported an improvement in labour market outcomes. The unemployment rate declined from around 11 per cent immediately following the early 1990s recession to around 5½ per cent in the years immediately before the COVID-19 pandemic. The unemployment rate reached a low of around 3½ per cent in mid-2022 (Chart 1.2). This decline over the inflation-targeting era coincided with a decrease in the sustainable rate of unemployment, as estimated by the non-accelerating inflation rate of unemployment (NAIRU; a measure of full employment commonly used by central banks that represents the lowest rate of unemployment that can be sustained without fuelling excessive inflation).

These outcomes were achieved despite major overseas crises buffeting the Australian economy throughout the inflation-targeting period. The RBA's actions during some of these crises highlighted strengths in how it conducts monetary policy within the current monetary policy framework. For example, the RBA showed good judgement in response to the Asian Financial Crisis by not raising interest rates in response to an exchange rate depreciation. This contributed to a strong performance of the Australian economy during the episode (Bean 2000; Bell and Hindmoor 2019). During the Global Financial Crisis and COVID-19 pandemic the RBA responded quickly. It coordinated effectively with other arms of policy and introduced new tools and approaches in response to changing circumstances (IMF 2009; Senate 2009; OECD 2010; Davis 2011; Quiggin 2013; Makin 2016; OECD 2021; IMF 2021; Gross and Leigh 2022).

While the conduct of monetary policy in Australia can generally be seen as very good, among advanced economies Australia was not unique in experiencing low inflation and less-variable economic growth (Table 1.2). Other countries also successfully implemented inflation-targeting frameworks. Favourable structural changes, such as the integration of Asian economies into global supply chains, helped to limit global inflationary pressures during much of the inflation-targeting period (BIS 2014). Growth in China and other Asian economies supported global growth and Australia was a major beneficiary of this. Domestically, a range of other government policies contributed to Australia's economic performance. For example, Australia's fiscal responses during recent economic crises are often cited as a primary factor contributing to Australia's relatively good economic performance during those episodes (IMF 2009; Senate 2009; OECD 2010; Quiggin 2013; IMF 2021).

The positive overall assessment of the RBA's performance during the inflation-targeting era is consistent with feedback provided to the Review by people in Australia and overseas.

During the Review's consultations, concerns raised about the RBA's performance focussed on the Reserve Bank Board's actions during 3 episodes: the low inflation period between 2016 and 2019, the COVID-19 pandemic and the current period of high inflation. The performance of the monetary policy framework and decision-making process during these 3 episodes are explored in more detail in the following sections.

Table 1.2: Economic indicators in selected economies 1993–2021

Economy	Headline CPI inflation			Real GDP growth per capita		Unemployment rate	
	Annual average	Current target	Standard deviation	Annual average	Standard deviation	Annual average	Standard deviation
Australia	2.4	2–3	1.1	1.7	1.4	6.3	1.6
Canada	1.8	2	0.7	1.3	2.2	7.7	1.4
European Union	3.5	na	4.0	1.4	2.3	9.4	1.5
France	1.5	2	0.8	1.0	2.4	9.4	1.0
Germany	1.6	2	0.9	1.1	2.1	7.0	2.5
Sweden	1.7	2	1.0	1.7	2.4	8.0	1.6
Japan	0.2	2	0.9	0.6	2.0	3.9	0.9
Korea	2.9	2	1.8	3.9	3.2	3.6	1.0
New Zealand	2.1	2	1.1	1.8	1.9	5.6	1.5
Singapore	1.5	na	1.7	3.5	4.5	2.4	0.6
United Kingdom	2.0	2	0.9	1.4	2.9	6.2	1.7
United States	2.3	2	1.0	1.5	1.9	5.8	1.6

Note: Standard deviations and averages are based on annual changes. Inflation targets are as at March 2023. For Canada and New Zealand midpoints of their inflation target ranges of 1–3 per cent are shown. The inflation target for France and Germany is the target for the European Central Bank.

Source: IMF; International Labour Organization.

Episode 1: Undershooting the inflation target between 2016 and 2019

Criticism about the RBA's performance from people consulted by the Review focused on the Reserve Bank Board's actions between 2016 and 2019, when the average trimmed mean inflation rate of 1.6 per cent was below the target of 2 to 3 per cent.

Throughout this period, the RBA consistently expected a tighter labour market and a pick-up in wage growth to lift trimmed mean inflation back to the target range. However, the RBA's forecasts for increasing inflation were gradual and, at best, the RBA expected inflation to reach only the bottom of the target range (Chart 1.3). At the same time, the RBA expected the unemployment rate to decline gradually but remain above its best estimate of the NAIRU (Chart 1.4).

In the end, meaningful progress was not made towards the RBA's targets. Headline and trimmed mean inflation remained below the RBA's target throughout almost all of the 2016 to 2019 period, averaging 1.7 per cent and 1.6 per cent, respectively. The unemployment rate declined faster than expected, but the lack of an inflation response indicated that the sustainable level of unemployment was likely lower still. The RBA revised its estimate of the NAIRU lower over this period.

Chart 1.3: Trimmed mean CPI inflation and RBA forecasts
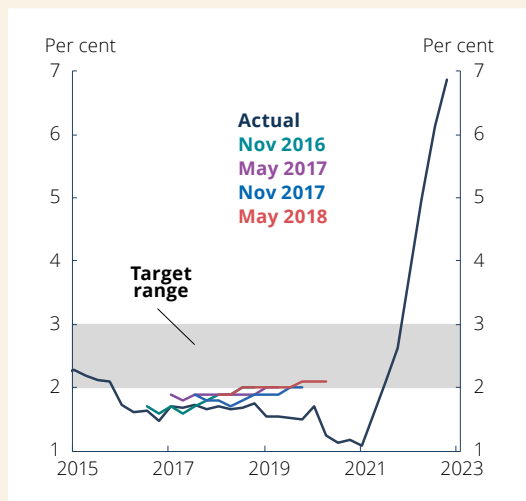
Chart 1.4: Unemployment rate and RBA forecasts
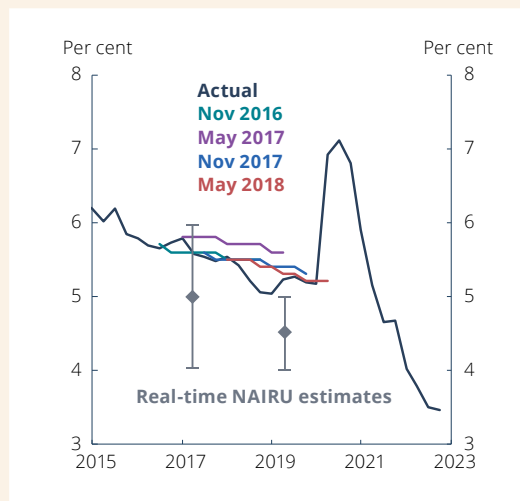
Note: Quarterly unemployment rate data are shown. Model-based estimates of the NAIRU from Cusbert (2017) and Ellis (2019). Central estimates of the NAIRU with 70 per cent confidence intervals are shown in grey. Source: ABS Consumer Price Index; ABS Labour Force Survey; Cusbert (2017); Ellis (2019).

Most people consulted by the Review concluded with hindsight that monetary policy did not sufficiently support the economy between 2016 and 2019. Over the course of 2015 and 2016, the RBA progressively cut its target for the cash rate – the interest rate charged on overnight loans between banks, the primary way the RBA influences economic conditions – from 2.5 to 1.5 per cent (Chart 1.5). The RBA could have reduced the cash rate target further before reaching the 'effective lower bound' – the lowest it can practically go. Instead, the RBA chose not to adjust the cash rate for a record 30 consecutive meetings before reducing the target to 0.75 per cent between June and October 2019.

Chart 1.5: Cash rate target
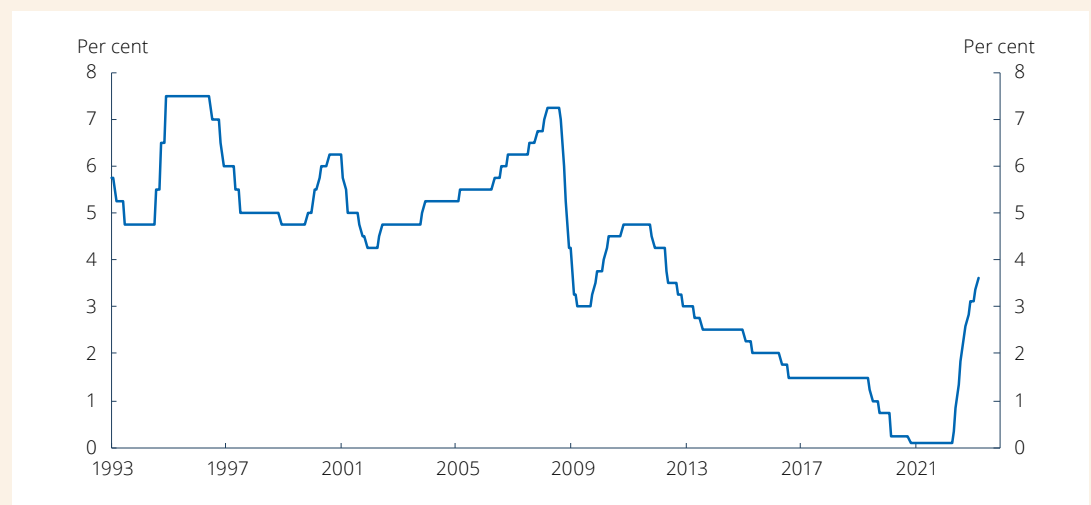
Source: RBA.

Australia may have had stronger employment and inflation outcomes had interest rates been lower through this period. Using the RBA's macroeconomic model, the MARTIN model, Gross and Leigh (2022) found that a lower policy rate between 2016 and 2019 could have achieved a lower unemployment rate. At the same time, inflation could have been closer to the RBA's target. Gross and Leigh estimated that foregone employment was equivalent to approximately 270,000 people out of work for a year.

These observations raise questions around why the Reserve Bank Board was willing to accept the prospect of gradual progress towards its inflation and employment targets rather than easing policy further. They also raise questions around why, in the end, even gradual progress towards the inflation target was not achieved.

The RBA expected to make gradual progress towards its targets

The previous section noted that inflation target misses over this period partly reflected the Reserve Bank Board's strategy of making gradual progress towards its targets. Professional observers of the RBA and former and current Reserve Bank Board members provided various explanations as to why the RBA held the cash rate at 1.5 per cent for most of the period, while expecting inflation to, at best, reach the bottom of the target band in 2 to 3 years. The unemployment rate was expected to remain higher than the RBA's best estimate of the NAIRU at the time.

During much of this period, the Reserve Bank Board did not provide a detailed account of the factors influencing its decisions in its post-meeting statements and *Minutes.* For example, in the *Minutes* of the August 2017 meeting, the Reserve Bank Board added text that there was a 'need to balance risks associated with high household debt in a low-inflation environment', without further explanation. Instead, detail about the RBA's thinking was set out by the RBA executive from time to time in Parliamentary testimonies and speeches.

These public appearances by the RBA executive indicate the Reserve Bank Board and executive were concerned about contributing to risks associated with rising household indebtedness. The RBA expressed concerns about developments in the housing market, particularly the large increase in housing prices and strong growth in investor borrowing. This concern was noted in the *Minutes* on a number of occasions (for example RBA 2017; RBA 2018a). The RBA executive considered that a low level of interest rates might contribute to a build-up of vulnerabilities from higher leverage. In February 2017, Governor Lowe stated:

> *'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? I accept that different people will come to different points on judging that trade-off.'*

> *Australian House of Representatives 2017*

The Governor further argued that the Reserve Bank Board's objective to contribute to 'economic prosperity and welfare' gave it a broader mandate than many other central banks. This allowed the Reserve Bank Board to keep interest rates higher than otherwise to limit the build-up of vulnerabilities (Australian House of Representatives 2017).

These arguments were echoed in a speech by the Governor in May 2017 (Lowe 2017), which explained how vulnerabilities associated with high household indebtedness and housing prices could affect economic stability.

> *'Instead, the issue we have focused on is the possibility of future sharp cuts in household spending because of stretched balance sheets. Given the high levels of debt and housing prices, relative to incomes, it is likely that some households respond to a future shock to income or housing prices by deciding that they have borrowed too much. This could prompt a sharp contraction in their spending, as they try to get their balance sheets back into better shape. An otherwise manageable downturn could be turned into something more serious. So, the financial stability question is: to what extent does the higher level of household debt make us less resilient to future shocks?'*

Whether these risks around household debt could have justified a higher level of interest rates is contentious, as reflected in some submissions to the Review. At the same time, higher interest rates likely contributed to below-target inflation and higher unemployment than otherwise. The decision not to reduce the cash rate further between 2016 and 2019 was an important policy judgement on the part of the Board.

Beyond the issue of household indebtedness, other reasonings within the RBA as to why interest rates should not be lowered included that:

- It was not possible to fine-tune economic outcomes, and the RBA should instead be a 'source of stability and confidence' while wages and inflation gradually picked up.

- The public might interpret additional rate reductions from already low levels as bad news, thereby hurting confidence and activity.

- It might be prudent to keep some policy room in reserve in case of future downturns ('keep the powder dry'), an argument explored in a 2017 Reserve Bank Board paper but later dismissed (for example Debelle 2018a).

- Further rate reductions might be less effective at low interest rates for other reasons, including because banks might not fully pass on further cash rate reductions, or the cash flow channel of monetary policy might be weaker.

The first 2 of these arguments featured in the RBA's public communication. Some commentators outside the RBA cited them as reasons the Reserve Bank Board did not reduce rates further. The Reserve Bank Board's judgement that it should be a source of stability and confidence featured in the *Minutes* through much of 2018 and early 2019 (for example RBA 2018b; RBA 2019a). The argument that further cash rate reductions might hurt confidence appeared in RBA communications in the second half of 2019 (for example RBA 2019b). The operation of the cash flow channel of monetary policy and pass-through of cash rate reductions were considered in Reserve Bank Board papers in 2016 and 2019, respectively.

It is unclear from the *Minutes* how much weight the Reserve Bank Board placed on these arguments in practice. For example, the view that cash rate reductions might undermine confidence was contested by RBA staff members. Ultimately, the Reserve Bank Board assessed that the net effect of reductions in the cash rate was still stimulatory, and it reduced the cash rate target further in 2019 (RBA 2019c). In October 2019, the Reserve Bank Board papers acknowledged the argument that a weaker effect of monetary policy might be a case to do more, not less. In its conversations with current and past Board members, the Review heard different accounts about whether housing affordability was or was not a consideration.

The variety of explanations provided for the policy choices of the Reserve Bank Board between 2016 and 2019 suggests to the Review that the RBA's communications about its decision making were unclear. Differences in views about the correct interpretation of 'economic prosperity and welfare' likely added to confusion about what the RBA was trying to achieve.

The Review's assessment is that it would have been more transparent had the Reserve Bank Board provided a more detailed explanation of the risks it was concerned about and presented evidence for how these risks could have affected its ability to achieve its policy objectives. It could have also explained how that justified its policy strategy and shared empirical estimates of the trade-offs that it was making between its objectives. This is particularly important given evidence in the economic literature suggested that monetary policy is a costly means to deal with a build-up of financial vulnerabilities, particularly relative to more targeted micro and macro prudential tools (for example IMF 2015; Saunders and Tulip 2019; Svensson 2016).

Progress towards the inflation target fell short of the RBA's forecasts

During the low inflation period of 2016 to 2019, the RBA's forecasts for progress towards its inflation objective were not realised. The RBA was not alone in seeing inflation undershoot its forecasts (and targets) over this period. It was the experience of many central banks and private sector forecasters. Consultations and empirical analysis commissioned by the Review identified potential explanations, including a structural decline in real interest rates, limited fiscal support and weaker-than-expected prices for imported goods and housing construction.

A structural decline in neutral real interest rates – the real cash rate at which monetary policy is neither stimulatory nor contractionary – may have contributed to the forecast errors. While it was clear that neutral interest rates were declining, there was considerable uncertainty in real time around the magnitude of the decline (McCririck and Rees 2017). This may have led the RBA and other central banks to overestimate how much support they were providing to their economies, resulting in forecasts for spare capacity and inflation that were too optimistic (see Chapter 2 for details on the structural decline in the neutral interest rate).

Some people consulted by the Review pointed to fiscal policy and the role it was playing in Australia. During this period, fiscal consolidation weighed more heavily on domestic demand than the RBA had expected. Prior to the outbreak of the COVID-19 pandemic, the 2019–20 Budget projected a balanced fiscal position for the financial year. At the same time, the cash rate was at historic lows. The Review heard from some that fiscal settings should have been looser to assist monetary policy to bring inflation closer to its target and boost employment.

The Review also considered the results of a modelling exercise conducted by the RBA for the Review (RBA 2022a). The exercise used 2 of the RBA's full-system macroeconomic models – MARTIN and a dynamic stochastic general equilibrium model – to investigate the main drivers of the weaker-than-expected inflation outcomes. While the specific findings are a function of the models' structures (meaning different models could provide different results), the results suggest that the weakness reflected supply-side factors. Weakness in input costs for housing and imports was particularly important. The latter is consistent with the view that global factors played an important role. Internal RBA forecast reviews from the time indicate that larger-than-expected labour market spare capacity, weaker-than-expected economic growth and structural factors (such as stronger retail competition and global forces) all contributed.

The Reserve Bank Board could have more thoroughly interrogated the RBA executive's policy strategy

The evidence gathered by the Review suggested that there was not a sufficiently deep ongoing debate around the strategy of accepting gradual progress towards the Reserve Bank Board's targets. The Board papers contained only limited consideration of alternative strategies, whether because the executive chose not to put them forward or the Board did not ask for this material.

In mid-2017, the Reserve Bank Board was provided with a detailed written briefing about the arguments for and against its approach that accepted gradual progress towards its targets to limit the build-up of vulnerabilities associated with rising household indebtedness.

This Board paper included an independent assessment by an overseas expert. These materials equipped Reserve Bank Board members with the necessary information to genuinely explore and debate alternative viewpoints on the appropriateness of the policy strategy. Importantly, the written briefing acknowledged there was a body of empirical research that showed the costs of using interest rates to address financial stability risks outweighed the benefits. The material also presented the view that prudential measures were a more effective way of addressing these risks, though warned that conclusions about the effectiveness of these measures remained tentative.

There is limited evidence in Reserve Bank Board papers or meeting *Minutes* that the question was re-examined in a meaningful way over the next 2 years. Between 2016 and 2019, the Reserve Bank Board never took a decision that went against the recommendation of the RBA executive. This is despite inflation consistently undershooting the Reserve Bank Board's target. Indeed, the Reserve Bank Board papers focused on describing the flow of data and the economic outlook. Throughout most of the period, little discussion in the Board papers was dedicated to policy options or decisions. Alternative views among RBA employees and alternative policy choices – and their costs and benefits – were rarely presented. These written materials did not engage with whether the Reserve Bank Board's strategy was still correct, or whether alternative approaches should be considered.

The Reserve Bank Board was presented with a paper in late 2018 that summarised some arguments for a lower or higher cash rate target. The Board papers further explored alternative policy options in the lead up to the cash rate target cut in June 2019. However, in both cases the papers did not provide a fulsome discussion of the issues that would have enabled the Board to assess and challenge the policy strategy proposed by the RBA executive.

Conclusion: RBA's actions between 2016 and 2019

The RBA's performance during this low inflation period highlights the importance of:

- **Clearly specified monetary policy objectives:** Greater clarity will help to foster a deeper understanding of the Reserve Bank Board's actions and allow others to better assess and challenge policy judgements.

- **Transparent and effective external communication:** Improved understanding about the factors that drive decisions is needed to maintain trust in decision making, particularly when the Reserve Bank Board is using the flexibility in its framework. This should include an explanation of the trade-offs being made and how the Reserve Bank Board came to its view that the benefits associated with using this flexibility in its framework outweigh the costs.

- **Robust challenge and debate throughout the monetary policy process:** Fostering an environment that better encourages challenge and debate, including at the Reserve Bank Board, should help to surface differing views and test policy recommendations. In this regard, the structure and composition of the Board, as well as the nature of the information that the Board receives and requests, are relevant considerations.

- **Considering the role of other tools in macro-stabilisation:** Greater engagement is needed with other authorities (including via the Council of Financial Regulators) to adequately consider whether other tools, such as fiscal and macroprudential policies, might help to reduce trade-offs.

Episode 2: Using additional monetary policy tools to respond to the COVID-19 pandemic

Before the pandemic, the Reserve Bank Board had achieved its desired level of policy support through changes in the cash rate target alone. In contrast, many other central banks had been using additional monetary policy tools, such as the asset purchase programs introduced during the Global Financial Crisis.

The extraordinary circumstances and extreme uncertainty created by the COVID-19 pandemic prompted the Reserve Bank Board to reduce the cash rate target to what the RBA considered to be the effective lower bound. As a result, the Reserve Bank Board decided to use a range of additional monetary policy tools for the first time to achieve its inflation and employment objectives.[1] Box 1.1 provides a detailed description of the new monetary tools used by the Reserve Bank Board.

In assessing the Reserve Bank Board's use of these new tools, the Review considered:

- the RBA's preparation ahead of time

- how the Reserve Bank Board made its decisions (including assessments of expected benefits and costs, risks, and impact on the economy)

- the implementation and ongoing monitoring of policies

- the RBA's evaluation of the policies after the fact.

The Review drew on decision-making documents prepared for the Reserve Bank Board, consultations with current and former Reserve Bank Board members and staff members, and advice from external experts with an international perspective.

Overall, the Review is of the view that the Reserve Bank Board acted decisively and successfully at the onset of the pandemic to protect against more severe outcomes and support the economic recovery. That said, the Review considers, with the benefit of hindsight, that a number of important lessons for the future use of additional monetary policy tools can be drawn.

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1   The RBA had not previously operated an asset purchase program, yield target or term lending facility, nor offered either calendar or state-based forward guidance. However, in the Global Financial Crisis it did relax the terms of its regular lending operations to provide additional liquidity to the market (see RBA 2008).

Box 1.1: Additional monetary policy tools used during the COVID-19 pandemic

In response to the pandemic, the Reserve Bank Board reduced the cash rate target to what the RBA considered to be the effective lower bound and used a range of additional monetary policy tools to support the economy.

Each tool was intended to contribute to an overall easing of financial conditions by lowering borrowing costs, improving access to credit and/or contributing to a lower exchange rate than otherwise. In addition, the tools supported the fiscal response to the pandemic by lowering government borrowing costs (Debelle 2021a). The tools were designed to complement each other and operate as a package.

Term Funding Facility

Term funding schemes typically involve central banks providing low-cost, longer-term funding to banks to help reduce funding costs (and, as a result, interest rates for borrowers). They often include explicit incentives to bolster the supply of credit to businesses.

The Reserve Bank Board established the Term Funding Facility in March 2020. It provided 3-year funding to banks at a fixed rate of 0.25 per cent (lowered to 0.1 per cent in November 2020). The initial funding allowance for each institution was up to 3 per cent of existing outstanding credit, available until 30 September 2020. It provided an additional allowance for institutions that increased their lending to businesses, available until 31 March 2021.

The Reserve Bank Board expanded and extended the Term Funding Facility in September 2020. It introduced a supplementary allowance of up to 2 per cent of existing lending, available until 30 June 2021, and extended the deadline for the additional allowance to 30 June 2021.

The Term Funding Facility closed to new drawdowns on 30 June 2021.

Forward guidance

Forward guidance is a central bank statement that provides explicit information about the future state of monetary policy. It is intended to influence interest rate expectations.

The Reserve Bank Board provided forward guidance in March 2020. This guidance was 'state-based', meaning that it committed to keeping the cash rate unchanged until specific economic conditions were met:

> '*The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band.*'

The RBA added a 'calendar-based' component to their forward guidance in a speech by the Governor in October 2020 and in Reserve Bank Board statements from November 2020. They indicated a time horizon of 3 years over which the cash rate would be unlikely to change:

> '*The Board will not be increasing the cash rate until actual inflation is sustainably within the target range. … On our current outlook for the economy…this is still some years away. So, we do not expect to be increasing the cash rate for at least three years.*'

This language was updated in February 2021:

> '*The Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. … The Board does not expect these conditions to be met until 2024 at the earliest.*'

The Reserve Bank Board maintained this calendar-based component of forward guidance until November 2021. It continued state-based forward guidance until May 2022.

Yield target

A yield target involves a central bank setting a target for a term interest rate and pledging to buy (or sell) enough bonds to keep the rate from rising above (or falling below) its target.

The Reserve Bank Board introduced a target for the yield on 3-year Australian Government bonds of around 0.25 per cent in March 2020 (lowered to 0.1 per cent in November 2020). It viewed the yield target as reinforcing its forward guidance for the cash rate. In practice, this operated as a ceiling on yields. The RBA supported the target through bond purchases in the secondary market when needed. The target focused on the bond that was closest in maturity to 3 years: the April 2023 bond until October 2020 and the April 2024 bond thereafter.

The yield target was discontinued in November 2021.

Bond purchase program

Asset (or bond) purchase programs involve central banks purchasing assets (usually government bonds) with the aim of easing financial conditions by lowering funding costs and influencing the exchange rate.

The Reserve Bank Board commenced a bond purchase program in November 2020. The initial commitment was $100 billion of bond purchases to be made over 6 months, at maturities of around 5 to 10 years. The purchases were made at a rate of $5 billion a week, split 80/20 across nominal bonds issued by the Australian Government, and the states and territories.

The bond purchase program was extended on 3 occasions. In February 2021, the Reserve Bank Board committed to purchasing another $100 billion of government bonds from April to September 2021 at the same pace of $5 billion a week. In July 2021, the Reserve Bank Board announced it would continue purchases until November 2021, but at a tapered rate of $4 billion a week. In September 2021, purchases were extended until February 2022 at the same weekly rate.

The bond purchase program ended in February 2022.

The Reserve Bank Board's use of additional monetary policy tools during the pandemic was similar in many respects to its central bank peers. Like most of its peers, the Reserve Bank Board reduced the cash rate to what it judged to be the effective lower bound but did not take its policy rate negative. Many peer central banks also introduced forward guidance, a bond purchase program and a term funding scheme.

One unusual feature of the RBA's package was the use of a yield target. No other peer central bank introduced a yield target in response to the COVID-19 pandemic. However, the Bank of Japan has operated a yield target since 2016, and the US Federal Reserve had previously considered how such targets might be implemented (Federal Reserve 2010). Some aspects of the implementation of additional monetary policies also differed to other peer central banks.

March 2020: Initial response to the COVID-19 pandemic

The Reserve Bank Board announced its initial response to the COVID-19 pandemic on 19 March 2020. The response included a reduction in the cash rate target to an historic low of 0.25 per cent and a package of additional monetary policy tools. The package included a yield target, term funding facility and state-based forward guidance (Box 1.1). The size and speed of the response were motivated by the Reserve Bank Board's desire to do 'whatever is necessary' to support the economy (Lowe 2020a).

The Review recognises the significant challenges of decision making in a period of such extreme uncertainty. The health advice was dire. The economic outlook justified quick decision making, which unavoidably came with extra risk. The RBA and Reserve Bank Board deserve considerable credit for the initial response to the pandemic. They were decisive at a time of national crisis and extreme uncertainty and the collective actions of government and the RBA avoided the worst.

There were some shortcomings in decision-making processes during this crisis that offer valuable lessons for the future. They highlight the importance of having strong and systematic frameworks in place ahead of time to help guide decision makers during periods of extreme uncertainty.

Preparatory work on the use of additional monetary policy tools

The RBA had done some preparatory work ahead of the crisis. In mid-2019, the Reserve Bank Board was presented with options to pursue if the cash rate reached its effective lower bound and further support was required. The preferred option presented in the Reserve Bank Board paper was a package that included reducing the cash rate target, purchasing bonds and providing state-based forward guidance. The paper made no explicit mention of a yield target and noted there would be little benefit from a term funding facility (in most circumstances). The paper also noted some of the risks of calendar-based forward guidance.

The support package introduced in March 2020 differed from the preferred option presented in 2019. No explanation for the change was offered in written materials provided to the Reserve Bank Board in 2020. Further, the written materials only briefly described how each program would operate and a short qualitative discussion of risks.

The attraction of a yield target is that, if credible, it requires fewer purchases of bonds to initially achieve the target. However, the Reserve Bank Board written materials gave little attention to how unusual a yield target was internationally or the fact that there was no international precedent for exiting from a yield target. The written materials also did not consider the plausible risk that the yield target might make it more difficult to change course if economic circumstances changed quickly.

Information received and requested by the Reserve Bank Board to support deliberations

The Reserve Bank Board was not provided with, and on the available evidence did not demand, enough information in advance to fully debate and challenge the key design choices for the tools proposed by the RBA executive. For example, the term funding facility option presented to the Reserve Bank Board proposed to offer banks funding at a fixed interest rate. It was acknowledged in written materials that this approach carried some interest rate risk. But the risk was said to be small and warranted and was not quantified. The paper did not explore the option of offering an attractive floating interest rate, such as in the Bank of England's otherwise similar program.

This was an option that carried less interest rate risk and would arguably have made little difference to the attractiveness of the scheme, with interest rates expected to remain low. As such, Reserve Bank Board members would have benefited if they had received or requested information in order to properly assess whether the fixed interest rate approach was best.

The RBA developed a set of internal papers outlining more detail on the design of the yield target and term funding facility, but these materials were not provided to the Reserve Bank Board. These papers considered the design of the programs, including some discussion of risks and how the proposed term funding facility would compare with programs overseas. The RBA considered these materials to have a level of technical detail that was not required for the Reserve Bank Board's decision.

The Review's assessment is that these materials included information that would have been valuable for the Reserve Bank Board and would have helped them think about risks and implementation, as well as frame questions. It is not unusual for there to be more detailed background work that is not incorporated into the formal decision-making documents. However, the Review considered that members of a monetary policy decision-making body should be expected to have the time, expertise and support from staff members to consider evidence and advice in papers of a technical nature and of such length.

Judgements made under pressure and uncertainty require expertise

This episode underscores that Reserve Bank Board members make judgements on complex monetary policy issues, sometimes in periods of extreme uncertainty. These judgements require some expertise in the matters at hand. For example, people with a deep practical understanding of the financial system and markets would have been well placed to challenge and offer alternative views on the design of key policies.

The lack of detail in Reserve Bank Board materials and short time frame to discuss them (see Chapter 3) limits the depth of Reserve Bank Board members' engagement on issues. The effect of this is to concentrate responsibility on the RBA executive and the Governor in particular. This poses risks to the robustness of decision making and downplays the role the Reserve Bank Board can play in supporting the RBA's executive.

The approach of doing 'whatever is necessary' in a crisis is not unconditional. Selecting between options requires an understanding of how the tool or intervention works in practice, and how the various measures work together as a package (Orphanides 2023). It requires the Reserve Bank Board to explicitly test the benefits and costs and to form a judgement about the net benefit, to assess the conditions for successful implementation, to test how different tools interact, and to judge how and when the intervention should be stopped or reversed.

The fact that a crisis curtails the time to develop options reinforces the importance of having strong preparatory work in place ahead of time. While no one could have predicted the onset of the pandemic in 2020 or the Russian invasion of Ukraine in 2022, some of the shortcomings of the yield target may have been avoided had it been thoroughly assessed in 2019. The episode also highlights that, during a crisis, adopting policies that have not been subject to preparatory work entails additional risks compared with using those that have been more fully developed. In the context of a crisis, there is less scope to explore and understand these additional risks.

Collectively, these factors limited the Reserve Bank Board's ability to interrogate the specifics of the complex new tools and provide alternative views to the proposals provided by the RBA executive. This suggests an opportunity to make the policy process more robust by increasing the extent to which the Board is able to engage with and test policy proposals put to it by the executive.

September to November 2020: Additional monetary support

From September to November 2020, the Reserve Bank Board expanded and extended existing programs and introduced a new monetary policy tool. The changes were motivated by the RBA's assessment that additional monetary support was required.

In September 2020, the Reserve Bank Board expanded and extended the Term Funding Facility. The Reserve Bank Board also announced that the target bond for the yield target would move from the April 2023 bond to the April 2024 bond. This in effect meant a one-year extension of the yield target.

In October 2020, a speech by the Governor introduced a calendar-based component to the RBA's forward guidance. It also updated the state-based forward guidance to link to economic outcomes rather than forecasts, as discussed at the prior Reserve Bank Board meeting.

In November 2020, the Reserve Bank Board announced it would commence a bond purchase program.

There were valid economic arguments for and against providing additional monetary policy support in late 2020 that many central banks around the world were weighing. The RBA was forecasting a long and slow recovery, there was significant uncertainty about the economic outlook, and ongoing concern about further outbreaks of the virus. At the same time, early indications were that activity and employment outcomes would not be as bad as expected earlier in the year. Some individuals consulted by the Review noted the significant stimulus already provided and suggested that additional stimulus was unnecessary at this point (Orphanides 2023). Regardless of the merits of the case for providing additional support, the Review's assessment is that the Reserve Bank Board did not receive or request sufficient material to support a robust debate about whether further monetary support was required.

Cost-benefit analysis for the bond purchase program

The Review identified other aspects of the RBA's processes that could better support decision making.

Unlike in March 2020, the RBA executive, staff members and the Reserve Bank Board had more time to prepare a case for additional monetary support, develop options, conduct risk analysis and consider clear exit strategies, particularly in the case that these risks materialised.

Prior to the start of the bond purchase program, the Reserve Bank Board was presented with the view in Board papers that the economic effects of the program were likely to be small, although no supporting analysis was provided. The Reserve Bank Board papers did not address why a program targeted at the 4-to-10-year segment of the yield curve would have a significant economic or financial impact, particularly given housing finance and bank funding in Australia (unlike in some other countries) largely occurs at the short end of the term structure. The Reserve Bank Board was provided with general information about financial risks associated with bond purchases, without specifying what they would look like for this program, any order of magnitude, or whether it could accelerate exit from the 3-year yield target.

The RBA highlighted in Reserve Bank Board papers that Australia stood out among its peers in not having an asset purchase program across the yield curve. The Review heard in consultations that part of the motivation for implementing the bond purchase program was to match its peers. The RBA in part motivated decisions about extensions of the program by referring to the actions of its peers, in the context of the impact on the exchange rate. However, no supporting analysis was provided to the Reserve Bank Board.

The Reserve Bank Board would have been better equipped to consider and decide whether to pursue the program if they had received or requested more analysis on how it might interact with the specific features of Australia's economy and financial system, as well as quantitative cost-benefit analysis tailored to the specifics of the program. This type of analysis is particularly relevant for a bond purchase program given it has uncertain benefits and involves significant financial risks with fiscal impacts (Box 1.2).

With the benefit of hindsight, the economic benefits of the bond purchase program appear to have been small relative to the scale and potential cost of the program. According to RBA modelling conducted following the completion of the program and provided to the Review, the program is estimated to have provided over 3 years a cumulative boost to nominal GDP of $25 billion and real GDP of $13.5 billion, and a total increase in employment of 37,000 jobs. This compares with estimates of the potential direct financial losses associated with the program of between $35 and $58 billion (RBA 2022b; Box 1.2).

At the same time, the financial costs have been much larger than was expected. This reflects that interest rates have had to rise much faster than was contemplated in response to stronger than expected inflation.

To the Review, this episode highlights the value in undertaking thorough risk assessments for new policy options in advance, and after the fact, in drawing lessons from them for future decision making.

Ongoing risk monitoring and assessments

The RBA's processes for monitoring ongoing financial risks related to the bond purchase program and the Term Funding Facility were incomplete. In particular, the RBA's regular risk assessments did not pay sufficient attention to the risks posed to the RBA's earnings if the cash rate increased by more than expected. These risk assessments, including written material that went to the Audit Committee, did not contain any scenario analysis detailing the earnings impact of unexpected movements in the cash rate arising from these programs until August 2022.

Decisions about calendar-based forward guidance

The Reserve Bank Board did not receive any written briefings proposing calendar-based forward guidance before it was introduced by the Governor in a speech in mid-October 2020.

The October 2020 meeting *Minutes* record the Board's shift to focusing on getting actual inflation in the band before raising rates but not the introduction of a calendar-based element to the guidance. The new focus on calendar-based guidance was not presented to the Reserve Bank Board for decision as a policy instrument. That said, Reserve Bank Board members were aware that the RBA's base case forecasts, along with existing guidance and the yield target, implied that the cash rate would not change for at least 3 years. The Reserve Bank Board considered in August and November 2020 scenarios under which inflation pressures turned out to be stronger than in the base case, but these scenarios did not address the implications for the policy rate and, in turn, the forward guidance.

The lack of written briefing for the Reserve Bank Board at the outset is notable given the RBA's advice on forward guidance to the Board in 2019 which focused on the drawbacks and risks of calendar-based guidance. Based on the Review's consultations and Reserve Bank Board materials, the introduction of calendar-based guidance was not treated in the same way as other policy shifts, and there was no documented discussion of the risks and implications of this shift. The lack of consultation reduced the opportunity for the Reserve Bank Board to debate, challenge and collectively own the decision.

Many central banks used forward guidance during the pandemic, although the RBA's calendar-based guidance design was different in several respects. In contrast to most of its peers, the RBA offered guidance over a long time-horizon and did not update its guidance as the economic outlook changed (Box 1.3). This made the RBA particularly vulnerable to unexpected (positive) economic developments. The Reserve Bank Board written materials also provided relatively little recognition of international experience that there was a risk of guidance being misunderstood (Committee on the Global Financial System 2019) or discussion of how to exit from the guidance should upside risks to inflation materialise.

Box 1.2: Fiscal costs of additional monetary policy tools

The Reserve Bank Board's use of additional monetary policy tools at the start of the COVID-19 pandemic resulted in a significant expansion of the RBA's balance sheet. The RBA's assets expanded as it purchased government bonds (under the bond purchase program) and issued banks with 3-year loans at a fixed interest rate (under the Term Funding Facility). The RBA's liabilities expanded as it funded bond purchases and loans by crediting the exchange settlement accounts of the respective financial institutions.

The RBA projects that the cumulative financial cost of the bond purchase program to its underlying earnings over the next decade is likely to be large, at between $35 billion and $58 billion (RBA 2022b). The RBA provided information to the Review indicating that the cost of the Term Funding Facility is also likely to be large, in the order of $8 billion. These programs incur a substantial cost because the interest rate paid by the RBA on reserves used to fund bond purchases and the Term Funding Facility are linked to the cash rate (and so have increased significantly recently), while the returns on the corresponding assets are fixed. At the same time, the market value of bonds purchased by the RBA have declined as bond yields have risen, resulting in large unrealised valuation losses.

The ultimate financial gain or loss for both programs is not yet certain, however, and will depend on the path of the cash rate in coming years. It is also important to note that these estimates do not capture the full effect of the schemes on the public finances. For example, the schemes are likely to have lowered the cost of government debt issuance somewhat, as well as raising revenue and reducing expenditure through the modest boost they provided to economic activity.

Many other advanced central banks have reported significant losses from their use of additional monetary policy tools in the pandemic, including the US Federal Reserve, Bank of England and the Bank of Canada. For example, Levin and others (2022) estimated that the US Federal Reserve's pandemic quantitative easing program will reduce dividends to the US Government by US$760 billion over the next decade.

The RBA's losses will ultimately result in lower government revenue than otherwise. The RBA has indicated that its preference is to offset accumulated losses and replenish its capital before resuming paying dividends to the Government. In its 2022 Annual Report, the RBA did not expect these conditions to be met within its projection period, which extended to 2032 (RBA 2022c). By contrast, the average annual dividend paid to the Australian Government in the 5 years prior to the pandemic was $1.7 billion.

A lesson from this episode is that additional monetary policies that entail asset purchases amplify the interactions between monetary and fiscal policy, and that additional monetary policies can accrue significant fiscal costs. Therefore, they should be considered alongside the relative net benefits of other fiscal efforts to support the most effective policy mix and consideration of the risks to the public sector balance sheet as a whole.

The Reserve Bank Board decided not to seek a government indemnity for the bond purchase program. By contrast, some other central banks use indemnities to transfer gains or losses from asset purchases directly to the government budget. The Reserve Bank Board made a judgement that it would ultimately make no difference to the overall public sector balance sheet, as any losses from bond purchases ultimately accrue to the government balance sheet, whether via reduced dividends or an indemnity. Nonetheless, the spillovers of additional monetary policy tools to fiscal policy show the importance of ongoing discussions between monetary and fiscal authorities, including consideration in advance of the risks. Discussion regarding an indemnity is a clear mechanism to recognise these interactions between monetary and fiscal policy concretely ahead of time.

Box 1.3: International comparison of the use of forward guidance during the COVID-19 pandemic

Most advanced economy central banks used some form of forward guidance during the pandemic. The most common form of guidance was state-based guidance. The US Federal Reserve, the Bank of England and Bank of Japan all offered solely state-based guidance, linking a future increase in the policy rate explicitly to progress towards its inflation target. Like the RBA, most other comparable central banks provided some form of calendar-based guidance alongside state-based guidance.

Relative to the RBA, most other central banks that offered calendar-based guidance provided it over a shorter time horizon or updated it more frequently than the RBA (Table 1.3). For example, the Reserve Bank of New Zealand and Norges Bank provided calendar-based guidance, but only for 12-month and 6-month periods, respectively. The Bank of Canada provided 3-year guidance in 2020, but this was updated and shortened twice in 2021 as the economic outlook improved. The Sveriges Riksbank was the only comparable central bank to offer guidance out to 2024 for a similar length of time as the RBA.

Table 1.3: Use of calendar-based forward guidance

Central Bank	Summary of Approach
Reserve Bank of Australia	Provided state-based guidance from March 2020 until May 2022. Calendar-based guidance was added in October 2020. The initial time horizon was 3 years, which was updated to 'until 2024' in February 2021. This guidance remained in place until November 2021.
Bank of Canada	Provided state-based guidance from July 2020 until January 2022. Conditional, calendar-based guidance was added in October 2020. The initial time horizon was 3 years, but it was updated twice in 2021 to shorten the horizon. Forward guidance was dropped in January 2022.
European Central Bank	Provided state-based forward guidance from March 2020 until June 2022, linking a future increase in the policy rate to an inflation threshold. Calendar-based guidance was provided in a speech in late 2021 that the policy rate was unlikely to rise in 2022.
Reserve Bank of New Zealand	Provided calendar-based guidance in March 2020 that the policy rate would remain unchanged for a fixed 12-month horizon. The guidance was changed to state-based guidance in February 2021, which was in place until July 2021. The Reserve Bank of New Zealand provided policy rate forecasts throughout the pandemic, as it had done since 1997.
Norges Bank	Initially, guidance was provided through policy rate forecasts but was updated to a state-based commitment in November 2020. Guidance was changed to calendar-based guidance at a 6-month horizon in March 2021, which continued until June 2021. Norges Bank provided policy rate forecasts throughout the pandemic, as it had done since 2005.
Sveriges Riksbank	Provided policy rate forecasts throughout the pandemic, as it had done since 2007. From April 2020 until November 2021, the policy rate was forecast to remain at zero for the forecast period (about 3 years). In February 2022, the policy rate was forecast to not rise until the second half of 2024. The Sveriges Riksbank decided to increase its policy rate in late April 2022.

2021 to present: Exit from additional monetary policy tools

Throughout 2021 and 2022, economic conditions improved much faster than the RBA had expected when additional monetary policy tools were first introduced (Charts 1.6 and 1.7). In response, the Reserve Bank Board began unwinding its additional monetary policy tools in June 2021 (with the closure of the Term Funding Facility). The rate of bond purchases was tapered in July 2021 (and purchases ceased in February 2022). In November 2021, the yield target and calendar-based forward guidance was discontinued. The Reserve Bank Board started raising the cash rate target in May 2022.

Chart 1.6: Unemployment rate and RBA forecasts
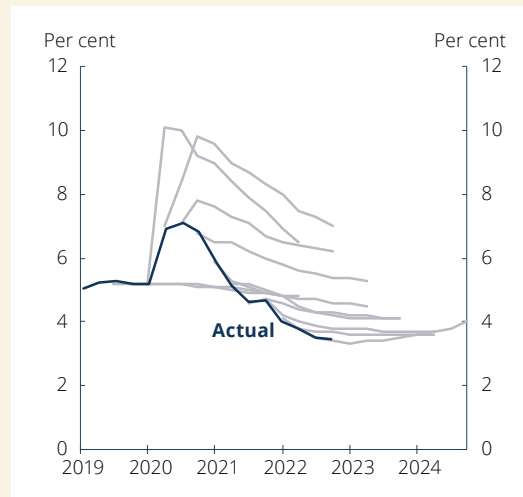
Chart 1.7: Headline inflation and RBA forecasts
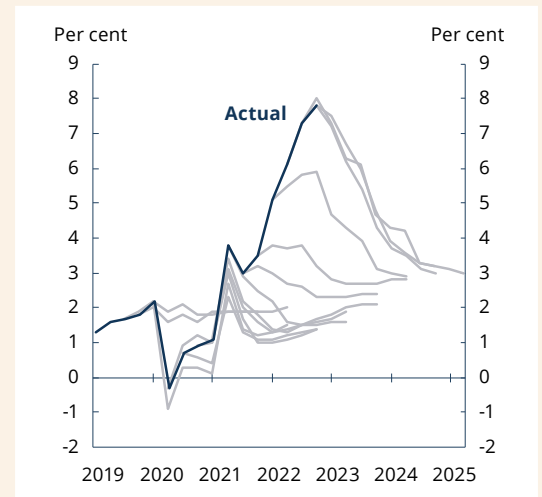
Note: Grey lines represent quarterly RBA unemployment rate and inflation forecasts from November 2019 until February 2023. Source: ABS Labour Force Survey; ABS Consumer Price Index; RBA.

With the benefit of hindsight, the Reserve Bank Board was too slow to wind back the overall level of monetary support in the face of rising inflationary pressures. This was true of many other central banks.

In part, this reflected the fact that the Reserve Bank Board's policy decisions throughout the COVID-19 pandemic were motivated by a desire to insure against downside risks to inflation and employment. This led the Reserve Bank Board to provide more support and for longer, rather than risk not doing enough. Like at many central banks, the RBA's thinking during the COVID-19 pandemic may have downplayed the burden of higher prices, particularly for those at the lower end of the income distribution, and the costs to the economy of bringing inflation down when it becomes embedded in expectations.

The RBA's response also reflected persistent errors in forecasting inflation and unemployment (Charts 1.6 and 1.7). After many years of low inflation, the RBA and many other central banks paid insufficient attention to the upside risks, such as persistent supply chain issues and inflation expectations, and relied too much on wage pressures as an advanced signal of persistent inflation pressures.

However, the Review is of the view that aspects of the policy-making process also contributed. These include how risks were presented to the Reserve Bank Board and factored into decisions about monetary policy strategy, the extent of debate and challenge, and the approach to communication. For example, there was little discussion in Reserve Bank Board papers about how to address the inherent inflexibility of a yield target and calendar-based forward guidance to changes in the economic outlook.

Calendar-based forward guidance

The Review heard from many stakeholders that the Reserve Bank Board's use of forward guidance significantly affected the RBA's public credibility.

As late as November 2021, the Governor said that the next cash rate increase would likely come in 2024 (Lowe 2021a). Even after this guidance was dropped and other advanced economies were increasing their policy rates, the Governor maintained that the probability of a cash rate increase in 2022 was low (Lowe 2021b). While the Reserve Bank Board provided conditions alongside this calendar-based guidance, many in the public understood this to be a commitment. The Review heard from people who interpreted the decision to increase interest rates in May 2022 as a 'broken promise'.

The Review considers that the fallout from this relatively sharp change of direction on forward guidance could have been reduced if the Reserve Bank Board had updated the guidance earlier as the economic outlook improved. That said, there were also issues that were seeded in the original design of the forward guidance, including the long time horizon of the guidance and the RBA's reliance on detailed caveats to its forward guidance, which were not well understood by the public.

In the Review's view, the Reserve Bank Board and executive could have given more consideration to the credible views being expressed by outsiders, and reflected in financial market prices, of emerging upside risks to inflation. Such views could have prompted discussion of alternative communication strategies.

The episode underscores that forward guidance is an element of the RBA's policy strategy toolkit that carries significant reputational risks. As such, future decision making by the Reserve Bank Board on forward guidance should be supported with similarly substantive material for discussion as for other monetary policy tools.

Operation and exit from the yield target

The yield target initially operated effectively, but the Review considers that the RBA made errors in how it subsequently exited from the yield target. The Review has heard strong criticism from stakeholders regarding the RBA's exit from the yield target. The RBA has acknowledged that the exit was disorderly and caused some reputational damage to the Bank.

The RBA appears to have given limited consideration in the design phase on to how it would exit from the yield target, and accompanying forward guidance, particularly in the case of the economic situation improving earlier than expected. Orphanides (2023) has noted that the bond purchase program also carried a foreseeable risk of creating pressure on the yield target, commenting that it 'added an unnecessary complication to policy that proved counterproductive'. While the yield target was put in place during a crisis period, there was time afterwards to consider the changing risks around the scheme and potentially adjust its design. For example, the US Federal Reserve (2010) considered how a yield target could be designed with the risk of rising yields in mind. While the RBA designed and implemented the yield target, the Reserve Bank Board had responsibility and could have been expected to provide challenge on these points.

Those risks began to materialise over 2021, culminating in a disorderly exit. Following stronger-than-expected inflation data in October 2021, the yield on the target bond moved sharply away from the target. The RBA did not make any purchases to defend the target or explain its position on not defending the target. This operational decision had policy implications, creating uncertainty in financial markets about whether the target had been discontinued. The target was not formally dropped until the Reserve Bank Board meeting the following week. The Review heard that this disorderly exit caused substantial (though mostly temporary) market disruption and that the RBA's credibility, especially with market participants, was damaged as a result.

This raises governance concerns regarding the role of the Reserve Bank Board in decision making and the ability of the Governor to stop implementing a decision of the Reserve Bank Board without first consulting them. The Reserve Bank Board did not have the opportunity to contribute to what was a significant policy decision that they were responsible for. This highlights a governance flaw, potentially stemming from an unclear operational responsibility of the RBA executive in implementing the Reserve Bank Board's decisions.

In the months leading up to the Governor's decision to stop defending the target, there were significant gaps in the information available to the Reserve Bank Board, and the Review is unaware of any Board requests for information on this topic. This curtailed the Reserve Bank Board's ability to fully appraise the operation of the yield target and make strategic decisions. The Reserve Bank Board was not made aware of the views of some senior staff members shared with the Governor that the RBA should exit the yield target in mid-2021. At this point, market overnight index swap rates of similar maturity had moved away from the target government bond rate, indicating that the target was not transmitting effectively to other rates in the economy. Likewise, the Reserve Bank Board was not provided with written analysis of the growing risk that the target may need to be defended or abandoned in 2021, though the risk was noted once in Board materials in February 2021. Moreover, the Reserve Bank Board only received written material on an exit strategy once throughout the life of the program, also in February 2021. Had the Board been fully aware of staff concerns, including growing risks and declining effectiveness, it may have reached an earlier view that exit or adjustment of the scheme was appropriate.

Internal reviews of additional monetary policy tools

The RBA has published internal reviews for each of the additional monetary policy tools introduced during the pandemic (Black and others 2021; RBA 2022b; RBA 2022d; RBA 2022e). These reviews concluded that the programs achieved their objectives, while noting some implementation issues.

These internal reviews provide a useful explanation of the RBA's policy choices, and it is good practice for institutions to reflect on their own performance and learn lessons. That said, because self-appraisals are like grading one's own exam, reviews of significant importance should also be conducted at arm's length. In the case of the RBA's economic assessment of the bond purchase program, for instance, the Review heard in consultations that it was viewed as being superficial and that the GDP results were presented in a misleading way (that is gross nominal terms as opposed to net real terms).

It would be particularly beneficial to draw on external perspectives to ensure the conclusions drawn from the reviews are viewed as being credible and robust to different methodologies. For example, the internal review only made brief mention of the waning impact of the yield target on financial conditions. In contrast, research by the Federal Reserve Bank of New York on the Australian experience found that the impact became extremely limited over time (Lucca 2022).

Over time, more internal research should be undertaken to supplement the initial internal assessment.

Collectively, additional analysis will inform public understanding of and decisions of the Reserve Bank Board about future use of additional monetary policy tools. The Reserve Bank of New Zealand offers a good example of this practice (Kengmana 2021). It has provided a clear public assessment of the use of additional monetary policy tools during the pandemic, informed by a set of published principles. These principles offer guidance for how they will consider additional monetary policy tools in the future.

Conclusion: The RBA's actions relating to the COVID-19 pandemic

The RBA's use of additional monetary policy tools during the COVID-19 pandemic highlights the importance of:

- **Bolstering the Reserve Bank Board's collective expertise:** Reserve Bank Board members with a deeper understanding of the financial system and familiarity with international experience would be better placed to offer alternative views on complex and novel monetary policy tools.

- **Enabling the Reserve Bank Board:** The Board needs to be more actively involved in policy formulation, especially when the RBA executive propose novel tools and/or policy options with significant risks. To achieve this, the Reserve Bank Board needs to receive and request sufficient information, time and staff support.

- **Preparing for the use of additional monetary policy tools:** The need to act quickly in a crisis underscores the importance of laying the foundations for sound decision making by undertaking thorough preparatory work. A more fully articulated approach to potential tool design, calibration and risk measurement and mitigation could have led to a more robust decision-making process over the course of the crisis.

- **Fully assessing costs, benefits and risks:** The Reserve Bank Board should receive and request comprehensive quantitative and qualitative assessments of costs, benefits and risks to inform decision making. In addition, the Reserve Bank Board should consider upside and downside risks to the economic outlook as part of the monetary policy decision-making process, particularly in periods of considerable uncertainty.

- **Risk monitoring and exit planning:** The disorderly exit from the yield target highlights the need for the Reserve Bank Board to receive regular risk assessments and exit planning while additional policy tools are in operation. Exit planning should consider interactions between tools and the implications for sequencing.

- **Taking forward guidance decisions cautiously:** The choice to introduce calendar-based or other forms of forward guidance should be a Board decision and considered carefully. It should be treated as a policy decision equivalent to the use of other additional monetary policy tools. Decisions should be informed by a staff assessment and Reserve Bank Board discussion of the benefits and risks of the type of forward guidance being considered, and strategy to update the guidance over time.

- **Carefully considering how best to communicate with the public on monetary policy:** The RBA's experience with forward guidance highlights the need for communication to be effective at relaying the intended message to the target audience.

- **Clearly delineating responsibilities:** The RBA executive's decision not to involve the Reserve Bank Board in the decision making to stop defending the yield target highlights the need for greater clarity around the respective responsibilities of the RBA executive and Reserve Bank Board, including the boundary between operational and policy decisions.

- **Reviewing and drawing lessons from experience:** A frank and transparent post-implementation assessment of the net benefits of additional monetary policy tools would help to identify lessons for how and when they might best be used in the future. The assessment should consider the interactions between tools and the operation of the package as a whole (Orphanides 2023).

Episode 3: Overshooting the inflation target since 2021

Since mid-2021, inflation in many advanced economies has increased sharply to be well above central banks' targets (Chart 1.8). In Australia, headline inflation reached 7.8 per cent in the December quarter of 2022, its highest rate in more than 3 decades, and trimmed mean inflation reached 6.9 per cent.

The Review considered the RBA's response to these inflationary pressures and has made some initial observations. However, there remains significant uncertainty around how events will play out. The Review suggests that this episode be revisited in future reviews.

Chart 1.8: Headline inflation in Australia and selected advanced economies
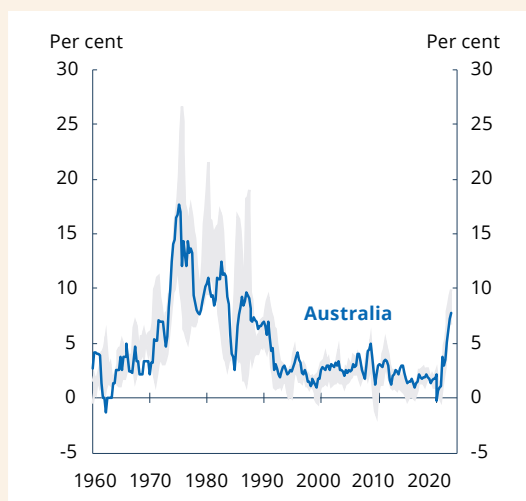
Chart 1.9: Central bank policy rates
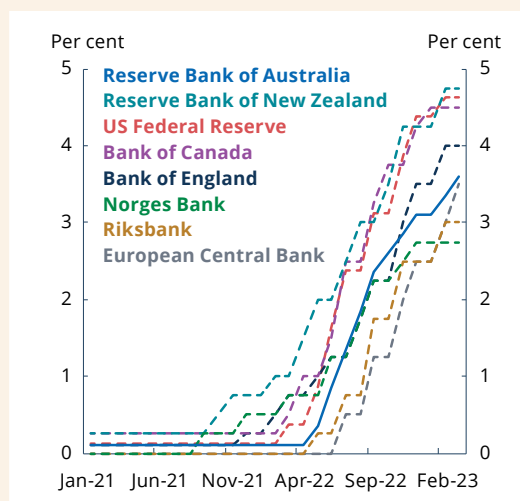
Note: The shaded region represents the range of quarterly headline CPI inflation in Canada, Euro area, New Zealand, United Kingdom and the United States. Australian consumer price inflation excludes interest charges and tax changes in 1999-2000. Central bank policy rates updated to 20 March.

Source: ABS, Bank for International Settlements, IMF.

In early 2021, signs of growing inflationary pressures began to emerge in many advanced economies, including Canada, New Zealand, the United Kingdom and the United States. At the time, the RBA believed Australia was unlikely to experience as large a rise in inflation as was observed overseas. It anticipated more modest effects of supply disruptions, including in energy markets, and expected higher labour force participation and inertia in wage setting to dampen wage growth domestically. Like many peer central banks at the time, the RBA expected some of the pick-up in pricing pressures that was occurring to be temporary.

By the second half of 2021, the RBA was faced with a large upside surprise to inflation. Trimmed mean inflation jumped to 2.1 per cent in the September quarter, compared with a forecast of 1.7 per cent. This forecast miss was large by historical standards, at around the 95th percentile of historical one quarter ahead forecast misses since the early 1990s. The RBA acknowledged the faster-than-expected progress towards its inflation target. However, it maintained that it expected further increases would likely be gradual and inflationary pressures would remain relatively narrow.

Inflation turned out to be stronger and more broad-based than the RBA (and most others) expected. Large forecast misses in the December quarter 2021 and March quarter 2022 – the largest in the inflation-targeting period – led the RBA to progressively revise its forecasts for inflation significantly higher (Chart 1.7).

The Reserve Bank Board began to increase the cash rate target at its May 2022 meeting, only somewhat later than the US Federal Reserve and Bank of Canada, which began increasing their policy rates in March 2022. By comparison, the Reserve Bank of New Zealand and the Bank of England started raising their policy rates in October and December 2021, respectively.

While the Reserve Bank Board was initially slower to respond to signs of inflation than some of its peer central banks, it acted decisively once underway. The Reserve Bank Board has increased its policy rate by a cumulative 3.5 percentage points since May 2022. This is one of Australia's fastest tightening phases of monetary policy in the inflation-targeting era. It is comparable with the increases of other central banks (Chart 1.9).

The RBA was slower than some others to respond to inflationary risks

The RBA was not alone in misjudging the size and persistence of the increase in inflation. It came as a surprise to other central banks and official forecasters. Indeed, the RBA's forecasts for inflation in Australia in 2022 evolved broadly in line with those of the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD) and market economists surveyed by Consensus Economics (Chart 1.10).

Chart 1.10: Evolution of forecasts for inflation in 2022 in Australia
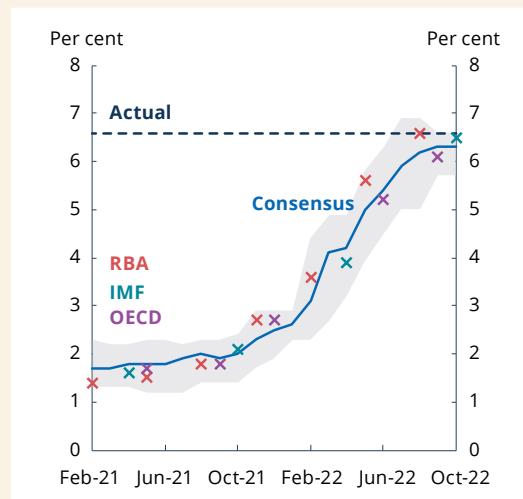
Chart 1.11: Policy rate expectations

Note: Grey region represents range of consensus forecasts for average headline inflation in 2022. Prices for overnight indexed swap contracts of varying maturities used to measure policy rate expectations of financial market participants.
Source: ABS Consumer Price Index; RBA; IMF; OECD; Consensus Economics; Bloomberg.

Some private sector forecasters and financial market participants identified inflation risks from mid-2021, earlier than the RBA. The policy rate path implied by financial markets moved notably higher throughout 2021 and deviated significantly from the RBA's expectation at the time that the policy rate would remain unchanged at 0.1 per cent until 2024 (Chart 1.11).

But even among those that did identify risks to inflation early on, the magnitude of the increase in inflation (both in Australia and globally) was surprising.

To some extent, this reflects the fact that the increase in inflationary pressures has been partly driven by major supply disruptions – notably disruptions to energy and food supply from Russia's invasion of Ukraine and natural disasters – that were inherently unpredictable. However, other factors that contributed to the pick-up in inflation were arguably more foreseeable, particularly as the economic recovery progressed into 2021. For example, while the Review (and many consulted by the Review) considers the strong and rapid fiscal and monetary policy response at the onset of the pandemic to be appropriate given the threat to lives and livelihoods, the cumulative effects of the measures over time contributed to the overshoot of inflation in Australia. Indeed, Murphy (2022) found that, combined, the fiscal and monetary stimulus added 3.0 percentage points to inflation during 2022. Of this, 0.6 percentage points were attributable to monetary policy being more accommodative than would normally be the case given prevailing economic conditions.

The RBA's focus on wages

While the RBA clearly could not have anticipated wars and natural disasters, the Review believes that certain choices and judgements by the RBA made it more likely to misjudge the size and persistence of the inflation shock as time progressed. They also may have made it more difficult for the Reserve Bank Board to pivot to increasing the policy rate once signs of inflationary pressures emerged.

With the benefit of hindsight, the RBA was overly focused on its view that evidence of wage growth would be needed to achieve sustainably higher inflation. The RBA did not weigh highly enough risks that were becoming evident in other countries or the possibility that firms' pricing behaviours could change in an environment of widespread price increases. Indeed, papers provided to the Reserve Bank Board throughout 2021 contained little discussion of the risks posed by non-wage sources of inflation. The Reserve Bank Board papers also lacked meaningful assessment of the degree of spare capacity in the economy during this period.

This led to insufficient attention being paid to upside risks to inflation during this period. The alternative scenarios that were presented to the Reserve Bank Board (and published in the *Statement on Monetary Policy* throughout 2021) focused on different assumptions about COVID-19 health outcomes and spending patterns. They did not consider, however, upside risks to inflation stemming from sources such as higher-than-expected input costs.

Forecasting tools of the RBA

The Review is of the view that the RBA's forecast models fell short in an environment of large and persistent supply disruptions, and when monetary and fiscal policy interactions were important. Again, the RBA was in good company as models used by central banks tend to face similar shortcomings, especially when faced with such an unprecedent situation.

Historically, the RBA's forecasting process has primarily relied on single equation models maintained by subject-matter experts. In response to recommendations from an external review of the RBA's forecasting process in 2016, a large macroeconometric model, MARTIN, is now also used to provide a whole-of-economy perspective (Pagan and Wilcox 2016). However, in both cases, the models include little detail on the economy's supply side, including how inflation passes through supply chains. This made it difficult to capture the supply-driven inflationary pressures witnessed during the period.

Indeed, an examination of the main drivers of the RBA's inflation forecast errors, using the RBA's MARTIN model, suggests that the stronger-than-expected outcomes largely reflect unexplained upside surprises in inflation itself (RBA 2022a). The RBA's existing modelling framework could not sufficiently capture inflation dynamics during this period given the unique nature of the shock.

Influence of policy design on decision making

Some of the specific design choices for policy tools introduced during the pandemic contributed to the RBA's inaction in the face of growing inflationary pressures.

In October 2020, the Reserve Bank Board adopted a strategy of placing more weight on actual, not forecast, inflation in its decision making (Box 1.1). The stated purpose was to be clearer about how the RBA would react to incoming economic data in a world of heightened uncertainty (Lowe 2020b). The US Federal Reserve had made a similar change to its forward guidance in September 2020 (Federal Reserve 2020a). However, the strategy increased the likelihood of inflation overshooting the RBA's target. The *Minutes*, Reserve Bank Board paper and a speech by Governor Lowe at the time indicated that the Reserve Bank Board discussed the shift in strategy. However, there is no evidence in Board papers that the trade-off in terms of a higher risk of an inflation overshoot was made explicit to the Reserve Bank Board at the time. Orphanides (2023) judged that this shift in strategy was 'unwise' in his paper for the Review.

More broadly, the decision to introduce a 3-year yield target, and forward guidance that the policy rate would remain unchanged until 2024, may have contributed to the RBA's hesitancy to act, at least initially. These policies may have affected the openness of the RBA to respond to early signs of inflation by upgrading the inflation forecasts given this may have required earlier changes to the RBA's forward guidance.

Conclusion: The RBA's actions since 2021

While there remains significant uncertainty around how events will play out, at this point in time, the Review's assessment of the RBA's performance during this period highlights the need to:

- **Encourage robust debate and challenge:** RBA staff members and Board members should interact more with each other and seriously consider opposing views (both internal and external) to identify risks and blind spots.

- **Consider formal modelling of alternative scenarios:** There should be an ongoing focus on risks, including through scenario analysis, to surface and test differing perspectives.

- **Engage in deep discussions about monetary policy strategy:** The Reserve Bank Board should regularly step back from immediate decisions and consider whether its broader strategy offers the greatest chance of meetings its objectives. Scenario analysis can support these discussions.

- **Avoid being trapped by previous narratives:** Monetary policy decision makers should remain agile in shifting the narrative of monetary policy, including communicating new views in a timely way as circumstances change.

- **Invest continually in state-of-the-art models and data:** The RBA should, for instance, invest in forecasting models that include more detail on the supply side of the economy, especially given the prospect of more supply-side disruptions in the future, and on fiscal interactions including a regard for nonlinearities at the effective lower bound.

Communication

The RBA's approach to communication has evolved considerably over recent decades. Like many of its peers, there has been a greater emphasis on openness and transparency and using communication as a tool to support monetary policy actions.

Throughout the Review's consultation process, many stakeholders welcomed recent initiatives to increase the understanding of monetary policy decisions and improve accountability and transparency. These include the introduction of ad hoc press conferences, the publication of the RBA's main model of the Australian economy, the release of more detailed information around forecasts and the expanded and formalised approach to public education. Stakeholders were also aware that greater transparency increases the risk of miscommunication and talked about the importance of clear, purposeful and professional communication.

The RBA's approach to communication, nonetheless, emerged as a prominent area of criticism throughout the Review. The shortcomings in the RBA's approach to communication that were most often mentioned relate to the way it communicates its policy strategy and decisions, as well as how it engages with the public.

Communication of policy strategy and decisions

Like many of its peers, the RBA uses a variety of channels to communicate its policy decisions and analysis of economic developments. This includes media releases, the *Statement on Monetary Policy* and associated debriefs with business and community groups, Reserve Bank Board meeting *Minutes*, speeches, liaison program and research papers.

While there has been a significant increase in communication in recent years, the RBA's regular communications are still less transparent than those of some other peer central banks. For instance, explanations of monetary policy strategy lack important information, and there is limited discussion of the range of views held by Reserve Bank Board members. In a small survey of professional economists in Australia conducted by the Review, only about 15 per cent thought the RBA was better than its peers in communicating the rationale for its policy decisions. Just 5 per cent thought it was better than its peers at communicating how it responds to new information about the economic outlook.

There are a variety of methods used by other peer central banks to support understanding (and promote accountability), including:

- **Press conferences:** Most of the RBA's peers conduct regular press conferences. While the RBA started holding ad hoc press conferences during the pandemic and often allows for Q&A sessions at the end of speeches by RBA executives, there was widespread support among those consulted by the Review for the RBA to commit to regular press conferences to explain monetary policy decisions and respond to questions. Press conferences are a valuable opportunity for a wide range of Australians to learn about monetary policy decisions. This information is also key to considering the appropriateness of policy decisions and adjusting expectations about future policy decisions as new data arrive.

- **Speeches:** Many of those consulted by the Review found the regular speeches given by RBA executives useful, although some were of the view that more speeches would not necessarily be helpful. The regular Q&A sessions at the end of speeches were highlighted as being particularly valuable. But some consulted by the Review drew attention to the fact that the Governor is the spokesperson for the Reserve Bank Board and so the views and opinions of other members of the Reserve Bank Board are not well understood. This is in contrast with some other peer central banks, such as the Bank of England, where other members deliver speeches.

- **Voting records:** Many of the RBA's peers release the voting record of monetary policy decision makers, including information on areas of agreement and dissent. While the Reserve Bank Board *Minutes* provide a brief summary of the discussions that take place in Reserve Bank Board meetings, they do not provide a strong sense of the balance of views or how close each decision is. Voting records are not released.

- **Publicly available forecast data and liaison information:** Most of the RBA's peers provide forecasts in easily accessible and convenient data formats (for example Microsoft Excel). Many peer central banks also regularly share detailed insights from business liaison programs, including the US Federal Reserve, which has done so for decades. This transparency around key inputs to the monetary policy decision-making process supports a deeper understanding of the rationale for decision making and is important for accountability. The RBA does not provide its forecasts in convenient data formats (only published tables with rounded data), although it recently started to share detailed liaison information.

- **Scenario analysis:** Used by some peer central banks as it allows for more transparent explanations of policy strategies and decisions. While the RBA used scenarios to convey risks around its forecasts during the COVID-19 pandemic, it has not used scenarios to publicly convey the economic outcomes of alternative policy paths.

In terms of the content of the RBA's communication, many people consulted by the Review expressed a strong desire for greater transparency around the factors that drive policy decisions. Indeed, many cited the low inflation period between 2016 and 2019 as an example of when the main considerations driving policy decisions were unclear. Many also highlighted this as a time when greater clarity was needed around how the RBA was managing trade-offs. Clearer communication, together with greater clarity around the RBA's objectives, would have helped.

Overall, the Review is of the view that the RBA's communications should focus less on the publicly available facts and more on the reasoning behind monetary policy decisions. The RBA should provide more clarity around why alternative policy options are not pursued, and how current policy settings fit into a broader strategy to achieve its objectives.

Communication with the public

The Review heard strong feedback that the RBA needs to do more to communicate effectively with the public. Many people rely on messages they hear from the RBA to guide their decisions because they believe the RBA is better placed to make judgements on the economic outlook. The public can find it difficult to accurately interpret the RBA's communication.

Criticism was particularly focused on the RBA's use of forward guidance during the COVID-19 pandemic, when the conditionality of the RBA's statements was not well understood. In its internal review, the RBA determined that if this type of forward guidance was used again it would need to be clearer about the caveats. However, it is the judgement of the Review that any future use of forward guidance needs to account for the strong possibility that messages intended for the public cannot rely on detailed caveats given that they may not be well understood.

The RBA should do more to effectively communicate its policy decisions and thinking to the public. Indeed, in focus groups conducted for the Review, members of the public expressed a desire for more proactive communication from the RBA. They expressed a desire to know more about why policy decisions have been made and about the state of the economy more generally (see Chapter 2 for details on the feedback received through focus groups).

The RBA has already trialled some approaches adopted by other central banks to communicate with the public more effectively. For example, the RBA has used a 'layered' approach to communicating its F*inancial Stability Review* since October 2020. This involves publishing an accessible version of the main messages alongside the detailed report.

The Review also heard that the RBA's public education program is a valued part of the RBA's communications. It is valuable not just in assisting teachers and students but also increasing understanding of the public. The Review is of the view that the RBA should build on the success of this initiative.

Conclusions on past performance

Overall, Australia's economic outcomes over the past 3 decades have been very good, and the actions of the RBA have generally contributed to these good outcomes and demonstrated sound judgement. Throughout this period, the Reserve Bank Board has tended to conduct monetary policy effectively. It has generally set policy in a way that is forward-looking and responsive to changes in the economic outlook, including in very difficult circumstances involving considerable uncertainty and financial crises.

There are, as is to be expected, important lessons for the future that can be learned from the RBA's performance, particularly in recent years when the RBA has operated in an increasingly complex environment. This chapter has highlighted some specific episodes that, in the judgement of the Review, expose underlying shortcomings in Australia's monetary policy arrangements that can be addressed.

It is not possible to know how alternative arrangements would have fared over the recent period. However, the Review considers strengthening the following aspects of current arrangements will increase the robustness of the policy framework to future challenges and, in turn, the likelihood of good outcomes:

- **Clearly specified monetary policy objectives:** Greater clarity is needed around the RBA's objectives to foster better understanding about how decision makers will respond to new data and changes in the economic outlook, assess and challenge policy settings in real time, and maintain trust in decision making.

- **Constructive challenge and debate throughout the monetary policy making process:** Greater debate and challenge is needed during the policy formulation and deliberation process to help surface differing perspectives, test policy recommendations and strategy, and manage risks. To help achieve this a number of adjustments need to be made, including:

  - **Increased economic expertise of monetary policy decision makers:** The Reserve Bank Board requires the right mix of skills, including some members with expertise in areas relevant to monetary policy, such as open-economy macroeconomics, the financial system, the labour market or the supply side of the economy. The Reserve Bank Board would also benefit from regularly discussing alternative policy views with other external economists.

  - **Deeper involvement of decision makers:** Decision makers needs to be more deeply involved in the policy-formulation and decision process. Board engagement that robustly challenges the views of the RBA executive is more likely to lead to better decisions and outcomes.

  - **More support for decision makers:** RBA staff should provide Board members with greater support to ensure members have the information required to develop their own views on policy issues and challenge positions taken by the RBA executive. Board members should request this information when necessary. This information should include providing comprehensive quantitative and qualitative assessments of costs, benefits and risks to help inform decision making. Scenario analysis could also be used to help surface and test differing perspectives, including on the broader monetary policy strategy.

    – **Greater exposure to internal debate within the RBA:** The RBA needs to better embrace a culture of robust and constructive challenge, so that debates and alternative views are better integrated into monetary policy decision making. This should involve two-way dialogue between subject matter experts and Board members and ensuring decision makers benefit from hearing the alternative views and perspectives of RBA staff members. A more robust culture of debate would also help ensure that economic forecasts are responsive to developments and emerging risks.

- **Forecasting toolkit that incorporates state-of-the-art models and data:** The RBA would benefit from forecasting models that include more detail on the supply side of the economy. Climate change and the prospect of more supply disruptions in future underscore the importance of this uplift in capacity. The RBA would also benefit from further enhancing its capability to model the economic effects of other macroeconomic tools, including fiscal policy, and their interactions with monetary policy.

- **Transparent and effective communication:** The RBA needs to improve public understanding of its decision-making process and strategy, including how it is making trade-offs, especially when it is using the flexibility in its inflation-targeting framework.

- **A decision-making framework for additional monetary policy tools:** The RBA would benefit from a clear framework for deciding on and implementing additional monetary policy tools in future, drawing on lessons learned from the recent experience and research. This framework needs to bring cost-benefit and risk analysis to the forefront of decision making, especially when using innovative monetary policy instruments.

- **Clear understanding of responsibilities between the Board members and executive:** The decision of the RBA executive to stop defending the yield target emphasises the need for clarity around the respective responsibilities of the RBA executive and Board members.

The following chapters draw on the experiences and lessons learned from this assessment of the RBA's performance, alongside other evidence gathered by the Review, to motivate a range of recommendations related to Australia's monetary policy arrangements and the RBA's governance and culture. These recommendations are designed to help the RBA continue to achieve excellence in meeting its key objectives in the future.

2

Chapter 2:
A clearer monetary policy framework

Chapter 2: A clearer monetary policy framework

> This chapter addresses the objectives and operational framework for Australian monetary policy, the RBA's role in contributing to financial system stability, and the interactions between monetary, fiscal and macroprudential policy. It outlines existing arrangements, then makes 7 recommendations for improvement.

Monetary policy is a core tool of macroeconomic management, with a substantial influence on economy-wide outcomes such as inflation, economic activity and employment.

The welfare of Australians is best served by an independent RBA conducting monetary policy based on legislated objectives to contribute to price stability and full employment. As well as clear objectives, independence must be accompanied by a clear approach to the policy framework and tools, and public accountability for performance.

Monetary policy is not the only tool that is important for macroeconomic management. It is important that there are strong links between monetary policy makers and fiscal and regulatory policy makers to encourage the best possible response to macroeconomic challenges.

The existing monetary policy framework is fit for the future in many respects. That said, the Review recommends several improvements to the framework through:

- clarifying the RBA's monetary policy objectives, how trade-offs between objectives are made, and the toolkit
- better communicating RBA decisions and assessments related to monetary policy
- clarifying the RBA's role in contributing to the stability of the Australian financial system
- reinforcing how the RBA contributes to complementary fiscal and regulatory policies
- setting out mechanisms that would keep the framework suitable for the future, as well as to increase accountability for policy outcomes.

Box 2.1: Principles to guide Australia's monetary policy arrangements

The Review's recommendations for Australia's monetary policy arrangements are based on the following principles:

- The arrangements should support, to the greatest extent possible, the welfare of Australians.

- The arrangements should be robust to the future economic environment and its challenges.

- The RBA's legislative objectives should be clear to support decision making and accountability. They should be achievable using the RBA's policy tools, so that the public can be confident that the RBA can achieve them.

- The operational framework should provide sufficient flexibility for the RBA to balance its legislated objectives when they are in conflict.

In considering the interactions of monetary policy with other government policies, the Review has made its recommendations using three further principles:

- The role of the RBA should be clearly defined relative to other policy agencies where their objectives overlap, supporting clear accountabilities.

- Where the objectives of government agencies overlap, the agencies should coordinate so that information and analysis is shared, decisions are not made in isolation and the best-suited tools are chosen to pursue that objective.

- Coordination should be done in a way that does not impinge on the independence of monetary policy decisions or the accountability of other agencies with economic management or financial stability responsibilities. Communication does not itself undermine independence.

Recommendations in this chapter

Recommendation 1: Affirm the RBA's independence and clarify its statutory monetary policy objectives

1.1 The RBA should continue to have operational independence for monetary policy. The Government should remove the power of the Treasurer to overrule the RBA's decisions.

1.2 The Government should amend the *Reserve Bank Act 1959* such that:

- The RBA has dual monetary policy objectives of price stability and full employment.

- The 'economic prosperity and welfare of the people of Australia now and in the future' is an overarching purpose for the RBA rather than a separate objective for monetary policy.

1.3 The Government should remove the RBA's power (in the *Banking Act 1959*) to determine the lending policy of banks.

Recommendation 2: Keep a flexible inflation targeting framework but clarify how it operates

2.1 The RBA Monetary Policy Board (see Recommendation 8) and the Government should agree in the *Statement on the Conduct of Monetary Policy* that:

- Equal consideration should be given to price stability and full employment in setting monetary policy.

- There should be a flexible inflation target of 2-3 per cent.

- The Monetary Policy Board should aim for the midpoint of the inflation target in order to maximise the chance that the target is met and best anchor inflation expectations.

- The Monetary Policy Board should set out its assessment of its full employment objective, as reflected in a range of relevant indicators of labour market conditions.

- The Monetary Policy Board has the flexibility to vary the timeframes over which it aims to bring inflation back to around the midpoint of the target, taking into account the full employment objective, when significant deviations occur.

2.2 The *Statement on the Conduct of Monetary Policy* should outline how the RBA Monetary Policy Board will communicate its use of the framework's flexibility including expectations that the RBA will, in its regular communications:

- explain how long inflation is expected to be materially away from the midpoint of the target and why, how long labour market conditions are expected to deviate from full employment and why, and how it is balancing its two objectives

- explain the key factors affecting its decision making, such as financial stability risks which should be a consideration in monetary policy decisions to the extent that they may influence the price stability and full employment objectives

Recommendation 3: Promote a better understanding of the relative roles of fiscal and monetary policy

3.1   The *Statement on the Conduct of Monetary Policy* should acknowledge the importance of both monetary policy and fiscal policy for macroeconomic outcomes. The Government (in particular Treasury) and the RBA should commit to:

- continue to regularly share information about the economic outlook, risks and policy constraints

- work together to analyse the impacts of monetary policy decisions on fiscal policy, and the impacts of fiscal policy decisions on monetary policy

- jointly develop scenario analysis that identifies the best combination of policy responses to economic challenges, in ways that do not compromise monetary policy independence

- identify how the RBA's monetary policy framework and the Government's fiscal approach can together best support good economic outcomes and acknowledge that fiscal policy may have a larger role in some circumstances, for example when the cash rate is at its effective lower bound.

3.2   The RBA and Treasury should develop an Australian Macroeconomic Policy Research Program to promote applied research and analytics on Australian monetary, fiscal and financial policy, working with universities and think tanks that have such programs.

3.3   The RBA should publish a framework for the use of additional monetary policy tools in the future. The *Statement on the Conduct of Monetary Policy* should set out what the framework will cover, including the expectations of the Government and RBA Monetary Policy Board around:

- transparency

- assessing costs and benefits

- managing risks

- considering exit strategies at the outset for different scenarios

- discussions on the appropriateness of fiscal policy as an alternative policy lever.

Within the agreed framework, the RBA should retain instrument independence.

Recommendation 4: Institute regular reviews of the monetary policy framework and tools

4.1   The Government and RBA Monetary Policy Board should instigate a formal review of the monetary policy framework and tools every 5 years, jointly led by the RBA and Treasury and including formal and transparent input from independent domestic and international experts with a wide range of viewpoints. The purpose of the review should be to ensure the monetary policy framework and tools remain appropriate, and it should inform the renewal of the *Statement on the Conduct of Monetary Policy.*

Recommendation 5: Legislate the RBA's financial stability role

5.1   The Government should specify in the *Reserve Bank Act 1959* that the RBA has a responsibility to contribute to financial system stability, in cooperation with other government agencies, especially the Australian Prudential Regulation Authority (APRA).

Recommendation 6: Reinforce cooperation arrangements for promoting financial stability

6.1   The Council of Financial Regulators should renew memorandums of understanding between its members so that there is:

- clarity on the outcomes the group is responsible for delivering and the specific roles of each agency
- a shared responsibility for identifying regulatory gaps at a 'whole of system' level
- a shared commitment to reduce the risks posed by such gaps.

6.2   The RBA Monetary Policy Board should commit to inform the Council of Financial Regulators when monetary policy is likely to affect, or be affected by, risks to financial stability. This should include formal advice from the RBA to APRA on its use of macroprudential tools. This advice to CFR and APRA should be published after 5 years.

6.3   The RBA and APRA should update their public memorandum of understanding so that it sets out clear and specific commitments to cooperation in promoting financial stability, including the way APRA consults the RBA on macroprudential policy settings.

Recommendation 7: The RBA should take account of climate risks but not use monetary policy to address them

7.1   The RBA should continue to:

- integrate the implications of climate change for the Australian economy and financial system into its analysis
- contribute more generally to the effective regulation of banking and finance on climate risk and natural capital management through the Council of Financial Regulators and international forums.

7.2   The Government should not make transition to a low carbon economy an explicit objective of monetary policy. The Government should set the mix of policies to pursue and manage the transition, rather than the RBA using its balance sheet or directing private lending to accelerate transition.

Monetary policy arrangements in Australia and their context

Australia's monetary policy framework

The *Reserve Bank Act 1959* (the RBA Act) s 10 imposes a duty on the Reserve Bank Board to conduct its 'monetary and banking policy' … 'to the greatest advantage of the people of Australia' and use its statutory powers in a way that 'will best contribute to:

- stability of the currency of Australia,

- maintenance of full employment in Australia, and

- economic prosperity and welfare of the people of Australia'.

While these objectives in the RBA Act have been unchanged, the monetary policy framework – the RBA's broad strategy to fulfill these objectives – has gone through several iterations in the period since. Prior to adopting flexible inflation-targeting in the early 1990s, Australia had experimented with a number of monetary policy frameworks – including targeting the money supply, a fixed exchange rate regime, and a 'checklist' approach with substantial discretion.

The RBA's approach to meeting its legislated monetary policy objectives is set out in an agreement between the Treasurer and the Governor: the *Statement on the Conduct of Monetary Policy* (the Statement on Conduct). The Statement on Conduct has not been significantly changed since its inception in 1996, though minor revisions have been made. Bipartisan support for the monetary policy framework has been an immense strength of Australian economic policy. The Government affirms in the Statement on Conduct that it will respect the RBA's independence as provided by the RBA Act.

The Statement on Conduct outlines how the Government and the Governor interpret the RBA's legislated objectives. It interprets the first objective of the RBA Act, 'stability of the currency', as 'price stability'. It notes that the Reserve Bank Board will also take into account the impact of monetary policy on activity and employment in the short term, but that price stability is 'a crucial precondition for long term economic growth and employment'.

The Statement on Conduct outlines that the RBA pursues its objectives through a flexible medium-term inflation target. The most recent version of the Statement on Conduct describes the inflation target as follows:

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

At various points in time, the RBA has set out more detail about how it approaches the flexibility in the inflation target framework. In particular, it:

▪ does not explicitly aim for the midpoint of the 2-3 target range, although the target range does not represent a 'zone of policy inaction' (Debelle 2018b)

▪ lets 'bygones be bygones' so that past inflation outcomes do not alter the inflation target for the period ahead (the RBA will not attempt to offset any past over or undershooting of inflation) (Debelle 2009)

▪ does not adhere to a specific timeframe over which to aim to return inflation to target, or over which to assess performance in hindsight (Debelle and Stevens 1995).

The flexibility in Australia's framework recognises that unexpected developments will, at times, push inflation outside the target range. Given that these shocks occur, it is sometimes neither realistic nor desirable to use monetary policy to keep inflation within the target range. Two reasons for this are:

▪ Monetary policy has long and variable lags in its effects on the economy. RBA research suggests that monetary policy's strongest effects on employment and inflation occur around 1-2 years after a change in policy (see for example Beckers 2020).

▪ The RBA takes account of more than just price stability in setting monetary policy; at times the RBA will aim to bring inflation back to target slower than otherwise to the benefit of its objectives for full employment and the welfare of Australians.

The RBA's interpretation of its full employment objective is less explicitly specified than its price stability objective. This reflects that full employment is not directly measurable and changes over time. The RBA considers a range of measures of labour market conditions, with a particular focus on the non-accelerating inflation rate of unemployment or NAIRU. On occasion, the RBA has published its estimates of the NAIRU (Ellis 2019).

The interpretation of the 'economic prosperity and welfare' objective is the most ambiguous element of the RBA's framework. One interpretation sees it as a reiteration of the broad purpose of the RBA, within which the price stability and full employment objectives for monetary policy are nested. A second interpretation sees it as a separate, additional objective for monetary policy which provides the Reserve Bank Board with discretion to trade off its price stability and full employment objectives against other factors it judges as relevant to Australians' welfare. The RBA has made comments that can be taken to support both interpretations in the past (Debelle 2018b, Lowe 2019).

While the RBA is generally understood as having a key role in financial stability and this is acknowledged in the Statement on Conduct, neither the RBA Act nor the Statement is explicit about how financial stability considerations ought to influence monetary policy decisions. The Statement on Conduct excerpt above suggests that monetary policy decisions may take into account financial stability concerns since it is one of the 'broad objectives of the Bank', although these broad objectives are not articulated in the RBA Act.

In practice, the potential for easier monetary policy to stoke financial risks has been cited as a basis of monetary policy decisions (see Chapter 1). The RBA recently reaffirmed that the framework provides flexibility for the RBA to strike a balance between achieving the inflation objective in the short term and avoiding the build-up of financial stability risks (Lowe 2022).

Monetary policy and fiscal policy interactions

Monetary policy and fiscal policy both affect inflation and employment and are the two most important policy areas for management of the macroeconomic cycle.

Australia's monetary policy framework focuses on relatively targeted objectives. Compared to monetary policy, fiscal policy has broader objectives, including maintaining and improving the performance of the economy, the security of the community, the provision of public services, the distribution of income and opportunity, as well as preserving fiscal sustainability. Fiscal policy also plays an important role in influencing economic activity through tax and transfer payments. At times, fiscal policy and monetary policy have had either reinforcing or opposing influences on economic growth:

▪ During the Global Financial Crisis and COVID-19 pandemic, fiscal and monetary policy both added stimuli to support the economy in managing severe shocks.

▪ In the period prior to COVID-19, in contrast, fiscal policy was more contractionary as the Government sought to restore its balance sheet. Meanwhile, monetary policy had a more stimulatory stance.

Fiscal policy can also influence the productive capacity of the economy. Where used in this way, fiscal policy can sometimes generate stronger employment outcomes without stoking inflation.

The sustainability of government finances can also affect inflation outcomes. If government finances are perceived as becoming unsustainable, this is likely to provoke higher inflation due to concerns that governments and central banks will pursue higher inflation or debt monetisation in order to lower the real value of debt. Exchange rate depreciation further boosts inflation in this scenario. The Statement on Conduct acknowledges 'the role that disciplined fiscal policy must play in achieving medium term price stability'.

There are a number of other ways in which monetary policy and fiscal policy interact, including:

▪ Monetary policy influences the cost of government debt. Policies such as bond purchases can have significant effects on the earnings and capital position of the central bank and therefore the dividends paid to the government.

▪ Monetary policy also has distributive impacts within the private sector. If the nature or extent of these impacts is undesirable from a broader social perspective, then fiscal policy has access to more targeted tools through the tax and transfer system and social spending to shape outcomes.[1]

Leeper (2023) sets out a more detailed discussion of the interactions of monetary and fiscal policy. Given these links, it is important that there is cooperation between monetary and fiscal policy makers and that their respective longer-run policy frameworks are compatible. But this cooperation should not threaten the independence of monetary policy decision making to pursue its legislated objectives.

Current arrangements support cooperation between monetary and fiscal policy makers. The RBA Act requires that the Governor and the Treasury Secretary establish 'close liaison', and that the Secretary to the Treasury be an ex officio member of the Reserve Bank Board (s 13 of the RBA Act). RBA leadership also communicates directly with the Prime Minister and the Treasurer, particularly during crises or differences of opinion (s 11 of the RBA Act).

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1   As an example of these tools in action, the Productivity Commission found that government spending and transfers measurably reduced inequality (Productivity Commission 2018). Specifically, Australia's income Gini coefficient was reduced by a third, from 0.6 to 0.4, by the tax and transfer system, and by a further third, to 0.2, by social spending on public health, education and housing.

At the staff level, arrangements exist to share information on economic developments (as opposed to policy deliberations) between the RBA and Treasury. For example, the Joint Economic Forecasting Group brings together officials from the RBA, the Treasury, and other government departments to discuss the domestic and global outlook. The RBA and Treasury are also members of the Council of Financial Regulators.

Financial stability and macroprudential policy

In Australia, responsibility for promoting financial stability is spread across several agencies.

The RBA is widely accepted to have financial stability responsibilities, despite not having an explicit legislative mandate to support this objective, outside of its Payments System Board's responsibilities. The RBA has a powerful toolkit to support financial stability, including the power to provide liquidity support to the financial system. Monetary policy can also affect financial stability through its influence on risk taking, growth in debt and asset prices, and on the balance sheets of the household, corporate and financial sectors.

The Australian Prudential Regulation Authority (APRA) has an explicit legislative mandate to promote financial system stability and powers that enable it to directly alter the behaviour of financial institutions.

The overlapping responsibilities for financial stability between APRA and RBA make close coordination essential. Both agencies bring complementary lenses to financial stability issues, with the RBA generally taking a top-down macroeconomic view and APRA having more bottom-up insights from supervised institutions. Effective information sharing and cooperation is essential to risk identification, the determination of appropriate policy responses and oversight of potential regulatory gaps.

A key area of common interest between the RBA and APRA is the interaction between monetary policy and macroprudential policy. Macroprudential policy is the use of prudential powers to mitigate risks to financial stability through actions such as imposing limits on lending or varying capital requirements.

When used in a complementary way, macroprudential policy can provide monetary policy with greater flexibility to achieve its economic objectives while mitigating potential unintended consequences for financial stability. In particular, macroprudential policy can help reduce the build-up of financial vulnerabilities that might otherwise happen when interest rates are low for a long period, by reducing excessive risk-taking among financial institutions.

Recognising the importance of the RBA and APRA working together on financial stability issues, there are a range of formal and informal arrangements at various levels to support effective cooperation. The RBA and APRA agreed a memorandum of understanding in 1998, which sets out some of the specifics of cooperation and information sharing, including regular meetings of senior officials. It has not been updated since.

Cooperation on financial stability issues is also facilitated through the Council of Financial Regulators (CFR). CFR is chaired by the Governor and brings together APRA, the Australian Securities and Investments Commission, the RBA and Treasury on areas of common interest, including macroprudential policy. CFR is a non-statutory group, with no formal regulatory or decision-making powers. It provides a forum for member agencies to share analysis, identify risks and discuss policy responses. APRA's Macroprudential Policy Framework indicates that consultation with CFR is an essential prerequisite to initiating macroprudential policy actions (APRA 2021).

Monetary policy arrangements overseas

Australia's monetary policy framework shares many similarities with comparable economies, though there are differences in how the inflation target is defined and what priority is given to full employment or other objectives.

Most other central banks have a narrower set of objectives for monetary policy than the RBA (see the comparison of objectives in Appendix 3). A small number of central banks have price stability as their only objective. Many others have price stability as their primary objective, with a secondary or subordinate objective to support economic growth or full employment. Similarly, another group of central banks has a subordinate objective to support the economic policies of their government provided that it does not impinge on their objective of price stability. A final group, including the US Federal Reserve and the Reserve Bank of New Zealand, have 'dual mandates' where objectives for price stability and full employment are given equal weight.

The RBA's objectives are unusual in that a duty to contribute to the 'economic prosperity and welfare of the people of Australia' sits alongside the objectives for price stability and full employment. A number of other central banks have a broad objective to contribute to their nation's welfare, but it is positioned as an overarching purpose for monetary policy, that is, monetary policy delivers on this overarching purpose by pursuing price stability and maximum employment.

Inflation targeting is nearly universal as the operational framework used by central banks in comparable economies to meet their objectives. However, inflation targets vary in their specifications. Australia's inflation target is at the more flexible end of these and sets a slightly higher target level of inflation. A few central banks, such as the Reserve Bank of New Zealand and the Bank of Canada, set a wider range of 1-3 per cent for their target while emphasising the 2 per cent midpoint. Other central banks, such as the European Central Bank and the Bank of Korea, set a point target of 2 per cent. The RBA, like most central banks overseas, targets a measure of inflation based on a consumer price index.

A number of central banks overseas have undertaken reviews of their monetary policy framework in recent years. They considered similar alternative frameworks to those considered by this Review (see Appendix 2 for a description of the alternative frameworks considered). They assessed those alternatives based on criteria like how well the framework would stabilise inflation and the real economy, how well it would be understood and the potential implications for financial stability. In all cases, these reviews recommended that the central bank continue with an inflation target. Several of these reviews recommended a greater emphasis on the central bank's employment mandate. Other particularly notable outcomes were the US Federal Reserve's change before the pandemic to an average inflation target that seeks to offset periods of low inflation with a subsequent period of 'over-shooting' the target; and the European Central Bank's move to a symmetric 2 per cent inflation target which gives deviations above and below the target equal consideration in policy setting.

There is also a variety of approaches overseas to managing macroprudential policy and regulation of the financial system. Some central banks are also the prudential regulator and hold macroprudential powers. In other countries there are separate institutions with arrangements for how they interact. Australia's coordination arrangements between financial regulators are comparatively informal compared to its peers.

Box 2.2: Economic trends and the implications for monetary policy

Monetary policymakers are operating in an increasingly complex environment. The challenges that have arisen since the COVID-19 pandemic are a testimony to this, with inflation globally at a decades-long high. Geopolitical risks are heightened, and climate change and the global response add to economic uncertainty. While the RBA's monetary policy framework has performed well since the 1990s (Chapter 1), the Review is tasked with assessing whether that framework remains suitable in a changing environment.

Based on expert commentary and the Review's consultations, there are 4 longer term trends that are particularly relevant to monetary policy. These are domestic and international, both being relevant given Australia's high level of integration with the global economy.

Changes in trade and globalisation: In recent decades, economic growth has been supported by growth in global trade and financial flows. This trend will likely provide less support for growth in the period ahead, as barriers to free trade have become more common (Schnabel 2022; Gopinath 2022). Disruptions during the pandemic and trade sanctions as geopolitical tensions rise have shown vulnerabilities in global supply chains and raised the prospect that firms and countries will increasingly prioritise supply security over lower costs (IMF 2022). The implication is that this source of economic growth and disinflationary force may be dissipating.

Climate change: Climate change is resulting in more frequent disruptions to the economy, particularly for food and commodities (Schnabel 2022; Gopinath 2022). There are risks to the transition to carbon-neutral economies, including effectively investing funds to adapt the capital stock, managing the impact of structural economic changes on communities and industries, and volatile commodity prices (particularly energy). There are concerns about the implications of a disorderly transition, should it occur, which would cause frequent disruptions across the economy.

Demographic changes: An increasing working population has supported economic growth and labour supply globally and within Australia, China and other economies. Now, for some countries, the working population is declining or projected to decline relative to the rest of the population, tempering this as a source of growth. While migration helps offset population ageing in Australia, the ratio of working-age people to those over 65 is projected to fall substantially over the next 40 years (Treasury 2021). As well as implications for labour supply, these demographic changes also affect the balance of preferences for savings and investment and the level of interest rates.

Changes in wealth, debt and income distributions: Globally and in Australia, debt has grown considerably for households, government, and the private sector over recent decades. This is largely attributed to declines in average interest rates over the period and the deregulation of the financial sector. Within Australia, growth in debt has also been driven by real income growth and household ownership of rental real estate (Kearns, Major, and Norman 2020). At the same time as debt has risen, there has been a rise in wealth and income inequality in many economies, and there is evidence of a slight increase in inequality in Australia (Productivity Commission 2018).

These trends point us to two key conclusions relevant to choosing the most appropriate monetary policy framework for the period ahead.

First, changes in trade patterns and an increased frequency of severe climate events indicate that supply may be less flexible to changes than in the past and may face more frequent disruptions. This suggests more volatile inflation and trade-offs between price stability and employment objectives that are more acute. An appropriate monetary policy framework must function well in such circumstances. As monetary policy is a tool that primarily influences demand in the economy through channels with significant lags, policy makers must be aware of the limits of what it can achieve in such scenarios. Governments need to consider carefully how they can contribute to economic outcomes through fiscal policy, measures to improve productivity, the response to climate change, as well as other structural reform and international cooperation and trade (Carstens 2022).

Second, there is substantial uncertainty about the outlook for the neutral interest rate. It could return to the low levels apparent before the COVID-19 pandemic, with monetary policy close to the effective lower bound, or it could settle somewhere higher. There is some debate about why neutral interest rates have declined in advanced economies over recent decades. Lower economic growth (driven by the demographic and trade trends noted above, among other things), increases in inequality, and other causes of a greater preference for savings than investment are considered important (Mian, Straub and Sufi 2021; Rachel and Smith 2015). There is an ongoing debate about whether these factors will persist for some time (Blanchard (2023) and Summers (2023) provide two perspectives). What matters to the Review is the reasonable chance that they do persist. While central banks can use additional monetary policy tools at the effective lower bound, there appear to be practical limits to how much monetary policy can stimulate the economy by these means. The monetary policy framework must be robust to this, and it may have implications for the relative roles of monetary policy and fiscal policy in stabilising the macroeconomy.

These economic trends, and assessments of their implications, will no doubt evolve in the coming years, which is why the Review recommends that the monetary policy framework is reviewed every 5 years (see Recommendation 4). A changeable economic environment also requires that the RBA's research practices are as robust as possible, and that it has agile analytical processes to respond to emerging economic risks (see Chapter 4).

Recommendation 1: Affirm the RBA's independence and clarify its statutory monetary policy objectives

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1.1   The RBA should continue to have operational independence for monetary policy. The Government should remove the power of the Treasurer to overrule the RBA's decisions.

1.2   The Government should amend the *Reserve Bank Act 1959* such that:

- The RBA has dual monetary policy objectives of price stability and full employment.

- The 'economic prosperity and welfare of the people of Australia now and in the future' is an overarching purpose for the RBA rather than a separate objective for monetary policy.

1.3   The Government should remove the RBA's power (in the *Banking Act 1959*) to determine the lending policy of banks.

The Government should clarify the RBA's role through updates to the RBA Act. By making the RBA's objectives for monetary policy more specific, these changes help make the link between policy decisions and objectives clearer than the existing legislation and improve the ability of the Parliament and the public to hold the RBA to account. The RBA Act would remain an enduring guide to the objectives of monetary policy and the RBA's other operations, with finer details of the RBA's approach to be outlined periodically in the Statement on Conduct. Recommendations for the Statement on Conduct are discussed in Recommendation 2.

These improvements to the job description for monetary policy are complemented by Recommendation 5, which establishes a clear legislative basis for the RBA's financial stability role.

Recommendation 1.1: An independent RBA

Operational independence of the RBA

The Review strongly supports the ongoing operational independence of the RBA. There is a strong case for separating monetary policy decision making from shorter-run government priorities. The consultation and submission process showed widespread support for this independence. There is scope for this to be bolstered through removing the Treasurer's power to overrule decisions.

Independence allows central banks to credibly commit to their objectives. If an elected government controls monetary policy there are risks that it may try to push the economy to run above its capacity, resulting in higher inflation but with no lasting impact on employment. Or it could more easily choose to finance budget deficits by printing money. In either case, government control of monetary policy limits the credibility of any commitment to delivering low and stable inflation.

The evidence and consensus internationally support these arguments for an operationally independent central bank. The independence of monetary policy and the application of inflation targeting frameworks have coincided with an increase in the credibility of central banks' commitment to price stability and lower inflation outcomes (Balls, Howat and Stansbury 2016). There is evidence of this at present across a range of countries including Australia, where market-based indicators suggest that inflation is expected to return to low levels, even in the face of dramatic economic events. This is not causal evidence, but it is certainly supportive. Conversely, where governments have asserted influence over monetary policy settings, such as in Argentina and Turkey in recent years, this has contributed to persistently high inflation and poor macroeconomic outcomes more generally.

Removing the Treasurer's power to overrule RBA decisions

To further enhance the RBA's monetary policy independence the Review recommends the repeal of s 11 (2)-(7) of the RBA Act, which sets out a procedure for the Government to override decisions of the Reserve Bank Board. While no Australian Government has used these override powers, there is the possibility that established conventions cease to be observed. The current legislation creates the risk that the Government wields, or threatens to wield, power in a way that undermines the independent operation of monetary policy. Parliament should define the RBA's objectives and independence through the underlying legislation, without the option for overrule by executive Government.

One area in which the RBA is not independent is in its obligation to act as 'banker and financial agent' of the Government as required in s 27 of the RBA Act. The repeal of s 11 (2)-(7) does not affect this obligation, which the Review considers as compelling the RBA to provide the banking services necessary for the Government to implement its policies.

Box 2.3: The current monetary policy environment and alternative tools for managing inflation

Monetary policy has had primary responsibility for active management of the macroeconomic cycle over recent decades, seeking to stabilise inflation and contribute to full employment. By contrast, fiscal and regulatory policies have tended to focus on other priorities, except for the operation of 'automatic stabilisers' in the tax and transfer system or the stimulus packages implemented during severe disruptions like the Global Financial Crisis or the COVID-19 pandemic. This policy dynamic has existed in Australia and comparable economies. For substantial periods of the last century, the opposite dynamic – with a more passive monetary policy, and more activist fiscal policy – prevailed.

The recent steep increase in interest rates, in response to high inflation and a strong labour market, has drawn considerable attention on monetary policy, its objectives, and the broader public policy response to stabilising inflation. Australians are raising important questions: is the best approach to reducing inflation to increase the interest rate? Is this the only way to address this issue? Can we do better? These questions are important to the Review.

There are two elements that are helpful in working through these questions.

The first element is the nature of the shocks. Recent high inflation has been caused by a combination of supply disruptions and strong demand. On the supply side, Russia's invasion of Ukraine has disrupted global supplies of food and energy commodities. This came in addition to the supply chain disruptions that followed the COVID-19 pandemic and recent extreme weather events. RBA analysis suggests that disruptions to supply account for between half and three-quarters of the recent increase in inflation in Australia (RBA 2023). Strong demand has also contributed to high inflation, especially for goods, driven by changes in consumption patterns and the significant fiscal and monetary policy stimulus that followed the outbreak of COVID-19.

The RBA, like other central banks in advanced economies, has responded to these conditions by raising interest rates. The Governor has said that the Reserve Bank Board hopes to tread a 'narrow path' in moderating demand and keeping expectations for inflation consistent with the inflation target without causing a sharp contraction in employment (Lowe 2022b).

The second element is to understand how monetary and fiscal policies work and what they affect.

Monetary policy affects inflation and economic activity in multiple ways (for example, Atkin and La Cava 2017). Higher interest rates curb household spending by increasing the cost of new and existing borrowing, reducing the disposable income available after debt repayments and increasing the return to savers. Lower asset prices, including house prices, in turn reduce household spending and housing investment. Less spending and investment lead businesses to raise their prices by less, so inflation falls.

Businesses employ fewer people than otherwise, so there is less demand for labour which puts downward pressure on wages growth. Higher Australian interest rates cause the Australian dollar to be more expensive than otherwise, which leads to lower net exports and less inflation imported from overseas. The monetary transmission mechanism can vary over time as the structure of the economy changes.

In these ways, higher interest rates mainly affect inflation by reducing demand. Monetary policy cannot address supply disruptions directly. It is often said that under a flexible inflation target monetary policy should 'look through' temporary disruptions to supply. To respond to temporary disruptions would reduce demand and employment unnecessarily, given inflation should be expected to fall quickly on its own account.

However, current high inflation is being driven by strong demand as well as supply disruptions. Another complication is that recent supply disruptions have been persistent, contributing to a sustained period of high inflation that risks becoming entrenched if expectations change, and high inflation seems normal. These are the two key arguments for restrictive monetary policy at present.

Monetary policy has important distributive effects. Higher interest rates benefit savers over borrowers and disadvantage a small proportion of workers for the benefit of sustainable economic outcomes for Australians as a whole. When interest rates fall, the opposite occurs. Also, by working to keep inflation low and stable, central banks contribute to more stable growth in incomes and employment, reducing the risk of the kind of economic instability that is most harmful to those that can least afford it.

Fiscal policy is much better placed than monetary policy to directly address distributional issues. Monetary policy is sometimes described as a blunt instrument because its distributive effects cannot be calibrated to change their relative impacts. In delegating power to an independent institution, the public and government must understand the distributional impact of monetary policy decisions (Tucker 2019). Fiscal policy's diverse set of tools are better placed to contribute to offsetting undesirable distributional implications of monetary policy.

The Review received several suggestions for using fiscal and regulatory policies instead of monetary policy to manage economic cycles. Proposals included constraining inflation through regulations to support market competition, increased use of price controls, financial regulation, or intervention in supply chains. There were also proposals for delegating some fiscal and regulatory policy powers to an independent institution with a mandate for macroeconomic stabilisation.

Fiscal policy is an important part of managing macroeconomic cycles, but it has limitations. Automatic stabilisers play an important role, and discretionary fiscal policy has been particularly important during recent crises. However, fiscal policy generally faces limitations relative to monetary policy as an active tool for managing the macroeconomic cycle. It may not be as nimble as monetary policy in either the speed of decisions, or ease of withdrawal. Fiscal and regulatory policies can also have undesired impacts, such as on competition or the efficient operation of the economy. Fiscal policy cannot commit as credibly to delivering low and stable inflation, relative to an independent central bank, if still operated directly by the Government. Moreover, monetary policy can be especially important in helping stabilise expectations of future inflation.

Fiscal and regulatory tools also help support a non-inflationary growth environment in ways that extend beyond managing macroeconomic cycles. For example, the Government can set regulations and make investments that support competition, productivity growth and supply chain resilience.

Monetary policy remains a key tool in the economic toolkit for price stability and full employment. Monetary, fiscal and regulatory tools all remain part of the solution to the complex economic challenges that Australia faces. What is especially important at this time is understanding the interaction of these different elements and ensuring that the best outcomes for price stability, full employment and fairness are achieved. That means good information, analysis and clear objectives that are shared between different decision makers in the public sector and with the public. Whatever the case, the central bank's mandate for monetary policy setting, as an independent body, should remain clear.

Recommendation 1.2: Amend the RBA Act to set dual monetary policy objectives

Independence for policy makers is most appropriate when their objectives and tools are well defined, and there is a sound approach to ensuring their accountability to the public. The Review's recommendations seek to support each of these.

The Review recommends clarifying the legislative objectives for the RBA's monetary policy as a dual mandate to contribute to price stability and full employment. A dual mandate provides a more specific basis for monetary policy decisions than the current set of three objectives. It also gives appropriate prominence to full employment alongside inflation while providing flexibility for the RBA to make trade-offs in the best interests of Australians.

In practice a dual mandate is not a substantial departure from the status quo. RBA executives have indicated, at times, that they already consider the objectives of monetary policy in these terms. A dual mandate would make it clearer that these objectives are the central focus of monetary policy and that the RBA Monetary Policy Board is accountable for delivering both.[2] However, this requires specifying that the Board's current third objective – the economic prosperity of Australians – is restated within the RBA Act as the overarching purpose of monetary policy that is achieved through price stability and full employment.

The stability of prices and employment levels are critical to the welfare of Australians

The availability of quality employment is fundamental to the wellbeing of Australians. Beyond the financial benefits to individuals and the broader economic benefits to society, employment can provide substantial psychological benefits. It is clear that unemployment and underemployment are detrimental to people's life satisfaction and happiness (Krueger and Mueller 2012, Wilkins 2007). Moreover, beyond these, other factors such as job security and conditions are important to Australians, but less directly affected by monetary policy. Employment is of more tangible and direct importance to Australians than economic activity, even though the two are closely related. For this reason, the Review supports full employment as an objective for monetary policy rather than an objective related to the level of economic activity.

Price stability also confers significant benefits. Price stability reduces inflation to a second–order issue in people's lives. As a result, the benefits of price stability are easier to demonstrate by the costs of price instability. In focus groups with the community conducted for the Review, it was clear that current inflation rates represent a concerning rise in the cost of living for many Australians (see Box 2.4). High, variable and unexpected inflation increases uncertainty, erodes households' savings, and distorts incentives to invest. High inflation damaged many economies in the 1970s and 1980s, leading to a prioritisation of price stability as a macroeconomic policy objective.

Monetary policy is well placed to contribute to price stability and full employment

Monetary policy has a material impact on inflation in both the short-to-medium and the long run. There are of course other factors that influence inflation, including fiscal and other policies and domestic and international economic circumstances. Consequently, monetary policy cannot control inflation precisely. However, an independent central bank can generally provide a credible commitment to low and relatively stable inflation.

Similarly, monetary policy also has a material impact on real economic activity and labour market outcomes in the short-to-medium run, while not being the sole determining factor.

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2   The Review recommends the creation of a Monetary Policy Board with responsibility for monetary policy decisions. Recommendations in this chapter will refer to the Monetary Policy Board where it concerns responsibility for monetary policy. See Chapter 3 for further discussion.

There are limits to the effect of monetary policy on real economic activity and the labour market, particularly in the longer run

Monetary policy largely takes the productive capacity of the economy as determined mainly by other factors. These include the extent of skill mismatch in the labour market and other 'structural' factors that determine longer-run employment outcomes.

Monetary policy cannot generate, as a matter of course, better longer-run real economy or labour market outcomes by pursuing a higher rate of inflation on average. The only material advantage to a policy of higher inflation could be lowering the probability of the RBA being constrained by the effective lower bound on the policy rate.

However, because price stability is an important foundation for a strong economy, a central bank can contribute indirectly to good real economic outcomes in the longer run. In addition, when monetary policy provides stimulus to moderate an economic downturn, it reduces the scarring in the labour market that tends to occur. In this way, monetary policy may have some additional positive effects on employment outcomes beyond the short term.

An objective for full employment provides balance to monetary policy's objective for price stability

An objective for price stability alone may incentivise monetary policy to generate substantial and undesirable volatility in the real economy and the labour market. This is best demonstrated by a scenario in which there is a prolonged disruption to the economy's supply of goods and services. Disruptions to supply cause inflation to rise, while economic activity and employment decline or at least increase less quickly than would otherwise be the case. A central bank focused solely on inflation might increase its policy rate and exacerbate the employment decline. To the extent that scarring occurs in the labour market, employment may be persistently lower as a result. In that scenario, an approach that pursued low inflation as soon as possible and at any cost would damage overall wellbeing.

In contrast, a central bank with a dual mandate will seek to strike a balance between reining in inflation and minimising the cost to employment, in the short and longer term. Thus, the dual mandate allows the central bank necessary flexibility to adjust its approach to match the nature of the challenges facing the economy.

There is a risk that the Australian economy will face more frequent disruptions to supply in the period ahead, presenting trade-offs between price stability and employment outcomes (see Box 2.2). This makes flexibility in the approach to monetary policy more important, even as the trade-offs make monetary policy decision making more difficult. By contrast, price stability and employment objectives have been aligned for much of the inflation-targeting period. For example, inflation, economic activity and employment rates were likely to be low at times of subdued demand for goods and services. Here, there is no trade-off between the dual mandate objectives. The RBA can lower its policy rate in order to move both inflation towards target and employment rates towards their maximum sustainable level or 'full employment'.

Defining a legislative objective for price stability

Price stability is measurable and so lends itself to a numerical target. This promotes accountability for the performance of monetary policy. Part of the success of inflation targets over the past 30 years has come from central banks' demonstration of a track record of meeting a clear numerical target.

The RBA Act currently prescribes an objective of 'stability of the currency' but the Statement on Conduct suggests the modern interpretation of this is 'price stability'. The Review recommends updating the legislation to match the modern interpretation of this objective, without precluding changes to the flexible inflation targeting framework if appropriate. The RBA Act was written at a time when the Australian currency was pegged to the British pound as part of the Bretton Woods system. The operation of Australian monetary policy has evolved since that time, and it is appropriate that the RBA Act reflects the importance of internal price stability rather than external (exchange rate) stability.

Defining a legislative objective for full employment

In contrast to price stability, full employment is a complex concept that is not directly measurable. Consistent with this, our focus groups of a cross-section of Australians found the full employment objective relatively difficult to understand. It is also more difficult to operationalise for a number of reasons:

- An economy is unlikely to be able to operate sustainably with zero unemployment. A healthy economy is likely to have some small proportion of those participating in the labour market 'between jobs' at any point, because the process of matching jobs and workers takes time and there may be mismatches between the skills, available hours or physical location of those looking for work and available jobs. A reasonable employment objective must take these factors into account.

- Judging how much employment can be achieved without causing undue inflation requires complex modelling and judgement, as it cannot be directly observed and changes over time. Central banks and others that make estimates of the 'natural' unemployment rate or the non-accelerating inflation rate of unemployment point out that these estimates are subject to substantial uncertainty (Chua and Robinson 2018, Cusbert 2017, Ellis 2019).

- Full employment should not be measured by one metric, but rather by a range of indicators. For instance, the extent of underemployment is both important for economic welfare and may have implications for inflation. Other indicators, like the tenure of unemployment and the rate of job separations, provide important perspectives. Wage growth is an important indicator of the balance of supply and demand in the labour market.

Despite the difficulties in measuring it, full employment is a vital objective for good monetary policy.

In order to maintain the operational independence of monetary policy, it is important that the RBA retain independence to judge the specific labour market conditions that are consistent with full employment at any point in time. Nonetheless, it is appropriate for the Government to set a full employment objective for monetary policy, and to reach agreement with the RBA in the Statement on Conduct on the broad considerations for the RBA's assessment of full employment.

Recommendation 2 calls for some improvements to the RBA's approach to meeting its full employment objective.

Welfare of Australians as an overarching purpose

The RBA Act s 10 should be updated so that the RBA's objective to contribute to the 'economic prosperity and welfare of the people of Australia now and in the future' is moved to be the RBA's overarching purpose. This is the appropriate purpose for all the RBA's activities, including its monetary policy, contributions to financial stability, and its roles in the payments system, note issue and as banker to the Government.

With regards to monetary policy, the Review recommends that the 'economic prosperity and welfare of the people of Australia' should not be a specific objective for monetary policy. The legislated objectives for the RBA's monetary policy should be focused on a dual mandate of full employment and price stability, and the third objective should be removed.

The Review heard a range of views on the existing 'economic prosperity and welfare' objective for monetary policy.

- Some in favour of clarifying that it is not an objective for monetary policy suggested that it gave the RBA too much flexibility to determine, without input, what outcomes are in the best interests of Australians. They suggested that this gave the RBA much more flexibility in meeting its mandate than other central banks.

- Relatedly, some suggested that such a broad objective made it difficult to hold the RBA to account for its monetary policy performance.

- Others were keen to see greater emphasis on this objective in the monetary policy framework. In particular, it was suggested that the RBA should play a larger role in the transition to a carbon neutral economy, including through an explicit legislative objective for this. Recommendation 7 discusses central banks and climate change in more detail.

The Review's recommendation reflects the importance of welfare in broad terms as a guide for the RBA's work, while creating the necessary focus of monetary policy objectives that would best match central bank tools and support clear accountability. Focusing monetary policy on price stability and full employment would not preclude the RBA considering a broad array of factors that influence economic outcomes, and from using flexibility in the monetary policy framework.

The RBA Act is the best place to clarify the dual mandate for monetary policy and reposition 'current and future economic prosperity and welfare' as an overarching purpose for the RBA. Chapter 7 discusses non-legislative approaches to implementation and the associated limitations.

Additional objectives for monetary policy

Good monetary policy decisions are based on consideration of a wide range of evidence. That includes some of society's key issues – such as climate change, housing market developments or inequality – which have important implications for inflation and employment. Many of these issues have been discussed by the Reserve Bank Board in recent years.

While these are important considerations for monetary policy, the central bank is not well positioned to adopt these issues as additional legislative objectives for monetary policy. Other Government policies better target these issues. In contrast, monetary policy is a 'blunt instrument' that cannot be targeted to these issues and any contribution it can make would likely come at too great a cost to monetary policy's contribution to price stability and full employment.

Beyond monetary policy specifically, a broad overarching purpose for the RBA – to contribute to 'current and future economic prosperity and welfare now and in the future' – would support the RBA to contribute on broader issues. For instance, many of these issues are relevant to the RBA's work on the financial system and the RBA has an important role in raising awareness of risks and working with other arms of government on potential policy responses in its public communications.

Looking at the Review's views on some of these issues in more detail:

▪ **Housing prices:** The RBA should continue to monitor and communicate the implications of developments in the housing market for monetary policy. Housing prices are influenced by monetary policy but are also influenced by a range of other factors over which monetary policy has no control such as demographic trends, the policies of governments and councils on zoning, transport infrastructure and tax settings. Beyond the cyclical effects of monetary policy, the longer-run downward trend in interest rates – a global phenomenon over which the RBA has little control – has also contributed to the longer-run upward trend in house prices. If monetary policy were to have an objective for lower or more stable housing prices, it would require the RBA to deliver considerably more volatility in inflation and employment. The Review considers that other Government policies are better placed to manage housing affordability through the economic cycle by influencing the balance of supply and demand in the housing market.[3]

▪ **Wealth and income inequality:** Monetary policy has cyclical distributional impacts – as discussed in Box 2.3 – but the Review considers that central banks are poorly placed to target an explicit objective for inequality. Monetary policy, unlike fiscal policy, does not have nuanced tools to influence the distribution of wealth and income. The Review supports an approach where monetary policy focuses on its dual macroeconomic objectives, for which it has appropriate tools, and the Government's fiscal policy takes responsibility for achieving any desired changes in the distribution of wealth and income. It is important that work on measuring and assessing income and wealth inequality, such as the work undertaken by the Productivity Commission in 2018, continues into the future. There is merit in the RBA continuing its research into income and wealth inequality in Australia and examining the distributional impact of monetary policy (Australian House of Representatives 2022).

▪ **The transition to a low carbon economy:** This topic is examined in Recommendation 7.

Recommendation 1.3: Removing the power to direct lending policies of private banks

The RBA Act includes broad powers for the RBA, including powers to transact in financial markets. These powers are fundamental to the smooth operation of monetary policy, and critical for the RBA to meet its objectives.

The RBA also has other powers in legislation, including the power to direct the lending activities of banks. Section 36 of the *Banking Act 1959* states:

> *"Where the Reserve Bank is satisfied that it is necessary or expedient to do so in the public interest, the Reserve Bank may determine the policy in relation to advances to be followed by ADIs [banks]."*

This power was created when the RBA had responsibility for the supervision of the banking sector, a responsibility that was transferred to APRA in 1998. In line with its mandate, APRA now has powers that allow it to influence the behaviour of financial institutions, including setting rules regarding banks' lending activities for purposes of financial safety and financial stability. In recent years, APRA has introduced limits on higher-risk residential mortgage lending to reduce financial stability risks.

The RBA does not need, nor should have access to, powers that enable it to direct the lending activities of banks. The RBA no longer has supervisory responsibilities for the banking sector – banks are licensed and supervised by APRA. APRA is accountable for maintaining financial safety and stability and has been provided with appropriate powers to do so. The power under s 36 is significant for an independent body to wield without a clear link to its role.

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3 Some overseas central banks have been instructed to consider housing prices in their pursuit of their objectives, though this is not a goal in and of itself for monetary policy. For example in 2021, the Reserve Bank of New Zealand was directed to consider the government's housing objectives in setting its financial stability policy. In New Zealand, the central bank has a broader toolkit than the RBA, including control of macroprudential policy. The Reserve Bank of New Zealand was also directed to assess how its decisions on monetary policy affect house price sustainability, though this does not appear to have altered the way that the decisions themselves are made.

While some stakeholders have suggested that banks should be directed to do 'green lending', this is not an appropriate power for the RBA to exercise independently. This type of policy should be the responsibility of elected officials and be subject to legislative processes.

Box 2.4: Views on the RBA's role from the general public

The Review undertook a series of focus groups with members of the public. These conversations ensured that the voices of a cross-section of Australians were heard by the Review, with a particular focus on the public's understanding and perceptions of the RBA. Separately, the Review received submissions from members of the public on a range of issues within the Review's Terms of Reference.

The public round tables raised four key themes:

1. The current economic context is challenging. Australians are facing pressure from high inflation. Participants of the focus groups experienced this directly from higher prices and higher interest rates. Some participants identified the reasons why interest rates were rising, while some were sceptical about the logic of raising interest rates to reduce high inflation. There were concerns that some households face a greater burden from higher interest rates than others. For the Review, these conversations underscored that price stability is important for Australians and that the direct effects of the RBA's tools (on borrowers and lenders) are more obvious than the less direct effects (on underlying economic conditions).

2. There is broad trust in the RBA. Some recognised that the RBA's actions were successful during the Global Financial Crisis or other periods and indicated that this had helped develop trust. Some comments were caveated that this trust was 'blind' trust or 'hope', given the complexity of the issues the RBA deals with. The Review saw this observation as consistent with the conclusion that the RBA's monetary policy had contributed to good economic outcomes over recent decades. These conversations also highlighted the importance of the RBA's institutional reputation and the value of evaluating the RBA at regular intervals to support and enhance the institution and its reputation.

3. The RBA's inflation objective is better understood than the employment objective. Some participants identified that the RBA has an inflation target, while most were unfamiliar with the employment objective. This may reflect, in part, the current economic context in which high inflation is a pressing issue. It was unclear to some participants how the role of the RBA differed to that of the broader government. For others this distinction was clear, and the RBA's independence was understood. These conversations highlighted the challenges associated with communicating the RBA's employment objective.

4. The public learns about the RBA through second-hand sources. Media sources were the primary way participants received information regarding the RBA. Most noted they pay little attention to the RBA – or indeed the broader macroeconomy – except when developments influence them directly, for instance, when interest rates are moving or someone they know loses a job. The RBA is generally seen as an organisation that is knowledgeable and expert. Some expressed views that it is technical, faceless, and disconnected from the impact of its decisions. Others raised that they would like to see both more honest communication, as well as a clear indication of where there is uncertainty. The Review concluded that there are substantial challenges for the RBA to inform Australians about its policies, given the complexity of the issues and the public's narrow bandwidth to engage with communication and that the news media plays a crucial role.

The full report on the focus groups can be found at: www.RBAReview.gov.au

Recommendation 2: Keep a flexible inflation targeting framework but clarify how it operates

Recommendation 2: Keep a flexible inflation targeting framework but clarify how it operates

2.1   The RBA Monetary Policy Board (see Recommendation 8) and the Government should agree in the *Statement on the Conduct of Monetary Policy* that:

- equal consideration should be given to price stability and full employment in setting monetary policy

- there should be a flexible inflation target of 2-3 per cent

- the Monetary Policy Board should aim for the midpoint of the inflation target in order to maximise the chance that the target is met and best anchor inflation expectations

- the Monetary Policy Board should set out its assessment of its full employment objective, as reflected in a range of relevant indicators of labour market conditions

- the Monetary Policy Board has the flexibility to vary the timeframes over which it aims to bring inflation back to around the midpoint of the target, taking into account the full employment objective, when significant deviations occur.

2.2   The *Statement on the Conduct of Monetary Policy* should outline how the RBA Monetary Policy Board will communicate its use of the framework's flexibility including expectations that the RBA will, in its regular communications:

- explain how long inflation is expected to be materially away from the midpoint of the target and why, how long labour market conditions are expected to deviate from full employment and why, and how it is balancing its two objectives

- explain the key factors affecting its decision making, such as financial stability risks which should be a consideration in monetary policy decisions to the extent that they may influence the price stability and full employment objectives.

The operational framework used by the RBA to pursue its monetary policy objectives is broadly fit for purpose. There is scope for the operational framework to be specified with greater clarity, which has the potential to improve monetary policy decision making, communication and accountability. These changes do not require changes to legislation and can be implemented through changes to the Statement on Conduct.

Recommendation 2.1: Refining the flexible inflation targeting framework

The Review supports the RBA's flexible inflation target of 2-3 per cent. This recommendation proposes refinements to support stable expectations around the midpoint and clarify the use of flexibility.

A flexible inflation targeting framework remains suitable

Retaining a flexible inflation targeting framework is supported by the balance of the evidence, including the Review's assessment of the performance of the RBA in Chapter 1, and the research to date on inflation targeting and alternative frameworks.

The success of, and broad understanding of, flexible inflation targeting means the bar is high for adopting a different framework, especially given the risk that this could de-anchor inflation expectations or otherwise confuse understanding of monetary policy. The Review assessed the merits of alternative frameworks against this risk, based on how well they might achieve the monetary policy objectives of the RBA. The factors considered included:

- how effectively it can be communicated to support the public's understanding of monetary policy

- whether it supports stable inflation expectations

- whether it is robust to the challenges posed by the economic outlook, particularly in terms of how it handles disruptions to supply

- how trade-offs can be managed to support the achievement of both monetary policy objectives.

There is a material body of research that has considered the merits of alternative frameworks. Central banks overseas have assessed alternative approaches and generally supported flexible inflation targeting, noting that in 2020 the US Federal Reserve introduced a flexible average inflation target (Federal Reserve 2020; Bank of Canada 2021; European Central Bank 2021). The supporting research included model simulations, surveys and focus groups run by the central bank, and some externally authored research.

In the Australian context, there is a small but growing body of research on the potential performance of alternative frameworks. For instance research around adopting the inflation target in the 1990s suggested that inflation targets or nominal income targets might perform similarly well (including de Brouwer and O'Regan 1997; Edey 1997; McKibbin 1997). More recent Australian research has pointed to the successful anchoring of inflation expectations and the challenges and opportunities that presents for inflation targeting (for example Gillitzer and Simon 2015). Some research has pressed the case for a nominal income target including McKibbin and Panton (2018) and Kirchner (2021). Other research has suggested that nominal income targets perform poorly compared to a flexible inflation target, and that some variants of flexible inflation targeting may outperform others (Gross 2023).

While some research suggests that alternative frameworks such as nominal income targets would be better suited, the Review did not find sufficiently strong evidence to support a switch to an alternative framework. The bulk of the consultations conducted by the Review supported the flexible inflation target framework because it had performed well and was understood by the public. Alternatives that introduce 'make-up' strategies or nominal income targets may perform well in particular circumstances, but they also have disadvantages relative to flexible inflation targeting.

The Review has also identified opportunities to refine the flexible inflation targeting framework, which are described in the following sections.

Appendix 2 includes a summary of the possible benefits and limitations of alternative frameworks, including average inflation targeting, price level targeting, nominal income level targeting and nominal income growth targeting.

Be clear that the framework gives the dual mandate objectives equal consideration

The Review supports the equal consideration of monetary policy's objectives for price stability and full employment and recommends this is emphasised in the Statement on Conduct.

A flexible inflation targeting framework presents to some as focusing on the price stability objective over the full employment objective. However, a central bank is able to give equal consideration to both objectives within such a framework, when those objectives are considered over the medium run. In fact, other central banks with dual mandates also use flexible inflation targeting frameworks. This recognises two things:

- That flexibility within the inflation targeting framework allows for both objectives to be weighed when they are in conflict in the short term. For example, if inflation is above target and employment below target following a protracted supply disruption, the RBA can seek to return inflation to target more gradually than otherwise in order to foster better employment outcomes. At other times, the two objectives will not be in conflict and it is more straightforward for monetary policy to contribute to both.

- That price stability is an important foundation for a strong economy, including good employment outcomes over the medium run. In the example of a protracted supply disruption, price stability may be emphasised in the short term, even as some weight is given to minimising the cost to employment. In so doing, monetary policy is supporting good outcomes for both objectives over the medium run.

Equal consideration of the objectives does not prescribe a fixed decision rule for how monetary policy should respond to all economic circumstances. These decisions are complex and the Monetary Policy Board is best placed to determine the appropriate action in the face of deviations from the inflation and employment targets.

A 2-3 per cent target is appropriate

The Review supports a flexible inflation target of 2-3 per cent. It is well understood, it is credible to the public, and has supported good economic outcomes. There is sound evidence that it has supported stable inflation expectations over the past three decades (see Chapter 1: Performance). It is appropriate in both its level and range.

- **Level of the target:** The Review recommends that the level of the inflation target remain such that its midpoint is 2½ per cent. The Review heard arguments for both a higher and a lower target and has noted the mix of views in academic literature (Lockyer 2022). A higher target would have the benefit of increasing distance between the nominal neutral interest rate and the effective lower bound on the policy rate, increasing the capacity of monetary policy to respond to downturns with the cash rate, before facing the effective lower bound. It would come at the cost of higher inflation on average, which would have redistributive effects on announcement (benefiting borrowers relative to savers) and increase bracket creep in the tax system.

  Regardless of the merits of higher inflation in general, the Review does not recommend increasing the inflation target during the present period of high inflation. To do so could undermine the credibility of the RBA in responding to future periods of above-target inflation.

  A lower target would also not be appropriate. It would exacerbate the constraint of the effective lower bound during downturns, and in the short run, would make it even more difficult for the RBA to balance its employment objective as it seeks to moderate current high inflation.

  The Review does not consider there to be a fundamental issue with Australia having a slightly higher average level of inflation to other similar economies.

- **Range of the target:** The Review is comfortable with a target range of 2-3 per cent, since consultations suggested it was well understood and is consistent with the idea that it is not possible to control inflation with any great precision. A range target provides the RBA with reasonable leeway when being held accountable after the fact for inflation outcomes.

Aim to keep inflation at the midpoint

In retaining a 2-3 per cent target, the Monetary Policy Board should clarify that it sets policy with the aim of keeping inflation around the midpoint of the target. Aiming for the midpoint will maximise the chance that the target is met. In addition, providing a consistent focal point for future inflation should help to better anchor inflation expectations in the centre of the range.

A focus on the midpoint of the target in setting policy will also support the communication of and accountability for the RBA's monetary policy decisions. This is particularly the case where the RBA is making trade-offs between its dual objectives or making intertemporal judgements about how to contribute to its objectives (for example, by judging that more expansionary policy settings would stoke financial vulnerabilities and put at risk the dual objectives in the future). The increased clarity for close observers of the RBA can be achieved without changing the existing target range, which is familiar and well-established in public perception.

A range target without a focus on the centre provides a less clear guide to the direction of future policy. For example, markedly different policy paths might be required to bring inflation to 2 per cent rather than 2½ per cent or 3 per cent, at a given horizon. A range target without setting an emphasis on the midpoint implies the RBA is indifferent between these different outcomes, creating greater uncertainty among observers about the outlook for the policy rate and the economy.

It follows that where the RBA is close to the edges of its target range (as well as outside), it should aim for the middle – this should continue to negate any view that the band is a 'zone of inaction'. The consequence is that in practical terms, the RBA should be comfortable with inflation that is close to the midpoint.

Substantial flexibility would remain in the monetary policy framework, even with an approach of aiming for the midpoint of the target range. The framework already provides the RBA with the flexibility to vary the horizon for bringing inflation back to target (to best meet its employment objective). The further degree of flexibility afforded by the target range is arguably unnecessary and reduces the clarity of the framework.

The existing target range remains the best way to judge the RBA's performance ex post. This appropriately recognises that attempts to control inflation will be imprecise, and that inflation is subject to unexpected fluctuations. All outcomes within the band should be considered a success ex post.

Provide its assessment of full employment

The RBA should better explain its understanding of the employment objective and how it uses flexibility to balance trade-offs between employment and price stability.

At present, it is unclear how the RBA considers its full employment objective in monetary policy decisions which makes it difficult to assess the success of the RBA in achieving its full employment objective. Full employment is inherently a more complex objective than price stability. This means that the RBA should place more emphasis on communicating how it considers its employment objective.

In particular, such communication should include:

- The role in general of the employment objective within its framework, affirming that it receives equal consideration alongside price stability.

- The RBA's best assessment of full employment at any point time, including the RBA's estimates of the non-accelerating inflation rate of unemployment, and other relevant factors, as appropriate.

- The way the RBA is approaching trade-offs or complementarities of its two monetary policy objectives in making its decisions.

Flexibility refers to the period to return inflation to target and reach full employment

The flexibility within the framework refers to the timeframe to pursue the inflation target and employment target in the face of significant deviations, rather than flexibility in the target itself. With greater focus on the midpoint of the inflation target, the RBA would still have substantial flexibility to decide on the best time frame to return inflation to around 2½ per cent. Equivalently, the RBA has flexibility in the time it takes to reach full employment where deviations occur, while noting that the RBA's assessment of full employment is subject to change according to its assessment.

The current time frame for the inflation target, 'on average, over time' is unhelpfully imprecise (see for example Preston 2019). It offers little guide to monetary policy decision makers about the speed with which to return inflation to target and does not support either ex ante or ex post accountability for monetary policy decisions. The Review recommends removing 'on average, over time' from the Statement, but does not recommend replacing it with a prescriptive time period (say, 2 years). The RBA must retain flexibility in the time frame for how it pursues its two targets, so it can properly balance its dual objectives in the face of diverse economic circumstances. The RBA has highlighted the value of this flexibility in recent speeches (Lowe 2022b).

The Review does not suggest prescribing a particular time frame over which to evaluate ex post performance against the inflation target range. Instead, the RBA should be held accountable for the plausibility of its policy strategy at each point in time, and for the validity of the reasons for ex post deviations from the target range over any given period.

Recommendation 2.2: Explain how the RBA uses flexibility in the framework

There are two areas in which the RBA could better explain the flexibility in the monetary policy framework, and in doing so strengthen its communication.

Explain the timeframe to return to inflation and employment to target

Recommendation 2.1 set out that flexibility in the framework refers to the time frame for the RBA to return inflation to around the midpoint of the target and attain full employment. Where the RBA exercises its flexibility, it is appropriate that it explains this to the public.

The RBA should commit to clearly explain how it is using this time-period flexibility at each decision point. When inflation moves significantly away from the midpoint of the target, the RBA should explain its plan to return inflation to around the midpoint including how long it expects this to take.

Equivalent communication should occur regarding full employment. Further to setting out its assessment of the full employment objective (Recommendation 2.1), the RBA should explain how long employment will deviate from full employment and why. The RBA should also note how its approach is balancing monetary policy's dual objectives.

Explain the role of financial stability in monetary policy

The role of financial stability in the monetary policy framework should be clarified. Financial vulnerabilities should be considered in monetary policy decision making to the extent they may influence the price stability and full employment objectives.

A key area of focus in the Review's consultations was how vulnerabilities in the financial system influence the RBA's monetary policy decisions. A range of perspectives were put forward. Some suggested that the RBA's monetary policy considered financial stability as part of its 'economic prosperity and welfare' objective; others thought that financial stability was considered via its expected impact on economic outcomes (including on price stability and employment).

Greater clarity on this issue has the potential to improve the RBA's decision making, communication and accountability, as well as improving the coordination of monetary policy and APRA's macroprudential policy.

Financial instability and cycles in indebtedness can create significant economic instability that exacerbates economic downturns and impedes recovery. The Asian Financial Crisis of the late 1990s, the Global Financial Crisis of the 2000s and European debt crisis of the 2010s are key examples. Clearly financial system stability is an important prerequisite to the RBA's objectives of price stability and full employment.

A more contentious issue is whether the RBA should seek to use the cash rate or other monetary policy tools to try to limit growth in vulnerabilities in the financial system (including on household or business balance sheets). Evidence shows that monetary policy influences risk taking, growth in debt and asset prices and so can influence vulnerabilities in the financial system. However, easier monetary policy also promotes employment and economic activity. There is significant debate about both the efficacy and the trade-offs of using the policy rate to manage vulnerabilities to the financial system.[4] There is also debate about whether this was an important factor driving Australian monetary policy in 2016-2019 (see Chapter 1).

On balance the Review recommends that financial stability risks should be considered in setting monetary policy to the extent that they may affect the RBA's dual monetary policy objectives. Macroprudential policies, among other financial system safeguards, can provide a more targeted approach to mitigating risks to financial stability (see Recommendation 6 for further discussion of the coordination of monetary and macroprudential policies). The Council of Financial Regulators should be a forum to facilitate collaboration and coordination of financial stability policies among Australia's financial regulators.

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4   See for example Saunders and Tulip (2019), Svensson (2017), Borio (2016), Gourio, Kashyap and Sim (2017) for a range of perspectives.

There are, however, limitations to what macroprudential policy can achieve, and it may not be appropriate in all instances. APRA's actions can have direct impacts on financial institutions' resilience and risk taking, but asset prices or indebtedness can only be impacted indirectly. There can also be sources of risk outside APRA's or other authorities' regulatory perimeters. Failing to account for these risks would be counterproductive to the RBA's ability to meet its long-term objectives. It is important, therefore, that the RBA retains flexibility to set monetary policy in a way that accounts for the potential impacts of vulnerabilities in the financial system on price stability and full employment.

The Review's recommendation provides the RBA with flexibility to contribute to price stability and full employment over the longer term as well as the shorter run. However, this flexibility requires careful analysis and greater transparency. The RBA must ensure that its judgements in this regard, and the evidence it relies upon, are as clear as possible, both internally and in public communication. The Review recommends a greater focus from the RBA on communicating how financial stability concerns are incorporated into monetary policy decisions. Greater clarity on this issue will come, in part, from focusing the discussion on how financial stability contributes to price stability and full employment.

Recommendation 3: Promote a better understanding of the relative roles of fiscal and monetary policy

Recommendation 3: Promote a better understanding of the relative roles of fiscal and monetary policy

3.1   The *Statement on the Conduct of Monetary Policy* should acknowledge the importance of both monetary policy and fiscal policy for macroeconomic outcomes. The Government (in particular Treasury) and the RBA should commit to:

- continue to regularly share information about the economic outlook, risks and policy constraints

- work together to analyse the impacts of monetary policy decisions on fiscal policy, and the impacts of fiscal policy decisions on monetary policy

- jointly develop scenario analysis that identifies the best combination of policy responses to economic challenges, in ways that do not compromise monetary policy independence

- identify how the RBA's monetary policy framework and the Government's fiscal approach can together best support good economic outcomes and acknowledge that fiscal policy may have a larger role in some circumstances, for example when the cash rate is at its effective lower bound.

3.2   The RBA and Treasury should develop an Australian Macroeconomic Policy Research Program to promote applied research and analytics on Australian monetary, fiscal and financial policy, working with universities and think tanks that have such programs.

3.3   The RBA should publish a framework for the use of additional monetary policy tools in the future. The *Statement on the Conduct of Monetary Policy* should set out what the framework will cover, including the expectations of the Government and RBA Monetary Policy Board around:

- transparency

- assessing costs and benefits

- managing risks

- considering exit strategies at the outset for different scenarios

- discussions on the appropriateness of fiscal policy as an alternative policy lever.

Within the agreed framework, the RBA should retain instrument independence.

Policy makers must recognise the significant interactions between the objectives and effects of monetary policy and fiscal policy in order to fulfil their mandates. As part of this, some cooperation is desirable. The case for cooperation is even greater to the extent that monetary policy is frequently constrained by the effective lower bound or faces more frequent supply disruptions. This recommendation would recognise the roles of fiscal and monetary policy in supporting sound macroeconomic outcomes, strengthen cooperation without weakening monetary policy independence, and build a better knowledge base on Australia's key macroeconomic policies.

Recommendation 3.1: Acknowledge the interaction of fiscal and monetary policy and support cooperation between policy makers

The Statement on Conduct should explicitly acknowledge that fiscal policy, alongside monetary policy, contributes to inflation and employment outcomes. Any belief that these outcomes are solely under the control of monetary policy risks diminishing the responsibility of Government and setting unrealistic expectations of the RBA. As well as seeking to provide greater transparency and clearer accountabilities, the Review's recommendation seeks to support stronger coordination between fiscal and monetary policy, without undermining monetary policy's operational independence.

Information sharing arrangements

Sharing information, such as on the economic outlook, risks and policy constraints, between the RBA and Treasury is crucial for ensuring that Australia's key macroeconomic policies are deployed effectively. It is important that this is facilitated not only through the Treasury Secretary's position on the Reserve Bank Board, but also through various levels across the RBA and Government. The Review recognises the value of the existing cooperation arrangements and encourages the RBA and Government to look for further opportunities. Conversations about policy and the economy should not be seen as a risk to the RBA's independence.

Consider respective policy impacts

Fiscal and monetary policy makers must consider the impact of the other's policies on their objectives (Leeper 2023). These considerations should be embedded across analysis, including modelling, and decision making. More specifically, the RBA should consider the implications of current and expected fiscal settings under currently announced policies as well as credible alternative scenarios. This should include consideration of the likely fiscal response to RBA policy changes, if any. As noted in the discussion of Recommendation 9.4, this requires sufficient modelling capability to conduct scenario analysis that includes fiscal policy and the RBA has recently expanded the detail on fiscal policy in one of its key macro models. Likewise, Treasury should consider not just the expected path of RBA monetary policy, but also consider how changes in fiscal policies may result in changes to monetary policy settings.

Undertake joint scenario analysis

RBA and Treasury counterparts should undertake joint scenario analysis exercises to prepare for challenging circumstances. Contingency plans help to identify the best combination of policy responses for circumstances such as protracted disruptions to supply, financial crises or other adverse events that might push the central bank policy rate to its effective lower bound. They promote a mutual understanding of risks, for example those related to additional monetary policies that may increase the government's liabilities (Leeper 2023). Contingency planning can also build relationships, networks and trust that are especially important in times of stress and crisis. These exercises should build the evidence base for the best policy approach to different scenarios. This would support timely policy formulation (both preventative and responsive) and decision making should similar circumstances arise, including the potential for explicit coordination between monetary and fiscal policy when the economy experiences substantial disruption, like the Global Financial Crisis or the pandemic. A form of contingency planning already exists in the Council of Financial Regulator's agreement on the approach to financial distress management (CFR 2008).

In addition to the approach to financial distress management, the Review's proposal is for broader discussions of macroeconomic policy. Model projections of various up and downside scenarios and alternative policy responses could provide a coherent foundation for discussion (Leeper 2023). This recommendation does not prescribe that fiscal and monetary policy should be set in an explicitly coordinated way. The RBA and Government must determine their policy settings independently, taking into account their individual objectives and constraints as well as the lessons from the scenario analysis exercises.

Long-term frameworks should be compatible

Fiscal and monetary policy will perform best if their long-term frameworks are aligned. The Review heard views about times at which fiscal policy and monetary policy were pulling in the same or opposite directions. Given that the objectives of fiscal policy are much broader than those of monetary policy, some degree of this may be inevitable at times. However, good policy frameworks should minimise unnecessary conflict.

While the Review's recommendations generally focus on the RBA and changes to the Statement, there is value in recognising fiscal policy's role in price stability and full employment in the Australian Government fiscal strategy (as normally included in Budget Paper 1). In the most recent fiscal strategy, the Government indicated that full employment is one of the objectives of fiscal policy, as well as inclusive and sustainable growth. The strategy also acknowledges an immediate priority of not adding to inflationary pressures, at a time of high inflation. The Review supports these inclusions in the strategy. Contributing to inclusive and sustainable growth requires that fiscal policy makers consider their influence on inflation dynamics. Beyond these issues, it should be acknowledged that fiscal policy may have a greater role in contributing to inflation and employment outcomes for example when monetary policy is constrained by the effective lower bound or when responding to some large scale supply disruptions.

Recommendation 3.2: Sponsor a research program on fiscal and monetary policy

The Review recommends that the RBA and Treasury sponsor a joint policy program for work on fiscal and monetary policy in the Australian context that draws in universities and think tanks that have relevant research programs. Relevant international organisations might also have a role.

This Australian Macroeconomic Policy Research Program should strengthen the knowledge base of fiscal and monetary policy related issues, support collaboration across participants by fostering connections and a good understanding of research priorities, and develop the capabilities of experts in this field within Australia. It should provide an evidence base for policy decisions and inform the scenario analysis exercises described in Recommendation 3.1.

Program participants should establish a research agenda of common interest that would be suited to collaboration. Research priorities should include an understanding of more frequent supply shocks and financial market crises, and how they should be approached by monetary and fiscal policy. Other possible topics could include the role of automatic fiscal stabilisers, the impact of additional monetary policies and the feasibility of fiscal rules. Researchers should examine the optimal policy mix between monetary and fiscal instruments, and assess the distributional impacts of policy choices.

A monetary and fiscal policy research program would also support the objectives of Recommendation 11.4, to strengthen the role of RBA research, set the RBA as a thought leader, and draw on a broad knowledge base in the formulation of monetary policy.

Recommendation 3.3: Articulate a framework for additional monetary policy tools

The Review acknowledges that the RBA may again need to use additional monetary policy tools if the effective lower bound constrains the cash rate in future (see Chapter 1 for discussion of additional monetary policy tools). It is important that the RBA retains flexibility and, within the authority granted by the RBA Act, independence in its choice of tools.

This independence obliges the RBA to be transparent about its considerations when choosing to use additional monetary policy tools.

The Review recommends that the RBA articulate a clear framework to explain how additional monetary policy tools might be used in the future. Research commissioned for the Review on the RBA's use of additional monetary policy tools concludes that there would be benefits from a 'more systematic policy framework' (Orphanides 2023).

The framework should detail:

- the available policy tools, the channels through which each operates and their estimated impacts

- the benefits, costs and risks of available policy tools, drawing on Australian and international evidence and research

- independent expert assessments of the RBA's use of additional policy tools, with Orphanides (2023) being a good example

- how it intends to weigh these various considerations when deciding on the choice and sequencing of policies

- implementation considerations and exit strategies

- the RBA's overall assessment of each tool, including how likely it would be to use each tool.

The RBA has begun the process of reflection on the use of additional monetary tools in its public reviews. However, it has not yet drawn together this analysis to explain overarching considerations. Such a framework would help formalise and embed lessons from the pandemic, both from the Australian and international experience. The paper produced by Orphanides (2023) for the Review is a step in this direction. It identifies lessons from the recent period, as well as providing insight into how additional monetary policy tools could be used more effectively in the future.

This framework should be made public to encourage external scrutiny and build public understanding about additional monetary policy tools. It would also clarify the RBA's own thinking and encourage the RBA to explain when that thinking evolves, which may in turn draw out other relevant ideas and perspectives. For example, the RBA had done some preparatory work on a potential package of monetary tools ahead of the pandemic (see Chapter 1). However, the package introduced in March 2020 differed in important respects, without explanation in Reserve Bank Board papers. A public framework would have required the RBA to clearly explain its choices.

The RBA should agree what this framework would cover with the Government in the Statement on Conduct, including joint expectations for transparency, assessments of costs and benefits, managing risks, and discussions on the appropriateness of fiscal policy as an alternative policy lever. The Statement on Conduct should emphasise that the RBA retains independence to choose its monetary policy tools within the framework.

Recommendation 4: Institute regular reviews of the monetary policy framework and tools

Recommendation 4: Institute regular reviews of the monetary policy framework and tools

4.1   The Government and RBA Monetary Policy Board should instigate a formal review of the monetary policy framework and tools every 5 years, jointly led by the RBA and Treasury and including formal and transparent input from independent domestic and international experts with a wide range of viewpoints. The purpose of the review should be to ensure the monetary policy framework and tools remain appropriate, and it should inform the renewal of the *Statement on the Conduct of Monetary Policy.*

Regular reviews of the RBA's monetary policy framework and tools will ensure that monetary policy contributes as effectively as possible to its legislated objectives. Future reviews will ensure that the RBA's frameworks and operations remain the best approach as the economy and our understanding of it can evolve over time.

Organisations perform best where their goals, processes and instruments are assessed and improved upon. In the case of the RBA, the legislated objectives for monetary policy should be enduring, while adjustments to the RBA's monetary policy framework and toolkit may be required very occasionally. In contrast, adjustments to the RBA's internal operations should be required frequently, with these adjustments managed by senior RBA staff and supported by recommendations from the APS Capability Review program (see Recommendation 13.2).

Prior to this Review, there had been some evaluation of elements of the RBA's framework and tools from time to time. This had taken place at RBA conferences, in Reserve Bank Board papers, and in some recent evaluations of specific policy responses to the COVID-19 pandemic. The RBA had also engaged external experts for a review of its forecasting processes (Pagan and Wilcox 2015). These methods of review did at times incorporate perspectives external to the RBA, but are not regular or supporting ongoing evolution.

This recommendation would align the RBA with standard practice of central banks elsewhere. For example, reviews of the policy framework are required at regular intervals at the Bank of Canada and the Reserve Bank of New Zealand. Others are less structured, for example the US Federal Reserve and the European Central Bank. Across the Review's consultations and submissions, some advocated for a regular review process for the RBA, while others highlighted that review processes can strain the capacity of central bank staff.

The Review recommends that future framework and tools reviews are undertaken every 5 years, led jointly by the RBA and Treasury with input from domestic and international experts. The reviews might include an assessment of how the framework has operated over the previous period, and an assessment of how it could compare to plausible alternatives in the future. The specific scope of each review should be defined by a set of focused questions that are agreed by the Monetary Policy Board and Government.

Each review should be published in full and should be used by the Monetary Policy Board and the Government as evidence when considering updates to the Statement on Conduct. In general, material changes should not be made to the Statement on Conduct upon changes in Government, consistent with the bipartisan support of the monetary policy framework over the past 30 years.

Recommendation 5: Legislate the RBA's financial stability role

Recommendation 5: Legislate the RBA's financial stability role

5.1   The Government should specify in the *Reserve Bank Act 1959* that the RBA has a responsibility to contribute to financial system stability, in cooperation with other government agencies, especially the Australian Prudential Regulation Authority (APRA).

The Government should legislate the RBA's financial stability responsibilities in the *Reserve Bank Act 1959* so that there is a clear basis for its role.

There is currently no explicit financial stability responsibility for the RBA in legislation (excluding the responsibilities of the Payments Systems Board). However there is broad acceptance of the RBA's financial stability responsibilities. These are set out across a range of documents, including the Statement on Conduct, RBA's memorandums of understanding with APRA and other members of the CFR, and RBA publications, including its website and some speeches. APRA has a defined financial stability role in legislation.

It is important that there is a clear statutory basis for the RBA's contribution to financial stability. This will reinforce accountabilities and strengthen the foundation of cooperation arrangements with other agencies that share a mandate for promoting financial stability, particularly APRA (see Recommendation 6).

The statutory changes and associated changes to the Statement on Conduct should clarify that there are several ways in which the RBA is expected to promote financial stability, including by:

- setting monetary policy to contribute to price stability and full employment, both of which contribute to – and rely on – a smoothly functioning financial system

- providing liquidity to institutions and markets, including as lender of last resort

- collaborating with other government agencies with shared responsibilities, especially APRA

- oversight of the payments system (which is already legislated).

The RBA also has a role in contributing to the broader process of monitoring, research and policy formulation among Australia's financial regulators.

Recommendation 6: Reinforce cooperation arrangements for promoting financial stability

Recommendation 6: Reinforce cooperation arrangements for promoting financial stability

6.1   The Council of Financial Regulators should renew memorandums of understanding between its members so that there is:

- clarity on the outcomes the group is responsible for delivering and the specific roles of each agency

- a shared responsibility for identifying regulatory gaps at a 'whole of system' level

- a shared commitment to reduce the risks posed by such gaps.

6.2   The RBA Monetary Policy Board should commit to inform the Council of Financial Regulators when monetary policy is likely to affect, or be affected by, risks to financial stability. This should include formal advice from the RBA to APRA on its use of macroprudential tools. This advice to CFR and APRA should be published after 5 years.

6.3   The RBA and APRA should update their public memorandum of understanding so that it sets out clear and specific commitments to cooperation in promoting financial stability, including the way APRA consults the RBA on macroprudential policy settings.

The overlapping responsibilities for financial stability between Australia's financial regulators make close coordination essential. Failure to identify risks or use the most appropriate tool to respond to risks would come at a cost, including potentially to system stability.

Reinforcing the relationship between the RBA and APRA, with arrangements that support clear communication and accountabilities, is particularly important in the context of this Review.

Recommendation 6.1: Renew memorandums of understanding across the Council of Financial Regulators

Stakeholders generally considered that cooperation between Australia's financial regulators had been effective in mitigating financial stability risks. They highlighted the role of the CFR, in particular, in coordinating policy actions in times of stress. The CFR brings together the Australian Securities and Investments Commission, APRA, RBA and Treasury.

The Review heard that Australia's response to COVID-19 and the Global Financial Crisis were seen as key strengths of the financial regulatory system, with stakeholders noting that regulators had acted decisively and collaboratively. Stakeholders suggested that, in times of crisis, regulators were not excessively rigid or narrow in interpreting their mandates and focused on a whole-of-system response.

However, the Review also heard some criticisms of existing cooperation arrangements. Some stakeholders noted a general lack of clarity regarding how agencies work together, what each was responsible for and how agencies would seek to address perceived gaps in the regulatory architecture. In addition, Kashyap (2023) – in a paper commissioned for this Review – highlights some specific concerns about how the CFR agencies work together on financial stability policies. The recent stresses in the US and European banking sectors, at a time when interest rates globally have been rising in response to high inflation, underscore the important interactions between financial stability and monetary policy and the value of close cooperation and clear processes among financial regulators.

The Review recommends that memorandums of understanding across the CFR be updated, with a greater focus on the outcomes the group is responsible for delivering. Existing commitments to cooperation tend to be expressed in passive terms, with the group's Charter noting, for example, that "the Council of Financial Regulators aims to facilitate cooperation and collaboration between member agencies".

Stronger commitments to cooperation are needed, with greater clarity on the outcomes the CFR is responsible for delivering. It is important that agencies are clear on their individual accountabilities and how they work collectively to ensure a whole-of-system response. This includes where risks might be outside traditional regulatory perimeters. Strategy sessions to identify new risks could be an important supplement to the CFR's existing risk register, and specifically committed to in updated memorandums of understanding.

The CFR is a key feature of the Australian regulatory architecture. The recommendations in this Review seek to introduce greater formality and specificity to cooperation arrangements. However, this could be taken further by making the CFR a statutory body – with a role and responsibilities in legislation – to provide for stronger joint accountabilities. It would be prudent for the CFR to revisit their arrangements in five years to assess whether a new statutory role could help strengthen the system and better protect against unforeseen circumstances.

Recommendation 6.2: Formalise financial stability advice to the Council of Financial Regulators

The Review heard a range of views on the interactions between monetary policy and macroprudential policy. In particular, questions were raised around whether more active use of macroprudential policy could have given the RBA greater comfort to cut interest rates in the 2016-19 period to achieve more optimal price stability and employment outcomes (see Chapter 1). This lack of clarity resulted in stakeholders speculating about cooperation arrangements between RBA and APRA: some stakeholders questioned whether RBA had approached APRA to explore potential policy options; others questioned whether APRA had determined that macroprudential policy was not an appropriate response.

The Review also heard calls for more fundamental changes to the allocation of powers between financial regulators to strengthen the connections between monetary policy and macroprudential policy. However, while important, the Review considers these suggestions beyond its terms of reference. For example, the Review heard some suggestions of providing CFR, or a similar body, with the power to direct or recommend agencies to undertake actions on its behalf, including macroprudential policy. In this vein, Kashyap (2023) suggests that a representative of the RBA should be an observer, or member, of a macroprudential committee. While this type of decision making could reduce the risk of tension among regulators, it could undermine the clarity of individual accountabilities. The potential risks and benefits would need to be more fully assessed.

In line with its terms of reference, the Review has focused on reinforcing cooperation and transparency. There are good working relationships between financial regulators, and close and frequent engagement. However, these structures can lack formality and have relied somewhat on existing personal relationships. This can be a strength since it allows for flexibility and supports timely responses to stress. But without clear and firm commitments to cooperation and transparency, there is a risk that this effectiveness could wane over time.

The Review recommends the RBA Monetary Policy Board commit to providing CFR with formal advice, when monetary policy is likely to affect, or be affected by, risks to financial stability. This should include formal advice to APRA on its use of macroprudential tools.

On receipt of the advice, CFR would then need to discuss how agencies could work together to mitigate risks to financial stability. While macroprudential policy is an obvious potential tool, it has limitations and might not always be appropriate in all instances.

To reinforce accountability, the RBA Monetary Policy Board's advice to the CFR and APRA should be made public with a lag of 5 years, other than where there are important sensitivities that mean publication is not in the national interest. Likewise, where there are sensitivities with the publication of certain content, the Review supports providing some discretion for deciding the best course of action. This is consistent with the recommended approach to publicly releasing RBA Monetary Policy Board papers (see Recommendation 10.4). It balances the need for agencies to privately discuss potential solutions, while publicly holding them to account for their decisions.

This recommendation also complements Recommendation 2.2. The cash rate should not be considered the 'first line of defence' against financial stability risks. In instances where the RBA's pursuit of its price stability and full employment objectives could give rise to financial stability risks, it is important that macroprudential (or other) policies have been actively considered as a potential mitigant. The ultimate objective would be to provide the RBA with more flexibility to use the cash rate in pursuit of its price stability and full employment objectives, while containing risks to financial stability with more targeted tools.

Recommendation 6.3: Update the memorandum of understanding between APRA and the RBA

With RBA and APRA having important complementary tools for promoting financial stability, it is important that bilateral cooperation arrangements between these agencies are strong. The Review's recommendation seeks to reinforce accountability, by setting out specific commitments to cooperation between APRA and RBA publicly and formally.

The memorandum of understanding between APRA and the RBA has not been updated since it was first created in 1998, around the time of APRA's inception. The Review is aware that RBA and APRA have recently been discussing potential changes, and it is important that this update includes more specific and more active commitments to cooperation. It is good practice for memorandums of understanding to be regularly reviewed as conditions evolve.

The updated memorandum of understanding should clearly set out how the RBA is consulted as part of APRA's regular review of its macroprudential policy settings. The Review is aware that there is regular sharing of financial stability risk assessments between APRA and RBA. However, there is no formal process for capturing the RBA's views on financial stability risks for APRA's macroprudential policy decision makers.

While it is important that APRA has clear accountability for macroprudential policy decisions, the RBA's insights should be a key consideration for decision makers. Macroprudential policy will not be an appropriate response to all sources of financial stability risk; however, greater RBA consultation would provide for more robust challenge and debate on potential policy options. APRA might consider, for example, including a formal view from the RBA on its policy papers or having RBA staff present at macroprudential policy discussions.

Recommendation 7: The RBA should take account of climate risks but not use monetary policy to address them

Recommendation 7: The RBA should take account of climate risks but not use monetary policy to address them

7.1   The RBA should continue to:

- integrate the implications of climate change for the Australian economy and financial system into its analysis

- contribute more generally to the effective regulation of banking and finance on climate risk and natural capital management through the Council of Financial Regulators and international forums.

7.2   The Government should not make transition to a low carbon economy an explicit objective of monetary policy. The Government should set the mix of policies to pursue and manage the transition, rather than the RBA using its balance sheet or directing private lending to accelerate transition.

Climate change is a critical concern for humanity and has important implications for the Australian economy and the RBA. Submissions, consultations and the research undertaken by the Review have made clear that this is a priority of the community. Reflecting this, the Review has summarised its views on the issue in a single recommendation, which cuts across the RBA's monetary policy and financial stability responsibilities.

Recommendation 7.1: Continuing to incorporate climate risks into analysis of the macroeconomy and financial system

Climate change is increasing the frequency of some natural disasters and disruptions to supply. At the same time, government are responding through policy change, and there is a need for substantial investment to transform the capital stock for energy production, transmission, storage and use. Through these channels, climate change affects the responsibilities of central banks for price stability, employment and the stability of the financial system.

For monetary policy, central banks globally are improving their economic analysis and modelling methods to take account of these developments and integrating this into their macroeconomic assessments and decision making (for example ECB 2021b). The RBA is likewise establishing these capabilities (Debelle 2019). It recently created new positions dedicated to climate analysis.

In their work on financial stability, central banks are incorporating physical and transition risks into their analysis and contributing to the adaptation of financial markets and institutions to these risks (see for example Powell 2023, da Silva 2021). In this context, the RBA is acting collectively with other members of CFR (Debelle 2021b, CFR 2021). This has included:

- contributing to work led by ASIC on climate-related disclosures

- chairing the CFR Climate Working Group, where the RBA published an assessment of climate risks for banks' loan books alongside the APRA-led Climate Vulnerability Assessment of Australia's largest banks

- contributing to the development of an Australian taxonomy for what is 'green' or 'sustainable', in work led by Australian Sustainable Finance Institute

- the RBA and APRA are also members of the Basel Committee for Banking Supervision, which is currently assessing the implications of climate risks for bank capital standards, and the Network for Greening the Financial System, a group of central banks and financial supervisors that aims to accelerate the scaling up of green finance and develop recommendations for central banks' role in climate.

It is important that the RBA continues to strengthen its understanding of the implications of climate change for the Australian economy and financial system. This will require a continued focus on building stronger analytical capabilities. The RBA also has an important role in shaping relevant regulation for the financial sector. It should continue to collaborate with its regulatory peers, both domestically and internationally.

Recommendation 7.2: Transition to a low carbon economy should not be an objective for monetary policy

The transition to a low carbon economy should not be an explicit objective for monetary policy

Some submissions to the Review advocated for the RBA to have a legislated objective for monetary policy to support the transition to a low carbon economy.

A few other central banks have an explicit mandate to support government economic policy, including those related to climate change and the transition. In these instances, any support for government economic policy is not to compromise monetary policy's focus on price stability.

At present, there is no explicit climate change objective for the RBA. However, the objective to contribute to the 'economic prosperity and welfare' of Australians provides a basis for the RBA to support the transition to a low-carbon economy where appropriate. Recommendation 1, above, is that this objective be made an over-arching institutional objective and that it be made explicit that this objective relates to welfare now and in the future. This would make it clear that this objective encompasses issues relevant to longer-term outcomes such as climate change. This would also make it clear that the RBA can take steps within its own operations that are consistent with the transition to a low carbon economy.

The Review does not support a climate-related objective that is specifically for monetary policy. This is because standard monetary policy tools would not provide a targeted response to the risk. To use monetary policy to pursue a climate-related objective would involve substantial trade-offs for its contribution to price stability and full employment (Schnabel 2023)[5].

Governments should set the mix of policies to manage the transition to a low carbon economy

In the Review's opinion, fiscal, tax and regulatory policies are best placed to best address climate change and manage the transition to a low-carbon economy. They are able to be more targeted and with less undesired consequences than using monetary policy.

Some central banks have adjusted the financial market operations that implement their existing monetary policy, to provide some marginal support for the transition. For example, the Bank of England and the European Central Bank have adjusted their support for corporate bond markets in favour of 'greener' corporate bonds. Currently the RBA does not consider climate-related criteria in its balance sheet operations. However, given the RBA does not hold corporate securities, where climate-related criteria are most relevant, such a practice would have very little impact in Australia. The RBA does, however, accept some corporate bonds and other non-government securities as collateral in its open market operations. The RBA also invests in the Asian Bond Fund, which has announced it will purchase green sovereign bonds to encourage their development in the region.

Some submissions have suggested the RBA go further in supporting the transition to a low carbon economy. For instance, there were suggestions for alternative monetary policies, or for the RBA to provide directions to banks, to support the flow of credit to initiatives that facilitate the transition. There is some precedent for this internationally, in Japan and India (Amamiya 2022, Rao 2022).

The RBA has relevant powers within its legislation:

- The RBA has a latent power to direct banks to lend, which could potentially be directed towards green firms or transitional projects (s 36 of the Banking Act). However, the Review recommends removing this power (see Recommendation 1).

- The RBA also has broad powers under s 8 of the RBA Act to lend (newly created) money without any restriction on the nature of that lending other than it being consistent with the Reserve Bank Board's objectives.

However, credit allocation between sectors should not be the decision of unelected public officials. The Review considers that it should be governments that determine whether to implement preferential lending schemes. Governments are best placed to compare such schemes to the other tools that are available and ultimately the costs of such choices accrue to the Government's balance sheet. Other government initiatives already exist to support the availability of capital for the transition, such as investments made by the Clean Energy Finance Corporation and the Australian Renewable Energy Agency. Relative to that approach, there would be material risks to price stability if the central bank were to use its balance sheet to implement stimulus for climate action.

For central banks and other financial regulators, the coordination of standards around climate-related disclosures and taxonomies is a more targeted contribution to allocating capital to initiatives that support the transition.

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5   For instance, Schnabel (2023) discusses the possibility of conflict in the current economic environment between restoring price stability and supporting the transition to a low carbon economy. Higher interest rates may slow investment to support the transition, but central bankers recognise that it is necessary to achieve low and stable inflation, which in the long run is necessary to support the transition. The alternative is a high inflation environment, which effectively taxes investment, and requires even higher interest rates to curb and bring about price stability.

3

Chapter 3: Stronger monetary policy decision making and accountability

Chapter 3: Stronger monetary policy decision making and accountability

This chapter outlines Australia's current monetary policy decision-making arrangements and identifies areas where they could be strengthened to ensure the best outcomes for Australians. It contains 3 recommendations to improve the effectiveness of monetary policy decision making, including the establishment of a dedicated Monetary Policy Board.

Good decision making requires that those taking the decisions have sufficient skills, information, time and support to genuinely deliberate and reflect on decisions. They must also be accountable for their choices. The RBA is a public institution empowered by legislation to manage public resources and make policy decisions that affect the welfare of all Australians. High standards of governance in the RBA's making of monetary policy are essential to support sound decision making and public trust. In return for being given the independence to exercise significant powers, the RBA must be transparent and accountable for how it uses those powers.

The environment in which the RBA sets monetary policy has become more complex and uncertain (see Chapters 1 and 2). Decision makers have had to make judgements on the use of a range of more complex monetary policy tools. They have confronted large and persistent supply shocks and a shifting geopolitical environment. In addition, the effects of climate change, the transition to a lower carbon economy and demographic shifts will pose further challenges for monetary policymakers in the future (see Chapter 2). This environment will continue to test the RBA's monetary policy governance arrangements.

Chapter 1 identified areas where current arrangements could be strengthened. The collective skillset of decision makers is not matched to the complex and uncertain environment in which the RBA operates. The supporting arrangements and briefing for the Reserve Bank Board do not equip members with sufficient time and information to test policy proposals or influence outcomes to the extent they should. There is insufficient transparency and accountability. In these areas, the way monetary policy operates in Australia falls short of best practice for central banks (see Box 3.1; Gai 2023; Levin 2023).

The Review is an opportunity to strengthen Australia's monetary policy arrangements and better position the RBA to meet future challenges. Recommendations in this chapter focus on strengthening the:

- mix of skills, experience and capabilities of decision makers

- resources, information and opportunities for decision makers to fully engage in the policy process

- accountability and transparency of decision makers for their monetary policy decisions

- safeguards in respect of conflicts of interest.

The chapter draws on a range of information, including input from current and former Governors, Reserve Bank Board members and staff members; consultations and submissions; international experience; a survey of professional economists; the academic literature; and the advice of experts commissioned by the Review.

Box 3.1: Principles to guide monetary policy governance

The Review commissioned 2 international experts, Professor Prasanna Gai and Professor Andrew Levin, to advise on best-practice governance arrangements for monetary policy at central banks. Their papers have been published alongside the Review's final report.

Drawing on the advice of these experts and Archer and Levin (2018), the Review identified 6 principles that helped to guide the Review's recommendations in this chapter:

1. Central banks require a high degree of **independence** to safeguard against short-term political interference in the setting of monetary policy.

2. Independence must be supported by **accountability** and **transparency** to maintain public trust in the central bank's role.

3. Monetary policy decisions are complex decisions that are best made by a group with **diverse perspectives** and **expertise** relevant to monetary policy.

4. The group members should be able to have **roughly comparable influence** on the decision. This involves members having the appropriate **information and support**, as well as **expertise** relevant to monetary policy.

5. Members should be able to **explain Board decisions** if asked.

6. The process of selecting members should be **systematic, transparent and open**, with regard to avoiding material conflicts of interest.

Recommendations in this chapter

Recommendation 8: Constitute an expert Monetary Policy Board with diverse perspectives and knowledge

8.1   The Government should constitute a Monetary Policy Board with responsibility for monetary policy decisions and oversight of the RBA's contribution to financial system stability (except payments system policy), but not broader corporate governance.

8.2   The Monetary Policy Board should comprise the Governor, Deputy Governor, Treasury Secretary and 6 external members, with the Governor as chair.

8.3   The Government should clarify in the *Reserve Bank Act 1959* that the Treasury Secretary acts on the Monetary Policy Board in their individual capacity not at the direction of the Treasurer. The *Statement on the Conduct of Monetary Policy* should state that the Treasury Secretary has a responsibility to provide insight on the outlook for the economy and for fiscal policy.

8.4   The Monetary Policy Board's external members should be able to make a significant contribution to monetary policy setting through expertise in areas such as open-economy macroeconomics, the financial system, labour markets, or the supply side of the economy, and in the context of decision making under uncertainty.

8.5   External Monetary Policy Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest, drawing on a matrix of required skills and experience. A panel comprising the Treasury Secretary, the Governor and a third party should recommend options for suitable candidates to the Treasurer.

8.6   External members of the Monetary Policy Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.

Recommendation 9: Improve processes to support deeper consideration of monetary policy decisions, strategy and research

9.1   The Monetary Policy Board should meet 8 rather than 11 times a year to allow for more in-depth discussions including of the forecast, strategy and other monetary policy issues. The meeting cycles should:

- allow sufficient time between initial discussion of the issues and the final decision for members to reflect on the issues and request follow-up analysis as necessary

- provide opportunities for the Monetary Policy Board to hear the views of a wider range of RBA staff on issues that would inform the decision.

9.2   The 6 external Monetary Policy Board members should have direct access to RBA staff for support on technical matters and additional analysis when requested.

9.3   The RBA should increase its forecasting and macroeconometric modelling capability, for example around the supply side of the economy and fiscal policy and continue to build on its use of new data sets. This will support better consideration of monetary policy strategy under uncertainty.

9.4   The Monetary Policy Board should convene and engage with an expert advisory group on monetary policy.

9.5   The Monetary Policy Board should receive, and request as necessary, briefings that more fully consider monetary policy strategy, alternate policy options, costs, benefits and risks.

Recommendation 10: Strengthen monetary policy transparency and accountability

10.1   The Governor should hold a press conference after each decision meeting to explain the Monetary Policy Board's view of policy and economic developments.

10.2   External Monetary Policy Board members should be expected to discuss the decisions and thinking of the Board publicly, including through at least one speech or public engagement a year.

10.3   The public statement after each Board meeting should be released by the Monetary Policy Board and approved by members as a fair reflection of the decision and discussion. The statement should report unattributed votes.

10.4   The RBA should publish more of the information underlying the Monetary Policy Board's decisions, including detailed forecast data and assumptions and insights from business and community liaison. Board papers should be published after 5 years.

10.5   The RBA should strengthen its professional capability in strategic communications to support both the Monetary Policy Board and the RBA executive.

10.6   The RBA should strengthen conflict of interest policies for members of the RBA's Boards to provide additional appropriate restrictions on financial transactions.

Monetary policy decision-making arrangements

Board composition and processes

The RBA's governance arrangements for monetary policy are set out in the RBA Act. The RBA Act specifies that the RBA has 2 boards – the Reserve Bank Board and the Payments System Board – and sets out their respective responsibilities. The Review considered only the responsibilities of the Reserve Bank Board in line with the Review's Terms of Reference (see Appendix 1).

The RBA Act gives the Reserve Bank Board responsibility for the RBA's monetary and banking policy decisions and RBA policy on 'all other matters', except its payments system policy. In practice, the Reserve Bank Board is primarily responsible for monetary policy and assumes a very limited role in overseeing other RBA policies (see Chapter 5 for details on the Reserve Bank Board's roles and responsibilities).

Reserve Bank Board composition

Under the RBA Act, the Reserve Bank Board comprises 9 members: the Governor (who is Chair), the Deputy Governor (who is Deputy Chair), the Treasury Secretary, and 6 external members who are appointed by the Treasurer.[1] The Governor and Deputy Governor are appointed for terms of up to 7 years and are eligible for reappointment. The Treasury Secretary is an ex officio member. The external members are appointed for terms of up to 5 years. There is no limit on the number of terms they may serve.

The *Statement on the Conduct of Monetary Policy*, agreed between the Treasurer and the Governor, sets out the current procedure for new external appointments to the Reserve Bank Board. The Treasurer appoints Reserve Bank Board members from a shortlist of candidates maintained by the Treasury Secretary and the Governor. The current members are from business, academia, public policy and the not-for-profit sector.

The Reserve Bank Board meets 11 times a year, typically for a little under 4 hours, on the first Tuesday of each month except January. Consistent with the RBA Act, the Reserve Bank Board makes decisions by a majority of the members present, with 5 members forming a quorum. The Chair has a casting vote if necessary. In practice, the Board reaches decisions through a broad agreement of Board members without recording or publishing individual votes (Australian House of Representatives 2019).

Information provided to the Reserve Bank Board to support decision making

Papers support the Reserve Bank Board's deliberations. These papers cover domestic and international economic developments, monetary policy considerations and special topics of interest. RBA staff members prepare most papers with oversight from Assistant Governors of policy groups, the Deputy Governor and the Governor (the executive). The executive prepares the paper on monetary policy considerations. This paper typically includes a policy recommendation, although in some cases more recently, multiple options have been put forward for discussion by the Reserve Bank Board.

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1   Throughout this report, external members are the 'other members' referred to in s 14(1)(d) of the RBA Act, comprising all members of the Reserve Bank Board except for the Governor, Deputy Governor and Treasury Secretary.

The papers are prepared by RBA staff members as part of a 2-week monetary policy formulation process. Around 2 weeks before the Reserve Bank Board meeting, the Governor and Deputy Governor attend meetings with all policy staff in Economic Group and Financial Markets Group. At these meetings, staff members present key updates in their areas of responsibility, followed by a discussion of monetary policy. One week before the Reserve Bank Board meeting, executives and senior staff members from across policy departments meet to discuss the Board papers and policy considerations. Following this process, the papers and policy recommendation are finalised and distributed to Reserve Bank Board members on the Friday before the Tuesday meeting.

Accountability and transparency

The RBA is granted significant operational independence to make policy decisions in pursuit of its objectives. The Review strongly affirms this independence and considers it an essential ingredient for sound monetary policy decision making (see Chapter 2). Independence requires transparency and accountability for how the RBA's powers are being exercised.

Accountability

The *Statement on the Conduct of Monetary Policy* sets out accountability measures to support transparency around the conduct of monetary policy. This includes that the RBA will announce and explain its monetary policy decisions, release minutes of Reserve Bank Board meetings and provide commentary and analysis on the economic outlook.

As noted in the previous section, the Reserve Bank Board makes decisions by broad agreement, and individual votes and dissent are not recorded or published. In addition, Reserve Bank Board members currently agree as part of the *Code of Conduct for Reserve Bank Board Members* (*Code of Conduct*) that the Governor, and where appropriate the Deputy Governor, is the spokesperson for the Board on monetary and financial system stability policy.

The *Statement on the Conduct of Monetary Policy* states that the Governor will appear before the House of Representatives Standing Committee on Economics twice a year to report on the conduct of monetary policy and other matters falling within the responsibility of the RBA. Senior RBA officials participate in other Parliamentary processes to answer questions about the operations and performance of the RBA (see Chapter 5). External Reserve Bank Board members do not appear before Parliament or other forums to answer questions about monetary policy.

In addition, the *Public Governance, Performance and Accountability Act 2013* (the PGPA Act) requires that the RBA and other Commonwealth entities maintain high standards of accountability (see Chapter 5 for details on the PGPA Act). At the RBA, responsibility for this largely rests with the Governor, the accountable authority in respect of the PGPA Act. As part of this responsibility, the Governor prepares an annual report for presentation to the Treasurer and tabling in Parliament. The report includes a statement about the RBA's performance over the period.

Other duties of the RBA in relation to accountability are set out in the *Freedom of Information Act 1982*, *Archives Act 1983*, *Privacy Act 1988* and guidance from the Australian Public Service Commission related to the receipt of gifts and benefits.

Conflict of interest arrangements for Reserve Bank Board members

The RBA Act, PGPA Act, the *Public Governance, Performance and Accountability Rule 2014* and the *Code of Conduct* provide the framework for managing conflicts of interest of Reserve Bank Board members (including the Governor and Deputy Governor). These include that Reserve Bank Board members:

- must not hold positions in any authorised deposit-taking institutions or finance provider, and at least 5 of the 6 external members cannot also be a staff member of the Reserve Bank or appointed or engaged under the *Public Service Act 1999*

- are required to provide an annual disclosure of their material personal interests to the Treasurer (and inform the Board if new material personal interests arise since their last disclosure). Only the declarations of the Governor and Deputy Governor are made public (on a voluntary basis).

- must advise the Governor of any material personal interest in an authorised deposit-taking institution or financial entity

- must declare to other members of the Reserve Bank Board any material personal interest they have in a matter relating to the affairs of the Reserve Bank Board other than monetary and financial stability policies

- must not trade some financial instruments in the 'blackout period' between when they receive Reserve Bank Board papers and when the monetary policy decision is announced.

More broadly, while members of the Reserve Bank Board are not subject to the directors' duties of private companies, they do have statutory duties which emphasise similar obligations. As members of the Reserve Bank Board, they are bound by the duty to ensure that the policies of the Reserve Bank Board are 'directed to the greatest advantage of the people of Australia', and that the Reserve Bank Board exercises its powers 'in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to the stability of the currency of Australia, the maintenance of full employment in Australia and the economic prosperity and welfare of the people of Australia' (RBA Act, s 10(2)).

Under the PGPA Act (ss 25 to 29), Reserve Bank Board members also have general duties, including to:

- perform their functions with reasonable care and diligence

- act honestly, in good faith and for a proper purpose

- not improperly use their position or information to gain advantage or cause harm

- disclose material personal interests.

Separate from their role as a Reserve Bank Board member, the Treasury Secretary, in their substantive position, has additional roles and responsibilities under s 57 of the Public Service Act 1999. These include advising the Treasurer, managing the Department of the Treasury and assisting Treasury portfolio Ministers with their responsibilities in the Treasury portfolio. The Treasury Secretary is also the accountable authority of the Department of Treasury and subject to the duties in sections 15 to 19 of the PGPA Act in respect of that Department.

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8.4   The Monetary Policy Board's external members should be able to make a significant contribution to monetary policy setting through expertise in areas such as open-economy macroeconomics, the financial system, labour markets, or the supply side of the economy, and in the context of decision making under uncertainty.

8.5   External Monetary Policy Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest, drawing on a matrix of required skills and experience. A panel comprising the Treasury Secretary, the Governor and a third party should recommend options for suitable candidates to the Treasurer.

8.6   External members of the Monetary Policy Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.

Monetary policy decision makers are often required to make expert judgements about policy in complex and uncertain environments (see Chapter 1). The Review expects this to remain true in the future, as central banks use a wider range of monetary policy tools and face economic disruptions that create material and complicated trade-offs. These trade-offs must be understood and assessed to make sound monetary policy decisions.

In this environment, the best chance of good outcomes is to combine the judgement of a group with deep and relevant expertise, with all members able to robustly challenge the views of others and bring an independent perspective.

The external members of the Reserve Bank Board have been outstanding leaders in their fields. People consulted by the Review spoke with respect about Reserve Bank Board members.

However, many consulted by the Review were concerned that the Reserve Bank Board as currently set up can provide only limited challenge to the view of the RBA executive. The Reserve Bank Board has not voted against a recommendation of the RBA executive in at least the last decade (RBA 2022g). Current and former Reserve Bank Board members themselves described the Reserve Bank Board's role in various ways, ranging from providing real-time feedback on the economy, to an informed second opinion, to a 'pub test' of how decisions might be understood by the public. These explanations centred on the external members providing a non-expert challenge to the RBA executive's proposed monetary policy approach. That leaves the underlying economic and financial judgements with insufficient external scrutiny or challenge and represents a missed opportunity.

The economic expertise of the Reserve Bank Board's external members is lower than for comparable central banks, such as the Bank of England, US Federal Reserve, Norges Bank and Reserve Bank of New Zealand. This has limited the depth of challenge and debate at the Reserve Bank Board. For example, during the pandemic, people with a deeper understanding of the financial system may have been better placed to offer alternate views on the design of the complex monetary policy tools proposed (see Chapter 1). The level of economic expertise among external Reserve Bank Board members was a factor that some (both inside and outside the RBA) pointed to as lowering the demand for technical insight and research within the RBA (see Chapter 4). It has likely contributed to a research culture at the RBA that is not well embedded in the policy process.

The Review recommends changing the structure of the Board to ensure decision makers in future have the expertise to understand complex economic assessments on issues that are relevant to monetary policy and offer their own well-considered views with confidence. The Review considers that the Board members should, collectively, have a deep understanding of areas such as open-economy macroeconomics, the financial system, labour markets and the supply side of the economy. The focus on expertise should not be interpreted to mean that the Review is recommending a purely academic Monetary Policy Board; it is not, although it would very likely mean more academic expertise than is currently on the Reserve Bank Board. The Review interprets expertise and diversity of perspectives broadly.

The Review recommends implementing an open and transparent appointment process for the RBA's Boards. It agrees with comments received during the consultations that the current process is opaque, with limited accountability and safeguards against bias. This may affect its ability to get the right skills and experience. The Australian Banking Association and a number of individuals shared similar views in their submissions to the Review and in consultations.

The full implementation of Recommendation 8 would require changes to the RBA Act. Chapter 7 discusses this and what changes might be possible without legislative change.

Recommendation 8.1: A Monetary Policy Board deeply engaged in the policy process

The Review recommends that monetary policy be set by a dedicated Monetary Policy Board. The RBA Act should be amended to state that the Monetary Policy Board is responsible exclusively for setting monetary policy and oversight of the RBA's contribution to the stability of the financial system, except in respect of payments system policy. The Monetary Policy Board would replace the existing Reserve Bank Board as the monetary policy decision-making body.

The Monetary Policy Board would be responsible for:

- all policies, instruments and facilities intended primarily to influence monetary conditions or to influence supply and demand in the foreign exchange market

- policy decisions related to financial system stability (except payments system policy), including lender and market-maker of last resort interventions

- oversight of the implementation of policies, instruments, and facilities, including operations in financial markets to give effect to decisions (for example to keep the cash rate consistent with the target)

- oversight of the RBA's broader contribution to financial system stability including its financial stability analysis, engagement with the Council of Financial Regulators, and engagement in international forums

- communication of Monetary Policy Board decisions, including the post-meeting statement (see Recommendation 10.3).

The Payments System Board would continue to be responsible for payments system policy. A Governance Board would be responsible for all other matters, including banking operations and the issuance of banknotes. The Governance Board would be the accountable authority under the PGPA Act (see Box 5.4 in Chapter 5 for details on board responsibilities).

In carrying out its responsibilities, the Monetary Policy Board must act in a manner consistent with the RBA's broader objectives, functions and role. While the Monetary Policy Board would not be the accountable authority of the RBA under the PGPA Act, it must uphold established risk practices and performance reporting obligations set by the Governance Board and take into account the effects of its decisions on the financial resources of the RBA. As is currently the case for members of the RBA's Boards, Monetary Policy Board members (except the Governor and Deputy Governor) would not be officials of the RBA under the PGPA Act but be subject to the general duties set out in sections 25 to 29 of the PGPA Act.

The Monetary Policy Board should be focused on policy decision making

The Monetary Policy Board should have a clear focus on policy decision making, with no broader organisational role. The oversight of management and corporate governance should be the responsibility of a separate body. This reinforces other recommendations to create more opportunities for challenge and debate on policy among decision makers. A clear and narrow set of responsibilities fosters accountability. In addition, this change resolves the current uncertainty about the Reserve Bank Board's responsibilities regarding broader corporate governance, which has been interpreted by the Reserve Bank Board in different ways over time (see Chapter 5).

To enable its focus on policy decision making, the operational implementation of the Monetary Policy Board's decisions should be the responsibility of the RBA executive. This division of responsibilities should be clearly set out in a charter (see Recommendation 12.3 in Chapter 5). The Monetary Policy Board should retain an oversight role for market operations and liquidity facilities.

In relation to financial system stability, the Monetary Policy Board should decide on any advice to APRA on the use of macroprudential tools (see Recommendation 6.2 in Chapter 2). Further, it should decide on any crisis management actions such as lender or market-maker of last resort operations. The Monetary Policy Board should establish a clear framework to enable rapid decision making during crises, with clear delegated authorities where appropriate.

The Review expects that, given the broad scope of financial system stability issues, the Monetary Policy Board will rely to a somewhat greater extent on the advice of the RBA executive when making its decisions than is the case for monetary policy. That will particularly be so for financial stability issues that have a less direct bearing on monetary conditions and the achievement of its monetary policy objectives. In line with this, the Monetary Policy Board should be informed and retain oversight of the RBA's broader financial stability analysis, but the Governor and executive should be empowered to develop the RBA's positions and to engage with other agencies through the Council of Financial Regulators.

A Monetary Policy Board would foster debate and engagement in the policy process

The Review envisages a Monetary Policy Board in which policymakers are more deeply engaged in the policy formulation and deliberation process than the current Reserve Bank Board. In this environment, Monetary Policy Board members develop their own policy views and bring different perspectives on the policy decision. The Board genuinely considers and tests proposals before a decision is reached.

> *'The Committee engages in a search for truth, exploring the economic landscape with no shortage of intellectual curiosity. Members seem to be testing out ideas and advance alternative hypotheses, which are then rigorously deliberated, debated, and, often, dismissed. This is a genuine deliberation, and one that plays a key role in guiding the Committee's decision the following day.'*
>
> *– Observations on the Bank of England's Monetary Policy Committee by Kevin Warsh, 2014*

Some of those consulted by the Review favoured the RBA having a more-specialised decision-making body for monetary policy. Public submissions by the Business Council of Australia and academic experts offered support. The Monetary Policy Committee of the Bank of England and the US Federal Open Market Committee were considered successful examples of such bodies. The Reserve Bank of New Zealand recently established a dedicated Monetary Policy Committee.

Some of those consulted by the Review preferred the current model of a 'generalist' Reserve Bank Board. They emphasised the value of non-expert challenge, the experience of business leaders in making judgements under uncertainty and the ability of business leaders to bring real-time information about economic conditions. Some preferred an approach where the current Reserve Bank Board increases its responsibility for some corporate governance matters (see Chapter 7 for further discussion).

On balance, the Review considers that a more-specialised Monetary Policy Board would be best practice for fostering the type of genuine debate and engagement in the policy-formulation process that is needed to get the best monetary policy settings for Australia in the future. The Monetary Policy Board should have greater depth of economic expertise to draw on, while retaining a diversity of experience and perspectives. While the Monetary Policy Board would have fewer generalist members than the current Reserve Bank Board, decision makers would continue to benefit from the real-time insights on economic conditions uncovered through the RBA's business liaison program. The Review makes related recommendations on the balance of skills on the Monetary Policy Board (see Recommendation 8.4); and for a Governance Board to boost oversight of internal management (see Chapter 5).

The Review notes that reserving monetary policy responsibilities to a more specialised board echoes the structure in place for payments system policy. The Payments System Board has had sole responsibility for the RBA's payments system policy since the late 1990s.

Recommendation 8.2: The Monetary Policy Board should have 9 members and be chaired by the Governor

The Review recommends that the Monetary Policy Board has 9 members, comprising the Governor, Deputy Governor, Treasury Secretary and 6 external members (Figure 3.1). In line with the arrangements of the current Reserve Bank Board, the Review recommends that the Governor chair the Monetary Policy Board, and that the Treasury Secretary be a voting member.

Figure 3.1: Composition of the Monetary Policy Board
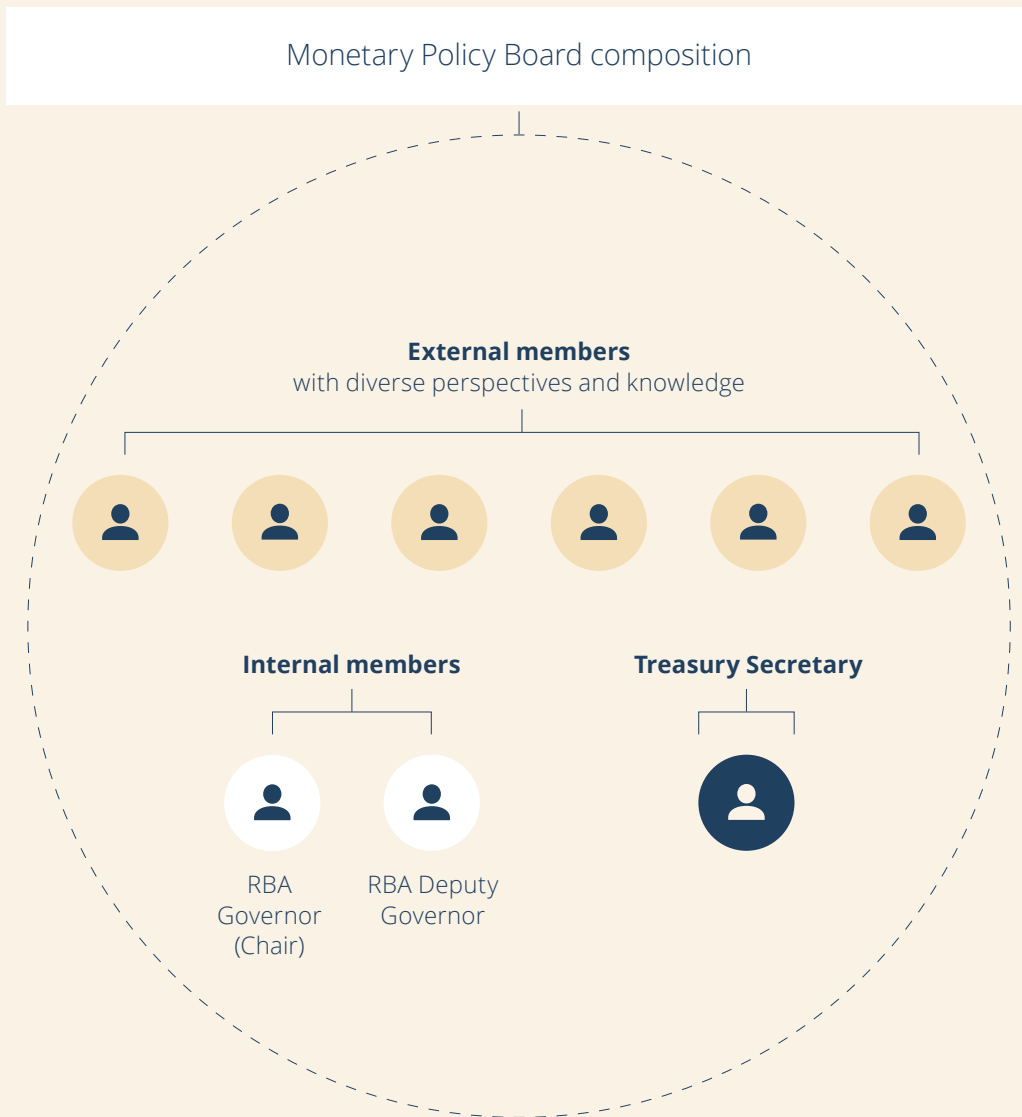
By including 6 external members, the Monetary Policy Board would be weighted in favour of external members. This would provide a healthy counterbalance to the influence of internal members.

Some consulted by the Review favoured appointing an external member of the Monetary Policy Board as chair. Gai (2023) and Levin (2023) shared this view. Chairs are influential in discussions because they set agendas and can frame and shape the discussion. Choosing a chair from among the external members would help to decentralise power (Gai 2023; Levin 2023).

While acknowledging these points, the Review considers that the Governor is best placed to be the chair of the Monetary Policy Board. The Governor will be responsible for communicating the decisions and reasoning of the Monetary Policy Board through regular press conferences (see Recommendation 10.1). The Governor has depth of expertise and strong familiarity with monetary policy issues. The Governor will be the only member of all the RBA's Boards.[2]

The continued inclusion of the Deputy Governor in monetary policy decision making is valuable, given the Deputy Governor's expertise and depth of understanding in monetary policy issues. In practice, the Deputy Governor provides valuable alternate perspectives on issues and, as in other monetary policy committees, is free to vote differently from the Governor.

Including the Deputy Governor on the Monetary Policy Board also manages key person risk and succession planning with regard to the Governor, although it should not be assumed that a Deputy Governor is the next Governor in waiting. At the moment, the Deputy Governor's role is broad and encompasses policy and the running of the institution. To support the Deputy Governor's effectiveness in their policy role, the Review recommends creating a complementary position of Chief Operating Officer (see Chapter 4).

Treasury Secretary should be a member of the Monetary Policy Board

The Treasury Secretary is well placed to provide an independent economic perspective and challenge the view of the RBA executive. The Treasury Secretary has access to expert Treasury staff views on economic conditions and to separate forecasts. Consultations with current and former Reserve Bank Board members highlighted the value of these perspectives. The Treasury Secretary also plays an important role as an information conduit between the decision-making bodies for fiscal and monetary policy, particularly during crises.

Some consultations and submissions raised concerns about having the Treasury Secretary on the Reserve Bank Board. These included the risk of actual or perceived interference with the RBA's independence. Based on its conversations with current and former Treasurers, Treasury Secretaries and Governors, the Review is confident that a Treasury Secretary has not been directed in recent decades to argue the position of the Treasurer in the Reserve Bank Board.

The Review acknowledges that inclusion of the Treasury Secretary as a voting member is unusual, and some stakeholders strongly disagreed with their full participation. At most of the RBA's peer central banks, an official of the treasury or finance ministry does not attend decision-making meetings for monetary policy. In a few cases, an official attends but does not vote (for example the Bank of England and the Reserve Bank of New Zealand).

The Review's assessment is that the risks to RBA independence from the influence of a single member are limited and can be managed with the additional safeguards set out in Recommendation 8.3. In the Australian institutional context, the net benefits can be substantial. The Review also recommends the removal of s 11 of the RBA Act in order to strengthen further the RBA's independence (see Recommendation 1.1 in Chapter 2).

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2   The Deputy Governor is a member of the Reserve Bank Board under s 14 of the RBA Act. The Deputy Governor may also sit on the Payments System Board as the RBA's representative under s 25A of the RBA Act. The Review recommends the Deputy Governor is an observer on the Governance Board (see Chapter 5).

Recommendation 8.3: Clarify the role of the Treasury Secretary

The RBA Act should be amended to clarify that the Treasury Secretary acts on the Monetary Policy Board in their individual capacity and cannot be directed by the Treasurer. The *Statement on the Conduct of Monetary Policy* should acknowledge the unique responsibility of the Treasury Secretary on the Board to provide insights on the outlook for the economy and fiscal policy (see Chapter 2 for further discussion). These changes would add safeguards around the continued involvement of the Treasury Secretary in monetary policy decision making and reinforce their role as an avenue for information sharing between monetary and fiscal authorities.

Currently, there is no clear direction on the Treasury Secretary's role on the Reserve Bank Board and the extent to which they represent the view of Treasury or the Government. That said, the evidence the Review has found indicated that, for a number of decades, the Treasury Secretary has not been directed to argue the Government's view to the Reserve Bank Board. The current Treasury Secretary has stated publicly that they are acting in their individual capacity when on the Reserve Bank Board (Kennedy 2022).

Recommendation 8.4: Bolster expertise in line with a skills matrix

The Review recognises the value of Board members who are not professional economists. A group with diverse backgrounds brings a wider range of perspectives and expertise to decisions. The RBA executive has stated that it values business people's ability to make decisions under uncertainty (Australian House of Representatives 2019). The Review does not recommend the Monetary Policy Board be comprised solely of monetary policy and macroeconomic experts.

At the same time, there are strong arguments for increasing economic expertise on the Monetary Policy Board. The Review envisages a Monetary Policy Board deeply engaged in the policy process and whose members provide genuine independent views and challenge the prevailing internal RBA thinking. This is becoming more important in an increasingly complex and uncertain monetary policy environment. The Review heard widespread support for increasing the level of expertise on the Reserve Bank Board. External experts commissioned by the Review shared this view (Gai 2023; Levin 2023).

The Review recommends that, compared with the current Reserve Bank Board, the Monetary Policy Board should contain more members with deep formal expertise on economic and financial system matters. Other members who bring a broader skillset, such as from business experience, should have sufficient knowledge, experience or training to make a significant and informed contribution to the formulation of monetary and financial system policy. This minimum requirement could be set out in the legislation (see Recommendation 12.4 for further discussion).

The Review recommends that a skills matrix be developed that sets out the skills, experience and capabilities considered essential for the effectiveness of the Monetary Policy Board (see Box 3.2). The matrix would support future appointments to the Monetary Policy Board by identifying skill gaps and would assist with succession planning. The skills matrix should emphasise practical experience and qualifications in the following fields: open-economy macroeconomics, the financial system, labour economics and the supply side of the economy. The skills matrix should be implemented outside the RBA Act, so it is flexible to evolving needs.

Over time and as needs change, the Treasurer could approve changes to the skills matrix at the recommendation of the Monetary Policy Board. The regular framework and tools review would provide an opportunity to reassess the skills matrix to ensure members collectively continue to have the skills needed to meet future challenges (see Chapter 2).

The importance of appointing members with skills and focus that best serve each Board's distinct and varied responsibilities means it would be likely there would be different external members on the 3 RBA Boards.

These changes will result in a better balance between expertise, breadth and diversity.

Box 3.2: Skills matrix for the Monetary Policy Board

The skills matrix should set out the skills, experience and capabilities considered essential for the Monetary Policy Board to operate as an effective monetary policy decision-making body. Individual members would not be expected to have all attributes in the matrix but rather to bring different skills that complement other members. That said, all members should be independently minded and able to make a significant, informed contribution to the formulation of monetary and financial system policy. They must be of the highest integrity.

Table 3.1 is an example to make clear the direction of the Review's recommendations on developing a skills matrix but is not prescriptive.

Table 3.1: Example Monetary Policy Board skills matrix

Skills and experience	Description
Economic expertise	Significant practical experience or qualifications in one of the following fields: open-economy macroeconomics, the financial system, labour markets and the supply side of the economy.
Analytical ability	Demonstrated ability to digest large volumes of information and/or research and develop reasoned views quickly.
Strategic perspective	Demonstrated ability to decide and deliver on complex business plans under conditions of heightened uncertainty, anticipate emerging issues, and balance risks.
Communications	Experience communicating complex issues with complete credibility and ideally to diverse audiences.
Leadership and corporate experience	Senior-level experience collaborating in an environment that requires constructive deliberation and debate, including in a committee or board context.

Recommendations 8.5 and 8.6: Adopt a more transparent and open appointment process

Appointment process for external members should be more transparent and open

The Review recommends that the appointment process for external members of the Monetary Policy Board be made more transparent and open. This would reinforce the RBA's independence, bolster public trust in the institution and increase the likelihood of identifying outstanding candidates.

Positions should be open and advertised for expressions of interest, including to international applicants. The selection criteria should be published. These changes better align the appointment process with the best-practice approaches recommended by the Grattan Institute (Wood, Griffiths and Stobart 2022). Opening the process to international applicants could bring valuable outside perspectives and help to address concerns of some stakeholders about the ability to recruit enough suitable candidates in a country of Australia's size. A specialised recruitment firm could be engaged to assist the recruitment process. The pool of potential candidates should not be limited to those who responded to the expression of interest process.

A panel comprising the Treasury Secretary, Governor and a third independent party (for example the Chair of the Governance Board, a previous member of one of the Boards or another respected expert) should recommend a shortlist of suitable candidates to the Treasurer. The Treasurer should make an appointment from this shortlist.

To further reinforce the appointment process, it would be valuable to release information about how the appointee's skills and experience will help the Board in achieving its objectives, when the appointment is announced. This would be in line with information on new external appointments published by the Bank of England.

The Review notes that the Government has commenced a review of the process for public sector board appointments. The *Briggs Review of Public Sector Board Appointments Processes* will consider how to make board recruitment more transparent, the advice ministers receive in making board appointments, and how the diversity of boards can be improved. A final report is to be delivered in mid-2023. The Government should draw on the insights and suggestions from that report when amending the appointment process for the RBA's boards.

External members should be appointed for 5-year terms, with the option of a short reappointment

The Review recommends that external members of the Monetary Policy Board be appointed for a single 5-year term, with the possibility to be reappointed for up to one year. This is comparable to the terms of external monetary policy decision makers in Sweden, Norway and the United Kingdom, which range from 3 to 6 years. It differs from the current approach of making appointments for up to 5 years with no limit on reappointments.

Terms of 5 years provide members with enough time to 'learn the ropes' and make a substantive contribution. They guard against actual or perceived political interference because the entire Monetary Policy Board could not be replaced within a single term of government. The choice of a single 5-year term for external Monetary Policy Board members is broadly consistent with the recommendations of Gai (2023) and Levin (2023). The Review acknowledges that shorter terms would offer greater flexibility if a Monetary Policy Board member was not a good fit. However, the introduction of a more rigorous appointment process should help to minimise this risk.

The Review considers that having the option to reappoint Board members for up to one year would provide appropriate flexibility for unforeseen circumstances. For example, if a Board member decided to end their term early, it may be useful to extend the length of another member's term to ensure an appropriate level of experience on the Monetary Policy Board.

Appointments to the Monetary Policy Board should be staggered. This can help to reduce groupthink while maintaining institutional memory of the Board (Gai 2023). It can act as a further safeguard to independence. Ideally, one or at most two appointments would be made around the same time each year, for example in the middle of the year.

The appointment process for the Governor and Deputy Governor

The Treasurer should continue to be responsible for choosing the Governor and Deputy Governor through the conventional cabinet processes.

The Thodey Review recommended an open and transparent process supporting the advice to the Prime Minister on the appointment of departmental secretaries (Department of the Prime Minister and Cabinet 2019). If that occurs, it may have implications for the appointment process for the Governor and Deputy Governor, which would, regardless, remain the decision of the Treasurer.

Recommendation 9: Improve processes to support deeper consideration of monetary policy decisions, strategy and research

Recommendation 9: Improve processes to support deeper consideration of monetary policy decisions, strategy and research

9.1 The Monetary Policy Board should meet 8 rather than 11 times a year to allow for more in-depth discussions including of the forecast, strategy and other monetary policy issues. The meeting cycles should:

- allow sufficient time between initial discussion of the issues and the final decision for members to reflect on the issues and request follow-up analysis as necessary

- provide opportunities for the Monetary Policy Board to hear the views of a wider range of RBA staff on issues that would inform the decision.

9.2 The 6 external Monetary Policy Board members should have direct access to RBA staff for support on technical matters and additional analysis when requested.

9.3 The RBA should increase its forecasting and macroeconometric modelling capability, for example around the supply side of the economy and fiscal policy and continue to build on its use of new data sets. This will support better consideration of monetary policy strategy under uncertainty.

9.4 The Monetary Policy Board should convene and engage with an expert advisory group on monetary policy.

9.5 The Monetary Policy Board should receive, and request as necessary, briefings that more fully consider monetary policy strategy, alternate policy options, costs, benefits and risks.

The Review's assessment is that current processes do not sufficiently support Reserve Bank Board members to effectively challenge and develop their own independent views and contribute to discussion at the Board.

Reserve Bank Board members do not have adequate time, resources or information to challenge the RBA executive's view. By and large, Reserve Bank Board members do not have access to staff below Assistant Governor level or attend internal policy deliberations or briefings ahead of their decision. Papers are received on the Friday before the Tuesday Board meeting. Board members were complimentary of the quality of the papers they receive and of the RBA's responsiveness to questions they ask at the time. However, the Review observed that current papers are limited in their discussion of policy considerations and alternate views, and the current schedule significantly limits the Board's time to question or probe perspectives presented in the papers.

In addition, there are examples of the Board not receiving nor requesting sufficient information to challenge the RBA executive's view. For example, throughout the low inflation period between 2016 and 2019, the papers provided to the Reserve Bank Board focused on describing the flow of data and the economic outlook. There was little discussion dedicated to the policy decision in the papers. Alternate policy choices – and their costs and benefits – were generally not presented in the papers (see Chapter 1). More recently, the Reserve Bank Board did not receive nor request sufficiently detailed cost-benefit analysis or financial risk assessments of the bond purchase program prior to approval. While there was a need to act quickly in March 2020, this was less of a constraint in November 2020 when the Reserve Bank Board chose to implement the bond purchase program. Further, the Reserve Bank Board was not made aware of options discussed by senior staff members to discontinue the yield target in mid-2021.

There is evidence that the Reserve Bank Board is not always fully involved in decisions. For example, the Reserve Bank Board was not consulted on the extension of the yield target in September 2020 and the choice not to defend the yield target in October 2021. The introduction of the calendar-based element of forward guidance by the Governor in mid-October 2020 was not presented as a policy decision in the preceding Reserve Bank Board papers.

Current processes create a situation in which the Governor, Deputy Governor and Treasury Secretary have much more information than external Board members. This, together with the expertise imbalance, reduces the ability of external board members to have a comparable influence on the decision (Box 3.1). While there will always be an information imbalance, the gap can and should be minimised, especially if the Board is a decision-making body rather than an advisory body.

The meeting cycle adds to the information imbalance. Reserve Bank Board meetings are more frequent than at comparable central banks but are shorter. The Reserve Bank Board meets 11 times a year, compared with 8 times a year in most comparable central banks. The Reserve Bank Board meets for a little under 4 hours and has limited policy discussion outside of this. At other central banks, external monetary policy decision makers commit more time to the policy process.

The frequency and length of Reserve Bank Board meetings limits the depth of research and analysis that RBA staff members have time to prepare and debate among themselves before it is sent to the Reserve Bank Board. For example, senior staff members in policy areas meet to discuss at least the documents on economic conditions and financial markets before they are sent to the Reserve Bank Board (Bullock 2022a), but there is only one day to take on any comments. This, in turn, limits the depth of analysis the Board receives and the time for internal debate and discussion about policy strategy and communication.

The Review recommends changes to Board processes to better support policy discussions and decisions and to increase debate and challenge by decision makers.

Recommendation 9.1: Hold fewer meetings to allow more time for deeper discussions

The Monetary Policy Board should hold 8 meetings a year alongside a longer policy discussion and formulation cycle. The Reserve Bank Board meets relatively frequently compared with its peers overseas but spends less time discussing monetary policy decisions and strategy.

A shift to 8 meetings a year would allow for a longer and more robust policy formulation and discussion process ahead of and during each individual meeting. A longer process would allow time for external members to influence the analysis and forecasts. Holding 8 meetings a year would preserve the quarterly frequency of forecast updates and the *Statement on Monetary Policy*. There may be rare occasions, for example during a crisis, where the Monetary Policy Board may need to arrange additional meetings, and it should remain free to do so.

The Review heard mixed views about the frequency of meetings, including among current and former Reserve Bank Board members and senior RBA staff members. Financial market participants and professional economists were largely in favour of the monthly schedule. They suggested that it enabled greater agility in response to economic developments. The Reserve Bank Board has generally expressed satisfaction with the number of Board meetings in annual surveys of the Reserve Bank Board.

Academic experts, international central bankers and RBA staff mostly favoured holding 8 meetings a year. The desire of RBA staff to have fewer meetings was not based on a desire to have 'less work', but rather a desire to have greater scope to do deeper and better preparatory work for each meeting, including more internal policy research. Staff surveys show that RBA staff have very high engagement with the institution and a willingness to go above and beyond to deliver on the organisation's objectives (see Chapter 4).

Monetary Policy Board members should dedicate more time to the policy process

The Review envisages a Monetary Policy Board that actively participates in the policy discussion and formulation cycle, including by external members dedicating significantly more time to it than at present. The expectation is that external Monetary Policy Board members (that is excluding the Treasury Secretary) would dedicate the equivalent of around a day a week to the monetary policy process, concentrated around key dates in the deliberation cycle. This compares with a day or two a month for current Reserve Bank Board members.

By comparison, at the Bank of England, external members of the Monetary Policy Committee receive the same staff briefings as internal members, are closely involved in the forecast process and participate in discussions around policy tool development. They commit the equivalent of 3 days a week to the process. In New Zealand, all members of the Monetary Policy Committee are involved in multiple policy meetings and discussions with internal staff, as well as 8 days of full meetings ahead of every second meeting.

As well as external members being more actively involved in the process ahead of each meeting, the Review sees value in the Monetary Policy Board devoting more time to discussing longer-term policy strategy and communications planning. Dedicated strategy days for the Monetary Policy Board should support this focus on strategy and communication. A strategy day would provide an opportunity to reflect on the operating context for monetary policy and the high-level strategy for responding to this context. This could include discussing risks to the current strategy (and planning how the Monetary Policy Board would respond if the risks were realised), lessons learned from previous decisions and the experience of central banks overseas, and the implications of longer-term macroeconomic trends for the Monetary Policy Board's policy strategy.

Monetary Policy Board should hear a wider range of staff views

The Review recommends greater engagement between internal RBA staff members and Monetary Policy Board members (excluding the Treasury Secretary) to better support external Monetary Policy Board members in forming their views. The Review notes that it is common practice at the RBA's peer central banks for decision makers to attend earlier staff briefings ahead of decision meetings.

The Review recommends that external Monetary Policy Board members participate in staff briefings and policy discussions ahead of the decision meeting on monetary policy. These meetings could involve assessment of incoming data and implications for the outlook, as well as substantive policy discussions. These meetings would provide external members of the Monetary Policy Board with an opportunity to hear a wider range of staff views (not just the view of the RBA executive), including about the economic outlook and policy, and to flag issues that they are interested in and their perspectives on those issues.

Recommendation 9.2: Provide external members of the Monetary Policy Board with access to RBA staff

The Review recommends that external members of the Monetary Policy Board should be able to engage with staff members (beyond the Assistant Governors) when they have questions, particularly about technical issues and to better understand alternate policy views. It will be important that external Board members are in turn disciplined in their demands and access to staff members.

A secretariat should be established within the RBA to support the external members of the Monetary Policy Board as a group. These staff members would report directly to the external members. Their remit would be to help the external members develop and communicate their views. This could involve helping Board members engage directly or via the secretariat with staff subject matter experts, advising on technical monetary policy issues and providing analysis to support external members. The secretariat could assist external members ahead of public appearances or speeches (see Recommendation 10.2).

These recommendations do not apply in the case of the Treasury Secretary. The Review considers that it would be inappropriate for the Treasury Secretary to attend internal RBA discussions or directly access RBA staff members. The Treasury Secretary has support staff and access to independent forecasts and advice. These independent perspectives should be preserved.

Recommendation 9.3: Increase forecasting and macroeconometric modelling capability and build on the use of new datasets

Build further capability in forecasting and macroeconometric modelling

The Review recommends that the RBA strengthens its forecasting and macroeconometric modelling capabilities, particularly in respect of the supply side of the economy. Because it takes time for monetary policy changes to have their full effect, forecasts about future economic conditions are a critical input to monetary policy decision making and strategy. Large-scale models can help to ensure consistency in the RBA's understanding of the economy and provide an efficient tool for scenario analysis.

Chapter 1 highlighted that the RBA's framework for forecasting and modelling does not contain sufficient detail on the supply side of the economy. This shortcoming has been apparent through the current inflationary period, where supply factors have played a significant role in driving inflation. The Governor stated in February 2023 that 'our models are not well suited for supply shocks' (Australian House of Representatives 2023). The risk that the Australian economy will experience more frequent supply disruptions in future underscores the importance of building capability in this area (see Chapter 2).

Another area for development is the capacity of the RBA's models to fully factor in other arms of macroeconomic policy, particularly fiscal policy. An understanding of the economic effects of fiscal policy and its interactions with monetary policy is central to decisions on monetary policy (Leeper 2023). This is particularly important in crisis periods, where the links between the arms of policy can be amplified.

The RBA has made progress on its forecasting and modelling capabilities in recent years. This includes changes made in response to recommendations from a 2016 external review of the RBA's forecasting process (Pagan and Wilcox 2016). For example, the RBA developed a large macroeconometric model, MARTIN, to provide a whole-of-economy perspective to forecasting, working alongside the RBA's long-standing single-equation forecast models (Ballantyne and others 2019). In line with the Pagan and Wilcox review, the RBA should continue to integrate the use of MARTIN into its forecasting process given the usefulness of large-scale macroeconomic models in providing consistency across all forecasts.

As the primary consumers of the RBA's forecasts, the Monetary Policy Board should work with staff members to increase forecasting and modelling capabilities and ensure modelling is integrated into decision-making processes. As part of this process, the RBA should seek external views and perspectives to ensure the RBA's capabilities are fit for purpose and evolve in line with best practice.

Continue to invest in new datasets and analysis to support decision makers

It is vital that the decisions of the Monetary Policy Board are supported by the best possible data.

The Review considers that the RBA should be a leader in the use of large datasets for macroeconomic and financial analysis and endorses the RBA's increased focus in this area in recent years. This includes the creation of a data science team in the Economic Research Department and a sizable Enterprise Data Office. Analysis of large datasets can support decision makers by increasing understanding of economic conditions and improving forecasting. The RBA should continue to publish and explain its insights from large datasets.

In addition, the Review welcomes the introduction by the Australian Bureau of Statistics of a monthly consumer price index indicator, which provides a timelier update of prices for a subset of consumer goods and services (Australian Bureau of Statistics 2023). The Review supports the development of a full monthly consumer price index – one that includes updated prices for a fuller range of consumer goods and services – and improved monthly measures of underlying inflation (for example trimmed mean inflation). These are important ways the Australian Bureau of Statistics could support the Monetary Policy Board's decision making.

Another area where a further investment in data is likely to be helpful is in measuring the effects of fiscal policy. Leeper (2023) argues that fiscal and monetary policy makers must carefully consider the impact of each other's current and expected policy actions. Expectations for fiscal policy should be considered seriously, as expectations for monetary policy are considered at present. For example, the RBA and Treasury should consider the merits of investing in quality and timely surveys of expectations for government taxes and spending in Australia.

Recommendation 9.4: Create and engage with an expert advisory group on monetary policy

The Review recommends that the Monetary Policy Board convene an expert advisory group on monetary policy to provide the Board with external views. The expert advisory group should build on the success of the RBA's existing academic and private-sector economist panels but have a broader remit and direct engagement with the Monetary Policy Board.

Since 2019, the RBA has held an annual panel of academic economists to hear external views on monetary policy frameworks and settings. Summaries of these meetings are distributed internally within the RBA. The RBA recently announced that it has increased the frequency and size of the academic panel meetings and established another panel to hear the views of private sector economists (RBA 2022f). These 2 panels offer a structured way for RBA staff to hear alternate views held by external economists.

The Review sees value in these panels and recommends they be consolidated into an advisory group that has similar membership but an expanded role. In particular, the Review recommends that the Monetary Policy Board convene an expert advisory group comprised of at least 12 economists of significant standing in academia and the private sector. The group would meet with the Monetary Policy Board biannually and provide views on topics such as:

- current economic conditions and the outlook

- key policy issues and the Monetary Policy Board's strategy

- the RBA's forecasting and modelling capabilities

- emerging research areas and the direction of the RBA's research agenda.

It is envisaged that insights from this advisory group will become an important input into the Monetary Policy Board's ongoing assessment of issues and strategy, but it should not become a 'shadow monetary policy committee' that provides direct policy advice. As such, the Panel recommends transparency around the nature of discussions that the expert advisory group has with the Monetary Policy Board. To achieve this, a summary of the main views presented at the meeting could be published, as is done for the Federal Reserve Bank of New York's Economic Advisory Panel (for example, see Federal Reserve Bank of New York 2022). Such an advisory group would help build a cohort of academic and private sector economists who may later be suitable members of the Monetary Policy Board.

Figure 3.2: Range of support provided to monetary policy decision makers

Support for monetary policy decision makers

Monetary Policy Board

Staff briefings and policy discussions

Expert advisory group

Direct access to policy staff

Secretariat support for external members
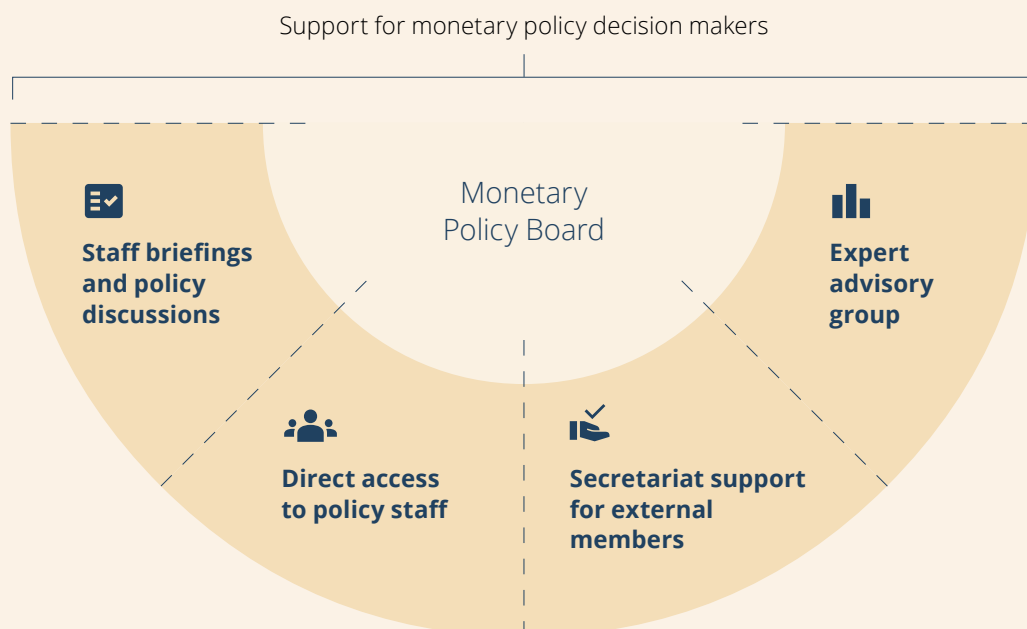
Recommendation 9.5: Provide more analytical depth on monetary policy strategy, alternate policy options, costs, benefits and risks in Board materials

Monetary Policy Board members would be better supported in making policy judgements if papers or other briefings contained more fulsome discussions of monetary policy considerations and options. The Monetary Policy Board should receive, and request as necessary, this information.

Briefings for the Monetary Policy Board should include a genuine exploration of alternate views and policy choices, and their costs and benefits. Quantitative scenarios that illustrate the implications of different policy choices could help the Monetary Policy Board to better assess trade-offs and determine whether its strategy remains appropriate. Scenarios can also help to consider how the economy might evolve if specific risks are realised and assist the Monetary Policy Board to plan how its policy strategy might need to change in different situations. Such scenario analysis could be presented to the Monetary Policy Board at the same time as the quarterly forecast updates.

The papers should provide a fuller understanding of staff views, especially counterarguments to the central recommendation or to the overall strategy being pursued. The RBA should consider what internal processes would best achieve this outcome. For example, the Monetary Policy Board could consider requesting an attachment in the Monetary Policy Paper that allows for relevant departments to include their own comments, similar to 'coordination comments' in cabinet submissions in the Australian Government. Such changes to internal processes may require holding internal policy meetings further in advance of the decision meeting than at present, to allow time for wider staff engagement.

The Monetary Policy Board should play an active and ongoing role in the development of Board materials. They should consider regularly whether the materials they receive equip them to make informed decisions and should request additional materials as required.

The Review recognises the steps that the RBA has taken over time to deepen its discussion of alternate policy choices. Relative to the late 2010s, the section of Reserve Bank Board papers on monetary policy considerations now tends to be longer and contain more discussion of counterarguments. In some circumstances, no recommendation has been put forward, with the Reserve Bank Board instead presented with options (for example in May 2022). The Review supports the Reserve Bank Board considering and communicating the effects of different policy choices in a systematic way, but RBA executives should always have a view and be prepared to argue it.

The Review recommends setting clear expectations for what information should be presented to decision makers when making choices about additional monetary policies. This reflects lessons from decision-making processes during the COVID-19 pandemic (see Chapter 1). For example, the large fiscal implications, both positive and negative, of additional monetary policies emphasise that detailed Board consideration is warranted. For clarity and transparency, expectations about what information is provided by the RBA executive to the Monetary Policy Board when considering additional monetary policy tools should be set out and published in a board charter (see Chapter 5).

The RBA executive and staff members should provide the Monetary Policy Board with:

- explicit analysis of expected costs and benefits, including details of the expected economic impact of the policy
- quantitative analysis of risks, including implications for the public sector balance sheet as a whole
- detail and options that enable decision makers to assess the design of policies
- exit strategies.

Decision makers should continue to receive and request sufficient information to assess the operation of additional monetary policies over time and consider their effectiveness against the balance of risks.

The Review acknowledges that quantitative analysis of costs, benefits and risks can be difficult, especially in periods of extreme uncertainty. Estimates will be imprecise. However, like any forecast, such estimates can still help to encourage deliberations and inform policy strategies, including circumstances that might force a rethink. Setting expectations also encourages people inside and outside the RBA to develop better methods and models to do such analysis.

Recommendation 10: Strengthen monetary policy transparency and accountability

Recommendation 10: Strengthen monetary policy transparency and accountability
10.1   The Governor should hold a press conference after each decision meeting to explain the Monetary Policy Board's view of policy and economic developments.
10.2   External Monetary Policy Board members should be expected to discuss the decisions and thinking of the Board publicly, including through at least one speech or public engagement a year.
10.3   The public statement after each Board meeting should be released by the Monetary Policy Board and approved by members as a fair reflection of the decision and discussion. The statement should report unattributed votes.
10.4   The RBA should publish more of the information underlying the Monetary Policy Board's decisions, including detailed forecast data and assumptions and insights from business and community liaison. Board papers should be published after 5 years.
10.5   The RBA should strengthen its professional capability in strategic communications to support both the Monetary Policy Board and the RBA executive.
10.6   The RBA should strengthen conflict of interest policies for members of the RBA's Boards to provide additional appropriate restrictions on financial transactions.

The Review finds that current arrangements do not adequately support transparency and accountability of the Reserve Bank Board and its members. Communications with the public are also not as effective as they could be.

Like many central banks, the RBA's approach to communication has evolved considerably over recent decades. There is now a greater emphasis on openness and transparency and using communication as a tool to support monetary policy actions. However, the RBA's regular communications are still less transparent than those of some other peer central banks (see Chapter 1).

The RBA should improve outside understanding of policy strategy and decisions. Australians have limited visibility about the range of issues considered, and views held, by their monetary policy decision makers, particularly when compared with people in some jurisdictions overseas. This makes it difficult to consider the appropriateness of policy decisions and hold decision makers accountable for their policy judgements. This includes when the RBA is making trade-offs and using the flexibility in its framework. For example, the RBA's explanations of its policy decisions during the low inflation period between 2016 and 2019 lacked sufficient detail to assess the RBA's policy strategy. Stakeholders were critical of the RBA's use of calendar-based forward guidance, when the conditionality of the RBA's statements did not appear to be recognised by the broader public.

> *'[The RBA's] understanding and description of the state of the economy is usually very good. It is when decisions and the outlook come together that communications have fallen down.'*
>
> *– Response to RBA Review survey of professional economists*

More broadly, the RBA could communicate with the public more effectively. Public focus groups conducted for the Review generally reflected positively on the RBA's economic knowledge and decision making for the benefit of Australians. However, focus group members did not feel that the RBA understands them. People also saw the RBA's communications as being too technical for their needs.

At present, the RBA's communications function is insufficiently positioned in the organisational structure to provide influential strategic communications advice. It has less prominence in the organisation than in some other central banks. The RBA's communications function is a team within the Secretary's Department and is led by a Senior Manager. It is close to the RBA's executive but is just one part of the Secretary's many functions. Peer central banks tend to have more senior and prominent functions. For example, at the Bank of England, the communications function reports directly to the Governor. At the Bank of Canada, the communications function reports to the Senior Deputy Governor. At the European Central Bank, it reports to the Executive Board.

The Review is cognisant of the fact that more frequent communication is not always best. Yet there is scope to significantly improve the RBA's regular communications to improve understanding of its policy decisions and strengthen transparency and accountability mechanisms.

The treatment of conflicts of interest is another important aspect of accountability because actual and perceived conflicts of interest can undermine the quality and credibility of decisions. The Review did not hear evidence of issues in the recent past related to conflict of interests of Reserve Bank Board members. However, conflict of interest policies for Reserve Bank Board members are currently relatively limited, and, as discussed below, the Review recommends that they be strengthened.

Recommendation 10.1: Require greater public explanation of monetary policy decisions and strategy

The Review recommends the RBA take steps to improve the way it publicly communicates its monetary policy strategy and decisions, including holding a press conference after each monetary policy meeting.

Many stakeholders expressed a strong desire for greater transparency around the factors that drive monetary policy decisions. For example, in a small survey of professional economists conducted by the Review, only a little more than half thought the RBA explained its rationale for monetary policy decisions well. Just a third thought it explained its reaction function well (see Appendix 4).

In the opinion of the Review, regular press conferences are an important mechanism to support improved transparency and accountability. The Review heard that people have valued the press conferences that the Governor has held since the start of the COVID-19 pandemic. Among professional economists surveyed by the Review, regular press conferences were viewed as the leading way to improve RBA communication.

> *'More regular press conferences would provide more scope for the RBA to address and respond to criticism or alternative views about the appropriate monetary policy settings and, in turn, this would be likely to enhance the focus on alternative options and viewpoints within the RBA as part of policy decision making.'*
>
> *– Response to RBA Review survey of professional economists*

The RBA has stated that it only plans to hold press conferences on an ad hoc basis, when it has 'something significant and important to say' (Bullock 2022b). This approach neglects the possibility that observers may have questions to ask at other times and that being available to answer questions is an important accountability mechanism, and risks 'dramatising' any ad hoc press conferences. This suggests that the timing of press conferences should be independent of the perceived importance of the policy decision. This is the case at many of the RBA's peer central banks who already hold regular press conferences.

Holding a press conference after each monetary policy meeting would provide regular opportunities for the Governor to explain the Monetary Policy Board's decisions and reasoning in an open and transparent way, and to answer questions. By speaking to a wide audience, press conferences guard against perceptions that certain interests or individuals receive more, or more timely, information from decision makers.

More broadly, the Review recommends that the RBA's regular communications focus more on the reasoning behind monetary policy decisions. It should explain why alternate policy options were not pursued, and how current policy settings fit into a broader strategy. To achieve this, the RBA could consider scenario analysis based on different assumptions about policy. Scenario analysis, as used by other central banks, can be an effective approach to clearly explain the reasons for policy decisions.

The Review considers it is particularly important, for transparency and accountability, that in situations where inflation deviates significantly from target, the Monetary Policy Board clearly communicates its plan to bring inflation back to around the midpoint of the target, taking into account the full employment objective. This should include guidance around how long it expects this will take.

Finally, it is important that the RBA clearly explains when financial stability concerns are influencing its monetary policy decisions (see Chapter 2). In periods when financial stability concerns are influencing monetary policy decisions, the RBA should:

- explain why macroprudential policy cannot be relied upon in the first instance

- outline how its policy choices during these periods affect its ability to achieve its inflation and employment objectives in the short- and medium-run

- explain how it came to the view that the medium-term benefits outweigh the short-run costs.

Recommendation 10.2: Require external Monetary Policy Board members to occasionally discuss publicly the decisions of the Monetary Policy Board

As decision makers afforded with significant independence, Monetary Policy Board members need to be accountable and so should be expected to explain the Board's views on key issues in public.

The current *Code of Conduct* for Reserve Bank Board members prevents external Reserve Bank Board members from speaking on monetary and financial system stability policy in public. The Review recommends that this restriction be removed so that all Monetary Policy Board members can speak publicly about the decisions and thinking of the Monetary Policy Board.

The Review heard some concerns that allowing Board members to speak publicly on policy would result in a 'cacophony of voices'. As Blinder (2004) notes, a central bank that speaks with too many voices, may, in effect, have no voice at all. That said, differing views and perspectives can improve transparency and reveal relevant information to the path of future policy (Blinder 2018). Also, a requirement to speak to Australians from time to time on policy issues strengthens the incentives to form considered views and foster a sense of ownership of Monetary Policy Board decisions, which discourages free riding.

On balance, the Review considers that occasional commentary from external members of the Monetary Policy Board would provide a suitable level of accountability. In particular, external members of the Monetary Policy Board should be expected to make at least one speech or participate in at least one public engagement (such as a business or community roundtable, including in regional Australia) a year. Board members should be given appropriate support from RBA staff members to do this (see Recommendation 9.2).

Recommendation 10.3: Require Monetary Policy Board members to approve the post-meeting statement and publish unattributed votes

Monetary Policy Board members to approve the post-meeting statement

The public statement released immediately after Reserve Bank Board meetings is currently approved and signed by the Governor. This arrangement reflects the Governor's role as the sole spokesperson for the Reserve Bank Board. The Review finds that this approach does not accurately convey that monetary policy decisions are the collective responsibility of all members of the Reserve Bank Board.

The Review recommends that the Monetary Policy Board approve the public statement released after each Board meeting, as a fair reflection of the decision and discussion. This change would be consistent with the approach adopted by a number of peer central banks that have dedicated bodies for monetary policy decision making, including the Bank of England.

Unattributed voting records for Monetary Policy Board meetings

The Review recommends publishing an unattributed record of votes of the Monetary Policy Board in the post-meeting statement. This would involve publishing the number of members who voted in favour of the decision, voted for an alternative and abstained. The *Minutes* should describe the areas of disagreement.

Voting records would provide information about the level of consensus on the Monetary Policy Board. In other countries, this has been shown to provide useful information about future monetary policy (Horváth and others 2012). In particular, it helps financial markets to update their expectations about future policy. This supports the transmission of monetary policy.

> *'[Publishing unattributed votes] gives a sense of where the debate lies on the board and how close the decision was. A close call when rates are changed signals that the bank is closer to the end than the beginning of the cycle, which is useful information.'*
>
> *– Response to RBA Review survey of professional economists*

The publication of even more extensive voting records is common for other advanced economy central banks. For example, the US Federal Reserve, the Bank of England, Sveriges Riksbank, Bank of Japan and Bank of Korea publish attributed voting records with detailed information on agreement and dissent. The Review heard concerns in consultations and submissions about publishing *attributed* votes and dissenting views. Some considered that this would discourage frank discussion and may entrench people in prior positions. The Review also heard concerns that it may open members up to lobbying, or pressure members into voting for sectoral interests. However, the Review is not aware of evidence that this has occurred in jurisdictions where attributed voting records are published.

The publication of *unattributed* votes balances the benefits of increased information and transparency while managing the risks of hindering open discussion at the Monetary Policy Board. The Review does not support publishing attributed votes or attributing views in the *Minutes* to specific Board members given the risk that this could stifle open and frank discussions, and open members up to lobbying.

Recommendation 10.4: Publish more information about the RBA's forecasts and messages received through business liaison, and publish Board papers

Publish key inputs into the monetary policy decision-making process in real time

The Review considers it important that the Monetary Policy Board be transparent about the information that it uses to justify its policy decisions. This is essential for accountability and to better enable external assessments of the RBA's forecasts and policy decisions in real time. It would also help the public better understand the reasons for the Monetary Policy Board's policy decisions and strategy.

The Review supports the recent announcement that the RBA intends to regularly publish insights from its business and community liaison program (Lowe 2022b). The Review heard a widespread view that stakeholders would find such information valuable. It may also help draw out alternate views from firms not included in the RBA's program. Previously, the RBA referenced liaison messages throughout its reports. However, unlike many of its peer central banks, there was no clear summary of the main messages published. Stakeholders identified this as a gap in 2022 when the RBA cited liaison messages as early evidence of a pick-up in wages growth, which the RBA used to justify a pivot in policy.

The RBA should publish key forecast profiles, along with the assumptions underpinning them, in an accessible and convenient data format (for example a format compatible with Microsoft Excel) when it publishes the quarterly *Statement on Monetary Policy*. This includes its assessments of potential output and the level of unemployment that is consistent with full employment. The RBA provides limited transparency around its assessment of these variables, with updates provided on an ad-hoc basis in speeches and research papers. The RBA should publish its assumption (but not necessarily its own expectations) for the cash rate, which at present is a rate derived from a blend of financial market pricing and surveys of market economists. The RBA currently describes its assumption for the cash rate in high-level terms. Without this information it is not possible for external observers to assess the RBA's forecasts or explore the effects of alternate policy choices. This, in turn, limits the ability of the RBA to benefit from external views and perspectives on ways to improve its forecasts (and forecasting process) and policy strategy in real time.

The RBA could do more to communicate the main risks around its central forecasts. The RBA publishes confidence intervals around its forecasts based on historical forecast errors. Other than this, the RBA largely relies on a narrative style approach to communicate the main risks that it is thinking about. During the pandemic, the RBA illustrated key risks through the use of scenarios. The Review sees value in this approach, although emphasises the need for the nature of these scenarios to be dynamic as risks evolve.

> *'Regular publication of scenarios would put greater focus on the uncertainty around economic forecasts and therefore reduce the scope for policy and communications errors that might be made through a lack of adequate focus on upside and downside risks.'*
>
> *– Response to RBA Review survey of professional economists*

Finally, the RBA could do more to increase transparency around revisions to its forecasts. The RBA could, for example, regularly publish charts that show how forecasts for key economic variables (such as GDP growth, the unemployment rate, and inflation) have been revised over time. Increased transparency around forecast performance is an important mechanism to support accountability and would also help in external communication around the rationale for policy decisions.

Publish Monetary Policy Board papers after 5 years

The publication of papers presented to the Board would increase transparency about the RBA's internal analysis, the reasoning behind its recommendations and how material is presented to the Monetary Policy Board. It would provide accountability against the Review's recommendations focused on improving the information set provided to the Monetary Policy Board (see Recommendation 9.5).

There is some risk that publication of documents presented to the Monetary Policy Board reduces the extent to which these papers offer a frank assessment. The Review considers that publishing papers after a period of 5 years strikes the right balance between managing this risk and adding to transparency and accountability. It mirrors the approach taken by the US Federal Reserve, which publishes its briefing documents for decision makers after 5 years.

The Review acknowledges there may be sensitivities with the publication of certain content. The Review supports providing some discretion for deciding the best course of action in these circumstances. For example, similar to exemptions under the *Freedom of Information Act 1982*, material could be excluded if it was obtained in confidence, affects international relations, or if disclosure would, on balance, be contrary to the public interest.

Recommendation 10.5: Strengthen the capacity of the RBA in strategic communications

The Review recommends building a professional communications capacity – under a Chief Communications Officer – that seeks to improve the effectiveness of the RBA's communications.

This recommendation is intended to ensure that the RBA has the depth of skills and expertise at a sufficiently senior level to provide strategic communications advice to the RBA's executive and its boards. A key focus of this new function should be advising the Monetary Policy Board on its communications.

This communications function needs to have an appropriately prominent position within the organisational structure. The Chief Communications Officer should report directly to the Governor. This will give the role sufficient exposure to senior forums to take a strategic perspective across the RBA. It is important the role is given appropriate access to the RBA's executives and boards, and its expertise be drawn on by them. The Chief Communications Officer will need to be actively engaged in discussions from an early stage to enable them to offer timely and informed advice.

The communications function should undertake and draw upon internal and external stakeholder analysis. This would assist the RBA to develop a richer understanding of the communication needs of its stakeholders, especially the public. Understanding these needs will ensure that the RBA's communication approach is tailored to its audiences. For example, like some of its peer central banks, the RBA has started using a layered approach for its *Financial Stability Review* to better reach the public.

Recommendation 10.6: Strengthen conflict of interest policies for members of the RBA's Boards

Most members of the RBA's Boards will serve on a part-time basis. As such, they can be expected to have other employment and roles. The Review recognises the benefits of the outside perspectives, networks and skills that this brings, as well as opportunities for information sharing. However, this arrangement raises the risk that outside considerations might influence – or be thought to influence – members to make choices that do not best contribute to achievement of the objectives of the RBA.

The Review did not hear evidence of conflicts of interest impairing decision making of Reserve Bank Board members. In addition, in Reserve Bank Board surveys between 2017 and 2022, all members either agreed or strongly agreed that 'conflicts of interest are handled appropriately'. That said, even the perception of conflicts of interest has the potential to damage the credibility of decisions, so it is important that conflict-of-interest arrangements are carefully managed (Box 3.1).

The Review identified some aspects of current safeguards that could be strengthened further for members of the Monetary Policy Board and Governance Board:

- The conflict of interest policies should contain a more fulsome description of situations where real or perceived conflicts could arise. In particular, the policy should include guidance on roles in sectors that are sensitive to interest rates, which may not disqualify candidates but need to be managed carefully.

- There should be tighter restrictions on the financial transactions of members of the Monetary Policy Board and Governance Board (and their immediate family), in line with those that apply to RBA staff. For example, Board members should be prohibited from *active* trading in financial instruments and from transacting in certain types of financial products, such as interest rate derivatives and foreign exchange. The so-called 'blackout period' for discretionary financial transactions on most financial products should be longer, reflecting the earlier involvement of policymakers in the policy formulation process (see Recommendation 9.1).

- The RBA should increase transparency around conflict-of-interests by including declarations of conflicts as a standing item in all Monetary Policy Board meetings and all published *Minutes*.

Chapter 4:
An open and dynamic RBA

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An open and dynamic RBA

This chapter considers how the RBA is operating as an institution, including its internal governance processes, its flexibility and dynamism. It looks at how leaders undertake their people leadership responsibilities and drive high-performing teams, the environment for constructive challenge and debate, and how the RBA is using its capability for economic research. The chapter makes a wide-ranging recommendation aimed at further strengthening the management, culture and operations of the RBA.

An organisation's leadership, culture and strategy fundamentally shape its performance. High-performing institutions have a culture that is aligned with their strategic direction. Culture is the shared values and beliefs that guide how members of an organisation approach their work and interact with each other (Department of the Prime Minister and Cabinet 2019). It lies at the heart of how organisations work. Important drivers of culture include the structure, systems (including governance), organisational policies and leadership of the organisation. Strategy focuses the organisation's actions and decision making.

The first part of this report has focused on the RBA's monetary policy and financial stability functions. The remaining chapters of the report consider organisation-wide matters and how they affect the broader performance of the RBA. This chapter considers the management, culture and operations of the whole of the RBA. Accordingly, the observations and assessments reflect views from across all areas of the institution. While many observations in this chapter relate to the whole organisation, a subset relate to the RBA's policy functions.

The Review has used various methods to understand the RBA's culture, recognising that culture is difficult to assess. People can have very different experiences of culture shaped by their values and beliefs, and also circumstance, such as where in the organisation they work. Adding to this complexity is that an organisation's culture is typically not homogeneous; sub-cultures often exist in parts of an organisation. To capture these perspectives, the Review consulted with a large range of people, both within and outside the RBA, and conducted a survey of RBA staff members (Appendix 4 has further details of the consultation process).

Many staff members generously shared their time and thoughts with the Review about how the RBA operates, what they appreciated about the RBA and how it could be improved. Those same staff members commonly started their comments by emphasising how privileged they felt to work at the RBA and how deeply they respected and cared for the institution. Feedback was shared with the intent of building on this strength and making the RBA the best it can be. The assessments and recommendations in this chapter reflect the balance of perspectives heard by the Review but are not necessarily the lived experience of every RBA staff member.

The RBA has a strong track record, its staff is motivated and highly capable, with a commitment to rigorous analysis and quality outputs. It has a supportive and collegiate environment and staff members are especially driven by their commitment to public service. The RBA's leaders have undertaken many initiatives over recent years to make the RBA a more open and dynamic institution that is well equipped to support its staff and carry out its duties. The Review's assessments and recommendations provide practical ways that the RBA can continue to build on this work.

The Review identified 4 focus areas for further action:

1. **Empowered staff in a more dynamic organisation:** The Review heard that the RBA, like many public sector entities, has a hierarchical culture, with a lack of or inconsistent delegation and an aversion to risk taking. This has resulted in some staff members feeling disempowered. Organisational structures, resourcing and processes are not as flexible as they could be. As such, the organisation does not always manage change well or efficiently.

2. **Stronger leadership capability to optimise performance:** The RBA should more consistently value and develop leadership and management skills. Accountability for leadership performance and processes for upwards feedback should be more robust and better embedded in the organisation. Significantly increasing transparency around internal rotations and appointments would support staff members' agency in career development.

3. **Constructive challenge and openness to diverse views:** There is a risk of groupthink within the RBA, which can be driven by concentrated policy and operational decision-making processes. The RBA could be more open to diverse voices internally and externally. These factors can inhibit constructive challenge and debate and stifle innovation and creativity.

4. **Enhanced use of technical skills and research capability:** The RBA could foster a better research culture, by enhancing and better using specialist expertise. It could more effectively utilise its own research capability in the policy process, and better engage the Reserve Bank Board in discussions of monetary policy strategy. This would support the attraction, development and retention of technical expertise.

Recommendation 11 sets out actions to address these issues. The Review recognises that the RBA's leaders are largely aware of these issues and in many cases are undertaking concerted efforts to address them. The recommended actions acknowledge these efforts and are intended to reinforce and accelerate the progress already made. The remainder of the chapter sets out an assessment of each area and detail on how these recommendations should be implemented.

Recommendation 11: Strengthen the RBA's management, culture and operations

Recommendation 11: Strengthen the RBA's management, culture and operations

11.1 The RBA should further empower its staff and raise the dynamism of the organisation. To support this, it should appoint a Chief Operating Officer, at Deputy Governor level, who:

- leads all corporate and enabling functions
- is tasked with improving delegation, strategic workforce planning, succession planning, the allocation of resources, risk management and driving cultural change.

11.2 The RBA should strengthen and extend its leadership capability through:

- mandatory leadership training for all managers
- annual externally facilitated 360-degree feedback mechanisms for managers with subsequent leadership coaching services
- ensuring its leaders are assessed for how effectively they deliver performance management and development processes that capture both the business outcomes and how those outcomes were achieved
- more routine and transparent processes for internal job and rotation opportunities.

11.3 The RBA should further encourage diverse viewpoints and constructive challenge, including by:

- ensuring its leaders are assessed for how well they listen to and engage with staff members, and welcome alternative views
- advertising management role vacancies externally as a default and better enabling external hires to succeed in the RBA through improved onboarding and support
- setting diversity targets and tracking progress against them.

11.4 The RBA should strengthen the role of research in policy formulation, including by:

- establishing a monetary policy strategy team
- increasing collaboration between policy groups, including through cross-departmental projects
- developing and executing a research strategy and agenda overseen by the Monetary Policy Board
- increasing engagement with universities and thinktanks
- deepening analytical capability by attracting, developing, and retaining technical expertise.

Building on strengths

The RBA's values are an embodiment of its strengths. The Review overwhelmingly heard that RBA staff members are strongly committed to these values (see Box 4.1). Staff members told the Review:

'The Bank's values very much align to mine, and this continually motivates me to go above and beyond and bring my best self everyday.'

'Staff at all levels clearly embody the bank's values and take their work and responsibilities very seriously.'

– RBA staff members

Box 4.1: The RBA's values

The RBA currently has 5 organisational values:

Promotion of the public interest	Integrity	Excellence	Intelligent inquiry	Respect
We serve the public interest. We ensure that our efforts are directed to this objective, and not to serving our own interests or the interests of any other person or group.	We are honest in our dealings with others within and outside the Bank. We are open and clear in our dealings with our colleagues. We take appropriate action if we are aware of others who are not acting properly.	We strive for technical and professional excellence.	We think carefully about the work we do and how we undertake it. We encourage debate, ask questions and speak up when we have concerns.	We treat one another with respect and courtesy. We value one another's views and contributions.

In October 2022, the Government announced it would extend the Australian Public Service (APS) values across all agencies covered by the PGPA Act (Gallagher 2022). This means all relevant agencies will have a core set of values including being impartial, committed to service, accountable, respectful, and ethical. The Government has also committed to include stewardship as an APS value. Agencies can continue to have agency-specific values that co-exist alongside the core set.

In the case of the RBA, this will mean that the institution will need to evaluate its agency-specific values to work cohesively with the core set of APS values.

RBA staff members have a very strong sense of pride and attachment to their organisation, ranking more highly than the APS across a range of indicators including loyalty to their organisation, motivation and purpose (Chart 4.1). RBA staff members also felt very positively about the RBA's approach to health and wellbeing (Chart 4.2). Note, throughout this chapter, responses to the RBA Review Staff Survey are benchmarked to the APS where available. RBA staff members are not engaged under the *Public Service Act 1999*, but the RBA has similarities to APS entities in terms of the public sector values and practices expected of its staff, and functional similarities in its work. While the APS provides a useful comparator, the Review recognises that the RBA has its own character, and organisational approaches need to be aligned to what is best for the RBA's role.

Chart 4.1: Staff perceptions of the RBA
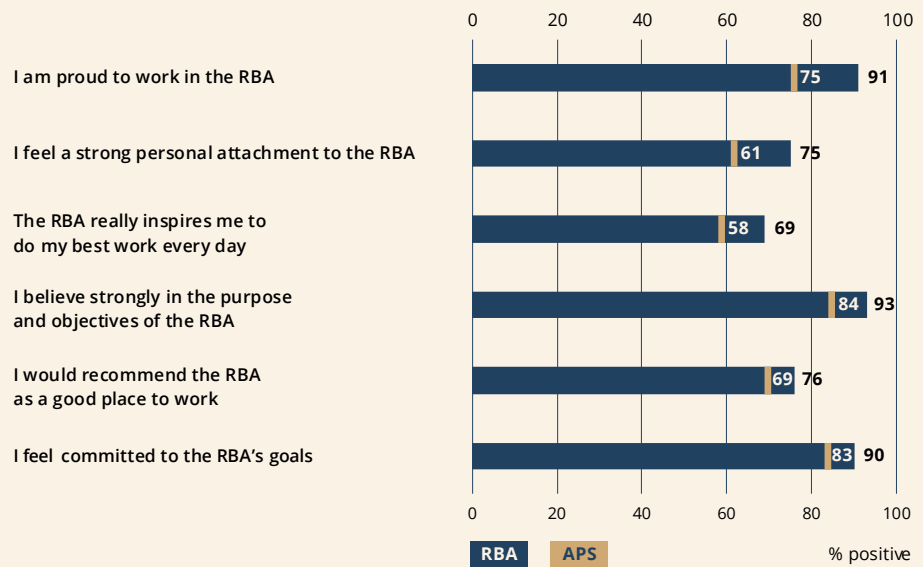
Source: RBA Review Staff Survey (2022)

Note: Ordered by the magnitude of variation from the APS. Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Bars indicate proportion of respondents who selected 'strongly agree' and 'agree'.

Chart 4.2: Staff perceptions of health and wellbeing
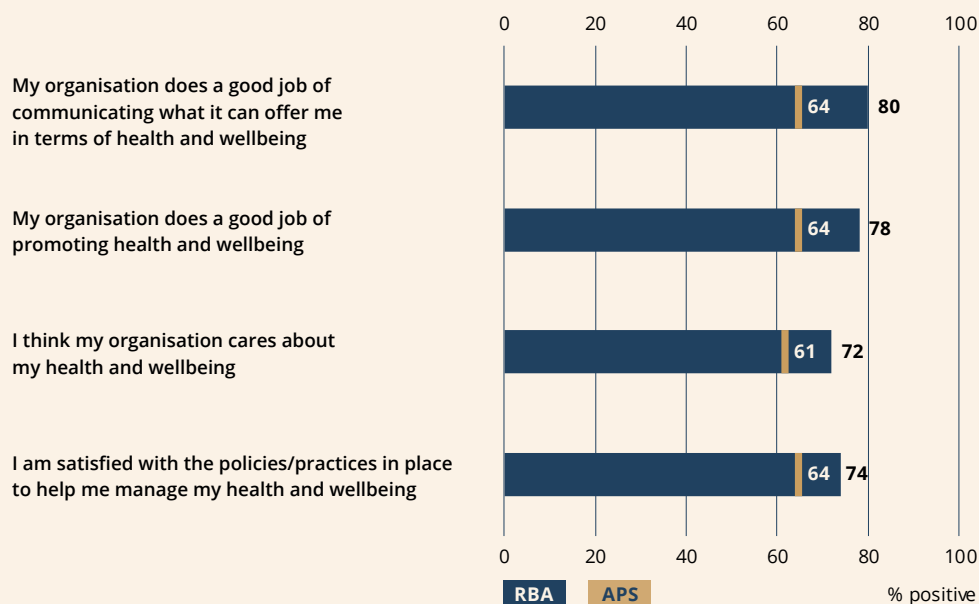
	RBA	APS
My organisation does a good job of communicating what it can offer me in terms of health and wellbeing	64	80
My organisation does a good job of promoting health and wellbeing	64	78
I think my organisation cares about my health and wellbeing	61	72
I am satisfied with the policies/practices in place to help me manage my health and wellbeing	64	74

% positive

Source: RBA Review Staff Survey (2022)

Note: Ordered by the magnitude of variation from the APS. Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Bars indicate proportion of respondents who selected 'strongly agree' and 'agree'.

External stakeholders commented on the high calibre of the RBA staff. A former Reserve Bank Board Member commented that, 'the quality of staff is the best'. Many stakeholders remarked that the RBA provides high quality technical training and continues to be an employer of choice for graduates.

The calibre of staff members is reflected in high-quality outputs. Current and former Reserve Bank Board Members consistently praised the quality of board papers (Chapter 3 discusses ways the scope of papers should be adjusted to improve monetary policy deliberations). External stakeholders noted that the RBA's published research and analytical notes were a valuable resource upon which they drew.

Many staff members also commented on the supportive and collegiate environment at the RBA. Common words used to describe the RBA were 'inclusive', 'supportive' and 'friendly' (Figure 4.1).

Figure 4.1: Most common words staff members used to describe the RBA

Source: RBA Review Staff Survey (2022).

Note: Font size correlates to the number of mentions.

Opportunities to grow

A common challenge for organisations and leaders is that strengths can become weaknesses when they are overplayed. It is difficult to get this balance right. Examples at the RBA include that strong commitment to the organisation can breed a lack of openness to external ideas. Collegiality can lead to avoidance of difficult discussions to resolve issues. Respect for and deference to senior leaders can result in a lack of challenge. Commitment to excellence can result in risk aversion that limits delegation and empowerment of junior staff members. Strengths and weaknesses are inevitably intertwined. Striking the right balance will ensure that the RBA can best use its strengths. Many of the recommendations in this chapter address instances where strengths appear to have been overplayed.

Much of the difficulty in achieving the right balance of behaviours stems from managing trade-offs between different approaches to and perspectives on issues. For example, some staff members suggested to the Review that promotion on the basis of technical and analytical skills detracts from leadership capabilities, while others suggested the opposite. This has resulted in staff members believing that both technical and leadership capabilities are undervalued or underdeveloped at different times for different roles. As these skills are not mutually exclusive, one way this trade-off can be managed is through training and development. Similarly, some staff members suggested that calls for a greater level of challenge and debate at the RBA could create a more combative and aggressive environment that would result in a less inclusive workplace. These trade-offs can be managed through resetting shared norms of engagement.

It is important to resolve perceived or actual trade-offs and conflicts. This involves open, honest and frank discussions with staff members, clearly outlining desired behaviours and shared goals, and then encouraging these through performance incentives. Ultimately, the goal is to foster and maintain an environment that strikes the right balance in behaviours to enable staff members to contribute to their full potential. These ideas are embedded in the Review's recommendations.

Recommendation 11.1: Empowered staff in a more dynamic organisation

> **Recommendation 11.1: Empowered staff in a more dynamic organisation**
>
> 11.1   The RBA should further empower its staff and raise the dynamism of the organisation. To support this, it should appoint a Chief Operating Officer, at Deputy Governor level, who:
>
> - leads all corporate and enabling functions
> - is tasked with improving delegation, strategic workforce planning, succession planning, the allocation of resources, risk management and driving cultural change.

Every institution has ways in which it can improve. The Review has identified the following issues for which a continued and sustained focus by the RBA is required:

- The RBA has a hierarchical culture which can slow down decision making, limit sensible delegation and lead to some staff members feeling disempowered.

- Organisational structures, resourcing, and processes are not as flexible as they could be, meaning change is not always managed well or efficiently.

- While siloes have reduced overtime, the RBA could do more to improve collaboration and lift performance by exploiting efficiencies and sharing learnings across the organisation.

- The RBA has more to do to deepen its professional corporate expertise, which is critical to adopting best-practice ways of working.

- Excess risk aversion is an issue in some parts of the RBA and staff members' understanding of good risk management practices varies across the organisation.

Many of these issues are interlinked, and staff members relayed to the Review how they reinforce one another. Addressing them requires a multifaceted and strategic approach, covering changes to formal rules and approaches and importantly, improving the tone and culture of 'how the RBA does things'.

The RBA's staff and leaders have identified similar issues in the past and have taken various steps to address them. However, a gap remains in the lived experience of staff and there is an opportunity to do more. The recommended actions are intended to support the RBA's continued focus on these issues.

A new Chief Operating Officer (COO) should be appointed at the same level as the Deputy Governor in the RBA's operational structure to support the RBA to continue building an organisation that is more empowered, strategic, and dynamic. The role should have responsibility for the RBA's corporate and enabling functions. The COO should sit on the RBA's Executive Committee and Governance Board (discussed in more detail in Chapter 5).

Creating the new COO role will:

- Enable an executive leader with seniority to guide enterprise-wide initiatives and uplift the consideration of strategic operational issues within executive decision making forums.

- Support improved enterprise risk management, including frameworks and processes, and embed better understanding of these issues among the RBA's staff.

- Bolster the work of the RBA's other executive leaders to effectively manage the RBA and allow the Deputy Governor (who currently has these responsibilities) more time to focus on policy.

- Enable greater communication between the RBA's executive leaders and staff members on organisational issues, including through driving the development of a Culture Plan which outlines changes the RBA will pursue and a plan for achieving them (see Chapter 6).

- Provide an additional authoritative voice of constructive challenge in the RBA's governance forums.

The COO should look for ways to improve how effectively resources are used, and enhance delegation and decision making. The COO should look for opportunities to reorganise resources to reduce overlap and promote greater efficiencies. They should consider whether the RBA's structure and internal processes support effective collaboration and the dynamism to rapidly redeploy resources for changing needs (for example, in the form of taskforces). Several RBA staff members highlighted to the Review the positive example of the RBA's recently formed Climate Analysis and Policy section and its use of expertise from across the organisation. They noted this could be replicated more proactively in response to emerging issues.

The COO should oversee work to examine the roles, responsibilities and management spans of control at all levels to ensure they are appropriate and support the RBA's structure. The design of these should enable streamlined processes and communication. It should also reduce unnecessary layers of decision making that can waste effort and create risk. The aim is to have clear accountabilities to facilitate decision making at appropriate levels – that is, decisions are not unnecessarily escalated or retained at more senior levels. The size and composition of teams should enable managers to provide support and guidance while empowering team members.

The RBA should develop a strategic workforce planning capability and improve its succession planning. A greater focus on strategic workforce planning will assist the RBA to identify and plan how to close the gap between current and future workforce needs to enable delivery of its mandate. It will assist the RBA to consider the balance of different expertise and the design of the roles it will need in the future. Relatedly, the RBA should have robust processes for succession planning to ensure it has a high-quality pipeline of future leaders. Processes for succession planning for the RBA's senior leaders (such as its Department Head, Deputy Head and Senior Manager roles) and executive leaders should be consistent and structured. They should give regard to both the relevant experience of individuals and the overall skills mix needed by the RBA's management team. Oversight by the Governance Board (see Chapter 5) will help to ensure that the executive leadership team has the appropriate balance of skills and experience to deliver on the RBA's strategic objectives.

The RBA should take further steps to improve its risk culture and management. Building on the work it already has underway, the RBA should embed a strong understanding of risk management across all levels of the organisation. This will help staff members to better assess different types of risks and appropriate responses. Over time, it should help to diminish unnecessary risk aversion, promote better risk identification and management, and risk assessment related to strategic decisions. Progress should continue to be made through induction, training, and awareness initiatives so that these practices are consistently adopted.

Active sponsorship and support from executive leaders[1] are essential to help drive cultural and behavioural changes in the RBA's approach to risk. This includes accepting manageable risks and acknowledging that failures inevitably come with taking on more risk. The RBA's staff should be encouraged to innovate, and be supported when learning from mistakes, with the recognition that decisions not to act often also entail cost and risk. Setting this tone will help to reduce unnecessary 'gold plating' or perfectionism. It will also support a culture where failures that are a natural part of innovation are seen as ways to learn. These changes should be overseen by the Governance Board (see Chapter 5).

Supporting assessment

Greater delegation and empowerment of staff members

RBA staff members frequently raised decision making, delegation, and hierarchy as areas for improvement. The Review heard from staff members that decisions tend to be pushed up to or retained exclusively at more senior levels. Others relayed that delegation was inconsistent across teams or could change at short notice, creating risk. Staff members identified various drivers for this including:

- risk aversion, which in this context shifts accountability or blame for potential mistakes

- lack of clear accountability

- a culturally ingrained deference to authority

- incentives that reward individuals for analytical output and those who appear to be across technical issues, resulting in resistance among some managers to genuinely delegate and empower team members.

This was not a universal view. Some staff members felt empowered to do their work and thought delegation was working well, and suggested that different experiences were driven by individual managers. Staff members reflected that better and more consistent delegation would empower them, improve efficiency and better manage risks. Having clearer accountabilities would enable decisions to be delegated to an appropriate level. As one staff member commented:

'It is very difficult to implement change because all levels of management are keen to comment on everything, even very small changes. Things could be better delegated, or staff trusted to make decisions up to a certain point. Sometimes it's not entirely clear whose sign off you need on certain things because everyone has an opinion, but no one will make the final call.'

– RBA staff member

———

1 Throughout this chapter, the terminology of *executive* is used to distinguish the RBA's Assistant Governors and above from other leadership positions.

A substantial proportion of respondents to the RBA Review Staff Survey indicated that decision making processes created barriers to them performing at their best (Chart 4.3).

Chart 4.3: Staff perceptions of barriers to them performing at their best (decision making)
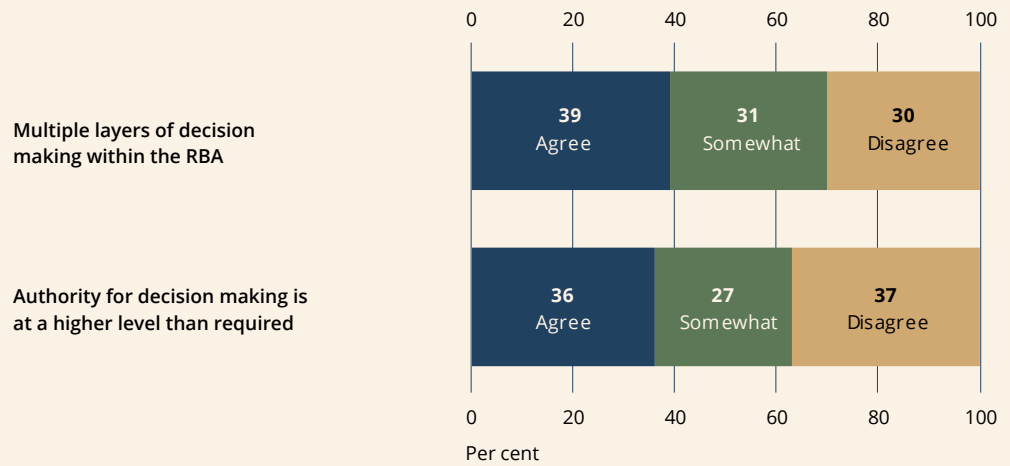
	Agree	Somewhat	Disagree
Multiple layers of decision making within the RBA	39	31	30
Authority for decision making is at a higher level than required	36	27	37

Per cent

Source: RBA Review Staff Survey (2022).

Note: Response scale was 'to a very great extent', 'to a great extent', 'somewhat', 'very little', 'not at all'. Agree includes 'to a very great extent' and 'to a great extent'. Disagree includes 'very little' and 'not at all'.

Staff observations included:

> '...The RBA should become better at empowering, delegating responsibility and holding to account, rather than pushing the accountability to the highest level. This practice also removes decision makers from the subject matter, enabling poor decisions to be made, especially when a lack of cognitive diversity and hierarchical culture silence voices that could challenge decisions.'
>
> – RBA staff member

The RBA would benefit from identifying opportunities to improve the clarity and consistency of delegation among its staff. This should be supported and sponsored by the COO, and should include consideration of roles, responsibilities, accountabilities, and management spans of control across all areas and levels of the RBA. Delegation authorities in important operational areas of the RBA should be subject to occasional internal audits to ensure they are being followed.

More dynamic and flexible structures and approaches

The RBA has long-standing and relatively unchanged organisational structures. Several senior staff members noted that significant restructures are rare. The last major organisational restructure was catalysed by external events in 1998 – the Government's shifting of bank prudential supervision to APRA, and the establishment of the Payments System Board. Staff members also reflected that short-term mobility and reorganisation of resources to quickly respond to emerging issues is not a well-established or particularly valued way of working within the RBA. However, the onset of the COVID-19 pandemic did necessitate some rapid reorganisation of employees, showing that it is possible.

Long-standing structure has some benefits. Staff members reflected that it is 'easy to figure out who does what' at the RBA. In the RBA Review Staff Survey, 83 per cent of employees thought it was clear what their duties and responsibilities were. However, staff members generally expressed a greater desire for more agility in how they worked. Comments to the Review included:

> *'There is a Bank-wide issue in sometimes not being bold enough to 'give something a shot', or to restructure teams and try new things. In part, this is because the Bank hasn't faced the same external pressures as other organisations.'*

> — *RBA staff member*

The RBA would benefit from more regularly considering how its organisational structure could be adapted to better enable it to respond to emerging risks, challenges and short-term pressures. This would also help to ensure that its resources are being used effectively and efficiently.

Related to this, the RBA should enhance its strategic workforce planning, which is currently an area of limited capability and capacity. The RBA is not alone in this with only 54 per cent of APS agencies having their own workforce plan and 76 per cent of APS capability reviews conducted between 2011 and 2015 identifying workforce planning as a serious concern (Independent Review of the Australian Public Service 2019).

During focus groups and interviews, staff members relayed examples of areas where they thought the RBA should plan to develop enhanced skills to improve its future performance. These included expertise in computer coding and modern, accessible communications. Planning for such changes would also enhance the RBA's ability to uplift career planning and development, a point of consistent calls for improvement from staff members (see also Recommendation 11.2 of this chapter).

The Review also heard concerns from staff members that internal RBA processes were quite inflexible. Staff members gave multiple examples of processes that were unnecessarily drawn out. For example, several staff members told the Review that procurement processes could require so many layers of approval that quotes had expired by the time the process was complete. Other staff members relayed that processes around decision making could be performative and superficial rather than genuine, and that it was difficult to prosecute new ways of doing things and push back against a 'we've always done it this way' attitude.

In the RBA Review Staff Survey, perceptions of administrative burden and change management were poorer than across the APS (Chart 4.4). The proportion of respondents who agreed that change is managed well in their organisation was 9 percentage points lower than the APS.

Chart 4.4: Staff perceptions of change management and administrative processes
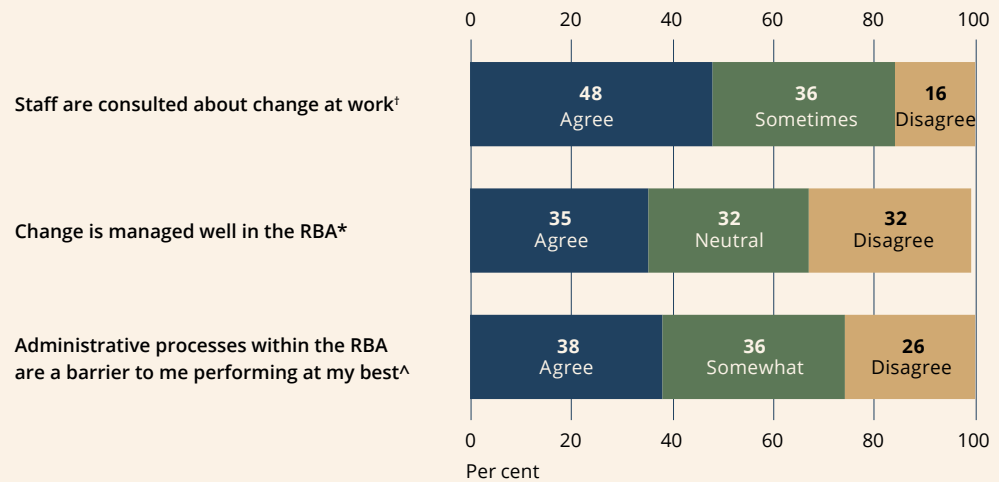
	0 20 40 60 80 100
Staff are consulted about change at work†	**48** Agree / **36** Sometimes / **16** Disagree
Change is managed well in the RBA*	**35** Agree / **32** Neutral / **32** Disagree
Administrative processes within the RBA are a barrier to me performing at my best^	**38** Agree / **36** Somewhat / **26** Disagree

Per cent

Source: RBA Review Staff Survey (2022).

Note: Bars may not sum to 100 due to rounding.

†Response scale was 'always', 'often', 'sometimes', 'rarely', 'never'. Agree includes 'always' and 'often'. Disagree includes 'rarely' and 'never'.

*Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Agree includes 'strongly agree' and 'agree'. Disagree includes 'disagree' and 'strongly disagree'.

^Response scale was 'to a very great extent', 'to a great extent', 'somewhat', 'very little', 'not at all'. Agree includes 'to a very great extent' and 'to a great extent'. Disagree includes 'very little' and 'not at all'.

When asked about what they would like to change about the RBA, comments from staff members included:

> 'More agility when working through projects and considering opinions/processes/best practice from external organisations. We are fairly stuck in our ways when it comes to getting things done. Good ideas can sometimes get lost in thought chambers.'

> 'There is a lack of understanding that you reap rewards of changing systems and processes even if there is short-term cost. Managers tend to only see change through a cost lens.'

> — RBA staff members

In a constantly changing environment, it is important the RBA maintains flexibility. It needs to be able to rapidly plan for and realign its operations to meet changing priorities. To continue to be a high performing institution, the RBA must be proactive in looking for ways to continuously improve, harness new technologies, anticipate and address risks, and enable innovative solutions to complex problems.

Enhanced collaboration

The Review heard from staff members that the RBA can be quite siloed and there can be barriers to collaboration. In the RBA Review Staff Survey, 28 per cent of respondents thought that siloed work practices were, to a great or very great extent, a barrier to them performing at their best.

A further 32 per cent thought that they were somewhat of a barrier. Observations from staff members included:

> '*A lot of the things we do are often relevant to multiple departments at the Bank, but there sometimes appears to be an invisible barrier between departments when it comes to communication and collaboration. There should be ways to manage this more effectively or at least promote within the Bank that we can be one team and not work as silos.*'
>
> *– RBA staff member*

The survey results indicated that there were differences in staff members' perceptions on siloes across the RBA. Respondents in departments such as Finance, Human Resources, and Audit (captured as part of the Executive Support Group) considered siloed work practices a greater issue when compared with staff from policy departments (Chart 4.5). In focus groups with RBA staff members, those in enterprise-wide roles such as risk, human resources and IT were much more likely to be concerned about siloes across the organisation, possibly reflecting that their jobs often involved implementing RBA-wide initiatives.

Chart 4.5: Staff perceptions of whether siloed work practices are a barrier to them performing at their best, by functional group
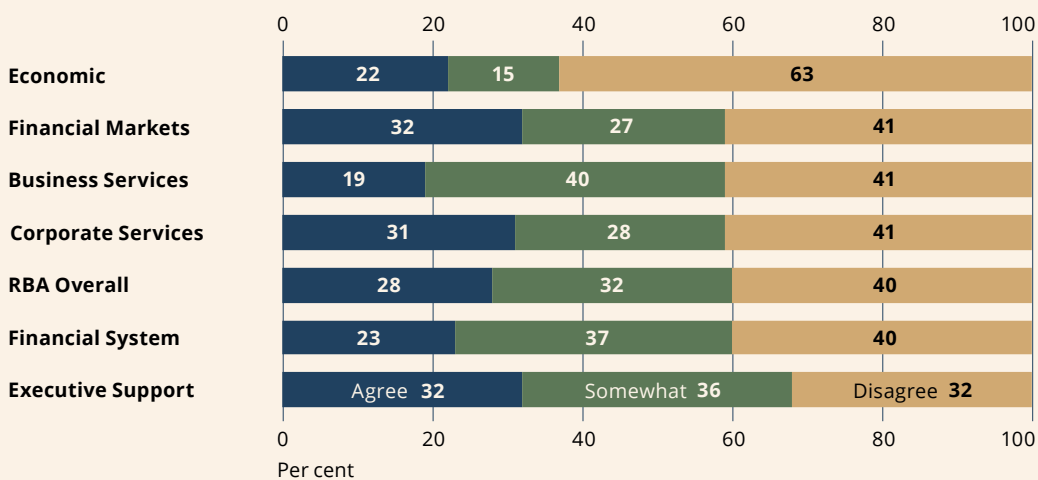
Source: RBA Review Staff Survey (2022).

Note: Response scale was 'to a very great extent', 'to a great extent', 'somewhat', 'very little', 'not at all'. Agree includes 'to a very great extent' and 'to a great extent'. Disagree includes 'very little' and 'not at all'.

Focus groups and survey responses suggested that the long-standing organisational structures, while creating clarity about subject matter responsibilities, had acted to limit opportunities for collaboration. For example, a staff member observed:

> '*The organisational structure creates and enables a siloed approach, in effect the Assistant Governors are enabled to do what they see fit, this creates pockets of excellence, but overall enables inconsistent approaches and ultimately sub optimal outcomes.*'
>
> *– RBA staff member*

Breaking down these barriers would help the RBA to better harness the expertise and knowledge from across the organisation and support good local initiatives to be more widely adopted. Sharing of knowledge, experiences and lessons learned would help to build more effective processes.

Valuing professional corporate expertise

The RBA has made a concerted effort to bring more senior external expertise into its corporate functions over recent years. The Review recognises this progress and supports it continuing. It is also the case that some of the RBA's corporate functions – such as external financial reporting – are very well regarded and the concerns the Review heard around professional corporate expertise do not apply consistently across all areas.

Nonetheless, the Review heard from both policy and operational staff members that the RBA has been slow to deepen its professional corporate expertise. This was particularly in the areas of risk, human resources, legal services, and communications. While the Review acknowledges the improvements the RBA has made, staff members observed that some legacy issues remain, and the RBA is behind comparable organisations with respect to some of its work practices. For example, staff members considered that the persistence of some of the behaviours outlined in this section were in part due to the relatively late development of a leadership strategy and more balanced capability framework, as well as a historical tendency to limit external hiring.

Many staff members remarked to the Review that the RBA has a long history of transferring professional economists from policy departments into senior corporate roles. A common remark the Review heard was that the organisation was 'run by economists for economists'. Asked about what they would like to change about the RBA's culture, staff members' observations included:

> *'There are economists everywhere in the Bank where they shouldn't be, and their opinion is weighed higher than all others. Employing them removes the opportunity for subject matter experts to actually improve and innovate.'*

> *'I think there is a fundamental bias in the RBA's culture to promote economists even though there are staff who have years of operational experience. Due to this, I've seen operational staff with a lot of corporate knowledge leave the bank.'*

> *– RBA staff members*

Many senior leaders at the RBA commented to the Review that the introduction of a dedicated COO role would be a significant improvement. It is unusual for an organisation the size of the RBA not to have a sole executive leadership position with responsibility for leading corporate and executive operations. Some senior staff members thought that without a dedicated executive and authoritative voice, important corporate strategic issues were not always fully considered by the RBA's executive decision making bodies. There can be difficulty at the RBA in trying to achieve consistency and buy-in across the RBA's functional areas in terms of implementing best practice ways of working. Siloing can lead to partial solutions for issues that are enterprise wide, with an insufficient focus on end-to-end processes. For example, a staff member commented to the Review:

> *'Departments are run as 'fiefdoms', who come up with their own ways of doing things in terms of processes and delegation. This makes it difficult to design governance and controls effectively. It is not clear who really has the power to corral the Departments in a centralised way and get them to operate consistently.'*

> *– RBA staff member*

Currently, the role of the Deputy Governor – which has responsibility for the RBA's enabling functions, as well as policy responsibilities – is too large to give appropriate regard to both and should be split. Overseeing the RBA's policy functions requires different skills to overseeing its corporate and operational functions, and it is challenging for any single person to cover this breadth of skills.

Improving the risk culture

The Review notes that operational areas of the RBA generally have a well-developed and balanced approach to risk management. This in part relates to the nature of the risks faced by these areas, with risks generally being more measurable and immediately consequential. Nonetheless, in some areas there are opportunities for improvement, which is why the RBA has undertaken several initiatives including:

- refreshing its Risk Appetite Statement and engaging employees on its content

- reviewing its Risk Management Framework

- requiring all departments to undertake risk culture self-assessments

- developing an Executive Accountability Framework

- implementing a network of 'Risk Champions' throughout the organisation who raise broader awareness of good risk management practices.

Shifting risk culture and embedding sound practices takes time so the RBA should maintain momentum on this important work. In this regard, the Review heard from a range of staff members that concerted effort continues to be needed in several areas. First, promoting a more mature risk appetite in some parts of the RBA. Second, embedding risk management frameworks in areas where they are less developed, such as policy areas. Third, ensuring that risk is a well-established and consistent consideration in the RBA's decision making and project management processes. These changes need to be supported by making sure that the risk management function is empowered to act with an authoritative voice and as a meaningful line of defence.

A range of staff members reported that there was excess risk aversion in some parts of the organisation. This was seen to detract from efficiency and the ability to make improvements and innovate. For example, RBA staff members commented to the Review:

'A lot of the time the RBA wants gold plating. Although this attitude has changed a lot in the last 5 years. We spend most of the time in achieving the last 10 per cent of the objective instead of doing more substantial work. Sometimes security controls and business expectations for systems are not realistic relative to the tiering of the systems. There is always a big unknown question to solve 'what if this happens' leading to over-engineering of solutions and processes.'

'Culture can vary significantly by department and section, so making broad generalisations that apply to the Bank as a whole can be difficult. My experience of culture at the Bank varies significantly as I have moved teams. However, broadly speaking there is a perfectionist culture at the Bank that results in 'gold-plating' internal work. This can result in timelines for pieces of work being stretched for little additional benefit.'

– RBA staff members

Results from the RBA Review Staff Survey reinforce these views. A substantial proportion of respondents considered the RBA's appetite for risk and resistance to trying new things were barriers to them performing at their best (Chart 4.6).

Chart 4.6: Staff perceptions of barriers to them performing at their best (risk)
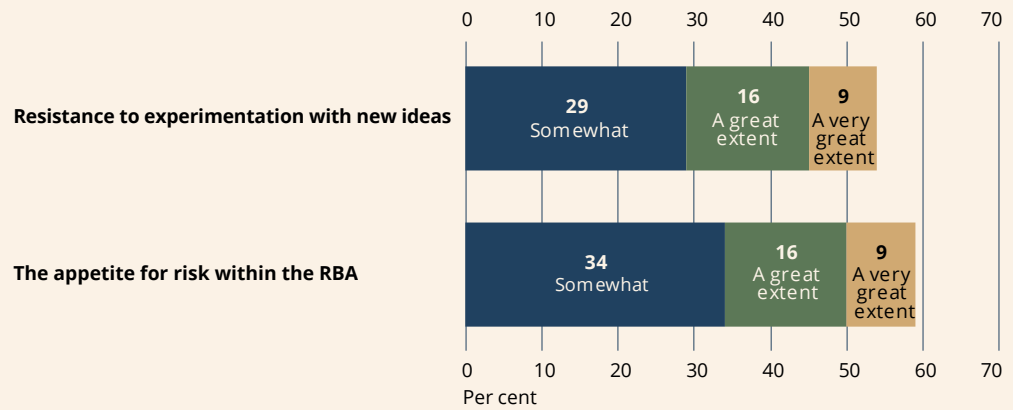
Source: RBA Review Staff Survey (2022).

Note: Response scale was 'to a very great extent', 'to a great extent', 'somewhat', 'very little', 'not at all'.

The Review heard that one reason for risk aversion in some parts of the RBA is because of a low tolerance for failure. Survey data showed that only 38 per cent of staff members agreed that the RBA supports the idea that failure is a part of innovation. Staff members told the Review that the RBA has a 'long memory'. In focus groups conducted as part of a Psychosocial Risk Audit for the RBA in 2021, many accounts were provided of issues that had occurred ten or more years ago. The Review heard that in some cases, mistakes become part of RBA folklore and the stories continue to be shared years later. While this can reflect learning over time, the Review also heard that these examples were seen as signifying that making mistakes was a terrible thing and attached negatively to the individuals involved.

A common theme the Review heard was that the RBA does not handle bad news well and that this means people do not want to raise problems or point out mistakes. Staff members remarked that this strengthens risk aversion and fear of failure:

'...Another issue is an unwillingness to hear about problems. Reasonably, senior leadership wants a focus on solutions, but it does mean discussion of problems gets supressed and is seen as career limiting/not taking an 'all of Bank' view and various other characterisations.'

– RBA staff member

These issues can manifest as 'gold plating' where minor risks are overmanaged. Staff members reported that this could be the case even for outputs that they considered lower risk in terms of the RBA's reputation (for example, internal analytical notes). Staff members reported that various factors, including the presence of fewer external hires, bred an environment in policy departments that was more insular than other areas of the RBA and that this could result in the loss of broader perspective. An RBA staff member told the Review:

> 'The RBA puts too much emphasis on perfecting the minutiae of internal work relative to getting the bigger picture approach correct. In particular, too much time is spent editing and re-editing internal work which impedes the pace and scope of analytical work. Managers therefore spend much of their time editing, when time would better be spent exploring better ways to answer policy-relevant questions.'
>
> – RBA staff member

The Review heard that risk aversion can be particularly problematic for initiating new projects and changing how the RBA operates. Several people commented that project initiation involved excessive analysis and information up front relative to the risks involved, creating issues with timely project delivery. Staff members in corporate roles have, at times, been expected to draft long analytical notes in the same style as those in policy roles, hampering quick innovation. Others highlighted the lengthy discussions and approvals involved in attempting to improve processes used to produce and deliver regular pieces of analysis. Some reflected that these are long-running issues at the RBA. A comment from the RBA Review Staff Survey that was reflective of this, was:

> 'The Bank is too hierarchical and struggles with delegated decision making. It tends to fall into analysis paralysis where staff want all the detail up front rather than being able to embrace progressive elaboration. Providing more delegation and becoming a bit more agile would go a long way.'
>
> – RBA staff member

In relation to better embedding risk management frameworks, the Review heard more needs to be done to deepen staff members' knowledge of risk management. This includes better understanding the RBA's risk appetite, how it translates to their work, what controls might apply, and expectations for good risk management behaviours. The most critical element is helping staff members to understand how risk assessment and risk management practices add value to and support their everyday work. Some staff members relayed to the Review that they would like to better understand these issues to improve their work. Successfully improving risk culture requires executive leaders to emphasise the value of risk management and how it enhances the RBA's work. As one RBA staff member put it:

> 'It would be wonderful to see the RBA encourage, embrace and reward innovation with an increase in appetite for measured risk taking. I believe this would help break down some barriers (perceived or real) and enable the Bank to evolve into a more innovative, engaging, collaborative and inspired organisation.'
>
> – RBA staff member

Recommendation 11.2: Strong leadership capability to optimise performance

Recommendation 11.2: Strong leadership capability to optimise performance

11.2   The RBA should strengthen and extend its leadership capability through:

- mandatory leadership training for all managers
- annual externally facilitated 360-degree feedback mechanisms for managers with subsequent leadership coaching services
- ensuring its leaders are assessed for how effectively they deliver performance management and development processes that capture both the business outcomes and how those outcomes were achieved
- more routine and transparent processes for internal job and rotation opportunities.

The Review acknowledges the initiatives the RBA has implemented to improve its leadership capability and its people management frameworks. The Review has identified 4 opportunities for further improvement that are intended to be addressed by Recommendation 11.2:

- Further action could be taken to recognise the importance of leadership capability in driving high-performing teams, including that leadership training be made compulsory.
- Consistency of, and manager accountability for, delivering effective performance management and two-way performance feedback could be strengthened.
- Managers' support for career development and planning discussions could be improved to help staff members take greater ownership of their career development.
- Transparency of internal opportunities for promotion and rotation could be increased to improve the ability of RBA employees to take ownership of their career paths.

The aim of this recommendation is to support consistent, high-quality people leadership, performance and development capability at the RBA. Building and maintaining this capability takes time – for training but also for ongoing feedback, coaching and support. It is important that people leaders be given the time and space to prioritise and develop these skills. The actions outlined in this recommendation are interlinked. Improved mechanisms for 360-degree feedback enable better performance assessments, which in turn support better development planning. Development planning may, in turn, include steps for further improving leadership capability.

Importantly, while the RBA's human resources function can facilitate these changes, successful implementation requires strong and active sponsorship from the RBA's executive leaders, and a willingness to hold managers to account for delivery.

Mandatory leadership training tailored to different levels of management will help to equip people leaders at all levels with the skills necessary to engage and get the most out of their teams. The training should emphasise that leaders need to focus on both the 'what' in terms of the business outcomes they deliver, but also on the 'how' in terms of the behaviours they adopt in delivering.

Training should include developing the self-awareness of people leaders as well as their ability to have difficult conversations and effectively manage conflict. It should support creativity and innovation to enable different types of thinking and solutions development. It should enable leaders to have high-quality conversations with their staff members about career goals and development needs, and coach them towards their goals.

Training should be available to employees who are not yet people leaders but have development plans that indicate an interest in and potential to be future leaders.

An executive leadership training program for the RBA's executive leaders (Assistant Governors and above) should be implemented and include a focus on working as a cohesive leadership team to deliver on organisation-wide priorities. Executive leaders should have the capability to develop, clearly communicate and execute longer-term strategic plans. This will assist the RBA to identify priorities, establish goals and objectives. It will enable strategic consideration of structure, resource allocation and requisite expertise to achieve its priorities. It will also facilitate decisions on what should be de-prioritised given limited resources. The RBA has begun work on developing an executive leadership training program. As part of this, it should consider how best to make use of existing external leadership training programs in the public and private sector and ensure that executives are exposed to other external influences.

It is important that the RBA's executive leaders can drive organisational change, inspire staff members, and promote greater psychological safety. Immersing executive leaders in these practices is vitally important to maintaining a high performing institution.

Implementing a rigorous process for 360-degree feedback that feeds directly into performance assessment for all managers including the RBA's executive leaders will ensure they receive a variety of performance feedback from their direct reports, peers, and managers. This is valuable for developing leadership capability, strengthening accountability, and creating a culture of self-reflection among all staff members. It will enable better, more accurate performance discussions.

The 360-degree feedback process should be externally administered to remove any anxiety among the staff about delivering genuine feedback and include external benchmarking of leadership performance where possible. It should be followed up with coaching for leaders to ensure that they are supported to effectively consolidate the learnings from both the feedback and mandatory leadership training. Improving genuine two-way feedback will not only help to lift leadership performance, but also retention and engagement of staff members.

Driving more consistent use and understanding of performance management, development and career planning frameworks will support managers to provide constructive feedback to staff members and manage underperformance more effectively. Manager performance in these areas will also be improved by training and the 360-degree feedback they receive. Staff members should receive regular and useful feedback to improve their performance. Performance should be assessed consistently across the organisation with respect to the evaluation of skills and behaviours.

People leaders should have high-quality conversations with staff members about their career goals and professional development needs and be able to coach them effectively to achieve these. This will support more self-driven career and development planning. Staff members (including leaders) should have individual career development plans to better track goal progress.

In relation to talent management, the RBA's senior leaders and executives should ensure that consistent and rigorous approaches to assessing performance and potential are incorporated into the RBA's approach. Leaders across all levels must demonstrate genuine buy-in to ensure that effective and consistent people processes are widely embedded in how the RBA operates.

Greater transparency and openness around internal vacancies and movements will support employees to have more agency over their careers and professional development within the RBA. It will ensure that competitive processes find the best candidates for jobs and provide a safeguard against the possibility of favouritism, which can embed a lack of diversity. Staff members need to trust that positions are filled transparently and based on merit, so that they are more engaged and empowered. This does not mean that all positions must be filled through the same process. The need to quickly mobilise resources or fill very short-term positions can make such processes undesirable. However, openness and transparency should be the default.

Supporting assessment

Valuing and improving leadership capability

The Review acknowledges the work the RBA has already undertaken and continues to pursue to develop leadership capability, including:

- In 2015, the introduction of a leadership development strategy including foundational leadership and management training.

- In 2020, the launch of MyCareer, the RBA's overhauled career progression and capability frameworks. The framework more clearly outlines both the technical outputs expected from staff members, as well as expected behaviours including people leadership responsibilities.

- In 2021, an external Psychosocial Risk Audit, which built upon an earlier 2017 assessment. Improvements were noted in the RBA's approach to mental health and wellbeing, but leadership quality was identified as a key risk that remained.

- The launch of iLead, a revamped leadership development program that has a deeper focus on self-awareness, as well as empowering and developing others. This program aligns more closely with MyCareer, which has a greater emphasis on leadership capabilities.

The Review supports these developments and believes the RBA should continue to enhance its leadership capability initiatives as leadership capability remains varied across the organisation.

The Review recognises that the RBA needs both effective people leadership skills and technical capability, and these are not mutually exclusive skill sets. The challenge is to get the appropriate balance in expectations for different roles, and across the organisation as a whole.

Many staff members noted a historical tendency of the RBA to promote people into management positions based on technical abilities or tenure. A strong perception among staff members was that this preference has sometimes come at the cost of having good people managers. Comments from RBA staff members included:

'... Leadership in the Bank is poor – most leaders feel that their role is only about producing analytical pieces rather than inspiring innovation and excellence and, as a result, the culture of fear is pervasive.'

'Much more consideration needs to be given to candidates' leadership skills. Too much focus is placed on technical skills, which are clearly important, but aren't a good indicator of emotional intelligence.'

— RBA staff members

In the RBA Review Staff Survey, more staff members agreed that technical ability was given enough emphasis in promotion decisions than agreed that effective people management skills were (Chart 4.7).

Chart 4.7: Staff perceptions of the importance of technical and leadership capabilities in promotions
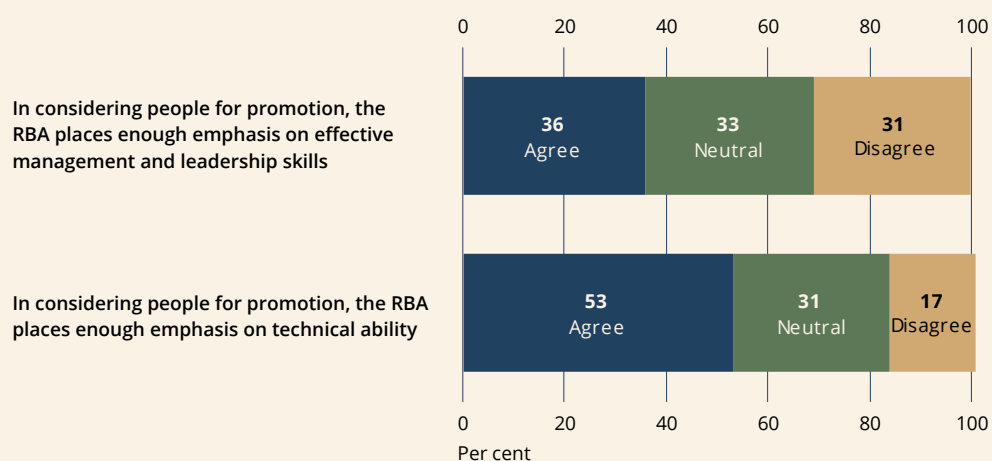
Source: RBA Review Staff Survey (2022).

Note: Bars may not sum to 100 due to rounding. Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Agree includes 'strongly agree' and 'agree'. Disagree includes 'disagree' and 'strongly disagree'.

The Review heard that the RBA's leadership development should be strengthened. Staff members described a relatively passive approach to leadership development, with some senior leaders described as 'passengers'. Views from staff members included:

'We have very smart people at the top but all of the change training is focused on senior managers and below when the real leadership and culture change is needed in Heads of Departments and above.'

—*RBA staff member*

However, not all of these perspectives were universal. Some staff members thought that technical expertise was undervalued. This was reflected in some RBA Review Staff Survey responses and in some focus groups and interviews. Some staff members also spoke very highly of their current managers and noted that over recent years there has been a marked improvement in the RBA's approach in these areas.

The Review draws two points from the survey results and feedback received:

- For many roles, staff members think that a higher weight should be placed on effective leadership skills than is currently the case. Adjusting leadership development and selection approaches is a way to address this.

- Some people have very strong technical capabilities but are not suited to people leadership positions. For those people, a technical career pathway (see Recommendation 11.4) may better support their contribution, than trying to fit them into a people leadership position.

Opportunities exist to continue to strengthen the RBA's leadership capability, through the approaches to both promotion and staff development. At present, leadership training is offered on an opt-in basis and there is little differentiation for different levels of management. The RBA does not currently have an executive leadership program but has begun work on developing one.

The RBA's approach to performance assessment (discussion to follow) presents a further opportunity to strengthen leadership capability.

Stronger performance management

The Review heard that the RBA could strengthen performance management – the processes by which managers assess, measure and develop the performance of staff members. Some managers felt there could be better support within the RBA to undertake performance management in a more meaningful way. Many staff members across a wide range of levels considered that performance management was not particularly helpful to them. Some considered that this was because there was not strong accountability for managers to deliver it. The RBA Review Staff Survey highlighted that the RBA ranked more poorly than the APS on staff members' perceptions of performance management (Chart 4.8).

Chart 4.8: Staff perceptions of performance management
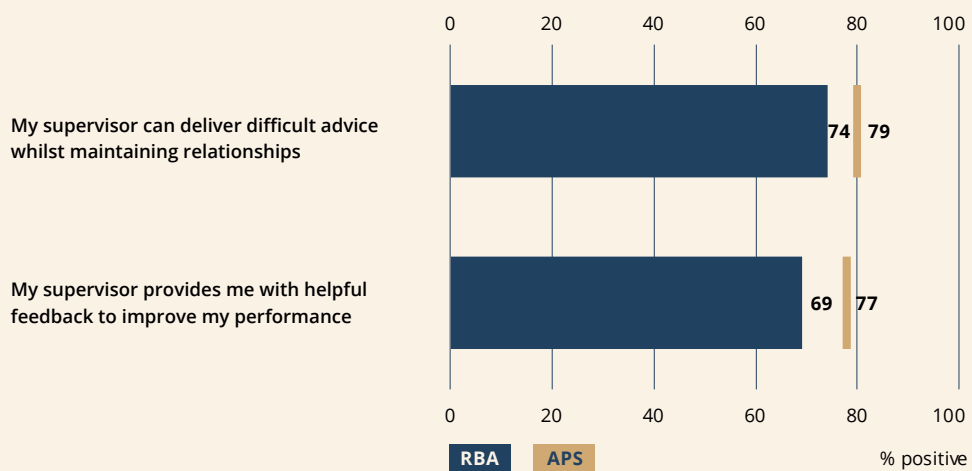
My supervisor can deliver difficult advice whilst maintaining relationships — RBA 74, APS 79

My supervisor provides me with helpful feedback to improve my performance — RBA 69, APS 77

RBA | APS | % positive

Source: RBA Review Staff Survey (2022).

Note: Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Bars indicate proportion of respondents who selected 'strongly agree' and 'agree'.

A recurring observation from staff members was that the RBA's leaders were not consistently good at delivering constructive feedback and managing underperformance. The Review often heard that managers could be 'conflict avoidant', prioritising a collegial atmosphere and friendly long-term working relationships. As one staff member noted:

> '*Performance management of underperforming staff is non-existent. Trouble staff are simply rotated until if ever, they decide to leave.*'
>
> —*RBA staff member*

The Review heard that there was inconsistency in the extent of two-way feedback in performance management processes. Only 59 per cent of respondents to the RBA Review Staff Survey thought they had sufficient opportunity to provide feedback on their manager. One commented to the Review:

> '*I've never been asked in 3 years of work to provide feedback on my managers' leadership of the team, so it's unclear to me what managers' performance reviews are based on.*'
>
> —*RBA staff member*

Some staff members reflected to the Review that at times there was still too much focus within the RBA's culture on individual achievements, and not enough on how staff members (and particularly managers) work with and develop others and improve their teams. One comment to the Review that reflected this was:

> '*In the past, technical skills have been far more valued than management skills in promotion. I think this has been somewhat improved by the work HR did on the core capability framework...I think this could be taken further...mid-level managers should be better rewarded and recognised by the progression and success of those they manage rather than on their individualistic work.*'
>
> —*RBA staff member*

Many staff members commented to the Review that the RBA's new capability framework is a welcome change, with its split in technical outputs and expected behaviours. The Review supports this work and acknowledges that changing behaviours will take time. On talent management, it was noted that the RBA's approach has not always been based on a consistent way of assessing potential and could be more rigorous in this regard. The RBA has further to go to ensure its people management frameworks are well understood, appreciated, and implemented so that the benefits can be fully realised.

Greater staff ownership of career development

A common criticism the Review heard from RBA staff members was that, despite some improvements, they felt they had limited opportunities for career advancement. Senior leaders at the RBA are acutely aware of this – it has been a key feature of their own internal engagement surveys and exit surveys of staff members. In part, limited career opportunities are related to relatively low levels of turnover among managers and executive leaders. However, the Review considers that there are broader factors that negatively affect staff members' perceptions of their opportunities for career advancement within the RBA.

Staff members reported to the Review that their managers cared about their development. In the RBA Review Staff Survey, 70 per cent of respondents agreed that their manager is highly invested in their development (Chart 4.9). However, only 40 per cent of respondents considered career development discussions at the RBA had helped them to pursue their career goals. The Review heard that career development practices are inconsistent across the RBA. Staff suggested that while some managers make considerable efforts, in other cases they feel they do not receive adequate support or guidance. Similarly, staff members spoke to the Review about not always having the knowledge about their performance or potential pathways within the RBA (or elsewhere) to take ownership of their career development.

Chart 4.9: Staff perceptions of career development
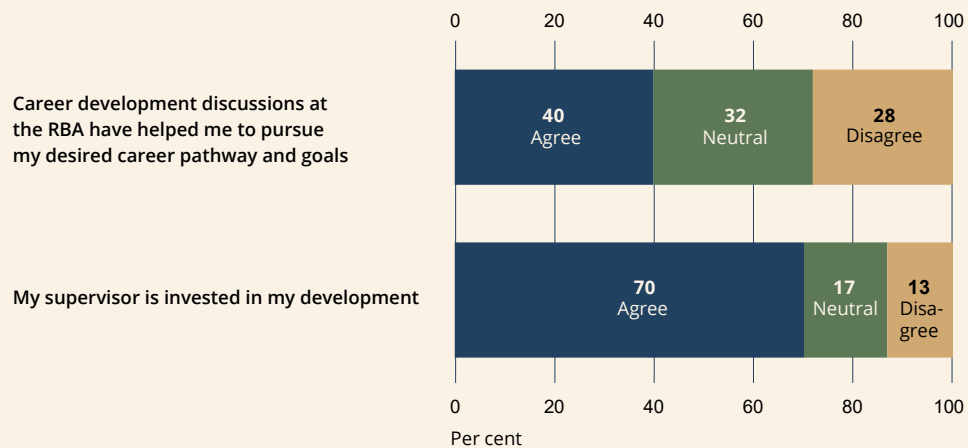
Source: RBA Review Staff Survey (2022).

Note: Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Agree includes 'strongly agree' and 'agree'. Disagree includes 'disagree' and 'strongly disagree'.

While staff members were generally positive about the recent improvements in the RBA's people frameworks, some thought that the introduction of the new Lead Analyst position had not achieved the intended outcomes. The design of the role had not addressed key concerns of staff members. In addition, a hierarchical culture and lack of delegation in some parts of the organisation has meant that some in the role are not always afforded the intended development opportunities.

The most critical factor for improving career development at the RBA is to better train and support leaders to be effective at using these frameworks, and ensure they are embedded in regular people processes. The quality of the conversation is crucial to staff members feeling empowered in their career choices.

Increasing the transparency of opportunities

The Review heard from staff members that vacancies and opportunities at the RBA are not always transparent. This affects the ability of employees to plan their careers, creates the potential for favouritism with staffing choices, and potentially means good candidates are overlooked. The Review is aware that processes exist to increase transparency of certain opportunities internally and externally. The Review also acknowledges that an open and transparent recruitment process is not always suitable to fill vacancies.

However, at present there is ambiguity and a lack of consistency about whether internal positions should be visible. Many staff members spoke to the Review about the opacity of the process for internal rotations in which Department Heads and/or their Deputies come together to discuss vacancies they have and staff members they would like to rotate. As one RBA staff member explained:

> *'At-level staff rotation seems problematic. I don't know how it is actually executed but little attention seems to be paid to preferences of staff or to the degree of specialisation required in different roles. I would like to see more consultation and agency in rotation decisions because it has a big impact on the workflow of the areas people are rotated through (and obviously on the people themselves).'*
>
> *— RBA staff member*

In the RBA Review Staff Survey, confidence in recruitment decisions and the perceived transparency of these processes was quite poor (Chart 4.10).

Chart 4.10: Staff perceptions of the transparency of recruitment processes
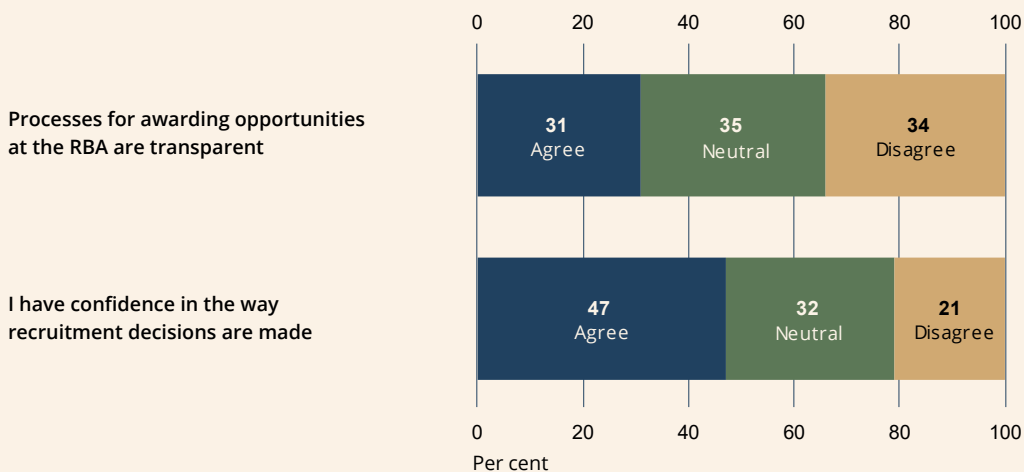
	Agree	Neutral	Disagree
Processes for awarding opportunities at the RBA are transparent	31	35	34
I have confidence in the way recruitment decisions are made	47	32	21

Per cent

Source: RBA Review Staff Survey (2022).

Note: Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Agree includes 'strongly agree' and 'agree'. Disagree includes 'disagree' and 'strongly disagree'.

Additionally, only 40 per cent of respondents agreed that opportunities are awarded on merit at the RBA, and 45 per cent thought they have an equal chance at promotion within the RBA (Chart 4.11).

Chart 4.11: Staff perceptions of the merit of promotion decisions
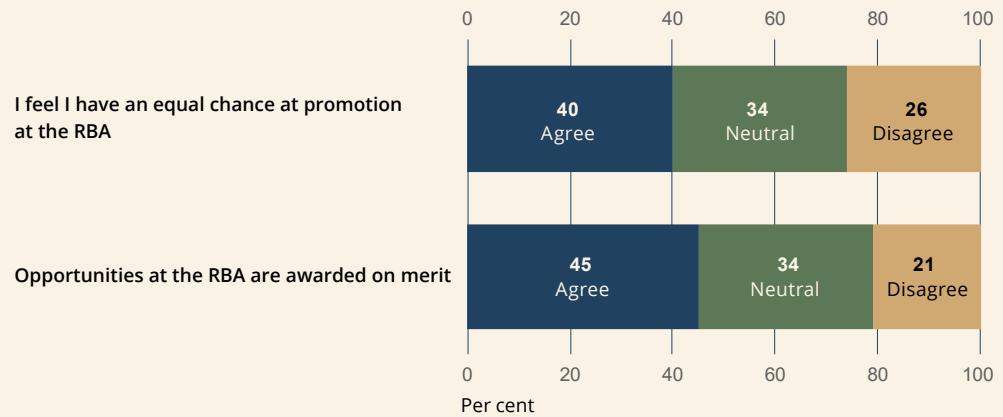
Source: RBA Review Staff Survey (2022).

Note: Response scale was 'strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. Agree includes 'strongly agree' and 'agree'. Disagree includes 'disagree' and 'strongly disagree'.

The reasons staff members gave in the RBA Review Staff Survey for not feeling they have an equal chance at promotion were varied. But the most common reason that stood out was a feeling among some staff members in non-policy roles that policy graduates and those with economic expertise were regarded more highly within the RBA and were more likely to progress than they were. More broadly, staff members spoke about favouritism, and needing to have personal relationships and/or a long tenure to progress.

Recommendation 11.3: Constructive challenge and openness to diverse viewpoints

Recommendation 11.3: Constructive challenge and openness to diverse viewpoints

11.3   The RBA should further encourage diverse viewpoints and constructive challenge, including by:

- ensuring its leaders are assessed for how well they listen to and engage with staff members, and welcome alternative views

- advertising management role vacancies externally as a default and better enabling external hires to succeed in the RBA through improved onboarding and support

- setting diversity targets and tracking progress against them.

The RBA has undertaken a range of actions to encourage staff members to speak up and share their views. The Review has identified the following areas in which the RBA could take further action to encourage constructive challenge and openness to diverse viewpoints:

- Some staff members felt the RBA could do more to foster an environment that encourages contrary or dissenting views to be expressed.

- Leaders could more actively share reasoning and engage in discussion with staff members about why decisions are made.

- The RBA could be more open to engaging with external ideas and voices.

- Greater effort is needed to boost gender and cultural diversity in the RBA's management roles.

In part, this list reflects underlying issues such as how supported and safe staff members feel to speak up and challenge the status quo, and how they perceive promotion incentives. The actions of leaders are critical to much of this (discussed further in Chapter 6). Other factors, such as selection, induction and incentives can also drive meaningful and enduring change.

The aim of this recommendation is to ensure that policy and operational decisions made by the RBA are subject to rigorous debate and testing from a diverse range of perspectives. This recommendation is complemented by recommendations in the Review to strengthen monetary policy decision making processes (see Recommendation 9) and for leaders to drive and model change (see Recommendation 13).

Leaders should be assessed for how well they listen to and engage with staff members, and welcome alternative views. Junior staff members should feel comfortable to share ideas and be able to discuss these ideas in more depth with senior leaders, including understanding how leaders think through matters, the merits of the ideas, and the potential issues. This will improve the quality of outcomes, by ensuring more contestability in developing and implementing decisions – both policy and operational. Staff members need space to express their views in different formats rather than needing to fit a particular profile or style of working to have their voice heard. They need to feel safe and supported to raise ideas that may be contrary to the RBA's public position.

Leaders taking action in these ways will assist junior staff members to better understand the rationale behind key decisions, enhancing their professional development. When implementing this recommendation, senior leaders need to be mindful to strike an appropriate balance in how they engage. Leaders need to listen, discuss and ask questions but not crowd out views of junior staff members. Debate needs to be respectful and not combative or overly aggressive. Leaders' skills in achieving this balance should be considered in regular performance assessments to hold leaders to account and incentivise development of these skills.

The RBA should advertise vacancies for management roles externally as a default and improve onboarding support for experienced hires. The RBA should foster an environment that is more open to engaging with external viewpoints and supportive of practices which enable a greater flow of ideas into the organisation. Staff members should be encouraged to engage with external ideas and organisations. Leaders should elevate and clearly articulate the benefits of genuine engagement with external voices and make concerted efforts to resist insular thinking. These actions should bring in new ideas, new ways of doing things, and different attitudes to risk and openness to change.

To help achieve this, the RBA should increase openness to hiring experienced external candidates, including at senior levels and particularly within the RBA's policy groups. Currently, the RBA has policies to externally advertise senior positions (Head of Department and above, with a similar expectation for Deputy Head roles) as a default. The RBA should extend this policy to cover external advertising of all management roles (Managers and above) as a default. While this should be the general approach, the Review acknowledges that it is not always possible and/or desirable to fill all such vacancies in this way. To further promote openness and balance in recruitment decisions, the RBA should also consider having an external member on all recruitment and selection panels for Deputy Head of Department roles and above.

The increased openness to external hiring should be complemented by greater onboarding support for experienced hires to ensure they can succeed at the RBA. Additionally, staff should be supported, encouraged, and incentivised to complete secondments away from the organisation and their experience fully recognised upon their return.

Diversity targets for senior leaders (managers and above) should be implemented to create a disciplined approach to drive change and benefit decision making. There is currently a lack of diverse representation in the RBA's senior leadership positions, particularly cultural and linguistic diversity (CALD), and this is more so the case in the RBA's policy areas. In the near term, the RBA should consider how best to implement targets for CALD representation among its management positions to complement existing targets for gender equity. The Review notes that the RBA is closely considering ways to better integrate approaches to diversity and inclusion, including via recruitment, promotion, performance assessment and leadership behaviour. The Review supports this work continuing and believes that the RBA should continue to consider how it can best target broader dimensions of diversity in management positions over time.

The Review recognises that the economics profession is not as diverse at it could be, and that the pipeline of economics students has become less diverse over recent years. The Review also acknowledges the significant work the RBA undertakes to understand diversity trends in economics and influence positive change in this area. While there are challenges, the Review has made this recommendation because progress in this area is important. Targets have been shown to improve focus, boost accountability, improve talent and succession planning, and increase the chances that the best person is selected for the job (WGEA 2013, Chief Executive Women and Male Champions of Change 2014).

The aspiration is that over time, the senior leadership cohort at the RBA becomes more reflective of the community it serves. Given the work the RBA has commenced on measuring and understanding the drivers of these issues, it is well placed to move forward and implement targets.

A range of factors can influence meeting such targets, ranging from underlying organisational problems like unconscious bias, to the timing and the availability of individuals and roles. These targets should, therefore, not be overly prescriptive on timing to allow for some flexibility.

Supporting assessment

Welcoming different views

The RBA has introduced various initiatives to encourage constructive challenge and debate, and inclusive discussion (RBA third information request). Examples include:

- changes to make the Policy Discussion Group (and the equivalent forum for less senior staff members) more inclusive, including through more structured chairing of meetings and key discussion topics being provided in advance

- the 'VoxEC' internal blog to share internal research and promote debate

- the Economic Research Department's 'challenge notes' and quarterly 'challenge meetings' (although these have been more limited in recent times)

- the Governor's anonymous 'Suggestions Box'

- and a range of grass roots initiatives within each department such as regular 'catch up' meetings to discuss policy issues, analytical work, strategic priorities and organisational topics.

However, the Review heard mixed views on how widespread improvements have been. As one staff member observed:

'I am able to feel included, learn and make mistakes and also provide healthy challenge without any negative repercussion. I know that my personal experience isn't exactly echoed throughout the Bank and some people have wildly different experiences to mine.'

— *RBA staff member*

Results from the RBA Review Staff Survey indicate that staff members perceive senior leaders to be less open to challenge and debate than their immediate managers. While the majority of staff members perceived their immediate supervisor as open to challenge and debate, Chart 4.12 shows that staff members' perceptions of openness to challenge and debate drops as seniority increases.

Chart 4.12: Staff perceptions of openness to challenge and debate
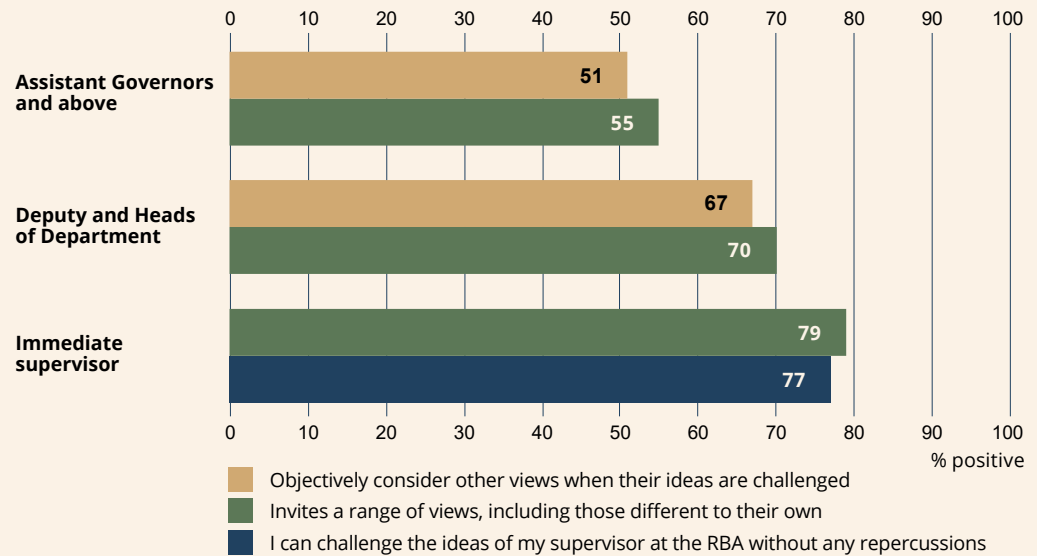
Source: RBA Review Staff Survey (2022).

Note: Response scale was 'Strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. % positive includes 'Strongly agree' and 'agree'.

Staff members can sometimes find it not safe to speak up on both policy and organisational issues. The RBA Review Staff Survey showed that around one quarter of current staff members and half of former staff members do (or did) not feel safe to speak up and challenge the way things are done at the RBA, fearing repercussions including derision. This is not a new issue – for example, the 2019 RBA Staff Engagement Survey showed that many staff members did not think differing opinions were openly discussed before reaching decisions. The 2021 RBA Psychosocial Risk Audit conducted by The Centre for Corporate Health also found that challenging ideas and engaging in healthy conflict tends to be avoided. They found that some people are fearful of making mistakes or speaking out against more senior leaders and that challenging ideas in a constructive manner can at times not be welcomed. They noted that the potential impact of this is that it stifles innovation and productivity and encourages a passive aggressive culture. This can contribute to poor psychological safety.

Some suggested that staff members can feel incentivised to express views that align with their direct managers and senior leaders. Some staff members expressed a perception that contradictory views may affect promotion prospects, with some noting that they had explicitly been given this feedback. These are symptoms of groupthink, where there is psychological pressure on staff members to conform to the views of leaders (Fisher 2021). Research on this topic has shown that individuals subtly adjust their preferences to be aligned with the majority view (Fisher 2021). This limits consideration of alternative views and challenge and debate.

Some staff members mentioned that at times when junior staff members are asked for their views by more senior staff members they are careful to not 'blindside' their immediate managers by saying something they would disagree with. Others remarked 'conversations are shut down because higher-ups won't like something' and 'ideas and suggestions are sometimes not put up the line because managers fear it won't be well received higher up'. Some people noted that they keep hearing the phrase 'small target' when requesting approval on new projects or initiatives. For example, some staff members have heard managers say, 'we don't know what so and so thinks yet, so let's make this look as small as possible so we can get approval'. Several people noted that most people hedge when offering opinions until they know what side of an argument the Governor is on and then repeat phrases he has used in his speeches or in monetary policy statements. The Review heard that managers at times justify decisions by saying 'this is what the Governor would want'. Similar examples are easily found in the public service more generally.

Several staff members thought a tendency not to speak up was more common in policy areas than corporate areas. Others thought it was more common in relation to organisational issues, pointing out a strong commitment to debating policy views, but a resistance to challenging how the RBA is run as an organisation. Some noted that staff members have been discouraged from putting criticisms or disagreements in writing. They attributed this to the fear of a Freedom of Information request, where released information could subsequently damage the RBA's reputation. The Review heard multiple accounts of stories of this nature. One example shared in a submission indicated that publication of a paper detailing the RBA's forecast errors was opposed by senior management as it 'reflected poorly on the Bank'.

Many staff members told the Review that a greater degree of challenge and debate within the Reserve Bank Board would flow into more demand for hearing alternative perspectives throughout the RBA. This sentiment was captured by a submission that said, 'the Board is shielded from internal staff debate, which occurs below Assistant Governors' which means 'senior management are not challenged when they present their own narrative'.

The Review heard that a more expert board with greater access to staff members would likely increase the incentive for senior leaders to engage with a broader range of perspectives ahead of Reserve Bank Board meetings.

Promoting more meaningful communication and discussion

RBA staff members told the Review that when they do express views, they would like to have more meaningful conversations with senior leaders. Many people the Review consulted indicated a desire to hear more on senior leaders' reactions to staff members' views. They wanted to better understand the rationale for key decisions, especially where decisions differed from staff members' views. This understanding would better enable staff members to challenge policy decisions and improve their trust in decision making. It would also aid junior staff members' career development by exposing them to a broader range of perspectives and thinking.

Some staff members relayed that the RBA has a 'nice culture'. This can be driven by a common desire to avoid conflict (Clark 2021). This can stifle the expression of opinions up the chain of authority and limit communication coming back down. In consultations, several people noted that if someone disagrees with something, they are more likely to humour you and do nothing than openly disagree with you. The Review heard multiple accounts of examples of this nature. In one specific example, senior leaders took 16 months to respond to an intended Research Discussion Paper that challenged the stance of monetary policy.

Several people noted having been told not to criticise arguments that others were making for the sake of collegiality. Some noted that those who question or challenge in meetings are subsequently told they are 'too negative', or their intervention was 'not constructive'. Others nuanced this by observing that while staff members should feel free to constructively challenge, it should be done respectfully and in a way that does not intimidate others, particularly more junior staff members.

Another potential factor affecting engagement by senior leaders is a desire to not 'crowd out' staff members. At times, attempts to create a space for staff members to speak can leave some feeling like they are speaking into a void. Again, this highlights the challenge for leaders of finding the right balance. Staff members said they would welcome more feedback from and deeper engagement with senior leaders on their views. Senior leaders should continue to pursue ways to actively engage with staff members (for example, through more open questioning) that do not leave them feeling that leaders are either disengaged or trying to shut down discussion.

Improving openness to external ideas and people

RBA staff members have a very strong sense of pride and attachment to their organisation when compared with the APS. They are more likely to be proud to work in their organisation, feel a strong personal attachment to their organisation, believe strongly in the purpose and objectives of their organisation, recommend their organisation as a good place to work, and feel committed to their organisation's goals (RBA Review Staff Survey 2022).

Yet, the Review also heard that this strength can be overplayed, resulting in some insularity, arrogance, and over-confidence among staff members. This can inhibit constructive challenge and debate, which can stifle innovation and have a detrimental impact on good decision making (see Chapter 1).

The Review heard from some stakeholders that the RBA is a bit of a 'closed shop' with little interaction with the broader economics community. One person summarised these views by noting:

> *'As an observer, it would appear to me that the RBA has an insular culture that is not particularly open to ideas from outsiders and is prone to groupthink'.*
>
> *–Submission to the RBA Review*

In the RBA Review Staff Survey, 53 per cent of current employees and 24 per cent of former employees agreed with the phrase, 'the RBA takes into account the views of a broad range of external stakeholders'. These results were much worse for staff members in the Economic Research Department (10 per cent agreed), the Financial Stability Department (39 per cent agreed), and the Human Resources Department (40 per cent agreed). Staff members in these areas expressed a stronger desire to see external ideas and research feeding into policy and internal debates more often (see Recommendation 11.4).

The Review heard that increasing the share of external hires, particularly at senior levels, would help reduce insularity. Over the last 5 years, the share of external hires in policy departments has increased at junior levels – but this is less true for senior levels (Table 4.1). 74 per cent of staff members in policy departments ranked manager and above started as graduates with an average tenure of 17 years. Senior roles are often filled by those that began their careers at the RBA, and have been shaped by the culture, which can limit diversity of thinking.

Table 4.1: External hires as a share of total appointments in policy departments

	Past 5 years (August 2017 – August 2022)		Previous 5 years (August 2012 – August 2017)	
	Number	Share	Number	Share
Graduate	-	-	-	-
Analyst	64 / 168	38%	15 / 145	10%
Manager	5 / 31	16%	3 / 32	9%
Senior Manager	2 / 15	13%	2 / 22	9%
Deputy Head of Department	1 / 5	20%	0 / 7	0%
Head of Department	1 / 3	33%	0 / 2	0%
Assistant Governor	0 / 1	0%	0 / 2	0%
Total (Manager & above)	9 / 55	16%	5 / 65	8%
Total	72 / 223	32%	18 / 210	9%

Source: RBA

Note: Defined as the number of vacant positions filled by an external appointment during the period (a flow rather than a stock) and is compared against the total number of vacant positions filled. For Analysts, total appointments include graduates promoted to analysts at the end of the Graduate Development Program.

At present, policies exist at the RBA to externally advertise senior positions (Head of Department and above, with a similar expectation for Deputy Head roles) as a default, but these are not always followed. Staff members also reported reluctance among some of the RBA's senior and executive leaders to engage in standard external hiring practices, such as the use of recruitment agencies.

Finding the right balance of internal promotions and external hires will encourage learning and development, and broader competitive merit-based recruitment (also relevant for Recommendation 11.2). The appropriate balance will ensure that the RBA retains critical institutional knowledge and skills but is still able to benefit from an openness to new ways of thinking and working. On balance, the Review found a lot of support among current staff members and senior leadership for boosting the share of external hires, particularly from diverse backgrounds.

Stronger processes for external hiring should be complemented by a renewed focus on ensuring experienced hires are well supported. The Review heard that, at times, some managers and staff members could pre-emptively lack confidence in the capability or experience of external hires as they have not been trained by the RBA. Staff members also relayed that onboarding support for experienced hires was variable, dependent upon individual managers, and considerably less developed than that available to graduates.

The Review heard that more short-term secondments would be helpful. Several staff members commented that increased movement between the RBA and the APS has helped to improve diversity of views. In February 2023, 13 RBA staff members were on an external secondment (0.9 per cent of 2022 staff base) and there were 4 secondees working at the RBA (0.3 per cent of 2022 staff base). In comparison, in June 2022, 111 or 2.5 per cent of ongoing staff members from a central APS agency were on an external secondment to another APS agency and there were 135 or 3 per cent of ongoing APS employees seconded into a central APS agency (APSED 2020-22). Note, this comparison is a lower-bound, as it excludes non-ongoing employees and employees seconded to non-APS workplaces (such as those in the private sector). In the RBA Review Staff Survey, one staff member said:

> *'Junior staff are reluctant to take secondments, or study for PhDs as they feel as though it will slow the pace of career progression. We should include these as highly desirable in the selection criteria for manager and above positions in policy areas and make decisions accordingly.'*
>
> *– RBA staff member*

Some staff indicated that the RBA's superannuation defined benefit scheme, which closed to new members in 2014 (RBA 2020), disincentivises movements out of the RBA. Others noted that for those who did leave and return (or consider returning), their outside experience was often not recognised as having contributed to their professional development and expertise. In effect, they were expected to return at the same level making such a move considerably less attractive.

Decision making that benefits from diversity of thinking

The Review recognises the important work the RBA has already done to encourage greater diversity and inclusion, and the progress that has been made. The RBA has undertaken a wide range of initiatives, including but not limited to:

- Establishing a refreshed Diversity and Inclusion Strategy in 2020 with a substantial focus on integrating broader approaches to diversity and inclusion, including via recruitment, promotion, performance assessment and leadership behaviour.

- Establishing and reporting against explicit targets for female representation in management positions.

- Establishing several Employee Resource Groups to focus on specific areas (including disability, gender equity, First Nations, LGBTQIA+ and race and cultural awareness) which are convened underneath a Diversity and Inclusion council chaired by the Deputy Governor.

- Publishing various data and communications about progress on diversity and inclusion initiatives in its Annual Report.

The Review strongly supports this work. An openness to diverse views can drive constructive challenge and debate and improve organisational performance (Deloitte 2013) (see Chapters 1 and 3). The Review's recommended actions are intended to support further progress in these areas.

The RBA Review Staff Survey showed that while senior leaders are thought to have good intentions on diversity and inclusion, many staff members do not think this is translating into action (Chart 4.13).

Chart 4.13: Staff perceptions of diversity and inclusion

The RBA has good intentions on diversity and inclusion

The RBA supports and actively promotes an inclusive workplace culture — 51 — 83

The RBA is committed to creating a diverse workforce — 56 — 80

…but has a way to go to execute it well…

The RBA encourages diversity of thought through recruitment — 35 — 54

The RBA's Diversity and Inclusion Strategy is effective — 28 — 51

The RBA values diversity in recruitment as a way of facilitating different views and expertise — 21 — 47

…and many staff do not feel the impact

Personal background is not a barrier to success in the RBA — 37 — 65

I feel I have an equal chance at promotion at the RBA — 13 — 40

Legend: Current staff | Former staff | % positive

Source: RBA Review Staff Survey (2022)

Note: Response scale was 'Strongly agree', 'agree', 'neither agree nor disagree', 'disagree', 'strongly disagree'. % positive includes 'Strongly agree' and 'agree'.

The Review heard that there is a lack of cultural diversity in senior leadership positions as measured by non-English speaking background status and country of birth. Analysis by the RBA's Race and Cultural Identity Employee Resource Group confirmed that staff members from non-English speaking backgrounds are underrepresented in management, particularly at the senior and executive leadership levels. They are also underrepresented in policy departments. While one in three staff are from a non-English speaking background, these staff members represent one-quarter of staff members in most policy departments. Additional data show that while almost half of staff members are born overseas, most managers and executives are born in Australia. Those born in Asian countries are much less likely to be represented in management.

> 'There is a major problem whereby staff from culturally diverse backgrounds, while well represented in junior to lower-mid level positions, are severely underrepresented in leadership positions… The problem is mirrored at the Board level, with no member of the Board appearing to be from a non-European background.'
>
> – Submission to the RBA Review

The RBA should continue to investigate why this is the case by studying data related to its recruitment and promotion processes and act to correct any biases or other aspects of the process that contribute to this outcome. The RBA's Race and Cultural Identity Employee Resource Group recommended that the RBA monitor the share of culturally diverse staff members and their career progression to better understand the barriers. The Review affirms this recommendation, and suggests the RBA also work to understand barriers at the recruitment phase.

The Bank of England investigated a similar issue in their 2021 Review of Ethnic Diversity and Inclusion and found that the share of those from a diverse background dropped at each stage of recruitment, as preference was given to internal candidates who tended to be less diverse than external applicants (Bank of England 2021).

The Review heard that diversity targets for leaders (managers and above) would create a disciplined approach to drive change.

> *'Given the severity of the problem and its embedded roots in unconscious biases, just like for gender, the only way to meaningfully tackle it is to introduce targets for culturally diverse staff in leadership positions.'*
>
> *– Submission to the RBA Review*

The Review heard support for more diversity in gender, socioeconomic status, educational background, disability status, and indigenous status. However, a selection of staff members disagreed with these views, and thought that efforts to increase diversity (particularly with respect to gender and external hiring) were coming at the cost of merit-based recruitment practices. Given this, the RBA should consider how to better communicate and educate its employees on the benefits of diversity and inclusion. Many staff members would like leaders to be accountable for supporting diversity and inclusion efforts across a range of dimensions and for all employees to be assessed against this in their performance appraisals.

Recommendation 11.4: Enhanced use of technical skills and research capability

Recommendation 11.4: Enhanced use of technical skills and research capability

11.4 The RBA should strengthen the role of research in policy formulation, including by:

- establishing a monetary policy strategy team

- increasing collaboration between policy groups, including through cross-departmental projects

- developing and executing a research strategy and agenda overseen by the Monetary Policy Board

- increasing engagement with universities and thinktanks

- deepening analytical capability by attracting, developing, and retaining technical expertise.

The RBA is recognised as having a high calibre staff with strong technical skills and expertise. The Review has identified the following areas that could enhance the RBA's use of technical skills and research capability to support better policy outcomes:

- Including more people in decision making with respect to monetary policy recommendations to improve staff members' ability to contribute to the development of monetary policy strategy.

- Improved buy-in from senior leaders with respect to establishing a research strategy and agenda, which would enhance engagement with universities and thinktanks.

- Systematic processes to integrate the RBA's research capability into the policy formulation process.

- Career pathways that enable the best use, development and maintenance of technical expertise.

This recommendation is complemented by those that relate to strengthening monetary policy decision making processes (see Recommendation 9) and leaders driving and modelling change (see Recommendation 13).

A new monetary policy strategy team would empower more staff members to contribute to and collaborate on the development of monetary policy strategy. This type of team exists in some peer central banks. It would enable staff members other than the Governor, Deputy Governor and Assistant Governors to be responsible for bringing together a staff view on policy alternatives. This team is not intended to have sole responsibility for monetary policy strategy; rather, it is intended to become a place for people to contribute their ideas and thinking. The team should collaborate with and leverage expertise from across the RBA. Providing alternative policy options to the Monetary Policy Board will give more scope for papers to include technical analysis and relevant external economic research.

The new monetary policy strategy team would complement the work of existing teams responsible

for monitoring, analysing and forecasting sectors of the economy, by being explicitly tasked with answering questions such as:

- Given the set of forecasts and risks, what would be the best policy response?

- Is the overall stance of monetary policy appropriate?

- What mix of policy tools should be used and how do they work?

- Are the trade-offs that are being made explicit and sensible?

- What does the literature say about the policy approach that is being taken?

- Is the RBA's communication being perceived in the desired way?

The new team would provide more support to external Monetary Policy Board members. Currently, Reserve Bank Board members rely very heavily on the Governor and Deputy Governor to bring together a consolidated view and share dissenting (if any) positions. It would also complement the Monetary Policy Board members having direct access to RBA staff (see Recommendation 9.2).

A research strategy overseen by the Monetary Policy Board would improve research capability, bring research insights into the policy process, shape a policy-relevant research agenda and promote greater engagement with universities and think tanks. The strategy should initially cover a 2-year time horizon and should be reviewed each year. It should set out objectives and key change priorities, timing and accountability for implementation, and success criteria. An important overarching aim should be to create a stronger research culture within the RBA. To support this, the strategy should:

- Set out an approach to recruiting, developing and incentivising technical experts, for example by creating technical career pathways, encouraging secondments, renewing support for PhD study, ring fencing research time and rewarding high quality journal publications.

- Outline steps to further encourage collaboration between policy departments, and between analysts and technical experts, to ensure policy decisions draw fully on the RBA's expertise and that evidence and research insights are brought to bear in a rigorous way on policy questions.

- Identify a clear set of research priorities, approved by the Monetary Policy Board, to guide the direction of RBA research, ensure its policy relevance and promote collaboration with outside experts. These priorities should draw on input from the expert advisory group (see Recommendation 9.4) as well as RBA staff members and should have regard to the research agenda of the proposed Australian Macroeconomic Policy Research Program (see Recommendation 3.2).

- Set out how the RBA could make use of new channels to disseminate research insights to a wider audience.

The RBA should keep under review how research is organised and administered in the RBA to ensure it best supports the Monetary Policy Board and its research strategy objectives, and should develop measures of desired outcomes.

The design of technical career pathways is a challenging area that the RBA will need to carefully consider. The number, distribution, team structure and expectations for these types of roles will determine how effectively they can be implemented. This challenge is not uncommon. For example, the Australian Public Service Commission is currently exploring ways to strengthen specialist career streams across the APS (APS Commission Hierarchy and Classification Review 2022). In implementing this recommendation, the RBA should also consider learnings from peer central banks.

Supporting assessment

Economic research provides the foundations for central banks' understanding of the economy and their role in it. The expertise and skills that researchers bring can contribute to better policy. They bring evidence to bear in a rigorous way and help decision makers evaluate different arguments and perspectives.

As our economy evolves over time, it is important to understand how these changes might affect the operation of monetary policy. Increasing the focus and value placed on research in the policy process will ensure that the RBA is well placed to meet future challenges.

A culture that recognises the value of research and technical expertise will make the most of the RBA staff members' research capability and support better policy outcomes. Factors such as how specialist expertise is utilised, how open and inquisitive the institution is to external ideas and research, and how policymakers use research as an input to their decisions affect these outcomes.

Better linking staff members and research with policy decisions

The Review heard that a new monetary policy strategy team would be a way to better link staff members and research to decision making. The lack of a central team currently results in very senior staff members writing the final Reserve Bank Board paper recommendation. This in turn results in some staff members feeling like it is difficult to be part of the real conversation about the policy approach. Peer central banks, like the European Central Bank and Sveriges Riksbank, have a dedicated monetary policy strategy team (European Central Bank 2022, Sveriges Riksbank 2023).

Many noted to the Review that there are no effective forums for questioning monetary policy strategy and too great a focus on descriptive analysis. One comment that captures this sentiment is:

> *'Over the years there have been a lot of "policy" meetings, but they rarely engage in policy. Rather, these meetings just summarise the facts.'*

> *– RBA staff member*

A dedicated team would provide more scope to include technical analysis and relevant external economic research in Monetary Policy Board papers. It would have more capacity to draw on research that can help inform policy discussions and be well placed to help researchers identify topics of policy relevance.

Greater engagement by senior leaders in research findings for policy deliberation

The Review heard strong feedback from staff members that research (both internal and external) does not appear to be valued as highly as it should be in policy deliberations. A specialist Monetary Policy Board (see Recommendation 8.1) would likely increase demand for research, especially that focused on informing policy decisions. It would also give the staff scope to share more technical analysis to inform policy deliberation.

In the RBA Review Staff Survey when asked, 'If you could change one thing to improve the effectiveness of your workplace, what would it be?', some staff members said they would like to see greater engagement with research when deliberating on monetary policy strategy.

Similarly, when asked, 'Thinking about the RBA's culture, is there anything you would want to change and why?', many staff members said improving the willingness of senior executives to listen to research, referencing the pre-pandemic low inflation period when rates were not cut further (also see Chapter 1). The Review heard that sometimes senior executives are at times openly dismissive of views offered by academics in academic panel discussions.

The Review heard research can be commissioned to rationalise and defend decisions rather than to inform them. Several people indicated that analysis can be requested to support preconceived views, rather than undertaken to develop and inform views. Many people expressed a desire for research to play a stronger ex ante role in the policymaking process.

The Review believes the RBA should develop a new research strategy and refreshed research agenda, overseen by the Monetary Policy Board, that leverages external collaboration. This would enhance the value of research as an input into policy deliberations.

Research that is objective and forthright

Researchers should be able to develop and present research that may disagree with the RBA's public position. The Review heard several examples of research being edited to ensure it aligned with the RBA paradigm. One person noted that in one case, the narrative of a research paper was almost reversed. In other cases, it was noted that if the findings are inconvenient, research is not released or no explicit response is provided so the research cannot be released.

Many people would like to see research playing a greater role in promoting healthy challenge and debate at the RBA. While staff members acknowledged that the Economic Research Department's 'challenge notes' and quarterly 'challenge meetings' were a step in the right direction, these have been limited as of late.

Making progress on increasing challenge and debate (see Recommendation 11.3) would help enable research that is more forthright.

A central bank that attracts, develops, and retains technical expertise

The Review heard that the RBA faces challenges in attracting, developing, and retaining technical expertise at the RBA. In consultations, several people noted a lot of basic analysis could be further developed, but the lack of specialists prevents this occurring. Of current employees who responded to the RBA Review Staff Survey, 48 per cent think there are skills or capability gaps in their current department, and a further 30 per cent are unsure. This perception is much higher for former employees, with 71 per cent believing there are capability gaps at the RBA. When asked what skills or capabilities are below the level required for effective performance, staff members were most likely to report subject matter expertise and technical skills.

The Review heard greater encouragement to publish in research journals would help the RBA attract and retain technical expertise. Compared to some foreign central banks, such as the US Federal Reserve and the European Central Bank, the Review found there is less use of channels outside of the long-standing Bulletin and Research Discussion Paper series.

People told the Review there should be more incentives to publishing research in peer reviewed journals. Peer reviewed publications are attractive for researchers as they are read by a wider audience, are internationally recognised, and help boost profile and reputation. They also boost interactions with academia and drive constructive challenge and debate, and ensure research is objective. Currently, around one quarter of Research Discussion Papers are published in peer reviewed journals. The Review also found an appetite for less formal arrangements, such as external blog posts, which can reach a much wider audience, much more quickly, and so have a meaningful influence on policy debate.

The Review heard that a lack of career progression opportunities for technical specialists is detracting from the RBA's capabilities. Currently, the promotion pathway for technical specialists is into management roles, even if they lack a desire and aptitude to manage and lead teams. The alternative pathway for many technical specialists is to leave the organisation, resulting in a significant loss of expertise and institutional knowledge.

> *'The career structure at the RBA means that there are no real progression opportunities for staff with strong technical skills but no desire or capability to be a people manager. The RBA therefore often faces a choice between losing staff with strong technical skills or promoting them into management roles for which they are not well-suited.'*
>
> *– RBA staff member*

The APS Hierarchy and Classification Review also received similar feedback, for example:

> *'Many technical specialists do not want to manage employees but want to have a career path where the increased complexity of work can be recognised as they progress through the classification structure.'*
>
> *– Public submission to the APS Hierarchy and Classification Review, 2022*

A significant proportion of those consulted thought increasing opportunities for technical specialists to progress would help the RBA attract and retain these skills. Ideally this would not be restricted to the Economic Research Department. Rather, many people thought that increasing opportunities for technical specialists to progress across a variety of teams would instil a stronger organisation-wide research culture and give greater scope for research to be focused on bank-wide issues.

Staff members reported that there could be greater opportunities to hire technical specialists at more senior levels, including international experts. It was noted that such staff members bring significant positive externalities to others, by sharing technical capability and the latest developments in academic literature.
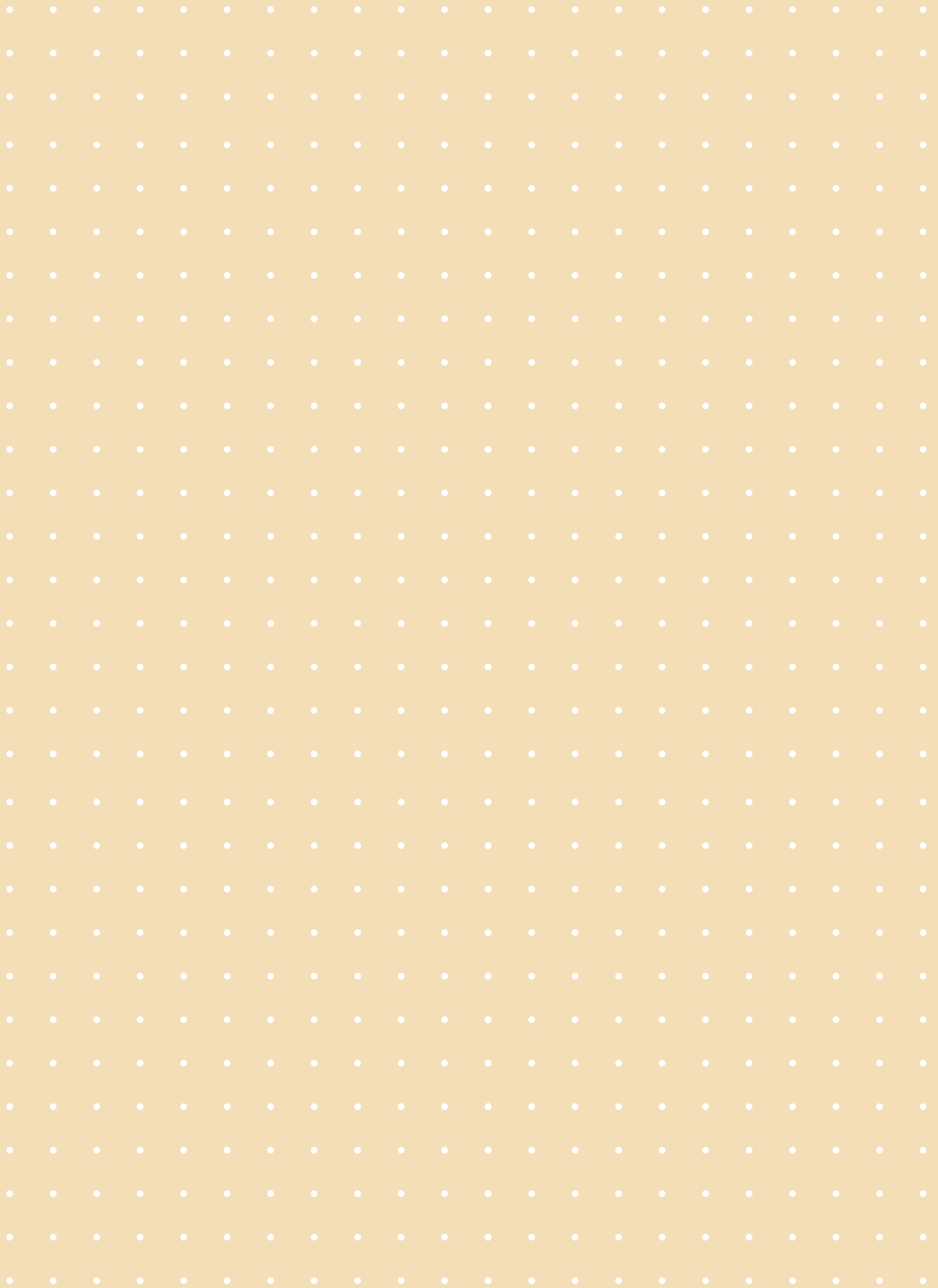
The Review heard from some staff members that the RBA could be encouraging more employees to take up PhDs in economics, including at internationally renowned institutions overseas. There was a concern from some staff members that there had been a decline in the value placed upon such experience. This was resulting in a missed opportunity to boost links with academia, which could help foster a better research culture. The Review acknowledges this support is a significant investment and completion times for such degrees have increased over time (particularly overseas). Given the RBA's ongoing need for research skills and the benefits these linkages can bring, it would be helpful to consider how best to support this type of study in the future.

5

Chapter 5: More robust corporate governance

Chapter 5: More robust corporate governance

> This chapter outlines the RBA's arrangements for corporate governance and assesses their appropriateness for the future. It contains a recommendation to create a Governance Board. This recommendation will increase oversight and accountability on corporate governance matters at the RBA.

'To ensure sound and effective decision-making, central banks need to have robust governance arrangements.'

– Bossu W and Rossi A (2019), The Role of Board Oversight in Central Bank Governance

The corporate governance arrangements of an organisation are crucial for ensuring good institutional performance and accountability. These arrangements cover 'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations' (Owen 2003). Corporate governance arrangements also cover the mechanisms by which those in control are held to account.

Strong corporate governance is fundamental for the effective functioning of the RBA as it builds trust, transparency and accountability in the institution. It affects the quality of the RBA's policy making because of its impact on decisions related to resourcing, succession planning, risk management and technology.

Over recent decades, consensus on what constitutes best-practice corporate governance has evolved significantly, including for government corporate entities (see Tricker 2015). Institutions have moved away from reliance on a single individual towards group-based decision making that draws on professional corporate expertise. Best practice corporate governance today emphasises the role of boards with non-executive directors setting the strategic objectives and overseeing management's implementation of those objectives. In the private sector, the board chair is generally not the same individual as the CEO (Blanchflower and Levin 2023).

Management structures and practices at the RBA have changed significantly in the past decade or so. The RBA also increased external recruitment and the professionalisation of corporate and enabling functions.

At the same time, corporate governance oversight has been relatively unchanged since the establishment of the RBA and falls short of contemporary best practice. Under the RBA Act the Governor is responsible for the management of the RBA and is the key decision maker on corporate matters. The Reserve Bank Board provides little oversight of management. These arrangements concentrate responsibility (perhaps unfairly) on one individual and create risk. They do not allow sufficient scope for outside expertise to support the executive and help guide the management of the institution, and they may unintentionally create conditions where debate and challenge are less likely to flourish.

More robust corporate governance would better position the RBA to adapt to future challenges. The Review has identified a significant agenda for further strengthening the culture and processes of the RBA. Stronger corporate governance is a critical lever to drive sustained cultural change and operational excellence.

The recommendations in this chapter focus on strengthening the RBA's corporate governance to ensure sufficient focus and oversight.

Box 5.1: Best practice corporate governance of central banks

Strong corporate governance requires both robust internal governance processes and board oversight of these processes.

Good corporate governance design for central banks differs from both corporations and other public institutions. Central banks are predisposed to many of the problems inherent in public institutions: weak incentives to innovate and reduce costs, diluted monitoring incentives driven by multiple layers of delegation and political distortions (Frisell and others 2008). However, their independence means central banks face less parliamentary scrutiny over internal processes and budgets.

Drawing on the Australian Securities Exchange Corporate Governance Principles and Recommendations, the Review identified 4 best practice components that helped guide the Review's recommendations in this chapter:

- The respective roles and responsibilities of boards and management should be clearly delineated.

- The Governance Board should be an appropriate size and collectively have the skills, commitment and knowledge to enable it to discharge its duties and add value.

- A majority of the Governance Board should be independent directors, the chair of the board should be independent and separate from the CEO – in this case the Governor.

- The Governance Board should convene an audit and risk committee, chaired by an independent director.

Recommendation in this chapter

Recommendation 12: Update RBA oversight and accountability by establishing a Governance Board

12.1	The Government should establish a Governance Board with responsibility for overseeing the management of the organisation, including organisational strategy, performance, finances, large projects, resourcing, remuneration, succession planning, risk (such as cyber risk), and delivery of banking and banknote services.
12.2	The Governance Board should be the accountable authority in respect of the PGPA Act and expand the Audit Committee to be an Audit and Risk Committee.
12.3	The Governance Board's membership should comprise the Governor, Chief Operating Officer and 5 external members. An external member should be chair.
12.4	External Governance Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest drawing on a matrix of required skills and experience. The process should be managed by the Secretary to the Treasury, the Governor and a third party.
12.5	External members of the Governance Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.
12.6	The RBA Boards should establish charters setting out their responsibilities and those of the RBA executive. A memorandum of understanding should be established between the 3 RBA Boards.

The RBA's corporate governance arrangements

The RBA is a Corporate Commonwealth Entity established under the RBA Act. A Corporate Commonwealth Entity is a body corporate with a separate legal personality from the Commonwealth Government.

The specific governance arrangements of the RBA are set out in 2 pieces of legislation – the RBA Act and the PGPA Act. The RBA Act sets out the responsibilities of the Governor, the Reserve Bank Board, and the Payments System Board. The PGPA Act sets out the duties that apply to the RBA's accountable authority and officials. It deals with planning by, performance and accountability of, the RBA (including a corporate plan, annual report, financial statements, and performance statements) and the proper use and management of public resources by the RBA. As an independent central bank, the RBA has some specific exemptions from the PGPA Act relating to budget estimates, banking, and investment.

The RBA is a large and diverse institution with over 1,400 staff members in 2022. It is an institution with complex operations and risks, many of which are essential to the sound functioning of the Australian economy but are much less visible to the public than monetary policy. In addition to its responsibilities around monetary policy and payments policy, the RBA is responsible for providing banking services to the Government, managing Australia's foreign exchange reserves, banknote provision and running critical national payments infrastructure. Only around 375 people (around 25 per cent of RBA staff members) work in core policy roles, including monetary and payments policies.

The operations of the RBA have become more complex over time. Most notably, technology and related cyber risks are increasingly important in the RBA's operations. Reflecting this, the number of staff employed in IT has almost doubled in the past decade to around 420 staff members. Around 30 per cent of RBA staff are now employed in IT, up from around 20 per cent in 2012.

Figure 5.1: RBA governance structure
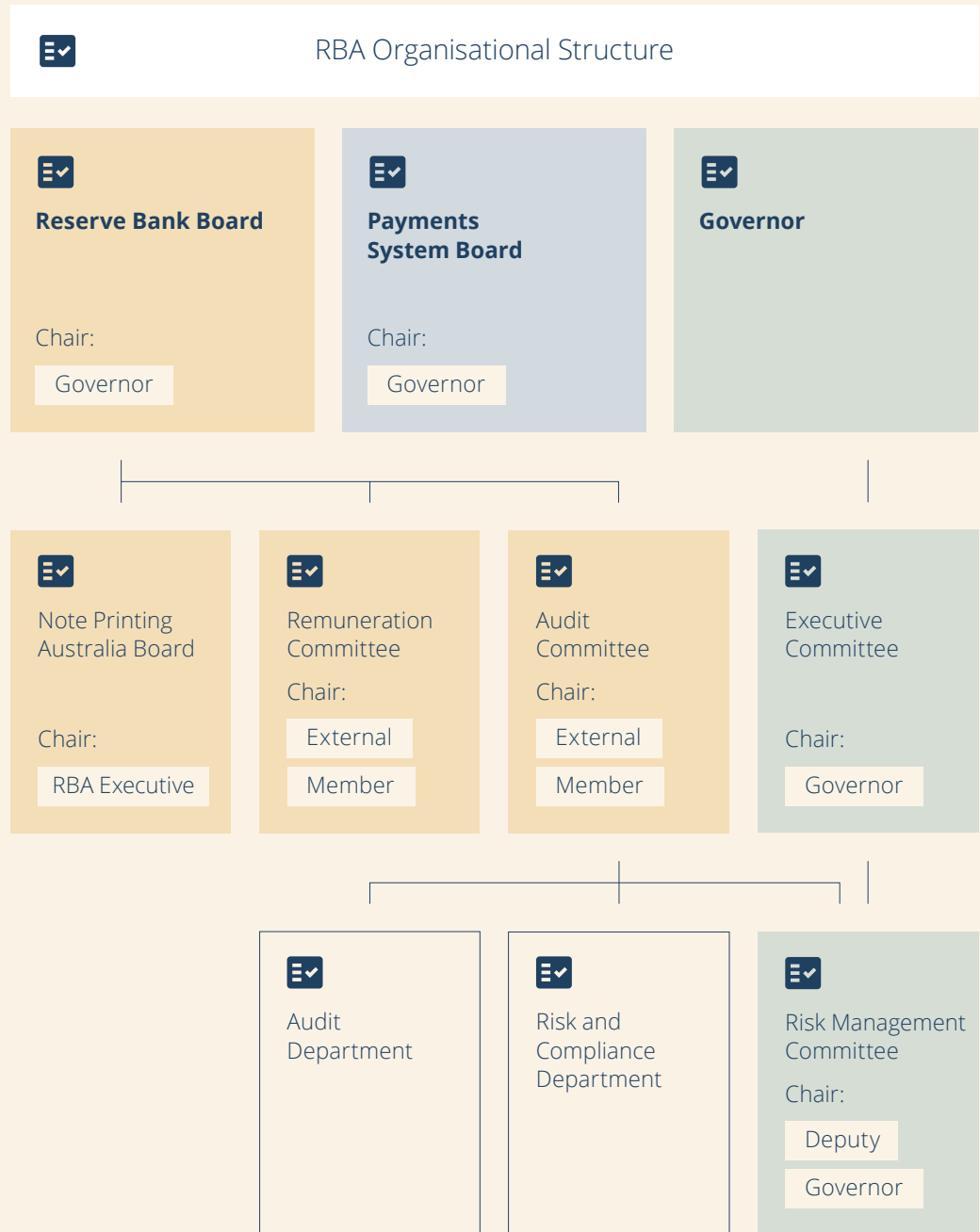
The Governor

The Governor is responsible for managing the RBA and has a duty, as a member, to perform the functions of the Reserve Bank Board and the Payments System Board. The Governor is the accountable authority under the PGPA Act. This means the Governor has a broad range of statutory obligations and duties. These include a duty to govern the RBA, establish and maintain systems relating to risk and control, encourage cooperation with others, promote proper and efficient use of public resources and measure and report on the achievement of the RBA's purposes. The RBA's purposes under the PGPA Act are to promote the economic welfare of the people of Australia through monetary and financial policies and operations. The Governor is also required to ensure the RBA's corporate plan and annual report provide meaningful planning and performance reporting to Parliament and the public.

The Governor's role as the sole accountable authority is unusual among Corporate Commonwealth Entities. Of the current 72 Corporate Commonwealth Entities, only 7 have single-person accountable authorities, including the RBA. A board is the accountable authority for most Corporate Commonwealth Entities. Some comparable Australian policy-making entities, most notably APRA and the Australian Securities and Investments Commission, are Non-Corporate Commonwealth Entities and have individuals as their accountable authority.

In practice, the Governor manages corporate governance obligations through internal processes with assistance from the Deputy Governor, the Executive Committee and the Risk Management Committee.

- **Deputy Governor:** by custom, is in charge of the day-to-day operations of the RBA. The Deputy Governor oversees six executive support departments: Finance, Audit, Human Resources, Risk and Compliance, Information, and the Secretary's Department (which includes Legal).

- **Executive Committee:** is the key internal decision-making body and comprises the Governor (Chair), Deputy Governor and Assistant Governors. The Deputy Governor is responsible for representing each of the 6 executive support departments within their remit. It meets regularly to advise on matters of strategic or institution-wide significance. For instance, the RBA's annual budget, projects, and operational and staffing matters are discussed in this committee. The Governor seeks to achieve a consensus view on matters. In cases where no consensus is reached, the Governor makes the final decision.

- **Risk Management Committee:** is responsible for ensuring that operational and financial risks are identified, assessed, and properly managed across the RBA. It is chaired by the Deputy Governor and comprised of senior representatives from the operational areas of the RBA. It meets at least 6 times a year and informs the Executive Committee and the Audit Committee of its activities.

The Reserve Bank Board

The Reserve Bank Board's role in the corporate governance of the RBA is both limited and unclear under current arrangements.

The Reserve Bank Board has a statutory obligation to:

- approve the RBA's annual financial statements before the Governor gives the statements to the Auditor-General

- determine the Governor and Deputy Governor's remuneration (with advice from a Remuneration Committee comprised of 3 external members of the Reserve Bank Board)

- approve the Audit Committee's charter, which sets out the objectives and responsibilities of this committee.

The Audit Committee must be established under s 45 of the PGPA Act and comprises a subset of external members of the Reserve Bank Board and at least one external appointment. It assists the Governor (as the RBA's accountable authority) and the Reserve Bank Board by reviewing the appropriateness of the RBA's financial and performance reporting, risk oversight and management systems, and internal control systems.

In addition to these statutory obligations, the Reserve Bank Board also has the 'power to determine the policy of the Bank in relation to any matter, other than its payments system policy' (s 10(1) RBA Act). It is 'responsible for the Bank's monetary and banking policy, and the Bank's policy on all other matters, except for payments system policy' (s 8A(2) RBA Act).

There is ambiguity around whether 'any matters' and 'all other matters' include corporate governance responsibilities and powers. Since the early 2000s the Reserve Bank Board has received, or been made aware of, differing legal advice on the powers and responsibilities of the Reserve Bank Board. Until December 2012, the Reserve Bank Board took the view that it had no positive duty to determine policies beyond those going to the monetary policy and financial stability mandates and certain other aspects of its central banking business.

In December 2012, the Reserve Bank Board settled on an approach whereby the Governor provides a report to the Reserve Bank Board each year listing policies that set a strategic direction (or articulate a framework for decision making) in the areas of governance, risk, human resources, health and safety, and major assets and resources. The report also covers significant changes to these policies over the preceding year and details their compliance arrangements (RBA 2022g).

Since the introduction of the *Work Health and Safety Act 2011*, the Reserve Bank Board has received and discussed a report on workplace health and safety matters at least once a year. The Reserve Bank Board does not approve individual policies at the RBA or the RBA's budget. These are seen as decisions made by the Governor, consistent with the Governor's responsibility under the RBA Act to manage the RBA. Despite the apparent ambiguity, Reserve Bank Board surveys from 2017 to 2022 found that in all but one case, Reserve Bank Board members either agreed or strongly agreed that 'the Board's role and responsibilities are well defined and understood by members'.

Analysis of Reserve Bank Board agendas confirms that meetings are almost entirely focused on monetary policy, with corporate governance matters appearing only occasionally. Consultations with past and current Reserve Bank Board members found that most members viewed the Board as a monetary policy making body, with corporate governance largely falling outside their remit.

Risk governance responsibilities

The formal roles and responsibilities relating to risk governance are somewhat unclear, with responsibility split between the Governor, the Reserve Bank Board and the Payments System Board.

As the accountable authority, the Governor has a duty to establish and maintain risk management systems at the RBA. The Reserve Bank Board does not have an explicit statutory responsibility for risk.

The Governor sets the Risk Management Policy, which includes the Risk Appetite Statement. The Deputy Governor chairs the executive Risk Management Committee, which assists with the implementation of the Risk Management Policy.

The Audit Committee assists the Governor in fulfilling their risk governance duties by reviewing the appropriateness of the RBA's systems. The Reserve Bank Board sets the charter of the Audit Committee, and as noted, the Audit Committee also reports to the Reserve Bank Board on related matters, such as financial reporting.

The Charter of the Audit Committee includes a comprehensive approach to reviewing risk controls and aligns with the suggested content in the model audit committee charter published by the Department of Finance.

According to the RBA's 2022 Annual Report, risks associated with the formulation of monetary and payments policies are the direct responsibility of the Reserve Bank Board and the Payments System Board. The 2022 Annual Report also notes that the boards review the management of these risks annually and as part of their regular decision-making processes. According to the Audit Committee charter, the Audit Committee does not specifically consider these policy risks.

Public accountability measures

Under the PGPA Act, the Governor must prepare and give to the Treasurer for presentation to the Parliament an annual report and must prepare and give to the Treasurer and Finance Minister an annual corporate plan. Both the annual report and corporate plan must be published. The Review received very positive feedback about the quality of the RBA's reporting, including the financial statements in the annual report.

The RBA is unusual among Commonwealth entities in that it does not rely on an appropriation for funding and does not have the same requirements to attend Senate Estimates hearings as other Commonwealth entities do. Since 2020, the RBA has received requests to attend Senate Estimates to answer questions about monetary policy and other aspects of its central banking activities. These were typically attended by the Deputy Governor and an Assistant Governor. In late 2022 and early 2023, the Governor attended these hearings. In recognition of the RBA's independence, no Government ministers are in attendance as witnesses while representatives of the RBA are present at Senate Estimates.

As part of the *Statement on the Conduct of Monetary Policy*, the Governor agrees to appearances at the House of Representatives Standing Committee on Economics, and other Parliamentary committees as appropriate. Reflecting the nature of these committees, these Parliamentary appearances have tended to focus on monetary policy decisions, rather than corporate matters.

Other governance arrangements

Other key bodies at the RBA are outside the scope of the Review but interact with parts of the institution that are in scope (Figure 5.1).

- **Payments System Board:** is responsible for payments system policy. If a policy conflict arose between the Reserve Bank Board and this Board, then the Reserve Bank Board's policy would prevail. If there were a disagreement on whether a conflict exists or which of the Boards is responsible for determining the RBA's policy on a matter, then the Governor would be responsible for resolving the matter. No conflict has arisen between the Boards since the establishment of the Payments System Board in 1998.

- **Note Printing Australia:** is a wholly owned subsidiary of the RBA. It operates under a charter approved by the Reserve Bank Board.

Recommendation 12: Update RBA oversight and accountability by establishing a Governance Board

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12.4   External Governance Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest drawing on a matrix of required skills and experience. The process should be managed by the Secretary to the Treasury, the Governor and a third party.

12.5   External members of the Governance Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.

12.6   The RBA Boards should establish charters setting out their responsibilities and those of the RBA executive. A memorandum of understanding should be established between the 3 RBA Boards.

The RBA's corporate governance arrangements do not reflect current best practice (see Box 5.1). Decision making is highly concentrated in the Governor with limited board oversight. Despite these structural challenges, the RBA has found ways to make the current arrangements work. This is in part due to the quality of executives and staff. The Review found that internal governance processes were largely well done. However, this was not uniformly the case and these arrangements are likely to become more strained given the RBA's increasingly complex operations and exposure to technological and cyber risks. In addition, the Review has recommended a significant amount of change and current governance arrangements are not well placed to drive this change. Successful implementation of the recommendations will rely on accountability, external input and the expertise of a wide range of professionals. Strengthening arrangements would also support the parallel changes to the monetary policy decision-making processes.

Under current arrangements, the Reserve Bank Board functions almost entirely as a monetary policy decision-making body. In contrast, the Governor is heavily involved in monetary policy and corporate governance, effectively operating as both the Reserve Bank Board Chair *and* the CEO of the institution, out of alignment with corporate best practice. This adds to the structural concentration of power in the position of Governor as the Reserve Bank Board has limited corporate governance responsibility and oversight over the executive. The Reserve Bank Board could potentially take a more active role in corporate governance, although this is limited by the Governor's responsibilities as the accountable authority under the PGPA Act. This arrangement differs from many of RBA's peer central banks which have separate governing boards (see Box 5.2).

The Review heard examples where this concentration of decision-making power and limited independent oversight resulted in poorer institutional outcomes. An emerging theme from corporate and executive support areas was that decision making on management matters can be tightly held, with the ultimate decision maker or makers not necessarily seeking input from the relevant professional experts or those who would need to implement the decision. Membership of the Executive Committee is weighted to the policy areas of the RBA relative to headcount. Most members have spent significant parts of their career at the RBA. This contributes to institutional inertia and reduced willingness to provide advice.

The current governance framework has created uncertainty around the roles and responsibilities of the Reserve Bank Board and Governor. The unilateral decision of the RBA executive to not defend the yield target in October 2021 without first consulting the Reserve Bank Board is one example where the respective responsibilities of the executive and Reserve Bank Board were not as clear as they could have been. The Reserve Bank Board did not have the opportunity to contribute to what was a significant policy decision that they were responsible for.

Roles and responsibilities relating to risk management are currently quite complex and somewhat unclear. This lack of clarity has given rise to issues related to risk governance. For instance, during consultations, concerns were raised that decisions or matters of the internal Risk Management Committee were not always adequately heard and considered.

The Review recommends updating and strengthening the RBA's corporate governance with the creation of a Governance Board. The intent of this recommendation is to align the RBA with current best practice, reduce risk, clarify accountability, drive organisational change and support a high-performing RBA.

Box 5.2: International comparison of central bank governance arrangements

There is significant variation in the governance arrangements of central banks internationally, reflecting the diversity of responsibilities of central banks as well as differing legal traditions and governance norms. Table 5.1 details the corporate governance arrangements for a selection of inflation-targeting central banks.

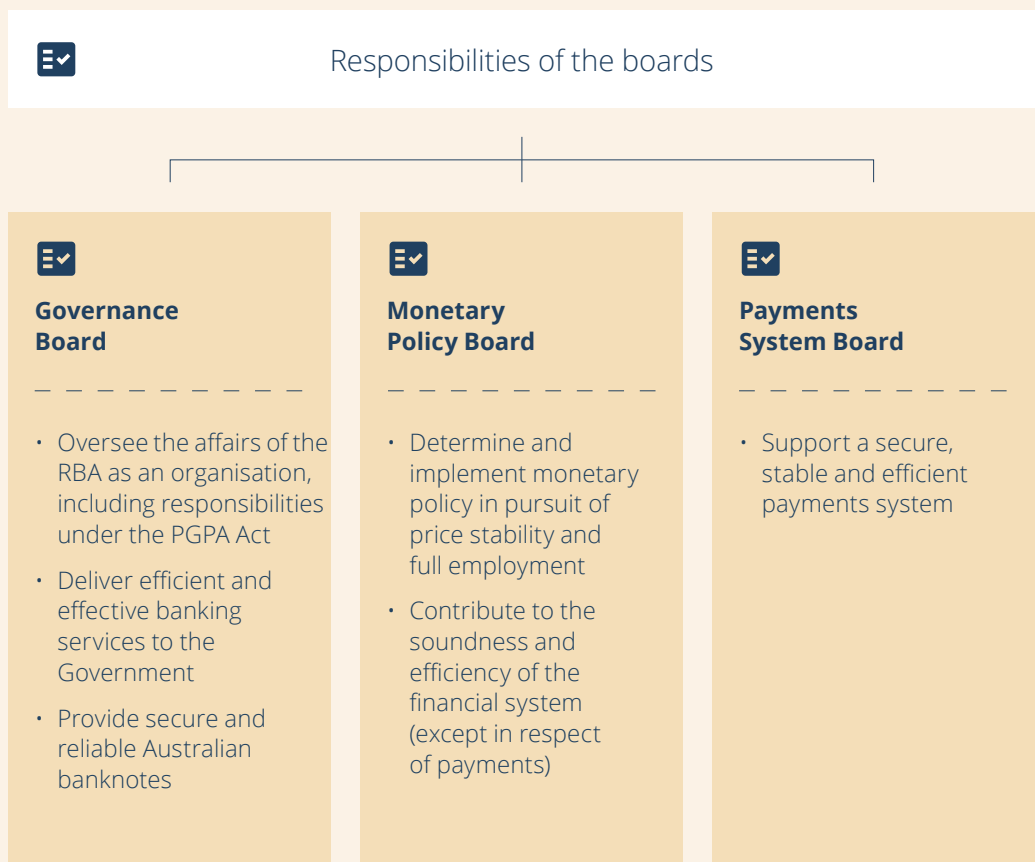**Table 5.1 Governance arrangements in central banks**

Country	Governance body (Chair)	Separate monetary policy committee/board? (Chair)
Australia	Reserve Bank Board (Governor)	No
Canada	Board of Directors (Governor)	Governing Council (Governor)
Euro-area	Governing Council (President)	No
India	Central Board of Directors (Governor)	Monetary Policy Committee (Governor)
Japan	Policy Board (Governor)	No
Korea	Monetary Policy Board (Governor)	No
New Zealand	Reserve Bank Governance Board (External member)	Monetary Policy Committee (Governor)
Norway	Executive Board (Governor)	Monetary Policy and Financial Stability Committee (Governor)
Sweden	General Council* (External member)	Executive Board (Governor)
United Kingdom	Court of Directors (External member)	Monetary Policy Committee (Governor)
United States	Board of Governors (Chair)	Federal Open Market Committee (Chair)

*Oversight body of which most members are Parliamentarians

Recommendation 12.1: Establish a Governance Board

The Review recommends amendments to the RBA Act to establish a Governance Board with responsibility for overseeing the RBA's management as an organisation, excluding those responsibilities reserved to the Monetary Policy Board and Payments System Board. Figure 5.2 provides the broad division of responsibilities recommended for the 3 boards.

Figure 5.2: Responsibilities of RBA boards

Responsibilities of the boards

Governance Board

- Oversee the affairs of the RBA as an organisation, including responsibilities under the PGPA Act
- Deliver efficient and effective banking services to the Government
- Provide secure and reliable Australian banknotes

Monetary Policy Board

- Determine and implement monetary policy in pursuit of price stability and full employment
- Contribute to the soundness and efficiency of the financial system (except in respect of payments)

Payments System Board

- Support a secure, stable and efficient payments system

In overseeing the management of the RBA, the responsibilities of the Governance Board would include:

- setting organisational strategy (excluding monetary and payments policies) to ensure the organisation operates effectively and delivers on policy goals

- overseeing the organisational change (including cultural change) recommended in this Review (and future reviews) and modelling the behaviour it expects from the organisation

- assessing the performance of the RBA (through internal or external review), including its monetary and payments policy

- overseeing the RBA's routine balance sheet management policies, with the exception of special tools assigned to the Monetary Policy Board that affect the balance sheet

- overseeing effective systems of risk management and financial reporting

- overseeing consultations with the Government about the RBA's capital position and the payment of dividends through the Governor

- ensuring efficient use of the organisation's resources

- overseeing large projects and infrastructure, including when they cover multiple functions (for example payments system infrastructure and IT)

- overseeing staff resourcing, including recruitment and development policies, succession planning and remuneration (see Chapter 4)

- setting the remuneration of the Governor and Deputy Governor based on the advice of the Remuneration Tribunal.

The Governance Board should have no role in monetary, financial stability or payments policy, and should not be involved in the day to day running of the RBA.

The creation of the Governance Board enables greater oversight of the RBA's complex affairs without compromising the focus and specialisation on monetary and payments system policy. This complements the recommendation in Chapter 3 to create a Monetary Policy Board. Just as monetary policy decision making can benefit from the expertise, broad knowledge, and skills from a variety of areas, so can the governance functions of the RBA when overseeing technology, human resourcing, risk, and financial reporting, among other matters.

Some consulted by the Review preferred the current model of a generalist Reserve Bank Board covering both monetary policy and some role in corporate governance. This was due to concerns about adding bureaucracy and structure and perceived difficulties in recruiting suitable candidates. The Review considered these concerns but, on balance, concluded that the additional structure serves an important purpose, and the pool of suitable applicants is significantly large. Overall, the advantages of creating a Governance Board significantly outweigh these concerns. Chapter 7 sets out an alternative option the Review considered.

The Review recommends the Governance Board determine its own meeting frequency. As a starting point the RBA Act could specify the Governance Board convene at least 4 meetings a year. Short virtual meetings could be held as required for financial reporting. This should provide a balance between suitable oversight, time commitment of Governance Board members, and responsiveness to emerging issues. The Governance Board could be convened at other times as necessary. The RBA's Executive Committee would continue to meet more regularly to implement the policies of the Governance Board.

The Review emphasises the need to establish a clear delineation between the responsibilities of the Governance Board, Monetary Policy Board and Payments System Board (see Recommendation 12.6).

Recommendation 12.2: Make the Governance Board the accountable authority and expand the Audit Committee to an Audit and Risk Committee

The Review recommends the accountable authority of the RBA with respect to the PGPA Act shift from the Governor to the Governance Board. This would ensure that the body responsible for overseeing corporate governance matters will also be accountable for those decisions. The shift in accountable authority will not alter the Governor's role in monetary and payments policy formulation.

As the accountable authority, the Governance Board would have a range of obligations to properly govern the RBA, including promoting proper and efficient use of public resources and maintaining appropriate systems relating to risk management and oversight. The Governance Board should play a role in assessing and developing an appropriate risk appetite that allows for 'manageable failures' and lessons learnt. The Governance Board would be responsible for the annual report and corporate plan.

Audit and Risk Committee

As the accountable authority, the Governance Board would be responsible for the RBA's systems of risk oversight and management. To provide assurance on this duty, the Governance Board would convene an Audit Committee under section 45 of the PGPA Act.

The Review recommends that the Governance Board establish an Audit and Risk Committee to fulfil this requirement. The statutory functions, membership requirements and reporting obligations in relation to the committee would remain the same as the current Audit Committee. Similar to the current composition, the Audit and Risk Committee would likely include some members not on the Governance Board with qualification and skills relevant to financial and performance reporting, risk oversight and systems of internal control. Expanding the name of the committee to include risk would signal a strengthening to the RBA's formal approach to risk assurance. The importance of naming was highlighted in the 2018 Independent Review into the Operation of the PGPA Act and Rule.[1]

The scope of the Audit and Risk Committee should include the process of both the Monetary Policy Board and Payments System Board for internal and audit assurance purposes only.

The RBA's internal Risk Management Committee should continue to exist as an arm of the executive to drive risk culture across the institution. The Risk Management Committee should be chaired by the Chief Operating Officer rather than the Deputy Governor as is the case now. The Chief Operating Officer will have direct reports on all corporate matters, including risk, and therefore be well-equipped to chair the internal Risk Management Committee. The Chief Operating Officer will be a voting member of the Governance Board, meaning they will be able to provide sufficient contextual knowledge to inform debate at the Risk Management Committee meetings. The Risk Management Committee would be responsible for developing and embedding a more consistently mature risk culture across the organisation (see Chapter 4).

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1   Recommendation 15 of the PGPA Act and Rule review noted that the name reinforces the important role of these committees in supporting accountable authorities to manage and engage with risk. The Governance Board could also consider Recommendation 14, which recommended organisations with particularly complex risks should go further and establish a separate Risk Committee.

Recommendation 12.3: Governance Board membership and external chair

The Review recommends the Governance Board has 7 members: the Governor, the Chief Operating Officer and 5 external members. The Deputy Governor is to be an observer. This board size is in line with the norm for Australian public sector boards and medium ASX-listed companies (Australian Institute of Company Directors 2019). Given the Governance Board's responsibility for executive and strategic oversight, the Review supports ensuring the majority of the Governance Board are external members. As such, the Review recommends a quorum of 5 members, with at least 3 external members and at least one of the Governor or the Chief Operating Officer residing. The Chair would hold the casting vote in the case of a tied decision.

There are two sides to the argument of whether an external Governance Board member or the Governor should be the chair.

The argument for an independent governance chair is that it offers the strongest form of oversight. A chair who is also the CEO cannot provide effective oversight of how the CEO and the executive team manage the organisation. For this reason, an independent chair aligns with the ASX Corporate Governance Council recommendations for good corporate governance of listed entities (ASX Corporate Governance Council 2019) and is the norm for most private and public sector boards in Australia. Some central banks have an independent chair of their governance boards, notably the Bank of England and the Reserve Bank of New Zealand.

The argument for the Governor to chair the Governance Board is that it ensures coherence between the Governance Board, Monetary Policy Board and Payments System Board as the same person chairs all 3. There are instances of other central banks with governance boards that are chaired by the Governor, like the Bank of Canada and Norges Bank.

On balance, the Review believes that an independent external chair provides the best option for governance, subject to a clear delineation of the roles and responsibilities of the various boards.

The Review recommends the Chief Operating Officer be a member of the Governance Board. This position will be essential for providing advice to the Governance Board and implementing the Governance Board's decisions. The Review recommends that the Deputy Governor sit on the Governance Board as an observer or as a voting member if deputising for the Governor in their absence. This will ensure the Deputy Governor is informed of Governance Board discussions for contingency purposes, and for participation in strategic planning, while maintaining a significant majority of external members.

Recommendation 12.4: Adopt a more transparent and open appointments process that uses a skills matrix to assess potential candidates

Appointments process

In line with the recommendations for the Monetary Policy Board, the Review recommends the appointments of external Governance Board members should be transparent and open. All external Governance Board positions should be publicly advertised for expressions of interest alongside selection criteria. A panel comprising the Treasury Secretary, Governor and a third independent party (for example an independent external member, such as a former member of one of the Boards or another respected expert) should recommend a shortlist of suitable candidates to the Treasurer. The panel can also include names of people on the shortlist who it thinks clearly meet the selection criteria, independent of the expressions of interest process. The Treasurer would make an appointment from this shortlist.

As recommended for the Monetary Policy Board, appointments to the Governance Board should be staggered to safeguard against groupthink and maintain the Board's institutional memory (Gai 2023). Staggered appointments also guard against actual or perceived political interference because a Treasurer cannot replace the entire board within a single term of government. The findings of the forthcoming Briggs review of the processes for public sector board appointments should be taken into consideration.

Skills matrix

A skills matrix should set out the skills, knowledge, experience and capabilities that are considered essential for the effectiveness of the Governance Board. As with the Monetary Policy Board, the matrix would be used to identify gaps and support the appointment, training and succession process.

The Review acknowledges the importance of different skill sets and backgrounds for the Governance Board. Key skills may include risk management, technology, strategic planning and human resources. The skills matrix should be flexible and regularly reviewed to reflect changes in the operating environment. An example skills matrix is in Box 5.3.

In the first instance, this skills matrix would be created through an agreement between the Treasurer and Governor as part of the implementation of the findings of this Review. In future, the Treasurer could approve changes to the skills matrix at the Governance Board's recommendation. Capability Reviews would provide an opportunity for the Governance Board to reassess the skills matrix to ensure members collectively continue to have the skills needed to meet future challenges (see Chapter 6).

While the skills matrix should be flexible and regularly reviewed, the Review recommends broad criteria for the Governance Board be included in the RBA Act to provide a safeguard against politicisation. This is in line with the general direction taken in enabling legislation. For example, the *Australian Securities and Investments Commission Act 2001* states that nominations for appointments to the Australian Securities and Investments Commission can only be made if the person is qualified for appointment by their knowledge of, or experience in: business; administration of companies; financial markets; financial products and financial services; law; economics; accounting.

Box 5.3: Skills matrix for the Governance Board

The skills matrix should set out the skills, experience and capabilities that are considered essential for the Governance Board to perform as an accountable decision-making body. Individual members would not be expected to have all attributes in the matrix, but rather to bring different skills in a way that complements other members.

The following table is an example to make clear the direction of the Review's recommendations but it is not prescriptive.

Table 5.2 Example Governance Board skills matrix

Skills and experience	Description
Leadership	Experience leading large and complex organisations in the private, public or non-profit sectors, or in academia.
Technology	Experience in technology strategies, project management and innovation.
Risk management	Experience in identifying, assessing and managing different types of enterprise risks.
Strategic perspective	Demonstrated ability to decide and deliver on complex plans under conditions of heightened uncertainty, anticipate emerging issues, and balance risks.
Human resources	Demonstrated understanding of workforce planning, remuneration agreements and succession planning.
Finance	Proficiency in financial accounting and reporting, capital management and/or actuarial experience.

The table of appropriate skills for the Monetary Policy Board can be found in Chapter 3.

Recommendation 12.5: Appoint members for 5-year terms with the flexibility of a one-year reappointment

The Review recommends Governance Board members be appointed for 5-year terms, with a maximum of one reappointment of up to 1 year. This recommendation corresponds to the recommendation and rationale for the Monetary Policy Board members set out in Chapter 3. Terms of 5 years provide members with enough time to 'learn the ropes' and make a substantive contribution, while the option of an additional year affords flexibility to ensure appointments are appropriately staggered.

The remuneration of Governance Board members should be set by the Remuneration Tribunal, an independent statutory authority that determines the remuneration of significant appointments. This mirrors the current arrangements for Reserve Bank Board and Payments System Board members.

Recommendation 12.6: Establish board charters and a memorandum of understanding between the boards

It is important to clearly set out the respective roles and responsibilities of the boards and the RBA executive. One of the risks of a separate Governance Board is the potential conflict between the RBA Boards and how differences would be resolved. Differences must not create uncertainty or limit the ability of the central bank to act quickly in a crisis with the instruments it thinks are necessary. This risk can be mitigated by being clear about the roles and responsibilities of the various boards, including that the Monetary Policy Board has the instruments and authority to act quickly in a crisis.

Each board should formalise, through a published charter, the RBA executive's areas of responsibility and authority to take decisions. The charter should include the specific decisions that must be approved by the relevant board and expectations around the information that the RBA executive will provide to the boards to foster debate and inform decision making. It should also cover each board's processes for periodically reviewing its own effectiveness. Publishing a board charter is in line with best-practice governance for listed firms in Australia (ASX Corporate Governance Council 2019) and is common for public sector boards.

The Review also recommends that the Governance Board, Monetary Policy Board and Payments System Board together establish and publish a memorandum of understanding. This memorandum would record the common understanding of their responsibilities and their expectations for information exchange and consultation on matters of mutual interest. The Monetary Policy Board and Payments System Board have unique insight into the work of the RBA as an institution and will be important sources of feedback to the Governance Board about the performance of the RBA.

The legislation should set out the responsibilities of each board and the ultimate mechanism for dispute resolution. The memorandum of understanding should include any further detail, as required, about how the boards will approach issues if there is a lack of clarity or overlapping responsibilities (see Box 5.4).

Box 5.4: Interactions between the RBA's boards

A clear understanding of responsibilities is central to effective governance. The responsibilities set out in this chapter, in Chapter 3 and in the RBA Act (in respect of the Payments System Board) offer clear instruction in most circumstances. However, the Review acknowledges that there will be instances where the responsibilities of these bodies will interact, or even conflict.

For example, the use of additional monetary policy tools (see Chapter 1 and 2) is an example where the responsibilities of the Monetary Policy Board and Governance Board would overlap. The Monetary Policy Board may wish to purchase government bonds to provide further support in pursuit of its inflation and employment objectives. This decision, however, has direct implications for the RBA's balance sheet and risks, which would be the general responsibility of the Governance Board.

In such cases, the Monetary Policy Board needs to have complete authority to take actions to meet its monetary policy goals. The Governance Board's responsibility is limited insofar as it is to agree processes for the Monetary Policy Board's decision making and ensure it is provided with all suitable materials, such as on risk oversight, to inform its deliberations. The Monetary Policy Board should take into consideration the obligations of the Governance Board, as accountable authority, under the PGPA Act. This includes upholding risk management practices and performance reporting obligations set by the Governance Board and considering the expected costs and benefits of its actions and their impact on the financial resources of the RBA (see Chapter 3).

Open communication between the boards will help manage these interactions. The responsibilities of the boards with respect to consultation should be set out in a memorandum of understanding. The Governance Board should regularly seek feedback from the Monetary Policy Board and Payments System Board on the RBA's performance. The Governor will play an important role as a member of all 3 boards.

The Review considers that ultimately the Governor should have the power to determine a policy where there is a disagreement between the boards on matters of overlapping responsibility that cannot be resolved through consultation. The Governor is uniquely placed to play this role, being a member of all 3 boards and an expert with full visibility of the issues. This could be implemented through an amendment to Section 10C of the RBA Act, which currently deals with differences between the Reserve Bank Board and Payments System Board and provides similar authority to the Governor.
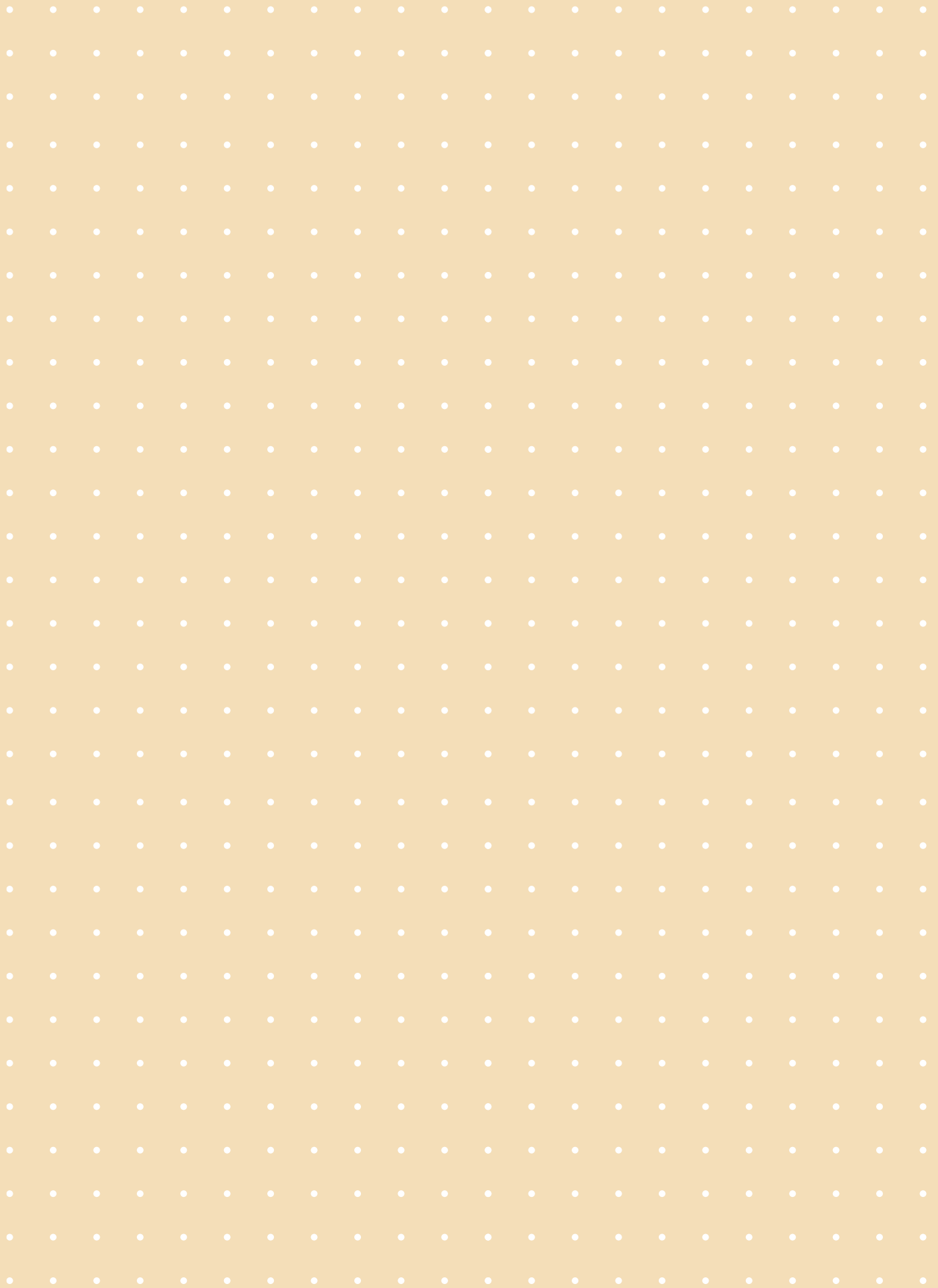
6

Chapter 6:
RBA leaders drive institutional and cultural change

Chapter 6: RBA leaders drive institutional and cultural change

> This chapter outlines the importance of leaders driving and modelling change within the RBA, through their behaviours, words and actions. It makes 2 recommendations aimed at ensuring leaders are held accountable for delivering the Review's changes and that these translate into staff members' lived experience.

In preceding chapters, the Review has proposed changes to the RBA's frameworks, governance, structures and processes to strengthen the RBA's effectiveness. These changes will only have their desired impact if they translate into changes in the experience of RBA employees. This chapter discusses the role of leaders in delivering this change.

The RBA's leaders[1] are critical to ensuring that the organisational and cultural changes proposed in this report transform the actual experience of RBA employees and the broader public.

This requires:

- leaders to drive and model the changes

- leaders to measure and assess through staff feedback the lived experience of these changes and act on gaps

- the RBA as an institution to transparently hold itself to account for achieving change

- the RBA working to identify opportunities for further growth as an organisation.

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1 'Leaders' refers to the RBA's management level staff (Level 5) and above. The terminology of *executive* is used in this chapter to distinguish the RBA's Assistant Governors and above from other leadership positions.

Recommendation 13: RBA leaders should drive and measure change

Recommendation 13: RBA leaders should drive and measure change	
13.1	The RBA's leaders should be assessed on how they deliver and model cultural change, including as measured through staff surveys.
13.2	The Governance Board should assess and report publicly by June 2025 on the RBA's progress in implementing the Review's recommendations and achieving its objectives. The Governance Board should also identify new opportunities for improvement through 5-yearly Australian Public Service capability reviews.

Recommendation 13.1: Leaders should model cultural change

The RBA's leaders have undertaken many initiatives over recent years to make the RBA a more open and dynamic institution that is well equipped to support its staff and carry out its duties. Yet, there remains a gap in the lived experience of staff members. Recommendation 13 is designed to address 2 issues that contribute to the gap between intended outcomes and lived experience:

- Leaders' behaviours, actions and decisions need to be consistent at all times with the culture the RBA needs for high performance.

- Leaders need to receive sufficient, good quality feedback on their performance and on how they affect staff members, to better target their efforts to improve.

The following recommendations are designed to help leaders as they work to better support overall organisational performance.

Leaders model the change

Leaders are always being observed, so what they say, how they act, and what they prioritise has a strong influence on the culture of the organisation (Chief Executive Women and Male Champions of Change 2014). For example, decisions and responses to matters such as failures and mistakes, risk incidents, role appointments and project outcomes send strong signals on what the organisation truly values (Muth and Selden 2018). These behaviours need to be consistent with the organisational characteristics and the culture the RBA needs to achieve. For staff members, the bar is high.

The Review offers suggestions for implementing Recommendation 13.1, highlighted in bold text throughout this section.

The RBA's leaders should adopt behaviours to demonstrate the changes the organisation should seek to achieve. Table 6.1 sets out the 3 organisational characteristics the RBA should seek to achieve, examples of the leaders' behaviours needed to achieve them, and areas that could be the focus of performance assessments. The cumulative effect of these actions and interactions will help to change the lived experience of RBA employees.

Table 6.1: Examples of contributing behaviours by organisational characteristic

Adaptable and open to change and innovation with an empowered staff	Engages in constructive challenge and values diverse views in decision making	Embraces accountability as individuals, as leaders and as an institution
Leaders should empower staff members: actively push decisions down to the lowest appropriate level and look for opportunities to encourage this to occur	**Leaders should engage in discussion:** actively engage, ask questions, adapt processes to enable more time for diverse viewpoints to be incorporated	**Leaders should have high quality performance management conversations:** providing constructive feedback, addressing difficult issues and underperformance
Leaders should innovate: provide clear guidance on the RBA's risk appetite to enable staff to innovate and adopt new ways of doing things or try and fail fast, and celebrate the lessons learned	**Leaders should validate diverse contributions:** explain the rationale for decisions including rationale that was not in line with staff members' views	**Leaders should invite and encourage staff to provide feedback** on the leader's own performance
Leaders should be adaptable: demonstrate flexibility to revise organisational priorities quickly where needed; review and change structures, processes and teams as needed; develop a mix of skill sets across the organisation to enable adaptability across teams	**Leaders should be open to views:** authentically encourage staff members to share their views, find different mechanisms to enable views to be shared, and actively and openly listen to and consider the views	**Leaders should commit to and actively build leadership capability** in themselves and others
	Leaders should authorise staff members to present their own views to Monetary Policy Board members: actively encourage and support staff members to present diverse views for consideration in decision making	**Leaders should call out behaviours out of step with the RBA's values** and encourage others to do so
		Leaders should educate the organisation on accountability, the importance and value of it to improving the RBA's performance and buttressing its independence

The RBA's executive leaders should, in consultation with staff, develop a statement about the cultural change they are seeking and a plan for achieving it. These should be set out in a Culture Plan that senior leaders explain to the staff. The Culture Plan should at a minimum include:

- Behaviours being assessed as part of formal performance reviews. The capability framework should reflect the expected behaviours and leaders' performance needs to be genuinely assessed against it.

- An approach to embed change into the organisation's internal policies, processes, and systems. This includes in areas such as recruitment, performance and development, talent discussions, succession planning and training. It should also consider promotions, rewards, and incentives.

- An approach to embed change in policy formulation and decision-making processes. Changes in the leadership behaviours are needed to ensure process and systems changes, such as to the Monetary Policy Board papers and processes (see Recommendation 9) and risk appetite (see Recommendation 11.1) have their intended impact.

The Culture Plan can be a key component of the RBA's broader implementation roadmap (see Recommendation 14.5).

The RBA's executive should lead a process involving staff members to update the RBA values. The Government's decision to extend the APS values across all agencies covered by the PGPA Act is an opportunity to reflect on and update the RBA's values. Agencies can continue to have agency-specific values that co-exist alongside the common set of public sector values. As such, the RBA should refresh its values so that they complement these and promote the particular behaviours and principles to which RBA staff members are expected to adhere.

Assess impact and address gaps

Even with the best of intent, leaders can have blind spots as to how their actions are received by others. This is why it is important to measure the change, receive frequent feedback and adjust approaches openly and pragmatically. These actions will help to ensure that leaders' behaviours and organisational initiatives are having the intended impact for staff members.

The RBA should run an annual staff engagement survey to assess progress and focus actions on gaps. Currently, the RBA runs a biennial staff engagement survey. Increased frequency will enable it to identify issues earlier and set and monitor progress against targets more closely. It will also enable it to share updates with the organisation and the Governance Board more regularly. The surveys should be supported by conversations with staff members about the results, and what changes they would like to see. Where ongoing matters or issues of particular concern are identified, these should attract stronger focus. This may involve deeper discussions with staff members and further analysis to help develop more targeted actions. Where possible and relevant, survey results should be benchmarked against the APS.

Leaders should be clear that they welcome feedback at any time about how organisational changes are being experienced by staff and on their performance as leaders. Annual externally facilitated 360-degree feedback for leaders (see Recommendation 11.2) will support this intent. Staff members also need to see commitment from leaders to addressing matters raised.

Executive leaders should consider putting in place a regular forum for themselves where they discuss how they are working together as a team, provide feedback and hold each other to account on behaviours.

Leaders need to measure and be transparent on progress against the Culture Plan. This is discussed in more detail in Recommendation 13.2.

Supporting assessment

The RBA's leaders are central to shaping a culture that supports long-term high performance and the changes set out by this Review. Their behaviours guide the actions of those around them, shaping culture. Leaders' behaviours can either reinforce or undermine organisational values. Leaders therefore need to be conscious and deliberate in their behaviours, actions and words, and these need to be consistent with and reinforce each other.

The RBA's strengths include its high calibre and well-regarded staff with a strong commitment to public service, intellectual rigour and high-quality outputs, and a collegiate environment. As noted in Chapter 4, the RBA's leadership is looking to build on these by implementing a raft of change initiatives including efforts to make policy forums more inclusive, initiatives to encourage staff to speak up and improvements to risk management. However, despite these positive steps the lived experience of staff does not always align with the intent and words of leaders. At times leaders' decisions and actions are seen as inconsistent with the stated process or direction and can undermine the intended impact. For example:

- The new career framework places stronger emphasis on leadership capabilities but this message is diluted when staff perceive opportunities to still be awarded largely based on technical expertise.

- Senior leaders are thought to have good intentions on diversity and inclusion, but RBA Review Staff Survey results show many staff members do not think this is translating into action or outcomes (Chart 4.13: Staff perceptions of diversity and inclusion, Chapter 4).

- Of the RBA Review Staff Survey respondents who experienced or witnessed bullying or harassment, around half did not report the behaviour, and the most common reason given for not reporting was 'I did not think action would be taken'. This problem is shared with the APS as a whole.

- Several staff members noted that they want to be innovative, but lack the incentive given senior leaders are quick to shut down ideas if they do not conform to the RBA's 'way of doing things'.

- Although the RBA has released podcasts and articles on the value of research, some staff members noted a lack of engagement from senior leaders in staff-driven research and policy discussions. One submission noted that this creates the perception that staff members are 'just talking to themselves'.

Recommendation 13.2: The RBA makes itself publicly accountable for delivering on change

Accountability and transparency are important to many aspects of the RBA's role. They build public trust in the strength and integrity of the institution. They enable the RBA to show it is a well-run institution, explain its monetary policy decisions and strategy, and demonstrate it pursues ongoing organisational renewal. These in turn help to buttress the independence of the RBA, which is central to effective monetary policy decision making. Increasing transparency and inviting more external scrutiny and challenge will help the RBA to publicly demonstrate its accountability, improve its policy deliberations and be a source of ideas on how to improve the organisation.

The Review offers suggestions for implementing Recommendation 13.2, highlighted in bold text throughout this section:

The Governance Board should hold leaders to account for delivering cultural change.
As discussed in Chapter 5, an important function of the Governance Board will be to hold senior leaders to account for progress in delivering the recommendations of this Review. This should include a strong focus on the plan for cultural change. The Governance Board needs to monitor progress regularly and challenge senior leaders where positive change is not evident, or progress is too slow. The Governance Board should ensure senior leaders are open and transparent with staff on plans and progress.

The Governance Board should assess how effectively the organisational and cultural changes (see Chapter 4) have been implemented, in terms of progress on initiatives but more importantly in terms of staff experience. The Governance Board can highlight and celebrate success in organisational renewal. The Governance Board should also seek to identify future priorities for organisational renewal. Priority issues may shift over time, including as progress is made on the priorities identified in this Review.

The Governance Board should assess progress on recommendation implementation and report publicly by June 2025. After the Governance Board is formed, it should monitor and assess progress on implementation of the Review's recommendations against the RBA's implementation roadmap (see Recommendation 14.5). An assessment of the RBA's progress should be released publicly by June 2025 as part of demonstrating accountability for delivery against the Review's recommendations.

The Review recognises that some recommendations will take time to action and for the impact to be felt, particularly in relation to cultural change. The Governance Board should consider what mechanisms it could use for future transparency and public accountability on ongoing progress.

The RBA should be included in 5-yearly Australian Public Service capability reviews to identify new opportunities for growth. This is distinct from the recommended regular reviews of the monetary policy framework and tools (see Recommendation 4), the goal of which is to ensure the framework is fit for purpose and inform renewals of the *Statement on the Conduct of Monetary Policy.*

Capability reviews are forward-looking reviews that independently assess an organisation's ability to meet future objectives and challenges. They aim to facilitate discussions around an organisation's desired future state, highlight capability gaps and identify opportunities to address them.

Being subject to 5-yearly capability reviews will help the RBA continue to adapt and maintain its ability to perform at a high level into the future. Future capability reviews will also allow monitoring, tracking of progress and external reporting in areas such as cultural change where outcomes take significantly longer periods of time to achieve.

This recommendation is consistent with the Australian Government's commitment for independent, fully transparent, and forward-looking capability reviews of departments of state and major agencies.

Supporting assessment

As discussed throughout the report, the independence of the RBA's actions needs to be matched with clarity of mission, capability to deliver and accountability for performance.

Accountability supports organisational performance and independence

Strong accountability is critical to ensuring that public institutions perform well. As discussed previously, accountability and transparency are critical pillars to support the independence of the RBA, which in turn is essential for effective setting of monetary policy. As former Chairman of the US Federal Reserve Ben Bernanke has observed, independence does not exempt organisations from external scrutiny or challenge:

> *'Central bank independence is essential, but, as I have noted, it cannot be unconditional. Democratic principles demand that, as an agent of the government, a central bank must be accountable in the pursuit of its mandated goals, responsive to the public and its elected representatives, and transparent in its policies.'*
>
> *– Ben Bernanke, 2010*

The Review has outlined some of the important accountability mechanisms that the RBA has, including formal requirements to report under the PGPA Act, appearances before parliamentary committees, publication of decisions and statements on monetary policy, regular reports, and speeches.

The Review has identified several areas where stronger accountability would improve the RBA's performance and benefit the Australian community (see Box 6.1)

Box 6.1: Strengthening RBA accountability – measures from the Review

Clearer objectives in the RBA Act and Statement on the Conduct of Monetary Policy. More explicitly outlining the RBA's dual objectives of price stability and full employment, how the RBA approaches flexibility in its framework, as well as its role in supporting financial stability, will strengthen accountability for delivering on its mandate (see Chapter 2).

Accountability for monetary policy decision making. A dedicated Monetary Policy Board, with more and varied external communications by the Governor and Board members will increase transparency around how and why policy decisions are taken (see Chapter 3).

Accountability for individuals' performance. Holding managers and executive leaders to account for delivering on their people leadership responsibilities (such as performance management and staff development) will drive a more engaged, capable and adaptable workforce to deliver the RBA's objectives (see Chapter 4).

Oversight of executive management. The establishment of a Corporate Governance Board as the accountable authority of the RBA, complemented by a new COO (see Chapter 4), broadens responsibilities and accountabilities across the institution and will apply more scrutiny to how the RBA is being run by its executive leaders (see Chapter 5).

### Delivering organisational and cultural change

The importance of strong accountability mechanisms extends to the new Governance Board working with the RBA's leaders to ensure the changes recommended by this Review are delivered (see Chapter 5). Ongoing scrutiny and guidance by the Governance Board and external parties will help the RBA to look for ways to continuously improve.

The Governance Board provides a mechanism to help enable, provide advice and ensure progress on challenging issues. By regularly monitoring progress, the Governance Board can help to steer change and ensure that impacts are being felt by staff members.

External reviews for organisational improvement and renewal

The RBA has not been the subject of recent or regular external review. Prior to this Review, the last time the RBA was fully and independently examined was as part of the Campbell Review which issued its final report in 1981. The RBA was in part examined as part of the Wallis Inquiry in 1997, which recommended shifting bank prudential supervision into a new prudential regulator. While the 2014 Murray Inquiry could consider the RBA's conduct of monetary policy, the terms of reference explicitly ruled out making any recommendations in this area.

The Australian Public Service capability review structure would provide a useful framework for future reviews. These reviews are independent and provide advice on how an organisation needs to set itself up to meet future challenges. Capability reviews are consistent with organisational independence. They provide a source of advice and independent evidence base for improvement. They are honest and constructive. They do not override the ultimate responsibility of accountable authorities to choose how to run their organisation. They would enable the RBA to pursue ongoing organisational improvement.
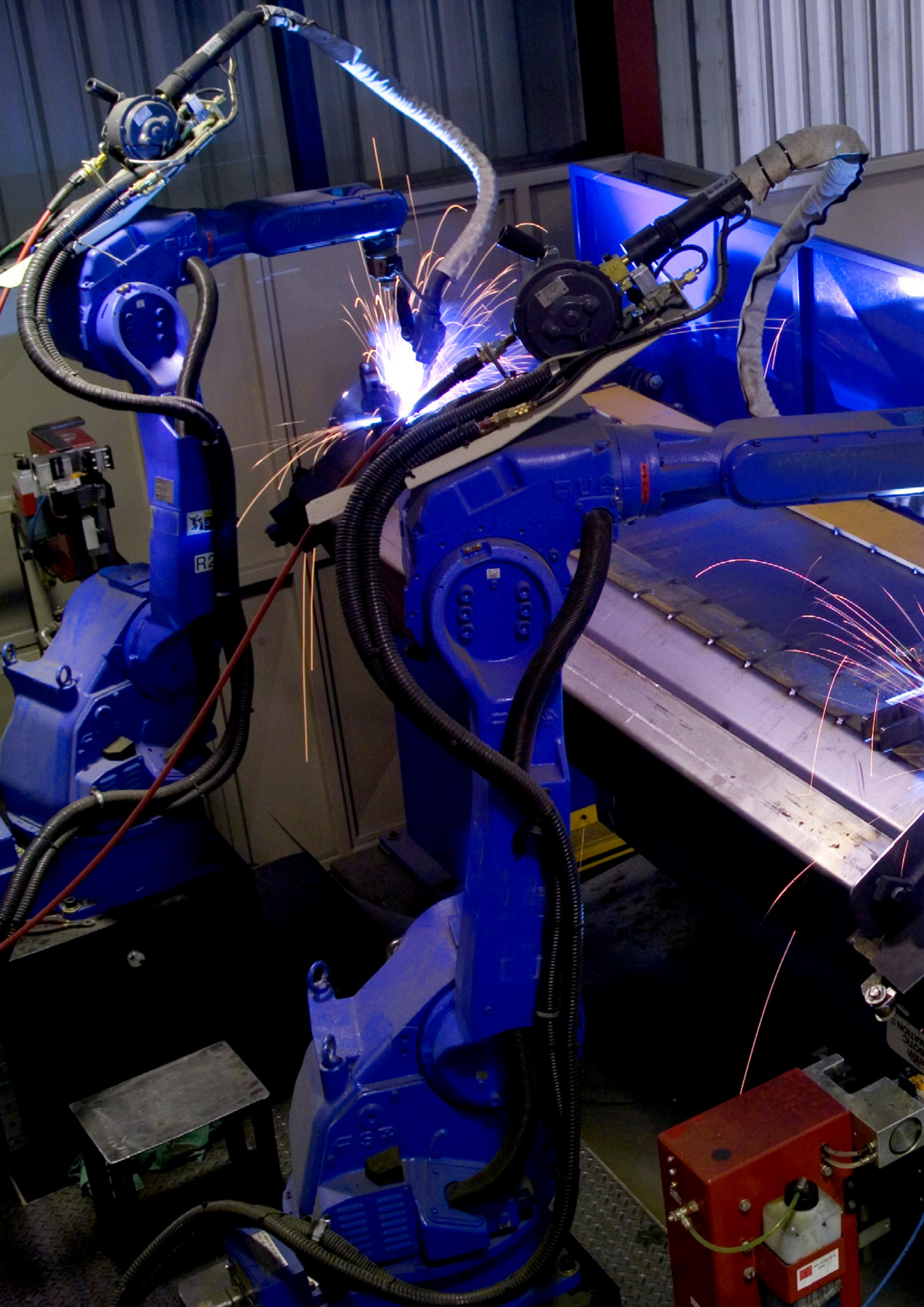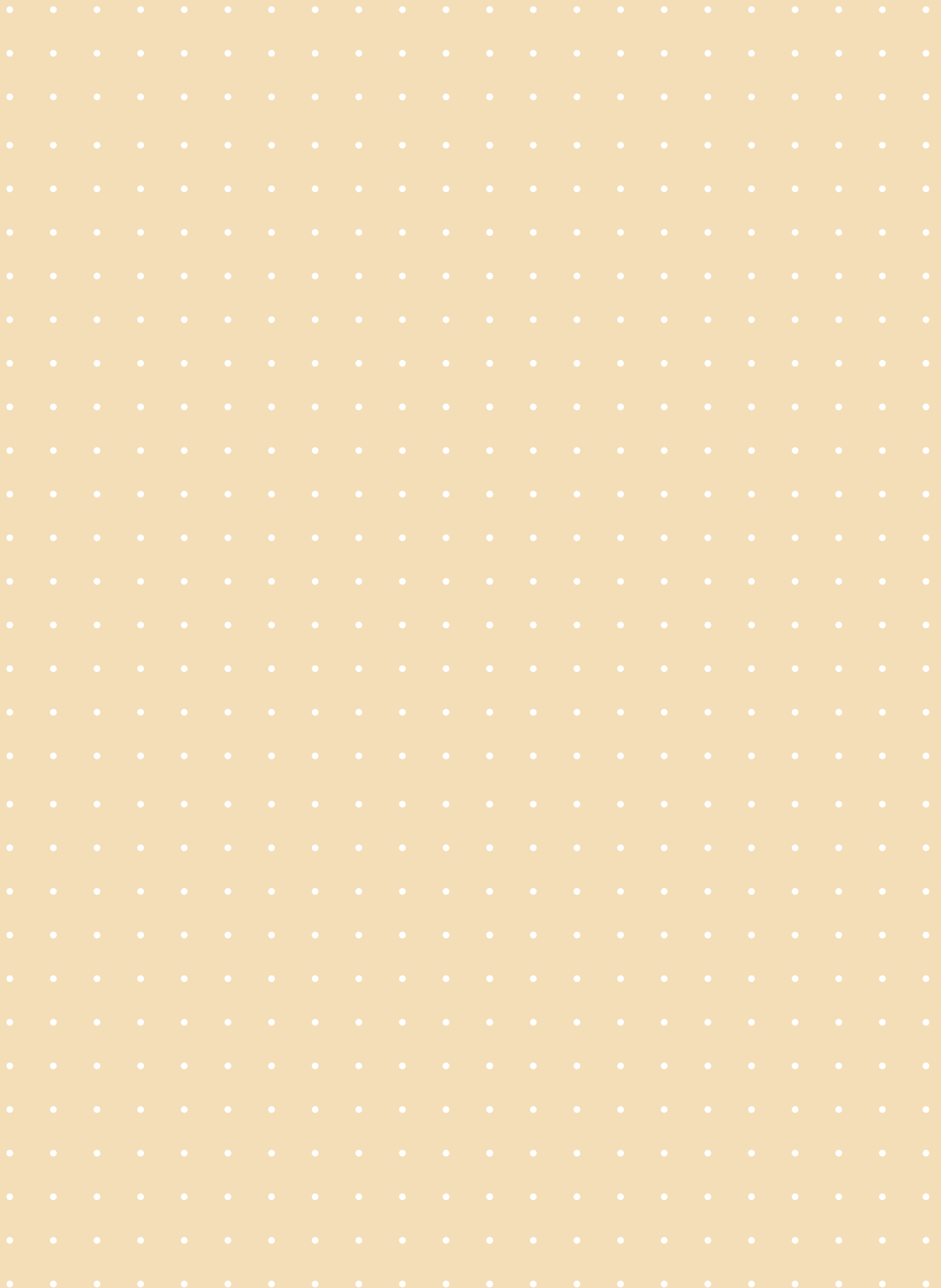
Chapter 7: Implementing the Review

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This chapter considers the best way for the Australian Government and the RBA to implement the recommendations of this Review so that changes are managed smoothly and align with the Review's intent. It recommends a process for implementation to ensure continuity of core operations and effective delivery of the changes. It then outlines how, in the absence of legislative change, the Review's aims could be partially met.

The Review's recommendations aim to heed the lessons of the past and help build a stronger RBA that is ready for the challenges of the future. The work should begin now, and the implementation should be planned methodically and well-paced over time. This should minimise disruption to the RBA's functions and to achieve sustained benefits.

The RBA is a strong institution and the recommended changes should not be seen as responding to immediate events and issues. Implementation should not, and cannot, be completed overnight. Some of the Review's recommendations, such as those that require legislation or new appointment processes, will require time to be put into effect. Changes to how an institution operates and how it feels to its staff also take time to become embedded.

The Review suggests that in implementation, the RBA and Government focus on both the specific recommendations and their broad intent. The preceding chapters provide detail on the suggested approach to implementing each recommendation. In many cases, the more significant challenge is to achieve the underlying behavioural and cultural change that the recommendations seek.

Recommendation 14: Ensure continuity through the implementation process

Recommendation 14: Ensure continuity through the implementation process
14.1 For recommendations that require legislation, the Government should legislate the changes to commence on 1 July 2024, to allow time to plan and prepare.
14.2 The Government should make any new appointments to the existing Reserve Bank Board before 1 July 2024 using an interim skills and experience matrix, expressions of interest, and a process managed by the Treasury Secretary, the Governor of the RBA and a third party.
14.3 The Government should make Board appointments with a view to supporting the continuity of decision making now and in the future by: ▪ making new appointments to the existing Reserve Bank Board on the basis these members would complete their terms as members of the Monetary Policy Board ▪ asking other existing Reserve Bank Board members to continue their term on one of the new Boards ▪ varying the terms of appointees to the new Boards, as needed, to avoid bunching of future appointment dates.
14.4 The Government should consult with the Shadow Treasurer about the implementation of the recommendations of the Review, to ensure broad bipartisan support for the new arrangements.
14.5 The RBA should develop an implementation roadmap to progress the Review's recommendations that creates clear accountabilities and milestones and ensures continuity of the RBA's functions, taking into account the Government's legislative plans.
14.6 For recommendations that do not require legislation, the RBA should in 2023 prioritise implementing the recommendations that strengthen monetary policy decision making, communications and the RBA's management, culture and operations.
14.7 The Treasurer and the Reserve Bank Board should agree an updated *Statement on the Conduct of Monetary Policy* by the end of 2023.

Legislation changes to commence on 1 July 2024 or later

Fully implementing the Review requires changes to the legislative framework. Recommendations 1, 5, 8 and 12 all call for changes to the RBA Act and the Banking Act.

The Review recommends legislating the changes to commence on 1 July 2024 or as soon as practicable after that. This would allow time for the Government to develop and consult on Bills to put to Parliament and for Parliament to consider these Bills. If the legislative process were to take longer, the commencement date should also be delayed to ensure smooth implementation and continuity of decision making. A commencement date of 1 July 2024 or later would allow for the transition arrangements for the changes to the composition of the RBA's Boards, under Recommendations 8 and 12.

Transitioning appointments for the new Boards

Board appointments made between now and 1 July 2024, and the initial constitution of the 2 Boards from 1 July 2024, should be managed to provide some continuity of membership between the Boards, a staggering in the terms of appointment for Board members and bipartisan support for the newly constituted Boards.

Some appointment or reappointment decisions will need to be made before 1 July 2024, due to the appointment expiry dates for some current Board members. Further, a range of new appointments will need to be made for the new arrangements to commence from 1 July 2024. The proposed Monetary Policy Board and Governance Board increase the number of external Board members from 6 on the current Board to 11 across the 2 Boards.

The Review recommends making any new appointments to the existing Reserve Bank Board before 1 July 2024 using an interim approach similar to the one proposed at Recommendations 8 and 12. The process should commence by seeking expressions of interest and publishing the skills and experience matrix that will guide selection, with the candidate identification process augmented by direct approaches to other qualified people who meet the criteria. The process should be managed by the Secretary to the Treasury, the Governor of the RBA and a third party who recommend options for suitable candidates to the Treasurer, based on the expressions of interest and other qualified people who meet the criteria.

Initial terms of appointment on the new Boards should be staggered so that there is a pipeline of regular term expirations, with one or two expiring around the middle of each year. This would promote continuity and the regular refresh of the Boards. There are several ways to achieve this.

- New appointments made before 1 July 2024 should be on the basis that new Board members would complete their terms as members of the Monetary Policy Board when it comes into being.

- Existing Board members should be asked to consider appointment in a role on one of the new Boards, for the remainder of their terms.

- Consideration should also be given to varying the length of terms for appointees to the Monetary Policy Board and Governance Board, both when the new Boards are created and if required in the future (for example, to fill an unexpected vacancy).

A consultative implementation process

Broad bipartisan support is one contributor to the strength and credibility of the RBA and monetary policy. The Government should consult the Shadow Treasurer about the implementation of the recommendations of this Review, to ensure broad bipartisan support for the new arrangements.

The RBA should develop an implementation roadmap

The Review's recommendations represent significant transformation across many aspects of the RBA.

As change is implemented, the RBA will concurrently need to ensure continuity of its functions. To help manage these risks and support implementation, the RBA should consider engaging the assistance of external services.

The Review's changes will have resourcing implications both in the transition and in the long run. For example, the RBA will need a small team to manage the transition, and new and changed positions and functions involve costs. These costs are worth bearing given the economic and social benefits that flow from strengthening monetary policy decision making and RBA governance. This transition should be resourced properly, so it is effective and does not divert RBA staff from existing core RBA business.

The RBA should demonstrate its prudent use of public resources by making strategic choices on what to pursue and what to stop doing, although timing of identifying and implementing these strategies should respect capacity constraints over the implementation phase. Some recommendations in the Review, for example updated operational approaches at Recommendation 11, offer opportunities to save costs in the future. The Governance Board's assessment of implementation should consider opportunities for efficiencies, which will inform a future capability review (see Recommendation 13).

To prepare for the changes, the Review recommends the RBA develop an implementation roadmap to support successful delivery. The roadmap should, at a minimum, set out:

1. Priorities for reform – the order in which the RBA intends to address items, noting that some may require Government action

2. Specific actions – identify the activities and actions the RBA plans to undertake for each recommendation

3. Specific accountability – allocate accountability for delivery of each action (or group of actions) to individual RBA leaders

4. Governance – outline the mechanisms for managing, monitoring and overseeing progress.

The Governance Board has responsibility for overseeing and holding the RBA's leaders to account for delivering these changes and is expected to report publicly on progress against this roadmap by July 2025 (see Recommendation 13.2).

Priority recommendations for the RBA in 2023

Of the recommendations that do not require legislation, the RBA's implementation should prioritise progressing 3 recommendations in 2023. The priority actions should be to:

- Improve processes to support deeper consideration of monetary policy decisions, strategy and research to strengthen the monetary policy decision making process (Recommendation 9), including changing the frequency of meetings and the process within the meeting cycle, and increasing Reserve Bank Board member access to the RBA staff.

- Strengthen monetary policy transparency and accountability (Recommendation 10), including press conferences, having the Reserve Bank Board approve the statement released after each Board meeting and enhancing the RBA's strategic communications capability.

- Strengthen the RBA's management, culture and operations (Recommendation 11), including appointing a Chief Operating Officer, implementing mandatory leadership training, assessing leaders on their promotion of challenge and debate, and establishing a monetary policy strategy team.

Update the Statement on the Conduct of Monetary Policy

Recommendations 2, 3 and 8 require updates to the *Statement on the Conduct of Monetary Policy*, and include that future versions be agreed between the Government and the Monetary Policy Board instead of the Governor.

These are updates to provide greater clarity about the approach to monetary policy. They should be progressed during 2023, with an eye to finalising the agreement between the Government and the Reserve Bank Board by year end. This approach would reinforce the objective of continuity between the Reserve Bank Board and the new Monetary Policy Board, rather than waiting until the Monetary Policy Board commences in the second half of 2024.

Implementing the Review without legislation

As noted, fully implementing the Review's recommendations requires changes to the legislative framework. The Review considers that the benefits of strengthened monetary policy decision making, corporate governance and oversight outweigh the costs and risks of changing legislation.

The foundational pillars of an independent central bank conducting monetary policy, broad bipartisan support for the framework and a high degree of stability in the framework, are of absolute importance. The Review does not support pursuing legislative changes if the process risks any of these foundational pillars.

The table below outlines how to achieve as much of the spirit of the Review's recommendations as possible, without legislative change. Many of these approaches involve changes to the *Statement on the Conduct of Monetary Policy* rather than legislation.

Table 7.1: Implementing the spirit of the recommendations, within the current legislative framework

Recommendation	Alternative approach, without legislation
Recommendation 1: Affirm the RBA's independence and clarify its statutory monetary policy objectives	
1.1 The RBA should continue to have operational independence for monetary policy. The Government should remove the power of the Treasurer to overrule the RBA's decisions.	The Government and the RBA should clarify these issues in the *Statement on the Conduct of Monetary Policy*, including a statement that the Government will not use its overrule power and the RBA will not use its power to determine the lending policy of banks.
1.2 The Government should amend the *Reserve Bank Act 1959* such that: ▪ The RBA has dual monetary policy objectives of price stability and full employment. ▪ The 'economic prosperity and welfare of the people of Australia now and in the future' is an overarching purpose for the RBA rather than a separate objective for monetary policy.	
1.3 The Government should remove the RBA's power (in the *Banking Act 1959*) to determine the lending policy of banks.	

Recommendation	Alternative approach, without legislation
Recommendation 5: Legislate the RBA's financial stability role	
5.1 The Government should specify in the *Reserve Bank Act 1959* that the RBA has a responsibility to contribute to financial system stability, in cooperation with other government agencies, especially the Australian Prudential Regulation Authority (APRA).	The Government and the RBA should clarify these issues in the *Statement on the Conduct of Monetary Policy*.
Recommendation 8: Constitute an expert Monetary Policy Board with diverse perspectives and knowledge	
8.1 The Government should constitute a Monetary Policy Board with responsibility for monetary policy decisions and oversight of the RBA's contribution to financial system stability (except payments system policy), but not broader corporate governance.	The Government should strengthen the existing Reserve Bank Board's ability to engage more deeply in monetary policy decision making by:
8.2 The Monetary Policy Board should comprise the Governor, Deputy Governor, Treasury Secretary and 6 external members, with the Governor as chair.	a) appointing external members who can make a significant contribution, assessed through use of a skills matrix focused on monetary policy
8.3 The Government should clarify in the *Reserve Bank Act 1959* that the Treasury Secretary acts on the Monetary Policy Board in their individual capacity not at the direction of the Treasurer. The *Statement on the Conduct of Monetary Policy* should state that the Treasury Secretary has a responsibility to provide insight on the outlook for the economy and for fiscal policy.	b) adopting the proposed appointment process. The Government should clarify in the *Statement on the Conduct of Monetary Policy* that the Treasury Secretary acts on the Reserve Bank Board in their individual capacity, not at the direction of the Treasurer.
8.4 The Monetary Policy Board's external members should be able to make a significant contribution to monetary policy setting through expertise in areas such as open-economy macroeconomics, the financial system, labour markets, or the supply side of the economy, and in the context of decision making under uncertainty.	
8.5 External Monetary Policy Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest, drawing on a matrix of required skills and experience. A panel comprising the Treasury Secretary, the Governor and a third party should recommend options for suitable candidates to the Treasurer.	
8.6 External members of the Monetary Policy Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.	

Recommendation	Alternative approach, without legislation
Recommendation 12: Update RBA oversight and accountability by establishing a Governance Board	
12.1 The Government should establish a Governance Board with responsibility for overseeing the management of the organisation, including organisational strategy, performance, finances, large projects, resourcing, remuneration, succession planning, risk (such as cyber risk), and delivery of banking and banknote services.	In the absence of legislative change, changes to the Reserve Bank Board should focus on strengthening its monetary policy decision-making role.
12.2 The Governance Board should be the accountable authority in respect of the PGPA Act and expand the Audit Committee to be an Audit and Risk Committee.	a) The RBA should pursue some strengthening of corporate governance by convening a specialised advisory committee to assist the Governor.
12.3 The Governance Board's membership should comprise the Governor, Chief Operating Officer and 5 external members. An external member should be chair.	
12.4 External Governance Board members should be appointed through a transparent process. Positions should be advertised for expressions of interest drawing on a matrix of required skills and experience. The process should be managed by the Secretary to the Treasury, the Governor and a third party.	
12.5 External members of the Governance Board should be appointed for a term of 5 years, with the possibility of reappointment for up to one year, if flexibility is needed. End dates should be staggered.	
12.6 The RBA Boards should establish charters setting out their responsibilities and those of the RBA executive. A memorandum of understanding should be established between the 3 RBA Boards.	

For recommendations about the RBA's objectives and role, these alternatives might achieve somewhat similar outcomes (see Recommendations 1 and 5). However, changes progressed via the *Statement on the Conduct of Monetary Policy* and other non-legislative means, are less formally binding and more vulnerable to further change over time. Also, progressing changes in this way would not resolve the discordance between the wording of the RBA Act and the current intent of the Government and the RBA.

For recommendations that relate to explicit legislative powers, these alternatives only partially achieve the intended outcome. This is relevant for Recommendations 1.1 and 1.3 which go to the power of government to overrule the RBA and the power of the RBA to set lending policies of private banks. Commitments about how powers will be used in the future are not binding, and these broad powers would remain enshrined in legislation.

The most significant beneficial change to strengthening the RBA's monetary policy and corporate governance – creation of a separate Governance Board and Monetary Policy Board – could not be achieved without changes to the RBA Act. In the absence of legislative change, the Review strongly recommends the priority be to strengthen the existing Reserve Bank Board's ability to engage more deeply in monetary policy decision making. The appointment process and skills matrix that are proposed for the Monetary Policy Board, should instead be used for the Reserve Bank Board. Many of the recommended changes to the monetary policy decision-making process (such as different frequency and length of meetings and greater access for Board members to the RBA staff – see Recommendation 9) could still be progressed without legislation.

Under this approach, the RBA should strengthen its corporate governance through other means, such as convening a governance committee formed of external experts, to help advise the Governor. Such a committee could offer insight across all aspects of the RBA's corporate governance but would not have the benefit of the formal role and accountability proposed by the Review.

An alternative approach, that the Review does not advise, would be to increase the expectations on the existing Reserve Bank Board, to have both a deeper involvement in monetary policy decision making and a deeper involvement in corporate governance. Under this approach, the Reserve Bank Board would provide input and advice to the Governor in carrying out the Governor's responsibilities as the accountable authority in respect of the PGPA Act.

The Review thinks that asking the Reserve Bank Board to fulfil an expanded role in both these areas, under the existing legislation, would have significant drawbacks.

- The challenges of having a single-decision maker on corporate governance (as discussed in Chapter 5) would remain.

- It would be necessary to strike a compromise in the Board's composition between monetary policy expertise and corporate governance expertise, reducing the benefits of specialising each Board to its role. People are likely to be relatively specialised in monetary policy decision making or in corporate governance, rather than both (although some people can be well placed to do both). A single board doing both roles would mean some of the monetary policy experts would need to participate in corporate decision making for which their skills are less well suited, and vice versa for corporate governance experts and monetary policy decisions.

- Increasing the corporate governance role of the existing Reserve Bank Board would significantly increase the time demand on Board members, which could discourage members or crowd out time for monetary policy decision making.

- The legislated responsibility of the Reserve Bank Board on corporate governance matters would remain unclear.

- The formal roles and responsibilities relating to risk governance would remain unclear.

Setting the RBA up to face the challenges of the future means implementing the best possible governance model. The Review strongly supports legislative change to implement its recommended approach.

If the Government decided not to proceed with separating monetary policy decision making and corporate governance, it would still be possible to make more limited changes to the RBA Act to update the monetary objectives and to make the Board the accountable authority under the PGPA Act (which is the default position under the PGPA Act).

Appendices

Appendix 1:
Terms of Reference

The Review of the Reserve Bank of Australia (RBA) is designed to ensure that Australia's monetary policy arrangements and the operations of the Bank continue to support strong macroeconomic outcomes for Australia in a complex and continuously evolving landscape.

1. The Review will assess Australia's monetary policy arrangements:

   1.1 The RBA's objectives, as outlined in the *Reserve Bank Act (1959)* and in the *Statement on the Conduct of Monetary Policy*, including the continued appropriateness of the inflation targeting framework.

   1.2 The interaction of monetary policy with fiscal and macroprudential policy, including during crises and when monetary policy space is limited.

      1.2.1 This will include Australia's macroprudential governance arrangements but exclude APRA's statutory role or functions.

2. It will also assess the following aspects of the RBA:

   2.1 Its performance in meeting its objectives, including its choice of policy tools, policy implementation, policy communication, and how trade-offs between different objectives have been managed.

   2.2 Its governance (including Board structure, experiences and expertise, composition, and the appointments process) and accountability arrangements.

   2.3 Its culture, management, and recruitment processes.

3. The Review will exclude the RBA's payments, financial infrastructure, banking, and banknotes functions.

4. The Review will consult extensively with domestic and global experts and members of the public.

5. The Review will take account of analysis conducted in prior reviews of other central banks, including the US Federal Reserve, the Bank of Canada, the Reserve Bank of New Zealand, and the European Central Bank.

6. The Review may invite and publish submissions and seek information from any persons or bodies.

7. A final report, with a set of clear recommendations to Government, is to be provided to the Treasurer no later than March 2023.

Appendix 2: Alternative monetary policy frameworks

This appendix considers some advantages and disadvantages of various alternative monetary policy frameworks. The crucial criterion for evaluating a framework is the extent to which it achieves the RBA's monetary policy objectives of low and stable inflation and full employment.

Average inflation-targeting

Under average inflation-targeting, the RBA would seek to deliver an average rate of inflation over a specified rolling multi-year window. The benefits of average inflation-targeting are:

- Stronger monetary policy stimulus at the effective lower bound for the policy rate, as a commitment to offset a period of low inflation creates expectations of stronger inflation and economic activity and lower real interest rates, providing additional stimulus (for recent assessments see Dorich, Mendes and Zhang 2021; Amano, Gnocchi, Leduc and Wagner 2020; European Central Bank 2021; Arias et al 2020). There are arguably macroeconomic stabilisation benefits too during periods of strong demand and above-target inflation.

Research on average inflation-targeting also suggests potential drawbacks to the framework:

- An average inflation-target may tend towards tighter monetary policy in the early phase of a downturn that follows a boom as the central bank seeks to compensate for the earlier period of above-target inflation. It is unclear that an average inflation target would deliver less volatility in economic activity over the cycle as a whole.

- Average inflation-targeting may not be perceived as credible because the central bank may face incentives to renege on its commitment to 'make-up' past misses of the target (Jia and Wu 2022). In particular, a central bank may be hesitant to deliberately engineer inflation above target following a period of low inflation, because aiming for modestly above-target inflation increases the risk that inflation overshoots the target by even more than desired and becomes very costly to normalise.

- Even if credible, an average inflation target is likely to be more difficult to communicate to the public and markets. The purported benefits of an average inflation target will be reduced if the framework is not credible, it is poorly understood or if businesses and households are not particularly forward-looking in the way they make decisions (Wagner, Schlanger and Zhang 2021; Hebden and others 2020; European Central Bank 2021a).

- It will generally result in holding the policy rate at low levels for longer during a downturn, which may promote growth in financial stability risks (Bank of Canada 2021; Goldberg and others 2020).

- It would make it more difficult for monetary policy to 'look through' temporary fluctuations in inflation, for instance, due to short-lived supply shocks or one-off shifts in administered prices. A need to respond in subsequent years to offset those one-offs might come at a substantial cost to central banks' employment or real activity goals (European Central Bank 2021).

Price level targeting

Under price level targeting, the RBA would seek to achieve a set path for the price level consistent with inflation having been 2½ per cent (Kulish 2020). Price level targeting is a stricter and longer-memory version of average inflation-targeting. Its potential benefits and drawbacks are generally more extreme versions of those described above for average inflation-targeting (the communication challenges of a price level target in particular are described in Kostyshyna, Petersen and Yang 2022). One specific advantage noted by proponents of price level targeting is that it offers the greatest certainty about the longer-run path of prices, which reduces one source of uncertainty for households and businesses.

Nominal income growth targeting

Under nominal income growth targeting the RBA would target the growth rate of nominal GDP or some other measure of nominal economic activity. The relative importance of commodity exports to Australia's economy and the tendency for commodity prices to be volatile means that nominal GDP would make for an unhelpfully volatile target variable in Australia. For this reason, a measure of nominal activity that excludes resource exports would probably be more appropriate for Australia, such as nominal gross national expenditure or nominal domestic final demand.

Research also suggests the following distinct potential benefits of a nominal income target:

- A nominal income growth target builds in a balance between price and real activity objectives to the target variable. Supply shocks drive real activity lower but also drive prices higher. So nominal income fluctuates less in response to temporary supply shocks than does consumer price inflation. As a result, monetary policy may react less to temporary supply shocks under a nominal income target, particularly compared to a strict inflation-targeting regime. A minimal monetary policy response to temporary supply shocks is likely to enhance the stability of the macroeconomy and enhance welfare. That said, it is not clear that the monetary policy response to a supply shock would be very different under a nominal income target versus a flexible inflation target, which also provides scope to 'look through' temporary periods of high inflation.

- A nominal income growth target may help to alleviate the constraint of the effective lower bound. If there is a more permanent decline over time in the average rate of real activity growth – which is one of the possible causes of a lower neutral rate and the proximity of the effective lower bound – then a credible nominal income target should lead average inflation expectations to rise to offset. Higher expectations for inflation, and in turn for nominal activity growth, should give central banks greater distance on average from the effective lower bound.

- There may also be benefits to financial stability from consistent growth in nominal incomes, as it facilitates a stable income stream with which to repay nominal debt burdens.

- Nominal income targeting may reduce the need for central banks to use estimates of 'potential GDP' or the non-accelerating inflation rate of unemployment in their forecasting process. These estimates are subject to substantial uncertainty and are a potential source of policy errors (Orphanides and van Norden 2002; Gruen, Robinson and Stone 2002).

At the same time, several concerns have been expressed about nominal income targeting:

▪ It may be less compatible with central banks' objectives than a flexible inflation target. By construction, a nominal income target places exactly equal preferences on the deviations of real activity and prices from target which may not match society's preferences. Further, nominal income measures do not connect directly to central banks' employment mandate (where they have one). Though there is a reasonably strong correlation between activity and employment outcomes over time, it is far from exact.

▪ A nominal income target would represent a substantial departure from the RBA's current monetary policy framework, even if in practical terms it would prescribe a similar policy response to flexible inflation-targeting in many circumstances (Debelle 2018A). This raises the prospect that the public and financial markets find it a difficult adjustment to understand. If economic decision makers don't understand it, are not paying attention or are not forward-looking in the way they make decisions then the purported benefits of nominal income targeting will be greatly reduced.

Nominal income level targeting

Under nominal income level targeting the RBA would target a path for the level of nominal GDP or some other measure of nominal economic activity (Beckworth 2019). Targets for the level of nominal activity introduce some need to 'make-up' for past misses of the target, similar to that characteristic of an average inflation or price level target. A common set of advantages and disadvantages apply to all frameworks with 'make-up' characteristics.

In particular, an important potential benefit of a nominal income level is that it may better promote economic recovery from downturns, particularly where monetary policy faces the effective lower bound constraint. When there is a downturn in real activity, a nominal income level target provides scope for a central bank to tolerate higher than normal inflation and/or economic growth for a time. This might deliver higher inflation expectations and lower real interest rates, relative to an inflation-targeting regime, getting the economy closer to the best possible outcome. There may also be benefits to financial stability from increases in inflation expectations at times of surprisingly low economic growth since higher inflation reduces real debt burdens.

Some of the other advantages and disadvantages of nominal income growth targeting apply to some extent to nominal income level targeting.

One particular concern for nominal income level targeting is that nominal income measures are frequently revised, such that the goalposts for monetary policy will change in unpredictable ways. A historical revision could leave central bank with an unexpected gap to 'make-up'. Consumer price index data are not revised, while employment data are. Nominal income measures are also released with a greater lag than the inflation and employment data and are only available on a quarterly basis, though both of these features could presumably be improved if they were a priority.

Appendix 3: Table of central bank objectives

Central bank	Objective	Inflation target	Employment objective	Recent changes and reason
Reserve Bank of New Zealand	Dual mandate for price stability and maximum employment.	To keep future annual inflation between 1 per cent and 3 per cent over the medium term, with a focus on keeping future inflation near the 2 per cent midpoint.	Support maximum sustainable employment.	Emphasis on the midpoint of the inflation target was added in 2012. This was motivated by the desire to anchor inflation expectations more firmly to 2 per cent, as they had been close to the upper end of the target band for most of the inflation-targeting period. Contributing to maximum sustainable employment was included in 2018, to be pursued alongside the inflation target (RBNZ 2022).
US Federal Reserve	Promoting maximum employment, stable prices, and moderate long-term interest rates (Federal Reserve 2021).	The Committee seeks to achieve inflation that averages 2 per cent over time, and therefore judges that, following periods when inflation has been running persistently below 2 per cent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 per cent for some time.	The maximum level of employment is a broad-based and inclusive goal. The decisions must be informed by assessments of the shortfalls of employment from its maximum level.	Prior to 2020, the inflation target was not specified as an average. Average inflation targeting was introduced with a view to better anchor inflation expectations. Introduction of the average inflation target followed a period of persistent low inflation, concerns of the potential for a decline in longer-run inflation expectations and, relatedly, concerns about the effective lower bound on the policy rate (Federal Reserve 2020b).

Central bank	Objective	Inflation target	Employment objective	Recent changes and reason
Bank of England	Price stability, and subject to that, support the economic policy of the Government, including for growth and employment.	The inflation target of 2 per cent applies at all times. This reflects the primacy of price stability and the inflation target. The Monetary Policy Committee may wish to allow inflation to deviate from the target temporarily.	The Government's economic policy includes high employment.	In 2013 the remit changed to emphasise the need, when large or persistent shocks occur, to consider and communicate the trade-offs between keeping inflation at the target and avoiding undesirable volatility in output.
Norges Bank	The purpose of central banking operations is to maintain monetary stability and to the stability of the financial system and an efficient and secure payment system. Monetary policy shall maintain monetary stability by keeping inflation low and stable. The central bank shall contribute to high and stable production and employment (Norges Bank 2022).	The operational target of monetary policy shall be annual consumer price inflation of close to 2 per cent over time.	Norges Bank seeks to stabilise employment around the highest level that is consistent with price stability over time.	A new monetary policy mandate was introduced in 2018. This included a reduction in the inflation target to 2 percent from 2.5 and amending the formulation to be high and stable output and employment. It also included that inflation targeting should contribute to preventing the build-up of financial imbalances.

Central bank	Objective	Inflation target	Employment objective	Recent changes and reason
Sveriges Riksbank	Maintain permanently low and stable inflation. Without neglecting the price stability objective, the Riksbank shall contribute to a balanced development of production and employment. The Riksbank shall, without neglecting the price stability objective, contribute to the stability and efficiency of the financial system, including the ability of the public to make payments.	Hold inflation around 2 per cent a year with a tolerance band of +/- 1 per cent.	[The Riksbank is] endeavouring to stabilise production and employment around paths that are sustainable in the long term. This does not mean that the Riksbank neglects the fact that the inflation target is the overriding objective.	A 1-3 per cent variation band was introduced in 2017 to show that inflation varies around the target. The variation band is not a target interval.
Bank of Canada	Preserve the value of money by keeping inflation low, stable and predictable.	The best contribution of monetary policy to the wellbeing of Canadians is to continue to focus on price stability. The inflation target is 2 per cent, the midpoint of a 1 to 3 per cent target range.	The best contribution of monetary policy to the wellbeing of Canadians is to continue to focus on price stability. The Government and the Bank also agree that monetary policy should continue to support maximum sustainable employment, which is the level of employment beyond which inflationary pressures arise.	The inflation target was maintained following review of the inflation target framework concluding in December 2021. The renewed statement included that the Bank of Canada will consider a broader range of labour market indicators and actively seek the level of maximum sustainable employment needed to keep inflation on target.

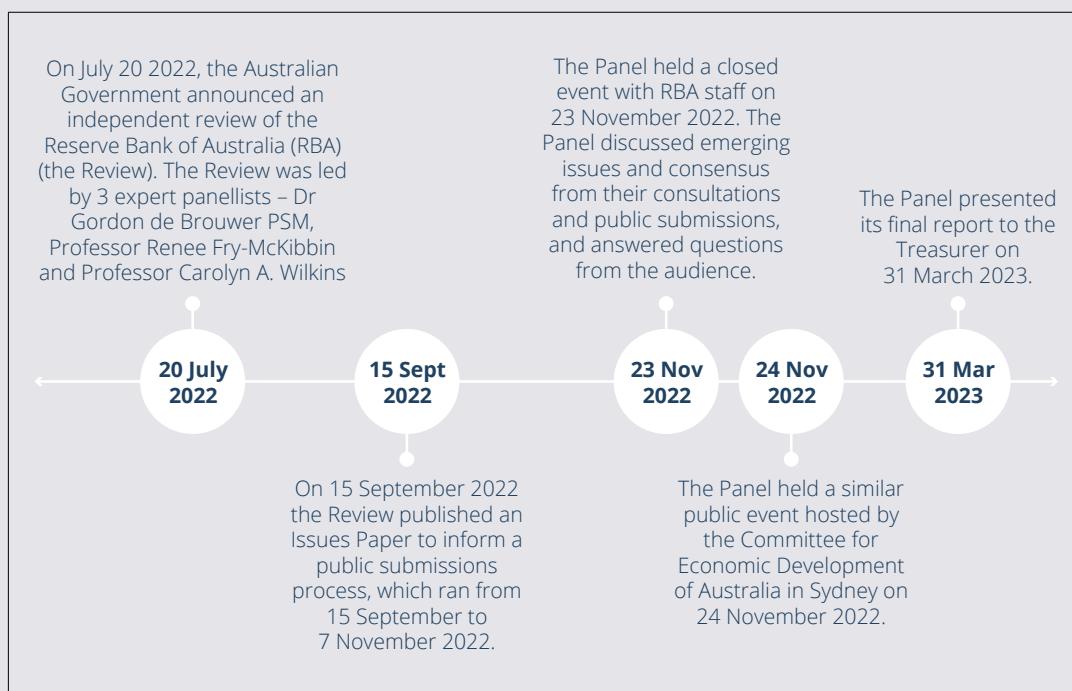| Central bank	Objective	Inflation target	Employment objective	Recent changes and reason
European Central Bank	Price stability and without prejudice to the objective of price stability, the European Central Bank shall also support the general economic policies in the EU with a view to contributing to the achievement of the Union's objectives (ECB 2021).	The inflation target is symmetric at 2 per cent over the medium term.	Price stability supports economic growth and job creation (the European Central Bank does not pursue a first-order employment objective).	In July 2021, the European Central Bank switched to a symmetric medium-term 2 per cent inflation target. Prior to this its quantitative definition was below but close to 2 per cent. The new target was expected to help bring up low inflation by contributing to anchoring longer-term inflation expectations more solidly.
Bank of Korea	To contribute to the sound development of the national economy by pursuing price stability through the formulation and implementation of efficient monetary policy (Bank of Korea 2023).	The Bank of Korea will conduct its monetary policy with the aim of keeping CPI inflation at 2 per cent over the medium term, while considering symmetrically the risks of inflation remaining persistently above or below the target.	By pursuing price stability, monetary policy contributes to the sound development of the national economy. There is no employment objective.	In 2019, the target was lowered to 2 per cent from 3 per cent (with a target band of 2.5-3.5 per cent).

Appendix 4: Methodology

Timeline and Process

On July 20, 2022, the Australian Government announced an independent review of the Reserve Bank of Australia (the Review).

The Review was led by 3 expert panellists – Dr Gordon de Brouwer PSM, Professor Renee Fry-McKibbin and Professor Carolyn A. Wilkins (the Panel).

Consistent with the Terms of Reference, the Panel considered the RBA's objectives, performance, governance, culture and management and the interaction between monetary, fiscal and macroprudential policy. See Appendix 1 for the full Terms of Reference.

The Australian Government asked the Panel to produce a report and recommendations by the end of March 2023 (Figure 1).

Figure 1: Timeline

On July 20 2022, the Australian Government announced an independent review of the Reserve Bank of Australia (RBA) (the Review). The Review was led by 3 expert panellists – Dr Gordon de Brouwer PSM, Professor Renee Fry-McKibbin and Professor Carolyn A. Wilkins

The Panel held a closed event with RBA staff on 23 November 2022. The Panel discussed emerging issues and consensus from their consultations and public submissions, and answered questions from the audience.

The Panel presented its final report to the Treasurer on 31 March 2023.

20 July 2022 — **15 Sept 2022** — **23 Nov 2022** — **24 Nov 2022** — **31 Mar 2023**

On 15 September 2022 the Review published an Issues Paper to inform a public submissions process, which ran from 15 September to 7 November 2022.

The Panel held a similar public event hosted by the Committee for Economic Development of Australia in Sydney on 24 November 2022.

The Panel was supported by a Secretariat of 18 staff members drawn from Treasury, RBA and APRA. The Panel put in place secondment agreements to make it clear that the Secretariat was obliged to act in the interests of the Review, under the direction of the Panel and Review executive. This also made it clear that members of the Secretariat were to act independently of their home agencies.

On 15 September 2022 the Review published an Issues Paper to inform a public submissions process, which ran from 15 September to 7 November 2022.

The Panel held a public event hosted by the Committee for Economic Development of Australia (CEDA) in Sydney on 24 November 2022. The Panel discussed the issues that had been raised and balance of viewpoints from their consultations and public submissions and answered questions from the audience. The Panel held a similar closed event with RBA staff on 23 November 2022.

The Panel presented its final report to the Treasurer on 31 March 2023.

Secretariat members	
Hamish McDonald	Head of Secretariat
Tim Taylor	Deputy Head of Secretariat
Monique Champion	
Sally Clarke	
Andrew Hartley	
Kate Hickie	
David Lancaster	
Jitana Lyall	
Matthew Mercer	
Emily Milford	
Ben Mowatt	
Suh Mian Ng	
Michelle Noack	
Jenelle Provost	
Ewan Rankin	
Sarah Thomas	
Miles Waring	
Georgia Wiley	

Information sources

The Panel gathered a range of inputs to inform its assessment and recommendations. These inputs included:

- consultations with domestic and global experts, businesses, unions and the community
- public submissions
- focus groups
- surveys of current and former RBA staff members.

In all, the Review benefitted from more than 1,500 contributions and conducted events to outline what it was hearing which directly reached almost 1,000 people.

The Panel is deeply grateful to all the people who contributed their time and insight to the work of the Review.
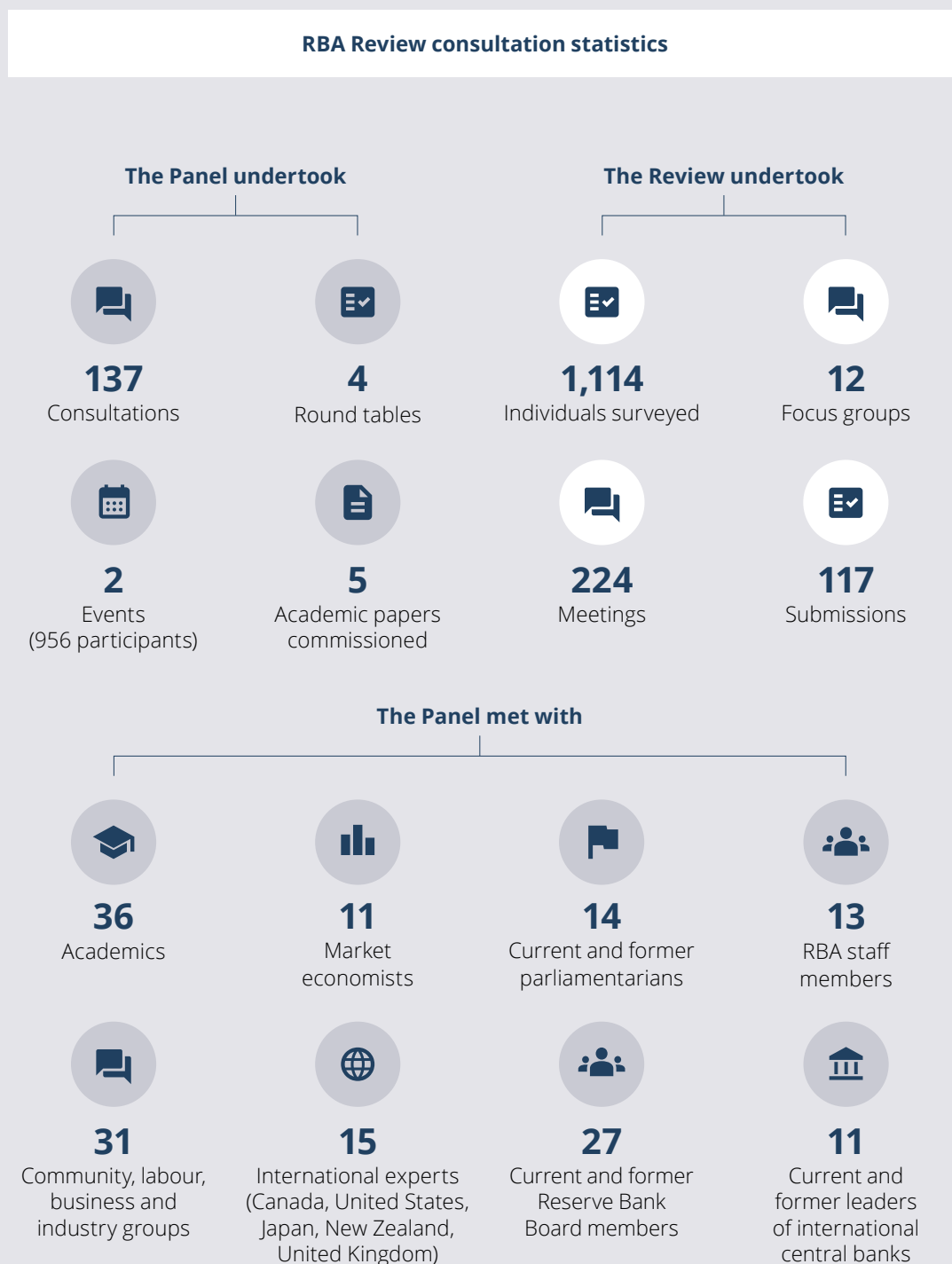
Panel consultations

The Panel consulted with 137 global and domestic experts, including current and former Reserve Bank Board and staff members, parliamentarians and academics. It also consulted with representatives of businesses, unions, public institutions and community groups. (Figure 2)

Many of these consultations were conducted by videoconference. Panel members also conducted in-person interviews over 2 weeks in August and November 2022, including meetings in Sydney, Melbourne, and Canberra.

As part of these consultations, the Panel conducted 4 round table conversations with leading academics and market economists across Australia.

A list of people the Panel engaged directly with is included at the end of this section.

Figure 2: Consultation statistics

RBA Review consultation statistics

The Panel undertook

137
Consultations

4
Round tables

2
Events
(956 participants)

5
Academic papers
commissioned

The Review undertook

1,114
Individuals surveyed

12
Focus groups

224
Meetings

117
Submissions

The Panel met with

36
Academics

11
Market
economists

14
Current and former
parliamentarians

13
RBA staff
members

31
Community, labour,
business and
industry groups

15
International experts
(Canada, United States,
Japan, New Zealand,
United Kingdom)

27
Current and former
Reserve Bank
Board members

11
Current and
former leaders
of international
central banks

The figures above exclude consultations where the participant asked to not be identified. Some of the individuals the Panel consulted are counted in more than one category.

Public submissions

The Review provided the public with an Issues Paper and submission guidelines and asked submitters to address the Terms of Reference.

The Review received a total of 117 submissions from diverse stakeholders, including from the finance industry, community service sector, union groups and members of the public.

Participants provided submissions by the RBA Review website portal and by email. Some RBA staff also provided confidential submissions via a separate portal, which could not be accessed by RBA secondees. The Review accepted late submissions by email for a short time after the official closing date. The Review accepted public, anonymous, and confidential submissions to allow for input from the widest range of contributors.

The Review published 78 submissions on its public website on 8 December 2022. Some submissions were not published due to confidentiality or legal policy.

Information requests

The Review issued 4 information requests to the RBA, on 15 August 2022, 27 September 2022, 30 November 2022 and 16 February 2023. These requests covered all aspects of the Terms of Reference.

The Review has published the three summary notes provided by the RBA in response to these requests on its website. Alongside these summary documents the RBA provided nearly 500 supporting documents. Many of these were confidential internal documents such as board papers and human resources documents. The RBA provided all documents and information requested.

The RBA was given the opportunity to provide written comments in response to a draft of the Review.

Survey of current and former RBA employees

The Review engaged a commercial provider, Big Village, to conduct an extensive survey of current and former RBA employees.

Big Village designed the survey to provide the Review with quantitative data on the RBA's workplace culture, values, and job satisfaction levels. The survey also asked participants to provide information on areas for improvement.

The commercial provider sent the survey to all current RBA employees. The survey was also sent to a list of former staff members identified by the Secretariat and the RBA. 982 current and 107 former staff completed the survey, with responses received from 17 October to 5 November 2022.

Data were broken down into categories based on gender, job classification level, employment status, and whether the respondent has a PhD/other postgraduate degree, was born in Australia or overseas, speaks a language other than English at home, their gender and sexuality and whether they identify as having an ongoing disability.

As part of preserving confidentiality, the Review team were provided with quantitative data where there were 10 or more respondents in any grouping (for example, particular demographics or by work unit). The Review did not have access to complete individual survey responses but was provided with de-identified responses to free-text questions.

The results from the survey were compared to the most recent Australian Public Service survey to gain further insights into RBA culture in contrast to broader public service culture.

Questions sought insight into staff perceptions on:

- what the RBA is doing well

- what the RBA could be doing better

- potential skills gaps

- diversity and inclusion

- recruitment culture

- management styles

- the effectiveness of the workforce.

Participants were asked to respond to multiple-choice questions and the survey included free text questions.

Summary reports of the surveys of current and former RBA staff were published on the Review's website at the time that the final report was released.

RBA focus groups

The Review conducted 6 Focus groups with 40 current RBA staff in November and December of 2022. The groups consisted of people from various work areas and levels, representing a sample of the broader work population and included people in management positions, economic and IT experts, corporate, and communications roles.

The focus groups helped gather evidence in a format that would suit those who prefer group discussion and provided the participants the opportunity to explore themes from the staff survey results.

Topics discussed by focus group participants included:

- recruitment and promotions

- risk culture, appetite for innovation and creativity

- diversity and inclusion

- hierarchy and decision making

- career pathways and development

- openness to internal and external policy discussion

- monetary policy decision making

- leadership capability

- change management.

Focus groups with members of the public

In October 2022, the Review commissioned EY to conduct 6 focus groups, with a total of 42 members of the public, to gauge the perception of the RBA, including the role and function of the RBA.

The Review conducted focus groups to gather data from members of the public who may not have contributed via the submissions process. Each focus group was held with participants' consent and data were deidentified.

The focus groups included participants with a range of ages, genders, locations, incomes and wealth, household structures, and levels of education and financial literacy.

Participants shared their views on the Australian economy and discussed their perceptions on the impact of RBA policy on their own lives and the lives of other Australians. Topics covered included:

- the impact of the economic environment
- participant engagement with Australia's economic management
- perceptions of Australia's economic management
- perceptions of the RBA
- the role of the RBA.

The report is published on the Review's website.

Expert reports

The Panel commissioned 5 academic experts to produce papers on aspects of the Review:

- Professor Prasanna Gai on central bank governance
- Professor Anil Kashyap on the interaction between macroprudential and monetary policy
- Professor Eric Leeper on the interaction of fiscal and monetary policy
- Professor Andrew Levin on monetary policy frameworks and central bank governance
- Professor Athanasios Orphanides on the RBA's choice of policy tools.

The Panel, the Secretariat, and each academic expert first discussed the proposed theme of the research paper to establish the topic and scope of the paper. Each expert then produced their work independently while consulting with the Panel and providing drafts to the Secretariat to be considered throughout the process.

This approach allowed the Panel to consider the valuable work of the academic experts throughout the drafting of the report while maintaining the integrity of the papers as independent academic research.

The reports are published on the Review's website.

Economist survey

The Review surveyed Australian business economists to assist with research into the perception of the RBA communications strategy, and received 25 responses. The survey focussed on gaining an understanding of opportunities to improve communication about monetary policy decision making and strategy.

The survey asked participants to respond to a series of multiple-choice questions on scale from "strongly agree" to "strongly disagree", and additionally included some free text questions.

Participants rated their satisfaction with RBA communications, including in comparison to global peers.

The survey provided insight from financial sector professionals and explored feedback on potential improvements to the communications strategy of the RBA.

Participants in panel interviews

The Panel consulted with 137 people between September 2022 to March 2023.

This list contains the names of interviewees who spoke to the Review Panel.

This list does not include names of individuals who asked to remain anonymous. It does not include the names of individuals the Panel has decided to hold in confidence either due to their position, or the confidential nature of their conversation with the Review. It does not include the names of people who spoke to the Secretariat but not the Panel.

Current Reserve Bank Board Members	
Mark Barnaba	Board Member
Michele Bullock	Deputy Governor
Dr Wendy Craik	Board Member
Professor Ian Harper	Board Member
Carolyn Hewson	Board Member
Dr Steven Kennedy	Secretary to the Australian Treasury
Dr Philip Lowe	Governor
Carol Schwartz	Board Member
Alison Watkins	Board Member

Former Reserve Bank Board Members	
Ric Battellino	Former Deputy Governor (2007 - 2012)
Jillian Broadbent	Former Board Member (1998 - 2013)
Dr Guy Debelle	Former Deputy Governor (2016 - 2022)
Dr John Edwards	Former Board Member (2011 - 2016)
Kathryn Fagg	Former Board Member (2013 - 2018)
Bernie Fraser	Former Governor (1989 - 1996) Former Secretary to the Australian Treasury (1984 - 1989)
John Fraser	Former Secretary to the Australian Treasury (2015 - 2018)
Phil Gaetjens	Former Secretary to the Australian Treasury (2018 - 2019)
Professor Bob Gregory	Former Board Member (1985 - 1995)
Dr Stephen Grenville	Former Deputy Governor (1996 - 2001)
Dr Ken Henry	Former Secretary to the Australian Treasury (2001 – 2011)

Former Reserve Bank Board Members	
Ian Macfarlane	Former Governor (1996 – 2006)
Professor Warwick McKibbin	Former Board Member (2001 – 2011)
Allan Moss	Former Board Member (2015 – 2020)
Professor Adrian Pagan	Former Board Member (1995 – 2000)
Dr Martin Parkinson	Former Secretary to the Australian Treasury (2011-2014)
Glenn Stevens	Former Governor (2006 - 2016)
Catherine Tanna	Former Board Member (2011 - 2021)

Current RBA Staff	
Michele Bullock	Deputy Governor
Anthony Dickman	Secretary
Dr Luci Ellis	Assistant Governor
Dr Bradley Jones	Assistant Governor
Dr Jonathan Kearns*	Head of Department
Dr Christopher Kent	Assistant Governor
Dr Marion Kohler	Head of Department
Dr Philip Lowe	Governor
Michelle McPhee	Assistant Governor
Catherine Parr	General Counsel
Dr John Simon	Head of Department
Dr Penny Smith	Head of Department
Susan Woods	Assistant Governor

*Head of Department at the time of interview, no longer an RBA staff member.

Appendices

Current and Former Parliamentarians	
Hon Dr Jim Chalmers MP	Treasurer, Australian Labor Party
Kate Chaney MP	Member of Parliament, Independent
Hon Peter Costello	Former Treasurer (1996 – 2007), Liberal Party of Australia
Zoe Daniel MP	Member of Parliament, Independent
Hon Josh Frydenberg	Former Treasurer (2018 – 2022), Liberal Party of Australia
Dr Helen Haines MP	Member of Parliament, Independent
Senator Jacqui Lambie	Senator, Jacqui Lambie Network
Hon Dr Andrew Leigh MP	Assistant Minister, Australian Labor Party
Senator Nick McKim	Senator, Australian Greens
Dr Monique Ryan MP	Member of Parliament, Independent
Dr Sophie Scamps MP	Member of Parliament, Independent
Allegra Spender MP	Member of Parliament, Independent
Zali Steggall, MP	Member of Parliament, Independent
Hon Angus Taylor MP	Shadow Treasurer, Liberal Party of Australia

Other Contributors	
Dr Shiro Armstrong	Australian National University
Tom Arup	Senior Specialist Stewardship, Centre for Policy Development
Dr Sally Auld	Chief Investment Officer, JBWere
Dr Andrew Bailey	Governor, Bank of England
Hon Anna Bligh	CEO, Australian Banking Association
Alexi Boyd	Former CEO, Council of Small Business Organisations Australia
Sarah Breeden	Executive Director, Bank of England
Dr Peter Burn	Head of Influence and Policy, Australian Industry Group
Wayne Byres	Former Chair, Australian Prudential Regulation Authority (2014–22)
Dr Mark Carney	Former Governor, Bank of England and Canada
Karen Chester	Deputy Chair, Australian Securities and Investments Commission
Melinda Cilento	Chief Executive, Committee for Economic Development of Australia
Brendan Coates	Economic Policy Program Director, Grattan Institute
Associate Professor Selwyn Cornish	Australian National University
Charmaine Crowe	Social Security Program Director, Australian Council of Social Service
Dr Peter Davidson	Principal Advisor, Australian Council of Social Service
Katie Dean	Head of Fixed Income, Currency and Cash, Australian Super
Dr Pragyan Deb	IMF Mission Team

Other Contributors	
Professor Begona Dominguez	University of Queensland
Dr Jose Dorich	Deputy Managing Director, Bank of Canada
Peter Downes	Director, Outlook Economics
Dr Malcolm Edey	Former Assistant Governor, RBA (2009 - 2016)
Saul Eslake	University of Tasmania
Bill Evans	Chief Economist, Westpac
Faysal Fassi	Executive Director, Indigenous Business Australia
Harald Finger	IMF Mission Team
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Professor Prasanna Gai	University of Auckland
Dr Christian Gillitzer	University of Sydney
Dr Isaac Gross	University of Melbourne
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Assistant Professor Steven Hamilton	George Washington University
Dr James Hansen	University of Melbourne
Dr Qazi Haque	University of Adelaide
Dr Timo Henckel	Australian National University
Professor Richard Holden	University of New South Wales
Andrew Hudson	CEO, Centre for Policy Development
Rodney Jones	Principal, Wigram Capital Advisors
Dr Kenichiro Kashiwase	IMF Mission Team
Professor Anil Kashyap	University of Chicago
Lord Mervyn King	Former Bank of England Governor
Dr Stephen Kirchner	University of Sydney
Alan Kirkland	CEO, CHOICE
Dr Donald Kohn	Former Vice Chair Federal Reserve
Dr Siddarth Kothari	IMF Mission Team
Professor Mariano Kulish	University of Sydney
Professor Eric Leeper	University of Virginia
Professor Andrew Levin	Dartmouth College
Professor Guay Lim	Melbourne Institute
Joseph Longo	Chair, Australian Securities and Investments Commission
John Lonsdale	Chair, Australian Prudential Regulation Authority

Appendices

Other Contributors	
Dr Tiff Macklem	Governor, Bank of Canada
Dr John McDermott	Former Assistant Governor, Reserve Bank of New Zealand
Dr Huw McKay	Vice President (Chief Economist), BHP
Andrew McKeller	CEO, Australian Chamber of Commerce and Industry
Sally McManus	Secretary, Australian Council of Trade Unions
Kirsty Moore	CEO, Indigenous Business Australia
Professor James Morley	University of Sydney
Dr Adele Morris	Senior fellow and policy director, Federal Reserve Board of Governors
Ben Moxham	Legal and Policy Director, Australian Council of Trade Unions
Professor John Muellbauer	Oxford University
Cherelle Murphy	Chief Economist, Ernst and Young
Su-Lin Ong	Chief Economist, RBC Capital Markets
Professor Athanasios Orphanides	MIT Sloan, Former Governor of the Central Bank of Cyprus
Professor David Orsmond	Macquarie University
Alan Oster	Chief Economist, National Australia Bank
Dr Evan Papageorgiou	IMF Mission Team
Professor Bruce Preston	University of Melbourne
Professor John Quiggin	University of Queensland
Dr Mala Raghavan	University of Tasmania
Chris Richardson	Economist, freelance
Dr Tim Robinson	Melbourne Institute
Dr Claudia Sahm	Economist, Sahm Consulting
Masaaki Shirakawa	Former Governor (2008 - 13), Bank of Japan
Associate Professor Aarti Singh	University of Sydney
Professor John Stachurski	Australian National University
Dr Nour Tawk	IMF Mission Team
Dr Peter Tulip	Chief Economist, Centre for Independent Studies
Patrick Veyret	Head of Policy and Government Relations, CHOICE
Professor David Vines	Oxford University
Stephen Walters	Chief Economist, Business Council of Australia
Dr David Wilcox	Former Director, Federal Reserve Board of Governors
Luke Yeaman	Deputy Secretary, Treasury

Appendix 5: Glossary

Additional monetary policy tools	Monetary policy tools beyond the use of the cash rate. In Australia, they have included purchases of government bonds, a term funding facility, a yield target and forward guidance.
Aggregate supply/ demand	The total supply or demand of goods and services in an economy. The interaction between aggregate supply and demand affects the price of goods within the economy.
APS	Australian Public Service
Asian Financial Crisis	A period of financial stress directly impacting multiple countries in East Asia between mid-1997 and end-1998.
Asset purchase program	A central bank program to purchase financial assets such as bonds, with the aim of easing financial conditions.
Australian Prudential Regulation Authority (APRA)	The Australian prudential regulator, supervising financial institutions across banking, insurance, and superannuation. APRA is responsible for macroprudential policy.
Australian Securities and Investments Commission (ASIC)	The Australian regulator for corporate, market and financial services and consumer credit.
Automatic fiscal stabilisers	Legislated government policies that affects total spending and/or taxation in the economy in a way that varies according to economic conditions. Such policies can automatically dampen changes in aggregate demand. For example, in an economic upturn, the government collects more additional taxation revenue, thereby reducing aggregate demand. Similarly, social insurance payments or services typically increase in a downturn, which can increase aggregate demand.
Banking Act	*Banking Act 1959*
Bond	A loan made by an investor to a borrower for a set period of time in return for regular interest payments; rights to the loan and interest payments are often bought and sold among investors in financial markets.
Bond Purchase Program	An RBA commitment to purchase specific quantities of government bonds announced in November 2020, with the aim of easing financial conditions.
Calendar-based forward guidance	A commitment to a cash rate path until a future date.
Cash rate	The interest rate charged on overnight loans between banks; the primary way the RBA implements monetary policy is by influencing the cash rate.

Consumer price index (CPI) inflation	The change in the price of goods and services that households buy. It is often reported as the change in prices over a year.
Corporate governance	Describes the system of rules, practices and processes that enable a person or group of people to run an entity.
Cost benefit analysis	A process of comparing the estimated costs and benefits associated with a decision to evaluate its overall value.
Council of Financial Regulators	The coordinating body for Australia's main financial regulatory agencies. This includes the RBA (its chair), Treasury, APRA and ASIC.
COVID-19 pandemic	A worldwide pandemic declared by the World Health Organisation on 11 March 2020.
Diversity targets/quotas	Numerical requirements for hiring and promoting members of a particular group who are typically underrepresented in specific positions.
Effective lower bound	The lowest level the cash rate can practically reach.
Ex ante	Ex ante refers to future events, so is based on forecasts rather than actual results.
Exchange settlement account	Accounts held with the RBA by banks and other eligible financial institutions for the settlement of payment obligations with each other.
Executives	Refers to the RBA's Assistant Governors and above.
External Reserve Bank Board members	The 'other members' of the Reserve Bank Board referred to in s 14(1)(d) of the RBA Act, comprising all members of the RBA Board *except* for the RBA Governor, RBA Deputy Governor and Treasury Secretary.
360-degree feedback	A method of performance review where employees receive feedback from their supervisors, peers and reporting staff members.
Financial conditions	The ease with which finance can be accessed by households and businesses.
Fiscal consolidation	Government policies that intend to reduce deficits and the accumulation of debt.
Fiscal policy	Decisions about how much governments spend and how much they raise in revenue.
Focus group	A facilitated group discussion on a particular topic involving a small number of demographically similar people or participants who have other common traits/experiences.
Forward guidance	The RBA's communication about its intentions for future monetary policy.
Freedom of Information	The concept that information held by governments should be accessible to the public under certain circumstances. In Australia, the *Freedom of Information Act 1982* gives the right to request access to government held information.

Global Financial Crisis	A period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009.
Government indemnity	An agreement to transfer central bank gains or losses to the government budget.
Gross domestic product	A measure of the amount of economic activity that occurs within a given time period and often reported in terms of the growth of economic activity over a year.
Gross national expenditure	A measure of the consumption and investment expenditure of domestic households, governments and businesses within a given time period and often reported in terms of the growth since the year before.
Groupthink	A phenomenon in which a group of individuals tries to minimise conflict and reach a consensus decision without critical evaluation of alternative viewpoints, by actively suppressing dissenting viewpoints and isolating themselves from outside influences. Loyalty to the group requires individuals to avoid raising controversial issues or alternative solutions (Janis 1971).
Headline inflation	A measure of consumer price inflation that includes prices for all goods and services collected by the Australian Bureau of Statistics.
Macroprudential policy	The use of regulations to mitigate risks to financial stability at a system level.
Management	Refers to the RBA's management level staff (Level 5) and above.
MARTIN	The RBA's large-scale macroeconometric model of the Australian economy.
Memorandum of understanding	A written agreement between parties, that does not imply an enforceable legal commitment.
Monetary policy	Decisions about influencing interest rates in the economy to affect overall demand, employment and inflation.
NAIRU	The non-accelerating inflation rate of unemployment – the lowest level of unemployment that can be sustained without causing excessive inflation.
Neutral real interest rate	The real policy rate required to bring about full employment and stable inflation over the medium term.
Non-policy areas/groups	Refers to the RBA's Corporate Services, Business Services and Executive Support groups.
Overnight index swaps	A derivative where one party pays a fixed interest rate on a notional amount in exchange for receiving the average cash rate on that amount; used to provide information on market expectations of monetary policy.
Policy areas/groups	Refers to the RBA's Economics, Financial Markets and Financial System groups.
Psychological safety	The belief that one will not be punished or humiliated for speaking up with ideas, questions, concerns, or mistakes.

PGPA Act	*Public Governance, Performance and Accountability Act 2013*
Public Service Act	*Public Service Act 1999*
RBA Act	*Reserve Bank Act 1959*
RBA Review staff survey	The survey of RBA staff conducted between 17 October – 5 November 2022 by the Review of the RBA to gauge their perceptions of the RBA's culture.
Reaction function	The way that the RBA changes monetary policy settings in response to new data and changes in the economic outlook.
Research discussion papers	Papers published by the RBA with the results of longer-term research conducted by RBA staff.
Risk culture	The norms and traditions of behaviour of individuals and of groups within an organisation that determine the way in which they identify, understand, discuss, and act on the risks the organisation confronts and the risks it takes (APRA 2016).
Risk management	The process by which organisations identify, assess and treat or control risks that could potentially affect their operations.
Secondary bond market	The market where bonds are traded between investors, after they have been issued.
Secondment	The temporary transfer of an employee to another position within or outside the organisation.
Senior leaders	Refers to the RBA's management level staff (Level 5) and above.
Span of control	The number of staff or direct reports a supervisor is responsible for.
Spare capacity	The difference between actual output and potential output.
Special board paper	Papers provided periodically to the RBA Board on topics of special interest. They often cover medium-term issues. Examples in recent years include the neutral interest rate, inequality and monetary policy, and the implications of climate change.
State-based forward guidance	A commitment to a cash rate path until specific economic conditions are met.
Succession planning	A process and strategy for identifying and developing future leaders.
Superannuation defined benefit scheme	A type of superannuation product previously common in public sector and local government workplaces. It defines or guarantees the amount you will receive in retirement.
Supply/demand shock	A sudden and unexpected change to the supply/demand of a product or market, that affects the price of the good and its availability.

Term Funding Facility	An RBA lending program introduced in March 2020 to provide cheaper financing for banks, with incentives to lend to small and medium-sized businesses.
Trimmed mean inflation	A measure of consumer price inflation that excludes the prices of goods and services with the largest movements (positive or negative).
Two-way communication	The process of sharing information back and forth between two parties.
Underlying inflation	Underlying measures of inflation exclude items that have particularly large price changes (either frequently or in a given period).
Unemployment rate	The number of people who are able and willing to work but do not have a job, as a percentage of all people who are able and willing to work.
Yield	The expected rate of return for an investor who buys a bond; at the time the bond is issued, it is also the cost of the loan for the borrower.
Yield target	A monetary policy tool that involves setting a target for the yield of specified bonds to reduce borrowing costs for households and businesses.

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