Reserve Bank of New Zealand
Te Pūtea Matua

The Review of the Monetary Policy Committee's Remit

Summary of submissions from the first public consultation

October 2022

Contents

Introduction

As part of the five-yearly review of the Monetary Policy Committee's (MPC's) Remit (*Remit*), the Reserve Bank of New Zealand – Te Pūtea Matua (Reserve Bank) conducted a consultation to hear feedback from the public on important issues with respect to the design of the *Remit*. This was the first public consultation, with a second public consultation to be conducted later in the year.

The consultation window opened on 1 June 2022 alongside the release of the first consultation paper, 'Supporting New Zealand's economic stability – Toitū te Ōhanga', and closed on 15 July 2022. The consultation paper set out the high-level issues and options for redesigning the *Remit*. It specified consultation questions centred around the broad themes of: (1) 'the *Remit* and economic wellbeing'; (2) 'achieving price stability and maximum sustainable employment'; and (3) 'the broader context for monetary policy'.

In conducting the first public consultation, the Reserve Bank sought feedback through several different channels. In total, around 1500 individuals and groups provided feedback through the consultation process. Submitters could provide written feedback to the consultation questions through an email submission, or through an online questionnaire on the Reserve Bank's website. 17 submissions were received via email and 19 via the online questionnaire.[1] Email responses tended to be more detailed and were mostly from financial institutions, unions, industry organisations, and monetary policy experts, while the online questionnaire tended to attract more submissions from the general public. The Reserve Bank also held several briefing sessions: one with academics, one with unions, one with professionals from the banking sector, an open session, and a public Q&A session.

In addition to this, Kantar Public ran deliberative workshops in Auckland, Wellington, Napier and Christchurch, which Reserve Bank staff attended. These workshops were used to help gauge some members of the public's views and preferences around inflation and unemployment through discussions on simple scenarios and what their impacts would be on the participants and the public more broadly. Lastly, an online survey was conducted, through Dynata, to understand the public's preferences around inflation and unemployment. The responses included a representative sample of 1,041 New Zealanders, as well as a self-selected sample of 321 New Zealanders.

There were a range of issues and feedback received from submitters. This report presents the key issues and themes, rather than providing an exhaustive summary of all feedback received. Individual submissions, Dynata survey results, and a summary of the deliberative workshops by Kantar have been published on the Reserve Bank's website alongside this paper.

Executive summary

- Many submitters commented on the weighting of our price stability and employment objectives. A large number of submitters favoured a stronger weight on inflation, while some preferred a more balanced weighting. Deliberative workshop participants tended to place more weight on price stability.

[1] Blank submissions via the questionnaire have been excluded from these numbers.

- There was general support for retaining the Consumer Price Index (CPI) as the price stability measure. However, many submitters from the wider public wanted more weight on house prices in the measure.
- There were a range of views on the level of the inflation target and on its prescriptiveness. While some favoured a lower target, most respondents who commented favoured retaining the existing target.
- Many submitters were uneasy about the ambiguity of the concept and measurement of Maximum Sustainable Employment (MSE), although few advocated targeting a single labour market measure.
- There was broad (but not complete) agreement that house price sustainability should not be in the *Remit*. However, a minority of respondents expressed support for exploring ways in which house prices can be better incorporated into monetary policy decision-making.
- Most respondents felt that distributional impacts, and climate change should also not be in the *Remit*, however there was some support towards the inclusion of climate change considerations, in particular from union representatives and some members of the general public.
- Most submitters did not comment on the effective lower bound (ELB). One suggested that the ELB might motivate consideration of a higher inflation target if the Reserve Bank cannot address constraints on lowering the official cash rate (OCR) well below zero.

1. The *Remit's* primary objectives

1.1 Weighting of price stability and MSE objectives

In general, there were mixed views on how the price stability and MSE objectives should be weighted in the *Remit*. Many submitters, for example, were of the view that price stability should be given primacy or a higher weight, or that the employment objective should be removed altogether. These views tended to be shared by some industry organisations, alongside quite a few submitters from the general public and some participants in the briefing sessions. One submitter provided the suggestion of hierarchical preferences (or, more technically, lexicographical preferences) along the lines of "Support maximum sustainable employment, subject to maintaining price stability".

There were several reasons provided in favour of price stability over MSE. Some reflected a view that monetary policy is best suited to dealing with inflation over the long run, and that maintaining price stability is the best contribution monetary policy can make to wellbeing (including to employment). Some thought that this was the lens through which the employment objective should be interpreted, or suggested that this narrow and specific role of monetary policy should be reflected in the *Remit*. Furthermore, some were of the view that the MSE objective was ambiguous, distracting, or hard to measure and monitor. One considered that the MSE objective amounted to having "many balls in the air", which could create conflicting priorities, and that it is unclear which objective will take precedence in the MPC's decisions. Some also noted that it could reduce the credibility of the inflation target and New Zealanders' confidence in the independence and predictability of Reserve Bank monetary policy over time.

Others were either more supportive of the MSE objective or raised no specific objection. Support tended to be more shared by unions and wider public submissions, although was not exclusive to these groups. One submitter expressed that employment more directly captures the concept of excess demand, which is a root driver of inflation, and that it is less prone to 'noise' from large transitory movements. Another submitter stated that the MSE objective has the benefit of giving the Reserve Bank licence to discuss employment, (which can otherwise be a sensitive issue).[2]

Other respondents discussed that price stability and MSE should be considered equal goals and that MSE should not be perceived or understood as a subsidiary goal, while one respondent suggested that the Reserve Bank had been pursuing "textbook" inflation targeting despite the MSE objective, and that the current *Remit* implies a hierarchy of importance in which MSE sits below price stability.

In general, there was little support from expert and institution submissions for a more specific weighting scheme between the two objectives. However, many of those who submitted via the questionnaire (largely the general public) were of the view that more guidance should be provided. Deliberative workshop participants saw both inflation and employment as important, but saw inflation as slightly more important. This may partly reflect that inflation was seen as being outside individuals' control, while employment was seen as within someone's control. When considering higher unemployment, participants tended to be concerned about demographic groups potentially vulnerable to losing employment, such as those early in their careers or in low skilled work, rather than themselves.

1.2 Level and range of price stability objective

On balance, submitters appeared to be supportive of the current 1-3% target range with the mid-point focus. Those who were particularly supportive referred to the range as being proven to be credible (or achievable from a historical monetary policy perspective), and that it is well entrenched in the public's inflation expectations. Related to this, some noted the risks to inflation expectations if the target were to be changed, and the "dangerous" signal it could send in the current environment.

1.2.1 General level of the target

Several participants in the briefing sessions were comfortable with the 1-3% range, mostly on the basis that it would appropriately safeguard against ELB risk, and help the Reserve Bank maintain its credibility. A few submitters, however, noted that there should be serious consideration for a lower target (e.g. 0-2%). They noted the costs of higher inflation – in particular with respect to possible tax system distortions arising from the current (and higher) target – and a few submitters challenged whether 2% inflation can be credibly defined as 'price stability' (i.e. with prices doubling around every 35 years at this rate).

One submitter was of the view that if the Reserve Bank cannot address the ELB, then it should look harder at raising the inflation target. This respondent was of the view that the Reserve Bank had not made an adequate case for the status quo (for example, why a target level that made sense 20 years ago when the neutral interest rate was thought to be around "6%" would still make sense now).

Some questioned whether it made sense to react to the low inflation experienced as a result of globalisation and technological advances, which was arguably benign. Two suggested that the

[2] With respect to this, this submitter favoured keeping the MSE objective as a "guiding force" rather than a specific target.

Reserve Bank commission an expert review to assess which annual rate of the CPI is consistent with achieving and maintaining stability in the general level of prices over the medium term.

Participants in the deliberative workshops generally supported an inflation target of anywhere between 0% and 3% annually. Many expressed the view that the ideal rate of inflation should be 0% (however they tended to support a rate above zero after watching the Reserve Bank's video explaining the current target).

1.2.2 Midpoint, flexibility, and other views

Those who commented on the idea of a midpoint focus were generally supportive of it. One submitter noted that the 2% midpoint was well entrenched in the public's expectations and that it helped avoid a drift upward in inflation that could be created by the employment objective, while another submission noted that the midpoint provides flexibility to deal with future shocks.

However, one submission stated that the Reserve Bank should be more clearly directed to consider utilising the full width of the range when appropriate, even if it would mean deviating from the midpoint for a sustained period. This respondent was of the view that the Reserve Bank may at times have focused too narrowly on the midpoint, and not fully utilised the flexibility available. They suggested that this flexibility would reduce volatility in interest rates, GDP growth, asset prices and the current account balance, and implied it would better support the wellbeing of NZ citizens. A few other submitters also emphasised the importance in the MPC having flexibility, and two other respondents advocated for a wider band (e.g. 0-4%) to – amongst other reasons – reduce the need for aggressive OCR changes. Other suggestions included a consideration for "rolling averages" to allow more economic shocks to transmit through markets without the need for immediate policy responses. Public aversion to sharp changes in interest rates also came up in the deliberative workshops.

There were a range of other suggestions from the public, including a target to soften asset prices over time, a gradual move to a -1 to 1% range to promote "sustainability", a moving target linked to our trading partners' inflation rates to promote credibility, and targeting based on market forecasts of inflation (rather than the Reserve Bank's in-house forecasts).

1.3 The measure of price stability

There was no clear consensus on the best price measure for the Reserve Bank to target to maintain price stability. A material portion of submissions advocated for retaining the CPI as the target measure of price stability. The main reasons given were that it is well measured and well understood, and that changing the approach might create unnecessary confusion as to what the goals of monetary policy are. One submission, for example, noted that no price measure will be perfect, so it makes sense to use a basic measure that is easily understood and very visible. Another respondent stated that they would not support making ad-hoc adjustments to official series for the sake of creating an 'ideal' target measure. This sentiment was shared by another submission, which noted that the CPI should not be tampered with without very good reason.

One submission noted that other measures, like the GDP deflator, would have several disadvantages such as data revisions, and volatility. They also made the point that the *Remit's* focus on future inflation made it redundant to specify a 'core' measure as the target (because the Reserve Bank's forecasts of inflation over the medium term are usually driven by a 'core' view of inflation).

Some submitters, however, presented the view that the CPI understates inflation. This was supported in the Dynata data, with 41% of respondents stating that they have experienced higher inflation than the CPI average over the past five years, while only 5% said they have experienced less than this. These concerns also came through very strongly in the submissions via the questionnaire, which tended to be from the general public. For example, 10 of the 16 who answered the referenced question said they'd prefer an alternative price measure.[3] Overwhelmingly, the comments that followed were for the price measure to 'better' account for the cost of housing or attach more weight to it. In a similar vein, one suggested that the CPI should be focused on essential items. A few others noted that the Reserve Bank should also consider price measures for different demographics, such as the Household Living-Costs Prince Indexes (or HLPIs) produced by Stats NZ.

A few submitters from the general public expressed a need to ensure that the CPI is impartially calculated. One referred to claims that the US CPI is "manipulated" relative to historical approaches, and another viewed the CPI is understating inflation as goods with rising prices eventually receive less weight as people substitute away from them.

1.4 Specification and measurement of the MSE objective

Most of the comments relating to the specification of the MSE objective related to it being an ill-defined and hard to measure concept. One submission, for example, noted that MSE is not widely understood and can be difficult to understand, and that it doesn't align well with having "operational targets for the MPC that the public can readily monitor" (the Reserve Bank's words in the first consultation paper). Another submission stated that, preferably, the Reserve Bank should "measure the output gap, rather than MSE". Other responses included that MSE is a "fuzzy and distracting concept", that "there is no measure of it that cannot be reasonably contested technically", and that the current wording gives little guidance to MPC, and that this should be simplified or improved.

One submission argued that focusing on one indicator would not provide a full picture of MSE given the range of other factors that can influence employment trends, while another was supportive of the Reserve Bank looking at a broad range of indicators, and emphasised that this will drive improved performance on inflation over time. Another submitter suggested that the measure of MSE could be the percentage of available working hours that are actually worked.

There were inquiries into the operational definition of MSE, with one submission questioning whether the Reserve Bank should narrow the operational target to something more easily observable and understood (e.g. a flexible unemployment rate target, which would not preclude monitoring other measures). Related to this, a respondent that was broadly supportive of the current employment objective noted that the Reserve Bank is asked to "support" rather than "achieve" MSE, which "makes it clear that the responsibility for MSE lies with the government policy in general, with monetary policy playing a supporting role."

Participants in the deliberative workshops were sceptical about measures of employment, including the definition of "unemployed" in the unemployment rate (for example, with respect to what the unemployment rate actually captures), with some questioning the credibility of the metric. Many

[3] Similarly, when Dynata survey respondents were asked about which prices were of most worry to respondents and their families, food and groceries was most of concern (57%), followed my rent/mortgage costs (24%). There was significant concern for electricity/power and transport/petrol costs, however these were more likely to be respondents' second or third concern. In the open text section to discuss their main concerns about high inflation, 44% of respondents mentioned increasing unaffordability and cost of living.

participants in the deliberative workshops thought that the ideal unemployment rate should be 0%. At the same time, some participants were concerned about how challenging it was to hire (implying some aversion to a tight labour market).

2. Additional *Remit* considerations

Many submissions that addressed climate change, distributional effects, and house price sustainability, argued against the inclusion of these factors within the *Remit's* additional considerations.

2.1 House price sustainability

The majority of submissions did not support the inclusion of house price sustainability as an additional consideration in the *Remit*. Many expressed concern that including house prices distracts from, and may conflict with, the primary objectives of the *Remit* (being price stability and MSE).

2.1.2 Where to consider house price sustainability

There was broad acceptance that, although house prices shouldn't be included in the *Remit*, they play an important role in the economy, financial system, and in the overall wellbeing of New Zealanders. Hence, many submitters argued that they should be considered in wider decision-making at the Reserve Bank.[4]

In general, suggestions fit into three categories:

1. That monetary policy should already account for house prices in the *Remit* under primary objectives and existing decision-making methods.

2. That the Reserve Bank can better address house price concerns through macro-prudential policy.

3. That house prices would be better addressed by the Reserve Bank via other amendments. Proposed other amendments included a Letter of Expectations, and adding "asset prices" to 2(2)(b) of the *Remit* as an alternative way to incorporate house price sustainability.

Some respondents were of the view that government is better placed to deal with house price sustainability through fiscal and regulatory policy, while some respondents suggested the CPI be changed to Reserve Bank better account for house prices.

2.1.3 Additional comments related to housing

One submission argued that the scope of thinking about house prices proposed in the consultation is too narrow, and proposed the consideration of:

1. Research regarding house price cycles and their relationship with cycles in monetary policy settings.[5]

[4] Respondents suggested various ways of doing this with varying degrees of detail.
[5] NBER research in 2018 suggest economic welfare could be improved by including house prices in monetary policy criterion.

2. The links between the neutral interest rate, asset prices, and monetary policy. Some research argues monetary policy settings influence neutral rates, and a falling neutral rate is shown to coincide with rising asset prices, including housing.

Another submission noted that the current *Remit* wording in section (3) regarding investor demand and first-home buyers is one-directional in regards to inflation objectives. In this context, they argued that this is "short-sighted" in its failure to account for the opposite direction, and therefore not appropriate for inclusion in the *Remit*. Moreover, a different respondent believed that the transmission of rising house prices to broader inflation has potentially been underestimated, and that this is an area for further consideration.

2.2 Distributional effects

From the submitters that addressed distributional issues, most argued that distributional effects are not relevant for inclusion in the *Remit*. Several of these specified that distributional concerns are a matter for government policy. Two submitters, for example, believed the best way monetary policy can impact distribution is by focusing on the price stability objective and preventing high inflation.[6]

Individual public submissions were more likely to emphasise inequality impacts of monetary policy, while some industry submitters described distributional impacts as an inherent and inevitable part of monetary policy. During briefing meetings, union representatives were particularly concerned about distributional issues and enquired about how monetary policy could be adapted to better account for distributional impacts. There was concern voiced about corporate profits outpacing wage growth, and real wage declines over a number of years in New Zealand. Another briefing session participant proposed consideration of the distribution of inflation across different demographic groups, addressing the shortfall of the CPI as a 'weighted average' of consumer price inflation. This sentiment was shared by some participants in the deliberative workshops, who were concerned about the impacts of inflation on certain demographic groups such as lower income households.

Many participants in the deliberative workshops shared the view that monetary policy could better account for distributional impacts, arguing that the Reserve Bank should make monetary policy decisions that benefit *all* New Zealanders.

2.3 Climate change

Of the submitters that commented on climate change, a significant majority believed that it should not be included in the *Remit*. Some respondents specified that climate change is better dealt with by the government and fiscal policy, while one believed that financial decision-making regarding climate change is best left to the private sector and capital markets. On the other hand, several respondents from the general public supported consideration of climate change in the *Remit*, noting the importance and breadth of the climate change challenge.[7] In general, union representatives in the briefing session were particularly concerned and questioned the ability of conventional monetary policy frameworks to address climate change.

There was acknowledgment from some submissions that climate change will affect monetary policy indirectly through its impacts on the wider economy. One submitter, for instance, re-emphasised

[6] In the way that low to middle income earners are worse impact by high and volatile inflation.

[7] Respondents didn't specify how climate change should be considered, one noted that the Reserve Bank should do further research in this area.

the importance of the price stability objective, stating that this is the best way for monetary policy to 'impact' climate change. This was largely argued on the basis that high and volatile inflation distorts investment decisions. Furthermore, many participants in the briefing sessions found climate change to be an important issue but perhaps outside the scope of core monetary policy (this is excluding the union briefing session, where participants tended to advocate strongly in favour of this). A couple of participants in other briefing sessions saw climate change as outside the scope of monetary policy and perceived it to be largely a prudential regulation issue.

2.4 Other additional considerations

There were a number of submitters who supported removing additional considerations, however it was not clear whether they were referring to house prices, climate change, and distributional effects, or whether they were also referring to sections 2(2) and (3) in the existing *Remit*. This was in contrast with two respondents who proposed the *Remit* explicitly direct the Reserve Bank to work more cooperatively with government and regulatory bodies in order to produce better economic outcomes in relation to the current and proposed additional considerations.

Several respondents supported removing both the primary objective of employment and additional considerations from the *Remit*, preferring that the Reserve Bank focus solely on the price stability objective. There was concern, for example, that when more considerations are added to the *Remit*, the risk of distraction from the price stability objective increases and that this may impact the credibility of the Reserve Bank. One respondent saw current additional considerations as appropriate in their role of clarifying a degree of flexibility in Monetary Policy.

A few submissions supported the removal of all current references to government economic objectives in the *Remit* by removing 2(2)(d) and 2(3), arguing that these references interfere with the independence of the Reserve Bank. One submitter noted that the mention of government policy sets an expectation that new governments will change the *Remit*. Another, on the contrary, proposed adding "asset prices" to 2(2)(b) as an alternative way to incorporate house prices.

3. Wider ideas and views

3.1 *Remit* design principles

Most submitters either agreed with, or made no objection to, the design principles for the *Remit* review.[8] Where there was contention, it was typically with a single criterion that a submitter felt should be omitted or modified. For example, while in support of the overall principles, one submitter suggested that the overarching principle should be a focus on expected outcomes rather than the "process of setting monetary policy".

One member of the general public suggested that the flexibility principle should be removed as it creates a degree of 'uncertainty' that can come at a cost to society and the wider economy. Likewise, some industry groups noted that there might be trade-offs with different design principles (for example, in their view flexibility may be inconsistent with the ability to monitor performance).

Another submitter argued that there should be a greater focus on achievability and technical feasibility when designing the *Remit*. Related to this, a different submitter argued that the design

[8] Note, the design principles are outlined in the first consultation paper.

principles for the *Remit* should align with the view that monetary policy is a 'single instrument' capable of achieving one objective, that is price stability.

Other suggestions from the general public included: having an "effectiveness" principle, ensuring that the *Remit* is "as minimal as possible" to "maintain faith in the currency that the Reserve Bank prints", that the Reserve Bank should target balanced current accounts, and that the Reserve Bank should be representing the consumer in the "battle" for fair shares of productivity growth.

3.2 Changing the *Remit* to assist the MPC in future economic downturns

The responses were mixed with respect to whether the *Remit* should be changed to aid the MPC in responding to future economic downturns. Many submissions didn't comment extensively on this point.

One submitter emphasised the importance of 'addressing the ELB issue', commenting that significant movements in policy rates (>500 basis points in this example) have been required in the past to ensure macro stabilisation. The same submitter suggested that the Reserve Bank could be exposed in the next economic downturn, and that the *Remit* review should focus on achieving more conventional monetary policy leeway.

Other suggestions from members of the general public included that 'tailoring' the *Remit* to suit responding to short-term economic shocks could threaten the credibility of monetary policy, that allowing business cycles and 'moderate' recessions to occur is necessary to 'reset the market' and reduce malinvestment, and that the Reserve Bank should have the capacity and be prepared to act in extraordinary times such as in response to War and natural disasters.

3.3 Other views

One submitter suggested that a more concerted focus on dealing with the implications of uncertainty when re-evaluating the *Remit* could lead to significant adjustments to the policy process. This submitter in particular noted that uncertainty and potential non-linearities are always features of monetary policy decision-making (not just near the ELB). A different submitter critiqued the Reserve Bank for "offering no serious or sustained review of the experience of monetary policy (under the current *Remit*) over the last 2.5 turbulent years in particular", and that "very little Reserve Bank formal research has been published in recent years".

Three submitters advocated for the removal of the Government's economic objectives clause under the current *Remit*. Two of these submissions advocated for the removal of the sentence starting with "Context", arguing that the *Remit* should not start with a broad statement of Government objectives. One noted that it encourages a mentality that the *Remit* should be altered every time there is a new government.

One member of the public suggested that the *Remit* should be as minimal as possible, to ensure the Reserve Bank maintains its credibility as an independent agency. On the other hand, another member of the public suggested that independence could be a drawback, referencing the need for cross-governmental coordination on issues such as wealth inequality and household indebtedness. This respondent also argued in favour of transparency and open communication with the public under an "issues of concern" clause within the *Remit*. Lastly, other suggestions from certain members of the wider public included: allowing the OCR to be 'set by auction' without 'pre-set limits', and a 10 yearly review process (rather than 5 yearly).

Appendix

Consultation Questions

Q1. Do you have any questions on our design principles for the *Remit* review or the description of global practice? Are there any other principles that you think would be important for the *Remit* review?

Q2. The current *Remit* sets a target to "keep future inflation between 1 and 3 percent over the medium term, with a focus on keeping future inflation near the 2 percent midpoint". Do you think this target is about right? If not, what do you suggest that the target range be changed to, and why?

Q3. The *Remit* states that inflation should be measured using the "All Groups Consumer Price Index as published by Statistics New Zealand". What are your views of this measurement approach, and whether alternatives should be considered?

Q4. Do you have any thoughts on how maximum sustainable employment could be measured reliably, or whether the *Remit* should include reference to the benefits of high employment?

Q5. Do you think the *Remit* gives the Monetary Policy Committee the right level of guidance to achieve the price stability objective? What changes, if any, should the Reserve Bank focus on?

Q6. Do you think the *Remit* should include guidance on the weight of the inflation and employment objectives? What changes, if any, should the Reserve Bank focus on?

Q7. Should the *Remit* be changed to aid the MPC's response to future economic downturns? If changes should be made, what options should we focus on?

Q8. Do you have any comments about the current additional considerations included in the *Remit*?

Q9. Do you have any comments about the relevance of house price sustainability for monetary policy?

Q10. Do you have any comments on the relevance of distributional effects for monetary policy?

Q11. Do you have any comments on the relevance of climate change for monetary policy?

Q12. Are there any other issues that the Reserve Bank should consider for inclusion in the additional considerations of the *Remit*?