AXIS
FINANCIAL GROUP

# ECONOMIC INDICATORS

*Edition 3*

> *“Economic growth without social progress lets the great majority of people remain in poverty, while a privileged few reap the benefits of rising abundance.”* John F. Kennedy

## AUSTRALIAN ECONOMIC MANAGEMENT

In this edition of our Economic Indicators publication, we take a closer look at the various macroeconomic policy mechanisms currently underpinning the economic management of the Australian economy.

Macroeconomic policy is concerned with the operation of the economy as a whole. In broad terms, the goal of macroeconomic policy is to provide a stable economic environment that is conducive to fostering strong and sustainable economic growth, on which the creation of jobs, wealth and improved living standards depend. [1]

The 3 key pillars of macroeconomic policy are:

- Fiscal Policy
- Monetary Policy
- Exchange Rate Policy

The table below maps out each arm of macroeconomic policy, where control for the policy lays, the economic objectives and the methods that are used to meet those objectives.

| 3 Key Pillars of Macroeconomics | | | |
|---|---|---|---|
| **Policy** | **Controlled By** | **Economic Objective** | **Method Used** |
| **Fiscal[1]** | Government | – Stabilising fluctuations in economic activity.<br>– Ensuring long-term sustainability of budget and capacity to meet future challenges (i.e. ageing population).<br>– Increase long-term growth potential of economy (via investments in infrastructure and education). | – Changes in level and composition of government spending.<br>– Level and types of taxes levied.<br>– Level and form of government borrowing. |

| 3 Key Pillars of Macroeconomics | | | |
|---|---|---|---|
| **Policy** | **Controlled By** | **Economic Objective** | **Method Used** |
| **Monetary[2]** | Reserve Bank of Australia (RBA) | – Low and stable inflation (i.e. consumer price inflation kept to 2% - 3% on average over the medium term).<br>– Full employment.<br>– Economic prosperity and welfare of the Australian people. | – Setting of the interest rate (i.e. Cash Rate) on overnight loans within the money market. |
| **Exchange Rate[3]** | Floating Exchange Rate Regime | – Cushion economies from shocks.<br>– Allow monetary policy to be focused on targeting domestic economic conditions. | – Market forces of supply and demand for foreign exchange. |

## FISCAL POLICY

The table below shows the relationship of fiscal policy methods enacted by the government in managing the economy.

| Fiscal Policy Economic Influence | | |
|---|---|---|
| **Government** | **Direct Influence** | **Indirect Influence** |
| **Methods Used[1]** | – Recurrent expenditure.<br>– Capital expenditure. | – Spending.<br>– Taxes.<br>– Transfers of private consumption.<br>– Investment.<br>– Net exports. |

## CONVENTIONAL MONETARY POLICY

The table below shows the impact that the Reserve Bank of Australia's (**RBA**) enactment of conventional monetary policy (i.e. movement of **Cash Rate**), generally has on the economy.

| Conventional Monetary Policy Economic Influence | | |
|---|---|---|
| **Area** | **Impact of Cash Rate Increase** | **Impact of Cash Rate Decrease** |
| Economy | Used to slow the economy | Used to stimulate the economy |
| Mortgage Rate | Higher interest rates | Lower interest rates |
| Savings Rate | More interest earned | Less interest earned |
| Exchange Rate | Appreciates the AUD | Depreciates the AUD |
| Consumer Confidence | Lowers spending | Increases spending |
| Asset Prices | Reduces asset prices | Increases asset prices |

In summary, **conventional monetary policy** is where the Reserve Bank of Australia (**RBA**) enacts changes to the Cash Rate in order to achieve its set economic objectives.

This then leads one to ask:

- What is unconventional monetary policy exactly?
- What triggers the implementation of unconventional monetary policy?
- What are the impacts of unconventional monetary policy on the economy?

## UNCONVENTIONAL MONETARY POLICY

According to the Reserve Bank of Australia (**RBA**):

- Unconventional monetary policy occurs when tools other than changing a policy interest rate (i.e. **Cash Rate**) are used.[4]
- COVID-19 pandemic triggered the largest peacetime contraction in the Australian economy since the Great Depression of the 1930s and required an unprecedented monetary policy response.[4]
- In response to the economic effects of COVID-19, in March 2020, the Reserve Bank of Australia implemented unconventional monetary policy measures in Australia for the first time.[4]
- In November 2020, the Reserve Bank of Australia announced further unconventional monetary policy measures.[4]

The table below defines the unconventional monetary policy tools currently being used by the Reserve Bank of Australia in the management of the Australian economy.

| Unconventional Monetary Policy | |
|---|---|
| **Tool** | **Definition** |
| Forward Guidance | – Provides market participants and the general public with guidance on likely trajectory of Cash Rate. This can be time based or based on the state of the economy.[5] |
| Asset Purchases | – Involves the creation of 'central bank reserves' (in Australia these are called Exchange Settlement balances) to fund the outright purchase of assets from the private sector. Some refer to this as '**printing money**'.[5]<br>– A target can be set for the **quantity** of assets that will be purchased (at any price) also known as **quantitative easing** (QE) or a target for the price of an asset (purchasing whatever quantity of assets will achieve that price); for a bond, the relevant price is its interest rate.[5] |
| Term Funding Facility | – Banks (and other authorised deposit taking institutions) borrow funds from the RBA at an agreed interest rate. Banks can use this funding to make loans to businesses and households.[5] |

## IMPLEMENTATION OF UNCONVENTIONAL MONETARY POLICY USED TO MANAGE THE AUSTRALIAN ECONOMY

The table below maps out a time line relative to the implementation of unconventional monetary policy enacted by the Reserve Bank of Australia (**RBA**) in response to managing the Australian economy in a COVID-19 climate.

| Implementation of Unconventional Monetary Policy Time Line | | | | | |
|---|---|---|---|---|---|
| **Policy Tool** | **March 2020** | **September 2020** | **October 2020** | **November 2020** | **February 2021** |
| **Cash Rate[6]** | – Reduced from **0.5%** to **0.25 %** | - | - | – Reduced from **0.25%** to **0.10%** | |
| **Forward Guidance[6]** | – No cash rate increase until **2%** to **3%** inflation target is estimated to be met sustainably and progress is made towards full employment. | - | – RBA board changed focus to actual outcomes for inflation, rather than expected outcomes in guiding its future policy decisions. | - | - |
| **Exchange Settlement Balances Interest Rate6 Settlement Balances Interest Rate[6]** | – Reduced to **0.10%** | - | - | – Reduced from **0.10%** to **0.00%** | - |
| **Asset Purchases[6]** | – Introduction of **3-year** Australian Government bond yield target of **0.25%**<br>– Purchase of bonds to address dysfunction in the Australian government bond market. | - | - | – **3-year** Australian Government bond yield target from **0.25%** to **0.10%**<br>– RBA to buy **$100 billion** worth of government bonds (focus on 5 to 10 year segment of yield curve) over next 6 | – RBA to buy **additional $100 billion** worth of government bonds, after the first program completed. |

| Implementation of Unconventional Monetary Policy Time Line | | | | | |
|---|---|---|---|---|---|
| **Policy Tool** | **March 2020** | **September 2020** | **October 2020** | **November 2020** | **February 2021** |
| **Term Funding Facility[6]** | - Funds equivalent to 3% of lending could be borrowed from the RBA for **3 years** at **0.25%** (against eligible collateral) up until end September 2020. | - Additional low-cost funding equivalent to **2%** per cent of lending in the banking system.<br>- Extend the drawdown period until June 2021. | - | - Interest rate reduced from **0.25%** to **0.10%** on new drawings borrowed for **3 years** from RBA. | - |

It is worth noting that the Reserve Bank of Australia's Board does not expect actual inflation to be sustainably within the 2% to 3% target range before 2024. In order to achieve that level of inflation the labour market will need to be tight enough to generate wages growth that is materially higher than it is currently.[4]

The main objectives the Reserve Bank of Australia (**RBA**) is seeking to achieve are:[4]

- To keep interest rates low in order to make it easier to borrow.
- To keep the exchange rate lower than it would otherwise be.
- To increase confidence to spend.

## IMPACTS OF UNCONVENTIONAL MONETARY POLICY

Unconventional monetary policy has the same goals as conventional monetary policy. It is effectively a way that interest rates can be lowered further than is possible by adjustments to the **Cash Rate** alone (which may be at its effective lower bound).[4]

Unconventional monetary policy is designed to make it easier for people to borrow with the goal of increasing their confidence to spend. It also puts downward pressure on the exchange rate and leads to higher prices for some assets (i.e. **housing and shares**) than what they otherwise would be. That being said, it should also be noted that rapid growth in asset prices, accompanied by unsustainable growth in debt, can increase the risk of financial instability.[4]

## CONTACT AXIS

As super specialists, we have a keen awareness of key economic indicators and have been assisting individuals with growing and protecting their super for over 25 years.

Give us a call on **1800 111 299** or email **super@axisfg.com.au**

## REFERENCES


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