RESEARCH NOTE

MADE BY GOVERNMENT: NEW ZEALAND'S MONETARY POLICY MESS

MARCH 2023

BRYCE WILKINSON

FOREWORD BY DENNIS WESSELBAUM

THE NEW ZEALAND INITIATIVE

www.nzinitiative.org.nz

About the Author

Dr Bryce Wilkinson

Dr Bryce Wilkinson is Senior Research Fellow with the New Zealand initiative and Director of Capital Economics limited, a Wellington-based economic consultancy. He worked in the New Zealand Treasury until 1985 when he joined a share broking firm to undertake capital market research. He set up Capital Economics Limited in 1996. His publications on New Zealand's economic reforms during 1984-1995 include a co-authored review in the Journal of Economic Literature (1995). He has since proposed both a Taxpayer Bill of Rights and a Regulatory Responsibility Act for New Zealand to strengthen fiscal and regulatory disciplines.

Acknowledgements

The author is grateful to many colleagues and former RBNZ and Treasury employees, particularly Michael Reddell, for helpful comments and criticisms of earlier drafts. The author alone is responsible for any remaining errors and for all opinions expressed.

About the New Zealand Initiative

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

Contents

Foreword iii
Introduction – Central Banks globally put price stability at risk, New Zealand included 1
The central concern – inflation unwittingly unleashed at great cost 2
Is the employment story a redeeming factor? 9
Erratic signals concerning prudential regulation 10
RBNZ distractions 11
Astonishing disregard for core expertise 13
The culpability of the Board and the Minister of Finance 14
The extent of the disquiet and concern 17
Conclusions 19
Bibliography 20

Foreword

New Zealand experienced high inflation rates since mid-2021 peaking at 7.3 percent in the June 2022 quarter. To put this number in perspective, we must recall that the target for the Reserve Bank (RBNZ) is to keep inflation within the 1 to 3 percent range. New Zealand has not experienced such high inflation rates since the 1980s and early 1990s, when inflation approached 20 percent. Since the introduction of the inflation targeting regime, we have not seen such high inflation rates.

The sources of this high-inflation period have been discussed controversially. The RBNZ and the Government blame primarily external factors, while many economists argue that it has predominantly domestic causes. Whatever the relative importance of external and domestic factors is, an important question is: could these high inflation rates have been prevented?

Any answer to this question suffers from “hindsight bias”: past events appear to be more predictable than they really were. Bryce’s report goes a long way in addressing the mistakes made by the RBNZ by comparing what the RBNZ said, what was known at the time, and the discrepancy between the two.

In my opinion, the key reason why we have high inflation rates is fiscal policy and not monetary policy. Monetary and fiscal policies are bound together by a common budget constraint and, therefore, coordination is needed. Any difference between the real value of government debt and the present value of surpluses generates changes in the price level (i.e. inflation) that leads the economy back to equilibrium. The key mistake was to ignore the importance of this mechanism. Monetary policy was too accommodative for too long, given the large debt-financed (LSAP, that is) fiscal spending programmes (incl. the cost-of-living payment in 2022) that were issued without a strategy on how this debt will be repaid in the future.

However, the RBNZ did make mistakes, makes new mistakes, and has not learned its lessons. Bryce’s report is the best account of these mistakes to date. In my opinion, which seem to align with Bryce’s, there are two types of mistakes that interact with each other: structural mistakes since Governor Orr took office and preventable policy mistakes since the end of 2020.

Structural mistakes include the demise of the research team which led to an inexcusable brain-drain and loss of human capital, and a culture in which research is not appreciated by senior leadership. Appointments of some individuals to senior leadership positions, the Board, and the Monetary Policy Committee have been made without these individuals having any credible history of research, expertise, or practice in monetary policy (often even macroeconomics or finance) contrary to international standards.

These monetary policy makers should, at least by early 2021, have realized the danger of high inflation rates combined with more insights into how COVID-19 and public health measures affects the economy and increased the OCR at that time.

Governor Orr gave a speech in March 2021 about “Some policy lessons from a year of COVID-19”. One of the sections of his speech is titled “Being prepared beats guessing”.

Exactly the opposite happened: The RBNZ was ill-prepared to deal with the looming crisis, despite clear warning signs.

For example, I warned about high inflation in an op-ed in May 2021 concluding that "*we are likely heading to a low growth-high inflation environment, so-called "stagflation", over the near future.*" or take the comment from Arthur Grimes in the 2021 April NZIER Monetary Policy Shadow Board report: "*interest rates need to rise to […] head off incipient goods market inflation pressures*".

Compare this to the May 2021 Monetary Policy Statement: "*A range of domestic and international factors are expected to lift headline inflation above 2 percent for a period. Members noted these factors are expected to be temporary […]*". It gets better: "*The Committee discussed the risk that these one-off upward price pressures may promote a rise in more general inflation and inflation expectations. However, the Committee agreed that these risks to medium-term inflation were mitigated by ongoing global spare capacity and well-anchored inflation expectations.*"

In the May statement you can see a graph (Fig. 2.16) which forecasts inflation. Guess what the maximum inflation rate was they predicted. It was well below three percent and, by mid-2022 it predicted it to be close to 1.5 percent (actually, it was and is 7.2 percent).

The RBNZ under Governor Orr also focused on non-standard monetary policy issues (e.g. climate change, inequality,…). While we can argue about the usefulness of these adventures, the problem is that these appeared to have become more important than ensuring price stability.

Furthermore, what exactly did the RBNZ do with respect to, for example, climate change? Did it set the interest rate differently? Did it say it will only buy "green" bonds? Did it introduce climate-adjusted risk regulation or stress testing? I am not aware of anything the RBNZ *did* about climate change.

Overall, in my opinion, even if the RBNZ had not made mistakes, I doubt that it could have avoided high inflation. However, it could have limited the increase and the duration of inflation. As the saying goes "*Hindsight explains the injury which foresight would have prevented*".

Dr. Dennis Wesselbaum
Associate Professor of Economics at the University of Otago

Dennis is a Senior Lecturer in Economics at the University of Otago, the Vice President of the New Zealand Association of Economists, Editor-in-Chief of New Zealand Economic Papers and Associate Director of the University of Otago's Economics PhD Programme.

Dennis is a macroeconomist with both theoretical and empirical interests. His research activity is split between macroeconomic topics and the impacts of climate change. His research interests are Macroeconomics (esp. Monetary and Fiscal Policy), Quantitative Economics, Economic Growth, Migration, and, more generally, the interaction between climate, environment, and society.

Introduction – Central Banks globally put price stability at risk, New Zealand included

Central banks, above all, are responsible for overseeing systemic financial stability and for using monetary policy instruments to limit inflation.[1] This article is about the latter.

In the medium term, controlling money supply growth controls inflation–defined as an ongoing increase in consumer prices. The medium term might be 2-5 years.

Central banks are responsible for controlling inflation because no one else can. They control base money as a government monopoly. Wage and price controls merely suppress inflation–until wages and prices can be suppressed no longer.

Many central banks, including the Reserve Bank of New Zealand (RBNZ), inadvertently fueled excessive inflation through their responses to Covid-19. Many have thereby imposed massive losses on taxpayers for little if any demonstrable public benefit.[2]

Last year, the New Zealand Initiative published a report, *How central banks mistakes after 2019 led to inflation*. Graeme Wheeler, a former Governor of the Reserve Bank of New Zealand, and I wrote it. A former Deputy Governor of the Bank of Canada wrote the foreword.

That report attributed the outbreak of inflation to six errors or weaknesses:

1. Central banks were too confident about their credibility for preserving low inflation.
2. They put too much faith in models that built in this over-confidence.
3. They were too confident that output and employment would respond in a predictable way to cheap money. But how people respond depends on the broader context.
4. Central banks got distracted by non-core issues such as climate change, economic inequality, sustainability and in at least one case, indigenous issues.
5. Dual inflation and employment mandates for monetary policy weakened the anti-inflation focus.
6. Central bankers are responsible to politicians and are to a degree, susceptible to political pressures to fund fiscal deficits cheaply.

The report focused on the US Federal Reserve banking system, the Bank of England and the European Central Bank, but the scope was broader, encompassing "advanced economies" generally.

---

[1] The lender of last resort role is an aspect of the financial stability responsibility.

[2] Mercatus Centre researchers Andy Levin and Bill Nelson assessed the costs and benefits of the US Federal Reserve's quantitative easing measures from mid-March 2020 to March 2022. Their estimated cost to taxpayers was around US$1 trillion. On the benefit side, they credit the programme with helping prevent a global financial collapse in March 2020. However, they could not find any significant evidence of subsequent benefits in the form of either reduced borrowing costs or a stronger economy. Instead, the programme likely "exacerbated the US housing boom during late 2020 and 2021". See Andy Levin and Bill Nelson. "The Federal Reserve's Balance Sheet: Costs to Taxpayers of Quantitative Easing", Policy Briefs (Mercatus Center, 10 January 2023).

On the OECD's November 2022 forecasts, consumer prices in 2024 will be higher than in 2019 by at least 15 percent for Korea, Australia, Canada, Finland, Norway, Denmark, Sweden, the US, the Euro area, New Zealand (23%), the United Kingdom and Iceland (29%). The forecasts for the best performers, Japan and Switzerland, are for rises of 6% and 7%, respectively.

Critically, central banks failed to forecast the rise in inflation. When it became apparent, they doubled up on this mistake by declaring that the rise was temporary.

The fourth aspect listed above–central bank distraction with issues peripheral to keeping inflation low–was a prominent theme in a special feature article in April 2022 in the UK magazine *The Economist*.[3]

Central banks have ventured into broad policy issues such as inequality and climate change. Monetary policy can control neither. Neither issue needs expertise in monetary policy to assess. Both are inherently political. Yet the credibility of monetary policy depends on convincing bond buyers and wage and price-setters that a central bank's monetary policy decisions are apolitical.

The sixth aspect above concerns the potential conflict between the tasks of inflation control and funding government deficits. The latter subverts control of inflation. Central banks play with fire when they fuel monetary growth to fund government deficit spending, thinking they can stop in time to prevent inflation.[4]

The big expansion in central banks' balance sheets increases political risks. They will experience pressure to use their vastly expanded balance sheets to channel investments into politically 'worthy' directions, such as so-called 'green' bonds or 'sustainable' energy. Lobbyists and vested interests have swarmed like bees to the honey pot. Political decisions about sustainable energy, for example, can easily be a fiasco, even if not fueled by central banking funding biases.[5]

The central concern – inflation unwittingly unleashed at great cost

All these concerns, and more, resonate in the case of the RBNZ.

New Zealand's recent monetary policy outcomes are worse than unsatisfactory. They include whiplashing house price volatility, consumer price inflation far above the RBNZ's 1-3% target range, and a $9 billion loss on the Reserve Bank's large-scale asset purchase programme (LSAP). That loss represents over $4,500 per household.

---

[3] *The Economist*, "The danger of excessive distraction", 20 April 2022.

[4] Figure 23 in RBNZ, *In Retrospect: Monetary Policy in New Zealand 2017-2022* (Reserve Bank of New Zealand, November 2022), shows that the RBNZ's purchases of government bonds between March 2020 and September 2021 broadly matched government debt sales. Figure 33 shows LSAP purchases as a proportion of government bonds on issue. The Bank did not think at the time that this was at the expense of inflation.

[5] Germany's energy policy is a notable example. See for example, Matt Burgess, "Switched on! Achieving a green, affordable and reliable energy future" (New Zealand Initiative, 2019) and Oliver Hartwich, "Germany faces a new kind of cold war this winter" (New Zealand Initiative, 6 September 2022).

The Bank's monetary policy stance was aggressively expansionary before 2020 even though inflation was benignly within the 1-3% pa target range. Its concern was to lift consumer price inflation to around 2% pa. The Governor was anticipating publicly the possibility of future negative official cash rates in the event of a future downturn.[6]

An expansionary stance in conjunction with the Government's March 2020 Covid lockdown was reasonable. The deep concern is with how extreme and prolonged it became.[7] This is illustrated by the unprecedented expansion in the Bank's balance sheet, the 64% rise in transaction deposits with the banks between December 2019 and December 2022, the near-zero levels for the Bank's official cash rate (OCR) and the record low yields at which the Bank was purchasing government bonds.

During the Covid pandemic, the Governor virtually invited the Minister of Finance to instruct him to fund the Government's pandemic-swollen fiscal deficit.[8] That call potentially undermined perceptions of the Bank's commitment to the inflation objective. Fortunately, the Minister of Finance did not respond.

To its credit, in November 2022, the Bank released a useful, albeit somewhat self-serving, review of its recent monetary policy management, along with independent assessments by two international experts.[9] In this review, the Bank conceded that, with the wisdom of hindsight, it maintained for too long into 2021 an expansionary monetary policy response to Covid19.[10]

Its review also acknowledged, with the wisdom of hindsight, that its Funding for Lending Programme was expansionary for too long.[11] (It preannounced that the facility would be available for a two-year period ending in December 2022. Inflation became a problem much sooner.)

Only conceding these things with the wisdom of hindsight is not good enough. The need is to learn how to do better next time. Figure 46 of the review, replicated below, illustrates the forecasting errors. Quarter after quarter after 2020, the RBNZ failed to forecast the extent of the rise in the Consumer Price Index (CPI), and its persistence. That forecasting failure is a central concern.

---

[6] Bernard Hickey, "Why Orr prefers negative interest rates to QE", *Newsroom*, 13 August 2019.

[7] Figure 35 and Table 6 in the Bank's *In Retrospect* op. cit., show the increases in the RBNZ's target for buying government bonds from $30 billion on 23 March 2020 to $60 billion on 13 May 2020 and to $100 billion on 12 August 2020. Yet Figure 34 shows that the motivating spike in government bond yield bid-ask spreads in late March 2020 was largely over by May 2020.

[8] Bryce Wilkinson, "Doing whatever it takes with someone else's money", Research Note (The New Zealand Initiative, 12 June 2020).

[9] RBNZ, *In Retrospect* op. cit.

[10] Ibid., 12, 61 and 69.

[11] RBNZ Funding for Lending Programme, website. This programme allowed banks to borrow from the Bank at the Bank's overnight cash rate during a two-year period. The term was for 3 years. A bank could not borrow more than 4% of its eligible loans. But it could borrow in addition fifty cents of each dollar of net growth of eligible loans from 1 November 2020 up to a maximum of 2 percent of eligible loans. The programme started on 7 December 2020 and ran to 6 June 2022 for the initial allocations and to 6 December 2022 for the additional allocations. The Bank reported that eligible banks had taken up around two thirds of the initial allocation by the time it closed this window in June 2022. By July 2022, eligible banks had borrowed $12.66 billion of three-year money under these terms.

Nor did its forecasting accuracy improve over time. From 2021, the Bank's forecasts always expected its policy actions to quickly reduce CPI inflation to around 2% pa. They still do. Its November 2022 MPS expects annual headline inflation to fall below 3% during 2024.

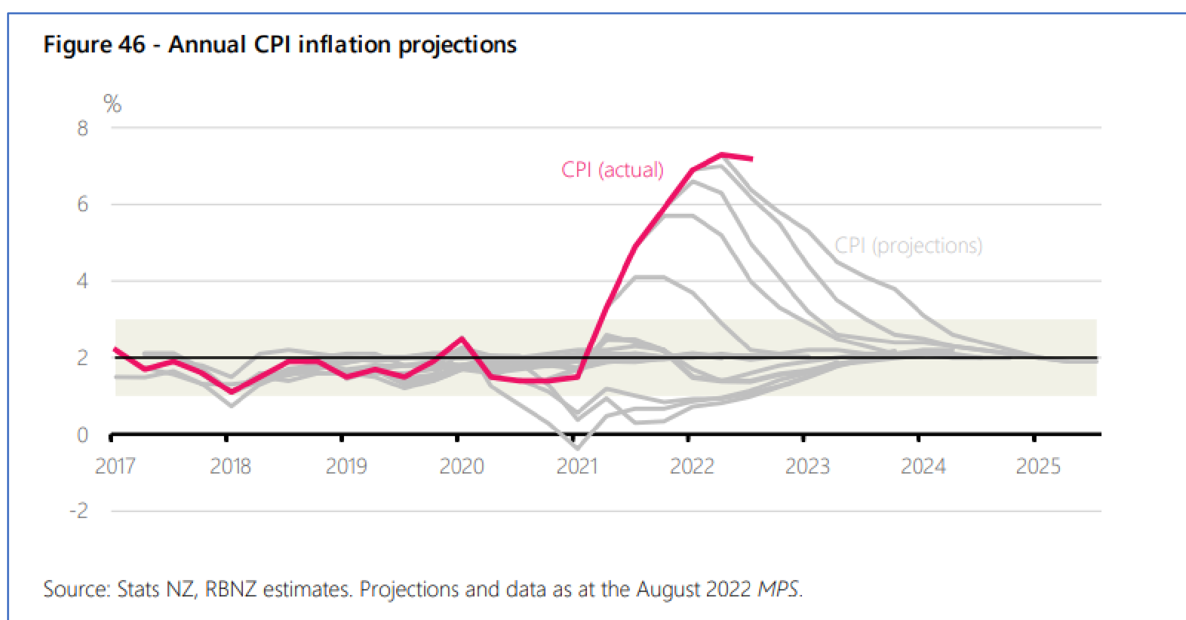
Of course, for a central bank to forecast otherwise would be to declare that it did not intend to achieve the Government's inflation target for the foreseeable future.

Hand in hand with these inflation forecasting errors were major errors in assessing what the future value for of the OCR would need to be to keep inflation within the target range.[12]

In short, the Bank has conceded that overly optimistic forecasts sanctioned monetary policy settings that were too loose for too long.

Such errors reduce the credibility of a central bank's commitment to keeping inflation low. The lower its credibility, the more investors can be expected to put a margin into the interest rates to cover inflation risk. It is of real concern that the Bank found that a majority of 1,000 people surveyed in 2022 "had little or no confidence in the Reserve Bank's ability to bring inflation within the target band by 2024". [13]

Figure 1:Annual CPI inflation projections



The Bank's review explained that monetary policy decisions in 2020 were taken in the expectation of a major pending economic contraction. It and the Monetary Policy Committee (MPC) deliberately put a stimulatory bias into monetary policy decisions as a "least regrets" strategy. It preferred too much stimulus to too little.[14]

The initial forecasting error is understandable. The epidemic and the lockdown were extraordinary events. From May to November 2020, the Bank's baseline forecasts did not

12 RBNZ, *In Retrospect*, op. cit. Figure 25 compares the Bank's OCR projections with the outcomes.
13 Ibid., 99.
14 Ibid., 50 and 51, particularly 51.

expect real GDP seasonally adjusted to recover to its December 2019 quarter level before the March quarter of 2022. Only in time for its February 2021 Monetary Policy Statement did the Bank have SNZ's estimate that this recovery had occurred in the September quarter of 2020.

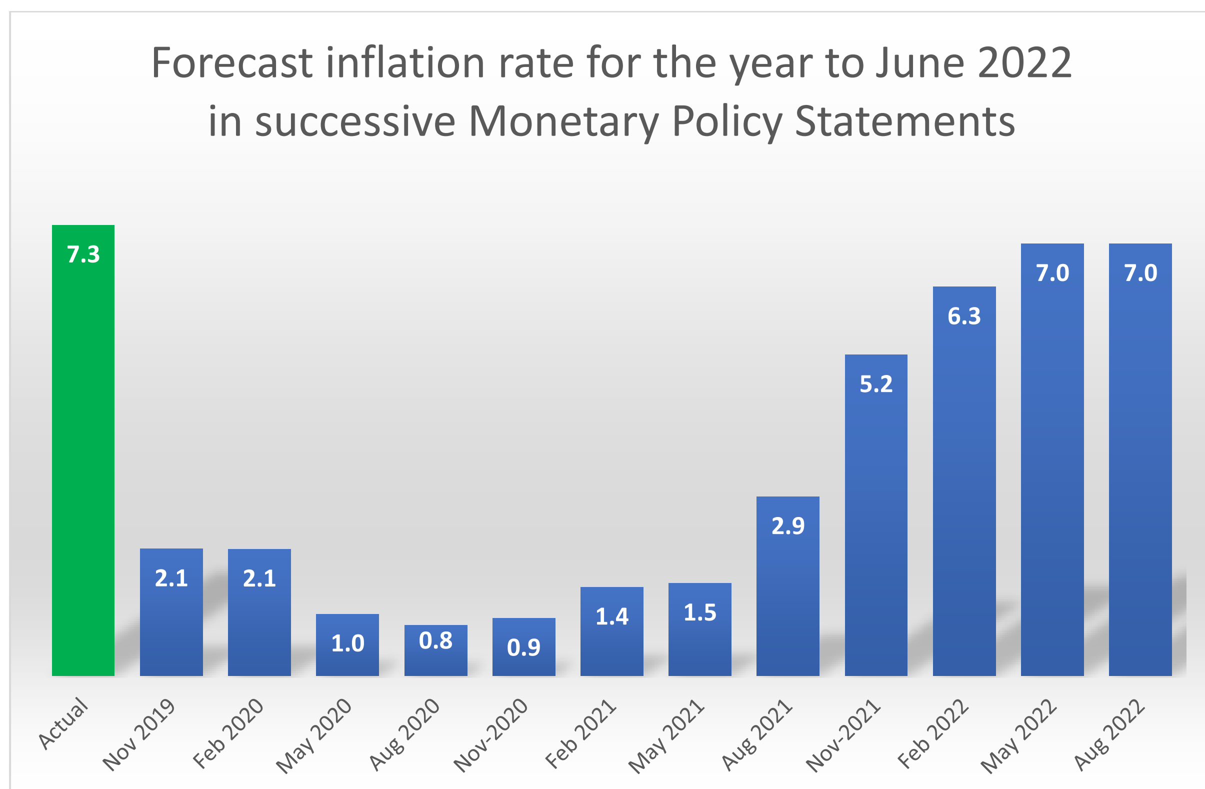
However, even when the magnitude of the rebound in real GDP was known, the Bank's forecasts for consumer price inflation seriously underestimated what was in train. The following chart shows its successive forecasts for the increase in the CPI between June 2021 and June 2022.

It was only late in 2021 that the Bank realised that CPI inflation for the year to June 2022 would be far above the 1-3% target range.

The overly loose policy settings have had socially divisive consequences for house prices. House prices rose a wealth-redistributing 49% between March 2020 and March 2022.

The faster response of house prices is understandable. Market asset prices respond much faster to unexpected changes in monetary policy settings than output and employment. Wage rates and the prices for goods and services are likely to be the slowest to respond.[15]

Figure 2: Forecast inflation rate for the year to June 2022 in successive Monetary Policy Statements



[15] John Greenwood, Chief Economist, International Monetary Monitor, has drawn my attention to these sequenced timing issues.

Publicly, the Bank's Governor, Adrian Orr, argued as late as November 2021 that monetary policy played only a bit role in causing such asset price inflation amidst lockdowns and job losses.[16] The analytical basis for this assertion was unclear to a disturbing degree. The Bank's November 2022 *In Retrospect* concedes that "increased monetary stimulus" likely "played a key role in causing house prices to rise rapidly over the second half of 2020.[17] Consistently, house prices fell after the Bank tightened monetary policy settings.

It later transpired publicly that the Bank had warned the Minister of Finance and the Treasury as early as January 2020 that the risk of greater house price inflation was real under the LSAP option. Wealth inequality would rise. The Bank suggested the Minister and Treasury look at supplementary policy options to reduce the effect in the then-unlikely event that LSAP needed to be used for monetary policy purposes.[18]

Strangely, despite this warning to its Minster, in May 2021, the Bank published an analytical note assessing the distributional effects of monetary policy. This note did not express an opinion on the adverse distributional effect of the house price inflation it fueled. Instead, it begged the question by observing that higher house prices might not increase wealth inequality "if home ownership is broadly distributed among the population".[19]

Just as strangely, the Bank did not predict house price inflation when introducing the LSAP scheme in March 2020. In May 2020, it forecast that house prices would be fractionally *lower* in March 2022 than in March 2020. That is a serious forecasting error.

Readers might think that such major forecasting errors should trouble the head of a Bank charged with controlling inflation. Apparently not. In May 2022, the Bank's Governor told a Parliamentary Select Committee he had "no regrets" about being slow to react to inflation taking off.[20] Those who borrowed heavily to buy over-priced houses for "fear of missing out", will be feeling differently.

The no-regrets comment is extraordinary given the $9 billion cost of the LSAP to taxpayers. The March 2020 announcement of a $30 billion LSAP probably did help calm the stresses in the New Zealand government bond market in the next few days. Much more important globally was the prompt global response of the US Federal Reserve system. US economists Andy Levin and Bill Nelson pointed out, in an article published by the Mercatus Institute, that US Federal Reserve action arrested that US and global liquidity problem very promptly.[21]

In its review of monetary policy during this period, the RBNZ ignores the US response, despite the spike in New Zealand government bond yields mirroring that in US Treasury

[16] Tom Pullar-Strecker, "Adrian Orr says Reserve Bank only has 'bit role' in unsustainable house prices", *Stuff*, 2 November 2021.

[17] RBNZ, *In Retrospect*, op. cit., 103.

[18] Thomas Coughlan, "Reserve Bank repeatedly warned Government that printing money would lead to house price inflation", *Stuff*, 5 February 2021.

[19] Jinny Leong, "An overview of the distributional effects of monetary policy", Analytical Note (Reserve Bank of New Zealand, May 2021).

[20] Brian Fallow, "Reserve Bank Governor Adrian Orr goes on the defensive", *NZ Herald*, 12 May 2022.

[21] Levin and Nelson, op. cit. See also Figure 34 in the Bank's *In Retrospect*, op. cit.

yields. That omission helped it conclude without further evidence that: "[t]he LSAP programme was highly effective in response to the liquidity crisis that emerged in early 2020" and the Bank should use it again in similar circumstances.[22]

This defense does not justify the Bank's decision to extend the scale and duration of the LSAP beyond April 2020. It increased the $30 billion cap to $60 billion in May 2020 and $100 billion in August 2020. Those decisions cannot be justified as a response to liquidity problems in the New Zealand government bond market. The Bank's *In Retrospect* review demonstrates the quick restoration of market calm in its Figure 22.[23]

The Governor's defense of the benefits of its LSAP programme relies on mere assertion. For example, in an interview for *The Herald*, Auckland's dominant daily newspaper, he asserted that the wider economic gains from the LSAP programme were "some multiples" of its financial losses.[24]

The Governor presumably wants the public to assume there were significant gains from greater output and employment. But why would the public assume that? Even the Bank's review does not claim this, let alone attempt to demonstrate it.

The Bank should publish a competent analysis demonstrating gains rather than bluster.

The bottom line is that this massive financial gamble imposed enormous losses on taxpayers, without effective parliamentary scrutiny, without clear published estimates of the potential scale of the losses and without any apparent interest in making a formal assessment of whether benefits to the community would exceed the costs.

When appearing before the same select committee in November 2022, the Governor asserted that:

> "For us to have maintained inflation between the 1 to 3 percent target range, we would've had to predict the 2022 Russian invasion of Ukraine in early 2020".

This assertion is embarrassingly wrong. Russia invaded Ukraine on 24 February 2022. Inflation took off in New Zealand in the June quarter of 2021, when it rose 1.3%. New Zealand's CPI rose 5.9% in 2021. This was before the invasion. In May 2020, the Bank's baseline scenario predicted it would only rise by 0.5%.

The Governor has blamed New Zealand's inflation problem on the higher global energy and food prices resulting from that invasion. Even worse, the Minister of Finance used this defense in the Government's Budget Policy Statement 2023.[25]

---

22 RBNZ *In Retrospect*, op. cit., 13.

23 Figure 34 in *In Retrospect* tracks bid-ask spreads for two-year and 10-year government bonds during this period. They are another indicator of how liquidity was changing. That figure shows a notable spike that lasted for weeks rather than months.

24 Jenée Tibshaeny, "Adrian Orr accepts mortgage rates could fall next year", NZ Herald, 19 August 2022, provides a link to Orr's interview. The claims of multiple benefits come at 15:05 minutes and 15:45 minutes. Michael Reddell's blog "Orr defending the LSAP", 23 August 2022, examines the RBNZ's claims of gains from the LSAP programme.

25 New Zealand Government, *Budget Policy Statement 2023*, (New Zealand Government, 14 December 2022), Figure 1, 3.

Global inflation does not determine domestic inflation when a country has a floating exchange rate. New Zealand has one. A floating exchange rate allows monetary policy to target domestic inflation. When global inflation exceeds New Zealand's target inflation rate, the New Zealand dollar should trend up, and vice versa.[26] Under a floating exchange rate, domestic inflation is determined by domestic monetary policy settings.

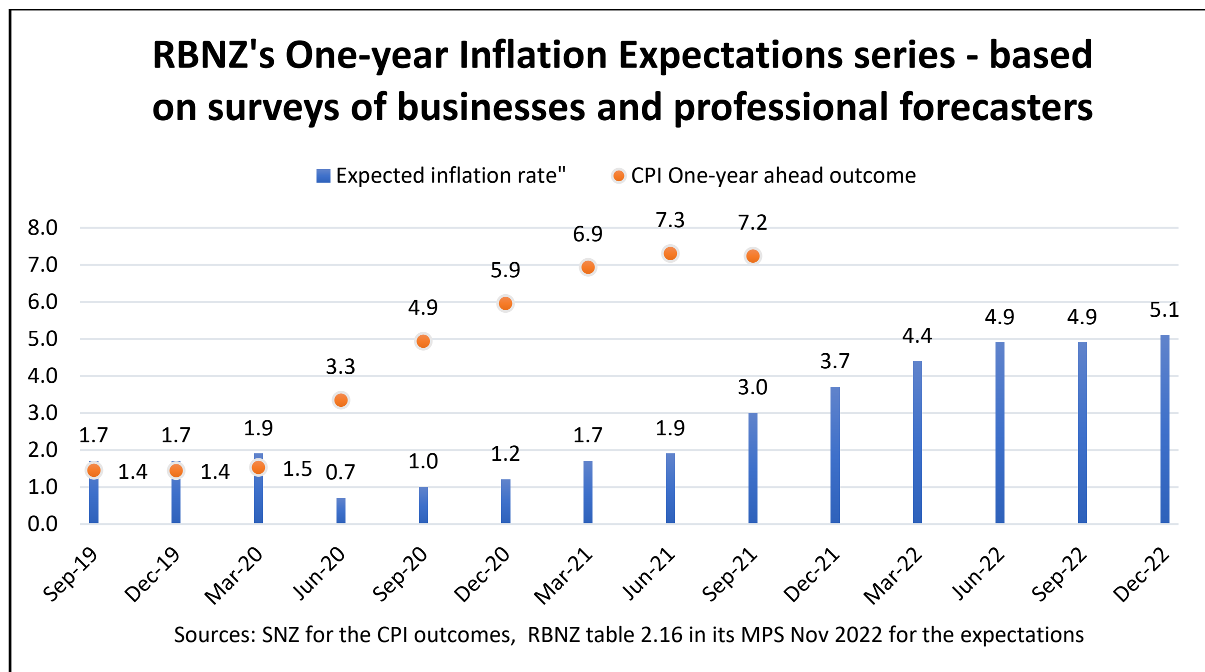
Another credibility-reducing argument from the Bank is that inflation has blown out by more in many other countries.[27] Even if this is true, so what? The RBNZ has no mandate to inflate with everyone else. Central bankers should not act like lemmings.

In any case, invasion-related energy prices have most affected European countries. New Zealand's inflation rate, excluding energy and food, compares much less favourably.[28]

The Bank's February 2020 MPS reported that, on balance, surveyed businesses and professional forecasters expected 1.9% inflation for the year to the March quarter of 2021. The actual outcome was 1.5%. The surveyed expectation reported in the Bank's May 2020 MPS was for the CPI to rise by only 0.7% in the year to June 2021. The actual rise was 3.3%.

Nor did expectations adjust rapidly once the June quarter 2021 rise was known. The August 2021 MPS assessed the CPI would rise just 3.0% in the year to September 2022. The actual increase was 7.2%.

Figure 3: RBNZ's One-year Inflation Expectations series – based on surveys of businesses and professional forecasters



---

26 If import prices rise faster than export prices there is a real income loss for New Zealand, regardless of what is happening to monetary policy or the exchange rate. But New Zealand's export prices are still extraordinarily high relative to import prices from a historical perspective.

27 See for example Figure 1 in the RBNZ's *In Retrospect*.

28 Oliver Hartwich, "Inflation and the smoking gun in the case of NZ's central bank", *The Australian*, 8 November 2022. Also see Michael Reddell, "At it again", Croaking Cassandra blog, 16 December 2022.

In short, in 2020 the Bank was not alone in failing to forecast the strong resurgence of CPI inflation in 2021, well before the Russian invasion. Nevertheless, the inflationary risks of the Bank's policy actions had long been clear to outside observers. In July 2022, the New Zealand Initiative documented nine warnings of the risks that it had published between March 2018 and June 2021.[29]

Central banks and private forecasters globally will seek to improve their forecasting methods.

The forecasting problem concerns timing, not direction. Sustained easy money will generate inflation, not deflation. Errors in forecasting timing arise because of long and variable lags between a change in monetary policy settings and the effects on measured inflation.

As assessed by Wheeler and Wilkinson, central banks became over-confident that their forecasting models were sound, and the public would stay confident that any departures from the target range would be short-lived. The RBNZ shared this belief.

Is the employment story a redeeming factor?

Did the Bank rightly put achieving low unemployment ahead of the risk of inflation breaking out? Did expansionary monetary policy prevent the feared collapse in output and employment that Covid-19 would cause?

The Bank has blandly asserted that its measures materially supported economic activity, but what is needed is convincing supporting evidence.[30]

Forecasting errors have many sources. Outcomes may be better than expected simply because the underlying 'no-policy-change' forecasts were too pessimistic in the first place.

The Bank's early 2020 forecasts for economic activity and inflation were necessarily tentative to the point of being heroic. A national Covid lockdown was an unprecedented event for the forecasters. The margin for error was much greater than usual. The May 2020 MPS forecast that the rate of unemployment would increase from 4.2% in March 2020 to 9.0% in September 2020. The August 2020 statement reduced the September 2020 estimate to 7.0%. The November 2020 statement reported the final outturn of 5.3%.

Additional new monetary policy measures cannot explain those reductions.[31] Monetary policy measures do not have fast, predictable effects on the rate of unemployment. Monetary policy changes affect asset values before they affect interest rate-sensitive spending. The latter includes spending on consumer durables. Businesses initially meet

---

[29] Oliver Hartwich and Bryce Wilkinson, "Foresight economics correctly predicted New Zealand's loss of price stability", media release, New Zealand Initiative, 28 July 2022.

[30] Susan Edmonds, "Reserve Bank says its actions helped save the economy during pandemic", *Stuff*, 18 August 2022. Challenged by a parliamentary select committee for evidence of benefits to offset the extraordinary fiscal costs Governor Orr blustered "the economy we have today". Well, why could we not have had a better economy today without those losses?

[31] See Appendix C in the Bank's *In Retrospect* for a chronological list of policy measures.

changes in demand from existing inventories. It takes longer for output and employment to respond. Moreover, the magnitude of any output response will depend on the broader context. For example, it may be low if businesses think the demand change is temporary.

The related argument–that reducing unemployment is better than achieving and sustaining low inflation–has an empirical basis.[32] But as a guide to monetary policy, it assumes that there is a trade-off to exploit. Will bringing inflation down quickly cause more unemployment for longer than bringing it down slowly? Perhaps yes, perhaps no. The problem is that to reduce unemployment today at the expense of inflation is to need to do the opposite later. Monetary policy cannot sustainably reduce the rate of unemployment.

The argument that the RBNZ knowingly put inflation at risk to lower unemployment is inconsistent with the Bank's inflation forecasts, as in the charts above. The Bank was not expecting to breach its 1-3% inflation rate target. It did not plan to violate its mandate.[33]

It had this in common with other central banks. None expected inflation to break out; when it did, the defensive reaction was to call it temporary. They were proven wrong each time. They need to learn from these errors.

Erratic signals concerning prudential regulation

Before the onset of Covid in 2020, the RBNZ was intent on raising banking system prudential requirements to a level that it considered would protect banks against a one in a 200-year adverse event. Why so high? On inquiry, the RBNZ could not produce any sound analysis to justify imposing these costs on the community. Tailrisk Economics, headed by Ian Harrison, an ex-RBNZ expert in banking risk analysis, has published three critiques of the RBNZ's case for this measure. See the bibliography for details.[34]

Once Covid-19 struck, the RBNZ expediently relaxed this policy. It assured the public that the banks were sound without the policy. That seemed inconsistent with its earlier position.

The Bank effectively urged the banks to lend imprudently from a commercial perspective.[35] This was in the hope of making its monetary policy easing more effective. Yet, if banking system reserves were inadequate before Covid, surely the lockdown of many borrowers' businesses would have put the banks at even greater risk?

Prudential regulation is efficient when the benefits to the community exceed the costs relative to the next best alternative. Assessing this is difficult, but the costs of getting it wrong are potentially great.

---

[32] Lina El-Jahel, Robert MacCulloch and Hamed Shafiee, "How does Monetary Policy affect welfare? Some new estimates using data on life evaluation and emotional well-being", Motu Working Paper 20-06 (Motu Economic and Public Policy Research June 2020).

[33] Bryce Wilkinson, "The false 'inflation versus jobs' narrative", Policy Note (The New Zealand Initiative, 18 August 2022).

[34] See also, the independent evaluation by Ross Levine, "A report on the Reserve Bank's Capital Review", (Reserve Bank of New Zealand, August 2019). This evaluation was commissioned by the RBNZ.

[35] Hamish Rutherford, "Covid 19 coronavirus: Reserve Bank urges banks to consider 'social responsibility' in business lending", *NZ Herald,* 19 April 2020.

The need to ensure that financial regulators take the assessment of costs and benefits seriously is heightened by the lop-sided nature of their incentives. They get the blame if a crisis occurs, but do not personally bear the costs that their regulatory dictates impose on the community. That can make them too risk averse.[36] On the other hand, political pressures to fuel a boom can induce them to fail to act.[37] The eternal question is: "who monitors the monitors"?[38]

RBNZ distractions

The Government appointed the current Governor in March 2018. His period in office has been action-packed. Major changes have occurred in the Bank's legislation, governance, organisational direction, and focus.

His period in office has been controversial. He has a strong personal agenda on issues such as climate change, diversity, and ethnicity.[39]

He also takes criticisms personally.[40] There is a serious lack of relevant expertise in monetary policy and financial market regulation in the RBNZ's Board, its MPC and its governors.

Under his leadership, the RBNZ portrays itself as the hubristic overseer and guardian of New Zealand's financial system, and indeed the economy.[41]

Rather than seeing itself as solely responsible for diligently doing its delegated monetary policy and regulatory tasks as a government agent, the RBNZ now sees itself as having a vision and values of its own and the autonomy to impose "our long-term objectives for the financial system". It even declares it has "an ultimate purpose".[42]

It seems to see itself as more of a director than a facilitator of financial market intermediation between borrowers and lenders.

The following statement illustrates the open-ended scope of its presumptions of guardianship. It also indicates the importance it attaches to ethnicity:

---

[36] The flip side is that when it comes to putting taxpayers' money at risk, they can be too risk-loving.

[37] See for example, The Financial Crisis Commission, "*The Financial* Crisis *Inquiry Report*: Final *Report* of the National Commission on the Causes of *the Financial* and Economic Crisis in the United States", "We conclude widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets" … Too often, they [the regulators] lacked the political will … ." (US Government, January 2011), p xviii,

[38] Roger Partridge, "Who Guards the Guards? Regulatory Governance in New Zealand", (Wellington: The New Zealand Initiative, April 2018).

[39] See for example, Oliver Hartwich, "NZ's revolution in central banking and the stagflation monster", *The Australian*, 25 May 2022. The RBNZ has been less strident on the issue of inequality, perhaps because it has been heavily criticised for fuelling house price inflation and thereby wealth inequality.

[40] Kate MacNamara, "A year of anger between Reserve Bank governor Adrian Orr and NZ Initiative's Roger Partridge", *New Zealand Herald,* 16 February 2016.

[41] Specifically, the RBNZ parallels itself with a giant kauri tree in New Zealand, Tāne Māhuta, that some call the "God of the Forest", website.

[42] RBNZ, "Our purpose, vision and values", 28 February 2022, website.

> As New Zealand's central bank, we are the kaitiaki (guardian) of Aotearoa's economy and financial system. Through our Te Ao Māori (Māori world) strategy, we are building relationships with tangata whenua to influence the long-term economic well-being of Aotearoa.[43]

In the same website, the RBNZ aims "to reflect the Treaty principles of partnership, protection and participation within the core tenants [sic] of our strategy". What those principles really are is deeply contested and highly political.[44]

The RBNZ might now be endorsing spiritualistic explanations for natural phenomenon. Its Te Ao Māori strategy presumably envisages all animate and inanimate elements are infused with spirit or living essence.[45]

When he spoke to an international audience of central bankers in June 2022, the Governor demonstrated the extraordinary degree to which this world view drives his actions. Apparently, without this Māori worldview the RBNZ would be less able to take a holistic and long-term approach to performing its statutory functions. Implicitly, other central bankers will fail unless they do the same.[46]

Climate change is another political issue the RBNZ has taken an advocacy approach to under the Governor's leadership. For example, the RBNZ's website asserts unequivocally that: "Climate change poses a direct challenge to financial stability".[47] On inquiry, it could produce no empirical, analytical research supporting such certainty. Regrettably, on one occasion, its response omitted an internal assessment that was inconsistent with the claim.[48]

The Governor is creating the impression that he is prone to committing the RBNZ to a policy position in advance of any serious supporting case for that position.

The RBNZ is also beating its chest about reducing its own carbon footprint.[49] This is mere posturing since nothing it does can change New Zealand's net emissions under the Emissions Trading Scheme. The Bank needs to demonstrate that the expected benefits to the public from these actions exceed the costs, but that seems too much to hope for.

---

43 Finance and Expenditure Committee 2022" (Reserve Bank of New Zealand 14 December 2022).

44 For example, the Waitangi Tribunal's 2019 Hauroa report found on page 163 "that the Crown's 'three Ps' articulation of Treaty principles is outdated and needs to be reformed". The report proposes five replacement principles for the primary health system. (The RBNZ endorses the three P's formulation – for now– but has no authority on these matters.) See also Anthony Willy, "Fairy Tales for the gullible" (New Zealand Centre for Political Studies,1 June 2022).

45 See for example: RBNZ, "Te Ao Māori–An evolving and responsible strategy", website; The Aotearoa Circle, "Te Ao Māori context", website, and J Keelan (aka Kuia Pakeha) "What has animism got to do with Mātauranga Māori?", 19 November 2012.

46 Adrian Orr, "Why we embraced Te Ao Māori", Speech delivered to the central banking global summer meetings, 2022. In this speech he expresses the view that Tāne Māhuta, aided by light, "enabled life to thrive" and asserted that "[t]he Reserve Bank is akin to the being Tāne Māhuta of New Zealand's financial landscape". In this speech "inflation" got two mentions, "financial stability" one mention, and "Māori", over ninety mentions.

47 RBNZ, "How we approach climate-related risk", Reserve Bank of New Zealand, website.

48 Ian Harrison, "Climate change and the risk to Financial Stability: Reality or overreaction", *Tail Risk Economics*, October 202, 4. See also his paper "The European Central Bank's Climate Change stress test", *Tail Risk Economics*, January 2022.

49 RBNZ, "Our annual review with the Finance and Expenditure Committee 2022" (Reserve Bank of New Zealand 14 December 2022).

The RBNZ has also used the threat of discriminatory policing of individual financial institutions which do not bend to its whims regarding climate change responses. Economist Matt Burgess has made the case that this is a serious abuse of monopoly regulatory power.[50]

Returning to the issue of long-term objectives not related to ethnicity, many, including the writer, consider that the prime goal of an efficient financial system would benefit New Zealanders. It would allow New Zealanders to transact with each other at least risk-adjusted cost, including inconvenience.

Astonishing disregard for core expertise

The Reserve Bank's Board, its governors and its MPC seriously lack relevant expertise.

Staff turnover at the top of the RBNZ has been extraordinarily high. Too many replacement staff lack expertise in economics, monetary policy, and financial market regulation. Instead, the focus seems to have been on those interested in diversity, climate change, and/or sustainability.

The RBNZ currently has nine governors. The Governor has appointed the other eight since 2018. Only two governors have an academic qualification in economics, and neither have a PhD in any subject. Even so, their pay is extraordinary by New Zealand standards. The salary bill for governors in the year to June 2022 was $5.44 million. If divided by nine, the average is $604,000.[51]

The Bank has lost much technical expertise in monetary policy and institutional knowledge because of high turnover and its employment focus. This is a concern because the RBNZ's core tasks require expertise in monetary policy and macroeconomics, regulatory economics, and finance. A pragmatic understanding of commerce is also essential.

It is particularly disquieting that the RBNZ's recently appointed Assistant Governor responsible for macroeconomics and monetary policy has no formal qualification in this area and does not appear to have long had a serious interest in it. Instead, she has experience in banking and a strong interest in sustainability. The RBNZ merely reports that she has an undergraduate degree from the University of Canterbury, but it does not reveal the main area of study. Expert staff reporting to her will surely lack confidence in her ability to assess disagreements over technical issues. Of course, it is not her fault that she was offered the job.

The changed composition of its staff also shows the Bank's priorities. In June 2022, only thirty-two employees were categorised as "economics staff". There were more in 2013. Yet staff numbers on a full-time equivalent basis rose 80%, from 252 in June 2017 to 454 in June 2022.

---

[50] Matt Burgess, "Climate of fear: How the Reserve Bank is overstepping its mandate", New Zealand Initiative, 9 November 2021.

[51] This may overstate the average salary of the nine incumbents, because it likely includes payments to existing governors.

Former senior employee Michael Reddell has documented the Bank's extraordinary decline in recent years in the number of its published research discussion papers. He worried that a Reserve Bank that continued to thus signal that it was not much interested in being a research informed central bank would be "another sign of a deeply troubled institution".[52]

The number of staff in human relations rose from five in 2017 to 24 in 2022, communications staff rose from six in 2013 to 24, and staff in the Governor's office rose from six in 2017 to 32.

In contrast, staff numbers on a full-time equivalent basis rose by only four percent between 2017 and 2022 at the Reserve Bank of Australia (RBA).[53]

The RBA is also far stronger at the top level in relevant technical expertise. Its Governor's impressive credentials include a PhD in economics and econometrics from the prestigious Massachusetts Institution of Technology. Furthermore, the three assistant governors in charge of its economic, financial market and financial system areas each have PhDs in economics or finance.

Expertise in monetary policy can rule out eligibility for external members of the MPC. Official documents released under the Official Information Act include the following Treasury summary for the Minister of Finance of the situation in early 2019:

> As you previously agreed with the Board, a strict approach has been taken regarding conflicts of interest. This has included excluding from consideration any individuals who are engaged in, or likely to engage in future, in active research on monetary policy or macroeconomics.[54]

Professors of macroeconomics in New Zealand are ineligible because of their expertise and research interests. This policy, in the name of avoiding conflicts of interest, invites tokensim in appointments and makes it easier for the Governor to dominate MPC meetings and decisions. This policy was reaffirmed in 2022.

The culpability of the Board and the Minister of Finance

The Minister of Finance bears the heaviest responsibility for monetary policy decisions. He determines its objectives and appoints the Governor. He plays a decisive role in making appointments to the Reserve Bank Board, and also influences MPC appointments.

Documents released under the Official Information Act show that the Minister of Finance has pressured the Board to "focus" on gender diversity when making appointments, with no

---

[52] Michael Reddell, "Central Bank Research", Croaking Cassandra blog, 20 January 2022.

[53] See the New Zealand National Party Press Release, "More spin doctors, fewer economics staff at RBNZ", 18 August 2022, the RBNZ's OIA release on 19 August 2022 and Michael Reddell, "An expanding empire", Croaking Cassandra blog, 16 August 2022.

[54] New Zealand Treasury. "Monetary Policy Committee: Documentation to Confirm Appointments, T2019/90", 29 January 2019.
Michael Reddell, "Expertise and the MPC", Croaking Cassandra blog, 16 February 2022. See also Jenée Tibshraeny, "Policy to disqualify monetary policy researchers from joining the Reserve Bank's Monetary Policy Committee retained, as new appointments need to be made", interest.co.nz, 19 February 2022.

suggestion that merit should be an over-riding consideration. For example, a Treasury Aide Memoire (T2019/279) on 11 March 2019 stated that:

> Following these appointments, the MPC will have only one woman as a member, with all internal members being men.
>
> The Minister of Finance has asked through the letters of expectation to the Board of the Reserve Bank and the Governor to focus on supporting more women into senior leadership at the Bank. Both the Board and the Governor have confirmed that this is a matter of priority for them.
>
> The Minister of Finance has also asked the Governor to write to him and the Minister for Women to set out the steps he intends to take to support and encourage more women into leadership positions in economics in New Zealand, and what ministers can do to support this important priority. The Board and the Governor's focus on increasing the representation of women in the bank and in economics should see the gender balance on the MPC improve over time.

Such instructions are invidious for the female appointees. Better-performing or better-qualified staff may start to look elsewhere for employment. If those making important decisions in a central bank are not qualified to make them, the potential national economic and financial cost is large. A fundamental problem such instructions seem to overlook is that far fewer women than men graduated in finance and economics a couple of decades ago.

If the problem is that the Bank is refusing to hire on merit, it is unlikely that women will be the only casualty. Unfortunately, on the evidence above, merit is not the Minister's concern.

There are other concerns. The sixth Labour Government has significantly changed the RBNZ's structure and responsibilities since 2017. In 2018 it amended the Reserve Bank of New Zealand Act (1989).

On the positive side, the new Act and subsequent changes have made the Bank's Board more responsible for the Bank's performance. The worry is with the lack of quality appointments to the Board.

As documented by New Zealand Initiative's Roger Partridge, expertise in monetary policy and economics were not appointment priorities for the Board. Apart from the Board's chair, no one appointed to the newly constituted Board on 1 July 2022 has any identified economic expertise.

The Board is likely to flounder for lack of experience and expertise in the face of any future financial crisis. Even conflicts of interest in the appointments became a source of disquiet, discomfort, and bureaucratic embarrassment.[55]

---

[55] Roger Partridge, "Flawed RBNZ board appointment process symptom of wider malaise", *NZ Herald,* 7 September 2022. See also Jenée Tibshraeny, "The Opposition's warning about 'dubious' Reserve Bank board appointments", *NZ Herald,* 3 Sept 2022.

The new Act created the MPC to make monetary policy decisions. As discussed above, skill deficiency in the MPC is particularly unfortunate, and again it is the Minister of Finance who has acquiesced in this situation.

The Minister of Finance is also responsible for weakening the focus of monetary policy on "maintaining a stable general level of prices over the medium term". He has done so by requiring it to also support whatever "maximum sustainable employment (MSE)" means.

No one has thought of a satisfactory way of making that goal operational. Monetary policy cannot hope to alter employment in the long run. It is also problematic for it to successfully 'fine-tune' output and employment in the short run. Nor does the twin objective provide the Bank with any guidance about what to do when the two goals conflict.

The above changes also confer on current and future Ministers of Finance greater powers to direct the MPC using remits. This is a double-edged change.

The first remit, in February 2019, failed to provide any meaningful guidance concerning what is meant by MSE. Another concern is that it opened the way for the Bank to take a grandiose view of its role. To make matters worse, the subsequent February 2021 remit asserts (incorrectly) that:

> The Reserve Bank of New Zealand Act 1989 (the Act)… requires that monetary policy promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy.[56]

This open-ended directive invites the Bank to use monetary policy instruments to fine-tune any aspect of our lives that it claims monetary policy can usefully influence. It licenses distraction.

(Less contentiously, the remit maintained earlier requirements to: achieve specified targets for inflation; have regard to the efficiency and soundness of the financial system; avoid unnecessary instability in output, interest rates and the exchange rate; and discount transitory effects on inflation.)[57]

On 22 February 2021, a replacement remit imposed an additional consideration on the MPC. It was and is to assess the effect of its monetary policy decisions on government policy "to support more sustainable house prices". But what ratio of median house price to median income is sustainable? Is it really government policy, for example, to reduce house prices by over 50% to bring them closer to a more affordable and long-standing relationship of 3:1 relative to household income?[58]

---

[56] See RBNZ, "The remit for the Monetary Policy Committee", 14 February 2019. Note that the Reserve Bank Act 1989 as amended in 2019, states that the purpose of the Act is to promote prosperity and well-being etc. It does not say that this is a responsibility for the Reserve Bank, or for monetary policy. (The 2018 version of the Act did not include any such provision in its section 1A purpose statement.) The discrepancy between the Act and the remit is disturbing.

[57] See RBNZ, "The remit for the Monetary Policy Committee", 14 February 2019.

[58] To its credit, the Bank's *In Retrospect* called for this provision to be removed.

Poor governance arrangements for the RBNZ must produce inferior outcomes. That will tend to politicise the Bank. For example, the major opposition party in Parliament, National, has called for greater accountability for monetary policy mistakes, including an independent review. It has strongly criticised the Minister of Finance for extending the current Governor's term in office despite National's opposition. This situation is unfortunate for the Bank's independence.[59]

To summarise, with respect to the current deficient situation, the Minister of Finance bears primary responsibility for:

- The open-ended provision in the Bank's remit that invites the Bank to use monetary policy to pursue any course of action it fancies it can justify as promoting the prosperity and well-being of New Zealanders. The scope for distraction is obvious.
- Weakening the objective for monetary policy by introducing an ill-defined and potentially conflicting dual objective – achieving maximum sustainable employment.[60]
- Appointments to the Reserve Bank Board who have no experience or expertise in assessing how competently the Bank is doing its job or in reacting to a financial crisis.[61]
- Perpetuating the astonishing practice of ruling out those with expertise in monetary policy and financial markets from being external members of the MPC.
- Indemnifying the Bank for losses on its LSAP, at great expense to taxpayers and without adequate parliamentary scrutiny.
- Somewhat politicising the Bank by reappointing the Governor for a five-year term without first obtaining the support of the major parliamentary opposition.[62]
- Conferring a major increase in the Bank's budget and acquiescing in the Bank using that to expand into non-core activities to do with climate change, ethnicity, and income distribution.

The extent of the disquiet and concern

The criticisms and disquiet canvassed above are widespread amongst the well-informed.

In particular, serious concerns about the Bank's competence and the Governor's interests are common among its former expert staff. Former Governor Graeme Wheeler's more generic criticisms above provide one example. Dr Arthur Grimes, a former chair of the Bank's Board and before that its former Chief Economist has strongly criticised the prolonged looseness of monetary policy in response to the pandemic, seeing it as having produced perhaps the greatest 'wellbeing disaster' New Zealanders have seen in the last

---

59 Russell Palmer, "National shocked by reappointment of Reserve Bank Governor Adrian Orr", *Radio New Zealand*, 8 November 2022.

60 When stagflation occurs, the Bank has no basis for knowing whether its priority should be to increase employment (in the short turn) or reduce inflation.

61 A link to this material is in the Bibliography section below, see under Robertson, Grant. See the reference above to Treasury's Aide Memoire.

62 Russell Palmer, "National shocked by reappointment of Reserve Bank Governor Adrian Orr, *Radio New Zealand*, 8 November 2022.

two decades.[63] Grant Spencer, a former acting Governor of the Reserve Bank, has also criticised the excesses of the RBNZ's response to the Covid pandemic.[64] Former Assistant Governor, Dr John McDermott, considers that history will likely conclude that quantitative easing is "a really bad idea", except in emergencies.[65] Ian Harrison, former expert in risk analysis at the Reserve Bank has severely criticised the Bank's risk analysis in support of its capital adequacy regulation. He has also critically assessed the claim that climate change is a material threat to financial stability, in the EU and New Zealand. Respected former staffer Geof Mortlock wrote an open letter to the Minister of Finance and the Bank's Board in June 2022. It attacked the current Governor's politicisation of the bank.[66] In August 2022, he broadened his criticisms.[67] But the most persistent and prolific of the public critics amongst the Bank's former staff, beyond doubt, is Michael Reddell, who blogs as Croaking Cassandra.[68]

It is very unusual for former senior insiders to publicly criticise their successors (and implicitly those responsible for their performance). The fact that so many have done so shows a very high degree of concern.

The public criticisms from many respected former senior Reserve Bank experts are body blows that needed to be said. Sober leaders of opposition parties have expressed concerns in an appropriately muted way. The less a central bank is politicised, the better.

Criticisms from those subject to the Bank's discretionary regulatory powers are less public for obvious reasons. Such criticisms will have a self-serving element, as will a regulator's responses. Either way, what counts is the quality of the case.

---

63 Jenée Tibshraeny, "Inflation targeting architect Arthur Grimes says RBNZ should target lower inflation and house prices, as the status quo has caused a 'wellbeing disaster'" Interest.co.nz, 20 July 2021.

64 NZ Herald, "On the Tiles: Former Reserve Bank Governor Grant Spencer wights in on recent policies", 19 November 2022.

65 Gareth Vaughan, "Motu Executive Director and ex-RBNZ Assistant Governor John McDermott assesses the state of the local & international economies as 2022 hurtles towards 2023, *interest.co.nz* 21 December 2022. McDermott had expressed his concerns more explicitly in a 4 July 2022 podcast with Dr Oliver Hartwich: "Transcript: Oliver Hartwich and John McDermott discuss winding back the overhang of monetary stimulus", podcast, (New Zealand Initiative, 4 July 2022).

66 Jenny Ruth, "Former central banker slams Adrian Orr's 'dancing' with forest fairies", 21 June 2022.

67 Tom Pullar-Strecker "Former Reserve Bank senior staffer renews criticism of bank under Adrian Orr", *Stuff,* 2 August 2022.

68 See, for example, Michael Reddell, "Reappointing Orr", Croaking Cassandra blog, 9 November 2022.

Conclusions

Internationally, the RBNZ does not stand out as an outlier bad performer amongst central banks in its monetary policy responses to the onset of Covid-19. Its *In Retrospect* review and its explanations for its actions were useful, and the independence and quality of its reviewers were a credit to its processes.

But the international comparison is a poor yardstick on this occasion. The outcomes for New Zealanders count, and the inflation and fiscal cost outcomes were poor. The Bank needs to produce a credible demonstration of greater offsetting benefits for output and employment or be much less strident in its claims.

The “extra-curricular” enthusiasms of the current Governor heighten the concerns about the Bank’s focus and capabilities.

Poor governance arrangements, conflicting goals, grandiose aspirations and distractions, an excessive budget, and a lack of core expertise in key appointments have created the current mess. The “extra-curricular” enthusiasms of the current Governor have not helped.

An excess of enthusiasm to ease monetary conditions amidst undue complacency about inflation and the dangers of stagflation has led to big swings in policy stance. The fiscal cost is serious and house prices have whiplashed.

The Bank needs to improve the accuracy of its inflation forecasts. That is not an easy task. To achieve that requires the successful employment of technical expertise.

What will trigger change for the better? Not much under the current Minister of Finance. He is culpable for much of the current mess. There is little political reason for him to make useful changes now. He could even seek to do the opposite–pull the Bank back from its current more hawkish approach in an election year. But to do that would further undermine its need to re-establish lost credibility as an inflation fighter.

The real message in this report is for those who might form the next Government. They need to pay serious attention to what changes they might make to reposition the Bank. As a boat, it is off course and far from watertight.

A future Government could turn the Bank around given enough Ministerial will, but not in a hurry. Credibility is hard to earn and easy to undermine.

Bibliography

Burgess, Matt. "Climate of fear: How the Reserve Bank is overstepping its mandate" (Wellington: New Zealand Initiative, 9 November 2021). https://www.nzinitiative.org.nz/reports-and-media/media/media-release-45/

Burgess, Matt. "Switched on! Achieving a green, affordable and reliable energy future" (Wellington: New Zealand Initiative, 2019). https://www.nzinitiative.org.nz/reports-and-media/reports/switched-on-achieving-a-green-affordable-and-reliable-energy-future/document/691

Coughlan, Thomas. "Reserve Bank repeatedly warned Government that printing money would lead to house price inflation", *Stuff*, 5 February 2021. https://www.stuff.co.nz/national/politics/300223358/reserve-bank-repeatedly-warned-government-money-printing-would-lead-to-house-price-inflation

Edmonds, Susan. "Reserve Bank says its actions helped save the economy during pandemic", *Stuff*, 18 August 2022. https://www.stuff.co.nz/business/300664829/reserve-bank-says-its-actions-helped-save-the-economy-during-pandemic

El-Jahel, Lina, Robert MacCulloch and Hamed Shafiee. "How does Monetary Policy affect welfare? Some new estimates using data on life evaluation and emotional well-being", Motu Working Paper 20-06 (Motu Economic and Public Policy Research, June 2020). https://motu-www.motu.org.nz/wpapers/20_06.pdf

Fallow, Brian. "Reserve Bank Governor Adrian Orr goes on the defensive", *NZ Herald*, 12 May 2022. https://www.nzherald.co.nz/business/brian-fallow-reserve-bank-governor-adrian-orr-goes-on-the-defensive/3YMV7WBLBKGYWFRLZEMUGVFMZQ/

Harrison, Ian. "Climate change and the risk to Financial Stability: reality or overreaction", *Tail Risk Economics*, October 2021. http://www.tailrisk.co.nz/documents/ClimatechangeandFinancialStability.pdf

Harrison, Ian. "Tailrisk Economics Pinocchio awards: Reserve Bank of New Zealand's proposed capital increases", *Tail Risk Economics*, March 2019. http://www.tailrisk.co.nz/documents/PinocchioAwards.pdf

Harrison, Ian. "The 30 Billion dollar whim", *Tail Risk Economics*, March 2019. http://www.tailrisk.co.nz/documents/HowMuchCapitalIsEnough.pdf

Harrison, Ian. "The European Central Bank's Climate Change stress test", *Tail Risk Economics*, January 2022. http://www.tailrisk.co.nz/documents/ECBclimatechange.pdf

Harrison, Ian. "Third time lucky?", *Tail Risk Economics*, May 2019. http://www.tailrisk.co.nz/documents/RBNZ_NewAnalysis_May.pdf

Hartwich, Oliver and Bryce Wilkinson. "Foresight economics correctly predicted New Zealand's loss of price stability" Media release (Wellington: New Zealand Initiative, 28 July 2022). https://www.nzinitiative.org.nz/reports-and-media/media/media-release-foresight-economics-correctly-predicted-new-zealands-loss-of-price-stability

Hartwich, Oliver. “Germany faces a new kind of cold war this winter” (Wellington: New Zealand Initiative, 6 September 2022). https://www.nzinitiative.org.nz/reports-and-media/opinion/germany-faces-a-new-kind-of-cold-war-this-winter/

Hartwich, Oliver. “Inflation and the smoking gun in the case of NZ’s central bank”, *The Australian*, 8 November 2022. https://www.nzinitiative.org.nz/reports-and-media/media/media-release-foresight-economics-correctly-predicted-new-zealands-loss-of-price-stability

Hartwich, Oliver. “NZ's revolution in central banking and the stagflation monster”, *The Australian*, 25 May 2022. https://www.nzinitiative.org.nz/reports-and-media/opinion/new-opinion-242/

Hartwich, Oliver. “Transcript: Oliver Hartwich and John McDermott discuss winding back the overhang of monetary stimulus” podcast (Wellington: New Zealand Initiative, podcast 4 July 2022). https://www.nzinitiative.org.nz/reports-and-media/opinion/transcript-oliver-hartwich-and-john-mcdermott-discuss-winding-back-the-overhang-of-monetary-stimulus/

Hickey, Bernard. “Why Orr prefers negative interest rates to QE”, *Newsroom*, 13 August 2019. https://www.newsroom.co.nz/why-adrian-orr-prefers-negative-interest-rates-to-qe

Keelan, J. “What has animism got to do with Mātauranga Māori?”, Kuia Pakeha blogsite, 19 November 2012. https://jkeelan.wordpress.com/2013/11/19/what-has-animism-got-to-do-with-matauranga-maori/

Leong, Jinny. “An overview of the distributional effects of monetary policy” (Reserve Bank of New Zealand, May 2021). https://www.rbnz.govt.nz/-/media/ae7c5c39ce5c4c5da20116651ce1e529.ashx

Levin, Andy and Bill Nelson. “The Federal Reserve’s Balance Sheet: Costs to Taxpayers of Quantitative Easing”, Policy Briefs (Mercatus Center, 10 January 2023). https://www.mercatus.org/research/policy-briefs/federal-reserves-balance-sheet-costs-taxpayers

Levine, Ross. “A report on the Reserve Bank’s Capital Review” (Reserve Bank of New Zealand, August 2019). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/external-reviews/capital-review-external-experts-report-ross-levine.pdf?sc_lang=en&hash=37D371D9A851EA4B7A038A7B7832E922

MacNamara, Kate. “A year of anger between Reserve Bank governor Adrian Orr and NZ Initiative’s Roger Partridge”, *Stuff*, 16 February 2020. https://www.stuff.co.nz/business/opinion-analysis/119530605/a-year-of-anger-between-reserve-bank-governor-adrian-orr-and-nz-initiatives-roger-partridge

New Zealand National Party. “More spin doctors, fewer economics staff at RBNZ”, press release, *Scoop*, 18 August 2022. https://www.scoop.co.nz/stories/PA2208/S00165/more-spin-doctors-fewer-economics-staff-at-rbnz.htm

New Zealand Treasury. “Monetary Policy Committee: Documentation to Confirm Appointments, T2019/90”, 1 February 2019. This is from document 12 at https://croakingcassandra.files.wordpress.com/2019/07/grant-robertson-oia-release-on-mpc-appointments.pdf.

NZ Herald. “Former Reserve Bank governor Grant Spencer weighs in on recent policies”, Podcast on the Tiles, *NZ Herald*, 19 November 2022. https://www.nzherald.co.nz/nz/politics/on-the-tiles-former-reserve-bank-governor-grant-spencer-weighs-in-on-recent-policies/P7JAUUPPR57WCY5TCS5KFJTP3M/

Orr, Adrian. ”Why we embraced Te Ao Māori”, speech to the Central Banking Global Summer Meetings 2022, (Bank of International Settlements 13 June 2022). https://www.bis.org/review/r220614b.htm and https://www.rbnz.govt.nz/hub/publications/speech/2022/speech2022-06-13

Palmer, Russell. “National shocked by reappointment of Reserve Bank Governor Adrian Orr”, *Radio New Zealand*, 8 November 2022. https://www.rnz.co.nz/news/political/478300/national-shocked-by-reappointment-of-reserve-bank-governor-adrian-orr

Partridge, Roger. “Flawed RBNZ board appointment process symptom of wider malaise“, *NZ Herald*, 7 September 2022. https://www.nzinitiative.org.nz/reports-and-media/opinion/flawed-rbnz-board-appointment-process-symptom-of-wider-malaise/

Partridge, Roger. “Why RBNZ Governor Adrian Orr should be in Finance Minister Grant Robertson's sights“, *NZ Herald*, 27 October 2022. https://www.nzinitiative.org.nz/reports-and-media/opinion/why-rbnz-governor-adrian-orr-should-be-in-finance-minister-grant-robertsons-sights/

Partridge, Roger. “Who Guards the Guards? Regulatory Governance in New Zealand”, (Wellington: The New Zealand Initiative, April 2018). https://www.nzinitiative.org.nz/reports-and-media/reports/who-guards-the-guards-regulatory-governance-in-new-zealand/

Pullar-Strecker, Tom. “Adrian Orr says Reserve Bank only has 'bit role' in unsustainable house prices”, *Stuff*, 2 November 2021. https://www.stuff.co.nz/business/126856502/adrian-orr-says-reserve-bank-only-has-bit-role-in-unsustainable-house-prices

Pullar-Strecker, Tom. “Former Reserve Bank senior staffer renews criticism of bank under Adrian Orr”, *Stuff,* 2 August 2022. https://www.stuff.co.nz/business/129449929/former-reserve-bank-senior-staffer-renews-criticism-of-bank-under-adrian-orr

RBNZ. “The remit for the Monetary Policy Committee” (Reserve Bank of New Zealand, 14 February 2019). https://www.rbnz.govt.nz/-/media/f0cbac9a30904b7aa115549e5ca01b16.ashx

RBNZ. “How we approach climate-related risk”, Reserve Bank of New Zealand website. https://www.rbnz.govt.nz/about-us/how-we-work/how-we-approach-climate-related-risk.

RBNZ. “Our annual review with the Finance and Expenditure Committee 2022” (Reserve Bank of New Zealand,14 December 2022). https://www.rbnz.govt.nz/news-and-events/events/2022/december/our-annual-review-fec-2022

RBNZ. “Our purpose, vision and values”, 28 February 2022, Reserve Bank of New Zealand website. https://www.rbnz.govt.nz/about-us/our-purpose-vision-and-values

RBNZ. “Ramped up: RBNZ’s Additional Monetary Policy toolkit”, August 2021, Reserve Bank of New Zealand website. https://www.rbnz.govt.nz/hub/publications/bulletin/2021/rbb2021-84-01

RBNZ. "Tane Māhuta and our finance system", 28 February 2022, Reserve Bank of New Zealand website. https://www.rbnz.govt.nz/about-us/tane-mahuta-and-our-financial-system

RBNZ. "Te Ao Māori – an evolving and responsible strategy", Reserve Bank of New Zealand, 28 February 2022, website. https://www.rbnz.govt.nz/about-us/how-we-work/te-ao-maori---an-evolving-and-responsible-strategy

RBNZ. "Funding for Lending Programme", Reserve Bank of New Zealand website. https://www.rbnz.govt.nz/monetary-policy/monetary-policy-tools/funding-for-lending-programme.

RBNZ. *In Retrospect: Monetary Policy in New Zealand 2017-2022* (Reserve Bank of New Zealand, November 2022). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2022/rafimp---in-retrospect-monetary-policy-in-new-zealand-2017-22.pdf

RBNZ. "Response under the Official Information Act to questions about staff number increases", Reserve Bank of New Zealand, 19 August 2022. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/oias/2022/oia2122_124-growth-of-rbnz.pdf

Reddell, Michael. "An expanding empire", Croaking Cassandra blog, 16 August 2022. https://croakingcassandra.com/2022/08/

Reddell, Michael. "At it again", Croaking Cassandra blog, 16 December 2022. https://croakingcassandra.com/2022/12/16/at-it-again/

Reddell, Michael. "Central Bank Research", Croaking Cassandra blog, 20 January 2023. https://croakingcassandra.com/2022/01/20/central-bank-research/

Reddell, Michael. "Expertise and the MPC", Croaking Cassandra blog, 16 February 2022. https://croakingcassandra.com/2022/02/16/expertise-and-the-mpc/

Reddell, Michael. "MPC Appointments: Prioritising sex over expertise", Croaking Cassandra blog, 29 July 2019. https://croakingcassandra.com/2019/07/29/mpc-appointments-prioritising-sex-over-expertise/

Reddell, Michael. "Orr defending the LSAP", Croaking Cassandra blog, 23 August 2022. https://croakingcassandra.com/2022/08/23/orr-defending-the-lsap/

Reddell, Michael. "Reappointing Orr", Croaking Cassandra blog, 9 November 2022. https://croakingcassandra.com/2022/11/09/reappointing-orr/

Robertson, Grant. "Release under the Official Information Act", Croaking Cassandra, 11 June 2019. https://croakingcassandra.files.wordpress.com/2019/07/grant-robertson-oia-release-on-mpc-appointments.pdf

Ruth, Jenny. "Former central banker slams Adrian Orr's 'dancing' with forest fairies", *BusinessDesk*, 21 June 2022. https://businessdesk.co.nz/article/finance/former-central-banker-slams-adrian-orrs-dancing-with-forest-fairies

Rutherford, Hamish, "Covid 19 coronavirus: Reserve Bank urges banks to consider 'social responsibility' in business lending", *NZ Herald,* 19 April 2020. https://www.nzherald.co.nz/business/covid-19-coronavirus-reserve-bank-urges-banks-to-consider-social-responsibility-in-business-lending/VBH5ZQFKTKVERGR5P2DY2ITLTA/

The Economist. "The danger of excessive distraction", 20 April 2022. https://www.economist.com/special-report/2022/04/20/the-danger-of-excessive-distraction

The Aotearoa Circle. "Te Ao Māori context", website. https://www.theaotearoacircle.nz/te-ao-maori-context#:~:text=Te%20Ao%20M%C4%81ori%20context&text=The%20defining%20principle%20is%20wh%C4%81naungatanga,essence)%20and%20related%20through%20whakapapa.

The Financial Crisis Commission. "The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of **t**he Financial and Economic Crisis in the United States", (US Government, January 2011). https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

Tibshraeny, Jenée. "Inflation targeting architect Arthur Grimes says RBNZ should target lower inflation and house prices, as the status quo has caused a 'wellbeing disaster'" *Interest.co.nz*, 20 July 2021. https://www.interest.co.nz/news/111369/inflation-targeting-architect-arthur-grimes-says-rbnz-should-target-lower-inflation-and

Tibshraeny, Jenée. "Policy to disqualify monetary policy researchers from joining the Reserve Bank's Monetary Policy Committee retained, as new appointments need to be made", *interest.co.nz*, 19 February 2022. https://www.interest.co.nz/public-policy/114423/policy-disqualify-monetary-policy-researchers-joining-reserve-banks-monetary

Tibshraeny, Jenée. "The Opposition's warning about 'dubious' Reserve Bank board appointments", *NZ Herald*, 3 Sept 2022. https://www.nzherald.co.nz/business/the-oppositions-warning-about-dubious-reserve-bank-board-appointments/BKDBXM4A35Q2ZURIDIYYRC5OTE/

Tibshraeny, Jenée. "Adrian Orr accepts mortgage rates could fall next year", *NZ Herald*, 19 August 2022. https://www.nzherald.co.nz/business/adrian-orr-accepts-mortgage-rates-could-fall-next-year/QF5ULUGTCPSC2BW632XWC4HQSI/

Vaughan, Gareth. "Motu Executive Director and ex-RBNZ Assistant Governor John McDermott assesses the state of the local & international economies as 2022 hurtles towards 2023", *interest.co.nz*, 21 December 2022. https://www.interest.co.nz/business/118954/motu-executive-director-and-ex-rbnz-assistant-governor-john-mcdermott-assesses

Waitangi Tribunal. "Hauora: Report on Stage One of the Health Services and Outcomes Kaupapa Inquiry", Waitangi Tribunal Report 2019, WAI 2575. https://forms.justice.govt.nz/search/Documents/WT/wt_DOC_152801817/Hauora%20W.pdf

Wheeler, Graeme and Bryce Wilkinson. "*How central banks mistakes after 2019 led to inflation*," (Wellington: New Zealand Initiative, July 2022).

Wilkinson, Bryce. "Doing whatever it takes with someone else's money", Research Note (Wellington: New Zealand Initiative, 12 June 2020). https://www.nzinitiative.org.nz/reports-and-media/reports/research-note-doing-whatever-it-takes-with-someone-elses-money/document/655

Wilkinson, Bryce. "The false 'inflation versus jobs' narrative", Policy Note (Wellington: New Zealand Initiative, 18 August 2022). https://www.nzinitiative.org.nz/reports-and-media/reports/the-false-inflation-versus-job-narrative/

Willy, Anthony. "Fairy Tales for the Gullible", New Zealand Centre for Political Studies, 1 June 2022. https://www.nzcpr.com/fairy-tales-for-the-gullible/

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. www.nzinitiative.org.nz | +64 4 499 0790 | info@nzinitiative.org.nz

Views expressed are those of the author/s and do not necessarily reflect the views of The New Zealand Initiative, its staff, advisors, members, directors or officers.

Research Note
ISSN 2816-0347