Monetary policy framework

Institutional and operational framework

Monetary policy objectives and instruments

The objectives of monetary policy specified in the *Reserve Bank Act 1959* concern the stability of the currency of Australia (that is, prices), the maintenance of full employment in Australia, and the economic prosperity and welfare of the people of Australia. Price stability is a crucial precondition for sustained growth in economic activity and employment. Since 1993, the Reserve Bank of Australia (henceforth, the Reserve Bank) has pursued the objective of keeping inflation *between 2 and 3 per cent, on average, over the cycle*. This objective was formalised in the August 1996 *Statement on the Conduct of Monetary Policy* between the Treasurer and the Governor of the Reserve Bank.

Australia's inflation targeting framework incorporates some limited flexibility in contrast to the 'hard-edged' targets that have been adopted by some central banks. This flexibility allows the Reserve Bank to respond to unforeseen shocks while accommodating the inherent variability of the inflation rate over the cycle.

The stance of monetary policy is expressed in terms of an operating target for the cash rate (the interest rate on overnight loans made in the money market). The cash rate is used as an operational target for monetary policy because it underpins all other interest rates in the money market and, through its effects on banks' costs of funds, also underpins banks' lending interest rates.

Independence

The *Reserve Bank Act 1959* provides for the independence of the Reserve Bank. This is restated in the *Statement on the Conduct of Monetary Policy* of August 1996.

Section 11 of the *Reserve Bank Act 1959* (*Differences of opinion with Government on questions of policy*) prescribes procedures for the resolution of policy differences between the Reserve Bank and the Government. In the event of a material difference in opinion, these provisions allow the Government to determine policy. However, the procedures underlying such provisions are politically demanding and their nature is designed to reinforce the Reserve Bank's independence. These provisions have never been used.

In addressing the Reserve Bank's responsibility for monetary policy, the *Reserve Bank Act 1959* also provides that the Reserve Bank Board shall, from time to time, inform the Government of the Bank's policy. Such arrangements are a common and valuable feature of institutional systems in other industrial countries with independent central banks and recognise the importance of macroeconomic policy coordination.

Reporting and accountability

The legislated reporting and accountability obligations of the Reserve Bank are set out in the *Commonwealth Authorities and Companies Act 1997*. These provide for an annual report, including financial statements, and an auditors' report to be provided to the Treasurer (due within a set time period) and tabled in Parliament as soon as practicable.

For a number of years, the Reserve Bank has published regular reports on the state of the economy, in addition to its annual report, and the Governor and other senior Reserve Bank officers have made public speeches on the operation of monetary policy. As agreed in the *Statement on the Conduct of Monetary Policy* the Governor, the Deputy Governor and other senior Bank officials appear before a Parliamentary Committee every six months, and a *Semi-Annual Statement on Monetary Policy* is concurrently issued. In the intervening quarters, the Bank publishes *The Economy and Financial Markets*, which assesses current economic conditions and the prospects for inflation and output growth.

In addition, when the Reserve Bank Board decides that a change in monetary policy should occur, it specifies a new target for the cash rate. The Board's decision is announced in a media release, which states the new target for the cash rate, together with the reasons for the decision. This media release is distributed through electronic news services on the day on which the change is to take effect, usually at 9.30 am, the time when the Reserve Bank normally announces its daily dealing intentions.

Transparency

Disclosure standard: International Monetary Fund (IMF) draft Code of Good Practices on Transparency in Monetary and Financial Policies

Australia has undertaken a comparison of its monetary and financial policy framework against a working draft of the proposed IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies — Declaration of Principles*. These principles provide a comprehensive 'benchmark' for assessing the degree of transparency of the institutional and operational frameworks for monetary and financial policies. For the purpose of the draft Code, transparency refers to an environment in which the objectives of policy, its legal, institutional, and economic framework, and policy decisions and their rationale are provided on a comprehensive and timely basis to the public. The draft Code is in two parts. The first, *Good Transparency Practices for Monetary Policy by Central Banks*, identifies desirable transparency practices for central banks in the conduct of monetary policy. That part of the Code is the subject of this section of the report. The second section of the Code, *Good Transparency Practices for Financial Policies by Financial Agencies*, is the subject of the section on financial sector supervision in Part II of this report.

Australia's monetary policy arrangements are generally consistent with the principles underlying the IMF's draft Code. (A detailed discussion of how Australia's arrangements compare against each of the principles is provided in Attachment B.) While Australia's compliance with the letter of the Code is very close, there remains one primary issue of substance where compliance diverges. Australia's 'modalities for accountability' of the central bank are not defined in legislation (section 1.1.5 of the draft Code). Rather, good practice has been built up through convention.