

# The Treasury

## Tax, Housing and RBNZ Information Release

April 2021

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### Cabinet Document Details

Title: **Cabinet Paper: CAB-21-SUB-0018: Housing policy and the Reserve Bank**

Date: **12 February 2021**

Creator: Office of the Minister of Finance

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[36] 9(2)(h) - to maintain legal professional privilege

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## **Housing policy and the Reserve Bank**

### **Proposal**

- 1 This paper proposes that Cabinet:
  - 1.1 Authorise the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office for an Order in Council to replace the remit for the Monetary Policy Committee.
  - 1.2 Agree the replacement remit would see the Reserve Bank take into account the government policy objectives relating to housing affordability.
  - 1.3 Note my intention to issue a direction to the Reserve Bank to have regard to a government policy on housing in relation to its financial policy functions, under section 68B of the Reserve Bank of New Zealand Act 1989 ('the Act').
  - 1.4 Note my intention to also invite the Reserve Bank to provide me with further advice about the inclusion of debt serviceability restrictions such as debt-to-income limits in the Memorandum of Understanding on macroprudential policy and the impact of interest-only mortgages on financial stability and Government housing objectives.
- 2 This paper sits alongside the paper 'Backing first home buyers and encouraging property investment into new housing supply' that I am bringing to Cabinet with the Minister of Housing and the Minister of Revenue. Together, these two papers form part of the Government's broader package of work to improve housing affordability.

### **Executive Summary**

- 3 Since the onset of COVID-19, the Reserve Bank's monetary actions in reducing the Official Cash Rate (OCR) and conducting Large Scale Asset Purchases (LSAP) have played a key role in cushioning the economic blow of COVID-19, and positioning the economy for recovery. However, the Reserve Bank's actions under both its monetary and financial functions can temporarily influence house prices, particularly in a context of constrained housing supply. The Reserve Bank also has a statutory purpose to promote the maintenance of a sound and efficient financial system, and uses tools such as loan-to-value ratio (LVRs) restrictions to reduce the risk associated with 'boom-bust' cycles. The design of these measures can have differential impacts on groups of buyers. The Reserve Bank has taken financial measures, including the removal of LVRs, in response to COVID-19.
- 4 While supply-side reforms are fundamental to the long-term provision of affordable housing, demand-side measures can help to moderate house price growth while the supply side catches up. Given this, on 24 November 2020 I wrote to the Governor of the Reserve Bank to seek his views on whether the monetary policy remit should be amended to include stability in house prices. In the Governor's response on 9 December, he recommended that the Government's specific housing objective be issued as a factor for the Reserve Bank to have regard to when setting financial policy. This direction would be issued under section 68B of the Act and ultimately articulated in the Reserve Bank's Financial Policy Remit, pending further legislative reform of the Act.

- 5 Following the Governor's response, officials at the Reserve Bank and the Treasury have worked together to identify further options for elevating the prominence of house prices in the Reserve Bank's decision-making. This paper sets out recommendations to elevate how both the Reserve Bank and its Monetary Policy Committee (MPC) considers the housing market outcomes of their decisions. On financial policy, this paper notes that I intend to issue a direction under section 68B of the Act outlining the Government's housing objectives. On monetary policy, this paper seeks your endorsement to progress a new remit that would see the Reserve Bank take into account the Government's housing objectives. The replacement remit would be issued via Order-in-Council and would therefore be subject to a legislative drafting process. I intend to report back to Cabinet with recommended wording for the remit next week.
- 6 Subject to Cabinet and Executive Council agreement, I intend to announce the proposals before the end of February, alongside the announcement of the measures contained in the companion paper 'Backing first home buyers and encouraging property investment into new housing supply'.

### **The lack of affordable housing is one of the country's longest-standing and largest issues**

- 7 As discussed in the companion Cabinet paper, 'Backing first home buyers and encouraging property investment into new housing supply', New Zealand house prices are among the highest in the world relative to incomes. Nationally, median house prices are ten times higher than median disposable income, a value that has doubled since 2000. From 1991 to 2019 (before COVID-19) our house prices had the highest real growth in the OECD at 266 percent. Homeownership rates are significantly lower now than they were at their peak in the 1990s and, as at the 2018 Census, were at their lowest since the 1950s.
- 8 While increasing housing supply is the key to providing affordable housing in the long term, demand-side factors are also putting upward pressure on prices. Falling interest rates – and particularly very low interest rates in response to COVID-19 – have increased house prices, creating capital gains for existing property owners but worsening the position of first-home buyers. The removal of LVR restrictions in response to COVID-19 made it easier for highly-leveraged investors to re-enter the market, thus potentially exacerbating price pressures. High population growth has increased demand for housing over recent decades. Finally, investors are active in the market partly due to favourable tax treatment of housing investment and the widely held view that housing is a one-way bet.

### **This paper is part of a broader programme of work to improve housing affordability**

- 9 The companion paper 'Backing first home buyers and encouraging property investment into new housing supply' proposes that the Government agree to the following overall objectives for the housing market:
  - 9.1 Ensure every New Zealander has a safe, warm, and dry and affordable home to call their own – whether they are renters or owners.
  - 9.2 In the short to medium-term, support more affordable house prices by dampening investor demand for existing housing stock, which will allow additional opportunities for first-home buyers.
  - 9.3 Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well-regulated.

- 10 In line with these objectives, this paper proposes measures to direct the Reserve Bank and its MPC to consider relevant aspects of government policy relating to housing affordability when making decisions in respect of financial and monetary policy.
- 11 Alongside this, the companion paper 'Backing first home buyers and encouraging property investment into new housing supply' proposes tax measures that would increase the tax paid by residential property investors. Responsible Ministers also intend to propose options for improving housing supply to Cabinet over the next few months.

### **The Reserve Bank's role and support for the Government's economic objective**

- 12 The Reserve Bank has two main policy functions: monetary policy and financial stability policy. Each is governed by the Act but with separate decision-making arrangements. We changed the monetary policy framework through 'Phase One' of our reforms to the Act. The second phase, which will reform the Bank's financial stability framework, is still in progress.

#### *Monetary policy*

- 13 Under the Act, the MPC is required to formulate monetary policy directed to the *economic objectives* of:
  - 13.1 achieving and maintaining stability in the general level of prices over the medium term; and
  - 13.2 supporting maximum sustainable employment.
- 14 These are specified further in the *operational objectives* set out in the monetary policy remit. The remit may also set out further matters that the MPC must consider when pursuing its operational objectives. These matters must not be inconsistent with an economic objective. This means that any move to give greater weight to house price considerations in the remit would only lead the MPC to promote housing affordability if doing so was consistent with its primary objectives. As background, the current remit is appended at the end of this paper (Annex 1).

#### *Financial policy*

- 15 Under its role relating to the registration and prudential supervision of banks, the Reserve Bank is required to exercise its powers for the purposes of promoting the maintenance of a sound and efficient financial system. The Reserve Bank does this by imposing a range of regulatory requirements on banks. Its regulatory policies are broadly in line with international practice and include disclosure rules as well as capital adequacy and liquidity requirements. Macroprudential policies such as LVR restrictions are part of this suite of policies. Apart from imposing requirements on banks, the Reserve Bank also monitors compliance and supervises banks, taking enforcement action and managing failures when required.
- 16 The Act provides for the Minister of Finance to issue a direction to the Reserve Bank to have regard to a government policy. The direction would require the Reserve Bank to have regard to the government policy when taking decisions on the design of financial stability policies. However, the primary objectives of the Reserve Bank's financial policy (financial soundness and efficiency) would remain unchanged.
- 17 As noted above, Phase Two of the Government's reforms to the Reserve Bank's financial stability functions is currently in progress. This phase is considering key governance questions. The Reserve Bank of New Zealand Bill, which modernises the Reserve Bank's governance and decision-making framework, is currently being considered by Parliament's Finance and Expenditure Committee. I expect to introduce a further Bill creating a new

regulatory regime for banks and other deposit takers and introducing a deposit insurance scheme by the end of 2021.

### **Housing market impacts of Reserve Bank policies**

- 18 The Reserve Bank's actions under both its monetary and financial functions can influence house prices, particularly in a context of constrained housing supply. For example, reductions in the OCR under its monetary policy function may increase demand for housing by reducing the cost of borrowing. Conversely, the use of LVR restrictions for financial stability purposes may reduce demand for housing by increasing the required deposit.
- 19 The Reserve Bank has publicly stated that the MPC already considers housing costs and house prices to an extent. The MPC considers the housing market insofar as it is a driver of inflation and employment. For example, housing costs – such as rent, maintenance and the cost of construction of a new house – enter into the measure of the Consumer Price Index (CPI) that the MPC targets for its price stability objective. However, the CPI does not include house prices directly, and it gives little weight to the cost of land. This means the CPI gives an incomplete picture of housing inflation for policy purposes. Similarly, in undertaking its financial stability role, the Reserve Bank considers house prices in the context of financial stability.
- 20 However, as New Zealand's stronger-than-expected economic performance has flowed through to renewed housing demand, the time is right to reconsider whether the importance of house prices in Reserve Bank decision-making should be elevated. To this end, on 24 November 2020 I wrote to the Governor of the Reserve Bank to seek his views on whether the monetary policy remit should require the MPC to seek to avoid unnecessary instability in house prices. The Governor's response, received on 9 December, suggested that the Reserve Bank's financial stability functions might be a more appropriate vehicle for such a consideration. Following this, I asked officials from the Treasury and the Reserve Bank to advise on options to elevate the prominence the Reserve Bank and its MPC give to housing outcomes when making financial policy decisions and monetary policy decisions, respectively.
- 21 The changes I am proposing reflect that advice, and do not involve a fundamental departure from either the current institutional framework or the Government's medium-term direction of reform to the Act through Phase Two. Attempting to use monetary policy to change the long-run level of house prices would require a persistently higher level of interest rates than otherwise warranted, which could be highly damaging to the economy, and result in higher unemployment. Similarly, replacing or supplementing the Reserve Bank's financial stability objective with housing affordability objectives could lead to the Reserve Bank taking action to lower house prices that comes at the expense of financial stability. I therefore propose to retain the Bank's primary objectives for both monetary and financial policy.

### **Proposal to seek replacement remit for the Monetary Policy Committee**

- 22 As noted above, the Treasury and the Reserve Bank have worked together to identify how a replacement remit for the MPC could give greater emphasis to housing affordability considerations in the MPC's decision-making framework, while clearly retaining the primacy of the MPC's economic objectives.
- 23 The replacement remit would be issued via Order-in-Council and would therefore be subject to a legislative drafting process. Officials have advised that the replacement remit should:

- 23.1 Set the expectation that the MPC comprehensively understands the effects its decisions have on the Government's housing objective, while it is pursuing its economic objectives.
- 23.2 Provide transparency and assurance about how the MPC understands these effects.
- 24 The MPC would retain autonomy over whether and how its monetary policy decisions take account of potential housing consequences. At the margins, the MPC's assessment of likely housing consequences may impact its choice of the monetary policy mix (that is, the mix of traditional and alternative tools it deploys).
- 25 Following its decisions, the MPC would need to explain regularly how it has sought to assess its impact on housing outcomes. This would support transparency about how the MPC considers its impact on housing outcomes. This reporting obligation would arise because the MPC's Charter requires the MPC to explain how it met the requirements of clause 2b) of the remit in its quarterly Monetary Policy Statements.
- 26 Officials also recommend updating the contextual information attached to the remit to note the important role of the housing market in supporting the Government's economic objective; an effective functioning housing market is a critical component of a sustainable and inclusive economy and promotes the maintenance of a sound and efficient financial system. This update would complement the section 2B requirement to assess the impacts of monetary policy on the Government's housing objective, and support the section 68B direction.
- 27 I propose that the replacement remit would expire on 14 February 2024 (that is, the same date that the current remit is due to expire).

### **I intend to issue a section 68B direction on government policy**

- 28 I also intend to issue a direction under section 68B of the Act to require the Reserve Bank to have regard to a government policy on housing. The Reserve Bank would be required to have regard to this policy when pursuing its financial soundness and efficiency mandate.
- 29 Section 68B empowers the Minister of Finance to direct the Reserve Bank to have regard to a government policy that relates to the Bank's functions under Part 5, Parts 5B and 5C (bank registration, prudential supervision, statutory management, and regulation of payment and settlement systems) of the Act.
- 30 Section 68 of the Act states the powers conferred on the Governor-General, the Minister, and the Bank by this Part of the Act, which includes the 68B direction power, shall be exercised for the purposes of:
- 30.1 promoting the maintenance of a sound and efficient financial system; or
- 30.2 avoiding significant damage to the financial system that could result from the failure of a registered bank.
- 31 Once a direction has been issued, the Reserve Bank is required to 'have regard to' the government policy, which is generally understood to mean it must give genuine attention and thought to the direction, weigh it against other relevant factors, and give it the weight the Reserve Bank considers is appropriate in the circumstances. It does not change the nature of the Reserve Bank's functions or require the Reserve Bank to give effect to the government policy itself.

*I have considered several options for expressing Government policy in the section 68B direction*

32 I have sought advice from the Treasury and the Reserve Bank on how the Reserve Bank could be required to have regard to house prices, and I have considered the following options for expressing the Government policy on housing. These options are based on wording from the government policy objectives on housing, which are being proposed in the companion paper 'Backing first home buyers and encouraging property investment into new housing supply'.

32.1 Option 1: "To support more sustainable house prices" (Reserve Bank preferred option)

32.2 Option 2: "To support more affordable house prices, including by dampening investor demand for existing housing stock which would allow more opportunities for first-home buyers" (Treasury preferred option)

32.3 Option 3: Including all the Government's policy objectives on housing in the direction itself, which include ensuring every New Zealander has a safe, warm, dry and affordable home and creating a high-performing housing supply system.

#### *Treasury comment*

33 The Treasury considers that Option 2 best achieves the overall objective of communicating the Government's relevant housing priorities. It is preferable to Option 1 because it provides information on which parts of the market the Government intends to focus its policies on, and also requires the Reserve Bank to have regard to how it could achieve its financial stability mandate without coming at the expense of first-home buyers. [36]

#### *Reserve Bank comment*

34 The Reserve Bank has a strong preference for the direction to refer to 'sustainable' house prices. Sustainability is well linked to its financial stability mandate, where deviations from fair value suggest growing risks of future house price correction. The Reserve Bank considers that it is also an easier concept for it to assess and build a modelling framework around. The Reserve Bank has noted that in contrast 'affordability' is not a well-defined concept and is open to significant differences in interpretation. For example, temporary reductions in interest rates can improve short-term affordability for home buyers, but can worsen long-run house price sustainability if this results in an increase in house prices. In the Reserve Bank's view, this would lead to significantly less clarity as to how to incorporate the direction into its policy decision making, which could ultimately weaken the effectiveness of the direction. The Reserve Bank's view is also that Option 1, unlike Options 2 and 3, would reduce the risk of unrealistic expectations about the ability of the Reserve Bank to target specific subsectors of the housing market. The Bank considers that Option 1 is a more enduring requirement, as it would be relevant in future circumstances where there was a desire to bolster housing demand from both owner occupiers and investors.

35 While the Bank would prefer not to have the reference to affordability in the direction itself, it has suggested that it could be incorporated in the direction by including it at the end of the sentence, for example: "support more sustainable house prices, including by dampening

investor demand for existing housing stock which would improve affordability for first-home buyers”

*My preference is for Option 2*

- 36 Affordability and sustainability are both challenging concepts to define and require judgements. [36]

The most important point is that the direction captures the Government’s broader policy objective accurately. The Reserve Bank will need to have regard to the objective but it is not accountable for delivering it. The Reserve Bank will need to communicate how it has had regard to the direction, which would help to manage expectations about what the Reserve Bank can achieve.

- 37 Therefore my preferred approach to issuing a section 68B direction is Option 2 above. I believe this would express Government policy in a way that clearly communicates the Government’s relevant housing objectives and highlights which parts of the housing market the Government intends to focus its policies on. A key part of the Government’s housing policy is to moderate house price growth, including by tilting the balance away from investors and more towards first-home buyers. Once a government policy direction has been issued, it is up to the Reserve Bank to respond to the policy in a way that the Reserve Bank considers best aligns with its financial stability mandate.

- 38 While the Government policy on housing could be stated in more general or specific ways, I consider that the wording above best captures the Government’s concerns about the housing market and the role of the Reserve Bank in relation to the complex and multifaceted drivers of the housing market, while also meeting the legislative requirements set out in section 68 and 68B. While I acknowledge there are some concerns that the Government policy as stated in the direction could be perceived as setting unreasonable expectations about the ability of the Reserve Bank to target certain segments of the housing market for broader policy reasons, I consider these can be managed by clear communication.

*I am exercising this power for the purpose of promoting the maintenance of a sound and efficient financial system*

- 39 I am exercising this power to issue a section 68B government policy direction for the purpose of promoting the maintenance of a sound and efficient financial system, in accordance with section 68 of the Act.

- 40 I consider that requiring the Reserve Bank to have regard to the government policy of ‘supporting more affordable house prices’ is aligned with the long-term economic fundamentals of housing and is consistent with the Bank’s financial soundness mandate. ‘Affordable’ and ‘sustainable’ house prices have similar meanings, in that house prices should be within some range of ‘fair value’, that is by reference to affordability for owner-occupiers in the macroeconomic context, or the cost of building a new house.

- 41 There are strong links between affordability and financial soundness. If house prices go up rapidly and become more unaffordable relative to average household incomes, they increase the risk that households can no longer afford the ongoing costs of servicing mortgage debt. They also increase the risk of a sharp correction in the housing market and consequent financial sector disruption.

*The Government policy in this direction is related to the Reserve Bank’s financial policy functions*

- 42 The Reserve Bank's relevant functions are the prudential supervision and implementation of rules that promote the maintenance of a sound and efficient financial system.
- 43 The Government's housing policy is also to increase the proportion of owner-occupiers in the housing market, which can only be achieved by increasing the rate of first-home buyers.
- 44 This policy is consistent with the financial stability purpose above because of the differential financial risks posed by different types of borrowers. Investors may be associated with greater financial stability risks because they may be more likely to sell their properties quickly in response to declining house prices, which increases the risk of 'fire sales' in a downturn.
- 45 The Government policy as expressed above relates to the Bank's functions. When the Reserve Bank carries out its Part 5 functions, it treats investors and owner-occupier borrowers differently for some of its relevant policies. For example, on loan-to-value restrictions, the Reserve Bank already distinguishes between investors and owner-occupiers by imposing stricter requirements on investors than owner-occupiers.
- 46 The Bank could consider whether it could undertake its functions without coming at the expense of first home buyers, and its financial policies could bring house prices closer to their 'fair value', including if overvaluation were caused by investor speculation.
- 47 A draft Government Policy direction is attached to this paper (Annex 2).

*This direction will be replaced by a financial policy remit*

- 48 The Reserve Bank of New Zealand Bill provides for a financial policy remit, which will need to be issued by the Minister of Finance and reviewed at least every five years. [36]

It will

also be supported by additional accountability and reporting requirements and will apply across all of the Reserve Bank's financial stability functions. The Remit is designed to provide a balance between protecting the Reserve Bank's operational independence, and providing an appropriate level of democratic influence over the significant policy making functions that Parliament has delegated to the Reserve Bank in relation to financial stability.

- 49 I expect that the Reserve Bank of New Zealand Bill will be enacted by the end of this year and that it will commence on 1 July 2022, with the first financial policy remit coming into force at this time. I expect to review this section 68B direction in the first half of 2022, as part of finalising the new financial policy remit.

### **Other financial policy tools that may impact on the housing market**

*The Reserve Bank has requested the Government consider adding debt serviceability restrictions to its toolkit*

- 50 Another suggestion in the Governor's letter of 9 December was that the Government consider adding restrictions on debt serviceability (including debt-to-income (DTI) limits) to the permitted tools in 2021.
- 51 I am seeking more information and specificity about how the Bank would implement them, particularly in light of any section 68B direction issued. I am particularly interested in whether DTIs could be targeted at investors and not at first home buyers. Therefore, I intend to invite the Bank to provide further advice to me before making any decision to add DTIs to the Reserve Bank's toolkit.

*I am also requesting advice from the Reserve Bank on interest-only mortgages*

- 52 As part of the Treasury's advice to me on housing affordability, it has also noted that a high proportion of residential property lending to investors is interest-only (i.e. no repayments of the principal over the mortgage period). Interest-only mortgages comprise over 40% of new investor lending, compared to just over 20% for owner-occupiers. Interest-only mortgages – combined with interest payment being tax deductible – appear to be an enabler of speculative investment in housing.
- 53 Given this, I also intend to invite the Reserve Bank to provide advice to me on the extent to which interest-only mortgages, (particularly to investors) pose risks to the Reserve Bank's objectives of financial soundness and efficiency, and whether restrictions on interest-only mortgages may support the Government housing policy objectives.

### **Implementation**

- 54 I intend for the replacement remit for the Monetary Policy Committee to be in place in time for the MPC's regular monetary policy announcement on 14 April 2021 (this means that the MPC will make its next decision under the existing remit, at its 24 February Monetary Policy Statement).
- 55 I will issue the section 68B direction by providing a signed written statement to the Reserve Bank. As soon as practicable after the direction has been transmitted, I will present this to Parliament and publish this in the Gazette.
- 56 I will separately write to the Reserve Bank seeking further advice on DTIs and interest-only mortgages.

### **Financial Implications**

- 57 There are no financial implications associated with this paper.

### **Legislative Implications**

- 58 The remit for the Monetary Policy Committee cannot be amended before its expiry however it can be replaced by Order in Council, on the advice of the Minister of Finance. I intend to provide an Order in Council to Cabinet for submission to the Executive Council.

### **Regulatory Impact Statement**

- 59 For the issuance of a section 68B direction, the regulatory impact analysis requirements do not apply, and a regulatory impact statement has not been prepared.
- 60 For the replacement remit, the Regulatory Impact Analysis Team at the Treasury has determined that the regulatory proposal in this paper is exempt from the requirement to provide a Regulatory Impact Statement on the basis that it has no or minor impacts on businesses, individuals or not for profit entities.

### **Population Implications**

- 61 The following population groups are likely to be particularly affected by the proposals in this paper:
- 61.1 There are differing views on the likely impact of these measures on rents. To the extent that the policy proposals within this paper place upward pressure on rents, this appears more likely to disproportionately impact Māori and Pacific people, who are

less likely to own their home (or hold it in a trust) than other ethnic groups. In 2018, the proportion of Māori and Pacific people living in owner-occupied homes were 47.2% and 35.1% respectively, compared to the total population figure of 64.3%. Government is taking other measures to improve housing for Māori and Pacific, including through Progressive Home Ownership, MAIHI partnerships and our Public Housing build programme. In addition, as around 43% of children are living in rental accommodation, upward pressure on rents could have negative impacts on child wellbeing and child poverty.

61.2 Given that declining home ownership rates have been sharper amongst younger people, upward pressure on rental prices risks particularly affecting this group. Balanced against this is the potential for increased affordability for first home buyers, including among young people.

62 As noted above, the magnitude of the effect of the two tax measures on property and rent prices is uncertain. Accordingly, the size of the impact on population groups described above is also uncertain.

### Human Rights

63 There are no human rights implications raised by the proposals in this paper.

### Consultation

64 The Reserve Bank of New Zealand has been consulted on this paper, the draft direction and the proposal to seek a replacement remit. The Department of the Prime Minister and Cabinet has been informed.

### Communications

65 Subject to Cabinet and Executive Council agreement, I intend to announce the proposals before the end of February, alongside the announcement of the measures contained in the companion paper 'Backing first home buyers and encouraging property investment into new housing supply.' As housing affordability is of high public concern, any new measures will be of considerable media and stakeholder interest. Proactive Release

66 I propose to proactively release this Cabinet paper following public announcement of these proposals.

### Recommendations

The Minister of Finance recommends that Cabinet:

- 1 **note** this paper is part of a series of Cabinet papers to improve housing affordability in New Zealand,
- 2 **note** that the Reserve Bank's actions in the past year have played a critical role in supporting New Zealand's economic recovery, but have contributed to house price increases,
- 3 **note** this paper sits alongside the paper 'Backing first home buyers and encouraging property investment into new housing supply', and that together these two papers form a part of the Government's broader package of work to improve housing affordability,

- 4 **note** that the Government’s policy objectives for the housing market will be agreed to in the companion paper above and are relevant to the proposals in this paper. These objectives are to:
- 4.1 Ensure every New Zealander has a safe, warm, and dry and affordable home to call their own – whether they are renters or owners.
  - 4.2 In the short to medium-term, support more affordable house prices by dampening investor demand for existing housing stock, which will allow additional opportunities for first-home buyers.
  - 4.3 Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well-regulated.

*Monetary policy remit*

- 5 **authorise** the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office for an Order in Council to replace the remit for the MPC,
- 6 **agree** the replacement remit will incorporate government policy objectives relating to housing affordability, with the intent of:
- 6.1 setting the expectation that the MPC comprehensively understands the effects its decisions have on the Government’s housing objective, while it is pursuing its economic objectives,
  - 6.2 providing transparency and assurance about how the MPC understands these effects,
- 7 **authorise** the Minister of Finance to progress any other policy issues that arise during the Order in Council process,
- 8 **note** that I intend to bring an Order in Council to Cabinet next week for submission to the Executive Council,
- 9 **agree** that I will bring the Order in Council direct to Cabinet for submission to the Executive Council and I will not bring an item on this matter to LEG committee,

*Section 68B direction*

- 10 **note** that I intend to issue a direction under section 68B of the Reserve Bank of New Zealand Act to require the Reserve Bank to have regard to a government policy on housing,
- 11 **note** that I have considered the three following options for expressing the Government policy in the section 68B direction:
- 11.1 Option 1: “To support more sustainable house prices” (Reserve Bank preferred)
  - 11.2 Option 2: “To support more affordable house prices, including by dampening investor demand for existing housing stock which would allow more opportunities for first-home buyers” (Treasury and Minister of Finance preferred)
  - 11.3 Option 3: Including all the Government’s policy objectives on housing in the direction itself, which include ensuring every New Zealander has a safe, warm, dry and affordable home and creating a responsive housing and urban land market,

- 12 **note** that my preference for expressing the Government policy in the section 68B direction is Option 2,
- 13 **note** that the Reserve Bank has been consulted prior to the issuing of this direction,
- 14 **note** that I intend to issue the attached *Section 68B direction on government policy* to the Reserve Bank,
- 15 **note** that this direction will be presented to Parliament and published in the Gazette as soon as practicable after it is issued,
- 16 **note** that I intend to review this section 68B direction in the first half of 2022, as part of finalising the new financial policy remit,

*Other financial policy tools that may impact on the housing market*

- 17 **note** that I intend to invite the Reserve Bank to provide further advice on the impact of debt-to-income restrictions and interest-only mortgages on financial stability and the Government housing policy objective,

*Next steps*

- 18 **note** that, subject to Cabinet and Executive Council agreement next week, I intend to announce these proposals before the end of February, and
- 19 **note** that I propose to proactively release this Cabinet paper following public announcement of these proposals.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance

# Annex 1: Current remit for the Monetary Policy Committee

## The Government's Economic Objective

The Government's economic objective is to improve the wellbeing and living standards of New Zealanders through a sustainable, productive and inclusive economy. Our priority is to move towards a low carbon economy, with a strong diversified export base, that delivers decent jobs with higher wages and reduces inequality and poverty.

## Context

Monetary policy plays an important role in supporting the Government's economic objective. The Reserve Bank of New Zealand Act 1989 (the Act) requires that monetary policy promote the prosperity and wellbeing of New Zealanders, and contribute to a sustainable and productive economy. Monetary policy contributes to public welfare by reducing cyclical variations in employment and economic activity whilst maintaining price stability over the medium term.

This remit is issued by the Minister of Finance to the Monetary Policy Committee (MPC) under Clause 3, Schedule 1 of the Act.

### 1) *Monetary Policy Objectives*

- a) Under Section 8 of the Act the Reserve Bank, acting through the MPC, is required to formulate monetary policy with the goals of maintaining a stable general level of prices over the medium term and supporting maximum sustainable employment.

### 2) *Operational Objectives*

- a) For the purpose of this remit the MPC's operational objectives shall be to:
  - i. keep future annual inflation between 1 and 3 percent over the medium term, with a focus on keeping future inflation near the 2 percent mid-point. This target will be defined in terms of the All Groups Consumers Price Index, as published by Statistics New Zealand; and
  - ii. support maximum sustainable employment. The MPC should consider a broad range of labour market indicators to form a view of where employment is relative to its maximum sustainable level, taking into account that the level of maximum sustainable employment is largely determined by non-monetary factors that affect the structure and dynamics of the labour market and is not directly measurable.
- b) In pursuing the operational objectives, the MPC shall:
  - i. have regard to the efficiency and soundness of the financial system;
  - ii. seek to avoid unnecessary instability in output, interest rates, and the exchange rate; and
  - iii. discount events that have only transitory effects on inflation, setting policy with a medium-term orientation.

Agreed by

Hon Grant Robertson  
**Minister of Finance**

Adrian Orr  
**Governor of the Reserve Bank of New Zealand**

## **Annex 2: Section 68B direction on government policy**

Pursuant to section 68B of the Reserve Bank of New Zealand Act 1989 (the Act), I direct the Reserve Bank of New Zealand (the Reserve Bank) to have regard to the following government policy that relates to its functions under Part 5 of the Act.

### **Government policy**

It is Government policy to support more affordable house prices, including by dampening investor demand for existing housing stock which would allow more opportunities for first-home buyers.

### **Consultation**

The Reserve Bank has been consulted on this direction.

### **Communication**

Pursuant to section 162B(1)(d) of the Act, the RBNZ is required to report on how it has had regard to this direction in its next Statement of Intent.

### **Review**

I expect to review this section 68B direction in the first half of 2022, as part of finalising the new financial policy remit under the Reserve Bank of New Zealand Bill, if enacted.

Issued at Wellington this [X] day of February 2021

**Hon Grant Robertson, Minister of Finance**

**Explanatory note** (*not part of this direction*):

Section 68 of the Act requires that the powers conferred on the Reserve Bank under Part 5 be exercised for the purpose of promoting the maintenance of a sound and efficient financial system. To promote the maintenance of sound and efficient financial system, the Reserve Bank imposes a range of conditions of registration on financial institutions in relation to a bank's ability to carry on its business in a prudent manner.

The adoption and implementation of these conditions have implications for the housing market and also for the Government's broader policy objectives.

The Government policy which is the subject of the direction forms part of the Government's overall economic objective is to improve the wellbeing and living standards of New Zealanders through a sustainable, productive and inclusive economy.

An effective functioning housing market is a critical component of a sustainable and inclusive economy and promotes the maintenance of a sound and efficient financial system. Access to affordable housing is a significant and growing concern for New Zealanders. Despite the impact of COVID-19, median house prices have increased significantly in the past year.

The current state of the housing market creates significant societal inequities, and cuts across a number of this Government's goals.

To that end, the Government's overarching objectives are:

1. Ensure every New Zealander has a safe, warm, and dry and affordable home to call their own – whether they are renters or owners.
2. In the short to medium-term, support more affordable house prices by dampening investor demand for existing housing stock, which will allow additional opportunities for first-home buyers.
3. Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well-regulated.