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RESEARCH SUMMARY

Reforming Australian Monetary Policy: How Nominal Income Targeting Can Help Get the Reserve Bank Back on Track

The mandate of the Reserve Bank of Australia (RBA) is to promote stable prices, full employment, and the economic prosperity and welfare of the Australian people (Reserve Bank Act 1959). The RBA has also been pursuing the objective of financial stability. The RBA kept monetary policy tight between 2016 and 2019 to promote greater financial stability ("leaning against the wind") and made policy mistakes that undercut efforts to fulfill its mandate, particularly its inflation target. In "Reforming Australian Monetary Policy: How Nominal Income Targeting Can Help Get the Reserve Bank Back on Track," Stephen Kirchner proposes three steps to address these mistakes and to improve central bank credibility and accountability.

1. Introduce a nominal gross domestic product (NGDP) targeting regime. This would replace the RBA's current inflation targeting framework.

- Targeting NGDP (the income growth of the economy) would require the RBA to take more decisive action on expansionary policy and would promote financial stability.
- Adopting an NGDP target would not need legislative change for its implementation.
- The RBA could be required to publish a multiyear target path for NGDP and then explain its policy decisions in reference to its target path.

2. Implement institutional reforms. These would restore RBA credibility and accountability and improve its governing structure.

- The RBA board, which is responsible for monetary policy decisions, consists of the governor, deputy governor, Treasury secretary, and six part-time external board members. The presence and participation of the Treasury secretary is inconsistent with RBA independence.
- Instead, decision-making should be delegated to a committee consisting of the governor, deputy governor, assistant governor, and four full-time external board members with monetary policy expertise.
- To strengthen accountability and transparency standards, committee member votes and meeting minutes could be made public.
- The role of the board should include explicit governance and performance oversight of the governor and monetary policy committee to ensure policy decisions are consistent with the RBA mandate. This would include the appointment of external monetary policy committee members to add a degree of separation between board members chosen by government and policy setting.

3. Create an NGDP futures market. This would use a "wisdom of crowds" approach to give RBA policymakers the ability to measure the real-time effects of their policy decisions.

- As participants trade on the price of NGDP futures, the RBA could tie policy changes to shifts in the price of these futures.
- Not only would this help inform policymakers of the expected effect of their decisions, but the existence of this market could also act as a hedging instrument for financial institutions and corporations whose revenues are tied to NGDP growth.
- Although these types of prediction markets have a limited record of success globally, they could be effective with explicit backing from the RBA and other financial system regulators.