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Westpac Institutional Bank

New man at the helm

Graeme Wheeler appointed Governor of RBNZ

- **Mr Wheeler has previously served as Treasurer and Managing Director at the World Bank.**
- **Appointing an outsider opens up the possibility of change in the way the RBNZ operates.**
- **But for the transition period, we consider the Reserve Bank firmly "on hold". We continue to forecast the first OCR hike in March 2013.**

This morning the Minister of Finance Bill English announced that he has appointed Graeme Wheeler as the next Governor of the Reserve Bank, for a five-year term to begin when Dr Alan Bollard steps down on 25 September.

Mr Wheeler has worked at the NZ Treasury as Deputy Secretary and Treasurer of the Debt Management Office. From there he worked at the World Bank as director of its financial services department (1997-2001), vice-president and treasurer (2001-2006), and managing director (2006-2010), that organisation's most senior staff role. Mr Wheeler is the author of *Sound Practice in Government Debt Management*, published in 2004. Mr Wheeler is reputed to have a superb understanding of the global economy and financial markets, and was noted as a manager of people at the World Bank. He gained particular prominence for his role when World Bank President Paul Wolfowitz resigned amid revelations of serious conflicts of interest.

The appointment of a new Governor who has never previously worked for the Reserve Bank of New Zealand could be a harbinger of change for the nation's central bank. Both the previous two Governors (Dr Brash and Dr Bollard) came from outside of the RBNZ, and both implemented sweeping changes in their first few years in office. Dr Brash introduced inflation targeting (a world first). Dr Bollard beefed up the Reserve Bank's banking supervision capabilities while taking a softer approach on inflation.

As the next tightening cycle gets under way, the new Governor will have the opportunity to use a range of 'macro-prudential' tools in addition to the RBNZ's traditional interest rate levers. The RBNZ has spent the last few years investigating these tools, and is developing four of them: adjusting trading banks' minimum core funding ratio over the cycle; adjusting bank capital requirements over the cycle; increasing capital requirements for specific loan types; and restricting loan-to-value ratios. The next five years are likely to be an exercise in operationalising these tools, educating the market and the public in how they work, and studying their effects.

Other possibilities for change are the Bank's newly-acquired responsibilities for regulating the insurance industry, or shifting to a committee structure for monetary policy decisions (which would require legislative change).

It is too soon to tell how Mr Wheeler's approach to monetary policy might differ from Dr Bollard's, but we may get a clue when the new Policy Targets Agreement (PTA) that the Governor negotiates and signs with the Minister of Finance is announced. New Zealand law simply states that price stability is the primary objective of monetary policy. The Policy Targets Agreement provides the definition of price stability for the purpose of holding the Governor to account. The Minister of Finance has said that he doesn't envision any major changes to the current PTA; however, he added that "the global financial crisis has focused some attention on monetary policy frameworks, and I want to ensure that the PTA continues to reflect best international practice."

The historical tendency within New Zealand's monetary policy framework has been "PTA-creep." Successive PTAs have introduced progressively more lenient definitions of price stability, and have been progressively laxer on inflation. This might reflect the evolution of economic thought since inflation targeting was first introduced. Or it might reflect the innate preference for lower interest rates possessed by elected governments within a highly-indebted electorate. Either way, if there is any change to the PTA it is likely to be in a direction that is ultimately softer on inflation.

As far as the immediate outlook for interest rates goes, we have not altered our view. We consider the RBNZ firmly "on hold" during this transition period. The new Governor may be reluctant to change the OCR early in his term, particularly in an upward direction. Consequently, even if New Zealand GDP growth continues to accelerate and house prices keep rising, we would not expect an OCR hike before March 2013. Of course, there remains the risk of a full-blown banking crisis in Europe, in which case the Reserve Bank would reduce the OCR no matter which Governor is at the helm.

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