Adrian Orr: Opening remarks to Finance and Expenditure Committee

Opening remarks by Mr Adrian Orr, Governor of the Reserve Bank of New Zealand, to the Finance and Expenditure Committee (FEC), Wellington, 14 December 2022.

* * *

Introduction

Tn koutou katoa

It is again a privilege to be here with you today – alongside other members of the Executive Leadership Team – to report on the Reserve Bank of New Zealand's activities for the 2021/2022 financial year.

With me at the table are Greg Smith and Juliet Tainui-Hernandez, Assistant Governors of Finance and People respectively. The remainder of the Executive Leadership Team are also with me in the room to assist on any questions you may have.

I do wish to pass on to the committee that our Board chair, Professor Neil Quigley, very much hoped to be here but the challenges in re-scheduling and a graduation ceremony which he attends as Vice-Chancellor have precluded it this time.

I know the committee has seen a lot of us recently. I have valued all of our meetings, and want to thank the committee for your ongoing interest in our work.

The 2021/22 Annual Report covers the last year under our old governance arrangements. The refreshed Reserve Bank of New Zealand Act 2021 was operationalised on 1 July 2022.

A lot of the year under review was thus spent building the foundational systems and processes we need to support our new Act. I will briefly outline this work and then respond to questions the Committee may have.

But, first, I will reflect on the economic environment we were operating in during 2021 /22 financial year.

Delivering our monetary policy mandate

During the 2021/22 financial year we operated in an environment of extreme uncertainty.

In most part the uncertainty was due to the global economy experiencing historically significant shocks – in particular to global supply capacity.

During the year, in the face of rising inflation pressures, our Monetary Policy Committee was one of the first in the world to start tightening monetary conditions.

In July 2021 we ended our Large Scale Asset Purchase programme, and in October 2021 we commenced raising the Official Cash Rate (OCR). The OCR move was delayed from August due to the imposition of Level 4 COVID-19 restrictions across the country.

As outlined in our recently released Review of monetary policy, in hindsight the Committee could have commenced its tightening cycle earlier in 2021 so as to better contain core inflation pressure. Nonetheless, the subsequent rise in international food and energy prices would still have led to headline Consumer Price Index inflation exceeding 6% now.

In an absolute sense, actual and expected inflation is too high and needs to be reduced.

Subsequent Monetary Policy Committee decisions have seen the OCR rise from 0.25% in August 2021 to the current rate of 4.25%.

Our actions display the Monetary Policy Committee's determination and confidence in returning annual inflation to within our 1% to 3% target range.

Our focus on low and stable inflation is the best contribution we can make to the overall wellbeing of New Zealanders.

In a relative sense, New Zealand is in a strong macroeconomic position relative to most OECD nations.

- We are around the lowest quartile for both inflation and unemployment relative to other OECD nations.
- We have a stable and well-functioning financial system that is resilient to a wide range of interest rate and employment shocks.
- And, as outlined in our most recent *Monetary Policy Statement*, we have resilient household, public, and business sector balance sheets in aggregate.

New Zealand has a near record low unemployment rate of 3.3% and exceptionally high labour force participation rates.

Households have accumulated financial savings, with average household incomes rising in line with inflation. Nominal wage rates have risen, with incomes further bolstered as people moved jobs to earn more, worked longer hours, or gained promotions.

Average hourly earnings growth for the private sector was 8.6%[1] in the year to September 2022, compared with Consumer Price Index inflation of 7.2% in the same period.

As interest rates rise, we expect spending to slow and unemployment levels to increase as more people join the workforce over the coming year. Even with the expected slowdown in the period ahead, it is anticipated that the level of employment will remain high.

Large Scale Asset Programme

I'd like to briefly comment on the Large Scale Asset Purchase and Funding for Lending programmes which featured during the 2021/22 financial year.

The Review and Assessment of Monetary Policy over the past five years showed that the Large Scale Asset programme was highly effective in response to the liquidity crisis that emerged in early 2020 and in lowering longer-term interest rates.

The Funding for Lending programme also gave banks confidence that a stable and secure funding source was available during a period of heightened financial market uncertainty. Banks were able to continue their business of financial intermediation, avoiding a credit squeeze or worse.

This lending programme needed a period of commitment from the Reserve Bank in order to provide banks the confidence to include the use of the facility in their forward plans. In hindsight, it could have been designed with more flexibility. The additional allocation drawdown window for the programme ended on 6 December this year.

The interest rate charged for accessing funding under this programme rose in line with the OCR, and the volume accessed accounted for only about 2 percent of bank funding.

Our experience with both these tools has built our capability to respond to unexpected events in future.

Delivering financial stability

As highlighted in the recent *Financial Stability Report,* while our financial system as a whole is resilient, some households and businesses will be challenged by the rising interest rate environment needed to curb inflation.

Financial institutions must take a long-term view when supporting customers and allocating credit to the wider economy.

The New Zealand banking system is well positioned to do this, with higher capital buffers and low non-performing loan rates. Banks also have strong profitability and funding profiles, and liquidity is strong.

Our recent stress tests have demonstrated banks' resilience to severe but plausible economic scenarios.

That said, financial institutions will need to continue investing in their systems, governance, and risk management to build their long-term resilience.

In coordination with our regulatory partners – the Council of Financial Regulators- we are committed to continuing to work with the industry to support financial stability, and ensure our priorities are risk-based, evidence-led and outcome-focused.

Developing our 'regulator-regulated' relationships

We are responsible for the prudential supervision of 27 banks, 17 Non-Bank Deposit Takers, and 90 insurers.

We also supervise 5 designated Financial Market Infrastructures, as well as 79 institutions under the Anti-Money Laundering and Countering the Financing of Terrorism Act 2009.

In response to the most recent IMF Financial Sector Assessment Program review, we are building a more intensive approach to prudential supervision, while also building strong and productive relationships with stakeholders.

Our current priorities are monitoring and responding to risk, strengthening the regulatory framework, and building our policy, supervision, and enforcement capabilities.

We have focused our resource in Auckland, where many financial institutions are headquartered.

Relationship with the sector

In 2018 we introduced a Relationship Charter with our regulated institutions to ensure we build on our supervision performance. We have surveyed these institutions annually to ensure we are meeting the Charter commitments.

As at the end of the 2021/22 financial year, regulated banks rated our relationship highly.

- 93% of bank participants gave a rating of 4 or 5 out of 5, compared to 91% in 2021 and 68% in 2020.
- No bank participants gave a low rating.

In this the second year the insurance sector has been surveyed, 72% of insurer participants rated their relationship with us highly (4 or 5 out of 5), which was an increase from 67% last year.

Overall, banks and insurers' responses to the 2022 survey indicate that we have continued to build on the gains made on our key performance measures.

Our people and capability

We have also been in a period of deliberate growth in people to build the capacity and capability where we need it.

And at the same time we've been working to ensure our people are well supported, appropriately paid, and feel valued and included.

I want to take this opportunity to acknowledge my colleagues for their many, significant, contributions during this period.

Growth and transformation

Our transformation strategy has been well planned so as to keep pace in a changing operating environment.

Our *Funding Proposal 2020-25* identified the need for significant investment in people, technology, and systems, and has detailed information on what it means for each area of our work.

The formal questions included in your pack also contain a wealth of facts, figures, and five-year history.

I will summarise by saying we are implementing the new *Reserve Bank of New Zealand Act* that maintains our mandates while modernising the way we operate. The Act has significant implications for our broader legislation (the Deposit Takers Act currently in consideration in Parliament), as well as governance, digital capability, business services, and capacity and capability development.

During the year we completed a bank-wide function and leadership review, and resulting reorganisation. This included the creation of reshaped business units, an expanded Executive Leadership Team, and a supporting tier of operational leaders undertaking 28 functions in total.

The roles are designed to have balanced portfolios and an appropriate span of control to improve efficiency and depth of knowledge. We are pleased that many of our existing senior leaders filled these new or reshaped positions.

Overall, the turnover rate for Te Ptea Matua as at 30 June 2022 was 21.7%. This aligns with the overall public sector rate of 21.7% for the same period, but includes the necessary bank-wide re-organisation.

Similar to other organisations we are experiencing higher than normal levels of staff turnover, in part promoted by the ongoing impact of COVID-19. We are however seeing strong demand in the marketplace for our roles and a high calibre of candidates coming on board.

Wellbeing

The lingering COVID-19 health challenge created a difficult work environment for many over recent years.

We run a number of initiatives and training to support staff wellbeing.

We have operated and modernised our corporate policies to best support our people – with policy topics including, for example: Wellbeing; Support for Flexible Working; Prevention and Management of Harassment and Bullying; Whistleblowing; and an Employee Assistance Programme available to all staff at any time.

In August 2022 we ran an employee engagement survey to check in on all aspects of work life at Te Ptea Matua.

79% of our people completed the survey and the aggregate Health & Wellbeing score was 7.7/10 consistent with our benchmark.

Overall, there were many positives around health and wellbeing, but more support was requested in managing workloads.

Diversity and inclusion

We are committed to a goal of the representation of ethnic groups: our workforce should reflect modern Aotearoa, and we are focused on ensuring it does while building our capabilities. In order to achieve our goal we have:

- Refreshed our Diversity, Equity and Inclusion strategy;
- Commenced measuring critical areas of activity for gender and ethnic pay gaps;
- Commenced a Women Leaders programme; and
- Piloted a number of programmes in unconscious bias and cultural intelligence.

Te Ao Mori

We have also continued to build out our Te Ao Mori strategy.

We recognise Mori as tangata whenua, and commit to working in a manner that gives effect to Te Tiriti o Waitangi. As a kaitiaki of the financial system, we want to both enable a thriving Mori economy and support economic wellbeing for all New Zealanders.

Our activities included:

- Our Te Moni Anamata work programme included partnering with Mori to explore how access – or lack thereof - to physical currency impacts financial inclusion;
- We completed our collaborative work identifying barriers to Mori accessing capital, and are now partnering with Mori, financial institutions, and government agencies to reduce these barriers; and
- We are an active member of the Central Bank Network for Indigenous Inclusion, which shares knowledge and practices aimed at better financial engagement with Indigenous Peoples.

Cyber security

I also just wanted to touch on the progress we made this year in cyber security.

We have made significant progress in uplifting all elements of our protective security controls, monitoring systems, and associated governance frameworks to ensure we provide our functions with stability and continuity.

Our work includes building capabilities to improve cyber resilience, data management, and security awareness and event monitoring. The work has included undertaking priority investments in critical infrastructure.

Climate Change

To turn then to another topic that has received considerable interest, and that is climate change. Climate change brings significant physical risks and transition challenges to a low-carbon economy.

We are now reporting on our own carbon footprint, and we will be sharing our emissions targets and planning early in 2023.

In collaboration with the Financial Markets Authority, we are including climate change in our scheduled supervisory engagements with our regulated institution's management and boards.

We are also including regular climate change risk elements into our banks stress test, and we are finalising formal guidance on climate change risk management for our regulated entities.

Conclusion

We have made continued good progress on our transformation as set out in the five-year funding agreement. However, there is much more to be done especially as we build for the new Deposit Takers Act.

I am very proud of, and thankful for, our new governance arrangements and Board, the Monetary Policy Committee, our Leadership team, and all of our people. It has been a year of considerable commitment, effort, and determination in supporting all New Zealanders during a very challenging year.

Thank-you once again to this Committee, for your attention and support, and for holding us to account to the public of New Zealand.

Meitaki ma'ata

Tn koutou, tn koutou, tn koutou katoa

---

[1] Quarterly Employment Survey, September 2022