Reserve Bank of New Zealand
Te Pūtea Matua

Have your say

Toitū te Ōhanga
Supporting New Zealand's Economic Stability

A public consultation on the five-year review of the *Remit* that guides monetary policy decisions.

We're asking New Zealanders for feedback on the *Remit* for monetary policy so that we can be confident we're making the best economic decisions over the next five years.

The *Remit* is the document that guides our Monetary Policy Committee's decision making on monetary policy and Official Cash Rate adjustments every six weeks.

It is important that the long-run settings in the *Remit* are relevant and fit-for-purpose to allow for past and future changes in the economy.

Consultation is open from 1 June – 15 July 2022. You can have your say by completing a quick survey or reading the full Consultation Paper and submitting your feedback.

Find all the links at the end of this Summary Guide.

Why Monetary Policy Matters

The economy goes through 'boom and bust' cycles; times of strong economic growth, high employment and increasing prices, followed by times of recession, where unemployment is high, demand is low, and inflation is low. Monetary policy helps stabilise these cycles; reducing demand for goods and services when the economy is overheating, and vice versa.

Monetary policy influences the general increase in inflation, people's wages and savings, and whether they can borrow and at what cost. When our incomes and the prices of goods and services are stable, we can get on with our lives. We can budget and make plans for the future, and we can have certainty around the lifetime value of our loans and investments.

Whether you are working or retired, a saver or a borrower, monetary policy affects you.

New Zealand's monetary policy framework

The Reserve Bank Act specifies the Monetary Policy Committee's economic objectives of price stability and maximum sustainable employment.

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Government gives guidance to the MPC about how to fulfill the economic objectives in practice through the *Remit*.

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The *Remit* is reviewed every five years and is open to feedback from the public.

Have your say

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MPC use the *Remit* guidance when determining monetary policy and setting the Official Cash Rate (OCR).

The role of the monetary policy *Remit*

The Monetary Policy Committee (MPC) is the decision-making group at the Reserve Bank that is responsible for making monetary policy decisions.

The Reserve Bank Act tasks the MPC with maintaining price stability and supporting maximum sustainable employment, or the highest amount of employment the economy can maintain without creating excess inflation. These economic objectives are thought to be the best contribution that monetary policy can make to economic wellbeing.

Monetary policy steers the economy, and the ***Remit*** guides how best to go about this. The *Remit* can provide targets for the economic objectives, guidance how the MPC should go about achieving these targets, and sets out what other factors the MPC should take into account in its decisions.

Why we are reviewing the *Remit*

Every five years, the Reserve Bank will advise the Minister of Finance about possible changes to the *Remit*. This review is now underway.

We want to hear about what matters to you, and any changes to the *Remit* you think could better support the economic wellbeing of New Zealanders, both now, and through whatever economic changes may come our way.

Five principles have been developed to ensure that the future *Remit* guides the MPC to make decisions that work best to enhance the economic wellbeing of New Zealanders.

Legitimacy

The *Remit* aligns with the MPC's economic objectives of price stability and maximum sustainable employment.

Credibility

The public hold a durable belief that the MPC can achieve the objectives in the *Remit*.

Achievability

Monetary policy has a clear and measurable effect on every objective in the *Remit*.

Flexibility

Targets for the economic objectives are not so strict as to adversely impact overall wellbeing.

Clarity and transparency

The public can monitor the performance of the MPC against the *Remit*.

Over the past three decades, inflation has been generally low, and more stable and predictable.

Inflation targeting has contributed to the wellbeing of New Zealanders by keeping inflation generally low, and supporting the ecomomy and employment through a range of economic conditions.

Monetary policy keeps inflation low and stable ...

In 1990, New Zealand led the world by being the first country to adopt 'inflation targeting'. Monetary policy is still tasked today with keeping inflation low and within a target range.

The objective of keeping inflation within target is easy for the public to understand. Expectations of future inflation have become anchored to the target, making it easier for the MPC to achieve price stability.

As the public became more confident that price stability would be maintained, monetary policy was able to take into account how it affected the economy in other ways.

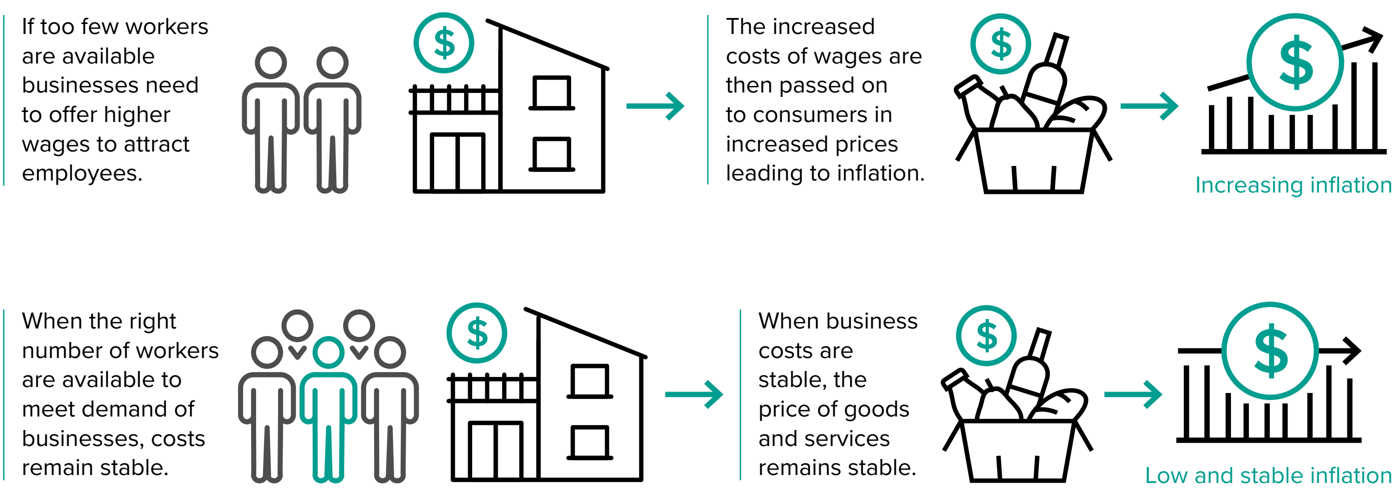
... and supports maximum sustainable employment

Employment allows people to support themselves, their whānau and their wider community, which is essential for physical and mental wellbeing. In 2019, monetary policy was given a new objective to support maximum sustainable employment (MSE).

Monetary policy is about achieving low inflation together with supporting employment being near MSE because:

- if unemployment is too high, lower incomes will reduce spending, and lead to a lowering of prices and a reduction in inflation. Similarly, if unemployment is too low, demand for goods and services will increase. Businesses will compete for workers to produce more, and higher wage costs and prices are likely to result.
- without price stability, employment cannot be maintained near MSE. If inflation is too high, workers will demand higher wages to compensate for higher prices, and businesses will respond by increasing prices further. Higher interest rates will be required to reduce demand and control inflation, resulting in less need for employees, and an increase in unemployment.

The impact of employment on prices



The following sections set out the three main ways the *Remit* could be changed. More detailed discussion and supporting research is contained in the full Consultation Paper. We would like your feedback on which aspects of the *Remit* we should consider in-depth.

Part A

Defining the economic objectives

The pros and cons of changing the operational targets for the MPC's economic objectives of price stability and MSE.

Achieving low and stable inflation, while supporting employment near MSE, is the best contribution of monetary policy to economic wellbeing.

Price stability

The current inflation target is consistent with the principle that low, positive and stable inflation is monetary policy's best contribution to long-term economic prosperity. High and volatile inflation makes it difficult to make long-term investments, and makes day-to-day planning more difficult. On the other hand, inflation that is too low makes it more difficult for the MPC to support the economy during a recession, where unemployment rises sharply, and incomes and spending drop. Changing the inflation target could erode trust in the MPC achieving price stability over time.

The current *Remit* directs the MPC to monitor inflation using the Consumers Price Index published by Statistics New Zealand. This index measures the change in prices for a representative basket of goods and services purchased by New Zealand households, such as fruit, petrol, haircuts, university fees, toys, life insurance, rent, and the construction of new housing. While there are alternative ways to measure price stability, the CPI has been a critical guide for monetary policy decision-making for an extended period.

Price stability objective – current *Remit*

"keep future annual inflation between 1 and 3 percent over the medium term, with a focus on keeping future inflation near the 2 percent midpoint".

Low and stable inflation

Maximum Sustainable Employment

While the *Remit* has an explicit inflation target, there is no equivalent for MSE. This is because MSE changes over time due to factors such as demographics, and employment conditions, and other factors that are unrelated to monetary policy. The Reserve Bank uses a range of indicators to monitor MSE, but a single comprehensive measure does not exist.

Maximum sustainable employment objective – current *Remit*

"… consider a broad range of labour market indicators to form a view of where employment is relative to its maximum sustainable level, taking into account that the level of maximum sustainable employment is largely determined by non-monetary factors that affect the structure and dynamics of the labour market and is not directly measurable."

Part B

Achieving price stability and maximum sustainable employment

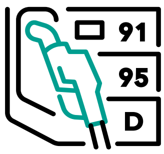
The trade-offs involved in determining how prescriptive the *Remit* is about the MPC's strategy.

The MPC makes difficult judgements about how best to achieve price stability and support MSE.

Deciding how much guidance to put in the *Remit* is a balance. A more prescriptive *Remit* provides more certainty to the public about how the MPC will respond to changes in the economy, but also reduces the MPC's flexibility to respond to unexpected circumstances.

Returning inflation to target

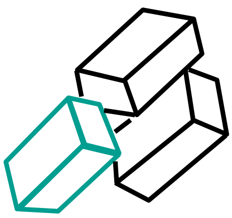
A change to the OCR today will take time to affect the economy. As a result, the MPC must set policy to impact future inflation, not current inflation. How it goes about this is guided by the *Remit* through:



- **The price stability target** – The inflation target range of 1-3 percent provides flexibility for temporary deviation around the midpoint of 2 percent.
- **The time horizon** – the MPC is required to return inflation to target "over the medium term". This recognises the forward-looking nature of monetary policy.
- **The transitory effects** – the MPC is guided to ignore temporary changes in inflation that the MPC cannot realistically influence, such as temporary changes in global oil prices.

Balancing inflation and employment

The best contribution that monetary policy can make to employment is typically to set policy to keep inflation low and stable. However, the *Remit* could be extended to guide the MPC on how it should manage situations where there are trade-offs between inflation and employment.



Managing risk and uncertainty

The MPC acted decisively to limit risks to the economy resulting from the Covid-19 pandemic. Because interest rates were low prior to 2020, the MPC had to use a range of new tools to stimulate the economy.

Changes to the *Remit* could be made to aid the MPC in stimulating the economy during future economic downturns, even if the OCR is already low.

Part C

The wider context for monetary policy

The relevance of housing, distributional outcomes and climate change for monetary policy

Housing, climate change and inequality are big topics we are grappling with as a society. The Reserve Bank is working hard to understand the implications for the economy and financial system, and what they mean for monetary policy.

The MPC currently takes into account a range of factors other than price stability and MSE through the current *Remit*. Requiring the MPC to have regard to housing, distributional outcomes or climate change would have uncertain benefits, and could make it more difficult to achieve price stability and support MSE.

Housing sustainability

The sustainable level of house prices over time is driven by factors other than monetary policy, such as global interest rates and planning rules. However, monetary policy can influence house prices in the short term, through its impact on the cost of servicing a mortgage.

Increasing interest rates in response to unsustainable house prices would tend to lower inflation and employment, and would have uncertain benefits for house price affordability and financial stability.

Inequality

Income inequality in New Zealand has generally worsened over the past 30 to 40 years. This has led to an increased focus on the relationship between monetary policy and how wealth and incomes are distributed across society.

The effect of monetary policy on inequality is uncertain. A lowering of the OCR may improve inequality by reducing unemployment and improving incomes of low-skilled workers, while at the same time, worsening inequality by increasing the prices of assets held by wealthy groups.

Climate change

There is growing evidence that climate change will affect economic growth, inflation and the financial system. Extreme weather events result in losses of production, equipment and buildings, while policies to manage the transition to a green economy could also affect the price of specific goods and services.

It is not clear that monetary policy can influence climate change or its economic impacts. However, the macroeconomic consequences of climate change are likely to have an impact on the MPC's economic objectives.

The Reserve Bank is committed to understanding the impacts of climate change as outlined in its *Statement of Intent* and *Climate Change Report*. We are also part of the international Network of Central Banks and Supervisors for Greening the Financial System.

Have your say

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We want to hear what matters to you, and any changes to the *Remit* you think could better support the economic wellbeing of New Zealanders, both now, and into the future.

We will use your feedback to recommend changes to the *Remit*.

Consultation is open from 1 June – 15 July. Have your say by completing a quick survey to tell us what you think about monetary policy and how it affects your day-to-day life and that of your whānau, your business and your community, or read the full Consultation Paper and submit your feedback.

- Take our survey
- Read the Consultation Paper and make a submission online
- Attend an online briefing

Feedback closes at 5.00pm on Friday 15 July 2022.

Take our survey

Read our Consultation Paper and make a submission

Attend an online briefing

Find more resources that explain monetary policy, read the full Consultation Paper or register to attend an online briefing in June 2022.

www.rbnz.govt.nz/remit-review

What is Inflation?

What is Maximum Sustainable Employment?

What is Monetary Policy?