

# The monetary policy decision-making process

This note describes the processes by which the Governor is advised on monetary policy issues. It details the composition and role of the Monetary Policy Committee (MPC). Emphasis is given to the nature and sequence of MPC discussions leading up to the OCR decision and publication of the *Monetary Policy Statement*.

## Introduction

1. This note describes the processes by which the Governor is advised for the purposes of OCR reviews and publication of the *Monetary Policy Statement*. In this paper, we focus on the way in which views are formed and issues debated. The paper [\*“The projection process and accuracy of the RBNZ projections”\*](#) covers the types of information brought to bear on the assessment and policy decision on each occasion, and discusses how that information is processed in forming a view on the economic outlook and risks associated with it.
2. Key points in this paper include that:
  - the policy assessment process is intensive and draws directly upon the knowledge and experience of senior Bank officials;
  - issues are debated openly and robustly, with the aim of appropriately capturing the range of reasonable policy options confronting the Governor;
  - the process systematically incorporates information and views from a range of internal and external sources; and
  - the Governor is actively involved in the discussion at all points.
3. In the rest of this note, we outline the activities of the Monetary Policy Committee during the main phases of the policy assessment round, to illustrate each of these points.

## The Monetary Policy Committee

4. The Monetary Policy Committee (MPC) is a group of senior Bank officials that meets weekly to advise the Governor on issues relating to the formulation and implementation of monetary policy. The MPC has no basis in legislation, and is expressly *not* a decision-making committee. MPC members do not vote and minutes are not published. Rather, the intent of MPC discussions is to ensure that the Governor is exposed in a systematic way to alternative views and a broad sweep of opinion throughout the policy assessment process. Members of the OCR Decision Group (ODG) – a subset of MPC with membership limited for security reasons – each have the duty to provide a written recommendation to the Governor regarding the OCR decision whenever it is reviewed.

5. The MPC's and ODG's terms of reference and details about their membership are shown in the [Appendix](#).

### ***Monetary Policy Statements and the policy assessment process***

6. The Reserve Bank's four *Monetary Policy Statements* each year, published roughly quarterly, provide the main vehicle for expressing our view about the outlook for the economy and inflation pressure, and for discussing the policy issues we see as salient at any particular time. Each *Statement* is accompanied by an OCR announcement. In addition to these four 'major' OCR reviews, we schedule 'interim' OCR reviews between *Statements*, providing a total of eight OCR reviews per annum.
7. The conduct of monetary policy is not simply about the particular setting of the OCR on each occasion. As discussed in greater depth in the paper "[Publication of projections](#)", financial markets and the general public also pay close attention to our discussion in *Statements* of the outlook for the economy, the risks around that outlook on each occasion, and the policy issues associated with our assessment and the OCR decision. Therefore, the MPC spends a lot of time discussing the outlook, and the content and drafting of the *Statement*.
8. Our published central projection is a key part of the policy assessment and has a strong relationship to the chosen OCR setting. However, we do not think of it so much as the 'driver' of the OCR decision in a mechanistic sense, but rather as a framework for the systematic analysis and assessment of the economic outlook, and as a benchmark against which to characterise risks and issues in a formal way. The projection is the product of a host of contestable empirical and theoretical assumptions, and sensitive to different views on those assumptions.
9. Moreover, our model-driven projections feature "endogenous" monetary policy – in other words, a projection for interest rates consistent with the maintenance of price stability *given* the view of inflation pressure encapsulated within the model framework. That policy projection is itself generated by a benchmark or "rule of thumb" characterising the response of interest rates to variations in (future) inflation pressure (in the jargon, a "reaction function"). Given any view of future inflation pressure, though, there are a range of interest rate projections consistent with price stability that could be chosen instead of the model's benchmark projection. For example, the Bank could choose to adjust interest rates faster or slower than the benchmark projection.
10. The contestability of assumptions and availability of non-trivial policy choices – given any particular set of observable facts – make it essential that the Governor and the MPC thoroughly explore the range of views of what is reasonable prior to drafting each *Statement* and prior to the Governor's OCR decision. The series of MPC meetings and sequencing of the presentation of information to MPC are designed with that purpose in mind.

## Three phases of discussion and consideration

11. The policy assessment process from the beginning of the forecasting round (marked by the completion of the forecasting group's business visits) to the publication of the *Statement* spans about eight weeks. The paper [\*"The projection process and accuracy of the RBNZ projections"\*](#) discusses the forecasting process; in this paper we focus on the nature of the discussions at MPC through the *Statement* round. There are three broad phases: first, a "broadening" of thought, setting the scene and canvassing the issues to be explored in depth; second, presentation and discussion of the forecasting group's formal analysis of the data, the model-based projection, and associated policy issues; and finally, a "narrowing" towards an agreed central projection, content for the *Statement*, and the OCR decision itself.

### Broadening

12. The thought-broadening process occurs in the fourth week of the *Statement* round. Information from a range of sources (listed in full in the [\*Appendix to "The projection process and accuracy of the RBNZ projections"\*](#)) is tabled and discussed, including the findings from the business visits, a summary of the latest economic forecasts from a range of private and public sector organisations, and the key issues about the upcoming assessment to be explored in greater depth during the process. Also, at this point selected members of MPC are asked to write and table short notes advocating a "hawkish" policy stance (ie one that perceives a threat of rising inflation), and a "dovish" policy stance (a scenario of weaker inflation pressures). Each member must write both to encourage balance while canvassing a wide range of plausible alternative scenarios and policy recommendations.
13. The tabling of the commissioned hawk and dove scenarios is deliberately done at the broadening phase of the process – *before* the formal and systematic analysis presented by the forecasting group. The idea here is to encourage relatively unconstrained and impressionistic thought by the MPC about the outlook, so that the precise benchmark projection numbers are consciously set in the context of a wide array of alternative views of the economy.

### Formal forecast presentation

14. The forecasting group's presentation of the benchmark projection (the development of which is discussed in detail in [\*"The projection process and accuracy of the RBNZ projections"\*](#)) takes place at the beginning of the fifth week. The implications of latest data, the forecasters' judgement and other assumptions are presented using the medium-term macroeconomic projection as a framework. Forecasters also present sensitivity analyses and risk scenarios requested by the MPC, and note the key policy issues that they consider the projection development process has highlighted.

15. Later in the week, the MPC meets again to consider the forecasters' presentation and discuss the issues raised. The hawk and dove scenarios are revisited in the context of the benchmark projection, and MPC members discuss their own considered views of the outlook.

### **Narrowing**

16. The third, "narrowing", phase of the process occurs in the sixth week as the OCR decision is approached. The MPC directs the Bank's forecasters to make any adjustments to the projection that may be necessary before incorporation as the central projection into the published *Statement*. Given that central projection, the OCR Decision Group meets to provide specific recommendations to the Governor regarding the OCR decision and the accompanying content in the *Statement*.
17. ODG members are each invited to discuss their written recommendations, distributed some days earlier. After listening to the discussion, the Governor announces to the group his provisional decision about the OCR, his rationale for that decision and, as a consequence, directions for the content and tone of the *Statement*. Considerations for the content of the *Statement* include the choice of alternative scenarios and risks to illustrate, and text boxes covering special issues.
18. The remaining two weeks of the *Statement* round consist of drafting and production activities. The Prime Minister, Treasury Ministers and Treasury officials are briefed on the *Statement's* contents – without disclosure of the OCR decision itself – one or two days before the release of the *Statement*. The Governor's OCR decision is finalised on the morning of the day before release.

## Appendix

### Monetary Policy Committee: Terms of reference

- Membership:**
- |                                 |  |
|---------------------------------|--|
| Governor Brash                  |  |
| Deputy Governor Sherwin (Chair) |  |
| Deputy Governor Carr            |  |
| Chief Managers                  | Economics<br>FMD<br>BSD                                      |
| Managers                        | Forecasting<br>MPI<br>Economic Issues<br>Modelling<br>Policy |
| Senior Advisors & Advisors      | FMD<br>Economics   |
| Secretary                       | Provided by MPI/Forecasting                                  |
- Additional participation will be drawn from Economics and FMD as appropriate to the issues under discussion.
- In attendance:** Manager, Corporate Affairs (as necessary)
- Frequency:** Weekly, normally at 3.00 p.m. Tuesdays. Where the agenda is light or non-urgent, the meeting may be cancelled at the initiative of the Chair.
- Functions:**
- To consider, and advise the Governor on, issues relating to the formulation and implementation of monetary policy.
  - To provide a forum for the exchange of information on, and analysis of, current developments in financial markets and newly released economic data.
  - To provide a forum for the consideration of research and analysis relevant to the formulation and implementation of monetary policy.
  - To consider and establish priorities for future research and analysis of monetary policy and related issues.
- Important note:** With respect to the key monetary policy issues, MPC is not a decision-making body. Rather, its role is to provide advice to the Governor, thus assisting him in his statutory role as the sole monetary policy decision-maker.
- Minutes:** Minutes of the meetings should record those in attendance, provide summaries of the significant discussions and themes

