Graeme Wheeler: Decision making in the Reserve Bank of New Zealand

Speech by Mr Graeme Wheeler, Governor of the Reserve Bank of New Zealand, to the University of Auckland Business School, Auckland, 7 March 2013.

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I'm sure that central banking was the furthest thing from his mind when the British mountaineer, Eric Langmuir aptly said:

> "A decision without the pressure of consequence is hardly a decision at all".

Central bankers are often criticised for avoiding decisions, although leaving policy settings unchanged is often a major decision in itself. Sometimes they are accused of communicating in a secret code with the real meaning known only to other central bankers. So how do we undertake important policy decisions in the Reserve Bank and how do we endeavour to communicate?

i) Operational independence

In 1990, the Reserve Bank became the first modern central bank to have a legislated structure in which the government took the lead in setting the objective, while the central bank had operational independence in, and formal accountability for, the execution of monetary policy. New Zealand also led the way with flexible inflation targeting, a framework now widely adopted by central banks across the OECD region. The 1989 Reserve Bank of New Zealand Act states that "the primary function of the Reserve Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices".

The legislation created provision for a Policy Targets Agreement (PTA) between the Minister of Finance and the Governor of the Bank. In practice, the PTA defines the objectives of the Bank, specifies an inflation range representing price stability and outlines considerations that the Bank must give weight to in framing monetary policy decisions. The current PTA, signed on 20 September 2012, introduces the goal of keeping future average CPI inflation near the two percent target mid-point of the one percent to three percent range. Like its predecessor PTAs, it also requires the Bank to seek to avoid unnecessary instability in output, interest rates, and the exchange rate.

The Governor's responsibilities and obligations are conferred and imposed under the 1989 Reserve Bank of New Zealand Act, the 2009 AMLCFT Act, the 2010 Insurance (Prudential Supervision Act), to which is expected to be added the Non-Bank Deposit Takers legislation currently in the House. The Governor has the power to act for the Bank on all matters within the ambit of the Acts that are not required to be dealt with by the Board of the Reserve Bank (which relate to the appointment, remuneration and removal of the Deputy Governors). The Governor may delegate decision making authority to other officers of the Bank.

ii) The bank's span of responsibilities

The Reserve Bank is a full service central bank and its responsibilities are broader than most other central banks. Not all central banks are responsible for prudential and regulatory oversight of the banking and payment systems, or have the authority to undertake exchange rate intervention. In addition, the Bank has an extensive programme of financial stability-related initiatives underway that includes Open Bank Resolution, the introduction of macro-prudential instruments, a review of the payments system, and implementation of Basel III capital requirements. The Bank has also taken on responsibilities for anti-money laundering and regulation of insurance companies and non-bank deposit takers.

iii) Important checks and balances

The checks and balances and accountability mechanisms relating to the Bank are considerable and include:

- Publication of an annual report, at least two Monetary Policy Statements (we do four), and two semi-annual Financial Stability Reports. The Bank's reports are reviewed by Parliament's Finance and Expenditure Committee, the Board of Directors of the Reserve Bank, and the Bank provides press conferences around each Monetary Policy Statement and Financial Stability Report.
- External auditing of the Bank's financial reporting, oversight by the Audit Committee of the Reserve Bank Board, and a strong in-house internal auditing function that reports to the Governor and works closely with the Board's Audit Committee.
- Publication of regulatory impact assessments of any prudential policy that it adopts.
- Monitoring and oversight by the Board of Directors of the Reserve Bank, which acts as agent to the Minister of Finance in reviewing how well the Bank meets its legislative responsibilities. The Board reviews the Bank's performance under the PTA, and its efforts to promote the maintenance of a sound and efficient financial system. In considering the Bank's monetary policy decisions, the Directors receive all of the papers discussed by the Bank's Monetary Policy Committee, the written advice that the Governor receives from individual members of the Monetary Policy Committee, and webcasts of the Governor's press conferences.

  The Board meets nine times a year (four times a year outside of Wellington where receptions are held with the business community) and provides advice to the Governor on various management issues. The Board assesses the Bank's performance in meeting its obligations and responsibilities, discusses this with the Minister of Finance, and publishes its review in the Bank's Annual Report.
- The Minister of Finance's powers under the Reserve Bank of New Zealand Act to direct the Bank to formulate and implement monetary policy for different economic objectives to those specified in Section 8, and to determine the basis for foreign exchange intervention by the Bank. The most coercive powers exercisable against registered banks may only be exercised by the Minister, or with his consent. These powers must be exercised transparently, and have not to date been used.

iv) The policy decision making framework

In order to assist with major policy decisions, we recently introduced a Governing Committee, comprising the Governor, the two Deputy Governors and the Assistant Governor, under the chairmanship of the Governor. The Governing Committee will discuss all major monetary and financial policy decisions falling under the Bank's responsibilities, including decisions on monetary policy, foreign exchange intervention, liquidity management policy, prudential policy (both micro and macro) and other regulatory policies. To date, individual Governors have taken responsibility for particular areas of the Bank, such as operations, monetary policy and financial stability. Going forward Governors will have more individual and collective involvement in key decisions taken across all areas of the Bank. This is the same decision making framework adopted by the Bank of Canada, which also has a single decision maker model. As with the Bank of Canada, the Governor retains the right of veto on committee decisions. The Committee formalises and expands past practice.

Several other central banks, including the central banks of Brazil, Mexico, and Sweden, make monetary policy through a central committee comprising the Governors, although sometimes other internal members are included. These committees benefit decision making by pooling the knowledge, wisdom, and expertise of individual Governors. Such committees bring strength, especially where considerable uncertainty is involved, and can mitigate extreme preferences of an individual.

The Bank's Governors team has extensive experience inside and outside the Reserve Bank. While the change represents a management rather than governance initiative, the Governing Committee will maximise the knowledge and experience of the Governors individually and as a collective, rigorously test ideas and build consensus around major policy decisions.

Analytical and policy papers are discussed in several important committees including the Monetary Policy Committee, Macro-financial Committee, Financial System Oversight Committee, and the Assets and Liabilities Committee (which examines impacts of portfolio decisions and changing relative prices on the Bank's balance sheet). These committees have clear terms of reference, mainly meet fortnightly, and are chaired by a Governor. Usually decisions are taken at the committee meeting, but major and complex policy decisions will often be referred to the Governing Committee. Management decisions are taken at weekly meetings of the Bank's Senior Management Group and all communications issues and requests are discussed weekly at the Communications Committee.

v) Communicating policy decisions

We are expanding our on-the-record speaking by increasing the number of speeches, broadening the range of topics while remaining within the Reserve Bank's framework, and increasing the number of speakers. At the same time, the Bank will continue its extensive off-the-record briefings to groups ranging in size from 15 to 400 people, but we will become more selective in the 80–100 briefings we provide each year. We are also expanding our communications through social media, in-house videos, webcasts and other online channels.

We provide considerable background briefings to the media, but announce our policy decisions through our publications, speeches, and press conferences. We will also provide six-monthly briefings to the caucuses of the political parties, and are redesigning our website to expand its information content and increase its accessibility.

To be effective, monetary policy requires transparency in terms of policy goals and how these are to be achieved. The former is contained in the Policy Targets Agreement; the latter through our Monetary Policy Statements, OCR announcements, speeches and press conferences. In commenting on monetary policy decisions and especially those relating to the official cash rate, we are conscious that traders pre-position themselves prior to policy announcements and that the exchange rate and interest rate spreads can alter depending on the policy decision and the language that accompanies it. Above all, we want policy statements to accurately reflect the economic conjuncture and outlook as we see it, and the range of considerations we are weighing in fulfilling our responsibilities. In the case of monetary policy, these include implementing monetary policy in a sustainable, consistent, and transparent manner, having regard to the efficiency and soundness of the financial system, and seeking to avoid unnecessary instability in output, interest rates, and the exchange rate.

The 90-day interest rate projection contained in the Monetary Policy Statement is a form of forward guidance as to our expectations of movements in the Bank's Official Cash Rate. It is intended to help businesses and households plan with greater confidence in managing their consumption patterns and saving and investment decisions, and to help shape expectations about the future path of inflation and interest rates. This also helps market participants to anticipate the Reserve Bank's policy responses as new data becomes available. As with most conditional projections, the interest rate path is affected by the risks and uncertainties that usually increase with time. In practice, the balance of language around the projection is at least as important as the projection itself in shaping expectations of the outlook. When market expectations adjust smoothly and efficiently, it can diminish the need for larger policy adjustments by the central bank that could otherwise unsettle markets and have greater impacts on asset prices and spending decisions.

Concluding comments

Global financial markets are still dealing with the major regulatory changes and the massive adjustments taking place in government, corporate, financial sector and household balance sheets in economies that generate around two thirds of world output and over three quarters of cross border capital flows. The spill-overs from these adjustments and the fiscal and monetary responses to them can be especially challenging in small open economies with stronger growth prospects, and where there are high expectations of what central banks can achieve.

The Reserve Bank endeavours to provide an accurate assessment of the implications and challenges of these adjustments for the New Zealand economy. In doing so, we seek to be clear on what we can and cannot influence, and how government policy instruments and private sector responses can increase our effectiveness. At the same time we've been extending our regulatory oversight, building the protections available to taxpayers in the event of bank failure, and increasing the range and scope of instruments to help deliver price stability and increase the efficiency and soundness of the domestic financial system.

Within the Bank we are looking to the team of Governors to debate major policy matters leading to decisions, and increasing the frequency and scope of our on-the-record reporting.