Essay on the monetary policy of australia

Parts of the World, Australia

Introduction

The monetary policy is a policy that is used by the monetary authority of a given country to control the money supply in the economy. This policy frequently targets a certain interest rate with an objective of promoting economic stability and growth in an economy. The official goals normally include relatively low unemployment and stable prices. This policy can either be expansionary or contractionary.

Expansionary monetary policy

An expansionary monetary policy is the one that increases the total money supply in an economy more swiftly than usual. Therefore, this is a policy that is used when there are low economic activities in an economy. This means that it is used to combat the unemployment that occurs during recession through decreasing the rates of interests. Thus the easy credit created helps to expand the businesses.

Contractionary monetary policy

On the other hand, a contractionary monetary policy is the one that expands or increases the supply of money more slowly than normal or even shrinks the money supply. Therefore, this is a policy that the monetary authority uses to slow the inflation occurring in an economy hence this helps such an economy to avoid the subsequent deterioration and distortions of asset values.

Australian monetary policy

Having defined the concept of monetary policy, it is now important to concentrate on the objective of this essay, which is to addresses the monetary policy of Australia. It is worth to note that the Reserve Bank of Australia is responsible for the country’s monetary policy. In Australia, this policy involves setting the rates of interest on the overnight loans in money market or what is commonly called the “ cash rate.” Cash rate influences the other interest rates in the Australian economy. For that reason, this affects the behaviors of the lenders and borrowers, the economic activity, and eventually the rate of inflation.

Objectives of Australian monetary policy

In determining the monetary policy, the Reserve Bank of Australia has an obligation to maintain full employment, currency stability or price stability, and the welfare of the Australian citizens and economic prosperity. For this bank to achieve the above mentioned statutory objectives it has an “ inflation target” and in addition it seeks to keep the consumer price inflation in the whole economy to 2-3% on average over medium term. Monetary policy thus helps to control the inflation hence this preserves money value in addition to encouraging sustainable and strong growth in the Australian economy in the long run. Therefore, this is essentially the principal way where the monetary policy can aide to form sound basis for the long term economic growth.

Australian Monetary policy framework

The primary medium term objective of the Australian monetary policy is to control the inflation. For that reason, an inflation target is essentially the centerpiece of Australian monetary policy framework. The treasurer and the governor in Australia have actually agreed that the target that is appropriate for the country monetary policy is to realize a 2-3 percent inflation rate on average over a given cycle. This is essentially a rate of inflation that is sufficiently low and does not significantly distort the economic decisions in Australian community.

On average, while seeking to attain this inflation rate, this target provides the discipline for making decision in monetary policy hence it serves like an anchor for the expectations of private sector inflation. However, experience in the Australia has actually shown that it is difficult for inflation to fine tune within narrow band. Therefore, inflation target is necessarily forward looking. Thus, this approach permits a role for the monetary policy in dampening output fluctuations over the business cycle course.

The decision process in monetary policy

Reserve Bank Board has a primary responsibility of formulating the monetary policy. Normally, this board meets 11 times every year, on the initial

Tuesday of each month except in the month of January. For every meeting, the staffs from this bank prepare detailed account of the developments in both international and Australian economies in addition to international and domestic financial markets. It is interesting to note that these papers comprise a policy decision recommendation. The senior staff also attends this meeting and offers their presentations. The Reserve Bank Board decisions concerning the monetary policy are actually communicated publicly just after the meeting conclusion.

Monetary policy implementation in Australia

The Domestic Markets Department of the Bank has the undertaking of maintaining the money market conditions so as to maintain the cash rate near or at an operating target that is decided by the Board. Cash rate is essentially the rate that is charged on the overnight loans between the financial intermediaries. This has a dominant influence on the other rates of interest hence this forms the ground on which interest rates structure in the Australian economy is built. Changes in the monetary policy mean the operating target for cash rate change hence shift in interest rate structure that prevails in Australian financial system.

The Bank Board’s explanations of the decisions in monetary policy are announced in media release. In addition, Reserve Bank uses its open market operations or domestic market operations to keep cash rate close to target set by the bank board. It does this through managing supply of the funds available to all the banks in money market. In money market, cash rate is essentially determined by the interaction of supply of and demand for the overnight funds. The ability of the Reserve Bank to successfully pursue target for cash rate comes from the control it has over the funds supply that the other banks use in settling transactions among themselves. Thus, these are referred as exchange settlement funds.

If there are more supplies of exchange settlement funds by the Reserve Bank than commercial banks desire to hold, banks will thus try to shed their funds through lending extra in cash market. This will result to a tendency for cash rate to fall. On the contrary, given that Reserve Bank supplies a smaller amount than the commercial banks desire to hold, they will thus respond through trying to borrow extra in cash market so as to build up their exchange settlement funds exchange.

Transmission of Monetary policy to Australian economy

The movements in cash rate are rapidly passed through to the other capital market rates of interests like bond yields and money market rates. These rates of interest also are influenced by investors risk tolerance and the preferences for holding the funds in forms, which are readily redeemable. Cash rate and the other capital market rates of interest then feed over to whole structure of lending and deposit rates.

Most loans and deposits in Australia are at short term fixed rates or at variable. Therefore, there’s high pass through changes in cash rate to lending and deposit rates. However, the lending and deposit rates do not normally move in the lockstep with cash rate due to the other factors that influence the rates in the capital market and the fluctuations in banking sector competition level. The interest rates changes in Australia affect inflation and the economic activity with much longer lags since it takes time for the businesses and individuals to change their behaviors.

Conclusion