Economic Bulletin.

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It's on the house – Changes to the RBNZ's remits.

- The Finance Minister has made changes to the role that the housing market will play in the Reserve Bank's remits.
- The RBNZ will need to assess the impact that monetary policy decisions have on house prices, though this remains subordinate to the inflation and employment goals.
- We don't expect this to lead to different OCR outcomes in the foreseeable future.
- If anything, this may be a positive change – the RBNZ may end up thinking more deeply about the transmission channel from interest rates to house prices.
- The RBNZ will also have to consider how its financial stability policies fit with the Government's broader goals around housing affordability, especially for first-time buyers.
- Further restrictions on lending to investors, such as debt-to-income ratio limits, are on the table, although the experience overseas casts some doubt on their usefulness.

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Finance Minister Grant Robertson has announced changes that will require the Reserve Bank to assess the impact of monetary policy on house prices, and to take the Government's broader housing policy into account when setting financial stability policy. These changes are the end result of a proposal by the Minister last November, which we wrote about here.[1]

The Minister appears to have split the difference between his initial proposal and the RBNZ's response. The RBNZ's Monetary Policy Remit (MPR) now includes a sub-clause around assessing the impact of monetary policy on house prices, although this is less constraining than what was initially proposed (which wasn't particularly onerous anyway). Housing considerations have also been added to the financial stability remit, which the RBNZ believed was the more appropriate place for it.

Our view on these changes is much the same as it was in November. At the margin it might lead to the RBNZ taking a more gradualist approach on occasion, but it won't make a great deal of difference to the long-run level of interest rates or house prices. Hence, we see no reason to adjust our OCR forecasts. The market response to today's announcement, with interest rates and the New Zealand dollar jumping even higher, is probably more a symptom of current market sentiment – 'reflation trades' are in vogue, and it doesn't take much to prompt interest rates even higher.

Change 1: The monetary policy remit.

The RBNZ's Monetary Policy Remit now includes a new sub-clause:

"In pursuing the operational objectives, the Monetary Policy Committee shall… assess the effect of its monetary policy decisions on the Government's policy [to support more sustainable house prices]."

1 https://www.westpac.co.nz/assets/Business/economic-updates/2020/Bulletins/RBNZ-commentary-Nov-2020-Westpac-NZ.pdf

The Minister's initial proposal would have directed the RBNZ to avoid "unnecessary instability" in house prices (among other things) when setting monetary policy. The final version is less binding than that, since it doesn't require the RBNZ to act any differently – just to report on the effects of its actions.

In either case, it's important to note that housing is a secondary consideration – the RBNZ's dual mandates of price stability and supporting maximum sustainable employment still take precedence. Adding the housing market to the mix might, at the margin, lead the RBNZ to take a more gradual path towards reaching its main goals. Indeed, we had already factored this into our forecasts last year, one of several factors that led us away from forecasting further OCR cuts. In that respect, today's announcement was less significant than what we had already assumed.

We should note that we're broadly supportive of this change. We have long felt that the RBNZ has underplayed the link between interest rates and house prices. Forcing them to consider this link more deeply might actually lead to better forecasts of activity and inflation, and hopefully better monetary policy outcomes over time.

Change 2: The financial stability remit.

The changes around financial stability policy are perhaps more significant. Under the RBNZ Act, the Minister has directed the RBNZ to:

"have regard to the impact of its actions on the Government's policy of supporting more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers."

Financial stability policy, unlike monetary policy, is not subject to clearly-defined outcomes. So in this case there is genuine scope for trade-offs – for instance, the RBNZ may be willing to accept more risk around the build-up of debt by first-home buyers, if it serves the Government's wider housing affordability goals. Arguably the RBNZ's prudential polices have been heading in this direction in recent years anyway, but the Minister's directive formalises this arrangement.

The Minister has also asked the RBNZ for advice on debt-to-income ratios (DTIs) and interest-only mortgages – again with a focus on tilting the playing field away from property investors and towards first-home buyers. The RBNZ has wanted for some time to add DTI limits to its macroprudential toolkit, and the Minister now appears to be more open to the idea (though only for investors).

Greater use of macro-prudential tools to cool the housing market, if successful, would have knock-on effects for economic activity and inflation pressures. That could mean lower interest rates than otherwise, while the loan limits remained in place. That said, the experience of loan-to-value ratio (LVR) limits in New Zealand and overseas suggests that the impact on house prices has been fairly muted, and probably wouldn't have led to different decisions on monetary policy.

Our reading of the overseas evidence is that DTIs are more of a substitute for LVRs than a complement – it's not a matter of one tool getting into the cracks that the other tool can't reach. In that respect, the question of whether a DTI limit would be 'effective' would depend on how tightly it was set, rather than the nature of the tool itself.

We also note that DTI limits are considered more difficult to enforce than LVR limits. Loan amounts and house values are easily observed, but income has proven to be more difficult to pin down (especially for investors, who may have multiple income streams against multiple loans). Where other countries have imposed DTI limits, they are more often applied to owner-occupiers than to investors – contrary to the Finance Minister's wishes.

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