Appendix 1

Regulatory Impact Statement: Removing the "dual mandate" from the Reserve Bank of New Zealand Act 2021

Coversheet

Purpose of Document	
Decision sought:	Cabinet decision to remove the dual mandate from the Reserve Bank of New Zealand Act 2021
Advising agencies:	The Treasury
Proposing Ministers:	Minister of Finance
Date finalised:	30 November 2023

Problem Definition
The Reserve Bank's Monetary Policy Committee (MPC) is required by the Reserve Bank of New Zealand Act 2021 (the Act) to have regard to the dual economic objectives of achieving and maintaining price stability and supporting maximum sustainable employment (MSE). This is the "dual mandate". The Government has committed to removing the dual mandate to ensure that monetary policy decision makers are focused primarily on the achievement of price stability. This was a pre-election commitment made by the National Party and the ACT Party.

Executive Summary
To remove the dual mandate, a bill is required to amend the Reserve Bank of New Zealand Act 2021. Alternatively, a new MPC Remit (only) may be issued by the Minister of Finance but, without amending the Act, the MPC would still be required to have regard to maximum sustainable employment as well as price stability. The Treasury is supportive of an approach to monetary policy that more clearly prioritises achieving price stability. Owing to the value of an enduring and stable legislative regime for the Reserve Bank, the Treasury's preference is for a new MPC Remit (only) to be issued, although it is recognised that issuing a new MPC Remit without amending the Act cannot fully meet the Government's commitment to remove the dual mandate. The view of the Treasury is that issuing a new MPC Remit without amending the Act would be sufficient to ensure monetary policy decision makers focus primarily on achieving and maintaining price stability (i.e., by setting out a hierarchy for the dual economic objectives). Nonetheless, there is value in amending the Act to signal a greater focus on price stability than that which could be achieved through a new MPC Remit alone.

Limitations and Constraints on Analysis
This brief Regulatory Impact Statement was produced under compressed timeframes owing to the fact that removing the Reserve Bank’s dual mandate is a key priority of the Government, and was campaigned on prior to the 2023 General Election.

Responsible Manager(s) (completed by relevant manager)
Simon McLoughlin Manager Macroeconomic and Fiscal Policy The Treasury  30 November 2023

Section 1: Diagnosing the policy problem

Background

1. 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 (the Act).
2. 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:
    a. achieving and maintaining stability in the general level of prices over the medium term, and
    b. supporting maximum sustainable employment (MSE).
3. The Government has committed to introduce legislation to remove the dual mandate; specifically, to remove the economic objective to support maximum sustainable employment. This was a commitment campaigned on throughout the 2023 General Election and is part of the coalition agreement between the National Party and the ACT Party. The stated purpose of the Government's commitment to remove the dual mandate is to ensure that monetary policy decision makers are focused on ensuring price stability.

Policy problem

4. Inflation has been well above its target level since June 2021. The Government has committed to restoring the Reserve Bank's focus on price stability over MSE.
5. Although inflation is currently above its target level, the Reserve Bank's review of monetary policy decision making *In Retrospect: Monetary Policy in New Zealand 2017-22* concludes that "the [Monetary Policy] Committee's inflation and MSE objectives have not been in conflict: During periods when the inflationary outlook was weak, employment was not above its maximum sustainable level. During periods when there were strong inflationary pressures, employment was considered above its maximum sustainable level."[1]
6. The Treasury has similarly concluded that giving the price stability objective a greater weighting than MSE in the MPC Remit would be "unlikely to alter the way monetary policy is formulated in practice, and it could provide benefits in clarifying how the MPC operates."[2] The recent review of the Reserve Bank of Australia (RBA) found that the RBA should have dual monetary policy objectives of price stability and full employment, with equal consideration given to each.[3]
7. Nonetheless, the dual mandate affects not only the policy decisions made by the MPC, but also perceptions of the effectiveness of monetary policy. Expectations can have a significant impact on inflation outcomes. When the dual mandate was introduced, the 2018 Regulatory Impact Statement noted the "risk that market participants … interpret the Reserve Bank's new employment objective as weakening its focus on inflation."[4]

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1 Page 107, RAFIMP for publication (rbnz.govt.nz)

2 Page 2, Treasury Report T2023/555: The Reserve Bank's 2023 Monetary Policy Committee Remit Review - 27 April 2023 - Treasury Advice on the 2023 Monetary Policy Committee Remit Review Information Release - The Treasury

3 Page 86, Review of the Reserve Bank of Australia - An RBA fit for the future

4 Page 2, Reserve Bank Act Review - Regulatory Impact Statement - 26 March 2018 (treasury.govt.nz)

8. This is important because, as the Reserve Bank itself notes, “some aspects of the Reserve Bank’s work – such as supporting maximum sustainable employment – appear to not be well understood by the public” and “clearly explaining and justifying monetary policy decisions is imperative in retaining credibility.”[5]

9. The Treasury and the Reserve Bank have both recently advised that the MPC Remit make clear that the employment objective is subordinate to achieving price stability. In the Reserve Bank’s review of monetary policy, it was recommended that the MSE measure be refined to provide further clarity about its nature and how it fits within the MPC Remit, as this is “somewhat opaque and is not well understood by the public.”[6] The Reserve Bank’s advice on the current MPC Remit (issued on 28 June 2023) was that a hierarchical ordering of the dual economic objectives of monetary policy would be helpful, as this would “clarify that achieving price stability is an important prerequisite to pursuing other objectives.”[7]

10. However, full employment is a complex concept that is not easily measurable. By placing more emphasis on the objective that can more easily be measured (price stability, by way of the Consumers Price Index), “policy errors from measurement issues associated with targeting less well-measured objectives” can be reduced.[8]

11. Returning to a single mandate will also mitigate the risk that the MPC’s consideration of MSE contributes to higher-than-otherwise inflation. Perhaps more importantly, it may influence perceptions of the Reserve Bank’s willingness to take action – which may itself support the achievement and maintenance of price stability.

Relevant publications

In Retrospect: Monetary Policy in New Zealand 2017-22 (Review and Assessment of the Formulation and Implementation of Monetary Policy, “RAFIMP”): https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2022/rafimp---in-retrospect-monetary-policy-in-new-zealand-2017-22.pdf

Reserve Bank Act Review Regulatory Impact Statement: https://www.treasury.govt.nz/sites/default/files/2018-04/rbnz-rev-ris-phase1.pdf

Review of the Reserve Bank of Australia – An RBA fit for the future: https://rbareview.gov.au/sites/rbareview.gov.au/files/2023-06/rbareview-report-at_0.pdf

Supporting New Zealand’s economic stability – Toitū te Ōhanga: The five-year review of the Remit that guides monetary policy decisions: Advice to the Minister: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/monetary-policy/about-monetary-policy/supporting-new-zealands-economic-stability-toitu-te-ohanga.pdf

Treasury Report: The Reserve Bank’s 2023 Monetary Policy Committee Remit Review (T2023/555): https://www.treasury.govt.nz/sites/default/files/2023-06/rbnz-mpc-4777238.pdf

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5 Page 107, RAFIMP for publication (rbnz.govt.nz)

6 Page 13, RAFIMP for publication (rbnz.govt.nz)

7 Page 5, Supporting New Zealand's economic stability - Toitu te Ohanga (rbnz.govt.nz)

8 Page 5, Supporting New Zealand's economic stability - Toitu te Ohanga (rbnz.govt.nz)

Section 2: Deciding upon an option to address the policy problem

Options and criteria

12. To ensure a primary focus on price stability, the Government could:
    a. introduce legislation to amend the Act to remove the economic objective of supporting maximum sustainable employment (MSE)
    b. issue a new MPC Remit only, requiring the MPC to place greater weight on its price stability objective relative to MSE, such that MSE becomes a secondary objective, but leaving the Act unchanged, or
    c. temporarily suspend the objective to support MSE by way of an Order in Council under section 125 of the Act (for a period not exceeding 12 months).
13. All of these options entail issuing a new MPC Remit.
14. In assessing the different options available to the Government, the Treasury has considered the following criteria:
    a. Achieving the Government's policy intention to restore focus on price stability
    b. An enduring legislative regime
    c. Procedural expediency
    d. International best practice
    e. Impacts on markets and public confidence

Analysis

15. Given that the Government has committed to introducing legislation to remove the dual mandate, the Treasury recognises that amending the Act is the Government's preferred approach, and this is what will be expected by market participants.
16. Nonetheless, the Treasury's recommendation is to issue a new MPC Remit only. In making this recommendation, the Treasury has weighed more heavily the need to achieve the Government's policy intention to restore focus on price stability, and the importance of an enduring and consistent legislative regime. The Treasury has not placed much weight on procedural expediency, given the priority the Government has placed on this process.
    a. **Achieving the Government's policy intention to restore focus on price stability –** the Treasury believes that, at this time, issuing a new MPC Remit would send a sufficiently clear signal of the importance of price stability for monetary policy. Although MSE is now considered as part of the decision making process, the dual mandate has not made a material difference to the outcomes of monetary policy decisions since its introduction, according to the Reserve Bank. This is largely because the two economic objectives (price stability and MSE) are aligned over time. Therefore, removing the dual mandate from the Act would be unlikely to alter the general stance of future monetary policy decisions except for in the rare circumstances where these objectives may be misaligned.

b. **An enduring legislative regime** – the Treasury puts significant weight on the value of a stable and enduring legislative regime for the Reserve Bank, which supports public and market confidence in the independence of the institution.[9] In the Treasury's view, it is preferable to use the MPC Remit to provide guidance on the economic objectives of monetary policy, rather than for Governments to change the Act. The Reserve Bank's statutory framework is of considerable interest to market participants, and changes to it – or the use of some options – may trigger market concern.

c. **Procedural expediency** – issuing a new MPC Remit is the quickest and least resource intensive way to ensure a clear prioritisation of price stability.

d. **International best practice** – in recent years, there has been a trend towards the adoption (and retention) of dual mandates for central banks. While a small number of central banks have price stability as their sole economic objective, a larger number of central banks have a dual mandate that equally weights price stability and employment objectives (including the US Federal Reserve) or a dual mandate that sets out employment as a secondary objective. The March 2023 review of the Reserve Bank of Australia, for example, recommended in favour of formalising a dual mandate (as opposed to a triple mandate, which includes "economic prosperity"), and the Bank of Canada is now required to "actively seek the level of maximum sustainable employment when conditions warrant" (although this falls short of a dual mandate *per se*).[10]

e. **Impacts on markets and public confidence.** The Treasury recommends against the use of an Order in Council to achieve the Government's policy objectives. Conversations with a number of market participants from commercial banks, as well as with the Reserve Bank, have signalled that the use of an Order in Council could be received poorly.

    i. Using an Order in Council may highlight to markets the limits of the Reserve Bank's independence and create a precedent whereby the Reserve Bank's objectives are easily overridden (or at least the expectation of such), which could in turn weaken the inflation targeting regime. The practical and perceived independence of the Reserve Bank is seen as highly important to market participants. Use of an Order in Council may also raise concerns among international market participants, many of whom may not fully understand the Reserve Bank's legislative regime, meaning communicating the benefits of an Order in Council could be challenging for the Government.

    ii. The Treasury believes that the view of section 125 as a reserve "emergency" option for the Government is relatively widely held. Although section 125 is a lawful option here and is still a useful section of the Act for when there might be ongoing divergence between the two economic objectives (e.g., a period of stagflation), we believe that the benefits of an Order in Council at this time do not outweigh the risks.

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9 A post-implementation review of the Reserve Bank of New Zealand Act 2021 is due by the end of 2027.

10 Joint Statement of the Government of Canada and the Bank of Canada on the Renewal of the Monetary Policy Framework - Bank of Canada

Options Analysis Summary

	Option A Amending the Act	**Option B** Issuing a new MPC Remit only	**Option C** Order in Council suspending the MSE objective
Focus on price stability	+ + This would clearly signal to the Reserve Bank and the public the focus on price stability	+ This would reduce, but not eliminate, MSE as a consideration	+ This would remove the focus on MSE, but only for a limited period of time (requiring further action)
An enduring legislative regime	- This could be seen as reducing future barriers to legislative change	+ + Using levers in the existing legislative framework supports an enduring regime	+ Using levers in the existing legislative framework supports an enduring regime
Procedural expediency	**0** Requires House time and associated resource – although can be done under urgency	+ Some procedural requirements but relatively straightforward	+ Some procedural requirements but relatively straightforward
International best practice	**0**	+	-
Market and public confidence	+	+	- - This would likely cause concern with domestic and international markets

Section 3: Delivering an option

How will the new arrangements be implemented?

17. In order to meet the Government's stated commitment, a bill will be introduced to amend the Reserve Bank of New Zealand Act 2021. The passage of this bill will require a new MPC Remit to be issued by the Minister of Finance, and for a new MPC Charter to be agreed with the Reserve Bank. The Treasury expects the Parliamentary process to be completed under urgency, and for the changes to come into force this year.

18. The Reserve Bank's Monetary Policy Committee will be responsible for making monetary policy decisions in a manner consistent with the (now sole) economic objective and the new MPC Remit.