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The Relationship between Monetary Policy and Macroprudential Policy in the Final Report of Australia's Napier Royal Commission, 1935-37

Peter Docherty,
University of Technology Sydney

Abstract

The 1935-37 Royal Commission into the Australian Monetary and Banking Systems is frequently credited with recommendations that later provided the foundation for Australia's monetary policy framework. These recommendations focused on the question of compulsory reserves that banks would be required to hold at the Commonwealth Bank, specified as a percentage of Australian deposit liabilities. A version of this recommendation was eventually incorporated into the *Banking Act* of 1945. Such a requirement may be understood within the money supply multiplier framework as a reserve requirement capable of adjustment in response to general macroeconomic conditions such as inflation. Inflation was in fact an important policy concern at the end of World War II when the Banking Act was passed. The Final Report of the Royal Commission, however, contains an extensive analysis of the banking failures that occurred in the financial panic of 1893 as well as the financial pressures of the Great Depression. This analysis suggests that financial stability was an important objective in the minds of the Report's authors. A question is thus raised as to the relationship between what we understand today as *monetary policy*, on the one hand, and what has come to be called *macroprudential policy*, on the other, in the Report's analysis. This paper provides a careful analysis of the Report's structure and argument, assessed against understandings of monetary policy and financial stability in major works available at the time, including Bagehot's *Lombard Street* and Keynes's *Treatise on Money*. It concludes that the Report's major recommendations are best understood in terms of macroprudential regulation rather than monetary policy although there was a close relationship between the two.