

26 March 2018 – Hon Grant Robertson, Minister of Finance

Questions and answers: New PTA and Phase 1 of the Review of the Reserve Bank Act

Purpose and Background

What is the rationale for the Review?

The goal of Phase 1 of the Review was to modernise the legislation underpinning New Zealand's monetary policy framework.

The Coalition Government is committed to creating sustainable employment opportunities for New Zealanders. It is important that monetary policy plays its part in meeting that goal.

Price stability remains important. The long period of price stability we have experienced under the existing Act has been crucial for supporting the wellbeing of New Zealanders through the past three decades. The Government remains committed to ensuring our monetary policy regime continues to deliver low and stable average rates of inflation over time.

Purpose of the Act

What changes are proposed to the 'purpose' section of the Act?

The preamble to section 1A of the Act will be amended to express that the overall purpose of the Act is to promote the prosperity and wellbeing of the people of New Zealand, and to contribute to a sustainable and productive economy. This gives clarity to the ultimate aim of monetary and financial policy to improve the wellbeing and living standards of New Zealanders.

Employment objective

What is the new employment objective for monetary policy alongside price stability?

The new monetary policy objective will state that monetary policy is directed at achieving and maintaining stability in the general level of prices over the medium term and supporting maximum sustainable employment.

What impact do you expect the Phase 1 changes will have on how the Bank makes decisions?

The revised monetary policy objectives require the Reserve Bank to consider employment outcomes, in addition to price stability, when formulating policy. While the Reserve Bank already considers employment as part of its flexible approach to inflation targeting, the new dual monetary policy objectives reflect the Government's desire to set a clear and enduring role in the Act for monetary policy to support employment outcomes. While the pursuit of price stability will often also be consistent with supporting employment, there will be times where the Bank will need to balance these objectives.

The Government understands that there are limits as to the extent to which monetary policy can influence employment outcomes, as monetary policy is just one of many contributors to employment levels.

Will there be a quantitative target for employment or the unemployment rate?

No. As announced in November 2017, the Government is not setting the Reserve Bank a specific numerical target for employment or the unemployment rate. This is because monetary policy is only one contributor to employment outcomes and the level of unemployment. Phase 1 of the Review looked at how to update the Act to make maximum employment a consideration that the Bank must take into account when formulating monetary policy.

Are we going to lose our focus on price stability?

No. It is important for New Zealand that we control inflation. We have seen the damage that out-of-control inflation can do to our economy. Reflecting this, the inflation target band in the Policy Targets Agreement is unchanged from the last PTA.

Is a dual inflation/employment target common internationally?

The central bank legislation of the United States and Australia refers to full employment and several other central banks are required to consider employment outcomes under their legislation.

Committee decision-making: the Monetary Policy Committee (MPC)

What are the benefits of moving to a Committee with external members?

Committee decision-making bodies for monetary policy are likely to deliver better-quality decisions on average over time by harnessing a broad range of perspectives while guarding against the risk of extreme preferences. Committee decision-making for central banks is common practice internationally.

While the Reserve Bank has already instigated an informal internal Governing Committee to consider monetary policy decisions, formalising this in the Act will ensure committee decision-making is durable and allows the committee to be designed from first principles.

A minority of the MPC will be external members. These members will play an important role by ensuring that a range of independent expertise and outside perspectives are considered in monetary policy decisions.

How are the legislative proposals different to the current Governing Committee?

Committee decision-making will be required under the Act rather than being the de-facto approach. The Governor will no longer have sole legal responsibility for monetary policy decision-making.

The MPC will also look different from the current Governing Committee. For example, the MPC will have external members, and all the members will be

appointed by the Minister of Finance on recommendation from the Board. The Act will also provide more mechanisms for transparency. For example, it is intended that the Committee will publish a record of its meetings.

What will the MPC be responsible for?

The MPC will have collective responsibility for all monetary policy decisions and strategy. This responsibility will include, but is not be limited to, decisions about the Official Cash Rate (OCR). For example, the MPC will also have responsibility for strategic choices around the monetary policy tools used by the Reserve Bank. The Governor will chair the MPC and will be the sole spokesperson on its decisions.

How many members will the MPC have?

The new Act will specify a range of five to seven members for the committee. It is expected that the first MPC will have seven members. The Act will set a minimum of at least two external members and a maximum of four internal members to allow for flexibility in the size of the committee over time. A majority of members will be internal.

The legislative range will provide flexibility for the committee to evolve over time, as well as enabling long-term vacancies to be managed should they occur. A committee of seven members will ensure sufficient space for a range of skills and perspectives but still support deliberative decision-making. Beyond seven, the marginal benefits of additional members are likely to be small.

Who will the external members be?

External members will have knowledge and experience in relevant policy areas (such as economics, finance, banking, or public policy). However, members will not be limited to monetary policy experts. External members will need to be free from conflicts of interest and will not be on the MPC to represent a particular sector.

Who will appoint the MPC?

Each MPC member will be a decision-maker in their own right, exercising considerable powers. Given this, all members of the committee will be appointed by the Minister of Finance following nomination by the Reserve Bank Board. This appointment process is the same as the “double-veto” one currently used for the appointment of the Governor.

This appointment approach is consistent with the Minister having overall political responsibility for the Reserve Bank, and ensures that the Governor does not have disproportionate power within the committee. Requiring the Board to first nominate members to the Minister will limit the risk of accusations that policy decisions are politically motivated.

What is the MPC Charter and how will it work?

The MPC Charter will be an agreement between the Minister of Finance and the MPC about the detail of the MPC’s practices. The Charter will provide further details on a defined set of issues where the Minister of Finance is likely to have an interest,

where practice may need to evolve over time, or where more detail is required than can be set in primary legislation. These issues will include the detailed approach to transparency (e.g. minutes and voting). The exact content of the Charter will be determined as the legislation is developed.

How will the MPC take decisions?

It is expected that the MPC will aim to reach decisions by consensus. Where a consensus cannot be reached, decisions will be taken by a majority vote, with the Governor having the casting vote if necessary.

What documents will the MPC publish?

In addition to Monetary Policy Statements, it is intended that the first Charter agreed between the Minister and the MPC will require the MPC to publish non-attributed meeting records that reflect differences of view between MPC members where they exist. It is also intended that the MPC will publish the balance of votes for any decision where a vote is required, without attributing votes to individuals. This approach will balance the need for transparency about the decision-making process with the need for clarity and coherence in communicating the MPC's decisions.

What will the role of the Treasury non-voting observer be on the MPC?

The Government has decided to introduce a non-voting Treasury observer on the MPC to help improve information flows between the Reserve Bank and the Treasury. This will be an important conduit between fiscal and monetary policy as the decisions of the committee are being made.

Will a Treasury observer on the MPC erode the Reserve Bank's independence?

No. The operational independence of the Reserve Bank remains paramount.

Australia and the United Kingdom are examples of other countries that currently have a Treasury representative on their monetary policy committees.

Will the process to set the policy target for monetary policy change due to the MPC having responsibility for policy decisions rather than the Governor alone?

Currently, the PTA is an agreement between the Minister of Finance and the Governor. Looking forward, as the MPC will be collectively responsible for making monetary policy decisions, it would be inappropriate for the Governor to be the sole member of the MPC to agree the operational objectives for monetary policy. As a result, we are changing to a model where the Minister of Finance sets the operational objectives for monetary policy. These objectives will be set after non-binding advice from the Reserve Bank and the Treasury (as the Minister's advisor) is released publicly.

The approach the Government has agreed to for the setting of operational objectives going forward was recommended by the Independent Expert Advisory Panel. This approach imposes discipline on the decisions of the Minister, given the fact that the Minister's decision will need to take account of publicly disclosed advice from the

Reserve Bank and the Treasury. Further accountability measures, such as requiring the Minister to justify decisions before the House, will be considered in the detailed design of this policy proposal.

It is also intended that the setting of monetary policy objectives going forward will involve greater transparency and public input. Decisions on monetary policy objectives are important, and therefore public debate and understanding should be required.

Role of the Board

Will the role of the Reserve Bank Board change?

The Board will continue its role of monitoring monetary policy performance, although some modifications will be required in light of Phase 1 changes. The Board's role in appointments will be expanded, as the Board will nominate candidates for the MPC to the Minister.

The Government has also agreed that the Chair and Deputy Chair of the Board will be appointed by the Minister of Finance. This will make the practice consistent with most other state sector boards.

Consultation

Who has been consulted on Phase 1 changes?

The Treasury conducted targeted consultations with a range of monetary policy experts on Phase 1. The Treasury also received a number of submissions from the public. The Treasury has provided the Minister of Finance with a summary of these stakeholders' views for consideration alongside officials' advice.

Has the Reserve Bank been involved?

The Treasury and the Panel have worked closely with the Reserve Bank in developing these proposals.

What was the role of the Panel in Phase 1 of the Review?

The Government formed an Independent Expert Advisory Panel (the Panel) in December 2017 to provide input to the Review. Suzanne Snively is Chair of the Panel, joined by members Dr Malcolm Edey and Dr Girol Karacaoglu. These high-calibre members of the Panel have brought extensive experience in their respective fields.

The Panel delivered a report to the Minister of Finance on Phase 1 of the Review in March. This advice covered monetary policy objectives, recommendations on an MPC, and implications of these changes for the role of the Board.

Next steps

What are the next steps for progressing the outcomes of Phase 1 of the Review?

Officials will advise the Minister of Finance on detailed implementation issues associated with the high-level Phase 1 decisions by late May. Following consequential drafting work, a Bill will be introduced to Parliament in the middle of 2018.

The new PTA signed today will remain in force at least until the legislation is passed into law, when new objectives will be set under the new dual mandate of the Act.

What are the next steps for progressing Phase 2 of the Review?

Phase 2 of the Review is currently being scoped. It will focus on the Reserve Bank's financial stability role and broader governance reform. The Panel is due to give the Minister of Finance its recommendations for the scope of Phase 2 of the Review shortly. Announcements on this will be made in the coming months. Subsequent policy work will commence in the second half of 2018.