

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](#)).

