WHY CENTRAL BANKING WON'T RETURN TO NORMAL:

THE RBA, THE PROPERTY MARKET, AND AUSTRALIAN HOUSEHOLDS

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During 'normal' times, central bankers like to project an image of boring integrity and impeccable professionalism, committed to keeping the national economy stable while remaining staunchly independent from special interests. During the decade following the Global Financial Crisis, however, when central banks had recourse to 'exceptional' measures like large-scale asset purchases, that image was often hard to maintain. The COVID-19 pandemic took those difficulties to an entirely new level. To stop the economy from sinking into a severe recession, central banks across the world were called upon to orchestrate a dramatic extension of the financial safety net. The same central bankers who pride themselves on being immune to politicians' preferences were now taking their orders directly from governments.

As the pandemic era came to an end, central banks tried to restore the status quo – a task that became all the more pressing as inflation surged. However, many have struggled with this transition. Experiences vary across countries and regions, of course. The European Central Bank is quarantined, by design, from national political influence and public opinion. Challenges to central bank independence have been particularly prominent in the US, where both the left and the right seek a politicisation

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of monetary policy. Taking aim directly at Federal Reserve chair Jerome Powell, President Trump has actively rejected the notion that the central bank should enjoy institutional independence and has demanded executive influence over monetary policy.

Although Australian central bankers have not had to contend with politicians openly questioning their intelligence, the Reserve Bank of Australia too has had a very hard time restoring its image as an a-political, expertise-driven overseer of the financial system. The 'return to normal' has been a fraught trajectory during which the Bank has repeatedly found it difficult to avoid stepping onto politically charged terrain. This article examines that dynamic in relation to one of its main sources: the entanglement of monetary policy with Australia's housing market and mortgage credit system. Of course, central bank policy always has distributional consequences and it has never actually been apolitical or neutral. But we argue that, in recent years, it has especially been the Bank's relationship to the property market that has caused practical problems when it comes to maintaining or restoring appearances of distributional impartiality. The next section elaborates this claim and lays out the structure of the argument developed in the rest of the article.

Central banking and the property market in Australia

Like other central banks, the Reserve Bank of Australia is expected to balance different objectives, including employment, inflation, and financial stability (Goodhart 2011). However, the notion that has gained singular prominence over the past four decades (the 'neoliberal' era) is that central banks should focus primarily on controlling consumer price inflation, engaging other aspects of economic life to the extent that they affect general economic stability as reflected in the price level. This perspective is consistent with the 'New Keynesian' theory of inflation-targeting that has supported central bank independence during the 'neoliberal' era. According to that framework, when central banks become tempted to stimulate growth directly by seeking to boost employment levels or asset values, such policies are not only likely to backfire due to their inflationary effects but also encourage favour-seeking behaviour, resulting in a politicisation of their operations and a loss of credibility.

Heterodox perspectives have criticised this account of monetary policy, pointing out that central bank policies such as interest rate changes have major consequences for the distribution of income and wealth in society and are therefore never neutral or apolitical. The commitment to containing inflation in particular implies an alignment with the interests of investors and property owners (Rochon and Setterfield 2008; Fanton 2018). While our analysis is broadly consistent with that heterodox critique, the objective of this article is not primarily to expose the ideological character of central bank neutrality but to examine how practices of monetary policy are shaped by the *limits* on a central bank's ability to shield the distributional impact of its policies from public scrutiny. In other words, we are less interested in 'unmasking' the central bank as a creature of neoliberalism, than in investigating what happens when the ideological mask slips of its own accord. Thus, the article analyses the dynamics set in motion by the tension between official representations of neutrality on the one hand and the undeniable distributional consequences of central bank policies on the other.

An analysis rooted in the prevailing heterodox critique of neoliberal central banking is likely to view the near future in terms of a fairly clear choice: neoliberal retrenchment, or a successful political challenge to that project. This article suggest that the waters are muddier: even in the absence of an organised political challenge from outside, the RBA's attempts to return to a neoliberal inflation-targeting framework are likely to be fraught. The reason is that the way the RBA has come to rely on the property market for the pursuit of its objectives means that it frequently and inadvertently politicises its decisions and policy strategies. That is not to trivialise the difficulties that can arise in other areas. For example, the channel whereby interest rate changes feed through into growth and employment levels is relatively indirect, mediated by many variables and characterised by longer timelines. Distributional consequences appear more diffuse, and popular interest remains relatively limited. By contrast, the impact of RBA policy on the mortgage market and household budgets is more direct and therefore it attracts far greater attention – RBA-watching has migrated from the sphere of high finance to the popular press.

Several specific institutional features of the Australian mortgage and housing system are responsible for their sensitivity to central bank decisions. First, Australia has a high rate of owner-occupancy. Although it has fallen in recent years, property ownership remains deeply embedded in the national imaginary and continues to be viewed as an essential ingredient of a middle-class lifestyle. Second, a series of legislative changes related to the treatment of capital gains and tax write-offs has meant that many Australians also invest in property that they do not occupy. Third, most mortgages are what is known as 'variable-rate', meaning that repayments are readily adjusted via response to the RBA's interest rate changes. Thus, the bulk of Australia's mortgages, and therefore many households' budgets, are exposed in a direct way to the central bank's interest rate settings.

When the RBA comes under popular suspicion of having fomented a housing bubble and so having contributed to affordability problems, or when politicians accuse it of keeping rates artificially high and so harming mortgaged households, it invariably gives rise to RBA efforts to re-affirm its official mandate, and to declare its independence from special interests, whether politicians, households or the construction sector. But the frequency with which it has been seen to veer off course has complicated its ability to communicate a consistent message to the public and the markets.

Mirroring the tenets of hegemonic New Keynesian theories of monetary policy, the formal RBA position is that monetary policy takes account of financial dynamics and property markets only insofar as they affect inflation expectations and overall economic instability. But that has in practice not always been an unambiguous guideline. Financial change is volatile and its effects hard to predict, and the rapid growth of a debt-financed asset economy has often been judged to require forceful and even pre-emptive interventions.

The RBA has tended to justify such interventions by arguing that it does not target financial market indicators as objectives in their own right, and that mortgage market conditions are just an increasingly important transmission mechanism. However, as a way of justifying its policy stances to the rest of Australian society and government, that means/ends distinction has been imperfect. For many market participants and households, the 'merely a transmission mechanism' argument is a distinction without a difference – their primary concern is not with the Bank's reasons or intentions but with the effects of its actions on their budgets. This generates pressure that has not always been easy to ignore for the RBA. At various points, as we demonstrate below, the RBA has found it difficult to maintain the pure instrumentality of the mortgage channel and has taken into account the effects of its interest rate decisions on housing market conditions and household portfolios in their own right.

In other words, the role of the RBA is marked by a degree of confusion that reflects the contradictions of the neoliberal restructuring of the Australian economy and society. That confusion is not intellectual or epistemic in nature, manifesting at the level of formal statements or communications. Indeed, few public agencies take as much care in arriving at their judgements and putting them out into the world, and even fewer have at their disposal so much research capacity to support that process. Instead, it is social and institutional, shaped by political perception and popular impression – the RBA is in a bind not of its own making. The Bank is situated at the intersection of conflicting forces and imperatives that it is not by itself able to harmonise, and this troubles the implementation of policy according to a clear hierarchy of mandates, each achievable with instruments that don't interfere with progress towards other objectives. In the language of Marxist state theory, the structural tensions of the capitalist economy become inscribed at an institutional level where they manifest as policy conundrums, i.e. situations where an official response or action is required but where all available courses of action appear to have severe or even intolerable downsides.

The article draws on a content analysis of public documents from the Reserve Bank of Australia, the Australian Prudential Regulation Authority and Government Inquiries that discuss housing in relation to monetary policy. The analysis of these public documents has been supplemented by interviews with ex-Reserve Bank economists regarding their perceptions of the role of housing in the policy making decisions of the RBA, focusing primarily on the years between 2000 and 2023.

Following a brief prehistory of housing policy and financial governance from World War II until the neoliberal era, the article examines three periods in the evolution of the relationship between the RBA and the Australian housing market. The first period is the decade before the GFC which is typically seen as the high tide of inflation targeting. We show that the RBA kept a close eye on the housing market as it developed a series of positions meant to make that concern consistent with its inflation targeting mandate. By the end of the period, the housing market had come to be viewed as a key transmission channel monetary policy. However, the means/end distinction on which that conceptualisation rested was often difficult to maintain.

Then, following the onset of the GFC in 2008, the RBA made explicit use of its ability to affect household liquidity and demand through the mortgage channel. During the next decade, it would try to return to a model of neutral, depoliticised inflation targeting, but its ability to do so was complicated by the fact that safeguarding financial stability was added to its mandate. The result was a series of policy shifts that led to a widespread perception that the RBA was at least partly in the business of managing asset price dynamics that did much to damage the RBA's reputation for independence and neutral expertise.

The third period began when attempts to address this problem were overtaken by the onset of the COVID-19 pandemic, during which the RBA was drafted into the government's response to the possibility of a severe recession and its operations explicitly politicised. Subsequently, Australia, like many other countries, experienced a resurgence of inflation. The Bank rapidly raised interest rates to curb inflation as it sought to restore an image of independent expertise immune from political interference. However, monetary policy was now working primarily through households' mortgage outlays, and the Bank was widely held responsible for exacerbating the 'cost-of-living' crisis. Despite the best efforts of present governor Michelle Bullock to project an aura of technocratic impartiality, the RBA's decisions remain highly publicised and politicised, viewed as involving a degree of discretion that the Bank is at pains to deny.

The RBA and the housing market before the GFC

Post-World War Two Australia achieved high rates of property ownership. Housing finance was insulated from broader monetary changes through interest rate caps, and savings banks and building societies were subject to portfolio restrictions to limit and direct the provision of credit. Mortgages for the purchase of rental properties were actively suppressed, treated as business loans at higher interest rates and for shorter duration than mortgages for owner occupation. Although financial regulations were designed to assist the house purchases of low-income earners, they kept mortgage finance relatively illiquid which resulted in rationing of funds as demand exceeded supply.

From the mid-1980s, following the recommendations of the 1981 Campbell Committee report (Australian Financial System Inquiry 1981), controls on the cost and distribution of mortgage finance were abandoned. Limits on savings banks deposit and mortgage interest rates were lifted, as were prescribed asset ratios and portfolio restrictions. From the late 1980s and throughout the 1990s, households could access larger loans more easily as lenders aggressively extended new mortgage products. This rapidly increased property prices, generating significant capital gains for property owners while making it more difficult for lower-income households to enter the market. The *de facto* emphasis on investor-landlordism intensified as nominal interest rates fell and the taxation of capital gains from the sale of investment properties was halved in 1999.

As mortgage interest rates were deregulated and households took on larger loans relative to their wages, interest rate movements attracted greater attention. The public soon realised that monetary policy influenced whether mortgage repayments rose or fell, and whether the paper value of real estate was likely to appreciate or depreciate. However, the perception that the housing market had a privileged relationship to monetary policy was contested by official opinion and expertise. For every observation of the relationship between house prices and levels of mortgage debt, an expert could be found to reassure the public that household debt was only a means, not an objective, of macroeconomic management.

The RBA argued that falling interest rates had contributed to rising house prices only to the extent that Australians had *chosen* to use their increased borrowing power to purchase more expensive or better housing (Macfarlane 2002; Stevens 2007). This position aligned with the Great Moderation narrative (put forward in the early years of the 21st Century by future Federal Reserve chairman and Nobel Prize winner Ben Bernanke (Bernanke and Reinhart 2004)), which held that central banks' commitment to keeping inflation low had facilitated stable economic growth, and that it was not central banks' responsibility to actively manage asset prices. The RBA remained relatively unconcerned about rising house prices and increasing household debt – the key question on its mind was when a 'new equilibrium' would be reached, and at what levels of indebtedness the economy would settle on a 'long-run sustainable path' (Ellis 2005:5).

The public's perception of the relationship between interest rates and house prices became increasingly prominent during the house price boom of the early 2000s. When the RBA cut rates in 2001, the *Herald-Sun* called it a 'Win for Home owners', calculating that homeowners would save almost $200 from their mortgage repayments and noting 'those who plough the savings back into their mortgage could pay off their house up to six years early' (Webber 2001). The rapid growth of house prices gave rise to public concerns about affordability, which resonated with sentiments *inside* the RBA that had become concerned with the possibility that the rapidly rising household mortgage debt could have destabilising effects on the entire Australian economy (Stevens 2004).

When in 2002 the RBA started increasing rates, speculation was rife that it did so out of concern with the state of the property market. Media commentary regularly linked the cash rate increase to the overheated property market with headlines such as 'Home is where rate rise is' (Megalogenis 2002) and 'Hot property may tempt RBA to hike' (Marris and Grayson 2002). Addressing this public discourse in 2003 to the House of Representatives Standing Committee on Economics, Finance, and Public Administration, then governor of the RBA Ian Macfarlane acknowledged: 'It is clear that, despite our best endeavours to explain ourselves, a number of people think that the Bank tightened to cool down the property market' (Macfarlane 2003:11). He noted that the Bank had been accused of even more nefarious practices, namely 'of setting monetary policy in relation to the Sydney and Melbourne housing markets, and ignoring the rest of the country' (Macfarlane 2003:11). He vehemently assured the legislators that his institution was keenly aware of the danger of such practices: 'monetary policy has to be set taking into account the average of all the parts of the economy, not to what is happening in one sector' (Macfarlane 2003:11).

The public's perception nonetheless complicated the RBA's job in future years. The Bank responded with efforts to re-educate the public on its purportedly limited role and the purpose of monetary policy. Key to this narrative was framing monetary policy as a limited tool that can only address aggregate inflation and one that is inherently unsuitable for targeting developments in a specific sector. The RBA claimed that issues of housing affordability were best addressed by policy levers other than interest rates (Macfarlane 2002). It argued that 'house prices', not interest rates, were to blame for unaffordability, and that such prices were determined by a variety of factors on the demand and supply-side of the economy over which it could exercise no direct control (Macfarlane 2006). In particular, it pointed to the inelastic supply of housing as the cause of house price appreciation (Macfarlane 2006). Supply-side constraints have remained a mainstay in central bankers' explanations for why the public should not be looking to the RBA for solutions to housing affordability (Lowe 2016; Lowe 2017).

In a speech, Governor Macfarlane acknowledged the problem of housing affordability and emphasised that it was the responsibility of *other* parts of the government to fix it:

> this situation [the large rises that have occurred over the past five years in house prices] is one that we at the Reserve Bank are not entirely comfortable with. While it may give home owners a happy feeling, we cannot help but also think of the people – mainly in the younger age groups – who aspire to own a home, but are finding it increasingly difficult to do so because rising prices are putting home ownership out of their reach. But since this is mainly a wealth distributional issue, rather than something that directly affects the economy's ability to continue its low-inflation economic expansion, it is not something that can or should be directly addressed by monetary policy. As always, monetary policy has to be directed towards how the average of the whole economy is evolving, not to what a particular sector is doing (Macfarlane 2002).

However, this stance tended to produce its own contradictions. To many observers it seemed that, if the RBA is indeed an apolitical institution, that should also mean being quiet about what other parts of the government should or should not be doing. Either the property market was relevant to monetary policy, in which case the Bank should manage the problem; or it wasn't, in which case the Bank should stay out of that discussion.

The problem with the RBA's position was compounded by the fact that it had difficulty convincing its *own* economists that the housing market was just one sector among others. They recognised that house prices and mortgage lending had begun to influence the macroeconomy more broadly, and that monetary policy makers needed to reckon with the gyrations of the Australian housing market. That approach is articulated in statements the RBA made to distance itself from responsibility for asset price inflation while also leaving room for the Bank to take asset prices into consideration. In 2004, then Deputy Governor Glenn Stevens reminded the public that 'asset prices per se should not be a target of monetary policy', while also conceding that asset prices are considered in central bank decision making 'for what they say about the likely evolution of the macroeconomy' (Stephens 2004).

To demarcate its responsibility, the Bank crafted a narrative that separated a concern for the price of housing from a concern with housing as an asset class. The former was outside its mandate; the latter was crucial to financial stability and therefore within its mandate and purview. This was articulated by then deputy governor Stevens in June 2004:

> we have been worried about the housing market as an asset market, and about the borrowing behaviour of participants in that market. The concern was not out of a desire to target house prices, but more over the potential risks to macroeconomic stability from a major boom – and possible bust – in the household sector's main asset class (Stevens 2004).

However, in the public's mind, there existed an obvious tension between the RBA's active concern with mortgaged real estate as a leveraged asset class on the one hand, and its insistence that issues of housing affordability were beyond its remit on the other. The distinction served as the intellectual rationalisation for the RBA's wish to influence housing markets to manage financial instability while continuing to deflect blame for housing unaffordability. For many homeowners, however, the claimed distinction was illusory – a contrived rationalisation to legitimate an incoherent position.

The RBA and homeowners from GFC to the COVID crisis

That the Australian public had reason to be suspicious became apparent with the onset of the GFC in 2008. The property market had increasingly come to serve as the key transmission channel for monetary policy. While the Bank never neglected to claim that influencing the market was a means and not an objective, the tidiness of that distinction broke down.

With the prospect of a severe recession looming, the RBA acted on its understanding of the role that mortgaged owner-occupiers and investors could play in maintaining aggregate demand. Through a steep reduction in the cash rate (from 7.25% in August 2008 to 3% in May 2009), the RBA relaxed the budget constraint on mortgaged households and injected liquidity into the economy. The RBA explained its thinking as follows:

> An important channel for the transmission of monetary policy easing to economic growth is through reductions in interest rates paid by households on their housing loans. Lower interest rates on existing loans reduce households' interest payments, which increases the income available to indebted households who tend to have a higher propensity to consume. Lower rates on new loans also boost demand for dwellings, thereby supporting house prices and residential building activity (RBA 2009a).

The Bank thus explicitly centred the property-owning household as a driver of economic growth.

The RBA was aware that its policy leverage was in no small part due to the specific institutional structure of the Australian mortgage market: it attributed Australia's macroeconomic performance during the GFC to the high proportion of variable rate loans that directly expose Australian households to monetary policy decisions:

> The responsiveness of household debt servicing to changes in central bank policy rates depends in part on the prevalence of variable rate loans. In Australia and the United Kingdom, where mortgage-related interest payments are a large share of debt servicing and home loans are predominantly extended on variable rate terms, the recent policy easings have significantly lowered household debt servicing […] However, in countries such as the United States where mortgages are mainly at long-term fixed rates, household debt servicing has fallen by relatively little (RBA 2009b).

During the response to the GFC, the narrative that had been crafted during previous years – that the property market was beyond the remit of the RBA – fell by the wayside.

In the wake of the GFC, governments around the world moved to shore up financial supervision, including of mortgage markets (where the instability had originated). In Australia, a financial stability mandate was written into the 2010 agreement between the RBA and the government (RBA 2010). It stated that 'without compromising the price stability objective, the Reserve Bank seeks to use its powers where appropriate to promote the stability of the Australian financial system.' Previous agreements had stipulated the RBA's responsibility for 'the economic prosperity and welfare of the people of Australia' but had not included a specific mandate for financial market stability (RBA 2007). The 2010 financial stability mandate allowed the RBA to explicitly address asset price inflation for the first time.

Australian house prices remained relatively stable during the GFC and began to increase again soon after. This led to mounting concern within the Bank about the potential development of a speculative housing bubble. During the next decade, and particularly from 2014 to 2019, the RBA held interest rates high for longer than conventional modelling indicated it should, repeatedly choosing to keep inflation below target to dampen fluctuating asset prices.

The RBA justified this stance with reference to a 'medium term' inflation target which implied a mandate for making decisions that could mean keeping inflation outside the target range of 2-3% for some time. Philip Lowe articulated the challenge his institution faced as follows:

> 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. At the moment, I think we are in a reasonable place, because the unemployment rate is broadly steady and household debt and house price growth at the aggregate level are fast enough. I feel that, if they were even faster at the moment, we would be moving into the area where the vulnerabilities are increasing perhaps to unacceptable levels. We will keep those two balancing on track (Lowe 2017).

As the RBA's position became increasingly difficult, it turned to the Australian Prudential Regulation Authority (APRA) to slow the growth of riskier mortgage products. Between 2014 and 2018, APRA imposed limits on the growth in total lending to investors and of new high-debt-to-income and high loan-to-value loans (RBA 2018; APRA 2019). The composition of lending changed as banks shifted away from investors and towards owner-occupiers and first-home purchasers. Despite these measures being explicitly targeted at 'lending practices' and financial stability, and not 'house prices or matters of affordability' (APRA 2021; Falinsky 2022: 129), APRA's increased prudential regulation effectively slowed and then reversed house price growth. With its hands untied, the RBA lowered the cash rate in line with orthodox inflation targeting principles.

When asked about the sequence of policies leading up to this institutional solution, ex-RBA economists noted the extent to which the Bank's policies went against its own macroeconomic models. Put provocatively by one former RBA economist, 'I think honestly, it [housing] paralyses them, and it causes them to make mistakes. So you can argue that the 2015 to 2019 period, you know, there were policy mistakes that were made specifically because they were looking at the housing market too much'. In describing this period, this same economist noted how the RBA's modelling suggested that it should be cutting interest rates and that its decision to hold steady contradicted its internal research:

> So a, a model which the RBA uses, you know they developed they use themselves, was calling for lower interest rates and clearly the outcomes that we were, we were seeing at that time were below what the RBA states their intention is, you know, inflation was below 2%, unemployment was drifting sideways or up during that period. So you know, the standard reaction we would expect it to have was, was policy rates to be lower and, like I say, this well publicized research says, like even in their own model, it says it should have been.

Another former RBA economist characterised that same period as dominated by internal debates about the relative weight the Bank should give to financial stability compared to inflation targeting. This economist described it as follows:

> a period where the RBA had inflation below target persistently and unemployment above the, the Bank's estimates of the, the natural rate of unemployment, and so, looking purely on macroeconomic grounds, they would have been, there was a strong case for a more accommodative monetary policy, so lower interest rates. But the, the bank decided to hold the cash rate constant at one, I think it was one and a half percent for several years and so the interpretation was, the bank was putting weight, was doing that by putting weight on its financial stability objectives.

Fraught attempts to return to normal

When, in 2020, the COVID-19 pandemic broke out, the claims to institutional independence that the RBA had built up during the previous years were summarily sidelined as the RBA was drafted into a monetary-fiscal policy mix coordinated to prevent the Australian economy from flatlining. Both the RBA and the government were cognisant of the direct impact that interest rate changes have on household balance sheets and the fact that the disposable income of mortgaged homeowners and investors is largely determined by the size of their mortgage repayments (Konings *et al.* 2021). Even more than during the GFC, the pandemic revealed house prices and household budgets to be crucial levers of macroeconomic management (Lowe 2020). The RBA referred to the strong recovery in the housing market as 'build[ing] a bridge' to the other side of the pandemic (Bullock 2021).

As the acute phase of the pandemic passed, the RBA sought to return to its core mission of inflation targeting. Efforts to re-affirm the policy independence of the RBA took on added significance when inflation surged in mid-2021. Re-adopting its earlier position that house prices remained outside its remit, Governor Phillip Lowe asserted that 'the RBA does not – and should not – target housing prices' (Lowe 2021).

However, monetary tightening was now fully bound up with the Bank's ability to take liquidity out of household budgets through the mortgage debt channel. In February 2022, Lowe emphasised how the high level of household debt would 'make the tightening of monetary policy more effective' (Lowe 2022). The effects of interest rate rises were thus conceptualised in technical terms of the interaction of macroeconomic variables. But in a question-and-answer session in April 2023, Lowe acknowledged that the RBA's use of heavily mortgaged household budgets as a brake against inflation represented an 'uncomfortable truth':

> Part of the other uncomfortable truth here: we needed growth in aggregate demand to slow. It was growing too quickly relative to the ability of the economy to produce goods and services. And, if we'd allowed that situation to continue, inflation wasn't going to come down. So the higher interest rates in a high-debt environment is the mechanism through which spending slows (Lowe 2023b).

The distributional aspect of monetary policy had become impossible to ignore. To the home owning public, it was of little comfort or relevance that in the RBA's mind it was just a means to the end of controlling consumer price inflation. The high concentration of variable rate mortgages among Australian households bolstered the efficacy of monetary policy, but it also exposed the Bank's decisions to a level of popular scrutiny that increasingly constrained its ability to formulate policy autonomously.

At the start of the pandemic, Lowe had tried to support the government's recession-fighting efforts by reassuring the public that interest rates would remain low until 2024. This was in keeping with the practice of 'forward guidance', which, during the decade following the GFC, had emerged as an important technique for central bankers to stabilise market expectations. But, with inflation surging, he found himself with little choice but to join central banks everywhere in quickly raising them. For many mortgage holders, this translated into hundreds of dollars per week being added to their repayments. That the policy shift was comparable to a sudden and dramatic increase in taxation was reflected in media reports that cited not the level of the 'cash rate', but the number of dollars that would be sucked out of median households' budgets.

The Australian public's sense of betrayal was intense and the outcry enormous. The tabloid the *Daily Mail*, not normally in the business of covering economic policy, ran headlines like 'How Philip Lowe MISLED Australia: Nation's top banker made a series of blunders and vowed to keep mortgage payments low – while enjoying his own very luxurious lifestyle' (Johnson 2022). Australians had taken guidance for their borrowing and spending decisions from public officials like Lowe. Many borrowers, especially those who purchased at the peak of the market, were heavily penalised for having done so.

The RBA was cognisant of the unequal impact of its policies. In an August appearance before government, Lowe specifically identified young borrowers who had taken out mortgages earlier on during the pandemic as most severely impacted by interest rate rises compared to older households (Lowe 2023c). There was more, however, to these concerns than ethical misgivings. Even when assessed on its own technical terms, the strategy of slowing demand by manipulating households' mortgage outlays did not work without significant friction. Bringing down inflation was increasingly complicated by the disparities of housing wealth that the previous decades had generated. Many older households who have little or no mortgage debt and very substantial wealth in the form of property and/or equity greatly benefited from the interest rate increases and *increased* their consumer spending (CommbankIQ 2023), creating further inflationary pressure that needed counteracting. Thus, the RBA seemingly needed to inflict more pain on young, illiquid and highly indebted households just to compensate for the spending habits of cash-rich, wealthy households.[1]

The unevenness of property wealth that had grown during the previous decades was manifesting as a condition that directly interfered with the operation of the transmission channel. When, during the previous decade, mainstream economists had reached for complex technical explanations to account for the difficulties that monetary policy was experiencing in getting the economy out of its deflated state and to perform at its full growth potential, heterodox authors – led by Thomas Piketty (2014) – had already pointed out that many of these problems were bound up with an

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[1] Borrowers from the lowest income quartile devote about a third of their incomes to mortgage payments whereas the upper quartile of borrowers pay a mere five percent of their income (Jones 2023).

increasingly unequal distribution of wealth that had political origins and could only be addressed through government intervention. The way that wealth inequality was now making itself felt at the most basic level of monetary policy conduct expressed the growing difficulty of keeping politics out of monetary policy. No longer was wealth inequality a purely distributional issue that the RBA could hope to pass to the politicians; instead, it had direct implications for the conduct of monetary policy.

Ahead of the 2022 federal election, the main political parties agreed that the next government would initiate an independent, comprehensive expert-led review of the role and operation of the RBA. The findings of the review (Australian Government 2023) were unsurprising: the Australian government needed to maintain the RBA's independence, and the RBA needed to recommit to inflation-targeting and ignore political pressures, pundits and favour-seekers. Lowe did several rounds of *mea culpa*, expressing regret that he had waded into politicians' territory. But the damage done by broken promises is not easily restored, and he was unable to save his own job.

The new governor, Michelle Bullock, used the review as a platform for a reset, yet it does not appear that the RBA will soon cease to be the focus of public attention. When Bullock hinted that the Labor government's public spending could be contributing to above-target-inflation, government ministers shot back saying that the Bank should consider itself 'independent' but not 'immune' (Crowe 2024). Nor have politicians been able to resist the temptation to intervene. Treasurer Chalmers only recently complained that the RBA's high rates are 'smashing the economy' (Evans 2024), maintaining the highly politicised atmosphere that the Bank has been so eager to leave behind. The newspaper *The Australian* raised the question explicitly: 'Who does the RBA serve?'.[2] However, the failure of the RBA to stick strictly and mechanically to its core mandate is not the fault of its officers saying the wrong things when under pressure. It should, rather, be attributed to problems embedded in the basic operations of monetary policy by the growing and unequally distributed weight of housing assets and mortgage debt.

[2] See: *https://www.theaustralian.com.au/commentary/letters/who-does-the-rba-serve/news-story/0c09a51265720709c319f8b0601a81bb*.

Conclusion

In the neoliberal model of central banking, central banks should be independent – not serving any other group or agency but simply the general interest in a stable economic system. That model experienced its heyday during the period of the 'Great Moderation'. But following the GFC, when central banks everywhere pursued 'exceptional' policies to stabilise financial markets and were then drafted into the government response to the Covid crisis, their operations increasingly appeared to be politically shaped and distributionally consequential. That has politicised the role of central banks: too many groups in society don't accept the idea that the RBA's operations are 'neutral'.

The Bank has at times been highly cognisant of that perception; and it invests considerable energy and resources into trying to understand the dynamics at play and to adopt better communication strategies and impression management. However, the public's concern is usually not with the Bank's reasons or intentions, however earnestly held, but with pocketbook outcomes. For this reason, the Bank's efforts to actively manage the problem often have not worked; they have, rather, tended to drag it deeper into terrain it is eager to avoid. What the RBA intends as a depoliticising move may not appear as such to a general public more inclined to view it as yet another discretionary decision that privileges the portfolios of some people over others. A straightforward return to 'normal' is therefore unlikely to materialise.

Frustrated by the RBA's commitment to fighting inflation by keeping interest rates high, Treasurer Jim Chalmers has on occasion threatened to use fiscal policy to undo the effects of tight monetary policy on household budgets. More recently, the minority Greens Party has demanded that the Treasurer force the RBA to lower interest rates to support mortgage holders (Greens 2024). Greens Senator Nick McKim claimed that 'The Reserve Bank Board are not infallible high priests of the economy who are above criticism' (Greens 2024). The prospect of political influence over the RBA's decisions is sufficiently real that the RBA review recommended formally taking the constitutional power to veto any central bank decision out of the hands of the Treasurer. How these tensions will play out remains to be seen; but one cannot understand the forces at work unless one recognises how the Bank's policies are bound up with the mortgage market and household budgets.

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