Response to the Reserve Bank of New Zealand's Submission on Petition CRM:0124357

To: The Chair and Members, Finance and Expenditure Committee, House of Representatives, Wellington, New Zealand.

Honourable Members,

We write as the submitters of **Petition CRM:0124357**, which calls on Parliament to inquire into the Reserve Bank of New Zealand's (RBNZ) capacity to use **Direct Monetary Financing (DMF)** to fund urgent public infrastructure investment. This document serves as our formal rebuttal to the Reserve Bank's submission dated 13 March 2026.

While we appreciate the RBNZ's detailed response, its core objections rest on text-book theories, flexible design choices treated as immutable natural laws, and a selective reading of macroeconomic history. The current monetary framework chokes productive investment while actively inflating non-productive assets and private debt. Parliament deserves a complete picture before closing the door on this vital inquiry. Below we address each of the Reserve Bank's objections, under the headings used in its submission.

DMF is often characterised as a zero- or low-cost financing option; however, the costs are ultimately borne within the economy.

***How* or *if* the cost is borne by the economy is a design choice within the power of the Reserve Bank, not an inevitable outcome.**

The Reserve Bank argues it "would incur losses, as it would receive no interest on the bond issued by the Crown while continuing to pay OCR-linked interest to banks" on increased DMF settlement cash.

However, the Reserve Bank does not have to pay interest on the DMF portion of settlement cash. As it admits itself, the Reserve Bank could limit losses by introducing a tiered framework where no interest is paid on the DMF portion of settlement cash. The Reserve Bank has two concerns about this solution: undermining OCR effectiveness; and increasing costs for borrowers via pass-through effects.

OCR Effectiveness – The Reserve Bank argues a tiered framework "would likely undermine the effectiveness of the OCR in influencing market interest rates." We have three counter arguments:

1. The Reserve Bank's argument flies in the face of international evidence, where central banks have operated with a zero-interest tier and still been able to control interest rates, such as the Swiss National Bank.

Further, the so-called ample (interest-earning) reserves has changed how the OCR transmits monetary policy but overall economic gains may be small or negative when billions of dollars of interest costs are added to the comparison.

2. Presumably the Reserve Bank makes its 'reduced effectiveness' argument based on the reduction in the remunerated amount of settlement cash. However, prior to 2020 the Reserve Bank influenced interest rates effectively with a much smaller amount of settlement cash (around $5B), compared to the $30B or so today, and for many years, banks received no interest on settlement balances.
3. More broadly, the RBNZ has an indefinite capacity to buy bonds from the private sector if it wishes to influence rates. It does not need to restrict itself to current practice.

Increased Cost due to Pass-through – The Reserve Bank argues a tiered framework "would also reduce the interest income banks receive on their settlement balances, with potential pass-through effects to households and business via higher lending rates."

Pass-through effects are feasible if the RBNZ does not pay interest on all the settlement balances or take other measures to mitigate the problem. Pass-through could be avoided via system design; or welcomed as a positive outcome. Again, it depends on the Reserve Bank's design, which is within its powers.

Avoiding Pass-through – Not all DMF cash that ends up in people's bank accounts will have interest paid on it. For example, the cash could sit in demand accounts, as some $60B does today, where no interest is paid. Such an outcome would not affect bank profit and would not require a pass-through to cover DMF interest expenses.

If lower interest receipts on settlement cash reduce bank income, banks could offset this loss by reducing interest paid to depositors rather than by increasing interest charged to borrowers.

Alternatively, if pass-through was considered an undesirable issue, the Reserve Bank could choose to pay a small interest rate (less than 1% say) on 'DMF settlement cash' as recompense for operating the payments system and to avoid the pass-through effects.

Lastly, some reduced interest income could be absorbed by bank margins. The Reserve Bank as regulator should watch this closely to ensure any pass-through is fair to banks and the public.

Positive Pass-through Effects – The Reserve Bank should consider the potential positive monetary policy and economic impacts of any pass-through:

- The government's lower interest bill benefits tax payers and/or ratepayers (i.e. every person, not just a few). This is a significant, broad-based gain for the economy since it delivers more public goods and services for the same taxes, and arguably delivers greater overall productivity and welfare benefits than the extra bank lending would deliver – especially given how little is likely to go to productive investment.
- Part of this pass-through should act like an OCR rise which is good; i.e., when passed on as higher lending rates, it would reduce private credit creation and spending, thus freeing up non-inflationary space for the public goods it finances. This should reduce or delay the need for an OCR rise to counter any inflation impact from the fiscal spending.
- This is a positive overall, as long as the public spending delivers more economic and welfare gains than the extra bank lending – which is not hard when we look at the track record over decades on NZ bank lending.
- Reserves - a cost of doing business. There is a perfectly sound argument that tying up financial capital is a cost of doing business for a bank. That is what reserve ratios are about. High settlement balances will offset some of the need for more expensive forms of capital such as Tier 2 capital (e.g. subordinated bonds which charge an interest premium to banks). This could potentially save banks money and reduce the need for any pass-through.

DMF injects new purchasing power into the economy, which can amplify aggregate demand relative to conventional financing.

The Reserve Bank worries that DMF will cause inflation. This needn't be the case. The rate of DMF issuance can be controlled so as not to exceed the capacity of real resources. If inflation turned out to be a problem, the RBNZ and government have many tools to deal with it. For example, in conjunction with DMF, credit to the private sector (say, for property speculation) could be restricted via credit guidance rather than increasing interest rates. Infrastructure bonds could be sold, or taxes raised. Depending on the design, DMF would actually give the RBNZ more weapons to deal with inflation: additional bonds it can sell to the private sector.

DMF could erode monetary policy credibility and lead to less favourable inflation outcomes with greater economic costs.

DMF, implemented well, could instead strengthen monetary policy credibility and lead to more favourable inflation outcomes.

Fiscal Dominance – The Reserve Bank is concerned that monetary policy would be "believed to be shaped by fiscal financing needs rather than being directed by the objective of price stability", which they call "fiscal dominance". We argue that this risk could be managed through good, transparent, institutional design, such as what PMNZ proposed in Local Water Financing Done Well.

More broadly, the inflation targeting regime pioneered by the Reserve Bank with some early success and copied around the world, needs to be reviewed. "Tradeable" inflation and deflation from overseas have affected the overall CPI, masking the actual performance of inflation targeting. The focus on controlling the money supply via interest rates, while ignoring where in the economy new money is directed, has been damaging to society. It is time to look more broadly at the results and reconsider the design.

Reduced Credibility Through Precedent – The Reserve Bank argues that establishing a DMF framework may affect perceptions of the future boundary between fiscal and monetary policy, increasing the sensitivity of inflation to demand and requiring more potent and costly monetary policy. We ask, what about the precedent set from 1936 – 1980 when DMF was used successfully to fund state housing, infrastructure, and agricultural working capital? We maintain that DMF, done well, will enhance productivity, get infrastructure built sooner, create growth without inflation, create jobs, and reduce poverty, to name a few benefits. This is at the heart of our petition that Parliament inquire into using DMF for infrastructure.

DMF would represent a significant departure from the existing institutional framework.

We agree, and this is a reason to proceed with an inquiry rather than persist with a system which, while having some benefits, has huge drawbacks.

The current system chokes productive investment and inflates non-productive private debt. The system was more stable when private debt was lower. Increasing private debt increases the fragility of the financial system (Hyman Minsky). New Zealand went from less than 50% of private debt as a percentage of GDP (when you could ignore it) prior to 1989 to over 160% today. The Reserve Bank is ignoring the main cause of instability as

evidenced by the data: the private credit system. Our proposals would actually strengthen the Reserve Bank and make the economy more stable, while maintaining a mixture of public and private money creation.

Conclusion: A Call for Democratic Scrutiny

The Reserve Bank's submission presents standard institutional warnings that treat flexible policy choices as absolute economic barriers. By evaluating alternative financing models entirely through the lens of its own rigid economic modelling and existing monetary framework, the Bank remains structurally blind to the supply-side, capacity-building benefits of infrastructure investment.

New Zealand faces a massive public infrastructure gap that threatens our future prosperity and well-being. The blanket assumption that there is no alternative to expensive commercial borrowing or private bank credit creation deserves deep, rigorous, democratic scrutiny.

Relying on the current framework has driven private debt to an unstable **160% of GDP** while leaving our public infrastructure underfunded. Utilizing DMF, executed under transparent parliamentary guardrails, would give New Zealand the power to build critical public assets sooner, insulate the economy from private credit fragility, and ensure money creation serves the public good rather than commercial profit.

Parliament must not defer blindly to the very institution guarding the status quo. We respectfully urge the Committee to reject the Reserve Bank's recommendation and proceed with the full, comprehensive inquiry called for in our petition.

Yours faithfully,

Don Richards
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