

# Changing of the watch

## Thoughts on the new era for the RBNZ

- **Reserve Bank Governor Bollard will step down when his term ends on 25 September.**
- **The changeover period is less likely to involve changes in the OCR, so we have pushed out our call for the first hike to December.**
- **Broader changes to how the RBNZ operates have been discussed in the media. These are only options, and there is unlikely to be any significant change by September.**

This week Dr Alan Bollard confirmed that he won't be seeking a third term as Reserve Bank Governor. His current term ends on 25 September, shortly after the September *Monetary Policy Statement*. During his tenure we've seen the Official Cash Rate (OCR) reach record highs and record lows, through a housing boom and a global financial crisis. Dr Bollard also led a major expansion of the RBNZ's roles in financial sector regulation and supervision, compared to the relatively light-touch approach that he inherited ten years ago.

Our initial thoughts are that the change of Governor will have only modest implications for monetary policy over the medium term. However, the timing of the changeover complicates our previous forecast of a September OCR hike, and is one of the reasons why we have now shifted our call to December.

There was some speculation that the change of Governor could be used as an opportunity to make broader changes to the RBNZ's duties and/or structure, although this has been largely dismissed by the Prime Minister and Finance Minister. Even a cursory read suggests that it would be prohibitively difficult to push through any such changes as early as September, and there's no obvious reason why they would need to coincide with a change of leadership anyway. That's not to rule out changes altogether, but anything that does happen is more likely to be in the first few years of the next Governor's tenure.

### Change of Governor

The most immediate implications of Dr Bollard stepping down are around the monetary policy decisions in late 2012. It's well recognised that the next move in the OCR will be up, once reconstruction in Canterbury is underway and some of the risks

around Europe's debt problems have been resolved. In the last week, the RBNZ has indicated that rate hikes are likely to resume later than the June start date that was implied in the December *Monetary Policy Statement*. Our previous pick was for a September hike; other analysts have been pushing out to December or beyond, and market pricing implies no hikes for over a year.

The change of governor complicates the matter at the margin, and is one reason why we've pushed our call out to December. It's not impossible that Dr Bollard could end his term by kicking off a tightening cycle, but it's not ideal either. Similarly, using the September review to signal hikes could be seen as committing his successor to an action. And the new Governor may look to bed themselves down at first, so an October hike seems unlikely as well. As a result, December looks like the earliest practical date for starting a tightening cycle. That said, we do expect some catching-up in the early stages of the cycle; we still see an OCR of 3.25% by March next year.

Beyond the issue of the starting date, the impact on monetary policy is likely to be modest. It's fair to say that Dr Bollard has taken a consistently dovish stance as governor (i.e. favouring easier policy settings), which led to some issues during his first five-year term but generally served him well during the second term. The odds are that any new appointee would be less dovish, given the same policy targets. This wouldn't necessarily mean higher interest rates over the longer term – ultimately, even a dovish governor has to do what's needed to meet the inflation target – but it could mean, for example, that rate hikes are signalled and delivered earlier in the cycle than otherwise, while rate cuts may tend to be more delayed.

### Changes to the RBNZ

The speculation about changes to how the RBNZ operates stems from recently disclosed advice from the Treasury to the Finance Minister. The Minister and the new Governor will need to negotiate a new Policy Targets Agreement (PTA), and the Treasury normally conducts a review of the monetary policy framework in preparation for the negotiations. The Treasury advice noted that it planned to look at broader issues such as

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the type of price target, the use of macro-prudential tools, and shifting from a single decision-maker to a committee.

First, it's important to note that these are merely issues that Treasury has raised for discussion; there's no indication that the government favours any of these options – in fact, the Finance Minister has since dismissed any major changes to monetary policy. Second, our assessment is that these changes would require more than a new PTA, and it's very unlikely that they could be pushed through as early as September.

That's not to rule out these options altogether. But if there were an appetite for change, it's far more likely that the Board would appoint a new Governor who was amenable to the changes, and could shepherd them through in the first few years of their term. For the record, we review the options in order of least to most likely:

*Change in the RBNZ's targets:* The current government does not favour directing the RBNZ to target other economic measures such as employment or growth. We note that doing so would require more than a change to the PTA. The Reserve Bank of New Zealand Act is quite clear about what the PTA involves: it sets out how the RBNZ should achieve its "primary function", which in turn is defined as maintaining price stability. The PTA can direct the Governor to set policy with regard to wider economic issues (the list already includes output, interest rates, the exchange rate, commodity price spikes, government policies and natural disasters), but that would fall well short of a change of target.

*Monetary policy committee:* The RBNZ is in the minority of central banks in having a single decision maker for monetary policy, and is perhaps unique in its mechanisms for accountability: the Board can recommend to the Minister of Finance that the Governor be removed if he breaches the PTA. Given how much the inflation target has been watered down over the years, it's questionable whether this clause has any teeth these days. Nevertheless, switching to a committee with joint responsibility for monetary policy would involve rewriting a substantial chunk of the Act relating to governance and management issues. Past changes to the Act have taken years to complete.

*Macro-prudential tools/goals:* In recent years the RBNZ has sharpened its focus on macro-prudential issues such as asset prices and credit growth – where individuals may appear to be acting rationally, but could collectively endanger the stability of the financial system. This role is largely justified under section 68 of the Act, which refers to "promoting the maintenance of a sound and efficient financial system".

It's worth noting that this portion of the Act confers powers on "the Bank" rather than the Governor, so new policies need not coincide with the appointment of the Governor. For that matter, the RBNZ doesn't need to be 'given' new policy tools: the legislation sets out the RBNZ's goals and leaves it largely independent as to the means used to achieve them. (A notable exception is the tight conditions on foreign exchange

intervention, probably due to its potential to generate billions of dollars of losses on behalf of the taxpayer.)

The RBNZ has been investigating macro-prudential tools for several years, and at this stage it seems inevitable that they will be adopted in some form in coming years. The most likely candidates involve adjusting banks' minimum capital and funding requirements in a counter-cyclical manner (they are currently set at fixed levels throughout the cycle).

Even so, the November 2011 *Financial Stability Report* noted that there is still a substantial amount of work to be done, such as determining the criteria for intervention and the choice of policy tool. With the RBNZ driving this research agenda, there is no obvious reason for the government to rush something through in time for the change of Governor.

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