

## **Reserve Bank – keep it simple**

Political party policies on the Reserve Bank are beginning to emerge.

National has not released its policy yet but has begun a review coinciding with the signalled departure of the Reserve Bank Governor.

Labour and the Greens have indicated they want to change the Reserve Bank Act, proposing to broaden its objectives to include a commitment to full employment.

NZ First wants to go further and include objectives for the exchange rate and economic and export growth as well as employment.

With Labour, NZ First and the Greens all looking to broaden the mandate of the Reserve Bank, it is worth looking at what that might mean.

Currently the Reserve Bank's main monetary objective is keeping consumer price inflation between one and three percent, with a target of two percent. (It also has a separate responsibility for prudential supervision of the banking and financial sector.)

The Reserve Bank's key objective of restraining inflation has served New Zealand well over the last few decades. Since its establishment there have been no instances of runaway inflation such as experienced in the 1970s and '80s.

It can be argued that this singular focus on inflation has enabled this success.

There are problems with a central bank having multiple objectives.

First, multiple objectives could mean conflicting objectives. If objectives around growth, exports or employment conflicted with inflation objectives, which one would take priority? There would be a danger of inflation control being always subject to other priorities.

Second, growth and employment objectives are intrinsically linked to a political viewpoint. Any Government that changed the Reserve Bank to include growth or employment targets would presumably do so from the standpoint of its own political outlook. Widening the Reserve Bank's mandate to include these objectives could put its political neutrality at risk and there's a danger of political objectives trumping the good work of inflation control.

Third, multiple objectives could upset the balance of powers currently existing in New Zealand's constitutional arrangements. A Reserve Bank charged with controlling employment, growth and currency outcomes would have enormous power that could challenge the Government's own power to govern.

Perhaps the main issue around Reserve Bank objectives other than inflation is whether they can actually be achieved.

It has been demonstrated that the Reserve Bank can control inflation outcomes - inflation control is an achievable objective.

But there is no evidence to suggest that it can directly control outcomes such as employment or economic growth.

Of course there is a link between inflation control and other economic outcomes, but it is an indirect, flow-on effect. A central bank may not be able to directly control economic or employment growth, but by directly controlling inflation it indirectly helps economic and employment growth over the longer term.

BusinessNZ has consistently advocated for retaining the Reserve Bank's single-minded focus on inflation.

Hopefully Government's review of the operation of the Reserve Bank will affirm this focused approach.

It could also consider looking at the Reserve Bank's responsibilities for prudential supervision.

The Reserve Bank's rebalance of responsibilities following the global financial crisis has included more emphasis on regulation of banks and financial institutions. Its resulting loan to value restrictions have harmed the prospects of young and first home buyers while failing to significantly reduce house price inflation.

The Reserve Bank's objectives for prudential supervision should be scrutinised with a view to ensuring they do not lead to counterproductive regulation.

A Reserve Bank with clear and appropriately narrow objectives can bring great benefit to the economy.

Election policies signalling change to those objectives should be carefully debated.

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