Submission

By

THE NEW ZEALAND INITIATIVE

to the Reserve Bank of New Zealand

on its

Consultation Paper
on the Monetary Policy *Remit*

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1 INTRODUCTION AND SUMMARY

1.1 This submission responds to the Reserve Bank's 1 June 2022 consultation paper, *Supporting New Zealand's economic stability*. The Bank's consultation process is part of the review of the monetary policy remit that is required at least once every five years.

1.2 This submission is made by The New Zealand Initiative (the **Initiative**), a think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.

1.3 The Initiative undertakes research that contributes to the development of sound public policies in New Zealand and the creation of a competitive, open, and dynamic economy and a free, prosperous, fair, and cohesive society.

1.4 The Initiative's members span the breadth of the New Zealand economy, including the financial sector. However, the views expressed in this submission are the views of the author, not those of our members.

2 BACKGROUND

2.1 Section 9 (1) of the Reserve Bank of New Zealand Act 2021 sets the Bank the twin economic objectives of:

i. Achieving and maintaining stability in the general level of prices over the medium term; and

ii. Supporting maximum sustainable employment.

2.2 The Remit's prime purpose is to provide operating targets consistent with the pursuit of those economic objectives. The consultation paper seeks submitters' comments on twelve matters:

1. The Paper's design principles for the review and global practice;
2. The current 1 to 3 percent target range for inflation;
3. The use of the All Groups Consumers Price Index as the inflation measure;
4. How the maximum sustainable employment objective could be best estimated, or interpreted;
5. What changes to the Remit should the RBNZ focus on;
6. Should the remit provide guidance as to the relative importance of the two objectives;
7. Should the remit provide guidance to the Monetary Policy Committee on how to respond to future economic downturns;
8. The additional considerations currently in the remit;
9. House price sustainability in relation to the remit;
10. Distributional aspects of monetary policy;
11. The relevance of climate change to monetary policy; and
12. Any other monetary policy issues.

2.3 This submission responds in respect of matters 2, 3, 4, 5, 6, 7, 8, 9, 10, 11 and 12.

3 SUMMARY RESPONSES

3.1 The following table summarises our responses

Number	Issue	Response
2	Target range	Returning to a 0-2% range merits serious consideration
3	CPI	Concur with its being the central measure
4	MSE	Monetary policy cannot achieve MSE, however measured
5	Remit focus	Simply the target range for the CPI
6	Weights	The greater the weight on the price objective, the better
7	Downturns	See the answer to 6
8	Additional	Delete from the Schedule the matters specified below
9	House prices	Monetary policy affects asset prices, and not just through the exchange rate. Asset price volatility can broadly affect financial system stability (as it did in the GFC).
10	Distributional	No, one instrument, one objective
11	Climate	No, one instrument, one objective
12	Other	It is akin to economic sabotage not to have relevant outside expertise on the MPC and the RBNZ board.

4 ELABORATION

4.1 **The target range.** The low rates of traded goods price inflation internationally that followed China's integration into global trade were arguably benign. The attempts by central banks to lift CPI inflation undermined the concept of price (level) stability and put inflation expectations at risk. If section 9(1)(i) of the Reserve Bank Act is to be taken literally, as it should be, the Reserve Bank should commission an expert review of the All Groups Consumers Price index to assess what average annual rate of increase in that index would be consistent with "achieving and maintaining stability in the general level of prices over the medium term".

4.2 **Maximum sustainable employment (MSE).** This is a fuzzy and distracting concept. There is no measure of it that cannot be reasonably contested technically. Expert opinion is that monetary policy cannot determine the level of employment enduringly. There is room for debate about how accurately in can 'fine-turn' the path for the real economy without undermining its price stability objective. People may misread or mistrust central bank signals and there are many uncertainties about transmission channels.

4.3 Although this is beyond the scope of the review of the remit, the current government's imposition of a dual mandate is a mistake that undermines the credibility of the inflation objective. What is a central bank to do under a dual mandate when the objectives conflict? They do when stagflation is the problem. Section 9(1)(a)(ii) should be removed from the Act and related references to it from the Schedule.

4.4 **Delete peripheral matters from the remit's current schedule.** These include:

- the section headed "The Government's economic objective" (It is mere political grandstanding at best – and could be a distraction at worst.)
- The first sentence under "context" (It is also irrelevant to what the Act requires.)
- Section 2(2)(d) and (3) which also seek to introduce contending considerations for monetary policy.

4.5 **Under the remit heading "Operational Objectives" the wording of 2(1)(b) could be improved.** If the dual mandate is removed, it could be deleted.

4.6 **House prices and asset markets more generally.** Asset prices in the major economies have been artificially inflated by easy money and the perception that the monetary authorities will 'do whatever it takes' to prevent major crashes. This dates back at least to the "Greenspan put" era. The underlying concept – that profits are private, but losses will be borne by taxpayers – has rightly offended the public globally and undermined confidence in the probity of bankers and others. Official risk weightings that favour lending to government and for housing may be part of the problem. These concerns raise issues that are outside the scope of the review of the remit.

4.7 **Other matters.** It is hugely damaging to a central bank when experts in financial markets can see that key appointments have no credible expertise or experience. Outsiders appointed to the Monetary Policy Committee should have recognisable familiarity with monetary policy and a good understanding of financial markets. Appointees to the Reserve Bank board should also have expertise in evaluating responses for financial market crises. Again, this observation is outside the scope of the remit.