Economics
29 April 2014

New Zealand Economics Comment

Opposition proposes changing RBNZ mandate

New Zealand's opposition Labour party has proposed adjusting the RBNZ's inflation targeting regime, as a part of its agenda in the lead up to the September election. They propose that the current account position should be part of the RBNZ's policy targets agreement and the central bank be given another tool to adjust household saving rates via superannuation contributions through the cycle, partly to weaken the high NZD. In our view, this is over-engineering and would be demanding too much from monetary policy. Instead, addressing the underlying causes of low saving, a persistent current account deficit and poor productivity growth would better tackle the issues of an elevated exchange rate.

New Zealand was famously the first central bank to formally adopt inflation targeting in 1990 and, until recently, had run an orthodox inflation targeting framework. However, since the global financial crisis, politicians and economists have questioned the suitability of strict inflation targeting regimes. In particular, there is a view that there may be situations where central banks should also 'lean' against asset price bubbles, to improve financial stability.

The RBNZ has already altered their monetary policy framework to enable the flexibility to respond to these financial stability risks. The central bank now has at their disposal a number of 'macro-prudential tools', such as adjusting maximum loan-to-valuation ratios on mortgages, which it has already used in an attempt to limit the build-up of financial stability risks in the housing market (see *'RBNZ Observer Update: LVR restrictions adopted, but will they work?*', 20August 2013).

Now, New Zealand's opposition Labour party has proposed expanding the focus of the central bank even further, as a part of its campaign agenda for the election due to be held on 20 September. The proposed objective is to improve New Zealand's external balances as well as attempt to take pressure of the exchange rate, which has been very high, in order to help improve the competitiveness of the country's export sector.

The Labour party today announced that it is proposing to add the promotion of a positive external balance to the central bank's mandate, while maintaining the central bank's independence and focus on inflation. Of course, to take on a new job, the central bank would probably need a new tool. The Labour party suggests that the central bank could be mandated to alter the rate of individual contributions to a compulsory savings scheme. The idea being that, when the economy is booming, the levy could be increased, and vice versa during a downturn. In principle, this could take pressure off interest rates and the exchange rate and help limit increases in the current account deficit during a boom.

However, in our view, broadening the focus of the RBNZ's mandate is an inefficient solution to this problem, which also brings significant risks. A fundamental problem with the proposition is that saving is fungible. Forcing households to save in one area may just encourage them to reduce saving elsewhere. With this in mind, the new policy tool may not even achieve its fundamental objective of lifting saving at all. A variable saving levy would also come with some costs. It could


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make planning for retirement more difficult as it would force savings when the returns may not justify such behaviour, or a household would be better placed paying down a mortgage. It could also have negative distributional consequences, as the burden would more heavily fall on low and middle income households, given they would have less ability to lower saving elsewhere.

Additional tools and mandates would also complicate the task of the RBNZ and may distract them from their main goal of maintaining stable inflation. Coordinating multiple objectives is a very tricky business. Indeed, it is already proving difficult for the RBNZ to communicate its intentions with regard to its macro-prudential setting and its interest rate setting, let alone also adding an external balance objective and the setting of a compulsory saving rate.

Because high and volatile inflation does have negative consequences for an economy, making it difficult for business to plan and encouraging unproductive investment to guard against inflation risks, any policy that diverts the RBNZ's mandate away from inflation targeting could raise the costs to the economy, without delivering stronger growth. In our view, this would be over-engineering and would demand too much from monetary policy.

Other policy options may be better targeted at improving New Zealand's savings track record and the competitiveness of the export sector. Policies that remove distortions to savings and investment behaviour should help improve New Zealand's savings performance and help boost the country's international competitiveness. In a similar vein, a continued commitment to fiscal consolidation will also help improve national savings, take pressure of interest rates and subsequently the exchange rate. More broadly, a focus on productivity enhancing reform would also help to improve New Zealand's competitiveness. After all, in the long-run, monetary policy can influence inflation but has little enduring influence on a country's growth potential.

Disclosure appendix

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