**Child Poverty Action Group: February 2021**

**Submission to the Finance and Expenditure Select Committee on the Reserve Bank of New Zealand Bill**

## Background

1. The operation of New Zealand's central bank and its management of our financial system have implications for social equity. The policy and financial misadventures which were the South Canterbury Finance and AMI Insurance collapses may eventually cost taxpayers $2 billion. This is $2 billion which cannot be spent on building social housing or improving our schools. Such opportunity costs and the prospect that more may lay in the future with poorly regulated banking and insurance sectors are the motivation for Child Poverty Action Group's (CPAG) submission to the Reserve Bank of New Zealand Bill.

2. CPAG is a civil society organisation which has, since 1993, provided independent research on child wellbeing issues as well as advocacy for policies which may reduce the incidence and impacts of child poverty in New Zealand. To this end, CPAG takes an interest in macro-economic policy questions as we believe that much of the poverty we see in New Zealand is due both to poorly directed economic policies as well as poorly designed social policies. The failure to adequately tax wealth and in particular residential property wealth is an example, in our opinion, of such misalignment.

3. CPAG's submission on the Bill relate to its proposals to change the Bank's objectives and governance arrangements.

## Proposals to change the Bank's objectives

4. Clause 9 of the Bill reframes the Reserve Banks's objectives to be about *'achieving and maintaining stability in the general level of prices over the medium term'*, '*supporting maximum sustainable employment'* (the economic objectives) and '*protecting and promoting the stability of New Zealand's financial system'* (the financial stability objective). We note that the financial stability objective in the current Act requires the Bank to promote '*the maintenance of a sound and efficient financial system'.* CPAG has two problems with these proposed objectives.

5. The first objection we have is to the singular reference to the general level of prices and not also to asset prices. As we have seen recently, the Reserve Bank and its Governor have been blithely indifferent to the impact which its monetary policy settings have had on house prices.

6. It will take some time for higher house prices to filter through into higher living costs for most New Zealanders so there is no immediate threat to the general level of prices from rising house prices. This delay and the weak transmission of one sort of inflation to another sort of inflation, is partly because only a small proportion of houses are traded at these higher prices in any single year and because the cost to those who do borrow and buy houses at higher prices is offset by very low interest rates – for now at least. Low and falling interest rates of course reduce living costs for mortgaged home owners as well so the inflationary pressure is already being reduced by current monetary conditions.

7. Rising house prices will assist the Bank's monetary policy settings to have positive impacts in the real economy by stimulating demand. This then helps the Bank to fulfill its second economic objective of '*supporting maximum sustainable employment'*. This stimulation of demand will be through the wealth effect which most homeowners will feel as their biggest asset increases in value by 10% to 30% in one year. It is easy to feel optimistic when you are receiving such windfalls and this consumer optimism may be one reason why the anticipated COVID-19 recession has not been as deep as expected.

8. But rising house prices exacerbate the plans of aspiring first home buyers and most likely will eventually translate into higher rents. Rising house prices also widen what are, in our opinion, already unjustifiable wealth disparities although the wealth of averagely wealthy New Zealanders is buoyed by this inflation. In addition, rising house prices and the rising indebtedness which is associated with these, create both a risk to these borrowers in the event that interest rates rise soon and perhaps a moral hazard if their distress leads to taxpayer supported bail outs.

9. For these reasons CPAG asks the Committee to consider adding some reference to asset prices in the first part of the economic objective dealing with price stability. In making this suggestion we appreciate that the more objectives a policy mechanism is expected to serve the more its effectiveness may be undermined and perhaps its real impacts obscured. However, it is almost unconscionable that the impacts of any public policy on housing affordability are ignored as appears to be the case with the current set of objectives and the Reserve Bank's observance of these.

10. The second concern which CPAG has is around the deletion of efficiency from expectations around how the bank will undertake macroprudential regulation of the banking sector. In our view, if concern for the efficiency of the financial system to price risk and allocate capital is no longer important, we may end up creating a regulatory culture which is far more risk averse and in doing so perhaps allow the major banks to game this aversion.

11. CPAG believes that Parliament and the Reserve Bank are right to be concerned about the systemic risk within the banking system especially as we move into reliance on funding for lending programmes. However, an obsession with risk at the expense of efficiency may tilt commercial banks' lending preferences even more towards residential property and away from those parts of the economy which generate output and jobs.

12. We ask the Committee to consider the retention of an efficiency objective in the Bank's financial stability related objective.

**Governance arrangements**

13. CPAG is generally supportive of proposals within the Bill which will ensure that there is greater political influence over the governance and policy direction of the Reserve Bank. We encourage the Committee to support these provisions.

14. Our reason for this support is that we consider it important that all public agencies should be accountable politically and hopefully democratically for the policies and regulations they administer on the public's behalf. The independence of central banks has been something of a mantra within western political systems for more than 30 years and while this independence has served us well for much of the intervening time it has let us down sometimes. The GFC being an obvious example of the later although New Zealand was relatively unscathed by this failure. These extraordinary times of almost zero interest rates, extended quantitative easing, funding for lending programmes and the continuing growth in household debt point to the need for a more pragmatic and less doctrinaire approach to the operation of our central bank. With the additional Ministerial oversight proposed in the Bill, the New Zealand public, which ultimately bears the costs of failure, have slightly more influence over how risks and burdens are managed and shared.

15. Specifically, we ask the Committee to support the following clauses in the Bill.

- Cl.26 relating to the accountability of Board members to the Minister
- Cl.118 relating to Ministerial review of the MPC remit
- Cl.131 regarding Ministerial instructions around foreign exchange dealing
- Cl. 169 requiring the Bank to take a whole of government approach to its work when directed to do so
- Cl. 200 requiring the Minister to determine the Bank's financial policy remit.
- Cl. 219 regarding Ministerial involvement in the preparation of the Bank's statement of intent
- Cl. 230 regarding Ministerial involvement in the preparation of the statement of performance expectations

16. Finally, CPAG would like to thank the Committee for the opportunity to participate in this review. As a national community we take for granted the openness, transparency and probity of our public institutions which of course includes our central bank. This Bill, and its proposed changes, are in our view overdue and necessary. With the modest expansion of the Bank's overall objectives which we propose, the Bank's statutory and governance base will continue to offer these valuable institutional qualities and to serve New Zealand and New Zealanders well.