

Submission by



to the

**Reserve Bank of New Zealand (RBNZ)**

on

**Supporting New Zealand's Economic Stability**

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

February 2023

# **SUBMISSION BY BUSINESSNZ<sup>1</sup> TO THE RESERVE BANK OF NEW ZEALAND ON SUPPORTING NEW ZEALAND'S ECONOMIC STABILITY**

## **1.0 BACKGROUND**

- 1.1 BusinessNZ welcomes the opportunity to submit on Supporting New Zealand's Economic Stability – A second public consultation on the five-year review of the Remit that guides monetary policy decisions ("the Consultation Paper.")
- 1.2 In summary, BusinessNZ broadly supports the policy discussion on issues outlined within the Consultation Paper, including the Reserve Bank's recognition of the need to avoid having too many objectives for monetary policy and hence the decision to deem distributional issues and climate change as being 'out of scope.'
- 1.3 BusinessNZ notes that the purpose of the Consultation Document is to get feedback on the Remit for monetary policy given the Remit guides decision-making by the Monetary Policy Committee (MPC) on monetary policy and Official Cash Rate (OCR) adjustments.
- 1.4 BusinessNZ made an extensive submission on the first public consultation paper in July last year so issues and background contained within that submission are not repeated here – suffice to say that BusinessNZ considers that the Remit is an important component of the overall monetary policy framework and carries weight in the sense of focusing the minds of the monetary policy committee on the core task of monetary policy, which is to maintain price stability.
- 1.5 It should be noted the greater the number of objectives and requirements a Remit places on the Reserve Bank, the more likely will it become increasingly difficult to achieve the Reserve Bank's primary objective of delivering on price stability. In this respect it is pleasing that the second consultation paper has largely taken on board this point by ensuring distributional issues and climate change are now considered 'out of scope,' although it is disappointing that reviewing the desirability of the dual mandate (Maximum Sustainable Employment - MSE) was not considered as part of the consultation exercise given that the dual mandate is now a requirement in the Reserve Bank of NZ Act 2021. Notwithstanding, BusinessNZ continues to advocate for the Reserve Bank to be solely focused on achieving price stability.

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<sup>1</sup> Background information on BusinessNZ is included as Appendix 1.

## **2.0 QUESTIONS (P.3-4 OF THE CONSUTLATION PAPER)**

2.1 For the sake of brevity, the remainder of this submission responds to the twelve questions set out on pages 3-4 of the Consultation Paper.

### **Chapter 2 – Monetary Policy Frameworks**

**Q1. Do you have any comments on the proposal that New Zealand should retain a flexible inflation targeting framework?**

#### ***Response***

2.2 BusinessNZ broadly supports the current flexible inflation targeting framework. As the Consultation Paper correctly states, inflation targeting is the most widely used framework across the world and has the benefit of already being well understood and credible in the NZ context.

2.3 In addition, it provides a degree of flexibility whereby the Reserve Bank can take into account 'shocks' but with a clear expectation that price stability is to be achieved and maintained.

2.4 As stated in our previous submission (July 2022) the danger with having MSE as an equal and additional objective may create some tension between ensuring price stability and ensuring MSE. In this respect, it is important that the price stability objective (1-3 percent) is achieved and maintained as public confidence in the Reserve Bank may falter if this is not the case.

2.5 As stated earlier in this submission, the greater the number of objectives and requirements a Remit places on the Reserve Bank, the more likely will it become increasingly difficult to achieve the Reserve Bank's primary objective of delivering on price stability. In this respect it is pleasing that the second consultation paper has largely taken on board this point by ensuring distributional issues and climate change are now considered out of 'scope,' although the continued inclusion of the MSE (a requirement under the Reserve Bank of NZ Act 2021) may create tension, despite the Reserve Bank stating in the Consultation Paper that the Monetary Policy Committee's inflation and employment objectives have not been in conflict

over the review period (p.15). This may well change if inflation remains elevated over this year and employment falters, potentially leading to a period of stagflation.

### **Chapter 3 – Design of the Primary Objectives**

**Q2. Does the current Remit strike the right balance between credibility (that a Monetary Policy Committee (MPC) can meet its objectives and keep inflation expectations anchored) and flexibility (to contribute to supporting maximum sustainable employment and stabilising economic output)?**

#### **Response**

- 2.6 BusinessNZ notes that the RB considers that the MPC's inflation and employment objectives have not been in conflict over the review period. However, as stated above, this does not mean they will not come into conflict at some stage in the future, perhaps sooner than many expect.
- 2.7 BusinessNZ considers that price stability should be given more focus in the remit than simply standing alongside the MSE objective. In this respect it is better to foresee potential conflict between objectives before they become apparent, to ensure that credibility in the RB to achieve and maintain price stability is not undermined.
- 2.8 In this respect, and given the dual mandate is already included in the Act, BusinessNZ would support boosting the emphasis on price stability while supporting MSE, so long as the price stability objective was not undermined as a result. Price stability must take precedence over MSE if push comes to shove. The current Remit is too vague on this point.
- 2.9 It should be noted that ideally, BusinessNZ would advocate for the Reserve Bank of NZ Act 2021 to focus solely on price stability.

**Q3. Do you think a hierarchical ordering of the primary objectives – which would require the MPC to consider supporting maximum sustainable employment subject to meeting the price stability objective – should be introduced into the Remit?**

**Response**

- 2.10 Yes – if the MSE is to be retained in the Act. (See comments above).

**Q4. Do you have any comments on the proposal to retain an undefined 'medium term' as the target horizon for the price stability objective in the Remit?**

**Response**

- 2.11 BusinessNZ supports the current approach where the 'medium term' is not defined.
- 2.12 While there are pros and cons of defining the 'medium term,' BusinessNZ supports the statement outlined on p.40 of the RB Consultation Paper:

*"Adding an explicit definition of the time horizon to the Remit may limit the flexibility of monetary policy. The optimal horizon depends on the type of shock and may vary over time. For example, a supply-side (cost-push) shock may require a longer time horizon for returning inflation to target compared with responding to a demand-side shock. Similarly, the optimal time horizon can increase with the persistence and size of shocks. A risk of defining a target horizon is that it may require the MPC to return inflation to target more quickly than is optimal in some circumstances." (p.40).*

**Q5. Do you have any comments on the proposal that the price stability target should continue to include a mid-point and a range?**

**Response**

- 2.13 BusinessNZ supports the current approach of having a mid-point and a range ('hybrid regime').
- 2.14 This is well established and well understood in the wider business community. It is entrenched in the public's expectations of inflation.

- 2.15 It provides for some flexibility, but is within clear bounds, and generally minimises the risk of inflation creeping outside the target range.

**Q6. Do you have any comments on the proposal that the current range of the inflation target of plus or minus one percentage point remains appropriate?**

***Response***

- 2.16 BusinessNZ generally supports setting the annual inflation rate at between 1 and 3 percent over the medium term, with a focus on staying near the 2 percent midpoint, as in the current Remit.
- 2.17 A 1-3 percent inflation provision has worked reasonably well over recent years and is now generally well understood. It is important for the Reserve Bank to retain credibility by showing it can deliver on price stability within a reasonable timeframe (the medium term).
- 2.18 Putting aside for a moment the current global pandemic and high rates of global inflation, over recent years global competition and innovation have enabled the development of better products and services at lower cost. Consequently, the argument that as demand ratchets up, prices will rise does not now necessarily hold as good as it did in the past, although more recently, an international move towards greater nationalisation and geopolitical tensions bring new risks. Risks notwithstanding, consumers now have much more choice about where they can source their products, including the fact that on-line shopping has become a very fast and efficient method of obtaining goods and services.
- 2.19 This would suggest that while inflation is currently very high by recent historical standards, it is likely to return to the very low levels that existed pre-2021/22 over the medium term. Therefore, the current approach (1-3 percent over the medium term with a focus on keeping inflation near the 2 percent mid-point) is still highly appropriate. Moreover, any changes to the Remit's price stability objective would send a very dangerous signal to markets (particularly given that for a range of circumstances, some domestic and some international inflation is currently well above the Reserve Bank's target range).

## **Chapter 4 – Calibration of the Primary Objectives**

**Q7. Do you have any comments on the proposal that the existing level of the inflation target – which is centred on 2 percent – should be retained?**

### **Response**

2.20 BusinessNZ supports the existing level of the inflation target (see response to Q6 above).

2.21 BusinessNZ also particularly endorses the comments made on page 52 of the Consultation Paper that retaining the existing target is the option best supported by the current available evidence:

*"Despite New Zealand – and many other economies – experiencing high and volatile inflation in recent years, the Reserve bank has been largely successful thorough its history in maintaining inflation within its target range. This target, therefore, is likely to remain achievable from a monetary policy perspective and credible, clear, and transparent from the public's perspective. The 1 to 3 percent range around the 2 percent mid-point also allows for flexibility to meet secondary objectives outside the price stability objective, as well as accounting for the volatility that New Zealand may experience as a small open economy." (p.52).*

**Q8. Do you have any comments on the proposal that the inflation target should continue to be based on the Consumers Price Index?**

### **Response**

2.22 BusinessNZ supports the proposal that the inflation target should continue to be based on the Consumers Price Index (CPI). The CPI is a widely understood concept having been utilised by many businesses and individuals over the years as a sound measure of consumer prices. It is respected (independently developed and maintained by StatsNZ) and has a long history which should not be tampered with without very good reason.

## **Chapter 5 – Additional Considerations for the Remit**

**Q9. Do you have any comments on the proposal that the clauses related to house price sustainability should be removed from the Remit?**

### **Response**

- 2.23 BusinessNZ supports the removal of the clauses relating to house price stability from the Remit. Their initial inclusion was largely politically motivated and seemed to be out of place in the context of the Remit.
- 2.24 This is not to downgrade the importance of sustainable house prices, however there are fundamental issues, well outside monetary policy settings, which have driven house price increases over recent years (although prices have declined significantly since the beginning of 2022).
- 2.25 Housing affordability has very much to do with overburdensome land supply planning, lack of financial options for funding new infrastructure, and a broad range of regulatory requirements regarding what and how something should be built, apart from meeting reasonable building standards and not adversely affecting others in the community.

**Q10. Do you have any comments on the proposal that the clause related to the financial system should be redrafted to align with the Reserve Bank Act 2021.**

### **Response**

- 2.26 This would appear logical that the two should be aligned.

**Q11. Do you have any comments on the proposal that the clause related to avoiding unnecessary instability in output, interest rates and the exchange rate should be retained?**

### **Response**

- 2.27 BusinessNZ supports the continued inclusion of this clause, noting that it has been part of the Remit and previous Policy Target Agreement (PTA) since 1999, and

provides a degree of flexibility required to deal with, at times, rapidly-changing domestic and international conditions.

**Q12. Do you have any comments on the proposal to remove or reword the clause related to discounting transitory effects? If you agree, which option would you prefer (remove or reword)?**

**Response**

- 2.28 BusinessNZ supports removing the transitory effects clause for the reasons outlined in the Consultation Paper on pages 68 and 69, particularly the point that the clause is semantically redundant because the price stability objective is already based on a flexible inflation target in 'the medium term'.

**Q13. Do you have any comments on the proposal that the Remit should not further specify the governance of additional monetary policy tools?**

**Response**

- 2.29 BusinessNZ does not consider that the Remit should specify the governance of additional monetary policy tools. The objective of the RB is clear – to achieve and maintain price stability over the medium term – and how it achieves this is an operational issue, obviously assisted by public transparency surrounding its monetary policy decisions.

**Q14. Do you have any comments on non-Remit text or the role of the Remit and Charter in supporting monetary and fiscal policy coordination?**

**Response**

- 2.30 BusinessNZ strongly supports the independence of the Reserve Bank.
- 2.31 In this respect, BusinessNZ supports removing the non-Remit text as outlined on p.72 of the consultation paper given that this could increase the clarity of the Remit and enhance the independence of the RB, reducing the risk of the RB being beholden to the particular policies of the Government of the day.

- 2.32 Notwithstanding the above, it has long been the view of the business community that 'monetary policy needs mates.' Achieving and maintaining price stability is much easier to achieve, with fewer adverse impacts on the real economy, if fiscal and regulatory policies together contribute to ensuring inflation remains under control.
- 2.33 In short, Government fiscal and regulatory policies can act to support or undermine the ability of the RB to maintain price stability over time. In this respect successive Governments should carefully review their fiscal and regulatory policies to ensure that they do not negate or undermine the achievement of price stability.

## **Chapter 6 – The MPC Charter**

**Q15. Do you have views on the decision-making model the *Charter* should be based on, or wider changes the MPC could make to improve its decision-making?**

### **Response**

- 2.34 While the Consultation Paper states there are pros and cons on whether MPC decisions should be made by consensus (the current approach) or by voting, BusinessNZ does not have a view on whether one is better than the other.
- 2.35 BusinessNZ is reasonably conformable with the transparency surrounding the decision-making of the MPC. The minutes of the meetings and decisions taken are available for those wishing to peruse them.

**Q16. Do you have any views on the communications approach the *Charter* should be based on, or wider changes the MPC could make to improve its communication?**

### **Response**

- 2.36 Nothing in particular. See response to Q15 above.

## **Appendix One - Background information on BusinessNZ**

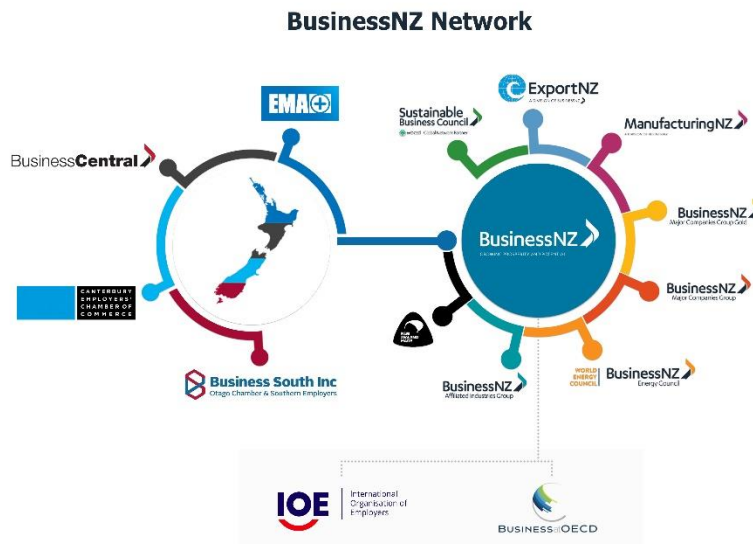


The BusinessNZ Network is New Zealand's largest business organisation, representing:

- Business groups [EMA](#), [Business Central](#), [Canterbury Employers' Chamber of Commerce](#), and [Business South](#)
- [BusinessNZ](#) policy and advocacy services
- [Major Companies Group](#) of New Zealand's largest businesses
- [Gold Group](#) of medium-sized businesses
- [Affiliated Industries Group](#) of national industry associations
- [ExportNZ](#) representing New Zealand exporting enterprises
- [ManufacturingNZ](#) representing New Zealand manufacturing enterprises
- [Sustainable Business Council](#) of enterprises leading sustainable business practice
- [BusinessNZ Energy Council](#) of enterprises leading sustainable energy production and use
- [Buy NZ Made](#) representing producers, retailers and consumers of New Zealand-made goods

The BusinessNZ Network is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

The BusinessNZ Network contributes to Government, tripartite working parties and international bodies including the International Labour Organisation ([ILO](#)), the International Organisation of Employers ([IOE](#)) and Business at OECD ([BIAC](#)).



**From:** [Paul Hay](#)  
**To:** [Paul Conway](#); [Reserve Bank Remit Review](#)  
**Cc:** [Cliff Joiner](#); [Fiona Morrison](#)  
**Subject:** Remit Review - Second Consultation [BNZ-DOCUMENTS.FID31013]  
**Date:** Monday, 30 January 2023 4:33:57 pm

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Hi Paul and team.

[REDACTED]

As per the earlier discussion on this round of consultation, BNZ broadly supports the recommendations in the consultation paper, with our feedback solely on the transparency of decisions made by the Committee. We submit that thought should be given to how the Committee might share more information about the views taken by individual members going into the decision-making process, so it is clear and transparent that the views/challenge at the Committee, and final outcomes, reflect the importance of the Committee's decisions and member contributions. We note that this is the process followed in some overseas jurisdictions and believe that this might also further improve the already well-developed operating model for the Committee.

If you have any questions in relation to the point made above, please let me know.

Ngā mihi

Paul Hay (he/him)

Te Pou Whakahaere mō ngā take Waeture  
(GM Regulatory Affairs)

Risk

[REDACTED]

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Reserve Bank of New Zealand – Te Pūtea Matua

27/01/2023

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Submitted via: [www.rbnz.govt.nz/remit-review](http://www.rbnz.govt.nz/remit-review)

RE: Remit Review

Community Housing Aotearoa – Ngā Wharerau o Aotearoa (CHA) thanks the Reserve Bank of New Zealand - Te Pūtea Matua (RBNZ) for the opportunity to share our perspectives on the Remit Review. We have prepared this submission following review of the consultation documents provided by the RBNZ. Our submission focusses on Question 9 regarding the proposal to remove the clauses related to house price sustainability from the Remit, which we oppose. We also express concern on the choice to not take up the challenge of climate change in this review.

CHA is an Incorporated Society and a peak body for the community housing sector. To achieve our vision of ‘all New Zealanders well-housed’, we have a strategic focus on supporting a well-functioning housing system and working toward the realisation of the right to housing. We are also mindful of the larger institutional and regulatory settings within which our members and other community organisations operate. In this instance, the considerations of the RBNZ as regards their monetary policy decisions on house prices have significant impacts on our members and the many families and whānau they serve.

Our 82 provider members provide homes for nearly 30,000 kiwis nationally across 18,520 homes, and our 37 partner members include developers, consultants, and local councils. Community Housing Providers (CHPs) are primarily not for dividend entities that develop, own, and manage social and affordable housing stock, with rental and progressive homeownership tenure offerings. We work closely with national Māori housing advocate Te Matapihi, which represents Iwi-based and Māori community housing providers. More about us can be found [here](#).

*9. Do you have any comments on the proposal that the clauses related to house price sustainability should be removed from the Remit?*

CHA strongly believes that house price sustainability should **remain** in RBNZ Monetary Policy Committee’s (MPC) Remit and continue to be a central consideration in RBNZ’s decision-making matrix.



The *Remit Review Summary Guide* states that: “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”.

We agree with that assessment, particularly regarding the ability to borrow and at what cost along with the lifetime value of loans and investments. Housing assets constitute around 57% of total household wealth and housing costs frequently total 30%-50% of a household’s weekly expenses. House prices and weekly housing costs have significant impacts on the spending behaviours of households meaning it cannot and should not be disentangled from the consideration of monetary policy nor the other facets of MPC’s remit.

The actions of the Reserve Bank have traceable consequences on house price sustainability. The June 2022 RBNZ paper *Housing Supply, House Prices, and Monetary Policy* clearly draws this through-line between MPC’s Official Cash Rate decisions and house prices. RBNZ actions in recent years have also demonstrated how their other prudential and regulatory instruments can have major consequences on house price sustainability. RBNZ should consider the causal relationship their actions have on house prices and housing costs, rather than interpreting them as external factors which the RBNZ decision-making is reactive to.

House prices and related housing expenses are both inputs for and outputs from the RBNZ’s decision-making. House prices frequently influence the spending and saving habits of New Zealanders and are directly impacted by RBNZ policy decisions, necessitating house price sustainability remaining in RBNZ’s remit. We need all levers working in unison to resolve our housing crisis, ensure house prices are sustainable, and create the conditions for ‘all New Zealanders to be well housed’.

We acknowledge and agree with the RBNZ that monetary policy and the prudential and regulatory tools available to it cannot on their own fully address house price sustainability. Fiscal policy plays an important role and is the responsibility of the government. Retaining consideration of house prices within the Remit ensures that the RBNZ clearly analyses and articulates what it can influence and the limits of its reach. This transparent approach can then inform the coordination of fiscal and monetary policy channels described in the *Second Consultation Paper*.

We reach different conclusions than RBNZ when reviewing the two options related to house price sustainability using the Remit design principles. We believe retaining house price sustainability meets the Remit design principles in the following ways. It will increase public confidence in the Legitimacy of the



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RBNZ by clearly providing an objective way to communicate the limits of its role without compromising the MPC's ability to achieve the economic objectives. This also supports the Credibility principle as it helps to focus the public's expectations on those matters which the MPC directly controls. We do not think consideration of house price sustainability will impact on the Achievability of the MPC's economic objectives nor limit its Flexibility in that regard. Finally, we believe it will increase Clarity and Transparency so the public can monitor the MPC's performance and better understand the limits of its ability regarding house prices. We believe the analysis in the consultation document highlights the need to improve communications and clarity of messaging, rather than actual conflicts with the design principles.

We note in the consultation documents that the RBNZ acknowledges its pioneering status as the first central bank to establish inflation targeting in 1990. The world economy has fundamentally changed since the 1990's and a blinkered focus solely on inflation targeting is no longer sufficient, however comfortable it may be for policy makers. We believe that the RBNZ needs to lead again is considering how its decisions impact housing and also climate change. The challenges facing us and the expectations of the public for more equitable outcomes both socially and environmentally, if ignored, risk compromising the public's faith in the RBNZ's role as kaitiaki of the financial system, including in its monetary policy decisions. We believe considering impacts on the housing market when determining monetary policy decisions will likewise be seen in another 30 years as the start of a global trend. We also ask the RBNZ to reconsider its views on climate change and its ability to positively impact environmental sustainability through both its monetary and regulatory tools.

We are happy to mee should you wish to discuss any of the points we have made.

Ngā mihi,

Paul Gilbert, CEO

Community Housing Aotearoa – Ngā Wharerau o Aotearoa





# Submission on Supporting New Zealand's Economic Stability Toitu te Ohanga

Federated Farmers of New Zealand

27 January 2023



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## **SUBMISSION ON SUPPORTING NEW ZEALAND'S ECONOMIC STABILITY TOITU TE OHANGA**

**TO:** Reserve Bank of New Zealand

**DATE:** 27 January 2023

### **ADDRESS FOR SERVICE**

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Federated Farmers of New Zealand  
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### **ABOUT FEDERATED FARMERS**

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the commodities levy act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have a long and proud history of representing the needs and interests of New Zealand's farmers.

Federated Farmers aims to empower farmers to excel in farming. Our key strategic outcomes include provision for an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of a vibrant rural community; and
- Our members adopt responsible management and sustainable food production practices.

## **SUBMISSION ON SUPPORTING NEW ZEALAND'S ECONOMIC STABILITY TOITU TE OHANGA**

### **1. INTRODUCTION**

- 1.1 Federated Farmers of New Zealand welcomes the opportunity to submit to the Reserve Bank on the consultation document *Supporting New Zealand's Economic Stability Toitu te Ohanga* ('the consultation document'). This is a second public consultation on the five-year review of the *Remit* that guides monetary policy decisions.
- 1.2 This consultation document follows an earlier consultation on which Federated Farmers submitted in July 2022.
- 1.3 As stated in our earlier submission Federated Farmers strongly supports the Reserve Bank's monetary policy objective of 'achieving and maintaining stability in the general level of prices over the medium term'. We did not support the addition of an additional objective of 'supporting maximum sustainable employment' (MSE) and we continue to think it an unnecessary and potentially harmful distraction to the price stability objective. MSE is more appropriately addressed by other aspects of government policy.
- 1.4 Monetary policy should be focused firmly on price stability, which is the best way for the Reserve Bank to contribute to wellbeing. Current high inflation is harming wellbeing by driving up the cost of living and eroding living standards (i.e., real incomes), especially for those on low-to-middle levels of income and wealth. Federated Farmers' position continues to be for the Reserve Bank to have a single mandate focusing on achieving and maintaining price stability as the best way it can contribute to wellbeing.
- 1.5 Federated Farmers stands by its position on the need for the Reserve Bank to have a single mandate of price stability. However, considering the Reserve Bank Act provides for the dual mandate we generally support the discussion in the consultation document. We strongly agree with the proposed retention of flexible inflation targeting for price stability and the retention of a 1-3 percent target range with 2 percent mid-point. We are also assured by the Reserve Bank's recognition of the need to avoid having too many objectives for monetary policy and with the decision to deem distributional issues and climate change as 'out of scope'.
- 1.6 Although not a matter specifically raised in this consultation, Federated Farmers also believes it is important for the Reserve Bank's Board to have stronger expertise on critical competences of central banking, economic policy, and prudential regulation. Some of the members of the current Board appear to have limited if any experience or expertise in these competencies. Although the Board is not responsible for monetary policy decisions (which is a matter for the Monetary Policy Committee), it is responsible for the other aspects of the Reserve Bank's work, some of which influence monetary policy.
- 1.7 The remainder of this submission addresses the questions posed in the consultation document.

## 2. CONSULTATION QUESTIONS

### Chapter 2 – Monetary Policy Frameworks

1. Do you have any comments on the proposal that New Zealand should retain a flexible inflation targeting framework?

*Federated Farmers supports flexible inflation targeting but we are cautious on the 'flexible' aspect of the approach.*

*As the consultation document observes inflation targeting is "the most conventional approach to achieving price stability". It is simple, easy to understand, and it has "proven successful and has kept inflation expectations anchored at low and stable levels". It was certainly very successful in New Zealand in early 1990s as inflation was brought under control and it continued to be successful over the next thirty years, notwithstanding the current period of high inflation.*

*The consultation document also observes that inflation targeting has become more flexible over time as various changes have been made to objectives and additional caveats included. Making inflation targeting more flexible has in most cases helpfully acknowledged the 'real economy' effects of monetary policy while not compromising the key objective of price stability.*

*However, as the Reserve Bank has recognised, having too many objectives for monetary policy (i.e., too much flexibility) should be avoided as they generate difficult trade-offs when they come into conflict. Monetary policy may not be the best way to handle multiple goals, with other government policies better placed. Too many objectives also risk reducing clarity and accountability.*

*As we have previously observed Federated Farmers considers that including an objective for MSE pushes the boundaries of flexibility too far.*

### Chapter 3 – Design of the Primary Objectives

2. Does the current Remit strike the right balance between credibility (that a Monetary Policy Committee (MPC) can meet its objectives and keep inflation expectations anchored) and flexibility (to contribute to supporting maximum sustainable employment and stabilising economic output)?

*As mentioned in our earlier submission, Federated Farmers does not support having an objective for MSE. However, recognising that this objective is stipulated in the Reserve Bank Act, we believe price stability should be emphasised over the MSE objective and we would support changes to the Remit to enhance the credibility to price stability.*

3. Do you think a hierarchical ordering of the primary objectives – which would require the MPC to consider supporting maximum sustainable employment subject to meeting the price stability objective – should be introduced into the Remit?

*Federated Farmers does not support having an objective for MSE. However, recognising that this objective is stipulated in the Reserve Bank Act, we believe price stability should be emphasised over the MSE objective. We would therefore support a clear hierarchy that places price stability above MSE.*

*We note the discussion in Box D (page 35) about research into New Zealanders' inflation and unemployment preferences. While of interest, such research should not determine policy. A recent article in the 17 December 2022 edition of The Economist magazine ('The Insidious Threats to Central-Bank Independence') made some very pertinent comments on 'forces threatening central bankers' independence in new and insidious ways':*

"The first is that central banks are less hard-nosed and keener to play to the gallery than they were. In the Volcker era economists speculated that independent central bankers might work best if they were more hawkish than society about inflation. Over time they came to reject "inflation nutters" in favour of "flexible" inflation targeting which took employment into account, too. By 2020 central bankers looked jobs-nuts. The Fed said it would not raise rates at all until the labour market was tight, an approach which left it hopelessly adrift as inflation took off. Its top brass had been on a "Fed listens" tour at which the public, having not been seriously troubled by inflation for decades, told central bankers that stimulating employment should be their priority. Advocates for making central bankers directly accountable forget that politicians' desire to distort monetary policy comes from listening to what voters want.

"Central bankers need independence from the public as much as they do from their elected representatives. But they spend ever more time in press conferences and giving speeches. At the moment, Mr Powell and his peers use their public profile to speak hard truths about how long-term price stability is the foundation of prosperity. But their resolve is yet to be tested by a recession which could provoke a backlash like the one Volcker had to see off. Only after such a backlash will it be clear whether central bankers see their job as to lead or to listen."

*The Reserve Bank is taking a commendably blunt approach to the current fight against inflation and publicly highlighting the likely economic impacts. However, it should think very carefully about the risks of taking too much of a 'listening' approach. The Reserve Bank was very successful in the period after 1989 only because it did what had to be done to reduce inflation and did not bow to considerable public concern and political pressure about high unemployment. It will need a similar resolve in 2023, especially as it is an election year.*

4. Do you have any comments on the proposal to retain an undefined 'medium term' as the target horizon for the price stability objective in the Remit?

*Federated Farmers is relatively comfortable with using an undefined 'medium term' target horizon, noting that most central banks we compare ourselves with take a similar approach. The consultation document notes that in practice the Reserve Bank considers 'medium term' to mean 12-24 months, which seems appropriate given the lags in policy's impact on inflation.*

5. Do you have any comments on the proposal that the price stability target should continue to include a mid-point and a range?

*Federated Farmers supports the continuation of a 'hybrid' approach for the price stability target, using a mid-point and a range. It appears to be credible and well entrenched in inflation expectations.*

6. Do you have any comments on the proposal that the current range of the inflation target of plus or minus one percentage point remains appropriate?

*Federated Farmers supports the continuation of target of plus or minus one percent. This two-point range provides a good balance between the need for flexibility and the need for accountability for achieving the inflation target. We would not support an increase in the range as it could un-anchor inflation expectations.*

#### **Chapter 4 – Calibration of the Primary Objectives**

7. Do you have any comments on the proposal that the existing level of the inflation target – which is centred on 2 percent – should be retained?

*Federated Farmers supports retaining the existing 2 percent mid-point. We would not support increasing it. As the consultation document says a higher inflation target would impact on the credibility of monetary policy, especially in today's high inflation environment. It would send all the wrong signals at the worst possible time.*

8. Do you have any comments on the proposal that the inflation target should continue to be based on the Consumers Price Index?

*Federated Farmers agrees that the inflation target should continue to be based on the CPI. It is a well understood measure and it has currency and credibility.*

*We would support increasing the CPI's frequency to monthly (from quarterly) as a monthly CPI would support effective and timely monetary policy decision-making.*

*We would also support more frequent re-weighting of the CPI, perhaps annually (rather than three-yearly at present).*

#### **Chapter 5 – Additional Considerations for the Remit**

9. Do you have any comments on the proposal that the clauses related to house price sustainability should be removed from the Remit?

*As we said in our earlier submission, Federated Farmers considers that house prices are relevant for monetary policy, but consideration should be limited to how changes in house prices spill into consumer prices. If removing house price sustainability does not prevent this consideration, we would not object to its removal from the Remit.*

*House prices and the risks from the housing market are a more valid consideration for the Reserve Bank in exercising its financial stability role and the use of its macro-prudential tools.*

10. Do you have any comments on the proposal that the clause related to the financial system should be redrafted to align with the Reserve Bank Act 2021.

*This seems a sensible approach. The respective wordings are similar but not identical so this would be a tidy-up.*

11. Do you have any comments on the proposal that the clause related to avoiding unnecessary instability in output, interest rates and the exchange rate should be retained?

*Federated Farmers is comfortable with this clause, which has been used since 1999. We believe it provides as much flexibility as is needed under a flexible inflation targeting approach.*

12. Do you have any comments on the proposal to remove or reword the clause related to discounting transitory effects? If you agree, which option would you prefer (remove or reword)?

*Federated Farmers is comfortable with removing this clause. As the consultation document states, this clause has become less important as targeting has become more flexible.*

13. Do you have any comments on the proposal that the Remit should not further specify the governance of additional monetary policy tools?

*Federated Farmers agrees that the Remit should not further specify the governance of additional monetary policy tools. As the consultation document states there are downsides to doing so. We firmly believe the Reserve Bank's MPC should retain operational independence.*

14. Do you have any comments on non-Remit text or the role of the Remit and Charter in supporting monetary and fiscal policy coordination?

*Federated Farmers is a strong supporter of operational independence for the Reserve Bank, subject to it complying with its Act. Paragraphs on the Government's economic objective and how monetary policy can meet the Government's economic objective imply a degree of political direction which could impact on perceptions (if not reality) of the Reserve Bank's operational independence. For the avoidance of doubt, we think these paragraphs should be removed.*

*Regarding monetary and fiscal policy coordination, the response to Covid-19 and the more recent fight against inflation (in part caused by the large fiscal and monetary stimuli from that very response) has shown the importance of coordination. This coordination should continue albeit recognising the need to preserve the Reserve Bank's operational independence.*

## **Chapter 6 – The MPC Charter**

15. Do you have views on the decision-making model the *Charter* should be based on, or wider changes the MPC could make to improve its decision-making?

*As the discussion document states there are pros on cons on whether MPC decisions should be made by consensus (the current approach) or by voting. Federated Farmers does not have a strong view on this.*

16. Do you have any views on the communications approach the *Charter* should be based on, or wider changes the MPC could make to improve its communication?

*The clear communication of monetary policy decisions is very important given their influence on financial markets. The current approach of coordinated communication seems to be working reasonably well and we are not sure if any changes could be made that would be a material improvement and not result in more risks.*

ENDS

Ian Mansell MSc BCom ACA(NZ)

Whangarei, New Zealand

26/01/23

Permission granted for public display.

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### **Consultation questions**

*1. Do you have any comments on the proposal that New Zealand should retain a flexible inflation targeting framework?*

Yes, Monetary policy has lags in its impacts on inflationary expectations etc. Timing differences. Furthermore, as the RBNZ does not appear to have a truly floating exchange rate but keeps it within certain tolerances of the weighted averages of our trading partners, thus by implication NZ has to import our trading partners inflation and as such exogenous / uncontrollable elements will flow through. Short time frame reactions are just as likely to lead to exacerbating oscillations rather than containing them.

*2. Does the current Remit strike the right balance between credibility (that the MPC can meet its objectives and keep inflation expectations anchored) and flexibility (to contribute to supporting maximum sustainable employment and stabilising economic output)?*

Yes, although believe that 2% for inflation is too low. 3% is more credible and gives more headroom for variability and zero bound issues.

By Zero bound issues (In addition to the liquidity trap) I am inferring very low investment hurdles which artificially spike markets (Bubbles, Zombie companies etc - Malinvestments) and stoke house prices (low mortgage rates) setting up the next recession as the eventual return to the mean plays out.

From observation there has been too much emphasis on supporting markets and not equal consideration in with containment of market exuberance in alignment with long run growth expectations.

*3. Do you think a hierarchical ordering of the primary objectives – which would require the MPC to consider supporting maximum sustainable employment subject to meeting the price stability objective – should be introduced into the Remit?*

No, because it could lead to some adverse scenarios, such as high international inflation appearing in imports requiring monetary policy to increase interest rates pushing up the NZD making imports cheaper but reducing exports, thus impacting employment.

Governments are keenly interested in unemployment, so you could end up with government pushing fiscal spend to drive employment with monetary policy trying to counter the resulting inflation. Something that appears increasingly evident in the US.

So, technically I believe that monetary policy should only be interested in sound(ish) money (With increases for Growth & Inflation) and keeping the credit cycle aligned with expected long-term growth. But the reality is that employment matters, there is an implicit 2-way bargain between the Reserve Bank and the Government. Monetary prudence and Fiscal prudence need to be aligned.

*4. Do you have any comments on the proposal to retain an undefined 'medium term' as the target horizon for the price stability objective in the Remit?*

Medium term would appear to indicate 2-5 years.

Monetary policy has effect lags. Base rate Interest rate changes are generally thought of taking 3 quarters to appear in the economy (US). Furthermore, consumer expectations take longer to reign in, the FED is in this process, they've indicated that they'll keep interests high until they have effectively broken the back of expectations, this could be late 2023 or into 2024.

If the RBNZ removed 'medium term' it would be removing credibility as its base tools work more in the medium term... and it is reliant on our trading partners to achieve their own inflation targets, so imported inflation converges with our targets.

*5. Do you have any comments on the proposal that the price stability target should continue to include a mid-point and a range?*

Yes. However rather than 2% if the target was 3% with the +/- 1% then the RBNZ would be in range with 2-4% inflation. As I have discussed before, I sincerely believe there are too many adverse risks with inflation at/below 2%.

*6. Do you have any comments on the proposal that the current range of the inflation target of plus or minus 1 percentage point remains appropriate?*

If there was no allowable tolerance then the RBNZ would 'always' be wrong. The RBNZ is in a dynamic market system, so to prescribe achievement of absolute numbers infers a level of control it does not possess. Hence impact on credibility.

+/- 1% on a 2% target is about as much as the RBNZ can feasibly request, otherwise the error term would be as great as the target.

*7. Do you have any comments on the proposal that the existing level of the inflation target – which is centred on 2 percent – should be retained?*

- 1) It lacks credibility. Most market experts believe that the days of 2% inflation are over, and they believe that interest rates will never be raised sufficiently enough to bring back inflation. Either elevated interest rates will break the financial markets or unemployment will cause a pivot or require fiscal stimulus.

If we assume that the US is a material driver to world inflation. Then we simply need to consider a few aspects to see that inflation will continue to be created.

- Large and growing trade deficits \$1.8T currently.
- No signs of Fiscal prudence, \$1.7T of unfunded spend recently signed off.
- Ageing population. Higher outlays on social security etc.
- Increasing debt servicing costs (\$31T debt). Within 5 years +\$1T of additional interest.
- Reducing globalisation (Increasing costs).
- De-Dollarisation / Foreign holdings of US treasuries being sold off. Thus, higher cost of debt servicing.

Hence the most likely scenario is the FED is bounded by how high it can increase the base rate, with inflation allowed to run hotter. Especially as fiscal spend will aim to keep employment 'robust' and fend off a recession/depression. Inflation as a tax is really the only tool to redress the imbalances. Market commentators are increasingly talking of a US debt death spiral if current policies continue.

NZ could logically achieve low inflation through higher interest rates appreciating the NZD. However, if as in my first submission the NZD is effectively pegged then we have to accept world inflation increasing import costs and thus local inflation.

So, the answer is, whether is NZ prepared to appreciate its currency to keep inflation down at 2% which other economies are not achieving? That's why on my first submission NZ should really aim to achieve an inflation comparable to our trade peers (TWI etc).

- 2) The second reason I disagree with a low inflation target is that this leads to an elevated value of asset classes. Residential housing being the largest. Given that house prices are a function of mortgage serviceability, which in turn is function of mortgage interest rates, then logically as inflation/interest rates get closer to zero then House prices exponentially increase. This then leads to far greater volatility as

interest rates fluctuate, exacerbating economic cycles. (Then there's dislocation/drag aspects with house prices quick to go up, but sticky on the way down).

Then consider the wealth transfer aspect, low interest rates leading to higher house prices favours buyers with already accumulated equity deposits. Landlords/Investors and previous homebuyers are at an advantage relative to first time home buyers.

As I stated in my first submission, if mortgage rates had effectively a floor on them, then a more stable housing market (price) would ensue (I advised of a mechanism to achieve this). House values would trend closer to increases in household incomes.

*8. Do you have any comments on the proposal that the inflation target should continue to be based on the Consumers Price Index?*

The CPI is a sufficient baseline so long as it is comparably measured with other peer nations and retains its independence.

*9. Do you have any comments on the proposal that the clauses related to house price sustainability should be removed from the Remit?*

From a pure adherence to the aims of the Remit on Inflation and Employment, then house prices are a secondary and a consequential effect.

Housing however generally comprises 80% of Banks lending. Hence inflation is a key driver in house price variability and consequentially consumer demand which drives economic cycles. This is why I state in Question 7 whether 2% is too low of a target as variability around it (and trying to forcefully achieve it) can exacerbate house price volatility.

Given the lags and inertia of house prices relative to monetary intervention, is the main reason I suggest an automatic stabiliser in my first submission. A floor on mortgage rates would counteract the exponential increase in house prices as mortgage rates headed towards 'zero'.

But yes, house prices should be removed from the Remit and the government of the day should be resolving the demand supply and price issues independently. Housing issues are not inherently a matter that can be resolved by monetary policy by the RBNZ.

*10. Do you have any comments on the proposal that the clause related to the financial system should be redrafted to align with the Reserve Bank Act 2021?*

I presume that we are responding to what appears to be a supporting requirement at an operational level of 'the financial stability objective of protecting and promoting the stability of New Zealand's financial system' in the Remit. Whereas within Section 9 of the Reserve Bank Act 2021 it ranks equally with the Inflation and Employment objectives.

Given the Remit (Order in Council) prioritises the Reserve Bank Activities then, it would seem incongruent that the stability of the financial system would be supporting rather than primary objective.

Logically the Remit (Order in Council) should really only be an overlay for operational directions rather than a somewhat redundant reiteration of what is already in the 2021 Act.

*11. Do you have any comments on the proposal that the clause related to avoiding unnecessary instability in output, interest rates and the exchange rate should be retained?*

It should be retained, some of these requirements are necessarily vague to ensure overarching general guidance conformity. Use of professional judgement rather than a prescriptive iterative task.

*12. Do you have any comments on the proposal to remove or reword the clause related to discounting transitory effects? If you agree, which option would you prefer (remove or reword)?*

Keep transitional effects in. Use professional judgement.

*13. Do you have any comments on the proposal that the Remit should not further specify the governance of additional monetary policy tools?*

There should be far greater governance and oversight of additional monetary policy tools. A post investment type review should occur examining the costs and benefits of what was achieved through their application.

I have specific concerns that relate to the LSAP Quantitative easing programme as listed below. These relate to 1) A 'True and Fair' view 2) Economic application

### **True and Fair view around the LSAP**

The Reserve Bank of Australia (RBA) engaged bond buying (Quantitative Easing – QE) and publicly announced a financial loss of \$40 billion AUD in 2021/22 from this activity.  
<https://www.rba.gov.au/speeches/2022/sp-dg-2022-09-21.html>

Given the Reserve Bank of New Zealand (RBNZ) engaged in a similar bond buying programme (Large Scale Asset Purchases (LSAP)) then by implication proportionate losses are likely to have been sustained.

In order to ascertain this impairment amount, an OIA (Official information Act) request was submitted to the RBNZ for the impairment calculated (At last financial year end date), and any crystallised losses. I have not received this information at this time, and it's beyond the

statutory time for its communication. In theory this is a single line number from their balance sheet.

Looking at the latest RBNZ financial accounts (Balance Sheet) to 30 June 2022

<https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/annual-reports/annual-report-2022.pdf>

An impairment cannot be readily sighted. If we look at page 103 it clearly shows the value of the LSAP at 30 June 2022 as \$51,283 million and its fair value shown as \$51,283 million.

Looking at the Public Finance Act it clearly states that financial accounts must be prepared under GAAP and by implication show *'the impact of exchange-rate, interest rate and other movements as a result of market conditions on the value of financial assets and liabilities.'*

<https://www.treasury.govt.nz/publications/guide/guide-public-finance-act-html>

Showing the impact would mean show the impairment.

Hence, under normal accounting principles you would expect to see the market purchase price of the LSAP bonds purchased with an impairment (provision) shown and then a net balance being the arm's length fair market value in the marketplace.

The RBNZ and Treasury / NZ Debt Management have a memorandum of understanding, with an explicit basis to value bonds in the open marketplace. Even though the purchases of bonds were voluminous they can actually be categorised into (Roughly 20 tranches) as they collectively pool to previous bond issues and their respective expiry dates.

The RBNZ is a separate legal entity to the Government (Crown/Treasury) so it should be showing this detail. Having a related party indemnity should not allow net offs and other information to preclude the readers of the financial statements from objectively seeing market values and any diminution between purchase and current market value. RBNZ is the legal owner of the Bonds.

If we revert to the 'Financial Statements of the government of New Zealand' then looking at financial years ending 30 June 2020, 2021 and 2022 then we can sight losses sustained on the LSAP programme of (yearly) \$3.3 billion, \$3.976 billion and \$1.0 million respectively.

<https://www.treasury.govt.nz/system/files/2022-10/fsgnz-2022.pdf> page 76

<https://www.treasury.govt.nz/system/files/2021-10/fsgnz-2021.pdf> page 19

The RBNZ in its accounts to 30 June 2022 page 73 refers to a reduction in LSAP

*At 30 June 2022, LSAP programme assets were \$6.2 billion lower than in 2021, largely due to rising market interest rates driving unrealised mark-to-market losses on these bonds.*

Contrast this against the Crown statements that on a consolidated basis of a loss of \$1.0 million occurred.

If we look at the financial year to 30 June 2022 the OCR went from 0.25% to 2.00% which would add weight to the RBNZ comment around a reduction in market value during the year of \$6.2 billion. The first tranche of bonds transferred over to NZ Debt management (treasury) was at 3.955% (July 2022) and these bonds were initially purchased with a yield according to the RBNZ LSAP worksheet of approximately 1.213% (Weighted).

The real issue with all this is it's almost impossible to actually work out the performance of the LSAP programme. Too much apparent smoke and mirrors, the RBNZ worksheet on its bond purchases doesn't reconcile to numbers in its financial statements, there is little to tie in what is a melange of numbers.

The true opportunity cost of the programme is cash out and in up to 30 June 2022 (For the run off of expiring bonds prior to 30 June 2022) plus the change in arms-length market value of the bonds on hand at 30 June 2022. It shouldn't be difficult.

The Crown indemnity, and using the difference between the OCR and the coupon payments obfuscates the underlying substance of the programme. The financial engineering that has taken place between the Crown and the RBNZ is one between related parties and a True and Fair view should require that we the readers of the accounts (We the citizens) being able to meaningfully assess the performance of the LSAP programme. Open and accountable government. The numbers should be straight forward, commentary should be complementary to assist the reader.

A proper independent review should be undertaken of the LSAP to calculate the benefit of the change in market value of the bonds that benefited financial institutions, as the mirror image is the opportunity cost that New Zealand citizens incurred, who could have had the same capital deployed elsewhere.

### **Economic application of the LSAP**

The justification for the LSAP (Quantitative easing) according to Treasury

*The aim of the LSAP programme is to inject money into the economy to lower borrowing costs to households and businesses and to depreciate the New Zealand dollar.*

The RBNZ in its annual report to 30 June 2020 shows on page 52 how the yield curve has been depressed through large scale intervention in the markets through the LSAP

<https://www.rbnz.govt.nz/-/media/301c3767ba264fbc87723df01f0eeb29.ashx>

The are several issues with this approach

- 1) This is a short run effect. The deluge of liquidity may temporarily push down interest rates but they wash back as part of the Tsunami of inflation pressure in the medium/longer term, thus pushing up interest rates higher than they ordinarily likely would have been. Consider whether the LSAP could be unwound with resale back into the market at the same speed the programme ramped up, and the consequential effects on interest rates. It's not symmetric. Hence the long lag running it off.
- 2) The RBNZ/Crown is buying inflated financial assets (bonds) from financial institutions providing them with a windfall (Artificially pushing up the price of those bonds) then having the citizens of New Zealand bear the reversion to the mean (yields) and the issues in point 1), that further depress the value of the bonds now held in their name. It is a massive wealth transfer to Financial Institutions from citizens.
- 3) The stated benefit of providing liquidity to the Financial Institutions places too much risk on citizens for the benefit of those financial institutions. As an example, financial institutions could simply have pledged as collateral their Bonds, thus retaining the risks and benefits of those bonds and not the citizens of New Zealand. At absolute worst the RBNZ could have bought very short duration bonds thus reducing exposure to changing market values.
- 4) The LSAP works through financial intermediaries to the end benefit of citizens. The issue I have is that while Quantitative easing has some potential in benign rust belt economies/economic conditions by lowering cost of capital, in the situation of New Zealand it was a robust economy simply suffering from an adverse and temporary exogeneous shock. In this situation the financial intermediaries would in all likelihood simply have hoarded the receipts, and continued to retrench until the external shock was better quantified, able to be managed, or had passed.
- 5) Given the inefficiencies of 4) there has to an assessment against more direct interventions which bypass these financial intermediaries. Monetary policy should not be the panacea for all issues, it might be efficient, but Fiscal intervention also needs to be considered, especially with regards Risk and Return to the citizens of New Zealand.
- 6) I sincerely don't see any effect the LSAP has had on the exchange rate. As an example, the NZD/GBP was 0.5058 on 1/1/20 and 0.5056 on 1/1/22. I don't expect either to see the reverse situation, as the programme runs off. No symmetry again.
- 7) The costs and losses of the programme are quantifiable, verifiable and largely permanent. The benefits are subjective, qualitative and temporal. As such, in any normal business case the benefits would require far more scrutiny especially when we consider the absolute billions being transferred from the public purse to financial institutions. Financial institutions are not benevolent charities and shouldn't be an extension of quasi government, they should face off with government the way they do with their own customers.

*14. Do you have any comments on non-Remit text or the role of the Remit and Charter in supporting monetary and fiscal policy coordination?*

Given the Remit is effectively embedded within the Reserve Bank Act then it should be attenuated to simply any divergence/prioritisation the Minister of Finance requires. The Finance Minister can overlay an order at any point. (I've only quickly sighted the documentation and this is based off recollection of the interconnections).

*15. Do you have views on the decision-making model the Charter should be based on, or wider changes the MPC could make to improve its decision-making?*

This is covered in Question 13. I do think the RBNZ lacks commercial awareness and just follows every other Reserve Bank.

*16. Do you have views on the communications approach the Charter should be based on, or wider changes the MPC could make to improve its communication?*

Reports should be weighted towards ensuring material issues like the LSAP have greater prominence and explanation. The loss on the LSAP is the biggest in New Zealand commercial history, but trying to ascertain its magnitude has been very problematic (and still unresolved) and leads to a major question of confidence over openness and transparency.

**From:** [Kushlan Sugathapala](#)  
**To:** [Reserve Bank Remit Review](#)  
**Subject:** Remit Review  
**Date:** Saturday, 3 December 2022 8:26:14 am  
**Attachments:** [image001.gif](#)

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Kia ora,

The inflation Target should be more flexible

- Inflation was low for the past two decades due to several factors – Low or negative import inflation mainly due to the China factor, the impact of technology on communications etc. There are many factors beyond the control of RBNZ -the cost of imports like the oil price, the strength of NZ exports like dairy prices which set the local prices for those goods, and the strength of the dollar led by exports.
- It's counter-productive to throttle the local economy to compensate for external factors and engineer recessions and unemployment. The importance given to inflation is due to the high inflation of the 1980s, which was due to an entirely different economic environment.
- Medium-term changes like higher global factors like higher prices for Chinese imports and less globalisation are likely to warrant a higher inflation target.
- Perhaps we live in the past and must adapt to higher inflation, higher interest rates and lower asset prices.

Hierarchy of Primary Objectives

- This is essential. In my opinion, the most crucial objective should be **low unemployment**. Our measly social welfare system and social issues caused - deprivation, hunger, crime etc., warrant considering employment the most important target. The unemployment target should be explicit despite this being politically sensitive. One of the primary objectives of the Federal Reserve Bank in the USA is full employment – "*in pursuit of full employment and stable prices*". Most citizens would consider a level of inflation over being unemployed or their neighbour being unemployed.

House Prices

- House prices should definitely be part of the remit. Housing affordability is the most significant problem in New Zealand at

present. Recent house price inflation proves how much this is affected by low-interest rates. The low-interest rates have been a significant factor in housing inflation over the past two decades. Asset price inflation has led to high inequality and other social issues. This is one issue over which RBNZ has direct control over.

Nga Mihi

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## Comments on second round of Reserve Bank MPC remit review consultation

Michael Reddell

27 January 2023

1. These comments should be read together with my submission on the first round consultation document (which you will have, but which is also available here [comments-on-first-round-mpc-remit-review.pdf \(wordpress.com\)](https://www.michaelreddell.com/wp-content/uploads/2023/01/comments-on-first-round-mpc-remit-review.pdf)). My comments are organised broadly in the order of the issues raised and questions posed in your paper.
2. I strongly support the retention of inflation targeting (and prime focus on CPI-based measures) as the basis for the formulation and implementation of monetary policy. There are arguments for a different targeting basis (whether nominal GDP or nominal wages) but the transitional costs would be substantial and any practical gains likely to be minimal in most circumstances. There are also arguments in some quarters for models which provide more discretion to the Reserve Bank and MPC, but since the quid pro quo for more discretion is, almost inevitably, less effective accountability and the last couple of years have provided a good example of how little effective accountability there often is in the current system I would strongly oppose any such shift. Citizens cannot assume that officials will consistently and capably act in the public interest, and the extent of the delegated authority already provided to the Bank, and the damage it can do (and has done recently) highlights the importance of keeping accountability in focus (without pushing towards mechanical approaches which prioritise accountability over substance).
3. Consistent with the emphasis in the previous paragraph I support
  - a. Retaining the current width of the target band,
  - b. Retaining both the explicit midpoint focus and the explicit target range (they serve two different purposes),
  - c. Retaining the “medium term” horizon, although perhaps with the addition of a specific requirement on the MPC to outline from time to time how it sees the “medium term” in practice (e.g. it might state that it expects to forecast that inflation 2 years ahead will routinely be very close to the target midpoint, and adjust policy to underpin such forecasts).
4. Consistent with past submissions, including at the time the legislation was going through Parliament, I see the fundamental purpose of active discretionary monetary policy as being to do what it can to stabilise output and unemployment (the latter in particular), subject to keeping core inflation in check. However, given that this review is working within the confines of the current act, and given the public and political pressures and sensitivities that have arisen through the last couple of years, there could be merit in clarifying in the Remit that medium price stability is the overriding goal and constraint, and that any trade-offs between the two limbs are only short-term in nature.
5. I do not favour the retention of a 2 per cent target midpoint, although would prefer the status quo to any suggestion of raising the target. My comments on this point in my submission as part of the first round of consultation stand. There is no credible way that a

target centred on debasing the value of the currency by 2 per cent per annum can be considered as price stability (such a rate of inflation over the 33 years of New Zealand inflation targeting would have almost halved the value of the currency) and there is no good reason why we should settle for such targeted changes in one of society's principal measures (we don't do for example with weights or lengths or temperatures). The main obstacle to a lower target, something centred on "true zero", appears to be the failure of central banks, including the RBNZ to deal effectively with the near-zero current effective lower bound on nominal interest rates, a bound that itself only exists now because of the choices of central banks and their political masters, against a backdrop of steadily improving payments technologies.

6. Central banks' revealed reluctance to do anything about removing, or greatly alleviating the binding nature of, the effective lower bound, is puzzling, and the Reserve Bank of New Zealand has made no satisfactory case. Even if - as you appear to - one were to be persuaded of the merits of instruments like the LSAP or FLP, few serious observers regard such tools as fully effective substitutes for the ability to adjust the policy rate directly (including because policy rate changes do not expose taxpayers to the huge fiscal risks programmes like the LSAP entailed). Moreover, there is a danger now of fighting the last war - focusing on the recent outbreak of high core inflation - and not to focus sufficiently on the risks around the next demand-led recession which will tax monetary policy capacity in a way that Covid did not.
7. In practical terms, I would favour an explicit statement in the next Remit that it is expected that the target will be reduced to 0-2 per cent inflation over the next few years and explicitly requiring the Bank and the MPC to take steps (including recommending any necessary supporting legislative fixes) to ensure that the effective lower bound was removed or greatly alleviated by the end of 2024.
8. Finally on this topic, I was disconcerted to read paragraph 51 of the consultation document, in which it is suggested that there is some substantive economic merit in having a very similar inflation target to that in other countries. Such claims recall half-baked arguments about focusing on the inflation rates of our "trading partners" that were being made when inflation targeting was first being developed in New Zealand, and have no apparent macroeconomic merit. The arguments in that paragraph seem particularly threadbare, and there is no serious case to be made that aiming at an inflation rate the same of those of some other countries - and note that New Zealand's has always been below that in the economy we have the tightest links to, Australia - will assist in achieving price stability (especially when the current inflation target itself is barely consistent with medium-term price stability).
9. In terms of the "additional considerations" for the Remit, I
  - a. Agree that the clause relating to house price sustainability should be removed (and should never have been inserted),
  - b. Would favour the complete removal of the financial system provision (it never having been clear that here or in the Act it had any real substance that aided decision-making or accountability, and

- c. Favour the complete removal of the “unnecessary instability” clause. It does relatively little harm, but muddies the water and as you will be well aware over 24 years now it has never been clear to anyone (in the Bank or holding it to account) what the words really meant and what policy implications, if any, they should have.
10. I am fairly strongly opposed to the removal of the “transitory effects” clause, and if anything would favour a return to a somewhat more expansive, if inevitably illustrative approach, of the sort adopted in many successive Policy Targets Agreements. Removing the clause will unbalance the document, and weaken the MPC’s hand in conducting policy as it should. A clause of this sort is an important balance to the (inevitably somewhat imprecise) “medium term” phrasing of the primary objective itself.
11. Contrary to the consultation document’s proposal, I consider that it would be highly desirable to include some explicit material in the Remit regarding the governance of alternative instruments, and particularly those (unlike say the FLP) that expose taxpayers to considerable financial risk. The Remit is the central document for monetary policy targeting and around which accountability is supposed to focus, but it and its predecessors have a structure designed for an era in which short-term policy rate adjustments (or, pre-99, counterpart quantities) were the primary, and low risk, instruments. As the material in the document notes - and it is one of the flaws in the new legislative model - there are anomalies in which the MPC and the Board both have responsibilities in this area, but that is not an adequate reason to simply ignore the issues in the Remit document (especially as the Board itself is subject to much weaker accountability and transparency provisions than the MPC). I do not have a specific formulation to suggest, but would lean towards a model that required the MPC to outline in a timely and full way the risk analysis undertaken before alternative instruments were deployed and a requirement to report regularly and routinely on the extent of the financial risks and any financial gains/losses.
12. I do not favour (but also do not feel particularly strongly about) text on monetary and fiscal policy coordination, for various reasons including those you outline in the document.
13. I have written extensively on issues around the MPC composition, charter, and communications, and do not propose to repeat all that material at vast length here. However, in brief:
14. You ask whether I have views on “the decision-making model the Charter should be based on, or wider changes the MPC could make to improve its decision-making”. The short answer is yes. The key change that should be made is to move away from the current Governor-dominated system, which has proved particularly problematic when the first Governor under the new system is both a very strong personality but also one without evident leading expertise in monetary policy or matters macroeconomic. In general, with such a heavy focus now on the Bank’s prudential regulatory responsibilities (and with a Board more focused there) there is no guarantee that any future Governor will be primarily an expert in matters directly relevant to monetary policy.
15. Within the confines of the current legislation (which should be amended) a significant first step would be to remove the current policy barring anyone from consideration as an external MPC who has ongoing or likely future research or analytical focus on monetary

policy and macroeconomic issues. This has proved particularly problematic as the quality of the internal MPC members has deteriorated - and thus we have one senior figure with no subject expertise or background at all – but would be a serious flaw in the system (and unknown in any other central bank now) even with a very strong bench of internals. The current restriction biases appointments towards people at or very near retirement, and while many such people may be quite able, they are not the only ones likely to be able to bring expertise or insight to the MPC process. Moreover, such people may be more likely to be willing to simply go along with management, since the MPC appointment may well be their last significant role.

16. Perhaps as importantly, there should be a shift to a model in which each MPC member is required to register a vote on each monetary policy decision, and where that vote (and a summary of reasons for it) is published as part of the minutes. At present, it is impossible for any outsider to have any basis for confidence that external MPC members are adding any value at all, and there is no accountability for those individuals (especially as the externals are outnumbered by management MPC members, all of whom work for the Governor). We have come through a period of the worst monetary policy failure in decades and it appears that no MPC member ever thought there were sufficient problems to put on record a dissenting view. In any functioning group of able and energetic people that simply should not have been possible, and suggests that one or both of the following has happened: a poor quality of people have been appointed, and/or the people appointed have not felt the necessity of or freedom to marking out distinctive positions and adequately identifying emerging risks/threats.
17. The current system has put a strong emphasis on the idea that MPC members should form a consensus view. Monetary policy decisions - characterised by a huge amount of inevitable uncertainty at the best of times, revisited frequently - are not ones that naturally cry out for consensual decision-making. Instead, with respect for one another at an individual level, what we need is evidence of clear contest of ideas, and a ready openness to the possibility of being wrong, all combined with some serious accountability.
18. As your document notes, the current Charter allows non-executive MPC members to make speeches etc. In fact, of course, there have been none, and we (and Parliament's FEC) have hardly ever heard from any of the external MPC members (and have heard almost as little on monetary policy issues from some of the internals). The rare occasions when external MPC members have been heard from - e.g. the recent questions Peter Harris answered – have not been to the credit of the institution or the individuals concerned. Better outcomes could no doubt be achieved within the current Charter wording, but a superior route would be to amend the Charter to explicitly articulate an expectation that MPC members (internal and external) will be giving serious on-the-record speeches and interviews, and that they will be encouraged to lay out and articulate the thinking, analysis, and evidence they are each using to shape their views. The contest of ideas, and serious scrutiny of the arguments MPC members are making, should lift both the quality of the MPC's own deliberations (including making it less Governor dominated) and outside confidence in the systems and processes (reducing risks of groupthink and free-riding). It is a system that works well in the US and UK, even if it is no guarantee of better policy outcomes. (Consistent with this sort of expectation I would favour making available to external MPC members a small amount of independent research assistance).

**From:** [REDACTED]  
**To:** [Reserve Bank Remit Review](#)  
**Subject:** Submission on Monetary Policy  
**Date:** Thursday, 19 January 2023 2:00:25 pm

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Hi

It's not OK to double the interest rate over a short period.  
The effect is to double mortgage payments, reducing discretionary income and reducing property values, eroding equity.

The RBNZ should have separate tools and policy settings for the business and household sectors.  
Eg: a separate Home Mortgage OCR and Business OCR.  
As soon as home prices fall by a %age the RBNZ should stop increasing mortgage rates, or when they become harsh on families.

If someone has bought a \$1million average home they will probably have an \$800k mortgage.  
Interest on that is \$32,000 at 4% and it was probably a stretch to afford that. If you increase mortgage rates from 4% to 8% that's another \$32,000 that the family needs to find.  
Where do you expect them to get that sort of money from? They would need a \$45,000 salary increase to be able to afford it.  
So you should deal more gently with policy tools impacting household interest rates.

Thanks

[REDACTED]

Sent from my iPhone

**From:** [James Weir](#)  
**To:** [Reserve Bank Remit Review](#)  
**Subject:** FW: Remit review second public consultation  
**Date:** Thursday, 1 December 2022 8:51:25 am  
**Attachments:** [image001.jpg](#)  
[image002.jpg](#)  
[image003.jpg](#)

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**From:** Nik Zahariadis <niknkatz@gmail.com>  
**Sent:** Wednesday, 30 November 2022 9:12 PM  
**To:** James Weir <James.Weir@rbnz.govt.nz>  
**Subject:** re: Remit review second public consultation  
Good evening James,

Just a brief comment from me in relation to the RB's performance over recent years under my ex-National Bank colleague (Adrian Orr) and that is that the RB appear to be making decisions that would affect New Zealanders long term "on the run".

It is less than three years ago or close enough that you were considering a "negative OCR" which forced a lot of prudent investors to place their available funds on 3 to 5 year Term Deposits at nominal interest rates -a situation that changed within the next 12 -15 months- and cost them the loss of a substantial part of their income to support their increased cost of living!

Currently you are advocating a probable OCR at over 5% which would be great for me as a net investor (thankfully not a borrower at my age) but your comments have almost placed a stop on the property market!

I feel that you need to get out of your offices and talk to a few "ordinary" New Zealanders to get first hand their reactions to your recent decisions and how much they are affected by each & every announcement you make on long term interest policy.

Thank you & kind regards,

Nik Zahariadis, Retired National Bank Audit Manager - Corporate & Commercial Banking

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Submission to the RESERVE BANK OF NEW ZEALAND on the:

## **Monetary Policy Committee Remit Review**

Submitted by the New Zealand Council of Trade Unions Te Kauae Kaimahi  
27.01.2023

**IN UNION, TOGETHER.**  
[union.org.nz](http://union.org.nz)

This submission is made on behalf of the 31 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With over 340,000 union members, the CTU is one of the largest democratic organisations in New Zealand.

The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Rūnanga o Ngā Kaimahi Māori o Aotearoa (Te Rūnanga), the Māori arm of Te Kauae Kaimahi (CTU), which represents approximately 60,000 Māori workers.

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## 1. Summary of Recommendations

The CTU:

- 1.1. Recommends that full employment should be a central macroeconomic policy goal in New Zealand.
- 1.2. Supports the retention of a flexible inflation-targeting framework.
- 1.3. Supports a balance between the two primary objectives – price stability and maximum sustainable employment – and notes that the current Remit, and the MPC's operationalisation of the Remit, is biased towards the price stability objective.
- 1.4. Opposes the suggestion that the primary objectives of the Remit should be hierarchically ordered – requiring the MPC to consider supporting maximum sustainable employment *subject to* meeting the price stability objective.
- 1.5. Supports the retention of an undefined medium term as the target horizon for the price stability objective, and notes that the RBNZ should do more to “look through” the current inflationary pressures and that higher-frequency data on inflation would assist with this.
- 1.6. Supports the continuance of a range and mid-point for the RBNZ's inflation target.
- 1.7. Recommends a moderately higher range and mid-point is adopted for the RBNZ's inflation target, the benefits of which outweigh the costs.
- 1.8. Supports retaining the clause related to avoiding unnecessary instability in output, interest rates, and the exchange rate.
- 1.9. Recommends maintaining a clause that the MPC must discount the transitory component of an event's impact on inflation.
- 1.10. Opposes removing the preamble paragraphs in the Remit that set out the Government's economic objectives and the ways in which monetary policy can contribute to realising the Government's economic objectives.

## 2. Introduction

- 2.1. The CTU welcomes the opportunity to submit on the Monetary Policy Committee Remit Review (the Review). The CTU supports a macroeconomic policy framework that places the wellbeing of New Zealanders at its centre. The Reserve Bank of New Zealand (RBNZ) can play an important role here by helping to achieve price stability, full employment, and a sound financial system.
- 2.2. The CTU's view is that a central objective of macroeconomic policy should be the promotion of full employment – defined as a situation in which every person in New Zealand who is willing and able to work can obtain legal employment.<sup>1</sup> A fully employed society has been a long-standing goal of progressive economic policy and is a foundation of the UN's Universal Declaration of Human Rights and Sustainable Development Goals.<sup>2</sup>
- 2.3. At the time of writing, New Zealand's headline unemployment rate sits at 3.3 percent. By recent historical standards, this is a record low. Between the 1950s and the late 1970s, the unemployment rate in New Zealand was consistently below 2 percent, although this was achieved in a very different economic environment to that of today. During the restructuring of the 1980s and 1990s – which included the passing of the Reserve Bank of New Zealand Act 1989 and the development of inflation targeting – unemployment rose sharply, peaking at 10.9 percent in 1991. Over the following two decades headline unemployment slowly trended back down, reaching a low of 3.4 percent just before the onset of the 2008 financial crisis. In the wake of that crisis, unemployment almost doubled, reaching a peak of 6.7 percent in 2012. Unemployment then slowly declined over the next eight years, reaching a pre-pandemic low of 4 percent in 2019.<sup>3</sup> Today's rate of unemployment is therefore the lowest we have seen since the early 1980s.
- 2.4. The CTU's view is that policymakers should seek to preserve the current low rate of unemployment, which is an important economic and social achievement. Indeed,

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<sup>1</sup> There will always be a degree of “frictional” unemployment in a market economy, as people look for new work in response to business closures, technological change, and economic restructuring, among other things. A small amount of frictional unemployment need not be a problem so long as there is a robust social-welfare system and active labour market policies that are available to support workers through that period.

Unemployment becomes problematic when people are unable to find work within a reasonable timeframe.

<sup>2</sup> Full employment was a central pillar of macroeconomic policy in New Zealand during the post-war decades. By contrast, the central pillars of macroeconomic policy since the early 1990s have been (1) price stability and (2) fiscal balance: [D. Rose](#), “Fiscal History, Fiscal Policy”, *IGPS Working Paper 19/03* (2019). For greater clarity, we note that New Zealand should strive for full employment in *decent work* – i.e., work that has a lasting positive impact on the worker, the employer, and the wider community, affords good pay and conditions, and in which both employers and employees are treated with respect and dignity. We recognise that ensuring the availability of work of a particular standard is primarily the responsibility of elected Government, unions, business, and other civil society actors, not the central bank.

<sup>3</sup> Rose, “Fiscal History, Fiscal Policy”, pp. 14–16.

our view is that more could and should be done to drive the rate of unemployment lower over time. New Zealand should aim to consistently have one of the lowest rates of unemployment in the developed world.

- 2.5. The CTU recognises that maintaining stability in the general level of prices is also an important objective for macroeconomic policy, because sustained periods of high inflation can have negative economic consequences that undermine wellbeing and social stability, including the availability of employment. We also recognise that the RBNZ is constrained in its ability to support a full-employment goal, and that the primary levers through which this can be achieved are fiscal and structural. Nevertheless, our view is that the RBNZ can still make an important contribution towards supporting full employment in this country. At minimum, the RBNZ's policy framework and implementation should be consistent with such an objective.
- 2.6. With these points in mind, this submission focuses on how the MPC Remit can better support high levels of employment in New Zealand without unduly undermining the maintenance of price stability over the medium term. In section 3, we respond to questions raised in the consultation document regarding the monetary policy framework and the primary objectives. In section 4, we respond to selected questions raised about the calibration of the primary objectives and additional considerations for the Remit.

### **3. The Monetary Policy Framework and Design of the Primary Objectives**

- 3.1. This section responds to all six questions raised in chapters 2 and 3 of the consultation document.

#### **The monetary policy framework**

- 3.2. The CTU supports the retention of a flexible inflation-targeting framework.
- 3.3. There is a voluminous literature on the debate over “rules versus discretion” in monetary policy. Without trudging through the details of this debate here, we note simply that a prescriptive, rules-based framework is an *inappropriate basis* for monetary policy – and for macroeconomic policy in general.
- 3.4. Rules may be an appropriate basis for policymaking if one is dealing with a stable system to which all relevant information is accessible and whose future state can

be accurately forecast. The opposite is true of market economies, which are *dynamically unstable* and are characterised by *imperfect information* and *fundamental uncertainty*. In this context, policymakers need a degree of latitude if they are to make optimal decisions – i.e., “when the facts change”, policymakers need to have a reasonable degree of freedom to calibrate their response accordingly. A flexible inflation-targeting framework provides policymakers some latitude in setting monetary policy; it also helps policymakers to support high employment and avoid causing unnecessary economic instability in the pursuit of their mandates.

### **Weighting of the primary objectives – “credibility versus flexibility”**

- 3.5. The RBNZ currently has a “dual mandate”. It is required “to formulate monetary policy with the goals of [1] maintaining a stable general level of prices over the medium term and [2] supporting maximum sustainable employment” (MSE). The consultation document raises concerns that the RBNZ’s “credibility” as an inflation manager – i.e., its *commitment to low inflation* and its *ability to deliver low inflation* – may have been undermined by the adoption of the MSE objective and/or a lack of guidance regarding how trade-offs between the two primary objectives should be managed. The CTU’s view is that this is not a realistic concern, for three reasons.
- 3.6. First, there is scant empirical evidence that the RBNZ’s credibility as an inflation manager has been undermined over this period. Long-term inflation expectations are often taken as a proxy measure for a central bank’s credibility as an inflation manager. According to the surveys cited in the *Monetary Policy Statements*, both 5-year and 10-year inflation expectations have hardly budged since the MSE objective was introduced in early 2019. Both remain well within the RBNZ’s 1–3 percent inflation target and near to the 2 percent midpoint. We return to this issue in more detail below; the point made here is simply that these measures in no way suggest the RBNZ’s credibility as an inflation manager has been undermined by the adoption of the dual mandate or a lack of clear guidance regarding trade-offs.
- 3.7. Second, “maximum sustainable employment” is a very different concept to that of “full employment”. As the RBNZ’s operational definition reads, MSE is “The highest utilisation of labour resources that can be maintained without generating an acceleration in inflation”. By contrast, full employment can be defined as a situation in which every person in New Zealand who is willing and able to work can obtain legal employment. By definition, MSE is a *conditional* term, while full employment is an *unconditional* term. The conditionality of MSE is further evidenced by the fact

that the current Remit outlines a specific numerical target for the price stability objective: to “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”. By contrast, there is no numerical target for the MSE objective, which, as the Remit notes, “is largely determined by non-monetary factors that affect the structure and dynamics of the labour market and is not directly measurable”.

3.8. Third, the asymmetry of the two primary objectives is evidenced by the RBNZ’s recent response to above-target consumer-price inflation. Since October 2021, the RBNZ has aggressively tightened monetary policy. It was one of the first advanced economy central banks to raise rates;<sup>4</sup> to date, it has also raised rates higher than most other advanced economy central banks (Figure 1), even though New Zealand has recorded lower rates of inflation than most other advanced economies over this period (Figure 2). On its current forecasts, the RBNZ expects that it will raise the OCR to a peak of 5.5 percent. The bank forecasts that this will send New Zealand into a shallow but reasonably lengthy recession in 2023 and early 2024 and will drive unemployment up to 5.7 percent by early 2025.<sup>5</sup> In other words, the RBNZ is actively seeking to drive economic output down and unemployment up in order to lower inflation.

3.9. In short, there is little reason to think that the RBNZ’s credibility as an inflation manager has been undermined by the adoption of the “dual mandate” or the lack of a clear position on how trade-offs should be made between the two primary objectives. As such, there is no compelling reason why the flexibility afforded the RBNZ by the current Remit should be curtailed in any way.

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<sup>4</sup> Only the Norwegian central bank raised rates earlier, by two weeks.

<sup>5</sup> Other recent forecasts are not quite as pessimistic, but still see unemployment rising significantly. The Treasury forecasts that unemployment will peak at 5.5 percent in 2024; and NZIER’s consensus forecast is that it will peak at 5.1 percent in 2025/26. [The Treasury](#), *Half Year Economic and Fiscal Update* (December 2022); [NZIER](#), *Consensus Forecasts* (December 2022).

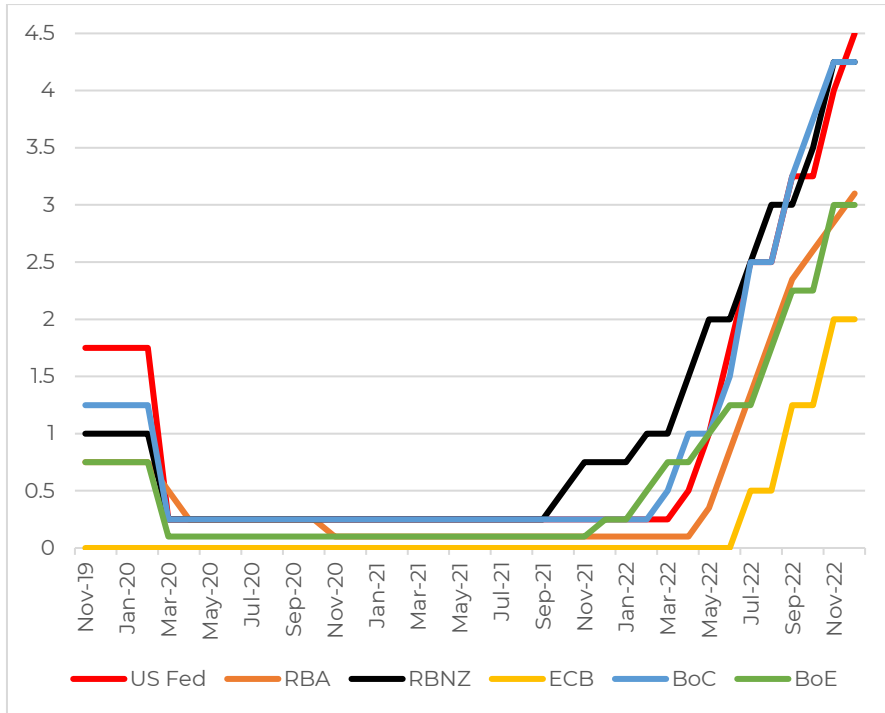


Figure 1: Central bank policy rates, 2020–2022.

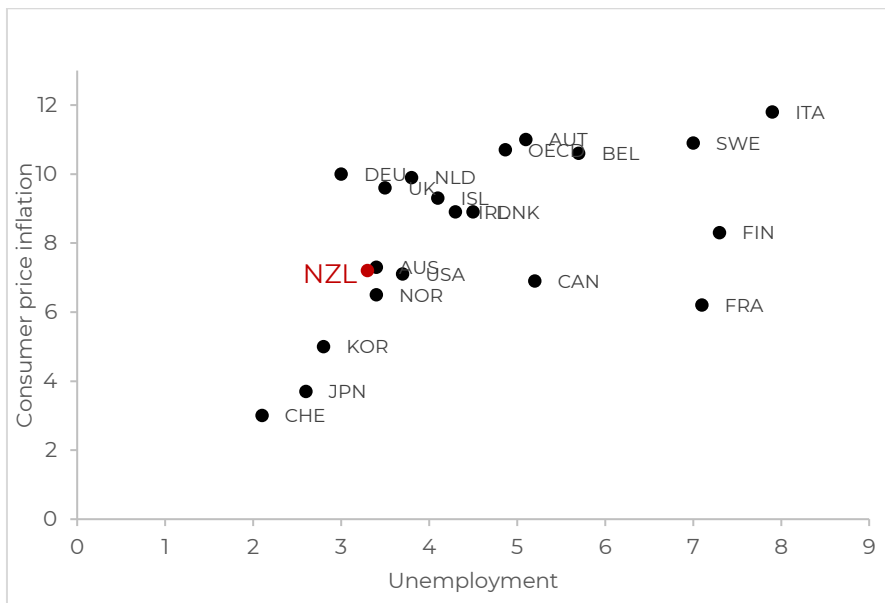


Figure 2: Advanced economies misery index, December 2022 (OECD data).

### Hierarchical ordering of the primary objectives

3.10. The CTU strongly opposes the suggestion that the primary objectives of the Remit should be hierarchically ordered – requiring the MPC to consider supporting MSE *subject to* meeting the price-stability objective. Further emphasising the primacy of the price-stability objective would only reinforce the RBNZ’s current price-stability bias. It would also undermine the recent progress that has been made in

bringing an employment objective back onto the agenda of macroeconomic policy in New Zealand.

- 3.11. As discussed above, there is little evidence to suggest that the RBNZ's credibility as an inflation manager may have been undermined by the adoption of the MSE objective and/or a lack of guidance regarding how trade-offs between the two primary objectives should be managed. Indeed, the question can be reversed: is the current Remit – and its operationalisation by the MPC – excessively concerned with keeping consumer-price inflation between 1–3 percent, and does this come at the expense of supporting MSE?
- 3.12. Inflation in New Zealand has primarily been driven by exogenous shocks caused by the COVID-19 pandemic and the war in Ukraine. Globally, demand rotated away from services and into goods during 2020 and 2021, putting enormous pressure on supply chains; this was compounded by shipping jams and port lockdowns, among other idiosyncratic issues. In this context, energy, food, and commodity prices began to rise in price in late 2021 and then further in response to the Russian invasion of Ukraine in early 2022. This imported inflation still accounts for around half of total CPI in New Zealand, and the rising costs of imported goods has been a significant factor driving up the costs of domestic goods and services.
- 3.13. The RBNZ is unable to do anything about these international price shocks. The relevant domestic question is whether these price shocks have given rise to a self-sustaining inflationary dynamic in New Zealand. Here, two main justifications have been drawn upon by the RBNZ to support its rapid monetary tightening: (1) the threat of a “wage–price spiral” developing; and (2) the risk that inflation expectations are becoming “unanchored”. Empirically, neither justification is well supported.
- 3.14. The first argument is that rising wage demands are evidence of an evolving wage–price spiral, suggesting that employment is “above its maximum sustainable level”. The upshot is that unemployment needs to increase so as to generate some “slack” in the labour market, which will help to moderate wage demands.
  - 3.14.1. This, of course, is not a distributionally neutral response. At the time of writing, around 100,000 people are unemployed in New Zealand and another 180,000 are underutilised. If the unemployment rate peaks at 5.7 percent in early 2025, then monetary policy tightening will have pitched roughly 70,000 *more* New Zealanders into involuntary unemployment, and more again into underemployment. These job losses will not be experienced evenly across

demographics. History suggests those who are at the highest risk of losing their job as the economy cools are Māori, Pasifika, the young, and the low-paid (it would be difficult to find a group in the workforce that is less able to influence the setting of prices and wages). Thus, the current policy response asks some workers (predominantly the most vulnerable workers) in New Zealand to “take one for the team”.

3.14.2. Regardless of these distributional issues, it should be noted that there is scant evidence that a wage–price spiral is on the cards for New Zealand. Real wage growth continues to lag inflation in New Zealand and inflation continues to be driven primarily by international factors that are beyond the RBNZ’s control. New Zealand is not alone in this situation. As the ILO’s recent *Global Wage Report* details, there is currently “no evidence of a wage–price spiral either in high-income countries or in middle- and low-income ones”.<sup>6</sup> And as research from the IMF has found, only in rare cases have historical episodes of rising inflation and low unemployment combined with rising nominal wages and falling real wages – the precise dynamic we are currently experiencing in New Zealand – resulted in wage–price spirals.<sup>7</sup> In short, wage–price spirals are rare economic phenomena and the evidence thus far does not suggest we are on the cusp of one emerging in New Zealand. The threat of a wage–price spiral is therefore not a credible basis for rapid monetary policy tightening aimed at driving unemployment up.

3.15. The second argument is that inflation expectations are showing signs of becoming unanchored, which may be a sign that either the central bank’s credibility as an inflation manager is at risk, or that high inflation is becoming self-sustaining, or both.

3.15.1. The question of inflation expectations is a vexed one. The dominant view in the modern literature on central banking and monetary policy is that inflation expectations are an important driver of observed inflation. This argument boils down to the idea that expectations about future inflation determine price-setting behaviour in the present. If price-setters expect that inflation will be high in the future, then they will be more inclined to raise prices in the present. It is argued that a central bank is capable of “anchoring” inflation expectations at a low level if it is widely perceived as a credible inflation manager – i.e., that it will intervene forcefully to keep inflation low. The dominant view is that

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<sup>6</sup> [ILO](#), *Global Wage Report* (2022).

<sup>7</sup> [IME](#), *World Economic Outlook* (October 2022).

credibility has been “won” through the institutions of central bank independence and inflation targeting over the past 30 years or so. The emergence of a low-inflation economic environment across the advanced economies from the 1990s has been taken as evidence that inflation can be anchored by a credible central bank. Today, central banks are set on “winning back” or “protecting” their hard-earned credibility by stamping out the current inflation, even if this comes at the cost of higher unemployment and lower growth.

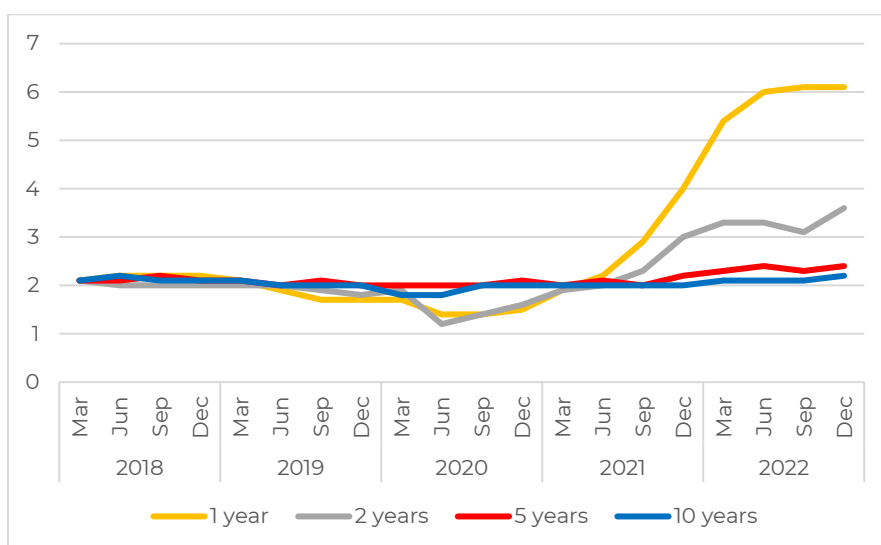
- 3.15.2. This is certainly a neat narrative; however, it is not at all clear that it is correct. While research confirms that the period of independent, inflation-targeting central banks has been one of low inflation,<sup>8</sup> this correlation does not amount to causation. Other research points to the salience of institutional and structural dynamics such as globalisation, the declining power of organised labour, and relative geopolitical (and therefore energy-price) stability over this same period.<sup>9</sup> Indeed, despite the existence of quite different central bank mandates and institutional structures across the advanced economies over the past three decades, low and stable inflation has been a *common* experience across the developed world. This suggests that these structural factors have been salient. This is not to entirely invalidate the conventional narrative; but it does suggest it is not a particularly robust basis for policy decisions.
- 3.15.3. Nevertheless, if we set the above points to one side and assume that inflation expectations and central bank credibility *do* matter a great deal, then the literature is clear that it is *long-term* inflation expectations that are the relevant metric. While short-term inflation expectations may quite reasonably adjust up or down in response to economic shocks, the theory is that long-run inflation expectations should remain anchored near the central bank’s inflation target if it is viewed as a credible inflation manager.
- 3.15.4. Notably, long-term inflation expectations in New Zealand have remained *flat* over the past five years – which is the period in which the MSE objective was introduced (see Figure 3). Although 1-year inflation expectations have shot up

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<sup>8</sup> E.g., [A. Cukierman](#), “Central Bank Independence and Monetary Policymaking Institutions – Past, Present and Future”, *European Journal of Political Economy* 24, no. 4 (2008).

<sup>9</sup> E.g., [BIS](#), *Annual Economic Report, June 2021* (2021); [H-F. Hung and D. Thompson](#), “Money Supply, Class Power, and Inflation: Monetarism Reassessed”, *American Sociological Review* 81, no. 3 (2016); [A. Stansbury and L. Summers](#), “The Declining Workers Power Hypothesis: An Explanation for the Recent Evolution of the American Economy”, *Brookings Papers on Economic Activity* (Spring 2020); [D. Ratner and J. Sim](#), “Who Killed the Phillips Curve? A Murder Mystery”, *Federal Reserve Board, Finance and Economics Discussion Series* (2022).

as the inflationary shock of 2021 and 2022 has unfolded, they now appear to have peaked, remaining stable over the last three quarters of 2022. Meanwhile, 2-year inflation expectations have remained reasonably close to the RBNZ's target range (the 2022 peak being 3.6 percent). More significantly, 5-year inflation expectations have risen by only 0.3 percent and 10-year expectations have hardly budged. As of the latest MPS, 5-year expectations are at 2.4 percent and 10-year expectations are at 2.2 percent, both well within the target range of 1–3 percent and close to the mid-point of 2 percent. Currently, neither measure is appreciably higher than the pre-pandemic norm; and neither measure has risen appreciably higher than the pre-pandemic norm throughout the last five years. This suggests two things: (1) the adoption of the dual mandate has had no effect on the inflation-fighting credibility of the RBNZ (indeed, short-term inflation expectations actually fell after the introduction of the dual mandate in early 2019); and (2) the RBNZ's fears that inflation expectations are becoming unanchored are not well grounded in evidence and are therefore not a compelling justification for continued OCR hikes.



**Figure 3:** Inflation expectations in New Zealand, 2018–2022 (RBNZ data).

3.16. It is reasonable to be concerned about inflation pressures becoming embedded, as the evidence suggests that transitions from low-inflation regimes to high-inflation regimes are self-sustaining.<sup>10</sup> However, there is a need for monetary policy decision-makers to be more circumspect in the present conjuncture. The evidence does not suggest that inflation is becoming self-sustaining, either through wage pressures or through the drift of inflation expectations. Further, there is a material risk that

<sup>10</sup> BIS, *Annual Economic Report, June 2022* (2022).

the RBNZ is on course for an “overcorrection” with its tightening cycle. This would cause unnecessary economic harm and would undermine the wellbeing of both individual New Zealanders and the country as whole.<sup>11</sup>

- 3.17. In sum, although some monetary policy tightening was warranted from 2021 (and, in retrospect, the Large Scale Asset Purchase programme and the Funding for Lending programme could have been ended earlier), our view is that the tightening trajectory that the RBNZ has set itself on is excessive, and that this stems from its price-stability bias.<sup>12</sup> The RBNZ could be doing more to “look through” the current inflationary pressures and preserve New Zealand’s low rate of unemployment, which is an important policy success.
- 3.18. We therefore strongly oppose the suggestion that the primary objectives of the Remit should be hierarchically ordered – requiring the MPC to consider supporting maximum sustainable employment *subject to* meeting the price stability objective. Further emphasising the primacy of the price-stability objective would only reinforce the current price-stability bias and undermine the recent progress that has been made in bringing an employment objective back onto the agenda of macroeconomic policy in New Zealand.

### **The “medium term”**

- 3.19. The CTU supports the retention of an undefined medium term as the target horizon for the price stability objective. However, we note that the RBNZ should do more to “look through” inflation that is generated by transitory shocks, such as the post-COVID inflation; this should be strongly encouraged in the Remit. When responding to inflationary pressures, a patient, medium-term approach is needed to ensure not only that economic volatility is minimised, but also that the negative employment effects of rising interest rates are minimised.
- 3.20. Although monetary policy is a very blunt instrument, it can be a useful tool to deploy when inflation is driven primarily by excess *aggregate* demand. However, it is too blunt an instrument to deal effectively with inflation that is driven primarily

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<sup>11</sup> As the RBNZ is aware, changes to the OCR take between 12–24 months to be fully felt in the wider New Zealand economy. Because around 90 percent of New Zealand mortgages are on fixed-term rates, changes to the OCR are not widely felt until most mortgage holders have had to refix. The majority of mortgages are due for refixing over the next 12 months and refixing at far higher rates will likely have a significant negative impact on aggregate demand. In short, the full effects of the last 12 months of OCR hikes are yet to be felt. The risk of overcorrection is compounded by the fact that imported inflation pressures are easing and global economic growth is widely forecast to be sluggish in 2023, which should act to further drag down inflation.

<sup>12</sup> We note that the Reserve Bank of Australia has embarked on a more cautious series of rate hikes over the past year. Although inflation is running at 7.3 percent in Australia at the time of writing, the RBA has only raised rates by 300 basis points thus far, from 0.10 percent to 3.10 percent.

by, for example, sectoral shocks that constrain supply or shift demand patterns from one sector to another – which is a fair description of the post-COVID inflationary dynamic.<sup>13</sup> In these circumstances, fiscal and structural policies are far more effective and do not have the same adverse side effects as monetary policy. Indeed, one of the side effects of restrictive monetary policy is that it undermines future productive capacity, thereby potentially *intensifying* inflationary pressures over the long run. In these contexts, the RBNZ needs to have more flexibility to “look through” periods of inflationary adjustment. In turn, government needs to be prepared to lend the RBNZ a hand by using fiscal and structural policy to build out New Zealand’s productive capacity in a way that enhances our resilience to future inflationary shocks.

- 3.21. If a more specific timeframe for what constitutes the “medium term” were to be adopted it should be *no shorter than two years*, as this is the estimated time that it takes for the effects of monetary policy decisions to be fully felt in the wider economy.
- 3.22. A further point to be made here is that New Zealand lacks high-frequency data on consumer-price inflation. StatsNZ only publishes this data on a quarterly basis, meaning that the MPC’s monetary policy decisions are based on excessively backward-looking data. This increases the likelihood of monetary policy being set pro-cyclically, both when inflation is rising and when it is falling. Publishing monthly consumer-price inflation data and using this higher-frequency data to inform MPC decisions should result in better monetary policy decisions.

### **The target range for inflation**

- 3.23. The CTU supports the continuance of a range and mid-point, as it provides a desirable level of flexibility and helps to minimise unnecessary instability in output, interest rates, and the exchange rate.
- 3.24. The CTU supports maintaining the current range of plus or minus 1 percentage point. However, as discussed in the next section, we suggest that a higher inflation target may provide significant benefits at little cost and should therefore be seriously explored.

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<sup>13</sup> [J. Stiglitz and I. Regmi](#), “The Causes of and Responses to Today’s Inflation”, *Roosevelt Institute Report* (December 2022); [I. Weber et al.](#), “Inflation in Times of Overlapping Emergencies: Systemically Significant Prices from an Input–Output Perspective”, *University of Massachusetts Amherst, Economics Department Working Paper* (2022).

## 4. Calibration of the Primary Objectives

- 4.1. This section responds to selected questions raised in chapters 4, 5, and 6 of the consultation document.

### The level of the inflation target

- 4.2. The CTU recommends that a moderately higher range and mid-point for the RBNZ's inflation target may provide significant benefits while imposing minimal costs.
- 4.3. "Price stability" is a relative term and an inflation target is ultimately an arbitrary number. However, an optimal inflation target is one that enables at least three things to be true at once. First, the target needs to be high enough to provide a buffer against hitting the effective lower bound (ELB) and to allow for the necessary price adjustments that enable resource reallocation across the economy. (For this reason, having a zero-inflation target is economically harmful and the CTU would strongly oppose lowering either the range or the mid-point from its present levels.) Second, the target needs to be low enough to help stabilise inflation expectations over time; ideally, inflation should be something that firms and households do not think all that much about. This, again, is relative – what is considered unacceptably high inflation differs across time and place. Third, it needs to be a target range that the central bank can reliably hit over time, without causing unnecessary instability in output, interest rates, and the exchange rate – and without, we would add, undermining the country's employment goals. If the central bank cannot reliably hit its inflation target without causing unnecessary economic instability, then its credibility as an inflation manager will be undermined, as will the country's economic welfare.
- 4.4. With these points in mind, we recommend that a range of 2–4 percent with a 3 percent mid-point would offer significant benefits and impose minimal costs. A target around this level or slightly higher has received widespread support from economists in recent years.<sup>14</sup> There are two main reasons why a moderately higher inflation target would be beneficial.

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<sup>14</sup> E.g., [O. Blanchard et al.](#), "Rethinking Macroeconomic Policy", *IMF Staff Position Note 10/03* (2010); [L. Ball](#), "The Case for a Long-Run Inflation Target of Four Percent", *IMF Working Paper 14/92* (2014); [J. Gagnon and C. Collins](#), "The Case for Raising the Inflation Target is Stronger than You Think", *Peterson Institute for International Economics* (2022).

- 4.5. First, as many economists have argued over the past decade, a slightly higher inflation target would provide central banks with more room to conduct counter-cyclical policy without running into the ELB.
- 4.5.1. As the Bank for International Settlements notes, “monetary policy loses traction when nominal interest rates are very low. [...] The more limited traction of monetary policy at low levels of inflation means that bigger moves in the policy instrument are needed to produce the same inflationary effect, with larger side effects for the real economy”.<sup>15</sup> Many central banks have been faced with this problem since the 2008 financial crisis. In response, they have resorted to sub-optimal “alternative” monetary policy tools, especially large-scale asset purchases (quantitative easing/QE), which help the central bank to meet its inflation target but can also undermine financial stability and contribute to wealth inequality.<sup>16</sup>
- 4.5.2. A higher inflation target should help to lift the average level of the nominal interest rate, meaning that the RBNZ has more room to cut rates to stimulate economic activity in a downturn, or in response to an unexpected shock, before it runs into the ELB. This should help to keep unemployment lower on average and to avoid having to resort to sub-optimal policy tools.
- 4.6. Second, it is likely that we are entering a period of structurally higher inflation – or at least of more frequent inflationary price shocks. In this context, a higher inflation target will assist central bank credibility by making it easier for the central bank to both meet its inflation target and support high employment without causing unnecessary economic instability.
- 4.6.1. As discussed in section 3, the evidence is mixed regarding exactly what has underpinned the low-inflation regime of the past three decades. However, based on the wider literature, it is reasonable to argue that the low-inflation regime was underpinned by the combination of four key factors: (1) globalisation, which opened up new sources of supply and put downward pressure on wages; (2) the decline of organised labour and the flexibilization of labour markets, which also put downward pressure on wages; (3) relative geopolitical stability, which helped to keep energy and other commodity prices low; and (4) the combination of inflation-targeting central banks and

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<sup>15</sup> BIS, *Annual Economic Report, June 2022*, p. 60.

<sup>16</sup> [D. Gabor](#), “Revolution Without Revolutionaries: Interrogating the Return of Monetary Financing”, *Transformative Responses to the Crisis, Finanzwende, Heinrich-Böll-Foundation* (2021); [J. Montecino and G. Epstein](#), “Did Quantitative Easing Increase Income Inequality?” *Institute for New Economic Thinking Working Paper* 28 (2015).

fiscal policy focused on returning balanced government accounts. To this list, we should also add a fifth factor that contributed to low inflation: a stable and relatively predictable global climate.

- 4.6.2. As even a casual observer would note, points 1 and 2 no longer hold to the same extent that they did throughout the 1990s and the first two decades of the 2000s. Globalisation has come under immense stress politically and great power conflict is back. These developments should be expected to put significant pressure on supply chains in the future and to make inflationary price shocks more common. The acceleration of climate change and the need to ramp up emissions-reduction policies that require significant fiscal investment and resource reallocation further increases the likelihood that inflationary shocks will become more common in the future. Finally, it is now widely recognised that the policy mix of inflation targeting and fiscal balance, while helpful in keeping inflation low, has contributed to higher levels of unemployment, rising inequality, and chronic underinvestment in infrastructure over the past three decades. This is not socially sustainable and suggests that increased fiscal expenditure is necessary over the coming decade.
- 4.6.3. In this context, a higher inflation target will reduce the risk that the RBNZ will consistently overshoot its inflation target and will therefore aid the RBNZ's credibility. It will also enable better monetary and fiscal policy coordination in the context of the higher fiscal expenditure that is needed to address New Zealand's infrastructure deficit and green transition needs, among other things. Finally, by making it less likely that the RBNZ will be in a situation where it faces a "trade-off" between inflation and unemployment, a moderately higher inflation target will also assist the RBNZ in meeting its employment objective.
- 4.7. Over the past three decades, advanced economy central banks have adopted very low inflation targets in the range of 1–3 percent per annum. The basis for these low targets has been the argument that low inflation is key to enabling strong and stable economic development. It should be noted, however, that this is not well supported by the empirical evidence, which suggests that inflation only imposes significant economic costs when it rises to double digits.<sup>17</sup> Indeed, recent research finds that high-income economies have historically achieved *stronger* real GDP

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<sup>17</sup> [J. Kirshner](#), "The Political Economy of Low Inflation", *Journal of Economic Surveys* 15, no. 1 (2001); [L. Ball](#), "The Case for a Long-Run Inflation Target of Four Percent", *IMF Working Paper 14/92* (2014).

growth when inflation runs significantly higher than the 1–3 percent range.<sup>18</sup> It should also be noted that the RBNZ’s consultation document does not discuss in any depth what the negative welfare effects of a moderately higher inflation target would be.<sup>19</sup>

- 4.8. By contrast, it is likely that a moderately higher range and mid-point would help the RBNZ to avoid the problem of the ELB, better support high employment, and assist its credibility in a changing economic system (not to mention a changing climate). Thus, the benefits of a moderately higher inflation target appear to substantially outweigh the costs.

### **Additional clauses**

- 4.9. The CTU supports retaining the clause related to avoiding unnecessary instability in output, interest rates, and the exchange rate. We also recommend including employment in this list. The RBNZ should always seek to ensure that monetary policy is implemented in a way that minimises economic instability.

- 4.10. The CTU recommends maintaining a clause that the MPC must discount the transitory component of an event’s impact on inflation; however, this could be reworded and included in the primary objective, as suggested in the consultation document. As discussed above, the RBNZ should be doing more to “look through” the current inflationary pressures. Maintaining the above clause is important in helping to encourage such an approach in the future.

### **Monetary and fiscal policy coordination**

- 4.11. The CTU does not support removing the paragraph that sets out the Government’s economic objectives. Nor does the CTU support removing the paragraph that sets out the way in which monetary policy can contribute to realising the Government’s economic objectives.

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<sup>18</sup> [R. Pollin and H. Bouazza](#), “Considerations on Inflation, Economic Growth and the 2 Percent Inflation Target”, *PERI Working Paper* (2022). As the authors note, in high-income economies “the evidence suggests that they are paying a significant penalty in terms of foregone GDP growth when policymakers set an inflation target at 2 percent as the central goal of macroeconomic policy” (p. 22).

<sup>19</sup> The consultation document does raise the issue of a “transition risk”, whereby the RBNZ’s credibility as an inflation manager is negatively impacted if the public perceives that the inflation “goalposts” are being shifted. This is not an unreasonable concern, and we would suggest that shifting the target range and midpoint upwards should only happen after the current inflationary shock has abated, and inflation has shifted down close to, or within, the current range of 1–3 percent. More generally, though, a shift upwards by 1 percent or slightly more would not be a dramatic change to monetary policy in New Zealand. The New Zealand public has coped perfectly well with the previous three major changes to the numerical target since the passing of the Reserve Bank Act. In 1996, the inflation target was shifted from 0–2 percent to 0–3 percent. In 2002 it was shifted from 0–3 percent to 1–3 percent on average over the medium term. And in 2012 the 2-percent midpoint was introduced.

- 4.12. The consultation document suggests that removing these paragraphs may “enhance the perception of central bank independence”. However, it is difficult to see how either of these paragraphs materially undermine central bank independence in the first place – and the consultation document does not elaborate on this issue further. It should be recalled that central bank independence means *operational* independence – i.e., independence in determining how to achieve the objectives laid out for the RBNZ in the relevant legal texts. As such, there is no contradiction between (a) the Government providing guidance on how the RBNZ can support the Government’s economic objectives and (b) the central bank’s ongoing operational independence in the pursuit of the monetary policy objectives it has been delegated. Indeed, in a democratic society it is both inappropriate and potentially destabilising for a central bank to pursue – intentionally or not – objectives that run contrary to those of elected government. Doing so undermines the legitimacy and credibility of government, which is brought to power by the public on the understanding that it can reasonably pursue the objectives on which it campaigned. This erodes public confidence in the state, thereby undermining the longevity of central bank independence itself.
- 4.13. More broadly, since the early 1990s the orthodoxy has been for the two sides of macroeconomic policy to be separated, and the primary burden of economic stabilisation given to central banks. As has been widely discussed, the problems with this regime became increasingly evident after the 2008 financial crisis.<sup>20</sup> Through the 2010s, economists, central banks, and international organisations have increasingly called for more assistance from fiscal authorities in the context of “overburdened” central banks and sluggish economic growth across most advanced economies. As the consultation document notes, the COVID-19 pandemic further highlighted the necessity of macroeconomic policy coordination. Our view is that removing the preamble paragraphs to the Remit would undermine recent progress in the direction of better macroeconomic policy coordination. Future Remits should, on the contrary, convey expectations of deeper and ongoing policy coordination between the RBNZ and the fiscal authority.

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<sup>20</sup> For differing perspectives on this issue see, e.g., [A. Tooze](#), *Crashed: How a Decade of Financial Crises Changed the World* (London, 2018); [O. Blanchard and L. Summers](#), *Evolution or Revolution? Rethinking Macroeconomic Policy After the Great Recession* (Massachusetts, 2019); [C. Borio](#), “Central Banking in Challenging Times”, paper presented at SUERF Annual Lecture, Milan, 2019; [A. Korinek and J. Stiglitz](#), “Macroeconomic Stabilization for the Post-Pandemic World: Revising the Fiscal–Monetary Policy Mix and Correcting for Economic Externalities”, *Hutchins Center Working Paper 78* (2022).

## 5. Conclusion

- 5.1. This submission has focused on how the MPC Remit could better support high levels of employment in New Zealand without unduly undermining the maintenance of price stability over the medium term. The CTU's view is that both the maintenance of price stability and the promotion of full employment are critical objectives of macroeconomic policy. Although its powers are limited, the RBNZ has an important role to play in supporting both objectives.
- 5.2. The CTU thanks the RBNZ for the opportunity to engage on the Monetary Policy Committee Remit Review. We look forward to further engaging with the RBNZ on this work and on other monetary and financial policy issues.

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# **PSA Submission to the Monetary Policy Committee Remit Review Second Consultation**

January 2023



## About the PSA

The New Zealand Public Service Association Te Pūkenga Here Tikanga Mahi (the PSA) is the largest trade union in New Zealand with over 82,000 members. People join the PSA to negotiate their terms of employment collectively, to have a voice within their workplace, and to have an independent public voice on the quality of public and community services and how they're delivered.

We are a democratic and Te Tiriti O Waitangi responsive union representing people working in the public service (including ministries, departments, crown agents, other crown entities, and state-owned enterprises); local government; tertiary education institutions; and non-governmental organisations working in the health, social services and community sectors.

Te Rūnanga o Ngā Toa Āwhina represents and promotes the interests of our Māori members and are committed to honouring Te Tiriti o Waitangi across the public sector and inside the union. Our structures ensure a Māori perspective is heard in all levels of our organisation.

The PSA is affiliated to Te Kauae Kaimahi the New Zealand Council of Trade Unions, Public Services International and UniGlobal.

## PSA recommendations

The PSA endorses the submission of the New Zealand Council of Trade Unions and the economic arguments made by the New Zealand Council of Trade Unions.

We wish to make three key points in response to the questions raised in the second consultation for the Monetary Policy Remit Review:

1. The two objectives should be seen as separate and equal goals. Maximum sustainable employment should not be understood as subsidiary goal to price stability.
2. The current level of flexibility should be maintained, as should the requirement to avoid unnecessary instability in output, interest rates and the exchange rate.
3. The requirement to discount transitory events should be adapted rather than removed.

## Wider issues

The current economic moment underscores the costs of the Reserve Bank relying on the tool of raising interest rates to meet monetary policy goals. An increase in unemployment and a recession are a high price to pay to try and combat inflation that is largely caused by global crises. Taking actions that increase unemployment to try to reduce inflation ensures that the economic costs fall on working people and those least able to afford them. Wider reform of the monetary policy that would increase the tools used to achieve the goals of price stability and full employment is beyond

this remit review, but it is crucial to ensure that the costs of keeping inflation down do not fall disproportionately on those already marginalised and disadvantaged.

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# Westpac New Zealand Limited

Submission to the Reserve Bank of New  
Zealand on *Supporting New Zealand's  
economic stability Toitū te Ōhanga*

26 January 2023



## 1. INTRODUCTION

- 1.1 This submission to the Reserve Bank of New Zealand (**Reserve Bank**) is made on behalf of Westpac New Zealand Limited (**Westpac**) in respect of *Supporting New Zealand's economic stability Toitū te Ōhanga: A second public consultation on the five-year review of the Remit that guides monetary policy decisions* (**Consultation Document**). Thank you for the opportunity to provide feedback on the proposals.
- 1.2 Capitalised terms used in this document have the meaning given to them in the Consultation Document.
- 1.3 Westpac's contact for this submission is:  
  
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## 2. KEY SUBMISSIONS

- 2.1 We support the flexible inflation targeting framework that is specified in the current Monetary Policy Committee (**MPC**) Remit (**Remit**). This is also the Reserve Bank's favoured option.
- 2.2 A key feature of the current Remit is that the Reserve Bank is required to keep *future* inflation within a 1-3% range, effectively making it an inflation *forecast* targeting approach. This requirement is much more achievable in practice than a strict inflation target, and greatly reduces the need for the Remit to prescribe when and where flexibility may be required.
- 2.3 However, it may be helpful for the Remit to place some boundaries around how that flexibility is used. We propose a hybrid approach to the inflation target: a requirement for forecast inflation to return to 1-3% within two years, with a focus on returning to the 2% midpoint over an undefined time period.
- 2.4 We propose that the MPC Charter (**Charter**) should provide for vote-based decision making and a more individualistic approach to communication. In our view, this better reflects how the Committee already operates in many respects.

### 3. RESPONSE TO CONSULTATION QUESTIONS

#### Question 1: Do you have any comments on the proposal that New Zealand should retain a flexible inflation targeting framework?

- 3.1 We believe that flexible inflation targeting strikes the best balance in terms of: (1) aligning with the Reserve Bank's legislated objectives; (2) providing a credible anchor for inflation expectations; (3) being achievable within a reasonable timeframe; (4) providing flexibility to deal with a range of conditions and shocks to the economy; and (5) encouraging transparency around how price stability is to be achieved. As this is also the Reserve Bank's favoured option, we will comment only briefly on the alternatives.
- 3.2 Since the 2012 Policy Targets Agreement, the price stability objective has been explicitly defined in terms of *future* inflation outcomes. This effectively makes the Reserve Bank an 'inflation *forecast* targeter', as described in its Monetary Policy Strategy. In practice, this means that the Reserve Bank's task is not to keep inflation within a certain range at all times, but to project a credible path towards the inflation target over the medium term through adjustments to monetary policy.
- 3.3 We regard the focus on future inflation as a major advance over strict inflation targeting, and we believe that this wording should be retained. In particular, it provides the flexibility needed to deal with the range of possible future circumstances, and greatly reduces the need to provide specific guidance on this in the Remit.
- 3.4 As an example, if the economy faces a negative supply-side shock, such as a sharp rise in oil prices, there will be an immediate lift in the inflation rate. Under the current approach, the Reserve Bank is not obligated to respond to the initial move. Instead, its task is to assess factors such as the negative impact that higher transport costs will have on activity, the likely degree of passthrough to non-fuel prices, and ultimately the consequences for inflation in the years ahead. None of this needs to be prescribed in the Remit, as it is already implicit in the focus on future inflation.
- 3.5 Other frameworks such as price level targeting or average inflation targeting might appear to score better in terms of maintaining credibility. Under both these approaches, when inflation deviates from the target, the Reserve Bank would be required to strengthen its response in order to balance it out. However, most people would find it difficult to relate to these concepts, and it is likely that they would look to translate any such target into an implied inflation rate for the year ahead. This would essentially reduce to a standard inflation targeting approach, but with the target rate changing every three months. This would not be effective in providing an anchor for inflation expectations.
- 3.6 Nominal GDP targeting represents a move away from price stability and towards a broader concept of macroeconomic stabilisation – strictly speaking it would require a change to the legislation, not just the Remit. Aside from the stated issues around data quality and interpretation of the target, we note that most of the claimed benefits of nominal GDP targeting are in comparison to strict inflation targeting. The Reserve Bank's focus on future inflation, which requires consideration of both prices and real activity, already captures the same idea.

**Question 2: Does the current Remit strike the right balance between credibility (that the MPC can meet its objectives and keep inflation expectations anchored) and flexibility (to contribute to supporting maximum sustainable employment and stabilising economic output)?**

- 3.7 The inflation forecast targeting approach scores particularly highly on flexibility, as it allows the Reserve Bank to chart a balanced path back to the inflation target whenever a shock occurs. However, this approach does place a high burden on the credibility of the Reserve Bank's forecasts, and therefore demands a high degree of clarity and transparency around how those forecasts are produced. The current Charter provides some guidance around this, but it is worth considering whether some more specific language in the Remit could be helpful.
- 3.8 Placing some guardrails around how this flexibility is used may also help to enhance the Reserve Bank's credibility. As detailed in our response to questions 4-6, we propose a hybrid definition of the price stability target, with a time limit on bringing inflation within the target range, but more flexibility in terms of when the midpoint of the range is achieved.

**Question 3: Do you think a hierarchical ordering of the primary objectives – which would require the MPC to consider supporting maximum sustainable employment subject to meeting the price stability objective – should be introduced into the Remit?**

- 3.9 As we noted in our first submission, the legislation states that while the Reserve Bank is required to "achieve and maintain" price stability, it is required only to "support" maximum sustainable employment (**MSE**). In other words, a hierarchical ordering is already implicit in the legislation. The responsibility for achieving MSE lies with government policy in general, with monetary policy playing a supporting role where feasible.
- 3.10 However, we acknowledge that this distinction is not well recognised. It is common to hear of the Reserve Bank's "dual mandate", with the implication that the two objectives are of equal standing. We agree that it would be helpful to make the distinction explicit by introducing a hierarchical ordering to the Remit, with the Reserve Bank expected to support a move towards MSE subject to fulfilling its price stability objective.
- 3.11 In our first submission we argued that the labour market can provide significant insight into the degree of inflation pressures in the New Zealand economy, and that the Reserve Bank should be encouraged to contemplate issues such as MSE. However, this is quite different from setting it as a target, or as something to be traded off against achieving price stability.

**Question 4: Do you have any comments on the proposal to retain an undefined 'medium term' as the target horizon for the price stability objective in the Remit?**

**Question 5: Do you have any comments on the proposal that the price stability target should continue to include a mid-point and a range?**

**Question 6: Do you have any comments on the proposal that the current range of the inflation target of plus or minus 1 percentage point remains appropriate?**

- 3.12 We have grouped these three questions together as they are interrelated.

- 3.13 Generally, the shorter the target horizon, the more appropriate it is to provide some flexibility around the range of outcomes.
- 3.14 As a rule of thumb, it takes about two years for a change in monetary policy to have its greatest impact on activity and ultimately on inflation pressures. This suggests it would be reasonable to expect the Reserve Bank to be able to project a path back to 2% inflation within two years – if it had perfect knowledge about the state of the economy and the effectiveness of monetary policy. However, given the uncertainty around these factors, some leeway is necessary over a two-year horizon.
- 3.15 Over longer horizons, however, it becomes less appropriate to specify the inflation target as a range. For example, allowing inflation to remain outside a 1-3% range right up until the end of a five-year horizon would undermine the credibility of the Reserve Bank's commitment to its inflation target, creating a serious risk that inflation expectations become unanchored.
- 3.16 These considerations lend themselves to a hybrid form of the price stability objective. We propose setting a fixed time horizon of two years to bring projected inflation back within a 1-3% range. The focus on the 2% midpoint of the target should be retained, but with no set timeframe for achieving this.
- 3.17 For the inflation target to carry any weight, there must be at least the possibility of it being breached. Over the last decade, the Reserve Bank has almost always been able to project a credible path back to 1-3% inflation within two years. The exception, and even then only marginally, was in mid-2020, during the most uncertain period of the Covid response. This suggests that the inflation target range does not need to be any more flexible than what we propose, and if anything could be tighter.
- 3.18 If the inflation target is defined in a way that can be breached, then it is also necessary to set out the consequences of a breach. Note that in the context of a focus on future inflation, a 'breach' would be a failure to forecast a return to 1-3% inflation within two years. In most circumstances, a failure over this time horizon would likely be by choice. If the Reserve Bank's inflation forecasts are not consistent with the target as specified in the Remit, it should be required to explain what measures would be needed to comply with the target, and why it has chosen an alternative path. This would provide additional transparency around the Reserve Bank's decision making.

**Question 7: Do you have any comments on the proposal that the existing level of the inflation target – which is centred on 2 percent – should be retained?**

- 3.19 We support retaining the 2% midpoint of the target. A stable target provides certainty around the Reserve Bank's intentions, and gives people and businesses a benchmark for their own pricing decisions.
- 3.20 A large body of research over the years has found that a low, positive rate of inflation is optimal. Even a small increase in the rate of inflation can have distortionary effects on the economy. In particular, the interaction with the tax system means that inflation can skew investment towards activities that are untaxed, rather than those that are most productive, in an attempt to avoid tax on returns that merely reflect inflation compensation.
- 3.21 While the effective lower bound for the OCR is a genuine concern, it is not something that could be addressed sufficiently through the inflation target. Historically, central banks have had to reduce their policy rates by several percentage points during economic downturns. Providing this degree of

headroom for the future would require the inflation target to be several percentage points higher than it is today. That would mean substantial distortionary costs from inflation during normal times, in order to provide more flexibility during the occasional downturn. It is not clear that this would amount to a net benefit over the full economic cycle.

**Question 8: Do you have any comments on the proposal that the inflation target should continue to be based on the Consumers Price Index?**

3.22 We support using the Consumers Price Index (CPI) as the target measure. This index has the advantages of being well understood, well measured, and produced by a reliable source.

**Question 9: Do you have any comments on the proposal that the clauses related to house price sustainability should be removed from the Remit?**

3.23 We support removing this clause from the Remit.

**Question 10: Do you have any comments on the proposal that the clause related to the financial system should be redrafted to align with the Reserve Bank Act 2021?**

3.24 There is no objection to aligning this clause with the wording in the Act. However, we note that the purpose of the Remit is to clarify and operationalise the objectives set out in the legislation, and any proposed redrafting of the clause should expand on the wording of the Act to achieve this.

**Question 11: Do you have any comments on the proposal that the clause related to avoiding unnecessary instability in output, interest rates and the exchange rate should be retained?**

3.25 We favour removing this clause altogether. It was added to the 1999 Policy Targets Agreement to address concerns about the Reserve Bank being overly focused on inflation. However, it provides no guidance on what is “unnecessary” versus “necessary” volatility, or on the relative importance of these factors and the inevitable trade-offs between them.

3.26 Furthermore, the intention of this clause has been better addressed by subsequent changes to the Reserve Bank’s mandate. Flexible inflation targeting already captures the idea of avoiding unnecessary volatility, and the MSE objective gets closer to the heart of why volatility in the economy can be harmful.

**Question 12: Do you have any comments on the proposal to remove or reword the clause related to discounting transitory effects? If you agree, which option would you prefer (remove or reword)?**

3.27 We agree that the shift to inflation forecast targeting has made this clause redundant, and that it can be removed.

**Question 13: Do you have any comments on the proposal that the Remit should not further specify the governance of additional monetary policy tools?**

3.28 We agree with the Reserve Bank's assessment that this is better dealt with outside the Remit.

**Question 14: Do you have any comments on non-Remit text or the role of the Remit and Charter in supporting monetary and fiscal policy coordination?**

3.29 We support removing the first paragraph setting out the Government's economic objective as we consider that it has no bearing on the conduct of monetary policy.

3.30 The second paragraph on context notes that: "Monetary policy contributes to public welfare by reducing cyclical variations in employment and economic activity whilst maintaining price stability over the medium term." This seems to suggest a hierarchical ordering of the objectives that is contrary to the one the Reserve Bank proposes. If this paragraph is retained then it would need to be substantially reworded to address this.

3.31 We do not support including any language around monetary and fiscal policy coordination in the Remit. Any impression that policy settings may be jointly determined, behind closed doors, would severely undermine the public's confidence in the Reserve Bank's independence and in the Government's commitment to price stability. While information-sharing by policymakers is to be encouraged, we consider that this is already taking place and does not require further direction from the Remit.

**Question 15: Do you have views on the decision-making model the Charter should be based on, or wider changes the MPC could make to improve its decision-making?**

3.32 We favour a voting approach to decision-making, with votes attributed in the published decision. This is the approach taken by many overseas central banks and is well understood in financial markets.

3.33 One of the purported benefits of consensus decision-making is that it creates a sense of buy-in and involvement for those implementing the decisions made. However, we consider this to be less relevant as MPC members are not involved in the implementation of its decisions. Against this, a consensus approach is associated with a higher risk of groupthink and 'compromise' decisions.

3.34 While the MPC has adopted measures to mitigate these risks, these measures blur the distinction between voting and consensus. The Consultation Document notes that during a full monetary policy decision, the preliminary views of member are recorded (which could be viewed as an early vote). Once those individual views have been tabled, it is likely that the majority view will dictate the final decision that the MPC converges on, whether this is by consensus or a unanimous vote. If the MPC fails to converge on a view in this way, the Charter already provides for a simple majority vote.

3.35 We consider that there are some aspects of how the MPC operates that are not well suited to a consensus approach. The MPC signs off not just the OCR decision, but also the Monetary Policy Statement (**MPS**) and the analysis and forecasts within it. The MPS is produced by Reserve Bank

staff and not the MPC, and therefore in practice it is unlikely that this could be developed and approved by consensus of the MPC.

- 3.36 Additionally, we also note that section 99 of the Act requires the Board to regularly review the performance of both the MPC and of each of its members. It could be argued that under a consensus approach it is unclear how individual members have contributed to policy decisions, making it difficult to assess their performance.

**Question 16: Do you have views on the communications approach the Charter should be based on, or wider changes the MPC could make to improve its communication?**

- 3.37 In line with our support for a voting approach to decision making, we would also favour a more individualistic approach to communication. Firstly, members' votes should be attributed in the monetary policy release. Secondly, the record of the meeting should include the range of views that were discussed; individual views do not need be attributed as a matter of course, but members should have the option to disclose their views via on-the-record speeches or statements. Thirdly, any on-the-record statements should be notified to the MPC but need not require approval.
- 3.38 The current Charter seems to only envision speeches by MPC members, given the requirements to provide public notice in advance and to make the content available in real-time. In practice, the MPC does not appear to have been constrained by this, with members regularly conducting media interviews (sometimes to paywalled media outlets) and providing significant insights about the MPC's decisions and its assessment of the economy. We suggest that the Charter should be revised to reflect the current practice.
- 3.39 External members of the MPC are placed at a disadvantage in terms of their communications compared to the internal members, as they spend less time on monetary policy issues and have fewer resources to draw on. We propose that the Charter should include a formal arrangement whereby all MPC members are able to draw on Reserve Bank staff to prepare speeches and statements, and to commission research on topics that are relevant to monetary policy. This would also assist the Board in assessing the contribution of individual members.