

Hon Grant Robertson

MP for Wellington Central
Minister of Finance
Minister for Sport and Recreation
Minister for Cyclone Recovery
Leader of the House



27 February 2023

Don Richards
info@positivemoney.org.nz

Dear Don

Thank you for writing to the Hon Kiritapu Allan, on 29 November 2022. Your email has been passed on to me to respond to as it falls within my portfolio as Minister of Finance. I apologise for the delay in responding.

Under its monetary policy mandate, the Reserve Bank of New Zealand (Reserve Bank) is responsible for maintaining price stability and supporting maximum sustainable employment. As you've noted, New Zealand is currently experiencing a period of high inflation and this has led to the Monetary Policy Committee (MPC) increasing its policy rate, the Official Cash Rate. This is a necessary step in order for the MPC to meet its price stability and maximum sustainable employment objectives. In practice, low and stable inflation over time is the best contribution that monetary policy can make to overall wellbeing.

Commercial banks play a fundamental role in New Zealand: they act as financial intermediaries, contribute to economic development, and assist with the efficient allocation of resources in the economy. Although central banks are conducting research into the role of central bank digital currencies, private forms of money – including commercial bank deposits – still remain important to the general public (see the Reserve Bank's future of money consultation document cited at the end).

As you've mentioned, commercial banks create money through their lending behavior. When a customer takes out a loan, a commercial bank will credit the customers' account with a deposit reflecting the notional amount of the loan. This money creation process is dependent on how profitable it is to lend to customers, which is largely influenced by the interest rate set by the Reserve Bank. There are, however, constraints on the magnitude of money that can be created by commercial banks. The most significant of which is the price of loans – or the interest rates set by commercial banks – which guide borrowing decisions in the economy. Different factors influence this, including: monetary policy, prudential regulatory policies, market pressures, the behaviour of households and firms, and internal risk measures used by commercial banks.

New Zealand has experienced increased prices in asset classes such as housing in recent times. However, it is generally accepted that monetary policy can only have short run effects on asset prices, with structural factors being more influential in the long run. See Conway (2022), referenced at the end of this letter for more detail on this topic.

Lastly, the Large Scale Asset Purchase programme was effective in restoring functionality to the financial system and providing monetary stimulus by lowering interest rates in the economy. This was necessary, especially in a period of significant uncertainty due to COVID-19 and the liquidity crisis that emerged.

Further details on some of these issues may be found in the links below:

- <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy.pdf?la=en&hash=9A8788FD44A62D8BB927123544205CE476E01654>
- https://www.rbnz.govt.nz/-/media/cf29f61659304d70ad9c1f504d5b5f4f.ashx?sc_lang=en
- <https://www.rbnz.govt.nz/-/media/5a9a859d945f4f53b878fb14f13f293d.ashx>
- <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/future-of-money/future-of-money-summary-of-responses.pdf>
- <https://www.rbnz.govt.nz/-/media/3a82b34177de41c493c9e278591abc7b.ashx>

Again, thank you for writing to me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Grant Robertson', written in a cursive style.

Hon Grant Robertson
Minister of Finance