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Perceived Monetary Policy Rules: Evidence from Professional Forecasters in Australia*

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Abstract

We study how professional forecasters perceive a central bank's reaction function and how those perceptions evolve over time, using survey evidence from Australia between 2015 and 2025. Adapting recent survey-based approaches, we recover time-varying perceived policy rules that map expected macroeconomic conditions into expected policy rates. We find that perceived responsiveness to inflation was modest prior to the pandemic, collapsed at the effective lower bound, and rose sharply only after sustained policy tightening began in 2022. Central bank communication about labour market conditions and financial stability shaped perceptions of the reaction function. However, during periods of elevated uncertainty—particularly following COVID—beliefs about the importance of inflation adjusted only after forecasters observed realised policy actions, highlighting the limits of guidance alone. We also show that heterogeneity in long-run beliefs, including views about long-run inflation, plays an important role in shaping interest rate expectations, but can be parsimoniously captured using forecaster fixed effects.

JEL Classification: E43, E52, E58

Keywords: Perceived monetary policy rules; Survey expectations; Central bank communication; Reserve Bank of Australia

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1 Introduction

People's expectations about future interest rates influence their behaviour today. A key way that a central bank can shape these expectations—and thereby achieve its intended policy outcomes—is by having a clear reaction function, so that households and markets understand how policy will respond to changing economic conditions. When the reaction function is well understood, economic agents can respond directly to news without waiting for explicit guidance from the central bank (Woodford 2005). Similarly, if agents believe that the central bank will respond forcefully to inflation, this can help limit inflationary spirals and reduce the trade-offs between stabilising inflation and unemployment. As a result, what people *believe* about a central bank's reaction function plays a central role in the transmission of monetary policy.

Given the importance of a well-understood reaction function for the conduct of monetary policy, this paper addresses the following questions for Australia: *What reaction function do professional forecasters perceive the Reserve Bank of Australia (RBA) to follow? Do forecasters share a common view of the RBA's reaction function, or do their views differ? And have perceptions evolved over time?*

These questions are particularly important in the current context. The RBA Review (2023) emphasises the importance of clear communication about policy strategy and the rationale for decisions, arguing that well-understood frameworks strengthen the effectiveness of monetary policy. Moreover, recent evidence suggests that markets have systematically misread how the RBA responds to economic data, indicating that market participants do not have a clear understanding of the RBA's reaction function (Hambur and Haque 2024). Quantifying *perceived* policy rules, how they change over time, and what drives them therefore speaks directly to both of these concerns.

To answer these questions, we adapt the survey-based framework of Bauer, Pflueger, and Sunderam (2024b, 2024a) to the Australian context. Using forecaster-level data from the *RBA Market Economist Survey* from 2015 to 2025, we estimate Taylor-style rules that map expected inflation, unemployment, and—in extensions—wage growth into expected cash rates. We then relate shifts in the perceived reaction function to RBA communication and to high-frequency surprises around policy announcements. We also extend existing approaches by directly incorporating forecasters' perceptions of unobservable "star" variables, such as long-run inflation, the neutral interest rate, and the non-accelerating inflation rate of unemployment (NAIRU). This allows us to assess the extent to which heterogeneity in these long-run beliefs helps explain differences in interest rate expectations.

In doing so we extend the existing literature along a number of dimensions. First, we extend the literature to Australia, a small open economy with a long-standing inflation-targeting framework. While much of the existing evidence focuses on the United States and the euro area, examining Australia is informative for several reasons. Australia has operated under a stable monetary policy framework for decades, experienced a comparatively short effective lower bound episode, and faces inflation dynamics that are influenced by global forces. This allows us to study how market participants form and revise beliefs about policy function when the formal framework is unchanged, but

uncertainty about policy implementation and economic conditions evolve over time.

As well as the country dimension, we extend on the existing literature along two methodological dimensions. First, we incorporate dynamic panel estimator approaches, and consider how important they can be for the interpretation of the results. Second, we incorporate direct estimates of forecasters' views on unobservable, like long-run inflation and the neutral rate. This allows us to assess how current approaches of partial ling out these expectations using fixed effects are in practice. Directly incorporating these expectations also allow us to better understand how heterogeneous such assumptions are, their role in influencing rate expectations, and so their information content.

Several findings and lessons emerge. First, markets perceive the RBA to be less reactive to inflation than might be expected. In particular, on average over the pre–COVID-19 period, market participants perceived that the RBA placed a lower weight on inflation than is embodied in many of the RBA's structural macroeconomic models, such as its macroeconometric model MARTIN (Ballantyne et al. 2020) or its DSGE model DINGO (Gibbs, Hambur, and Nodari 2018). Accounting for these differences and what they imply about peoples' expectations for future policy is therefore important for policy analysis, scenario design, and the interpretation of yield curve movements.

Second, central bank communication can shape perceptions of the reaction function. During the mid-2010s, markets inferred that the RBA would not respond strongly to deviations in inflation, coinciding with communication that emphasised housing and financial stability risks. Following the COVID-19 recession, language stressing the importance of preserving labour market gains aligned with a temporary strengthening in the perceived responsiveness to unemployment during 2021–22. Similarly, repeated references to the need to see wages growth before policy lift-off led to an increase in the perceived weight placed on wages in the RBA's reaction function. However, the effectiveness of communication is not uniform over time.

Third, we show that sometimes actions speak louder than words, particularly during periods of elevated uncertainty. Coming out of COVID-19, despite increasingly hawkish communication, perceptions of the weight the RBA placed on inflation did not adjust materially until after policy rates began to rise. As rate increases accumulated through 2022–23, the perceived inflation coefficient rose sharply, reflecting a reassessment of the Bank's commitment to returning inflation to target. These patterns closely mirror findings for the United States and the euro area (Bauer, Pflueger, and Sunderam 2024a).

What explains the delayed adjustment in perceived inflation responsiveness despite large inflation surprises and hawkish communication? We show that this timing cannot be attributed to beliefs that inflation was transitory or to perceptions of a persistent "lower-for-longer" policy framework. Instead, the evidence points to a learning mechanism under uncertainty: with substantial disagreement about when and how forcefully the RBA would tighten, forecasters waited for sustained policy actions before revising their views about the reaction function. As in Bauer, Pflueger, and Sunderam (2024a), realised actions—rather than forward guidance—ultimately re-anchored beliefs during this period.

Fourth, we find that most disagreement about future interest rates reflects disagreement about

future economic conditions and long-run "star" variables, rather than disagreement about the reaction function itself. On average, only around 30 per cent of disagreement in interest rate expectations is attributable to differences in perceived policy responses, although this share rises during certain periods, such as in 2025. This suggests that communication may be most effective at reducing disagreement when targeted at shaping views about economic conditions.

Finally, variation in long-run inflation expectations is moderate but economically important. Differences in long-run inflation beliefs account for a substantial share of variation in interest rate expectations, and failing to allow for such heterogeneity leads to markedly lower estimates of the perceived inflation coefficient. This indicates that long-run beliefs are not merely noise, but form a core component of forecasters' broader economic outlooks.

Taken together, these findings underscore the importance of clear and targeted communication, supported by credible policy actions, in shaping interest rate expectations. They also demonstrate a practical set of tools that can be used to assess whether central bank communication is being interpreted as intended.

Our paper relates to a growing literature documenting that monetary policy surprises are partly predictable using information available prior to policy announcements. Hambur and Haque (2024) show that policy surprises around the RBA's announcements were partly predictable from publicly available information, while Bauer and Swanson (2023) find similar evidence for the United States. These findings challenge the interpretation of high-frequency monetary policy surprises as fully exogenous shocks and instead point to an important role for learning about the central bank's reaction function. This perspective is consistent with the broader idea that asset prices and expectations are governed by a *market-perceived* policy rule—an object that can be inferred from market responses to macroeconomic information, but which we study directly using survey expectations (Hamilton, Pruitt, and Borger 2011).

Our paper also relates to the emerging literature that estimates perceived central bank reaction functions using survey data. Most closely related are Bauer, Pflueger, and Sunderam (2024b, 2024a), who document substantial time variation in perceived reaction functions in the United States over long samples and during the COVID period in the United States and the euro area, respectively. This work emphasises that the object relevant for expectations formation and financial market reactions is the policy rule inferred by private agents rather than the central bank's internal rule. Relatedly, disagreement across forecasters can reflect uncertainty and learning about the policy framework itself, rather than only heterogeneous macroeconomic outlooks (Sastry 2025). This insight motivates our use of panel variation in expectations to study the evolution of perceived policy rules.

Finally, our paper relates to a broader literature that uses survey expectations to estimate monetary policy reaction functions, particularly when conventional estimation is complicated by the effective lower bound. Fujiwara, Nakazono, and Ueda (2015) use survey data for Japan to assess whether aggressive monetary easing—combining large-scale quantitative and qualitative easing with explicit forward guidance—induced a perceived regime change in monetary policy, while

Kim and Pruitt (2017) estimate perceived Federal Reserve policy rules during the zero lower bound period and document a decline in the perceived inflation response alongside a stronger emphasis on unemployment; Bundick (2015) provides related evidence. Complementing this, recent work treats central bank communication itself as rule-like and time-varying, arguing that shifts in the "communication rule" can generate a learning period (Gáti and Handlan 2022). We extend this literature by showing that while central bank communication can influence expectations in normal times, belief updating about the reaction function during periods of elevated uncertainty is driven primarily by realised policy actions.

The remainder of the paper proceeds as follows. Section 2 describes the data, methodology, and identification strategy. Section 3 presents estimates of the average perceived reaction function. Section 4 documents the evolution of the perceived reaction function over time, including the pre- and post-COVID periods, the delayed response of perceived inflation weights, and the role of "star" variables. Section 5 examines heterogeneity in forecasters' expectations, and Section 6 concludes with implications for communication and policy strategy.

2 Methodology

As noted above, we build on the survey-based approach developed by Bauer, Pflueger, and Sunderam (2024b, 2024a). This framework estimates perceived Taylor rules by exploiting variation in professional forecasters' expectations for interest rates, inflation, and economic activity across horizons. Relative to these earlier papers, we focus on unemployment rather than output gaps as our measure of economic slack and employ dynamic panel estimators to account for policy inertia. This section outlines the framework, data, estimation approach, and identification assumptions.

2.1 Framework

We assume that forecasters believe the RBA sets the policy interest rate according to a Taylor-style rule (Taylor 1993, 1999), in which the cash rate responds to deviations of inflation and unemployment from their long-run benchmarks, as well as to its own lagged value:

$$i_t = \beta_t i_{t-1} + (1-\beta_t)\big[r_t^* + \pi_t^* + \theta_t(\pi_t - \pi_t^*) + \delta_t(u_t - u_t^*)\big] + \varepsilon_t, \tag{1}$$

where β_t captures policy inertia; θ_t and δ_t measure the responsiveness to inflation (π_t) relative to its target (π_t^*) and unemployment (u_t) relative to the NAIRU (u_t^*); r_t^* denotes the neutral real interest rate; and ε_t is a monetary policy shock.

Under this perceived rule, forecaster j's expectation at time t of the cash rate at horizon h can be written as

$$i_{t,t+h}^{(j)} = \hat{\beta}_t i_{t,t+h-1}^{(j)} + (1-\hat{\beta}_t)\big[r_t^{(j)*} + \pi_t^{(j)*} + \hat{\theta}_t(\pi_{t,t+h}^{(j)} - \pi_t^{(j)*}) + \hat{\delta}_t(u_{t,t+h}^{(j)} - u_t^{(j)*})\big] + \varepsilon_{t,t+h}^{(j)}, \tag{2}$$

where hats denote perceived policy parameters, and $\varepsilon_{t,t+h}^{(j)}$ captures forecaster-specific views about

future policy shocks or model misspecification.

We allow beliefs about long-run "star" variables—the neutral real rate, inflation target, and NAIRU—to vary across forecasters and over time, but not across horizons within a given survey. That is, forecasters may revise their views about long-run benchmarks over time, but conditional on information at time t they do not expect these benchmarks to evolve systematically over the forecast horizon. Similarly, while perceived policy parameters may change over time, they are assumed constant across horizons within a survey. In other words, forecasters do not expect the RBA to place different weights on inflation or unemployment in the future than it does at present. We assess the plausibility of this assumption in Section 4.

To recover the perceived policy coefficients, we estimate the following panel regression:

$$i^{(j)}_{t,t+h} = \hat{\beta}_t i^{(j)}_{t,t+h-1} + (1-\hat{\beta}_t)\left[\hat{\theta}_t \pi^{(j)}_{t,t+h} + \hat{\delta}_t u^{(j)}_{t,t+h}\right] + \alpha^{(j)}_t + \varepsilon^{(j)}_{t,t+h}, \tag{3}$$

where $\alpha^{(j)}_t$ is a forecaster-specific intercept that absorbs persistent beliefs about the inflation target, the NAIRU, and the neutral rate. This formulation allows differences in long-run expectations to be correlated with forecasters' macroeconomic projections, ensuring that the estimated slope coefficients reflect perceptions of the RBA's responsiveness to changing economic conditions rather than differences in levels.

Our framework imposes a single, common perceived reaction function. To the extent that true heterogeneity in perceived policy rules exists, our estimates should therefore be interpreted as averages across forecasters. We explore the implications of this assumption in Section 5.

A key departure from Bauer, Pflueger, and Sunderam (2024b, 2024a) is our use of unemployment rather than an output gap. We do so for two reasons. First, unemployment aligns more closely with the RBA's dual mandate of price stability and full employment. Second, it requires weaker identifying assumptions. As Bauer, Pflueger, and Sunderam (2024b) note, using GDP forecasts and output gaps requires imposing a common assumption about future potential output growth. By contrast, using unemployment only requires that forecaster-specific NAIRU beliefs are constant across horizons.[1]

Our baseline specification assumes that inflation and unemployment are the primary drivers of policy. If forecasters believe the RBA responds systematically to additional variables, omitted-variable bias may arise. We address this by extending the rule to include wage growth (WPI) and show that our main results are robust. The wage growth extension also provides additional insight into the role of labour-market conditions in shaping perceived policy.

2.2 Data

We use survey data from the RBA's Market Economist Survey (MES), a quarterly survey of approximately 10–20 professional forecasters. The MES collects quarterly forecasts for a range of

1. For the United States, Bauer, Pflueger, and Sunderam (2024b) show that unemployment- and GDP-based specifications yield very similar time-series patterns.

macroeconomic variables at multiple horizons, extending up to roughly 2.5 years ahead. For this paper, we use forecasts of trimmed-mean inflation, the unemployment rate, and the cash rate, which are available from 2015 to 2025.

2.3 Estimation approach

The regression in equation (3) is estimated in a panel setting. Each forecaster–survey-date pair (t, j) is treated as a panel unit, with forecast horizons (h) forming the time dimension.

We estimate both a static version of the rule, which omits the lagged interest rate, and a dynamic specification that allows for policy inertia. Standard errors are robust and clustered at the forecaster-by-time level.

Unlike Bauer, Pflueger, and Sunderam (2024b), we estimate the inertial specification using a dynamic panel GMM estimator. The inclusion of a lagged dependent variable induces small-sample bias when fixed effects are present (often referred to as the Nickell bias). To address this, we employ an Arellano–Bond–style difference GMM estimator (Arellano and Bond 1991). We prefer difference GMM to system GMM because the latter requires assuming that changes in expectations are uncorrelated with forecaster-specific fixed effects—an assumption that is unlikely to hold in this setting. For example, forecasters with higher neutral-rate beliefs are likely to expect smaller future declines in interest rates, all else equal. Difference-in-Hansen tests also reject the validity of the additional moment conditions required for system GMM.[2]

Inflation and unemployment expectations are treated as predetermined rather than strictly exogenous: past shocks to interest rate expectations may affect future inflation and unemployment forecasts, even if contemporaneous shocks do not. Accordingly, these variables enter as GMM-style instruments with appropriate lags. We find evidence that forecast errors are autocorrelated across horizons, with AR(2) dynamics in the differenced residuals. To address this, we use deeper lags of the instruments—third lags for interest rates and second lags for inflation and unemployment.

All dynamic specifications are estimated using the two-step GMM estimator with the Windmeiger (2005) finite-sample correction. As a robustness check, we vary the number of lagged instruments to assess potential effects of instrument proliferation; the results are very similar across specifications.

2.4 Identification and assumptions

Our survey-based approach is designed to recover *perceived* policy rules rather than the RBA's actual decision rule. Identification relies primarily on *within-forecaster, cross-horizon variation.* For a given forecaster and survey date, we recover perceived policy slopes from how the expected path of the cash rate co-moves with that forecaster's own inflation and unemployment forecasts

2. The difference-in-Hansen test assesses the validity of the additional moment conditions required for system GMM. In our setting, these conditions are rejected, indicating that changes in expectations are correlated with forecaster-specific fixed effects, and motivating our use of difference rather than system GMM.

across horizons. Each forecaster therefore provides a "term structure" of expectations, and it is the slopes of these profiles—rather than their levels—that identify the perceived reaction function.

Figure 1 illustrates that forecast profiles exhibit substantial cross-horizon variation. For example, during 2021–22 forecasters anticipated sharp increases in inflation but relatively muted cash rate adjustments, whereas by 2023–24 expected rate increases became more closely aligned with inflation forecasts. These horizon-level differences underpin our identification strategy.

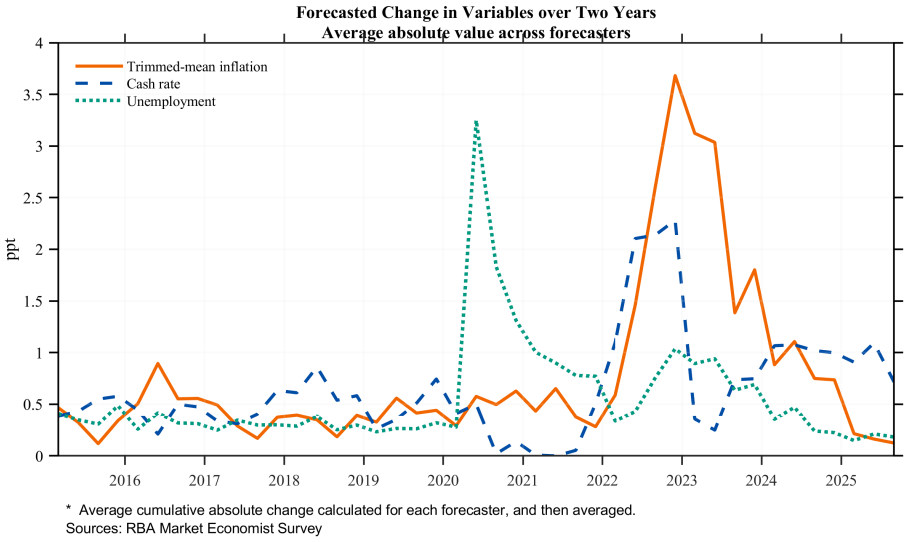


Figure 1: Cross-horizon variation in forecasts.

Cross-forecaster disagreement further enhances identification and precision. Figure 2 shows that disagreement over inflation, unemployment, and cash rate expectations varies considerably over time, particularly around major turning points such as the onset of the COVID-19 shock and the beginning of the tightening cycle in 2022.

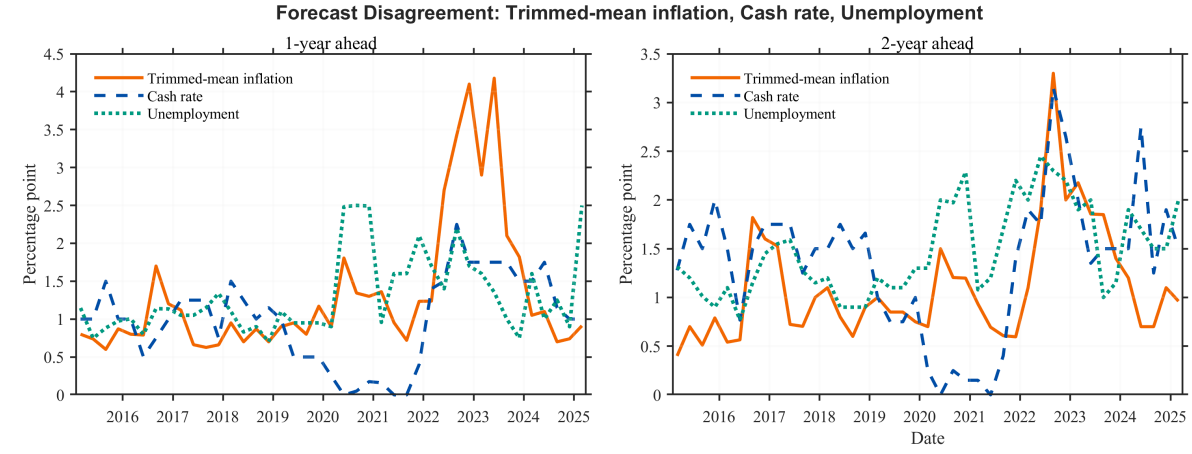


Figure 2: Cross-forecaster variation in expectations.

As with any Taylor-rule regression, reverse causality is a potential concern: interest rates may

influence inflation and unemployment as well as respond to them. In our setting, as discussed in Bauer, Pflueger, and Sunderam (2024b), this concern is mitigated by the use of simultaneous survey expectations. At a given survey date, forecasters report expected paths for interest rates, inflation, and unemployment formed from a common information set. The co-movement we exploit therefore reflects how forecasters map their macroeconomic assumptions into policy expectations, rather than feedback from realised policy to subsequent outcomes. While the assumption that economic forecasts are independent of future policy shocks is unlikely to hold exactly, any resulting bias is expected to be limited. More generally, Carvalho, Nechio, and Tristao (2021) show that bias in OLS estimation of Taylor rules is small when monetary policy shocks are not primary drivers of macroeconomic outcomes.

3 The Average Perceived Reaction Function

We begin by examining the average perceived reaction function over the pre–COVID-19 period. This provides a benchmark for assessing how market perceptions compare with the Taylor rules embedded in standard policy models.

Table 1 reports estimates from two specifications: one without policy inertia and one allowing for a lagged cash rate. Both specifications imply similar short-run responses to inflation and unemployment. A one percentage point increase in unemployment is perceived to lower the cash rate by around 80 basis points, while a one percentage point increase in inflation is perceived to raise the cash rate by roughly 25 basis points. Under the inertial specification, these imply long-run responses of approximately 350 basis points to unemployment and 115 basis points to inflation.[3]

Relative to benchmark policy rules, the perceived response to unemployment is somewhat stronger, while the perceived response to inflation is noticeably weaker. In particular, the inflation coefficient is well below that implied by the Taylor rule in the RBA's macro-econometric MARTIN model, which is calibrated rather than estimated (Ballantyne et al. 2020). The perceived inflation response is closer to, but still below, the long-run response estimated in the RBA's DSGE model (Gibbs, Hambur, and Nodari 2018).

3. In the inertial specification, the long-run response is calculated as the short-run coefficient divided by $(1 - \hat{\beta})$, where $\hat{\beta}$ is the estimated coefficient on the lagged cash rate.

Table 1: Average Taylor Rule – 2005–2019

	Perceptions no lagged cash rate	Perceptions lagged cash rate	MARTIN rule	DSGE
Lagged cash rate	n/a	0.764 (0.636, 0.892)	0.700	0.870 (0.840, 0.890)
Inflation – short run	0.218 (0.102, 0.334)	0.272 (0.145, 0.398)	0.600	0.195
Inflation – long run	n/a	1.152	2.000	1.540 (1.400, 1.700)
Unemployment – short run	-0.807 (-0.962, -0.652)	-0.834 (-1.110, -0.558)	-0.600	n/a
Unemployment – long run	n/a	-3.535	-2.000	n/a

These differences have direct implications for how interest rate expectations respond to economic news. Consider the September quarter 2025 CPI release, in which trimmed-mean year-on-year inflation was around 0.3 percentage points above median market expectations. Applying the MARTIN rule would imply an increase in the cash rate of roughly 18 basis points using the short-run coefficient. Under the perceived rule, the implied response is closer to 8 basis points. In practice, yields at the short end of the curve rose by around 10 basis points. The lower perceived inflation weight therefore helps explain the muted response of interest rate expectations to the inflation surprise.

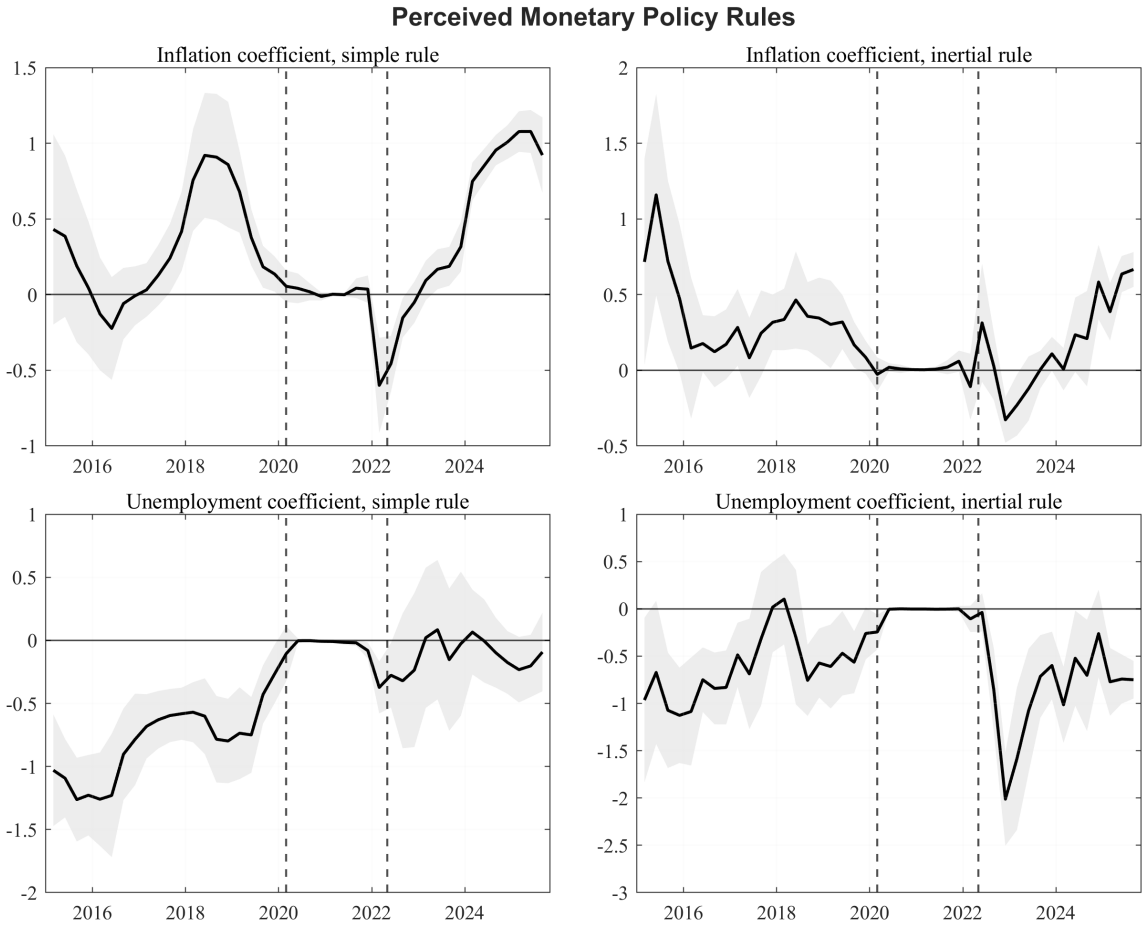
These findings also matter for the interpretation of macroeconomic models, particularly forward-looking DSGE frameworks. To the extent that such models embed stronger inflation responses than those perceived by market participants, they may overstate the stabilising role of systematic monetary policy. This highlights the value of considering alternative policy rules in model-based analysis as robustness, or considering extensions—such as bounded rationality or myopia—that dampen forward-looking dynamics.

4 Evolution of the RBA's perceived reaction function

Figure 3 summarises the estimated coefficients from the baseline survey-based Taylor rule regressions. The top panels report the estimated inflation coefficient from the simple specification (left) and the inertial specification (right), while the bottom panels show the corresponding unemployment coefficients. Shaded regions denote 95% confidence intervals, clustered by forecaster and

horizon, and dashed vertical lines mark the effective lower bound period between March 2020 and May 2022. Unless otherwise stated, the estimates are constructed using rolling four-quarter trailing samples to smooth high-frequency variation.

In what follows, we adopt a largely narrative approach, highlighting economically meaningful movements in the estimated coefficients and interpreting them in light of contemporaneous data, policy actions, and central bank communication. An alternative would be a more systematic regression-based analysis; however, the relatively short sample and the time-varying nature of policy communication limit the scope for such an approach. Given our focus on how communication and actions shape perceptions—and the likelihood that the relevant communication channels and messages evolve over time—a narrative interpretation is both informative and appropriate.



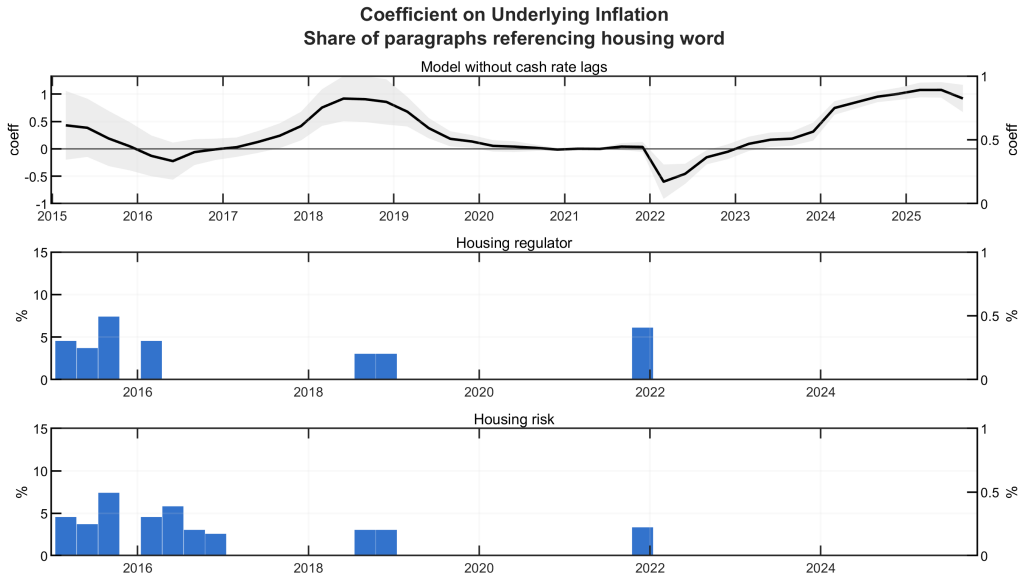
Notes: Coefficients of perceived monetary policy rules estimated using rolling 4-quarter panel regressions on survey data from RBA market economist survey from February 2015 to August 2025. The left panels show estimates of the simple rule and the right panels show estimates that allow for monetary policy inertia. Gray-shaded areas are 95% confidence intervals based on clustered standard errors (by forecasters and horizon). Vertical lines show the zero lower bound period between March 2020 and May 2022.

Sources: Authors' calculations; RBA

Figure 3: Perceived monetary policy rule coefficients: baseline model.

4.1 Pre-pandemic dynamics

In the mid-2010s, forecasters inferred that the RBA placed only a modest weight on inflation in its perceived reaction function. This interpretation aligns with contemporaneous communication that foregrounded financial-stability considerations—particularly housing market risks—and signalled a reluctance to ease policy further despite persistently subdued inflation (e.g., Lowe 2016). Simple text analysis supports this reading: references to housing risks and regulatory intervention in policy communications rose sharply in 2015–16, coinciding with the period in which the estimated inflation coefficient fell (Figure 4). While these correlations are descriptive rather than causal, the timing suggests that the financial-stability framing influenced how market participants mapped economic data into expected policy responses.



Note: Housing words include: dwelling prices, housing credit, housing market, housing conditions and household debt. Risk words include: downside risk, concern(s) and risk(s). Regulator include regulator(s) and APRA. Uncertainty words include: uncertain, uncertainty and volatile. Abating words include: eased, declining, decline(s), easing, fall(s) and abate. Housing risks includes a housing word and a risk wording. Housing regulator includes housing and regulator word. All groups exclude any abating words. Data to August 2022.
Sources: Authors' calculations; RBA

Figure 4: Inflation coefficient and references to housing risk and regulation in monetary policy announcements.

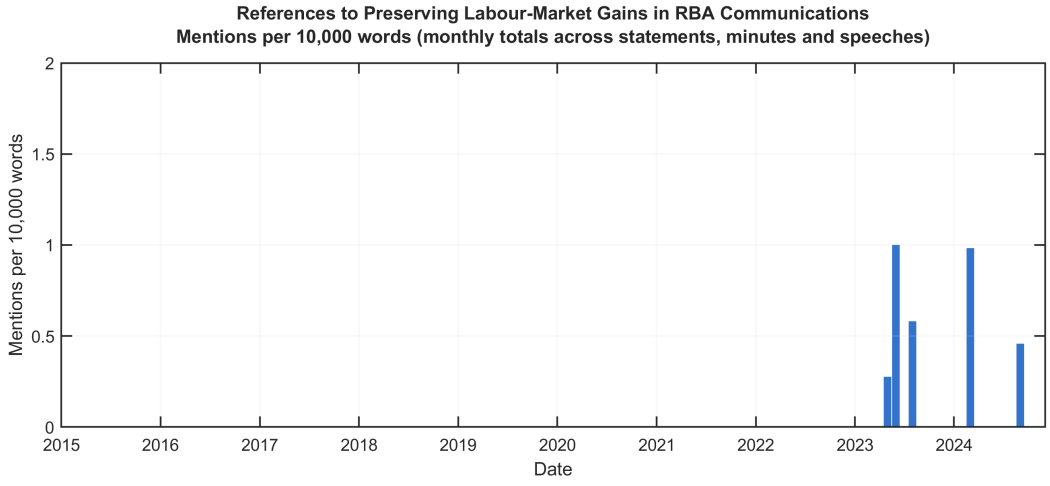
Over the same period, the perceived response to unemployment gradually declined toward zero. This pattern is broadly consistent with a communication stance that elevated housing and financial-stability concerns, potentially reducing the salience of labour-market conditions in the perceived reaction function. However, the timing of movements in the unemployment coefficient is less tightly aligned with communication shifts than in the case of inflation.

Taken together, these findings suggest that RBA communication during the pre-pandemic period shaped perceptions of its reaction function. By emphasising financial-stability risks and signalling caution about further easing, the RBA appears to have dampened forecasters' perceptions of its responsiveness to inflation deviations from target, and (potentially) to a lesser extent to fluctuations in unemployment.

4.2 COVID and post-COVID dynamics: shifting emphasis back to inflation

A striking feature of the effective lower bound (ELB) period from 2020 to 2022 is the near-zero perceived responsiveness of the RBA to both inflation and unemployment. This pattern closely mirrors evidence for the U.S. Federal Reserve documented by Bauer, Pflueger, and Sunderam (2024a). During this period, forward guidance combined with the binding lower bound appears to have led markets to interpret policy as largely inert: estimated reaction coefficients fell sharply, and forecasters perceived little systematic response to either macroeconomic variable, despite perceived variation in expected future conditions (see Figure 1).

In the immediate post-pandemic period, the estimated coefficients in Figure 3 display a clear asymmetry. The perceived response to unemployment strengthens (in absolute terms) relatively quickly, particularly for the intertial rule, while the perceived response to inflation remains muted for an extended period. This pattern aligns closely with our language-based measures, which show a pronounced increase in references to "preserving labour-market gains" across RBA statements, speeches, and minutes from early 2023 onwards (Figure 5). Taken together, the coefficient estimates and the text evidence point to a phase in which markets inferred that policy was prioritising the recovery and durability of employment, while largely looking through temporary, supply-driven inflationary pressures—consistent with delayed policy lift-off and the tenor of RBA communication at the time.



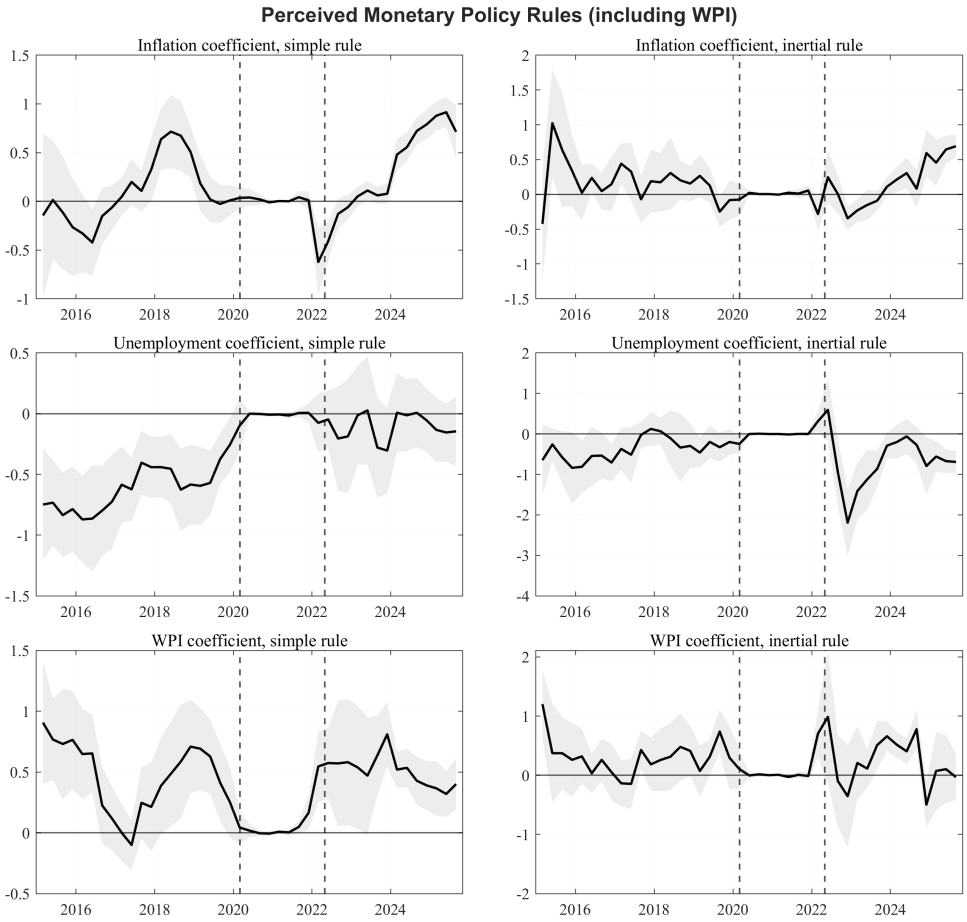
Notes: The series counts mentions of phrases related to preserving labour-market gains (e.g., "preserve the gains", "preserving gains") in RBA policy meeting statements, meeting minutes, and speeches. Values are monthly totals of mentions per 10{,}000 words across documents. Months with no documents are left blank (shown as gaps).
Sources: Authors' calculations; RBA

Figure 5: References to preserving labour-market gains in RBA communications.

A further salient feature of RBA communication during this period was the emphasis on sustained wage growth as a precondition for a durable return of inflation to target from late 2021.[4] To assess whether this framing shaped forecasters' perceptions, we augment the perceived reaction

4. For example, the November 2021 policy announcement noted "The Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. This will require the labour market to be tight enough to generate wages growth that is materially higher than it is currently." (Reserve Bank of Australia 2021)

function to include a direct response to wage inflation, measured using forecasts of the Wage Price Index (WPI). Incorporating WPI leaves the estimated inflation and unemployment coefficients largely unchanged, indicating that our baseline results are not driven by omitted wage dynamics. However, the extension reveals that the perceived response to wage growth begins to rise in late 2021—before the inflation and unemployment coefficients increase—consistent with the view that markets interpreted wages as an early conditioning variable for policy normalisation (Figure 6).



Notes: Coefficients of perceived monetary policy rules estimated using rolling 4-quarter panel regressions on survey data from RBA market economist survey from February 2015 to August 2025. The left column shows estimates of the simple rule and the right column shows estimates that allow for monetary policy inertia. Gray-shaded areas are 95% confidence intervals based on clustered standard errors (by forecasters and horizon). Vertical lines show the zero lower bound period between March 2020 and May 2022.

Sources: Authors' calculations; RBA

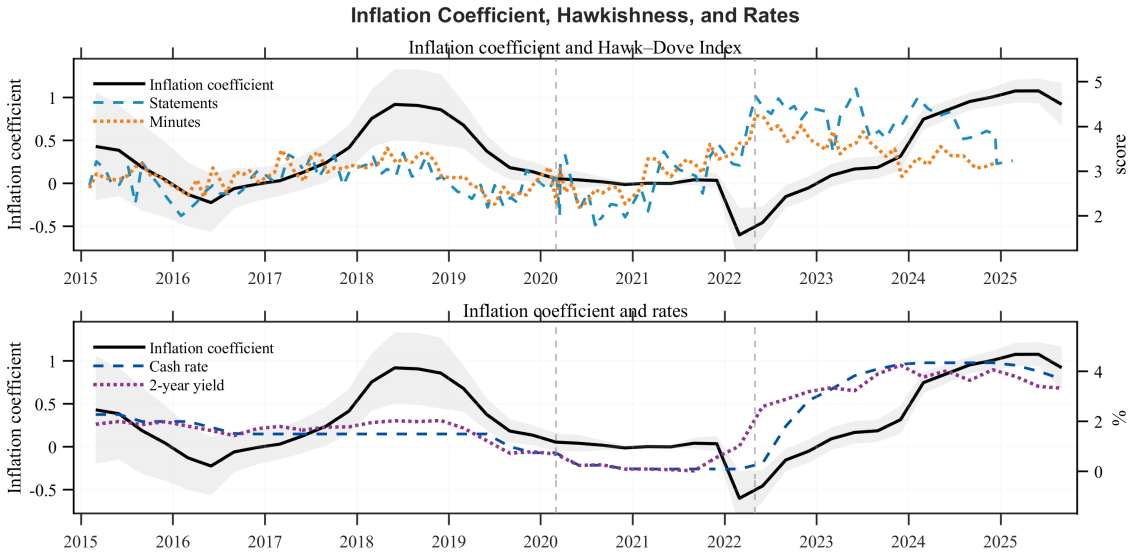
Figure 6: Policy rule coefficients with WPI included.

As the tightening cycle progresses, the perceived inflation coefficient rises materially, signalling a reassessment of the Bank's willingness to respond forcefully to persistent inflation. By contrast, the unemployment coefficient exhibits no comparable and sustained rebound, remaining relatively subdued in the simple specification, with only a temporary increase in the inertial specification around 2022. Overall, the evidence points to a transition from an initial post-pandemic emphasis on labour-market preservation toward a renewed focus on inflation, as policy actions accumulated and macroeconomic conditions evolved.

4.3 Why did the perceived inflation response rise only after lift-off?

A striking feature of the estimates in Figure 3 is that the perceived response to inflation remained subdued throughout 2021 and into 2022, despite large and persistent inflation surprises, and rose sharply only after the RBA began tightening policy in May 2022. This pattern is particularly notable given that RBA communication became progressively more hawkish over this period, even if it did continue to highlight the importance of preserving labour market gains.

This disconnect is illustrated in Figure 7, which plots the perceived inflation coefficient alongside a text-based measure of policy tone—a Hawk–Dove index constructed separately for meeting minutes and post-meeting statements by Jones (2025).[5] The tone of RBA communication shifts decisively in a hawkish direction prior to lift-off, with the index rising markedly in late 2021 and early 2022. Yet over this same period, the estimated inflation coefficient remains low.



Notes: The perceived inflation coefficient is the estimate from the simple policy rule. Hawk–Dove indices are constructed from RBA Minutes and Statements.
Sources: Authors' calculations; RBA; Jones (2025)

Figure 7: Perceived inflation coefficient, Hawk–Dove index, and interest rates.

Why, then, was communication insufficient to induce an earlier reassessment of the perceived inflation response? Following Bauer, Pflueger, and Sunderam (2024a), who document similar patterns for the United States and the euro area, we consider three potential explanations for the delayed increase in perceived policy responsiveness: (i) forecasters viewed the inflation surge as transitory; (ii) forecasters expected a persistent "lower-for-longer" policy framework; and (iii) forecasters primarily learned about the reaction function from realised policy actions under heightened

5. Methodologically, Jones (2025) construct the index using a supervised text-classification framework that guides a large language model with human-authored decision trees. Policy documents are scored on a five-point scale—dovish, leaning dovish, neutral, leaning hawkish, and hawkish—based on a balanced vocabulary capturing emphasis on inflation risks versus growth and labour-market concerns, and then standardised for comparability across sources and over time. In this context, *hawkish* denotes a tighter policy bias, reflecting greater readiness to raise or maintain interest rates in response to inflation risks, while *dovish* indicates a greater emphasis on activity and employment risks.

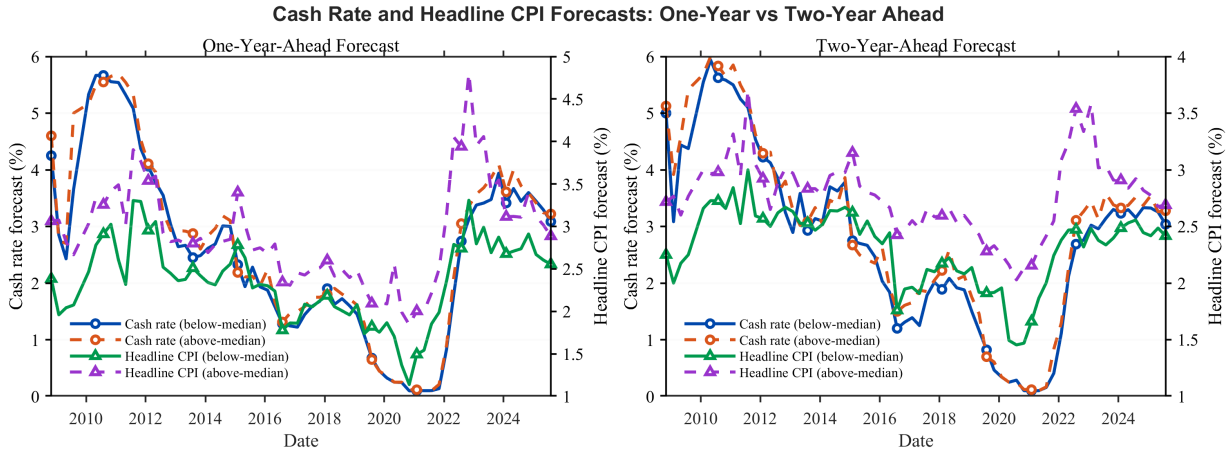
uncertainty.

4.3.1 Transitory inflation views

One potential explanation is that market participants viewed the inflation surge of 2021 as largely transitory. Under this interpretation, forecasters would have expected inflationary pressures to fade without requiring a strong monetary policy response, leading them to anticipate little immediate adjustment in the RBA's reaction function.

To assess this hypothesis, we partition forecasters into two groups based on whether their inflation forecasts lie above or below the cross-sectional median. If forecasters who anticipated more persistent inflation also expected a stronger policy response, they should have projected an earlier and more pronounced lift-off from the effective lower bound.

In practice, however, the two groups forecast remarkably similar paths for the cash rate during and following lift-off (Figure 8). This similarity indicates that differences in beliefs about inflation persistence alone cannot account for why the perceived inflation response remained muted until after policy tightening had begun.



Notes: Solid = below-median forecasts; dashed = above-median. Left axis: cash rate; right axis: headline CPI. Markers distinguish cash (circles) vs CPI (triangles).

Sources: Authors' calculations; RBA

Figure 8: Cash rate and headline CPI forecasts.

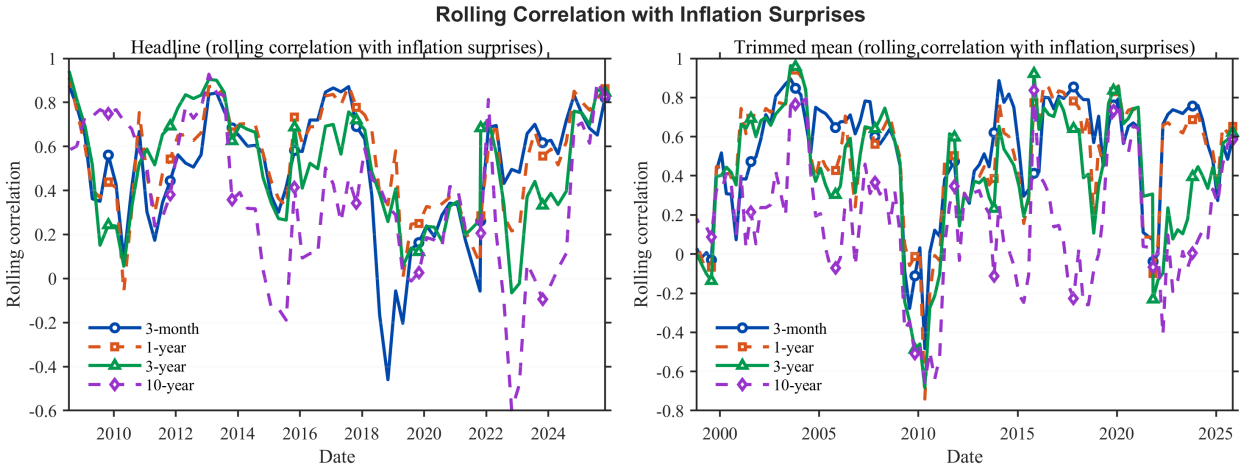
4.3.2 History-dependent or "lower-for-longer" expectations

A second possible explanation is that forecasters interpreted the RBA's strategy as deliberately history dependent, allowing inflation to temporarily overshoot the target following a prolonged period below it. Under such a framework—akin to average inflation targeting (AIT) or "lower-for-longer" policy rules—the central bank would tolerate near-term inflation without immediate tightening, while signalling a stronger response once cumulative inflation overshoots became sufficiently large.

If market participants expected this form of history dependence, longer-term interest rates should have become more sensitive to inflation surprises even while short-term rates remained

constrained. Figure 9 examines this implication by plotting correlations between inflation surprises (measured relative to Bloomberg median forecasts) and interest rates at various maturities.

The figure shows no economically meaningful increase in the sensitivity of longer-term rates to inflation surprises during this period. If anything, correlations at shorter maturities increase somewhat earlier.[6] Taken together, this evidence provides little support for the view that markets interpreted RBA policy through a "lower-for-longer" or average-inflation-targeting lens.



Notes: Each line represents rolling correlations (8-period window) between inflation surprises and bond yields at different maturities.

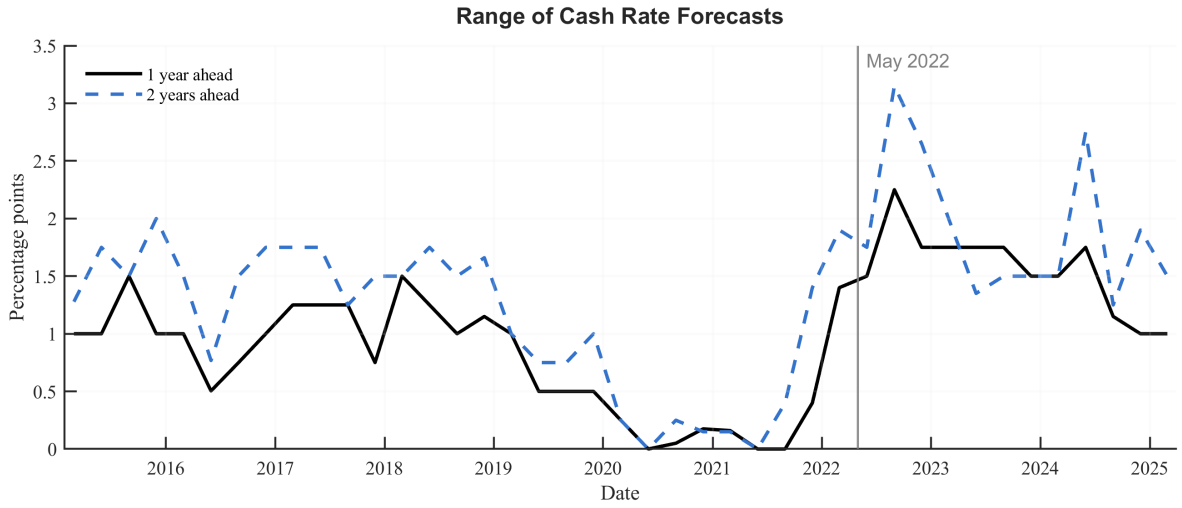
Sources: Authors' calculations; RBA

Figure 9: Correlations between inflation surprises and interest rates at various maturities.

4.3.3 Learning from monetary policy actions under uncertainty

The third—and most consistent—explanation is that forecasters required concrete policy actions to update their beliefs about the RBA's reaction function. During 2021–22, uncertainty surrounding the near-term policy outlook was unusually elevated: communication emphasised labour-market recovery and patience, while global inflation dynamics were shifting rapidly. As shown in Figure 10, the dispersion of one- and two-year-ahead cash rate expectations widened sharply as market participants attempted to infer both the timing and the pace of future tightening. Following the onset of rate increases in May 2022, and as tightening continued through 2023, this dispersion narrowed, suggesting that realised policy actions clarified the Bank's intentions.

6. A similar increase in the responsiveness of shorter-term rates has been documented elsewhere including the US, Euro area, Canada and UK (**bauer2024changing** ; **xia2026**)

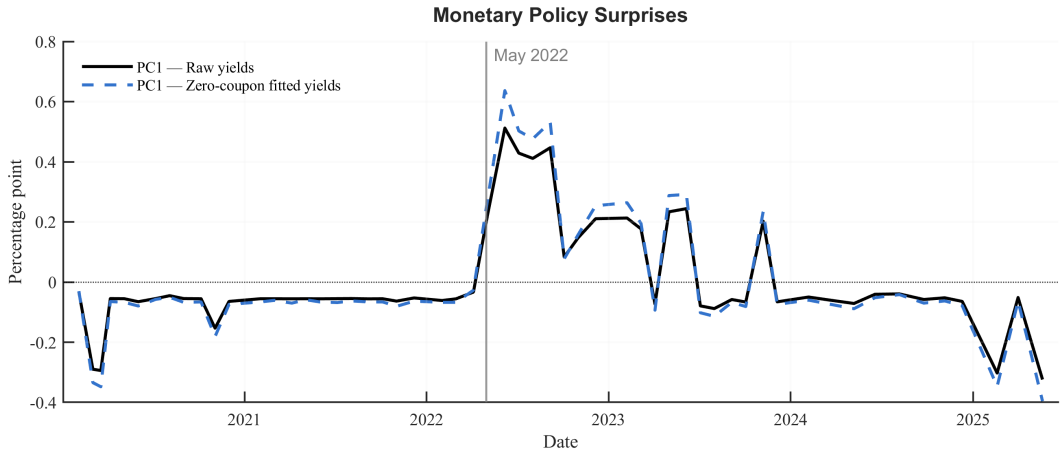


Notes: Range is defined as max minus min across forecasters at the indicated horizon.
Sources: RBA Market Economist Survey

Figure 10: Range of cash rate forecasts.

High-frequency evidence reinforces this interpretation. Figure 11 plots the first principal component of changes in zero-coupon yields with maturities up to one year around RBA announcements. The magnitude of policy surprises increased sharply following lift-off, consistent with substantial revisions in beliefs about the policy rule. Had market participants already internalised the RBA's intended strategy, post-announcement yield movements would have been more muted. Instead, the evidence suggests that forecasters learned about the renewed primacy of inflation control primarily from realised policy decisions.

Taken together, these results indicate that the re-anchoring of policy perceptions after 2022 was driven less by forward guidance and more by the sequence of actual rate increases. In periods of heightened uncertainty, communication alone proved insufficient; sustained policy actions provided the clearest signal of the RBA's true reaction function.



Monetary policy surprises, calculated as the first principal component of high-frequency changes around RBA announcements in raw and fitted zero-coupon yields with maturity up to 1 year. Vertical lines indicate liftoff in May 2022.
Sources: Authors' calculations; RBA

Figure 11: High-frequency monetary policy surprises.

4.4 Aiming for stars

As discussed in Section 2, our baseline specification uses forecaster–time fixed effects to absorb forecaster-specific views about long-run "star" variables, including the neutral real rate, the NAIRU, and the inflation target (or long-run inflation). A natural question is how effectively these fixed effects capture long-run beliefs when recovering the perceived policy rule. By relying on within-forecaster, cross-horizon variation, this approach deliberately abstracts from level differences across forecasters. While this helps isolate perceived policy slopes, it may also discard potentially informative cross-sectional variation if long-run beliefs themselves contain economically relevant information.

To assess this issue, we exploit the fact that the Market Economist Survey includes explicit questions on the NAIRU, long-run inflation, and the long-run equilibrium nominal interest rate (i.e. the nominal neutral rate) from 2024 onwards. Using these data, we re-estimate the model without forecaster fixed effects and instead directly incorporate forecaster-specific estimates of the star variables. We consider two variants. In the first, which we label the *Star model*, we include forecaster-level estimates of all three star variables. In the second, the *Star model—constrained*, we impose a common inflation target of 2.5 per cent and replace only the neutral rate and NAIRU with forecaster-specific estimates. This comparison allows us to assess (i) whether long-run inflation expectations exhibit meaningful dispersion, and (ii) whether that dispersion reflects noise or instead captures systematic differences in forecasters' broader views of the economy. The distinction is important for understanding how well inflation expectations are anchored.

Figure 12 summarises the results. First, the baseline and Star model estimates are very similar, both in levels and in their evolution over time. This finding suggests that the fixed-effects approach advocated by Bauer, Pflueger, and Sunderam (2024a, 2024b) provides a good approximation when direct measures of star variables are unavailable. Second, the constrained Star model yields no-

ticeably lower estimated inflation coefficients. Imposing a common long-run inflation expectation leads to a significant downward bias: forecasters with higher long-run inflation expectations—and therefore higher short-horizon inflation forecasts—are incorrectly treated as expecting larger inflation gaps. Because these forecasters do not, on average, expect correspondingly higher policy rates once differences in nominal neutral rates are taken into account, the estimated relationship between inflation gaps and expected interest rates is attenuated.

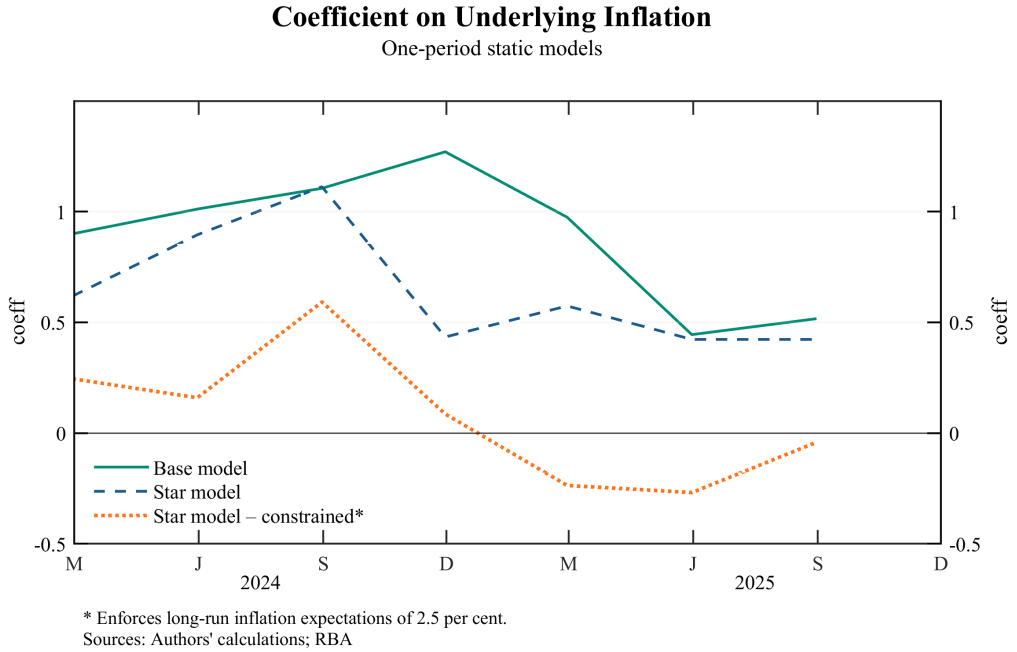


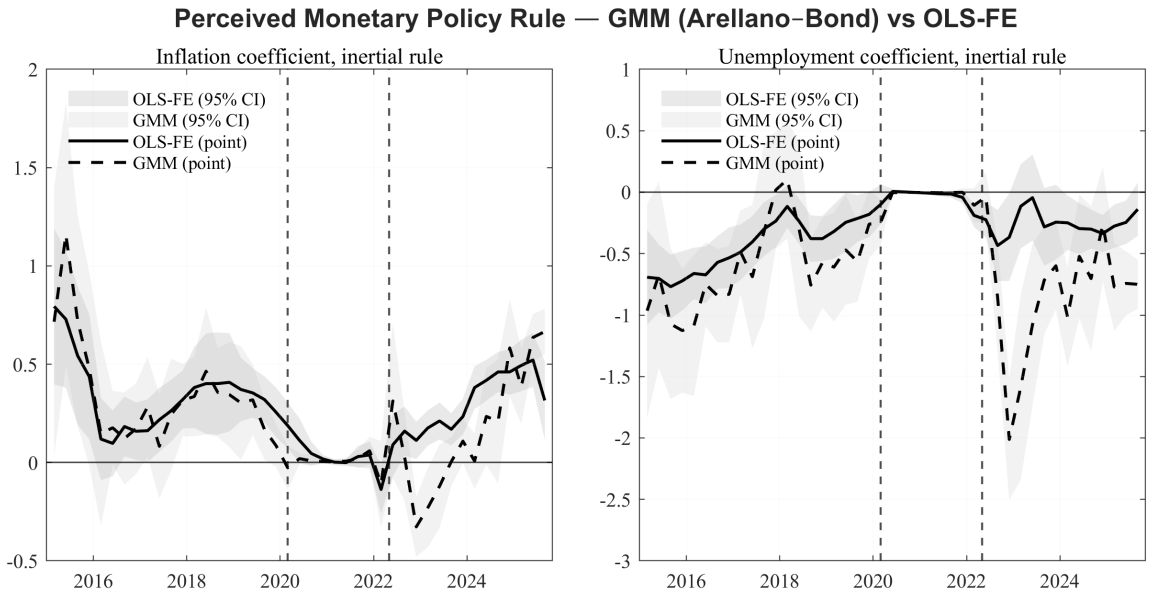
Figure 12: Perceived coefficients on inflation from star-variable models.

Overall, the evidence indicates that variation in long-run inflation expectations is both economically meaningful and systematically related to forecasters' broader macroeconomic views. This suggests that monitoring the distribution of long-run inflation expectations—not just their average—can provide valuable information about how monetary policy is perceived and how expectations are anchored.

4.5 Sensitivity analysis

We assess the robustness of our results to a range of modelling choices. First, Figure 13 compares estimates from the inertial specification obtained using Arellano–Bond GMM with those from an OLS estimator with fixed effects. The resulting time profiles are similar, particularly for the inflation coefficient: confidence bands largely overlap, and the key qualitative features—muted responsiveness in the mid-2010s and near-zero coefficients during the effective lower bound period—are preserved. One notable difference is that the inflation coefficient rises somewhat earlier under OLS, underscoring the importance of using an appropriate dynamic panel estimator when interpreting the timing of changes in perceived policy responsiveness. Differences are more pronounced for unemployment, with GMM yielding more negative estimates around 2022, consistent with it correcting

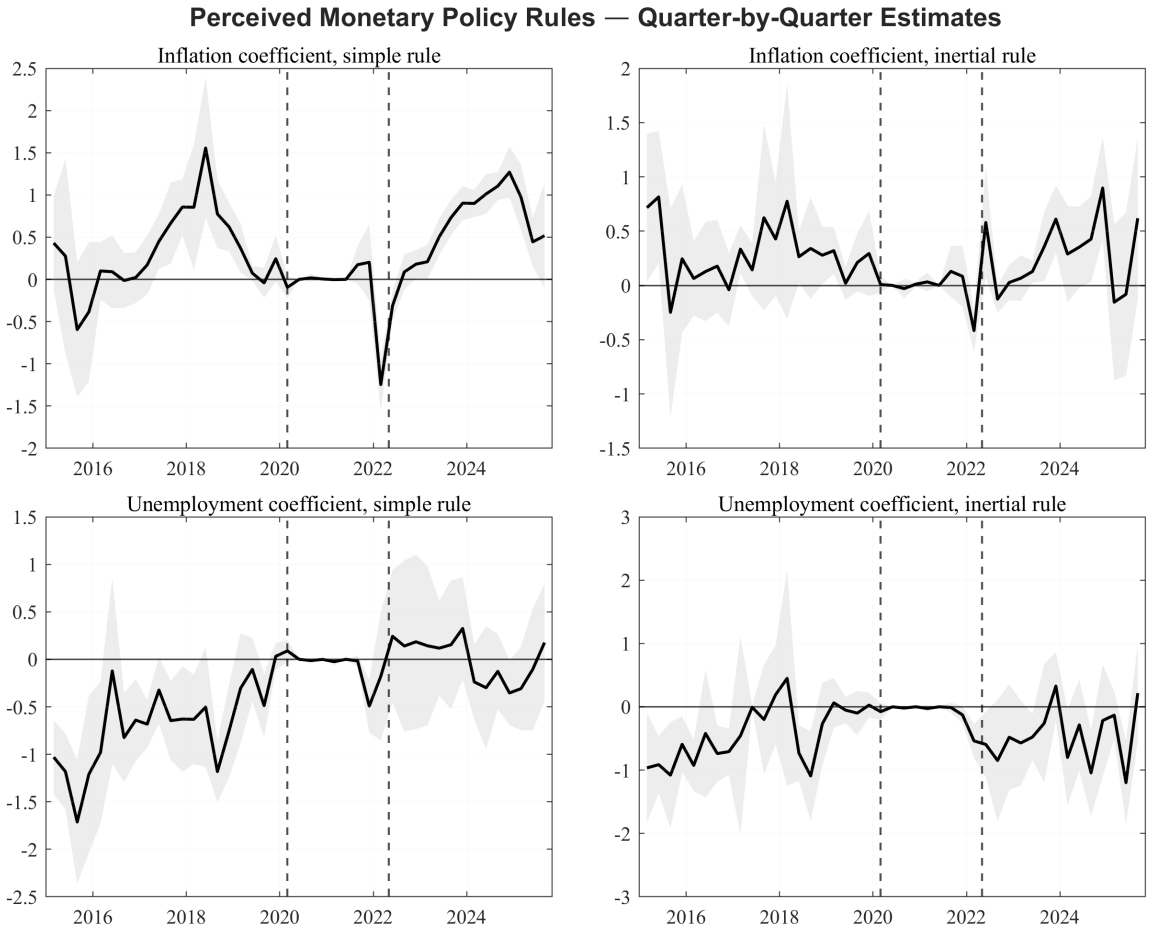
the small-sample bias that arises in dynamic panels with lagged dependent variables.



Notes: Coefficients of perceived monetary policy rules (inertial specification) estimated using rolling 4-quarter panel regressions on RBA market economist survey data (Feb 2015 – Aug 2025). Black lines are point estimates; grey areas are 95% confidence intervals with standard errors clustered by forecaster and horizon. Estimates labelled "GMM" use the Arellano–Bond estimator; "OLS-FE" runs OLS with forecaster fixed effects. Vertical dashed lines mark March 2020 and May 2022.
Sources: Authors' calculations; RBA

Figure 13: Perceived monetary policy rule (inertial specification): Arellano–Bond GMM versus OLS with fixed effects.

Second, Figure 14 reports quarter-by-quarter estimates rather than rolling-window averages. Although these series are naturally noisier, they convey the same message: perceived policy responsiveness to inflation is muted in the mid-2010s, close to zero during the effective lower bound period and rises materially thereafter once rates lift-off. The broad narrative is therefore unchanged, indicating that the headline results are not an artefact of the smoothing procedure.



Coefficients of perceived monetary policy rules estimated quarter-by-quarter from RBA market economist survey, February 2015 to August 2025. The left panels show estimates of the simple rule and the right panels show estimates that allow for monetary policy inertia. Gray-shaded areas are 95% confidence intervals based on clustered standard errors (by forecasters and horizon). Vertical lines show the zero lower bound period between March 2020 and May 2022.

Sources: Authors' calculations; RBA

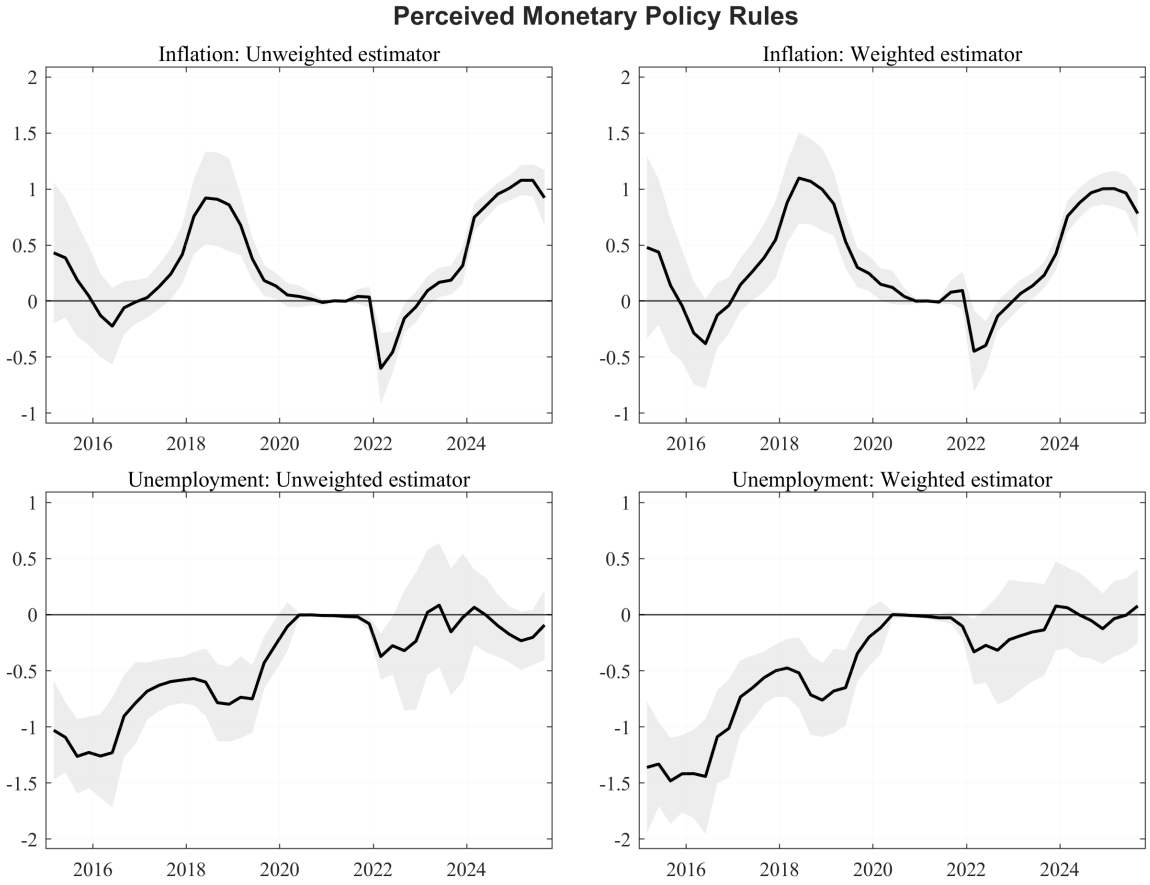
Figure 14: Quarter-by-quarter estimates of perceived policy rule coefficients.

Finally, we examine the robustness of our maintained assumptions that policy coefficients and star variables are constant across horizons. Two considerations motivate this exercise. First, forecasters may perceive the RBA's reaction function itself to vary by horizon—for example, assigning less weight to inflation in the near term but more weight over longer horizons. Second, forecasters may have different degrees of confidence in their perceived policy rule across horizons, effectively implying horizon-specific error variances. This could arise if short-run policy decisions are viewed as subject to greater discretion or noise, while longer-horizon forecasts better reflect beliefs about the underlying reaction function.

To address these possibilities, we allow for horizon-specific weighting in the estimation, adopting an approach consistent with the latter interpretation. Under the inertial specification, a one-unit shock to the policy rate decays at a rate of approximately 0.7 per period. We use this implied decay to construct horizon-specific standard deviations and weight observations by their inverse, yielding

a GLS-style estimator in which the error structure is disciplined by the model's dynamics.[7]

Figure 15 presents the resulting estimates. For both inflation and unemployment, the weighted and unweighted coefficients are nearly identical in both level and time profile. This similarity suggests that our assumptions of constant perceived reaction function parameters and star variables across horizons are reasonable and do not drive the main results.



Notes: Each panel shows point estimates (black line) and 95% confidence intervals (gray band) based on the simple rule without lagged cash rate.

Sources: Authors' calculations; RBA

Figure 15: Perceived coefficients on inflation and unemployment: unweighted versus weighted estimators.

5 What drives cash-rate disagreement?

Thus far, we have focused on the average perceived reaction function across forecasters. A natural question is whether disagreement about future cash rates reflects heterogeneity in perceived policy rules, or instead differences in expectations about future economic conditions. The distinction

7. An alternative would be to weight observations using the empirical variance of cash rate forecast errors. However, such variances mechanically increase with the forecast horizon as additional shocks accumulate, and would introduce time-varying weights that complicate interpretation.

has important implications for central bank communication. If disagreement primarily reflects uncertainty about the reaction function, clearer guidance about the policy framework may be most effective. If, instead, disagreement mainly reflects differing views about the economic outlook, communication may be better directed toward clarifying the assessment of incoming data and risks.

To address this question, we examine how well each forecaster's own outlook explains their expected cash rate at a given survey date, under the maintained assumption of a common perceived reaction function. Specifically, we estimate the survey-based Taylor-rule regressions described above and track the rolling R^2 from the forecaster–horizon panels. A high R^2 indicates that most dispersion in expected interest rates is accounted for by differences in expected conditions, while a low R^2 suggests a greater role for disagreement about the policy rule itself. Alternatively, low fit may also reflect disagreement about omitted policy-relevant variables or model misspecification, such as nonlinearities. We conduct this analysis using the static specification, as interpreting disagreement in the inertial model is complicated by the fact that past disagreement is mechanically propagated through the lagged interest rate term.

Disagreement in the level of expected cash rates is sizable at key turning points. As shown in Figure 10, the cross-sectional range (max–min) of one- and two-year-ahead expectations is roughly 1 and $1\frac{1}{2}$ percentage points, respectively, during 2015–2019; collapses toward zero at the effective lower bound; widens sharply through 2021 as lift-off approaches; and then narrows again toward historical norms in 2023–2024.

Figure 16 (left panel) shows that for most of the sample, around 60–80 per cent of the variation in expected cash rates is explained by differences in forecasters' own outlooks. Roughly half of this explanatory power reflects heterogeneity in beliefs about long-run "star" variables, such as the neutral rate (r^*), the NAIRU (u^*), and long-run inflation (π^*).[8]

Two episodes stand out. First, in 2016 the R^2 declines, consistent with a period in which communication elevated housing and financial-stability considerations and markets inferred a relatively weak inflation response. The reduction in explainability could reflect disagreement about the reaction function itself—specifically the relative weight placed on inflation versus financial-stability objectives. Alternatively, it may reflect disagreement about the outlook for those additional considerations, which are omitted from the baseline rule. Without direct forecasts for housing prices or related variables, we cannot disentangle these channels. Nevertheless, in either case, the episode reinforces earlier findings that communication around financial stability had important implications for perceived policy rules.

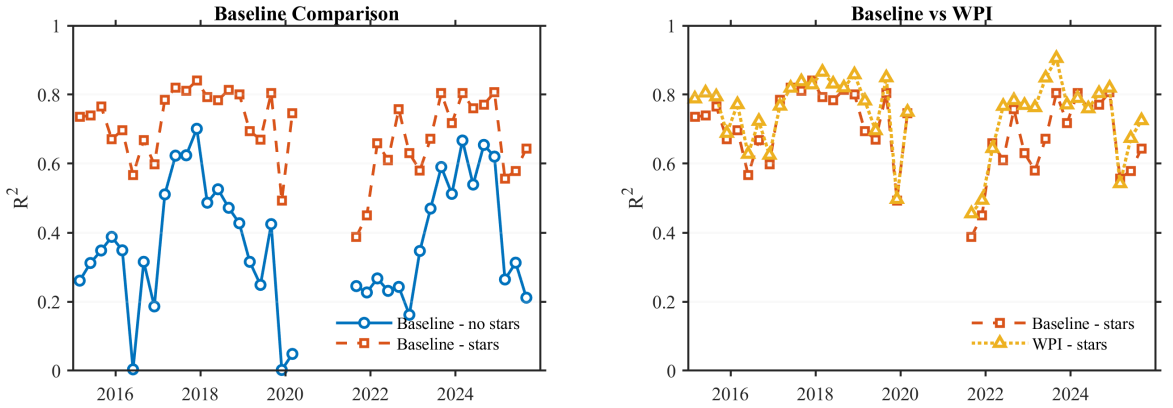
A second decline in fit occurs in 2022–2023, coinciding with a renewed widening in the dispersion of cash-rate expectations (Figure 10). Part of this appears to reflect the perceived importance of wage outcomes in the policy rule during this period, coupled with disagreement about wage dynamics. Consistent with this interpretation, augmenting the rule to include wage growth (WPI)

8. We assess the contribution of star-variable beliefs by comparing rolling R^2 values from specifications that include forecaster-specific fixed effects—which absorb r^*, u^*, and π^*—with variants that omit them. The resulting change in fit provides an indicative decomposition.

substantially attenuates the decline in R^2 (Figure 16, right panel).

Taken together, these patterns reinforce a broader narrative: clearer guidance about which observable conditions are relevant for policy decisions tends to align beliefs about the reaction function and reduce disagreement. When market participants infer that additional conditioning variables have entered the policy rule, disagreement naturally increases until those beliefs are validated by subsequent data and policy actions.

One final period of note is 2025, when explainability declines again—even after including wage growth in the specification.So it appears there was increased disagreement about the reaction function at this time.



Note: Rolling R^2 from forecaster--horizon Taylor-rule regressions. The left panel compares Baseline models with and without stars; the right panel compares the Baseline with the WPI extension.
Sources: Authors' calculations; RBA

Figure 16: Share of variation in expected cash rates explained by differences in expected conditions.

6 Conclusion

This paper provides a time-varying account of how professional forecasters financial markets perceive the Reserve Bank of Australia's reaction function. Using forecaster-level expectations across horizons, we recover perceived policy rules and link their evolution to communication, disagreement, and high-frequency announcement-window surprises. Several themes and lessons emerge.

First, reaction functions perceived by market participants can differ markedly from those embedded in standard macroeconomic models. This has important implications for interpreting movements in yield curves and for the use of such models in policy analysis and scenario design, particularly when assessing the stabilising role of systematic monetary policy.

Second, central bank communication can materially influence perceptions of the reaction function. This is evident in the mid-2010s, when communication emphasising financial-stability risks coincided with a perceived weakening of the inflation response, and in the post-COVID period when discussions of preserving labour-market gains and conditioning policy on wage growth shaped market beliefs. These episodes highlight both the power of clear, targeted communication and the risk that communication may shift perceptions in unintended ways.

Third, actions can speak louder than words, especially under heightened uncertainty. In the period following COVID, increasingly hawkish communication did not translate into a stronger perceived inflation response until policy tightening actually commenced. Sustained policy actions, rather than forward guidance alone, ultimately re-anchored beliefs about the primacy of inflation control.

Fourth, most disagreement about future interest rates reflects disagreement about future economic conditions rather than disagreement about the reaction function itself. This suggests that when central banks seek to align expectations across agents, communication may be most effective when directed toward clarifying the assessment of economic conditions and risks, rather than restating the policy framework.

Finally, dispersion in long-run inflation expectations is an important driver of heterogeneity in interest rate expectations. These differences reflect systematically different views about the economy, underscoring the importance of looking beyond average measures when assessing the anchoring of inflation expectations and the formation of beliefs.

Taken together, our findings underscore the value of clear communication, reinforced by consistent policy actions, in shaping expectations and enhancing the effectiveness of monetary policy.

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