SALT INSIGHT

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Restoring the RBNZ's focus to solely price stability is a welcome development

As part of the new coalition Government's 100-day plan, the Reserve Bank of New Zealand (RBNZ) is to return to a sole focus of maintaining price stability.

This is a welcome development.

As the new Policy Targets Agreement (PTA) was agreed in 2018 between the then Minister of Finance, Grant Robertson, and the incoming Reserve Bank Governor, Adrian Orr, two changes were implemented. Full employment (or to be more precise "maximum sustainable employment") was included alongside price stability. Secondly, the RBNZ was also required to move to a committee structure when making policy decisions rather than interest rate decisions being made by the Governor alone.

The move to a committee structure was, in our view, a sensible decision. The inclusion of an employment mandate, not so much. Just because the United States and Australia does it doesn't necessarily make it a good idea for us (or them, for that matter).

That's for two reasons. Firstly, in extreme cases, there are potential conflicts between the dual objectives. Pursuit of full employment could result in expansionary monetary policy, including lower interest rates and even quantitative easing, to stimulate economic activity.

While these measures may boost employment in the short term, they could also contribute to inflationary pressures and financial imbalances over the long term.

The second and more important reason is that central banks lack the tools and direct influence needed to affect employment outcomes. Employment is influenced by a complex interplay of factors, including fiscal policies, labour market dynamics, and broader structural issues.

That's not to say labour market outcomes aren't important for the RBNZ – they are. Wage inflation accounts for the lion's share of domestic inflationary pressures. They just shouldn't be charged with achieving specific labour market outcomes.

Central banks primarily control interest rates and money supply which have limited impact on employment in the absence of comprehensive structural reforms. Higher labour productivity would make the RBNZ's job easier – they simply lack the tools to influence it.

A singular focus on price stability provides clarity and a straightforward mandate for central banks. By concentrating on controlling inflation, central banks can contribute to a stable economic environment, which is essential for sustainable long-term growth.

The reality is there are a multitude of other government agencies that should be taking responsibility for labour market outcomes. Removing this deliverable from the Reserve Bank's objective set may also have a beneficial longer-term transparency impact by forcing governments to openly address micro-economic distortions and problems with the agencies best able to fix them.