The Treasury

Reserve Bank Dual Mandate Change Information Release

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Office of the Minister of Finance

Removing the "dual mandate" from the Reserve Bank of New Zealand Act 2021

Proposal

1 This paper seeks agreement to remove the economic objective to support maximum sustainable employment (MSE) from the Reserve Bank of New Zealand Act 2021 (the Act).

2 By removing the objective to support MSE from the Act, the Reserve Bank of New Zealand (the Reserve Bank) will return to a single mandate for monetary policy; to achieve and maintain stability in the general level of prices over the medium term. This change will ensure that monetary policy decision makers are once again focused principally on their job of targeting low and stable inflation.

Relation to government priorities

3 The National Party and ACT Party policy programmes for this Government set out our intention to introduce legislation to remove the dual mandate to get the Reserve Bank focused on putting the lid back on inflation (i.e., to remove the economic objective to support MSE). We have committed to introducing legislation to remove the dual mandate within our first 100 days in Government. I intend for a bill to be passed under urgency to amend the Act before Christmas.

4 The Government has also committed to examine other issues relating to the performance of the Reserve Bank, as set out in the coalition agreement between the National Party and the ACT Party. Namely, we have agreed to take advice on:

4.1 replacing "medium term" with specific time targets

4.2 removing the Treasury Observer, and

4.3 returning to a single decision maker model.

5 I propose that I work with the Associate Minister of Finance, Hon David Seymour, to consider the advice we receive on these matters before bringing any potential subsequent recommendations to Cabinet.

6 [33]

Executive Summary

7 When formulating monetary policy, as set out in the Reserve Bank of New Zealand Act 2021, the Reserve Bank has a dual economic mandate. Monetary policy decision makers are required to:

7.1 achieve and maintain stability in the general level of prices over the medium term, and

7.2 support maximum sustainable employment.

8 The dual mandate was added to the Reserve Bank of New Zealand Act 1989 in 2019 and was carried over into the present 2021 Act. Prior to the 2019 amendments, achieving and maintaining stability in the general level of prices was the primary function of the Reserve Bank.

9 As we have seen, inflation in recent years has been consistently well above the Reserve Bank's target of achieving and maintaining annual inflation between 1 and 3 percent over the medium term, as measured by the All Groups Consumers Price Index (CPI), which is published by Stats NZ.

10 Persistently above-target inflation is negatively impacting the ability of hard-working New Zealanders to meet their day-to-day living costs. There is therefore a need to ensure that monetary policy decision makers have a much stronger focus on achieving price stability. The way to do this, as proposed in this paper, is to remove the Reserve Bank's dual mandate to ensure a focus on achieving and maintaining price stability.

11 Following Cabinet's agreement to the policy decision to remove the economic objective to support MSE, I will return to Cabinet on **Monday 11 December** to seek approval to introduce a bill to amend the Act. Upon the passage of the bill, a new MPC Remit and MPC Charter will be required, and I intend to provide draft versions of both documents to Cabinet on Monday 11 December as well.

Background

12 The dual mandate of the Reserve Bank was introduced by a 2019 amendment to the Reserve Bank of New Zealand Act 1989 and was carried over into the present Reserve Bank of New Zealand Act 2021. Section 118 of the Act requires the Monetary Policy Committee (MPC) to formulate monetary policy in a manner consistent with the dual economic objectives of:

12.1 achieving and maintaining stability in the general level of prices over the medium term, and

12.2 supporting maximum sustainable employment.

13 As measured by the CPI (on an annual percentage change basis), inflation in New Zealand has been above the Reserve Bank's 1-3 percent target band consistently since June 2021. In June 2022, the annual percentage change in the CPI rose to a high of 7.3 percent, falling to 5.6 percent for the year to the September 2023 quarter – significantly above the upper end of the target band for the Reserve Bank. This persistently high level of inflation is negatively impacting the ability of hard-working New Zealanders to meet their day-to-day living costs.

14 I believe that having a dual mandate clouds monetary policy decisions and, during a period of elevated inflation, this matters a lot. By returning to a single objective focused on achieving and maintaining price stability, the task of the MPC is clearer, simpler, and therefore more likely to be met. Under a single mandate approach, it is also easier to determine when the MPC has – or has not – fulfilled its primary function.

15 The Treasury is supportive of an approach to monetary policy that more clearly prioritises achieving price stability. Similarly, as set out in their advice on the existing MPC Remit, the Reserve Bank is in favour of an approach to monetary policy that clarifies that price stability is "an important prerequisite to" other objectives.[1]

16 It is important to note that returning to a single mandate will not require the MPC to discount the impacts of monetary policy on the real economy. Flexible inflation targeting – whereby the MPC has regard to the impact of monetary policy on the broader economy when determining how quickly to return inflation to target – has been central to New Zealand's inflation targeting regime for many years, regardless of whether the Reserve Bank has a single or dual mandate.

17 There are multiple ways that a flexible inflation targeting arrangement can be maintained, without explicitly requiring consideration of MSE. For example, under a single mandate to achieve and maintain price stability, the MPC can still be required to have regard to the need to avoid unnecessary instability in economic output, interest rates and the exchange rate, as was the case in Policy Target Agreements agreed under the Reserve Bank of New Zealand Act 1989.

Removing the dual mandate

18 I have considered two options to remove or amend the dual mandate:

18.1 A **bill** could be introduced to amend the Reserve Bank of New Zealand Act 2021 to <u>remove</u> the objective to support MSE, as set out in this paper.

18.1.1 Upon the passage of a bill, a new MPC Remit will be required, given that any new MPC Remit issued under the existing monetary policy framework would still require some consideration of MSE to remain consistent with the Act.

[1] Page 5, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/monetary-policy/about-monetary-policy/supporting-new-zealands-economic-stability-toitu-te-ohanga.pdf.

18.1.2 As I recommend that this bill is accorded urgency, I intend to return to Cabinet on Monday 11 December with a new MPC Remit to be issued before Christmas (following the required consultation with the Reserve Bank), and with a new Charter to be agreed with the MPC.

18.2 Alternatively, I could issue a **new Remit** (only) for the MPC to increase the weighting of the economic objective to support price stability relative to the economic objective to support MSE, while maintaining the requirement to support MSE.

19 I recommend that we agree to introduce a bill for the following reasons:

19.1 Amending the Reserve Bank of New Zealand Act 2021 provides clarity to the MPC (and market participants) as to how monetary policy decisions should and will be formulated. Removing from the Act the objective to support MSE provides greater clarity than the alternative, which would be to require MPC decision makers to put less weight on MSE when making monetary policy decisions.

19.2 It is possible that, by providing a clear signal of the importance of achieving and maintaining price stability, a bill will positively influence expectations for future rates of inflation. Reducing inflation expectations is an effective way to dampen inflationary pressure, as heightened and/or unanchored inflation expectations require a more robust central bank response to return inflation to target.

19.3 Introducing legislation to remove the dual mandate is a key Government priority, as set out in advance of the election and in the coalition agreement between the National Party and the ACT Party.

20 Although a new MPC Remit could change the weighting of the economic objectives, a new MPC Remit by itself could not remove the dual mandate. This is because, in the absence of legislative change, the MPC will still be required to formulate monetary policy in a manner consistent with both economic objectives set out in the Act. For this reason, in order to achieve our commitment to "remove" the MSE objective, a bill is required.

21 I do not consider the use of an Order in Council (under section 125 of the Act) to be a suitable option at this time. Although an Order in Council could be made to temporarily suspend the MSE objective, either ahead of or in place of a bill, I believe that using an Order in Council introduces to the process a number of risks and unnecessary complexities. Specifically:

21.1 Given that we have publicly committed to introduce legislation to change the Act, it is prudent to follow through on this commitment in the way expected by market participants.

21.2 There is a risk that the use of an Order in Council negatively affects market participants' perceptions of the future independence of Reserve Bank decision making by setting a precedent for the Government to use such an instrument on a regular basis to influence the course of monetary policy.

21.3 An Order in Council under section 125 is a temporary instrument. This means that, upon the expiration of the Order in Council (which may be made for a period not exceeding 12 months), either the period of the Order in Council would need to be extended, a bill enacted, or monetary policy decision making would return to a dual mandate. In my view, this introduces unnecessary uncertainty into the future course of monetary policy decision making, which itself would not be conducive to our goal of ensuring a primary focus on price stability and dampening inflation expectations.

21.4 If this bill is accorded urgency, and passed before Christmas, the new framework will be in place in time for the next Monetary Policy Statement (28 February 2024), meaning temporary suspension of the dual mandate in advance of the passage of legislation is not required.

Implementation

22 Introducing a bill will require:

22.1 Cabinet agreement to introduce the draft bill (on 11 December 2023, I will seek the approval of Cabinet to introduce this bill).

22.2 A new MPC Remit issued by me, and a new Charter agreed with the MPC (I intend to share these documents with Cabinet).

Milestone	**Timeframe**
Bill approved for introduction by Cabinet	11 December 2023
New MPC Remit and Charter provided to Cabinet	11 December 2023
Bill introduced	11 December 2023
First reading (urgency)	12 December 2023
Second reading	12-14 December 2023 (Bill accorded urgency, so no preceding Select Committee)
Committee of the Whole House	12-14 December 2023
Third reading	12-14 December 2023
Royal assent	18 or 19 December 2023 (timing uncertain)
Commencement of bill	Following Royal assent
New MPC Remit issued (under new framework) and new Charter agreed with MPC	Upon passage of the bill (Cabinet to be informed in advance)

23 As this bill is necessary to quickly implement a pre-election commitment, in advance of the next Monetary Policy Statement (in February 2024), I recommend that the bill is accorded urgency in the House.

Cost-of-living Implications

24 Removing the dual mandate will support New Zealanders with the cost of living by ensuring that the Reserve Bank's Monetary Policy Committee is once again focused primarily on achieving price stability in the New Zealand economy, as measured by the CPI.

Financial Implications

25 This paper has no financial implications.

Legislative Implications

26 In order to remove from the Act the economic objective that the MPC formulate monetary policy to support MSE, an amendment bill is required.

27 A new MPC Remit alone cannot remove the economic objective to support MSE. This is because the MPC Remit cannot be inconsistent with the Act and, so long as MSE is an economic objective set out in the Act, the MPC will be required to formulate monetary policy consistent with this objective.

28 I therefore seek Cabinet's approval to include this bill in the Government's 2023 Legislation Programme. I propose that this bill is include as a category 2 priority (it must be passed in 2023), owing to the fact that this is a small and simple bill that can be introduced at pace, and it will give effect to one of the Government's key 100-day commitments.

29 As this bill was a key pre-election commitment, I do not expect its introduction to be contentious.

30 As the Reserve Bank of New Zealand Act 2021 binds the Crown, so too will this bill.

Impact Analysis

Regulatory Impact Statement

31 Some regulatory impact analysis has been completed and is attached in Appendix 1.

32 Cabinet has decided to suspend the requirement for Regulatory Impact Statements for 100-day Plan initiatives that involve solely the repeal of legislation [CAB-23-MIN-0468 refers]. RISs that are completed have been exempted from normal quality assurance processes.

33 For this proposal to amend the Act, the Treasury has developed some regulatory impact analysis to inform decision making. The Treasury notes that this analysis has been prepared under compressed timeframes, owing to the fact that removing the dual mandate is a key priority of the Government, so the scope of this analysis is limited.

Population Implications

34 I believe that achieving and maintaining low levels of inflation will support, in particular, those on low incomes. This is because low wages can often be slow to change in response to increased price pressures and low-income earners often have less in savings to draw on.

35 It is appropriate that the Reserve Bank focuses primarily on achieving and maintaining price stability. Having monetary policy decisions clouded by multiple objectives distracts from the primary task of ensuring low and stable inflation, which is important for future growth in the economy (e.g., by supporting investor confidence). It is primarily the role of fiscal, not monetary, policy to address distributional issues in the economy.

Human Rights

36 No rights implications have been identified.

Use of external Resources

37 No external resources were used in the preparation of this Cabinet paper.

Consultation

38 On the basis that this paper seeks agreement to progress a policy set out in advance of the election, and agreed to as part of coalition negotiations, I have not consulted Ministers across Government parties. Consultation across Government agencies is not necessary in this case, as this is a matter that affects the Reserve Bank only. The Reserve Bank has been informed of the Government's intention to remove the dual mandate in 2023.

39 With respect to the prioritisation of this bill in our Legislation Programme, the Leader of the House and Parliamentary Counsel Office have been consulted.

Communications

40 Cabinet's agreement to remove the dual mandate will be communicated to the House of Representatives upon the introduction of a bill.

Proactive Release

41 This Cabinet paper will be proactively released within 30 business days.

Recommendations

The Minister of Finance recommends that Cabinet:

1 **note** that, at present, the Reserve Bank of New Zealand (the Reserve Bank) is required by the Reserve Bank of New Zealand Act 2021 to formulate (through the Monetary Policy Committee) monetary policy in a manner consistent with the dual economic objectives (the "dual mandate") of:

1.1 achieving and maintaining stability in the general level of prices over the medium term, and

1.2 supporting maximum sustainable employment

2 **note** that the removal of the Reserve Bank's dual mandate is a commitment agreed to in the coalition agreement reached between the National Party and the ACT Party for the 54th Parliament

3 **note** that, in addition to the removal of the dual mandate, the Government has committed to take advice on a number of other issues relating to the Reserve Bank, as set out in the coalition agreement between the National Party and the ACT Party, namely:

3.1 replacing "medium term" with specific time targets

3.2 removing the Treasury Observer, and

3.3 returning to a single decision maker model

4 **note** that the Minister of Finance and Associate Minister of Finance, Hon David Seymour, will jointly consider the advice received on the matters set out in recommendation 3 before bringing any potential subsequent recommendations to Cabinet

5 [33]

6 **agree** to remove the economic objective to support maximum sustainable employment from the Reserve Bank of New Zealand Act 2021 in order to ensure that monetary policy decision makers are focused on achieving and maintaining price stability

7 **note** that removing the dual mandate from the Reserve Bank of New Zealand Act 2021 is not inconsistent with the continuation of a flexible inflation targeting regime, whereby the Reserve Bank has regard to the real economy when considering how quickly to return inflation to target

8 **invite** the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office to draft a bill to give effect to the recommendations in this paper

9 **authorise** the Minister of Finance to make consequential changes to the bill, consistent with recommendation 6, on issues identified during drafting and passage through the House

10 **agree** to include the bill in the Government's 2023 Legislation Programme, with a priority of category 2 (must be passed in 2023)

11 **agree** that this bill should be accorded urgency in the House, so that it may be enacted ahead of the February 2024 Monetary Policy Statement, and

12 **invite** the Minister of Finance to report back to Cabinet by Monday 11 December 2023 with a draft bill for Cabinet's approval.

Authorised for lodgement

Hon Nicola Willis

Minister of Finance