Memorandum of Understanding between the Minister of Finance and the Reserve Bank of New Zealand regarding the use of alternative monetary policy tools

This Memorandum of Understanding between the Minister of Finance (the Minister) and the Reserve Bank of New Zealand (the Bank) sets out a process by which the Bank may request an indemnity from the Crown pursuant to section 65ZD of the Public Finance Act 1989 (the PFA) in relation to any financial losses arising out of, or in connection with, the use of alternative monetary policy (AMP) tools in New Zealand.

The Minister and the Bank agree as follows:

1. **Purpose of AMP tools**

   The purpose of any AMP tools is to **best enable the Bank, acting through the Monetary Policy Committee (MPC) to continue to meet the economic objectives** as specified in the remit and section 8 of the Reserve Bank of New Zealand Act (1989) (the Act).

   Achievement of these objectives is monetary policy's best contribution to the prosperity and well-being of New Zealanders, and to a sustainable and productive economy.

   Since 1999, the Bank has used the Official Cash Rate (OCR) as its primary monetary policy tool. However, in the event that the OCR could not be lowered further in response to economic developments that compromised the achievement of the economic objectives, AMP tools may be required.

2. **Authority to use AMP tools**

   The Act provides the MPC the responsibility to formulate monetary policy and the Bank to implement the decision of the MPC. It does not specify or limit the tools which the Bank may use for this purpose. The starting point is that this is a matter of operational independence for the Bank.

   For the purposes of clarification only, some alternative monetary policy tools potentially available to the MPC include, but are not limited to:
3. Process for requesting indemnity

While the Bank has the capacity to use AMP tools such as those specified above, the Minister and the Bank recognise that the use of some of these tools results in a significant increase in financial exposure for the Crown. The Bank recognises that this needs to be balanced against its operational independence.

Without an indemnity for its potential financial exposure, the Bank's view is that it would not have sufficient capital to use these AMP tools were they necessary to achieve the economic objectives. In the Bank's view, an appropriate indemnity would enhance the Bank's credibility in using the AMP tools.

For this reason, the Minister and Bank agree that a process should be followed for requesting a Crown indemnity prior to the use of any AMP tools by the Bank.

The process for the Bank to request an indemnity from the Crown is as follows:

a. The Bank write to the Minister requesting an indemnity for losses arising out of, or in connection with, the use of an AMP programme. This letter will set out the nature of the AMP tool, the scale and description of the financial risk of the programme, the proposed duration of the indemnity and any other information that may be relevant in the context of that particular AMP tool.

b. The Minister to consider the request, on behalf of the Crown, in accordance with section 65ZD of the PFA. The Minister must consider the merits of each request in accordance with the requirements of section 65ZD.

c. If the Minister agrees to give an indemnity on behalf of the Crown under section 65ZD of the PFA, the Minister will respond on this basis to the Bank. The reply will set out any terms and conditions attached to the indemnity (e.g. reporting requirements, risk management controls, term or dollar figure limits).

d. Both parties will agree a Letter of Indemnity or an equivalent document that sets out the terms of indemnity.

e. The exchange of letters and indemnity documentation will be published online.
4. Reporting and accountability

The Bank is, at least four times a year, required to report on monetary policy, as per section 15C of the Act (Regular reports on monetary policy). These reports must (among other things) specify the approach by which the MPC intends to meet its operational objectives, and the MPC’s reasons for adopting that approach. Such reports would therefore include an explanation of any AMP tools used.

The Bank must review and assess the formulation and implementation of monetary policy at least every five years, as per section 15D of the Act (Longer-term report on formulation and implementation of monetary policy). This review would incorporate an analysis of any AMP tools used, including their effectiveness in enabling the MPC to achieve its economic objectives and any other consequences of these tools on the New Zealand economy.

The Minister and the Bank agree to review this Memorandum of Understanding at least every five years and on any earlier date as agreed by the Parties.

Ho Grant Robertson
Minister of Finance

Adrian Orr
Governor
Reserve Bank of New Zealand

Dated 21 March 2020